The Australian Finance Podcast Episode Transcript

Episode: Economics crash course with Dr Sam Wylie
Release Date: 13/12/2021
Speakers: Kate Campbell & Sam Wylie
Duration: 45:52

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Episode transcript:

Kate:
Sam, welcome onto The Australian Finance Podcast today.

Sam:
Hi Kate. Thanks for inviting me.

Kate:
Now, you have a lot of experience in the finance industry and you were just telling us off-air before you've been working at Melbourne Business School for well over a decade, which as a young person is hard to imagine staying in one spot that long. But just to kick off this episode, it'd be great to... If you could tell us a little bit about how you got into the industry and what you do maybe day to day in your job as an educator.

Sam:
Well, I became an economist, not exactly by accident, but I started off as an engineer. Went to work for the federal government for a bit, thought about studying an MBA, then was drawn into economics. Went overseas. Me and my wife, Tracy, went to London. She worked for the city of Westminster and I did a PhD at the University of London. Then we went to America for seven years and I was a professor at Dartmouth University. And then we came back to Australia and I've been at the University of Melbourne since then. So, I teach in the business school at the

University of Melbourne, not in the economics department, not in the undergraduate economics department, but in the graduate business school. You know universities have got graduate schools for medicine and law and architecture and veterinary science and business. So that's where I teach. And I work on things to do with banks, to do with corporations, to do with wealth management, et cetera.

Kate:
We've got you on the podcast today to break down some of the concepts about the economy that really listeners should know, but maybe don't know. And even some of the things that I really want to learn a bit more about, because sometimes we toss around terms on the podcast like inflation and interest rates and the reserve bank, we don't unpack them. So on today's podcast, we've got you on to really explore all of those things in more details. To kick it off, I was wondering if you could explain what is economics and why, as investors and just individuals living in a country that, we should be aware of this.

Sam:
Well, economics is science. It's a social science, it's not a physical science like physics or chemistry or biological science or life science. It's not one of those sciences, it's a social science like psychology or sociology or the like, deals with humans. And in particular deals with how people make decisions about resources. I know that sounds like a whole bunch of jargon, but it is about that. About how people make choices, the kind of choices that you and I need to make. So, how much am I going to work to earn, as opposed to how much of my time am I going to spend on something else? When I make money, how much of it... The government's going to take a big chunk of that in taxes, but then apart from that, how much am I going to save as opposed to how much I'm going to spend?

Sam:
When I spend it, what am I going to spend it on? Am I going to spend it on travel, accommodation, health, food, entertainment, et cetera. And when I save it, where am I going to put it? Am I going to put it in the bank? Am I going to put it in my super, am I going to save for a deposit for a house, et cetera? See, those are all choices. That's the first thing, understanding how people make choices. But then the second thing is all of those choices add up to something. So individuals make choices, individual people like you and me, Kate. But also individual companies like BHP or CSL or National Australia Bank, they're really big companies, but small companies are the same. If they're a local plumbing company or local travel agent, they have to make choices about what they're going to produce, how much they're going to charge in price, how many people they're going to hire, how much they're going to pay those people, et cetera.

Sam:
So you've got individuals, companies making choices. And all of those choices add up to something. They all come together. The total number of people deciding whether they're going to get rid of their petrol car and buy an electric car, adds up to the total demand. The total increase in demand for electric cars and decrease in demand for petrol cars. Then from that,

you get from the total demand and total supply by companies bringing things to market, you get prices. The aggregation, the bringing together of all those individual choices. And that's the second thing that economics is about. Firstly, it's about those individual choices. Then it's about what all those choices add up to. And they add up to lots of things. They add up to interest rates. They add up to how much the Aussie dollar is worth versus the US dollar.

Sam:
They add up to inflation. They add up to total government spending. All of those macro things, they're interesting. The micro of individual decisions adds up to the macro of exchange rates and interest rates and prices and government spending, et cetera. Then the third thing, and it's a long answer, so I'll be briefer. But the third thing is, we're interested in the organisations that bring all that together, the government, the banks, the super funds, the companies, the unions. All of those kind of organisations that facilitate that choice-making and all that economic activity, we're interested in those organisations. How do they work? How should they work? Those kind of things.

