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FTMA
Trussted Insight

AFTER THE BOOM...

AUSTRALIA'S HOUSING MARKET IS HEADED FOR ITS SHARPEST DOWNTURN IN DECADES

WITH TIM WOODS OF INDUSTRYEDGE

After the Boom…

Australia's housing market is headed for its sharpest downturn in decades. Here are some clues about why, when, how bad it might get and what you can do about it.

From Tim Woods at [IndustryEdge]

Which housing market?

In some respects, Australia has two housing markets, one already declining quickly and the other, preparing for a bust.

What are these two markets?

First, there is the market for existing dwellings, which is usually described in terms of house prices, auction clearance rates and rental costs.

Second, there is the new dwelling approval and building market.

Of course, these two markets are connected. Together, they form the total market, but they operate to somewhat separate dynamics and drivers and right now at least, on different timeframes.

Here, we address both these elements of the total market in this analysis, before joining the pieces to provide some insight for the future, on the total market.

Is the boom still going? No, and also… yes

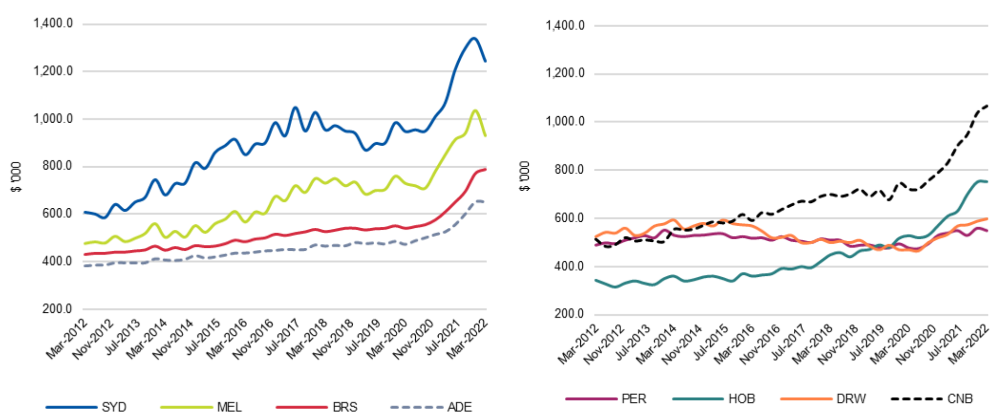
Like all speculations, the established housing market has a long history of booms and busts.

In a boom, a complex mix of drivers (low interest rates, low unemployment, government stimulus, land-banking and slow government land releases, that type of thing) typically causes house prices to rise. The herd follows and prices rise ahead of inflation, with the irrational certainty the boom will never end.

Then, one or more of the drivers turns and the market returns to its senses and the boom heads to bust. The longer the upcycle, the longer the fall and the lower prices for established dwellings fall.

Prices were forecast to contract by the March quarter and the latest data shows that is now happening as we can see below. We have used two charts so everyone can see their favourite capital city.

Median Established House Transfer Prices: Selected Capitals: MQ12 – MQ22 ($,000)



Source: ABS

The most telling factor here is that Sydney and Melbourne got a belting in the March quarter, signalling prices are on the slide.

Most recently, and widely reported, CoreLogic's house price indexes for July show the beginning of very sharp falls, as we can see below. In Sydney, some market participants report dwelling values have declined at their sharpest rate in 40 years.

Median Dwelling Value Changes (All Dwellings)

31st July 22	Month	Quarter	Annual
Sydney	-2.2%	-4.7%	1.6%
Melbourne	-1.5%	-3.2%	0.3%
Brisbane	-0.8%	0.1%	22.1%
Adelaide	0.4%	3.6%	24.1%
Perth	0.2%	1.2%	5.5%
Hobart	-1.5%	-1.3%	10.1%
Darwin	0.5%	1.9%	5.3%
Canberra	-1.1%	-0.9%	12.1%
Combined Capitals	**-1.4%**	**-2.6%**	**5.4%**
Combined Regions	**-0.8%**	**-0.2%**	**17.0%**
National	**-1.3%**	**-2.0%**	**8.0%**

Source: CoreLogic

So, at its simplest, established house prices are falling, doing so quickly and all the gains of the last couple of years are now under threat.

