

Australian housing & household sector update

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Are Australian house prices 'overvalued'?

Much talk of housing 'bubble' - but fundamentals sound

- *Record* population gains & inadequate supply growth
- Critical housing shortage worsening/demand momentum strong
- FHB replaced by investors, upgraders & offshore buyers
- *Conservative lending/low delinquencies/no sub-prime/full recourse loans*

Household sector well placed

- Economy & labour market solid, unemployment falling - *no forced sales*
- Low delinquencies reflect comfortable debt servicing
- Solid gains in real household incomes
- Growing skilled labour shortages/upward wages pressure

Financial system solid

- On balance sheet lending raises incentives re. sustainable serviceability
- Conservative lending = low delinquencies
- Full recourse lending cf. US = less incentive to default

Risks

- Rising interest rates/deteriorating affordability could *cap* price gains
- Policy reversal of 2009 FIRB changes?
- Change in immigration policy?
- Rising unemployment/recession?



Australia: the 'Goldilocks' economy

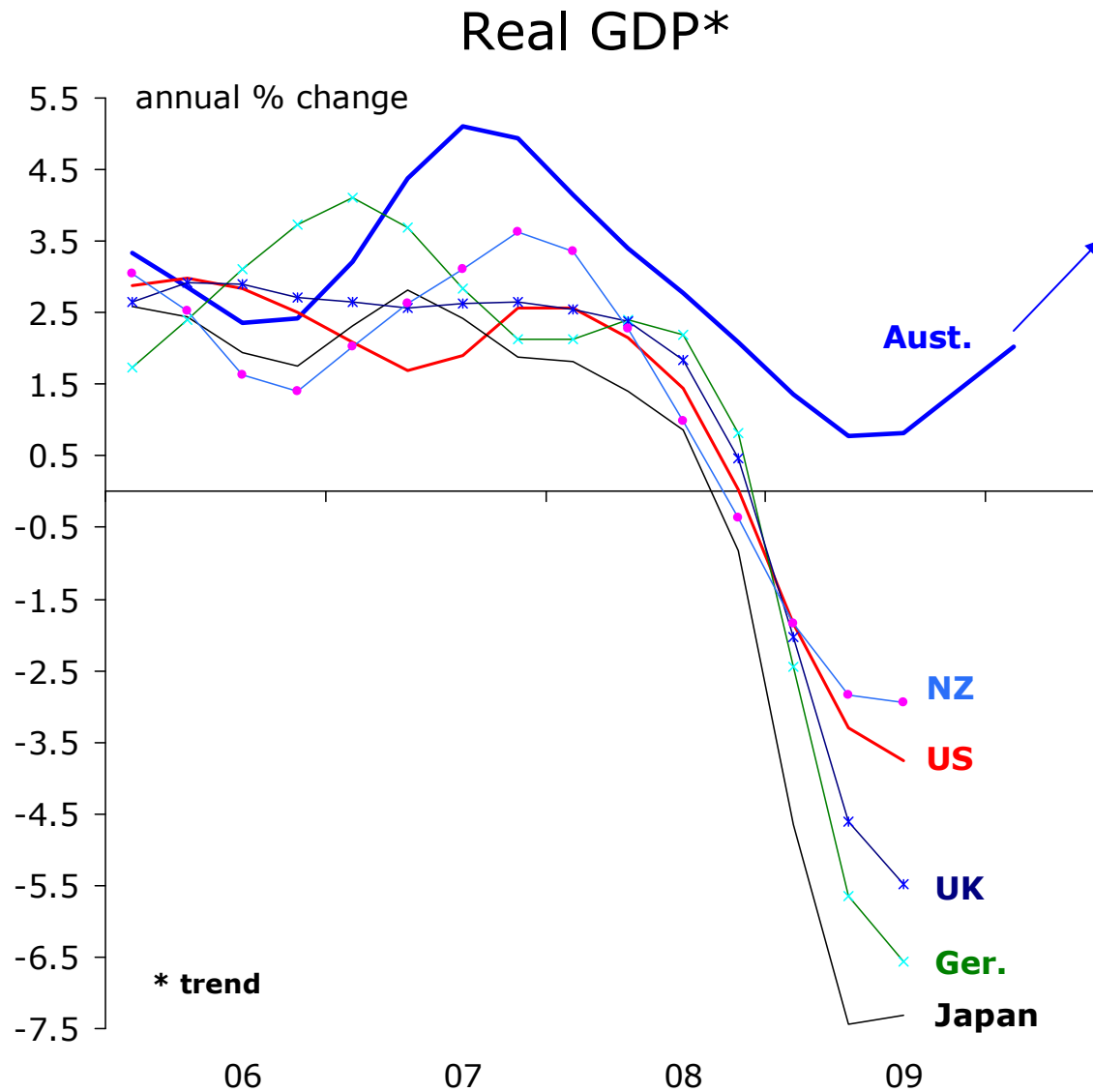
Australia outperforms and outlook bright

- Consumer and business sentiment strong
- Dwelling investment turning up
- Bulk commodity rebound/China
- Corp. profit/govt revenue boost
- Investment intentions strong
- Return to 'trend' growth in 2010
- Healthy finance sector – availability of credit

Much depends on the RBA's ability to manage expansion

- Interest rates headed back towards 'neutral'
- Increased household debt raises potency of monetary policy
- Fiscal stimulus winding down
- Excess 'heat' in private sector demand will dissipate
- Inflation should return to RBA target band

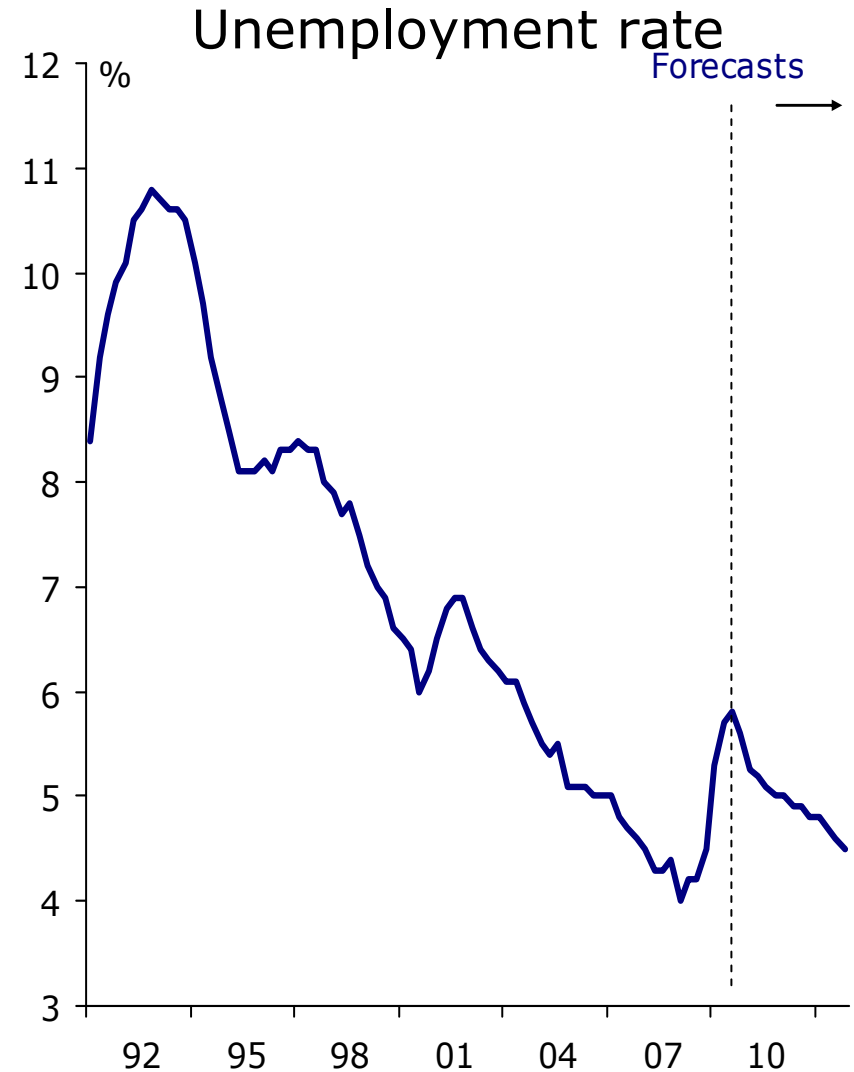
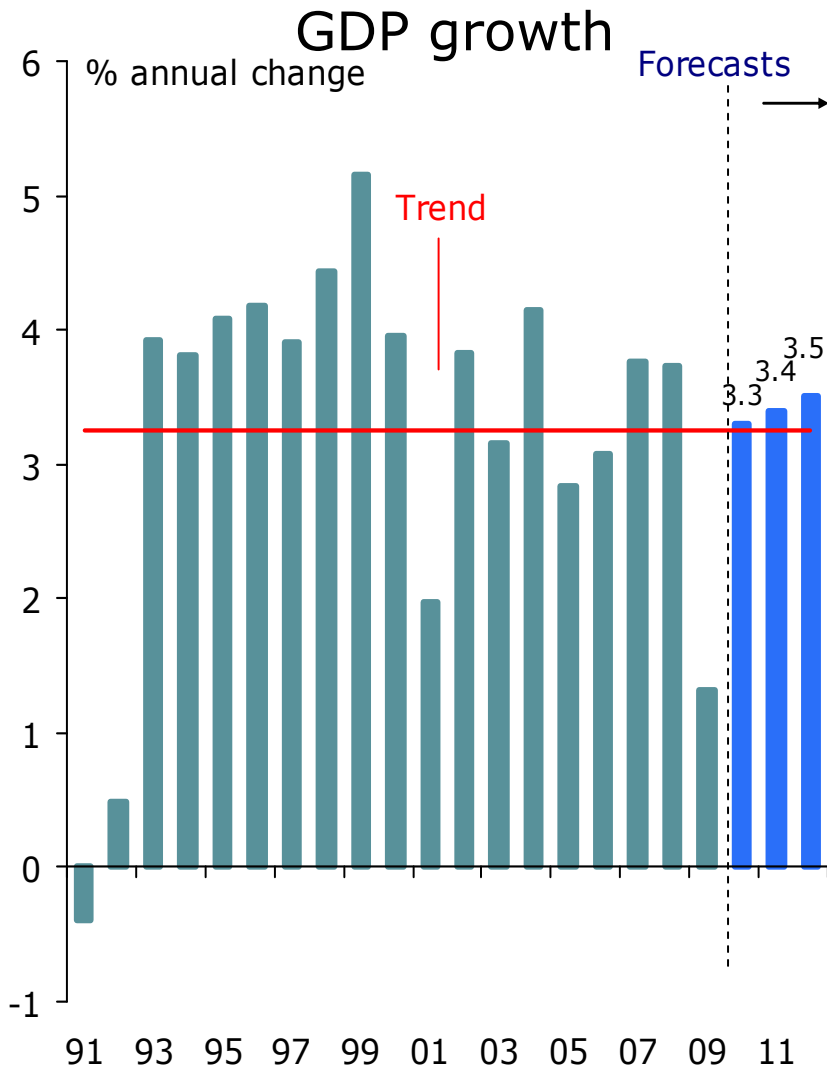
Australia effectively 'decoupled' from the developed world during the GFC



- Conservative bank lending
- No sub-prime
- Full recourse loans
- Minimal exposure to CDS
- Housing shortage - resilient house prices
- Significant, pre-emptive & effective policy action
- Record population gains
- China rebound



Australia is forecast to return to trend growth in 2010 and unemployment will continue to fall



Tightening demand/supply fundamentals and a healthy economic outlook are positive for housing

2009 price momentum *very* strong

- Low interest rates
- FHOB
- Tightening demand/supply balance
- Relaxation of FIRB restrictions

Early 2010 very solid but prices will *decelerate*...

- Rising interest rates
- Exit (temporary) of FHB

...but price gains will remain positive

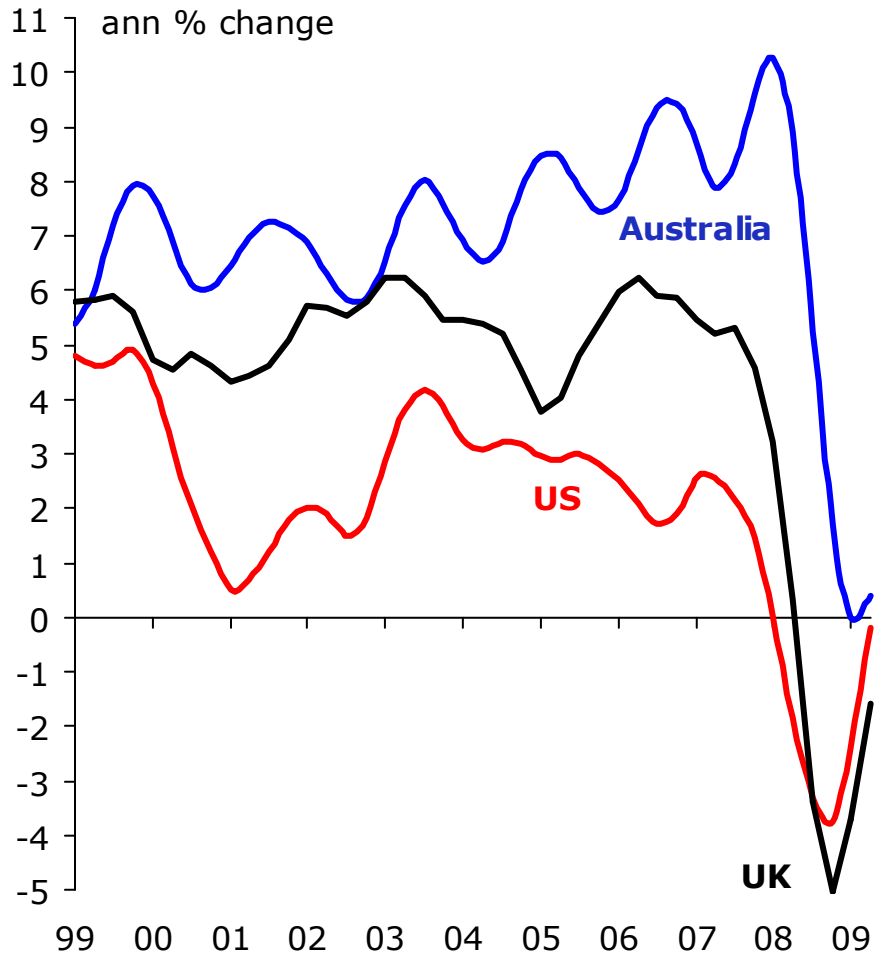
- Market momentum strong/supply limited
- Improved economy/labour market/sentiment
- Foreign demand
- Housing shortage *will* get (much) worse, vacancies tighten, rents re-accelerate & *affordability will deteriorate*

Australian, US and UK residential
property market fundamentals
have very little in common...

