The RBA's Ongoing Interest Rate Dilemma

This Issue:
June 20, 2017

It seems the Reserve Bank is stuck in a constant Groundhog Day, living one intractable interest rate dilemma to another, month by month.

It must be getting a little tedious to say the least, and really quite stressful. Because if it wasn't already a case of 'damned if you do and damned if you don't' when it comes to interest rate movements in Australia for the past two plus years, it most certainly is now.

What would the US do?

Whatever method America happens to be using to extrapolate future forecasts around inflation, dollar values, consumer sentiment, employment and general economic wellbeing, versus interest rates, at any given time; is largely the path our own policymakers have followed throughout history.

There's an undeniable pattern to the decisions that have always been made around the raising and lowering of rates in a bid to keep the economy anywhere close to that delicate balance, between too much inflation too soon, and an all out recession.

Essentially, the approach has long been a cautiously bullish one when it comes to anticipating inflation, both here and in other developed economies like the UK and the US.

I know that sounds like a contradiction, but it essentially means regulators don't necessarily wait until they see evident signs of rampant inflation taking hold before upping interest rates, because by then it could be too late to pull back on the reins and things could get our of control.

So what do you do instead? You predict the rate of inflation based on its relationship to unemployment figures. Because logically, when more people are gainfully employed, they have more money to spend and will in turn; start to make the economic wheels turn faster. Right?

Well, according to the so-called Phillips Curve, that's exactly how it should work. Some contrary economic boffins from high up in the annals of the good ol' US of A disagree with such a simplistic notion of measuring inflation in the modern world however.

Mistakes…I've made a few

Of course, America still seems to be following the Phillips Curve theory, with three interest rate hikes in the last six months to, "…reflect the progress the economy has made and is expected to make," according to Fed Chair Janet Yellen.

Recently though, former US Treasury Secretary Larry Summers articulated why this might not be such a crash hot idea, in a piece imaginatively entitled 5 Reasons Why The Fed May Be Making A Mistake.

Summers believes that interest rates should only be lifted when those in power are absolutely certain inflation is going to happen because, well, it's already happening. He calls this the "shoot only when you see the whites of the eyes of inflation" paradigm.

Summers contends that the old way of thinking is obsolete. He says even if the Phillips Curve was once reliable – which in itself is a hotly contested debate – it's extremely difficult to statistically estimate the point where unemployment and inflation are in perfect harmony – the Non-Accelerating Inflation Rate of Unemployment (NAIRU) as it's called. Or my personal favourite – the Goldilocks Effect.

A major issue with this method of forecasting inflation against employment figures to determine whether or not you'll raise interest rates, is that not everyone who's 'gainfully employed' is making enough money to participate in driving inflation.

The wage growth gripe

Summers has suggested that advanced economies like the US and Australia are suffering from "secular stagnation", whereby the economic speed limit has almost halved due to an overabundance of savings versus too few productive investment opportu-nities.

He goes on to point out that timing an interest rate rise incorrectly at this stage of the game could be extremely detrimental to the US economy.

"And I am confident that if the Fed errs and tips the economy into recession the consequences will be very serious given that the zero lower bound on interest rates or perhaps a slightly negative rate will not allow the normal countercyclical response," says Summers.

Here in Australia we're also enjoying relatively low levels of unem-ployment right now, with the ABS announcing a drop in May to 5.5 per cent. On its own, this figure is potentially compelling enough by traditional forecasting standards to suggest an interest rate rise might be well timed right about now.

But when you hold this figure up to the incredibly low wage growth we've experienced since before the turn of this century, the reason for our remarkably low rate of inflation becomes more apparent, along with the RBA's reluctance to raise interest rates. Particularly when you consider the alarming rate of (growing) national household debt we seem to be in.

If Summers' argument is as watertight as it appears on the surface, the implication is clearly that the RBA will be forced to, at the very least, remain firmly seated on its hands when it comes to making a move on interest rates.

Or, conversely, the only way Governor Lowe could possibly go is further down, by perhaps as many as two further cuts, before the year is out.

Of course that brings us to the other inescapable dilemma faced by the Reserve…the perpetual brink of an alleged 'bubble' that our key property markets are perched on, due to a flurry of investor activity driven by…you guessed it…low interest rates.

See…damned if you do…damned if you don't…these are the dilemmas of deciding our nation's fiscal fate. Glad it's not me!

Investment Opportunities In Australia's Changing City-Scapes

This Issue:
June 20, 2017

In a recent article for The Australian, noted demographer Bernard Salt provided a different take on the shifting face of Australia's cities, and emerging 'areas of note' for investment and development potential.

