



Australian Real Estate Market Focus

The following represents a monthly snapshot of how we see the 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 Westpac-MI Consumer Sentiment Index rose strongly by 4.5% in November but still stands below 100 at 97.0. The AiG PMI for November was down by 3.5 points to 48.1 and falling into contraction below 50 while the PSI was also down 1.5 points but stayed above 50 at 53.7. The Westpac-MI Leading Index lifted slightly in October from -1.01 to -0.91 but still materially below trend. Westpac's current forecast for GDP growth in 2020 is 2.4%.

At its December meeting the RBA Board held the Cash Rate steady for the time being at the record low of 0.75%. Governor Lowe has spoken of the likelihood of further easing and the November quarterly SoMP also pointed that way. The Q3 GDP came in at a sluggish 0.4% with the annualised rate rising to 1.7%; the OECD announced global growth for Q3 slowed to 0.3% compared to 0.4% for Q2. Retail sales for October were once again weak, being flat at 0.0% and down to 2.1% for the year following on the third quarter which was actually down -0.1%. The US Fed is not expected to cut at its December meeting and Chairman Powell's remarks appear to signal some doubt about more cuts. With markets unsure about further cuts to rates by the RBA the AUD rose in late October to above USD 0.68 and then fell below that level with many senior economists now looking to a cut in February after the RBA returns from its Christmas / New Year's break. It is now just a bit above that level.

CoreLogic housing prices for November showed further strong gains in Sydney and Melbourne houses at 3.1% and 2.4% respectively. Units were up as well, 1.1% for the month in Sydney and 1.4% in Melbourne but we remain concerned about the ongoing supply of newly completed apartments. The month-on-month lift of 1.7% in national housing values was the largest monthly gain since 2003. Our News and Views section covers the lively debate on Fiscal and Monetary Policy and the important impact this has on interest rates with the three rate cuts earlier this year contributing to the housing recovery.

There have been a couple of changes in our ratings and trends this month. Melbourne and Sydney Residential are upgraded to Good for Houses and with an Improving trend. Units remain Fair and Stable, in both cities, despite comments above. Industrial ratings in both cities were upgraded to Strong earlier last quarter matching the Office sector there making four markets rated as Strong and Improving with all in Sydney and Melbourne. Perth's Resi-Homes rating moved to Fair. Adelaide has three Improving trends and Brisbane has two. Retail is Fair and Stable except Adelaide which is Weak. Retail trends remain a concern and we discussed that in more detail in our last Quarterly Update. The Jan-March Update will be our next publication as we take a short break in the Monthly over the holidays.



	Sydney	Melbourne	Adelaide	Brisbane (SEO)	Perth
Resi- Homes	Good Improving	Good Improving	Fair Improving	Fair Stable	Fair Stable
Resi- Units	Fair Stable	Fair Stable	Fair Improving	Fair Stable	Weak Deteriorating
Office	Strong Improving	Strong Improving	Fair Improving	Fair Improving	Fair Stable
Retail	Fair Stable	Fair Stable	Weak Stable	Fair Stable	Fair Stable
Industrial	Strong Improving	Strong Improving	Weak Stable	Fair Improving	Weak Stable

Sources: ABS, ACCI, AiG, ABS, AFR, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic, Cushman & Wakefield, HTW, IMF, MSCI, JLL, Knight Frank, Melbourne Institute, OECD, PCA, Preston Rowe Patterson, RBA, RLB, Savills Research, Westpac Economics, World Bank

