Houses, homes & price crashes

The housing market is overheated

The recent Australian Bureau of Statistics (ABS) numbers outlining the record-breaking increase in capital city house prices during calendar 2021 have focused attention on the potential for a housing market crisis developing in FY2022/23.

The ABS numbers indicate that overall residential prices increased by 24% in capital cities across Australia. However, when the focus is shifted to house prices, on a quarter-on-corresponding-quarter basis, increases have gone over 30% in some capital cities, as illustrated in Chart 1.

Concerns have increased as the US central bank, the Federal Reserve, has signalled US interest rates will reach 1.9% by the end of calendar 2022 in a move to curtail consumer spending and thus curb inflationary trends. That rate target has increased certainty that Australian interest rates will also head upwards early in FY2022/23.

None of this is unexpected. For the past four years (at least) many respected senior economists have been sitting at their desks with their fingers – metaphorically – pressed into their ears, waiting for the housing market to implode.

That irrationality has been clearly detailed by economists such as the Nobel Prize (2013) winner Robert Shiller, who has explained in his book Narrative Economics how little rational basis there often is to price rises in housing and other markets. There is not much doubt that in the market's current state, achieved in the second half of 2021, house prices are now going up just because, well, house prices are going up. House buyers are now worried they will miss out on the investment opportunity. So, the market has achieved that circular logic where past rises fuel future rises, in a structure somewhat like a Ponzi scheme.

The problem is, of course, that once that positive market signals goes negative, or even declines significantly in strength, the market can crash.

RATIONALITY IN THE HOUSING MARKET

Rationally, house prices should rise in response to improving economic conditions. In the 2021 boom, however, it has been quite the reverse. House prices have risen due to the application of a strong stimulus, in the face of an economy that did not fare as badly as expected.

The real stimulus, however, has actually been a lack of certainty and a perception of threat. Faced with lockdowns and the need to make their houses be everything from a schoolroom to an office to a gym, homeowners wanted to either get a bigger house, or move outside of metropolitan regions.

The real problem is that now the economy could be heading towards a triple-threat. While there are signs that the latest mutation of COVID-19, the BA.2 variant of Omicron, is more contagious, and is boosting infection rates in New South Wales (NSW), the most likely solution to that is an increase in takeup of the third, booster dose of a vaccine – and potentially a fourth vaccination as well.

Secondly, of course, there is the effect of inflation, and how this relates in particular to increases in wages. In classical economics, wage equilibrium is achieved when wages growth is equal to non-wage based inflation plus productivity. According to Australia's Productivity Commission, multifactor productivity went up just 0.18% in FY2020/21, below the five-year average of 0.35%. Labour productivity in contrast went up by 1.07% for FY2020/21, above the five-year average of 0.91%.

As Chart 2 shows inflation has moved to be above growth in the wage index, even without taking productivity gains into account. While some inflationary pressure comes from resolvable supply issues, other causes, such as rising petrol prices, are likely to persist through to the end of 2022.

Thirdly, there is the problem of how you stop inflation in an economy. That means cutting government expenditure and allowing interest rates to rise – essentially, you reduce consumer expenditure. Demand falls, supply increases, and prices are cut, bringing inflation back down.

So Australia could face a reduction in the perception of the pandemic threat (thus limiting housing demand), inflation above 3.0% which continues to reduce real wage growth, and the introduction of higher interest rates to curtail inflation. That combination would likely result in a fall in overall residential dwelling prices.

Of course, that is not what the Australian federal government has planned. Some factors, such as the resolution of constrictions in the supply chain, will reduce inflation – or so it is hoped. But the key cornerstone to the government's plan is that a continuing decrease in unemployment will lead to an increase in wages.

