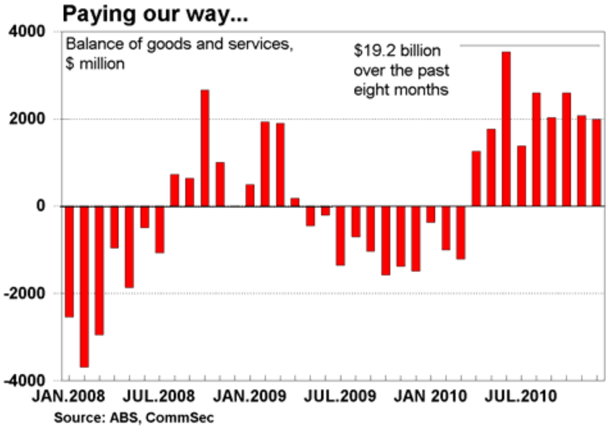
House approvals remain at 18 month lows

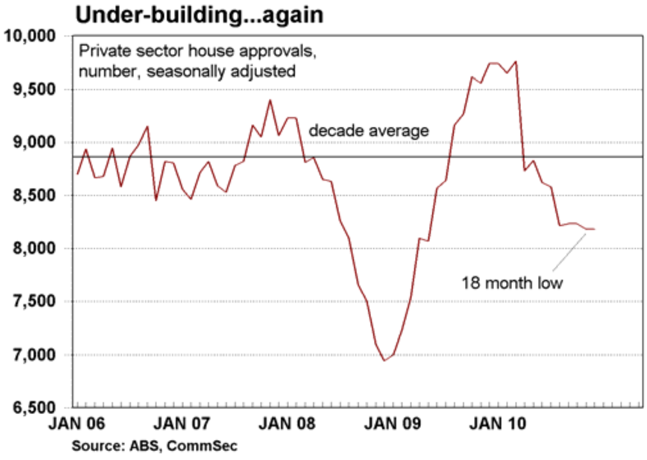
Building Approvals; Trade; New Vehicle Sales; PSI

- **Approvals to build news homes rose by 8.7 per cent in December. However all the gains were centred on apartment approvals - which tend to be volatile. Apartment approvals surged by 23.4 per cent in December after sliding by 8.5 per cent in the prior month.**
- **The all-important private sector new house segement was unchanged, holding at 18 month lows.**
- **Australia's trade surplus narrowed by $97 million to $1,981 million in December – in line with economist expectations. Australia has chalked up trade surpluses of $19.2 billion over just the past nine months.**
- **The services sector is still going backwards. The Performance of Services index eased modestly from 46.4 to 45.5 in January. Any reading below 50 suggests that the services sector is contracting. The services sector has only expanded for just two months in the past year.**
- **In January, 73,584 vehicles were sold, down by 1.7 per cent compared with a year ago. In seasonally adjusted terms CommSec estimates that sales eased 2.0 per cent in the month. Sales of "other" vehicles like utes, trucks and buses totaled just 13,013 in January – marking the lowest reading in two years.**

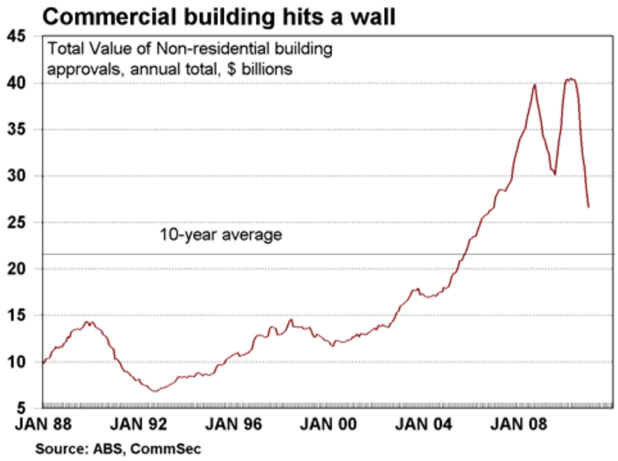
What does it all mean?

