HOUSING MARKET UPDATE

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WEEK ENDING 15TH OCTOBER 2021

BOQ GROUP

Key points

- **House prices are on track for the strongest year of growth in over 30 years;**
- **Very low interest rates, easy availability of finance, strong demand and undersupply of standalone houses have all played a role in boosting prices;**
- **High house prices is leading to higher supply;**
- **I expect house price growth nationwide to be 8% next year, and 4% in 2023.**

Summary

We have to go back over thirty years to see house price growth stronger than what we have seen over the past year. Price growth has been uniformly strong for standalone housing. The performance of units has been more mixed. That house price growth has been strong across states and territories indicates they are common drivers (very low interest rates and easy availability of finance). But the pace of growth has not been the same. This reflects differences in the strength of population growth, the state of the economy, supply of housing and affordability. These differences become starker at the local level.

According to industry feedback the biggest impediment to growth in the established residential real estate market is the lack of supply (or stock). The history of the housing market is that higher demand leads to higher prices. And in time higher prices leads to higher supply. But the supply pickup has been less certain on this occasion than it has been for the past twenty years. The main reason is the impact of lockdowns has had on both the willingness and ability to sell a house.

New listings has increased in a number of market segments in some cities over the past year. Most of the large rise in listings has taken place in units in the four largest cities. In some cases though higher prices has not led to rise in the number of listings. In the Adelaide, Canberra and Hobart standalone housing market (and the Hobart unit market) the number of listings has fallen.

High house prices should encourage the building of more new homes (along with very low interest rates) to help alleviate some of the supply problems. That has been the case in WA, SA and Tasmania. In Sydney, Melbourne and Brisbane the big increase in residential construction has been mainly standalone housing. Greater supply of housing is on the way, much of which will hit the market by the end of next year.

The combination of strong demand and a lack of supply has led to house prices rising more than units over the past year in many capital cities. The outperformance of houses over units has been a long-term trend reflecting strong population growth, the desire of many people to live close to the CBD in the major capital cities and the scarcity of land in those major cities (notably Sydney). With affordability a growing issue across all states the better value of units is likely at some stage to find stronger demand.

Housing prices have been on a tear over the past year. This momentum will almost certainly continue for the rest of this year. But price growth is likely to slow over the next couple of years. Interest rates are unlikely to be heading any lower. It won't be getting easier to get a loan any time soon. Population growth has been slow. More supply is hitting the market. Affordability is a growing issue.

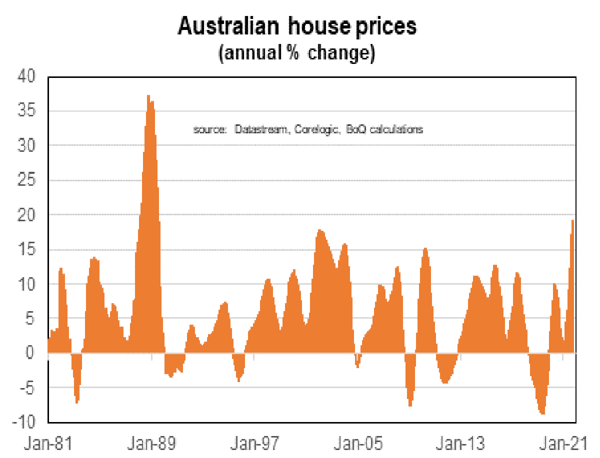
The economy is likely to have a decent couple of years. Consumer confidence in the economic outlook is high. And interest rate changes over the next couple of years will be modest. All of this suggests that house prices are still likely to go higher. But not as fast as we have experienced over the past year. And from a sustainability standpoint, that is a good thing.

