

EUREKA *report*



Housing's day of reckoning delayed

By Steve Keen
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PORTFOLIO POINT: Boosting grants to first-home buyers will only serve to inflate the housing bubble further, making the eventual bust more painful.

Eureka Report editor James Kirby writes: Earlier this week our property correspondent Monique Wakelin inflamed the property market bears when she declared house prices are set to rise. Monique believes the combination of a housing shortage, falling interest rates, rising rental yields and now the prospect of higher first-home buyer packages will push up values. The logic may be simple, yet her comments were counter to key market commentators who have been arguing that house prices were actually at the beginning of a long and precipitous descent.

Today one of the best known housing bears, Steve Keen explains his view on the future. Keen, an economics professor at the University of Western Sydney, is so negative on residential property that he has put his inner-city Sydney apartment up for sale. He has said he believes Australian house prices are heading for a 40% fall ... but when?

Many elements of the recently announced package are justified. When the economy is about to go into a debt-induced recession, government spending both boosts demand and provides the private sector with cash flow needed to meet its debt repayment commitments.

Equally vital was the guarantee of all bank deposits. A run on the banks would be disastrous, and this guarantee ensures that this will not happen.

But yet another increase to the First Home Buyers Grant??? Is this because, um, house prices are, like, maybe too low?

Oh please, some reality here: the root cause of this crisis is excessive debt that drove house and share prices to unsustainable levels. Times appeared rosy as the house (and stockmarket) bubble continued, but this was only because borrowed money was adding to demand.

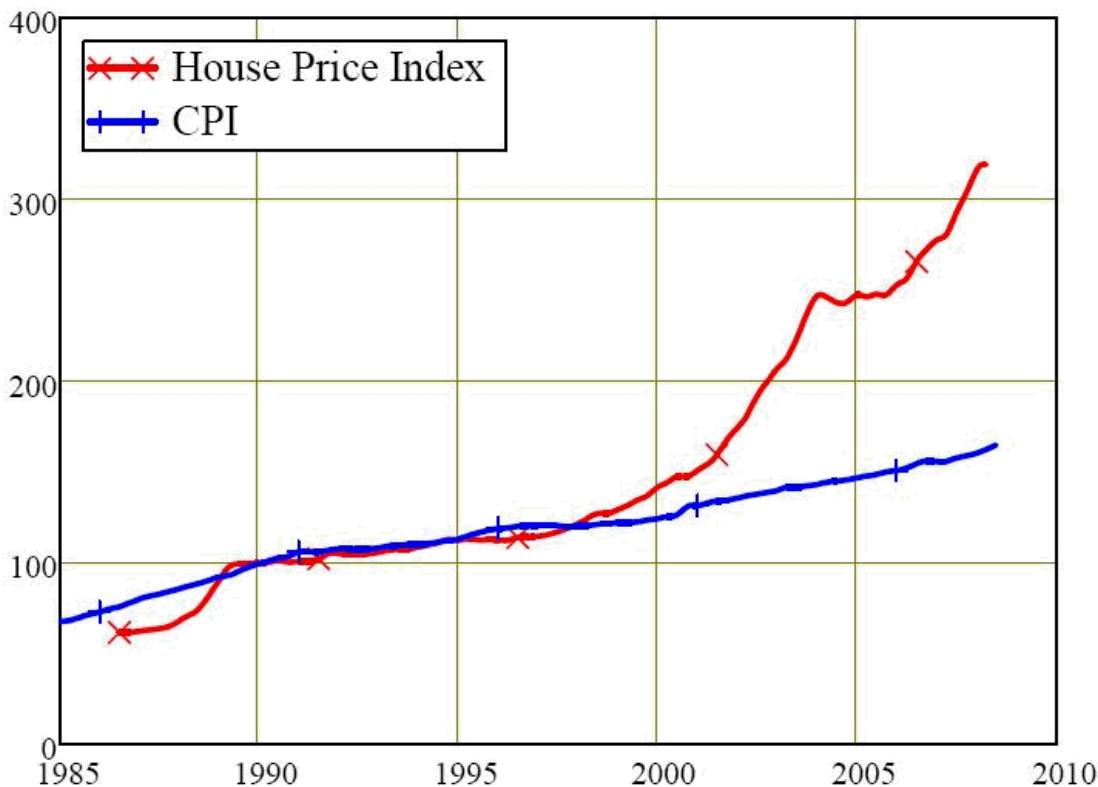
No one worried about this when it was easy to flog a house for a higher price. But unfortunately, this game had to come to an end, because debt servicing became prohibitive as house prices rapidly outstripped incomes. The bubble burst first in the US, and the carnage it has wreaked there should warn us all that asset price bubbles are dangerous.

