HOUSING MARKET UPDATE

PETER MUNCKTON – CHIEF ECONOMIST

WEEK ENDING 16TH JULY 2021

Summary

- Not for the first time, Australia has seen a patch of very strong house price growth;
- The story of higher prices is consistent across most areas and segments;
- All the factors that drive housing have helped drive prices higher;
- But starting from next year those factors become more mixed;
- The lockdown will only modestly impact the Sydney housing market;
- After very strong growth of 16% this year, I expect a slower place in both 2022 (8%) and 2023 (4%).

Last year the worry about house prices is that they might fall. This year it is by how much they have risen. Growth across Australia averaged in the double digits in the year to June 2021. Historically, such a pace of price growth is not unusual.

Growth has been strong across the major capitals. One topic of conversation is that house prices have risen by more than units. That has been the case in Sydney, Melbourne, Brisbane, Adelaide and Canberra, but not elsewhere. Another discussion has been the outperformance of house prices in regional centres. That story differed between states. Regional outperformance has been significant in NSW, Victoria and (to a slightly lesser degree) Queensland. Perth and Darwin have clearly outperformed the rest of the state.

A third feature discussed has been that the highest price rises have been for the most expensive homes. The actual story is again more complicated. Expensive home outperformance has been most obvious in Sydney and Canberra (and to a modest extent in Adelaide). But in Perth, Hobart and Darwin the best price growth over the past year has been at the cheaper end.

The most significant driver of high house prices has been the extremely low level of interest rates. The maximum impact from the decline of interest rates hit the housing market in the middle of 2021. If interest rates stay where they are history would suggest they will provide a diminishing impact over coming months. All the recent discussion has been about the potential for higher interest rates.

Over the long term a significant driver of house prices is population growth. A rise of immigration is unlikely to occur until there is widespread vaccination. Treasury assumed that international borders will start to open up around the middle of next year, with a return to 'normal' immigration levels gradually ramping up to mid-2024. This means a return to pre-COVID rates of population growth is still 2-3 years away.

The other important driver of house prices is supply. Industry feedback is that a lack of stock is the biggest constraint on the established housing market. There is a large amount of new houses being built, although most may not be completed until next year.

It is hard to see how the Sydney lockdown will not have some impact on the housing market. But the fundamentals of a strong economy, falling unemployment, very low interest rates, strong demand for houses in places where the has been an under supply should mean that Sydney should still record decent house price growth.

By year-end I look for house prices to be about 16% higher on average across Australia. In 2022 I expect house prices on average to rise by around 8% and about 4% in 2023.

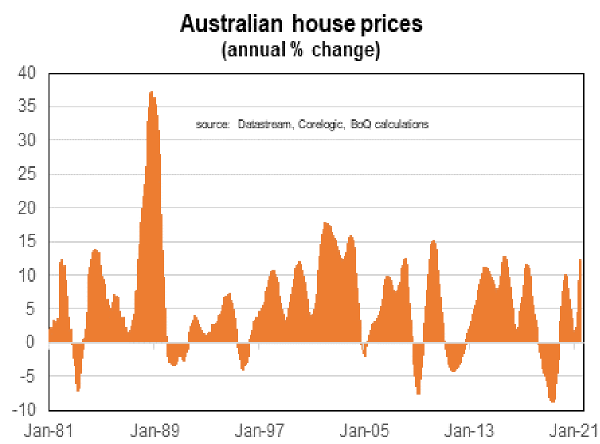
Houses prices – Red hot growth, and not for the first time

House prices, the never-ending BBQ-stopping topic of conversation, remains on the tip of the tongue. Last year the worry was how much prices might fall. Wherever you go this year in Australia it is by how much they have risen. Growth across Australia averaged in the double digits in the year to June 2021. Historically, such a pace of price growth has not unusual.

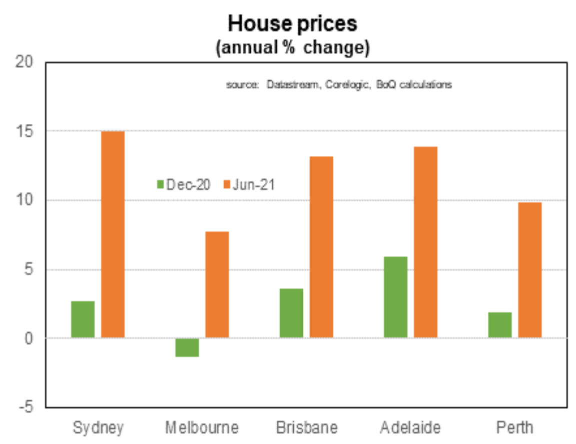
Growth has been strong across the major capitals over the past year. Sydney, Brisbane and Adelaide have been the standouts. It is no surprise that Melbourne has lagged. Price growth has been more than decent in Perth. But given the evident strength of the WA economy, the low unemployment rate and modest number of new residencies built over recent years the surprise is that growth has not been higher. The strong performance of Sydney also attracts a second glance given that city's low population growth of the past year.

