

## Much Ado About Housing



### Introduction

The high cost of housing in Australia, commonly referred to as housing affordability, has become a topic of vigorous debate in this country. Housing affordability can be defined as the relationship between housing costs (including prices, mortgage repayments and rents) and household incomes in reference to the overall housing system.

A key challenge in analysing and discussing the housing market is the fact that housing is an emotive issue for many, and this is because shelter is a basic need.

Housing is a global issue, with commodity rich nations including Canada, New Zealand and Australia facing similar challenges.

**Housing Stress** - Households in the bottom 40% of the income distribution that pay more than 30% of their gross income on mortgage or rent payments are considered to be in housing affordability stress.

Higher income households are typically excluded due to their increased capacity to afford higher housing costs without experiencing problems (source: [www.ahuri.edu.au](http://www.ahuri.edu.au)).

An escalation in concerns around housing affordability has seen the federal government dragged into the broader housing policy debate. Although housing is normally the domain of the state governments, there were growing calls for the federal government to address taxation arrangements, to level the playing field between home buyers and investors.

Investors have dominated activity in recent years, and combined with strong demand by overseas buyers, give rise to the notion of a bubble.

Key drivers for home prices include supply and demand, population growth, employment and interest rates. Australia reveals relatively strong population growth, whilst employment growth has been more subdued in recent years. The supply of dwellings, notably units and apartments has rocketed higher in Sydney, Melbourne and Brisbane as prices have risen and interest rates have fallen to historic lows.

### Interest Rates

Global bond yields sank sharply throughout the first half of April, but staged a comeback during the latter half of the month. The declines in global bond yields coincided with question marks surrounding the sustainability of the reflation trade, as well as Trump's ability to deliver upon his ambitious promises for infrastructure spending and tax reform.

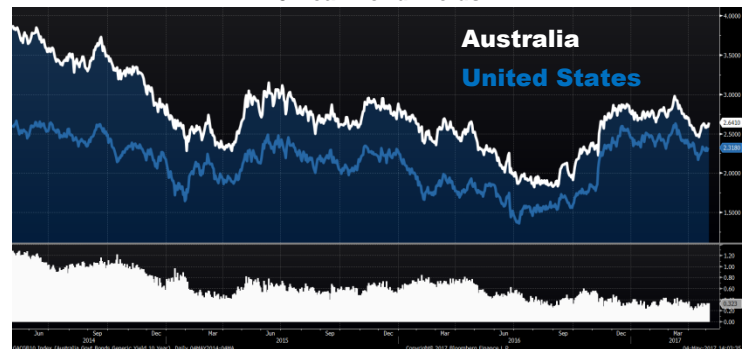
In contrast, however, both Chinese and Indian 10 year yields climbed sharply higher throughout the month. Apart from China's deliberate ploy to curb financial speculation via the repo market, both countries experienced high rates of growth and some pressures from the US rate hikes.

The shorter term two-year sovereign yields were far less volatile, and the US two-year Note closed virtually unchanged at 1.26%.

Amongst the central banks, there were six rate cuts (Mozambique, Uganda, Brazil, Ukraine, Russia and Colombia) and two rate hikes by Argentina and Tunisia. It was Brazil's fifth rate cut (amounting to 3%) during their cutting cycle which commenced in October 2016. Russia continued down their rate cutting path, after the key policy rate struck a 17.0% high in December 2014.

Australian ten-year bond yields typically tracked the US market closely, although ten year spreads contracted below 20bps for the first time since Trump's election on the 9<sup>th</sup> November. Aussie ten year yields climbed towards month end to 2.58%, as did the spread to US bonds to 30bps.

10 Year Bond Yields



Bond spreads at decade lows (Bloomberg)

# Monthly Market Update

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The shorter term benchmark, the three year government bond, made a definitive break 10bps lower during the month, but remains little changed from two years ago.

