



2017 Annual Conference

Thursday, 8 June 2017

The global markets impact on Australia

Thursday, 8 June 2017



QIC SLIDES FOR FRONTIER

Katrina King

8th June, 2017

GLOBAL
DIVERSIFIED
ALTERNATIVES

QIC

GLOBAL INTERACTIONS ARE IMPORTANT



The pace of Central Banks balance sheet growth is set to change, removing a key dampener on term premium

A faint, dotted world map serves as a background for the text boxes.

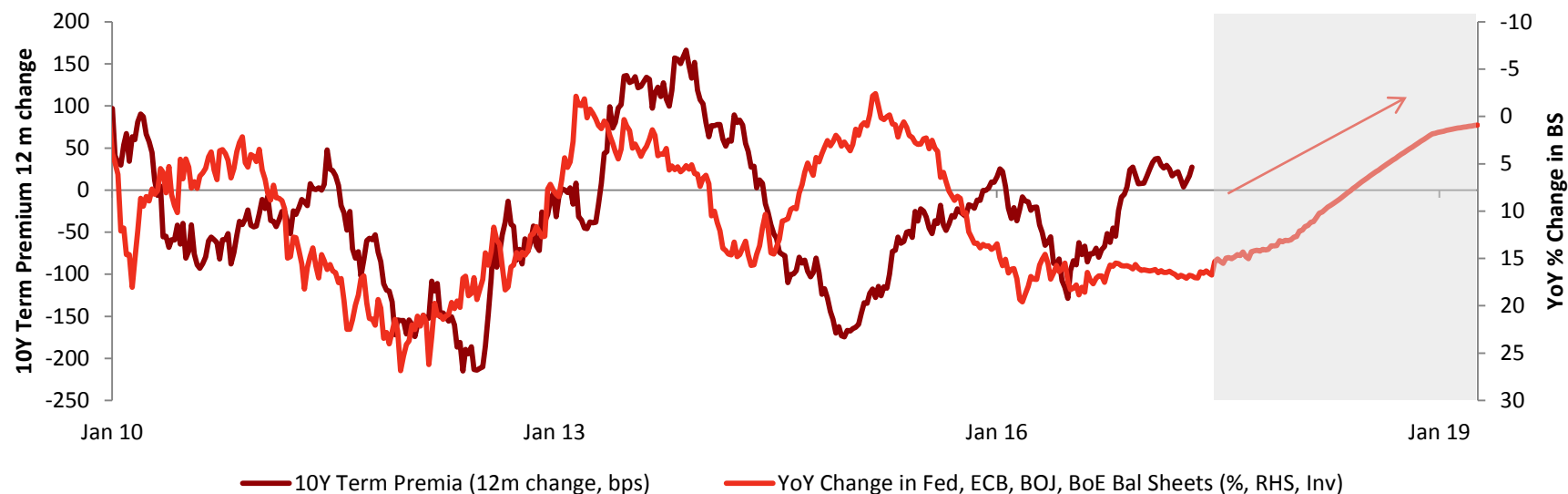
US Fed: likely to announce the roll off of balance sheet investment in Q4 2017

Bank of England: finished QE in February 2017

ECB: stepped down from €80bn to €60bn per month in March – looking at next step down in early 2018

