

Australian economic & property update

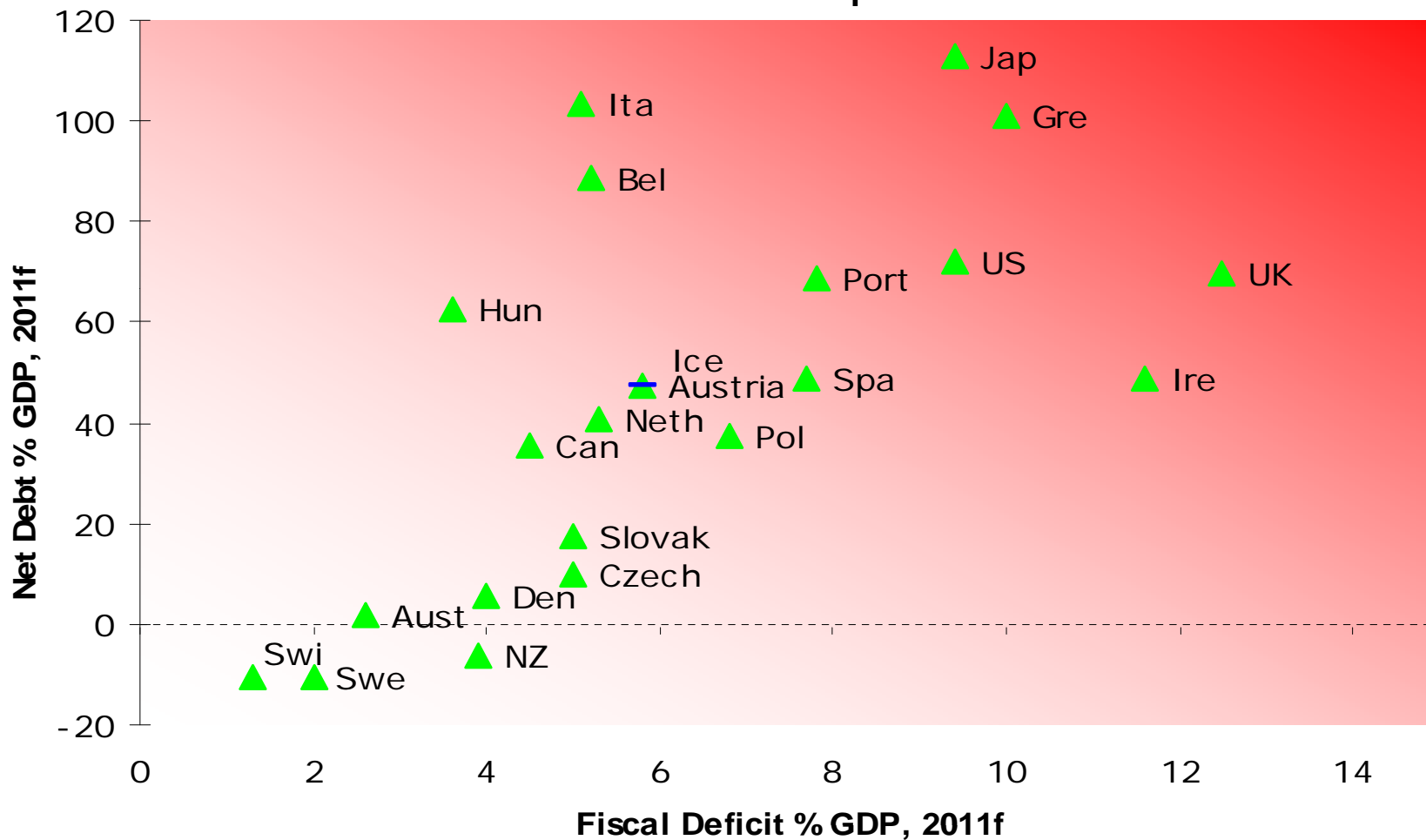
Paul Braddick
ANZ Banking Group Limited
Perth

November 2010



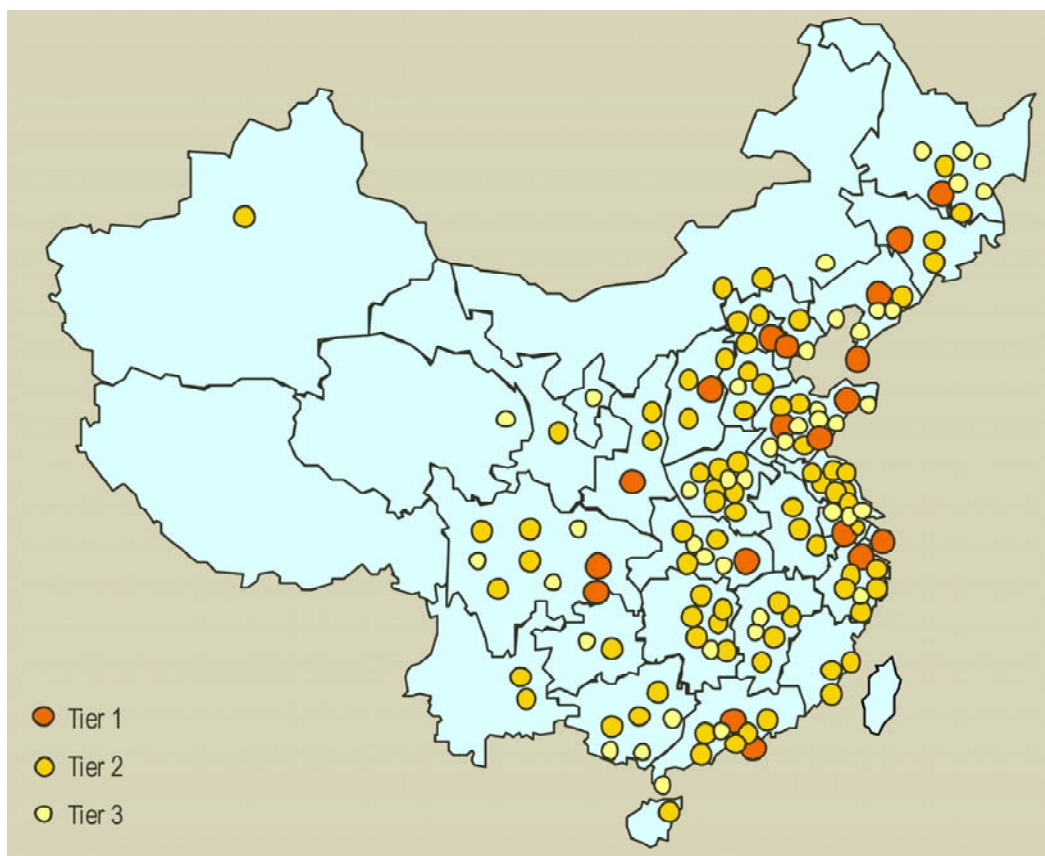
Debt overhang a key structural constraint for many key economies for years to come...

Fiscal & Debt position



...but China growth story is structural and ongoing

China's tiered city structure (2003 and 2025)



2003:

45 tier 1-3 cities

2025:

147 tier 1-3 cities

20 large economic zones

358 cities in total

11 cities ~ 15 million

18 cities ~ 10 million

US quantitative easing: inflation risks overplayed?

US growth languishing

- Unemployment remains stubbornly high
- Housing still in the mire
- Inflation low/xs capacity huge

Other policy measures exhausted

- Can't lower official policy rates
- Massive public debt -fiscal policy constrained

Fed to inject 600bn over 8 months

- \$75bn per month or 0.9% of M2 (flexible target)

Talk of excess liquidity overdone

- Hawks nervous but policy flexibility means QE can be lowered/stopped/reversed if necessary
- Lower US\$ will help ailing US economy

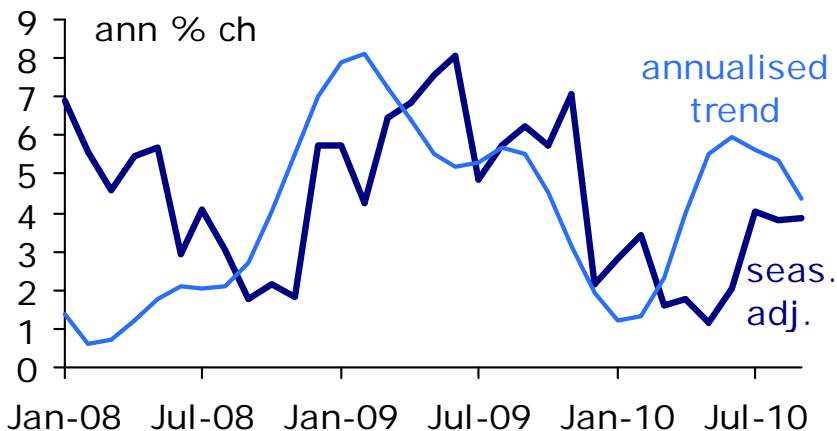
Will push A\$ higher

- Will lower import prices, hurt domestic competitiveness and reduce inflationary pressures

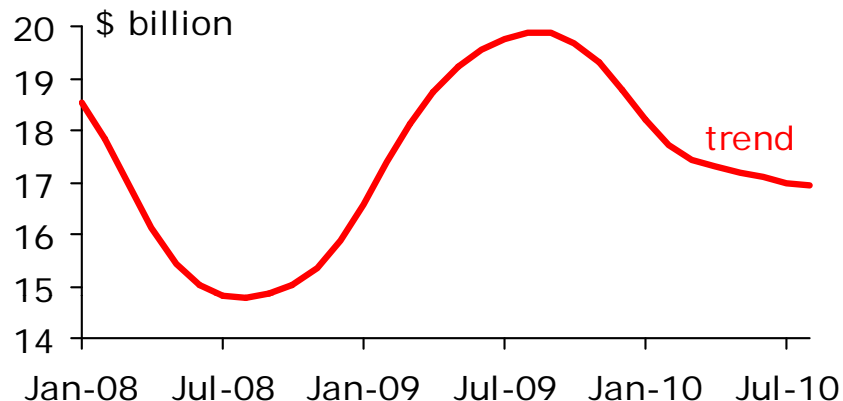


Domestic data flow softened as stimulus withdrawn but underlying momentum solid

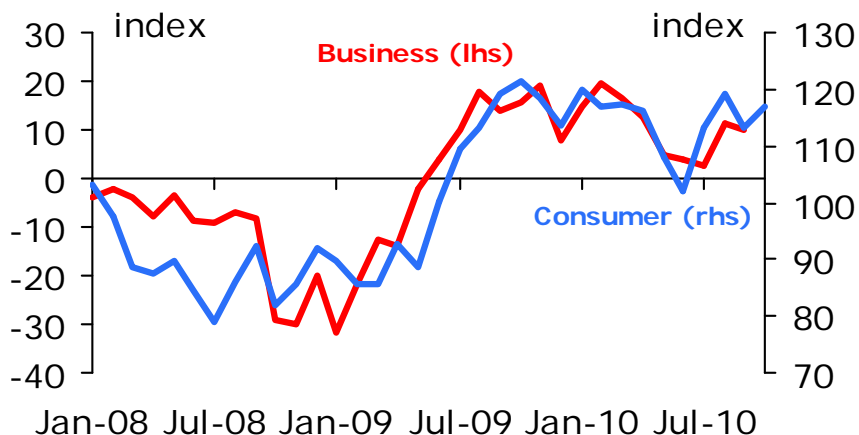
Retail trade



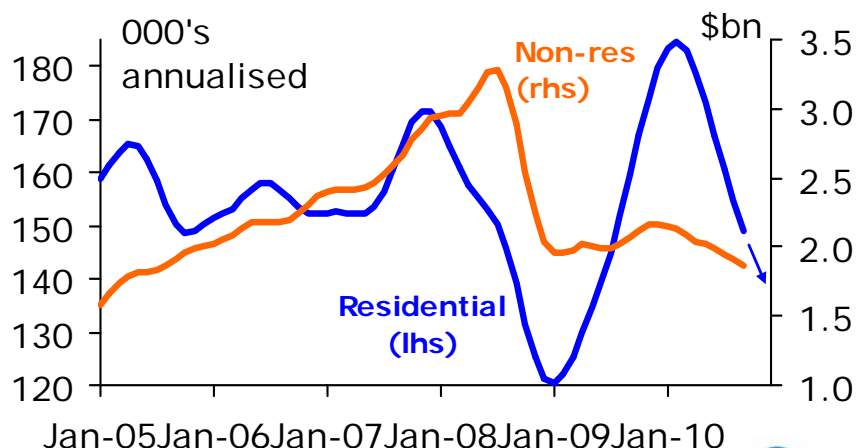
Housing finance (ex-refin.)



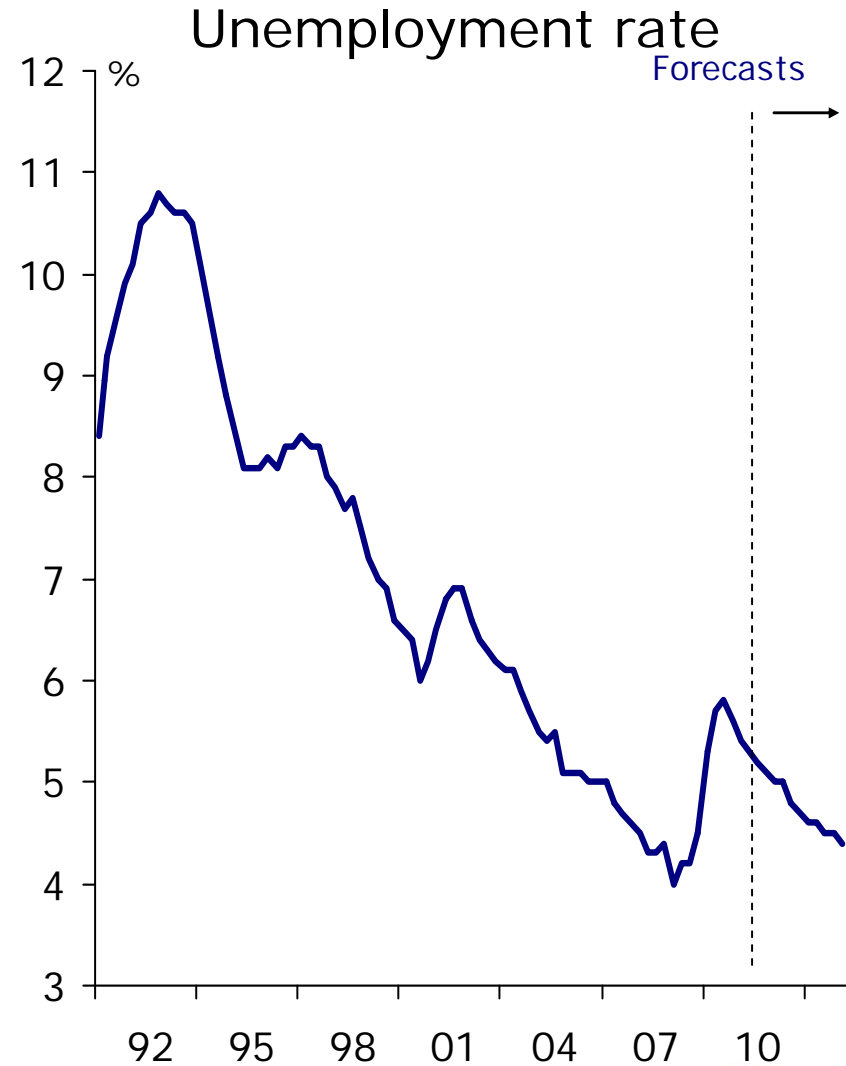
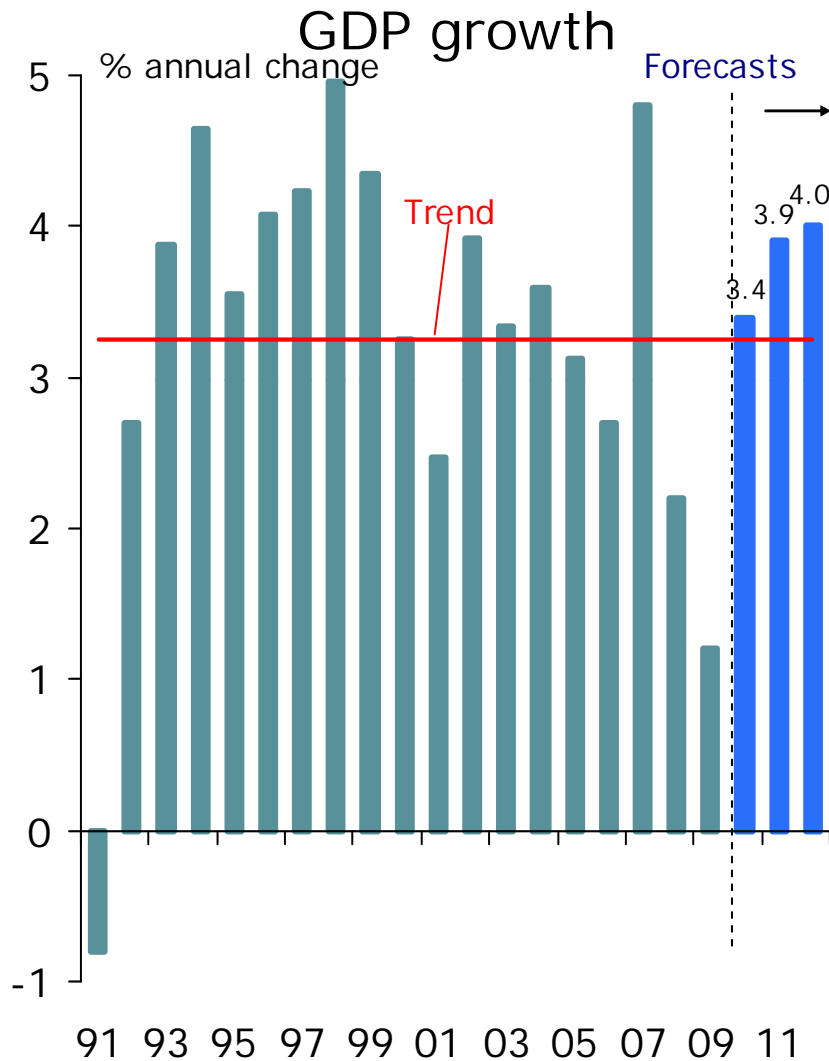
Consumer & business confidence