The RBA opted to remain on hold for an eighth consecutive meeting in May at 1.50%. Whilst the RBA struck a slightly more upbeat tone on the global and domestic economies, markets sense little chance of any change for the remainder of the year. Interestingly, cash markets (OIS pricing), suggest a rate cut is the more likely outcome. At the time of writing, a November rate cut was priced at a 9% chance against 0% for a rate hike.

### Currencies

Currency markets were broadly divided into two distinct camps in April, whereby safe haven currencies performed strongly whilst commodity currencies fell sharply.

The US dollar spot index (BBDXY) posted a second consecutive monthly decline, amid concerns around the reflation trade, and a surprise slowing in first quarter GDP growth at 0.7%. The below chart for the DXY Index (and not the BBDXY due to a lack of historical data) reveals the US dollar has a tendency to peak circa the 100 level. This time around, however, markets widely expect further Fed rate hikes both this year and next year.

US Dollar Index (DXY)



The US dollar reaches a pivotal point (Bloomberg)

The British pound (GBP) was a standout, as markets took comfort from Prime Minister, Theresa May's, decision to call a snap election is expected to lay a firmer platform (and political mandate) in the Brexit negotiations from the European Union (EU).

The Euro dollar (EUR) reached its highest levels since November last year. The European region benefited from a firming in the Eurozone economy, including a near decade low in the unemployment rate.

Asian currencies were a mixed bag, with the Malaysian ringgit and Indian rupee leading the monthly tables on the back of firming manufacturing and trade. At the other end, the South Korean won (-1.7%) struggled from the escalation in tensions with North Korea.

The yen and yuan were little moved in April. Analysts were buoyed by China's broad based improvement in economic growth, but worried by their clamp down on speculation in credit markets.

The Aussie dollar registered a consecutive monthly slide, as the economy experienced a tilt away from the rampant housing sector back toward the mining sector. The narrowing in interest rate spreads to the US likely weighed.

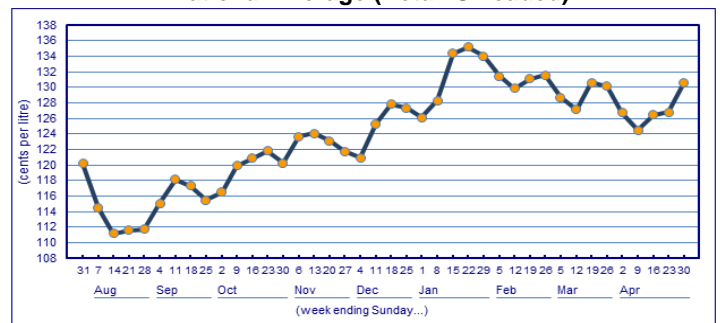
Commodity currencies were broadly lower as softer commodity prices, in particular oil, applied downward pressure. Consequently, the Canadian (-2.5%), New Zealand (-2.0%) and Australian dollars (-1.9%) held down the bottom three positions for the month.

### Commodities

Another disappointing month for commodity markets saw both the CRB and the Bloomberg Commodity Indices register declines. Livestock futures were once again the only sector to register a monthly gain. Oil prices were particularly volatile, whereby Brent Crude briefly touched US\$56.7 a barrel before closing out the month 2.1% lower at US\$51.7.

Australian fuel prices have been a source of inflation in the domestic economy, but the forty week average appears to have turned a corner since peaking in January. Interestingly, the Transport, Postal and Warehousing industry sector was responsible for the largest number of new entrants amongst small businesses in 2015/16.

National Average (Retail Unleaded)



Fuel prices trending down (www.aip.com.au)

The RBA's Index of Commodity Prices declined in April by 3.5%, and the preceding month was also revised to a fall of 1.7%. (both in SDR terms). Iron ore was the biggest monthly detractor, and more than offset price gains in coking coal.

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Coking coal enjoyed a doubling in price to over US\$300 a tonne in the aftermath of the recent cyclone. However, most of the damage to rail networks has been repaired and coal prices have subsequently fallen sharply to US\$246 a tonne.

The smaller rural and base metals subindices also registered monthly declines.

