

# Australian Economic & Property Update

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## Australia, the 'Goldilocks' economy...

*...but will the RBA spoil the party?*

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Developed world sick, but China will pull us through

- Commodity price upswing
- Mining investment (LNG, coal, iron ore)
- Export volumes to rebound

Australian outlook increasingly positive

- Consumer and business sentiment strong
- Dwelling investment turning up / business investment intentions solid
- Strong population growth and investment

Housing market strong

- Critical shortage worsening / price momentum very strong
- Delinquencies low

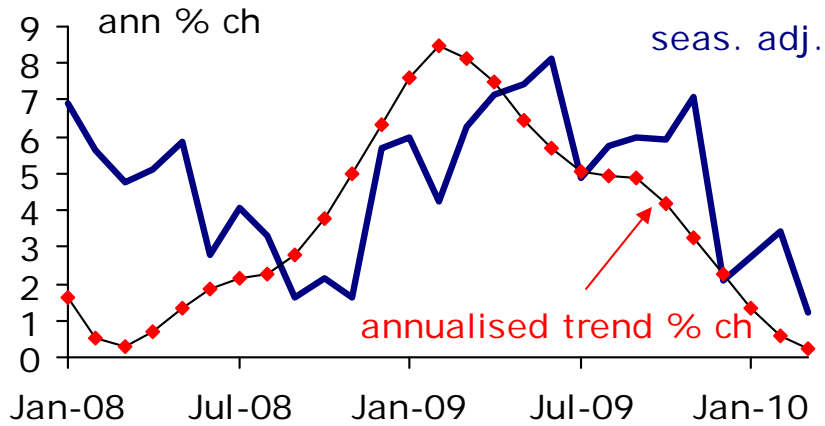
But headwinds remain

- Direct stimulus withdrawal as cash handouts and the FHOG phase out
- *Interest rates rising rapidly*
- Credit markets have improved - but supply / cost of funds still tough
- Developed world sick, especially Europe (PIGS economies)

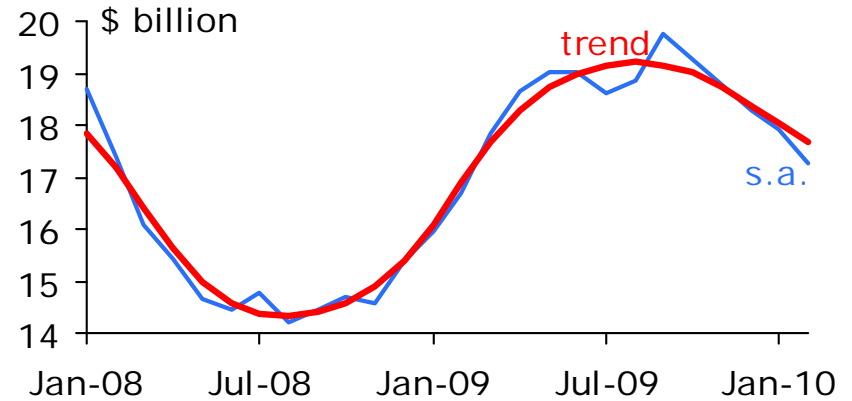


# Domestic data flow strong in H2 2009, but *could have been* mainly stimulus driven

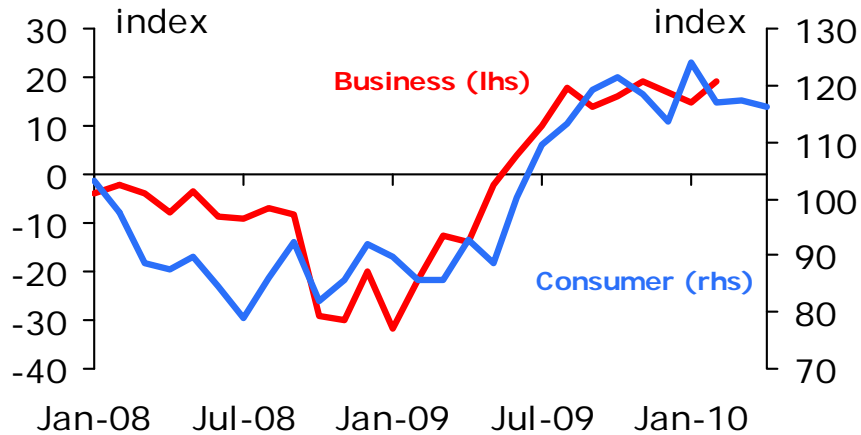
Retail Trade



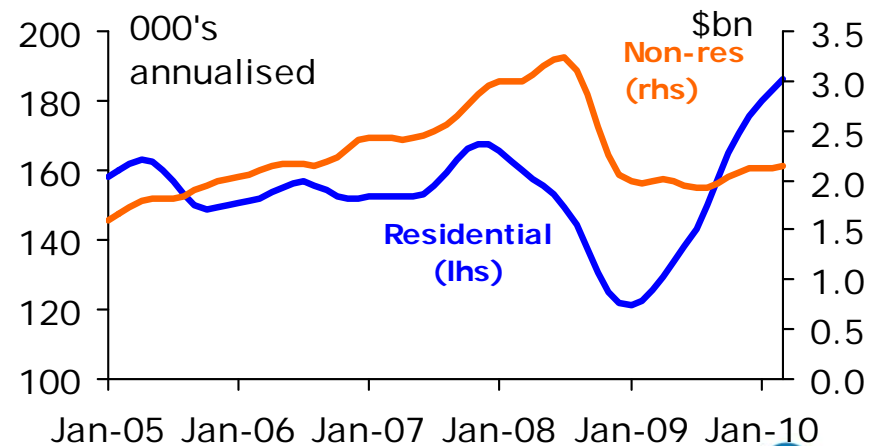
Housing Finance (ex-refin.)



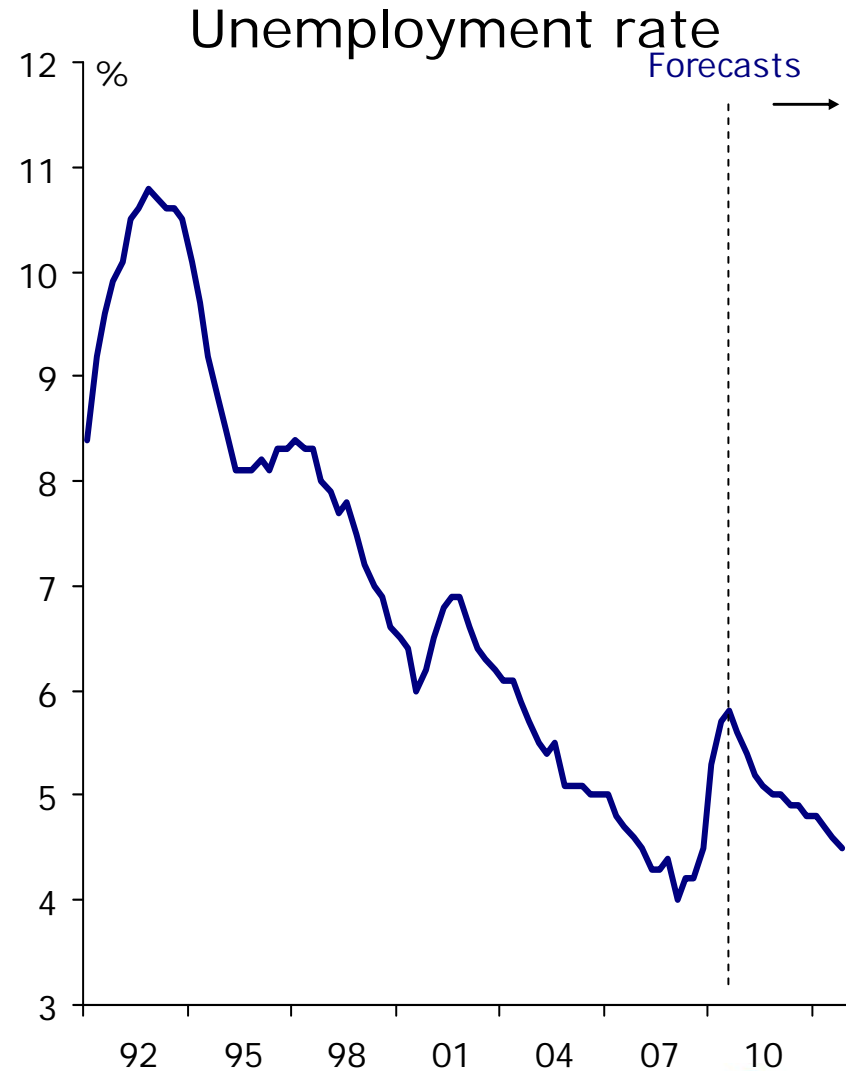
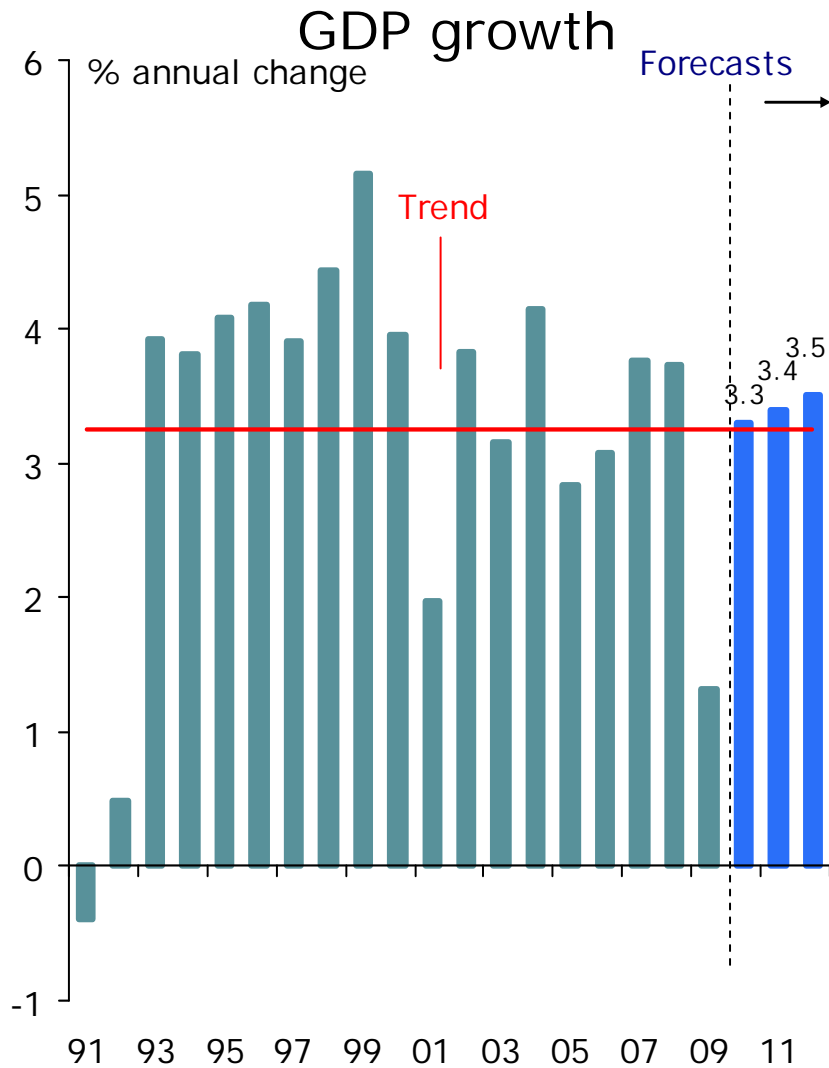
Consumer & Business Confidence



