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Recession Avoided – Implications for Commercial Property

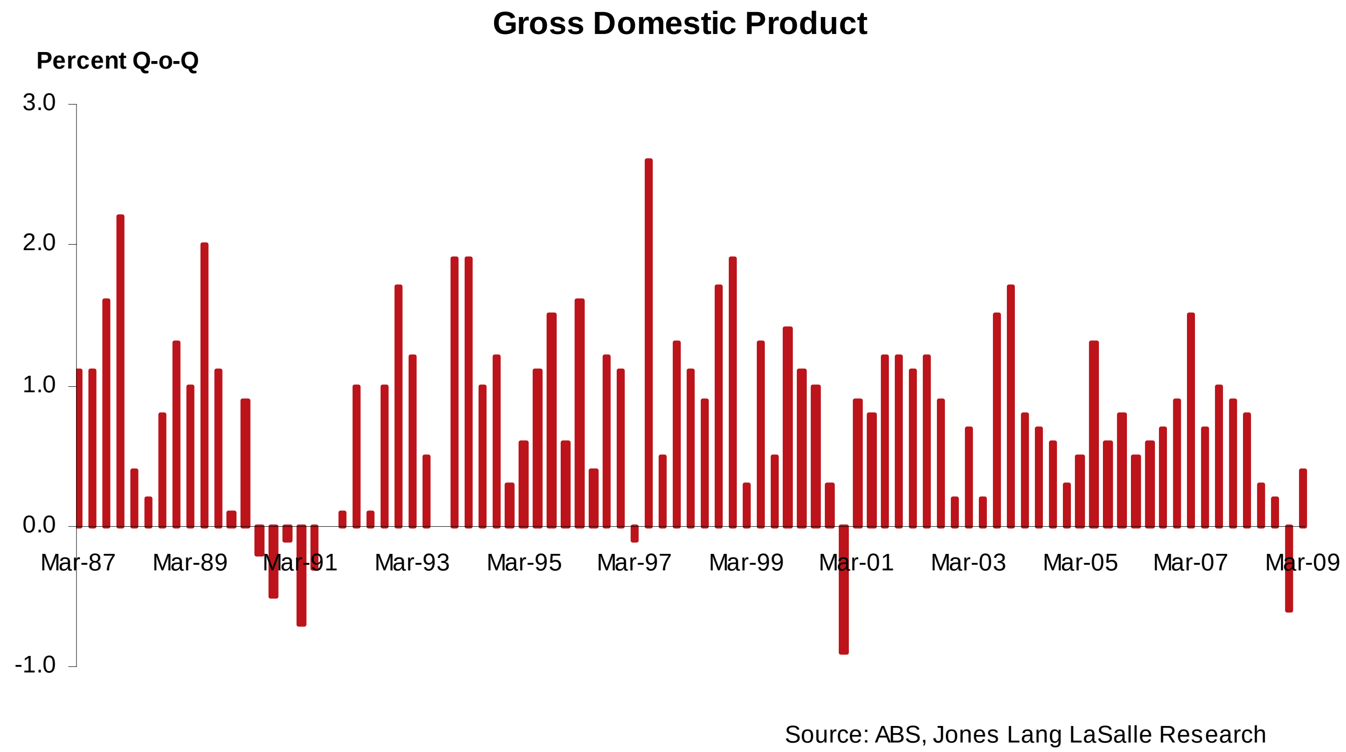

Figure 1

What happened?

The Australian economy grew by 0.4% in the March 2009 quarter to avoid a technical recession, conventionally defined as two successive quarters of negative economic growth.

Key drivers of the positive growth performance in the March quarter were a sharp fall in imports, growth in the volume of exports and continued strength in consumer spending. Weak private investment spending (-6.3%) and further falls in inventories weighed on the negative side of the ledger, but not by enough to overwhelm the positives.