And how does the Australian government respond? By providing yet another stimulus on the demand side.

A collapsing housing bubble may be a scary prospect, but the more it is inflated, the scarier the final bust. And Australia's, on any measure, is bigger than America's.

A simple comparison of the ABS Established House Price Index (ABS 641601 and 641603) to the CPI shows just how large the Australian house price bubble is (see Figure 1).

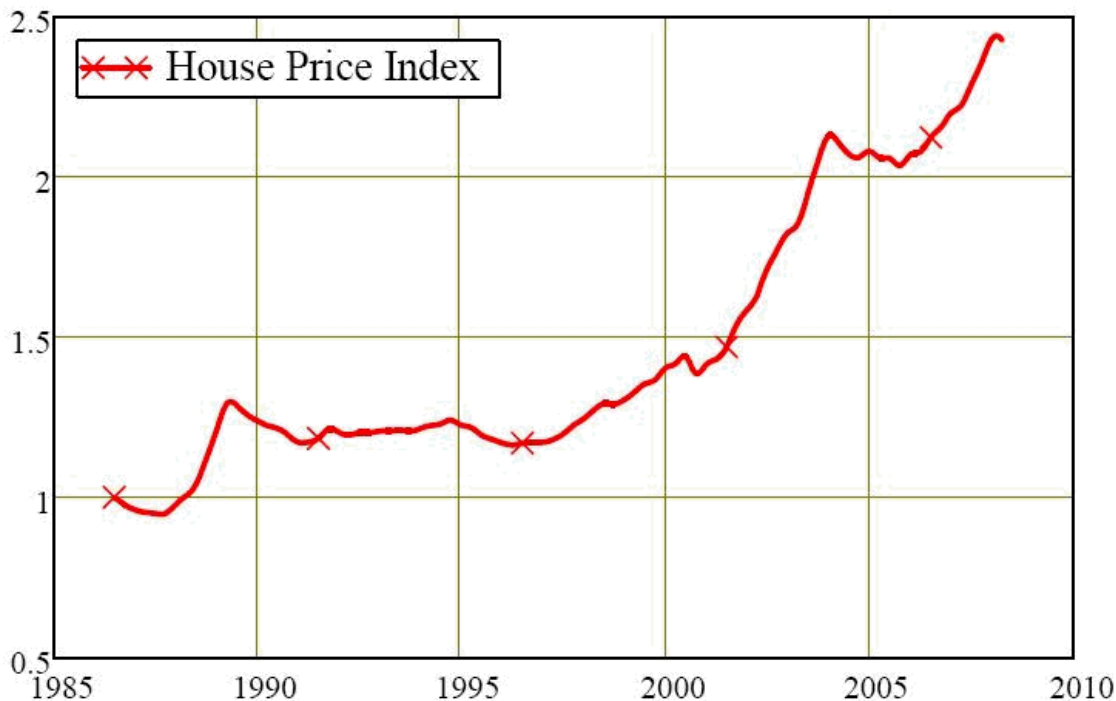
nFigure 1: ABS Established House Price Index vs CPI



Since 1987 – hardly a time when Australian house prices were low by historical standards – house prices have increased two and a half times as fast as consumer prices (see Figure 2). Median incomes have fared little better than the CPI, so that houses are 60% less affordable now than in 1987.

Figure 2: Ratio of Established House Price index to the CPI

1987=1



That's also true, even when we take into account lower interest rates. Yes, rates are about half what they were in 1987 (see Figure 3); but debt is six times larger as a percentage of household disposable income than it was then (see Figure 4) – so that merely paying the interest on outstanding mortgage debt consumes 13¢ in the household dollar, versus a mere 3.5¢ back in 1987.

