Are Interest Rates Still Enough To Keep The Economy Moving?

This Issue:
January 10, 2017

Ongoing low interest rates across the globe have caused a good deal of controversy, creating significant shifts in market movements and forcing powerhouse economies into fiscal submission.

Unlike many of our developed counterparts, Australia has managed to keep itself afloat without interest rates dive-bombing into zero or negative territory.

In fact our central bank is one of the few fortunate monetary policymakers throughout the world, which still boasts some breathing room to stimulate the economy further if (or when?) required.

For the majority…well, it's tough to go much further down when you're already putting a minus sign in front of the number.

But many economic boffins and pollies are now claiming, including Treasure Scott Morrison, that when it comes to keeping the capital flowing across our wide brown land, interest rates no longer cut it (pardon the obvious pun).

Doth the RBA protest too much?

Citing an internally produced research paper by economists Gianni La Cava, Helen Hughson and Greg Kaplan, the Reserve Bank argues that the numbers demonstrate the power of a rate reduction in boosting spending across other sectors.

Findings from "The household cashflow channel of monetary policy" suggest that a 1 per cent rate cut results in a 0.1 to 0.2 per cent increase in household spending, or a dollar amount of $2.3 to $4.6 billion.

The paper concludes, "Lower interest rates increase household cash flows, and spending in aggregate, via the cash flow channel."

Are Aussie battlers better for our economy?

The Reserve Bank admits however, not everyone runs out and starts throwing extra money around when interest rate reductions are passed on through lower monthly mortgage commitments.

In fact it's those who can perhaps afford to spend less, the ones the research paper classifies as "hand-to-mouth-households", who will be more inclined to buy what are known as 'durables', like fridges and cars.

These tend to be newer borrowers who'll seize a windfall opportunity to buy the white goods they've been waiting to upgrade, for instance.

The RBA says these people spend an average of 16 cents per each extra $1 in their pocket, resulting from an interest rate cut. Interestingly, 70 cents is put back into the mortgage and another 14 cents is saved.

What about bubble trouble?

Of course the major conundrum the RBA faces if they're backed into further rate reductions over the next 12 months, is potential bubble trouble for Australia's property markets.

Governor Philip Lowe says this is the reason for the Reserve's recalcitrance to consider further rate reductions. Not because it might do little for the economy, but because it could conceivably encourage further speculation in the housing sector.

This is a relevant concern when you consider that, despite regulatory intervention designed to reduce investor based borrowing and activity, housing demand has remained strong in more popular investment hotspots particularly.

The problem is that the numbers make real estate hard to resist. According to CoreLogic data, our 5 largest capital cities enjoyed double-digit price growth and an average combined annual gross return of 14.7 per cent across the 2016 calendar year. Not to mention the significantly higher returns enjoyed across Sydney (19.2%) and Melbourne (17.1%).

Compare these figures with your balanced super fund at an average return of around 7.2 per cent and, well…

Where does the speculation lead?

Most analysts are suggesting that due to the very slow contraction of housing market activity, chances of another rate cut from the RBA at this point are slim. But it's not necessarily the central bank we should all be watching.

Millions of Aussies could be hit with rate hikes this year, after the banks recently repriced over $500 billion worth of loans.

Research from Canstar reveals some borrowers will face hundreds of dollars in extra costs, as lenders increase variable rates on products for investors as well as owner occupiers.

Of course this has the reverse effect of stimulating our economy, reducing disposable income further in the wake of rising fuel, electricity and gas consumption costs and health insurance premiums.

There are so many variables weighing on global economies at this point, it's difficult to know where 2017 will lead. All we can do is hang on tight to what works for us as investors while we continue riding the rollercoaster of history making change.

More First Homebuyers Borrowing From The Bank Of Mum And Dad

This Issue:
January 10, 2017

Many baby boomers on the brink of retirement have been looking forward to a post work life free of financial burdens, having amassed super funds and/or investment portfolios they were fortunate enough to accumulate during a number of rather impressive market booms.

