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CoreLogic-Moody's Analytics Australia Home Value Index Forecast, 2016Q2

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Introduction

Momentum in Australia's housing market has been sustained through the second quarter. The CoreLogic Home Value Index rose 1.7% in May after a similar gain in April.

Price growth in Melbourne and Sydney, after a period of deceleration, picked up again in April and May, and signs of a recovery are evident in Brisbane and Perth. However, the markets in Adelaide and Darwin are sluggish and are expected to underperform.

The Reserve Bank of Australia's May interest rate cut will provide a small fillip to house value growth, as will a further cut in the cash rate that Moody's Analytics expects to occur in the second half of 2016.

House values nationwide are expected to rise 6% this year and 4.1% in 2017. Much of this rise will be driven by continued gains in Sydney, where values are forecast to rise 7.3% this year, or about half the 14.9% rise in 2015. Meanwhile, Melbourne's market is nearing a peak and could be entering a slump because of high incoming supply.

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BY ALAISTAIR CHAN AND FARAZ SYED

- Activity in Australia's housing market remains robust on a national basis, and Moody's Analytics expects values nationwide to rise 6% this year and 4.1% in 2017.
- Momentum in Australia's housing market has been sustained through the second quarter.
- Sydney's housing market is on a renewed upward trend, while Melbourne's market is forecast to be close to a peak.
- The rate of decline across Perth's housing market is easing, and values are forecast to grow modestly in the third quarter of 2016.
- Brisbane's improving job market is lifting house values.
- Slower income growth in Adelaide continues to weigh on house value growth. Falling rents in Darwin are similarly cooling the market there.

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Table 1: Hedonic HVI Forecasts

% change yr ago

Region	2016Q2	2015	2016	2017
National	7.2	9.1	6.1	4.1
ACT	3.4	1.9	4.1	3.1
Adelaide	3.6	2.4	5.0	5.1
Brisbane	6.2	3.8	5.8	6.1
Darwin	-2.8	-2.5	-0.7	2.9
Hobart	2.3	1.0	4.3	3.3
Melbourne	10.4	9.9	7.1	-0.2
Perth	-1.7	-0.9	-0.1	4.1
Sydney	8.4	14.9	7.3	6.7
Rest of New South Wales	4.6	7.3	4.2	4.2
Rest of Queensland	0.4	1.9	0.4	1.3
Rest of South Australia	-1.3	-0.2	-1.5	0.2
Rest of Victoria	0.9	2.2	0.3	-1.0
Rest of Western Australia	-6.2	-2.4	-4.2	0.5

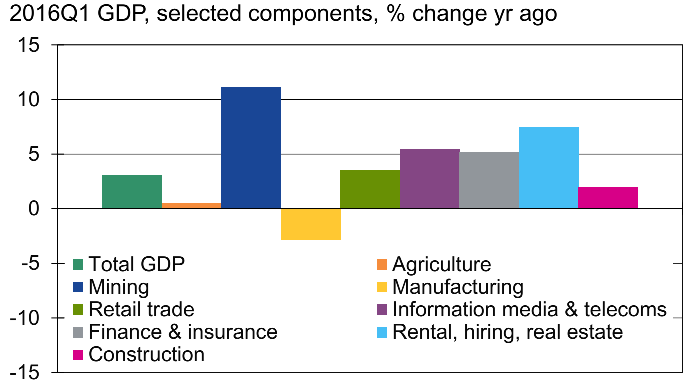
Source: Moody's Analytics

Support from low interest rates

Australia's mining sector continues its transition away from investment, which has fallen 46% from its peak in 2013, and towards production and exports. The fall in mining investment continues to constrain overall economic growth, despite healthy activity in many nonmining sectors, especially rental, hiring and real estate activity, information media and telecoms, and finance and insurance (see Chart 1).