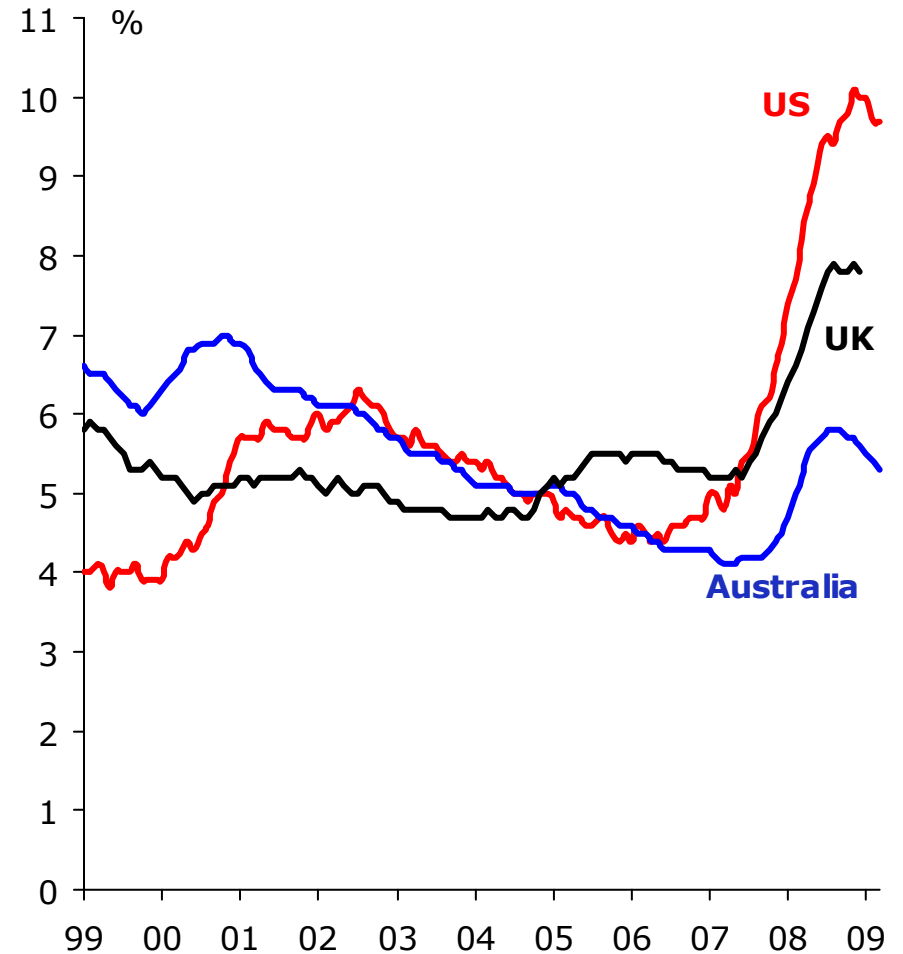


1. "It's the economy stupid!"

Nominal GDP growth

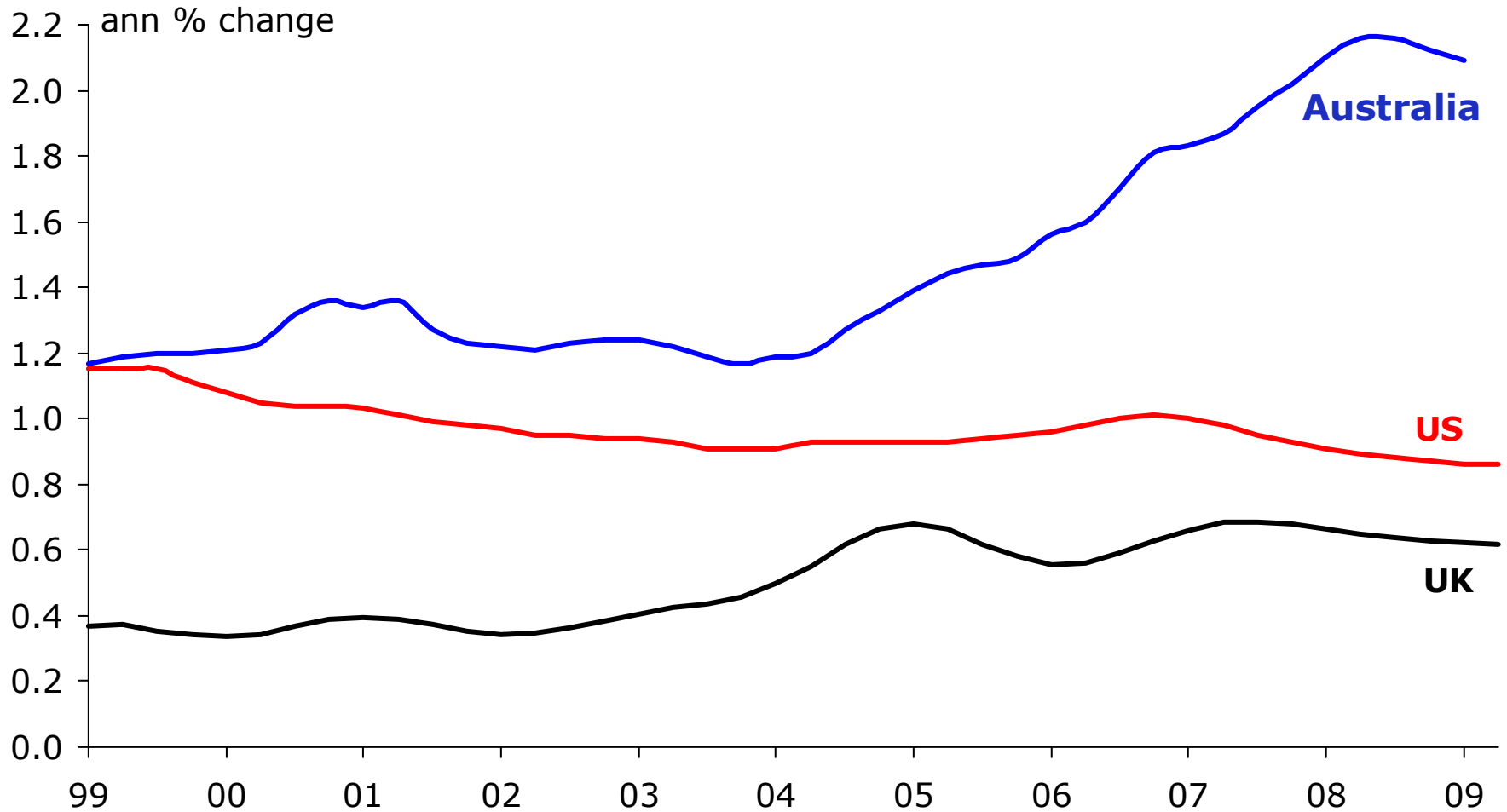


Unemployment rate



2. Australian population growth the *strongest* in the developed world

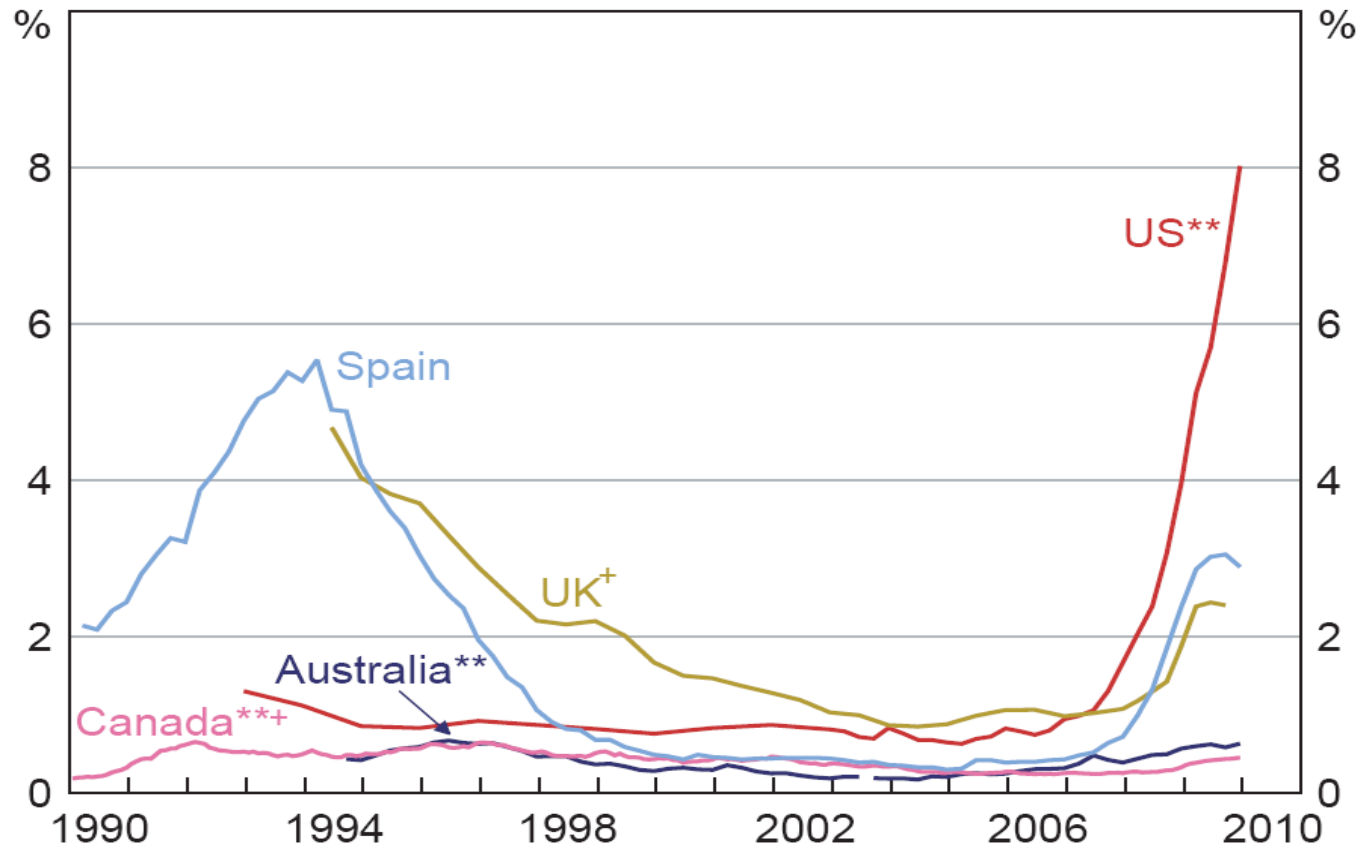
Population growth



3. Conservative lending/no sub-prime = low delinquencies + few forced sales...

Non-performing Housing Loans

Per cent of loans*



* Per cent of loans by value. Includes 'impaired' loans unless otherwise stated.
For Australia, only includes loans 90+ days in arrears prior to September 2003.

