HOUSING MARKET UPDATE

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Summary:

- Population growth over the next year likely to be the slowest in over a century;
- Lower population growth is a negative for house prices;
- But improved affordability is a positive.
- The house price decline has a little further to run;
- But a modest pickup is likely in 2021-22.

Treasury projects population growth will be 0.2% in the 2021 financial year and 0.4% in the following one. They think there will be net emigration in those two financial years. Treasury also makes an assumption that there will be a (modest) decline in the birth rate over the next couple of years as a result of the uncertainty surrounding COVID.

How strong and quickly the Australian economy recovers (both absolutely and relative to country peers) will play a crucial role in determining the future strength of immigration. The level of immigration will also depend upon society attitude. The Treasury assumptions on when immigration numbers will start to rise again appear reasonable. But the uncertain economic outlook means that the growth of immigration might be lower than in the decade prior to COVID.

The year-to-year link between the state of the economy and the birth rate over the past 60 years has been less than clear. The success of the Governments' income support programs means that while the economy has gone through a rough patch this has yet to translate into (most) household disposable incomes. Consumer confidence is also currently highest amongst adults during the prime child-bearing years

For the housing market slower population growth means there will be less people to buy a house. Historically lower population growth has coincided with a lower house price in most major capital cities. Interestingly the link between population growth and house prices has not been as tight over the past decade. Low affordability reduced demand as it cut the number of people who were able to afford to buy a house.

As the economy improves next year (and assuming a vaccine is found) demand for housing should improve. This should help house prices to pick up in the second half of next year, although that rise will be partially mitigated by the rise in the supply of new houses. Consensus expects a small fall in house prices next year, with a modest rise expected for 2022.

Treasury says there will be less of us

Perhaps the most talked about assumption in the recent Budget was the Treasury view that there will be a dramatic slowing in population growth. Treasury projects population growth will be 0.2% in the 2021 financial year and 0.4% in the following one. If this is correct it will be the slowest rate of population growth in a century. They think that there will be net emigration in those two financial years as students and long-term visitors return home (partially offset by returning Australians). Treasury expects that a gradual recovery in long-term immigration will take place from late next year once a vaccine is in place. International travel is projected to pick up from early 2022. State border restrictions are assumed to be lifted by year-end (apart from WA where borders are assumed to open 1 April 2021).

Treasury also makes an assumption that there will be a (modest) decline in the birth rate over the next couple of years as a result of the uncertainty surrounding COVID.

What has happened to immigration?

Net Overseas Migration (NOM) has been a significant driver of population growth over the past fifteen years. By my calculations the contribution of NOM to population growth over the past decade has been the strongest since the post Second World War immigration boom. Discussion about immigration is often focused on skilled migration. But in recent years the biggest flows have been university students (a proportion of which do stay permanently), long-term visitors and those on working holidays.

But there have been other times over the past 100 years when NOM has been low (or negative). Understandably this happened during periods of great upheaval (such as the Great Depression and the Second World War). But NOM contribution to population growth was also low in the 1970s, and again in the early 1990s. The impact on aggregate population growth was partially disguised by a higher birth rate (particularly in the 1970s).

The consistent theme of the periods of low NOM growth was that they coincided with weak economic growth (or a high level of uncertainty such as during the Second World War). So how strong and quickly the Australian economy recovers (both absolutely and relative to peer countries) will play a crucial role in determining the future strength of immigration. The level of NOM will also depend upon society attitude towards immigration (which is often influenced by the state of the economy).

The Treasury assumptions on when immigration numbers will start to rise appear reasonable. But the uncertain economic outlook means the risk is that the rate of NOM will be at a level lower than in the decade prior to COVID.

Interstate migration matters at a state level

As would be expected lower immigration has a significant impact on all states' population growth. In recent years NOM has been particularly significant for NSW, Victoria and Tasmania. That has been less the case for Queensland.

