21 April 2023

HOUSING MARKET UPDATE

Not (quite) yet at the bottom

Key Points

- **House prices rose surprisingly in the month of March despite higher interest rates;**
- **A decline in the supply of homes for sale was the likely reason for the rise;**
- **The risk of a further rise in interest rates and weakening economic growth means it is too early to call the bottom of house prices;**
- **Strong population growth is boosting underlying demand;**
- **The Perth, Darwin and Adelaide housing markets will outperform amongst capital cities in this housing cycle.**

Like most forecasters I spent much of 2022 (and the early months of this year) revising down my view of how much house prices would decline. The decline in house prices that took place last year (mainly) reflected the aggressive interest rate rises that took place as a result of the surprising rise of inflation. Between July 2022 and January 2023 those house price declines averaged over 1% per month. This decline was centred around the capital cities on the East Coast. Generally speaking, the other capital cities and regional areas performed better.

The rate hikes that took place in February and March meant there were good reasons to think house price decline would continue into 2023. At that time financial markets were also pricing more interest rate increases for later in the year.

But the month of the first rate hike this year, was also the month where the momentum of house prices changed. In February, standalone house prices were almost flat. Even more surprising was the rise in house prices in March. The change in momentum has been clearest in the five largest cities. Price declines continued in Hobart, Canberra and Darwin. Clearly affordability was not the driver given that houses prices rose in Sydney despite low affordability but fell in Darwin despite better affordability.

Perhaps the rise occurred because high-income earners being less impacted by the rising cost of living have taken the opportunity provided by the fall in house prices to step back into the market. That is consistent with the observation that it was the prices for higher-priced houses in Sydney that started to pick up first. But in March prices also rose for lower-priced houses in Sydney.

Immigration growth and a reduction in the size of households over the past couple of years has led to an increase in the underlying demand for housing. Strong competition amongst lenders has also meant that the rise in mortgage rates has been less than the rise in the cash rate. But the number of loans for owner-occupied housing has continued to decline, suggesting that stronger demand has not been the key driver of the renewed rise in house prices.

In my view the bigger factor in the jump in house prices in March was the decline in the number of existing houses available for sale (as well as the ongoing slowness of building new houses). The level of supply of housing has declined to be a closer match for the lower level of demand. The better match between supply and demand has meant there was less pressure for house prices to decline, and even allowed for the possibility for some increase.

Another positive for the outlook for house prices is that they appear better value from an investment standpoint. The premium of the rental yield over long-term government bond yields suggests Sydney house prices are now only modestly overvalued. By that measure most other cities (including Melbourne, Brisbane and Adelaide) are around fair value. Perth (and Darwin) appears cheap.

Affordability though remains a negative for housing across most cities (Perth and Darwin are again the exceptions). This suggests that the demand for housing in coming months is more likely to come from buyers with either minimal demand for debt or from high-income earners.

I think it is too early to call the bottom in house prices. Inflation remains too high and this means the risks are that interest rates may need to rise further. At a minimum, rate cuts are some way off into the distance. At the time of writing, financial markets had not fully priced even one cash rate reduction within the next 15 months. Concerns about the rising cost of living could see some households needing to sell their investment properties. We have yet to see any deterioration in the jobs market. A survey by NAB indicates that the residential industry thinks access to credit is a drawback. The result is that my view on the outlook for house prices from January remains unchanged.

The underlying economic drivers of strong population growth and projected slowing of supply are factors pushing for higher house prices. So, it is possible that house prices will not decline as much as I had forecast. And it is possible that we may have already see the bottom of house prices in this cycle.

