ECONOMIC UPDATE

BUDGET 2024/25

COMMERCIAL PROPERTY IMPLICATIONS

MAY 15, 2024

3 KEY TAKE AWAYS

1

985,000

Net overseas migration (NOM) through FY28

2

2.75%

CPI by 2024/25

3

$6.2 billion

To increase the supply of housing

WHAT HAPPENED?

Last night the Treasurer handed down the 2024/25 Federal Budget. While much has been written on the topic, this paper will focus on the issues more relevant to commercial real estate (CRE). Although CRE is not the specific target of support in the budget, several of the measures announced will impact the sector.

A key focus of the economic discussion was around the moderately expansionary budget and whether cost-of-living relief measures would add to inflationary pressures. Namely, the tax cuts to all income earners, a $300 energy rebate to all households, and a 10% increase to Commonwealth Rent Assistance. The latter two measures will directly lower headline CPI, though falling wholesale energy prices and base effects may mute the aggregate impact of these measures on inflation.

Whether the path of disinflation forecast by the government comes to fruition will ultimately depend on whether individuals and households save or spend this additional income. Household savings rates are currently the lowest since before the Global Financial Crisis, so there is the possibility that at least some of the cash transfers will be used to rebuild households' savings buffers. Lower income households are more likely to spend this money, but will likely spend it on non-discretionary goods which are not currently driving inflationary pressures.

Against this backdrop the government has maintained that the CPI will fall back within the Reserve Bank of Australia's (RBA) target band in 2024/25, circa 6 to 12 months ahead of the RBA's own forecast released last week. As such, the risk to the government's forecast is certainly skewed towards the upside.

FIGURE 1
Economic forecasts[1]

	2023/24	2024/25	2025/26	2026/27	2027/28
Real GDP %	1.75	2.0	2.25	2.5	2.75
NOM ('000s)	395	260	255	235	235
Employment %	2.25	0.75	1.25	1.75	1.75
Unemployment rate %	4.0	4.5	4.5	4.5	4.25
Wage price index %	4.0	3.25	3.25	3.5	3.5
CPI %	3.5	2.75	2.75	2.5	2.5

1 Real GDP and Nominal GDP are percentage change on preceding year. The consumer price index, employment, and the wage price index are through-the-year growth to the June quarter. The unemployment rate is the rate for the June quarter.
Source: Treasury

KEY POINTS:

In announcing the 2024/25 Budget, the Federal government is attempting to provide some cost-of-living relief for households while maintaining a path of disinflation.

The overall outlook for the economy remains upbeat; growth is forecast to remain positive, and inflation fall back within the RBA's target band over the next fiscal year. However, near-term growth forecasts have been trimmed from the last budget, albeit modestly.

The pipeline for net overseas migration remains supportive of all segments of Australian CRE; net overseas migration is forecast to be nearly 1 million over the next four years.

Addressing housing supply was a key component of this budget. A number of measures supporting the living sector were announced, including an additional $6.2 billion to increase housing supply. Measures supporting student accommodation, social housing and rent assistance also featured prominently.

Nearly $3 billion in new infrastructure commitments were announced. A $1.9 infrastructure package for Western Sydney headlined the announcements.

The Budget aims to provide a path forward for the Australian economy. However, Australia is vulnerable to external shocks, which could cause the outlook to be revised.

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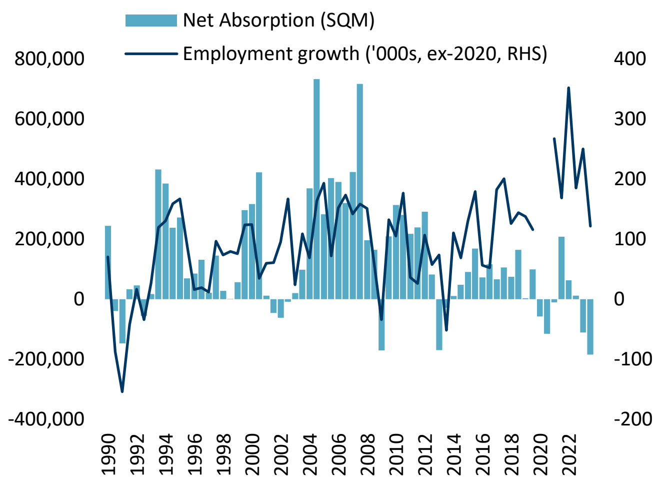
OFFICE