Bank of Japan: buying below their target of Y80t per annum

CENTRAL BANK INTERVENTION



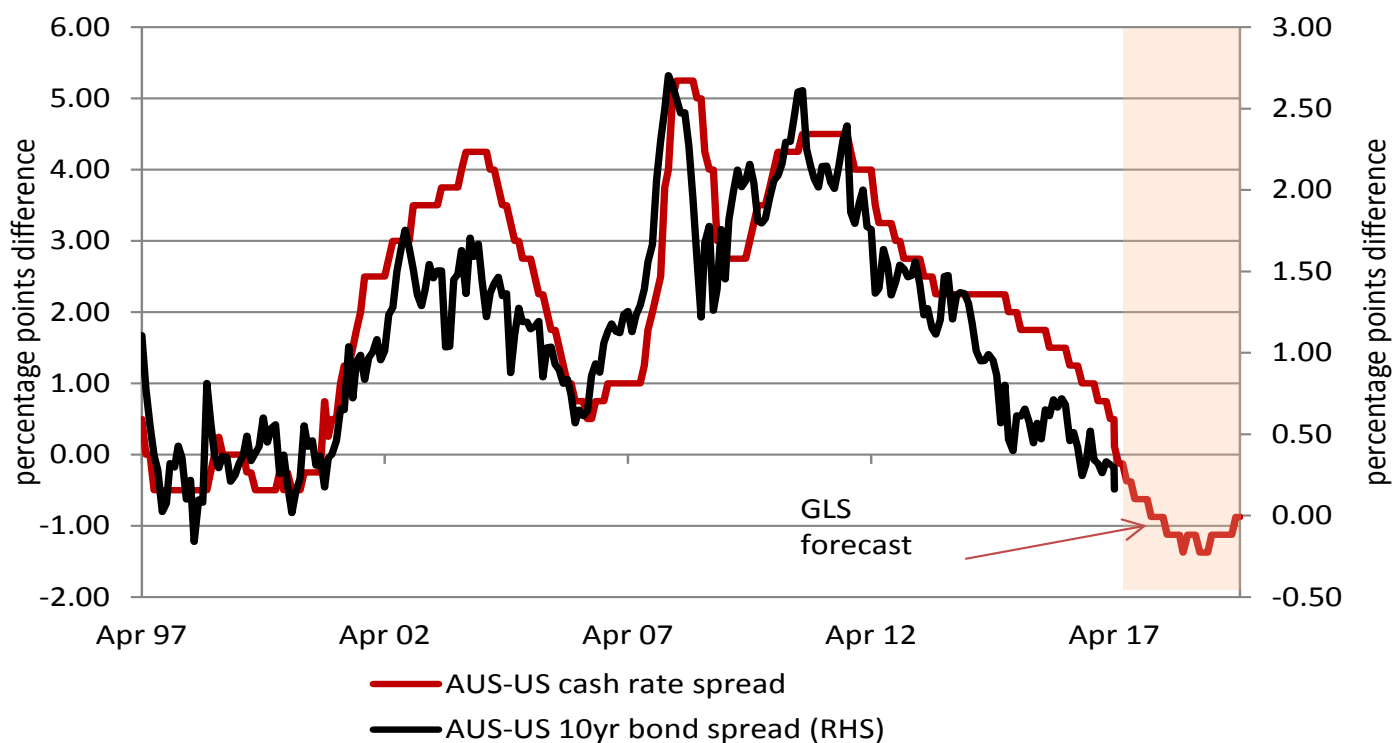
CENTRAL BANK TAPERING : QUANTITATIVE TIGHTENING

Now that bond risk premiums have normalised to some extent, we expect the sell-off in US bonds is likely to prove more gradual from here :

- A more hawkish Fed is now in prospect
- Reinvestment of balance sheet likely to taper from 2018. Shift from Quantitative Easing to Quantitative Tightening

LOOKING FOR INVERSION?

Australian bond yields to invert against US?



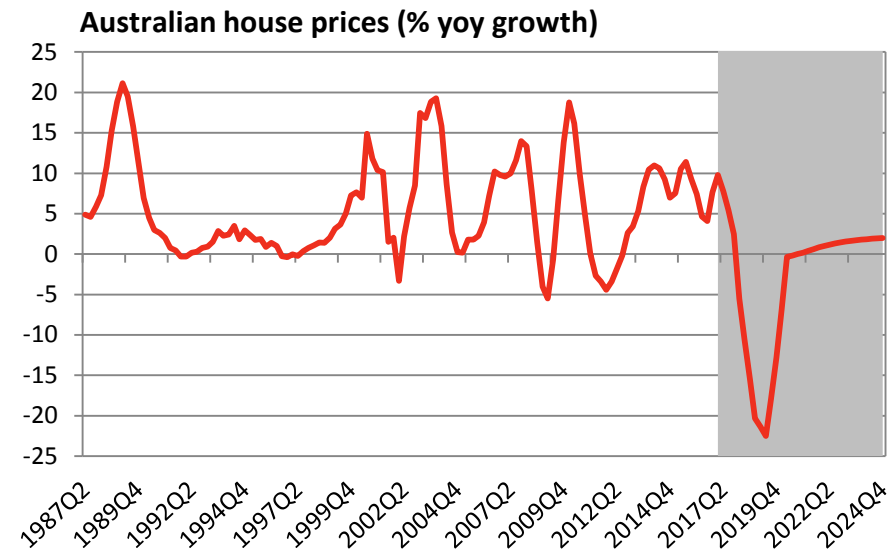
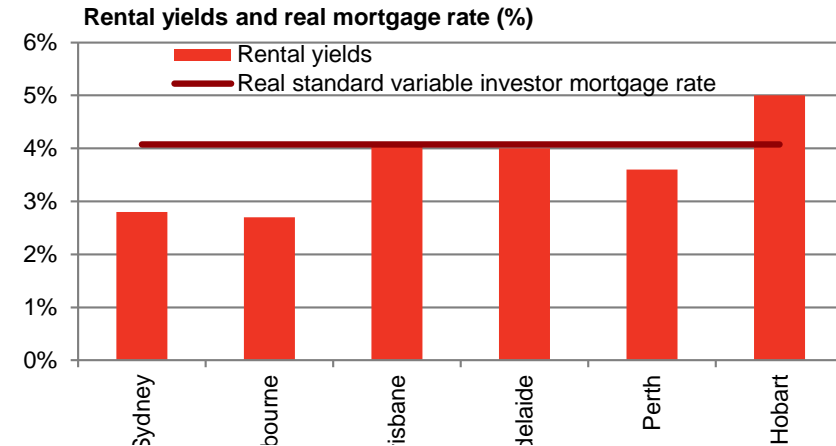
Source: QIC, Bloomberg. Forecast results are predictions only and may be affected by inaccurate assumptions and/or by known or unknown risks and uncertainties. Forecast results may differ materially from results ultimately achieved.

WHAT IF THERE IS A BIGGER HOUSING CORRECTION?



What would a severe correction in the housing market look like?

