PREPARE FOR LIFE

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WHAT WILL AUSTRALIA LOOK LIKE IN 2060?

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About every five years the Australian Government commissions an "Intergenerational Report".[1] The 2021 Report has just been released.

The purpose of the Intergenerational Report is to look 40 years into the future and draw a picture of what Australia will look like. The Report is then used to help the Government plan for the future.

While the focus of the Report is to look at economic and fiscal impacts, it also paints an interesting picture of what society is expected to look like in 40 years.

The Australian population is expected to age considerable largely because of improved life expectancy and low fertility rates. By 2060 almost a quarter of the population (23%) is expected to be over 65.

The ratio of working-age people to those aged over 65 is expected to fall from the current 4 people, to 2.7.

As the population ages we can expect to see a corresponding decline in workforce participation, resulting in fewer workers to fill job vacancies. This may also lead to less personal tax revenue being collected as fewer people are in the workforce. To be able to meet demand for products and services, businesses will need to become more innovative and embrace emerging technologies.

Currently around 75% of senior Australians receive some form of income support from the government, mainly through the age pension or service pension.

Close to 50% of this cohort receive the full rate of age pension while the remaining 25% received a reduced pension because of the application of the income or assets tests.

However, with the maturity of the compulsory superannuation system, it is expected that by 2060, more Australians will be fully funding their own retirement resulting in an anticipated reduction in the proportion of people relying on part of the full age pension. In fact, it is expected that the proportion of the population receiving the full rate of age pension will reduce to approximately 25%, and those receiving a part age pension will increase to around 35%. Overall, the proportion of the population receiving a part or full age pension is expected to reduce from the current 75% to around 60%.

With an ageing population will come increased costs of providing health care. This will be "the elephant in the room".

By 2060, government spending on aged care is expected to represent 2.1% of gross domestic product (GDP) ($113bn in 2020-21 dollars). This represents a doubling of spending as a share of the economy from 2020-21.

Looking forward to the issues that will face Australia in 40 years is a mind-boggling exercise and will present many challenges.

The take-out from the Intergenerational Report is we all need to be taking steps to provide for our own future. This not only includes getting and keeping our financial house in order, but also focusing on our health and well-being so we can live a long and healthy life without becoming a burden on our families and society.

[1] All figures are sourced from the 2021 Intergenerational Report, Commonwealth of Australia 2021

THE ECONOMIC IMPACT OF COVID-19

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Australians have once again faced another round of lockdowns as COVID-19 outbreaks emerge across the country, with record high case numbers across NSW.

The country has been battling snap lockdowns as the Delta variant of COVID-19 remains prevalent within communities due to its increased infectiousness.

How will our economy recover from the impact of the Delta variant?

What are the impacts of these new lockdowns on the Australian economy?

As the recent lockdowns have only been in place since the end of June 2021, there are only a couple of months where we can analyse the effects these restrictions are having on the wider economy.

Based on the most recent data regarding consumer confidence, business confidence, and retail sales, it is clear these lockdowns are having a negative impact.

- Consumer confidence is close to falling below zero, which also occurred through the recession in 2020.
- Retail sales have already contracted two months in a row, however only contracted once in 2020.
- Business confidence has fallen below zero in the latest data release suggesting negative business sentiment.

