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Crossing the Bridge to 2021 & Beyond

Rebounding from COVID-19 Uncertainty

Brook Monahan
Founder & Managing DIrector

Understandably, many people are anxious to comprehend what impact COVID-19 will have on the Australian economic outlook over the next six to 12 months, especially here at home in South East Queensland.

My first thoughts continue to be with those who are deeply feeling the devastating impact of COVID-19, here and overseas. I am extremely conscious of the crippling effect it is having on key industries and their employees, as well as the obvious health impacts globally. Collectively, from the local community to the Federal Government, we should do all we can to rally behind these cornerstone sectors, so they are positioned to recover as quickly as possible. It is indeed heartening to see the historic measures the Government is currently putting in place to help ensure this.

At this critical time, with the continuing flood of media stories and a palpable feeling of confusion and uncertainty, it is vital to maintain a level perspective. This update intends to assist in providing important context around the current COVID-19 climate and some assurance on the strength of the Australian property market's fundamentals, especially South East Queensland.

Establishing a realistic perspective of the current crisis

Let's consider the following six points to assist in establishing some important context.

1. STRICT MEASURES ARE BEING ENFORCED TO FLATTEN THE CURVE QUICKER

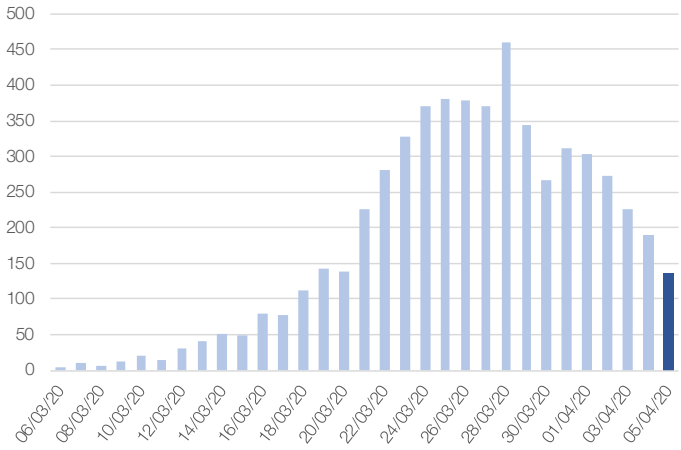
Australia is well positioned to come out of this crisis much more quickly than most countries on a global comparative basis. Whilst it is certainly early days, the coordinated approach of States and Territories to enforce the Stage 2 (and in some States stage 3) shutdown measures as recommended by the National Cabinet appear to be already having a notable impact on the rate of daily increase in all states and territories, with the majority of the success so far a result of preventing travellers entering Australia.

An anticipated nationwide Stage 3 shutdown for a short period will almost certainly help us reach the peak of the virus and flatten the curve faster. It will be especially important in controlling the next wave of threat associated with the virus, undetected community transmission, and vital to starting the journey back to normality as soon as possible. The immediate period ahead (next 2-3 weeks) is absolutely critical to eventually coming out of this crisis relatively quickly.

Based on the latest data, early signs indicate with more consistency that Australia is currently on track to follow the trajectory of South Korea and Japan, not that of Europe and the USA. Australia is certainly not on the same path seen in Italy and Spain as many feared several weeks ago.

Australia now leads the world in the number of tests per 1,000 people (in line with Germany), and we also have the lowest fatality rate of infected patients. Should this trend continue, along with the enforcement of the strict social distancing guidelines, relatively low base load of cases, and falling daily infection rate, Australia will get through the worst of the virus sooner than expected, with a recovery more akin to that of both South Korea and Japan.

DAILY CONFIRMED COVID-19 CASES - AUSTRALIA



(Source: covid19data.com.au)

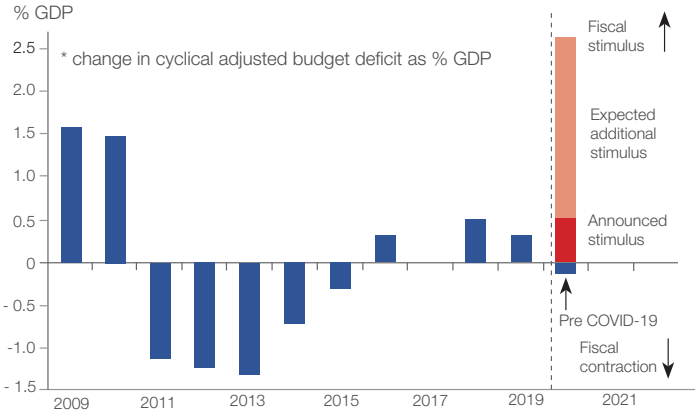
2. MONUMENTAL STIMULUS PACKAGES ANNOUNCED TO SUPPORT BUSINESS, INDUSTRY AND EMPLOYMENT CONTINUITY

The Federal Government has announced a third, historic stimulus package, that will allow businesses directly impacted by COVID-19 shutdowns to hibernate for six months by providing, in essence, a universal base wage.