Building Approvals

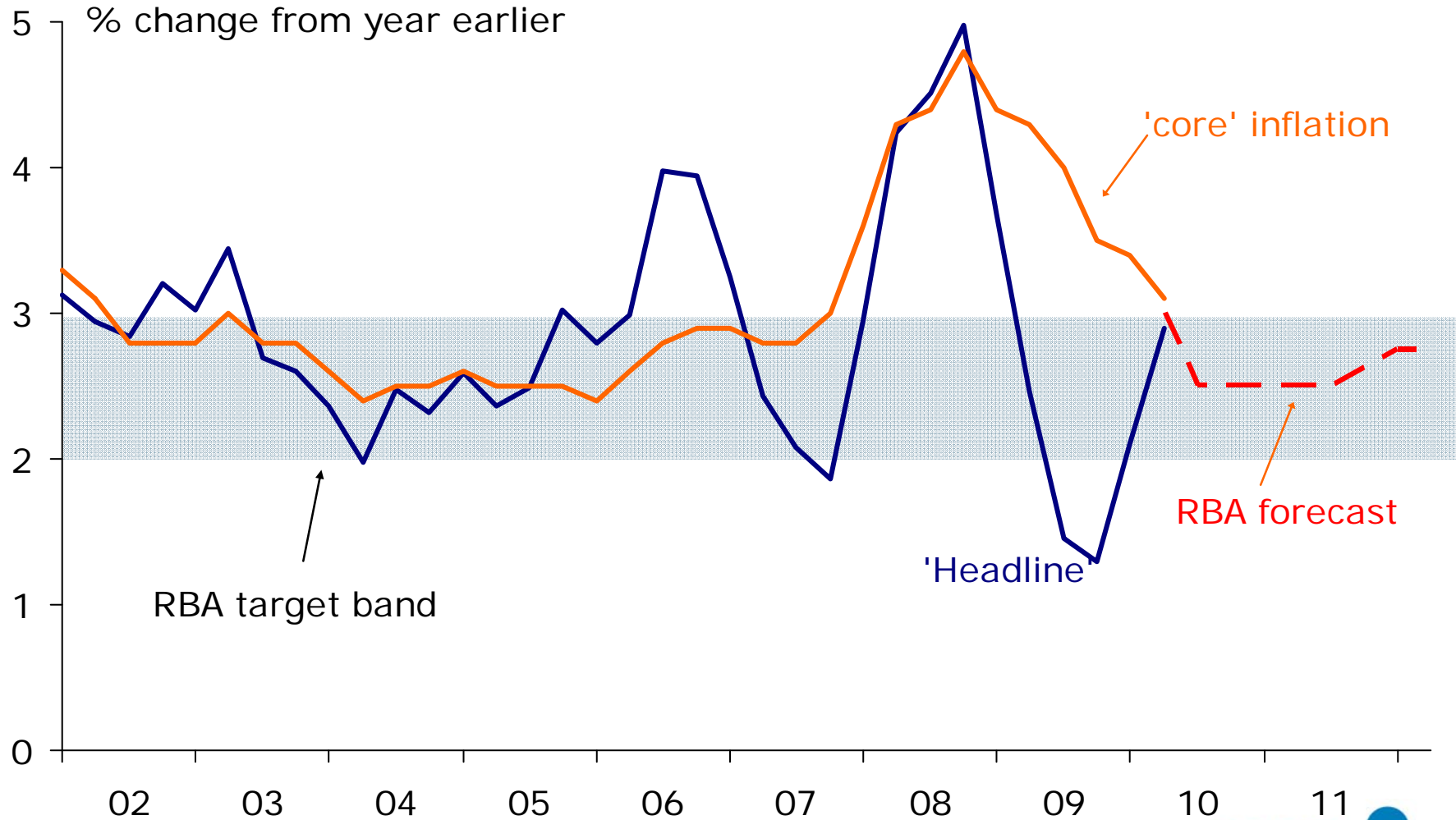


# Australia forecast to return to trend growth in H2 2010, and unemployment will fall



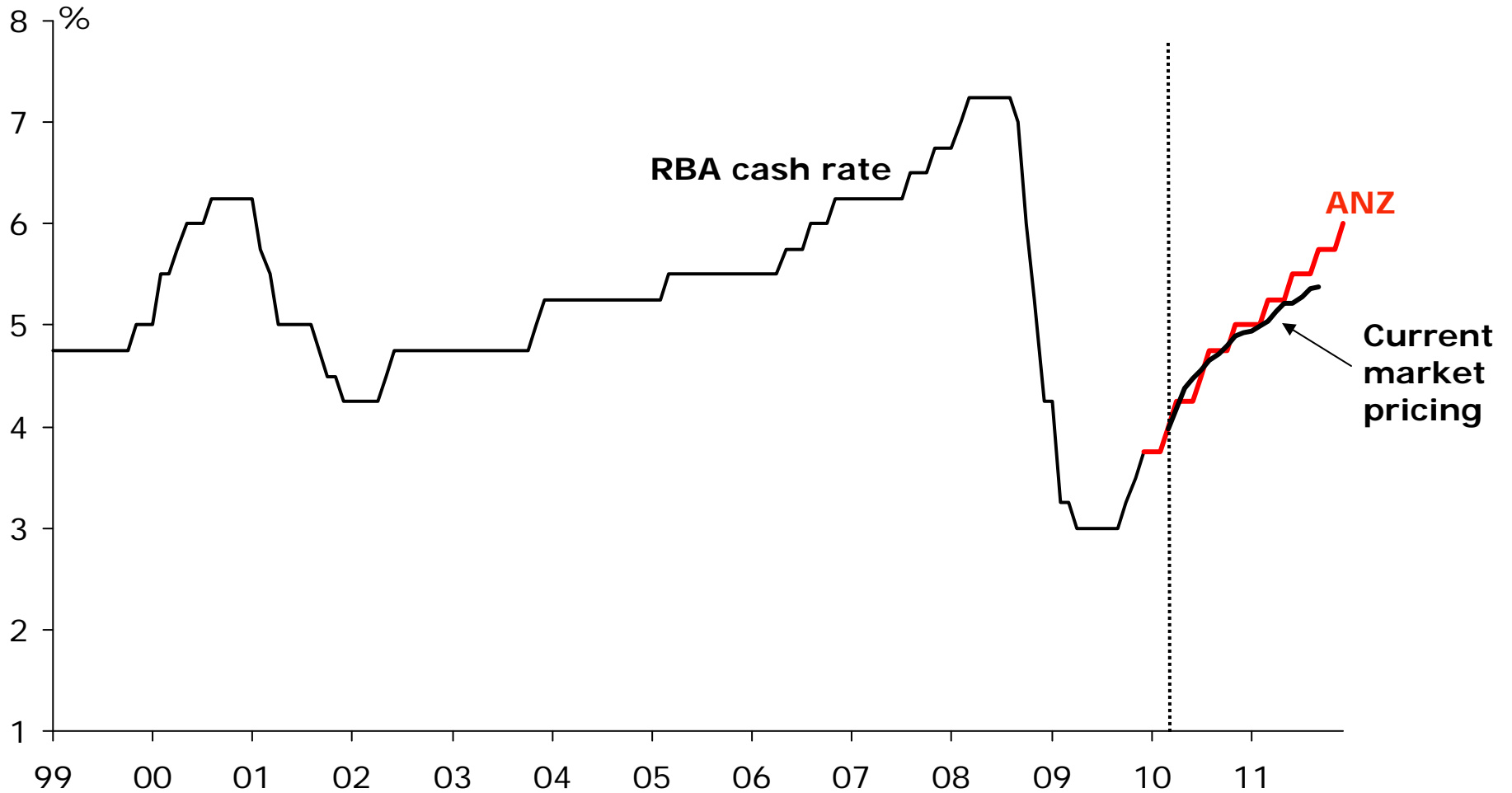
# But 'underlying' inflation remains high, with growth now accelerating and capacity tight

