INFORMED INVESTOR

February 2024

threePILLARS
wealth management

CONTENTS

Economic Update

Falling inflation – what does it mean for investors?

Want to earn more and keep your Age Pension?

As scams evolve, so can you

Australian household wealth

Welcome to the February edition of our quarterly newsletter, Informed Investor.

ECONOMIC UPDATE

A rally in the second half of the month helped global share markets generate solid gains in January, extending the rally from November and December.

The latest indicators suggest economic conditions are holding up quite well in most regions, which augurs well for corporate earnings.

With inflation still above central bank targets, investors pared back their expectations for interest rate cuts this year. At the beginning of January investors had been anticipating six rate cuts in the US this year, with the first expected in March. That timing now seems unlikely, with policy settings more likely to be eased a little later.

It was a similar story elsewhere, with investors conceding that policy settings are unlikely to be loosened as much as previously thought in the near term.

Bond yields rose against this background, which weighed on returns from fixed income markets.

Geopolitical risk remained elevated, particularly in the Middle East. A series of attacks on commercial vessels in the Red Sea by Houthis – a Yemen-based group, backed by Iran – prompted some shipping companies to divert Asia-Europe traffic around the tip of Africa, instead of through the Suez Canal, increasing freight times and costs. In some cases, shipping costs have more than trebled over the past two months, which could feed through to consumer goods inflation and, in turn, make it less likely that central banks will lower interest rates.

Continued over...

FURTHER INFORMATION

Julian Payne
Three Pillars Wealth Management

P: 02 4969 8402

E: julian@threepillarswealth.com.au

Three Pillars Wealth Management Pty Limited is a Corporate Authorised Representative (No.1239479) of Capstone Financial Planning Pty Ltd. ABN 24 093 733 969. Australian Financial Services Licence No. 223135. Information contained in this document is of a general nature only. It does not constitute financial or taxation advice. The information does not take into account your objectives, needs and circumstances. We recommend that you obtain investment and taxation advice specific to your investment objectives, financial situation and particular needs before making any investment decision or acting on any of the information contained in this document. Subject to law, Capstone Financial Planning nor their directors, employees or authorised representatives, do not give any representation or warranty as to the reliability, accuracy or completeness of the information; or accepts any responsibility for any person acting, or refraining from acting, on the basis of the information contained in this document.

Capstone
FINANCIAL PLANNING

ECONOMIC UPDATE CONTINUED

AUSTRALIA

All measures of inflation slowed sharply in the December quarter, which was consistent with previous guidance from Reserve Bank of Australia policymakers. At the headline level, consumer prices rose at an annual pace of 4.1%, down from 5.4% in the September quarter.

Inflation remains significantly above the 2.0% to 3.0% target, but officials will nonetheless be happy with the direction of travel.

The economy lost more than 65,000 jobs in December, which surprised economists and came after four months of gains.

Combined with moderating inflation, any prolonged downturn in the labour market would likely increase the probability of interest rates being cut in the months ahead.

The latest projections suggest official borrowing costs will be lowered in the second half of 2024 and by between 0.50% and 0.75% by the end of the year.

NEW ZEALAND

Inflation slowed to 4.7% year on year, which was in line with consensus forecasts.

Business confidence levels improved, which prompted some observers to suggest policymakers might be hesitant to lower official borrowing costs as quickly as previously thought.

At the beginning of January, a rate cut in May had been fully priced into the market. During the course of the month however, the probability fell to around 50%.

US

GDP growth in the December quarter was stronger than anticipated. The economy grew 2.5% in 2023 as a whole, supported by robust consumer spending.

Retailers enjoyed strong pre Christmas trading, according to the latest retail sales data. Discretionary spending appears to be holding up well despite higher borrowing costs, perhaps owing to the strong labour market and a good level of wage growth.

The latest employment data suggested US firms remain quite optimistic about their future prospects. More than 200,000 new jobs were created in December, which was above forecasts.

Most importantly of all, annualised inflation in December quickened from the prior month and was comfortably above consensus forecasts.

Combined, these data led investors to question whether policymakers will be willing to lower interest rates in the near term. There had been speculation that the Federal Reserve would lower borrowing costs in March, but by month end traders were only pricing in a 35% likelihood of such a move.

ASIA

Q4 GDP growth data were released in China. Real GDP was reported at 5.2% for the full 2023 year, while nominal GDP came in at 4.2% owing to the deflation seen last year.

Apart from COVID-affected 2020, this was the slowest annual growth rate in the world's second largest economy since the mid 1970s.

Home sales remain subdued and a downturn in import volumes suggests households and business are cutting back on discretionary expenditure.

Authorities appear concerned about the outlook for the year ahead too and responded by lowering the reserve requirement ratio, which determines how much cash banks need to keep in reserve. The policy change is designed to make more cash available for lending, in turn boosting spending and supporting overall economic activity levels.

In Japan, comments from central bank officials were closely scrutinised, as investors believed policymakers were preparing to raise interest rates for the first time since 2007.

Inflation remains significantly above the long term average, questioning the rationale for persevering with negative rates.

EUROPE

Inflation in France and Germany continued to ease, consistent with forecasts from European Central Bank officials.

Nonetheless, policymakers poured cold water on investors' expectations for interest rate cuts in the near term, indicating that official borrowing costs are unlikely to be lowered until the middle of the year at the earliest.

This could disappoint manufacturers, which continue to struggle against a background of stalling demand. Industrial output in Germany shrank 2.0% in 2023, for example.

Curiously, employment trends are holding up quite well despite the subdued economic backdrop. Unemployment has fallen to a record low of 6.4% in the Eurozone, which could feed through to wage demands and, in turn, further inflationary pressures. According to the European Central Bank, wages rose more than 5.0% in 2023.