It's a case of classic market economics: more people employed means fewer people available for jobs, so wages rise as some employers move to hire employees away from other employers. Yet that relationship does not seem to hold in the current economy. As the governor of the RBA, Philip Lowe, put it in his keynote address to the AFR Business Summit on 9 March 2022:

> The RBA's central forecast is for growth in aggregate labour costs to pick up further as the labour market tightens. This pick-up is likely to be gradual, though, given the multi-year enterprise agreements, the annual review of award wages and public sector wages policies.
>
> There are, however, uncertainties about the future growth of labour

CHART 1

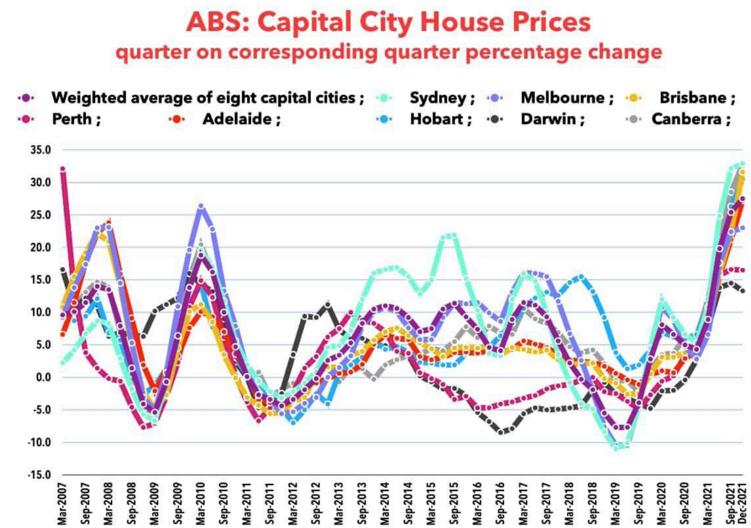
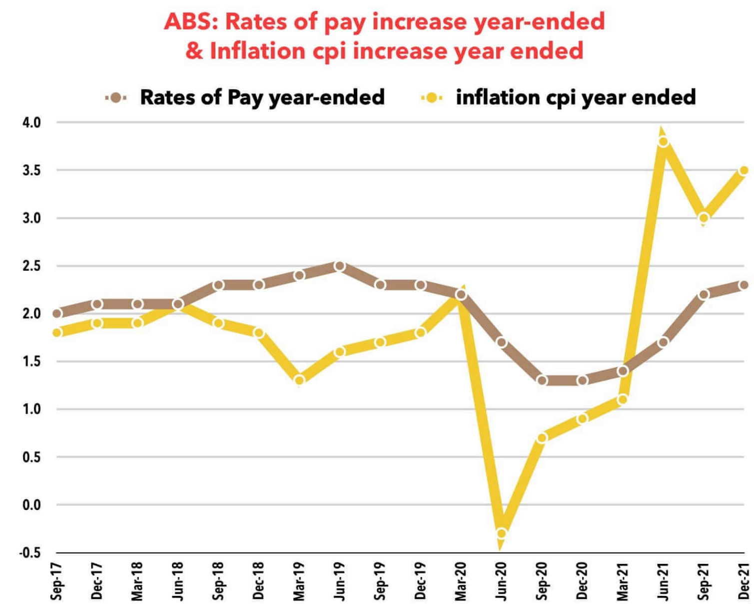


CHART 2



> costs. This is partly because we have no contemporary experience of a national unemployment rate below 4 per cent. The closest experience we have is that in the years leading up to the pandemic some of the larger states had unemployment rates around 4 per cent and wages growth hardly moved.

Philip Lowe, "Recent Economic Developments"

Chart 3 shows the relation in NSW between the percentage increase in hourly wages to the unemployment rate.

NSW makes the best test case because its monthly unemployment rate has dipped below 4.0% during certain months recently. This chart does indicate that there may be some relationship between a falling unemployment rate and increases in hourly wage rates. Yet it is not quite the optimistic relationship that the current government, or even Mr Lowe, might hope for. It looks as though, mathematically, if the unemployment rate does go down to 3.7%, for example, hourly wages will increase, but probably to a level around 2.7% to 2.8%. If inflation remains at around 3.0%, and labour productivity continues to improve at around 1.0% a year, then real wages, or simply "fair" wages, will continue to go backwards.

What is hoped for, of course, is that there will be a "magic" unemployment number that will see the relationship between unemployment and wage rises become exponential – a curve rather than a straight line. That might be possible, but it is likely to require that the unemployment rate is held down below 4.0% for two or three quarters. With the government signalling there will be a reduction in stimulus during FY2022/23, it's more likely the unemployment rate will settle at between 4.1% and 4.5%.

