

Economic trends shaping the future of the Australian housing market

Presentation to the Financial Review's
Australian Housing Congress

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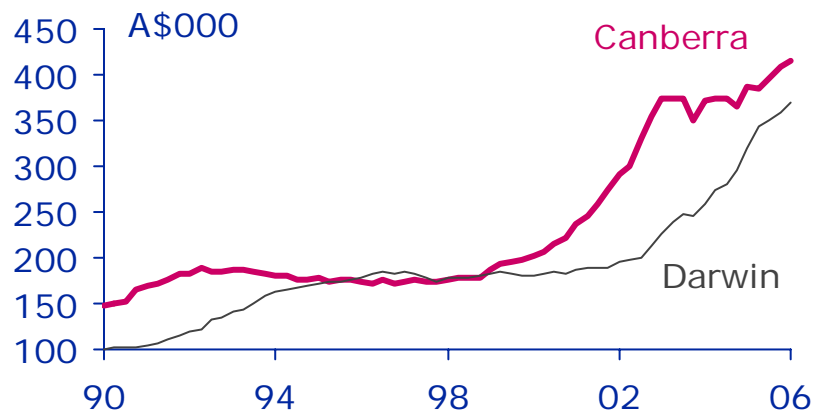
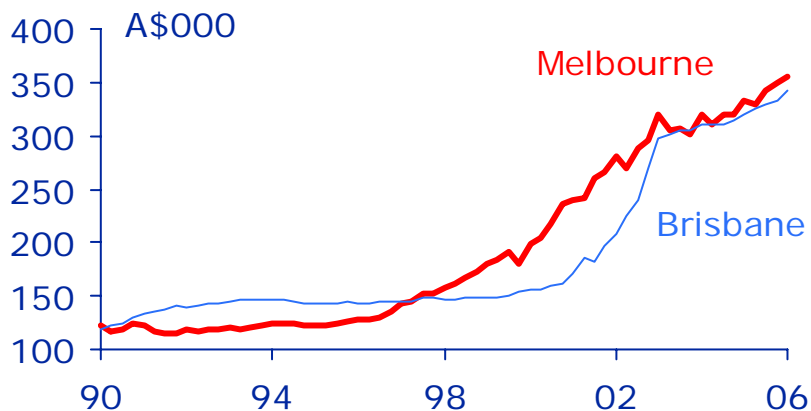
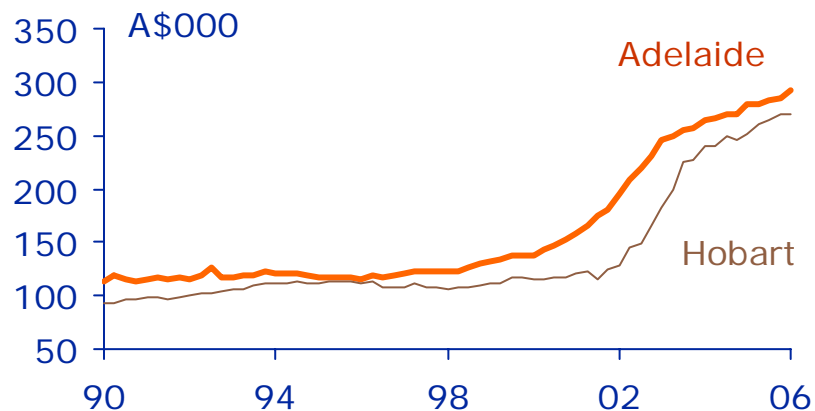
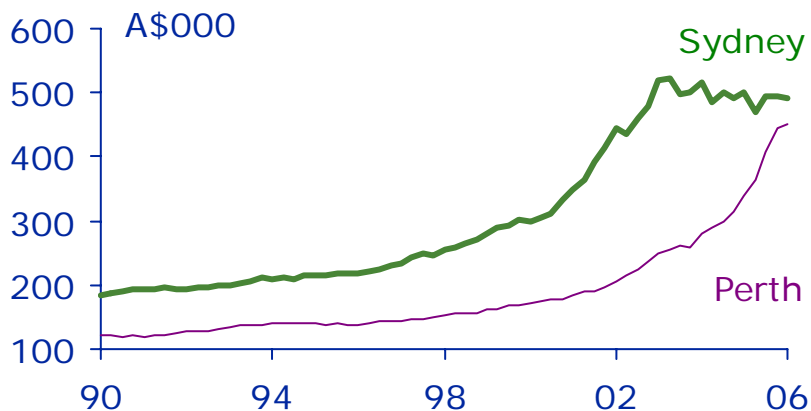
Rendezvous Hotel
Melbourne
8th March 2007

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House prices continuing to rise in most cities except Sydney, and especially Perth and Darwin

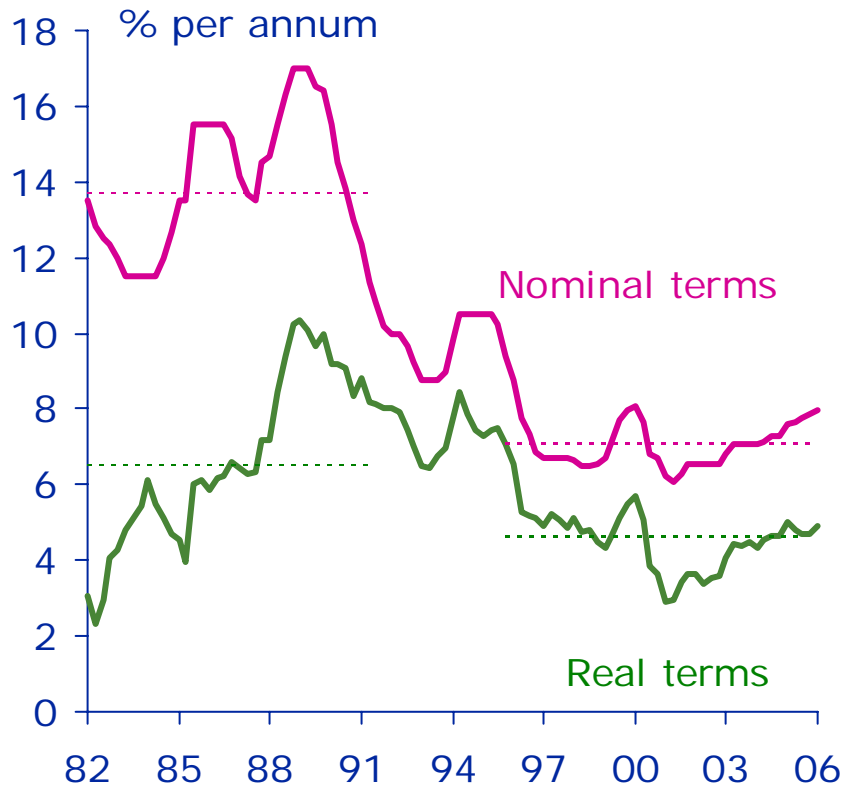
Established house prices



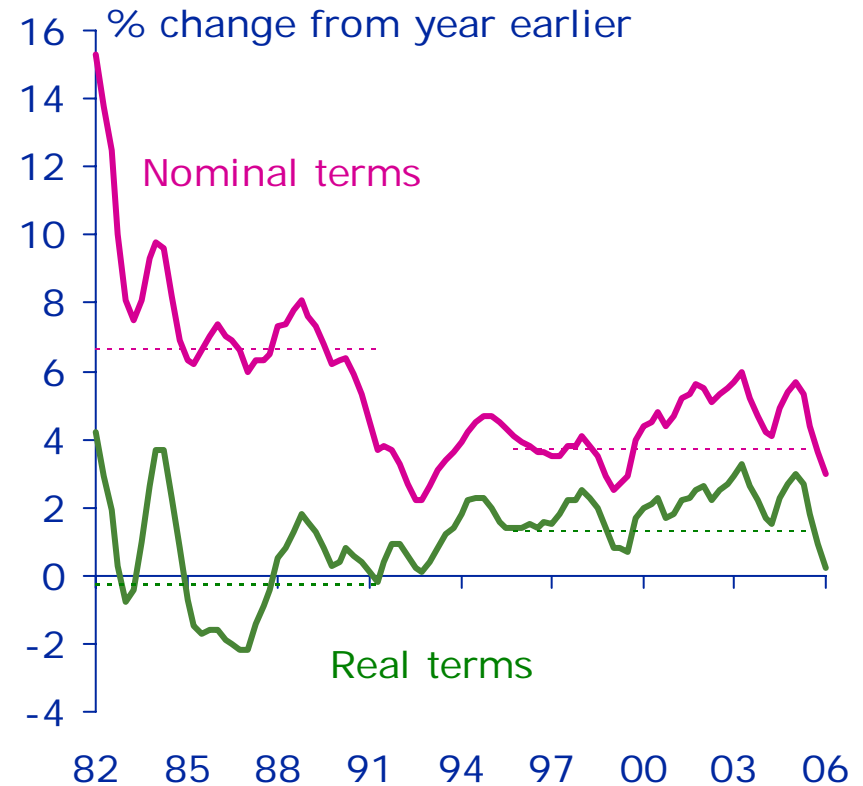
Sources: ABS; Economics@ANZ.

Over the past decade mortgage rates have halved while real incomes have grown by 11½% ...

Standard variable mortgage rate



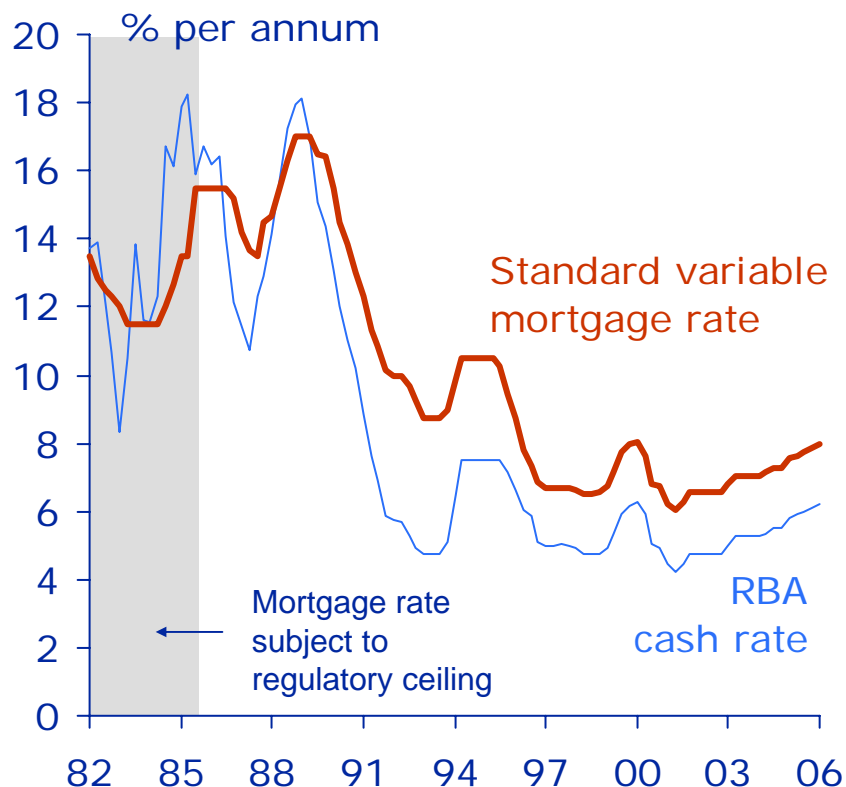
Average weekly earnings



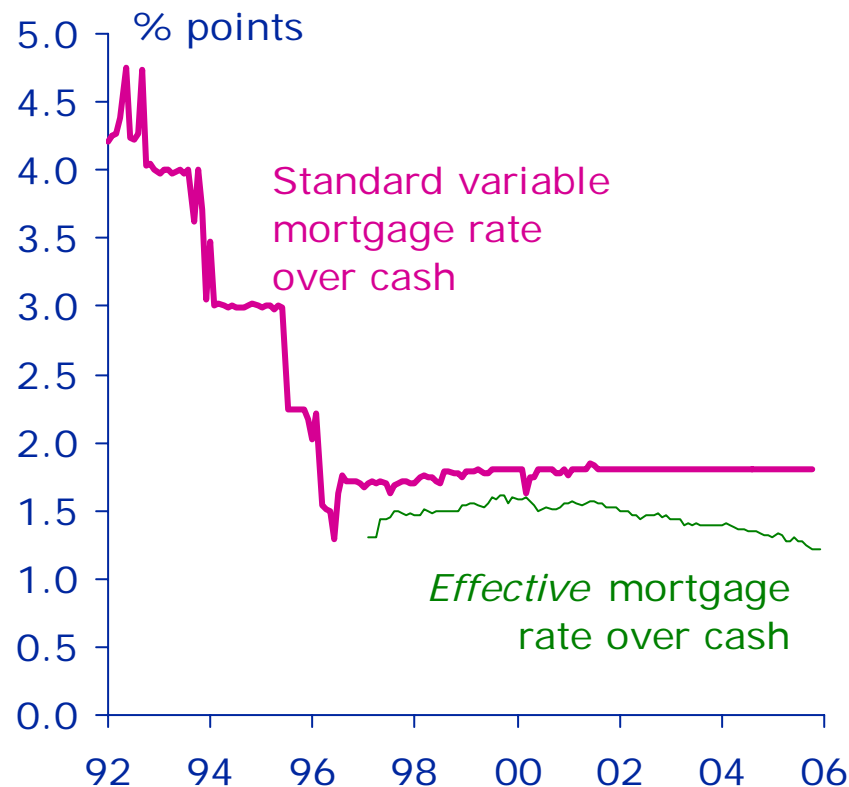
Note: dotted lines show averages 1982-1992 and 1996-2006.
Sources: RBA; Commonwealth Treasury; Economics@ANZ.

Competition among lenders has resulted in a further lowering of effective mortgage rates

Standard variable mortgage rate vs cash rate



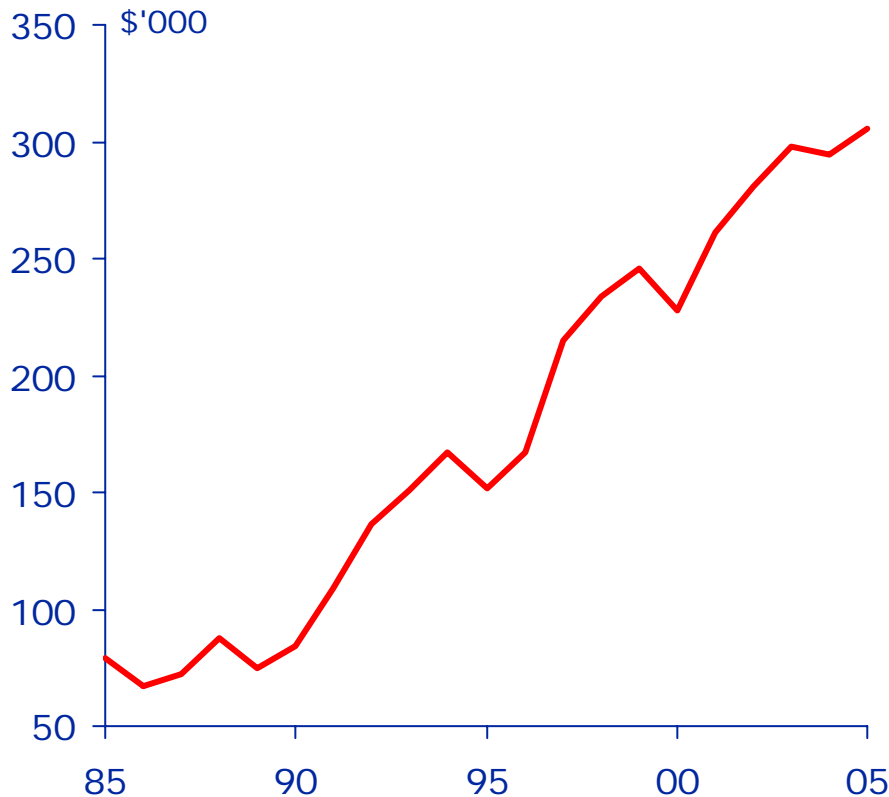
Mortgage lenders' margins



Sources: RBA; Economics@ANZ.

... so that 'borrowing capacity' for a 'typical' household has risen by at least 125%

Maximum borrowing by couple earning average male and female earnings, repayments capped at 25% of gross income and 20% deposit



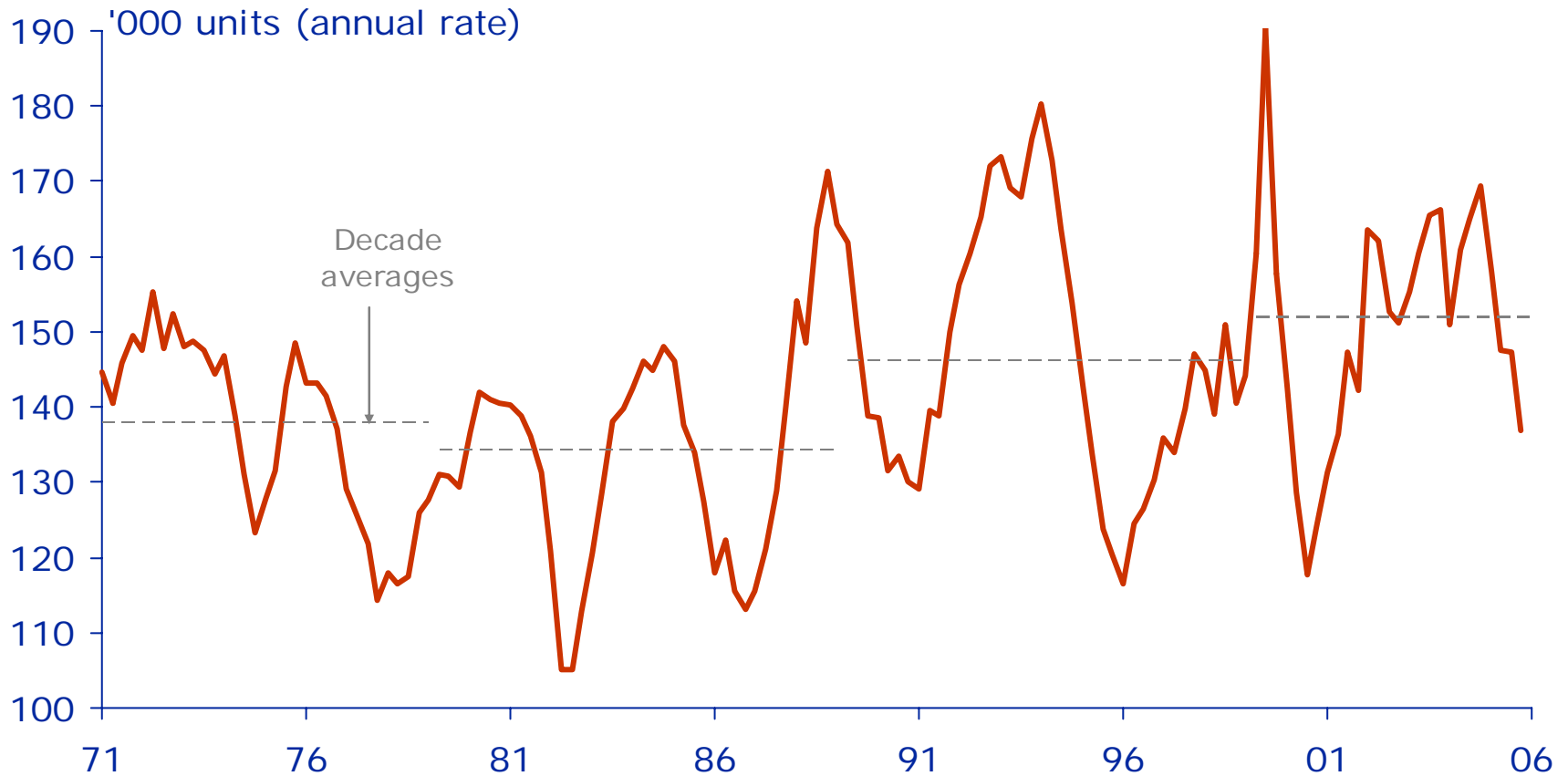
Note: data are for the June quarter each year.

Sources: ABS; Economics@ANZ.

- Since the early 1990s, average earnings have risen by over 60% while the standard variable mortgage rate has halved
- This has increased the maximum amount which a 'typical couple' can afford to borrow under standard lenders' rules from around \$135 000 in 1992 to \$305 000 in 2006
- In practice the rates actually paid by borrowers have fallen by more than the standard variable rate, while the traditional 'rules' are much less rigorously applied

The stock of housing has grown substantially over the past 15 years

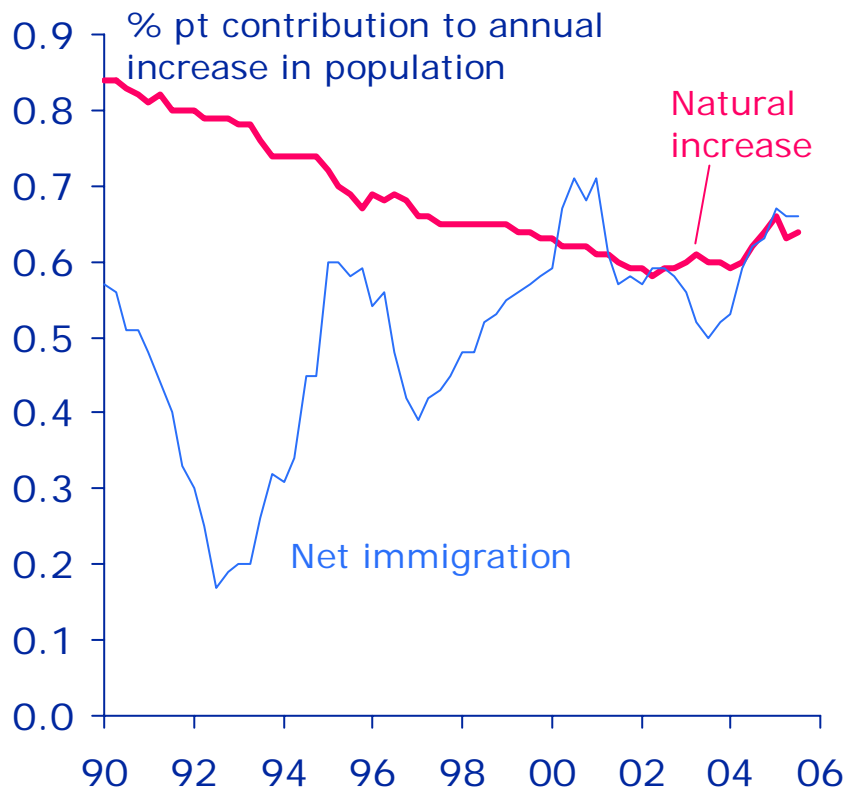
Housing completions



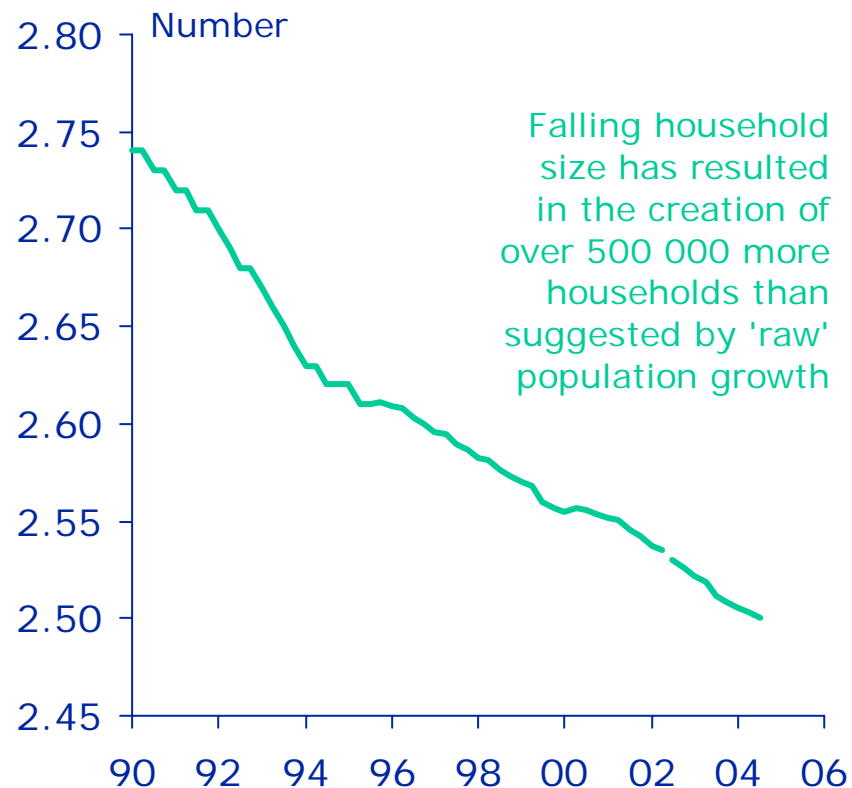
Sources: ABS; Economics@ANZ.

