HOUSING MARKET UPDATE

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WEEK ENDING 16TH APRIL 2021

Summary

- This year house prices have been driven higher by a number of factors;
- But those factors become less positive over the next couple of years;
- This suggests that while Australia-wide house price growth will be strong this year (+15-20%);
- They will be less strong in future years (2022 +5-7%, 2023 +3-5%).

Rising house prices is currently a topic of conversation in more countries than just Australia (as recently highlighted by the RBA). No surprise given that a strong rebound in economic growth and extremely low interest rates is a feature of many economies.

One reason to think house prices can remain strong is growing confidence in the economy. Firms' report that conditions are currently as good as they have seen them for at least two decades. Consumers are also feeling bubbly helped by an improving jobs market. The unemployment rate is falling.

Perhaps the most important driver of house prices is interest rates. Right now the housing market is benefitting big time from the rate reductions over the past couple of years. The RBA has recently made it clear that it thinks it will not be changing the cash rate to at least 2024. Financial markets are pricing rate hikes into 2023, a year earlier than the RBA public statements.

Plenty can happen between now and 2023. Financial markets and the RBA can probably agree on two things. First, the cash rate is unlikely to be changing for at least the next 18-24 months. Second, given the evident strength of the economy the next move of interest rates is far more likely to be up than down. Unless rates fall further the positive impetus of lower interest rates so evident today will start to ebb towards the back end of this year.

Over any extended period of time it is growth in the population that drives the demand for housing. And Australia is on track this year to have its lowest population growth in over one hundred years. Two-thirds of population growth pre-COVID has been immigration. And while the international borders remain closed it will be hard for population growth to be strong.

The supply-side has also acted to boost house prices this year. In recent years we have not built enough homes in Perth or Brisbane (and a number of regional areas) to meet the increased demand. We have built plenty of units (particularly in inner-city Sydney and Melbourne) but they have been negatively impacted by the fall in immigration.

Strong housing demand, very low interest rates and government support programs (HomeBuilder and state government housing programs) are creating a significant boost to the supply of housing. Extra supply will hit the market over the next 1-2 years at the same time as lower population growth bites into demand.

A strong rise in house prices (15-20%) Australia-wide is very likely this year. But next year the factors for higher house prices are less positive. This is likely to mean slower house price growth (5-7%) in 2022. And even slower the year after (3-5%).

Higher house prices: A road well-travelled

In recent weeks the 'progress' of the vaccine rollout has (rightly) been the major news item. But there has also been another topic that has captured news headlines (and has done so for decades): house prices.

Rising house prices is currently a topic of conversation in more countries than just Australia (as recently highlighted by the RBA). No surprise given that a strong rebound in economic growth and extremely low interest rates is a feature of many economies. Indeed, by the standard of peers the rise in Australian house prices has actually been quite modest over the past year! Higher house prices started gathering momentum from 2019 in other countries (and even earlier in the US, Canada and New Zealand). Reflecting the later pickup of house prices, credit growth is currently more modest in Australia then elsewhere (but it is picking up).

The pattern of house price changes in Australia is not dissimilar to that experienced in other countries (notably the US). Smaller capital cities and the regions (particularly those near large cities) have done best. Houses in the suburbs have done better than units in the inner city. The benefits of living in an affordable house with more space has made a comeback.

