WILSONS

The global housing phenomenon

Our weekly view on Asset Allocation

5 July 2021

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Property prices have seen broad-based growth

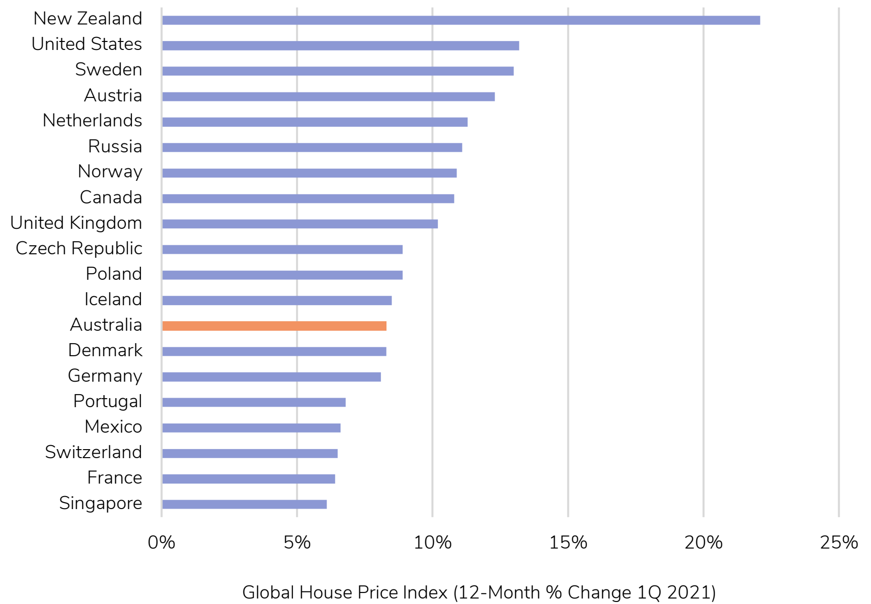
In Australia, property prices have surged over the last year, increasing by 8.3% to March 2021 and increasing by 13.5% in the year to May. This situation is not isolated to Australia. House prices across most developed nations have been rising throughout the COVID-19 pandemic. According to the Knight Frank Global House Price Index, global house prices grew at their fastest rates since 2006, increasing by 7.6% in the year to March 2021.

Like most asset classes, the pandemic has been a tailwind for property prices as record low interest rates and quantitative easing made finance on a home cheaper. At the same time, large fiscal stimulus packages aimed at protecting those impacted by lockdown restrictions also lined the pockets of wealthier households. The Australian, UK and US saving rates were at record highs in 3Q 2020. Over the last 12 months, money was poured into equities and cryptocurrency, but households were also investing in property or buying bigger homes. This all happened while housing stock was very low, adding further momentum to house prices.

Global economies generally benefit from higher house prices

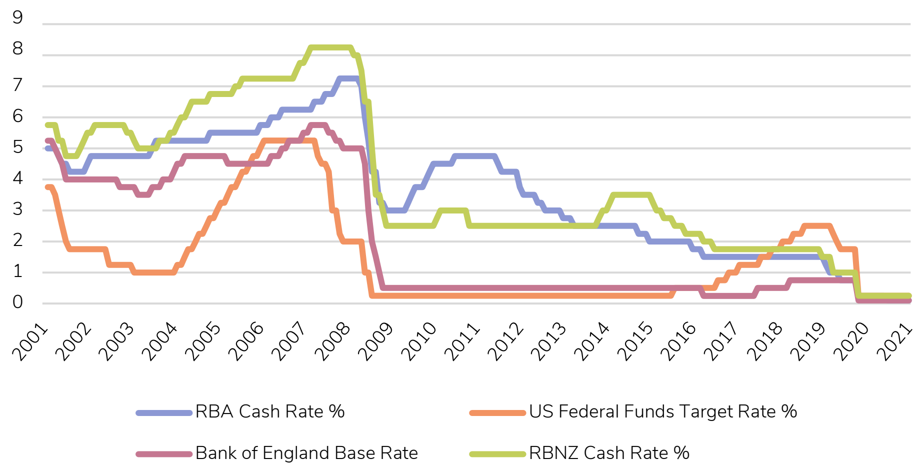
Most governments consider the recent surge in property prices as beneficial for the COVID recovery. Higher consumption (as consumers feel wealthier) and more jobs (due to housing construction) are typical by-products of rising house prices. Generally, an upturn in the property market is normally seen as a good indicator that monetary policy is working and that the economy is improving – therefore, higher asset prices. Although, this argument does have its limits.

