Bank of Melbourne

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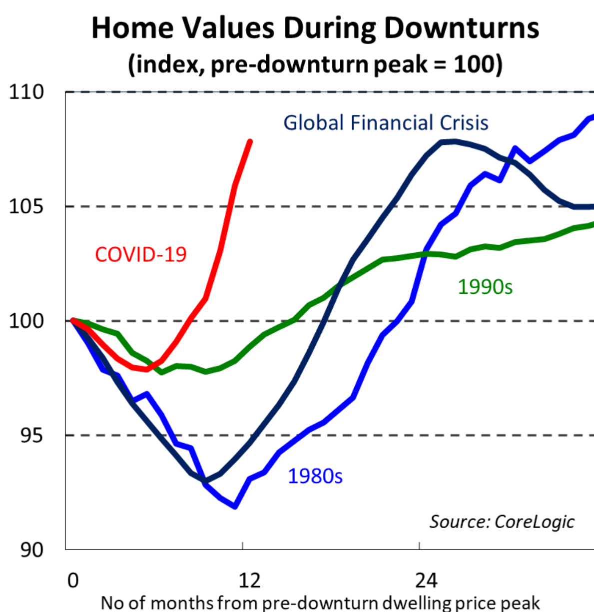
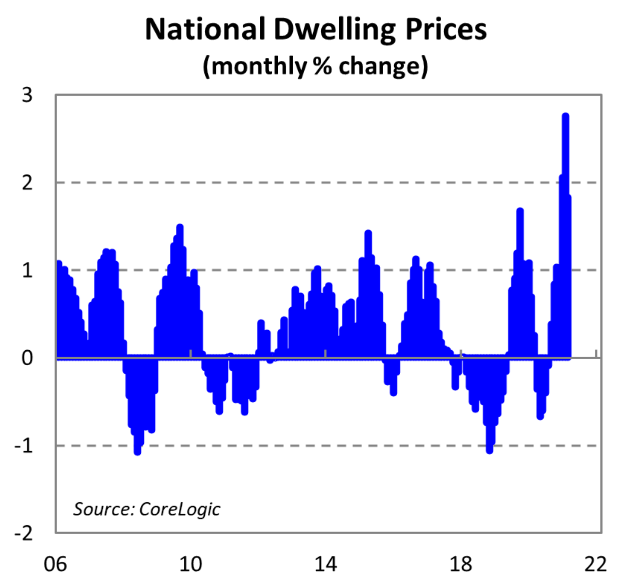
The Supercharged Housing Recovery

Fastest Rebound in Over 40 Years

- **Dwelling prices have recovered from the COVID-19 recession faster than any other major economic downturn in the past 40 years. Prices bounced back to their 2020 peak within a mere 8 months. Following the recessions in the 80s and 90s, and the Global Financial Crisis, it took prices around 18 to 24 months to return to pre-downturn levels.**
- **The rapid rebound in employment, ultra low interest rates, government support, elevated consumer confidence and low supply have underpinned the supercharged recovery.**
- **In previous rebounds, price growth slowed or reversed once dwelling prices were 3–8% above their pre-downturn peak. Dwelling prices are already nearly 8% higher than their peak in April 2020. Previous experience suggests that price growth at the pace we have seen over recent months will not be sustained.**
- **While authorities have underscored that, so far, lending standards remain sound, we expect a tightening in macroprudential policy in 2022.**
- **We expect 15–20% growth in dwelling prices in 2021 followed by a slower pace of growth in 2022 after prudential controls and affordability constraints kick in. The bottom line is that dwelling prices have further to go but the remarkable pace of growth we have seen in recent months will not continue.**





A smaller downturn and a faster recovery

Australia has experienced four economic downturns since 1980, when the CoreLogic house price data begins. There were recessions in the early 80s, early 90s and 2020. There was also a slowdown in economic activity during the Global Financial Crisis (GFC), but a technical recession was avoided.[1] Dwelling prices declined during these downturns, although the speed of the recovery and the magnitude of the decline varied significantly between episodes.

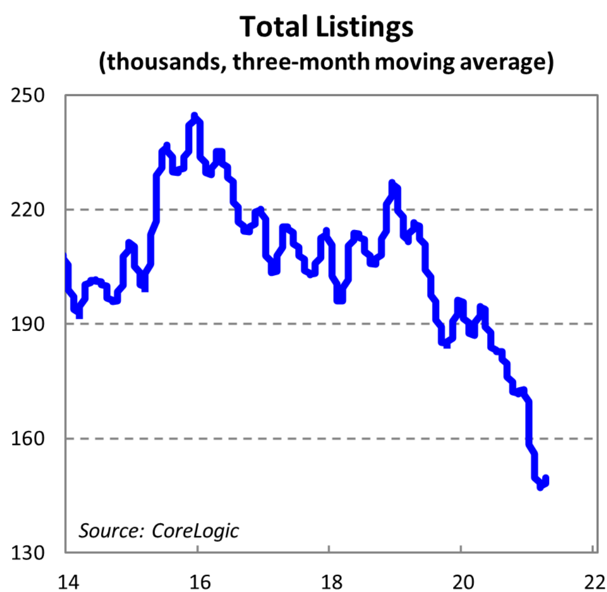
Dwelling prices have rebounded from their COVID-induced lows remarkably quickly. In fact, prices were back at their 2020 peak within 8 months. Following the recessions in the 80s and 90s, and the GFC, it took around 18 to 24 months for prices to return to their pre-downturn peak.

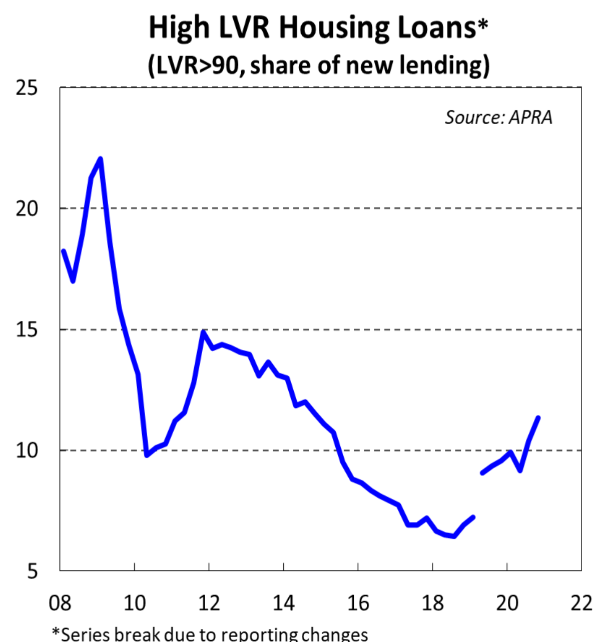
The decline in prices during COVID-19 was also smaller than the falls during the 1980s recession and the GFC. In 2020, prices troughed 2% below their peak, which was around the size of the fall during the 1990s recession. In the other downturns, prices fell 7% or more before turning around.

There are several factors underpinning the supercharged housing market recovery in this cycle.

First and foremost, the economy has rebounded much faster than in other downturns. The labour market has roared back faster than economists and policymakers expected. We have already recovered the jobs lost between February and May 2020 and then some. Following the recessions in the 80s and 90s, it took over two years for employment to get back to its pre-recession peak.

In addition, the Reserve Bank's cash rate is at a record low and the RBA has indicated it expects to keep it there until 2024 at the earliest. As a result, variable mortgage rates are very low, which supports higher for housing demand. Fixed mortgage rates are also relatively low, but as they are priced off swap rates, the trough in the fixed rates might be behind us. Swap rates have moved off their 2020 lows as investors have reassessed the outlook for economic growth and inflation. Government support for first-home buyers is also playing a role.





[1] There is no single definition of a recession. The most common definition used in the media is a technical recession, which means there have been two consecutive quarters of negative growth in real GDP. Australia did not experience a technical recession during the GFC because GDP only declined in one quarter. However, the GFC still represented a significant negative shock to the economy and unemployment rose sharply to close to 6%.

The improvement in the economic outlook has bolstered confidence alongside progress in the development of vaccines and the relaxation of social-distancing restrictions. Consumer sentiment is elevated at around ten-year highs and this optimism is helping to fuel spending.

On the supply side, the low level of housing stock is also propelling prices higher. At the end of April, the total advertised listings were more than 30% below their average in the five years before the pandemic.

Examining previous house prices cycles can also shed light on when the housing market may begin to cool off.

During previous rebounds, price growth slowed or reversed once dwelling prices were 3–8% above their pre-downturn peak. The slowing in dwelling prices growth could be underpinned by several factors such as the normalisation in economic growth and a pullback in stimulus. Affordability pressures may also play a role – later this week we will be releasing another note in this housing series examining affordability more closely. Dwelling prices are already nearly 8% higher than their 2020 peak. Previous experience suggests that price growth at the pace we have seen over recent months will not be sustained.

Policymakers are holding off intervening for now

The strength in the housing market has raised the question: will policymakers put the brakes on by tightening prudential controls?

Across the Tasman, regulators in New Zealand have recently implemented aggressive measures to clamp down on risks in the housing market. However, the market is running much hotter across the ditch. New Zealand dwelling prices were up an eye-watering 18.4% over the year to April, according to CoreLogic data. In Australia, annual growth was running at 7.8% in April.

Macroprudential controls were previous introduced in Australia in 2015 and 2017. Regulators implemented a 10% limit on investor loan growth and a 30% limit on the share of ‘interest only’ loans, amongst other measures. Dwelling prices fell in Sydney and Melbourne following the introduction of these policies. Both of these measures were removed by 2019.

We think it is a matter of when, not if, there will be a tightening in prudential controls. Although recent communications from the RBA and APRA suggest that authorities are some way from seeing the need to intervene.

Importantly, what concerns regulators is not rapid price growth itself but the risky lending which can be associated with sharp increases in prices. While credit growth has increased, it remains modest and has largely been driven by lending to owner occupiers. Policymakers are typically more concerned by rapid growth in lending to investors. When macroprudential controls were last tightened in 2017, loan approvals to investors accounted for a much larger share of new lending. However, it appears investors are starting to come to the party. In March, new lending to investors jumped 12.7%, the strongest monthly growth in almost 18 years.

Policymakers have underscored that, so far, lending standards remain sound. This refers to indicators like the share of new lending with high loan-to-valuation (LVRs) ratios and debt-to-income ratios. These measures remain low relative to historical levels, although notably the share of new lending with LVRs greater than 90 picked up in the second half of last year.

There are also positive spillovers to the broader economy from a strong housing market. And as such, policymakers will not want to clamp down on housing pre-emptively, particularly as the

economy recovers from the COVID-19 recession.

Taking into consideration recent communications of policymakers, we expect an intervention is likely next year.

Outlook

We expect 15–20% growth in dwelling prices in 2021 followed by more moderate growth in 2022.

The forces which have driven the increase in prices are not going to dissipate any time soon. Interest rates will remain very low for some time yet. The economic backdrop will improve further as the labour market continues to recover, interest rates remain low and vaccines are rolled out. We also expect the housing stock will remain low as while building approvals have lifted, it will take a while for this to flow through to the housing supply. The reopening of international borders and the resumption of immigration will also put upward pressure on prices.

However, we expect price growth will slow next year. The run up in prices will see affordability pressures bite. The tightening in prudential controls we expect in 2022 will dampen demand. And eventually, the lift in building approvals will boost the housing supply through more residential construction activity.

The bottom line is that dwelling prices have further to go but the remarkable pace of growth we have seen in recent months will not be sustained.

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