



# LEADING THE WAY

## SCA NATIONAL CONFERENCE

HOBART 30 MAY - 1 JUNE 2018



# The big picture for the Australian residential property market

SAUL ESLAKE

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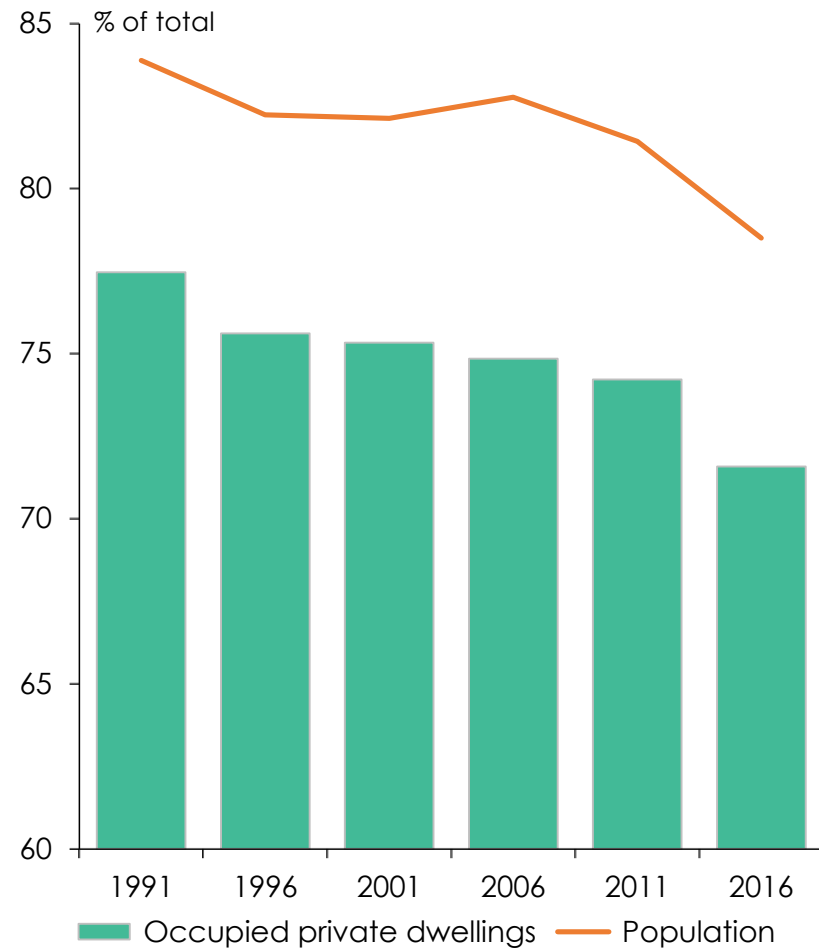
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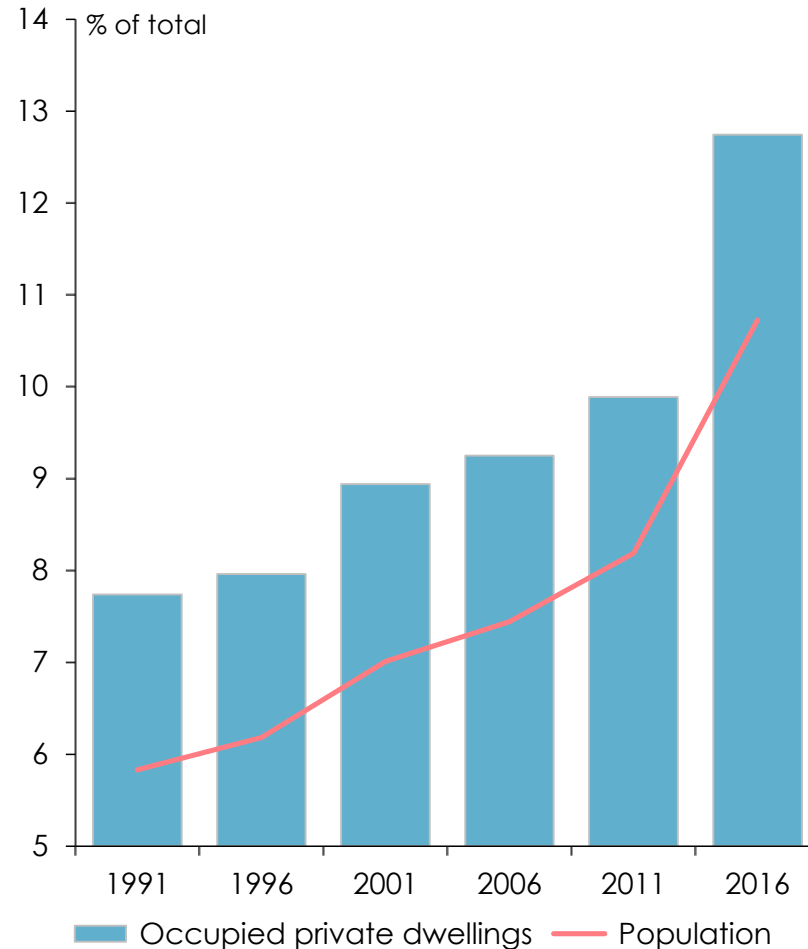
# The Australian housing stock, and the way Australians live, is slowly changing

## Occupied private dwellings by type, and population living in them, at Censuses

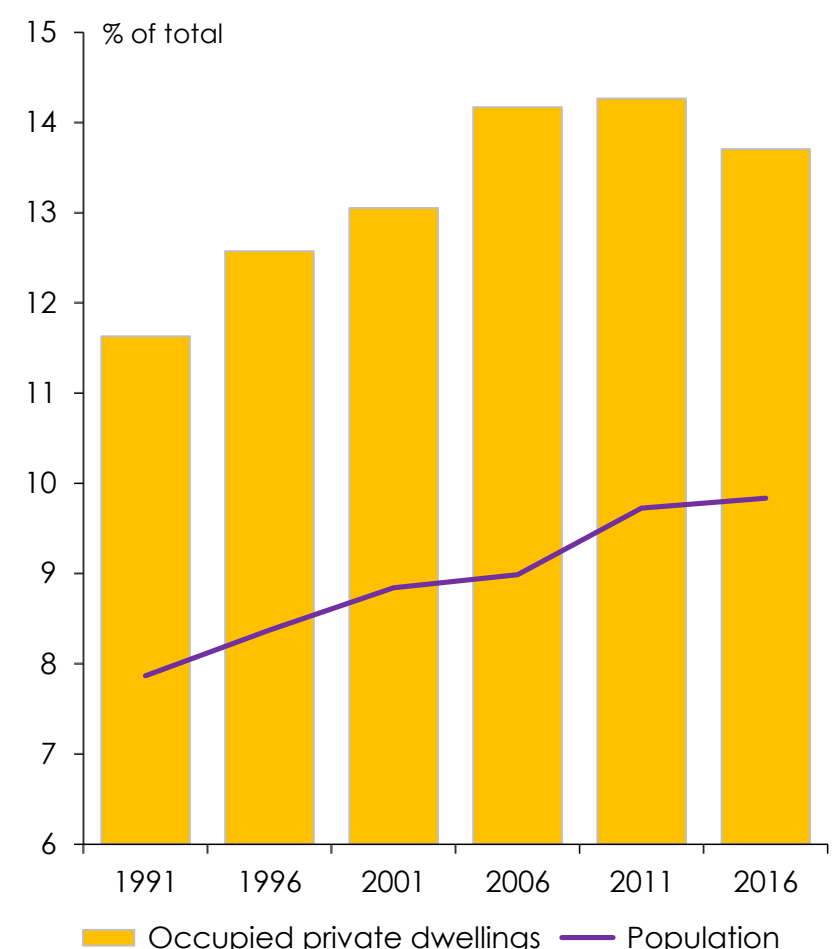
### Detached houses



### Semi-detached dwellings



### Apartments



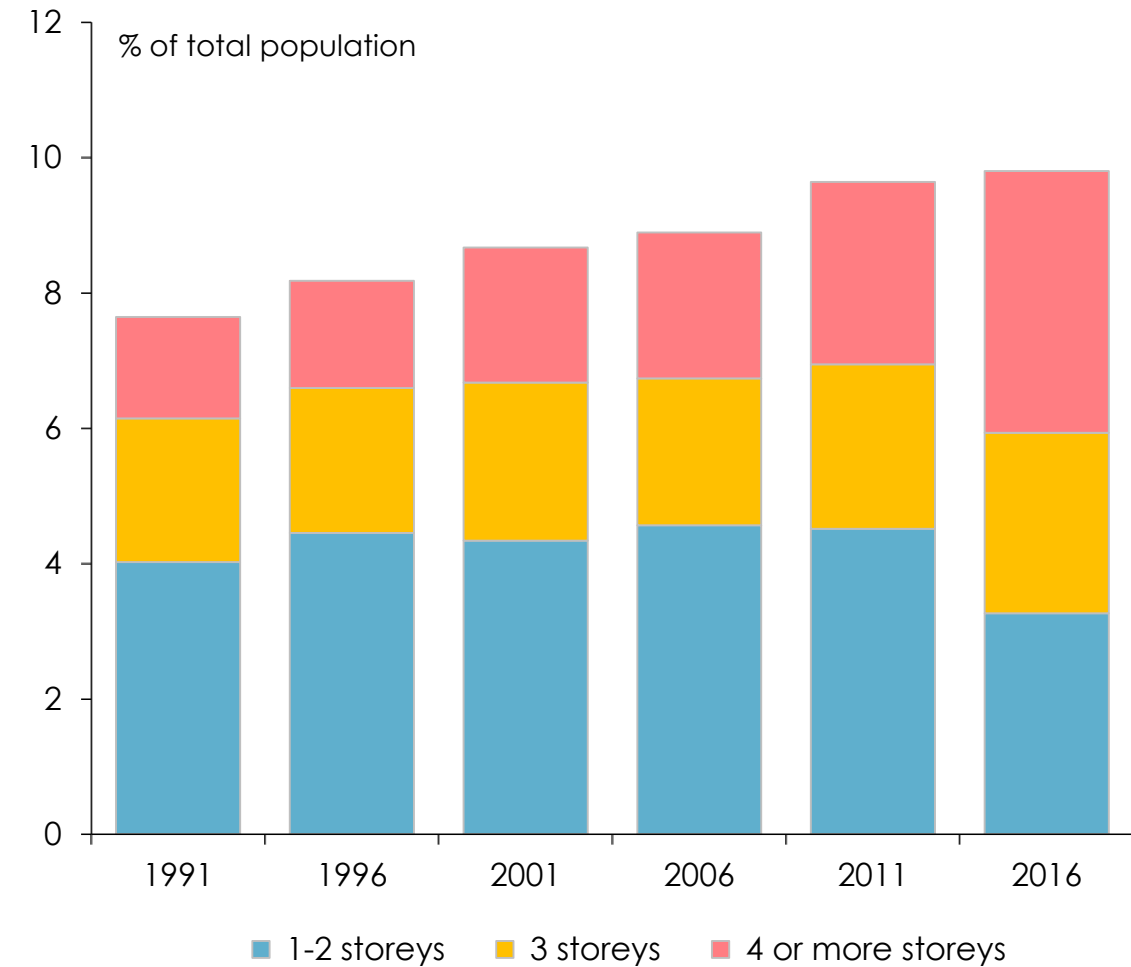
# Larger apartment blocks are becoming more common, and a growing proportion of the population is living in them

## Apartment blocks, by size, as a proportion of housing stock and population

### Proportion of occupied private dwellings



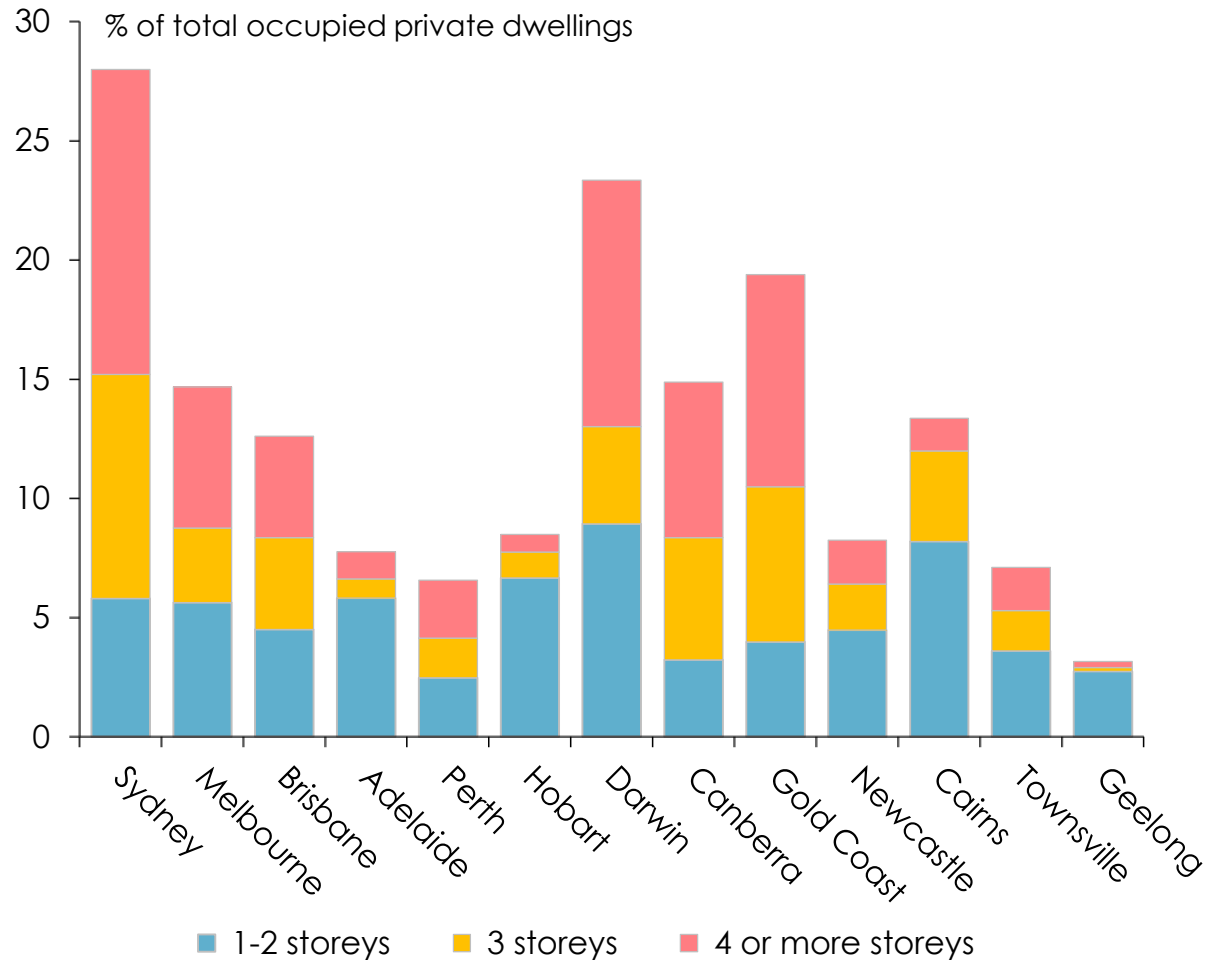
### Proportion of population



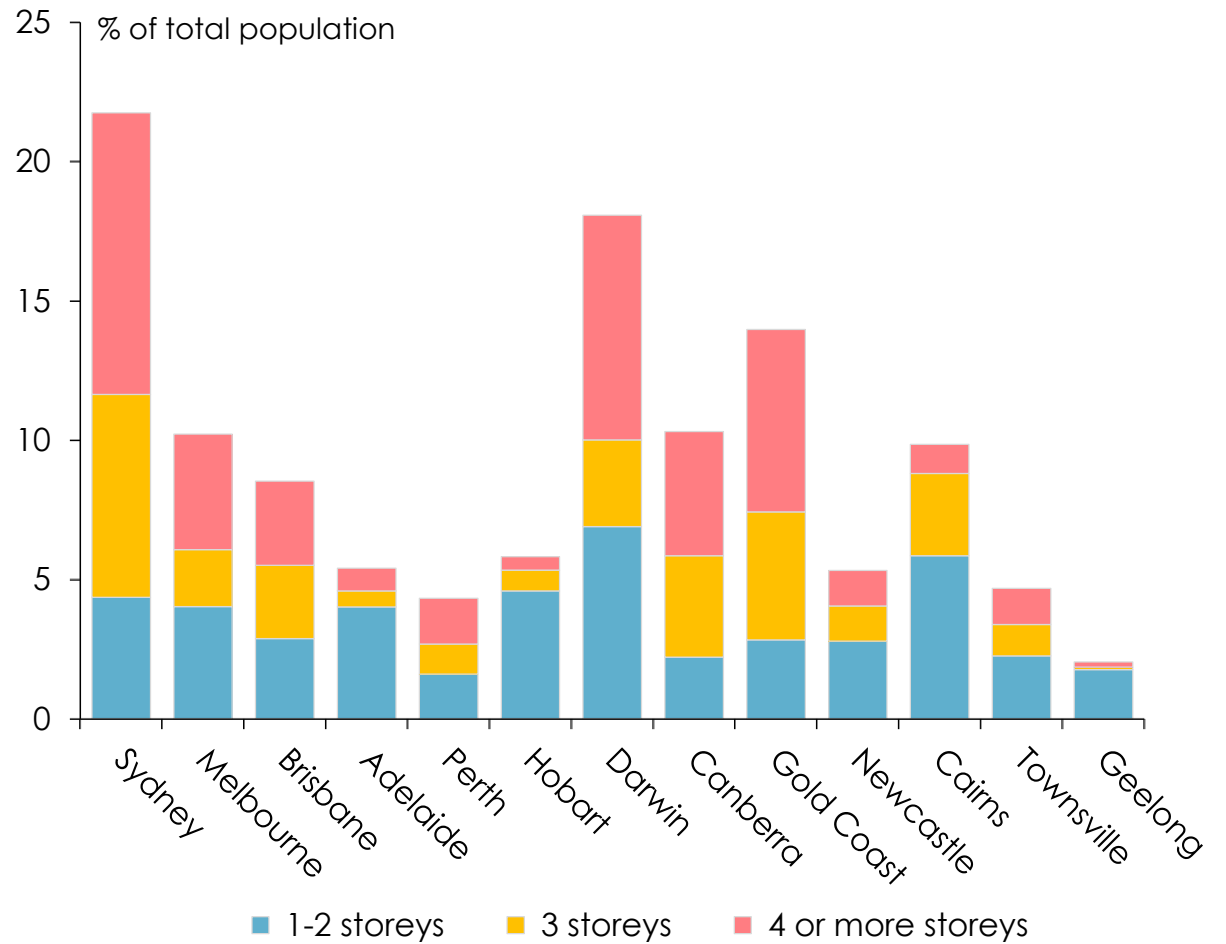
# ... particularly in Sydney, Darwin, the Gold Coast, Canberra and Cairns

## Apartment blocks, by size, as a pc of housing stock and population – major cities, 2016

### Proportion of occupied private dwellings



### Proportion of population



Source: Australian Bureau of Statistics, 2016 Census data

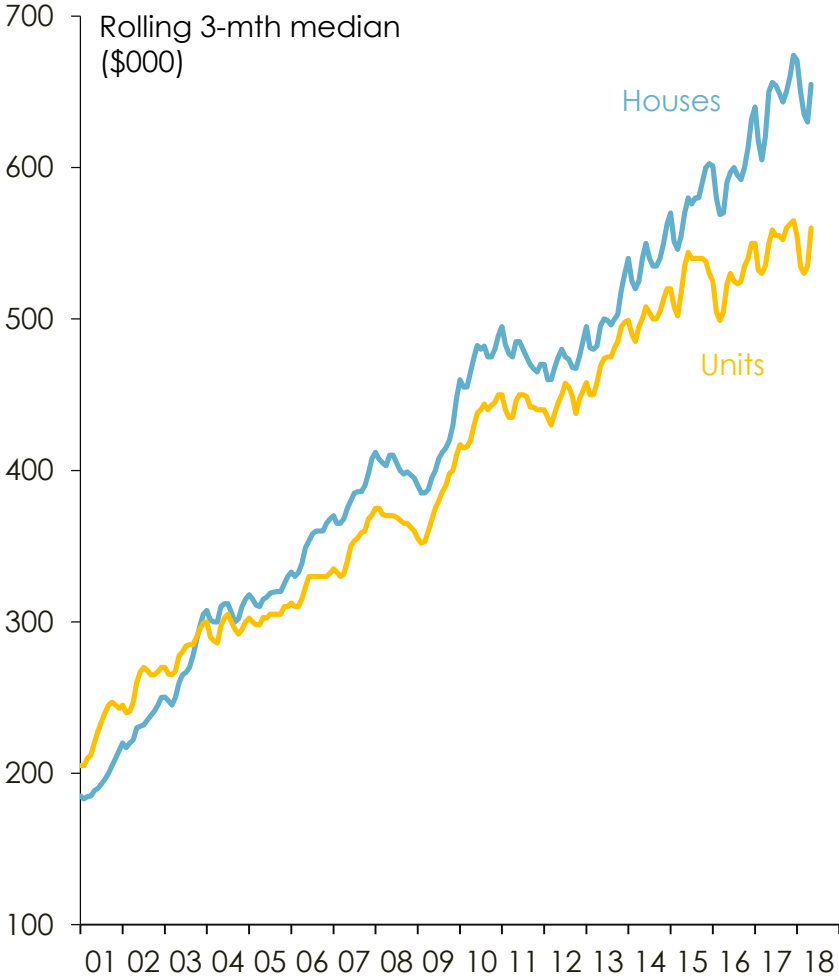
# Recent developments in property prices



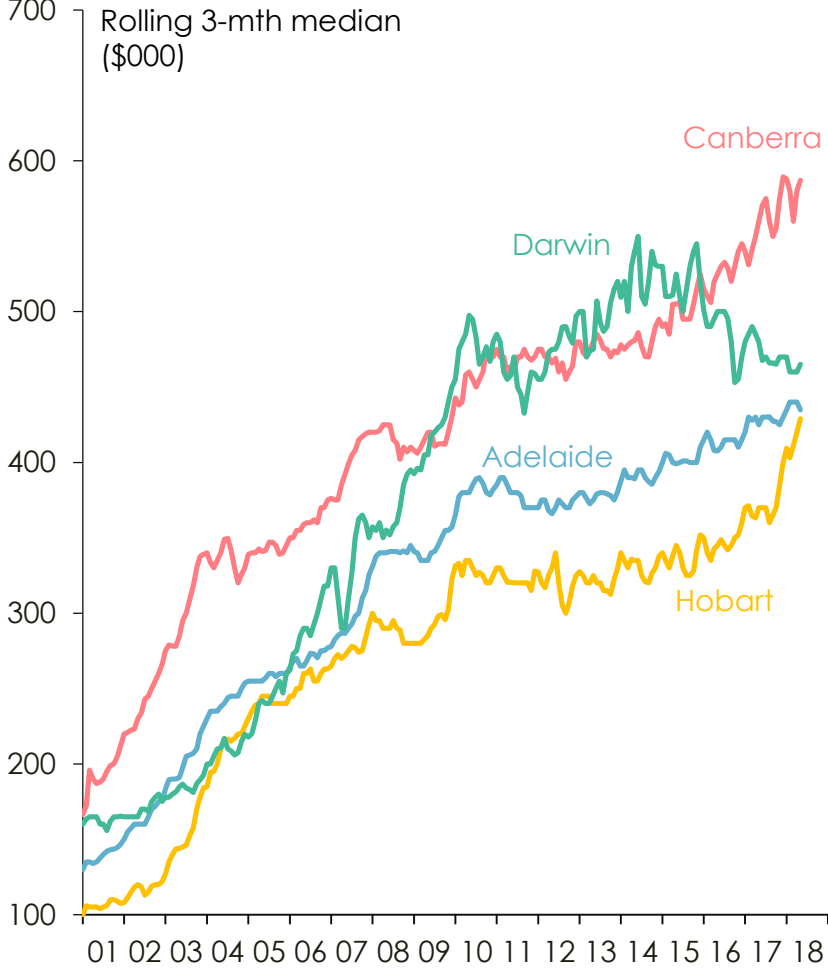
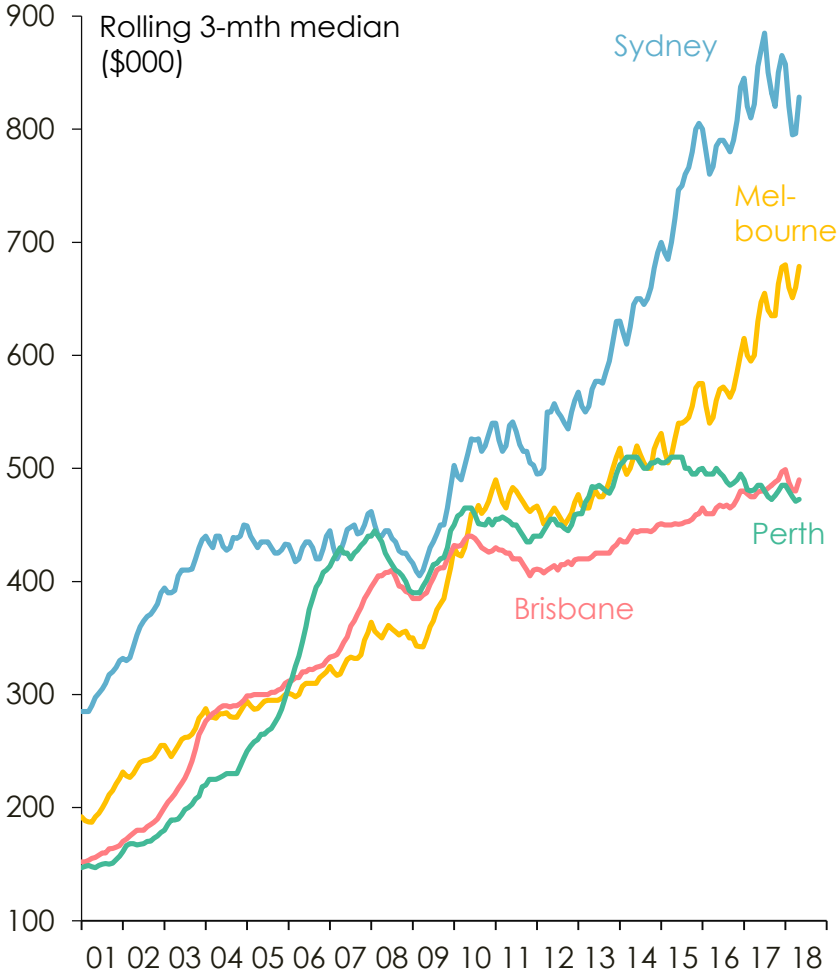
# Property prices appear to have passed their peak in most Australian capital cities

