Thinktank

Leading Commercial Finance

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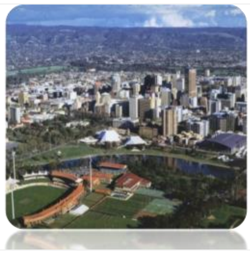
Australian Commercial Real Estate Market Focus



The following represents a monthly snapshot of how we see the commercial property markets across the country along with the near term outlook. For a more detailed commentary, please visit our website thinktank.net.au for our Quarterly Market Update.

The W-MI Consumer Sentiment Index fell back by another 3.1 points in July quite possibly reflecting disappointment in a long election campaign that seemed to yield not much in terms of results. Even the vote counting was drawn-out. This brings the index back to 99.1 and below the 100 level of optimism. As the anti-climax of the very long Federal election campaign sank in during July the reality of the slimmest of margins in the House of Representatives and the lack of any resolution to the Senate stale-mate will fail to build on what had seemed to be a reasonable first half of the year. On the other hand, the AiG-PMI for July rose by 4.6 points to 56.4 and remains in expansion above 50 points with business seemingly putting the election behind it. This was also reflected in the latest D&B Business Expectations Index which surged from 12.3 to 17.9 in its post-election survey.

The RBA Board cut rates again in August as many expected following another low CPI figure for the June quarter released in late July. The 25 basis point cut brought the Cash Rate to a new low of 1.50% and many are speculating that this may now be the bottom of the cycle. The second quarter CPI figures released on 27 July were not surprisingly higher than the first quarter, which was negative -0.2%, and came in at 0.4% for the quarter and 1.0% for the year. We discuss the various measures of inflation used by the RBA and how they correlate to other economic indicators in our News and Views section of this note. One might speculate that the election result made such a cut even more probable. The Brexit vote in the UK also seemed to put an interest rate increase by the US FOMC out of reach for the moment but perhaps more likely later in the year.

Not unexpectedly, residential homes prices and auction clearance rates have picked up again in Melbourne and Sydney. Many of us however continue to be concerned about the state of the multi-unit high-rise development market. Both unit and house markets reacted predictably to the May cut in interest rates and we are expecting the same from this month's cut. The trouble is the evidence of looming oversupply in a number of inner-city unit markets. We look at this in more detail in our Quarterly Market Update.

We have made one change to our ratings this month moving Perth Residential to Weak. As a result we have seven markets that are Good now level with the seven that are Weak. Sydney and Melbourne Residential trends remain Stable with Good ratings although our focus is more on homes than it is units which as mentioned above remain a worry for us. Five of the eight Sydney and Melbourne sectors are Improving. Perth and Adelaide now have eleven ratings Weak and/or Deteriorating. Brisbane's Commercial is still Weak and Deteriorating with vacancies heading up but with other sectors Stable or Improving.

	Sydney		Melbourne		Adelaide		Brisbane (SEQ)		Perth	
Residential	Good	Stable	Good	Stable	Fair	Stable	Good	Stable	Weak	Deteriorating
Commercial	Good	Improving	Good	Stable	Weak	Deteriorating	Weak	Deteriorating	Weak	Deteriorating
Retail	Fair	Improving	Fair	Improving	Weak	Stable	Fair	Stable	Fair	Stable
Industrial	Good	Improving	Good	Improving	Weak	Deteriorating	Fair	Improving	Weak	Deteriorating

Sources: ABS, ACCI, AiG, ABS, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic RP Data, HTW, IMF, IPD, JLL, Knight Frank, Melbourne Institute, OECD, PCA, RBA, , Savills Research, Westpac Economics

News and Views

- The Australian Bureau of Statistics (ABS) releases quarterly statistics on the Consumer Price Index (CPI) that are used extensively at the Reserve Bank Australia. These are useful in assessing current inflation pressures in the economy as well as the outlook for future movements in the CPI. The inflation target is expressed in terms of the average rate of increase in the CPI. In particular, to ensure that the rate of increase in the CPI averages between 2 and 3 per cent over the medium term. In assessing current inflation pressures and the outlook for CPI inflation, the RBA makes use of a wide range of measures of ‘underlying’ inflation which attempt to moderate the short-term volatility in some prices.

- The ABS releases four main measures of price increases every quarter. They are: All groups CPI, All groups CPI seasonally adjusted, Trimmed mean and Weighted mean. The All groups CPI is made up of eleven different categories of goods and services and each is listed with a calculated price change for the quarter and the year. It is also calculated for each Capital City for which a separate report is produced. There are many ways to estimate underlying inflation, but the two approaches most commonly used by central banks are ‘exclusion-based’ measures and ‘trimmed-mean’ measures. Trimmed-mean measures are defined as the average rate of inflation after ‘trimming’ away a certain percentage of the distribution of price changes at both ends of that distribution.

