HOUSING MARKET UPDATE

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BOQ GROUP

Summary:

- **Despite all the worries, house prices ended up rising in 2020;**
- **The power of low rates was the major, but not the only, factor;**
- **I expect Australia-wide prices to be up 7-8% this year, then 3-4% in 2022;**
- **Low rates and an improving economy will be the positives;**
- **But excess supply will be a moderating factor, particularly next year.**

Aggregate house prices rose by a bit under 2% for the five major cities in 2020. This was the fourth consecutive year that annual house prices growth had been under 5%. That might sound disappointing but last year's performance was outstanding given the weak economy. Much of the rise in prices happened in the second half of the year. House prices rose the most in Adelaide and Brisbane. They fell in Melbourne, and rose only modestly in Sydney.

The main driver of the better than expected house price performance was the power of very low interest rates. Easier access to finance helped. The better than expected economy, strong Government support for household incomes (JobKeeper) and improving housing affordability played their parts. Consumer surveys indicated demand for housing rose in most states as optimism about the economy improved, and ran ahead of the stock of houses for sale. Houses in the suburbs and regions were in greater demand than inner-city units.

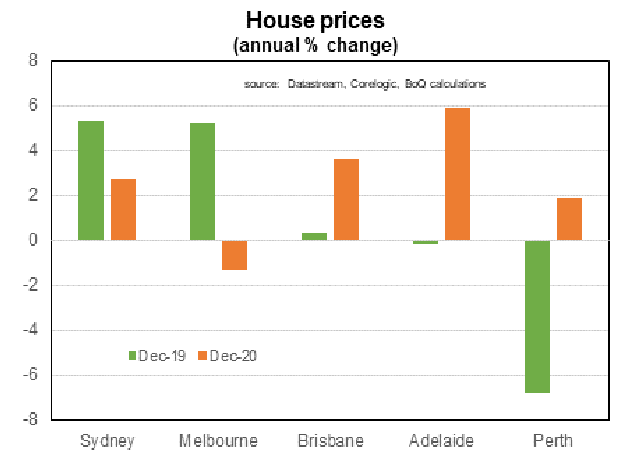
My view is that house prices will rise across Australia by 7-8% in 2021, before slowing to 3-4% growth in 2022. Very low interest rates, easy lending standards and an improving economy are the positives. But higher prices means reduced affordability. Higher prices will also mean more supply coming on to the market. And combined with increased supply of new homes (turbo boosted by the HomeBuilder program) and modest demand (due to lower population growth) the supply-demand balance will act to moderate price growth moving into 2022. The outlook will differ by region and property type.

House prices in 2020

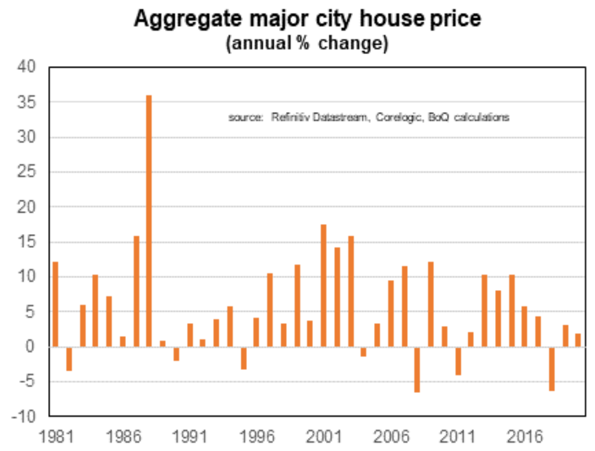
Back in March/April there was plenty of doom and gloom about house prices. It wasn't uncommon to see forecasters plumping for falls of 20-30% in 2020. In the event aggregate house prices rose by a bit under 2% for the five major cities. This was the fourth consecutive year that annual house prices growth had been under 5%. That might sound disappointing but last year's performance was outstanding given the weak economy. Much of the rise in prices happened in the second half of the year.

As is often the case performance was mixed between regions with outcomes the mirror image of 2019. House prices rose the most in Adelaide and Brisbane. But they fell in Melbourne, and rose only modestly in Sydney. By year-end all major cities (and many regional centres) recorded decent monthly house price growth.

Adelaide and Brisbane were the standouts for house price rises in 2020.



House prices have risen only modestly in recent years.



Price drivers in 2020

The main driver of the better than expected house price performance was the power of very low interest rates. Very low rates enables households to borrow more. It makes it easier to repay loans. And very low rates underpins the value of all asset prices, including housing.