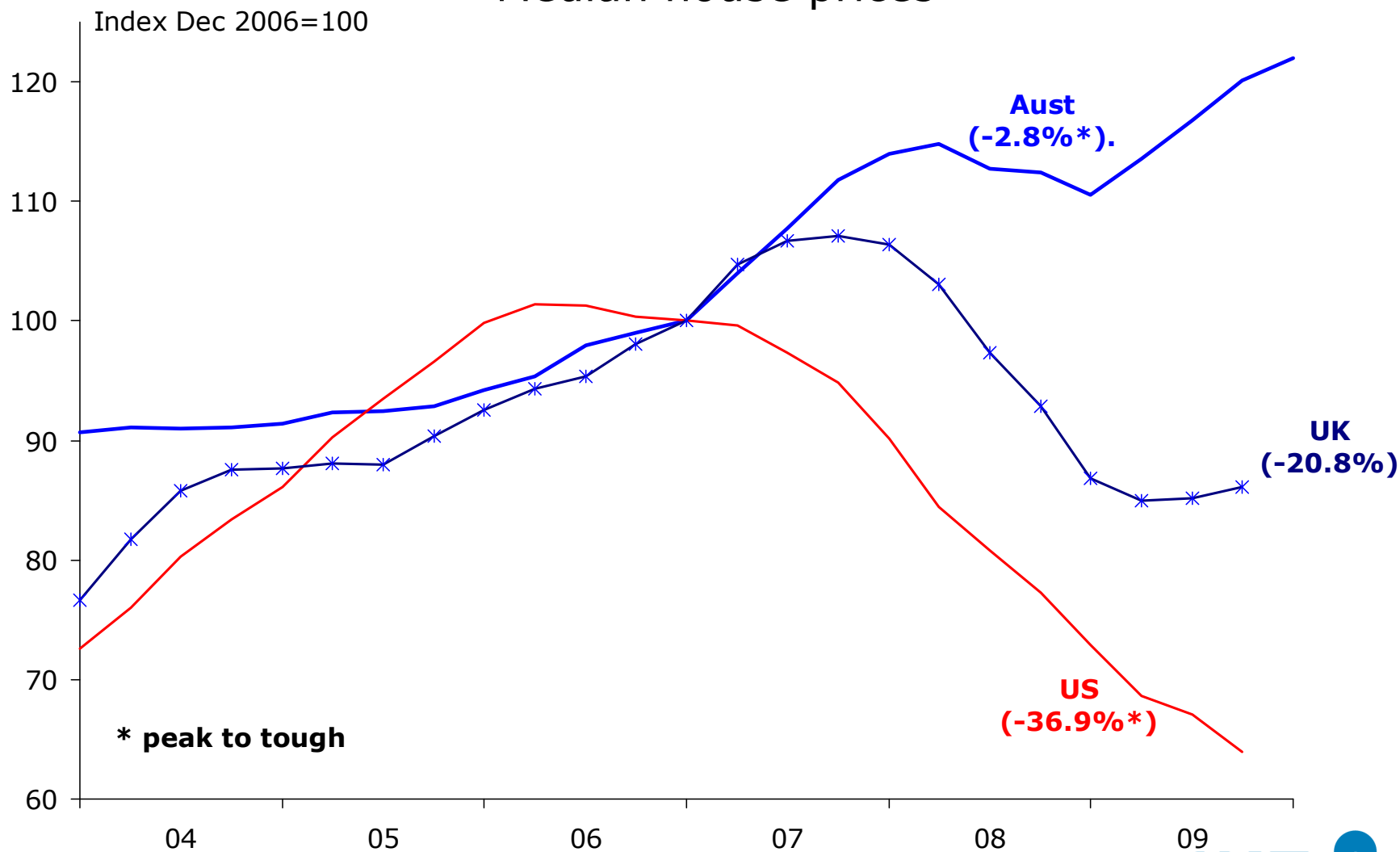
** Banks only.

+ Per cent of loans by number that are 90+ days in arrears.



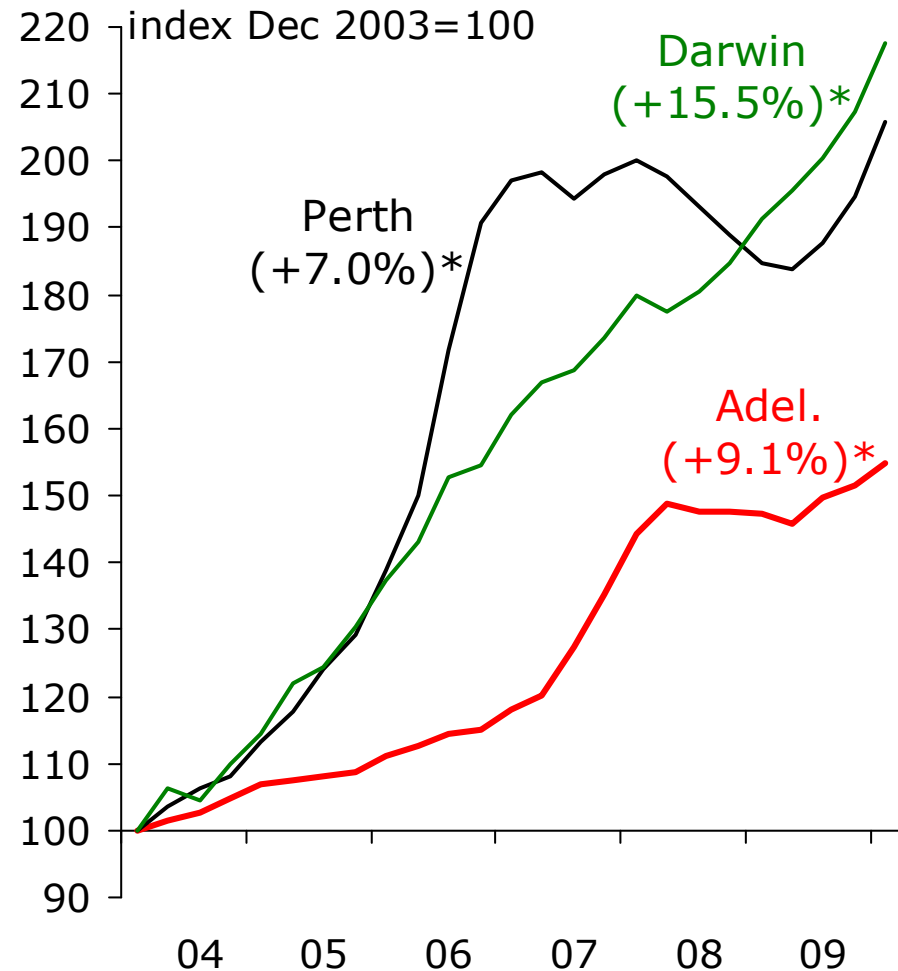
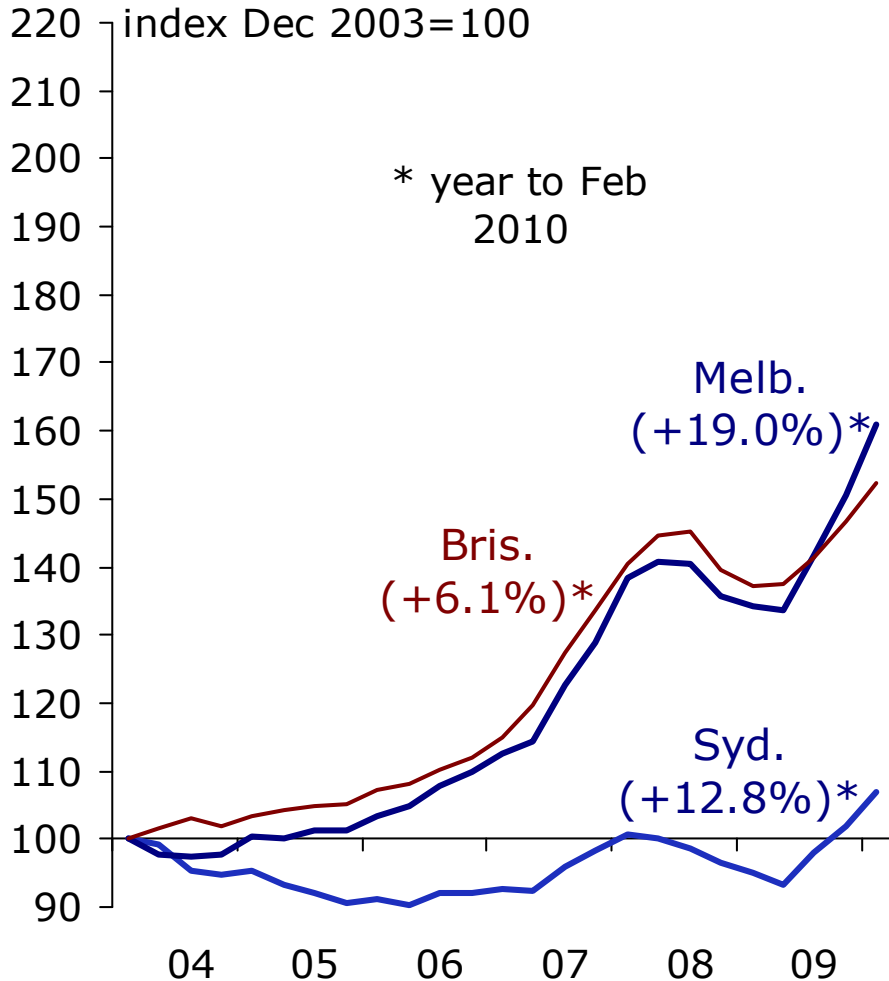
...consequently, Australian house prices were *remarkably resilient* cf. other developed nations

Median house prices



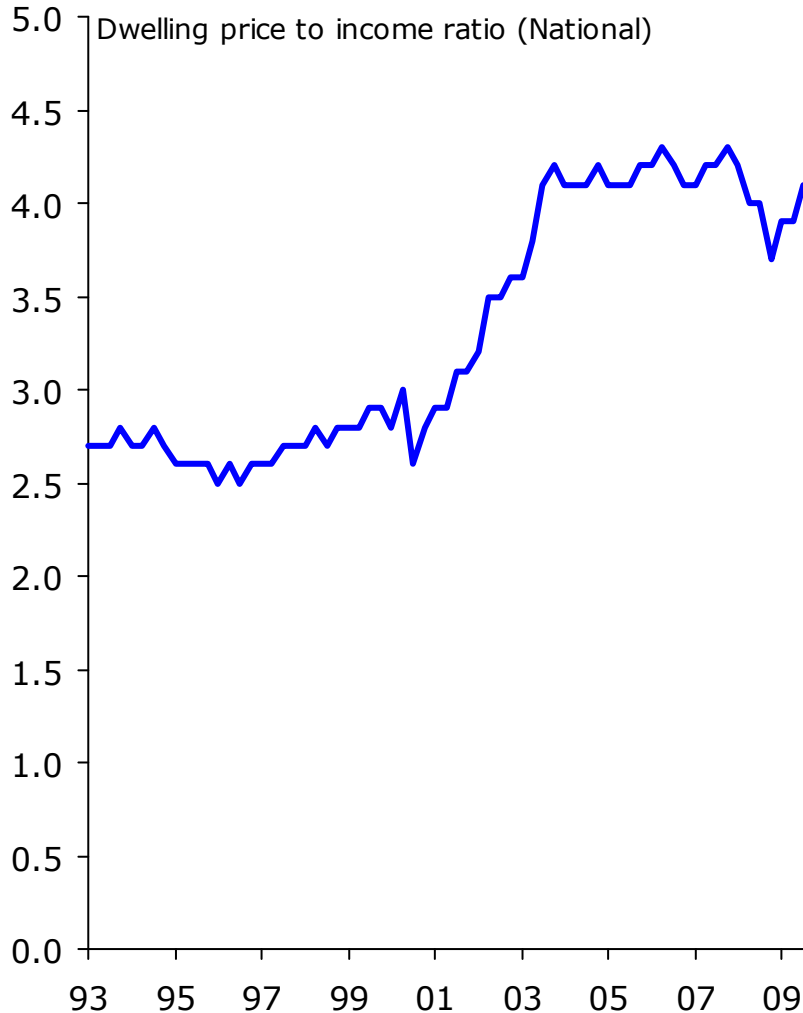
Moreover, house prices rebounded remarkably strongly in 2009-2010 in most capital cities