This was a generation that saved its pennies, took out small and feasible loans (because your friendly local bank manager wouldn't want to see you over-reaching) and worked hard to pay down the mortgage on their family home.

And, for the extra future conscious among them, there were incredible timing opportunities for wealth creation, particularly in the property markets...as long as you were astute enough to select your markets (and assets) wisely.

Now though, the pendulum has shifted and the fortunes which once favoured their baby boomer parents are turning on younger generations preparing to fly the family nest.

For these would-be first time buyers, the road to home ownership is a much rockier one than their parents travelled back in the latter half of last century.

Real estate is less affordable for one, especially in and around our major capital cities, where the majority of this demographic generally has to linger for employment opportunities.

For some, the solution is to share the good fortune between generations. This includes younger people remaining at home a lot longer than has traditionally been the norm, with continued financial support from their parents.

But a growing trend, and one that has the Australian Treasury somewhat concerned, is more adult children relying on their parents to secure property, whether it be with personal loans, monetary gifts, or guaranteeing loans on their behalf.

Treasury secretary John Fraser told a Senate Estimates hearing last October, "The bank of mum and dad...is becoming more and more prevalent.

"It has impacts on where superannuation is going. It has impacts on why people are saving in their older years, to fund their children's housing needs, and not just purchases, but also often rents. And it is a concern. This is an issue that is prevalent around the world."

Principal of Digital Finance Analytics and economist, Martin North, has been documenting this growing trend. He claims around 52 per cent of first home buyers are in some form reliant on their folks for housing finance.

Interestingly, North noted a significant correlation between the amount children are asking from the bank of mum and dad, and recently rocketing house prices. In 2010, the average request amounted to $23,173. Last year that figure had increased to a whopping $83,397.

This is are hardly surprising though, when you consider that in the last decade, residential property prices have increased by an average 73 per cent, while wages have grown by just 37.5 per cent, all in the midst of tightening loan practices from the banks. And we'd best not get started on the cost of living.

The problem is becoming pretty extreme for first homebuyers, who now only account for around 13 per cent of all active participants in the housing market.

And gone are the simple years when you could just whack a signature on the loan papers and 'go guarantor' to give your kids a leg up the property ladder. These days, what with rising property prices and tougher credit policies, just accumulating a 10 to 20 per cent deposit is beyond the reach of many.

North says his household surveys demonstrate that 40 per cent of potential homebuyers who need parental assistance are now asking for help to accumulate a sufficient deposit.

While in close to 25 per cent of instances, parents are actually helping to pay down their offspring's' mortgage on an ongoing basis.

Risks and rewards

Seeing your child happily establishing their own family nest is something we all aspire to as parents. But the potential ramifications for hastily offering help into the housing market can be quite problematic.

The obvious issue to start with, is that dipping into your retirement fund could conceivably leave you short on cash in your golden years, when any chance of generating an income through work related activities diminishes greatly.

Any type of arrangement that involves blood and money also needs to be planned and entered into under a carefully structured agreement that contains clear exit terms.

Under no circumstances should you feel over-exposed or fiscally jeopardized by any proposed agreement. Everything falling in a big heap won't be helpful for you or your kids in the long run. So whatever you do, never extend yourself too far.

And don't be persuaded to hand over a large chunk of money on a housing asset that's obviously not worth the asking price your children might be determined to pay, because it's their 'dream home'.

Ultimately, the logical question you need to consider as a parent contemplating handing credit of some kind to your most beloved is... if the banks are reluctant to go there, should you really be lending the money?

The next best question is...if you're going to hand it over, are you prepared to part with it permanently? That's always the bottom line risk.

Should You Name Your Property Investments? A Farmer's Perspective...

This Issue:
January 10, 2017

I was chatting to a farmer recently about what's commonly referred to as "ethical" agriculture and the moral implications of raising animals for human consumption.

