

News Release

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BIS Shrapnel forecasts a slowdown in house price growth

Rising interest rates will continue to influence affordability

Leading industry analyst and economic forecaster, BIS Shrapnel, expects price growth for residential properties to slow in 2010 after the first-home buyer and low interest rate-induced rebound in prices in 2009.

According to the company's *Residential Property Prospects, 2010 to 2013* report, lending activity is already easing, with first-home buyer demand in the March quarter of 2010 down by 44 per cent on the same period last year, and upgrader activity plateauing. This is flowing through to softer demand for residential property.

BIS Shrapnel senior project manager and study author, Mr Angie Zigomanis, says a combination of factors have caused the momentum that built up in house prices in the second half of 2009 to stall in 2010. There has been a fall in first-home buyer demand after the expiry of the First Home Owner's Grant Boost Scheme at the end of 2009, a subsequent slowing in upgrader demand as a result, and affordability has deteriorated due to higher prices and sharp rises in interest rates.

"The strong price growth in the second half of 2009 was a rapid adjustment to housing variable interest rates that were at 40-year lows," says Zigomanis. "With interest rates quickly lifting from these 'emergency' levels, and the current variable rate of 7.4 per cent now being close to long term trends, the recent levels of price growth cannot be maintained."

However, BIS Shrapnel does not expect house prices to fall. Investors are beginning to return to the market and pick up some of the reduction in owner-occupier demand – loans to investors were up by an annual 26 per cent in the March quarter of this year.

While rental growth did slow in 2009, part of the slowing was due to first-home buyers moving from rental to owner-occupation, as well as the lower interest rates reducing the incentive for landlords to pass on further interest rate rises.

"Even though overseas migration inflows are steadily easing, a deficiency of stock is still in place with dwelling construction below underlying demand," says Zigomanis. "This is expected to put pressure on vacancy rates and result in stronger rental growth later in 2010. The deficiency of dwellings, and improved rental picture, will continue to maintain investor demand and assist prices.

"In addition, the current round of interest rate rises is expected to have run its course, with further rises expected to be more moderate," adds Zigomanis. "Our forecast is for the cash rate to increase by 50 basis points in 2010/11, and a further 50 basis points in 2011/12. The more stable interest rate environment is expected to underpin purchaser confidence as economic conditions continue to strengthen, and should continue to push through moderate house prices rises."

In effect, the surge in prices in the second half of 2009 in most cities has 'front loaded' price growth in this upturn, leading to a flatter cycle in prices as the economic recovery continues. Higher interest rates will maintain price growth at a more moderate level, despite the acceleration in economic growth driven by the recovery in resources investment.

"Normally price growth is moderate at the beginning of the upturn and accelerates to a peak at the end of the cycle as economic growth also peaks," explains Zigomanis. "However, the very low interest rates in 2009 initiated stronger rises, so the sharp 1.5 percentage point rise in the cash rate between October 2009 and May 2010 has already begun to strain affordability, causing future price growth to be more muted."

The spectre of strained affordability is expected to remain over the residential market for the near future. BIS Shrapnel says affordability in most capital cities is now at around 2007 levels, after which further rate rises in early 2008 caused price growth to weaken despite a booming resource-led economy.

Similarly, further economic growth will have only a limited impact on prices, with affordability constraints keeping a lid on price rises as interest rates rise. This is expected to keep price growth to an average in the mid-single digit percentage range over the next three years.

Among the state capitals, BIS Shrapnel forecasts those starting from the lowest price base will experience the most solid price growth. Real house prices in both Sydney and Perth are still below their previous peak levels, and this should underpin stronger growth relative to the other capitals. Price levels in Adelaide are below the other mainland capitals.

More moderate growth is expected in Brisbane, Hobart and Canberra due to weaker underlying demand and local economic conditions over the next three years, while the very strong price rises in Melbourne and Darwin have pushed affordability and will limit further rises.

Outlook for price growth by region

Sydney

Sydney's median house price is forecast to be \$615,000 in June 2010. While this represents a 12 per cent increase for the year, house prices in real terms remain 10 per cent below their peaks. On this basis, Sydney house prices are at 2002 levels in terms of affordability.

New dwelling construction in Sydney is well below the levels needed to accommodate population growth which means vacancy rates will remain low, maintaining upward pressure on rents.

