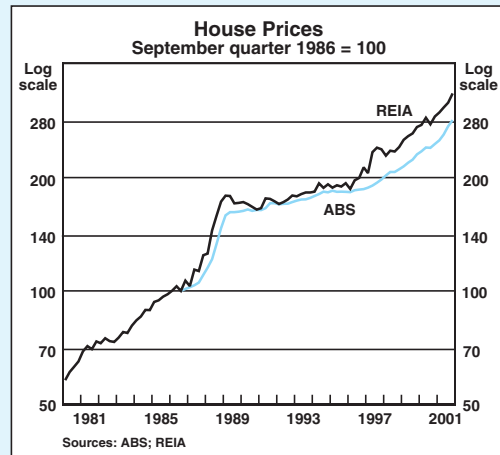


Box C: House Prices

House prices in Australia have been rising strongly for some time, with increases of the order of 15 to 20 per cent being recorded over the latest year in several of the major cities. While increases of that magnitude are not exceptional in a single year, a feature of the current expansion is that strong rates of increase have been sustained for several years, so that the cumulative increase in house prices has been substantial (Graph C1).

To put these increases in perspective, it is useful to compare the experience of recent years with the previous period of rapidly rising house prices, which occurred in the late 1980s. One important difference between the two periods is that most of the increase in house prices in the late 1980s was concentrated in a two-year period ending in the first half of 1989, a period of extremely rapid house price inflation. By contrast, the recent experience has been characterised by less extreme increases in any given year, but with strong rates of increase being sustained over a longer period. The cumulative

Graph C1



movements in the two episodes are summarised in Table C1.

The aggregate nominal increase in house prices in the late 1980s period, at 114 per cent, was much larger than in the most recent five years, but this difference is largely accounted for by the fact that the general rate of inflation was higher. In real terms, the

Table C1: House Prices
Percentage change over five years

	Nominal		Real ^(a)	
	Five years to: Mar 1989	Dec 2001	Five years to: Mar 1989	Dec 2001
Sydney	140.4	47.7	68.0	33.2
Melbourne	122.2	93.1	55.3	74.1
Brisbane	47.9	46.3	3.4	32.0
Adelaide	43.9	37.4	0.6	23.9
Canberra	42.8	42.5	-0.2	28.5
Perth	142.0	34.6	69.1	21.4
Darwin	na	16.2	na	4.8
Hobart	na	13.5	na	2.4
Australia^(b)	113.9	56.8	49.5	41.4

(a) Deflated by the CPI excluding interest charges, adjusted for tax changes and the introduction of Medicare

(b) Chain-weighted by number of capital city households

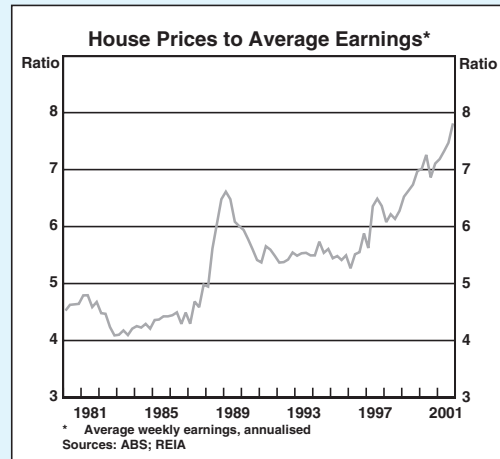
Sources: ABS; RBA; REIA

cumulative increases are of similar magnitude, at 49 per cent in the late 1980s compared with 41 per cent in the recent period. However, in the current period, house prices are still rising; the CBA/HIA measure recorded a further large rise in the March quarter 2002. Another noteworthy feature of these comparisons is the geographic spread of house price increases. The rise in prices in the late 1980s was heavily concentrated in Perth and Sydney (and to a lesser extent, in Melbourne), whereas this time house price rises have been experienced in most of the major cities, with particularly large increases in Melbourne.

An alternative benchmark for assessing house prices over time is to express them as a ratio to average earnings (Graph C2). This ratio rose rapidly in the late 1980s to peak at around 6½ in 1989 (that is, the average house price was 6½ times annual average earnings). It then fell for two years, and remained steady for a period in the early to mid 1990s. The ratio has been on a rising trend since 1996 so that currently, at just under 8 times earnings, it is well above its previous peak.

A rising trend in the ratio of house prices to incomes may in part be a natural consequence of improving living standards. As incomes increase, households can afford to devote an increasing share of their income

Graph C2



to housing. The growth in the number of two-income households will have contributed to this trend. In addition, it appears that the rise in house prices in recent years partly reflects the adjustment to the low-inflation environment. The low nominal borrowing rates that have resulted from lower inflation (as well as increased competition in the home-lending market) have increased the scope of households to borrow by reducing the front-end hurdle of the standard home loan. This has been reflected in the rapid growth of household borrowing over the past five years.

But whenever an adjustment of this type occurs, there is the risk that prices may

Table C2: Rental Vacancy Rates
Per cent

	Latest ^(a)	Average since 1980	High	Low
Sydney	3.8	2.3	4.1	0.8
Melbourne	4.8	2.7	5.2	1.0
Brisbane	2.2	3.9	7.7	0.5
Adelaide	2.1	3.0	5.7	0.9
Perth	4.6	3.6	8.6	0.8
Canberra	1.9	2.7	6.1	0.3
Australia^(b)	3.4	2.8	4.5	1.4

(a) December quarter 2001, except for Brisbane, where March quarter 2001 applies.

(b) Weighted by number of capital city households.

Source: REIA

overshoot, as some purchasers extrapolate past movements as a guide to future capital gains. This may be occurring at present, since the low rental yield on property, and high rental vacancy rates, seem inconsistent with rapidly rising house prices. Moreover, further downward pressure on rental yields may be in prospect as additional dwellings under construction are completed, especially in the

medium-density sector. Some of these properties will be made available for lease at a time when vacancy rates have risen in all capital cities to high levels. The rise in vacancy rates has been most pronounced in Sydney and Melbourne where they are now among the highest in the country, especially compared with their long-term average levels (Table C2). ↗