Australian real estate market focus

March 2023

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 latest MSCI Real Asset Briefing for the quarter ended 31 December 2022. We also have included some comments on the AiG Index changes.

The Westpac-MI Consumer Sentiment Index fell in February by 6.9% to 78.5 reversing its unexpected January gain and falling to near historic lows well below the 100 (neutral) level of confidence, described as "deep pessimism" impacted by inflation and interest rate increases. The Westpac Leading Index for February saw the index move just slightly lower to -1.08 from -0.96 pointing to below trend growth for most of 2023. This was consistent with the earlier December quarterly Westpac – ACCI Survey of Industrial Trends which fell sharply from September's 64.6 to 49.6. The AiG Australian Industry Index launched in a different format in February gaining 9.8 points to -1.8, the index has been in contraction for 10 of the past 12 months (see News and Views).

At its March meeting, the RBA Board raised the Cash Rate 0.25% as widely expected. This increases the rate from 3.35% to 3.60% taking the rate from its low of 0.10% less than a year ago. While further increases were expected as we entered 2023, the slowing of the pace of increase over the past few months is viewed positively but there is still plenty of debate about the terminal rate we will see and if rates will flatten by mid-2023. Retail sales for January were up 1.9% for the month and 7.5% yoy. CPI for the 4th quarter was up 1.9% and 7.8% for the year which is still hoped to be the high point in this cycle. The unemployment rate of 3.7% in January was up slightly but little changed in months. The US Federal Reserve at its last meeting raised its base rate by 0.25% and while signalling more increases to come, they are unlikely to be the same when they meet again on March 21-22. The Bank of Canada meets on 8 March and has signalled it may now pause its cycle of rate increases. Currently 10 year US Treasury Yields are trading at 3.98% and AUS 10 year Gov't bonds were at 3.78% with the US yield up but still inverted from the 2 year by 90 bps. The AUD is down to around USD 0.66.

CoreLogic dwelling prices for February continued their decline but only just as several markets have flattened out or risen slightly. National Housing values posted a 0.1% fall for the month compared to -1.0% in January. The improvement was based on Sydney's 0.3% increase for the month. This has been seen as "a false dawn" by some but we find it very welcome and a true reflection of the Sydney market with some segments performing very well. For the quarter, nationally Housing was down by just 2.3% from 3.5% last month. The quarterly fall of 2.4% in Sydney and 2.7% in Melbourne were also both down slightly. In Sydney, House prices were up 0.3% for the month with units were up 0.1% and the results for Melbourne while still down were improved with houses down for the month 0.5% and units also down 0.2%. Adelaide and Perth continue to do well this month but still slightly lower with dwellings down just 0.2% and 0.1% respectively but Brisbane fell 0.4% for the month.

We have reflected the slower decline of Residential in almost all areas and have adjusted our ratings and trends for Sydney but maintained them across other Capitals. Melbourne houses and units remain Weak and Declining as does Brisbane. Retail continues to be showing some recovery as sales continue to improve as noted above. Office continues its slow recovery from the pandemic lockdowns but is just Fair with some changes reflected in the PCA report featured last month. Industrial remains very strong and we are maintaining our Ratings and Trends which are either Strong or Good with an Improving or Stable Trend in each of the Capitals. The MSCI report inside supports these views as does the recently released Knight Frank Australian Industrial Review.

