Australian property prices fall faster than during global financial crisis

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Australian house prices have continued their precipitous fall, prompting warnings from analysts and financial institutions of a crash of the inflated property market, which could trigger a broader economic slump.

Australian Bureau of Statistics data released this week showed that house prices in Australia's capital cities fell by a combined 2.4 percent over the 2018 December quarter. This equates to a market contraction of $133.1 billion in just three months. The declines were sharpest in Sydney, where prices fell by 3.7 percent, and Melbourne, where they were down 2.4 percent.

There are growing signs that the slowdown is spreading beyond the east coast capital cities, with price reductions also registered in many other locations.

The latest decline follows price falls in Sydney every quarter since September 2017, and in Melbourne, during the past 12 months. Sydney values have plunged by 16 percent since their peak in 2017, while in Melbourne, the price decline is approaching 10 percent.

Indicating the magnitude of the slowdown, 2018's national price fall of 5.1 percent is greater than the annual drop of 4.6 percent in 2009, in the immediate wake of the global financial crisis.

Analysts have declared that house prices are falling more quickly than in any previous property market contraction. Recent modelling by BIS Oxford Economics senior manager Angie Zigomanis found that price falls were occurring at roughly twice the speed of an average downturn.

Commentators noted that the current reversal is taking place under conditions of far greater global economic and geopolitical turbulence than during previous property market slumps, including a protracted slowdown in the 1980s.

They have warned that a host of global factors, including US trade war measures against China and other countries, political upheavals in Europe and the slowing of the Chinese economy, could transform the downturn into a full-blown crisis.

Others have insisted that unlike previous property slowdowns, the current declines are intersecting with deep-rooted structural factors, including soaring household debt and the unprecedented exposure of the banks and financial institutions to mortgage debt.

In comments to news.com.au this week, John Adams, a former Liberal-National Coalition advisor, pointed to the parallels between Australia's property slowdown and the Irish housing market crash that began in 2007, and triggered a full-blown financial crisis.

Adams noted that Australian household debt to gross domestic product (GDP) stood at 120 percent, compared with 100 percent in Ireland in 2007. In that year, Ireland's household debt to disposable income ratio was roughly 200 percent, while the Australian figure stands at around 188 percent, one of the highest ratios in the world. Some two thirds of net Australian household wealth is invested in real estate, compared with 83 percent in Ireland before its crash.

Adams said that while Australia had "never been the first economic domino to fall during a global economic crisis," it "may buck this trend and go first."

Eddie Hobbs, an Irish financial advisor, similarly drew a parallel between the financial speculation that led to the Irish crash and the flood of investment into the Australian property market over the past decade. "Much like Ireland ingesting mispriced capital caused by the aftermath of German reunification, which stoked the Irish bubble, Australia has had a similar steroid after the GFC [global financial crisis] and precisely at the wrong time," he said.

Martin North of Digital Finance Analytics commented that international experience had indicated that if price falls exceeded 20 percent, it often led to “second order falls as buyers seek to sell,” so that “further falls then become self-perpetuating.”

North stated: “We have already passed this benchmark in some postcodes like Liverpool [a Sydney working class suburb] (with 23 percent falls). Plus, we know many households are finding it hard to manage their finances as flat incomes, rising costs and large mortgages create medium-term pressure on many.”

Already there are indications that the property slowdown is hitting the broader economy. An estimated 40,000 jobs have been destroyed in the construction sector over the past year.

Property developers, who have amassed immense wealth, are increasingly abandoning projects for fear they will not be sufficiently profitable. BCI Australia, a construction group, recently surveyed the fate of property developments planned in 2015. Only half had reached the construction stage in New South Wales and South Australia, while the figure was just 20 percent in Victoria.

The reduction in building activity threatens further mass job losses, amid a broader destruction of permanent positions, enforced by state and federal governments and the trade unions. The construction sector employs an estimated 1.1 million people across the country.

The property slowdown is creating a social crisis for millions of working class mortgage holders. More than one million households, accounting for 30 percent of owner-occupiers, are already afflicted by mortgage stress, meaning they struggle to meet their repayments.

Moody’s Investor Service this week predicted an increase in the number of mortgage delinquencies over the coming months. An estimated 400,000 homeowners owe more on their mortgage than the current value of their homes. In other words, they are unable even to sell off their property and clear their debt.

Moody’s wrote: “Meanwhile, a large number of interest-only mortgages are due to convert to principal and interest loans over the next two years, which will cause some delinquencies over this period.”

The widespread provision of interest-only loans, whereby the borrower pays just interest for a fixed term before beginning to pay the principal, was part of a broader promotion of risky lending practices by the banks, assisted by financial regulators. The major banks are therefore heavily exposed to any housing crisis, with mortgage debt comprising up to 60 percent of their assets.

Having promoted a frenzy of speculative investment, governments and financial regulators confront a dilemma. The Reserve Bank has held the official interest rate at a record low 1.5 percent for 30 consecutive months. It fears that any move to raise interest rates could lead to a sharp contraction in lending, precipitating a major slump. Already, a limited tightening of lending practices by some banks has led to warnings of a broader credit crunch.

That is why the Reserve Bank has recently flagged the possibility of further rate cuts. This would be a desperate attempt to stimulate the economy. The major private banks, however, are under pressure to increase their own lending rates, in line with hikes on international markets, where they borrow their funds.

Whatever measures are carried out, the banks and financial institutions, and the Labor and Liberal-National governments that represent them, will do everything they can to place the burden of the deepening crisis on the backs of workers, young people and the poor.