NEWSLETTER
August 2022

SHANLEY
FINANCIAL PLANNING

Introduction

Welcome to our August newsletter. As promised last month, we take a close look at the residential property market this month – and the news is good for homeseekers. We also look at how inflation and higher interest rates seem to be pushing the share market… higher. Enjoy and let us know if there is anything that you need from us.

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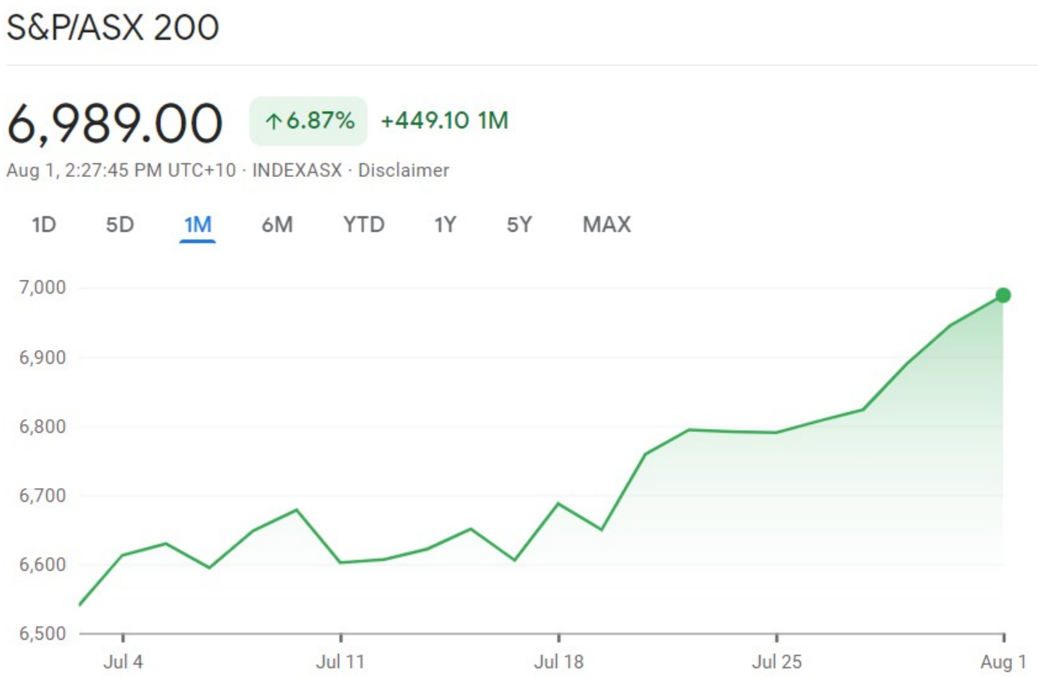
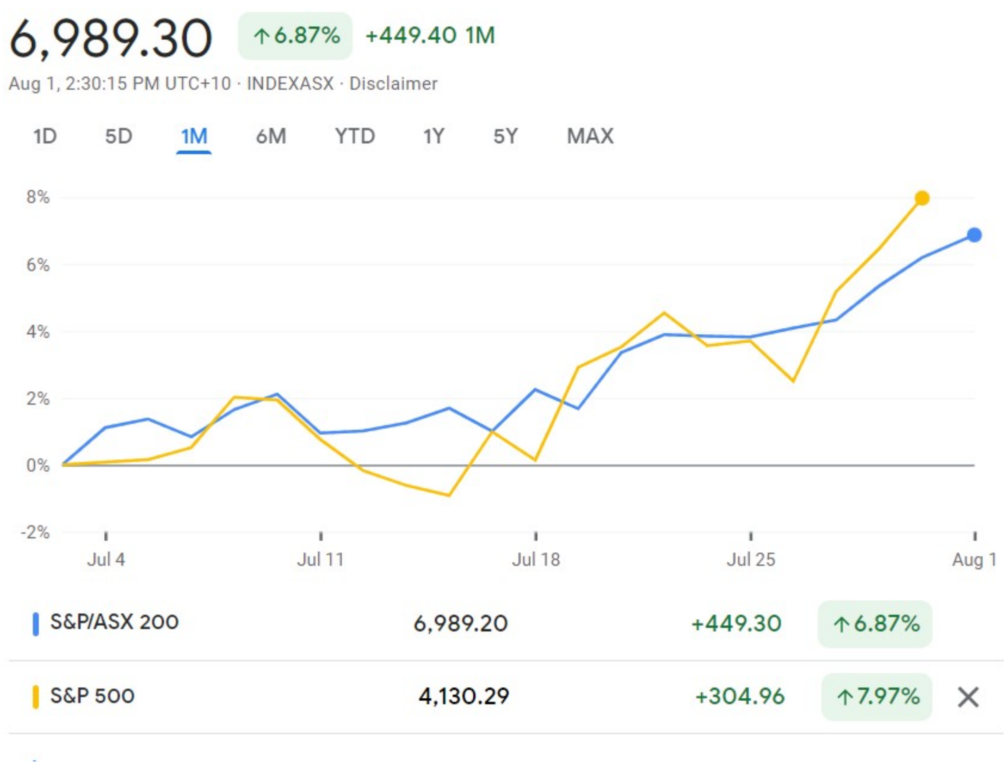
The Share Market

