Lower interest rates, house prices and super:

The keys to Australia's household wealth

June 2021

Australia's household wealth stands at almost $14 trillion: This is what it looks like

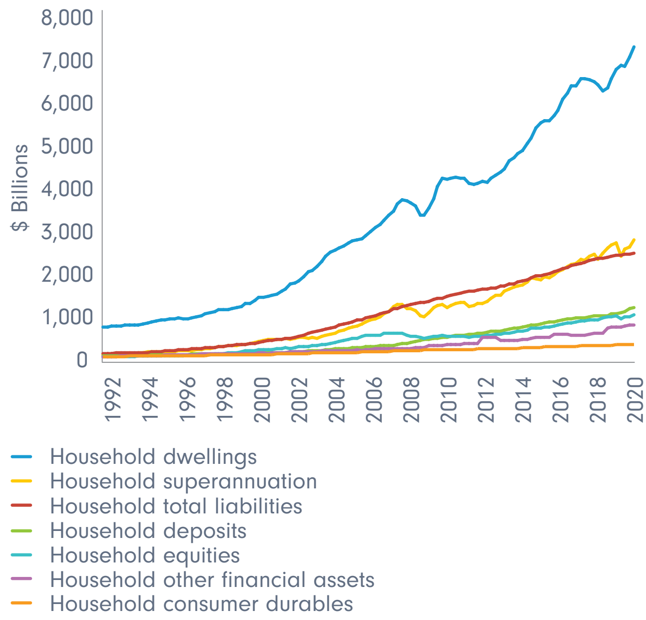
One of the most important channels that lower interest rates works through is via higher asset prices, leading to increased levels of household wealth. Theoretically, households should consume more as wealth rises. Changes in the 'wealth effect' are a key factor in assessing the outlook for the Australian economy, because a large share of the economy is household consumption.

Household wealth is measured as the household sector's assets minus its liabilities. Household assets comprise financial assets, which include bank deposits, direct equity holdings and superannuation balances, and non-financial assets, which include housing and durable items such as motor vehicles. The household sector's liabilities are largely made up of residential mortgages, but also include items such as credit card debt and personal loans.

As at the end of 2020, Australian households had amassed around $14 trillion in wealth while liabilities stood at close to $2.5 trillion – resulting in a net worth position of $11.3 trillion.

The composition of Australia's household wealth has remained relatively consistent over time. The value of household dwellings – at almost $7 trillion – makes up the bulk of household wealth, followed by superannuation assets at $2.8 trillion and deposits at $1.3 trillion. Super has grown from 11% of household wealth in 1989 to 21% today, reflecting an environment of asset price inflation over the time period, fueled by ever-lower interest rates.

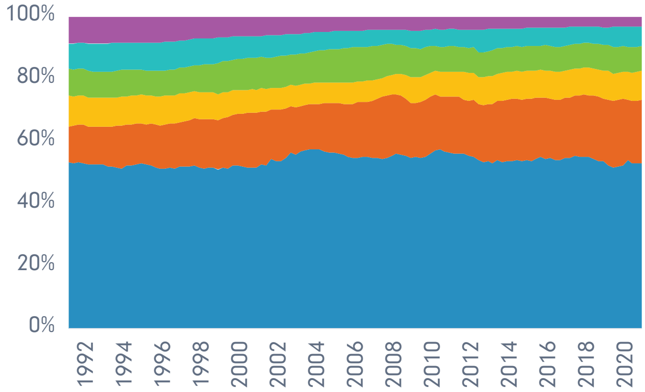
Figure 1: Australian household wealth (1991 – 2020) is approaching $14 trillion. Dwellings, superannuation, and deposits are Australians' main assets.



Source: Fidelity International, ABS, RBA, June 2021.

All references to dollars are in Australian dollars unless otherwise stated.

