Australian real estate market focus

April 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 upcoming Quarterly Market Update. This month in News and Views we take a closer look at the latest developments with respect to Interest Rates both here and globally as well as the impact on Office markets.

The Westpac-MI Consumer Sentiment Index was steady in March at 78.5 after reversing its unexpected January gain in February and falling to near historic lows described as “deep pessimism” impacted by inflation and interest rate increases. The AiG Australian Industry Index was launched in a different format in February and in March lost 4.4 points to -6.1 as new orders evaporated. The index has now been in contraction for nearly a year since May 2022. The sub-indicators were split with the PMI up 11.9 at 5.6 and the PCI slightly down 0.8 to -5.8.

At its April meeting, the RBA Board paused the Cash Rate at 3.60% after increasing it from 0.10% less than a year ago. While not forecast by all commentators it is seen as a welcome relief even if further increases resume as suggested by quite a few market economists and the Governor himself in both the release accompanying the Rate announcement and in a speech the following day. While further increases may be expected by some, 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 when rates might begin to fall. We discuss this in more detail in our News and Views section inside. Retail sales for February were up 0.2% for the month and 6.4% yoy. CPI for the 4th quarter was up 1.9% and 7.8% for the year but the monthly indicator was 6.8% for the year. The unemployment rate of 3.5% in February was down slightly but still little changed. 10 year US Treasury Yields are trading at 3.26% and AUS 10 year Gov’t bonds were at 3.18% with the US yield still inverted from the 2 year at 3.79% by 53 bps. All of these rates are down from last month. The AUD has moved up slightly to around USD 0.67.

CoreLogic dwelling prices for March finally reversed their decline on a National basis for the first time since April 2022. National Housing values posted a 0.6% gain for the month compared to -1.0% fall in February. The improvement was based on gains in Sydney and Melbourne of 1.4% and 0.6% respectively for the month with Brisbane and Perth also posting gains. We see this as a continuation of last month’s initial recovery that will be further assisted by the RBA’s decision this month to pause its interest rate increase cycle. For the quarter, nationally Housing was down by just -0.6% from -2.3% last month. The quarterly fall of -2.4% in Sydney was reversed to a gain of 0.4% and a fall of just -0.9 in Melbourne. In Sydney, House prices were up 1.5% for the month with units up 1.0% and the results for Melbourne were also improved with houses up for the month 0.6% and units also up 0.4%. Adelaide, Perth and Brisbane all did better this month with Adelaide dwellings down just 0.1% but Brisbane up 0.1% and Perth up 0.5% for the month and 0.1% for the quarter.

We have reflected the improvement of Residential in almost all areas and have adjusted our ratings and trends for Melbourne to match Sydney at Fair and Stable. Across other Capitals we have also adopted those same ratings which are slight adjustments down for Adelaide and Perth and up for Brisbane. Retail continues to be showing some recovery as sales continue to improve as noted above. 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. Office continues its slow recovery from the pandemic lockdowns but is just Fair with changes reflected in the comments inside in our News and Views section noting weakness in Secondary CBD properties and the very different levels of vacancies and rentals depending upon which Capital you are in.

	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEQ)		PERTH	
Resi- Homes	Fair	Stable	Fair	Stable	Fair	Stable	Fair	Stable	Fair	Stable
Resi- Units	Fair	Stable	Fair	Stable	Fair	Stable	Fair	Stable	Fair	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 Charts below show the recent activity by Central Banks both here and abroad with the notable levelling out of policy interest rates in a number of advanced economies. Important comparisons for Australia are the United States where the Federal Reserve recently reduced their increase to 25 basis points near the end of March and in Canada, the Bank of Canada paused at its meeting on 8 March. It is also worthwhile to note that just in those two cases, the current rates in those countries are considerably higher than our 3.6% Cash Rate with the Fed Rate in the US being 4.75% - 5.00% while the Bank of Canada Rate is 4.5% and they meet again on 12 April.