Kate:
I think it's interesting to think of it that way, as in all those individual choices. Because sometimes a country's economy can seem like just something the government controls, whereas that's a really different perspective. Isn't it?

Sam:
Well, that's a neat insight. That there is this sort of key difference between free market economies, where individuals make those choices and those choices add up to macro things. And centrally planned economies, where some central planner, the government, makes the choice. Then basically tells people what they're going to do. Now, every real economy is somewhere in between those two things. If you went back to the Soviet Union, which for me, people talked about it a lot when I was a young guy, but for you it probably seems like about three or four centuries ago. But actually, if you went back to the Soviet Union from the last century, then they really was centrally planned. They really did make up all these plans for how much wheat's going to be grown and how much steel there's going to be, and what the price of this is going to be and the price of that. And they told everyone.

Sam:
That was one extreme. Then also, if you went back a long way in history, there was no regulation. There was no regulation of what choices people were allowed to make or not. There no minimum wage. There was no regulation on how much pollution you could produce. So you need to have the right balance between people having the freedom to make their own choices and having some government control to make sure that those choices don't harm each other too much. And every country and every economy needs to find that balance between the central planning and the freedom of individual choices. And every country is at a different point on those spectrums. Australia's quite a long way towards free market and individuals getting to make their own choices and do what they want.

Kate:
That's interesting. Just bring it back to finance, something like getting a statement of advice from a financial advisor like we've spoken about in the show is quite expensive. And maybe the financial advisor wants to charge only a hundred dollars, but they can't because there is some manner of regulation and oversight and compliance involved by the government. So I guess that would be when you talked about the free market and the centrally planned, that might be somewhere in the middle there. Where each party doesn't get full control, so it sort of settles in the middle a bit.

Sam:
Well, that's a neat insight as well. That balance between government control and individual freedom, and every country needs to find that balance. But in Australia that has an expression in financial advice, as you were just saying. And Australia's kind of unique in that respect. So you can make a set of choices in Australia that you can't make elsewhere. Take super, for instance. We have compulsory superannuation. That's the government telling us what to do. 10% of our salaries have to go into superannuation, at a maximum of 27.5k, but 10% of your salary goes into super. And you don't have any choice about that. But then once it does go into super, you have a lot of choices. You can move from super fund to super fund, that's true in most countries. But in Australia, you can have your own, self-managed super fund.

Sam:
I don't know if it's something you know a lot about. But in Australia, you can have your own super fund. Not where you can just say, "I want a lot in Aussie shares and I don't want so much in bonds. And I want a lot in commercial real estate, and I don't want so much in global shares, for instance" Not just that kind of choice, but you can actually run the super fund completely yourself. You can be the trustee of the super fund. That's a lot of choice. So we have a lot of freedom in Australia. Unfortunately, freedom can be a curse rather than a blessing unless you know what you're doing. Ideally in Australia, what we would have is either very strong education, finance education and finance literacy.

Sam:
And that's what you are engaged in, is elevating finance literacy for people. Especially for young people, which is extremely helpful thing. So we'd either have good finance literacy, or we'd have reliable, cheap, trustworthy financial advice. Then that freedom of choice, instead of being a curse would be a blessing. But actually, we don't have either of those things. We don't have high levels of financial literacy. I know you're working on that and doing a good job. I am too. We don't have high levels of financial literacy, and our financial advice sector is an absolute mess. You said just a moment ago, Kate, that the high regulation of financial advice, which has come of about through necessity. Because a lot's going wrong in financial advice in Australia, has come about through necessity, but it does mean that it's more expensive than it would be otherwise. So it is quite problematic.

Kate:

One of the other terms that listeners may be aware of and have seen these people on the TV speaking about very issues is economists. We've never had an economist on the show, so I was wondering if you could talk a little bit about what they do. What their role is and whether they're worth paying attention to when they start pulling out all the graphs and talking about the Australian dollar on the news each night.

