Australian real estate market focus

August 2022

Thinktank..

The following represents a monthly snapshot of how we see the property markets across the country along with the near-term outlook. For more in depth commentary, please visit our website thinktank.net.au for our latest Quarterly Market Update. This month in News and Views we take a look at the outlook for Monetary Policy after the Reserve Bank of Australia's (RBA) third consecutive increase of the Official Cash Rate (OCR) by 50bps.

The Westpac-MI Consumer Sentiment Index fell sharply again in July by 3% to 83.8 remaining well below the 100 level of confidence, impacted by inflation and interest rate increases. The Westpac Melbourne Institute Leading Index fell to 0.40% in June from 0.56% in May. July's result for the AiG Manufacturing Index was negative 1.5 points to 52.5 after last month's gain of 1.6 points but staying in positive territory above 50. The other AiG index that has reported PCI construction index down in July by 0.9 points to 45.3, in contraction. The PSI covering services and retail was up by 2.9 points to 51.7and into expansion above 50.

As expected at its August meeting the RBA Board again raised the OCR by 0.50% for a third time taking it from 1.35% to 1.85% while further increases are expected this year by most market economists. This was another large increase and Governor Lowe's remarks after the meeting and in the SoMP issued later mentioned high inflation as a key factor. The 1st quarter GDP results at 0.8% for the quarter and 5.3% yoy; were good but on the back of a high quarterly CPI for June of 6.1%, the strongest rise since 2001. Retail sales for June were also positive being up 0.9% for the month and 10.4% yoy. The unemployment rate of 3.5% in June, down from 3.9% also evidenced the resilience of the Australian economy. Globally, the IMF World Economic Outlook released in July and featured in our July Quarterly Market Update was titled "Gloomy and More Uncertain" with world growth forecast to slow to 3.2% in 2022 from 6.1%i n 2021; 0.4% less than predicted in April. Last month the Bank of Canada increased its Cash Rate by a full 1% on 13 July two weeks before the FOMC again raised its Fed Rate by 0.75%. 10 year US Treasury Yields traded at 2.75% at the start of the month while AUS 10 year Gov't bonds were at 3.13%. The AUD was slightly up at the start of this month at USD 0.70 but just below that now.

CoreLogic dwelling prices for July continued their decline at an accelerated pace. National Housing values posted a 1.3% fall for the month, and after last month's fall was down 2.0% for the quarter with a fall of 4.7% in Sydney and 3.2% in Melbourne. In Sydney, House prices were down 2.5% for the month with units down 1.5% and the results were similar in Melbourne for houses being down for the month 1.6% while units were down by 1.2%. Adelaide and Perth continued to stay in positive territory again this month with dwellings up 0.4% and 0.2% respectively but Brisbane Houses fell 1.1% for the month. Regionals outperformed Capitals but were still down by -0.8% to -1.4% for July and -0.2% to -2.6% for the quarter. Rents are rising right across the country.

We have reflected the further decline of Residential in almost all areas and have modified our ratings and trends but with some still remaining relatively stable for the near term. Sydney and Melbourne houses and units remain Soft and Declining. Retail continues to be showing the expected signs of volatility as sales continue to improve as noted above. Office continues its slow but steady recovery from the pandemic lockdowns while Industrial remains very strong and we are maintaining our Ratings and Trends which are either Strong or Good with an Improving Trend in each of the capitals. It still remains to be seen how interest rate increases will impact on commercial capitalisation rates but a relatively flat yield curve appears to be encouraging as well as strong rental growth in the Industrial sector. We looked more closely at this topic in our Quarterly Market Update and

	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEQ)		PERTH	
Resi- Homes	Soft	Declining	Soft	Declining	Good	Stable	Fair	Declining	Good	Stable
Resi- Units	Soft	Declining	Soft	Declining	Good	Stable	Fair	Stable	Good	Stable
Office	Fair	Stable	Fair	Stable	Good	Stable	Fair	Stable	Fair	Stable
Retail	Weak	Stable	Weak	Stable	Good	Stable	Fair	Stable	Fair	Stable
Industrial	Strong	Improving	Strong	Improving	Strong	Improving	Good	Improving	Good	Improving