- How big a correction?
 - Rental yields on houses in Melbourne and Sydney are currently less than 3%, while real mortgage rates are around 4%
 - These yields imply that the Melbourne and Sydney housing markets are around 30% overvalued
 - Multi-res dwellings in Melbourne and Brisbane are significantly oversupplied: a 30% price correction is also touted as a possibility in these markets
 - We model a 30% correction in the prices of dwellings over two years: 2018-19 (5% quarterly increments)
 - This would be an historically unprecedented correction in Australian history (although I am assured that in Colonial times, house prices fell by around 30%)
 - Australia would lose its AAA rating
 - Banks would not emerge unscathed
 - Bank lending rates would rise by 1.25ppts across the board
 - Australian share market would take a hit
 - A-Reits and Bank stocks would fall by 20%
 - Foreigners would view Australian assets as a more risky investment: term premia would rise by 1ppt



Note: Grey shaded area is a QIC house price scenario
Source: ABS, Rp Data-Rismark, RBA, QIC

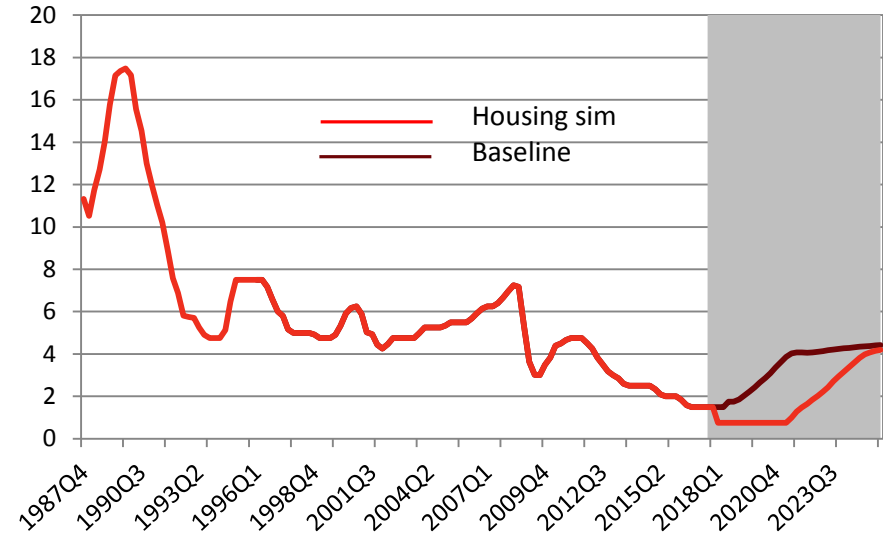
WHAT IF THERE IS A SEVERE HOUSING CORRECTION?



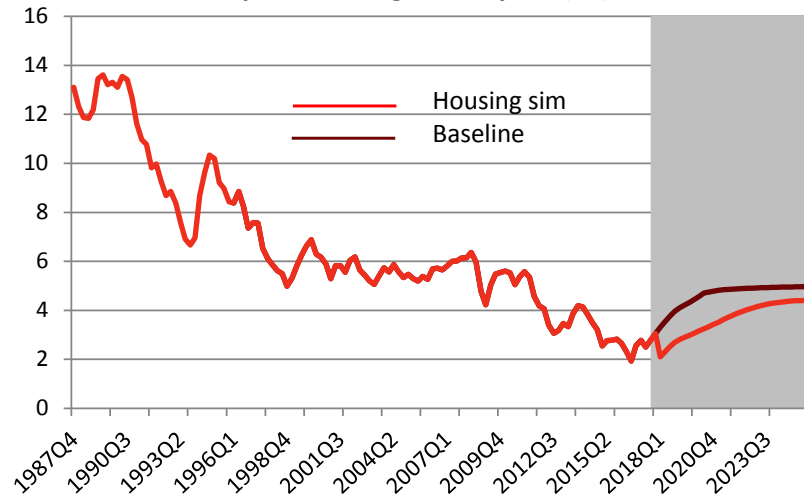
Impact on rates and FX

- Australia experiences a mild recession in quarterly growth terms in 2018/19 *cf* 1991/92
- Significant easing in financial conditions as RBA cuts rates
 - Official cash rate cut to floor of 0.75% in 2018q1 and is held at this level until 2021q2 (could be considered as a QE equivalent)
 - 10-year govt. bond yield falls by 95 bps in 2018q1
 - AUD falls to US\$0.64 in 2018q1

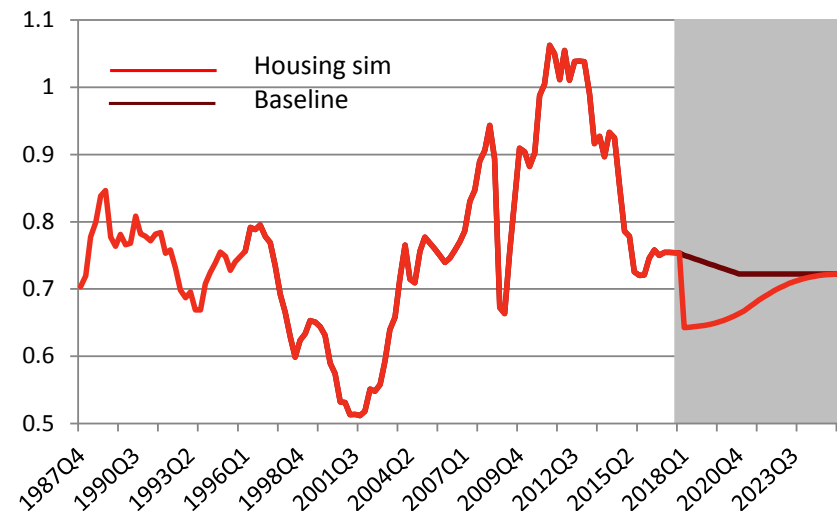
Australian official cash rate (%)



Australian 10-year sovereign bond yield (%)