Sam:
There's not a lot of people who call themselves economists, but economics is everywhere. It's a little bit like, you probably don't know a lot of people who would call themselves mathematicians. The viewers here on the podcast probably don't know anyone who would describe themselves as a mathematician, but you use math all the time. All day, every day, you're making simple mental calculations. So you use maths, but you don't know anybody who studies or teaches maths. Of course you know math teachers, and we can think of them as mathematicians. It's the same with economics. So you probably don't know anyone who's called an economist, who studies economics and wants to understand it at a deeper level or teaches economics in school or at university, or works in a government department on economic policy. You probably don't know anyone like that, but people use economics, use the fundamental ideas about the things we were talking about earlier. Making choices and what those choices add up to, and the different institutions and intermediaries and organisations. It gets used all the time and everywhere.

Kate:
When they pop up on TV, are they... When they're giving you those charts and things, is it more just displaying the facts and them interpreting it in a certain way? Or do they put their own spin on things?

Sam:
That's a great question. That was the second half your question, thanks for reminding me of that. So, yes. Look, you need to take it with a grain of salt, in a couple of ways. People present themselves as being experts when they're not necessarily. And they present themselves as knowing things that they don't or can't necessarily know. But having said that, yes, you do need to pay attention and you do need to find good sources of information and elevate yourself going forward. Now, let me give a couple examples of what I mean about people pretending they know more than they do. So when people stand up and start looking at graphs on the TV. You're watching The Nightly News, or you're watching a website or a podcast or something, and somebody comes up and they're looking at a graph and they can explain what's happened.

Sam:
The price of gold went up and here's why. Well, you can always explain graphs. You can always explain history. Everyone can look backwards into the past and impose an explanation on what happened. I'd be impressed if they could look forward. If instead of saying what happened to the gold price yesterday, tell me what's going to happen to the gold price tomorrow. Then let's come back tomorrow and see if you were right or not. Now, they never do that, because what that's going to reveal is that they're just making it up. That they're just... Anyone can look backwards

into time and pretend that they can explain what happened, give that illusion of expertise. And anyone can say, "Okay, Sam or Kate, oil price is going up. BHP is going down, the Aussie dollar is going up, inflation's going this way, et cetera." They can make those strong statements, but we never come back to check whether they were right or not.

Sam:
Look, you need to have a healthy level of scepticism about the level of expertise that people project to you through the screen. They always... There's more pretending in finance than there is in almost anything else in the world. People are pretending that they're experts. And usually because they're trying to sell you something. I know that's not what's going on here, but usually it's because they're trying to sell you something. But they project a level of expertise they don't have. And if you're sceptical about that, that's a healthy... It's good to have a healthy level of scepticism. But having said that, it is important to elevate your knowledge as time goes on. So the kind of things that you are engaged in, Kate, are very helpful for that. People need to find good sources of information and elevate their understanding as time goes on.

Kate:
As investors, what are some key economic terms or concepts we should be aware of? So when we do see that coming on TV, or we see some mentioned in articles, we go, "Oh, I know what that is, or I can understand what they're saying here."

Sam:
That's a good question. Now, it depends. You know I'm going to say it depends, people always say that. But it does depend upon where you are in your investment journey. If you were my age, it'd be, what should I do about my super? I know that's an important question at your age as well, but it's more important at my age. I'm going to be retired in X year's time, have I saved enough money? I need to really pay attention to super and get it right. Maybe I own a home and I paid that off, how can I use the money that I've got stored in my home to pay for my retirement? And for that kind of thing. Now, for people who are your age, then it's going to be more about saving for a home or saving to travel overseas, for instance and such.

Sam:
So it's going to be a different set of criteria. So I do think... Let's take that. Let's take your example rather than my example. I think some things to really pay attention to are interest rates and also interest rates, mortgages in general, inflation and the things that are going to really affect the goals that you're are trying to achieve here. You're saving to buy a house or an apartment, you're saving to go and live overseas. You have some short-term, medium-term, long-term financial goals, and in filtering out all of that information that's coming to you, focus on the things that are important for those goals. If you're saving to buy a house, for instance, to buy an apartment or buy a house, then focus on those things. Focus on interest rates, fixed rates, floating rates. How inflation is affecting that, how much money you can borrow to invest, et cetera. So filter out the stuff that's important for the short-term and medium-term goals that you've got.