In the article below, we discuss how residential property prices fell in many places during July. As if to underscore the importance of diversification of your assets, the share market did the exact opposite. As measured by the ASX 200, the market rose by almost 7%. Here is how it looked, thanks to Google and the ASX:



If you are wondering what drove the market, look no further than the USA. Here is how the two markets performed during July, with the US market measured by the S&P 500:



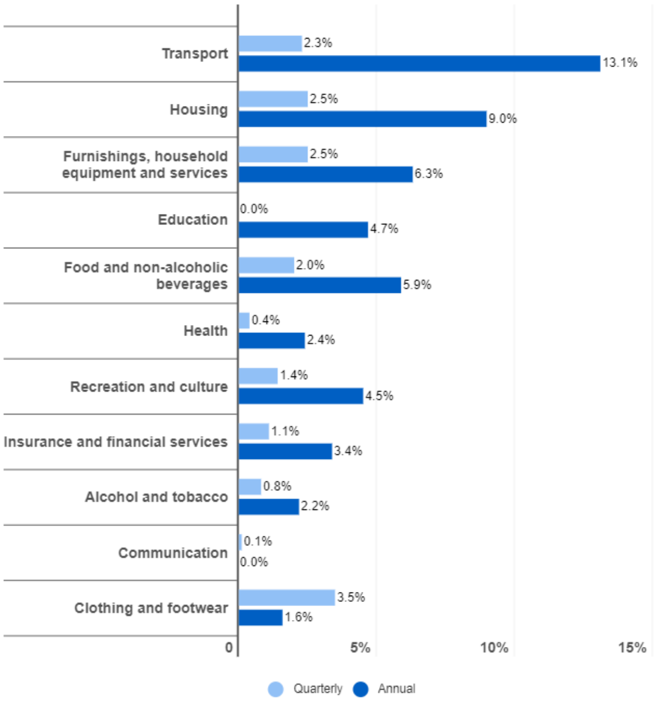
Once again, we see the Australian and US markets moving in very close alignment.

Inflation and Interest Rates

The performance of the two markets must be assessed against the backdrop of inflation that is occurring in both countries (and most other ones, as well). In the US, the latest inflation figures were released on July 14. They account for the lowpoint in US prices in the graph above, which also occurred on that date. And the figure was a large one: 9.1% on an annualised basis.

Australia's latest official inflation figure (the Consumer Price Index) was released a little later, on July 27. It was a 'milder' number than in the US, at 6.1%. It was also a lower figure than many people had been expecting.

As anyone who has driven past a petrol station lately will know, much of the increase in prices was related to transport prices. Housing was not far behind. The table to the right shows how www.news.com.au reported the quarterly and annual changes in prices in each of the categories used to compile the CPI.



Source: Australian Bureau of Statistics' Consumer Price Index data, released July 2022

Country	Last	Previous	Reference	Unit
Saudi Arabia	2.3	2.2	Jun/22	%
Japan	2.4	2.5	Jun/22	%
China	2.5	2.1	Jun/22	%
Switzerland	3.4	2.9	Jun/22	%
Indonesia	4.94	4.35	Jul/22	%
South Korea	6	5.4	Jun/22	%
Australia	6.1	5.1	Jun/22	%
France	6.1	5.8	Jul/22	%
Singapore	6.7	5.6	Jun/22	%
India	7.01	7.04	Jun/22	%
South Africa	7.4	6.5	Jun/22	%
Germany	7.5	7.6	Jul/22	%
Italy	7.9	8	Jul/22	%
Mexico	7.99	7.65	Jun/22	%
Canada	8.1	7.7	Jun/22	%
Netherlands	8.6	8.8	Jun/22	%
Euro Area	8.9	8.6	Jul/22	%
United States	9.1	8.6	Jun/22	%
United Kingdom	9.4	9.1	Jun/22	%
Spain	10.8	10.2	Jul/22	%
Brazil	11.89	11.73	Jun/22	%
Russia	15.9	17.1	Jun/22	%
Argentina	64	60.7	Jun/22	%
Turkey	78.62	73.5	Jun/22	%

Anecdotally, since the end of June (the time to which these figures relate), it looks as if petrol prices have fallen somewhat, which will reduce any inflation for the current quarter - assuming they do not rise again before the end of September.