I wondered how they managed their investment – their livestock of sheep and bovine – to ensure optimal wellbeing, while maintaining enough detachment to send them to the slaughterhouse. I know…graphic images, but it's where our food comes from after all!

She explained to me (did you immediately picture an old guy in overalls when I mentioned 'farmer' earlier?) that it's much easier to see your stock as a commercial enterprise when you don't name them.

Her and her husband found this little gem out the hard way mind you, after giving each member of their initial flock of lambs his or her own personal identity and in turn, establishing a more intimate connection with the animals.

This is the difference between having an objective interest in your investment or being emotionally invested in your interest.

The former allows you to make decisions based on reason and logic over sentiment and 'feelings'. Whereas the latter can bias your judgment, causing costly mistakes that you'd otherwise identify as risks, and therefore either resolve or avoid.

What do sheep have to do with property investing?

The reason I impart this story is not to turn you into a Vegan or influence your WOE in any way (social media speak for what food you choose to stick in your gob).

Rather, I felt it was an excellent reminder that if we hope to be successful in property investment when it comes to building long term, sustainable profits, we must maintain this level of calculated distance between us and our growing portfolio.

As with farming however, this is often easier said than done. The financial investment we make in a housing asset is so significant that it naturally engenders a deep emotional response at an intuitive level.

But the more you can apply logic and reasoning to your intuition, the sounder your investment decisions will be…unless you're really bad at planning of course.

A lifetime of logic over a second of sentiment

This is a good way to remember the need to remain objective when it comes to mapping your investment journey and working out optimal asset selection.

Applying rational analysis of the facts and figures surrounding the investment in question is key.

Whereas if you allow that second of sentimentality you'll undeniably feel due to the large financial investment you're about to make spill over,
unconstrained by logic and reason, you're more likely to be blinded into bad investments.

Ask yourself, will it yield the returns you need and assist in meeting your long-term objectives?

Yes? Then do some further number crunching and perhaps consult an expert or two for a second, unbiased opinion.

Not sure? Then consider whether the questions surrounding the asset's suitability are coming from your head or your heart.

You're well advised to seek experienced industry guidance and mentorship in the initial phases of your journey particularly.

As a more seasoned and confident property investor however, you'll be less inclined to look for external validation of the decisions you make.

Can you weather all conditions?

The same applies to market conditions and how well you ride out the various peaks and cycles that naturally accompany any type of investment – be it property or poultry.

Farmers are often challenged beyond what many could endure by Australia's unforgiving climate.

Those who survive droughts, floods and everything in between, generally enter their agricultural enterprise with a sound long-term plan, and the tenacity that comes from doing something with the intention of helping generations to come.

Building your future fund with real estate, as with building a sustainable modern farm, is about more than immediate personal gains. It's about building a strong foundation for your family's future.

Making the tough choices easier

As a property investor seeking profits, you'll no doubt be required to make difficult decisions along your journey and be challenged by the innate personal feelings that arise when called on to make certain choices.

You might think that selling an asset, which happens to be dragging down your entire portfolio, is a fairly simple prospect to deal with on an emotional level for instance. It's all about the bottom line after all.

But what if that asset happens to be the house you acquired with your new wife twenty years ago and brought your firstborn home to?
The one you turned into a rental investment when the decision was made to upsize into a dwelling more suited to your growing family at the time.

Emotionally detaching from housing assets can be particularly challenging for the first time property developer, who risks becoming too invested in their first project.

Be it a small cosmetic makeover, a significant renovation or a brand new apartment build, the possibility of over-capitalising and missing the market is very real if you facilitate what's often an emotionally charged experience without a decent application of logic and reason.

The bottom line is…don't make it personal when it comes to property investing. Don't be the farmer who names his cow Bessie or Daisy because, at the end of the day, it's really a big Miss Steak.

If you would like to know more about making objective, sound property investment decisions, particularly when it comes to optimal debt structuring for your portfolio, why not connect with the team here at Trilogy Funding?

