

Updated Forecast on Brisbane House Prices

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With a year of data since my original forecast on Brisbane house prices now out – which was actually my first paper in this area – and a few significant changes to the policy backdrop, I thought it was time to go back and look at how my original forecast stacks up and revise my forecast in line with those changed policies.

I will add now that this is almost certainly the last forecast of Brisbane house prices that I will make publicly available for one important reason – in the next few months it will become possible to trade futures on Australian capital city house prices on the ASX, and I intend to take on very large short positions on Australian house prices in anticipation of significant price falls. (One of the investors that I admire most is Jeremy Grantham, and I note his lament in his last quarterly newsletter that with the bursting of the US and UK housing bubbles, amongst other events, there are no more sure things out there – which he defines as 90% probability of occurring. He doesn't cover the Aussie housing market – at least I've never seen him mention it – so I think he is unaware of the last 90% probability trade – the popping of the last remaining housing bubble!) Now I have little respect for the market economists who are continually in the media talking their own book. And I certainly don't want to leave myself open for people to suggest that my comments are tainted by a vested interest. So I am setting myself a higher standard than the usual commentators out there, and I will restrict any further comments on housing to politically related issues such as housing affordability and fairness in housing policy.

So how does my original forecast stack up?

I published my original paper around a year ago and it is available at <http://www.geocities.com/homes4aussies/080708paper.pdf>

You may wish to refresh your memory by reading it again. The forecast is presented in Figure 3 in that paper.

In Figure 1 below I have reproduced that graph with actual data now extended to the March quarter of 2009. Note that it is a plot of the house price INDEX using ABS data, and the full methodology was presented in the original paper. I have just included the latest release of the ABS data, including some revisions of earlier data.

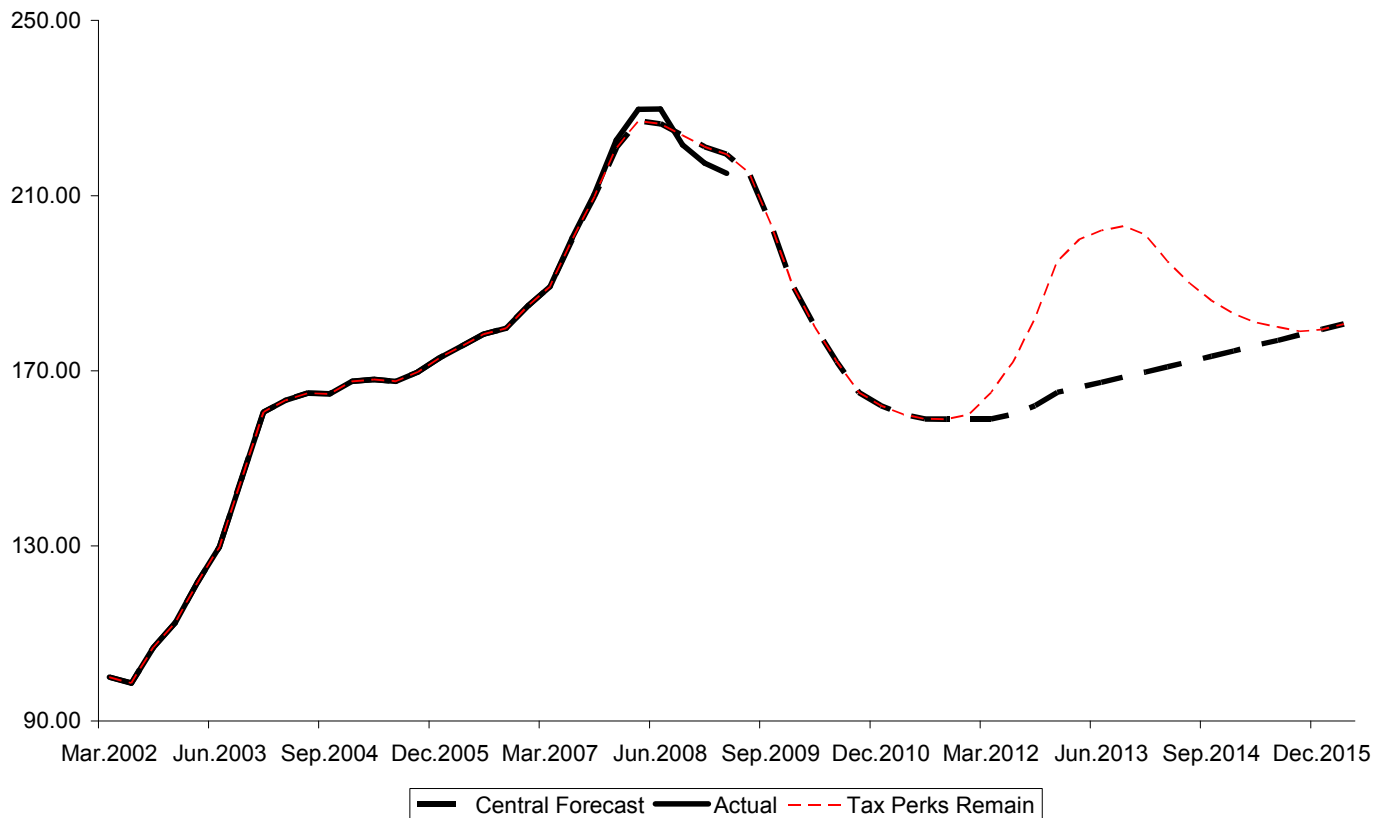


Figure 1. House Price Index for Brisbane based on data from the Australian Bureau of statistics, together with original forecasts of future house price movements.

