



Headwinds to New Housing Supply in 2023

The Irish residential property market has been characterised by marked upward pressure on prices and rents over the past couple of years. However, there have been signs in the autumn that the sharp rate of increase in house prices and rents is moderating. The most recent CSO data on house prices show a 0.4% monthly increase nationally in October, which followed a 0.6% rise in September. The monthly rate of increase averaged 0.8% in the first eight months of 2022 and 1.1% in 2021.

The year-on-year growth rate provides further evidence of a deceleration in house price inflation, albeit while still remaining at an elevated level. In October, the annual growth rate slowed to 9.8% from 10.7% in September. This compares to a peak of 15.0% in the February-March period.

Meantime, the geographical breakdown of the data showed a continuation of the trend where the rate of increase in prices outside of Dublin is outpacing the Capital. This has been a feature of the property market since mid-2015. Non-Dublin prices rose by 11% y/y in October, while the capital experienced an 8.3% y/y increase. Again, similar to the national picture, both have experienced a deceleration in the pace of annual growth over recent months.

Meanwhile, the pace of increase in rents is also moderating. Rents rose by 0.4% in October and 0.5% in November, having increased at an average monthly rate of circa 1% since mid-2021. The annual rate of growth in rents stood at 11% in November, down from a recent peak of 12.9% in July.

The persistent supply shortfall in the Irish residential property market has been the key factor underpinning the sharp increase in prices and rents over the past two years. Based on underlying demographics, the economy needs at least 30,000 new units to be built each year. Given that new supply has been running well below this level over the past decade, it means that significantly more than 30,000 units are required to be built on an annual basis to satisfy yearly demand as well as the pent-up demand that has been accumulating over recent years.

In terms of supply, the pandemic and the associated restrictions in effect stalled the gradual upward momentum in residential building activity that had been in place since 2014. New supply flat-lined at around 21,000 units per annum in the 2019-21 period. The most recent CSO data on completions, though, indicate that there was a renewed uplift in activity last year. By the end of September, the four quarter total of completions was running at 27,700 units. This represents a rise of over 30% compared to year earlier levels. As a result, new housing supply is on track to register a total of around 28,000 units for the full year in 2022.

However, forward looking supply indicators suggest a loss of momentum in building activity. The latest commencement data show that new housing starts have fallen below the 27,000 level on a 12-month cumulative basis to November. By comparison, the 12 month total for commencements ranged from 30,000 to 35,000 units between September 2021 and May 2022.

Meanwhile, the housing component of the construction PMI has also weakened and has been in contractionary territory for five of the last six months. The November reading of 41.6 points to a fast pace



of contraction in house building activity. Elsewhere, planning permissions data in the third quarter of 2022 were noticeably lower in year-on-year terms, due to a fall-off in apartment activity. Taking on board these raft of indicators, it seems likely that new supply will not be able to maintain its 2022 levels in the coming year. Indeed, the ESRI is forecasting that completions will fall back to 26,000 units in 2023.

For this reason, the issue of a shortfall in supply will continue to be the defining characteristic of the Irish residential property market in 2023. Higher building costs, shortages in relation to workers, increased uncertainty regarding the general macro-economic outlook, availability of funding and delays in the planning process are all major headwinds impacting the level of future supply.

The supply issue is a key focus of government policy, with ambitious targets set out in this regard in its Housing for All Strategy. In a recent paper, the ESRI identified a number of initiatives to help improve supply. These included increased State investment in housing, greater use of vacant homes and more diversified production methods. Meanwhile, there are draft proposals before the cabinet designed to try and improve the planning system. However, new initiatives will take time to formulate and come into effect, meaning there is no quick solution in sight to the housing supply deficit.

The ongoing supply shortfall, large increase in household savings, as well as the strong labour market should help to underpin house prices. Meanwhile, the Governor of the Central Bank has stated that an easing in the macro prudential mortgage lending rules this year would likely result in some "modest" increase in prices.

Overall though, the recent trend of a moderation in house price and rent inflation is likely to continue amid the rising interest rate environment and against the backdrop of slower growth in the Irish economy in 2023 and with high inflation depressing spending power. Therefore, the coming year is likely to see a further slowdown in house price and rent inflation.

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