

BC'S BUSINESS BRIEFS

Volatility and what to do?

It seems at the moment that hardly a day goes by without news of another major international financier either going broke or being saved from bankruptcy by a central government bank bailout or takeover by a competitor. Add in oil price fluctuations of up to \$35US/barrel in 1 day and stability is a thing of the past. With the worlds financial systems currently under significant pressure and the speed with which events are reported, it would be easy to wonder if the world as we know it has changed significantly. It is important that each of us, when assessing the impacts on ourselves of the current turmoil, doesn't jump to conclusions and take hasty decisions.

How should each of us react to the rapid and wild fluctuations happening in world markets?

What is important to note in looking at the activity in world markets at the moment is that nothing that is happening today, hasn't happened before. Recessions and market crashes have happened many times in the past and will happen again in the future. Did the world investment markets survive the Great Depression? Of course they did – albeit in a changed state. If there is a difference today, it is the speed of communication and therefore the speed with which markets react to news. Computerised trading systems in both the share markets and currency markets both assist in terms of efficiency and lead to rapid movements in values due to their in built safety systems based on market movements. However, taking a longer term view, the values of currencies and sharemarkets will ultimately be determined by the underlying financial performance of the economies concerned or the companies, in the case of sharemarkets. Those economies that have sound fundamentals will ultimately have stronger currencies and sound companies will ultimately have stronger share prices.

If there are two key thoughts to bear in mind when factoring into financial decisions the likely market movements, they are:

- 1 Think medium to long term – trying to predict short term is virtually impossible and the wild fluctuations of recent times are likely to continue;
- 2 Where possible, ensure that investments are spread to minimize the impact of volatility in any one investment area. This includes diversification across all asset classes and not just spread across individual investments within 1 or 2 asset classes.

Tax Rate Changes

The new individual tax rates apply from 1 October 2008. These rates are part of a program of rate cuts designed to finish at 1 April 2011. Obviously a change of government in the up coming

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election will throw this program into doubt and if the opposition are to be believed, the rates will be cut more and at a faster rate if they are elected.

Personal Rates comparison

	Existing rate		New rate
Income to \$9,500	15%	Income to \$14,000	12.5%
\$9,501 - \$38,000	21%	\$14,001 - \$40,000	21%
\$38,001 - \$60,000	33%	\$40,001 - \$70,000	33%
\$60,001 & over	39%	\$70,001 & over	39%

Interest Rates – where are they going?

The Reserve Bank Governor has made some significant moves to reduce the interest rates that people are paying in New Zealand in the last 2 months, reducing the OCR by a total of .75% in 2 separate moves. These 2 moves flew in the face of what many of the economists, largely employed by the major trading banks, were predicting. The Reserve Bank Governor's contract is centrally based around the requirement to keep underlying inflation in the 1 – 3% band, over the medium term. The view being espoused by a number of economists was that inflation pressures had not eased significantly enough to allow the decreases that have in fact eventuated. The Reserve Bank, on the other hand clearly believes that the underlying inflation (excluding significant "one off" type shocks) is likely to come back within the target band as a result of the world economic situation and the lag effects of the high rates that we have had for the last couple of years. They were also conscious of the fact that if they didn't ease rates, we ran the serious risk of "Stagflation" over an extended period. This is the situation when we have no economic growth and inflation, predominantly driven by imported cost increases. This situation, if it occurs, can very quickly destroy income levels and therefore living standards in an economy. Events in the last few weeks have tended to reinforce the actions taken by the Reserve Bank as the strains in the financial systems of the USA and Europe were suggesting that perhaps the world financial system was facing it's greatest challenge since the Great Depression. Expect then, more of the same with perhaps another equivalent reduction over the course of the next few months likely to feed through the interest rates that borrowers are required to pay bottoming out sometime next year. **Look to lock in the rates on offer, therefore, sometime in the middle of next year as we reach the bottom of the rates cycle.**

Please feel free to contact the writer should you wish to discuss any of the contents above further.

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