

## Investment Strategy Update #73

### APRA - the spanner for a red hot property market

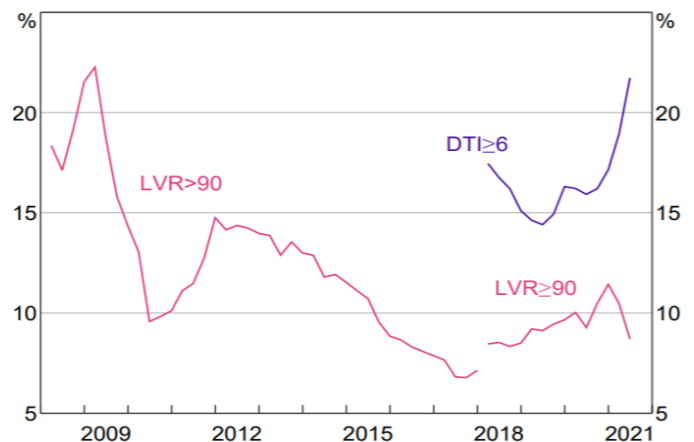
- Last week, the Australian Prudential Regulation Authority (APRA) increased the serviceability buffer it expects banks to apply to new borrowers from 2.5% to 3.0% above the base rate.
- This is the first macro prudential measure implemented to help cool the housing market via restricting borrowing amounts (APRA estimate by ~5%), and ultimately help improve long-term financial stability across the housing sector.
- History suggests that APRA will get its desired outcome, even if not at the first attempt, as it did following the implementation of its speed limit policies in 2014 and 2017. However, the impact on credit growth should be fairly modest, and largely confined to highly indebted investors, as most borrowers don't borrow at their maximum capacity.
- After a rapid rebound through 2H20 / 1H21, house price growth was already beginning to slow down. The momentum driven by a combination of factors including pent up demand, limited supply, a substantial decline in borrowing rates and elevated confidence could not continue at the current pace even prior to the latest APRA measures. We think price growth will decline from above 20%pa into the high single digit range over the coming 12 months. However, with rates on hold out through 2023/24, lockdowns ending and international borders reopening, we don't see an end to the housing upswing.
- A slowdown in housing credit growth and house price growth is not a threat to Australia's economic recovery. However, if APRA is successful in cooling riskier lending and runaway house price growth, this should help ease fears of the need for an early RBA rate hike.
- We don't think APRA's cooling measures will have a meaningful impact on the equity market. Increased regulation is a net negative for sentiment towards banks and property developers, but credit growth is likely to remain positive for banks while developer exposures to investors are well below previous peak levels. Similarly, we expect consumer / investor confidence to remain robust even into further – targeted – cooling measures.

#### What changes have been introduced?

APRA has increased the minimum interest rate buffer it expects banks to use when assessing serviceability on home loan applications. APRA now expects ADIs (authorised deposit-taking institutions) to assess the serviceability of new borrowers at a level at least 3.0% above the loan's interest rate, up from 2.5% currently.

APRA's objective is to reinforce the stability of the financial system by ensuring banks are lending to borrowers who can afford the level of debt they are taking on, both today and into the future if interest rates rise. APRA's role as supervisor of the banking sector provides it with a range of more nuanced tools than the RBA. Lifting the home loan buffer will target lending to highly indebted households, while if the RBA were to lift the cash rate it would dampen activity across the entire economy.