In the UK, inflation quickened in December for the first time in eleven months.

AUSTRALIAN DOLLAR

The AUD weakened by 3.6% against the US dollar in January. This primarily reflected broad based strength in the USD, rather than any local influences affecting the 'Aussie'. The USD strengthened against most major currencies, following strong employment data and higher than expected inflation.

That said, the AUD weakened against other majors too, depreciating by 1.9% against a trade-weighted basket of international currencies.

AUSTRALIAN EQUITIES

Australian equities closed January at an all time high, surpassing levels not seen since August 2021. The market was buoyed by cooler than expected local inflation figures and may have influenced the decision by the Reserve Bank of Australia to leave interest rates unchanged at its February meeting.

The S&P/ASX 200 Accumulation Index ended January 1.2% higher.

The Energy sector outperformed, soaring 5.2% as escalating tensions in the Middle East bolstered oil prices. Uranium miners, Boss Energy and Paladin Energy also generated stellar returns, between 30% and 40%, given tight global supply and demand fundamentals for the commodity.

The Financials sector (+5.0%) also fared well, supported by insurance stocks. AUB Group (+10.5%), QBE Insurance Group (+7.0%) and Insurance Australia Group (+6.7%) all made positive contributions.

The lithium price came under pressure, adversely affecting miners such as Sayona Mining (-43.7%), Liontown Resources (-37.6%) and Arcadium Lithium (-20.6%). These stocks were among the worst performers in the Materials sector (-4.8%).

Iron ore prices oscillated during the month, initially rising but then dropping back and closing the month, little changed. The price movements were driven by changing expectations for steel demand in China, Australia's largest iron ore customer, alongside reports of further deterioration in the Chinese property market.

The Utilities sector (-1.5%) was among the laggards, with APA Group (-0.6%) and AGL Energy (-8.5%) offsetting a positive contribution from Origin Energy (+0.6%).

Small cap stocks underperformed their large cap peers, continuing the trend seen in 2023 where investors typically favoured larger, quality stocks. The S&P/ASX Small Ordinaries added 0.9% in January.

GLOBAL EQUITIES

Share markets made a strong start to the new year, with the MSCI World Index adding 4.5% in AUD terms during the month.

Favourable moves in US listed stocks set the tone. The S&P 500 Index added 1.7% over the month. Technology stocks continued to fare well too, which helped the NASDAQ rise 1.0%.

Interestingly, while the major US indices roared towards record highs, Chinese shares slumped to their lowest levels for more than three years. China's CSI 300 Index and the Hang Seng in Hong Kong closed January 6.3% and 9.2% lower, respectively, reflecting a broad based economic downturn and underwhelming earnings prospects for the year ahead.

Japanese shares performed much more strongly. The Nikkei added 8.4% over the month. After 35 years in the doldrums, Japanese shares are reapproaching record levels seen in the late 1980s.

European markets were mixed, but made modest progress in aggregate. Swiss stocks were among the best performers in the region, while those in the UK and Spain underperformed.

GLOBAL AND AUSTRALIAN FIXED INCOME

The release of inflation data and evolving forecasts for official interest rates continued to affect bond yields and drive returns from fixed income.

Government bond yields edged higher in all major markets, as the timing of anticipated rate cuts was pushed out. This was a headwind for fixed income and resulted in a return of -0.3% from the Bloomberg Global Aggregate Index in AUD terms.

Despite higher than expected inflation readings in the US, benchmark 10 year Treasury yields were little changed over the month. The timing of the first interest rate cut could be delayed a little, but ultimately investors are still expecting policy settings to be eased significantly over the course of this year.

More significant moves were seen in Europe. Yields on 10 year government bonds in the UK and Germany rose 0.26% and 0.14% respectively, as Bank of England and European Central Bank officials indicated rate cuts are unlikely in the near term.

Yields on Japanese Government Bonds rose quite meaningfully too. No changes to monetary policy are anticipated at the next central bank meeting in March, but a subtle change in the tone of forward looking commentary from officials was enough to push yields higher.

Yields on 10 year Australian Commonwealth Government Bonds closed January slightly above their end December levels. Yields had risen much more significantly in the first half of the month, but trended lower into month end – particularly following the release of lower than expected inflation data for the December quarter.

GLOBAL CREDIT

Global credit continued to fare well in January, following a period of very strong performance during November and December.

Spreads on investment grade issues tightened, closing the month at their lowest levels for two years.

European issuers performed particularly well, after GDP data showed the Eurozone economy avoided recession in the December quarter. Reasonably resilient activity levels and the prospect of rate cuts later in the year augur well for corporate earnings in the region and are helping support demand for high quality credit.

US continued to perform well too. Around US$240 billion of new corporate issues were priced during the month, which underlined the strong demand that exists currently for securities offering yields over and above those on offer from cash and comparable government bonds.

In Asia, attention remained focused on the beleaguered property sector. Towards month end, a court in Hong Kong ordered the liquidation of developer, China Evergrande Group. With more than US$300 billion of liabilities, Evergrande was the world's most indebted developer and had struggled to come up with a credible restructuring program over the past two years.

The episode highlights the peril of over leveraging for companies and provides a reminder of the importance of careful security selection in this asset class.

Source: First Sentier Investors

KEY POINTS

- Inflation is in retreat thanks to improved supply and cooling demand. A further fall is likely this year.
- Australian inflation remains relatively high – but this mainly reflects lags rather than a more inflation prone economy.
- Profit gouging or wages were not the cause of high inflation.
- The main risks relate to the conflict in the Middle East escalating and adding to supply costs; a surprise rebound in economic activity and sticky services inflation; and floods, the port dispute and poor productivity in Australia.
- Lower inflation should be positive for investors via lower interest rates, although this benefit may come with a lag.
- The world is now a bit more inflation prone so don't expect a return to near zero interest rates anytime soon.

