Perennial Perspective

The BIG investment news! - a five minute refresher

Brian Thomas

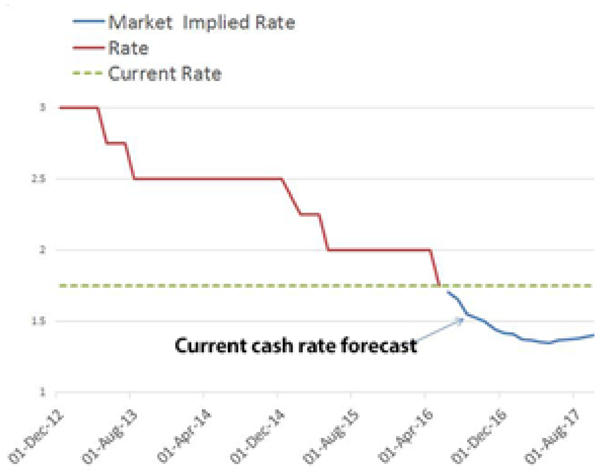
Late April early May has been punctuated with a string of announcements, including an election, a surprise rate cut and the Federal Budget speech all which have contributed to transforming the landscape for Australian investors, particularly around interest rates and superannuation.

The Reserve Bank of Australia (RBA) gets the deflation jitters, and surprises many with a rate cut dropping the cash rate to 1.75%.

The global obsession with deflation, apparently the natural enemy of central bankers, spread to Australia with a surprise fall in inflation reported by the Australia Bureau Statistic (ABS) in late April and more importantly a fall in the expectations around future inflation as outlined in the RBA's Statement on Monetary Policy released on 5 May. Expectations are now that underlying inflation which sit under the RBA's 2% to 3% target until 2018. With the economy and unemployment travelling reasonably well many have raised the question as to why there is a need to cut rates? Why not "keep your powder dry" in case of further global instability. The key here is that the inflation target range is one of their key objectives when setting rates as is the case for most central banks. Many economists say that just like cockroaches, there's usually more than one rate cut around after you sight the first one and consensus has already shifted to another cut with the market now pricing a further 25 basis points rate cut over the next 12 months, perhaps as early as August after the election. In addition the Reserve Bank must be particularly pleased with our dollar trading at 72.82 US cents as I write this.

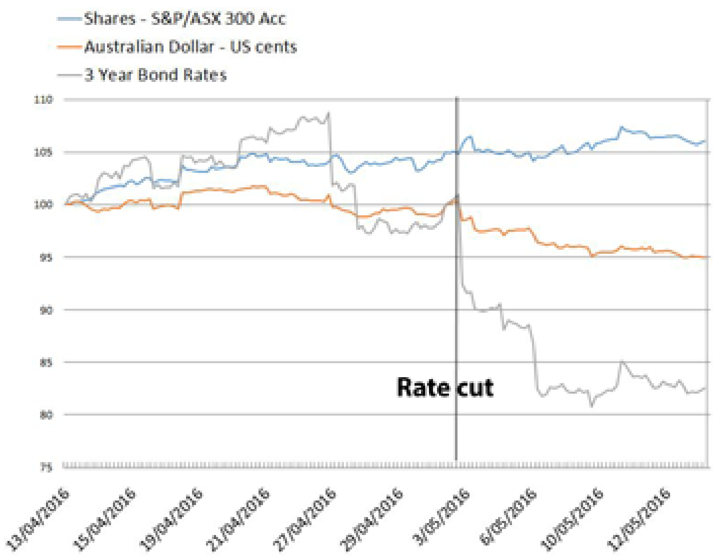
Below are two charts that illustrate the new expected path of interest rates and the reaction of the dollar, stock market and dollar after the rate cut.