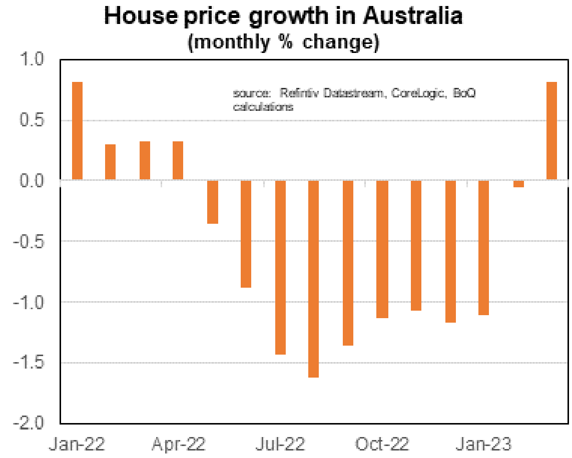
By city, my Brisbane, Hobart, Canberra, and Darwin forecasts have essentially been met. The Sydney and Melbourne forecasts though require another leg down in prices. It is looking increasingly unlikely that the extent of my forecast decline of house prices in Adelaide and Perth will occur. By historical standards affordability in Adelaide looks challenging. Adelaide though has been supported by strong level of interstate migration although that flow is starting to slow. The strong decline in national prices was the main reason I expected some fall of property prices in Perth. But it appears that the combination of a strong local economy and supportive valuations will limit the extent of any decline in this cycle.

Forecast standalone house price peak-to-trough declines in this cycle

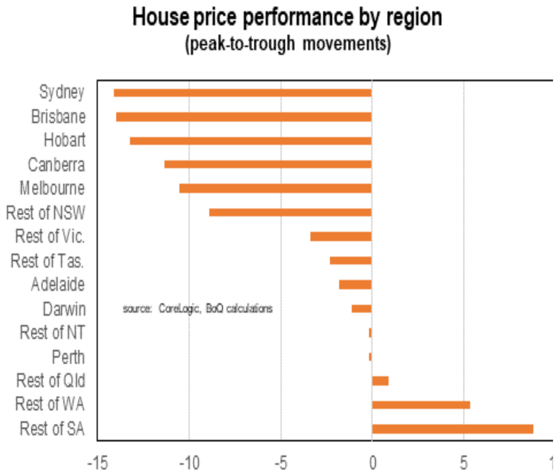
City	% decline to date from peak to trough	Projected decline
Sydney	-14	-17 to -22
Melbourne	-10	-12 to -17
Brisbane	-14	-15 to -20
Adelaide	-2	-8 to -13
Perth	-	-3 to -8
Hobart	-13	-13 to -18
Darwin	-1	-2 to -7
Canberra	-11	-12 to -17

Source: BoQ Economics. Forecasts based upon CoreLogic data for median sales AVM value for standalone houses

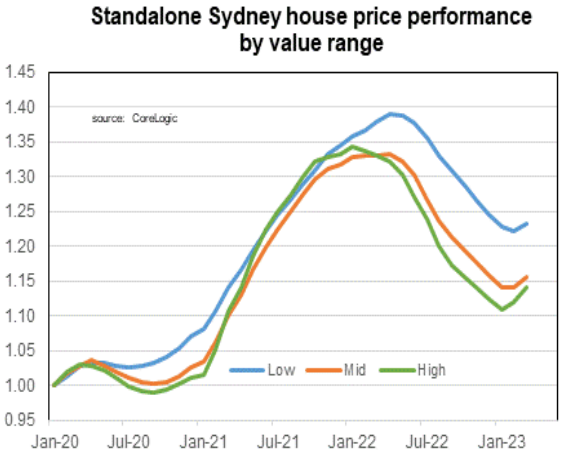
House prices unexpectedly rose in March.



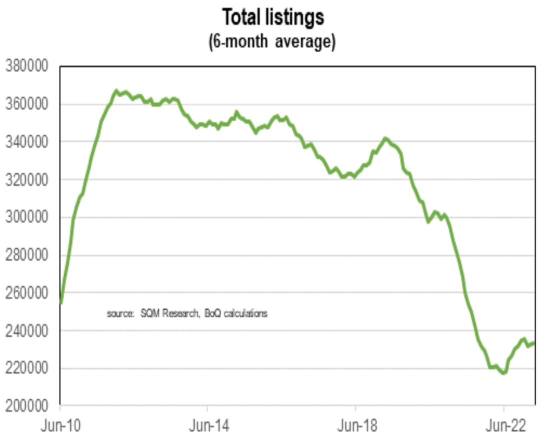
House prices have declined by most in the major capital cities in this cycle.