Chart 1: Mining and Real Estate Drive Growth

2016Q1 GDP, selected components, % change yr ago



Sources: Australian Bureau of Statistics, Moody's Analytics

The drop in mining expenditure has pushed total capital expenditure down by 24% from 2013 levels. Business conditions are unfavorable, and corporate profits fell 4.7% in the first quarter of 2016, with those for nonmining companies falling 3.1%. Wage growth is also slowing; at just 0.4% in the first quarter, total hourly wages are rising at their slowest pace since the Australian Bureau of Statistics began reporting the series in 1997 (see Chart 2).

Job growth has also slowed; only 37,200 jobs were added in the first four months of 2016, compared with 77,500 in the December quarter of 2015. That situation, coupled with a drop in headline inflation to just 0.2% in the first quarter, prompted the RBA to resume its easing cycle in May after a yearlong hiatus, pushing the cash rate down to 1.75%.

This development can be seen in the first quarter GDP results, which show strong export growth and steady household spending. Despite that, the prevalence of lower prices through the economy and falling business investment meant that nominal GDP—a useful summation of aggregate economic conditions—grew just 2.1%.

The current accommodative monetary policy will continue through 2016, before policy normalisation begins in late 2017. Although Moody's Analytics generally expects another 25-basis point cut in the cash rate in the second half of this year, emerging signs of a recovery may prompt the RBA to stay its hand.

Business sentiment is recovering: The NAB survey of business conditions surged in March, reaching its highest level since February 2008. The lower Australian dollar is likely to be playing a big part in the export rise.

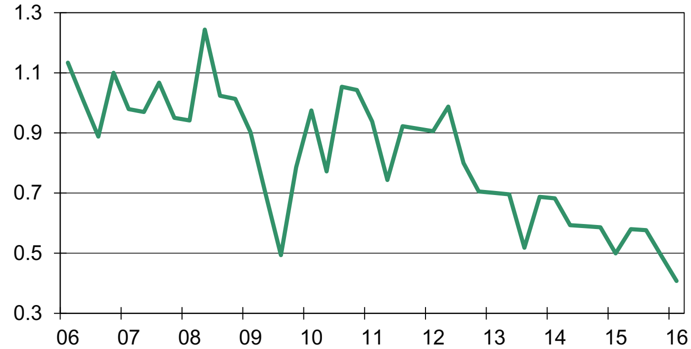
And lower interest rates are pushing up house values. We find that a 25-basis point cut in the cash rate would cause house values to rise an extra 0.2 percentage point than otherwise, all else being equal.

Increased lending for housing continues to drive overall credit growth. Housing loans in April were 7.4% higher than a year earlier, with lending for owner-occupiers up 12.6%. The Australian Prudential Regulation Authority continues to hold banks to tougher lending standards. Approvals for mortgages with loan-to-value ratios of more than 90% have dropped over the last year, while loan approvals for LVRs with less than 60% have risen.

The biggest beneficiaries of the shift in economic growth drivers are Australia's southeastern regions, that is, New South Wales and Victoria. Unemployment rates in both, at 5.3% and 5.6%, respectively, are the lowest among Australia's states. Thanks to higher job growth in the cities, Moody's Analytics estimates that unemployment in Greater Sydney—now 4.7%—will fall to 4.5% by year's end (see Chart 3 and Chart 4).

Chart 2: Incomes Are Not Growing Much

Hourly wage growth, % change qtr ago



Sources: Australian Bureau of Statistics, Moody's Analytics

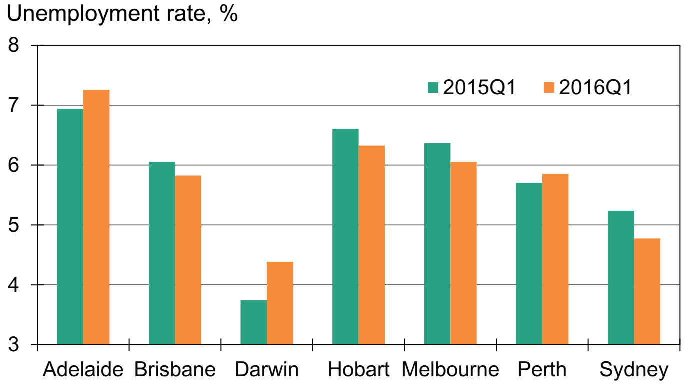
Strong gains in Sydney's house values are expected for the rest of this year and in 2017. House values in Sydney jumped 3.1% in May, taking the market to a record high. Valuations fell in late 2015 but have since recovered.

