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Property painkillers

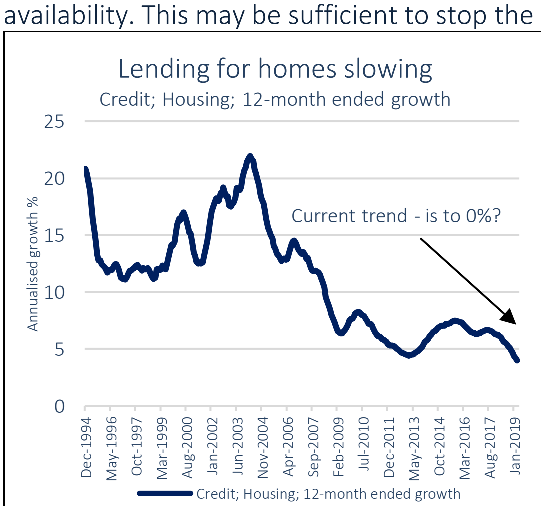
First regulators capped how much banks can lend to homeowners. Now, it appears it will be up to the banks to set the limit. Bankers being bankers, they will likely up the size of home loans, chase market share, and crank up lending once again. This is not the only recent positive news for the property market. Fears of property related tax changes from the poll-leading Labor party evaporated over the weekend. Mortgage rates too have fallen and the RBA yesterday signaled it is increasingly inclined to cut rates for the first time since 2016. Lastly, properties are around 7% cheaper than the end of 2017. To us, this makes a recipe that could the see property market declines slow or halt in the coming months. True, the levels of household debt remain elevated. Triggers for systemic financial risk, though, look to be pushed out further down the track. This makes Australian banks and local corporate bonds safer than we previously thought.

APRA changing its tune

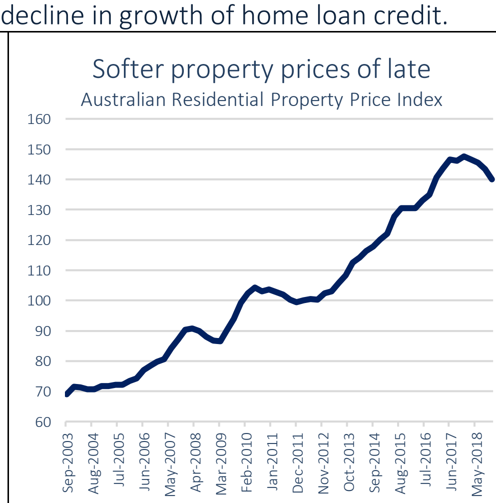
Be careful, lend less, especially for interest only loans and investor borrowers. These positive prudential steps guided by the regulator looked to have been turned on their head as of late. Previously, APRA prescribed deposit taking institutions to assess whether borrowers could service their home loans if interest rates were 7% or 2% higher than the current interest rate. Yesterday APRA proposed letting lenders set their own interest rate floor. Our guess is that lenders will agree to setting their own rates and that these rates will be substantially below the 7% target.

Getting the loan books growing again

The lower reference interest rate for serviceability means that borrowers will be able to borrow more. We suspect banks will be willing and many will take up this increased credit availability. This may be sufficient to stop the decline in growth of home loan credit.



