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# RBA warns on housing shortage

■ Need for better planning and skills

■ Inflation risk in supply constraints

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The Reserve Bank of Australia has warned that house prices and rents could surge as the resources boom intensifies the strain on the economy's capacity and exacerbates the housing shortage.

RBA assistant governor Philip Lowe said yesterday more needed to be done to tackle planning shortcomings and looming skills shortages that will hamper the supply of new houses.

With official figures showing that demand for home loans sagged in January for a fourth month in a row under pressure from rising interest rates and reduced government incentives, Mr Lowe warned the nation faced a "significant challenge" in boosting the supply of housing when

## ECONOMIC OUTLOOK

**'Some are questioning how the top economic forecasters failed to see the strength of the economy. These are more than technical errors since they determine the contours of the economic debate going into the next election.'** Geoff Winestock, page 61

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business investment was already surging higher.

"We will need to keep a strong focus on improving the supply side of the economy so that demand can grow solidly without putting upward pressure on inflation," he told an urban planning conference in Sydney.

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A lack of planning, materials and skilled labour is threatening the supply of housing.

Photo: JAMES DAVIES



# RBA warns on housing shortage

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"We face the significant challenge of increasing the supply of housing at a time when business investment is also very high."

Mr Lowe said if there was a failure to increase the supply of homes by building smaller houses or investing more in housing construction, "further adjustment in housing prices and rents is likely to occur to balance supply and demand".

House prices rose almost 12 per cent in the year to January, according to RP Data. This was the fastest growth in almost two years.

The RBA's warning on housing came as evidence emerged that although higher interest rates have cooled demand for housing finance, particularly from owner-occupiers, they have barely dented confidence.

The Westpac-Melbourne Institute consumer sentiment index edged 0.2 per cent higher this month despite a 0.25 percentage point lift in interest rates, and a National Australia Bank survey has found that optimism about the outlook is high among small and medium businesses.

Market response to the mixed readings on the economy was modest, with investors raising the odds of a 0.25 percentage point rate rise next month by just 3 percentage points to 35 per cent.

Mr Lowe backed confidence in the recovery, saying the RBA's central case was for the economy to grow at or above average pace over the next two years, supported by robust Asian demand, a strong labour market and moderate inflation.

But the central bank official said achieving such a benign outcome

would require dealing with challenges that, if left unaddressed, could lead to damaging price pressures.

"For Australia, the main task is to expand the supply side of the economy so that demand can grow solidly without causing inflation to rise," Mr Lowe said, identifying investment and productivity growth as key to achieving this.

"If we are to grow strongly on a sustainable basis we will need to ensure that both our capital and our workforce are used as efficiently as possible [because] the economy is likely to undergo considerable structural change, particularly as the resource sector expands."

The latest reading on the strength of the recovery comes today, with employment data expected to show the economy created 15,000 jobs in February, to hold the unemployment rate steady at 5.3 per cent.

The rebound in global commodity prices since early last year has encouraged resources companies to ramp up their investment. An Australian Bureau of Statistics survey showed investment in the sector could reach a record high of almost \$50 billion next financial year.

Mr Lowe said strong private capital expenditure had already added to the economy's capacity and would continue to do so, but in the short term it meant tying up resources that were in demand elsewhere.

He said business investment was already around 16 per cent of gross domestic product, not far below the 40-year high reached earlier last decade, and was set to climb higher in the next two years.

"Investment in the resources sector

has been particularly strong and this is now starting to bear fruit, with resource exports rising recently and further significant increases expected," Mr Lowe said.

Indicating that interest rates were likely to go higher, he said high levels of investment were driven by high expected return on capital, which in turn was typically associated with relatively high real interest rates.

This highlights the increasingly difficult challenge that will confront policymakers as they attempt to contain the inflationary effects of the resources boom while trying to foster an increase in the supply of housing.

## The removal of the first home buyer boost and increasing interest rates have clearly lowered activity.

The ABS reported yesterday that the number of mortgages taken out by owner-occupiers plunged 7.9 per cent in January, well below market expectations of a 2 per cent increase, and is down 21.2 per cent from the peak reached in mid-2009.

Driving the result was a 31 per cent fall in loans to first-home buyers, with just 8316 mortgages taken out from these borrowers in the first month of the year, the lowest such outcome in five years.

Industry groups said the fall showed that rising interest rates and the progressive withdrawal of government incentives to first-home buyers since October were undermining the recovery in housing activity.

Though economists said the rise in housing finance and building approvals during 2009 ensured a strong pipeline of building work this year, Master Builders Australia and the Housing Industry Association warned further rate rises could harm the sector's recovery, particularly if investor interest did not improve.

"The removal of the federal government's first-home buyer boost and increasing interest rates have clearly lowered activity in both the new and existing homes market," HIA senior economist Ben Phillips said.

"The RBA must take stock of the impact that higher interest rates are having on the new homes market.

"Aggressive interest rate increases will ultimately constrain new housing and push up prices for both home purchase and renters."

Westpac chief economist Bill Evans warned that although consumers had so far taken rising interest rates in their stride, monetary policy could be close to the point at which it begins to have a major effect on confidence, with standard variable mortgage rates among the major lenders at 6.9 per cent.

Mr Evans said recent experience showed that a mortgage rate of 7 per cent was a significant threshold for consumers.

"Based on this evidence we may be nearing the point where confidence becomes much more sensitive to increases in interest rates," he said.

He predicted this increased sensitivity would mean that, after pushing the cash rate to 4.5 per cent later this year, the RBA might leave monetary policy unchanged for an extended period.