AUD



Note: Grey shaded area is a QIC house price scenario

Source: Thomson Reuters, QIC

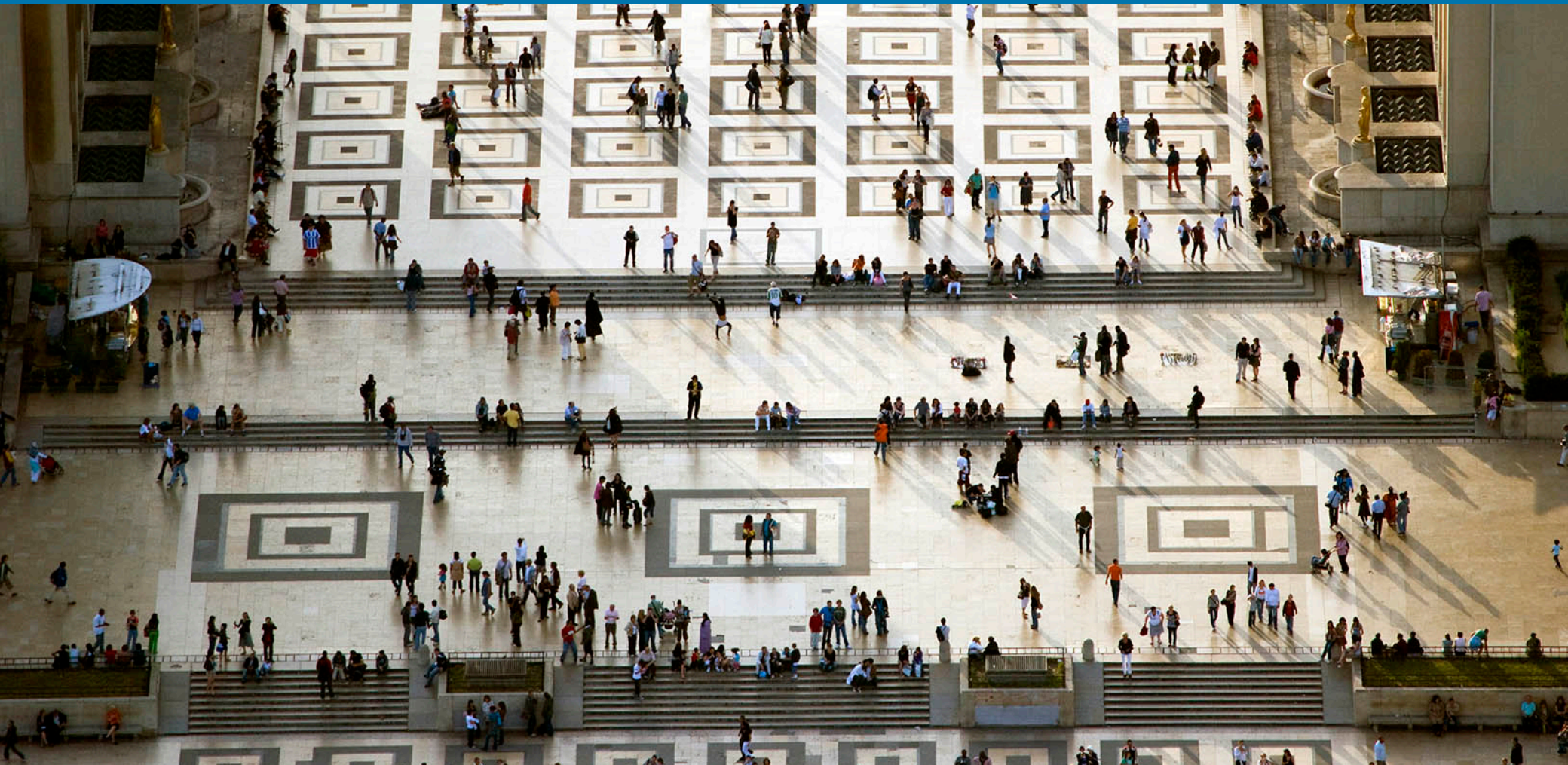
THE MACRO INVESTMENT OUTLOOK

AMPCAPITAL 

JUNE 2017

DIANA MOUSINA

ECONOMIST

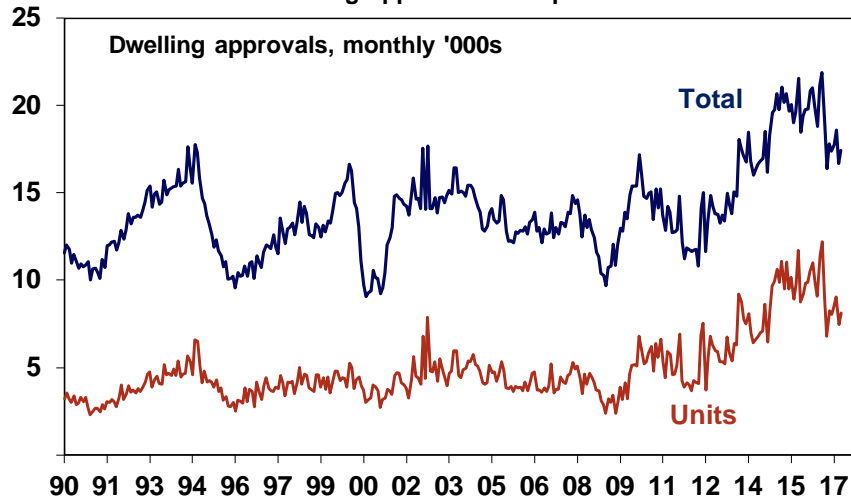


THE AUSTRALIAN ECONOMY

STILL CONSTRAINED

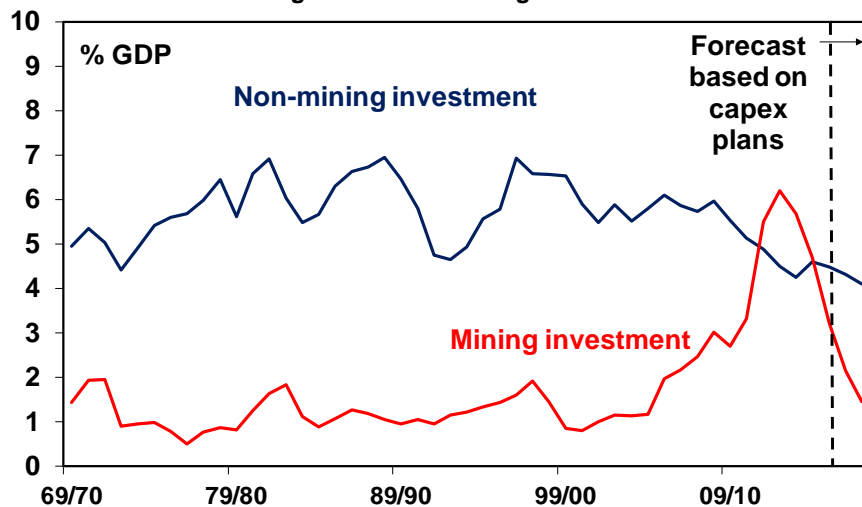