Median house prices



House prices have tracked incomes since 2004

House price to income ratio

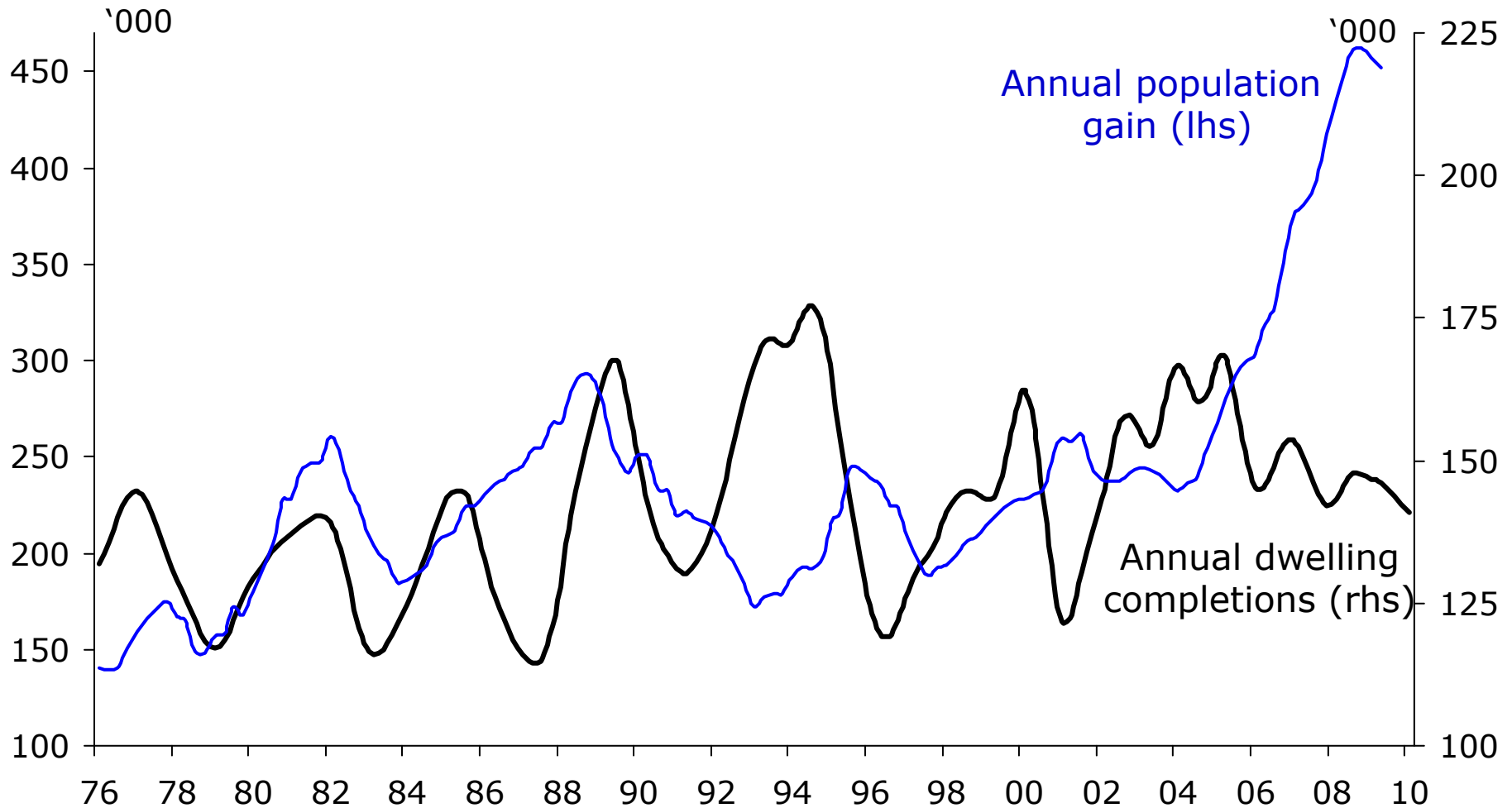


Mortgage interest bill*



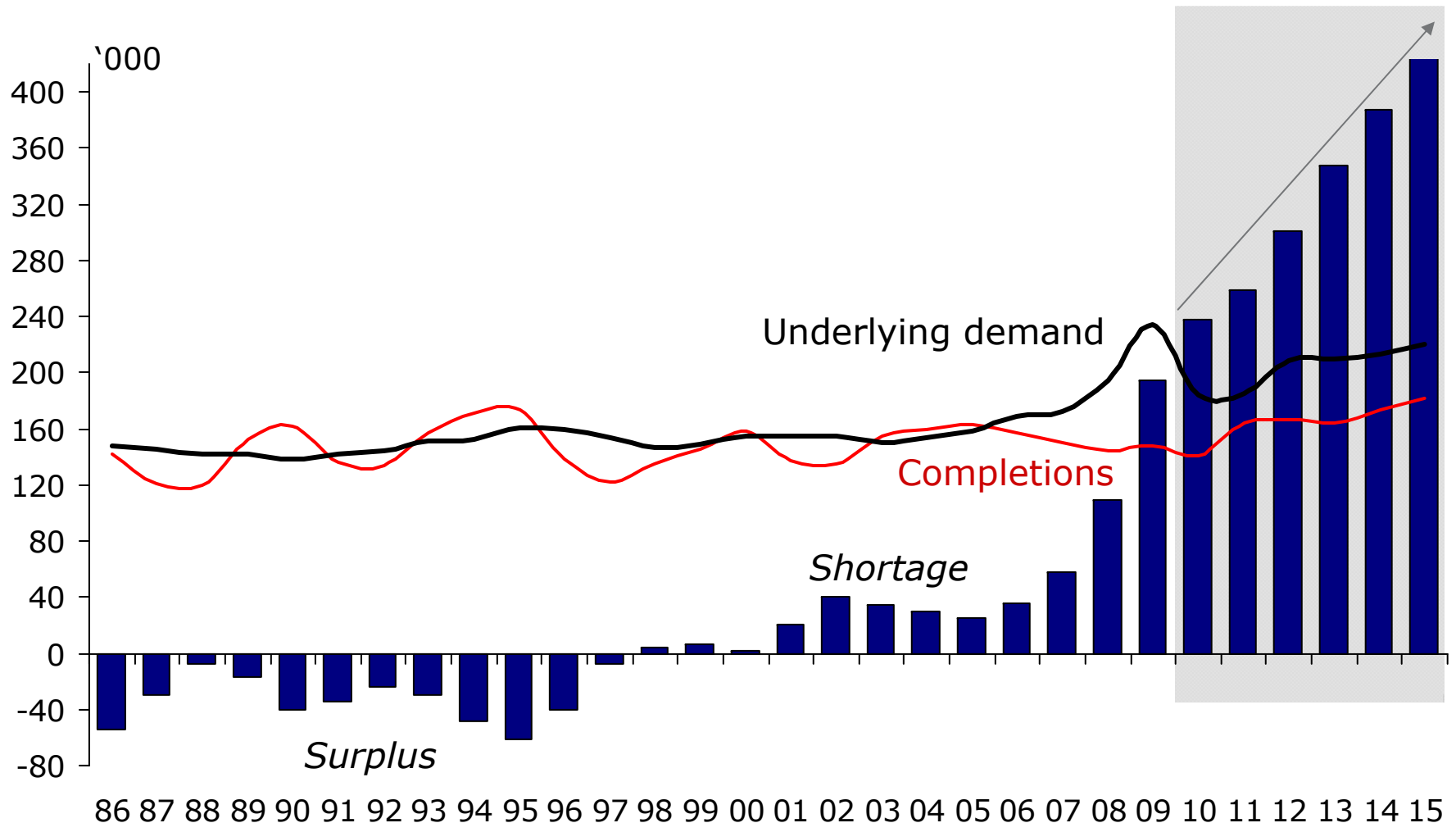
Australian population accelerated to *record highs* while home building weak

Population growth vs. dwelling completions



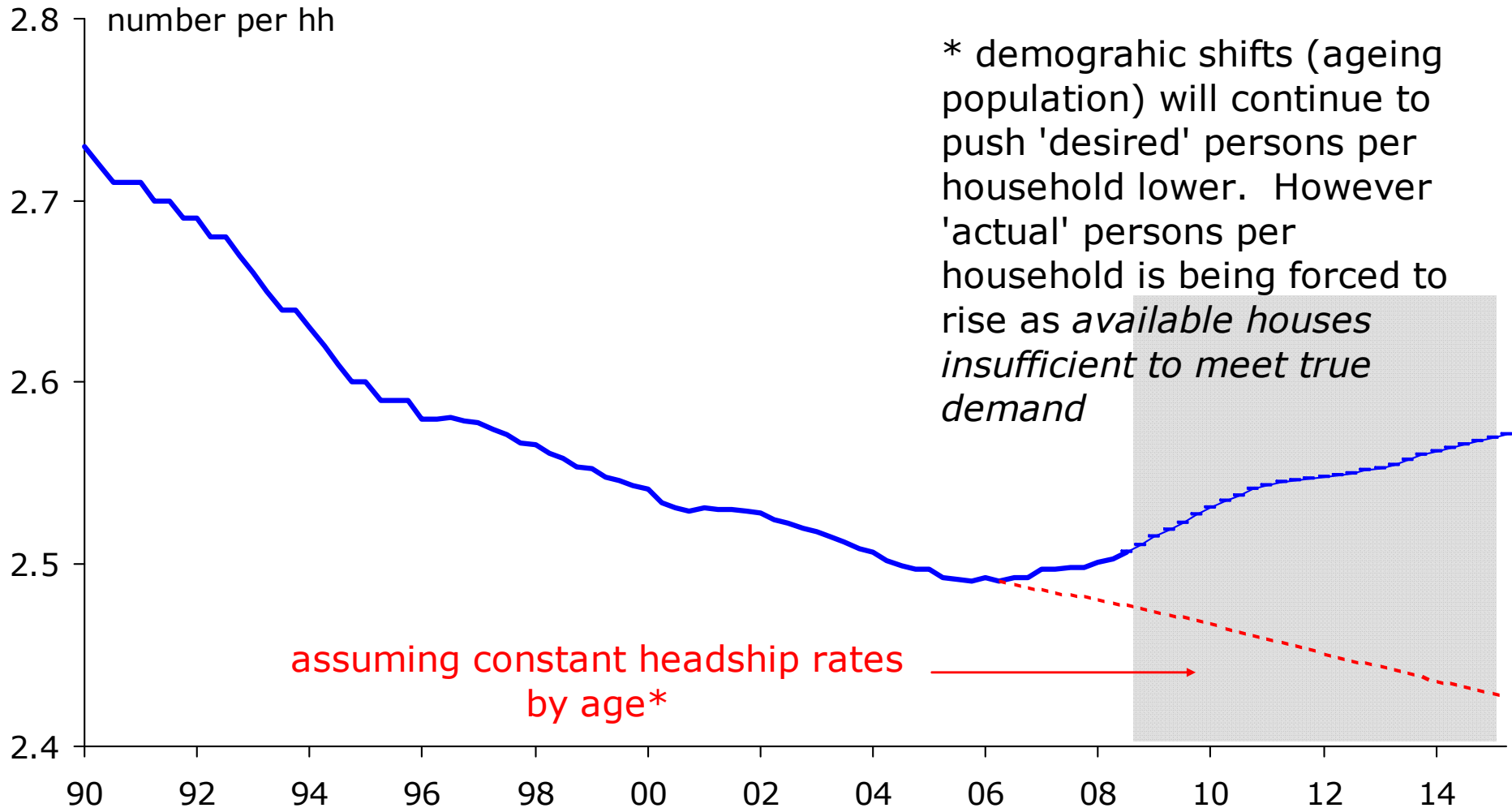
The housing shortage has already reached unprecedented levels – and will get worse!

Housing market balance



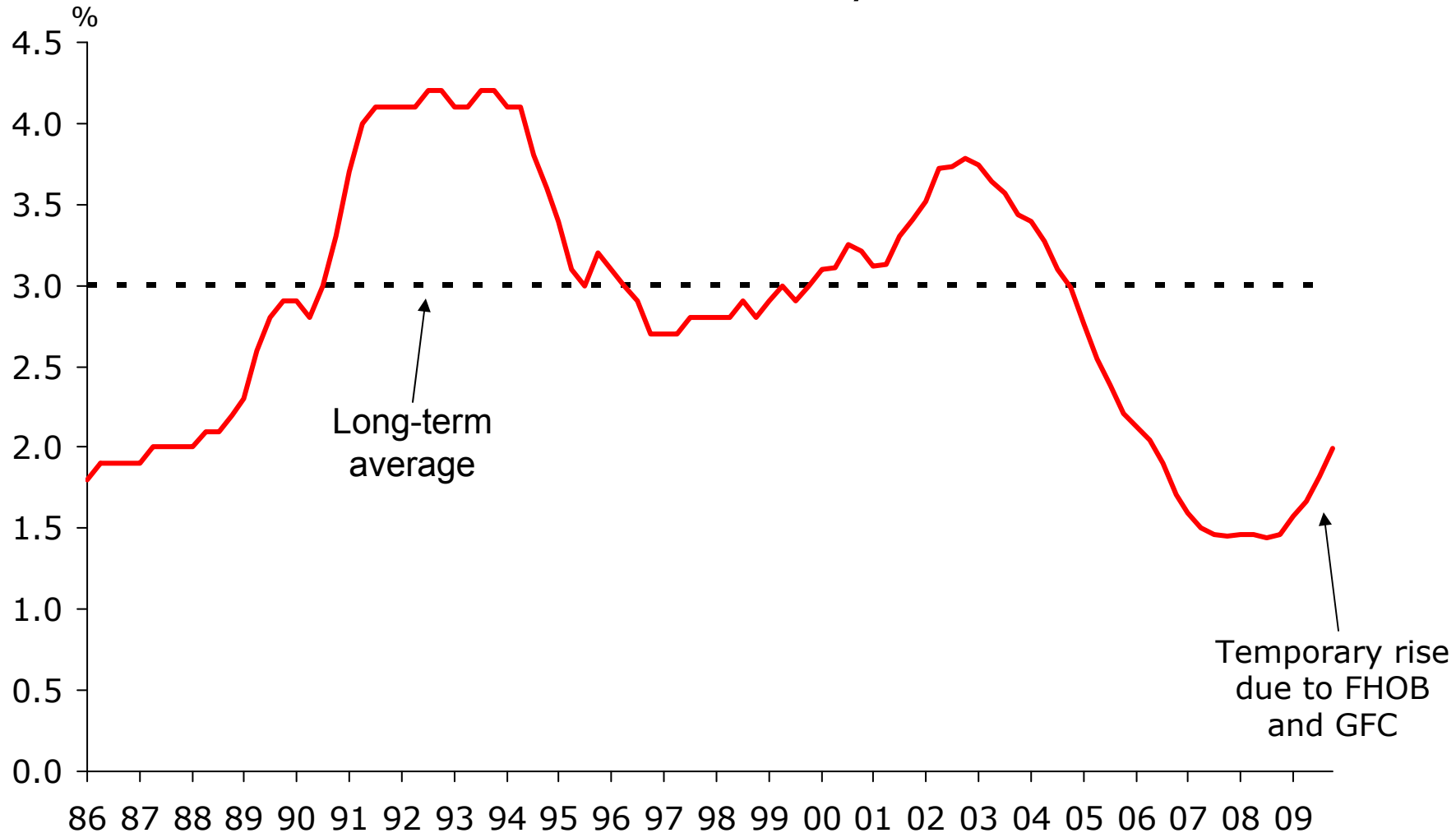
Shortage of housing forcing an *involuntary* rise in persons per household