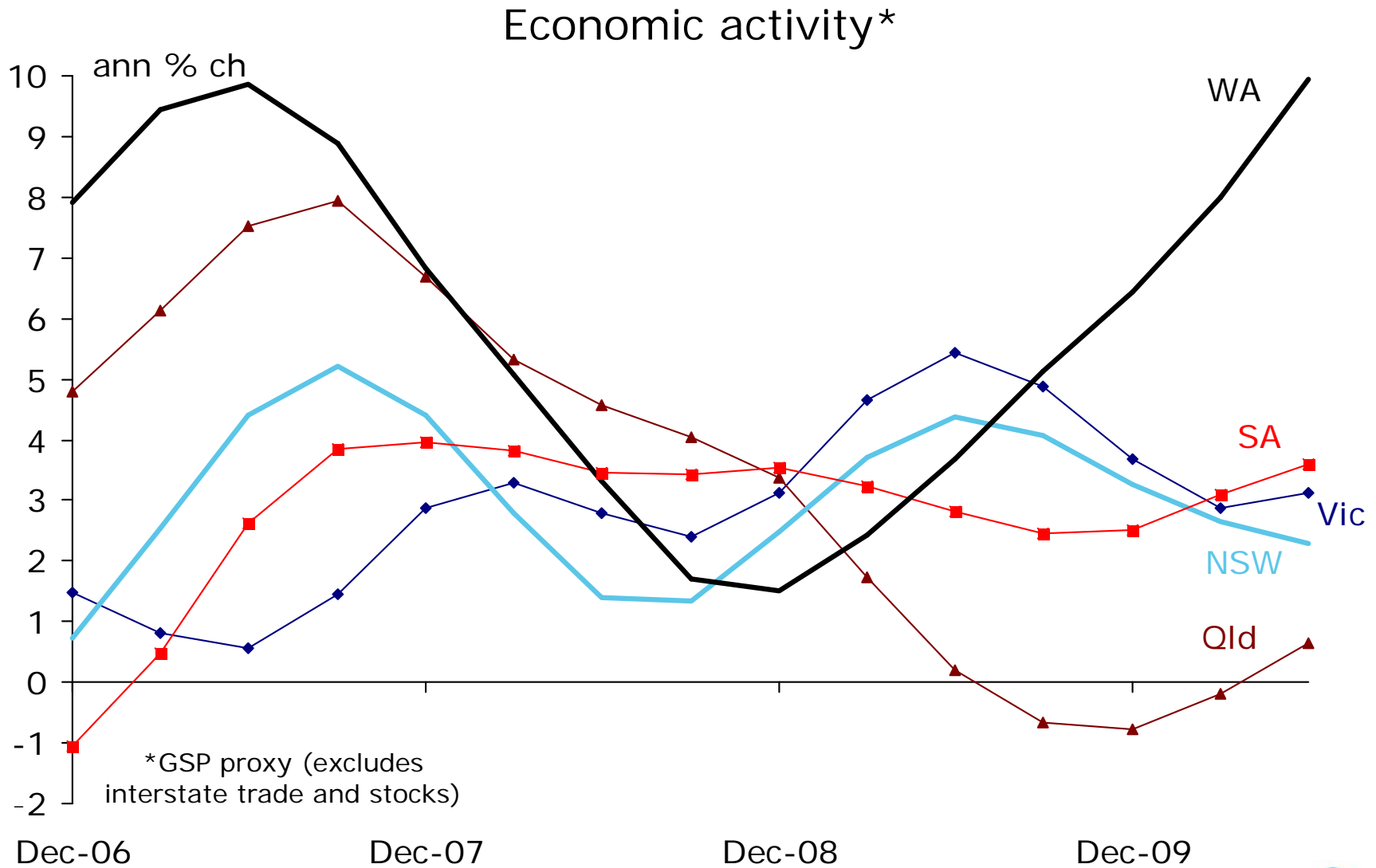
Building approvals



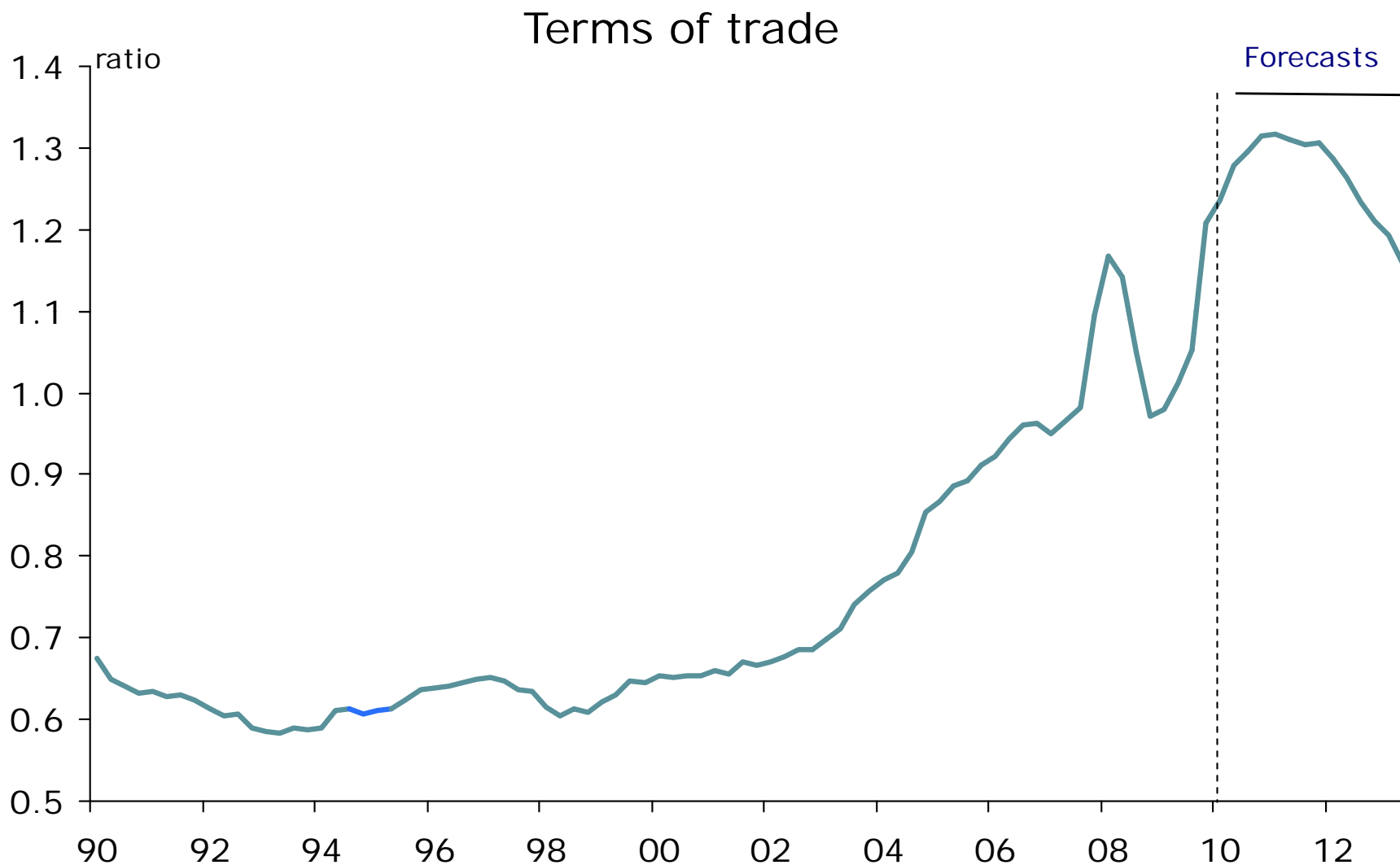
Australia has returned to trend growth, and unemployment will continue to fall



Return to a two speed economy?

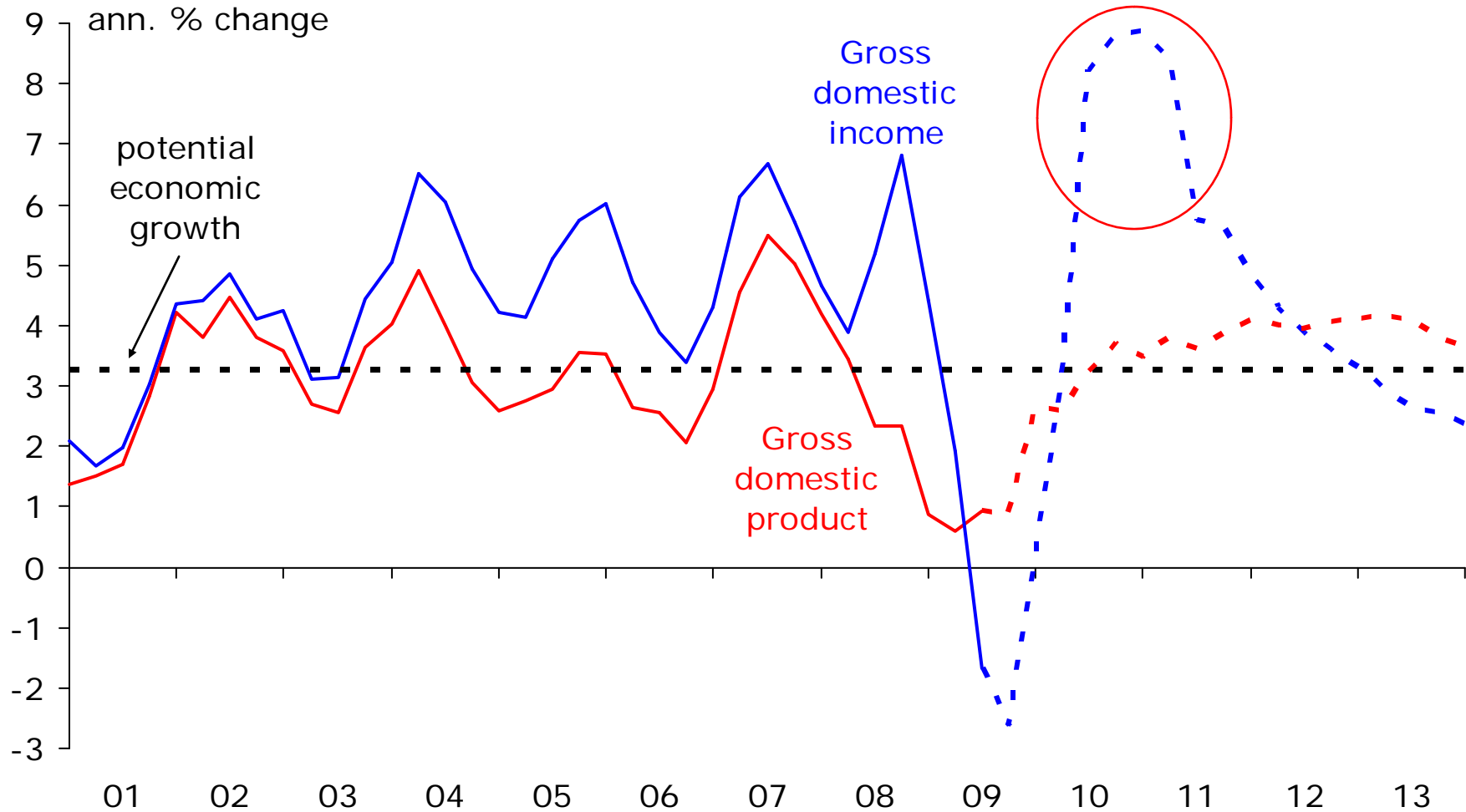


Commodity boom a key driver of growth in 2010-11



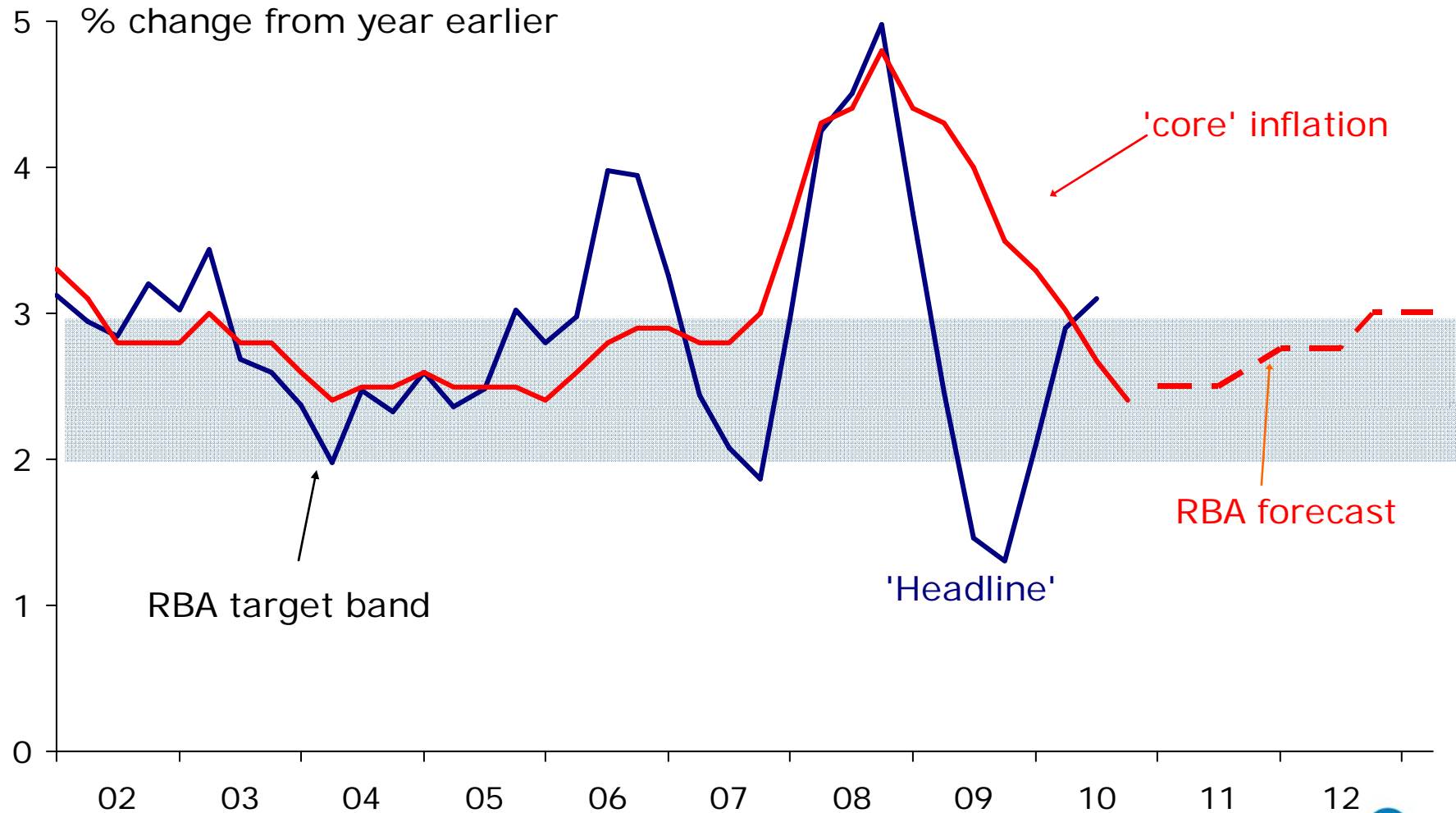
Rising terms of trade will provide a huge boost to income before tailing away in 2012

Economic growth



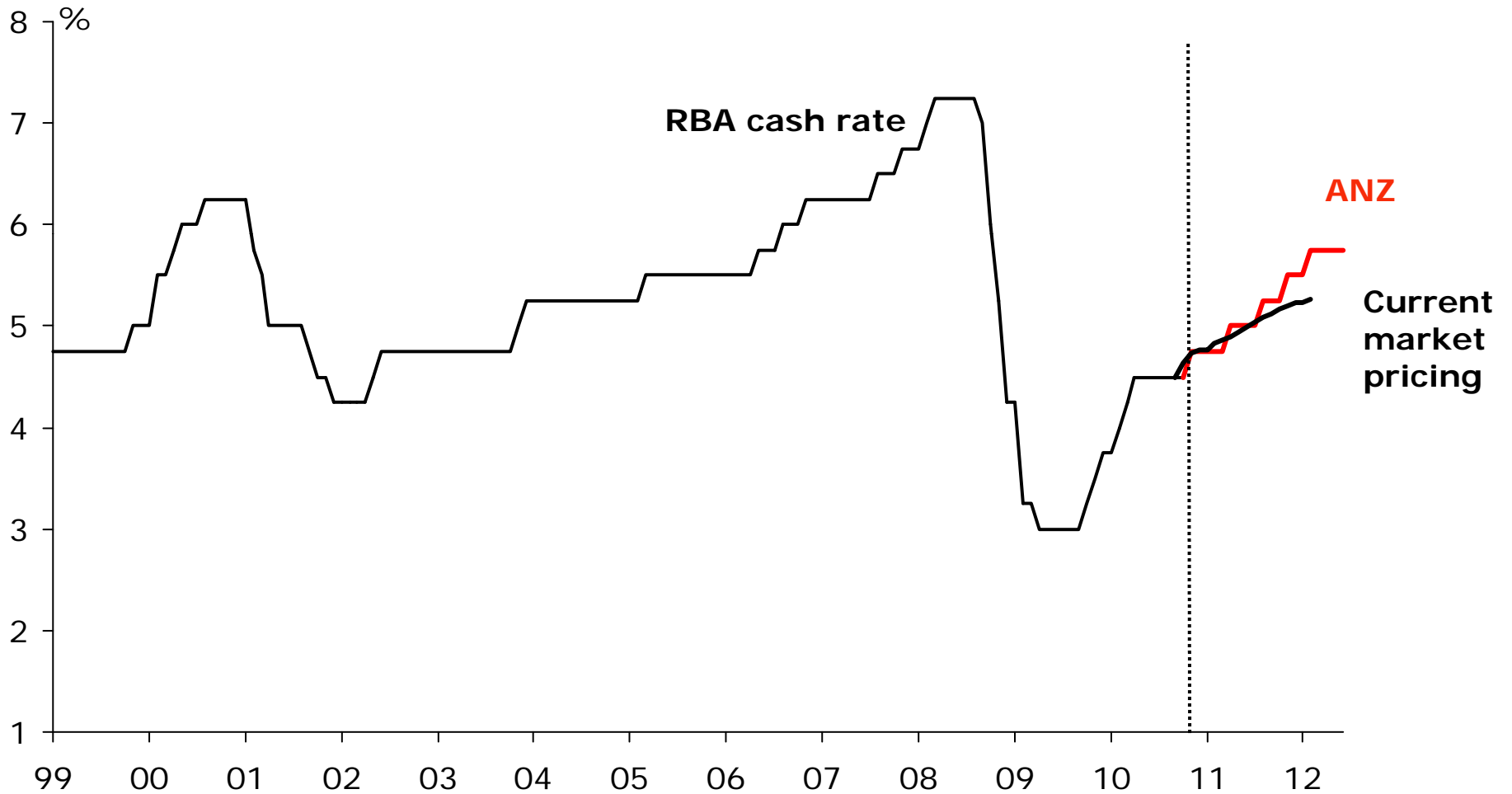
'Underlying' inflation back in target range but growth now accelerating *and capacity tight*

