

AUSTRALIAN HOUSING PRICES: ARE THEY SUSTAINABLE?

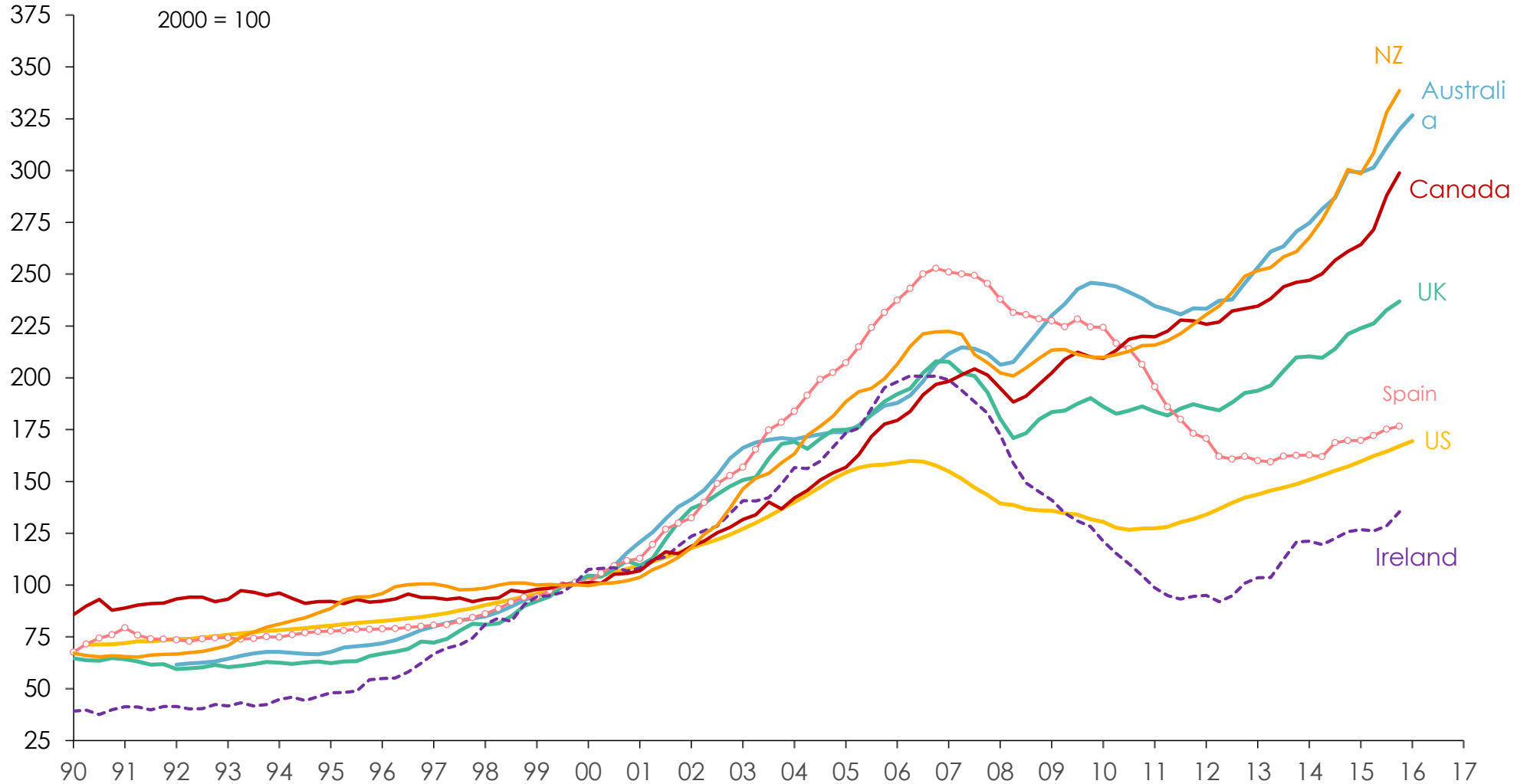
PRESENTATION TO A TELECONFERENCE
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24TH MAY 2017



Australian house prices are high, both by historical and international standards

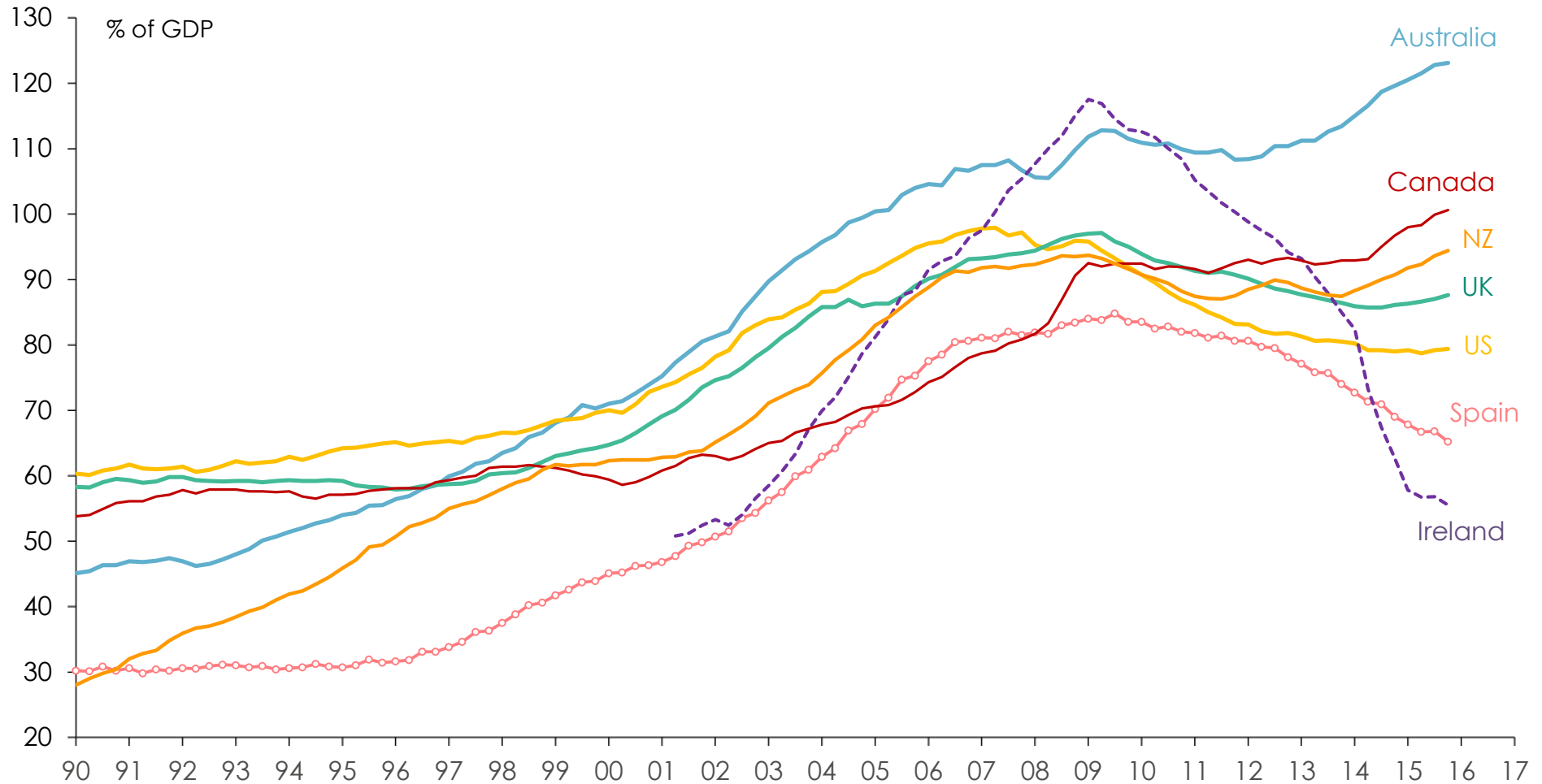
Housing prices



Sources: CoreLogic; S&P; Bank for International Settlements.