Consumer Price Inflation

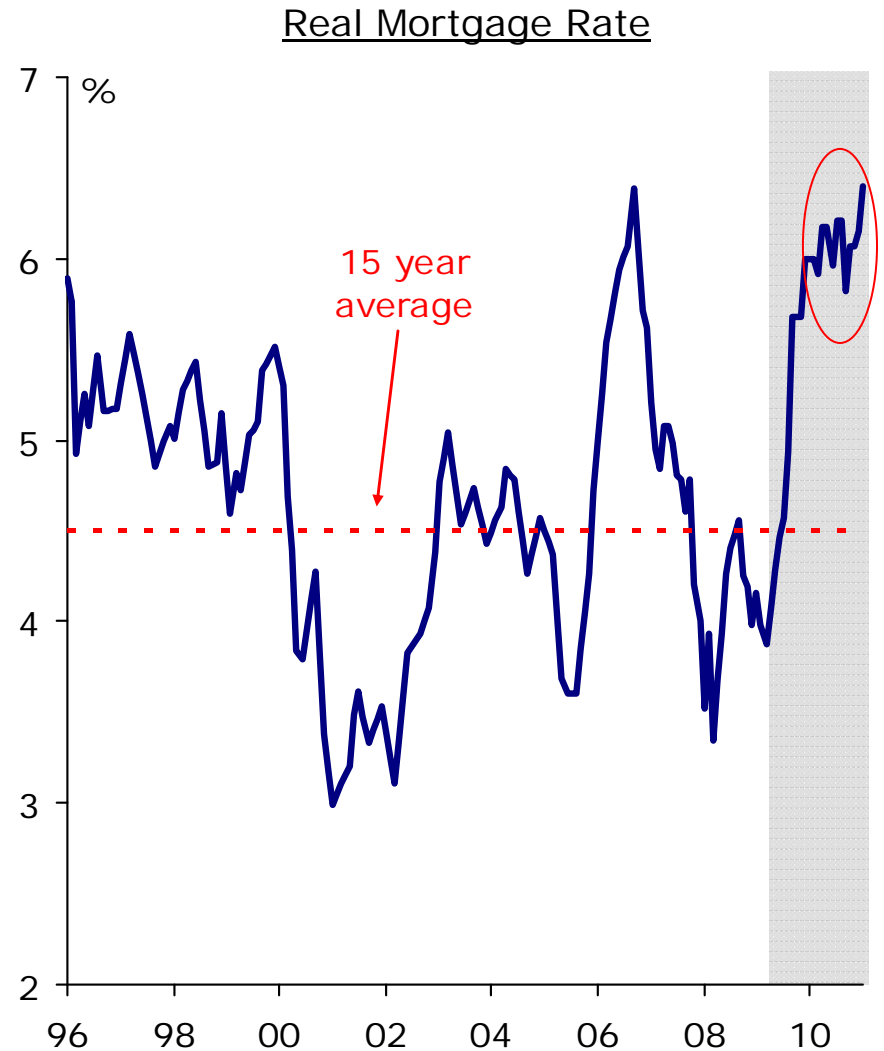
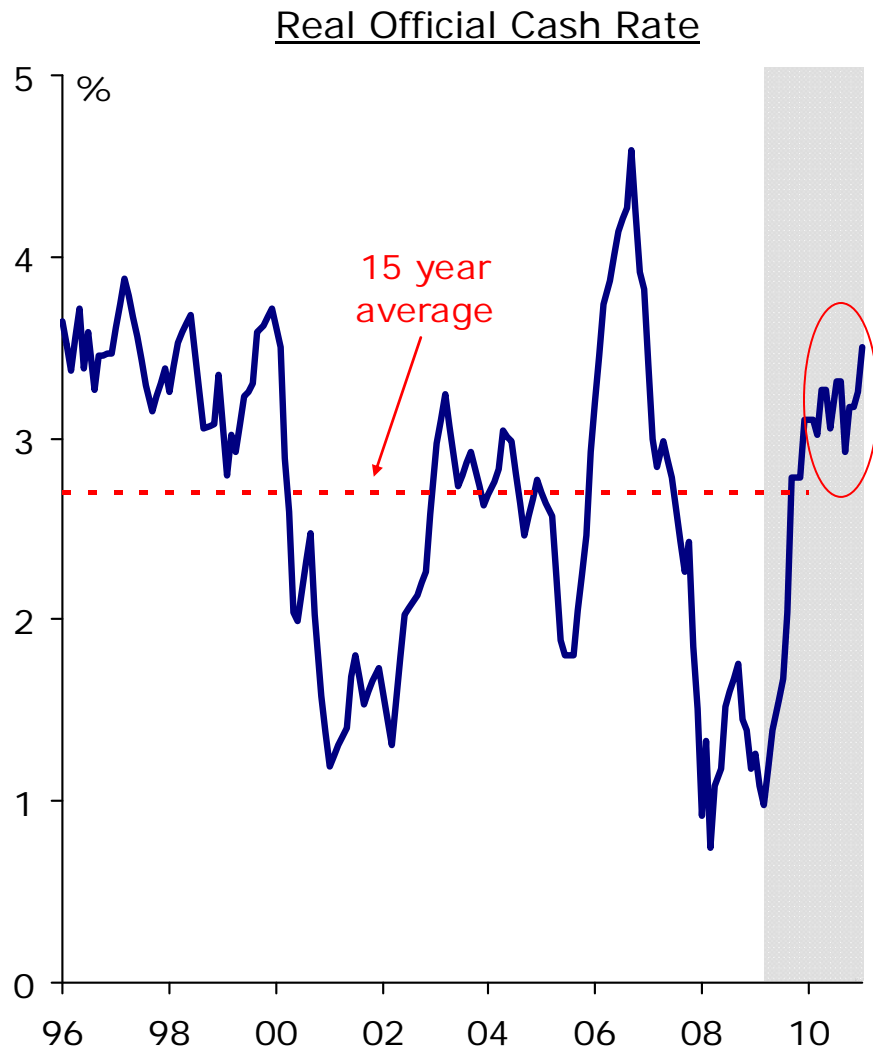


