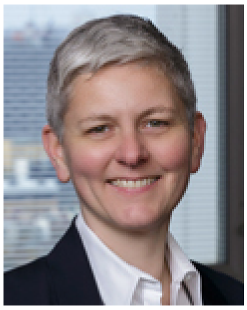
RESERVE BANK OF AUSTRALIA

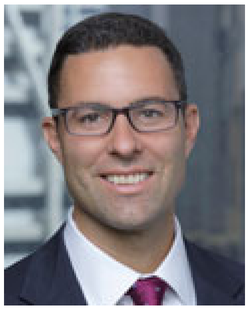
Speech

Opening Remarks to the Inquiry on Housing Affordability and Supply in Australia

Luci Ellis
Assistant Governor (Economic)

Bradley Jones
Head of Economic Analysis





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Thank you, Chair, for the opportunity to appear again before this inquiry into an important topic. Shelter is a fundamental human need, so naturally housing affordability is a keenly felt issue. Its importance is highlighted by the number of parliamentary and other inquiries on housing over the past 20 years.

Our submission to this inquiry covers a range of aspects of this issue. In my opening remarks I will confine myself to some observations about the longer-run context for housing markets, and then outline some noteworthy features of the current situation, as Australia emerges from the COVID-19 pandemic.

The longer-run context is that financial deregulation in the 1980s and the global decline in inflation in the 1990s combined to reduce nominal interest rates. With lower interest rates, people could service a bigger mortgage with the same repayment. Some of this extra buying capacity financed an increase in the quality of the housing stock. But because most of the housing stock was already in place, the main effect was to bid up housing prices; this was captured in land prices. There were some distributional consequences to this. The price increases were greatest in the most desirable regions and neighbourhoods. First home buyers now had to save a bigger deposit relative to their incomes. And some features of the tax system, combined with the possibility of leverage, meant that buying rental properties became especially attractive. The big-picture story, though, was one of increased demand stemming from greater availability and serviceability of finance.

The pandemic and policy responses to it have shifted the balance of supply and demand in some housing markets. Over the past year or so, we have again seen strong growth in housing prices. This followed periods of weakness in 2018 and early 2019, and again, briefly, at the very beginning of the pandemic. Properties coming onto the market are being snapped up quickly. Data on housing finance show that this increase in demand was initially mostly owner-occupiers, but demand from property investors has also increased recently. Clearly some purchasers are willing to pay these prices, although others have missed out. Indeed, strong rises in housing prices have been a feature of many advanced economies' recoveries from the pandemic. This is not surprising when interest rates are low, incomes were boosted by fiscal policies and many households are cashed up with savings accumulated during lockdowns.

Another common feature across countries is that many households are wanting larger homes than they did before the pandemic. The combination of the time confined at home during lockdowns, and the likely future of more working from home, has brought the quality and size of one's home sharply into view. We do not know how lasting this shift in preferences will be. For now, though, renovation activity, commencements for new detached homes and price growth of high-value homes are all at high levels.

This demand response to the pandemic relates to the quality and comfort of each individual home. That is a very different margin of adjustment than the number of new homes. In Australia, additions to the housing stock have run ahead of population growth for a number of years. This led to higher vacancy rates in the largest capital cities. Vacancy rates in the two largest cities rose further following the onset of the pandemic; with the international border closed, population growth dropped sharply. At the same time, the HomeBuilder subsidy and similar state-based grants have encouraged more home building, and will for a while yet. So we do not have the ingredients of an obvious overall shortage of homes.

If Australia had not been building enough homes to house its population, you would have seen rents rising across the country. Instead, the situation has been mixed in recent years. In the larger cities, where most of the new apartments were built, rents were quite flat. Lower migration and other shifts in population in response to the pandemic and related health measures have mostly exacerbated these trends. Rents have been quite weak in the two largest cities of late, but in some regional areas, pressures on rental affordability are reportedly quite acute.

As we outlined in our submission, the supply side of the housing market has inherently limited capacity to adjust to sharp increases in demand. There are some things that could be done to make the flow of new housing supply more responsive. These include speeding up planning systems to reduce general inefficiencies, improving transport infrastructure and lowering the cost of new construction. Supply-side changes of this nature would dampen the increase in prices that ensues when demand increases. But they will not undo the fact of rising demand, and they will not prevent price increases entirely. Moreover, housing market policies that add to demand will only amplify any upswing in prices.

My colleague Brad Jones and I would be happy to answer any questions you may have about the Bank's submission.

The Reserve Bank of Australia acknowledges the Aboriginal and Torres Strait Islander Peoples of Australia as the Traditional Custodians of this land, and recognises their continuing connection to Country. We pay our respects to their Elders, past, present and emerging.