Macquarie Property Insights Report

January 2020

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Introduction
January 2020

Welcome to the January 2020 edition of the *Macquarie Property Insights Report*, which reveals recent trends in the local residential real estate market. It's full of important information that's useful to everyone from first time buyers to people refinancing or buying their next home, as well as property investors.

The property market is showing signs of strength as we start a new year. Sydney and Melbourne housing prices rose strongly in the final few months of 2019 and prices in other capital cities also improved.

The about-turn in the property market has been supported by lower interest rates, with the Reserve Bank of Australia (RBA) cutting the cash rate three times since mid-2019. Macquarie expects one more 0.25% cut in early 2020 to bring the cash rate down to 0.5%, which should further stimulate the market.

There has been some conjecture that the sizeable increases in housing prices in Sydney and Melbourne have been the result of thin sales volumes. However, sales volumes have strengthened and Macquarie expects volumes to rise further as rising property prices give sellers more confidence in the market turnaround.

While the domestic economy was unexpectedly soft in 2019, it's anticipated Australia's GDP growth will look a bit better as 2020 progresses, which should also help support the property market. While Australia's unemployment rate has risen modestly, at 5¼% it still remains low in an historical sense.

In this issue of the *Macquarie Property Insights Report*, we take a look at how Australia's property market performed in 2019 and the key factors that will drive the property market in 2020, with the help of Macquarie's senior economist **Justin Fabo**.

How did the residential property market perform over the course of 2019?

The residential property market continued to strengthen in the final quarter of 2019, in the wake of three interest rate cuts in June, July and October.

CoreLogic data show that nationwide dwelling prices rose 4% over the three months to December 2019. Sydney and Melbourne led the national rebound, with dwelling price growth of a little more than 6% in both cities over that period. Sydney and Melbourne home prices have risen 10% from the mid-2019 troughs. [Figure 1]

Figure 1. Dwelling prices in Sydney and Melbourne have lifted sharply

		Change in dwelling values (as at 31 December 2019)			
	Median dwelling price	Month	Quarter	Annual	Since peak
Sydney	$840,072	1.7%	6.2%	5.3%	-6.4%
Melbourne	$666,883	1.4%	6.1%	5.3%	-2.3%
Australia	$537,506	1.1%	4.0%	2.3%	-3.1%

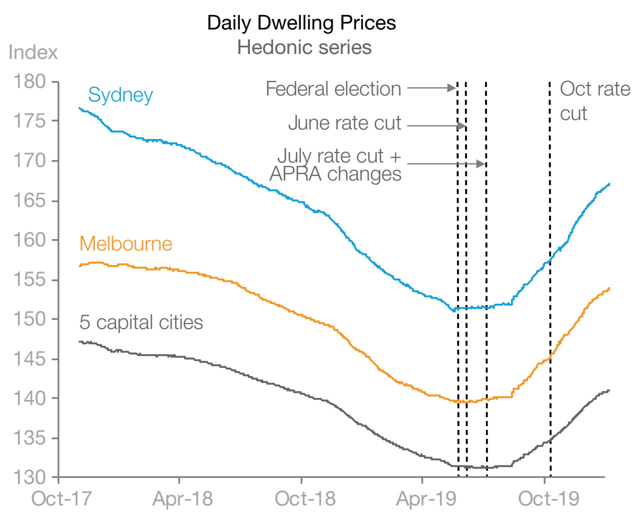
Source: CoreLogic

"The pick-up in Sydney housing price growth has been the fastest in several decades, with Melbourne price growth also very strong by historical standards", says Fabo.

Sydney and Melbourne dwelling prices both rose 5.3% over 2019, but were still below their mid-2017 peaks by 6.4% and 2.3%, respectively. Nonetheless, high-frequency data reveal that prices in both cities have continued to rise so far in 2020.

Aside from the combined 75 basis points of RBA rate cuts since June, the housing market has benefitted from several other factors that have worked to lift home buyer sentiment. Firstly, the outcome of the federal election helped to settle housing policy uncertainty. Secondly, the Australian Prudential Regulation Authority's (APRA's) changes to the minimum interest rate thresholds used to gauge a borrower's ability to repay a home loan. [Figure 2]

Figure 2. Dwelling prices began to lift following the outcome of the federal election and RBA and APRA policy changes



Source: CoreLogic, Macquarie Macro Strategy

These factors helped support gains in other capital cities. Outside of Sydney and Melbourne, dwelling price growth has recently been strongest in Hobart and Canberra, where values rose 3.9% and 3.1%, respectively, over 2019. [Figure 3]

"In Hobart, dwelling prices have been performing well since 2015 and after a slight dip in the middle of last year, the market is again tracking at record highs", says Fabo.

