The return of HEW?

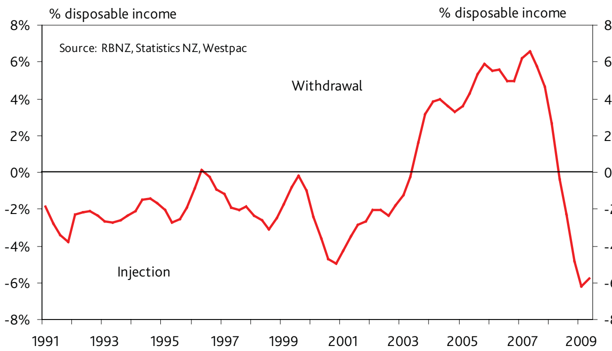
A brief look at the latest changes in housing equity withdrawal

- **There has been a huge switch from housing equity withdrawal to housing equity injection over the past two years.**
- **The redirection of funds has been a key factor behind the 9% drop in retail sales per capita over this period.**
- **More recently, the degree of equity injection appears to be easing, with a corresponding boost to consumer spending.**
- **The RBNZ will be watching changes in housing equity withdrawal for any signs of a return to the borrow-and-spend mentality of the past.**

Housing equity withdrawal (HEW) occurs when households, on average, withdraw equity from the housing stock. HEW can occur via several channels. For example, a household could withdraw equity by increasing debt on an existing property. Conversely, a household could inject funds by paying down debt, or in other ways like financing renovations at least partly from their own funds. HEW can also change as a result of a property transaction where the buyer and seller have different levels of equity.

Reducing leverage by housing equity injection (HEI), has been the dominant trend during the housing market downturn. We estimate around $5.6 billion more funds (equivalent to 5.8% of household disposable income) have been injected into housing than withdrawn over the past year. That is in stark contrast to the $5.6 billion equity withdrawn at the peak of the housing boom two years ago. But there is now a sense of another change, with the amount of equity injection starting to ease.

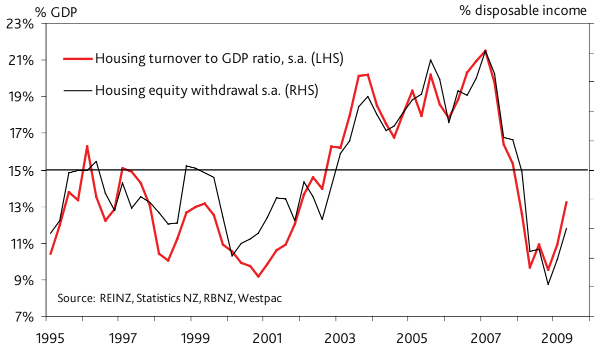
Figure 1: NZ housing equity withdrawal
Annual total



Our previous research[1] found a close connection between HEW and housing turnover. That is, the majority of changes in overall HEW occur as a result of property transactions. The strong rise in house sales and stabilisation of house prices over recent months suggest the annual injections of equity into the housing stock will start to ease. Indeed, on a quarterly basis this easing appears to be already underway.

Figure 2 shows housing equity injection as a percent of disposable income and housing turnover as a percent of GDP. Our estimate for the June 2009 quarter suggests the degree of equity injection has reduced significantly.

Figure 2: HEW and housing turnover
Quarterly total



Changes in HEW contributed to recession

Movements in HEW can have profound effects on growth in consumer spending and economic activity. This has been all too clear over the past two years. The change from peak equity withdrawal of $5.6 billion in the year to June 2007 to maximum injection of $5.9 billion in the year to March 2009 represents a massive $11.5 billion turnaround. The housing market correction and feedback to consumer spending through changes in HEW has been a major factor in the domestic recession.

Our previous research suggested 25% to 30% of HEW is spent (as opposed to buying other non-housing assets or paying down debt). This points to around a $3 billion dollar drag on household

[1] See our 16 May 2008 Bulletin, *'(P)HEW'*.

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spending over the two years to March 2009. This drag has played a key part in the 9% drop in retail sales per capita over the past two years (with sales of durable items bearing the brunt of reduced spending).

What next?

Less equity injection into housing that is now taking place will give substantial support to future economic activity. We anticipate a further reduction in equity injection over the coming year with the potential for a return of equity withdrawal as the number of house sales continues to rise modestly and some house price appreciation occurs through 2010. Even if equity injection only dwindled to zero, this would support consumer spending to the tune of $1.4 billion to $1.7 billion (around 1.0% pa). After all, it is the change in HEW that matters most for spending and economic growth. Even so, we do not anticipate strong increases in consumer spending ahead as a softening labour market and low income growth discourage extra spending.

The RBNZ has expressed concern about a return to a borrow-and-spend mentality among households. A rapid rebound in housing market turnover and continuing low interest rates will encourage such activity. Economic recovery is desirable, although lop-sided, consumption-centric growth may prove unsustainable. Changes in HEW are worth watching. If equity withdrawal were to show signs of kicking into full swing quickly, the Reserve Bank may well lift interest rates sooner than currently anticipated to nip it in the bud.

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