Kate:
Absolutely. And if we take your example of saving up for our first home, which I know many of our listeners are trying to do. One of the key terms that comes up again and again, and we see on the advertising from the bank is what the interest rate is. Are you able to unpack that term a little bit more, and what we need to know about interest rates and how they impact our lives?

Sam:
Sure. First of all, let's start, Kate, with two types of interest rates. Floating or variable interest rates. Usually we call them variable interest rates, but sometimes floating. So interest rates that go up and down versus interest rates that are fixed. And you can get a mortgage of either kind. You can get a mortgage where the interest that you pay is fixed for three years or five years. But it's more common, about 75% of mortgages in Australia are variable, floating interest rate. So let's just take an example. Let's say that you want to get a mortgage for $500,000. You saved a $100,000, you're going to borrow $500,000. That'd mean that you would have a loan to valuation ratio, which was 500, over 600. Of the $600,000 apartment that you're going to buy, the bank's bringing 500K, you are bringing a 100K, the loan, the 500 to the valuation.

Sam:
The 600 is the 500 over 600, which is about 85%. And that's pretty high, but that's what you've got to do to get into the property market, is to borrow a lot of money. So let's say that we had a 500K loan, then you've got to pay interest on that. Now, let's imagine that your interest rate at the moment is, let's say that it's 2.4%. So you go and see a mortgage broker. Maybe you go to the bank, but the most important thing is to go and see a mortgage broker. A mortgage broker can put you in touch with all the banks, because if you go and see a particular bank, if you just go to National Australia Bank. I don't mean to pick on NAB, they're a fine bank. But if you just go and see one bank, in a way you're just telling the bank that you're not really going to search. You've got a, I don't need a very low interest rate sign on the top of your head, if you just go to the bank branch.

Sam:
Whereas if you go to the mortgage broker, and especially if you let the mortgage broker know that you are talking to another mortgage broker. Then you're going to have, I need the lowest interest rate possible sign on your head. And the mortgage broker's going to try as possible how it is possible to get your low interest rate. So let's say that you've got a $500,000 mortgage. It's 2.4%. How much is that? 1% of 500,000 is 5000. 2.4 times 5,000 is $12,000 a year, so you'd have to pay 12,000 of interest per year on that mortgage. And then you'd have to pay the principle as well. If it was a principle and interest loan, which is what it's going to be, it's not going to be an interest only mortgage, interest only loan. That's what you would want if you are an investor.

Sam:
Investing in a property rather than buying one to live in. So it's going to be principle and interest. You're going to be paying the $12,000 interest, and you're going to be paying back the $500,000. That's the principle part. That'll be on top of it. But if it's a variable rate... I know this is

a long answer, so I'll shut up in a moment. But if it's a variable rate mortgage, which most likely it's going to be, could be fixed rate for three years. But if it's variable rate, then if the RBA, the Reserve Bank of Australia, and let's come back to them in just a moment. If they put interest rates up, then your 2.4% will go up. And if they put interest rates up, because the RBA sets the interest rate here, then the banks add a margin on top of it of about 2.4%.

Sam:
We live in extraordinary times, Kate, as you know, and interest rates are approximately zero from the RBA at the moment. And the banks always put about 2.4% on top of that to make their profits, so you've got 2.4%. But if the RBA increased it... It's actually a 0.1%, but that's pretty close to zero. If they increased it to 1.1%, the banks would add that on. And we'd go from 2.4 plus 1.1 to let's say 3.5. Then we would go from you paying $12,000 interest to paying $17,500 in interest. It would drift up. In the last few years, those interest rates have been drifting down. But if the RBA, the Reserve Bank of Australia increases interest rates, then they'll drift up. [crosstalk 00:22:27].