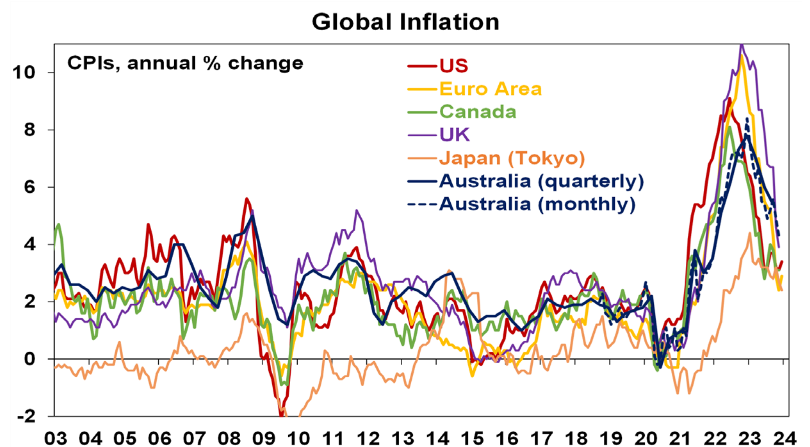
FALLING INFLATION – WHAT DOES IT MEAN FOR INVESTORS?

INTRODUCTION

The surge in inflation coming out of the pandemic and its subsequent fall has been the dominant driver of investment markets over the last two years – first depressing shares and bonds in 2022 and then enabling them to rebound. But what's driving the fall, what are the risks and what does it mean for interest rates and investors? This article looks at the key issues.

INFLATION IS IN RETREAT

Inflation appears to be falling almost as quickly as it went up. In major developed countries it peaked around 8% to 11% in 2022 and has since fallen to around 3% to 4%. It's also fallen in emerging countries.



Source: Bloomberg, AMP

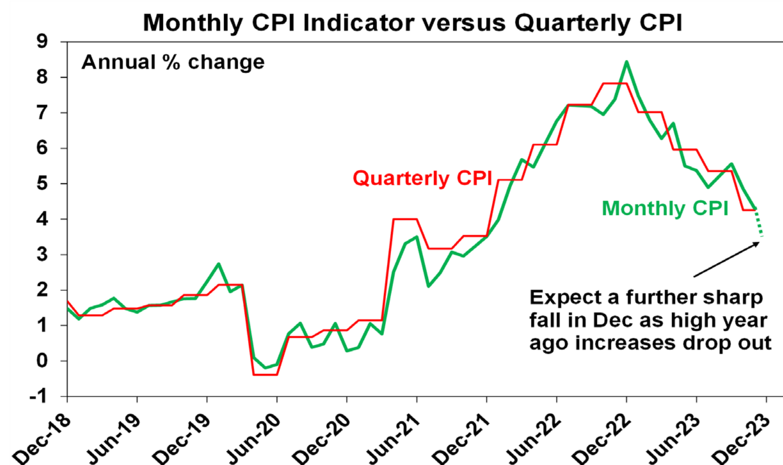
WHAT'S DRIVING THE FALL IN INFLATION?

The rise in inflation got underway in 2021 and reflected a combination of massive monetary and fiscal stimulus that was pumped into economies to protect them through the pandemic lockdowns that was unleashed as spending (first on goods then services) at a time when supply chains were still disrupted. So it was a classic case of too much money (or demand) chasing too few goods and services. Its reversal since 2022 reflects the reversal of policy stimulus as pandemic support measures ended, pent up or excess savings has been run down by key spending groups, monetary policy has gone from easy to tight and supply chain pressures have eased. In particular, global money supply growth which surged in the pandemic has now collapsed.

WHY IS AUSTRALIAN INFLATION HIGHER THAN OTHER COUNTRIES?

While there has been some angst about Australian inflation (at 4.3% year on year in November) being higher than that in the US (3.4%), Canada (3.1%), UK (3.9%) and Europe (2.9%), this mainly reflects the fact that it lagged on the way up and lagged by around 3 to 6 months at the top.

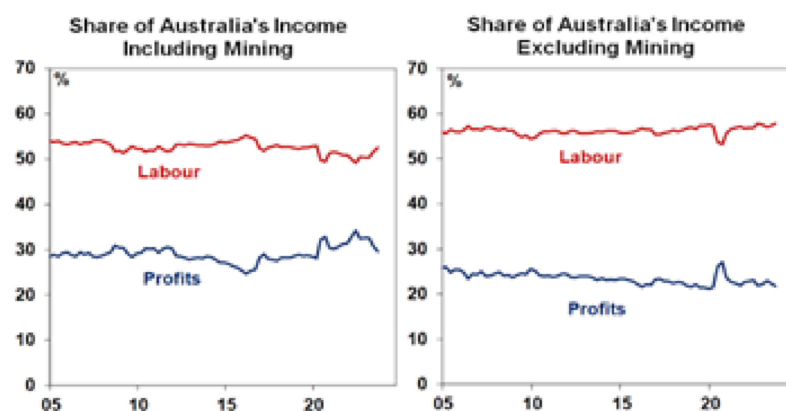
The lag partly reflects the slower reopening from the pandemic in Australia and the slower pass through of higher electricity prices. So we saw inflation peak in December 2022, whereas the US, for instance, peaked in June 2022. But just as it lagged on the way up it's still following other countries down with roughly the same lag. In fact, with a very high 1.5% month on month implied rise in the Monthly CPI Indicator to drop out from December last year, monthly CPI inflation is likely to have dropped to around 3.3% to 3.7% year on year in December last year, which is more in line with other countries.



Source: Bloomberg, AMP

WHAT ABOUT PROFIT GOUGING?