- The measures most commonly cited are the “Headline” (All groups CPI) and the “Underlying” (Trimmed mean). These two measures are shown in Chart 1 opposite against the shaded area identifying the 2% to 3% band mentioned above as the RBA’s target range over the medium term. You can see right away the way in which the Underlying rate is much less volatile than the Headline figure but still follows the same trend over several periods. Chart 2 which graphs the Underlying Rate against two key economic indicators shows how the CPI correlates with Unemployment and GDP.

- CBA Global Markets Research made the following remarks in a recent article considering whether the RBA should change its Inflation Target following the recent CPI report. “The key to success for an inflation targeting central bank is that the target is credible and inflation expectations remain anchored. A lowering of the target in the face of a below target inflation episode could undermine the credibility of the central bank’s monetary policy framework. It may also lead to lower inflation expectations which could push inflation down even further. Both headline and underlying inflation have been trending downwards since mid-2014, with underlying inflation falling below the bottom of the RBA’s target in late 2015. The Q2 2016 result showed headline inflation was just 1.0% higher over the year. Underlying inflation was up 1.5% which is the lowest recorded annual rate. “

- Chart 3 accompanied comments from Westpac Economics at the same time and were as follows:” A key factor for our Q1 re-assessment of the near-term inflation outlook was the recent soft prints for housing costs. Following on from a soft 0.1% in Q4 and 0.3% in Q1, it did appear that housing may have become a disinflationary force. It is not so clear now with a bump up in dwelling costs in Q2 (0.9%/qtr as prices lifted by this much in Melbourne and Brisbane supporting the 1.5% bounce in Sydney) being constrained in the quarter by the 0.2% lift in rents and a 0.4% fall in electricity price. While some volatility is to be expected going forward it does appear that, at least for now, we may have found a floor for housing cost inflation.”

Charts 1 & 2: Headline and Underlying Inflation / CPI and Key Economic Indicators

