

Why unemployment scare will not seriously damage property prices

By **STUART WEMYSS**

3:50PM MAY 1, 2020 •  7 COMMENTS

Most economists are forecasting the coronavirus pandemic will have a negative impact on property prices. Various economists expect the median house value to fall, with most projections in the range of 10 and 30 per cent.

Economists believe that house prices will fall due to the rise in unemployment, lower economic activity, lower mortgage volumes, falling rents and fewer overseas buyers.

Simple logic suggests that if fewer people are employed, fewer people will be able to afford to purchase a property. In addition, newly unemployed people may be forced to sell their homes, if they are unable to make mortgage repayments. As a result, sellers outnumber buyers, and prices fall.

However, the historic evidence does not support the notion that higher unemployment leads to a fall in property prices. I compared the prevailing unemployment rate between 1980 and 2017 with the subsequent three years of property growth.

I expected to see the rolling three-year growth rate fall, as unemployment rose. However, there was no clear relationship. For example, there were historical periods where the property growth rate was falling at the same time the unemployment rate was falling, which seems illogical.

Moreover, looking back at Australia's last recession, property price falls preceded a rise in unemployment, not the other way around.

Between 1990 and 1992, unemployment rose from 5.85 to 11.2 per cent. During this period, the subsequent rolling three-year annual property growth ranged between 1.1 per cent per annum and 3.4 per cent per annum. Inflation was about 1.5 per cent during this period, so in real terms, property prices were flat.

Looking back at what had actually happened, it turns out there was very strong price growth between 1985 and 1988 (over 20 per cent a year) and property prices started falling from early 1989 until the end of 1990. But unemployment only started to rise in early 1990.

Why might there be a weak link between unemployment and price growth? I cannot offer a definitive answer, of course. But I think a large part of the answer lies in two factors. Firstly, we all need somewhere to live. Secondly, the housing market is close to equilibrium in terms of demand and supply. For there to be large falls in prices, there needs to be more sellers than buyers — mass selling. That can occur with other asset classes (such as shares) with limited practical consequences. However, that is more difficult to do with property. Of course, investors and holiday-home owners have the discretion to sell, but in the main, these people tend to have a stronger financial position than the average Australian.

The important distinction that makes our current situation unique for property is caused by a contraction in supply, not a fall in demand. Normally, an economic slowdown is caused by a fall in consumer spending.

Today, most consumers are happy to spend: the latest statistics or a visit to Bunnings will prove that! Once restrictions have been lifted, demand will likely return at a faster rate than in a demand-driven recession.

Also, the government has initiated mechanisms to help home owners avoid having to sell their home, including banks offering repayment pauses, JobKeeper and JobSeeker programs. These initiatives should minimise forced sales.

Economists cited other factors that may cause property prices to fall, including a decline in rents, subdued economic activity and a contraction in mortgage volumes.

Falling rents are unlikely to have a material impact on property values. I find it difficult to believe that either a property purchaser or seller would factor in the temporary impact on rents (caused by coronavirus) when forming a view on a property's value.

Similarly, the impact on economic activity is likely to be patchy. Naturally, there will be some geographic locations that will be impacted by the recession to a greater extent or duration. Of course, that could weigh on property values. However, if the predicted V-shaped recovery materialises, in the main, property prices should weather this temporary storm.

Money supply and property growth do have a strong relationship. I expect that mortgage volumes to fall severely this quarter, mainly due to the lower demand by borrowers but also operational issues (banks have a large backlog of work due to the disruption of offshore personnel). This contraction in money supply could be a drag on property price growth.

It is also important to understand the data. Most people would not decide to sell a property today unless they had to do so for financial or other reasons. It is therefore reasonable to assume that most people that are currently selling property are either motivated vendors (and will drop their price in order to secure a sale) or the achievable sales price is not a driving factor. Either way, if this type of vendor is dominating the market, it should not be surprising to see a temporary drop in median prices.

Stuart Wemyss is an independent financial adviser and author of Investopoly & Rules of the Lending Game.

swemyss@prosolution.com.au