It has been a big year for house prices

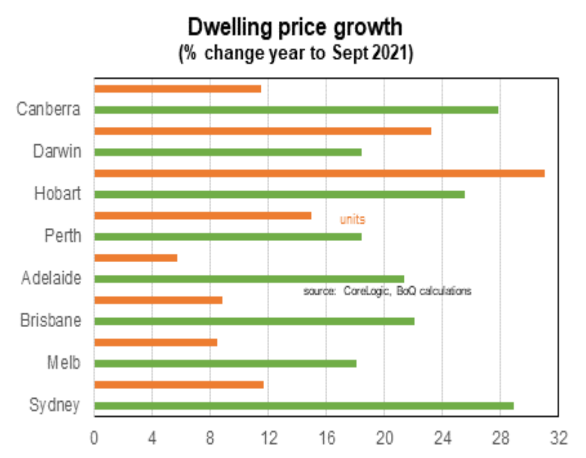
The pandemic has had a massive impact on parts of the economy. Air and Rail transport, Arts and Recreation and Accommodation and Food Services have had a difficult past eighteen months. But some areas of the economy are doing well. Notably people looking to sell a house. We have to go back over thirty years to see price growth stronger than what we have seen over the past year. Price growth has been uniformly strong for standalone housing in all the major capital cities. The performance of units has been more mixed. But the performance of even the worst performing category (Adelaide units up 'only' 6%) can't be sneezed at.

Regional outperformance (ie, places outside of the capital city) has been an oft-cited theme of this house price boom. That has been the case in Victoria, and to a lesser extent in NSW and Queensland. But regional outperformance has not been stark in WA or Tasmania. And it has not occurred in either South Australia or the Northern Territory.

House price growth has been the strongest for over thirty years.



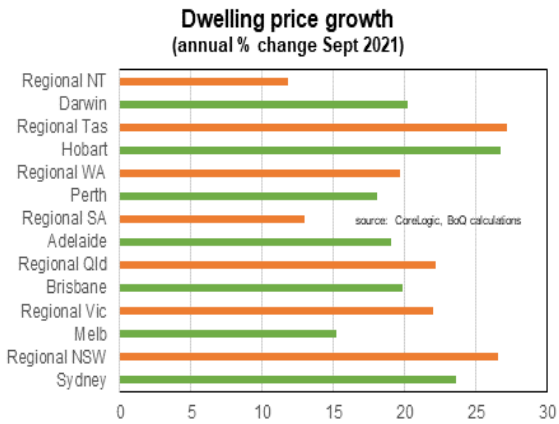
Standalone housing has outperformed units in most major capital cities.



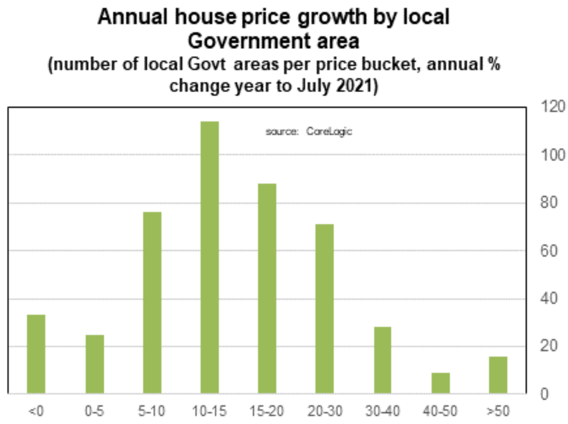
That house price growth has been strong across states and territories indicates they are common drivers (very low interest rates and easy availability of finance). But the pace of growth has not been the same. This reflects differences in the strength of population growth, the state of the economy, supply of housing and affordability.

These differences become starker at the local level. Some of the local government price rises over the past year have been extraordinary. Over 50 local government areas have seen price rises of over 30% (in the year to July 2021), and 16 over 50%! But not everyone has got an invite to the house price rise party. According to Corelogic data dwelling prices declined in 33 local government areas. That there have been falls in some local government areas during a period of widespread strong price increases underlines that house prices don't always go up.

In most states and territories the strongest price growth has been outside of the capital cities.



Some local government areas have seen massive house price rises. But some areas have also seen declines.



The factors remain in place for decent house price growth over the next couple of years

The main factors that drive house prices suggest further rises over the next couple of years', albeit not at the same speed witnessed over the past year. My forecast is that house prices across Australia will rise by 8% next year and 4% the year after.

Interest rates are at historic lows, and are likely to remain there for at least the next 18-24 months. Sure financial markets are speculating that the first cash rate hike could happen as early as late next year. But that view is inconsistent with the current level of inflation and wages, as well as the RBA's public statements on the interest rate outlook. As I noted last week there are scenarios where interest rates could decline (mainly a result of the high level of debt in some parts of the world). But given rising inflationary pressures globally it looks increasingly likely that the next move in the cash rate will be up.

