

2018 - The Year That Was...and the Year Ahead What to Expect in 2019

with CoreLogic Head of Research Tim Lawless



Contents

Introduction	3
Housing Finance	4
Interest Rates	4
Sentiment	5
Economic Conditions	5
Supply	6
Demand	6
So... what does this mean for housing markets?	7
Focusing on each of the States and Territories	8

Introduction



At a macro level, the Australian housing market delivered a consistent downwards trajectory throughout 2018, following a peak in national housing values in October 2018. By the end of the year, we expect the CoreLogic national dwelling value index will be close to 5% below the recent peak, however, national dwelling values remain 22% higher relative to five years ago.

National headline results omit the fact that Australia's housing market performance is diverse and non-homogeneous. It's a market influenced by local economic and demographic factors as well as tighter credit policies which have contributed to reducing the availability of housing finance for prospective buyers. Based on CoreLogic data through to the end of November, the annual change in capital city dwelling values ranged from an 8.1% decline in Sydney and 5.8% fall in Melbourne, to a 9.3% rise in Hobart and 4.0% lift in Canberra values.

In all likelihood, five of Australia's capital cities will finish the year with a positive annual movement in dwelling values, highlighting that weaker conditions in Sydney and Melbourne, and to a lesser extent, Perth, are the main drag on the national index.

To assess the housing market trends over the coming year, it's important to reflect on the factors that have driven the market performance more recently and how they are likely to change over the coming twelve months.

Housing finance

The lack of credit availability is a key factor in the current housing market downturn and forms one of the major differences relative to previous declines where the catalyst for a turn in the market has typically been changes in monetary policy settings (interest rates) or an economic shock such as the Global Financial Crisis or the recession back in the early 1990s. Credit availability has been tightening, especially for investment purposes, since early 2015 after the first round of macro-prudential policies was introduced by APRA. Importantly, the second half of 2018 has seen a sharp reduction in the value of owner occupier lending which reflects a tightening of lending standards and a heightened risk assessment from lenders, as well as a modest lift in mortgage rates due to funding cost pressures faced by lenders.

How will the lending environment change in 2019? We've already seen a winding back of the first round of APRA's macro-prudential policy (the 10% speed limit on investment lending), however with household debt remaining at record levels in 2018, it's hard to imagine the 30% limit on interest only lending would be lifted. Additionally, with the final report from the Royal Commission due in early 2019, we expect lenders will remain conservative in their approach. This implies that high quality borrowers will be in the driver's seat (i.e those with large deposits, low debt relative to their income and a strong serviceability position). Borrowers with less than a 20% deposit and those with debt levels that exceed 6 times their income will find it harder to obtain finance and will likely face a premium on their mortgage rates.

Overall, we expect housing finance will remain a formidable obstacle to improving housing market conditions next year, but higher quality borrowers should be able to secure debt at very low rates as lenders compete for their business. If concerns about the decline in housing values and turnover grow amongst the Council of Financial Regulators during 2019, we may see some changes to the current macro prudential settings in order to soften the housing market declines.



Interest Rates

Considering the vast majority of mortgages are on variable interest rates, changes in the cost of debt may have a direct and immediate effect on the appetite for credit. The consensus view on interest rates is one of stability; the cash rate is likely to remain on hold through 2019 and financial markets aren't expecting any movement in the cash rate well into 2020. In fact, the cash rate futures market is now pricing in the small possibility of interest rate cuts over the coming months. Despite a lift of around 15 basis points on variable rate owner occupier mortgage rates in 2018,

mortgage rates haven't been this low since the 1960's. The low mortgage rate environment will help to support buyer demand, however, in the context of tight lending policies and limited availability of finance, cheap credit isn't likely to provide the same level of support as we have seen over recent years or in previous periods of declining interest rates.

