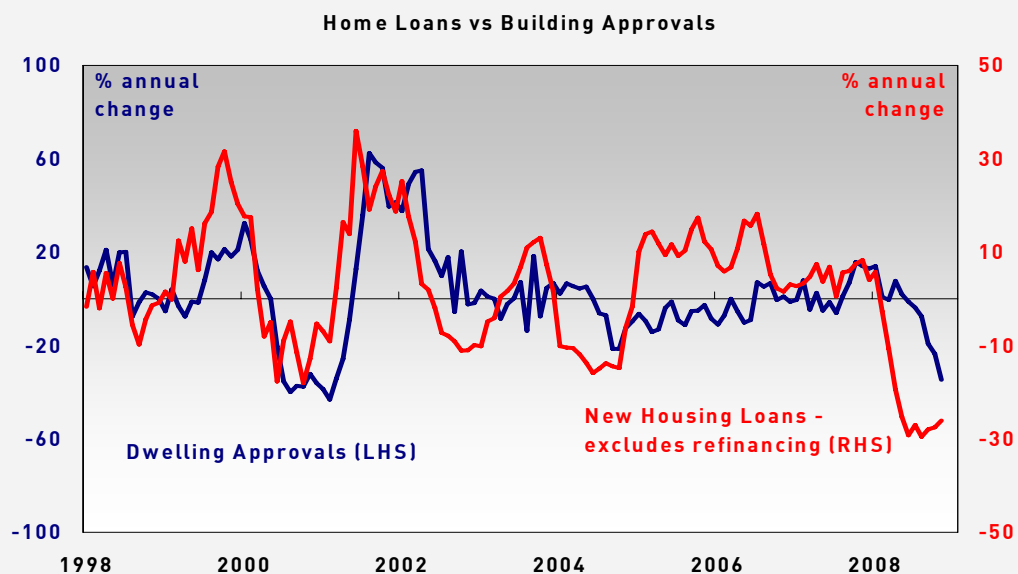


PROPERTY OUTLOOK

Wednesday, 21st January 2009

Summary:

- Finance for new homes and building approvals have been weak amid an economic slowdown. But there are signs that lending is picking up.
- The strong fundamentals of high population growth, limited housing stock and low rental vacancies are helping to support the housing sector. These fundamentals mean we are (cautiously) optimistic on the outlook for housing over the medium term.
- We expect that the Reserve Bank will cut interest rates further in coming months, providing more support to housing lending.



ECONOMIC CONDITIONS

The local economy has slowed considerably as a result of tighter financial conditions since the onset of the sub-prime credit crisis. Domestic demand has eased as the share market records hefty losses and the uncertainty weighs on consumer and business sentiment. The easing in domestic demand has also been felt in the property market.

HOUSING FINANCE

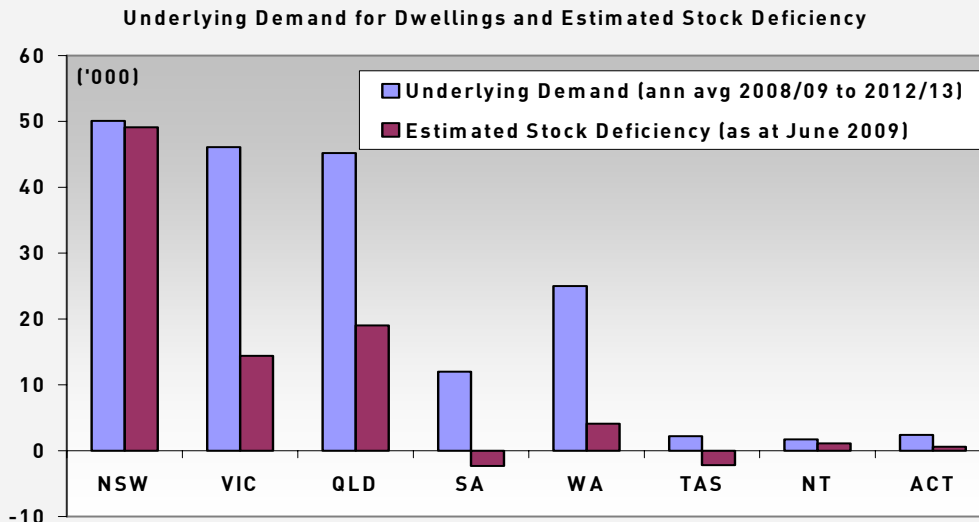
The credit environment has contributed to a cutback in the number of people seeking housing loans over the year. The number of home loans to owner-occupiers in Australia fell for eight consecutive months before recording an increase in October and November 2008. However, the annual rate shows that home loans to owner-occupiers are down by 24.9%. Meanwhile, the value of housing finance to investors fell by 27.3% over the same time period. This weakness in both investor and owner housing points to a property market where sales volumes are weak. On a positive note, the proportion of first-home buyers seeking housing finance rose to 23.6% in November 2008, from 19.5% in the previous month. This is a solid improvement compared to the average of 16.9% for the last five years.

BUILDING APPROVALS

The demand for building new homes has been weak as high interest rates and high development costs discouraged people from building. Building approvals have trended lower and are down 34.7% from the most recent peak recorded in November 2007. It takes the number of approvals to the lowest level since February 2001. The recent lower interest rate environment and the increase in the first-home owners grant are yet to show up in approvals.

POPULATION GROWTH

The softness in dwelling approvals is occurring at the same time as a spike in Australia's population. A high overseas migration intake (lifted even further in the Federal budget in 2008) and a rise in the natural increase has led to a solid rate of growth at 1.7% pa in the June quarter 2008 - the highest rate since 1989.



