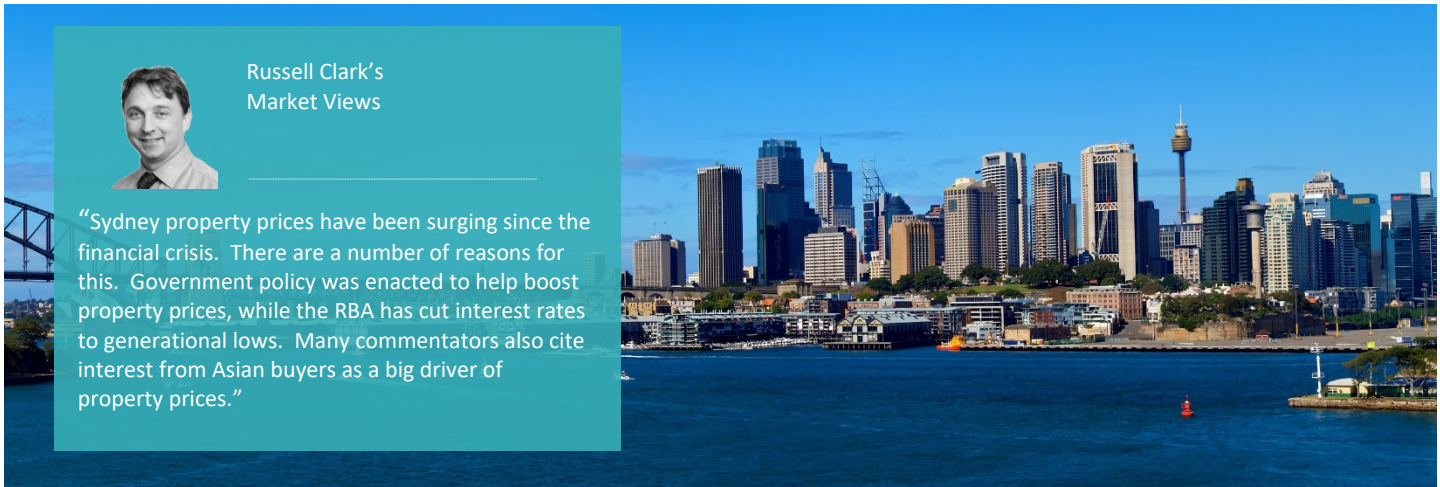


AUSTRALIAN PROPERTY – THE CHINA SYNDROME

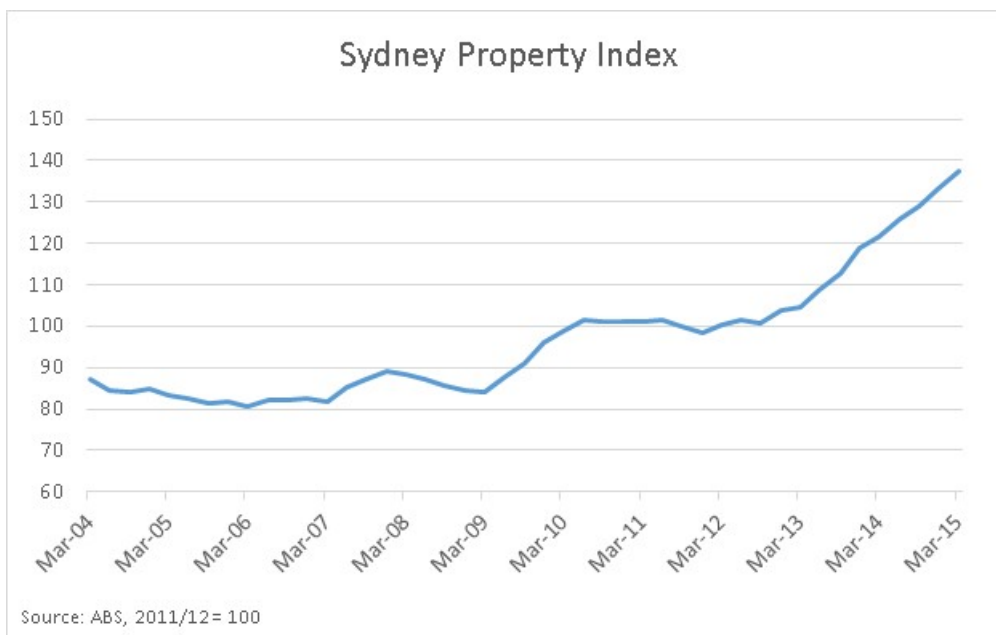


Russell Clark's
Market Views

“Sydney property prices have been surging since the financial crisis. There are a number of reasons for this. Government policy was enacted to help boost property prices, while the RBA has cut interest rates to generational lows. Many commentators also cite interest from Asian buyers as a big driver of property prices.”