Down the line...

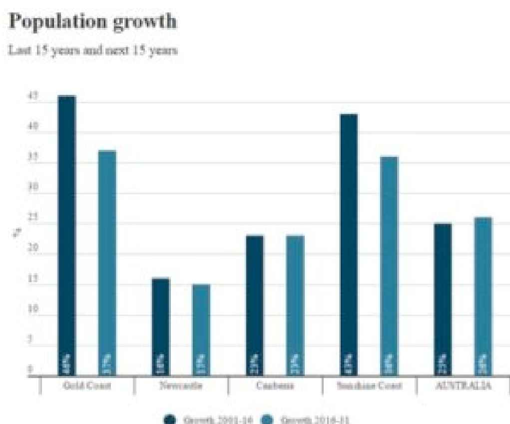
Salt proclaims four key locations as "next tier" cities, being the Gold Coast, Newcastle, Canberra and the Sunshine Coast. All of these locations are experiencing significant demographic transitions, driven by changing population growth and composition, which Salt says opens up numerous opportunities to those who can see it all occurring.

Notably says Salt; the three largest of these cities are, "inextricably linked to capital cities to the extent that it could be argued they are functionally co-dependent.

"Intercity commuter flows connect the two Queensland 'coasts' with Brisbane. Newcastle is less connected to Sydney by commuting but the city's growth nevertheless benefits from a Sydney overspill factor: people escaping the pressures and costs of Sydney living. Canberra, it could be argued, is a cultural outpost of Sydney and Melbourne."

Bigger and better...

Collectively, all four cities account for around 8 per cent of the total population in Australia or close to 1.8 million people. And all are currently in a state of re-establishment, after experiencing various economic and industry modifications, and now reaping the benefits of renewed interest in 'close-to-city-sea-change' locations as places to establish a more permanent lifestyle for commuter residents.



Salt points out that while all four of these cities might be linked by scale, each one has undergone its own unique evolution over time.

The Gold and Sunshine Coasts were largely built on the back of last century's sea change craze (obviously); where people wanted a retirement type atmosphere by the beach, with easy CBD access (to Brisbane).

Conversely, rather than happening due to a coincidental (?) lifestyle shift, Canberra was a city planned carefully and concisely to serve the purpose of acting as our nation's political heartland.

"The city has no equivalent of Toorak or Point Piper but, then, neither does it have struggle suburbs," notes Salt.

"Yes, there are variations but not the extremes of the free enterprise capitals. The city is measured; its people are measured; growth is considered and directed. This decade and into the next it is Gungahlin and perhaps some redevelopment opportunities in North and South Canberra."

Of these cities, strong population growth has been most consistent on the Gold Coast, with almost 14,000 new people flocking to its sunny shores in the 12 months to June last year, and close to 20,000 relocating to the holidaymaker's Mecca at the peak of the sea-change phenomenon more than a decade ago.

Salt says that with almost 6000 new people moving to the Sunshine Coast each year, along with 5000 to Canberra and 4000 to Newcastle, all four of these cities should be taken seriously as places where opportunities await the astute developer.

"Across the 15 years to 2016 the Gold Coast added 208,000 residents; the official projection for the following 15 years is 247,000," says Salt.

"On these figures the outlook for the Gold Coast is positive. And generally I would concur. The Gold Coast slumped after the global financial crisis and is reawakening only now, stimulated by infrastructure spending and the coming of the Commonwealth Games."

He adds that with a further wave of baby boomers soon looking to relocate from their inner city homes near the office, to a more relaxed lifestyle by the beach, prospects for growth in the next decade are looking increasingly optimistic for the Gold and Sunshine Coasts.

"During the 15 years to 2016 the Sunshine Coast added 105,000 residents, but in the next 15 years the outlook is for a net extra 126,000 residents. The Sunshine Coast is on the move, with plans for an expansion of the airport, the recent completion of the Kawana health precinct and the reimagination of the Maroochydore CBD," says Salt.

He believes these cities are well placed for future development and expansion to accommodate growing populations and as such, the potential for interesting investment opportunities.

While Salt concedes that forecasts suggest Canberra will also experience its fair share of population growth during the next 15 years, with a projected increase of 93,000 new residents over that time, he has a harder time working out the whys.

"I can see the logic behind escalating rates of growth on the Gold Coast and Sunshine Coast. I cannot see the driver behind faster growth in Canberra and especially when there must be restraint on growth in the public service," he says.

