

# Economic influences on the Australian mortgage market

## Presentation to Choice Aggregation Services

**Saul Eslake**  
**Chief Economist**  
**ANZ**

**Burswood Resort**  
**Perth**  
**3<sup>rd</sup> October 2007**

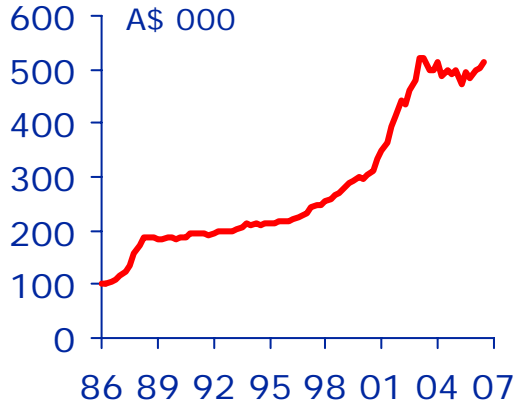
[www.anz.com/go/economics](http://www.anz.com/go/economics)

*economics@*

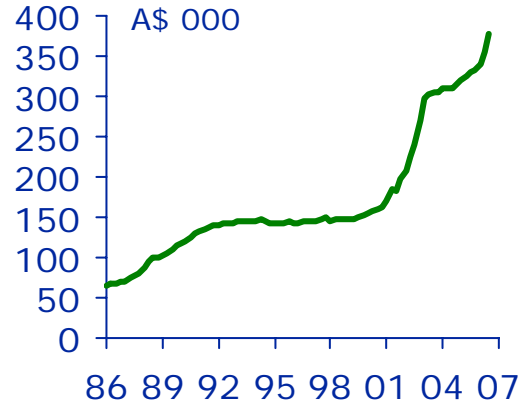
# Capital city house prices have been remarkably buoyant, except in Sydney

## Established house prices

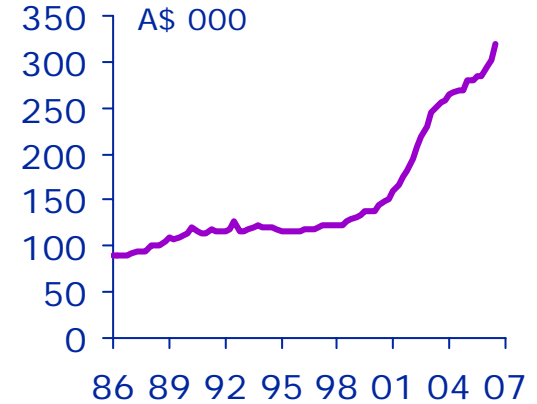
### Sydney



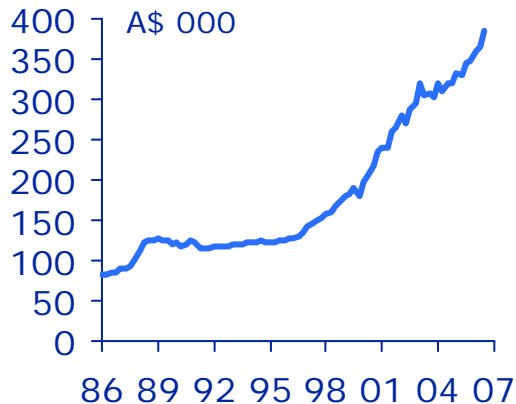
### Brisbane



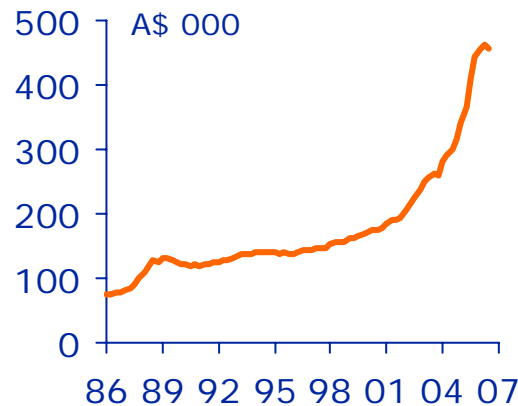
### Adelaide



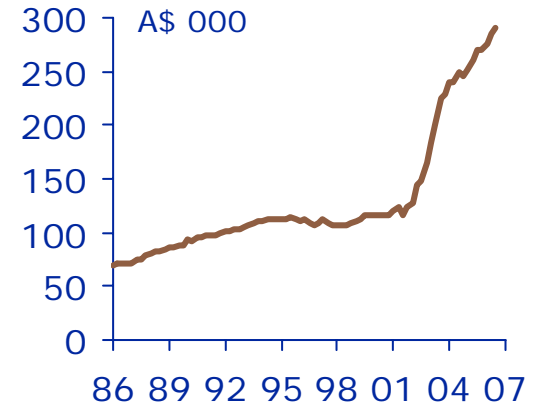
### Melbourne



### Perth

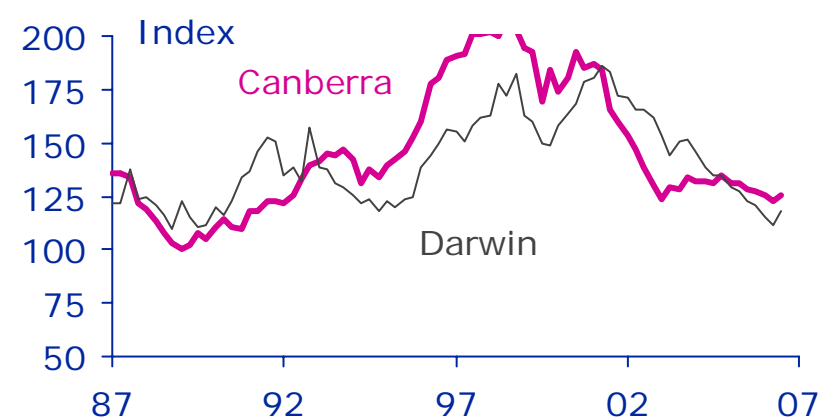
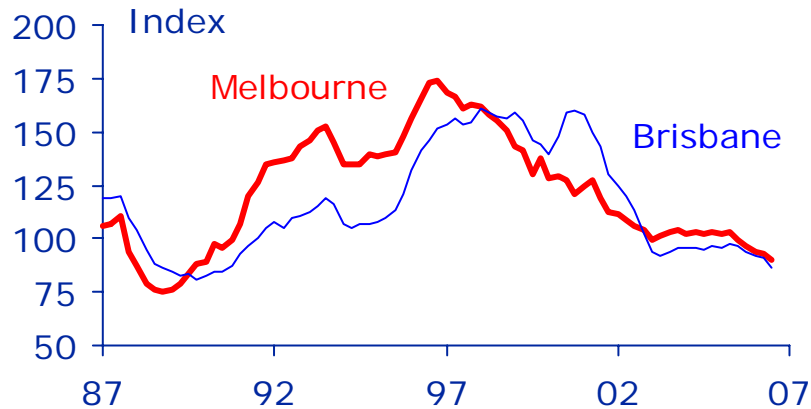
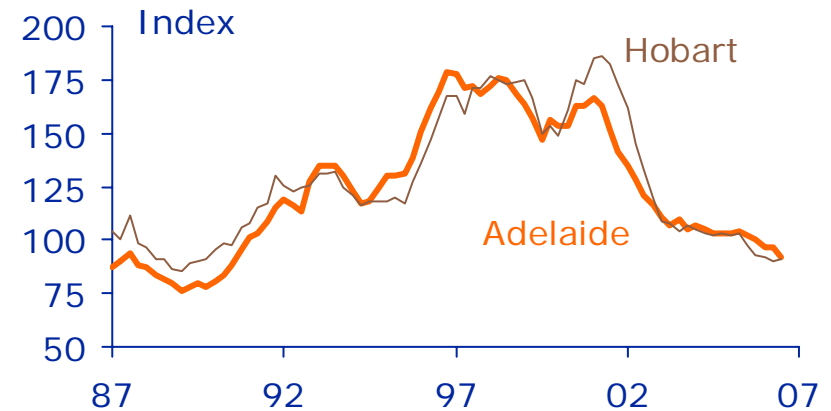
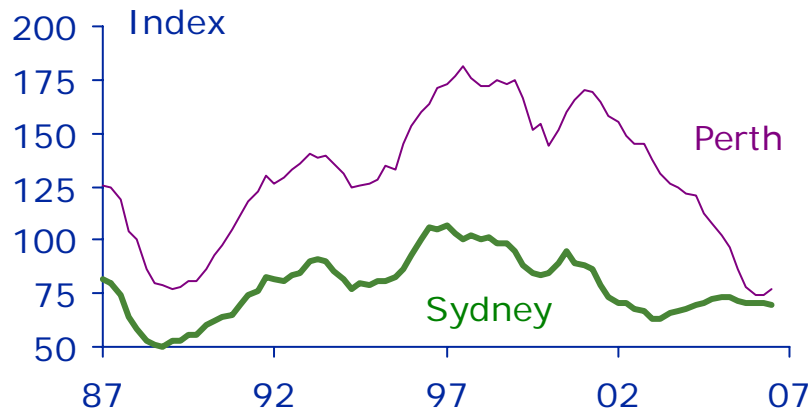


### Hobart



# Housing affordability is now close to record lows in most cities ...

## Housing affordability

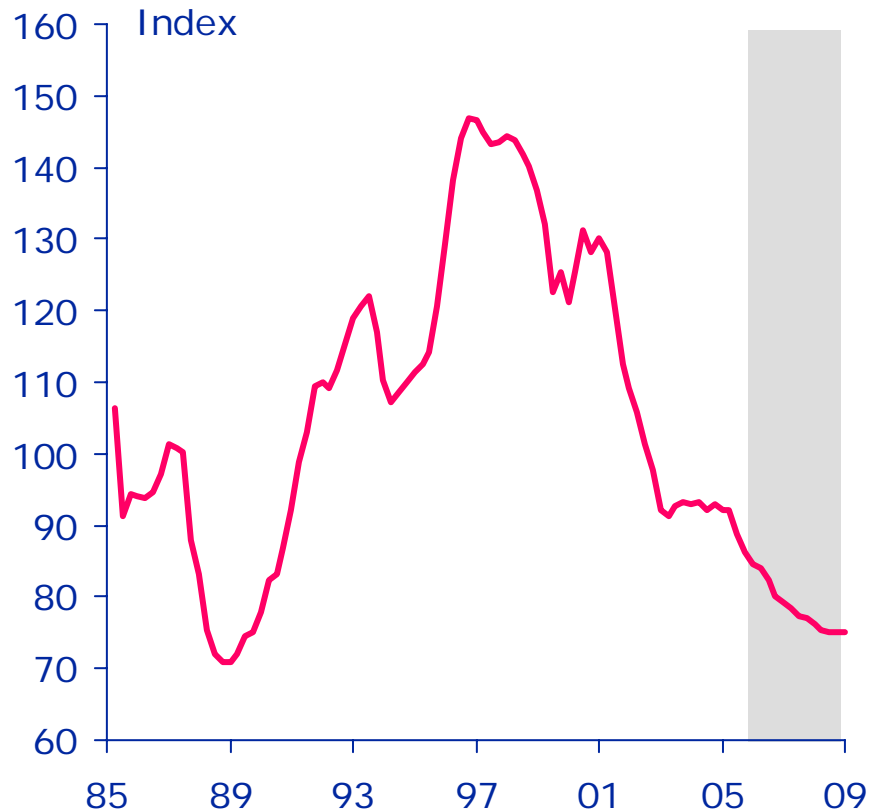


*Note:* The housing affordability index is the ratio of average household disposable income to the income required to service the mortgage required to buy a median-priced dwelling with a 20% deposit and a maximum debt service ratio of 30%.

