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ANALYSIS

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CoreLogic-Moody's Analytics Australian Home Value Index Forecast, 2017Q1

Introduction

» Australia's regional housing markets remain divergent but are expected to cool from 2018 onwards. Detached housing values across the capital cities are forecast to increase 5.6% in 2017.

» Sydney's strong local economy is boosting housing activity, but this will slow in 2017. Detached housing values are expected to increase around 7.2% in 2017, after a 10.9% gain in 2016. Apartment values are forecast to grow 7.5%, after a 10% increase in 2016.

» Slower growth in apartment values in Melbourne relative to detached houses suggests buyers are already pricing in expected supply. Detached housing values in Melbourne are forecast to grow 7% in 2017 after an 11.3% increase in 2016, and apartment values are forecast to grow 3.4%, after a 4.6% increase in 2016.

» Perth's housing market is showing signs that the worst is behind, and value gains could be seen in 2017. We forecast a 2.8% gain in detached housing values for 2017, after a 4.1% decline in 2016.

» Valuations in Brisbane, Hobart and Adelaide are improving, helped partly by better employment conditions. We forecast 3.3% growth in detached housing values for Brisbane this year, a 9.2% growth in Hobart and a 0.9% increase in Adelaide.

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BY ALAISTAIR CHAN, FARAZ SYED AND EMILY DABBS

- Australia's regional housing markets remain divergent but are expected to cool from 2018 onwards. Detached housing values across the capital cities are forecast to increase 5.6% in 2017.
- Sydney's strong local economy is boosting housing activity, but this will slow in 2017. Detached housing values are expected to increase around 7.2% in 2017, after a 10.9% gain in 2016. Apartment values are forecast to grow 7.5%, after a 10% increase in 2016.
- Slower growth in apartment values in Melbourne relative to detached houses suggests buyers are already pricing in expected supply. Detached housing values in Melbourne are forecast to grow 7% in 2017 after an 11.3% increase in 2016, and apartment values are forecast to grow 3.4%, after a 4.6% increase in 2016.
- Perth's housing market is showing signs that the worst is behind, and value gains could be seen in 2017. We forecast a 2.8% gain in detached housing values for 2017, after a 4.1% decline in 2016.
- Valuations in Brisbane, Hobart and Adelaide are improving, helped partly by better employment conditions. We forecast 3.3% growth in detached housing values for Brisbane this year, a 9.2% growth in Hobart and a 0.9% increase in Adelaide.

Australia's economic expansion in 2017 is set to overtake the Netherlands' 26-year global record, but a potential housing market slowdown, uncertainties around global trade, and a shift towards part-time employment are dampening the outlook.

Australia started 2016 in the midst of a transition away from mining investment. Investment in mining production steadily declined to below 40% of its 2014 peak as major projects neared completion, while the hoped-for boost from higher commodity exports remained uncertain because of China's slowdown (see Chart 1).

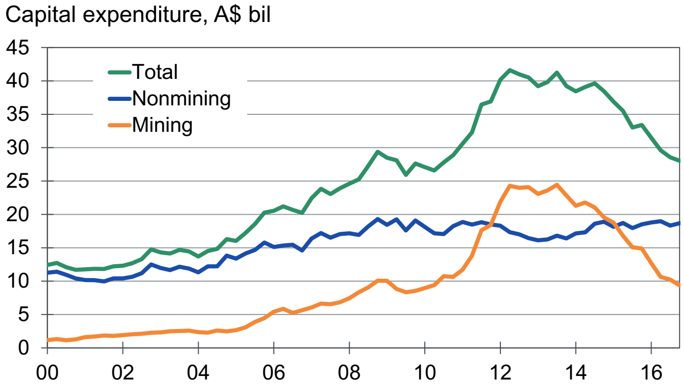
However, conditions brightened as the year progressed. China's steady economic situation in 2016 drove Australia's exports higher and helped backstop the economy, especially in the resource-heavy states. The Reserve Bank of Australia's Commodity Price Index (nonrural bulk commodities) rebounded 84% in 2016 after falling to an eight-year low in December 2015 (see Chart 2).

Moreover, a number of Australian mines reopened as a result of higher prices. Growing exports pushed the merchandise trade balance back into surplus in November and then to a record high in December. The shrinking current account deficit is forecast to turn—for the first time since the 1970s—to surplus in 2017.