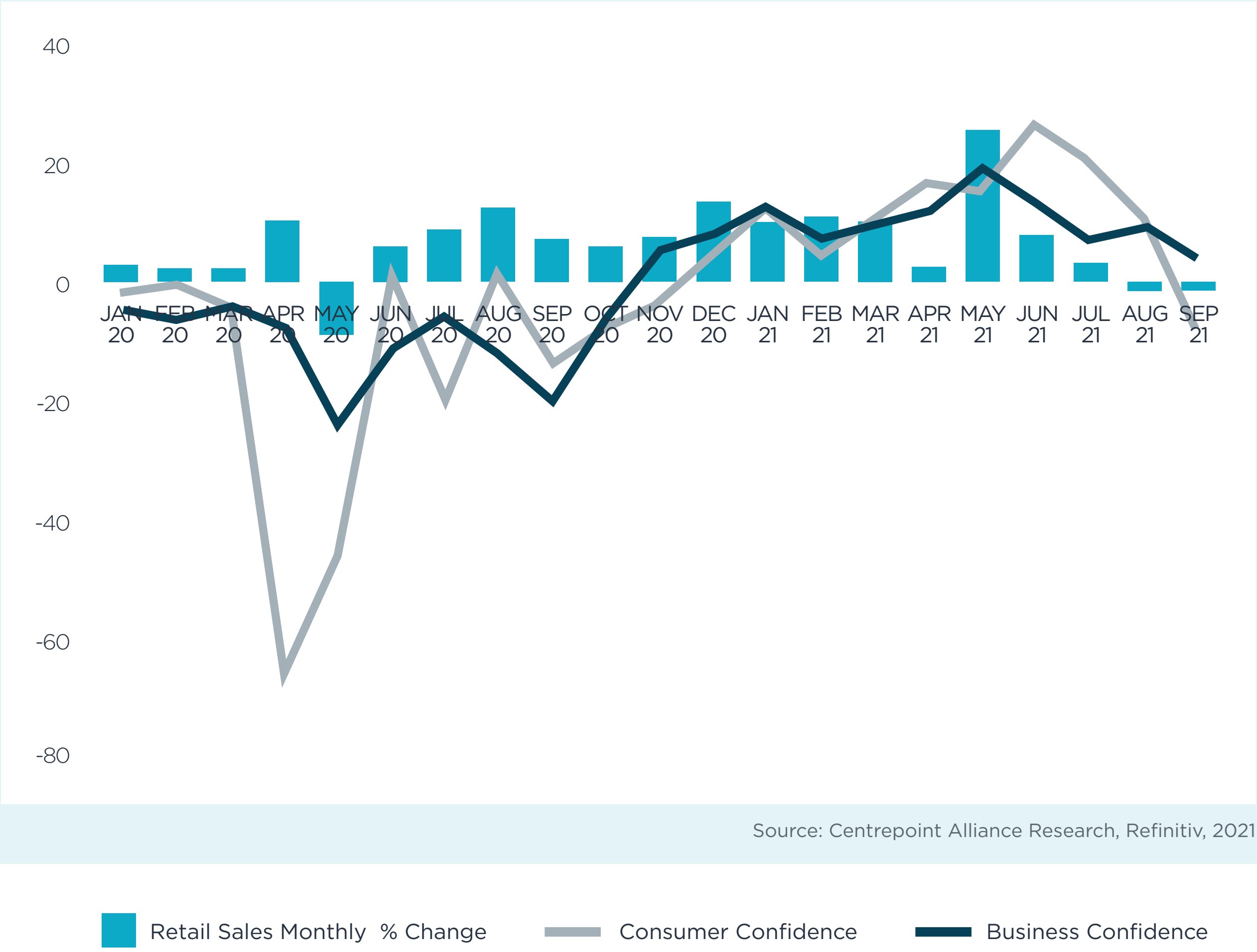
All three metrics point to worsening affects from the latest lockdowns on the wider Australian economy.

These lockdowns are having short-term impacts on the greater economy as retailers and service sector businesses predominately remain closed within Australia's largest city and many others around the country.

It is likely that there will be a flow on effect to the unemployment numbers as these businesses struggle to keep staff employed. Government support programs have been reinstated to aid workers who have had their weekly hours cut or taken away entirely.

These programs are a continuation of JobKeeper/JobSeeker-like programs that we saw in full effect throughout 2020/21.

Australia Retail Sales, Consumer Confidence and Business Confidence



Source: Centrepoint Alliance Research, Refinitiv, 2021

Is there any good news?

As soon as Australia was able to return to a mostly 'normal' society in 2020 after the easing of restrictions, consumer confidence, business confidence, and retail sales rebounded tremendously.

It would be expected that the same outcome will occur after Australians get through these current lockdowns. The difficult part, especially for small business owners, is to remain solvent during this period.