This stimulus package is imperative to ensuring we are in the absolute best position possible to rebuild and reemploy (while limiting more permanent unemployment issues) in the hardest hit industries when the shutdown measures start to ease, most likely in the third quarter of 2020.

The Government's consolidated package of $320 billion represents fiscal and balance sheet support across the forward estimates of **16.4% of annual GDP**, and the RBA is providing a $90 billion term funding facility for the banking system to support extremely low-cost lending to small and medium enterprises with no limit to the amount of further capital and liquidity that it can and is willing to provide if required. To provide some perspective of how significant the Australian response is so far, the current support package in the US only equates to 9.5% of GDP.

G20 COUNTRIES FISCAL THRUST*



(source: Bloomberg, AMP Capital)

I expect further, significant initiatives from Federal and State Governments (along with local Councils) to inject the necessary fuel to fire up the property market again in the second half of 2020, given it is fundamental to a fast recovery in the jobs market in Australia. This could include amongst many other initiatives, stamp duty concessions, infrastructure charge deferrals or discounts, expanded first homeowner grants, faster approvals for shovel ready new projects, reduction of red and green tape, brought-forward infrastructure, and holiday periods for interest-only loans.

These measures are essential, given construction and property is one of the largest employers in the country. This sector also contributes close to 1/10th of Australian GDP, and 1 in 4 wages, according to the Australian Property Institute. The vitality of the property industry was underlined when the Government announced on the 23rd of March that it is an "essential" service and will remain operational during the shutdown.

> *"I expect further, significant initiatives from Federal and State Governments (along with local Councils) to inject the necessary fuel to fire up the property market."*
>
> - Brook Monahan

Further to this, all States and Territories are now moving to extend official work hours on construction sites, including Sunday, to ensure they can remain an employment cornerstone during the worst of the crisis, and lead a sharp recovery out the other side.

Lastly, the Federal and State Governments are also moving to shore up a more binding and specific set of guidelines for ensuring a more sustainable path forward for tenants and landlords which will provide much needed confidence to the residential and commercial property sectors. In particular, it is expected that any residential tenant who is receiving the new $1,500 per fortnight Job Keeper payment will be required to pay their rent. This will be reassuring for residential property investment owners.

3. THE BANKS ARE COORDINATING IN THE BEST INTEREST OF THEIR CUSTOMERS

The banking system, coordinating at a local and global level, remains robust with a seemingly genuine commitment to a "whatever it takes" approach to supporting customers over the next six months and longer, if required. This includes the right steps taken by the RBA to stabilising long-term interest rates and providing unlimited liquidity for the banking sector.

Actions previously taken by APRA have ensured the banks are now in an incredibly strong position to support the economy, unlike during previous crises such as the GFC.

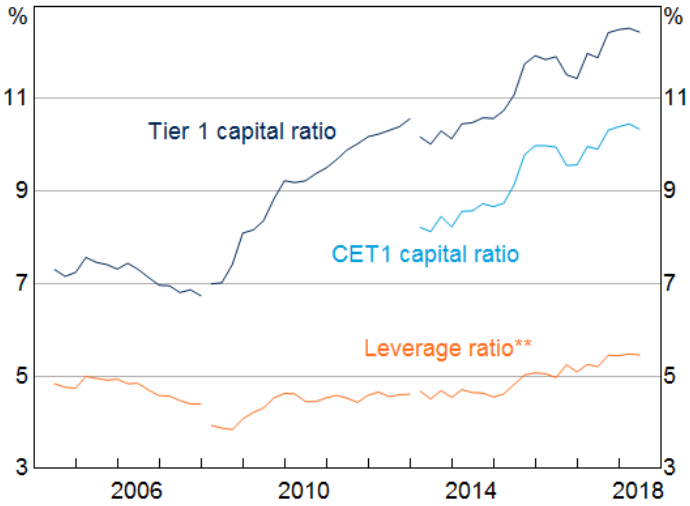
Once we are through this crisis, Australia will have the cheapest, most liquid availability of mortgages and credit in history. Banks will be ready to lend to qualified customers who are back into stable employment (assisted by the stimulus packages outlined above).

GRAPH OF CASH RATE TARGET

(Source: RBA)

MAJOR BANKS' CAPITAL RATIOS*

CONSOLIDATED GLOBAL OPERATIONS



* Break in March 2008 due to the introduction of Basel II; break in March 2013 due to the introduction of Basel III

** Estimated prior to September 2015 as Tier 1 capital as per cent of asssets

(Source: APRA; RBA)

4. THE PUBLIC RECOGNISE THIS IS A CRISIS AND ARE ACTING ACCORDINGLY

There has been a clear attitude shift in the last two weeks, with the public finally recognising the magnitude of the crisis and the essential role we each play in getting through it as quickly as possible.

Communities are actively working together to support each other while adhering to the shutdown measures, which places us in the best position for faster economic recovery.