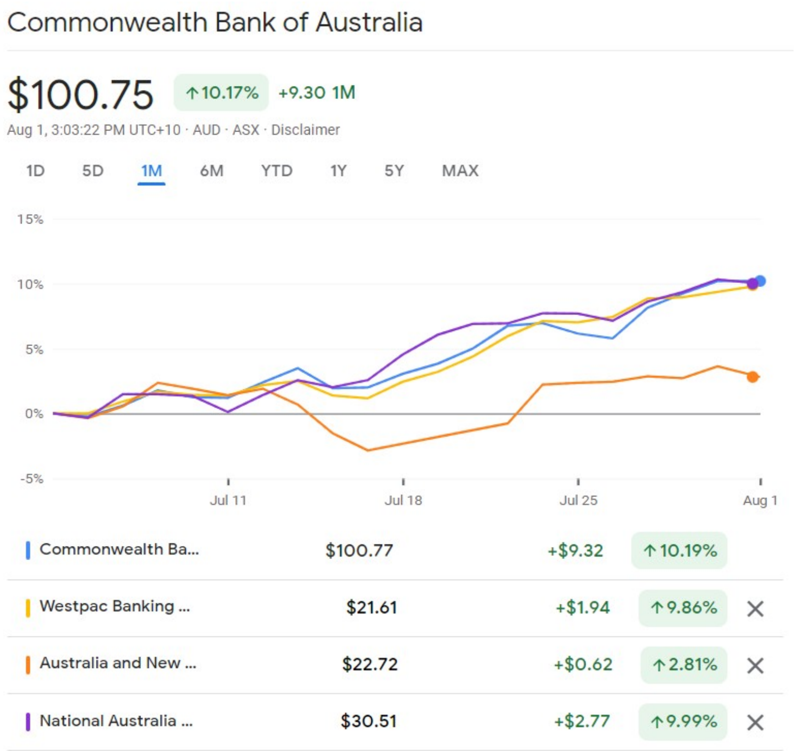
By world standards, Australia is actually not doing too badly when it comes to inflation. As the table to the left shows, of all the G20 countries, there is only a handful with lower rates of inflation than Australia. A few countries are really suffering, such as Turkey and Argentina. But only five countries are reporting lower inflation than Australia (South Korea is almost exactly the same).

One of the main responses to rising inflation around the world has been, of course, increased interest rates. Australian rates have risen in each of the past three months.

For compliance purposes, this newsletter is written before the Tuesday of the week in which it is published. This means that we do not know, as the time of writing, what the RBA did with interest rates on Tuesday of this week. But the entire market expects the current cycle of rising interest rates to continue. So, our economy will continue to feature both inflation and higher interest rates for some time to come.

One thing this data tells us is that share market investors in the US and Australia do not think that company profits are going to be negatively affected by rising inflation. This suggests that companies are confident that they will be able to pass on any rises in price of their inputs, keeping their profit margins healthy. This is the case even though most pundits are predicting that interest rates (and inflation) will continue to rise.

And, of course, we need to remember that higher interest rates themselves can be good news for some businesses – especially businesses involved in lending money. Higher interest rates mean higher prices and, because nothing else has changed, higher profits. This is what we are largely seeing. Here is how Australia's top 4 banks' share prices performed for the month of July:



All but one of the banks reported higher than average share price growth for the month, a reflection not only of the impact of previous rate rises, but also an indication that the share market expects rates to keep rising. Bank revenue is cirectly tied to interest rates.

So, share market investors remain optimistic despite (or maybe because of) rising interest rates and inflation. Unfortunately, the same cannot be said for residential property investors, as we write below.