The government relief now available is a standardised payment that may help many people, however businesses with large overhead costs and expensive rents may find themselves closing their doors for good.

It is not hard to see the "For Lease" signs of retail stores around cities and neighbourhoods that were clearly impacted by the COVID-19 pandemic. These recent lockdowns may put pressure on the remaining store fronts, especially in NSW.

Impact on investment portfolios

The Australian equity market continues to move to all-time highs despite the slowing economic conditions. Due to how quickly the Australian market rebounded out of the pandemic in 2020, a correction (-10% drop in the market) would potentially be a healthy reaction to cool down the market amid a slowing metrics of the wider economy.

If there is a pause in Australia's reopening trade, we would expect the same sectors that did well during last year's lockdown to provide a buffer once again, namely, technology. However, this safety trade may not last for an extended period of time.

The sharp and continued increases in vaccination rates may be helping markets see through this economic slowdown as investors know these lockdowns will not last forever. If this is the case, an equity market that gradually grinds higher amongst underlying economic optimism may continue to persist and may eventually cause yields to move higher over the coming 12 months as the Reserve Bank of Australia continues its tapering plan due to its surprisingly bullish stance on the Australian economy.

MORTGAGE OR SUPERANNUATION?

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Is it more important to pay off your mortgage as fast as possible or invest more money into superannuation?

As an esteemed colleague of mine often says "it depends".

I look at my own situation. At the age of 30 I was married with two young children, my wife at the time was not working and the interest on my mortgage was above 10% - with worse to come as rates over the next couple of year increased to 17% - quite a frightening prospect!

At the time with mortgage interest rates at record levels, my priority was to pay down my mortgage as soon as possible. Retirement was a long way off, so the thought of any extra money being invested in superannuation at that time did not make a lot of sense.

But what about now, with the interest rates at record low levels? If I was 30 would I still be concentrating on reducing my mortgage as soon as possible rather than investing extra money into superannuation?

With the average variable mortgage rate at approximately 4.5%, the fixed 3-year mortgage rates at just under 2% [1], and superannuation returns on median growth fund for the 12 months to June 2021 averaging close to 18%[2] - surely I would be much better off putting all my extra money into super?

Not necessarily. When you make financial plans, it is extremely important to look at issues over a longer period of time. Viewing mortgage rates and superannuation returns at a moment in time can be very misleading.

Let's have a look at this a little closer and in more detail.

According to the Australian Bureau of Statistics the average new home loan in Australia as of June 2021 was $735,024[3] which is equivalent to repayments of $3,604 per month over 30 years at an interest rate of 4.2%. Total interest paid over the 30 year is in excess of $500,000.

But what would happen if I were to pay an extra $1000 per month, increasing my repayments in the first scenario I have mentioned, to $4,604 per month?

My loan would be repaid in under 20 years and I would have saved over $215,000 interest.

Be mindful, if the mortgage rate increases to 6%, repayments will increase to $4,417 per month - negating the benefits of the extra $1,000 in repayments that you are making.

What would happen if I invested the extra $1,000 per month into super?

I am 30 with a superannuation balance of $45,000 invested in a balanced portfolio with an average return over 15 years of 5.6%, I am earning $100,000 per annum and my employer is already contributing the mandatory 10% Superannuation Guarantee. The extra $1,000 per month I salary sacrifice could increase my super balance over the 19 years by $249,689[5].

So which strategy is the best?

In very simple terms investing money into super over a long period of time could produce a better return as can be seen by my examples. However, everyone's situation is very different and over the 19 years I have used in my examples people's circumstances do change. So please do talk to an expert in these areas before making any decisions.

1. RBA; www.ratecity.com.au/home-loans
2. www.superannuation.asn.au/
3. www.abs.gov.au/statistics/economy/finance/lending-indicators/jun-2021#key-statistics
4. https://moneysmart.gov.au/home-loans/mortgage-calculator
5. https://moneysmart.gov.au/how-super-works/superannuation-calculator

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