WEEKLY ECONOMIC COMMENTARY

Week beginning 29th September 2014

ECONOMIC DATA ROUNDUP

DATA RELEASED LAST WEEK

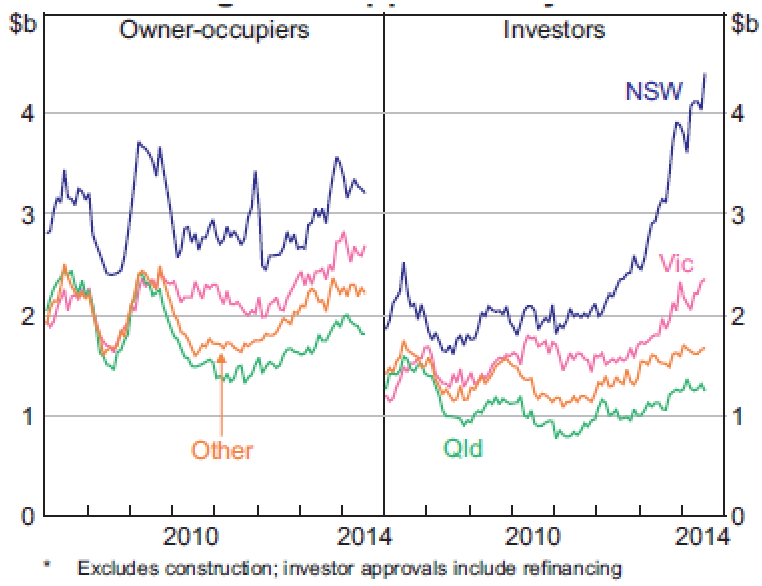
Economic Data	Period	Actual	Previous
DEER Skilled Internet Vacancies	August	+3.8%	+0.6%
ABS Job Vacancies	August quarter	-0.7%	+2.5%

The Department of Employment **internet vacancy index** was up 3.8% in August and 12.8% higher annually. The gain in August follows a 1.9% decline in July (revised from an originally reported 0.6% gain). In year-ended terms, internet vacancies are up 12.8%. The Department noted that the series has been revised "noticeably lower" following the removal of a contributing web-site from the sample. While this has reduced the number of internet vacancies reported each month, the underlying trends in vacancies remain similar.

The Australian Bureau of Statistics showed total **job vacancies** fell 0.7% in the August quarter, following a revised 2.4% rise the previous quarter. Vacancies of 145,800 were still up 4.1% on the same quarter a year earlier. Vacancies in the private sector fell 1% in the quarter while public sector vacancies edged up 2.4%, but from historically very low levels.

The Reserve Bank's **semi-annual Financial Stability Review** (FSR) doesn't normally receive much market attention, but it is worthy of a few comments given the increased concern the RBA has around housing. The language in the FSR is stronger than that used to describe house price and mortgage market dynamics in the September RBA Board Minutes. The increase in emphasis reflects the view that "new lending to investors is out of proportion to rental housing's share of the total housing stock" – especially in Sydney and Melbourne. It appears the RBA is paving the way for the introduction of measures to curb the pace of investor housing lending, with any such measures likely to be targeted towards that segment of the market. The RBA said it is in discussions with other regulators about "further steps" to tighten bank lending standards which would reduce the amount of credit made available to buy houses.

Housing Loan Approvals by State



Source: ABS & RBA

The potential options to cool the housing market include a higher risk-weight or interest rate buffer for investor home loans over and above those applied to other housing loans. This may be enough to take some steam out of the speculative elements of the housing market and would then give the RBA time to let the current low interest rates gain more traction in other sectors of the non-mining economy. Along with the assistance of a lower Australian Dollar, it suggests that any interest rate increase is not on the RBA agenda in the foreseeable future.

Data over the next week

Economic Data	Date	Period	Forecast	Previous
Private Sector Credit	30 Sept	August	+0.5%	+0.4%
NAB Online Retail Sales	30 Sept	August	n/a	+0.9%
Retail Sales	01 Oct	August	+0.2%	+0.4%
Trade Balance	02 Oct	August	-$800m	-$1,359m
Building Approvals	02 Oct	August	-1.0%	+2.5%
HIA New Home Sales	02 Oct	August	n/a	-5.7%

ECONOMIC COMMENTARY

LAST WEEK

A very quiet week for economic data releases in Australia, with the major developments being the continuing fall in the Australian Dollar and the release of the RBA's Financial Stability Review. The Review flagged risks to Australia's macro economy from the current pace of investor housing lending and escalating house prices, especially in Sydney and Melbourne. Economists suspect the RBA and APRA want to see some easing in the housing market before year-end.

