BOQ GROUP

1 November 2023

HOUSING MARKET UPDATE

Better than expected

BOQ | me | Virgin money | BOQ FINANCE | BOQ SPECIALIST | BOQ BUSINESS

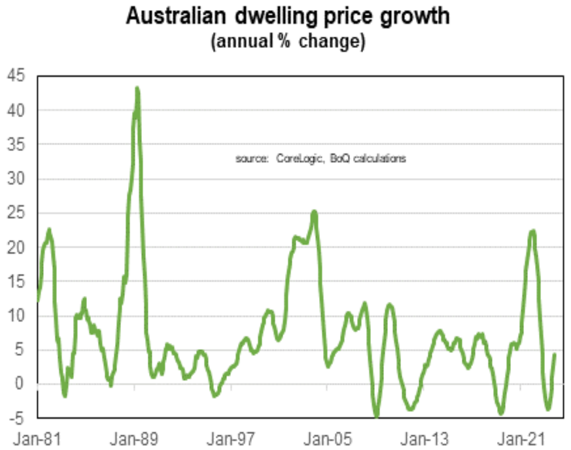
Key Points

- **House prices have risen by more than expected in 2023;**
- **The house price performance has been mixed across regions;**
- **This reflected different demand-supply dynamics;**
- **Slower house price growth is likely in 2024.**

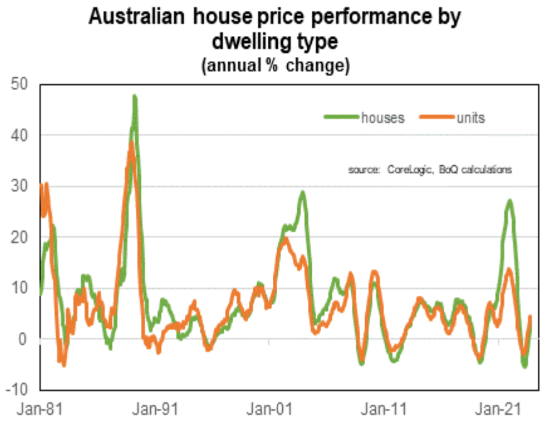
House price growth has been surprisingly strong

After a poor performance in 2022, dwelling prices Australia-wide have been on the rise for much of this year. As at October, prices were about 4% above their year-ago level. Reflecting affordability concerns, unit prices have risen by a little more than for standalone houses. The peak decline in prices recorded last year was about the same as it has been on three previous occasions over the preceding fifteen years.

Dwelling prices have risen over the past year.



Units have done a little better than houses.



The house price picture by region though has been mixed. Dwelling prices have risen in the five largest capital cities over the past year (although only modestly in Melbourne) and fell in the smaller ones. Regional dwelling prices have risen in Queensland, South and Western Australia and the NT. Outcomes have been mixed in the other states.

Dwelling price change

(annual % change to Oct 2023)

City	Houses	Units	Regional	Houses	Units
Sydney	11	6	NSW	1	2
Melbourne	2	2	Vic	-2	1
Brisbane	7	11	Qld	7	10
Adelaide	7	9	SA	12	22
Perth	13	10	WA	7	17
Hobart	-5	-3	Tas	-2	-2
Darwin	-2	-2	NT	4	2
Canberra	-1	-2			

Source: Corelogic, BoQ calculations

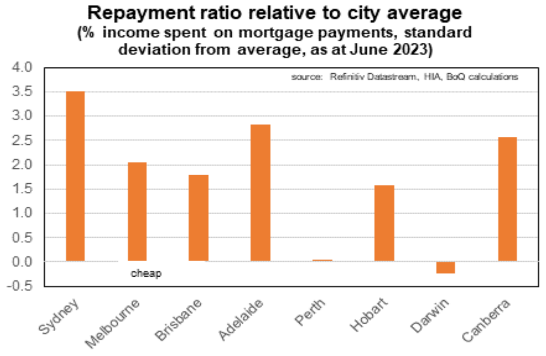
There has also been a mixed performance within cities. House prices have generally declined across the valuation range in the three smallest capital cities. In Adelaide and Perth the cheaper end of the market has outperformed. In Sydney it has been the mid to high-end. The performance has been reasonably uniform across price brackets in Melbourne and Brisbane.

