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Don’t blame Chinese buyers for Australia’s real estate boom

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Last week I argued that blaming Chinese money for the worsening real estate affordability in Australia was off the mark (*The property bubble myth that refuses to die*, 14 October 2014).

To recap: all foreign investment in the real estate sector requires approval from the Foreign Investment Review Board (FIRB). Drawing on FIRB data, research by the Reserve Bank of Australia (RBA) in June showed that over the past two decades the value of total foreign investment approvals in the real estate sector has fluctuated between just 5-10 per cent of total dwelling sales. The share rose to between 12-13 per cent in the first three quarters of 2013-14.

Chinese investment approvals are only a proportion of this. Since 2009, the Chinese share of total foreign investment approvals has been around 10 per cent. It’s likely higher right now but that’s hardly surprising coming from such a low base.

A potential limitation of this analysis is that FIRB data may under-estimate the true volume of foreign investment. This possibility has gained popularity since Kelly O’Dwyer, the Chair of the Inquiry into Foreign Investment in Residential Real Estate, cited anecdotal evidence that some foreign investors may be skirting the rules and not seeking FIRB approval before purchasing established homes. With few exceptions, the rules restrict them to buying new homes.

It was welcome news then when the National Australia Bank (NAB) released its third quarter 2014 residential property survey last week. A detailed discussion of the relative merits of FIRB data versus that from NAB can be put to one side for now. What is important is that the NAB data are compiled using a completely different methodology – a survey of 300 panellists with direct exposure to the sector such as real estate agents, investors, fund managers, and so on. In short, precisely the sort of respondent that some commentators view as being better informed of what is happening on the ground than FIRB.

One of the report’s findings was immediately trumpeted in the headlines – “One in six homes bought by foreigners”. So foreigners have been responsible for the sharp rise in Aussie house prices after all?

Not so fast.



The “one in six” refers to purchases of new homes. For established homes, foreign buyers were only responsible for one in twelve (8.2 per cent). This was slightly above the average share over the past couple of years of around 6.5 per cent but down from 9.5 per cent in the first quarter of this year. And again, remember that Chinese buyers are just a proportion of this.

Developments in the two markets where bubble fears have been greatest were far from conclusive. Between the first and third quarters of this year, foreign investors have been a growing proportion of established housing demand in Victoria (10 per cent to 11.5 per cent) but have fallen sharply in New South Wales (12.7 per cent to less than 8 per cent).

Thus, whether using FIRB or NAB data, the idea that Chinese investment has been driving price increases of established homes fails the common-sense test.

Now getting back to that “one in six”.

Contrary to the headlines, what the NAB survey indicates is that foreign investors are currently responding to rising house prices and buying into the section of the market where the rules allow them to – new housing. But they have not been responsible for driving up prices to date. And against a backdrop of low global interest rates due to quantitative easing in the U.S., Europe and Japan, who can blame them for seeking higher returns elsewhere?

According to the Australian Bureau of Statistics (ABS), house prices started accelerating at the end of 2012. Quarter on quarter growth peaked at 4.2 per cent at the end of 2013. In 2014, the pace has been less than half that.

If foreign investors had been responsible for pushing up prices, they should have emerged as a growing proportion of demand since the beginning of 2013. Except that they didn’t. According to the NAB survey, foreign investors remained a stable 12.5 per cent and 6.5 per cent share of new and established home demand, respectively. The jump to a 16.8 per cent share of new home demand (the much-reported “one in six”) only occurred in the most recent quarter. And this rise was made all the more dramatic by the fact that their share had actually fallen in the second quarter to 10.2 per cent.

If the NAB survey is correct, one might almost feel sorry for foreign buyers because it appears they are entering the market at what is likely the tail end of the boom.

In the new housing market, developments in New South Wales and Victoria are again far from black and white. In Melbourne, the foreign investor share of demand rose from 10 per cent in the first quarter of 2014 to 25 per cent in the third. But in Sydney it fell from 25 per cent in the first quarter to just 5 per cent in the second, before recovering to 17 per cent in the third.

Questions of scale aside, as long as we are talking about new homes, foreign investment means more capital available to expand housing supply. While increased foreign demand may pump up prices in the



short run due to inelastic supply, more homes available over time will dampen price growth. This is the whole justification for Australia's foreign investment regime which welcomes foreign capital for new housing.

With a small population and a limited savings pool, having foreign investment in a capital-intensive sectors of the economy such as real estate makes good sense, just as it does in other sectors such as mining and infrastructure.

The latest NAB survey also hints at the expected impact of the increase in housing supply. House prices are only expected to grow by 2.1 per cent in the next 12 months and 2.4 per cent over the next two years. Queensland, not New South Wales or Victoria, is expected to be the star performer. Rental growth will be anaemic at 0.7 per cent over the next 12 months and 1.2 per cent over the next two years, much slower than the forecast annual increase in the CPI found in the Commonwealth government budget papers of around 2.5 per cent.

It's time to slay the idea that Chinese money has been behind Australia's real estate price boom. Maybe then we can begin tackling the real culprits such as cheap credit, limited land releases and tax breaks such as negative gearing.

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