Sentiment

Consumer sentiment is an important factor in considering housing demand. Purchasing a property requires confidence and a willingness to make a high commitment financial decision. Based on the widely followed Westpac/Melbourne Institute consumer sentiment survey, confidence remains a little above a neutral setting, suggesting consumers are neither optimistic nor pessimistic at the moment. Delving a little deeper, the housing market sub-indices paint a more pessimistic view from consumers. The sub-index measuring house price expectations was tracking around record lows at the end of the year, and the time to buy a dwelling index, which shows an inverse relationship with housing market conditions was trending consistently higher.

The outlook for consumer sentiment is likely to be similar to what we have seen through 2018; a relative neutral setting with consumer optimism buoyed by low interest rates and improving labour markets and dampened by softer housing market conditions. The upcoming federal election to be held over the first half of the year, is also likely to have an impact, potentially quelling consumer spirits, at least temporarily.



Economic conditions

The latest national accounts data foreshadowed some weakness in the economy, driven by factors including a slowdown in large infrastructure projects, lower levels of household spending and a reduction in construction activity. Household saving reduced further, due to consumption rising at a faster pace than household incomes, which is a bad sign for household debt reduction and higher consumer spending. Recent retail trade data has also been weak, particularly in NSW where dwelling values are falling fastest. With private consumption (consumer spending) accounting for more than half of economic growth, a slowdown in spending could disrupt economic growth forecasts even further.

On a more positive note, labour markets are showing some strength, with unemployment trending lower and jobs growth remaining above average in late 2018. Should these conditions continue, we might start to see some further upwards pressure on wages which will support household incomes and confidence.

Overall, we will enter 2019 with economic conditions tracking below expectations but around longer term trend levels. There is a strong likelihood the RBA will be revising their growth forecast lower early in the year, with ongoing concerns around household debt and weaker household consumption weighing on policy decisions. If the RBA's forecast for economic growth are downgraded, it's a further firm sign that interest rates are set to remain on hold for an extended period of time.



Supply

Overall, housing supply was tracking roughly in line with housing demand through 2018, however there are some areas where the construction pipeline for multi-unit dwellings remains substantially higher than underlying demand. Construction activity across the multi-unit sector was tracking around record high levels in Sydney and Melbourne over the second half of 2018 and we are expecting a surge of new high-rise unit supply to transition from the construction phase to completion and settlement in 2019. We are already seeing evidence that a large and growing proportion of these projects are settling with a valuation lower than the original contract price which is likely to be a growing phenomenon in 2019.

More broadly, with dwelling approvals now trending lower and construction activity moving through peak levels, we should expect additions to housing supply to track lower through 2019 which will help to stave off more substantial declines in dwelling values overall. The detached housing sector has seen much more sustainable and practical levels of development and we have no concerns around a housing over supply in this sector of the market.



Demand

The demand side of the supply/demand equation generally remains healthy, at least at a macro level, however from state to state we are seeing substantial differences in the rate of population growth. Nationally, we saw overseas migration starting to ease through 2018 and this trend is likely to continue through 2019. There is rising debate at both the state and federal level around population growth targets and the 'big Australia' debate is likely to be a feature of the upcoming federal election as well as state level political debates.

New South Wales and Victoria are the two states where overseas migration is most concentrated, comprising nearly three quarters of national net overseas migration. The latest data shows net overseas migration was down 12.7% across New South Wales over the year and 6.9% lower in Victoria but tracking more than 20% above the decade average. We could see overseas population growth slip further in 2019, but from a high base. With this in mind, overseas migration is likely to remain a key driver of housing demand over the year, but not quite as strong as 2018. The reduction in overseas migration is likely to impact more on rental demand than purchasing demand.

Interstate migration rates have a more direct impact on purchasing demand, and the trends in interstate population movements are showing some substantial changes between the states. The outflow of migrants from New South Wales, and to a lesser extent, Victoria, was gathering pace in 2018 as residents took advantage of healthier housing affordability and improving economic conditions outside of the two most populous states. New South Wales has seen a substantial increase in residents leaving for other states which is which will continue to adversely affect housing demand if the trend persists through 2019. Improving housing affordability as values fall and incomes rise, as well as strong economic conditions in NSW may help to reduce the rate of interstate migration outflow through the year.

The key beneficiary from interstate migration is Queensland, where the net inflow of migrants from other states is the highest of any state and it at its highest level in more than a decade. Net interstate migration is also rocketing higher across Tasmania and improving from a low base in South Australia and Western Australia which will help to support housing demand in these areas through 2019.

So... What does this mean for housing markets?



1 Values to drift lower

At a broader level, we expect dwelling values to continue tracing lower through 2019, led by further falls in Sydney and Melbourne while other capital cities continue to lose some momentum but remain in positive growth, at least in nominal terms. There will be a few exceptions: with the improving trend in Darwin, it looks likely the top end market will continue what is likely to be a long and gradual recovery in 2019, while the Perth market could also move back into positive growth territory through the year.



2 Due to ongoing tight credit conditions and other factors

The primary driver of our soft outlook is a continuation of the tight credit environment which is likely to keep housing market activity at below average levels and prevent some prospective buyers from participating in the market. Another factor likely to dampen housing market conditions is persistently low consumer sentiment with relation to housing market expectations. Housing sentiment is already weak, but could be further hit as we approach a federal election where there is a real chance that taxation policies relating to negative gearing and capital gains tax could be wound back.



3 The new unit market in Sydney and Melbourne is looking risky

Slowing demand and higher supply in the multi-unit sector is playing out, which is likely to result in weaker conditions across the unit markets in Sydney and Melbourne where the new unit supply pipeline is the most concentrated. Demand is being negatively impacted by a range of factors including slowing migration rates from both overseas and interstate, fewer domestic and overseas investors (key target markets for the multi-unit sector), low valuations for off-the-plan unit settlements and overall tougher lending conditions.



4 Outside of the capital cities, we are likely to see lifestyle markets remain in positive growth territory while resource driven markets continue to gradually recover after a crash in values

Lifestyle markets along the coastline and hinterland locations adjacent to the major capitals have seen strong demand from a variety of market segments. Cashed up buyers from Sydney and Melbourne have utilised their improved wealth position following the housing boom to purchase second homes and holiday homes, while baby boomers approaching retirement are positioning themselves in these lifestyle markets as well. Professionals are also taking advantage of high speed internet services and efficient commuting times to work remotely. Growth conditions aren't likely to be as strong as last year, however the trends suggest values will continue to trend higher through the year.

As the most popular coastal markets become unaffordable, demand may spread further afield. We have already seen this trend across markets like Newcastle and Wollongong, where affordability constraints have slowed conditions across these areas.

The mining regions have benefitted more recently from rising demand as mining investment once again heats up. Dwelling values in some of these areas remain more than half of what they peaked at during the mining boom and rental yields in these areas are generally in positive cash flow territory which could become increasingly attractive to investors.

Focusing on each of the States and Territories



New South Wales

The Sydney housing market led the surge in dwelling values over the recent growth cycle, which ran from early 2012 to July 2017 with dwelling values up 75% over this period. We expect dwelling values will be down by close to 9% over the 2018 calendar year. In early December, the total decline in Sydney dwelling values since the market peaked is already greater than what we saw during the last recessions when Sydney values recorded a 9.6% decline from peak to trough between 1989 and 1991. Next year is likely to see more of the same for Sydney, with values set to drift lower throughout the year.

The persistent weakness is likely to be driven by a range of factors, including the ongoing restrictions on home lending, less housing demand as population growth slows and weaker conditions across the high-rise unit markets where new supply is set to surge as the large number of projects under construction move to settlement. Although housing prices are falling, the median value of a Sydney dwelling remains around 9 times higher than the median household income, reflecting affordability challenges that are likely to persist.

There are plenty of factors that will help to offset the headwinds, including strong labour market conditions, improving first home buyer participation, high overseas migration (although migration is expected to reduce over the year, it is falling from levels well above average) and a smooth transition from residential construction towards major infrastructure work.

Low mortgage rates will also keep a floor under housing demand, however with credit availability remaining tight, the stimulus of low interest rates is less effective.