Exhibit 1 Global homeowners have seen remarkable price rises



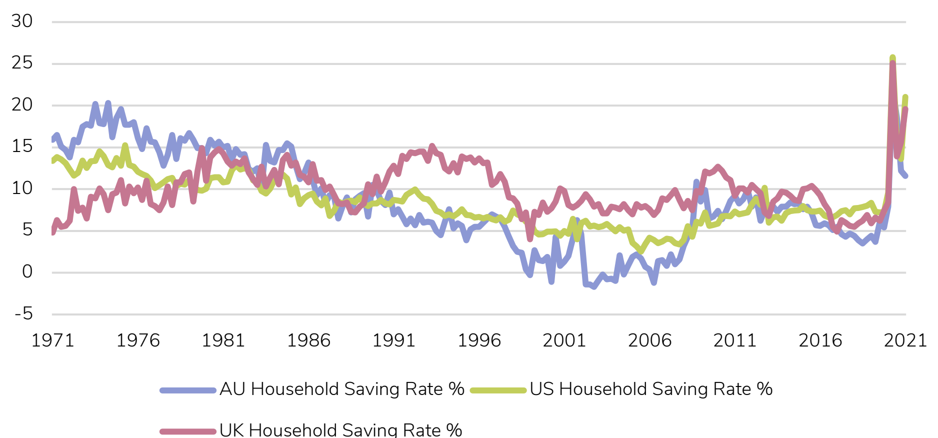
Source: Knight Frank Research, Wilsons

Exhibit 2: Global interest rates are at record lows



Source: *Refinitiv, Wilsons*

Exhibit 3: Saving rates are at elevated levels



Source: *Refinitiv, Wilsons*

Policymakers starting to get concerned

Over the last six months, policymakers have raised concerns that as the market gets hotter and there is more excess, the risk of financial instability gets higher, which could scupper any economic recovery. This is especially a concern for countries that are still licking their GFC inflicted wounds.

Housing affordability has also become an issue discussed by politicians and central bankers alike. Rising house prices are perceived to increase intergenerational inequality, which may come at a high social cost.

This raises the question of what central banks will do next. Many policymakers believe that interfering now is more likely to de-stabilise the recovery and that the benefits of ultra-loose policy still outweigh the negatives. Others believe that letting the boom continue, increases the chances of bust at the end of the cycle, and not interfering now will lead to longer term instability.

Different approaches could provide significantly different outcomes for countries coming out of the pandemic and have implications for investment markets.

House prices too hot for some

The Reserve Bank of New Zealand (RBNZ) was one of the first movers to signal the potential for a higher cash rate. In March, the Bank stated that interest rates would likely rise from mid-2022 due to record high asset prices. This came as a hawkish surprise to the market, and the 10-year government bond rate and NZ$ jumped at the news. This was after the Ardern government directed the RBNZ to include "maintaining a more price stable and well-functioning housing market" in its mandate.

Other central banks have also become more willing to cool property prices. The Bank of Canada recently became more hawkish, stating that household indebtedness due to high house prices was an important factor in their decision making. Norway recently hinted that it could soon tighten monetary policy to help soothe house price growth. Currencies in both nations appreciated on this news.

Certainly, if more central banks start to discuss raising rates based on higher house prices, this may provide a negative shock to global equity markets.

Housing chatter among the US Fed

Eric Rosengren, the Boston Fed president, recently remarked that: "It's very important for us to get back to our 2 per cent inflation target, but the goal is for that to be sustainable. And for that to be sustainable, we can't have a boom and bust cycle in something like real estate.

"I'm not predicting that we'll necessarily have a bust. But I do think it's worth paying close attention to what's happening in the housing market." – Eric Rosengren.

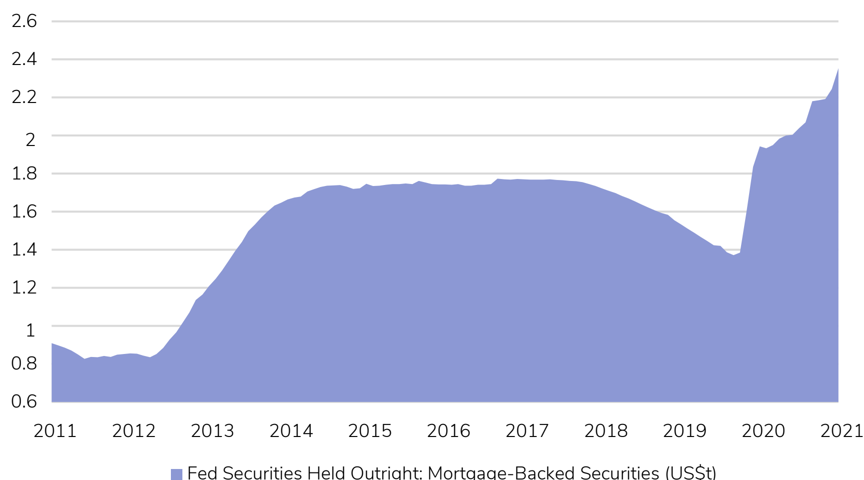
The Dallas Fed Chief, Robert Kaplan also stated a few weeks ago that the excess in the housing market could be an unintended consequence of the Fed's actions.