Easier access to finance helped. The arrival of COVID created a high degree of uncertainty about the economic outlook. But the stronger than expected bounce back of the economy has allowed banks to become more comfortable about increasing lending. Business surveys indicate that firms have noticed that it has become easier to access finance over the past few months.

Also important was that the better than expected economy and strong Government support for household incomes (JobKeeper) meant that the deterioration of the jobs market was not as bad as feared. Improved housing affordability played its part in supporting house prices, a result of both the big reduction of interest rates and the modest rise of house prices of recent years.

Consumer surveys indicated demand for housing rose in most states over the course of last year as optimism about the economy improved. This demand mainly came from owner occupiers. Investor participation was more muted reflecting tighter lending standards, falling house prices and rising vacancies. COVID concerns saw a pickup in demand for standalone housing, mainly in the regional and suburban areas. Demand fell for inner city units.

Until 2020 a significant driver of higher prices was the big increase in population. But population growth slowed sharply over the course of last year reflecting the large decline of immigration due to the closure of borders. Population outcomes varied between states, with inter-state migration holding up in Qld largely at the expense of NSW.

Supply helped underpin house prices. There was a substantial reduction in the stock of housing for sale as sellers turned cautious because of the uncertain economic outlook. Supply started to pick up by year-end as the economy revived. Rising vacancies indicated some over-supply in Sydney and Melbourne (particularly inner-city units). Supply shortages were more pronounced in Perth, Brisbane and many regional centres where residential construction activity has been more subdued in recent years.

Outlook: Strong house price growth in 2021, slower growth in 2022

My view is that house prices will rise across Australia by 7-8% in 2021, before slowing to 3-4% growth in 2022. Very low interest rates, easy lending standards and an improving economy are the positives. But higher prices means reduced affordability. Higher prices will also mean more supply coming on to the market. And combined with increased supply of new homes (turbo boosted by the HomeBuilder program) and modest demand (due to lower population growth) the supply-demand balance will act to moderate price growth moving into 2022. The outlook will differ by region and property type.

Below is an assessment on how the major drivers will influence Australia-wide house price growth over the next couple of years.

Interest rates: Positive

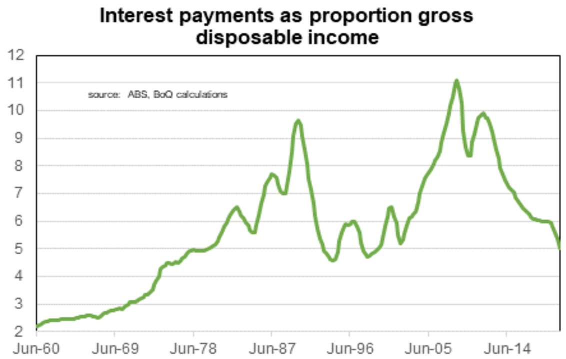
At the end of last year the RBA said that the cash rate would likely remain unchanged for the following 3 years. Whether that projection ends up being correct will depend upon how the economic and inflation outlook evolves. Certainly the economy looks to be doing better than what the RBA had forecast. But despite the improvement there remains plenty of spare capacity in the economy. Wages and CPI growth is too low. There are also identifiable downside economic risks (more virus outbreaks, the end of JobKeeper, potential for ongoing consumer and business caution).

I still think it is possible that the RBA will provide further monetary support to the economy this year. Any announcement will be made in the first half of 2021 (and go hand-in-hand with more fiscal support). Further monetary support would come in the form of Quantitative Easing (buying government bonds) and not lower interest rates. The RBA has made it clear it is not supportive of negative interest rates.

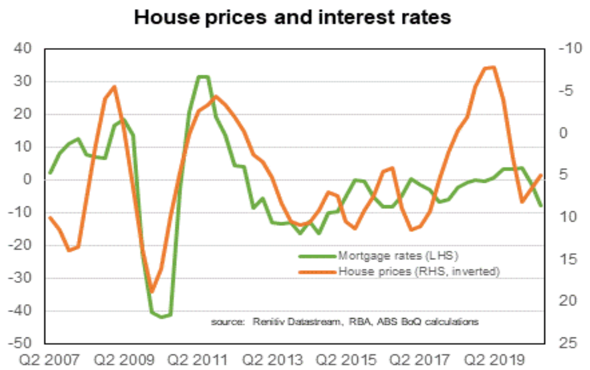
The bottom line is that interest rates are likely to remain at these very low levels for some time. If the economic momentum continues to build it is possible that interest rates might rise earlier than what the RBA has been suggesting. But not for at least the next 2 years. Further rate reductions are unlikely.