Less discussed has been the impact of border closures on state population. Over the year to March, interstate migration notably boosted the Queensland and Tasmanian populations but was a negative for NSW and SA. It had a smaller impact on WA and Victoria. This suggests that the opening up of state borders would provide the biggest boost to Queensland population growth, but be a negative for NSW.

Does the economy influence the birth rate?

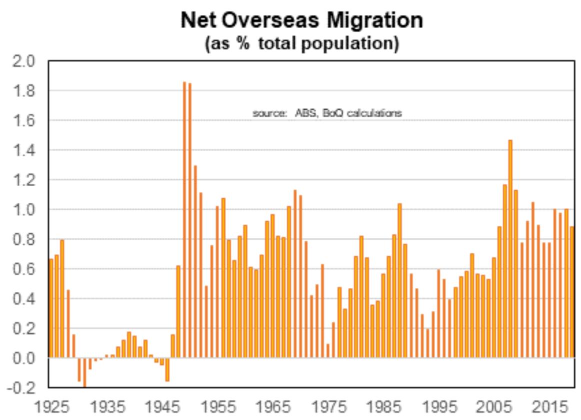
Over the medium term (5-10 years) there is a strong link between the birth rate and economic growth. After all, economic growth is the amount of work done be each worker multiplied by the number of workers. Raising kids is expensive, and certainly expectations of a sustained weak economy (with higher unemployment) would result in a lower birth rate. This is exactly what happened during the Great Depression.

But the year-to-year link between the state of the economy and the birth rate over the past 60 years has been less clear. And the success of the Governments' income support programs means that while the economy has gone through a rough patch this has yet to translate into (most) household disposable incomes. This is the reason why household views about the medium-term economic outlook (which should influence their views on whether to have kids) is well above average (helped by the generous Budget announcements). Consumer confidence is highest amongst adults during the prime child-bearing years (and weakest for the young that have suffered the biggest jobs fallout).

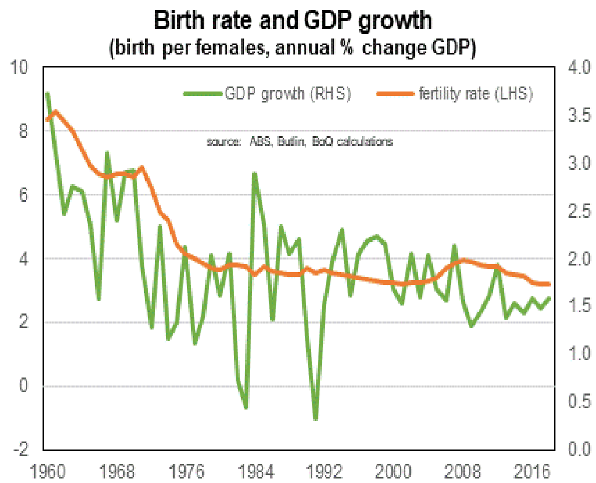
Of course this could change. But that would also mean that the economic outlook would be weaker for longer than what Treasury is currently forecasting (Treasury expects that the unemployment rate will peak at 8% at the end of this year).

Population growth over the next couple of years will be the slowest in over a century.

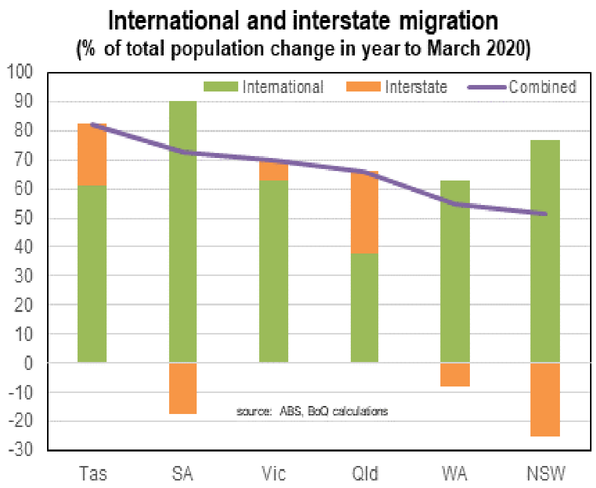
Immigration growth over the past decade has been as strong as post the Second World War