Housing investment is set to slow

Building approvals have peaked

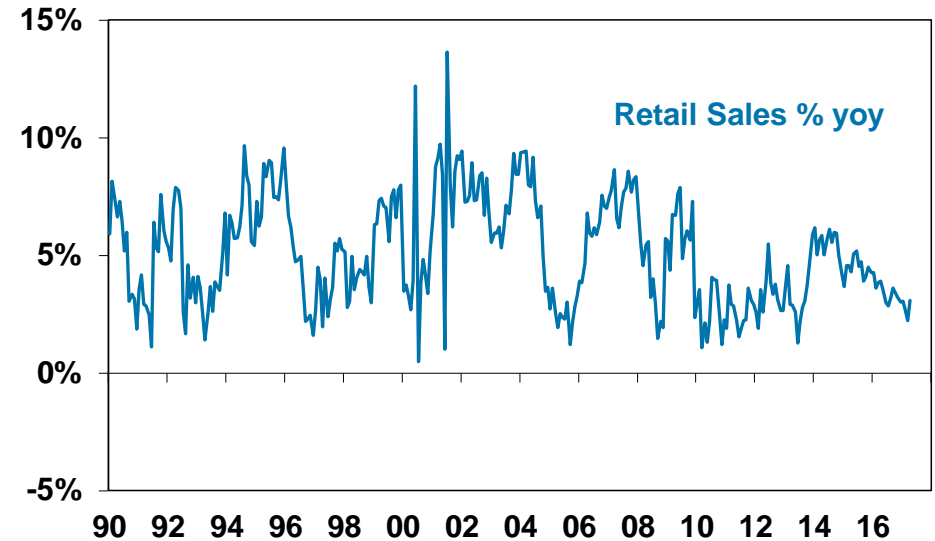


But mining investment is close to the bottom

Mining versus non-mining investment

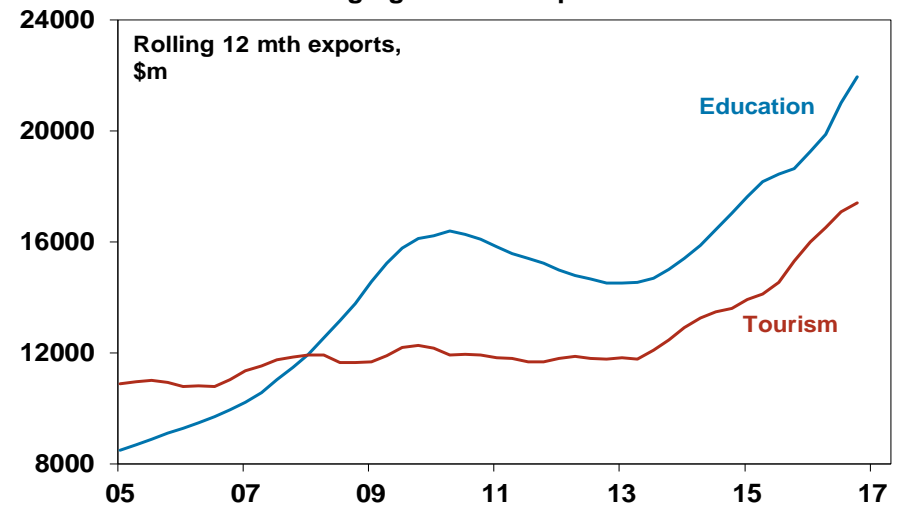


...and retail sales growth is sluggish



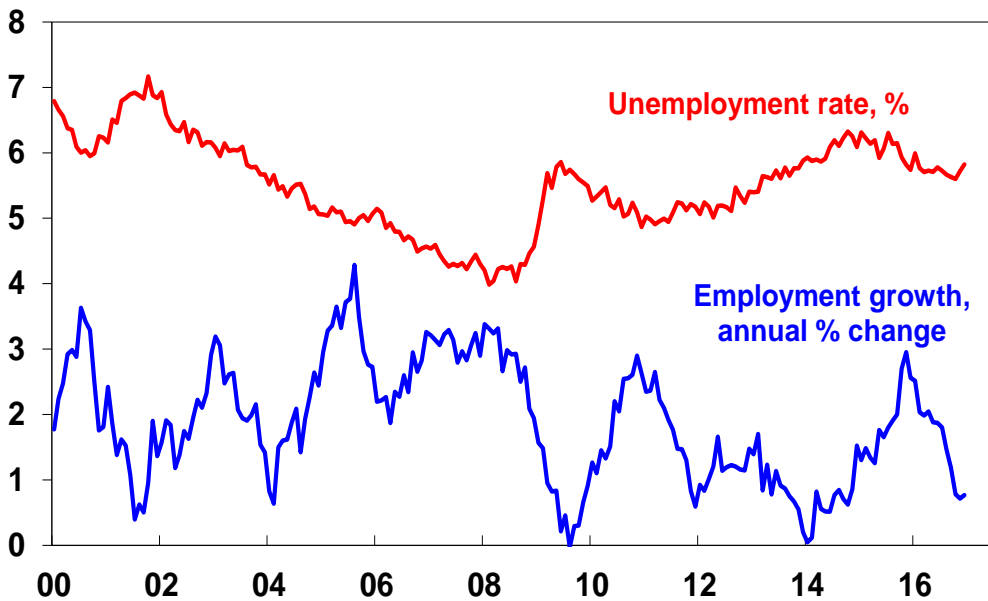
