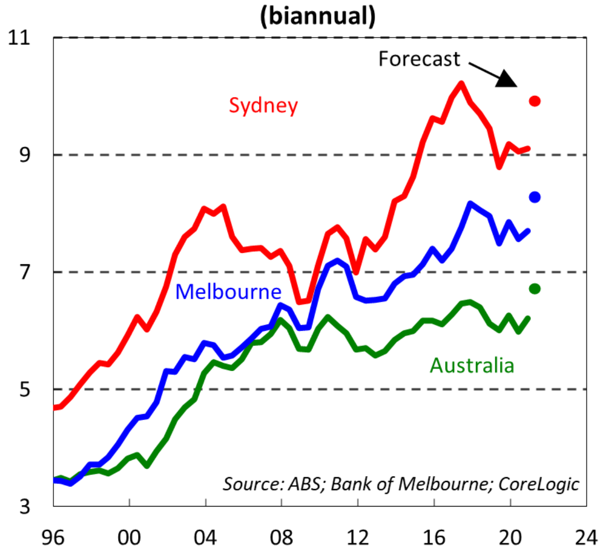
Wednesday, 19 May 2021

The Supercharged Housing Recovery

Affordability Pressures Set to Bite

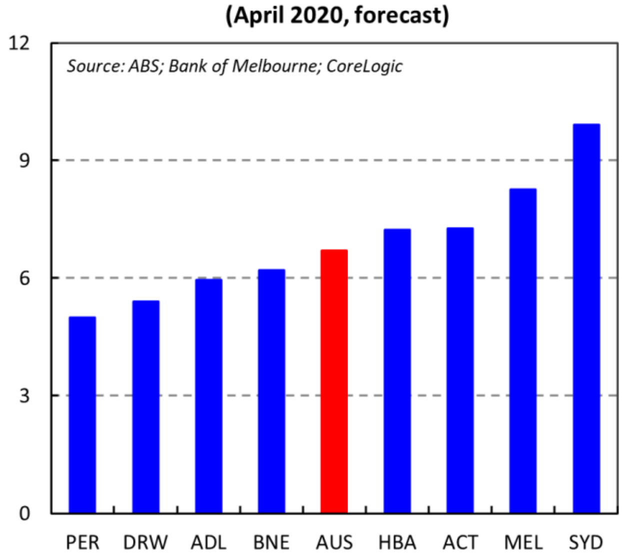
- **Housing affordability looks set to be squeezed with dwelling prices surging while wages growth remains stagnant.**
- **One measure of housing affordability is the ratio of the median dwelling price to average household income, estimated by annualised average weekly earnings. Our modelling suggests dwelling prices reached seven times average annual earnings at the end of April.**
- **Affordability constraints are most prominent in Sydney and Melbourne. In Sydney, the dwelling price-to-income ratio had increased to close to 10 by the end of April, not far from its 2017 peak. In Melbourne, the ratio increased to around eight in April, its highest level on record.**
- **Early signs of an affordability squeeze are apparent in lending to first-home buyers. This cohort tends have lower income and wealth than the average household, and are typically sensitive to affordability pressures. New lending approvals to first-home buyers peaked in January this year and edged down over the following months.**
- **Some prospective buyers will be deterred as affordability pressures bite, which will take some of the heat out of price growth. We expect 15–20% growth in dwelling prices in 2021 followed by a slower pace of growth in 2022 after prudential controls and affordability constraints take effect.**

Dwelling Price-to-income Ratio*
(biannual)



*Median dwelling price and annualised average weekly income

Dwelling Price-to-income Ratio*
(April 2020, forecast)



*Median dwelling price and annualised average weekly income

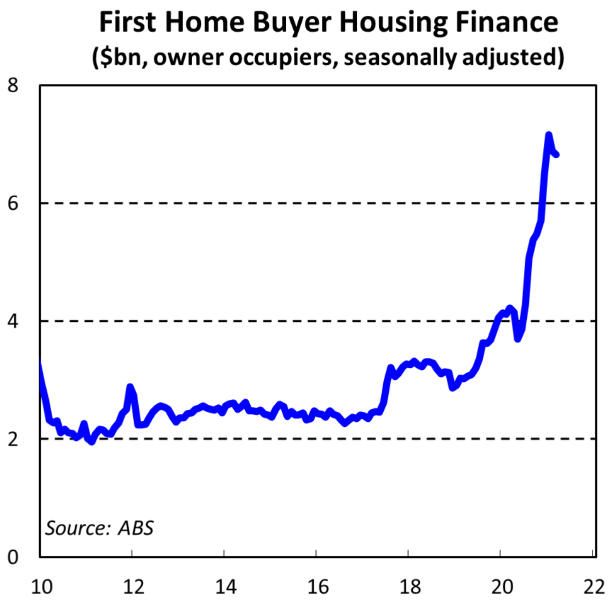
The accessibility of housing is central to Australian public debate. This issue will be in the spotlight in the coming period as affordability looks set to be squeezed with dwelling prices surging while wages growth remains stagnant.