Persons per occupied dwelling



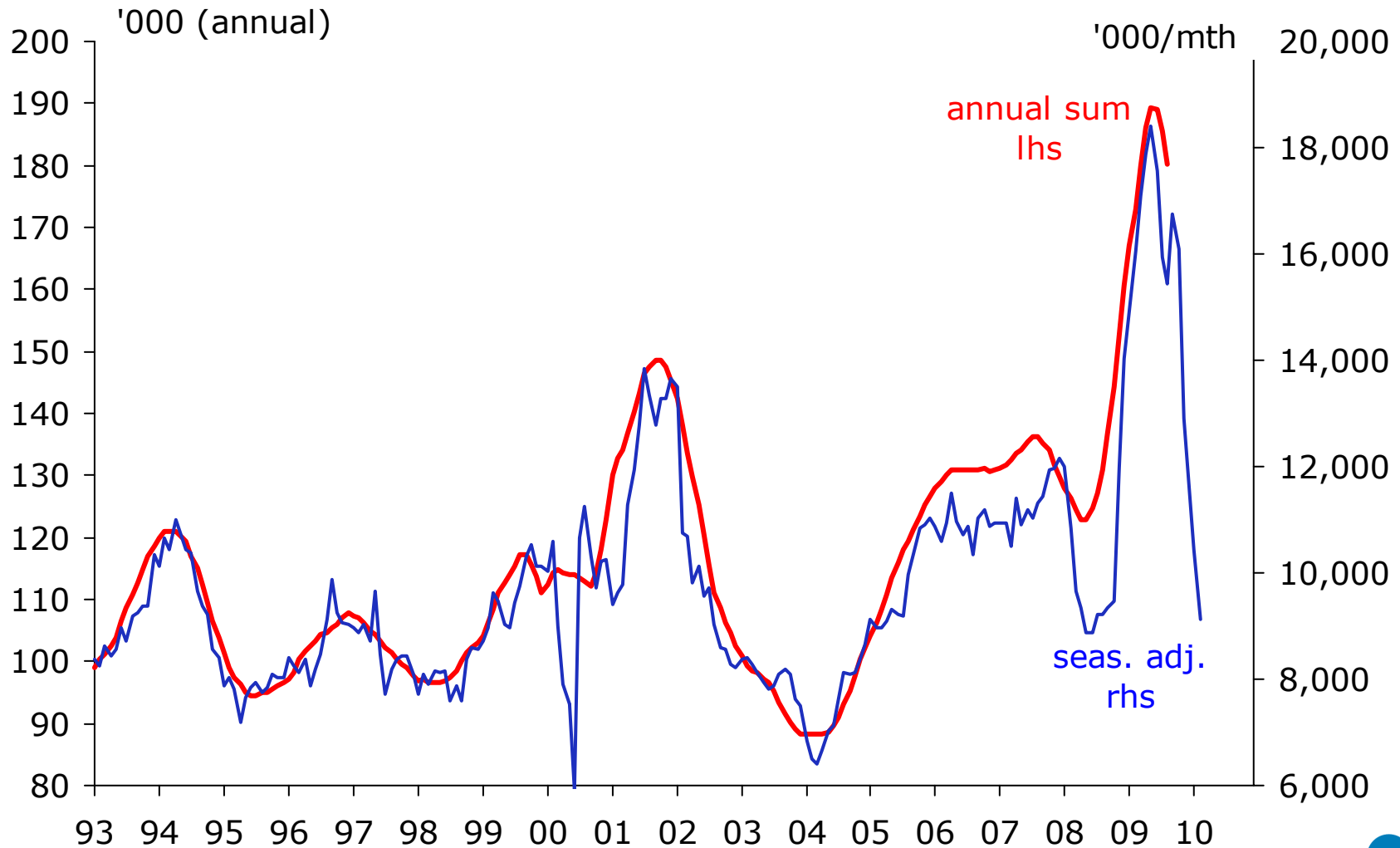
Vacancies remain tight (despite FHOB) and will tighten further in years ahead

Residential vacancy rate



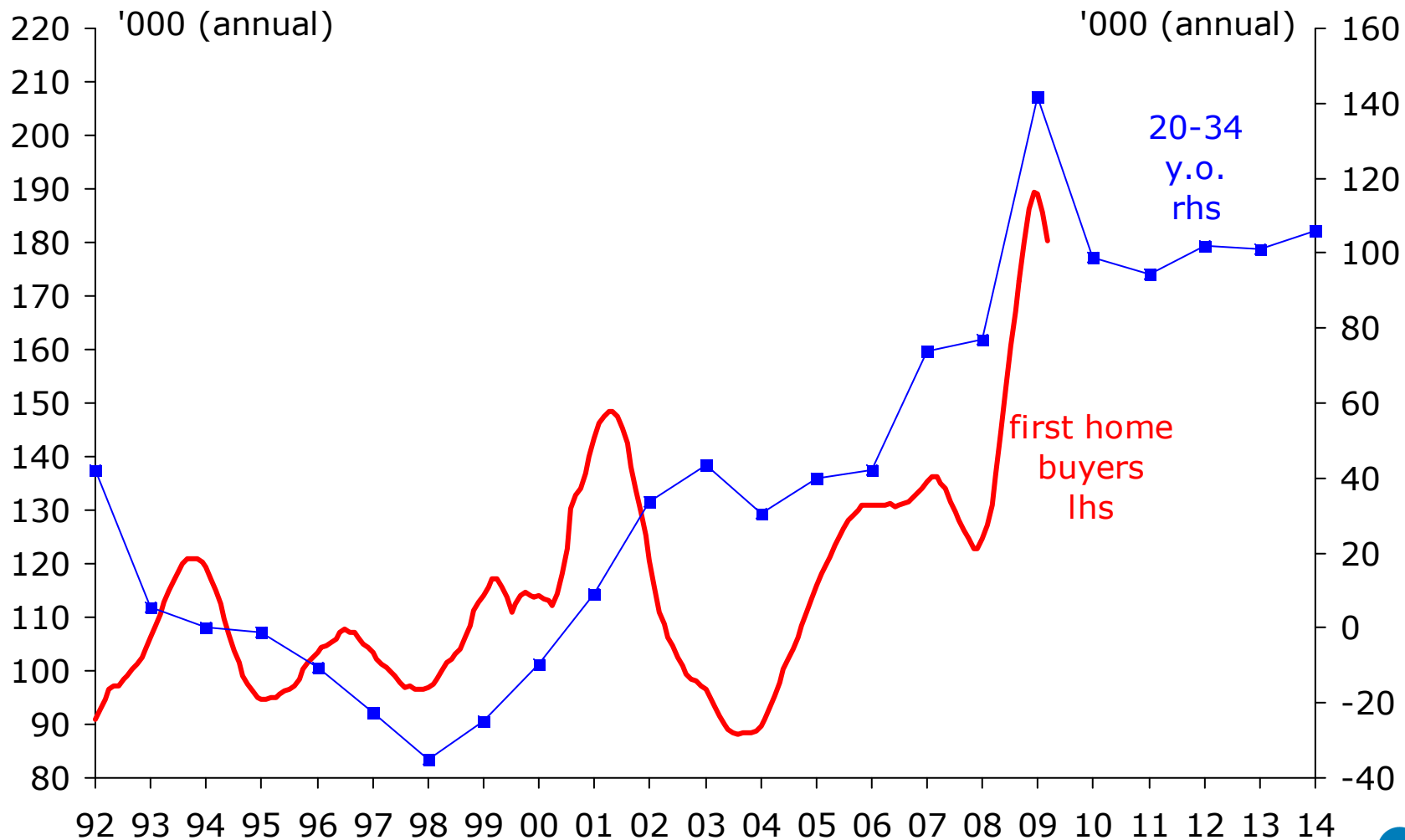
First-homebuyer demand falling sharply following expiry of FHOB and rising interest rates...

First home buyer finance commitments



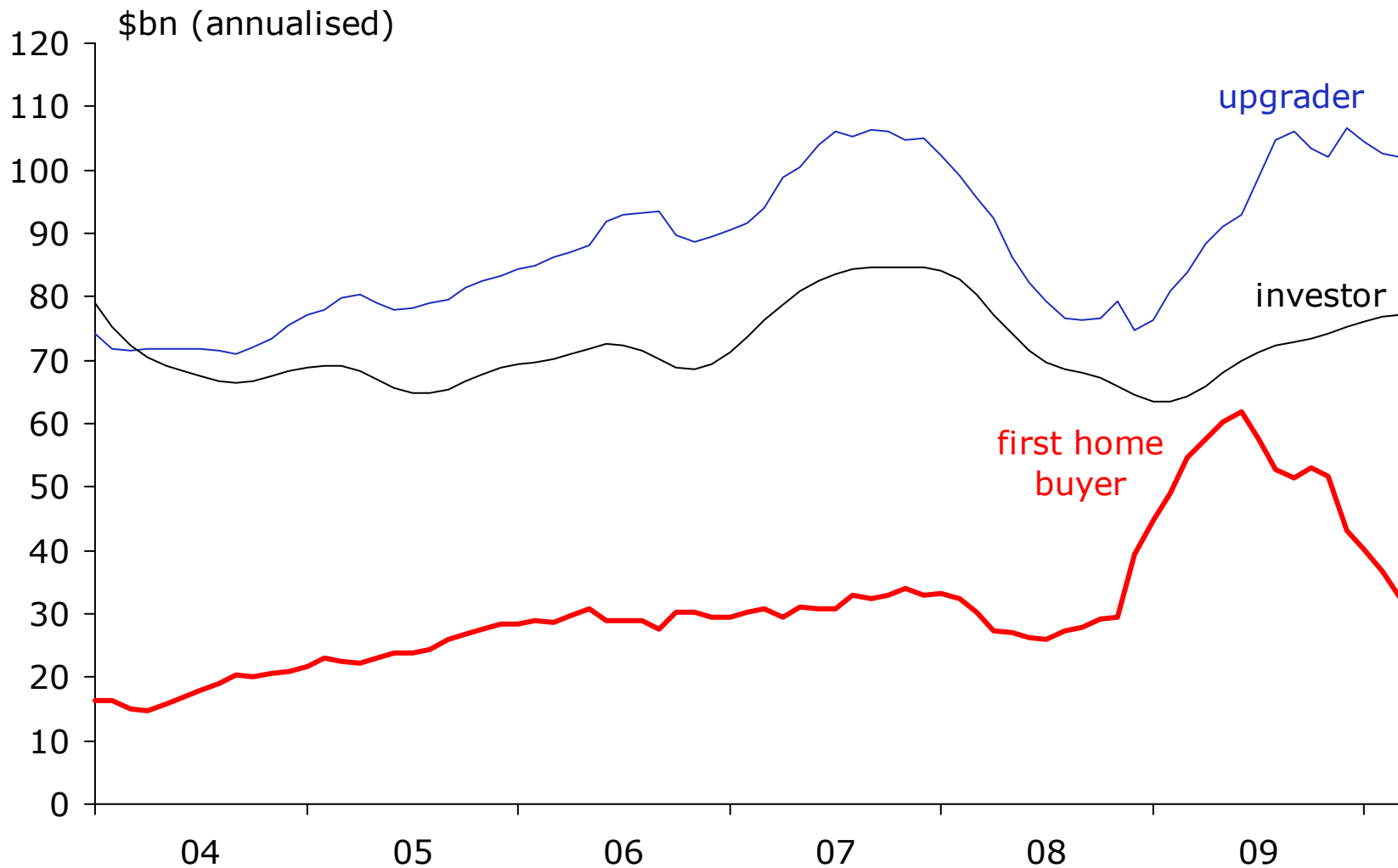
...but population growth should prevent a deep, protracted downturn...

First home buyers vs. population gain



...moreover, investors & upgraders replacing FHB demand

Housing finance commitments (excl. refin.)

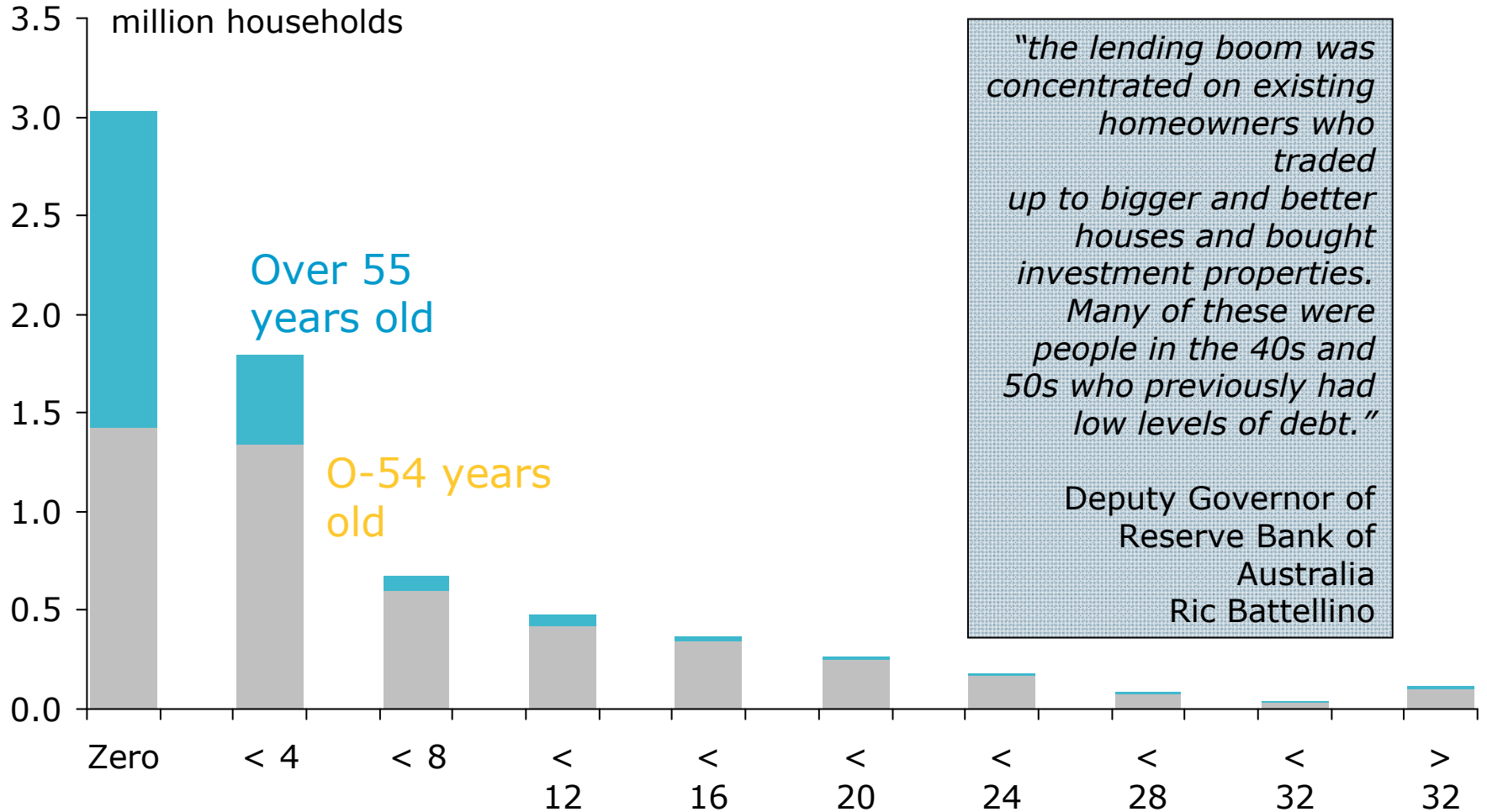


Despite rising household debt to income, the Australian household sector is in good shape

- Rise in *aggregate* debt to income ratio (or gearing or even dsr) *tells us little* about the underlying sustainability of household debt
- The *distribution of debt* is critical to its sustainability as is *loan criteria* applied
- Conservative lending means debt held by households that are well placed to service loans
- Low delinquencies reflect comfortable debt servicing
- Labour market solid, unemployment falling – no forced sales
- Solid gains in real household incomes
- Growing skilled labour shortages/rising wages

Two-thirds of households had little or no debt ahead of most recent debt-accumulation.