There has been some concern that the surge in prices is due to "price gouging" with "billion dollar profits" cited as evidence. In fact, the Australian Government has set up an inquiry into supermarket pricing. There are several points to note in relation to this. First, it's perfectly normal for any business to respond to an increase in demand relative to supply by raising prices. Even workers do this (e.g. asking for a pay rise and leaving if they don't get one when they are getting lots of calls from headhunters). It's the way the price mechanism works in allocating scarce resources. Second, national accounts data don't show any underlying surge in the profit share of national income, outside of the mining sector (see the second chart on the right). Finally, blaming either business or labour (with wages growth picking up) risks focusing on the symptoms of high inflation not the fundamental cause, which was the pandemic driven policy stimulus and supply disruption. This is not to say that corporate competition can't be improved.

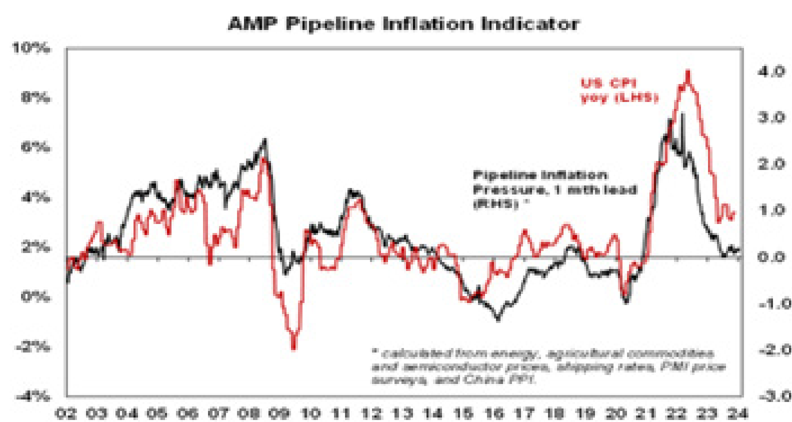


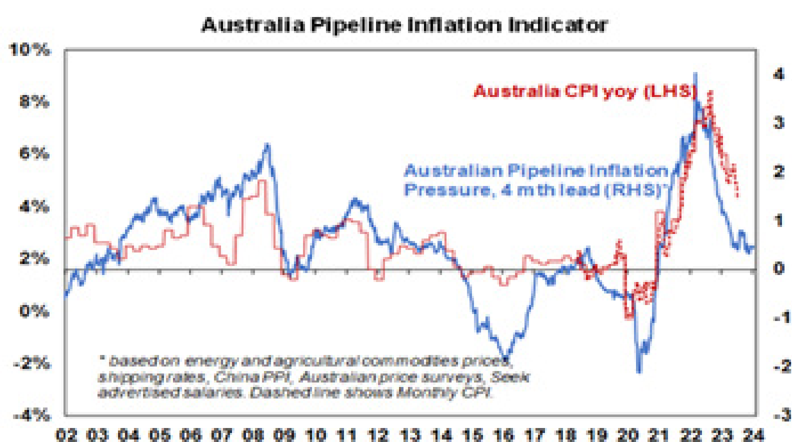
Source: ABS, RBA, AMP

WHAT IS THE OUTLOOK FOR INFLATION?

Our US and Australian Pipeline Inflation Indicators continue to point to a further fall in inflation ahead (see the charts on the right).

This is consistent with easing supply pressures, lower commodity prices and slowing demand. It's not assuming recession, but it is a high risk and if that occurred it would likely result in inflation falling below central bank targets. Out of interest, the six month annualised rate of core private final consumption inflation in the US, which is what the Fed targets, has fallen below its 2% inflation target. In Australia, it's expected that the quarterly CPI inflation to have fallen to around 3% year on year by year end. The return to the top of the 2% to 3% target is expected to come around one year ahead of the RBA's latest forecasts.





Source: Bloomberg, AMP

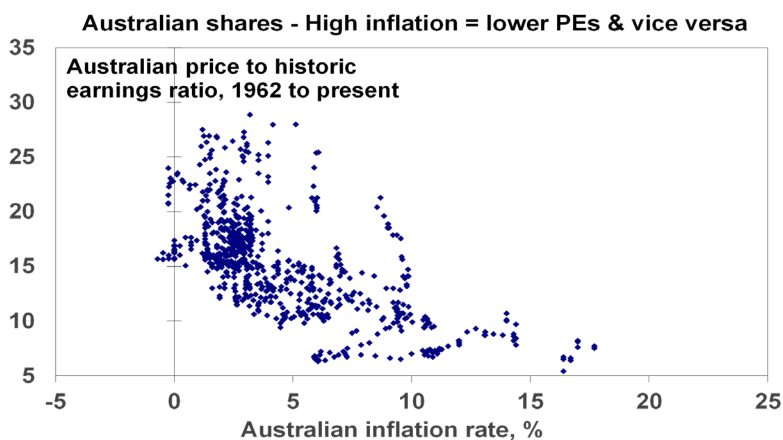
WHAT ARE THE RISKS?

Of course, the decline in inflation is likely to be bumpy and some say that the "last mile" of returning it to target might be the hardest. There are five key risks to keep an eye on in terms of inflation:

- First, the escalating conflict in the Middle East has the potential to result in inflationary pressures. Disruption to Red Sea/Suez Canal shipping is already adding to container shipping rates due to extra time in travelling around Africa. So far this has seen only a partial reversal of the improvement in shipping costs seen since 2022 and commodity prices and the oil price remain down. The US and its allies are likely to secure the route relatively quickly such that any inflation boost is short lived. The real risk though, is if Iran is drawn directly into the conflict, threatening global oil supplies.
- Economic activity could surprise on the upside again keeping labour markets tight, fuelling prices and wages, and hence sticky services inflation.
- Central banks could ease before inflation has well and truly come under control in a re-run of the stop/go monetary policy of the 1970s.
- In Australia, recent flooding could boost food prices and delays associated with industrial disputes at ports could add to goods prices. At present though, the floods are not on the scale of those seen in 2022 and it's expected that any impact from both to be modest (at say 0.2%).
- Finally, and also in Australia if productivity remains depressed, 4% wages growth won't be consistent with the 2% to 3% inflation target.

