NEWSLETTER

August 2023

2020 Financial Services

" A clearer vision for your financial future "

Introduction

Welcome to the August 2023 newsletter. We take a close look at rental returns, see what impact lower global inflation is having on world share markets, and enjoy the fact that the RBA decide to not increase interest rates again this month.

Glenn Bosse

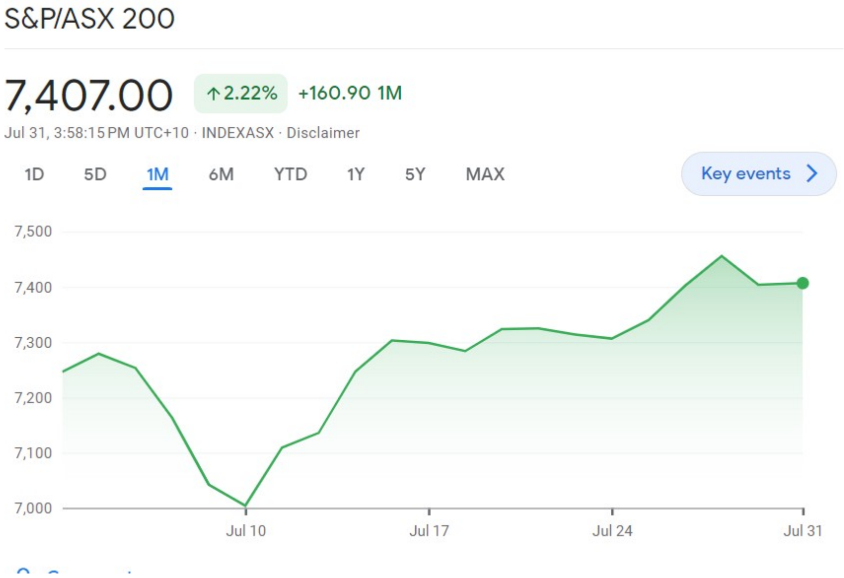
0416 082 117

glennb@2020financialservices.com.au

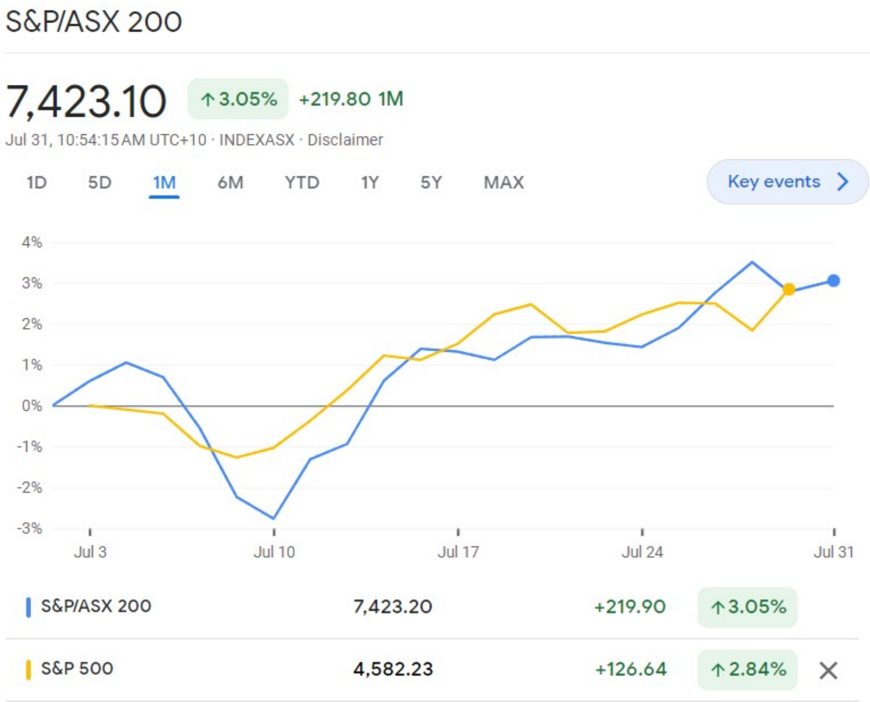
2020financialservices.com.au

The Share Market

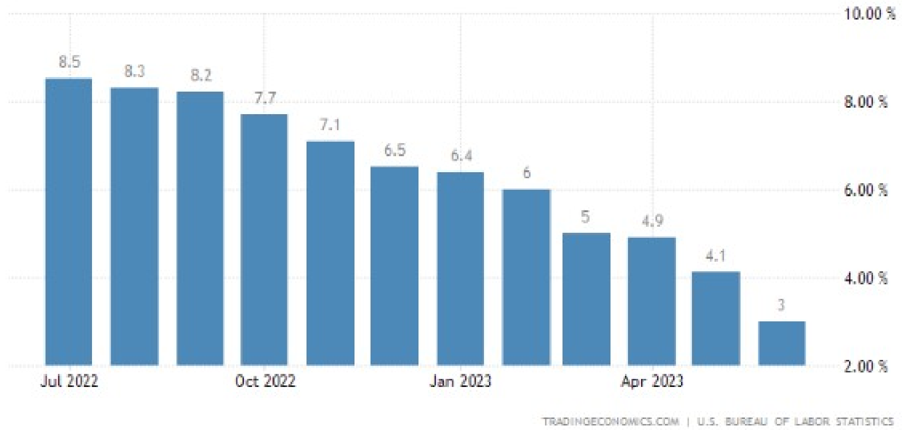
The first month of the 2023/2024 calendar year was a good one for share investors. The market rose by around 2.2% for the month to July 31. Here is how the market looked, as measured by the ASX 200 (thanks to Google and the ASX):