Low inflation, wages and high unemployment means interest rates are not going up for some time.

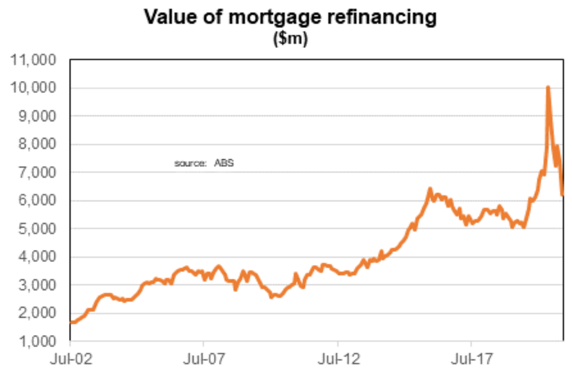
Falling interest rate payments is leaving more money in household bank accounts.



Interest rate movements have a heavy influence on house price movements.



The fall of interest rates lead to a splurge in mortgage refinancing.



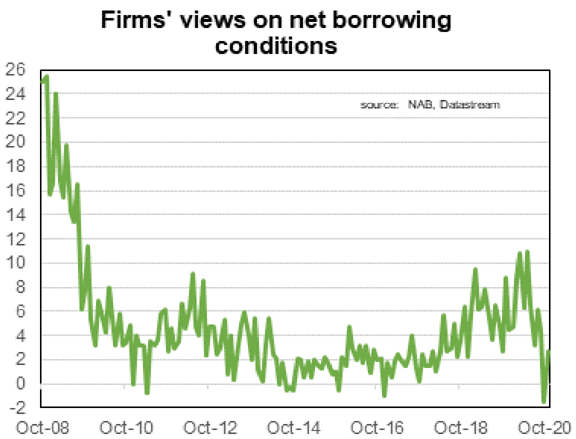
Lending standards: Positive

An improving economy and positive financial market sentiment should see financing remain accessible this year.

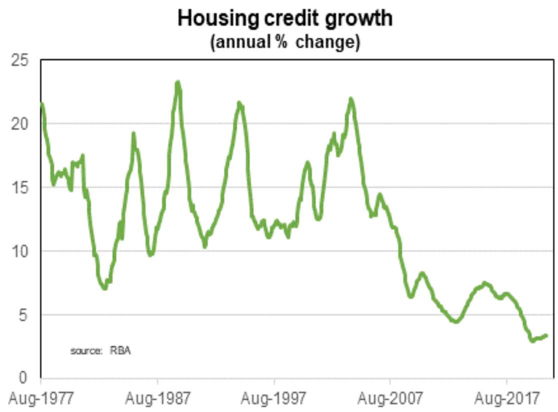
Given the economy is only just starting to improve any tightening of standards is some way down the track. But it is worth thinking about the sort of factors that regulators would look at when deciding whether to tightening standards. One variable to watch is the strength of credit growth. This is currently not a worry as the rise in house prices to date has so far coincided with only a modest of rises in mortgage credit growth.

Another variable to watch is how much borrowing is done by investors. Historically substantial rises in investor lending has been associated with concerns about unsustainable house price growth. Although investor credit has started to pick up the pace of growth is currently extremely subdued (although likely to rise further as housing prices increase). Finally, a rise in the proportion of loans that have high loan-to-income or loan-to-property value would be a worry. This is currently not an issue.

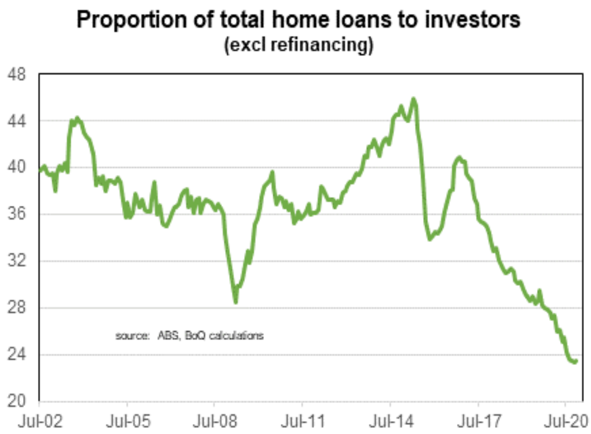
Firms' report that it has become easier to get financing.