A downturn in prices is one thing, but when it is driven by rising interest rates, making it harder to repay loans, lower house prices can be disastrous. At some point, the interest rates get to be too much, houses need to be sold and new buyers have less capacity to pay because of the same factors: rising interest rates and wages not keeping pace with inflation. That lowers prices and the seller has less money to buy another house, which takes prices down further. And that's a bust.

The market for new dwellings and the impact on builders

There is no doubt the same drivers that impact prices for established dwellings also impact the market for new builds.

This is especially the case for sharp rises in interest rates from their artificially and historically long lows, Interest rates are not the only factor, but right now, rising interest rates are making it very hard for many households to commit to a new build.

Latest intelligence from the volume builders is households have left the market. Robert Gottliebsen reported sales are already down 75% on a year ago and there are concerns that isn't the end.

In the certain knowledge and evidence of falling household capacity, developers are placing their cue in the rack also (including engaging in land banking, a topic we will return to in future). Labour shortages beset the entire economy right now, so delays in processes to just release land, approve developments, get finance approved and impacts all along the housing bureaucracy are all taking a toll.

Home builders are genuinely under pressure from the profitless boom. Fixed price contracts with sharply rising input costs and insufficient labour are immediate problems.

A lack of work will soon be the next big problem – and as we have discussed in previous analysis, input costs will not be coming down.

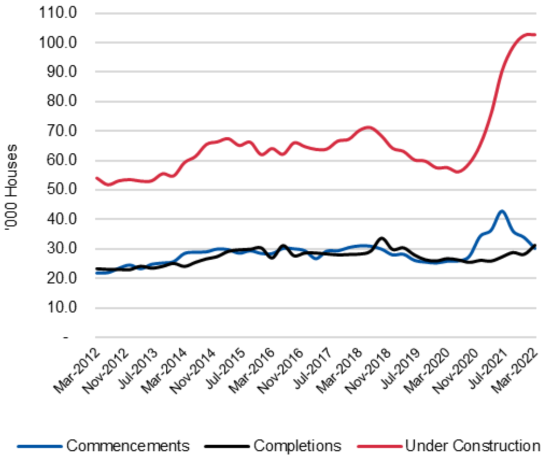
Pipeline of work has peaked

Meantime, there is work still to do, and much of it will be profitless and some of it will send builders to the wall for that reason.

The amount of work left to do is reflected in the housing pipeline chart shows below. It shows quarterly, the commencements and completions and it also shows the amount of work under construction. Noting this is just for houses, in the March quarter, the amount of work in the pipeline (under construction) was an all time high of 102,584 houses. However, that was just 0.3% higher than the previous quarter and with dwelling approvals softening, the consensus is the pipeline has peaked.

In fact, for the first quarter in two years, more houses were completed than commenced in the March quarter. In fact at 31,145 completions, the March quarter was just the fifth quarter in the last decade in which more than 30,000 houses were completed. For the record – and we'll return to this in a moment – the average completion rate since records began is 25,952 houses per quarter.

Australian House Construction Pipeline: MQ12 – MQ22 ('000 Houses)



Source: ABS

When the pipeline of work will dry up

Though we own no crystal ball, or more appropriately for the pipeline metaphor, we have no divining rod, having examined the data closely for some time now, IndustryEdge continues its view the pipeline for houses will not be 'built down' to average levels until late 2023 and perhaps early 2024.

Average levels in this case means something like the quarterly capacity of the system to build houses or something between 25,000 and 30,000 houses per quarter.

Though there is no certainty – and we can only do this in theory here – we assess the pipeline's decline as set out below.