As can be seen, my forecast was quite accurate – in fact, I was also correct that my forecast may prove to be on the conservative side for reasons explained in the original paper. In actual fact, my forecast was even more accurate than this graph shows because the most significant deviation is the higher starting point at March quarter 2008 which was actually caused by a revision to the ABS data! Whilst my forecast that the March quarter 2008 would prove to be the peak of the market was out, the June quarter median price was just \$100 more than the previous quarter!!

In figure 2 below, I have replotted my original forecast (tax rorts maintained) by splicing it on (the same percentage price movements) from the revised March quarter 2008 level.

It is clear from the plot of actual price movements that the bursting of the Brisbane bubble began abruptly and prices fell sharply after June quarter 2008. (Remember, the early part of my forecast was based on the Case Shiller 20 city composite index for the US, so prices have fallen faster than the US experience.) It is important to note that the turning in the market occurred before the intensification of the global financial crisis after the collapse of Lehman Brothers in late September 2008 – so Anna Bligh and Kevin Rudd trying to blame all of their financial challenges on the international crisis is a complete load of baloney!

Where to from here?

Now, in my original forecast I made a couple of assumptions, most importantly that the first home savers accounts would be well publicised by the government and that large numbers of young Australians would take them up.

This has not proved to be the case. Moreover, confronted with the popping of the housing bubbles around Australia, State and Federal governments have been busy attempting to revive them. The

greatest market distorting event, undoubtedly, was Mr Rudd’s introduction of the boost to the first home owner’s grant and the massive marketing program around it (whilst the first home savings accounts were forgotten!) Consequently, very few young Australians have made use of the savings accounts – which is a great shame since it is actually good policy as long as measures are also taken to prevent investors from taking advantage of first home buyers – and, lured by the extra cash, many have brought forward their purchasing decision even though they have minimal savings and prices have only just begun to retreat from their bubble highs.

These altered conditions have led to me revising my forecast as shown below.

