BNZ Weekly Overview

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Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

No New Housing Surge

The Reserve Bank surprised most people yesterday with its move to ease up the loan to value ratio (LVR) credit controls introduced in October 2013 then strengthened in October 2015 and July last year. From January 1 banks will be able to have up to 15% of mortgages with deposits less than 20% of the house purchase price for owner occupiers. Currently that is 10%.

For investors the minimum deposit (with 5% of loans exempted) falls to 35% from 40%.

Will these changes cause a new surge in the housing market? Clearly the Reserve Bank does not think so else they would not do it, and we also think a fresh wave of demand hitting the market and pushing prices newly skyward is unlikely.

The fundamentals still support prices rising – but not at an accelerating pace. And the bulk of the repricing of the country's housing stock to reflect changes in long-term fundamentals has probably already happened.

These long term fundamentals include things such as two incomes chasing a house instead of one per household up to the 1980s. Structurally lower interest rates courtesy of structurally lower inflation. This lowers the biggest cost of purchasing a house – the debt servicing burden. The reduction in this burden has been factored into the prices people are willing to bid.

There has been a structural lift in the depth and range of groups wanting to be investment property owners – foreigners, young people, savers, even Baby Boomers bemoaning low interest rates now offered for bank term deposits.

New houses are structurally very different from old ones with regard to levels of inspection and certification, energy efficiency, earthquake preparedness etc. Cities also have less land available near main centres of employment so land prices have structurally lifted. And so on.

Most notably however with regard to reasons why house prices won't surge anew is the absence now of FOMO. When prices rise firmly people feel a visceral need to jump into the market to avoid missing out on future gains which might come. This is happening with Bitcoins.

Since the second half of last year FOMO has plummeted with regard to Auckland and it is on the way out in the regions.

What will happen if the housing market remains relatively subdued for the first half of next year? Probably in that case the Reserve Bank will experiment with another easing in LVRs, perhaps taking the minimum investor deposit from 35% to 30%.

The key point to note here is that the Reserve Bank is trying to learn how effective LVR changes are. They have learnt that a 40% requirement for investors is very effective. 30% previously for Auckland was not. But back then FOMO was strong. In the absence of FOMO 30% effective from perhaps the end of May next year might still not elicit a fresh investor surge – especially as banks have tightened lending criteria anyway in an environment where low interest rates are making it difficult to raise deposits domestically and raising extra funds offshore is frowned upon by the regulatory agencies and the likes of the IMF.

If I Were A Borrower What Would I Do?

Earlier on today I gave a talk to BNZ Retirees at their annual Christmas function. While there was interest in the political scene and some of the long-term trends, the main thing people wanted to know was when term deposit rates would be going back up. I did not have a good message.

Almost all forecasts of sustained rises in interest rates in all countries have been wrong since 2009, apart from the United States for the past year. This reflects the structural decline in inflation caused partly by the absence of an acceleration in wages growth in response to fast jobs growth as used to occur before the GFC. Maybe one day wages growth will accelerate. But seeing as all forecasts that it would have so far been wrong it seems best just to wait until it does happen – if it does – then assess the inflation and interest rate impacts.

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. **This edition has been solely moderated by Tony Alexander**. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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