Data snapshot

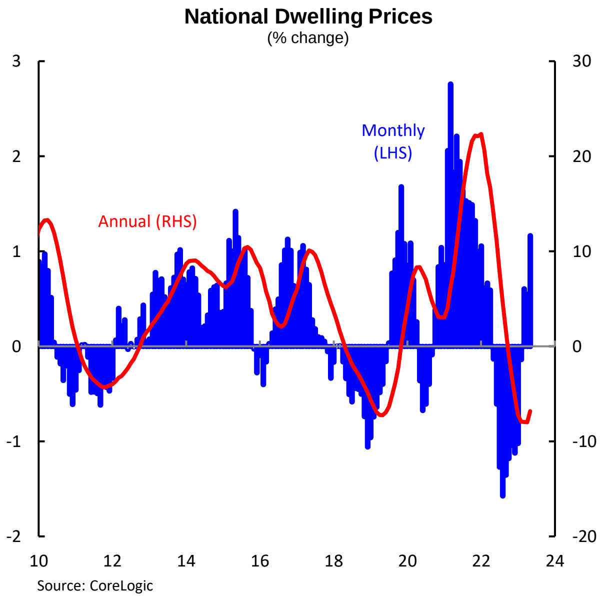
Bank of Melbourne

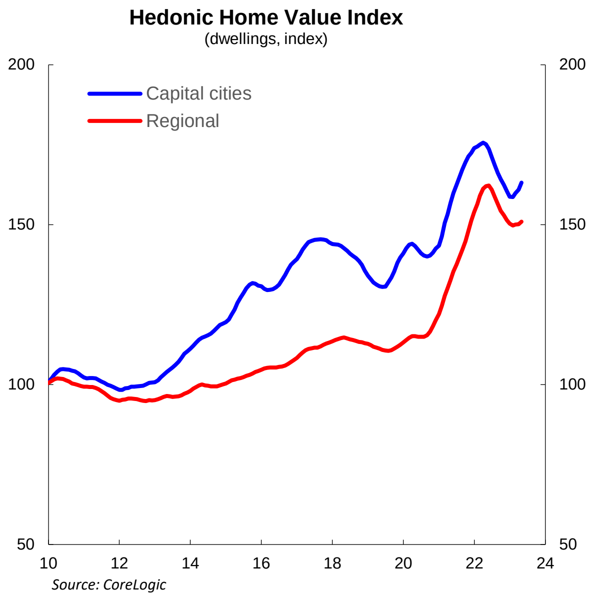
Thursday, 1 June 2023

Dwelling Prices

Demand Lifting As Price Growth Jumps

- **Dwelling prices rose 1.2% in May despite a cash rate hike in the month. This was the third consecutive monthly rise and followed gains of 0.5% in April and 0.6% in March. After a 9.1% drawdown from the April 2021 peak, prices have rebounded 2.3% since February 2023.**
- **The pace of growth broadened and accelerated. Monthly growth was the strongest since November 2021 and all capitals and regions (except regional Victoria) recorded robust growth.**
- **An imbalance between supply and demand continues to be a major driver. New and total listings are well below average. Total listings are almost 25% below their five-year average, while new listings are 13% down on the five-year average and 26% below 2022 levels.**
- **Against this backdrop, demand has accelerated. Record migration, an incredibly tight rental market, and expectations that interest rates are nearing a peak have supported demand. Sales volumes are picking up, and over the past three months have been 16% above volumes over the three months to February 2023.**
- **Sydney led the growth, with the more expensive quartile leading the way. Sydney dwelling prices rose 1.8%, marking the fourth consecutive month of gains and third consecutive month of growth above 1%. Brisbane and Perth also recorded monthly gains above 1%.**
- **Dwelling prices appear to have found a firm bottom and an uptrend is in place. The balance of competing factors is important. Our house view is for prices to be broadly unchanged in 2023, before rising 5% in 2024. However, with the current momentum, risks are skewed to the upside.**

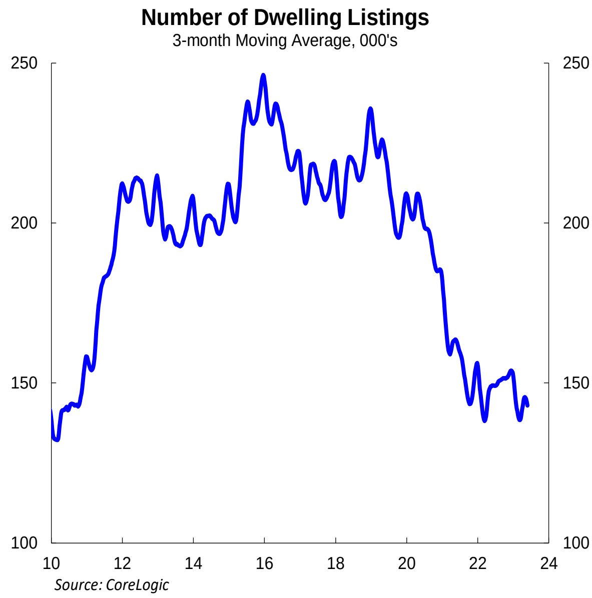


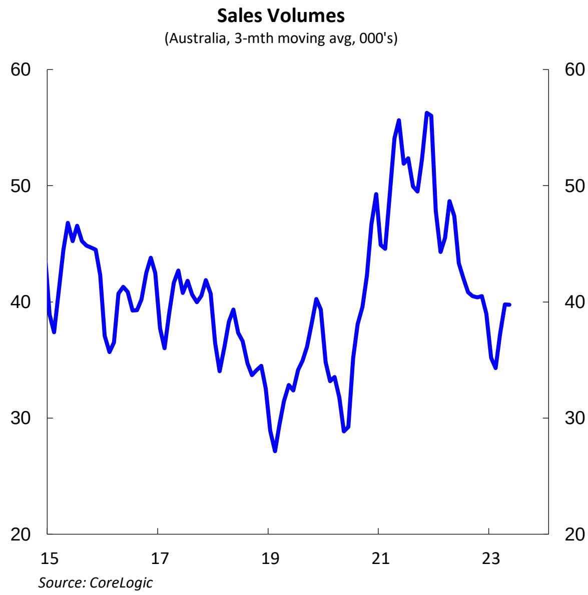


Dwelling prices rose 1.2% in May. This was the third consecutive monthly rise and followed gains of 0.5% in April and 0.6% in March. Nationally, dwelling prices are now 2.3% above their February 2023 level, which represented a 9.1% drawdown from the April 2021 peak. The monthly pace of growth accelerated in May, recording the strongest monthly growth rate since November 2021. In annual terms, prices fell 6.8% and are still 6.9% down from the April peak.

Supply/Demand Imbalance Continues

One of the consistent themes in the housing market over the past few years has been a trend decline in the number of listings. This is particularly stark given the population continued to grow strongly leading up to the COVID-19 pandemic. This trend accelerated during the pandemic and listings have been particularly low over the past year or so. Currently, total listings across the nation are almost 25% below their five-year average. Additionally, the flow of new listings has also been weak in 2023 and new listings are currently around 13% below their five-year average and around 26% below 2022 levels.





Demand

Against this backdrop of weak supply, demand has been gradually stabilising. A range of factors are impacting demand, including record migration levels, and tight rental markets encouraging those that can afford to buy to bring forward their purchase. The expectation that the cash rate is nearing a peak and that the housing cycle has bottomed has also played a role. For example, more expensive properties have risen faster than less expensive properties. The borrowing power of these types of buyers is likely to be less impacted by higher rates and they are perhaps taking the opportunity to purchase now as they feel the bottom has passed.

As a result, sales volumes have been picking up while listings remain low, contributing to price rises. Indeed, when looking at the rolling three-month average, sales volumes have risen by 16.0% over the three months to May 2023, compared to the three months to February 2023.

A rise in volumes against a backdrop of underwhelming listings is contributing to new listings being snapped up more quickly. The absorption ratio, which measures the ratio of sales volumes to new listings, has been rising as a result.

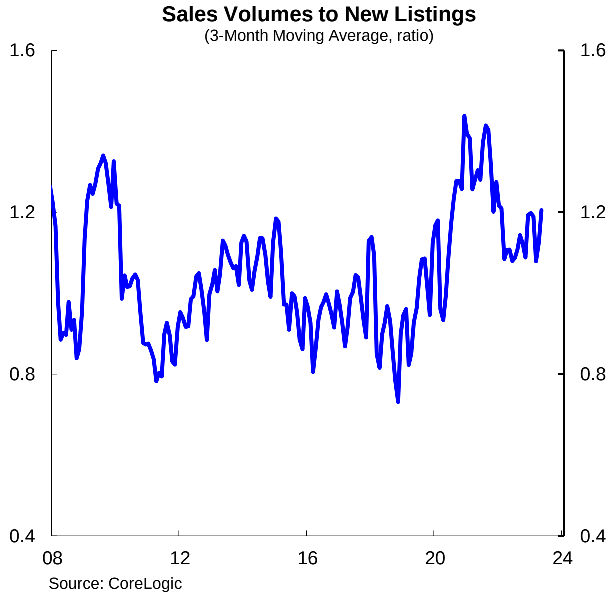
Supply

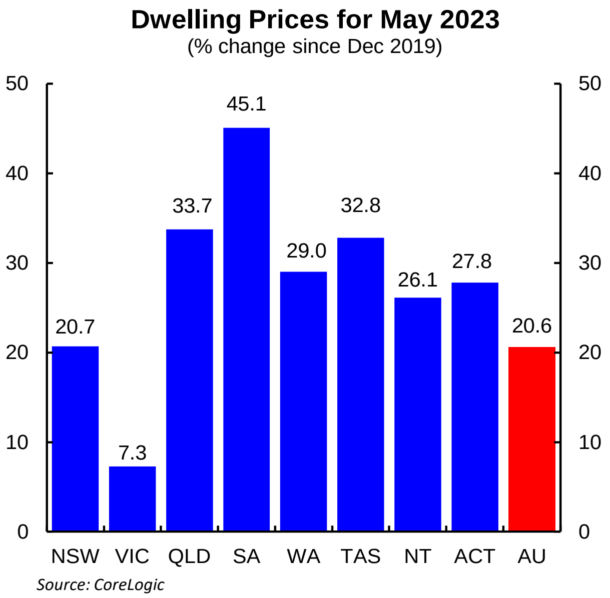
A range of factors are also impacting the willingness of existing owners to list their properties.

Firstly, as dwelling prices declined, sellers that didn't need to sell were more likely to hold back and wait for better market conditions.

Secondly, with a low amount of stock on market, owner-occupiers who may be looking to upsize or downsize may not be able to find the property they are looking for. In this circumstance, selling conditions for their existing property are likely to be relatively stronger as the market has bottomed. However, if the seller doesn't believe they will be able to purchase a new dwelling, they are less likely to list their existing dwelling despite the better selling conditions.

The incredible tightness of the rental market is also likely impacting the willingness of upsizers/downsizers to list their property. Rental vacancy rates remain around record lows and rental growth is in the double digits and is expected to remain elevated. This is likely to impact the willingness of some people to sell and temporarily rent while they look for a new dwelling, given the challenges of sourcing an adequate rental property, in addition to purchasing a new home.





Thirdly, transaction costs are very high for property transactions and rise with average prices. For example, stamp duty levies and real estate fees are typically applied as a percentage of the sale price. As a result, the dollar value of transaction costs rises as prices increase, leading to many existing homeowners choosing to adapt their existing homes, rather than face large transaction costs. This is a longer-term driver of the trend decline in listings.

Fourthly, as rents rise, so do rental yields for investors. Improving rental yields reduce the pressure landlords are facing from higher interest rates and reduce their incentive to sell. This also adds to demand as new investors look to get into the market to take advantage of improved rental yields.

Looking forward

Unfortunately, the imbalance between supply and demand is likely to get worse in the near term.

The record surge in migration will continue to add additional pressure to housing demand. The first order effect of this is predominantly via tighter rental markets and stronger growth in rents. However, there is a flow-on effect onto the housing market and purchasing demand, as we have seen over recent months. The tight rental market is also likely to continue to lead to those that can afford to purchase choosing to do so to get out of the rental market.

On the supply side, dwelling approvals have fallen sharply following the pandemic spike. New residential dwelling approvals are 50% below their March 2021 peak and are at their lowest levels in over a decade. Builders are also facing challenges, with insolvencies across the construction industry rising. The price of building a new home also surged during the pandemic and continues to rise, albeit at much slower rates over recent months. This means that the supply response will be slower and weaker than previous cycles, further adding to pressures.

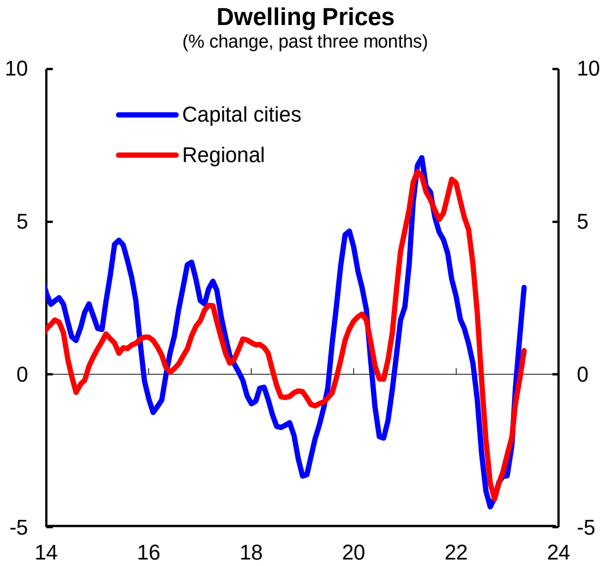
There will be some factors which will act as partial offsets, although they are unlikely to fully offset the factors mentioned above. One of these is average household size. This declined during the pandemic as people sought more space while spending more time in their homes. This led to an increase in the number of households and stronger demand for housing. This effect is likely to partially reverse as rents and dwelling prices continue to rise.

Additionally, a large pipeline of detached dwellings remains following the pandemic boom. This reflected strong demand in line with low interest rates, and stimulus in the form of HomeBuilder and other state-based first home buyer schemes. This pipeline is expected to be completed over the next 6-12 months and will add to housing supply.

Finally, as prices rise, sellers may be enticed back into the market. However, as noted above, there are questions as to how willing owner-occupiers would be to sell given they would need to enter the market again to purchase a new dwelling.

Capital Cities and Regions

Sydney led growth, with the more expensive quartile leading the way. Sydney dwelling prices rose 1.8% in the month, marking the fourth consecutive month of growth and the third consecutive month of growth above 1%. Houses outperformed, rising 2.1% versus a 1.1% gain for units.



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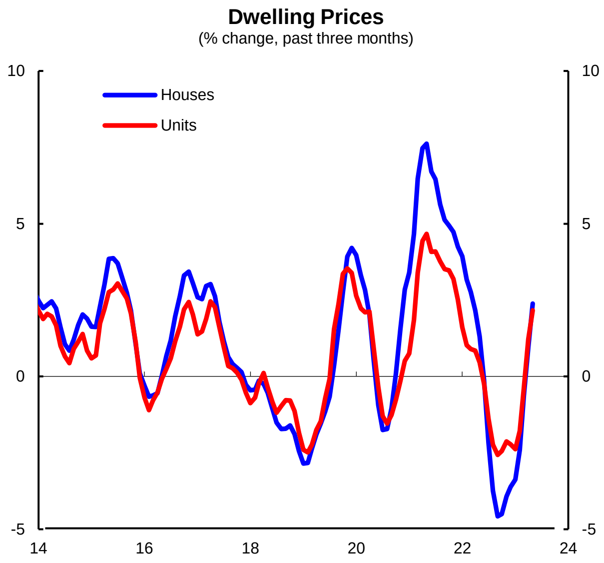


Source: CoreLogic

Brisbane (1.4%) and Perth (1.3%) also recorded monthly gains above 1%. Brisbane, along with Adelaide, recorded the sharpest capital city gains during the pandemic upswing as prices surged by over 40%. Prices across Brisbane pulled back 11.0% during the downturn but have now bounced by 1.8% over the past few months. The Perth market recovered from its extended post mining boom slump during the COVID-19 upswing and prices are still rising across the city, hitting new highs in May.

