Advice Matters

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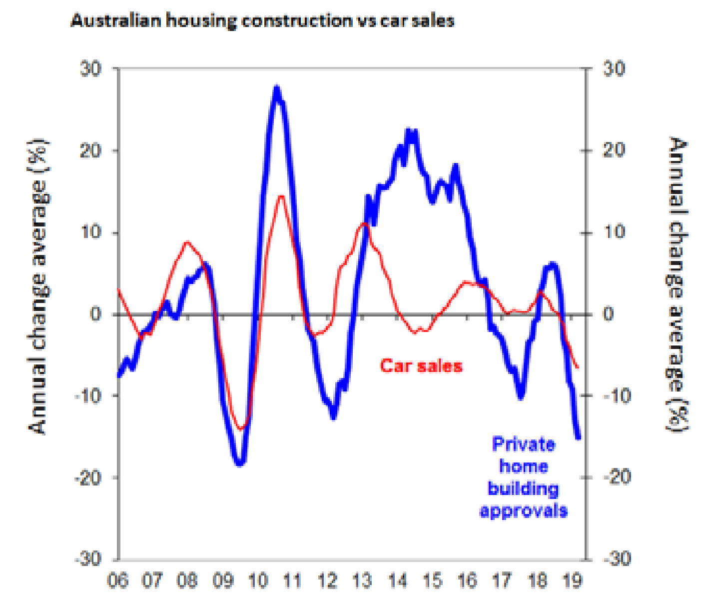
Economic Update

03 July 2019 | Bob Cunneen, Senior Economist and Portfolio Specialist

The Reserve Bank of Australia (RBA) has cut interest rates again by 0.25%. This now sees the official cash interest rate fall to only 1%. This seems extraordinarily low given that the Australian share market has generated a robust 20% return in the first half of 2019 and jobs growth is solid.

However, the key concern for Australia is the consumer's resilience to a trifecta of troubles. Falling house prices, high household debt and slow income growth have proven to be a troubling trio for the Australian consumer. This trifecta of troubles has seen the consumer struggle to maintain their spending appetite. Notably the very sharp falls in both new housing construction approvals (blue line) and car sales (red line) over the past year shows that Australian consumers have become very cautious.

Yet there is no guarantee that lower interest rates will provide the turning point for consumer spending and the housing market. Consumers could remain cautious, preferring to meet their key essentials of existing debt commitments, electricity and health care costs rather than increase their retail spending. However, a combination of lower interest rates and the Federal Budget's income tax cuts for low to middle income earners should help support the Australian consumer to eventually open their wallets and purses.



Elders Financial Planning

THE *REAL COST* OF RETIREMENT

When you're looking at saving and planning for retirement, it's important to know how much you can expect to be spending. The latest retirement standard figures and other data sources can give you an idea of the cost of retirement, but what else do you need to take into account to ensure your financial wellbeing?

Running the numbers – the retirement standard

Since June 2006, the Association of Superannuation Funds of Australia(ASFA) have been monitoring the living costs associated with retirement. Every quarter they research and publish the average annual budget singles and couples aged around 65 can expect to spend when living a modest or comfortable lifestyle in retirement. This is known as the "retirement standard" and for some time it's been a popular yardstick for what it costs to live as a retired person in Australia.

Your definition of comfortable

For a modest way of life, think essential living expenses, taking holidays in Australia only and limited spending on upgrades to cars, appliances and electronic items. Things like international travel, a new car from time to time and eating out on a regular basis are definitely the trappings of the "comfortable" lifestyle category.

Of course your idea of what a comfortable lifestyle looks like – and the money it takes to live it – could be quite different from the retirement standard definition and estimates. The amount you earn and spend in the lead up to retirement is just one of the things that can influence your budget and spending patterns after you've left work. How and where you plan to spend your retirement is also going to affect how much income you'll need.

The big ticket items – health and energy

According to a recent media release from the ASFA, budgets for singles and couples living comfortably have risen 23% and 26% respectively in the decade since the first retirement standard figures were published. The increases for a modest lifestyle are considerably higher, at 33% for a single person and 36% for a couple[1]. As the ASFA have identified the rising costs of power, food, rates and health care as the main culprits for these changes[2], it's not surprising that the impact is greater for those living modestly. In any household budget, these four items would be considered essentials rather than luxuries.

