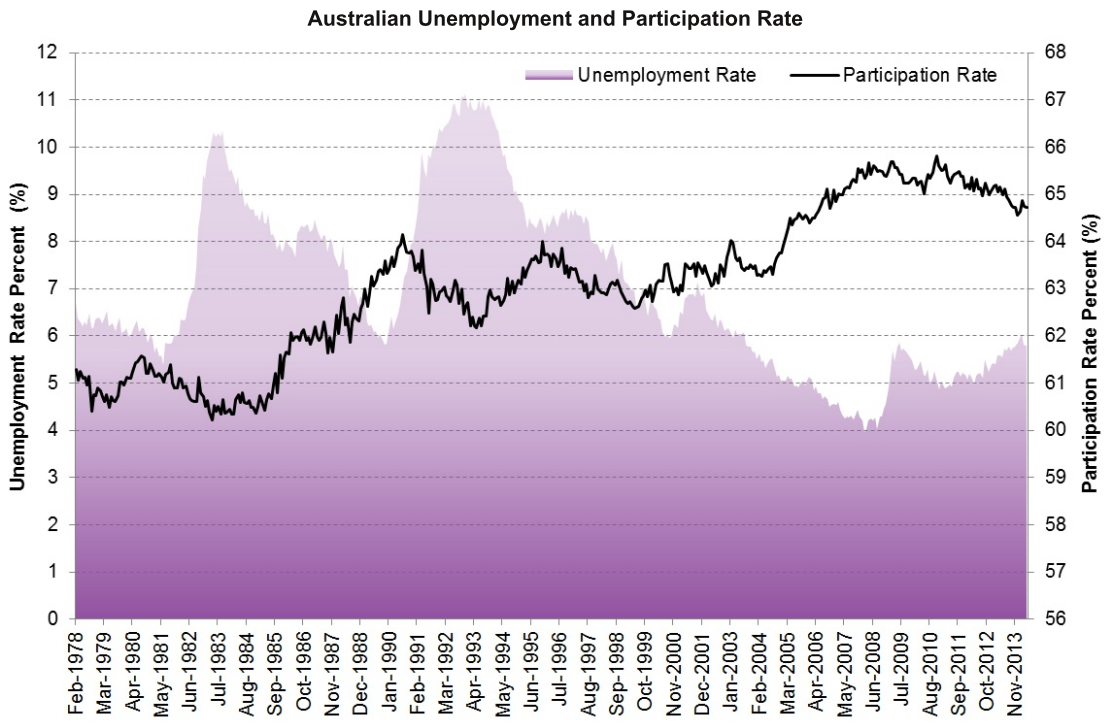
HOW FRAGILE IS THE RECOVERY?

The news keeps getting better on the interest rate front, however for all of the wrong reasons. We recently noted that Australian building approvals had come off, only marginally in housing by 0.3%, however private sector accommodation (excluding housing) had declined by a very significant 14.0% in seasonally adjusted terms.

The most recent housing finance data also showed a small decline from February to March in 2014 of -1.2%. Retail trade was also standing relatively still at a modest gain of 0.2% from March to April.

However wage price data released today is a very real cause for concern, albeit that it relates to the period concluding August 2013. For the first time since 2008, year on year data has actually seen real wage increases contract. This was a 2.0% decrease, something that the RBA and Australia's policy makers would be well aware of and very concerned about. Real wage decline has the capacity to influence two things, people's savings and spending habits. Wage increases are linked to confidence, firstly in business and secondly transferring through to the consumer.

Unemployment is at 5.8% which has continued to trend upwards from the low point in the cycle from December 2010 to June 2011 which spanned the two low points of 4.9%. However the more pressing concern is the number of people who have dropped out of searching for work.