Consumer price inflation



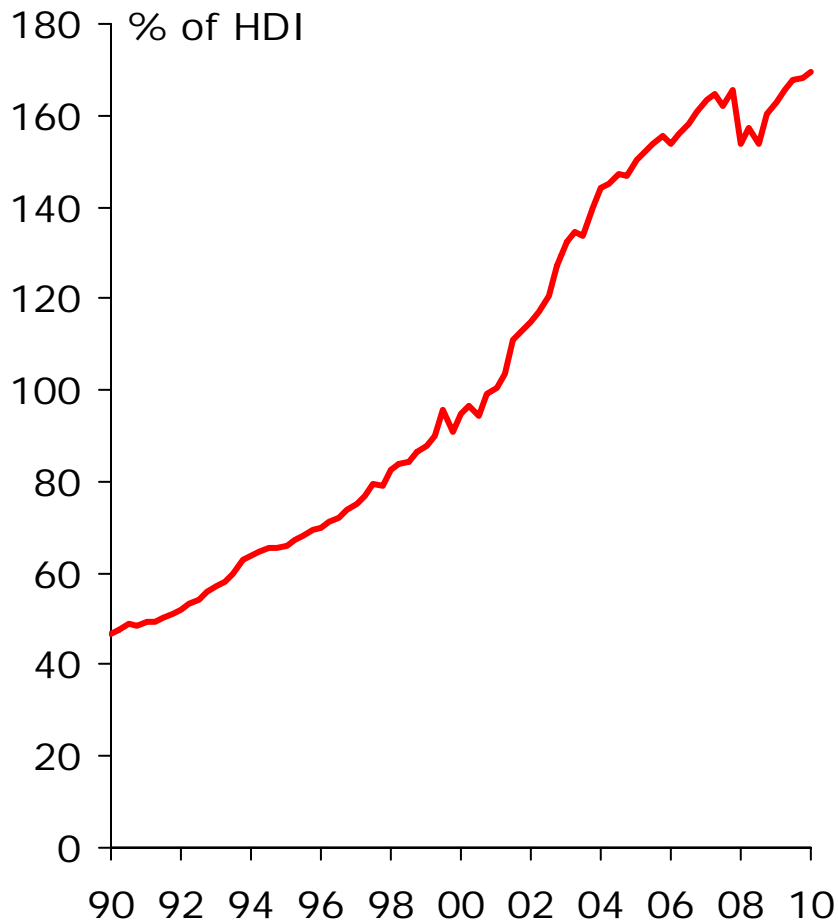
Consequently, further rate hikes still expected...

'Market pricing' of cash rate changes

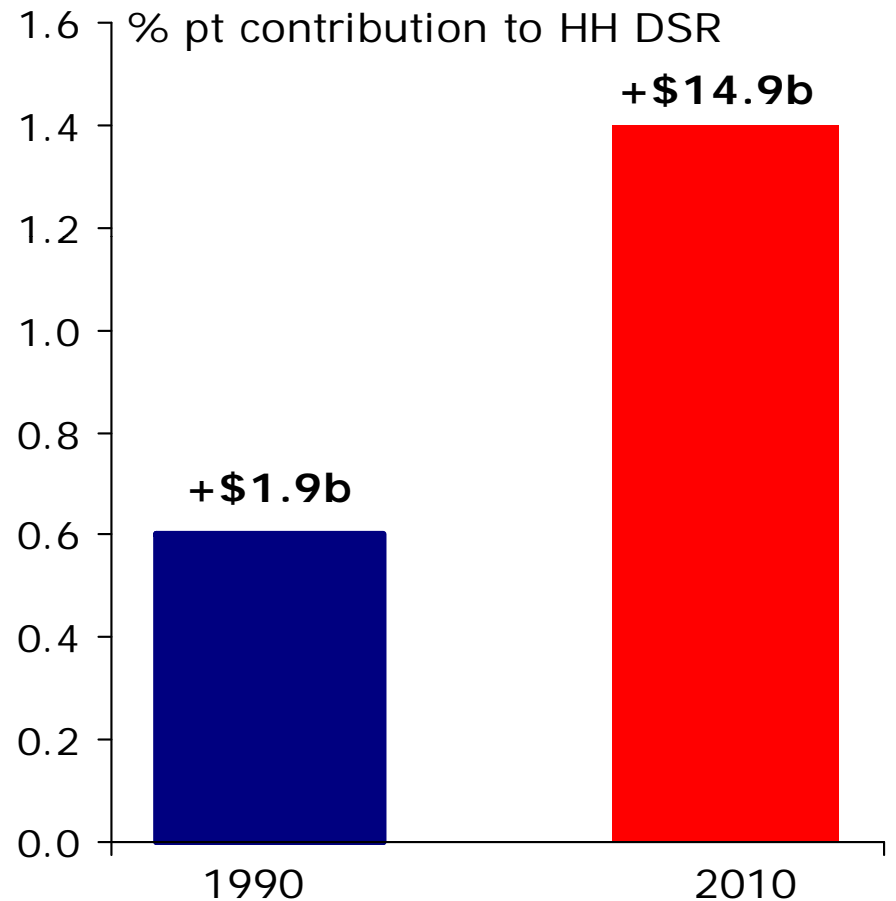


Monetary policy now has significantly increased leverage over the household sector...

Household debt to income ratio

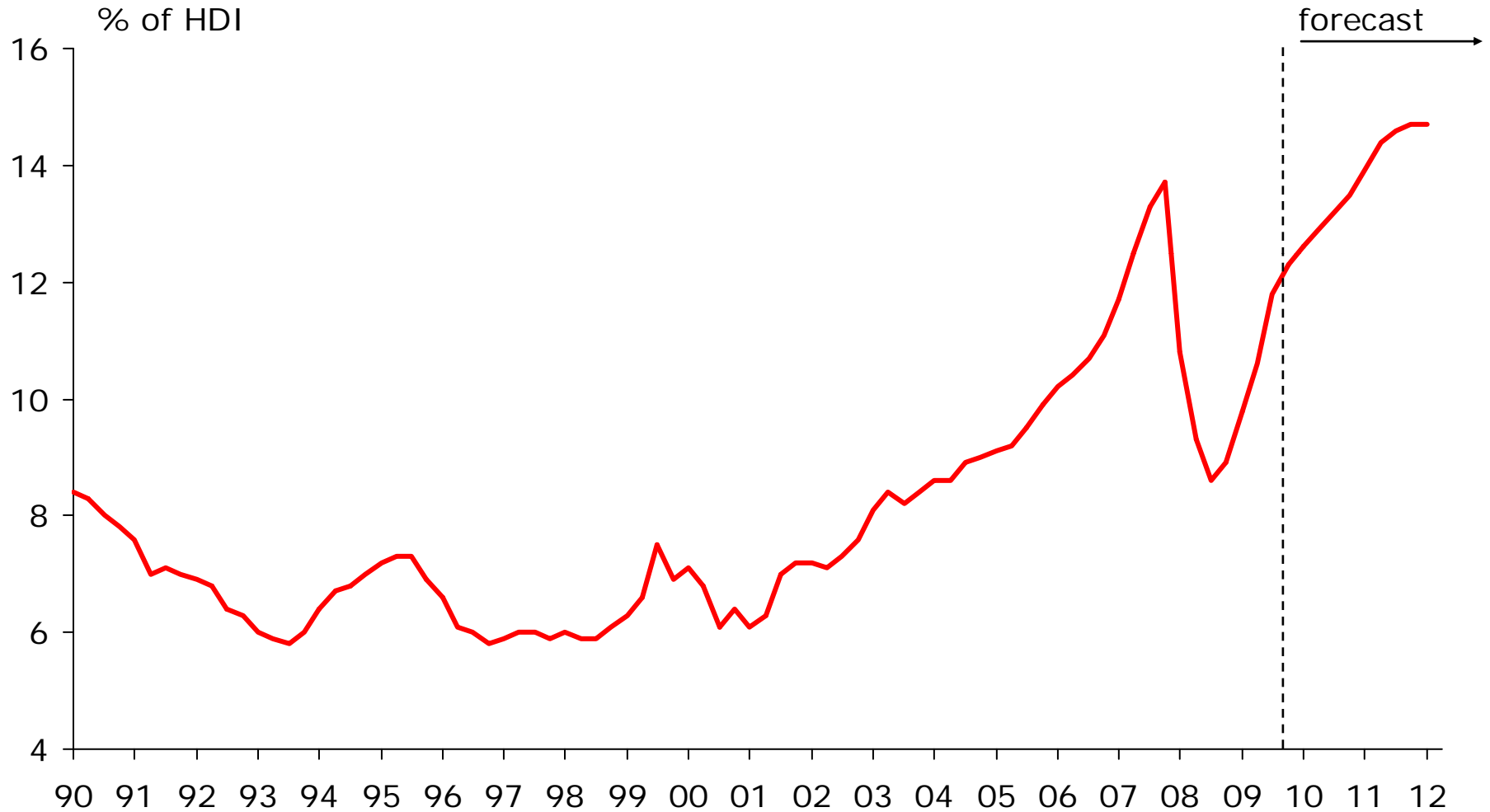


Impact on HH DSR of a 100 bps shift in monetary policy



...and the household sector could face a *record high* debt servicing burden in years ahead

HH debt service ratio



Despite risks, the housing outlook remains positive

House prices *decelerating...*

- Rising interest rates/FHB exit /FIRB back-flip/high \$A

...but buoyant economy...

- Strong economy/labour market/sentiment
- Substantial policy ammunition if global economy double dips (currency, monetary & fiscal)

...and strong housing fundamentals still very supportive

- Already severe shortage *will* get worse, vacancies tighten, rents re-accelerate
- Loan delinquencies remain low, reflecting conservative lending criteria
- *Forced selling a pre-requisite for significant house price falls* and rising unemployment *highly unlikely* in next 2 years

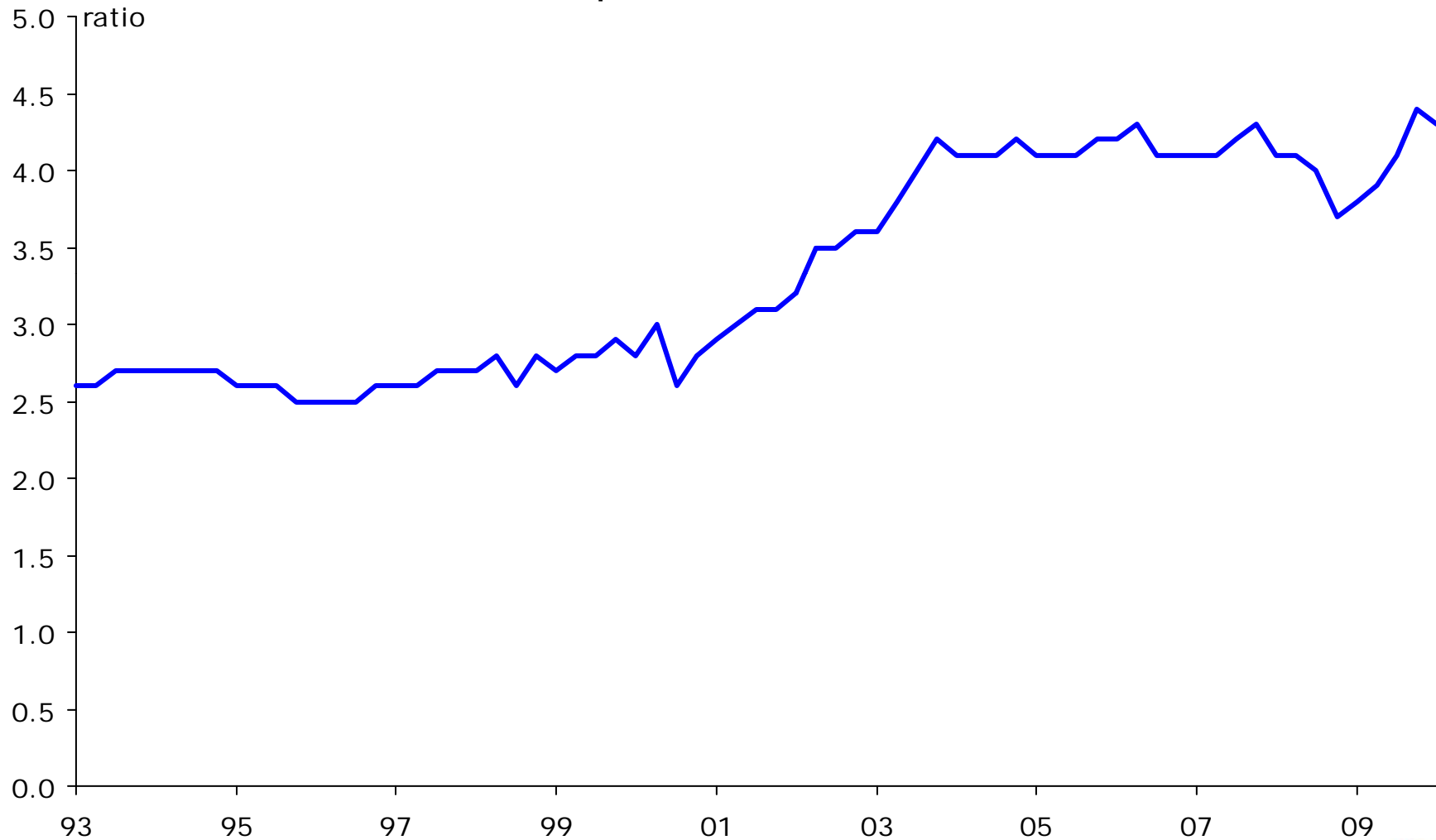
Household sector well placed

- Labour market strong, rising employment, wages, incomes
- Affordability will deteriorate, but interest rate buffers and income gains will protect serviceability