5. A SHIFT IN NARRATIVE – LIVELIHOODS ARE JUST AS IMPORTANT AS LIVES

There is an increasingly clear narrative from the Prime Minister, National Cabinet, select journalists, and leaders both here and overseas that, in the long run, livelihoods are just as important as lives. This means we must take an extremely measured and considered approach to navigating the COVID-19 crisis.

It is not merely physical health at significant risk right now. The ominous impact on social wellbeing will become apparent in the weeks ahead. This impact will undoubtedly play a role in the decision as to when shutdown measures should start to ease. Subject to our ability to continue to make rapid progress in controlling the virus, we expect this to be sooner than the Government is currently suggesting.

6. FORECASTING ACCURACY IS IMPROVING AT A RAPID RATE TO DETERMINE WHEN TO COMMENCE EASING SHUTDOWN MEASURES

Forecasting the virus's peak is fundamental to determining the time it will take for us to "cross the bridge" and start to get a clear picture of our exact position.

Our ability to forecast with greater accuracy is improving daily, both at a local and global level. There is great hope this will result in a significantly reduced number of lives AND livelihoods lost, allowing the economy to recover more quickly, without devastating long-term impacts.

The National Cabinet is currently pointing to a minimum six-month timeframe for the virus to be considered under control. It is anticipated that this will only be achieved under the very strict adherence to Stage 2 and Stage 3 lockdown guidelines, the most important of which is social distancing.

Our view is that this is not sustainable, even in the West. Despite everyone's best intentions, living under increasingly harsh shutdown measures will likely lead to serious social issues and in a worst-case scenario, broadscale civil disobedience or unrest at some point.

We feel the Government has intentionally worked to create enough fear to force the immediate and critical action required by the community and ensure everyone is prepared for the worst case. And whilst the West, including Australia, can maintain levels of lockdown or semi-lockdown for much longer than developing countries, we still do not feel that six months is plausible. Already we are seeing evidence of mounting disorder and social unrest in emerging countries that are in the very early phase of lockdown measures.

> *"We can seriously consider the possibility of slow, staged easing of lockdown measures sometime in June, with the community mostly back to business under a "new normal" by the third quarter of this year."*
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> - Brook Monahan

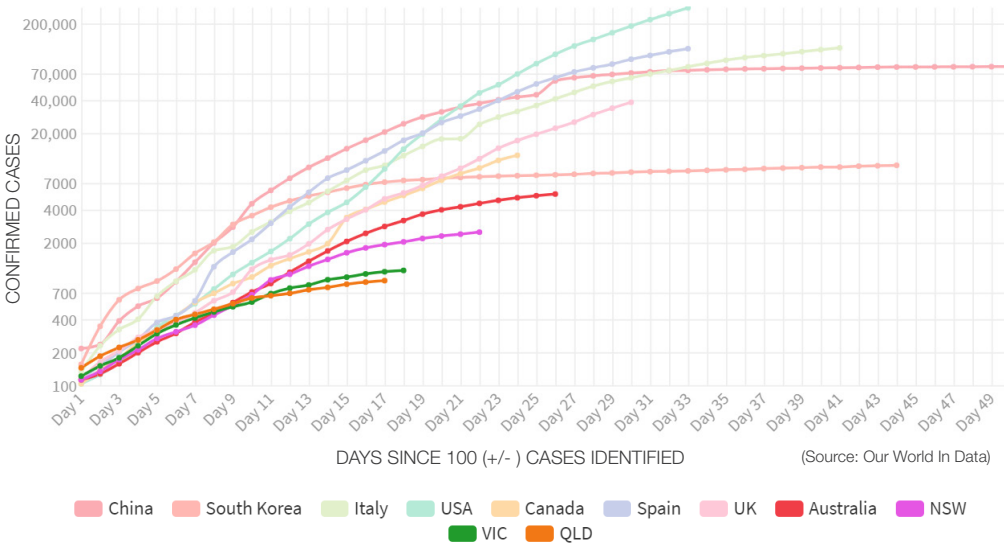
The consequence of this, of course, will be a substantial increase in infection and mortality rates in these developing or third world countries. Conversely, Australia's strict approach will likely see us reach peak virus by mid-April (if we haven't already reached it), with a flattening of the curve remaining substantially under control during May. Our capacity as a nation to substantially expand testing to less symptomatic sectors of our community and quickly (prior to our winter setting in), will enable the number of new cases to be quickly controlled and the curve kept in check all the way through to Spring.

This being the case, we can seriously consider the possibility of slow, staged easing of lockdown measures sometime in June, with the community mostly back to business under a "new normal" by the third quarter of this year (albeit with continued and strict social distancing enforced and heavily controlled movement of people through our borders).

It's clear that a vaccine would reduce the need for social distancing and thus relax the policy's chokehold on the local and global economy. However, timelines for this are likely to be long, and so the focus may well have to be on incremental innovation within the confines of existing solutions.

