AP ASSETS
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Property Talks

AUSTRALIAN ECONOMIC INSIGHT

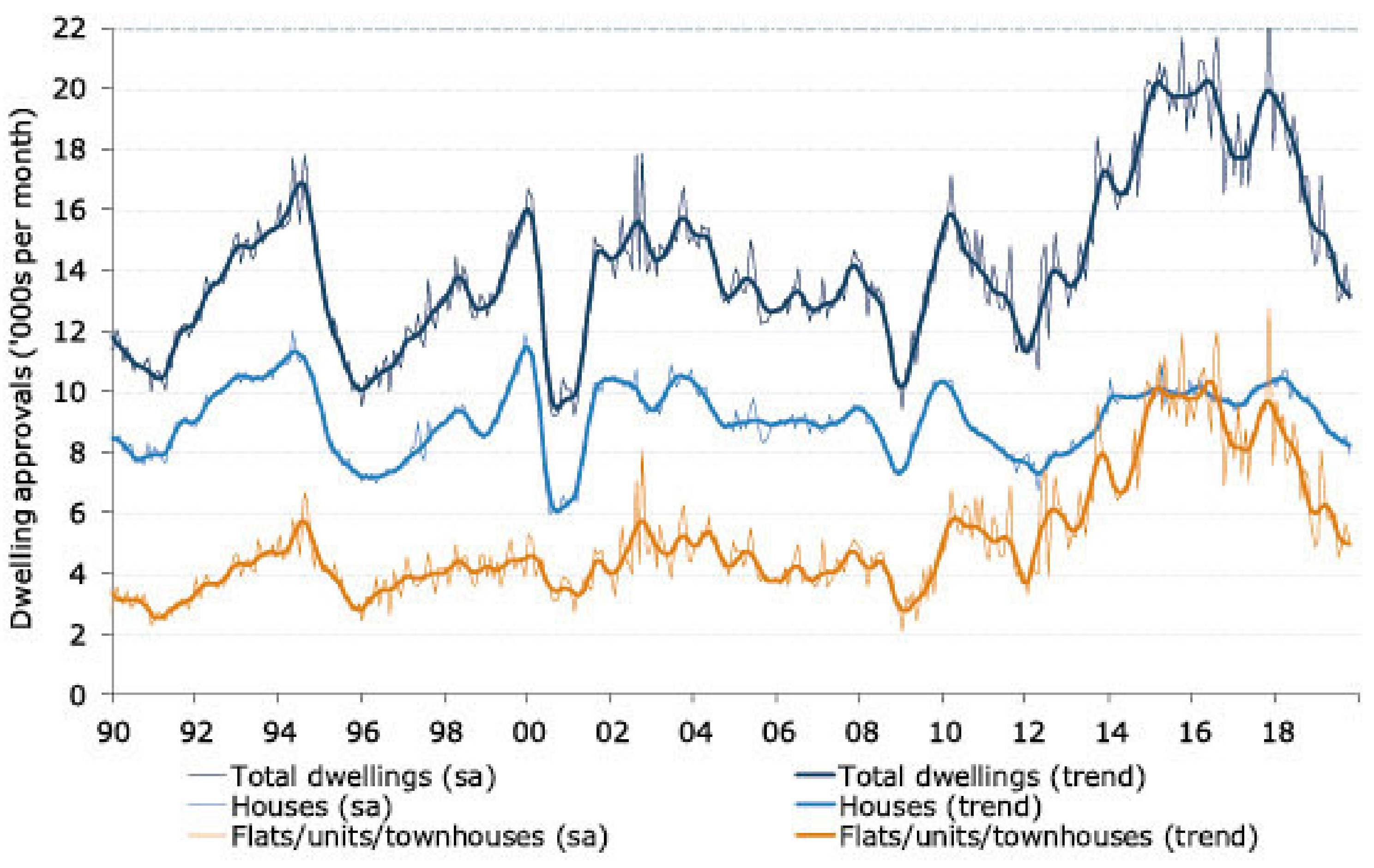
The looming housing shortage

- House prices are rising sharply, but the ongoing weakness in building approvals has raised concerns about a looming housing shortage, particularly in the apartment market.
- The lags between interest rate cuts and building approvals are lengthening as apartments (which take longer to approve and longer to build) become more significant in the housing mix. There are signs of a pick-up in some of construction's other leading indicators, which suggest a turn in approvals is imminent.
- The decline in approvals to date suggests that construction will fall for some months yet, not picking up until mid-2020. That fall will feed through to housing supply, and vacancy rates are set to decline over 2020 and 2021. Across the two major capital cities, the shortage of housing looks likely to be more marked in Melbourne than Sydney.

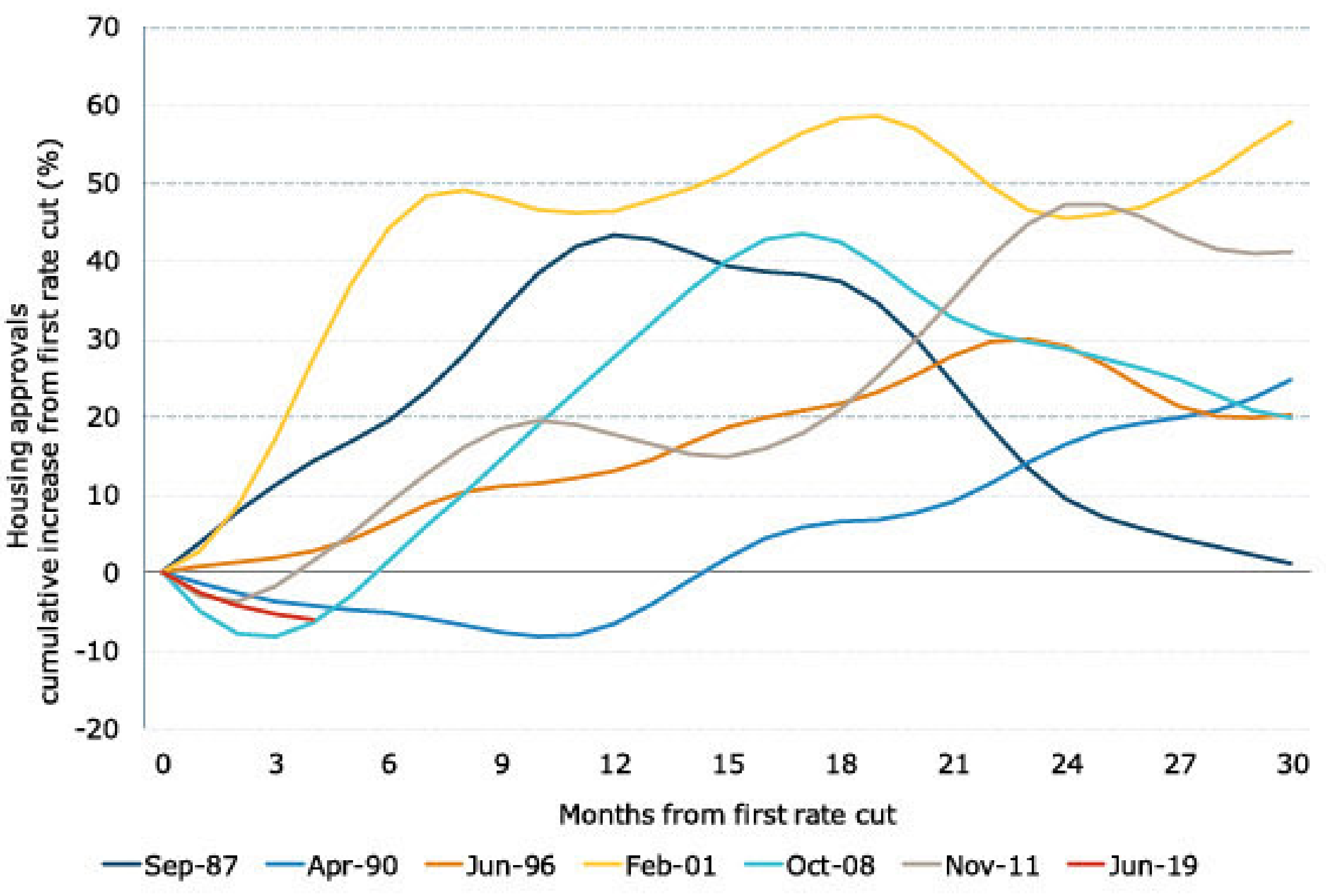
Housing turning, but not supply as yet

- The housing market has turned around sharply. Established home prices are rising in nearly all capital cities, and Sydney posted the strongest monthly gain in November since the late-1980s. If prices continue to rise at the current pace, Melbourne prices will be back to the 2017 peak by February 2020 and Sydney by March. But so far, there's little sign that higher prices for established homes are driving a pick-up in construction. RBA Deputy Governor Debelle noted in a recent speech that:

Building approvals are yet to respond to lower rates



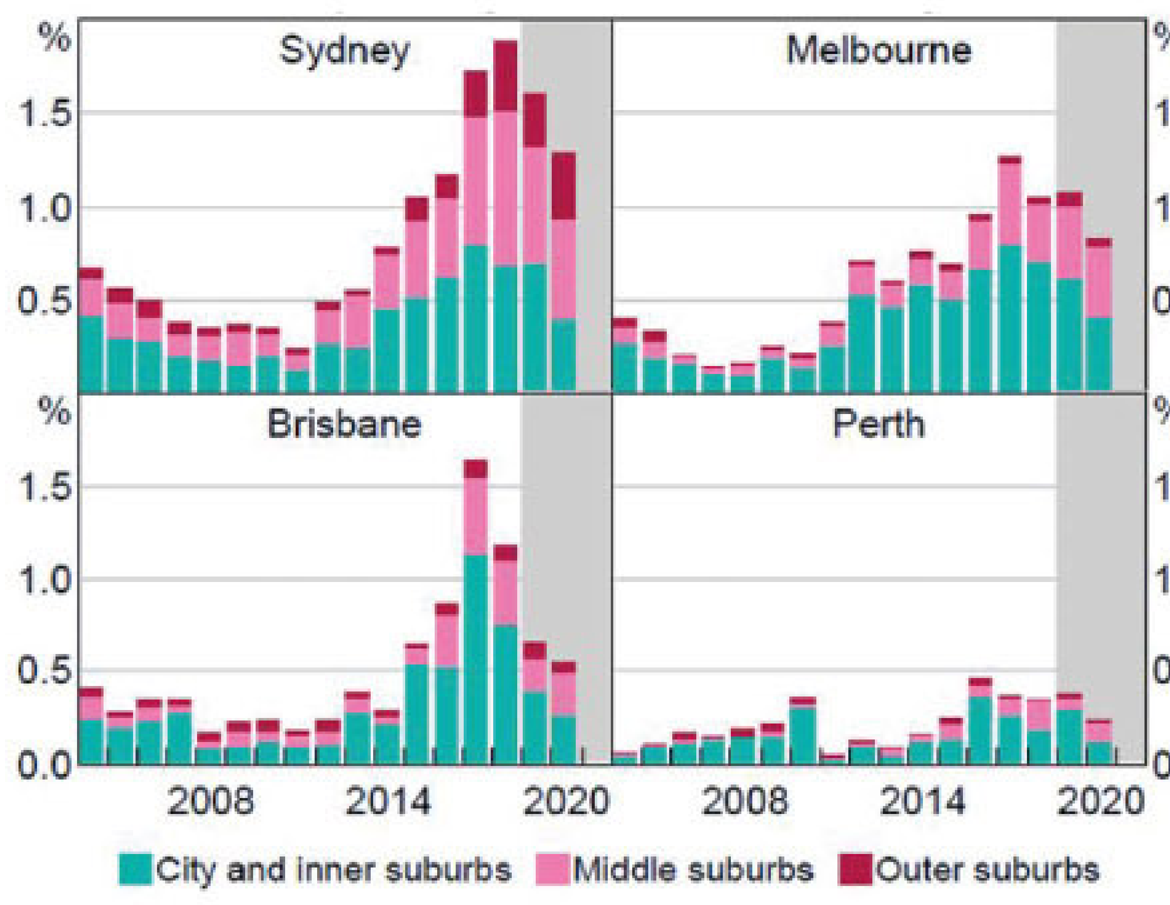
Approvals are responding more slowly to rate cuts in this cycle



Source: ABS, ANZ Research

- While the response of building approvals to the most recent rate cuts has been relatively muted, so far, it's not outside the range of experience. Given that apartment approvals account for a much larger share of overall approvals than has historically been the case, it makes sense that more recent cycles will be more lagged than was the case in the 1990s and early 2000s. Concerns about the quality of newly constructed apartments, particularly in NSW, may be weighing on approvals. Developers report that while sales of the existing stock of apartments have picked up strongly, pre-sales remain weak. With a large amount of stock still coming on stream over the next few years, particularly in Sydney, investors seem to be keen to snap up these (often discounted) properties, where they have the opportunity to assess quality rather than take the risk on an off - the-plan purchase.

