NEWSLETTER
October 2021

SHANLEY
FINANCIAL PLANNING

Introduction

This month we are going back to basics. An overview of the share market and a bit more of a deep dive into residential property prices and the way in which housing affordability has become a problem that regulators need to address. Let us know what you think!

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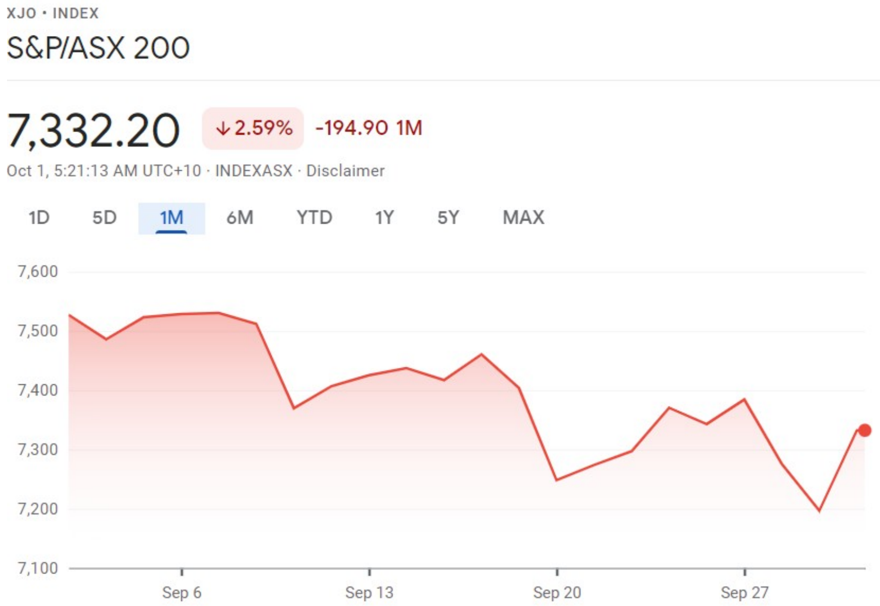
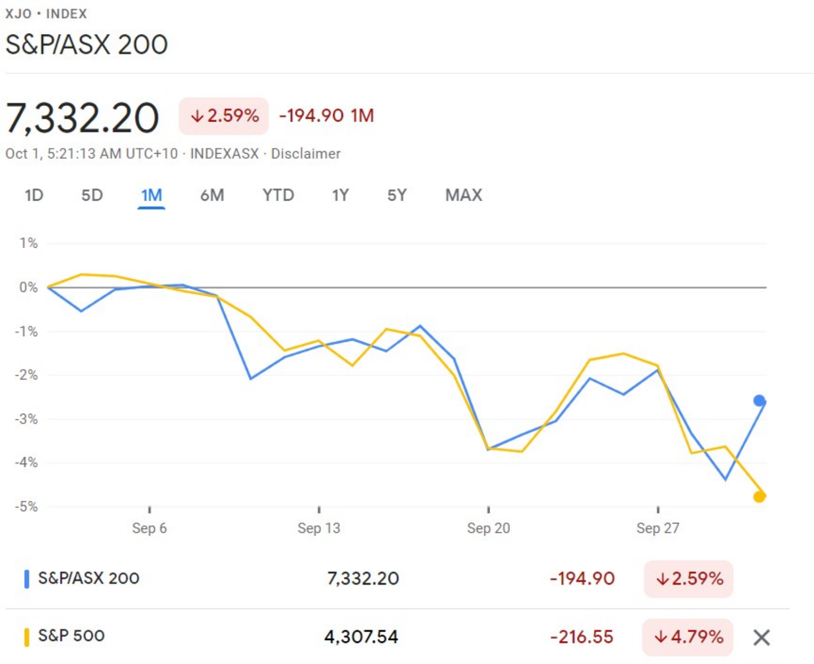
The Share Market

