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12 February 2010

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Industrial rents shown to be a key predictor of future economic trends

Sydney, NSW (12 February 2010)

Industrial rental data is a leading indicator of economic trends and could be a potential indicator of future monetary policy according to a new market analysis from CB Richard Ellis.

CBRE Forecasting Consultant Jatin Chand said an analysis of industrial data over the past two decades revealed that changes in Grade A warehouse rents generally preceded changes in the national unemployment rate and CPI inflation.

"A factor sometimes overlooked is that industrial rental data across the states may reveal more about the behaviour of key macro economic variables such as inflation and the national unemployment rate than vice versa," Mr Chand said.

"We would recommend that greater attention be paid towards collecting a broader set of statistics in the industrial sector as it may reveal important insights into the Australian economy."

A key finding of the Viewpoint report was that industrial rent changes have historically led real GDP in Sydney and Melbourne by between one and two quarters.

"In particular, the behaviour of net effective rent in Sydney suggests that it may be a leading indicator of the possible presence of an upcoming Australian recession," Mr Chand said.

"For example, when the economy registered two consecutive quarters of negative real GDP growth and fell into recession in September 1990, real net effective rent had already started to fall in Sydney from \$146/sq m in December 1989 to \$140/sq m on September 1990. Real net effective rent proceeded to keep on falling until it reached its bottom at \$105/sq m in December 1994, continuing to fall well after the economic recovery that followed the downturn."

The CBRE Viewpoint report points to the fact that in economic booms, tenants are likely to experience good future profitability, especially when consumer confidence and spending is strong. During these periods, tenants often actively seek to increase the stock of goods in their warehouses to meet forecast future demand and landlords may charge higher rents in order to extract part of that profitability.

Conversely, during tough economic periods inventories diminish, vacancies arise and landlords may respond by dropping or stabilising rents and increasing incentives.

“Using time series methods to compute cross correlations data over 1981-2008, the common pattern observed across all grade A industrial warehouse markets was that industrial rents were positively correlated with national CPI inflation and negatively correlated with the unemployment rate,” Mr Chand said.

“Net effective rent leads, and is mildly positively correlated with inflation, in Sydney, Brisbane and Adelaide by one to three quarters. This finding may suggest that rental behaviour may provide an insight into the conduct of future monetary policy. Rising inflation is a key determinant in whether the RBA takes action to raise the interest rate. As rising industrial warehouse rents in these three states precedes the increase in national CPI inflation, industrial rent changes may signal that a future inflation increase is likely and thus, monetary policy tightening in response to this may also be on the way.” (see Table 1 below).

Mr Chand said correlations also suggested that net effective rent led the national unemployment rate by one to three quarters in Sydney, Melbourne and Adelaide. In Perth, net effective rent was contemporaneously correlated.

Relatively stronger negative correlation was recorded over the quarters from March 1981 to September 2008 for Melbourne and Adelaide (-0.38) than Sydney (-0.29), Perth (-0.27) and Brisbane (-0.14).

TABLE 1: CORRELATIONS IN GRADE A WAREHOUSE RENT AND KEY MACROECONOMIC VARIABLES

Real net effective rent in	Real GDP	National Unemployment Rate	National CPI Inflation
SYDNEY	leads GDP by 2 qtrs (0.21)	leads by 1 qtr (-0.29)	leads by 1 qtr (0.33)
MELBOURNE	leads by 1 qtr (0.23)	leads by 1 qtr (-0.38)	lags by 4 qtrs (0.21)
BRISBANE	lags by 3 qtrs (0.14)	lags by 1 qtrs (-0.14)	leads by 1 qtr (0.25)
ADELAIDE	lags by 1 qtr (0.20)	leads by 3 qtr (-0.38)	leads by 3 qtrs (0.30)
PERTH	lags by 1 qtr (0.12)	contemporaneous (-0.27)	lags by 3 qtrs (0.14)

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