Mounting concerns over Australian housing bubble

Oscar Grenfell
8 April 2017

The Reserve Bank resisted calls for an interest rate hike last week, amid growing fears that the continuing rise of house prices is creating the conditions for a crisis across the property market that would have far broader ramifications.

On Tuesday, the bank's governor, Philip Lowe, announced that rates would remain at a historic low of 1.5 percent, after a series of cuts last year.

The decision followed reports last month that house prices continued their historically unprecedented ascent in 2016, with average value increases of 7.7 percent across the country. Average prices in Sydney and Melbourne, the centre of the property boom, rose by 19 and 14 percent respectively, and increased by around 6 percent in the December quarter alone. The median house price in Sydney is almost $1 million. In Melbourne, it is over $900,000.

In contrast, national wage growth was at its lowest level last year since records began in 1969, at just 1.8 percent across the private sector.

The divergence between the growth in property prices and the stagnant or declining incomes of millions of working people is fueling concerns that the housing bubble, built on a mountain of mortgage and household debt, to which the banks and financial institutions are heavily exposed, could collapse. Private debt across Australia is estimated at 187 percent of income. According to a report by the *Australian Financial Review*, mortgages make up around 62 percent of the assets of the major banks.

The Reserve Bank and other policymakers are trapped in an intractable dilemma. Any rise in interest rates could lead to a rapid fall in borrowing, posing the risk of a precipitous fall in house prices.

According to Digital Finance Analytics, mortgage stress rose by 1.5 percent between February and March, and is now affecting 22 percent of the country's 3.1 million mortgaged households. The rise was partly on the back of relatively small increases to home loan interest rates by the major banks.

Further cuts, however, or the maintenance of the current rates, will encourage a continuation of the risky lending practices that have contributed to the dramatic inflation of the market. Numbers of commentators in the financial press denounced the reserve bank for its "inaction" and "indecision" this week.

In his remarks on Tuesday, Lowe warned of interest-only loans, in which borrowers only pay interest on their mortgage for a fixed-term of up to seven years, before paying off the principal of the loan. Lowe described the prevalence of interest-only loans, which make up as many as 40 percent of housing loans, as "unusual." According to the *Australian*, as many as 60 percent of housing loans to investors are interest-only.

"Too many loans are still made where the borrower has the skinniest of income buffers," Lowe said. "In some cases, lenders are assuming that people can live more frugally than in practice they can, leaving little buffer if things go wrong."

Amid fears that the situation will lead to a growth in mortgage arrears and defaults, the Australian Prudential Regulation Authority (APRA) introduced new guidelines last week, aimed at forcing the banks to limit interest-only loans to 30 percent of their new transactions. There are also indications that APRA will move to lift the capital-to-loan ratios for banks. Currently, the banks are only required to hold 25 percent of capital compared to housing loans, on the basis that they are low risk.

Numbers of commentators have stated that the actions of regulatory authorities will change little.

The Australian Broadcasting Commission's business editor Ian Varrender wrote on Monday: "The problem, as is usually the case with bubbles, is that no-one really wants it to deflate, let alone allow it to burst. The consequences are unthinkable. And all the action so far taken to slow it has failed."

Varrender warned that the situation was a "perfect storm" and noted that shocks stemming from the global economic crisis could tip the housing market over the edge. "As one of the world's most trade exposed nations, any major global upheaval would filter through to us," he wrote.

Martin North, a property analyst, told an *Australian Financial Review* banking summit last week that he did not think a slowdown in the housing market would be "orderly."

"Regulators have come to the party three or four years too late," North said, adding, "I have a nasty feeling we are past the point of being able to manage this. There are not enough levers available to regulators to pull it back in line. I can't see anything other than a significant correction. It's not a question of if, but when."

The situation has intensified the crisis confronting the federal Liberal-National government of Malcolm Turnbull, which is riven with conflicts amid a slump of the Australian economy, and incessant demands from the corporate and financial elite for the imposition of sweeping austerity measures.

There are reportedly divisions within the government over proposals to reduce the 50 percent capital gains tax concessions for investors. While proponents of a cut are arguing that it could curb speculative and risky investments, any move would come up against the interests of the major property developers, who form a key constituency of the government. At the same time, surging housing prices have underpinned claims of continued economic growth, amid a slowdown of the mining and resources sector and slump in manufacturing.

For its part, Labor has issued populist demagogy, denouncing capital gains tax concessions. Successive governments, however, Labor and Liberal alike, have retained policies of negative gearing, capital gains concessions and the gutting of public housing stocks, which have provided a boon for property developers and investors, and contributed to a housing crisis for millions of working people.

A report in January found that 33 of 51 Australian housing markets surveyed were severely unaffordable, with Sydney deemed the second-most unaffordable market in the world. An entire generation of young people has been denied the prospect of buying a home. Just 29 percent of 25–34 years-old own their own home, compared to rates of over 60 percent in the early 1990s.

Workers have also been priced out of the market. From 2010 and 2015, the length of time it took for a two-income household, on average full-time wages, to save a median house deposit, rose from 5.8 to 7.9 years. Average mortgages are $381,000, up from $81,000 in the early 1980s.

Any "correction" of the market, let alone a full-scale collapse of the housing bubble, would see broad sections of the population left with debts and mortgages worth more than the value of their home.