

# Newsletter

## Welcome

First budgets are often the harshest of a government's entire term of office – but the latest one was surprisingly mild, despite concerns about interest rates and inflation.

We have our amazingly positive trade relationship with China to thank for this respite, so we thought a background piece on the Chinese economic miracle might be of interest to our readers.

By now of course, you know pretty well where you stand personally after the Budget, but we have included two brief overviews which focus on the big picture issues. The first looks at the budget from a point of view of managing rising interest and mortgage rates and spiralling inflation. The second examines some of the implications of the new income tax watershed – the \$150k p.a. cut off point that now defines your access to many tax benefits. It could have a short and medium term effect on your tax planning, and we will be monitoring it for you.

And finally, we look at a widely-held belief that “money cannot buy happiness”. Recent research indicates that financial security is indeed an important source of happiness, so there is no need to feel guilty about a successful investment or growing super fund!

On another note, we would like to thank our clients who have referred their friends, family and colleagues to us over the last quarter. We don't advertise, and as such our continuing growth and success is based on such referrals.

Kind regards



Brenton Tong & the team at PDB

## Up and Up!

### Chinese medicine keeps Australia's economy healthy

The relationship between China and Australia will endure as strongly as ever after the media frenzy surrounding the Beijing Olympics and the current crisis in Tibet die down. It has to, because both countries are so dependent on each other.

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Last year, China became Australia's biggest trading partner, overtaking Japan and the USA for the first time. This is extremely important, because both the American and Japanese economies are stagnating, while China's is growing faster than any other country in the world.

A few years ago, China's huge population of 1.3 billion was simply regarded by the developed world as cheap labour. Production shifted from western countries to make China the world's factory for cheap mass produced goods. In effect, the west was exporting jobs and importing commodities. For example, China produces 50% of the world's buttons and more than 50% of America's clothing.

But within a single generation, China has surged ahead into more sophisticated manufacturing and has overtaken the USA to become the world's largest exporter of IT and communications products. It also has its own thriving IT industry, designing new products as well as manufacturing and assembling for international brands.

For Australia, China is our shield against the effects of a world-wide recession that appears to be inevitable in the face of a stagnating US economy. China needs Australian iron ore, coal, wool, copper and crude petroleum to keep on growing. Australia needs low cost Chinese imports to keep consumer prices affordable.

The statistics are fairly mind boggling. In its push for growth and modernisation, China is consuming more than half of the world's concrete and steel and will construct more than half of the world's new buildings over the next decade.

In its hunger for electrical power, China consumes more coal than Russia, India and the USA combined. In the three years between 2003 – 2006, world coal consumption increased as much as it had in the 23 years beforehand and China was responsible for 90% of this increase.

Will China be affected by a world downturn that reduces demand for its manufactured exports? Possibly, but this could well be offset by increased consumption inside China, which has the world's fastest

growing middle class. By 2020, the Chinese middle class will have grown from 100 million to 700 million people. Car ownership will surge by 65% this year, and China's booming population of internet users has already soared to 221 million, tying with the United States for the biggest number of people online.

A growing middle class in China is a real positive for the Australian economy, with Chinese consumers striving to achieve living standards that are the norm in more developed countries. There will be major opportunities for quality Australian food producers and also for our tourism and hospitality industry. China's economic relationship with Australia should continue to be good news for all of us. ■

These statistics are drawn from 'The Last Empire: Can the world survive China's rush to emulate the American way of life?' Mother Jones, Dec 2007.



## Which way?

### Fixed or variable: Which is better for you in the new-look mortgage market?

We are living in a new era of home mortgage rates and some of the basics have changed. If you are currently paying off a mortgage or planning to buy a home in the near future, it is very important to understand the new pros and cons of the choice between a fixed rate and variable rate home loan.

If you choose to fix your interest rate, you will agree to freeze your mortgage at a fixed rate which is higher than the current variable rate for a certain number of years - say 10% a year for 5 years.

If interest rates rise above 10% over the next 5 years you save money and if they fall below 10%, you pay more than you may have had to.

On the other hand, if you choose a variable rate, you'll pay less while mortgage rates stay below 10%, and pay more if they go higher.

Since the Australian Reserve Bank uses interest rate rises to discourage spending and curb inflation, interest rates – including mortgage interest rates have traditionally tended to go up when inflation rates are higher and go down when inflation rates improve.

Unfortunately, one side effect of last year's collapse of the third tier bond market in the USA has been to sweep aside the direct connection between inflation and interest rates. For the first time ever, Australian banks are raising interest rates on mortgages on their own initiative, regardless of whether the Reserve Bank actually increases interest rates or not and irrespective of the inflation rate.



# Winners & losers

## Exit the Sheriff of Bennelong ... enter Robin Hood.

New times, new tax regime, with the Rudd Government taking from the rich and giving to the less rich. For the first time in a decade, when it came to budget tax breaks, top earners did not receive a bigger jackpot than lower paid Australians.

As part of this process, this government has redefined the meaning of rich and poor. Any family earning over \$150K p.a. is rich, and does not need too much government support to give their kids a fair start in life.

These families will lose the Part B family

Why is this happening? It's because for banks, the cost of borrowing funds to lend out as mortgages has increased. This is due to a tight international money market which results in banks having to pay higher interest rates themselves. As banks are publicly owned companies with shareholders, they are choosing to pass that increased cost on to their customers.

What makes the fixed vs. variable question a difficult one to answer, is that nobody really knows what will happen to interest rates or the money supply over the next few years. You can't fix a rate forever so whether it is better to switch from a variable to a fixed interest mortgage at this moment depends mainly on how you feel about where interest rates and the international money supply are heading. Another factor to consider is the flexibility of your family budget.

