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INFLATION AND IT'S POTENTIAL

A few thoughts, comments and suggestions:

- The average New Zealand inflation rate for the last 10 years has been 1.53%.
- The average New Zealand inflation rate for the last 20 years has been 2.09%.
- The average UK inflation rate for the last 20 years has been 2.00%.
- The average USA inflation rate for the last 20 years has been 2.06%.
- The average Australia inflation rate for the last 20 years has been 2.69%.
- The average New Zealand inflation rate for the last 40 years has been a compound 4%.
- The inflation rate in New Zealand from 1980 to 2020 has been 389% (40 years) - that is, $1,000 in 1980 is the equivalent of $4,868 today.
- What type of New Zealand goods have increased above the New Zealand inflation rate of the last 20 years - that is, above 2.09%:

  Health insurance
  Rates
  Houses and sections
  Some foods
  Some services (such as Women's hairdressing)

  This list is not exhaustive, but there must be quite a few goods that did not increase greatly as the average inflation rate of the last 20 years was 2.09%

- As accountants, we are striking family overall annual insurance/medical cost packages that are getting beyond some family's cashflow ability - in many cases, there is a very comprehensive overall cover in the event of the worst happening, but it is one of those situations where the operation was successful but the patient died.
- Let us take a family situation based on (close to a recent actual situation):

  (a) A couple aged 35 years (called, say, Vaughan and Rosemary) with two 12 year old twin boys;

  (b) They own a house and section - purchased five years ago, costing $500,000;

  (c) They have a house mortgage of $300,000 with a current interest rate of 3% with 2% of the mortgage principal being repaid each year (annual interest $9,000 + annual principal $6,000 - annual cost $15,000);

  (d) Their combined present gross income is $113,192; (Combined Income Tax is $21,373 - which represents 18.88% of the gross earnings - disposable income consequently is $91,819).

  (e) They feel that Vaughan should have Pure Term life assurance of $1,000,000 and Rosemary should have Pure Term life assurance of $500,000;

  (f) They feel that they need heath assurance cover for the four family members that would cover major surgery/medical costs, but feel they could always cover an excess of, say, $2,000 (that is, the first $2,000 of any medical/surgical event).

Based on (a) to (f), what would or could be an annual health/medical insurance package:

(1)	Life assurance - Vaughan - pure term - level term payments for $1,000,000 $166 per month to 65 years of age	$1,995 per year
(2)	Life assurance - Rosemary - pure term - level term payments for $500,000 $65 per month to 65 years of age	$780 per year
(3)	Family health/medical plan - $3,000 per year but with a $2,000 excess - annual cost is down to	$2,592 per year
	Estimated annual cost	$5,367 per year

- Let us also look at Vaughan and Rosemary's wish to plan forward for themselves and their children:

(a) What are the key parts of the plan?

(1) 30 year term;

(2) Invest $50,000 to start;

(3) Add $12,000 to the investment at the end of each year.

(4) Balanced fund investment 4.5%.

(5) Based on no withdrawals from the investment over the 30 years.

(6) Income Tax on investment income allowed for at 20%.

(b) What does the investment fund represent on this basis after the 30 year period and after allowing for Income Tax: $772,109 - if Vaughan kept working another five years and kept the annual investment increase going, the figure five years later would be $985,274.

- A few other issues following on from them turning 65 years of age:

(a) Probably won't receive the National Superannuation until they are 67 years old.

(b) Quite happy for the two boys to have a Student Loan.

(c) They would cancel probably 90% of Vaughan's life assurance and cancel 100% of Rosemary's life assurance.

(d) The health/medical insurance program they may leave unchanged but to offset the much higher annual costs that this program will involve when they are 65 years of age they may look at increasing their excess to $4,000 which would reduce the overall annual costs. Also terminating 90% of Vaughan's Life Assurance and 100% of Rosemary's Life Assurance when they turn 65 would save around $2,500 of annual cash to help towards their higher health/medical premium costs.

(e) After going through this exercise, it becomes very clear that many (most) New Zealand families need both spouses working and contributing towards the disposable income.

(f) They feel that the two boys could take over their own health/medical costs/policies probably when they are 25 years of age - maybe a bit earlier.

- One final issue with this exercise is the question that they have raised as to what should the two boys be thinking about and actioning regarding their own financial management?

(a) There should be financial management courses in every high school in New Zealand in the last High School year - but there isn't - a major weakness in our education system.

(b) Let's say a 20-year-old was living at home while studying for his or her future, they may have a Student Loan but need all and any cash they have until, say, they are 27 years old - at that point, let's say they have $6,000 of hard earned savings (Remember the minimum gross wage could then be around $52,000).

(c) Let's say they put aside $1,000 as an emergency fund and invest the $5,000 for 45 years on an aggressive asset allocations basis earning, say, 6% and adding $200 per month to the investment with no withdrawals.

(d) What have they got at the end of the 45 years - $400,485 (Tax paid).

Summary - where is all of this heading?

(1) Health and medical insurance costs have been increasing in New Zealand over the last 15 years at 15% - 17% per year - this issue needed to be addressed - a hip or knee replacement costs $17,000 - $25,000 plus some of your time lost.

(2) Life assurance needs to be thought through on the basis of what might happen if the 'breadwinner' died, but also on what fits into the annual cashflow - anything over, say, $8,000 per year for a family of four looks high on my calculations although it depends somewhat on age, health and history.

(3) What is a reasonable income retirement fund - this figure will be all over the place, but around 65% - 70% of pre-retirement gross earnings is a guide (including National Superannuation). For many couples, a minimum investment allowance for retirement would be around 12% - 15% of disposable income - in the example outlined, the annual further investment/savings as a percentage of their disposable income is 13.07%.

(4) To a fair degree, the success of our children's financial future is what they learn across the family kitchen table - they are not learning enough at school in this key area. I have covered a few thoughts in this regard - the four (a) to (d) points that Vaughan and Rosemary have commented on to their two boys need to be on the school noticeboard of every high school in New Zealand.

(5) Right now, the New Zealand inflation rates and interest rates are well below the historical averages - at present, all the signs are that this will continue for some time yet - when they rise, though, there will be a tendency for both to rise - plan for this to happen in time.

(6) Right now, it is hard to earn a meaningful return without taking on more risk than one would like - on the other hand, you will go backwards lending money to your bank, but should get the initial deposit back in due course, but I think its purchasing power will decrease - in my earlier 40 years New Zealand inflation comment, the purchasing power over the 40 year decreased by 79.5%.

(7) The massive money printing exercise by central banks around the world means the world, to a large extent, is awash with cash - no argument for the reasons for this at the time regarding the world financial crisis and Covid-19, but sooner or later all of this should be inflationary.

(8) Our potential first home buyers have not too much problem with a $700,000 house regarding the debt at, say, $490,000 at, say, 2.75%, but finding the 30% deposit of $210,000 (even 20% at $140,000) is a completely different matter - the Bank of Mum and Dad will become absolutely crucial - there are some 604,000 New Zealand households presently renting (around 34% of the total New Zealand households) - inflation and low interest rates are a big proportion of this issue.

(9) Don't purchase assets just because of low interest rates - government and councils do enough of this for all of us - repaying the debt principal from tax paid earnings is painful.

(10) Think about 'real' assets - land, sections, houses, antique cars, antique furniture, equity shares in New Zealand and world share markets, painting originals, forestry and commercial property. In time, I feel there will be a hunt for yield and real asset values will benefit - not tomorrow, but in time.

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