... but so has the number of households requiring accommodation

Sources of population growth



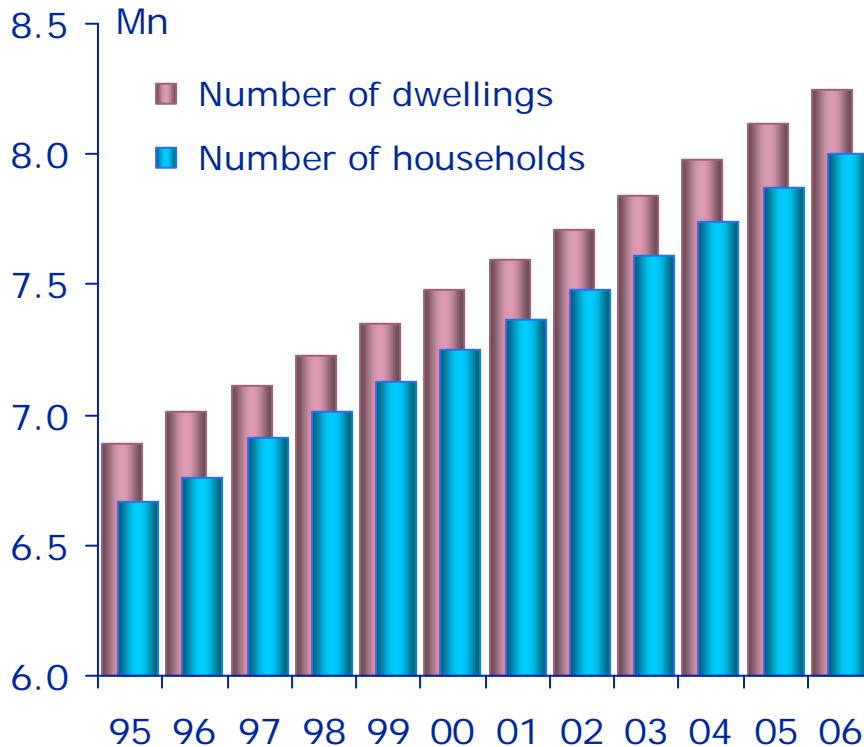
Average number of persons per household



Sources: ABS; Economics@ANZ.

Thus the supply of housing has barely kept pace with the increase in underlying demand

Number of households and number of dwellings



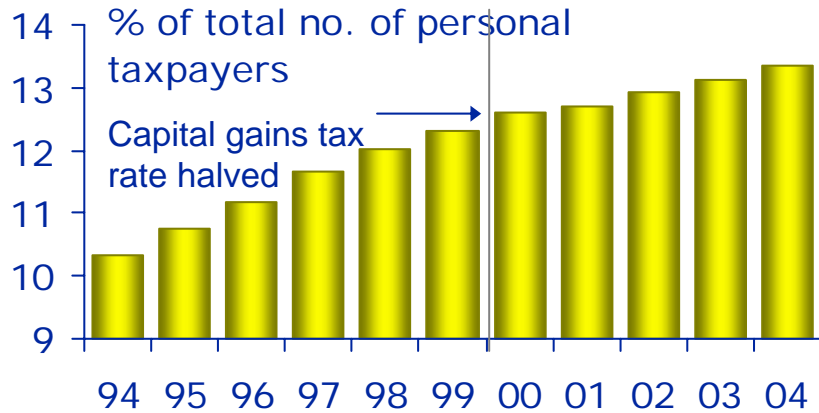
Note: Dwelling stock estimates for 1991, 1996 and 2001 based on census figures; other years interpolated using completions data.

Sources: RBA; ABS; Economics@ANZ.

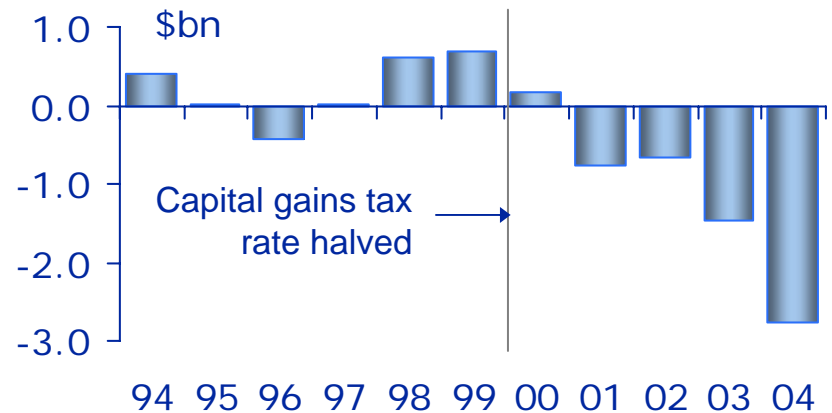
- Over the ten years to June 2006, the stock of housing increased by 1.24 million
 - 1.46 mn new dwellings were completed during this period, but around 222,000 old dwellings were demolished
- Over the same period, the number of households rose by exactly the same 1.24 million or 18%
 - faster than the increase in population (12.7%) because of falling average household size
- The increase in the supply of housing was thus entirely absorbed by increased demand

The tax system has encouraged investment in rental property especially after 1999

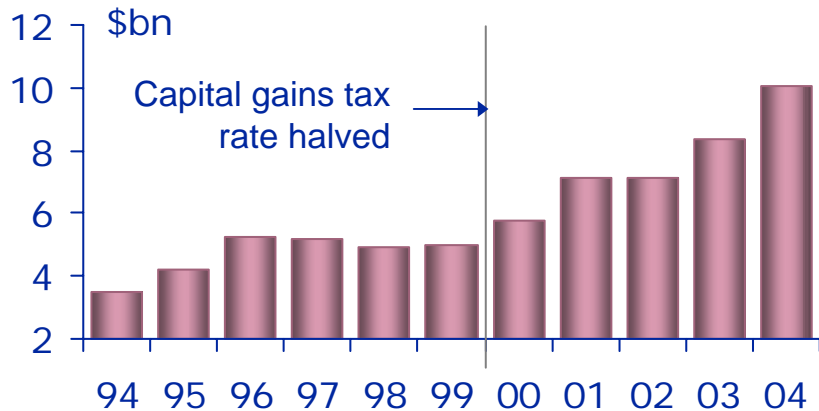
Taxpayers with rental income



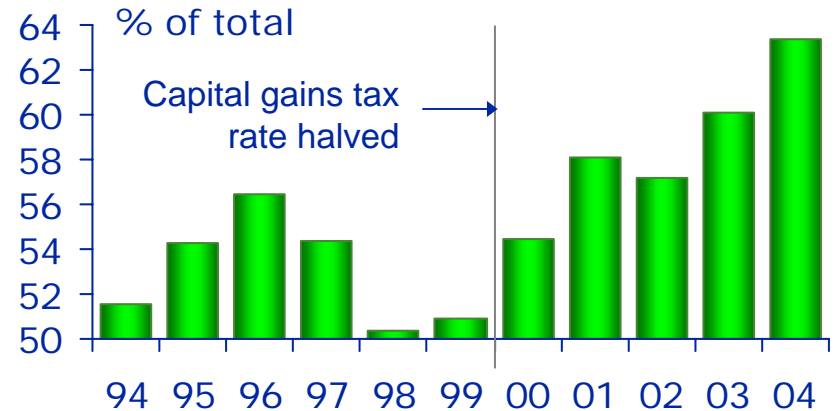
Net rental income



Interest paid by property investors



Loss-making property investors

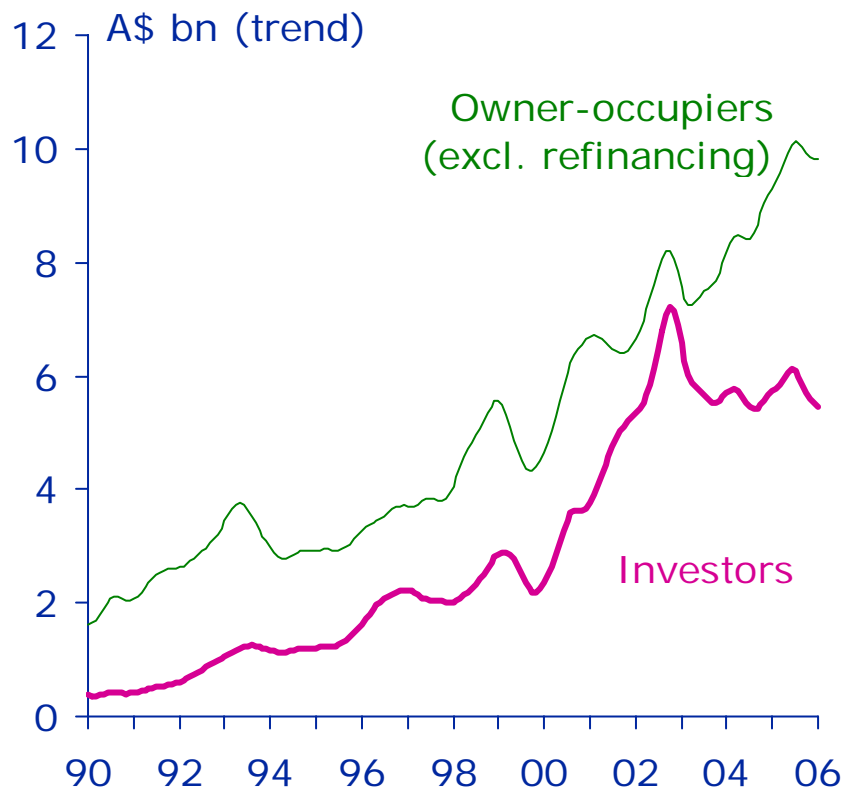


Note: Data are for fiscal years ended 30 June.

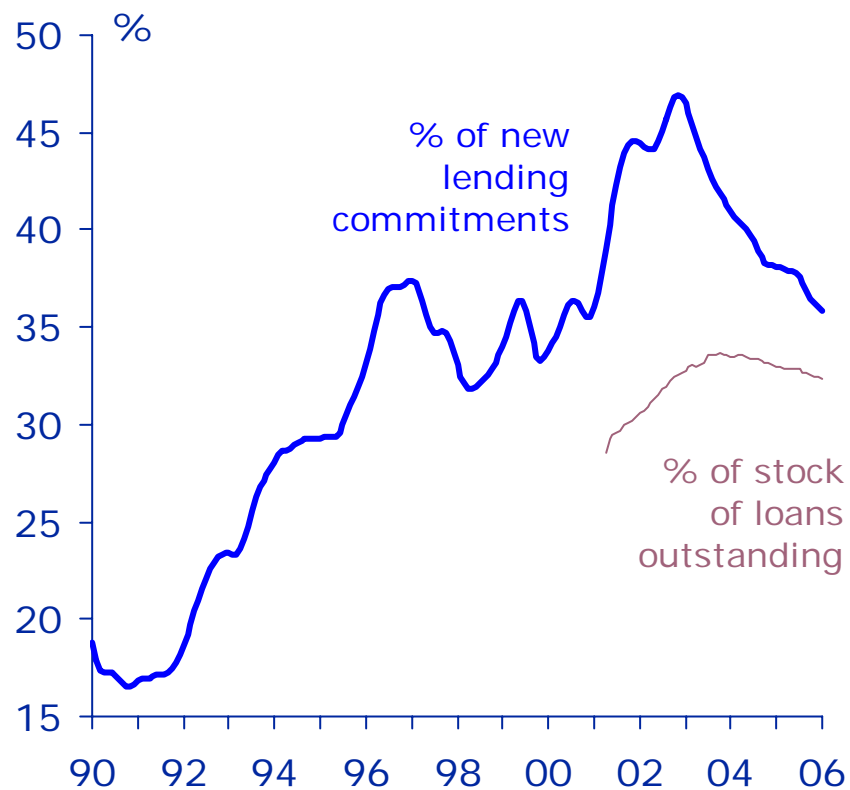
Sources: Australian Taxation Office; Economics@ANZ.

Investment property lending grew rapidly especially after the 1999 tax changes

Finance commitments to owner-occupiers & investors



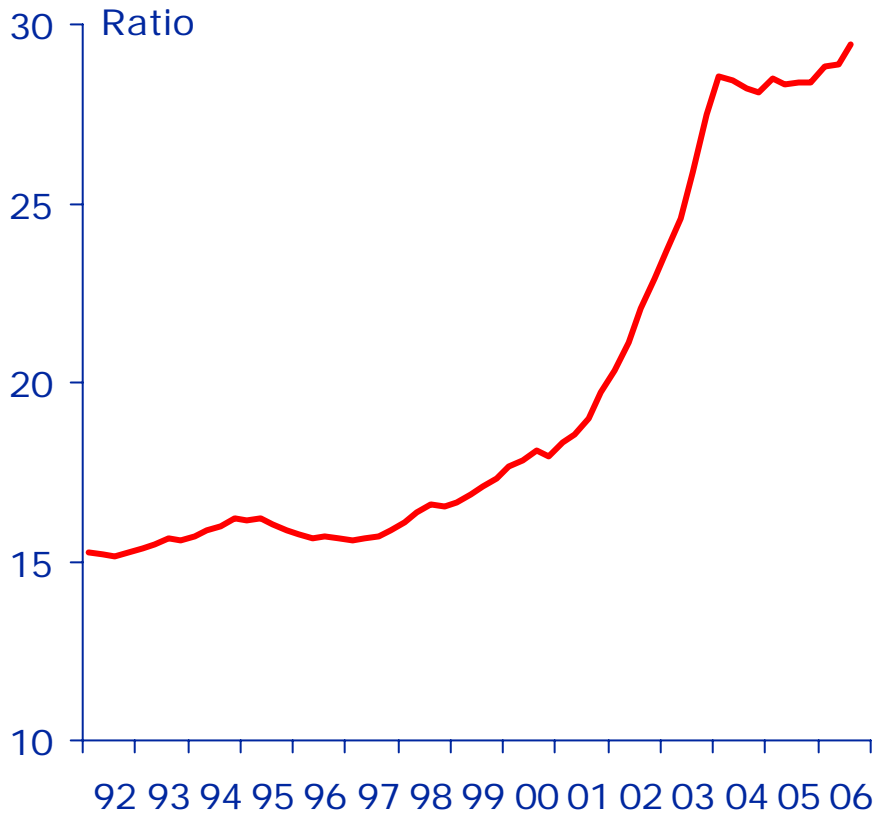
Loans to investors as a pc of total commitments