There are other factors that mitigate against this notion of a magic number. One is simply that unemployment benefits – JobSeeker or NewStart payments to the unemployed – have been deteriorating over the past six or seven years. The payments are now around 40% of the age pension, and the conditions to obtain these benefits have become steadily more onerous. That means that people are often forced to accept very low-wage jobs simply to escape from grinding poverty.

Another is that it has become increasingly apparent that Australian business in general has for some time been in a cycle that favours profit-taking over investment in growth. The chart that HNN keeps re-publishing that relates to this is straight from the RBA's own "chartpack" and shows business investment represented as a percentage of nominal gross domes-

CHART 3

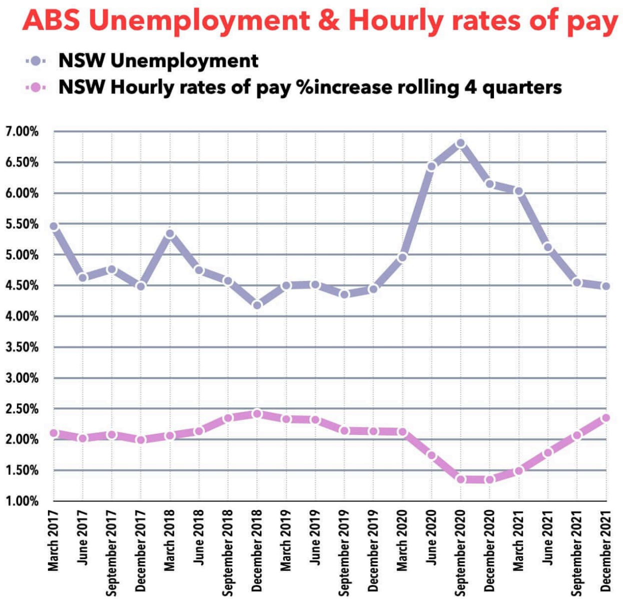
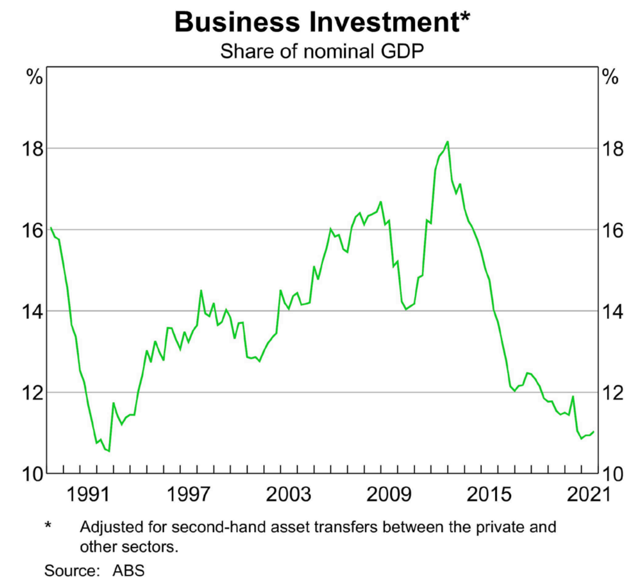


CHART 4



tic product.

Between 2003 and 2015 this was over 14% of GDP, reaching a peak of over 18%. Since 2018, it has been below 12%, a level not seen since the mid-1990s, 30 years ago.

Under conditions of profit-taking, there is a focus on cost-containment. In terms of wages this means that businesses are motivated to operate with unfilled job vacancies, even if this reduces output, rather than raise wages to compete for employees and thus increase expenses.

While that lack of investment in growth has broader origins than government policy, it's no secret that the government has, for at least the last five years, been "slow-walking" what is seen worldwide as the best growth opportunity, software-based systems. That can be seen clearly in the government's aversion to technology based renewable energy sources, and a truly retrograde attitude towards the adoption of other technologies, such as electric vehicles.

SOLVE FOR INEQUITY OR FOR GROWTH?

This combination of a society more accepting of inequity, a business focus on immediate profit, and a somewhat cultural aversion to the changes needed to embrace technology-driven growth affects more than just increases in the wage index. In fact, its imprint can clearly be seen on the housing market, and proposals to change this for the better.

The real misfortune at the moment is that while the forces for technological progress and for increasing equity in housing have similar goals in mind – broadly, enforcing the idea of affordable and adequate housing as an inborn human right – their approaches are so different that they frequently conceive of each other as not only antithetical, but actual "enemies".