I would like to thank our summer intern, Angel Dimitrov Simbaev, for his help with this note.

Sydney property prices have been surging since the financial crisis. There are a number of reasons for this. Government policy was enacted to help boost property prices, while the Reserve Bank of Australia (RBA) has cut interest rates to generational lows. Many commentators also cite interest from Asian buyers as a big driver of property prices.

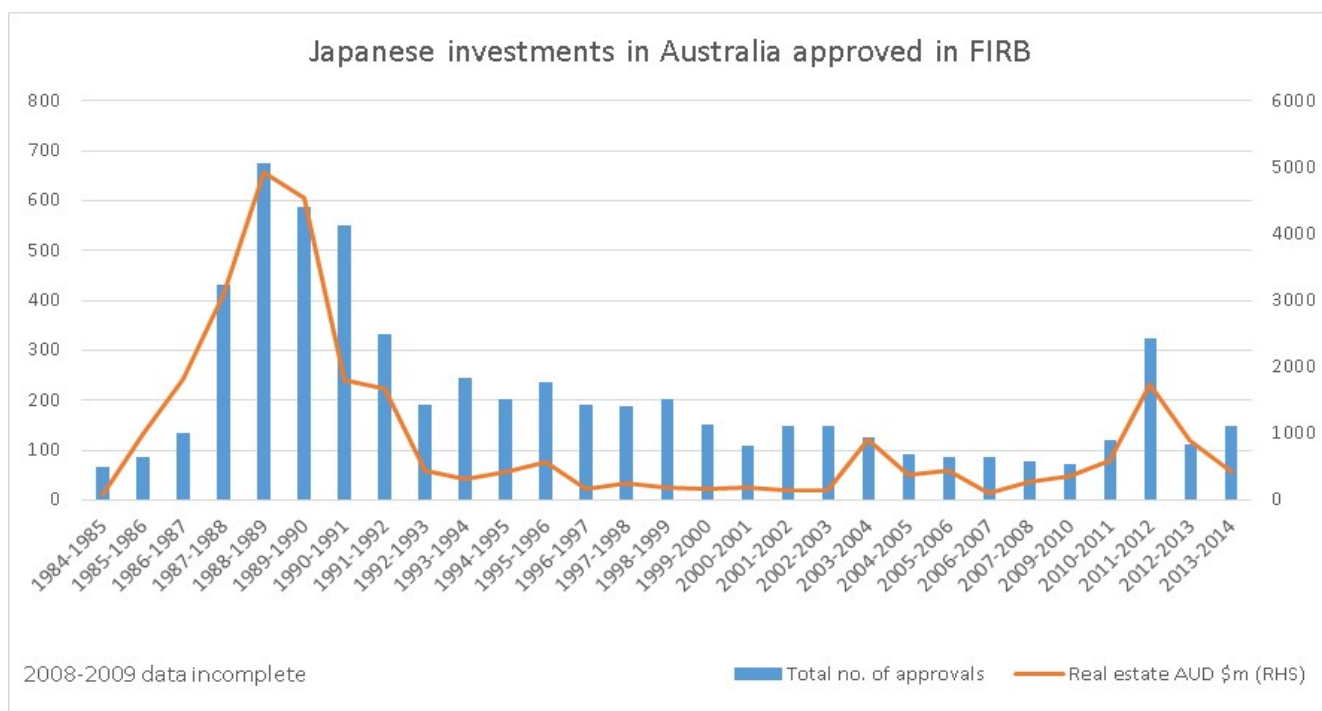


When thinking about Asian purchases of Australian property, I always wondered if the purchase was driven by the perceived “cheapness” of Australian property relative to their domestic market, or whether it was a defensive investment seeking to move hard cash out of their own economy to a “safe haven” such as Australia. If Asian investors are buying on a “cheapness” argument, then investment should decline as domestic property prices decline. Alternatively if Asian investors are seeking an economic safe haven, weakening domestic property prices could encourage even more safe haven flows.

