

House prices soft as economy weakens and uncertainty rises

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September Quarter House Price data

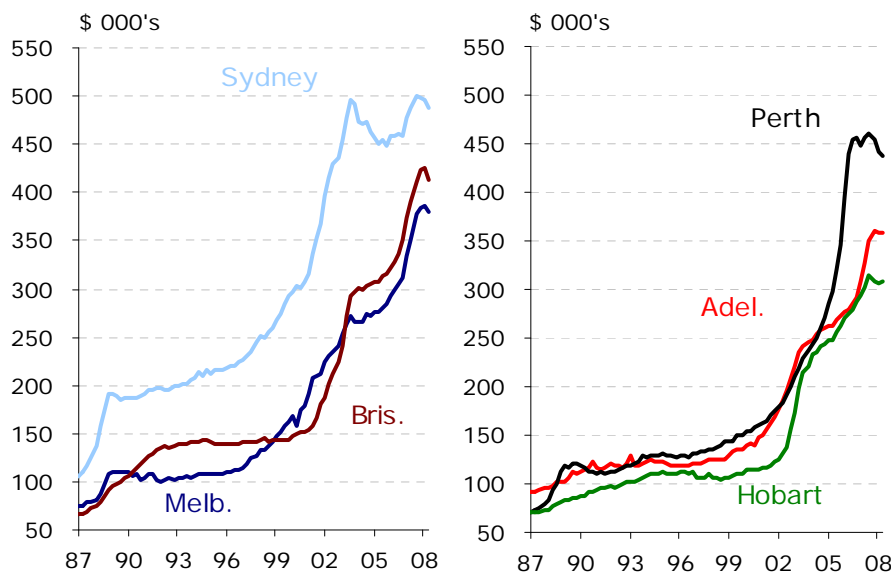
- Australian established house prices eased 1.8% in the September quarter the largest quarterly fall since 1978, yet were still up 2.8% in the year. Softer prices were experienced across most capital cities in the quarter as follows: Brisbane (-3.3%), Canberra (-2.5%), Melbourne (-1.9%), Sydney (-1.8%), Perth (-1.1%), and Adelaide (-0.1%). Hobart (+0.7%), and Darwin (+0.1%) experienced marginal increases
- The softness in prices was prompted largely by rising interest rates in H1-2008 which saw affordability deteriorate to levels not seen since the late-1980's. This was compounded by ongoing falls in equities and a slowing economy sapping any positive sentiment from the market and giving rise to high levels of uncertainty. As a result property market activity has fallen significantly, as evidenced by low auction clearance rates, and a stand-off between buyers and sellers has developed.

Key Figures

	Sept quarter (%)	Year to Sept quarter (%)	Median (\$000)*
Sydney	-1.8	-0.4	525.3
Melbourne	-1.9	8.1	408.6
Brisbane	-3.3	5.6	413.5
Adelaide	-0.1	9.7	367.8
Perth	-1.1	-4.1	443.1
Hobart	0.7	2.4	304.6
Darwin	0.1	6.4	429.1
Canberra	-2.5	0.0	464.2
Australia	-1.8	2.8	445.2

Source: ABS * Calculated from ABS price transfers data

Figure 1: Australia median house prices



Source: ABS

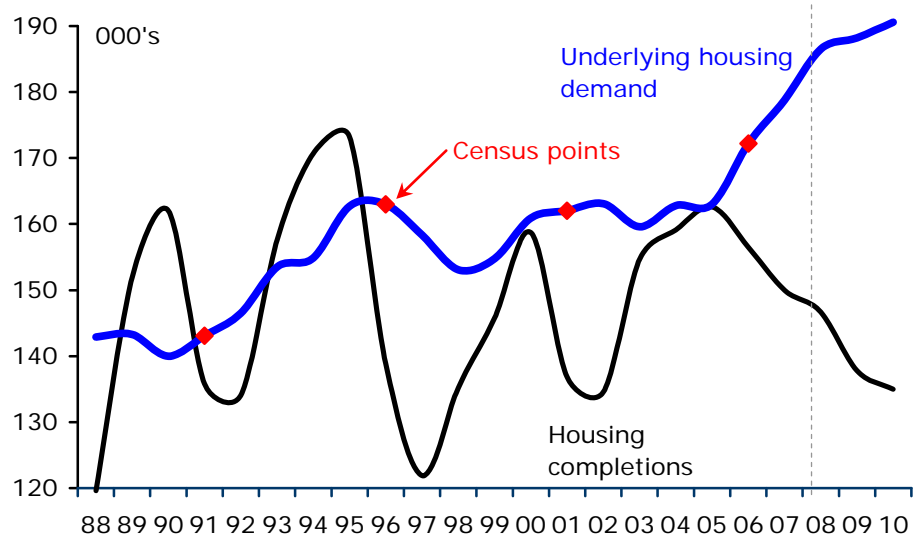
House prices soft, but do not expect US-style falls

House prices will be subject to divergent forces going forward that we expect will largely cancel out any significant price moves either up or down in the short-term. Yet it is our view that there are several factors that should shield the market from significant falls.

Increases in the first home buyers grant (from \$7K to \$14K) should provide some impetus to prices at the entry level. Further, significant cuts in official interest rates, 125bps so far and the strong expectation of another 50bps of cuts tomorrow, will only serve to improve affordability (for both new and recent entrants especially). Our current expectation is that official rates will fall to 4.5% by mid-2009, taking the mortgage rate to somewhere between 6-7%. This falling interest rate and only a modest rise in unemployment should also limit forced selling where sellers have to take lower prices. If other vendors don't have to, or want to, sell at a lower price, why would they?

Underpinning the market is the chronic shortage of housing (a factor that is largely undisputed amongst economists) which should also assist in putting a floor under prices as pent up demand pounces quickly on any opportunity.

Figure 2: The supply/demand fundamentals should support the market



Source: ABS, ANZ

Before the bears start tearing their hair out at this 'moderate' outlook, it should be noted that this view is predicated on an economic scenario in which recession is averted, however narrowly. Certainly a weaker than expected economy and any significant rise in the unemployment rate would pose further downside risks to house prices. That being said, we certainly do not expect the scale of any potential further house price falls in Australia to be the same as currently being experienced in the United States. This point was reinforced by the RBA Deputy Governor recently when he suggested that *"the Australian housing market will not follow the US market to the same degree"*. He cites domestic housing under-supply, the weight of outstanding debt being held by those that can most afford it (unlike the US) and the relatively solid footing of Australian household balance sheets as a few of the many key factors differentiating the two markets.

As such we find it difficult to envisage the mechanism by which Australian house prices would fall 30-40%, as suggested by a vocal minority – short of domestic economic catastrophe. The Australian housing market has entered a period of consolidation, with the performance of the capital cities, and suburbs within those cities mixed. However, as sentiment picks up in 2009, interest rates are lowered and affordability improves, we anticipate that Australian aggregate house prices will again begin to move upwards at a moderate pace.



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