

# BLa BLa BLa

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Around the office

It is probably true to say that 2010 turned out to be somewhat of a non-event as far as investment markets are concerned. The All Ordinaries started the year at 4847. It peaked on 15 April at 5024, before falling to 4250 on 5 July. At the time of writing it was floating around the 4800 mark.

Much of the investment news of the year was dominated by the lack of a bounce in the US economy and the problems of the PIGS of Europe (Portugal, Ireland, Greece and Spain). It seemed that every time share markets had a bit of momentum, problems in Europe sent a gloom over world share markets. As a result, buoyant Australian economic conditions went unrewarded in the Australian share market.

This was summed up very eloquently by one of our clients in a recent email:

*Well, it seems the world is going to 'hell in a hand basket'.*

*The market is dropping again, Obama has lost control of his house of reps and his treasurer is printing more money to try and stay afloat. Meanwhile the land of the brave and the free has millions of mortgagees in possession situations and are having trouble even feeding themselves. North Korea is stirring up trouble and heaven only knows what Iran is going to do next.*

*Ireland is being bailed out, Germany is cranky with everyone who wants a bail out because they are not doing too bad, Rolls Royce have a big problem with their A380 engines which might send them to the wall (again).*

*The Red Hyena is not doing anything and we'll be lucky to see the Labor Government go full term, let alone until the end of 2011. We've got a choice between a rock and a hard place with Labor/Liberal Parties. Heaven help us if the Greens become more powerful than they are.*

*You've got a miner buying 10% of Channel 10, probably so she can dictate editorial policy against the proposed mining tax. If that tax does not get up, then the budget will be stuffed. NSW is completely stuffed and even the upcoming change to a Liberal Government won't fix it in a hurry, if at all. Everyone is trying to tap coal seam gas, but it seems that it's all about greed and bugger what it does to the ground water. Electricity went up 12.5% on 1 July and it's going to keep going up. The unions are getting back on their feet (N.B the DeSal plant in Victoria). I could go on, but, hey, the glass is half full – right?*

*I have been concerned for some time about our exposure to stock markets. Maybe it is even time to just go back to cash?*

Most of the discussion of 2010 focused on two very different arguments. Those who view the glass as half empty focused on the underlying problems within the US economy, convinced that without growth in the US the world economy will continue to move sideways. Those who prefer the half-full analogy look at Australia's ties within Asia, particularly at the burgeoning Chinese and Indian economies, to see a bright future.

In this edition of *BLa BLa BLa* we consider both sides of the argument. So, is the glass half full or half empty?

# THE US SITUATION – THE GLASS SEEMS HALF EMPTY

It's a long-standing belief that when the US sneezes the rest of the world catches a cold. In a country where the population is only some 25% of that of China, there is no doubt that the US economy remains the engine room of the world economy.

To put this into perspective, China recently overtook Japan as the second biggest economy in the world, but the US is still the dominant global power despite its recent woes. China's gross domestic product (GDP) for the second quarter of 2010 was US\$1.335 trillion, compared to Japan's US\$1.286 trillion.

China's leapfrog over Japan came about due to Japan reporting sluggish growth of a mere 0.4% for the second quarter, after stellar first quarter growth of 4.4%. However China has some way to go to overtake the US.

US GDP was approximately US\$14 trillion in 2009 – China generated a mere US\$4.9 trillion. Predictions are that China will overtake the US as the world's biggest economy in 2030.

Nonetheless, the following map perfectly illustrates

the continued dominance of the US as an economic superpower. The map partners US states with countries based on their respective GDP.

The map is not based on current GDP levels so is not strictly accurate, but it certainly reflects the size of the market in the US despite most of the negative economic news of late.

Italy is equivalent in size to California, although GDP for the former in 2009 was US\$2.09 trillion compared to US\$1.85 trillion for the sunshine state. New York has been paired with Russia, with the *Big Apple's* nominal GDP in 2009 sitting at US\$1.14 trillion compared to US\$1.23 trillion for the former Soviet Union. Another interesting pairing is Brazil and Texas, while Australia has been partnered with Florida.

Clearly, the US economy is a major factor in the health of the world economy. Some 70% of US GDP relates to consumer spending, so if consumers have decided to shut up shop, there are obvious flow-through implications. If US consumers decide to stop purchasing consumer goods, exports from Asian-based exporters such as China and



Japan will fall, reducing demand for raw materials from countries such as Australia.

Unfortunately, there are many reasons for US consumers to stop spending. Unemployment rates are around double those of Australia. Traditionally, people who are worried about keeping their jobs tend to shelve spending plans for the short term. From an economic perspective, the US deficit is around 95% of GDP (compared with Australia's at around 6%). Interest rates are 0–0.25%, which means that rates can't be lowered to stimulate the economy. The only monetary option is 'quantitative easing' (or, put simply, print more money).

There is no doubt that there are problems in the US. The traditional levers to kick-start the economy are (1) cutting interest rates or (2) the government going into debt and implementing spending programs. Unfortunately, these two options are largely off the table right now. If the US Government is serious about reigning in debt, it must

either cut spending or increase taxes. But both these measures would have a negative impact on the economy, which is obviously not what is needed right now. It is estimated that tax increases have a –3X multiplier impact on the economy, meaning that to raise another 1% of GDP in taxes would cause a fall of 3% in GDP.

In Australia, the Reserve Bank Board raised interest rates in November because of underlying inflationary fears. The US is concerned about deflationary fears, as growth in the economy is not sufficient to soak up excess unemployment.

There is no doubt that if you focused on the US economy as the dominant factor in our economic health, you would hardly be feeling optimistic. However, the other side of the Australian economic debate lies closer to home, when we consider Australia as part of the Asian economic region.

A large part of the following information has been taken from a speech given by Phillip Lowe, Assistant Governor of the Reserve Bank of Australia, in September this year.