> *"Australia may in fact be already at peak virus with the US now pushing out to end of April as the more likely scenario."*
>
> - Coolabah Capital

CONFIRMED CASES OF COVID-19 AS AT 05/04/20 - SELECT COUNTRIES & STATES

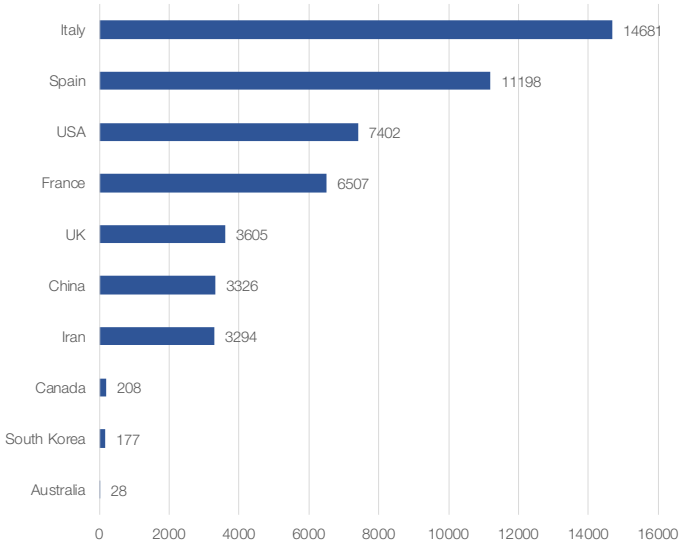


Examples of such innovation may be found across the entire medical spectrum (which are currently being pursued on a massive scale), along with more widespread and faster turnaround testing regimes.

Ultimately, a clear deceleration in infections is likely to be a necessary condition for more constructive global market sentiment. Coolabah Capital has released internal forecasts for the time intervals we are likely to observe a reduction in infection rates after the application of more expansive containment policies in the US and Australia. They have investigated a range of scenarios, modelled on the virus growth trajectories experience in key countries, including Italy, South Korea and China and applying various discounts for impaired containment in the US and Australia.

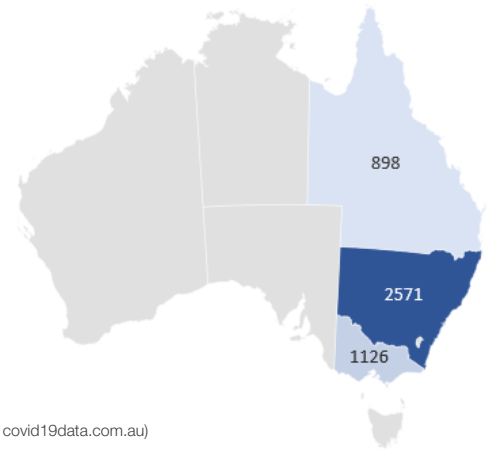
They have concluded that it is reasonable to expect US and Australian infection numbers to peak in early to mid-April with a decline evident 10 to 20 days after that.

DEATHS DUE TO COVID-19 - SELECTED COUNTRIES



(Source: John Hopkins University)

CONFIRMED COVID-19 CASES AS AT 05/04/20 QLD/NSW/VIC



(source: covid19data.com.au)

Since this initial report by Coolabah (recently updated from 23 March), it is becoming evident that Australia may, in fact, be already at peak virus with the US now pushing out to the end of April as the more likely scenario.

Further to this, extensive global trials using existing, approved drugs to treat COVID-19 patients are showing promising results, significantly reducing the severity and duration of the virus. This could mean a considerable reduction of infected patients requiring hospitalisation and ICU admission. In essence, an absolute game-changer for combatting the virus over the next 6-9 months while the world works to discover a vaccine.

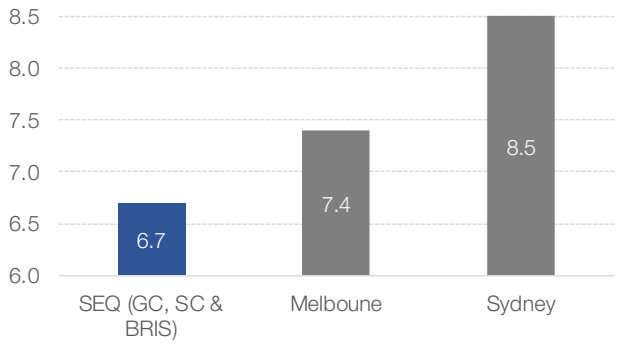
Remember…SEQ's fundamentals remain very strong

Mosaic's internal research team has studied in great detail historical trends, while closely monitoring current local, national and global economic indicators and their likely impact on Australia's core residential property markets. It is important to note that the Australian property market fundamentals, particularly South East Queensland's, remain strong, despite the market volatility COVID-19 is causing.