Sources: RBA, Spectrum

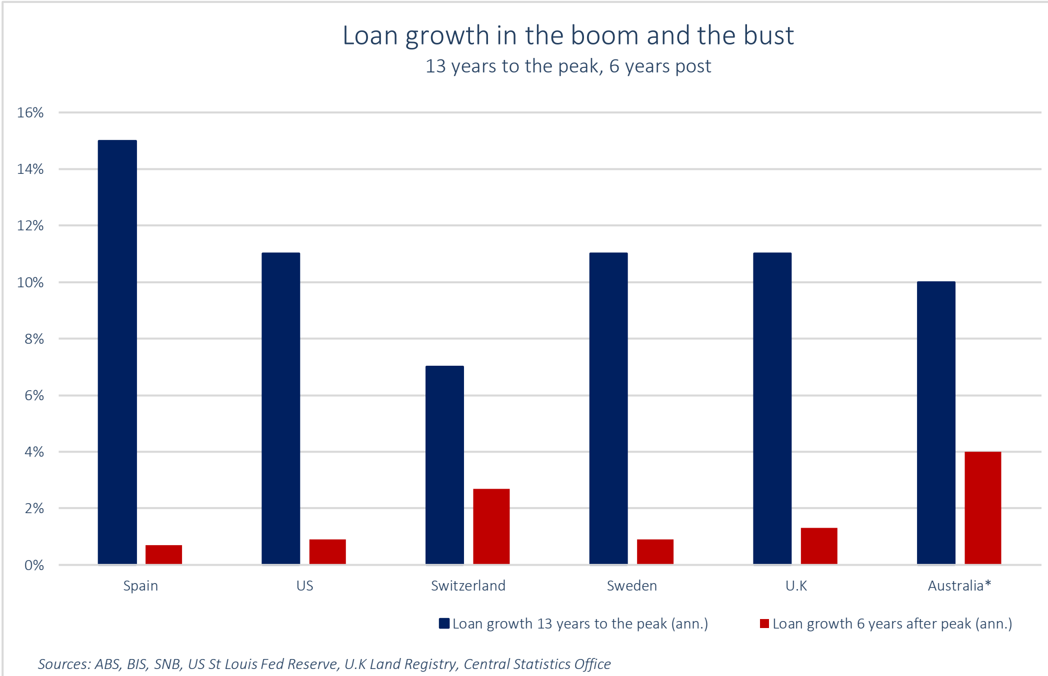


Source: ABS. Spectrum

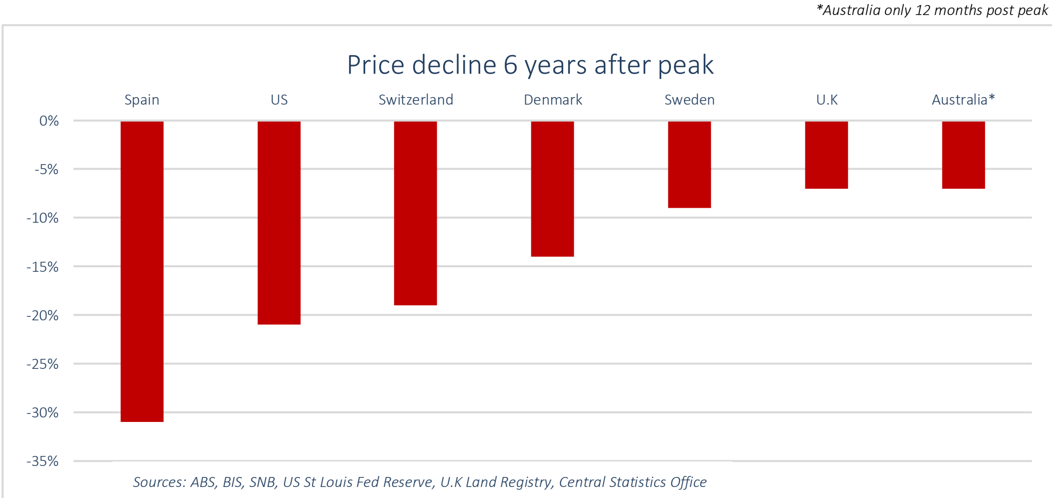
Why the worry

At Spectrum, we view that change in the credit provided to the home loan sector is typically the biggest influence on prices. As seen by the graph above, Australian home credit growth on its present trajectory looks like hitting zero percent.

The lessons from housing crashes from abroad is that sustained slow home loan growth coincides with sustained home price slumps.



*Australia only 12 months post peak



*Australia only 12 months post peak

Location and times of other property market cycles

	US	Spain	Sweden	Switzerland	U.K	Denmark	Australia
Peak era	30-Jun-06	31-Mar-08	31-Dec-91	31-Dec-89	30-Sep-07	30-Jun-86	31-Dec-17
Trough era	30-Jun-12	31-Mar-14	31-Dec-97	31-Dec-95	30-Sep-13	30-Jun-92	?

So far the price decline and softening of the Australian residential property market had occurred in an orderly manner. Default rates are picking up but so far look like they are manageable for lenders.

The risk is the falls reach a significant point or happen at a rate faster than expected, then the risks of unexpected shocks occurring upon lenders and the economy increases. Until recently that risk was growing.

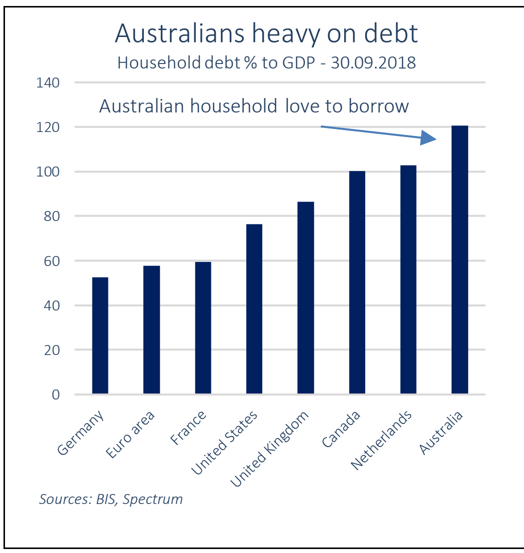
Now, as discussed above, there are several counter points to falling property prices falls. That is, the rate of decline in prices may slow or even stop in the coming quarters.

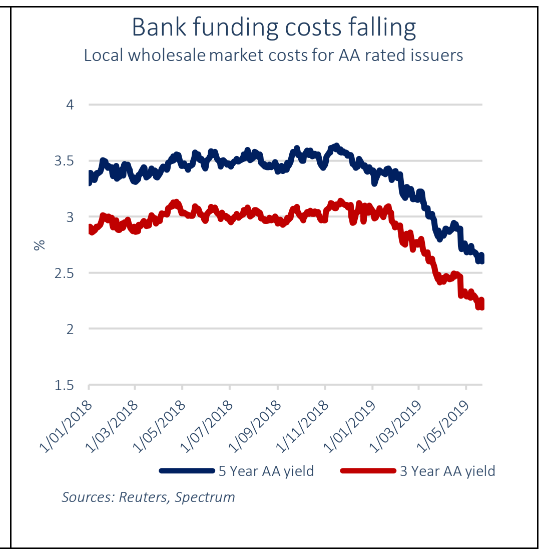
Risks not gone – just kicked down the road

That said, the risk of a widespread financial system and economic fall-out remains. Australian households remain highly indebted. This leverage may even grow if banks respond to the recent proposals from APRA and borrowers take advantage of lower mortgage rates.

Moreover, Australian banks remain highly dependent on foreign lenders. Should these providers of capital lose faith in Australian banks this could have a severe impact on the cost of funding and even the total size of loans available to local customers.

That said, the recent injection of property painkillers bodes well for the residential property market and makes the risk of a financial crisis now a more distant prospect.





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