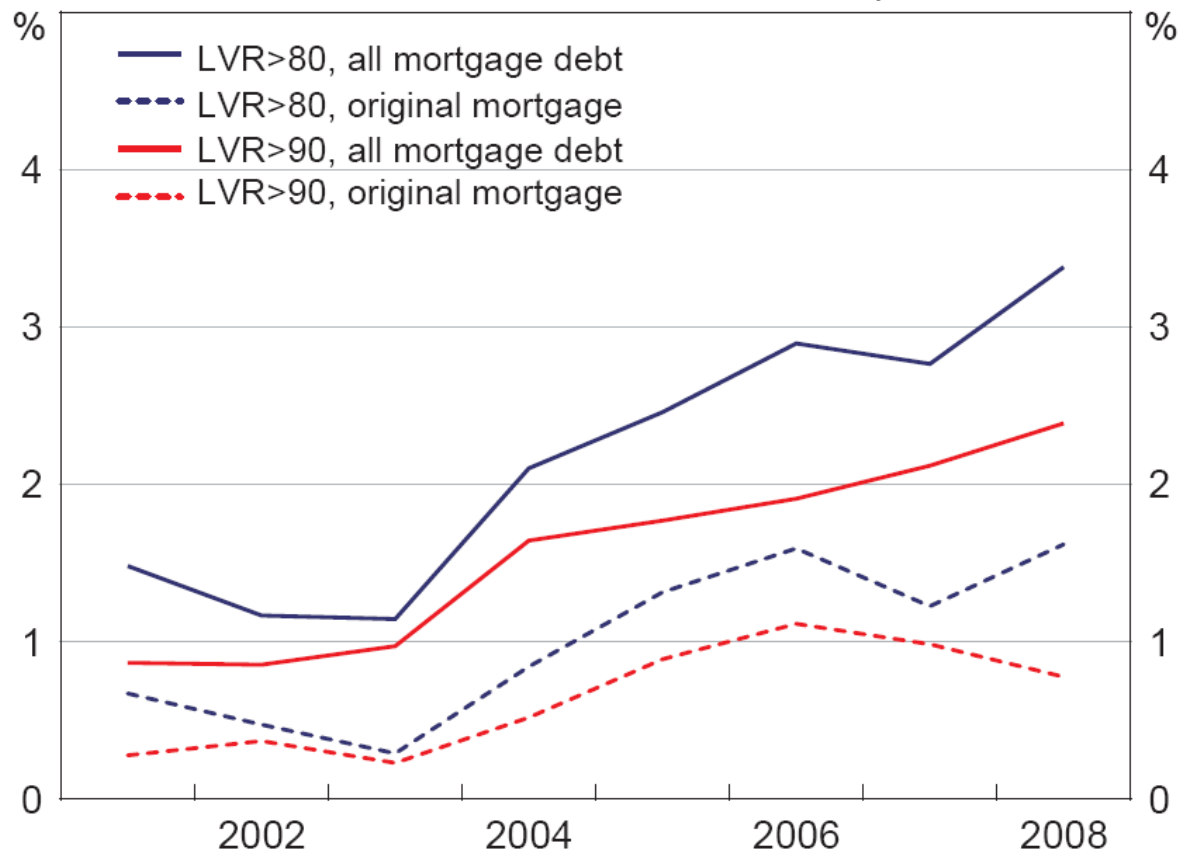
Debt servicing ratio



The proportion of households whose loans are 'vulnerable' remains low

Households with Low Equity and High Repayments*

Per cent of households with owner-occupier debt

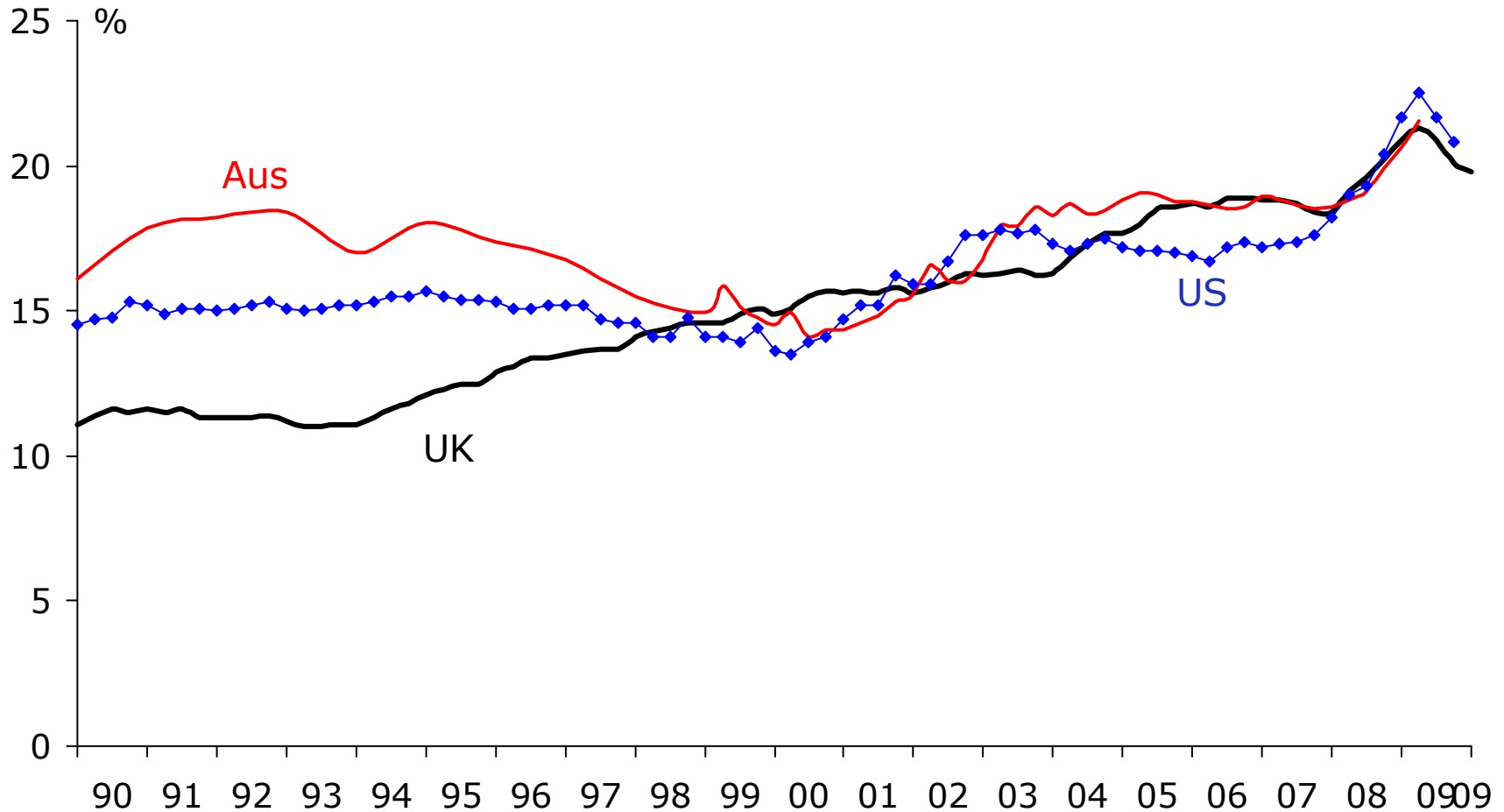


* Repayments on corresponding debt greater than 50 per cent of household disposable income



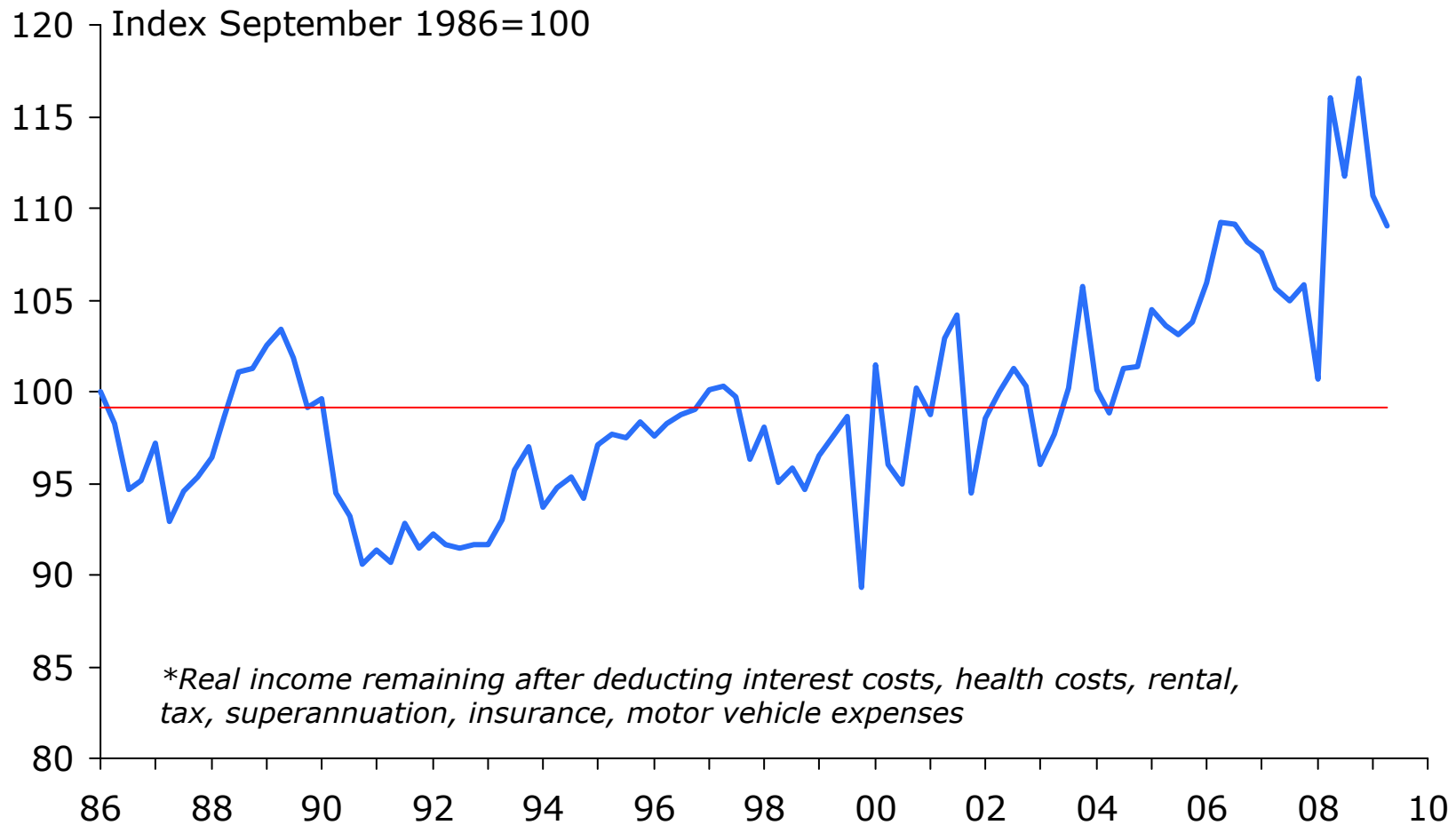
Aggregate household sector balance sheet suggest we're in the same shape as the US and the UK...

