

### Business Essentials: Australian Interest Rates & Inflation in Context

Let's review what is happening with interest rates and inflation in Australia at the moment and provide an historical perspective and a simple case study comparison of the business impacts and possible timeframes that may apply.

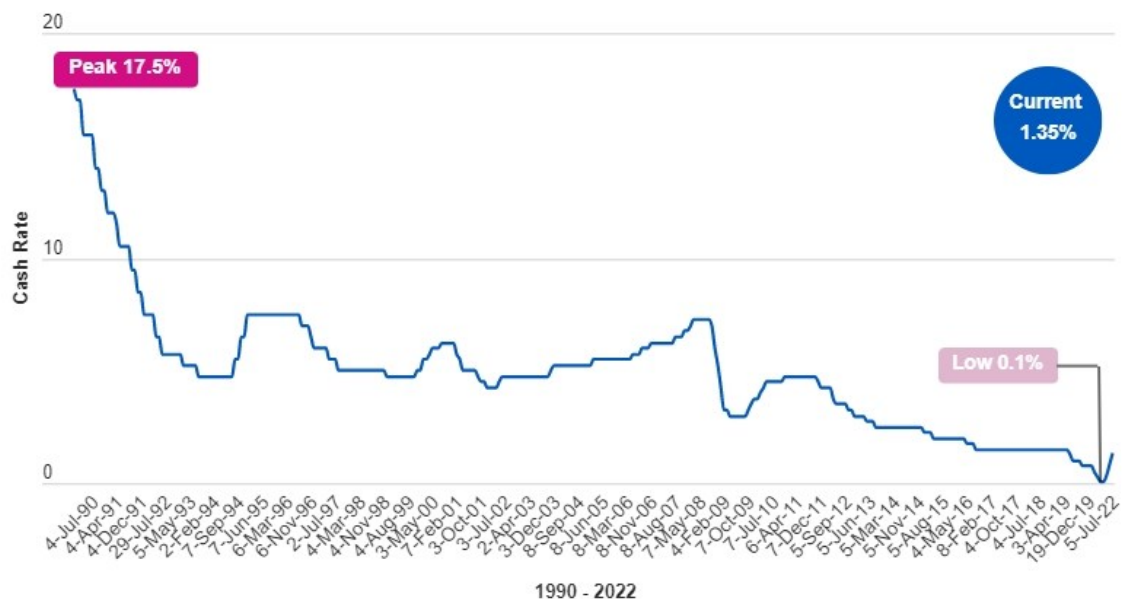
Relevant Time Frame	RBA Cash Rate (Interest %)	Inflation Rates (Actual/Indicative)	Top Personal Income Tax Rate (2) & Threshold	Company Tax Rate
August 1990	14.0% (1)	7.5%-	47% > \$50,000	39%
July 2022	1.35%	5.1%+	45% > \$180,000	30%/25% (3)
Changes	-12.65%	-2.4%	-2%/+\$130,000	-9%/-14%

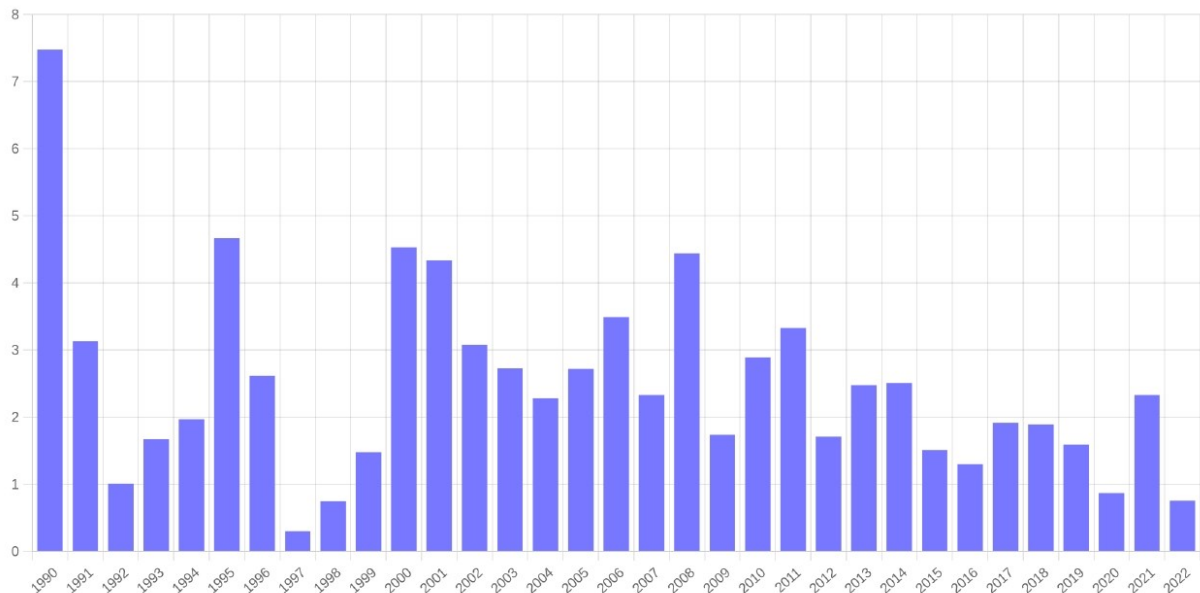
**Note 1:** The RBA Cash Rate declined to 5.75% by 8 July 1992 from a peak of 17.5% in July 1990.