In Brisbane, dwelling values rose 2.4% in the final three months of the year, ending 2019 0.3% higher than a year earlier. Meanwhile, Adelaide saw a 0.5% increase in the month of December, but dwelling values were still 0.2% lower than 12 months earlier.

There are signs that the prolonged fall in Perth home prices is abating, with prices broadly flat over the past four months. Nonetheless, Perth dwelling prices have fallen more than 20% since the peak in mid-2014.

Darwin is still the worst performing housing market as sharply lower resources investment weighs on demand. Housing prices fell nearly 10% over 2019 in Darwin and dwellings have lost more than 30% of their value since the peak. The rate of decline in prices, however, slowed in the final months of 2019.

Figure 3. Dwelling prices remain below peak in most capital cities, except Hobart and Canberra

	Median dwelling price	Month	Quarter	Annual	Since peak
Brisbane	$497,491	0.70%	2.40%	0.30%	-0.10%
Adelaide	$433,845	0.50%	1.40%	-0.20%	-0.20%
Perth	$437,080	0.00%	-0.10%	-6.80%	-21.40%
Hobart	$474,186	0.20%	3.40%	3.90%	at peak
Darwin	$388,018	-0.50%	-1.40%	-9.70%	-31.80%
Canberra	$611,841	0.10%	2.30%	3.10%	at peak
Australia	$537,506	1.10%	4.00%	2.30%	-3.10%

Source: CoreLogic

What’s the outlook for property prices in 2020?

Macquarie forecasts national housing prices will rise by a further 6% to 7% by the end of 2020, building on the strong momentum in the market at the end of 2019.

The Sydney and Melbourne residential property markets are likely to lead this trend, with prices expected to rise by about 8% to 10% in these markets by the end of this year, putting dwelling prices once again at record highs.

“While the recent extreme rate of growth in Sydney and Melbourne dwelling prices in 2019 is unlikely to be maintained, it now seems likely that dwelling prices are set for a period of sustained, solid growth,” says Fabo.

“Property prices in the two largest capital cities also experienced the deepest falls when property prices started to retreat from mid-2017, so they have further to bounce back than other markets,” he adds.

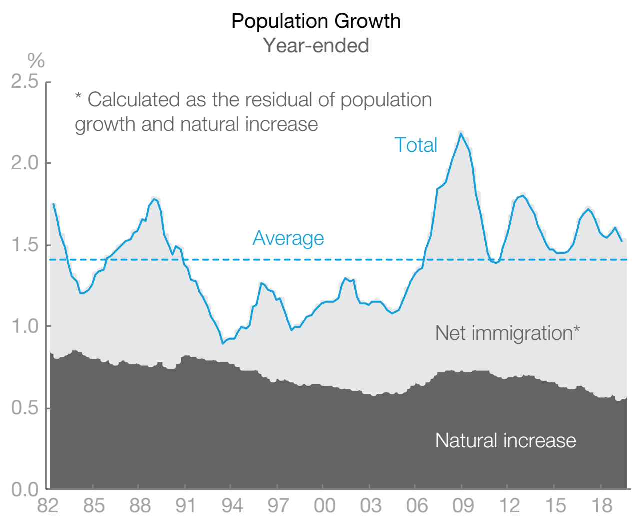
This year, rising property prices are expected to be further supported by historically low mortgage rates and the possibility of further cuts by the RBA.

“This could lead, once again, to the emergence of “animal spirits”, or FOMO – the “fear of missing out”, says Fabo.

Ongoing strong population growth of around 1.5% per annum is also helping to support demand for housing. [Figure 4]

“In our view, underlying demand for housing didn’t really weaken over the past couple of years, it just went into hibernation.”

