Economic Insights

CommSec

Economics | October 6, 2021

Regulator responds to housing market risks

Financial market issues

Home lending

- The regulator of banks, insurance companies and superannuation funds – the Australian Prudential Regulation Authority (APRA) – has today increased the minimum interest rate buffer it expects banks to use when assessing the serviceability of home loan applications.

- The letter sent to lenders (Authorised deposit-taking institutions or ADIs) can be found here.
https://www.apra.gov.au/strengthening-residential-mortgage-lending-assessments

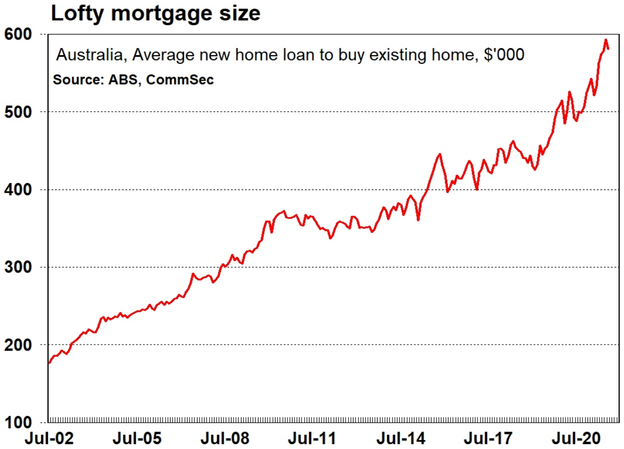
- The media release and additional background information are here:
https://www.apra.gov.au/news-and-publications/apra-increases-banks%E2%80%99-loan-serviceability-expectations-to-counter-rising

- In short, the central decision is: *"APRA has told lenders it expects they will assess new borrowers' ability to meet their loan repayments at an interest rate that is at least 3.0 percentage points above the loan product rate. This compares to a buffer of 2.5 percentage points that is commonly used by ADIs today."*

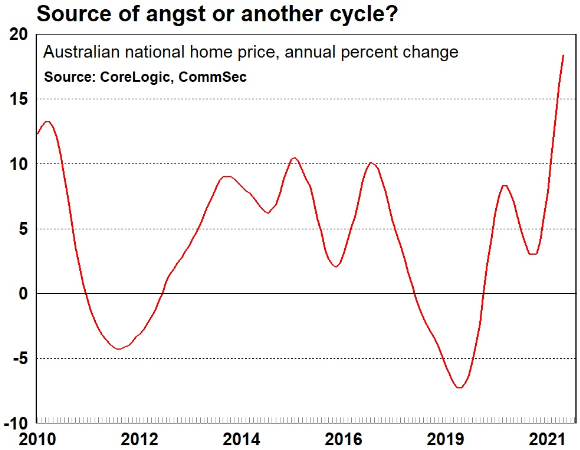
- APRA said that its decision *"is supported by other members of the Council of Financial Regulators (CFR), comprising the Reserve Bank of Australia, the Treasury and the Australian Securities and Investments Commission. In determining its course of action, APRA also consulted with the Australian Competition and Consumer Commission."*

- The decision is set against the background of the lowest interest rates ever recorded in Australia as the Reserve Bank attempts to supports and stimulate and economy buffeted by Covid-19. Low interest rates, government grants, Covid working-from-home arrangements and solid job security have translated to strong demand for homes. The Reserve

Lofty mortgage size

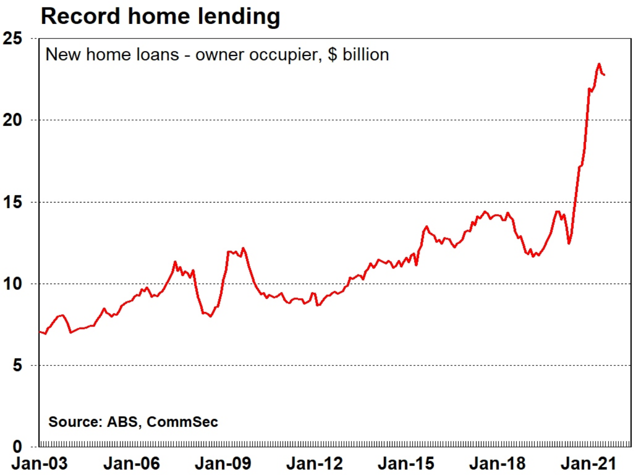


Source of angst or another cycle?



Bank has also indicated that rates are unlikely to rise until 2024, further underpinning the desire to borrow to buy property.

- At the same time that demand for homes has been super-strong, Covid-19 has been a key factor restricting the supply of homes on the market. Potential vendors have been reluctant to list properties until there is greater certainty on lockdowns, health orders and general mobility restrictions.



- The end result is that home prices are soaring – recording the fastest annual growth rate in 32 years. While the strong increases in home prices have boosted wealth for home owners and home buyers, it has also meant weakening housing affordability for those looking to buy. Already home loan demand from first home buyers has eased, constrained by the rapid increase in home prices.
- Wages are currently only growing at a 1.7 per cent annual pace but home prices are lifting at a near 20 per cent annual pace. The increase in debt taken on by home borrowers potentially means higher risks for the individual, the community and the broader economy.
- With more of a borrower's income taken up by loan instalments, there are pressures on the family budget – especially if hours of work are cut back or interest rates were to rise. In the current environment the risks are conveyed more by the former rather than the latter.
- In short, higher household debt increases the risk to the economy, especially through a loss of work and therefore income. And when eventually rates rise, the lift in rates could cause more borrowers into stress, restraining spending and overall economic growth.

Average Mortgage Size

Existing dwelling, Owner-occupier August 2021

	$'000	*Annual %*
Australia	580.9	16.0
NSW	760.8	20.1
Victoria	629.3	20.6
Queensland	466.0	10.0
South Australia	397.0	6.9
Western Australia	433.1	9.5
Tasmania	402.4	18.6
Northern Territory	401.6	12.6
ACT	569.9	11.8

Source: ABS, CommSec

- The Reserve Bank Governor recently spoke on rising home prices. Governor Lowe was quick to rule out rate hikes to slow demand: *"some analysts have suggested we might lift the cash rate to cool the property market. I want to be clear that this is not on our agenda."*
- Governor Lowe went on further to say *"More broadly, society-wide concerns about the level of housing prices are not best addressed through increasing interest rates and curbs on lending. While monetary policy is contributing to higher housing prices at the moment, the way to address these concerns is through the structural factors that influence the value of the land upon which our dwellings are built."*
- The good news is that a near record number of homes are being built. That additional supply should lead to slower, more sustainable growth of home prices.
- CBA Group economists expect that home prices will lift by 7 per cent in 2022 after growing by 20-25 per cent in 2021. The 'wildcard' for the property market remains immigration, with Australia's international borders expected to fully re-open during 2022. Of course, APRA could also implement additional macro-prudential policy measures to temper investor housing credit growth and cool home prices. The Reserve Bank will release the Financial Stability Review on Friday and will likely provide more details on its thinking on housing affordability and financial stability risks.

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