HOUSING UPDATE

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WEEK ENDING 20 JANUARY 2023

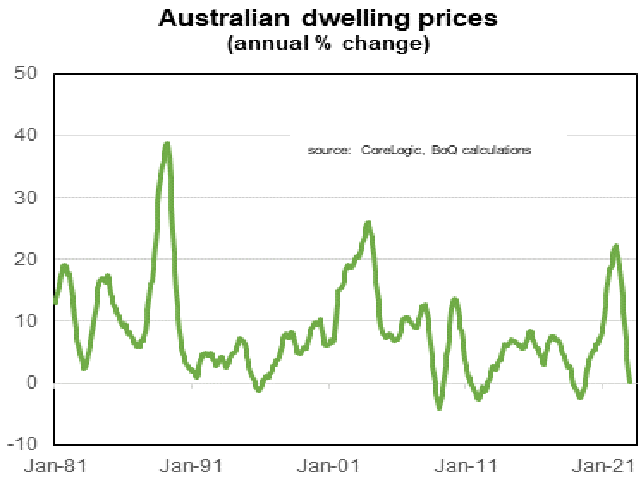
Key points

- **Nationwide house prices began their decline after the first cash rate rise;**
- **With interest rates likely to head higher, further house price falls are likely this year;**
- **Adelaide, Perth and Darwin have been the strong capital city performers;**
- **Regional areas outperformed cities in 2022.**

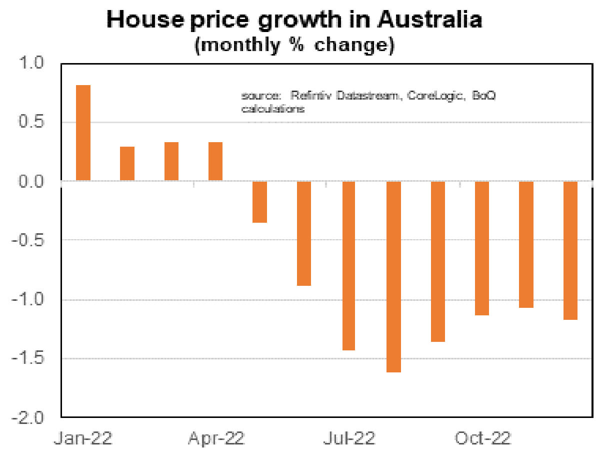
What happened to house prices in 2022

House prices across Australia (and dwelling types) were broadly flat in 2022. There were monthly rises in the early part of the year with the nation-wide decline beginning after the first cash rate rise in May. The monthly falls were most significant in the third quarter although the declines were still sizeable in the final months.

Dwelling prices were essentially flat over 2022.



House prices begun their decline following the first cash rate rise in May.



As is often the case, price movements differed between regions and types of dwelling. Generally, regions outperformed cities and units did better than standalone houses. All property in Sydney and Melbourne, as well as Canberra houses and Hobart units, suffered the biggest declines. Anything in South Australia and Queensland (except Brisbane houses) did well.

Dwelling price % change over 2022 (by region and dwelling type)

City	Houses	Units	Regional	Houses	Units
Sydney	-11	-7	*NSW*	1	2
Melbourne	-9	-6	*Vic*	3	3
Brisbane	0	9	*Qld*	9	11
Adelaide	13	13	*SA*	20	10
Perth	6	1	*WA*	8	6
Hobart	-3	-6	*Tas*	7	0
Darwin	4	4	*NT*	2	7
Canberra	-5	2			

Source: Numbers based on CoreLogic median sales AVM value for standalone houses

Using the calendar year as the benchmark disguises the extent of house price weakness in 2022. From the peak, there were double-digit declines in all the mainland east coast capital cities last year (and very close to that in Hobart). Units outperformed in most capital cities. Declines were more modest in regions across all states and territories. In Queensland, South and West Australia, and the Northern Territory, house price growth was either broadly flat by the end of the year or was still rising.

