

30 November 2009

## **RP Data – Rismark Home Value Index Release**

Australian House Prices Rise Strongly in October after Sluggish September...

*Australia's growth in home values rebounded in the month of October increasing by 1.4 per cent after a relatively flat September.*

Based on the rpdata.com residential property database, which is the nation's largest with over 226,000 sales in the first nine months of 2009 alone, Australia's housing market bounced back strongly in the month of October after little growth in September.\*

According to the market-leading RP Data-Rismark National Capital City Hedonic Index—which is published by the RBA in the Statement on Monetary Policy—Australian home values rose by an indicative 1.4 per cent in the month of October after just 0.4 per cent growth in September.\*\*

Over the first ten months of 2009, Australian home values have now risen by 10 per cent following on from their 3.8 per cent peak-to-trough falls in 2008.

According to rpdata.com's Senior Research Analyst, Cameron Kusher, "the strong growth figures throughout October after a slowdown during September show that the market is very resilient and that the 25 basis point interest rate increase during the month has not immediately impacted market."

Rismark International Managing Director Christopher Joye said, "Although we forecast a resilient recovery in 2009, we have been surprised on the upside by the strength of conditions, which reflects Australia's better-than-expected employment and growth outcomes. We project that as mortgage rates normalise capital growth rates will fall back to more subdued levels."

Cameron Kusher said the likeliness of further interest rate rises over the next 12 to 18 months is likely to result in more normal growth conditions over 2010.

"As interest rates rise over the next 12 to 18 months more normal rates of growth are likely. The

removal of the First Home Buyers Grant Boost and higher loan costs are will also result in greater pressure on the rental market,” he said.

Christopher Joye commented, “According to our analysis of all home sales in Australia, which we have privately shared with the RBA, the median Australian home value is only four times average disposable household incomes. This is inconsistent with claims that Australian dwelling prices are 6-8 times household incomes. People forget that 40 per cent of the housing stock is not located in the capital cities.”

“This data implies that Australian housing is not expensive by overseas standards, and also helps explain our internationally high rates of home ownership combined with very low mortgage default rates.”

“One question exercising people’s minds is the impact of higher interest rates. The RBA has pointed out that when they cut mortgage rates by 40 per cent in the second half of 2008 most borrowers did not actually reduce their repayments. The RBA suggested that this means that borrowers should be able to absorb future rate hikes as mortgage costs normalise,” he said.

When we divide the patented RP Data-Rismark Index up into the cheapest 20 per cent of suburbs ranked by price, the middle 60 per cent of suburbs, and the most expensive 20 per cent of suburbs (see chart), we see that contrary to popular belief the least expensive areas (+8.5 per cent) have significantly underperformed the luxury markets (+11.9 per cent) in the year-to-date. This reverses out the trend in 2008, when the cheapest areas fared the best while the luxury markets performed worst.

In the month of October homes values rose in every single mainland capital city except Darwin (-0.5 per cent), which is unsurprising given it has already experienced 12.7 per cent growth in the year-to-date.

Cameron Kusher commented, “Darwin has had a tremendous run over the last 18 to 24 months seemingly unaffected by the Global Financial Crisis. With values now similar to those recorded in Melbourne an eventual slowdown in growth was inevitable. From an investment perspective the city remains extremely attractive due to the impressive yields. Any slowdown in value growth is likely to have a further positive impact on yields.”

The biggest story of 2009 has been the strong recovery in the Melbourne and Sydney housing markets. In the three months to end October, home values in Melbourne and Sydney have

outperformed most other capitals rising by 4.5 per cent and 3.2 per cent, respectively (see attached summary tables for more).

Over the year-to-date, Melbourne has been Australia's best performing capital city, delivering capital gains of +14.9 per cent. Sydney is up by nearly 1 per cent per month with cumulative growth of 9.9 per cent. In the first 10 months of 2009, most of the other capital cities have performed strongly with Darwin (+12.7 per cent) leading the way, followed by Canberra (+11.0 per cent), Brisbane (+6.9 per cent), Perth (+6.1 per cent) and Adelaide (+4.6 per cent).

The RP Data-Rismark National Home Value Index results show that in the month of October, detached houses (+1.5 per cent) have once again shaded units (+1.1 per cent).

Over the three months to end October, house values (+3.3 per cent) have also outperformed units (+3.0 per cent). But in the year-to-date, units (+10.4 per cent) have generated slightly higher capital gains than houses (+9.8 per cent).

Mr. Joye said that the greater rate of growth for units over the year is likely due to the fact that in the first half of the year there was strong unit demand driven by first time buyers.

In the RBA's October Board Minutes, the Bank noted:

"[M]any households with home loans had not sought to lower their monthly payments when mortgage rates had fallen and had instead paid down their loan balances ahead of schedule. This would reduce the vulnerability of that part of the household sector to rising mortgage rates."

In a speech last week, the RBA's Deputy Governor reiterated concerns that we have previously raised about international interpretations of house-price-to-income ratios. He commented:

"International comparisons of the relativity between house prices and income have been the subject of considerable research over the years. One of the complications faced by people working on this topic is to ensure consistency in the data that underlie the comparisons. Do the figures relate to capital city prices, or the prices across the whole country? Do they cover all dwellings or just detached houses? Is income measured as average weekly earnings or average household income? It is not always possible to get entirely consistent data across countries, so we need to be careful in interpreting the results of these comparisons."

Based on RP Data-Rismark estimates, Australia's national dwelling price-to-income ratio of 4x is

a bit higher than the US metric of 3x, which is lower than most developed economy peers. Here the Deputy Governor of the RBA offered an explanation for the differences:

“There are a couple of reasons why Australian households seem to be able to sustain a higher ratio of house prices to incomes. First, Australians seem to spend less of their income on non-housing consumption than is the case for US households, with a significant part of this difference explained by lower health costs in Australia. Australian households therefore have greater capacity to service housing loans. Second, the level of gearing in the United States housing market is noticeably higher than in Australia. This may reflect the fact that Australian households are more active in paying down their loans after buying a home, possibly because owner-occupied mortgage interest rates are not tax deductible here as they are in the United States. The faster pay-down of mortgage debt in Australia reduces the risk of borrowers subsequently getting into financial difficulty. Overall, the experience of the last few years suggests that the Australian household sector as a whole appears to have the financial capacity to sustain a relatively high ratio of housing prices to income.”

On the subject of whether Australian housing is unduly expensive, the IMF commented in its October 2009 World Economic Outlook Report: “In the case of Australia, if the impact of long-term migration on housing demand is taken into account, the results do not produce evidence of a significant overvaluation of house prices.” The IMF also concludes that: “If past is prologue, these estimates suggest that...the [housing market] corrections in Australia and the United States are close to complete...”

In a recent presentation to the Melbourne Institute Rismark’s CEO examined IMF’s estimates of changes in real house price-to-income ratios from 13 OECD countries including Australia over the period 1997 to end 2008. It is noteworthy that the more recent period arguably disadvantages Australia since home values here fell only modestly in 2008 whereas they suffered precipitous falls elsewhere. On the basis of this benchmark, changes in Australian housing costs over time have been demonstrably ‘middle-of-the-road’. More precisely, between 1997 and 2008 Australia’s house price-to-income growth was lower than the following peers:

- The UK;
- France;
- Sweden;
- Spain;
- The Netherlands; and
- Ireland.

Australia's house price-to-income growth between 1997 and 2008 was only slightly higher than that which was realised in Italy, New Zealand and Norway. (The two clear international laggards were Canada and the US.)