31 July 2023

HOUSE PRICE UPDATE

The House Price Conundrum

Key Points

- **House prices have surprisingly bounced back despite higher interest rates;**
- **Strong population growth at a time of tight supply is the most likely cause;**
- **A slowing economy, the potential for more rate hikes and low affordability will cap house price growth over the next 18 months;**
- **Melbourne, Perth and Brisbane appear to offer better value than Sydney and Adelaide.**

What has happened with house prices in the year to date

It seems every year there is one big economic surprise. In 2021, it was how quickly the economy rebounded from the COVID lockdowns (as well as the aggressive rise in house prices). Last year it was the return of inflation. This year it has been the rise in house prices despite the ongoing increase in interest rates.

As often happens, house prices have risen by more in some regions than others. Property of any sort in Sydney and regional SA have risen strongly so far this year, as have houses in Perth. The biggest rise this year has taken place in units in regional WA. Dwelling prices were higher in most other places although standalone house prices in Tasmania have declined and there have been a small reduction in the price of regional Victorian and Canberra houses.

% change since end 2022 – June 2023

City	Houses	Units	Region	Houses	Units
Sydney	8	5	NSW	1	0
Melbourne	1	2	VIC	-1	0
Brisbane	3	4	QLD	4	4
Adelaide	2	3	SA	5	7
Perth	5	3	WA	3	12
Hobart	-5	0	TAS	-2	3
Canberra	-1	0	ACT		

Source: CoreLogic, Median Sales AVM series

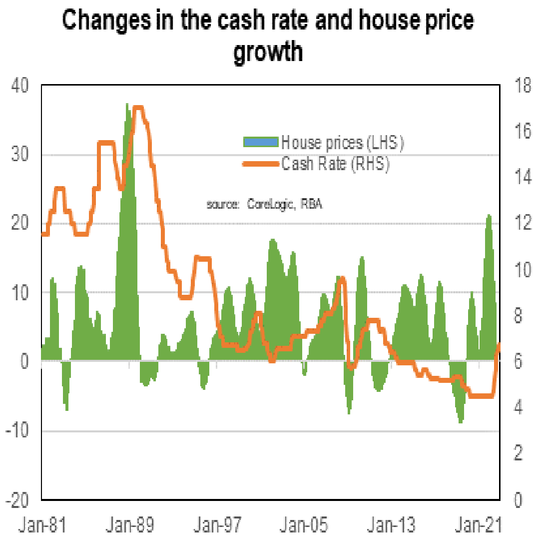
In recent decades the link between interest rate and house price movements has been one of the stronger economic relationships. A change in asset values (including house prices) has historically been one of the ways that monetary policy has influenced the economy. Higher interest rates reduces the demand for new borrowing as well as making it more difficult for existing borrowers to meet their financial commitments. The combination of rising mortgage rates and high house prices has meant affordability is well below its historical average in all capital cities (except Perth and Darwin). Rising interest rates also increases the attractiveness for savers to put their money into the bank or pay down debt as opposed to investing in housing.

On all but two occasions over the past forty years house prices have declined during an interest rate hike cycle. The two exceptions were in the mid-1980s and late 1990s. In both those cases housing was still relatively cheap and the rise in the unemployment rate modest (around 0.7-1.2 percentage points).

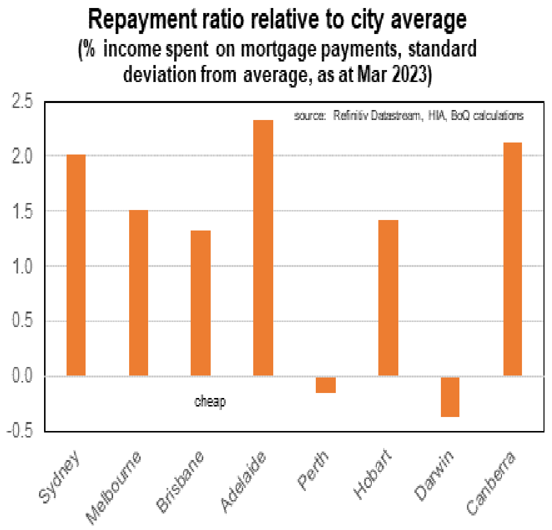
Typically rate cuts have been the catalyst needed for house prices to rise again. One exception was the long rate hike cycle in the 2000's when house prices declined in the early stage of monetary tightening. They then rose again in line with the big increase in national income due to commodities boom and a substantial pickup in population growth. House prices then declined again around the time of the peak in the cash rate cycle.