Peak to trough
(as at Dec 2022, by region and dwelling type)

City	Houses	Units	Regional	Houses	Units
Sydney	-14	-7	*NSW*	-8	-3
Melbourne	-10	-6	*Vic*	-3	-2
Brisbane	-12	-2	*Qld*	0	-1
Adelaide	-1	0	*SA*	-	-
Perth	0	-2	*WA*	-	-
Hobart	-9	-10	*Tas*	-2	-5
Darwin	-1	-	*NT*	0	-
Canberra	-10	-5			

Source: Numbers based on CoreLogic median sales AVM value for standalone houses

Despite the declines of 2022, dwelling prices over the course of the pandemic rose significantly across most regions. As discussed in further detail below, further house price declines are very likely this year. But outside of Sydney, Melbourne and regional Northern Territory, households who purchased their homes pre-pandemic should continue to enjoy substantial house price rises regardless of what happens in the housing market this year.

House price change since start pandemic
(as at Dec 2022, by region and dwelling type)

City	Houses	Units	Regional	Houses	Units
Sydney	20	0	*NSW*	50	43
Melbourne	11	0	*Vic*	47	43
Brisbane	41	27	*Qld*	43	51
Adelaide	48	32	*SA*	46	40
Perth	28	18	*WA*	41	30
Hobart	41	33	*Tas*	61	47
Darwin	25	40	*NT*	14	5
Canberra	37	35			

Main reason for house price declines has been higher interest rates.

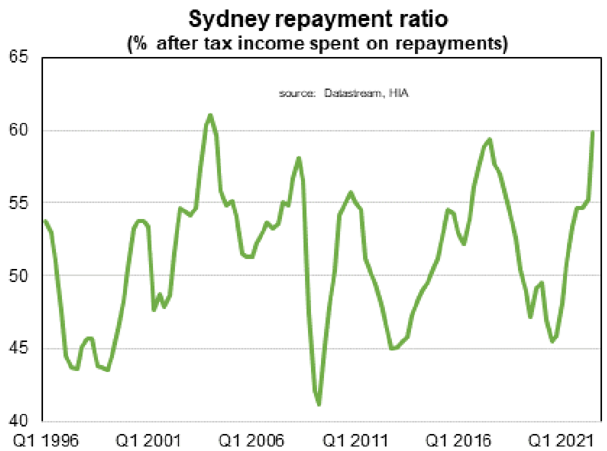
The main driver of the decline in house prices has been the increase in mortgage rates. Together with the high level of house prices, it meant that at the end of September (according to HIA calculations) affordability was near a record low in Sydney, and the worst it had been in 10-15 years in most other capital cities (Perth was an exception). The fall in affordability saw sentiment towards buying a house drop to its lowest level in about ten years. The significant price declines in the second half of last year though has seen some improvement in sentiment about buying a house in Sydney and Hobart. Sentiment about real estate as a saving destination in the December quarter was at its lowest-ever level.

Rising interest rates impact the housing market in a number of ways. It reduces the ability of new borrowers to enter the market. The proportion of loans going to first home buyers has declined over the past year (although in more recent months the decline in loans to first home buyers has been in line with the wider market). In theory, declining house prices should have less impact upon existing homeowners (the lower price they receive for selling their home is offset by a lower price they pay for their new house). But few people like selling for a 'loss'.

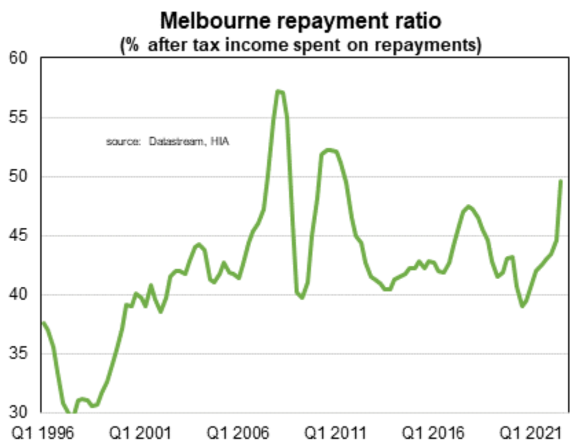
The bulk of existing borrowers that have owned their home for some years have built up both substantial equity in their home (and many also have substantial saving). More recent borrowers have had less time to build up equity and saving. For these borrowers in particular, cash-flow management will become increasingly difficult over this year, particularly for those on fixed-rate loans that rollover over the course of the next 12-18 months.

Providing they keep their job, it is probable that most borrowers will be able to manage (particularly if the majority of economists are right and rate cuts take place by end-2024). Investors with tight cash flows or concerns about losing their job may be sellers. The strong state of the rental market though is providing good cash support for most investors.

Affordability in Sydney is around its worst level over the past twenty five years.