In September, the Australian share market (as measured by the ASX) did an unusual thing. It fell! Here is how the month looked, thanks to Google and the ASX:



As you can see, the market fell by 2.59% during September. As often happens, this fall was linked very closely to the state of the US market. That market fell by even more during the month of September (again, with thanks to Google, the ASX and, this time, S&P):



In the second graph, you can see that the us market fell by 4.79% for the month. Unfortunately, this does not really mean that the Australian market 'outperformed the US market. The difference is really due to time differences. On the first day of October (the day before this newsletter was written), the Australian market fell by a further 2%, bringing it into very close proximity to the US experience for September.

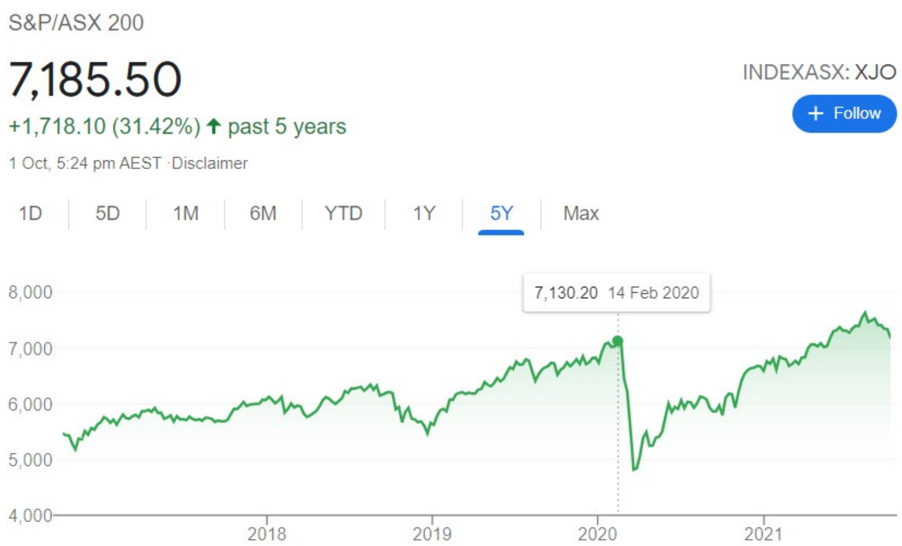
Somewhat strangely, this year's price performance in September is very consistent with what is sometimes known as the 'September effect.' Put simply, prices on the US market have been observed over a long period as tending downwards in September. According to an article by Business Insider, September is actually the worst month on the US market, and the average return in September has been negative since 1928. Indeed, prior to this year, average prices had fallen in 54% of Septembers since 1928.

The article from Business Insider seems to be putting things mildly. This article, from JP Morgan Chase, reports that prices on all the major US indices have averaged negative returns in September over a long period of time. As the article puts it:

> *"Historically, the market's three leading indexes lagged in September, with the Dow Jones Industrial Average (DJIA) having an average decline of 0.7% in September between 1950 and 2020, while the S&P 500 averaged a 0.5% decline during this timeframe. Meanwhile, the Nasdaq Composite has fallen an average of 0.6% in September since it was first established in 1971."*

No one really knows why prices often fall in this particular month. It is probably just coincidence: random chance tells us that one of the 12 months of each year has to be the one with the worst results historically. So the effect is probably not one to bet the house on.

That said, the fact remains that, as of the close of trade on October 1, the Australian market had 'given back' all of its gains since June. Things are not yet grim, though: prices remain higher than they were before the pandemic and higher than they have ever been prior to June of this year, as shown in this longer-term graph from Google and the ASX:



We have marked the previous peak from February 14 2020. There is still a lot of green in this graph, and it is also the case that prices have risen by an average of 31.42% over the past 5 years. If you add in a dividend yield of 4% per year, this means that share market investors have still received a return of about 10% per year since 2016.

Not bad. Not bad at all.

