NEWSLETTER
July 2022

SHANLEY
FINANCIAL PLANNING

Introduction

Welcome to our July newsletter – our first for the new financial year. The end of the financial year has seen dips in the prices of shares and residential property, with higher interest rates the cause for both. In this newsletter, we take a really 'techy deep-dive' into what is driving interest rates higher. Enjoy!

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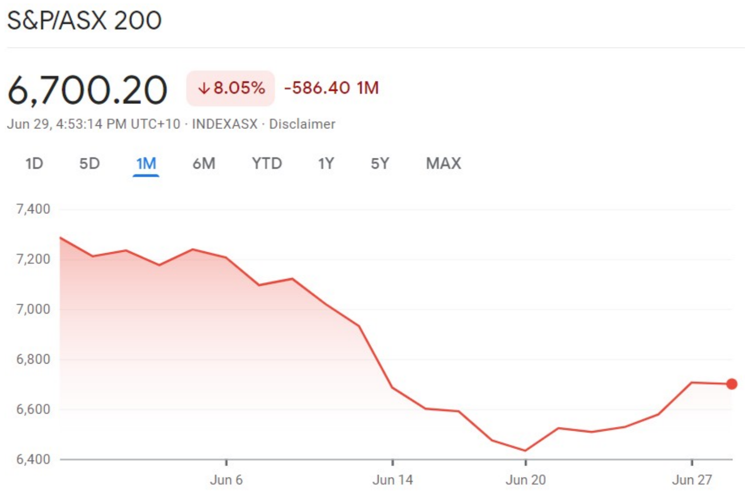
The Share Market

June is over and so therefore is the 2021/2022 financial year. This month, we want to give you a thorough review of the market's performance in the year just ended. Hopefully, the following is not too graphy and technical for you. If it is, then maybe go with this brief summary:

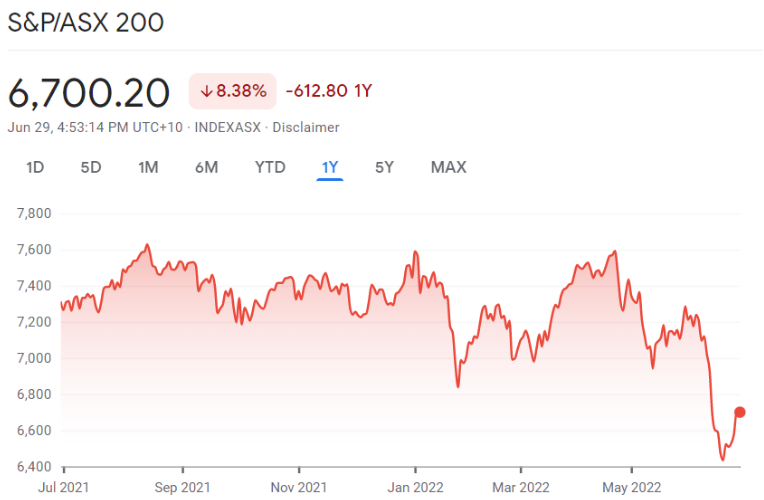
1. The market fell because of rising inflation;
2. Inflation rose because of global shortages in fuel and food;
3. These shortages are starting to lessen; and so
4. The smart people think that inflation will be lower in 2023. Share prices are ticking up accordingly.

Now for the more technical stuff…

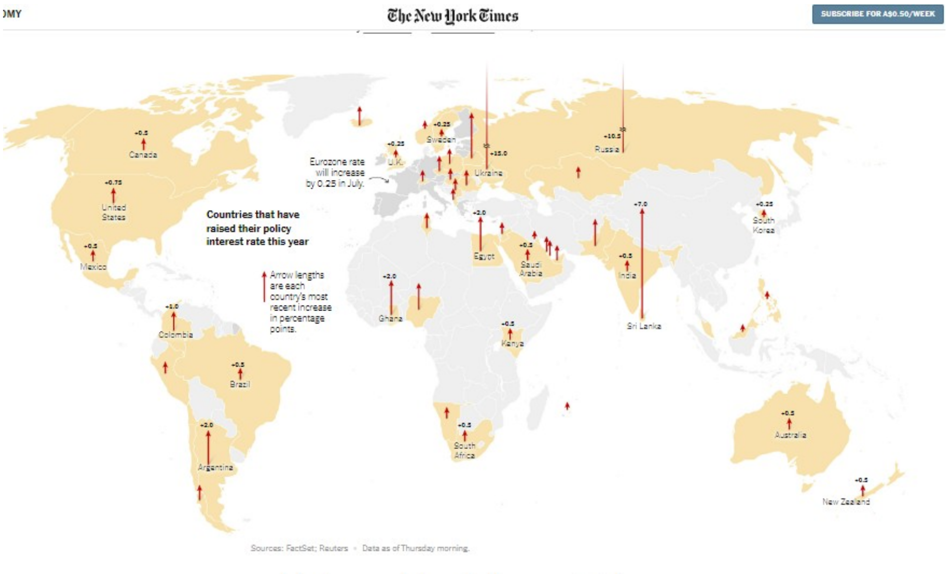
June was a negative month for share prices as measured by the ASX 200 index. We are actually writing this article on June 29, so things may change on the 30th, but for the month to Wednesday the 29th the market was down by more than 8% as measured by the ASX 200. Here is how it looked thanks to Google and the ASX:



As it happens, the monthly fall in June was almost the same as the performance for the entire year just ending. For the 12 months (again to June 29), the market was down only slightly more than 8.05%:

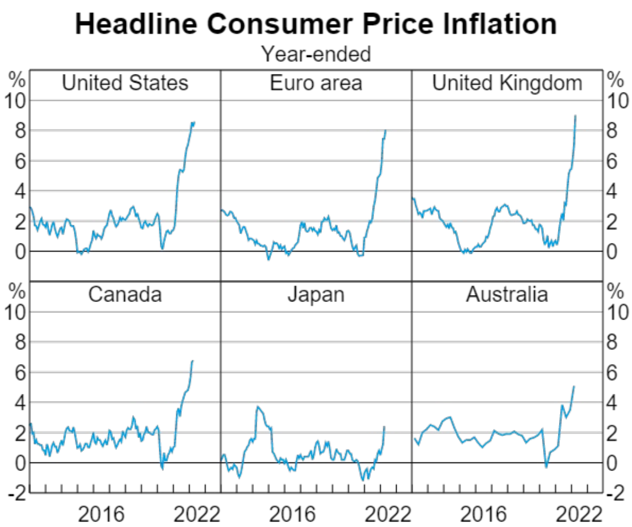


The reason for June's fall was pretty obvious. And it had little to do with anything specific about the Australian market. As you are probably aware, inflation has become a huge concern for most developed economies. And most of those economies have raised interest rates to try to address inflation. You can see just how widespread rising interest rates are in this wonderful graphic from the New York Times:



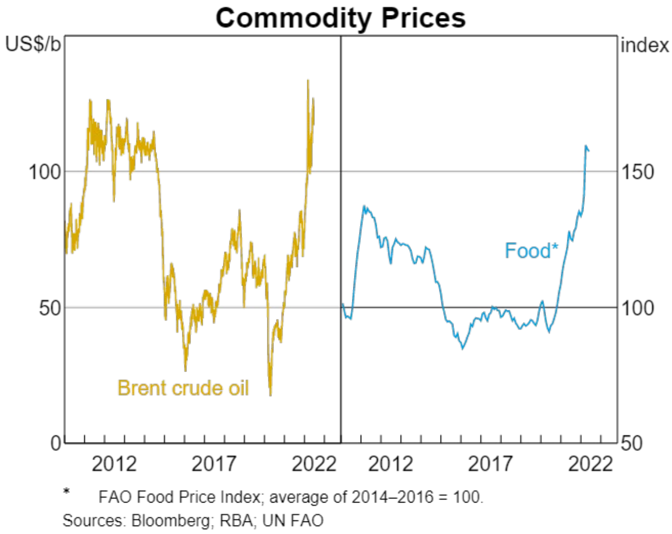
All those red arrows show countries where interest rates have risen this year. The Eurozone will join the herd in July, when its official target interest rate is also raised. As you may be able to see from the graph, Australia is a much better place to be than some other parts of the world, notably Russia and the Ukraine where rate rises this year have been in the double digits this year (no surprises there, really. Our thoughts remain very much with the people of the Ukraine at the moment, for whom economic disruption is only one of the troubles they current face).

