BULLETIN

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Australian housing on track for sustained, but constrained, price rises

- **Dwelling prices forecast to rise 7% in 2023, revised up from flat.**
- **Upgrade follows continued momentum, improved near term outlook for rates and growth.**
- **Interest rates assessed to have peaked, easing cycle to begin in September quarter 2024.**
- **Affordability to constrain price gains medium term, despite rate cuts.**
- **Price growth to continue in 2024 but at a more moderate 4% pace.**
- **Tension between undersupply and stretched prices tightening markedly.**

Positive developments

Australia's housing market has continued to outperform expectations, particularly with respect to prices. Across the five major capital city markets, dwelling prices have now risen 4% over the year to date - a 5.2% rebound from February's low retracing just over half of the 9.7% fall over the previous ten months.

Most notably, gains have been well-sustained despite further rate hikes from the RBA in February, March, May and June. The consistent picture from prices, turnover, auction activity, new finance approvals and sentiment is of a broadening recovery, albeit one that is being led by prices with the volume of activity and demand still relatively subdued.

As noted previously, the impetus for gains looks to be mainly coming from a sharp acceleration in migration inflows and an associated tightening in rental markets, all against a backdrop of low levels of 'on-market' supply. The turnaround in price growth has been strongest for markets where population growth has seen the sharpest pick-up (Sydney and Melbourne) and much more muted in markets that have seen a less pronounced shift (Adelaide, Hobart and Darwin). The same pattern is evident when we look at changes in rental vacancy rates and rental yields, and, to a lesser extent, when comparing shifts in on-market listings.

The surge in net migration inflows is showing no signs of slowing and instead looks to have accelerated further over the first half of 2023. Our most recent forecasts had net migration of 400k in 2022 moderating to a still elevated 350k pace in 2023 with population growth of 1.9%yr (see here). Latest indications from detailed ABS data on the labour force and retail sales suggest population growth has instead lifted to around 2.4%yr in mid-2023, consistent with an annual migration inflow of around 450k.

One aspect that may also explain the current upturn

A factor that may also be contributing to the surprising rebound in housing is the presence of significant accumulated excess savings across the household sector. The high 'forced' savings during pandemic lockdowns, when incomes were also being supported by generous policy measures, resulted in a little over $260bn in excess savings being accumulated across the wider household sector. This reserve is now being drawn down to buffer against cost-of-living and interest rate increases.

However, it may also be being put towards property purchases, by higher income households in particular. This group, which now hold most of the remaining excess reserve and is under less financial pressure from rising cost and rates, may be using these funds for property purchases, either directly as investors and/or indirectly through assistance to first home buyers who may be friends or family connections. This may explain why we are seeing first home buyer activity remain surprisingly elevated despite worsening affordability constraints. While the scale of this behaviour is hard to ascertain, it would only take a small portion of these funds being redirected to property to potentially shift a market that is currently transacting around $100bn a quarter.

Improved near-term outlook

Previously, we had expected further interest rate rises and a material weakening in the economy to drive a significant loss of momentum for housing near term. That outlook now looks less challenging.

Following the RBA's decision to pause in August, we now see interest rates remaining on hold for an extended period, albeit with rate cuts now expected to commence a little later, in the second half of 2024 rather than by mid-year (see here for more).

The growth outlook also looks a little less threatening, with labour market conditions holding up better than expected and rate rises now expected to deliver a milder hit to disposable incomes. GDP growth is still forecast to be very weak, running at just 1% in 2023 and 1.4% in 2024, but not quite as weak as the sub-1% average for the two years that had been forecast previously. Most importantly for housing markets, the associated rise in the unemployment rate is now expected to come through later and be milder, with a peak of 4.8% in early 2025 compared to a previously forecast of 5.5% (see here for more commentary on recent forecast changes).

Unusual cycle likely to quickly run in to affordability constraints

As noted in previous commentary, this is an abnormal upturn. Housing recoveries in the past have only tended to flow through to prices once the RBA is actively cutting rates or is very clearly poised to do so, and typically follow a sustained lift in turnover. Population drivers tend to act more slowly, and indirectly through tightening rental markets and firming yields attracting investor activity.

The low level of 'on-market' supply also speaks to some fragility. If and when sellers come back, a shift in the supply-demand balance will test the 'depth' of demand, and price gains may prove harder to sustain. Indeed, some of these dynamics already look to be coming into play in the Sydney market (see here for more). However, barring some other shock to demand or supply, these effects are more likely to moderate price growth than tip markets back into sustained price declines.

Even with some slowing, we expect price momentum to mostly sustain through the second half of 2023, with a 7% gain for the calendar year for the five major capital city measure.

Ordinarily, interest rate developments – expected and actual rate cuts – could be expected to provide additional impetus to housing markets and prices from 2024. However, the abnormal 'front-loading' of price gains suggests this will be offset by a much more stretched situation in terms of affordability.

Recall that our preferred measure of housing affordability looks at the proportion of income required to accumulate a deposit and make mortgage repayments on a purchase of a median-priced dwelling. The combined effect of rising prices and interest rate increases will see affordability deteriorate past historical extremes in most markets by late 2023 (Brisbane and Perth notable exceptions). Sydney and Melbourne prices may still be 4-5% below their previous peaks but that will be with interest rates 4ppts above where they were when those peaks were hit.

That tightness is expected to become a major constraining factor in 2024 and 2025, holding price growth to 4% in both years. It will also drive significant behavioural shifts, including around household formation and migration – the latter likely to see demand spillover into more affordable sub-markets.

Investors again the wildcard

One of the key uncertainties is the extent to which investor activity starts to drive housing markets. Low vacancy rates, rising yields, rising prices and positive price expectations should see some lift. Our consumer sentiment survey shows most Australians view residential property as a risky proposition – currently only 5% nominating it as the 'wisest place for savings'. That suggests we are a long way from seeing an 'investor boom' take hold. However, attitudes will undoubtedly shift as the as the interest rate environment becomes less threatening and rental returns and dwelling prices continue to rise. Investor activity will remain an area to watch closely as the upturn unfolds.

Conclusion

Westpac expects current momentum to be better sustained with prices rising 7% over calendar 2023. Population drivers look to be slightly stronger and headwinds around interest rates, growth and labour market weakening are expected to be less significant.

Price growth is expected to slow as affordability constraints emerge, prices forecast to rise 4% nationally in 2024 and 2025 despite an easing in interest rates. Notably, our revised forecasts mean prices nationally will be pushing above their previous peaks by late 2024 despite interest rates still being 3.5-4ppts higher than when those peaks were achieved in 2022.

Near-term, the main uncertainty surrounds the extent to which a lift in 'on-market' supply slows price gains. Over the medium term however, the outlook depends on how tensions between a physical undersupply of housing and stretched affordability are resolved, with investors and high income households being key wildcards.

Matthew Hassan, Senior Economist

Dwelling price forecasts

	2020	2021	2022	2023f	2024f	2025f
Sydney	3	25	-12	10	6	4
Melbourne	-1	15	-8	4	3	2
Brisbane	4	27	-1	6	4	3
Perth	7	13	4	8	8	6
Australia	**2**	**21**	**-7**	**7**	**4**	**4**

Source: CoreLogic, Westpac Economics

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