Sources: ABS; Economics@ANZ.

# ... and is likely to deteriorate further over the next two years

## ANZ housing affordability index – all capital cities

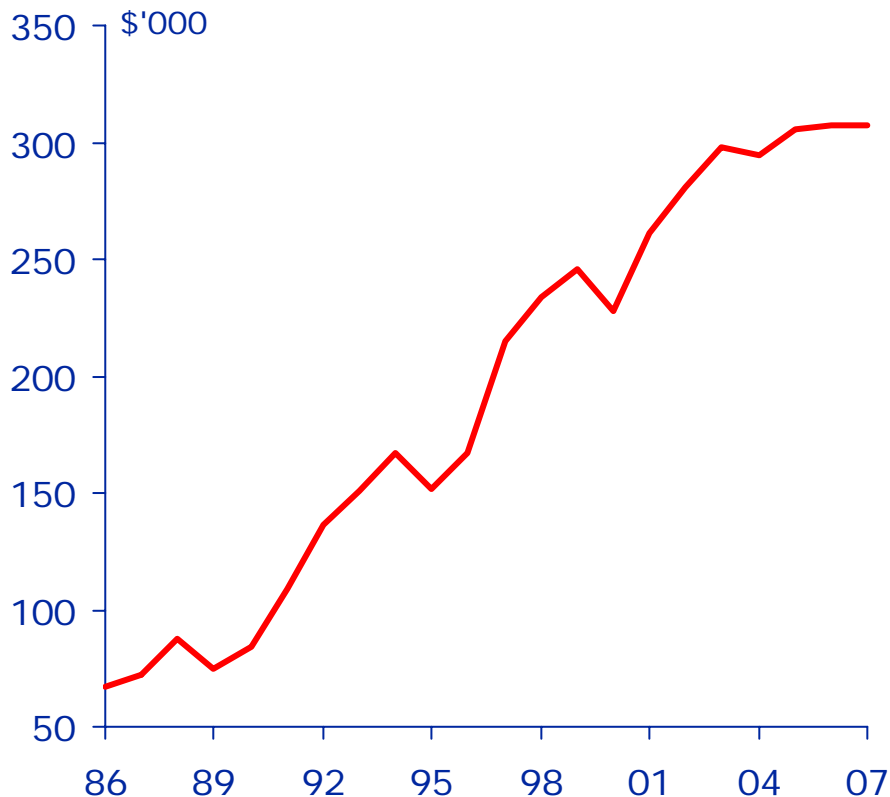


*Note:* The housing affordability index is the ratio of average household disposable income to the income required to service the mortgage required to buy a median-priced dwelling with a 20% deposit and a maximum debt service ratio of 30%.

- 'Housing affordability' is now almost as low as when interest rates were at their late 1980s peak
- With both interest rates and house prices more likely to rise than fall, housing affordability will deteriorate further over the next 2 years
- Whereas the late 1980s problem was caused by high interest rates – to which the 'solution' was lower interest rates ...
- .. the current problem has been largely caused by high house prices – to which the only 'solutions' are lower house prices or higher incomes (since lower interest rates are unlikely near term)

# Over the past 15 years the 'borrowing capacity' of the typical home-buyer has more than doubled ...

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



Note: data are for the June quarter each year.

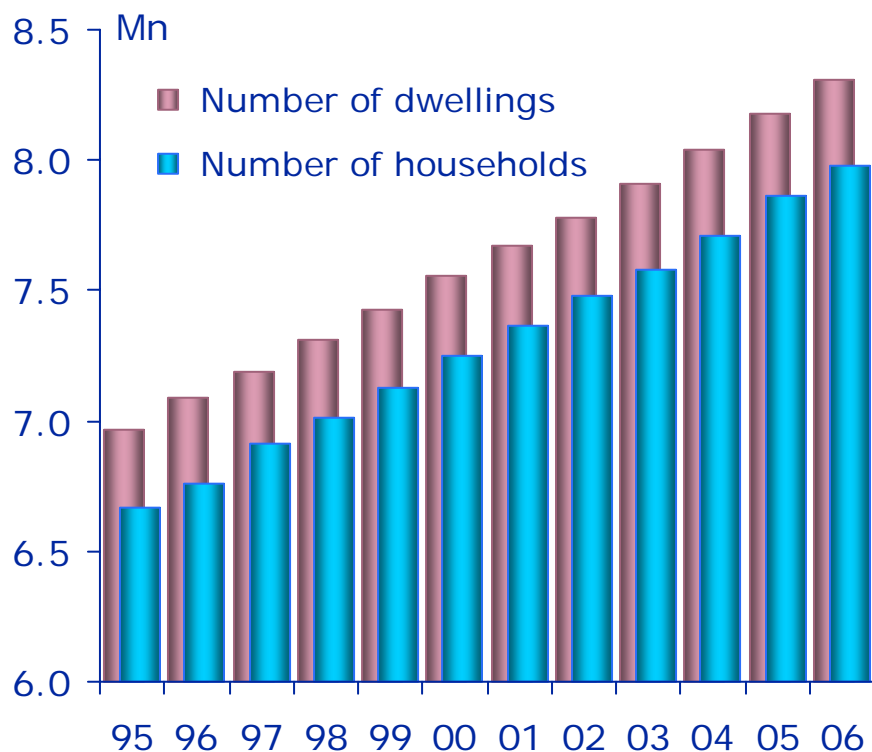
Sources: ABS; Economics@ANZ.

- Since the early 1990s, average earnings have risen by over 90% while the standard variable mortgage rate has fallen
- This has increased the maximum amount which a 'typical couple' can afford to borrow under traditional lenders' rules from around \$135 000 in 1992 to \$307 000 in 2007
- In practice, rates actually paid by borrowers have fallen by more than the standard variable rate, the traditional 'rules' are much less rigorously applied, and the maximum loan term has risen from 25 to 30 years

economics@ANZ

## ... while the supply of housing has barely kept pace with the increase in underlying demand

### Number of households and number of dwellings



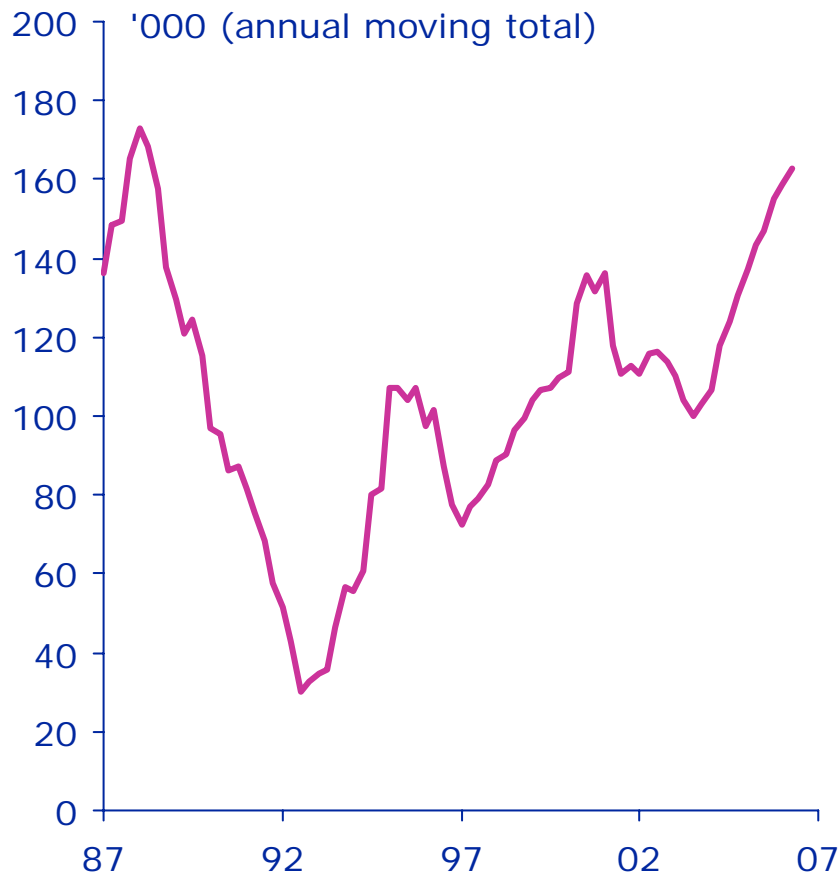
*Note:* Dwelling stock estimates for 1991, 1996, 2001 and 2006 based on census figures; other years interpolated using completions data.

*Sources:* RBA; ABS; Economics@ANZ.

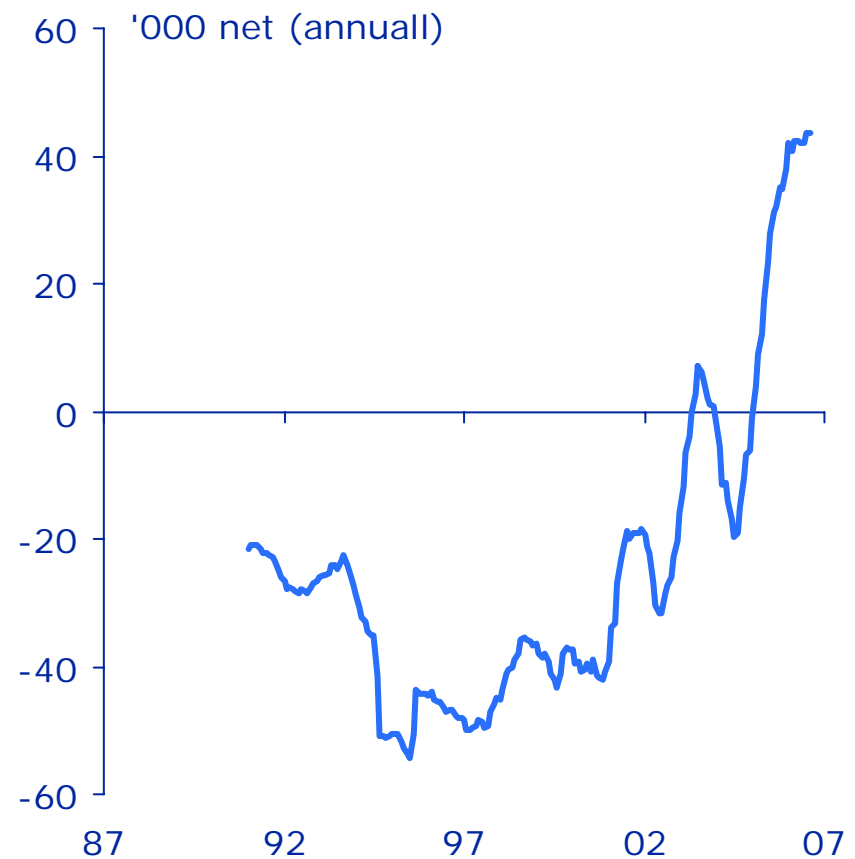
- Over the ten years to June 2006, the stock of housing increased by 1.22 million
  - 1.46 mn new dwellings were completed during this period, but around 259,000 old dwellings were demolished
- Over the same period, the number of households rose by 1.31 million or 18%
  - faster than the 13.1% increase in population because of falling average household size
- The increase in the supply of housing was more than absorbed by increased demand