Figure 4. Strong population growth equates to fundamental housing demand



Source: ABS, Macquarie Macro Strategy

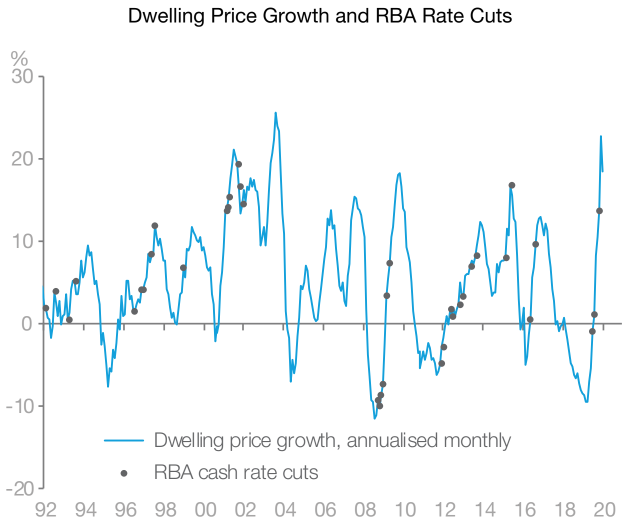
“...it now seems likely that dwelling prices are set for a period of sustained, solid growth.”

"Underlying demand for housing didn't really weaken over the past couple of years, it just went into hibernation."

What's the outlook for interest rates?

The RBA cut the cash rate by 0.75% in the second half of 2019 to a new record low of just 0.75%. [Figure 5]

Figure 5. The effect of lower interest rates and APRA's hange to interest rate thresholds has been swift



Source: CoreLogic, RPA, Macquarie Macro Strategy

While the central bank has left the door open for further cuts in 2020, the RBA Board has been careful not to be overly pessimistic about Australia's economic outlook.

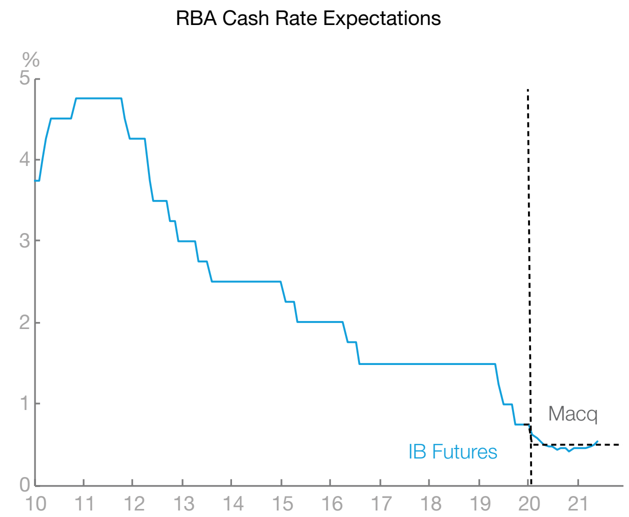
"The Bank's view is the economy is gradually improving after a soft period. We agree with their emphasis on the word gradual," says Fabo.

"The sharp pick-up in established housing prices and activity will be giving the Bank more confidence in its forecast that the economy is on the right track".

RBA Board members have agreed to reassess the economic outlook in their first meeting of 2020.

Macquarie has pencilled in a 0.25% rate cut in the first quarter of 2020 but expects Board members will then wait to see the overall impact of recent rate reductions on the economy over time. [Figure 6]

Figure 6. Macquarie expects another RBA cash rate cut in early 2020



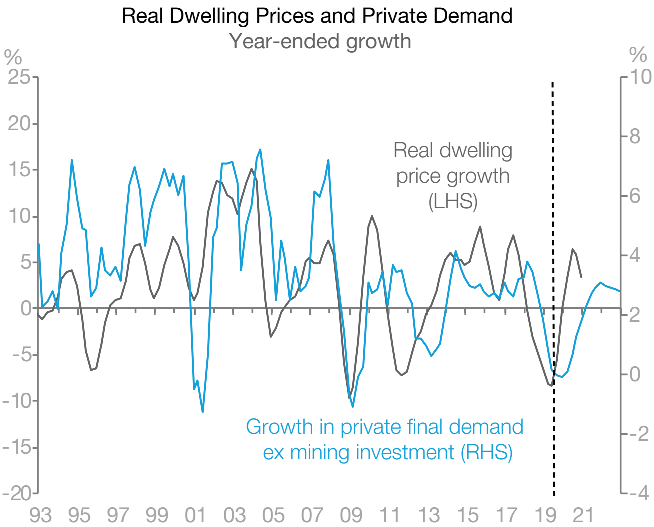
Source: RBA, Bloomberg, Macquarie Macro Strategy

The December RBA Board Minutes highlighted "only a small share of borrowers had actively adjusted their scheduled mortgage payments following the reductions in interest rates", suggesting the benefits of the rate cuts in terms of disposable income are yet to register for many borrowers.