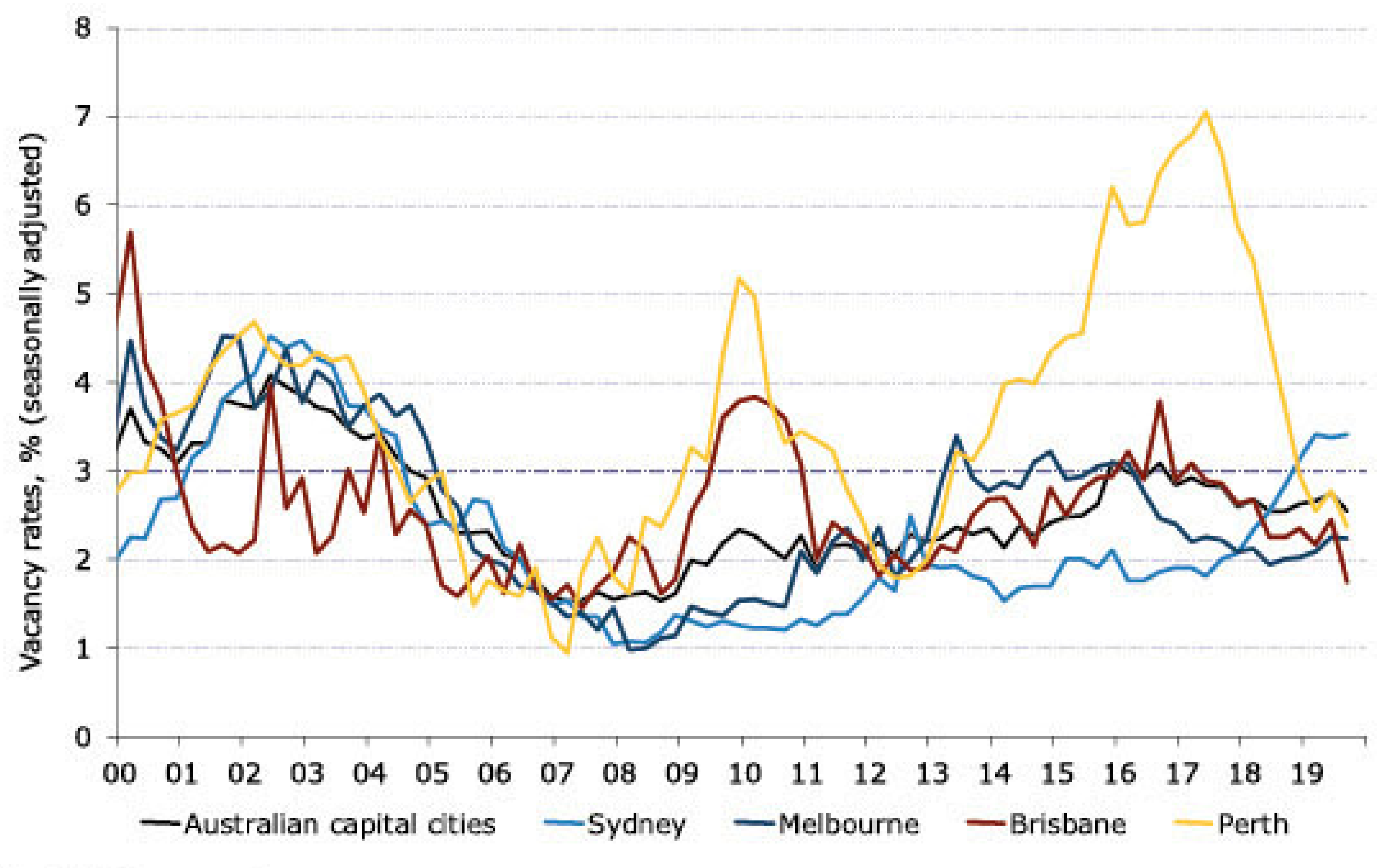
High density apartment completions (% of 2016 housing stock)



Source: ABS, RBA (In Financial Stability Review, April 2019, RBA)

Note: Grey area indicates estimated completions

Vacancy rates are high in Sydney



Source: REIA, ANZ Research

- This measured shortage of housing at the national level reflects different performances across the two major capital cities. In Sydney, where there is currently oversupply, our forecasts suggest that the excess supply will be eroded over 2020 and 2021, but the market will not move into undersupply if approvals pick up through 2020 as we expect. In Melbourne, however, we expect the vacancy rate to tighten further, with this putting upward pressure on rents and eventually prompting a bigger price and supply response. The behaviour of approvals over the next few months will be key to informing our view on the housing shortage further out.