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

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News & Views

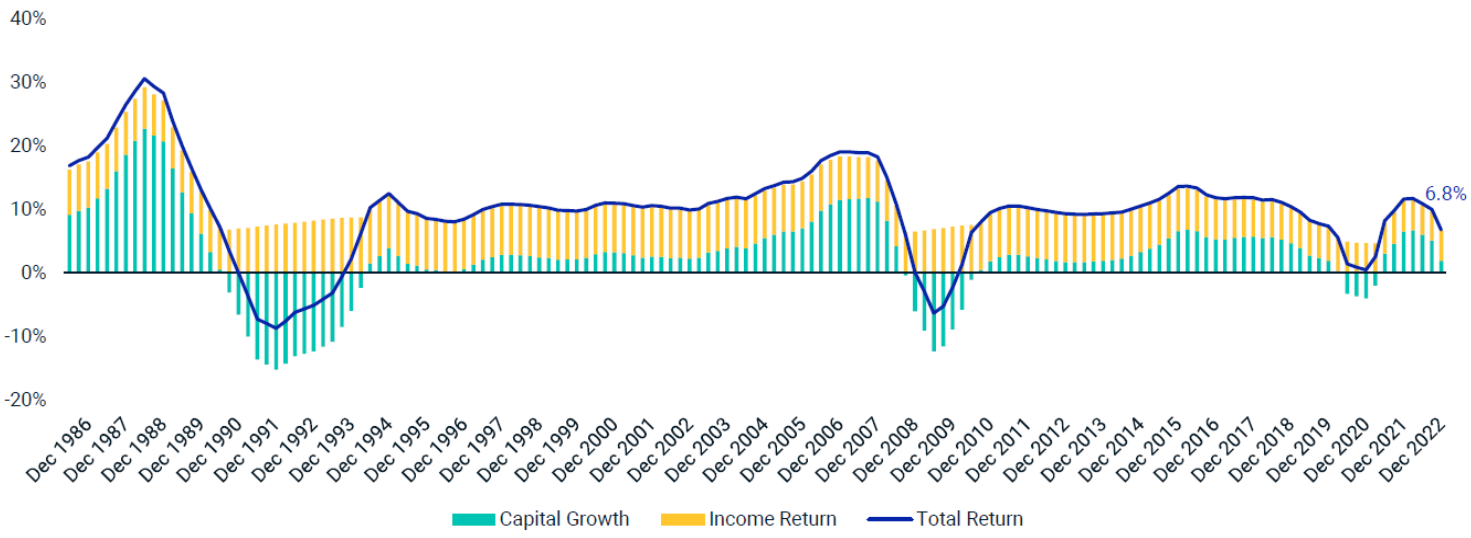
- The MSCI recently released their December 2022 update for Australian Commercial Property markets Office Market at briefings in mid-February. The chart below shows rolling annual returns broken into capital growth and income returns since 1986. This shows the most recent 6.8% return with capital growth virtually eliminated as interest rates continue to rise, forcing capitalisation rates up and property values down.

- Graph 1 opposite shows the movement over the past six quarters for each sector by Capital Growth and Income Return with all sectors declining as Capital Growth shrank but with Industrial well ahead in each quarter. The analysis of Capital Growth in the report over the last four quarters shows all values in all sectors declining in the fourth quarter with only Industrial and Hotels in positive territory and overall a negative result for Commercial Property as a whole. Transaction volumes were shown as having declined by 66% in the fourth quarter and down 21% for 2022 compared to 2021. This decline was quite evenly spread across the major sectors with Industrial and Retail quite comparable and with Office while down on the year still showing a closer performance in 2022 to 2021 and better overall transaction volumes.

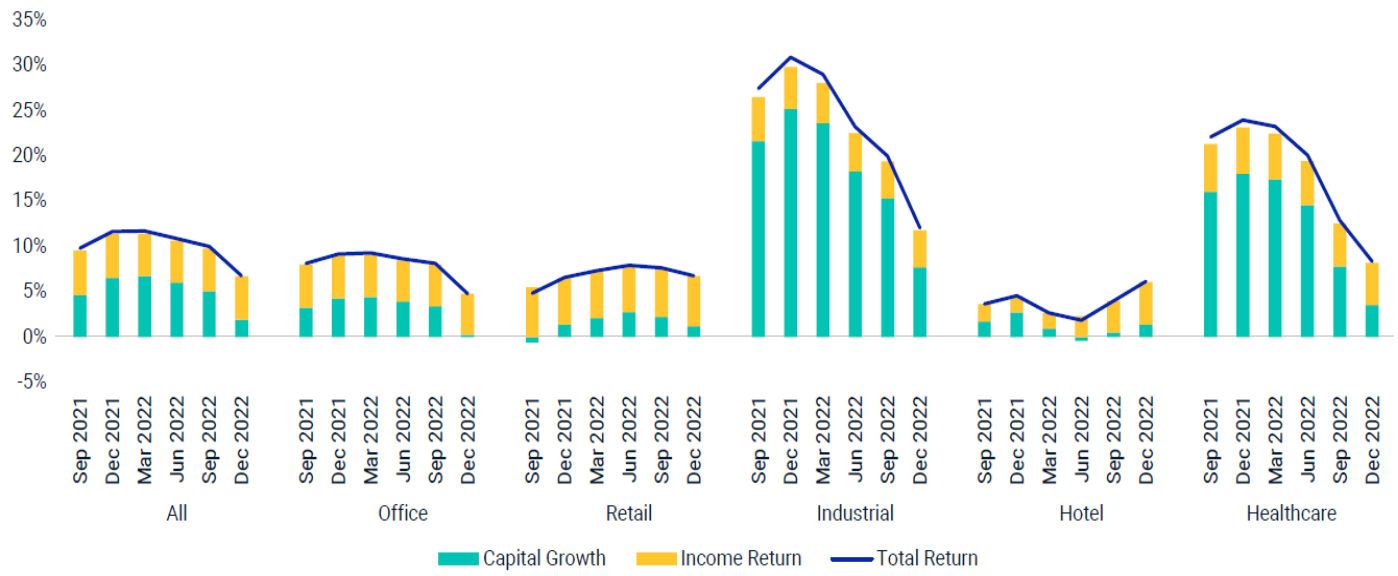
- Graph 2 opposite breaks down the various commercial property sectors in more detail and again shows how Industrial has outperformed for both this year and for the longer term. The recent Knight Frank research report on National Industrial Markets reflected the same results although more focussed on the past twelve months. Good rental growth was experienced in all Capitals and was particularly strong in Perth, Sydney and Melbourne; more than offsetting yield expansion for Prime properties. Quarterly Capital Growth was down for all sectors and as interest rates continue to rise this can be expected to continue with strong attention being paid to expectations for rentals to grow and in many cases make up for the lack of Capital Growth. KF summarised the National Industrial market as follows: “The leasing market continues to be very strong, driving widespread rental growth. Vacancy rates across the Eastern Seaboard continue to sit at record low levels and Perth is experiencing the fastest pace of rental growth nationally.”