Why have house prices done better than expected

While house price movements have been mixed across markets, in aggregate they have risen by more than what most analysts had expected. Typically, higher interest rates would result in lower asset prices (including house prices). This is after all, one way that monetary policy influences the economy.

Housing affordability has declined sharply over the past couple of years.

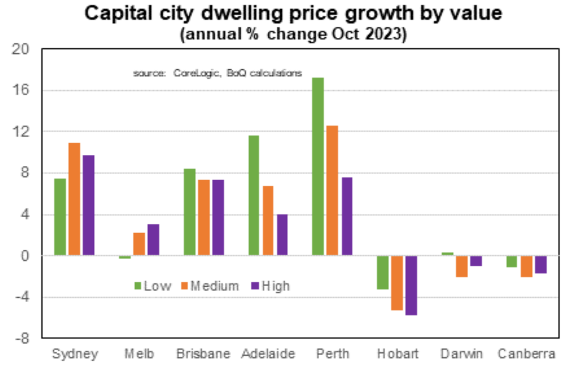
Affordability is an issue across most capital cities, although less so in Perth and Darwin.



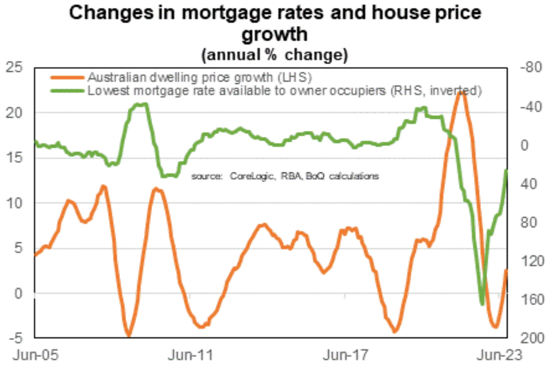
Some analysts have suggested that expectations and a perception that interest rates have been near their peak was a key factor driving house prices higher. To me this explanation does not gel. House prices started to rise in January. Since then, we have had a full percentage point increase in the cash rate. And at times financial markets have speculated on the need for an additional half percentage point increase.

Further, if interest rates were an important driver this year it would be expected that there would be a similar change in house prices (at least in direction) across market segments. That has not been the case. In any event, history suggests that the link between cash rate movements and house prices has been mixed.

House price movements have varied across City price buckets.



Historically the link between changes in the mortgage rate and house prices has been mixed.



The most likely reason that interest rates may not be having the same influence as in previous economic cycles has been the unusual trends created by the recovery of the economy from COVID. Typically, higher interest rates would in time lead to weaker employment growth and therefore an increase in the unemployment rate. The jobs market has slowed. But on this occasion the demand for labour has remained so strong that the unemployment rate has stayed low, even despite a very big increase supply of workers. Indeed, the strong jobs market is a driver of the recent strong immigration growth (in addition to the bounce-back as borders have re-opened).

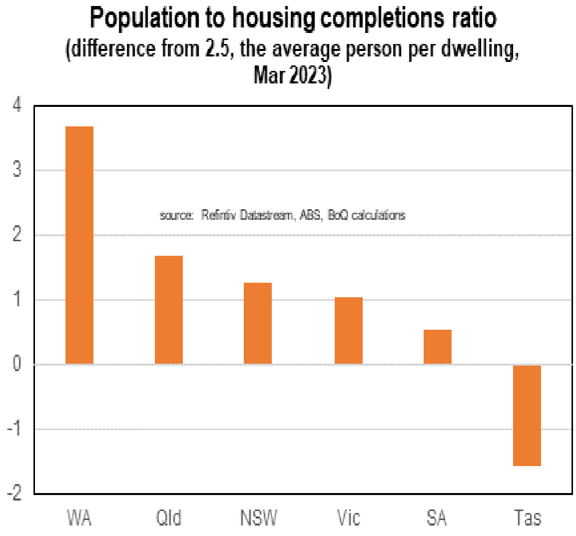
Housing demand also got an additional boost in this cycle from the working from home trend. According to RBA analysis, there was demand for an extra 140,000 dwellings, as people move out of group houses and into a place by themselves or with a partner wanting extra room to be able to work from home. This shift received initial encouragement from extremely low rents (notably in inner-city units) as overseas students and temporary visa holders left the country as the borders closed. The jump in rents over the last year is playing a role in a renewed rise in the number of people per dwelling (reducing the demand for housing).