House price declines occurred at different times during rate hike cycles. In the latest cycle, house prices started to fall around the time of the first rate hike. In other cycles the decline took place close to the peak of the rate hike cycle. So, there is a precedent that house prices could renew their decline as economic growth fades and the unemployment rate rises.

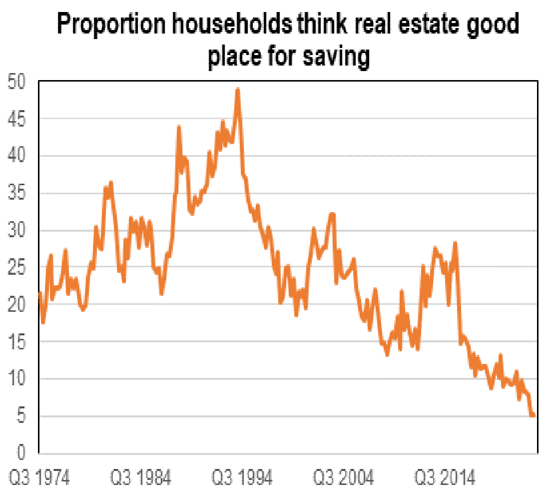
Higher interest rates often (but not always) cause a decline in house prices.



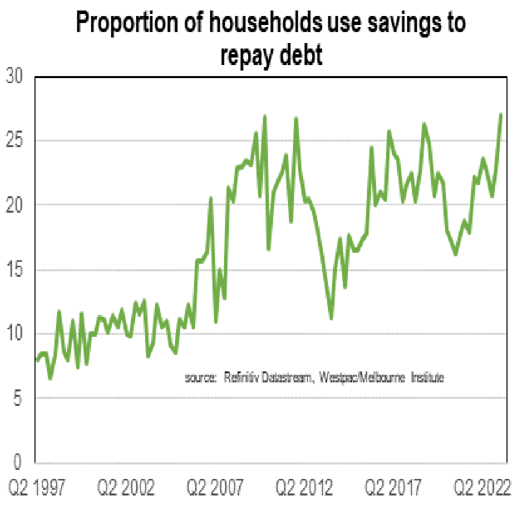
Housing affordability is an issue in most capital cities.



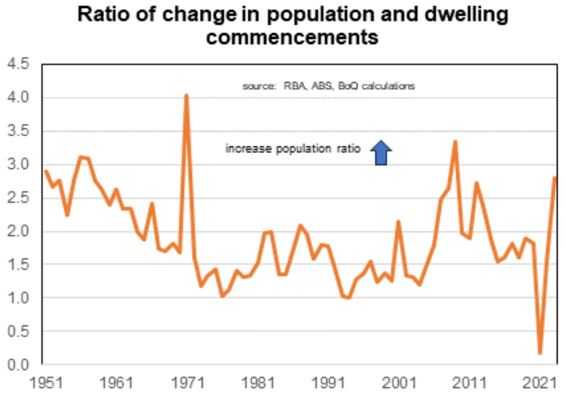
Affordability is reducing the attractiveness of housing as an investment.



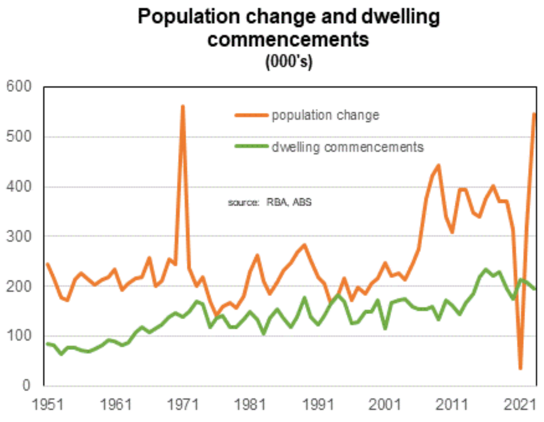
Households are more focused upon repaying debt.