# Rising immigration, both permanent and temporary, is also boosting housing demand

## Net permanent & long-term settler arrivals



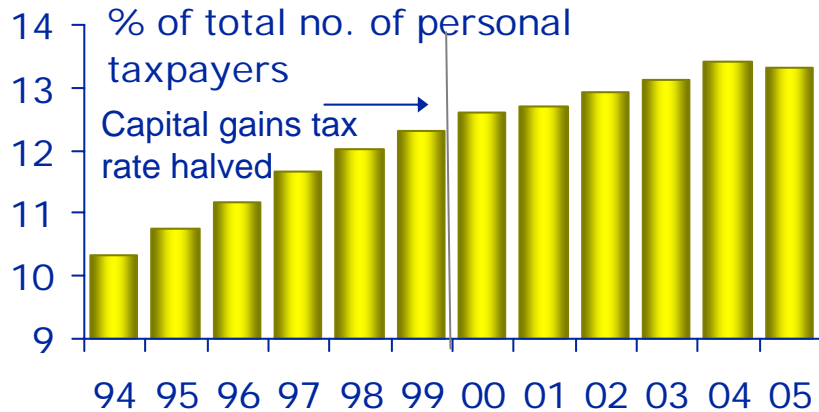
## Temporary migration 'for employment'



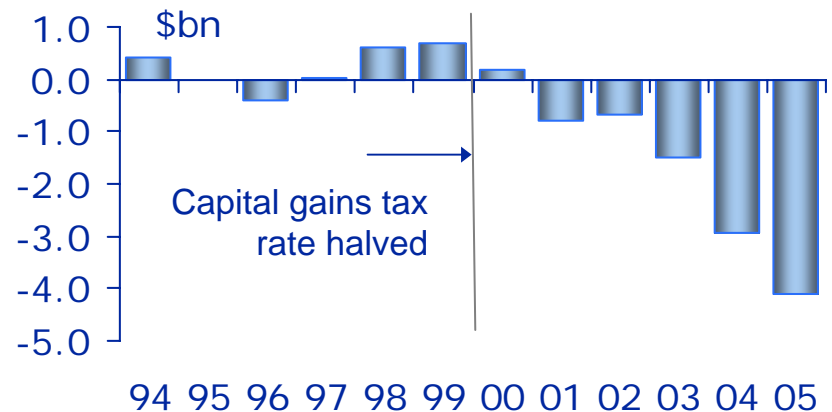
Sources: Australian Bureau of Statistics; Economics@ANZ.

# Changes to the tax system have stimulated investor demand for housing

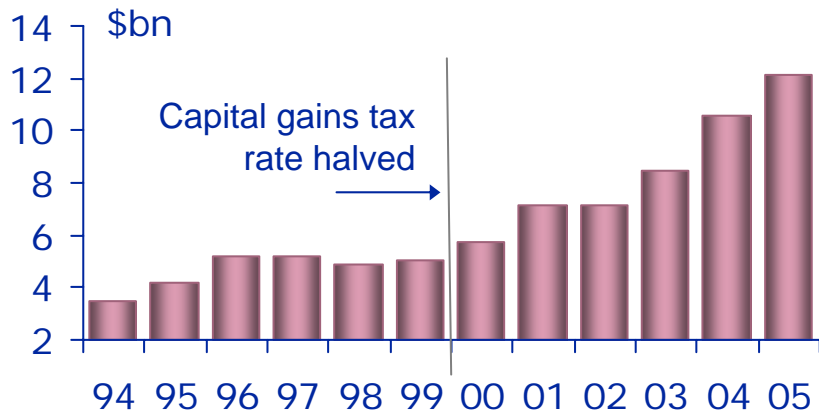
## Taxpayers with rental income



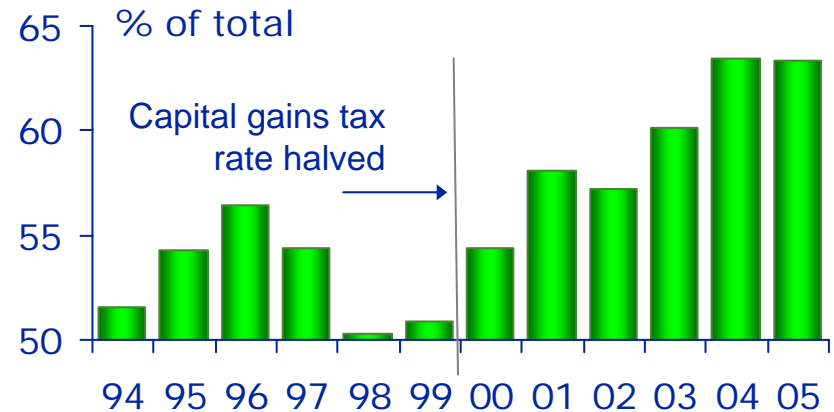
## Net rental income



## Interest paid by property investors



## Loss-making property investors

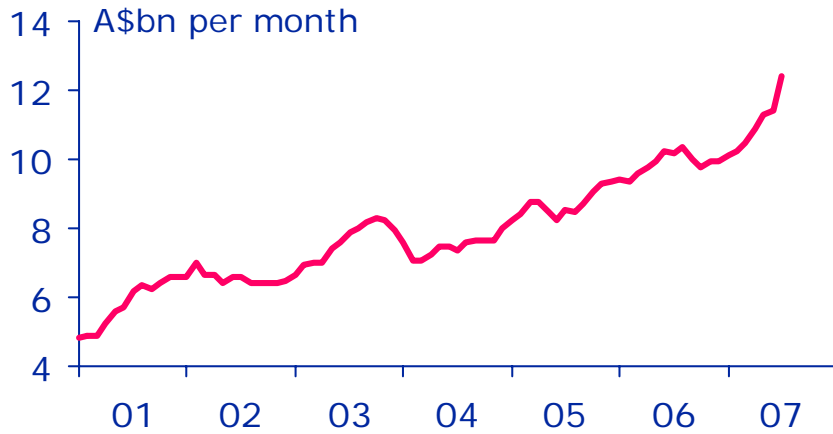


Note: Data are for fiscal years ended 30 June.

Sources: Australian Taxation Office; Economics@ANZ.

# Upward pressure on house prices reflects strong demand combined with limited supply

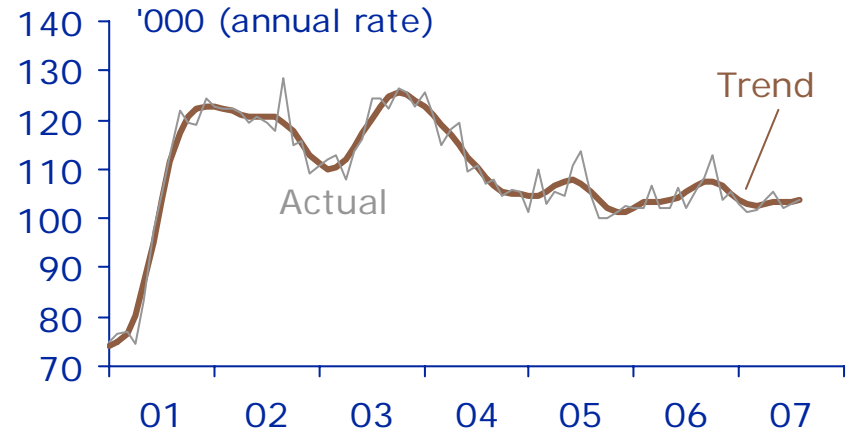
## Housing finance commitments Owner-occupiers



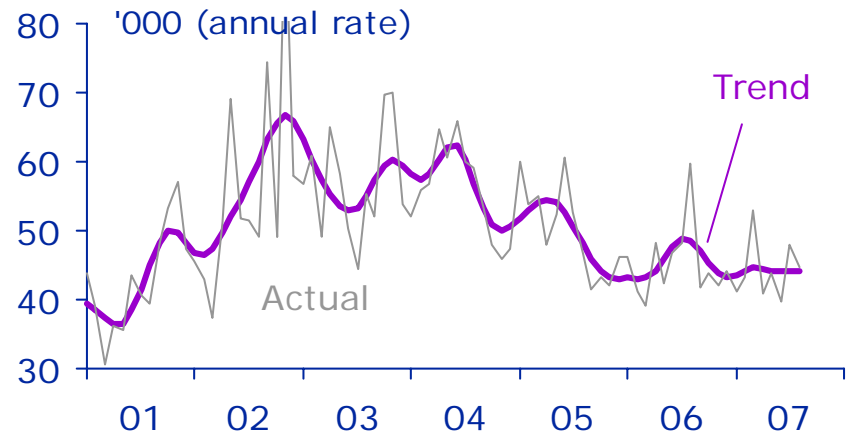
## Investors



## Residential building approvals Houses



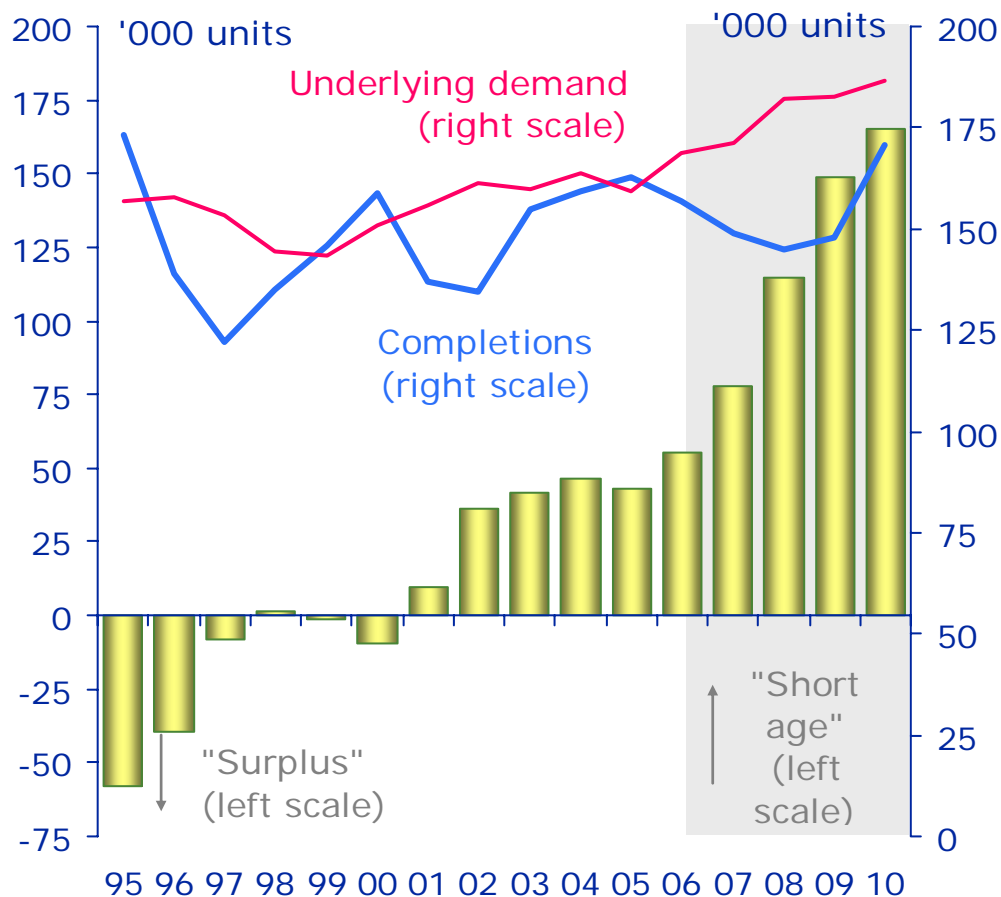
## Apartments, etc.



Sources: ABS: Economics@ANZ.

# The imbalance between housing demand and supply is likely to get worse

## National housing market balance

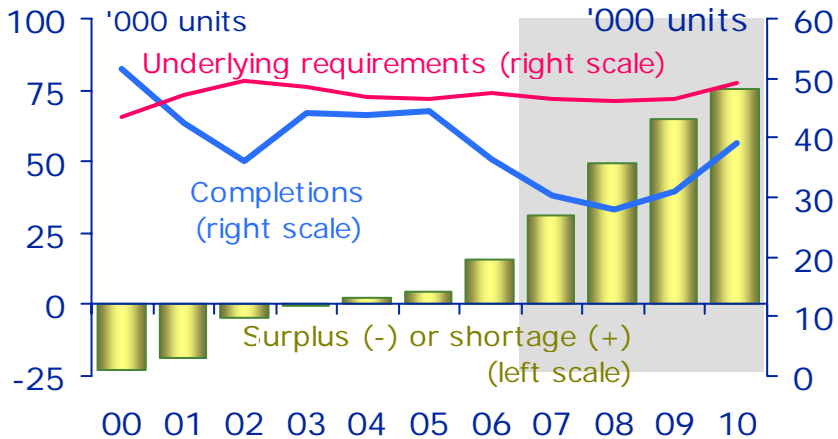


Note: 'Surplus' or 'shortage' is the cumulative difference between completions and underlying demand from an historical starting point. The direction of movements in this measure is more significant than the level. Sources: ABS; Economics@ANZ.

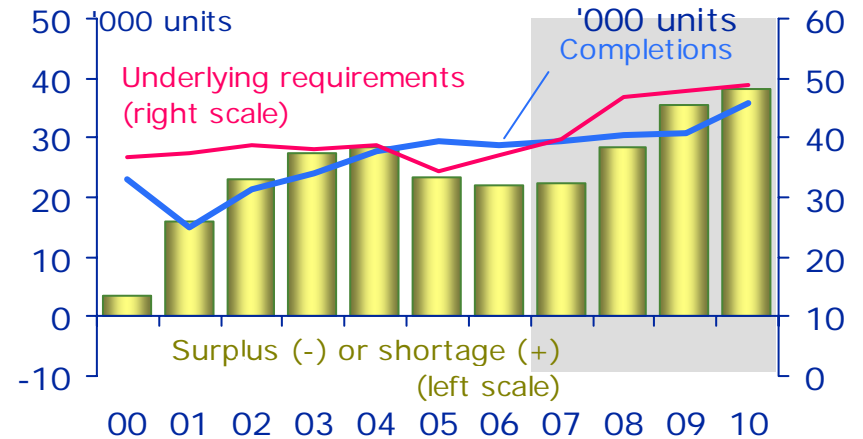
- Underlying demand for housing is running at around 165K units pa, driven by strong immigration and declining average household size
- Completions are likely to fall below 150K pa over the next 3 years
- So the shortage of housing is likely to get worse
- Commencements need to pick up to around 180K pa to begin making meaningful inroads into this shortage

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

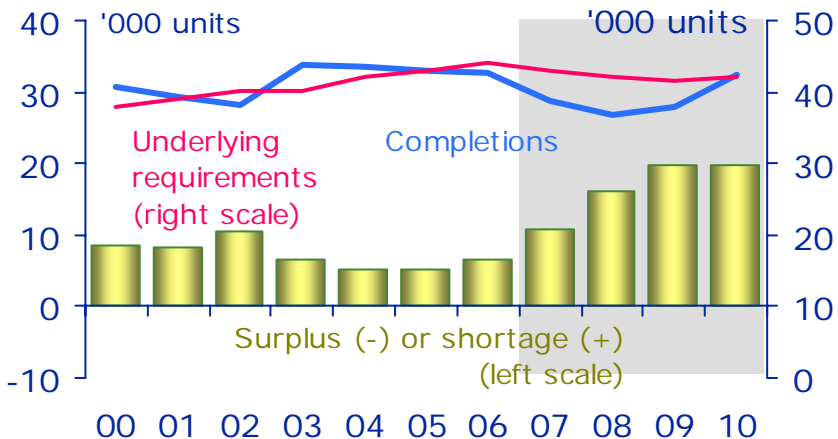
## New South Wales



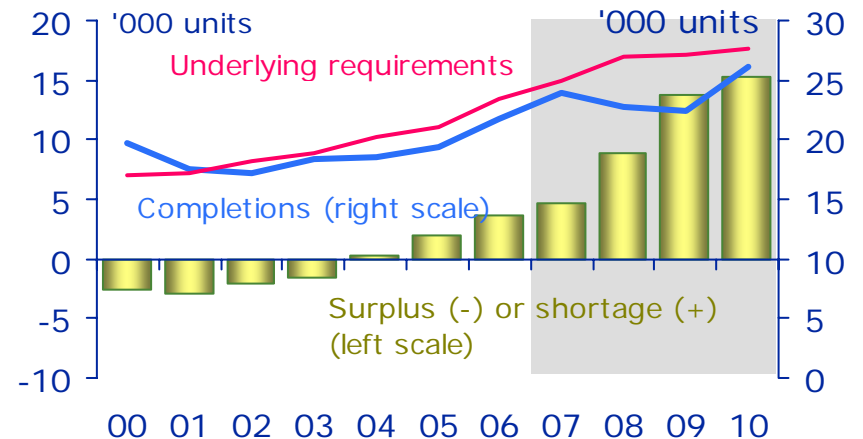
## Queensland



## Victoria



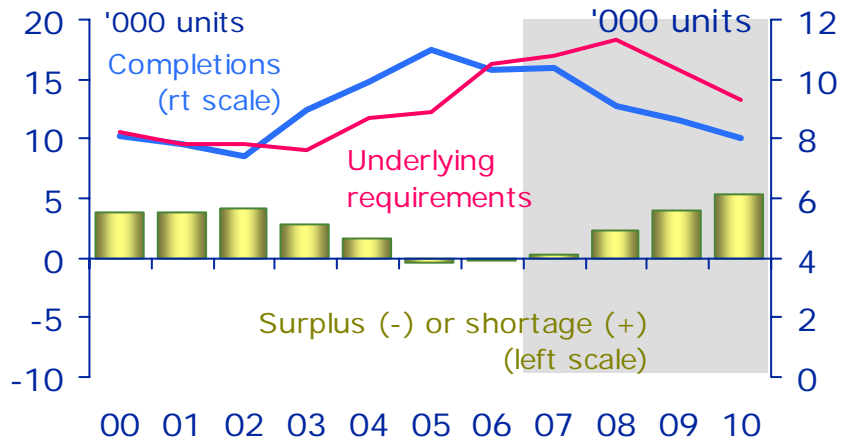
## Western Australia



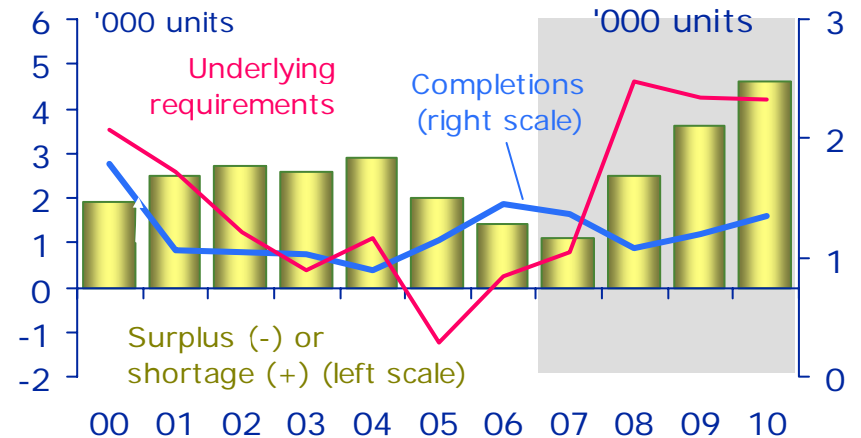
Note: see footnote to previous slide.  
Sources: ABS, Economics@ANZ.

# ... though smaller States and Territories will also have housing shortages

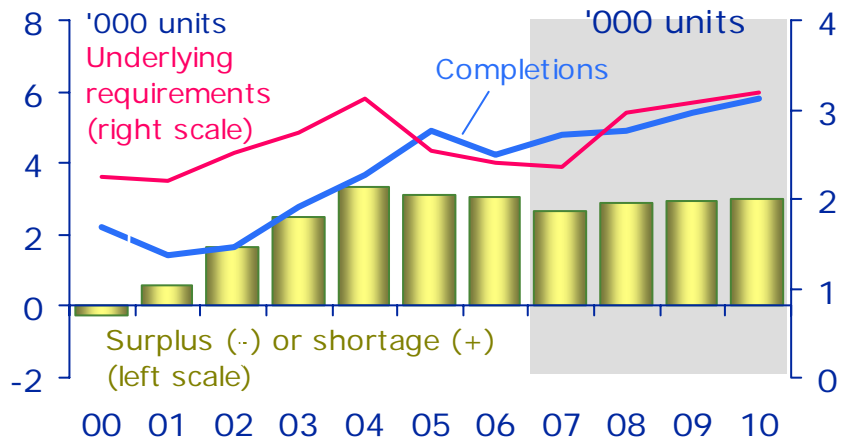
## South Australia



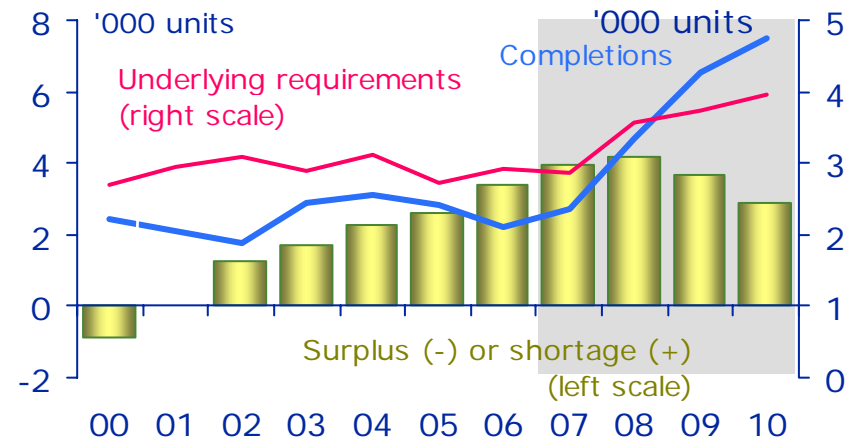
## Northern Territory



## Tasmania



## ACT

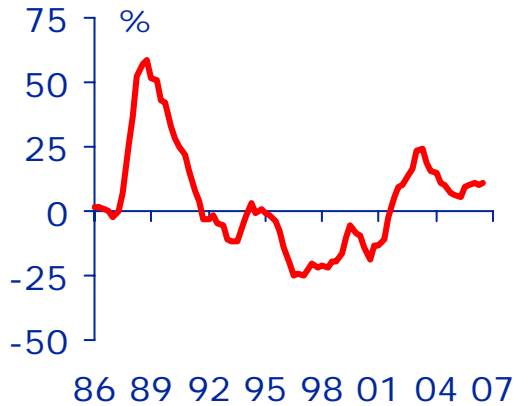


Sources: ABS, Economics@ANZ.

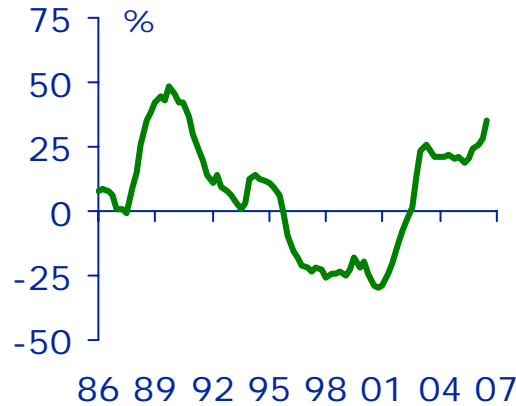
# House prices now look 'over-valued', especially in Perth ...