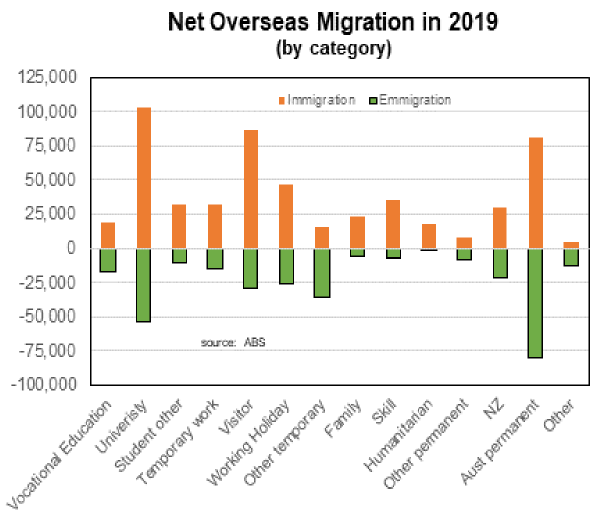
The short term link between GDP growth and the birth rate is mixed.



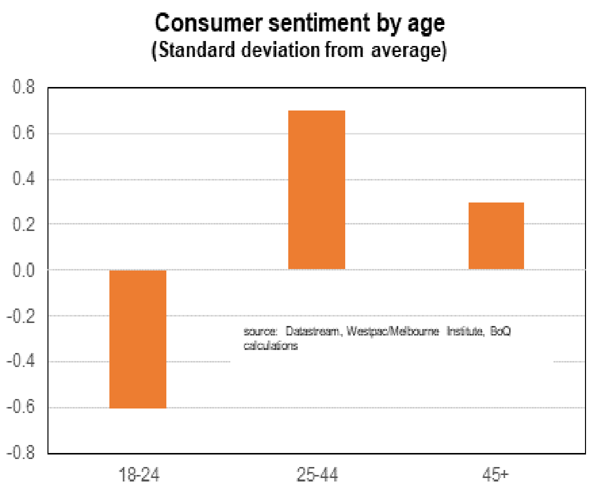
Interstate migration means more for Qld, international for NSW and Victoria.



Students, visitors and working holiday makers are the biggest driver of immigration.



Consumer confidence is strongest amongst those who are more likely to start a family.



Population growth and housing

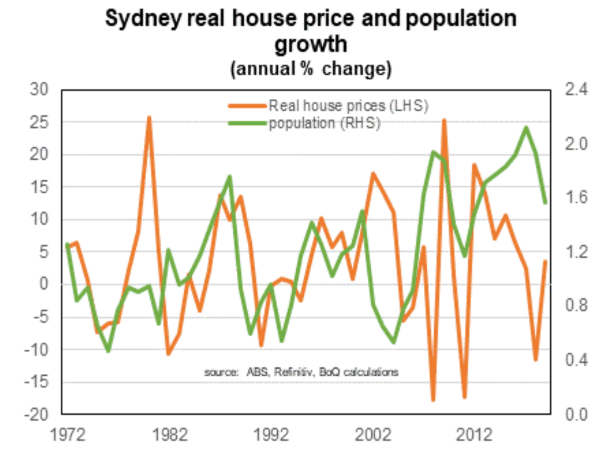
Clearly slower population growth will have a significant economic impact. It will mean that there will be less people to buy shoes or to catch a train. It will mean less workers. This will result in a period of weaker economic growth (unless there is an offsetting rise in productivity growth).

For the housing market slower population growth means there will be less people to buy a house. Historically lower population growth in most major capital cities has coincided with a lower house price. The exception is Perth, where the impact of the significant swings of the mining industry has been the driving factor for house prices.

