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Spring 2021

Quarterly Economic Review 30 June 2021

Global economy

The COVID-19 pandemic remains a major feature on the global stage, although global economic recovery continues, with the JP Morgan Markit Global Composite PMI remaining positive.

Inflation news has been mixed. If we focus on the US, businesses were still affected by restrictions on movement with stronger demand for goods following last year's lockdowns driving prices higher. However, the effect of more permanent triggers on inflation such as rising wages are not yet clear. For example, the Atlanta Fed median wage growth tracker has drifted lower in recent months (suggesting worker bargaining power is limited) while the participation rate for workers remains well below pre-pandemic levels (suggesting there are still many workers on the sidelines).

Australia

The Australian economy continued to improve for most of the June quarter. Business and consumer confidence remained strong with the NAB Business Survey highlighting business conditions at record highs and confidence above long-term average levels. Also, the unemployment rate continued to fall, down to 5.1% in May and pleasingly we saw the labour force participation rate recover above pre-pandemic levels as workers re-joined the workforce (a sign of improved confidence in job prospects). We also saw household savings rates continue to fall from a record high of 22% in June 2020 to 11.6% in March this year with retail sales, for instance, beating expectations in April and May.

Our caution about further COVID-19 outbreaks last quarter unfortunately bore fruit in June. The Delta strain of COVID-19 triggered lockdowns across the country. The speed of the outbreak's spread is a concern for both public health and the economy, prompting increased restrictions across much of the country. There have been some limited attempts at government support, but these pale in comparison to the initiatives in 2020 such as rental relief and JobKeeper. The fallout from these lockdowns poses a downside risk to the economy. The severity will depend on how much longer they are extended and the extent that new stimulus mitigates the damage.

Fixed income and currencies

Global central banks such as the US Federal Reserve maintained a commitment to keeping interest rates low in the near term. However, the signs of this commitment weakened when the US Federal Reserve flagged a possible 0.5% increase in 2023.

The Reserve Bank of Australia (RBA) restated its view that it will take until 2024 before the economy is sufficiently strong enough to increase interest rates from their record low level of 0.1%. The RBA also ended its Term Funding Facility (an emergency support program for Australian banks) which saw fixed mortgage rates rise across most major banks as they lost a cheaper source of funding. In addition, the RBA announced plans to gradually decrease its activity in the bond market.

Concerns of 'peak' economic growth being reached on the back of declining stimulus saw bond yields fall with both global (up 0.9%) and Australian bonds (up 1.5%) recovering from their weak performance in the March quarter. Even the prospect of higher US rates was insufficient to weaken the demand for bonds amongst investors.

It was a more uneven story for the Australian Dollar (AUD). In line with the improving economic outlook it was rallying for most of the quarter until the change in US interest rate expectations in June. This reduced the relative attractiveness of the AUD given the lower relative interest

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rate. The COVID-19 lockdowns also dampened sentiment. Accordingly, the AUD fell 1.3% against the US dollar and 1.9% against a broad basket of international currencies.

Shares

The Australian market continued to rise from its March 2020 lows, finishing the June quarter up 8.3%. However, it was a very different story at a sector level. Despite rising oil prices, Energy stocks fell while Utilities struggled amidst weak wholesale electric prices with industry giant AGL falling 15% for the quarter. Buy-now-pay-later businesses such as AfterPay enjoyed strong performance, rising 16.4% on the back of ongoing success in the US market.

Global share markets also performed strongly with the successful vaccine rollout in the US and Europe key drivers. Cyclical stocks (companies benefitting from stronger economic growth) struggled with the tech-heavy Nasdaq Index in the US (dominated by names such as Apple and Microsoft) outperforming the broader US share market. Much of this relative outperformance arose late in the quarter amidst peak economic growth concerns and the belief that higher rates in the US would slow the economic recovery.

If you have any questions, or would like to discuss this further, please speak to your Financial Adviser.