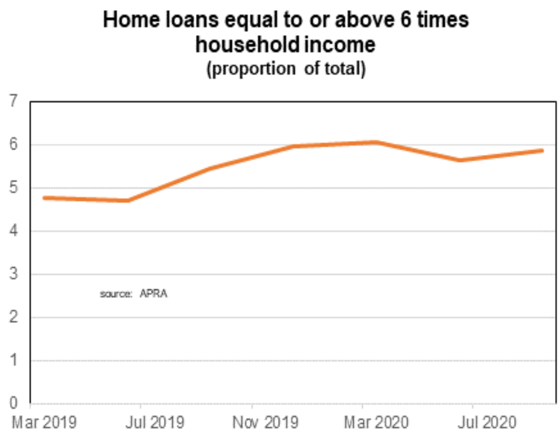
Mortgage credit growth has picked up a little over recent months.



The proportion of lending going to investors remains low by recent standards.



Only a small proportion of borrowers have large loans relative to their income.



Economy/Labour market: Positive

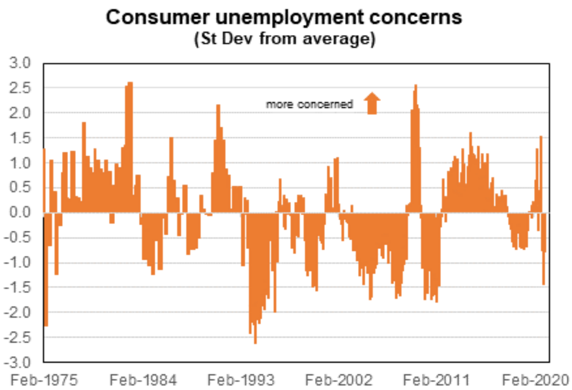
Over the past few months the economic news has been largely good. Economic momentum has picked up. A vaccine has been found, with the target of having most of the population immunised against serious illness before year-end. JobKeeper has achieved its aim of limiting the rise in the unemployment rate. The number of job ads and vacancies grew substantially in the last few months of 2020. Consumer fears about unemployment are below average. Financial Markets have become increasingly optimistic. A mini housing-building boom looks likely to take place this year.

Despite the clearing economic skies, more bad weather could be on the way. Insolvencies are likely to rise this year. JobKeeper (as well as mortgage and rent 'holidays') are coming to an end. The risk of further virus waves before immunity is achieved is high. Australia-China trade tensions will hurt some industries. Other sectors are having to come to terms with potential permanent changes in consumer behaviour (such as the impact that working from home on CBD businesses).

The economy is likely to finish the year in better shape than it started. That journey though may include a few stormy days. And to complete the journey the economy may need more fiscal and monetary help. Confidence about job prospects should improve further over the course of this year. And that typically means more people thinking about buying a house.

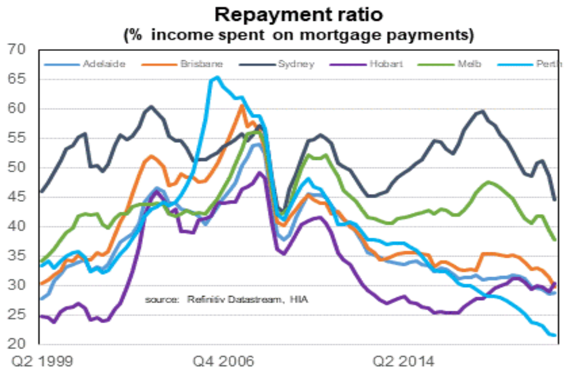
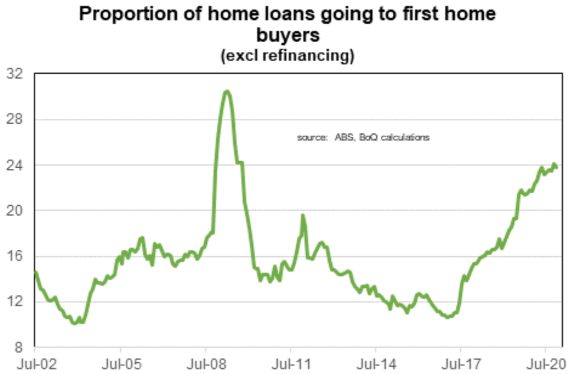
The unemployment rate is too high across states.

Households remain comfortable with the state of the jobs market.



Affordability: Neutral

The impact of affordability on house prices this year is likely to be a tale of two halves. In the first half of the year very low interest rates and still modest level of house prices should see housing remain affordable (helping first-home buyers). But as house prices rise affordability will deteriorate. Already surveys indicated that WA households had started to turn a little more cautious on housing likely reflecting the price rises of recent months.