Historically growth in Sydney and Melbourne property prices have often moved together. That is less common with the other major capital cities, particularly over the past decade. Sydney and Melbourne have been the main 'beneficiaries' of the strong population growth of the past ten years (driven by strong immigration). By contrast the past decade has seen other state economies having to deal with the end of the mining boom (particularly WA and the NT).

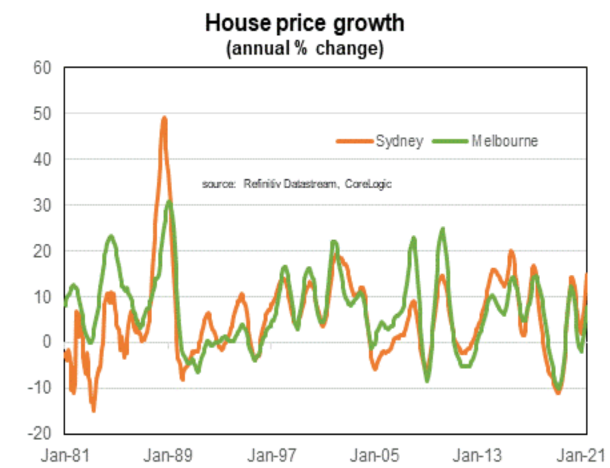
House prices have been strong over the past year. But we have seen this many times before.



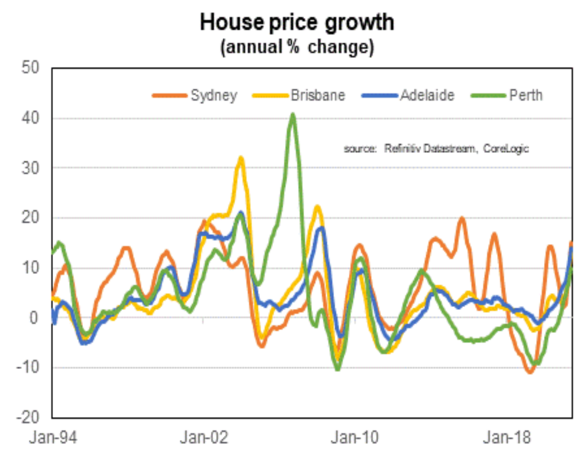
House prices have risen strongly across capital cities, with Melbourne lagging.



Changes in Sydney and Melbourne house prices are highly correlated.



The correlation is not as strong with the other capital cities, particularly Perth.



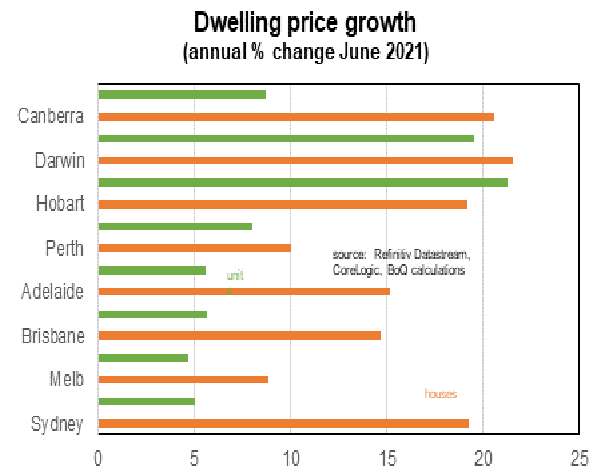
Each property cycle has a different tone (although they often have the same high and low notes). This one is no different. An often noted feature about this cycle is that house prices have risen by more than units. The outperformance of standalone houses has certainly taken place in Sydney, Melbourne, Brisbane, Adelaide and Canberra. It has been less dramatic in Perth and Darwin. And units have outperformed houses in Hobart.

One reason is that the construction cycle over recent years has differed between states. In Perth and Darwin there has been very few dwellings of any type built until very recently. While there has been plenty of residencies built in Hobart, they have mainly been houses. In the other capital cities (notably Sydney and Melbourne) there has been a significant boom in unit construction.