#### Highly leveraged households account for a larger share of new lending

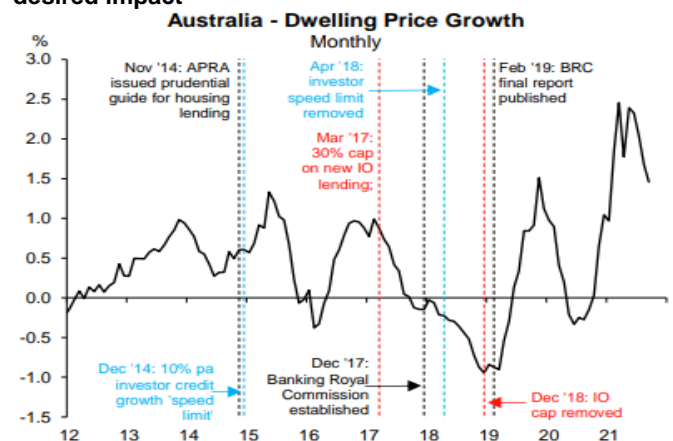


Source: RBA, October 2021

#### APRA has the tools to achieve its objectives

APRA's targeted actions to curb housing credit growth have previously had the desired impact and we expect this time will be no different even if not at the first instance. While initial prudential measures in 2014 to limit lending growth for investors made some headway in curbing credit growth, it was not until additional regulations issued in 2017 to restrict interest-only lending when house prices ultimately slowed down. Credit growth grew over 7% in June 2021 (on a three-month annualised basis), the highest growth rate since 2015, so credit growth can slow yet still remain at a healthy level.

#### Previous regulatory actions eventually achieved the desired impact



Source: CoreLogic, RBA, Macquarie Macro Strategy, October 2021

APRA has already indicated that is prepared to do more if necessary in order to achieve a slowdown in risky borrowing (with a secondary objective of slowing price growth we expect). While they will likely take some time to gauge the impact of last week's announcement, we expect further tightening if lending to highly indebted households (and or rapid price appreciation) does not begin to slow.

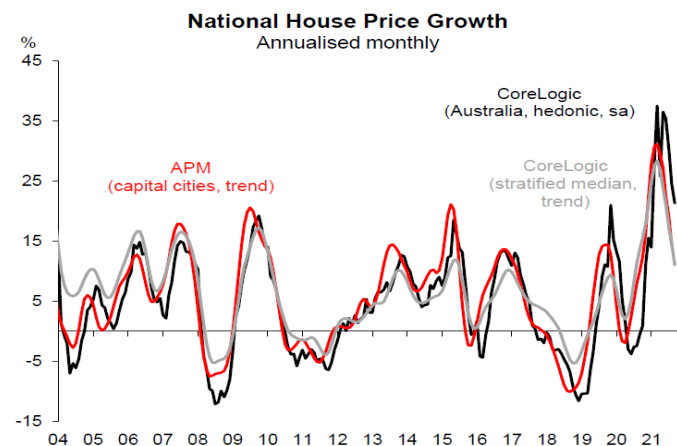
**Macquarie believes increasing the serviceability buffer is the cleanest way to tighten macroprudential policy. As such, we think further increases to the buffer would be a logical next step**, while other tools such as debt-to-income limits and increasing the interest rate floor used by banks would be more complex to implement and may disadvantage owner-occupiers more than investors.

## What areas are impacted?

### The property market

- We expect house price growth to begin to slow into 2022 and beyond but for gains of around 5-10% over the coming 12 months driven by owner occupiers.
- Despite increased attention from regulators, the sector remains underpinned by elevated consumer confidence, low borrowing rates, modest supply, the reopening of interstate/international borders, easing of Covid restrictions and a strong 'fear of missing out' on the part of buyers.

## Housing price growth is already moderating from peak levels

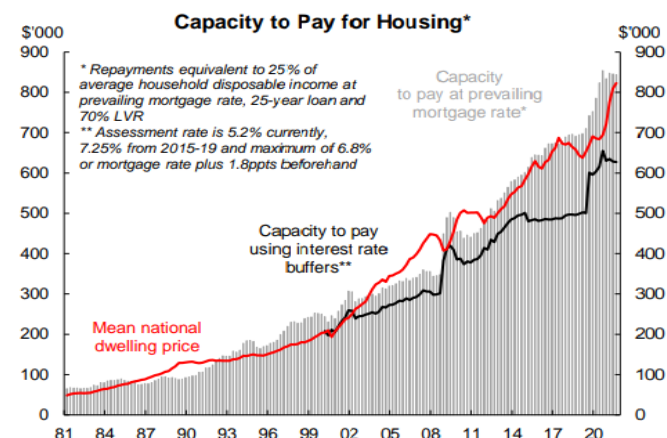


Source: ABS, CoreLogic, Macquarie Macro Strategy, October 2021

### Home borrowers

- The key objective of APRA's adjustment is to reduce the vulnerability of individual borrowers (and their lenders) to a rise in interest rates at some stage in the future.
- The increased serviceability requirement is **expected to have the largest impact on investors** rather than owner occupiers. This is because investors typically take on greater levels of debt (e.g. for tax purposes) and often have pre-existing debt held elsewhere which is taken into account when assessing serviceability.
- APRA expects the increase in the serviceability buffer to **reduce the maximum borrowing capacity by ~5%** for a typical borrower. However, borrowers may see minimal impact as i) many do not lend at their maximum capacity and ii) some borrowers are *already* constrained by the floor rates used by banks.