Leading by example

One of the most intriguing tales of two cities…or one in this case (but that doesn't have quite the same ring)…is in Newcastle. Built on the foundations of a local steel industry and then later the coal industry, the town has been forced to reinvent itself more than once since the 1999 closure of the BHP steel mill.

Salt suggests Newcastle's "reimagination" to more of a lifestyle destination should provide hope for towns currently experiencing similar industrial transitions that bring "profound economic and social change such as Geelong, Wollongong, Townsville and perhaps even Whyalla and the Latrobe Valley."

Newcastle, according to the demographer, appears to be the most stable of these 'next tier' cities when it comes to steady population growth, with 63,000 new residents settling there over the last 15 years and a further 65,000 expected to move in over the next 15 years.

"My view here is that the bigger, the meaner, the more congested, the less tolerable Sydney becomes, the greater the driver for overspill growth into Newcastle."

Looking at the numbers

Salt says investors would do well to explore population projections for Australia's various cities soon to be released in the upcoming 2016 Census data and look at them not as absolute markers, but as the "anticipated shift in the momentum of growth."

He challenges investors to consider whether the market you're operating in is rising or falling?

"Because I say that the markets are rising on the Gold Coast, the Sunshine Coast and Newcastle but have plateaued in Canberra.

"Making strategic decisions about which markets to enter and how much to invest are important. Get it wrong and you are locked into marginal markets. Get it right and success is more easily attained and sustained. Projections are important but they must be tem-pered — filtered, even — by a common sense evaluation of the drivers of demand."

Salt says while property is a good business to be in given that Australia is a growing nation, already experiencing obvious accommodation supply constraints, why just aim for 'good' when you can do your homework and uncover 'the best' the markets have to offer?

"Consider the 10 to 15-year outlook for cities and markets you are contemplating entering," he counsels. And then go for the ones with the most promise!

Who Are You Listening To When It Comes To Your Investment Decisions?

This Issue:
June 20, 2017

Who do you trust? This is an incredibly important question for property investors to consider, and then answer with forthright honesty. Do you trust your own instincts?

Or are you more inclined to listen to a multitude of other experts before you give your own inner voice any credit? And if it's the latter one, which experts should you pay attention to?

First know thyself

To make money as a successful property investor in today's markets, where the messages are mixed to say the least, requires tenacity and confidence in your abilities as a decisive action taker.

When you fail to understand who you are and what your objectives are regarding your own financial freedom and the future wellbeing of your family, then you have no real motive to succeed in your investment endeavours.

And without a real motive – a real driving passion, then there's no real reason for you to try very hard is there? There's no need for commitment. You can quite happily wander around in a state of perpetual procrastination even, without a clear destination to arrive at anytime soon. And let's face it..most people do just that!

So the first step, on a successful climb up to the top of the property ladder, is to work out what is driving you to do so? Why do you want to create a wealth generating real estate portfolio?

Is it to retire early and enjoy more time with your family? To travel the world and have wonderful, exotic adventures? So you have more to give back to friends, family and your community and more to contribute to the world?

Whatever your WHY might be, you need to uncover it, embrace it and keep it firmly in sight on your horizon as you keep walking forward into your growing and evolving future financial prosperity. If you chop and change your why every week, it just won't work for you.

One reason you'll end up failing when you fail to connect with your WHY is because you won't actually understand the authentic reason you have to succeed. And that's important to understand!

Because when you want to succeed at something, when you're passionate about it because you have very good reason to be like it changing your family's lives for the better and securing your children's' financial future – you are far more likely to do so! And you are far more likely to be your own best counsel!

Why? Pay close attention here...Because no one will ever care about your success as much as you do!

Listen to me!

From a very tender age we're taught that someone always knows better than us. Teachers, parents, our friends' parents (no matter how dysfunctional their family might have seemed), everyone who was a foot or more taller than us...everyone virtually knew better than us kids!

The problem with this message is that eventually, we forget to trust ourselves at all. Instead, we constantly look to someone else who 'knows better' to solve whatever problem we might have.

And while it's all well and good to consult the 'experts', and you should definitely do so when you want to succeed...you also have to know which experts you should be listening to and which you should be steering clear of. And how do you know that? Your own internal radar is how!

But if you've switched it off and are no longer listening to your own, internal GPS, then how do you recognise the good advice – the advice that resonates and aligns specifically with your WHY, from the bad – the stuff that's going to waste your time and money?

Feeling it

When you're attuned to your reason for wanting to invest in real estate, you'll very quickly be able to weed out the relevant information, knowledge and experts you want to engage and connect with.