Residential Property Markets and Housing Affordability

Typically, our monthly update on the state of residential property markets uses data from a commercial provider such as Corelogic, who we like a lot. This data is reliable but it can be prone to the problem of needing to be 'first to market' with research. The Australian Bureau of Statistics (ABS) is not affected by the demands of the news cycle. ABS data takes a little longer to arrive, but when it does we can be quite sure of its accuracy.

The time taken to compile data is why it was only in September that the ABS released data for movements in prices in the residential property market in the June quarter and the 2020/2021 year. The data shows that the weighted average of prices in Australia's eight capital cities (the six state capitals plus Darwin and Canberra) rose by 6.7% during the three months of the June quarter, and 16.8% for the twelve months ending on June 30 2021.

Within that weighted average, actual rises for the quarter ranged from 8.2% in Canberra to 4.6% in Darwin. Here is how prices moved for each of the capital cities, for the quarter and the year ending June 30 2021:

Residential property prices	Mar Qtr 21 to Jun Qtr 21	Jun Qtr 20 to Jun Qtr 21
	% change	% change
Weighted average of eight capital cities	6.7	16.8
Sydney	8.1	19.3
Melbourne	6.1	15.0
Brisbane	5.7	14.6
Adelaide	5.3	14.2
Perth	4.8	15.0
Hobart	6.3	17.7
Darwin	4.6	12.8
Canberra	8.2	19.1

As you can see, the quarterly performance reflected the annual performance. Canberra rose by the second most for the year (19.1%, just trailing Sydney's rise of 19.3%), with Darwin 'only' rising by 12.8%.

Increases like this are extraordinary and - to be honest – we hope they do not continue. To put it into perspective, prices rising by 19.3% pre year will double in less than four years (actually, it is about 3 and ¾ years – 45 months). Rises like this are unsustainable.

Across Australia, the ABS recorded that there are 10,679,500 residential dwellings ('dwellings' refers to all types of residence, including freestanding houses, units, apartments, cabins etc). The average value (based on the prices being seen in June 2021) of each dwelling was $835,700. To put this in perspective, elsewhere the ABS report that in May 2021 (the latest month for which there is data), the average annual income for a full-time employed Australian was $90,324. So, it takes an Australian working full-time for average earnings 9.25 years of work to purchase the average dwelling.

These earnings are, it has to be noted, pre-tax. The Australian Tax Office has a groovy little calculator that tells us that an annual income of $90,324 would lead to tax of $19,822. So, the average after-tax income is $70,500. This is important because the actual purchase price of dwellings must be paid *after tax*. Using this after-tax income, we now see that it takes a person earning an average income just under 12 years of full-time work to afford the average Australian dwelling.

That is a lot of work to buy the average home. The relationship between income and the price of housing is sometimes referred to as 'housing affordability.' The longer a person would have to work to buy a home, the less affordable housing becomes. The 2020-2021 was a terrible year for housing affordability, because average incomes did not grow at anything like the same pace as the average prices of property. Here is the data for rises in average earnings for the month of May 2021 and the 12 months to the end of May 2021:

		May 2021	May 2020 to May 2021
		$	% change
Seasonally Adjusted	Full-time adult ordinary time earnings (a)	1,737.10	1.4
	Full-time adult total earnings	1,798.00	1.6
	All employees total earnings (a)	1,305.80	0.1
Original	Full-time adult ordinary time earnings	1,737.10	1.4
	Full-time adult total earnings	1,797.00	1.6
	All employees total earnings	1,305.80	0.1

(a) This component is not seasonally adjusted.