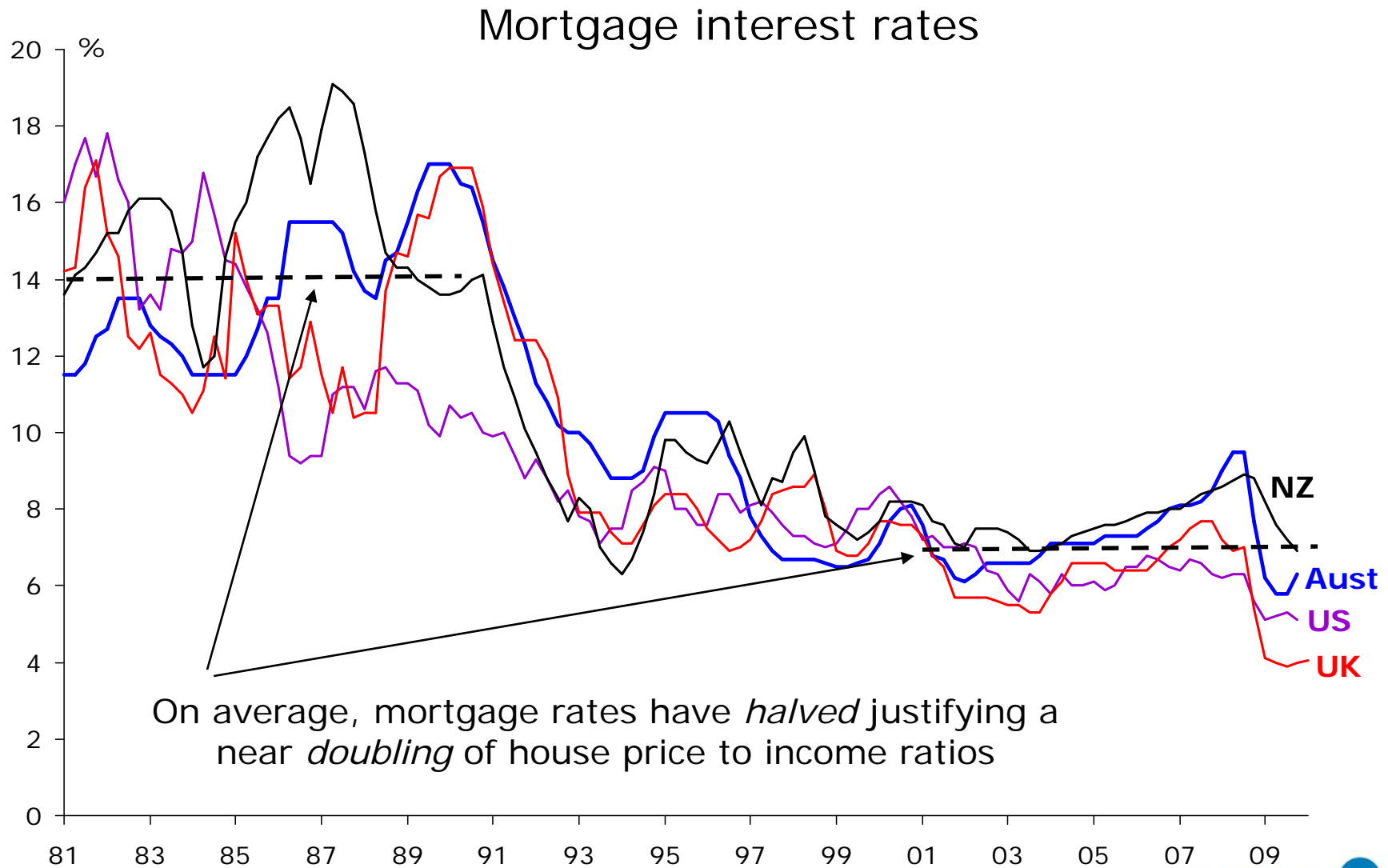


House prices have broadly tracked incomes since 2004

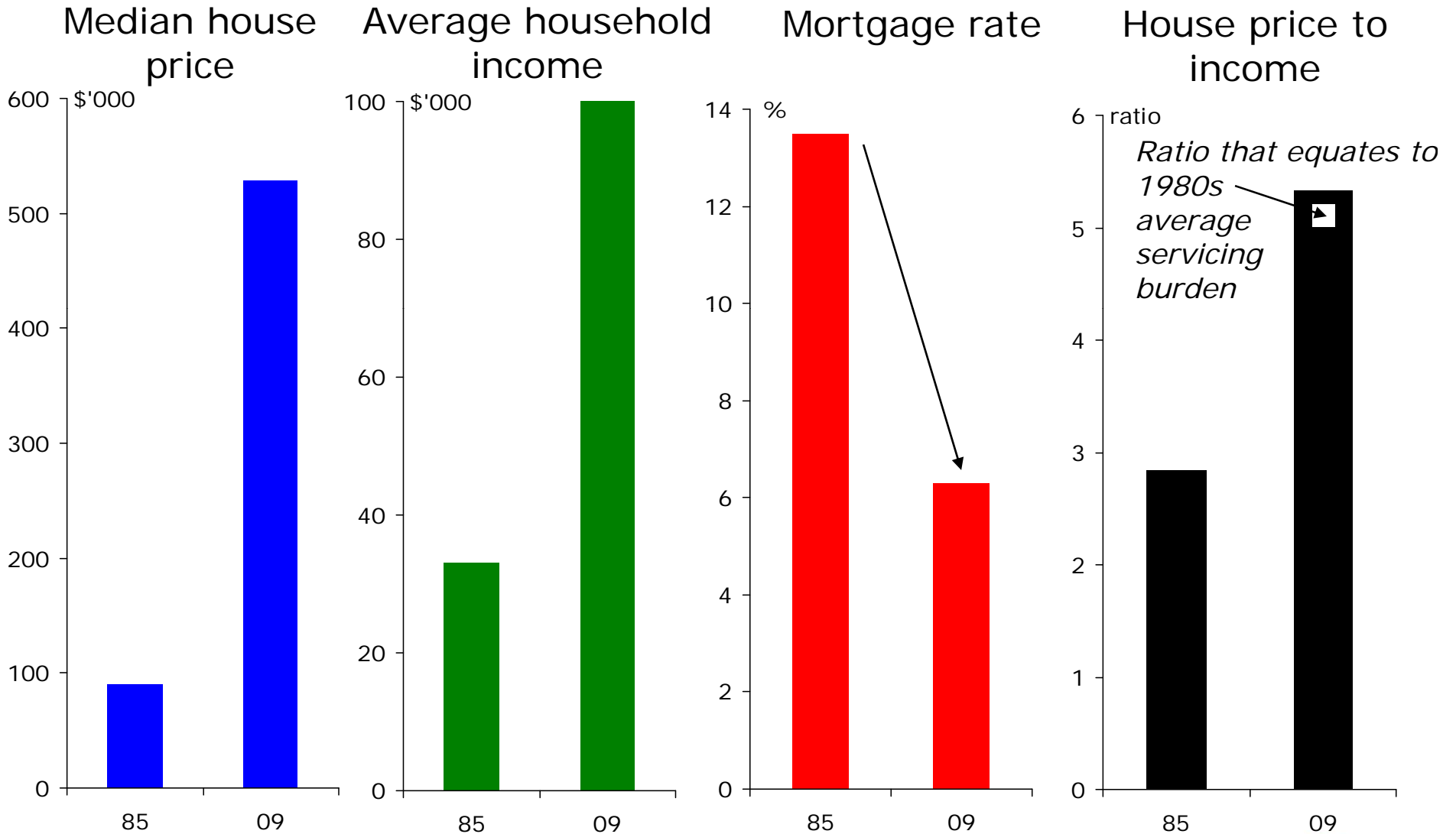
House price to income ratio



A structural lowering (halving) of mortgage rates has improved debt serviceability

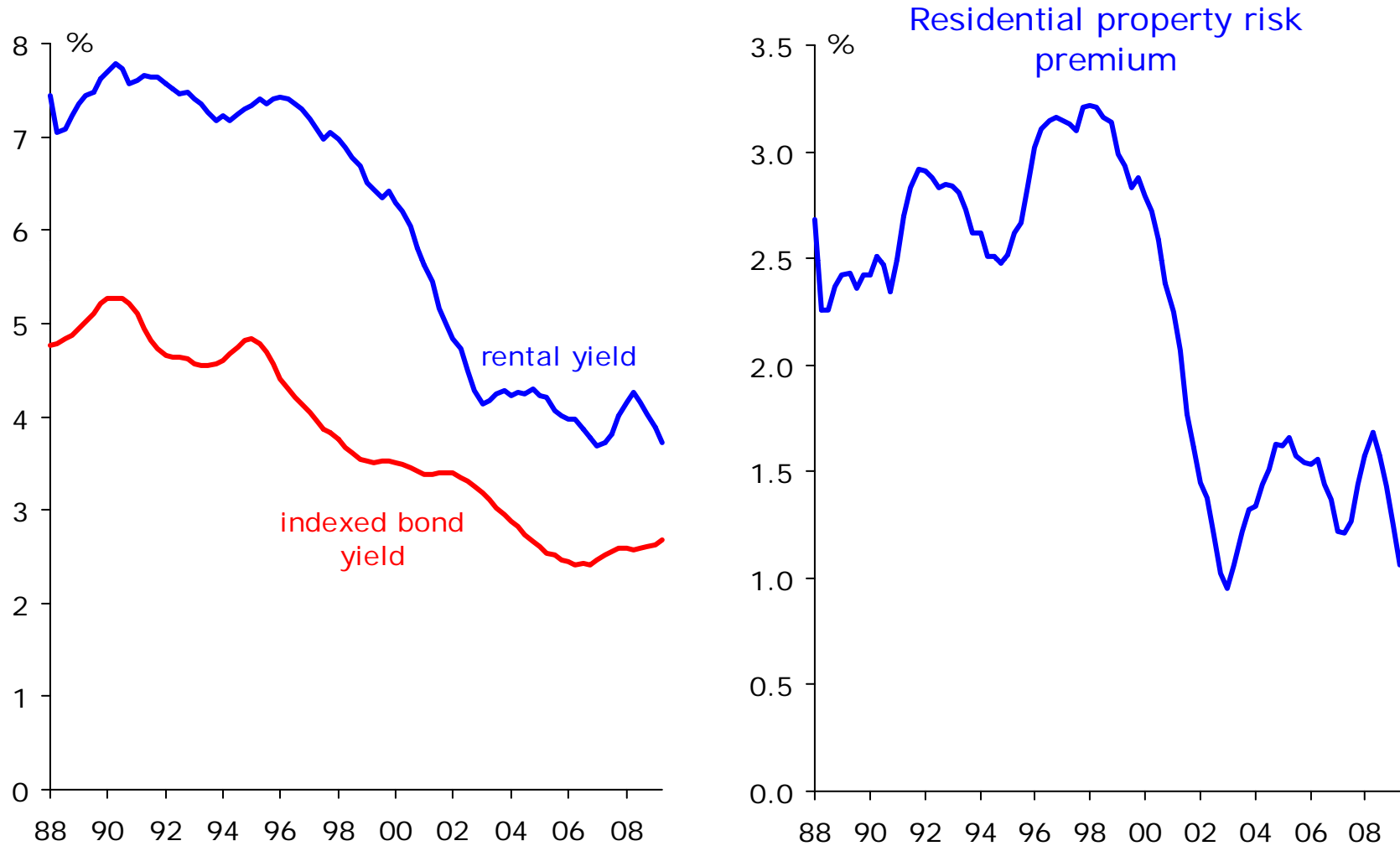


Increase in house price to income ratio *almost fully accounted for by halving of mortgage rate*



House prices have outstripped rental growth...

House prices to rent



...but does the significant decline in rental yields imply overvaluation?

- Decline partly explained by structural decline in risk free benchmark
- Nonetheless, residential 'risk premium' has also compressed
- 'Reversion' to average historical risk premium *implies house prices are 40% overvalued (ceteris paribus)*
- PV of future rental stream *implies house prices are 25% overvalued (ceteris paribus)*
- However, ceteris ain't necessarily paribus...
- ...rents adjust more slowly than prices and record low vacancies and deteriorating home purchase affordability suggest rent growth will outstrip prices in years ahead, pushing yields higher
- Risk premium dependant on:
 - market fundamentals (vacancy rates, housing shortage)
 - Relativity to other asset risk premia
- Highly questionable whether housing should be treated as a pure asset
- Rental yield *data* potentially misleading
- Conclusion: Use of rental yield or even risk premium as a measure of 'fair' value *highly questionable*



Are Australian house prices 'overvalued'?

Can we estimate 'fair' value?

Measures:

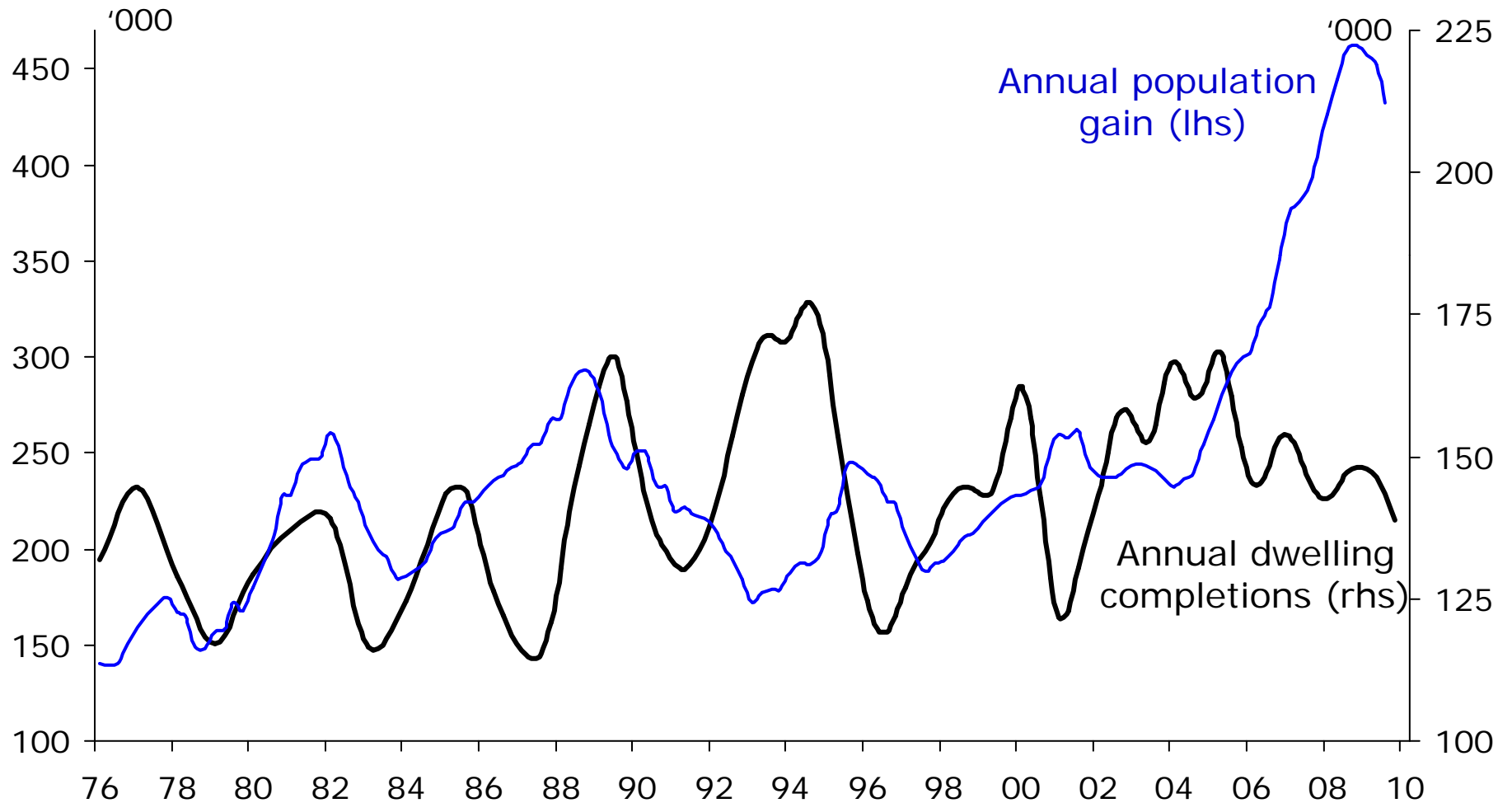
1. House price to income ratio (fundamentally flawed)
2. Housing debt service ratio (reasonable)
3. Prices to rent
 - Reversion to historic 'property risk premium' (questionable)
 - NPV future income (questionable)

No single measure can adequately account for the multitude of influences that determine house prices



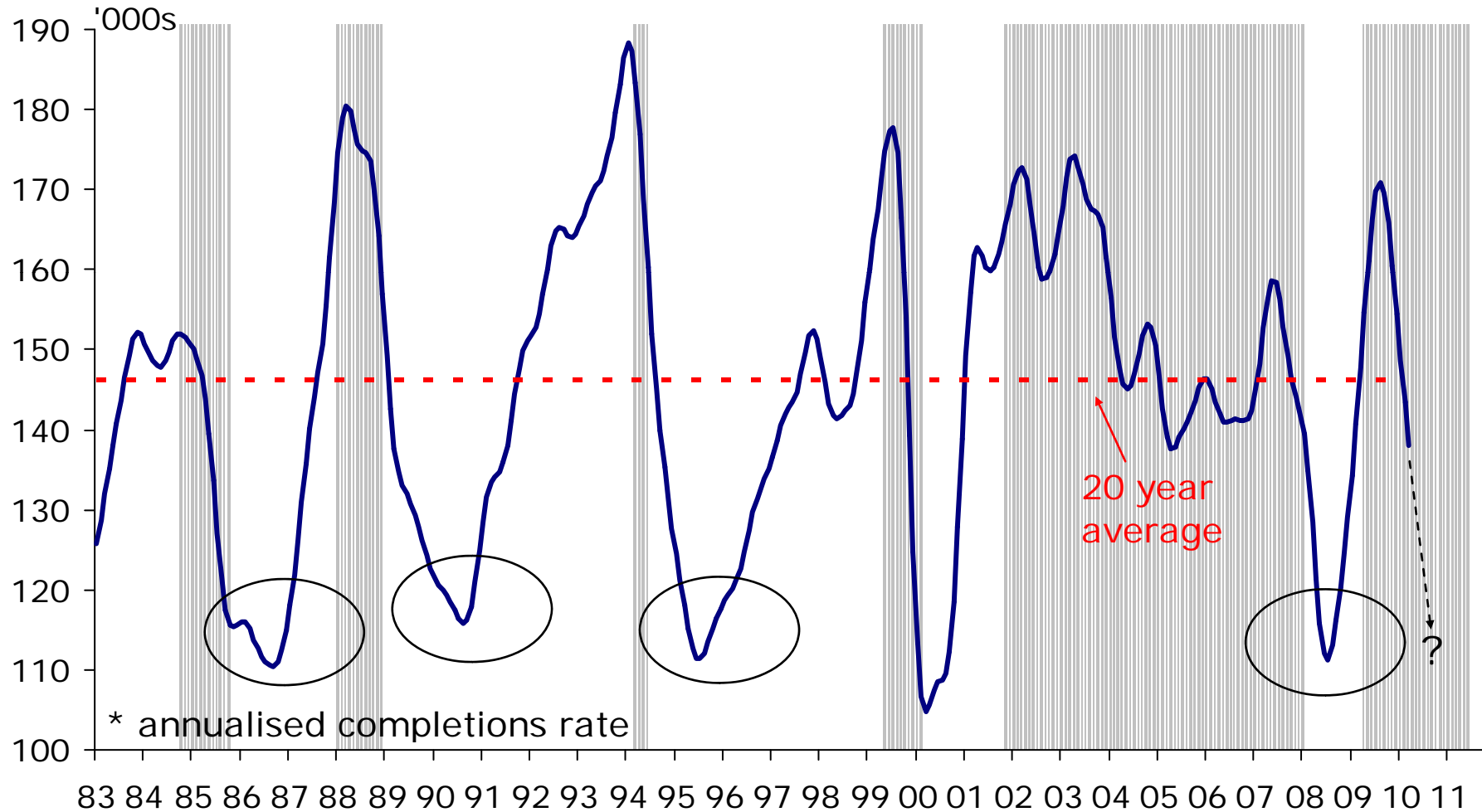
Australian population accelerated to *record highs* while home building weak