A robust housing market ameliorated the effects of the uncertain transition away from mining. Dwelling prices nationwide rose 7.9% in 2016 and are expected to increase an ad-

Chart 1: Mining Investment Still Falling

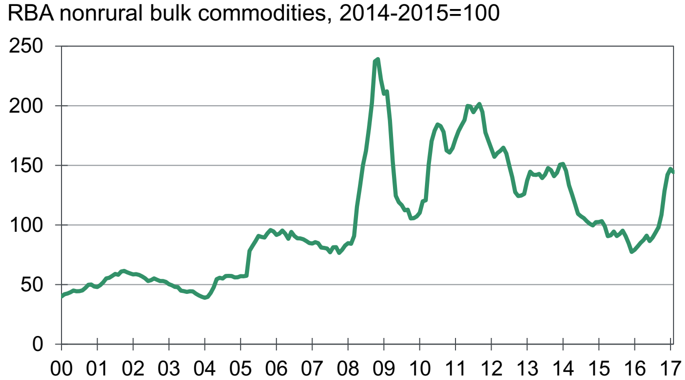
Capital expenditure, A$ bil



Sources: Australia Bureau of Statistics, Moody's Analytics

Chart 2: Commodity Prices Rebound

RBA nonrural bulk commodities, 2014-2015=100



Sources: Australia Bureau of Statistics, Moody's Analytics ditional 5.6% in 2017. Sydney and Melbourne are leading the market thanks to their stable local economies, although a large number of apartments completed in those cities could create oversupply issues (see Chart 3). Growth in mining exports should support a housing recovery in Perth and Darwin.

Housing market strength is prompting the RBA, which lowered the overnight cash rate by 50 basis points in 2016, to keep rates steady. Although the official monetary policy rate will remain on hold, this does not mean that mortgage rates will also stay low. The major banks have increased lending rates out of step with the central bank. Some of this action is being driven by regulatory tightening and will encourage a slowdown in market activity this year and next.

Assessing our model's performance

Moody's Analytics began forecasting CoreLogic's Home Value Indexes at the start of 2016. Having established a year of forecasts, we can now examine how they performed. Table 1 lists the forecasts for 2016, as generated at the beginning of the year, along with the actual results and the percentage-point difference.

Overall, our model was quite successful in estimating house price movements across Australia. Our forecasts for the Australian Capital Territory, Brisbane, Hobart and the rest of the state regions (the rest of South Australia excepted) performed very well. Those for Adelaide, Melbourne, Perth, and the rest of South Australia did moderately well, but there is room for improvement.

The big miss was that our forecast for Sydney was much too pessimistic. Our model forecast dwelling values to grow 2.2% for 2016; in reality, they grew 10.7%. This outcome stemmed partly from a recalibration of the parameters used by CoreLogic to calculate historical data; Sydney home values rose 2.4% in April and 3.1% in May.

Sydney has Australia's biggest housing market; it therefore has the biggest impact on the national index and so caused our national eight-city forecast to undershoot. However, after excluding Sydney, our forecasts outperform both a 'naive' forecast using the 2015 growth rates and a forecast using a 20-year average.

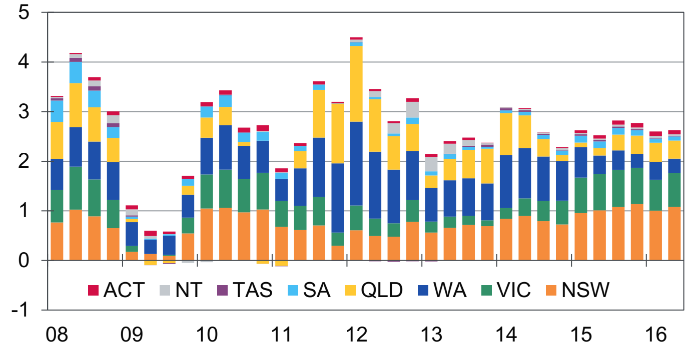
Overall, the assessment gives us reason to believe that our approach using macroeconomic forecasts is valid.