WHAT LOWER INFLATION MEANS FOR INVESTORS?

High inflation tends to be bad for investment markets because it means higher interest rates; higher economic uncertainty; and for shares, a reduced quality of earnings. All of which means that shares tend to trade on lower price to earnings multiples when inflation is high, and growth assets trade on higher income yields. We saw this in 2022 with bond yields surging, share markets falling and other growth assets pressured.



Source: Bloomberg, AMP

So, with inflation falling, much of this goes in reverse as we started to see in the last few months. In particular:

- Interest rates will start to come down. The Fed is expected to start cutting in May and the European Central Bank (ECB) to start cutting around April, both with 5 cuts this year. There is some chance that both could start cutting in March. The RBA is expected to start cutting around June, with 3 cuts this year.
- Shares can potentially trade on higher price-to-earnings (PEs) than otherwise.
- Lower interest rates with a lag are likely to provide some support for real assets like property.

Of course, the main risk is if economies slide into recession, which will mean another leg down in share markets before they start to benefit from lower interest rates. This is not our base case but it's a high risk.

CONCLUDING COMMENT

Finally, while inflation is on the mend cyclically, it's worth remembering that from a longer term perspective we have likely now entered a more inflation prone world than the one prior to the pandemic, reflecting bigger government; the reversal of globalisation; increasing defence spending; decarbonisation; less workers and more consumers as populations age. So short of a very deep recession, don't expect interest rates to go back to anywhere near zero anytime soon.

Source: AMP

WANT TO EARN MORE AND KEEP YOUR AGE PENSION?

Many people continue, or even start, working once they've reached Age Pension age. This may be for social reasons, personal fulfilment or to maintain their standard of living. With the higher cost of living at the moment, even more pensioners are taking up work.

But what does this mean if you're receiving the Age Pension? The government's Work Bonus means you can earn a little more without it affecting your pension. The permanent increase to the Work Bonus means you may be able to continue this longer if you choose.

Consider this example, of *Margaret*, to show what this could mean for you.

INTRODUCING MARGARET

Margaret has just reached her Age Pension age of 67 and owns a home with her husband (who has also just reached Age Pension age) and they have $440,000 in joint financial assets including super.

Like many others, Margaret was looking to do more in her retirement years. She missed the company of colleagues and doing something purposeful.

Through a friend, Margaret was offered an opportunity for some paid work for a charity that she was passionate about.

Margaret asked her friend about her work opportunity. Her well-meaning friend mentioned that even a small increase in Margaret's income would reduce her Age Pension. Regretfully, Margaret turned down the opportunity as she hated losing some Age Pension. However, Margaret didn't understand the full situation.

WHAT IS THE WORK BONUS?

The Work Bonus is a scheme offered by the government that increases what a person of Age Pension age can earn from work before it affects their pension amount. It's essentially an offset for assessable employment income in the Age Pension income test. Assessable income is the amount of income you earn that is assessed under the income test which helps determine how much Age Pension you receive.

In simple terms, it means eligible pensioners can keep more of their Age Pension while working.

The government provides the Work Bonus as an incentive to keep pensioners, and their valuable skills, in the workforce.

HOW MUCH IS THE WORK BONUS FOR PENSIONERS?

The Work Bonus is $300 per fortnight for eligible pensioners. This means the first $300 earned in a fortnight won't affect how much Age Pension you receive.

If you earn less than $300 in a particular fortnight, the unused bonus amount is accrued as a Work Bonus balance that you can apply to future income. This means, when you earn over $300 in a fortnight, the Work Bonus offsets the first $300 of your earnings and then any Work Bonus balance you have can be used to reduce your remaining employment income. So, your income will have less of an effect on your pension amount.

If the Work Bonus applied to you before, then you may be aware the limit that could accrue in a person's Work Bonus balance was previously $7,800.

Margaret was offered work that would pay $800 per fortnight (or $20,800 per year). Margaret went to see a financial adviser. After considering her full financial situation, her adviser determined that her and her husband's combined Age Pension under the previous Work Bonus rules would have reduced by almost $5,768 per year. On the one hand, Margaret was pleasantly surprised she could still receive some Age Pension while working – but it cost her more than a quarter of her new income. She was eager to understand what the new rules mean for her pension.

WHAT ARE THE CHANGES TO THE WORK BONUS?

Prior to 1 December 2022, a new Age Pension applicant started with a Work Bonus balance of zero. Any unused Work Bonus each fortnight would accrue in their Work Bonus balance up to a maximum of $7,800.

From 1 December 2022, pensioners received a one off $4,000 boost to their Work Bonus balance, while the maximum balance that could be accrued increased to $11,800. These temporary changes were due to cease on 31 December 2023, and amounts in a pensioner's Work Bonus balance over $7,800 would be forfeited.

However, this temporary increase will be permanent from 1 January 2024. This means those already on a pension will keep their Work Bonus balance which is subject to a maximum of $11,800. New pensions will have a starting Work Bonus balance of $4,000. So, you don't have to build up a balance but have an amount you can start using straight away.