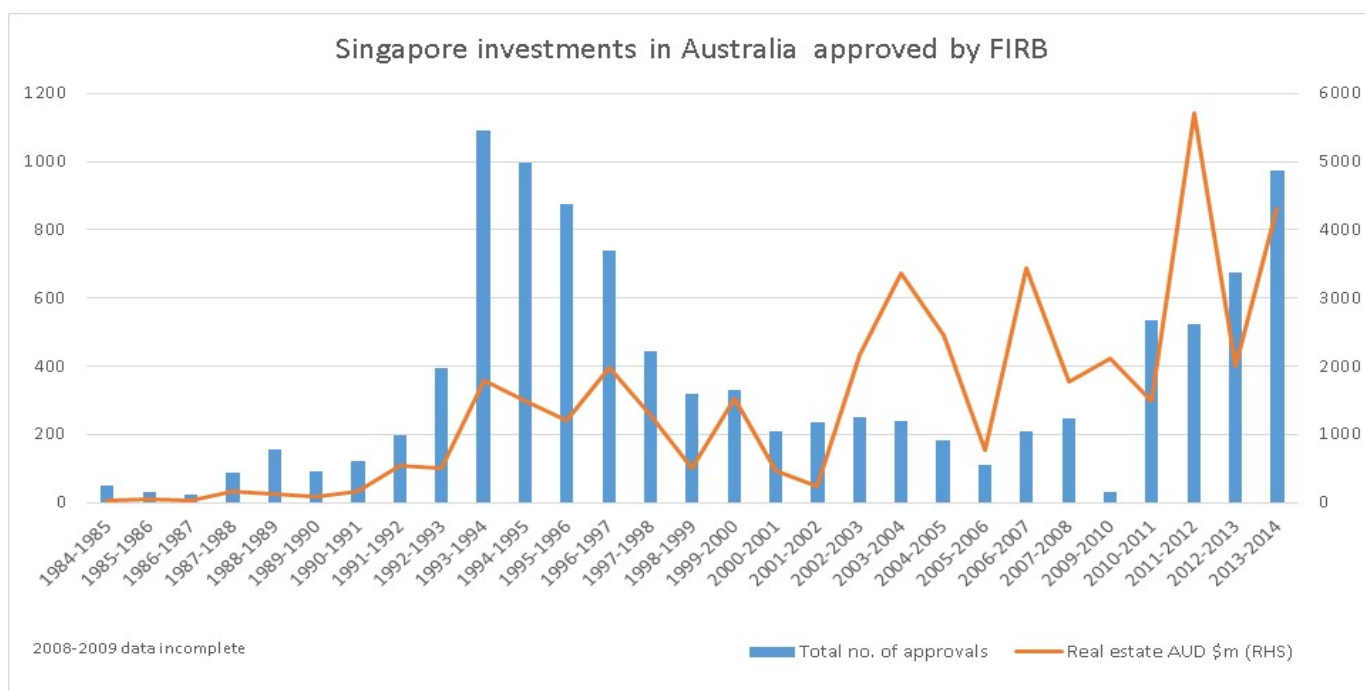
Australia requires foreigners to get approval before being allowed to make a purchase from the Foreign Investment Review Board (FIRB), who then collates the approvals in its annual report. This allows us to study other periods of Asian investor

interest in Australia to get an idea of how investment flows from Asia to Australia reacted when domestic conditions in Asia weakened.