These individuals are not worried per se about low rates but are more concerned about the Fed purchasing US$40b per-month of mortgage-backed securities (MBS), which directly supports the property market.

A solution could be to wind down MBS purchases so that the Fed stops purchasing MBS before they stop buying Treasuries. Unlike most central banks, this may provide the Fed with a lever to contain house prices while letting the economy run further and appeasing financial markets.

We believe that the Fed is still more focused on CPI inflation than asset price inflation and is unlikely to change the policy agenda based on house prices.

Exhibit 4: Since the COVID pandemic started in March 2020, the Fed has purchased about US$980b in Mortgage Backed Securities



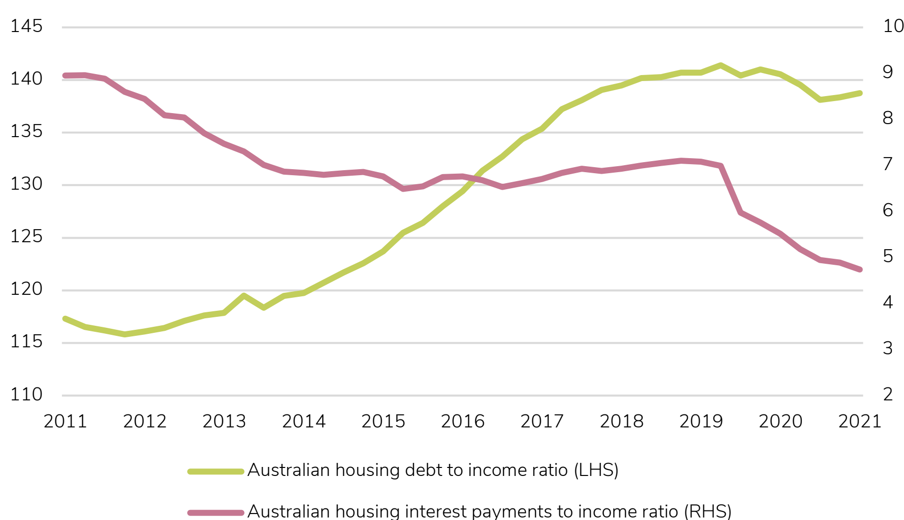
Source: St Louis Fed, Wilsons

RBA to focus on jobs rather than housing

RBA has stood firm that job growth is key to achieving its goals. In May, Deputy Governor Guy Debelle stated that unemployment would be higher if rates increased. Debelle also implied that other tools available to the government could be more effective at cooling the housing market rather than monetary policy, such as macro-prudential measures.

This confirms our view that macro-prudential measures from APRA are more likely before monetary policy is used in Australia. Therefore, like the Fed, the RBA is unlikely to hike rates due to an overheating property market and would encourage action from regulators before changing track.

Exhibit 5: Household debt to income is still below its 2019 peak and interest costs are still low



Source: Refinitiv, Wilsons

APRA indicators still not flashing red

APRA has said themselves that they are more focused on levels of household debt than house prices. Until household debt or the ratio of investors as a share of the market gets too high, regulators are unlikely to intervene.

Housing likely to cool

Forecast house prices are still set to be strong this year. The recent Westpac's Housing Pulse revealed that national prices in Australia are expected to rise by 15% in 2021 and 5% in 2022.

US forecasts are similar, with strong growth expected this year (10.6%) and for slower growth in 2022 (5.6%) and 2023 (4%).

This is consistent with our view of a soft landing. We believe that housing is past its peak rate of growth:

1. Stimulus packages wear off and international travel reopens, the saving rate will drop and housing demand will soften.
2. A gradual upturn in the rate cycle is likely to continue, increasing the cost of mortgage repayments (fixed rate loans are already edging up).
3. A lift in housing supply (Exhibit 6).
4. Affordability constraints (Exhibit 7).

