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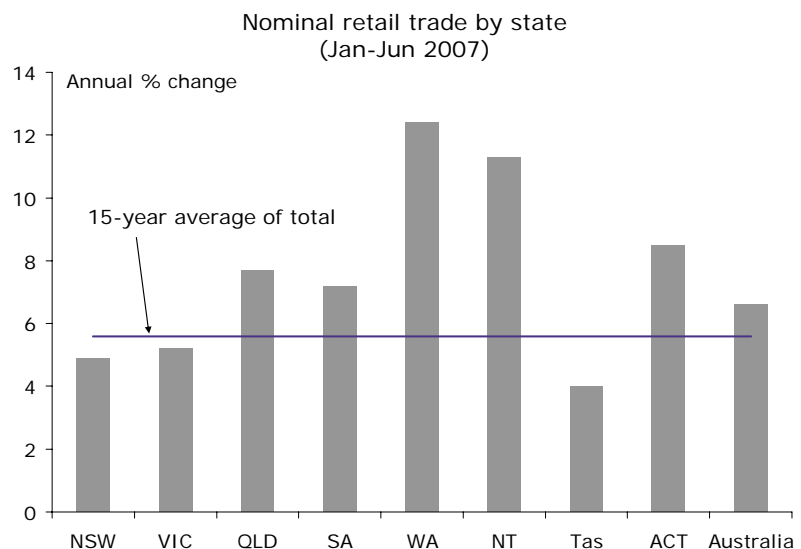
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The macroeconomic backdrop remains supportive of healthy retail sales growth over the next year. Nominal retail sales in the first half of this year rose by an annual rate of 6.6%, much stronger than the 5.8% recorded for the whole of 2006. The performance gap between the resource-rich economies of Western Australia, Northern Territory and Queensland and the south-eastern states is narrowing. This largely reflects a recovery in private spending and investment in the south-eastern states and bodes well for retail turnover. Over the first half of this year, Western Australia and the Northern Territory saw the strongest increase in sales, up by an average of 12.4% and 11.3% respectively in annual terms. While sales in New South Wales and Victoria stayed below the national average, turnover has ticked up, expanding by an average of 5.1% compared with an annual rate of 4.4% in the first half of 2006. The fortunes of Tasmanian retailers, although weak compared to the national average, have also improved in the first half of 2007. Sales are up nearly 4% from the same period a year earlier and real sales are 1.7% higher.

The new financial year has delivered further increases in disposable income and the unemployment rate remains at multi-year lows. Nevertheless, the risk of higher interest rates, petrol prices and uncertainty stemming from increased financial market volatility have the potential to slow the pace of discretionary spending, but on balance we expect nominal retail sales to continue to expand at an above-trend pace, rising by around 6¼% in 2007 and 2008. In volume terms, retail turnover is forecast to expand above 4¼% in 2007 and 2008.

Retail sales growth stays above trend

Sources: ABS, Economics@ANZ

The above-average pace of growth in retail sales has fuelled a surge in shop building activity with a strong pipeline of work ahead. For the twelve months to June 2007, shop building approvals were up 17% from the same period of the previous year. Overall income returns on retail property have edged down slightly with the breakdown by type of retail showing a more significant decline in yields in some segments over recent years underpinned by strong investment demand for retail assets. Rental growth should continue to be reinforced by a relatively healthy retail sales outlook and low vacancy rates, particularly in CBD areas, and this should support capital value growth.

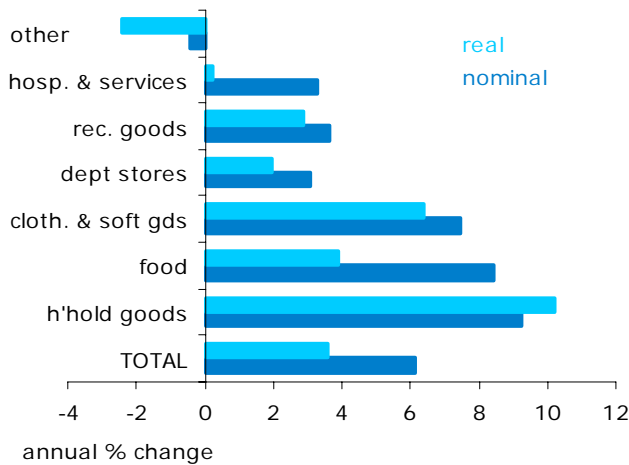
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Retail sales outlook

The landscape of Australian retailing is far from homogeneous, comprising contrasting sectors each with its own set of micro drivers and issues. In 2007, discretionary spending has been soft relative to the general retail industry. Nominal and real retail sales growth in the department store, hospitality and services, and recreational good retailing sectors has tracked below the industry average. In contrast, strong spending continued to dominate the more essential categories of food, household good and clothing and soft good retailing.

Mixed retail performance in the June quarter



Source: Australian Bureau of Statistics

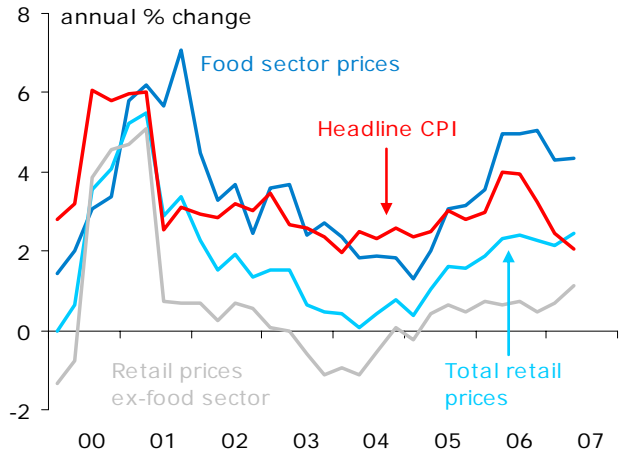
This pattern of spending suggests that something has been eroding spending power, forcing consumers to focus their limited resources towards those retailers selling more essential goods. And delving into the retail figures more closely, it soon becomes apparent that one of the reasons behind this circumstance has been the worrying pace of retail price inflation, particularly in the food sector (which comprises over 40% of total retail spending).

In the past, retail prices have tended to grow at a slower pace than general consumer prices, however this relationship appears to have changed over the past few quarters. As the chart below indicates, retail prices have risen 2.4% over the year to the June quarter, more than the 2.1% annual growth in the Consumer Price Index. This circumstance is being driven almost entirely by the rapid increase in food industry prices (+1.6% in the quarter, +4.4% in annual terms), largely reflecting the continued impact of the drought upon the supply of some key food items, sustained higher fuel prices pushing up transport costs, as well as new flood and cold weather related effects.

The annual pace of increase in food prices has remained uncomfortably high at above 4% for the past five quarters. It may be the case that some of the factors supporting higher food prices are not short term, but rather represent a structural shift in global food prices. This is consistent with rising global prices for food, partly due to increased demand from developing economies such as China

which are experiencing strong increases in incomes, and also due to increased use of grains for ethanol production.

Food prices continue to rocket ahead



Source: Australian Bureau of Statistics

Household budgets have been impacted by higher petrol prices recorded in 2007 (up over 10% in 2007 thus far) and a reduction in the deflationary impact that has been typical of those retail sectors selling mass manufactured goods made in China (eg. clothing and household goods). The likelihood of continued elevated interest rates over the forecast period will weigh on spending, although personal income tax cuts should more than compensate.

On balance looking forward, the fortunes of Australia's retailers in aggregate are likely to remain bright. Growth in real household disposable incomes is forecast to remain strong, buoyed by solid employment growth and wage outcomes. Retail sales in aggregate are forecast to remain solid, growing by 6½% in 2007 in nominal terms, although price pressures will continue to eat into such performance, with real growth of 4.3% expected. In particular, household good retailing is likely to continue to be one of the standout performers, although solid food prices are forecast to persist in weighing down real growth in that sector.

Retail sales forecasts and underlying macro assumptions

	06	07f	08f	09f
Retail sales (nominal)	5.8	6.5	6.2	6.0
Retail sales (volume)	3.5	4.3	4.4	4.0
Real GDP growth	2.7	3.9	4.2	4.0
Employment	2.1	3.0	2.9	2.0
Wages (real)	0.5	1.9	1.5	1.5
Wages (nominal)	4.0	4.2	4.2	4.2
CPI	3.5	2.3	2.7	2.7
Real HDI	3.3	5.1	4.7	3.3
HH consumption	3.1	4.1	3.9	3.8

Sources: Australian Bureau of Statistics, Economics@ANZ

Retail construction takes off

The above-trend rate of expansion in retail sales has supported renewed growth in retail floor space. We have seen a resurgence in building approvals in recent months. For the twelve months to June 2007, shop building approvals were up 17% from the same period of the previous year. These projects largely consist of extensions to suburban shopping centres and new developments along residential growth corridors.

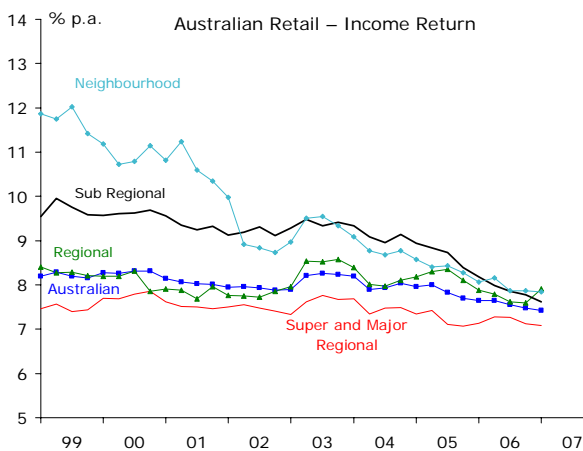
Further expansion in retail space



Source : ABS

The increasing number of inner-city residents and worker population is likely to keep retail tenant demand strong and together with limited stock, will continue to support growth in CBD rents. Supply in the bulky goods sector has seen considerable growth in recent years, however the large amount of new space coming on stream is likely to result in some cooling in returns. Nevertheless, a pick-up in housing construction activity is expected in 2009. This should help to support the sector as demand for household-related goods, which usually forms the bulk of the tenancy mix, strengthens.

Income return by retail-type



Source: Property Council, Economics@ANZ

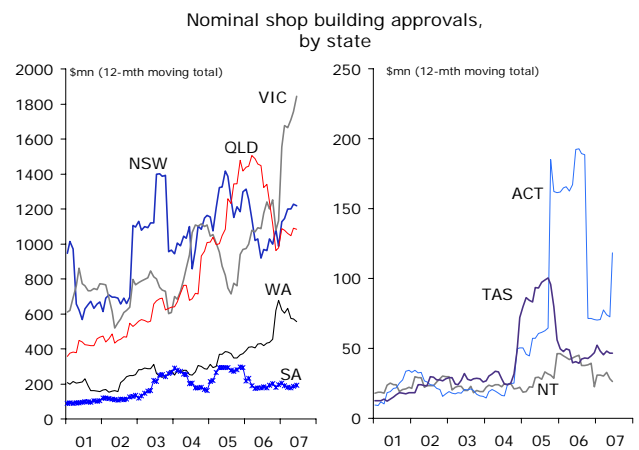
Overall retail property income returns have edged down slightly with the breakdown by type of retail showing a more significant decline in yields in some segments over recent years underpinned by strong investment demand for retail assets. However, the

income return on regional retail centres bucked the trend in the March quarter, edging up slightly. Rental growth should continue to be reinforced by a relatively healthy retail sales outlook and low vacancy rates, particularly in CBD areas, and this should support capital value growth. Capital returns have ticked up over the past few quarters.

Trends across the country

Building approvals data for the past year indicate an upturn in activity ahead in **New South Wales**. Several retail projects in the pipeline include the redevelopment of Pitt Street Mall, Glenrose Shopping centre and Stocklands Merrylands Mall. Retail spending conditions are improving, bolstered by stronger employment gains and declining unemployment rates. This has been reflected in growth in retail turnover which recorded an average annual rise of 4.9% in the first half of this year, much stronger than the rates of growth seen in 2006. However, further interest rate hikes are a potential threat to a more robust acceleration in retail turnover over the coming year.

Strong pipeline of work ahead



Sources: ABS, Economics@ANZ

Construction activity in **Victoria** continues to be brisk with the refurbishments and extensions of a number of suburban shopping centres such as Westfield Doncaster and Westfield Bay City, Geelong as well as the retail precinct of Waterfront City Docklands and Chadstone Place. An upgrade of the Myer Melbourne store on Bourke Street Mall and redevelopment of the Lonsdale Street site will also underpin building activity over the coming year. Retail sales in Victoria have picked up and solid economic prospects for the state bode well for turnover. Vacancy rates in the Melbourne CBD remain tight and growth in specialty stores as well as the development of Docklands and in particular, the opening of the Spencer Street Direct Factory Outlet, have added to the retail experience.

