Westpac Institutional Bank

Home Truths

17 June 2016

Red hot

The New Zealand housing market remains red hot. The REINZ House Price Index has now risen 6.9% over the past three months, which is the fastest three-month gain since 2005. And a wide tableau of other indicators all point in the direction of house prices continuing to rise rapidly over the coming months:

- House sales are running at their strongest pace since early 2007, save a brief flurry prior to last year's tax changes.
- The average number of days taken to sell a house has fallen to its lowest level since mid-2007.
- Realestate.co.nz is reporting an extraordinarily low level of inventory available for sale, particularly in Wellington.
- In April, mortgage lending grew at its fastest monthly pace since early 2008.
- Mortgage approvals data suggest that lending growth remained strong over May and June.

As mentioned in the April edition of Home Truths, our assessment is that low interest rates are the key driver of the market at present. Low interest rates are a common factor that can explain why house prices are rising across almost the entire country, while rents are increasing only slowly. Low interest rates also help explain why share prices and commercial property prices are rising at the same time as house prices.

Rising house prices have sparked a strong borrow-and-spend dynamic across the economy. When house prices rise, home owners tend to spend some of their increased wealth. Meanwhile, house buyers must borrow more – and they are able to do so, courtesy of low interest rates. The net effect is that the nation borrows and spends.

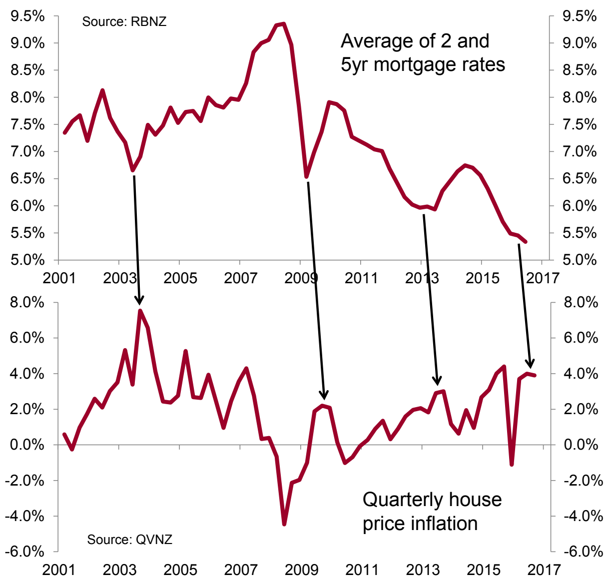
This is a familiar dynamic for the New Zealand economy. And once it gets going, it can develop a life of its own. Rising house prices and a borrow-and-spend environment can spark a lift in residential construction activity and consumer spending. That means jobs. And more jobs means more confidence to bid house prices higher. And so on and so forth.

This self-reinforcing cycle tends to continue until a circuit-breaker comes along to end the party. Last decade a sharp lift in interest rates was the circuit-breaker, but we don't expect a repeat of that any time soon. In fact, we can see no circuit-breaker at all over the coming year or so, which is why we are forecasting such strong house price inflation over that period.

REINZ housing data

	May-16	Apr-16	May-15
House sales, number, s.a.	**8330**	8369	7438
Mth % chg	**-0.5**	7.6	2.4
Ann % chg	**13.6**	18.4	21.6
Days to sell, sa	**30.2**	32.1	34.0
House Price Index (s.a.)			
Mth % chg	**2.1**	2.3	1.9
Ann % chg	**14.7**	14.5	11.8

Mortgage rates and quarterly house price inflation



In May, we issued a bullish house price forecast of 10.5% for this year. But recent data has been so strong that we are now revising that forecast up to 14.2%. That includes an allowance for more restrictions on mortgage lending from the RBNZ, which may slow the market for a time, but are unlikely to constitute a circuit-breaker.

We believe the circuit-breaker will come later in the decade. The wind-down of the Canterbury rebuild and a reduction in net migration are expected to lead to a slowdown in economic growth and a rise in unemployment around 2018. That may be enough to knock confidence in the housing market and reverse the borrow-and-spend dynamic.

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