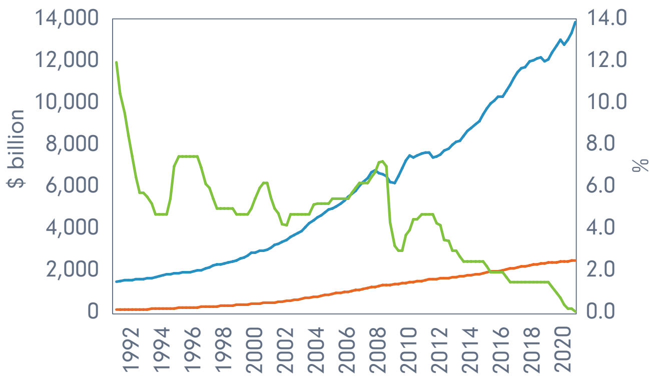
Figure 2: The evolution of Australia's household assets. Superannuation as a percentage of total household assets has doubled over 30 years.



Source: Fidelity International, ABS, RBA, June 2021.

The rate of growth of household wealth varies greatly from year to year and on several occasions, such as during the Global Financial Crisis and during the COVID pandemic, the value of household wealth has declined. These declines in wealth have been relatively short-lived, as the Reserve Bank of Australia (RBA) has inevitably responded to these economic shocks by cutting interest rates to a point that the cash rate has hit the effective lower bound and quantitative easing has been implemented.

Figure 3: A history of asset price inflation, debt, and the cash rate. Lower interest rates have resulted in higher house prices.



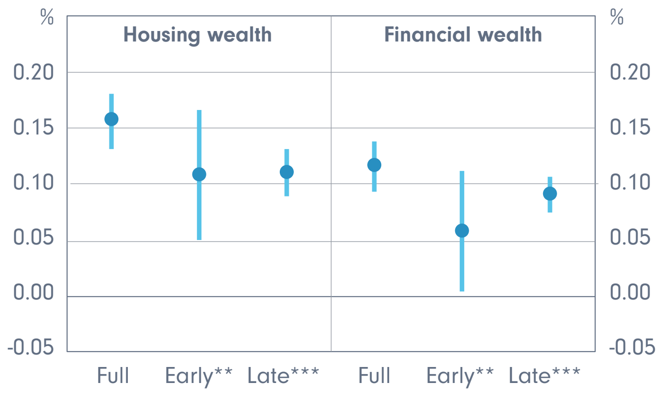
Source: Fidelity International, Bloomberg, RBA, ABS, June 2021.

Remember, the RBA wants higher house prices. It would be worried if house prices weren't rising given the impact this would have on consumer confidence. Indeed, house prices are now rising materially in many parts of the world including the US, Canada, New Zealand, the UK and Germany.

Central banks think that higher house prices should spur greater consumption, which is generally the largest contributor to economic growth of a developed economy. For example, an increase in household wealth may make it easier for households to borrow in order to smooth cyclical variations in their income. Expectations of improved economic conditions could lead to a rise in the value of shares and other financial assets, while at the same time encouraging households to consume more in anticipation of higher income in the future. In addition, rising housing prices are often associated with a larger number of housing transactions. Because households typically purchase housing-related goods and services in the months before and after a home purchase, an increase in housing transactions is likely to be associated with increased consumption.

Economists at the RBA have attempted to quantify the impact on consumption from rising wealth. In a paper released in March 2019, RBA analysis suggests that a 1% increase in the value of housing wealth will lead to a 0.16% increase in the long-run level of consumption, while a 1% increase in stock market wealth will raise consumption by 0.12%. Since December 2019, housing wealth has grown by 7.7%, suggesting an uplift in household consumption of 1.1% or around $3 billion in nominal terms. The RBA economists also estimate that almost half of this spending occurs in the first two quarters after the uplift in housing wealth. The rise in equity wealth since 2019, at 3%, represents around $1 billion of additional consumption over the long run for the Australian economy.

Figure 4(a): Long run wealth effects*
With 95% confidence intervals



* Eventual effect of a 1% increase in per capita wealth
** Covers September 1988 through to June 2001
*** Covers September 2001 through to June 2018

Source: Fidelity International, RBA, June 2021.

