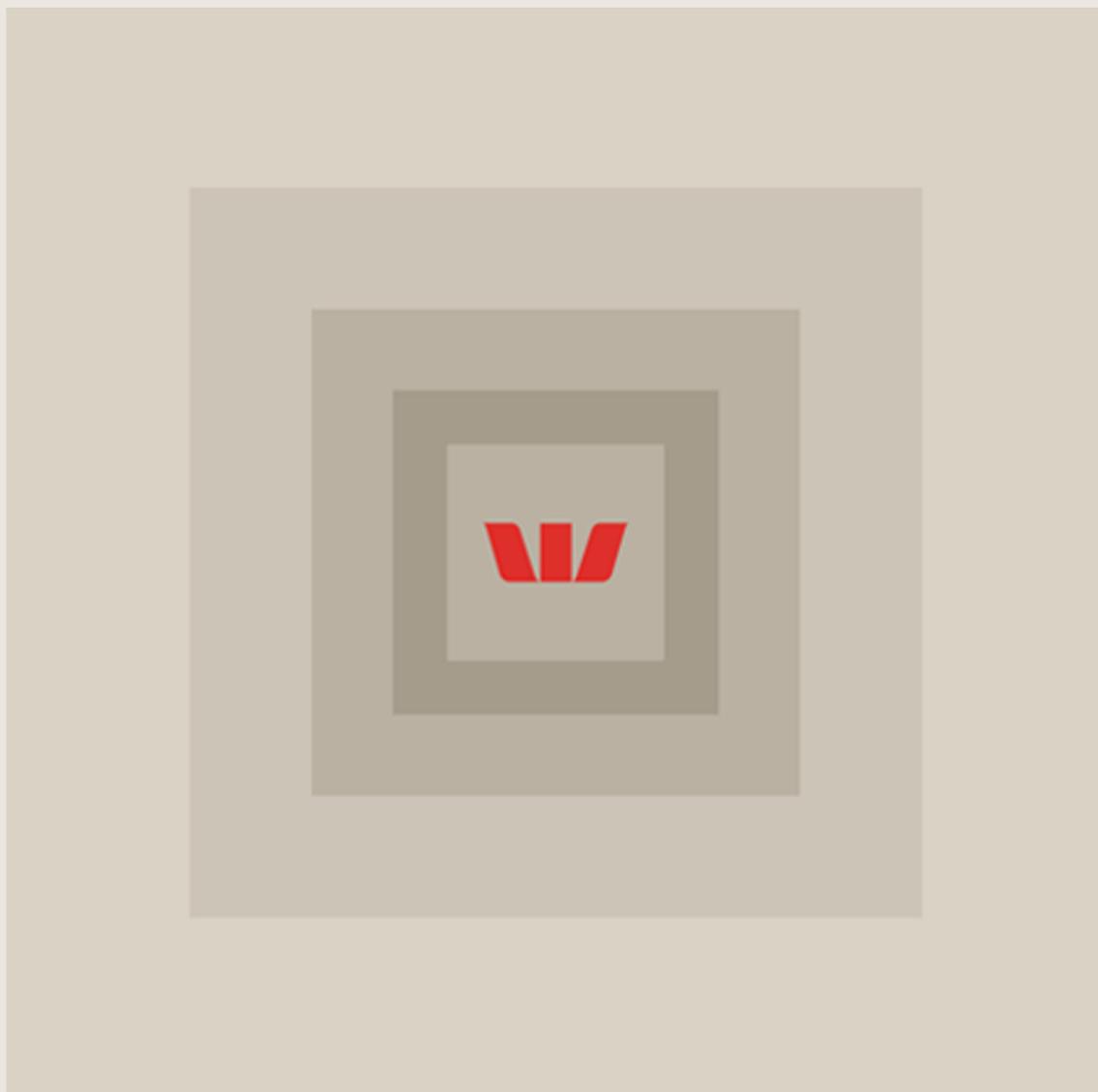


Home Truths: Westpac's monthly housing market analysis, May 2013

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Westpac

**Institutional
Bank**

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Welcome to the new look Home Truths.

House sales fell 5% in May, seasonally adjusted. This was the most substantial monthly drop since late 2010, and would normally be interpreted as a sign of price weakness to come. But I'm not sure we should be concluding that the house price upturn is over. The Real Estate Institute of NZ cites a shortage of listings across much of the country as the constraint on the number of sales, and I think there is merit in that idea. Last week we calculated that Barfoot and Thompson's available listings amount to just 2.8 months' worth of sales, making Auckland's market the tightest on a record going back to 1998 (see the chart below).

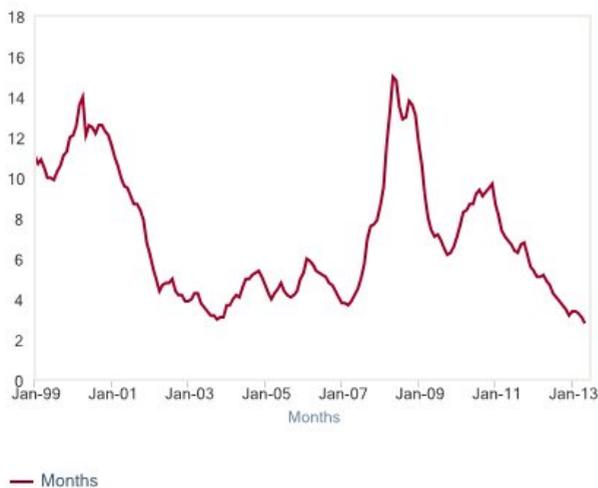
Equally, there is no convincing evidence that demand is slowing. In this month's data sale prices rose and the average time to sell shortened slightly.

In short, for now I am sticking with the view that house prices are going to keep rising this year.

REINZ house sales, May 2013. Seasonally adjusted by Westpac.

	Number, sa	%m/m, sa	%ann
Sales	1,080	0.4	10.2
New listings	1,346	-9.5	-7.5
Months' supply of available listings	2.8		
Available listings	3,038	-9.2	-30.3
Prices (average)	\$641,772	0.8	10.7
Prices (median)	\$571,109	0.6	13.1

Months' supply of houses available on Auckland market



Loan to value restrictions

The Reserve Bank is sounding keener to restrict banks' ability to make loans with high loan-to-value (LVR) ratios. The central bank would not ban high LVR loans altogether, but it might set a maximum on the proportion of high LVR loans that banks can make. At present around 30% of new loans are extended to borrowers with small deposits. The RBNZ might require banks to reduce that figure to something more like 12% of new loans.

So what effect would LVR restrictions have on the housing market? Overseas evidence suggests that mortgage restrictions can slow the rate of house price increase. But that relates to quite draconian restrictions and we don't know if the RBNZ is prepared to go so far. The awkward truth is that nobody knows exactly how much impact LVR restrictions would have on the New Zealand housing market.

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There is one thing of which we can be certain. Fewer first home buyers would be able to enter the market, so the rate of home ownership would fall. This would put downward pressure on house prices and upward pressure on rents.

But those are exactly the conditions on which property investors thrive. So the question becomes this: how far would house prices have to fall before investors step in and snap up houses? Nobody knows for sure, but my suspicion at this stage is: not far.

Investors enjoy far better tax treatment than highly leveraged home owners, because their mortgages are tax deductible. This explains why property investors, lurking at every auction is an investor who is willing to pay what the house is worth in the rental market – we call this the investment value. Are houses currently selling for much more than the investment value? Probably not.

So I suspect that although LVR restrictions would cause an initial shock to the market, in time we will see the available properties snapped up by investors.

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