

Economics

Issues

9 September 2020

Dwelling price outlook – smaller falls now likely and a bounce in H2 21

- The COVID-19 pandemic has had a negative impact on Australian residential property prices, but outcomes vary significantly by capital city.
- We expect dwelling prices to continue to decline at a modest pace and to trough in Q1 21. But we expect a solid recovery in prices from H2 21 as the borrowing cost once again becomes the dominant influence on prices.
- We expect Melbourne property prices to significantly underperform against the national benchmark.

Overview

In April 2020 we published updated dwelling price forecasts to reflect the impact of the COVID-19 pandemic on the Australian property market. Our central scenario was that dwelling prices nationally would fall by around 10% from their April peak. It is now September so we think that it's an opportune time to revisit our forecasts in the context of how the housing market has performed over the past six months and how our views on the economic outlook have evolved.

In doing so, two things immediately stand out to us:

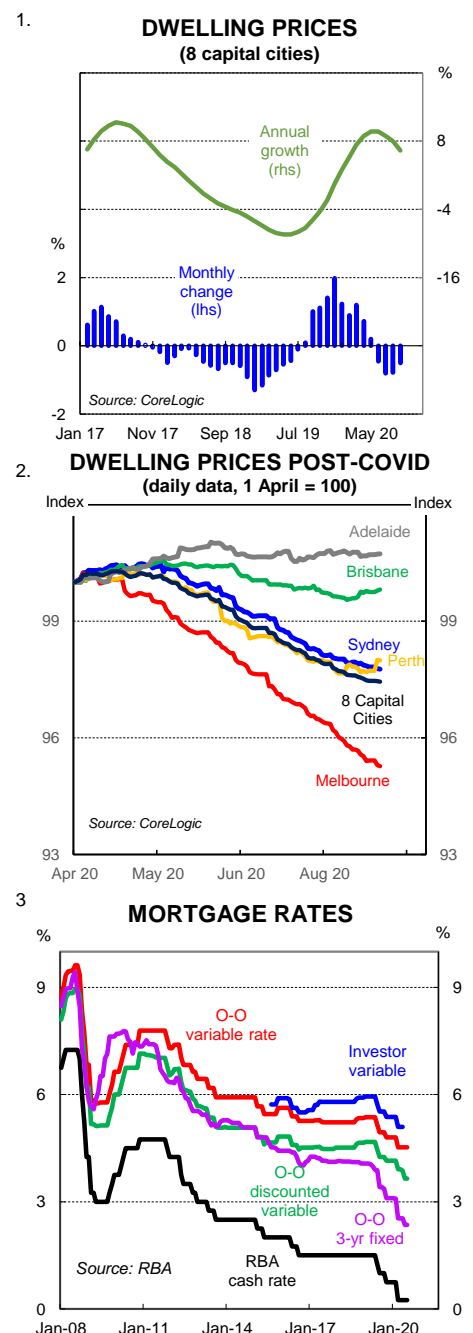
- (i) the fall in dwelling prices to date has been a lot smaller than we anticipated; and
- (ii) the variation between capital cities has been a lot larger than we expected.

For the record, we had always expected Melbourne and Sydney to underperform relative to the national average. The NSW and Victorian economies have more exposure to the most heavily impacted services sectors and less exposure to some of the more insulated sectors (i.e. mining and agriculture). In addition, the Sydney and Melbourne housing markets are more reliant on strong population growth via net overseas migration to underpin demand. But what we didn't know of course was that COVID-19 would have a much bigger impact on the Melbourne economy relative to the other capital cities.

Parking the Melbourne issues to one side, what has genuinely surprised us is the resilience of house prices in some of the other capital cities considering the negative shock to labour markets around the country.

We continue to expect prices to ease. But we are now looking for a national peak to trough fall of 6% versus our previous call of 10%. We now expect that trough to arrive in Q1 2021 (versus end 2020 previously). And we expect a much larger disparity between outcomes by capital city than initially forecast. For example, we have forecast a fall in Melbourne property prices of 12% from April 20 to Q1 2021, whilst prices are expected to *increase* modestly in Hobart and the ACT over that period.

Our forecast profile for dwelling prices has been extended to end-2021. Our central scenario is that dwelling prices plateau in Q2 21 before rising over H2 21. Our forecast is for solid price growth in H2 21 as the economic recovery gains traction and incredibly low interest rates once again become the dominant influence on dwelling prices. This note outlines our views on dwelling prices, our underpinning assumptions and the risks to our forecasts.





