

Box B

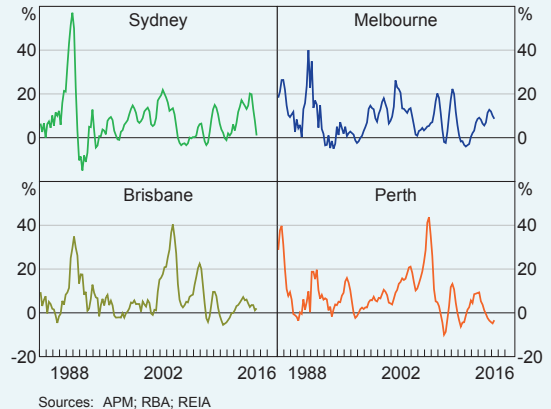
The Housing Market

Overall conditions in the housing market have been strong in recent years and have contributed to the rebalancing of economic activity towards the non-mining sectors of the economy. As expected, housing market activity has been relatively sensitive to the reduction in interest rates over recent years.¹ Population growth has also been an important driver of housing market trends across the country. Housing prices have increased and the construction of new dwellings has added to economic growth and employment.

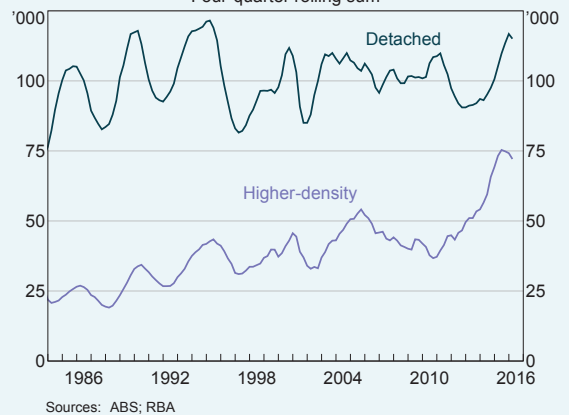
Housing prices in Australia have increased at an average rate of around 7½ per cent per annum since mid 2012. This has been largely driven by developments in Sydney and Melbourne, with more modest price growth in other capital cities over this period, especially in those cities with larger exposures to the mining sector (Graph B1).

Residential building activity has increased as a share of GDP, from about 4½ per cent on average in 2012 to almost 6 per cent in the March quarter 2016. The number of new residential building completions in Australia was around 190 000 in 2015, an increase of almost 20 per cent compared with a decade ago when it was generally judged that supply had not been keeping up with demand. Apartments have accounted for most of the increase in housing supply, although detached dwelling completions have also picked up over the past couple of years (Graph B2).²

Graph B1
Housing Price Growth
Year-ended



Graph B2
Private Dwelling Completions
Four-quarter rolling sum



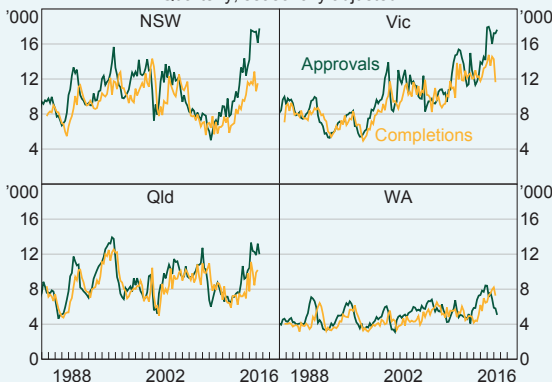
Since 2012, the supply of housing has increased in all Australian states, but activity has been concentrated in the four largest states of New South Wales, Victoria, Queensland and Western Australia, which together account for more than 90 per cent of Australia's total building activity. Building

1 See RBA (2015), 'Box C: The Cycle in Dwelling Investment', RBA *Statement on Monetary Policy*, May, pp 43–45.

2 See Shoory M (2016), 'The Growth of Apartment Construction in Australia', RBA *Bulletin*, June, pp 19–26.

approvals data suggest that there will be a further expansion of supply in these states over the next year or two (Graph B3).³ The number of newly approved dwellings has been above completions for some time, leading to a build-up in the pipeline of work yet to be done to historically high levels. In part, this reflects a shift in the composition of approvals towards higher-density dwellings, which typically take longer to complete than detached dwellings. This build-up in dwellings under construction or yet to be commenced is particularly apparent in New South Wales and Victoria (Graph B4).⁴

Graph B3
Private Dwelling Activity
Quarterly, seasonally adjusted



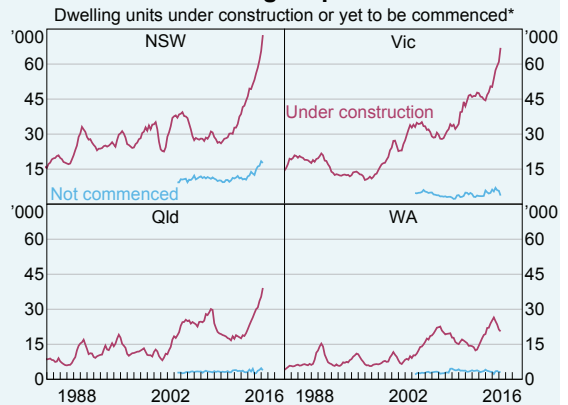
Sources: ABS; RBA

In addition to interest rates, growth in the number of households is a key determinant of housing demand. This in turn is a function of population

3 Building approvals are generally sought just prior to the commencement of construction work. These are separate from planning approvals, which can potentially precede building by many years.