In addition to the measures taken by banks, the RBA and the Government stimulus packages outlined above, South East Queensland boasts:

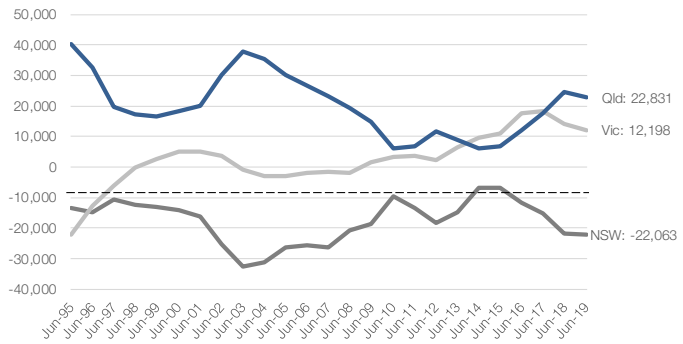
- A once in a generation level of infrastructure investment taking place right across the region, driving employment, migration (interstate and offshore) and property values.
- Record affordability compared to Sydney and Melbourne, in turn driving significant interstate migration numbers and creating major demand for premium quality residential property.

DWELLING PRICE TO INCOME RATIO - 2019



(Source: CoreLogic)

DWELLING PRICE TO INCOME RATIO - 2019

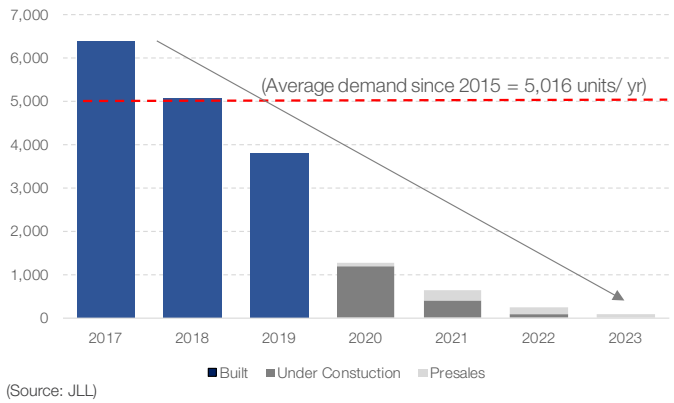


(Source: ABS)

- Significantly constrained supply, with high quality residential property shortages set to last for at least the next 3-4 years, further exacerbated by projects now delayed due to the current crisis.

POTENTIAL APARTMENT SETTLEMENTS

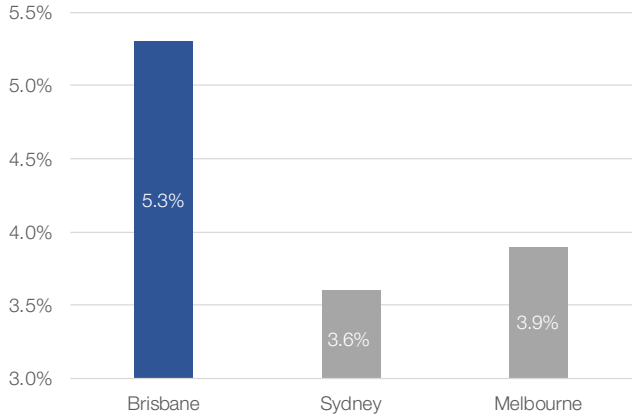
INNER BRISBANE



(Source: JLL)

- Strong rental yields and lower vacancy rates, driven by supply and demand. Increasing yields and decreasing vacancy rates will further strengthen in SEQ once the crisis has passed.

APARTMENT YIELD COMPARISON - MARCH 2020

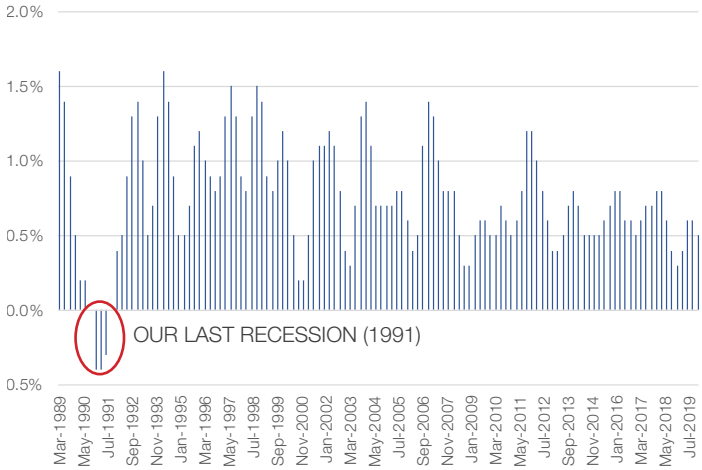


(Source: SQM)

It is also important to remember that demand for property historically increases when international stock markets fall, and our dollar weakens in response to global financial instability.