## THE ASIAN INFLUENCE – SPECIFICALLY CHINA

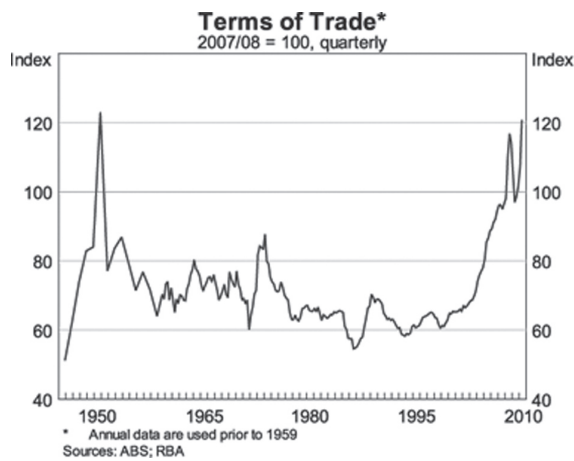
Two changes within Asia are particularly important. These are the twin processes of industrialisation and urbanisation. As the countries of Asia have industrialised and urbanised, the demand for infrastructure has grown very strongly. When people move to the cities, new dwellings need to be built, and as living standards rise, so too does the quality of the dwellings constructed. The growth of urban centres also requires the building of communication and transport networks, with the demand for roads, bridges, railways etc rising.

All this development requires raw materials. In particular, it requires steel to build the apartments in which the new city dwellers live and to build the infrastructure that supports those cities. For example, a typical 90 m<sup>2</sup> apartment in China requires about 6 tonnes of steel, and 10 km of

metropolitan subway requires around 75 000 tonnes. On average, every tonne of steel produced requires around 1.7 tonnes of iron ore and over half a tonne of coking coal. Australia is in the fortunate position of having ample low-cost, high-quality supplies of both. And with higher energy consumption also a feature of industrialisation, we are in the fortunate position of having large reserves of natural gas.

Not surprisingly, the strong growth in demand for raw materials in Asia has led to a large increase in the price of raw materials over the past decade. As a result, Australia's terms of trade have increased significantly and are now at their highest level since the spike in the early 1950s when wool prices soared due to the Korean War (see Figure 1).

Figure 1

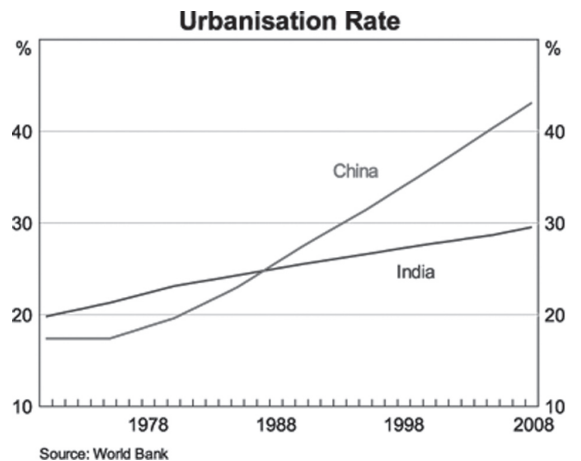


When discussing the impact of Asia on Australia over recent years, the focus has rightly been on China. The transformation occurring there is truly remarkable and is reshaping the global economy. Over the past three decades, the proportion of the Chinese population living in urban centres has more than doubled to almost 45% (see Figure 2). While there have been a couple of historical examples of other countries urbanising as quickly, the sheer number of people migrating to urban centres is unprecedented in human history – over the past 30 years, nearly 400 million Chinese citizens (almost 20 times the population of Australia) have moved to cities. As a result, there are now around 170 Chinese cities with more than a million residents, compared with only around 35 in Europe. And the urbanisation process still has quite a long way to run, with another 300–400 million people expected to move from the country to the city over the next 20 years.

But as we think about the future, the story is broader than China. In the years ahead, India, which also contains more than 20% of the world's population, is likely to become increasingly important to Australia. After India grew at a disappointing pace in the 1960s and 1970s, growth has picked up over recent decades, averaging 7% a year over the 2000s (see Figure 3). The economy has gradually opened up to foreign trade and capital, and government influence over investment decisions has been scaled back. While India will inevitably follow a different development path to that of China, the prospects for sustained solid growth look to be better than they have for many years.

Like China, India is also urbanising. But the process is

Figure 2

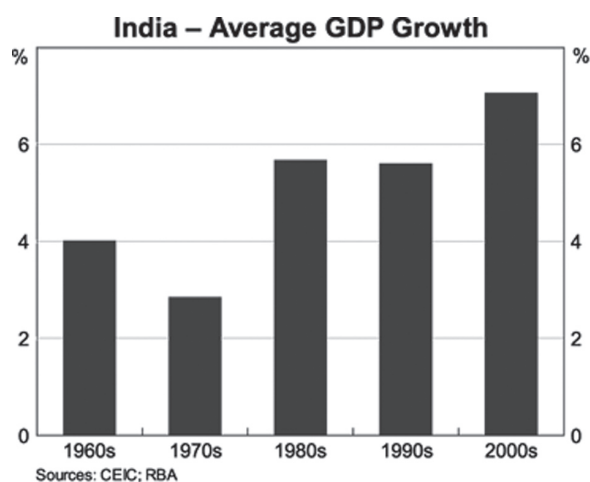


more gradual, with the number of people moving to urban areas over the past 30 years less than half that in China (see Figure 2). Despite India's population being only marginally lower than that of China, it has about 40 cities with a population of over a million, compared with China's 170 or so. This lower rate of urbanisation partly reflects the fact that India has not industrialised as quickly as China.