At the same time, typically a big increase in the supply of housing would be expected after a period of very low interest rates. But on this occasion supply-chain problems and worker shortages has meant that the typical rise in housing completions has been more drawn out than usual.

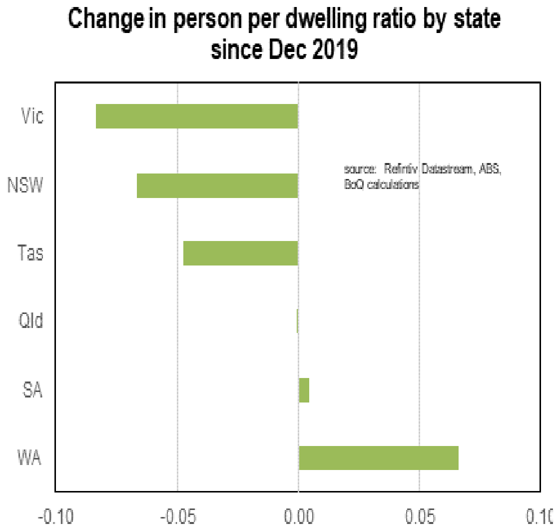
These factors have played out differently across regions. The biggest increase in underlying demand for housing (as proxied by population growth) relative to the number of housing completions has been in WA, with the smallest being in Tasmania. One result has been a rise in the ratio of number of people per dwelling in WA, but a decline in Tasmania. All of this is consistent with WA house price growth being stronger than in Tasmania (and Perth outperforming Hobart).

The growth of population has also been faster than the number of completions in all the other Australian states (and a key reason as to why there has been a rise in house prices). In Queensland and South Australia, the result has been a rise in the number of people per household back to the pre-COVID levels. The increase in people-per-dwelling has only just begun in NSW and Victoria.

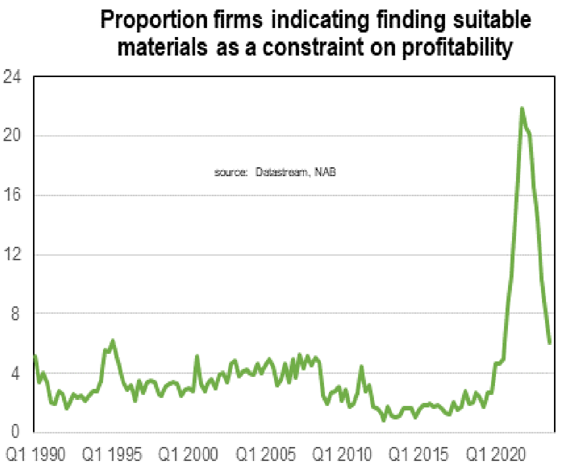
Population growth has been faster than the increase in the number of completions in all states bar Tasmania.



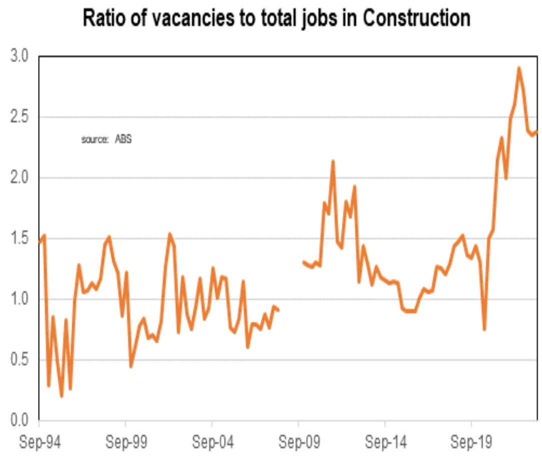
The rise in rents has seen an increase in the number of people per dwelling across most states.