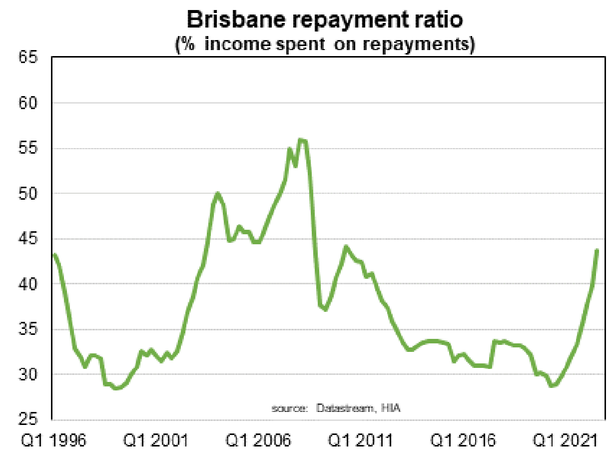


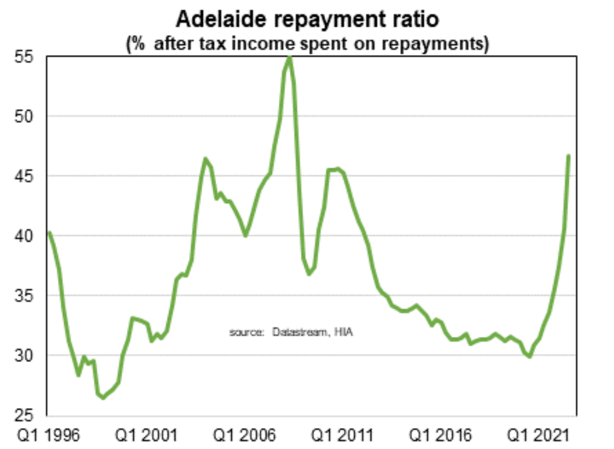
While not as bad, affordability has also been worsening in Melbourne.



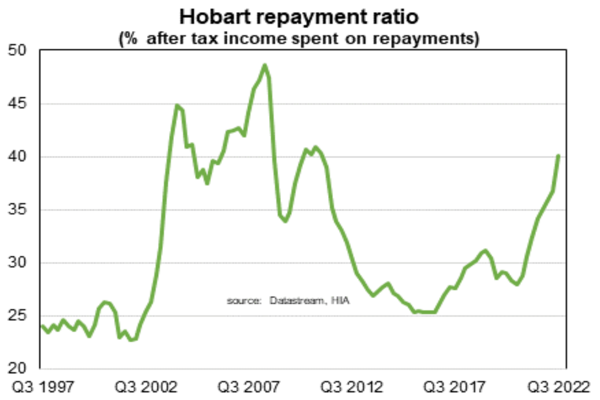
And Brisbane.

It has significantly deteriorated in Adelaide.

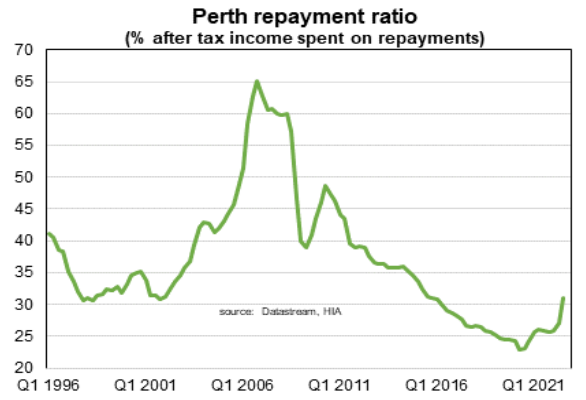




And Hobart.



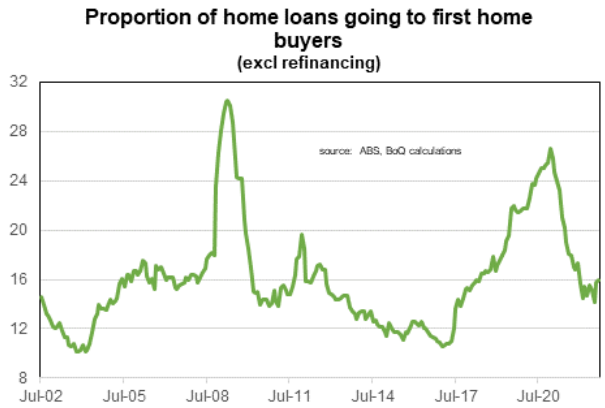
By contrast, the deterioration in Peth has only been modest.