...and services exports are strong

Surging services exports

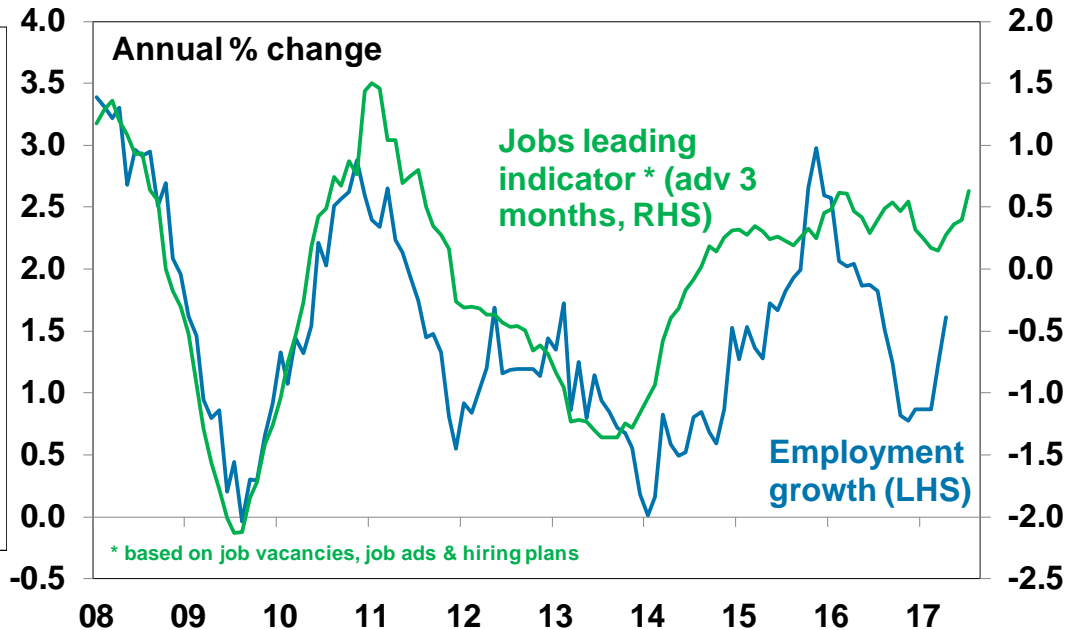


LABOUR MARKET HOLDING UP

Jobs growth versus unemployment rate

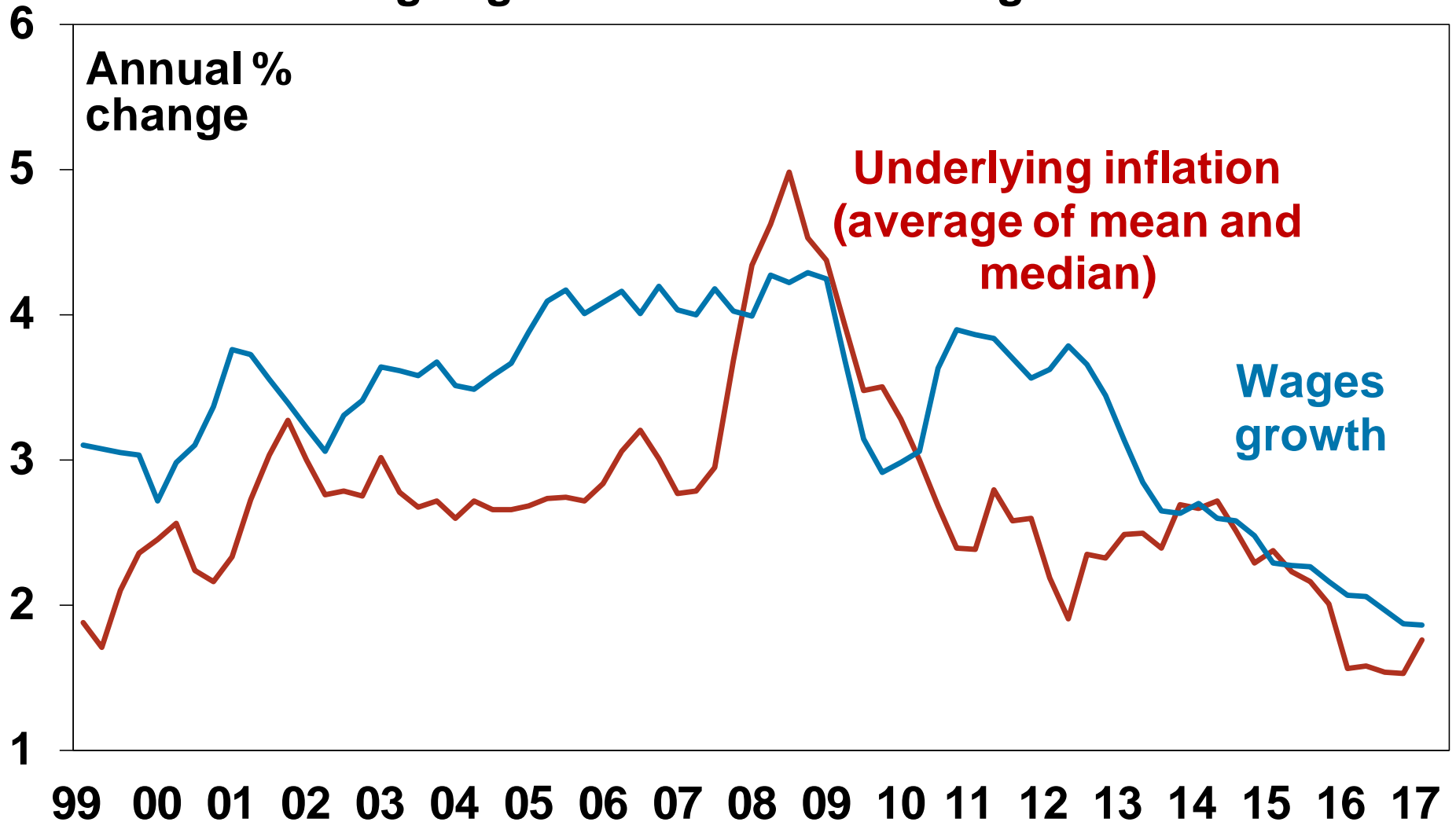


Australian employment vs jobs leading indicator

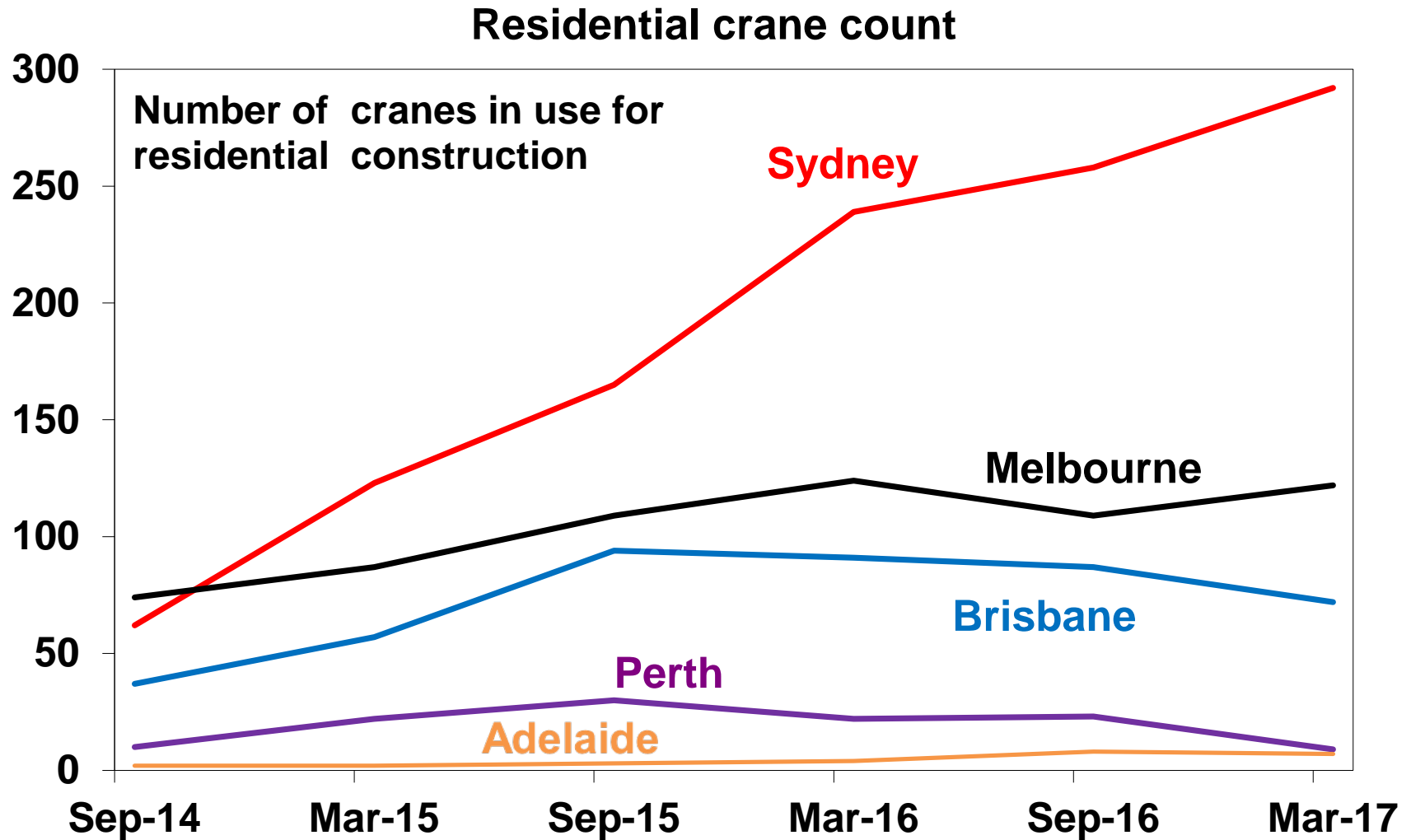


SPARE CAPACITY IN LABOUR MARKET IS DEPRESSING WAGES GROWTH