The modest living retirement standard figures are running well ahead of the Consumer Price Index (CPI) increase for the same period which was 28.6%[3]. But while it might seem retired people living a simple life are worse off than they were 10 years ago, changes in the Aged Pension tell a different story. In real terms, the Aged Pension rose by 70% for a single person and 54% for couples[4] during this time, making it possible for retirees to cover their living costs, in spite of major price hikes for essentials.

Relying on the aged pension?

This is an important reminder of the significance of the Age Pension in supplementing income from your super. In fact, the latest quarterly Milliman Retirement Expectations and Spending report published in June 2017, claims the median annual expenditure of a couple aged 65-69 is just $34,858, which is only marginally higher than today's full Aged Pension entitlement for couples of $36,301 per year.[5] But as January 2017 changes in the assets test for the Aged Pension demonstrate, it's difficult to have certainty about your future entitlement to government benefits in retirement.

Advice could make a difference

Even with the help of carefully compiled estimates, surveys and reports from the ASFA and Milliman, figuring out how much you should be saving for retirement and how best to invest it for a healthy return can be a challenge. Seeking advice from a Financial Planner can help you understand the super balance you're going to need to retire in comfort and come up with a strategy for working towards that target.

[1] ASFA Media Release Retirement cost increases driven by power prices, health care, food and rates 29 May 2017 "Between June 2006 and March 2017, the RS budget at the modest level for a single person increased by 33 per cent, while the single comfortable budget rose by 23 per cent. The budget for a couple at the modest level increased by 36 per cent and at the comfortable level by around 26 per cent." https://www.superannuation.asn.au/media/media-releases/2017/media-release-29-may-2017

[2] ASFA Media Release Retirement cost increases driven by power prices, health care, food and rates 29 May 2017 "Over the period, electricity costs increased by 124 per cent, health costs by 60 per cent, property rates and charges by 83 per cent and food costs by 24 per cent." https://www.superannuation.asn.au/media/media-releases/2017/media-release-29-may-2017

[3] ASFA Media Release Retirement cost increases driven by power prices, health care, food and rates 29 May 2017 "ASFA CEO Dr Martin Fahy said the figures compared to an overall 28.6 per cent increase in the Consumer Price Index (CPI)." https://www.superannuation.asn.au/media/media-releases/2017/media-release-29-may-2017

[4] ASFA Media Release Retirement cost increases driven by power prices, health care, food and rates 29 May 2017 "Over the more than 10 year period, the maximum Age Pension increased in real terms, by 70 per cent for a single person and 54 per cent for a couple."https://www.superannuation.asn.au/media/media-releases/2017/media-release-29-may-2017

[5] Milliman Retirement Expectations and Spending report Q2, 2017, 30 June 2017, page 8 "the Age Pension is expected to fund a large portion of household spend for many couples. The observed median annual spend for couples aged 65-69 is $34,858 which is only slightly higher than the full Age Pension."

WHAT REALLY INFLUENCES INTEREST RATES

Interest rates are very important for many Australians, and rightly so after all, whether it's the returns on savings accounts or mortgage repayments, the rate of the day can have a significant impact on the household budget for millions of Australians. So what influences interest rates, and why are they changed?

Who's navigating?

One of the many responsibilities and functions of the Reserve Bank of Australia (RBA) is to control domestic official interest rates in order to fulfil their charter, contained in the Reserve Bank Act 1959, which is to best contribute to the:

- stability of the currency of Australia
- maintenance of full employment in Australia
- economic prosperity and welfare of the people of Australia.

As a result of this charter, the RBA has determined that an inflation rate of between two and three per cent per annum is the best way to meet these objectives.

Why do they change?

The RBA lowers official interest rates to make borrowing cheaper, increasing spending (and therefore demand), which in turn increases inflation to the desired range. Increasing rates, on the other hand, discourages borrowing – and spending – easing inflationary pressures.

While fulfilling their charter may be the goal of the RBA, the same may not be said for central banks around the world. Low interest rates are usually associated with a lower dollar as they often mean less foreign investment as global investors look elsewhere for the highest returns for their money. In what sometimes looks like a race to the bottom between nations, a lower dollar makes manufactured goods cheaper for foreign buyers, boosting exports and increasing tourism.

Why is my loan interest higher than the cash rate?

