Dollar Growth Financial Group

SMARTTALK

Financial Planning | Tax and Accounting | Mortgages | Estate Planning

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DID YOU KNOW?

Reducing exposure to risky situations is a good financial strategy. The best way to do this is to avoid carrying risk that we don't have to by transferring that risk to somebody else. There is a premium to pay, but the alternative is to carry the full financial burden of any disaster that presents itself (and it will), on one's own shoulders.

Could you survive a major unexpected family situation? Or would you prefer to sleep comfortably in the knowledge that there is no risky financial overhang in your life?

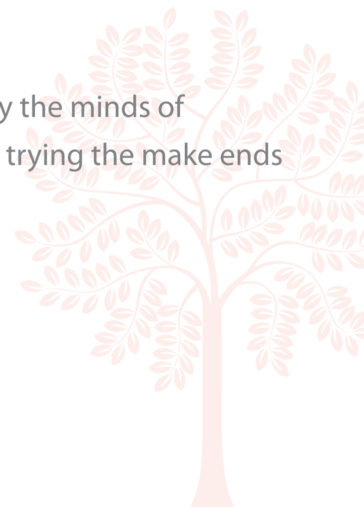
Message from Philip Enger

For at least the last five years (in the case of Japan, for over twenty years), the world has been struggling with a series of economic conundrums.

Since the American sub prime crisis in 2007 and the explosion of corporate debt that destroyed many banks, forced the bailout of some of the biggest, and sparked the biggest economic meltdown since the Great Depression, orthodox economic policies or remedies have failed to arrest declining economic growth rates and rising unemployment in the major economies of the world. Australia has performed much better then the others, but negative trends are beginning to emerge here as well.

We are tormented daily by the potential impact on our lives of 'fiscal cliff' and 'monetary easing' in the US; the imminent demise of the European Union as a result of default by one of its members; the is-it-on or is-it-off state of our mining boom; or the enigmatic nature of the Chinese economic model that we are increasingly dependent on for our livelihood. Surprisingly we are all still here and reasonably well off, and yet little progress has been made to stabilise the overhang of an ever increasing number of toxic issues.

I think it is time to look at one issue that constantly occupy the minds of politicians, central bankers, money markets and shoppers trying the make ends meet at the supermarket: **Inflation**.



Kind Regards,

Philip Enger
Managing Director

INFLATION

PART 1

Inflation is a key indicator of economic trends and wellbeing.

Too much (hyperinflation – prices continue to rise more quickly than normal), or too little of it (deflation – prices decline), can make us very sick. For investors it is crucial because their livelihood, one way or another depends on it. But what actually is it? Why is it so important? Although the subject is vast and very complex, I want to try to shed some light on why we should all keep an eye on this issue.

Inflation involves the creation of money and credit over and above what is necessary for the production of goods and services we all consume. This is stage one. The second stage when prices actually begin to rise is a direct consequence of the first stage of inflation. So inflation does cause prices to rise but it's not that simple and the issue of which prices rise is not at all self-evident.

TWO TYPES **OF RISING PRICES**

1. When prices rise on things we buy (Consumer Price Index or CPI)
2. When inflation cause prices to rise on assets we own - like houses, shares, bonds, gold, etc...

The Reserve Bank controls the creation of money and to a far less extent, credit. They are responsible for ensuring there is not too much money floating round in the system. Unfortunately central banks always concentrate on keeping CPI type of inflation within agreed limits and do not try to apply monetary brakes to asset inflation.

This can lead to the situation where the Reserve Bank in Australia overshoots the mark by slowing the economy more than it should. This can be achieved by increasing interest rates, which in turn reduces the credit available for home mortgage loans and business lending. This in turn reduces the amount of spare cash consumers have to spend. Such action will choke economic growth.

Often tragically and paradoxically, asset inflation is far more dangerous than CPI type inflation in the way it affects people's lives. Yes, bull markets make us all happy as we see our house values and shares spiking up, but because much of these investments are financed from credit when the bubble bursts as it always does, as we saw in 2008 and 2009, asset values drop sharply but the debt overhang stays. There is nothing worse than being a 'forced seller'.

With CPI type inflation the real value of debt declines as prices rise. For example, if you borrow to buy a house and then as your house value increases in tandem with your salary, it's a winning situation all round. The mortgage is easier to service from the increased salary, and the debt owed has dropped relative to the appreciating value of your house.

This issue of inflation could become very much more topical and potentially dangerous for the world economy, and therefore our economy - in the years ahead, because we appear to be entering what is being dubbed a 'helicopter era'. Please refer back to the second paragraph and to the observation that because orthodox economic policies are not working to generate GDP growth to reduce unemployment in the US and in the Euro zone, taboo and hitherto unconscionable and risky policy alternatives are being increasingly talked about and implemented.

Look out for the next issue of Smart Talk where we will reveal the next chapter in the story of inflation and its far-reaching effects.

For more information or to talk to one of our team, visit our web site or call us on **9787 5555**.

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