Recent story

According to CoreLogic, national dwelling prices peaked in April and have trended lower ever since (charts 1 & 2). Between April and August (latest available) price falls have been largest in Melbourne (-4.3%) and Sydney (-2.6%) – it's worth remembering that price rises were strongest in Melbourne and Sydney in the year leading up to the pandemic so the negative wealth effect on consumption is negligible at this stage. Prices have also declined in Perth (-2.2%) since April, but they are little changed in Brisbane (-0.9%) and Darwin (-0.7%) and have *risen* in Adelaide (+0.3%), Hobart (+1.0%) and the ACT (+1.8%).

In the context of an extraordinary negative economic shock the fall in national dwelling prices is modest. And whilst momentum in the Melbourne market is clearly negative, it is not particularly soft in Sydney and is holding up elsewhere. The reason for Melbourne's underperformance is obvious – the stage 3 and stage 4 lockdowns from July. It is clear that had Melbourne not gone back into lockdown price falls would be more modest.

National prices are likely to continue to slide in the near term, primarily because of the situation in Melbourne. Unemployment has not yet peaked in Victoria and rising unemployment is a clear headwind for property prices (note that it is the direction in unemployment that matters most for property prices as opposed to the level of unemployment). In addition the household perception of the national market is consistent with a further softening in prices and the demand impulse from net overseas migration is non-existent. This is more acutely felt in Melbourne and Sydney.

How much further will prices fall?

As a starting point we have input the latest leading indicators of the property market into our model. The CBA dwelling price model has a good track record in predicting national near term price movements (chart 4).

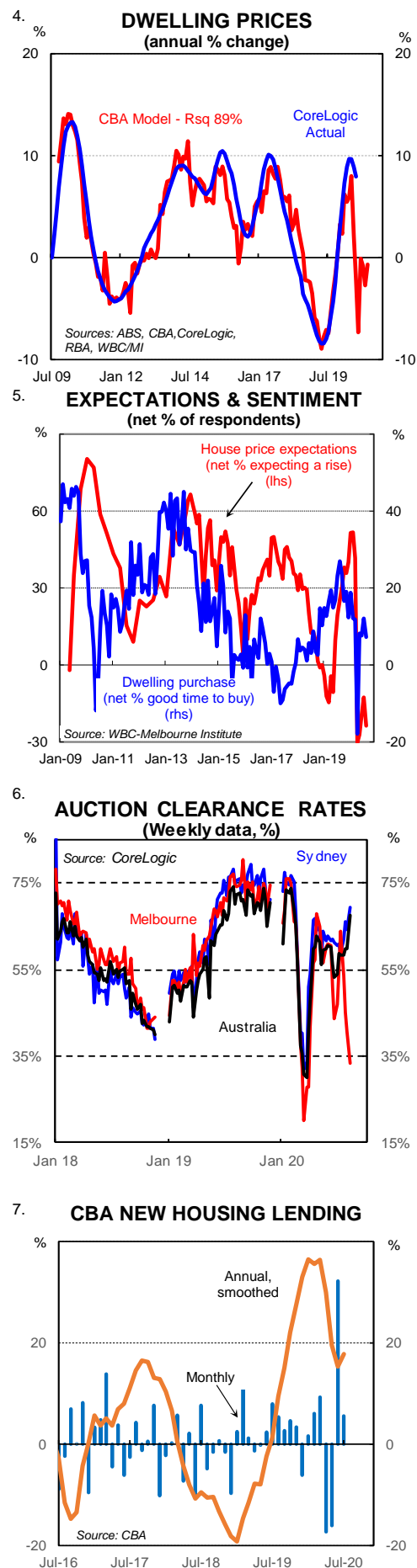
Our model puts the annual change in national dwelling prices as a function of the annual change in mortgage rates (1 year advanced), the annual change in the flow of credit (six months advanced), auction clearance rates (four months advanced) and the house price expectations index from the WBC/MI Consumer Sentiment survey (2 months advanced). The results are interesting because the inputs into the model are sending mixed signals.

House price expectations remains in the doldrums, but the national auction clearance rate is holding at a decent level (charts 5 and 6). The disparity is unusual. And whilst new lending is lower than its pre-COVID level, it has picked up in recent months (chart 7).

Our top down modelling points to prices falling by a modest ~0.6% a month over the remainder of 2020. Our bottom up approach by capital city suggests a similar outcome. We therefore expect national dwelling prices to be down by -1.8%/yr at December 2020 (implying a ~5.0% fall in prices from April 2020). We have pencilled in a further small fall in Q1 20 which takes the total peak to trough fall to ~6%. From there our central scenario is for a stabilisation in prices before a solid recovery from H2 21 (+3% over six months or an annualised pace of ~6%). See Table 1 on page 3 for our forecasts by capital city.

Why prices could bounce sharply in H2 21

The RBA cuts to the cash rate in 2019 and 2020 that took mortgage rates to record lows are the main reason why dwelling prices nationally have not fallen all that much considering the huge negative shock to the economy. As the economy recovers and the headwinds of rising unemployment and falling rents dissipate, we believe the borrowing cost will once again become the dominant driver of dwelling prices.





The RBA has tended to play down the influence of monetary policy decisions on dwelling prices. But we believe that changes in interest rates are the single most important driver of real property prices over the longer run.

The relationship between dwelling prices and monetary policy is quite straight forward: lower (higher) interest rates essentially means that for a given level of income a borrower can service a bigger (smaller) mortgage, all else equal. That means that lower (higher) interest rates put upward (downward) pressure on the demand for credit and therefore dwelling prices. We saw the profound impact that RBA rate cuts had on the property market as recently as last year. The housing market was reignited following three 25bp cuts to the cash rate in June, July and October 2019 and prices rose briskly until the pandemic arrived.

Importantly, lower interest rates don't just have an impact on housing prices because households can borrow more for a given level of income. They also increase the attractiveness of property from an investment perspective because the yield on property is compared to the risk free rate (i.e. the term deposits rate for households – chart 8). It's a similar story for equities, whereby lower interest rates push up equities prices, all else equal. Put another way, lower interest rates increase the demand for dwellings for both owner-occupiers and investors and they influence the price at which buyers and sellers will transact.

We have dived further into the relationship between interest rates and property priced and the evidence indicates that it is generally the *percentage change* in interest rates that has the greater impact on dwelling prices as opposed to the *percentage point* change in interest rates (chart 9). The distinction here is very important.

As interest rates approach the lower bound each *percentage point* shift lower in mortgage rates has an exponentially large impact on the interest cost of servicing debt because the *percentage change* in mortgage rates increases. In many ways that explains why property prices accelerated so quickly following the RBA's rate cuts in 2019 – the *percentage change* in interest rates was large because mortgage rates were already very low.

Our message here is very simple – the cost of money impacts all asset markets including housing. The reason that asset prices, including dwelling prices, can seemingly decouple from the economy comes down to largely one thing – central bank policy and changes in the cost of money.

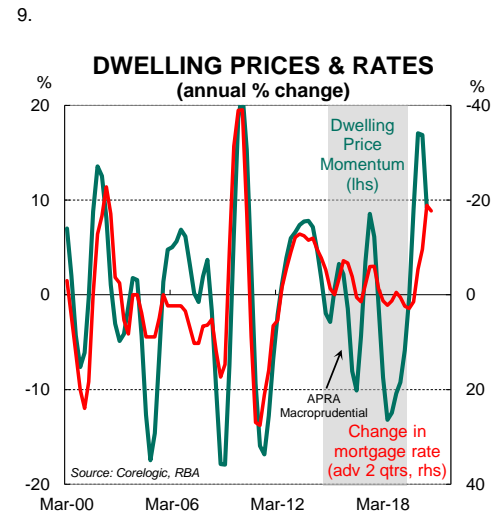
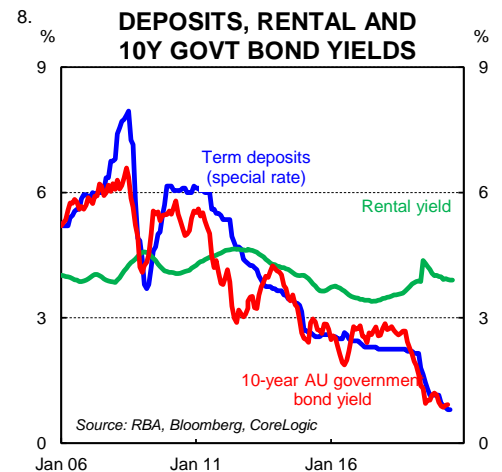


Table 1: CoreLogic Median Dwelling Prices: Actual and CBA Forecast

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Darwin	Canberra	8 Capital cities
ann % chg to Aug 2020 (a)	9.8	5.9	3.5	2.7	-2.0	5.5	0.0	6.9	6.3
ann % chg to Dec 2020 (f)	-0.9	-6.4	-0.8	1.1	-1.8	2.1	0.9	3.6	-2.2
ann % chg to Jun 2021 (f)	-4.9	-10.2	-2.5	0.2	-0.9	0.4	-0.2	2.3	-5.1
ann % chg to Dec 2021 (f)	2.9	-0.7	1.6	1.4	1.9	2.3	0.9	3.1	1.6

