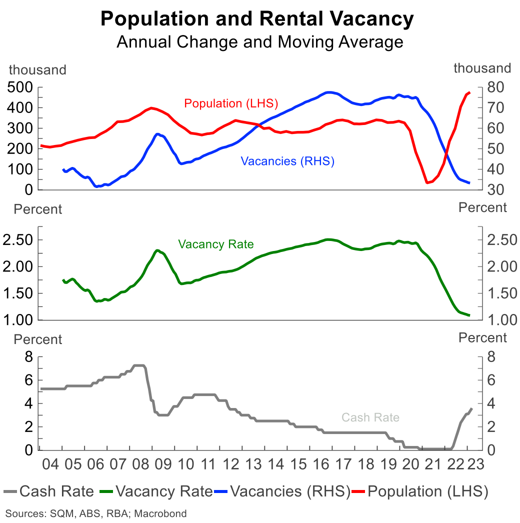
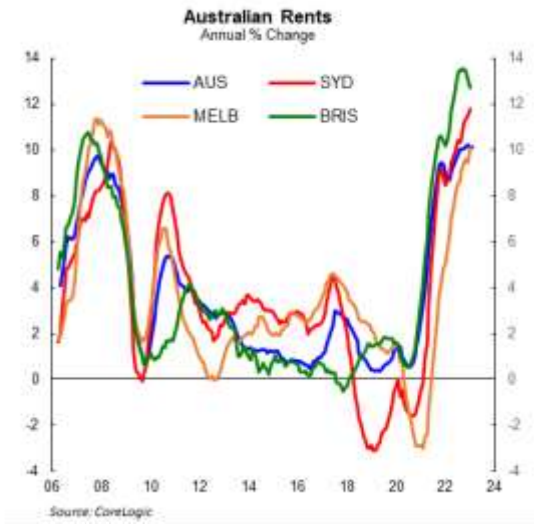
Thursday, 6 April 2023

Housing Insights

The Housing Crisis – a Double Whammy

- **There is a double-whammy facing the one-third of Australian households that rent – an ongoing march higher in rents and a stabilisation in dwelling prices.**
- **Back in mid February, we published research on the outlook for rents, outlining our expectation that advertised rents would rise by a record 11.5% this year. Rental vacancy rates are well below 3% in every capital city, and in some parts of Australia are at a record low, near zero. This is lighting a fire amid super-charged population growth.**
- **There are few short-term solutions to increase supply, indeed we expect the supply of new stock to respond with a longer than usual lag given the headwinds hitting the construction sector.**
- **But renters won't be able to easily make the switch to buy properties that have fallen in value due to higher mortgage rates. Dwelling prices appear to be finding a bottom. In March, dwelling prices recorded their first rise in eleven months.**
- **Typically, an upturn in dwelling prices does not occur when the RBA is still in a hiking cycle. But we are not living through a typical period. Demand, underpinned by strong population growth, is pushing up against low volumes of housing available for sale.**
- **It takes time to add to housing supply. Building approvals have fallen sharply, down over 45% from the cycle peak in 2021, suggesting that housing supply will not be forthcoming in a hurry. Moreover, it takes time for construction projects to be approved through the planning process and off the ground, leaving long lag times and mismatches between demand and supply.**
- **Governor Lowe said population growth has taken the RBA by surprise. Net overseas migration is driving the population gains. Our note in early February flagged the prospect of net overseas migration coming in north of 335,000 this financial year. Treasurer Jim Chalmers recently said the government is expecting circa 350,000. The lift is considerable.**





There's a double-whammy facing the one-third of Australian households that rent – an ongoing march higher in rents and a stabilisation in dwelling prices.

Back in mid February, we flagged the crisis circling the rental market. Our expectation was that advertised rents would rise by a record 11.5% this year, after accelerating by around 10% last year. In some parts of Australia, rents are now growing closer to 20% per annum, drawing some politicians to consider rental controls.

This spike in rents is causing rental stress. Yesterday, the Reserve Bank (RBA) Governor told the press club that the RBA speaks with financial councillors as part of its business liaison program. These councillors Lowe said are getting increased calls from people saying they are in stress and a lot of these people are renters. Lowe said that rental stress is at least as big of an issue at the moment, as mortgage stress.

Rental vacancy rates are well below 3% in every capital city, and in some parts of Australia are at a record low, near zero. This is lighting a fire amid super-charged population growth. There are few short-term solutions to increase supply, indeed we expect the supply of new stock to respond with a longer than usual lag given the headwinds hitting the construction sector.

But if you think renters can make the switch and purchase properties that have fallen in value due to the higher rates, think again. In March, dwelling prices recorded their first rise in eleven months. Typically, an upturn in dwelling prices does not occur when the RBA is still in a hiking cycle. But we are not living through a typical period. Demand, underpinned by strong population growth, is pushing up against low volumes of housing available for sale.