History has shown that despite global crises such as the GFC, 1991 recession, 1987 stock market crash and outbreaks of illness such as SARS, the Australian property market remained resilient. In fact, following the 1991 recession and Dotcom crash of 2001, Brisbane's property market experienced a boom due to its reliability, lifestyle and affordability, particularly relative to Sydney and Melbourne.

AUSTRALIA'S QUARTERLY GDP GROWTH



(Source: ABS)

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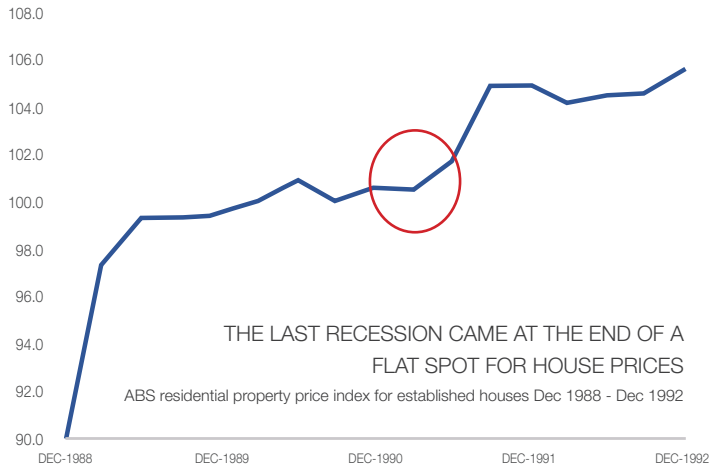

So when will we see a rebound?

There is currently an unprecedented quantum of liquidity being injected across the globe at levels that far surpass the post GFC measures. While it is our view that the contraction in the second quarter of 2020 will be unlike anything we have seen since World War II, we believe the crisis will ultimately be relatively short-lived, unlike the aftermath of the GFC.

By mid-2021, once global order is restored, most countries return to the free movement of people (post vaccine), infrastructure delivery is fast-tracked, jobs rebound across all sectors, and the virus is all but eradicated, we will see positive improvement in asset values, none more so than those underpinned by land.

This has been the case for every crisis and cycle that has existed prior to this one over hundreds of years, and we expect this current crisis is laying the foundation for an even stronger real estate cycle from mid-2021 to 2024.

As history shows, and will no doubt show again, following a sharp and volatile financial market contraction and a substantial hit to global GDP, we will see a period of robust, significant growth globally. We anticipate this to occur in 2021 (particularly the second half of 2021).

Global GDP growth has averaged 7.45% each year since 1960. In the two years preceding the "Dot Com Crash", yearly GDP growth averaged 12.3% and the two years preceding the GFC averaged 10.3%.

> *"We believe the crisis will ultimately be relatively short-lived, unlike the aftermath of the GFC. It is laying the foundation for an even stronger real estate cycle from mid-2021 to 2024."*
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> - Brook Monahan

Roadmap to a property recovery in late 2021

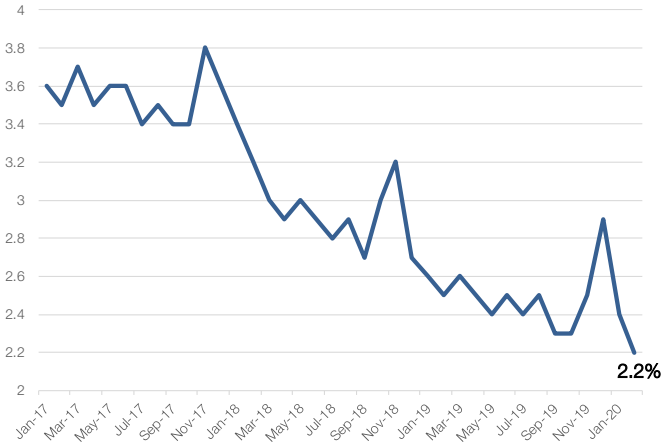
So, what is the most likely outcome with regards to real estate prices over the next 12 to 24 months?

Various alternative economic scenarios could play out depending on the length of time forced shutdowns remain in place across the globe. That said, our baseline views are:

- Residential real estate will enter a period of substantial hibernation over the next three to six months, or until life starts to return to "normal", most likely in the later half of 2020.
- With the historic level of stimulus and incentives on offer, and still set to be offered, to a broad cross-section of Australia's workforce (approximately six million), the residential property sector will hold up reasonably well over the next six months.
- Though a substantial fall in real estate listings and transactions is normally a lead indicator for falling house prices (and vice versa), we do not expect there to be the widespread falls witnessed during and post the GFC despite the significant short-term rise in unemployment.
- Unless in extreme circumstances, or as a result of intense fear, the vast majority of people will not look to sell their home until we are through the worst of the crisis. With a Government-mandated freeze on evictions and mortgagee sales for the next six months, along with freezing of mortgage payments, we envisage there will be limited external pressure, regardless of individual personal situations around employment, that will force sales on any scale that would have a notable impact on the residential property market over the medium term (12-24 months).
- The banks, with very high capital ratio buffers, will continue to maintain the availability of credit at extremely competitive rates through and beyond the crisis. While there will be individual circumstances, on a relatively small percentage basis in our opinion, where people will sell at a discount to current established values in certain areas, we do not see widespread or sustained downward pressure on house prices resulting from the current economic fallout.