Theoretical Australian House Building Pipeline: JQ22 – DQ23 (Number)

	JQ22	SQ22	DQ22	MQ23	JQ23	SQ23	DQ23
Actual Pipeline	102,584						
Est. Completions	30,000	30,000	30,000	30,000	30,000	30,000	30,000
Est. Commencements	28,000	24,000	22,000	20,000	18,000	16,000	14,000
Est. Pipeline (End of Qtr)	**100,584**	**94,584**	**86,584**	**76,584**	**64,584**	**50,584**	**34,584**

Source: IndustryEdge

In reality, it is very unlikely Australia will sustain completion rates of 30,000 houses per quarter through the next six quarters. Equally, we cannot be certain of the commencements, but if the drop off in sales is anything to go by, commencements will slow quickly.

In fact, the ABS has reported new house completion times have pushed out to an average 7.77 months, up an average 1.3 months from the start of the pandemic. That means it is taking longer to build the houses in the pipeline, so by the end of 2023, there may still be more work to do than we estimate here.

But supply of labour in the housing sector is short, a situation unlikely to change quickly and cash wages are increasing after years of barely moving in most sectors, driven higher by labour shortages and general inflation. Those on construction concerned about employment security are engaged, as other commentators have identified, in major long-term infrastructure projects, as well as apartment builds.

The constraint on the system's capacity to build is one thing, but the cost to build must increase also. The suspicion we have is that is already flowing into the market's understanding, which will further suppress demand for new housing, even as the pipeline is being built out.

Finding the bottom

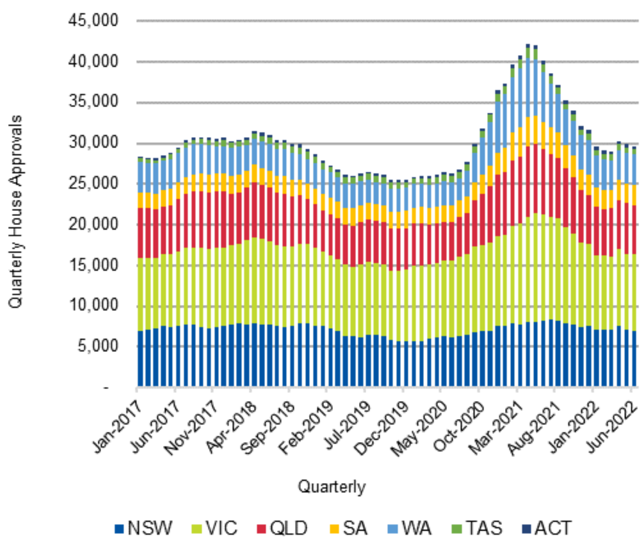
If we take our cue from the early commentators on this matter, the expected bust in the Australian housing market will be very bad indeed and could rival the great busts of the late 19th Century and the Great Depression of almost 100 years ago.

Language like 'housing bubble' creates a neat mental image because when a bubble pops, it disappears. We don't think it's a very helpful or kind way to describe what for many people and potentially the entire economy, could be catastrophic. There will be a downturn in prices and we don't know where exactly it will stop. Maybe the median price falls 10%, or maybe 20% in the major capitals, we simply don't know and we probably will not know for a year or more.

That short answer addresses – to some extent – the established house price question, but it does not deal with what is on the other side of the diminished pipeline.

From some point in early 2024, the housing supply chain can expect to have significantly less work to do. New home sales are drying up, approvals for houses, shown below on a rolling quarterly basis, are on the slide across the country.

New House Approvals by State: Jan '17 – Jun '22 (Number – Quarterly)



Source: IndustryEdge

	NSW	VIC	QLD	SA	WA	TAS	ACT
Jun-20	6,156	9,464	4,700	2,083	2,823	759	307
Jun-21	8,225	13,000	8,031	3,323	6,099	1,031	407
Jun-22	7,024	9,343	6,069	2,403	3,774	656	338
% Change 21 to 22	-14.6%	-28.1%	-24.4%	-27.7%	-38.1%	-36.4%	-17.0%

An already declining approvals rate will start to fall sharply in coming months. As the data shows, no jurisdiction will be immune. The data from NT was deliberately excluded because the numbers are so small, it is often unreliable.

We cannot predict the bottom of the market any more than we can be confident in forecasting the peaks.

However, let's say that at normal completion rates and on elevated completion times, with the approvals likely to flow over the next six quarters, by mid-2024, the Australian housing supply chain can expect to have far less work than it has now.