Shortages of supply is not just an issue for the rental market, but for the broader housing market. As a result, prices may find a trough earlier than expected and possibly even start turning higher ahead of any easing cycle. We still expect a sustained upswing will require rates to decline – borrowing capacity has taken a hit with new borrowers needing to show they can service mortgages with advertised variable mortgage rates of up to 9% (reflecting standard variable rates, which are currently sitting a bit under 6%, plus 300 basis points of interest rate buffer, as imposed by the banking regulator, APRA) compared to half of that in 2020.

The RBA Governor talked tough on inflation by saying the decision to hold rates steady this month doesn't necessarily mean rate rises are over. But at the same time, much depends on the data flow and the Governor stated that the RBA was more comfortable with allowing a slower return to target than other central banks, including their counterparts in the US and Europe. There are obvious reasons for this – wages growth is weaker and the higher share of households in Australia on variable loans means Australian households are feeling the impact of rate rises sooner. Given that wages growth is unlikely to turn into a wage-price spiral and that monetary policy has long and variable lags, longer this cycle with 880,000 fixed-rate loans due to expire this year, we cannot rule out that the RBA has reached the end of the hiking cycle.

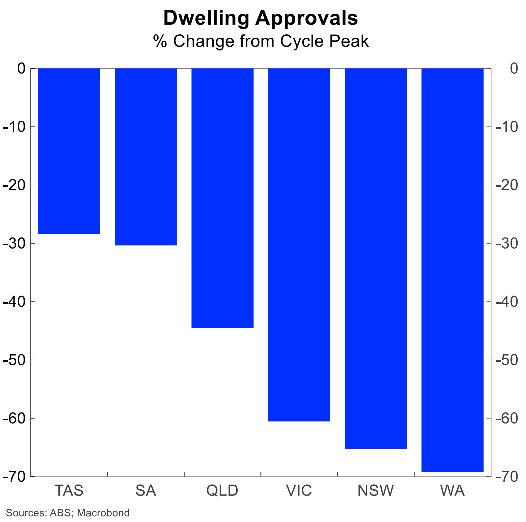
Interest-rate markets are convinced that the RBA is done and dusted. Rate cuts are partially priced in as soon as August and a 25-basis-point cut is fully priced by the end of 2023. This is too soon, and the Governor was at pains to suggest any expectations of rate cuts are premature. However, the speculation of rate cuts will play a role in the demand for housing loans.

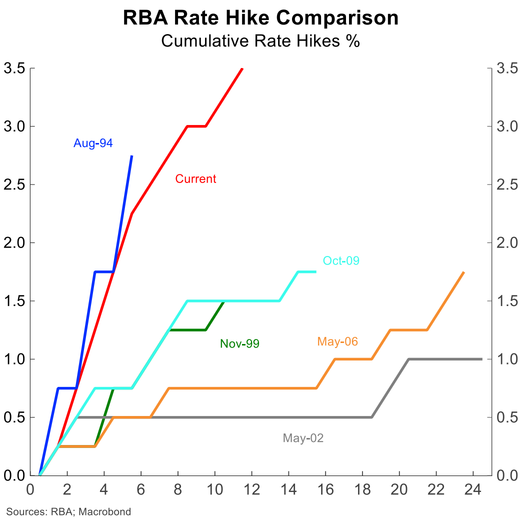
Demand appears to be shifting amid a shortage of supply. The lack of available supply is a big issue. Much of what was built in the last upturn in the residential construction cycle was stand-alone dwellings or low-rise apartments. High-rise apartments did not feature heavily in the mix and have contributed to the shortage of dwellings as population growth has recovered rapidly, particularly in the capital cities across Australia's east coast.

During the height of COVID, builders and developers were hit by rising material costs and labour costs, squeezing margins on existing fixed-price contracts. Whilst more builders have moved to cost-push pricing where possible and material costs have eased from the heights of last year, labour costs remain an issue and the squeeze doesn't unravel overnight.

The collapse of builders including the recent collapse of Porter Davis and Lloyd group just last week has further spooked confidence among property developers and builders. The squeeze is not confined to just the builders - it also flows to the downstream industries, such as the range of tradies and sub-contractors linked to the builder or to other builders that are vulnerable and experiencing cashflow issues.

It is only a matter of time before these issues reach a tipping point as it takes time for construction projects to get approved through the planning process and get off the ground. Indeed, in some cities such as Sydney the planning process can't be done in under 18-24 months, leaving very long lag times and mismatches between demand and supply. Moreover, data on building approvals shows sharp declines – down over 45% from the cycle peak in 2021 - suggesting housing supply is unlikely to hit the market in the near term.





Governor Lowe mentioned that population growth has taken the RBA by surprise. Net overseas migration is indeed surging. Our earlier note in WIRE in January flagged this prospect – we suggested net overseas migration would be at least 335,000 this financial year. Just two weeks ago, Jim Chalmers in a speech said they're expecting circa 350,000. To put this very number in perspective, this time last year, net overseas migration was forecast to be 165,000 by the previous government and 235,000 by the new Government in late October.

With the cash rate at 3.60% following the most aggressive cycle since before the 1990s – some households will come under stress and be forced to sell their home. However, loan arrears remain low and unemployment is near a 50-year low. We expect the unemployment to move higher through this year, but the level of the unemployment rate should help minimise some housing market stress.

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