Sustained uplift in supply still required

Based on underlying demographics, the Irish economy needs at least 30,000 new residential units to be built each year. However, new supply has been running well below this level since 2009, until it jumped sharply to 30,000 units last year.

Indeed, the recently released 2022 Census data showed that similar to the 2016 survey, population growth (+8% vs 2016) has been outpacing the growth in the housing stock (+5.0%). Although, this was mitigated to some extent by the number of vacant homes falling by 11% (circa 20,000) compared to 2016.

Taking this into account, growth in occupied dwellings averaged 23,000 in the period 2016-2021 versus estimated annual demand of 30,000. In short, it means that significantly more than 30,000 units are required to be built on an annual basis to meet yearly demand as well as the pent-up demand that has been accumulating over the past decade.

There are a number of challenges, though, to further boosting housing supply. These include higher building costs, shortages of workers, increased uncertainty regarding the general macro-economic outlook, rising interest rates, availability of funding and delays in the planning process. Indeed, recent forward looking supply indicators suggest the construction sector may fall short of matching last year's level of 30,000.

Commencement notices have been running around 27,000-28,000 on a 12-month cumulative basis during the first half of 2023, below their peak level of 35,000 reached in early 2022. Meanwhile, the housing component of the construction PMI survey has been in contractionary territory since October of last year. Elsewhere, the total number of dwelling units granted planning permission in the 12-month period to Q1 2023 stood at 37,313, which was 16% lower than the same period in 2022.

The latest forecast from the Central Bank of Ireland is that housing completions could amount to 27,500 units this year, while the ESRI is pencilling in 27,000 units. They see completions rising to 29,000-30,000 in 2024.

The marked increase in new housing in the past 18 months combined with the rising interest rate environment has seen a notable moderation in house price inflation. The most recent official CSO data showed that prices nationally fell by 0.2% in May, marking the fifth straight month of declines. The average monthly fall from January to May is 0.3%. On a year-over-year basis, the rate of growth slowed to 2.4%, well down from the 15% pace of increase registered in the February-March 2022 period.

In terms of demand indicators, underlying mortgage market metrics suggest homebuyer activity remains solid. The first time buyer segment of the market continues to exhibit some strength. Drawdowns by first time buyers rose by 7.6% y/y in value terms in Q2. Meanwhile, the number of new mortgage approvals was around 5% higher in the first half of 2023 compared to the same period last year.

Looking ahead, the rising interest rates environment may act as a headwind to homebuyer activity and exert some further downward pressure on prices. As a result, we would expect a further moderation in house price growth over the remainder of this year. Given the current downtrend in prices, there is a distinct possibility that prices could end the year below where they started it. However, the on-going supply shortfall is likely to mean the magnitude of these falls should be modest.

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