Australian Housing and Urban Research Institute

MEDIA RELEASE

Thursday, 8 June 2017

Soaring household debt poses potential risks to economy

With warnings from the Treasurer Scott Morrison about falling household consumption, new research from AHURI reveals how the housing market is one contributing factor to these macro-economic risks. The research, 'Housing prices, household debt and consumer spending', undertaken for AHURI by researchers from the University of Sydney examined the effects of house prices and house-price-induced increases in debt on general consumption spending in Australia, focusing specifically on how such links were affected by the GFC.

The research identified the consumption patterns for homeowners and home owning investors at different ages and who had greater or smaller amounts of debt or equity in their properties. Before the GFC, increases in house price were associated with increases in consumption (i.e. spending or borrowing) for homeowners, particularly because they borrowed a larger fraction of the property price (i.e. had a higher 'Loan to Value' (LTV) ratio). After the GFC these households with high LTVs became more conservative and were no longer increasing their debt to increase consumption as a response to increases in house prices.

'Our findings are relevant for macro-economic stability in Australia,' says Associate Professor Stephen Whelan, from the University of Sydney. 'In particular, the finding that households with higher levels of debt are most responsive to increases in house prices highlights a potential systemic risk. Financing higher consumption through taking debt among highly leveraged households exposes those households to the risk of significant loss if house prices fall or if interest rates rise. This is in contrast to a general belief in Australia that debt is held by those most able to service it, namely, higher income and higher wealth households.'

Before the GFC, for every $100,000 increase in house values old-aged households increased their consumption by $1,000 per year and middle-aged households increased consumption by $1,700. After the GFC, consumption by old- and middle-aged households dropped to $600 and $1,600 per year respectively.

The significance of this is seen if we consider there are 1.69 million households aged 65 and over who are homeowners (90% of these households do not own another property), then just $400 less being consumed each year by each household means a loss to the economy of approximately $608 million when compared to pre-GFC household consumption. (Household numbers and 2nd property owners data from ABS 4130.0 Housing Occupancy and Costs, 2013–14. Tables 9 and 13.)

The report also finds differences in the consumption responses of home owning investors with and without debt. Following the GFC home owning investors with no debt became more conservative, reducing their consumption response from around $3,000 to approximately $2,600 per annum for every $100,000 increase in house prices. Whereas investors with mortgage debt became more responsive as their consumption response rose from $1,700 per annum to almost $2,900 per annum for a $100,000 increase in house prices. This finding suggests that these investors with mortgage debt are not as risk-adverse when compared to other homeowners.

The researchers suggest macroeconomic policy-makers should acknowledge the potential risks associated with high levels of household debt and rising household income-to-debt ratios. In a number of countries with similar situations, regulations limit the growth of household indebtedness, while the need to ensure robust prudential regulation remains an important policy priority.

The research report is available to download from the AHURI website at **http://www.ahuri.edu.au/research/final-reports/282/**

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