Established house price deviations from 'fair value'

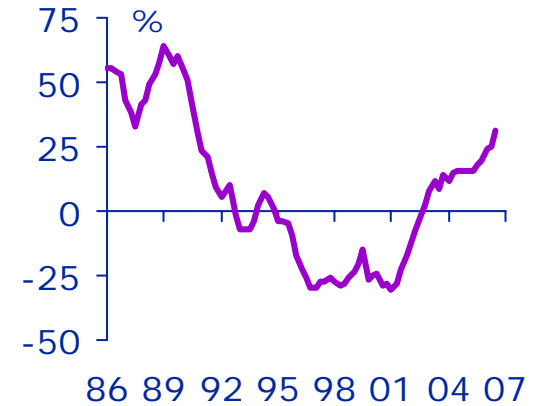
Sydney



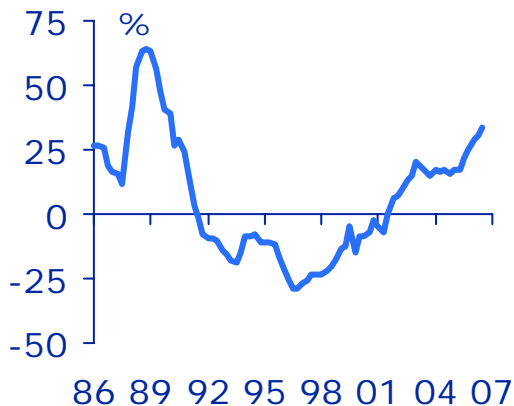
Brisbane



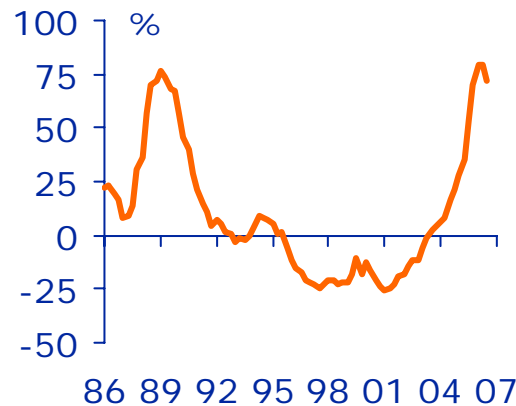
Adelaide



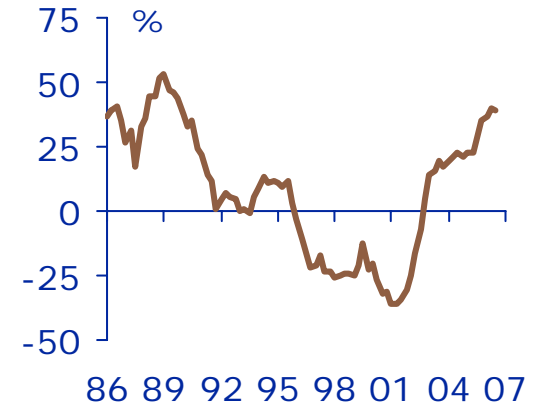
Melbourne



Perth



Hobart



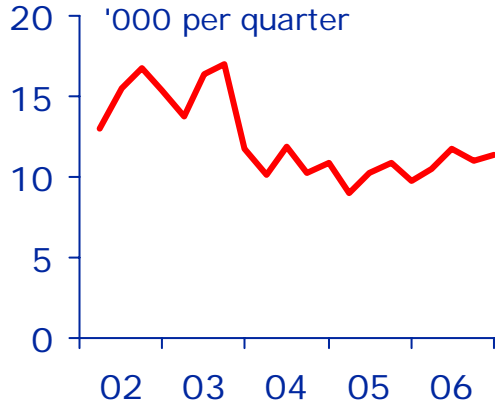
## ... but that doesn't necessarily mean that house prices are going to fall

- Housing market pessimists have for some time pointed 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'
- In such circumstances, it will be turnover rather than prices which decline

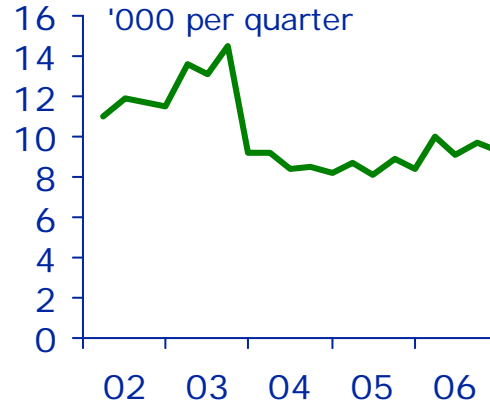
# Turnover, rather than prices, drop when buyers are priced out but owners aren't forced to sell

## Recorded transfers of established houses

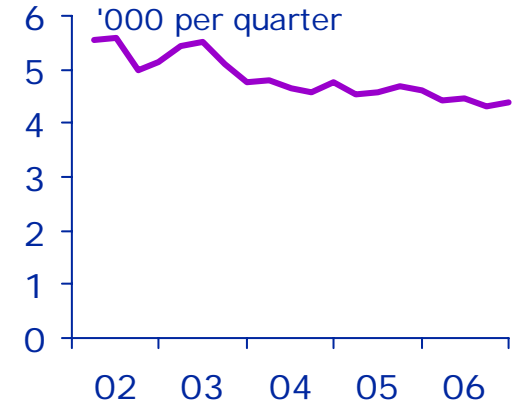
### Sydney



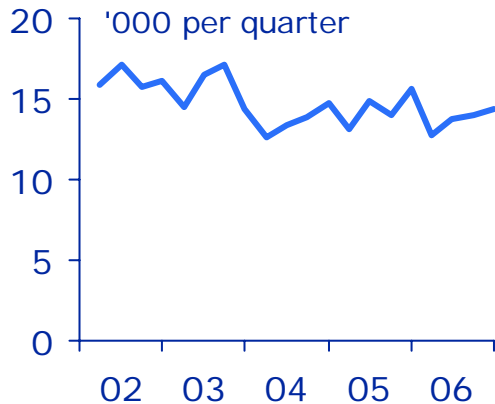
### Brisbane



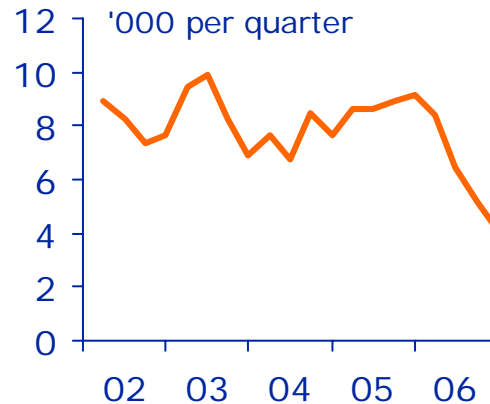
### Adelaide



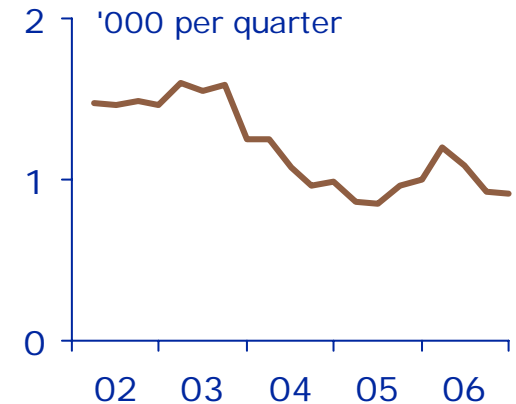
### Melbourne



### Perth



### Hobart



# Outlook for capital city house prices

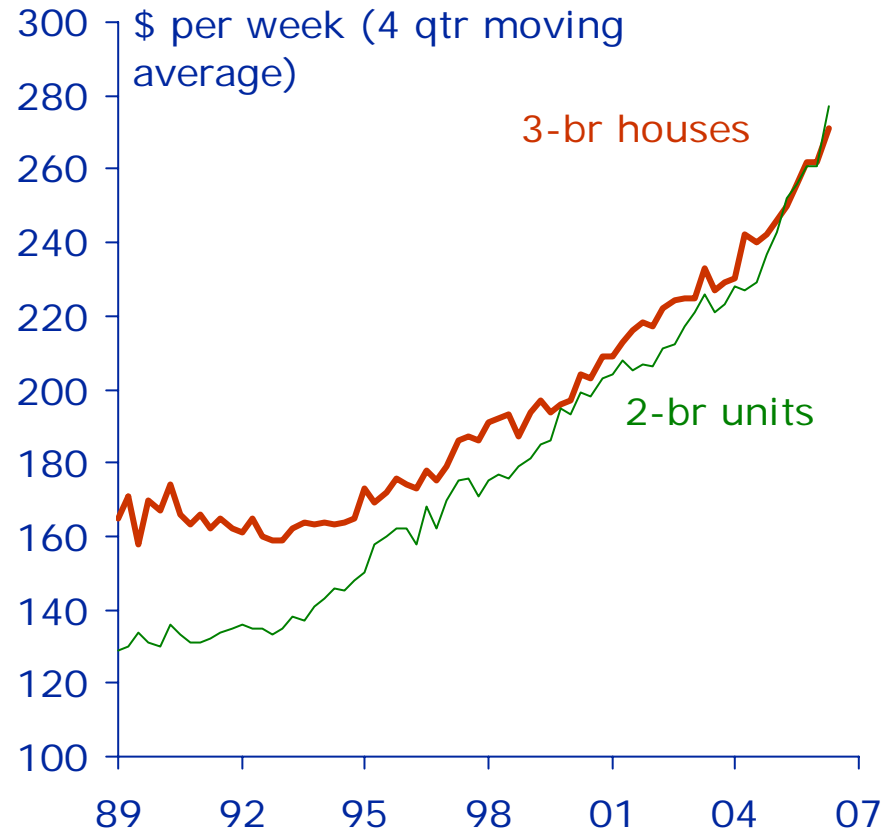
	Year ended 30 June 2008 (%)	2 years ended 30 June 2010 (% pa)
Sydney	8½	9-11
Melbourne	10	4-6
Brisbane	8	7-9
Perth	2	4-6
Adelaide	6	2-3
Hobart	2½	3-5
Darwin	5	3-5
Canberra	6	4-6
Average	7¾	6-8

# The housing shortage also implies further falls in rental vacancy rates and increases in rents

## Rental vacancy rate



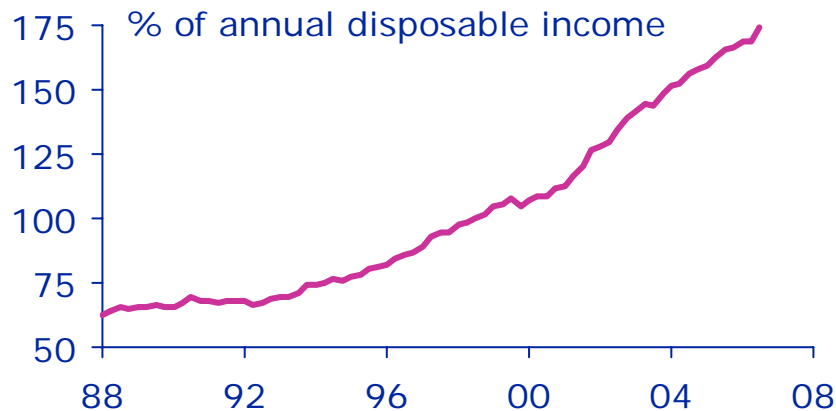
## Median rents



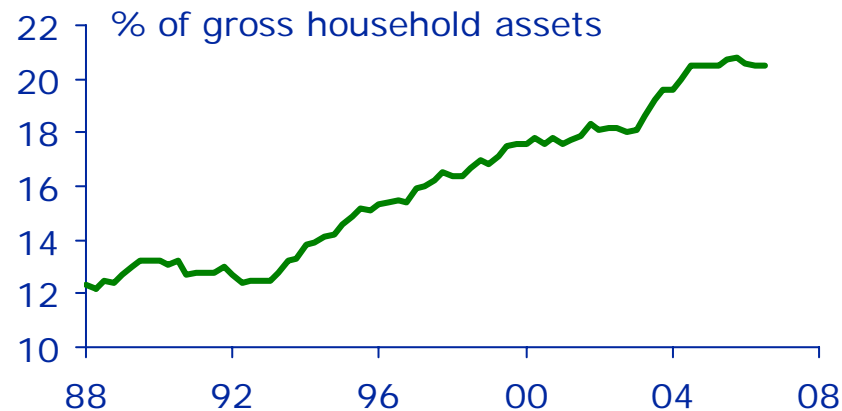
Note: data are weighted average of eight capital cities.  
Source: REIA; Economics@ANZ.