The regional markets of the state are varied, however the satellite cities adjacent to the Sydney metro area (Newcastle and Wollongong) are also seeing values drift lower as demand slows and finance availability remains tight. While we expect values are likely to trend lower in these areas during 2019, the decline is likely to be only mild relative to the larger declines in Sydney where affordability is more pressing and investor demand has been more concentrated. The regional coastal markets are generally more resilient, with values continuing to rise, albeit at a relatively mild pace, and we expect this trend to continue as lifestyle buyers remain active and baby boomers shift their focus to retirement options.



Victoria

Melbourne's housing market is following Sydney's lead, with values likely to be down by around 6.5% by the end of 2018. The rate of decline has gathered some pace and we expect values to continue trending lower throughout 2019 due to tight credit availability, slower population growth, and higher housing supply. Although housing prices are trending lower, housing affordability remains a pressing issue across the city, with dwelling prices still tracking around eight times higher than household incomes.

Factors that will help to support housing demand through the year include high population growth (although population growth is slowing, overseas and interstate migration rates remain well above the long term average), solid labour market conditions and low mortgage rates.

Across regional Victoria, the market is expected to be much healthier with values generally pushing higher through the year. Growth rates are starting to slow in the larger regional cities like Geelong, Ballarat and Bendigo, but remain positive; a trend we expect to carry through next year, driven by strong population growth, healthier affordability levels and healthy economic conditions.



Queensland

Brisbane's housing values tracked slightly higher than inflation and household income growth over the past five years, which has provided a sustainable platform for further modest growth in 2019. Dwelling values have increased at the annual rate of 2.7% over the past five years, with the pace of capital gains slowing in line with credit tightening over the past few years. We expect Brisbane values to be only half a percent higher than a year ago by the end of 2018, and the outlook for 2019 is likely to be quite similar.

The unit market has been a big drag on Brisbane growth rates, with unit values still around 5% lower than they were ten years ago. We expect the unit sector to recover gradually during 2019 due to rising migration rates resulting in higher demand and less new supply entering the market.

The coastal markets of South East Queensland have shown a stronger performance relative to Brisbane, although growth rates have slowed across the Gold Coast and Sunshine Coast over the last year. Similar to Brisbane, we expect these markets to remain in mild positive growth territory over the next year thanks to rising interstate migration rates and ongoing demand for lifestyle properties located close to major airports, amenity and employment opportunities.

Regional Queensland markets are more of mixed bag. The northern coastal and lifestyle markets have been recording weak conditions, with markets like Cairns continuing to see values drift lower over the past year. As demand for lifestyle properties ripples along the coastline, we could see these areas start to show an improvement in buyer interest and values during 2019.

Mining related areas were generally recovering through 2018, thanks to stronger commodity prices and improving levels of investment, and this trend is likely to continue as long as the Australian dollar remains low and commodity prices remain high.



South Australia

Adelaide's housing market has been a consistent performer, with dwelling values rising at the sustainable rate of 3.0% per annum over the past five years. The pace of capital gains has slowed more recently, in line with tighter credit conditions. We expect Adelaide dwelling values will end 2018 about 1.5% higher. With the pace of capital gains slowing, we may see a slightly lower rate of dwelling value growth in 2019, however we expect the trend in housing values to remain positive, driven by improving economic conditions and interstate migration rates as well as healthy levels of housing affordability.

Conditions across South Australia's regional markets haven't been quite as healthy as those for Adelaide. The last five years has seen dwelling values trend 0.1% lower each year, although the past twelve months has seen this

mild downwards trajectory flatten out and we could see some mild growth return to the regional areas of the state in 2019.

The stronger conditions across regional areas over the past year have been across the South East region of the state, where values were up 1.1%. Considering improvements to commodity prices and recently announced private sector investment, we are likely to see more positive housing market conditions spread to other areas of the state such as the Barossa-Yorke-Mid North over the next year.



