Lowe Lippmann WEALTH ADVISERS

September 2022

It's September and as winter draws to a close there's snow in the Alps and the wattle is blooming. Many Australians will soon receive a sizeable tax refund, if they haven't already, which should help ease those rising cost-of-living blues.

Rising inflation and interest rates were the focus of attention in July. The US Federal Reserve lifted its target rate by 75 basis points to 2.25-2.50% to tackle surging inflation of 9.1%. At the same time, the US economy contracted by 0.9% in the June quarter, following a 1.6% drop in the March quarter.

By contrast, Australia is performing relatively well. In his first economic statement, treasurer Jim Chalmers downgraded growth forecasts to a still solid 3.75% last financial year and 3% this financial year. Inflation jumped to 6.1% in the year to June and is forecast to peak above 7% in December. And the Reserve Bank lifted the cash rate by 50 basis points to 1.35% in July, with a similar increase tipped this month and more to come. Governor Philip Lowe said he expects rates to get to 'at least' 2.5%. Unemployment fell to 3.5% in June, but rising prices and interest rates dented confidence. The ANZ-Roy Morgan consumer confidence index sits at 82.4 points – below 100 is pessimistic. While the NAB business confidence index fell 5 points to +1.4 points in June.

The biggest hit to inflation has come from housing and construction prices and petrol. But the housing market is cooling due to rising interest rates, with national home values easing 0.6% in June and new dwelling starts down 6.5% in the March quarter. Petrol prices are also easing, down 19c to below $1.93 a litre in late July on falling global oil prices. The Aussie dollar gained a cent to finish the month around US70c.

All the best,
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HOW TO MANAGE RISING INTEREST RATES

Rising interest rates are almost always portrayed as bad news, by the media and by politicians of all persuasions. But a rise in rates cuts both ways.

Higher interest rates are a worry for people with home loans and borrowers generally. But they are good news for older Australians who depend on income from bank deposits and young people trying to save for a deposit on their first home.

Rising interest rates are also a sign of a growing economy, which creates jobs and provides the income people need to pay the mortgage and other bills. By lifting interest rates, the Reserve Bank hopes to keep a lid on inflation and rising prices. Yes, it's complicated.

How high will rates go?

In early May, the Reserve Bank lifted the official cash rate for the first time since November 2010, from its historic low of 0.1 per cent. The reason the cash rate is watched so closely is that it flows through to mortgages and other lending rates in the economy.

To tackle the rising cost of living, the Reserve Bank expects to lift the cash rate further, to around 2.5 per cent.[i] Inflation is currently running at 5.1 per cent, which means annual wages growth of 2.4 per cent is not keeping pace with rising prices.[ii]

So what does this mean for household budgets?

Mortgage rates on the rise

The people most affected by rising rates are likely those who recently bought their first home. In a double whammy, after several years of booming house prices the size of the average mortgage has also increased.

According to CoreLogic, even though price growth is slowing, the median home value rose 16.7 per cent nationally in the year to April to $748,635. Prices are higher in Sydney, Canberra and Melbourne.

CoreLogic estimates a 1 per cent rise would add $486 a month to repayments on the median new home loan in Sydney, and an additional $1,006 a month for a 2 per cent rise.

While the big four banks are not obliged to pass on the cash rate changes, in May they passed on the Reserve Bank's 0.25 per cent increase in the cash rate in full to their standard variable mortgage rates which range from 4.6 to 4.8 per cent. The lowest standard variable rates from smaller lenders are below 2 per cent.[iii]

Still, it's believed most homeowners should be able to absorb a 2 per cent rise in their repayments.

The financial regulator, APRA now insists all lenders apply three percentage points on top of their headline borrowing rate, as a stress test on the amount you can borrow (up from 2.5 per cent prior to October 2021).[iv]

Rate rise action plan

Whatever your circumstances, the shift from a low interest rate, low inflation economic environment to rising rates and inflation is a signal that it's time to revisit some of your financial assumptions.

The first thing you need to do is update your budget to factor in higher loan repayments and the rising cost of essential items such as food, fuel, power, childcare, health and insurances. You could then look for easy cuts from your non-essential spending on things like regular takeaways, eating out and streaming services.