Population growth vs. dwelling completions



New dwelling approvals already falling – will be hurt by further rate hikes

Dwelling approvals*

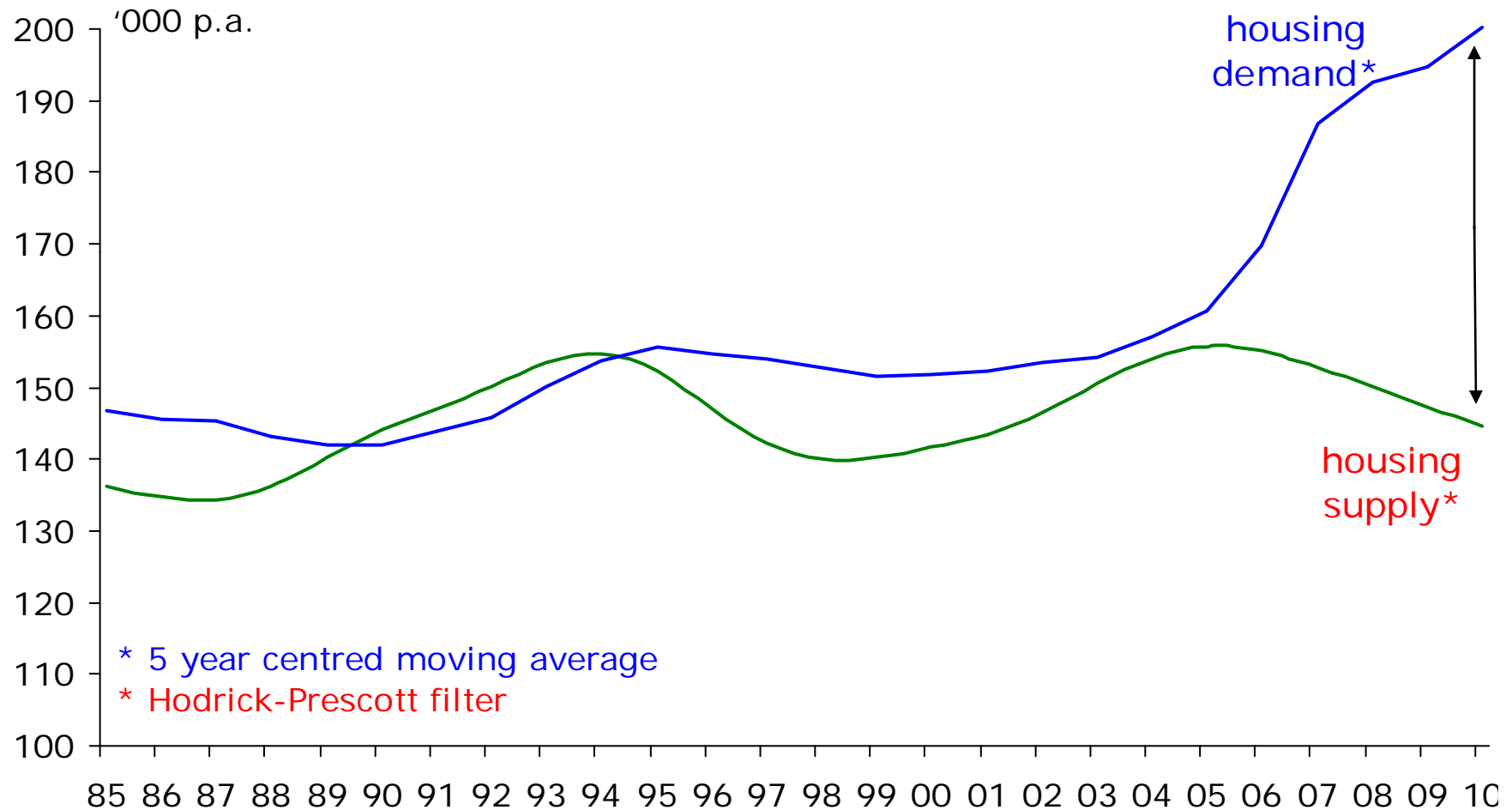


* annualised completions rate



Has a *structural* gap opened up between housing supply and demand?

Housing supply vs. housing demand



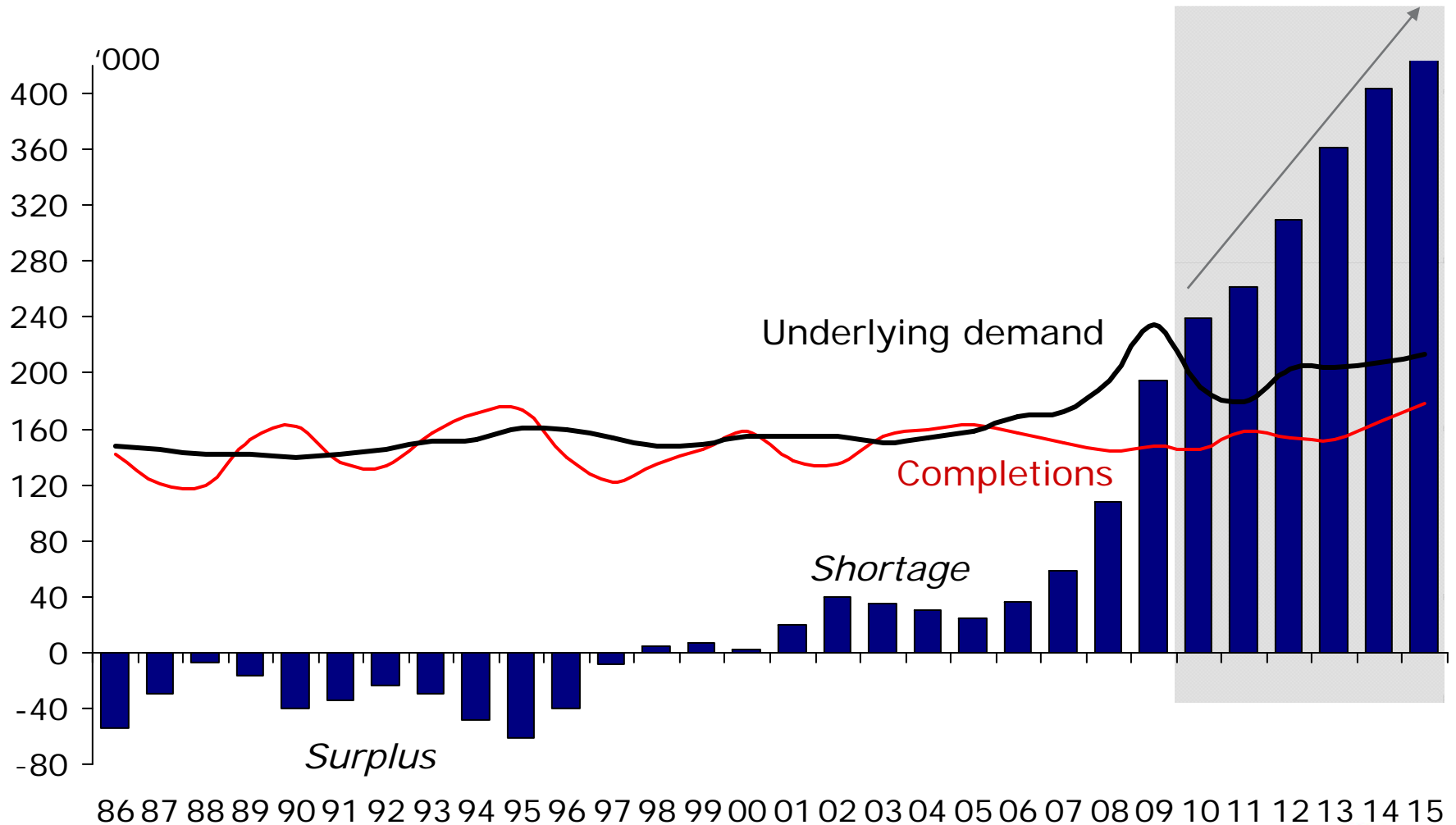
* 5 year centred moving average

* Hodrick-Prescott filter



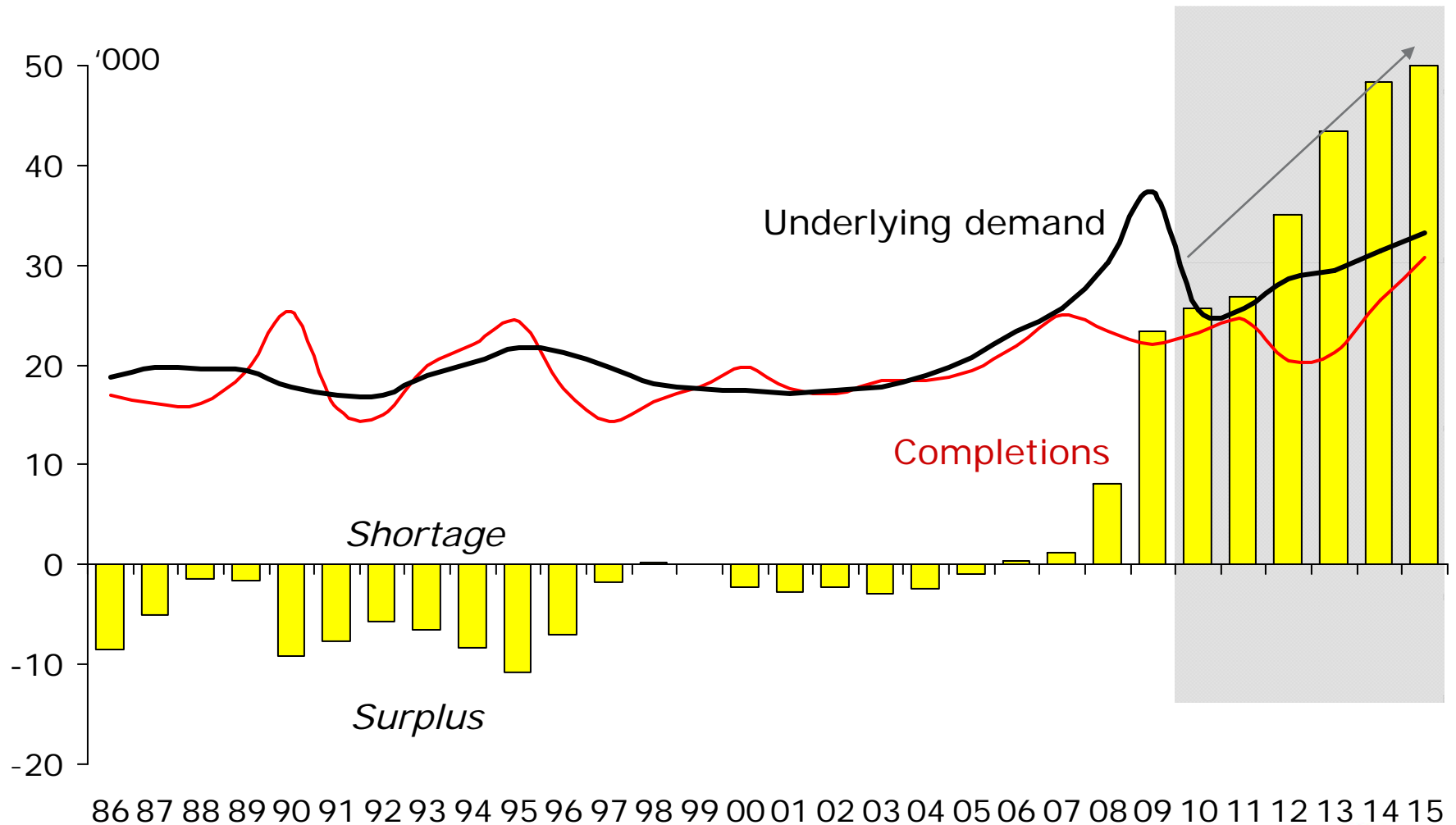
The housing shortage has already reached unprecedented levels – and will get much worse!

Housing market balance



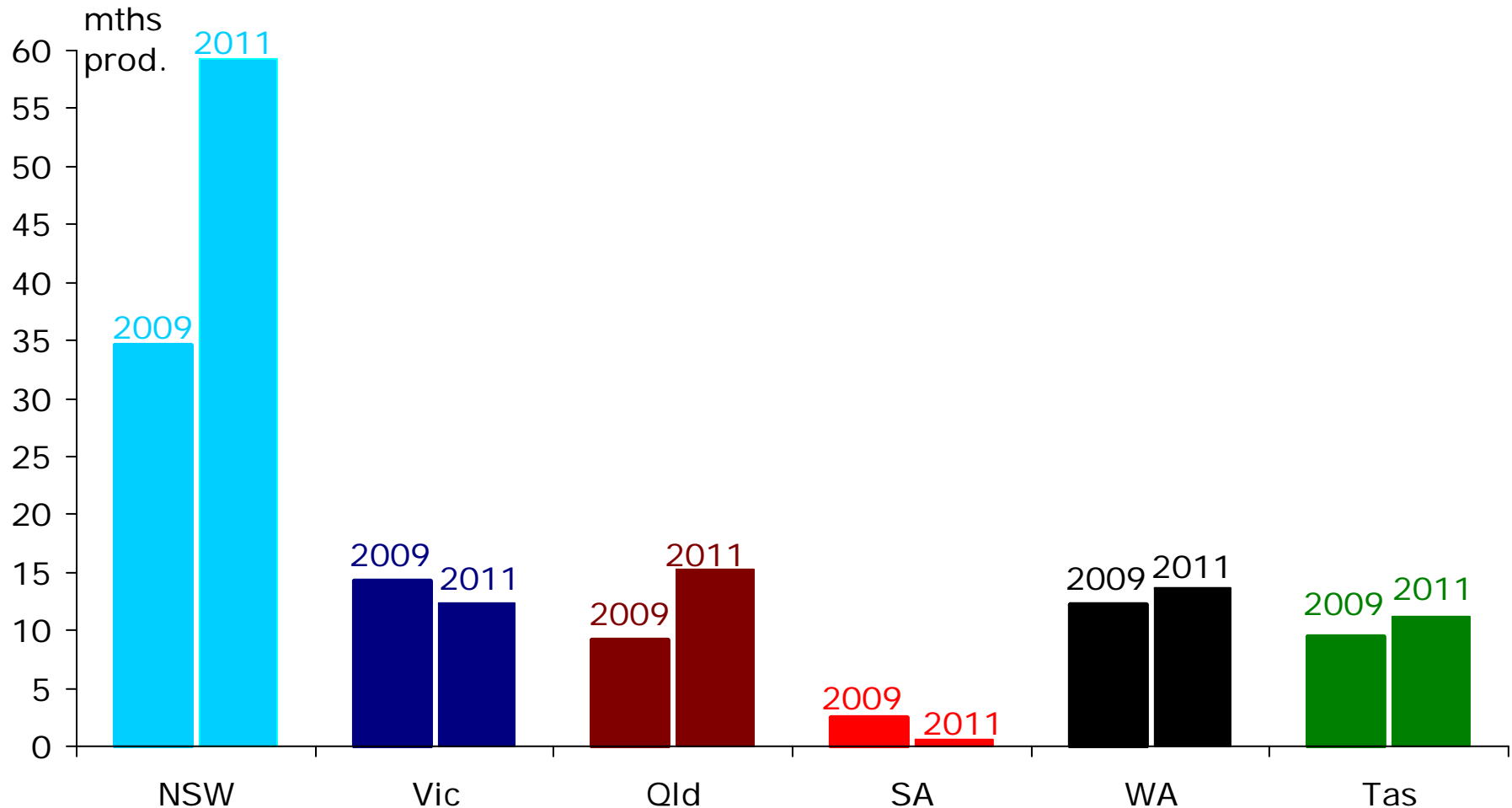
The housing shortage has already reached unprecedented levels – and will get much worse!