Over the longer one year timeframe, the commodity index rose in excess of 38%. Hence, the domestic economy is set to enjoy the benefits of a 'pay rise' via increased spending in infrastructure investment at both the federal and state government levels.

### Equities

Stock prices were dragged lower during the first half of the month as geopolitical risks weighed heavily upon investor sentiment. However, tensions eased by month's end after a cordial meeting between President Trump and President Xi, and fears surrounding the French elections abated. Consequently, stock markets rallied strongly to close out the month of April higher.

US stock markets posted better than 1% returns, and technology stocks helped to lift the NASDAQ beyond 6,000 for the first time. Consumer Discretionary, Industrials and Health Care chimed in with strong returns. In contrast, Telecoms and Energy stocks weighed during the month.

European bourses performed strongly, despite the distractions from the French elections. The ECB's, Mario Draghi, successfully soothed investor nerves by committing to stimulus measures.

Asian stock markets also posted healthy returns, notably after the Trump and Xi meeting. Hong Kong (2.8%) and South Korean (2.7%) exchanges performed particularly strongly, with the KOSPI reaching a new record high.

Australian stocks exhibited similar themes from around the globe to post a 1% return, and two year high for the ASX200. The accumulation index (including dividends) quietly struck a record high. Industrials, IT and Health Care were the best performing sectors. Conversely, the Telstra share price touched \$4.0 to drag the Telecoms sector almost 10% lower. Elsewhere, Wesfarmers (-5%) and Coca-Cola Amatil (-13%) hurt Consumer Staples, as investors feared the launch of Amazon Fresh in Australia. The Energy sector declined from the threat of government intervention via gas reservation.

### ASX200 Returns by sector (incl. dividends)

S&P/ASX ACCUM. 200 INDEX	1.03%
All Groups	
11) S&P/ASX 200 INDUSTR INDX	4.37%
12) S&P/ASX 200 INF TECH IDX	3.89%
13) S&P/ASX 200 HEALTHINDEX	3.19%
14) S&P/ASX 200 UTILITIES IX	3.14%
15) S&P/ASX 200 Real Estate	2.58%
16) S&P/ASX 200 FINANCINDEX	1.93%
17) S&P/ASX 200 CONS DISC IX	1.53%
18) S&P/ASX 200 MATERIALS IX	-0.15%
19) S&P/ASX 200 ENERGYINDEX	-0.63%
20) S&P/ASX 200 CONS STAP IX	-2.58%
21) S&P/ASX 200 TELECOM INDX	-9.86%

ASX200 including dividends in record territory (Bloomberg)

### Outlook

Financial markets endured plenty of worries during April, not least of all an escalation in geopolitical risks, yet asset prices pushed their way higher. The mid-month recovery in risk assets was surprisingly swift, but continues the trend of bouts of volatility being replaced by a compression in risk metrics. For example, the VIX briefly touched 16.3 before once again staging a recovery to historic lows around 10.

The Australian economy is widely expected to benefit from significant increases in infrastructure investment via the state and federal budgets. Indeed, the upcoming Federal Budget is likely to announce several projects to generate economic and employment activity. The housing sector can also expect the Federal Budget to include initiatives for first home buyers.

Australia's housing market consists of many distinct regions operating at various stages and cycles. Therefore, attempts to summarise such a disparate market into one single figure will continue to generate debate and bewilderment. However, the fact that the country is absorbing a surge of additional supply (mainly from the south-east) and regulators are tightening from the credit side, it is reasonable to expect price growth to slow if not decline in aggregate.

Measures to address housing affordability ought to come from both sides of the supply and demand equation, and include a co-ordinated effort from all levels of government. All this, likely means a long and slow process in achieving meaningful change!

