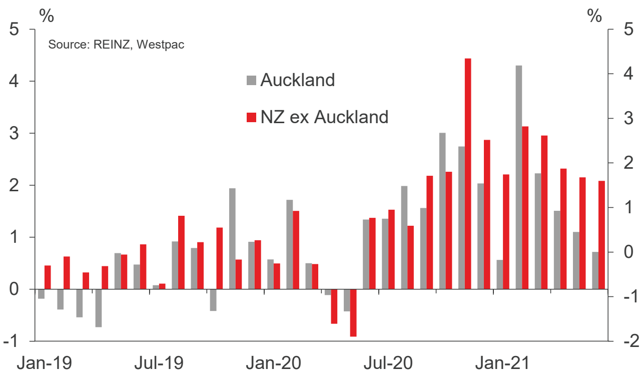
Home Truths.

15 July 2021

The housing market remained strong in June, though it's not running quite as hot as it was earlier in the year. The slowing that we've seen to date has been broadly in line with past occasions when the loan-to-value restrictions have been tightened – a modest impact, and more on turnover than on prices. But there's not much evidence so far that the tax changes announced in March are having a cooling effect above and beyond this.

We estimate that the REINZ House Price Index was up 1.5% in June in seasonally adjusted terms. (While the price index doesn't have much seasonality in it, there's enough in there to be worth adjusting for, if you want to get a handle on the market's recent momentum.) This is a strong increase in its own right, but it represents the smallest monthly increase in almost a year.

Monthly change in House Price Index

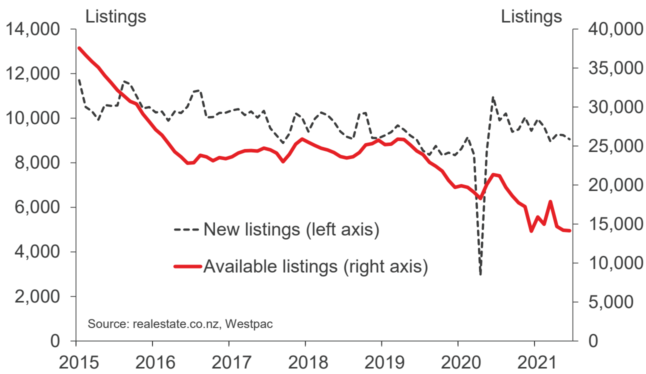


Within this, some regional differences are starting to emerge. Auckland house prices have been a relative laggard – up 3.4% in the past three months, compared to 6.7% in the rest of the country. It's not that Auckland was running hotter than the rest of the country previously; rather, it's more likely that the loan-to-value restrictions have had a greater impact in Auckland, where investors typically make up a bigger share of the market.

Gisborne, which was previously the hottest regional market, has seen prices fall slightly in the last two months. In contrast, prices in Canterbury have continued to surge, with little sign of a loss of momentum. We had previously identified this region as being undervalued compared to the national average – prices had been fairly flat up until last year – so there may be an element of catch-up going on.

We note that some people continue to attribute the strength in prices to a shortage of listings, with 'fear of missing out' driving buyers to pay over the odds. We'll reiterate our view that a shortage of listings is a symptom of a hot housing market, not a cause. While the *stock* of current listings has fallen to record lows, the *flow* of new listings is not unusually low, and in fact is still a little above pre-Covid levels. It's just that they haven't risen enough to match the surge in demand, with house sales running well above pre-Covid levels for the last year.

Property listings, seasonally adjusted

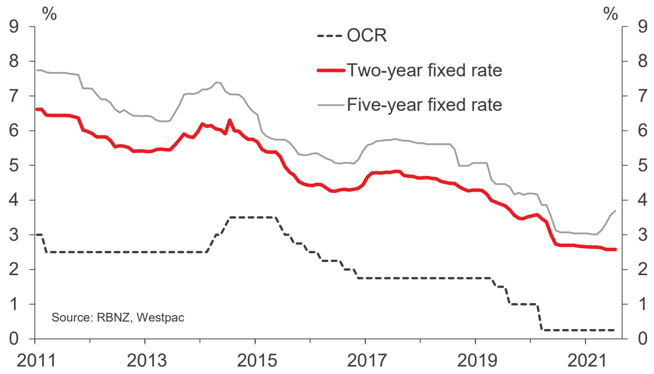


To the extent that loan-to-value limits and the recent tax changes have cooled investor demand, the evidence to date suggests that owner-occupiers have been willing to step into the breach and pay these kinds of prices. That could change once mortgage rates – in particular the popular one- and two-year fixed rates – start to rise from their lows, as the prospect of OCR hikes comes onto the horizon.

While we haven't had an OCR increase since 2014, there's a more recent example that could be instructive. Fixed-term mortgage rates rose between late 2016 and early 2017 in response to global interest rate trends, with the one- and two-year rates rising by 30-40 basis points. House price growth slowed markedly in that time, from around 15%yr in late 2016 to just 4%yr by the end of 2017. Auckland house prices even fell slightly.

A rise in mortgage rates wasn't the only thing happening in the housing market at the time – loan-to-value limits were also tightened in late 2016. But the fact that house prices didn't spring back when the LVR limits were loosened again a year later suggests that interest rates were playing the more substantive role.

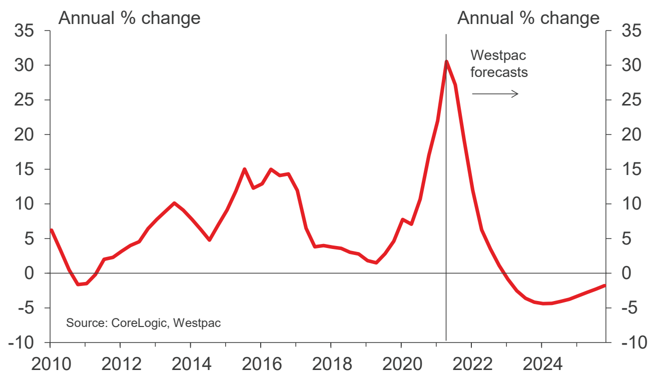
Mortgage rates



This suggests that a little could go a long way when it comes to interest rate hikes. We're now expecting the Reserve Bank to increase the OCR by 25 basis points in August, with a further series of hikes over the coming years – but we expect the pace to be gradual.

We're forecasting house price growth to continue to slow over the coming months. Even so, with the increases we've seen to date, this means annual house price inflation would still be running at around 19% by the end of this year. (Note that we forecast the quarterly CoreLogic price index, rather than the REINZ monthly series.) By the second half of 2022 we expect this to tip over into a period of modest price declines, as interest rates return to more normal levels.

House price growth forecasts



Michael Gordon, Acting Chief Economist
+64 9 336 5670

Contact the Westpac economics team.

Michael Gordon, Acting Chief Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Gregorius Steven, Economist
+64 9 367 3978

Any questions email:
economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer.