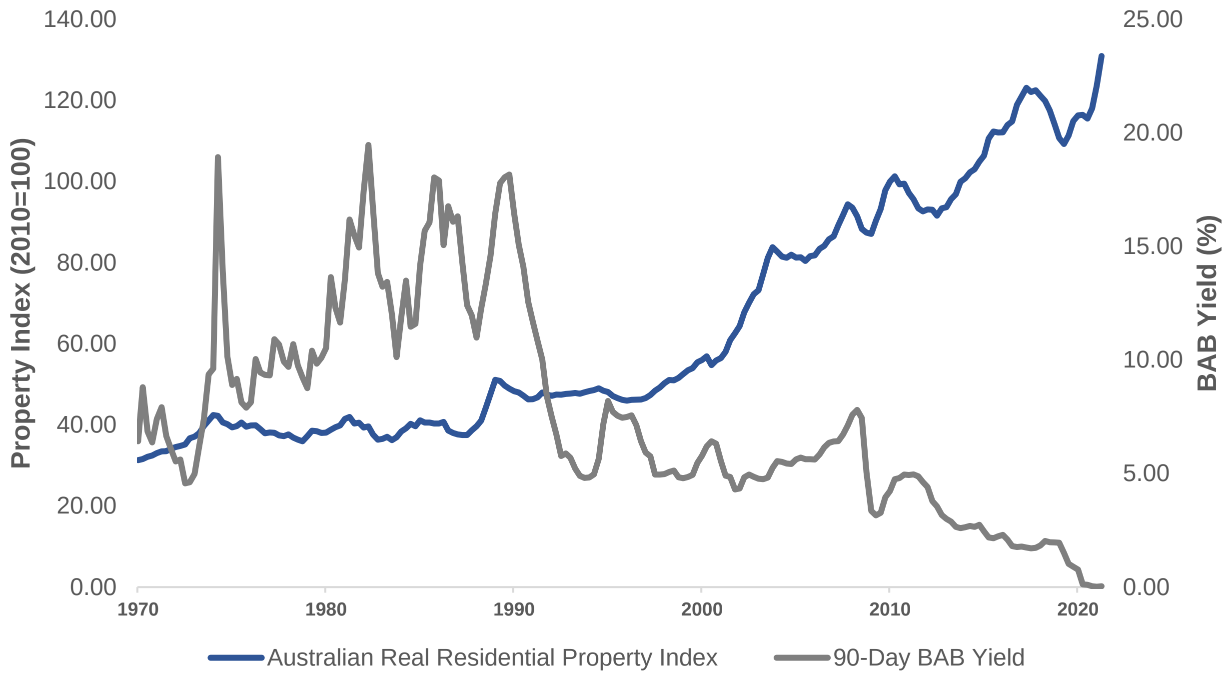
FINM3412 – Week 1

Case Discussion – Stimulus Materials

Australian Property Market Trends

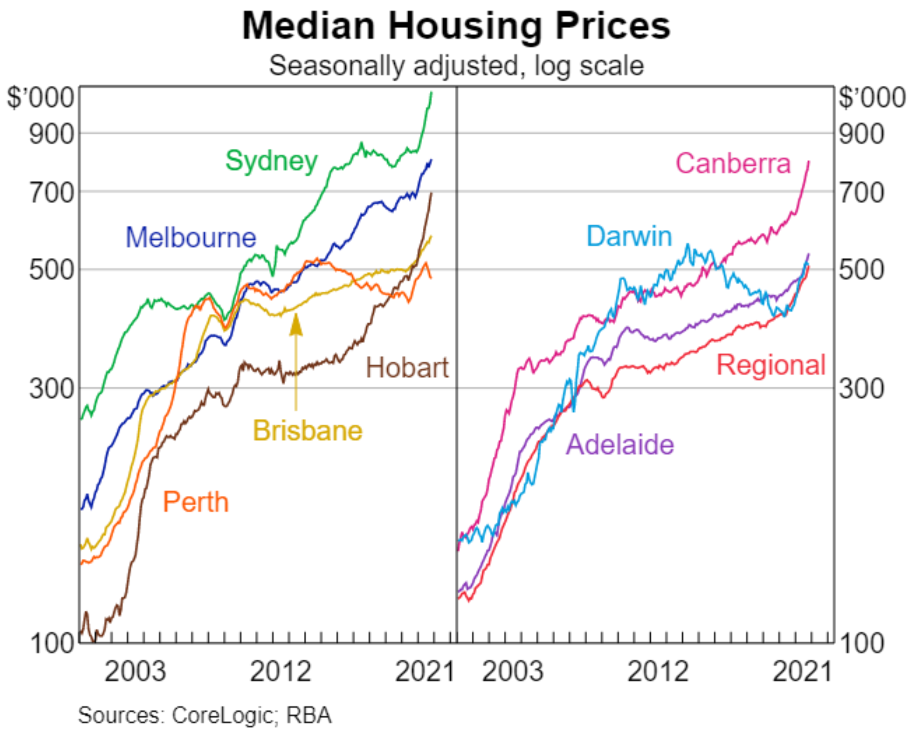
The Australian Property Market

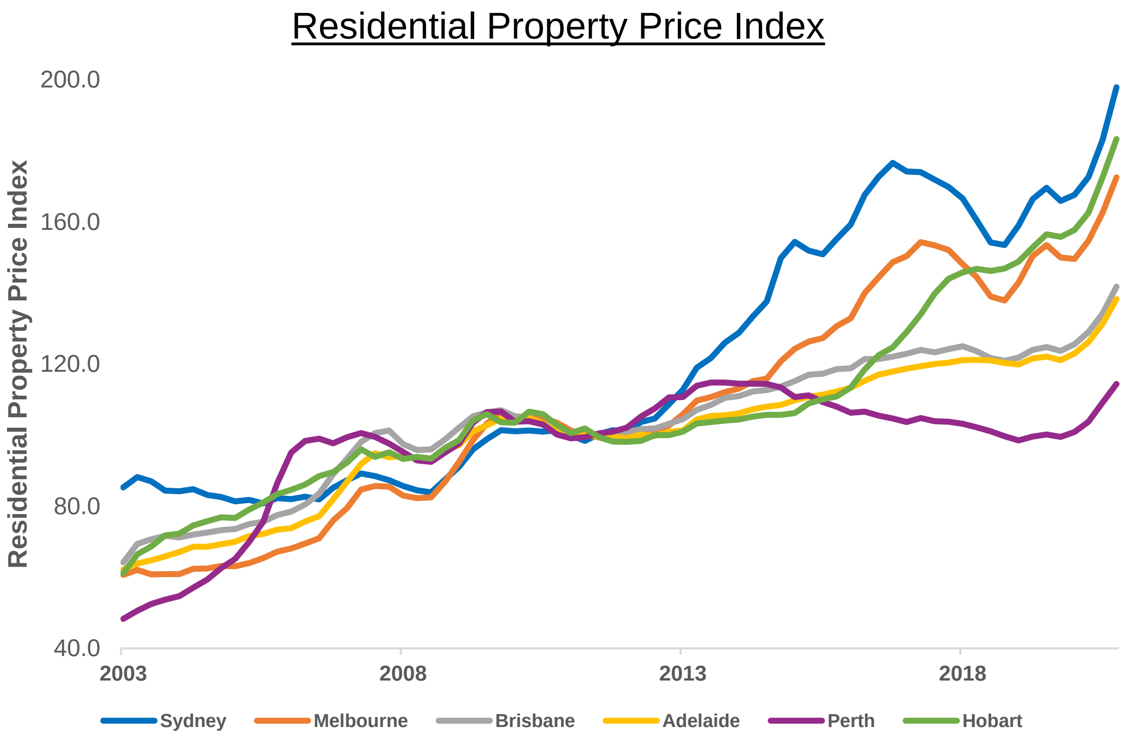
Australian Property Index vs 90-Day BAB Yield



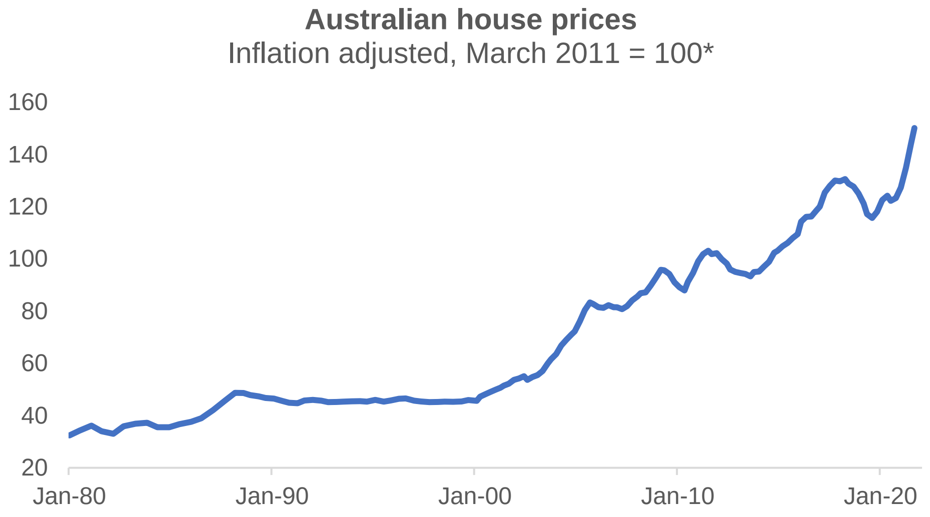
	CAGR
2000-2005	7.7%
2005-2010	4.2%
2000-2007	6.4%
2007-2010	5.0%

State Property Growth





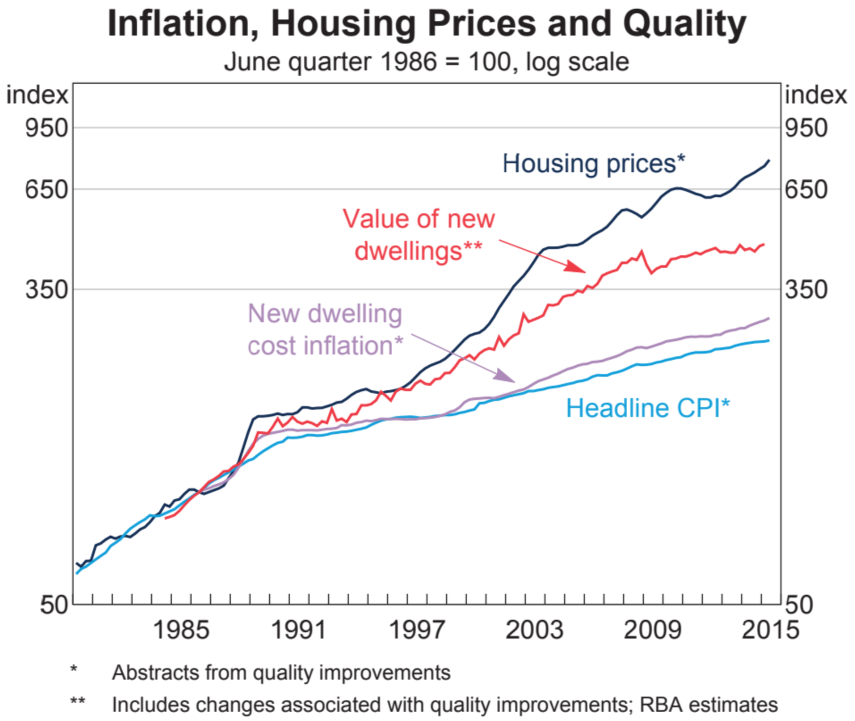
40-years of property growth



Over the past 40 years, Australian housing prices have increased on average by approximately 8.2% per year, and over the inflation-targeting period by around 7.5%

- Housing price inflation during the 1980s was relatively low, at ~1.4 per cent per annum compared with around 4.5 per cent during the period from 1990 to the mid 2000s
- In the post-GFC era, housing price has seen an average increase of ~7% per year, primarily driven by growth in 2021
- Forecasts see strong growth throughout 2022 of ~8% before contracting around 5% in 2023