"This deficiency is slowly encouraging investors back into the Sydney market," says Zigomanis. "With interest rates now expected to be more stable and economic and income growth gaining traction from 2010/11, confidence is expected to pick up and underpin reasonable, although unspectacular, growth in the coming years.

"We are forecasting total price growth in Sydney over the three years to June 2013 to be 20 per cent, representing average growth of around six per cent per annum."

Newcastle and Wollongong

Price levels in Newcastle and Wollongong are significantly lower than across Sydney. In the short-term, these markets may be weakened due to the fall in first-home buyer demand after the expiry of the First Home Owner's Grant Boost Scheme. However, demand is expected to benefit later on as rises in Sydney prices place pressure on affordability and encourage inward migration of residents from the state capital. This will lead to stronger growth later in the forecast period. Total growth in the median house price in Newcastle over the three years to June 2013 is forecast to reach 18 per cent, while the total rise for Wollongong is forecast to be 17 per cent.

Melbourne

Melbourne's median house price experienced a rise of 27 per cent in the 18 months to December 2007, followed by a decline of 10 per cent during calendar year 2008. However, the decline has been more than offset by the substantial 26 per cent rise that came through in 2009, with the estimated median of \$550,000 at June 2010 representing a further three per cent rise.

“On any measures, this substantial growth has led to affordability in Melbourne becoming very strained in a long-term sense,” says Zigomanis. “On top of this, although only moderate rises in interest rates are forecast in 2010/11 and 2011/12, this will nevertheless continue to tighten the screws on affordability in the city.”

Price performance will be patchy, although we expect the overall deficiency of dwellings will prevent a fall in the median house price. On the other hand, price growth will remain very limited despite strengthening economic conditions due to the rising interest rate environment pressuring affordability. Our forecast is for Melbourne’s median house price to rise by a total of 11 per cent over the three year period to June 2013, or a modest 3.5 per cent per annum.

Brisbane

Although Brisbane’s forecasted median house price of \$465,000 at June 2010 represents an 11 per cent rise for the year, it only reflects an annual rise of a moderate five per cent over two years, after taking into account the declines of the previous year.

Price growth in Brisbane has been impacted by weaker economic conditions due to the downturn in resources investment, as well as a collapse in non-residential building. This has also reduced underlying demand, with interstate migration into Queensland also weakening considerably.

“The recent rises in interest rates have again constrained affordability in Brisbane, while a lagging economy and weaker interstate migration will reduce upward pressure on prices in the short-term,” says Zigomanis. “By the time economic conditions in Queensland gain momentum we expect the peaking of interest rates in 2012/13 will halt any traction in price growth that may have emerged.

“As a result, overall price growth to 2012/13 is expected to be only moderate, totalling 12 per cent in the three years, or just under four per cent per annum.”

Gold Coast and Sunshine Coast

House prices on the Gold Coast and Sunshine Coast have generally moved in tandem with Brisbane, benefiting from the same drivers of population growth as the capital – primarily net interstate migration inflows and, to a lesser extent, overseas migration.

On the Gold Coast, BIS Shrapnel forecasts prices will increase by 11 per cent over the three years to June 2013, with a rise of 13 per cent anticipated for the Sunshine Coast. Price growth on the Gold Coast is expected to be marginally lower than Brisbane given its higher median house price, while on the Sunshine Coast it will be slightly stronger.

Townsville and Cairns

Price growth in both Townsville and Cairns in recent times has been underpinned by investment in the resources sector, which caused employment and population growth, as well as income growth. Price growth in both areas first weakened in 2008, then stabilised in 2009, in line with expectations for spending on new mining projects.

Price growth is expected to be modest in 2010/11 before the expected recovery in resources investment ramps up and leads to stronger price growth in 2011/12. However, peaking interest rates in 2012/13 are forecast to slow price rises before they can gain too much traction.

Cumulative price growth over the three years to 2013 is expected to be 17 per cent for Townsville and 16 per cent for Cairns, with the marginally weaker price growth in Cairns reflective of the impact of the tourism sector on its economy, which will continue to be affected by the higher Australian dollar.

Adelaide

With Adelaide having the lowest median house price of the mainland state capitals, it did not experience the same interest rate and GFC-induced decline in prices in 2008 as some of the other capitals. On top of this, Adelaide’s forecast median house price of \$410,000 at June 2010 represents a 14 per cent increase for the year.

“The solid rise in house prices in Adelaide reflects the impact of the First Home Owner’s Grant Boost Scheme and low interest rates of 2009,” says Zigomanis. “With Adelaide having the lowest median house price of the mainland state capitals, these incentives had the greatest financial impact.”

Nevertheless, relative prices and affordability in Adelaide suggest further moderate price growth can come through despite anticipated higher interest rates. This will be facilitated by strengthening economic conditions and South Australia gaining a greater share of overseas migration than its historical average. As a result, Adelaide's median house price is forecast to rise by 20 per cent over the three years to June 2013, an increase averaging six per cent per annum.

Perth

The Perth residential property market began to slow in 2007, well ahead of the eastern state capitals, after the median house price nearly tripled over the previous five years. This massive growth was supported by a rise in underlying demand and booming economic conditions, led by strong investment in the resources sector.

Price growth has recovered in 2009, and BIS Shrapnel's forecast median house price of \$500,000 at June 2010 represents an annual rise of 11 per cent. However, in real terms, prices will remain three per cent below their December 2007 peak.

"With prices below peak levels in real terms, and income in Perth set to grow substantially as the next round of resource expansion projects get up and running, solid price growth should continue," says Zigomanis. "Nevertheless, further increases in interest rates will prevent the boom in prices that we saw in the last upturn."

BIS Shrapnel forecasts Perth house prices to rise by 22 per cent over the three years to June 2013, representing an annual average rise of seven per cent per annum.

Hobart

Hobart's forecast median house price of \$390,000 at June 2010 represents a 16 per cent rise for the year. Price growth has been facilitated by a return of net interstate migration inflows from the mainland, which can be attributed to the 'tree change' as residents on the mainland considering retirement sell their homes to downshift to Tasmania.

"However, Hobart's median house price is getting close to the most affordable of the state capitals," says Zigomanis. "Any further significant price growth would reduce Hobart's affordability advantage and, consequently migration."

As a result, price growth is expected to be modest, particularly as Tasmania does not have significant employment drivers to underpin substantial income growth. Hobart's median house price is forecast to rise by 12 per cent over the 2009 to 2012 period, reflecting an average increase of four per cent per annum.

Canberra

Canberra's forecast median house price of \$520,000 at June 2010 reflects a 16 per cent rise for the year. Price growth in Canberra has been supported by positive sentiment from Federal Government employees, with jobs growth maintained to support the stimulus package.

"However, most of the stimulus measures are expected to end through 2010, and this will impact on employment," says Zigomanis. "In addition, the large Federal Budget deficit means employment growth is expected to be weak, as the Federal Government attempts to keep spending in check to bring the budget back into surplus."

As a result, prices are forecast to increase by a total of 14 per cent over the three years to June 2013, which reflects a rise of 4.5 per cent per annum.

Darwin

Darwin was the only capital city not to record declines in its median house price through the downturn, with strong growth in 2009. BIS Shrapnel's forecast median house price of \$570,000 at June 2010 represents a 23 per cent rise for the year. Price growth has been supported by the oil and gas sector, which did not weaken to the same extent as other commodities. In addition, expansion in defence and government administration also supported economic growth and prices.

However, the most recent price rises and interest rate increases have taken Darwin to its most unaffordable level recorded on BIS Shrapnel's measures. In addition, the boom in prices has underpinned strong investment activity and vacancy rates are starting to widen. Together, this will dampen price growth, particularly as interest rates are forecast to continue to rise. Total price growth of 12 per cent is forecast over the three years to June 2013, or an average of four per cent per annum.

About BIS Shrapnel

BIS Shrapnel is Australia's leading provider of industry research, analysis and forecasting services. BIS Shrapnel helps clients better understand the markets in which they operate, through reliable and detailed market data, analysis of developments and drivers and thoroughly researched forecasts.

BIS Shrapnel compiles accurate, clearly explained and detailed information on industry sectors, markets and industries in which their clients operate. BIS Shrapnel provides market size and segmentation data, market shares, consumer attitudes and supplier reputation information, and regularly conducts both business-to-business and consumer research.

Over the company's 46-year history, BIS Shrapnel has built up a strong level of expertise and unique methodologies for forecasting.

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