Figure 3: Interest rates and payment % of disposable income

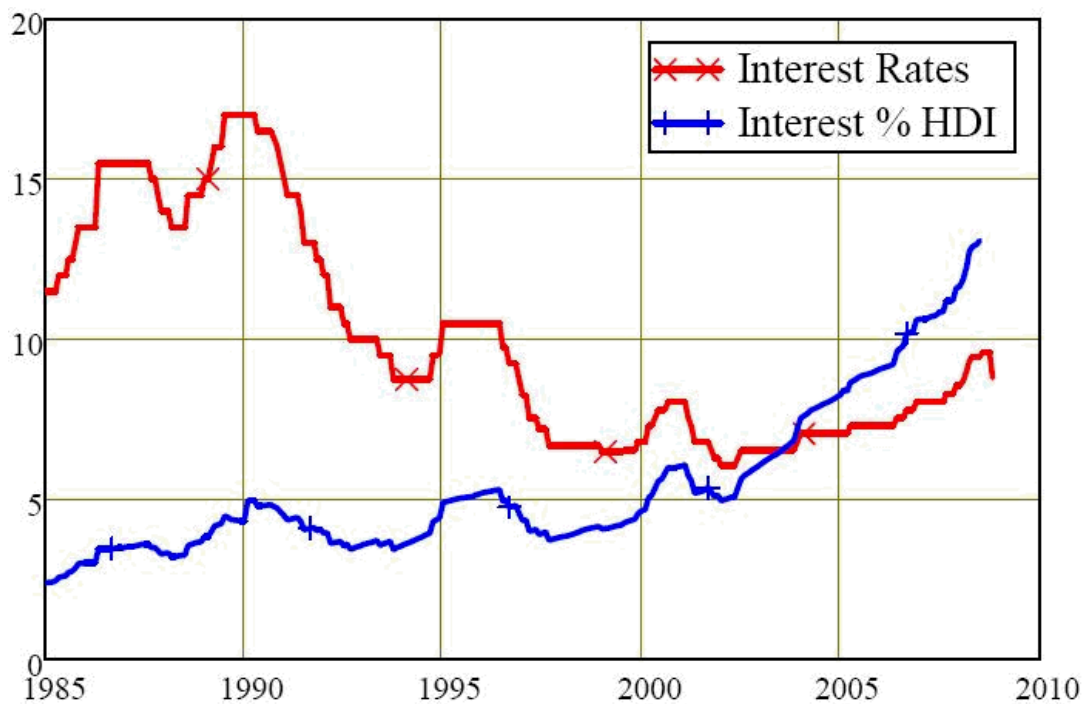
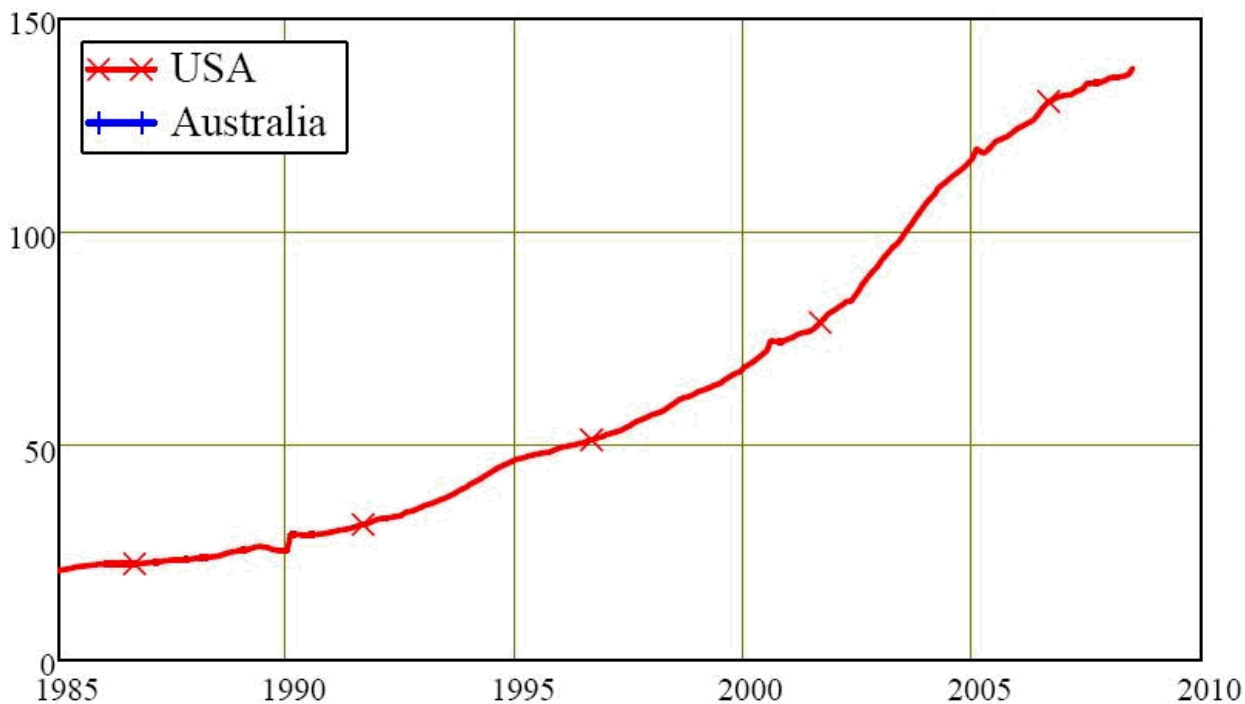


