Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates

2014 - 2015

Department/Agency: Treasury
Question: AET 201-207
Topic: Implications for economy of 'unbalanced' house price growth
Reference: written - 06 March 2015
Senator: Dastyari, Sam

Question:

201. What are the macroeconomic implications of rising house prices?
202. How will increasing land or leasing costs impact on Australia's competitiveness?
203. Do the recent surge in house prices (in Sydney up to 30% over the last two years) affect the international competitiveness of domestic Australian firms?
204. If a great proportion of savings/investment is invested in the housing market, how will this affect productivity growth?
205. If a great volume of savings/investment is invested in the housing market, how will this affect productivity growth?
206. Can it be asserted that higher housing/land costs are detrimental to productivity and competitiveness?
207. What could the government do to address some of these productivity and competitiveness issues?

Answer:

201. Rising house prices impact on macroeconomic outcomes through two main channels: household wealth effects and residential construction activity.

Household wealth effects – Australian households hold around 60 per cent of their assets in housing. Rising house prices increase the value of households' assets which stimulates increased household spending. Recent gains in house prices have supported household consumption.

Residential construction activity – rising house prices provide developers with the incentive to build more houses and profit from higher house prices. In response to recent house price gains residential activity has picked up strongly.

202. Australian business' leasing costs depend on conditions in commercial property markets, rather than residential property markets. Based on company tax data, rent and leasing expenses only accounted for around 2 per cent of total company expenses in 2011/12, so a rise in these costs would likely have a marginal effect on competitiveness. However, for some small businesses, including retailers, leasing expenses are likely to be a more important cost of doing business.

Source: Australian Taxation Office (ATO) Taxation Statistics 2011-12.

203. The rise in housing prices would have little effect on the competitiveness of domestic Australian firms. Domestic firms lease commercial property space, which has different zoning laws and fundamental drivers than the housing market. In fact, CBD office rents have

been declining over the past couple of years, reflecting subdued tenant demand in some states, and industrial and retail rents have been broadly flat. One potential benefit of the sharp rise in house prices is that small and medium sized businesses (SMEs) often need to use residential property as collateral for their business loans, so at the margin there may be more SMEs that can access finance.

204. and 205. The *volume* of investment in housing increases with population and household preferences. We are unable to isolate the impact of an increase in housing investment on productivity growth.

Many factors would determine the impact an increase in housing as a *proportion* of Australian savings/investment could have on productivity growth. This includes for example the scope of businesses and households to raise capital from overseas sources, the impact (if any) on domestic cost of capital, and the extent to which other sectors in the economy respond to stronger housing investment. We are therefore unable to generalise and assess the impact of increases in the *proportion* of housing investment on productivity growth.

Over the past ten years, housing as a proportion of total investment has been stable at around 19 per cent (this share was 19.5 per cent at the December quarter 2014), while housing as a proportion of Australia’s GDP has also stable averaging 5.3 per cent over the past ten years (at the December quarter 2014 housing investment accounted for 5.2 per cent of Australia’s GDP).

206. and 207. It *cannot* be asserted that higher housing/land costs are detrimental to productivity. Rent and leasing expenses only accounted for around 2 per cent of total company expenses and there is no clear link between housing as a *proportion* of Australian savings/investment and productivity growth.