Should we be bracing for an inevitable housing bubble bust?

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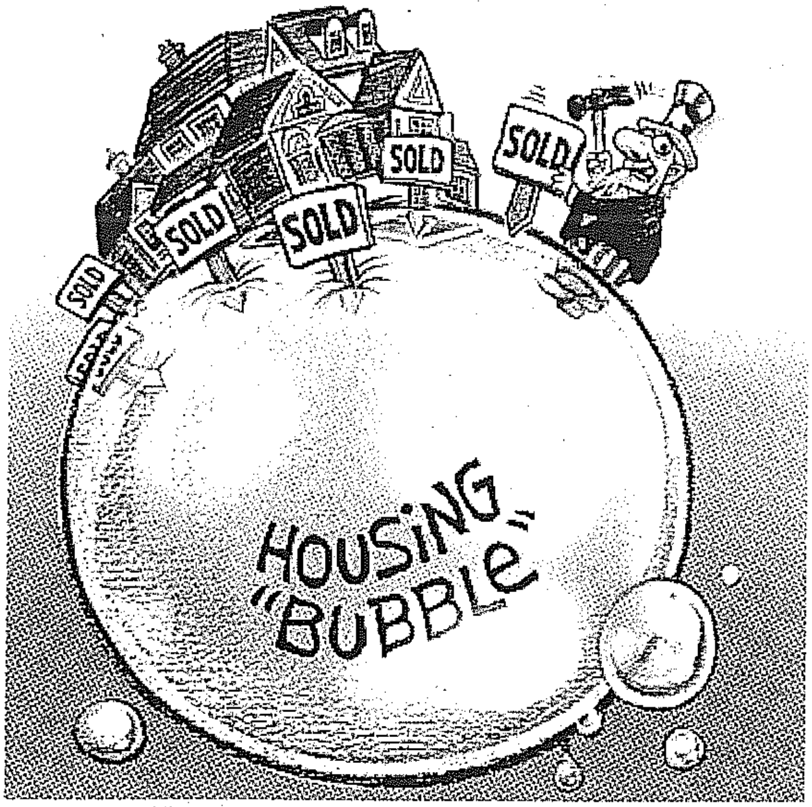

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Could a housing bubble burst occur in Australia similar to that of the Unites States?

By now it should be obvious to anybody who is not a banker or a real estate agent that Australia is in the grip of a substantial housing bubble.

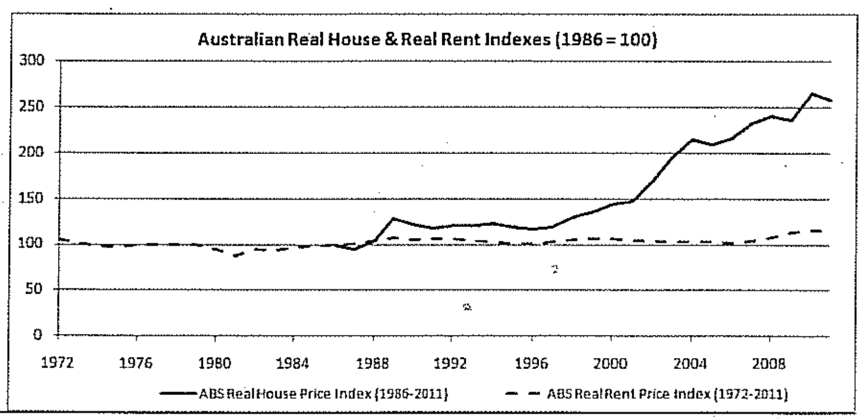
The greatest housing-price rise in the history of Australian residential property represents an inflated bubble – one that is ready to burst.

Perhaps unsurprisingly, only a handful of economists accept this view. This small number shows that the formation of a bubble requires a mass popular delusion to occur, with the vast majority of economists playing along by either missing it or denying its existence.

The economist James Galbraith has noted that only 12 out of 15,000 economists in the US noticed the US$8 trillion dollar housing bubble that occurred there. It appears that mainstream economists have the insight and independence of a herd of sheep.

From 1996 to 2010, house prices climbed by 127%, adjusted for inflation, though rents increased only 15% over this period.

The graph below shows the disconnect between housing prices and rents.



"Macrobusiness is one of the few voices of sanity left in Australia. Prosper Australia is another."

Current tax policies and programs have distorted the residential property market substantially. A Senate report on housing affordability aggregates the assistance provided to Australian property owners: $53 billion per year. This is five times the amount that is spent on public housing and rent assistance to the low-income earners.

