Future of the Melbourne Property Market

Many people have asked me lately what I think will happen to the Melbourne property market after the virus crisis. Like all predictions at times of uncertainty, it is impossible to know, but it IS possible to understand what the fundamental factors are that will move the market and therefore arm the reader with the tools they need to predict the market going forward, by watching those fundamentals. So here we go:

Our best prediction at this point is that Melbourne's property market will go through 3 phases in coming years:

1. **A short, sharp dip – 1- 3 months**: where those few properties that have to be sold will struggle to find buyers and may sell at below long-term value. The vast majority of potential sellers will hold through this period and the banks will not be forcing sales if at all possible;
2. **A solid recovery** – second half of 2020/2021: where if the economy can restart satisfactorily, the market will work to a new equilibrium, probably lower than where we left it in February 2020, but recovering gradually over the next year or so to get back to where we were;
3. **A potential immigration driven boom** – **2022 onwards**: government policy and the relative attractiveness of Australia to immigrants from not just Asia, but also Europe and the US – may lead to strong population growth tempered by the politics of higher immigration while Australian unemployment remains high at a time of still very low global interest rates – this would mean a likely boom in Melbourne property prices in the medium term.

These thoughts are heavily guarded by the many uncertainties that may make things work out very differently – here's our big 3 to watch out for.

Uncertainty # 1 – how long and how deep is the recession:

The major uncertainty facing the property market is how long and how deep the recession will be after the C19 crisis, but we are going to take you on a journey of our best guess as to how things may play out and if we are wrong (we will definitely be wrong (!) we just don't know which parts of our prediction will be or by how much) it will most likely be because we get our estimate on the severity of the recession wrong.

Our judgement at this stage is that Australia's recession will be shorter and less severe than almost all the rest of the world, certainly Europe and the US, though China may rebound even faster than we do. Clearly China rebounding will be good for us and the US and Europe mired in recession/depression will hurt us all at a certain level. But at this stage, Australia's quiet public service leaders can rightly lay claim to managing the GFC in 2008-9 at close to the top of the global class and managing the C19 health crisis better than anyone in Europe or North America, if not quite as well as some of the East Asian SARS veteran states like Singapore. It is also pretty likely they will manage the subsequent economic fall-out far better than most and Australia's strong balance sheet (our very low debt:GDP levels) and the evidence of the JobSeeker and related packages shows a strong willingness and capacity to bring strong Government stimulus to limit the impact of the recession.

The key will be how quickly we can get back to work:

Uncertainty #2 – how quickly we can get back to work:

If most of Australia can start back to work by the third quarter (July), then much of the economy will spring back to life. If it takes until fourth quarter (October), we will have already killed a lot of businesses and things will be much bleaker. If it is much longer than that, there may not be "a blade of grass left on the place" as a pollster friend of mine rather graphically put it.

Our best guess is that the greater availability of widespread testing and possibly some ameliorative treatments (not a vaccine – that will almost certainly take longer – but treatments that make it less likely a patient dies) should allow the Government to effectively partition the nation into 3 populations:

- The infected (about 0.1 % of the population at any one time);
- The vulnerable (those over 65 or immune-compromised – perhaps 20% in total); and
- Everybody else – 80% - including 98% of the workforce.

With widespread testing and quick, effective contact-tracing, it should be possible to get the majority of the population back to work – with the occasional infection quickly isolated and contacts traced and isolated – provided the vulnerable remain under very strict isolation until a vaccine is available. While this is a far from ideal outcome, especially for the isolated elderly, the ongoing damage to the economy will end up costing many more lives quite quickly (sadly not least to suicide and domestic violence and the crushing impacts of widespread poverty on health and violence) if the vulnerable can still be protected.

So we think the Government will look to restart the economy in stages once they have (a) widespread testing capacity; (b) reconsidered the benefits of facemasks as a spread-prevention more than a personal protection; (c) got access to any ameliorative medical treatments; (d) got strong reliable, probably a mobile phone App contact tracing technology.

They will start slowly to ensure we don't re-enter the crisis with a second infection spread and need for a second lockdown which would be catastrophic for health, mental health and the economy.

Uncertainty 3 – when does the population growth engine restart ?

There have been 3 main drivers of Melbourne's long-term bull market in residential property:

- Population growth (a constant for nearly 30 years);
- Interest rate reductions (over the last decade);
- Bank lending being loosened or tightened by government (as happened in the recent correction from late 2017 to mid 2019 and was then rapidly reversed after the election)
- Foreign Investment particularly from China (which has come and gone and appears to be just starting up again).

Interest rates are at record lows and should therefore be stimulating strong price growth and were beginning to do so again before the crisis.

Population growth has the been the Melbourne markets' great strength and bi-partisan Government policy as we have written about before.

For the first time in a generation, Melbourne's population growth has come to a shuddering stop with this crisis. Indeed, particularly with many foreign students going home, no use for AirBnB stock and many young adults moving back into Mum and Dad's place (what we call "household consolidation") we will see a surplus of housing in our market in the short term – both to rent and to buy – and consequent downward pressure on prices and rents.

But we believe it is settled government policy in Victoria to use population growth to drive housing construction to drive the economy and that will resume as soon as possible.

And in particular we believe given Australia's superior handling of the C19 health and likely economic crisis that we will become an even more attractive location for potential immigrants (and students) – including increasingly from Europe and the US as well as Asia.

So we think there may be an immigration driven boom in Melbourne's property prices once the economic and population growth engines are fully restarted. We suspect that might begin sometime in 2022 and continue on for some years.

BUT, if, for example, Government immigration policy were to change – either because the Australian economy remains in recession or possibly because of increasing nationalism/xenophobia (some possibly directed at China as the source of the virus ?) then we may not see the re-growth of immigration and student numbers. If that is the case, our biggest driver of price growth would be halted with significant consequences for the Melbourne market versus the pattern of the last 3 decades.

SHORT-TERM IMPACTS OF THE VIRUS ON THE PROPERTY MARKET

Population Growth

Positives	Negatives
Some expats/travellers return	Students home
Population Growth	Migration stops
But if we handle differentially well health and economy wise:	No travellers in rental market
Students return - especially vs US	Deaths if significant
Big inbound migration	

Foreign Investment

Positives	Negatives
China good and exchange rate low and domestic concerns	
Exchange rates low - good with expats and non-Chinese as well	
Good health and economic performance	

Supply

Positives	Negatives
Still some coming on now, but longer hole in new supply	

Economy - Serious slow-down even after crisis means:

Positives	Negatives
Supply side harder to finance	Money incomes lower and more risk averse so lower gearing

Interest rates: + Banks

Positives	Negatives
Interest Rates could not get any better	
Banks likely keen to restart their lending engines to improve their profits	