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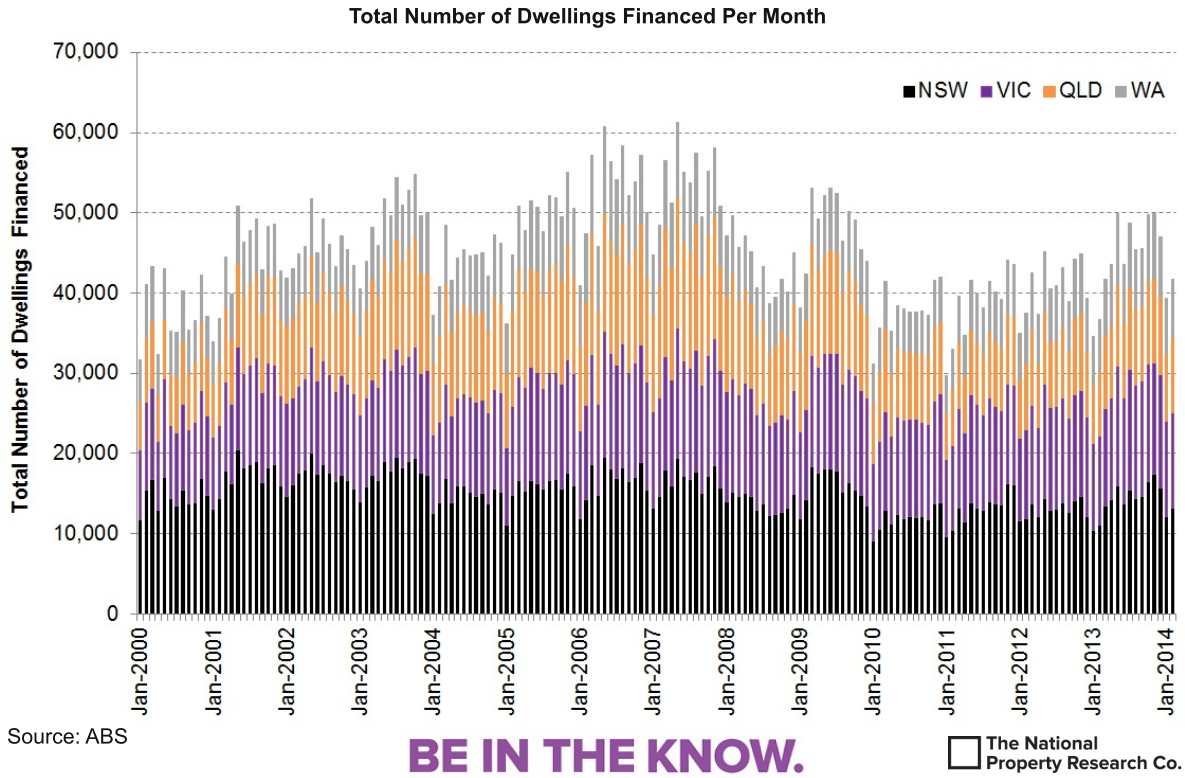
The total number of dwellings financed also points to a short term slow down in Australia's residential sector. Now this should not be interpreted for one minute as a bust, because the slow down is occurring in different parts of Australia for different reasons.

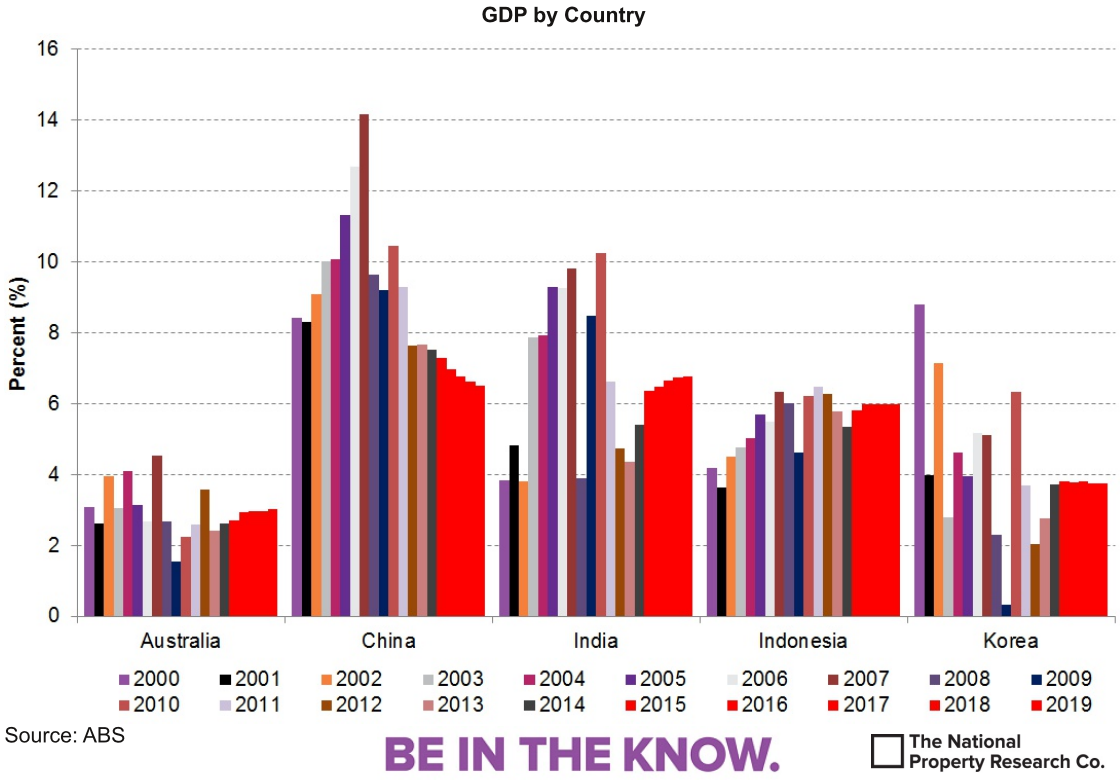
Outer Melbourne suburbs have an abundance of supply and generally remain reasonably priced, however a slowdown in the manufacturing heartland has many wondering how secure their employment is. New South Wales, more particularly Sydney is trying to catch its breath after some of the hottest market conditions since 2003. Price escalation in the last two years has been nothing short of extraordinary.

Queensland has suffered from a very obvious two speed economy. Now that mining construction has slowed, many regional centres have lost favour with the investment community, despite most having low vacancy rates. On the flip side to this is Brisbane which has some very real supply constraints in two of its fastest growing urban corridors.

