Home Truths

17 April 2018

Looming slowdown

Welcome to Home Truths, Westpac's regular update on the housing market.

The March monthly REINZ housing market data was mixed. Seasonally adjusted house prices rose 0.4%, although price moves were very mixed across regions – Auckland prices were flat while some others rose more sharply. Nationwide seasonally adjusted house sales were down 4.5% in the month, but it is hard to tell what that means – it comes after a very strong February for sales, and REINZ tends to undercount the number of sales at first. Overall, the housing market remains in broadly positive territory. New Zealand's housing market slowed in early-2017, especially in Auckland. But since late last year the market has been more positive, with slightly brisker price increases and slightly faster market turnover – again, this trend was most marked in Auckland, although it has occurred elsewhere too.

In our view the market became more positive due to an easing in financial conditions – banks began reducing mortgage rates independent of the OCR, and in January the Reserve Bank eased its LVR mortgage lending restrictions. But there may also be an element of buyers rushing in to beat upcoming tax and regulatory changes driving the market.

In our view the "good times" for the market are going to end very soon. We are forecasting a small decline in house prices for the second half of 2018. Looking through the factors that might affect prices over the coming year, there is a lot lined up on the negative side of the ledger, and not much at all on the positive side:

REINZ housing data, Westpac seasonal adjustment

	Mar-18	Feb-18	Mar-17
House sales, number, s.a.	6403	6707	6608
Mth % chg	-4.5	3.0	2.6
Ann % chg	-9.9	3.9	-9.5
Days to sell, sa	36.7	37.5	35.6
House Price Index (s.a.)			
Mth % chg	0.4	0.6	0.2
Ann % chg	4.2	3.9	10.7

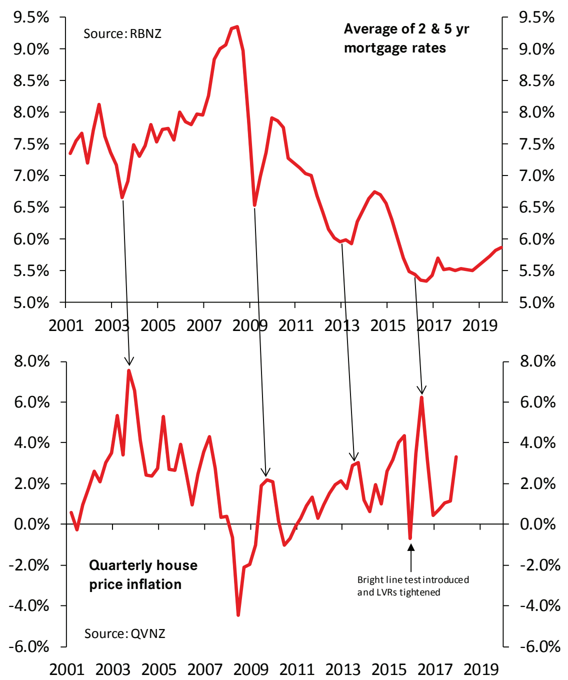
- **The Bright Line Test has been extended from two to five years.** In 2015 a new rule required people to pay tax on capital gain if they resold an investment property within two years. House prices had been rising at over 4% per quarter, but fell 0.7% in the three months after that rule was introduced (see figure 1). The extension of the Bright Line to five years will be a very significant change for investors, and can be expected to negatively impact prices at least for a short period.
- **Foreign buyers will be banned,** probably from the middle of this year. This can be expected to have a one-off impact on the level of prices. In Toronto, house prices fell 6% in the six months after a 15% stamp duty was levied on foreigners.
- **Property investors will lose part of their tax advantage over first homebuyers.** Currently, when landlords pay more in mortgage interest and expenses than they receive in rent, they can claim tax losses that reduce their overall tax bill. This practice of "negative

gearing" will be phased out or removed from next year. This will reduce, but won't eliminate, the tax advantage property investors have over first homebuyers and over other forms of investment.

- **The Tax Working Group will probably recommend a capital gains tax excluding the family home (CGTxFH).** In 2009 we analysed the potential impact of a 10% CGTxFH, and concluded that it would reduce house prices by 15% relative to the counterfactual. The Government has indicated that it would not introduce a CGTxFH before the next election, so there is considerable political uncertainty. However, the increasing risk of a capital gains tax will surely affect sentiment in the market over the coming years.
- **Mortgage rates are more likely to rise than fall.** The most important determinant of year-to-year changes in house prices is interest rates – see figure 1. Lower mortgage rates make property investment more attractive and home ownership more affordable. We are now in an environment of rising global interest rates, and New Zealand long-term mortgage rates will be swept higher on this rising tide over the coming few years.
- **Net migration is slowing and construction is picking up.** And both trends are expected to intensify. This will eventually start to ease housing shortages in a range of regions.

This is a prodigious set of negative factors, but for a few reasons we are forecasting only slight house price decline, rather than anything dramatic. First, the labour market is expected to stay in pretty good shape – sharp house price declines usually occur when unemployment rises, and that is not something we anticipate. Second, the Reserve Bank is ready and able to relax its LVR mortgage lending restrictions, particularly if the market were to turn very negative. And finally, the Government might go cold on some of its proposed policies if prices started to fall sharply – after all, the only thing less popular than rising house prices is falling house prices.

Figure 1: Quarterly house price inflation & mortgage rates



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