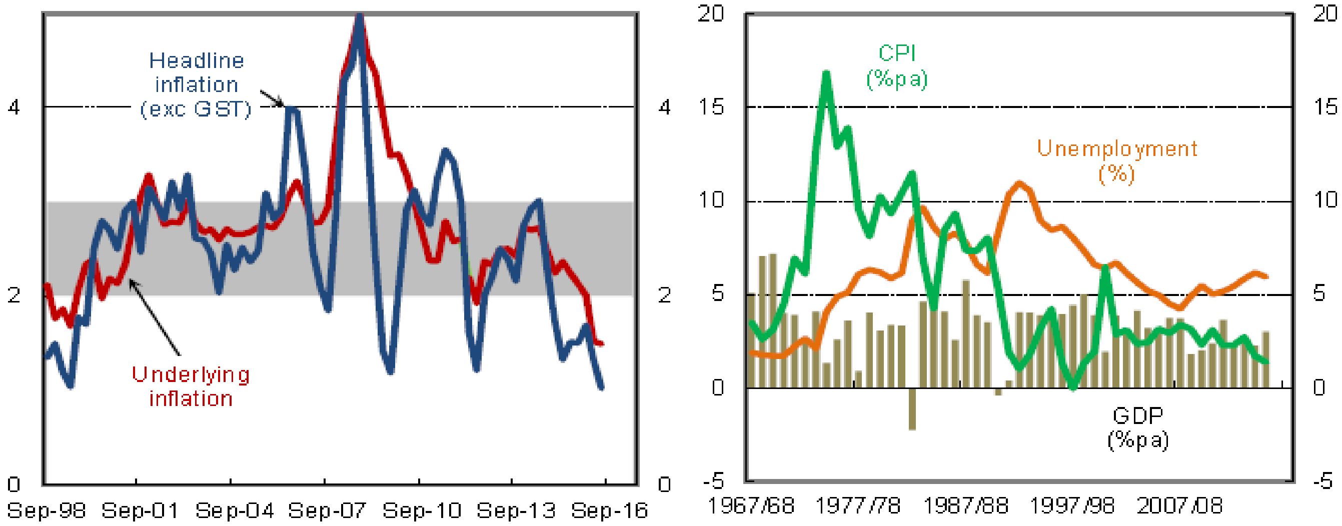
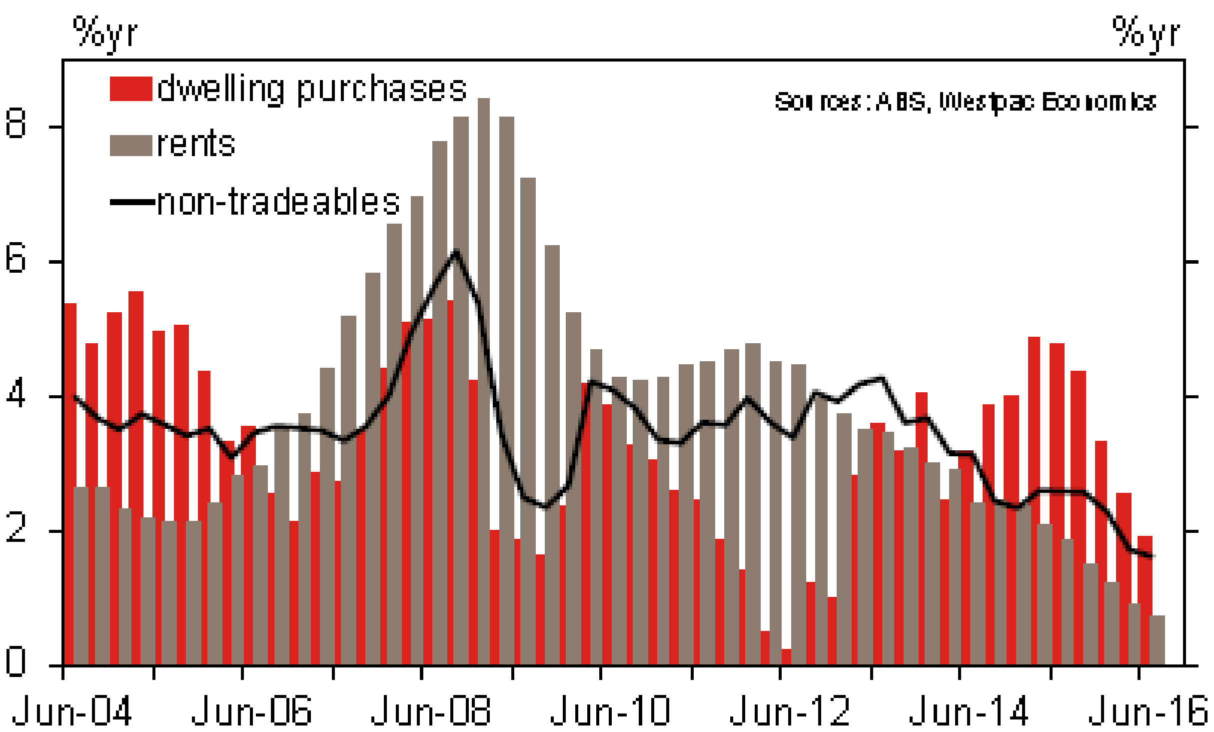


Chart 3: % Annual Increase in Dwelling Prices, Rents and Non-tradeable Goods



Sources: ABS, CBA and Westpac

For additional information, please contact:

Publications & Market Update

Per Amundsen
Executive Director & Company Secretary
T: (02) 8669 5515 M: 0417 064 252
Email: pamundsen@thinktank.net.au

Credit & Operations

Peter Kearns
General Manager & Executive Director
T: (02) 8669 5501 M: 0434 609 238
Email: pkearns@thinktank.net.au

Funding & Strategy

Jonathan Street
Chief Executive Officer
T: (02) 8669 5505 M: 0438 319 432
Email: jstreet@thinktank.net.au

Sales & Distribution

Peter Vala
Head of Sales & Distribution
T: (02) 8669 5512 M: 0468 989 555
Email: pvala@thinktank.net.au

Business Relationships and Loan Inquiries

Tony Zaccari
Senior Relationship Manager - VIC
T: (03) 9097 1781 M: 0403 758 514
Email: tzaccari@thinktank.net.au

Kevin Lane
Senior Relationship Manager - VIC
T: (03) 9097 1781 M: 0410 758 540
Email: klane@thinktank.net.au

Adam Hutcheson
Senior Relationship Manager- NSW / QLD
T: (02) 8669 5509 M: 0434 609 239
Email: ahutcheson@thinktank.net.au

Paul Burns
Relationship Manager – NSW / ACT / WA
T: (02) 8669 5510 M: 0434 609 241
Email: pburns@thinktank.net.au

Ranei Alam
Relationship Manager- NSW / SA
T: (02) 8669 5502 M: 0434 609 240
Email: ralam@thinktank.net.au

Kathryn Jones
Executive Assistant
T: (02) 8669 5513
Email: kjones@thinktank.net.au

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- Set and forget loan terms up to 30 years with no ongoing fees or annual reviews
- Self-Managed Superannuation Fund (SMSF) loans up to 75% LVR, and
- Loan options ranging from fully verified to self certification of income.

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