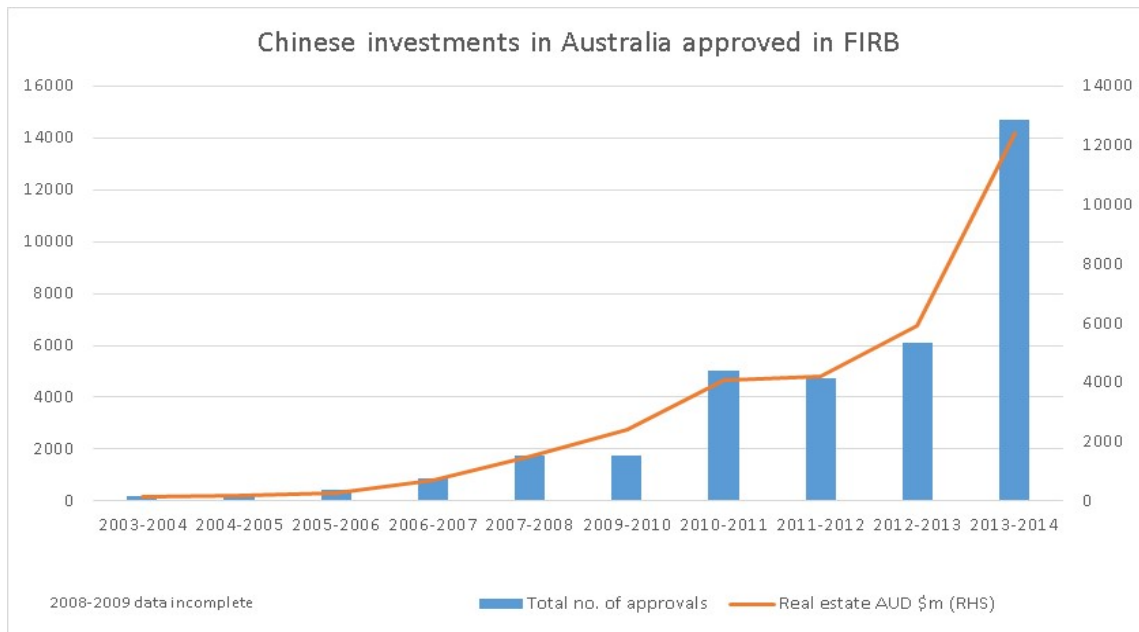
If we look at either the number of approvals or amounts invested into real estate, it is fairly clear that Asian property investment into Australia tends to rise and fall with domestic financial conditions. Japanese investment peaked in the late 80s and early 90s.



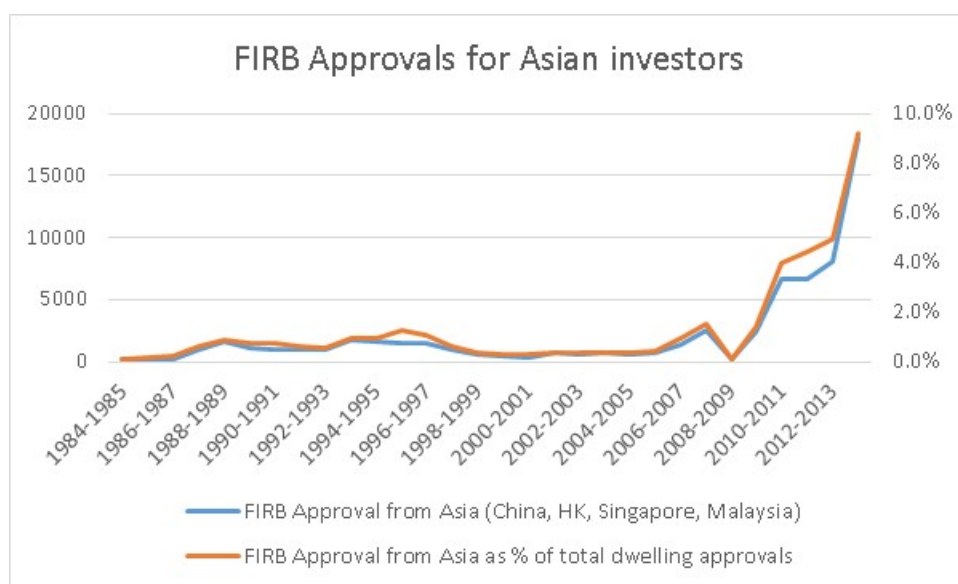
We use Singapore here as a proxy for Asia, and again investment peaked in the mid-90s before the Asian financial crisis before dropping off again.



Currently the largest single foreign investor into Australia by both approvals and amount is China. Growth in Chinese investment has increased dramatically since 2009, and exploded last year.