Another widely discussed feature has been the outperformance of house prices in regional centres. The story again differs between states. Regional outperformance has been significant in NSW, Victoria and (to a lesser degree) Queensland. But it has been less marked in Tasmania, and has not occurred at all in South Australia. And dwelling prices in Perth and Darwin have clearly outperformed the rest of the state.

The desire to skip the daily commute is likely greatest in the most populous cities. Melbourne and Sydney have also suffered more than other cities from COVID-lockdowns. Housing demand has been greatest in regional cities that offer a wide range of amenities and are close to capital cities. There are a number of these cities in NSW, Victoria and Queensland (and WA). Price declines of recent years meant that Perth and Darwin were very affordable. In NSW and Victoria nearby regional centres offered better value than Sydney and Melbourne.

Houses have outperformed units over the past year in all capital cities except Hobart.

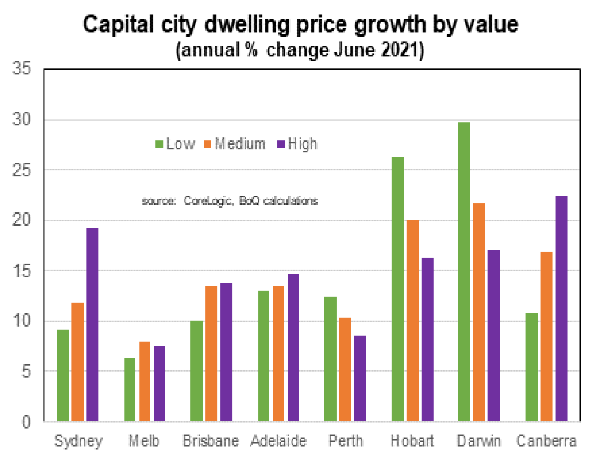


Regions have clearly outperformed in the large Eastern States but not elsewhere.

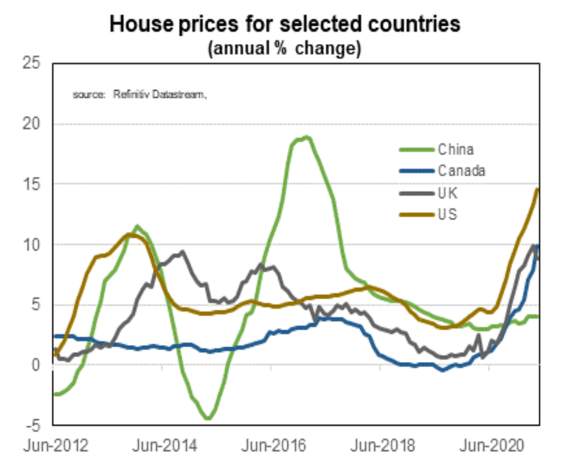
A third feature discussed in this cycle is that the highest price rises have been for the most expensive homes. Again the story is mixed. Expensive home outperformance has been most obvious in Sydney and Canberra (and to a modest extent in Adelaide). But in Melbourne and Brisbane it has been mainly a story of the underperformance of the cheaper homes. And in Perth, Hobart and Darwin the best price growth over the past year has been at the cheaper end.

Strong house price growth is not just an Australian phenomena but a feature across OECD countries. This is because developed countries are facing similar factors. Interest rates are extremely low, cheap funding is widely available, governments' have supported household incomes and there has been an increase in demand for houses in regions where the supply of dwellings has been tight.

Performance by house value has been mixed across cities.



Rising house prices have occurred across many countries, particularly in the OECD.



HOUSING MARKET UPDATE

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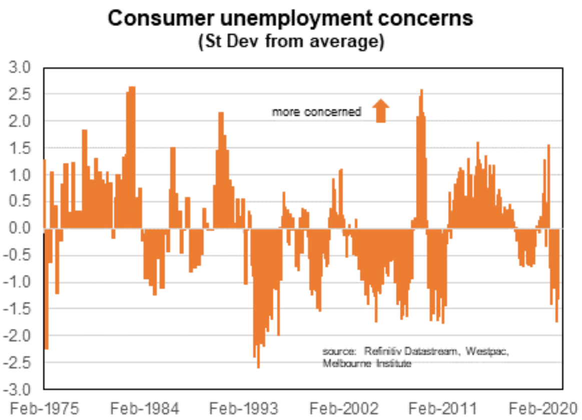
WEEK ENDING 16TH JULY 2021