If you have a home loan, then potentially the biggest saving involves absolutely no sacrifice to your lifestyle. Simply pick up the phone and ask your lender to give you a better deal. Banks all offer lower rates to new customers than they do to existing customers, but you can often negotiate a lower rate simply by asking.

If your bank won't budge, then consider switching lenders. Just the mention of switching can often land you a better rate with your existing lender.

The challenge for savers

Older Australians and young savers face a tougher task. Bank savings rates are generally non-negotiable, but it does pay to shop around.

The silver lining is that many people will also see increased interest rates on their savings accounts as the cash rate increases. By mid-May only three of the big four banks had increased rates for savings accounts. Several lenders also announced increased rates for term deposits of up to 0.6 per cent.[v]

High interest rates traditionally put a dampener on returns from shares and property, so commentators are warning investors to prepare for lower returns from these investments and superannuation.

That makes it more important than ever to ensure you are getting the best return on your savings and not paying more than necessary on your loans. If you would like to discuss a budgeting and savings plan, give us a call.

i https://www.rba.gov.au/speeches/2022/sp-gov-2022-05-03-q-and-a-transcript.html

ii https://www.abs.gov.au/

iii https://www.canstar.com.au/home-loans/banks-respond-cash-rate-increase/

iv https://www.apra.gov.au/news-and-publications/apra-increases-banks%E2%80%99-loan-serviceability-expectations-to-counter-rising

v https://www.ratecity.com.au/term-deposits/news/banks-increased-term-deposit-interest-rates

A WILL TO *give*

As baby boomers shift into retirement, Australia is on the brink of the nation's biggest ever intergenerational wealth transfer. Yet estate or inheritance planning is rarely discussed by families.

Talking openly about how you want your assets to be passed on can help avoid family disputes that take a toll both financially and emotionally. It provides a certain peace of mind for you – that your intentions will be met – and for your family and friends.

Certainly the stakes have never been higher, with growing house prices and healthy superannuation balances contributing to a considerable increase in the wealth of many older Australians in the past two decades.

Around $1.5 trillion was transferred in gifts or inheritances between 2002 and 2018. In 2018 alone, some $107 billion dollars was inherited while $14 billion was handed out in gifts.[i]

The importance of planning

With so much at stake, having an estate plan in place helps to protect the interests of those you care about and to fulfil your wishes. It takes careful thought and professional advice, but that is no excuse for putting the task aside for later. If something happens to you in the meantime, your assets may not be distributed as you would like and there could be tax implications for your beneficiaries.

An estate plan includes a Will and, in some cases, funeral arrangements and instructions for the care of children and animals. Without a Will, your assets will be distributed according to state inheritance laws which may not be what you intended.

A plan may also include instructions for a testamentary trust to hold assets that are then distributed in a tax-effective way to your beneficiaries. And don't forget your 'digital will', a list of any online accounts and passwords that may be important.

Meanwhile, to protect your interests in case you are incapacitated in some way, an enduring power of attorney and a medical power of attorney nominate the people you would like to handle your affairs until you are better.

Complex families

Estate planning is even more important in the case of blended families or for those with complex family relationships, especially where the emotional issue of the family home is concerned.

Disputes often centre around who gets the house when there are children from a previous marriage, but your new spouse is living in the family home. You could allocate other assets to the children and leave the home to your spouse or require that the house be sold and the proceeds distributed to all. Alternatively, your Will could grant lifetime tenure in the home for your spouse with it passing to your children after your spouse dies. Having conversations early about your intentions, can help alleviate possible conflict.

If you are concerned about protecting the interests of a family member with mental health or addiction issues, a testamentary trust can help to look after your assets and distribute funds in a controlled way. A testamentary trust is also often used to provide for young children, holding the assets until they reach adulthood.

Dividing it up

When it comes to deciding how best to allocate assets among children, some prefer to hand out equal shares no matter their individual financial circumstances, while others prefer to give extra to one who may be struggling. Given that Wills are frequently challenged by family members or others who believe they are owed a share or an even bigger share, it's wise to make your intentions clear in your Will including reasons and documentation.

