



What does a Homebuilding Downturn Typically Look Like?

The table below summarises the length and depth of the downturns that have taken place in new dwelling construction since the mid-1970s. While every downturn is different, a few generalisations can be made:

- ⌚ Activity has typically declined by 25.6 per cent from peak to trough during a downturn – equivalent to a reduction of 23,308 starts;
- ⌚ Previous downturns have usually tended to last about 7 quarters, although their duration has ranged from as short as four quarters (2000-01) to 14 quarters (2003-06)
- ⌚ The deepest downturn occurred between 1994 and 1996 when new dwelling starts fell by 64,054, or 35.1 per cent;
- ⌚ New commencements fell by 13.5 per cent between 2003 and 2006, representing the shallowest (and longest) downturn over the past four decades.

This analysis also shows that periods of rising interest rates have a strong tendency to correlate with falls in new home building activity. The causation is largely as a result of their adverse effects on demand, financing conditions and the cost of doing business generally.

On two separate occasions, government policy changes were responsible for triggering sizeable reductions in new home building activity. Firstly, the suspension of negative gearing for housing investors in 1985 – over the following two years, new home building declined by 36,720 or 24.0 per cent. Negative gearing was reinstated in 1987 and activity promptly recovered. The second is the even more dramatic down-turn caused by the introduction of GST in July 2000. New home building subsequently dropped by 33.5 per cent over the course of just four quarters and bottomed out at 111,961 during 2000/01, one of the weakest 12-month periods on record for new home starts.

Period of Downturn	Peak (Number of Starts)	Trough (Number of Starts)	Duration of Downturn (Quarters)	Size of Downturn (#)	Size of Downturn (%)	Causes of Downturn
1973 to 1975	176,157	118,109	7	58,048	33.0%	Oil crisis, international recession, inflation and interest rate hikes
1977 to 1978	144,223	113,933	7	30,290	21.0%	Various
1981 to 1983	149,165	103,993	7	45,172	30.3%	Second oil price shock, international recession and rising interest rates
1985 to 1987	152,720	116,000	9	36,720	24.0%	Suspension of Negative Gearing for investors, interest rate rises and commodities price slump
1989 to 1991	174,962	121,346	8	53,616	30.6%	Early 1990s recession in Australia, sharp reduction in inward migration and rising interest rates
1994 to 1996	182,627	118,573	7	64,054	35.1%	Sudden spike in global interest rates and persistence of domestic economic weaknesses
2000 to 2001	168,453	111,961	4	56,492	33.5%	Introduction of 10% GST in July 2000
2003 to 2006	173,285	149,977	14	23,308	13.5%	Rising interest rates
2008 to 2009	158,045	130,552	5	27,493	17.4%	Worsening of GFC after several interest rate rises
2010 to 2012	175,869	144,213	7	31,656	18.0%	Tapering of Government stimulus, interest rate increases and continued GFC fallout

International developments have also been shown to have a strong impact on new dwelling starts in Australia. In several instances, downturns in new home building were arguably triggered by external factors such as the two oil crises in the early and late 1970s and the outbreak of the GFC in the late 2000s.

Several of the downturns which resulted from RBA interest rate hikes were ultimately propagated from overseas – the RBA only increased rates because borrowing costs had already started going up in other advanced economies. Periods of sustained increase in interest rates on international financial markets therefore need to be watched carefully from the perspective of possible future developments in new home building activity in Australia.



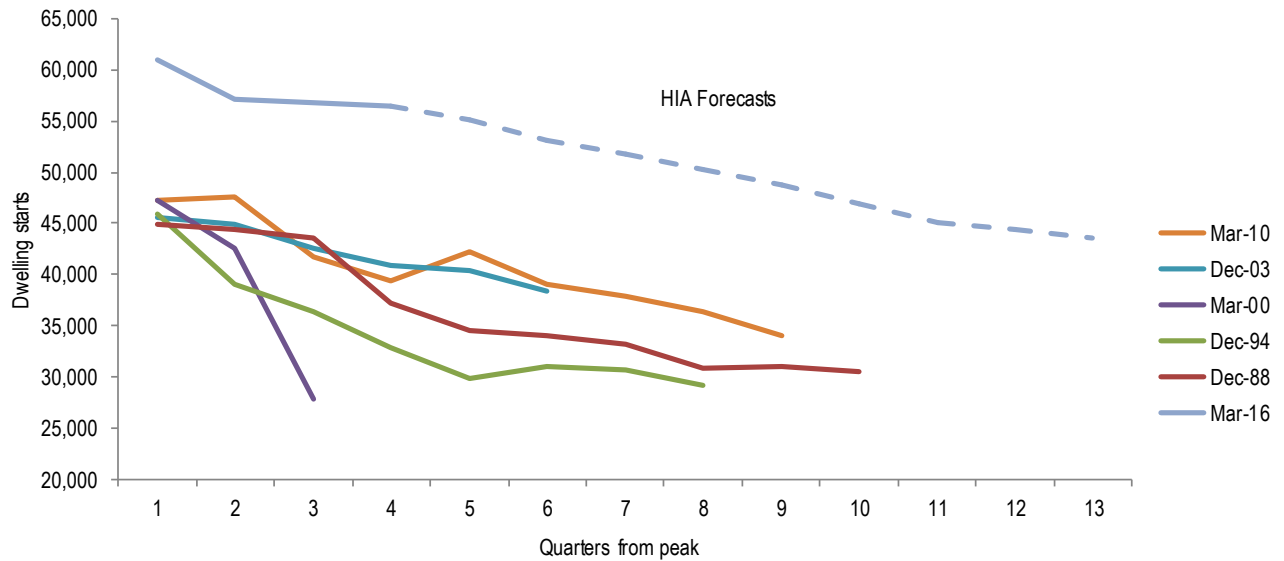
Building Activity

The current downturn in new home building has the highest peak on record as its starting point. It has been precipitated by a slow-down in mining investment, a tightening of regulations around foreign investor participation in Australian real estate, a slowdown in population growth over recent years and supply side constraints relating to housing infrastructure and residential land.

From peak to trough, HIA forecasts a 25.4 per cent decline in new dwelling starts which is equivalent to a reduction of 59,408 in volume terms. A comparison of the likely trajectory of the 2016-2019 downturn with previous episodes is illustrated in the chart below.

Residential Building Cycles - Peak to Trough Phase

Source: HIA Economics



The downturn that's underway is also likely to be unique in a number of other ways. Its forecast trough of 174,630 starts during the 2019 calendar year would easily be the higher ever bottoming out point for a housing cycle. In fact, the likely low point would actually be higher than the peaks of several previous housing cycles. The current downturn is also likely to be quite smooth, with the reduction in new home building spread out over a very lengthy 14 month period – equal in duration to the 2003-2006 downturn which was the longest to date. New dwelling commencements are projected to decline by 25.4 per cent from peak to trough, a reduction which is very consistent with the average decline experienced in previous downturns.

Residential building activity is one of the most pro-cyclical components of Australia's economy with the size of expansions and contractions being far bigger than in other sectors. The upturn which occurred between 2012 and 2016 was inevitably going to be followed by a contraction. The indications are that the contraction ahead will be relatively benign, involving an orderly and fairly smooth reduction in new home building starts with the eventual trough still representing an elevated level of activity by historic standards.