Divergence drives performance

Economic outcomes across Australia's states and territories are expected to remain divergent in 2017, and this will be key to their

Chart 3: Nonmining States Anchor Economy

State contribution to GDP growth, %



Sources: Australian Bureau of Statistics, Moody's Analytics

Table 1: Forecast Accuracy for 2016

Growth in total dwelling values, % change yr ago

Region	Forecast*	Final result	Difference between final and forecast	Difference between final and 2015 result	Difference between final and 20-yr average
ACT	5.3	6.3	1.1	4.2	0.7
Adelaide	0.3	3.5	3.2	1.2	3.2
Brisbane	4.2	4.5	0.3	0.7	2.5
Darwin	-1.7	-2.9	1.2	0.4	10.1
Hobart	6.6	6.0	0.6	5.0	0.7
Melbourne	7.2	10.6	3.4	0.7	1.8
Perth	-0.0	-4.0	4.0	3.1	11.6
Sydney	2.2	10.7	8.5	4.2	3.1
Rest of New South Wales	5.9	6.1	0.3	1.2	0.7
Rest of Queensland	1.7	0.8	0.9	1.2	5.6
Rest of South Australia	5.6	0.7	4.8	0.5	4.3
Rest of Victoria	2.1	2.4	0.3	0.2	4.4
Rest of Western Australia	-6.9	-7.1	0.2	4.5	15.4
Average difference			2.2	2.1	4.9
Average difference (ex Sydney)			1.7	1.9	5.1

* Forecast as given in 2016Q1 report

Sources: CoreLogic, Moody's Analytics

Table 2: Hedonic HVI Forecasts – Detached Houses

% change yr ago

Region	2017Q1	2016	2017	2018	2019	2020
National	10.3	7.9	5.6	-0.6	-0.3	-0.0
ACT	7.3	6.3	4.3	1.0	1.2	1.6
Adelaide	3.3	3.7	0.9	0.5	0.9	1.1
Brisbane	4.4	4.9	3.3	1.2	1.3	1.5
Darwin	-3.5	-3.3	-1.3	0.5	0.4	0.3
Hobart	8.0	5.6	9.2	1.8	1.1	1.4
Melbourne	12.9	11.3	7.0	-1.8	-1.0	-0.5
Perth	-0.9	-4.1	2.8	1.4	0.8	0.8
Sydney	15.9	10.9	7.2	-1.4	-0.9	-0.3
Rest of New South Wales	7.3	6.1	4.9	1.4	1.1	1.0
Rest of Queensland	1.9	0.8	1.7	1.3	1.0	0.9
Rest of South Australia	3.1	0.7	3.0	1.2	0.9	0.8
Rest of Victoria	1.0	2.4	0.9	1.4	1.1	1.0
Rest of Western Australia	-9.5	-7.1	-6.5	0.9	0.9	0.8

Sources: CoreLogic, Moody's Analytics

Table 3: Hedonic HVI Forecasts – Apartments

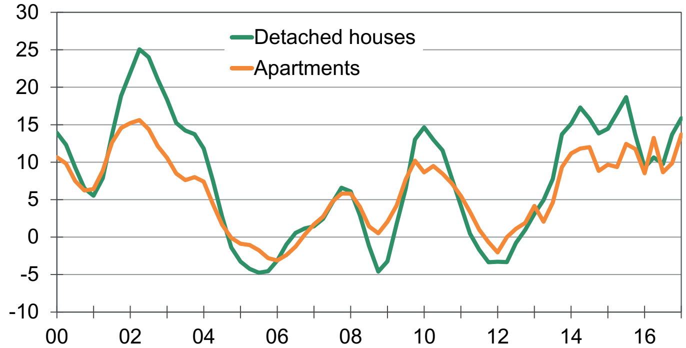
% change yr ago

Region	2017Q1	2016	2017	2018	2019	2020
National	8.5	6.8	5.4	0.0	0.3	0.4
ACT	5.6	0.8	5.3	0.9	1.1	1.3
Adelaide	0.4	2.0	-0.1	0.5	0.7	0.7
Brisbane	-1.5	1.1	-0.0	1.1	1.3	1.3
Darwin	3.2	-1.3	1.0	-0.8	0.4	0.3
Hobart	1.9	10.6	-0.9	-0.4	-0.1	0.1
Melbourne	3.6	4.6	3.4	1.0	1.2	1.0
Perth	-0.2	-3.3	5.6	1.4	0.8	0.8
Sydney	13.7	10.0	7.5	-1.2	-0.7	-0.4

