Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates 1 - 2 November 2006

Question: **sbt 10**

Topic: **Housing Prices**

Hansard Page: **Written**

Senator CARR asked:

(1) The Budget Papers (BP No. 1, Statement 3, Outlook for the Domestic Economy) refer to the increased willingness of householders to take on debt and the related boom in house prices:

a) Does Treasury consider the willingness to take on debt to have been the primary driver of the house price boom?

b) Does Treasury agree with the OECD's assessment, reported in early December 2005, that Australian house prices were the most overvalued in the Western World?

c) Does Treasury agree with the OECD that, historically, most booms in house prices have ended in a bust which, at worst, wiped out the rise in prices?

d) Did the Government seek any advice from Treasury on action it would take to stem the boom in house prices, given the likelihood of such booms leaving some families with negative equity in a rising interest rate environment?

e) Did Treasury provide any advice to the Government about the risks inherent in the housing boom? If so, please provide a copy of that advice.

(2) Treasury has based its assessment of investor activity in the housing market, in part, on there being a "period of low rental yields". What is the primary basis for the low yield expectation – high costs or relatively low rents? Has the significant tightening in the rental market, with vacancy rates below 2 per cent in most capital cities, affected this assessment?

Answer:

(1a) As stated in the 2006-07 Budget, "the long period of relative employment certainty, in combination with low interest rates, has given households the confidence to take on additional debt relative to their income, predominantly for expenditure on housing".

(1b) It is difficult to make a judgement about the fair value of housing. Treasury is aware of a number of estimates and is cautious in their use as there is a large band of uncertainty around these estimates.

(1c) As shown in the OECD report referred to, around half of the housing booms from the 1970s to date have been followed by some downturn. However, around three-quarters of these downturns did not see prices return to levels experienced before the boom.

(1d) Treasury provides advice to the Government on a range of matters.

(1e) Treasury provides advice to the Government on a range of matters.

(2) The 2006-07 Budget states that "The adjustment to a period of low rental yields, little growth in house prices and an expectation that this may continue for some time is likely to continue to discourage investor activity in the housing market. Moreover, the current strength of the stock market and the possibility of further capital gains are increasing the incentive for investors to shift their capital out of housing".

Rental yields are calculated by using annual rents divided by house prices. Rent growth has been much lower than house price growth, meaning that rental yields are lower. Any tightening in the rental market would, all else unchanged, likely place upward pressure on investment demand.