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

News and Views

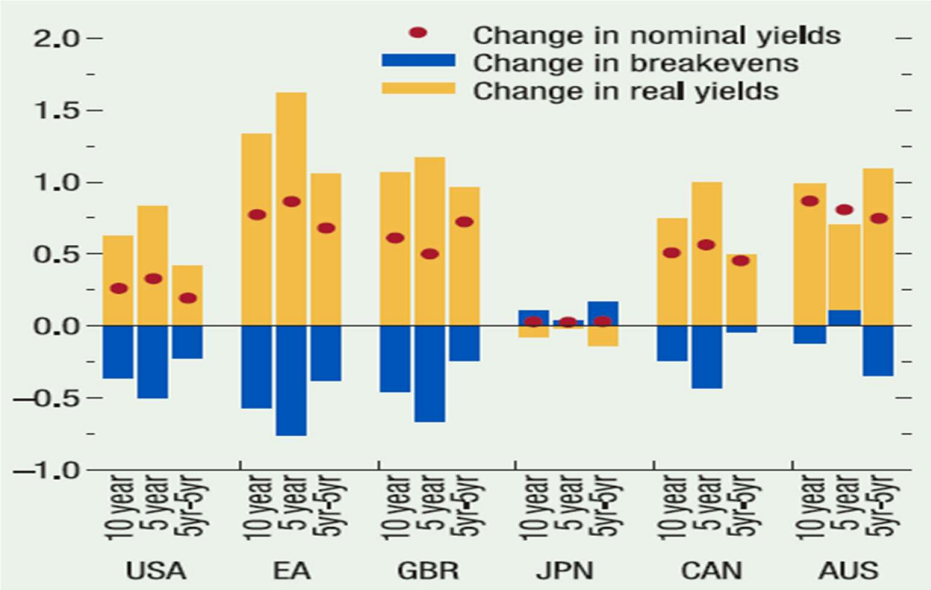
o During the past month Monetary Policy has been the main focus of economists both globally and domestically here in Australia. While a great deal of attention is focussed on the regular Central Bank meetings that set the various cash rates in their countries, longer term rates are set by the markets and vary in each market depending upon sentiment as to what the future holds for local economies. The chart below was featured in the IMF's World Economic Outlook. It noted that rising real rates have been the key driver of higher bond yields across maturities in advanced economies, and lower market-based measures of inflation expectations have partially offset real rates during this period. It also remarked that market-implied expectations of policy rates are currently signalling rate cuts in 2023 and 2024 in some advanced economies. The chart shows the greater change in 10 year real and nominal yields here in Australia than in the USA and Canada.

o Graphs 1 and 2 opposite show the yield curves for Australian and US government securities for up to 30 year residual maturities as at 1 August 2022 and comparative curves for 1 month and 6 months ago. We can see 10 year rates here in Australia in Graph 1 are higher than the shorter term rates and then relatively flat out to the 30 year maturities. In Graph 2 we see the 10 year Gov't Bond Yield falling below the 2 year rate creating the inverted yield curve. This then rises out to 20 year maturities and is pretty well flat after that out to 30 year maturities. Westpac has issued a long-term forecast for rates along the Australian Yield Curve starting at 15 July 2022 with 90 Bank Bills at 2.15%, 3 year Gov't Bonds at 2.98% and 10 year Gov't Bonds at 3.42%. We can see in Graph 1 opposite how these rates have flattened just over the past few weeks

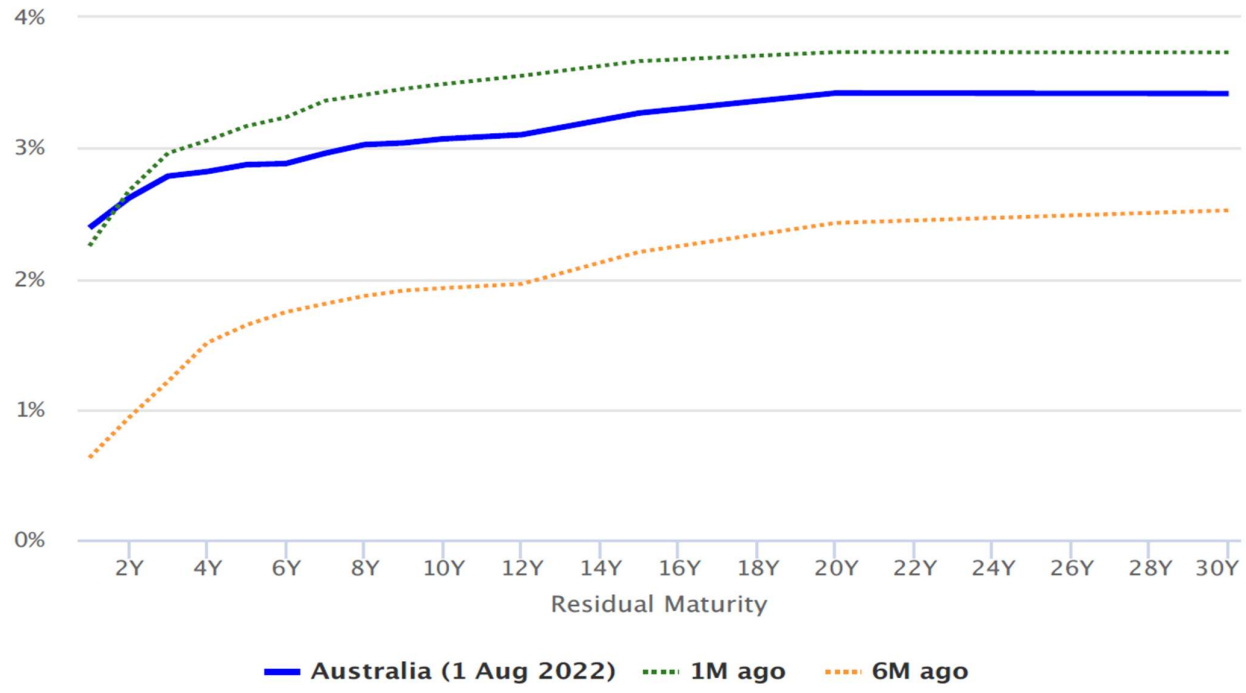
o Westpac sees this flattening of the yield curve continuing from the first quarter of next year and had seen the cash rate topping out at 2.60% but has since upped this to 3.35%. CBA has stuck with 2.60% as the terminal cash rate. Long-term Gov't Bond rates are seen as starting to fall a little earlier from Dec'22 when they top out at 3.10% and 3.50%. From then on both continue to fall until Sept'25 with the yield curve inverting slightly in March'24 when 3 yr Gov't Bonds reach 2.55% and 10 year yields are at 2.50%. This trend continues until Sept'25 when 3 yr yields are at 2.45% and 10 yr yields have fallen to 2.05% just 5 bps higher than that forecast for the equivalent US Gov't Bond at 2.00%.

