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What happened to the housing slump?

It was supposed to be the worst property slump in a generation. After a succession of interest rate rises, a sharemarket slump, corporate collapse and the psychological effects of the global financial crisis, 2008 had all the ingredients for a prolonged downturn. Some analysts warned that Australian house prices would fall by as much as half.

By the end of last year, buyers were deserting the Melbourne market, the auction clearance rate fell to just over half, and, anecdotally, property prices were in freefall. Just six months later, Melbourne's property sector is behaving more like the heady days of the 2007 boom.

Yesterday marked the eighth consecutive week when the clearance rate has been more than 80 per cent, a run unmatched except for the 2007 boom, when prices rose by a fifth.

The number of properties sold privately this year is now the highest on record and first home buyers have rushed into the market to take advantage of generous federal and state government grants.

The turnaround is being greeted with a kind of stunned disbelief by industry analysts and economists, who are trying to explain how the property market can be on the mend in an economy that remains weak.

"I'm surprised that the market has been as strong as it is given that we're still getting plenty of mixed messages about what's going on in the economy," the chief executive of the Real Estate Institute of Victoria, Enzo Raimondo, said.

"I don't think there was anyone who was expecting this would happen even a few months ago, let alone last year when things were looking pretty bleak."

Property analysts RP Data Rismark reported last week that Melbourne has posted the highest house price growth of any capital city in the five months to May, up 5.86 per cent to $469,357. It has now passed the previous peak median price of $465,216 set in February last year.

"Based on price growth, we're certainly seeing a recovery," RP Data analyst Tim Lawless said.

New figures from property analysts Residex show prices increased by 3 per cent in the last three months to May. During the downturn, which Residex says ran from January last year to February, the median house price fell by less than 2 per cent.

Residex chief executive John Edwards said the metropolitan property price had been propped up by increased demand in the so-called mortgage belt in the middle and outer suburbs.

"The important point about this return to growth is that its overwhelmingly focused at the lowest end of the market," Mr Edwards said. "These kinds of suburbs were slow to react to the downturn because they're not typically places where you see high rates of price growth anyway.

"Since then, we've seen the low interest rates and first home owner grant really start to stimulate this part of the market.

"For much of the rest of (Melbourne), prices have been static or falling." Residex reports that during the downturn, house values rose in suburbs where the median value was below $360,000, such as Laverton (18.9 per cent), Braybrook and Albion (19.6 per cent) and Broadmeadows (20.8 per cent).

Since March, values have continued to grow by up to 4.5 per cent in similar suburbs priced below $350,000. By comparison, values fell during the downturn in traditionally premium, high-performing suburbs such as Brighton (6.5 per cent), Aspendale Gardens (7 per cent), St Kilda (7.5 per cent) and Elsternwick (7.9 per cent). Inner-city areas have continued to show price declines of up to 3 per cent since February.

The cuts to interest rates since September is one of the most important factors underpinning the recovery, with mortgage rates now at about 5.1 per cent.

In October last year, as part of the $10.4 billion economic rescue package, the Rudd government also doubled the first home owner’s grant to $14,000 for existing properties and tripled it to $21,000 for new properties.

First home buyers accounted for 28 per cent of all housing loans in April, up 8.4 per cent since the boost was introduced to hit its highest level on record.

Demand for housing is also being driven by Victoria’s population growth and tight rental market. There also appears to be a psychological element to the surge in activity.

“Its partly a fear amongst prospective buyers of being caught out, of not taking the opportunity to get into the housing market whilst it’s there,” the ***director of research for Charter Keck Cramer, Robert Papaleo***, said.

“On a downswing, people hear all the bad news and that negative sentiment feeds upon itself. On the upswing, having been starved of positive news, people gravitate to the first glimpse of anything (positive) and just run with it - and they look to be running very hard”.

But there remain doubts about the future because of the prospect of interest rate movements, rising unemployment and the scaling back of the first home owner’s grant in October.

While any increase in official interest rates is likely to happen gradually, some industry figures expect that commercial lenders will start increasing lending rates independently to offset the growing cost of international financing.

The managing director of Fujitsu consulting, Martin North, says about a third of first home owners who entered the market thanks to the grants could be in some difficulty within a year.