At the end of last year affordability in most cities was at, or below, its lowest level for the past twenty years.	Improved affordability has seen first home buyers become a growing part of the market.
	

Demand: Negative

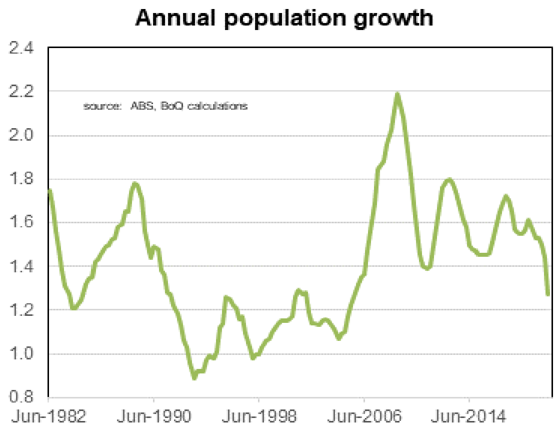
Demand for housing over the past year has been driven by existing homeowners upgrading and first home buyers. There is pent-up demand from first home buyers reflecting that until recently affordability levels had been low (and a reason why the size of households has risen over the past decade).

Over the long term the demand for housing is mainly driven by the strength of population growth. And population growth will be weak at least for the next couple of years as a result of the very low levels of immigration. Where immigration levels rise to will largely determine the strength of housing over the medium term.

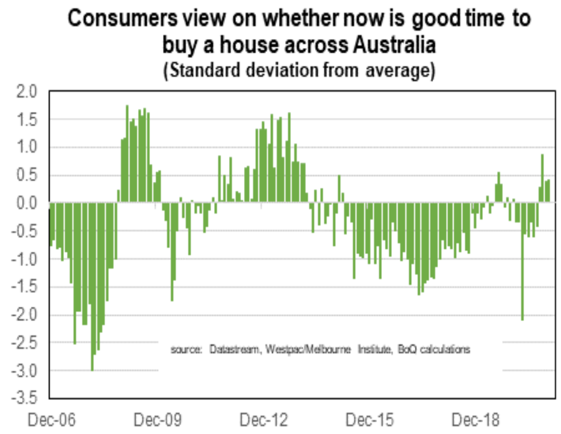
Population movements are still occurring between states. Queensland is typically the main beneficiary of inter-state migration. And that is likely to remain the case over the next couple of years with plenty of anecdotes about the strong demand for Queensland property out of NSW and Victoria. WA may also benefit from a pickup of inter-state movements (providing borders stay open) as a result of a strong economy. NSW and Victoria may struggle a little more with the lack of immigration.

Demand has also shifted within states. The decline of immigration has seen reduced demand for inner-city units. But the increased acceptability of working from home has led to some increase in demand for housing in suburban and regional areas. It is unclear as to how much of this demand will remain once the economy returns to 'normal'.

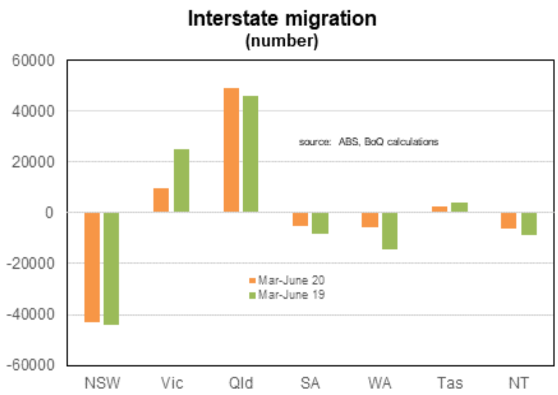
Population growth will be very low for the next couple of years.



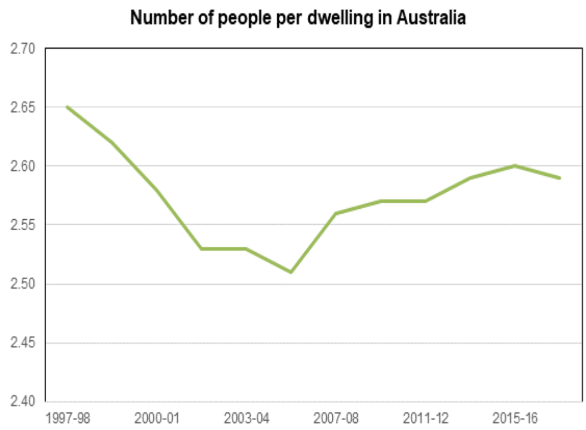
Surveys indicate a rising optimism about buying a house.