o During this time Westpac also sees the AUD rising against the USD to 80 cents through all of 2024. While US rates are cut by the Federal Reserve, the RBA here in Australia keeps the Cash Rate steady. CBA is forecasting 70 cents which is quite a difference. One of the implications of those forecasts is the Commercial Property values that are highly dependant on capitalisation rates which are sensitive to long bond yields may see a bounce as soon as next year when both Westpac and CBA see that gradual fall beginning as early as Dec'22.

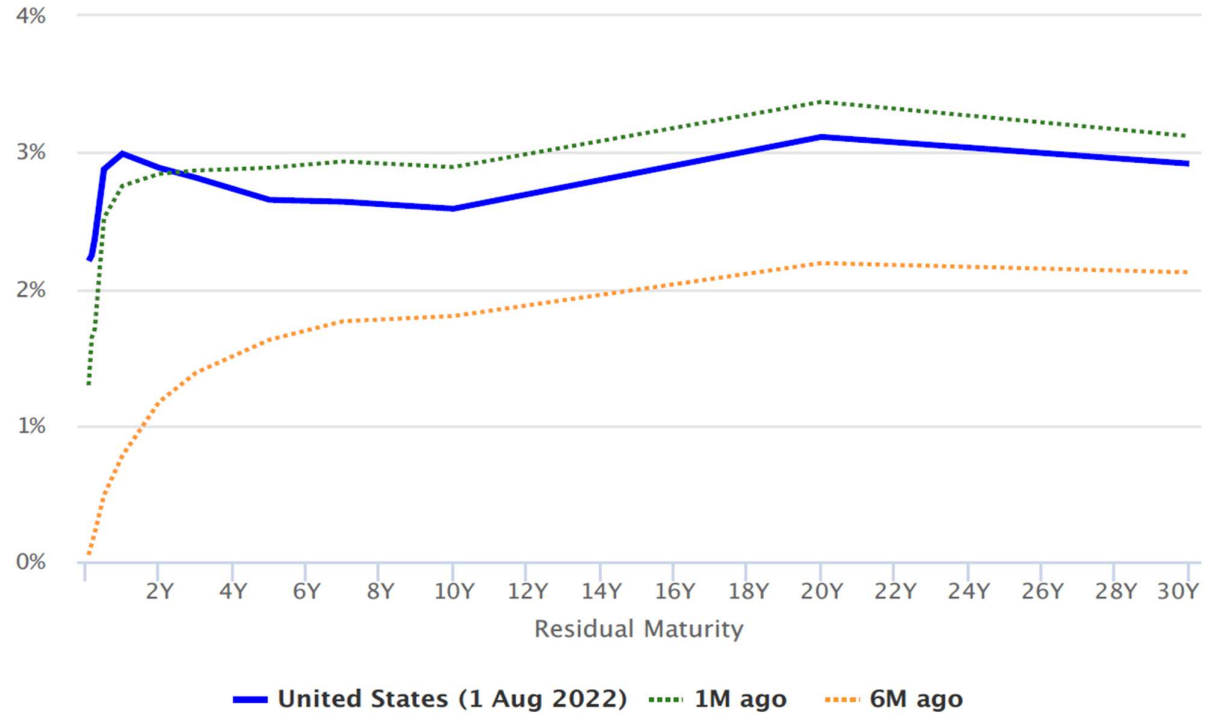
Global Financial Stability Update – IMF July 2022



Graph 1: Australian Government Bond Yield Curve, 1 August 2022



Graph2: United States Government Bond Yield Curve, 1 August 2022



Source:

WORLD GOVERNMENT BONDS

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