# Consequently, the market is pricing further rate hikes...

'Market pricing' of cash rate changes

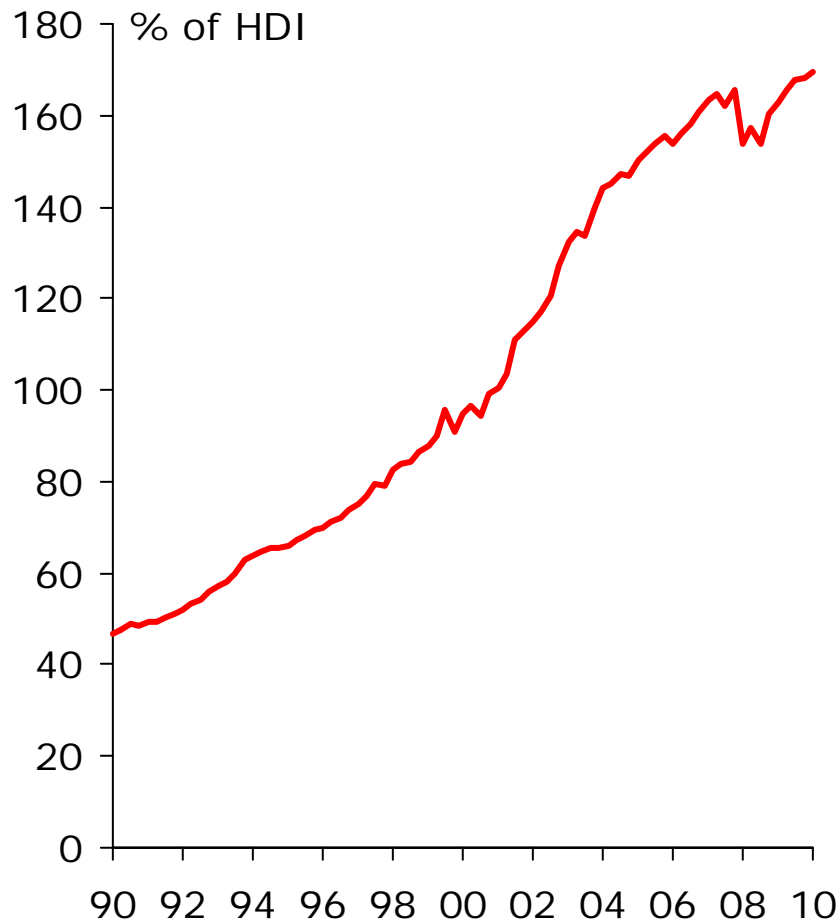


# ...and tightening could take policy *well beyond* 'neutral' in 2010-11

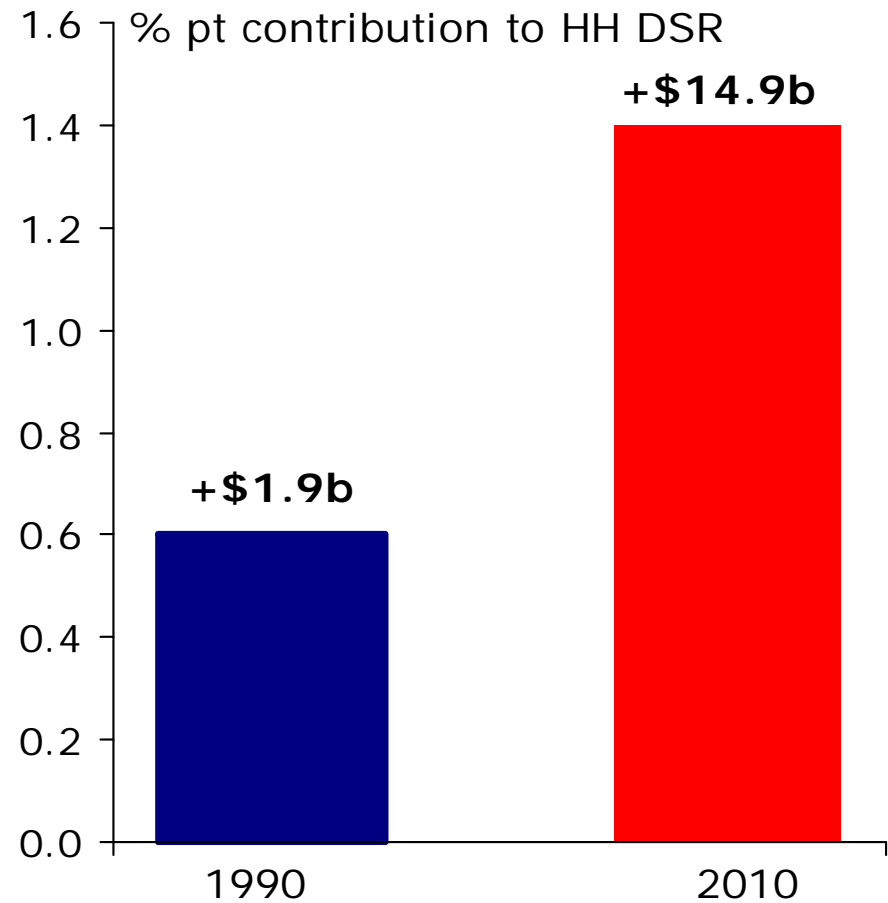


# Monetary policy now has significantly increased leverage over the household sector...

Household Debt to Income Ratio

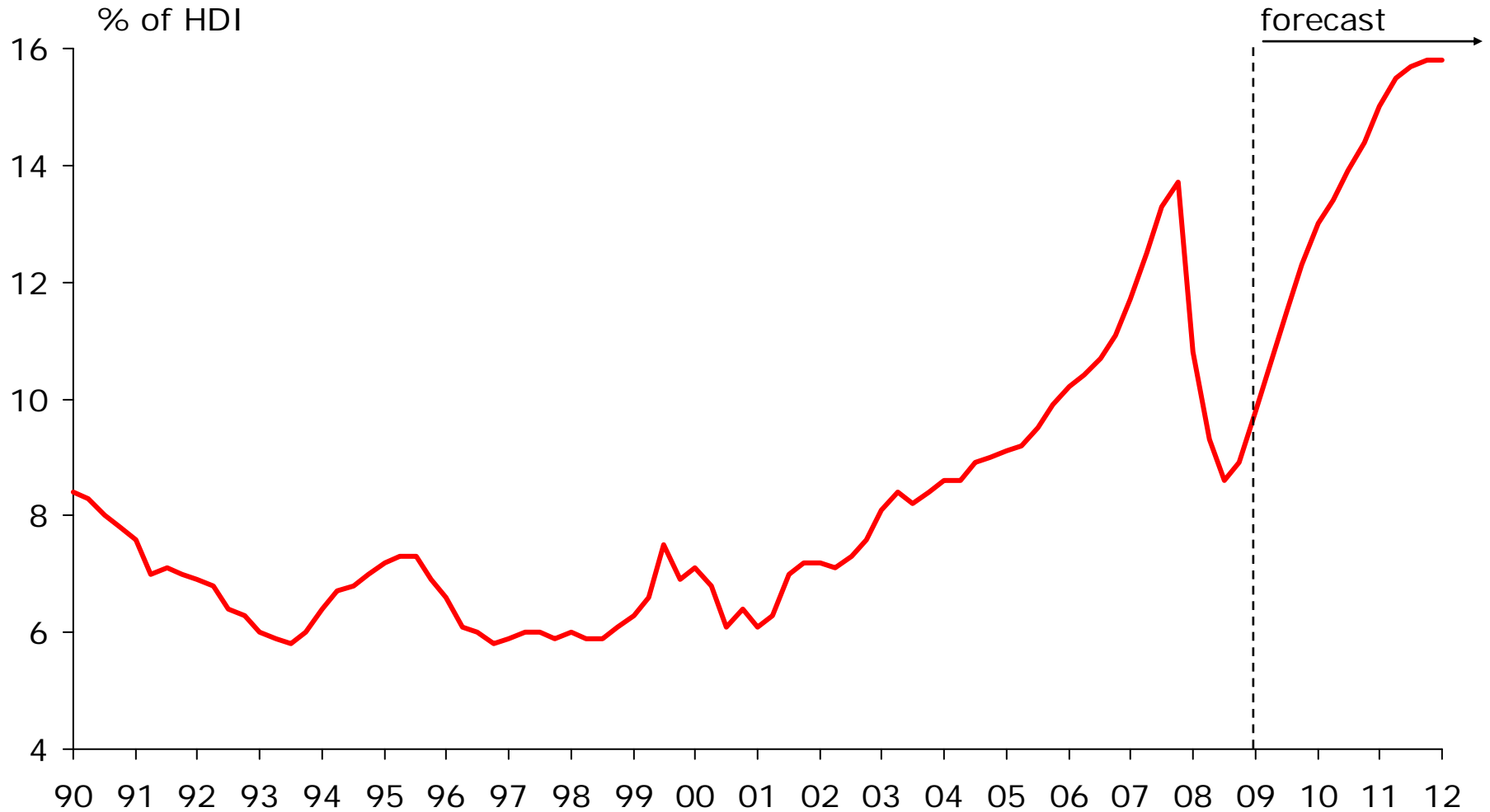


Impact on HH DSR of a 100 bps Shift in Monetary Policy



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

HH Debt Service Ratio



## Despite risks, the housing outlook remains positive

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2009 price momentum *very* strong

- Low interest rates
- FHOG
- Tightening demand / supply balance
- Relaxation of FIRB restrictions

Early 2010 signs solid – expect price increases to *decelerate*...

