

ANZ Housing Snapshot

Housing crisis to continue into next decade

April 2008

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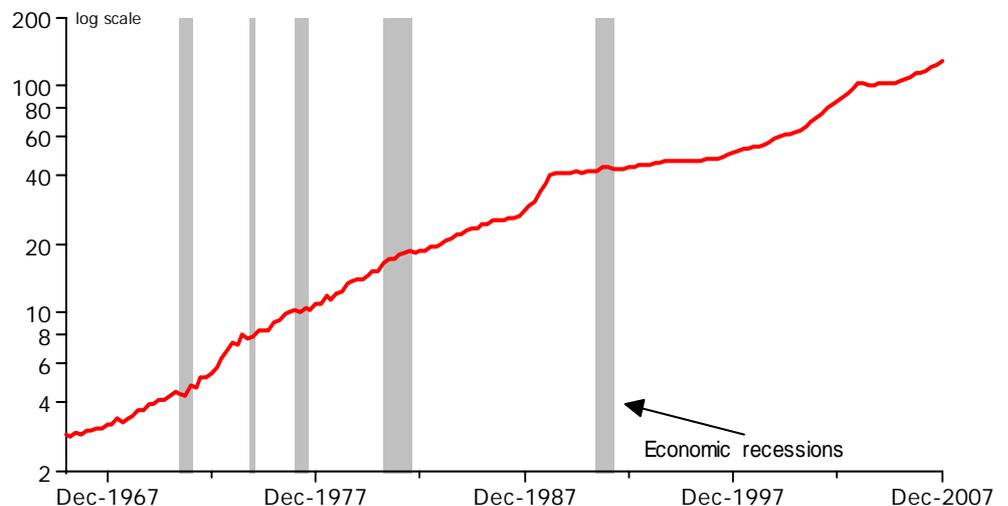
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Chronic market imbalance will support prices

The looming crisis in housing has left recent and aspiring entrants in to the residential market in despair. The dream of home ownership that is enshrined in Australian culture may be slipping out of reach of generations to come as affordability deteriorates to almost record levels. It has left many wondering, that in a country that has achieved almost 17-years of unbroken economic growth, why are people struggling to afford a home? In many ways, the current crisis in housing has been born from this protracted run of prosperity. The need to slow the capacity-constrained economy using monetary policy has heaped pressure on a housing market that will reach a record level of imbalance in coming years, as demand continues to outstrip supply.

The demand side of the market is being driven by a number of key factors: strong population growth; higher incomes supported by generous tax cuts; 34-year low unemployment; and a willingness to take on debt due to strong household balance sheets. The economic prosperity that has encouraged these factors has now brought with it high inflation and the need for higher interest rates. The housing market is a casualty of the RBA's war on inflation, exacerbating the affordability problem but also deterring investment in the building of residential stock. A chronic imbalance in the housing market will continue to push house prices and, due to record low vacancies, rents, higher in coming years.

Australian House prices

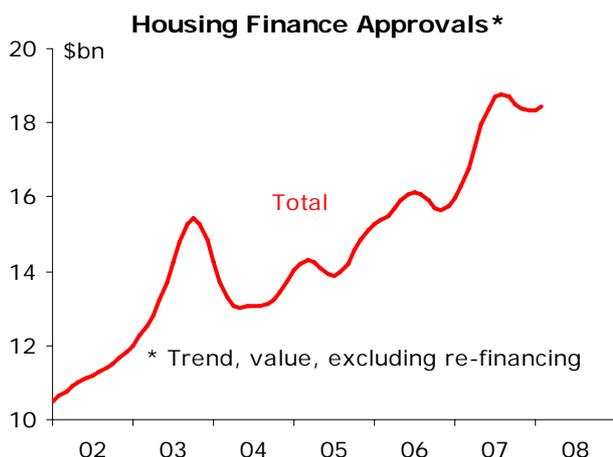
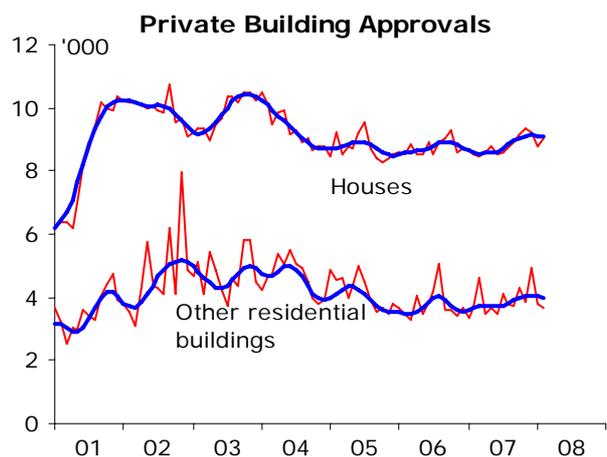
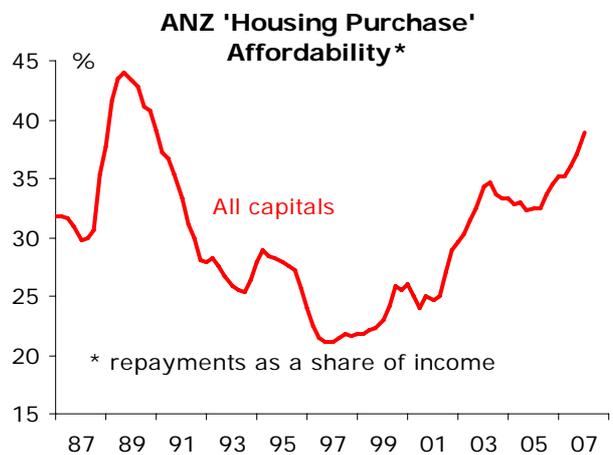
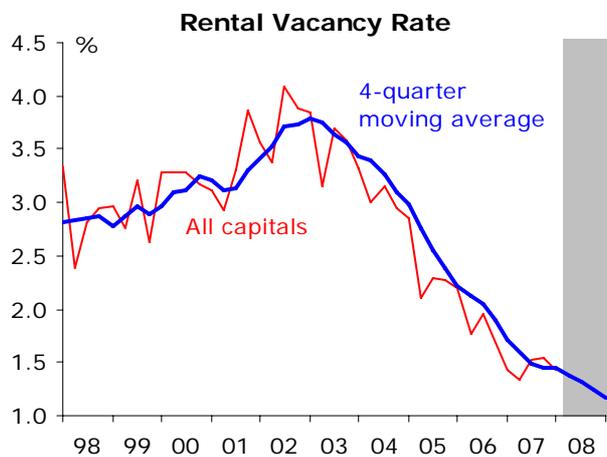
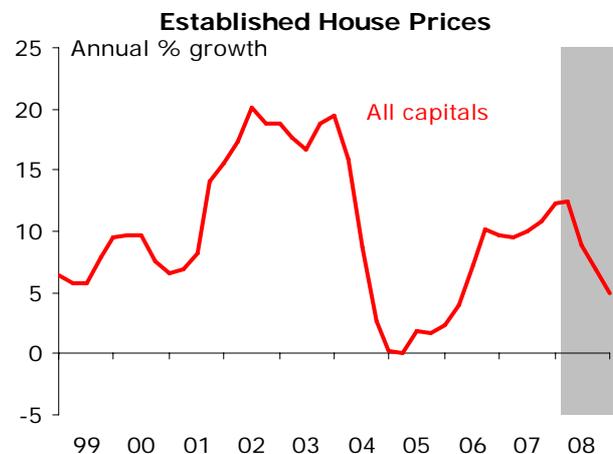
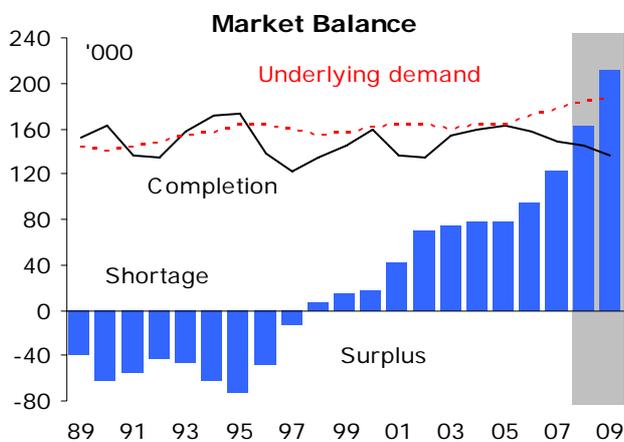


Source: ABS

Our current economic outlook, in the absence of a credit crisis 'event', also supports the contention that aggregate house prices are more likely to continue to rise, albeit at a more moderate pace, than to fall significantly. This is in stark contrast to some observers, including the IMF, who expect a marked correction in prices – we believe this view is misguided for two reasons. The first we have already outlined above, the record shortfall in housing expected in the next few years. The second is that we believe that house prices will only fall significantly if enough people are forced to sell their homes. Despite affordability being difficult, we believe interest rates have peaked, therefore this will only happen if unemployment rises appreciably - we do not expect it will. We do anticipate the economy will slow in coming years but there is little chance of a recession. The Australian economy has unprecedented insurance against the downturn that is occurring in many other developed nation economies, with second leg in the commodities boom delivering 50 year highs in the terms of trade. As can be seen from the chart, Australian house prices have never fallen and going forward we believe there will be no reason that they will.

Australia

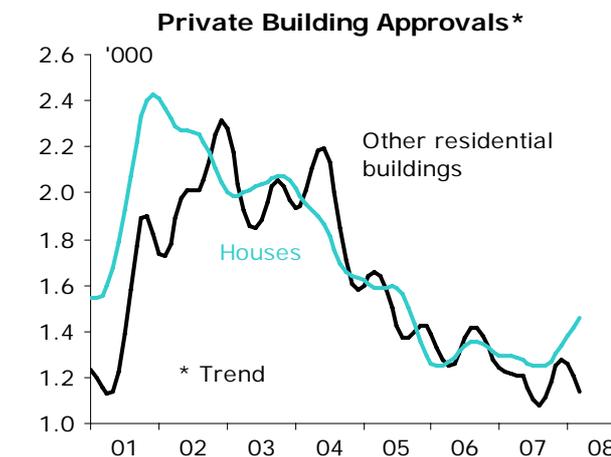
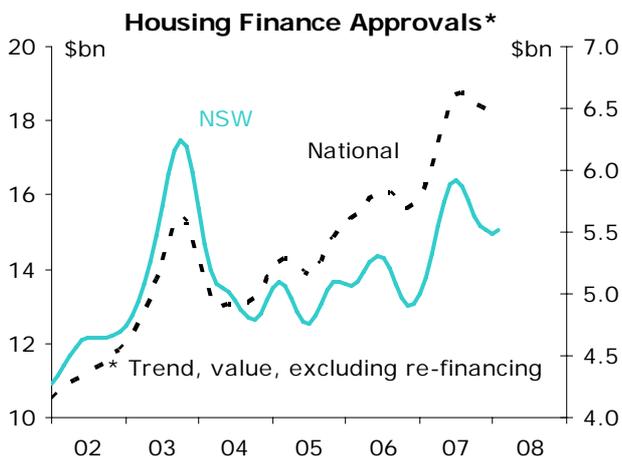
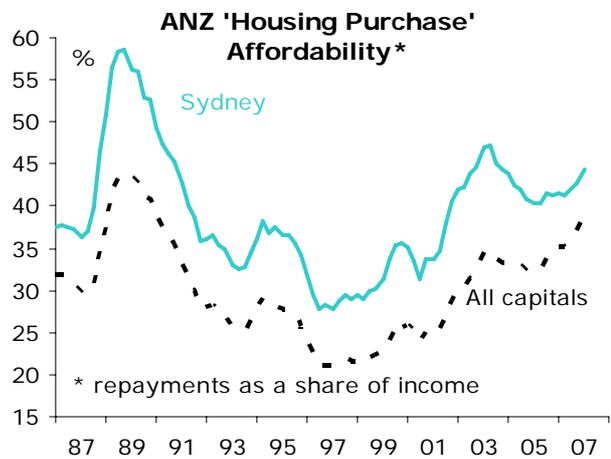
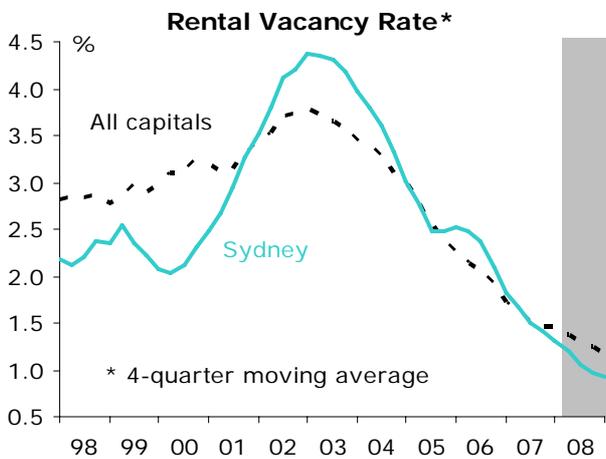
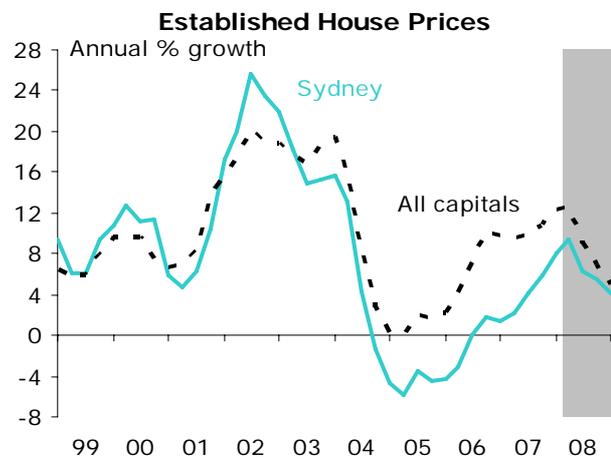
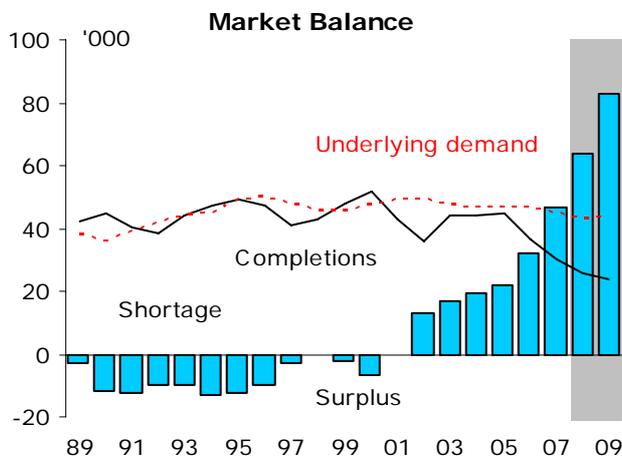
The shortage of housing has been building for over a decade, and has been further compounded by the longest monetary policy tightening cycle in the inflation targeting era. Underlying demand for homes will exceed 180,000 in 2007-08 while supply will be restricted to 145,000 and by 2009 the shortfall in the housing market will approach an unprecedented 200,000 dwellings. High interest rates have put the brakes on the number of completions, but fortunately building activity has not collapsed as in other interest rate induced boom-bust cycles. Key economic factors driving demand have been strong disposable income growth, a 34 year low in the unemployment rate and household balance sheets that have remained in good order. These factors have encouraged households to take on increased levels of debt, driving house prices higher, to the point where 'affordability' has been pushed back 18 years. Currently, average repayments have reached 39% of disposable income, with many households now experiencing 'mortgage stress'. Physical demand has also been very strong with population growth reaching an 18-year high of 1.53% in the year to Sept-07, driven by overseas migration of 179,000 in the year (a 25 year high). Pressures have also emerged in rental markets with buyers increasingly priced out of the owner-occupier market. As a result, vacancy rates have fallen to record lows, approaching sub-1% levels in many state capitals prompting double digit rental growth. It is expected that house price growth will moderate over 2008 under pressure from higher rates, yet in aggregate prices will continue to rise.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