WA housing market balance



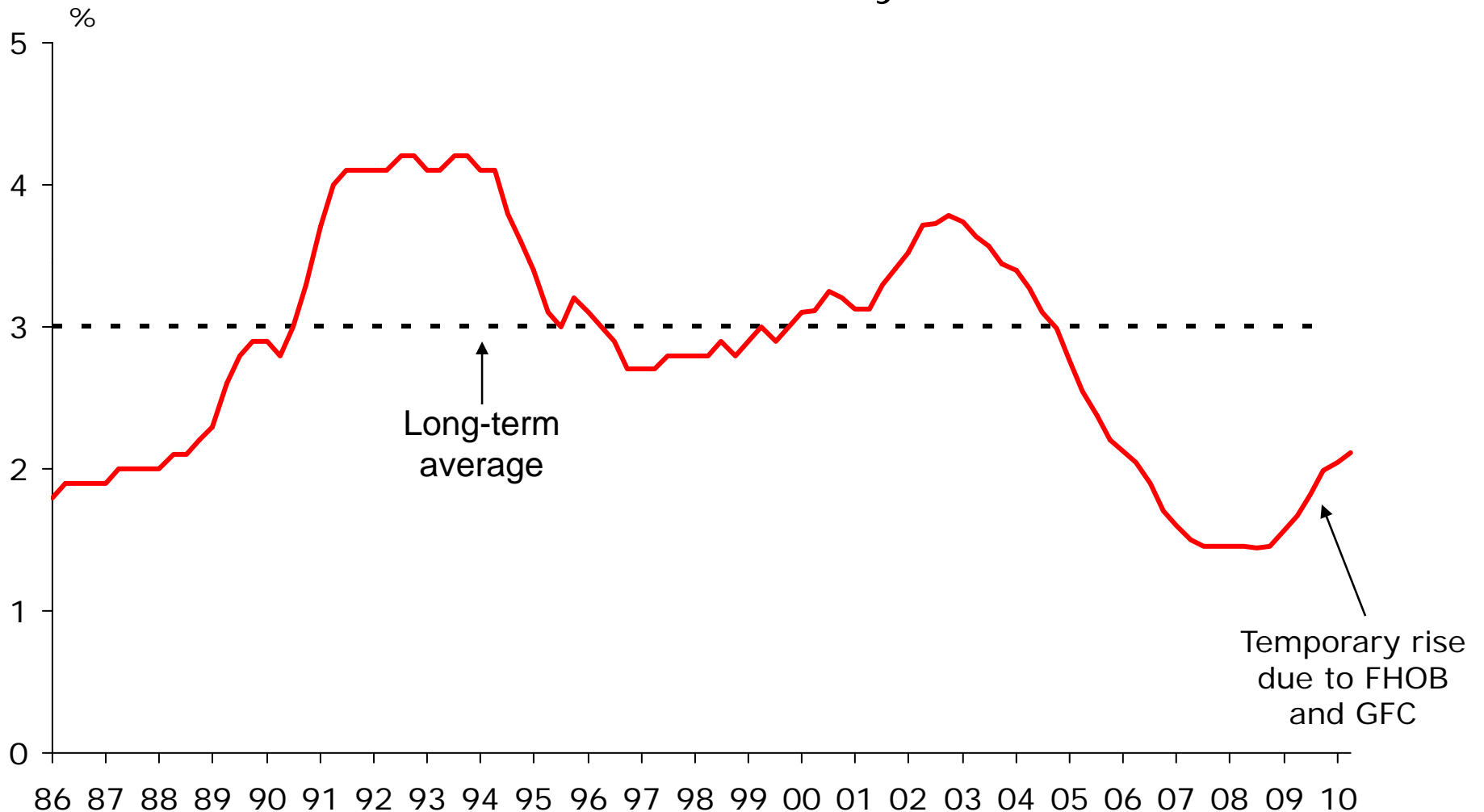
Pent-up demand is rising in all states, but especially in New South Wales – almost 5 years supply!

Pent-up housing demand by state



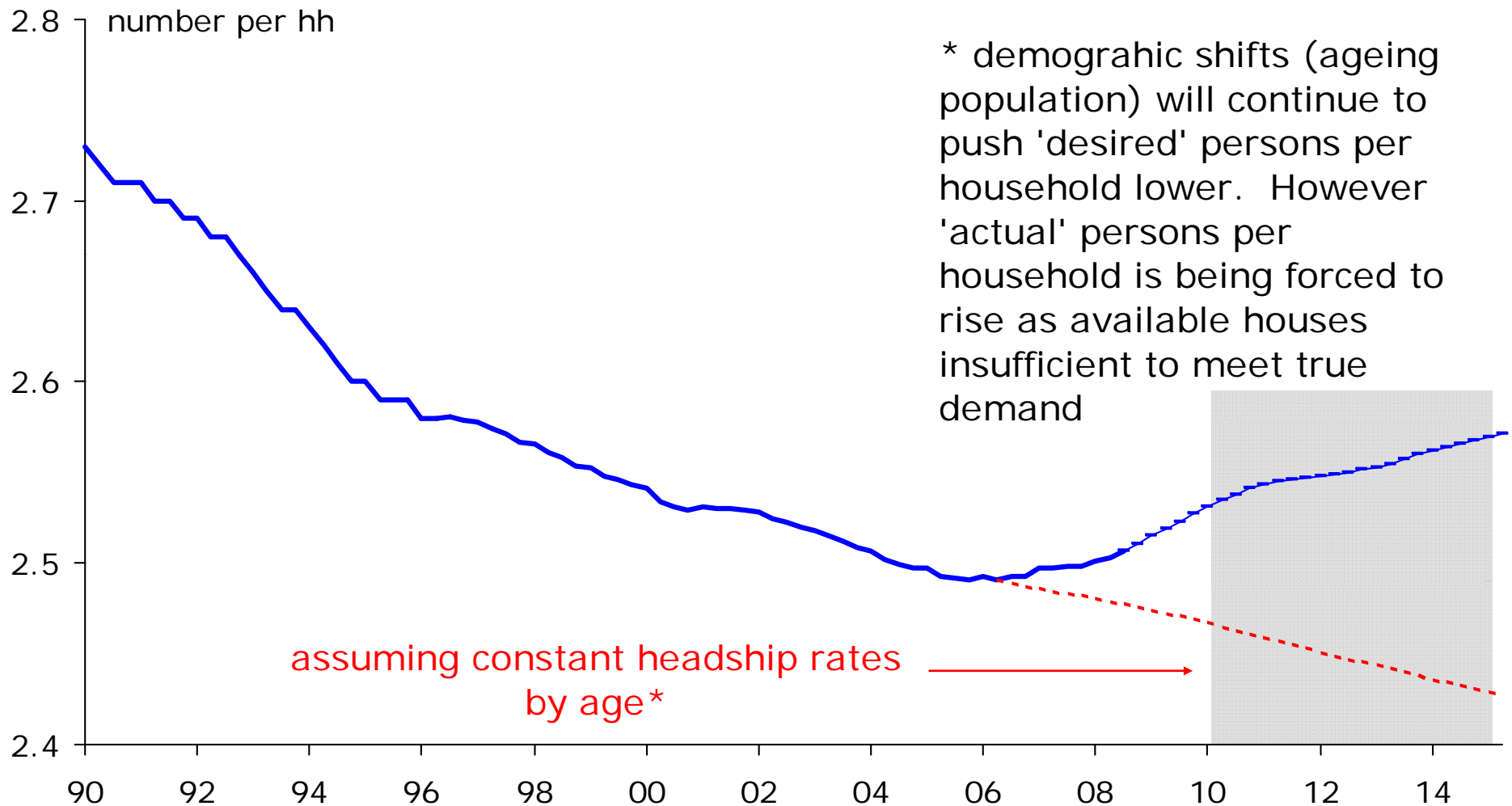
Vacancies tight (despite FHOB) and will tighten further in years ahead

Residential vacancy rate



Shortage of housing already forcing an *involuntary* rise in persons per household

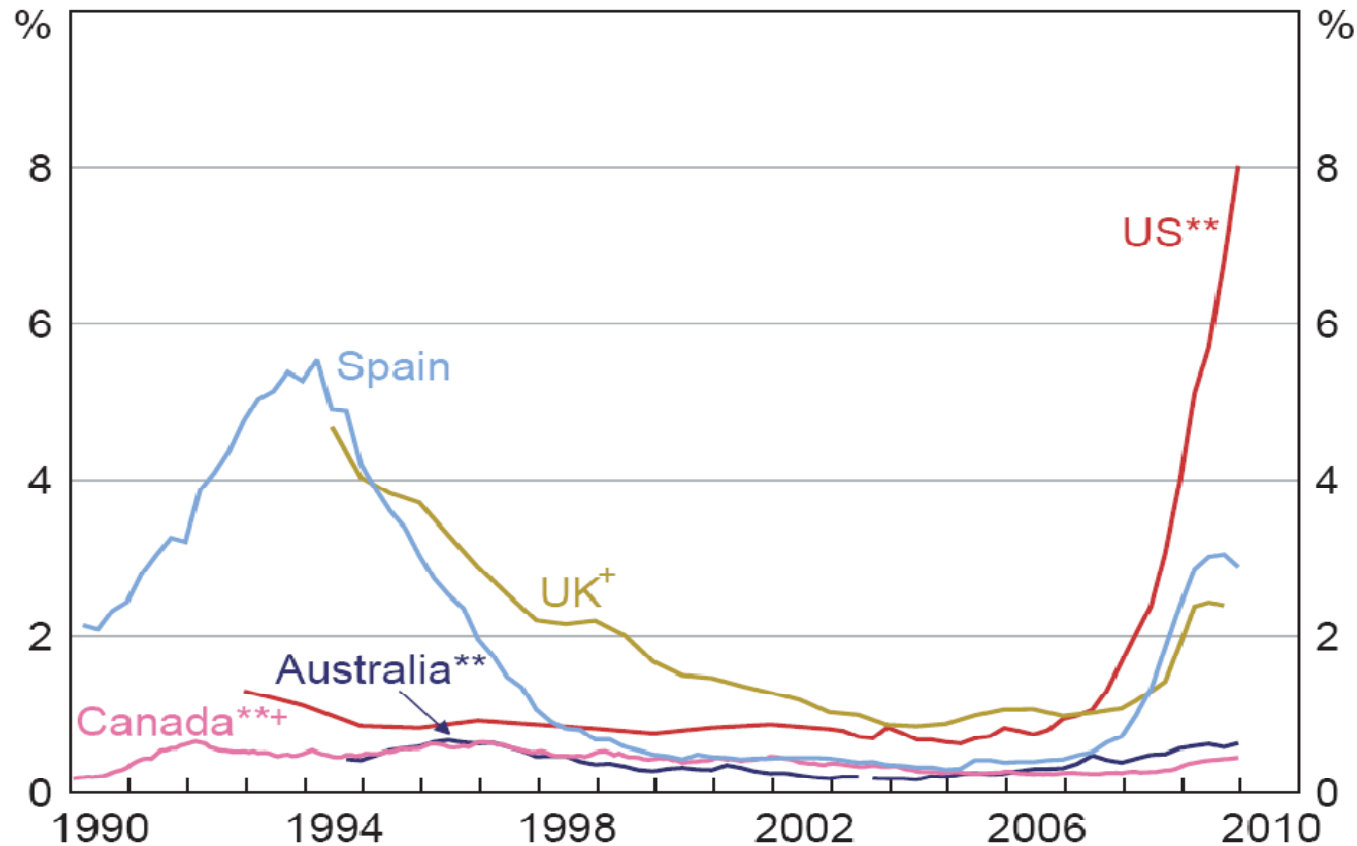
Persons per occupied dwelling



Conservative lending meant Australian banking sector remains sound – *very few forced sales*

Non-performing Housing Loans

Per cent of loans*



* Per cent of loans by value. Includes 'impaired' loans unless otherwise stated.
For Australia, only includes loans 90+ days in arrears prior to September 2003.

** Banks only.

+ Per cent of loans by number that are 90+ days in arrears.

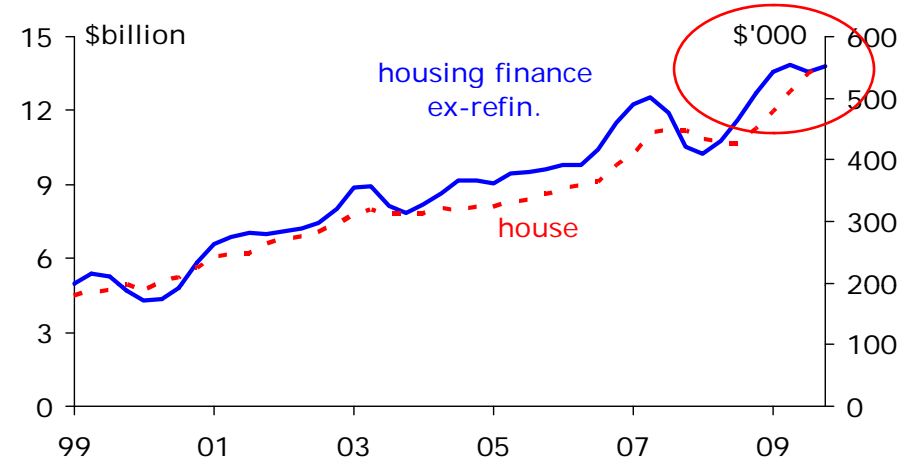
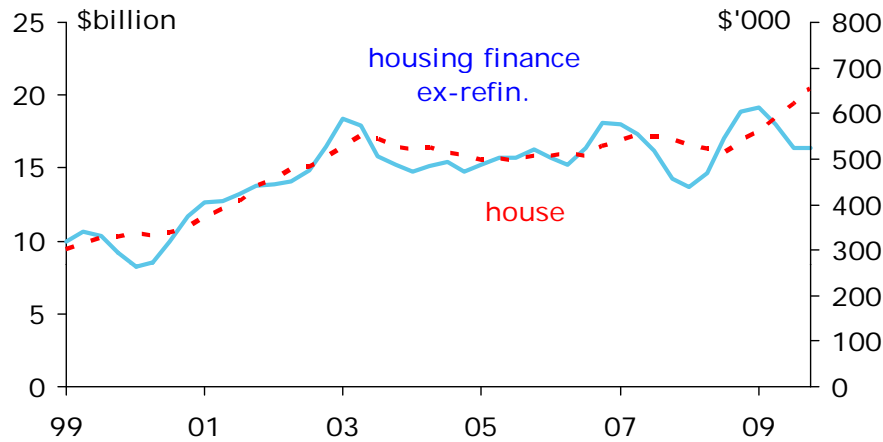


Housing finance has weakened everywhere *except* Victoria

Housing finance vs. house price

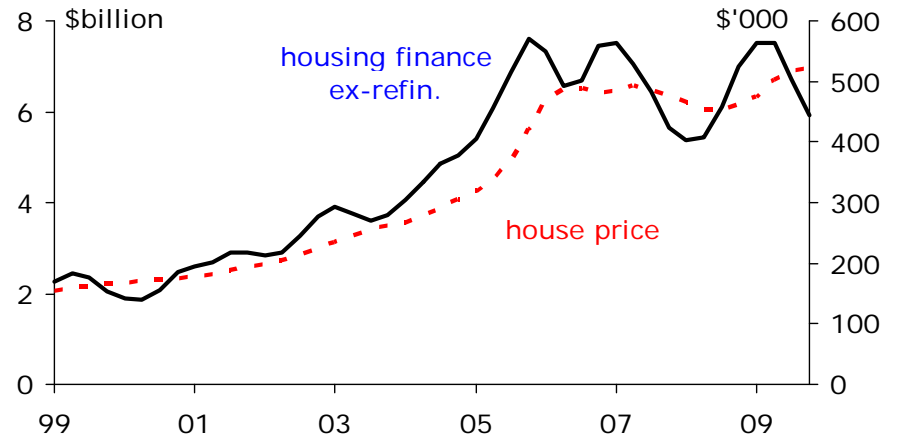
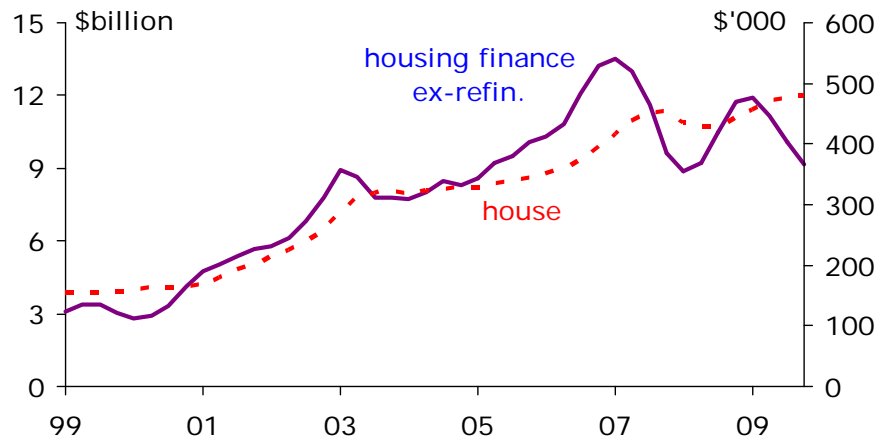
NSW

Vic.