We're very lucky in these circumstances that the well-known architect Tone Wheeler has written a concise essay that lays out the basics for the equity-based approach in both a clear and profound way. Mr Wheeler is well-known for his work at Environa Studio, where he is the principal architect. In his work at Environa Mr Wheeler has had a long-term engagement with both environmentally and socially conscious housing development. He is also an adjunct professor at the University of New South Wales, and president of the Australian Architecture Association.

The essay appeared originally in Architecture & Design, entitled "Housing Policy or Home Policy?".

Housing policy or home policy?

In a time where there is such an emphasis on being "for" and "against" certain things, we would like to make clear that our effort is to present some of what Mr Wheeler has had to say, and then to state in parallel with this a different opinion. We don't think these different viewpoints cancel each other out, but we do confess it is hard at times to find the bridge between them.

The "beating heart" of what Mr Wheeler has to say occurs in this paragraph:

> Current political analysis misses the root cause: high house prices benefit the majority over the minority, and with little social conscience, and the majority voting for parties to protect their property wealth, Australia has been uninterested in solving the inequality problem. It requires some drastic action.

In some ways, this is something of a call back to Gough Whitlam's "It's Time" speech of 1972, where he stated:

> The land is the basic property of the Australian people. It is the people's land, and we will fight for the right of all Australian people to have access to it at fair prices.

This is perhaps the key area where traditional thinking about social justice (SJ) and the technological progress (let's call it "TP" for short) approach are very much in agreement. There is a clear split being made in society between those who buy property and those who choose not to. As house prices have risen, this has become an increasingly regressive policy, delivering financial advantages to the better-off at the expense of those (mostly) less well-off.

Houses and rentals

Where the split between the two views begins to become evident is in what should be done about this situation. For Mr Wheeler the idea is to boost the level of home ownership from its current 66%, back up to 80% or so. To do this he believes it is necessary to provide a high level of incentives for owner/occupiers, and to disincentivize owner/investors, resulting in reduced overall demand and hence lower prices.

The incentives Mr Wheeler suggests to implement this shift include:

- Banks to provide low interest loans to first home buyers
- Deposits for first home buyers reduced through the use of mortgage guarantees
- Negative gearing available to owner/occupier, not owner/investor
- Capital gains tax on windfall profits from owner/investor houses, possibly as high as 80%

In terms of looking after the 20% still renting houses, Mr Wheeler suggests:

> Significant tax breaks should be offered for houses that are long-term rented at a pre-determined market value. This could

> be achieved by requiring houses to be managed by a Community or Social Housing Providers (CHP, SHP), who fix the rentals at reasonable market rates (say up to 4% of land and house value) for fixed periods of not less than one year, but up to ten or twenty years as happens in Scandinavia.

It's interesting, from the TP perspective, that Mr Wheeler doesn't mention the single greatest tax advantage given to home owners: interest payments on mortgages are tax-deductible. This is a consequential point to consider, because it goes to the heart of the implicit valuing of home ownership.

That tax deduction is, in economic terms, stating that the value of someone owning a house is equivalent to the tax that would have been paid on income equal to the amount of interest on the mortgage. What is the balancing value – in other words, what is the tax break buying – and where is it derived from? Mr Wheeler references former Liberal Party leader Sir Robert Menzies in his essay. Menzies made reference to housing in his "Forgotten People" speech of 1942:

> I do not believe that the real life of this nation is to be found either in great luxury hotels and the petty gossip of so-called fashionable suburbs, or in the officialdom of the organised masses. It is to be found in the homes of people who are nameless and unadvertised, and who, whatever their individual religious conviction or dogma, see in their children their greatest contribution to the immortality of their race. The home is the foundation of sanity and sobriety; it is the indispensable condition of continuity; its health determines the health of society as a whole.
>
> I have mentioned homes material, homes human and homes spiritual. Let me take them in order. What do I mean by "homes material"?
>
> The material home represents the concrete expression of the habits of frugality and saving "for a home of our own." Your advanced socialist may rave against private property even while he acquires it; but one of the best instincts in us is that which induces us to have one little piece of earth with a house and a garden which is ours; to which we can withdraw, in which we can be among our friends, into which no stranger may come against our will.