- However, over the next six to nine months, Melbourne and Sydney could quite comfortably give back their 10-12% gains achieved since the middle of 2019, as they bounced out the bottom of the last downturn, or even greater falls in oversupplied areas of lower quality investment grade product. But we expect those markets, particularly in the better areas, to recover quickly in the second half of 2021 for all the reasons outlined in this update.
- **South East Queensland will be far less impacted in the short-term** given the severe housing supply shortages, further exacerbated by a continuing fall in construction activity in 2020. This will place additional pressure on the need for high-quality in-fill housing by early 2021. Already SEQ is nearly three years past its peak supply from the previous cycle, compared to Melbourne and Sydney who have only just reached this point. SEQ has also not experienced the same price growth that Melbourne and Sydney achieved in the most recent cycle (Brisbane is currently far more affordable). As a consequence, it proved to be a far more resilient and robust market during the most recent downturn (2017-2019). It will continue to remain more resilient than Sydney and Melbourne in the 12 months ahead.

BRISBANE RESIDENTIAL VACANCIES



(Source: SQM)

- Not all areas and property types will fare the same in the short-to-medium term. It is our firm view that high-quality residential property in in-demand areas with low current and future supply, delivered by trusted brands with a strong track record, will hold up very well in the short-term and lead price growth when the market recovers from this crisis.
- We are confident that the second half of 2021 onwards will see positive price growth return to all Mosaic's core SEQ markets, with the potential for a substantial boom in the years that then follow.

> *"South East Queensland will be far less impacted in the short-term."*
>
> - Brook Monahan

- The top end of the residential market appears to be holding up well, which is quite different from previous cycles. We believe this is because this market understands the phenomenon - although severe - is short-term. With the ability to freeze mortgage payments for the mid-term, a strong banking sector, historically low interest rates, predicted employment bounce back by late 2020, and a substantial drop in sales listings, we anticipate this market will well and truly be back at full speed by mid-2021.
- With a far lower cost of debt and climbing yields, we also expect the net returns on high quality residential real estate in SEQ to improve significantly by mid-2021, moving into 2022.
- Finally, there is the enormous weight of foreign capital trying to enter the Australian market, especially with the low Aussie dollar. We can expect increased positive pressure on all forms of property values once we pass through the peak of the crisis and are again seen as a safe investment haven.

How is Mosaic navigating the crisis?

With staff health our primary focus, we took early, comprehensive steps to implement stringent hygiene procedures and guidelines, both in our offices and on our sites, to limit the potential impact or incidence of the virus. We have been quick to evolve and adapted, as the National Cabinet has continued to introduce additional measures and recommendations.

This means that a large portion of our workforce is now telecommuting. With a robust IT system and infrastructure framework already in place, our staff are continuing to work with minimal impact on productivity and a continued commitment to service excellence.

Further, per the Federal Government's advice on Monday 23rd March, construction sites are considered an "essential" service and remain open and operational. This means work continues on our projects currently under construction, with no anticipated delays to current delivery schedules - an extremely positive outcome for our trades and services from an employment continuity perspective, considering the acute uncertainty being felt in other sectors. It is also great news for our buyers, whose beautiful homes we will deliver on time and as expected.

We understand the obvious health concerns and Mosaic Construction has actively implemented a substantial range of strict measures to support the wellbeing of trades and suppliers on all of our sites. A culture of hygiene goes without saying. It's the contingency plans put in place that count. We will continue to adjust as the situation evolves to keep this essential sector moving.

We are also not impacted by supply chain issues, mainly due to the rigorous risk management procedures we implement as a standard business practice.

A real desire for quality is what drives customers to, and back to, the Mosaic brand. We continually review and evaluate our strategy to ensure we too will remain resilient and prosper, as we have done in the past through multiple crises and cycles. It primarily includes our response to keeping our team safe.

To summarise...

We believe the crisis, although severe initially, will ultimately be relatively short-lived, unlike the aftermath of the GFC.

