Home Truths.

13 October 2020

Party like its 2007.

The New Zealand housing market is booming. REINZ data for September was released today, and has been through our seasonal adjustment process. Seasonally adjusted house sales were the highest in any month since March 2007 – the hottest time of the hottest boom in recent history.

To be fair, some of these sales could represent catch-up from the Level 4 lockdown earlier in the year. The number of sales over the past six months in total have been only equal to the same six months a year earlier. But even if some sales are catchup, this is still a hot market.

The REINZ's House Price Index rose 1.8% after seasonal adjustment, and is now 11.1% higher than a year ago. In other words, house prices are now rising extremely rapidly.

Back in July we upgraded our house price forecast to an 8% increase over 2021, and in September we shifted again to a forecast of 6.3% house price inflation for 2020 and 8% in 2021. It seems we were too timid – the lift-off in house prices is turning out earlier and faster than we expected.

We expect the current strength in the housing market to continue well into next year. The boom is being driven by very low interest rates, and if anything, interest rates are going to fall even further. Other factors like net migration and economic confidence are currently, if anything, holding the housing market back. But by next year, both could be in recovery. When that recovery combines with low interest rates, house prices can be expected to continue rising.

An illuminating natural experiment.

Home Truths has long been of the view that interest rates are the key driver of house prices, whereas most other economic forecasters, policy makers, and popular opinion seem to focus on physical factors like net migration, or economic factors like unemployment.

This year, circumstances have delivered a natural experiment that should help settle the debate about what is the most important driver of house prices. Physical supply and demand factors are current aligned in the direction of falling house prices, while interest rates are aligned towards rising house prices. With each pulling in opposite directions, we should be able to discern which is most important.

Net migration has plunged from 70,000 last year to zero, the number of New Zealanders returning home on a permanent basis has dropped to a third of the usual number, and construction activity is booming. Anybody focusing on physical supply and demand would predict house price declines. The economic recession also points in the direction of weak house prices. Yet prices have actually risen, because of the dominant role played by interest rates.

Has the RBNZ over-egged the salad?

The house price boom will be a big surprise to the RBNZ. As recently as August the RBNZ was forecasting a 7.7% house price decline over the six months to September, and was predicting further declines in the December quarter. The RBNZ is going to have to make a major adjustment to its house price forecast, and therefore to its consumer spending forecast (because one reliably influences the other). This may call into question just how much monetary stimulus the RBNZ really needs to deliver. We continue to forecast that the OCR will drop to -0.5% in April next year, because the inflation outlook is so low. However, we do acknowledge that today's data is a mark against that forecast.

REINZ housing data, Westpac seasonal adjustment

	Sep-20	Aug-20	Sep-19
House sales, number (s.a.)*	**8687**	8354	6507
Mth % chg	**4.0**	0.1	4.0
Ann % chg	**37.1**	26.9	7.1
Days to sell, sa	**34.4**	33.7	37.5
House Price Index (s.a.)			
Mth % chg	**1.8**	1.5	0.7
Ann % chg	**11.1**	9.8	3.2

*Adjusted for initial undercount of sales

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