FTMA
FRAME & TRUSS MANUFACTURERS ASSOCIATION OF AUSTRALIA

Briefing #7:

Housing 'bubbles', the pipeline of work and supply chains

Prepared by IndustryEdge:
February 2021

IndustryEdge™

"Like bubble gum in the mouth of a show-off teenager, when a housing bubble bursts, there is always a mess, and more than often, the innocent get splattered as much as the guilty."

Housing 'bubbles', the pipeline of work and supply chains

Housing is very important to Australia and to Australians, and as a result, there is a huge amount of data about the housing sector, and just as much commentary and as many opinions about it.

Data can be interpreted in multiple ways, so this is by no means certain, but there is solid evidence to support the view that Australia is in the midst of a housing 'bubble'.

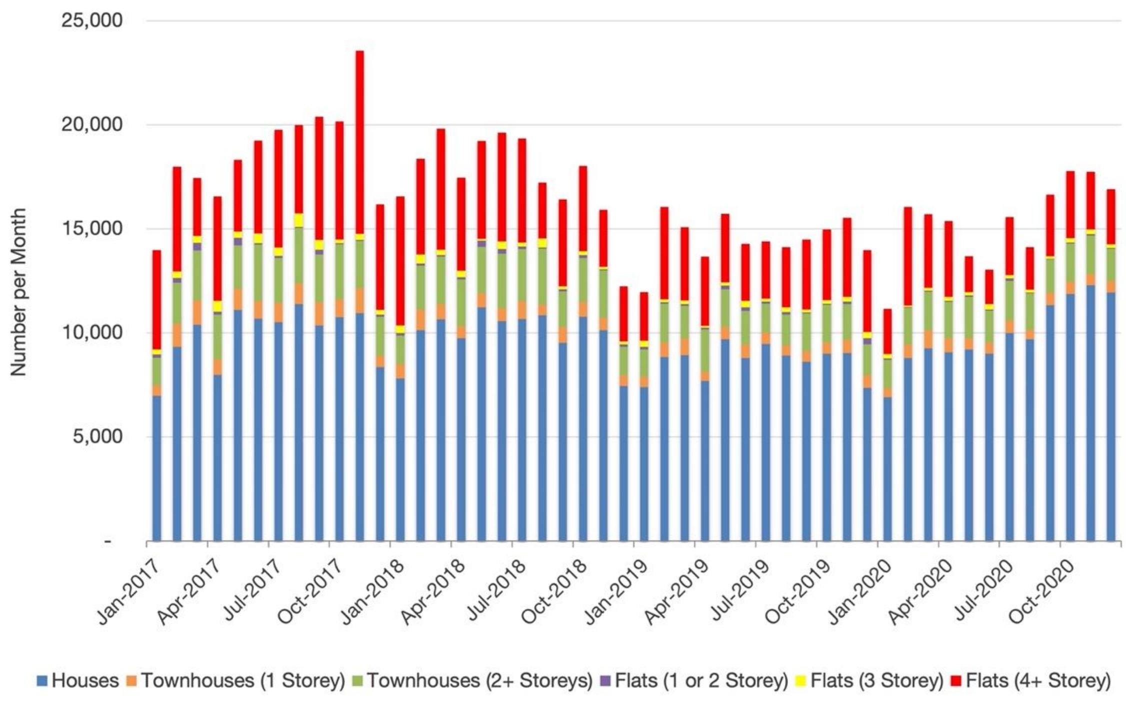
In this analysis, we will present the data that points to the existence of a housing market bubble, explain what that is and what the implications might be, especially for those engaged directly in the Australian housing supply chain.

Approvals data is important, but it lags the market

One data point that is examined every month is housing approvals data, which records the number of new dwellings (of all types) approved around the nation. It is a solid dataset that shows that for the year-ended December 2020, approvals totalled 183,769, up 5.5% on 2019, but still nearly 13% lower than in 2018.

As the chart shows, after tracking down in early 2020, approvals climbed back up over the remainder of the year, to reach two-year highs.

Australian Dwelling Approvals by Type: Jan '17 – Dec '20 (Number)



Source: ABS

This data about what has already been approved is interesting, and gives us the opportunity to tell our favourite stories ('Free-standing houses account for more than half of all approvals', 'Four plus storey apartment approvals collapsed' etc). However, this data is out of date by the time we get it (about five weeks) and it actually represents commitments made some time earlier than that.

In most cases, before a builder seeks an approval, they have a purchase commitment from a buyer (a sale) in their hand, and in some cases, that includes finance being organised. Although it varies, the approvals for December 2020 will have been signed up as far back as three months earlier.

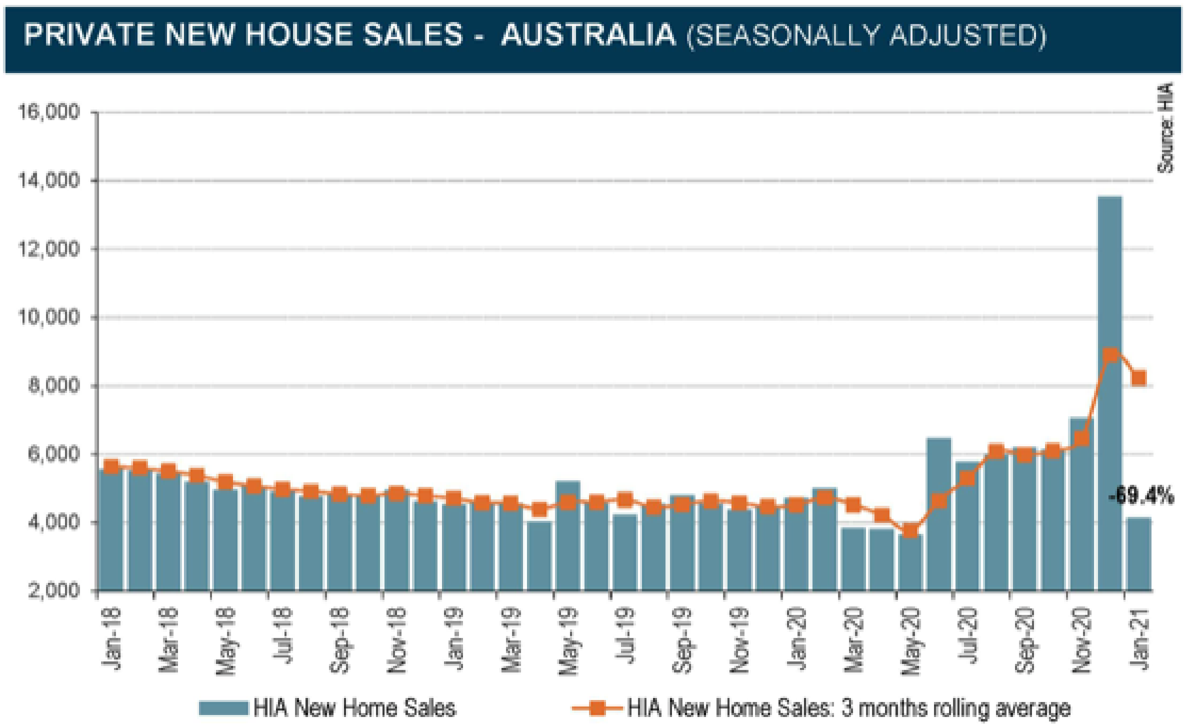
In that way, housing approvals data provides a lagging indicator of the health of the housing economy.

What is more, approvals data can also be misleading. Just because a dwelling gets approved does not mean that it will be built. There are plenty of examples of this for entire multi-storey apartment buildings, when developer finance falls over for instance. For free-standing houses, unbuilt approvals may become more prominent in 2021. More on that a little later.

Why sales data matters, but is also misleading

Despite being collected privately and retained as a member service by organisations like the HIA, monthly sales data provided direct by builders is fundamentally the 'go button' for the housing supply chain. This is the point at which the builder books the sale and holds a contract.

HIA members across Australia reported their sales of houses went through the roof in December 2020, approaching monthly record levels. As you can see below, sales as the $25,000 HomeBuilder stimulus ended (it is now $15,000 until the end of March), were pretty spectacular.



The huge lift in sales might well have included a bit of pressure selling, a bit of panic buying, and a whole load of one-off stimulus. With buyers potentially cooling off, banks rejecting finance and even some builders over-extending themselves, some sales will not reach approvals stage and still others will not reach settlement, meaning that not all of these sales will be built.

As one respondent to a draft of this analysis commented, our industry was highly sceptical, when HomeBuilder was first announced, that it would do anything to avoid the fast-approaching apocalyptic cliff. IndustryEdge concedes we were equally sceptical.

As the correspondent went on to comment, the reasons it worked might not be the stimulus itself, but rather the severe adjustment to household spending patterns brought about by the lockdowns. No overseas holidays for example, so where do you put your money? New house perhaps? Renovation possibly, and especially if you can now see yourself working from home for the foreseeable future and you have become all too aware of your house's limitations when no one could leave home for months at a time.

Useful though it is, the sales data can also be a bit misleading. Especially when, for reasons related to these drivers for the big lift in sales, we might be in the midst of this somewhat vague thing, a 'housing bubble'.

What is a housing bubble, and why is it bad?

Broadly, there are two bubbles in operation right now, in the Australian housing market. At least, that's the analysis we think is most accurate when looking at the available data.

The first bubble arises because the HomeBuilder stimulus appears to have pushed up house prices across Australia, with the exception of Melbourne, where the pandemic bit hardest and longest.

Core Logic's excellent monthly data series, shown below, demonstrates this clearly, but without the usual hyperbole of the tabloid news.

CoreLogic Home Property Value Index

City	All Dwellings		Houses	
	% Change prior Year	% Change prior Month	% Change prior Year	% Change prior Month
Sydney	+1.99	+0.43	+3.12	+0.67
Melbourne	-2.06	+0.43	-2.76	+0.58
Brisbane	+5.03	+0.98	+5.61	+1.10
Adelaide	+6.55	+0.88	+6.83	+1.05
Perth	+3.36	+1.55	+3.59	+1.66
5 Capital City Ave.	**+1.48**	**+0.62**	**+2.11**	**0.84**

Source: Core Logic

Some will say the recent price growth is natural and will be sustained.

We do not agree, mainly because of the effect of the stimulus in shifting prices up.

But also, we think this bubble in prices is not sustainable because it represents a moment of demand, met by an unforeseen under-supply. People returning home from less desirable locales than Australia are in the market, along with the first home buyers and those churning their existing residence.

Each has helped force demand up, and with limited supply, in an open market, prices rise.

What happens when the demand dries up? Say for example, when all those residents and citizens return and there is no new migration for a period of time? Prices will come down. There are other reasons prices are likely to come under pressure relatively soon. Again, we'll get to that.

Now spiking prices are a bubble for some, a curiousity for most and an opportunity for others, but the rising prices - think of it as a market reaction to unmet demand – has another consequence. Higher prices in established housing appears to have forced some would be buyers of existing stock, towards the bright lights of the HomeBuilder stimulus, which was attractive enough as it was.

That in turn forced up the number of sales – leading to subsequent approvals – and in our view, that is another bubble. Most likely, the role of HomeBuilder stimulus here has pulled demand forward. It is not enough money to have created demand that did not exist, especially when the desire to own one's own castle is so heavy-etched in our national psyche.

What might cause the bubble to burst?

Like bubble gum in the mouth of a show-off teenager, when a housing bubble bursts, there is always a mess, and more than often, the innocent get splattered as much as the guilty. Maybe more so

So, what causes a housing bubble to burst? In most cases, it will be the reversal of one or more of the factors that helped to create it, in the first place.

What might they be?

First, the HomeBuilder stimulus will end in March, having already reduced to $15,000 from the $25,000 on offer until the end of December. In terms of the number of sales and approvals, that could see demand fall off a cliff, although most commentators think there will still be demand left for the market to meet. We agree a dramatic fall is unlikely, but there will be a decline.

Second, at the end of March, the JobKeeper stimulus – the largest intervention in the Australian economy in at least living memory – comes to an end. Businesses will fail, jobs will disappear and for some, incomes will dry up. That will drag some demand out of the market and it will mean some commitments (sales and approvals) will not be met. We should expand this a little. When the pandemic is under control, will our governments (all levels) and many businesses really keep employing an additional cohort of cleaners, sanitation, quarantine and security staff that some estimates put at around 40,000 people? Not likely.

Third, and directly related, some of the businesses that fail will be smaller builders. It is already happening that some builders are over-committed and under-delivering. With their clients starting to find payments harder, the builders that fail may take some of the work down with them.

Fourth, interest rates are at historic lows and loans are being struck on capacity to pay at rates that might just begin to move up again, perhaps towards the end of 2022 (certainly not earlier and some suggest five years without interest rate movements). Because the pipeline of work is so full and there are delays all over the system, there are buyers/borrowers who look good now, but by the time of formal settlement, may not be able to cover the cost of the loan. Bankers with whom IndustryEdge engages report they have already increased their rejection rates.