Supply-chain problems has inhibited an increase in housing supply.



As has a shortage of construction workers.



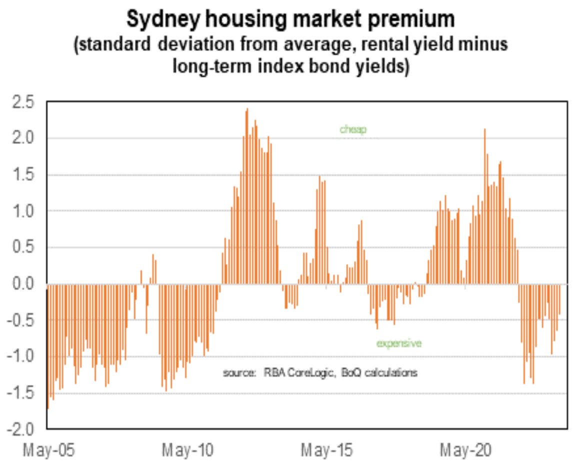
Other drivers of higher house prices

The change in the demand-supply dynamics across housing markets has also influenced house price valuation measures. One measure I use is the comparison of long-term 'real' (after-inflation) bond yields with rental yields. This measure compares the (after inflation) returns received from the housing market relative to the risk-free interest rate ('real' bond yields).

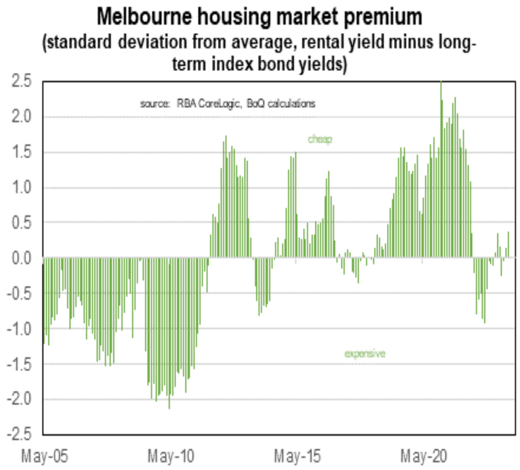
Although bond yields have risen this year they have been broadly matched by the rise in rental yields. On this measure, Perth and Melbourne housing markets are 'cheap' compared with their long-run average, while Brisbane and Adelaide appear around 'fair' value (near their long-run average). Sydney though looks expensive, albeit not as extreme as at the start of 2022.

Another valuation methodology is to compare the average house prices across capital cities to the average Sydney house price. By this measure Melbourne and Perth again appear cheap. The average house price in most other cities is not far from their long average compared with Sydney.

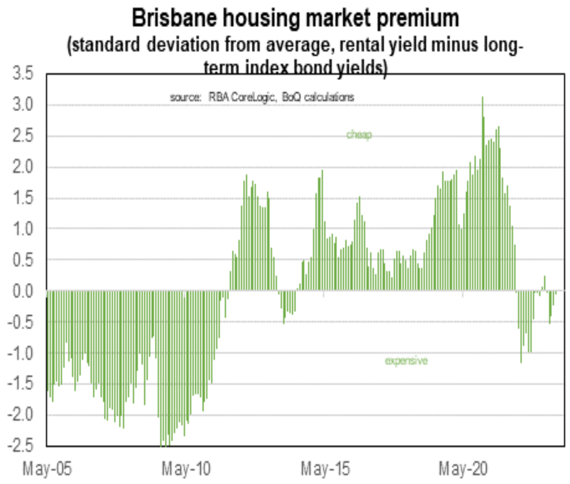
Sydney house prices appear a little expensive.



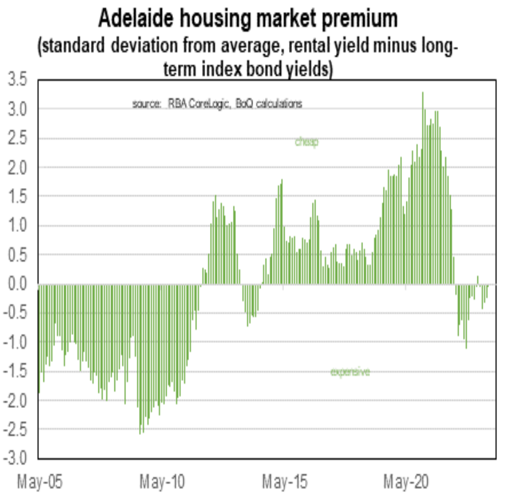
But Melbourne appears a little cheap.