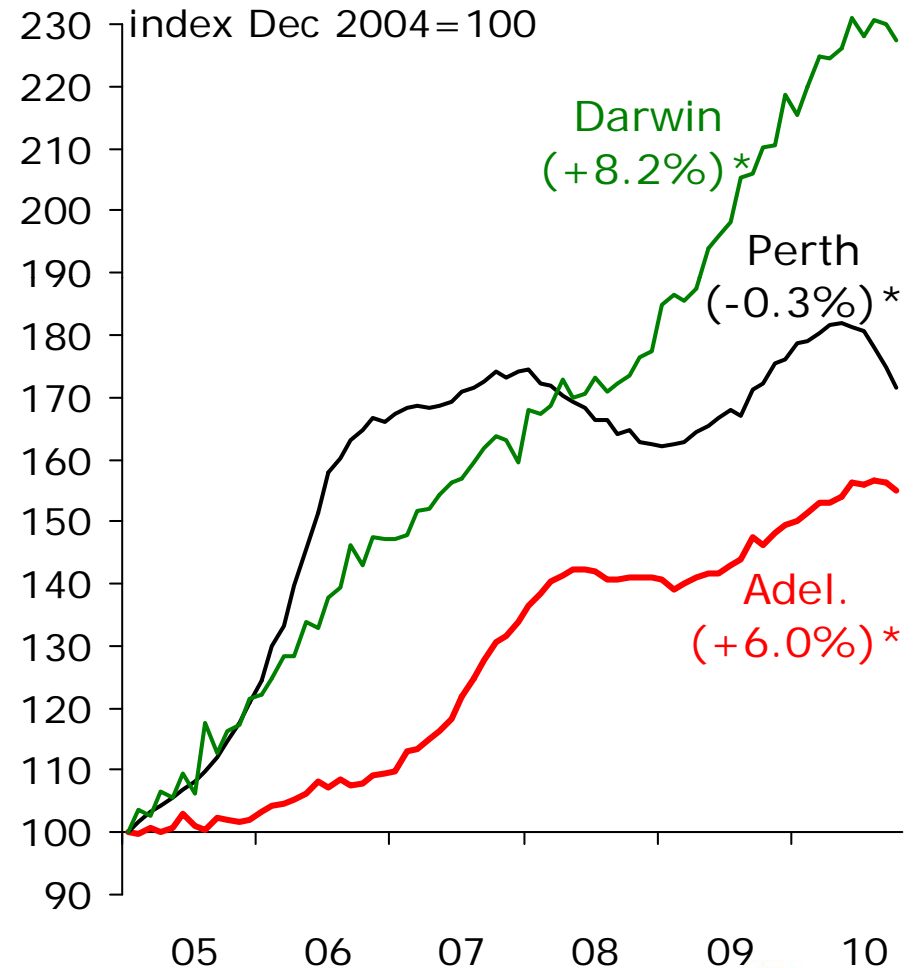
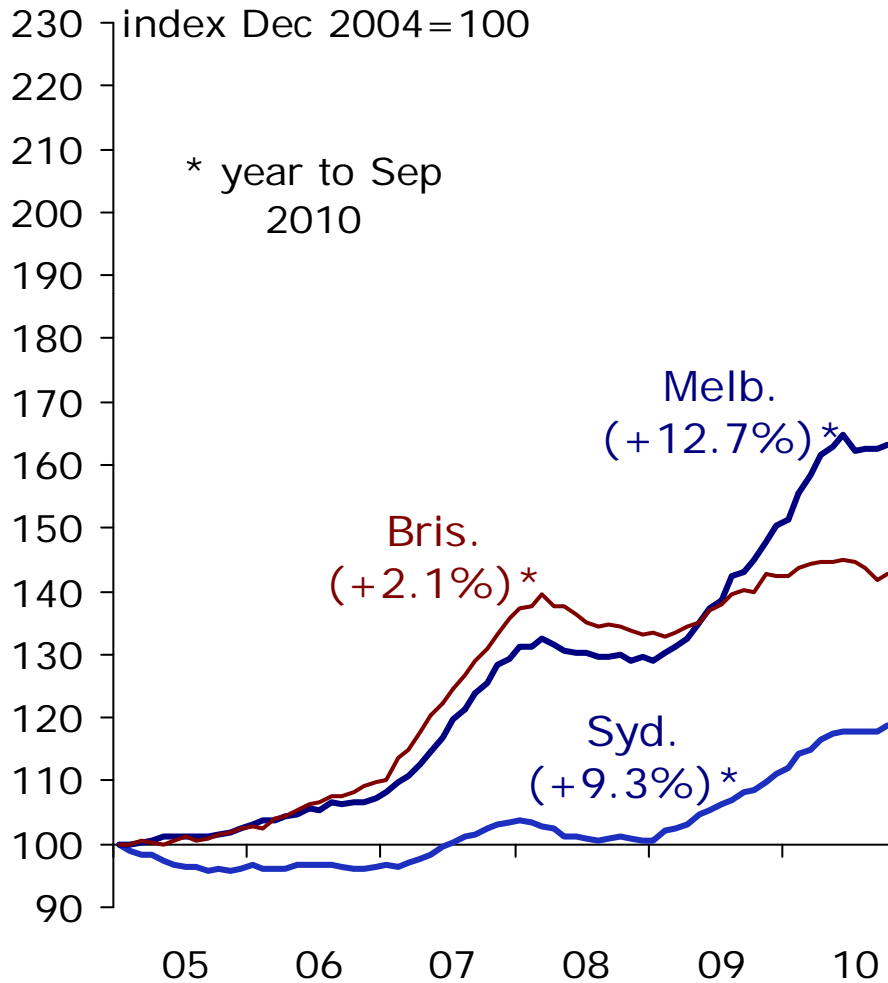
Qld

WA



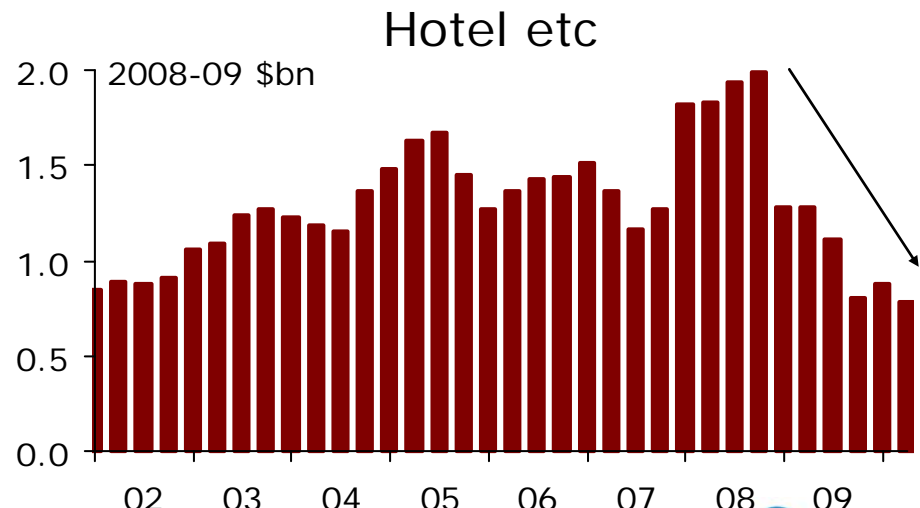
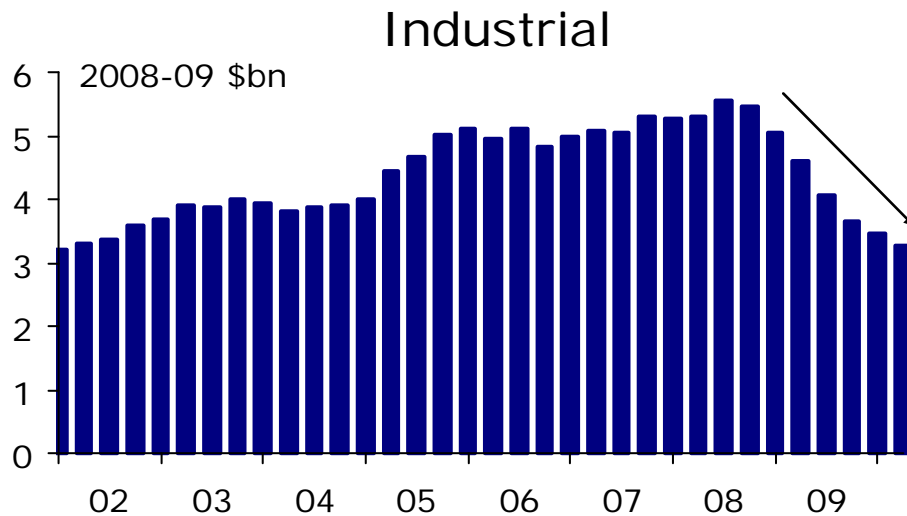
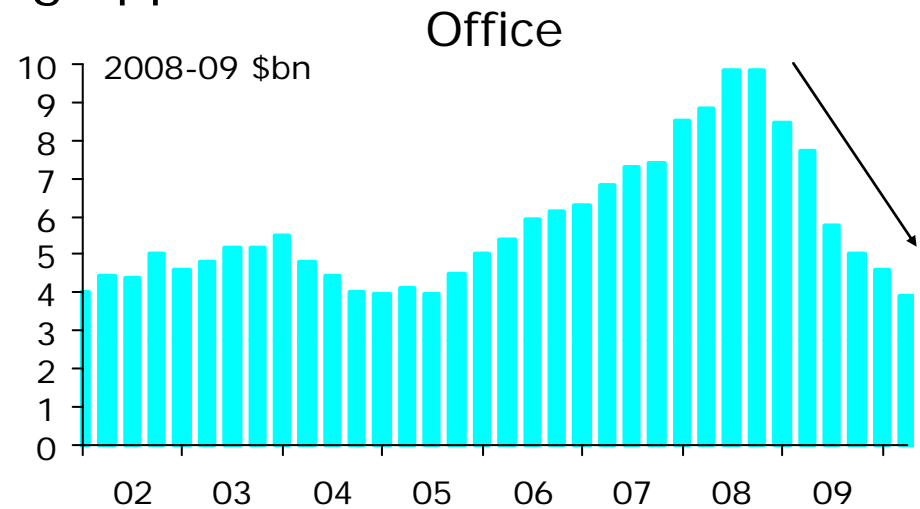
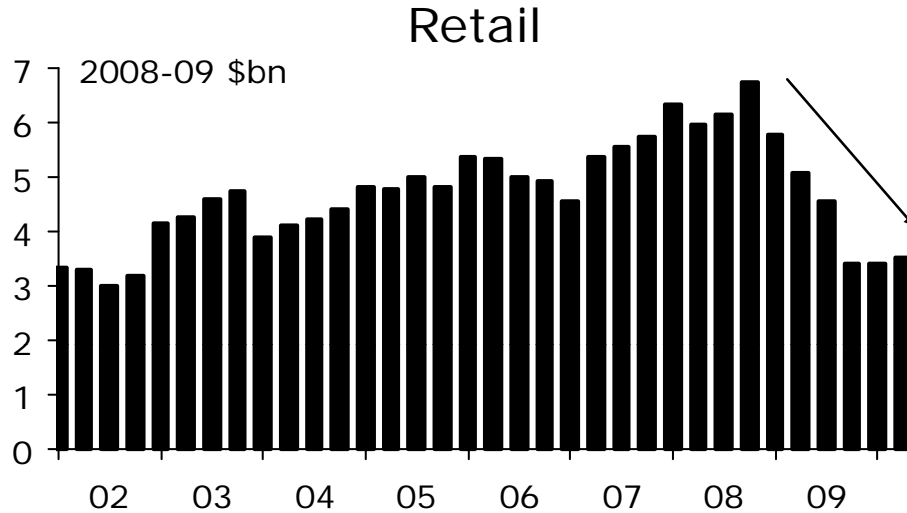
Moreover, house prices rebounded remarkably strongly in 2009-2010 in most capital cities

Median house prices



New non-res. building activity has slumped - supply additions will be very limited

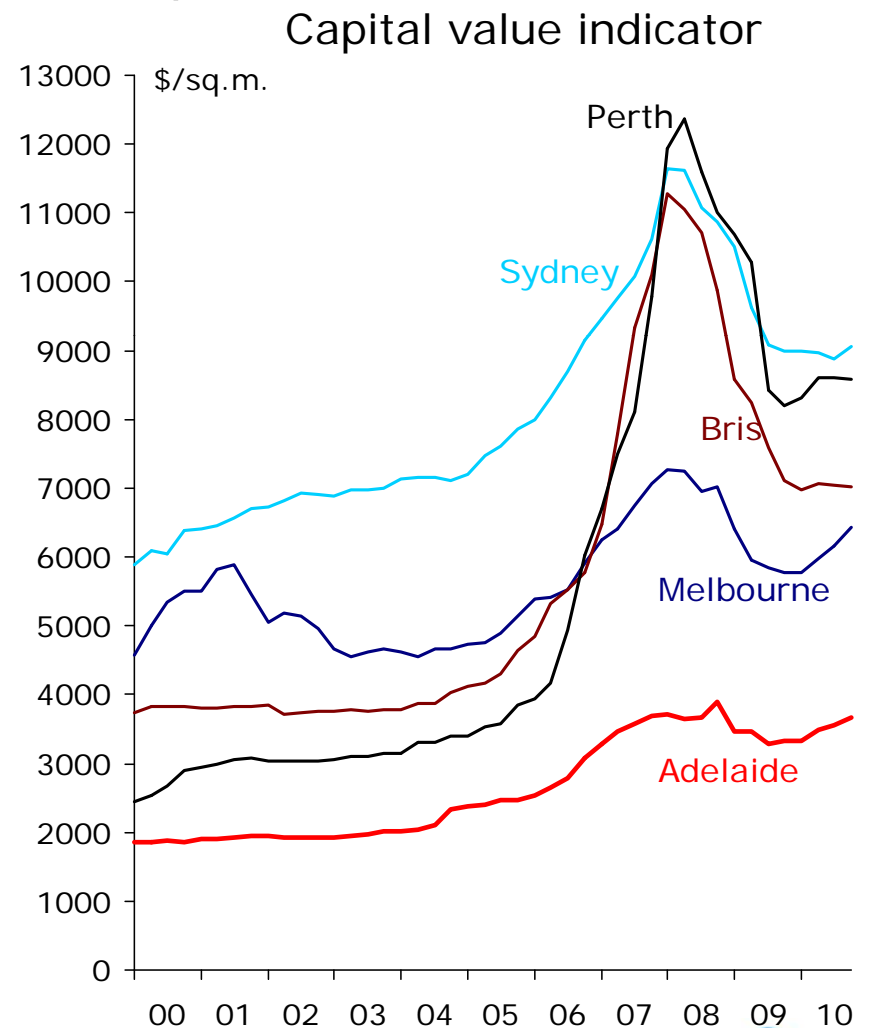
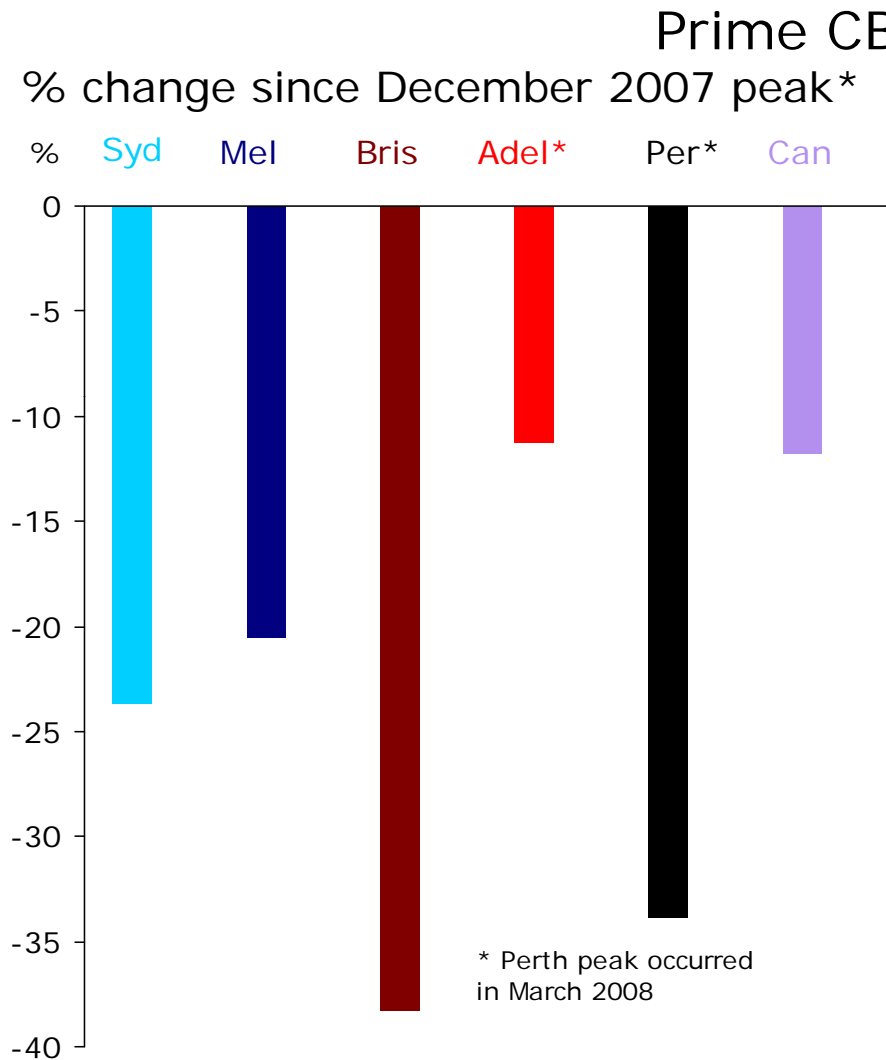
Non-res. building approvals*



* moving annual total



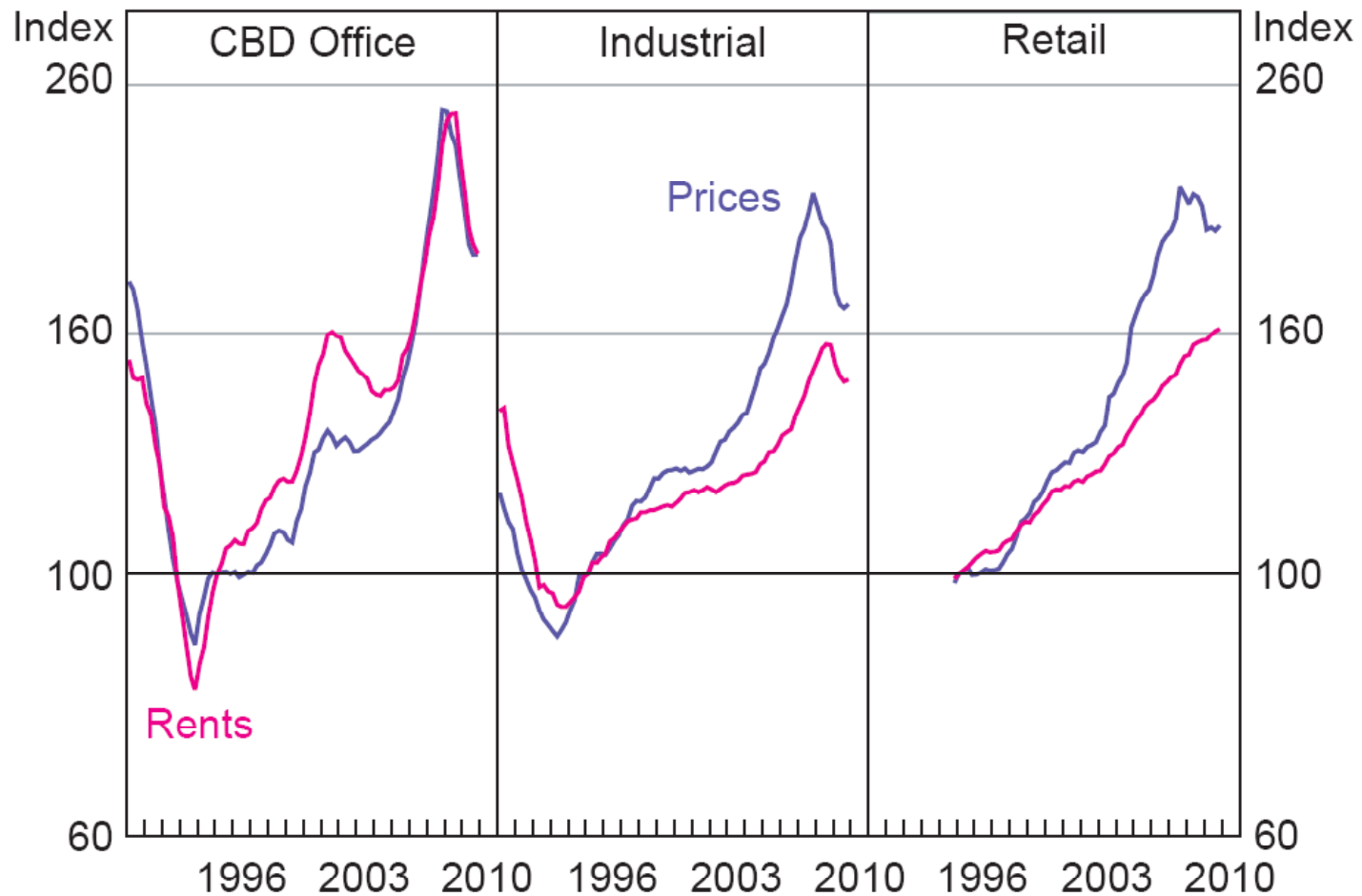
Values fell sharply with the resource states suffering most, but prices at or near nadir...