Continued job growth in Sydney will help house values rise 7.3% this year and 6.7% in 2017 (see Chart 5). However, incoming supply could depress house value growth thereafter. Building approvals rose 34% in 2015 and, as these new properties enter the market, they will constrain value growth, with values set to rise just 3.1% in 2018 and 1.5% in 2019.

House values in Melbourne also reached a new high in April, but the outlook here is less positive. The current momentum will enable values to gain 7.1% this year, but the effects of high levels of incoming supply—200,000 dwellings approved for construction from 2013 to 2015—will depress house values through to 2020.

Chart 3: Varied Labour Markets in Capital Cities

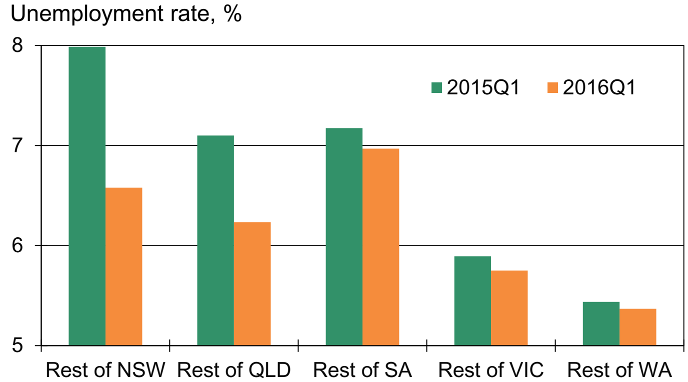
Unemployment rate, %



Sources: Australian Bureau of Statistics, Moody's Analytics

Chart 4: Labour Markets Improve Outside Cities

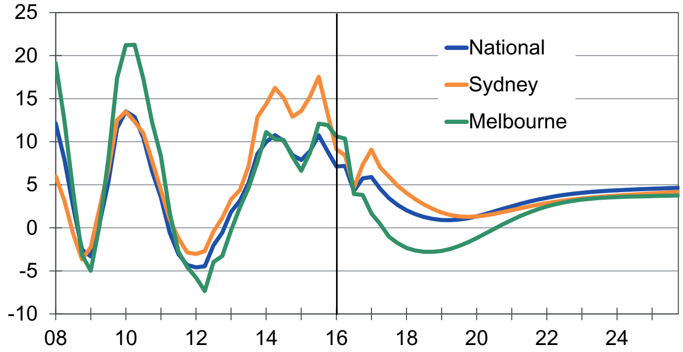
Unemployment rate, %



Sources: Australian Bureau of Statistics, Moody's Analytics

Chart 5: Slowdown in Sydney and Melbourne

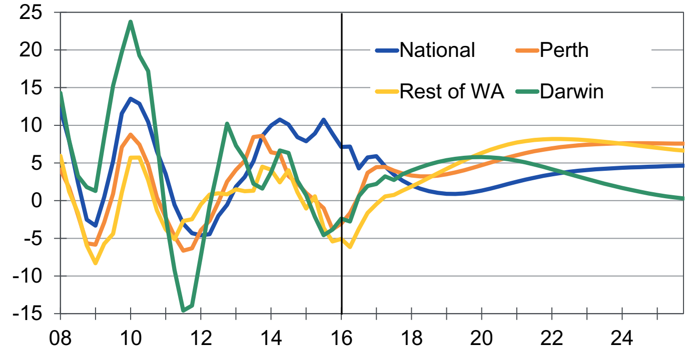
Hedonic Home Value Index, % change yr ago



Sources: CoreLogic, Moody's Analytics

Chart 6: Recovery in Mining Regions

Hedonic Home Value Index, % change yr ago



Sources: CoreLogic, Moody's Analytics

Despite expectations of steady income and jobs growth in Melbourne, house values are forecast to decline more than 6% from the end of 2016 through to early 2020. However, the declines are likely to be confined mostly to apartments in comparison with detached dwellings[1].

Signs of recovery in mining areas

Reduced mining investment has weighed on house values in Western Australia. House values in Perth are 4% lower than late 2014, while those in the rest of Western Australia are 7.5% lower (see Chart 6). But the slump is ending through a combination of a stabilization in the labour market and reduced future supply.

Unemployment in Perth peaked in the December quarter of 2015. Incomes are still falling—with another 4% decline in the first quarter—but the worst has passed, and we forecast a small improvement in the third quarter.

Perth's housing supply is not keeping pace with population growth: Building approvals fell 12% in 2015, although from a record level for 2014, while the population grew 1.4%. Home values in Perth grew modestly in March and April, and a recovery is forecast to occur in the third quarter. The slump in the rest of Western Australia will last a little longer, with house values declining through to the first quarter of 2017 before a moderate recovery.

1 Moody's Analytics will publish forecasts for apartments and detached dwellings along with its current total dwellings forecast from the third quarter of 2016.

Overall employment conditions have remained steady in Queensland, although the 6% jobless rate is slightly higher than the national average. Brisbane's improving job market is mitigating the effects of weaker mining employment in the rest of Queensland (see Chart 7).

This bifurcation in employment in the state is reflected in the differences in housing performances. Brisbane's house values are forecast to rise 5.8% in 2016 and 6.1% in 2017. But they fell 0.3% in the rest of Queensland in the first quarter. However, the 1.1% increase in March shows that the market is turning a corner. That said, values across the rest of Queensland are expected to stay fairly flat over the medium term, growing just 0.4% in 2016 and 1.3% in 2017.

House values in Darwin have slid 7% since mid-2014, and further declines are expected. Weak rents and an expected decline in income are the catalyst for further falls. Overall, values are expected to fall 0.7% in 2016, following a 2.5% drop in 2015.

Increased public spending in Canberra is lifting incomes, which had fallen almost 10% from 2013 to 2015. Slightly higher population growth in the Australian Capital Territory is also starting to put upward pressure on rents. House values in the Australian Capital Territory are set to increase 4.1% in 2016 and a further 3% in 2017.

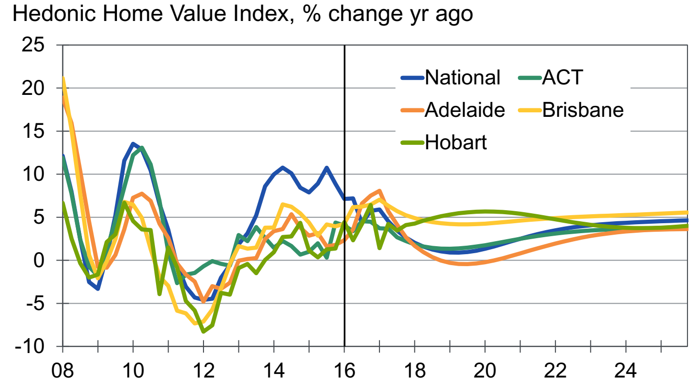
Meanwhile, in South Australia, shrinking manufacturing output is putting downward pressure on house values. House valuations in Adelaide will recover somewhat in the near term, with the momentum in early 2016 likely to carry over into the rest of the year. Over the longer term, however, the 2.1% annual growth rate in Adelaide's house values that we expect from 2016 to 2020 will be below the expected national average of around 3%.

Alternative scenarios

In addition to baseline forecasts, Moody's Analytics produces macroeconomic forecasts for Australia's national and subnational regions under a range of alternative scenarios that are used for a variety of stress-testing purposes.