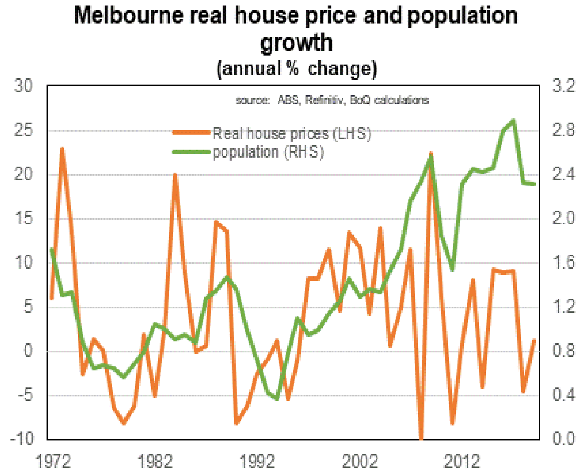
Interestingly the link between population growth and house prices has not been as tight over the past decade. If the historical correlation had held house price growth should have been substantially higher given the strength of population growth.

Maybe the supply response has been quicker over the past decade. But periods of low vacancy rates (and high rent increases) in Sydney and Melbourne suggests this is not the case. The tightening of lending standards has really only been an issue for the past couple of years. Perhaps a bigger reason is that the strong growth of house prices had meant affordability has been low for much of the past decade. Low affordability reduced demand as it cut the number of people who were able to afford to buy a house.

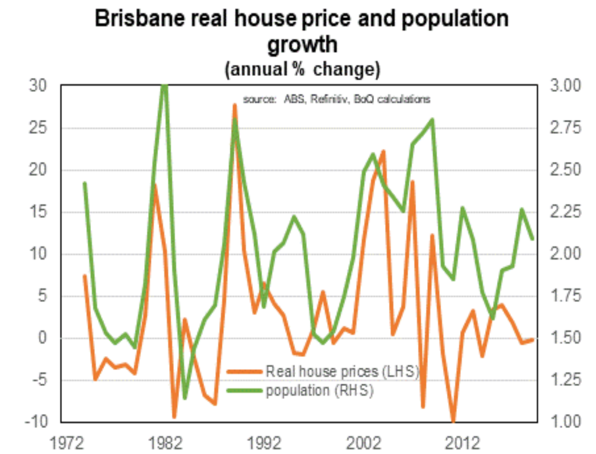
Population growth has had an impact on Sydney house prices.



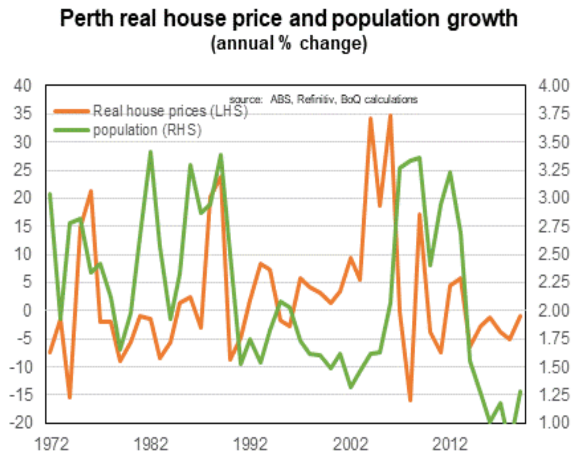
And also in Melbourne.



But this has been less the case over the past decade.



Changes in the fortune of the mining industry have a bigger influence in Perth.



BOQ GROUP

House prices likely to pick up in H2 2021

One outcome of low affordability has been that the number of people per dwelling has been increasing over the past decade as children stay at the family home longer. This means there is 'pent up demand' for housing from young adults. The fall in house prices and rock bottom interest rates means affordability has improved (and is at record highs in Perth). The result has been a significant rise in the proportion of home loans going to first home buyers over the past year.