Household debt to assets ratio



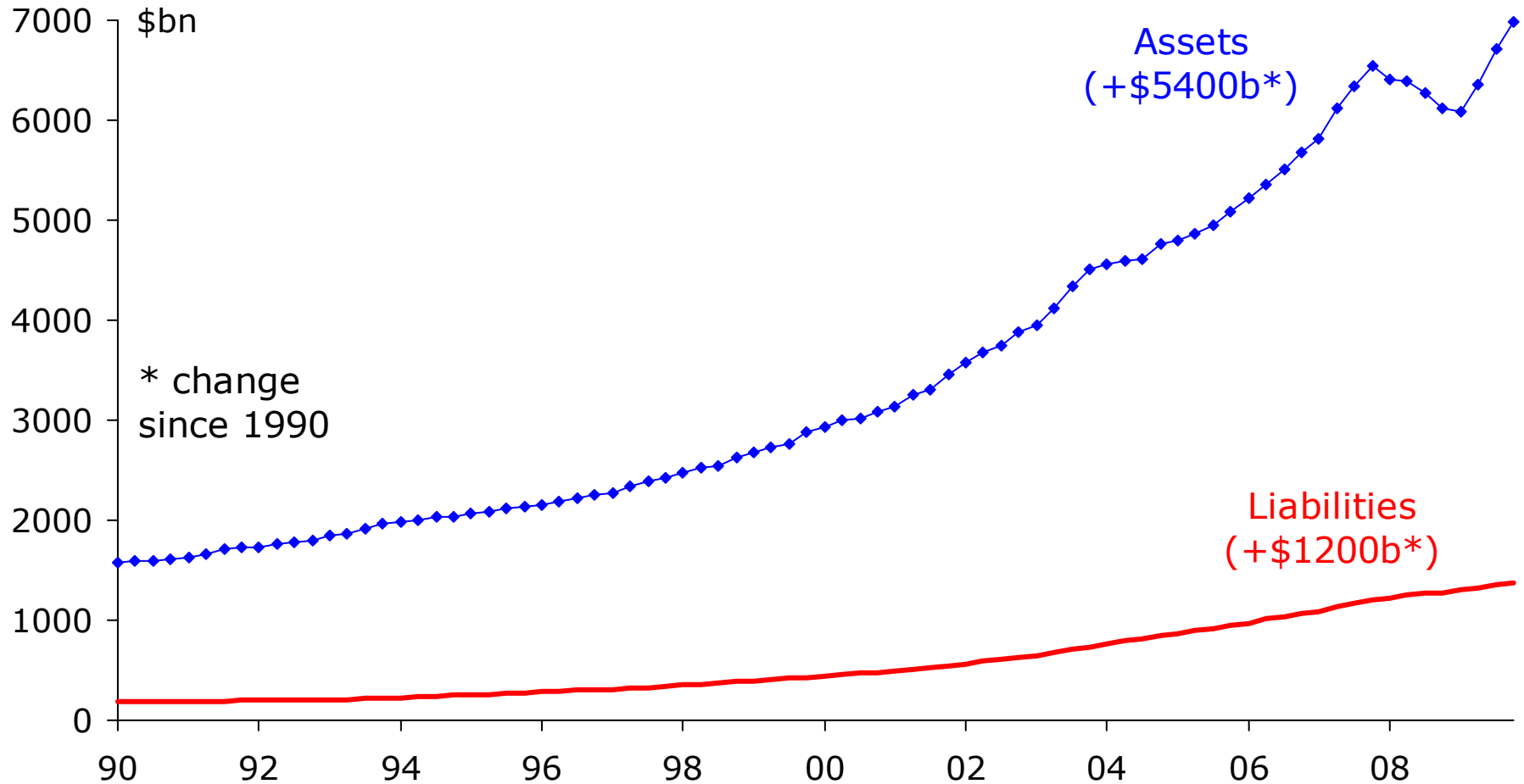
...but the household sector remains more 'income-comfortable' than it has ever been

Real 'discretionary'* income per household



Increased household debt has been more than offset by growth in assets

Assets vs. liabilities



Summary

Australia well positioned cf. rest of developed world

- China/commodity price upswing (esp. bulks)/TOT
- Debt burden manageable
- Mining investment (LNG, coal, iron ore)
- Export volumes to rebound

Housing outlook positive

- Record population gains
- Solid labour market
- Critical housing shortage will worsen
- If the GFC couldn't hurt house prices...

Household sector in good shape

- Conservative lending/no sub-prime = few vulnerable households
- Delinquencies remain low levels
- *Distribution* of household debt is critical to its sustainability
- Unemployment *falling*
- Wages rising/confidence high

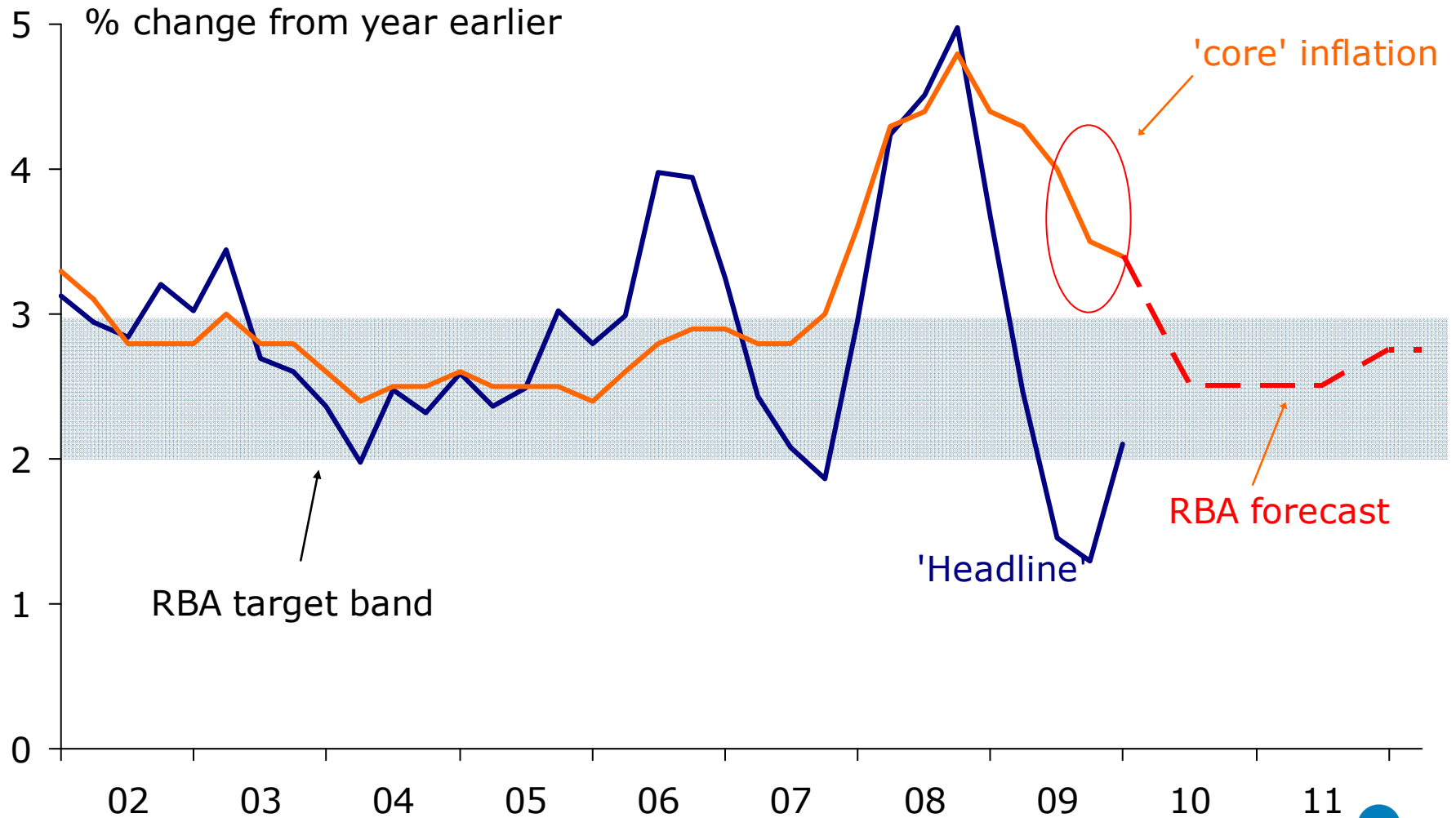


The risks...



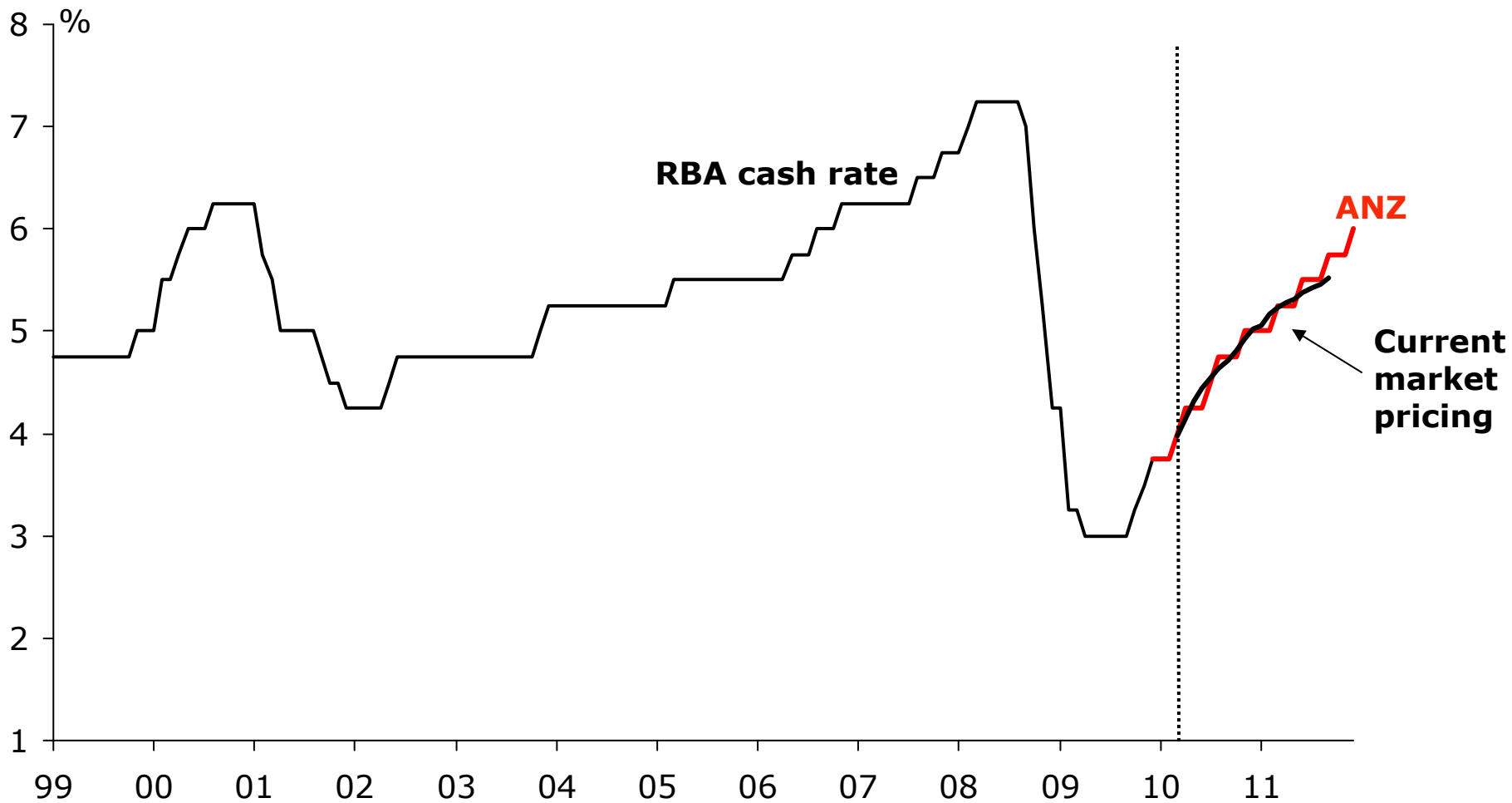
'Underlying' inflation remains high, with growth now accelerating and capacity tight

Consumer price inflation



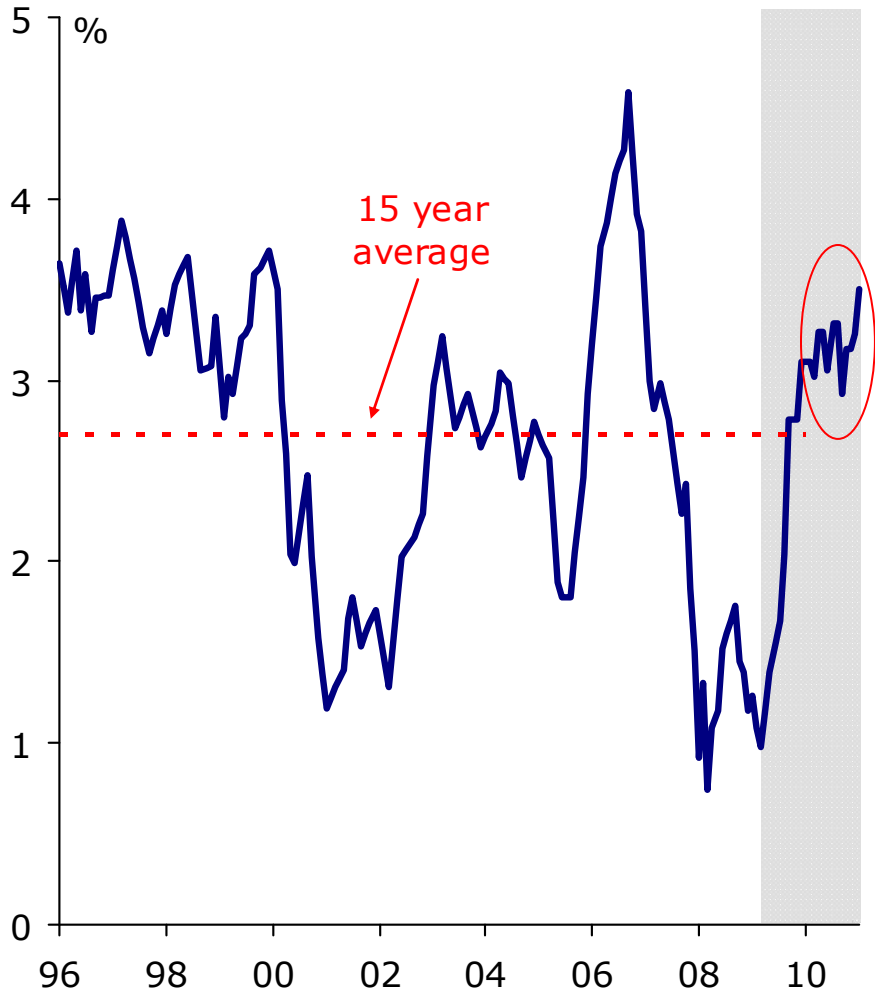
Consequently, the market is pricing further hikes...