"Many observers have become very impatient and there has been a degree of hyperventilating about the apparent lack of pass-through to the real economy from policy support delivered to date," says Fabo. "More time is needed to properly gauge the effects of last year's 75 basis points of cash rate cuts."

"The upshot is that monetary policy works with a lag. Historically, it has taken roughly six months for a pick-up in housing prices and turnover to have an effect on private demand in the economy." [Figure 7]

Figure 7. Rising dwelling prices give us some confidence that private demand growth will eventually lift



Source: ABS, CoreLogic, Macquarie Macro Strategy

Like all central banks, the RBA has a close eye on slowing global growth and potential geo-political risks.

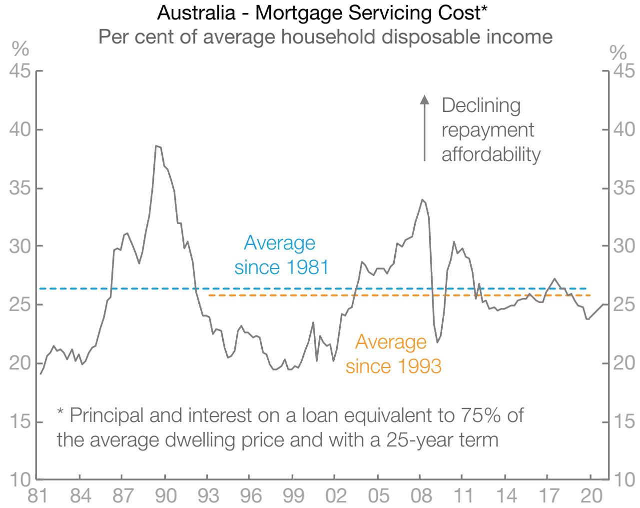
"Our view is that the slowing in global growth since late 2017 and uncertainties associated with the US-China trade and technology conflict have been a sizeable drag on the Australian economy", Fabo said. "There are tentative signs that the worst may be behind us but it's not yet entirely clear."

"More time is needed to properly gauge the effects of last year's cash rate cuts."

How will dwelling price rises impact housing affordability?

Should house prices rise as forecast across the country (growth of 6-7% over 2020), this would take typical mortgage repayment affordability to around its long-run average. [Figure 8]

Figure 8. A further 6-7% rise in national dwelling prices would take repayment affordability back to its average



Source: ABS, CoreLogic, Macquarie Macro Strategy

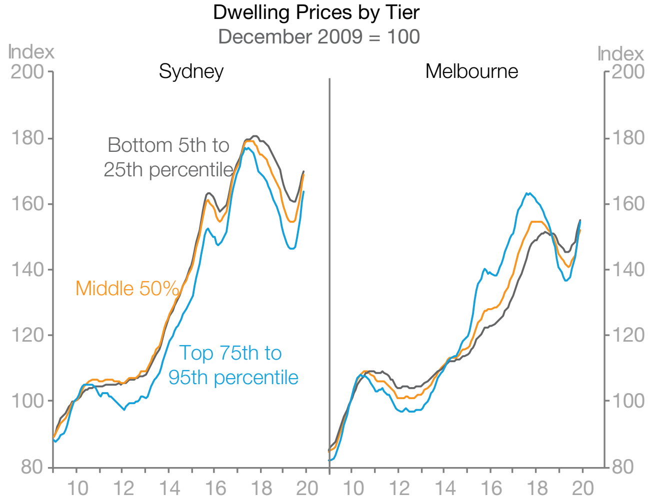
Fabo draws comparisons with the dwelling price growth experienced between early 2015 to the peak in mid-2017 – a period where the cash rate was lowered by 1%, noting that "repayment affordability is starting more favourably this time."

Lower dwelling prices have helped to improve mortgage repayment affordability over the past two years. Fabo explains that the parts of Australia's housing market that are now exhibiting the strongest improvement in prices, fell the most following the 2017 peak.

"While the largest recent price gains have been in Sydney and Melbourne, these cities also experienced the largest prior declines in prices (outside of the mining regions of Western Australia and the Northern Territory)".

He adds: "dwelling prices have so far risen more strongly for more expensive properties. But the prior price declines at the top end were also greater," he adds. [Figure 9]

Figure 9. Higher-priced properties in Sydney and Melbourne have fluctuated the most in recent years



Source: ABS, CoreLogic RPData, RBA, Macquarie Macro Strategy

Repayment affordability has also improved amid falling interest rates but there's an inherent risk to the economy from the elevated amount of debt being carried by Australian households.