Figure 4: Mortgage debt % of household disposable income

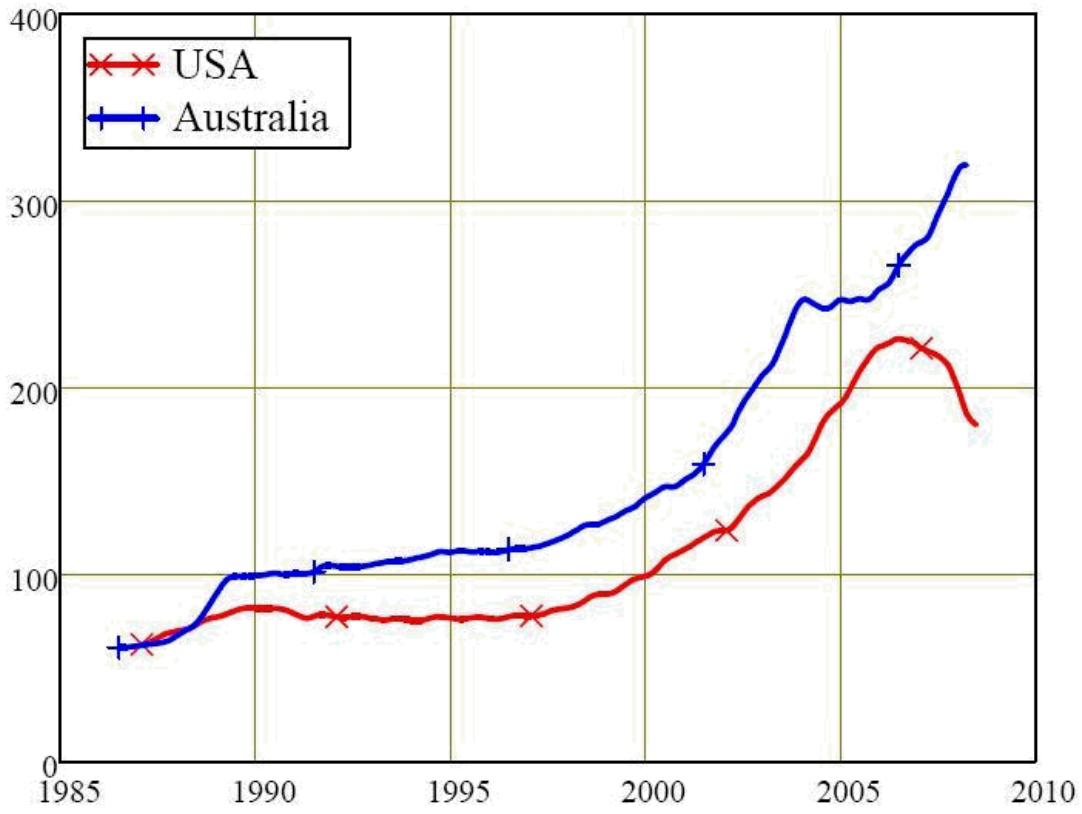


Increasing the amount of money that first-home buyers can slap down on a home may help those who can't afford to get into the market do so – great. It will also increase competition for houses, and potentially sustain the Great Australian Housing Price Bubble. Not great. As the US shows us, the pain of a bursting house price bubble can be pretty immense, especially since it's fuelled by excessive levels of debt.

But that pain will only get worse if the bubble is driven any higher. The higher up you are when you fall off a mountain, the more it hurts when you hit the ground. The Australian house price mountain, on any measure, is substantially higher than America's was when it began its long, painful descent (see Figure 5).

Boosting the First-Home Buyers Grant is a mistake, just as it was when the Howard government did it. It will merely delay the day of reckoning.

Figure 5: House price indices



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