New South Wales

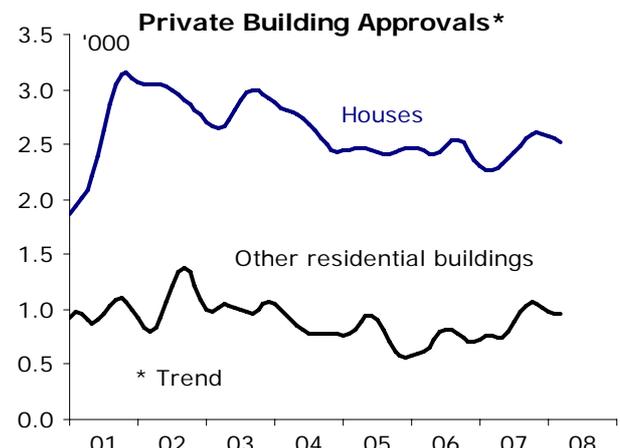
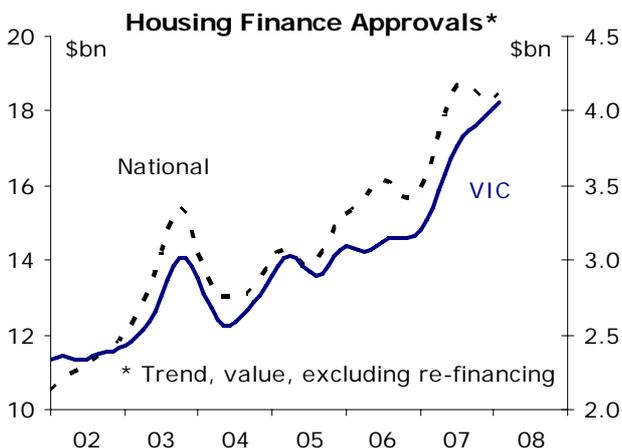
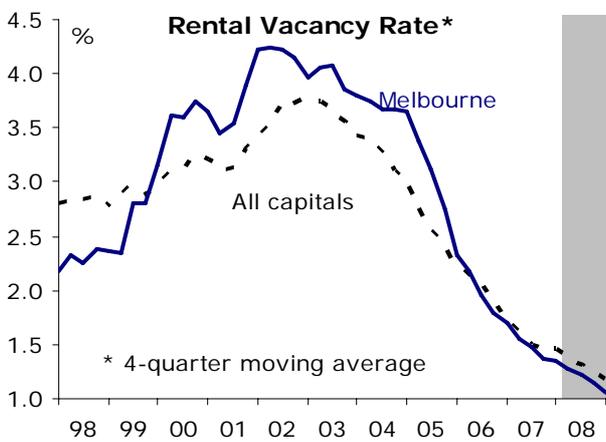
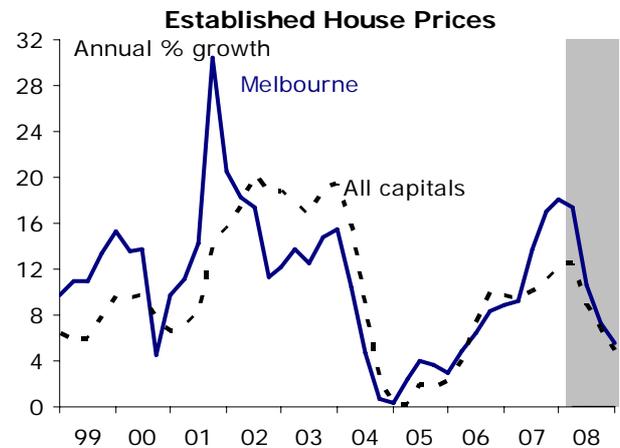
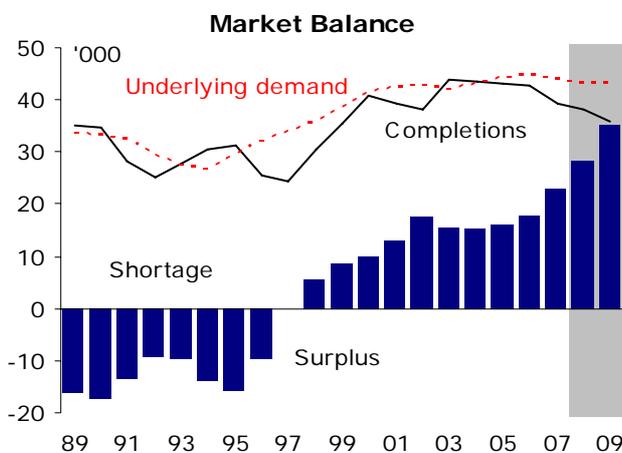
New South Wales economic and residential housing market performance probably suffered most as result of the 'two-speed' economy prompted by the commodity boom and higher interest rates of recent years. However, after a period in the doldrums recent data suggests that the NSW economy is showing signs of life. Consumers have led the way with an upswing in retail sales growth in the last six months amongst the strongest in the country. This improvement in sentiment has been positive for the housing market. Sydney's median house price rose by 8.0% in 2007. However, growth has been patchy with relatively soft prices in the west contrasting with stronger rises in the inner and eastern suburbs. Despite some improvement in activity, an upswing in building approvals, from a very low base, has not been enough to stem the growing imbalance in the housing market that has reached a shortage of just under 50,000 dwellings in 2007, the most pronounced imbalance in the country. As a result, affordability remains difficult and continues to drive high levels of interstate migration. The exodus to other states is being more than offset by overseas migration which is adding to physical demand for property. The continued strength of demand has seen the vacancy rate fall to a historic low of 0.8% in March 2008 pointing to sustained high rental growth. Advertised rents increased 21.6% last year. If recent history is any guide, it is difficult to see this renewed vigour in the NSW market fending off higher interest rates and activity and price growth will soften but continue to be supported by strong physical demand.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