Household sentiment towards purchasing a house has improved over the past couple of months. But it is still currently below average across most states and territories (WA is the exception). Investors though are negative on housing, no surprise given the decline in house prices and rise in vacancy rates (particularly in inner city units in the major East Coast cities).

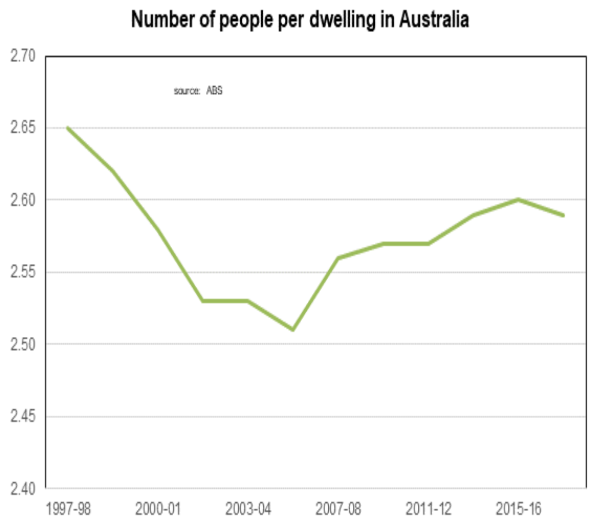
Sentiment towards housing is weaker in capital cities than in regional centres (consistent with the anecdotal feedback). Survey evidence from the residential sector is that the economy is seen as the major issue impacting housing. An improvement in the jobs outlook will therefore be a plus.

While demand is a big factor what drives prices is what happens to demand relative to supply. The number of new homes being built has been declining over the past couple of years. The leading indicators (such as building approvals and new orders) suggest that there is likely to be further falls in the building of units. But new orders for houses has been picking up reflecting the Government announced support for the industry (Homebuilder). Treasury is forecasting that residential building activity will rise 7% next financial year (with the strengthening in activity beginning the start of next calendar year).

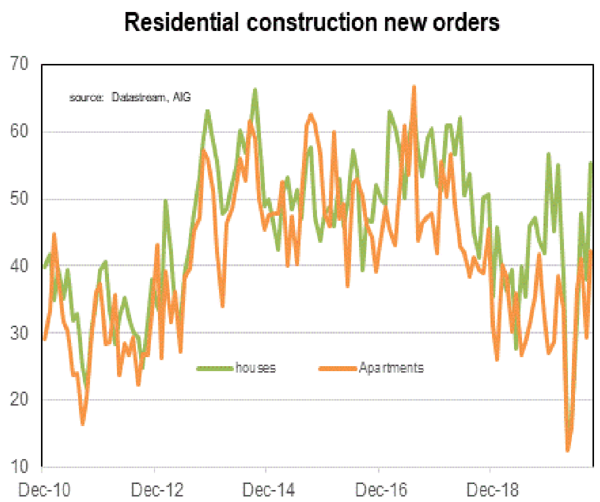
Since April the slowing in demand (because of weaker economy and slowdown of immigration) has more than offset the reduction of supply (lower prices means owners are less likely to sell). This has resulted in weaker house price growth, notably in Melbourne and to a less extent in Sydney. House prices have been flat to up in the other major cities where the economy is performing better and there has been less new supply. As the economy improves next year (and assuming a vaccine is found) demand for housing should improve. This should lead to house prices starting to pick up in the second half of next year, although that rise will be partially mitigated by the rise in the supply of new houses.

Consensus expects a small fall in house prices next year, with a modest rise expected for 2022. Economic (and health) developments will be critical. The movement of Australian house prices is expected to be weaker than peer countries next year (although the fall in Dubai is projected to be worse).