- Rising interest rates
- Exit of FHB
- FIRB back-flip

...but will remain positive

- Market momentum strong / supply limited
- Improved economy / labour market / sentiment
- Housing shortage *will* get (much) worse, vacancies tighten, rents re-accelerate & *affordability will deteriorate*



## Are Australian house prices 'overvalued'?

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Much talk of housing 'bubble' - but fundamentals sound

- *Record* population gains & inadequate supply growth
- Critical housing shortage worsening / demand momentum strong
- FHB replaced by investors & upgraders
- Conservative lending / low delinquencies / no sub-prime / full recourse loans

Household sector well placed

- Economy & labour market solid, unemployment falling – *no forced sales*
- Low delinquencies reflect comfortable debt servicing
- Solid gains in real household incomes
- Growing skilled labour shortages/upward wages pressure

Financial system solid

- On balance sheet lending raises incentives re. sustainable serviceability
- Conservative lending = low delinquencies
- Full recourse lending (compare to US) = less incentive to default

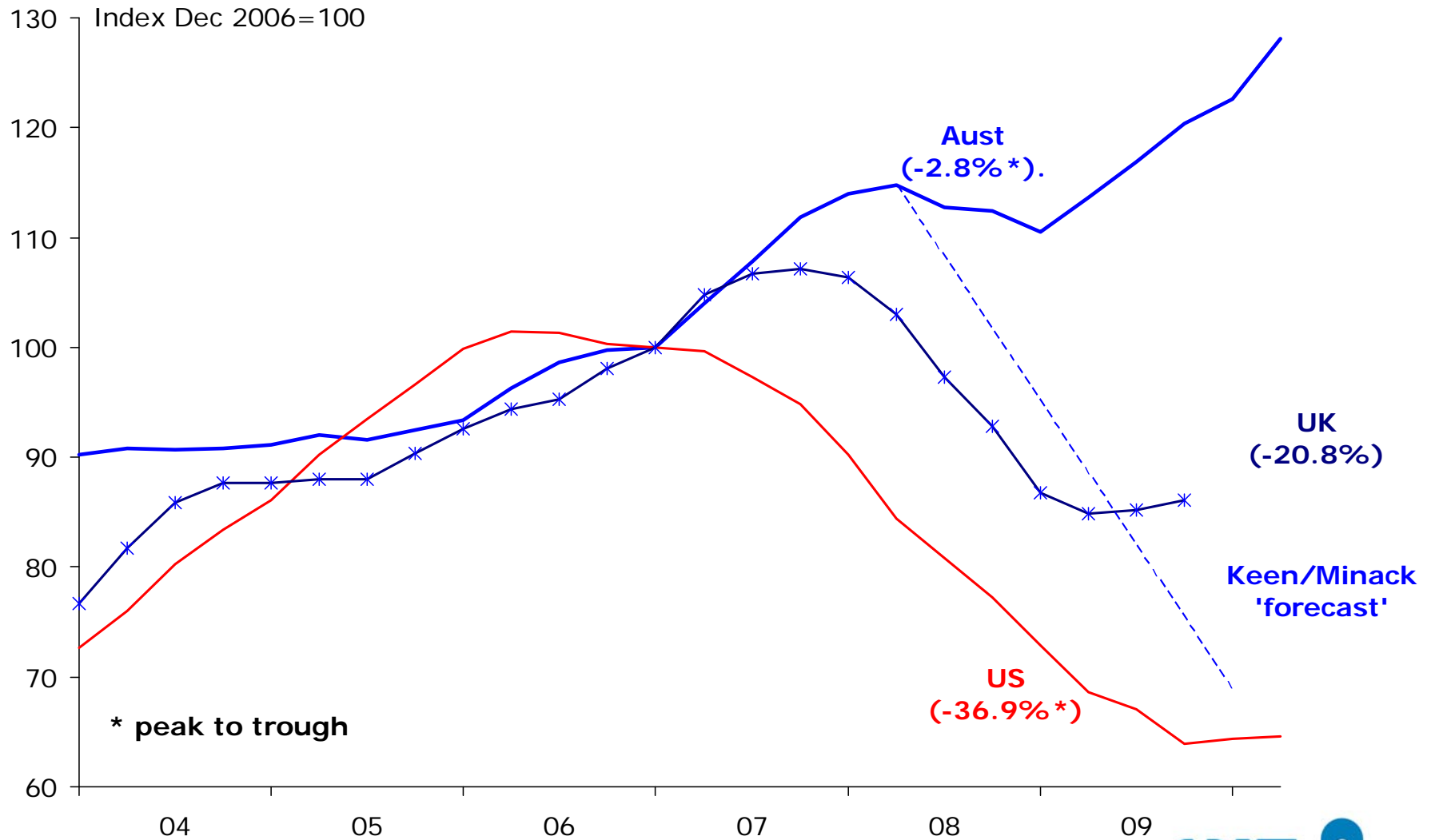
Risks

- Rising interest rates / deteriorating affordability could *cap* price gains
- Policy reversal of 2009 FIRB changes - impact?
- Change in immigration policy?
- Rising unemployment / "double dip" recession?



