Westpac Institutional Bank

Home Truths

15 April 2016

Full steam ahead

After an avalanche of interesting information, the Home Truths team has made some material changes to its house price forecasts.

First, the December 2015 instalment of New Zealand's best house price measure has been released. Quotable Value's Quarterly House Price Index showed that the Auckland market downturn of late-2015 was deeper, sharper and earlier than previously realised. Quarterly house price inflation in Auckland went from 6.4% in September to -1.4% in December. For comparison, in July 2015 Home Truths' suggestion that Auckland quarterly house price inflation would drop to zero by March 2016 was greeted with controversy and scepticism! The quarterly house price index also showed the extent to which Hamilton and Whangarei were caught up in the late-2015 market slowdown, although prices didn't actually fall in either locale. Finally, the quarterly data confirmed that house price inflation accelerated very sharply in the lower North Island and most of the South Island except Christchurch.

Second, Real Estate Institute data for the month of March has suggested that the Auckland market has exploded back into life, Hamilton and Whangarei are accelerating again, and the rest of the country has continued along its own merry path of rapidly rising prices – except Christchurch, where prices are still flat.

The fact that the Auckland housing market has rebounded is not particularly surprising – the tax and mortgage lending regulations introduced last year were always expected to have a temporary effect on the trajectory of house prices. But we must admit that the power and extent of the rebound in March has taken Home Truths by surprise. Seasonally adjusted housing market turnover was up 11.3% in Auckland, and seasonally adjusted prices were up 3.4%.

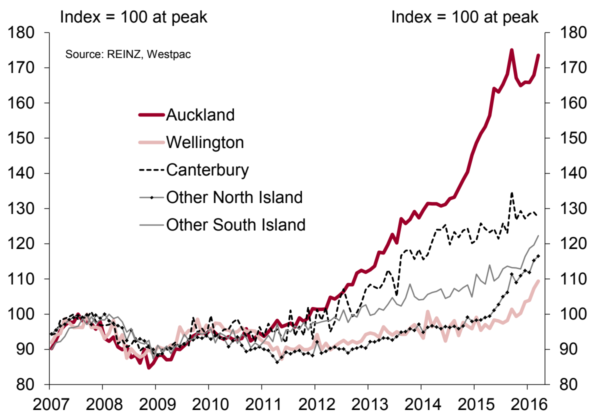
All of this adds up to some pretty chunky changes to our forecasts of nationwide house price inflation. House prices actually rose 10.7% in 2015, not 15.5% as previously thought. And we have upgraded our forecast of 2016 house price inflation from 6% to 11.5%.

Our take is that New Zealand's housing market is reacting to the big drop in mortgage rates over the past year. Strong population growth and the reasonably firm economy are obviously playing a role, but those factors have been around for a while. The big change recently has been interest rates.

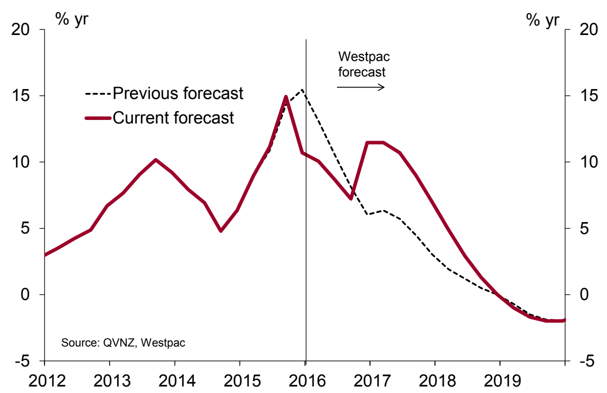
REINZ housing data

	Mar-16	Feb-16	Mar-15
House sales, number, s.a.	7590	7051	7017
Mth % chg	7.6	-3.0	0.2
Ann % chg	8.2	5.7	20.3
Days to sell, sa	32.7	31.1	34.9
House Price Index (s.a.)			
Mth % chg	2.2	1.8	1.0
Ann % chg	13.3	11.9	8.5

REINZ house price index, seasonally adjusted



Westpac annual house price inflation forecast



The evidence that interest rates are playing a role in the housing market lies in the facts that the market upturn is so widespread, and that households are taking on more debt. Mortgage credit extended by banks has been rising at an annualised pace of around 8% in recent times, compared to around 5% a year ago. This acceleration in credit growth has occurred at the same time as incomes in our biggest export industry have dropped away, and nominal GDP growth has slowed to around 3%. Because local income growth is not matching local demand for credit, New Zealand is plugging the gap by borrowing more from offshore.

Borrow-to-spend-facilitated-by-rising-house-prices is a dynamic that New Zealand economists are all too familiar with. It will support economic activity in the short run, but it also poses risks in the long run. Specifically, if interest rates rise materially then today's house prices will start to look less supportable, and today's debt levels will be harder to service. Rising interest rates is not something we think is going to happen for a long while yet – but that may only mean that economic imbalances and risks have a longer time in which to build.

With interest rates playing a role in current economic and housing market dynamics, one has the wonder how the Reserve Bank will respond. Clearly, the March housing data will be a mark against the idea of cutting the OCR again. But ultimately the RBNZ must adhere to its inflation target, and there are other factors, such as the strong exchange rate, that are currently suppressing inflation. The more likely reaction lies in macroprudential policy. If house prices continue on their current trajectory much longer, the RBNZ will start thinking about another round of mortgage lending restrictions – we will have more to say about that in upcoming releases of Home Truths.

Dominick Stephens
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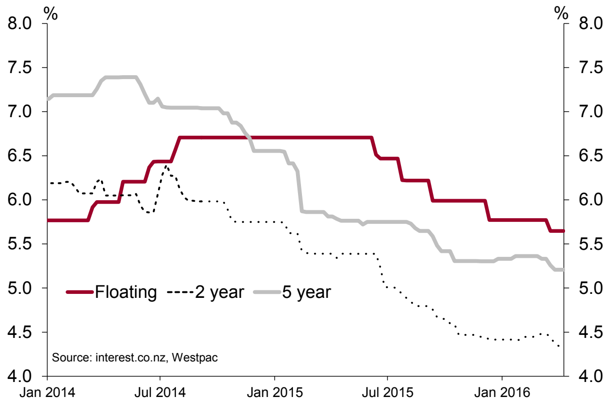
Average advertised mortgage rates



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