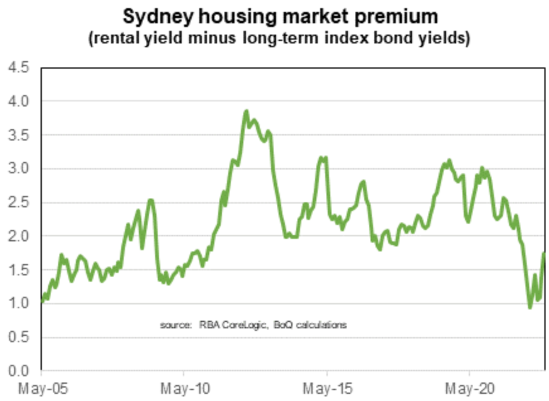
Another way that interest rates impact the housing market is as a competing investment. If interest rates are high (particularly after allowing for inflation) then investors are less likely to invest in other assets (such as real estate). In the early stages of the pandemic housing appeared relatively cheap, mainly reflecting the extremely low level of long-term interest rates. But by the start of 2022, the combination of rising house prices and rising interest rates had led to housing becoming overvalued.

By the end of 2022 the decline in house prices had removed a large part of the over valuation. Current valuations are consistent with further house price falls. But the potential for some (further) reduction in the level of long-term interest rates should provide some support to the housing market. A further rise in rents will also help.

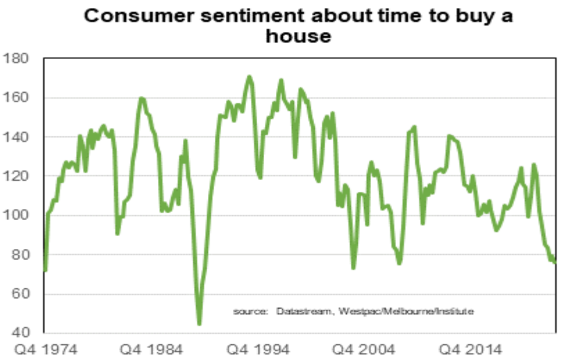
The proportion of loans going to first home buyers has deteriorated sharply over the past couple of years.



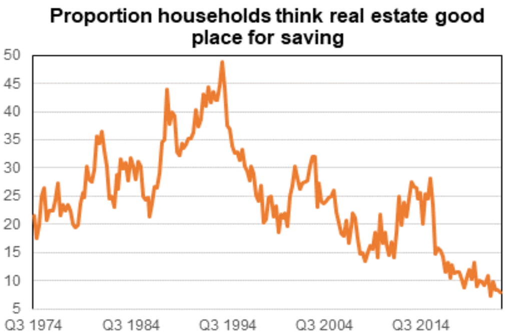
The over valuation on the housing market has been substantially reduced.



Sentiment about buying a house is at a low level.



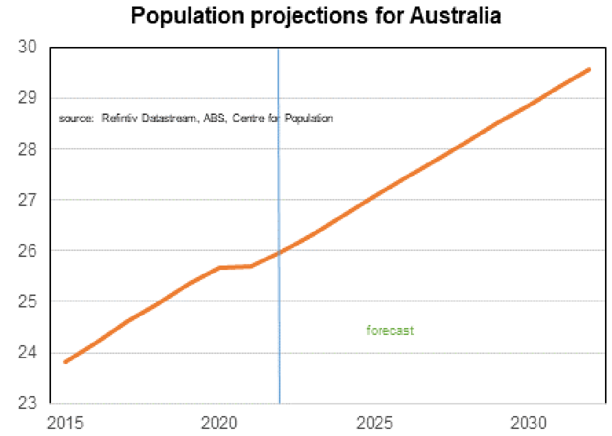
Very few households currently believe that real estate is a wise place for investment.