Our population growth has outpaced our ability to supply more dwellings.



This is despite an increase in the supply of new dwellings over the past decade.



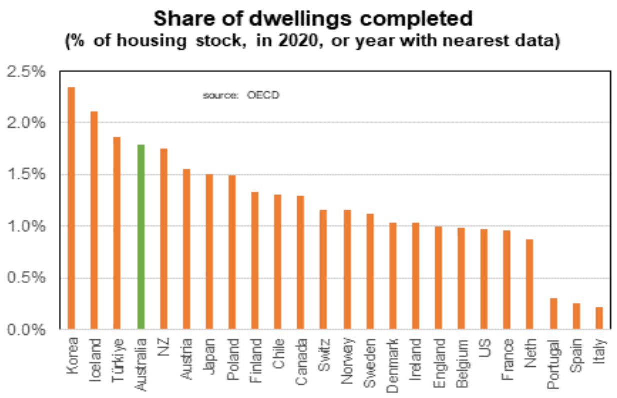
Why have house prices bounced back?

Why have house prices bounced back despite higher interest rates? Higher interest rates act to reduce demand for housing. So, it is fair to say that the interest rate downward pull on house prices is being outweighed by other factors. The unemployment rate is at fifty-year lows and wages growth is rising at its fastest level in over ten years. Many households are sitting on a mountain of savings built up through the pandemic. The RBA has noted that during the pandemic there was an increase in demand for housing as group houses became less popular and more people moved in with a partner. These positive demand factors are taking place at a time of tight supply, both in terms of construction of new dwellings and the number of existing home listings.

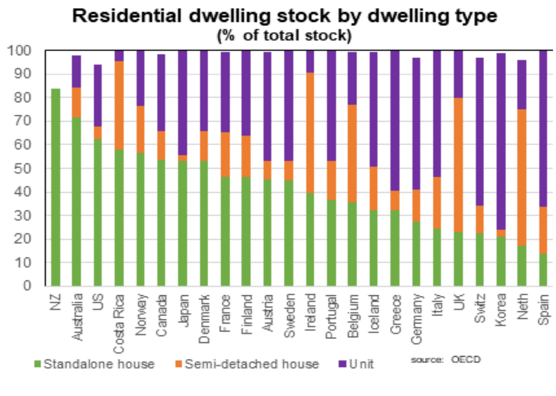
Many of those factors though were around in the second half of 2022 when house prices were declining by 1%-plus per month. The most probable cause of the recent rise in house prices has been the strong rebound in population growth at a time of tight supply. The cities that have had the biggest house price increase this year has been those with the most significant demand-supply imbalance (such as Sydney).

Valuations were also more supportive of a rebound in house prices at the start of 2023 than they were last year. In April the combination of declining house prices and rising rents meant that house prices were close to fair-value in Sydney and could have been considered cheap in the other four largest capital cities (using each cities historical spread between the rental yield and (real) interest rates as the benchmark).

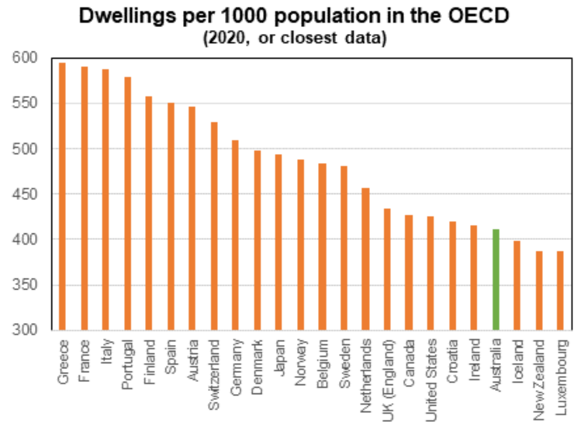
Australia does a decent job in boosting housing supply.