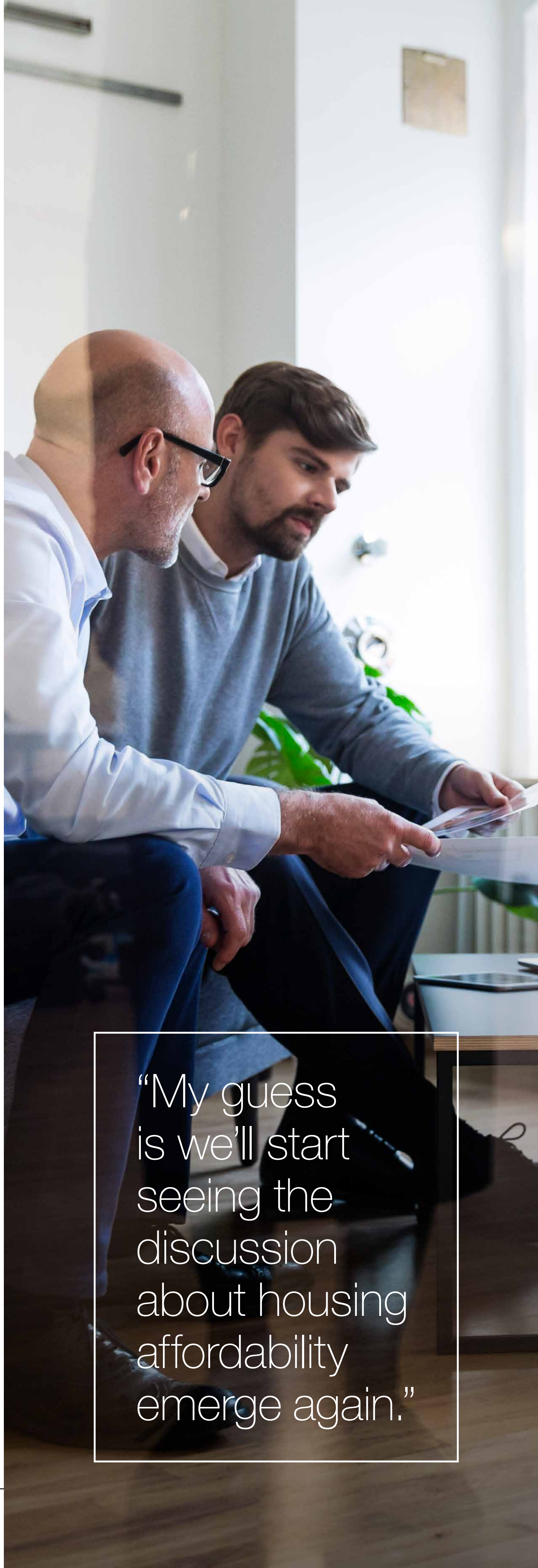
"Lower interest rates mean Australian households can afford to repay larger amounts of debt relative to their income compared with 20-30 years ago. But this has clearly increased the fragility of indebted households and the broader economy to persistent adverse income shocks," says Fabo. [Figure 10]

Figure 10. The ratio of dwelling prices to household income is forecast to hit a new historic high

Source: ABS, CoreLogic, Macquarie Macro Strategy

Fabo admits to not being bullish enough about how quickly house prices would strengthen in the latter half of 2019 and suggests solid dwelling price growth is likely to again put housing affordability issues on the radar.

"If you wind the clock back only three years the headlines were about an 'affordability crisis'. Those headlines quickly and predictably turned to 'risk of a house price crash' as dwelling prices declined. My guess is now the market's turned again, we'll start seeing the discussion about housing affordability emerge again."



In summary

Against this backdrop, the ingredients are in place to support further strength in the residential property market throughout 2020. This should be enhanced by ongoing low interest rates and the potential for rates to go even lower.

Macquarie expects the rapid rate of price growth experienced in Sydney and Melbourne in the final months of 2019 will ease in the new year. However, dwelling prices in these markets are still expected to grow 8-10% over the course of 2020.

Other capital cities are also likely to experience price growth. The markets of Canberra and Hobart have already returned to record highs, while Brisbane and Perth could see conditions improve as buyers take advantage of lower rates and more affordable prices in these markets.

Strengthening house prices may again put pressure on housing affordability but there are still downside risks to the property market outlook. Economists will watch for signs of further weakening in global growth as well as domestic warning signs that could impact confidence such as unemployment and wages growth.

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