Our longstanding industry expertise can assist in helping you stay on your path and see your plans come to fruition sooner rather than later. Click here now to connect with us today.

Warnings Of A Global Property Crash. How Would Australia Fare?

This Issue:
January 10, 2017

While the world continues on in a seemingly perpetual state of constant rocks and rolls, where down seems to be up and up seems to be down and nothing quite makes sense, the alarm bells are once again ringing…ringing in a new year with increased speculation of a global property price correction.

The Organisation for Economic Co-operation and Development (OECD) is carefully monitoring the state of play across a number of world residential and commercial real estate markets, where prices suggest impending instability.

London calling

London is an interesting market to watch, as much of the activity that's occurred in recent times has strongly reflected the property mania we've seen across Sydney and Melbourne in particular.

There's been a lot of high-rise residential construction occurring in and around the English capital, many are being locked out of the playing field by ongoing affordability issues, and overseas investors are having a field day snapping up new housing stock. Sound familiar?

And while we had regulatory intervention in the form of changes to borrowing practices slowing the breakneck trajectory of price growth in 'high risk' markets last year, the UK had the well-timed Brexit fiasco.

In August last year, reports from London based estate agent Haart showed a £30,000 decline in average property prices, as people tried to deal with the economic shock of the UK's controversial vote to leave the European Union.

"We've already seen some changes in real estate prices (particularly in) the London market," Mann observed.

"What's interesting in terms of the implications for the UK economy is who bears the burden – who bears the adjustment cost. If it's a non-resident then lower house prices could actually be good for the UK."

Of course many observers would suggest the same for Australia's real estate market. That we are in need of a slight slowdown and perhaps even a minor adjustment if things are to continue on an even keel.

The Times conducted a survey of well regarded economists at the end of last year, asking their forecasts for London housing markets into 2017. Out of the 39 who responded, 22 said prices will either flat-line or fall.

Two respondents, former member of the Bank of England's monetary policy committee, DeAnne Julius and chairman of Lombard Street Research, Charles Dumas, predicted corrections of up to 10 per cent.

Over to Sweden

And the outlook is equally pessimistic. Here though, it's not just the OECD with its knickers in a twist about unsustainable price movements, as global bank HSBC talks up the potential for a bursting bubble.

At the beginning of last year, HSBC economist James Pomeroy said that the Swedish economy doesn't need any further stimulus, given it's the fastest growing in the developed world, with average house prices accelerating at 18 per cent per annum.

He suggested however, that monetary policymaker Risbank would continue to ease official rates given the state of low global inflation.

"Should the housing market roll over at any point in 2016 (or 2017) the impact on the economy would be severe," Pomeroy cautioned at the time. "Estimates from the National Institute of Economic Research suggest that a 20% fall in house prices would lead to a recession-like impact on consumption and unemployment, with a smaller fall still having severe economic consequences."

Fast forward a year later and the official cash rate in Sweden is now -0.50 per cent, with the nation's housing market scored at the highest danger level of 2.2 by the European Systemic Risk Board. But of course, the collapse hasn't come.

Where do we stand?

Recent research from CoreLogic indicates that even though there's been a lot of talk about a slowdown in activity for our markets last year, capital city house prices nevertheless grew at their fastest pace in seven years.

In Sydney, average prices have increased by 97.5 per cent since January 2009, while in Melbourne they've gone up by 83.5 per cent for the same period.

The interesting thing about this ongoing property crash speculation is that it's been virtually incessant since the world started clawing its way back from the 2008 GFC. Yet here we are, still waiting for the most significant housing holocaust in history.

Are we heading towards our own downfall by continuing to actively participate in the real estate market? It's difficult to say. Maybe we are. But what's the alternative?

We all need a roof over our heads. And with so much uncertainty in every other financial market right now, many of us have decided there's no other investment option that's quite as safe as houses.

Maybe it's simply a case of…Stay calm and keep investing.