Vital Signs is a weekly economic wrap from UNSW economics professor and Harvard PhD Richard Holden (@profholden). Vital Signs aims to contextualise weekly economic events and cut through the noise of the data affecting global economies.

This week: new information points to a major house prices problem for regulators and governments.

It is ironic that at a time when so many young Australians are finding it so hard to break into the property market, commentators are finding it so hard to break out of discussing it.

This week we saw three notable pieces of information. First, the CoreLogic home value index showed further rises in property prices across the country in the month to March 31. Year-on-year, Sydney, Melbourne, Canberra and Hobart had double-digit percentage gains. Melbourne was up 15.9% and Sydney a staggering 18.9%.

And although prices have come down a little in the volatile Perth and Darwin markets, the numbers triggered further concern from regulators.

In keeping the cash rate steady at 1.5%, RBA governor Philip Lowe made the following observation is the formal announcement:

“Growth in household borrowing, largely to purchase housing, continues to outpace growth in household income. By reinforcing strong lending standards, the recently announced supervisory measures should help address the risks associated with high and rising levels of indebtedness. Lenders need to ensure that the serviceability metrics that they use are appropriate for current conditions. A reduced reliance on interest-only housing loans in the Australian market would also be a positive development.”

But it was comments made outside the official script that were the most revealing. The governor specifically tied prices to "taxation arrangements" and noted : "For many people, the high debt levels and low wage growth are a sobering combination."

Yup: negative gearing plus inadequate supply plus low wage growth equals financial distress.

Prudential regulation

The Australian Prudential Regulatory Authority (APRA) announced it wanted to see the proportion of interest-only loans fall from the current strikingly-high level of 40% of new loans, down to 30%.

That's fine, but three concerning things come quickly to mind: it treats the symptom not the cause of risky lending; it may be too late; and targets like this tend to lead to "gaming".

On the latter point, how much principal repayment qualifies? What about a loan with a 200-year maturity – is that interest only or not? You can bet the smart folks at the big banks are on the case figuring out how they can comply with the letter of the regulation but not necessarily the spirit.

Meanwhile, building approvals rose strongly in February, up 8.3%. This came mostly from NSW and Queensland, which were up 19.6% and 33.7%, respectively. These numbers reveal how volatile approvals are, and hence how little of a long-term supply trend they represent.

The numbers were also driven largely by apartment approvals, which are particularly lumpy. Moreover, if these don't sell well off-the-plan – perhaps because of interest-only loans drying up – then developers can quickly find themselves in trouble.

Much as I would like to read these figures as a positive supply response, it's hard not to be worried.

Governments aren't helping

So while the RBA keeps cautioning market participants, governments are doing very little, or things that are explicitly unhelpful. It was reported this week that NSW Premier Gladys Berejiklian favours extending the first home owner grant from new properties to existing properties in the June state budget. The premier has said previously that increasing supply is important (she is correct on that), but now seems to be undoing that by goosing demand.

That is the worst idea ever. Period. It just drives up prices and throws away precious government funds. As economist Saul Eslake has put it:

“All [FHOGs] do is increase the price of housing by that amount. There’s almost 50 years of evidence to show that when you give cash to would-be home buyers … the price of the housing they buy goes up by at least that amount. The people who get it think that it’s helping them - the government says ‘here’s a slab of cash’, and that’s popular, but it does nothing.”

Meanwhile, we wait with anticipation the housing affordability package in the Commonwealth budget on May 9. No shortage of dumb ideas have already been floated – including letting people dip into their superannuation to buy a property.

Let’s hope that economics trumps politics just this once. Negative gearing needs to be reformed, and supply needs to be boosted. Housing affordability, financial stability and economic inequality are all riding on it.

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