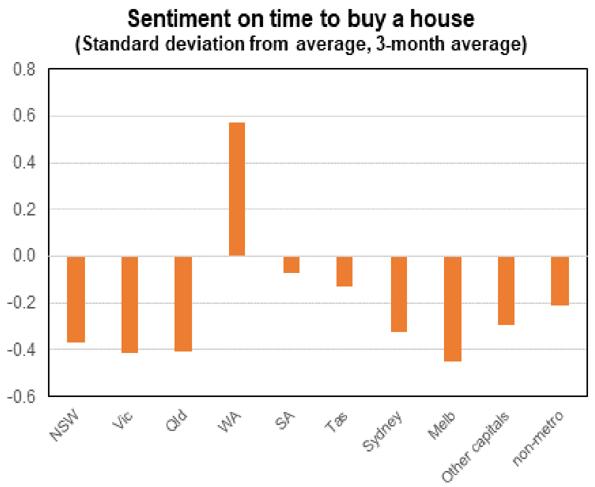
Falling affordability has led to a rise in the number of people per household



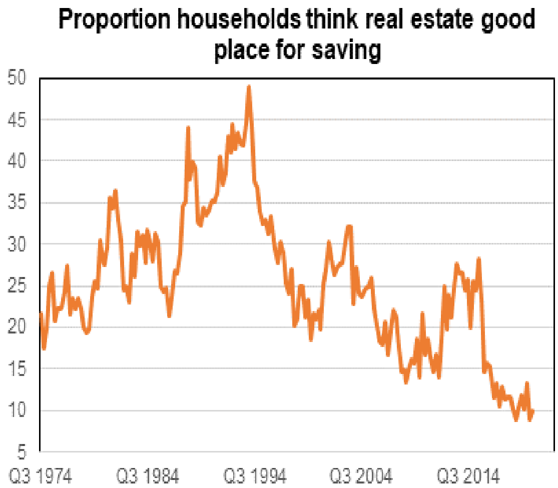
Orders for new homes has picked up, not so for units.

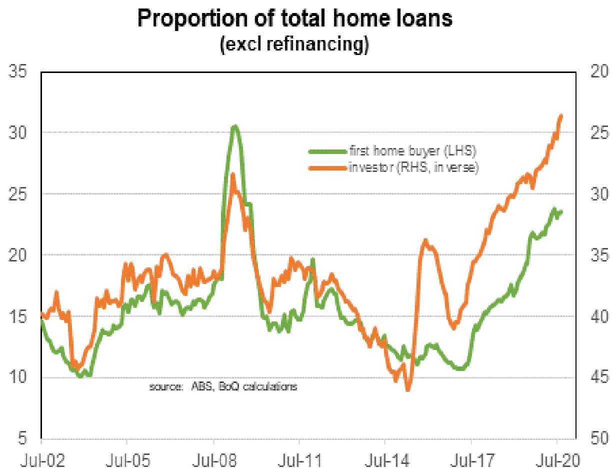
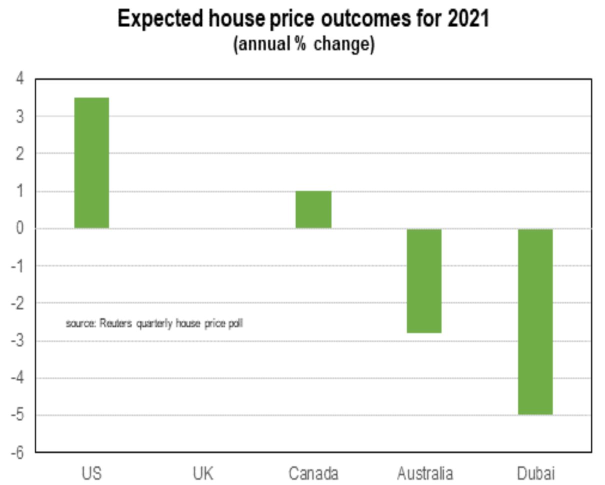


Sentiment about housing is a little below average in most parts of Australia, except WA.



And from many investors'.



As investors' have stepped back, first home buyers have stepped forward.	The outlook for house prices in Australia is a little weaker than for comparable countries.
	

We live in interesting times.

Regards

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