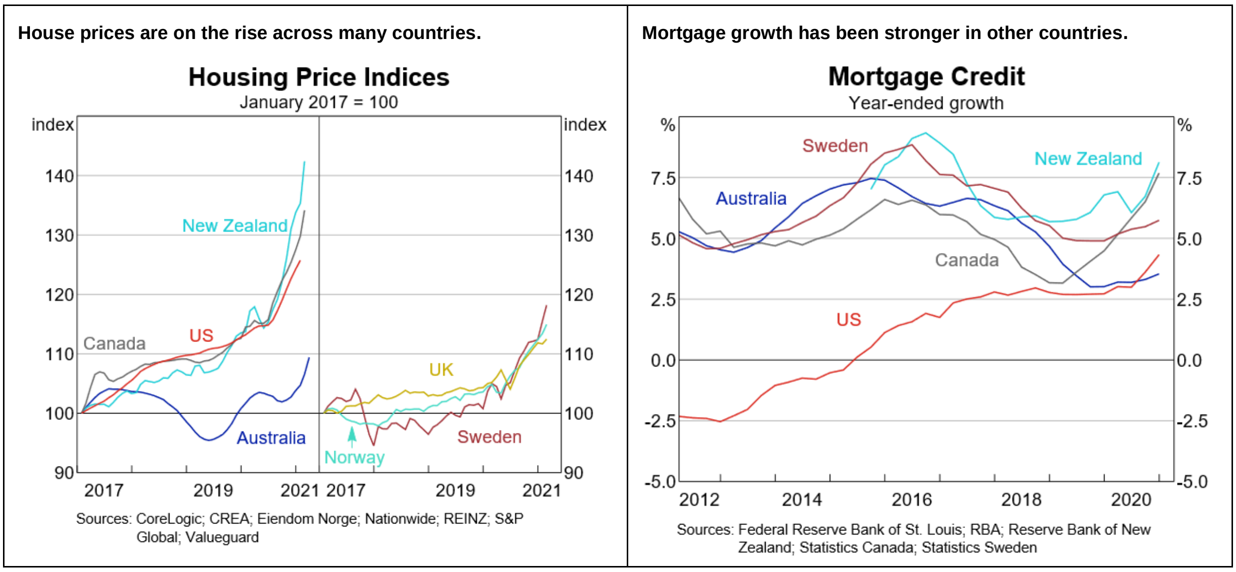


Chart source: RBA Financial Stability Review May 2021

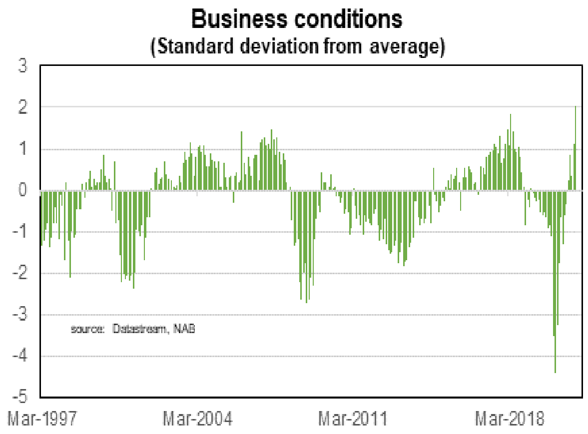
Accordingly to CoreLogic house prices were *only* up 4.5% over the year to March 2021. But that headline figure hides the momentum change that was evident from the second half of last year. Over the past six months house prices were up over 20% in annualised terms in Adelaide and Perth, almost that much in Brisbane and 10%-plus in Sydney. Even in Melbourne house prices rose by almost 8%. Some regional areas have done even better.

The outperformance of ‘small’ v ‘big’ cities has been put down to COVID. And there is something to that. But that outperformance started prior to the pandemic when the Brisbane (as well as Adelaide, Canberra and Hobart) markets started to outperform Sydney and Melbourne (Perth was an exception). Ditto many state regional markets had started to outperform the capital city. The constant in all cases was affordability. Housing affordability was extremely strong in all capital cities (particularly Perth) at the start of COVID. And affordability made the regions and smaller capital cities attractive relative to Sydney and Melbourne.

House price outlook

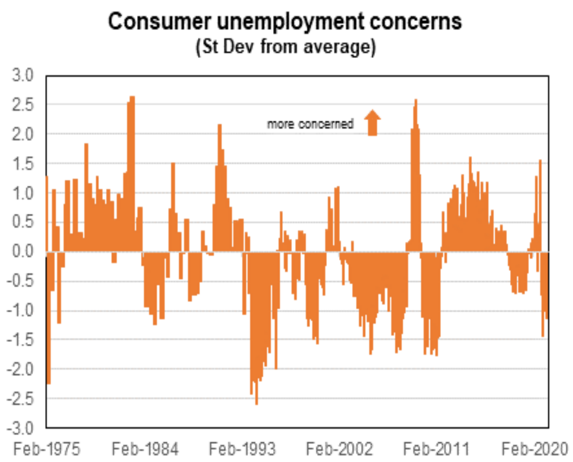
So house price growth has been very strong. And one reason to think they can remain strong is growing confidence in the economy. Firms’ report that conditions are currently as good as they have seen them for at least two decades. No surprises then that they also report they are increasingly happy to hire. Consumers are also feeling bubbly helped by an improving jobs market. The unemployment rate is falling.