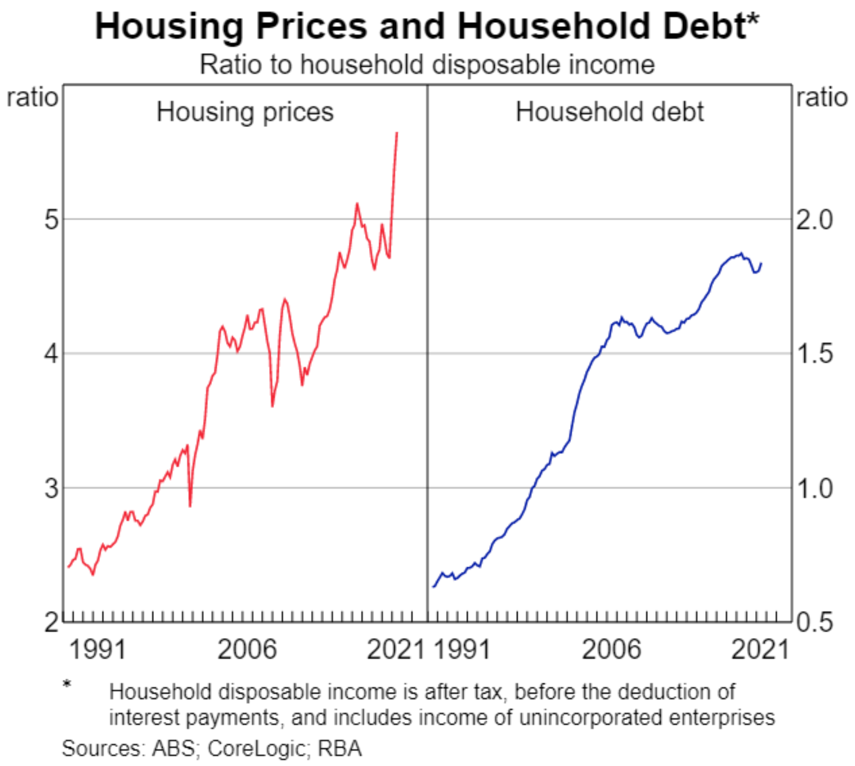
What’s driving this growth? (1)



When measured in nominal terms, growth in housing prices will be affected by the general level of inflation.

- During the 1980s, nominal housing price inflation was high at 10% and volatile, but so too was general price inflation. Until the late 1980s, housing prices grew broadly in line with general price inflation
- Over the past 20 years, inflation has been low and stable, consistent with the inflation target of 2-3% p.a. Housing price growth, however, has outstripped the rate of inflation in other prices in the economy including inflation in the cost of new dwellings
- **In real terms, housing price growth since the 1990s was above that of the 1980s. Why?**

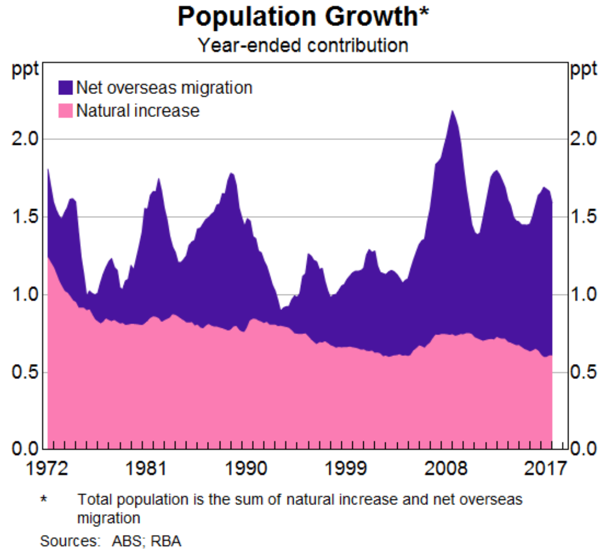
What's driving this growth? (2)

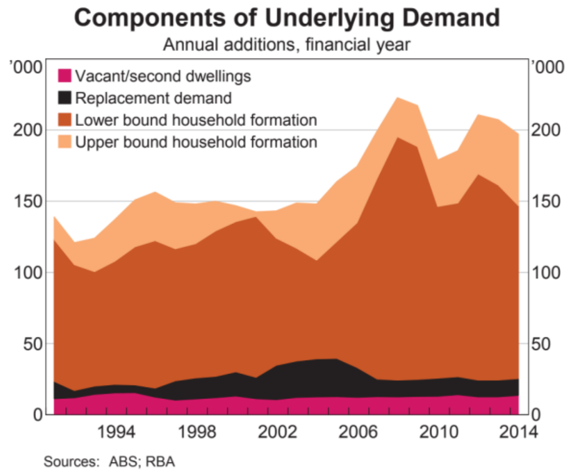


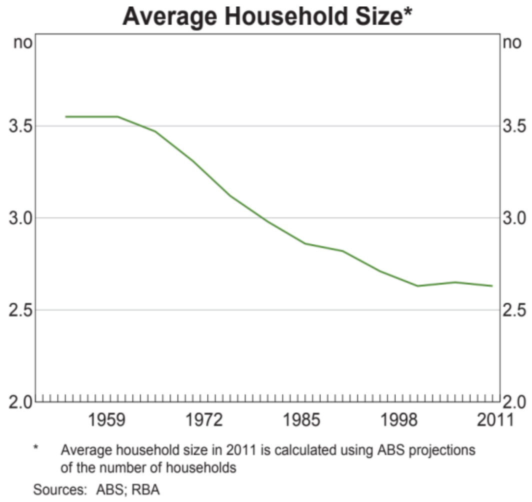
The deregulation of the financial sector during the 1980s and the shift to a low inflation and low interest rate environment in the early 1990s greatly increased household access to finance in Australia

- Financial deregulation, coupled with increased competition, increased borrowers' credit access and reduced its cost.
- The transition from a high- to a low-inflation environment in the 1990s also saw nominal interest rates decrease in-line with lower inflation
- Low inflation together with increased competition in the mortgage market reduced housing interest rates, thereby easing serviceability constraints. Previously credit constrained households were increasingly able to borrow more for a given level of income and pay higher prices.
- **What would be the effect on the housing market?**

What's driving this growth? (3)