# The Australian housing market was remarkably resilient - despite the best efforts of doomsayers

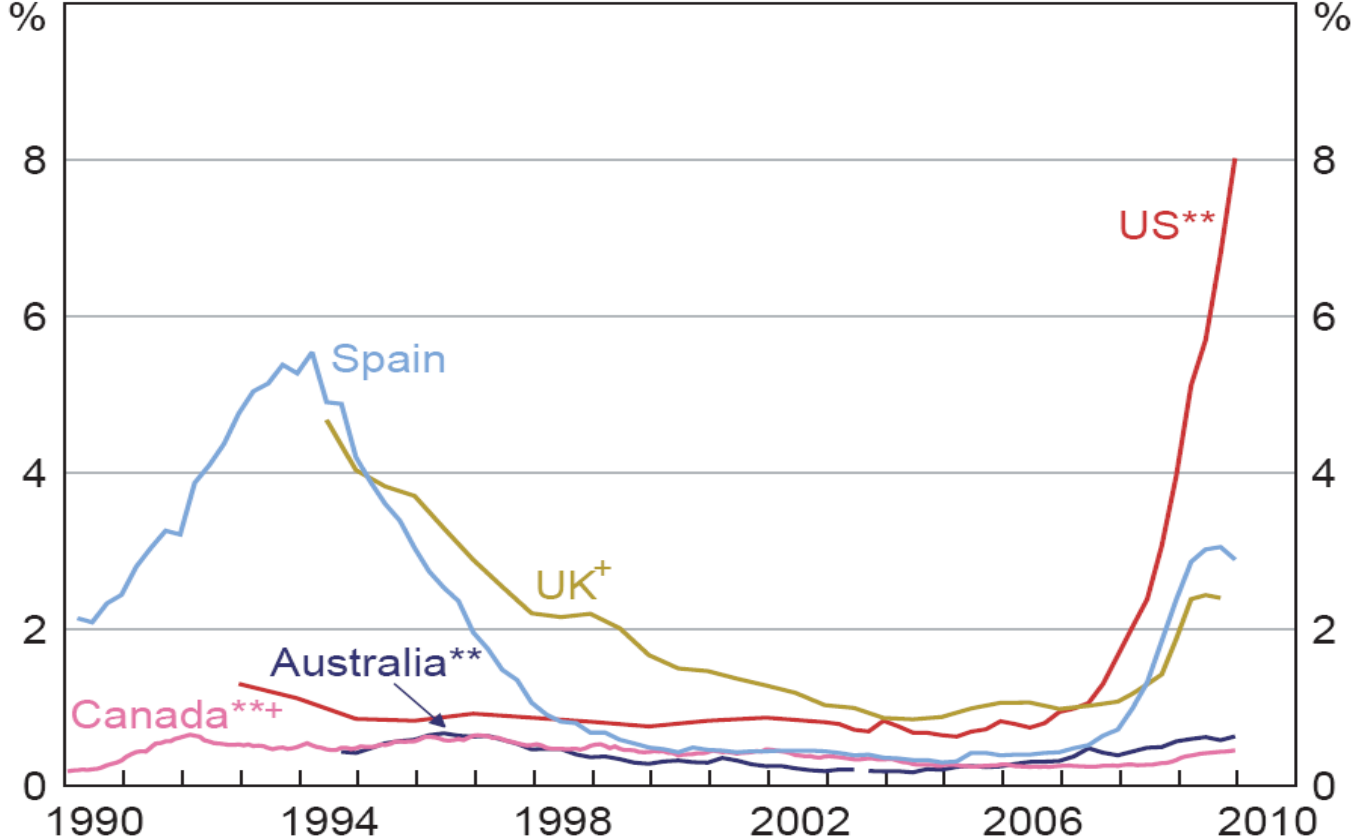
Median House Prices



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

### Non-performing Housing Loans

Per cent of loans\*

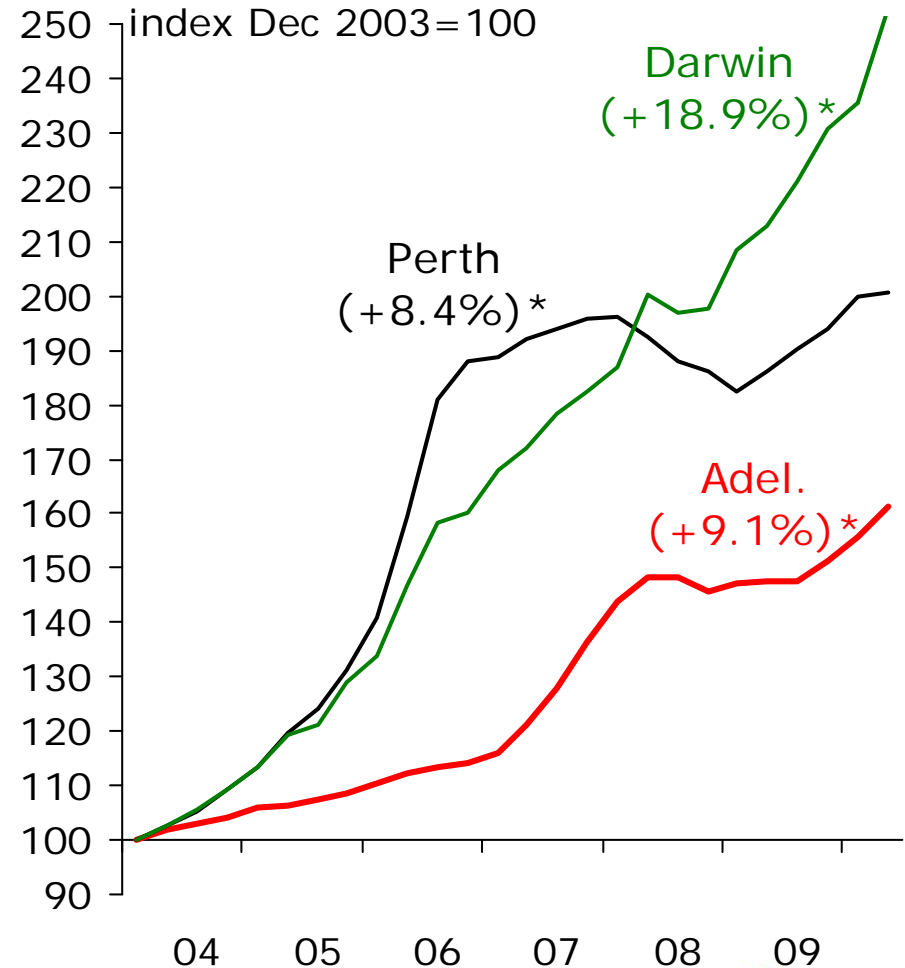
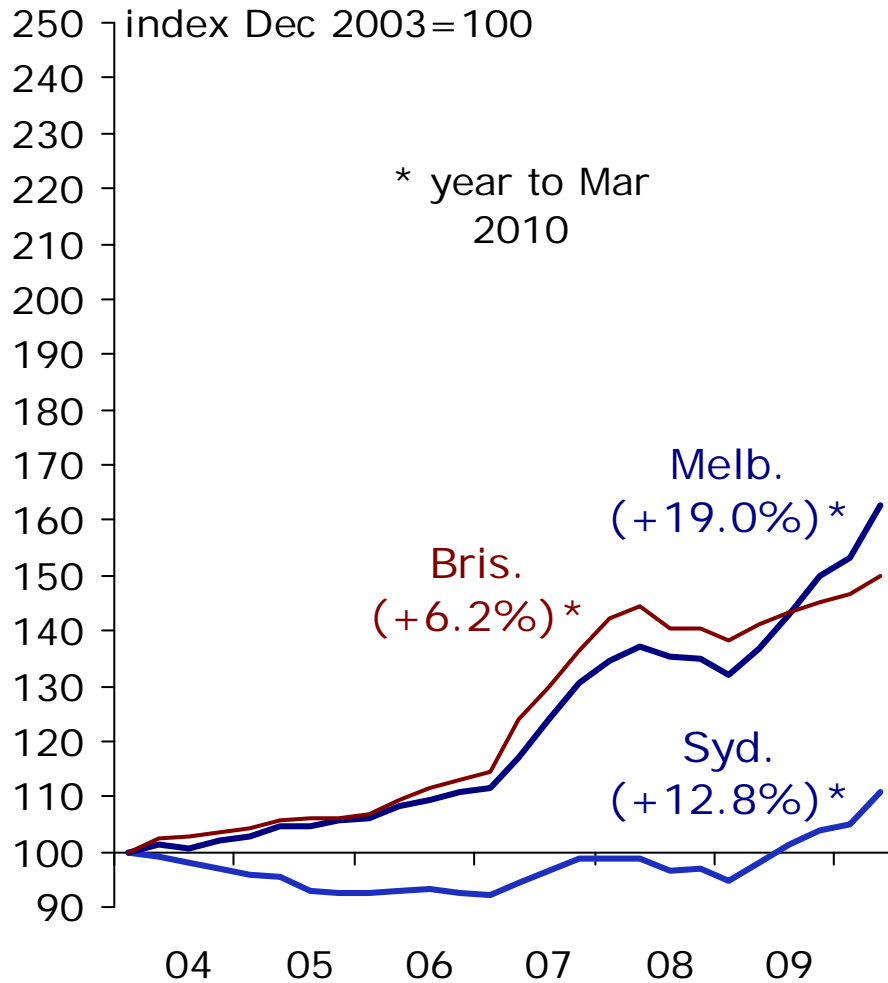


\* Per cent of loans by value. Includes 'impaired' loans unless otherwise stated.  
For Australia, only includes loans 90+ days in arrears prior to September 2003.  
\*\* Banks only.  
+ Per cent of loans by number that are 90+ days in arrears.



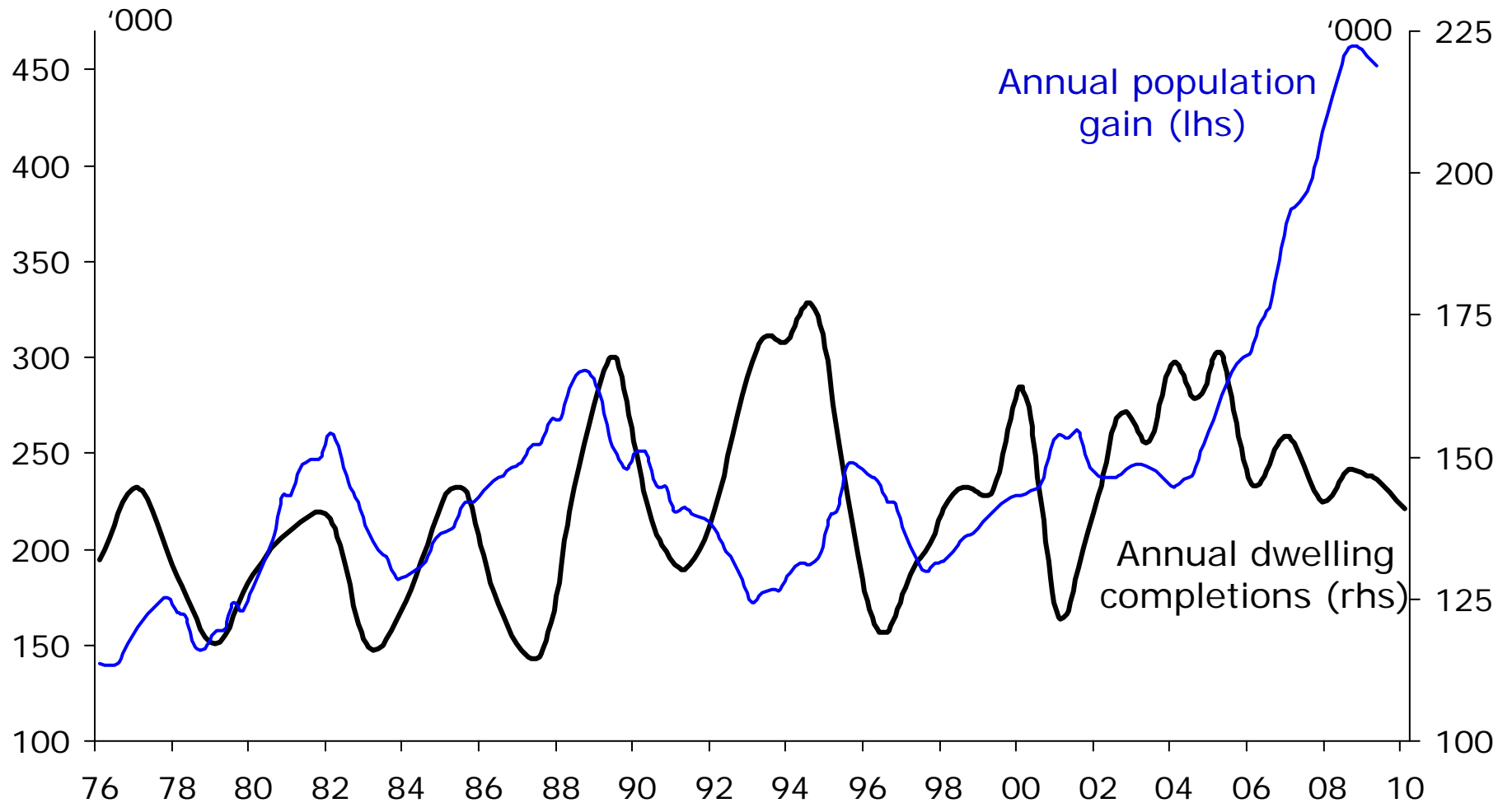
# House prices rebounded remarkably strongly in 2009 in most capital cities

