

Home Truths

14 August 2014

Don't get too comfortable

This month Home Truths recaps why we expect the housing market to stage a brief resurgence this year before a more pervasive downturn ensues.

But first, the July round of housing data offered further confirmation that the market is recovering after the slowdown of early-2014, even if the recovery has been rather pallid so far. House prices are on track to rise about five percent this year, compared to ten last year.

The Quotable Value Residential Price Movement Index, our preferred measure of price trends in the market, has risen 2.3% in the three months to July, compared to the 0.1% increase over the first three months of the year. But housing turnover is less ebullient. After adjusting for seasonal influences, we estimate that the Real Estate Institute measure of house sales rose 0.5% in July, and is still 13% lower than a year ago. Other market gauges, such as days to sell or available listings, all suggest that a "sellers' market" is developing, but only very slowly.

For some time the Westpac Economics Team has been forecasting a modest resurgence of house price inflation this year, before the market turns more decisively negative later next year. Despite our near-term bullishness, we anticipate a period of falling house prices later in the decade.

One rationale for such a multifaceted forecast is net migration. In the short run, net migration is set to hit an all-time high of 50,000 people per annum. Our research indicates that net migration usually plays only a relatively small role in determining house prices. But sheer weight of numbers means that even that small role will translate into a reasonable boost to house prices over the year ahead.

But the current net migration boom is likely to prove just as ephemeral as New Zealand's past experiences with net migration. We are forecasting quite a reversal in net migration over the second half of this decade as the recovering Australian economy attracts Kiwis back across the Tasman. Net migration can be expected to fall further when the Canterbury rebuild winds down. Slower population growth will surely translate into a slower housing market in years to come.

More important than net migration is the likely behaviour of interest rates. Over the years our Investment Value of Housing

Figure 1: Investment value of housing

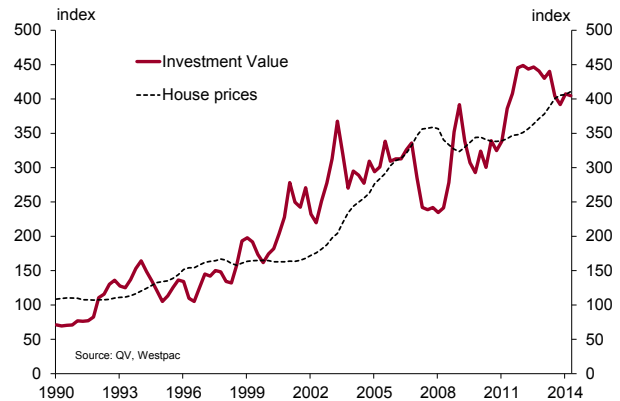
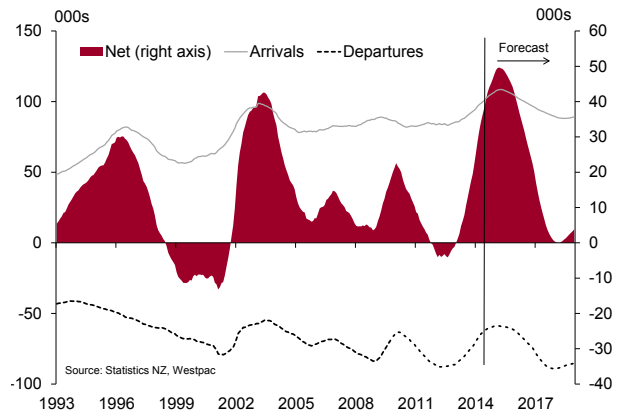


Figure 2: Net migration to New Zealand



REINZ housing data, July 2014

	Jul-14	Jun-14	Jul-13
House sales, number, s.a.	5898	5866	6779
Mth % chg	0.5	2.8	3.5
Ann % chg	-13.0	-6.1	14.7
Days to sell, sa	36.2	37.9	34.3
House Price Index (s.a.)	3921.0	3911.5	3701.9
Mth % chg	0.2	0.0	0.5
Ann % chg	5.9	6.2	8.6

model has proven an excellent guide to ups and downs in the housing market. The Investment Value is an estimate of the value to a property investor of the median house, based on current rents, interest rates, inflation rates, and tax treatment – with interest rates of paramount importance. When the Investment Value gets out of whack with actual house prices, it is a pretty good signal that the market is going to change. Back in 2012 the Investment Value rocketed upwards, correctly signalling that house price inflation would soon accelerate. The Investment Value fell sharply in late-2013 as mortgage rates rose. At that point in time we correctly predicted a housing market slowdown.

At present the Investment Value is sitting at a roughly neutral level, meaning financial factors are applying no particular directional pressure to the market. The Investment Value currently provides no counter-argument to the notion of rising house prices, in the short term at least.

But that is set to change. Over the coming years rising mortgage rates will become a major impediment to the housing market. If the two-year fixed mortgage rate rises to 7% as we expect, the Investment Value would drop well below the current level of house prices – indicating that prices could fall.

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