Western Australia

The Perth housing market has been doing it tough since mid-2014, with dwelling values tracking around 15% lower than they were at the market peak. The market continued to slide throughout 2018, with the annual change expected to end the year, down approximately 4.5%. The slide in dwelling values should find a floor in 2019, although we aren't expecting a rebound in housing values.

The Western Australia economy is seeing an improvement in jobs growth, lower unemployment and improving resources sector, with each of these indicators rising from levels that are well below average. Overseas and interstate migration has turned a corner, however, overseas arrivals are moving higher from a low base and net interstate migration trends remain well in negative territory, as substantially more residents leave the state than those arriving.

It's not all doom and gloom for the West. The long running downturn in housing markets does have a silver lining in that housing values are roughly at the same level as they were ten years ago, providing one of the most affordable entry points to a capital city housing market when measured against household incomes.

The regional areas of the state have seen substantially weaker conditions than Perth. Dwelling values across the regional northern area of the state remain approximately 55% lower than they were in 2012 and the broad southern areas of regional WA is recording values that are 35% below their 2008 peak. Values were still falling across these broad regional areas in 2018, however, similar to Perth, we are expecting markets to bottom out and show either steady or mild growth conditions through 2019.



Tasmania

Both Hobart and regional Tasmania stood out amongst the rest of the country as recording the highest rates of capital gain over the past couple of years, although the pace of growth has been cooling across Hobart over the second half of 2018 but ramping up across the regional areas of the state. By the end of 2018, Hobart values will be approximately 9% higher, while the combined regional areas of the state are set to see a higher rate of growth; around 11%.

Such strong conditions were fuelled by a combination of rising migration rates, insufficient housing supply, improving economic conditions, higher levels of investment, healthy housing affordability and strong rental market conditions. Some of these factors are now easing, especially housing affordability which has worsened

substantially since the surge in housing values commenced in mid-2015.

As housing credit remains harder to obtain and affordability constraints become deeper seated, it's likely the rate of growth will continue to drift lower across both Hobart and the regional areas of the state in 2019. The market is likely to record a capital gain that is substantially less than that recorded in 2018, however with migration remaining high against an undersupply of dwellings, there is a strong likelihood that Tasmania's housing markets will continue to be one of the best performers next year.



Northern Territory

The Darwin housing market has recently seen a consistent, but subtle, rise in dwelling values with values holding relatively firm of the 2018 calendar year after sliding by close to 24% since values peaked in 2014. Darwin is now the most affordable capital city housing market, both on a raw median value measure and relative to household incomes. It's also the capital city showing the highest gross rental yields. The combination of a low entry point and strong cash flow, with the potential for medium to long-term capital gains could start to lure more investor interest into this market in 2019.

On the flipside, migration rates remain weak and with no sign of large-scale infrastructure projects on the horizon to aid in kick-starting economic conditions and jobs growth.

With uncertain national economic conditions ahead, it's difficult to determine where the growth drivers will come from, however with housing now very affordable and new supply levels remaining low, we expect to see the Darwin market holding reasonably firm over the coming year.



Canberra

The Canberra housing market has been one of the most solid performers in terms of capital gains, rental yields and market activity. The past five years has seen dwelling values rising at the annual pace of 4.0%, which is roughly equivalent to the rate of capital gain recorded over the 2018 calendar year. Moving into 2019, jobs growth remains strong, unemployment is the lowest of any state or territory, migration is trending higher and wages growth across the public sector has been consistently stronger than the private sector. Additionally, with high household incomes, the dwelling price to income ratio in Canberra remains at a healthy 5.0.

Considering the strong backdrop of economic and demographic conditions, we are expecting dwelling values in Canberra to continue trending higher in 2019, likely at a similar pace to what we have seen in 2018.

Toll Free: 1300 734 318

This publication reproduces materials and content owned or licenced by RP Data Pty Ltd trading as CoreLogic Asia Pacific (CoreLogic) and may include data, statistics, estimates, indices, photographs, maps, tools, calculators (including their outputs), commentary, reports and other information (CoreLogic Data).

www.corelogic.com.au