As is so often the case, the Australian market basically took it's lead from the world's largest stock market, the New York exchange, which rose by almost exactly the same amount as our market. Here is how the performance of the two markets looked, side-by-side, with the US market being represented by the S&P 500:

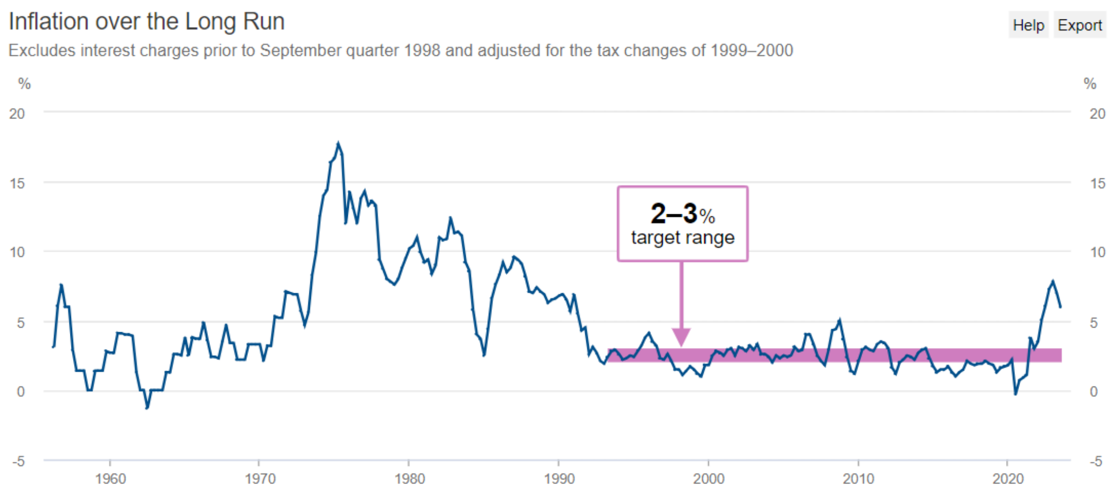


A 2.2% return for one month is a very good one. The upswing happened because the market took a turn to the positive mid-month when the US data on inflation came out. US inflation has turned down quite stunningly, as shown in this graph from Trading Economics:



One year ago, annual inflation in the US was 8.5%. In June of this year, it was down to 3%. Like the Australian central bank, the US Federal reserve sets a target for inflation. However, their target is a little more precise than ours: they aim for 2% per year, whereas we aim for inflation to be within a range between 2 and 3%. But 3% is quite close to 2%, giving confidence to markets.

