EVANS EDWARDS

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Housing Market: Bubble or Balloon?

As one of Australia's favourite assets, residential property is no stranger to news of a market bubble. Property works a little differently – making the cycle of house price rises less of a bubble and more of a balloon.

QUICK TAKE: WHAT'S A BUBBLE?

In short, a market bubble is an event where the price of an asset quickly exceeds its fundamental value – often by a large amount – before rapidly declining in value. There are usually five stages.

When we hear about market bubbles, it's often within the context of share markets – a fast-paced, speculative and volatile environment prone to the price fluctuations generally associated with a bubble.

Similarly, a property bubble can be driven by a new trend and the irrational fear of missing out. In this context, property prices are boosted when buyers take notice of the trend and enter the market – many of whom look to buy in before the market rises too quickly and hold to generate returns, renovate to manufacture equity, or sell later for a potential capital gain.

Naturally, this can have flow-on effects – in particular, on housing affordability for would-be homeowners struggling to meet the high costs associated with saving a deposit and applying for a home loan.

BLOWING UP AUSTRALIA'S HOUSING MARKET

For years, commentators have said Australia is experiencing a property bubble. And indeed, our $7.7 trillion residential property market has been thriving for decades – with house prices in the country's capital cities (particularly places like Sydney and Melbourne, where first-home buyers are watching prices outpace their ability to earn more money at work) rising so much that they've been called unaffordable, even by global standards.

So how did the housing market get to this point? There are a number of factors that have driven growth over the years. Below, we've highlighted some of the key drivers:

Foreign investment. Favourable economic conditions and the government's relaxed foreign investment rules have made Australia an attractive destination for investment.

Interest rates. The official cash rate has been below 5% for five years, creating a low-interest rate environment that has allowed investors to more easily access credit – for instance, some people can borrow for only a little above 2%.

Easy lending conditions. Previous deregulation across financial institutions resulted in an environment with a greater availability of credit, a wider variety of financial products and, for a time, easier access to interest-only loans.

Tax changes. The introduction of capital gains tax (CGT) for assets other than the family home increased the interest in owner-occupied housing over other assets – and so too have various tax incentives which have further incentivised property investing, such as the 50% CGT discount for property investment sales (when held for at least a year) and negative gearing, which allows investors to offset some property expenses against rental income.

Population growth. As an attractive, multicultural destination, the level of immigration to Australia has increased over the years – with many new arrivals clustering in major cities that have limited housing supply, further driving up the property prices in these areas.

Government incentives. The introduction of First Home Owner and other government grants to support first-home buyers has put a floor under housing.

Supply. The processes for new housing supply – which can require the release of new land, planning approvals and improved infrastructure (like public transport) – has often meant that supply is unable to keep up with demand.

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HOW DO WE KNOW IF THE BUBBLE WILL BURST?

We don't. It's easy to recognise a bubble in retrospect, but no one can forecast the future. However, there are indicators investors can look to for insight on economic conditions and market sentiment:

Interest rates. If the economy is growing too quickly, or if the economy experiences higher inflation, the RBA may hike the cash rate to cool and maintain balance in the economy. This could have the effect of making mortgage repayments more expensive for investors.

Inflation. In a post-pandemic world, markets are considering supply chain issues during the current economic re-opening – with a shortage of goods and services leading to higher costs for companies and, in turn, higher prices for consumers. These factors could result in higher interest rates and higher living costs for tenants paying rent, as well as homeowners and property investors making mortgage repayments.

Household debt. Australian household debt levels have increased substantially over the decades, with the debt-to-income ratio (a measure comparing household debt to income) sitting at about 190% (at November 2020) – most of which is housing debt. Heavily indebted households are more vulnerable to economic shocks, job losses and interest rate hikes.

Access to money. Recently, there was uncertainty around responsible lending legislation, leading banks to be more careful in providing money to borrowers.

Migration. With Australia's borders closed, one of the historic supporters of property has disappeared – but may also be the next leg up for markets or support for future prices.

We can't predict the future. But for now, at least, it seems that the property market will continue floating along – supported by the favourable economic environment.

Source: Colonial First State

If you have any questions around your particular circumstances, give Shaun or Vicky a call on 4927 4588 (Rockhampton) or 4939 1766 (Yeppoon).

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