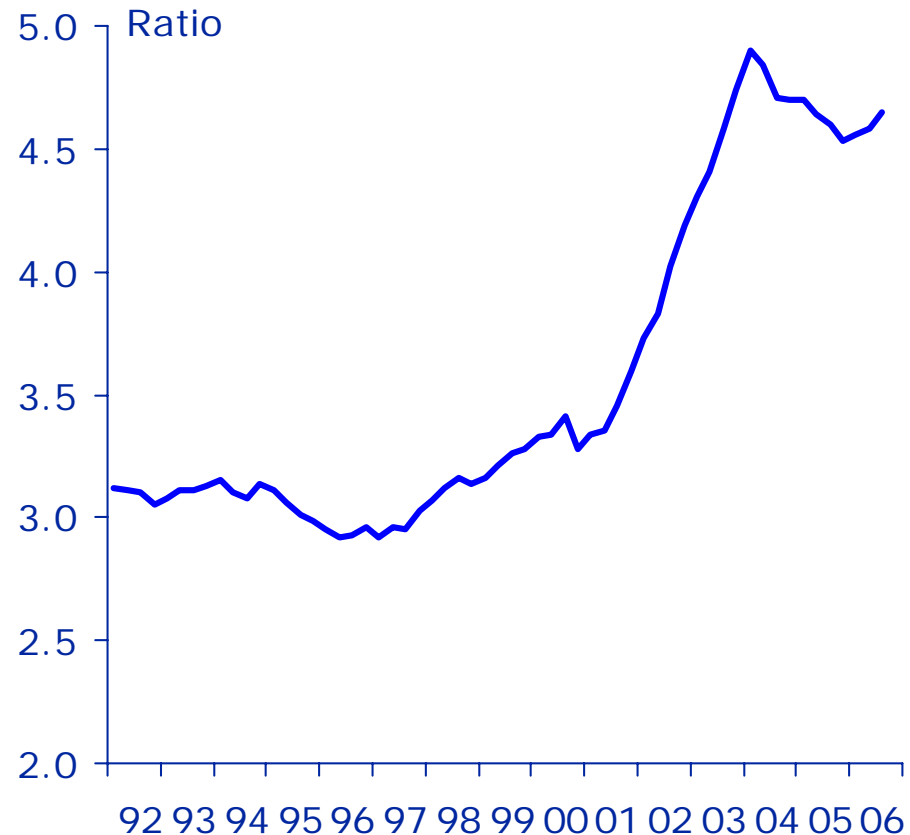
Source: ABS.

Australian houses now look very 'overvalued' on benchmarks analogous to those used for shares

Ratio of median house prices to median rents



Ratio of median house prices to average household incomes



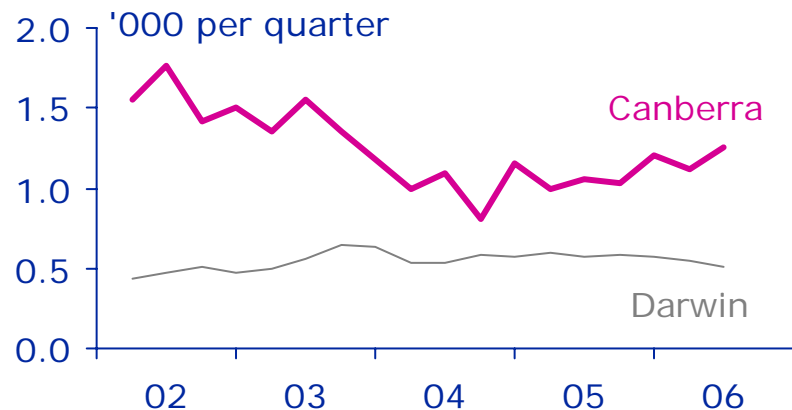
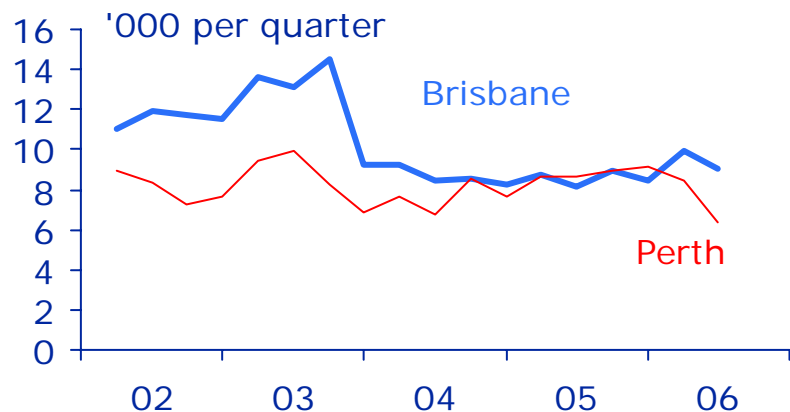
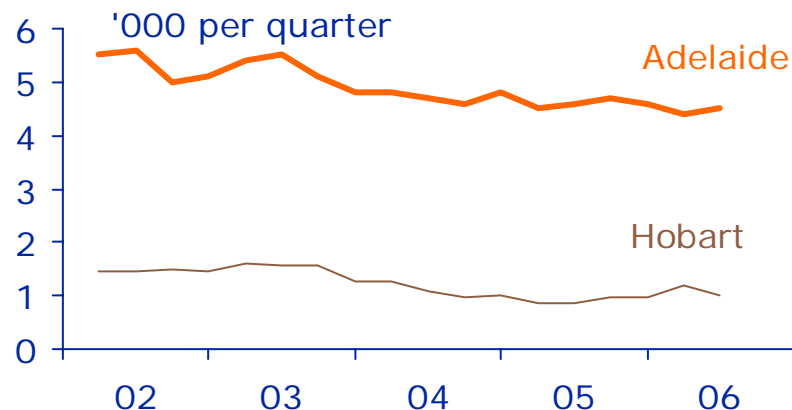
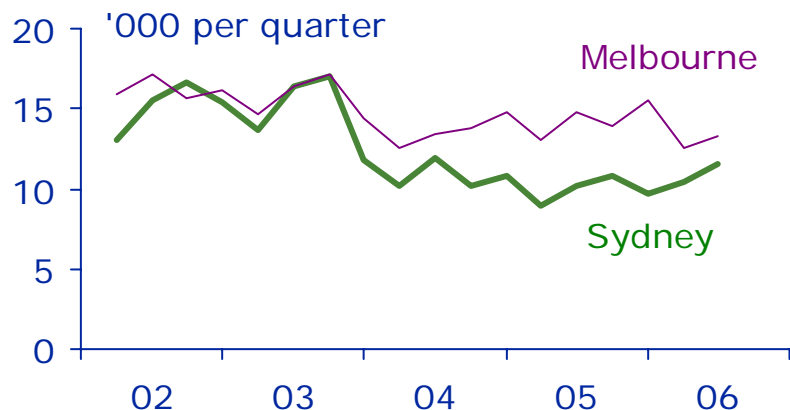
Sources: ABS; REIA, Economics@ANZ.

Housing bears' analogies between the share and housing markets miss some important points

- Housing market pessimists point to the (undeniable) fact that Australian house prices are now at record highs relative to incomes or rents
 - and use that to argue that, just as falls in share prices are often preceded by periods in which price-earnings ratios have been unusually high, high ratios of house prices to incomes or rents mean that house prices must 'inevitably' fall sharply
- This line of reasoning ignores a fundamental difference between the share and residential property markets
 - no-one has a 'natural long' position in the share market
 - but in cultures where home ownership is strongly preferred (such as Australia), the household sector does have a 'natural long' position in the residential property market
- ... which means that as long as interest rates remain at reasonable levels – so that currently marginal owners do not become forced sellers – people will not sell houses simply because houses appear 'over-valued'
- Rather, they are more likely to 'sit out' a period of stagnant prices

'Turnover' in the established house market has dropped by 28% over the past three years

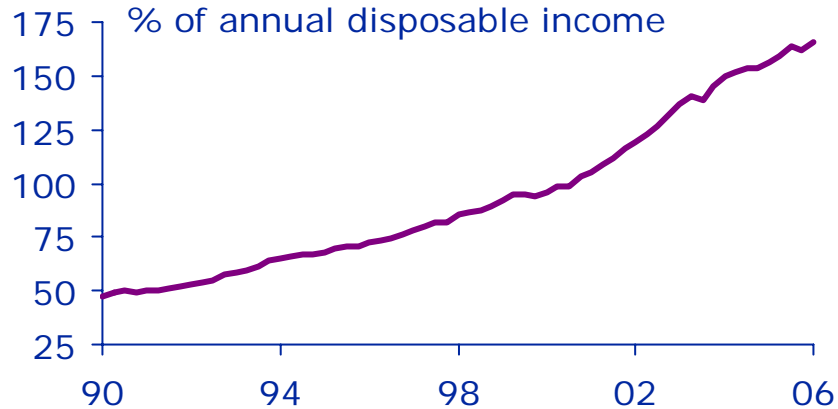
Transactions in established houses



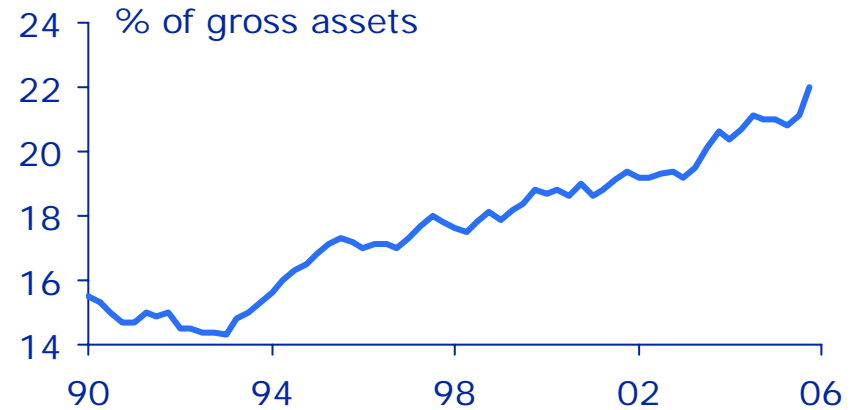
Sources: ABS (house price release); Economics@ANZ.

By the metrics that lenders use to assess housing loans, total household debt is not 'excessive'

Household debt to income



Household debt to assets



Household net worth to income



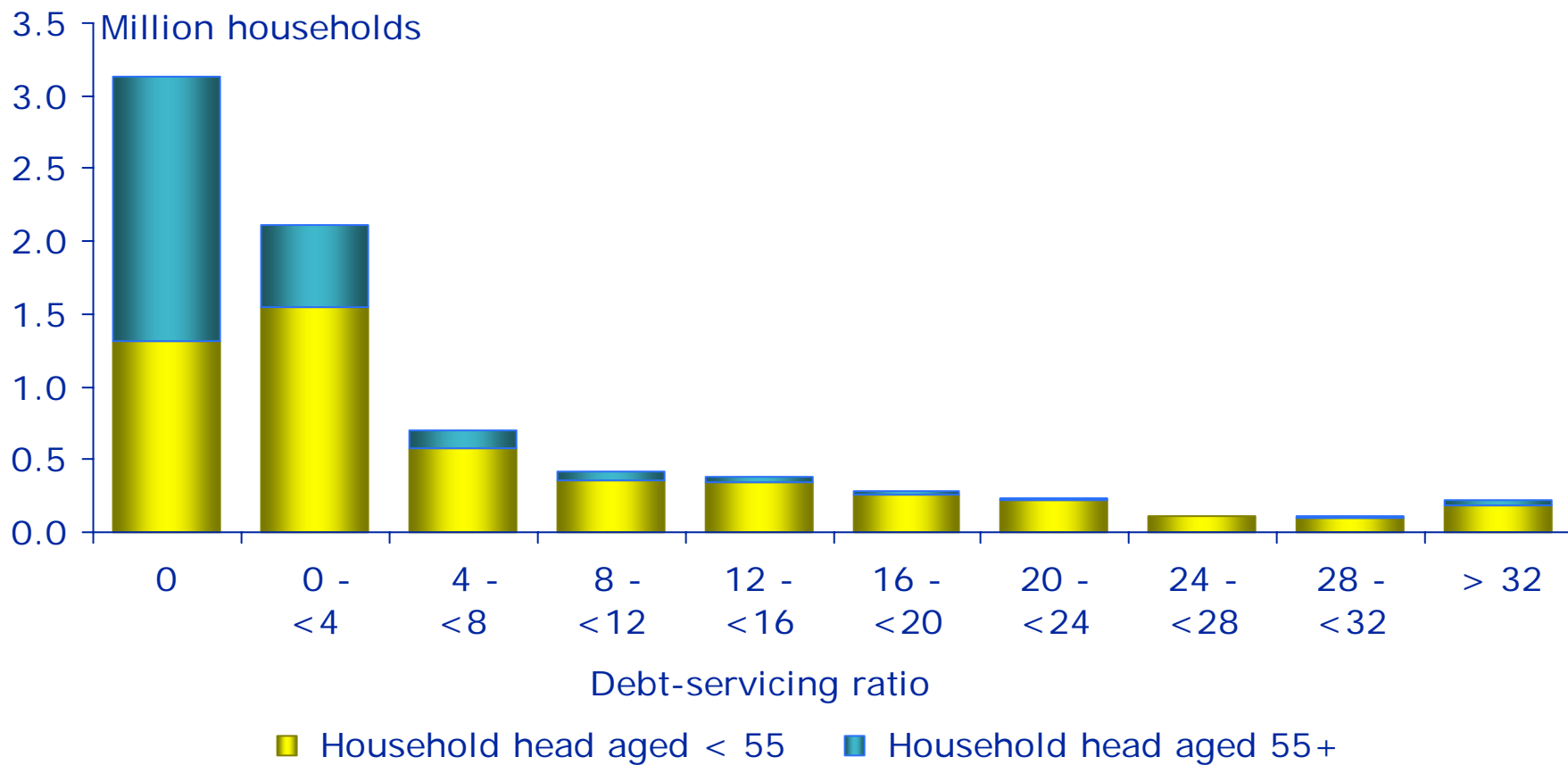
Interest payments to income



Sources: Australian Bureau of Statistics; Reserve Bank of Australia; Economics@ANZ.