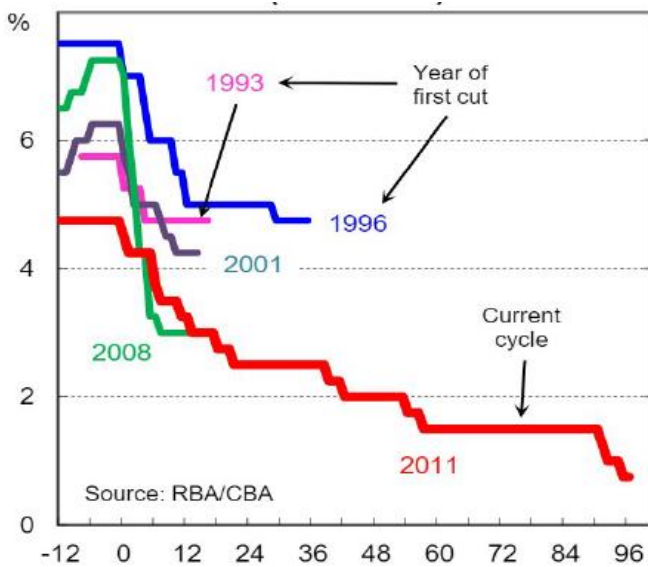


News and Views

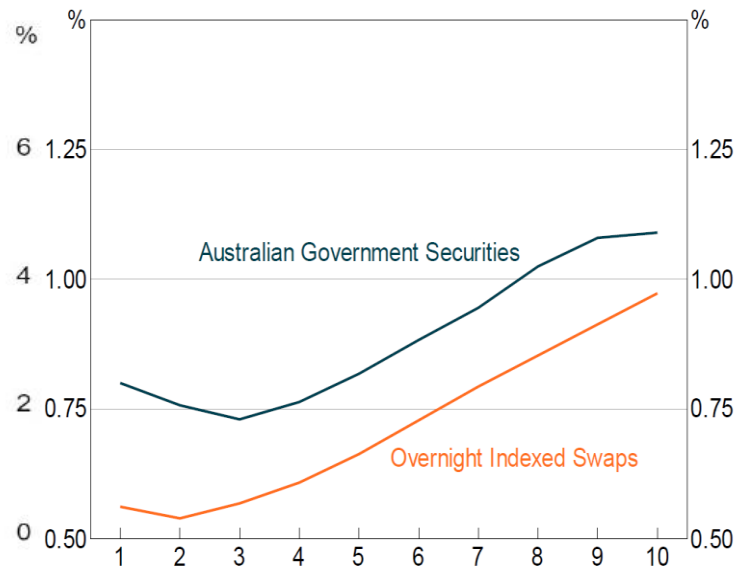
- The Reserve Bank of Australia (RBA) has been in the news even more than usual with plenty of comment from economists and financial journalists lately about interest rates and quantitative easing. The catalysts for all of the comment and media interest are of course record low interest rates plus the recent publication of the RBA's November Statement on Monetary Policy (SoMP) and RBA Governor Phillip Lowe's well publicised speech to the Australian Business Economists Dinner on 26 November 2019.
- Understanding the context of the RBA's current Monetary Policy naturally involves how this has developed as part of the current Interest Rate easing cycle and how that compares to previous cycles. To do this Graph 1 opposite is very useful and details the five easing cycles that have taken place since 1993 and illustrates quite clearly why the expression "lower for longer" is used so often to describe the current cycle. Governor Lowe specifically addressed this point in his 26 November speech and quite quickly economists such as Westpac's Bill Evans and CBA's Michael Blythe concluded/firmed up their forecasts for another rate cut of 25 basis points in February 2020 when the RBA Board next meets after its Christmas/New Year break. Westpac particularly expects another further 25 basis point cut later in 2020 bringing the Cash Rate to 0.25% which Governor Lowe has described as the low point to which they will go with no intention of considering negative interest rates as has happened elsewhere in the world.
- Graph 2 gives us a clear look at the much talked about "yield curve" showing what it looks like currently for Australian Government Securities (AGS) and Overnight Index Swaps (OIS) for maturities ranging from one to ten years. This graph was used by Governor Lowe in his Monetary Policy and Quantitative Easing speech and one can clearly see the negative slope for both with AGS declining for three years and the OIS for just two. They both then have a positive slope out to ten years but we can also see that the rise is only 35 basis points and 50 basis points respectively which is very modest. It is however not negative which is a good thing as this is generally viewed as a forecast of recession in as much as the inference is that long-term interest rates will be falling reflecting a weakening economy. Australia has in the past had quite a steep positive yield curve so responding to these changed circumstances is quite a challenge for both the Central Bank and the Federal Government.
- Graphs 3 and 4 go to key forecasts contained in the RBA's November SoMP and for many economists the points on which they differ from the views held by the RBA and why they are expecting 2020 to be a year of a further extension of the "easing cycle". Generally the RBA's forecast is for a gradual pick-up in GDP growth with a resulting fall in unemployment which will bring with it some renewed wages growth. The question of course is how will this occur when consumer confidence remains low with particularly weak retail sales growth and the reaction to the last three cuts in the Cash Rate has not been positive. It seems that some contribution is needed by Fiscal Policy controlled by the Federal Government and to date this seems unlikely to occur at the expense of a Surplus expected to be declared in the May 2020 Budget. Many believe that some stimulus as part of the December Mid-Year Economic and Fiscal Outlook (MYEFO) would be preferable given the recent weak statistics being reported but the Treasurer appears unmoved.
- What these forecasts mean for Australian property markets is that with low short term and long term rates we can expect borrowing costs to remain subdued and we may even see some further softening in capitalisation rates which means higher capital values assuming rental levels don't decline. The latter is a real risk in the Retail sector and increasingly commentators are saying that Retail landlords will have to start reducing rents especially for specialty shops. Industrial looks likely to benefit from both revenue and capital returns and while they may not be at levels as strong as the past few years they still look positive.
- For Residential properties the recovery has certainly taken hold and this month's figures as reported on our front page are the best in many years and seem to indicate that the lower rates being paid by borrowers and the improved access to credit have finally had their desired impact on investors.



