HOUSING: TAMING THE ELEPHANT IN THE ECONOMY

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Key points

- Over the last 40 years Australia's housing system outcomes have exacerbated inequalities of both income and wealth, compromised economic and financial stability, and negatively impacted on labour productivity.
- At the heart of the difficulty is a substantial capacity deficit – of skills, institutions and governance structures – to both understand the housing system and to construct a coherent housing market strategy and the policies to deliver it.
- The absence of a coherent housing market strategy matters, not only because the housing market impacts the whole housing system, but also because it is central to the development of the national economy.
- Among Australia's leading economists and housing experts, the overwhelming majority (85% in our survey) back the contention that 'policymakers should pay greater attention to the economic productivity effects of housing market outcomes, such as costs, tenure, quality and proximity to work'.
- By a margin of almost four to one (67% versus 17%), leading economists and other surveyed housing experts share the concern that 'the absence of a coherent housing market strategy for Australia now constitutes a significant barrier to structural adjustment in the economy and to an effective post-pandemic recovery'.

But while there is wide recognition that the economy drives the housing market, there seems little recognition that outcomes in the big housing system have significant feedback effects on the economy itself. Housing matters in employment, income, consumption, wealth and debt.

The scale of the housing market in the Australian economy and the diffuse, often disconnected, spread of policy powers that address different aspects of this system make the Parable of the Blind Men and the Elephant a perfect metaphor for our current predicament.

This strong conclusion has emerged from an on-line survey and interviews with a panel of 87 Australian sector experts[1] and from a major review of national and international literature[2] undertaken for the Housing Productivity Research Consortium. This report presents a synthesis of these findings and the conclusions and recommendations we draw from them.

1- Maclennan, D., et al. (2021) Housing and the Economy: Interrogating Australian Experts' Views. City Futures Research Centre, UNSW.
2- These will be published as three separate reports in July 2021.

Crisis? What Crisis?

By any measure, the housing market is a major sector in the Australian economy: the housing stock is now valued at an estimated $8.1tn – double the value of a decade ago – and almost three times the value of Australia's superannuation funds; housing construction provides 5% of all Australian jobs; consumer spending associated with rising house prices shape 15% of GDP; housing wealth comprises well over half of household assets; Australians, with record debt to income ratios, have $2.1tn in outstanding home loans.

But at the same time, since the mid-1990s, housing prices have consistently outstripped income growth, the national home-ownership rate has fallen by 4% and the ownership rate for under 35's has collapsed, building in structural problems for future decades.

Policy makers, restricted by their narrow roles, never fully recognise, let alone placate, the economic elephant that is the housing market.

For the economy, these trends reflect a triple crisis where housing price outcomes have exacerbated income and wealth inequalities, contributed to economic and financial instability and, often unrecognised, diminished productivity and growth.

Unfortunately, large system scale does not seem to have led to big thinking in designing policy and strategy for the national housing market and this contributes to problematic outcomes. For households, pervasive problems of affordability keep spreading up income and age ranges and the prospect of home-ownership for young Australians has been damaged by present policy approaches.

In responding to housing economics evidence, Australian housing policy actions seem to perfectly meet Einstein's test of madness, in repeating the same actions and expecting different results. Now, emerging from potentially the worst recession of the last 100 years, we already have a new housing boom rippling across the nation. Of even more concern, the RBA, almost flying in the face of advice from other central banks, has remained sanguine on rising house prices and argued they are good for growth. This view has no validity if the longer-term evolution of the economy and the housing market is the concern.

This key point from our research provides evidence that across the whole of government, and different orders of government, there now needs to be an integrated housing market strategy to deliver more Australian homes *and* more sustainable house price appreciation. Now, like the blind men and the elephant, policy makers grasp at different pieces of policy impacting housing, including tax policy, monetary policy, macro-prudential policy, housing, infrastructure, planning and other sector actions, but never grasp the whole system.

What Housing-Economy Links and Impacts Need To Be Recognised?

Productivity impacts

Residential property has profound impacts on wider economic productivity that are ignored in contemporary policy debates.

- Among Australia's leading economists and housing experts, the overwhelming majority (85% in our survey) back the contention that 'policymakers should pay greater attention to the economic productivity effects of housing market outcomes'.
- As many as 91% of our survey respondents agreed that 'high housing costs reduce consumption of non-housing goods'.
- Nearly three quarters (73%) agreed that 'metropolitan housing market distortions such as sub-optimal labour market matching due to high prices and rents are impairing economic growth and productivity'.

Rising residential housing markets can support positive impacts on productivity, for example when increased housing wealth is used as collateral to borrow to fund non-housing investments. At the same time residential investment can 'crowd out' investment in more productive activities and lead banks to prioritise lending to housing consumption and 'rent seeking' investment with no positive feedback into economic productivity. Australian evidence on the balance of these effects is missing.

High metropolitan house prices and rents push lower and middle income households further away from employment locations reducing overall labour productivity by diminishing the 'thickness' and matching effectiveness of labour markets.

Unaffordable, poor quality and badly located housing has clear and well documented impacts on human capital formation, through their repercussions on an individual's ability to develop productive capabilities. Despite its importance to economic growth and employment, evidence as to the actual productivity of the residential construction sector is lacking.

Instability impacts

Over several decades Australia's housing system has become more unstable, as a result of housing and mortgage market changes, and now poses a greater threat to economic and financial sector stability.