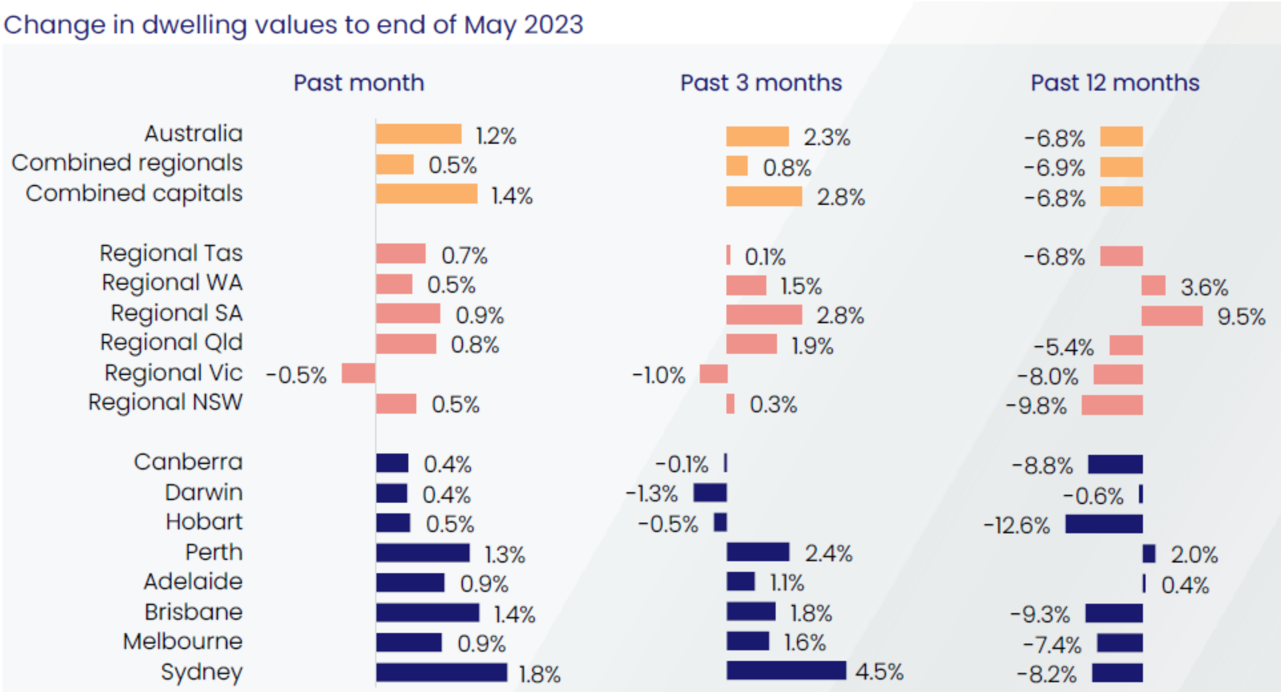
Adelaide and Melbourne both rose 0.9%, while Hobart (0.5%), and Canberra and Darwin (both 0.4%) recorded the slowest growth across the capital cities.

Regional areas rose 0.5% in the month. This reflected gains across regional SA (0.9%), Queensland

(0.8%), Tasmania (0.7%), WA (0.5%), and NSW (0.5%). Regional Victoria was the only region to record a fall in the month, slipping 0.5%.

Regional areas surged during the pandemic as people took the opportunity provided by working from home to move further away from capital cities. People in regional areas also didn't more to capital cities as they typically would, adding to demand. Moving regionally also enabled people to escape stringent lockdowns across some of our capital cities. Regional areas within reasonable commuting distance benefitted as people remained close enough to commute to work occasionally. Additionally, lifestyle regions also benefited as people sought a sea/treechange.

However, as conditions returned to normal and employers seek to get workers back into the office, it was expected that demand in regional areas would slow and future price growth would likely be more muted. Additionally, regional areas are not expected to see much of an increase in demand from surging overseas migration which is typically funnelled into the larger capital cities. This trend has been playing out and an underperformance of regional areas relative to capital cities is likely to remain a theme. For example, while regional areas are up 0.8% over the past three months, price growth is lagging the 2.8% gain across capital cities.



Source: CoreLogic

Outlook

Dwelling prices appear to have found a firm bottom and an uptrend is in place. The balance between supply and demand is likely to remain challenged, placing upward pressure on rents and prices. Some headwinds remain evident, including reduced borrowing capacity, the risk of further cash rate hikes, and the large stock of fixed rate mortgages rolling onto higher rates over 2023.

The balance of these factors will be important and may add to volatility in the near term. Our house view is that prices remain broadly unchanged in 2023, before rising 5% in 2024, as inflation and the economy slow, facilitating rate cuts from the RBA. However, with the momentum currently in place, risks are to the upside and gains may prove to be stronger than expected.

Jarek Kowcza, Senior Economist
Ph: +61 481 476 436

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 571 786

Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
+61 401 102 789