Median House Prices



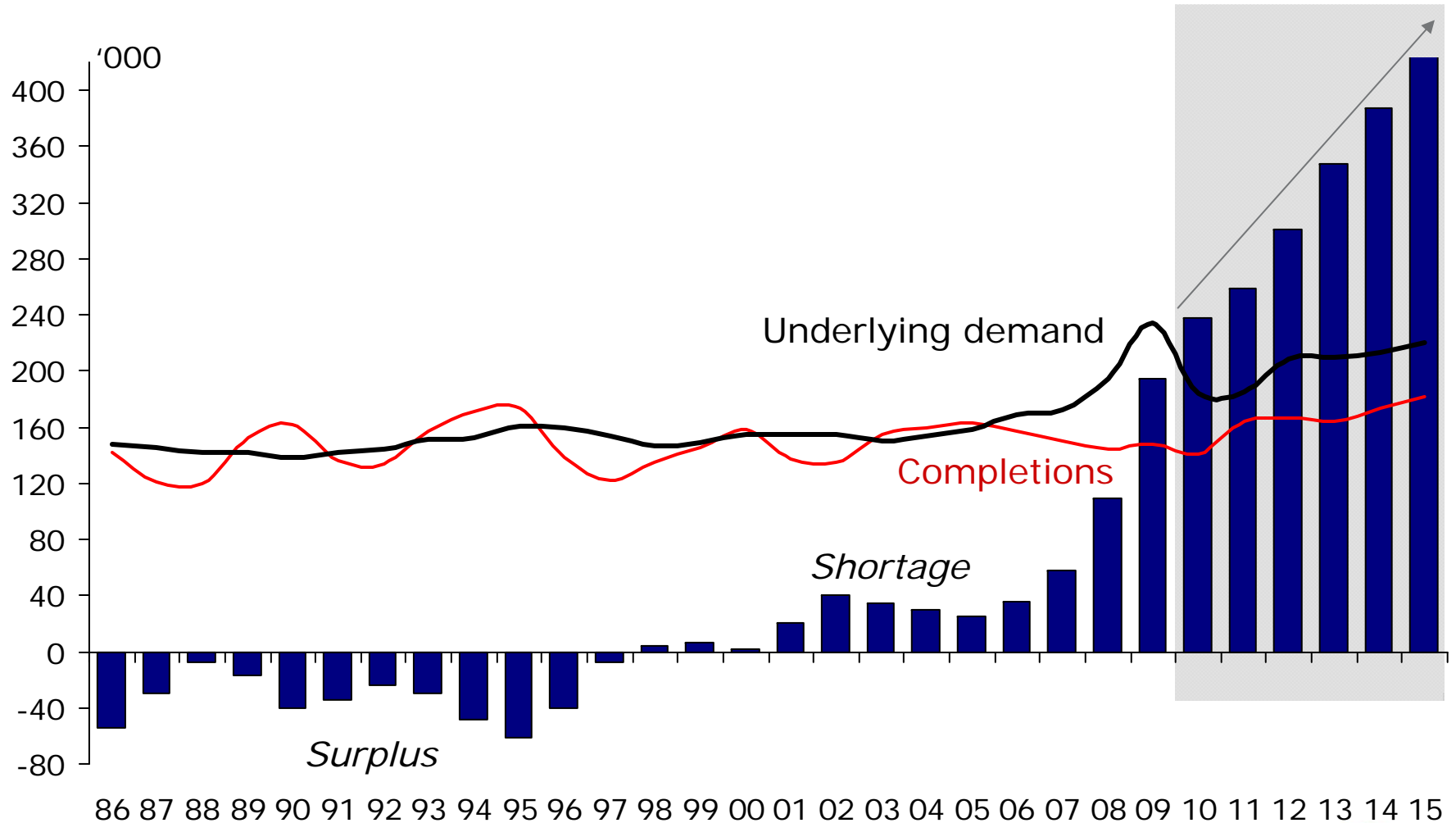
# Australian population accelerated to *record highs* while home building weak

Population Growth vs. Dwelling Completions



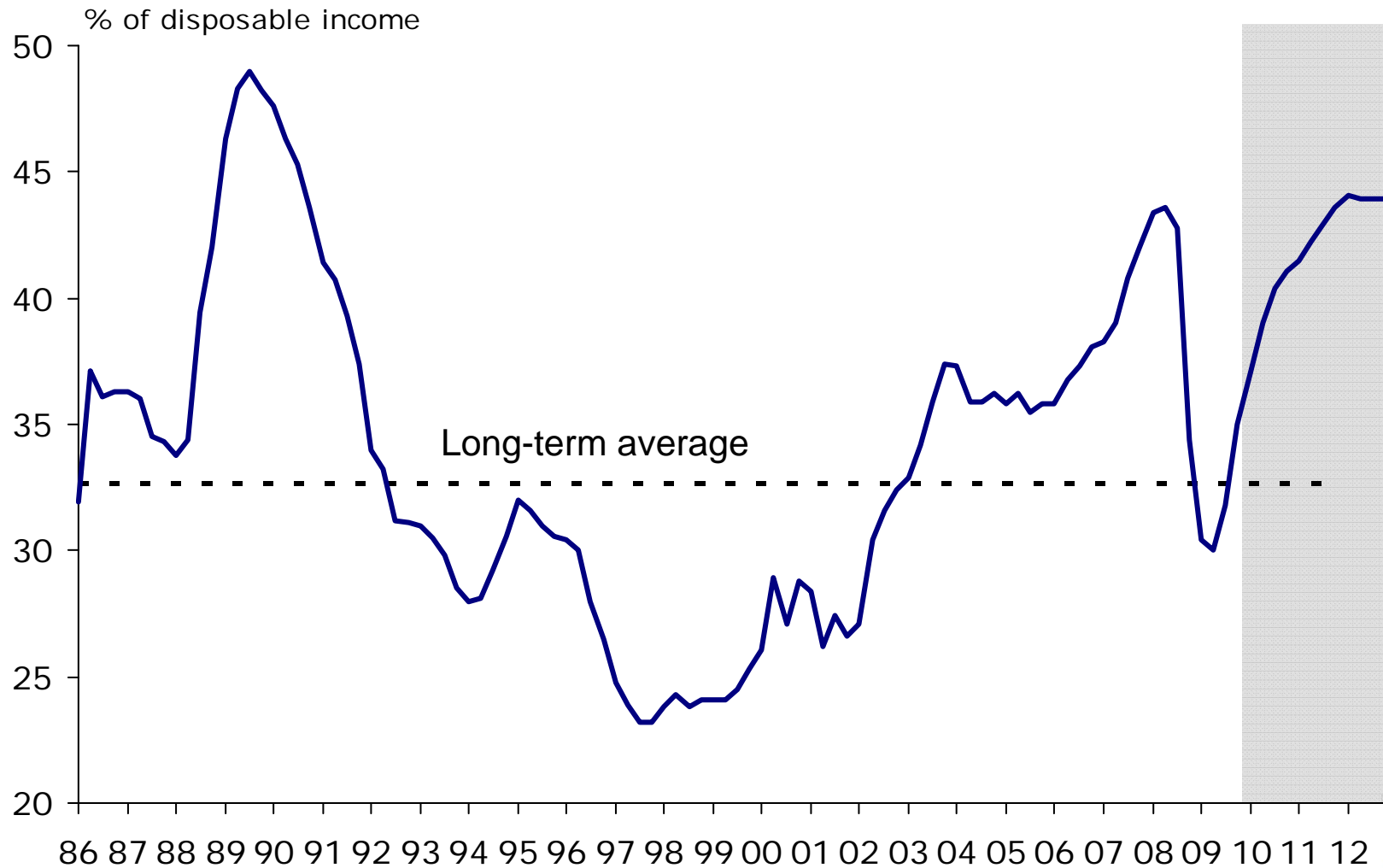
The housing shortage has already reached unprecedented levels – and will get worse! Unless something is done.