## Median sale prices – Australian capital cities

### 8-capitals average



### Dwellings (houses and units) by city

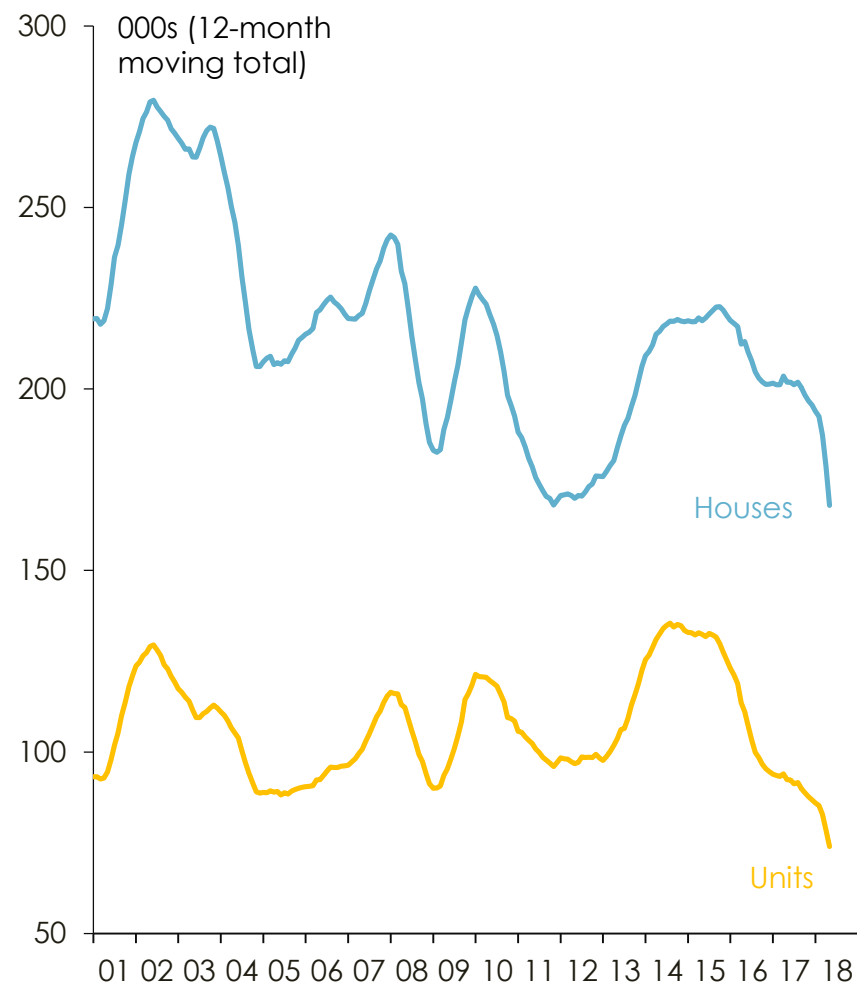


Source: CoreLogic.

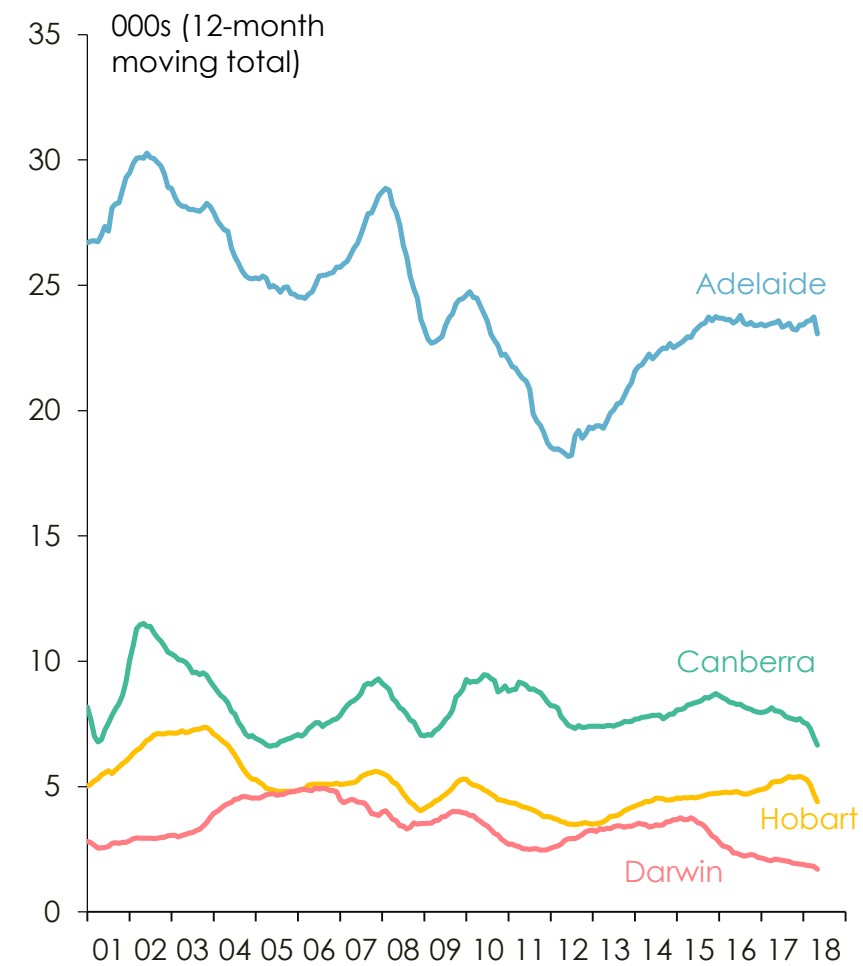
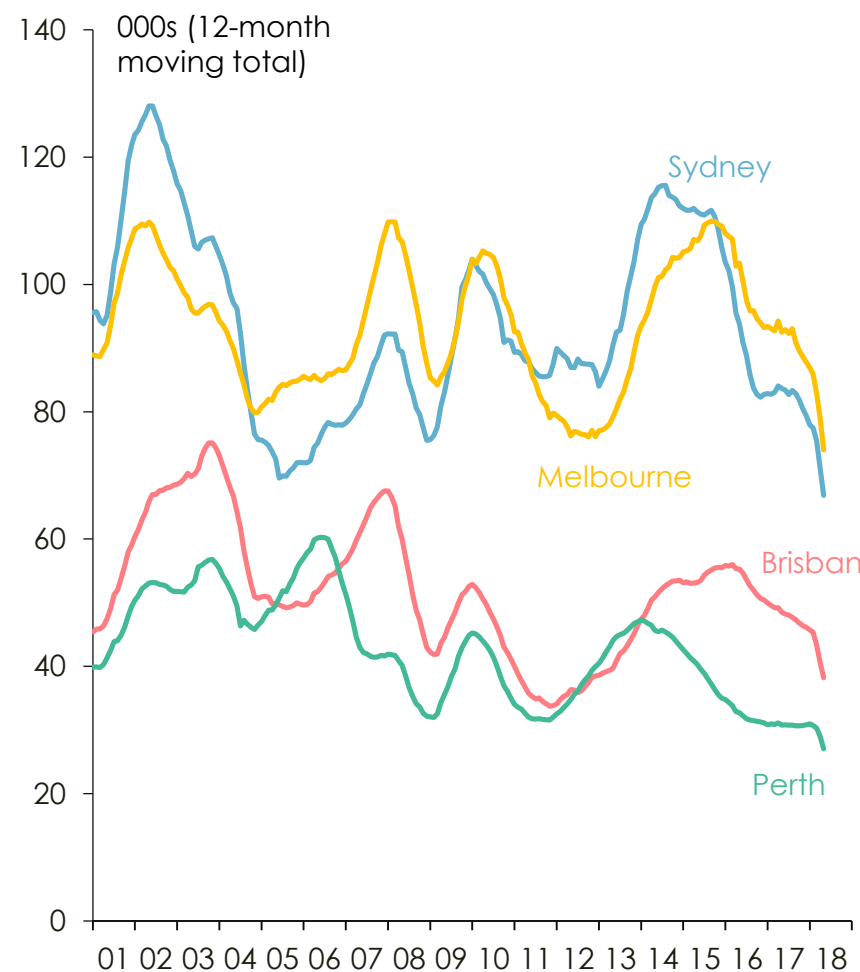
# Sales volumes have fallen in most capital cities – but particularly in Sydney and Melbourne

## Sales volumes – Australian capital cities

### 8-capitals total



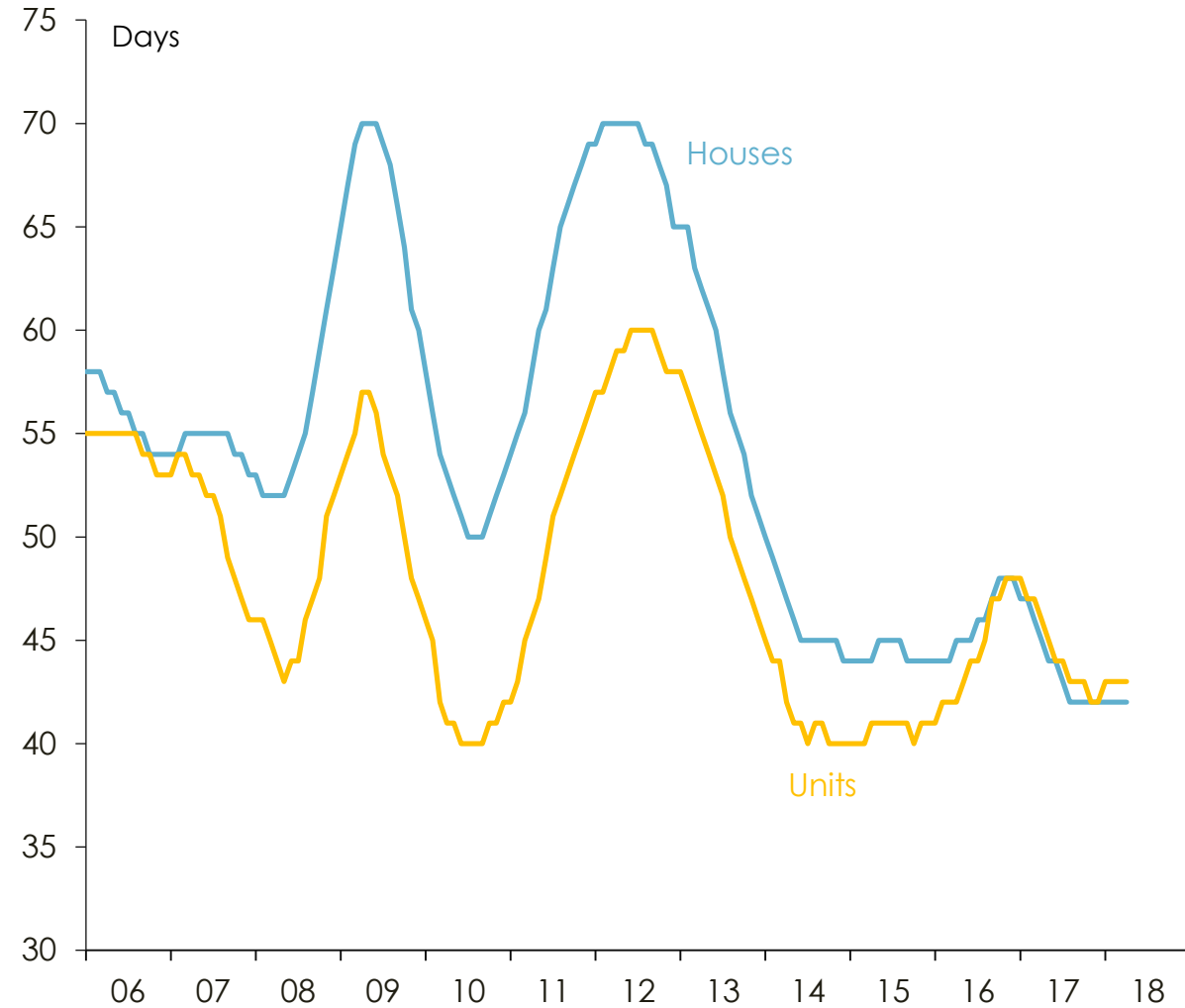
### Dwellings (houses and units) by city



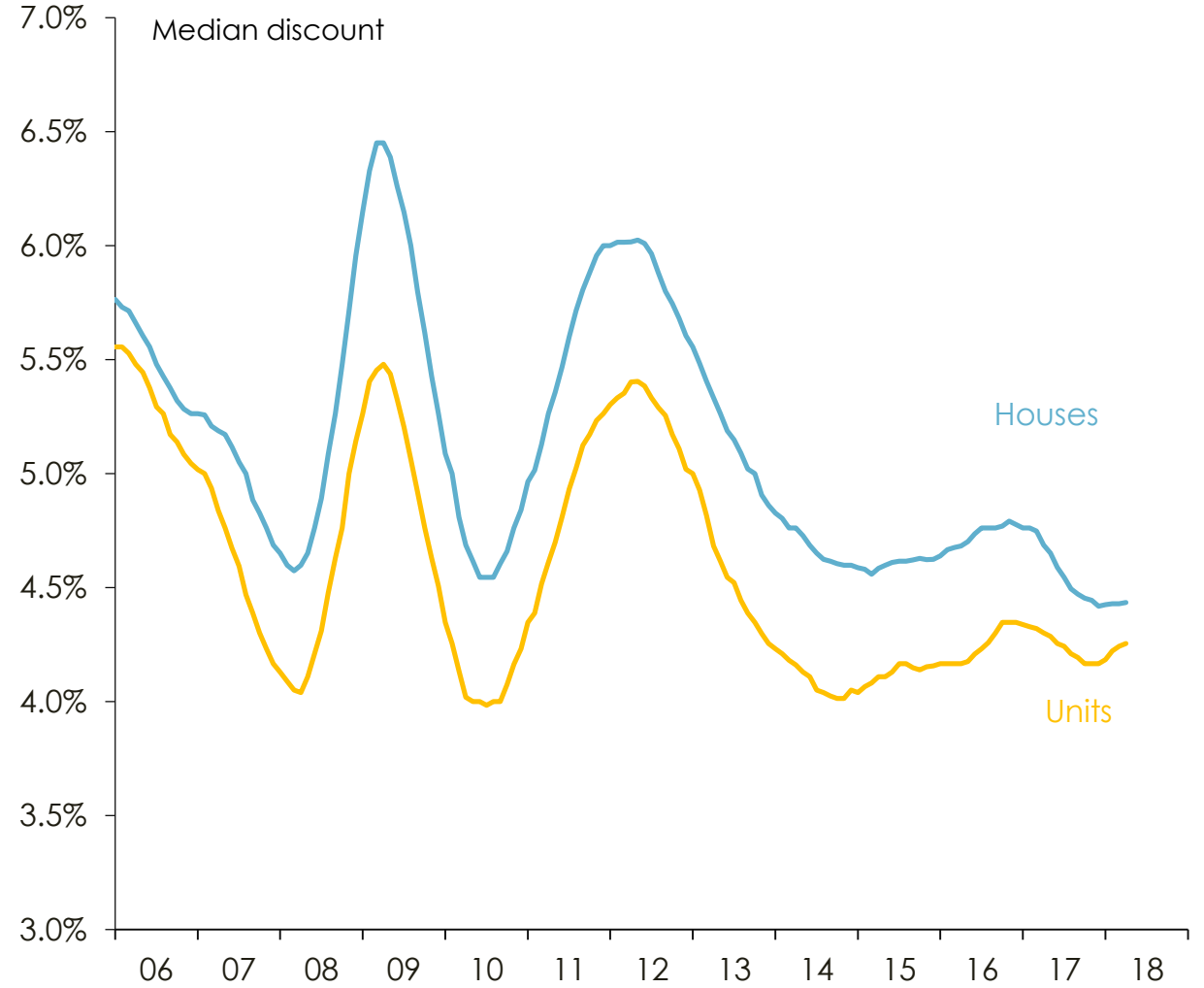


# So far there is no evidence of widespread distressed selling

## Median time on the market – average of 8 capital cities



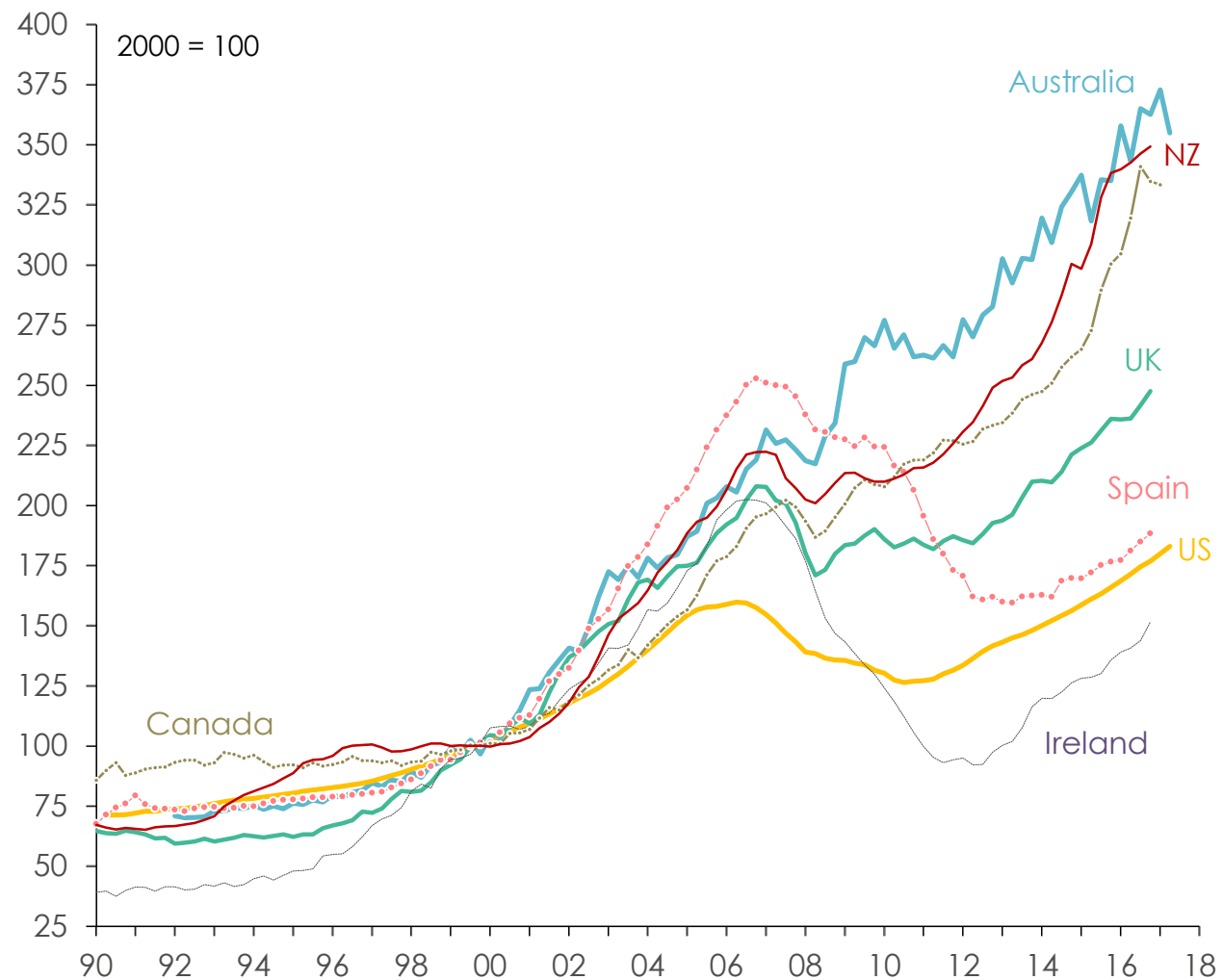
## Vendor discounting – average of 8 capital cities



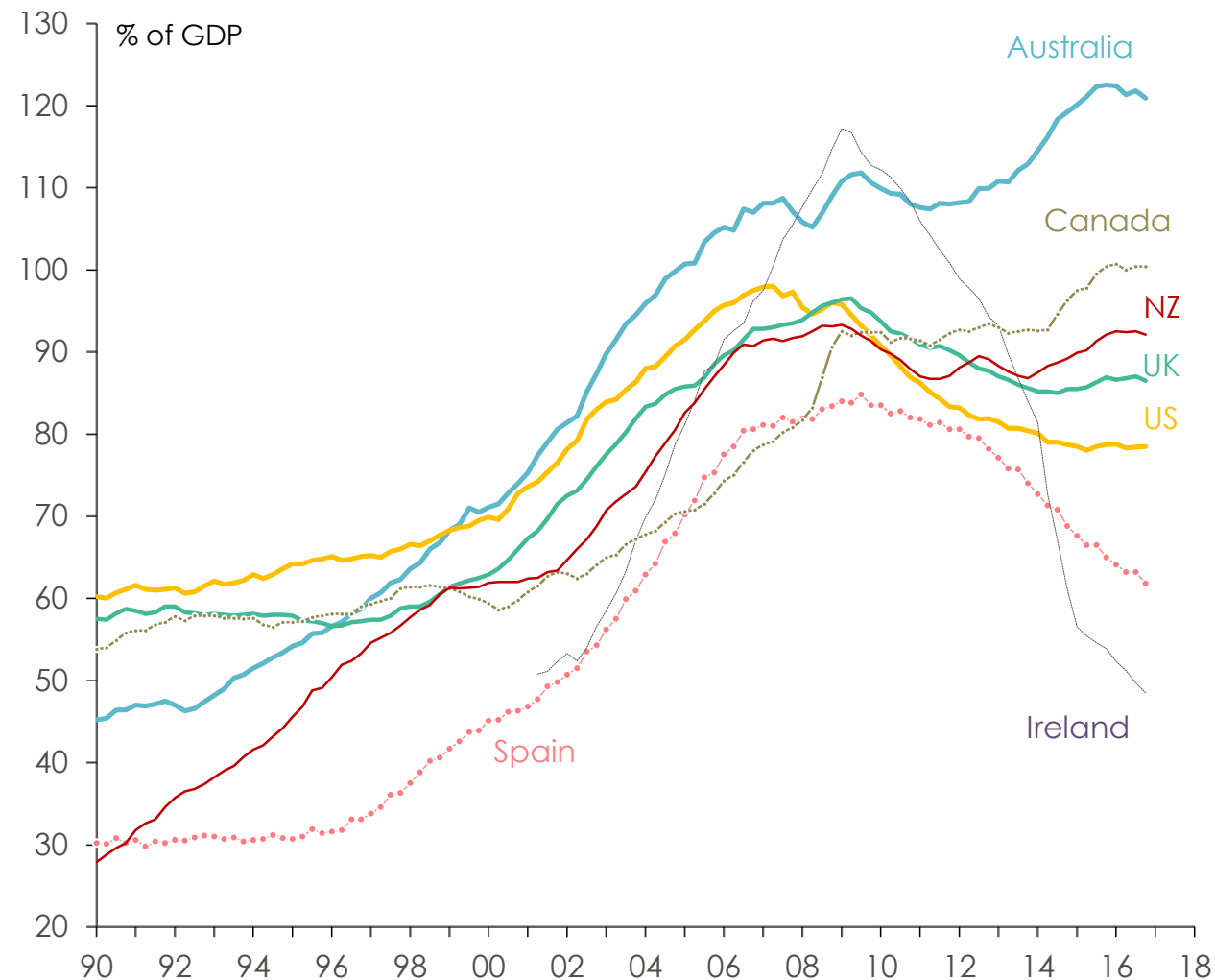
Source: CoreLogic.