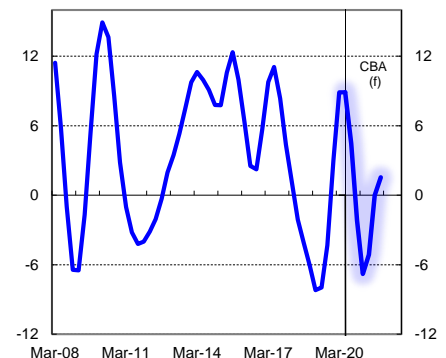
Risks

Back in April we wrote the following:

“There are both downside and upside risks to our dwelling price forecasts. The risks both hinge on the length of the enforced shutdown and restrictions placed on economic activity.

In a best case scenario government restrictions on economic activity could start to be lifted by the end of May. For that to occur, it would probably take several days of zero or very low community transmission of new COVID-19 cases. That is a possible scenario given the current trend in new COVID-19 cases. If that

CBA FORECAST: DWELLING PRICES (annual % change)





were to occur the plunge in economic activity that we expect would not be as large and the impact on the property market would not be as severe. Indeed the fall in property prices would be significantly smaller than our central scenario, particularly given the extraordinary low borrowing rates currently on offer.

There are scenarios, however, that are significantly worse than our central scenario. If restrictions are eased in Q3 20, as we expect, but a second round of COVID-19 new cases emerge then both the economy and housing market would be adversely impacted again. We would see restrictions return but the hit this time around on the economy and labour markets would be more significant and the damage would be longer lasting. Falls in dwelling prices far greater than our central scenario would be plausible. We believe that policymakers will be acutely aware of the risk of this scenario and as a result they will take a cautious approach to reopening the economy.”

As it turns out both risks essentially materialised. The best case scenario happened for all states other than Victoria where the downside scenario materialised.

Relative to our updated forecasts the risks are skewed to the downside. Any imposition of restrictions would likely see prices fall more than our central scenario which is based on no further lockdowns and a recovery in national economic activity from Q4 2020.



RETAIL CLIENTS

IMPORTANT INFORMATION AND DISCLAIMER FOR RETAIL CLIENTS

This report provides general market-related information, and is not intended to be an investment research report. This report has been prepared without taking into account your objectives, financial situation (including the capacity to bear loss), knowledge, experience or needs. It is not to be construed as a solicitation or an offer to buy or sell any securities or financial instruments, or as a recommendation and/or investment advice. Before acting on the information in this report, you should consider the appropriateness and suitability of the information to your own objectives, financial situation and needs, and, if necessary seek appropriate professional or financial advice, including tax and legal advice.

Commonwealth Bank of Australia (the "Bank") believes that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this report. Any opinions, conclusions or recommendations set forth in this report are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by the Bank or any member of the Commonwealth Bank of Australia group of companies. Any valuations, projections and forecasts contained are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. The Bank does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met. Past performance is not a reliable indicator of future performance.

Where 'CBA data' is cited, this refers to the Bank proprietary data that is sourced from the Bank's internal systems and may include, but not be limited to, credit card transaction data, merchant facility transaction data and applications for credit. The Bank takes reasonable steps to ensure that its proprietary data used is accurate and any opinions, conclusions or recommendations are reasonably held or made as at the time of compilation of this report. As the statistics take into account only the Bank's data, no representation or warranty is made as to the completeness of the data and it may not reflect all trends in the market. All customer data used, or represented, in this report is anonymised and aggregated before analysis and is used, and disclosed, in accordance with the Group's Privacy Policy Statement.

The CBA Spotlight Series does not contain any recommendations but provides commentary on Australian macroeconomic themes. As the CBA Spotlight reports are based on CBA Data, the IB&M Portfolio & Client Analytics (PCA) team provide raw data that may directly or indirectly relate to the themes that have been selected for coverage by the Chief Economist. The PCA team are subject to the same personal conflict requirements and trading restrictions as research, and individuals are wall-crossed per report. CBA Spotlight reports may be viewed in advance of publication by CBA Marketing and Communications in order to produce infographics. Reports are only provided to Marketing and Communications team members under strict wallcrossing and during this period their individual trading is monitored.

We are under no obligation to, and do not, update or keep current the information contained in this report. Neither the Bank nor any of its affiliates or subsidiaries accepts liability for any loss or damage arising out of the use of all or any part of this report. All material presented in this report, unless specifically indicated otherwise, is under copyright of the Bank. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior written permission of the Bank.