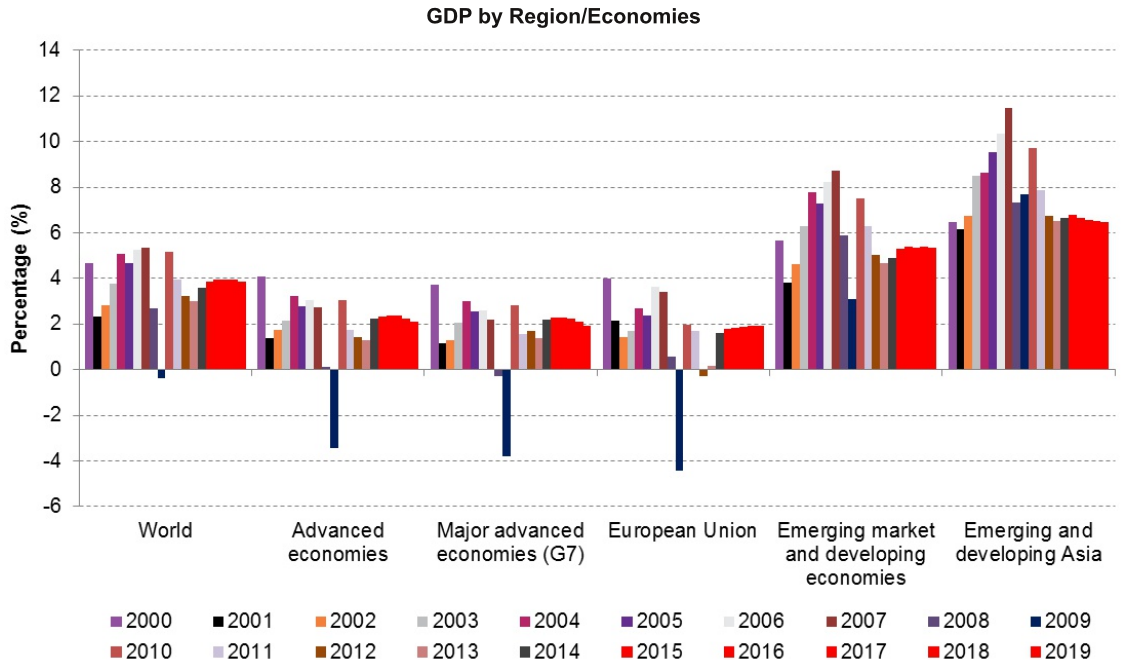


This should not read as the bubble bursting, quite the contrary. However what it does suggest is that Developers in particular should be very careful in what escalations they are building into their acquisition strategies. Many markets are fuelled by a very large proportion of international and interstate investors. The local market is being choosey in what they are buying and not all regions are recovering equally. In many areas apartments are recovering at a far greater rate than the housing sector, however as little as 50km away, the reverse is actually happening.

Market conditions are far better now than they were in almost every capital city compared to the same time last year. However we would caution about getting carried away with the robustness of the recovery given that the economic data at present does suggest that the nation is still very much in a period of transition.



It's not all doom and gloom though. The IMF has largely given most countries a favourable outlook, with perhaps the exception of China. However it should be noted that the Chinese Government has suggested that it will continue to maintain a monetary policy that will keep the economy at 7.5% GDP, more bullish than the IMF. Also far more sustainable than the peak of 14% in 2007.



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When the world economy is considered as a whole, the future is one of stability, rather than lumpy cycles for the next five years. Focus should be drawn to the Advanced economies that are expected to show modest growth of around 2.0%.

Recent media representations suggest that these leading economies are looking at avenues in which to increase the annual GDP to between 2.75% and 3.0%. This would prove to be a significant stimulus to the world if achievable. On the 5th of June 2014, Joe Hockey, the Australian Treasurer has suggested that the Australian economy is on track to grow at 2.75% this financial year. The challenge in many respects will be maintaining this through 2014-15. Growth however has been strong and is encouraging despite the high Australian Dollar.

One of the questions we were always asked during the GFC was when would the market conditions improve. Interestingly we are now being asked how long do we think this part of the cycle will last? In part, the answer will be reliant on just how fast things continue to escalate and how long it takes the broader economy to recover. The RBA will be very keen to ensure it has no false start on interest rates increasing. However, when interest rates do start to move, there is an expectation that it will happen in a fairly quick succession. Remembering that the long term variable rate sits somewhere around 7.2% with most banks offering a variable in the low 5.0%'s. That's an increase of almost 28% on most people's mortgage repayments. Watch this space.

So how fragile is the recovery. At present the upward cycle is being led by Sydney, a market that was in the doldrums for almost a decade. Current economic data suggests that the property cycle is well ahead of many other sectors and has got there very quickly. History tells us that this is not sustainable.

Every market has its own nuances, however we would suggest that some market segments in many of the capital cities would do well to pause for a breath to set up the preconditions for a more stable and longer term outlook.

History also tells us that we will make hay while the sun shines…

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