Fifth, wages growth in Australia is very low and unlikely to increase any time soon, especially when the unemployment rate lifts after the end of JobKeeper. In a climate of future interest rates being higher, the 'capacity to pay' will deteriorate for quite a number of buyers/borrowers. That could take demand out of the market and it could also cause some projects to be shelved.

Sixth and finally, the combination of all of these factors is also likely to remove the heat from the established home market, at least limiting the growth in housing prices we observed earlier, if not actually dragging it down.

If Australia is lucky, the bubble will subside, rather than burst. That would be good news, because it would allow for an orderly adjustment to normal levels of building activity, provide time for supply chains to respond and reduce the heat in the overall market.

We can hope for that to occur, but the risk of the bubble bursting is relatively high and the consequences could be quite serious.

How the housing bubble impacts supply chains – including yours!

To say this housing bubble was not predicted is an understatement. Less than one year ago, industry was preparing itself to batten down the hatches and almost enter hibernation for the second half of 2020 and perhaps the first half of 2021. Shifts were being reduced and lets remember, one million people lost their jobs.

The consensus was that the economy would collapse. And it came, when the nation slipped into an inevitable recession. But the dip in the housing market was a very unpredictable and short-lived blip that defied the consensus view that the housing market would crash. IndustryEdge was part of that consensus, and we were wrong.

Because of that near universal expectation, building industry supply chains were emptied to minimum levels. Inventories were reduced for all building materials. This is not just a factor impacting the forestry and wood products supply chain. Whether local production or imports, supplies of everything as diverse as glass and ceramic tools, bricks and roofing iron, and even ovens and dishwashers were wound back in expectation of a sharp fall in building activity.

Then came HomeBuilder, and the apparently indomitable spirit of optimism and desire that surrounds the housing market kicked in.

Demand surged rather than declined.

Empty supply chains struggled to respond, import lead times pushed out – and international freight costs climbed to unbelievable levels – and as a consequence, the work in hand continued to grow, and began to slow down. It is worth examining the causes of significantly higher freight costs. This is a topic in its own right, but if we think of the global freight system being a series of hubs and spokes, that is a start. At the far end of the spokes (Australia, for instance), empty containers are banking up and are not making their way back to the main global manufacturing centres. Loaded containers take precedence naturally, and the container ships are struggling to catch up with the backlog.

As Shipping Australia puts it perfectly:

> "All around the world, empty shipping containers are in the wrong place. They are in the countries that receive cargo, like Australia. They need to be in the places that send cargo, like China."

So, even with desire to supply, the supply lines into countries like Australia are long, arduous and right now, very expensive.

That all appears to have been compounded by the skilled labour challenges that regularly beset the housing sector. There is not an endless supply of people with skills capable of working in each stage of the building process, and they are not, except for the very-capable few, able to shift from bricks one week to carpentry the next and tiling the week after.

Under pressure to deliver progress, the limited number of specialist trades people are being pulled from one job to the next, delayed because the precursor trades haven't completed their work, or some material or another is unavailable for a time, or they are just trying to keep all of their builders happy.

The pipeline of work is being stretched out by this value-destroying economic 'friction'. The result is that houses are taking longer to build.

Look back upstream to your business and the pressures you face from the builder on the one hand, are pressures you place back on the supplier, on the other hand. But like Old Mother Hubbard, in a lot of cases right now, they open the cupboard (the warehouse anyway) and find the cupboard is bare. That is as true, it seems for the local producers, as it is for the importers. Our partner, Forest2Market, has just reported on the extent to which European supply is making its way into the surging US market for instance.

Despite the strength and pull of the US market, importers continue to report that there is supply available in many cases, but the shipping and freight challenges discussed earlier are constraining supply opportunities.

To get the supply chain back in order and for patterns of work to be more predictable requires something to give. Demand softening and slowing will take quite a long time to flow through to the housing economy. We don't really know how long this pipeline of work is right now, but there are builders reporting they have work they plan to commence late 2021.

To meet that, the smart end of the industry is working on securing as much supply as possible, including making commitments over longer periods, and working with their suppliers by sharing their planning and future needs as far ahead as possible.

When might the market return to equilibrium?

Not for some time yet!