# Australia now has amongst the world's most expensive urban residential real estate – and amongst the world's highest levels of household debt

## Residential property prices – Australia and selected other 'advanced' economies



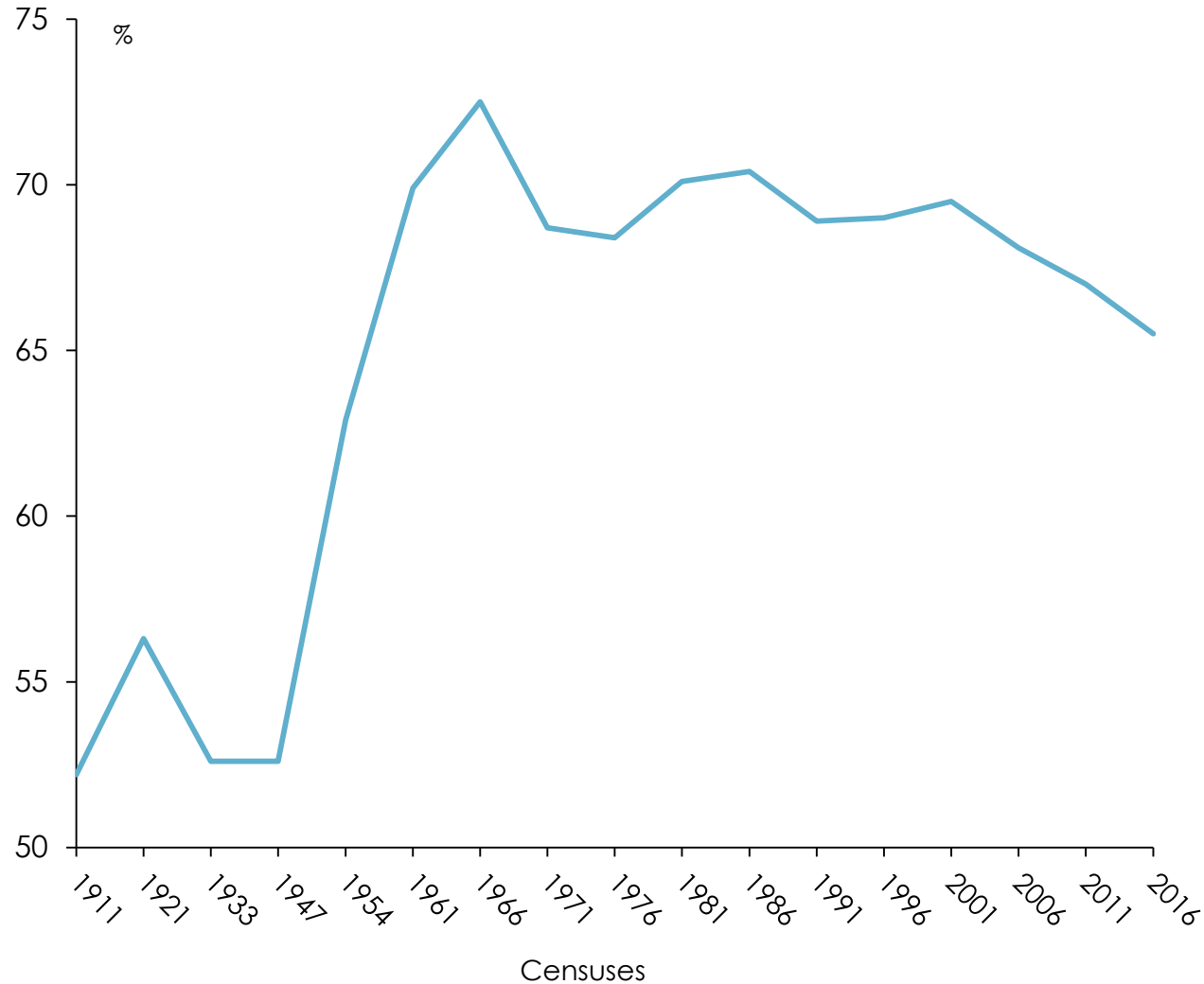
## Household debt as a pc of GDP – Australia and selected other 'advanced' economies



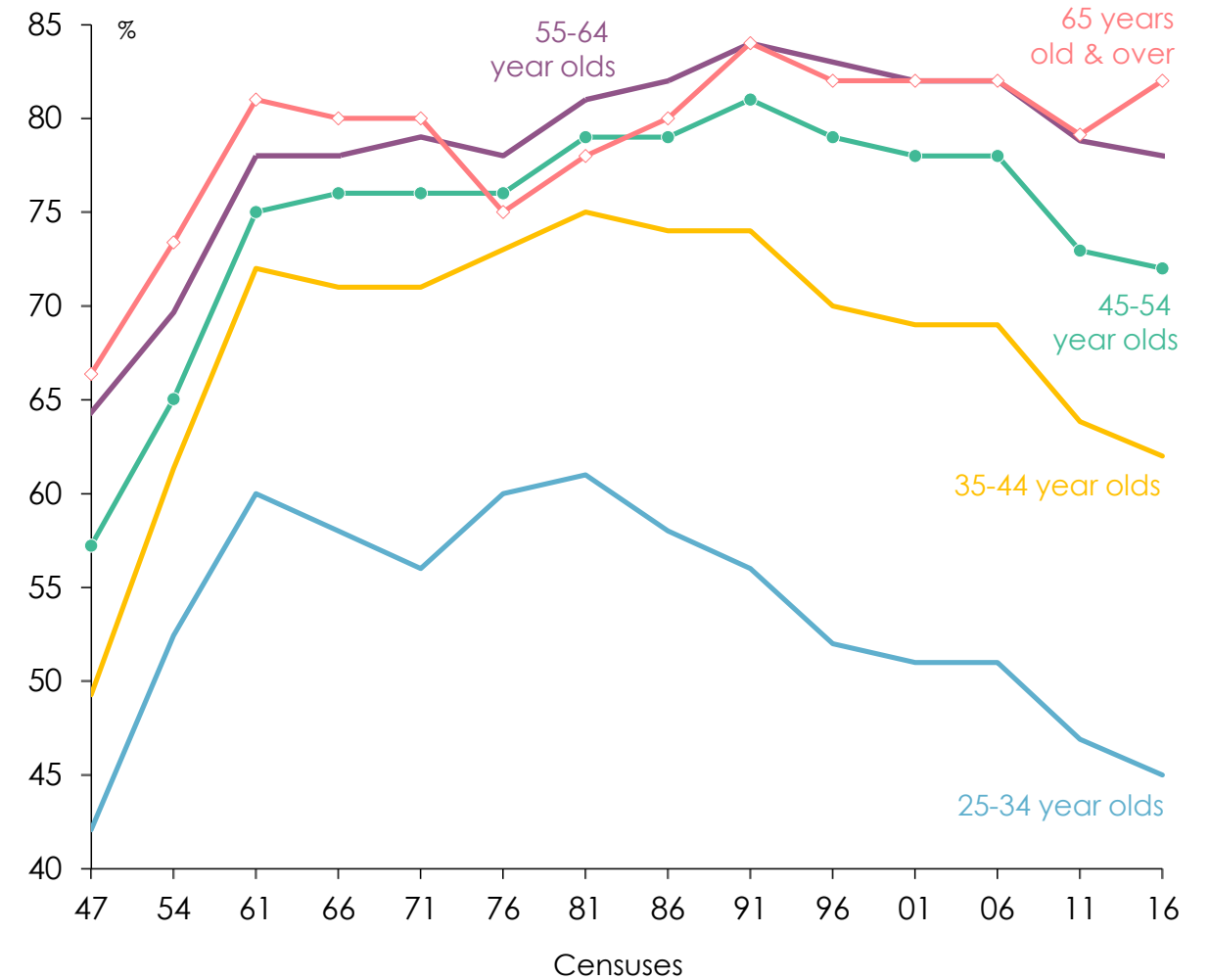
Sources: CoreLogic; Bank for International Settlements, Residential property prices: long series (nominal) and Credit to the non-financial private sector.

# Australia's home ownership rate is now lower than at any time since 1954 – and the decline has been especially marked among younger adults

## Home ownership rates at Australian censuses



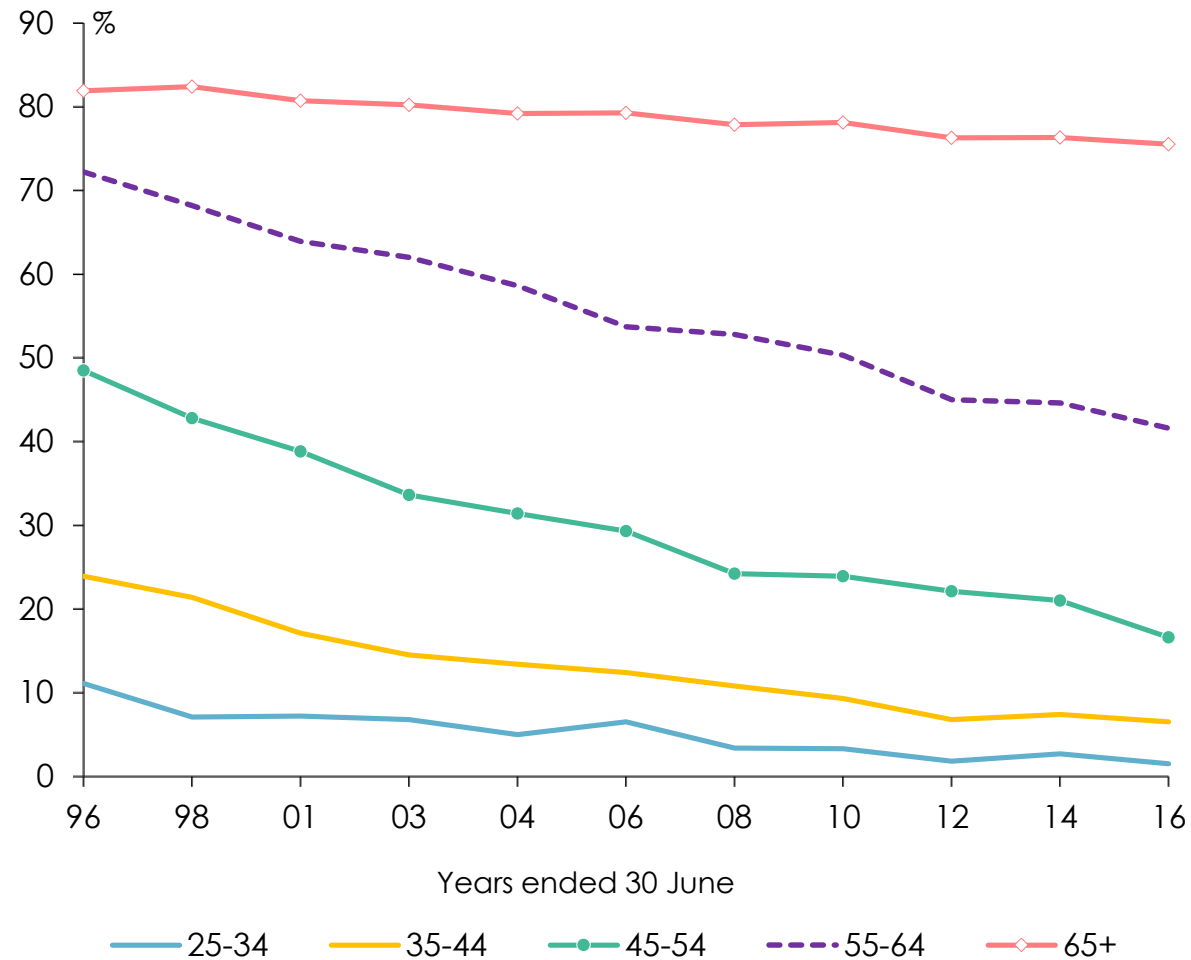
## Household debt as a pc of GDP – Australia and selected other ‘advanced’ economies



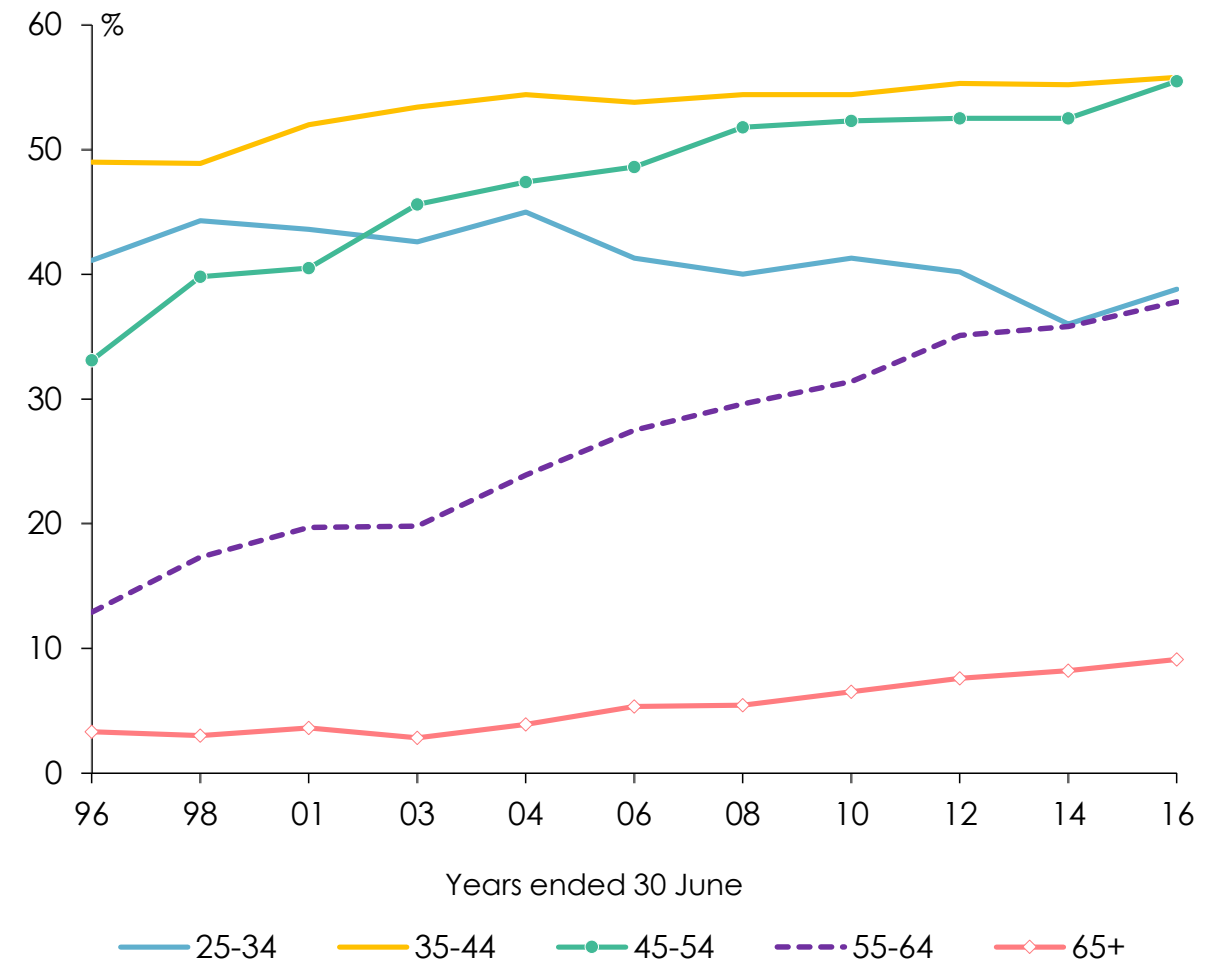
Source: Australian Bureau of Statistics, census data.

# A rising proportion of older home owners still have mortgage debt owing – and may have to use their superannuation to pay it off

## Proportion of home owners with mortgage debt outstanding, by age



## Proportion of home owners who own their homes outright, by age



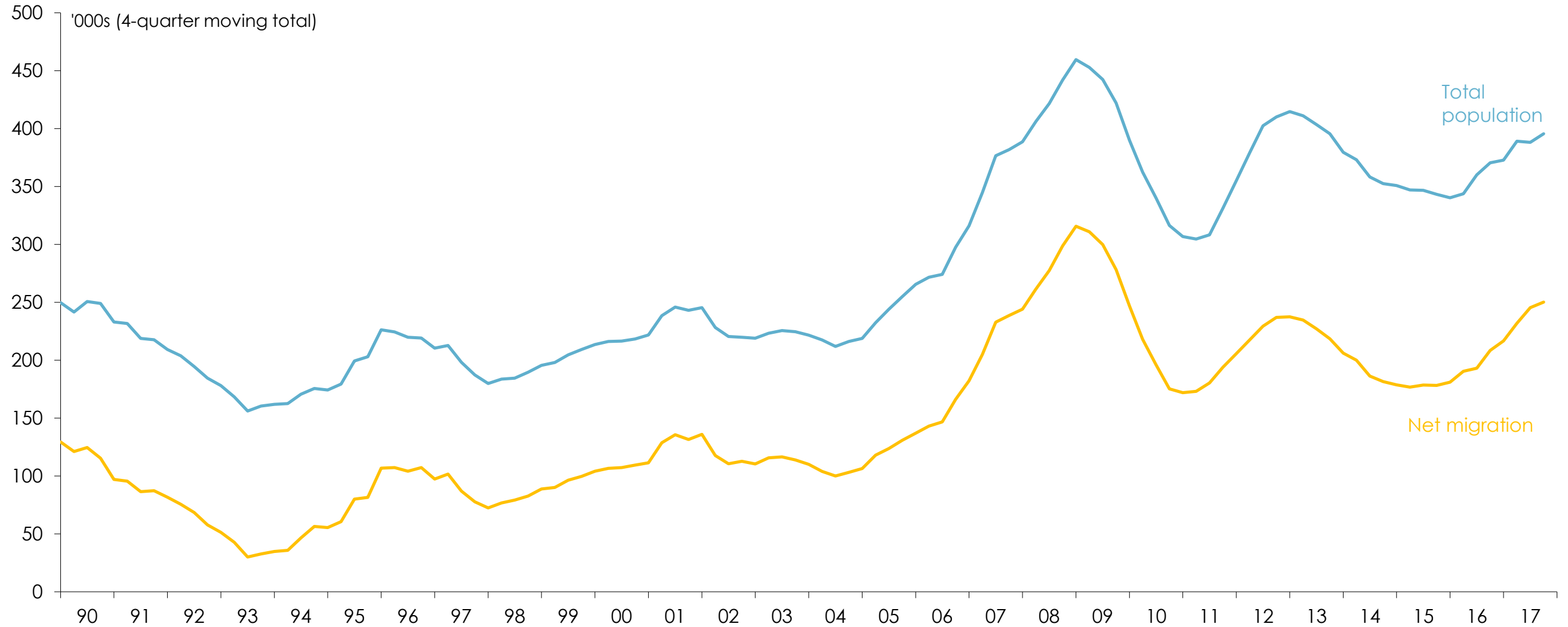
Source: Australian Bureau of Statistics, *Housing Occupancy and Costs* (4130.0).

# Fundamental influences on the demand for housing – the past 25 years, and now



# One of the principal drivers of the increase in housing demand has been strong population growth, largely reflecting higher immigration

## Australia's population growth

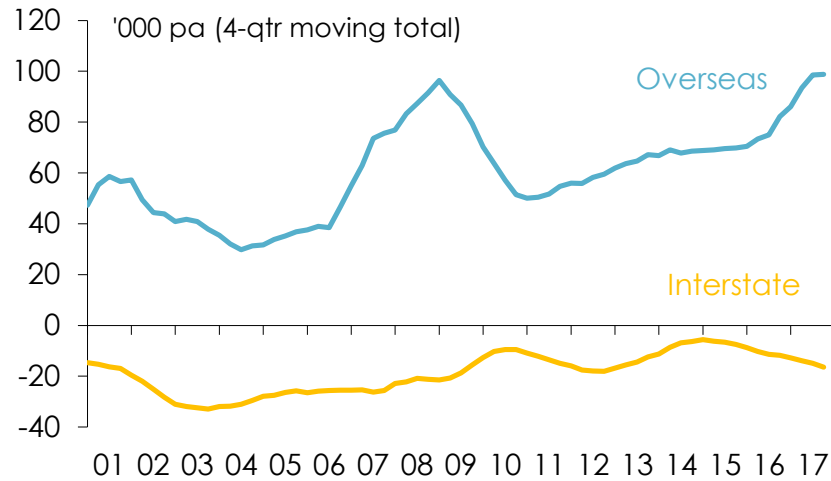


Source: Australian Bureau of Statistics, *Australian Demographic Statistics* (3101.0).

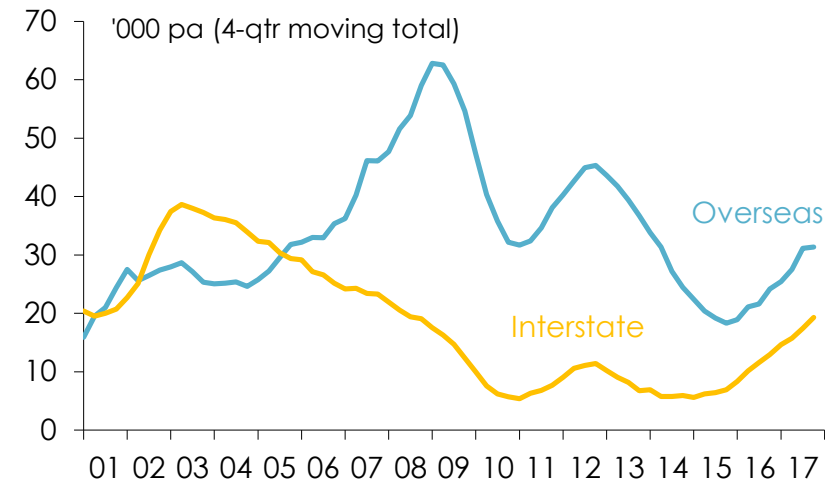
# Interstate migration flows either exacerbated or moderated the impact of migration from overseas on housing demand

