

# Buyer demand has fallen but so has supply, easing overpaying

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By **STUART WEMYSS**,  
12:00PM NOVEMBER 25, 2022

Residential property prices in the five largest capital cities have fallen by 7.1 per cent since May, when the Reserve Bank started hiking interest rates. Sydney has seen the largest price fall, down around 10 per cent, and Melbourne has fallen by nearly 7 per cent.

But it's not all bad news. House prices in Brisbane, Adelaide, and Perth are still materially higher than they were a year ago.

I've said all along that prices would fall 5 to 7 per cent. This has happened now, and I don't think we'll see any more (material) falls in investment-grade locations for the reasons set out below.

One of the reasons that prices have fallen this year is that it's no longer necessary to overpay to buy a property. Last year, I wrote that the only way to successfully buy a property in 2021 was to overpay. That's because potential buyers outnumbered sellers.

Buyer demand has fallen (probably due to higher rates, sharemarket volatility and talk of a recession) but so has supply and the number of new dwellings being built is below the five year average.

As such, the market is relatively balanced (between buyers and sellers) which means there is no need to overpay anymore. Good quality, investment-grade property is still attracting strong buyer demand and is typically selling for fair value.

Of course, some geographic markets might experience different conditions, such as regional towns and beachside locations. It is possible that some locations may experience larger declines in demand and as such, prices may continue to fall.

Most borrowers realised that interest rates would not stay at 2 per cent forever. Of course, if they were listening to (and believing) the RBA governor last year, they wouldn't have expected rates to rise this year (the governor was saying they'd rise in 2024).

It is true that the historically low rates in 2020 and 2021 did encourage people to borrow more. But not because they thought rates would never rise. Most borrowers realised that interest rates tend to range between 5 and 7 per cent over the long run, so they viewed borrowing in 2020 or 2021 as a bit of a free kick (cheap money for a few years), especially if they fixed, which many borrowers did.

Many existing borrowers took the opportunity to fix the interest rates on their mortgages during 2020 and 2021. These fixed rates will start expiring from next year and repayments will increase substantially – more than double in some cases. This will have an impact on discretionary spending, which hasn't yet declined.

Separately, variable interest rate borrowers haven't yet felt the full effect of the rate hikes, as there's a two to three-month lag.

The upshot is that most borrowers are prepared for higher loan repayments. There's a lot of fat in discretionary spending at the moment, particularly in hospitality, travel and retail that will need to be redirected towards servicing mortgages.

Given the low unemployment rate, the unusually high amount of savings that Australians accumulated during Covid-19 and the ability for people to curtail spending, I do not expect any material levels of financial stress. Of course, there will always be some people that have not planned for higher repayments, but these will be the minority.

Here are the swing factors at play.

## **Rates may soon peak.**

Perhaps the biggest factor that will help the market look beyond the recent rate hiking cycle is knowing what the terminal cash rate will be – how high will rates get.

Many commentators anticipate that the RBA may hike rates two more times (0.25 per cent each time) bringing the peak cash rate to 3.35 per cent: Once the terminal cash rate becomes clear, markets are more likely to look beyond this hiking cycle.

It is considered likely that higher interest rates in the US will push its economy into recession. That will cool global growth and could have an impact on our domestic economy. If that occurs, it is possible that central banks may need to start cutting interest rates in the second half of 2023.

However, higher inflation might be more persistent than most expect. Recent work by Research Affiliates suggest that historical data indicates that when inflation exceeds 8 per cent, it usually takes six to 20 years to revert to 3 per cent (with the mean period being 10 years). If history repeats itself, we could be in for a period of stagflation, which is when low economic growth and high inflation occur at the same time.

## **Rental yields are increasing**

Nationally, dwelling rents have increase by 10 per cent over the year to September 2022, according to CoreLogic. In October, the national vacancy rate was a mere 0.80 per cent with Adelaide, Perth and Hobart having the tightest rental markets. It is clearly a very tight market. Rising rents will eventually attract more property investors into the market, thereby raising the demand for property and therefore underpinning prices.

## **Our population is growing again.**

Overseas migration will once again stimulate the economy and demand for property. The Albanese government will increase the permanent immigration intake from 160k to 195k people this financial year. Temporary visa holders are quickly bouncing back to pre-Covid-19 levels too and have increased by 500k over the past year.

It is estimated Australia's population is likely to increase by 3 million people by 2030.

Assuming no major catastrophes occur, for the reasons situated above, I think we have seen the majority of the property value reductions in investment-grade locations. Prices will stabilise from here.

For prices to continue to fall, there needs to be an imbalance of supply and demand. Demand is already relatively low, and I can't see supply increasing dramatically.

*Stuart Wemyss is an independent financial adviser and host of weekly podcast, Investopolis.*  
[swemyss@prosolution.com.au](mailto:swemyss@prosolution.com.au)

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