Much of the housing stock is standalone houses.

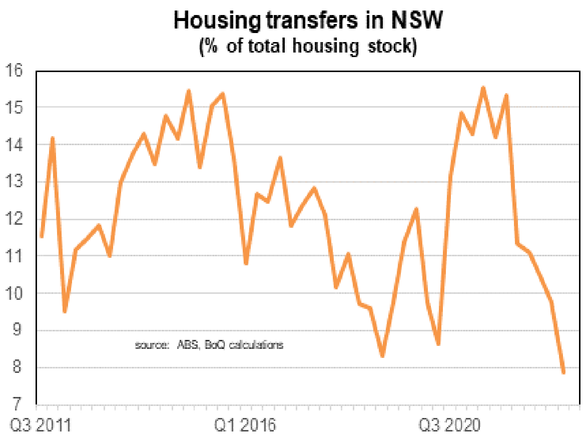


But strong population growth means the housing stock is low relative to the size of population.

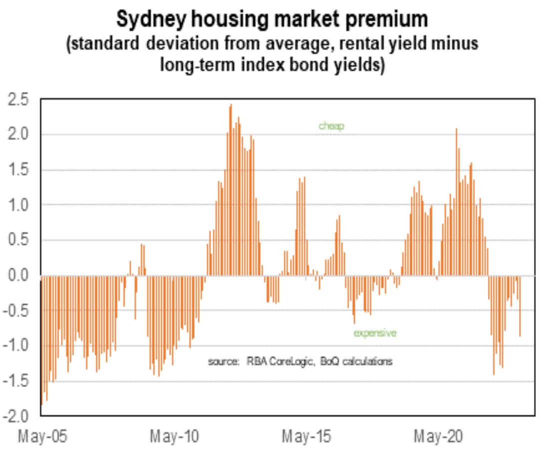


The stock of houses for sale on the market has been low in the recent years.

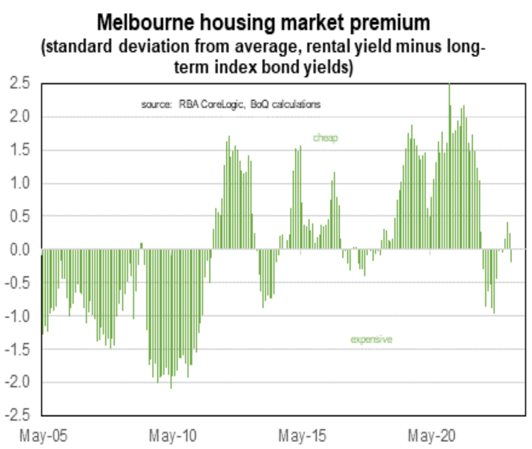
Low stock has been a factor behind the decline in turnover of recent times.



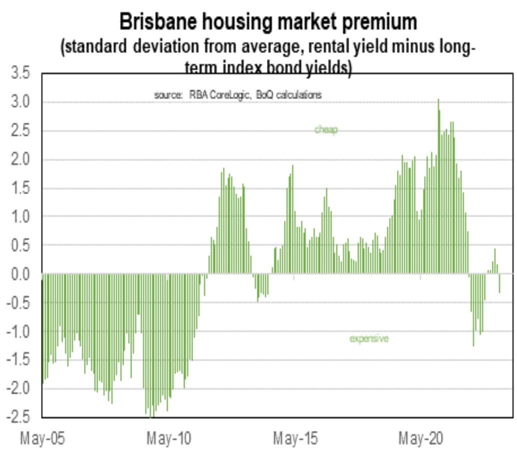
By some measures the Sydney housing market is looking expensive again.