Office and industrial prices & rents slump, but retail resilient

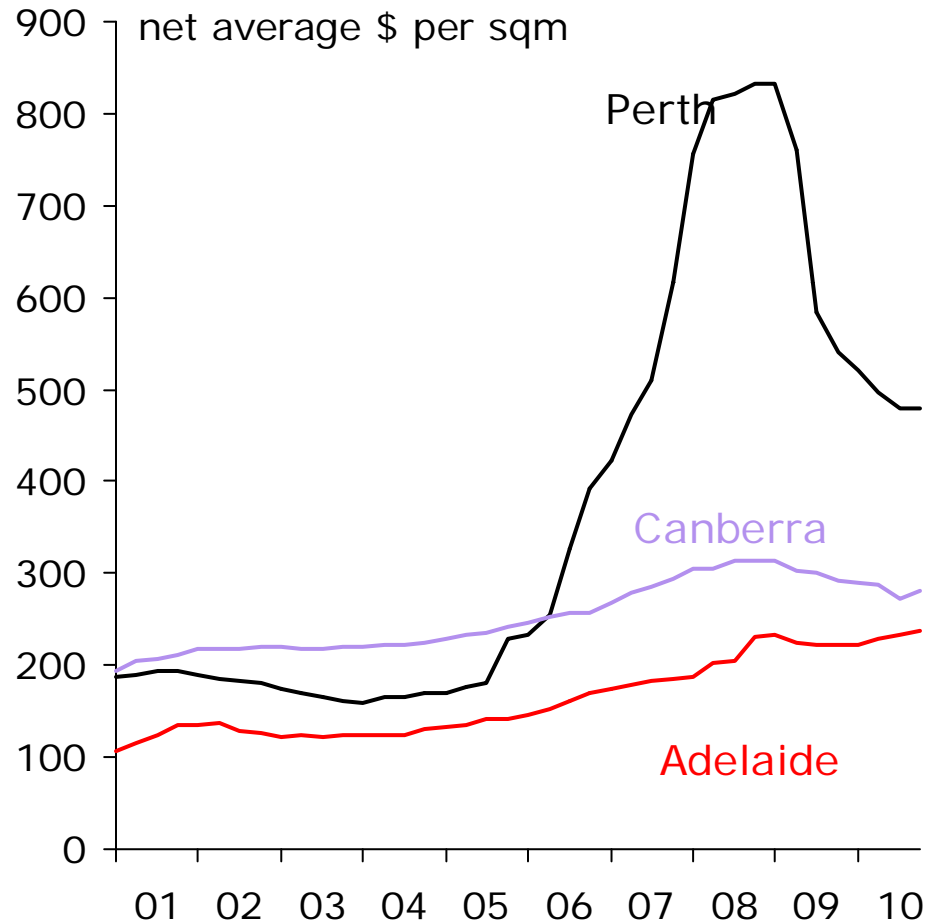
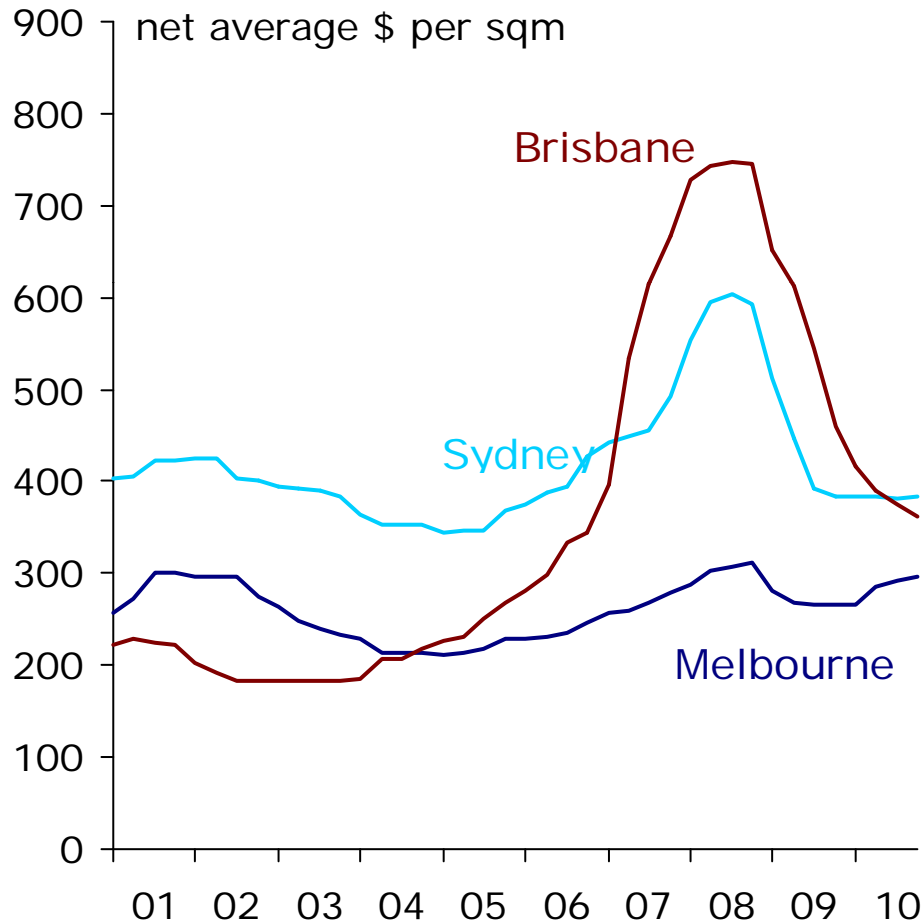
Commercial Property

March 1995 = 100, log scale



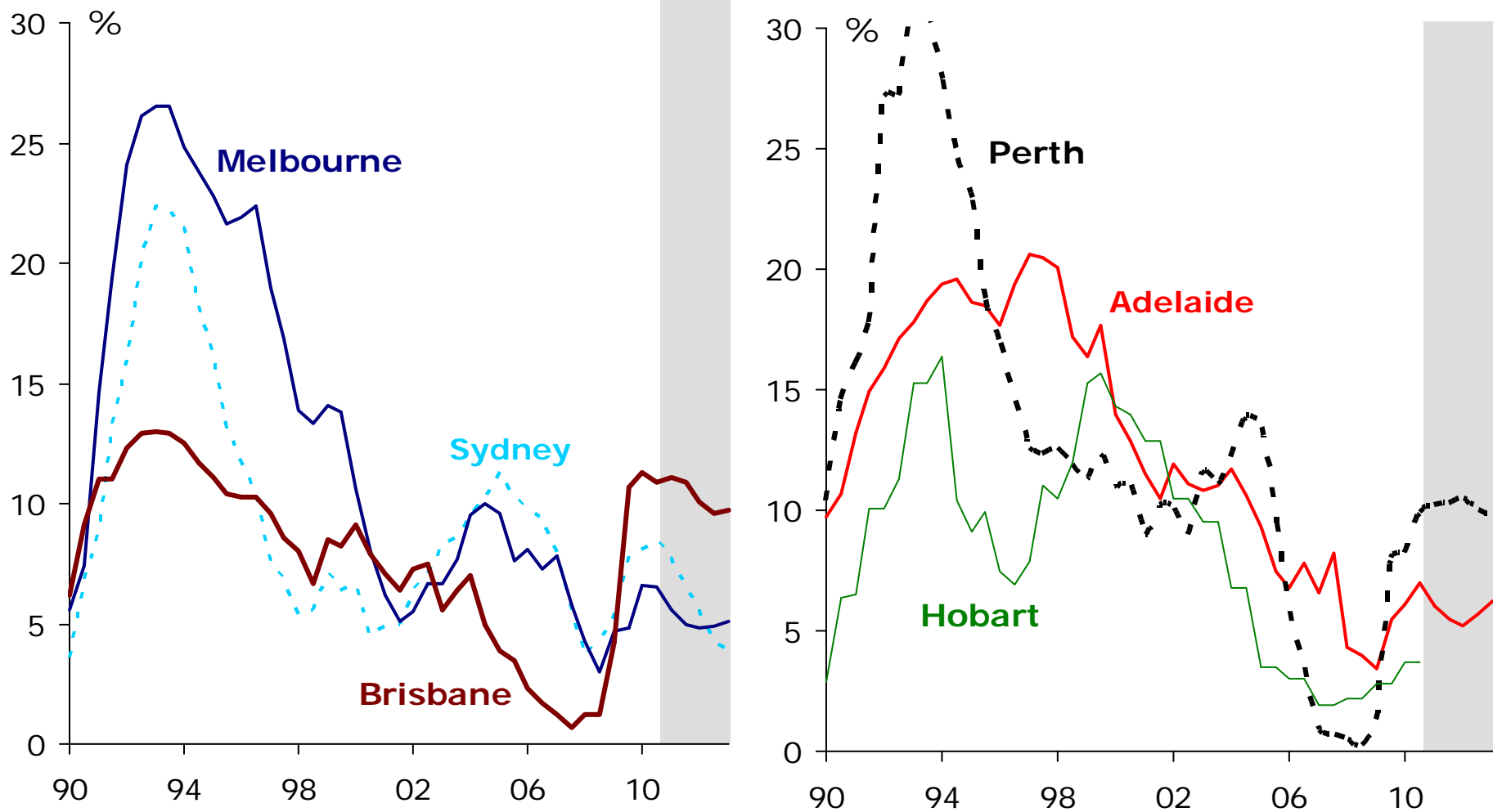
Rents appear to have bottomed (apart from Brisbane and Perth)

Prime CBD office rents (net effective)

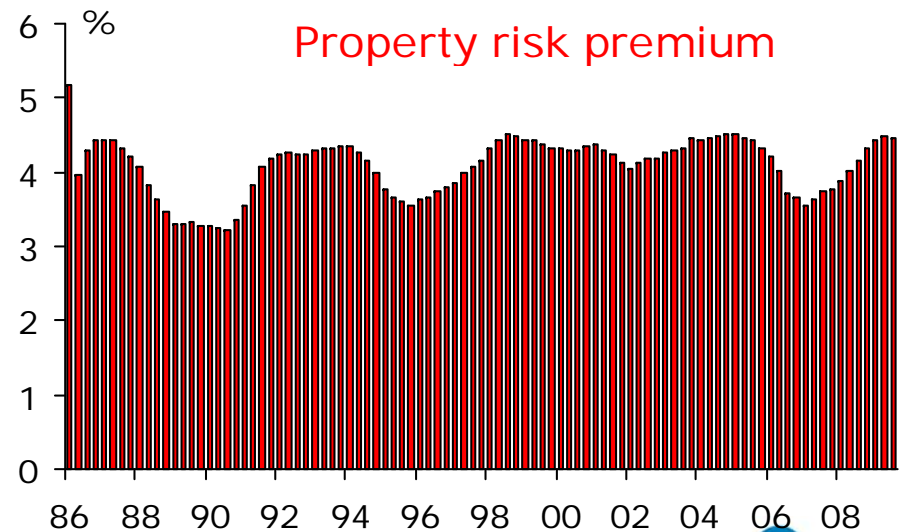
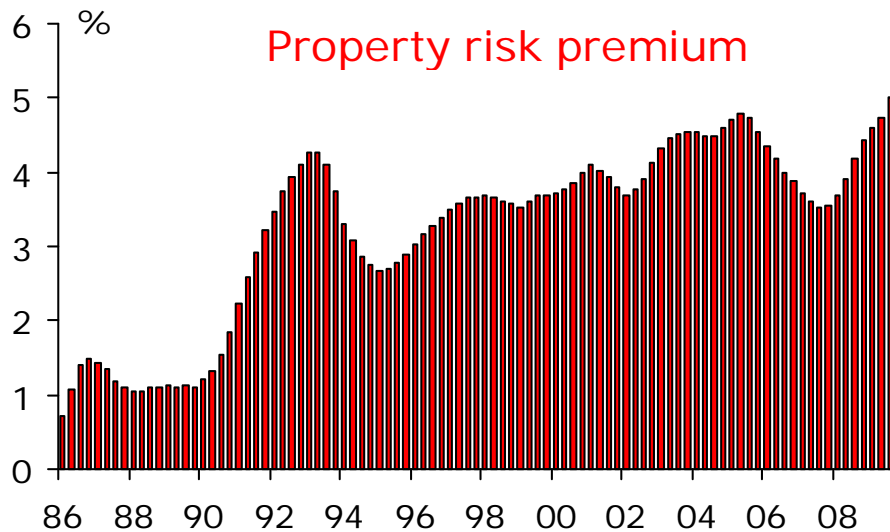
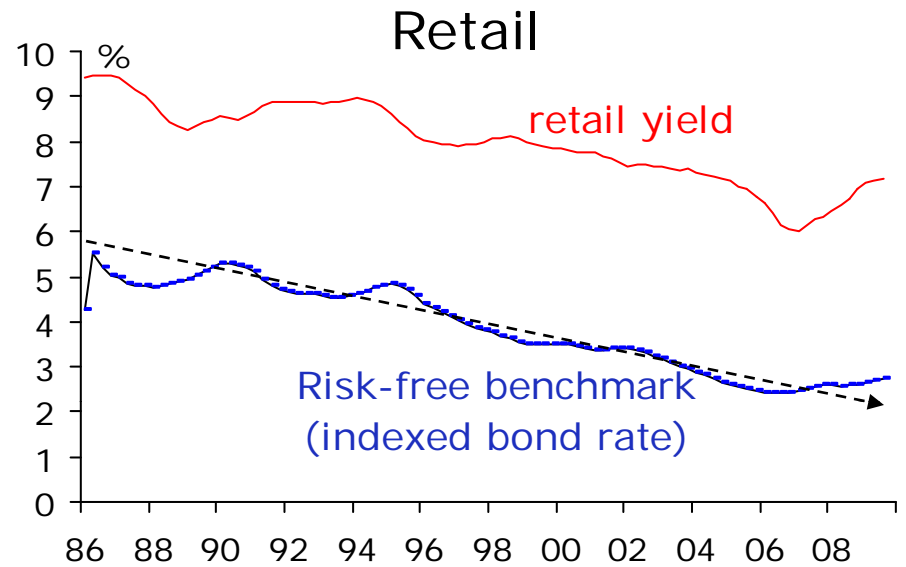
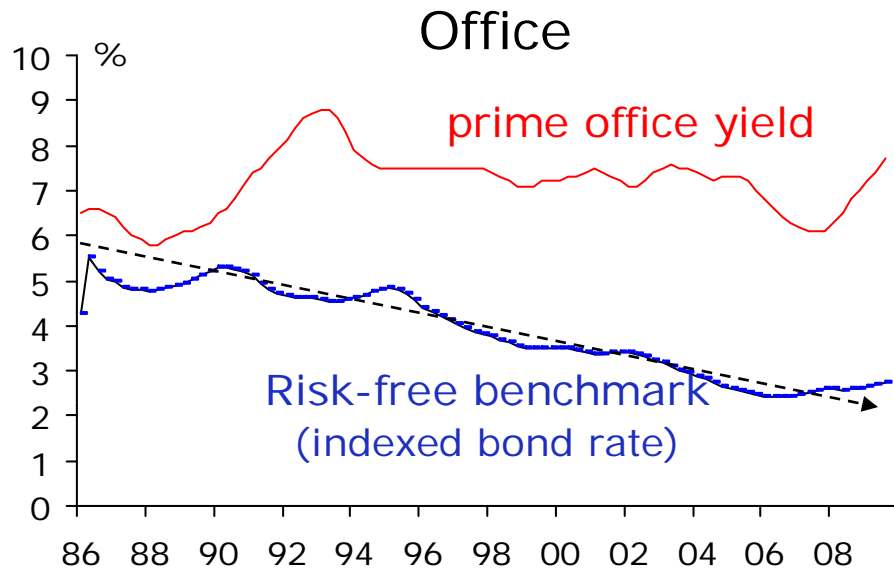


Office vacancies deteriorating (esp. Bris. & Perth) but recovery in sight

CBD office vacancy rates



Yields should re-tighten as recent sell off was 'overdone'



Disclaimer

This material provides general information current at the time of publication. This material does not take into account your personal needs, financial circumstances or objectives. Terms and Conditions, fees and charges apply to products and services listed. ANZ Private Bankers and ANZ Private Advisors are representatives of Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522, the holder of an Australian Financial Services Licence. Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522.