Geopolitical concerns following US-led missile strikes on jihadists in the Middle East, after the Russian High Court paved the way to seize foreign assets and uncertainty in equity markets, set a cautionary tone and prompted "flight to quality" buying of safe-haven US Treasuries and the US Dollar last week.

By the close of trading on Friday, the 90-day bank bill was trading at 2.73%, compared to 2.65% a week earlier. In the long term maturities, 3 and 10 year bond yields reversed the previous week's move, closing lower at 2.74% and 3.49% respectively, up from 2.91% and 3.73% a week earlier.

CURRENCY

The Australian dollar has cracked through USD0.88 to its lowest level in nearly eight months, as investors continued to snap up US Dollars on geopolitical concerns and after China all but ruled out further stimulus. Talk by the Reserve Bank of New Zealand Governor that the NZ Dollar's strength was "unjustified and unstable" given the decline in commodity prices sent the kiwi tumbling and inflicted some collateral damage to our currency, dragging the Aussie to a low of USD0.8764. This fall will please the RBA and provide further support to the Australian economy overall.

By the close on Friday, the Australian Dollar was still trading at USD0.8777 compared to USD0.8956 a week earlier.

EQUITIES

Investors hit the sell button last week, driven by worries of a weaker growth outlook in China. Concern about a potential economic slowdown in China and the comments from China's Finance Minister Lou Jiwei that further stimulus to support the economy is not forthcoming turned sentiment negative.

A large sell-off on Wall Street last Thursday night on the back of a large (3%) fall in Apple stock after it withdrew an update to its new operating system and following some negative publicity around their brand new iPhone 6, saw our market close the week on a negative note. Banks and miners both suffered hefty losses, extending the market's plunge to more than 5% over the past three weeks and eroding all the share market gains so far this year.

By the close on Friday the S&P/ASX200 Index was trading at 5,313.4 compared to 5,433.1 a week earlier.

THIS WEEK

The economic calendar picks up a little this week with a series of monthly data releases due out. August retail sales and Private Sector Credit will be the highlight of the week. To a lesser extent, given the recent fall in the iron ore price, the RBA commodity price index for September may gain some attention as will the trade deficit which is expected to narrow from last month.

INTEREST RATE VIEW

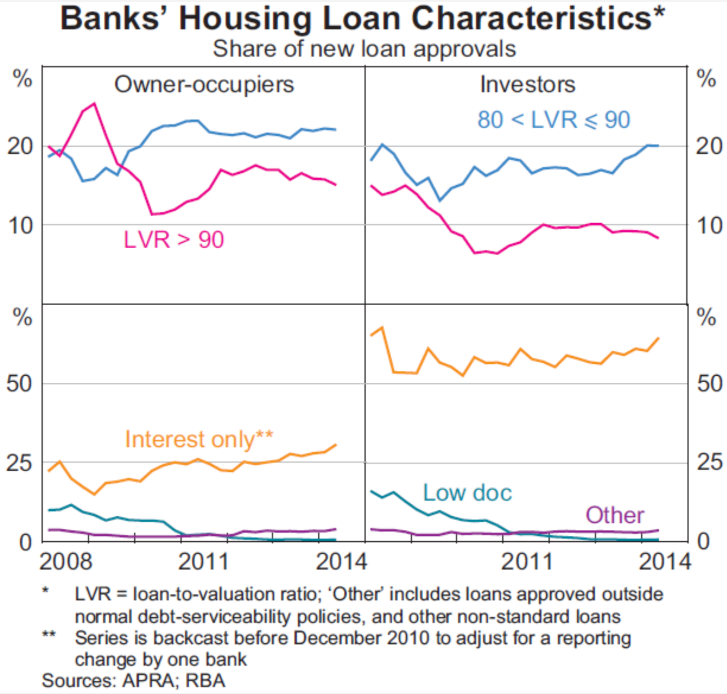
The long awaited fall in the Australian Dollar is timely given the recent increased concerns from the RBA over the impact of low rates on house prices. The support from the lower currency will take time to flow into the real economy but will eventually take some of the pressure off monetary policy. Financial markets are now bringing forward expectations of the timing of the start of the tightening cycle and are currently pricing a 50% chance of a 25bp rate hike by late next year.

