

# Home Truths.

18 February 2019



## Target acquired.

Back in April last year Westpac predicted that New Zealand house price inflation would reach 7% in 2020. At the time house price inflation was running at 1.4% and all other major forecasters were predicting that the market would remain subdued.

Today the Real Estate Institute revealed that its House Price Index rose 7% over the year to January 2020, meaning our forecast has come good.

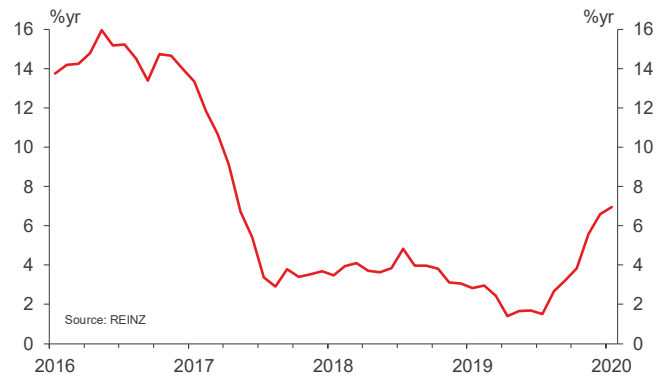
If anything, the market has proved slightly stronger than we anticipated. We now expect the current upturn to culminate at a rate of 10% annual house price inflation in the middle of the year. That said, we are not expecting a repeat of 2016. We predict that the pace of house price inflation will soon start easing off as rising fixed mortgage rates gradually crimp the market.

The market's behaviour over the past year is an example of how financial factors can trump physical supply and demand in the housing market. Over the past year New Zealand construction activity has ramped up substantially while net migration has steadily declined. However house prices have still shot higher. We think that has been due to a big reduction in interest rates combined with the cancellation of earlier plans to introduce a capital gains tax.

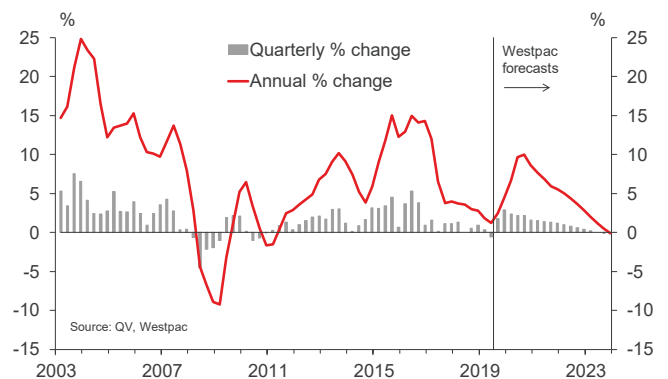
It is this type of experience that, years ago, led us to conclude that the only effective way to "solve" New Zealand's housing affordability crisis is to reform the tax system. The supply mantra advocated by successive governments is politically palatable, but it won't work so long as the tax system continues to favour property ownership. Policies designed to encourage building small houses, such as Kiwibuild, are a positive step for society at large. But those small houses will tend to be bought up by landlords so long as they receive tax deductions for interest payments and maintenance while usually paying no tax on capital gains. Meanwhile first homebuyers will remain out in the cold paying tax on their incomes and savings as they work towards raising a deposit.

Another prediction we made last year was that the most obvious turnarounds would be observed in the previously moribund Canterbury and Auckland markets. That has been more-or-less borne out. The whole country is now singing from the same house-price song sheet. Over the past few months house prices have increased at a more even rate across the country. Auckland is actually now among the faster-rising regions. Prices in Canterbury are rising, although to date this has been slower than many other regions.

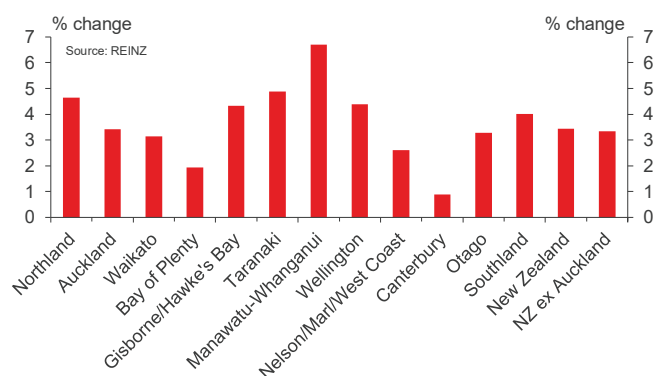
REINZ House Price Index, annual % change



Westpac house price forecasts



House prices by region, last 3 months compared to previous 3 months



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