Downturn in construction market to worsen in 2020

RBA Deputy Governor Guy Debelle opens CFA Societies Australia Beyond Disruption Conference

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Speaking at the CFA Societies Australia Beyond Disruption Conference today, Deputy Governor of the Reserve Bank of Australia (RBA), Guy Debelle stressed that interest rates are not the sole driver of the housing market cycle and pointed to the fact that the most recent downturn in the construction cycle was not preceded by rising interest rates, which has typically been the case in the past.

Deputy Governor Debelle said he expected a further 7% decline in dwelling investment over the next year, but said it could be higher.

"We expect that this decline will subtract around 1 percentage point from GDP growth, given it accounts for around 6% of GDP," he said.

Deputy Governor went on to talk about the spill over from the downturn in residential construction to other parts of the economy, highlighting small business earnings and income, which translated into a fall of 4% in disposable income growth.

Deputy Governor Debelle then spoke briefly about lending conditions, and when asked about the effect of recent tightening in lending standards stressed that lending conditions and house prices are not the same thing.

"They are highly correlated, but they aren't the same thing, and from a macro prudential point of view lending is about quality and appropriate lending standards. In my view, the recent fall in outstanding credit to investors is a function of a decrease in investor demand given falling house prices, more than the impact of lending conditions," he said

It wasn't all doom and gloom however. Deputy Governor Debelle said that while 2020 is likely to be the low year for the residential construction sector, he can see through the trough to the other side.

"Prices have turned in Melbourne and Sydney which I expect to bring investors back into the market, and growth in demand which won't be accompanied by meaningful supply due to the long lead times on higher-density construction that will lead to a price response," he said.

Deputy Governor Guy Debelle was followed by a panel discussion, "The State of the Economy", moderated by Brian Redican, Chief Economist NSW Treasury Corporation who asked Su-Lin

Ong, Chief Economist & Head of Australian Research at RBC Capital Markets and Ben Jarman, Senior Economist at J.P. Morgan the tough questions about the global economy.

The discussion started with the state of the US economy, which both agreed was unlikely to falter significantly, despite the collapse of US manufacturing, because the US consumer is in good shape, and the expectation is the that US Federal Reserve will maintain its dovish stance.

The pair touched on China and trade tensions with the US. Ms. Ong commented that the conflict is less about trade than it is about, a geo-political shift in power, technology, defence capabilities and beyond.

"As for the effect on markets of a US President with such an unusual method of communication, there's no doubt that it's politics which is driving the higher levels of volatility in markets, and I don't expect that to change," she said.

Ms. Ong then said she felt the US Federal Reserve is trying to use monetary policy, which is essentially a demand tool, to address what are in fact structural problems. She highlighted challenges central banks face when confronted with labour markets in good shape, but where wages growth is muted and inflation non-existent. How effective will further rate cuts be?

Mr Jarman said he expected the RBA's approach going forward to be orthodox – that "nothing works as well as dropping the cash rate" and that they will continue to prioritise conventional monetary policy tools.

In conclusion, he pointed what he sees as an upside risk – that we get more meaningful fiscal policy from governments globally.

"There's a growing chorus among central banks, and once they've drawn a line in the sand and run out of the conventional bullets of monetary policy, then the ball's in the court of fiscal policy – and it's back to the government," Mr Jarman said.

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