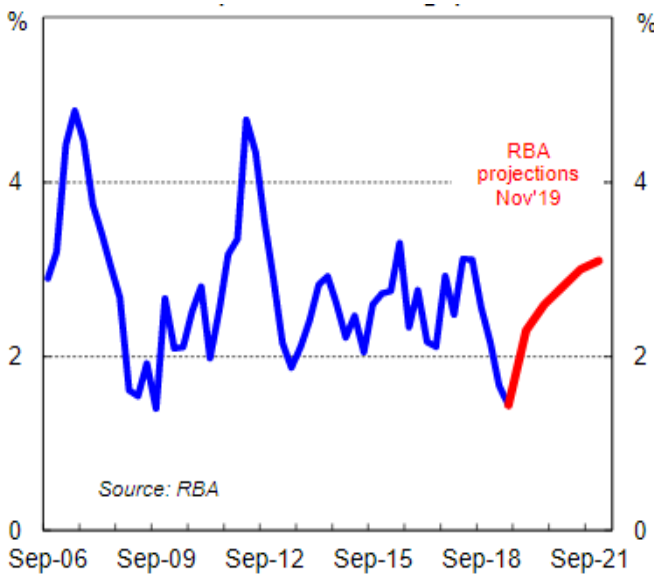
Graph 1 – AUD Rate Cut Cycles Since 1990



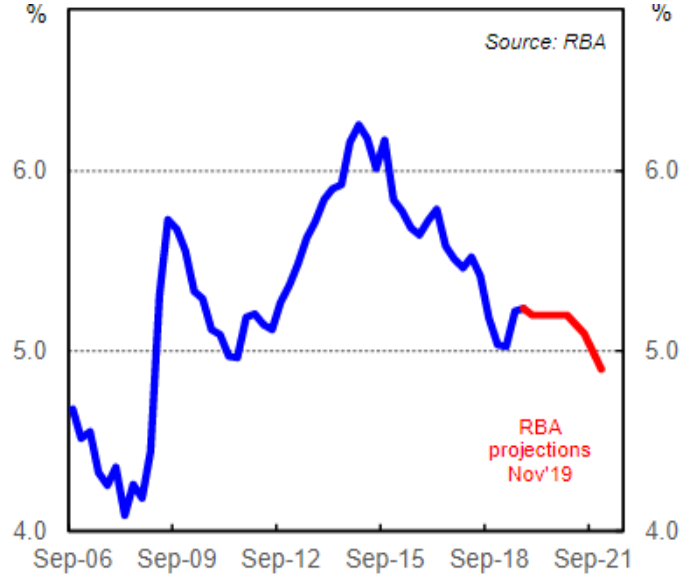
Graph 2 – Australian Yield Curve



Graph 3 – Australia GDP Growth p.a.



Graph 4 – Australia Unemployment Rate



Sources: Bloomberg, RBA and CBA



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