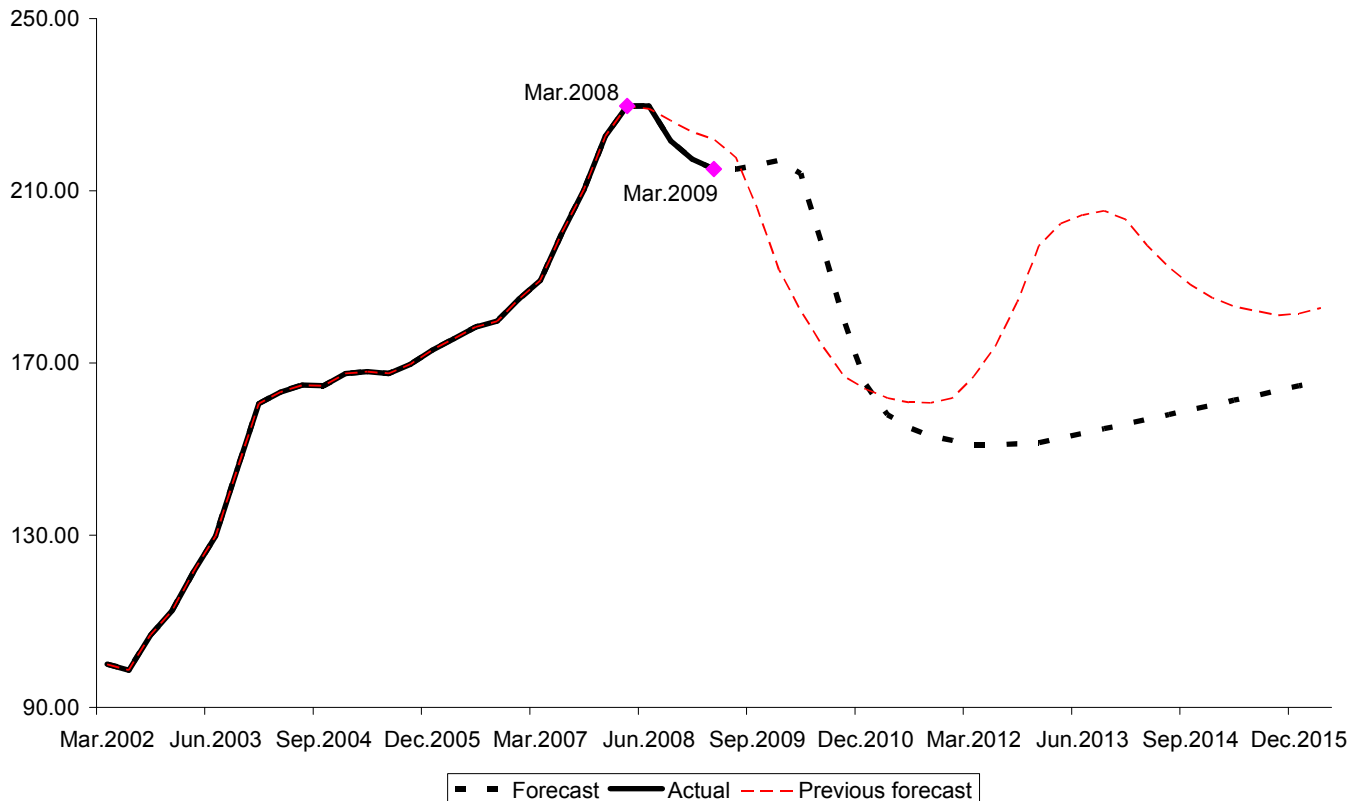


Figure 2. Brisbane house price indices and forecast (historical data from Australian Bureau of Statistics). “Previous forecast” spliced on to the ABS-revised March quarter 2008 median price.

NOTE that both forecasts assume that the tax rorts of negative gearing and capital gains tax concessions remain in place, even though I think it is quite likely that they will be ceased at some time in the forecast period, possibly soon after the release of the review “Australia’s Future Tax System” led by Ken Henry.

As can be seen from the plots, essentially Mr Rudd traded a floor under the housing market – even a mini bubble if the tax rorts remained in place – in the run-up to the first participants gaining access to their savings accounts in late 2012 for a brief stabilisation of the housing market now.

However, it is strongly my view that this stabilisation is a temporary phenomenon for the following reasons:

1. House prices relative to income remain at irrationally high levels, and when long term interest rates are considered – not just the temporary low interest rates at present – housing remains extremely unaffordable.

2. Investors are not very active in the market because of economic conditions, tighter lending standards on them, and because the price falls have gone a long way to ending the bubble psychology that was in place – most importantly, it is clear that house prices can and do fall!
3. There is only a finite number of naïve first home buyers to bring to the market - after all, credit conditions were only tight for 12 months before the boost was introduced, and any clown with a heart beat could get a loan on easy conditions before that (already there are reports of first home buyer loan numbers falling, even though the boost was extended.)
4. Banks have toughened their lending conditions on first home buyers – though they had been threatening this for a while, there is much discussion that this is actually occurring now.
5. The worst of the recession is still ahead of us, and sharply rising unemployment is going to put a great deal of pressure on the housing market (in the last few days there are reports that foreclosures were at record levels in April 2009!), and
6. Difficult economic conditions will see Aussies reassess the priorities in their lives – people will decide that owning lots of stuff, including a home rather than renting a perfectly good one for much less, is not worth putting children into long term daycare from an early age, or even putting off having a family indefinitely (and I, for one, will be glad to see this change!)

I still consider this a fairly conservative forecast and consider the risks to this forecast to be to the downside. Firstly, **I am not at all certain that the boost will add the degree of stability to the market** that I have included (for reasons discussed above.) Moreover, because I see no event as being a major trigger to placing a floor under the market – much like the US market at the moment – interest will only pick up in housing once prices reach rational levels. In this forecast house prices will retreat around 35% from peak prices and then grind upward with inflation. Still, because our prices are so high, it will be an extended period before prices reach around 3X average earnings. At the trough in nominal prices they will still be above 4X average earnings assuming 1% real growth in earnings. I do not believe that house prices will begin to move in line with earnings until prices are at most 3X average earnings, the international benchmark for affordability.

Over the medium term I think that Mr Rudd's policy rejig will have some unintended consequences which will actually be positive for fair housing policy. As my forecast shows, I think that house prices will actually end up lower than if he had stuck with his original policy. Moreover, I expect that investors, after experiencing the other side of the volatility coin – the price falls – are going to be so cheesed off with residential property that they will be keen to have policies that improve price stability – and leave them less vulnerable to spruikers – and foremost in this will be the removal of the greatest market distortions – negative gearing and CGT concessions (possibly going back to an inflation adjustment.)

As will be noted, without any event to trigger a surge in first home buyer activity over the forecast period, I seriously doubt that there will be any major up-tick in house prices in the foreseeable future. However, it has to be said that whilst the tax rorts remain in place, it seems young Aussies are destined to pay more (relative to their income) for the pleasure of owning a home, and we remain susceptible to boom-bust housing cycles. Nonetheless, given the size of this particular boom – a massive bubble – I would suggest that speculator psychology will be so damaged that such an occurrence is unlikely for well over a decade.