Welcome to the September 2019 edition of the Macquarie Property Insights Report, which explores current issues and trends across Australia’s property market and answers the real questions on the minds of everyone from first home buyers to seasoned property investors.

As we enter Spring selling season, property prices appear to be on an upwards trajectory, partly thanks to two consecutive cash rate cuts by the Reserve Bank of Australia (RBA) in June and July. Home buyer sentiment has also been lifted by recent changes to the way lenders assess borrowing capacity, with the Australian Prudential Regulation Authority (APRA) removing the “above 7%” threshold rate used to assess a borrower’s ability to repay their loan (with lenders now determining their own minimum thresholds).

While the RBA decided to leave the cash rate unchanged at 1% in August and September, it has acknowledged the global economic outlook remains uncertain. The Australian economy has been expanding at a slower rate than expected, with annual GDP growth of just 1.4% in the June quarter, the lowest reading in a decade. The RBA has lowered its growth forecasts and is leaving the door open for further rate cuts, anticipating more stimulus may be necessary to boost the economy.

Further rate cuts are expected to drive increased property market activity, which is already picking up quickly, at least in Sydney and Melbourne. Combined capital city auction clearance rates have surged above 70% and national dwelling prices rose 0.8% in August.

Over the following pages, we’ll unpack the details behind the headlines, with insights from our Senior Economist Justin Fabo.
Are we in a buyer’s market or seller’s market?

There are robust signs that activity in the property market is picking up. CoreLogic data show property prices in the two major capital cities have started rising sharply, with gains of 1.6% in Sydney and 1.4% in Melbourne in the month of August and further strong rises so far in September. Strong performance in these cities has lifted prices at a national level too, with month-on-month growth of 0.8% in August. [Figure 1]

<table>
<thead>
<tr>
<th></th>
<th>Median dwelling price</th>
<th>Change in dwelling values (as at 31 August)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sydney</td>
<td>$790,072</td>
<td>1.6%</td>
</tr>
<tr>
<td>Melbourne</td>
<td>$626,703</td>
<td>1.4%</td>
</tr>
<tr>
<td>Australia</td>
<td>$521,157</td>
<td>0.8%</td>
</tr>
</tbody>
</table>

Source: CoreLogic RPData

“We’re at a point in the cycle where there’s a bit for everyone. Prices in Sydney and Melbourne are still well off their respective peaks, so housing has become more affordable for buyers in those cities,” says Fabo.

Prices in the two major capital cities have been hard hit in recent years. In Sydney, dwelling values plunged around 15%, peak to trough. Melbourne prices proved more resilient but dropped close to 11% following the peak in August 2017.

Sentiment indicators, such as the Westpac-Melbourne Institute’s “Time to buy a dwelling” index, show consumer perceptions of value in the housing market have been trending higher over the two years dwelling prices have been falling. These trend lines, which often move in opposite directions, may intersect in the coming months if dwelling prices continue to climb. [Figure 2]

Assessing the current state of the market, Fabo remarks on the lack of supply, or new listings, which is typical following a period where prices have fallen. He expects more properties will come onto the market in the coming months, commensurate with a rise in auction clearance rates and house prices. [Figure 3]
“Typically, there’s a lag of about six months when clearance rates rise. After clearance rates lift, more stock tends to come on the market, in reaction to higher clearance rates and, subsequently, higher prices. In fact, broader turnover – including sales outside of auction – has been lifting for several months.”

“Auction clearance rates would suggest that if you’re selling a property, it’s likely to be snapped up, unless there’s something wrong with it. I’m not going to say it’s a buyer’s market, it’s not seller’s market; there’s opportunity on both sides at the moment,” Fabo says. [Figure 4]
Are auction clearance rates likely to fall if more properties come onto the market?

There’s been a lot of conjecture recently about whether auction clearance rates are an accurate indicator of near-term upward momentum in dwelling prices. Some market watchers are hesitant to call a trend, citing “low” auction volumes. The theory goes that as auction volumes increase, clearance rates might dip lower (as supply outstrips demand).

“We think this view is completely misplaced” says Fabo.

“Auction volumes are typically “low” in the winter months but it’s also a factor that volumes only seem low when compared with a period of very strong established housing turn over between 2013 and 2017”.

History shows auction volumes lag clearance rates, suggesting that we will see a pick-up in auction volumes in the coming months.

History also shows that it’s rarely the case that an increase in auction volumes is commensurate with a dip in house prices.

“Rising dwelling prices are likely to encourage more buyers into the market, as they become more confident that they cannot benefit from waiting for prices to fall further. It’s our sense that will be the case this time around”.
How are the other property markets around Australia faring?

Outside of Sydney and Melbourne, most capital cities are still experiencing weak property markets.

“Typically, what happens when Sydney and Melbourne markets experience price growth, the other capital city markets react with a lag,” says Fabo.