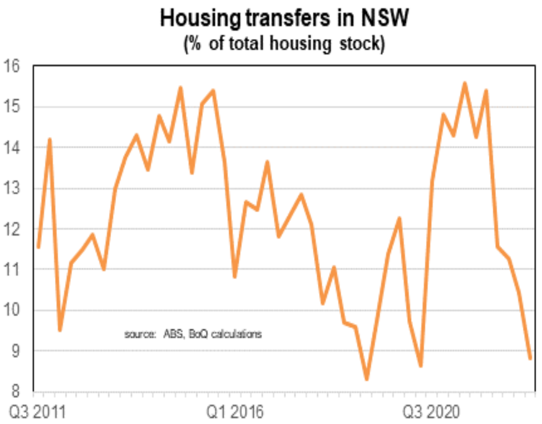
House prices have risen across the value range in Sydney over the past month.



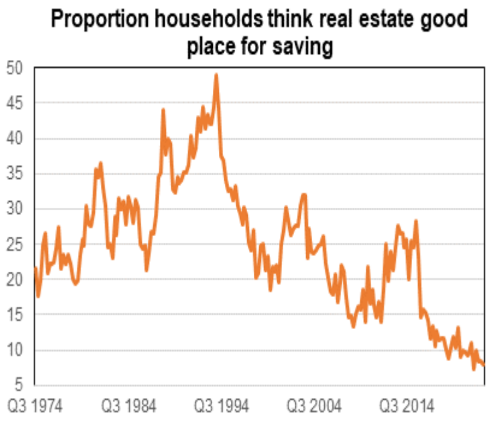
The supply of listings is very low.



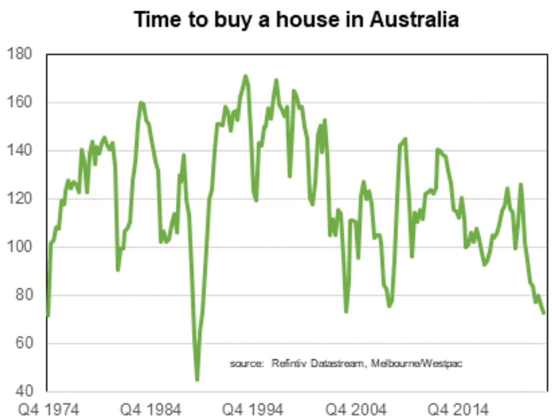
And that is consistent with a low turnover in the housing market.



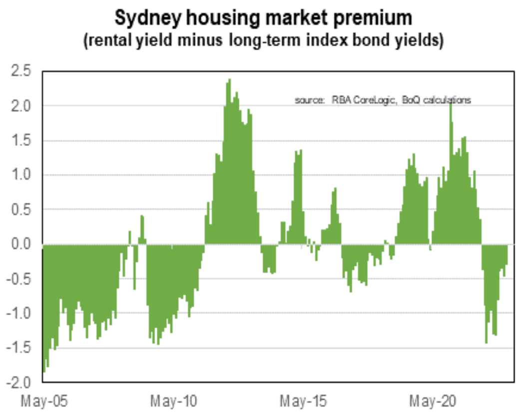
Households are not thinking about buying a house for investment.



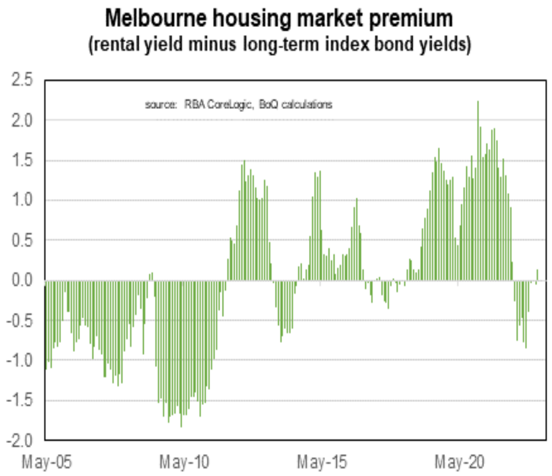
Or as an owner occupier.