Surveys indicate that business conditions are very strong.

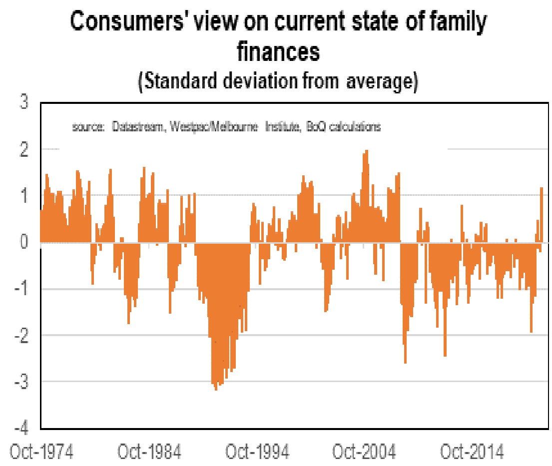


And that means they are happy to hire.

Stronger jobs growth means consumers are less worried about unemployment.



And this means they have become more comfortable about their finances.



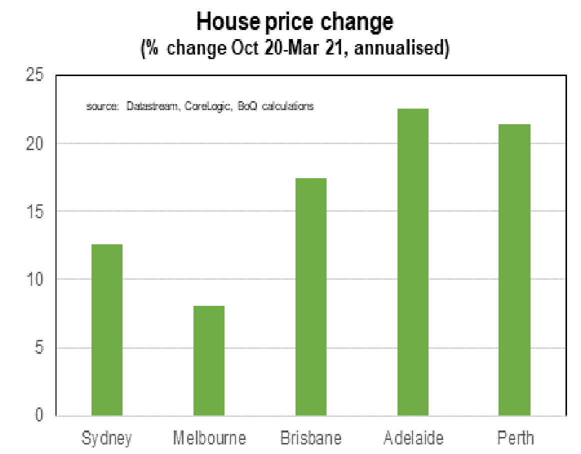
Extremely low interest rates has been very important

Perhaps the most important driver of house prices is interest rates. The lower the interest rate the more money consumers can borrow. Very low interest rates also drives money into looking at returns on other assets (including housing). Right now the housing market is benefitting big time from the rate reductions over the past couple of years. Historical relationships would suggest that the percentage decline we have had in mortgage rates over the past 1-2 years would result in about a 15% rise in house prices (which is about what we are having).

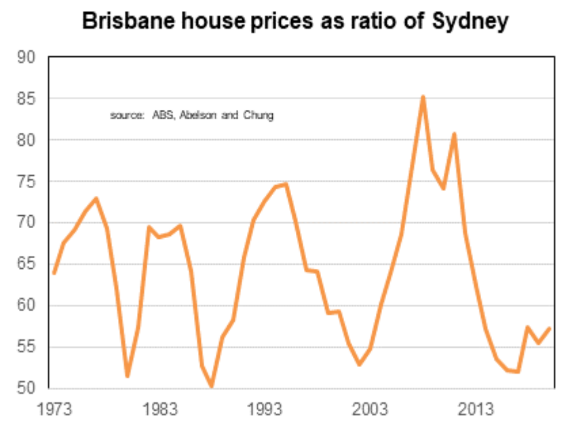
The RBA has recently made it clear that it thinks it will not be changing the cash rate to at least 2024. That is based on the view that it will take that long for the unemployment rate to get low enough for wages growth to move above 3% (the level the RBA believes is consistent with their inflation target). Financial Markets don't disagree with what the RBA is trying to achieve. But they (like the RBA) have been surprised as how strong the economy has become. And how quickly the unemployment rate has fallen. As a result financial markets are pricing rate hikes into 2023, a year earlier than the RBA public statements.

At the end of the day 2023 is two years away. And plenty can happen in that time that could challenge current market pricing. Both financial markets and the RBA can probably agree on two things. First, the cash rate is unlikely to be changing for at least the next 18-24 months. Second, given the evident strength of the economy the next move of interest rates is far more likely to be up than down. The bottom line is that unless rates fall further the positive impetus of lower interest rates on house prices so evident today will start to ebb towards the back end of this year.