On a state-by-state basis, South Australia was the strongest performer, posting a 2.0% rise in domestic final demand in the March 2009 quarter, followed by New South Wales (-0.2). ACT was flat while Victoria (-2.1%), Queensland (-3.1%) and Western Australia (-2.3%) all contracted sharply. Note that the domestic final demand statistic excludes the foreign trade sector, which is a big positive for states such as Queensland and Victoria.

Consumer spending grew in real terms by 0.8% and by 1.5% in current dollars in the March quarter. As expected, consumer spending growth was particularly strong in the so-called non-discretionary categories; food (1.1%), clothing (1.8%) and alcoholic beverages (0.7%). Spending on cars, household furnishing and equipment declined in real terms. The household saving ratio declined after a spike in December 2008, but remains positive.

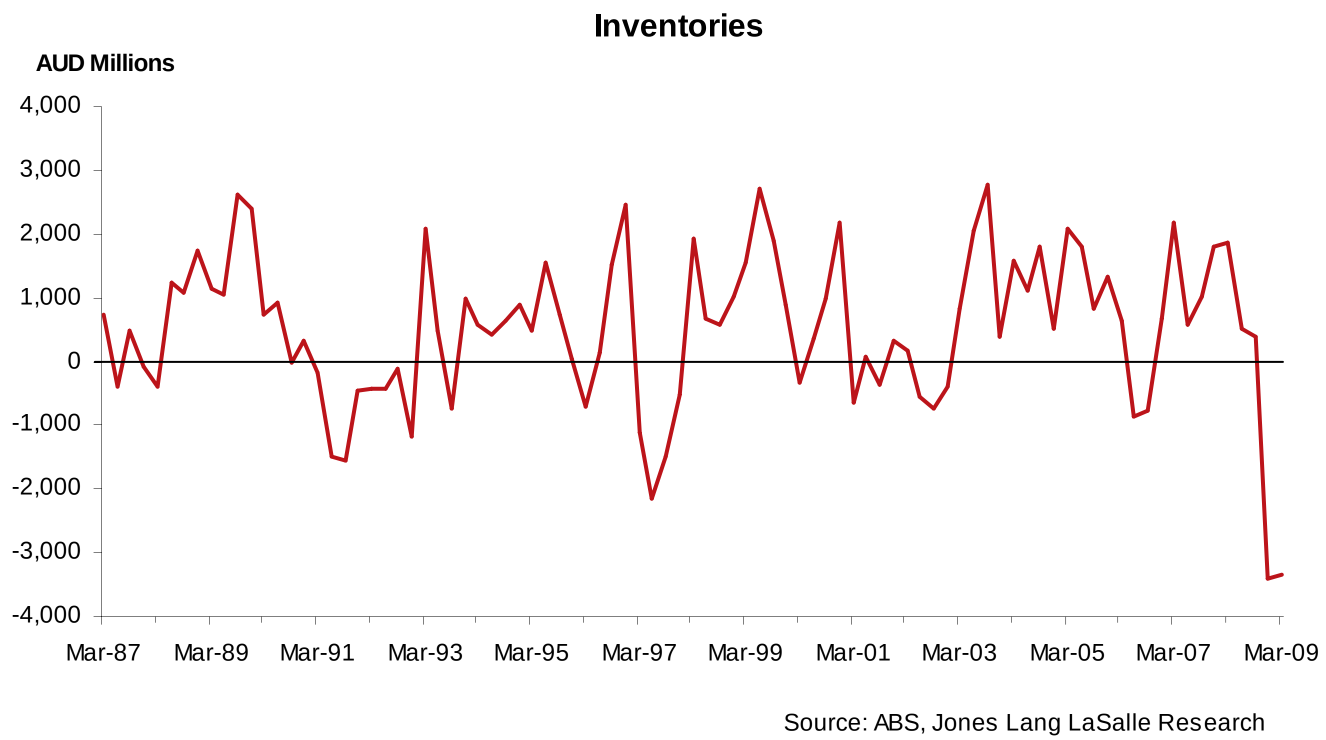

Figure 2

Implications

While the overall picture for the economy is positive, many of the *specific commercial property market drivers are relatively weak* in today's National Accounts. Property is inevitably heavily influenced by the performance of the domestic economy. As a measure of purely domestic activity, real net national disposable income (RNNDI) contracted by 1.7% in the March 2009 quarter. Gross national expenditure (GNE), also a measure of domestic economic performance, contracted by 1.0%.