Of course, contribution to society during and after World War II largely meant working in manufacturing factories. That required a good deal of stability, and the valued worker was the one who spent 20 or more years with the same employer, living in the same house. Tax deductible interest was designed to encourage that behaviour, providing what was essentially social welfare to what Menzies – among others – saw as a new kind of middle class. It was a class established by behaviour, not ancestry or wealth, and owning a house was one part of that behaviour.

But does that actually make any sense anymore? The most productive people in Australian society in the future are likely to be those in professions such as software development. Stability of employment just does not come into it.

Further, is it at all necessary to encourage people to buy houses through these financial incentives? What if instead tax deduction on mortgage interest were cut in half, and the tax raised used to fund more equitable housing choices?

In other words, do you boost home ownership, or make non-home ownership – rental or alternatives – more of a fair choice?

While Mr Wheeler's solutions for improving rentals are inventive, there are other solutions that would seem simpler and more effective. For overseas immigrants, in fact, one of the shocks of renting in Australia is how little protection renters have. Most major cities in the US, for example, have some form of rent stabilisation and control. In San Francisco, California, rents can only be raised annually, and by a fixed amount:

> The annual allowable [rent] increase determined by the Board shall become effective each March 1, and shall be no more than 60% of the percentage increase in the Consumer Price Index (CPI) for All Urban Consumers in the San Francisco-Oakland-San Jose region as published by the U.S. Department of Labor for the 12 month period ending October 31.

So, if the CPI goes up by 3.0%, the maximum rental increase is 1.8%. That kind of government guarantee against excess rent increases is highly effective. In that environment far from limiting how much owner/investors can make on their property, you want to increase it as much as possible. Renting in that case becomes not a profitable income stream, but a means to defray costs of ownership on an appreciating asset – a far more stable situation.

The inequality question

At the heart of the difference described above is really a deviation of intent between those seeking social justice in housing, and the TP view. TP is most interested in outcomes, where for social justice how outcomes are achieved is also very important. That's clear when it comes to direct discussions about inequality. Mr Wheeler begins his essay with this statement:

> Inequality is the greatest threat to our society; and nowhere is that inequality more evident than in housing. The rich get richer with ever more houses; the poor get rent stress or homelessness.

There are a couple of issues on either side of this debate where what one side says is very aggravating to the other side — and this is one of those issues. Inequality, and the need to have a more just division of profits from companies, and welfare from governments, has been a cornerstone of the socially conscious left for decades, and questioning this approach can seem challenging.

In some ways this equity question is also important from the side of TP, but it takes quite a different form. Where those who focus on inequality see there being a fixed amount of wealth and access to that wealth, that isn't how those in the TP camp see it. Rather than concentrating on more equitable distribution of existing assets, they would say the goal is instead to eliminate scarcity. That is to say, to affect supply in such a way as to make unequal distribution less of a concern.

A good example of this is the postal service in the 1970s and 1980s. Mail was relatively expensive, and there were a number of schemes to ensure equity in postal services. For example, the US Postal Reorganization Act of 1970 specified that:

> No small post office shall be closed solely for operating at a deficit, it being the specific intent of the Congress that effective Postal Services be insured to residents of both urban and rural communities.

A noble cause, but a very costly one. However, in the late 1980s a solution was found to these problems of equity. It was called "email" (and was originally developed in the 1960s). Email eliminated the issue of scarcity and hence equity in the delivery of messages and information. It was, effectively, cost-free, faster, and more adaptable to modern information needs.

What might email be in housing terms? Imagine if every landlord had to register vacancies with a government office, providing also a rental history and a tenant referral. This would make it possible for renters to search for available rentals across a wide area, with full knowledge of fluctuations, making for a more rational market.

The influence of tech

If discussions about a different view of inequity and equity can make those on the social justice side "see red", the same can equally be said for those on the TP side when reading about how those on the SJ side see the changes and innovations that technology has enabled.

An aspect of this is that one reason Australia managed to survive and quickly recover from pandemic restrictions on business was the rise of working from home (WFH). That was entirely enabled by the successful rollout of the National Broadband Network (NBN), introduced by the government of Kevin Rudd as an election promise in 2007, with implementation started in 2009. Every single government that followed did whatever it could to "slow-walk" the rollout of the NBN, which included a sharp reduction of its capabilities (introduced as a cost-cutting measure, but ultimately costing more than the original proposal).