CASH RATE AND MARKET IMPLIED RATE
TO OCTOBER 2017



Source: Perennial, CBA Economics, Bloomberg 2016

SHARES, THE AUD & 3 YEAR BOND RATE REBASED TO 100 AS AT 13 APRIL



Source: Perennial, CBA Economics, Bloomberg 2016

Federal Budget

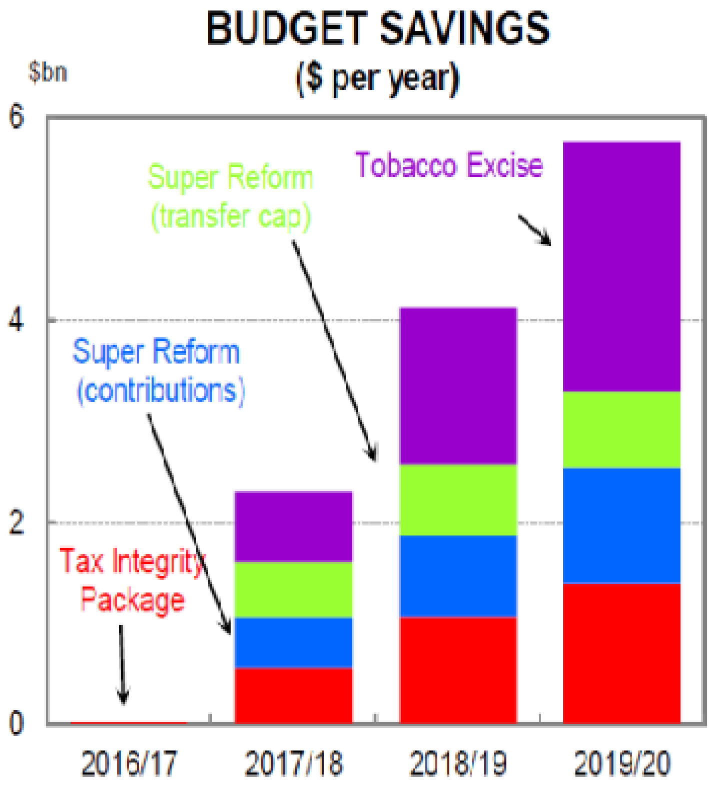
The retrospective cash grab on super was well telegraphed although a bit more hard hitting than many expected. In terms of long-term retirement planning the retrospective changes do not help with confidence in the system. I am reminded of Tony Abbott's statement in 2013 "There will be no adverse changes to superannuation," before correcting himself with the more ambiguous "no unexpected adverse changes to superannuation under a Coalition government".

Although superannuation tax benefits were skewed towards the middle to high income earners, the new $25,000 deductible contribution limit and concerns about extra taxes on higher balances will in my view drive two trends:

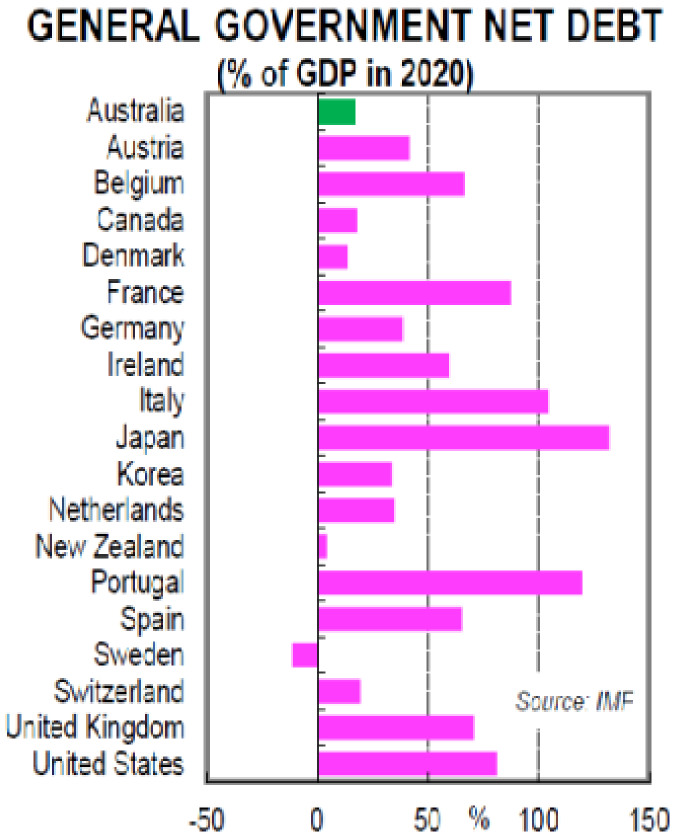
- More people will look to superannuation as a family issue with many now contributing deductible contributions for their spouse and possibly children;
- A further increase in property investment through negative gearing, as many middle to higher income earners will now find that superannuation is not enough to fund their lifestyle

expectations in retirement.

Most of the budget savings will come from four key revenue measures that will save over $12 billion over the next four years (see breakup in the following chart) with the Federal Budget not returning to surplus until 2020/21. Despite all the focus on our level of Government debt the state of our net debt still looks healthy relative to most other developed countries as illustrated below.



Source: CBA Economics, 2016



Source: CBA Economics 2016

Summary

The surprise interest rate cut plus now the prospect of another rate cut in the near future has worked a charm so far with the dollar falling and stockmarket confidence persisting. Let's hope that even lower rates and retrospective super changes don't flow over into a speculative cash driven property bubble.

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This article is an extract from Perspective May 2016.

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