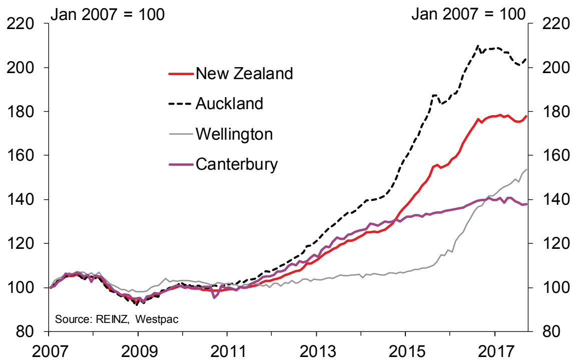
Home Truths

25 October 2017

Welcome to Home Truths, Westpac's regular update on the housing market. Home Truths has been absent for a while but is now back in action, so we will use our first month back to catch up on recent market trends and make some predictions about where to next for the market. After a period of sharply cooling house prices, the market may well have entered a more positive phase. But where the market heads next will depend on the new Government's policies.

The housing market slowed on all fronts between January and July 2017. Prices fell steadily in Auckland and Canterbury; in Northland, Waikato and Bay of Plenty price gains slowed to a standstill; and although prices kept rising in the rest of the country, they did so at a slower pace than last year. The rate of market turnover fell by around 20% across the country, and the stock of unsold homes sitting on realestate.co.nz rose, although that was mainly in Auckland. Finally, the average time taken to sell a house lengthened.

Figure 1: REINZ monthly house price index, seasonally adjusted



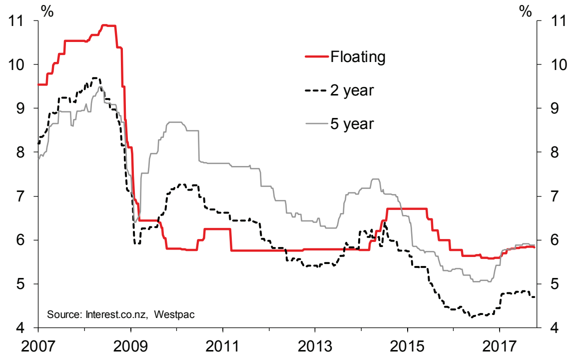
Over the past couple of months, market conditions have changed. REINZ figures, seasonally adjusted by Home Truths, show that nationwide average prices rose slightly in August, after having declined in four out of the previous five months. Then in September prices experienced their most rapid monthly increase in a year, rising 1% on a nationwide average basis. The September price gain was widespread across regions, with even Auckland and Canterbury prices up.

Monthly price data can be choppy and need to be treated with caution. But there are other straws in the wind suggesting that the market has turned slightly in favour of sellers. The inventory of unsold homes on realestate.co.nz has dropped sharply in Auckland, and remains low in the rest of New Zealand. And the number of days taken to sell a house fell in September. True, seasonally adjusted market turnover remains very low, and that is usually a sign of a weak house prices to come. But in this case the looming election probably distorted the picture a little – both buyers and sellers steered clear of the market in August and September, so slow sales did not necessarily indicate a dearth of buyers relative to sellers.

In our view, the main reason for the market slowdown of 2017 was a lift in mortgage rates. Two-year fixed mortgage rates jumped 0.35% at the start of the year – enough to add over $2300 per annum to the interest bill on an 80% mortgage over a median-priced Auckland house. That was a serious whack to affordability (or the profit/loss calculation for a property investor).

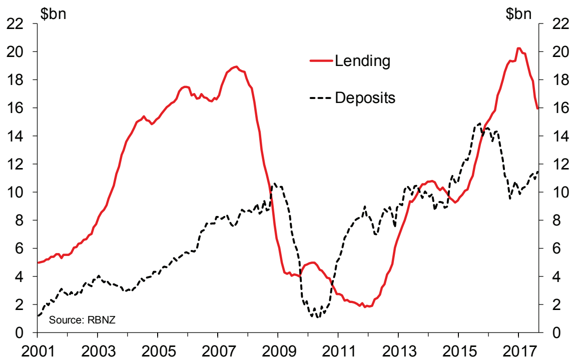
Mortgage rates rose, independent of the Reserve Bank, because the banking system was finding that deposit growth was dropping away while loan growth remained strong, creating a funding mismatch. In an effort to better balance deposits and loans, banks competed with each other to bid up term deposit rates. They also borrowed for longer terms from offshore, which attracts a higher interest rate. Either way, money was coming into the banking system at a higher average interest rate, and this was passed on as higher interest rates for borrowers.

Figure 2: Average advertised mortgage rate, five main banks



Another way the banking system addressed its “funding gap” was to reduce the quantity of lending. This has been felt in the property market as greater difficulty accessing finance, particularly for bigger property developers. This may have had a flow-on effect to house prices, as it would have curtailed investor interest in developable properties, and perhaps even forced some speculators to sell.