- Nearly three quarters of experts (73%) in our survey believed that 'high mortgage debts and burdens (reflecting high house prices) raise instability risks for the economy'.
- 85% of these experts rejected the statement that 'short-term interest rate policies are sufficient to ensure macroeconomic stability'.

Overall household debt has risen substantially relative to GDP from 70% in 1990 to almost 185% by 2020. Some three quarters of this debt is in mortgages and 60% of debt held by Australian banks is in the form of residential mortgages, one of the highest globally and greatly exposing the banking system to potential disruption.

International evidence suggests that house prices have, since the 1960s, become highly volatile and closely correlated with the business cycle. There is clear evidence from Australia and elsewhere that high and rising house prices have substantially exaggerated 'normal' business cycles, triggering and reinforcing wider systemic financial and economic crises.

Price changes that shift housing wealth have potentially significant transmission links back to the economy that are not captured in conventional/housing starts cyclical models, yet are key to understanding contemporary economic and financial instabilities.

Households may wish to hold more housing assets than required to meet their consumption demands. That is, investment or speculative demands. Aspiring rental investors are the most obvious example, but home-owners - especially older owners, living in homes with excess space simply because housing has a high net asset return - add substantially to this. Australian tax settings boost that speculative demand. APRA interventions, curbing access to interest-only mortgages, restrained investor lending in 2014 and in 2016 and had a beneficial, albeit temporary, effect in moderating these pressures. Investor purchases have risen sharply into 2021 as a growing share of property purchases. APRA regulations also frame 'safe mortgage lending' for owner occupiers. However, Australia's long-upward trend in the household debt to GDP ratio remains unchecked. And APRA's current reluctance to tighten regulations in the 2021 boom reflects a relatively short term view of the potential stability consequences.

Inequality impacts

Housing system outcomes of recent macro-economic policies, including QE, have exacerbated inequalities of both income and wealth.

- By a margin of five to one, economists and other experts saw 'status quo' economic policies as having exacerbated income and wealth inequality.
- Almost 9 out of 10 rejected the statement that 'claims that house price inflation has worsened income and wealth inequalities in Australia are overstated'.

Homeownership rates have dropped, halving for the under-35s since 1995, while housing wealth has concentrated in the hands of the over 65s. Nevertheless, the home-ownership rate among over 65s is predicted to fall from around 79% today to only 65% by 2056.

The growth of homeownership from the Menzies era until the mid-1990s was widely regarded as a spreading of wealth and reduction of overall inequality. This process has effectively reversed as asset speculation in housing has driven homeowner gains much more than the traditional life cycle saving objectives.

As a result, household wealth distribution in Australia is now significantly unequal and markedly more unequal than incomes.

Housing and the Economy: Taming the Elephant

Increasingly commentators, and national level policy politicians, comment that housing is a 'supply side problem' and many highlight 'planning' as the major cause of slow delivery of inadequate stocks of land and housing. Such conclusions are often based on anecdote and are somewhat incomplete. Housing price inflation is driven by excess demand, but rapid demand stimulus *as well as* sluggish supply can generate excess demand for housing. But even if sluggish housing supply rather than over-stimulated demand is problematic, then it is important to understand which element in the complex supply chain for homes is at fault, including the timing of land release by developers and financial constraints on development capacity, and not simply resort to blaming 'planning'. At local, metropolitan and national levels, housing supply chains need to be much better understood. But our policy making is bedevilled by a substantial deficit in the skills, institutions and governance structures needed to better understand Australia's housing market and strategies to make it more effective and stable.

The housing elephant is in the living rooms and Party rooms of Australia and is set for another rampage through the economy. It's time to tame it!

A system that raises housing costs for all Australians, that raises instability and lowers productivity does not serve the nation well. And as for rising housing wealth, it is not like the wealth created from effort and innovation, for that creates gains for all. Rather, it makes some Australians, the affluent and older, better off by making younger and poorer Australians, and also future buyers, worse off.

Key recommendations

Reversing the substantially problematic trajectory of Australia's housing system over recent decades will call for extensive tax, regulatory and other policy reforms. However, a pre-condition for any such program of work is the reshaping of relevant over-arching institutional frameworks. It is with this understanding in mind that the following measures are proposed:

- Given the fundamental nature of the issues involved, given their disparate nature across departments and levels of government, and to frame renewed government approaches, a ***Royal Commission on Housing Future Australia*** should be set up.
- ***A Cabinet-rank post responsible for Housing Policies and Outcomes*** should be re-established in the Commonwealth Government, a position that – given the highly diverse range of relevant policy instruments – should be closely linked to the Department of Prime Minister and Cabinet.
- As a crucial vehicle for inter-government co-ordination in this policy area, *a* ***permanent Housing Committee*** should be created as part of the National Cabinet structure.
- The Commonwealth Government should commit to developing a ***National Housing Strategy***, including a housing market strategy.
- Expand the National Housing Finance and Investment Corporation (NHFIC) as an enduring ***National Housing Agency*** tasked with informing government policy-making, championing actions to enhance housing-economy outcomes, promoting affordable housing development and re-establishing the analytical capacity of the former National Housing Supply Council.
- In the immediate term, Australian governments should give consideration to ***switching housing stimulus*** efforts from market housing to the social rental sector with potentially lesser inflationary consequences.
- The Australian Government should ***expand the formal accountabilities of the RBA*** to include maintaining a more price stable and well-functioning housing market.

The full report on which this summary is based is **'Housing: Taming the Elephant in the Economy' by Professor Duncan Maclennan and colleagues**. To download the report visit the UNSW City Futures Research Centre website at: https://cityfutures.be.unsw.edu.au/