Sources: CoreLogic, Moody's Analytics

Chart 4: Sydney Has Seen Strong Growth…

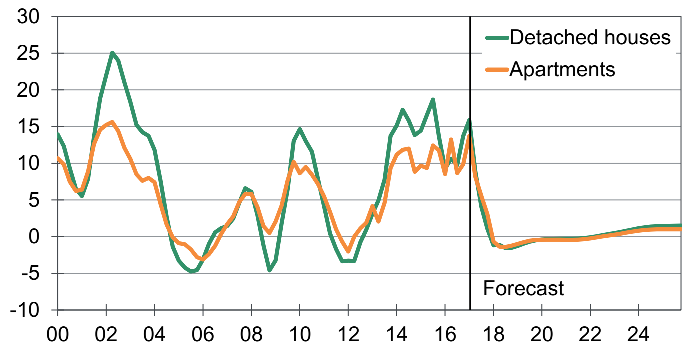
Hedonic Home Value Index, % change yr ago



Sources: CoreLogic, Moody's Analytics

Chart 5: …But Faces Slower Growth Ahead

Hedonic Home Value Index



Sources: CoreLogic, Moody's Analytics

respective housing markets. Dwelling values nationwide are forecast to rise 5.6% this year, a slight slowdown from 7.9% in 2016. However, we expect home values to cool from 2018 onwards, especially in regions where prices have accelerated sharply over the past four years (see Tables 2 and 3).

New South Wales performed solidly through 2016, with state final demand outpacing that of most of the other states and territories. Output grew 4.7% over the year and has contracted only once in the past nine quarters. Unemployment is among the lowest nationally, averaging 5.1% in 2016, and wage growth has remained above 2% year on year.

However, signs of weakness in the labour market have emerged, as job growth has been driven by part-time positions. In 2016, New South Wales lost around 67,000 full-time positions. Stronger business sentiment should help boost full-time employment in 2017, supporting wage growth and spending.

For Sydney, the strengthening local economy has been the key driver of real estate demand. The labor market is approaching full employment, with a jobless rate of 4.7 at the end of 2016. Furthermore, rents have stabilised after a drop in the first half of 2016; Sydney's rental prices grew 1% over the month in January. Overall, detached-home and apartment prices in the city are expected to increase 7.2% and 7.5% in 2017 respectively (see Chart 4).

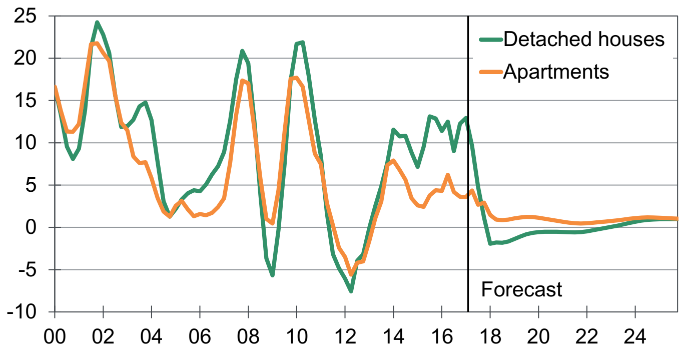
But prices are set for a minor correction. Detached-home values are expected to decline 1.4% in 2018, while apartment prices will likely fall 1.2%. Although we do not expect a steep decline in prices, Sydney's property market will likely stagnate through to 2020 as interest rates begin to normalize (see Chart 5).

The degree of correction will likely be uniform across apartments and detached houses. Although the stream of oncoming apartment supply has accelerated—more than 150,000 apartments have been approved compared with 70,000 detached houses being approved—unit prices have grown more slowly than detached-home values. From 2013 to the end of 2016, apartment values have risen 46%, but those for detached homes have jumped 67%.

Victoria is also growing steadily, albeit to a lesser degree than New South Wales. State final demand grew 3.1% q/q in 2016, hurt by the September quarter's 0.4% q/q decline. Increased rainfall in the September quarter contributed to the poor performance, as construction work was delayed, but a steady rebound occurred in the final quarter.

Chart 6: Slowdown Coming in Melbourne

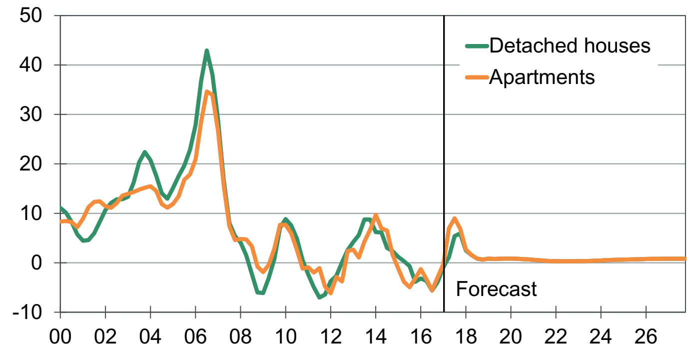
Hedonic Home Value Index



Sources: CoreLogic, Moody's Analytics

Chart 7: Perth's Market Remains Flat

Hedonic Home Value Index



Sources: CoreLogic, Moody's Analytics

Employment growth was strong in the state in 2016, growing 4% y/y in December and adding around 68,000 full-time positions over the year. However, this outcome was offset by higher participation, which pushed the unemployment rate up to an average 5.8% in 2016.