In the short-term, the economic outlook provided by the Treasury is mixed for the office sector. While the base case continues to be for a 'soft landing' - a temporary slowing of growth to allow the unemployment rate to return to more sustainable levels – both GDP and employment growth were revised 25 basis points (bps) lower for fiscal 2024/25 from the previous year's budget.

As is evidenced in Figure 2, employment growth has historically been well correlated with demand for office space in Australia. Pandemic related disruptions have led to this relationship breaking down more recently as employers continue to assess their space requirements following wider-spread adoption of flexible working practices. Nevertheless, the rate of employment growth remains a strong indicator of underlying office demand.

FIGURE 2
National office net absorption & employment growth (6-month)



Source: ABS, PCA, Cushman & Wakefield

The Treasury's forecast implies that in the short-term demand for office space is likely to remain muted. There remain some mitigating factors that could offset a slowdown in employment growth.

The Treasury forecasts the unemployment rate to rise to 4.5% during fiscal 2024/25 and remain around this level for three years. This is above most estimates of the Australian economy's equilibrium unemployment rate, which generally sit between 4.2% and 4.3%.

Such an outcome would represent a substantial unwinding of the tight labour market employers have struggled with over the past two years. In this environment, employers and employees may opt for a higher share of office attendance in their flexible working arrangements.

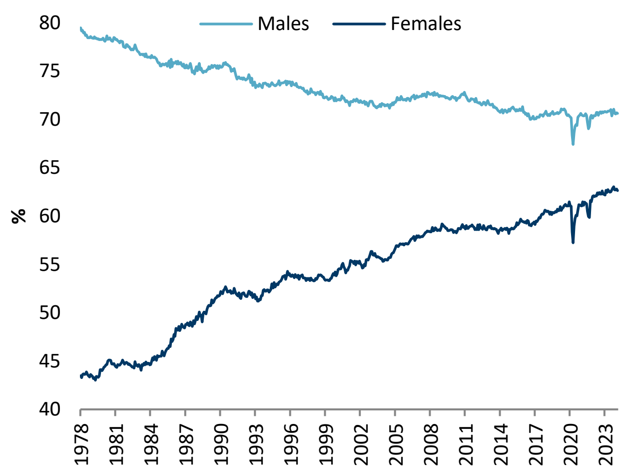
Workplace strategies remain in a state of flux, with companies continuing to analyse and assess which approaches work best for them. A stronger focus on in-office collaboration and connection could be supportive for space demand, mitigating some of the softer employment growth outlook.

A second factor that could bolster office demand in the short-to-medium term is the continued investment in childcare. The budget included a funding commitment to help attract more workers to the sector via pay rises.

Data shows that the burden of childcare costs on Australian households are amongst the highest in the OECD. Furthermore, data from the Australian Bureau of Statistics (ABS) shows that the main reason that working age (25-54) women give for not entering the workforce was caring for children.

The labour force participation rate for females has been rising steadily for the past three decades, though it remains circa 8 percentage points (ppt) below the male participation rate. For every 1 ppt increase in the female participation rate the labour force increases by 1,100, further reducing labour market frictions and contributing to office demand.

FIGURE 3
Labour force participation rate by sex



Source: ABS, Cushman & Wakefield

RETAIL

The retail sector should be a direct beneficiary of the cost-of-living measures in the budget, though the effects are likely to be muted. Lower-income households are generally more likely to spend rather than save this additional income as non-discretionary spending takes up a greater share of their income.