## Net overseas and interstate migration – by State

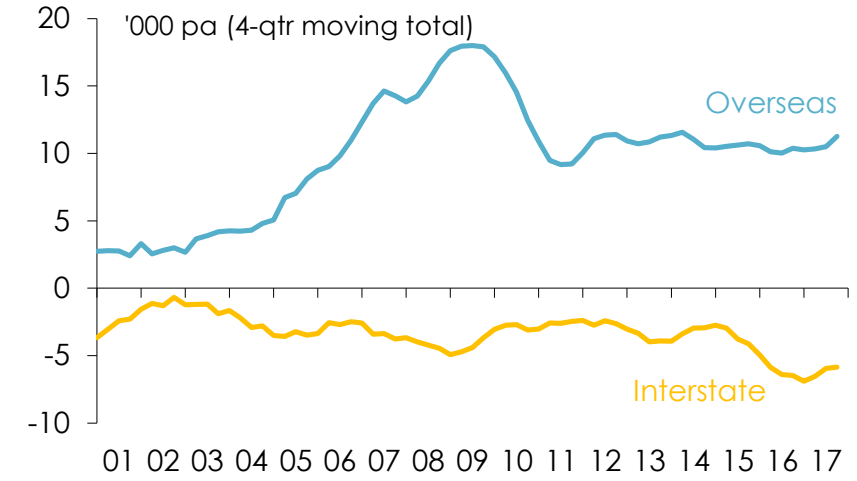
### New South Wales



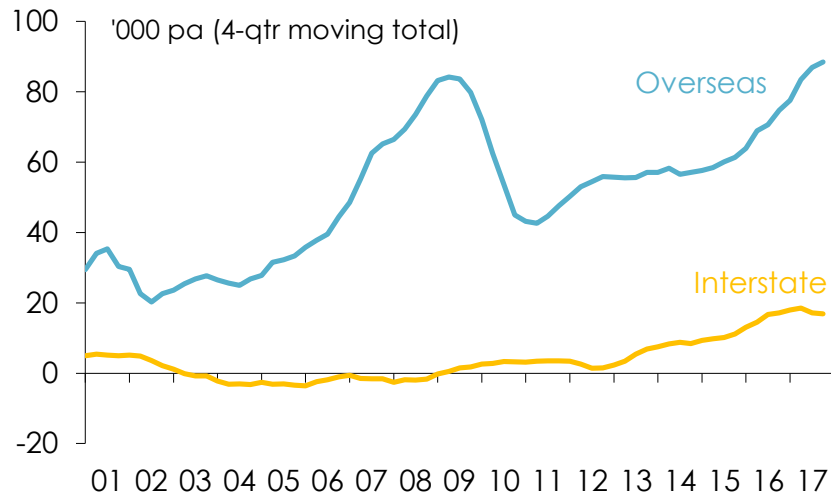
### Queensland



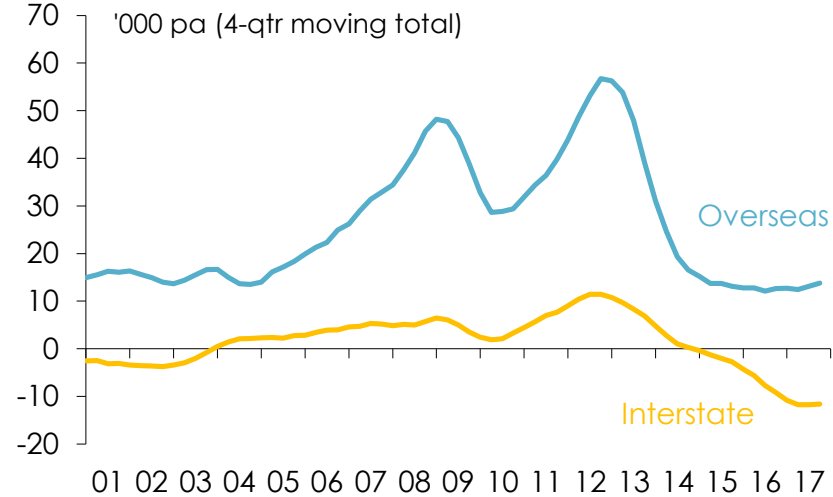
### South Australia



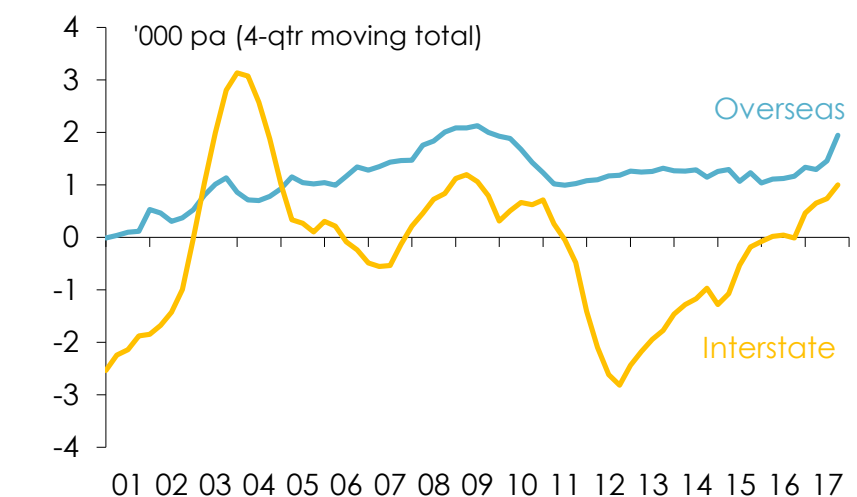
### Victoria



### Western Australia



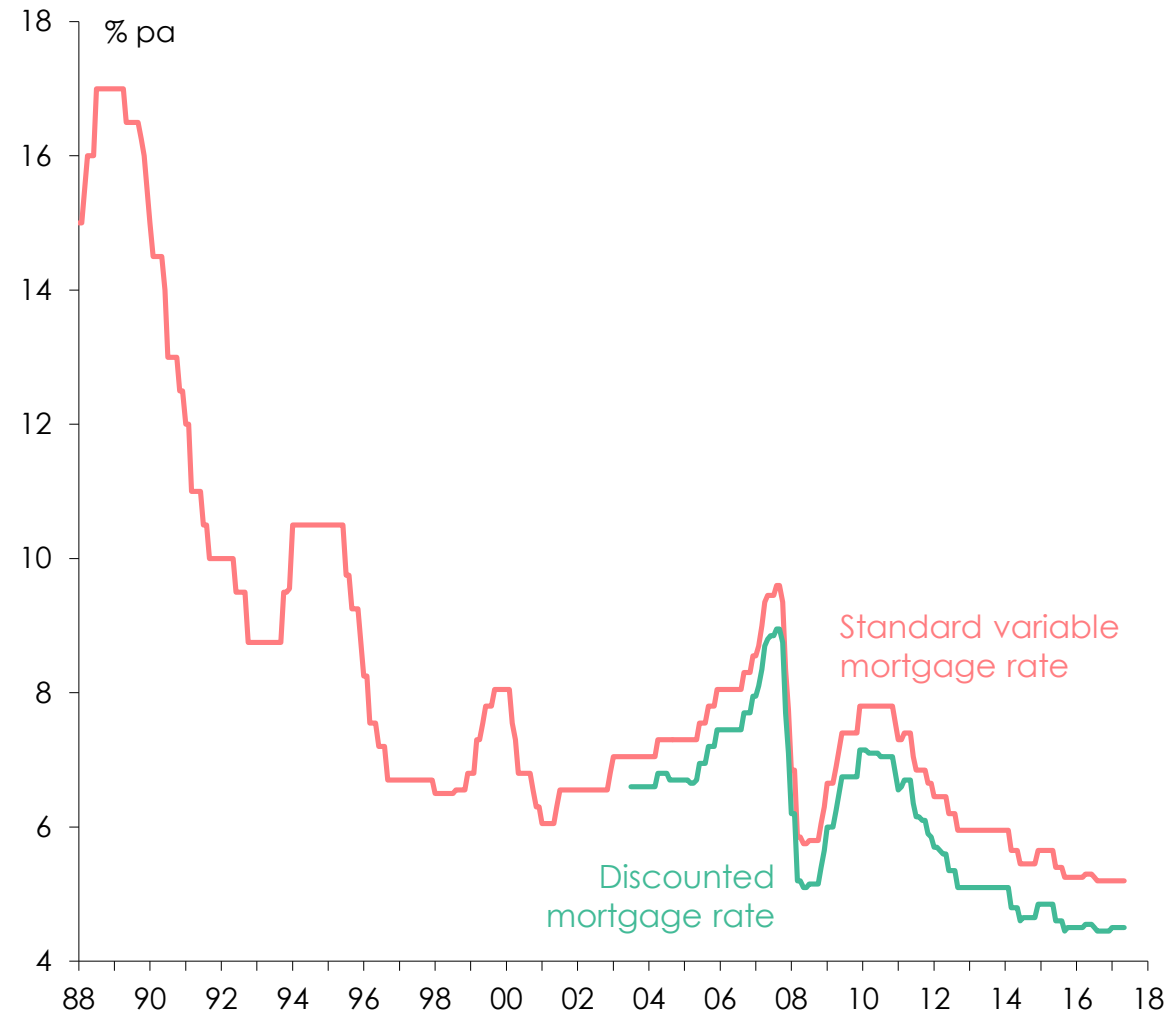
### Tasmania



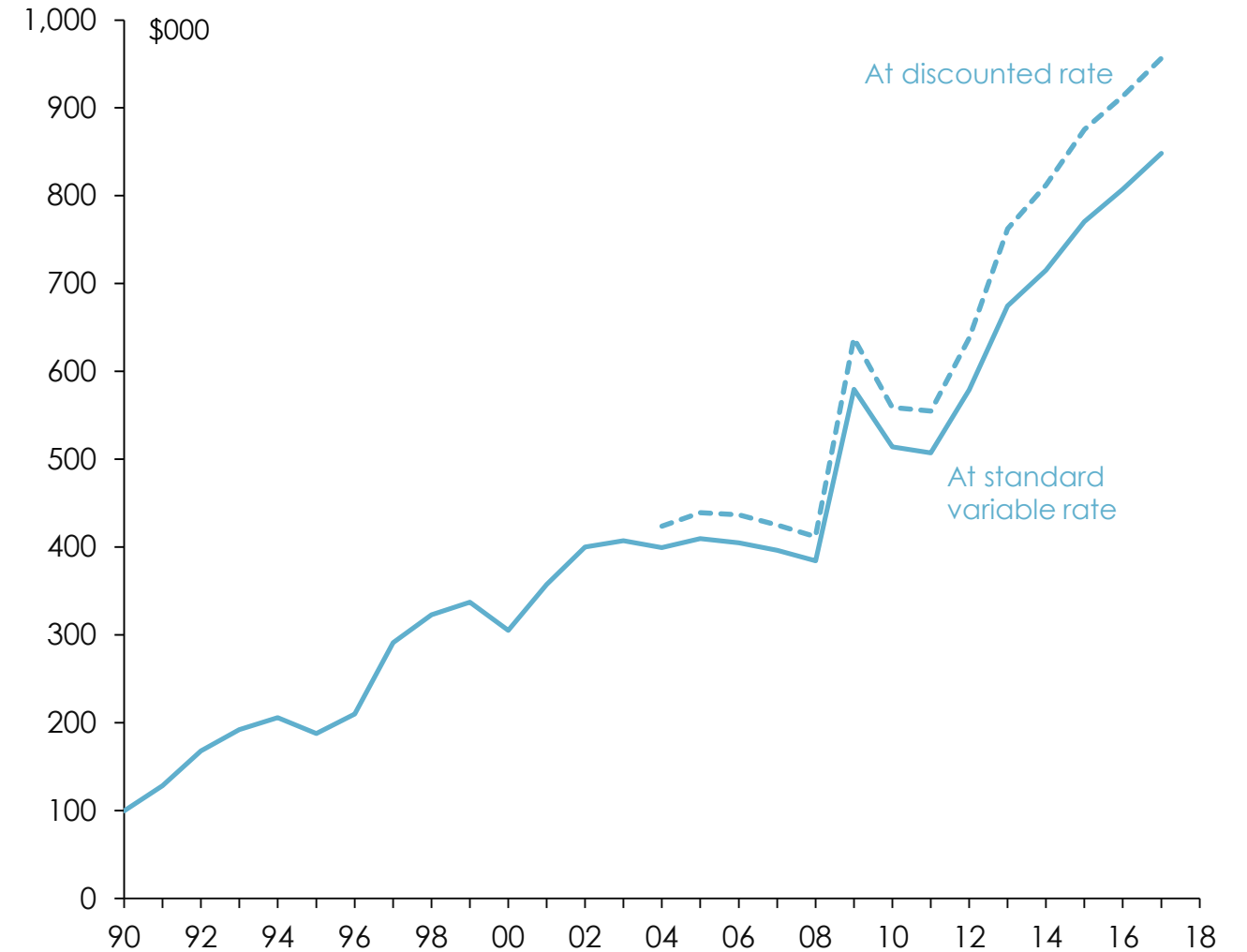
Source: Australian Bureau of Statistics, Australian Demographic Statistics (3101.0).

# The substantial decline in interest rates over the past three decades has greatly increased the amount which households can borrow

## Mortgage rates



## Maximum borrowing by two-earner household with repayments of 30% of average earnings



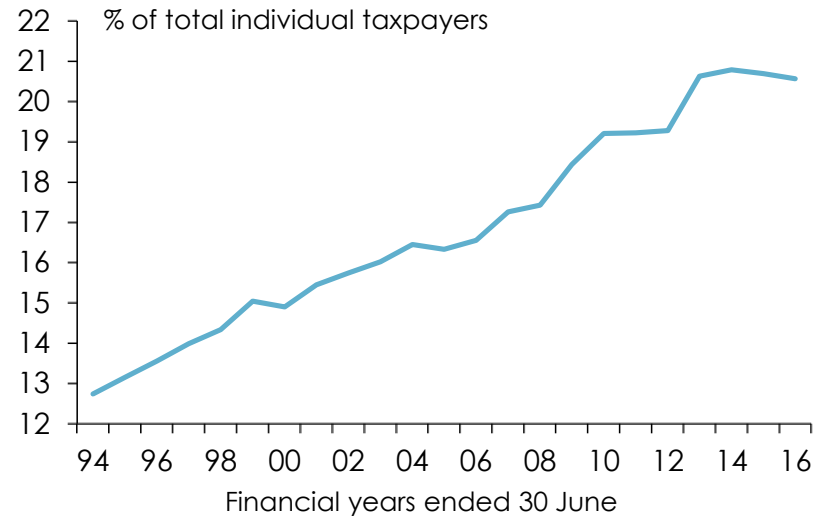
Note: Maximum borrowing assumes two-earner household earning average weekly ordinary time male and female earnings, a 25-year mortgage with monthly repayments set at 30% of gross income in the year in which the mortgage is taken out.

Sources: Reserve Bank of Australia Statistical Table F5; Australian Bureau of Statistics; Corinna Economic Advisory.

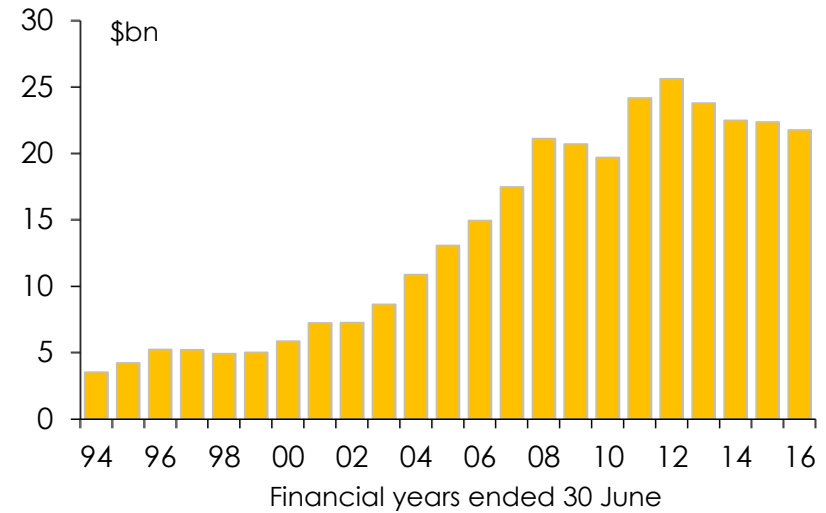


# Elimination of the interest rate premium on investor loans, and changes to the tax system, greatly enhanced the appeal of geared property investment

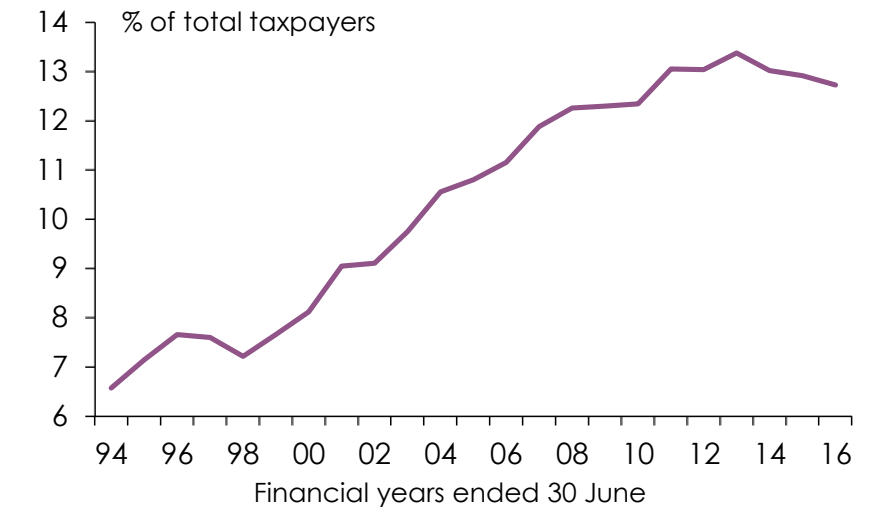
## Taxpayers with rental income



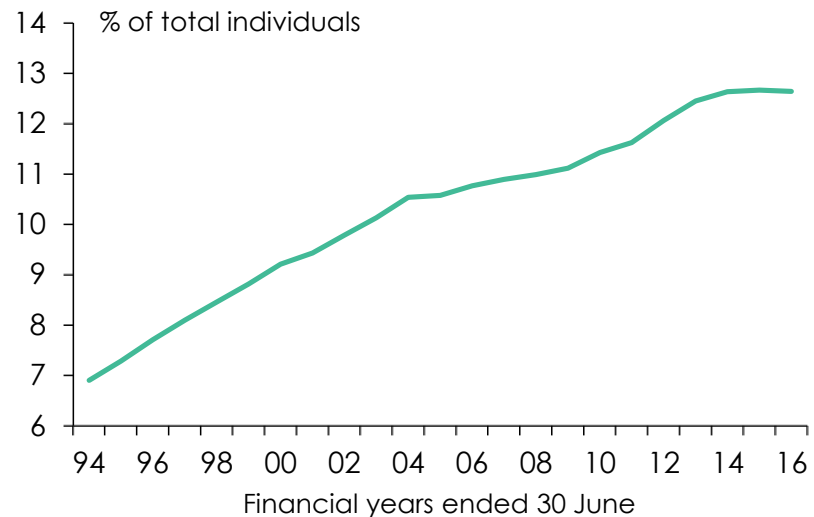
## Total rental interest deductions



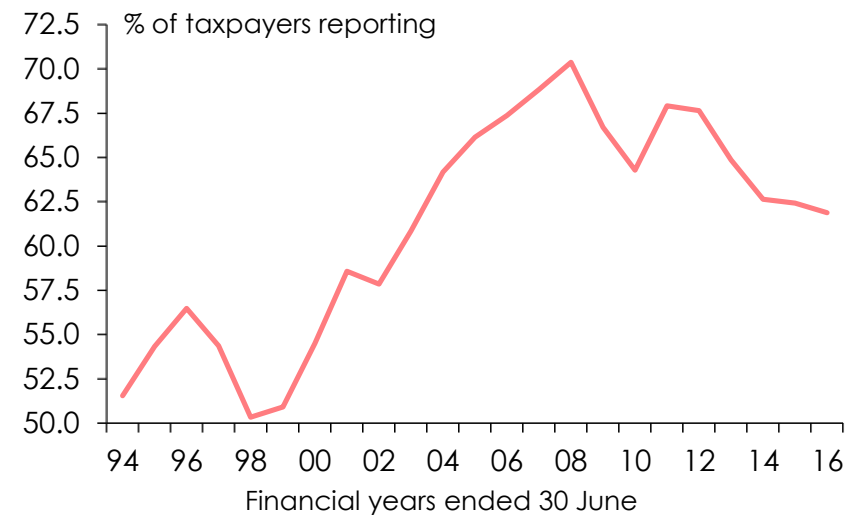
## Taxpayers with net rental income losses



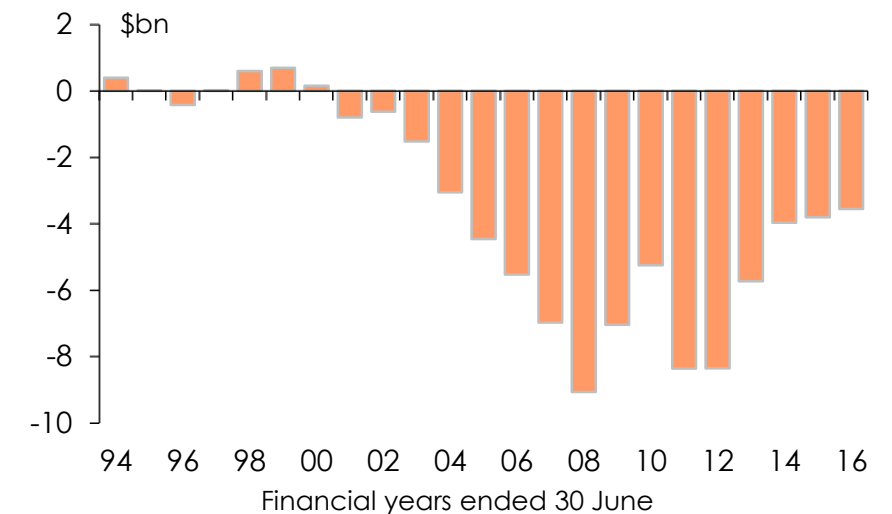
## Taxpayers with rental interest



## Landlords reporting net losses

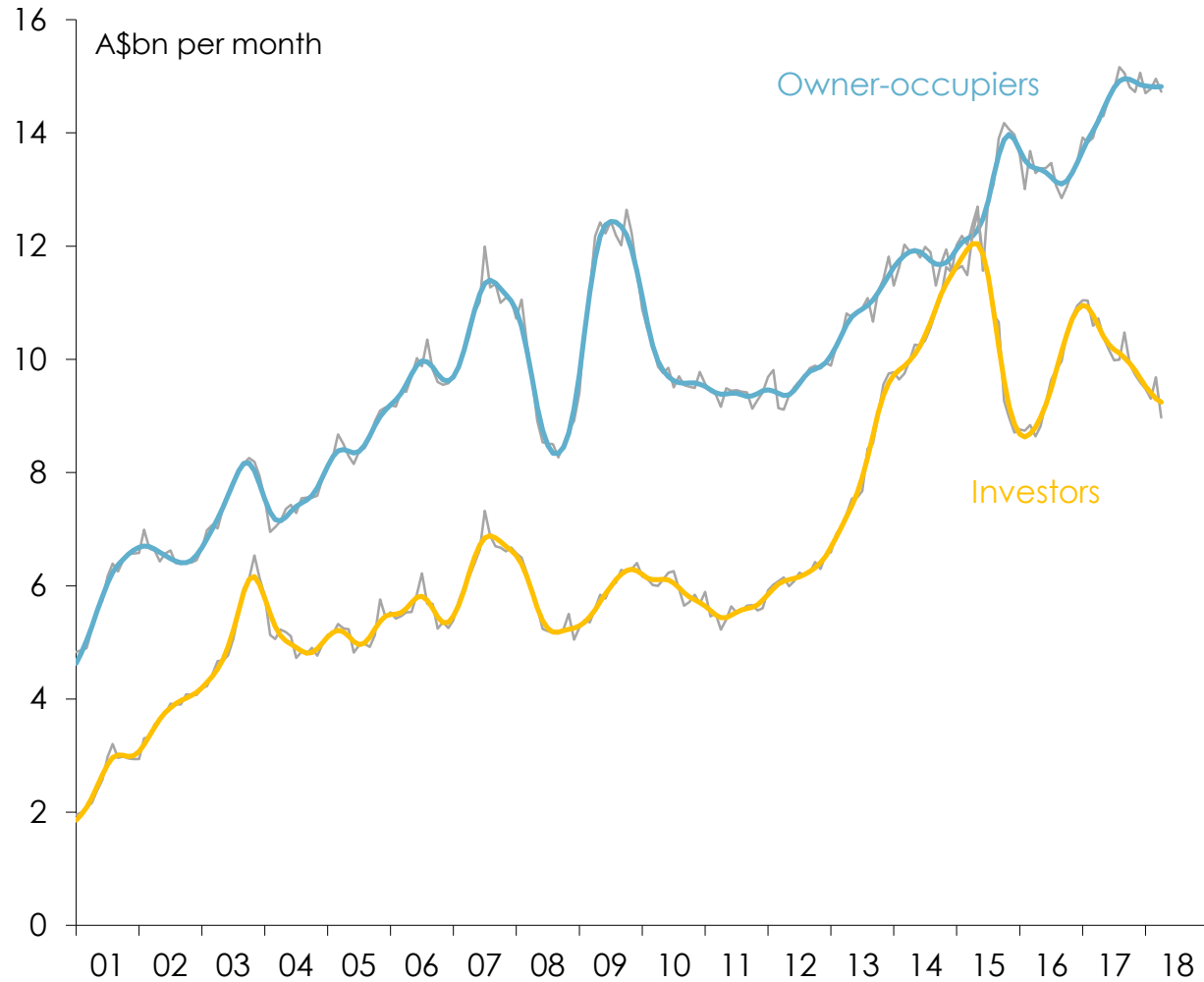


## Total net rental income

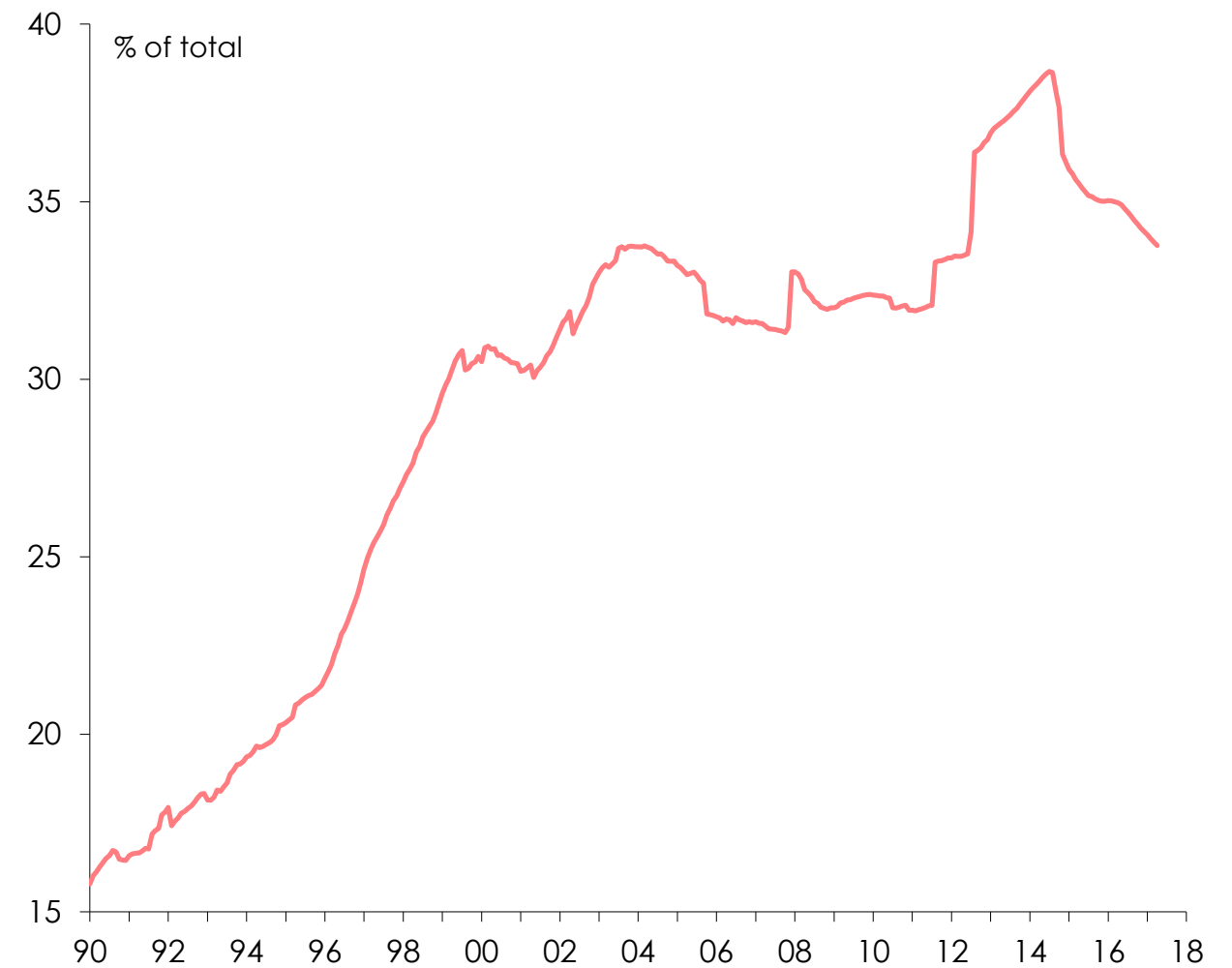


# Investors have played a much greater role in the Australian housing market since the early 1990s – although that seems now to have peaked

