Home Truths

13 August 2019

The jury is still out

The New Zealand housing market slowed sharply over the first half of 2019. Measured across New Zealand as a whole, June was the first quarter in which prices have fallen since December 2010.

But the Government cancelled its proposed capital gains tax in April, and fixed mortgage rates have been falling precipitously.

In May, the Westpac Economics Team predicted that tumbling interest rates and the cancellation of CGT would cause the housing market to pick up. We recognised that a range of factors would hold the market back, such as slowing net migration, burgeoning building activity, the foreign buyer ban, and the move to prevent landlords from using losses on rental profits to reduce their overall tax bill. But we predicted that the powerful effect low interest rates have on affordability would eventually dominate. Consequently, we forecast that house price inflation would accelerate to 7% per annum next year, from about 2% now.

We have encountered a great deal of scepticism about that forecast – most other economists expect the current low rate of house price inflation to persist.

This month Home Truths gets elbows-deep in the data to try to assess whether our bullish forecast in on the mark, or whether the more downbeat forecasters have got it right. At this stage, the jury is still out due to mixed evidence.

We'll start by describing what a typical housing market pickup looks like. The first sign of change is always evident in market turnover figures – rising house sales is a reliable sign of stronger price action to come. The second sign of an imminent market pickup is a reduction in the stock of homes sitting unsold on the market.

In the early stages of a market pickup, statistics like the number of days taken to sell and the selling price can actually *worsen*. That's because less desirable houses that have been sitting on the market for a while start moving. Consequently, a bunch of sales with high days-to-sell and low prices are recorded in the initial stages of a market upturn. Prices only really start rising about three to six months after the initial lift in house sales. The average number of days taken to sell typically drops at about the same time.

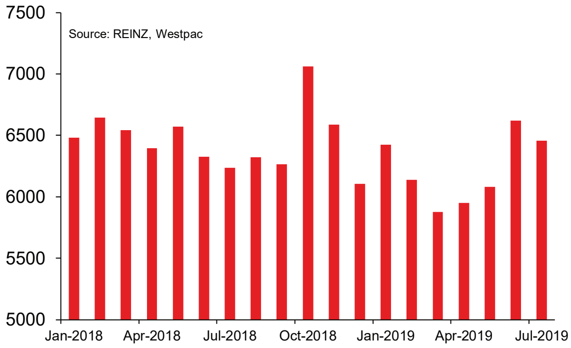
So if the market really is going to pick up, at this stage we should be starting to see higher market turnover and a reduction in the stock of unsold homes. We will start our assessment by looking closely at house sales.

The best data on house sales comes from the Real Estate Institute (REINZ). But the difficulty is that housing market turnover is highly seasonal. Most media reporting relies on comparing the latest data to the same month a year previously. But that is hopelessly out of date. A market pickup or downturn could be months old before year-ago comparisons register any change. We seasonally adjust the monthly data using a procedure recommended by the US Census Bureau, which accounts for both the time of year and the number of business days in each month (which can vary due to the timing of weekends and holidays). This allows us to make a meaningful comparison between any two months of the year.

Secondly, REINZ always under counts the number of house sales in the latest month. This is because not all sales are immediately reported to the REINZ. Late-reported sales are added to the historical record after the data is initially released. For example, a month ago the REINZ reported that there had been 5978 house sales in June (not seasonally adjusted). Today that June sales figure was revised up to 6156, a revision of 3%. The REINZ's initial undercount has averaged 2.4% since our record of it began eleven months ago. Thus, we will assume that the July sales figures, released today, have been underreported by 2.4%.

Figure 1 shows what has happened to monthly, seasonally adjusted house sales, including an adjustment for REINZ's initial undercount applied to the July figure. The data is choppy and hard to interpret. To our eye, sales reached their lowest ebb in March and have been trending higher since then. Sales rose very sharply in June, but retraced some of that gain in July. We would say that's just typical monthly volatility, but a more pessimistic forecaster might see it as a negative sign. The true trend won't be clear for a few more months.

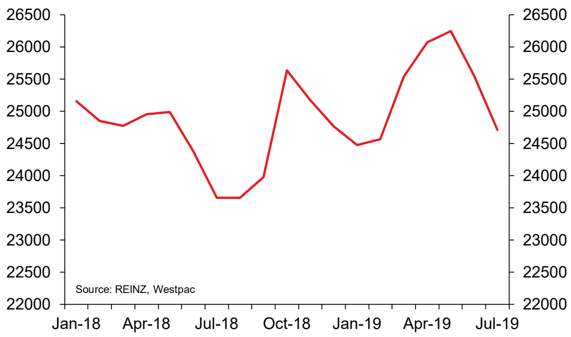
Figure 1: Monthly house sales, seasonally adjusted



In terms of regional detail, most of the lift in sales over the past two months has been in Auckland, Bay of Plenty, Canterbury and Otago. Auckland and Canterbury are the specific regions we think are going to change, so again this is tentatively consistent with our forecast. Last week Barfoot and Thompson (Auckland's largest real estate agency) registered a 10.4% lift in house sales for July (Westpac seasonal adjustment), offering confirmation that Auckland sales are lifting.

The second sign of a housing market pickup, if one is occurring, ought to be a drop in the stock of unsold homes on the market. Figure 2 shows the number of houses available for sale on realestate.co.nz, the largest real estate website. This data is seasonally adjusted by realestate.co.nz. The stock of unsold homes peaked in May and fell quite sharply over June and July (mostly in Auckland). We think that's going the right direction, but it is too early to call a two-month drop a trend. So really, the jury is still out on this one, too.

Figure 2: Homes listed on realestate.co.nz, seasonally adjusted



Today's July REINZ data showed that the seasonally adjusted nationwide House Price Index was unchanged in July compared to June, and that the seasonally adjusted average time taken to sell remained at 40.8 days, unchanged from June and the equal-worst since 2011. That's definitely weak data. But as mentioned above, it is too early to expect house prices or days to sell to be responding to any housing market pickup at this stage.

In conclusion, we think there are straws in the wind supporting our view that the housing market is going to pick up, so we are sticking to our forecast of 7% house price inflation next year. But the evidence is by no means conclusive – more data will be required before we can draw any real conclusions about which way the market is heading.

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