**Note 2:** The personal Income tax rate excludes the Medicare Levy.

**Note 3:** The lower rate of company tax (25%) applies to operating companies carrying on primarily business activities and with aggregate turnover in a financial year of less than \$50M. These eligible lower rate companies are called "Base Rate Entities" by the Australian Taxation Office. This corporate tax rate differentiation did not exist in 1990.

## Australia's Official Cash Rate





Australian Annual Inflation Rate from 1990 to 2022

Sources: Reserve Bank of Australia (RBA) & ABS

So let's compare the two time periods with one another and tax effect the interest cost on borrowings for a business that is operated by an eligible base rate entity company (25% company tax rate) today.

**Assumptions:**

- Business Working Capital Loan facilities of \$5M;
- Average business loans interest rate margins of +5.0% over the applicable RBA cash target rates.

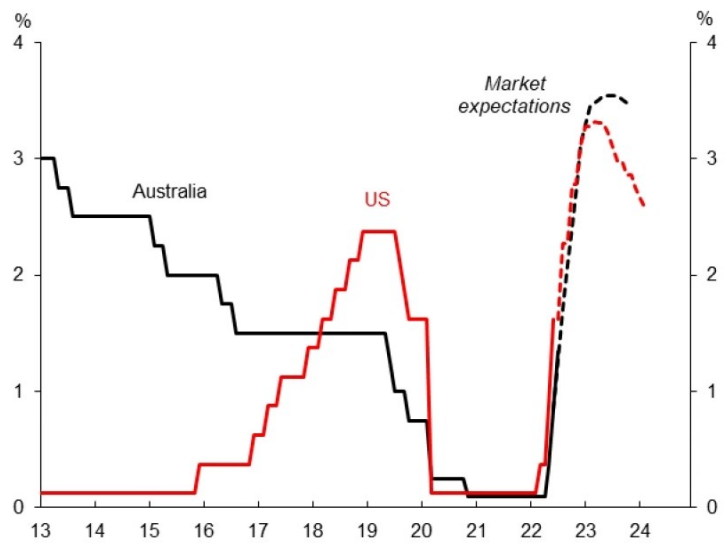
Year	Business Loan Facilities	Loan Interest Rate (Simple) pa	Loan Interest Amount	After Tax Cost of Loan Interest
1990/91	\$5,000,000	19.0%	\$950,000	\$579,500
2022/23	\$5,000,000	6.35%	\$317,500	\$238,125
Changes:		-12.65%	-\$632,500	-\$341,375
Total % Reductions			-66.6%	-58.9%

**Conclusions for Business**

At face value, this example (subject to the assumptions made in this case study) shows that a company today is significantly better off in the after tax cost of funding its working capital facilities and other business debt, whilst operating in a similar inflationary environment to 1990. Of course the example is simplistic, given it is based upon a snapshot in time comparison and the prevailing economic conditions can change very quickly, as illustrated by things such as:

- The reduction in the RBA cash rate in just two years - between July 1990 and July 1992 - (a reduction of 11.75% in the RBA target cash rate from the peak of 17.5%), when inflation also declined significantly in that same timeframe;
- The ongoing supply chain cost impacts on business today are significant, along with higher fuel, freight and energy costs on total overheads, that impact profitability, albeit with different industry sector effects;
- The normalised RBA cash rate target will most likely settle at around 2.5% to 3.0% (up from 1.35% now) in the next 12 to 18 months in Australia, with the Reserve Bank seeking to contain inflation – refer to the diagram below. This will further hit business cashflow and also customer demand (sales), because of personal cost of living increases and home loan repayment increases. This will generally continue to negatively impact many businesses profitability, in the short to medium term.

# RBA Cash Rate Expectations



Source: Bloomberg, RBA, Macquarie Macro Strategy

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