Two thirds of Australian households have little or no debt

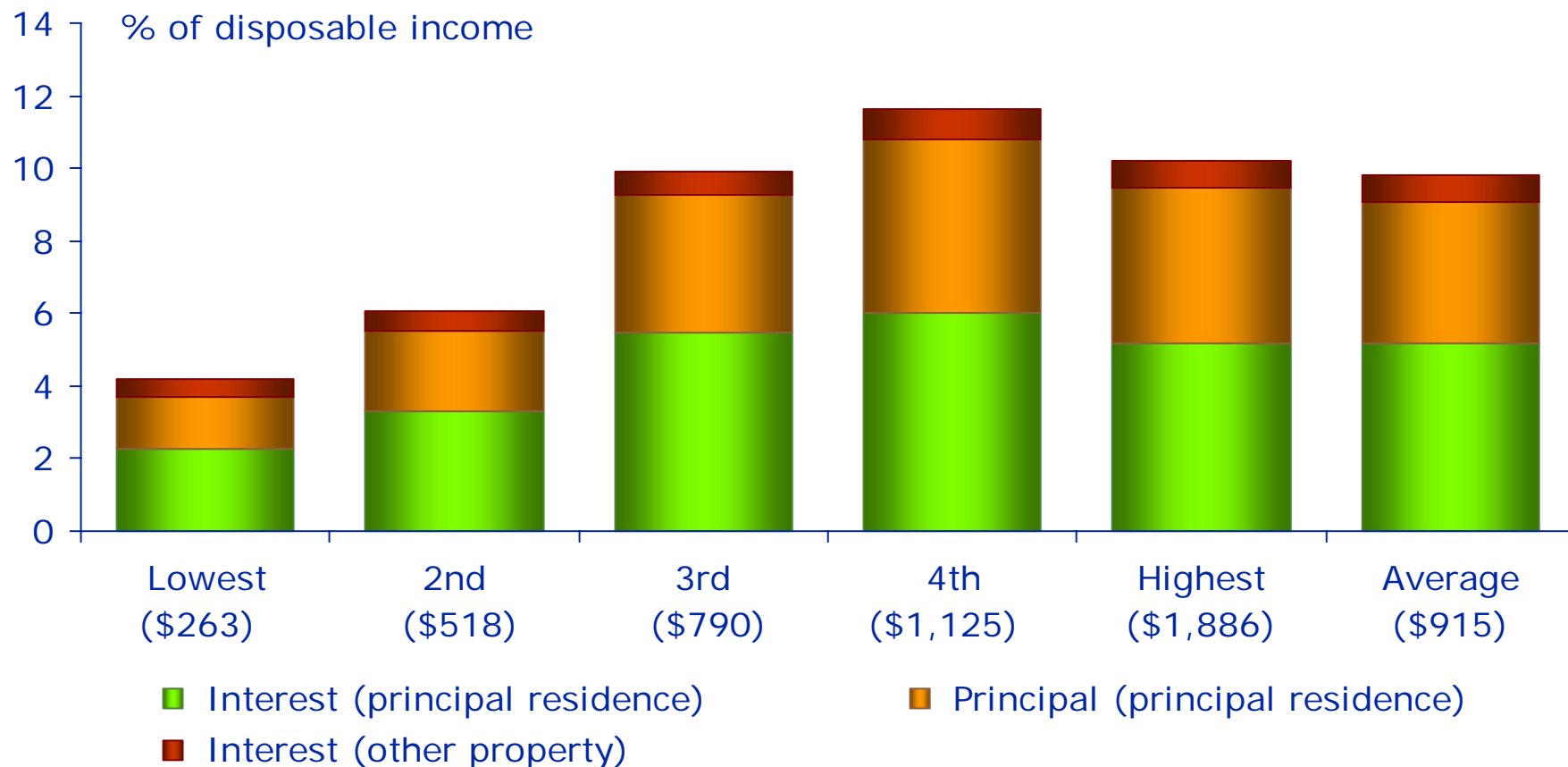
Debt service ratio by age of household head, 2003-04



Source: ABS (unpublished data from *Household Expenditure Survey*; Economics@ANZ.

High levels of household debt are concentrated among households who can service it

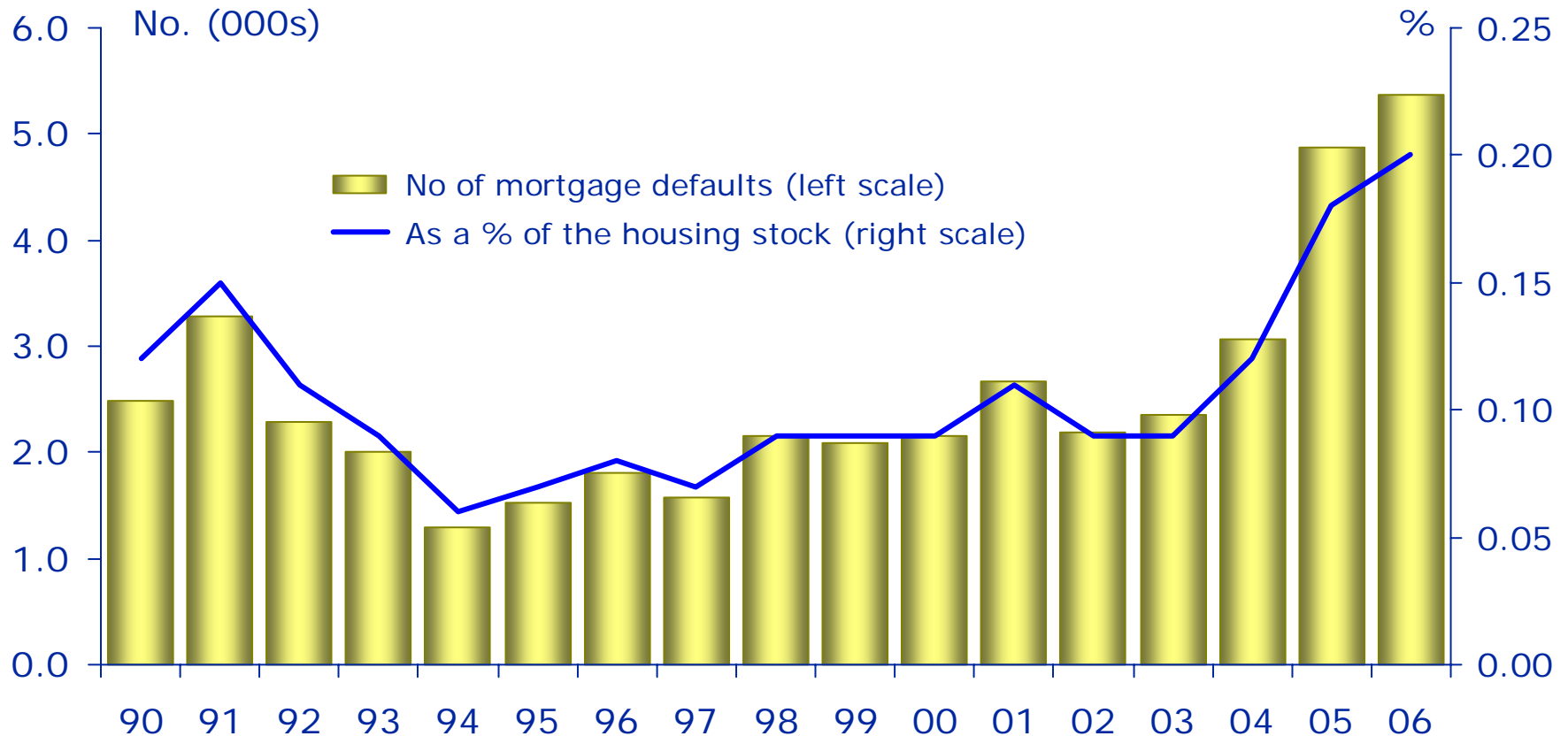
Interest and principal repayments as a p.c. of disposable incomes, by income quintiles 2003-04



Note: Figures in parentheses show average weekly household disposable income for each quintile. Source: ABS (HES); Economics@ANZ.

Mortgage defaults have risen sharply (in NSW) but are still a tiny proportion of home owners

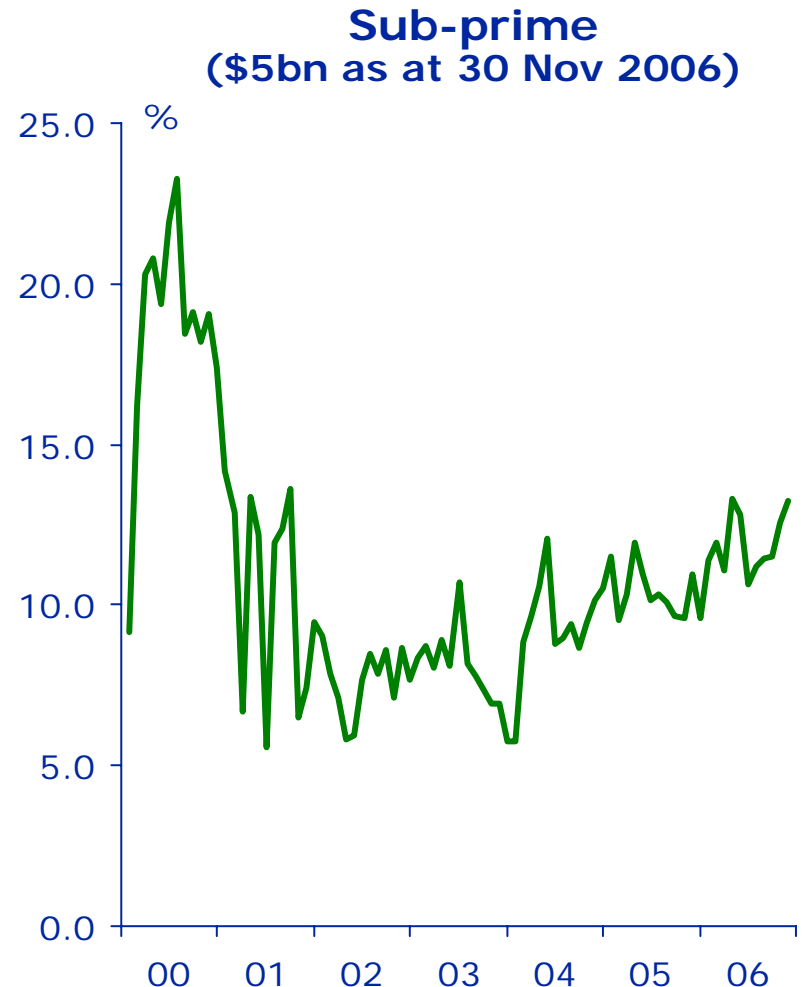
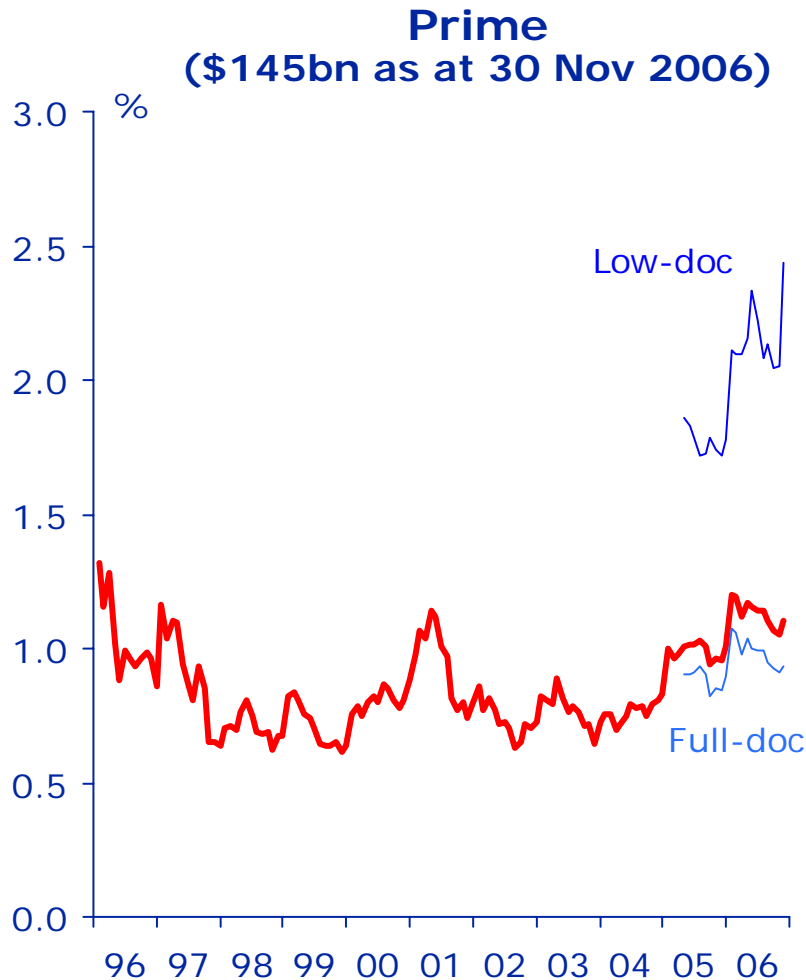
NSW mortgage defaults



Sources: Supreme Court of NSW; ABS; Economics@ANZ.