Source: IOOF Research

Understanding changes to granny flat arrangements

On 1 July 2021, a new capital gains tax (CGT) exemption was introduced for certain granny flat arrangements, making it easier for older Australians to enter formal granny flat arrangements with the added protection from possible financial abuse if circumstances within the family change.

A granny flat arrangement does not refer to a granny flat structure in someone's backyard, rather it refers to arrangements where a significant amount of money and/or assets is given in exchange for a right to occupy a dwelling for life. The dwelling can be a room or self-contained dwelling located on someone else's property, however there are other types of accommodation which can meet the definition for tax or social security purposes. Your Financial Adviser can discuss the types of accommodation in more detail, in relation to your situation.

The benefit of a granny flat arrangement

A granny flat arrangement offers an alternative housing option to retirement villages, lifestyle parks or residential aged care by allowing older Australians to live on the same property as a family member who can assist them with day to day living and personal care needs.

Understanding the new CGT exemption

The new CGT exemption (which provides that no CGT event happens) applies to the creation, variation, and termination of a granny flat interest if:

- an eligible individual (older person) is granted a granny flat interest by the grantor
- the grantor of the right owns the dwelling or agrees to acquire the dwelling in which the granny flat interest is or will be held
- the older person and the grantor of the right must both be parties to the arrangement
- the arrangement is in writing and indicates the intention of both parties to be legally bound by it
- the arrangement is not of a commercial nature.

For the CGT exemption to apply to a granny flat interest upon termination or surrender, the CGT exemption had needed to be applied when the granny flat interest was created or varied (on or after 1 July 2021).

Is the age pension affected?

Money or assets (or a combination of both) given for a granny flat interest may fall outside social security 'gifting' rules where certain conditions are met, which may mean the older Australian in the arrangement may retain or increase any age pension entitlements.

Tax implications

In the past, many families may have opted for informal granny flat arrangements to save time, expense and to avoid potentially significant tax consequences for the person granting the right ('grantor'), as the capital gain tax could be significant. The new CGT exemption removes some of the anxiety around the tax implications of having a formal arrangement in place.

Right to occupy

A granny flat interest requires that the older person be granted a lifetime right to occupy a dwelling. A dwelling could be accommodation in the grantor's family home, investment property or holiday home. A 'right to occupy' is distinguished from a life interest. A right to occupy provides the person with a right to live or reside in the property. A life interest may provide broader rights, for example, a right to 'use and occupy' a property, which may include rights to rents and profits from that property if the property was rented out. For social security purposes a granny flat interest may include a right to accommodation for life in the residence or a life interest in the residence.

The grantor of the granny flat interest owns the dwelling or agrees to acquire the dwelling

The grantor of the right must own the dwelling (or agree to acquire the dwelling) in which the older person has or will be granted a right to occupy for life.

Involve all family members in the process

The new CGT exemption for granny flat arrangements offers protection for older Australians because it details the obligations on each of the parties in the arrangement, and it ensures the arrangement is legally binding. For this reason, it is important that an open discussion with all the parties and family members who are likely to be affected takes place, along with financial planning advice from your Financial Adviser, and legal advice from your Lawyer or Solicitor.

Formal, written arrangements must be in place, usually drafted by a Lawyer or Solicitor, and the arrangement must not be of a commercial nature. Your solicitor can further explain the specific terms and both parties' rights and obligations under the arrangement.

Speak to your Financial Adviser

If you, or someone you know, is considering a granny flat living arrangement, it's sensible to have these conversations with your Financial Adviser and put something in place whilst all parties are of sound mind and have the capacity to sign the legal agreement.

Source: IOOF

Navigating your way through a redundancy

The Australian Bureau of Statistics announced a record 932,000 jobs were lost between the March and June 2020 quarters in the wake of COVID-19[1].

