ECONOMICS: AUSTRALASIAN PERSPECTIVES

HOUSING: THE NEXT SHOE TO DROP?

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Up until now, housing has been one of the bright spots in Australia's economic rebalancing story. But as supply dynamics start to shift, the outlook for this sector is set to become more gloomy. Even as some of the negativity fades from the commodity picture, there are still plenty of reasons to think Australia's economy will continue to underperform.

Housing Was a Bright Spot...

Amidst all the commodity-related gloom, the housing sector has been the one bright spot in the Australian growth story. While much of the attention has been focused on the sharp rise in house prices, particularly in Sydney (*Display 1*), there has been a sizable upswing in construction activity, too.

In 2011 and 2012, before capital spending in the mining sector started to peak, total housing starts were running at around 150,000 units per annum. In 2014, construction of close to 200,000 new dwellings was commenced. And that looks set to be surpassed in 2015—perhaps reaching as high as 225,000 units, based on the run rate implied by building approvals data.

As a result, dwelling construction has added half a percentage point to gross domestic product (GDP) growth over the past year, offsetting part of the one percentage point drag from weaker business investment. In turn, that's helped to cushion the employment impact of the mining capex bust. Construction jobs are up 7% from end-2012 despite the 20% fall in nonresidential construction.

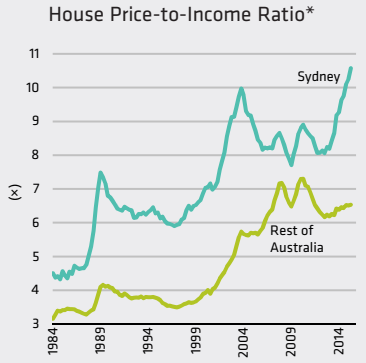
...but Supply/Demand Balance Is Shifting

But our suspicion is that this might be as good as it gets for housing. A 40%-plus increase in the number of dwelling starts represents a meaningful swing in the supply picture for housing. Particularly as this is occurring against the backdrop of slowing population growth. In 2008/09, Australia's population was growing at about 450,000 per year. That's now slowed to around 300,000, reflecting a sharp slowing in net immigration.

On average, there are 2.5 people per household. So—in rough, back-of-envelope terms—underlying demand for new housing to meet population growth has slowed from 180K per annum to 120K. While there has been a prolonged period of underbuilding (*Display 2*), that has now swung to overbuilding. By the end of this year, it's likely that housing construction will be running above 6% of GDP—a level not seen since the first half of the 2000s (*Display 3, next page*).

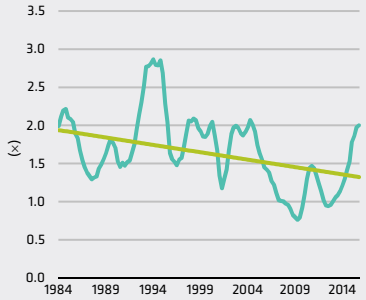
This swing in the supply/demand balance is already starting to have an impact on pricing. Growth in average rents, for example, has slowed sharply. Nationwide, rental growth has slowed from mid-to-high

Display 1
Sydney House Prices Rise to Record Highs



As of May, 2015
*Median House Price/FT-AWE
ABS quarterly data through 1Q:2015. AB estimate based on monthly RP-Rismark data
Source: Australian Bureau of Statistics, Bloomberg and AB

Display 2
From Shortage to Surplus?



As of June 26, 2015
Actual data through 4Q:2014. AB estimates through 4Q:2015
Source: Australian Bureau of Statistics, Bloomberg and AB

single digits in 2008/2009 to just 2% now (*Display 4*). And house price growth outside Sydney has slowed sharply too. Price growth in Perth and Brisbane, two cities at the heart of the mining boom-and-bust saga, is now negative.

In addition to these fundamental influences, there's also a technical wild card to consider. A historically disproportionate share of the housing upswing has been in multistory apartment buildings. Typically, they might represent 10%–15% of new starts. In this cycle, however, they represent close to 30%. A lot of this activity has been driven by foreign investors.

But with governments at both the federal and state levels tweaking with the rules—greater scrutiny from the Foreign Investment Review Board (FIRB), differential taxation regimes (Stamp Duty & Land Tax), changes to the Significant Investor Visa program—there is the potential for a sharp change in that landscape.

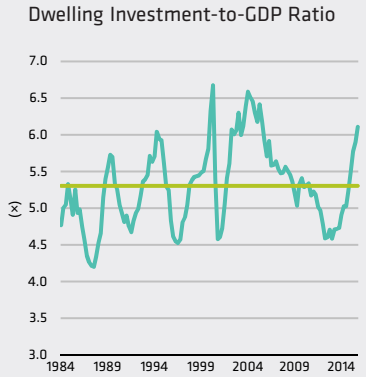
Outlook Set to Be More Challenging

Now, it's not necessarily the case that the end game here is a housing collapse and carnage—taking a page from the US, Spanish or Irish playbooks. That all seems too alarmist, particularly as the price boom and the construction upswing have not been accompanied by rampant growth in credit.

Having said that, it's almost inevitable, in my view, that we end up with some sharp falls in housing construction activity from the middle of next year (with some fallout on employment). And this may accompany a prolonged period of flat-to-down house prices. In turn, that will ramp up pressure on households to do a bit more deleveraging. And throw a bit more international focus onto the risks in the Australian banking system.

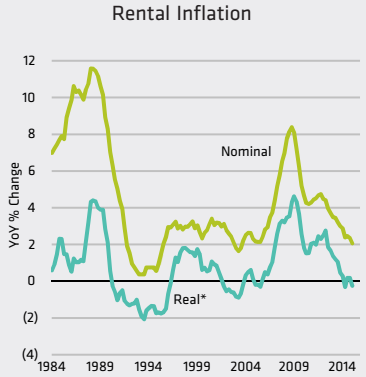
In short, even as some of the negativity surrounding commodities starts to fade, there are still plenty of reasons to be gloomy about Australia's growth prospects over the next couple of years. ■

Display 3
From Shortage to Surplus?



As of June 26, 2016
Actual data through 1Q:2015. AB estimates through 4Q:2015
*Real rate is based on the core consumer price index.
Source: Australian Bureau of Statistics, Bloomberg and AB

Display 4
From Shortage to Surplus?



As of June 26, 2016
Actual data through 1Q:2015. AB estimates through 4Q:2015
*Real rate is based on the core consumer price index.
Source: Australian Bureau of Statistics, Bloomberg and AB