Kate:
And as interest... No worries. As interest rates go up, that makes it potentially more difficult for people to pay that interest on their mortgage each year. Is that correct?

Sam:
That is correct. And look, it's not all bad. The reason that the RBA would put interest rates up is if they're worried about inflation. We've had low levels of inflation through time, where inflation means the general price of things. Let's call it consumer price inflation, CPI, consumer price inflation. The Australian Bureau of Statistics, let's not bring in too many different players. But the Australian Bureau of Statistics looks at... Just to tell you what inflation is and what CPI is. They look at a basket, a typical basket that a typical household buys. They look at 125 things. Everything from movie tickets to cars, to rents on houses, to health insurance, to computers, et cetera. To food and education and travel and everything. They look at 125 things. Then they look at that basket of things that a typical household buys, how much that goes up year by year.

Sam:
And if across the whole basket, those things... Because some will go down and some will go up. Maybe petrol goes up and computers go down or visa versa. But across that whole basket, if their prices go up by 2%, then that's what we mean by consumer price inflation. That gets released every quarter, every three months in Australia, the CPI figure. And it has a big effect. Now, the Reserve Bank of Australia... The way you should think about The Reserve Bank is it's the bank's bank. Just like you have a bank, like ANZ, or maybe you have a credit union, or maybe you have a building society. But just like you have a bank, then the banks have a bank. And their bank is called the Reserve Bank of Australia. And just as what you want from your bank is to be able to access money when you want it and to make payments.

Sam:

That's what they want from their bank, to access money, to get folding money when they want it. When you want some folding money for the weekend, then you go to the ATM. I know you don't use cash anymore, but when people want cash, and I don't either, but people do go to the ATM and get cash out. There's a lot of cash in circulation. When you want cash, you go to the ATM. When Westpac wants cash, they send an armoured car around to the RBA. You want 800 bucks for the weekend, they want 40 million stacked in the back of the armoured car. So the RBA is the bank's bank, but the RBA, the Reserve Bank of Australia is charged by the federal government with controlling inflation. Not letting inflation get too high or get too low. Too low has been the concern over the last 10 years, but too high is the concern now.

Sam:
In COVID-19, a lot of money got pumped into the economy. Job keeper and job seeker and all the kinds of incentives for companies. A lot of government spending and a lot of creation of new money in a thing called quantitative easing. Let's talk about that another time. But all of that stimulus has really sped up the economy. There's a lot of demand and it's pushing prices up. And the RBA's worried about it. The tool that they have to slow the economy down and to stop prices rising too quickly is to put interest rates up. And if they do that, variable mortgage rates will go up. Remember that the banks add about 2.4% on top of the interest rate that the RBA sets. Now, you know how I said... I know my answers are very long-winded, but I'll be brief with this. But you know how I said that the RBA's worried about inflation, prices are going up.

Sam:
Well, it has been very worried about deflation, prices starting to go down, or inflation getting very low. And that's why it cut interest rates all the way down to zero in COVID-19. We really do live in extraordinary times. Then you've got the 2.4% on top of that. And that's why mortgages are at about 2.4%, but now inflation is coming back. And what we are looking at is the RBA increasing interest rates to control inflation and that's pushing interest rates up. And then it'll push up the interest people have to pay on their mortgages.

Kate:
If inflation does go up, apart from having to pay high interest rates on mortgages, what are the other impacts to consumers that maybe we should be aware of?

Sam:
Well, for investors it's... The downside if you buy a house is... If buy an apartment or a house, the downside is, that if you've got a floating rate mortgage... Now, remember you can fix your interest rate and talk to your mortgage broker about that. Do I want a fixed rate or do I want a floating rate? And go to some different places. A good place to go to look at interest rates is RateCity, RateCity without any spaces dot com dot AU. I don't know if I'm allowed to mention that on your podcast. That's got nothing to do with me-

Kate:
I think we've mentioned that before.