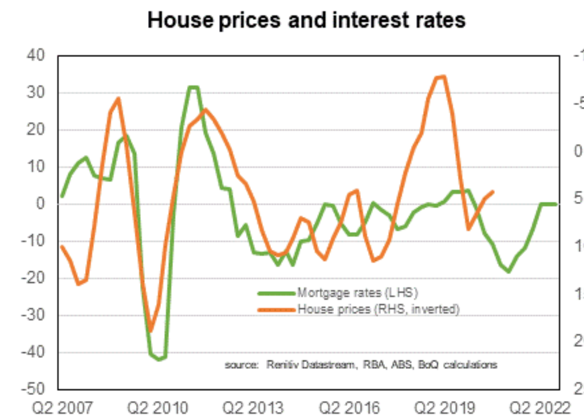
House price growth has been strongest in the 'smaller' capital cities and regions.



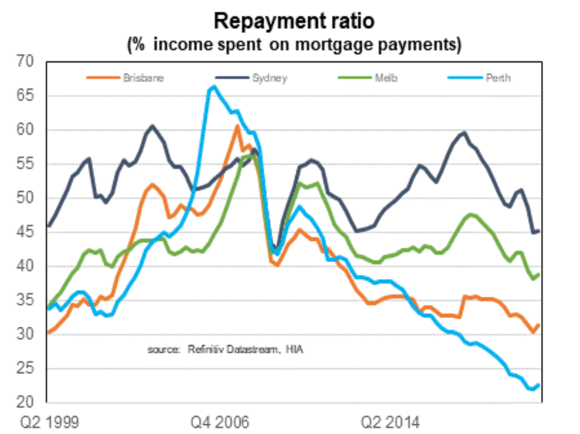
Brisbane house prices have been very affordable relative to Sydney for some time.



The decline of interest rates over recent years has been a major driver of house prices.



Affordability is very strong across most cities.



There is currently strong demand for housing

Another positive for the housing market has been rising demand. Improved affordability has attracted many first-home buyers back into the market. Affordability and the increased ability to work from home has opened up suburban and regional housing markets to new buyers. And the desire (and need) to work from home has highlighted the benefits of being in a home with plenty of rooms as opposed to a small unit.

But can it remain strong with weak population growth

But over any extended period of time it is growth in the population that drives the demand for housing. And Sydney and Melbourne for the first time in the almost 40-year history of quarterly population data experienced a fall in population in the September quarter 2020. The situation was less dire elsewhere, particularly Queensland that remained a significant net beneficiary of inter-state migration.

The big picture though is that Australia is on track this year to have its lowest population growth in over one hundred years. Two-thirds of population growth in recent years has been immigration. And while the international borders remain closed it will be hard for population growth to be strong.

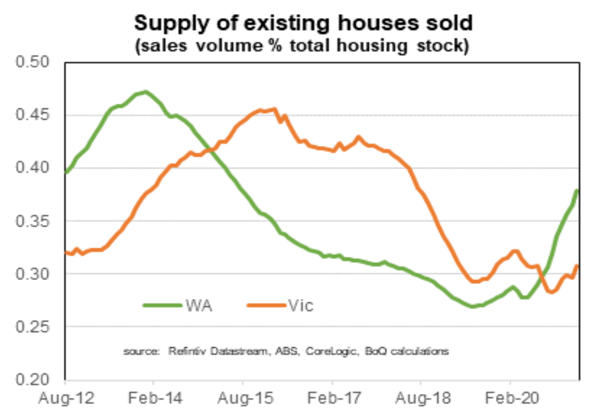
The composition of the demand for housing will change over the next couple of years. Rising house prices is reducing affordability and will lead to lower demand from first-home buyers. Already households' interest in the housing market has started to wane. There are signs that investors' are getting interested again in the housing market. At some point the price underperformance of inner-city units will make them (relatively) attractive again (from both a purchase and rental standpoint).