## Housing finance commitments to owner-occupiers and investors



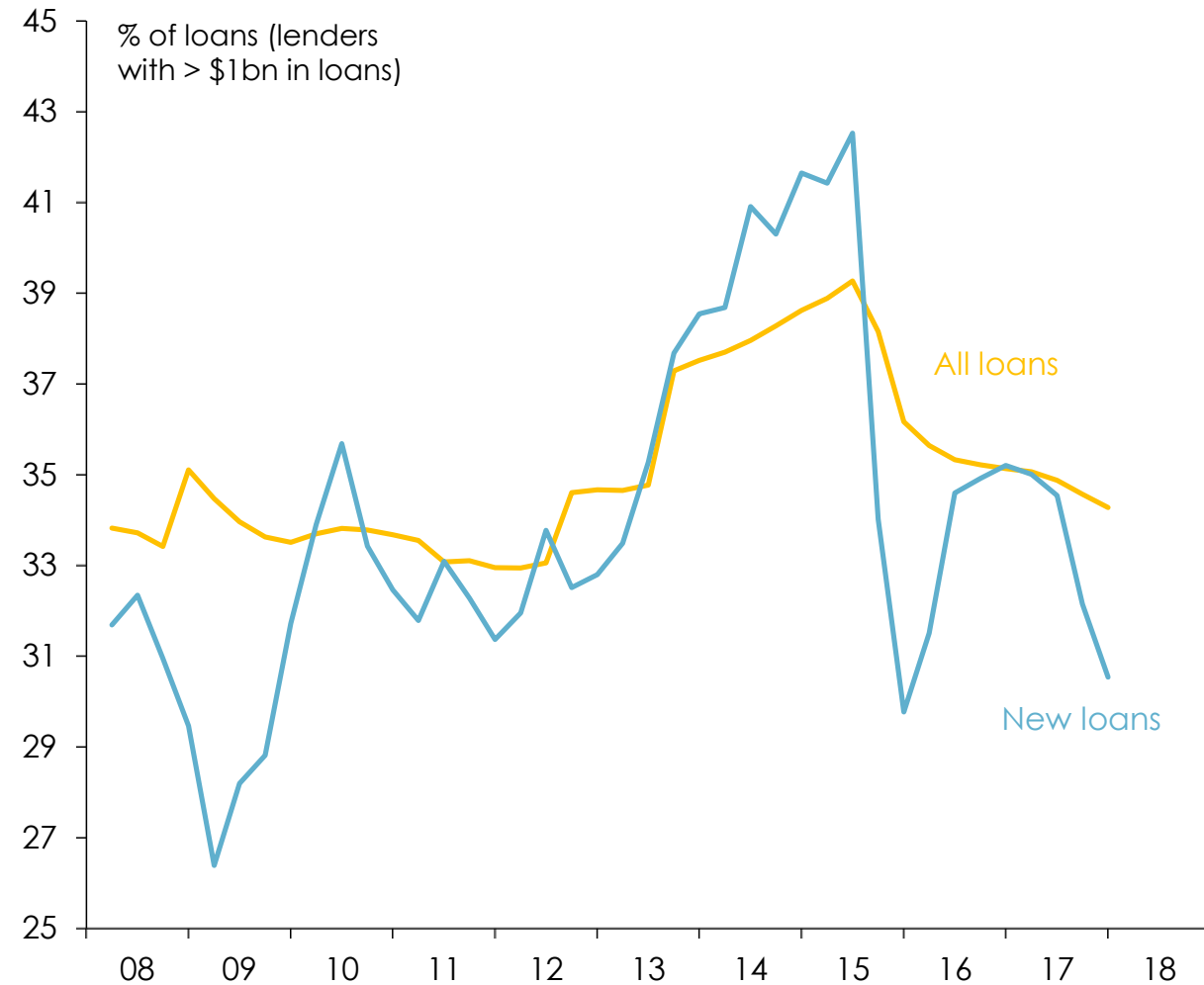
## Investor housing loans as a pc of total housing debt outstanding



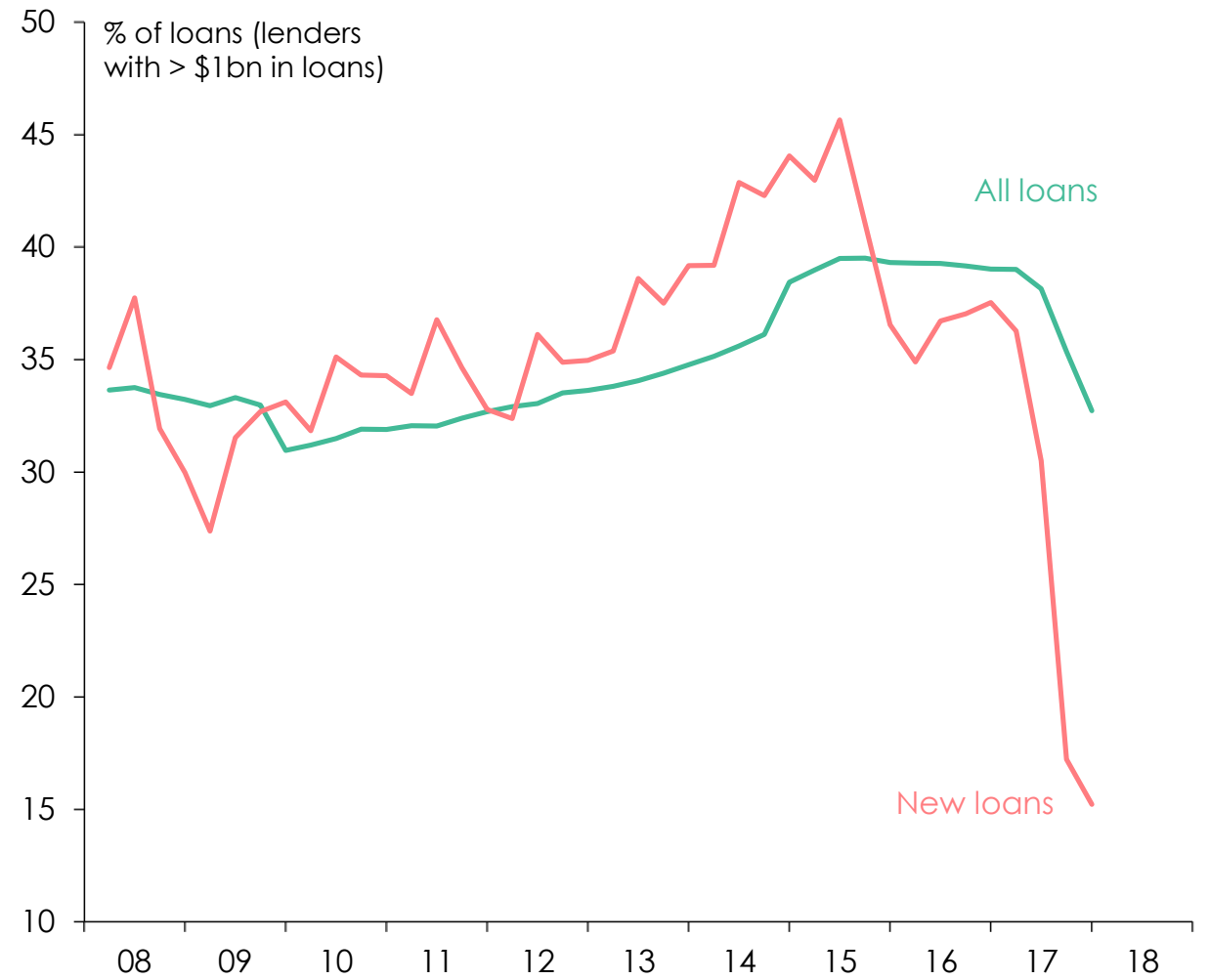
Source: Australian Bureau of Statistics, *Housing Finance* (5609.0); Reserve Bank of Australia, Statistical Table D2.

# Supervisory measures implemented by the banking regulator since 2015 have dampened lending to, and demand from, property investors

## Major lenders loans to investors as a pc of total housing loans



## Major lenders interest-only loans as a pc of total housing loans



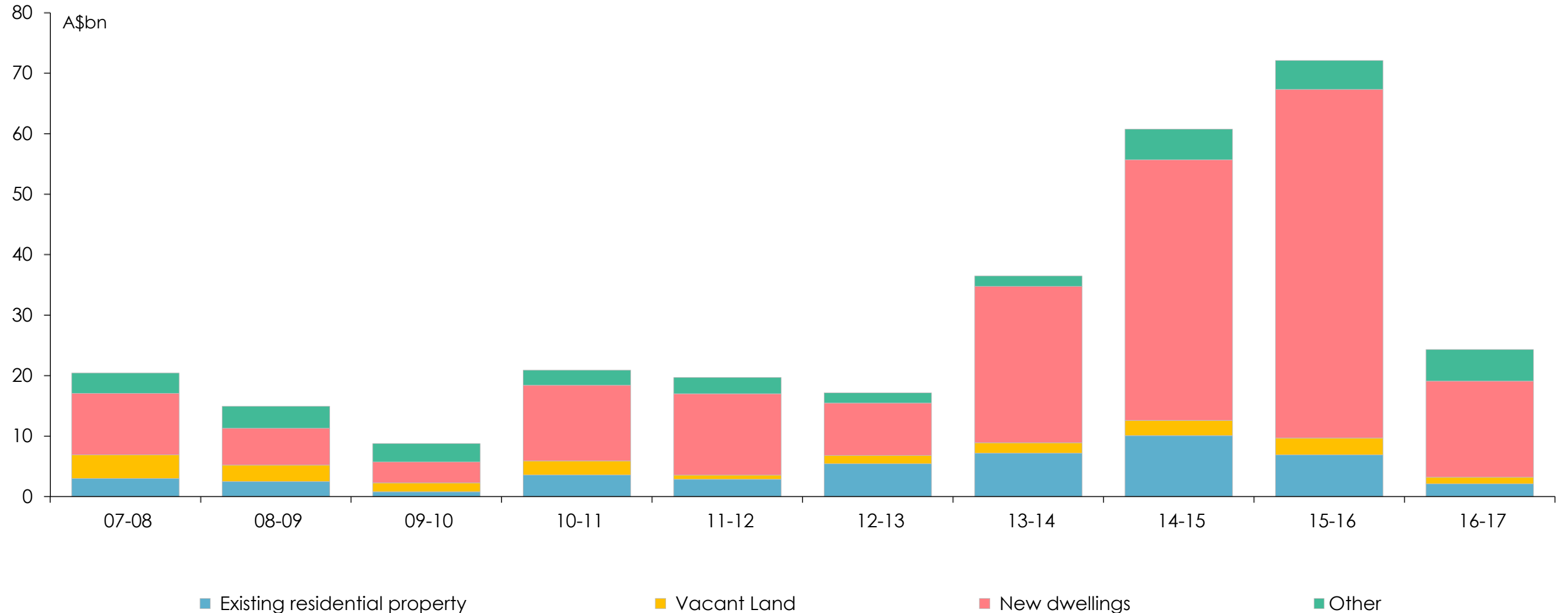
Source: Australian Prudential Regulation Authority (APRA), *Quarterly Authorised Deposit-taking Institution Property Exposures*.

# One area of potential risk noted by the RBA is borrowers transitioning from interest-only loans to principal-and-interest loans

- ❑ **The RBA estimates that interest-only (IO) loans averaging about \$120bn a year are due to convert to principal-and-interest (P&I) loans between 2018 and 2021**
  - in total this represents about 30% of the total outstanding stock of mortgage debt
- ❑ **The 'step up' in mortgage payments when IO loans convert to P&I can be in the range of 30-40%**
  - even though interest rates on P&I loans are (now) typically lower than on IO loans
- ❑ **However the RBA believes that “any resulting increase in financial stress should not be widespread”**
  - many IO borrowers have accumulated substantial pre-payments on their loans
  - some borrowers have switched to P&I repayments ahead of schedule in order to avoid the higher rates which have applied to IO loans since 2016 – and “these borrowers appear well placed to handle the higher repayments”
  - the 'buffers' incorporated into the serviceability assessments used to write IO loans include potential for future interest rate increases and the step-up in payments at the end of the IO period
  - this latter aspect of loan serviceability standards was tightened by APRA in 2014
- ❑ **The RBA believes that “the share of borrowers who cannot afford higher P&I repayments and are not eligible to alleviate their situation by refinancing is ... small”**
  - and “most would be expected to have positive equity given substantial housing price growth in many parts of the country over recent years and hence would at least have the option to sell the property if they experienced financial stress from the increase in repayments”
- ❑ **Overall, the RBA says that “regulatory measures and broader strengthening of lending standards have contributed to an improvement in the risk profile of new housing lending and the resilience of household balance sheets**

# Foreign investors were a significant source of demand, especially for new properties, between 2013-14 and 2015-16

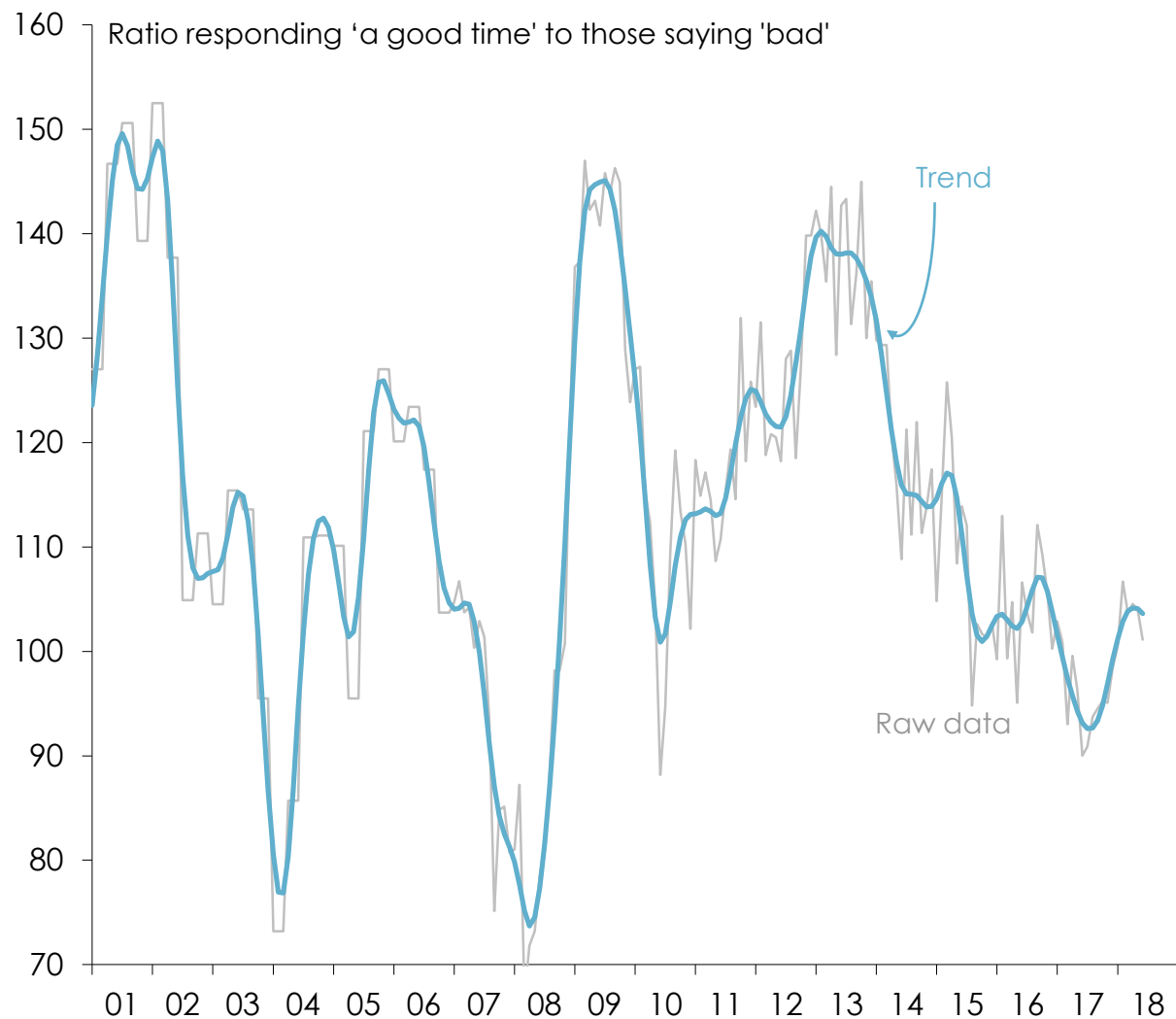
## Foreign Investment Review Board approvals of foreign investment in Australian residential real estate



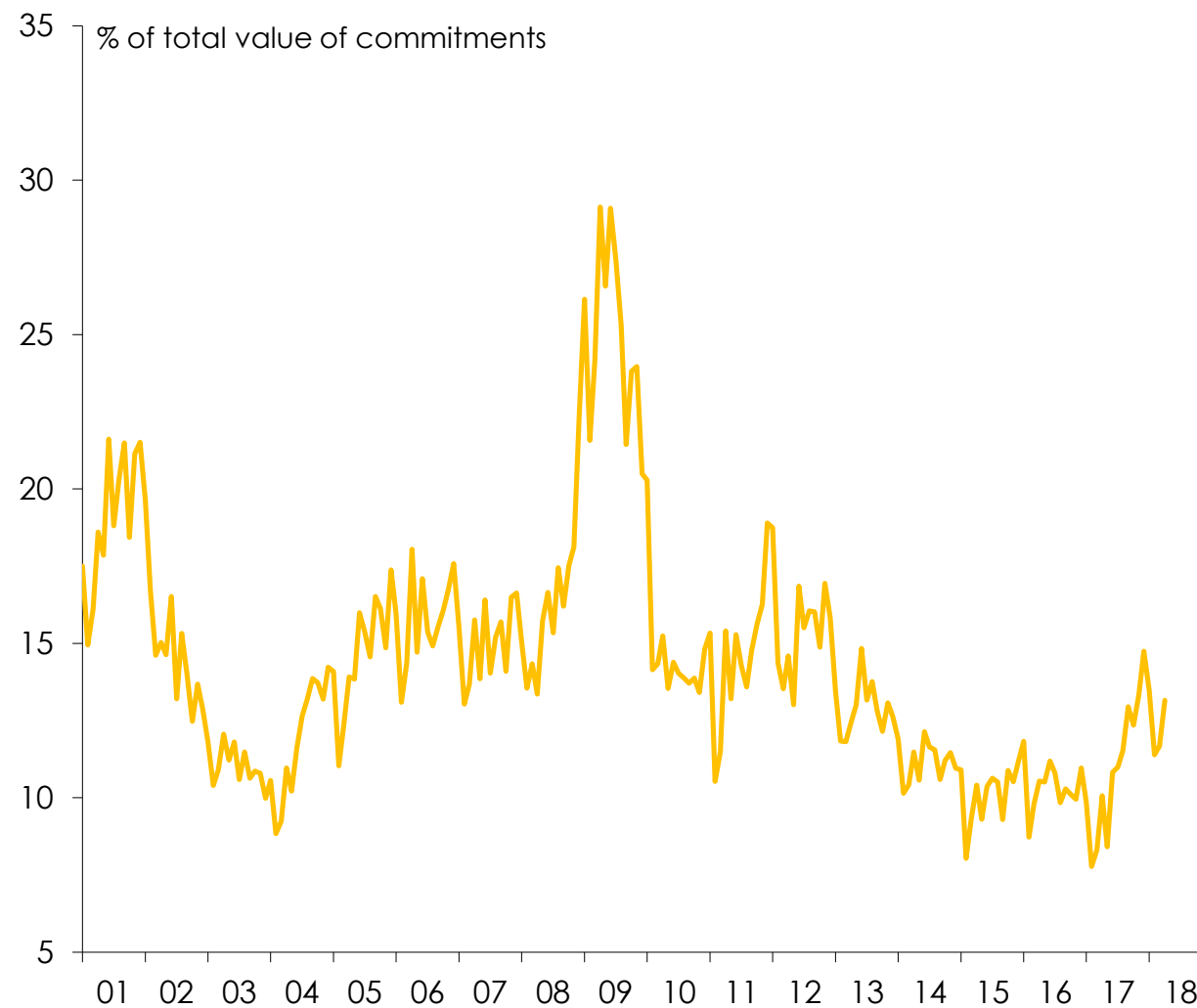
Source: Foreign Investment Review Board, *Annual Reports*.

# As investor demand for residential property has eased, first-time buyers are coming back into the market

## Consumer sentiment towards home purchase



## Housing finance commitments to first home buyers as a pc of total



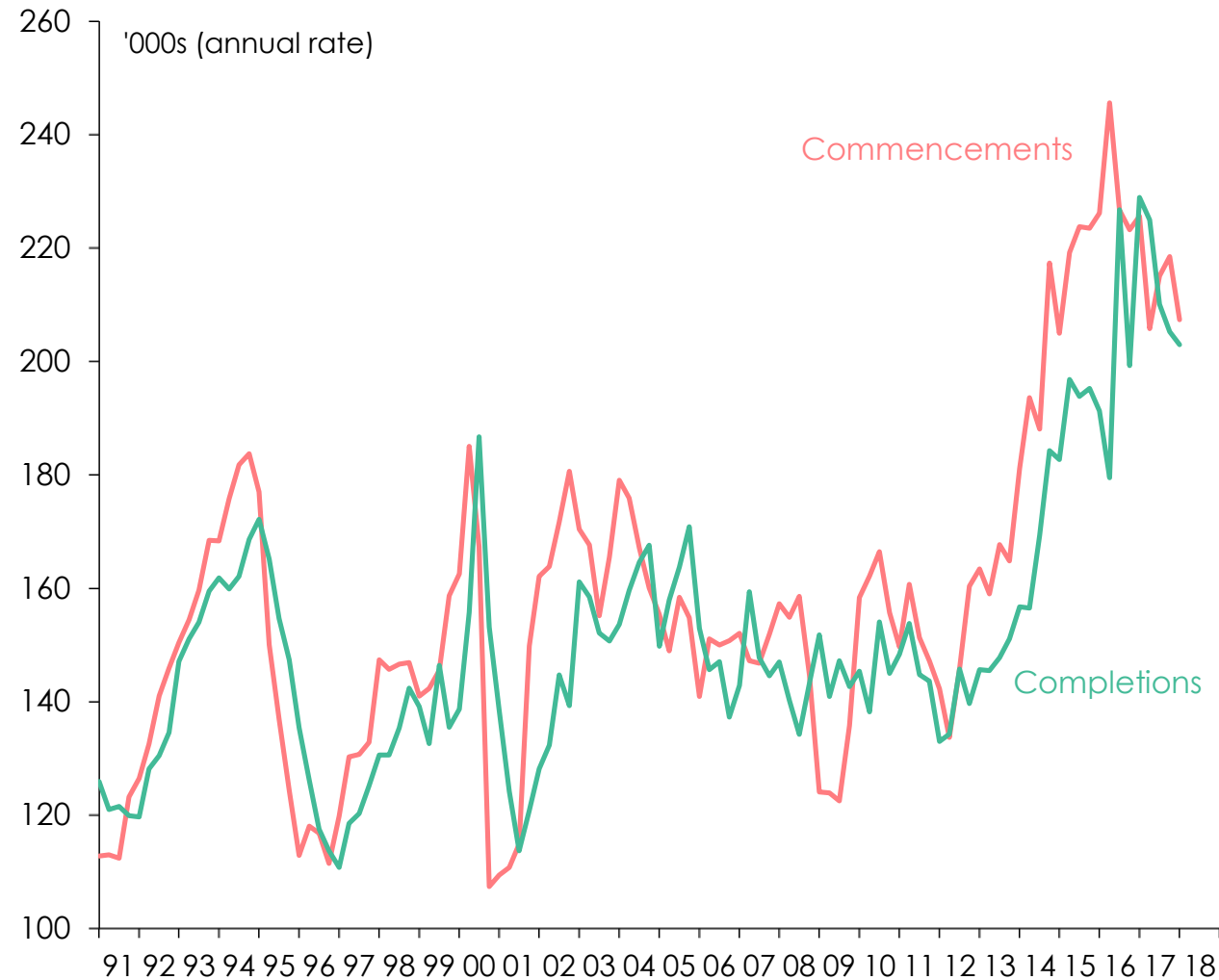
Sources: Westpac-Melbourne Institute consumer confidence survey; Australian Bureau of Statistics, *Housing Finance* (5609.0).