Something they say will make you sit up and pay attention. Your Google Maps will go off (whatever that means!) and you'll want to pay that person money to tell you everything they know on the topic of property investment as active investors themselves. That last bit of that last sentence is particularly important! You don't want to learn from just anyone!

Mentors and mastermind groups are great assets for the conscious, decisive, action taking property investor. And you will use them to your best advantage when you know how to apply their wonderful insights and experience to your own journey, because you can see where their story aligns with your future vision.

You'll be digging what they have to say, so you'll pay close attention and take that decisive action you're so good at! And that's how you get the proverbial done as a property investor!

5 Questions To Help You Be A Better-Prepared Property Investor

This Issue:
June 20, 2017

I was chatting to a psychologist friend the other day regarding perspective and preparation. For many years, I've erred on the side of caution when it comes to 'looking on the bright side'. While I like to hope for the best, I generally plan for the worst. That way you can't be caught out right?

She responded, as psychologists are wont to do, with the results of a study she'd recently stumbled on that suggested otherwise. In a nutshell, the researchers concluded that the disappointment experienced when something doesn't go as planned is just as palpable if you try to prepare yourself for it by anticipating a negative outcome.

On the other hand, if you remain positive in the lead up to the outcome, then you haven't potentially soured the journey to get there with a lot of negative emotions.

Some would even suggest a 'can do' attitude might generate a desirable result.

All self help insights aside, the point I want to make is that for property investors, it really is smart to assess and understand your 'worse case' scenarios.

The idea being…know what possible eventualities you're preparing for by way of a risk analysis, while having the confidence in your decisions to optimistically embrace the actions required to reach your objectives. Got it?

I don't know…sounds a lot like preparing for the worst but hoping for the best to me. Either way, here are 5 questions to help you become a more prepared property investor..

1. What if interest rates rise?

It's not so much case of 'if' as 'when' really. Indefinite low interest rates as the 'norm' would essentially mean our current economic model is dying a slow death, which may well be the case.

But ever the optimist, I like to think that one day, who knows when, the tide will turn and interest rates will again start to rise as influential world economies meander back on track.

When that day comes, will you be prepared? There's no doubt some who've entered the market in recent times will potentially feel the pinch if they're unaccustomed to anything but cheap credit. Comfortable in the current status quo, some will undoubtedly drown in debt when their repayments start to rise.

The key is to crunch the numbers from the outset with a decent interest rate buffer, thereby giving yourself a good deal of financial breathing space if AND WHEN interest rates start to creep up again.

2. What if the bottom falls out of the market?

Ah…the perpetual 'what if' that probably locks more people out of an income generating property portfolio and independent retirement wealth than any other nagging doubt…but a great one to consider in order to be a better investor.

Rather than scare yourself into inertia when contemplating future market activity, the idea is to understand that not all property markets are created equal.

Hence, you'll be more likely to do your homework and identify a quality investment over a subpar location that doesn't have the endurance to perform above long-term averages.

Yet again, this instills the necessary confidence in your investment decisions to take positive action.

3. What if my financial circumstances change?

Life is an unpredictable myriad of moments…highs, lows and all the mundane stuff in between. While it can be confronting to face the prospect of life altering directions that send you into a financial tailspin, we never know what's around the corner.

Taking on a significant commitment, in the form of a property investment loan, means being able to meet that commitment over many years in order to maintain your portfolio.

When reviewing the figures for your loan application, think about whether the debt still looks as manageable if say, you have no personal or rental income for a prolonged period.

You should also prepare a cashflow buffer to see you through any 'rainy day' events along the way.

4. Will my rental income be enough for the repayments?

If you feel confident that your property has the potential to generate sufficient income from tenants to service the monthly mortgage, without the need for you to dig too deep into your own pockets, it's likely your equity position is pretty solid.

However, if your mortgage repayments might require a substantial top up from your personal income each month, you need to consider where things are falling short, particularly in this low rate environment.

5. How should I structure the purchase?

This is another critical consideration that many 'newbie' investors simply fail to spend sufficient time thinking about or seeking expert guidance with, but one that will make the world of difference to your portfolio.

It's a particularly important question if you happen to be buying in a partnership or collective type arrangement, as you want assurance that the agreement will prevail as long as you need it to in order to reap the desired dividends.

Not wanting to sound negative…you need to consider whether those you call friend or purchasing partner today, will still be perceived in such a familiar and personable light tomorrow. Life is full of surprises after all!