Margaret's adviser explained how the new Work Bonus balance boost of $4,000 meant she could earn $800 per fortnight from working and her Age Pension would not be reduced until her Work Bonus balance is used which would take around eight fortnights. Margaret and her husband receive an extra $1,774 in Age Pension during this time due to the $4,000 boost. Margaret also learned that she could encourage her husband to get out there too as he could also earn up to $800 per fortnight for eight fortnights without their Age Pension being reduced during that time.

Margaret and her husband are now doing a mix of paid and unpaid work for the charity. They are loving being able to give back and afford a few more luxuries – not to mention a new social network.

They may need to reassess when their Work Bonus balances are used up, as any employment income from that point over $300 per fortnight each is likely to start affecting how much Age Pension they receive.

DOES THE WORK BONUS BALANCE RESET EACH YEAR?

The Work Bonus balance doesn't reset. It carries forward without a time limit. However, you can't grow your balance over the $11,800 cap.

WHO IS ELIGIBLE FOR THE WORK BONUS?

To receive the Work Bonus you need to be:

- of Age Pension age or over, and
- receiving the Age Pension, Carer Payment, Disability Support Pension, or an eligible payment from the Department of Veterans' Affairs.

The Work Bonus applies to reduce income earned from employment, as well as self employment income from doing gainful work (which is work that requires some effort).

Importantly, the Work Bonus applies automatically if you're eligible. So, you don't have to do anything to benefit from it.

Keep up to date on what you might be entitled to. Rules change often and you may find that you can receive additional benefits. You can check out your Age Pension eligibility using free Age Pension eligibility tools or you can speak to your financial adviser.

Source: CFS

AS SCAMS EVOLVE, SO CAN YOU

As scams continue to evolve, it's important to stay on top of the latest information. Here are some tips for staying protected against some of the most common scams impacting Australians today and red flags to watch out for.

WHAT CAN YOU DO TO STAY PROTECTED?

Anyone can fall victim to a scam. As well as learning more about the different types of scams and how to spot them, start a conversation with family members or friends. You might know the red flags to watch out for, but do your loved ones? Raising awareness and educating yourself and others are important steps to help combat scams and even prevent them from happening in the first place.

THREE SCAMS TO WATCH OUT FOR

Impersonation scams

Have you ever received a call and it just didn't feel right? It may have been part of an impersonation scam, which is when a scammer impersonates a bank or other service company by phone or SMS, asking you to authorise transactions, make a payment, or provide personal information.

According to the Australian Government's Anti-Scam Centre, three in four reported scams include some form of impersonation of a legitimate entity[1].

So how can you be sure next time that person calling you is really from where they say they're from? Here's a few things to remember:

- most financial institutions will never ask you to transfer funds to another account
- never share passwords with anyone
- avoid using phone numbers or links from text messages
- check contact information using a trusted source such as the company's website.

Investment scams

As of 9 November 2023, Australians have lost $240 million to investment scams[2]. Investment scams are often sophisticated which means they can be hard to spot. Investment opportunities offering fast results and big returns can have the potential makings of a scam.

Common investment scams include:

- unsolicited investment offers such as cryptocurrency, fake corporate or treasury bonds, and fake share IPOs (Initial Public Offerings), claiming to be from reputable businesses
- fake endorsement of an investment or other business opportunities from celebrities
- early access to superannuation with a fee.

Buyer/seller scams

Buying or selling on an online selling platform is great when it's quick and hassle-free. But scammers are popping up everywhere, so it's harder to stay safe online. Here are five red flags to look out for:

- being approached by someone who has no profile photo
- the price seems too good to be true
- a request for personal information such as your phone number or email
- the buyer overpays for an item and wants you to refund the excess amount
- the buyer wants to pay using a gift card or wants to send a prepaid shipping label.

Source: Macquarie

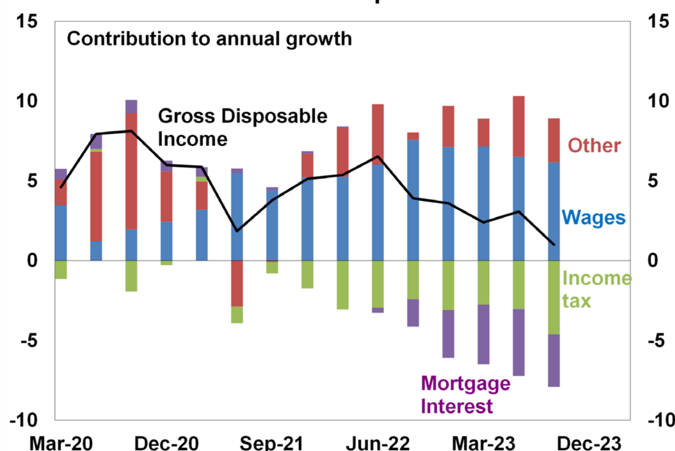
[1]scamwatch.gov.au
[2]scamwatch.gov.au as at 9 November 2023

AUSTRALIAN HOUSEHOLD WEALTH

Is high Australian household wealth a source of support for consumers?

KEY TAKEAWAYS

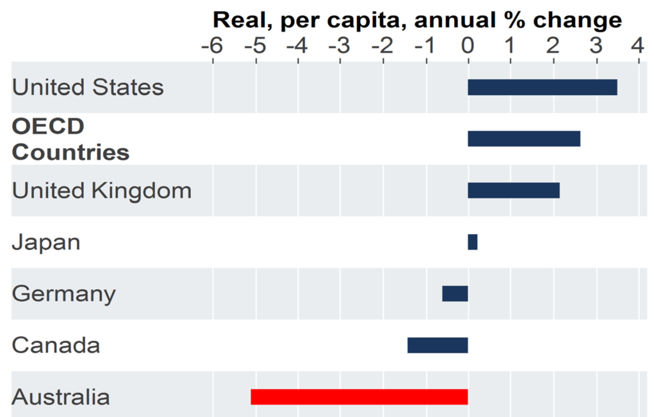
- Australia ranked as having one of the lowest rates of disposable income growth per capita amongst OECD countries in mid 2023.
- An increasing income tax burden and mortgage repayments have weighed on income growth, despite solid wages and salaries.
- But, household balance sheets in Australia look stronger compared to incomes. Household wealth increased in 2023, as home prices rose.
- However, growth in household wealth will decline in 2024 as home prices are expected to fall. Household incomes will also be under pressure as earnings growth slows from a softening labour market.
- As a result, high household wealth holdings will not be enough to offset a challenging environment for households in 2024, despite some easing in cost of living challenges.



