

Economic Issues Confronting South Australian Developers



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**Ian James
Senior Economist
ANZ Bank**

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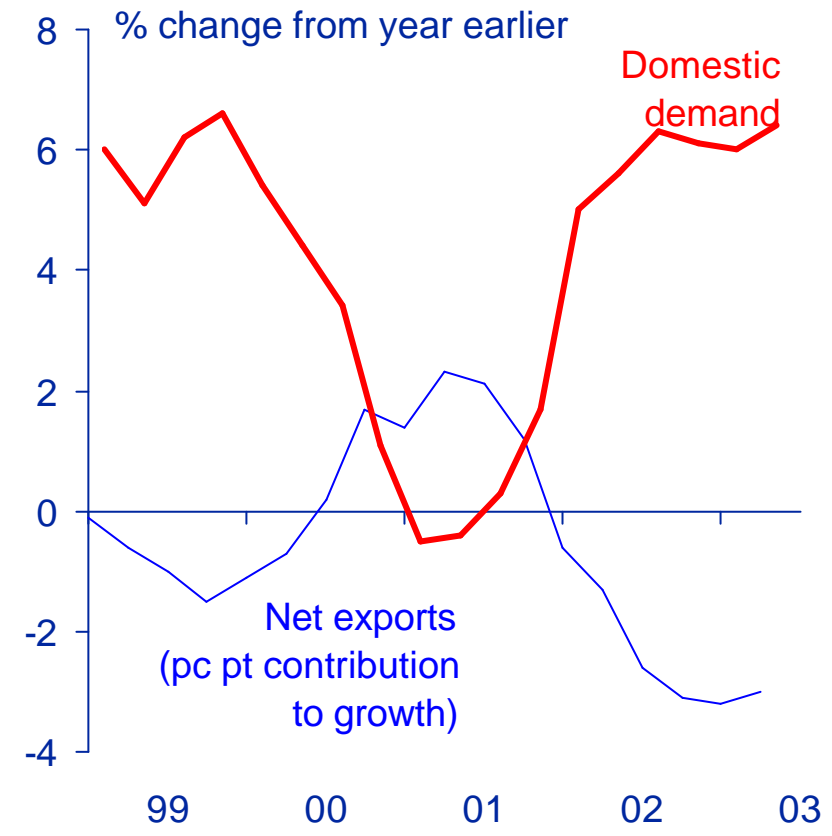
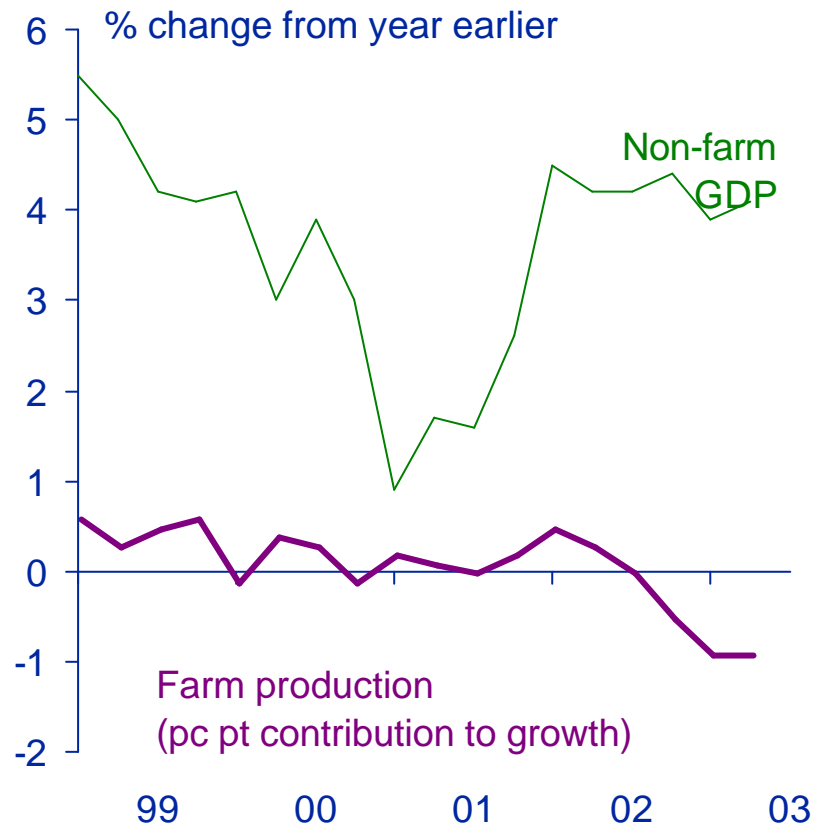
How is the Australian economy performing?