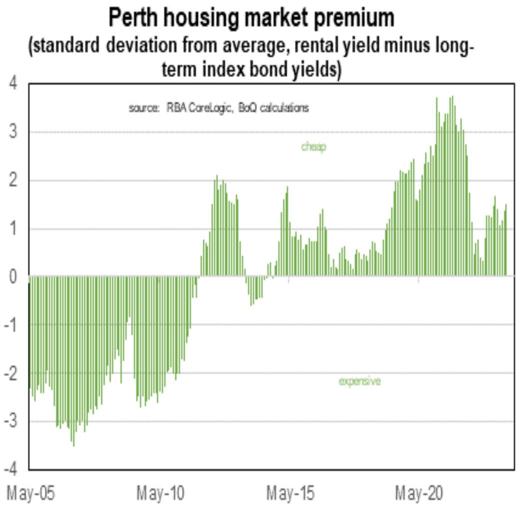
Brisbane house prices looks to be pretty close to fair value.



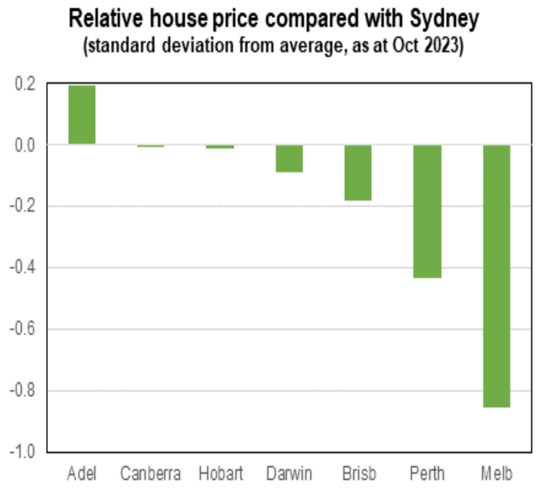
As does Adelaide.



The Perth market looks to be the cheapest of all the major capital cities.

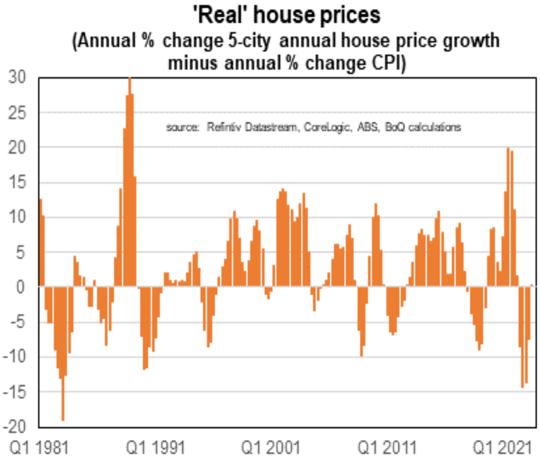


Melbourne and Perth house prices are low relative to their long-term average compared with Sydney.

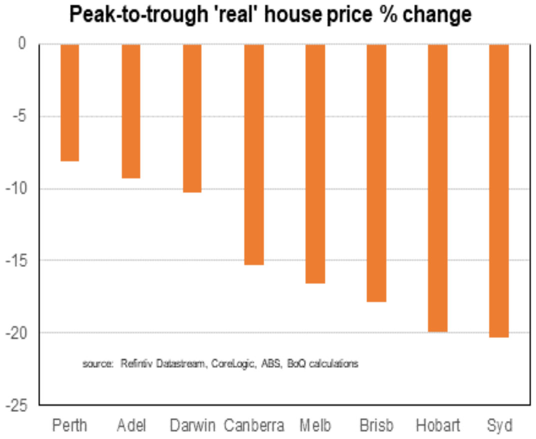


Perhaps the main reason why so many analysts got their forecasts wrong was that we were watching the wrong benchmark. Adjustments in the economy are done in 'real' terms (i.e., after allowing for the impact of inflation). Many analysts were forecasting that house prices would decline by 15-25% peak-to-trough in this cycle. In nominal (or actual) terms, house prices 'only' declined by around 5%. But after allowing for the impact of inflation 'real' house prices did decline by around the forecasted mark, particularly for the cities that looked most overvalued in 2021 (Sydney, Hobart and Canberra). Two of the cities that did best (Perth and Darwin) were (by my calculation) the cheapest.