Victoria

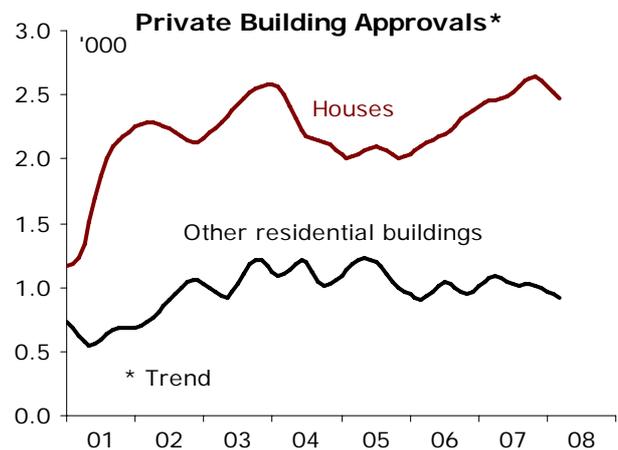
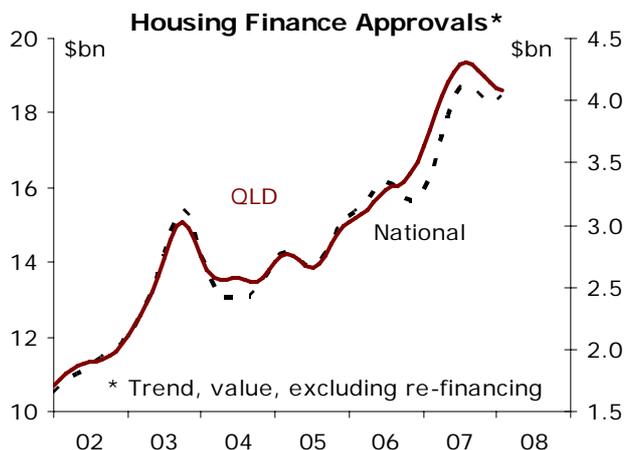
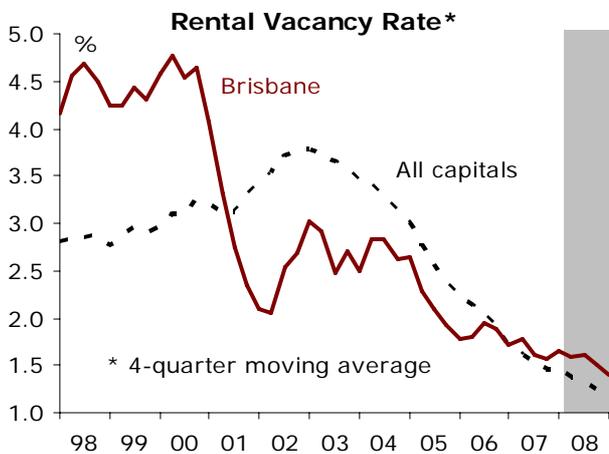
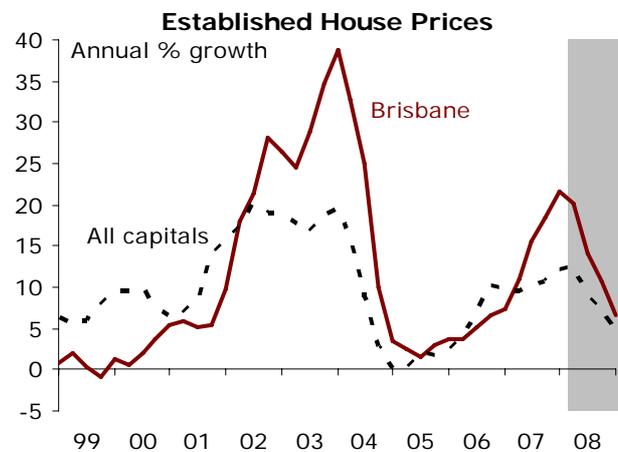
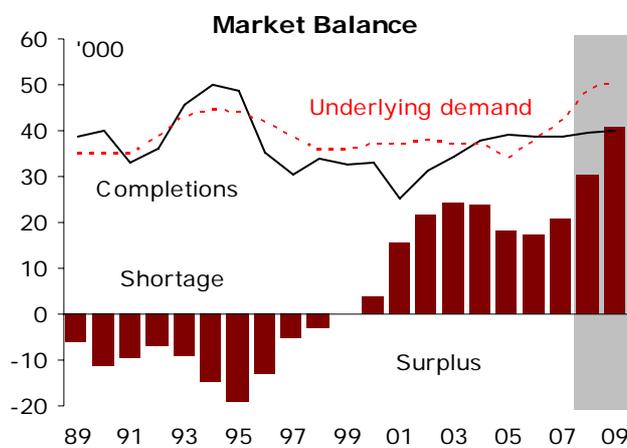
In contrast to NSW, Victoria has been one of the non-resource states where the housing market has remained buoyant despite some softness in the local economy. The strong activity in the market had kept the number of building approvals elevated throughout the second-half of 2007, despite higher interest rates. But even this has not been enough to meet burgeoning demand. Victoria has been able to keep losses from interstate migration to a minimum, whilst overseas migration has been strong. Consequently, Melbourne was the fastest growing capital city in the country in 2006-07 adding 61,700 residents. Such demand has seen house prices accelerate, increasing 18.1% in 2007. Suburbs in relatively close proximity to the city or in growth corridors have experienced the largest gains in prices, with most outer suburb price growth being much more subdued. Despite auction clearance rates falling recently, at this stage this most likely indicates only a marginal and welcome slowing of what has been frenetic activity. Anecdotal evidence would suggest falling clearance rates have only delayed sales with no widespread softening of prices. Solid demand has also seen vacancy rates plummet, now reported at below 1%. In such a tight market this foreshadows a continuation of what has been phenomenal growth in advertised rents (up 23.6% in 2007) for some time to come. Higher interest rates may slow the Victorian economy and activity in the housing market in 2008, yet strong demand should keep prices well supported especially in inner suburbs.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

Queensland

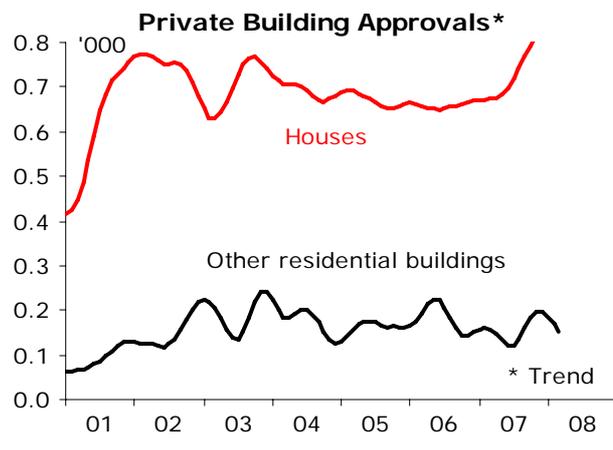
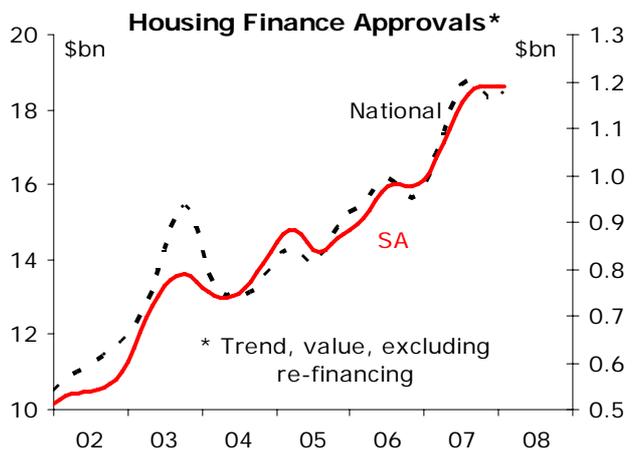
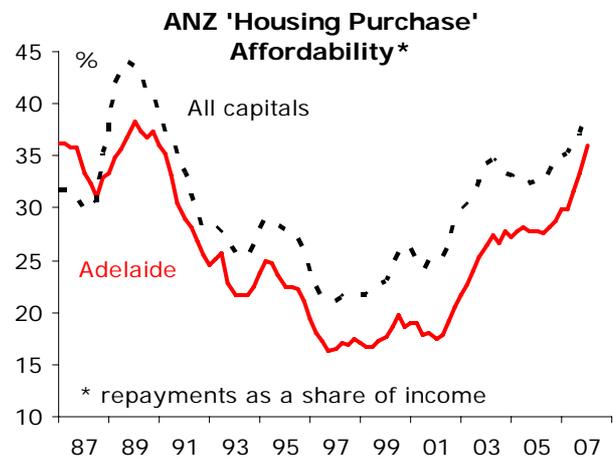
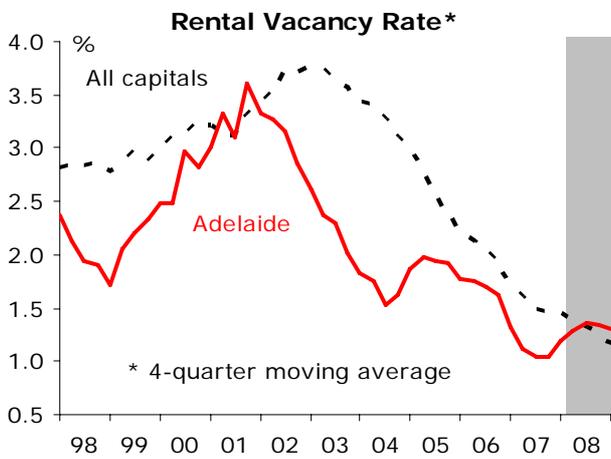
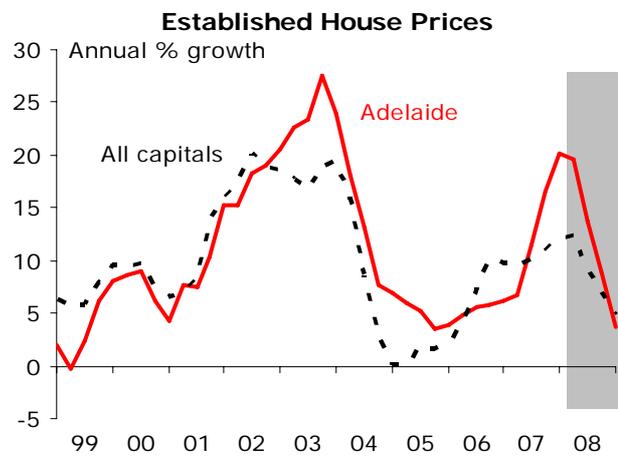
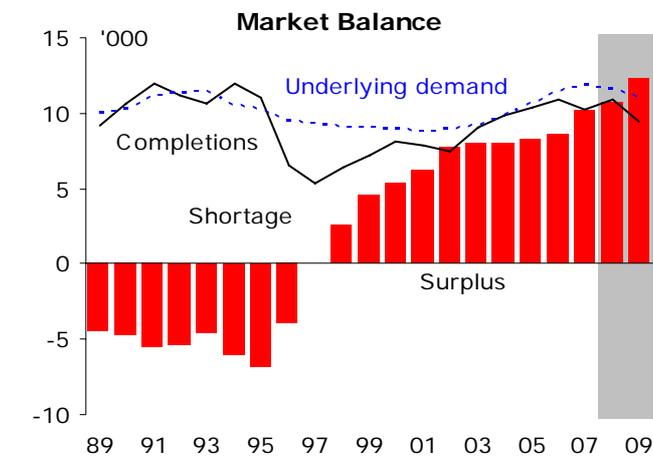
Fuelled by the ongoing commodity boom, the Queensland economy continues to fire on all cylinders with gross state product expanding by 4.9% in 2006-07. A sub-4% unemployment rate and employee compensation rates expanding by in excess of 10% per annum over the past 3 years has allowed house prices to be bid up significantly. In 2007, Brisbane house prices increased the most of any capital city to be 21.6% higher. As a consequence affordability has deteriorated significantly to be roughly equal to Perth and second only to Sydney. However this has not deterred population growth which has been running at over 2% per year for over seven years. This equated to an additional 91,000 people in the year to Sept-07, of which over 26,000 were from interstate, by far the highest of any state. The local building sector has been the most responsive in the country to this strong additional demand, despite higher interest rates. Building approvals were the highest in the country throughout much of 2007, slowing in early 2008 due to back-to-back interest rate hikes. Nonetheless, housing supply cannot keep pace with demand and the shortfall in the residential market will expand to around 8 months of production. Vacancy rates are heading towards 1-1½% and will continue to put upward pressure on advertised rents which were up 12-13% across the state last year. Ongoing strong economic growth will see housing market conditions continue to tighten. However, recent large price gains will moderate from recent peaks as higher interest rates act to cool the market.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