Rising mortgage arrears are (as one would expect) concentrated among sub-prime loans ...

Mortgage loans more than 90 days in arrears

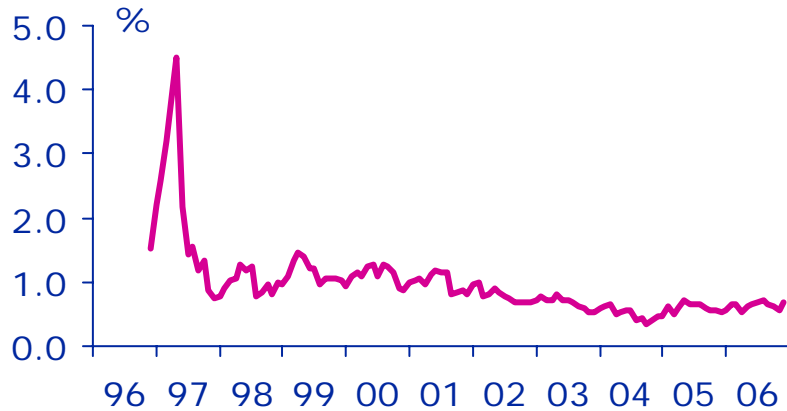


Source: S&P

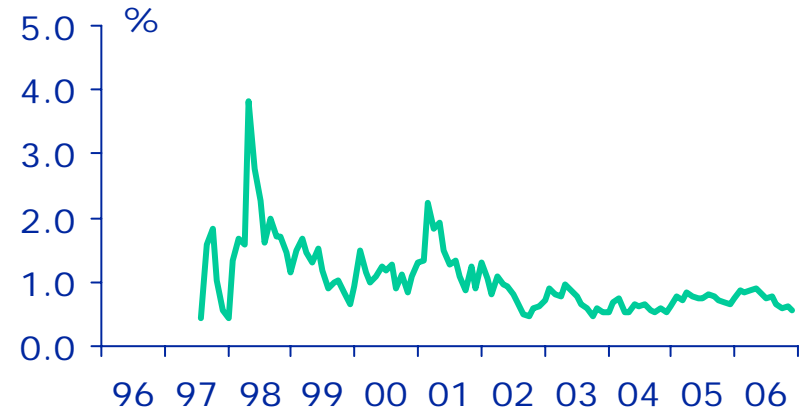
... and among 'non-traditional' lenders

Prime mortgage loans more than 90 days in arrears

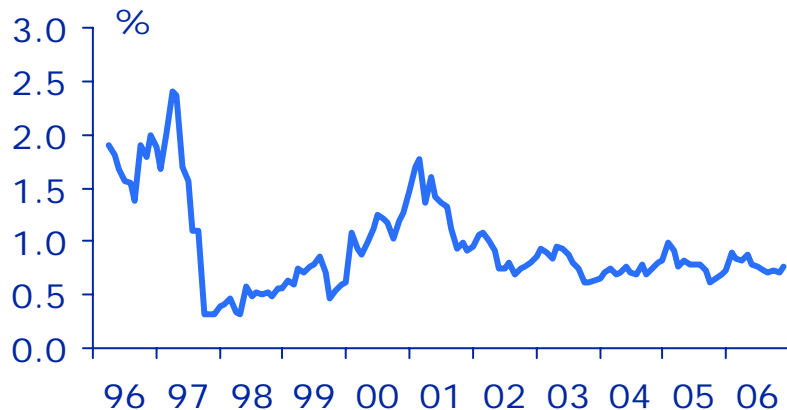
Major banks



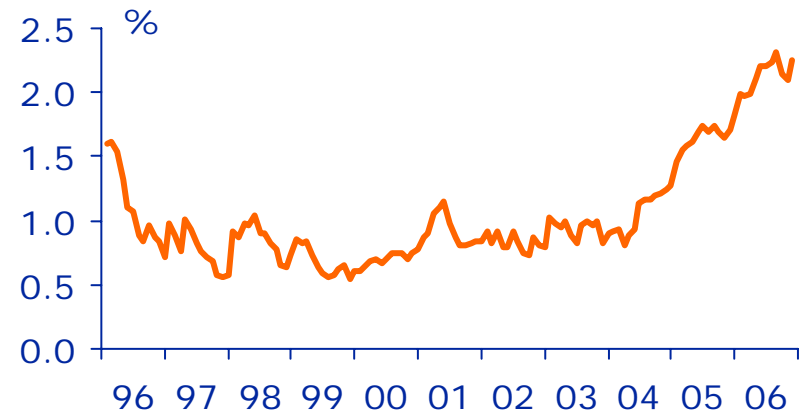
Non-bank FIs



Regional banks

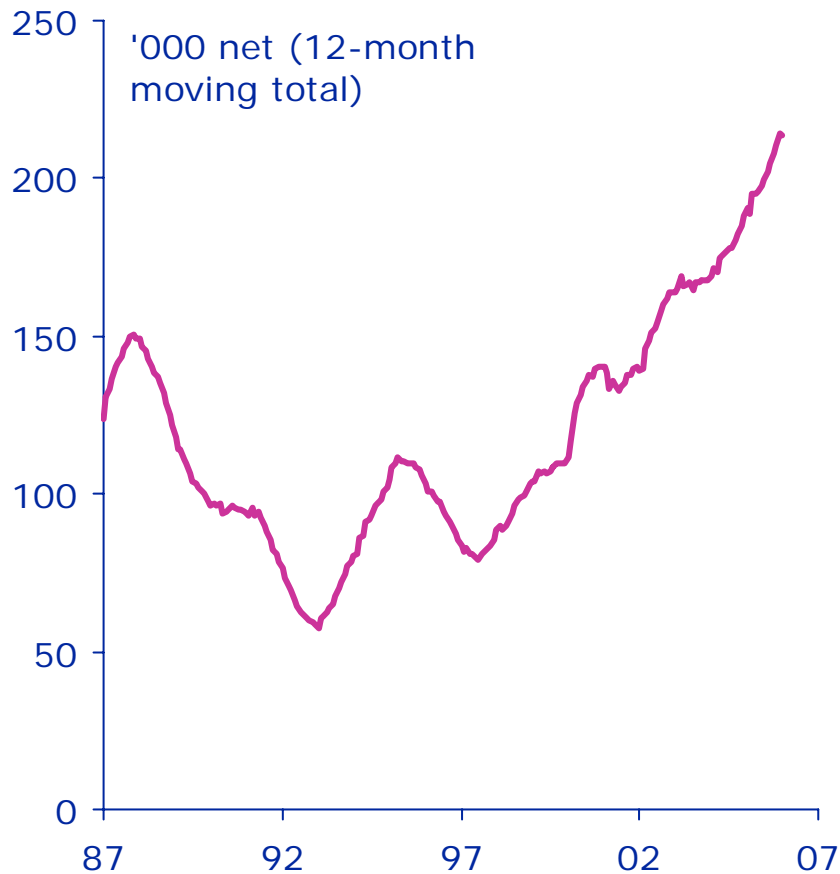


Non-bank originators

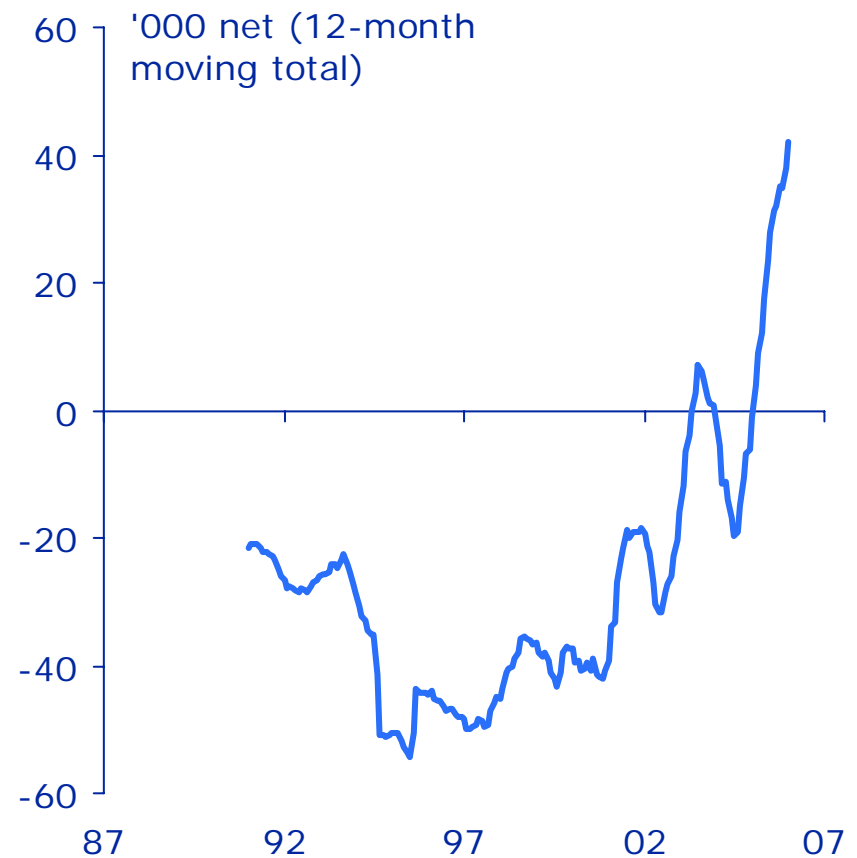


Immigration is making a growing contribution to underlying demand for housing

Permanent & long-term migration



Temporary migration 'for employment'

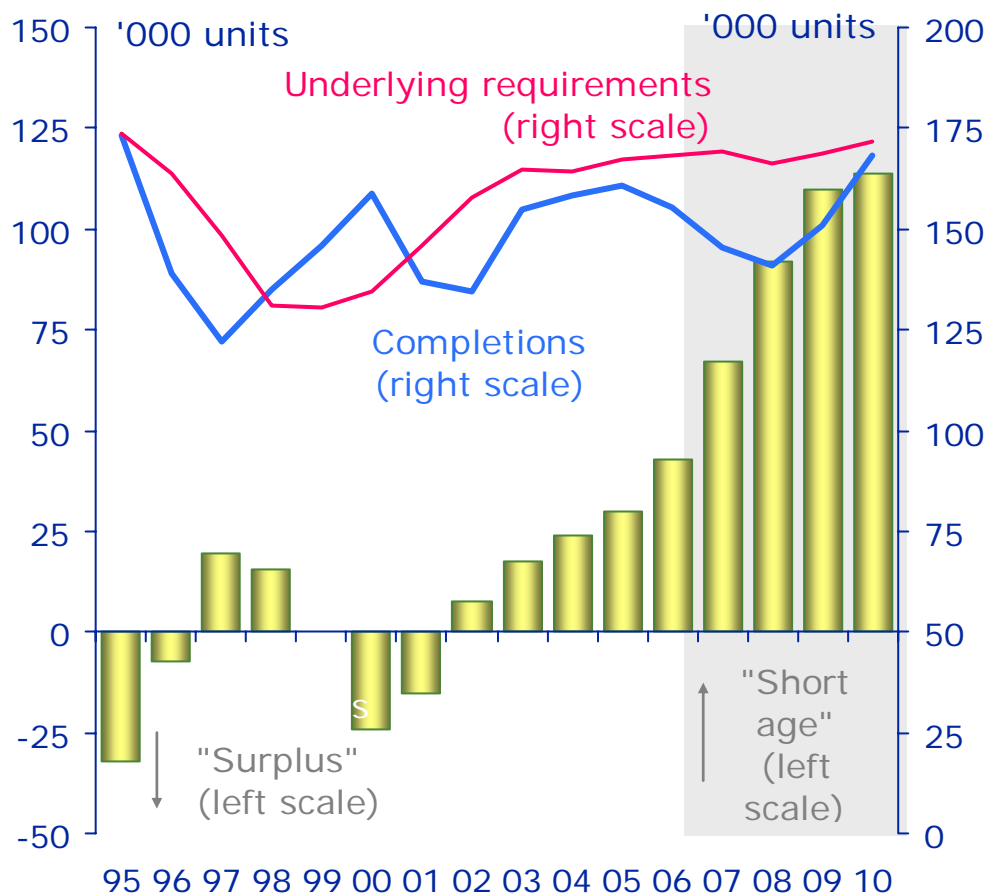


Note: these data are from the monthly overseas arrivals and departures series and don't include the 'category jumping' adjustment which has been over -50,000 pa in recent years.