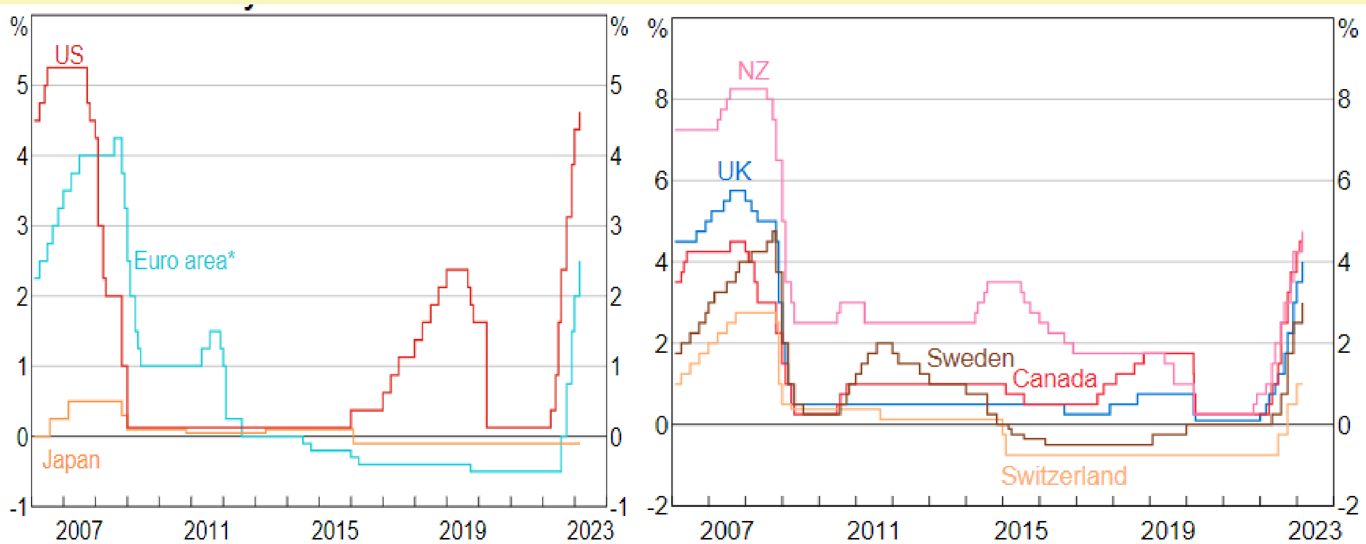
- What happens next is of course key and what do other factors tell us about what to expect. In the US the collapse of two large banks has impacted sentiment and for some time the US yield curve has been inverted meaning the markets' expectations for the economy are negative with expectations of a possible recession. That is not the case in either Canada or here in Australia but the current 90 basis point difference in our base rates is a factor to note. What the expected "terminal rate" here is Australia is remains quite encouraging of late with well regarded senior economists Bill Evans of Westpac and Gareth Aird of the CBA agreeing that following the April pause there would only be one more 25 bps increase before a 3.85% OCR remains in place for a while. What does this mean for property prices and especially the Office sector which has had plenty of negative press?

- Graph 1 opposite shows the assessment of CBRE of Office sector yields in the Capitals for Prime and Secondary properties as at December 2022. Other research houses have done their own reports on a sector wide basis and a number of new reports are being issued for individual Capitals as at the end of the first quarter by the likes of Knight Frank (KF) and we will discuss these in our Quarterly Market Update to be issued later this month. An example in the very recently published Perth CBD Office Market shows Prime Yields of 6.58% and Secondary Yields of 7.93%, so slightly higher in the former by 22 bps but much higher in the latter by 1.30%. The lack of comparable increases to capitalisation rates when compared to long-term bond yields suggests change is coming in the form of substantial adjustments to the valuations of major CBD Office portfolios.

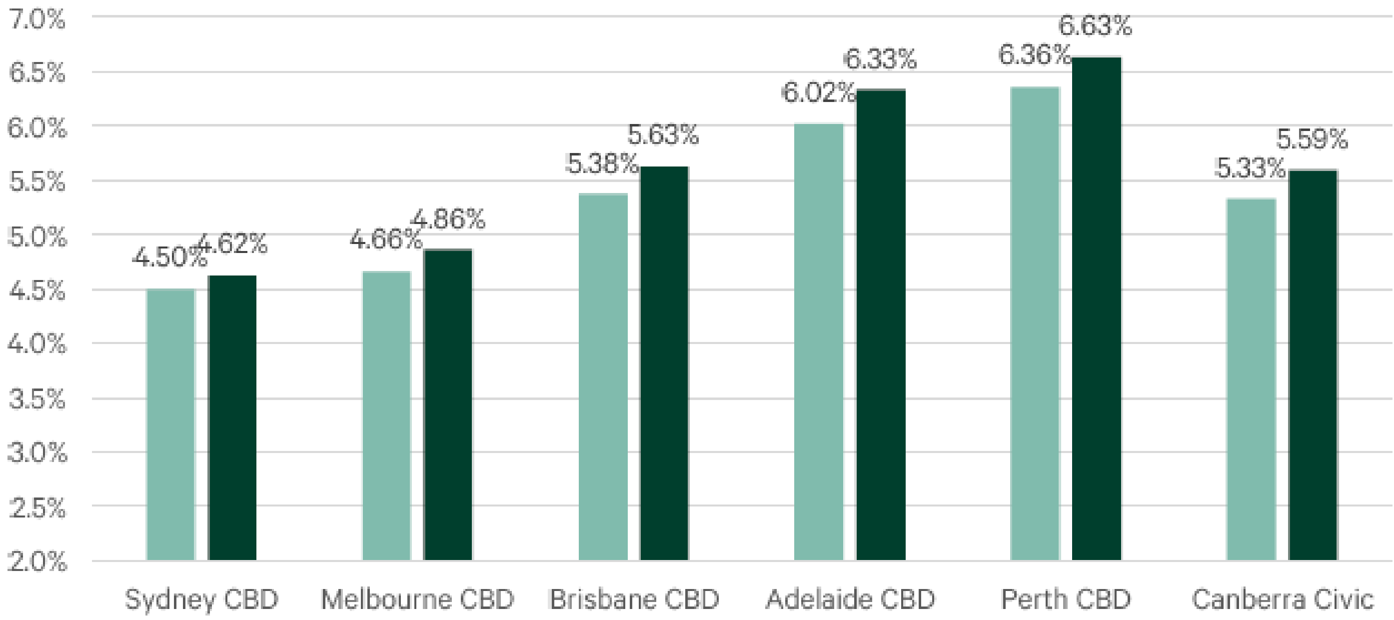
- Graph 2 shows the vacancy rates for Offices in each of the Capitals, again as at December 2022. This shows the considerable difference Prime and Secondary Offices and the various Capitals in which they are located. Prime are better in all Capitals except for Brisbane and the widest variance is in Perth as noted above.