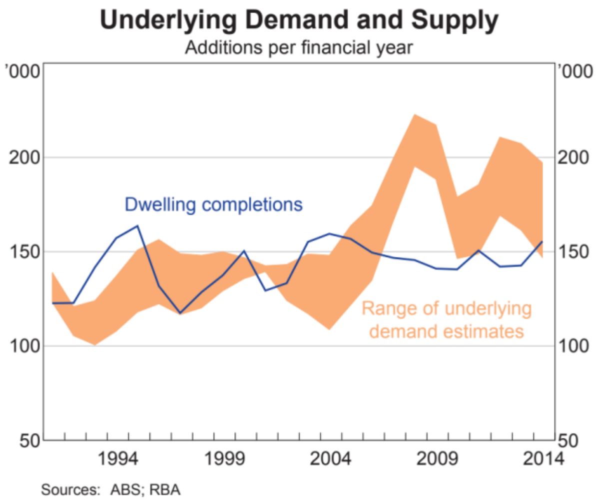


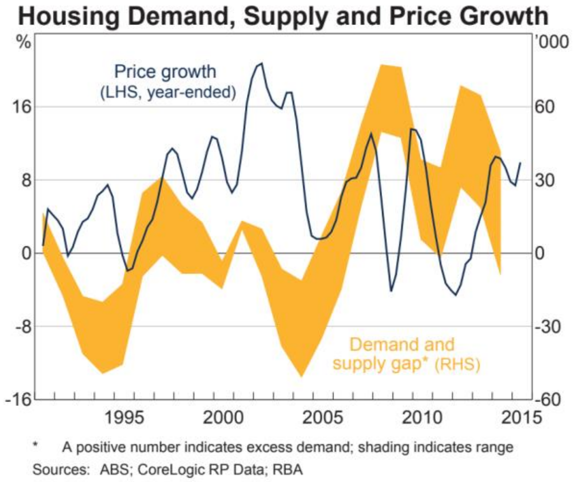


Underlying demand for new dwellings can be thought of as representing what demand for newly built housing may be given population growth and household size

- Underlying demand consists of three components: demand from newly formed households; demand for new dwellings to replace demolished ones; and demand for second or vacant homes
- The rate of household formation in turn reflects the interaction between population growth and average household size
- Combining these factors and the demand for second homes and replacement dwellings, suggests that annual demand for new housing was relatively stable prior to the mid 2000s, fluctuating between 120 000 and 145 000 new dwellings every year.
- Following large population growth, demand for new housing has increased by 40%
- **Why has Household size decreased over the past decades?**

What’s driving this growth? (4)

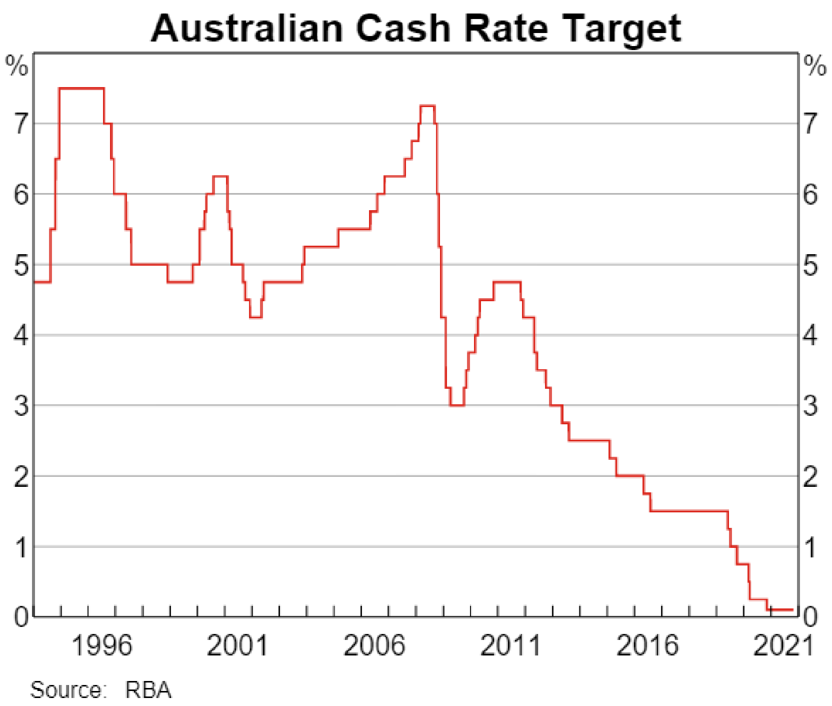




If an increase in demand leads to increased housing price growth depends on the response of supply to changes in demand.

- In the past three decades, dwelling completions have been relatively stable, at around 130 000 to 145 000 completions per annum
- However, completions alone hide the noticeable increase in size and quality improvements of new dwellings that have occurred over time, along with increased constructions costs
- Completions suggest that over the past decade, the supply side has been unable to respond to the significant increases in underlying demand
- **In the short run, there are lags in the ability of the supply of housing to respond to changes in demand. Why?**

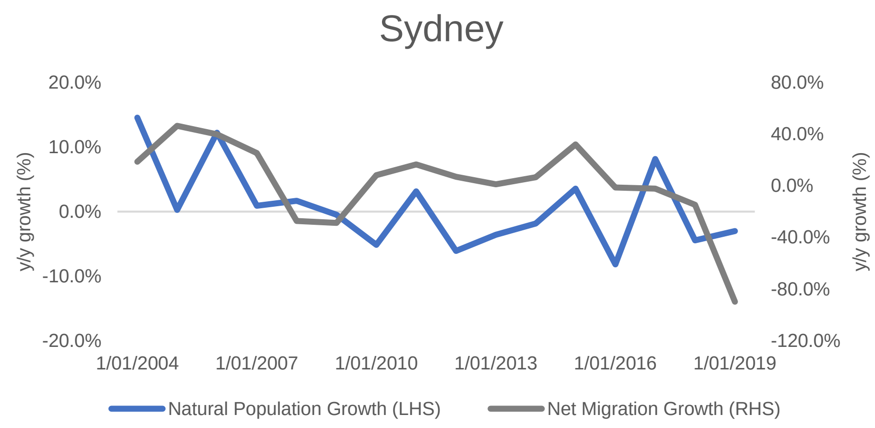
What’s driving this growth? (5)

