

## Five ways an Australian housing bubble could burst

Written by Wes Mountain, Deputy Multimedia Editor, The Conversation

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There's been quite a bit of speculation over whether Australia has a [property market bubble](#) - where house prices are over-inflated compared to a benchmark - and when it might burst. According to housing experts, there's at least four scenarios where this could happen.

Australia could see a property bubble burst due to:

- [Lending tightening, interest rate hikes and mortgage stress](#)
- [Underemployment and unemployment creating a slow deflation](#)
- [Government intervention failure and market repair](#)
- [Global crisis](#)

These four scenarios focus on different tension points in Australia's and the global economy. One scenario focuses on the balance of actions between regulators like APRA and the Reserve Bank, combined with household mortgage stress. Another envisions the affect that unemployment might have in certain areas.

Some of the factors we may see play out, such as the federal and state government trying to intervene to "fix" problems in the market, as happens in one scenario. But other factors may be out of the government's control, for example, where a global crisis pushes up risk premiums.

All of these scenarios highlight just how complicated and interrelated the steps that lead to a property bubble burst could be.

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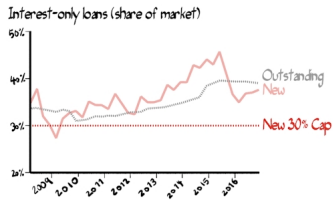
## Lending tightening, interest rate hikes and mortgage stress

Associate Professor Harry Scheule, UTS Business School

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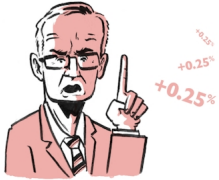
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## Step 1:

APRA applies new macroprudential measures to contain risk in the loan market

APRA encourages loan origination



## Step 2:

The RBA increases interest rates to avoid deflation

the Reserve Bank of Australia (RBA) do increase



## Step 3:

Higher interest rates lead to unmanageable repayments for many investors

most exposed to high interest rates as home loans are



## Step 4:

Investors find they're no longer able to roll over interest-only loans under new regulations

the interest is only

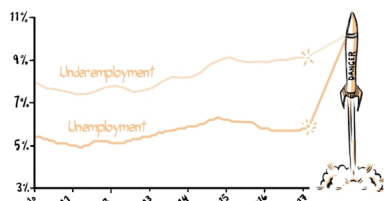


## Step 5:

Loan supply is increasingly restricted at the same time as borrowers default, causing prices to tumble

as a slow deflation

Danika Wright, Lecturer in Finance, University of Sydney



## Step 1:

Unemployment and underemployment rise

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Unemployment and underemployment - workers who want to work more but can't - increase. As the apartment development boom dies down, and without a mining boom to replace it, [construction industry workers are at high risk](#)



Step 2:

With less money in their pockets, people avoid spending and save their wages

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Households with a lot of mortgage debt are forced to limit their spending, particularly on discretionary items. This in turn affects companies that employ retail workers, reducing hours and employment.



Step 3:

Amenity house value – the value offered by being in a particular location – diminishes across the market

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Employment opportunities are a major component of house price amenity, in part because demand for housing is [pushed higher by inbound work-related migration](#). So, as there are less jobs nearby, the amenity value of some areas decreases.



Step 4:

Prices fall where mortgage stress is the highest

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The amount of [people at risk of defaulting on their mortgage increases](#) in areas where there is a loss of employment or reduced income. In 2008, arguably the last time Sydney house prices went through a correction, the incidence of mortgage defaults and property price declines was geographically localised.



Step 5:

Underwater borrowers trigger a bubble burst as the number of distressed property sales increases

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Borrowers who have the least amount of equity in their homes (typically the least wealthy, younger and newer entrants to housing market) [are the hardest hit](#) by falling property values. They are more likely to end up “underwater” – that is, owing more than the property is now worth – and face the prospect of a distressed sale. This in turn contributes to the downward spiral in house prices.

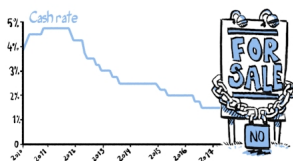
Australia has tighter lending criteria than regulators enforced before the global financial crisis in the United States. But concerns by regulators, including APRA, over current lending practices and potentially fraudulent activities [raise questions over the real quality of mortgages](#) and the ability of borrowers to repay them.

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## Government intervention failure and market repair

Professors of Economics, Jason Potts and Sinclair Davidson, RMIT

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### Step 1:

The RBA maintains low interest rates and state governments continue to maintain zoning that restricts supply

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A combination of [low interest rates and low growth](#) in new housing stock drive up Australian housing prices, a situation compounded by poor policy choices by state and federal governments and high demand from foreign residential property investors.



### Step 2:

With house prices too high for anyone without significant equity or wealth, Millennials delay leaving home and starting families

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As a result housing is misallocated in the Australian market, across demographic and especially

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age groups. This produces demographic pressures, as millennials delay leaving home, delay starting families. This leads to political pressure on governments – increases the urge to intervene.



### Step 3:

The Federal government attempts to solve the problem: increasing restrictions on foreign buyers and interest-only loans, and subsidising first home buyers

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The federal government intervenes, blaming the secondary drivers (particularly the non-voting group: foreign investors). They increase restrictions on foreign investment in residential housing stock.

The federal government also lobbies APRA to increase rules on financial products, while promoting a scheme to subsidise and promote first home ownership.



### Step 4:

Federal policy pushes prices even higher, as first-home buyers have more money while supply remains stagnant

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Because none of these previous measures from the federal government affect the primary drivers of the misallocation of housing, domestic interest rates don't change, and state governments do not act to release new stock. As a result housing prices continue to grow.



### Step 5:

With the Federal government policy failing, the RBA finally raises interest rates - causing investor stress and eventual defaults

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Increasingly alarmed that house prices continue to rise, the federal government starts to panic, threatening ever further regulation and starts to blame the financial system. This triggers the RBA to finally act, raising interest rates.

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As interest rates rise, this causes mortgage stress, resulting in default among investors with high amounts of debt, pushing these properties onto the market. These distressed sales finally cause prices to fall.

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## Global crisis

Timo Henckel, Research Associate, Centre for Applied Macroeconomic Analysis, ANU

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Step 1:

An international crisis – political, military or economic - leads to an increase in global risk premiums

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International crisis (whether it be political, military, economic) leads to an increase in global risk premiums.

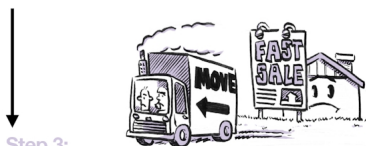


Step 2:

Borrowing costs for Australian banks rise as supply of global capital falls, pushing up domestic mortgage rates

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Borrowing costs for Australian banks rise because of this and supply of global capital falls, pushing up mortgage rates in Australia.



Step 3:

The most vulnerable owners can no longer afford their mortgages and are forced to sell

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The most vulnerable mortgagees can no longer afford their mortgages and are forced to sell their homes.

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Step 4:

House prices fall as interest rates rise, forcing many

to sell, which only escalates the decline. [More on the Australian housing bubble](#) [withing the five ways a housing bubble could burst](#)