If you are facing a possible redundancy at work due to the aftermath of COVID-19, or a company restructure, this is considered a significant life event that may impact your career, family, mental health and financial wellbeing. For those who are ready to retire, termination payments are likely to be a welcome windfall, but for those who don't have retirement on the near horizon, you may find redundancy stressful, as it tends to happen during an economic downturn when it may be harder to find a new job.

The immediate issue to consider is whether you have enough money to tide things over until the next job comes along. If you are working with a Financial Adviser, then they will have a good idea of what your current financial position looks like, and how long you can manage without a job. Your Financial Adviser can discuss different options to consider when it comes to a redundancy payout.

This is a great opportunity to make a real difference to your situation during a challenging time, and, if you are the employer, you may be able to support your employees to achieve a better outcome.

Genuine redundancy payment (GRP)

Payments on termination due to redundancy attract more generous tax concessions than if the employee resigns. If you are offered and accept a redundancy, it is worth knowing about the tax concessions and the conditions that must be met to be eligible.

A GRP must satisfy the following conditions:

- The employee is dismissed because the employee's position/ role no longer exists
- There is no arrangement between the employer (or another entity such as a company associated with the employer) and employee to rehire the employee after dismissal
- Where the relationship between the employer and employee is non-arm's length, the payment cannot be greater than the amount that would be reasonably expected if the relationship was at arm's length
- The dismissal occurs at the earlier of the following:
  - before the employee attains Age Pension age, or
  - before the employee attains the age, or completes a period of employment, when employment would have terminated

If these conditions are not met, the employee is ineligible for the tax concessions that apply to GRPs. For example, where redundancy occurs on or after Age Pension age, the employee is not eligible for a tax-free GRP.

Payments on termination

Payments that may be received by an employee who is made redundant include:

- salary and wages, overtime, bonuses and allowances
- unused annual leave and long service leave
- severance payments
- a gratuity or 'golden handshake'
- genuine redundancy or early retirement scheme payments
- non-genuine redundancy payments (eg redundancy occurs after employee reaches Age Pension age)
- payments in lieu of notice
- unused sick leave
- unused rostered days off

Taxation of payments

Payments on termination are categorised to determine how they are taxed. If you are offered a redundancy, you can plan ahead by asking your employer for an estimate of the payments you will receive, including withholding tax amounts. Your employer can provide you with an income statement at termination or you can obtain this from the Australian Taxation Office (ATO).

Payments eligible for concessional tax treatment attract tax offsets so that the tax paid does not exceed the concessional tax rate. Tax withheld by your employer reduces the final tax payable and if too much tax was withheld the excess is refunded to you.

Your Financial Adviser can help you identify and work out:

- Payments for earned income
- Tax on unused annual or long service leave
- Non-excluded employment termination payment (ETP), the tax-free genuine redundancy payment (GRP) and the excluded ETP

Other considerations

As well as working out any payments, your Financial Adviser can discuss other financial and personal considerations, including:

- How ongoing expenses can be met and for how long
- Whether you intend to retire and if not, how long it may take to find another job
- Other financial resources available to you
- Eligibility for social security payments and/or Family Tax Benefits
- Whether your employer has the flexibility to 'time' the redundancy and termination payments to assist with a better tax outcome
- Whether deferring taxable income (for example deferring the sale of investments with capital gains implications) will have a favourable outcome
- Your capacity to make personal deductible super contributions
- What you would like to do if you do decide to retire, and what your retirement lifestyle will look like given your financial situation
- If you decide to return to the workforce, whether your next job can pay a similar salary or if you take a pay cut in the current economic environment

Conclusion

A redundancy may be beneficial if you're ready to retire but stressful if you need to find a new job in a challenging economic environment. Some employers may be able to offer flexible payment arrangements on termination to facilitate a better tax outcome.

A Financial Adviser will discuss both the impact of a redundancy on your overall financial situation and how to achieve a favourable payment outcome.

Source: IOOF

[1] Source: Labour Account Australia

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