Source: BIS Shrapnel

HOUSING STOCK

The combination of high population growth and a low level of building have resulted in a nationwide shortage of dwellings. An undersupply of housing stock is essentially a major issue in the Australian property market – quite the opposite to the situation in the United States where there is an oversupply of houses. The chart above shows the annual underlying demand for dwellings (the annual average over 2008/09-2012/13) and the estimated stock deficiency as at June 2009. The total number of deficiencies in Australia is estimated to be 55,100 in 2008 and is forecast to grow to 83,700 this year and 103,900 in 2010. The States expected to record the largest deficiencies of housing stock in 2009 are New South Wales, Queensland and Victoria. Some of the major obstacles to new housing are increased development land costs, higher construction costs and high taxes.

THE RENTAL MARKET

The shortage in dwellings has pulled down the rental vacancy rates across all of the States and was as low as 1.2% in Sydney and 1.1% in Melbourne during the September 2008 quarter. This has led to large increases in rents, with the median weekly rent in Sydney rising by 17.8% for a 3-bedroom home and by 14.7% for a 2-bedroom apartment, over the year to September 2008, respectively. There will be a continued upward pressure on rent for dwellings as there is no quick bandaid solution for the shortage on dwellings.

HOUSING AFFORDABILITY

The lack of supply in housing is a factor that is keeping house prices afloat and raising the issue of housing affordability. In order to combat affordability, the Federal Government announced a boost to encourage first-home buyers to enter the property market. One such measure is the additional boost of \$7,000 for existing dwellings and an additional \$14,000 for new dwellings until June 30, 2009. The first-home owner's grant now totals \$14,000 for buyers of existing dwellings and \$21,000 for buyers of new dwellings. These incentives are likely to encourage more buyers at the lower end of the market. Nonetheless, there is the risk the end of the grant may be accompanied by a slump in prices.

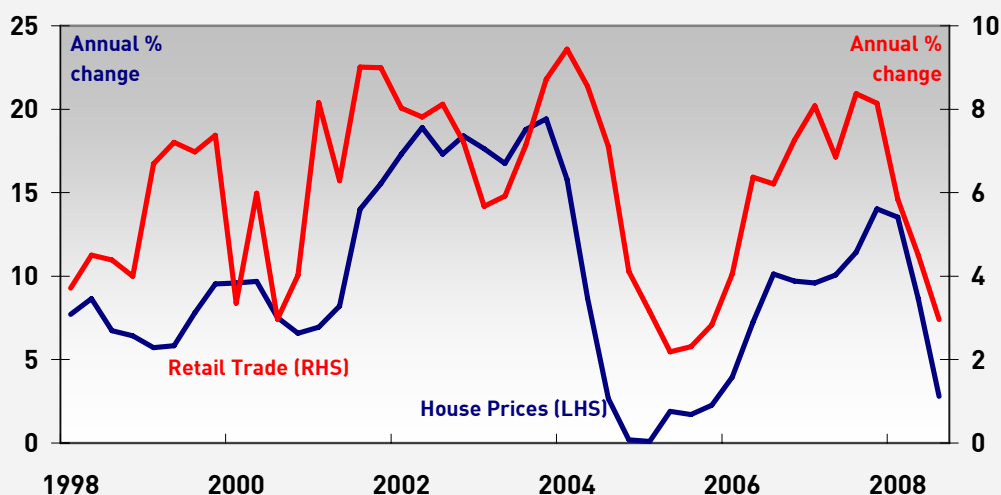
In terms, of rental affordability, the Federal Government has introduced the National Rental Affordability Scheme, which will stimulate the supply of up to 50,000 new affordable rental

dwellings.

RESIDENTIAL PROPERTY PRICES

National house prices have begun to flatten out with the latest figures from the Australian Bureau of Statistics showing that the weighted average house price for established houses fell by 1.8% in the September quarter. Over the year, the average house price is still holding in positive territory at 2.8%, due to the rapid growth in house prices in 2007. House prices will be under pressure in the short-term as investors oversee a decline in wealth as a result of losses in the share market. Further, the economic slowdown and global credit crisis will make households cautious in making discretionary and/or large spending outlays. However, high population growth, high immigration, limited housing stock and large increases in rental returns will encourage investors and first-home buyers to enter the market in the medium term. As such, with these strong fundamentals we are cautiously optimistic on the housing market over the medium term. Over this time, we need to see a pick up in the demand for housing among first-home buyers filter through to upgrader demand to ensure a broader housing recovery.

House Prices vs Retail Trade



NON-RESIDENTIAL PROPERTY

The non-residential property sector will not emerge unscathed from the dire state that the world economy is currently undergoing. Indeed, building approvals began to scale back in late 2008 with the moving annual total of the value of buildings falling by 5.0% in October 2008 and by 4.1% in November 2008. Office approvals have been hit by the financial crisis, particularly in NSW, where there is a high concentration of financial services employment. Hotels and other business premises had a fall in approvals as a result of funding issues and subdued demand. Meanwhile, approvals for retail, factories and education trended higher. Looking ahead, there is likely to be some softness in this sector due to falling domestic demand and rising unemployment. However, just as the residential property sector, supply continues to fall short of underlying demand and this will provide a floor for non-residential property.

INTEREST RATES

The RBA has acted swiftly to signs of an easing economy and has cut interest rates by 300bp (to 4.25%) since September last year. We expect a further aggressive cut in February when the RBA next meets. Thereafter, further easing is likely, with the extent of rate cuts dependant on the degree of weakness in the incoming dataflow. Our estimates are that the cash rate will reach a low point of 2.25% before the end of the year. The consensus among economists is mixed; a recent survey of 16 economists shows that two economists expect the low point to be 2.50%, two expect it at 2.75%, while four sit with 3%, three at 3.25%, and five at 3.50%.

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