Source: ABS, AMP

INTRODUCTION

Household income data from the OECD showed that Australia had one of the lowest rates of annual real household disposable income per person compared to its OECD peers (see the chart below). Over the year to June 2023, Australia's real per capita household disposable income was down by 5.1%, compared to a 2.6% rise across OECD countries.



Source: AMP, Macrobond

This occurred despite very healthy labour market conditions in Australia which saw employment growth running above 3.0% per annum all year, the unemployment rate remaining below 3.9% and underemployment continuing to be low, all of which boosted wages growth. Despite this positive earnings backdrop, the income tax burden increased in 2023 as households have been moving into higher income tax brackets (otherwise known as "bracket creep"), as well as the end of income tax concessions.

Mortgage interest repayments are also an increasing drag on incomes (see the chart on the left) as the cash rate has been increased by 425 basis points since May 2022. Australia's very high population growth in 2023 (running at 2.4% over the year to June 2023) also masked a fall in household disposable income growth per person, relative to other OECD countries.

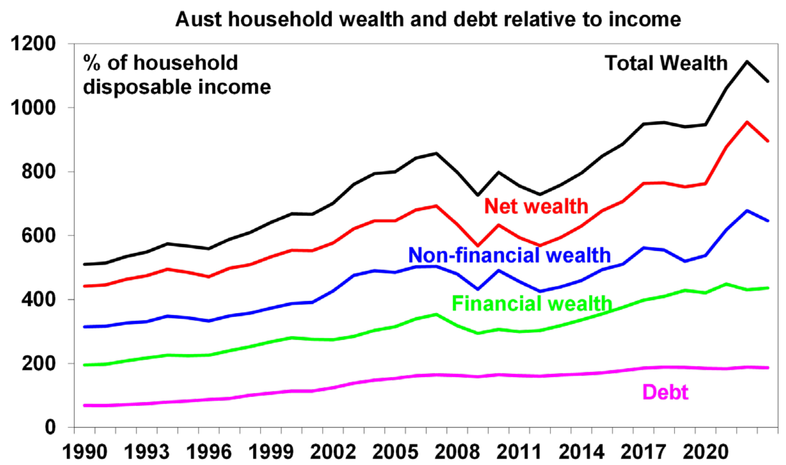
Just looking at household income accounts does not show everything about the position of households. In a country like Australia where home ownership rates are high (66% of Australian households own their home, with or without a mortgage), looking at household wealth is also important.

HOUSEHOLD WEALTH IN AUSTRALIA

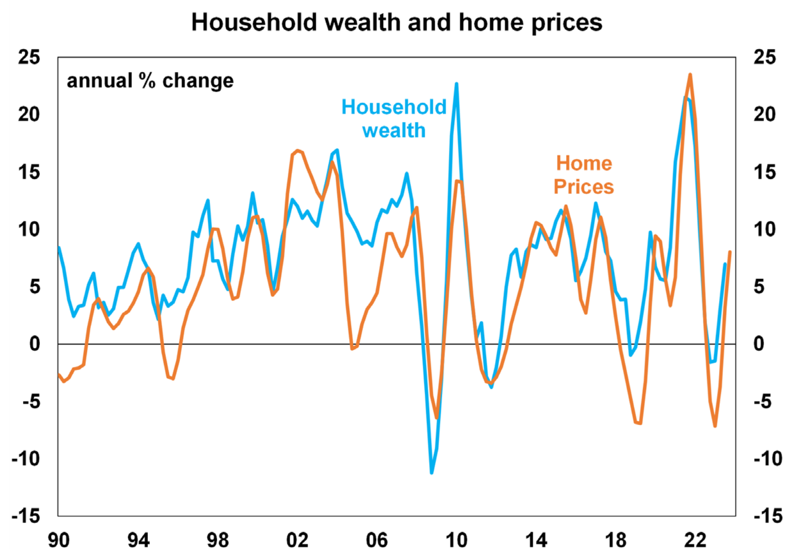
The Australian Bureau of Statistics estimates the value of a household's assets, liabilities and therefore wealth. Net worth or wealth is calculated as a household's total assets minus its liabilities. Total wealth is close to 11 times the size of household disposable income (or 1083%) and net wealth is 896% of income. The latest data for the year to June 2023 showed a slight fall in wealth as a share of income, after it reached a record high in 2022 (see the chart on the right). Non financial wealth is worth 647% of income, larger than financial wealth at 436% and well surpassing household debt, which is 187% of income.

Around 70% of Australian household wealth is tied to the value of homes (which is made up of land and dwellings) and moves closely in line with home prices (see the second chart on the right). Household wealth rose throughout 2023, in line with solid growth in home prices.