- The conclusions to be drawn in our view is that the CBD Office sector does indeed have the potential to experience a substantial correction where vacancies remain high and capitalisation rates have yet to adjust for the considerable increase in long-term interest rates. The same does not apply to all sectors however as for some such as Industrial, rentals have risen substantially and vacancies remain at less than 1% in many areas.

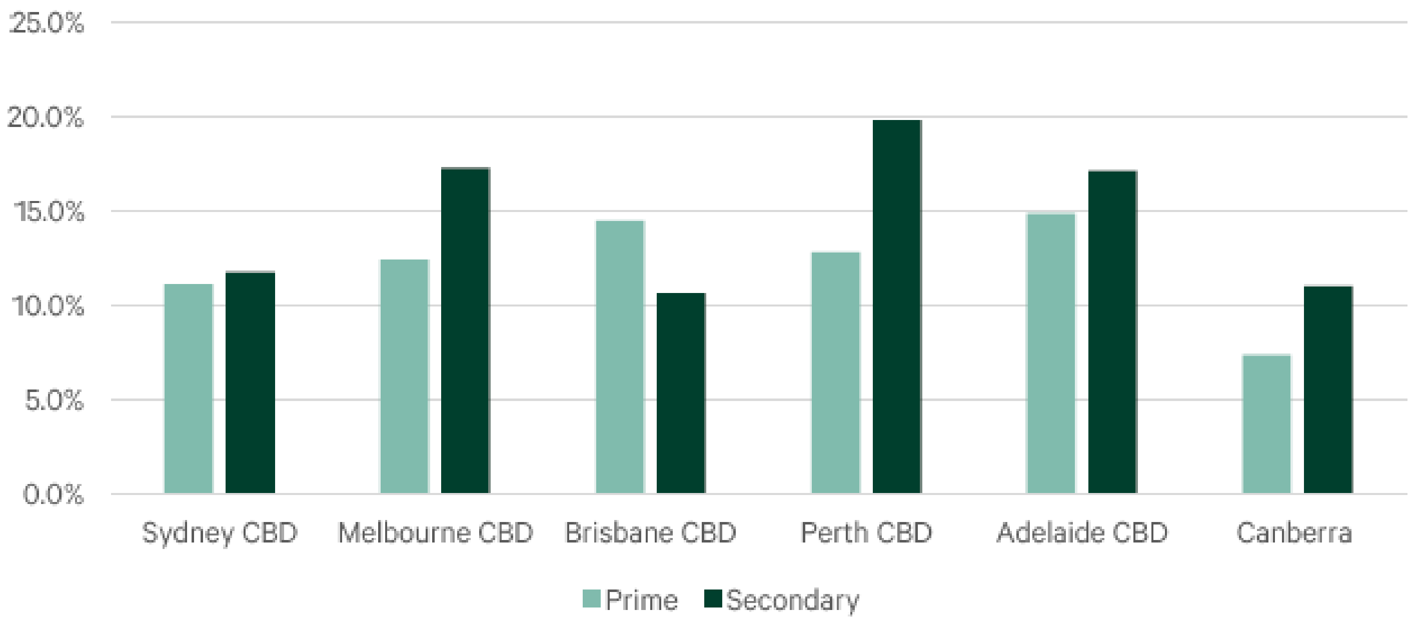
Central Bank Policy Interest Rates 2007 - 2023



Graph 1: Australian Capitals CBD Prime and Secondary Office Yields December 2022



Graph 2: Australian Capitals CBD Prime and Secondary Office Vacancy December 2022



CBRE

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