South Australia

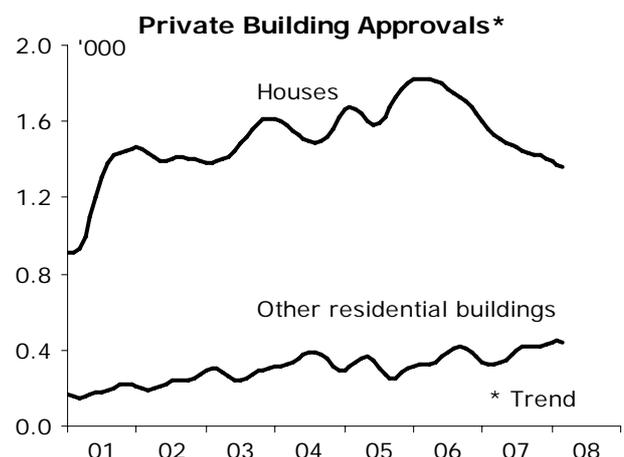
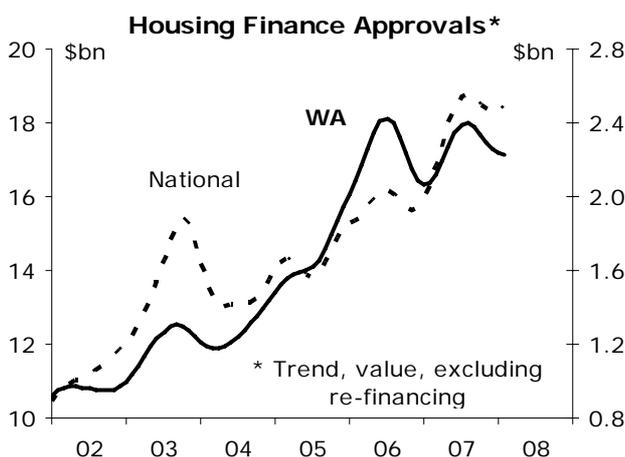
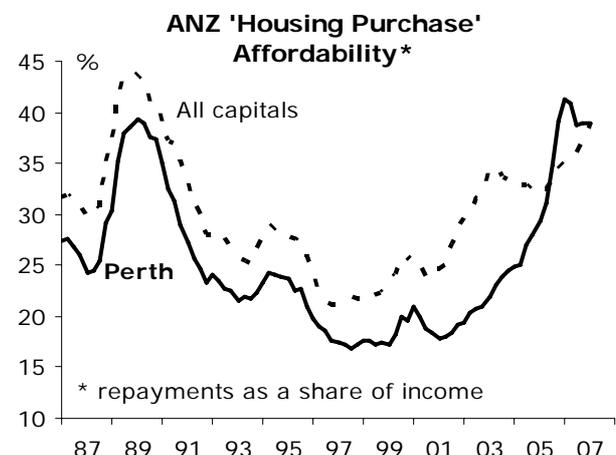
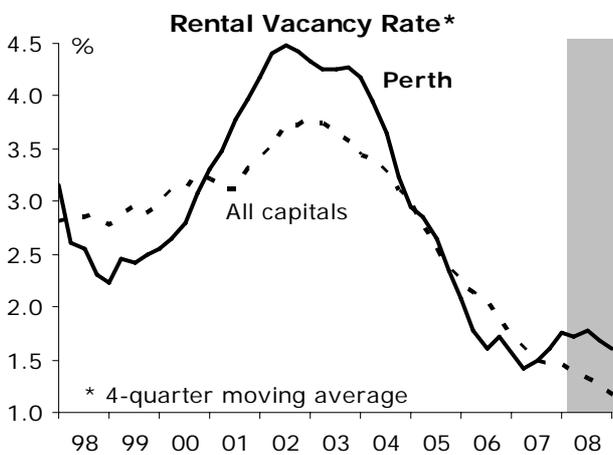
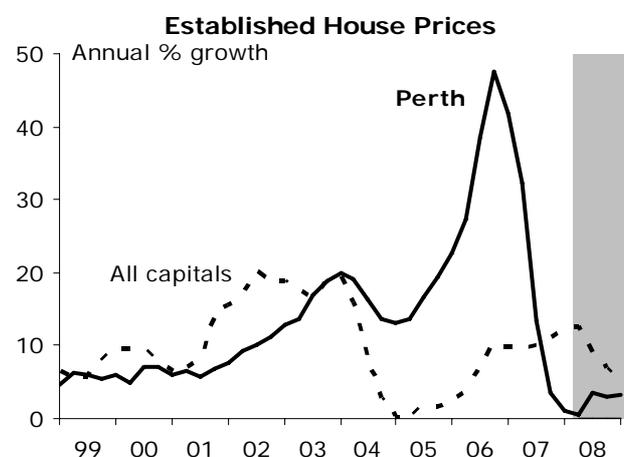
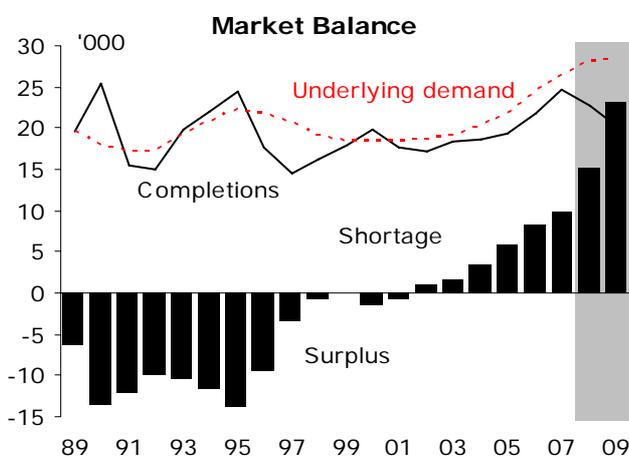
Hit hard by drought, the South Australian economy put in a weak performance in 2006-07 growing by just 0.8%, well below the national average. But with the worst behind it, we are now seeing some positive signs of recovery, led by and reflected in a pick up in building activity and strengthening performance in the housing sector. After contracting throughout much of 2006, new dwelling investment finished 2007 in a promising fashion to be up 13.4% over the year. The reinvigorated interest in housing market has seen prices growth accelerate to the second fastest rate in the country at just over 20%. With interest rates rising this has led to a significant deterioration of affordability which, after being well below for many years, is now approaching the national average. After remaining virtually unchanged, in trend terms, for much of 2005 and 2006 we have seen a significant rise in building activity, with the annualised rate of building approvals jumping by over 20% by the end of 2007. However, this additional supply will be absorbed relatively quickly with population growth running at over 1% per year for some time, despite ongoing outward interstate migration. It is anticipated that the SA economy will increasingly cash in on the commodities boom in coming years and as a consequence the demand for housing will remain strong and the shortfall in the residential market will rise. Rental vacancy rates will remain close to 1% supporting further rental growth in 2008. Despite some moderation through the year improving economic conditions and strong demand will put a floor under house price growth.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