So is Australian household debt

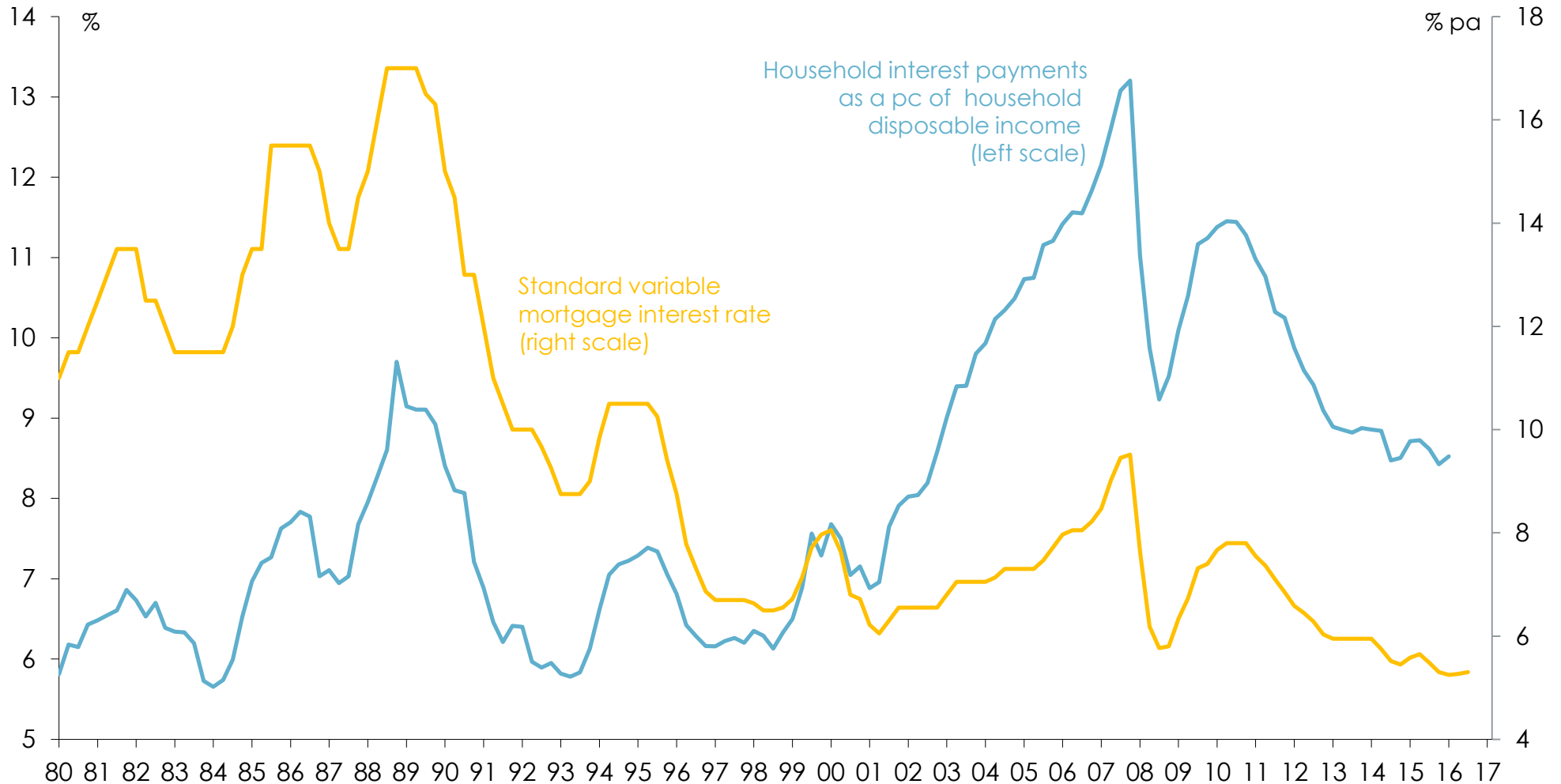
Household debt



Source: Bank for International Settlements.

Declining interest rates and growing incomes have allowed households to borrow a lot more

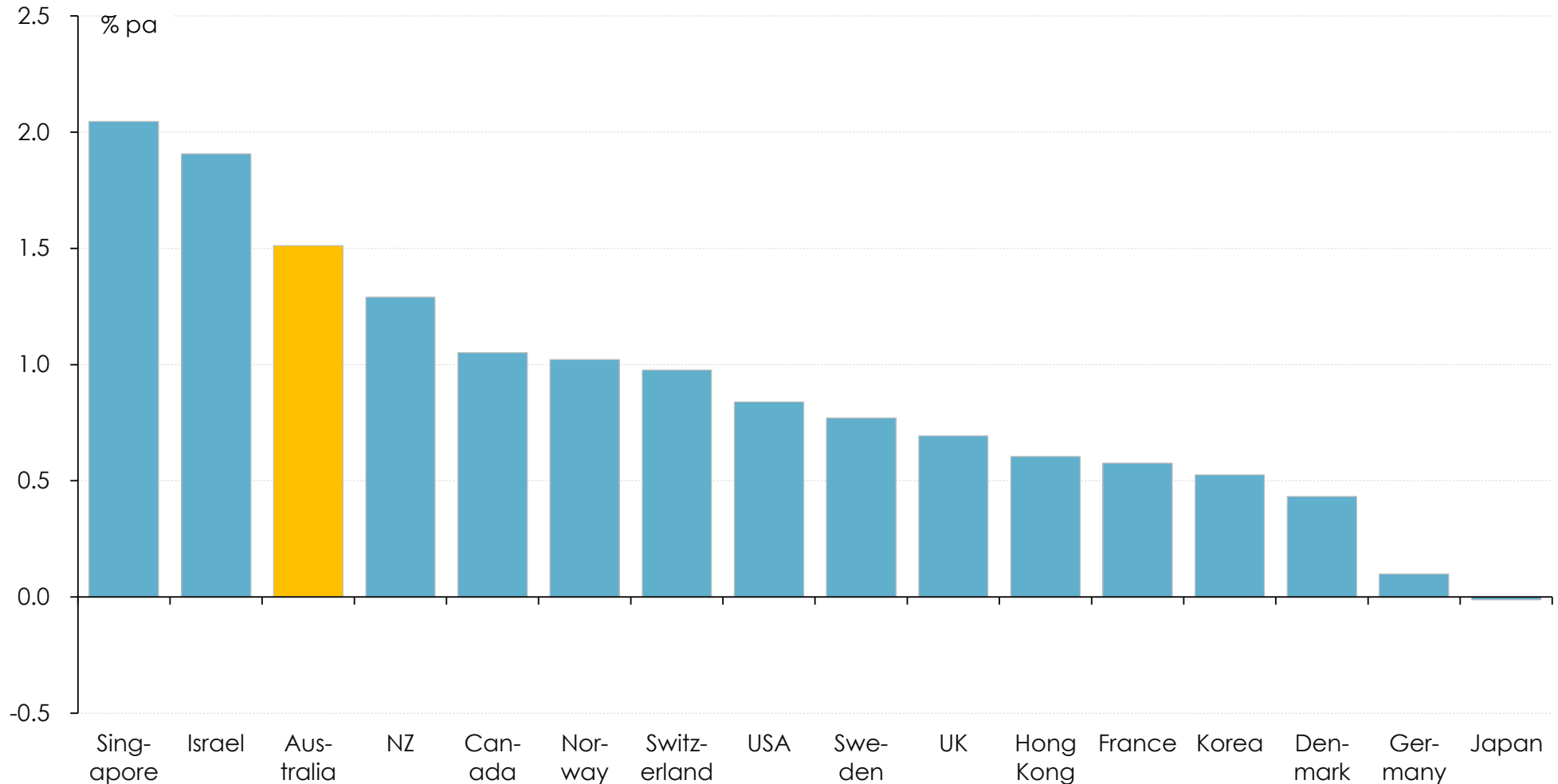
Mortgage rates and household debt service ratio



Sources: Reserve Bank of Australia; Australian Bureau of Statistics.

Australia's population has grown at a faster rate than that of most other 'advanced' economies