- As mentioned last month, the Australian Industry Group (AiG) has made changes to their monthly indices which we quote on our front page each month and which provide a good measure of activity in the Manufacturing, Construction and Services sectors. The change was announced in early February with the new index to be released on the first working Wednesday of each month. The single Industry index will replace the PMI, PCI and PSI which had been reported for 30 years however both the PMI and PCI will continue to be reported as sub-indicators within the AiG Australian Industry Index. For March the PMI rose 10.8 points but remains negative at -6.4; the PCI fell 16.4 points taking it into negative territory at -5.0. The change in the indices may take some time to adjust to in terms of their interpretation but all were in contraction this month.

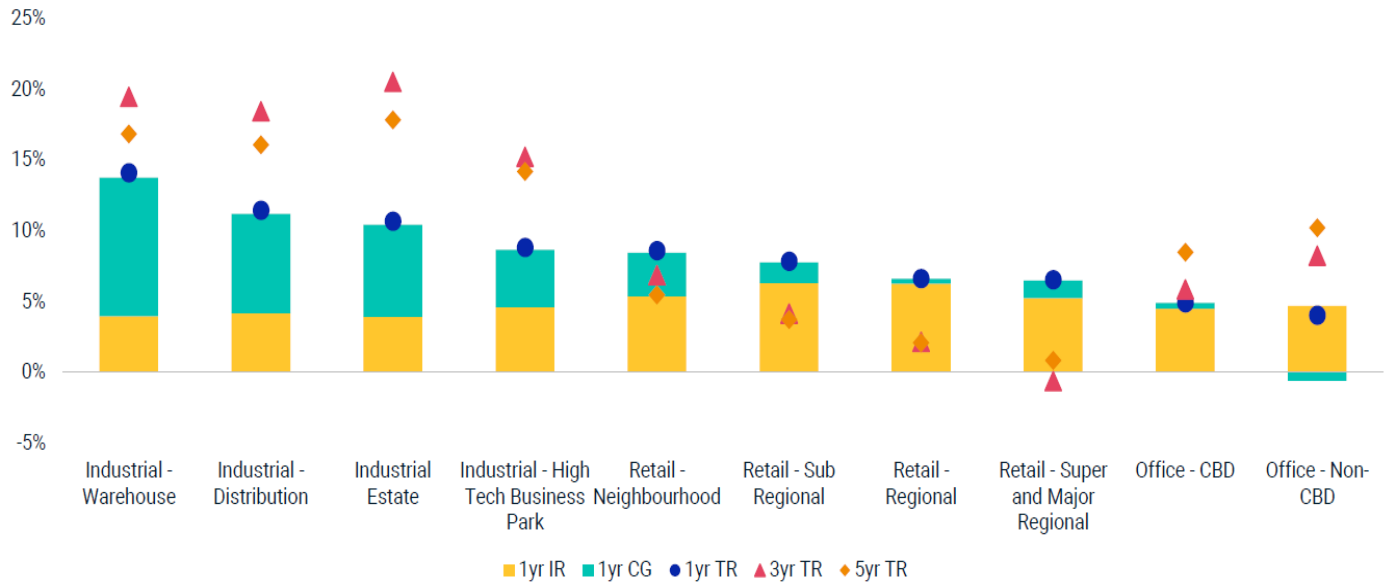
Australian Direct Property Returns 1986 to 2022 - MSCI



Graph 1: All Australian Sectors – Rolling Annual Returns



Graph 2: All Australian Sectors – Return Breakdowns



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