In the case of certain products, the Bank or one of its related bodies corporate is or may be the only market maker. Financial markets products have an element of risk. The level of risk varies depending on a product's specific attributes and how it is used. The Bank will enter into transactions on the understanding that the customer has: made his/her own independent decision to enter into the transaction; determined that the transaction is appropriate; ensured he/she has the knowledge to evaluate and capacity to accept the terms, conditions and risks; and is not relying on any communication (including this report) from the Bank as advice.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or that would subject any entity within the Commonwealth Bank group of companies to any registration or licensing requirement within such jurisdiction.

Unless agreed separately, we do not charge any fees for any information provided in this report. You may be charged fees in relation to the financial products or other services the Bank provides, these are set out in the relevant Financial Services Guide ("FSG"), relevant "PDS", relevant Terms & Conditions, and/or relevant contract. If you have a complaint, the Bank's dispute resolution process can be accessed on 13 22 21 when in Australia, and +61 2 9841 7000 from overseas. Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945 and its subsidiaries, including Commonwealth Securities Limited ABN 60 067 254 399 AFSL 238814 (CommSec), Commonwealth Australia Securities LLC and CBA Europe Ltd., are domestic or foreign entities. Global Economic & Markets Research is a business division of the Commonwealth Bank group of companies.



Global Economic & Markets Research

Stephen Halmarick Chief Economist - Head of Global Economic & Markets Research +612 9303 3030 stephen.halmarick@cba.com.au

Commodities		Telephone	Email Address
Vivek Dhar	Mining & Energy Commodities	+613 9675 6183	vivek.dhar@cba.com.au
Tobin Gorey	Agri Commodities Strategist	+612 9117 1130	tobin.gorey@cba.com.au

Economics		Telephone	Email Address
Gareth Aird	Head of Australian Economics	+612 9118 1100	gareth.aird@cba.com.au
Kristina Clifton	Senior Economist	+612 9117 7407	kristina.clifton@cba.com.au
Belinda Allen	Senior Economist	+612 9303 3110	ballen@cba.com.au
Nicolas Guesnon	Associate Economist	+612 9303 8273	nicolas.guesnon@cba.com.au

Fixed Income & Currency Strategy		Telephone	Email Address
Martin Whetton	Head of Fixed Income & Currency Strategy	+612 9303 3557	martin.whetton1@cba.com.au
Philip Brown	Senior Fixed Income Strategist	+613 9675 7522	philip.brown@cba.com.au
Tally Dewan	Senior Securitisation Strategist	+612 9118 1105	tally.dewan@cba.com.au
Elias Haddad	Senior Currency Strategist	+442077105603	elias.haddad@cba.com.au
Joyce Yu	Credit Strategist	+612 9118 1126	joyce.yu@cba.com.au
Belinda Cheung	Credit Strategist	+612 9303 1559	belinda.cheung@cba.com.au

International Economics		Telephone	Email Address
Joseph Capurso	Head of International Economics	+612 9118 1106	joseph.capurso@cba.com.au
Kim Mundy	International Economics & Currency Strategy	+612 9118 1107	kimberley.mundy@cba.com.au
Kevin Xie	China Economist	+612 9280 8058	Kevin.xie@cba.com.au
Carol Kong	Associate International Economics and Currency Strategy	+612 9303 8274	carol.kong@cba.com.au

Delivery Channels & Publications		Telephone	Email Address
Monica Eley	Internet/Intranet/Bloomberg/Database/Projects	+612 9118 1097	monica.eley@cba.com.au
Ai-Quynh Mac	Information Services	+612 9118 1102	maca@cba.com.au

Sales

Institutional	Telephone	Corporate	Telephone
Syd FX	+612 9117 0190	NSW	+612 9117 0377
	+612 9117 0341	VIC	+612 9675 7737
	+612 9117 0020	SA/NT	+618 8463 9011
Fixed Income	+612 9117 0020	WA	+618 9215 8201
	+612 9117 0025	QLD	+617 3015 4525
Melb	+613 9675 6815	NZ	+64 9375 5738
	+613 9675 7495	Metals Desk	+612 9117 0069
	+613 9675 6618	Agri Desk	1800 633 957
	+613 9675 7757		
Lon FX	+44 20 7329 6266		
	+44 20 7329 6444		
	+44 20 7329 6609		
Debt & Derivatives			
Credit			
HK	+852 2844 7539		
Sing	+65 6349 7074		
NY	+1212 336 7750		