As mentioned previously, as people move to cities, the demand for steel tends to rise. Not surprisingly, consumption of steel in China has more than quadrupled since 1997, with just over half of current steel consumption accounted for by the construction sector (see Figure 4). Indian steel consumption has also grown, but not nearly as quickly. But the experience of China and of other countries that have urbanised hints at the potential growth in India. While the bulk of the Indian population live in rural areas and investment in infrastructure has been relatively low, there is the potential for this to change over the years ahead, just as it has in China over the past 30 years. If this does indeed occur, then the demand for raw materials – and steel, in particular – is likely to be very strong over coming decades.

The impact of Chinese and Indian development is not just confined to the resources sector. As countries develop and living standards rise, not only does the demand for steel increase, but so does the demand for higher quality food, and consumption of protein increases. Again, the comparison of China and India is instructive (see Figure 5). As income per head in China has grown over the past 30 years, protein consumption per head has almost doubled.

Figure 3



Protein consumption has also risen in India, although the increases have been much smaller due to slower growth in income per head and differences in dietary preferences.

Again, it is quite likely that global demand for protein will grow strongly over the coming years, particularly if India and China continue on their current paths. With Australia's strong history of agricultural production, this is another area where we have an advantage.

The overall impact of this growth and urbanisation of Asia can be clearly seen in Australia's international trade statistics. The four largest markets for our exports in 2009 were China, Japan, India and South Korea. Over the first half of 2010, around 22% of Australia's export receipts came from China, and a further 8% from India. These export shares have been trending higher for some time and this is likely to continue over the medium term. There has also been a large increase in the share of resources in Australia's total exports. A decade ago, iron ore and coal together accounted for around 10% of Australia's total exports. In contrast, over the past 6 months, this share has been around one-third, with total resource exports accounting for 55% of aggregate export revenue, up from around 35% in the 1990s.

These changes in the country and product composition of our exports are very large. They are also likely to be persistent, given that Asian development still has some years to run. This development means that, in aggregate, the Australian economy has the potential to do very well over the years ahead. But conditions are likely to differ

Figure 4

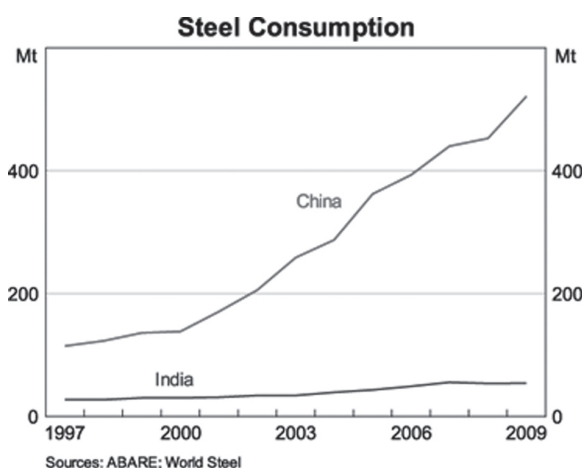
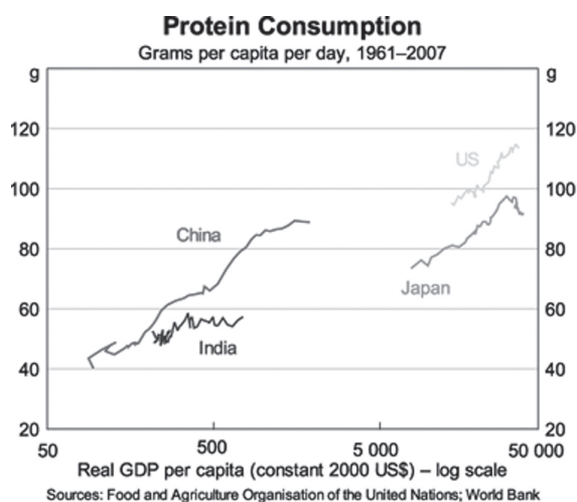


Figure 5



substantially across the various sectors of the economy. If past experience is any guide, the growth of the resources sector will have positive spin-off effects for some industries, and rising real incomes will increase demand for a wide range of goods and services. Other industries, though, will find conditions more difficult due to the exchange rate and the competition for labour and capital. While these differences across sectors will create some challenges, the overall medium-term outlook for the economy is positive.

# HOW MUCH INCOME DO YOU NEED FOR RETIREMENT? - PART 3

In the April and August editions of *BLa BLa BLa* we posed the questions of (1) how much income is needed in retirement and (2) how much capital is required to generate this desired retirement income. These articles are available at <http://www.blapl.com.au/newsletter/index.htm>.

The August article suggested that around \$17 of investment capital is required for every \$1 of net, consumer price indexed, annual income in retirement. This assumes earnings of 5% a year above inflation and retention of the capital base for a 30-year period. So if the desired net retirement income is (say) \$65 000, you would need around \$1 105 000 of income-producing assets at the point of retirement.

Many current retirees have been largely spared the need to accumulate this degree of wealth, as they have been fortunate enough to have grown up during the era of unfunded superannuation defined benefit arrangements, where the taxpayer provides an indexed pension at retirement. However, as we know, these schemes have been closed to new members for some time, so future generations will not have this luxury. There is no doubt that those starting their working life now will have to be far more conscious of building retirement wealth.

The cornerstone of retirement saving in Australia is of course the superannuation guarantee. All employees earning more than \$450 a month receive a 9% employer contribution to their superannuation. While these funds will undoubtedly form the cornerstone of retirement income, the \$64 000 question is whether this will be enough.

Take the example of someone who joins the workforce at age 25 after completing tertiary study. In 2010 dollars they earn \$65 000 a year, with this level of income increasing by 0.75% a year in real terms. By age 60, their superannuation guarantee will be between \$370 000 and \$670 000. The difference between the two amounts is the difference in earning rates within the funds, from 2% a year above inflation to 5%. This shows the importance of

investing for long-term growth with superannuation from an early age.

