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AUSTRALIAN CONSTRUCTION INSIGHTS
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# Construction Brief

29 October 2018

## ‘A brief history of the housing cycle’

It is safe to say that the opening month of the spring selling season has been a bit of a fizzer. Auction clearance rates during the first month of the spring selling season are well down compared last couple of years. Home prices are retreating and this week’s price data is likely is likely to see prices move further into the red.

News about home price falls were all over the news last week and will be in the news again this week when CoreLogic release their monthly update. The inevitable barrage of negative headlines will deliver another hit to confidence in the housing market but this is all part of the cycle.

Housing markets are continuing behave in cyclical fashion but there are a few aspects of the current cycle that are a little atypical.

In the past, bouts of home price growth have coincided with broader inflationary pressures so conventional monetary policy (i.e. a couple of interest rate hikes) was enough to cool things down. This time around broader inflationary pressures have been notably absent so the RBA have been hamstrung by their mandate to restore the rate of inflation. The RBA had little choice but to leave rate the cash rate at historic lows.

Meanwhile, there was growing concern that lenders had succumbed to the temptation to grow their loan book by competing for business at the cost of borrower quality. Enter APRA.

The banking regulator saw investor lending as the segment most likely to present a risk, to both the banking sector and the housing market and acted decisively. In late 2014 APRA instructed lenders to limit growth in their investor loan book to 10% per annum. The market subsequently recalibrated, only high quality borrowers could access credit and at a higher cost. Investor credit growth dropped well below the 10 per cent speed limit.

With rising unemployment and inflation still lacking any momentum, the RBA cut the official cash rate again. This overcame the cost barrier for marginal investors and they returned to the market, which undid APRA’s effort to reign them in.

At the same time, there was a groundswell of public concern about foreign investment in residential property. Our elected officials responded with due regard for popular opinion and we now have a raft of punitive taxes designed to ensure that foreign investors know that their capital is not welcome in Australia, even if they are contributing to the resolution of Australia’s housing shortage.

APRA’s next move was to restrict access to credit further. In late 2017, their focus had shifted to interest only lending. In an environment of rising home prices, modest growth in rental prices and stagnant wage growth, home buyers (both investors and owner-occupiers) were increasingly turning to ‘interest only’ lending products to increase their purchasing power. APRA instructed lenders to cap the share of lending on interest only terms at 30 per cent of new loans.

Property investors have seen the writing on the wall and have retracted from the market. Growth in investor lending has subsequently dropped to a historic low (1.5 per cent over the year to August). Owner-occupiers still need a roof over their heads and remain active in the market but there are now signs that they too are becoming less active.

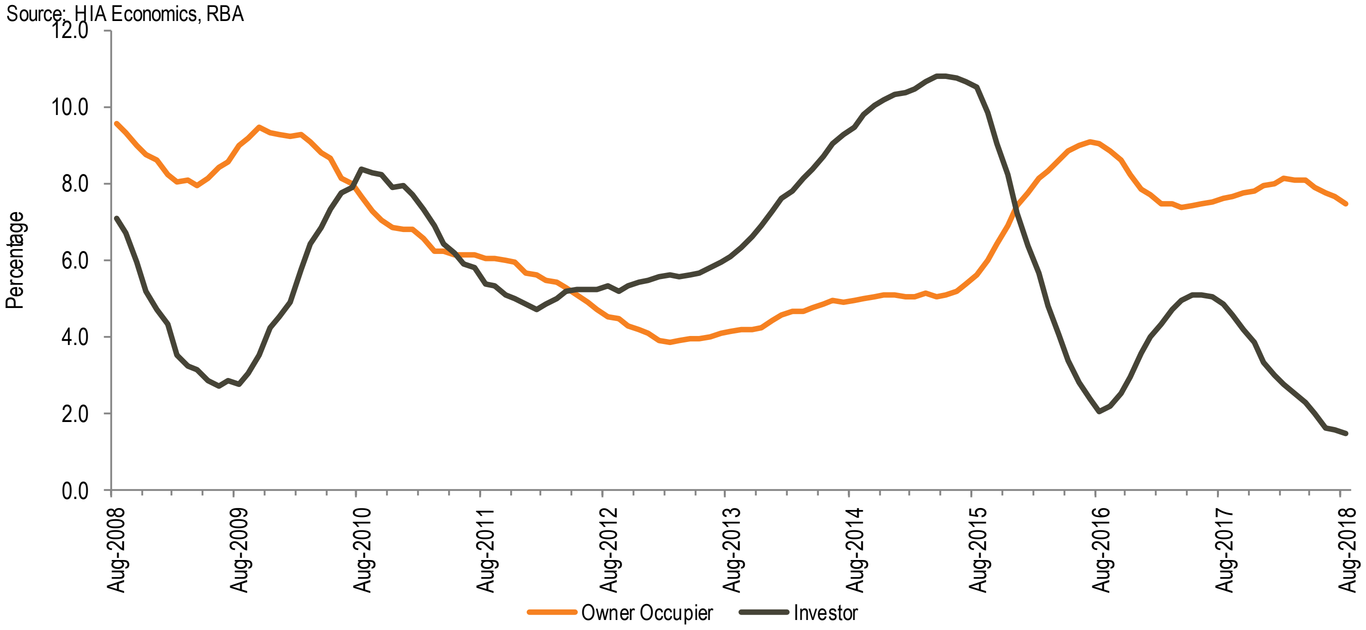
There is also growing concern that those who have previously been able to access finance on interest-only terms won’t be given the option to refinance on the same terms when the term of their existing interest only loans expire. This will force some households to reduce the size of their mortgage while others will need to direct more of their cash flow to repaying principal and interest loans.

In light of the fact that the banking regulator has done its best to orchestrate a moderation in home lending, governments have done the job of taxing foreign investors out of the market and the Hayne Royal Commission has lead to changing practices in the banking and finance sector, it shouldn’t be at all surprising that the market is now in a retreat.

Regulatory intervention kick-started the downturn but it now looks to have legs of its own. The question now is how far prices will fall and what would trigger the regulators to pull back on their restrictions on lending.

From the peak, the median dwelling price in capital cities has declined by 6.3 per cent to date (-9.1 in Sydney and by -4.4 per cent in Melbourne). The decline to date is not likely to cause regulators any concern but further declines are expected. Will they dial it back when price levels get back to 2016 levels, 2015 levels or 2014 levels? Regulatory interventions that were designed restore order to an overheated market now pose a risk that could destabilize the market in a cooling market.

## Annual Growth in Housing Credit




**The fortnight ahead – key dates and releases (AEST)**

**Monday 29 October**

HIA New Home Sales Report, September 2018, 11.00am

**Tuesday 18 October**

HIA Trades Report September 2018 quarter, 11.00am

ABS Building Approvals, September 2018, 11.30am

**Wednesday 31 October**

ABS CPI, 11.30am

**Tuesday 6 November**

ABS Regional Building Approvals September 2018, 11.30am

**Friday 9 November**

ABS Housing Finance September 2018, 11.30am

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