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IN THIS WEEK'S ISSUE

FROM THE EDITOR

The focus the last fortnight has been on the spectacular performance of the stock exchange and the fact that property prices are increasing – especially in the previously battered top end. Economists are no longer using the R word – it's now a downturn. The debate has moved onto when we will emerge from the downturn and whether the current good news is a precipitator to another decline (or what economists are calling a 'W' recovery).

Property is a strong theme in this edition of MBN Business News. The RBA governor has warned of a property bubble fuelled by declining supply. Prices are increasing but experts warn investors to exercise caution and buy smart.

Retailers are still cautioning against premature declarations that the economy is now on a growth part.

The government has stepped up its rhetoric and warned Australians to "tighten our belts". New words emerging from the Rudd government this last fortnight are: "increased economic pain", "unpopular budget cuts", "additional financial pressure on many families" and "sacrifice".

For many people this is all too confusing – are we on the path to recovery or not? The reality is that whilst there are many good signs, there are equally bad signs and its still too early to call.

Quote of the week:

"It is becoming more common for Australians to see the glass as half full than as half empty." Reserve Bank of Australia governor, Glenn Stevens.

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AUSTRALIAN ECONOMY

Risks to economy are receding but interest rate increases likely

Key points:

- RBA governor upbeat
- Government, however, still sticking to its view that the economy will contract this year
- Governor concerned about surge in house prices due to lack of supply
- Expectations that interest rates will rise
- Global environment improving

Reserve Bank of Australia governor Glenn Stevens has given his most positive assessment of the economy in nearly a year, as he cautioned about the risk of a housing bubble driven by low interest rates. Mr Stevens suggested the risks to growth were becoming more balanced. "We cannot claim Australia has avoided any downturn at all," he said. "It appears at this stage, however, that the downturn we are having may turn out not to be one of the more serious ones of the post-war era. We can much more easily imagine upside risks to the outlook, to balance out the downside ones, than was the case 6 months ago."

In remarks set to fuel the debate about the scale of the stimulus given to the economy, Mr Stevens warned about an unsustainable surge in house prices stemming from cheaper loans and lower purchase prices.

His comments stroked market speculation that interest rates could soon begin to rise.

Adrian Rollins, *The Australian Financial Review* – 29 July

(Editor: In the past the RBA has avoided increasing interest rates whilst unemployment rates have been high – in fact history shows that interest rates have been low whilst unemployment has been high. In a clear break from this policy, Mr Stevens said: "I've never seen written down or heard a discussion [at the RBA] some rule of thumb that says we wait till unemployment's peaked before we lift the cash rate.").

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Retailers still cautious

Myer chief executive Bernie Brookes says the retail giant is bracing for an "average Christmas" as consumers grapple with job insecurity and curb discretionary spending. "Consumer confidence is not good. People are still frightened about their job prospects and are staying at home more," he told a business forum.

"July and August performance – without the government's economic stimulus – will be traditionally very important months for Myer. We had a good July, but not as good as June. If we are ahead in August, then we are OK."

John Gillam, head of Bunnings said he was 'cautiously optimistic about the positive trading conditions over the next 6 months, but there could be some adverse headwinds."

Teresa Ooi, *The Weekend Australian* – 1 -2 August

Wesfarmers chief Richard Goyder says he expects "there's still a few potential bumps in the road" for the Australian economy despite a lift in positive sentiment. The head of the retail group, which owns Coles, Target, Kmart, Officeworks and Bunnings, said he was pleased confidence was coming back, but conditions in an early state of recover were "fragile". "I think….as a manager of businesses you have to be prudent at the moment, not just assume that the world is all of a sudden a much better place, while still looking for opportunities because they are there and they've coming."

Rachel Hewitt, *The Courier Mail* – 29 July

(Editor: Many retailers are concerned about the next quarter. Many are suggesting that sales will decline as the impact of the government's handouts fade.).

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Home approvals bounce back and impact on house prices

Top points:

- Residential building approvals rebound following months of decline
- The 11,086 approvals in June are still below long term average of 13,000 per month
- Economists of the opinion increase largely due to first home buyers
- Shortage of supply driving up house prices in an environment in which risks in the labour market and the general economy are still prevalent.

