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Australia’s property thought bubble

The Australian property market is far away from becoming over-inflated, according to a panel of economists and market analysts at this year’s AB+F Mortgage Innovation forum. Michael Davis reports.

There is probably a chart somewhere showing it, but intuition will have to do for now: it seems like every market economist outside Australia feels obliged to express a jaundiced view of our housing market, with the ‘b-word’ not far away.

In response, a panel of experts, including RP Data’s Cameron Kusher, Commonwealth Bank’s chief economist Michael Blythe, professional investor, Rob Camilleri and Moody’s Investor Services senior analyst Arthur Karabatsos, was brought together to refute the ‘bubble’ argument by outlining the state of play for the wider Australian economy and setting the scene for a more detailed discussion of the domestic housing market.

The panellists also addressed some of the differences between the Australian housing market and comparable offshore markets, particularly those in Europe and the US.

Michael Blythe opened the discussion by providing a relatively optimistic assessment of the Australian economy, subject to the usual economist’s caveat over certain risks.

“The Australian economic story is a very easy one to sell, especially to our clients overseas,” he said. “The trouble I find though, is when I’m speaking to our clients here, none of them believe it.

“Looking at the data, GDP growth last year was weaker than expected and if you look at the labour market, jobs growth has ground to a halt. While the economy still feels like it’s in pretty good shape, it’s not without some risks.”

Blythe said he expected the economy to grow at around trend this year, a marked improvement on the previous 12 months.

“If you talk about next year though, what you’ll find is pretty much every economist in the land - those at the Reserve Bank, those down at Treasury in Canberra and most private sector economists like myself - are forecasting something like trend growth.

“Trend growth in an Australian context means about three and a quarter per cent – while we didn’t quite get that last year I think it’s a pretty safe forecast for this next year.

And that’s because a lot of the Australian economic story is already locked in by this massive mining and construction boom that’s rolling through the economy.”

Even at a conservative organisation like the RBA, the mood is “almost bullish”, Blythe quipped.

Picking through the minefield

Blythe also touched on the uneven nature of growth in the Australian economy.

“Due to the mining boom, some sectors have got to step back and the only sector big enough to make room for the mining boom is the household sector,” he noted. “So the RBA is probably quite happy with the degree of caution they’ve seen across the consumer spending story and housing market story.”

Blythe also added his voice to the increasing chorus of economists and analysts factoring in a possible cut in the official cash rate this year.

Moving to the housing market, Cameron Kusher, senior research analyst at RP Data, observed that there was a big range in market performance across different geographic regions of the country.

“In 2011 we saw property values fall by about 4 per cent across capital cities and the falls are probably a bit less than that across regional markets – about 3 per cent,” he said, drawing out some of the highlights of the inaugural RP Data Property Capital Markets Report.

Diggers and dollars

While Sydney had barely seen a change in prices, Kusher noted that the poor performance of certain regional markets has been offset somewhat by strong performances in mining areas, such as the Pilbara region, Gladstone and the Darling Downs in Queensland.

“It’s quite a diverse performance right across the country, and the important thing to take out of that is, we talk holistically about the property market but each capital city, each region is quite different, and even within capital cities there can be a number of differences.”

Moody’s analyst, Arthur Karabatsos, added that the poor performance in a number of regional centres – which have among the country’s highest mortgage delinquency rates – could be explained by the fact that they are high tourism areas. In Queensland he noted, about 5.4 per cent of the state’s work force is employed by the long-suffering tourism sector.

Karabatsos said that the main driver of mortgage delinquency, other than falling house prices is “how much equity people have in their homes” – as measured by loan to value ratio (LVR). Many poor performing areas in terms of delinquencies such as the Fairfield and Liverpool areas in western Sydney, are characterised by high LVRs, he explained.

Downhill cycle

Rob Camilleri, from Realm Investment, said that rather than being in the midst of a property bubble, Australia may simply be experiencing an unfamiliar phase of a regular cycle.

“Australian property prices do go up and down quite regularly, they just don’t all go up and down at the same time,” he said

“Therefore you get these pockets of weakness, but that’s the nature of the Australian economy, because there are multiple levers of growth across the economy at any one time.

“So it’s important to keep in mind, when we talk about this concept of a ‘bubble’, there’s that rhetoric around expectation: [since] we’ve never seen an [overall] decline in property prices nationally, we assume that prices are too high."

Kusher pointed out that the rate of growth in house prices across capital cities had gradually slowed over the past ten years and was not a sudden change.

"Obviously we had that boom in values between 2001 and 2004, and that really was a one-off thing," he said.

"But if anyone is jumping into the market now, expecting they're going to see those sorts of capital gains over a short period of time, any time in the near future, they're absolutely kidding themselves."

In fact, on some of Kusher's numbers, even the supposed boom has been "exacerbated" over recent years, he asserted. "When you adjust for inflation, it's a different story – Sydney in particular, is well below its peak," Kusher said.

Supply and demand

CBA's Blythe explained that there are a number of unique forces supporting the property market in Australia, which explains why the country has not experienced a US-style "bursting of the bubble".

"Bubbles are pretty flimsy things and our housing market went through the stress-test a few years ago and came out the other side in pretty good shape," he said. "So that's probably a pretty good indication that it is not a bubble, as we know from historical experience."

Why did it come out in good shape?

Blythe said it comes down to "basic laws of supply and demand".

"The supply and demand balance in the Australian housing market, I believe, is putting a floor under house prices," he explained.

"We're just not building enough houses to keep up with the underlying demand in the economy. With the population growth we're seeing at the moment, we think Australia needs to build something like 185,000 new dwellings every a year. At the moment the rate is about 150,000 and there is [therefore] accumulated demand."

While strong demand for housing and housing shortages are common themes in many countries, Blythe noted that the key difference in Australia was that the banks kept lending even through a fall in prices.

"Therefore the demographic demand has translated into real demand, which places a powerful support under the market," he said.

The urban concentration effect

Michael Blythe, the CBA's chief economist re-iterated earlier this year that Australia suffers from what he characterised as "a significant measurement issue" in that residential property valuation calculations applied in other comparable economies do not work in Austrdalia for unique reasons.

"Australia is one of the most highly urbanised countries in the world. Most households reside in the capital cities," Blythe wrote in an economic note in February. This population concentration puts upward pressure on capital city dwelling prices. So house price to income ratios should vary with urban density. And equilibrium house price to income ratios should be higher in Australia than elsewhere."

Incomes are also higher in the capitals, so valuations based on capital city prices and Australia-wide incomes will have a natural upward bias, he pointed out. Further, these high population densities have some other implications:

• The dominance of the larger cities means Australia should be more susceptible to housing booms. In countries with less concentrated urban populations, price booms in one city have less effect on national average prices.

• Higher equilibrium house price to income ratios mean should mean that household debt to income ratios will be higher in equilibrium as well.

The implications of these arguments are that Australia's housing market is not the "bubble" that offshore observers perceive, but rather has a higher equilibrium point due to unique domestic factors that are well understood and have been in place for some time.

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