Mr Wheeler, however, sees largely negative consequences coming from WFH:

> Firstly, "working from home" prompted many to move to the regions. Cashed up, they pay city prices for houses, reducing affordability in areas of lower wages and pushing up rents. This forces the locals, many of whom rented, to move "out of town".

In terms of current social disruption, Mr Wheeler certainly has a point. However, it is difficult to see how WFH, and the subsequent ability of people to live further away from their place of work, does not have considerable benefits, even in the medium-term.

Many ex-urban and regional centres have suffered for decades from declining economies, with high unemployment, and a lack of services such as schools and healthcare. WFH has seen a sudden influx of people who are willing to spend locally, build new houses, and pay taxes. These are also people who know how to organise and get more vocal when insisting for service improvements.

There is a similar argument to be made regarding Mr Wheeler's complaint that in regional areas the use of short-term rental services such as Airbnb is undermining local rental markets:

> Secondly, closed borders created a rise in local tourism and holiday rentals within Australia. So, the smart money buys a second or third house in a holiday destination and then puts it on short term, but highly lucrative, rental such as "Airbnb". That formerly reasonably priced house is no longer available for long term occupation or rental. The decrease in available properties means higher rents.

Again, Mr Wheeler's point is certainly valid, rents have increased in regional holiday areas (later in the essay he names Byron Bay and Kiama). Yet, an additional way of seeing this is that some regions, after one to two years of very little tourist income, have found a way to maximise their income to make up for those losses. It may well not last for a long time, but it might open up those areas to a different kind of international tourism as borders reopen.

The hardest task that those on the TP side of discussions have is explaining how different the technological end of these businesses really are. To take an associated example, there has been a lot of criticism levelled at "gig economy" firms such as Uber, which provide minimum benefits to their contractor workers (though it's worth noting that taxi drivers never had it easy, either).

The reason why the TP side of things is not overly worried about Uber is that it has a built in assumption that Uber will be replaced in the future by services which provide far more value to the gig drivers. That's because Uber is busy developing the market, and a workforce of trained workers. Once that reaches a certain point, the winning play in the market is not to compete for riders, but for drivers. We'll end up with smartphone apps that access three or four transport services in an area and provide the customer with a range of options.

To fully understand that, you would have to know that building Uber-like software is a common programming project in second-year computing courses at universities. It's just not that hard to do with modern coding tools.

To put it in more general terms, outside of TP people tend to look at the past, then look at where a technology is today, and draw a straight line into the future. Tech just doesn't work that way. Every line is curved; if it looks straight, you're just at that point of the equation.

ANALYSIS

There is little doubt that the huge surge in house prices for 2021 represents a severe mistake in economic management. It is something like the difficulty many of us have experienced in, say, fertilising our lawns: the fertiliser helps the grass grow – but it also makes the weeds grow even better. Hence, of course, the invention of the almost universally used "weeder/feeder", which – so the label says – fertilises the lawn and kills the weeds at the same time.

Unfortunately, weeder/feeder is not something really (or only rarely) available in economic management. In creating stimulus through reduced interest rates, the RBA not only through out a lifeline to homeowners struggling through a period of low or no employment, they also gave market speculators a big boost.

Adding to that difficulty was the Australian government's HomeBuilder program – another welfare giveaway for the better off, this time worth over $2 billion. It took the combined force of those two boosts to deliver out of control increases in house prices for 2021.

From HNN's point of view, the main failure in forecasting comes down to underestimating technology. As we have said, the NBN and people's general ability to WFH at a high level of productivity might have saved the economy from a deepening spiral. At both a state and federal level, governments are not able to take technology into account in their economic planning.

It's likely that the more serious influence of technology on the housing market is just beginning. For example, we might see creative mayors of smaller, under-resourced towns moving to make high-speed broadband and other business services available in order to boost population with remote workers willing to trade a city lifestyle for better access to beautiful countryside. For people in hybrid work situations, there might be an increase in shared city houses, where the workers can stay overnight between their two days of in-office work – basically hybrid accommodation to go with the hybrid work.