Western Australia

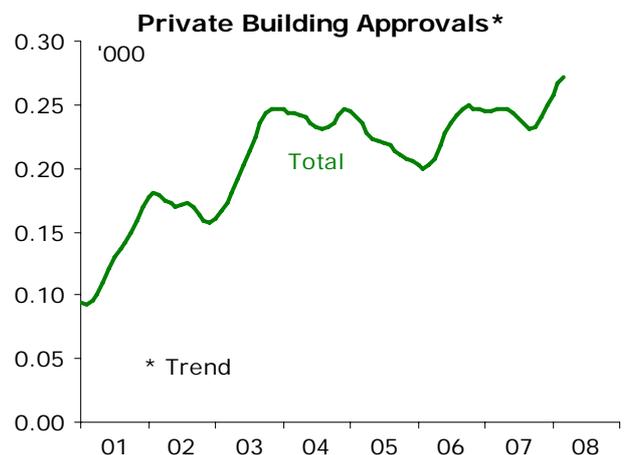
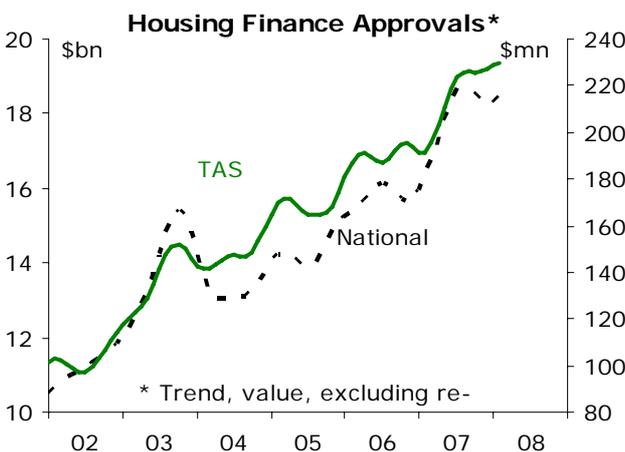
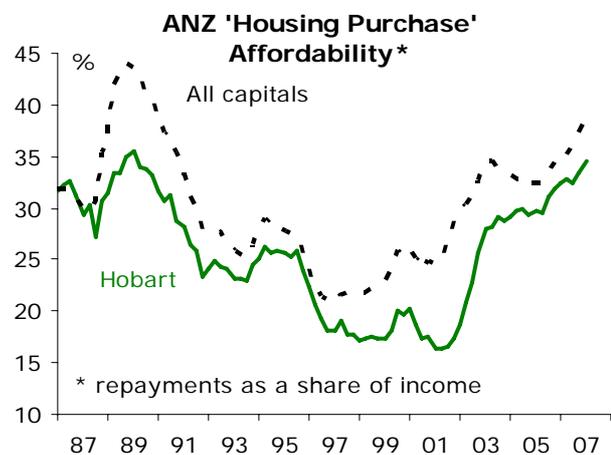
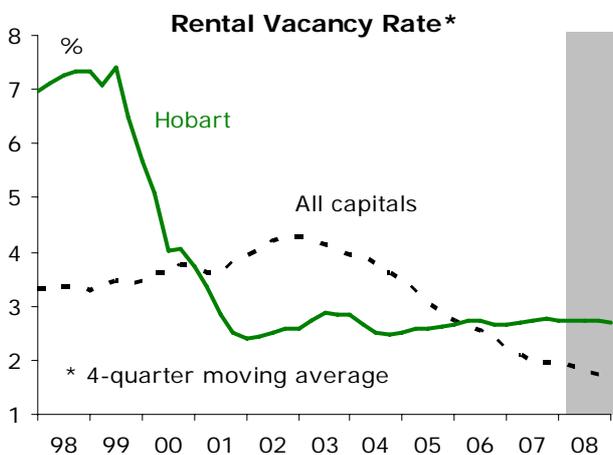
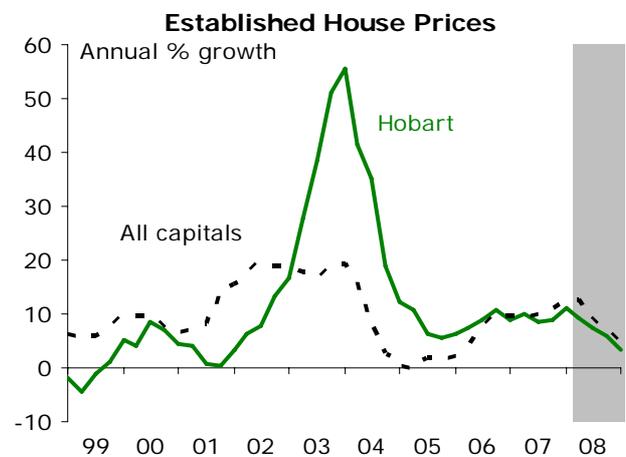
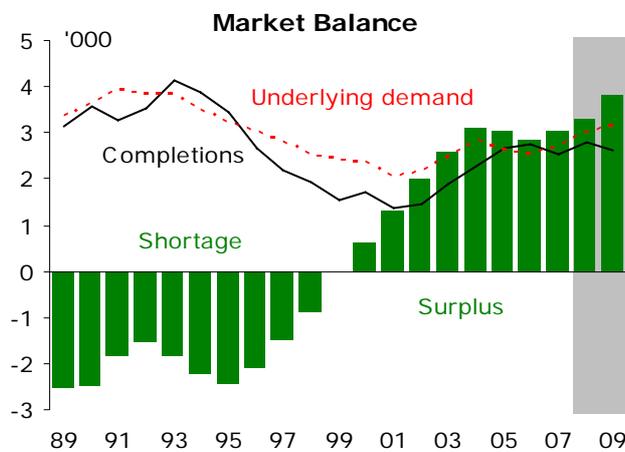
The Western Australian economy is still riding the wave of the commodities boom with real gross state product expanding by a massive 6¼ in 2006/07, while real gross state income grew at a remarkable 12%. Despite this stellar performance the residential housing market has run out of steam. This is unsurprising after Perth house price growth peaked at 47.5% in September 2006. Since then, price growth has virtually stopped, capped by the significant deterioration of affordability and as of December 2007 was running at only 1.1% in the year. However, we do not anticipate any significant 'correction' in prices with the strong economic environment maintaining a floor under the WA property market for the foreseeable future. Elevated commodity prices may push GSP growth as high as 7% in 2007-08. Household disposable income grew by 10.1% in the year to 2006-07, well above the national average of 7.4% and the unemployment rate is also better than average at an unprecedented 2.8%. Such employment prospects have residents flocking to WA with a record 49,000 new residents entering the state in the year to September 2007. Building approvals slowed markedly in the latter half of 2007 and the short-fall in the residential market is now beginning to mount. Lack of adequate rental supply has seen rents skyrocket with increases in advertised rents in excess of 18% in the year to December. With another upswing in bulk commodity prices expected to deliver significant economic benefits to WA, higher incomes will see pressure on prices build as supply continues to tighten.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