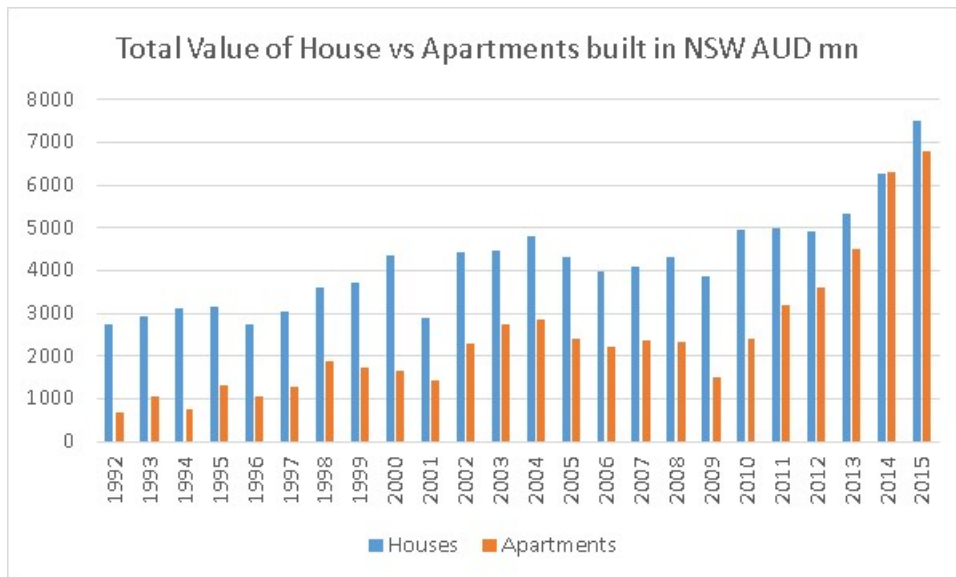


If we take a worst case scenario that the current slowdown in China morphs into a scenario similar to the Asian financial crisis, what implications would that have on Australian housing?

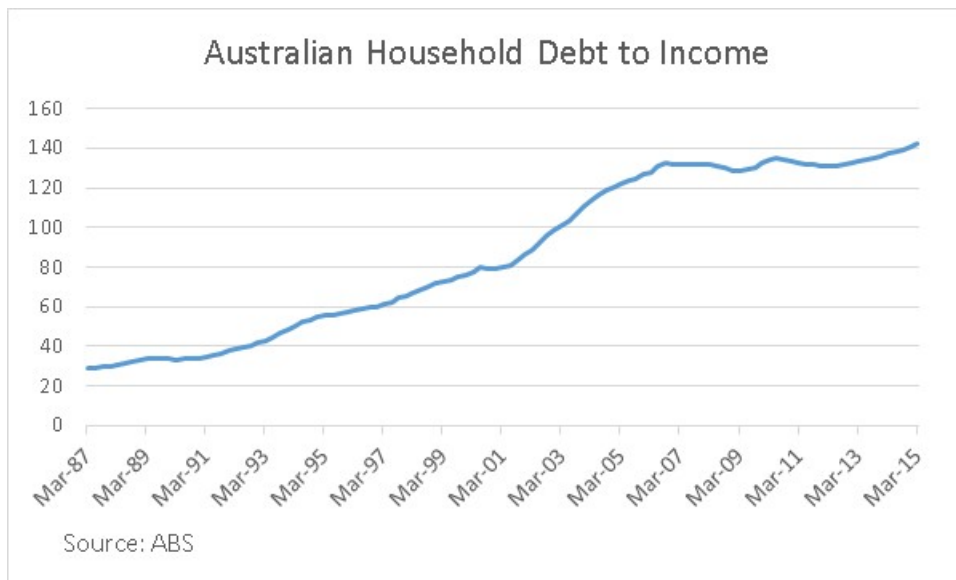


The scale of Asian investment, and from China in particular, dwarfs anything Australia has seen before.

Anecdotally, Asia based property investors prefer apartments in large cities. If we look at the value of housing being built by type, we can see that in 2000, the value of apartments being built in NSW was only half that in houses. In financial year 2014, the value of apartments being built in NSW overtook houses. I suspect this is the Australian property market reacting to surging investor demand from Asian investors.



Ever rising property prices have required Australians to take on ever larger amounts of debt to buy property.



This year has already seen signs of weakening property prices in China, and signs of slowing growth. Should Chinese buyers retreat from the Australian property market, I doubt domestic buyers will have the ability to step in. Australian assets have significant downside risk in my view.

INFORMATION

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