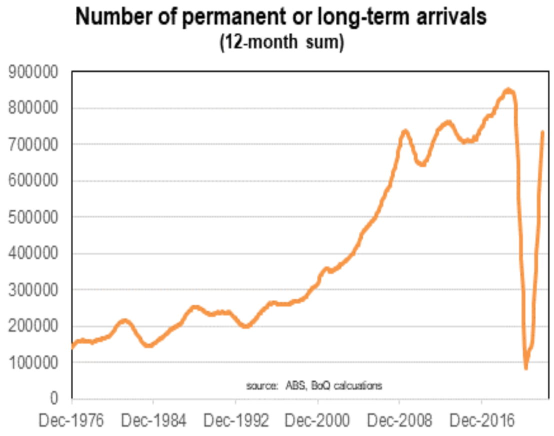
There is rising underlying demand for housing

While financial conditions are currently negative for the housing market, developments in the 'real' economy are more positive. Following the weakest growth since World War One, population growth picked up strongly over the course of 2022 reflecting the resumption of immigration. Up to mid-2022, population growth had been notably slower than usual in NSW, Victoria, Canberra and the NT. The two big states will be the main beneficiaries of the increased immigration (including students). The Centre for Population recently forecast that population growth over the next ten years will be strong in all capital cities, as well as regional Victoria and Queensland.

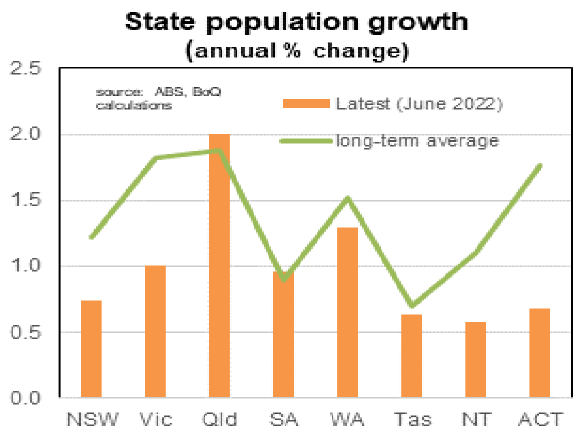
Population growth is expected to return to its pre-pandemic trend.



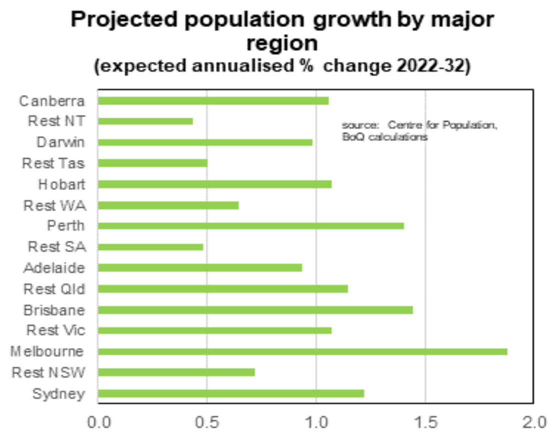
A key reason is a return of strong levels of immigration.



Population growth has been particularly weak in NSW, Victoria, Canberra and the NT.



Strong population growth is projected across most capital cities, notably Melbourne, Brisbane and Perth.

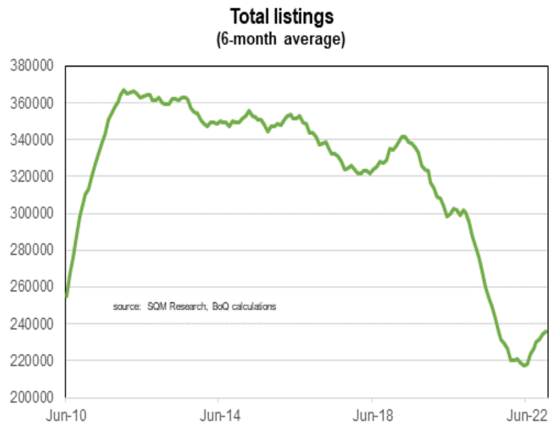


Declining supply

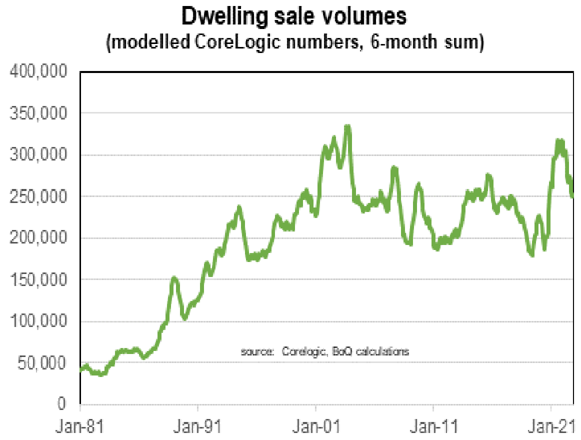
Supply developments will also support house prices. Over the course of the pandemic, there was a strong increase in approvals to build standalone houses reflecting government subsidies, low interest rates and the shift to working from home. Many of those houses have yet to be completed reflecting the lack of materials and tradies. But with the supply of materials improving, many of those homes should be completed by the end of this year. With approvals falling, this will mean a reduced supply of new homes being built in 2024, the same time population growth is rising.