# The 'supply side' of the housing market

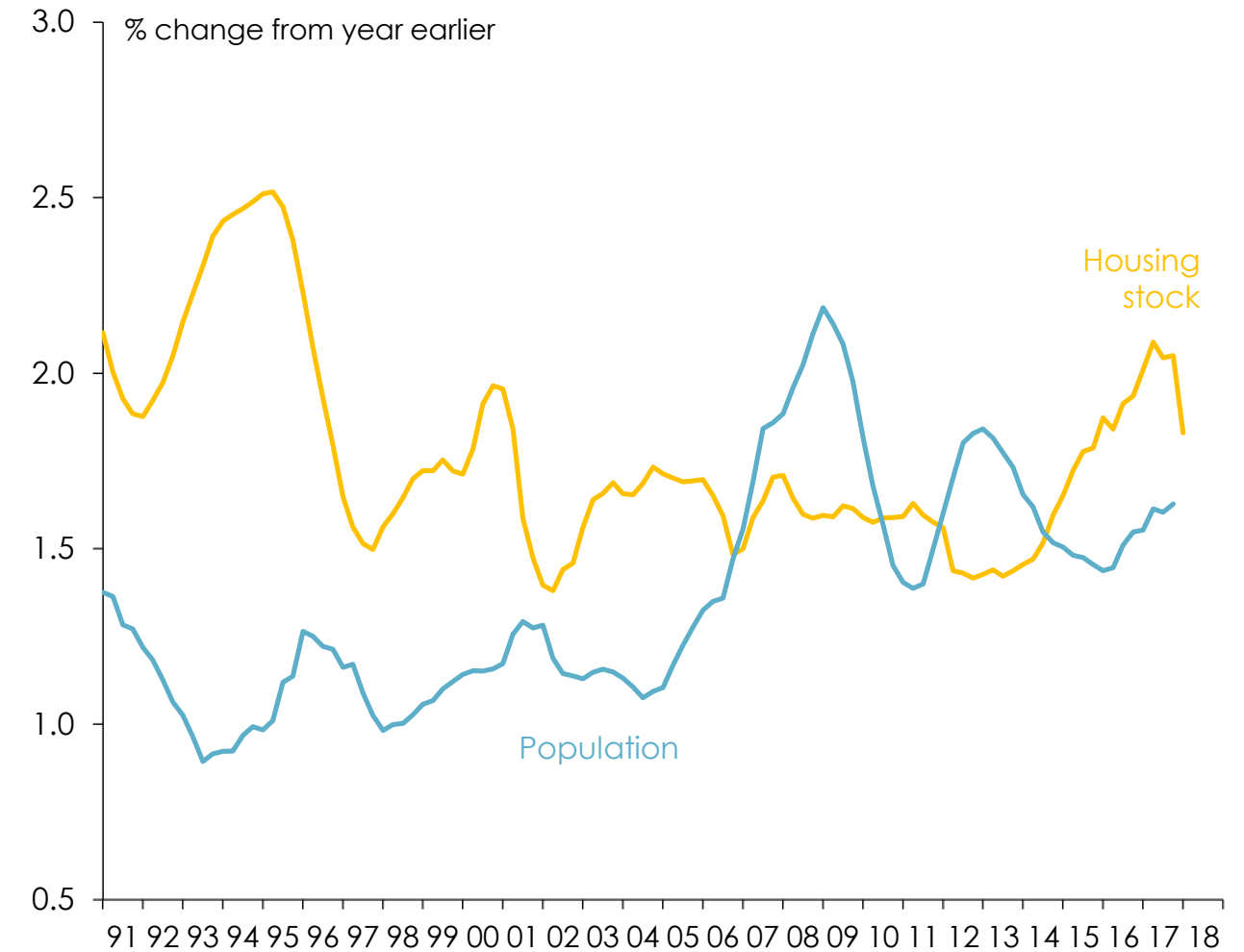


# The supply of housing took a very long time to respond to the pick-up in population growth

## Dwelling commencements and completions



## Growth rate of Australia's housing stock and population

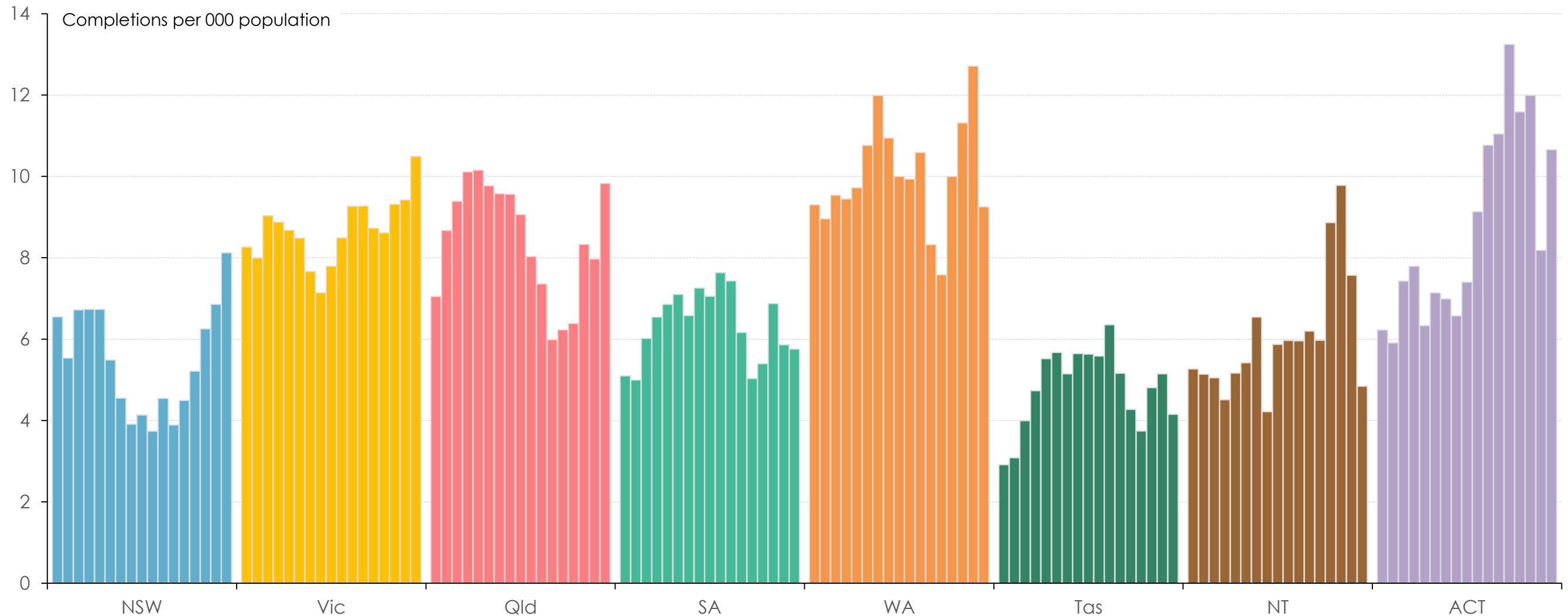


Sources: ABS, Building Activity (8752.0); Reserve Bank of Australia, Statistical Table E1.



# Supply-side constraints were particularly acute in New South Wales, until very recently, while supply growth has also been slow in SA & Tasmania

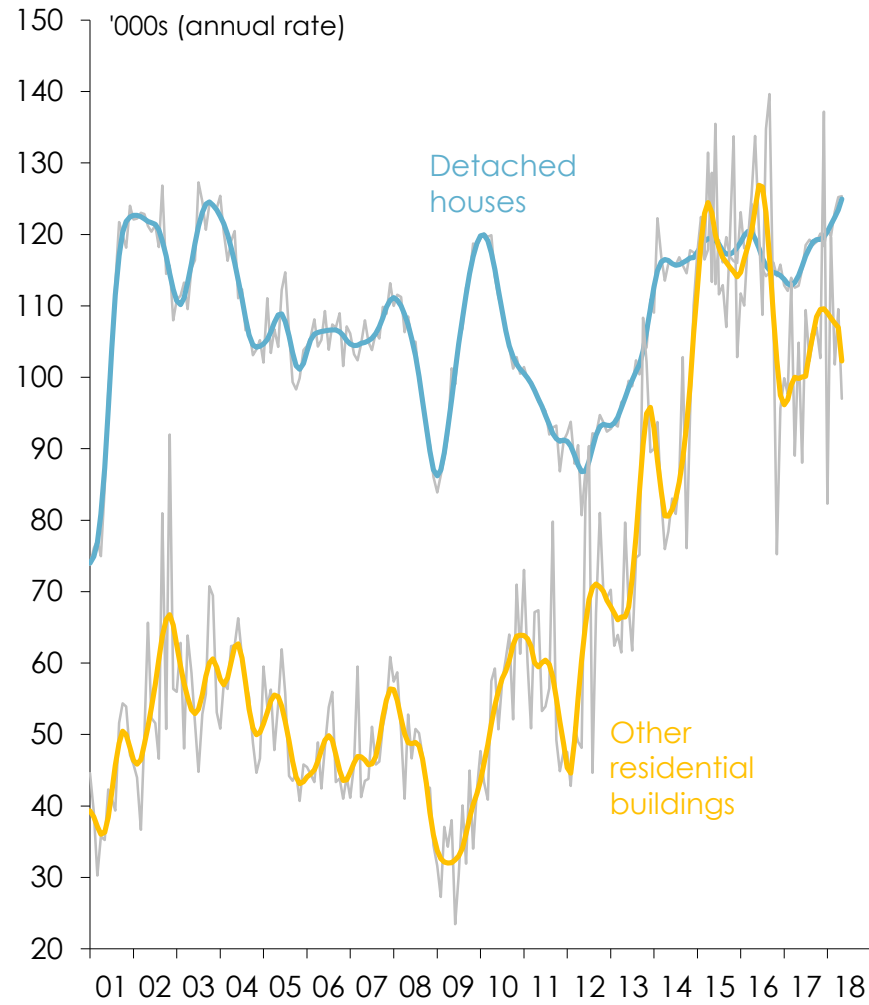
## Residential dwelling completions per 1000 of population, 2000-01 through 2016-17



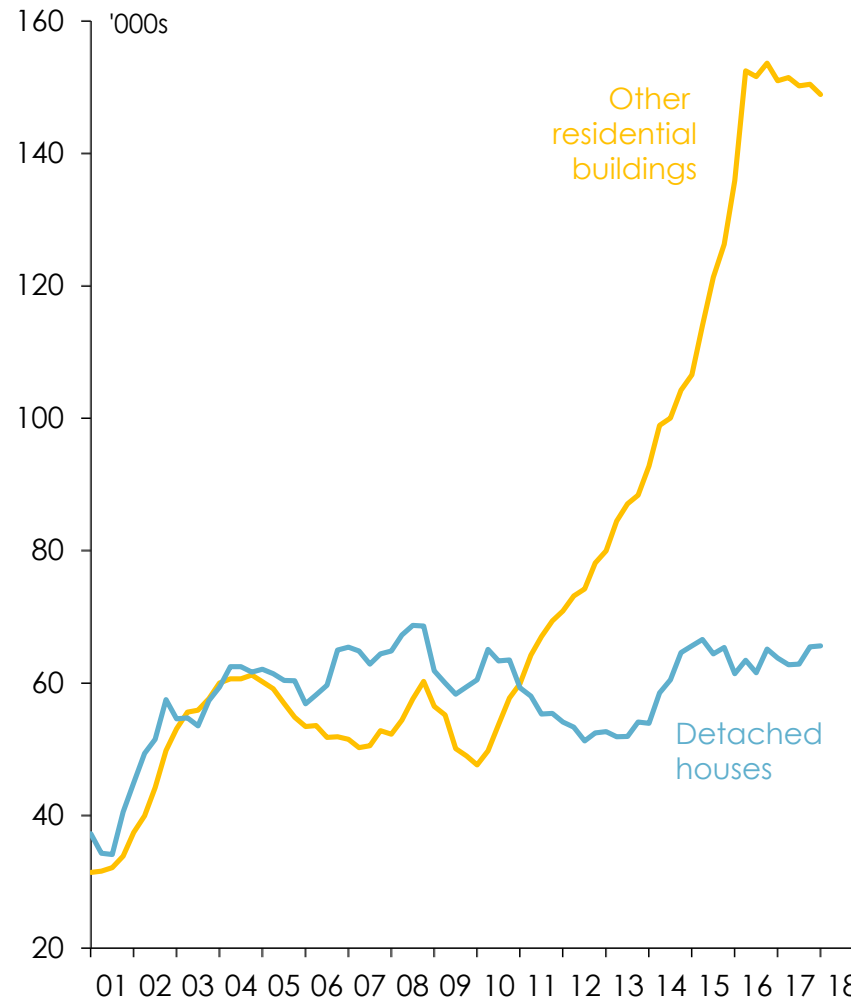
Sources: Australian Bureau of Statistics, *Building Activity* (8752.0) and *Australian Demographic Statistics* (3101.0); Corinna Economic Advisory.

# Apartment approvals peaked more than a year ago, but there is still a lot of new supply in the 'pipeline'

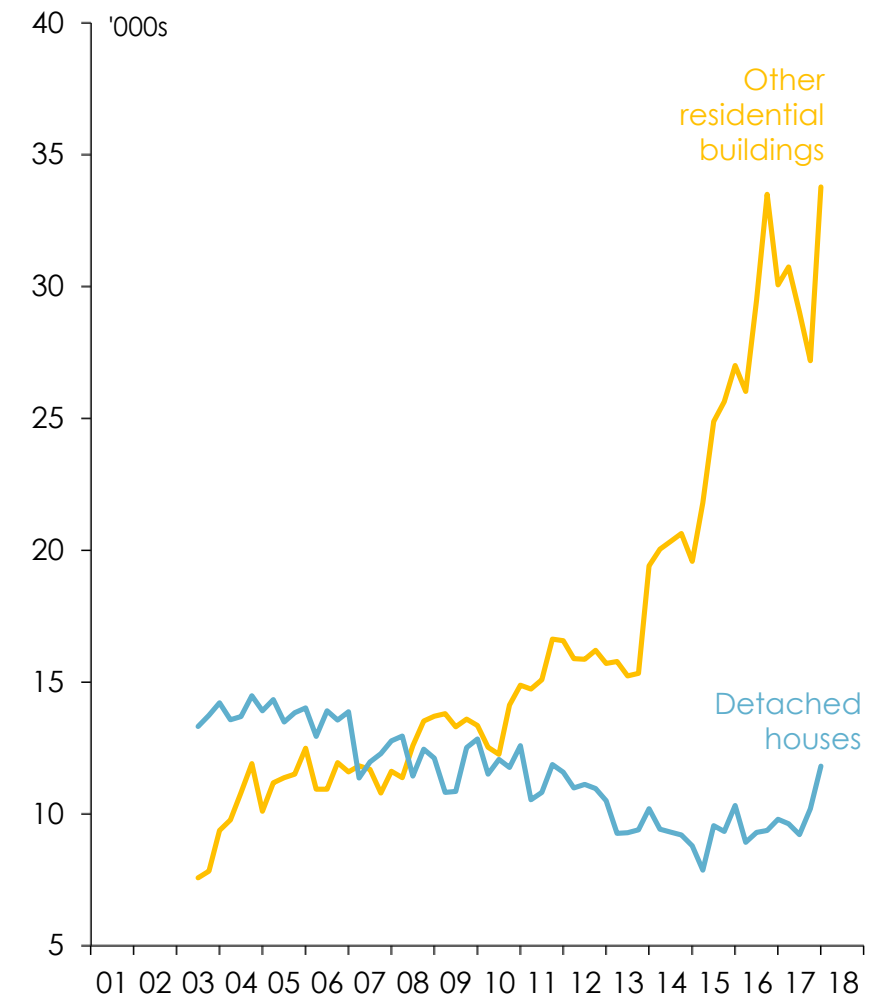
## Residential building approvals



## Residential building under construction



## Residential buildings yet to be commenced

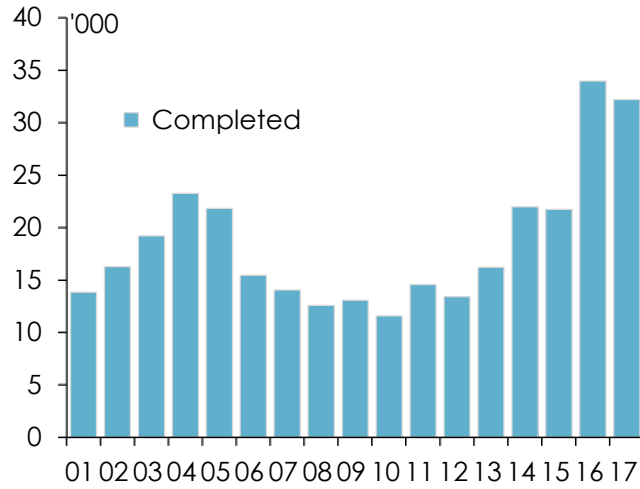


Source: Australian Bureau of Statistics, *Building Approvals* (8731.0) and *Building Activity* (8752.0).

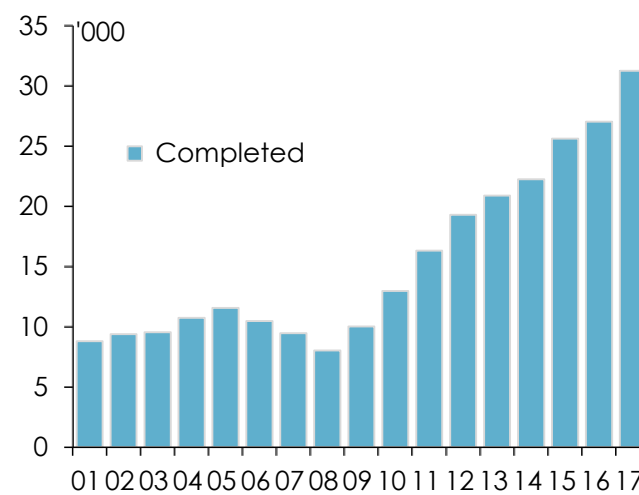
# There's a particularly large supply of new apartments entering the market over the next year or so in NSW, Victoria and Queensland

## 'Other residential building' completion, and pipeline, by State and Territory

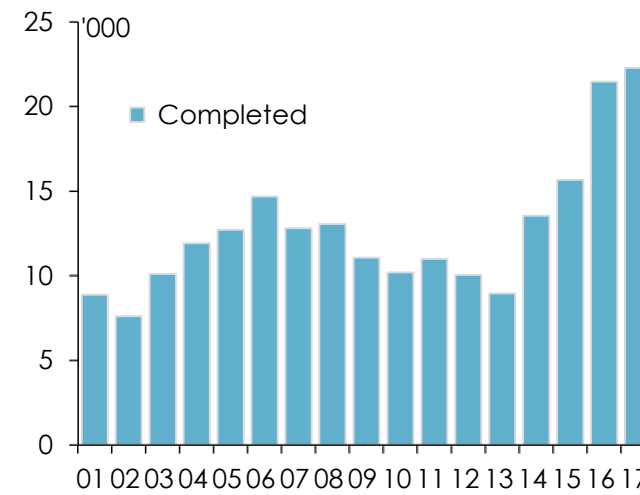
### New South Wales



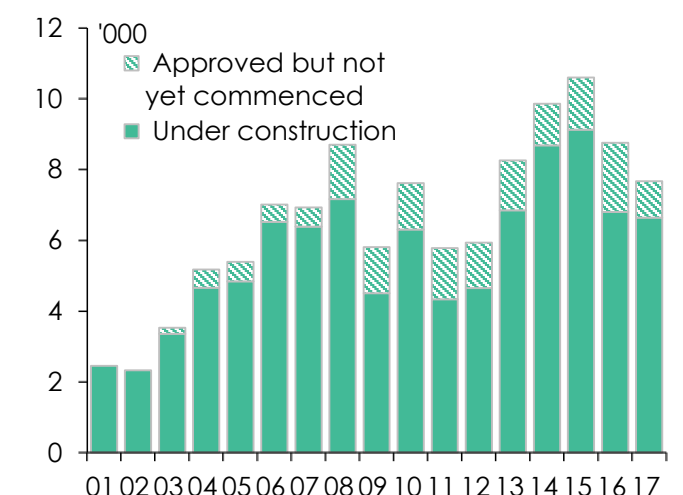
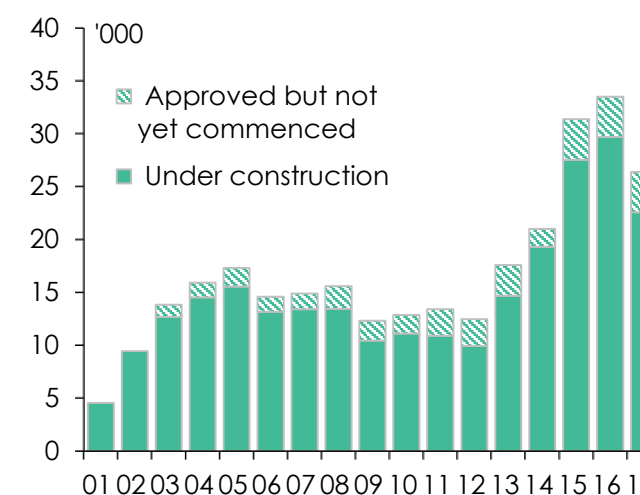
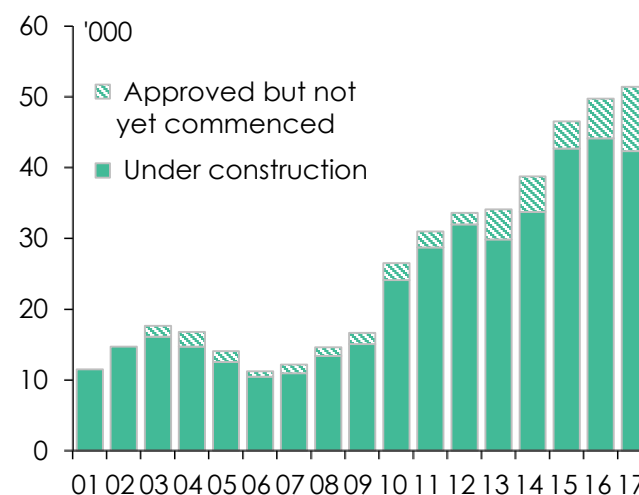
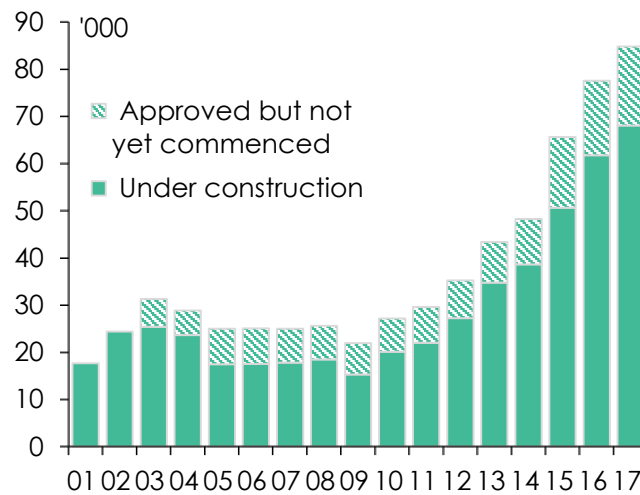
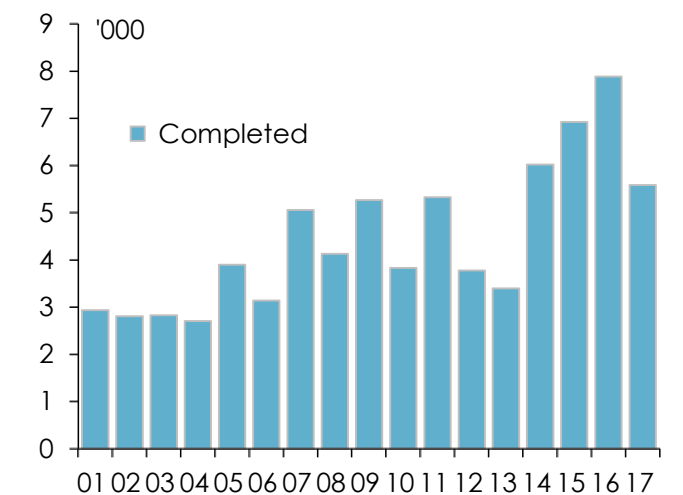
### Victoria



### Queensland



### Western Australia

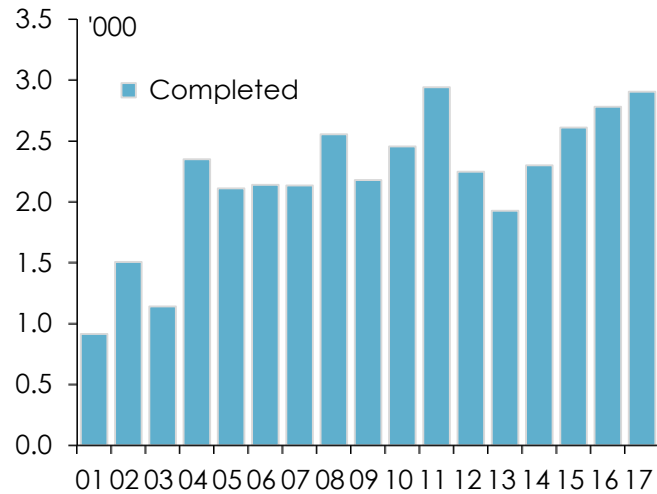


Source: Australian Bureau of Statistics, *Building Activity* (8752.0).

