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Reflections on the Global Economic Crisis

It is interesting that the current global financial crisis (GFC) has been labeled with the traditional three letter acronym (TLA) that indicates that it is now widely accepted in our society.

We have seen the excesses of the last 15 years come to a sudden and brutal end, and yet the pain continues. Globally we are seeing a drop in corporate earnings and a rise in unemployment not seen for many years. In Australia this has appeared less severe, but our analysis suggests we are not immune, just delayed as the mining boom forestalled our inevitable slide into recession.

Official figures measure the vital parts of our economy and report them some time later. Anecdotally we are seeing signs of major stress that indicate official figures for both economic growth and unemployment will worsen significantly. Specifically we are seeing:

1. Banks are tightening their lending policies. With a shortage of funds we are entering a period of credit rationing that we have not seen in 20 years. Lower quality borrowers (low deposit and/or uncertain income) will find finance simply unobtainable, whilst others will find it limited.

Implications – Cheaper house prices which have held up well so far, will fall in line with other house prices. The removal or reduction of the First Home Owners Grant could well trigger sharp falls in this market. Great care should be exercised if purchasing residential real estate. Quality tenants with long leases will prove very valuable in a tougher environment.

2. Businesses are reducing staff and expenses. For many businesses rent is the biggest expense after staff. I recently drove through a commercial suburb and noticed that every building (about 30 in total) on one street had a “For Lease” sign on it. This is an ominous sign for the commercial and industrial property sector.

Implications - Commercial and industrial real estate will suffer significantly as large amounts are put up for sale because banks will not rollover finance, and tenancy rates have dropped. Rents will drop significantly in this sector making it one of the worst affected areas. We would advise clients to defer direct purchases in this sector, and either wait for bargains or purchase in the listed property sector that has already fallen 70%.

3. Staff cuts are happening now. We are seeing a significant number of people who have been retrenched as businesses move into survival mode. Many of these are senior or long term employees.

Implications – Clients need to reassess their “emergency” funds to ensure they have sufficient cash to cope with a period of unemployment. This may mean reviewing spending or deferring large investments temporarily. It is essential that clients do not default on their loans as banks will be swift and brutal in acting to call in defaulting loans. Clients with unused credit should retain that for at least the next one to two years.

4. Retirees generally have entered a panic stage, as concern over investments grows. Many have reviewed their spending and made significant cutbacks. This wealthier segment of our community has had a significant impact on retail spending, further pressuring the economy as a whole.

Implications – Retirees need to temper their fear of running out of money with the knowledge that eliminating spending may mean that declining health and energy mean that they miss life experiences. Investment markets will recover and sensible spending can be maintained. Cash reserves for 2 to 3 years will see retirees through this tough time and allow their investments to grow when we inevitably recover.

5. Interest rates have fallen to record lows. As our economy recovers expect they will rise nearly as fast as they have fallen. In our view it is likely that longer term rates are close to their low point.

Implications – Cash investors should avoid locking in term deposits unless they can secure very good rates and wait for a recovery in interest rates before using term deposits again. Borrowers should be considering fixing rates. We are constantly asked whether rates will get lower and it is likely that cash rates will, but long term fixed rates may have already bottomed. Even if current rates are not the very cheapest they might get to, they will prove to have been very competitive in 3 to 5 years time. Those holding on for the bottom might be shocked by long term rates rising even as short term rates fall.

6. Sharemarkets will in our opinion continue to be volatile, however the falls are likely to be interspersed with rises, unlike the last 12 months. It is likely after the precipitous falls of the last year shares will once again be attractive buying, particularly as other assets lose their luster (Cash rates down to 2 to 3%p.a.). We are however advising cautious buying at this point.

2009 will be an amazing year and we will see further significant bad news, although most of this may already be factored into sharemarkets. The events of the last 18 months are part of the economic cycle (albeit extreme) and are akin to the “Liver Cleansing Diet” for the economy. Whilst painful now, they will give us a stronger economy ultimately and eliminate some of the excesses that have built up.

It is important to continue to act rationally and not to be drawn into the negative sentiment that currently pervades many peoples thinking. If you have concerns in relation to your financial situation please feel free to make an appointment to discuss those concerns with us.

We have received many referrals from clients for family and friends who have been impacted by these events and required advice. Thank you to those people who have referred family and friends to us. We have continued to grow to satisfy those referrals and we currently have some capacity to take new clients. If you are referring people please ensure that they are aware that waiting times remain at about 3 to 4 weeks and that they need to identify you as referring them, as we do not accept clients who are not referred.

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