Despite a weak growth figure for the June quarter the domestic economy is performing strongly

- **Domestic demand continues to grow strongly at an estimated 5% in the September quarter after growing 5.8% last financial year.**
- **Business and consumer confidence have bounced back strongly post Iraq.**
- **Household credit growth is extremely strong. Housing credit is growing at a staggering 22%. Private sector credit is also expanding strongly by 13.7% - the highest in 13 years.**
- **Construction activity remains strong and building approvals have rebounded from a fall in early 2003.**
- **Growth in retail trade continues at a rapid clip.**
- **Motor vehicle sales continue to surge past the record levels of last year with new car sales up 10.5% until the end of September compared to the same months of last year.**

A weak world economy and the drought have been a drag on growth

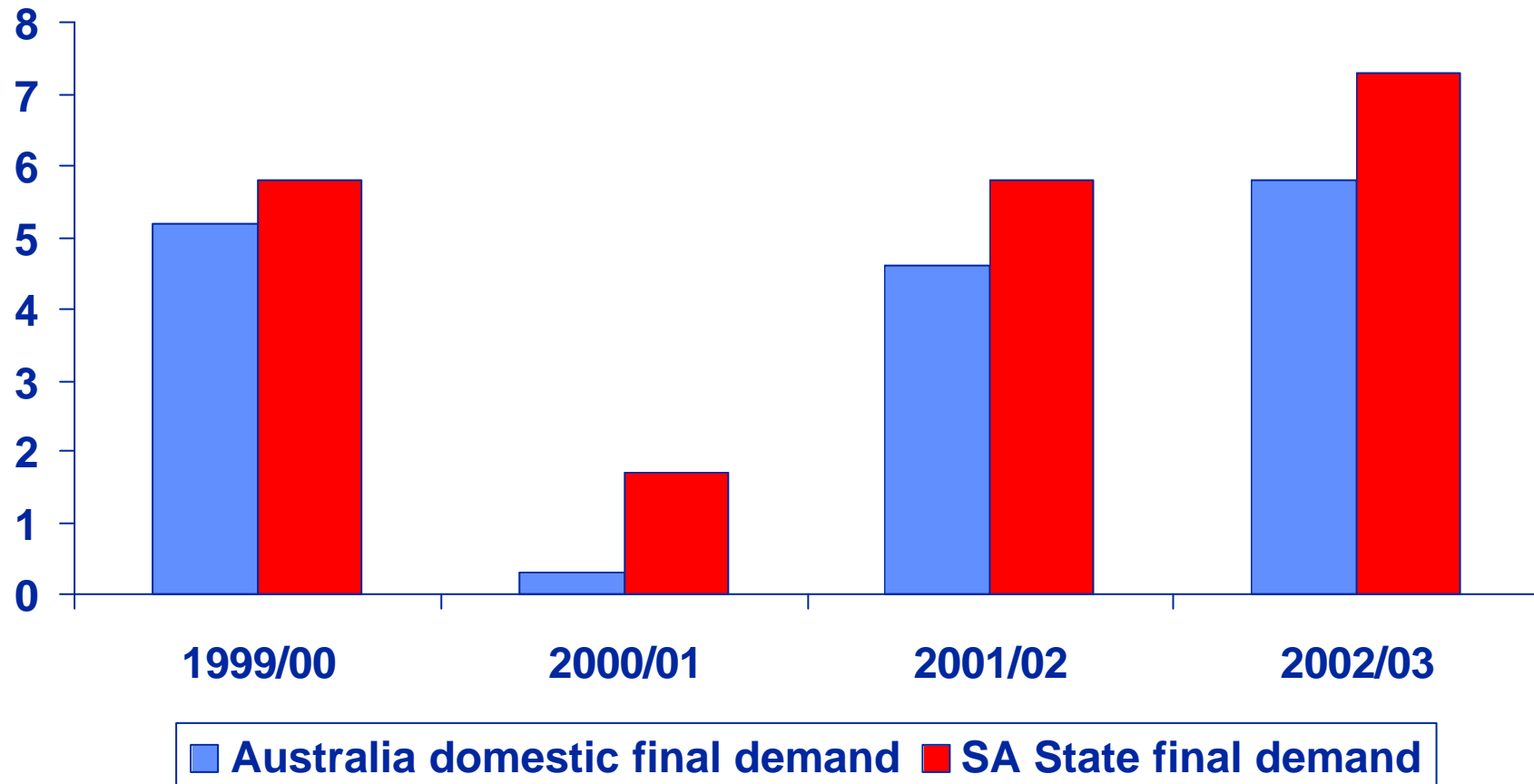
Australian economic growth



Sources: ABS; Economics@ANZ

The South Australian economy has outperformed the nation in recent years driven by.....