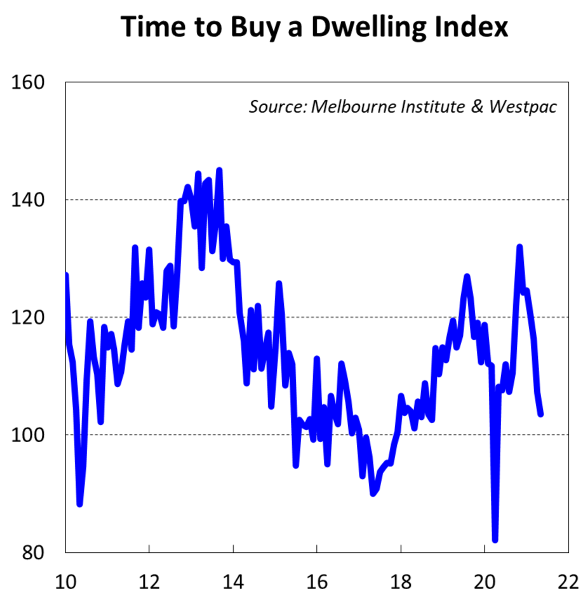
Aside from a bigger mortgage, higher prices also make saving for a deposit and the transaction costs associated with purchasing a house a bigger hurdle for would-be buyers.

One measure of housing affordability is the ratio of the median dwelling price to average household income, estimated by annualised average weekly earnings.[1] A higher ratio implies a deterioration in affordability. Average weekly earnings data are released only twice a year and the most recent reading is for November 2020. Our forecast assumes the average income level is unchanged since November 2020. According to this forecast, dwelling prices reached seven times average annual earnings at the end of April.

As has been the case for a number of years, affordability constraints are most prominent in Sydney and Melbourne. In Sydney, the dwelling price-to-income ratio had increased to close to 10 by the end April, not far from its 2017 peak. In Melbourne the ratio increased to around eight in April, its highest level on record. The dwelling price-to-income ratio is also above the national level in the ACT and Hobart. Dwelling prices have grown more sharply in these areas than other capitals over the past five years. Dwelling prices in Hobart rose 56.4% in the five years to April 2021 while in the ACT prices were up 36.0% in the same period.

Early signs of the affordability squeeze are apparent in lending to first-home buyers. This cohort tends be younger, with lower income and lower wealth than the average household, and are typically sensitive to affordability pressures. New lending approvals to first-home buyers peaked in January 2021 and edged down over the following two months. More broadly, new lending approvals for housing have continued to surge.





[1] Gross disposable income (GDI) is another measure of income which is also sometimes used in calculating dwelling price-to-income ratios. GDI is a broader measure than average weekly earnings because it incorporates non-labour components of income, including government support payments. We used average weekly earnings of full-time adults instead of GDI to strip out the impact of temporary income support payments, like JobKeeper.

Concerns over affordability are also apparent in the 'time to buy a dwelling' index from the Melbourne Institute's Consumer Sentiment survey. It has declined over 20% since November 2020. The index has historically been sensitive to affordability constraints.

Another metric of affordability is the mortgage repayment burden. Ultra low interest rates make housing more affordable by making it cheaper to service a mortgage. Indeed, this is one of the key drivers of the surge in housing demand.

However, while variable mortgage rates are likely to remain low until the RBA hikes the cash rate, the lows in the fixed home loan rates might be behind us with swap rates having troughed late last year. This will exacerbate the affordability pressures from rising prices.

So, what does this mean for prices? Some prospective buyers will be deterred as affordability is stretched, which will take some of the heat out of price growth. This is consistent with our expectation that the supercharged growth we have seen over recent months will not be sustained, as we explained in the first report in this series. We expect 15–20% growth in dwelling prices this year, followed by a slower pace of growth in 2022 after prudential controls and affordability constraints take effect.

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