House price outlook: Slowing growth

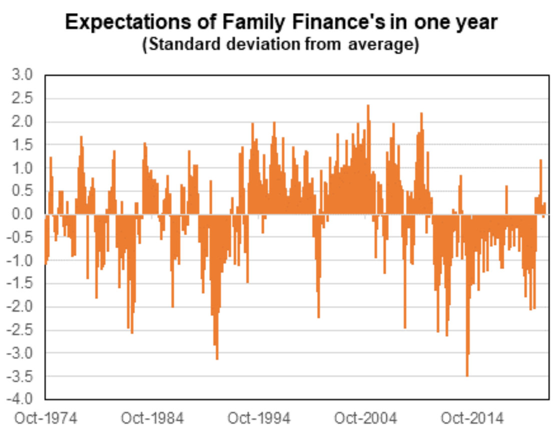
House price growth is driven by a number of factors. One is the confidence that households have about their finances. A big driver of that confidence is their views about the jobs market. A feature of this economic recovery has been the dramatic decline in the unemployment rate. All the forward indicators (job ads, vacancy data, employer hiring intentions) point to further declines in coming months. As a result consumers' confidence in the labour market is at its strongest since the peak of the mining boom.

This is also the case about the outlook for the family finances more generally. But it has been higher and this might reflect the current very low pace of wages growth. But with the demand for labour strong and the international border closed for the next 1-3 years it is likely that wages growth will pick up in coming quarters.

The strong labour market means few consumers' are worried about unemployment.



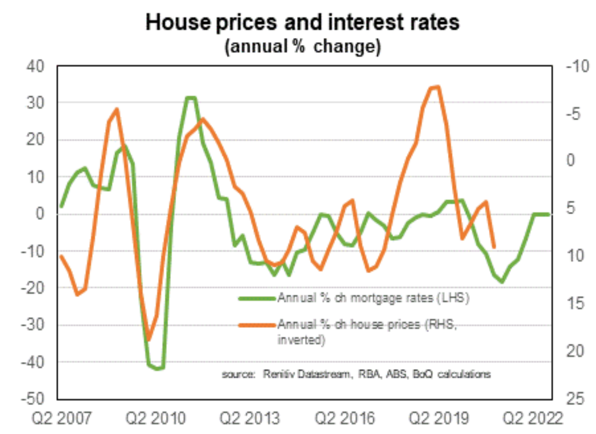
But views on the future of family finances is more mixed.



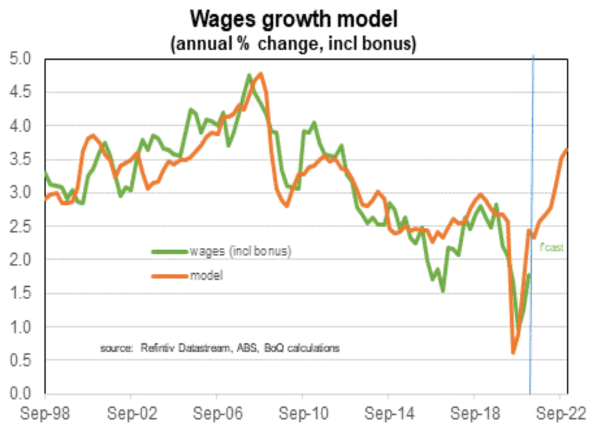
The most significant driver of high house prices over the past year has been the extremely low level of interest rates. Historical relationships suggest that the maximum impact of the decline in interest rates hit the housing market in the middle of 2021. If interest rates stay where they are history would suggest they will provide a diminishing impact on house prices (partly because the 'benefit' of the reduction of interest rates has been embedded in the rise in house prices).

Indeed, the discussion of recent times has been about higher interest rates. Financial markets are pricing the first rate hike in Australia towards the end of 2022. That looks early to me given the RBA's stated desire to see 'several quarters' of inflation of 2-3%. And that looks difficult to achieve before 2023. But at a minimum the very low level of interest rates, substantial fiscal stimulus and evident economic momentum means it is more likely that interest rates will rise in the foreseeable future. And there looks to be only a modest chance of any further rate cuts any time soon.

Very low interest rates has been the main driver of rising house prices.



The risks are interest rates are more likely to rise over the next 2-3 years.

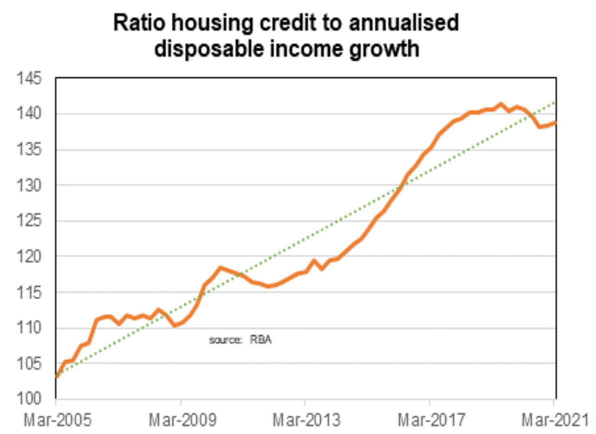


In addition to the cost of financing, another important driver of the housing market is the availability of financing. Right now business surveys indicate that financing is easily attainable. According to the NAB survey of the residential industry conducted in March, respondents indicate that access to credit is not a significant impediment to the established property market. Indeed, it ranked behind the lack of housing stock, affordability and job market concerns.

