THE AGE

POLITICS FEDERAL PROPERTY PRICES

RBA research shows rate cuts inflated the property market

By **Shane Wright**
March 11, 2019 — 3.30pm

Reserve Bank research has found its cuts in official interest rates drove up house prices, and cautions that long-term falls could in the worst case escalate into an American-sized drop in Australia's property market.

As recently as last week, Reserve Bank governor Philip Lowe downplayed the role of the RBA in the spike since 2011 in house prices, which in Sydney and Melbourne climbed by up to 75 per cent, peaking in 2017.

Since then they have fallen, with Sydney's house prices dropping at their fastest rate since the 1982 recession, while they are also trending down in every capital city bar Hobart and Canberra.

Dr Lowe said while low interest rates had increased the capacity of people to borrow, population growth and the slow manner in which a supply of new properties had come on to the market were the main reasons behind the surge in prices.

But Reserve Bank economists Trent Saunders and Peter Tulip said their research pointed to the role of interest rate cuts as the driving factor behind the pre-2017 property boom.

They found that a one percentage point cut in interest rates lifted house prices by 8 per cent in the two years after the move.

"The model suggests that much of the strength in housing prices and construction over the past
few years can be explained by the fall in interest rates," they found.

Research from within the Reserve Bank suggests its own cuts to interest rates drove up house prices. AAP

The RBA started cutting official rates in 2011 when they stood at 4.75 per cent. They are now at 1.5 per cent, with markets expecting the Reserve to cut them at least once this year due to the slowing of the economy and the impact of falling property prices.

Mr Saunders and Dr Tulip also noted that tightening of credit limits - which banks have introduced themselves in reaction to direction from banking regulators - "seems to be important in the decline in house prices in 2018".

The research found that increasing population growth will have some effect on the overall property market, largely by reducing rental vacancies, which in turn lifts rents and encourages more construction.

But other factors, including overall economic growth, construction costs, the price of vacant land and depreciation, had a "statistically insignificant" impact on prices.

The research also highlighted the potential economic damage caused by a collapse in prices.

While the research is predicated on house prices continuing to grow at a real rate of 2.5 per cent a year, as they have averaged since 1955, it also considered what would happen if prices were expected to remain static.

This would lead to a "fear of not getting out" response, particularly by investors, which would see a collapse in prices of more than 30 per cent over the next six years.

"This scenario is extremely unlikely: nothing like it has happened in Australia before," the authors noted.

"However, in scale and duration, it resembles the largest housing collapses seen during the global financial crisis (Ireland, Spain, United States), so is relevant as a worst-case scenario to be guarded against.

"Falling house prices result in large falls in investment, which reduce vacancies, boosting rents."

Former Reserve Bank economist Callam Pickering, who is now Asia-Pacific economist for Indeed, said the research suggested any future interest rate rises would be very difficult unless the economy was in a particularly strong position.

"House prices are simply too sensitive to rate changes for any sizeable tightening," he said.

Shane Wright

Shane is a senior economics correspondent for The Age and The Sydney Morning Herald.