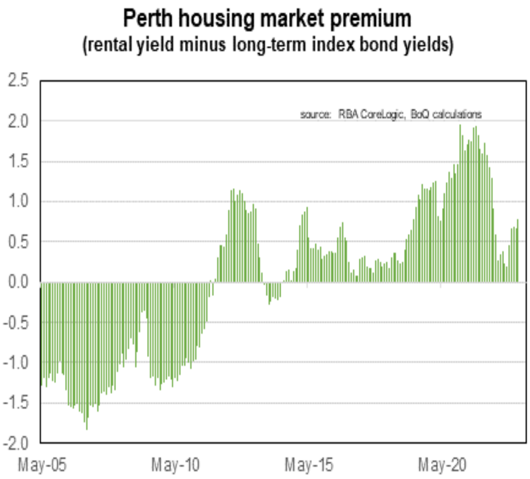
By some measures the overvaluation of the Sydney market has been dramatically reduced.



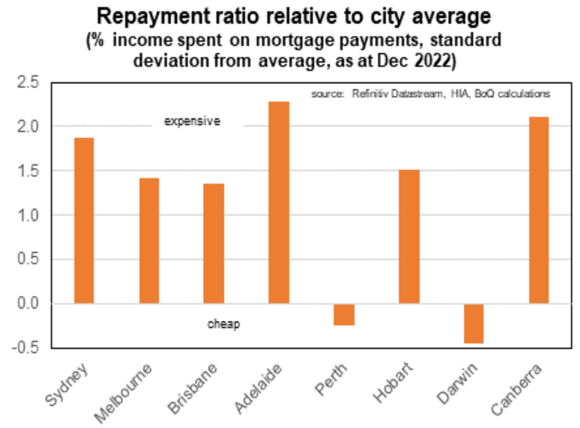
The Melbourne market looks to be close to fair value.



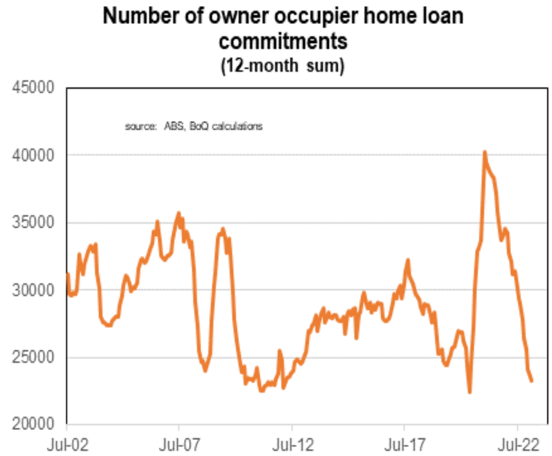
And the Perth market appears cheap.



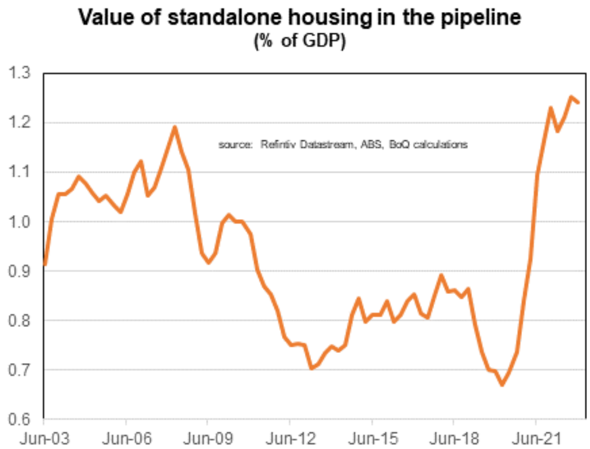
Affordability was an issue across most major cities at the end of last year, apart from in Perth and Darwin.



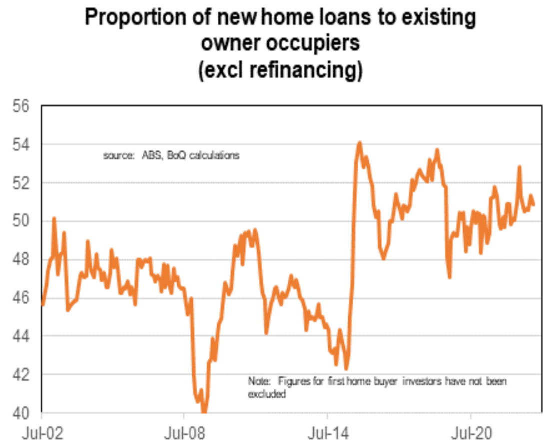
Demand for new loans remains low.



There is a large pipeline of new houses still to be built.



Reduced affordability has meant that existing owners have become more important buyers.



Regards

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