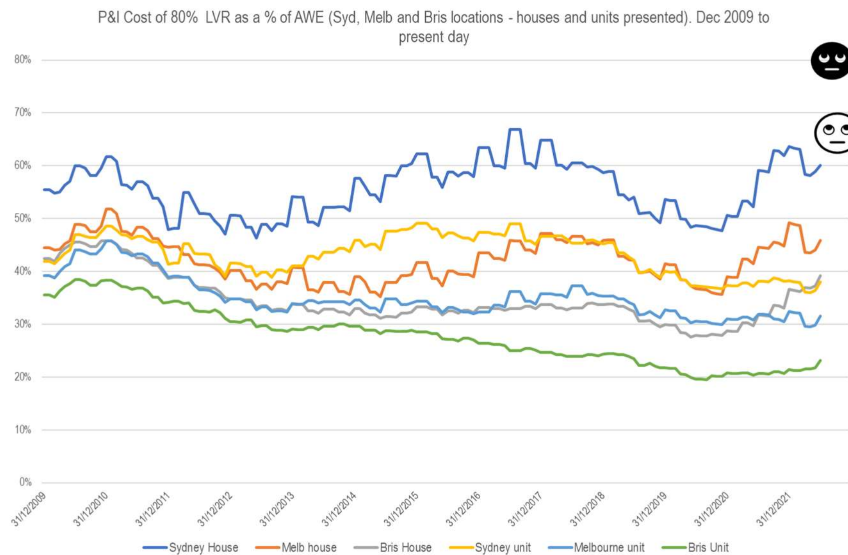
More charts on housing

Everyone's angst-ing again about house prices as the RBA puts interest rates up. We think the story mightn't be that bad. We have a theory that entry/median house prices adjust to what people can afford (i.e.) lots of buyers will bid to their borrowing capacity, which, in itself, is a function of income and the principal and interest (P&I) cost of servicing a home loan. If interest rates go up, banks will lend people less. The chart below shows the P&I cost of an 80% loan to valuation ratio (LVR) loan as a % of median average weekly earnings (AWE) given median house prices for various markets. (**Caveat**: most first homebuyers have more than 1 income and most buy property that is less than the median house price; so, the actual % of income that first home buyers use on house costs will probably be less than this model estimates; nobody can spend 70% of income on house purchase (this simple model looks at changes in affordability).



So, what do we think is interesting about chart?

- With the exception of Sydney, the effective cost of buying a house hasn't changed all that much (until the last few months) over the past 10 years. House prices have gone up, but interest rates have fallen, and incomes have risen, hence affordability isn't much changed. Makes sense; people will bid up houses up to the level that the bank will let them service.
- We've added a few extra data points; the emoji is if home loan interest rates increase to 5.5% and Sydney median home prices stay at June 2022 levels. The % of income allocated as per this model goes to 75% i.e., historically unaffordable. Guess what happens to house prices if that occurs?
- The other emoji is if home loan rates rise to 5.5% and house prices fall another 10%. Affordability gets close to historical levels. A 10% fall from here takes Sydney house prices back to mid-2021 levels. Lots of commentators are calling for 20% falls, but we that kind of outcome will make houses historically fundable.

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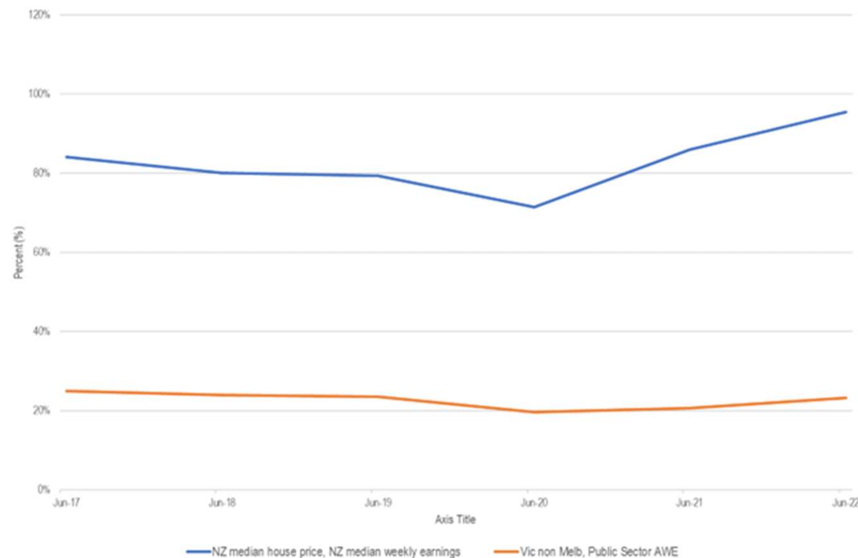
Places you'd rather be (or not be).

