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Inflation set to 'hit some schemes'

Alan Wood

Some Kiwi investors face a significant drop in the value of their investments due to higher inflation over the next few years, a New Zealand fund manager warns.

Inflation is the single biggest threat for New Zealanders relying on KiwiSaver to supplement their retirement and is set to expose unsophisticated KiwiSaver schemes, NZ Funds Management chief investment officer Michael Lang said.

Some of the KiwiSaver schemes available to the New Zealand public lacked the sophistication to cope with an unexpected rise in inflation, Lang said.

"Many of the current schemes are primarily comprised of cash, bonds or shares, and in some cases a mix of all three," he said.

"Each of these investment types is likely to disappoint over the short term, and in the case of cash and bonds, will continue to disappoint

over the longer term, during an inflationary episode."

Economists this week said the sharp rise in the cost of petrol and the increase in GST would lift inflation to at least 4 per cent for the year to December.

The latest consumer price index data is due to be released by Statistics New Zealand on Thursday.

Lang said some in the market were expecting annual inflation to head towards 6 per cent during 2011, and he thought it was unlikely to fall back to the levels seen earlier in 2010 or before the GST spike.

UBS New Zealand senior economist Robin Clements said while there were inflation hotspots around the world, inflationary pressures in New Zealand were unlikely to build significantly in the short to medium term.

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ment, and [world] reserve banks are hardly showing any immediate concern about inflation.

"So it's going to take quite a lot of time [for inflation to build] except for in a few areas – parts of Asia, China are facing inflationary pressures."

Most of the developed world was in the same position as New Zealand with central banks holding interest rates low to try to stimulate the economy, Clements said.

Lang said the most recent period of high inflation in New Zealand was from 1970 to 1980. If a cash-based KiwiSaver scheme had been invested in term deposits during this time it would have lost 54 per cent of its purchasing power over the 10-year period.

Lang said there were a number of asset classes that offered a measure of protection including shares, property and commodities.



Inflation threat to investors

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The inflation rate was influenced by offshore events and decisions including the prices of food, commodities and fuel. Another influence was the emergence of a middle class in China which was push-

ing up wages and would ultimately result in higher costs of production – as occurred during the 18th century industrial revolution in England.

While economies such as that in the United States had outsourced work like manufacturing to countries like China – keeping costs low – these costs would now begin to rise again due to wage inflation in China, Mr Lang said.

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Mr Lang said there were a number of asset classes that offered a measure of protection including shares, particularly those in the sectors of building materials, infrastructure and healthcare

Property and commodities were two other areas of potential investment to protect against the erosion of value via inflation.

One of the assets NZ Funds’ KiwiSaver scheme utilised to mitigate the impact of inflation was government issued inflation-linked bonds, which offered investors a level of interest as well as guaranteeing the capital value of the bonds increased by the level of inflation.

The Global Financial Crisis had led to the situation where central banks were keeping interest rates low to stimulate economies and some nations including Britain and the US had printed “an unprecedented amount of money”.

In this post-GFC environment, inflation threatened.

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