Residential building approvals rebounded strongly last month, underpinned by a surge in the number of apartments and units getting the go-ahead. The 9.3% rise in building approvals in June came on the back of a powerful 27.7% jump in 'other' dwellings receiving the green light, after approvals slumped to their lowest level in more than two decades in the previous month.

Economists are of the opinion that first-home buyers are still a major influencing factor in driving volumes. Economists are also of the opinion that the lack of growth in housing, despite the low interest rates prevailing, is one of the key reasons that house prices are still holding up. ANZ Bank economist Alex Joiner said: "This imbalance of supply and demand has helped to support house prices in an environment where they were expected by many to fall sharply. But now (house) prices are rising in an environment where risks to household incomes, the labour market and the broader economy are still prevalent, and this is of concern to the RBA."

Adapted from: John Kehoe, *The Australian Financial Review* – 31 July

(Editor: Apartments and units are usually volatile or 'lumpy' as they are approved in large slabs.).

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Backyards blitzed as Qld faces inflow

Key points:

- 754,000 new homes needed by 2031
- Suburbs with good public transport hubs earmarked for greater residential densities
- Population of 4.4m predicted in next 20 years

The Bligh government will struggle to meet the demand for another 754,000 dwellings in south-east Qld over the next 20 years as land and building costs continue to rise in the fast-growing region, property and industry groups say.

The region's population is expected to increase by 1.6 million people over the next 20 years, and the Bligh government is hoping to increase housing density targets by 10% to 50% to curb urban sprawl between Brisbane, the Gold and Sunshine Coasts and west to Ipswich.

Ludlow & Singer, *The Australian Financial Review* – 29 July

The Queensland government is proposing 'infill' developments in established suburbs and around rail and bus corridors to meet the demand as opposed to the traditional fix of establishing new housing estates on the city outskirts. Suburbs such as Indooroopilly, Carindale, Cleveland and Chermside, as well as coastal centres such as Maroochydore and Southport are scheduled for increased residential densities of up to 120 dwellings per hectare.

Craig Johnstone, *The Courier Mail* – 29 July

(Editor: Housing shaping up to be a good investment.).

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PERSONAL FINANCE

Sharemarket run the best in 20 years

The Australian sharemarket powered to 1.3% higher on Friday to finish the best 5 year run in 20 years. The market has been buoyed by good news emerging in Australia and globally. Global stock markets have rebounded sharply on the news that there is growing confidence that a global economic recovery is taking hold, buoyed by government stimulus packages.

AMP Capital Investors chief economist Shane Oliver said there was plenty of upside for the Australian stockmarket, and tipped it could reach 5000 points by the end of the year. (Editor: Currently at 4244 points). He did caution however that "…it's possible that shares are getting ahead of themselves in the short term and maybe due for a pause." He indicated that there was still plenty of 'upside' from here.

Some economists are predicting a correction of between 10 – 30%.

Daniel Morrissey, *The Weekend Australian* – 1 -2 August

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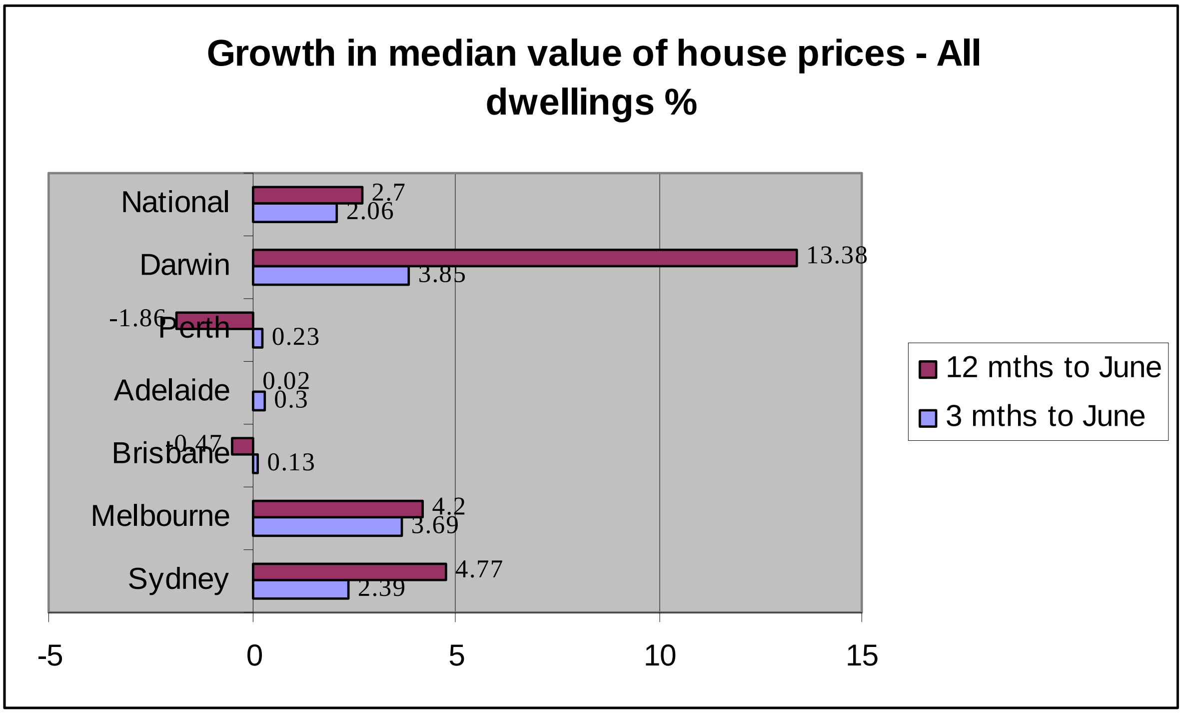
Home prices rebuild confidence