At the same time, a number of manufacturing closures announced for 2017 may hurt the strong labour market and limit growth in 2017.

Melbourne's property market will ease in 2018. But contrary to popular belief, the correction will likely be more severe in detached housing than apartments. Although the rise of housing supply has been more prolific in apartments—for every house, 1.23 apartments were approved between 2013 and the end of 2016—detached-home values have grown significantly more than unit values. House values in the city have increased 47% over the past four years, while apartment values have risen a relatively muted 23%.

Home values in Melbourne remain buoyant; prices rose 12.8% from January 2016 to January 2017. However, unit prices rose 2.8% during the same period. This situation suggests that the coming supply of apartments has already dampened value growth. Apartment values will rise 3.4% in 2017, and a period of stagnation will follow through to 2020. Detached-home values are expected to rise 7% in 2017, followed by a steady decline through to 2020 (see Chart 6).

Western Australia has been hit hard by the mining downturn, with state final demand declining for the five consecutive quarters to September 2016 before slightly rebounding in December. The weak conditions also pushed up the unemployment rate to a peak of 6.9% in November 2016, and the housing market has slumped, with Perth prices declining 4.3% in 2016.

Financial stress has increased in the state, including bankruptcies rising by more than 20% y/y in 2016. Conditions are likely to improve mildly in 2017 as the drag from mining slows.

The downturn in mining investment continues to weigh on Perth's housing market, but the recent rally in key commodity prices suggests that the fall is over. However, Perth's housing market is unlikely to rebound sharply because commodity prices will remain well below the levels experienced during the boom in 2011.

Perth's housing market is showing signs that the worst is behind. Over the year, the decline in total values across Perth slowed to 3.2% in January compared with the 7% falls in the second half of 2016. The trough has likely been reached in the rental market, as rents have stopped declining since late 2016 and have stabilised (see Chart 7).

Detached-dwelling prices in Perth are forecast to rise 2.8% this year after a 4.1% fall in 2016. Apartment values are expected to rise 5.6 % following a 3.3% decline last year. The recovery will continue through 2019 thanks to slower supply growth; building approvals peaked in mid-2014 and have since fallen 48%.

Queensland ended 2016 on a stronger note, but the slow start to 2017 resulted in one of the weakest rates of growth across Australia: just 0.4% in 2016. The biggest drag on economic activity is the slump in private investment, driven in part by the slowdown in mining activity. This development has also pushed up the unemployment rate, which at 6.2% is higher than the national average. The outlook is more upbeat, as rising tourism and higher coal prices should support economic activity and filter through to stronger employment outcomes.

After a strong showing in 2016, Brisbane's property market will cool in 2017 and 2018. The mining slowdown continues to weigh on job growth, and unemployment in the city's local economy is expected to remain elevated at around 6% in 2017.

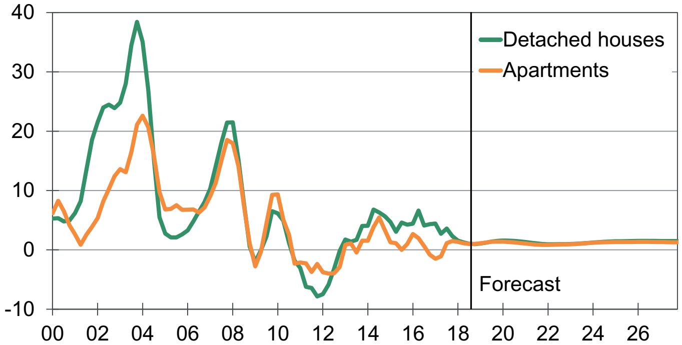
Apartment values are set to slow more sharply than detached-home values. The slight divergence stems from the prominent increase in incoming housing supply. Historically, for each apartment approved, 1.96 houses were approved. However, since 2012, the trend has reversed sharply, and there were 1.3 units approved for each house.