The above example of course assumes that a person receives the superannuation guarantee for an uninterrupted 35 years in the workforce. If an individual were to have, say, 5 years removed from their earnings (say between ages 30 and 35), the superannuation pool at age 60 (using the 5% real rate of return) falls from \$670 000 to \$537 000. The example also assumes that the superannuation guarantee is increased from 9% to 12%, in line with announced policy.

If each member of a couple had 35 years in the workforce, invested their superannuation guarantee for maximum growth, stayed together (which means there are two pools rather than one), it is feasible that the superannuation guarantee component could generate enough of a retirement pool to provide a \$65 000 net income in retirement (and maintain capital). This is also based on the rather large assumption that the superannuation guarantee rate increases from 9% to 12% (although this change is yet to be legislated). We are also assuming that the very favourable tax laws applying to superannuation (15% tax on entry and 0% on exit after age 60) are maintained.

The reality is that a lot has to 'go right' to rely on the superannuation guarantee to provide the sort of desired retirement income that many will expect. Although you can control some aspects of this equation (such as ensuring that your superannuation guarantee is invested in long-term strategies, rather than the default investment option that 80% of Australians use), many aspects are out of your control.

We are often asked what strategies we would use for younger people entering the workforce today. This question often comes from concerned parents who appreciate that their children have so much more stacked against them than they did at a similar stage in life. Many of our children now enter the workforce with a HECS/HELP debt around their neck and face the prospect of paying 8–10 times their annual salary for their first home, compared to the 4–5 times that we paid. There is no single solution, but here are our broad strategies.



## THE RISE AND RISE OF THE A\$

1. From day one, ensure that all superannuation accounts are consolidated into one fund. Do not fall into the trap of leaving pockets of superannuation all over the place. Whenever you move employers, ensure that the new employer makes contributions to your existing fund.
2. Ensure that the investment strategy of the superannuation fund is one that produces the highest possible returns. A person entering the workforce today is likely to have their superannuation locked up for 40+ years. A default 'balanced' fund with 30–35% in cash and bonds is totally ineffective for such a long-term investment strategy.
3. Don't pay any more to superannuation than the superannuation guarantee. For younger people, there are no guarantees when the funds will be accessed or what tax will be paid when they are. Unfortunately, if the government decides to change the rules, younger people will generally not be subject to the transitional provisions that those currently closer to retirement will receive.
4. Ensure that your death, disability and income protection insurance needs are effective and established through your superannuation fund. Not only is this more tax-effective for insurances that are not tax-deductible (like death and disability cover), it also frees up your disposable income for debt reduction strategies (see the next point).
5. Buy a house and pay it off as quickly as possible. An alternative retirement saving strategy to superannuation is negative gearing. This involves borrowing to finance income-producing assets (shares, property etc). When borrowing, it is far better to be using 'secured debt', such as that secured through a mortgage, rather than unsecured debt such as margin lending.
6. When debt levels are under control, look at tapping into the equity in your property to secure finance for a negative gearing strategy. Once you have around 50% equity in your property, you are generally in a position to look at drawing out this equity and purchasing shares or a second (investment) property.

Not many people appreciate that the A\$ is the fifth most traded currency in the world (behind the US\$, euro, yen and pound sterling). The A\$ has made a Lazarus-like comeback over recent years. After falling to a low of US\$0.60 in 2008, it passed parity with the US\$ in November 2010.

The way the Australian public cheered on the A\$ to achieve this point is truly odd. In reality, the only people the rising A\$ was helping were those who intended travelling to the US or acquiring US goods in the near future. Apart from that, an appreciating A\$ is generally a bad thing for our economy as it reduces superannuation fund returns, makes imports cheaper and exports more expensive, and has an adverse impact on government revenues.

Although the news generally focuses on the relationship between the A\$ and the US\$, this is only part of the story. Given that Japan constitutes our second largest trading partner, the relationship between the Japanese yen (JPY) and the A\$ is probably more significant.

Graph 1 shows a very different view of the strength of the A\$. Before the global financial crisis (GFC), the A\$ was buying 103 JPY, with this falling as low as 57 JPY during the worst days of the GFC. However, while the A\$ has recovered all the lost ground against the US\$, it has never fully recovered against the JPY, trading in a range of around 80 JPY for the past 18 months or so.

This shows the two sides to the currency debate. While there is no doubt that the A\$ has appreciated against most major currencies since the worst days of the GFC, this appreciation has not been uniform. Reaching parity with the US\$ is as much about the US\$ weakening as it is about our currency strengthening.

Having said this, however, there are clearly signs that the run of the A\$ against the US\$ may be at an end. After pushing so hard to touch parity, the wind seems to have gone out of its sails, as shown in Graph 2.

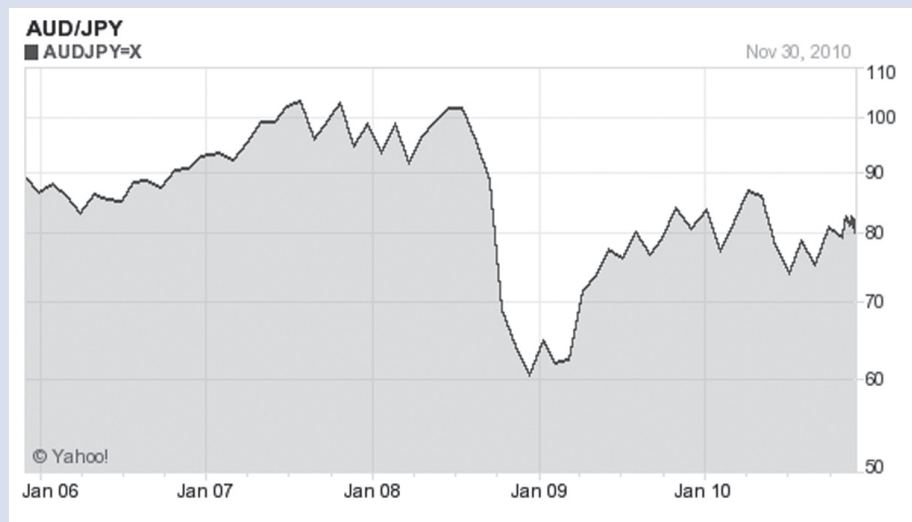
The shock interest rate rise by the Reserve Bank Board on Melbourne Cup Day seemed to provide the necessary momentum to get the A\$ to parity. However, since that time the A\$ has been trending sideways, largely on the back of economic uncertainty stemming from Europe.