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Interest Rates	30-Apr-17	31-Mar-17	%	30-Apr-16	%	30-Apr-14	%
Cash Rate	1.50	1.50	0.0%	2.00	-25.0%	2.50	-40.0%
Rate Change (%)	-2%	-0.01	100.0%	-57%	-96.5%	-1%	100.0%
90 Day Bills	1.75	1.80	-2.8%	2.15	-18.8%	2.68	-34.8%
3 Year Swap	2.02	2.07	-2.5%	2.06	-1.7%	3.09	-34.6%
5 Year Swap	2.45	2.52	-2.9%	2.33	4.9%	3.57	-31.5%
3 Year Govt	1.80	1.91	-5.4%	1.86	-2.9%	2.90	-37.9%
10 Year Govt	2.58	2.70	-4.5%	2.52	2.5%	3.95	-34.7%
US 2 Year Bond	1.26	1.25	0.6%	0.78	61.5%	0.41	207.5%
US 10 Year Bond	2.28	2.39	-4.5%	1.83	24.4%	2.65	-13.8%
Commodities	30-Apr-17	31-Mar-17	%	30-Apr-16	%	30-Apr-14	%
RBA Commodities Index	133	136	-2.1%	98	36.1%	129	3.1%
Beef (MLA - EYCI)	6.59	6.50	1.5%	5.46	20.8%	3.55	85.7%
Sugar	16.0	16.8	-4.3%	16.2	-0.7%	17.2	-7.0%
Cotton	80	77	3.8%	64	25.8%	94	-14.8%
Wheat	414	421	-1.5%	465	-11.0%	810	-48.9%
NSW Wheat	228	226	0.8%	261	-12.5%	330	-30.8%
Iron Ore	69	80	-14.4%	66	3.9%	106	-35.0%
Coal (Newcastle)	83.6	80.8	3.5%	51	64.6%	73	13.9%
Natural Gas (US)	3.3	3.3	0.7%	2.9	12.8%	4.3	-24.0%
Gold	1,267	1,249	1.4%	1,294	-2.0%	1,292	-1.9%
Brent Oil	51.7	52.8	-2.1%	48.1	7.5%	108.1	-52.1%
Copper	259	265	-2.5%	228	13.5%	303	-14.6%
Nickel	9,406	9,979	-5.7%	9,417	-0.1%	18,314	-48.6%
Currencies	30-Apr-17	31-Mar-17	%	30-Apr-16	%	30-Apr-14	%
TWI	64.5	66.2	-2.6%	63.8	1.1%	71.4	-9.7%
AUD/USD	0.7483	0.7629	-1.9%	0.7603	-1.6%	0.9287	-19.4%
AUD/NZD	1.0892	1.089	0.0%	1.09	-0.1%	1.0776	1.1%
AUD/EUR	0.6865	0.7160	-4.1%	0.664	3.4%	0.6697	2.5%
AUD/GBP	0.5776	0.6079	-5.0%	0.52027	11.0%	0.55051	4.9%
AUD/JPY	83.46	84.98	-1.8%	80.97	3.1%	94.95	-12.1%
EUR/USD	1.09	1.07	2.2%	1.15	-4.9%	1.39	-21.5%
Equities	30-Apr-17	31-Mar-17	%	30-Apr-16	%	30-Apr-14	%
MSCI World Index	1,878	1,854	1.3%	1,671	12.4%	1,688	11.3%
S&P 500	2,384	2,363	0.9%	2,065	15.4%	1,884	26.6%
VIX	11	12	-12.5%	16	-31.1%	13	-19.3%
STOXX600	387	381	1.6%	341	13.4%	338	14.6%
FTSE100	7,204	7,323	-1.6%	6,242	15.4%	6,780	6.3%
Asia APEX50	1,079	1,048	3.0%	856	26.0%	913	18.2%
Shanghai	3,155	3,223	-2.1%	2,938	7.4%	2,026	55.7%
ASX200	5,924	5,865	1.0%	5,252	12.8%	5,489	7.9%

*“The rate of home building has now responded and we are currently adding to the housing stock at a rate not seen for more than two decades.”*

~ Phil Lowe (RBA)

*“A man travels the world over in search of what he needs and returns home to find it.”*

~ George A. Moore

*“Disrupting negative gearing would not come without a cost, especially to renters, let alone the wider impacts.”*

~ Scott Morrison