While people who receive inheritances are usually well into middle age – on average 50-years-old[ii] – and perhaps comfortably well-off, you could choose to bypass the next generation. Instead, you might consider leaving your estate to grandchildren, to help set them up with a deposit for a home or covering school fees.

Another option is to begin distributing your estate while you are alive and can share the enjoyment of the benefits the extra financial help might bring.

What's not covered?

It is important to note that some assets are not covered by your Will. These include assets jointly held with someone else (such as a bank account or a house), super benefits and life insurance.

In the case of jointly held assets, ownership generally passes to the surviving partner and life insurance is paid to the beneficiary named in the policy. For super, it's vital to complete a binding death benefit nomination to ensure the funds are paid to the person you choose.

With so much to consider, expert advice is critical when preparing an estate plan, so call us to begin the discussion.

i https://www.pc.gov.au/research/completed/wealth-transfers

ii Wealth Transfers and their Economic Effects - Commission Research Paper - Productivity Commission (pc.gov.au)

Coming to terms WITH STAGFLATION

First, we had to brush up our understanding of inflation and what it means for our hip pocket and our investments. Now the term stagflation is being thrown into the economic mix.

For those with long memories, stagflation is a reminder of the late 1970s and early 1980s when the world economy fell into what then-Treasurer Paul Keating called "the recession we had to have".

The word has raised its head again with the World Bank warning that there is a rising risk of stagflation.[i] This took the wind out of the sails of global sharemarkets, with Australian shares down 10 per cent in the year to June, although they have since started to show signs of recovery.[ii]

Despite the term stagflation re-entering conversation, the general belief is that things will not get as bad as last century but they are still likely to be challenging.

So, what is stagflation? Basically, it's the combination of rising inflation, high unemployment, and weak economic growth. When all three happen at the same time, then the economy and living standards struggle. So let's look at each of these three markers in turn.

Rising inflation

The definition of inflation is a general increase in prices and a fall in the purchasing value of money.

Certainly, we are experiencing rising inflation right now. It's currently running at just over 6 per cent in Australia. The war in Ukraine took its toll on commodity prices globally which is contributing to the hike. While prices are off their highs, they are still hurting.

On the local front, floods on the east coast of Australia have damaged crops which will also push inflation higher.

Reserve Bank governor Philip Lowe has pointed to a top inflation rate of about 7 per cent in this current economic cycle which is well above the 2-3 per cent inflation target the Reserve Bank uses in setting monetary policy.

Slowdown in economic growth

Looking next at economic growth, and this is certainly slowing.

The OECD cut its outlook for global economic growth from 4.5 per cent in 2021 to 3 per cent this year and 2.8 per cent in 2023. In Australia, growth is expected to fall from 4.8 per cent to 3.5 per cent this year and 2.1 per cent in 2023.[iii]

The definition of economic growth refers to the size of a country's economy over time. It's measured in real and nominal terms. Nominal refers to the increase in the dollar value of production over time; real economic growth just looks at the volume produced. Real growth is the figure generally used.[iv]

Low unemployment

Unemployment, meanwhile, is at the lowest levels in Australia since 1974 at 3.9 per cent.[v] But despite the low unemployment rate, wage growth is less than half that of inflation, so it is hard to keep pace with the rising prices.

Looking at the three criteria for stagflation, unemployment in Australia is less than 4 per cent, inflation is running at just over 6 per cent and GDP growth is 3.3 per cent. At these levels it seems more likely, but far from certain, that we will experience a recession rather than stagflation.

Recession is defined as two consecutive quarters of negative growth.

Stagflation would be a bigger problem than a severe recession because the traditional ways to deal with it are either increased government spending or cutting interest rates. Unfortunately, these solutions are both inflationary and therefore not good tools for the current economic environment.

Big mortgages put brake on rate rises

Back in the 1970s and 1980s, interest rates hit 18 per cent as the Reserve Bank struggled to contain inflation. With mortgages at their current size, increased rates will start hurting much sooner so this will put a brake on inflation well before rates reach double digit levels.

The general view is that mortgage rates will peak at just over the 5 per cent mark.[vi]

Concern about the possibility of stagflation has fuelled the recent sharemarket volatility and uncertainty, although it seems unlikely on current evidence. As the future is impossible to predict, it is better to sit tight and wait for the market to recover rather than sell as a kneejerk reaction and realise losses.