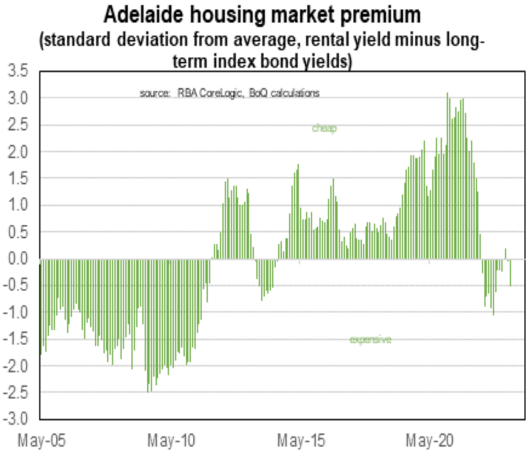
The Melbourne housing market appears to be better value.



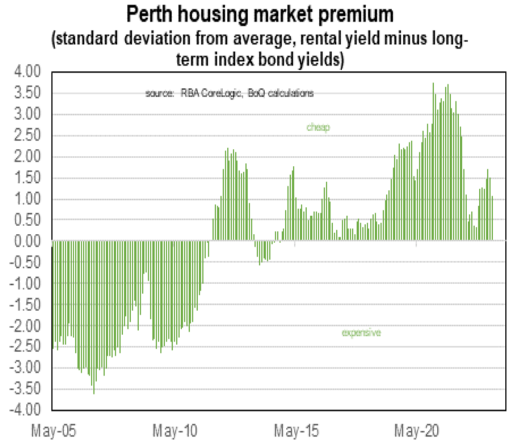
As does Brisbane.



The Adelaide market is starting to look a little stretched.



Perth appears to offer better value.



Short-term outlook

Ongoing strong population growth will underpin demand. But rising house prices and the possibility of further rate hikes means affordability will be a constraint. High rents and rising mortgage payments could well lead to a rise in the size of households as more people return to group houses (or moving back in with their parents). Easing supply chain problems and some reduction in skill shortages will mean more new housing will be completed over the next year. A weaker jobs market may see less people being comfortable about taking out a mortgage.

Affordability concerns may also see a rise in sales by existing homeowners. Already there is anecdotal evidence of an increase in listings by investors' in some regions near Sydney, Melbourne and Brisbane. The rise in house prices has meant that valuation does not provide the same support as it did earlier in the year. Sydney and Adelaide house prices now look a bit expensive although they appear closer to fair value in Melbourne and Brisbane (and continue to look cheap in Perth).

While population growth remains strong at a time of low supply it is hard to be too negative on house prices. But I look for price growth to slow given rising affordability concerns, the likelihood of a weaker jobs market and less supportive valuations. I am looking for flat to 2% growth across Australia for both the remainder of 2023 and in 2024. I suspect that Melbourne and Brisbane house prices may outperform (up 2-4%), while Sydney prices might underperform (-2% by end next year). I look for the performance of the Adelaide and Perth markets to be somewhere in between.

The Big Picture

The big picture is that population growth has picked up over the past fifteen years (except for the period around COVID). A big chunk of this additional population has moved to the major cities (mainly Sydney, Melbourne, Brisbane and Perth, and the surrounding areas).

This rise in population has been largely driven by higher immigration, something that has been mainly a good thing for the economy. It has increased demand. The average age of the immigrants has been lower than our existing population, helping to mitigate the problems of an aging population. A big part of the increase in immigration has been the rise in foreign students, allowing our education sector to become an important source of export earnings to the economy.

The problem (as we are currently finding out) is that higher immigration increases the immediate demand for housing. Australia's ability to supply new housing has been the amongst the best in the OECD in recent years. The problem is that we also have amongst the highest population growth in the OECD largely concentrated in a few urban centres. And we have struggled over the past decade to boost the supply of housing enough to match the stronger population growth.

The Federal and many of the state governments are aware of the need to boost the supply of housing. Governments are talking about increasing spending on delivering more housing although a complete solution could require changes to taxation policy and planning processes, as well as ongoing investment into transport, education, health and recreation facilities. If we are unable to boost the supply of housing to match the stronger population growth, pressure may come on to reduce the size of our immigration program. And a lower immigration program would be something that could have long-term economic and budgetary implications.

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)