Tasmania

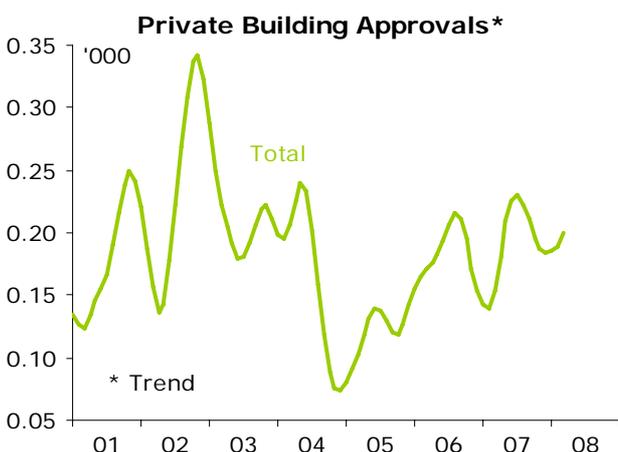
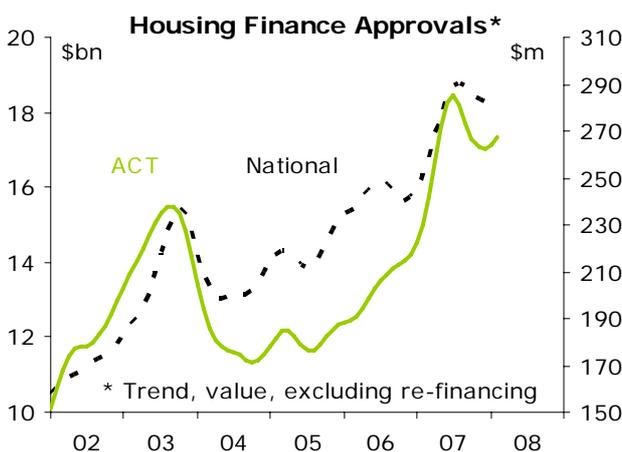
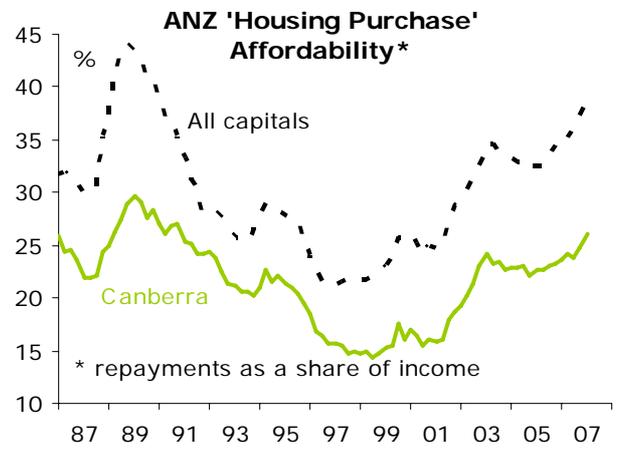
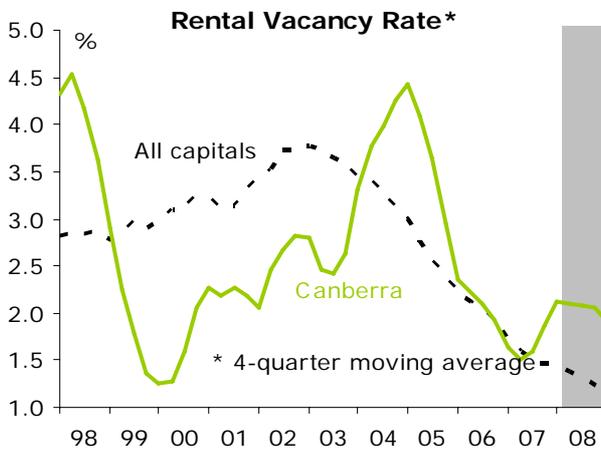
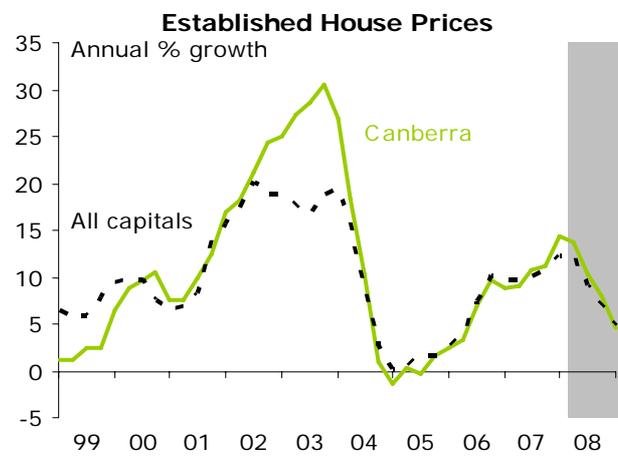
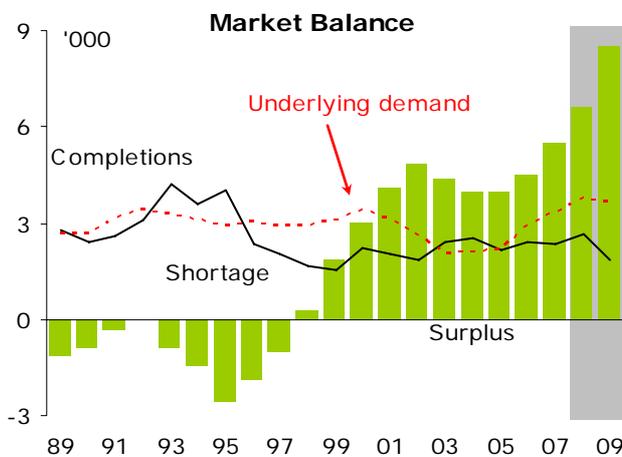
After economic growth slowed to 2.1% in 2006-07, there are signs that the Tasmanian economy is now beginning to strengthen. Household consumption and (new & used) dwelling investment growth were particularly strong in 2007 expanding 6.0% and 11.2% respectively. Further, compensation of employees ended last year 9.4% higher and the unemployment rate has remained stable at just over 5%. All these factors point to increased activity in the state's housing market, especially now that losses from inter-state migration have been stemmed. Population has been running just below 1% per year for some time and we expect this trend to continue with an increasing number of retirees choosing to settle in Tasmania. Building approvals have increased in the last six-months to meet additional demand and are now running in excess of an annualised rate of 3,100. This number of approvals has not been seen since the mid-1990s and represents a significant boost to activity especially amidst higher interest rates. However, as with the mainland states, interest rates and other constraints have kept the cautious building industry from fully meeting new demand. However, Tasmania does have the advantage of a significant amount of vacant land with future development potential relatively close to major cities to cater for additional demand. Yet in the short-term we expect market fundamentals to continue to tighten. As a result we are seeing house price growth beginning to accelerate, reaching 11.1% in the year to December 2007 and prices should remain well supported going forward.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