Darwin has been the worst-affected capital city since prices started falling. They’re currently about 30% down on the May 2014 peak and 1.7% lower than they were three months ago. [Figure 5]

<table>
<thead>
<tr>
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<tr>
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<td>$790,072</td>
</tr>
<tr>
<td>Melbourne</td>
<td>$626,703</td>
</tr>
<tr>
<td>Brisbane</td>
<td>$485,493</td>
</tr>
<tr>
<td>Adelaide</td>
<td>$428,203</td>
</tr>
<tr>
<td>Perth</td>
<td>$437,558</td>
</tr>
<tr>
<td>Hobart</td>
<td>$465,535</td>
</tr>
<tr>
<td>Darwin</td>
<td>$388,232</td>
</tr>
<tr>
<td>Canberra</td>
<td>$592,870</td>
</tr>
<tr>
<td>Australia</td>
<td>$521,157</td>
</tr>
</tbody>
</table>

Source: CoreLogic RPData

In Brisbane, there are signs prices have flattened out, with values rising 0.2% in the month of August.

“It’s been somewhat of a two-speed market in Brisbane in the last few years. Detached housing prices have done well, but unit prices have been weak for a decade,” Fabo explains. [Figure 6]

Adelaide has been one of the capital cities least affected by the decline in property prices, down only 1.5% since the peak in December 2018.

“Perth is still well off the peaks of several years ago. But the rate of decline has slowed in recent months,” says Fabo.

Prices in the mining-related capital hit a high in June 2014 and have declined more than 20% since then. Dwelling prices are down 1.8% for the quarter.

Hobart has been mostly immune to the declines experienced around the country. Dwelling values rose 0.5% in August and are up 3.1% on year. Hobart dwelling prices are now higher than Perth.
“Typically, when Sydney and Melbourne markets experience price growth, other capital city markets react with a lag.”
What impact have RBA cash rate reductions had on the property cycle?

Interest rates have fallen by 0.5% since the start of 2019, following consecutive interest rate cuts in June and July. Lenders have subsequently passed on about 40 basis points of the cuts, on average, to mortgage holders.

“We believe these interest rate cuts are the single greatest factor behind the turnaround in confidence and activity in the housing market. Rate cuts usually impact Sydney and Melbourne the most, and that’s what we’re seeing,” says Fabo. [Figure 7]

![Figure 7. Dwelling Price Growth and RBA Rate Cuts](image)

Source: CoreLogic RPData, RBA, Macquarie Macro Strategy

“As for the potential for further reductions to the cash rate and their likely impact on the market, our core view is interest rates have further to fall,” he adds.

The global backdrop indicates risks on the horizon, with the trade war between the US and China likely to cloud global growth for an extended period. Australia’s economic outlook is also precarious, with the RBA watching the labour market closely.

“We have two 25 basis point cuts pencilled in for October and November, but the risks are building that the RBA will take longer to deliver monetary policy stimulus and might look to their global counterparts to set the pace,” says Fabo. [Figure 8]

![Figure 8. RBA Cash Rate Expectations](image)

Source: RBA, Bloomberg, Macquarie Macro Strategy
“It’s possible that less of any future rate cuts may be passed onto borrowers, too. Mortgage rates are now very low by historical standards.” [Figure 9]

Figure 9. Dwelling Prices & Mortgage Rate*

*Average of bank discounted rate and mortgage manager basic rate.

Source: CoreLogic RPData, RBA, APRA, Macquarie Macro Strategy

It would take a surprise turnaround in global growth or a decline in the unemployment rate for the RBA to sit on its hands for the remainder of this year.

Macquarie thinks there is the risk of a modest increase in the unemployment rate in the coming months and near-term declines appear unlikely. This supports the case for rates to fall to a low of 0.5% by next year, given reasonable spare capacity remains in the labour market.

Aside from rate cuts, quantitative easing is also a theme to watch. RBA Governor Philip Lowe has said he doesn’t expect the cash rate to fall to 0% or to have to use the unconventional monetary policies other nations have had to resort to. However, these eventualities cannot be ruled out.

“Mortgage rates are now very low by historical standards.”
What’s the industry appetite for lending and what impact is this having on the property cycle?

The latest housing finance data is providing further evidence of a changing market, with the value of new loans issued to households surging 3.9% in July. The result was largely driven by demand from owner occupiers (excluding refinancers), who were responsible for a 5.3% lift in borrowing – the strongest read since mid-2015. [Figure 10]

Six months ago, institutions like the RBA said credit growth had weakened less because banks were less willing to lend but more because borrowers were less inclined to borrow,” says Fabo.

The slowdown in credit growth had been largely driven by a fall in investment lending, which is down 24% on year and has halved relative to its 2015 peak. Investor demand has softened in every state and territory and is only just starting to show signs of life, despite APRA’s removal of caps on investor and interest only lending in December last year.

Lending to investors rose 4.7% in July, but investors’ share of total housing loans edged lower, due to stronger demand from owner occupiers.

“Normally when price growth starts to pick up - with a bit of a lag - so too does investor activity. Anecdotal evidence also appears to point to a pick-up in investor demand, particularly at auctions in Sydney and Melbourne,” says Fabo. [Figure 11]

Fabo expects APRA’s recent changes to its serviceability buffer, which allows lenders to set their own interest rate floor using a buffer of 2.5% above the lending rate, will result in higher borrowing capacity for many borrowers.