In our wanderings, we found a recent article on NZ housing costs (Opinion: New Zealand shows how a housing crisis can become a catastrophe - The Globe and Mail) so we ran the same analysis, and, 'oof' that's brutal. Absent something we haven't considered, our methodology shows average wage earners have been locked out of the NZ market (blue line) for the past 3 years (but that hasn't precipitated big falls in prices yet).



Sydney gets all the expensive housing headlines, but in what would be a surprise to most harbour city dwellers, Sydney isn't Australia. Other parts of our fair brown land don't have a housing affordability problem. The chart also shows the same methodology (i.e a % of income for an 80% LVR loan for a median house) for, non-Melbourne Victoria (cheaper houses) and Public Sector wages (they get paid more than private sector AWE) and housing is surprisingly affordable and getting more so (orange line).

Australia's getting richer as well. It isn't as exposed to rising interest rates as some claim.

The second scariest chart in every economist's presentation is Australia's (gross) Household Debt as a % of GDP. Its big, (c120%) and higher than most of the rest of the world. With so much debt, the theory goes that increasing rates will cause a meltdown. Maybe, maybe not? We understand that some sectors (recent FHB in particular) are going to get smashed, but we can't quite see it at a GDP level. Over the past 2 decades, Australia has become phenomenally wealthy with household net worth increasing from around 4 times GDP to 6 times GDP. And it's not just housing that's contributing to the wealth. The chart below shows the growth in the components (assets above the line, liabilities below the line). Liabilities have grown strongly, but there has been stronger broad-based growth in housing, cash, super and investments. And in general, the liabilities have been taken on by the wealthier segments of society, but that increase in liabilities has been more than offset by asset growth.

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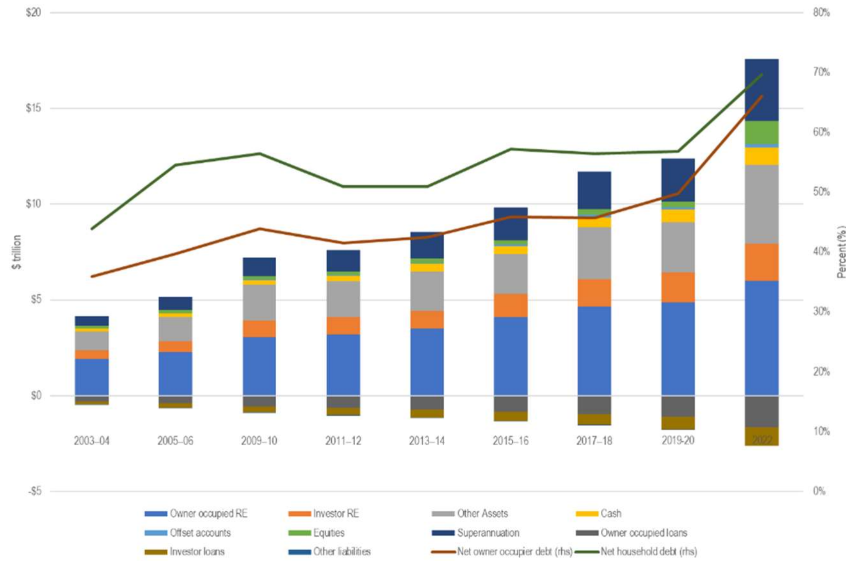

We also think the "gross" exposure is misleading. Household debt includes investor loans (which are offset by investor assets), student loans (which are only payable when there is income) and it doesn't include the amount of cash in offset accounts. We've tried to show this with 2 lines showing net mortgagee leverage (owner occupied debt – offset accounts)/ GDP and net household sector debt (total debt less cash/GDP). Both have been increasing, but neither are near danger levels (and if we include the amount of cash in super funds, it would be even less). This leads us to believe that the economy's sensitivity to higher interest rates may not be as great as some people think.

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