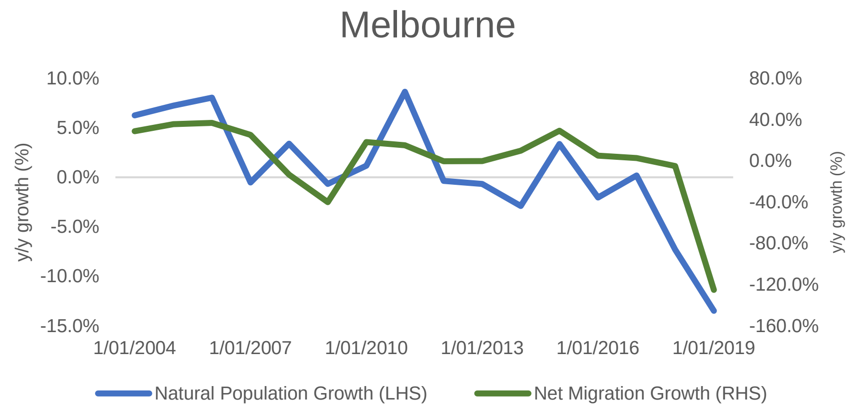


Monetary Policy has a strong effect on the housing market, both in the established market through higher activity and prices and in the new dwelling market

- The level of the mortgage interest rate was a significant explanator of Australian capital city dwelling price growth over a period of around 20 years
- A lower mortgage rate encourages consumption of housing to be brought forward, in the long run
- The reduction in real mortgage rates following 2011 has been closely associated with both stronger housing price growth and strong dwelling construction.

COVID – What's Next?

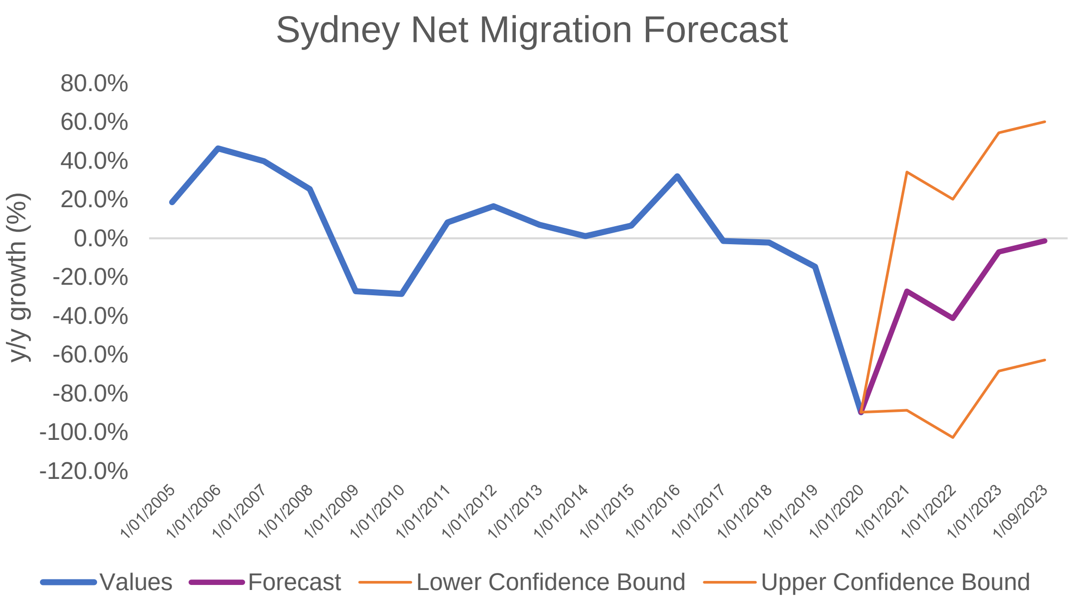


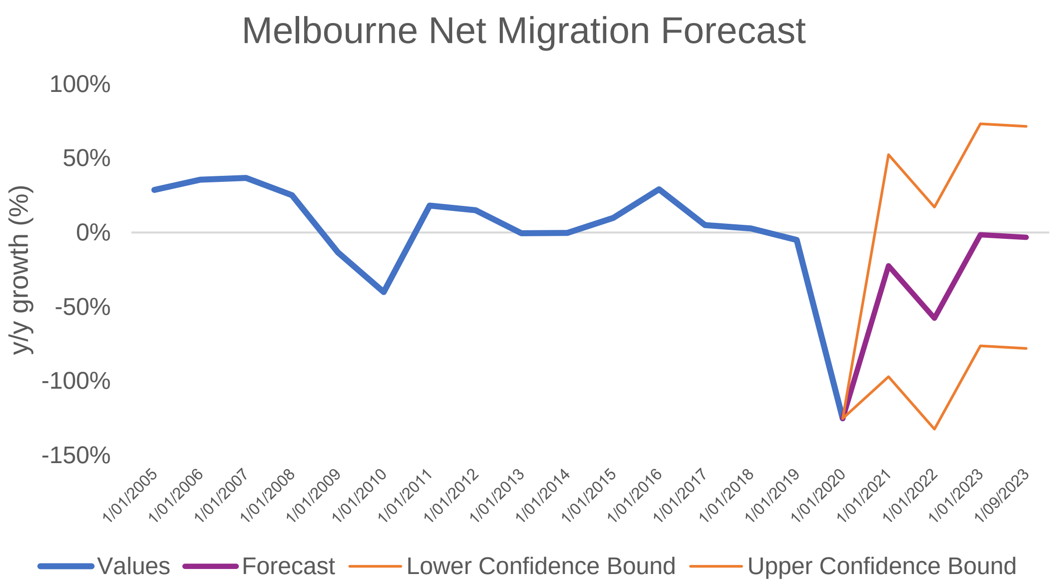


As country-wide lockdowns begin to ease and the country begins to open up, what will be the implications on population growth in our capital cities?