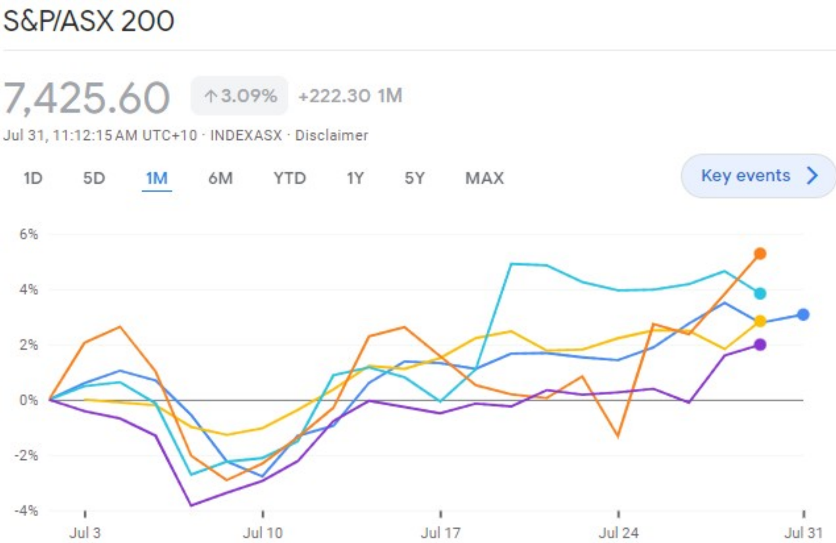
In many ways, having a target range for inflation is a good idea, if for no other reason than that it is easier to hit a bigger target! Here are two graphs showing the longer-term rates of inflation in the US and Australia. For the US, Trading Economics give us the twenty-five year experience, while for Australia we look at a 70 year time frame courtesy of the RBA:



Sources: ABS; RBA

The Australian graph highlights when inflation targeting was introduced in the early 1990s. As you can see, inflation has been either within or below the range for most of the time since, only breaking out following the pandemic and Russia's invasion of Ukraine.

We will discuss inflation in a little more detail below. But for now, in terms of the stock market, the basic idea is that US prices seem to be reverting to a more normal course. This has happened without the economy being slowed so much that it enters recession, and this has in turn caused optimism in world stock markets. The optimism is not limited to the US and Australia. As this comparison shows, the London, Hong Kong and German indices all performed similarly – and similarly well - in July:



S&P/ASX 200	7,425.30	+222.00	↑3.08%	
S&P 500	4,582.23	+126.64	↑2.84%	×
FTSE 250 Index	19,124.14	+707.38	↑3.84%	×
Hang Seng Index	19,916.56	+1,000.13	↑5.29%	×
DAX PERFORMAN...	16,469.75	+321.85	↑1.99%	×

The Residential Property Market

This month, we thought we should focus a little more closely on rental returns, rather than capital growth, in residential property. This builds a little on what we discussed last month, when we highlighted that rental vacancy rates were at historic lows across both capital city and regional markets. Here is how the rental situation looked graphically, thanks to Corelogic:

Low vacancy rates mean that the supply of rental housing is low relative to the demand for it. Basically, anyone who owns a place to rent is finding it very easy to find a tenant to live in that property. Demand rising relative to supply usually means price rises in most markets, and rental markets across Australia have been no exception. Once again, here is a table from Corelogic showing the extent to which rental values increased for houses and units in the 2022/2023 year:

Suburb market rent increases FY 2022-23

Volume and portion by capital city, region

Houses | Units

Region	Suburbs analysed	Annual rent rise #	Annual rent rise %
Sydney	504	463	91.9%
Melbourne	323	317	98.1%
Brisbane	276	275	99.6%
Adelaide	197	197	100%
Perth	240	240	100%
Hobart	39	25	64.1%
Darwin	28	20	71.4%
Canberra	79	2	2.5%
Regional NSW	370	286	77.3%
Regional Vic.	158	150	94.9%
Regional Qld	327	310	94.8%
Regional SA	26	24	92.3%
Regional WA	61	61	100%
Regional Tas.	39	36	92.3%
Regional NT	6		
Combined capital	1,686	1,539	91.3%
Combined regional	987	867	87.8%
National	2,673	2,406	90.0%

Source: CoreLogic. Note suburbs were only analysed where there was a minimum 20 sales in the year, 20 rental listings, and high confidence in the median home value of the suburb.

Suburb market rent increases FY 2022-23

Volume and portion by capital city, region

Houses | Units

Region	Suburbs analysed	Annual rent rise #	Annual rent rise %
Sydney	285	282	98.9%
Melbourne	232	230	99.1%
Brisbane	137	137	100%
Adelaide	60	60	100%
Perth	94	94	100%
Hobart	9	8	88.9%
Darwin	16	16	100%
Canberra	41	23	56.1%
Regional NSW	105	88	83.8%
Regional Vic.	40	39	97.5%
Regional Qld	122	122	100%
Regional SA	1	1	100%
Regional WA	8	8	100%
Regional Tas.	6	5	83.3%
Regional NT			
Combined capital	874	850	97.3%
Combined regional	282	263	93.3%
National	1,156	1,113	96.3%

Source: CoreLogic. Note suburbs were only analysed where there was a minimum 20 sales in the year, 20 rental listings, and high confidence in the median home value of the suburb.

The table on the left is for housing, the one on the right is for units.

The data is on a suburb-by-suburb basis. It shows that, for houses, rents rose in 90% of suburbs (including regional towns) across the country. In some markets, such as Adelaide and Perth, rents rose in every suburb during the calendar year. Rises in units were even more common, with a rise in more than 96% of suburbs nationally.

Now, in a time of high inflation, it makes sense that the cost of housing will rise. There is also a bit of chicken and egg about this, as the cost of rental accommodation is actually a component of the CPI. It would be difficult for the CPI to rise without rents having risen. But if prices are rising, then this will make the cost of providing rental properties to the market higher. Landlords will seek to pass these higher costs on to their tenants, and where there is also a shortage of rental accommodation, they have the pricing power that lets them do so.

Which brings us to the role of interest rates and their impact on rents. Many property investors make use of borrowed money to buy the properties that they rent out. As interest rates have risen, the cost of holding those properties must also rise. But the connection between interest rates and rents is not necessarily a close one, as this graph, also from Corelogic, makes clear:

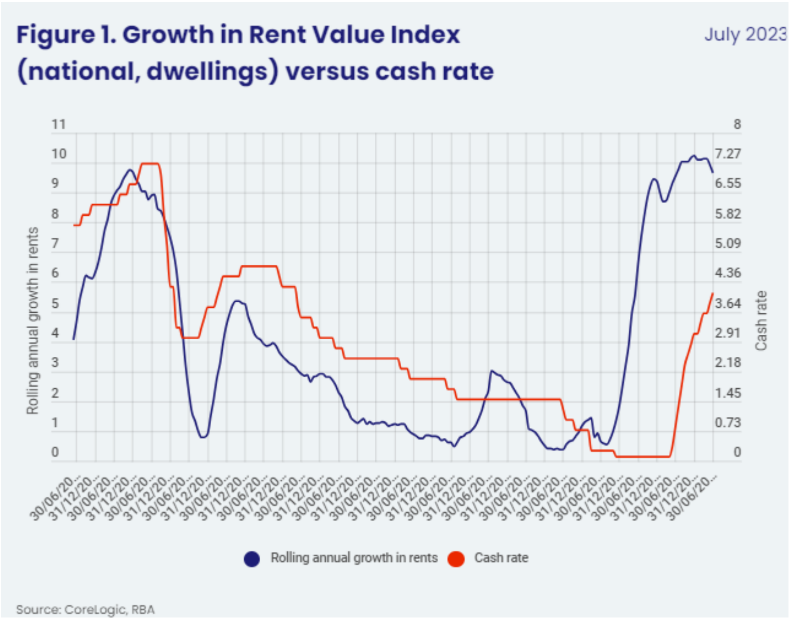


Figure 1. Growth in Rent Value Index (national, dwellings) versus cash rate

Source: CoreLogic, RBA

This data shows that, while rents and interest rates often move in the same direction, sometimes rents rise by more than interest rates and sometimes they don't. Indeed, rents started soaring during the early years of the pandemic, even while interest rates were not moving.

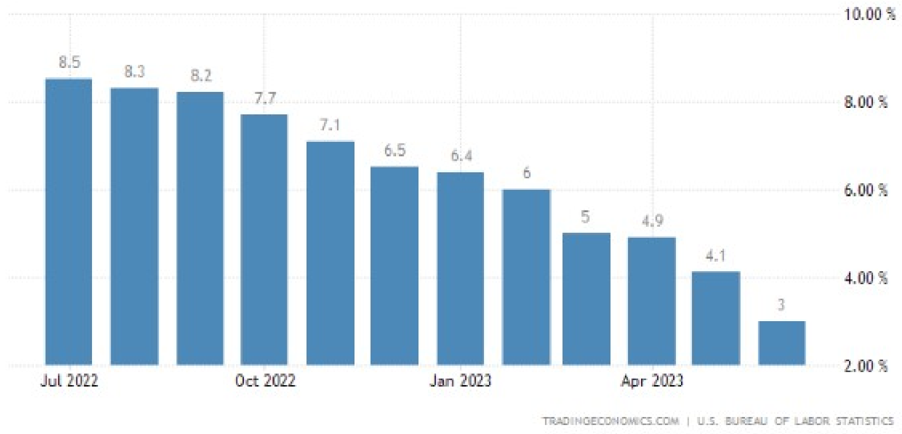
We also need to look at the graph a little cautiously, as a rise in interest rates of 4 percentage points is actually a doubling of the interest paid by a borrower (for example, if their interest rate rose from 4% to 8%). So, the red line is perhaps not on the correct scale in this presentation.

One of the reasons that interest rates and rents may not be too closely aligned is that interest rates for investors are usually tax deductible. This lowers the effect of any increase in the price of interest for the borrower. Basically, for a taxpaying landlord with a 32.5% marginal tax rate, about a third of any increased interest expense will be paid by the taxman.

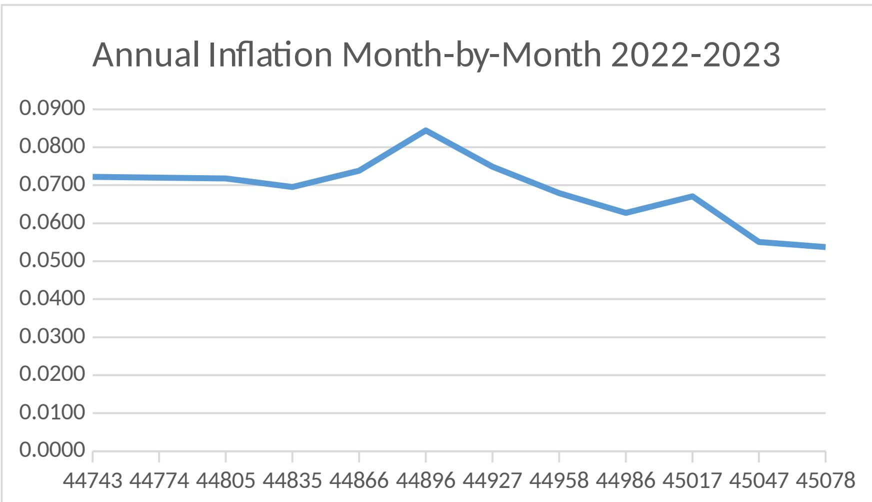
So, while interest rates do bear some responsibility for increases in rents, the relationship is not direct and not as strong as you might think. Rents were rising even before interest rates also started to do the same. The relative shortage of property is a much stronger cause of increased rents.

