

BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Official Cash Rate

Reserve Bank Governor Graeme Wheeler increased the Official Cash Rate by 25 basis points to 3.50% last week. Here is the statement issued at the time.

New Zealand's economy is expected to grow at an annual pace of 3.7 percent over 2014. Global financial conditions remain very accommodative and are reflected in low interest rates, narrow risk spreads, and low financial market volatility. Economic growth among New Zealand's trading partners has eased slightly in the first half of 2014, but this appears to be due to temporary factors. Construction, particularly in Canterbury, is growing strongly. At the same time, strong net immigration is adding to housing and household demand, although house price inflation has moderated further since the June Statement.

Over recent months, export prices for dairy and timber have fallen, and these will reduce primary sector incomes over the coming year. With the exchange rate yet to adjust to weakening commodity prices, inflation remains moderate, but strong growth in output has been absorbing spare capacity. This is expected to add to non-tradable inflation. Wage inflation is subdued, reflecting recent low inflation outcomes, increased labour force participation, and strong net immigration. It is important that inflation expectations remain contained. Today's move will help keep future average inflation near the 2 percent target mid-point and ensure that the economic expansion can be sustained.

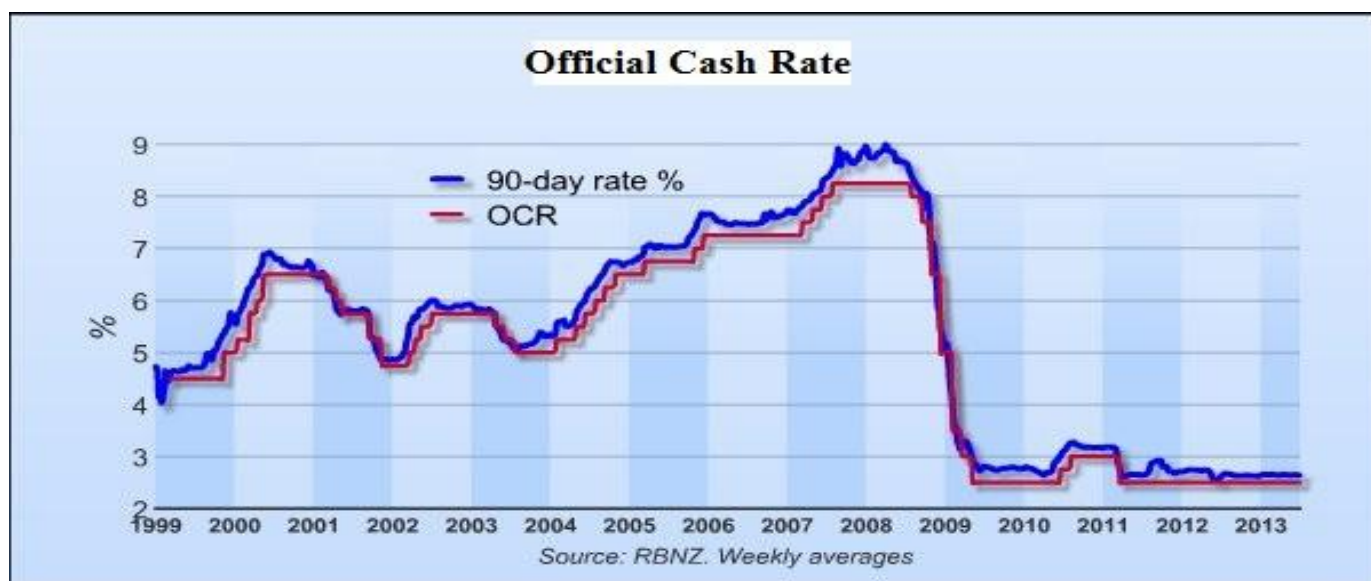
Encouragingly, the economy appears to be adjusting to the monetary policy tightening that has taken place since the start of the year. It is prudent that there now be a period of assessment before interest rates adjust further towards a more-neutral level. The speed and extent to which the OCR will need to rise will depend on the assessment of the impact of the tightening in monetary policy to date, and the implications of future economic and financial data for inflationary pressures.

Fixed interest investors should take some heart from this increase, and the comments regarding further increases that came with it. As the economy improves the OCR will increase, leading eventually to better returns on bank deposits and bonds.

What is the Official Cash Rate?

The OCR has a significant effect on our economy and the returns on our investments, yet many people have little idea of how it works or why it is necessary. In a nutshell the OCR is a tool used by the Reserve Bank to manipulate the economy in order to keep inflation within a pre-determined range. That range is set in the Government's Policy Targets Agreement (PTA). The current PTA signed in 2012 seeks to keep inflation between 1 and 3 percent over the medium term, with a target for future average inflation around 2 percent. Manipulating interest rates is a relatively crude, yet effective, way of controlling inflation. If interest rates are raised, economic activity will decrease, which inhibits inflation. If you had to pay 15% to borrow money you would be less inclined to do so to buy goods. You would instead be more inclined to put your money in the bank. When we save more or spend less there is less pressure on the price of goods to increase (inflation). The opposite effect can be achieved in times of recession. During the Global Financial Crisis central banks lowered interest rates to stimulate activity in an effort to lift economies out of recession.