- It is vital to maintain perspective during the COVID-19. Remember:
  1. Strict measures are being enforced to flatten the curve quickly. Australia is so far a global leader in dealing with the virus
  2. Monumental stimulus packages are supporting business, industry and employment continuity
  3. The banks are coordinating in the best interest of their customers
  4. The public recognises this is a crisis and are acting accordingly
  5. There is a clear shift in narrative – livelihoods are just as important as lives
  6. Forecasting accuracy is improving at a rapid rate, as is progress with various drug trials, to determine when to commence easing shutdown measures. Australia is now a world leader in this regard.
- Experts are currently pointing to a minimum six-month timeframe for the virus to be considered under control. Our view is that this is not sustainable and that we will most likely emerge out of these strict guidelines sooner than is being suggested.
- With a flattening of the curve remaining substantially under control during May. This being the case, we can seriously consider the possibility of slow, staged easing of lockdown measures sometime in June, with the community mostly back to business under a new normal by the end of the third quarter of this year.
- As history has proven, demand for property increases when international stock markets fall, and our dollar weakens in response to global financial instability. Safety of bricks and mortar as an investment choice is ingrained in Australia's DNA.
- South East Queensland's fundamentals remain the strongest in Australia.
- We are confident that the second half of 2021 onwards will see positive price growth return to all Mosaic's core SEQ markets, with the potential for a substantial boom in the years that follow.

What the experts are saying

I encourage investors to see this single event for what it is. A minor single event within a long-term investment cycle. There is no need whatsoever for panic.
– Morgan Stanley Associate, Kuldeep Yadav

Australians can take comfort from history, because economic shocks like the one triggered by the coronavirus have always heralded periods of robust growth. One thing we do know is that a shock is always followed by a period of strong growth, including employment growth.
– Ex-Treasury secretary Ken Henry

The bushfires and coronavirus are a short-term threat to Australian economic growth, expect GDP to fall this quarter followed by a strong rebound.
– Shane Oliver, Chief Economist AMP Capital

What the experts are saying (cont.)

We view it (coronavirus) as a transitory exogenous shock as opposed to an economic slowdown caused by endogenous pulls and pressures of an economy that is overheating and fundamentally challenged. We remain of the view that economic recovery is being delayed but not derailed.
– Morgan Stanley

With Australia's fears about the coronavirus weighing on the minds of investors, property prices are tipped to remain largely resilient, with room for further growth throughout 2020 and beyond.
– CoreLogic Head of Research, Tim Lawless

> *"Expect a quick recovery when the health threat recedes, the underlying economy is strong, banks well-capitalised, system not too leveraged. Unlike 2008, it will avoid systemic damage."*
>
> – Lloyd Blankfein, Retired Goldman Sachs CEO

All the talk of being "late cycle" is nonsense – this cycle is set to elongate for some time. When all is said and done, the current fear and anxiety will translate into a tremendous opportunity because COVID-19 has no real ramifications for the long run.
– Christopher Joye, Chief Investment Officer, Coolabah Captial (previously of Goldman Sachs & RBA)

Around the world market historians point to the fact that after previous medical emergencies, once the problem was contained, markets roared back. No one wants to be off the bus when that happens. In many areas of the property market shortages are on the horizon and so, the bullish scenario is that when the share market fall is over we can get back to our share and property booms, now further boosted by lower rates.
– Robert Gettliebsen, Economist & BRW Magazine Founder

Australia's financial system is resilient and well placed to deal with the effects of the coronavirus. The banking system is well capitalised and is in a strong liquidity position. Substantial financial buffers are available to be drawn down if required to support the economy.
– Royal Bank of Australia

COVID-19 will have an impact on the marketing of some properties and affect the rental market from Chinese students unable to get into Australia, but these impacts will be small and not impact the recovery in the housing market that has rebounded strongly since mid-2019 on the back of low interest rates and easier credit conditions.
– Jones Lang LaSalle

Higher levels of equity in the banks will let the financial system act as a "shock absorber", rather than amplifying problems like the sector did during the global financial crisis.
– Australian Prudential Regulatory Authority

With RBA action, government incentives and now some meaningful endeavours the second half of 2020 should be better, economically, than the first and 2021 should be much stronger than 2020. It is always the property fundamentals that really matter. The long-term view outsmarts short-term thinking. Things that really matter and most importantly supply and demand. None of these fundamentals are likely to be significantly altered by the current virus and the ensuing fear. People will always need somewhere to live, and homes are the true "safe haven" in the current environment.
- Michael Matusik, Property Market Analyst and Commentator

It is possible that we are near — or have even passed — the peak uncertainty bit of this crisis. We know for example that COVID-19 cases probably peaked in China in early February. We also have a sense of just how bad things were at their worst in China: So we have a rough guide as to what might happen elsewhere. We also know that China is recovering fast: The consensus appears to be that China is 85 per cent back to normal.
– Merryn Webb, Editor-in-Chief MoneyWeek

In the medium-term it's possible we could see a retreat in investors which may further dampen the volume of transactions, It's unlikely to affect the median house price, given Queensland is a strong investment market, has a strong history of economic performance, significant infrastructure projects and steady projected population growth.
– Antonia Mercorella, CEO Real Estate Institute of Australia

I think the government should start planning now for the reconstruction because things are going to bounce back quite quickly.
– AMP Chairman David Murray

> *Mid-cycle events don't usually affect the property market. This was indeed the case in the 2000–01 dotcom crash. Property markets continued their bull run through to a peak in 2007. A similar dynamic seems in play currently.*
>
> – Catherine Cashmore, Property Analyst and Commentator