'Market pricing' of cash rate changes

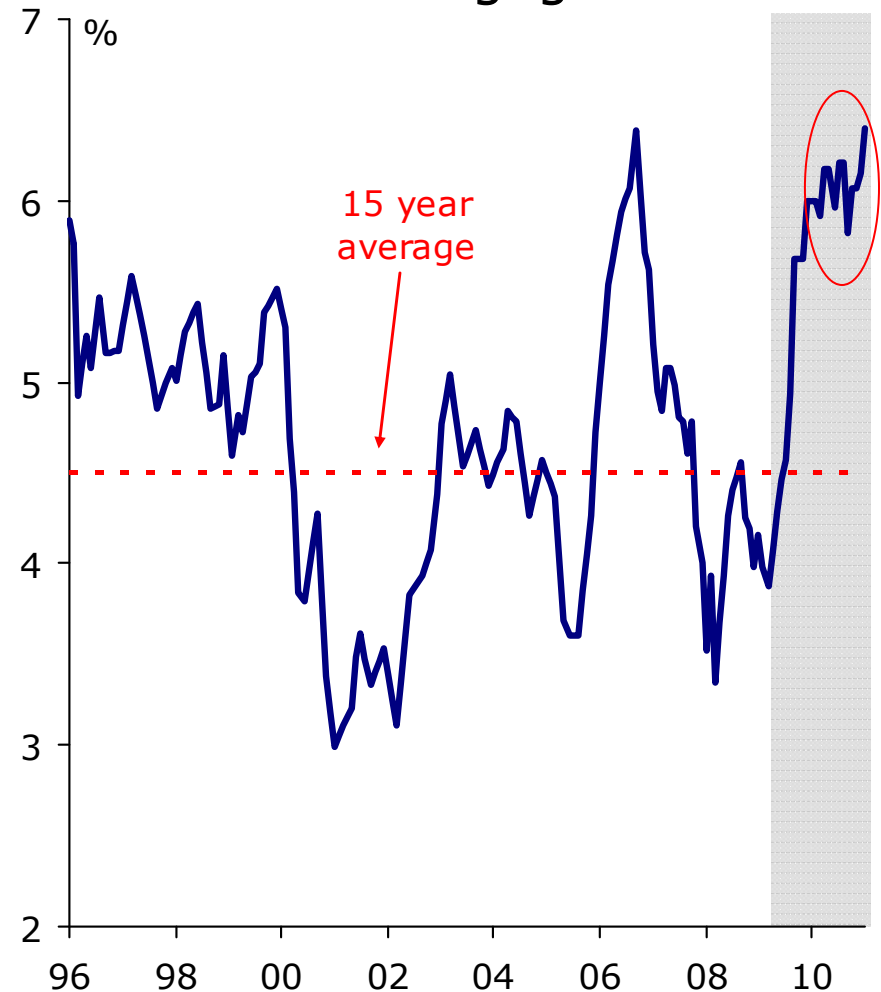


...and tightening could take policy *well beyond* 'neutral' in 2010-11

Real official cash rate

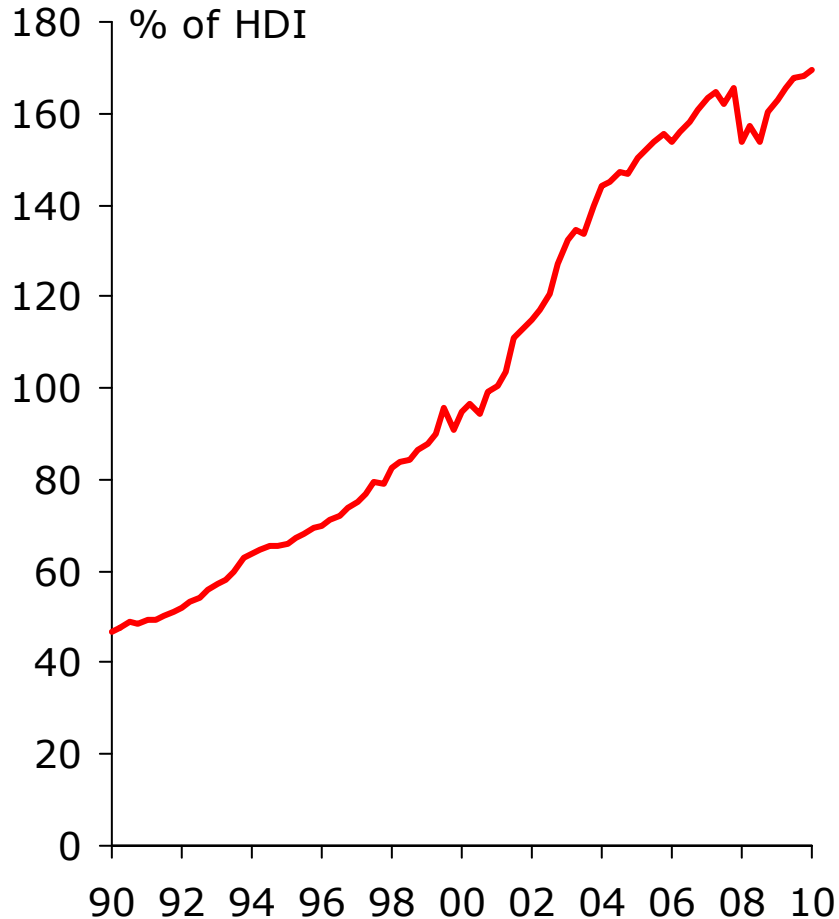


Real mortgage rate

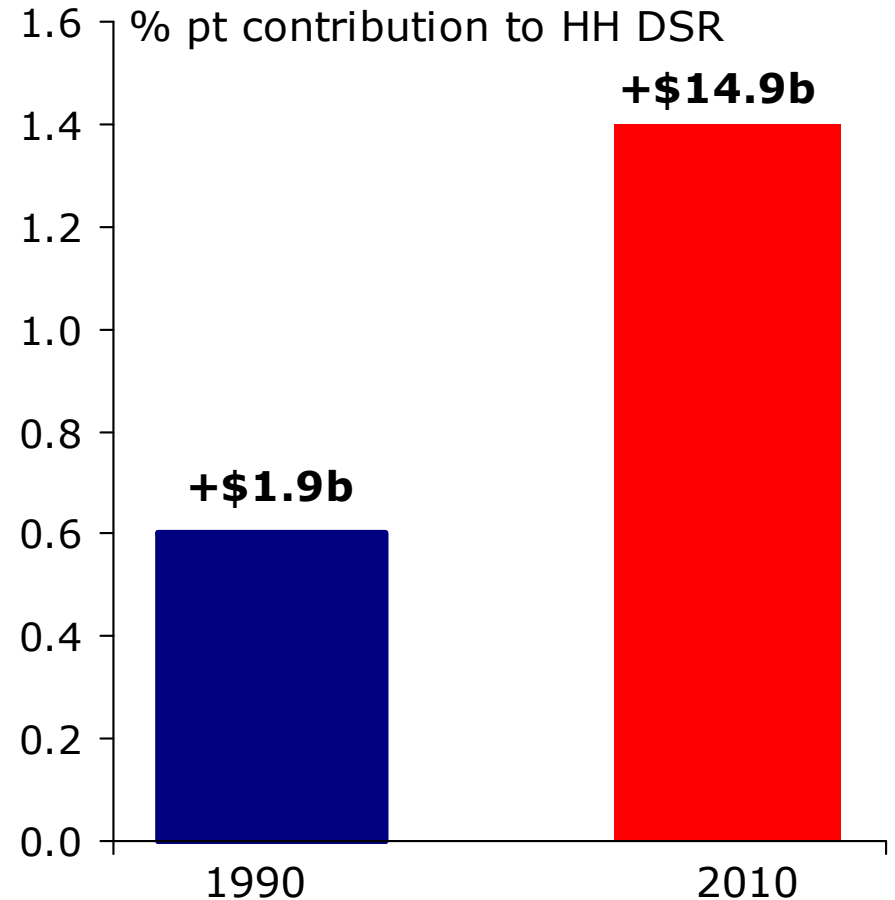


Monetary policy now has significantly increased leverage over the household sector...

Household debt to income ratio

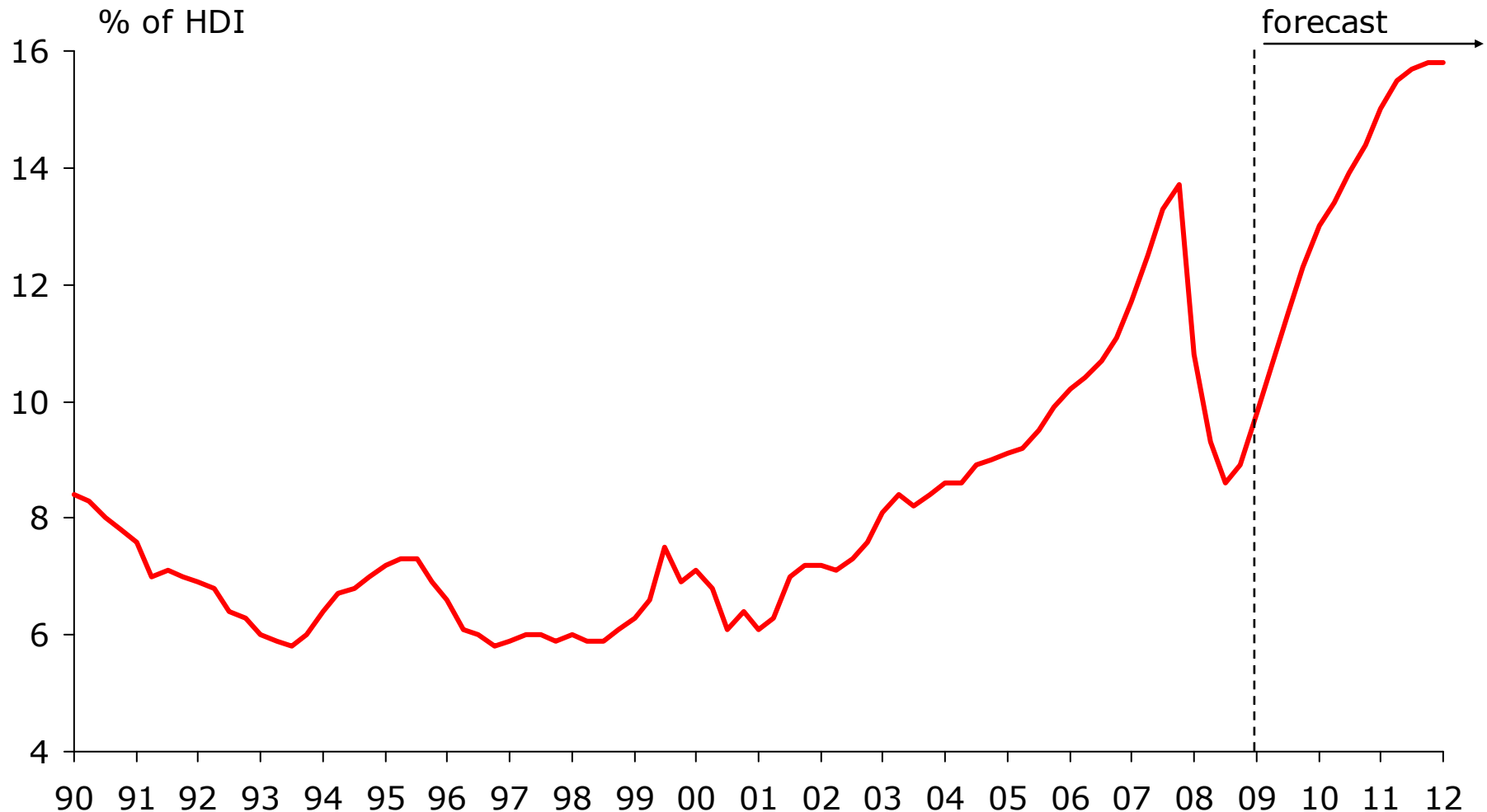


Impact on HH DSR of a 100 bps shift in monetary policy



...and the household sector will face a *record high* debt servicing burden in years ahead

HH debt service ratio



Rising interest rates will hurt affordability – but could also tighten fundamental market balance

Housing purchase affordability will deteriorate sharply

- Rising mortgage rates
- Rising prices
- Could *cap* further price gains

...but housing supply could be restricted...

- Home building could be 'collateral damage'
- *Every major cyclical downturn in housing construction has been triggered by rising interest rates*
- Critical housing shortage risks becoming intractable

...hence rising interest rates could *boost* house prices in the long-run

- Ultimately price a function of supply vs. demand
- Current new supply (flow) already well below underlying housing demand

Other risks

Policy shift

- FIRB reversal?
 - significant political pressure in election year
- Reduced net migration targets?
 - significant political pressure in election year *but* ultimately means reduced economic growth/reduced employment/reduced incomes
 - Skilled labour shortages already apparent

Economic risk

- Recession/rising unemployment/forced sales
 - Low probability in the near-term given position in the economic cycle
 - Commodity price/resource investment boom
 - Global backdrop?
 - China/India critical

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