Sources: Australian Bureau of Statistics; Economics@ANZ.

At current construction levels, the shortage of housing is likely to increase sharply

National housing market balance

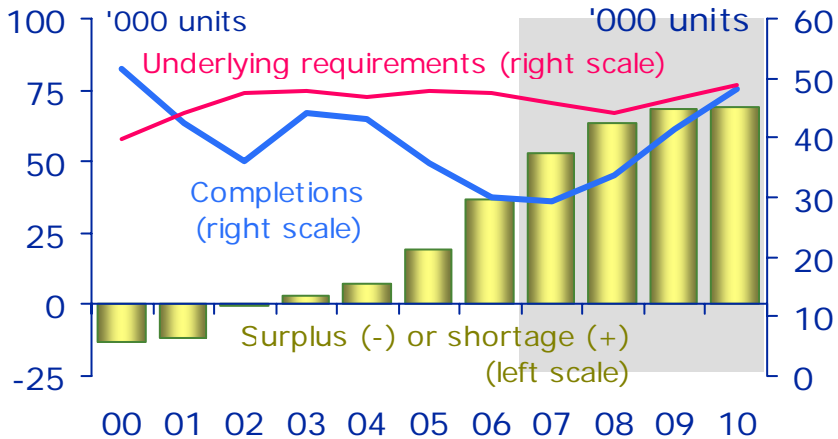


- Underlying demand for housing is running at around 165K units pa, driven by strong immigration and declining average household size
- Completions are likely to fall below 150K pa over the next 3 years
- So a significant shortage of housing is starting to develop
- Commencements need to pick up to over 170K pa to begin making meaningful inroads into this shortage

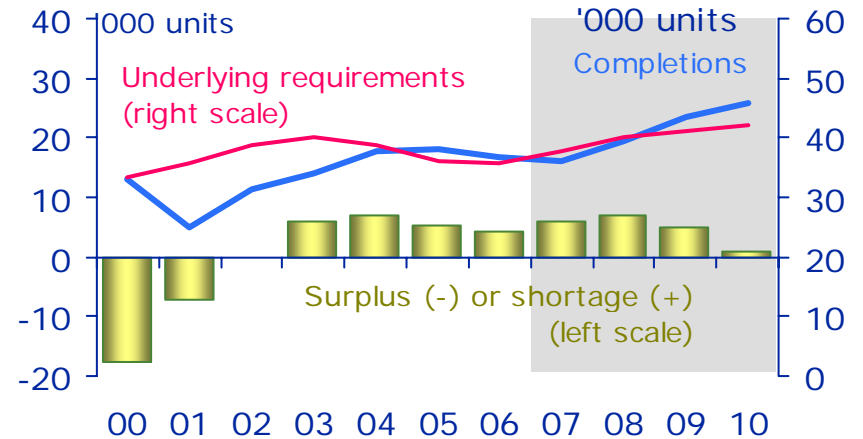
Note: 'Surplus' or 'shortage' is the cumulative difference between completions and underlying demand from an historical starting point. The direction of movements in this measure is more significant than the level. Sources: ABS; Economics@ANZ.

Housing shortages will be particularly acute in the larger States ...

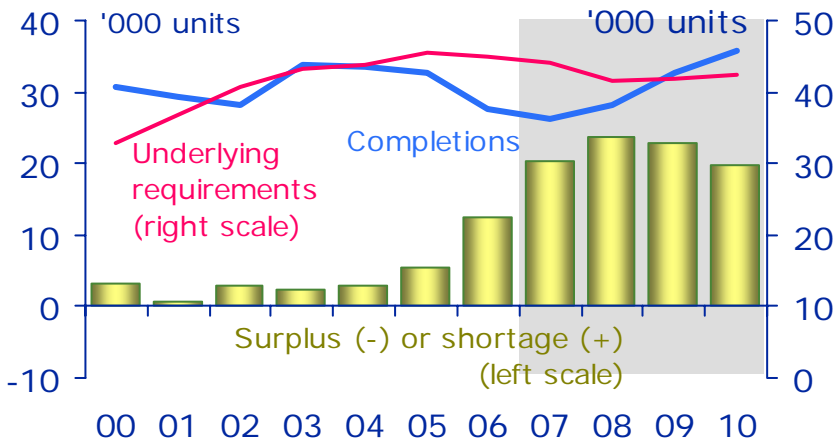
New South Wales



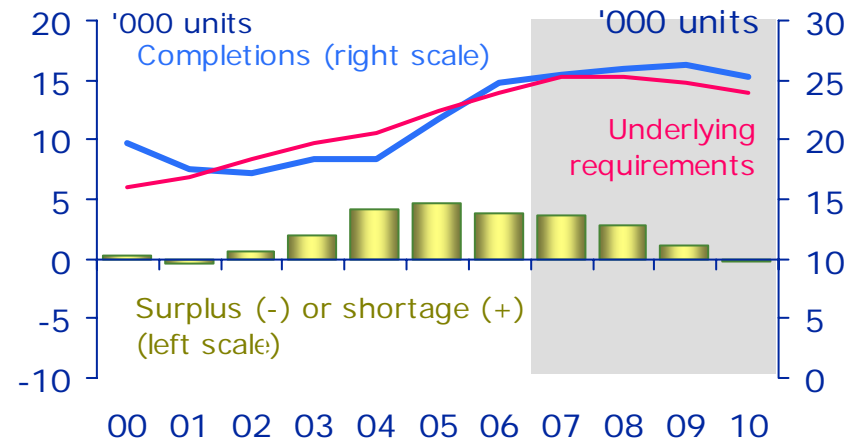
Queensland



Victoria



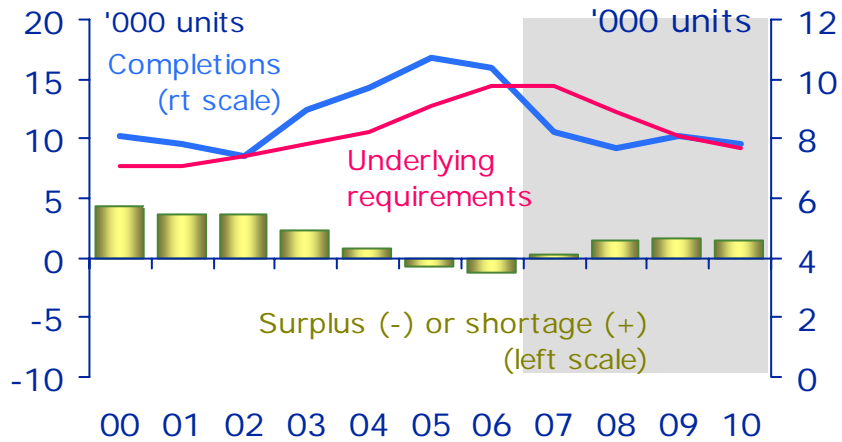
Western Australia



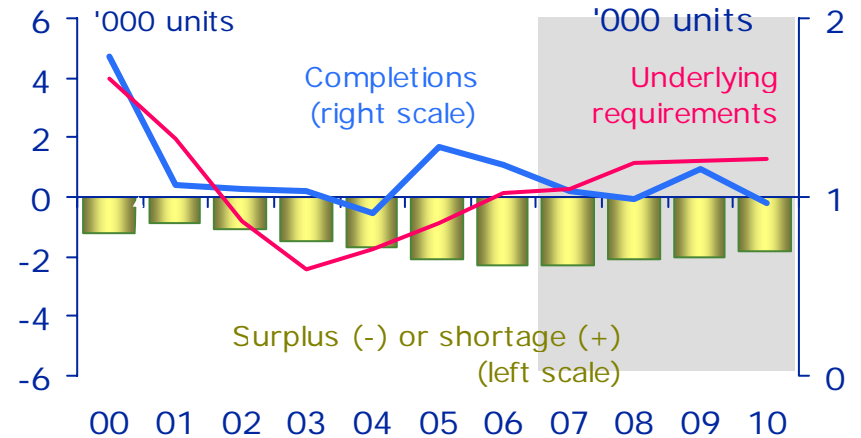
Note: see footnote to slide 18.
Sources: ABS, Economics@ANZ.