Determining fair value for a currency is not always easy to identify, particularly for a commodity based currency

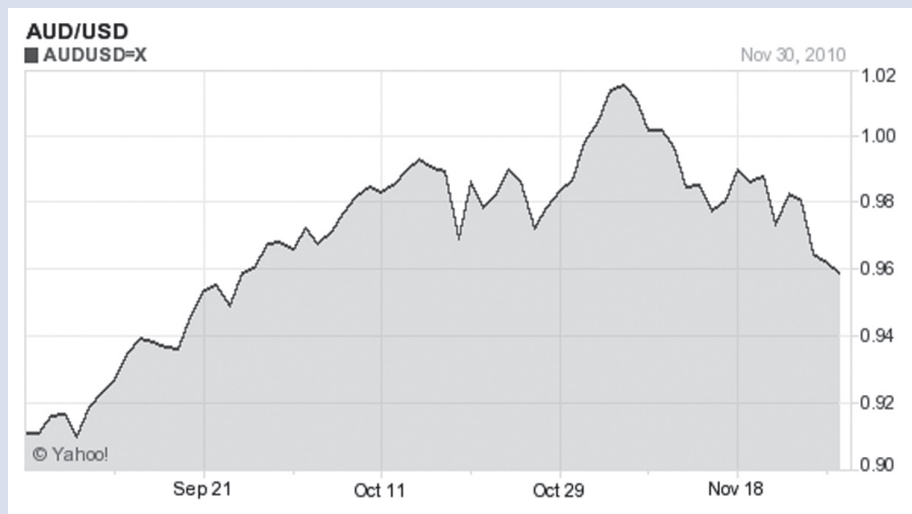
like the Australian dollar which can be buffeted by a wide variety of factors.

A common, fundamentally based approach to determining the fair value for a currency is to use Purchasing Power Parity (PPP) calculations. This aims to determine fair value for a currency based on the relative cost of purchasing a basket of goods in one country versus the cost of the same

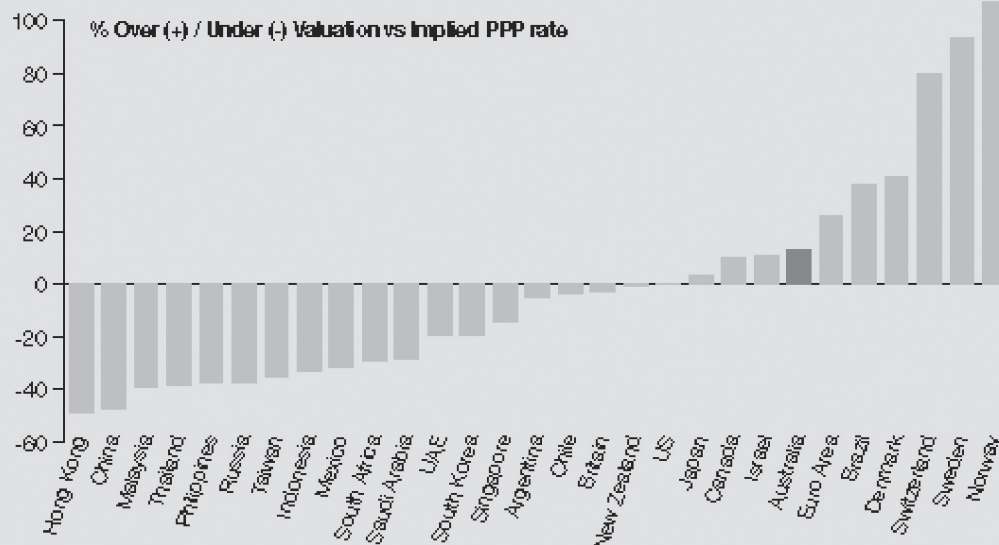
**Graph 1**



**Graph 2**



## Big Mac Index



Source: The Economist

basket in another. It then simply seeks to determine an exchange rate between the two currencies to equate the cost of those goods. The Big Mac index is a commonly quoted and simple PPP approach which determines currency fair values based on equating the cost of purchasing a Big Mac hamburger anywhere in the world. It's a very narrow and obviously simplistic means of trying to determine a fair value comparison between currencies.

The most up to date Big Mac index, released by The Economist, dates back to August 2010 and hence doesn't take into account the recent surge of the Australian dollar. At that time it registered the Australian dollar as being perhaps 10-15% overvalued. This has undoubtedly grown given the further appreciation of the Australian dollar versus the US dollar by approximately 10% since August. Other broader PPP measures such as that produced by the OECD have more recently suggested a more significant over-valuation. The OECD's own PPP analysis suggests fair value for the Australian dollar is somewhere around 68 cents, suggesting a close to 30% overvaluation versus the US dollar. As mentioned previously, given the particular factors at work to support the Australian dollar and depress

the US dollar, this does not suggest that the Australian dollar is necessarily likely to collapse in the immediate future. Any reversion to fair value may not necessarily be realised for some time – currencies can deviate widely from perceived fair value for extended periods as they are buffeted or buoyed by a range of cyclical and transitory factors. However, as the supportive near-term factors diminish, the fundamental valuation suggested by PPP analysis can start to exert a strong mean reverting influence.