Australian Capital Territory

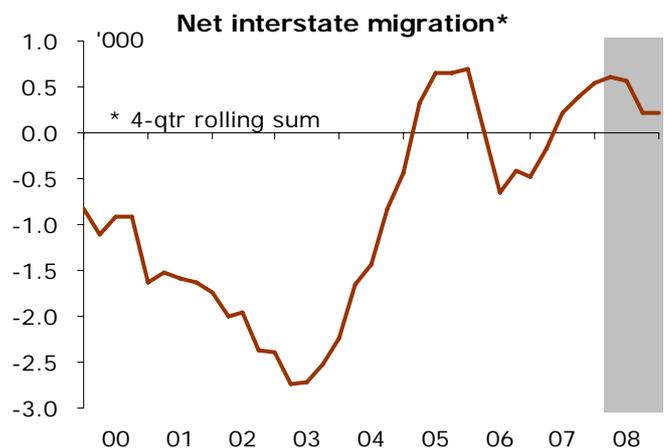
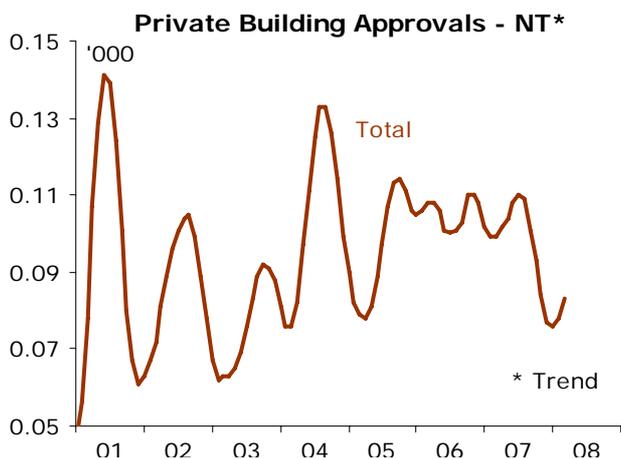
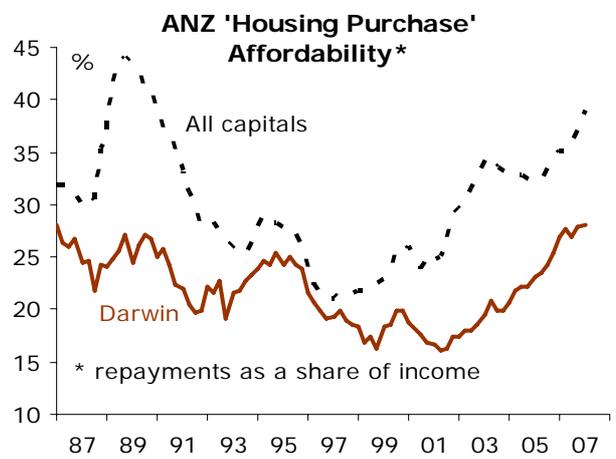
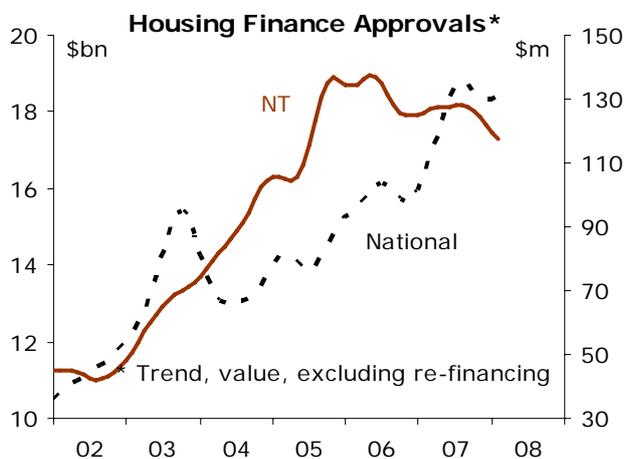
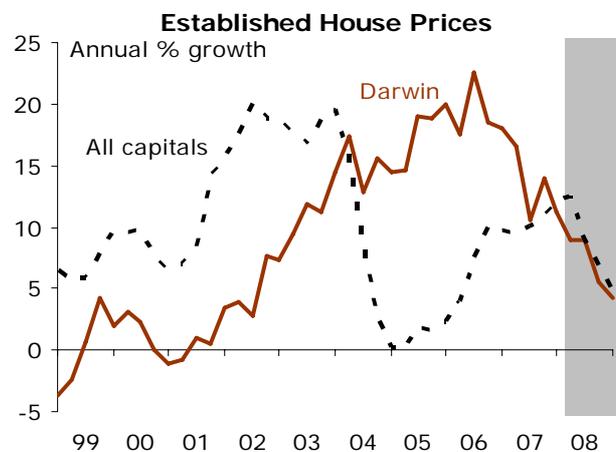
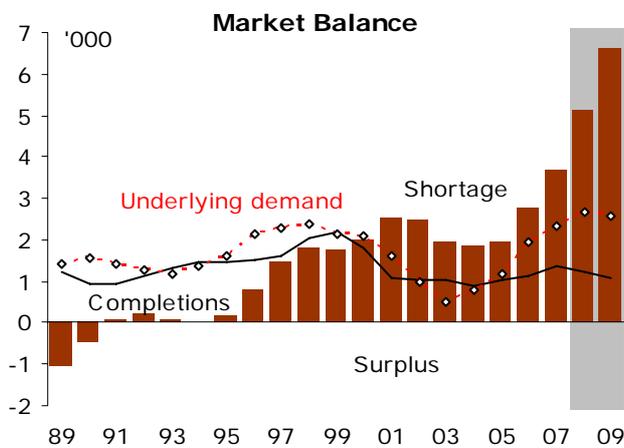
The ACT economy put in a strong performance in 2006-07, expanding by 5.0%, the fastest growth in the country for a non-resource region. However, more recent data suggests that the economy is in the midst of a slowdown. State final demand expanded just over 1% last year, led lower by particularly weak dwelling investment. Despite this, the ACT population continues to expand at a healthy clip. An additional 5,560 residents entered the ACT in the year to September 2007, a rate not seen since 1993. With most new entrants taking up positions in the public sector the unemployment rate is particularly low at 2.4%. The tightness of the labour market is also reflected in wages, with compensation of employees expanding by 11% last year. All this makes for fierce competition in both the residential housing and rental markets and although the number of dwelling approvals has remained solid, demand is clearly outstripping supply. As a result of the significantly tighter market conditions, house prices rose 14.3% last year. Despite this, ACT housing remains some of the most affordable in the country due to relatively high public sector incomes. Vacancy rates remain below historic averages and advertised rents grew 13% last year, to be the second highest in the country after Sydney. Slower economic growth and the prospect of cutbacks in Federal Government departments are limiting what has been a relatively rapid rise in population and may see an easing of housing market pressures in the second half of 2008.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

Northern Territory

After already putting in two successive years of 5½% growth the Northern Territory economy grew by 5.6% in 2006-07, second only to the other resources giant, Western Australia. This growth has been driven by the commodities boom and the massive increases in oil prices with mineral ores and mineral fuel exported in almost equal value in 2007. The expectation that prices for both of these resources remains elevated should continue to provide a fillip for the Territory's economy going forward. The unemployment rate remains relatively high at around 5% in trend term, yet employment growth has grown significant and is now at record levels. Strong labour markets have allowed solid private sector wages growth of just under 5%, prompting annual retail sales growth of over 10% last year. The attraction of strong employment prospects has seen annual population growth remain above an annual rate of 2% growth for more than two years. NT welcomed over 4,500 new residents in the year to September 2007 the largest increase in over a decade. With building approvals at near five year lows the shortage of housing in the Northern Territory is becoming acute. House price growth has slowed from an annual rate of 22.6% in June 2006 to a still solid 11.1% growth in December 2007. Housing finance commitments have slowed significantly under interest rate pressure which may take some pressure off the market and see recent rapid price growth continue to moderate. However, with vacancy rates in Darwin just over 1% the market remains very tight and advertised rents rose 11.1% last year.



Sources: Economics@ANZ, Australian Bureau of Statistics, RBA, REIA, Residex

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