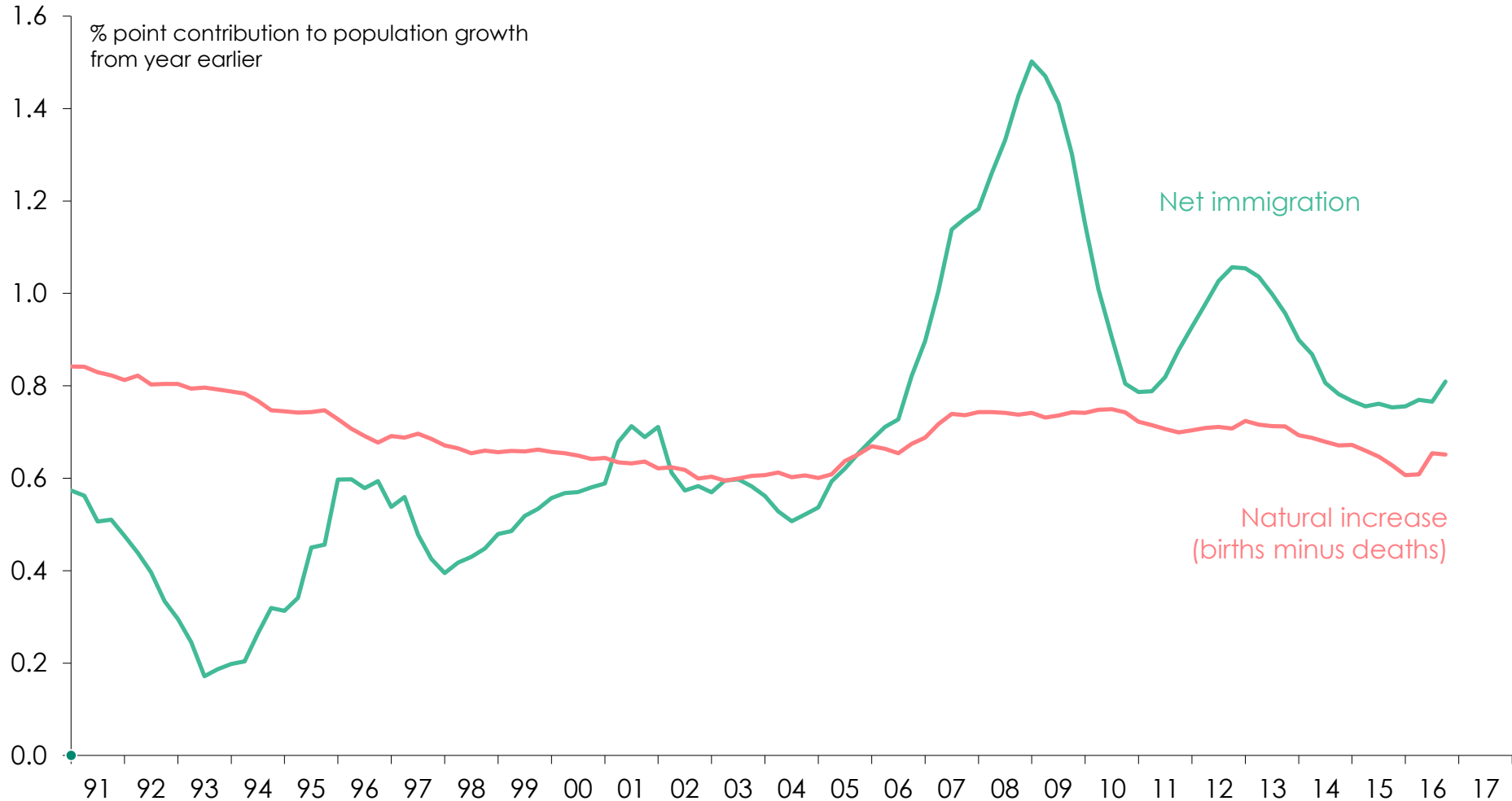
Population growth – selected 'advanced' economies, 2001-2016



Source: International Monetary Fund, *World Economic Outlook* database, April 2017.

... largely as a result of its high immigration intake, especially since about 2005

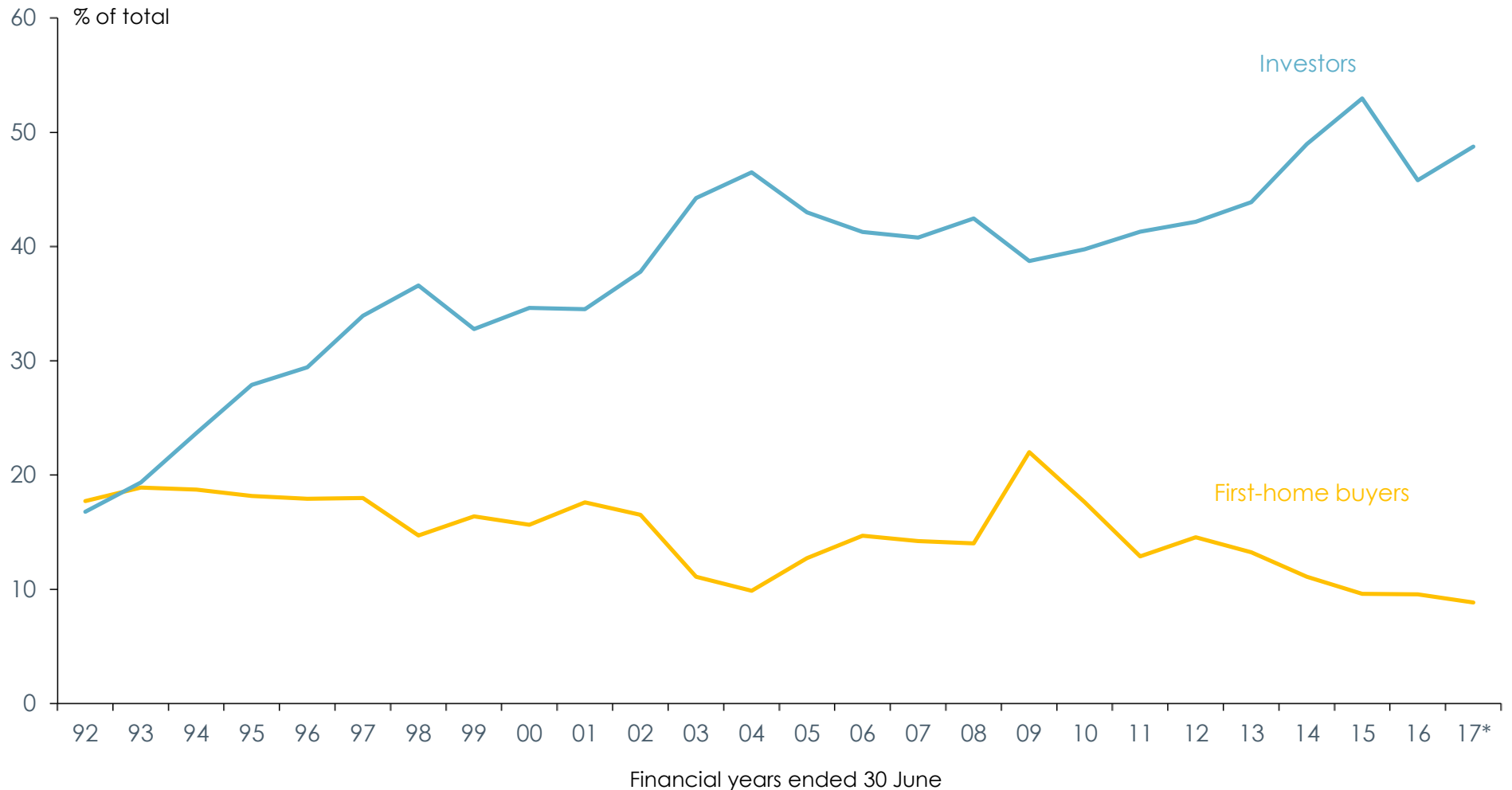
Sources of Australian population growth



Source: Australian Bureau of Statistics.

Investors (landlords) have become a much more prominent force in the housing market

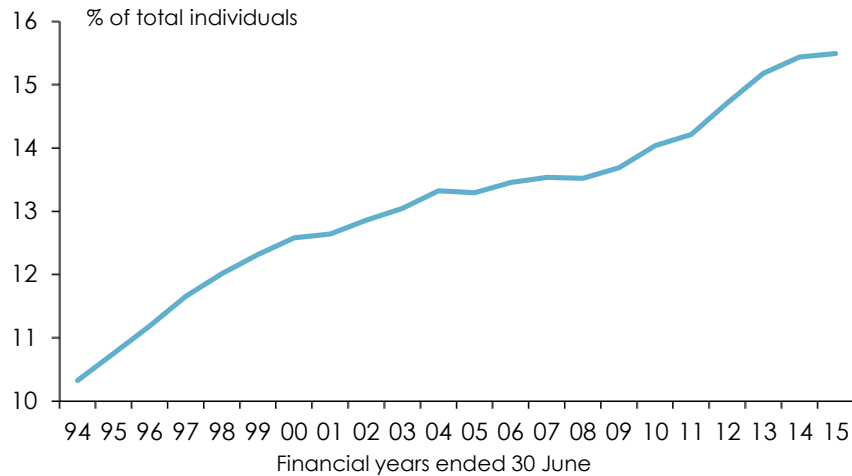
Lending for housing by type of borrower, 1991-92 to 2016-17



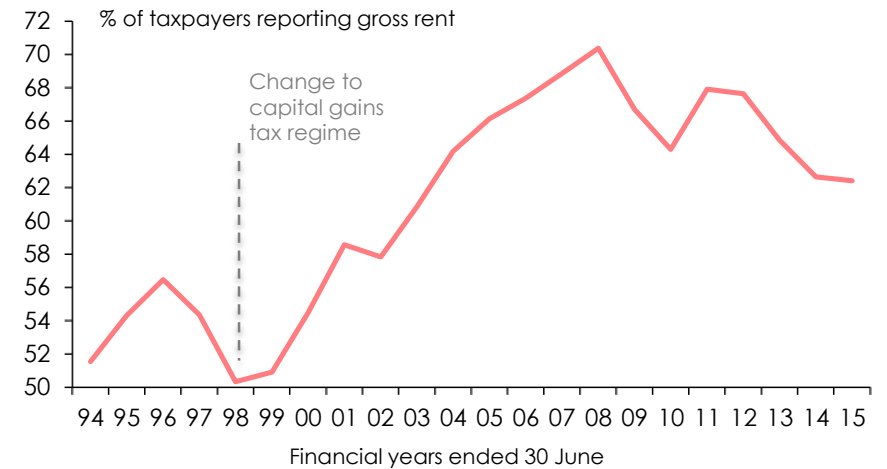
Note: Lending to owner-occupiers 'trading up' not shown. 2016-17 data are for July 2016 through March 2017. Source: Australian Bureau of Statistics.

