Your window into the future of the construction industry

AUSTRALIAN CONSTRUCTION INSIGHTS
Research powered by HIA Economics

Construction Brief

09 July 2018

Could the next RBA move be down?

Two months ago the RBNZ changed their expectations of their next move – from an increase in rates to a neutral stance. There are some economists who think that the RBA will follow suit and at some stage in the next year or two move the cash rate down.

The argument runs that: A rapid rise in energy prices has a similar impact on household demand as a rise in rates. It also dampens business investment.

It has not just been retail electricity prices that have increased 100 per cent in a couple of years. Retail gas prices have doubled over the same time and transport fuels have also seen a significant price rise in recent months.

Add to this, a rise in the effective interest rate faced by borrowers as banks tighten their lending practices in light of falling house prices. The rising cost of borrowing internationally will eventually flow through to higher effective rates (if the AUD does not devalue). The Banking Royal Commission receives considerable attention for causing this tightening in finance, but the move was most likely started in response to an increased risk that borrowers experience negative equity due to falling house prices.

Falling house prices is something that happens routinely, usually following a period of rapid prices rises. The fall in prices tends to last twelve to eighteen months and results in a 5 per cent to 10 per cent reduction in average prices.

For the fall in house prices to go beyond these historical norms would require a fundamental imbalance between the supply of and demand for new housing.

There is an automatic stabiliser in this situation. As house prices fall, existing houses become increasingly attractive to home buyers. On the other hand, new homes have fixed costs. The price of land was set years ago. The cost of materials is largely fixed. There can be some variability in builder margins but in the majority of occasions this is a highly competitive market and super normal profits are not readily available.

Add to this, first home buyers are no longer in a rush to enter the market as they can delay their purchase and expect lower prices. Existing homes will sit on the market unsold for longer, but for the new home market, it means fewer home sales and slowing building activity.

In this case, if Australia's population growth were to slow dramatically at a time when the domestic demand for homes is slowing, then there could be additional downward pressure on house prices.

Australia's population growth rate has been slowing for more than a year.

Hidden amongst the ABS population data released two weeks ago is a recalibration of its estimate of resident population based on the 2016 census (see figure below). The ABS has also made changes to the way it estimates resident population by switching to more reliable data than the passenger arrivals cards.

Previously the ABS had estimated our resident population growth rate was still accelerating. What we now know is that Australia's population growth rate has been slowing since March 2017. This is a material change that impacts GDP expectations.

These revised resident population figures show that Australia's population growth rate peaked in March 2017 at 1.69 per cent and has slowed to a growth rate of 1.59 per cent in December 2017.

The slowing growth rate coincides with the Government policy changes in April 2017 which tightened visa availability for students and skilled migrants. Intuitively the consequence of this policy shift is a slowing in the rate of net overseas migration.

This in itself is not of concern. A population growth rate of 1.59 percent is still very strong. The concern is, if this trend continues - against a backdrop of tightening lending conditions, slow wages growth, slowing building activity and falling house prices – it could set the framework for the next move in interest rates to be downward.

It is possible to paint a picture of a doomsday scenario for the Australian economy but the probability of this occurring is very small. A brief look at the macro indicators shows us that GDP growth is strengthening, unemployment is low and population growth is strong. Add to this, the dramatically increasing value of Australia's exports (due to the increasing volume and value of core exports, namely coal and iron), while key gas projects in Queensland are entering their 20 to 30 year production phase providing valuable export dollars. With these conditions in place there would need to be a material change to these macro factors before the RBA could even entertain a discussion on a downward move in interest rates.

The fortnight ahead – key dates and releases (AEST)

Wednesday 11 July

Westpac-MI Consumer Sentiment, July 2018

ABS Building Activity, March Qtr 2018, 11.30am

ABS Housing Finance, May 2018, 11.30am

Friday 13 July

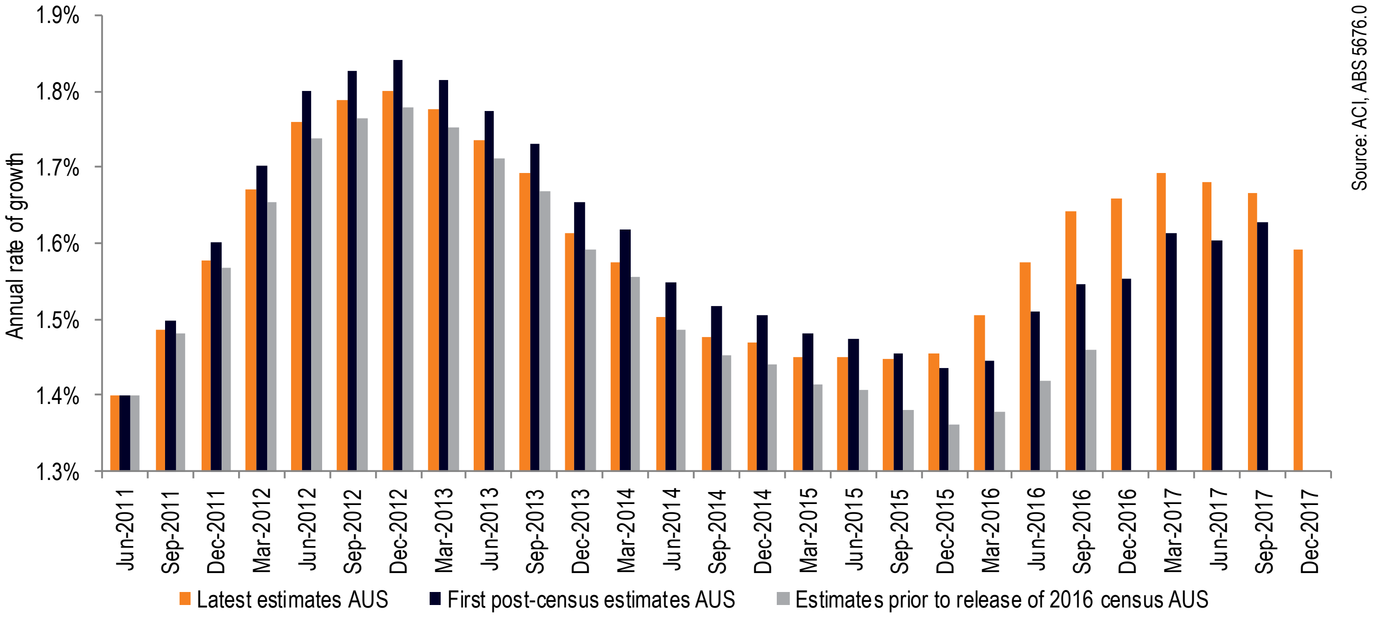
ABS Lending Finance, May 2018, 11.30am

Thursday 19 July

HIA Affordability Report, June 2018, 11.00am

ABS Labour Force, June 2018, 11.30am

REVISIONS TO POPULATION GROWTH ESTIMATES



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