From 1996 to 2010, the value of the residential property stock has increased by $2.5 trillion. Simply put, the government is forking out tens of billions a year to property owners as they privatise trillions in capital gains.

This is one of the reasons why the so-called experts have desperately attempted to deny the existence of a bubble using lies, damned lies and statistics: they want the gravy train to keep rolling, which overwhelmingly benefits the rich.

They have also promoted policies to benefit established owners and speculators to the detriment of first-home buyers and renters – under the pretext of helping first home buyers and renters.

The ratios and valuations mentioned above suggest that a substantial correction will have to occur if prices are to reflect fundamentals, with an approximate 40% fall on the cards. If the government does not intervene again, as it did during the GFC by boosting the first-home-owners grant, then the market should plunge. The results will not be pleasant, as evidenced in other countries affected by bursting bubbles.

Thus, the gravy train will run out of steam and eventually grind to a halt, with a less-than-tasteful result. The Great Australian Land Bubble will be replaced with The Great Australian Land Bust.

There are several solutions available to remedy the economic and social fallout. Some of the solutions are over a century old, for instance, land value taxes and debt write-downs or jubilees.

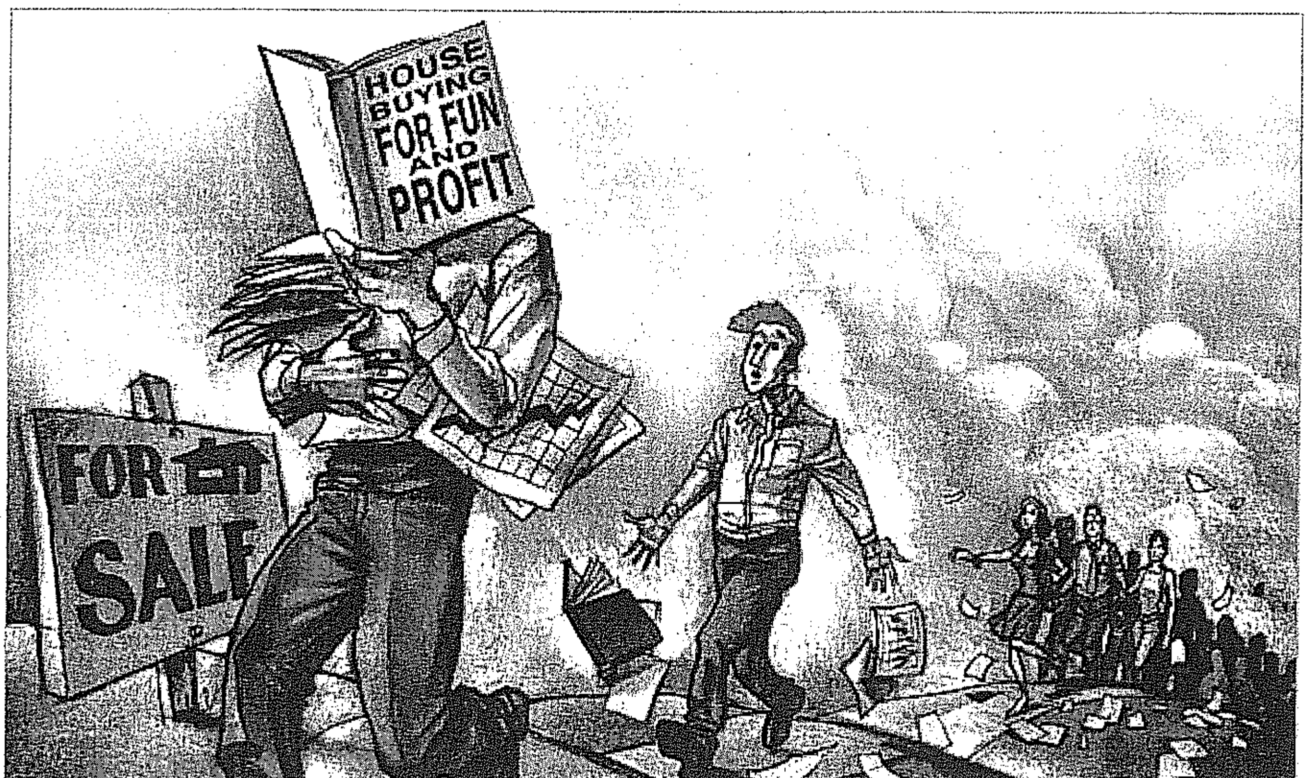
The Right to Rent plan and limiting the amount of mortgage debt that potential owners can access are policies proposed in recent years.

