Malcolm Edey: Inquiry into affordable housing

Opening remarks by Mr Malcolm Edey, Assistant Governor (Financial System) of the Reserve Bank of Australia, and Ms Luci Ellis, Head of Financial Stability Department of the Reserve Bank of Australia, at Inquiry into Affordable Housing, Canberra, 2 October 2014.

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Thank you, Chair, for the opportunity to discuss the Reserve Bank's views on this important topic of housing affordability.

This is a subject on which the Bank has published a good deal of analysis over the years. I will refer in particular to our submission to this Inquiry in February, and also to our most recent *Financial Stability Review*, released last week, which covers our assessment of current developments. My colleague Luci Ellis was the author of the February submission and she will be happy to answer any detailed questions on its contents in due course.[1] In these opening remarks, I will be drawing on some of the key points from those two sources.

There are a number of things that people might have in mind when they use the term "affordability". Affordability measures will differ depending upon whether we are talking about owners or renters, and on whether we are interested in some specific market segment, like first home buyers or low-income households. For owner-occupiers, perceptions of affordability will depend on many things including price, household income, the cost and availability of finance, and a host of factors affecting the needs and aspirations of the buyer. In any analysis it is necessary to make use of summary measures, while acknowledging that these inevitably gloss over the diversity of experience across different types of households.

Much of the public discussion on affordability is focused on home purchasers. A useful summary measure is the repayment on a typical new housing loan expressed as a ratio to disposable income. On that metric, housing affordability in Australia has fluctuated around a broadly stable average over the past three decades, with average repayments varying between around 20 and 30 per cent of disposable incomes. These data are reported in our submission. Currently this figure is a bit below average, but it has been rising in the period since the publication of the submission, as the housing market has gathered momentum.

Over the same 30-year period, the ratio of housing prices to incomes has increased substantially. These developments in prices and affordability have been inter related. Housing prices received a substantial boost from the combined effects of disinflation and financial deregulation, which lowered the cost and increased the availability of finance. Much of the increase in the price-to-income ratio was concentrated over the 10-year period to the end of 2003, when this ratio increased by around two-thirds.

It is reasonable to think of this as a transitional impact on housing prices that will not re-occur. Both the shift to low inflation, and the comprehensive deregulation of the financial system, are things that only happen once. In broad terms, the adjustment of the housing market to this new environment seems to have been completed by around the middle of the last decade. Since then, the ratio of housing prices to incomes has been relatively stable but, for reasons already alluded to, it has been rising recently and is now at the upper end of its recent range. I will return to this point in a moment.

To summarise these stylised facts:

- the ratio of housing prices to incomes is at the top of its historical range; but

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[1] RBA 2014, *Submission to the Inquiry into Affordable Housing*. Submission to the Senate Economics References Committee, February.

- over time, this has been more than offset by falls in financing costs, so that the typical repayment burden as a share of income is not particularly high. This of course does not rule out affordability problems in particular market segments or for particular types of households.

Our submission made the point that there is no shortage of housing finance in Australia. Housing loan interest rates are currently as low as they have been in a generation, and households are not artificially constrained from borrowing as much as they can reasonably be expected to repay. I have already made the point that perceptions of affordability will differ across different types of households; but, if there is a perceived affordability problem in Australia, it is not due to a lack of finance.

An important theme of our submission was that housing prices and affordability are affected by the interaction of both supply and demand factors. The factors that I have mentioned so far, such as household incomes and the cost and availability of finance, primarily affect the demand side of the market. In the short to medium term, it is these factors that will tend to have the predominant influence on housing price movements. The reason for that is that the supply side of the market is dominated by a large existing stock of dwellings, and new supply takes time to come on stream.

In the longer term, however, supply factors are critically important. It is the supply response that determines the extent to which additional demand results in higher prices over time.

Our submission highlights that Australia faces a number of longstanding challenges in this area, including regulatory and zoning constraints, inherent geographical barriers and the cost structure of the building industry. There are also obstacles to affordable housing created by Australia's unusually low-density urban structure, though this is gradually changing.

Our submission does not seek to offer policy prescriptions for improving the supply-side response. The general point I would make is that we can't improve housing affordability simply by adding to demand. Targeted assistance can certainly help particular groups such as first home buyers, but without a supply-side response, any generalised increase in demand will just be capitalised into prices. Hence an important emphasis in our submission is that due attention needs to be given to supply-side factors in any policy response to perceived problems of affordability.

Let me turn now to some current developments.

I have already mentioned the recent strength in Australian housing prices and I expect the Committee will be interested in the Bank's current assessment of this, particularly in light of the comments made in our *Financial Stability Review* last week.

Over the past couple of years, housing prices in Australia have been rising strongly. Some of this perhaps represented an element of "catch up" after some earlier weakness. Nonetheless, prices have continued to rise significantly faster than incomes, and this has been associated with strong growth in investor activity.

To cite a few key facts and figures:

- National housing prices have been rising at a rate of around 10 per cent over the past year, and around 15 per cent in Sydney.
- The rate of growth of investor finance is significantly outpacing the growth in household incomes.
- Loans to investors currently account for close to 50 per cent of new housing loan approvals.
- Investor activity has been particularly concentrated in New South Wales and Victoria. In New South Wales investor loan approvals have increased by about 90 per cent over the past two years.

It is against this background that the Bank said in its *Financial Stability Review* last week that the composition of housing and mortgage market activity is becoming unbalanced. The review also indicated that we are discussing with APRA steps that might be taken to reinforce sound lending practices, particularly for investor finance, though not necessarily limited to that.

I want to emphasise that the banks in Australia are resilient, and mortgage lending in this country has historically been relatively safe. APRA has, however, noted a trend to riskier lending practices, and over the past couple of years has been seeking to temper these through its supervisory activities. There are also broader concerns with the macroeconomic risks associated with excessive speculative activity, since this activity can amplify the property price cycle and increase risks to households.

Our discussions with APRA and other agencies on these matters are ongoing, and there will be more to say about them in due course. For now, my colleague and I will be happy to take any questions that you might have.