Sam:
Okay, good. And they've got nothing to do with me, doesn't help me to recommend them. They just have a good calculator. It's just a good way to find the lowest interest rate mortgages. And you want to go there before you go to the mortgage broker. You want to do your homework before you speak to someone who can actually get you a mortgage. And the reason for that is, your interest and the mortgage broker's interest are not perfectly aligned. You want the lowest interest rate, what they want is to get the transaction done quickly. On your $500,000 mortgage, they'll get paid $3,000 by the bank. And then they'll get a $1000 per year, 0.2% as a trailing fee. So they'll get $3,000 for getting all the paperwork done and the whole thing underway with the bank.

Sam:
Then they'll get a $1000 a year every year that the mortgage exists. So the mortgage broker just wants to get the job done. And what you want is the lowest interest rate. And it might be that if interest rates are a little bit higher, it'll be a bank that's easier for the mortgage broker to deal with. Less paperwork for the mortgage broker and happens faster. So there's less chance for the whole thing to fall over before they get their 3000 and a $1000 a year. You go to the mortgage broker and you just want the lowest interest rate. They want the most convenience. So you've got to do your homework before you go. Get the lowest interest rate in your mind, go to the mortgage broker and say, "I'm looking at ratecity.com, I can see this interest rate. And really low interest rates are around 2%.

Sam:
I said 2.4%, that was typical. But the lowest ones are around 2%. I can see an interest rate that's 2.05%, let's talk about that. When you go to speak to your mortgage broker. So look, inflation's not all bad, because when you buy the apartment, inflation will push the price of the apartment up and it'll push your salary up as well. The problem with interest rate is the bad comes immediately. So the RBA puts interest rates up by 1%, and it's a $500,000 mortgage. So you go from paying $12,000 per year to $17,000 per year, the extra 5,000, the 1% are the RBA trying to control inflation. The problem for you, increased interest payments, comes all in one go. Bang, you go from paying 12,000 to paying 17,000 in one go.

Sam:
17 and a half thousand from our example before in one go. But then the benefits come slowly. And in the end the benefits equal the problem, or might even exceed it. And the benefits are that your salary will go up with inflation. You'll have some kind of wage negotiation, there'll be tension for your employer to pay you more, otherwise you'll go to a better job. Then the value of your apartment will go up with inflation. So it won't be all bad. And in the end, the good might outweigh the bad. The problem is the bad's very front loaded. So you need to bear that it mind, you need to think forward a little bit. If interest rates went up 2%, am I going to be able to handle that? Am I going to have enough cash flow to make sure that I can make my payments, or am I overextending myself?

Sam:

Your question and your observation throughout this, Kate, is that there's a set of things that you need to concentrate on. And interest rates are one of them. So when people say the RBA interest rates, when you hear on the radio that you are... And you hear on Triple J, for instance. Sometimes I say two Triple J, which shows you what an old guy I am, because when I was your age, that's what they were called. They were Sydney radio station, believe it or not. And sometimes I actually say that, and my kids wonder, what is he talking about when he says two Triple J? But anyway, you hear on Triple J that interest rates have gone up. The RBA has increased interest rates from 0.1% to 1%. Now, that wouldn't happen. They would only increase it in quarter percent increments. They might increase it from 0.1% to 0.35 to 0.6, et cetera, small increments. They meet on the first Tuesday of every month, and they make that decision.

Sam:
Then you hear on Triple J on the news that interest rates have gone up, they're talking about the RBA interest rate. They're not talking about the 2.4 or 2.5% that banks add on top of that. So you want to pay attention to that. And think about where interest rates are going up and find some reliable sources of information like yourself about what's happening to interest rates. And think forward a little bit. Do I want to fix my interest rate? Is that going to work for me? Should I talk to my broker about that? So stay on top of what those things mean, listen to good sources of information and just think through what your own situation is and what your short-term and medium-term goals are. Your exact question was... Your direct question, Kate, was, is inflation always going to be bad? And what other things does it going to affect? Well, it's not always going to be bad. It's just that it's very front loaded when it comes to mortgages.