Regardless, this will not stop the finance, insurance and real estate sectors from huddling behind the conservative nanny state, begging for bailouts.

Given the track record of government, industry and economists over recent years, the public should be more skeptical of their pronouncements.

For instance, in the US, they missed – or denied – the existence of a US$10 trillion stock market bubble, an $8 trillion housing bubble and the GFC. In Australia, the same has occurred.

A sane course of action requires that we listen to the economists who have a track record of getting it right.



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This is one obvious indicator of a bubble because renting is a substitute for purchasing a home.

If prices have risen substantially, then people would adjust their preferences to renting, resulting in a fall in housing prices and a rise in rents until a balance is reached. Clearly, this is not the case.

Australians have embarked upon a speculative property binge, chasing capital gains rather than long-term net rental income.

As the US economist Dean Baker noted two years before the bubble burst in the US, "No one can produce an explanation as to how fundamental factors can lead to a run-up in home sale prices, but not rents."

Perhaps the idea of a bubble could be questioned if the price-to-rent ratio was the only confirmatory indictor.

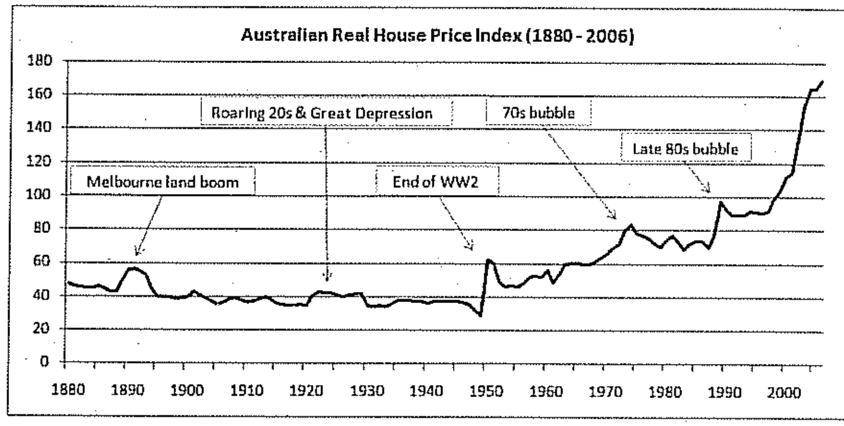
Unfortunately for the housing bubble deniers, there is little recourse. Many ratios and valuations point to a bubble, with the following showing that Australian property is severely overvalued: price to rent, median multiples, mortgage debt-to-GDP, household interest payments-to-disposable income, housing debt-to-disposable income, household debt-to-assets, and total residential housing stock value.

These statistics are publicly available, but for the most part have been swept under the carpet because the government and industry do not want to hear otherwise.

Below is a graph of Australia's long term housing price history from 1880 to 2006. It certainly contradicts the notion that prices always rise and never fall – the usual propaganda trumpeted by industry.

US, UK, Spain, Ireland – and now Australia – is that the housing shortage argument has been put forth to explain the price rises.

Yet, we know that once the bubbles burst, a huge oversupply of housing always emerges.



According to housing price data, eight of the nine substantial price increases over the last 131 years have resulted in a decline, with the only exception being a short three year period from 1961-1964. The question to ask now is whether the tenth and greatest price increase in Australian history will go the way of the other eight declines.

In response to the rapid escalation of housing prices, the housing bubble deniers have created an explanation of a housing shortage.

These deniers believe that the combination of population growth, net immigration and demographic change has resulted in increasing demand, thus causing an undersupply of housing.

One common factor between the housing bubbles of recent times in the

The National Housing Supply Council, which was set up by the government to monitor housing demand, has tried its best to create a shortage by twisting the social needs of the homeless, couchsurfers, those sleeping rough and caravan park residents into market demand.

Obviously, these people do not have the money to purchase a property, which explains their predicaments. Additionally, from 1951-2008, the year-on-year growth in dwellings was greater than population growth, and there have been more new dwellings constructed per new person in Australian than in the US over the last couple of decades.

The real reason for these astronomical prices are three factors: financial liberalisation with its liberal lending policies, government tax exemptions and programs, and restrictive planning policies.

What weighting should be given to each of the three is unclear, but all have contributed to the formation of the bubble. The last two are insufficient to push prices as high as they are now – rather they act as fuel, while the easy availability of credit acts like a fire starter.

Unsurprisingly, mortgage debt has increased rapidly, reaching over $1 trillion, or almost 90% of GDP, in recent years.

Pic: cpa.org.au/policymakers