Economic Data	12 months ago	6 months ago	3 months ago	1 month ago	Now
Official Cash Rate	2.50	2.50	2.50	2.50	2.50
90 day Bank Bill	2.59	2.69	2.71	2.63	2.73
180 day Bank Bill	2.59	2.73	2.72	2.65	2.77
1 year swap	2.74	2.91	2.87	2.81	2.91
3 year swap	3.28	3.40	3.09	3.04	3.14
5 year swap	3.82	3.91	3.49	3.40	3.54
10 year swap	4.56	4.60	4.12	3.90	4.03
AUD/USD	0.9327	0.9264	0.9431	0.9356	0.8777
S&P/ASX200 Index	5,307.1	5,366.9	5,445.1	5,624.4	5,313.4

CHART OF THE WEEK

Australia is becoming a nation of landlords and renters

The Reserve Bank of Australia's latest Financial Stability Review (FSR) potentially marks a turning point in the RBA's approach to managing house prices. The property sector is clearly unbalanced and increasingly driven by speculation, but who are these investors?

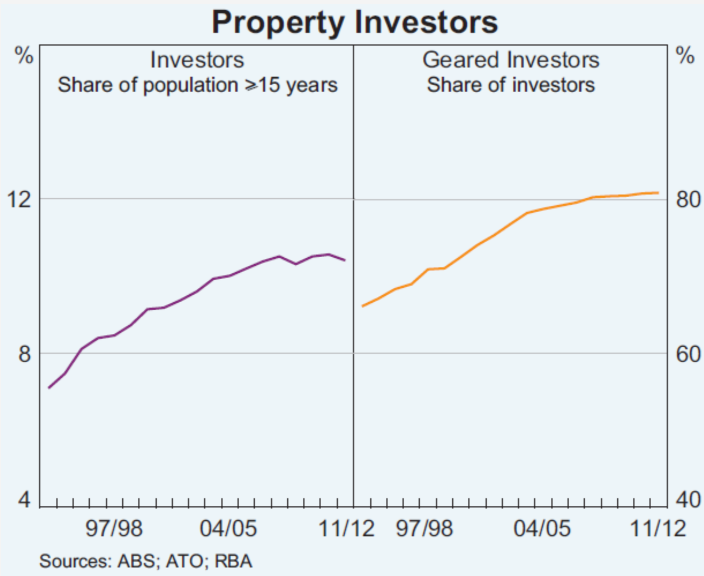


The FSR contained a short but interesting article on the characteristics of Australian property investors and how they have changed over time. Utilising data from the Australian Tax Office and the Household Income and Labour Dynamics in Australia survey they were able to track changes to the market and its composition.

The tax treatment for property investment creates incentives for risky behaviour, at least compared with owner-occupiers. Investors, for example, "have stronger incentives than owner-occupiers to take out interest-only loans".

Interest-only loans account for 64% of new investment loans, compared with 31% for owner-occupiers. The reason should be pretty clear: with interest expenses on investment properties tax deductible, an interest-only loan maximises that deduction. For owner-occupiers, the main reason for interest-only loans is simply to reduce the initial cost of the mortgage.

However, the data indicates that this doesn't necessarily encourage investors to maximise the size of their loan. Investor loans tend to have a lower loan-to-valuation ratio, although loans with LVRs over 80% still account for almost 30% of new investor loans. This would be considered excessive in most other developed countries.



Property investment continues to rise in popularity among Australians, consistent with trends across many developing countries, reflecting its favourable tax treatment. The share of the population over the age of 15 years with an investment property has increased to around 10 per cent but is likely to have ticked up further during the recent investor boom. We are slowly but surely turning into a country of landlords and renters.

The share of investors taking out a loan has increased towards 80% in recent years, which largely reflects the fact that the benefits of tax deductibility of interest payments increase with the size of the loan. As prices continued to rise, there are increasing incentives to leverage up and save some tax.

Investor activity is increasingly concentrated among older Australians. The data partly reflects the influence of baby boomers, who in 2003-04 were typically aged between 44 and 58 years but by 2011 were entirely contained within the two highest age groups.

Since 2011-12, the share of the population over 60 years old with an investment property would have increased further.

CHART OF THE WEEK

The age distribution creates an interesting dynamic. Older Australians are often asset-rich but cash-poor. Many will, at some point, look to downsize their home or sell off their investment properties. Unless they decide to reverse mortgage their property, they will need to accept whatever house price younger Australians can afford. It raises the question: have baby boomers made a big investment mistake?