After inflation, house prices declined by around 15% peak-to-trough.



'Real' house prices declined by around 20% in Sydney and Hobart but by under 10% in Perth and Adelaide.



Forecast for house prices for the remainder of 2023 and 2024

Standalone house prices look likely to be up strongly in 2023 in Sydney, Brisbane, Adelaide and Perth. A more modest rise looks to be on the cards in Melbourne. Prices are likely to be about flat in Hobart, Darwin and Canberra.

Next year I expect house price growth across Australia to be somewhat slower. Interest rates may not rise that much more next year but they also may not decline much. There should be some rise in housing supply as supply bottlenecks get resolved and a continued rise in the number of people per households will reduce the demand for housing (although offset by strong population growth).

Standalone house price growth is expected to be strongest in 2024 in Melbourne and Perth, the cities that I think currently appear relatively cheap. Price growth is expected to be slowest in either the most expensive city (Sydney) or those that have displayed the least positive demand-supply dynamic (Hobart, Darwin and Canberra).

Annual % change standalone house prices

City	2022 (a)	2023 (f)	2024 (f)
Sydney	-10	14	3
Melbourne	-8	5	7
Brisbane	-2	11	5
Adelaide	14	9	4
Perth	4	15	7
Hobart	-5	0	3
Darwin	4	0	3
Canberra	-2	1	3

Note: Numbers are for standalone houses and are annual % change end December. Forecasts are based upon CoreLogic house price data. Forecasts are by BoQ Economics.

We really do live in interesting times.

Regards

Peter Munckton
Chief Economist
Bank of Queensland

BOQ | 255 George Street Sydney NSW 2000

Twitter: @petermunckton

NOT INVESTMENT RESEARCH

This presentation was prepared by Bank of Queensland Limited ABN 32 009 656 740 Australian Credit Licence Number 244616 (Bank).

No Reliance

This presentation is not investment research and does not purport to make any recommendations. This report is for informational purposes only and is not to be relied upon for investment purposes. You should seek independent advice from a qualified professional on these matters.

This presentation has been prepared without considering your objectives, financial situation, knowledge, experience or needs. The content of this presentation is not to be construed as an act of solicitation, or an offer to buy or sell financial products. To the extent that you choose to make any investment decision after having read this report, you should consider the appropriateness and suitability to your own objectives and obtain independent professional advice about your particular circumstances.

The Bank makes no representations or warranties about the accuracy or completeness of the content contained in this presentation. Any opinions, conclusions or recommendations made in this report are subject to change without notice, and may differ to the opinions, conclusions or recommendation expressed elsewhere by the Bank. The Bank is under no obligation to update, keep current, the information contained in the report.

Forward-Looking Statements

This presentation may contain forward-looking statements about market conditions. These forward-looking statements may be identified using forward-looking terminology, including the terms “believe”, “estimate”, “plan”, “target”, “project”, “anticipate”, “expect”, “intend”, “likely”, “may”, “will”, “could” or “should” or, in each case, their negative or other variations or other similar expressions, or by discussions of future events.

Readers should not place undue reliance on any forward-looking statements. To the maximum extent permitted by law, responsibility for the accuracy or completeness of any forward-looking statements, whether because of new information, future events, or results or otherwise, is disclaimed. BOQ does not undertake to update any forward-looking statements contained in this document, subject to disclosure requirements applicable to it.

Liability

The Bank does not accept any liability for any loss or damage arising out of any error or omission in the information provided or arising out of the use of all or any part of this presentation.

"NOTICE (You must not remove this notice from this email)