Lowest wages growth on record driving inflation down



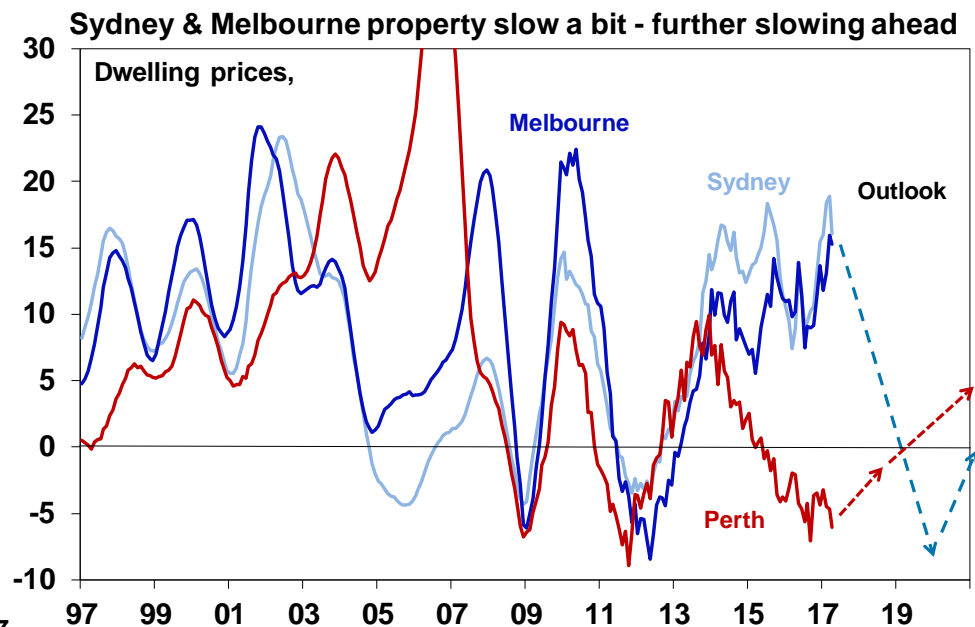
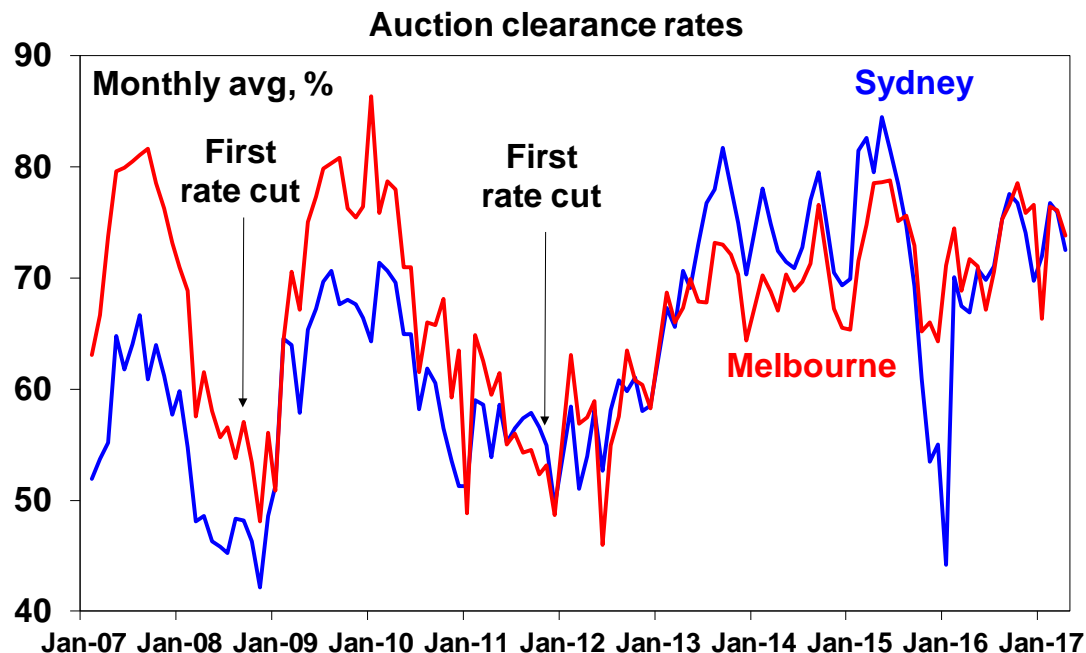
HEADING FOR A SHORT TERM OVERSUPPLY OF APARTMENTS






















Source: Rider Levett Bucknall Crane Index, AMP Capital

THE DIVERGENT AUSTRALIAN HOUSING MARKET

SYDNEY AND MELBOURNE STILL TOO HOT



TRAFFIC LIGHT SIGNALS FROM DAA PROCESS

Signal	Equities	Listed property	Fixed income	Commodities
Valuation				
Cycle				
Liquidity				
Sentiment				
Technical				
Result	Favourable	Neutral	Negative	Neutral

Source: AMP Capital. As at May 2017.

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