How did we get here?

It could be argued Australia has engaged in an orgy of consumption over most of the period since the GFC, fuelled by artificially low interest rates and government expenditure that all-too-often supported increased and very transitory consumption, instead of building the fundamentals to support future growth.

Because these analytical pieces focus on housing markets and wood products supply chains, we can use a housing example of the wasted opportunity.

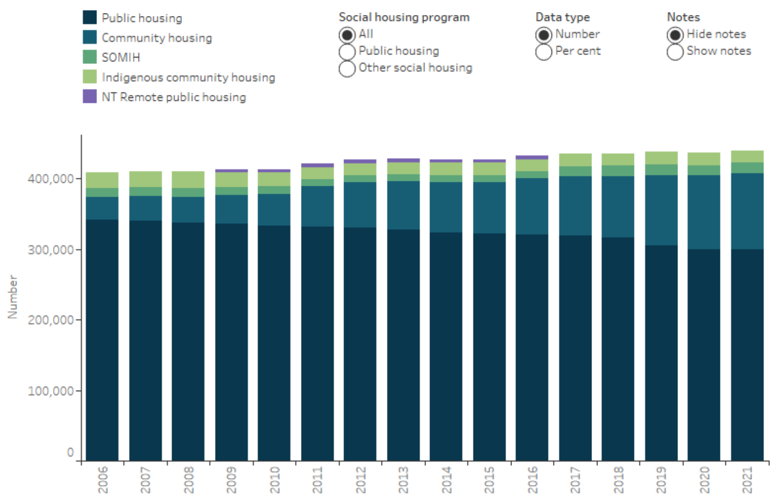
As Australia's population has grown (and continues to grow at its fairly predictable rate), we have always the capacity to predict our annual new dwelling need, within a range. We can even predict with a reasonable degree of certainty where that housing will be needed and what types of dwellings we need to build.

We also know that it is new migrants who fuel our population growth.

Australia's stock of dwellings has grown significantly over the last two decades (all that cheap money and stimulus being flung around like a drunken Melbourne Cup winning owner at Crown Casino on the first Tuesday in November). It has been so much fun for the established owners that every second coastal property is owned by an investor and lived in by a succession of holiday makers all aspiring to do exactly the same. That behaviour and the fiscal profligacy that has fuelled it has helped create a housing crisis in many regions, some major cities and even a few capitals.

Meantime, our stock of publicly funded housing or other forms of socially supported housing, to support new migrants and others in need has not kept pace with demand. The chart (next page) here from the excellent Australian Institute of Health and Welfare (AIHW) demonstrates the point.

Dwellings by Social Housing Program Type: 2006 – 2021 (Number)



Sources: AIHW National Housing Assistance Data Repository. Northern Territory Government. Department of Housing, Annual Report.Darwin, NT. Supplementary table DWELLINGS.1.

Some will argue this is not an economic issue, just a social issue. They are wrong.

So bad is the gap that as we approach something like full employment, the additional labour we might have been able to deploy to help work our way out of the mess we are in is unavailable because it doesn't have anywhere to live. Leave aside the inequality and unfairness of one of the wealthiest countries on the planet having families who cannot afford accommodation, the economic cost of 'non-deployable' labour is a potential disaster.

For the building supply chain, it is lost opportunity to have work during the quiet periods, like the one fast approaching.

Where to from here?

History will not judge the early part of the twenty-first century especially well when it comes to housing policy and the economics of supporting a housing market to deliver for the nation in the short, medium and long term. But that does not mean we are completely in the ditch.

At a policy level, increased emphasis on social housing, providing accommodation for much-needed new migrants, efforts to build houses more efficiently and to make further advances on supply chain integration can all make a difference.

The most immediate solution to a sharp downturn in the demand for new houses is not for government to thrust money at people who cannot afford to commit to a new house.

A government committed to expanding the nation's stock of public and social housing can do that in the next downturn and might be minded to just that. The question that arises from then is what type of housing and where it will be located.

That might be a question for another day, but as we consider the impending bust, it's certainly time to ask if our businesses are prepared for the downturn and the likely evolution of the housing sector.

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