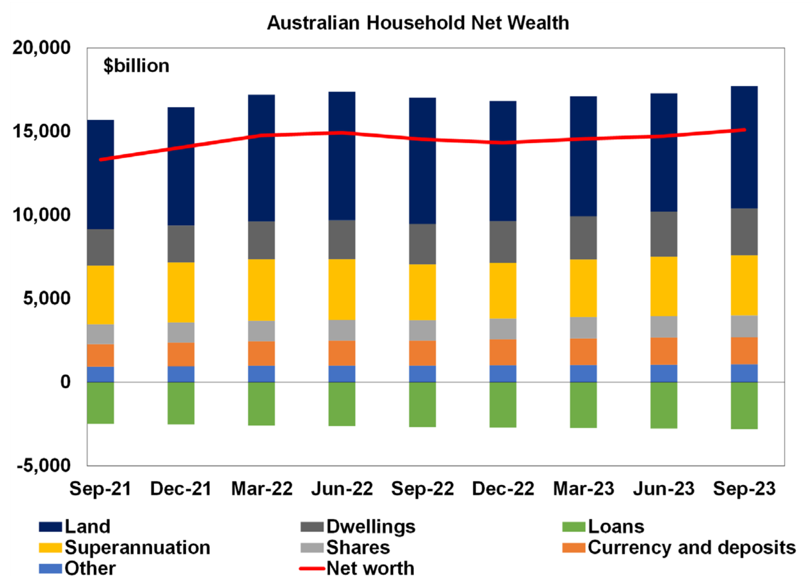
Other components of household wealth are shown in the third chart on the right. Assets include superannuation, shares and currency and deposits. Loans which are mostly for housing are the source of household liabilities.



Source: RBA, AMP



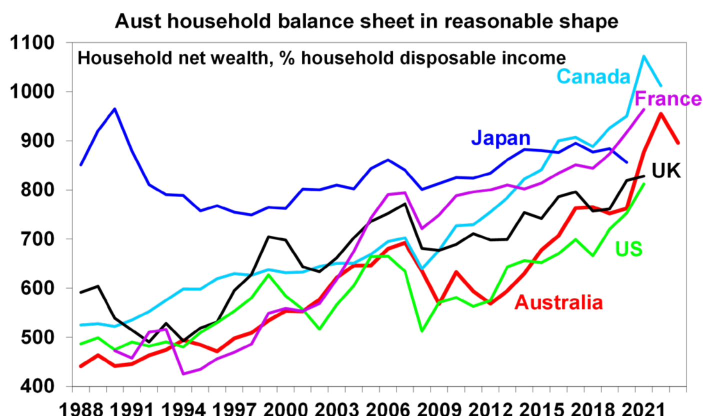
Source: ABS, AMP



Source: ABS, AMP

HOW DOES HOUSEHOLD WEALTH COMPARE AROUND THE WORLD?

Australian household wealth, as a share of household disposable income, is at the top end of its OECD peers (see the chart below).

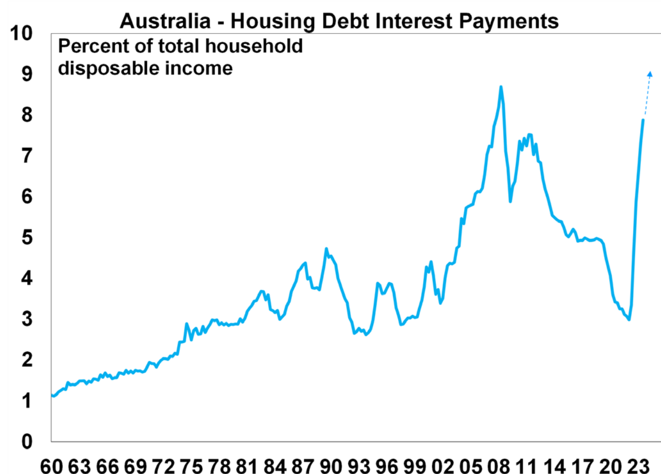


Source: OECD, AMP

High holdings of wealth could be considered a source of support for households, especially against record levels of household debt in Australia. This is a concept known as the "wealth effect". When household wealth increases, households feel more secure with their financial position and household savings tend to decrease which lifts consumer spending. When wealth decreases, households feel less secure which leads to an increase in savings and decline in spending. However, this relationship does not always work. Most recently in the pandemic, household wealth rose in 2021/22 alongside the lift in home prices but the savings ratio also surged thanks to government driven stimulus cheques. Since then, the household savings ratio has been falling but growth in total consumer spending has been low. We expect that the household savings rate will continue to fall in 2024 as it normalises after the pandemic but growth in consumer spending will still be low.

IMPLICATIONS FOR INVESTORS

Households dealt with a cost of living challenge in 2023 because of high inflation and rising interest rates. Inflation is expected to slow in 2024 and we expect the RBA to start cutting interest rates by mid year which should ease the repayment burden for households with a mortgage, as mortgage interest repayments as a share of income are rising to a record high (see the chart below).



Source: ABS, AMP

So, while cost of living issues should improve for consumers, household wealth will come under pressure in 2024 as we expect home prices will decline by 3.0% to 5.0%. This is likely to occur alongside a slowing in household incomes as the labour market weakens and the unemployment rate increases. This environment is expected to be negative for consumer spending and GDP growth. We see GDP growth rising by 1.2% over the year to June 2024, below the RBA's forecast of 1.8% and anticipate the unemployment rate to increase to 4.5% by mid year. This should see the RBA cutting interest rates by June and we expect a total of 3 rate cuts in 2024.

Wealth inequality between households is also an issue in Australia. The top 20% of households (by income quintile) owned 63% of total household wealth in 2019-20 but the bottom income quintile (the bottom 20%) owned less than 1.0% of all household wealth. In Australia, there is also increasing generational wealth gap, with wealth across older households increasing significantly over recent decades but this has not been the case for younger Australians. There are numerous government policies that could address these issues of wealth inequality, including improving the housing affordability issue (through lifting housing supply and/or looking at the favourable treatment of housing investment) and doing a tax review (looking at broadening the GST and examining the merits of a wealth or death tax), which could help the wealth inequality issue.

Source: AMP