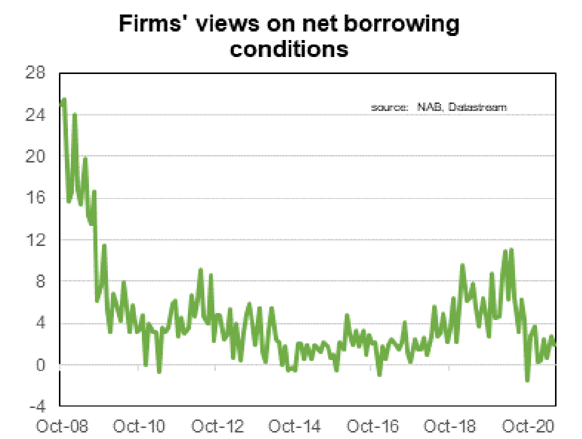
There has been discussion that the strong house price growth of recent times may lead to regulators tightening bank lending standards. The RBA recently indicated that they are watching credit growth as an indicator, and how it compares to the growth of consumer incomes. As at March those two growth rates were broadly similar. The strength of housing finance approvals suggests that the pace of mortgage credit growth will rise further in the second half of this year. There is also a good chance that wages growth will also rise.

It is not clear how much stronger credit growth will need to be than disposable income growth before there is regulator intervention. But given the pickup of finance approvals and the rise in house prices, at a minimum lending standards are unlikely to ease much further over the next couple of years.

Credit growth is currently growing at a moderate pace.



Firms' indicate that it is currently easy to get financing.

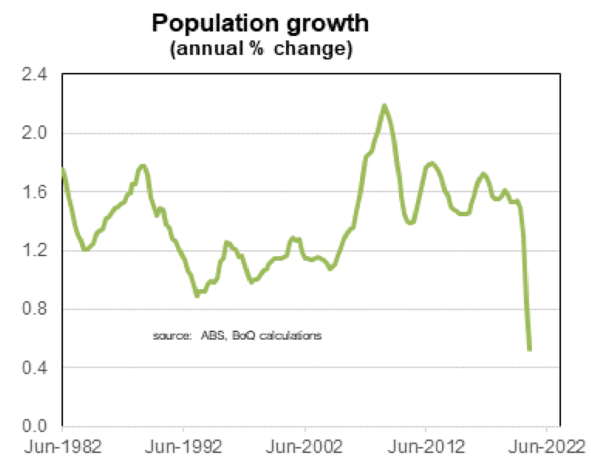


Over the long term, a significant driver of house prices is demand (population growth). Population growth across all states has slowed sharply, largely reflecting the closing of the international border. It has been strongest in Queensland, Western Australia and South Australia and weakest in New South Wales and (particularly) Victoria. Population growth has favoured the regions, notably in the three large Eastern States.

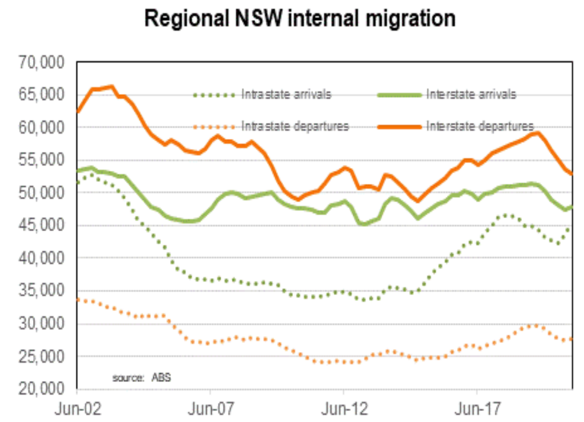
A rise of immigration is unlikely to occur until widespread vaccination. At Budget time Treasury assumed that international borders will start to open up around the middle of next year, with a return to 'normal' immigration levels gradually ramping up to mid-2024. This means a return to pre-COVID rates of population growth are still 2-3 years away.

Patterns of population growth will continue to differ between states. The delay in the returns to large scale immigration are likely to weigh most heavily on NSW and Victoria. Stronger population growth is more likely in Queensland and WA, partly a result of better housing affordability.