Retail spending in **Queensland** continues to grow at a solid pace, outstripping the national average. For the first half of this year, turnover was up 7.7% compared with the same period in 2006. Brisbane CBD yields remain firm, ranging between 6-7% for prime properties and 7-7.75% for secondary assets

although smaller assets have seen yields tighten further. Growth in inner city living and strong employment conditions (reflected by low office vacancy rates), is expected to continue to underpin tenant demand in the CBD. More broadly, over 270,000sqm of space was added to the southeast Queensland market in 2006 and over 800,000sqm is in the pipeline with potential completion in 2007 and 2008. Bulky goods centres are expected to account for close to half of the new space coming on stream, underpinned by the development of the southeast growth corridor. Some of this new supply will be located in West Ipswich, Maroochydore and Keperra.

Shop building approvals in **South Australia** have only edged up slightly. For the twelve months to June, approvals were 8% higher than the same period of the previous year. Thus far, activity has largely featured the refurbishment of neighbourhood centres and construction of bulky goods stores to support new residential developments. Projects in the pipeline include the \$200mn upgrade of the Marion shopping centre in Adelaide and the Tea Tree Plaza extensions. Although growth in retail sales has strengthened this year, exceeding the national average, new supply coming on stream could limit the pace of rental growth.

Western Australia has been recording one of the strongest rates of growth in retail turnover with sales rising by an average annual rate of 12.4% for the first half of this year, the strongest rate of expansion across the states and territories. Underlying economic fundamentals remain strong. The unemployment rate has stayed below 3.5% for over a year. Together with steady growth in wages and perceived wealth gains from rising asset prices, private consumption is expected to continue to expand at a healthy pace. The outlook for CBD retail is favourable and vacancy rates are expected to remain low. According to CB Richard Ellis, super prime gross face rents have increased by 25% over the year to the September quarter 2006. The completion of the Perth Metrorail is expected to further support retail turnover in the CBD. Close to zero vacancy in prime strip Perth CBD has underpinned strong rental growth. CBD new supply includes a 14,000sqm retail space at Raine Square with completion likely by the end of 2008 as well as a 15,000sqm retail component at Century City. The strength of the WA economy will continue to drive investment demand for retail property with yields expected to continue to tighten as they have over the recent past.

Tasmania's retail offering is expanding with the construction of homemaker centres and a direct factory outlet bringing labels not already in the market, thereby adding to the retail mix over the coming year. In nominal terms, retail sales growth has edged up and was 8% higher in the year to June, the strongest pace of expansion since March 2006. An expected pick-up in economic activity and employment growth is likely to underpin further expansion in retail spending although the retail

supply becoming available is likely to weigh on rental growth.

The **Northern Territory** has experienced a population boost over the past few years, owing largely to interstate migration, bolstered by growing employment demands from the resources sector. The NT population grew solidly in 2006 and has expanded by 6.7% since the start of the mining boom in 2003. Annual growth in employment has averaged 5.2% over the past year. This has led to a significant decline in the unemployment rate to as low as 2.9% in December 2006, down from a peak of 6.7% in August 2004, although the unemployment rate has since ticked back up to 4.6% in July 2007. Retail sales growth has been robust. Over the past six months, nominal through the year growth has averaged a bumper 11.3%. The growth in residential developments is likely to be accompanied by the expansion or construction of neighbourhood shopping centres to cater to the growing market. In the CBD, projects are likely to comprise mainly of the refurbishment of existing retail outlets to cater to tourist demand and complement medium-term plans to develop Darwin's waterfront.

There has been a surge in shop building activity in the **ACT** over the past year as reflected by data on value of work done. Some winding back of activity is likely but recent building approvals data suggest a steady pipeline of work ahead. Projects underway include a \$140mn Direct Factory Outlet and other bulky goods centres. Retail sales grew above the annual average rate for Australia in the first half of 2007. Through the year growth has averaged around 8.5% over the past six months against the comparative figure for Australia of 6.6%. With solid employment conditions, retail turnover is expected to continue to expand at a healthy pace.

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