The Residential Property Market

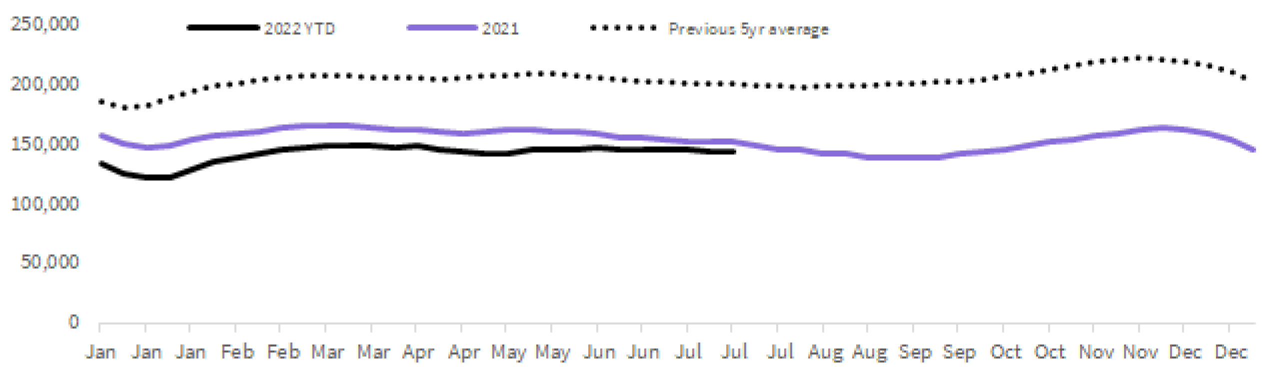
The news in residential property is changing. Last month, according to respected industry analysts Corelogic, prices in several markets around the country continued to drop, something we see only rarely.

The drops were the largest in Australia's two largest housing markets: Sydney and Melbourne. In Sydney, a monthly drop of 2.2% took the drop over the three months of May, June and July to 4.7%. These falls also meant that, between July 2021 and July 2022, prices in that market only rose by 1.6%. As we report elsewhere, for the 12 months to June 2022, inflation was a tad over 6%. When inflation generally rises faster than a particular asset type such as housing, then housing has become cheaper in inflation-adjusted terms. So, as long as people's incomes rise by at least 1.6%, Sydney housing became slightly more affordable over the last 12 months.

Melbourne's moves were also negative, although not to the same extent as Sydney. Brisbane, Hobart and Canberra also saw prices fall a little, but the influence of Sydney meant that the national average for capital cities was a fall of 1.4% for the month of July and 3.2% for the months of May, June and July. Here is how each of the capital cities looked, again thanks to Corelogic:

Index results as at 31 July, 2022	Change in dwelling values				
	Month	Quarter	Annual	Total return	Median value
Sydney	-2.2%	-4.7%	1.6%	3.4%	$1,087,376
Melbourne	-1.5%	-3.2%	0.3%	3.2%	$791,999
Brisbane	-0.8%	0.1%	22.1%	26.4%	$781,850
Adelaide	0.4%	3.6%	24.1%	28.3%	$650,047
Perth	0.2%	1.2%	5.5%	10.0%	$560,020
Hobart	-1.5%	-1.3%	10.1%	14.1%	$723,066
Darwin	0.5%	1.9%	5.3%	11.9%	$506,860
Canberra	-1.1%	-0.9%	12.1%	16.5%	$925,973
Combined capitals	-1.4%	-2.6%	5.4%	8.0%	$819,880
Combined regional	-0.8%	-0.2%	17.0%	21.1%	$600,105
National	**-1.3%**	**-2.0%**	**8.0%**	**10.8%**	**$747,812**

There is no great mystery as to why prices are tailing off in so many places. Firstly, they have risen extraordinarily over the last few years, so a correction of sorts was always going to happen. But the twin features of inflation and higher interest rates – and especially higher interst rates – has meant demand for housing has fallen significantly. As a result, prices are falling even though the total supply of housing to the various national markets has also fallen. Here is how this looks, again thanks to Corelogic:



As you can see, the 2022 line is below the 2021 line, and both are well below the average over the past five years.

Usually, lower supply of anything means higher prices, as the buyers in the market need to compete harder to successfully make a purchase. That prices are falling even in the face of lower supply tells us that demand has fallen by more than supply has fallen.

This is, of course, one of the risks associated with the RBA's strategy of increasing interest rates. If they do it to too great an extent, then they might create a spike in supply as people find their mortgages untenable. If supply were to rise, we could expect to see prices fall even further.

A widespread raft of sales induced by higher borrowing costs is unlikely, however. What we are probably seeing is a periodic correction to the fact that prices have risen – on the back of unusually low interest rates – so substantially since 2020. The whole point of a price peak is that you do not know you have reached it until prices fall a little bit. Until prices fall, you can't know whether you have reached the top. As prices are now falling in many places, we can conclude that prices probably peaked in early 2022.

If you bought right at the peak, you may be in for a year or two of difficulty. But in the long term, price peaks are a little like city buses: it is hard to know when the next one will come, but one will come, eventually.

The Legal Stuff

General Advice Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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