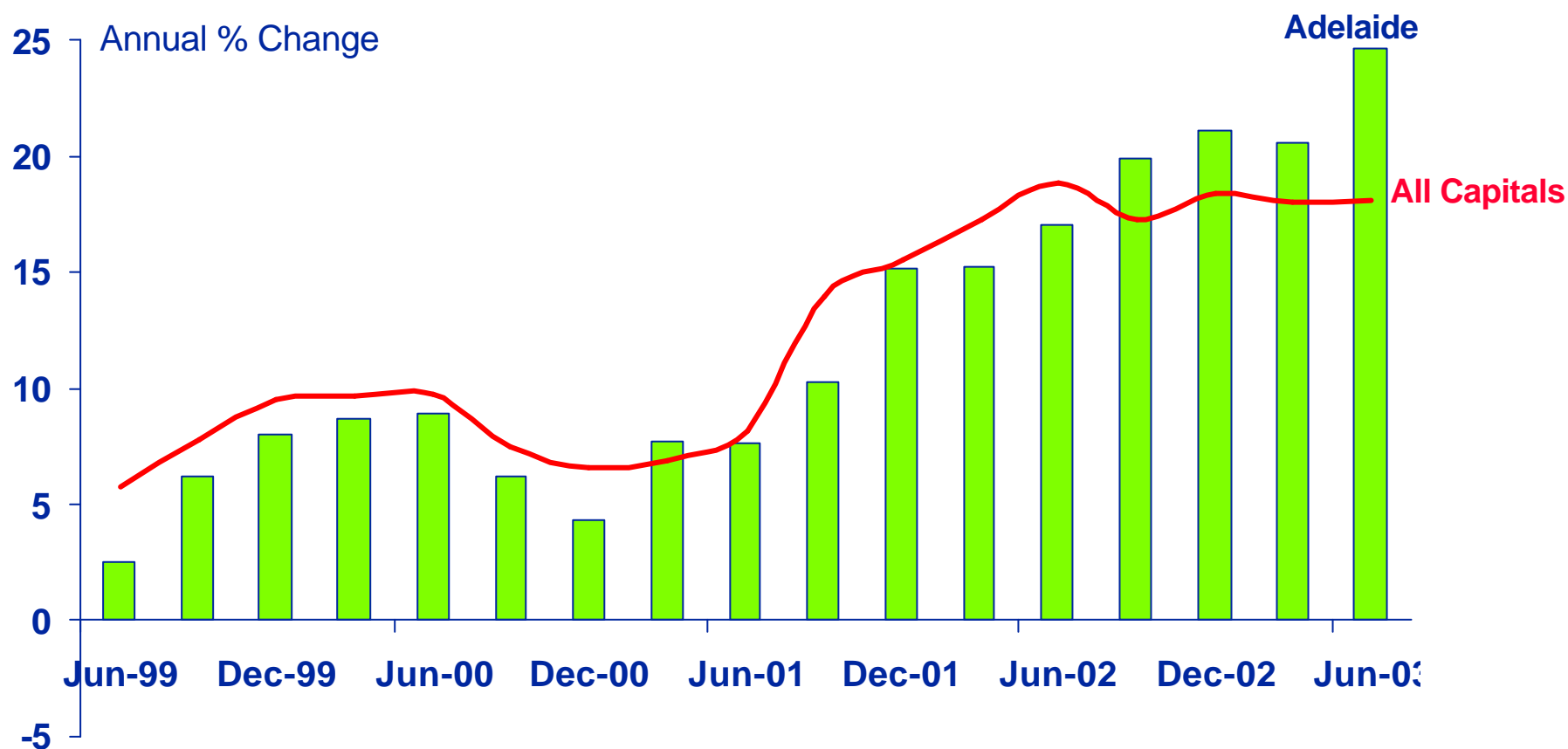
Annual % change



Source: National Accounts ABS Cat. No.5206.0

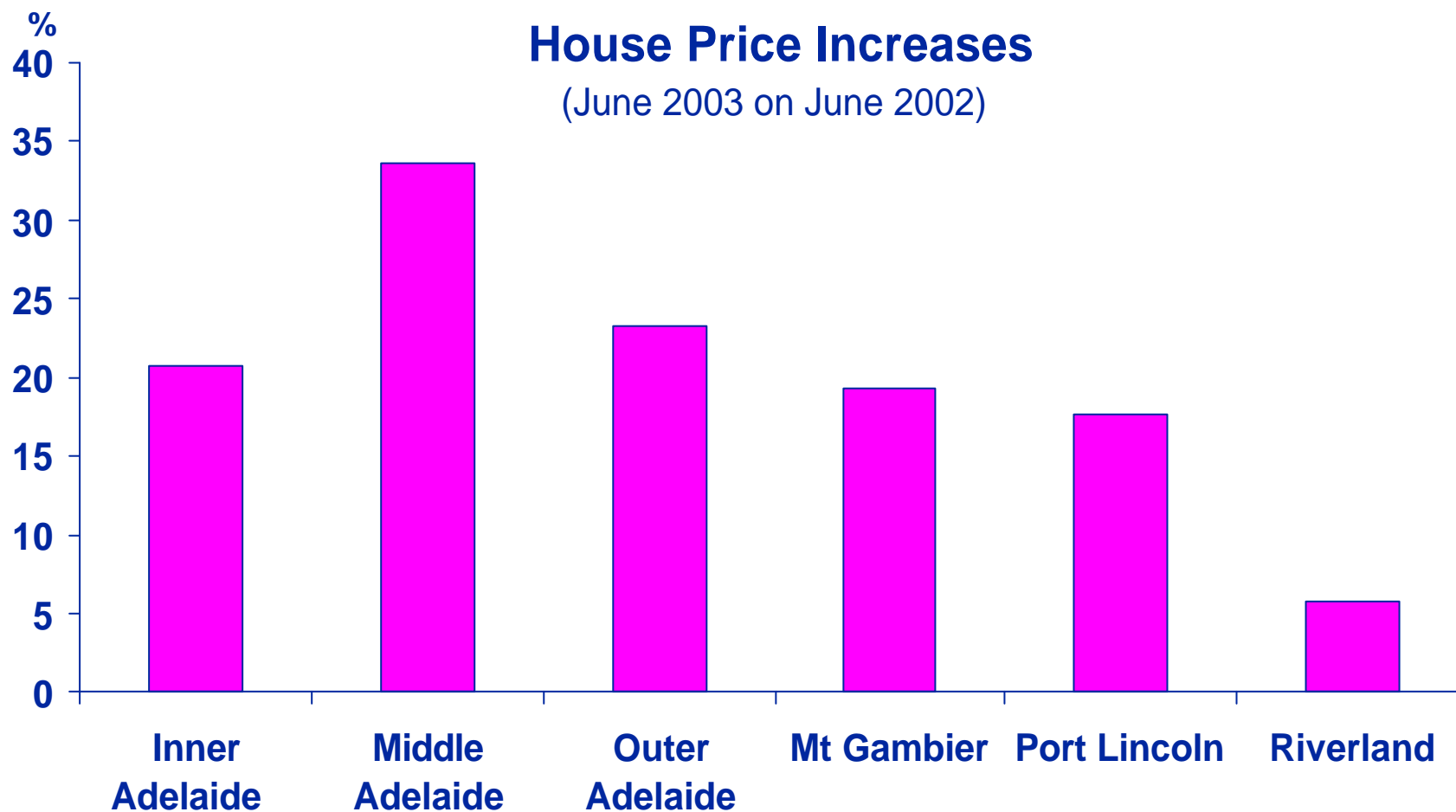
Adelaide house prices have accelerated strongly in the last year and above the national average

Established house prices



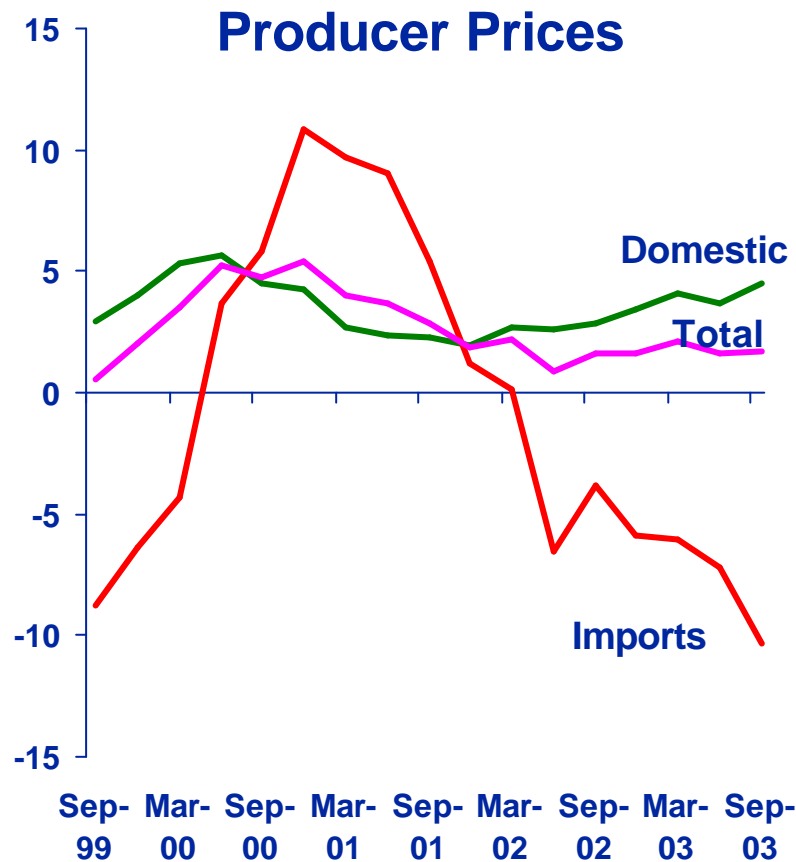
Sources: ABS Cat. No. 6416.0

Price growth has been particularly strong in middle Adelaide but strong gains have also occurred on the Fleurieu Peninsula and some regional towns



Source: REIA

However price increases outside of property have been benign



Source: Producer Price Indexes ABS Cat. No. 6427.0

- The latest inflation figures indicate an inflation rate well within the Reserve Bank comfort zone of 2% to 3%.
- Wages growth is moderate.
- The appreciating Australian dollar is assisting controlling inflation (despite the domestic boom) with imported producer prices down 10.5% for the year.