In our August edition of *BLA BLA BLA* we suggested that the time was coming to reverse an Australian investment bias that we temporarily adopted in 2008. For the last two years it has been good to minimise overseas assets, as the appreciating A\$ would have devalued the value of the asset base held in foreign currencies. Now that most of the appreciation seems to be behind us, we recommend that clients revert to their long-term portfolios, reweighting part of their Australian exposure to overseas assets. The logic behind this remains the same as reported in our August edition of *BLA BLA BLA*. Please contact us if you would like us to review your portfolio composition.

# HAVE YOU CONSIDERED TEACHING ENGLISH OVERSEAS?

Over the years we have seen many of our retired clients try their hand at teaching English overseas. Like most issues in life, there are both financial and utility aspects associated with this decision; however, it is interesting to consider the financial merits of this practice.

The clients who have tended to avail themselves of this opportunity tend to be those who are receiving a Commonwealth superannuation pension in retirement. This means that their Australian-based income will continue to roll in while they are overseas. Additionally, they have the opportunity to rent out their house while they are away, and potentially profit from what they are paid while overseas. This latter point is of interest to us, namely, what do you receive for undertaking this teaching and what expenses do you incur? Is this a good financial decision, or is it one of those situations where the finances are not really important?

Here are some questions we asked Alex, one of our clients who recently completed a stint in China, and his responses.

## **1. How do you go about arranging such a placement (the placement itself, accommodation, travel etc)? Is there an agency that 'does it all'?**

We were in our early 60s, both semi-retired and doing part-time contract jobs around Canberra. Life was good, but we wanted to do something a little more adventurous.

Having decided to try teaching English overseas, we enrolled in a TESOL course (Teaching English to Speakers of Other Languages). There are several options but we decided to do an online course that we could do at our own pace. The cost was about \$2000 each. It was money well spent as it gave us the basics of teaching.

We had heard there was great demand for English teachers in China, and started responding to advertisements on various websites. There are basically two markets: the private English language schools and the government sector (such as universities and colleges). The government sector is smaller

and pays less, but the hours are also less and do not normally involve weekend work, so we focused on that sector.

I answered about 40 advertisements. Finally, the China University of Petroleum (CUP) in Shandong Province offered me a position for the 2009–10 academic year. I found that many government institutions will not hire people over 60, as health insurance costs escalate as people get older, but fortunately some, such as CUP, still have a flexible hiring policy.

If you Google 'Teaching English in China' you will find many useful websites.

After we arrived, my wife was offered a job teaching English at the primary school on the university campus. That proved a great bonus, not only in financial terms but, more importantly, because it gave her a meaningful job. Life would have been quite boring for her without that activity.

## **2. Was a lack of Chinese an impediment?**

We did a 3-month evening course in Mandarin at the Bruce CIT before our departure. It is certainly useful to understand how Chinese is structured, and how it is pronounced. A knowledge of Mandarin was not necessary to teach English, but even a limited amount makes everyday living much more comfortable.

We were in a regional city and there was not much English spoken. The major cities such as Beijing and Shanghai have many more English speakers.

## **3. What hours/days did you work?**

I taught three courses: oral English, reading English, and American Culture. My teaching load was 16 hours a week in the first semester and 10 hours a week in the second. Each class comprised two 50-minute lessons, with a 10-minute break in between.

The foreign teachers (there were three foreign English teachers and two Russian teachers at CUP) had classes from Monday to Friday. Chinese lecturers also taught on Saturdays.



Teaching American Culture proved the most challenging, but also the most interesting, because I had to do considerable research to prepare each class.

#### 4. Can you provide a breakdown of the cost of living while over there (accommodation, food, entertainment, haircuts, wine etc)?

Many things seemed to cost roughly one-tenth of the cost in Australia. Some examples are listed in the following table. An exchange rate of A\$1 = Yuan 6 is used, which it was at the time we were there, but the A\$ has appreciated in the last few months and the current exchange rate is closer to A\$1 = Y 6.5.

Item	Price in Dongying, Shandong Province, China
500 ml bottle of beer	Y3 (A\$0.50)
500 ml bottle of water	Y1 (A\$0.17)
Man's haircut	Y8 (A\$1.35)
Woman's haircut (including colour)	Y24 (A\$4)
Bus ticket	Y1 (A\$0.17)
Meal in restaurant (one dish + rice) including tea	Y18 (A\$3)
Taxi ride (3 km)	Y6 (A\$1.00)
New bicycle	Y300 (A\$55)
New key	Y1.50 (A\$0.25)
Dry clean slacks	Y5 (A\$0.90)

Of course, prices of things like haircuts or meals in restaurants varied a lot, depending on sophistication. The above indicative prices are 'average'. I should add that these are indicative prices in a relatively small regional city of about a million – they would probably be considerably higher in Beijing or Shanghai.

Most people seemed to shop in wet markets, but there were also a number of modern shopping malls that included large and comprehensive supermarkets. The few imported

products, such as fresh coffee beans, were relatively expensive.

Our city had four KFCs and two McDonalds. There were also a couple of pizza restaurants, but these were of poor quality. All the food was basically Asian.

#### 5. What were you paid?

We were paid about A\$180 a week each, plus free accommodation. We lived in a two-bedroom apartment in a guesthouse on the CUP campus. It was small, but quite comfortable. The university arranged internet access (Skype is wonderful!) and three English language channels on TV (CCTV, Discovery and National Geographic).

We generally ate breakfast at home, and went to campus dining halls for lunch and dinner. We found that one salary was easily sufficient for our normal daily needs. We travelled around Shandong Province during long weekends and holidays, and that was quite expensive as we normally stayed in good hotels.

The university gave us an allowance of A\$1300 at the end of the academic year to cover the cost of return airfares from Australia to China.

#### 6. Did you rent out your house in Australia while overseas?

Yes, we rented out our home for 12 months as we didn't want to leave it empty for such an extended period of time. We stored our effects in a self-storage facility in Canberra so the house could be rented unfurnished.

Packing everything up and getting the house ready for rental was a major exercise and should not be underestimated.

