FINANCIAL REVIEW

House price rally not sustainable, warn economists

Cecile Lefort *Markets reporter*

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The recovery in property prices, led by surging population growth and a severe housing shortage, could prove short-lived if unemployment rises and the Reserve Bank keeps the cash rate high, economists warn.

House prices are up 6.3 per cent this year, according to data from property consultancy CoreLogic, rebounding after the fastest rate-rising cycle in three decades had initially cooled demand.

MLC's Bob Cunneen believes house prices will fall. **Nick Moir**

"I am worried that the recovery in property prices is a false rally," said Warren Hogan, economic adviser at Judo Bank. "The Australian housing market is yet to be stress-tested by a genuine slowdown in economic activity and softness in the labour market."

The Australian economy cooled to an annual pace of 2.1 per cent from 2.4 per cent in the June quarter.

Mr Hogan predicted that house prices would fall in 2024-25, but said the decline would be cushioned by population growth and the shortage of new dwellings. Building pipelines were near the lowest on record and almost one in three large home builders was struggling with rising wages and material costs, leading to a surge in insolvencies.
Exacerbating the housing shortage is a post-pandemic rebound in immigration. In May, the government's budget forecast 1.24 million arrivals over the next four years.

Even so, Bob Cunneen, chief economist at MLC, doubts that this year's rebound in property prices will last, and says the strong demand and constrained housing supply have overwhelmed the impact of higher interest rates and poor housing affordability this year.

Number distortion

The Reserve Bank has raised the cash rate 12 times since last year to 4.1 per cent and has indicated that it could increase this again to bring inflation back to its 2 per cent to 3 per cent target, from 5.9 per cent currently. Housing affordability is at record lows and Australian households are among the most indebted worldwide.

"A more moderate pace of immigration next year and the lingering impact of higher mortgage rates should again weigh against house prices," Mr Cunneen said. Migration is forecast to return to normal patterns from 2024-25 [https://www.afr.com/politics/federal/poor-policy-not-migrants-to-blame-for-housing-crisis-bca-20230809-p5dv0s].

Half of the 42 economists polled by *The Australian Financial Review* [https://www.afr.com/markets/debt-markets/economists-push-back-rba-rate-cut-to-august-2024-20230927-p5e7wo] in a quarterly survey expect at least one more rate rise and financial markets agree, implying a one-in-two chance of another increase.

Stephen Anthony at Macroeconomics Advisory is also sceptical about the robustness of house prices.

"It is more a reflection on the long and variable lags of monetary policy," he said, noting that the government's large increase in temporary visa holders had swelled the pool of demand for rental accommodation and soaked up the inventory of unsold housing stock. [https://www.afr.com/politics/federal/too-many-foreign-graduates-in-low-pay-low-skill-jobs-grattan-20231002-p5e927]

Sean Langcake, head of macroeconomic forecasting at Oxford Economic Australia, also expects property prices to dip as more stock comes on to the market. "But we expect this to be a very modest downswing relative to recent cycles," he said.

Don't hold your breath

Jarden's chief economist, Carlos Cacho, estimated that households had been hit by a 30 per cent reduction in borrowing capacity amid "the worst affordability on record".

"The two key risks for the housing market are higher rates for longer and a material increase in supply," he said. Many borrowers were optimistic that the RBA would start cutting rates sooner rather than later, he added.

Goldman Sachs expects the housing market to "materially soften" – reflecting additional tightening by the RBA. The bank's chief economist in Australia, Andrew Boak, forecasts one more rate increase in November in response to sticky inflation.

AMP chief economist Shane Oliver also expects property prices to slip as a pick-up in unemployment leads to distressed sales. "A further rate hike and delay in rate cuts next year would add to this risk," he said.

Some economists, including RBC Capital Markets' Su-Lin Ong, are not as bearish but caution that the best of the property market rally has passed.

"We do not expect the near 5 per cent gain of the last six months to be repeated in the next six months," she said, highlighting a subdued housing outlook.

David Bassanese of Betashares echoed the view. "At best, prices seem likely to only level out rather than fall back all that much," he said. He noted that this year's rally partly reflected the fear of missing out whereby investors "buy the dip" on expectations that the RBA is nearing the end of its tightening cycle.

David Robertson at Bendigo predicted that house prices were likely to be "much more modest" compared with the past decade, as core inflation would probably remain high.

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