Australia's tax system encourages highly geared property investment

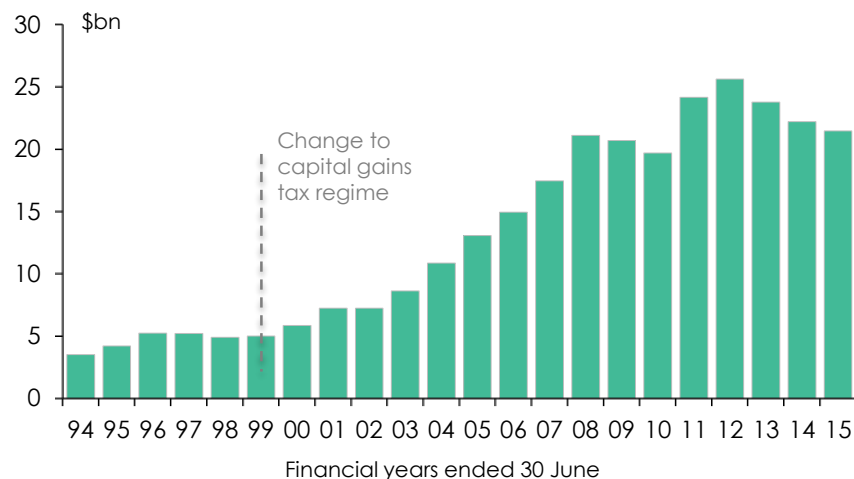
Taxpayers with rental income



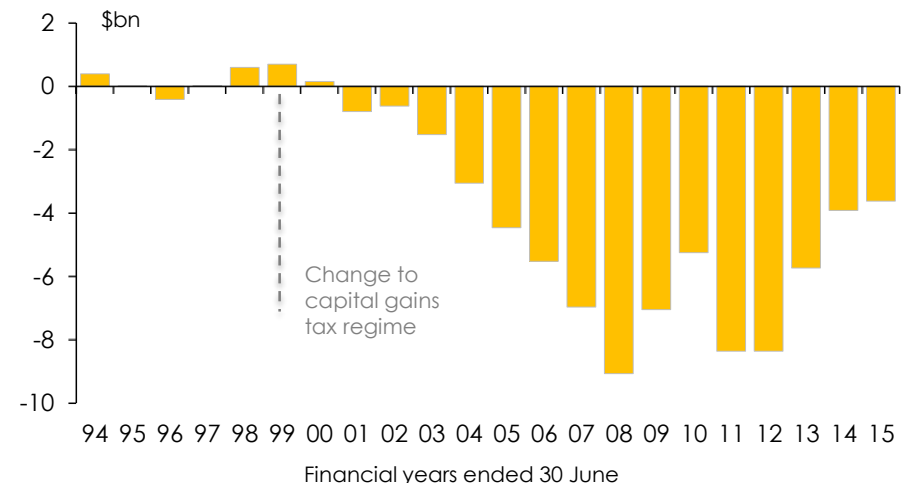
Pc of landlords claiming tax losses



Rental interest deductions



Total net rental income



Source: Australian Taxation Office, *Taxation Statistics 2014-15* (April 2017).

Some other reasons why Australian house prices are so high

❑ Australia is a highly urbanized country

- 60% of Australians live in cities of over 1mn population – a proportion exceeded only by Hong Kong, Singapore and Japan among high-income countries
- Australia has only five of these cities – only four other high-income countries (US, Japan, Germany and Korea) have more

❑ Australian cities are spatially large

- Sydney, Melbourne & Brisbane are the 104th, 106th & 250th largest cities in the world by population, but 32nd, 43rd & 47th largest by area
- so 'conveniently located' housing commands more of a price premium in Australian cities

❑ 76% of Australians live in detached houses – and they are big, by international standards

- the average new Australian house is 206m² (cf. US 203m², Germany 109m², Spain 97m², UK 76m²)
- 70% of them have 5 or more rooms

Sources: Demographia, World Urban Areas 2017; Reneweconomy.com; Nationmaster.com

What does overseas experience tell us about the 'causes' of housing price busts?

□ They require a 'trigger'

- such as a sharp increase in interest rates, or unemployment, or both
- or some other change (eg in the terms of loan contracts) which result in a material number of borrowers facing much higher repayments

□ They require a material number of 'forced sellers'

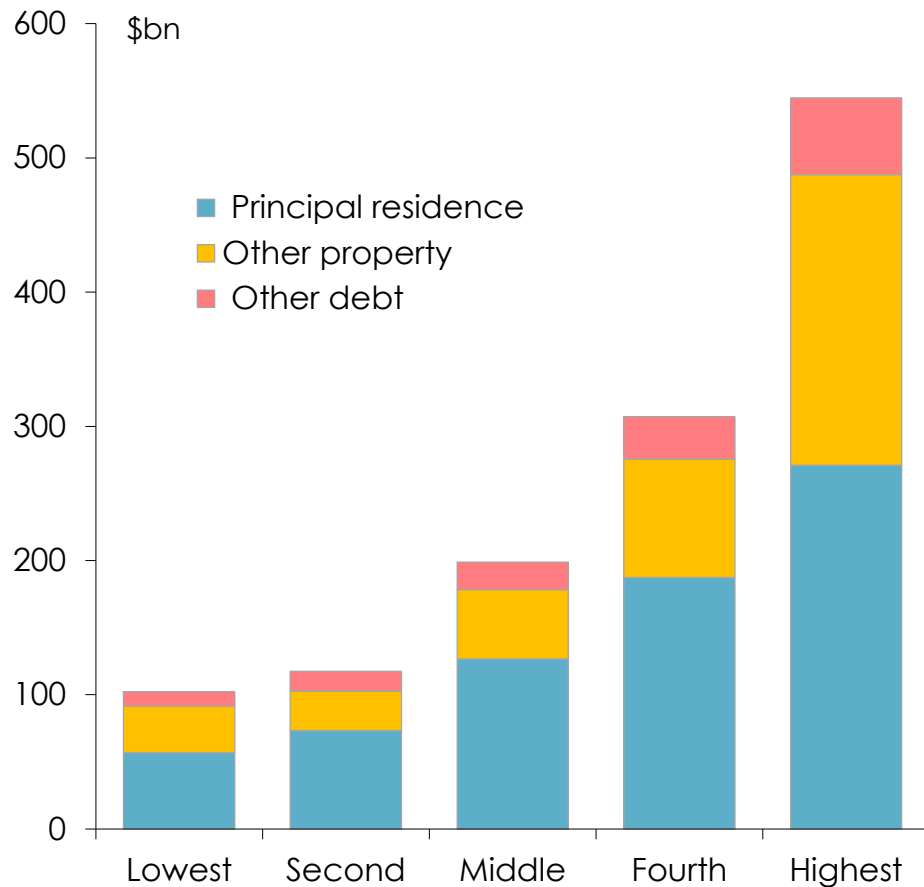
- that is, a large number of owners who are unable or unwilling to keep up the commitments associated with continuing ownership
- note that there is no such thing as a 'non-recourse mortgage' in Australia, and that having one's house 're-possessed' is one of the few things that carries a lot of shame in Australian culture