#### 7. How often did you return to Australia during your stay?

The university had a 6-week break during January/February and we returned to Australia to see family and friends and to check on our affairs. It was a wonderful break, and I must admit that we had some difficulty settling back into life in China.

# EXCESS CONTRIBUTIONS – CONCESSIONAL & NON-CONCESSIONAL

Despite numerous previous warnings we are still finding clients who have or are likely to exceed their contribution caps.

Contributions in excess of the non-concessional contribution cap are referred to as excess non-concessional contributions. Individuals are liable to pay tax at 46.5 per cent on excess non-concessional contributions. The Australian Taxation Office (ATO) will seek the excess contributions tax from the person and the person must withdraw the amount of this tax liability from their superannuation fund (where an interest exists – either accumulation or pension). The ATO will provide individuals liable for excess contributions tax with a release authority, that is, a written notice authorising an individual to withdraw money from a super fund. The release authority must be provided to the fund within 21 days or an administrative penalty may apply.

Likewise, contributions in excess of the concessional contribution cap (whether it be the transitional cap of \$50,000 for the over 50's or \$25,000 cap for the under 50's) are referred to as excess concessional contributions. These contributions are subject to tax by the superannuation fund (that is, up to 15 per cent), and individuals are liable to pay additional tax on the excess at the rate of 31.5 per cent (giving an effective tax rate of 46.5 per cent). However, unlike excess non-concessional contributions tax, individuals can choose whether or not to withdraw the amount of their excess concessional contributions tax liability from their superannuation fund.

Excess concessional contributions will also count towards the non-concessional contribution cap (but not vice-versa). In some circumstances this may mean the same contribution is effectively taxed more than once. If the non-concessional limit is exceeded, then a further 46.5 per cent tax can be imposed on the excess concessional contributions resulting in an overall tax liability on the excess concessional contributions of 93 per cent (15 per cent + 31.5 per cent + 46.5 per cent).

It is important to remember that, while a person must withdraw their excess non-concessional contributions tax liability, the obligation to pay this tax to the ATO is on the individual. It is due and payable 21 days after the ATO has issued an assessment of excess contributions. Therefore, due to the timing differences between payment of tax and releasing superannuation monies (up to 30 days for super providers), it may be advisable for an individual to pay the excess non-concessional tax liability directly to the ATO within 21 days and reclaim the amount from the superannuation fund.

Contributions that would have otherwise been treated as 'excess contributions' may be treated as non-excessive if a taxpayer, after applying to the Australian Taxation Commissioner in the approved form, is issued with a determination that part, or all, of the excess contributions (concessional or non-concessional) are disregarded or reallocated to another income year. The application must be made within 60 days of receiving an excess contributions tax assessment.

A determination will only be issued where the taxpayer can demonstrate that special circumstances exist (ie that it was unjust, unreasonable or inappropriate to impose the liability for excess contributions tax).

BL&A clients will therefore need to be extremely mindful of not breaching the relevant contribution cap as they will be liable for excess penalty tax with very limited recourse to the ATO.

The Commissioner must be satisfied there are special circumstances which is explained in more detail in the ATO's law administration Practice Statement LA2008/1 - <http://www.ato.gov.au/individuals/content.asp?doc=/content/00119316.htm&page=10&H10>. This practice statement explains what the ATO considers when deciding whether or not to exercise its discretion - especially that each case has to be considered on its merits, with proper regard to all the relevant facts. Each decision will depend entirely in the context of each individual's circumstances



to determine whether the facts are unusual, uncommon or exceptional and exercise discretion.

The following scenarios and examples have been discounted by the ATO as having a reasonable basis to exercise discretion:

- your employer's liability to make super contributions for you accrued in a different financial year to when they were actually made
- salary you sacrificed to super in one financial year was contributed by your employer to your super fund in another financial year
- you hadn't allowed for having a varying number of pays in a period – for example 53 weekly pays or 27 fortnightly pays in a year
- a particular employer contribution was paid early or delayed in a way you didn't expect so that, for example, you benefited from 13 monthly or five quarterly contributions in one year but 11 monthly or three quarterly contributions in another
- you didn't know something about how your employer makes contributions for you
- I or my adviser didn't fully understand the law or facts, and I wouldn't have made a contribution if I had
- the contribution was made by mistake
- the circumstances were unusual or once in a lifetime for me
- the tax is unfair because I didn't mean to exceed a contributions cap
- the Commissioner should remit the tax because of my exemplary compliance history
- your business income or your earnings from dividends and interest were less than you expected due to changes in financial conditions
- you weren't able to claim a deduction because you didn't meet the personal super deduction income test for that deduction – for example, you didn't allow for the reportable employer super contributions or you had less other income than you expected
- you failed to meet an administrative requirement to be allowed the deduction.
- you were unaware of a contribution made by someone else
- a person authorised to make a contribution on your behalf didn't make the contribution as they were instructed
- being treated for an illness, including a mental illness such as depression or anxiety
- experiencing a difficult time - for example, caring for seriously ill family members or grieving for a deceased relative or friend.

Importantly ignorance of a law or a particular fact isn't a basis on which the ATO Commissioner is likely to disregard or reallocate a contribution. Therefore, all BL&A clients should completely avoid the slippery slope of applying to disregard or reallocate excess contributions by ensuring they remain within their respective contribution caps.

# AUSTRALIAN AND GLOBAL HOUSE PRICES – UNDER OR OVERVALUED?

A recent survey of global house prices conducted by *The Economist*, a well-respected global business and current affairs publication, indicates that house prices in most markets are on the rise. Of the 20 property markets monitored, only five markets posted year-on-year declines (Italy, Spain, Japan, Ireland and US FHFA index – Federal Housing Finance Agency index, which excludes houses that are financed with large mortgages), while Ireland's property catastrophe has worsened.