What's the outlook for 2004?

A world economic recovery is underway led by the US

- **US economic indicators are showing recovery and repair of corporate balance sheets after the collapse of the dot-com. revolution is well under way.**
- **In the US all policy arms are stimulatory with the Fed funds rate at 1% and another round of tax cuts taking effect in July.**
- **Japan is now recording positive economic growth.**
- **Most of the rest of Asia has lifted its growth forecasts and the Chinese economy continues to grow strongly.**
- **Conditions are more subdued in Europe but some of the forward indicators are looking better and there has been a strong equity market recovery.**
- **Although equity markets have probably overpriced the recovery.**

In Australia economic indicators suggest that there is strong economic momentum going forward

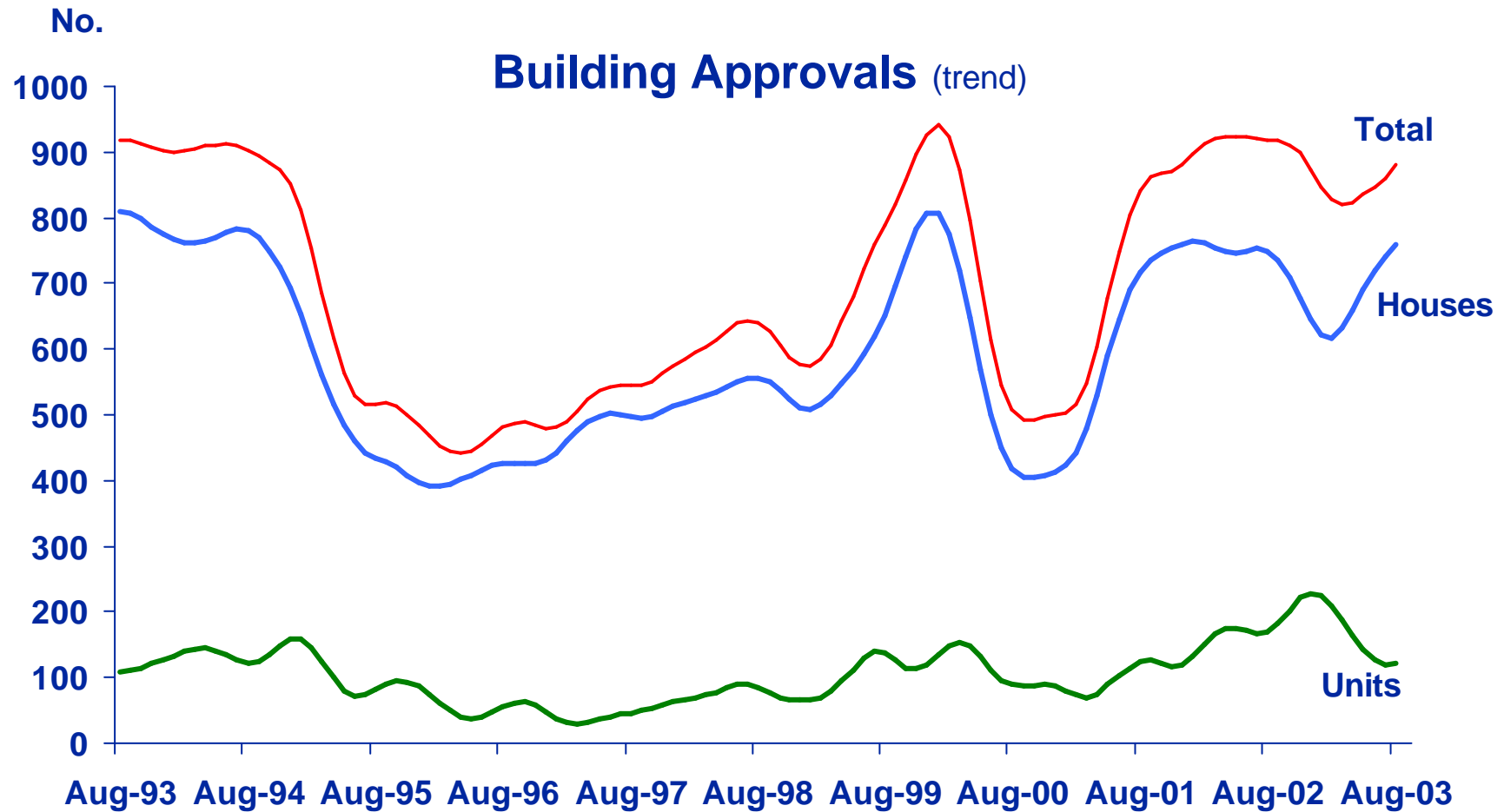
- **The dwelling construction cycle is peaking but compared to historical norms will only undergo a mild downturn during 2004.**
- **The boom in retail trade growth will end but nonetheless growth in consumer spending will remain solid.**
- **Work in the pipeline in engineering and non-residential construction suggest that these areas of construction will remain strong well into 2004.**
- **And despite the appreciation of the dollar exports are expected to pick up as the year proceeds and farm production recovers from the drought.**
- **Tourism is also likely to do much better.**
- **In short, a recovery in farm production and exports will partly offset some slowing in domestic demand through 2004.**

Latest figures suggest that the exceptional growth in retail trade that SA has experienced has slowed



Source: Retail Trade ABS Cat. No. 8501.0

But the forward indicators for housing construction remain robust suggesting that.....