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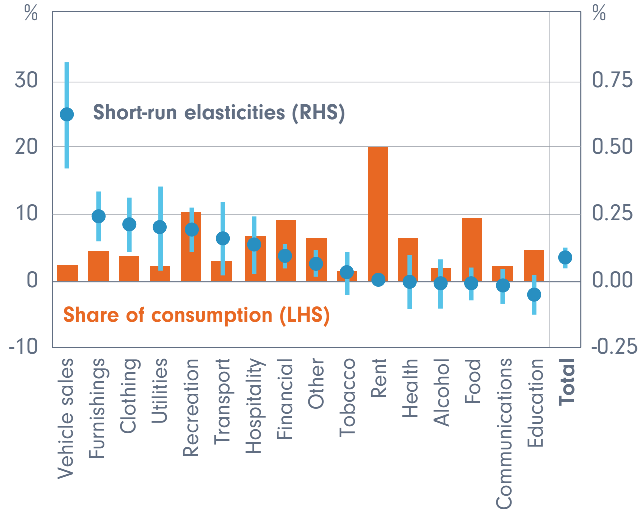
Figure 4(b): The impact of consumption of rising wealth. Rising wealth is important in supporting consumption and economic growth.



* Effects of a 1% increase in per capital housing wealth over two quarters

Source: Fidelity International, RBA, June 2021.

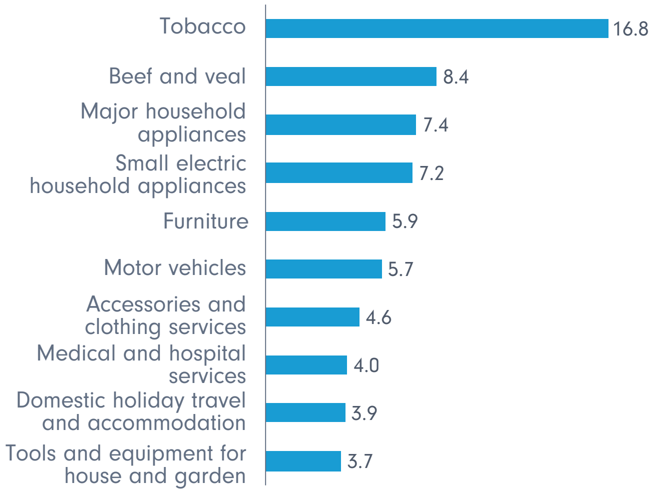
Helpfully for investors, economists at the RBA also estimated wealth effects by consumption category. The components of consumption that respond most to changes in wealth are typically durable goods, such as motor vehicles and household furnishings. The responsiveness of motor vehicles is particularly large – a 1% increase in housing wealth raises expenditure on motor vehicles by 0.6%. Many of the other expenditure categories that show a large response are discretionary items, such as recreation, furnishing and clothing. In contrast, expenditure on less discretionary items – such as food, rent and education – appears to be insensitive to changes in housing wealth. Several of these components account for a large share of aggregate consumption expenditure.

The RBA concluded in its research that when wealth increases, Australian households consume more. Spending on durable goods, like motor vehicles, and discretionary goods, such as recreation, appears to be most responsive to changes in household wealth, although many categories of consumption expenditure appear to grow more quickly when wealth increases.

The positive relationship between consumption and wealth is particularly robust for housing wealth and has been stable over time.

Interestingly, these results have been reflected in inflation over the past 12 months. Major household appliances are up 7.4%, furniture is up 5.9%, motor vehicle prices are up 5.7%, and domestic holidays and accommodation prices are up 3.9%.

Figure 5: Inflation in the fastest rising categories reflects increased demand and supply disruptions. Percentage change from previous year – March 2021



Source: Fidelity International, ABS, June 2021.

Low interest rates are designed to spur borrowing, reduce saving, and generate higher house prices. This assists the RBA in meeting its goals in terms of employment and inflation by stimulating consumption. The longer-term question for the Australian economy is whether the run-up in asset prices (and subsequent increased levels of household debt) will result in rising financial instability risks in the future, particularly should interest rates need to increase to control rising inflationary pressures.

For investors, understanding the impacts of higher house prices on wealth, and which companies and sectors stand to benefit most from the increased consumption that will likely follow, could help them in their pursuit of long-term share market gains.

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