Sadly, there remains a discrepancy between the incomes paid to women and the incomes paid to men. Here is the same data, this time divided between men and women:

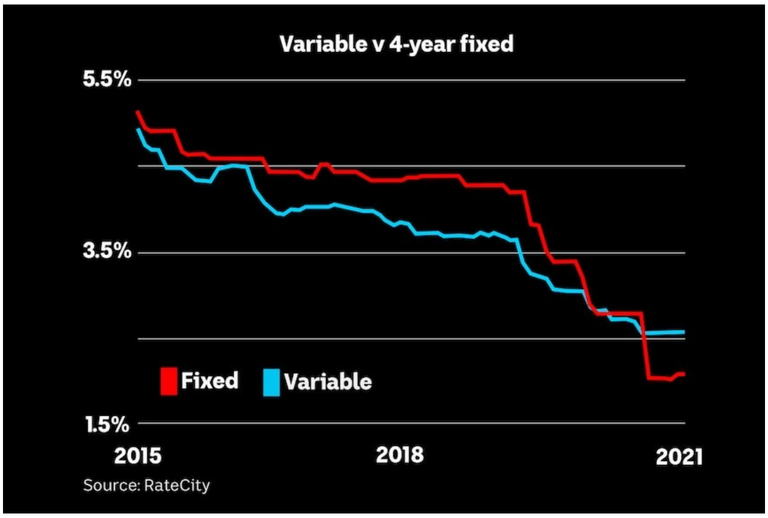
		May 2021	May 2020 to May 2021
		$	% change
Males	Full-time adult average weekly ordinary time earnings (a)	1,837.00	1.4
	Full-time adult average weekly total earnings	1,921.10	1.6
	All employees average weekly total earnings (a)	1,555.30	1.1
Females	Full-time adult average weekly ordinary time earnings (a)	1,575.50	1.1
	Full-time adult average weekly total earnings	1,597.80	1.3
	All employees average weekly total earnings	1,069.10	-1.3
Persons	Full-time adult average weekly ordinary time earnings (a)	1,737.10	1.4
	Full-time adult average weekly total earnings	1,798.00	1.6
	All employees average weekly total earnings (a)	1,305.80	0.1

(a) This component is not seasonally adjusted.

Women earn, on average, just over 90% of what men earn. Using this simple figure, we can adjust the 12 year figure for how long an average person would have to work to buy an average home at June 2021 prices. For women it is 13.15 years while for men the time falls to 11.29 years.

Why has this happened?

At first glance, it does not make much sense for housing to have become so much less affordable during a pandemic when so much of the country was in lockdown. But it did. There are a few reasons for this, but one of the most obvious is the fact that interest rates are at all time lows, as shown in the graph from the ABC:



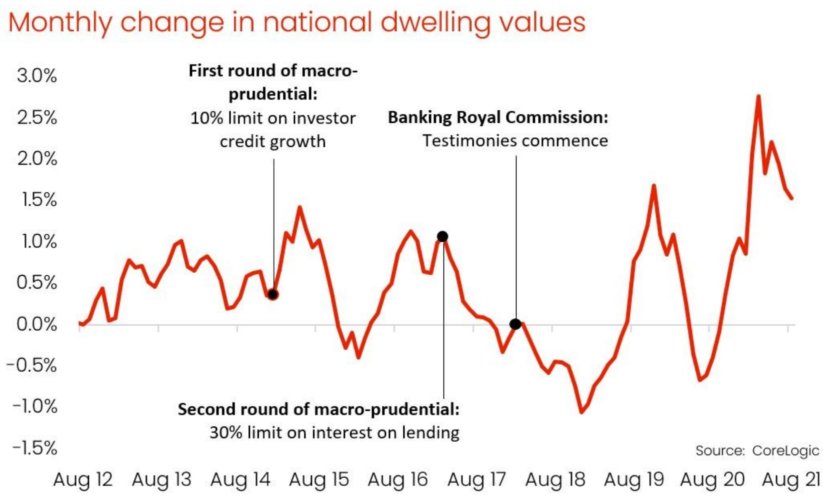
As you can see in the graph, interest rates have fallen dramatically, and fixed interest rates fell by even more than variable rates. This has made servicing loans a lot easier, which means that borrowers are 'qualifying' for increasingly large loans. This essentially stokes demand for housing, and increased demand will always drive prices higher unless it is met by an equally large increase in supply. Obviously, in Australia supply has not kept up.