The commercial property sector can therefore look forward to a few more challenging quarters until growth momentum is firmly re-established.

Industrial sector: The volume of imports fell by 7.0% and inventories continued to shrink, both negative factors for the industrial property sector. There is a reasonably consistent relationship between industrial rents in Sydney and Melbourne and the volume of container traffic through the ports. Despite the fall in inventories, the stock-to-sales ratio, perversely, rose in the March quarter, but this was because sales fell even more sharply than inventories.

The manufacturing sector, taken as a whole, recorded a 3.3% contraction in the March 2009 quarter. The various manufacturing sub-sectors shrank by 3% to 4% across the board with the exception of food, beverage and tobacco manufacturing (+0.3%). The transport and storage sub-sector recorded -1.5% (all numbers in constant dollar terms).

Of course, embedded in the inventory decline of the past six months is the inevitable prospect that at some point stocks will need to be replenished. Given the low stock-to-sales ratio that industry currently employs, the turnaround may be quite dramatic, when it occurs. And this week the AIG Performance of Manufacturing index recorded an upturn in May, albeit from a low level.

Retail sector: Continued growth in consumer spending is a positive for retail shopping centres. The unanswered question is how robust retail turnover will be over the remained of 2009 as unemployment rises, the impact of the first home owners' grant dissipates and the impact of the various fiscal stimulus measures diminishes. As the Reserve Bank noted following its 2 June policy meeting: *scope remains for some further easing of monetary policy, if needed*.

Office sector: The news here is mixed. Property and business services recorded a 2.8% decline in output, following a 2.2% decline in the December 2008 quarter. However finance and insurance managed a 0.2% gain. Other users of office space, such as government administration, education, and health and community services, showed modest positive growth. Aside from the National Accounts, other indicators, such as a surge in the sharemarket since early May, probably provide a more relevant and timely indicator that confidence is returning to financial markets and the associated services sectors.

Overall: Clearly the positive headline GDP growth figure will boost confidence. Offshore investors will take note of the quite exceptional performance of the Australian economy, which marks it out as a global out-performer. Within the Asia-Pacific region only South Korea, which posted positive growth of 0.2% in the March 2009 quarter, stands comparison.

The latest National Accounts also challenge some of the more negative commentary on the domestic economy emanating from many quarters. Forecasts of an inevitable recession for the Australian economy, that have been in the public arena since January 2009 or even earlier, were simply wrong – unless you redefine a recession as something like: rising unemployment; or, a contraction in non-farm GDP.

The decline in non-farm GDP in both the September 2008 and December 2008 quarters has been used as evidence that Australia was already in recession, so it's worth noting that non-farm GDP rose by 0.5% in the March 2009 quarter. The proposition that: "it may technically not be a recession but it feels like one" is evidently not shared by Australian households who spent $7.5 billion more on consumer items in the March 2009 quarter than they did in the March 2008 quarter.

Nevertheless, in the March 2009 quarter, as in the two preceding quarters, it has been a series of countervailing trends that have produced a succession of small positive or small negative headline GDP growth numbers. The headline GDP growth statistic, 0.4%, is an average of three alternative measures of GDP growth. In the March quarter the expenditure method (GDP(E)) produced +1.1%, The income measure (GDP(I)) was +0.9%. The production measure (GDP(P)) was -0.9%. In general, the outcome is too close for comfort.

Following today's numbers the Reserve Bank and the Treasury are likely to be revising their growth forecasts upwards. Property sector investors, financiers and owners are likely to reassess and do the same. The prospects of a property market downturn in 2009 to rival the cycle of the early 1990s are disappearing fast.

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