“It’s important to remember that most people don’t borrow the maximum amount anyway,” says Fabo.

Only around 10-15% of newly indebted owner-occupiers borrow close to the maximum loan size permitted.
What’s the near-term outlook for property prices?

Affordability in Sydney and Melbourne has improved over the past two years, thanks to a combination of double-digit price declines and lower interest rates. This is expected to set the scene for near-term price growth.

Dwelling prices in Sydney and Melbourne are already growing at a rate of more than 1% a month. The question is whether this sharp turn around will translate into sustained rapid growth over the longer term.

“If auction clearance rates maintain the levels we’ve seen, we would expect the pace of price growth to continue at about a per cent a month, which would translate into 12% growth over the next year. That’s fast, but it’s not out of the question, given the outlook for interest rates and the change we’ve seen already in sentiment,” says Fabo.

Macquarie’s view is still that national house prices will rise at least 5% by the end of 2020, supported by growth of around 10% in Sydney and Melbourne, however Fabo acknowledges this is not the consensus view.

“Other observers are expecting the tighter lending standards and a few other factors to dull the impact of lower rates.”

It’s also too early to predict how the RBA might react to increased activity in the property market.

“The RBA’s mindset at the moment is that they don’t expect credit growth, or household debt growth, to cause many problems in the year ahead. But historically, wherever house prices have gone, credit’s gone,” says Fabo.

“For now, the RBA is much more worried about the global downside risks than potential overheating in the housing market,” adds Fabo.
How has housing affordability changed over recent years?

Economists typically look at two measures when assessing housing affordability. The first is deposit affordability, which gauges the hurdle first home buyers have to overcome to get into the property market in the first place. The second is repayment affordability, which measures the cost of servicing a home loan.

**Deposit affordability**

The deposit “hurdle” for home buyers in Australia has risen over time. Most first home buyers need a deposit of between 10% and 20% of the property’s value to get into the market. In the years leading up to the house price peak, saving enough to put a down payment on a property became increasingly difficult because the house price-to-income ratio climbed substantially. [Figure 12]

**Repayment affordability**

Repayment affordability is closely connected to interest rates and assesses the share of average household income needed to meet repayments on a “typical” mortgage. 1

Mortgage repayment affordability has improved over the past two years, thanks to falling dwelling prices and lower interest rates. [Figure 13]

**Figure 12: Deposit Affordability - Australia**

<table>
<thead>
<tr>
<th>%</th>
<th>20% of the dwelling price-to-income ratio</th>
<th>Mean dwelling price as a ratio to mean household disposable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>81</td>
<td>86</td>
<td>91</td>
</tr>
<tr>
<td>20</td>
<td>30</td>
<td>40</td>
</tr>
</tbody>
</table>

Source: ABS, CoreLogic RPData, RBA, Macquarie Macro Strategy

Since mid-2017, however, an 8% decline in national housing prices and some income growth has seen deposit affordability improve.

“Even with the drop off in housing prices, the ratio of dwelling prices to household income is still around 2.5 times higher than it was in the early 1980s,” says Fabo.

One caveat to this is that the percentage required for a typical home deposit has changed over time.

“While a 20% deposit was commonplace in the past, smaller percentage deposits have become more prevalent,” says Fabo.

**Figure 13: Mortgage Servicing Cost*: Australia**

<table>
<thead>
<tr>
<th>%</th>
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Source: ABS, CoreLogic RPData, RBA, Macquarie Macro Strategy

“Our nationwide estimates show that mortgage servicing costs relative to income have fallen below long-run averages,” says Fabo.

Increased competition in Australia’s lending market since the mid-1990s has changed the way economists calculate repayment affordability. Fabo uses an average of discounted variable rates.

“Banks’ standard variable owner occupier mortgage rate has become less appropriate over time, as most borrowers now pay less than the advertised rate,” says Fabo.

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1 Macquarie estimates repayments on a typical variable-rate owner-occupier home loan with principal and interest repayments, and assumes a 25-year loan term and a loan-to-valuation ratio (LVR) of 75%.
“Since mid-2017, a decline in national housing prices and some income growth has seen deposit affordability improve.”
Two interest rate cuts appear to have prompted a substantial and positive turnaround in the property market, with prices now rising at a rapid pace in Sydney and Melbourne. Other capital cities around the country are yet to register notable gains, but this typically happens with a lag to the “global” cities.

In summary

The increase in auction clearance rates and dwelling prices suggest that auction volumes and new home listings will improve. Economists expect the RBA will make two further cuts to the cash rate, possibly in coming months, and this should help support relatively strong momentum in established housing markets.

Bank appetite for lending has been helped by the banking regulator’s removal of investor lending restrictions and serviceability buffer changes, while new housing finance data shows increased borrowing across all home buyer categories.

The overall outlook for the property market has strengthened considerably, but it’s important to also take into consideration factors that could cause this to change. Relatively weak domestic economic growth, teamed with uncertainties around the global outlook, are key risks to the future direction of the property market.