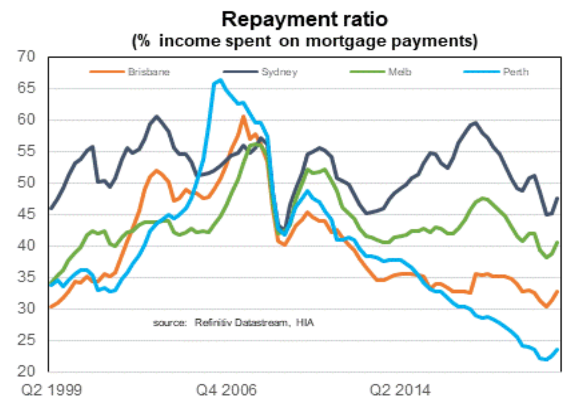
Population growth has fallen off a cliff.



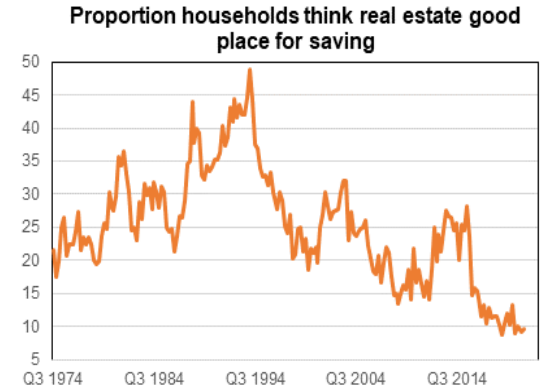
Regional population growth has increased in some states partly because less people are leaving.



Affordability was a key reason for the rising demand for housing.



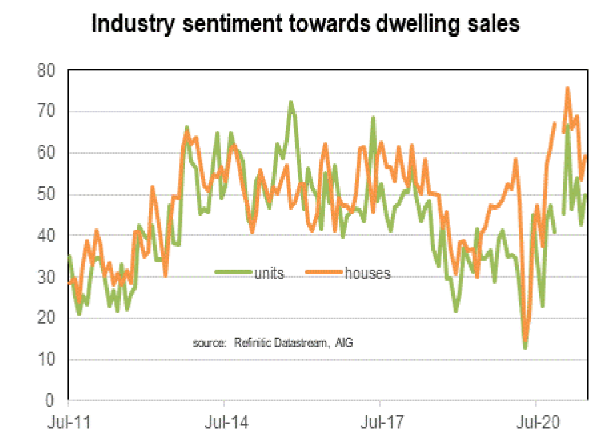
Many households don't think that housing is currently a good investment.



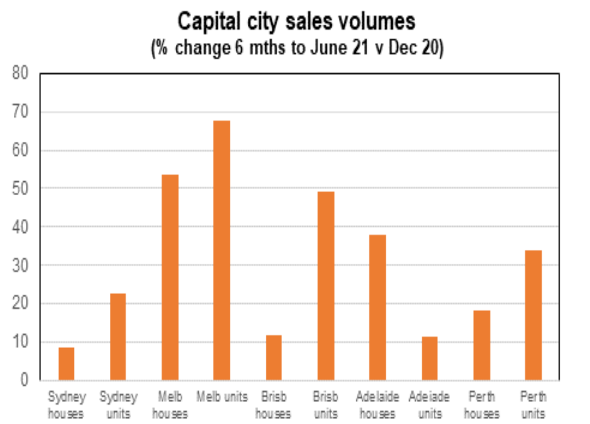
The other important driver of house prices is supply. With the exception of Adelaide, there has been more unit than house sales in all other major capital cities over the six months to June than in the six months to December. Price movements indicate that the lower sales numbers is not due to a lack of demand for standalone houses but a lack of supply. Industry feedback is that a lack of stock is the biggest constraint on the established housing market.

But strong demand, extremely low interest rates and government incentives means there is a large amount of new houses being built. Typically it takes around 9 months to finish construction of a standalone house, which would normally mean that many of the houses would be finished towards the end of this year. But the construction industry (like many other sectors) is facing a significant shortage of skilled workers. And (also like other sectors) it is facing a shortage of materials. This means it is will take longer to build a home (and it will be more costly). So the significant rise in new housing may not be finished be completed until next year.