The RBA's cash rate provides a level of interest rates that affects the rates paid in the wholesale market by the banks. While credit is available to banks in the wholesale market they will add a premium before applying the rate to retail loans and mortgages. The concept is the same as a supermarket buying produce in bulk at a lower price than offered to shoppers. Simply, this margin is how banks make their money.

For the best investment strategy in the current low interest rate environment, talk to a Financial Planner today.

Winners and losers from lower interest rates

Winners	Losers
Borrowers: mortgage holders and property investors benefit from lower repayments on loans.	**First home buyers:** lower interest rates contribute to the rise in house prices, meaning buying a first home just got harder.
Investors in overseas markets: international earnings benefit from a lower Aussie dollar.	**Insurance companies:** as insurance companies invest your premiums long-term, they are now facing lower returns which can put pressure on premiums.
Investors in the share market: due to low returns on fixed-interest investments, investors put more money into the share market.	**Savers:** reducing interest rates means lower returns on savings, affecting those who rely on interest for their income.

DON'T SHORT CHANGE YOUR MEDIUM TERM GOALS

When it comes to setting financial priorities, medium-term goals often suffer from middle child syndrome, not taken as seriously as the oldest or indulged as much as the youngest.

The serious long-term goal of saving for retirement gets lots of attention, and rightly so. It's super important. And next year's trip to Bali will be so much fun, even if it does drain all your savings.

It's little wonder there never seems to be enough money left over to save for those in-between things you hope achieve in the not-too-distant future. Things such as your children's education, a home deposit, renovations or a new car.

Yet those medium-term goals – for spending approximately three to 10 years away – are just as important to the life you want to create for yourself and your family. So how can you make sure you've got them covered?

Getting started

The first step is to find time to think about your medium-term goals. Write them down with an estimate of what each will cost, your time frame and how much you need to save each month to achieve them. The more specific you can be the better.

These goals will differ depending on where you are in life, but whether you are 25 and saving a home deposit or 55 and wanting to buy a boat, you need a plan. Otherwise you might be tempted to use high interest loans and credit cards or simply borrow more than you can afford.

Next comes the reality check. To work out whether your medium-term goals are achievable, you need to take stock of your current financial situation. Tally your income and expenditure to calculate how much you can afford to save and invest each month. There are plenty of free apps and online calculators that will help you do this.

Also look at what you owe. If you have any high interest debt, such as an outstanding credit card balance, you might consider paying this off first as the interest rate is likely to be higher than the return you could earn on your savings.

Weighing risk and reward

Setting an investment time frame is important because it has a bearing on how much risk you can afford to take. That's because the longer your investment horizon the more time to ride out short-term market fluctuations.

Say you are saving for a holiday next year. You can't afford to risk losing money in a sharemarket correction, so you park your savings in the bank. The interest rate may be low, but your capital is guaranteed.

With medium-term goals you can afford to take a little more risk for a higher rate of return. For example, over the five years to June 2018, Australian shares returned 10.3 per cent a year on average, listed property 12 per cent and Australian bonds 4.4 per cent. Over the same period cash returned 2.2 per cent a year, barely above inflation of 1.9 per cent.[i]

Of course, the exact return you earn on your investments will change from year to year but historically shares and property do better over the medium to long term than cash or bonds.

Even so, the last thing you want is for your investment to fall 10 per cent just before you need to spend the money. One way to avoid this is to spread your savings across a range of investments and asset classes, reducing the risk of a large or untimely loss in any one of them.

Finding a home for your savings

Unlike long-term savings which can be locked away in superannuation until you retire, you want your medium-term savings to be accessible. And unlike a bank savings account, you want an investment that will grow in value.

Alternatives you may wish to explore include managed funds and ETFs (exchange-traded funds). These options allow you to diversify your investments across the full range of asset classes and can be bought and sold whenever you want.

Some managed funds allow you to get started with a small initial investment and then make regular weekly or monthly contributions.

If you would like help to create an investment plan that includes all your important life goals, the long, the short and everything in between, contact your financial planner today.

[i] 'Where will your goals take you?' Vanguard 2018 Index Chart, https://static.vgcontent.info/crp/intl/auw/docs/resources/2018-index-chart-brochure.pdf?20180913%7C160622

Source: Centaur Financial Services

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