□ Those 'forced sellers' need to be selling into an 'oversupplied' market

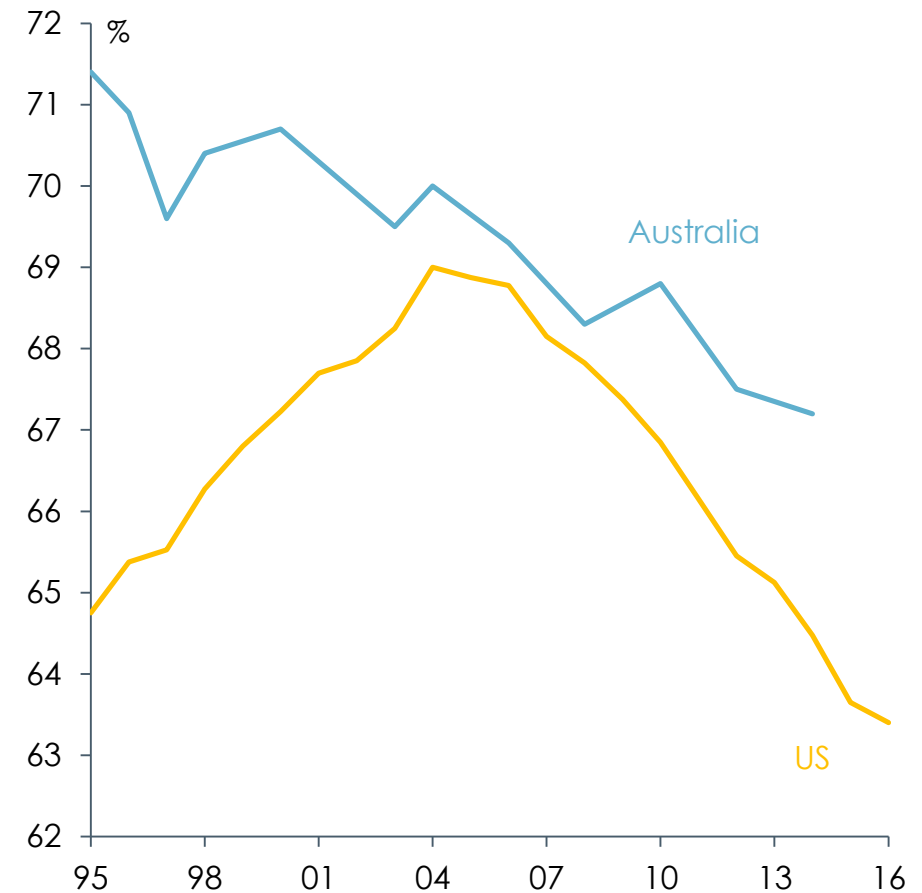
- that is, there needs to have been an extended period where the supply of housing has risen at a much faster rate than the 'underlying' demand for it

There hasn't been a lot of lending to borrowers of dubious creditworthiness in Australia

Household debt by income quintile, 2013-14



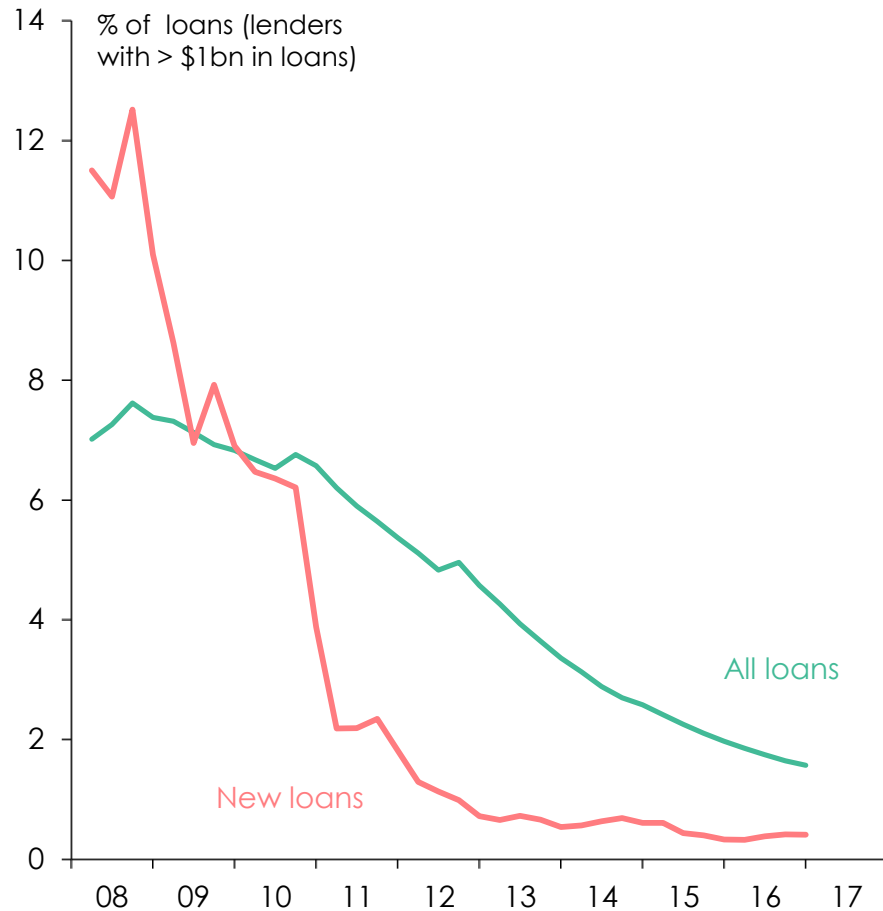
Home ownership rates, Australia vs US



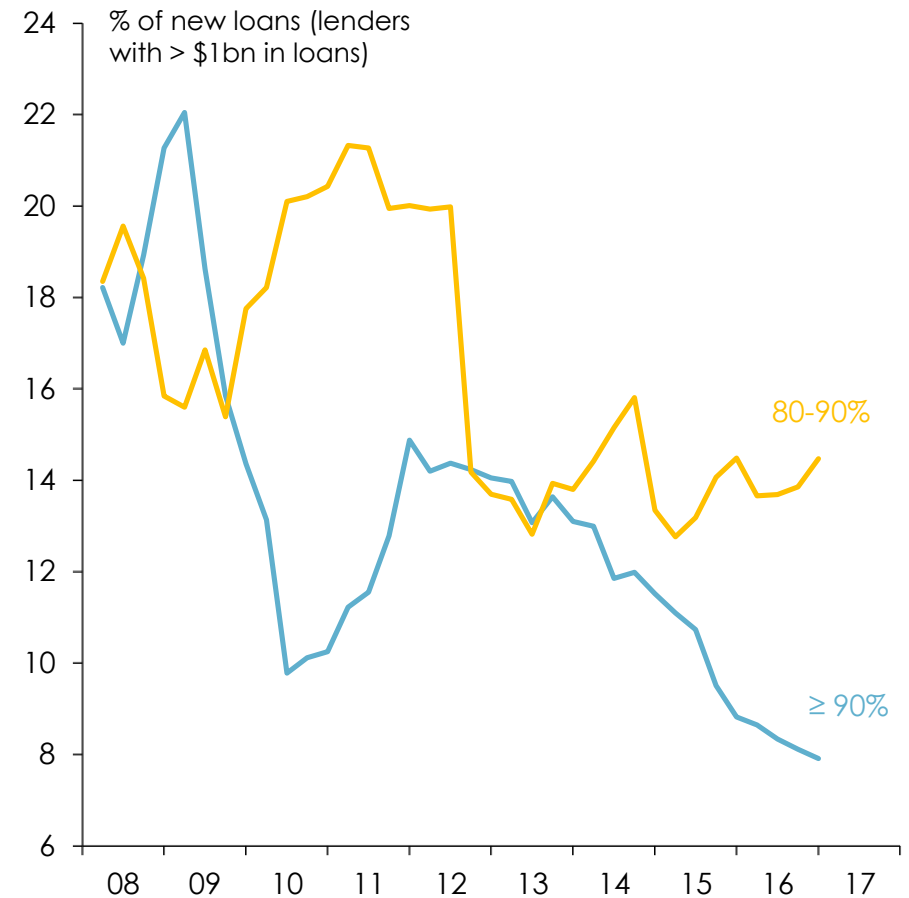
Sources: Australian Bureau of Statistics; US Commerce Department.

There hasn't been a lot of lending to borrowers of dubious creditworthiness in Australia