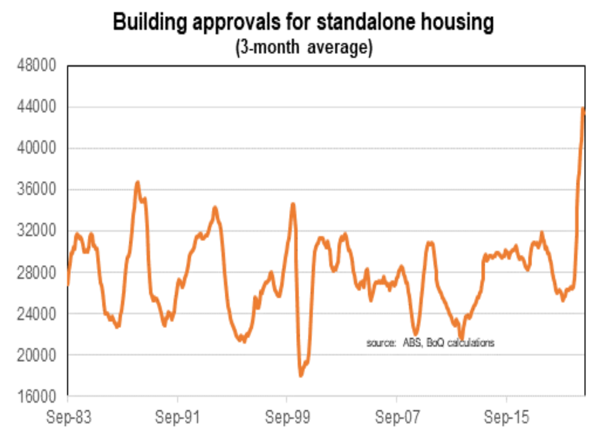
Confidence in sales of standalone houses remains high.



More standalone houses would have been sold if there was more stock on the market.

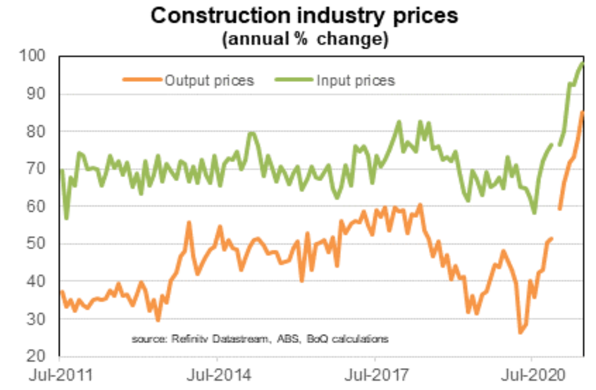


There is a large amount of supply of new houses in the pipeline.

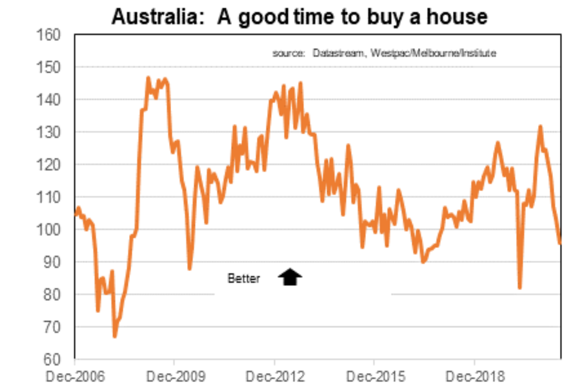


The problem is trying to find workers to build the houses.

The strong demand and a lack of supply of many materials is driving up the cost of building.



The rise in house prices has seen a drop in the confidence of households to buy a house.



Impact of lockdown on the Sydney Market

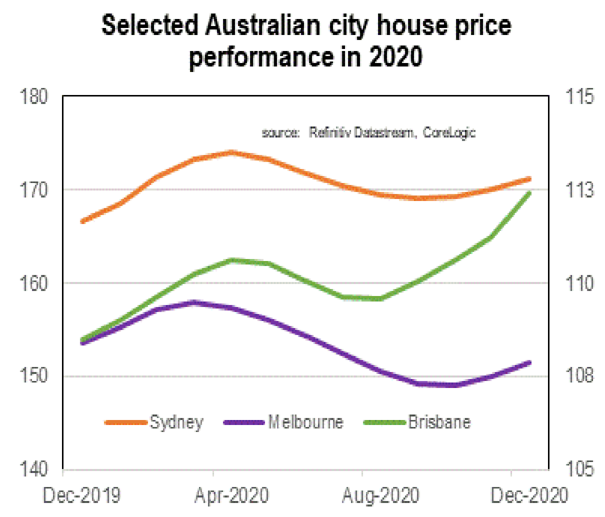
It is hard to see how the Sydney lockdown will not have some impact on the housing market. Surveys record a drop in consumer confidence in Sydney in July. But confidence has not fallen to an unusually low level. The economy is in good shape. Federal and state governments are providing support to consumer and small business incomes. How big an impact the lockdown has will depend upon the length and severity of the health outcomes, as well as the extent of any restrictions.

The Melbourne lockdown last year provides one gauge of what could happen in the Sydney property market. Across Australia confidence about the economic outlook started to pickup in Q3 and helped underpin a rise in most property markets (such as Brisbane). The upturn lagged in Sydney as NSW was facing a COVID wave. The downturn in Melbourne was slightly longer than in Sydney, and the subsequent upturn in prices has been less aggressive.