Consequently, detached-home values will likely rise 3.3% in 2017 and a further 1.2% in 2018. The oncoming supply from 2016 will cause apartment prices to remain flat in 2017. The Brisbane property market will likely recover from 2018 onwards, supported by population growth (see Chart 8).

South Australia has one of the highest unemployment rates because of weak manufacturing activity, averaging 6.8% in 2016. This situation has depressed state final demand, which grew just 1.3% in 2016.

Chart 8: Brisbane's Steady Growth

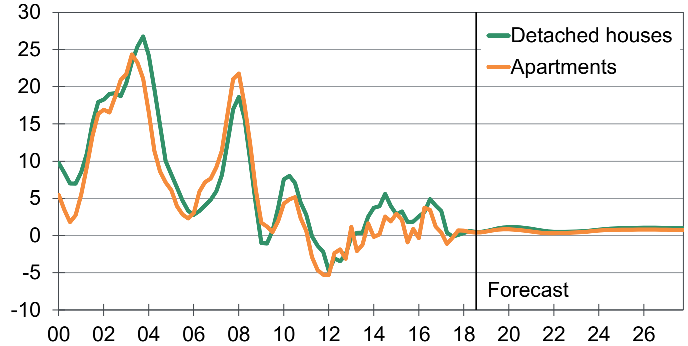
Hedonic Home Value Index



Sources: CoreLogic, Moody's Analytics

Chart 9: Adelaide's Flat Housing Market

Hedonic Home Value Index



Sources: CoreLogic, Moody's Analytics

Exports have been a bright spot, supporting growth through much of 2016. But this situation is unlikely to continue in the early part of 2017, as severe weather over the summer has hurt the production and shipment of agricultural products.

Adelaide's housing market has remained dormant relative to that of the rest of the country. Detached-home values have risen only 12% since 2013, while apartment values have increased a slight 2.3%. South Australia's uneven economic momentum can be attributed to the cool state of Adelaide's market.

Unemployment of 7% in greater Adelaide is well above the national average, although it has trended down from 7.8% in late 2015. Detached-home values are forecast to remain relatively flat, rising 0.9% in 2017 and 0.5% in 2018. Apartment values are expected to decline a little, by 0.1% in 2017, with a mild recovery of 0.5% in 2018 (see Chart 9).

Population growth in Tasmania has picked up, driven in part by stronger interstate inflows. This is helping to boost demand for services and tourism, supporting employment growth and pushing up house prices as demand grows.

State final demand was relatively upbeat at 2.3% in 2016. However, the higher participation rate also pushed up the unemployment rate to a peak of 7.2% in August before it trended down in the final months of the year. Plans to relocate a major university campus should boost construction activity in 2017.

Hobart's property market has gained traction this year as wage growth accelerated and the unemployment rate trended lower. Aided by a lower Australian dollar, tourism has buttressed the local economy. Home values are expected to rise 9.2% in 2017 and 1.8% in 2018. However, apartments will likely fall 0.9% in 2017.

The Northern Territory, like its mining counterpart Western Australia, is struggling with the industry downturn. State final demand contracted 3.8% in 2016, driven mostly by slumping private investment. Adding to the state's difficulties is a rapidly ageing population which reduces the working-age population, meaning the average unemployment rate of 3.8% in 2016 obscures issues in the labour market. The outlook remains downbeat, as the rise in commodity prices is unlikely to boost investment activity.

Mining has weighed on Darwin's property market, where values have fallen 11% from their peak in 2014. However, price growth across detached houses and units is set to diverge in 2017. Detached-home values will likely fall 1.3% this year, while apartment values are set to increase by 1%.

The recent rebound in commodity prices will support incomes over the short term. Apartment values rose in the four consecutive months to January, with growth over the previous year averaging around 8.2%. Meanwhile, detached-home values fell for 23 consecutive months. The trough for home values will likely be reached at the end of this year, but overall mining investment will remain sluggish, so Darwin's property market—both apartments and detached houses—is unlikely to rise sharply over the coming years.

A recovery in Canberra is boosting demand in the housing market, although a high level of supply is dampening prices in the apartment market. Rents in Canberra fell 16% from late 2012 to mid-2014 but have recovered 9.8% from that point.

Continued demand for detached housing will enable prices to rise 4.3% in 2017, slightly lower than the 6.3% in 2016. However, apartment prices, which rose 0.8% in 2016, are forecast to strengthen to 5.3% this year because relatively low supply is boosting valuations.

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