Unfortunately, while it is true that lower interest rates mean that people can borrow more to pay the same amount of interest, it can easily be forgotten that the actual amount borrowed has to be repaid. And this amount has to be repaid using after-tax income. Even if interest rates have fallen, borrowing more still means repaying more. This is why the number of years a person has to work has been increasing – it is not related to the amount borrowed (and spent), not the rate of interest that applies.

What might be done about this?

The RBA has repeatedly said it will not act to raise interest rates any time soon. Last week, the Federal Treasurer warmed the Australian market to the idea that other interventions designed to reduce demand for borrowed money are being considered.

These interventions are usually known as 'macroprudential' measures. In recent history, we have had two sets of macroprudential measures introduced to dampen demand in the housing sector. Both of them targeted residential property investors. As this graph from Corelogic shows, they had the effect of reducing the rise in house prices, and indeed led to small falls in prices:



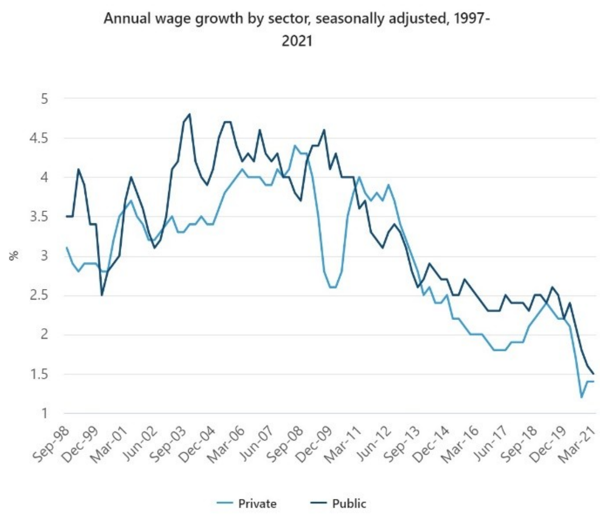
(The Royal Commission into the behaviour of banks saw people borrow less as well. That effect seems to have worn off!)

Measures like these are a far better way to improve housing affordability than doing things like giving grants to first home buyers. This is because giving people money to spend on housing stokes demand, which leads to higher prices. A far better way to improve affordability is to reduce demand, which usually means taking potential buyers out of the market. That is what the two previous rounds of macroprudential measures did: they discouraged investors in particular, which meant there were fewer people competing to buy housing.

The challenge for regulators and the Commonwealth Government is that they do not want to see house prices actually fall. A fall would be a 'double whammy' for people who have recently bought a place in particular, as they have paid more and then watched their assets reduce in value. Their loan to valuation ratio would also automatically rise. But prices falls are likely to be unpopular for anyone who already owns a property, as they will feel poorer as a result.

In a perfect world, regulators would be able to dampen demand to keep prices steady while average wages rise by a larger amount. Rising average wages mean that it takes less time to earn enough to buy a dwelling – as long as dwelling prices do not rise (or at least do not rise by as much).

Unfortunately, wages are simply not rising by much at the moment. The data above, showing a rise of just 1.4% for the 12 months to May 2021, continues a long-time trend as shown in this graph from the ABC:



Source: Australian Bureau of Statistics, Wages rose 0.6% in the March quarter 2021

Again, to put things in perspective, an annual rise of 1.4% means it would take 51 years for wages to double. Given that recent growth rates in house prices would see prices double in less than four years (if they continued), the problem seems stark.

So, unfortunately, it looks like low housing affordability may be here to stay for a while. It is going to continue to take longer to earn the money needed to buy a home. There is not much that a person can do about this – other than to reset their their expectations about owning a home. People simply need to accept that, for the foreseeable future, it will take more years of their working life to buy a home.

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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