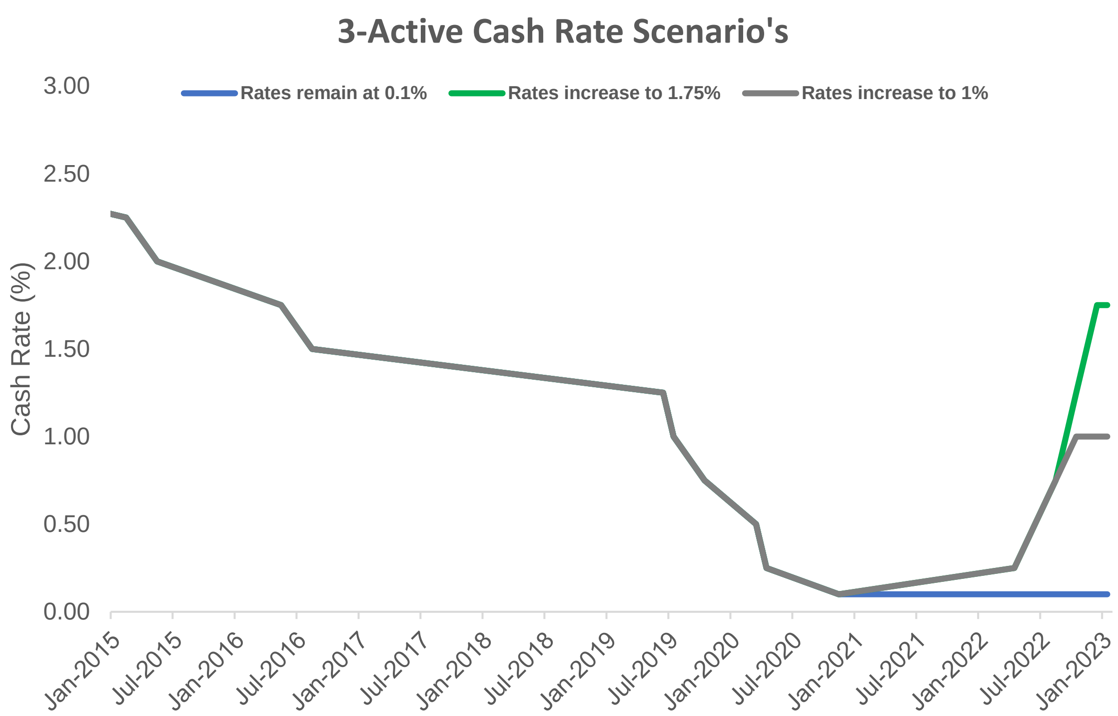
- As net migration, our main driver of population growth, begins to increase, underlying demand will begin to increase in all sectors
- This will begin to put even more strain on the property market
- **What should the RBA/government do about housing affordability?**

COVID – What's Next? – Population Forecasts





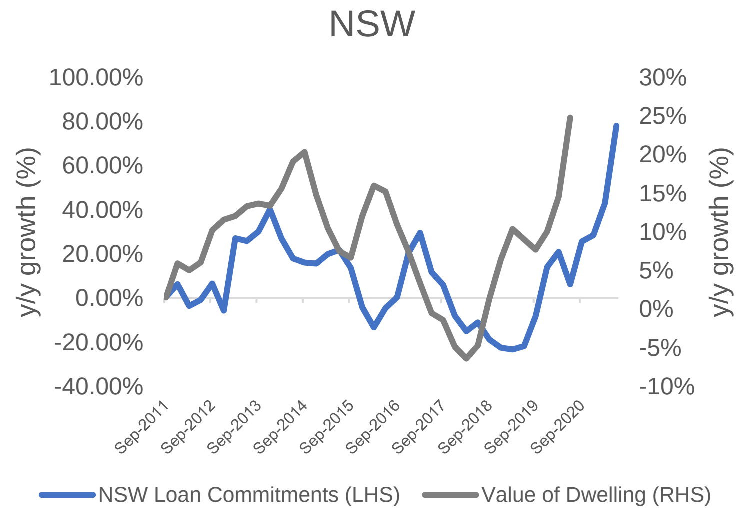
Future Implications of the current economic environment

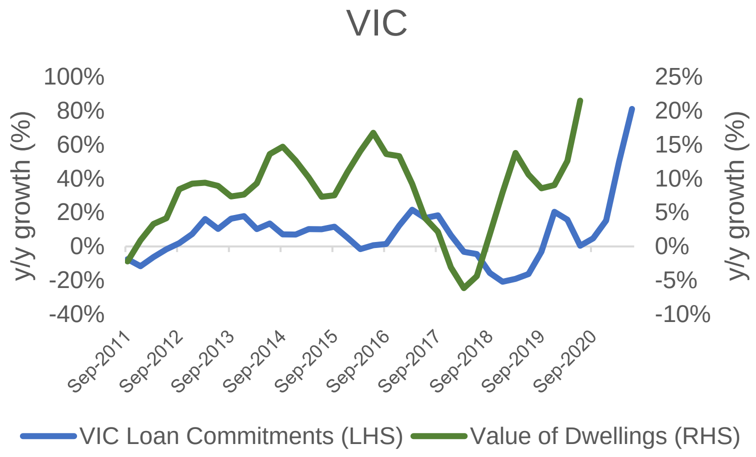


Following the latest US Inflationary data, it is inevitable that the Fed will likely have to increase interest rates from its current range of 0-0.25. In Australia, the implications are high.

- The consensus was that the RBA would not begin raising cash rates until 2024 but higher than expected worldwide inflation and property prices may change this
- It is likely that the RBA will have to follow the Fed and increase the cash rate.
- **Why would the RBA be concerned about raising rates?**

