The Impact of Interest Rate Cut on the Global Financial Planning Sector

[1]Leow Hon Wei
[1]SEGI International University

INTRODUCTION

The frontier of world economy, the US, experienced negative interest rate in the aftermath of the 2008 Global Financial Crisis. The recovery of the world economy remains suffocated in the competitive environment as globalization increases, inevitable for world financial planning industry. According to Thomson Reuters, on 16 February 2016, Bank of Japan launched negative interest rate as a stimulus plan to encourage banks to lend, businesses to invest and households to spend, reflecting Japan's lack of strategies to accelerate economic growth as global financial markets sputter. In addition, many countries also adjusted the interest rate as a radical plan. The following table shows the parity in interest rates as set by the central banks in global financial hubs.

Major Financial Hub Countries	Current Interest Rate	Previous Interest Rate	Last Change
Hong Kong	0.5%	1.5%	December 2008
United Kingdom	0.5%	0.5%	February 2016
Japan	-0.10%	0.10%	January 2016
US Federal Reserve	0.5%	0.5%	December 2015
Singapore	0.19%	0.65%	January 2016

Source: http://www.fxstreet.com/economic-calendar/world-interest-rates/ and http://www.tradingeconomics.com/country-list/interest-rate

The reduction in interest rate by the central bank is a common tool in most developed countries to accelerate the growth of economy. The challenge of financial planning is more crucial for individuals, businesses and as well as government. As it brings significant negative impact to the financial planning sector, the objective to achieve financial independence, business expansion and government budget planning through wealth accumulation will be affected.

In normal circumstances, the growth of interest rate is essential in financial planning. The interest rate is used and applied in life financial planning such as investment planning, retirement planning, education planning, cash flow planning, net worth analysis and so on. There are some impacts of low interest rate on global personal financial planning and industry.

Correspondence: lh_wai@hotmail.com

MFPC Malaysian Financial Planning Council Competence.Ethics.Standards
RFP Your Pathway to Professionalism
Shariah RFP A Premier Financial Planning Designation of MFPC

Insurance Plannning

Cash Flow Planning Net Worth Analysis → Investment Plannning → Education planning / Retirement planning / Estate planning

Tax Plannning

First and foremost, investment planning is defined as the management of financial resources for the purpose of accumulating funds to meet financial goals. When there is an interest rate risk, the worst scenario might be portfolio returns from the computation of investment portfolios will be diluted as the performance of single asset turns less attractive as interest rate decreases. For example, as the rate of return of fixed deposit decreases, this will cause the total interest received to reduce. For the longer period, the compounding effect of interest on interest will be diluted. The same implications apply to other investment assets as a whole. Therefore, the wealth accumulation based on the expected growth in investment planning will be affected.

Second, retirement planning is defined as the management of lifestyle choices immediately after the paid job ends. The primary sources of retirement funds come from EPF funds and various investments. If the interest rate declines, there is a high possibility that it will directly impact portfolio returns. In addition, if the interest rates do not improve in future, either the retirement age will need to be extended to an older age or there will be a need to a retain higher retirement fund needed during the retirement stage.

Third, tax planning involves reducing the tax liability by well-considered exemptions, exclusions, deductions and allowances. The impact of low interest rate on individual tax planning is relatively low unless government policies change. This is more significant for those companies with high debt ratio.

Fourth, estate planning is defined as the management of assets of a person's wealth and assets after his or her death. The impact of low interest rate on individual estate planning is irrelevant because interest rate plays no role in affecting the decision on how the next of kin or beneficiary inherit the assets or estates.

Fifth, education planning involves the management of planning for the future educational needs of the children. If a person has a new born child today, basically he will need to accumulate for 18 years of education cost; the funds are highly correlated with the investment planning, a long term investment plan. Therefore, either you have to allocate more funding for education cost today or tolerate a longer tenure for the same source of funding.

Sixth, cash flow planning and net worth analysis are the priority before other planning. For example, if a person with cash flow deficit or has no cash flow, it is not viable and advisable to consider investment or protection; it may create unforeseen problems to the client. Therefore, the impact of low interest rate on cash flow planning and net worth analysis is least important.

Seventh, insurance planning is the management of long-term care coverage and very crucial. We are more concerned about risk reduction rather than interest rate volatility. However, it will directly increase the interest rate risk but not influence the insurance planning. You still need coverage immaterial of the fluctuation of interest rate.

In addition, there are numerous spillover effects that arise from interest rate fluctuation. If the interest rate is too high, it may cause the cost of borrowing from a loan to increase. Meanwhile, if the interest rate is too low, it may cause no growth on investment. An equilibrium needs to be obtained and interest rate needs to be adjusted depending on the current situation of each country.

The financial planning industry faces many challenges because there is a need to propose some new strategies to solve the issue of low interest rate. For instance, which sector correlates negatively with low interest rate and which company has the least impact when interest rate risk increases. In a nutshell, interest rate should be more volatile in future due to higher uncertainties and a competitive environment. ■