- The improvement in building approvals is certainly encouraging but needs to be put in context. Dwelling approvals have slumped by almost 15 per cent in the past nine months despite the eight per cent surge in the latest reading. And more importantly the latest rebound is all apartment approvals, which tend to be lumpy. A few more months of rising approvals will be needed to claim a turnaround.
- More focus needs to be placed on the all important new house approvals which remain weak. Clearly it is too early to call a revival in the sector given one month's figures. While there are encouraging signs the trend is more important and it suggests the sector is likely to go sideways in the near term.
- The latest result effectively pre-dates the November rate hike, especially given that it takes a good 10 weeks to get finance, find a builder, comply with council requirements, apply and finally get approval. The latest approval figures are likely to be due to decisions made prior to the November rate hike. Overall interest rate hikes have taken some of the steam out of the housing sector and a consolidation period will remain part of the landscape in the near term.





Savanth Sebastian – Economist (Author)
(02) 9118 1805 (work), 0414 188 161 (mobile) | savanth.sebastian@cba.com.au

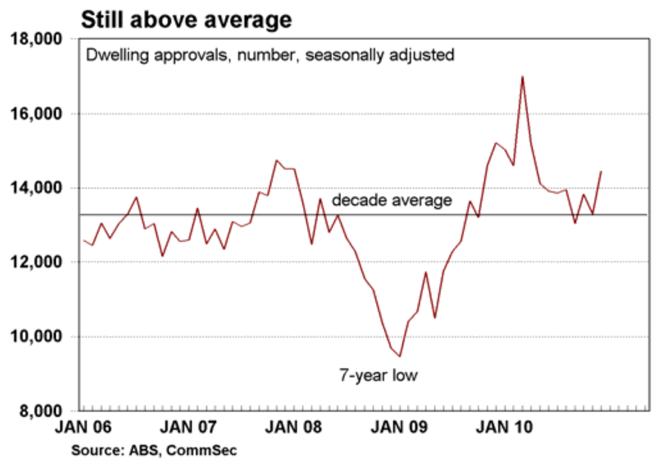


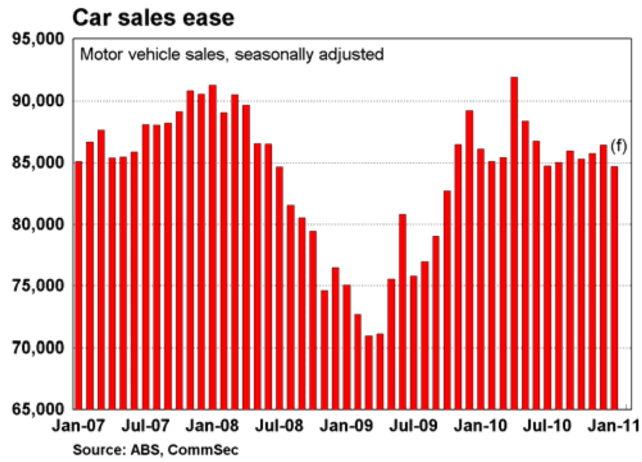
- It is important to highlight that while the housing sector is cooling it is not about to collapse in a heap. Overall CommSec expects house prices to consolidate over the next few months, but for the year as a whole we would expect prices to lift by 5 per cent.
- The economy may be going through a soft patch but the dollars keep rolling in. Australia has now notched up its ninth consecutive trade surplus, totalling in excess of $19 billion. Despite the boost to Australian coffers the impact has yet to have a resounding effect on the economy. The weakness in business and consumer spending suggests the additional income is being saved rather than spent.
- However as the Reserve Bank has highlighted increased savings will eventually mean a pickup in spending down the track. It is the multiplier effect that essentially the Reserve Bank is banking on to spur domestic growth over the coming year. At present the additional income is not being spent, but as the recovery gains traction it is likely that Australian businesses and consumers will follow through on spending and investment plans.
- Higher commodity prices and increased demand for coal and iron ore has helped insulate the Australian economy. However given the floods in Queensland it is likely that trade surpluses are likely to be more moderate in coming months.
- The data on Tuesday highlighted the contraction in the manufacturing sector and the story is no different for the service sector. There are a couple of factors driving the weakness in the services sector including higher interest rates, a stronger currency and the conservative buying behaviour of consumers and businesses.
- Businesses are under substantial pressure at present with costs edging higher and consumers driving hard bargains. Input costs and wages remain elevated but selling prices are flat. Business margins are constrained, thus depressing profitability. More concerning is the sharp slide in the forward looking index of new orders. A period of interest rate stability would clearly help the situation. If the Reserve Bank stayed on the interest rate sidelines over the next couple of months, activity levels should improve.