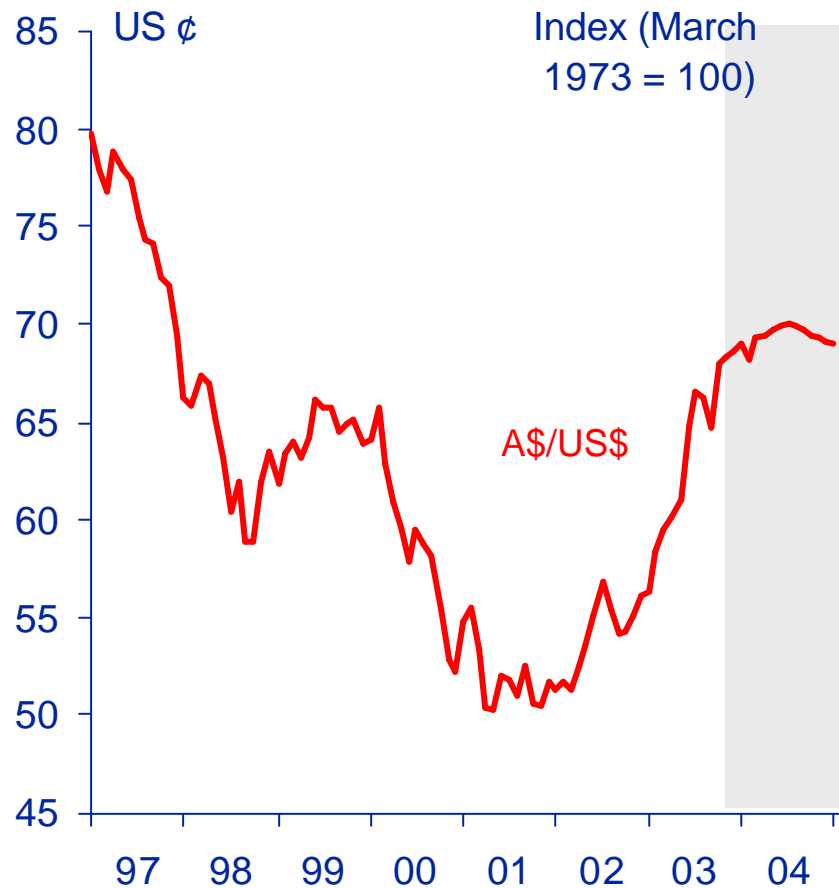
Source: Building Approvals ABS Cat. No.

Are there any risks out there?

Essentially four:

A surging A\$ is taking some gloss off the benefits of a recovering world economy