'Low-doc' loans as a pc of total



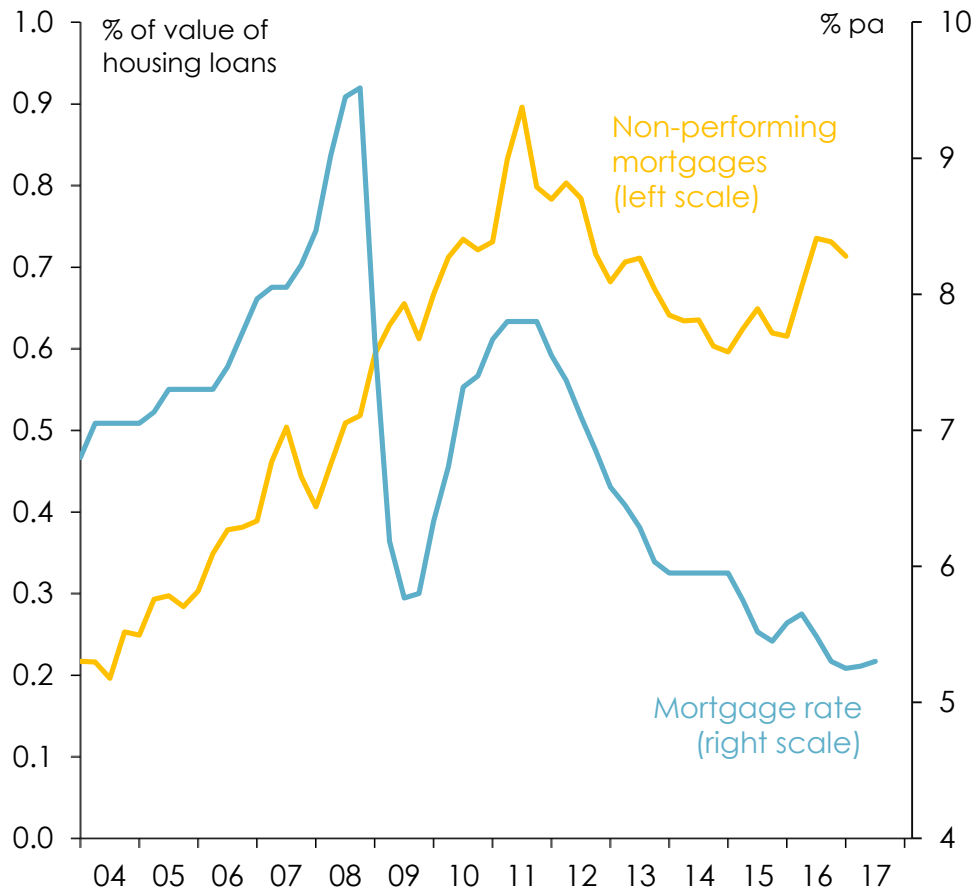
High LVR loans as a pc of total



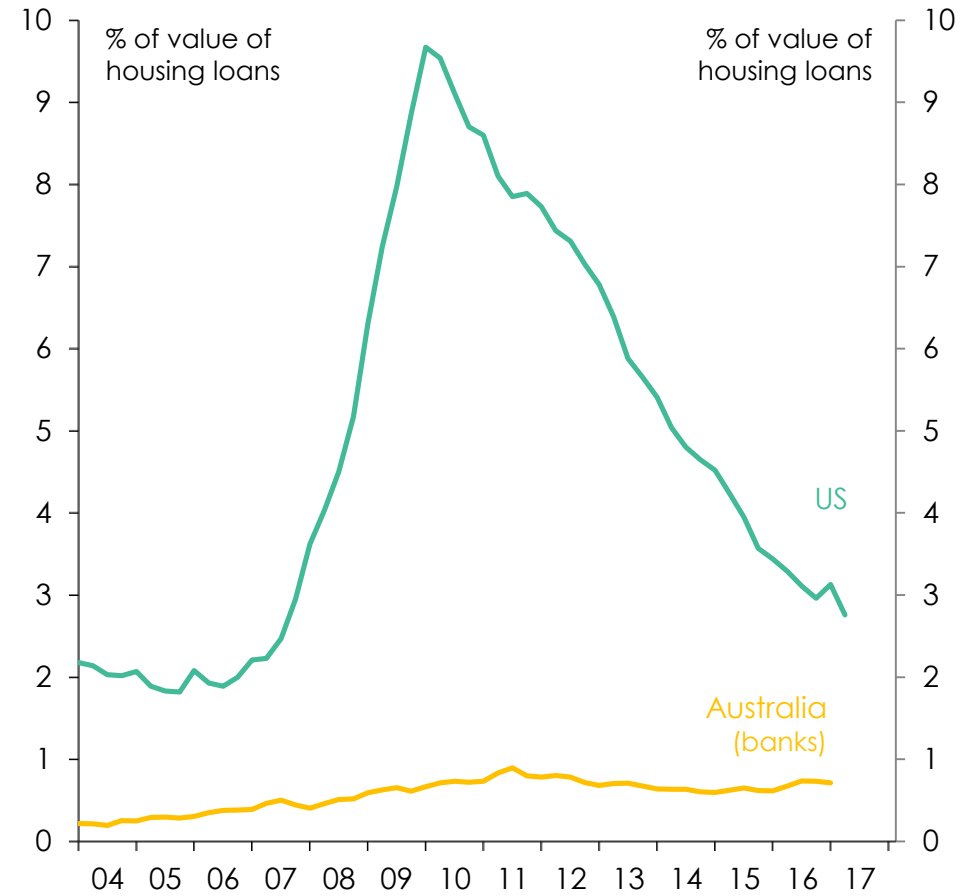
Note: 'Low-doc' = low documentation (proof of income, etc.); 'LVR' = loan-to-valuation ratio'.
 Source: Australian Prudential Regulation Authority.

Australian mortgage default rates have stayed low even when mortgage rates have been high

Banks' non-performing housing loans and mortgage rates



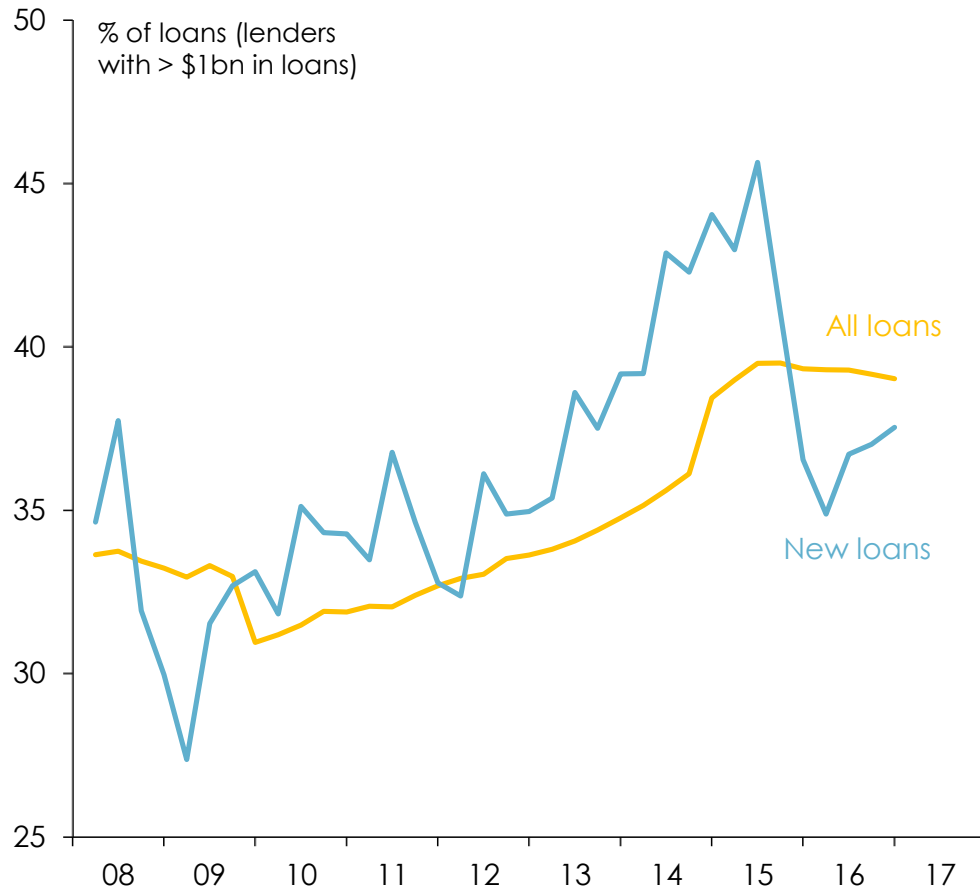
Non-performing housing loans – Australia vs US