Figure 3: Loan growth and deposit growth, New Zealand banking system



Over the past few months, financial conditions seem to have eased a little. Some mortgage rates and term deposit rates have actually fallen, and anecdotally, it is not getting any harder to access bank finance. This might have contributed to the recent lift in house prices. If mortgage rates fall further over the coming weeks, as we believe they will, there could be a little more positive impetus to the market.

But we doubt that this more positive market sentiment, if it comes to pass, will last long. There is only so far that mortgage rates can fall. Over a longer timeframe, mortgage rates are more likely to trend up, and that is the key reason that our longer-term house price forecast is flat to falling.

The second reason for our downbeat longer term house price forecast is that net migration is falling. The influx of people who entered New Zealand on temporary visas three or four years ago are now starting to leave. In our view, these natural forces will cause New Zealand’s annual net immigration to drop from 70,000 now to around 20,000 by the end of 2020, and that is before allowing for any change in Government policy. In our view the influence of net immigration on house prices is smaller than many people believe, but there is undoubtedly some effect – if net immigration drops away, there will be less pressure on rents and house prices.

Figure 4: Westpac house price forecast, before considering changes in Government policy

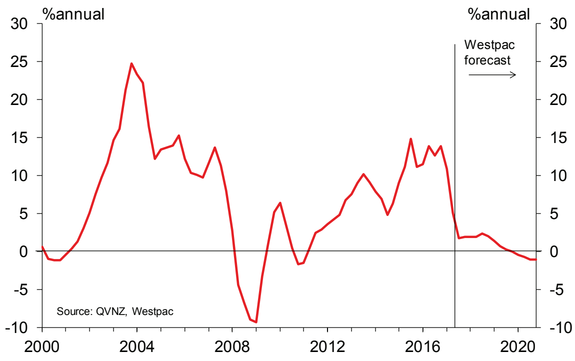
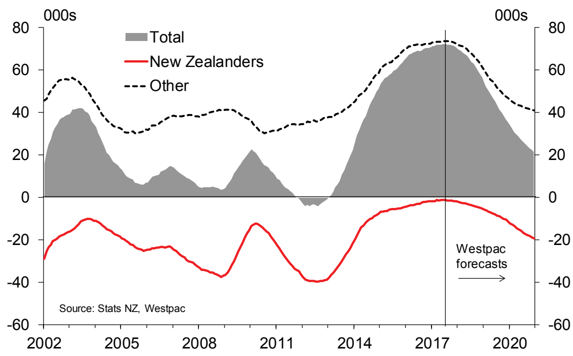


Figure 5: Net immigration



The house price forecast above is based on current legislation and has not been updated to reflect any changes to Government policy following the election. We will have to wait until policy details are announced before drawing definitive conclusions in that regard. But for now, we can provide some general points about the policy proposals of Labour, New Zealand First and the Greens as we understand them.

Before the election, Labour said that it would tax capital gains on property investors who resell within five years (currently two years), and remove property investors’ ability to write off losses on rental properties against their personal income. If this policy survives the coalition formation process it would have a negative effect on house prices, although in our assessment the lasting impact would be small.

Our understanding is that the Government plans to go ahead with Kiwibuild, which is an investment fund charged with building 100,000 affordable houses (and the associated infrastructure) over ten years. This might have a small negative effect on average house prices. It could have more of a negative effect on the relative price of small dwellings, as this is where the state-funded construction would be concentrated. Construction resources would be diverted away from larger houses, so to the extent that they become scarcer there could be some upward impact on prices in this category.

A ban on foreign buyers of residential property is part of the coalition deal between Labour and New Zealand First. This would have a downward effect on prices of impossible-to-determine magnitude, although international experience suggests the impact would be small. In July last year Vancouver taxed foreign buyers so heavily that it might as well have been a ban – sales to foreigners fell from 10% to 0.9% of the total. Prices fell briefly, but locals soon stepped into the breach and prices started rising again.

The new Government plans to tighten immigration rules, which could cause net immigration to fall even faster than we are currently forecasting. If so, there would be some downward pressure on rents and house prices.

All of the above are probably modest in their potential affect house prices. To us, the big uncertainty is what the Government does with the tax treatment of housing. A capital gains tax, land tax or similar would probably help right some of New Zealand's economic imbalances and housing affordability issues. But such a tax change could have a large impact on house prices. Labour planned to convene a tax working group that might recommend such taxes, but said it would defer any action until after the 2020 election. This is the space we are watching most closely as we sharpen our pencils ready to update our house price forecasts.

Dominick Stephens
Chief Economist

Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Shyamal Maharaj, Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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