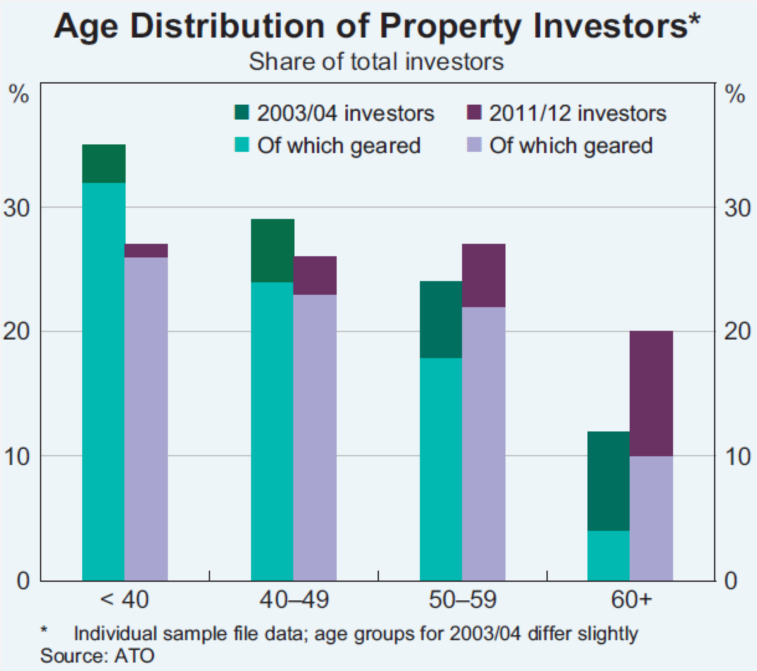
Of particular interest is the sharp rise in leverage among older Australians. They are not only more likely to have an investment property but also more likely to take out a loan compared with 2003-04.

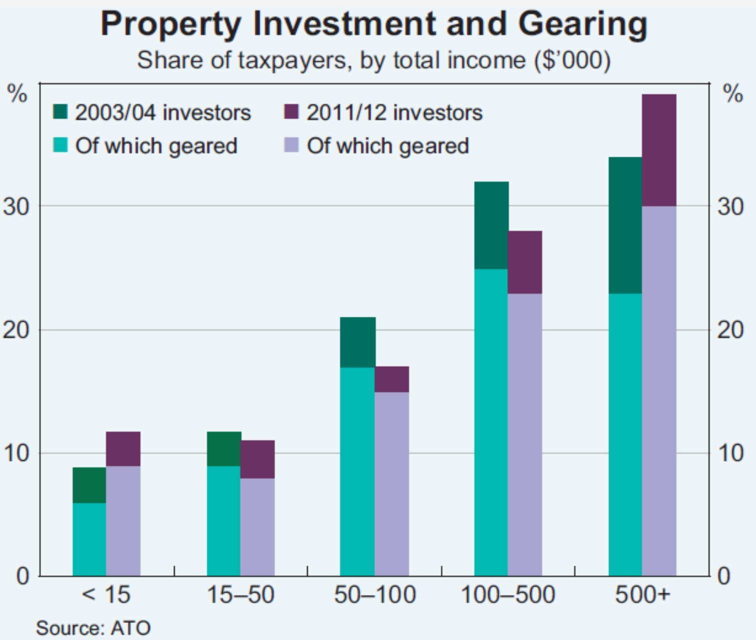
As a result of these dynamics, we have seen property investment rise at both the bottom and top of the income distribution. The rise at the bottom reflects retirees and certainly isn't a tick in the favour of housing affordability; the rise at the top simply reflects the fact that property investment is increasingly popular among wealthy Australians. We should also remember that property speculation is now at its highest level in history, a fact that is sometimes obscured when you look at population or income shares.

The important question that policymakers should be asking is whether increasing levels of property investment are desirable. Since investors increasingly shun new construction -- and the remaining investment amounts to speculation – I suspect the answer is no.

Typically investors simply bid up the price of property, collectively justifying their investment. The net result is that we spend an increasing share of our income on servicing debt rather than consumption or other, more productive, forms of investment.

The RBA notes that most investors are well-positioned to service their loans and yet clearly the pace of investor activity has them concerned. They have yet to commit to intervention but they have given their clearest signal yet that "macro-prudential" policies are in Australia's future. Given the sharp rise in speculative activity, this seems reasonable, but the disaggregated data provides a valuable insight into the various dynamics that are driving the national trend





Source: Business Spectator, 25th September 2014
Australian News: The Economy
By Callum Pickering

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