At the same time as the cost of finance has probably bottomed, it has started to get a little tougher to access finance. APRA recently nudged lending standards a little tighter. Regulators main concern is the high level of debt taken out by (some) households. Given the current momentum in credit growth the risk must be that standards are tightened further over the next 6-12 months. They are certainly unlikely to get much easier over that time.

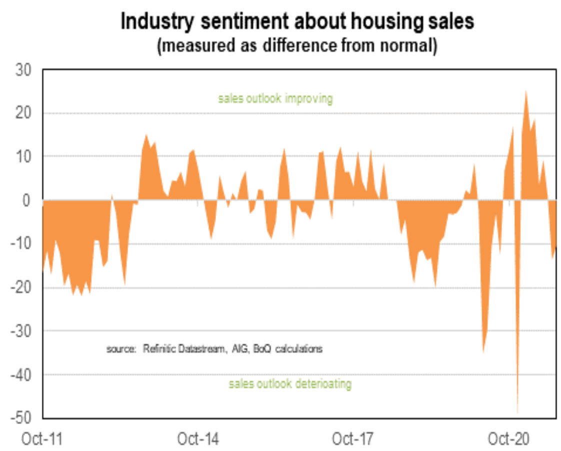
Despite the slowest population growth in over 100 years' the demand for housing has been strong. Twelve to eighteen months ago that strong demand reflected high levels of affordability attracting first-home buyers back into the market. Existing-home buyers then stepped up to the plate, as working-from-home opened up demand for bigger homes further away from the city centre. More recently, rising house prices has attracted investors' back to the market. But at some point the lack of population growth must weigh on demand.

One factor that is starting to have an impact is that affordability has declined across all states (particularly in NSW and Victoria). Surveys indicate a growing number of households across states think that now is not a good time to be buying a house. Affordability particularly impacts first-home buyers.

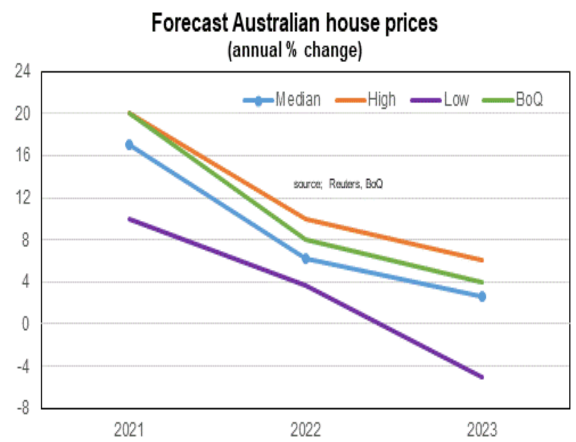
Focus on supply

According to industry feedback the biggest impediment to growth in the established residential real estate market is the lack of supply (or stock). In many markets it takes some time for supply to respond to changes in demand. This is particularly the case if the changes in demand takes place quickly. In the case of the residential real estate buying sentiment was generally negative in 2018 and 2019 reflecting the modest state of the economy and tight lending standards. Things started to improve in the second half of 2019 (a result of a fall in the cash rate) but then got whacked again when the pandemic hit. To everyone's surprise, housing prices (and sales) bounced back a lot quicker than expected in the second half of 2020 due to low interest rates and massive government income support programs. And got further turbo-boosted by government incentive programs announced in the 2020-21 Budget. But then came the 2021 lockdowns.

Sentiment about housing has changed swiftly over the past couple of years.

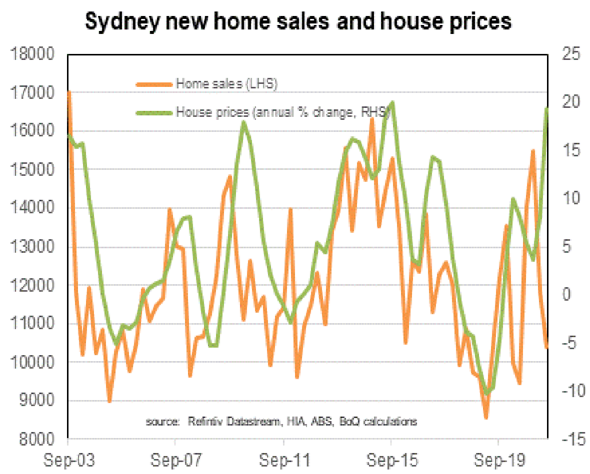


Slower, but still decent, house price growth is expected over the next couple of years