## Capacity to pay remains supported by low rates



Source: ABS, CoreLogic, Macrobond, RBA, Macquarie Macro Strategy, October 2021

### The Australian economy

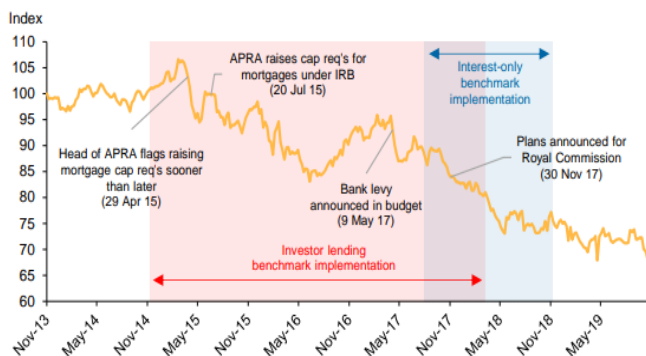
- We do not expect this regulation to be a meaningful drag for the Australian economy. APRA has been careful to implement this modest change at a time when the economy should be on a stronger footing as it emerges from lockdowns.
- Given both APRA and the RBA's focus on maintaining macroeconomic stability, the tempering of rapid credit growth should be supportive for the RBA to maintain their current expectations of keeping rates on hold through 2023/24.
- Further actions from APRA may be required, but is likely to remain targeted at specific borrowers. We do not expect a moderation in housing credit growth to change the trajectory of Australia's overall recovery. Importantly, the key structural growth drivers remain in place including: accommodative fiscal and monetary policy, a still solid housing market, elevated savings levels and upcoming state re-openings.

### The equity market

- Targeted policy tightening is not likely to have an impact on the overall equity market unless it drives a more severe slowdown in credit growth and/or house prices that then begin to undermine activity and confidence. We think the trend of cyclical improvement will be the over-riding driver for the equity market.
- Banks** have in the past been able to partly offset negative impacts on volume growth (i.e. lower credit growth) through repricing initiatives. However, given the current macroeconomic backdrop and banks' improved political standing, **Macquarie believes it will be more challenging for banks to reprice**, particularly for the more politically sensitive owner-occupier space.
- Macquarie believes the impact on credit growth will be small**, particularly for owner occupiers who benefit from attractive front-book interest rates, and **this implies further potential buffer increases** if credit growth does not moderate. The buffer increase does not apply to non-bank lenders which are marginal beneficiaries from the change.
- Macquarie holds a neutral view on the bank sector and sees short-term support from rising bond yields and reasonable relative valuations versus the market. Overall, APRA's announcement is only a modest initial tightening with limited impact, but a more aggressive round of measures that weakens housing sentiment would be a significant headwind for the sector, as it was in 2014-2017.

## Banks' historical share-price performance during macroprudential measures have been mixed

Relative performance of banks vs All Ords during prudential measures



Source: APRA, FactSet, Macquarie Research, August 2021

- **Property developers** may be negatively impact by APRA's tightening due to a relatively high exposure to property investors. Mirvac (MGR) has a 35% exposure to investors (19% domestic, 16% offshore) in its pre-sales residential development book, while Stockland (SGP) has a more modest 23% exposure.
- However, these exposures appear manageable and well below peak levels seen in 2015-16 (MGR 47%, SGP 29%) due to the roll-off in apartment sales in recent years.
- A potential offsetting factor is the strong demand backdrop, particularly in land markets, which is outstripping supply and leading to quick sell out of releases (which should be positive for 1Q21 updates from MGR/SGP). A moderating of demand could simply bring about more supply/demand balance.

## Macquarie WM Investment Strategy Team

The report was finalised on 11 October 2021.

**Recommendation definitions (Macquarie Australia/New Zealand)**

**Outperform** – return >3% in excess of benchmark return

**Neutral** – return within 3% of benchmark return

**Underperform** – return >3% below benchmark return

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