4 Information from liaison suggests that residential construction activity is operating at close to capacity in those markets where demand is strong. There may be some capacity to accommodate a further pick-up in the construction of detached houses in south-east Queensland and apartments in Melbourne (outside the inner city). In markets operating close to capacity, such as Sydney and the greenfield market in Melbourne, further increases in land and dwelling sales may lead to activity remaining at high levels for longer, but are unlikely to add to the level of activity in the near term.

Graph B4
Dwellings Pipeline



* Dwelling units under construction are private sector projects only; work yet to be commenced includes public sector projects

Sources: ABS; RBA

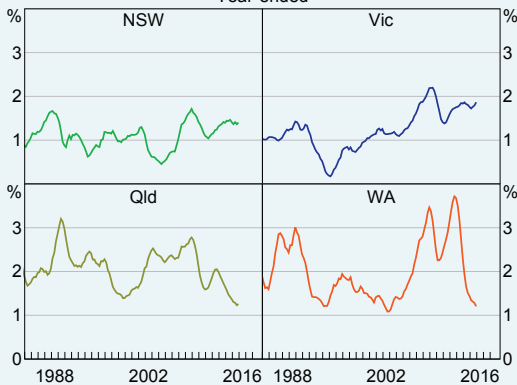
growth and changes in the average size of households.⁵ In New South Wales and Victoria, relatively strong population growth has supported underlying demand over the past few years (Graph B5). However, in Western Australia and to a lesser extent Queensland and South Australia, population growth has slowed following the end of the mining investment boom.

The balance between supply and demand for housing is ultimately reflected in housing prices, vacancy rates and rents. In Perth, the combination of slower-than-expected population growth, weaker household income growth and a high level of dwelling completions in recent years has placed downward pressure on housing prices. Rental vacancy rates in Perth have risen sharply to be more than double the average of all other capital cities, which is around 2½ per cent (Graph B6). Consistent with this, rents in Perth declined by 5¼ per cent over the year to the June quarter 2016 (Graph B7).

Despite the substantial increase in supply in recent years, vacancy rates in Sydney, Melbourne and

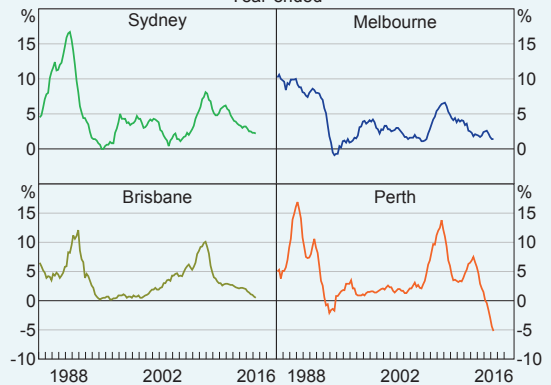
5 Average household size tends to change slowly. Between 1911 and 2001 average household size decreased by about 2 persons per household, from 4½ to 2½, but has since been little changed.

Graph B5
Population Growth
Year-ended



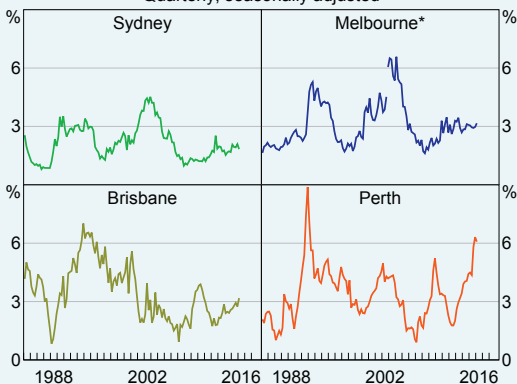
Sources: ABS; RBA

Graph B7
Capital City Rent Inflation
Year-ended



Source: ABS

Graph B6
Rental Vacancy Rates
Quarterly, seasonally adjusted



* Series break December quarter 2002

Sources: RBA; REIA; REIV

Brisbane have only risen a little, to be around their long-run average levels. That said, rent inflation in these cities has been declining, and has also been a little weaker than suggested by its historical relationship with the vacancy rate.

There are some concerns about the concentration of new supply in areas such as some parts of inner-city Melbourne and Brisbane. Downward pressure on prices from large increases in supply relative to demand for apartments in some areas could increase the risk of off-the-plan purchases failing to settle.⁶ More generally, a further increase in the supply of apartments is scheduled over the next couple of years. While this will continue to support economic activity over this period, it will tend to constrain growth in housing prices and rents, at least in some markets. ✖

⁶ See RBA (2016), *Financial Stability Review*, April.