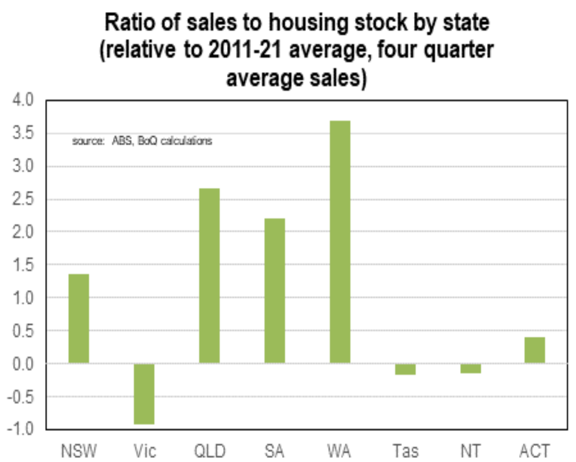


The history of the housing market is that higher demand leads to higher prices. And in time higher prices leads to higher supply. But the supply pickup has been less certain on this occasion than it has been for the past twenty years. The main reason is the impact of lockdowns has had on both the willingness and ability to sell a house. This factor has been most evident in Victoria. The stock coming to market has been better in the states that have been largely open and enjoyed decent economic growth (WA, SA and Queensland).

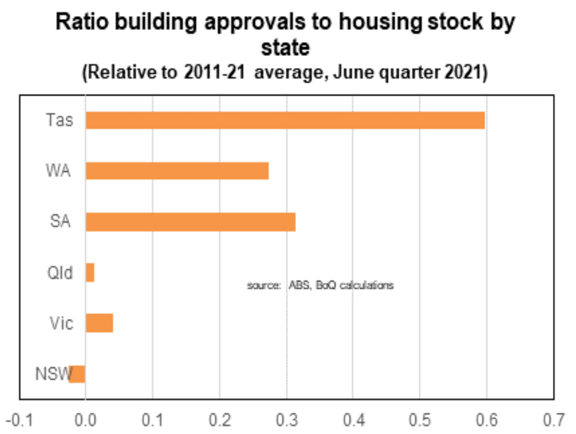
High house prices leads to higher supply.



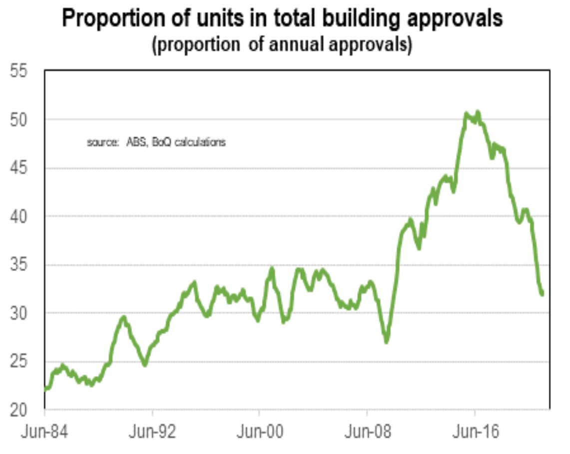
Stock on the market has increased in some, but not all, states.



There is a residential construction boom happening in some states.



That boom has mainly been of standalone houses.



The amount of stock sold though is not the best measure of supply. It is a measure of buyers and sellers agreeing to a price appropriate for the location and features of a dwelling. A more direct measure of supply (of existing dwellings) is the number of listings.

New listings has increased in a number of market segments in some cities over the past year. Most of the large rise in listing has taken place in units in the four largest cities. In Sydney, Melbourne and Brisbane that increase in listings (combined with moderate demand) meant that unit price rises lagged behind standalone houses. That was not the case in Perth, reflecting very strong demand and the lack of residential construction in WA over recent years.

In some cases though higher prices has not led to a rise in the number of listings. In the Adelaide, Canberra and Hobart standalone housing market (and the Hobart unit market) the number of listings has fallen. Unsurprisingly when combined with strong demand the result has been very strong price growth. In the Sydney (and Darwin) standalone housing market there has been a decent rise in listings over the past year. The problem is that the increase in listings has not been able to keep up with the increase in demand.