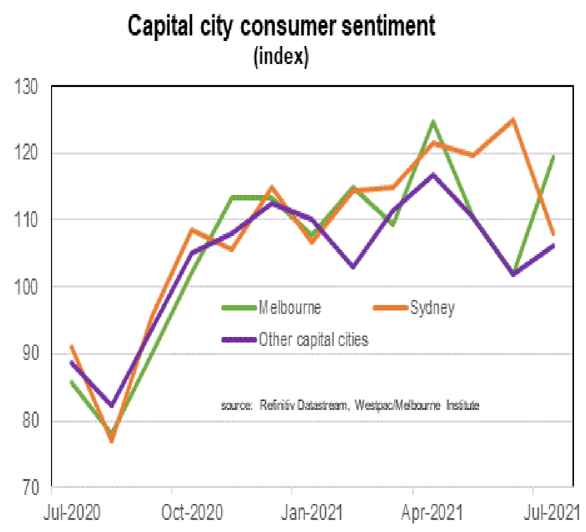
But there is only so far you can draw on history to forecast the future. Compared to last year, the fiscal response has been even stronger, interest rates are lower, economic momentum faster and the unemployment rate has fallen quicker.

Overall, I would expect some slowing in house price growth in the Sydney market over the next few weeks. And it is entirely possible that Sydney may underperform other cities. But the fundamentals of a strong economy, falling unemployment rate, very low interest rates, strong demand for houses in places where the has been an under supply should mean that Sydney will still record decent house price growth. The potential reduction of supply on the market is another factor that will support house prices in coming weeks.

The upturn of Melbourne house prices lagged other capital cities last year.



While consumer confidence has declined in Sydney in July it remains above its long-term average.



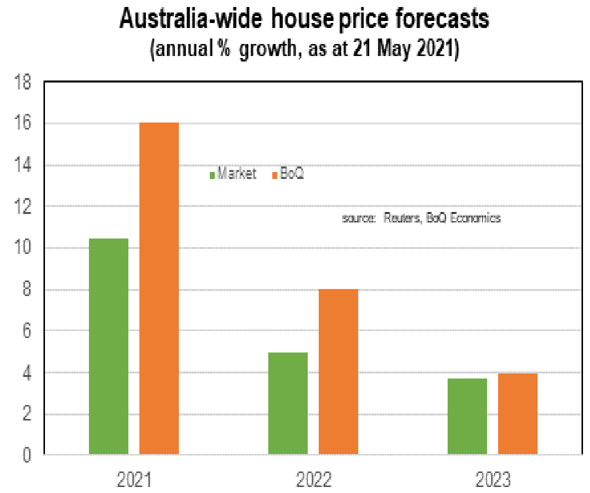
Forecast

This year most of the factors that drive house prices have been positive. This has led to strong house price growth. By year-end I look for house prices to be about 16% higher on average across Australia (a Reuters survey taken in May indicated that the consensus was for a rise of a bit over 10%). In 2022 I forecast house prices to rise by around 8%, still a decent number (the Reuters' consensus was for about 5%). The housing market still should have decent momentum entering next year. The cash rate will likely be unchanged. And the impact from the big increase in housing supply will only start to be felt in the second half of the year. Lower demand because of weak population growth will be a negative factor.

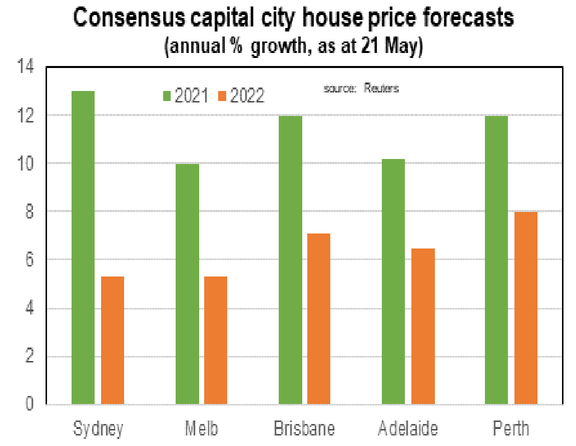
I expect further slowing of house price growth in 2023 (4%). Immigration growth should be stronger, but not yet at pre-COVID levels. And for a period there will be ample housing supply to meet any rise in demand. Importantly, a higher cash rate will weigh on a housing market. A strong economy and low unemployment rate are the pluses.

According to the Reuters' survey the consensus is that the strongest house price growth next year will be in Brisbane, Adelaide and Perth. Those cities certainly offer better value relative to Sydney and Melbourne. Brisbane and Perth are also likely to 'benefit' from stronger population growth, as well as the lower supply of housing over recent years.

House prices are likely to slow.



The moderation will likely occur across the capital cities.



We live in interesting times.

Regards,

Peter Munckton
Chief Economist
Bank of Queensland