What do the figures show?

Building Approvals:

- **New dwelling approvals** rose by 8.7 per cent in December, after sliding by 3.9 per cent in November. Over the calendar year 2010 dwelling approvals have risen in just four months. Dwelling approvals are down 5 per cent on levels of a year ago.
- House approvals rose by just 0.1 per cent in December (private sector unchanged), after sliding by 0.9 per cent in November. Apartment approvals rose by 23.4 per cent in December (private sector was up 23.4 per cent) after sliding by 8.5 per cent in November. In annual terms apartment approvals are up 17.6 per cent on a year ago.
- Dwelling approvals fell most in Queensland (down 5.6 per cent) and Western Australia (down 4.1 per cent) in December. Approvals improved the most in New South Wales (up 16.8 per cent).
- In annual terms approvals across the state: NSW (up 1.8 per cent), Victoria (up 7.0 per cent), Queensland (down





30.7 per cent), South Australia (down 11.6 per cent), Western Australia (down 13.2 per cent), and Tasmania (down 21.8 per cent).

- The value of building approvals rose by 8.3 per cent in December and was lower by 20.3 per cent on a year ago.

International trade

- Australia's trade surplus narrowed by $97 million in December to $1,981 million. In line with expectations. Exports rose by 0.3 per cent while imports rose by 0.8 per cent. It was the ninth consecutive trade surplus.
- Rural exports rose by 0.9 per cent in December while non-rural exports rose by 1.4 per cent.
- Within non-rural exports, coal, coke and briquettes fell by 5 per cent. "*On a recorded trade basis, between November and December 2010 exports of iron ore (lump) rose $172m (14 per cent) with exports to Japan up $116m (50 per cent) and China up $58m (8 per cent), driven by increases in volumes of 52 per cent and 5 per cent respectively. Hard coking coal fell $99m (5 per cent), semi-soft coal rose $39m (6 per cent). Bituminous (thermal) coal rose $170m (17 per cent)".*
- Within rural exports meat and meat preparations rose by $34 million or 6 per cent.
- Within imports, consumer imports fell by 0.9 per cent in December, capital goods imports fell by 3.8 per cent while intermediate goods imports rose 8.5 per cent.
- While the physical trade of goods is in surplus, the services account remains mired in deficit – the deficit narrowed from $305 million to $294 million in December. The high Australian dollar is a key culprit, depressing tourism receipts.