Interest rates are rising virtually everywhere because inflation is rising virtually everywhere as well. This was explained recently by the Governor of Australia's Reserve Bank, Philip Lowe, in a speech he gave to the American Chamber of Commerce in Australia. Governor Lowe pointed out that the inflation is a major issue in most developed economies, but that Australia is doing relatively well, as this graph shows:



Sources: ABS; RBA; Refinitiv

Governor Lowe also pointed out that the current inflation is being driven by global shortages in key commodities such as fuel and food. This is distinct to the other major way that inflation can arise, when higher prices are caused by increased demand. Global shortages mean that prices for both fuel and food are at their highest for at least the last ten years:



The rising prices for these items are due to a number of global factors, mostly to do with the lingering effects of Covid-19 on supply lines and, of course, Russia's invasion of Ukraine. The immediate impact of the invasion on global wheat prices, for example, is shown in this graph from Macrotrends (the invasion started in the last week of February):

If you look closely at this graph, however, you can actually find some some comfort and cause for optimism. The global wheat price is falling back towards its level before the Ukraine invasion. This is because, as Fortune Magazine reports, many wheat growing parts of the world, including Australia, are stepping up their production of wheat. In Australia, increased supply is also down to all that rain we have had – a silver lining to that dark cloud, perhaps.

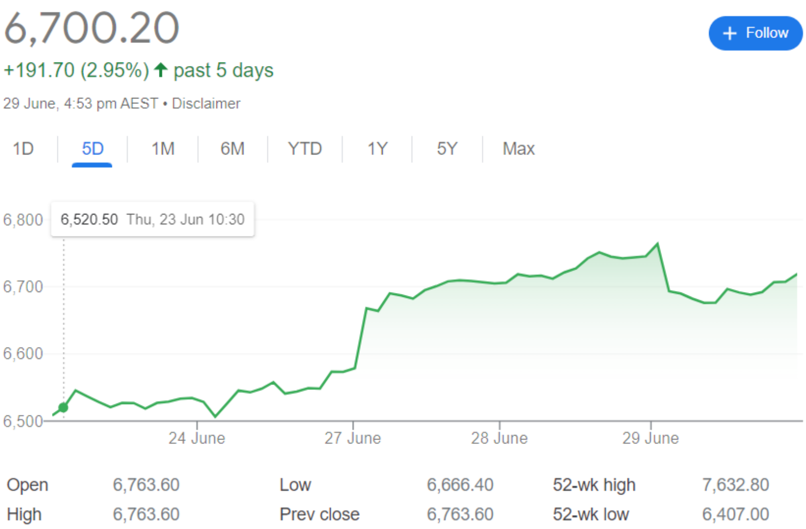
This is an example of the 'signalling' role that prices play in market economies. When prices rise, this can be a signal to people that the market needs more of that particular thing. Over time, production of that thing will increase as producers chase increased profits. This has definitely happened with wheat here in Australia, as the amount of land being used for wheat is at an all time high in 2022.

Similarly, increased prices can signal to buyers that they should try to find a cheaper alternative. In this case, the higher price tells people that other items are now relatively more cost-effective and thus worth considering. As people switch to the cheaper alternatives, this reduces demand for the original item, bringing its price down (or at least slowing its growth) and helping to bring inflation back under control. This is especially the case where the supply of the new item is not as limited, as the increased demand does not cause the price of this item to rise.

This is one reason why some commentators think that the current state of higher fuel prices will be good for the environment through stimulating demand for renewable sources of energy.

So, when inflation is caused by supply shortages, people react in one or both of two ways: produce more of the higher-priced items and purchase less of the same items. Either or both of these things will help bring prices down again – or at least help to stem the rise in prices. This is why in his speech to the Americans Governor Lowe told us that he and the RBA think that inflation will moderate in 2023. The current inflation, while very high, is not expected to last.

Governor Lowe gave that speech just last week, and we can see the impact of this kind of realisaion on the share market performance in the few days since. During the final week of June, the market bounced back almost 3% as investors looked more closely at what was driving our inflation and interest rate cycle:



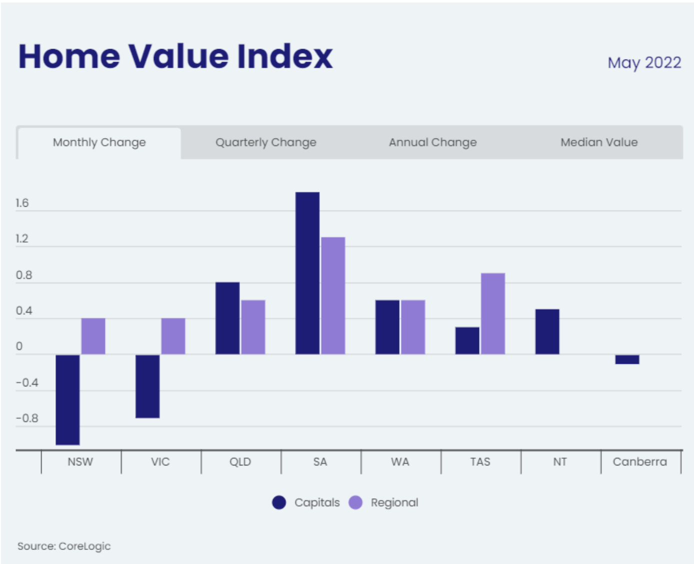
So, while the share market ends this financial year lower than it began, we also see further evidence of a truism that any longer-term investor must understand about volatile markets like share markets. Things are never as good or as bad as they seem.

The Property Market

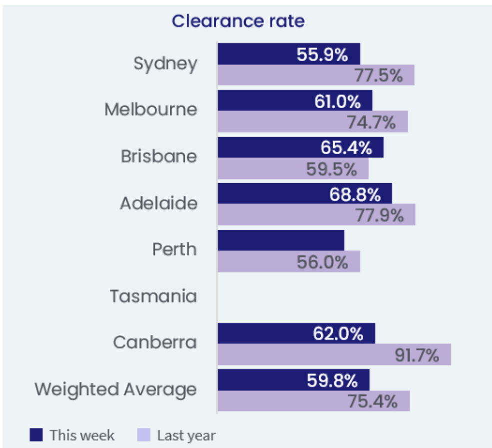
Rising interest rates have obviously impacted the share market. Residential property right now is also all about interest rates. Rates have risen substantially lately, and may rise yet further next month. As most residential property is at least in part debt-financed, this means that the effective cost of buying residential property is rising. This would normally see prices fall.

Rates have only recently started to rise, but the early evidence indicates that falling prices may be occuring. In early June, market researcher Core Logic reported that median prices in Australia's largest two residential property markets fell during the month of May. Sydney was down 1% and Melbourne was down 0.7%. Canberra was the only other capital to fall (0.1% down for the month), but such is the impact of Sydney and Melbourne on the nation, the national median house price was 0.3% lower in May than in April.

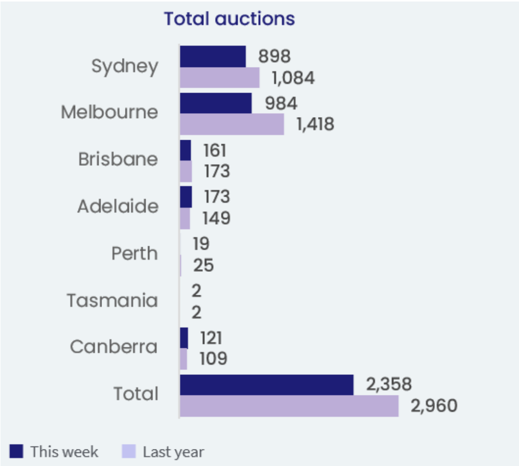
Here is how each state and territory looked during May:



More recently, the number of properties being successfully sold at auction has also fallen. A year ago, more than 75% of the properties presented nationally to the market via auction sold at that auction. In the week just passed, that number fell to less than 60% nationally. Again, here is how it looks thanks to Corelogic:



What's more, there were far fewer properties being presented to auction, with 20% fewer homes being sold via auction last week than at the same time last year:



So, there were fewer properties being auctioned and a smaller proportion of properties were then successfully sold. This means that there were substantially fewer property sales last week than there were at the same time last year.

More properties passing in at auction reflect two fundamental changes: buyers are less willing to pay higher prices and vendors are less willing to sell for lower prices. In an enviroment of rising interest rates, this fall in volume will somewhat cushion any fall in home prices – provided that it is sustained. Prices can really start to fall when people are forced to sell their homes even when they do not want to – that is, when vendors have to accept lower prices.

Interest rates have risen sharply, but they remain at historically low levels. That said, many commentators are expecting rates to continue rising. The RBA Board meets next Tuesday and their subsequent announcement will be watched with interest. One thing we can say is that interest rates will not fall any time soon. The era of record-low interest rates is over.

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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