# 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



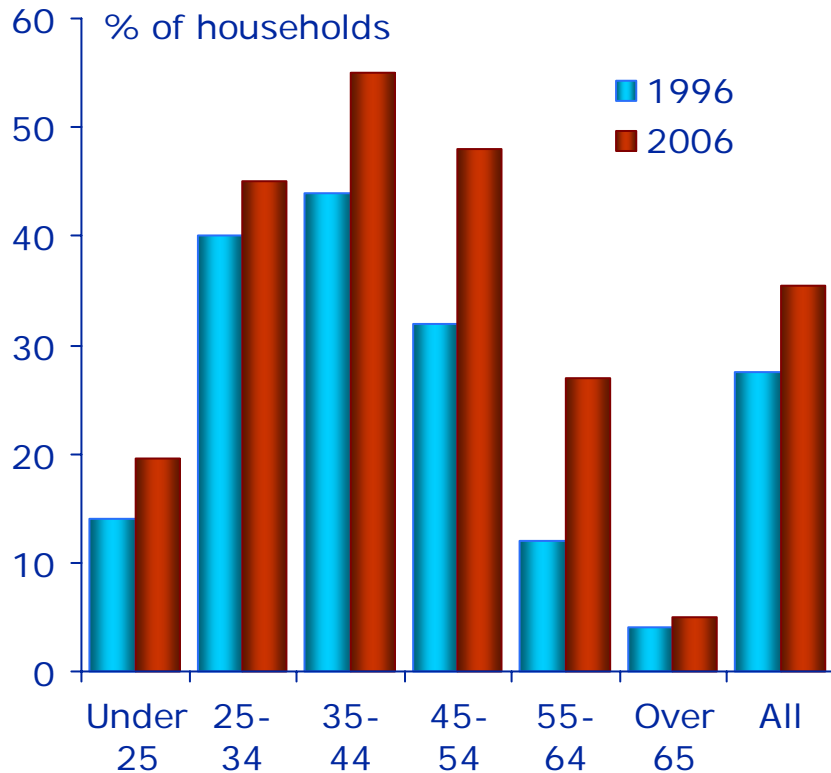
Sources: Australian Bureau of Statistics; Reserve Bank of Australia; Economics@ANZ.

# The increase in the debt-to-income and interest-to-income ratios reflects a variety of influences

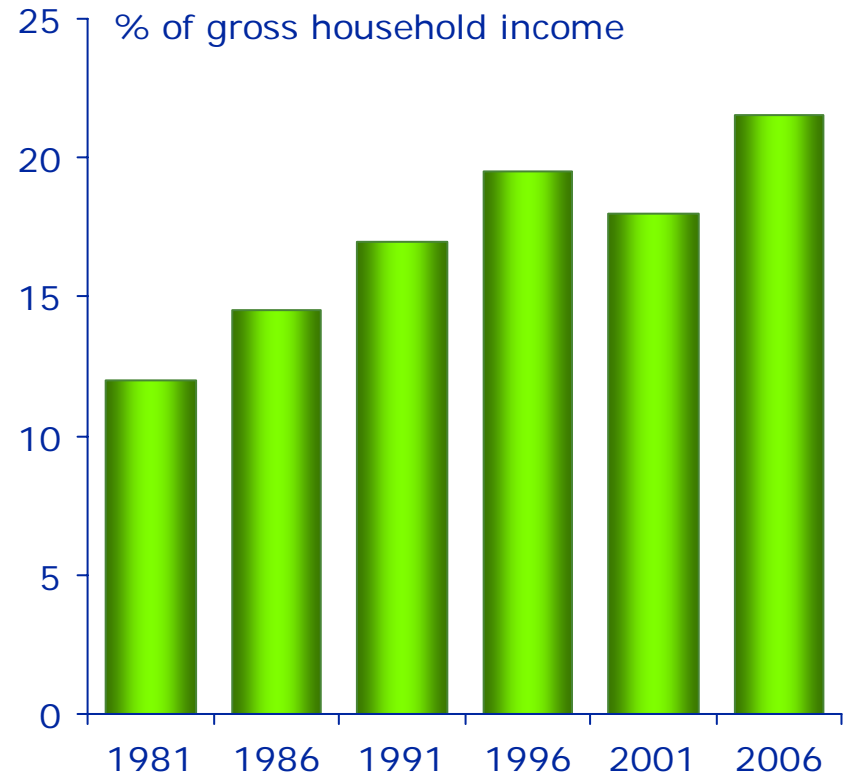
- House prices have risen from around 3½ times annual average disposable income in the early 1990s to 5¾ times today
  - so (for a given loan-to-valuation ratio) households have to take on a larger amount of debt relative to income in order to buy a median-priced house
  - there's cause-and-effect in this proposition
- There has been an increase in the proportion of households with owner-occupier mortgage debt
  - 35½% of households had a mortgage at the 2006 census, up from 27½% at the 1996 census
  - this increases the debt-to-income ratio for households as a whole even if the average debt for a household with a mortgage remains unchanged
  - according to the Reserve Bank, the median debt-servicing ratio of households with owner-occupier debt has risen only marginally from 20% in 1996 to 21½% in 2006
- There has also been an increase in borrowing for investment housing

# The rise in the debt service ratio over-states the rise in the ratio for households who have debt

Share of households in each age group with owner-occupier debt



Median owner-occupier debt-service ratio\* of households with owner-occupier housing debt

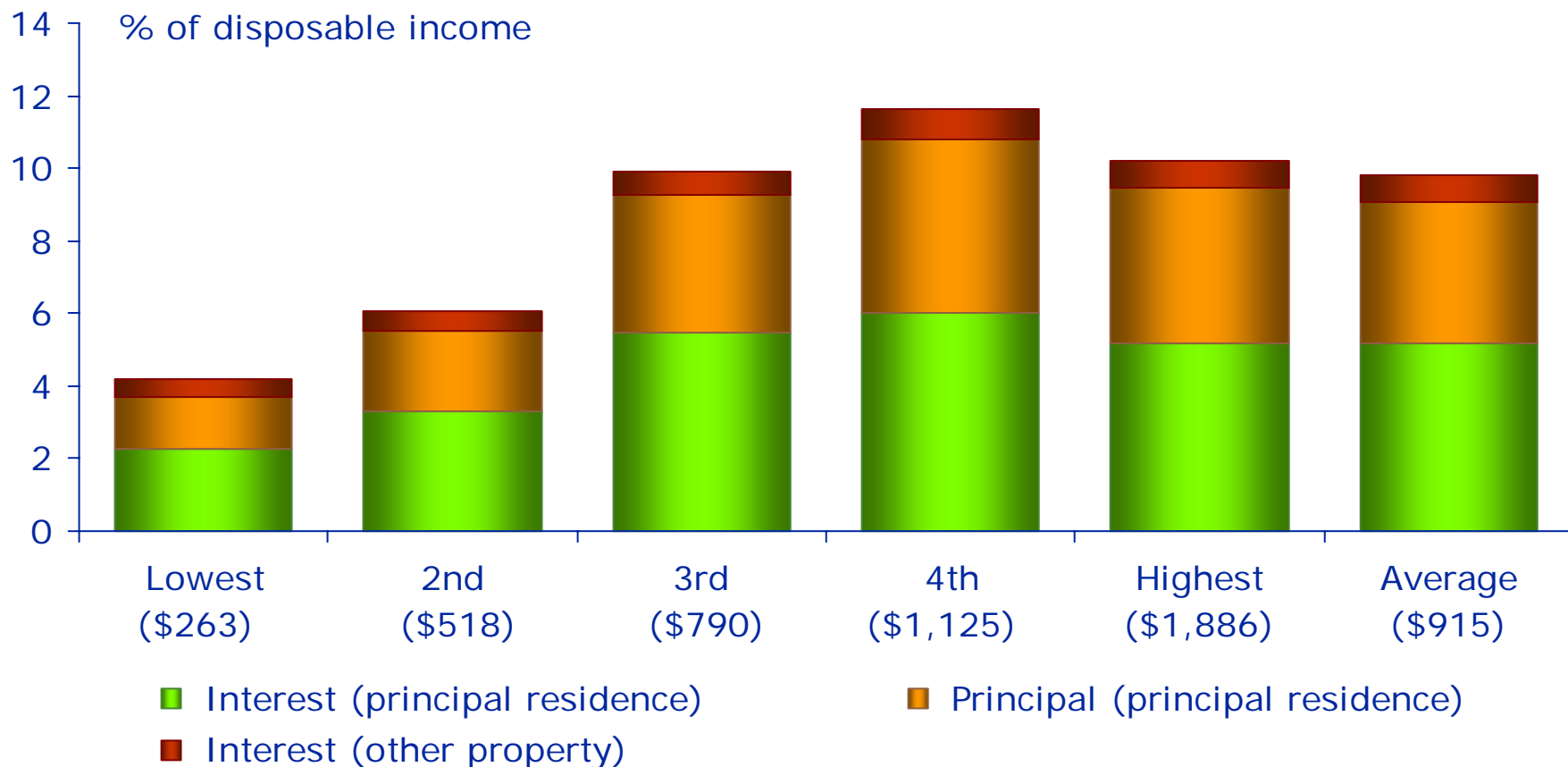


\* Owner-occupier interest and principal repayments (including any excess principal repayments) as a % of gross household income.

Source: RBA Financial Stability Review September 2007.