And there is a mixed supply story

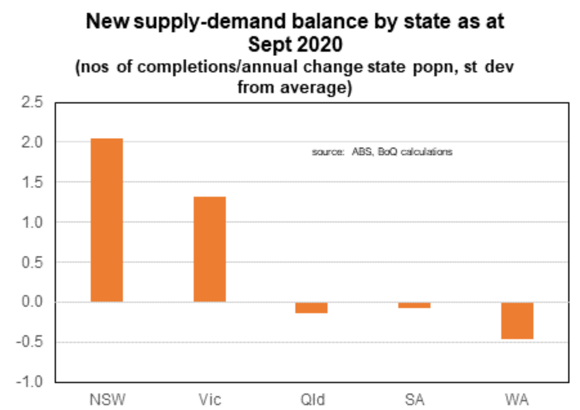
The supply-side has also acted to boost house prices this year. In recent years we have not built enough homes in Perth or Brisbane (and a number of regional areas) to meet the increased demand. We have built plenty of units (particularly in inner-city Sydney and Melbourne) but they have been negatively impacted by the fall in immigration. This combination of higher demand and modest supply is the reason why Sydney house prices have continued to outstrip unit prices.

High house prices is starting to encourage more houses to be put up for sale (notably in the stronger markets such as WA). Strong housing demand, very low interest rates and government support programs (HomeBuilder and state government housing programs) are creating a significant boost to the supply of housing. Builders' order books are bulging. All of this extra supply will hit the market over the next 1-2 years at the same time as lower population growth bites into demand.

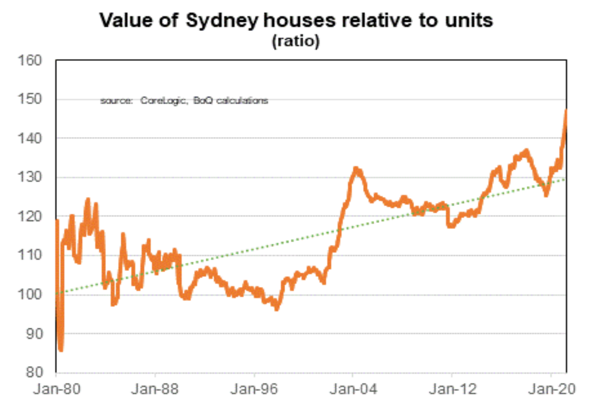
The strength of the market has seen the stock of houses for sale rising in WA. This has not yet happened in Victoria.



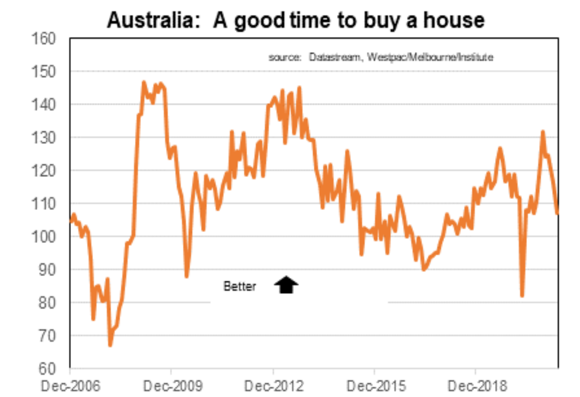
The rise in new supply relative to demand has been strongest in NSW and Victoria, weakest in WA, Qld and SA.



The price of a house in Sydney has been outperforming units.



Sentiment towards housing has started to turn down.



Bottom line: very strong house price growth in 2021, less strong over the next couple of years

Right now there are a bunch of factors driving house prices higher. Economic growth is rebounding sharply. Interest rates are extremely low. Improved affordability has encouraged first home buyers into the market. And together with the increased ability to work from home has led to a change in the pattern in the demand for housing. This change in housing demand has created undersupply in some areas (regional housing) and oversupply in others (inner-city units).

But the maximum impact of these factors is hitting the housing market now. In one year the economy still should be in good shape. But we are also likely to be one year closer to an interest rate hike. Weak population growth will hit housing demand. And higher supply will hit the market.

A strong rise in house prices (15-20%) Australia-wide is very likely this year. But next year the factors for higher house prices are less positive. This is likely to mean slower house price growth (5-7%) in 2022. And even slower the year after (3-5%).

House prices have always been a ‘hot-button’ topic in Australia. That is unlikely to change for the foreseeable future. But right now the topic is near the front page of newspapers. But as price growth moderates over the next year or two house prices will start slipping towards the back pages.

We live in interesting times.

Regards

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Bank of Queensland