If you have enough slack in your income to accommodate interest rate rises, you may wish to grit your teeth and sit out this period of rate uncertainty in the hope



support payment, miss out on the baby bonus and have to pay their own pre-school child care and school costs, while those families earning less than \$150K continue to receive the Baby Bonus and Part B family support payment, and receive new means tested subsidies for pre-school care and out of pocket school expenses such as computers.

As a result, a family earning around \$90K a year, with pre-school and school age kids or a baby on the way, could add more than \$4000 p.a. to the family purse in tax

that rates will drop again before too long.

Alternatively, if you are on a tight budget it may be easier for you to plan and budget when the mortgage repayment is known and frozen for the next few years.

Having a bet each way is another possibility. You can fix for a short term, say 2 years, keeping your options open after that. Or, you can freeze part of your mortgage while the balance remains variable, aiming for average mortgage repayments that are lower than the fixed rate.

You should never forget however, that interest rates are not always the most important factor in the cost of a mortgage – the ability to pay the mortgage off faster can actually save you a lot more than what you pay in interest rate rises. ■

breaks, subsidies and grants. Especially if they choose to opt out of private health insurance, as they now can, and take their chances with the about-to-be-boosted public health system.

There has not been a lot of criticism of the new tax rules. It may have given the wealthy a tap on the nose, but it hasn't yet drawn blood, thanks to the padding provided by some very generous tax breaks promised by the Howard Government and matched by the Rudd Government. This latest tax break gives those in the top income bracket an extra \$50-plus per week as balm for the pain.

There are many small niggles in this Budget which will annoy tax payers in the top bracket, such as the end of the import tax rebate on luxury imported cars, but there won't be many executives trading in their C Class Mercs for Subarus as a result. More of a blow is the ending of the tax concession for employees buying company shares, and the tightening of the FBT exemptions on work related electronic equipment and meal vouchers which will affect executives, white collar workers and tradesmen alike.

The other ticking time bomb is the prospect of much higher private health insurance costs as a result of younger families opting out of private health funds – which could ultimately make private health care as horrifically expensive a prospect for older Australians as it has become in the USA.

One ray of sunshine for those in the top tax bracket is that the superannuation tax concessions are unchanged – leaving super as just about the most tax-advantaged investment you can make (although the new first home buyers saving concessions run a close second).

And for those of us still paying off our homes and coming to terms with rising interest rates, the good news is the Treasury predicts inflation should be under control by June 2009, bringing some stability to mortgage rates.

The challenge for those who have benefited from the tax breaks will be to set aside money to build up investment capital or enlarge their super – this can create real prosperity long term. If you have adult children still living at home or paying rent, get them saving for a first home. With the new tax breaks on first home saving accounts, owning a home has become easier than it has been for many years. ■



## Is it true?

### Can money buy happiness?

Popular wisdom says that no matter how rich you are, it is the things that money can't buy that really matter, like health, love and the support of friends and family. But are the best things in life really free?

In Hollywood, "money can't buy happiness" is a mantra that has been communicated for decades – we've seen it as a message in literally hundreds of hit movies, from *It's A Wonderful Life* to *Pretty Woman*. But in Beverley Hills, where millionaires, celebrity divorces, and drug and alcohol rehab centres are thick on the ground, does anyone actually believe it?

The idea that living a good life is more important than riches is a very old one. The Bible tells us that it is easier for a camel (meaning a thick rope used on ships, not the ship of the desert) to pass through the eye of a needle than it is for a rich man to enter the kingdom of Heaven.

#### Are you serious...

Lots of small banks are failing.

I didn't realise how bad things were until I recently went to my local small bank to ask about a loan and they said, "Great! How much can you loan us?"



Earlier social research seemed to be on the bible's side. A landmark 1974 international study by Easterlin suggested that while the poorest people were happier once they could afford the necessities of life, as soon as this had been achieved, an increase in wealth did not lead to an increase in happiness.

On the other hand, this conclusion has been challenged by several more recent surveys. One of them, "money doesn't buy happiness - or does it?", a 2004 study by the Melbourne Institute of Applied Economic and Social Research, shows that when wealth (including assets - not just income) is measured, the rich are indeed happier than the poor.

Why assets and income, and not income alone? A USA study indicates that income delivers as much misery as happiness – because income is used as a benchmark to compare yourself with your peers. However much you earn, you tend to be dissatisfied if you earn less than your peers.

And what about people who become suddenly rich, like lottery millionaires? We've all read stories of how the windfall led to nothing but misery, but are they true? A 2006 British survey compared the happiness of those who had won the jackpot with those who had not. The conclusion: 96% were as happy or happier after winning the money and only 3% were not. At the same time, 59% of the winners were already satisfied with their lives, compared to only 40% of non-winners.

The study also found it was not necessarily material possessions that enhanced winners' lives. 44 per cent of winners said that being able to spend more time with their family contributed to their happiness, compared to 26 per cent who said it was the ability to buy or do what they liked. Dr Richard Tunney, one of the authors of the study, said: "The old saying 'money can't buy you happiness' may not be true, but traditional family values, a comfortable home and financial security are clearly key elements to a happy life".

Living in Australia, we do have one very good reason to be happy. A 2005 Roper survey of 30 countries found that Australians regarded themselves the happiest people on earth – the top scores were Australia 46%, U.S.A. 40%, Egypt 36%, India 34%, U.K. 32%. So our advice is to keep on living in Australia, and keep on investing to build up those happiness producing assets. ■