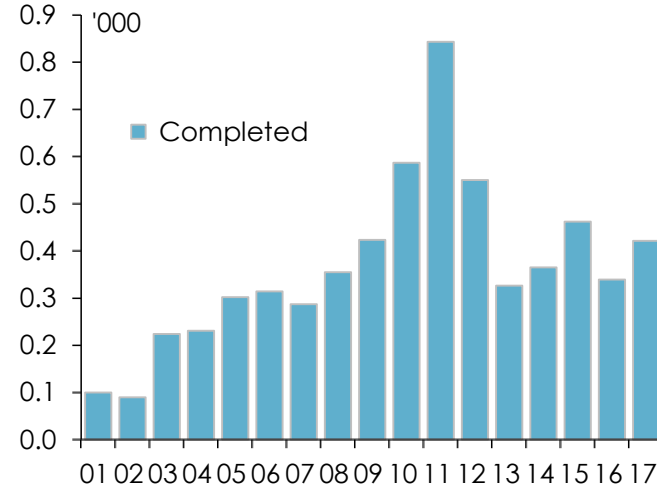
# Except for the ACT, there isn't a lot of new apartment supply (relative to the existing stock) coming on in the smaller States & Territories

## 'Other residential building' completion, and pipeline, by State and Territory (continued)

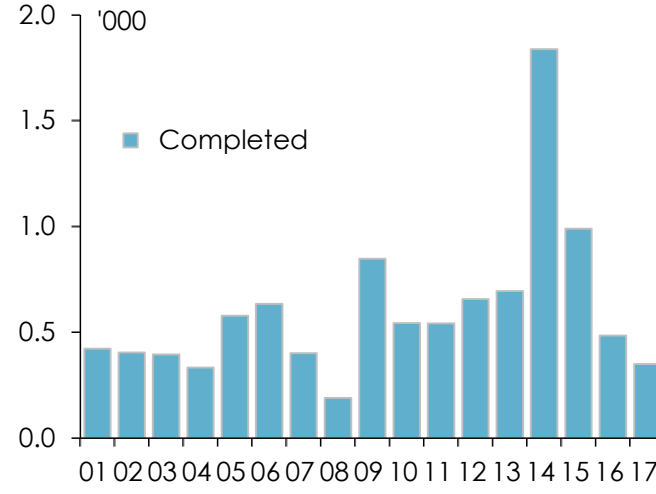
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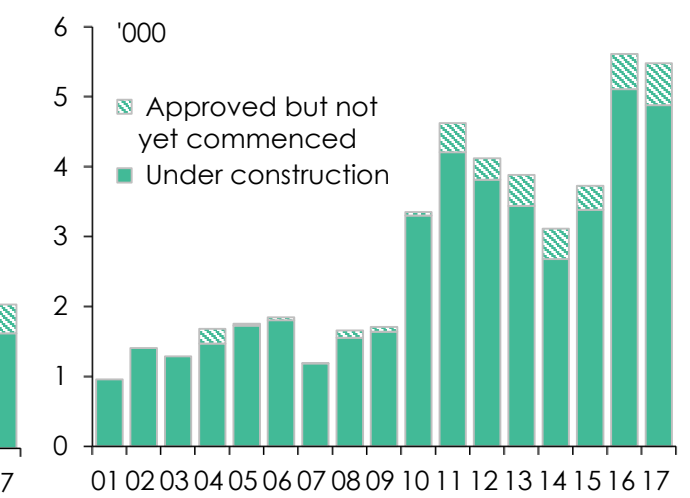
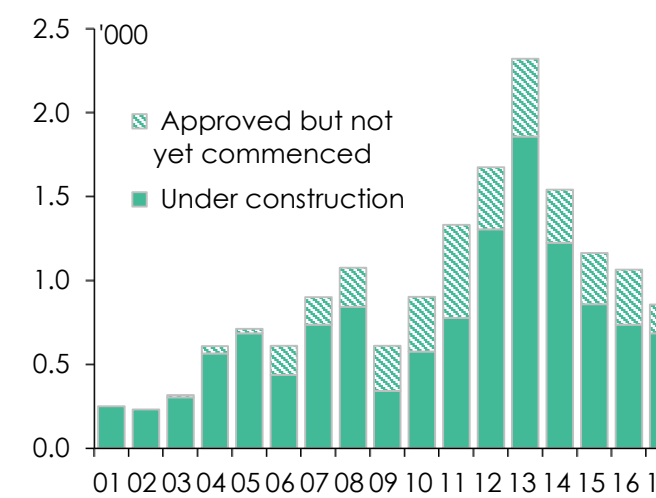
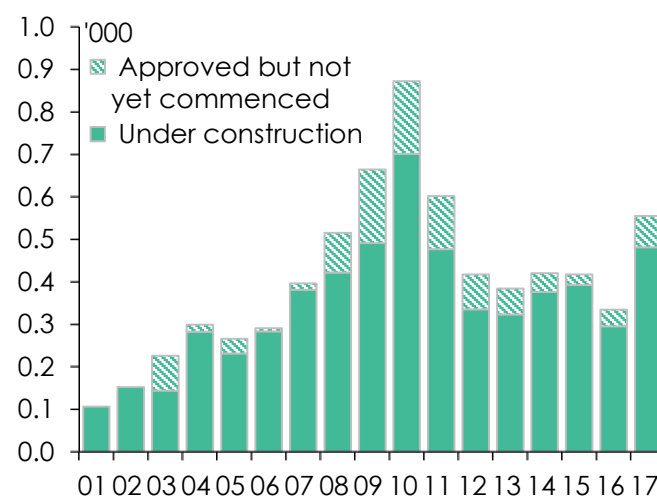
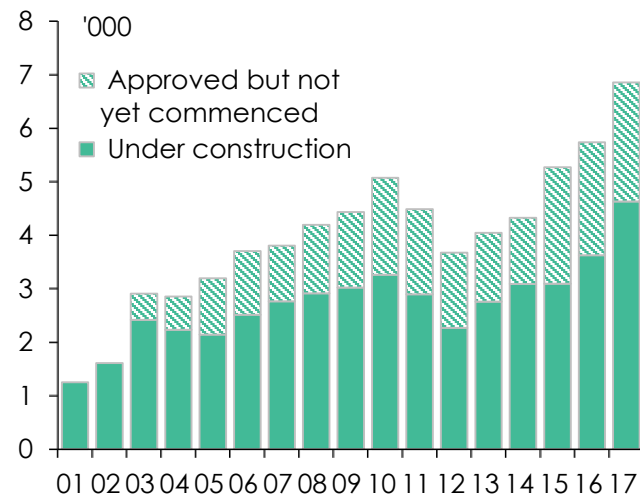
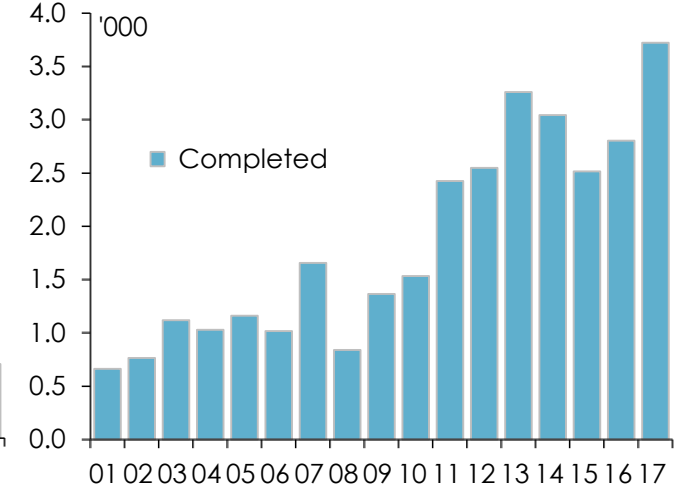
### Tasmania



### Northern Territory



### ACT



Source: Australian Bureau of Statistics, *Building Activity* (8752.0).

# A (very brief) glance at the outlook for interest rates

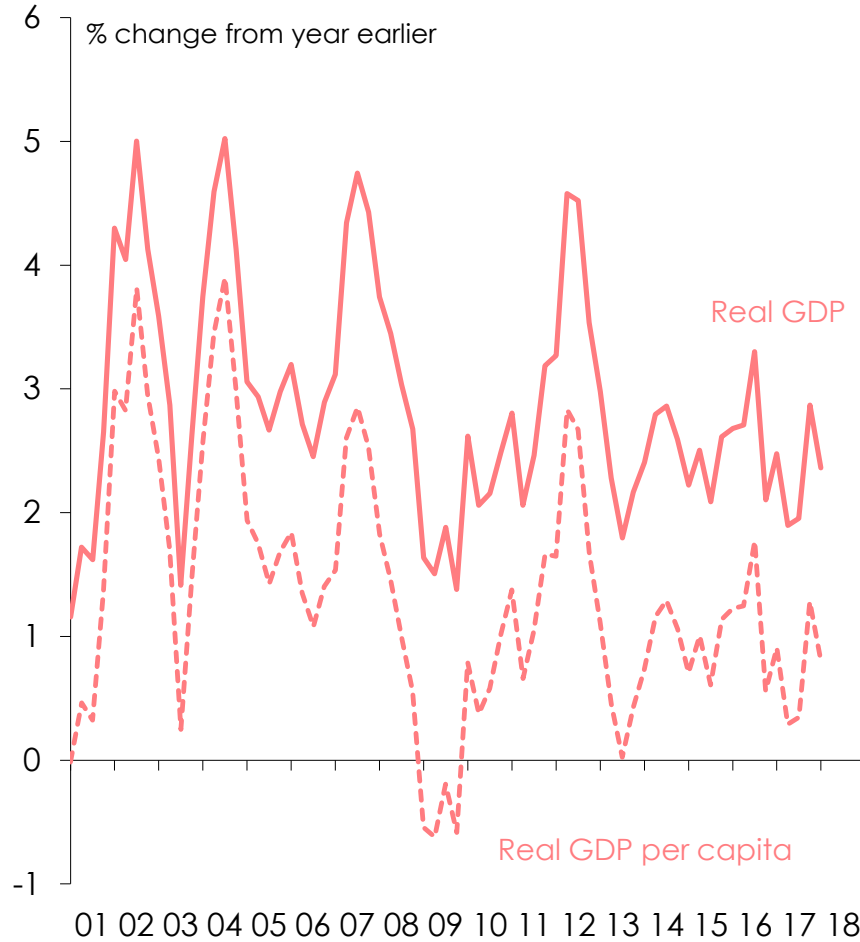


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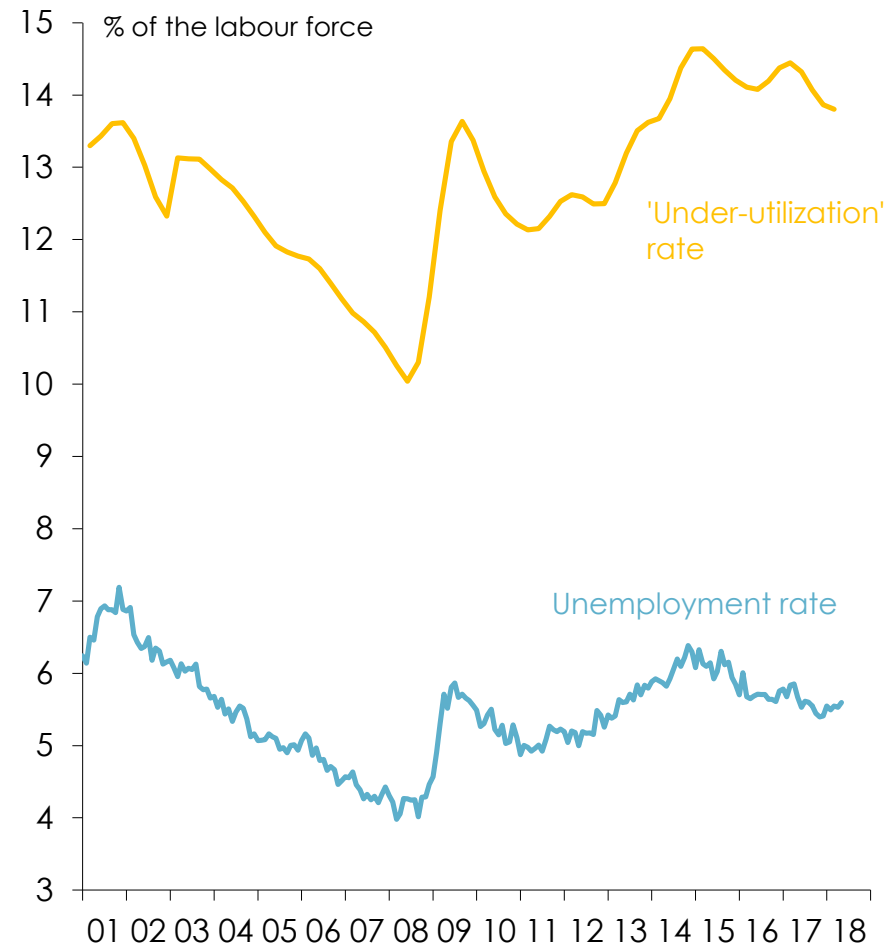


# Australian economic growth is still below trend, there is still a lot of spare capacity in the labour market and inflation is still (just) below-target

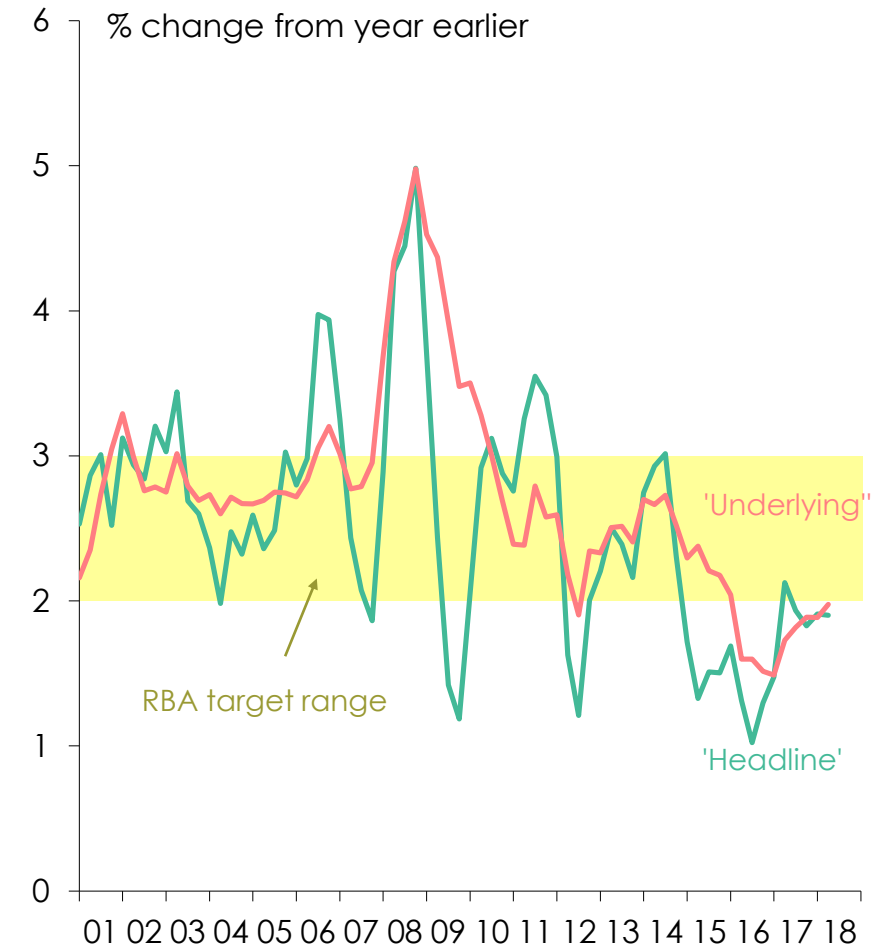
## Economic growth



## Unemployment and under-employment



## Consumer prices

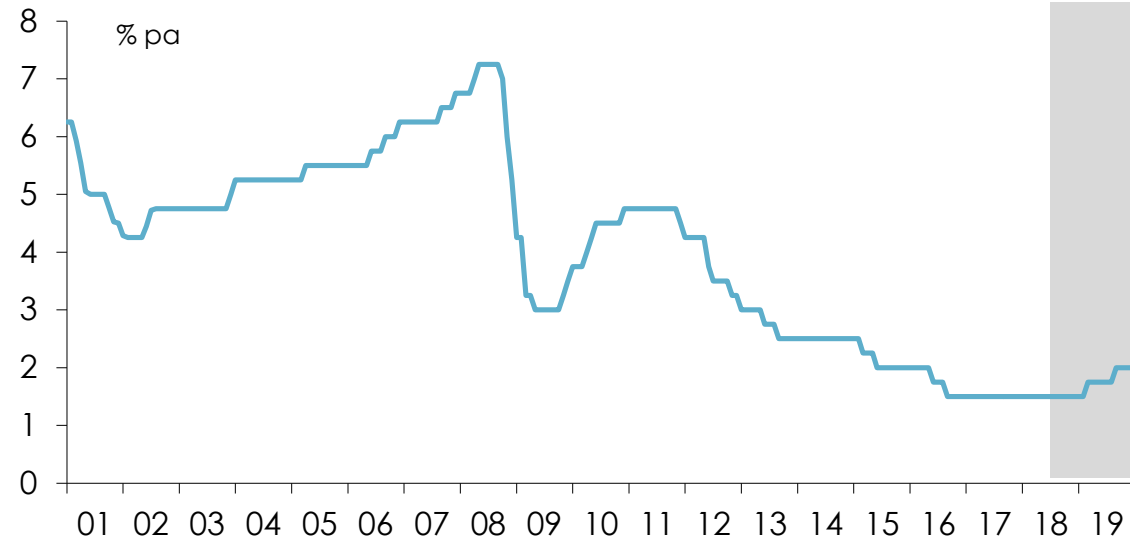


Note: The labour force 'under-utilization' rate includes people employed part-time who are willing and able to work longer hours (and weights them equally with people who are 'unemployed' in the conventional sense). 'Underlying' inflation abstracts from the impact of volatile items (typically items such as petrol, or fruit and vegetables) on the CPI.

Source: Australian Bureau of Statistics.

# The next movement in RBA rates will be upwards – but not in any hurry

## RBA cash rate



## RBA forecasts

	Year-ended					
	Dec 2017	Jun 2018	Dec 2018	Jun 2019	Dec 2019	Jun 2020
GDP growth	2.4	2¾	3¼	3½	3¼	3
Unemployment rate <sup>(b)</sup>	5.5	5½	5½	5¼	5¼	5¼
CPI inflation	1.9	2	2¼	2¼	2¼	2¼
Underlying inflation	1¾	2	2	2	2	2¼

- ❑ The RBA expects economic growth to remain ‘below trend’ until the second half of 2018, ‘spare capacity’ in the labour market to persist until after 2019, and ‘underlying’ inflation to remain below its target band until mid-2019
- ❑ These are not the forecasts of a central bank that is on the cusp of tightening monetary policy
- ❑ Of course, the RBA need not keep interest rates at current record lows until all of the key economic variables are where they want them to be
- ❑ But the RBA’s current set of forecasts does not impel any urgency about moving away from current monetary policy settings
- ❑ The RBA would be delighted to see [further] increases in foreign interest rates while it ‘stands pat’ reflected in a decline in the A\$
- ❑ First move now seems unlikely before next year

Source: RBA, *Statement on Monetary Policy*, May 2018.

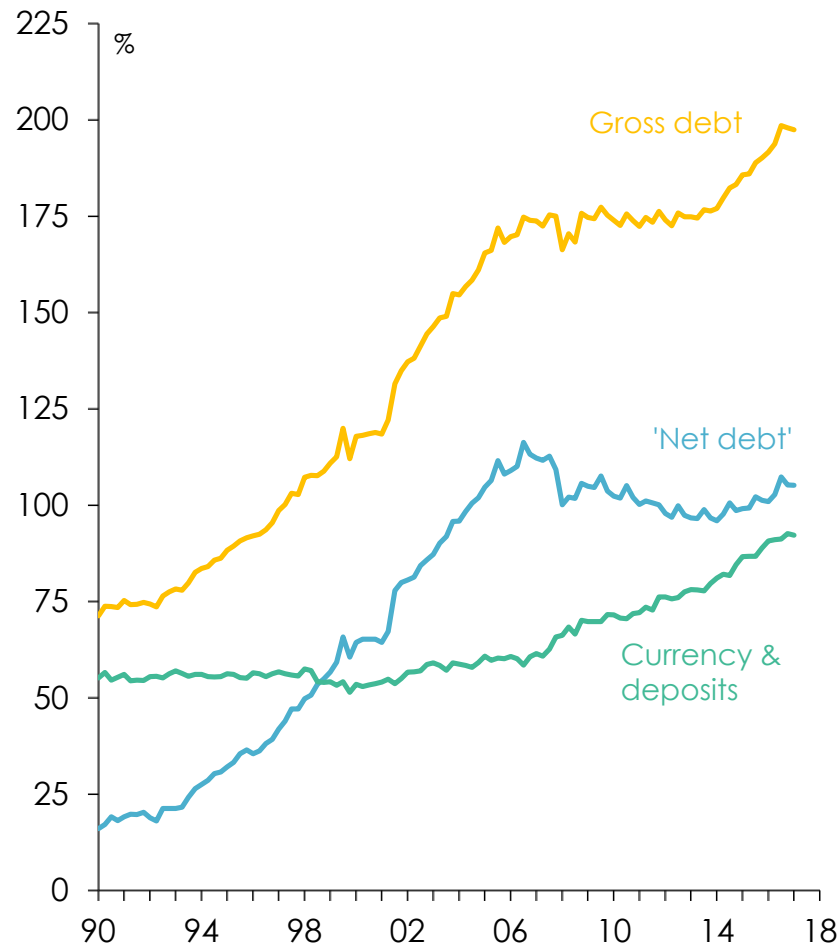
# What about all that household debt?