Housing Market Balance



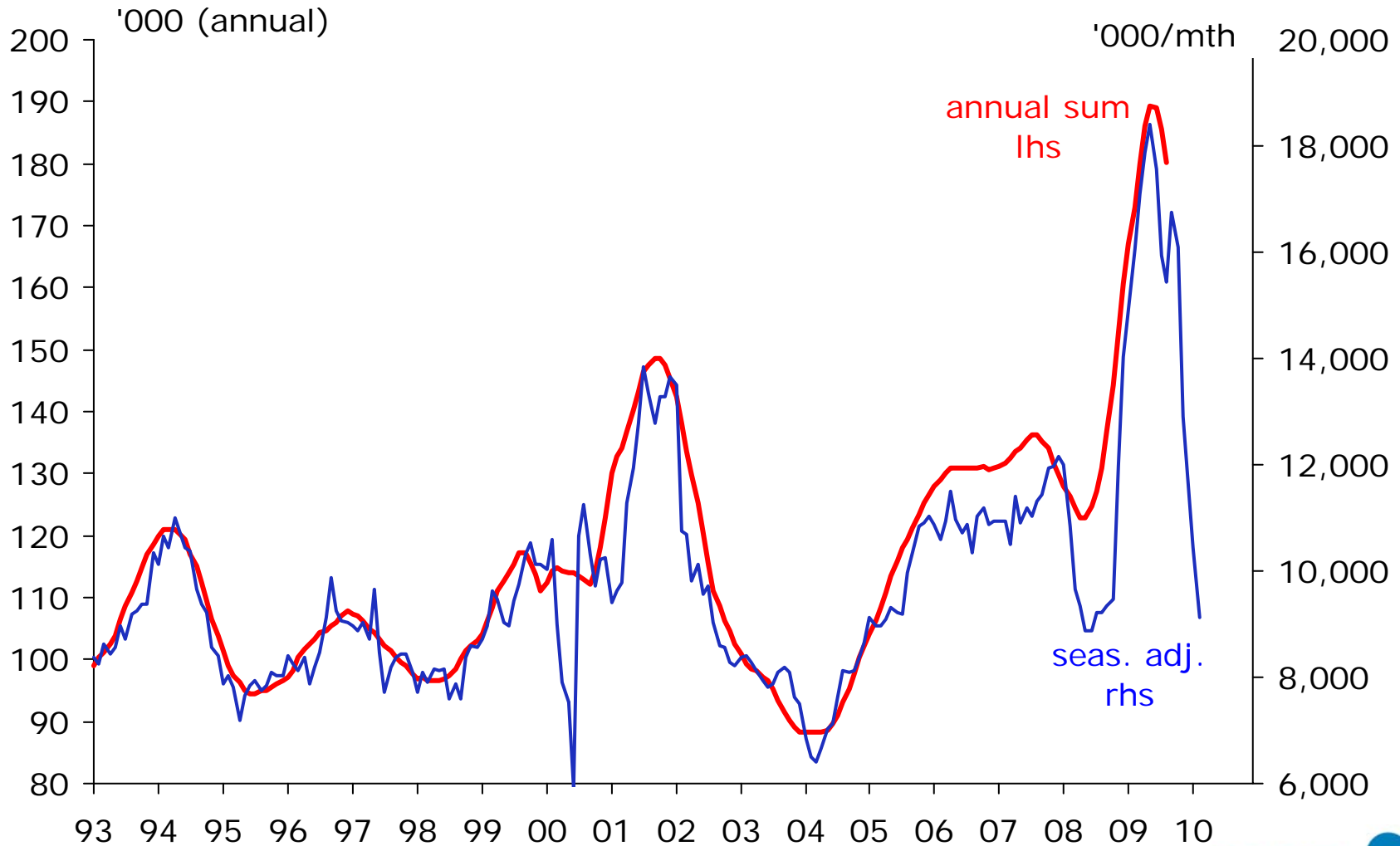
# Further price gains and rising rates will see affordability deteriorate sharply

Housing Purchase Affordability



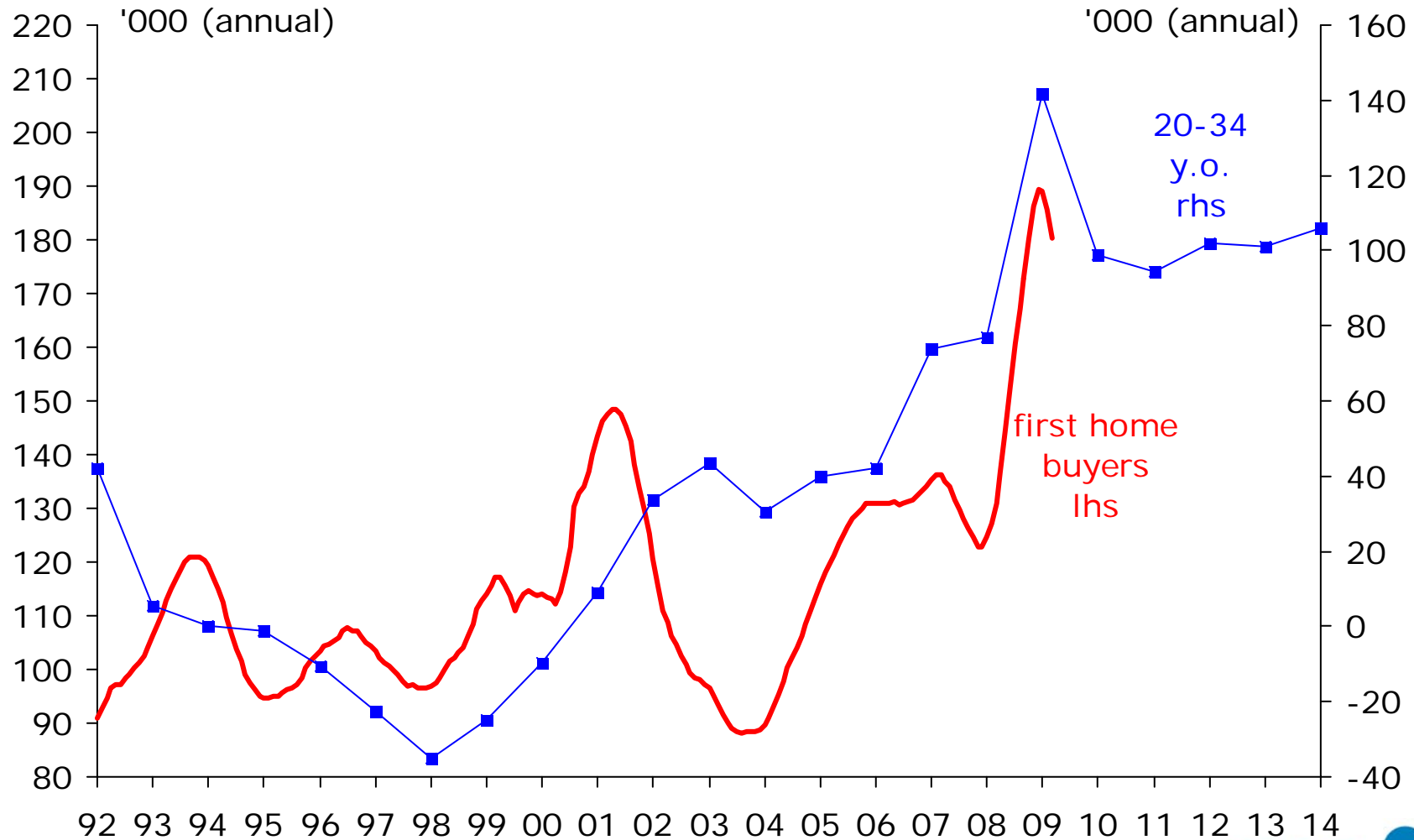
# First-homebuyer demand falling sharply following expiry of FHOG and rising interest rates...

First Home Buyer Finance Commitments



...but population growth should prevent a deep, protracted downturn

First Home Buyers vs. Population Gain



## Rising interest rates will hurt affordability – but could also tighten fundamental market balance

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Housing purchase affordability will deteriorate sharply

- Rising mortgage rates
- Rising prices
- Could *cap* further price gains

...but housing supply could be restricted...

- Home building could be 'collateral damage'
- *Every major cyclical downturn in housing construction has been triggered by rising interest rates*
- Critical housing shortage risks becoming intractable

...hence rising interest rates could *boost* house prices in the long-run

- Ultimately price a function of supply vs. demand
- Current new supply (flow) already well below underlying housing demand



## Other risks

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### Policy shift

- FIRB reversal
  - Will remove heat from some markets
- Reduced net migration targets?
  - Significant political pressure in election year *but* ultimately means reduced economic growth/reduced employment/reduced incomes
  - Skilled labour shortages already apparent

### Economic risk

- Recession/rising unemployment / forced sales
  - Low probability in the near-term given position in the economic cycle
  - Commodity price / resource investment boom
  - Global backdrop?
  - China / India critical