The following table shows that Asia's price rises lead the way, as they did when the data were last published in July. Singapore, Hong Kong and Australia boast the largest year-on-year price increases, even if the rate of appreciation is down a bit from the summer. House prices in China rose by 9.1% in the year to September, compared with a 12.4% rise in May. That is still too fast for the Chinese Government, which unexpectedly raised interest rates on 19 October and has outlined more measures to cool the market in recent weeks, including higher down-payment requirements and introducing a property tax in some cities.

*The Economist* analysis of 'fair value' in housing, which is based on comparing the current ratio of house prices to rents with its long-run average, suggests that China has less to worry about than the likes of Australia, which is again the most overvalued of the 20 markets monitored. It comes as no surprise that the Reserve Bank of Australia elected to tighten monetary policy with a 25 basis point

## **The Economist house-price indicators** % change

	Latest on a year earlier	Q3 2009 on a year earlier	1997- 2010*	Under(-)/ over(+) valued†
Singapore	23.1	-11.0	18	19.2
Hong Kong	20.6	3.2	-6	58.1
Australia	18.4	6.6	220	63.2
China	9.1	1.9	na	18.1
Sweden	8.9	1.4	173	41.5
Belgium	6.5	-2.9	157	21.6
France	6.0	-7.9	141	42.5
Germany	4.8	-4.4	na	-12.9
Switzerland	4.5	4.1	33	-6.4
Canada	4.5	-3.8	70	23.9
Netherlands	4.2	-6.8	92	23.6
United States (Case-Shiller ten-city index)	4.1	-10.6	102	4.6
United States (Case-Shiller national index)	3.6	-8.6	65	-2.1
Denmark	3.4	-12.2	98	19.4
New Zealand	3.4	1.1	108	20.2
Britain	3.0	-3.0	181	32.0
South Africa	2.9	-0.2	421	na
Italy	-2.8	-3.8	94	10.5
Spain	-3.4	-8.3	157	47.6
Japan	-4.0	-4.0	-37	-34.6
United States (FHFA)	-4.9	-4.0	70	10.6
Ireland	-17.0	-13.8	129	13.2

Sources: ABSA; ESRI; Hypoport; Japan Real Estate Institute; Nationwide; Nomisma; NVM; FHFA; Quotable Value; Stadim; Swiss National Bank; Standard & Poor's; Thomson Reuters; government offices; *The Economist*

\*Or most recent available figure  
†Against long-run average of price-to-rents ratio, latest available rents data

rise in the official cash rate to 4.75% on 3 November to curb the exuberance in Australian property valuations.

The Hong Kong authorities also recently took measures that include reducing maximum loan-to-valuation

## AROUND THE OFFICE

### Gypsy predictions

In the August edition of *BLa BLa BLa* we had a Czech client obtain a reading from a local gypsy as to how the election would go. Published one week before the August Federal election, we reported:

She looked at these pictures very intently for a few minutes and from her facial expression, she appeared unimpressed with both Julia Gillard and Tony Abbott. She saw a very close result, but with no clear winner. However, with the help of some third party or some independent candidates a leader would eventually arise. She termed this a 'hung parliament'.

She concludes by saying which ever person wins government, their term in office will be short-lived.

Obviously, she was pretty spot-on with the first part of her prediction. This was made even more impressive given her lack of any knowledge of the Australian political system and the fact that none of our most seasoned political reporters were canvassing this concept before the election.

We are waiting to see how accurate she is on the latter part of the prediction, suggesting that this government will be short-lived.

In order to make it interesting, we have decided to run an informal competition on this topic. All you have to do is email your guess on the date of the next federal election to [gypsy@blapl.com.au](mailto:gypsy@blapl.com.au). Winner(s) will receive an appropriate bottle of wine when the day comes!! Entries close 31 December 2010.

ratios for luxury and investment properties, tightening restrictions on debt-servicing ratios, increasing land supply, and increasing the cost of speculative transactions.

In Singapore, the government imposed sellers stamp duty on property resales within a specified period, raised the minimum down-payment required for home financing, and increased the supply of public housing.

Europe shows a familiar split between core and peripheral countries. Ireland, Spain and Italy continue to suffer year-on-year price declines. German and French homes have shown big gains in value over the past year, which represents a particular turnaround for France since the previous survey. The British housing sector's talent for defying gravity may be on the wane, with the pace of annual appreciation in the country's property market slowing over the summer. However, British housing is still overvalued, with outright falls predicted.

The US housing market, almost alone among those that experienced a big bubble, is more or less fairly valued at this point, at least according to price-to-rent ratios. But price rises may not last for long. Earlier gains were driven by substantial reward programs and government subsidies, many of which have now finished.

America's overhang of housing inventory may get worse if concerns over lender foreclosure processes jam up sales. The temptation for the country's 11 million underwater borrowers to walk away is another threat. And being at or below fair value is no guarantee of a bounce in prices. Interestingly, Japanese housing fell by 4% in the year to the end of the first quarter, despite being stuck far below its long-run price-to-rents ratio.

## IMPORTANT DATE FOR YOUR SOCIAL CALENDAR

Given last year's successful and most enjoyable twilight concert, BL&A are again proud to be the primary sponsor of the 2011 Hall Village Brass Band twilight concert, including a repeat performance by soloist Bronwyn Douglas, in the grounds of the old Hall school on Sunday 20 March 2011.

Mark this in your diary now as all BL&A clients and friends are most welcome. More information will be provided closer to the date.

## CHRISTMAS HOURS

It's beginning to look a lot like Christmas. The office of BL&A will close at 1 pm on Friday 24 December and reopen on Tuesday 4 January. Over this period we will check our email ([clients@blapl.com.au](mailto:clients@blapl.com.au)) and answering machine for any urgent messages.

We would like to wish all of our clients a safe and restful holiday period.

Chris, Deb, Doug, Fiona, Frances, Kimberley, Scott, Stephen, Steve and Wendy.



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