Where to from here for housing credit?

The annual rate of growth in housing credit has started to stall over recent months and with the banks tightening their lending criteria where will it go from here?

The Reserve Bank (RBA) publishes data on private sector credit each month. The coverage of the data set is for all Australian authorised deposit-taking institutions (ADIs), this includes banks, credit unions and building societies. Note that the coverage of the data does not include funds sourced from foreign banks operating off-shore.

The RBA published private sector credit data for May 2015 last week and it showed that total credit increased by 0.5% over the month. The growth in credit is largely being fuelled by the housing sector (0.5%) as opposed to business (0.4%) and personal lending (-0.1%). On an annual basis, total credit has increased by 6.2% with housing credit up 7.2%, business credit 5.2% higher and personal credit inching 0.8% higher.

In terms of the value of credit outstanding, Australian ADIs have a large exposure to the residential property market. According to the data there is $2.399 trillion in outstanding credit to ADIs in May 2015. Of this figure, $1.466 trillion was outstanding to housing (61.1%), $792.3 billion was outstanding to business (33.0%) and $141.1 billion was outstanding for personal loans (5.9%). The proportion of credit outstanding for housing is currently at a record high while outstanding business credit's proportion is at a record low. Housing credit has consistently had a higher value outstanding than business credit since April 2001. Lower arrears and a perception that housing lending is less risky is likely to be one reasons why most ADIs have higher housing credit outstanding compared to business and personal credit.

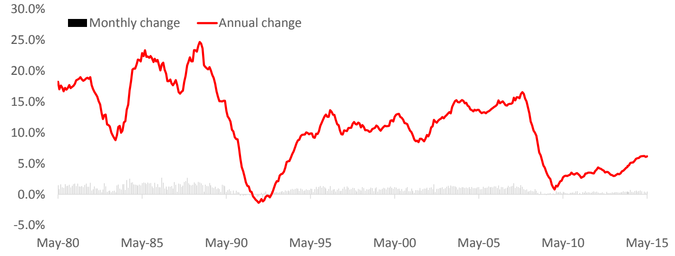
Housing is both the largest source of outstanding credit to ADIs and, housing credit is also expanding at the fastest rate of any lending segment. If we look at the historical growth in housing credit the current growth rate is quite moderate. Of course at the same time the amount outstanding is large. As the third chart shows over the past 35 years it has been pretty much one-way traffic for housing credit with it continually expanding over that time. To put the expansion into context, outstanding housing credit is currently $1.466 trillion, 10 years ago it was $674.4 billion and 20 years ago it was $160.1 billion. Over two decades outstanding housing credit has increased by more than 900%. While housing credit has expanded so too has household debt and housing debt, both of which are now at record high levels and trending higher. While credit and debt has expanded, the value of these assets, as at May 2015 the value of all dwellings in Australia was a significantly larger $5.9 trillion.

While housing credit has increased by 7.2% over the past year it has been the 10.4% rise in investor credit which has been most noteworthy compared to the 5.7% increase in owner occupier credit. In terms of value, outstanding credit to owner occupiers is $958.2 billion (65.4%) with the remaining $507.8 billion (34.6%) to investors. Investor credit which is much lower overall than owner occupier credit has generally expanded at a faster pace than owner occupier credit over the past 30 years.

Late in 2014 the Australian Prudential Regulation Authority (APRA) wrote to ADIs outlining sound lending practices and provided some warnings for those that don't conform. There were a raft of practices outlined but the one which garnered the most attention was that investor credit shouldn't expand at a rate materially above 10%pa. Since that time it has been indicated that the 10%pa is a bit more of a hard cap, yet it has grown above that rate for 6 straight months (ever since December 2014 when the letter was written). It should be noted that investor housing credit has expanded at an annual rate of 10.4% for 3 consecutive months. APRA has also since commented that it will take some time for the changes to flow through the system.

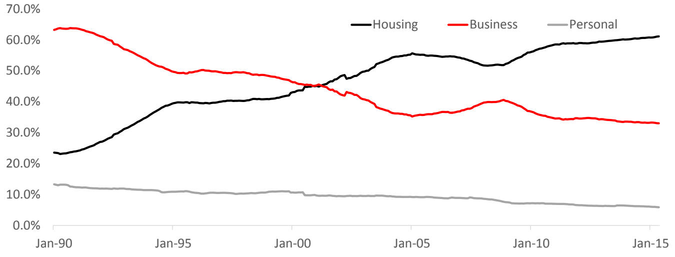
In May 2015 we started to hear about the first round of changes to lending policies from ADIs and we would expect more changes over the coming months. With plenty of competition in the mortgage market it will be interesting to see what, if any impact these changes have. One point to note is that the annual rate of growth for owner occupier has eased slightly over recent months. If lending does ease whilst it may help to cool growth in the Sydney and Melbourne housing markets it could also have un-expected consequences. Developers generally look for increasing values and transactions to start new projects. The current boom in residential construction is a key component of the economic handover as mining investment fades. Tighter lending criteria may result in developers finding pre-sales more difficult to obtain and may ultimately result in fewer projects going ahead. Of course this may not necessarily be a bad thing given the record pipeline of dwelling approvals. Ideally, you would expect the Federal Government would hope for a slight slowing in housing credit demand which is large enough to cool the current rates of value growth in Sydney and Melbourne and an equivalent if not larger pick-up in demand for business credit. Whether that is achievable remains to be seen.

Change in outstanding credit to ADIs



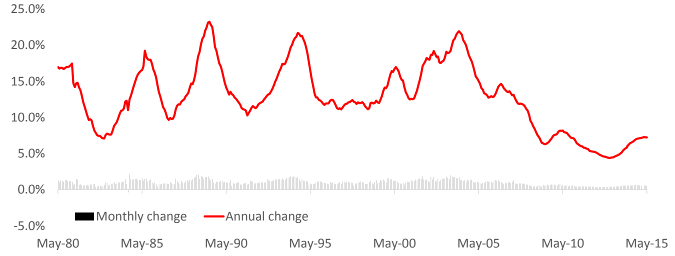
Source: CoreLogic RP Data, RBA

Proportion of total credit outstanding to ADIs by type



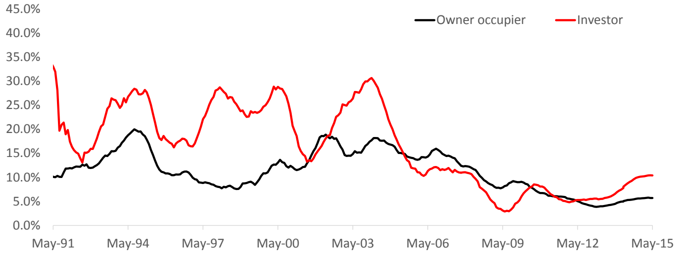
Source: CoreLogic RP Data, RBA

Change in outstanding housing credit



Source: CoreLogic RP Data, RBA

Change in owner occupier & investor housing credit over time



Source: CoreLogic RP Data, ABS