Liberal's Election Win, APRA, RBA Rate Cuts - SQM moves to Scenario 4

Tuesday 21 May 2019

As a reminder, our forecast for 2019 was as follows:

	ACTUALS	2019 Scenario 1 (base case)	2019 Scenario 2	2019 Scenario 3	2019 Scenario 4
City/Region	5 months to 20 May 2019 All Dwellings	• Cash rate unchanged/ cuts in late 2019. • Economy slowing • AUD ranges between US$0.65 - US$0.75 • Labor Govt. (May 2019)	• 0.20% interest rate rise by banks outside RBA by 2nd Qtr • Cash rate unchanged/ cuts in late 2019 • AUD ranges between US$0.65-US$0.75 • Labor Govt. (May 2019)	• 0.50% rate cut starting 2nd Qtr. Banks pass on 25 to 35bp net • AUD ranges between US$0.65-US$0.75 • Labor Govt. (May 2019)	• Scenario 1 PLUS • LIBS Hold Government
Perth	-3.9%	-1% to +3%	-2% to +2%	0% to +4%	**-1% to +3%**
Brisbane	-1.7%	-2% to +2%	-2% to +2%	+1% to +5%	**-1% to +3%**
Darwin	+0.2%	-8% to -4%	-8% to -4%	-8% to -4%	**-8% to -4%**
Melbourne	-4.2%	-9% to -6%	-11% to -6%	-3% to 0%	**-7% to -4%**
Sydney	-4.4%	-9% to -6%	-11% to -6%	-3% to 0%	**-6% to -3%**
Adelaide	-0.7%	-1% to +3%	-2% to +2%	0% to +3%	**-1% to +3%**
Hobart	+1.8%	+5% to +9%	+4% to +7%	+5% to +9%	**+7% to +10%**
Canberra	-2.4%	+2% to +5%	+1% to +4%	+3% to +5%	**+3% to +7%**
Capital City Average (weighted)	**-3.8%**	-6% to -3%	-7% to -3%	-2% to +2%	**-4% to -1%**

So far the market this year has fallen by another 3.8%. Our base case forecast, released in our 2019 Housing Boom and Bust Report back in November 2018, was for a total 2019 dwelling price fall of between -3% to -6%. It would be fair to say that up until this past weekend the market was heading towards the bottom end of that forecast (-6%).

Readers of our 2018/19Housing Boom and Bust report should now be put on notice that our **Scenario 4 (an Lib victory with interest rate cuts late in 2019) are now in play**.

In a surprise, the Liberal National Party has won the 2019 Federal Election. While counting is continuing, it appears the Liberal Government will achieve majority in the House of Representatives and will face a dovish Senate where the Centre Alliance will hold the balance of power, notwithstanding required support from the Conservative Party and One Nation.

That means it is likely the national housing market will record a price fall for this calendar year of between -1 to -4%. This is less than our Scenario 1 forecast which tipped a -3 to -6% price decline.

We believe the Liberal victory means increasing buyer confidence in the market which was severely lacking as a result of the anticipation of the change in negative gearing and capital gains tax by a Labor Government.

While our Scenario 4 suggests price falls for the full year, note the price falls already recorded. Our view is that dwelling price rises may materialise from the 2nd half of the year as demand increases as a result of the expected improvement in confidence.

However, there have been two key developments today which may well mean that there is risk to the upside on our Scenario 4 forecasts.

Scenario 4 also does not take into account additional loosening on credit lending. Today APRA has announced it is dropping the 7% theoretical interest rate for banks to use when calculating serviceability by borrowers.

Banks will be allowed to set their own minimum buffer instead, notwithstanding they still need to test if a borrower could still service a loan assuming a rate 2.5% higher than the lending rate applied to the borrower .

In other words, if you are applying for a loan with an interest rate of 4%, the bank will test to see if you can handle an interest rate of 6.5%.

In our view, this is another significant move by APRA to loosen present day lending restrictions and place more responsibility on the banks to determine their own limits.

This move should mean that more loan applicants will qualify for a loan and/or their borrowing limits will increase.

There is now more emphasis and weight applied to a more conservative use of HEM and credit control reporting, which is a good thing and should ensure reasonably responsible lending and therefore pace a reasonable anchor on the market.

I initially believed today's move by APRA was part of a strategic decision by the RBA to loosen credit restriction instead of relying on a further easing in monetary policy to stimulate housing, however, after today's statement by the Reserve Bank, it appears a cut in the cash rate next month is almost a certainty.

Scenario 4 does not take into account an earlier than expected rate cut. There are an increasing number of economists who are expecting rate cuts this year, starting as early as the first week of June of up to 50 basis points.

If there was such a cut over the course of June, July and/or August, it is likely the market would respond and demand for residential property would increase over and above our Scenario 4 forecast.

Needless to say a combination of loosening credit restrictions plus a cut in interest rates, increases the risk of another housing boom which I am sure that is not what the 'powers that be' would want, but they may well yet get.

Note, the Australian housing market still contains headwinds which include:

- The Sydney and Melbourne markets are still in overvaluation despite the price corrections that have occurred since mid-2017.
- Ongoing restrictions on home lending in the form of a more conservative HEM and reduced purchasing power multiples on reported borrower net income.
- Ongoing global trade tensions causing some economic uncertainty

- Ongoing high housing Debt to GDP levels
- Elevated rental vacancy rates, particularly for Sydney.
- Elevated listings in Sydney and Melbourne

These headwinds should initially prevent another rapid housing boom from developing. That is certainly our view if there is no rate cut. However, if we are to see a rate cut of 50 basis points or more over the next 2-3 months, combined with today's announcement by APRA, all cards are off the table for 2020. And for 2019, our Scenario 4 estimates may well end up being too conservative with the risks plainly being on the upside.

About SQM Research

SQM Research Pty Ltd is a respected Australian investment research house, specialising in residential property research and data as well as investment fund ratings on all asset classes.

It is founded and run by one of the country's most recognised and respected property analysts, Louis Christopher (former Head of Research and General Manager of Australian Property Monitors), whose objective, candid and honest approach to the real estate market is one of the foundations on which SQM Research has been built on.

The company was launched in 2006 and has now expanded to cover research and all major asset classes.

Recent forecasting history

- SQM Research was judged by *The Australian Financial Review* to be the most accurate Australian residential property market forecaster of 2015, 2016 and 2017.
http://www.afr.com/real-estate/2015-house-price-forecasts-the-good-the-bad-and-the-hopeless-20151230-glx5ih

- SQM Research correctly predicted the Sydney property boom 2013, 2014 and 2015
http://www.moneymanagement.com.au/news/financial-planning/sqm-optimistic-about-housing-market

- SQM Research correctly predicted the housing market downturn of later 2010/2011
http://www.smh.com.au/business/property/clearance-rates-under-60-point-to-correction-to-come-20100628-zcx2.html

A full list of media stretching back to 2002 can be found on www.sqmresearch.com.au/media.php