Westpac Institutional Bank

Home Truths

12 August 2013

This month, Home Truths ponders how the New Zealand housing market might react to restrictions on high loan-to-value ratio (LVR) home loans, which are widely expected to be imposed as early as this month. But first, we review the latest nationwide figures.

The number of house sales in New Zealand rose 3.8% in seasonally adjusted terms in July, recovering most of the slump in the previous two months (sales fell 5% in May and were flat in June). In particular, sales in Auckland rebounded to their highest level in six years. There was also a jump in new listings in July, which lends some credence to the idea that a lack of supply was constraining turnover in previous months. House prices rose 0.5% for the month, lifting the annual growth rate slightly to 8.6%. Annual house price inflation has been around the 8-9% mark for the last six months.

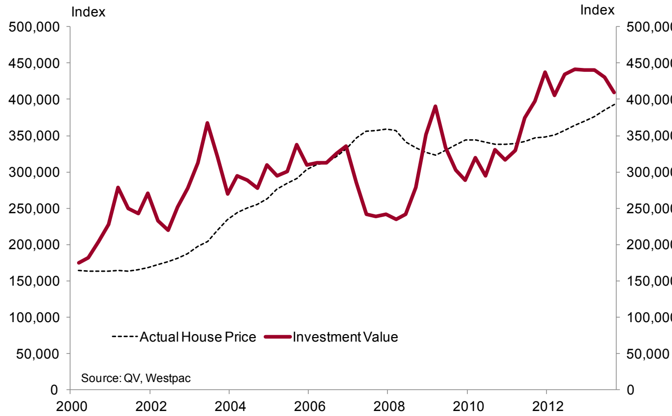
REINZ housing data

	Jun-13	May-13	Jun-12
House sales, number, s.a.	6772	6525	6121
Mth % chg	3.8	0.5	0.2
Ann % chg	14.7	0.0	19.9
Days to sell, sa	33.9	33.1	36.8
House Price Index (s.a.)	3698.3	3678.9	3401.6
Mth % chg	0.5	0.3	0.2
Ann % chg	8.6	8.4	5.2

Judging by the RBNZ's recent statements, it's no longer a question of whether it will use macroprudential tools to target the housing market, but what would hold it back from doing so. In our view, today's figures extinguish any hope that the market might be slowing of its own accord. So we suspect that once the technical details of LVR restrictions are finalised (the last round of consultation closed in July), the RBNZ is prepared to pull the trigger.

In our latest quarterly Economic Overview we considered the likely impact of these restrictions within our long-running Investment Value framework. To understand our conclusions, it's important to first recognise the starting point for this framework, i.e. what it implies in the absence of LVR restrictions. We find that current house prices are still below the maximum that an investor would be willing to pay, given current interest rates. That valuation gap has narrowed somewhat in recent times, as fixed-term mortgage rates have risen from their lows. (The last point in the chart to the right is our estimate for the end of the current quarter.) But there is still scope for house prices to be bid higher from here.

Investment value of housing



Our view is that the RBNZ's proposed 'speed limit' approach to high-LVR lending would lead to a bifurcation of mortgage rate pricing. High-LVR lending (i.e. above 80%) is likely to be rationed via price, in the form of either higher interest rates or a higher low-equity premium. But those borrowers who can muster a deposit of 20% or more may enjoy lower mortgage rates than otherwise, as lenders are likely to compete harder for this limited pool of customers.

So some potential buyers - more likely to be first-timers - will be shut out of the market. But for those who can provide a large enough deposit, their willingness to pay is unaffected by LVR restrictions - if anything, lower interest rates for low-LVR loans would leave them willing to pay more than otherwise. So we suspect that, over time, house prices would be bid up to much the same levels as they would in the absence of LVR restrictions - perhaps at a slower pace, with fewer competing bidders, but ultimately reaching a similar end-point.

In the short term, though, it's very likely that there would be some 'sticker shock' after LVR restrictions are introduced. In broad terms, the overseas experience has been that house sales fall sharply, and house prices and household credit rise at a slower pace, in the 3-6 months after LVR rules are tightened. We fully expect to see a similar slowdown in the months following the imposition of any LVR limits here.

It's important to recognise that any such short-term impact wouldn't change our overarching views on the housing market, nor should it be taken as a sign that LVR limits can 'fix' the housing cycle. Overseas experience also suggests two other outcomes: that the impact of macroprudential tools tends to be short-lived, and that measures that affect the cost of buying a house tend to be more effective than restrictions on quantity. Our Investment Value framework comes to the same conclusion: it is ultimately financial factors, such as interest rates, that determine the level to which house prices will gravitate.

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