... though less so in the smaller States

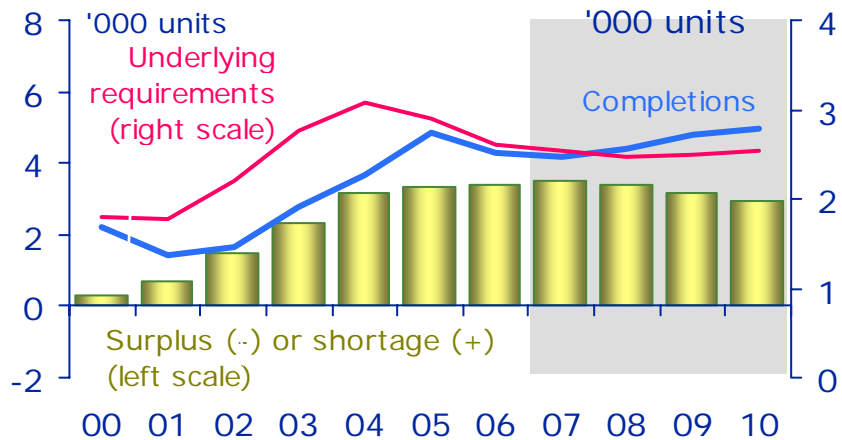
South Australia



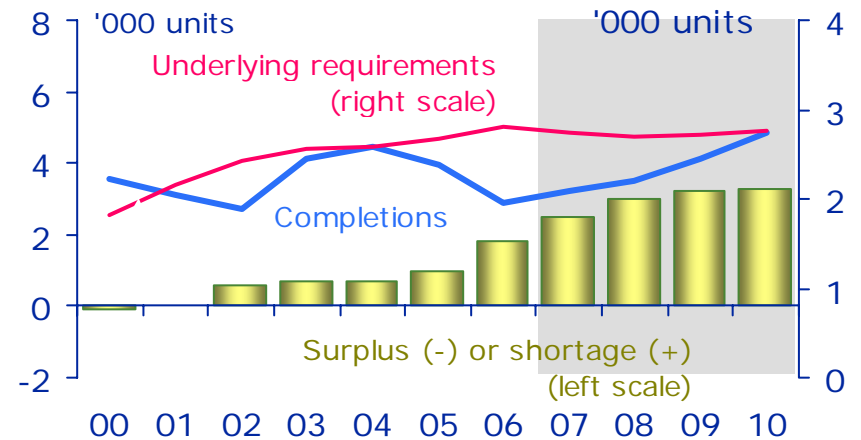
Northern Territory



Tasmania



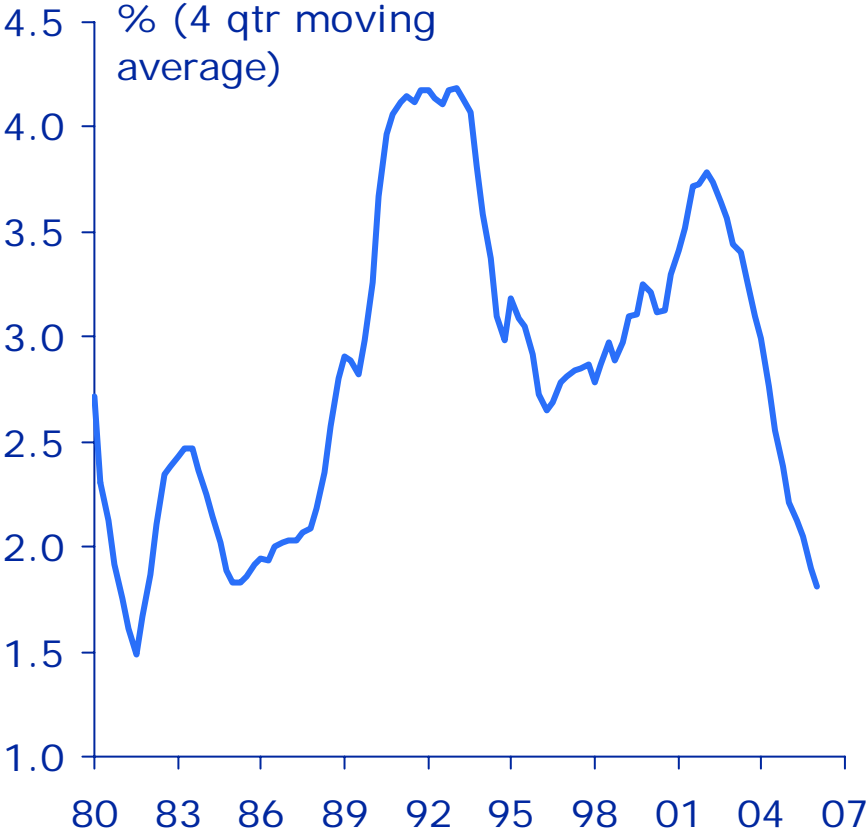
ACT



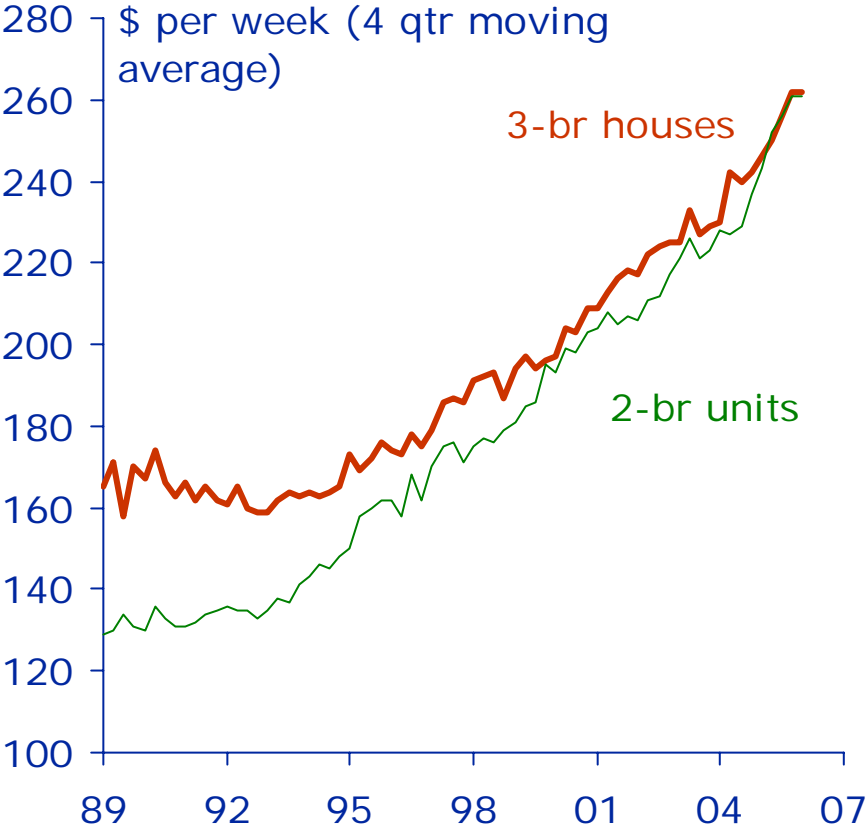
Note: see footnote to slide 18 which is particularly applicable to estimates for smaller States and Territories.

The 'net shortage' position is also apparent from falling vacancy rates and rising rents

Rental vacancy rate



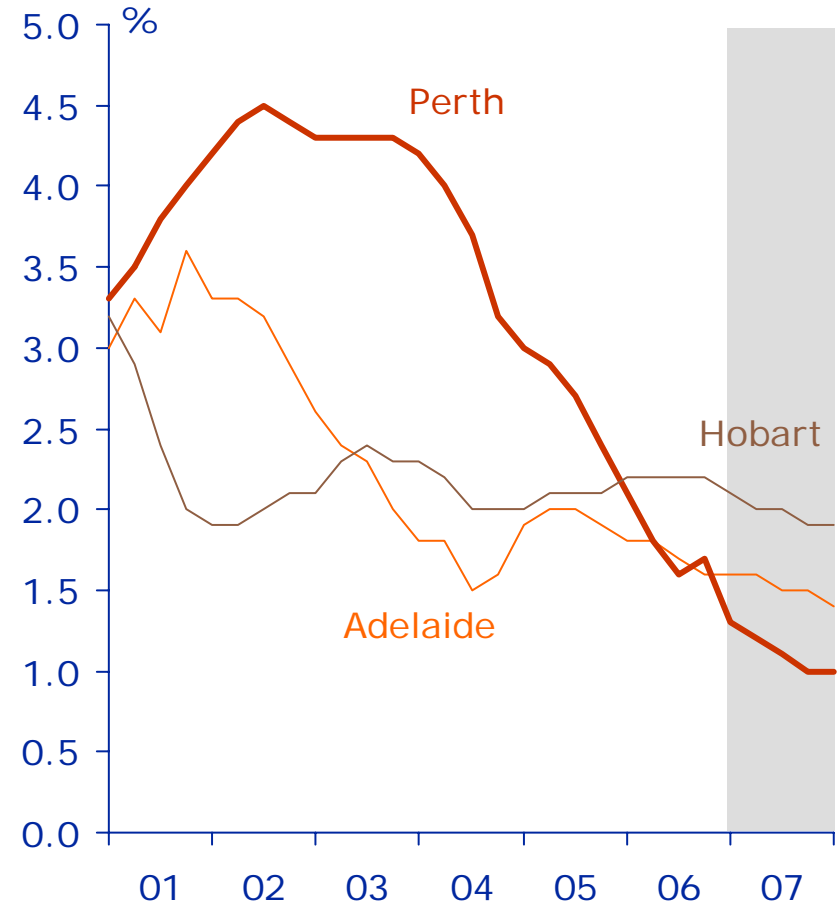
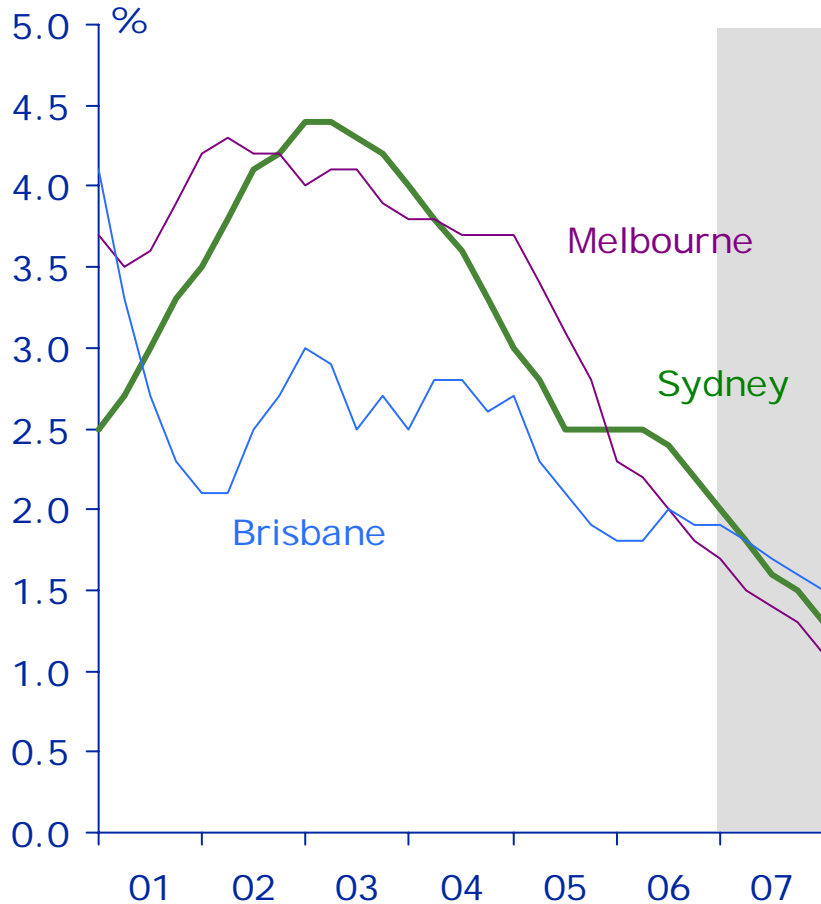
Median rents



Note: data are weighted average of eight capital cities.
Source: REIA.

Rental vacancy rates are likely to be down to critical levels in all capitals by the end of the year

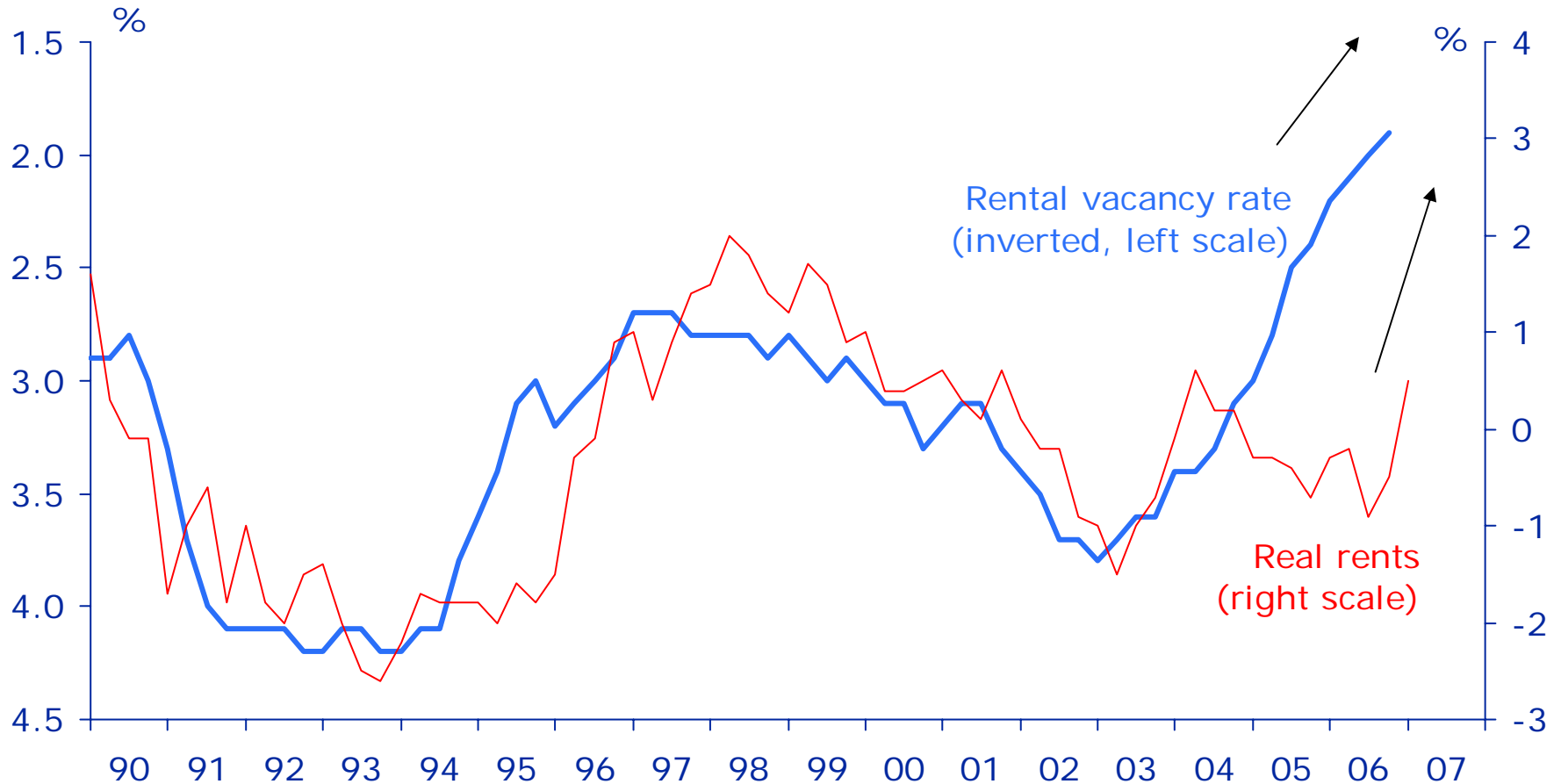
Rental vacancy rates



Sources: REIA; Economics@ANZ.

Declining rental vacancies will eventually push rents higher

Rental vacancy rate and real rents



Sources: ABS; Economics@ANZ; REIA

Summary

- The rise in Australian housing prices since the early 1990s largely reflects the 'capitalization' of lower interest rates, stronger income growth, enhanced tax concessions and easier availability of credit, as well as improving housing quality
 - these are for the most part once-off structural changes
 - in the absence of a sharp rise in interest rates and unemployment the likelihood of across-the-board falls in house prices is fairly small
 - although conversely it's unlikely that there will be further significant increases in the general level of house prices
- Attempts to improve 'housing affordability' by putting more cash in the hands of buyers will almost always fail
 - that cash will also be 'capitalized' into prices
 - rather, the primary focus should be on measures to increase the supply of housing (particularly 'affordable' housing)
- The current rate of additions to the housing stock are insufficient to meet growing underlying demand
 - driven by rising immigration and falling household size
- Diminishing rental vacancy rates will be reflected in rising rents