If you would like to discuss your overall financial position in these uncertain times, then call us.

i https://www.washingtonpost.com/business/2022/06/07/world-bank-global-growth-forecast-stagflation/
ii https://tradingeconomics.com/australia/stock-market
iii https://www.oecd.org/newsroom/oecd-economic-outlook-reveals-heavy-global-price-of-russia-s-war-against-ukraine.htm
iv https://www.rba.gov.au/education/resources/explainers/economic-growth.html
v https://www.abs.gov.au/media-centre/media-releases/unemployment-rate-39#:~:text=The%20seasonally%20adjusted%20unemployment%20rate,Bureau%20of%20Statistics%20(ABS).
vi https://www.ratecity.com.au/home-loans/mortgage-news/high-will-rates-go-here-experts-think-rba-cash-rate

Go on... TAKE A BREAK

One of the things many of us have been missing over the past few years is holidays, but now that the world is opening up again for travel and destinations that have been pretty quiet are now eagerly welcoming back tourists, taking a break has never been more appealing.

Holidays are not just a lovely way to spend time, they are fantastic for us on so many levels. Having a break from the daily grind gets us out of our usual routine, opens us up to new experiences and is good for us mentally and physically.

However, the stats tell us that for many Australians it's been a long time between breaks.

In fact, around 8 million Australians have accrued nearly 175 million days of leave over the past 12 months, up from 151 the previous year.[i] That's a lot of missed holidays!

Whether you are one of those who hasn't had much of a break lately or even if you've just got back from a trip and are planning your next one - there are a host of good reasons to take a holiday.

Holiday to keep the doctor away

Holidays have been proven to lower stress which has a myriad of benefits including addressing the risk of cardiovascular issues like stroke and heart attack. A study following more than 12,000 middle-aged men at high risk for heart disease, found those who took yearly breaks were less likely to die from any cause, including heart attacks and other cardiovascular issues.[ii]

It's not just physical health that benefits, taking a break is unsurprisingly pretty good for mental health with even a short break of a few days having a powerful mood enhancing effect.[iii]

Travel to broaden the mind

Lifelong learning is not only good for our careers but also important for our personal growth. And travel is a learning experience like no other, whether you are heading to a new country or a different part of your city or state you'll meet new people and experience a different way of life.

Travel is also the ultimate experience in mindfulness – you are living in the moment when you are on holiday. A break in routine takes us off autopilot and puts us in charge.

Having a break makes you more productive

If you are worried about the impact a break can have on your career – don't be! Research by Boston Consulting Group found that professionals who took planned time off were significantly more productive than those who spent more time working.[iv] Holidays offer time for introspection, goal setting and a chance to recharge your batteries for a new lease on life.

Planning for a wonderful time

Not all vacations are created equal. Just taking any quickly thrown-together escape may not provide all the health and productivity benefits associated with taking a vacation. A poorly planned break can be a source of tension and stress, rather than the opposite.

So how do you get the best out of a break?

Be flexible - While it's important to plan before you leave, have enough flexibility for discovery – be open to new experiences and willing to change the schedule to accommodate those spontaneous magical moments.

Don't sweat the small stuff - Things can and do go awry once you are away but don't let silly little things spoil the break.

Switch off - Don't be tempted to check your emails or socials every few minutes – stay in the moment. A decent break from work will also reinforce that the office doesn't need you 24/7 and that life comes first.

Watch the budget but have some allowances to splurge - Focus on experiences and the memories you'll take home with you rather than what's on sale at the gift shop or duty free.

And finally, don't feel that a holiday must be a luxurious destination or for a long period of time to count. A change of scenery can be as good as a holiday - even taking a mini break and heading off for a weekend away to a lovely destination can provide all the benefits of a holiday. So, what are you waiting for? Start planning that next trip. The wide, wonderful world awaits!

i http://www.roymorgan.com/findings/8696-annual-leave-holidays-march-2021-202105170711

ii https://pubmed.ncbi.nlm.nih.gov/11020089/

iii https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5800229/

iv https://hbr.org/2009/10/making-time-off-predictable-and-required