A\$ vs US\$

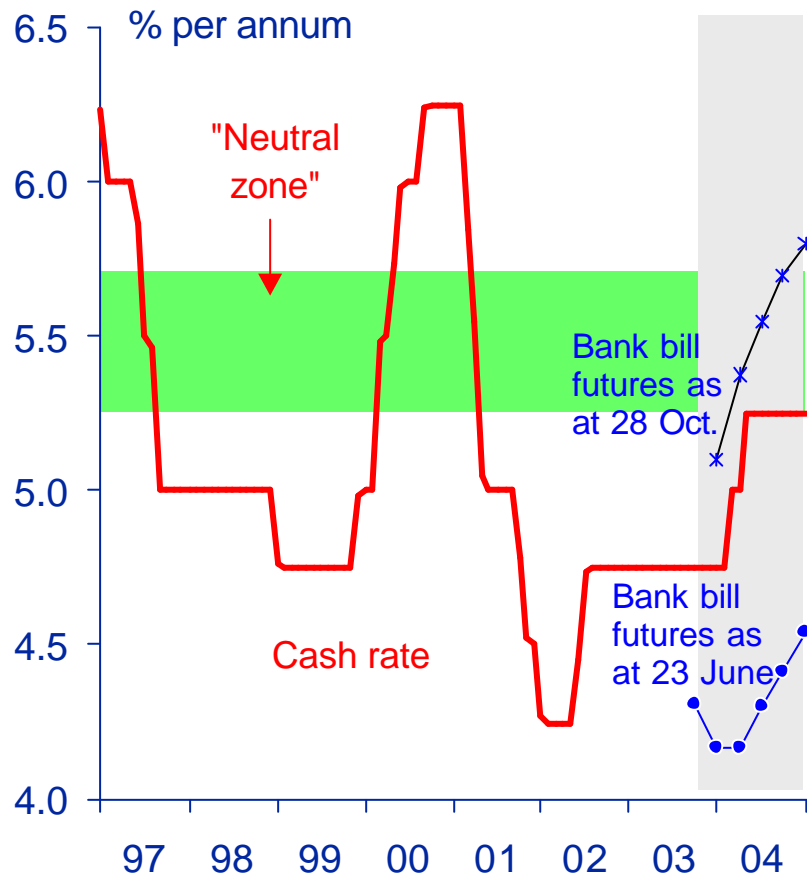


Sources: Datastream; Economics@ANZ

- Most of the rise in the A\$ since early 2002 is due to the decline in the US\$.
- The US\$ still has further downside given that the current account deficit will continue to widen well into 2004.
- The A\$ usually does well during periods when the global economy is strengthening and is gaining some support from the wide spread between Australian and overseas interest rates.
- With the US\$ likely to fall further the A\$ could peak at over US70¢ some time early next year.
- Australia's still large current account deficit and net equity outflows should act as a brake on 'run-away' A\$ appreciation.

The bias in interest rates is an upward direction

Short-term interest rates



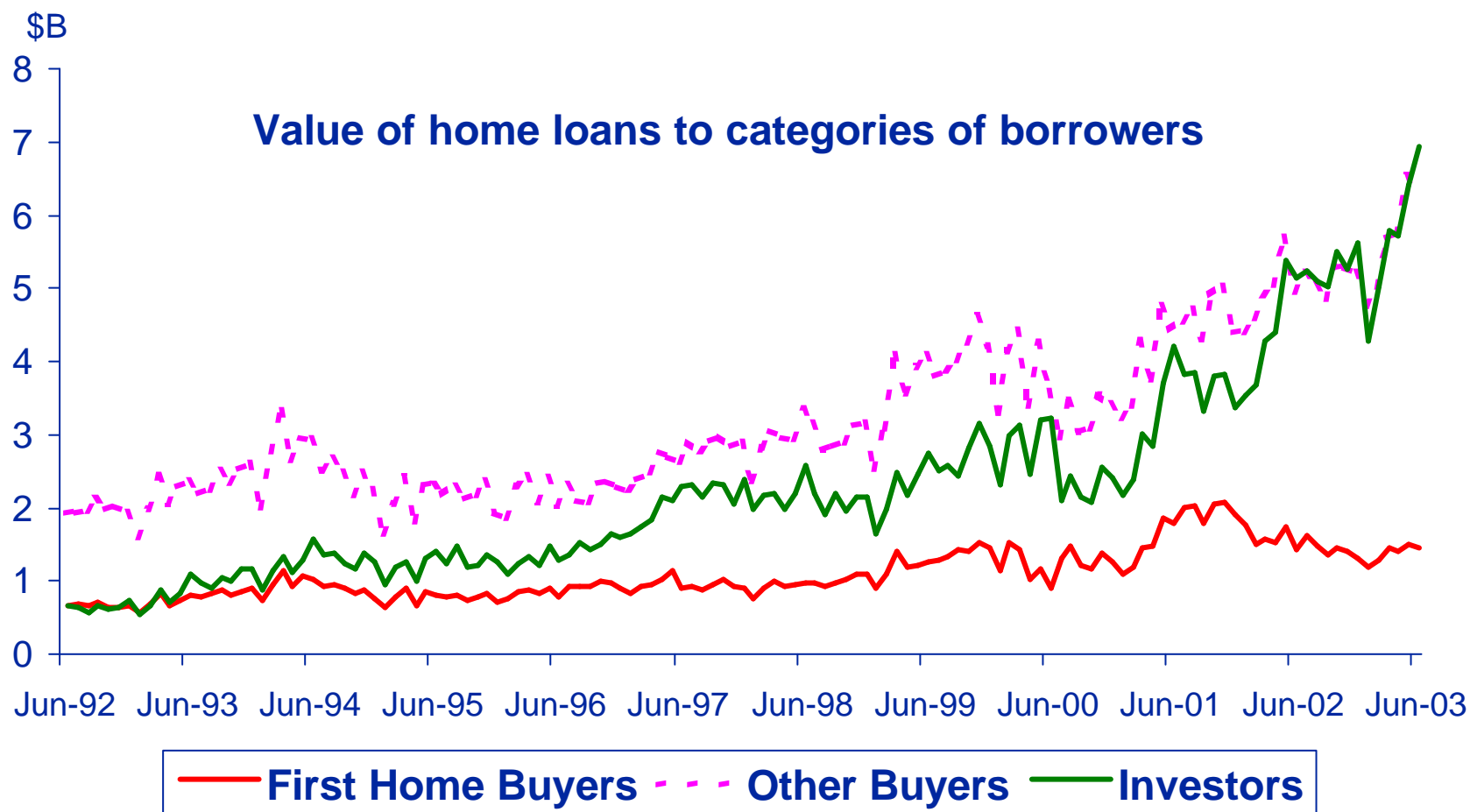
Sources: Reuters; Economics@ANZ.