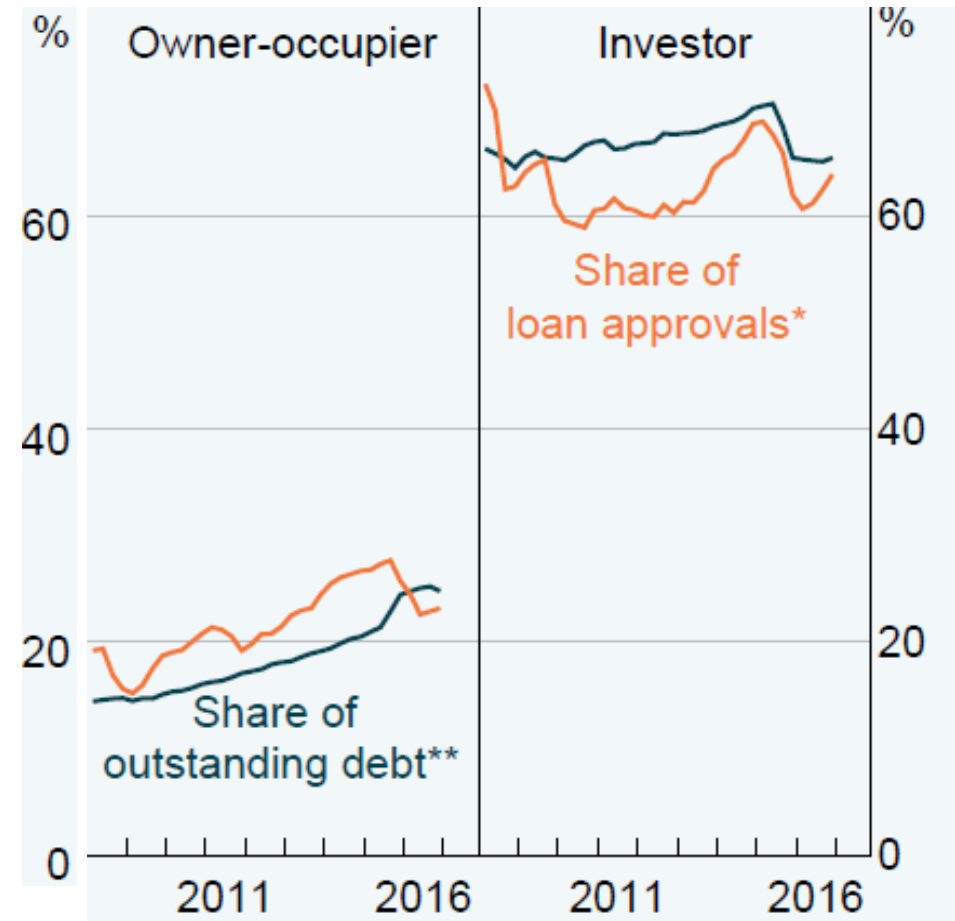
Sources: Australian Prudential Regulation Authority; RBA; Thomson Reuters Datastream.

The greatest area of concern is with interest-only loans

Interest-only loans as a pc of total



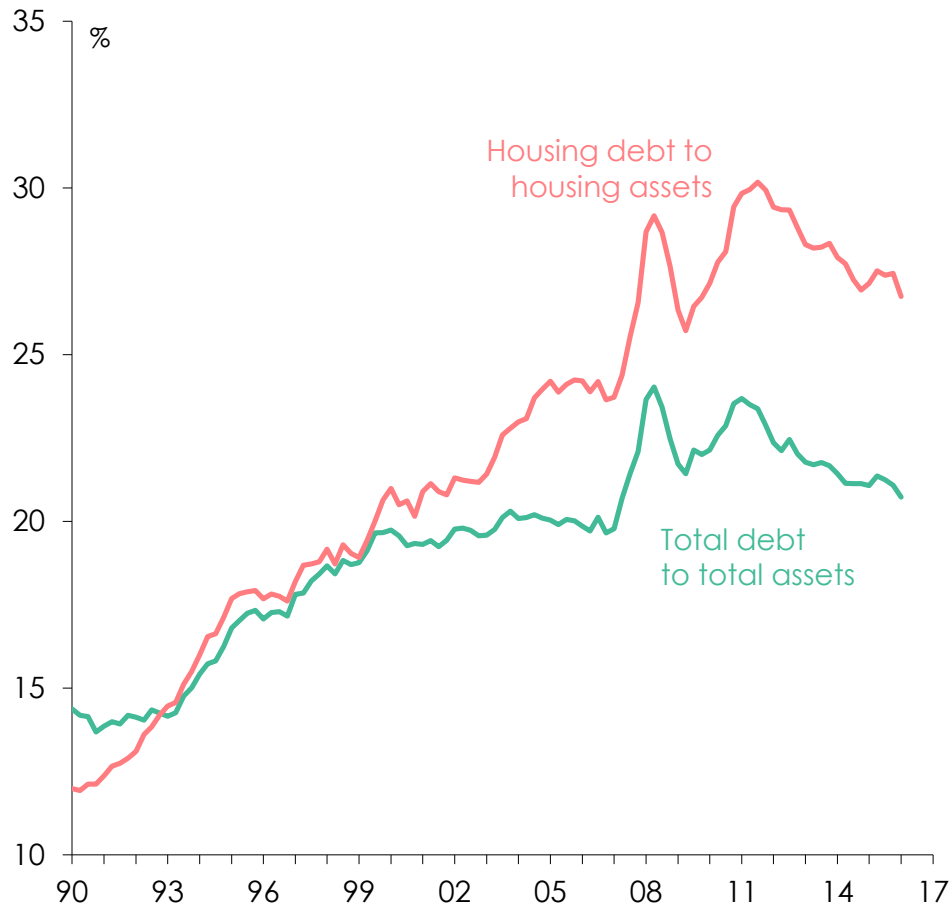
Interest-only loans by type of borrower



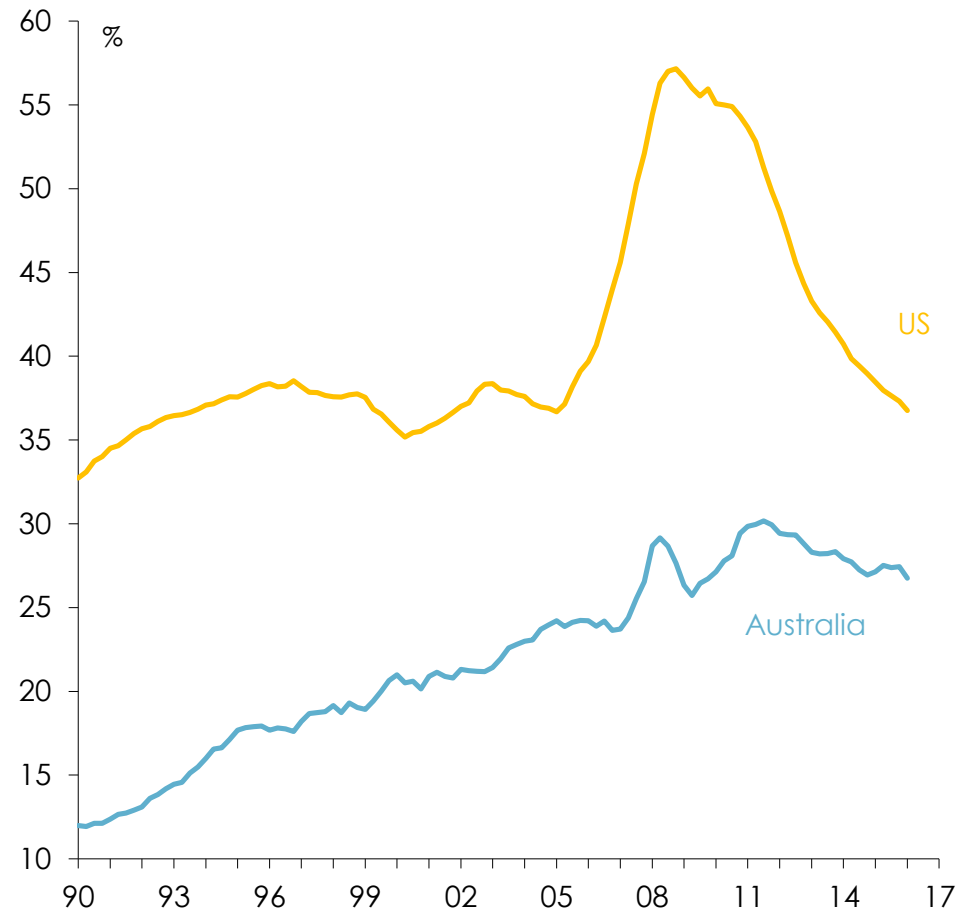
Sources: Australian Prudential Regulation Authority; Reserve Bank of Australia.