If house price growth slows, this will put less pressure on the RBA and the Fed to intervene in the market, leaving central banks to concentrate on their mandates. However, if house prices continue to grow at the current rate into 2022, central banks may have to pay more attention.

Housing is not a monetary policy issue (for now)

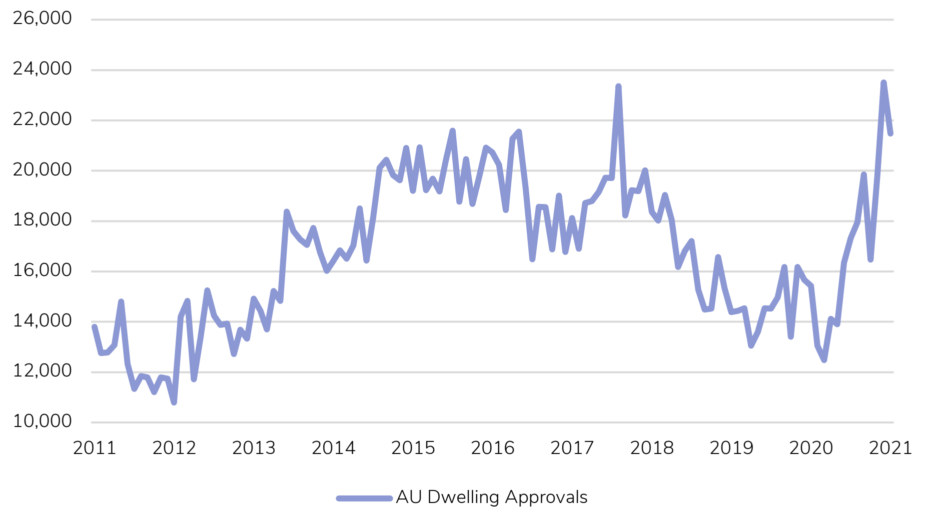
Even if prices continue to rise, we believe that the Fed is still on course to keep rates lower for longer, even after some hawkish squawks coming out of the Fed this month. The priority remains full employment and moderate inflation.

Domestically, in our view, macro-prudential measures are more likely to be used rather than monetary policy if the housing market becomes unstable, as we saw domestically in 2017.

Although some central banks have included house prices in their mandates, the two most important central banks for global and domestic equities, the US Fed and the RBA, have not. For most central banks (including the ECB and the Bank of England), the benefits of lower rates for the broader economy still outweigh any potential side effects, like asset mispricing.

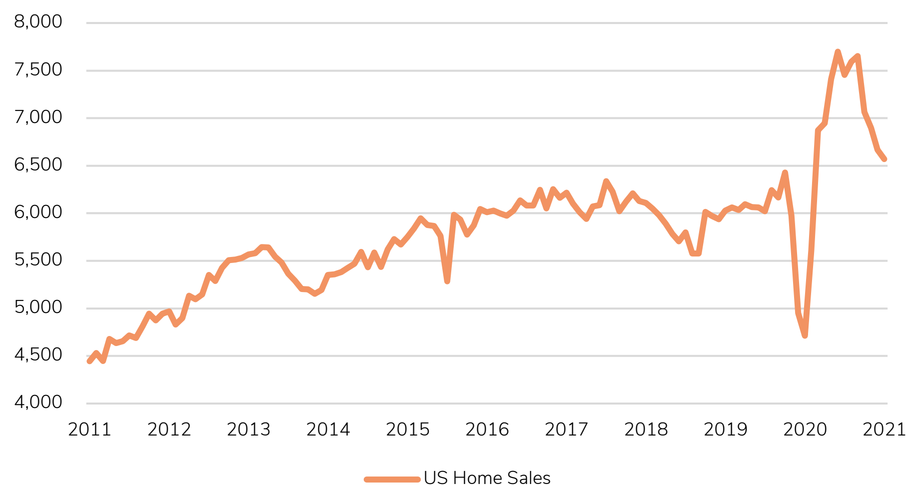
We still believe that most central banks will hold steady and that the full employment versus inflation trade-off is the key determinant to changes in monetary policy over the next 12-24 months.

Exhibit 6: Australian dwelling approvals have rebounded over the last year



Source: ABS, Wilsons

Exhibit 7: High house price are turning off US buyers, sales have started to decline



Source: Refinitiv, Wilsons

Investor implications

Investors should remain focused on employment and wages as key indicators of inflation. Higher asset prices should be less important to central banks than the broader inflation/economic story, which we believe has longer to play out.

Housing is also unlikely to cause economic instability if price growth moderates over the next year, keeping the economy (and company earnings) on the road to recovery.

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