Key points:

- Residential property has regained its losses from the end of 2008
- Sales volumes are increasing as more buyers enter the market

Australian house prices have risen in all market sectors in the first half of the year, led by the top end of the market, but the increase has started to moderate, according to new housing data. An RP Data Rismark National Home Value Index is showing the residential property has regained the losses it experienced at the end of 2008.



RP Data national research director Tim Lawless said residential property had experienced good news since January, but the month to month figures show growth slowed in June.

Rismark International managing director Christopher Joyce dismissed suggestions of a housing bubble and, although a recovery had been confirmed, said it was premature to assume higher growth rates would continue. "The housing industry will face challenges in the second half of the year as the first home owner's boost is withdrawn and fixed mortgage rates trend up," he said.

Michelle Singer, *The Australian Financial Review* – 31 July

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EMPLOYMENT

Downturn will not tie down unhappy employees

Employers should not grow smug or complacent in the face of the deteriorating job market, according to recruitment experts. They say employees are still restless despite the downturn and many expect to leave their current job as soon as the economy picks up.

An international survey by Manpower revealed that whilst 75 of the Australian workers interviewed said they were satisfied with their current jobs, a third were nonetheless planning to leave.

Jacqueline Maley, *The Australian Financial Review* – 30 July

(Editor: Prospective employees are also taking note of the actions of employers during the downturn and will factor this in recruitment decisions.).

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SPECIAL FEATURE

So…will we get a V, a W, a U, or an L shaped recovery?

Editor: Economists are debating what form the Australian recovery will take. There are a number of scenarios and these are explained below:

In a **V shaped recovery**, the recession is short, the economy bottoms out quickly and then responds quickly to monetary (lower interest rates) and fiscal (government spending and handouts) stimulus. The economy picks up quickly and zooms away to better times.

In a **W shaped recovery**, the stimulus initially works, the economy bounces back and all seems fine and then things slump again. This is sometimes called a "dead cat bounce" as after the initial bounce up, the economy falls flat again (sometimes back into recession) before the inevitable recovery comes.

Some argue that this will occur globally with a second wave of the global financial crisis. Others are suggesting that this could occur in Australia over the next few months because the government is running out of capacity to spend more. I would argue that this scenario is unlikely to happen as the RBA still has room to lower interest rates if our economy falters.

In a **U shaped recovery**, the stimulus doesn't work as quickly and the economy bounces along the bottom for a while. The downturn moves its way through all the excesses of the previous boom times and eventually the recovery comes, but the long period of economic downturn and negative sentiment impact on individuals, business and the property markets as they are bombarded with bad news and higher levels of unemployment for much longer.

Finally there is the **L shaped recovery**. This is bad news as the economy goes into recession and stays there for a long time while the recovery takes what seems like an eternity to take hold. The resultant level of unemployment is high and the media induced fear feeds on itself and the impact of lower confidence is felt through all levels of the economy.

Michael Yardney – July

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