The tax cuts, rent relief and energy rebates will directly support lower income households. Additionally, the budget included $41.2 million earmarked for pay increases to some jobseeker recipients, and a freeze on medication costs. These measures should translate into more spending on essential items such as food, clothing and school supplies. This should provide a cushion to the cost-of-living pressures that have weighed on household spending over the past year, particularly neighbourhood centres with a supermarket.

Other measures, namely the $3 billion in student debt relief, will also translate into additional retail spending. However, this expenditure is likely to be more broad-based, encompassing a higher share of discretionary services alongside essential goods.

LOGISTICS & INDUSTRIAL

Logistics & Industrial (L&I) CRE benefits from both the overall population growth, which drives demand for space, as well as infrastructure spending. Upgrading infrastructure improves connectivity and strengthens supply chain efficiencies, while also boosting warehouse demand as the materials and equipment needed to build these projects will flow through a warehouse at some stage.

The budget announced more than $2.7 billion in new infrastructure commitments, headlined by the $1.9 billion infrastructure spend in Western Sydney. Long term, these projects will result in productivity improvements.

Wider support for the manufacturing sector could be provided by the government's recently announced "Made in Australia" programme, though the timing and scale of the impact currently remains uncertain until greater details on the scheme are released. Note that the share of manufacturing gross take-up nationally has grown from 6% in 2019 to 14% currently and the budget announcement, which included a focus on renewables, could promote warehouse demand from a range of value-added sectors.

LIVING

The living sector was the primary beneficiary of the budget. Similar to many CRE segments, population growth naturally bolsters demand for living sector assets. However, numerous measures were also announced that directly impact housing, purpose-built student accommodation (PBSA) and social housing.

The budget unveiled an additional $6.2 billion to support housing supply in addition to existing outlays. An additional $1 billion towards the Housing Support Program which will fund the last-mile infrastructure required to construct new housing. To address labour shortages in the industry, the budget earmarks $88.8 million towards fee-free TAFE placements in the construction sector, as well as $1.8 million to streamline visa processes for migrant construction workers.

The government confirmed a previous announcement that the number of international students at Australian universities will be tied to each university's capacity to provide PBSA. This will provide a boost for the sector as it presents a clear incentive for universities to invest in PBSA, as international students represent higher fee income for universities.

The budget included an additional $1.9 billion in concessional loans to community housing providers (CHP) to deliver social and affordable homes. A measure to ease financing burdens on CHPs was also introduced.

The budget earmarked $1 billion for accommodation for women fleeing domestic violence through the National Housing Infrastructure Facility, and $9.3 billion over several years to fund the National Agreement on Social Housing and Homelessness with the states and territories.

INVESTMENT DEMAND

The main measure in the budget supporting CRE investment was $15.7 million to streamline the Foreign Investment Review Board (FIRB) processes.

As in most developed economies, CRE investment demand has been tepid against the backdrop of rapidly rising interest rates. A clear path for interest rates will bring buyers and sellers closer on pricing, enabling investment volumes to begin to rise.

Historically, CRE cycles do not begin to recover until following the first interest rate cut. Cushman & Wakefield Australian Research currently forecast the first rate cut to be in the fourth quarter of 2024, though acknowledge that recent developments in inflation do present some upside risk. However, the Treasury's forecast for unemployment at 4.5% and CPI at 2.75% in fiscal 2025 are consistent with a rate cut in Q4 2024.

Australia's stable economic outlook and population growth combined with relatively favourable CRE yields compared to overseas CRE or fixed interest assets will continue to drive demand once the market recovers. Although risks remain, quality Australian CRE assets should continue to attract both domestic and offshore investment demand.

CONCLUSION

The Federal Budget attempted to provide cost-of-living support to households without stoking inflationary pressures. Should this be achieved, population growth driven by overseas migration will continue to provide ongoing support for Australian CRE.

Rigidities in the housing market will likely be the key obstacle that the Australian economy will need to overcome in the short-to-medium term. The budget attempts to address this amidst a swathe of measures, but ongoing support to all segments of the living sector will be required, including social and community housing.

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