High house prices should encourage the building of more new homes (along with very low interest rates) to help alleviate some of the supply problems. That has been the case in WA, SA and Tasmania. But the amount of new building activity is not unusually high in the three large eastern states. That may partly reflect greater economic concerns (particularly in Victoria). And in the case of NSW, the difficulty in finding affordable land.

But Sydney, Melbourne and Brisbane have seen a big building boom in units over recent years. The popularity of units has fallen since COVID, partly reflecting the absence of immigration (particularly international students) and the trend towards working-from-home. But there has been an increase in approvals to build standalone houses in the three large states.

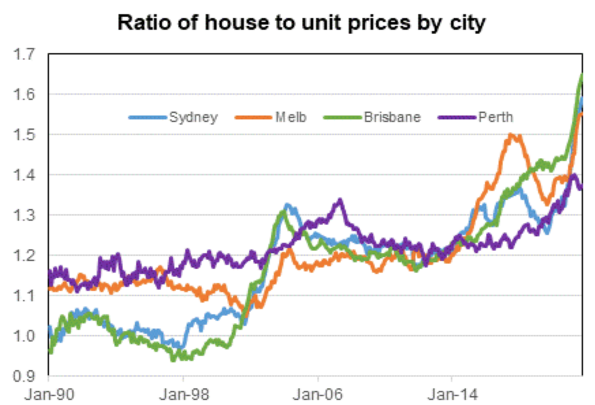
So the supply story is different between different regions and different market segments. In WA there was very little residential construction of any sort in the years' leading into COVID. The result has been a lack of supply of all dwellings. In Tasmania a strong economy has created strong demand for housing and the supply of new houses has not been able to keep up. So there is a large amount of residential construction taking place in both those states. In the other major cities the lack of supply has been mainly evident in standalone housing. More supply is on the way, much of which will hit the market by the end of next year.

City	Type dwelling	Annual % change listings past year	Annual % change price increase past year
Sydney	House	14	29
	Unit	12	12
Melbourne	House	8	18
	Unit	10	8
Brisbane	House	3	22
	Unit	10	9
Perth	House	8	18
	Unit	30	15
Adelaide	House	-3	21
	Unit	2	6
Hobart	House	-8	26
	Unit	-12	31
Darwin	House	11	18
	Unit	-4	23
Canberra	House	-2	28
	Unit	-3	12

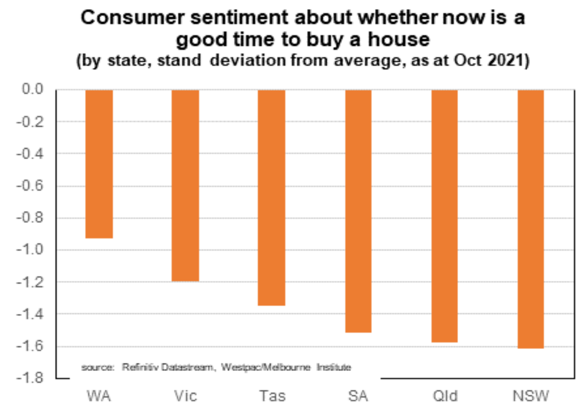
Source: Corelogic

The combination of strong demand and a lack of supply has led to house prices rising more than units over the past year in most capital cities. The outperformance of houses over units has been a long-term trend reflecting strong population growth, the desire of many people to live close to the CBD in the major capital cities and the scarcity of land in those major cities (notably Sydney). But the ratio of house to unit prices is at record highs in Sydney, Melbourne and Brisbane (and near to it in Perth). With affordability a growing issue across all states the better value of units is likely to at some stage find stronger demand.

Housing prices have outperformed units in the major capital cities over the recent years.



Rising concerns about affordability is weighing on consumer sentiment about housing.



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The economy is likely to have a decent couple of years. Consumer confidence in the economic outlook is high. And interest rate changes over the next couple of years will be modest. All of this suggests that house prices are still likely to go higher. But not as fast as we have experienced over the past year. And from a sustainability standpoint, that is a good thing.

We live in interesting times.

Regards

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