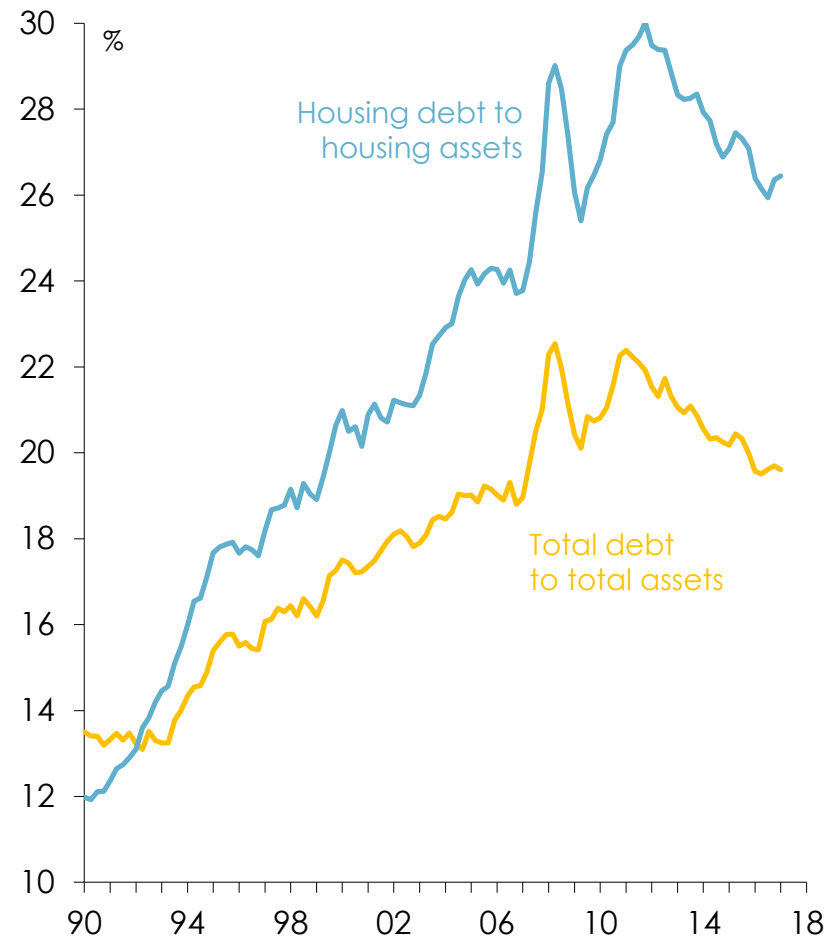


# High level of household debt shouldn't be considered independently of the level of liquid assets, other assets or debt servicing capacity

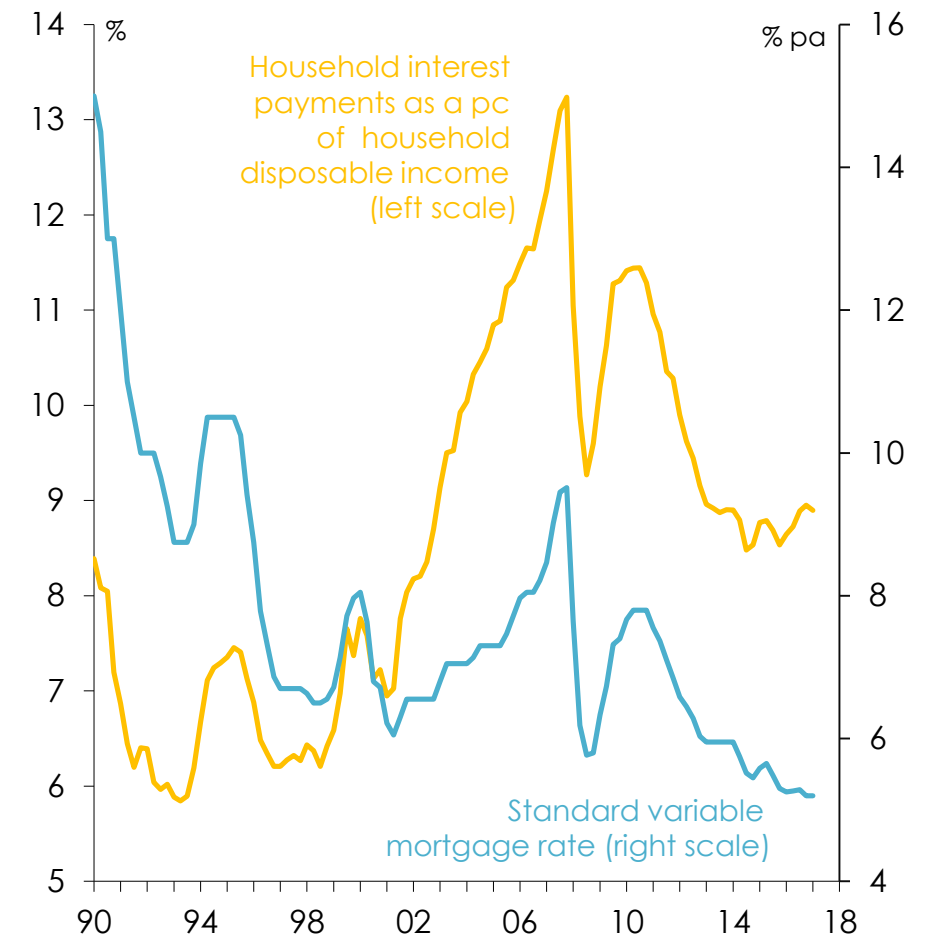
## Household gross debt, liquid assets and net debt



## Household debt-to-assets ratio



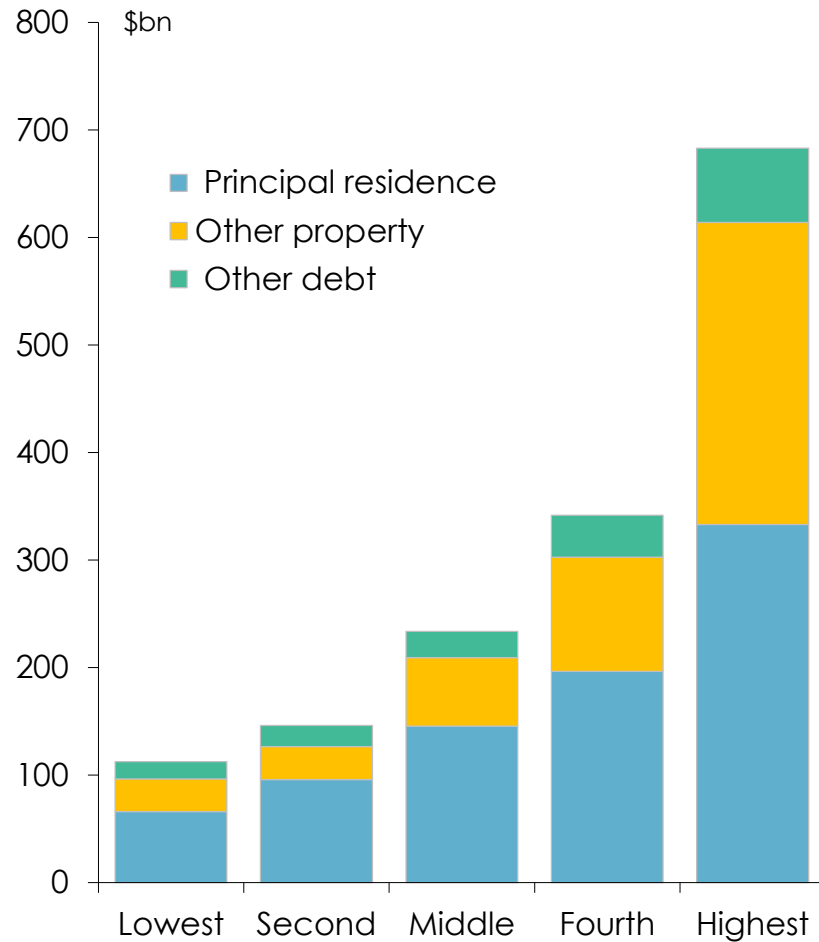
## Household interest-to-income ratio



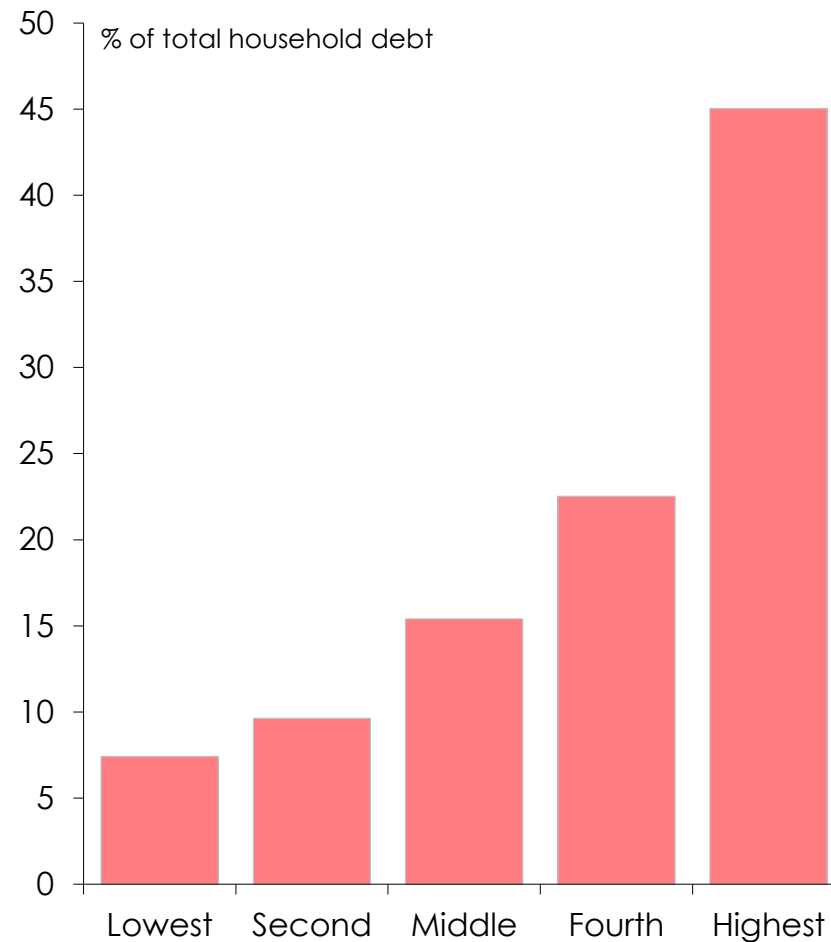
Sources: ABS; RBA.

# Two-thirds of Australian household debt is owed by the richest 40% of households – and that hasn't changed much over the past 12 years

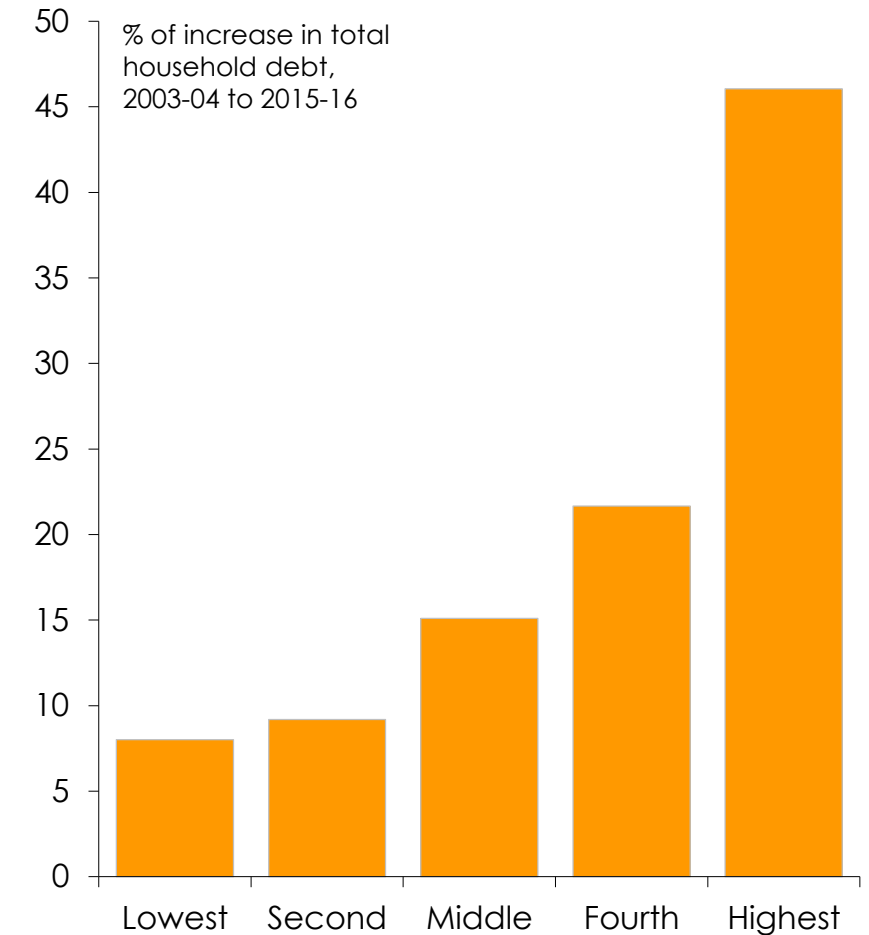
## Household debt by income quintile, 2015-16



## Share of total debt by income quintile, 2015-16



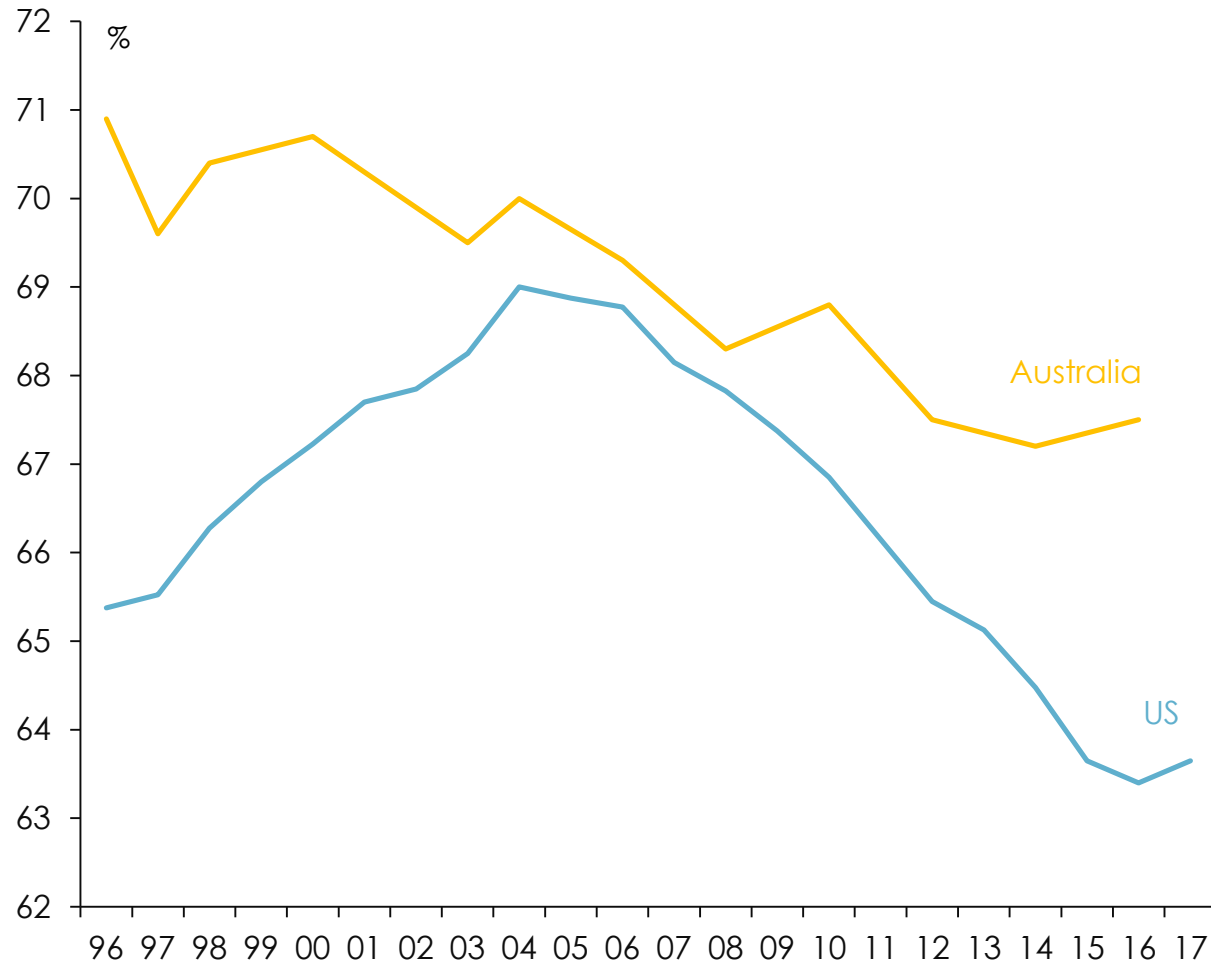
## Share of increase in debt by quintile, 2003-04 to 2015-16



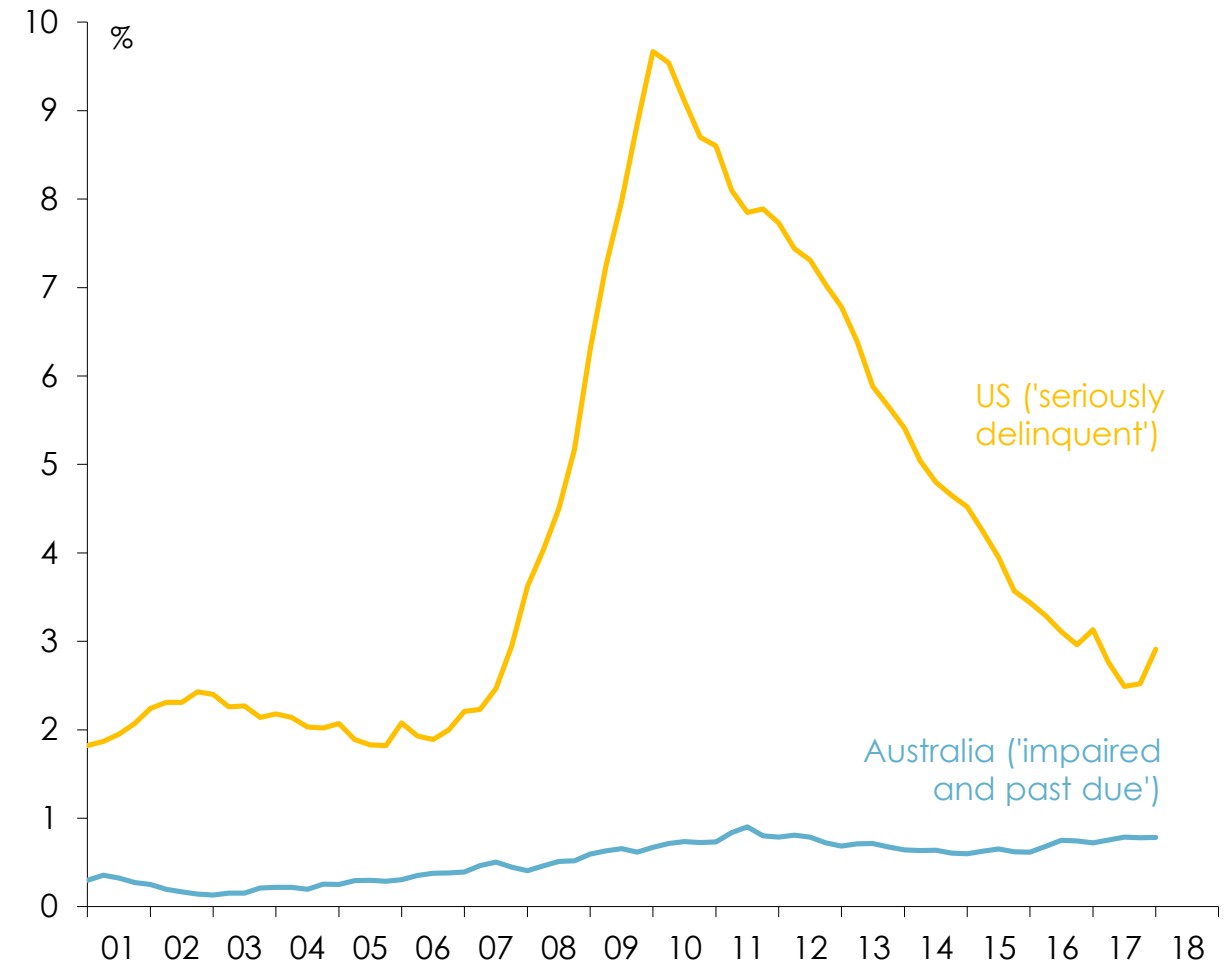
Source: ABS.

# There's unlikely to be a lot of 'forced sellers' in Australia, as there were in the US a decade ago ...

## Home ownership rates, US and Australia



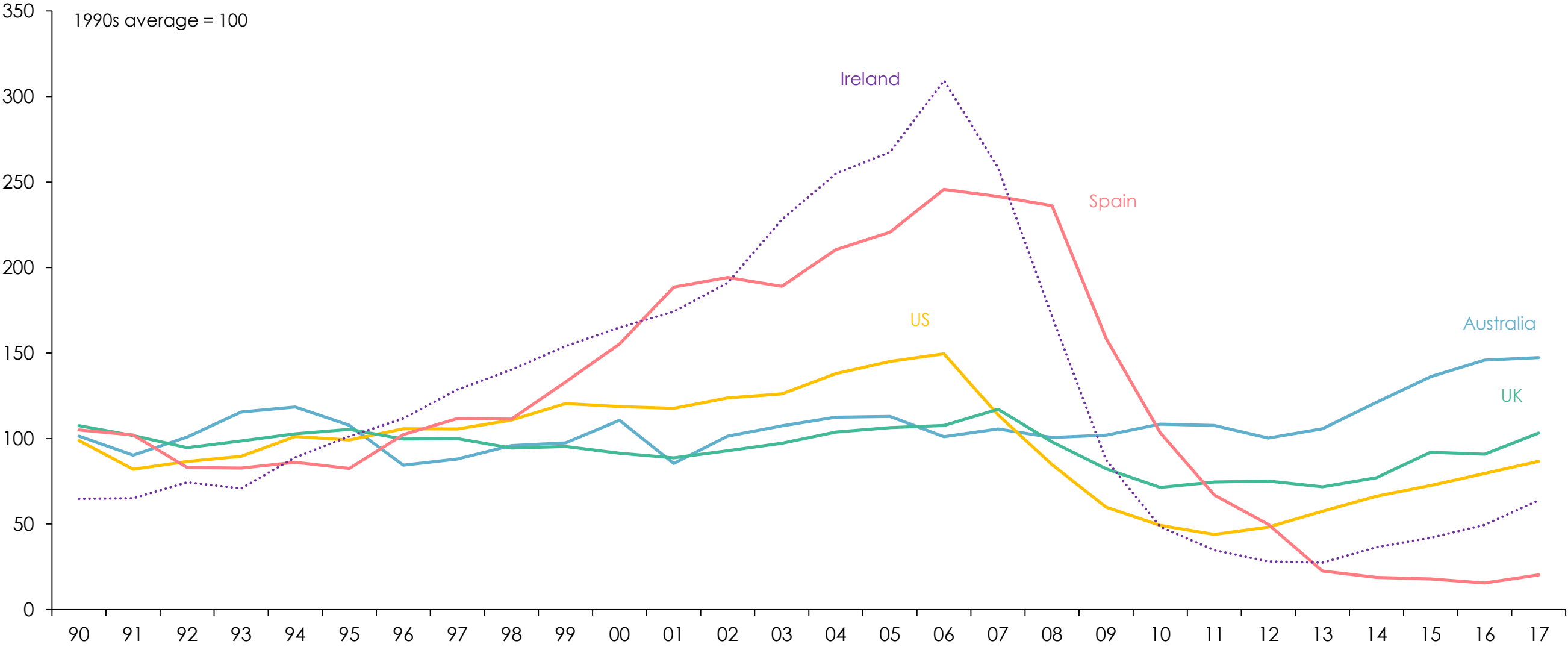
## Mortgage delinquency rates, US and Australia



Sources: ABS, US Department of Commerce; ; Reserve Bank of Australia; Mortgage Bankers' Association of America.

# ... and they're unlikely to be selling into an over-supplied market than in the US, Spain or Ireland a decade ago

## Dwelling completions – Australia and other 'advanced' economies



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

So, in summary ...



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# In summary, some of the 'fundamental' supports for the residential property market have shifted – and some haven't

## ❑ Some factors adding to demand have waned

- demand from domestic investors has been dampened by regulatory constraints on lending to investors
- demand from foreign investors has been dampened by a combination of increased taxes and charges imposed by the federal and state governments, and tighter controls on capital outflows from China

## ❑ Supply has (belatedly) begun to increase quite significantly, with more to come in the near term

- particularly of apartments, in the three large eastern States and the ACT

## ❑ But population growth remains strong by historical standards

- net immigration may slow a little over the next few years (and could be affected by changes in international student numbers), but calls for large cuts in Australia's immigration intake do not enjoy much support at senior political levels
- Interstate migration to Victoria remains strong, emigration from WA appears to be bottoming out, migration to Queensland has picked up, and fewer Tasmanians are moving to the mainland

## ❑ The RBA is in no hurry to start lifting interest rates, and has made it clear that when rates do start to rise, they will only rise gradually, and not by very much in total

- the impact of borrowers transitioning from I-O to P&I loans will be small and manageable
- and the vast majority of household borrowers will be able to cope with small and gradual rate increases

## ❑ If Labor wins the next federal election, the impact of its proposed changes to negative gearing and the capital gains tax discount will be relatively small

- although Labor's proposals will, as intended, dampen investor demand for established properties, 'grandfathering' of existing investors means they will not be rushing to sell
- Labor will need to think about the period between the next election (if it wins) and the commencement of its proposed tax changes



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