Interstate migration is still positive for QLD and negative for NSW. But has become less positive for Vic and less negative for WA.



Over the past decade declining affordability has seen more young adults remain at home.



Supply: Negative

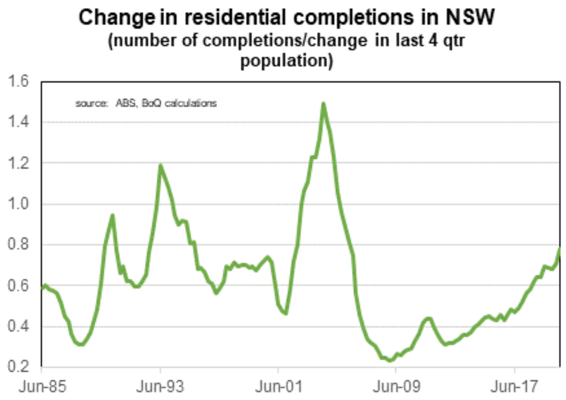
The supply of housing is likely to be an increasingly negative factor for house prices across states over the next couple of years. Sellers are becoming increasingly confident about the outlook and this will likely lead to more stock hitting the market. This already looks to be taking place in Adelaide where house prices achieved their greatest gain last year.

Different states are in different parts of the cycle with regards to new supply. Falling rents is an indication of oversupply in NSW and Victoria. There has also been a large amount of supply in Tasmania over the past couple of years. By contrast in WA and Queensland the number of new residencies built has been falling over the past few years. The supply of the number of new units will fall over the next couple of years reflecting lower demand.

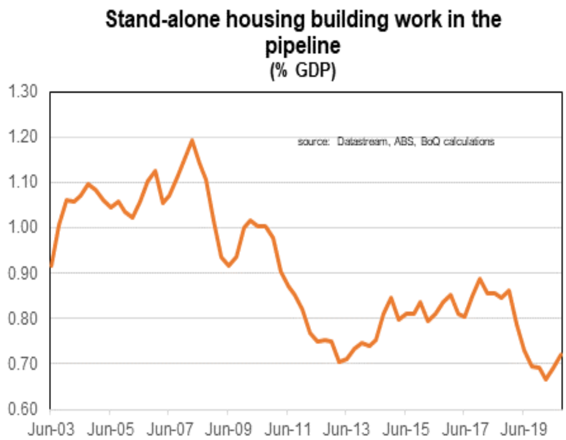
Government support programs for housing (such as HomeBuilder) looks like it will be a great success in helping to boost the economy. It has resulted in a big rise of orders for builders (for standalone housing), a large increase in the sale of new homes and more spending on alterations and additions. But the programs will boost the supply of housing at a time when underlying demand for housing (because of slow population growth) is falling. This is likely lead to a period of oversupply of housing in many areas and an increasingly negative factor for house prices over the next couple of years.

Turnover declined sharply last year in Melbourne but rose in Adelaide.

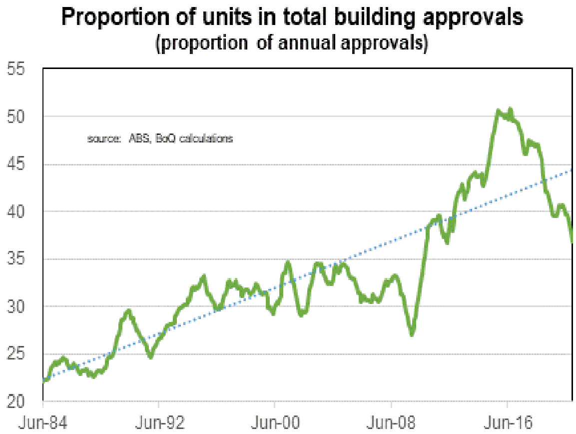
The supply of housing in NSW has been increasing faster than population growth.



The supply of new standalone houses in the pipeline has been modest but HomeBuilder is changing that.



The supply in the number of new units will slow over the next few years.



House prices are likely to rise notably this year, and a little more modestly next. The scenario for a larger rise in property prices would be an early return to the previous levels of immigration and a shift higher in consumer confidence. The downside scenario is if there is an earlier than expected rise of interest rates or a tightening of lending standards.

We live in interesting times.

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