Inflation and Interest Rates

As we wrote above, US inflation has fallen dramatically over the last 12 months. Trading Economics tell us that the annual rate has more than halved, falling from 8.5% to 3% between June 2022 and June 2023:



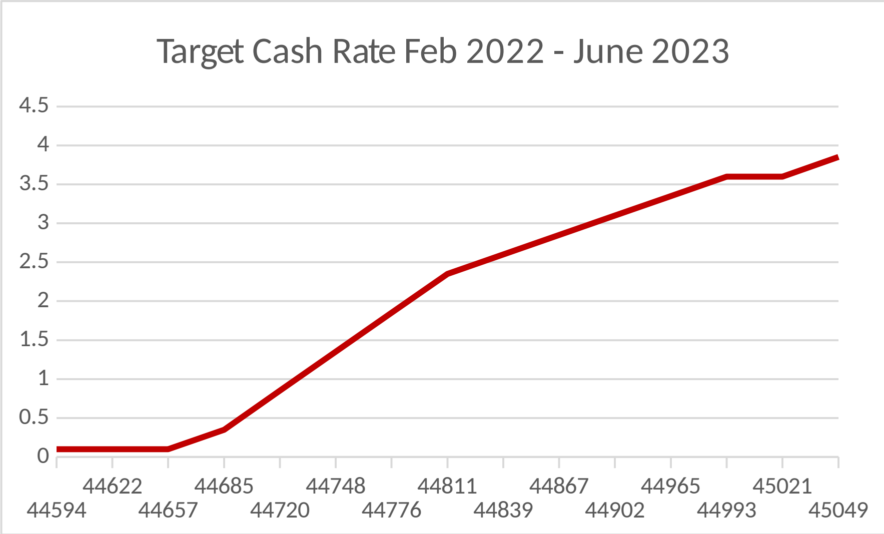
The Australian experience is not quite as stark, but our most recent inflation data is also quite promising. Here is how our annualised inflation looked over the last 12 months, thanks to the RBA:



Having peaked above 8% in the 12 months to December 2022, inflation for the 12 months to June 2023 was just 5.4%. What's more, and probably more important, is that the trend is clearly heading down.

As you know, the RBA has been trying to use interest rates to reduce inflation since May of last year. By the RBA's own analysis, interest rate changes take 12 months to have their full effect. That means that the first of the changes, in May 2022, only reached its full impact in May of this year – correlating with a marked downturn in CPI as shown in the above graph.

Of course, there have been many more changes to the target cash rate since then, as this graph sourced from RBA data also shows:



To the extent that interest rates do reduce CPI, we can expect the full effect of these many and rapid increases to be borne out on future monthly and quarterly data.

This almost certainly explain why the RBA have once again held interest rates steady this month – making it two months in a row without a change to the target cash rate. What's more, if we continue to see the downward trend in the CPI rate, we can expect that further rises in the future are also increasingly unlikely.

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.

Contact Details

Address	20 Willow Tree Drive Reedy Creek QLD 4227
Phone	0416 082 117
Website	2020financialservices.com.au
Email	glennb@2020financialservices.com.au

Licencing Details

2020 Financial Services Pty Ltd ABN 40 365 010 780 is a corporate authorised representative (no. 001289351) of Financial Force Pty Ltd ABN 42 091 425 464 (Australian Financial Service Licence no. 238337).