# 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

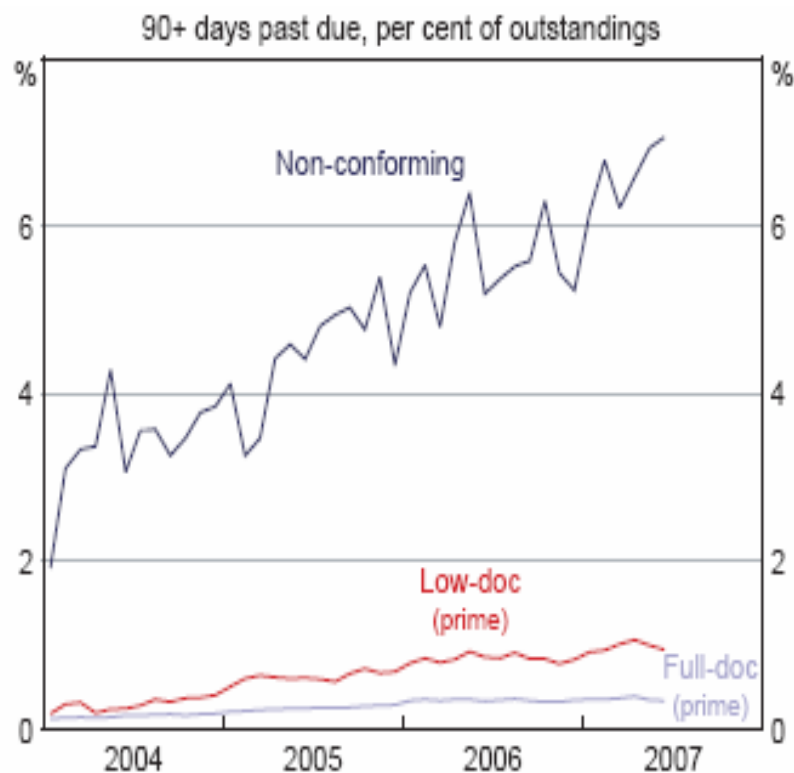
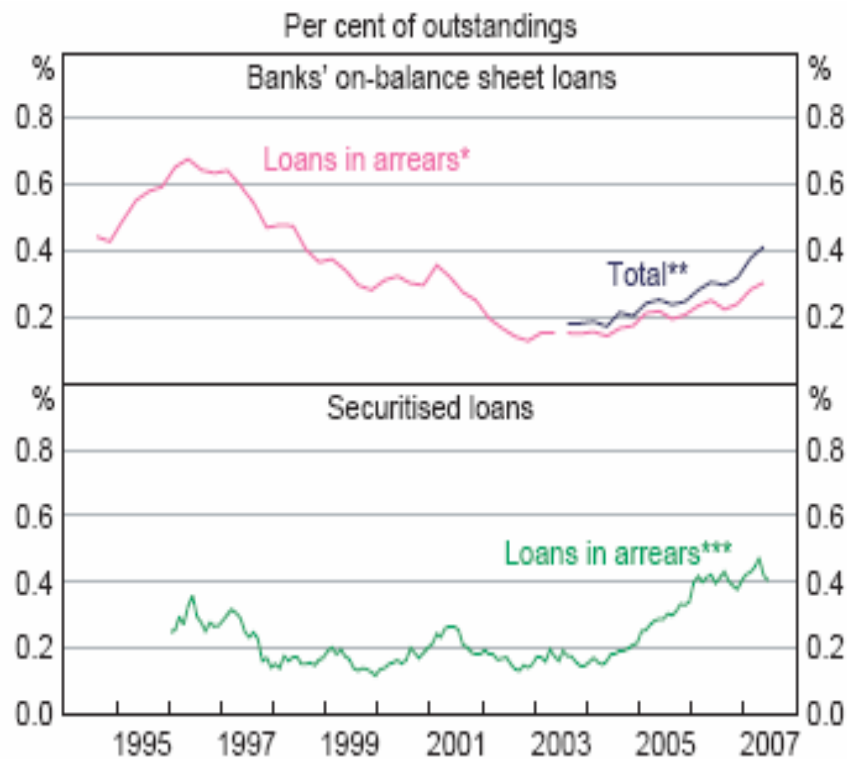


Note: Figures in parentheses show average weekly household disposable income for each quintile. Source: ABS (HES); Economics@ANZ.

# The proportion of mortgage loans in arrears is rising but is still very low

## Non-performing housing loans

## Housing loan arrears



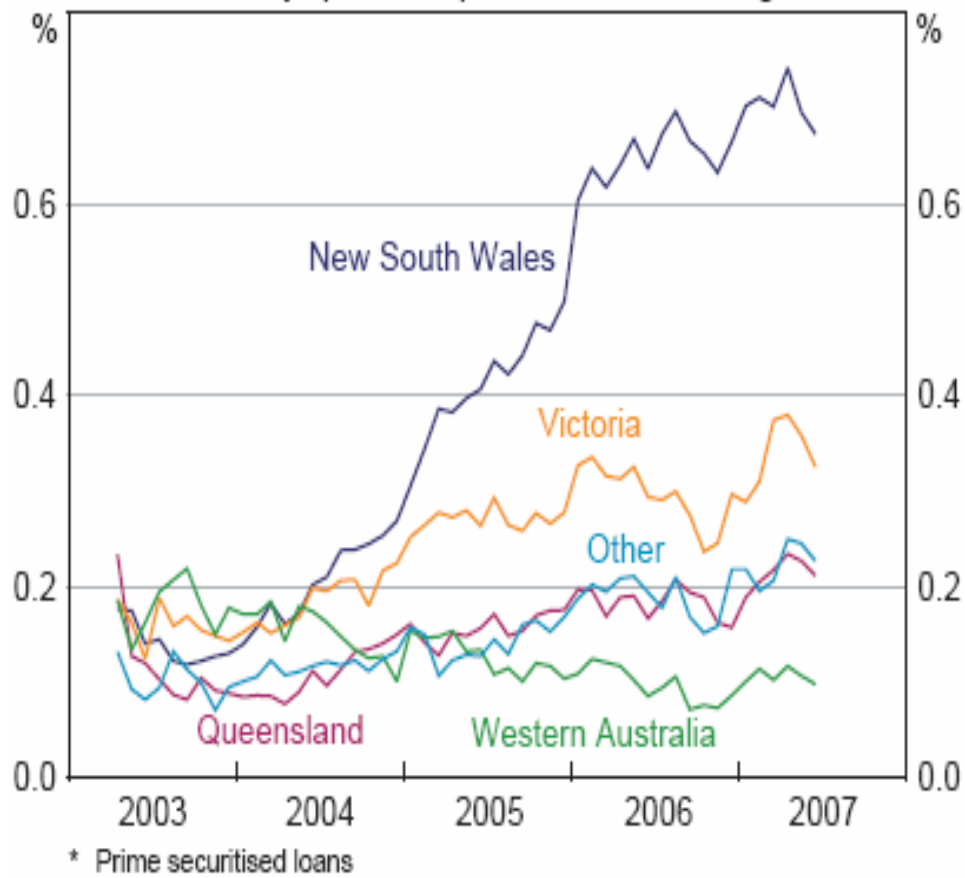
\* Loans that are 90+ days past due but otherwise well secured by collateral  
 \*\* Includes "impaired" loans that are in arrears and not well secured by collateral  
 \*\*\* Prime loans securitised by all lenders, 90+ days past due

\* Securitised loans

Source: Reserve Bank of Australia *Financial Stability Review* September 2007.

# Mortgage arrears have risen more in NSW than in any other State

## Housing loans 90+ days past due, by State

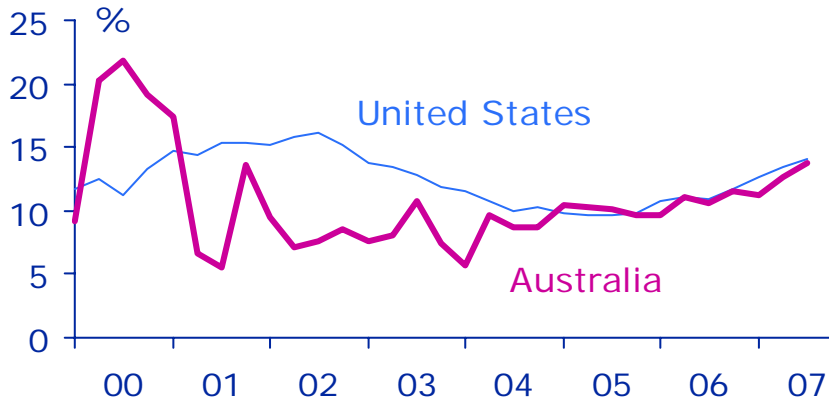


- Mortgage arrears (on prime loans) have more than doubled in NSW over the past three years, to a much higher level than in other States
- Of the 10 statistical divisions with the highest share of households with a debt-service ratio of over 30%, 8 are in Western Sydney
- According to the Reserve Bank, a disproportionately large number of households in this region took out investment housing loans at the peak of the Sydney housing cycle

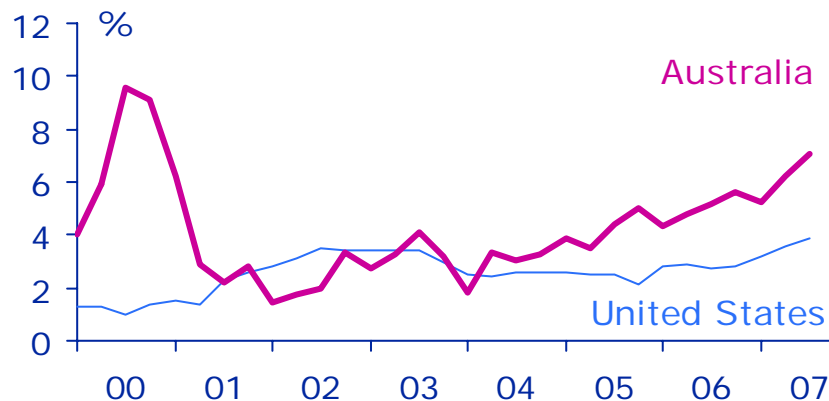
Source: Reserve Bank of Australia *Financial Stability Review* September 2007.

# Delinquency rates on Australian sub-prime mortgages are similar to or higher than in the US

## Securitized sub-prime mortgage delinquency rates 30-days+ past due



## 90-days+ past due

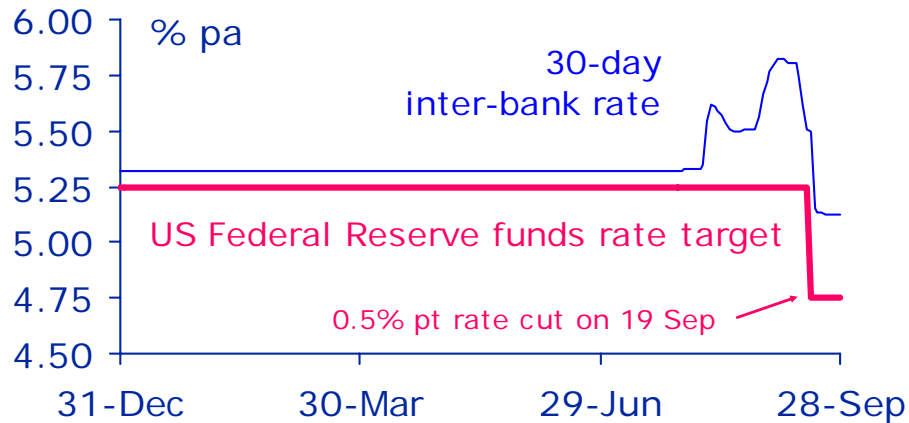


Source: US Mortgage Bankers' Association; S&P.