The largest component of supply is existing homes. One of the unusual features of this cycle has been the negligible rise in the number of listings despite the strong rise in house prices. The volume of sales though was strong. The proportion of the market that turned over was also high (notably in Queensland). This is indicative of both high auction clearance rates and houses spending less time on market. According to SQM Research data, the proportion of listings that were on the market for less than 30 days in 2021 was the highest for at least twelve years. This points to strong demand for housing at that time.

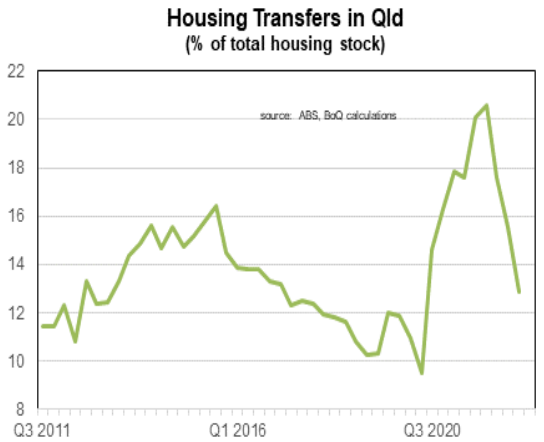
The number of listings was historically low in the recent housing cycle.



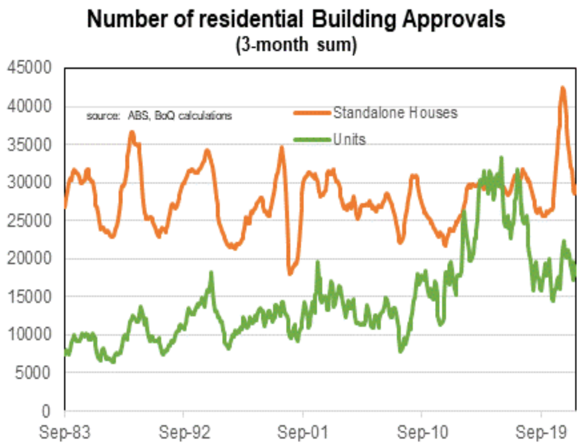
But the volume of houses sold was high.



As was turnover.



There were also problems in getting the supply of new homes onto the market.



Peak-to-trough view on house prices

Interest rates are likely to rise further, at least in the first half of this year. The full impact of the rate rises won't be felt until the bulk of fixed-rate loans roll off. Underlying demand for housing will rise as population growth picks up. And after rising through this year, the supply of new housing will decline into 2024 in line with the fall in building approvals. Declining prices will limit the number of existing homes coming onto the market.

The net result is that I think there is still further house price declines to come this year. I have (modestly) marked down expected price peak-to-trough declines (for standalone houses) in Sydney, Melbourne, Brisbane, Canberra and Hobart in recognition of the momentum in the market at the end of last year. I have not changed my view on Adelaide as its price decline has only just started (and where affordability has declined substantially). The performance of Perth and Darwin markets to-date suggests that the decline could be towards the lower end of my estimated range.

Projected peak-to-trough house price declines by capital city

City	% decline from peak to Dec 2022	September quarter forecast peak-to-trough decline	Updated expected peak-to trough decline
Sydney	-14	-15 to -20	-17 to -22
Melbourne	-10	-10 to -15	-12 to -17
Brisbane	-12	-10 to -15	-15 to -20
Adelaide	-1	-8 to -13	-8 to -13
Perth	0	-3 to -8	-3 to -8
Hobart	-9	-12 to -17	-13 to -18
Darwin	-1	-2 to -7	-2 to -7
Canberra	-10	-10 to -15	-12 to -17

Source: BoQ Economic forecasts. Forecasts based on median sales AVM value for standalone houses

We live in interesting times.

Regards

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