Kate:
I feel like the media attaches inflation to very negative words and negative imagery. So when I think of that word, that conjures up. But as you've explained it, there is pros and cons to inflation rising and lowering. And just thinking more broadly about how that impacts us as consumers and investors is really interesting to do.

Sam:
Yeah, it's not all bad. That harks back to bad experiences that people have had in the past. In all of culture, there is... Not just in economics, but in all of culture, in all of... And culture is really the conversation that society is having with itself all the time. In all of culture, the past is always with us, and people have the memory of what happened in the 1970s. We had very high unemployment, low growth, very high inflation. So there's a real negative sentiment associated with inflation. But actually some inflation, not too... What The Reserve Bank wants is inflation between two and 3% per year. But even if inflation went to four or 5% for a while, that wouldn't be such a bad thing. That could help in many ways.

Kate:
Absolutely. One of the last terms I wanted to unpack a bit more is the idea of supply and demand, as we hear about it a lot. Even just thinking examples at the moment, there's a lack of workers in the hospitality industry and all the cafes are having to pay higher wages. I think I saw an article of the $100 dishwasher, getting paid that much money to just wash dishes per hour

just because there's such a shortage. Are you able to talk a little bit more about supply and demand and how that affects asset prices?

Sam:
Let's start with the dishwasher and then we'll go to asset prices in just a second. So the supply of dishwashers, these are people we're talking about. The supply of people who wash... I'm just making sure that [inaudible 00:35:29] say something stupid. The supply of people who wash dishes or the number of people who wash dishes is much reduced for the catering sector, because we don't have a lot of foreign students and we don't have a lot of backpackers. I mean, a huge number of backpackers come to Australia, as you know, and a lot of them work in hospitality. A lot of them work in agri-business, in picking fruit and the like, then they sort of move backwards and forwards. And then they either stay.

Sam:
I personally think is a good thing, or they go home, et cetera. But that supply of people to do that has dried up. So now you've got the same amount of demand, or you've got returning demand. In the lockdowns people can't go to cafes, can't go to pubs, can't go to restaurants. So hospitality is very constraint. And you've got a big supply of labour... So you don't have all of those backpackers and foreign students, but you do have ordinary Australians and you don't have much demand for that labour. You've got a big excess supply to demand in the market and the government has to step in. That's why we have to have job keeper and job seeker, but especially job keeper at that point in the COVID-19 crisis, is because a lot of people who were previously working in hospitality, there's no demand for that.

Sam:
All the restaurants are shut, but everyone's got to live and we all got to carry on with biggity. So the government has to step in with job keeper there, but now we're in a situation where the demand's gone way up. Everyone's going back to pubs and to clubs and restaurants and the like. Demand's gone way up and now we've got excess demand. Now, the supply can increase. If people stop doing what they're doing, driving Ubers or whatever it is. Working in realty or something else. If they shift to the hospitality sector, so if there's excess demand for restaurant meals and not enough people to wait the tables and to clean the dishes. Then if the wages in that sector go up, if the price that is paid to people, wages are just prices after all, the price of labour.

Sam:
If those prices go up, it'll draw in those people from other sectors. So if wages in hospitality go up and wages elsewhere, in relative terms, don't go up. Then people will be drawn in. And you can see that it's the prices themselves that is getting supply and demand together. This is how it works in a free economy. That's why we started off this conversation, Kate, with you asking me and making observations that some economies are centrally planned. Where some bureaucrat is telling everyone what to do. And others are free market economies, where people decide for themselves. But what's the coordinating mechanism? What makes those people think, you know

what, I'm going to stop being a DiDi driver and I'm going to go and work in that restaurant? Well, it's wages. They're making their own choice.

Sam:
But the higher wage is the thing that's coordinating all those choices within the economy. So it's prices that coordinate all those choices. People look at prices and then make decisions. How much can I earn? How much is it going to cost me? I'm thinking of flying from Perth to Melbourne, should I fly on Virgin, or should I fly on Qantas? Well, maybe I should go to the Gold Coast instead. And in making those choices, I'm looking at prices. Aren't I? Everyone's looking at the same prices and making their own choices. So it's the prices that are coordinating all those individual choices and setting supply and demand equal to each other.