Future of Property Demand

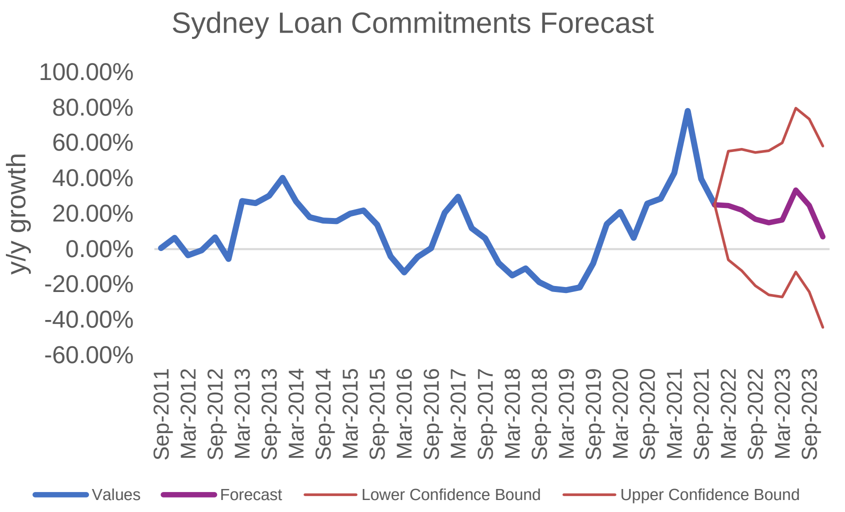


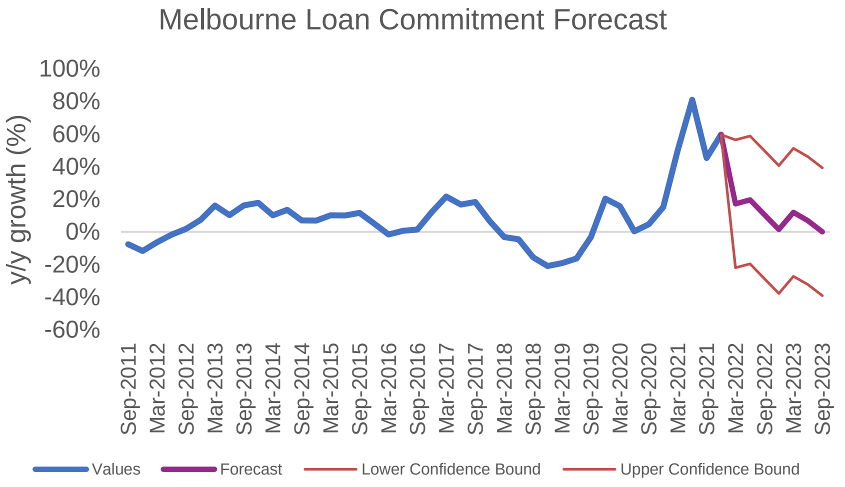


Property has seen surging demand in the past two years as a result of the low interest rate and inflationary environment

- Loan commitments have seen soaring growth over the past year underpinning a large portion of property demand growth in Melbourne and Sydney
- Finance housing approval growth implies that more people are getting into property, and we will have strong ongoing demand from owner-occupiers and investors over the next 6 months.
- Demand will depend upon the RBA's cash rate decision in the following months…

Property Demand Forecasts

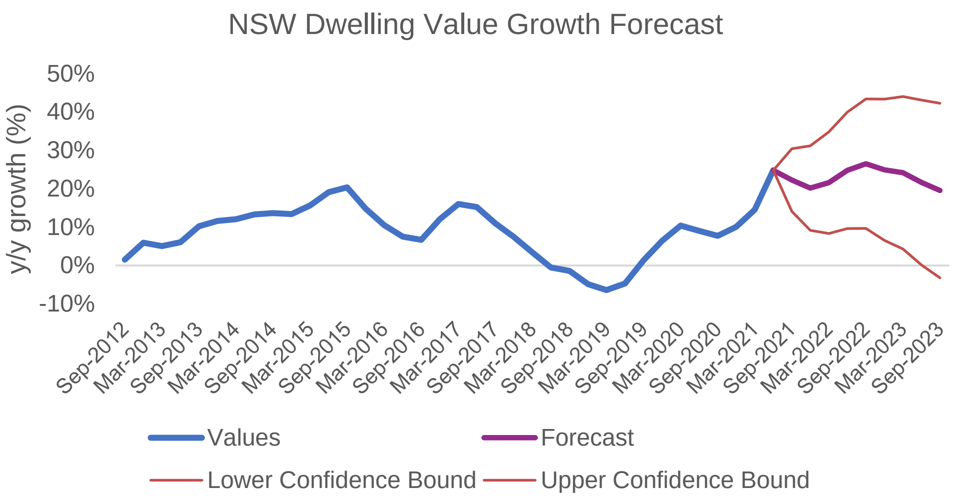


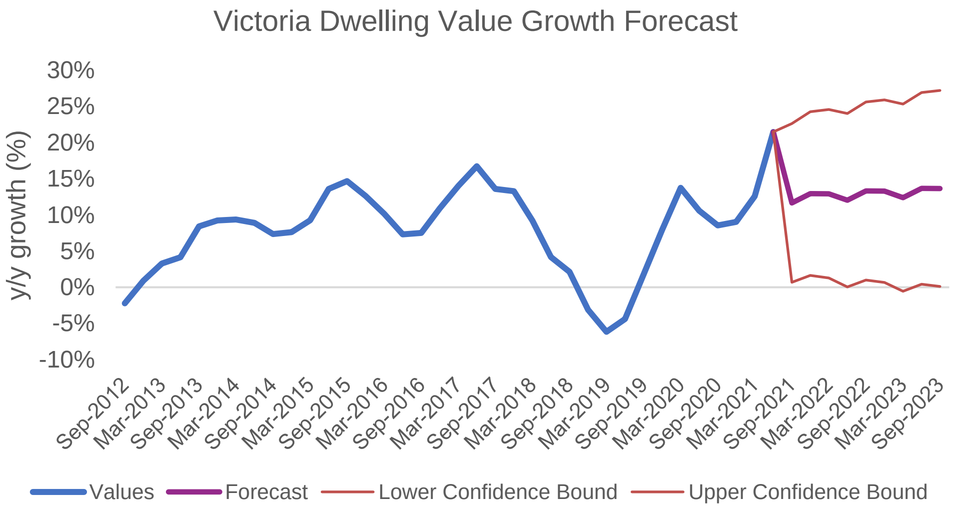


The Fed’s announcement that inflation is no long transitionary will likely see the Fed Fund rate increase

- Australia will likely follow suit and demand will respond
- Loan Commitments will likely decrease in the Sydney and Melbourne
- **What will be the impact on dwelling Prices?**

Property Demand Forecasts



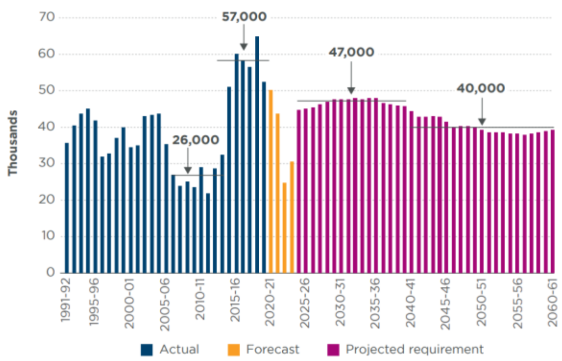


The inevitable cash rate rise will likely dampen the growth of dwelling prices in Melbourne and Victoria

