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By Shane Wright

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Why demographics and not interest rates are to blame for property prices

Australia's expensive property market has been blamed on high population growth, few large cities and sprawling low-density suburbs, rather than low interest rates and the tax system.

Research released on Tuesday by financial and property services companies LongView and PEXA finds that while interest rates contribute to short-term jumps in house prices, over the longer term, key demographic factors have helped make Australia one of the priciest property markets in the world.



Property prices, particularly in Sydney and Melbourne, started to fall ahead of the RBA's decision in May to begin lifting the cash rate.

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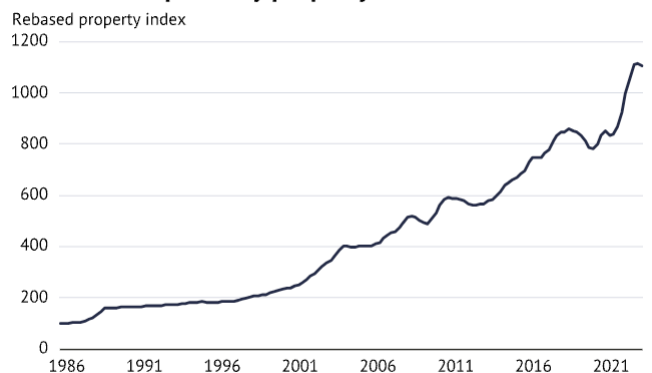
Prices surged by almost 30 per cent across the country during the COVID-19 pandemic as the Reserve Bank took the official cash rate to a record low of 0.1 per cent.

They started to fall – particularly in Sydney and Melbourne – ahead of the Reserve Bank's decision in May last year to begin lifting the cash rate. The RBA has increased the cash rate at its last nine consecutive meetings, with property prices in all capital cities now plummeting.

Research by central banks around the world has long-drawn a connection between changes in house prices and movements in official interest rates. Work done by the Reserve Bank in 2020 noted that the price of housing was sensitive to interest rates, but did highlight that other factors could affect specific property markets.

The LongView and PEXA research shows that while official interest rates have climbed and fallen over the past 60 years, house prices have grown at an average rate of 7 per cent. House prices doubled four times between 1960 and 1988 as interest rates moved up, and they doubled as rates fell between 1988 and 2021.

Australian capital city property index



Source: LongView PEXA Whitepaper

LongView executive chair Evan Thornley said while many commentators focused on interest rates and tax concessions such as the capital gains discount as reasons for Australia's high house prices, they ignored the key demographic factors affecting the property sector.

“Nearly every developed country has had record-low interest rates, supply constraints and

government subsidisation for housing,” Thornley said.

“What sets Australia apart is its consistently high population growth rates and urban concentration. Australian cities are unusual – they are few, they are large, and they all have dense CBDs and expansive suburbs with not much in between.”

The research shows that while house prices have grown sharply, much of that has been driven by a steep increase in land values.

Residential land now accounts for 48 per cent of Australians’ wealth, compared to 34 per cent in 2012.

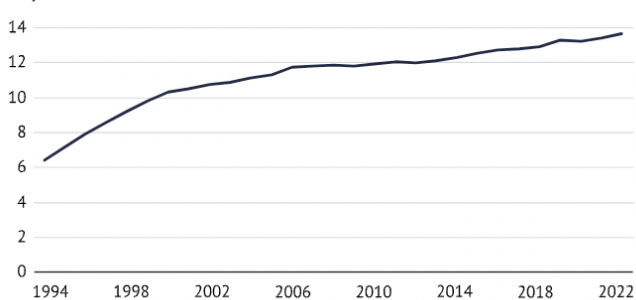
“Land appreciates, buildings depreciate – and Australia’s population dynamics mean our land appreciates faster and more consistently than almost anywhere else in the developed world,” Thornley said.

LongView and PEXA said demographic factors were driving the strong demand for housing and its impact on prices.

Australia’s population growth between 1982 and 2022 was second only to Israel, with much of that driven by migrants who needed to be housed once arriving in the country.

Average time to save for a median dwelling

In Eastern States capital cities
16 years



Source: LongView PEXA Whitepaper

About 51 per cent of Australians live in just three large cities – Sydney, Melbourne and Brisbane. By contrast, half of Britain’s population lives in its nine largest cities, while in the United States half the population lives in 36 large cities.

The population density of the Australian cities added to price pressures. While the CBDs of Sydney, Melbourne and Brisbane had high densities, this quickly fell in surrounding suburbs with an absence of moderately dense areas.

PEXA chief executive Glenn King said there were major long-term consequences for young Australians.

“Many first home buyers, who are forced to buy far from the centre of cities, are denied the opportunities that may increase their quality of life, including access to the higher paying jobs that are in the central city and employment hubs,” he said.

“Put simply, our largest cities are now too big for this.”

Over the past 40 years, homeownership rates have fallen across almost every age group. People aged between 35 and 44 are now 18 per cent less likely to own a home than they were in 1981, while for those aged between 25 and 34, homeownership is down by 20 per cent.

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