- Financial markets have given up on cuts in interest rates and are now factoring in a rise.
- Nonetheless with inflation under control there is little immediate justification for a rate rise.
- But the RBA remains worried about overheated housing markets and the cash rate is still below the range designated by the RBA as 'neutral'.
- With the global economy picking up and the drought largely over, the RBA will start giving greater weight to continuing rapid growth in credit.
- Our view is that interest rates will remain on hold this year and that unless the US recovery stalls that the RBA will increase rates by 0.5% in the first half of 2004.

Rising indebtedness of the household sector

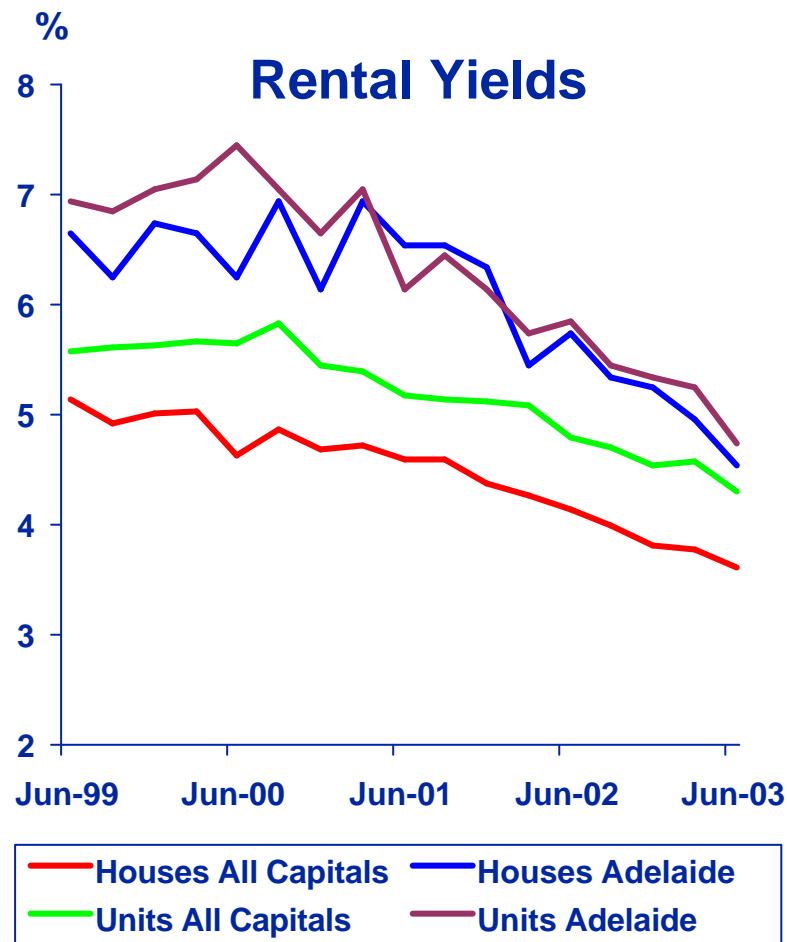
- Household debt continues to mount and the debt to income ratio has risen from 65% to 129% since 1996.
- The household saving ratio for the first time in history is now negative.
- Total household credit is growing at 20% and unsecured consumer borrowing 12.7%.
- And after years of building equity in their homes Australians are indulging in a new game – equity withdrawal to finance consumption expenditure – borrowing \$26 billion or equivalent to 5% of household income in 2002/03 against their houses.
- However the household debt service ratio while rising is lower than what it was at the peak of the last boom in 1990 suggesting that it remains manageable while existing economic conditions prevail.
- However Australian households have placed themselves in the position where they are more vulnerable to economic shocks.

A rapid rise in house prices has generated a strong interest in investing in residential property.



Source: Reserve Bank of Australia

The growing interest in investment in property markets may be a new source of volatility



- By definition, owner-occupiers face zero vacancy rates and rarely sell when faced with the prospect of declining house prices
- Owner-occupiers are thus an inherently stabilizing force in property markets – except during periods of rising interest rates and unemployment
- But investors may become net sellers in response to rising vacancy rates and ‘earnings disappointments’ – in the same way as investors in equities
- The enlarged presence of investors may thus have introduced a new source of volatility into property markets

Source: REIA, Economics@ANZ

The wealth and debt increases by the household sector may be drawing to a close

- The rapid increases in household debt and house prices are due to
 - declines in inflation and interest rates since the early 1990s
 - financial innovation and competition among lenders
 - a desire to diversify income sources
 - generational change
- Existing levels of debt, house prices and wealth are sustainable while current economic conditions prevail.
- However debt servicing levels are now much closer to the likely upper limit of what can be sustained and household spending is now more sensitive to perceived changes in economic conditions.
- Hence:
 - growth in debt and wealth will slow significantly
 - house prices will not (in general) rise faster than CPI inflation
 - household spending will grow more in line with household incomes

Would you like a “soft copy” of this presentation?

Do you have any other questions?

Send an e-mail to:

jamesi2@anz.com