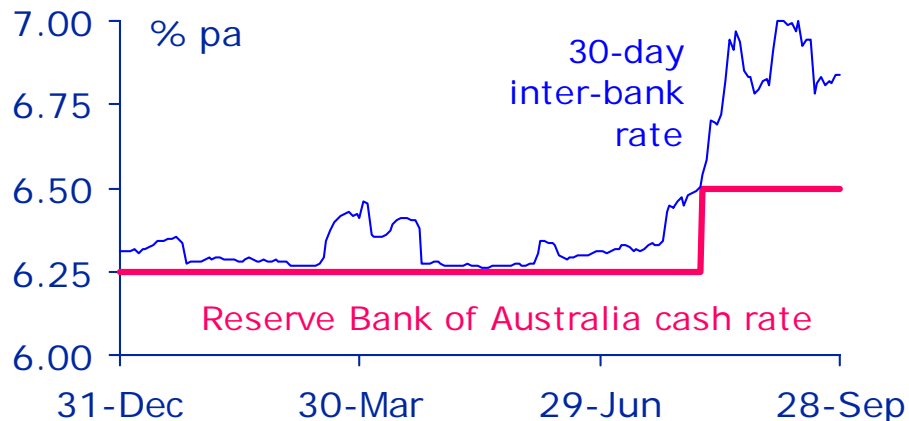
- Delinquency rates on sub-prime mortgages in Australia are similar to those in the US for 30-day periods ...
- ... and actually higher for 90 days past due
- What this means is that sub-prime mortgage delinquencies are rising more rapidly in the US than in Australia ...
- ... reflecting the fact that many US sub-prime mortgages written in the past few years have been on 'teaser' or 'honeymoon' terms and which are now re-setting at much higher interest rates
- Sub-prime mortgages account for just 1% of all mortgages in Australia, as against 15% in the United States

# Wholesale market interest rates have risen as a result of the US sub-prime meltdown

## United States



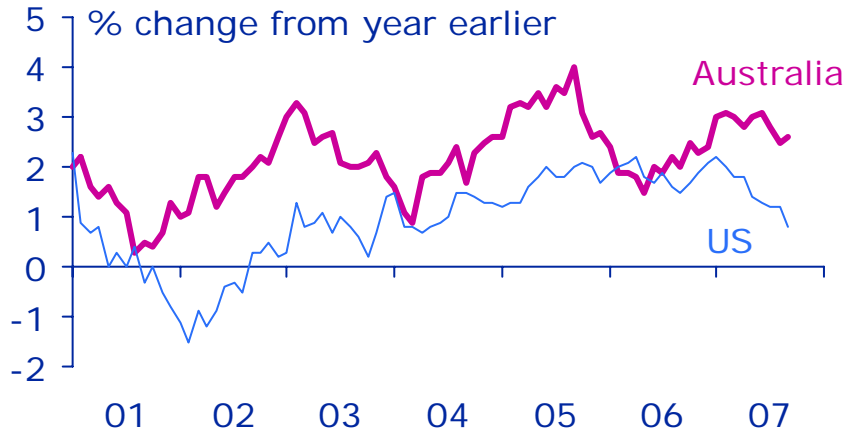
## Australia



- The US sub-prime mortgage meltdown prompted a loss of confidence in credit ratings and in asset-backed securities – and the effects weren't confined to the US
- Banks have become much more reluctant to lend to other financial institutions and more anxious to conserve liquid assets
- This has put upward pressure on short-term interest rates in wholesale markets, despite substantial efforts by central banks to 'inject liquidity'
- The US Federal Reserve has cut its cash rate, but other central banks seem unlikely to follow suit

# US rate cuts are warranted by slowing growth and inflation – that isn't the case in Australia

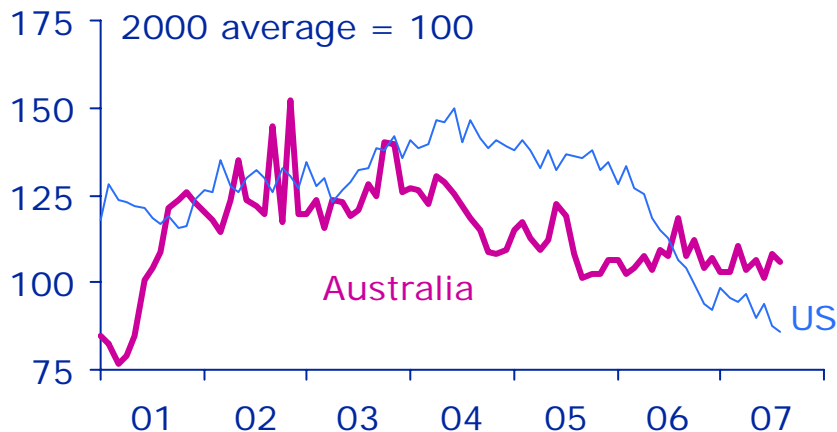
## Employment



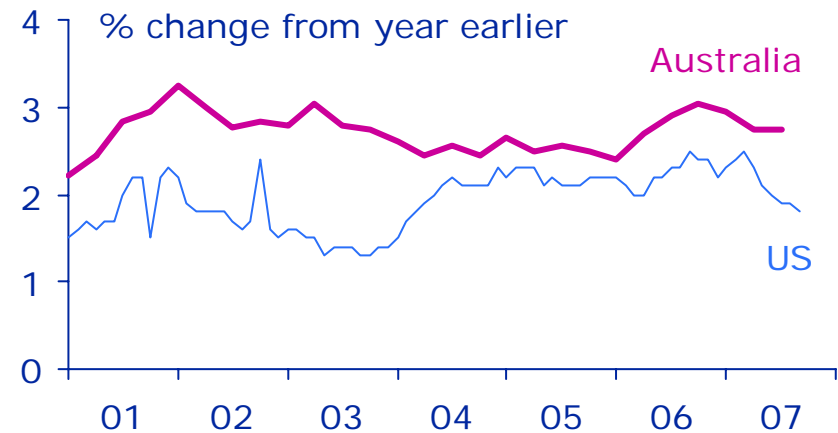
## House prices



## Housing starts



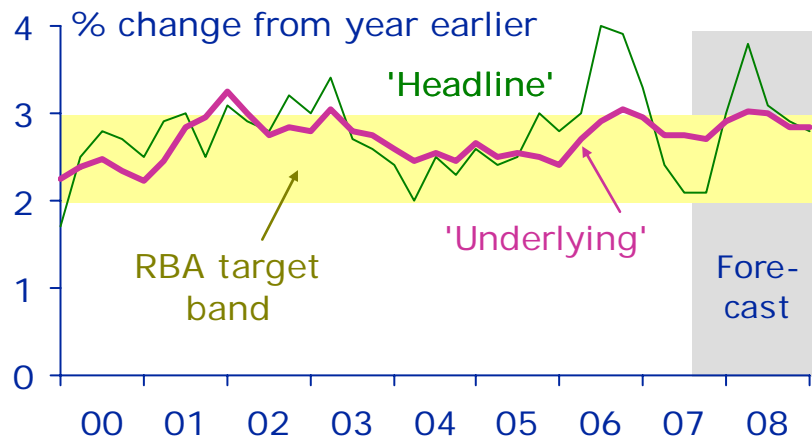
## 'Underlying inflation'\*



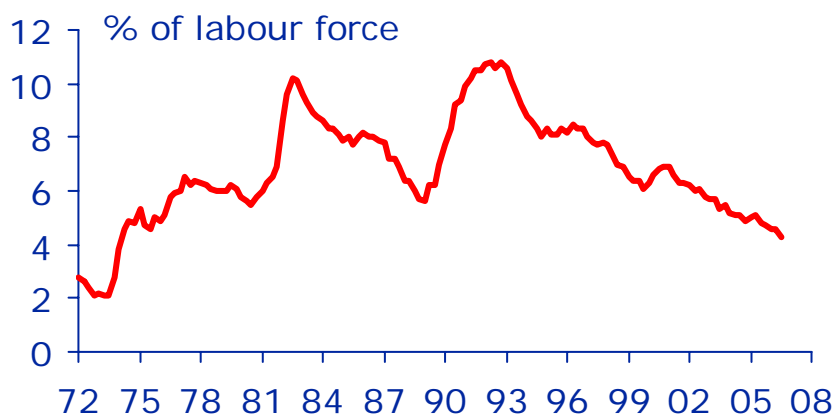
\* As defined by US Fed and RBA, respectively. Sources: ABS; US Bureau of Labor Statistics; Bureau of Economic Analysis; S&P.

# Most of the risks to the Australian inflation outlook seem tilted to the upside

## Consumer prices



## Unemployment rate

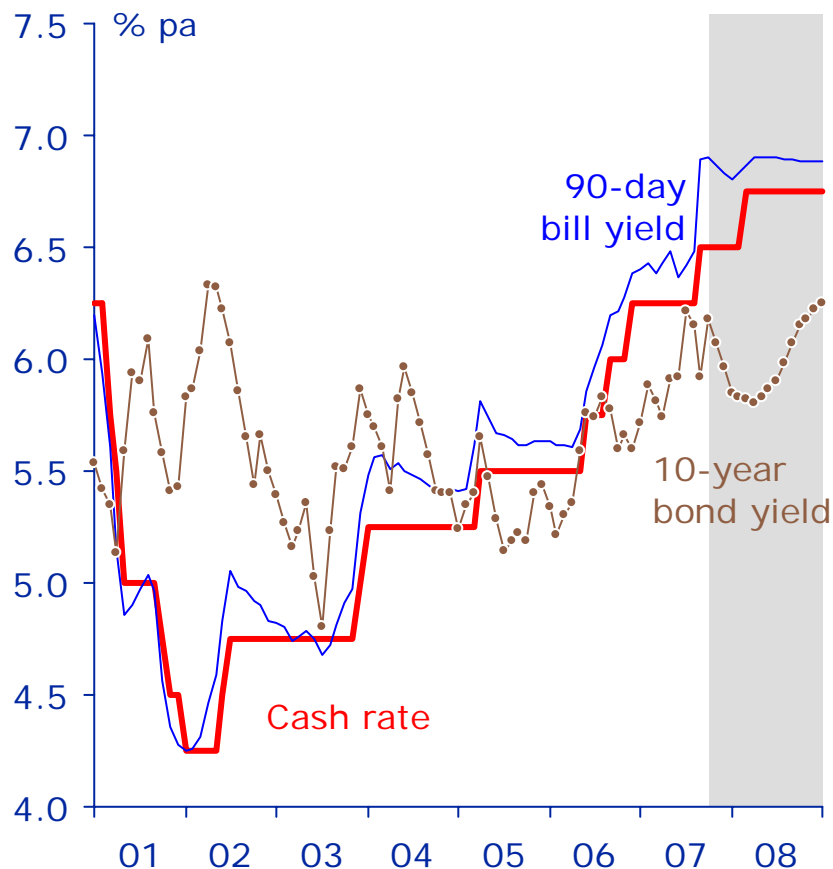


- Inflation tends to accelerate after the economy has been at or close to 'full capacity' for a while – and the Australian economy is now closer to 'full capacity' in many respects than at any time in 30 years
- At the same time demand is being boosted by buoyant commodity prices and substantial fiscal stimulus
- Particular areas of the CPI such as food and rents are likely to exert more upward pressure on inflation than in recent years
- Electricity and water prices are also likely to rise strongly
- The Reserve Bank thinks 'underlying' inflation will rise to 3% during 2008

Sources: ABS; RBA.

# Official rates will remain 'on hold' for the rest of 2007 but could rise again next year

## Australian interest rates



Shaded areas denote forecasts.

Sources: RBA; Datastream; Economics@ANZ.

- The August rate increase, the first in an election year in living memory, was prompted by the higher-than-expected June quarter inflation figure
- The RBA Governor has since indicated that a November election would not preclude a further rate increase should that be deemed 'necessary' (eg because of an uncomfortably high September quarter CPI)
- The rise in market interest rates over the past few weeks, if sustained, means an increase in official rates now looks unlikely this year
- The official cash rate is likely to rise again in 2008 given the inflation risks and the likelihood of an election 'bidding contest'

# Summary

- Housing prices have proven (and will remain) resilient in the face of modest increases in interest rates
  - reflecting the persistent excess of demand over supply
  - capital city house prices will likely rise by 6-8% pa on average over the next three years
- 'Housing affordability' is likely to deteriorate further over the next few years
  - and most of the proposed 'solutions' to this problem will make it worse rather than better
- Although Australian households are carrying a lot of debt by historical and international standards, the overwhelming majority of them are well-placed to service it
  - there is in fact scope for older and higher income households to take on more debt (if they wish to)
- Delinquency rates on Australian mortgages are rising, but remain low by historical and international standards
  - Fewer than 20 000 of the 5.3 million housing loans in Australia are 90 days or more overdue