Chart 7: Brisbane, Hobart Outperform

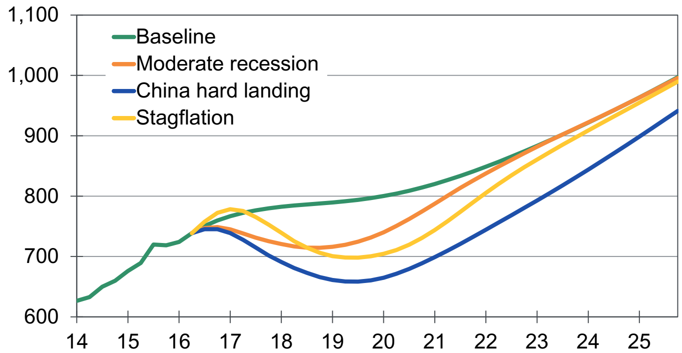
Hedonic Home Value Index, % change yr ago



Sources: CoreLogic, Moody's Analytics

Chart 8: Housing Under Alternative Scenarios

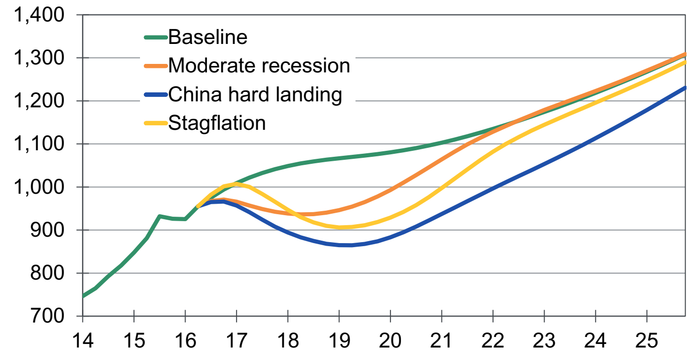
National hedonic HVI, selected alternative scenarios



Sources: CoreLogic, Moody's Analytics

Chart 9: Sydney Alternative Forecasts

Sydney hedonic HVI, selected alternative scenarios



Sources: CoreLogic, Moody's Analytics

These alternative scenarios, updated monthly, currently include a Chinese hard landing, a 'secular stagnation' scenario, and a euro zone breakup scenario, among others (see Chart 8).

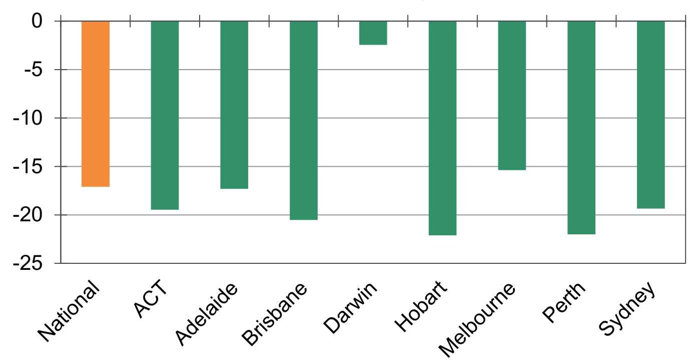
Moody's Analytics has taken these alternative scenario forecasts and used them as inputs into its housing model. In Sydney, a scenario of a moderate recession (where GDP falls 0.9% in 2017 before a recovery back to trend thereafter) would halt the momentum of the housing market and leave values 2% lower in nominal terms by mid-2018 (see Chart 9).

In the case of a Chinese hard landing, our model suggests that at their nadir in 2019, house values nationwide would be 17% lower than under the baseline scenario[2]. The effect across Australia's capital cities would be generally within the same magnitude (see Chart 10).

A few results stand out. Darwin's housing market would be relatively unscathed, which seems to be because of its disconnected cycle relative to the rest of the country and to China's economy.

Chart 10: Chinese Hard Landing

Maximum decline from baseline forecast, %



Sources: CoreLogic, Moody's Analytics

Melbourne's housing market could also withstand a Chinese hard landing somewhat better than the national average, with values falling 15% relative to the baseline. This assumption may be the result of Melbourne's relatively more domestically focused economy, which means that its incomes and rents are less affected by events in China.

2 Moody's Analytics defines this scenario as a financial crash in China that sends GDP growth there down to -0.6% in 2017, before a recovery towards trend growth by 2019.

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