So how can the OCR affect market interest rates? The major trading banks have accounts with the Reserve Bank which are used to settle obligations with each other at the end of each day. Thousands of transactions are conducted by individuals and businesses every day. The banks don't know with any certainty what amount of money is going to flow in or out of their accounts on any given day. The Reserve Bank provides an unlimited facility to the trading banks to settle these transactions each night. It charges interest on overnight borrowing and pays interest to banks with surplus funds. The rates it charges are closely aligned to the OCR. So if the Reserve Bank decides it needs to put the brakes on a rampant economy it will lift the OCR. Trading banks immediately follow suit so that they are recouping the extra cost of settling their overnight balances. The subsequent rise in general interest rates reduces economic activity and keeps a lid on inflation.



Retirement Planning

I have been meeting with clients through June and July for six-monthly portfolio reviews. For some the question arises, “how much money is enough to retire?” This question is almost impossible to answer given the following variables:

- The rate of return we can achieve in retirement
- The length of time in retirement (when will we die?)
- Inflation
- Taxes and other Government intervention

The best we can do is estimate these figures and produce a range of scenarios that at least gets the conversation started. Without pinning numbers on some of these things we simply flounder along hoping we are making the right decisions. Below is a table that has been published in the newsletter previously. It aims to show how much money you would need to accumulate in order to achieve a certain income. It’s by no means exact, but gives a rough idea of what is required.

Years in Retirement	10	12	14	16	18	20	25
Income (per annum)	Lump sum needed to generate extra income						
5,000	44,913	52,877	60,531	67,889	74,960	81,757	97,617
10,000	89,826	105,753	121,062	135,777	149,920	163,514	195,235
15,000	134,739	158,630	181,594	203,666	224,880	245,271	292,852
20,000	179,652	211,507	242,125	271,554	299,841	<u>327,029</u>	390,469
25,000	224,565	264,384	302,656	339,443	374,801	408,786	488,086
30,000	269,478	317,260	363,187	407,331	449,761	490,543	585,704
35,000	314,390	370,137	423,719	475,220	524,721	572,300	683,321
40,000	359,303	423,014	484,250	543,108	599,681	654,057	780,938

The table shows that if you want an income of \$20,000 per annum over and above Government Super, and you expect to use those funds completely over a twenty year period, you will need to have saved approximately \$327,000 by the time you retire. The figures are based on achieving an after-tax return of 4% on your lump sum, with average annual inflation of 2%. The rate of return you are able to achieve affects these figures significantly, particularly when calculated over a long term. For example achieving an extra 2% per annum return in our example reduces the lump sum required from \$327,000 to \$281,000. The figures aren’t precise as they assume your extra income is withdrawn on an annual basis. In reality you would be drawing funds down weekly or fortnightly which requires a slightly higher lump sum than shown in the illustration.

Once we set a target for our retirement income we can tackle the (sometimes daunting) task of trying to achieve the lump-sum needed to generate that income. How much do we need to save in order to achieve our lump-sum at retirement? This will depend on similar variables discussed previously, with the time until retirement being the most significant.

Years Until Retirement	10	12	14	16	18	20	25	30	35
Lump Sum Required	Annual Saving Required to Achieve Lump-Sun								
50,000	4,566	3,728	3,130	2,683	2,335	2,058	1,561	1,232	1,000
100,000	9,133	7,456	6,260	5,365	4,670	4,116	3,122	2,465	2,000
150,000	13,699	11,184	9,390	8,048	7,005	6,174	4,683	3,697	3,000
200,000	18,265	14,912	12,520	10,730	9,340	8,231	6,244	4,930	4,000
250,000	22,832	18,640	15,650	13,413	11,676	10,289	7,805	6,162	5,001
300,000	27,398	22,368	18,781	16,095	14,011	<u>12,347</u>	9,366	7,395	6,001
350,000	31,964	26,096	21,911	18,778	16,346	<u>14,405</u>	10,927	8,627	7,001
400,000	36,531	29,824	25,041	21,460	18,681	16,463	12,488	9,860	8,001
450,000	41,097	33,552	28,171	24,143	21,016	18,521	14,049	11,092	9,001
500,000	45,663	37,280	31,301	26,825	23,351	20,578	15,610	12,325	10,001
550,000	50,230	41,008	34,431	29,508	25,686	22,636	17,171	13,557	11,001

Let's assume we are twenty years from retirement, and would like to achieve that target of \$327,000 saved by the time we retire. The table indicates we are going to have to save somewhere around \$13,000 per annum in order to achieve that. Again these calculations assume an after-tax return on your savings of 4%, with an inflation rate of 2%.

Rabobank

Rabobank's short-term interest rates have increased again recently. Here are their current rates.

Term	Rate (annual interest)
Premium Saver (call account)	4.50%
1 year	4.80%
2 years	5.25%
3 years	5.50%
4 years	5.80%
5 years	5.95%

DISCLOSURE STATEMENT AVAILABLE ON REQUEST AND FREE OF CHARGE