Kate:
Is the goal-

Sam:
It's a big topic. It's hard to explain just by waving [crosstalk 00:39:36].

Kate:
Is the goal usually for supply to meet demand, or is that an impossible target?

Sam:
Well, unless there's something preventing it from happening. It's like water, it'll just flow to the same levels, unless there's some impediment in the market that is stopping supply and demand from coming together. Then that will happen automatically. Now, there's lots of things that can go wrong in markets. So sometimes the government has to intervene in the market. Like minimum wages, for instance. When the demand for people to wash dishes and to wait tables, when that demand goes way down in the COVID-19 crisis. It doesn't mean that restaurateurs can charge whatever they want. Sorry, pay whatever they want. You can't pay people less than the minimum wage. And that's the government intervening in the labour market just to establish a level of fairness and to prevent... And just to make sure that there's a balance in power here, between employees and employers.

Sam:
So it doesn't just reach its own equilibrium, its own balance between supply and demand, the government intervenes. Then you end up with supply being a lot more than demand, because wages can't fall, and then the government comes in with job keeper. Unless there's some impediment or some government intervention, supply and demand will just come together automatically. When there's a lot of demand for people to wash dishes, wages will go up and people will move from other sectors into hospitality. And then the supply of hospitality will go up. The prices themselves will bring supply and demand back into equilibrium. And you were asking earlier, Kate, does that happen in investing? Absolutely. It happens in investing. When we were talking about our mortgage example earlier, and we were saying that the interest rate is the...

Sam:
The RBA's part, at the moment that's close to zero, but we're expecting it to go up at some stage. Probably not next year, maybe the year after. There's the RBA's component, but then there's the bank's component. The 240 basis points, if I use that expression. So 2.4% is the same as 240 basis points, but that's a very common expression in talking about mortgages. But that 2.4%, that itself is supply and demand. There's a lot of demand for mortgages across all the people who want to refinance their existing mortgage or to get a new mortgage to buy something. Then there's a lot of supplier of mortgages, the money that banks have available to lend out to people.

Sam:
And those two things, the demand for mortgages, all of those millions of mortgages out there and the supply of money to be the mortgages from banks. Those two things have to come together at the interest rate. The interest rate is just a price. And if there's more demand for mortgages than there is supply, then that 2.4% will go up. Not the RBA's part, the RBA sets that. But the bank part, that bank margin will... If there's more demand than there is supply, that'll go up. If there's more supply from banks and more competition between the banks, that'll go down. Now, before COVID-19, that was about 2.6%, that part. It's pretty stable, but sometimes it's more and sometimes it's less. But that is supply and demand in the market. And we see that... So it's not just in hospitality, in goods and services, it's in investments as well, all types of investments.

Kate:
I think that's really good to just start observing the world around you a little bit more and looking at what the banks are doing, just to start to get an idea of these concepts and how it all interacts. And as you've mentioned, those individual decisions lead into the prices. There are so many more things I'd love to ask you, but I don't want to overwhelm anyone in today's episode. So Sam, thank you so much for coming on today. And if you want to... If anyone wants to get in touch with you or check out some of your amazing courses, are you able to just tell us a little bit more about them?

Sam:
I have a YouTube Channel, which is Windlestone. If you Googled Dr. Sam Wylie, S-A-M and Wylie is W-Y-L-I-E. Whiskey, Yankee, Lima, indigo, echo, if that makes it easier. So if you just Google Dr. Sam Wylie, then you'll come to my YouTube Channel. And you'll see also that I teach courses for private investors through our company, which is called Windlestone Education.

Kate:
I attended one of your webinars a few months ago and found it really beneficial. It was really a deep dive into inflation and how that impacts investors. So I definitely recommend checking Sam's channel ad, and I'll make sure I include it in the show notes so you can easily access it as well.

Sam:
Brilliant. Thanks for inviting me, Kate. Really enjoyed it.

Kate:
Thank you so much, Sam. I'll definitely have to get you back for a part two.

Sam:
I'd love that.