Australian debt-to-asset ratios have been falling in recent years, and are lower than in US

Debt-to-asset ratios, Australia



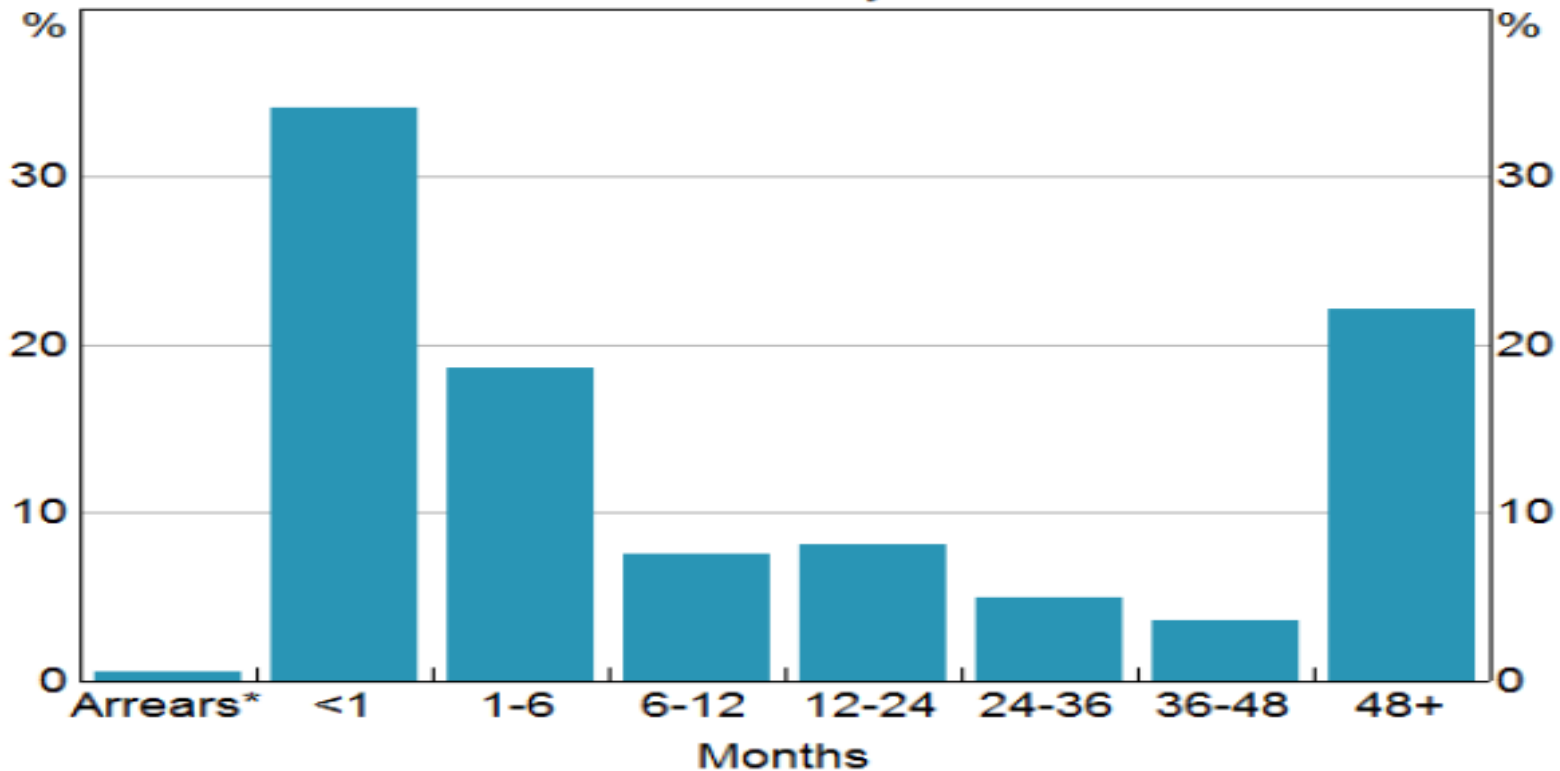
Housing debt to housing asset ratios, Australia and US



Sources: Australian Bureau of Statistics; US Federal Reserve.

Most mortgage borrowers are ahead of their contractual repayment schedules

Mortgage repayment 'buffers', 2017



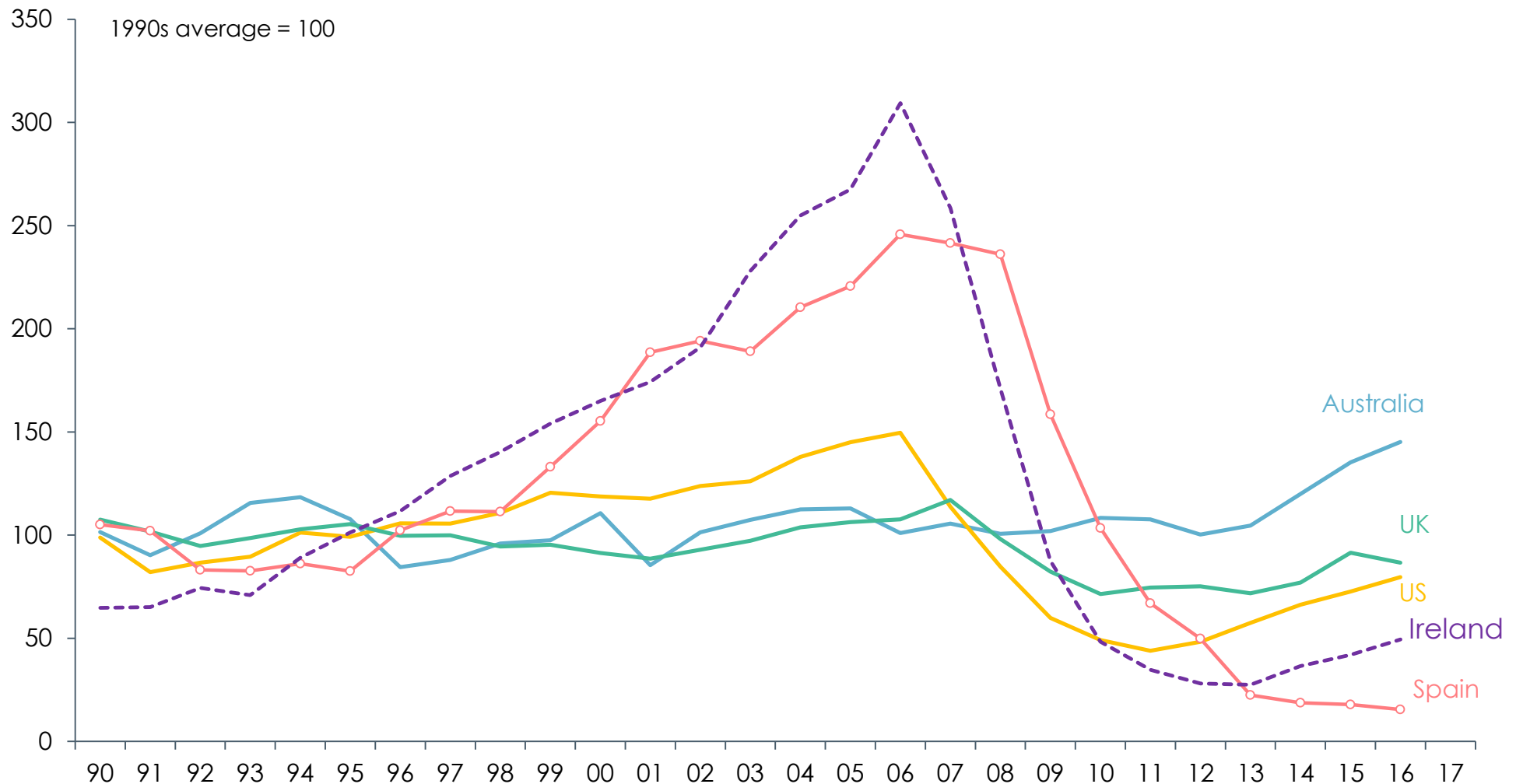
* 90+ days in arrears

Two-thirds of housing borrowers are at least one month ahead of their scheduled repayments and half of all borrowers are six months or more ahead

Source: Reserve Bank of Australia.

The 'supply side' of Australia's housing market has been more like the UK than Ireland or Spain

Dwelling completions – Australia and other selected economies



Sources: Australian Bureau of Statistics; US Commerce Department; UK Office of National Statistics; Instituto Nacional de Estadística d'España; Ireland Central Statistics Office

What are the principal risks to house prices in Australia?

❑ Sharply higher interest rates

- a multi-percentage point increase in mortgage rates would obviously cause considerable distress among mortgaged home-buyers
- however it's not at all obvious why Australian interest rates would increase significantly at any stage in the next few years (or at all)

❑ Relatively large proportion of interest-only loans

- possible risks from higher repayments when interest-only periods expire
- supervisory actions targeted to reducing this risk

❑ A significant cut in Australia's immigration intake

- possible in the event of a sharp rise in unemployment, or substantial gains by far-right political forces, otherwise highly unlikely

❑ Changes in Chinese government FX policies making it much more difficult for Chinese purchasers to fulfil contracts

- hard to calibrate, but could potentially lead to 'forced sales' by developers of projects heavily dependent on sales to foreigners
- changes to foreign investment rules in latest budget intended to reduce this risk

Summary

- ❑ Yes, Australian housing prices are undoubtedly high by both Australian historical and contemporary international standards, in absolute terms and relative to incomes
- ❑ And so is the level of Australian household debt
- ❑ However, there is no ‘law of gravity’ about these things – just because Australian house prices and household debt have gone up a lot, doesn’t mean that they must necessarily come down a lot at some point
- ❑ Australia’s housing market has much more in common with that of (south-eastern) UK (where prices have not fallen in any sustained way) than it does with those of the US, Ireland or Spain
- ❑ Of course it is possible that Australian house prices could fall a lot, under various plausible scenarios – but the probabilities attaching to those scenarios are not especially high