Performance of Services index

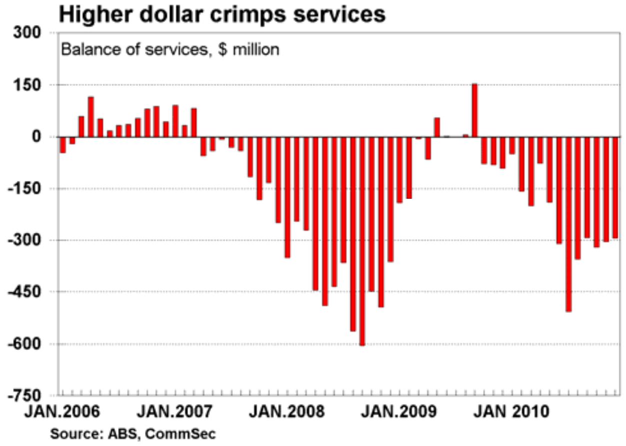
- The Performance of Services index fell modestly from 46.4 to 45.5 in January. Over the past year the PSI reading has only been above 50 on two occasions. Any reading below 50 indicates a contraction of activity.
- The January weakness was evident in both the sales and employment sub-indices and particularly noticeable in the new orders sub-index which fell sharply to 39.7.
- Accommodation, cafes, & restaurants, transport & storage and health & community services were the only sub-sectors to expand in the month. Activity contracted most noticeably during January in the retail trade, wholesale trade, communication, finance & insurance and personal & recreational services sub-sectors.

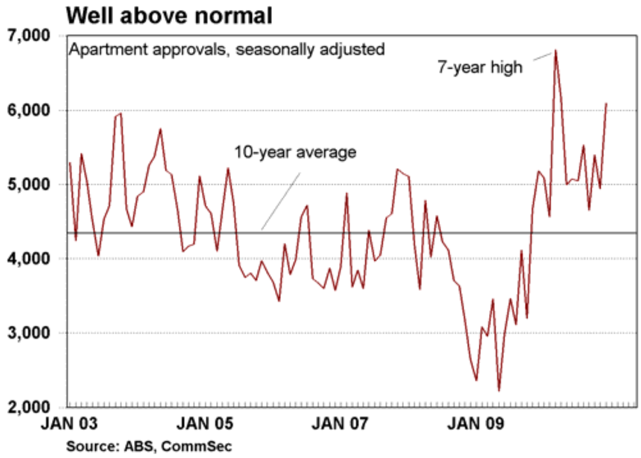
Car sales:

- The Federal Chamber of Automotive Industries reported that 73,584 new cars were sold in January, down 1.7 per cent on a year ago. Passenger car sales were 0.1 per cent on a year ago, 4WDs were down 0.8 per cent and "other vehicles" (trucks, utes etc) were down 9.5 per cent.
- CommSec estimates that in seasonally adjusted terms car sales rose 1.5 per cent in December.

What is the importance of the economic data?

- The Bureau of Statistics' monthly **Building Approvals** release contains figures on local council approvals to build residential structures such as homes and units as well as commercial premises such as offices and shops. Approval is one of the first stages of the construction 'pipeline' and is thus a key leading indicator of future activity. An increase in approvals would point to stronger future activity for construction-related companies.
- The Australian Industry Group and Commonwealth Bank release the **Performance of Services** index each month. The PSI is a key indicator of conditions in the services sector – includes retailing, finance, hotels and cafes.





What are the implications for interest rates and investors?

- Not surprisingly the strength of the Australian dollar continues to have a detrimental impact on the services sector. Australia's has notched up its 15th consecutive services deficit. No doubt the strength of the Australian dollar is making Australia a less attractive destination for overseas tourists and potential international students. Interestingly when the Aussie fell below US70c in 2009 the services sector notched up a series of surpluses.
- It is important to highlight that while the housing sector is cooling it is not about to collapse in a heap. The fundamental for property remain attractive. Population growth remains healthy, vacancy rates continue to slide and the employment growth will support activity in the mid to longer term.
- The rate hikes have certainly taken their toll on the housing sector over the past year and unfortunately for the sector it is unlikely that a turnaround is going to take place anytime soon – especially given the double whammy rate hike in November is yet to make its mark on the data
- Overall CommSec expects house prices to consolidate over the next few months, but for the year as a whole we would expect prices to lift by 5 per cent.

Savanth Sebastian, Economist, CommSec
Work: (02) 9118 1805; Mobile: 0414 188 161