RBA: sharp housing drop would shock economy but not banks

Reserve Bank governor Philip Lowe in Brisbane yesterday. Picture: AAP

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A sharp drop in house prices would not trouble "resilient" banks, but would cause homeowners to rein in spending and produce significant economic shockwaves, the Reserve Bank governor, Philip Lowe, has warned.

Dr Lowe yesterday also pushed back against criticism that ultra-low interest rates were to blame for the lack of affordable housing in Sydney and Melbourne.

"In other states the ratio of housing prices to income is below previous peaks … despite a common monetary policy. Factors other than interest rates are clearly at work," he said in Brisbane.

Australia's soaring house prices, reaching record levels in Sydney and Melbourne, have fuelled concerns that a sudden price slump could damage the financial system, which is heavily exposed to mortgages.

“A significant correction in the property market would, no doubt, affect (banks’) profitability,” he said. “But the stress tests that have been done under APRA’s eye confirm that the banks are resilient to large movements in the price of residential property.”

The RBA “strongly supported” recent moves by the Australian Prudential Regulation Authority, RA, the banking regulator, to slow property investor lending — including an immediate reduction in the proportion of interest-only loans banks are able to issue.

“Given the high levels of debt and housing prices, relative to incomes, it is likely that some households respond to a future shock to income or housing prices by deciding that they have borrowed too much,” Dr Lowe said, noting Australia’s household debt-to-income ratios were at record highs.

He did not mention the federal budget, to be brought down on Tuesday, although the central bank’s economic growth forecasts, to be formally released today, pencil in 3 per cent growth and falling unemployment.

Economists at Citi said Mr Lowe was adding his weight to limiting further rises in household debt: “The combination of high debt and low wage growth is crimping consumer spending growth and recent rises in lending rates will add to this.”

NAB chief executive Andrew Thorburn yesterday announced NAB’s $3.29 billion half-yearly cash earnings result, saying it pointed to cautious optimism about the economy.

While household debt was at record highs, household wealth was growing at a faster rate. “We really have become more conservative on our risk settings in those markets and particularly on inner-city postcodes,” said Mr Thorburn.

The RBA left its cash rate on hold at 1.5 per cent this week for the ninth month in a row, and flagged an improvement in the unemployment rate.

“My judgment is that, in the current environment, the resilience of our economy would be enhanced by an extended period in which housing prices and debt outstanding increased no faster than our incomes,” Dr Lowe said.

Interest rates would ultimately rise, he said, while playing down a near-term official rate rise. “To be clear, this is not a signal about the near-term outlook for interest rates in Australia, but rather a reminder that over time we could expect interest rates to rise, not least because of global developments.”

Dr Lowe said the RBA saw the rise of investors as inflating housing prices to the detriment of economic resilience. To alleviate the concerns, house price growth might need to stall for several years. He stressed, however, that was not a stated RBA objective.