- **What other factors are at play?**

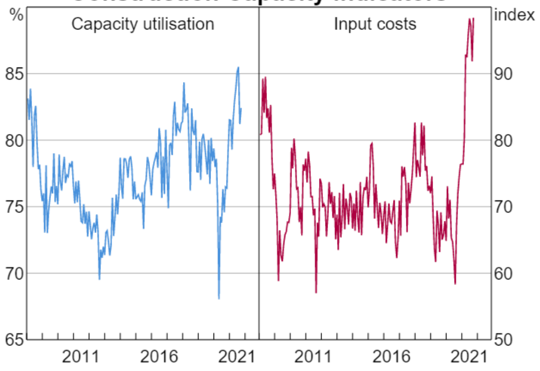
The Supply Problem

NET ADDITIONS TO NSW HOUSING STOCK: ACTUAL AND PROJECTED REQUIREMENT



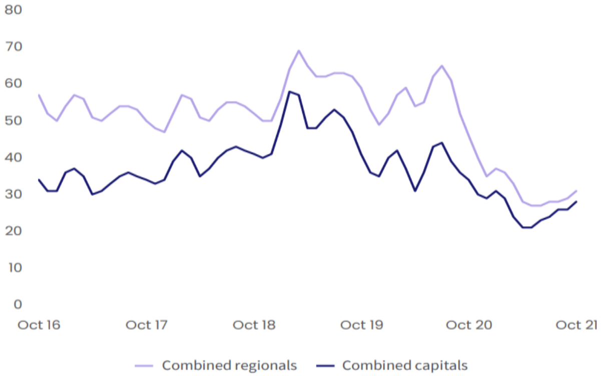
Source: ABS Census, ABS 8752.0 and NSW Treasury.

Construction Capacity Indicators



Sources: AIG; NAB; RBA

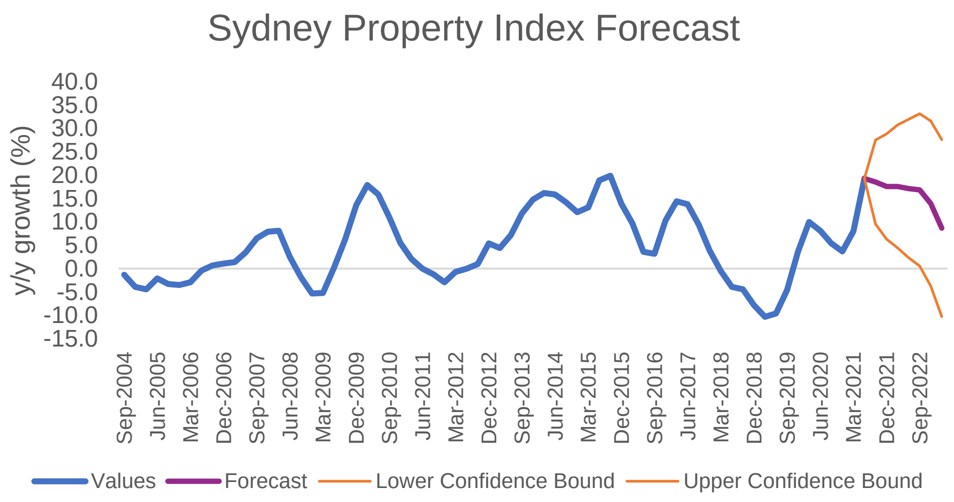
Median Days on Market

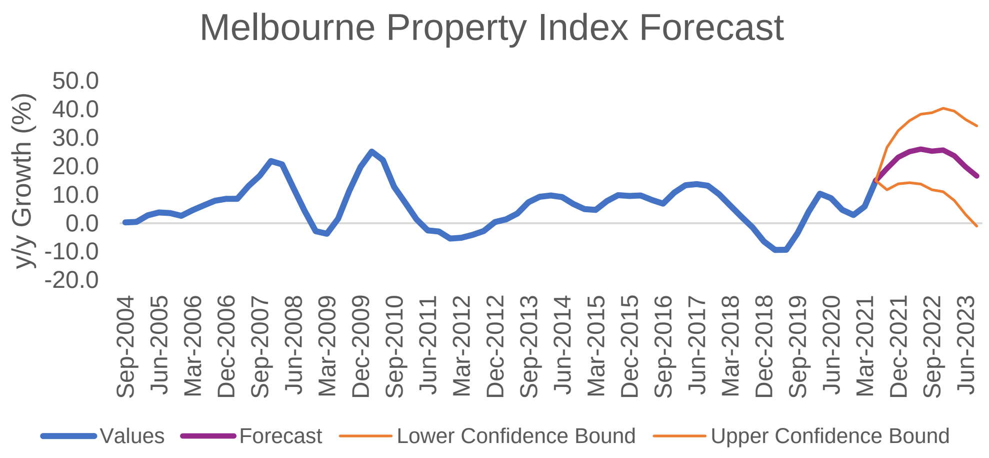


Property has seen surging demand but does not have the supply to meet it…

- Median days on market has seen considerable decreases over the past 18 months as supply begins to dwindle
- Construction input costs are rising and building approvals are decreasing drastically
- The supply shortage is only being exacerbated…

Putting it all together





The property market will continue to surge for the next 6 months-year until a few key factors come into play:

- RBA makes a cash rate decision stemming from inflation results and the Fed's decision
- Lockdowns and immigration restrictions are eased throughout Australia, and we begin to let in immigrants
- Regulation, if any, imposed by APRA to cool down the property market
- If construction input costs and underlying demand in the form of loan commitments begin to cool down
- If building approvals begin to increase to pre-COVID levels
- The current market is over-heating and will be interesting to see its position in 1-year's time

Official Forecasts

Dwelling price forecasts

	2018	2019	2020	2021f	2022f	2023f
Sydney	-8.9	5.3	2.7	27	6	-6
Melbourne	-7	5.3	-1.3	18	8	-6
Brisbane	0.2	0.3	3.6	22	10	-1
Perth	-4	-2.8	7.3	15	8	-1
Adelaide	1.3	-0.2	5.9	18	8	-2
Hobart	8.7	3.9	6.1	25	6	-2
Australia	-6.4	3.1	1.8	22	8	-5

All dwellings, Australia is five major capital cities combined measure.
Source: CoreLogic, Westpac Economics

Source: ANZ Property Forecast

What factors have ANZ and Westpac considered when devising this forecasts?

- Easing of lockdowns throughout Australia and its major capital cities
- Macro-prudential policy tightening coming into frame
  - APRA imposing buffer rate applied to loan serviceability assessments from 2.5% to 3%
- Timing of RBA Cash Rate tightening
- Population growth once border restrictions ease
- Surge in new building, supported by both low interest rates and the Federal government’s highly effective HomeBuilder scheme. There are likely to be around 200k new dwelling completions in 2021.