

Economic Note

Housing Insights

15 April 2021

No hard landing for housing

- No signs of slowing from March housing data, as they pre-date government announcements.
- We expect the market to cool from here.
- We've lowered our house price forecasts, but not aggressively so. There are still plenty of supports out there.

The Government's big housing announcement was made on the 23rd of last month, so March housing figures were never going to be particularly impacted. We'll have to wait for a couple more months of data to get a decent steer on whether investors are voting with their feet.

We'd expected March housing data to be strong, but perhaps with a few cracks starting to appear. In the event though, there was none of the latter. Up until March, the housing market remained as strong as an ox. Sales were the highest for a March month in 14 years, properties sold at a rapid clip (median days to sell of 31 days), and annual house price inflation rose to a fresh cycle-high of 24% courtesy of a strong 2.7% (s.a.) lift over March. LVR restrictions are now back on, but existing pre-approvals under the old regime may have encouraged a front-loading of purchases.

We expect the market to cool from here. The first thing to watch for, which we'd expect to come through over April and May, is a slowing in housing activity (sales). This would imply investors, and others, are indeed pulling back from the market to reassess. Fewer sales would in turn allow housing inventory to finally lift (we've already seen some signs of this), easing market tightness and reducing the upward pressure on prices. General uncertainty also leads to lower levels of activity, and this is likely to continue as we wait to see if the RBNZ will gain additional housing tools. It's also possible the May Budget will contain additional housing measures.

We have adjusted our house price forecasts in response to the Government's housing announcements. But not aggressively so. We'd already been expecting a slowdown over the second half of 2021. The Government's actions to quell investor demand mean the slowdown will now be more rapid. Rather than market heat reducing to "simmer" as we'd outlined in our last [Home Economics](#), it's more akin to a dousing in ice cold water.

It's now well understood that the cash flow implications of the removal of interest deductibility are material, particularly for highly-leveraged investors. Our own

REINZ NZ house prices growth and house sales



Source: Macrobond, ASB

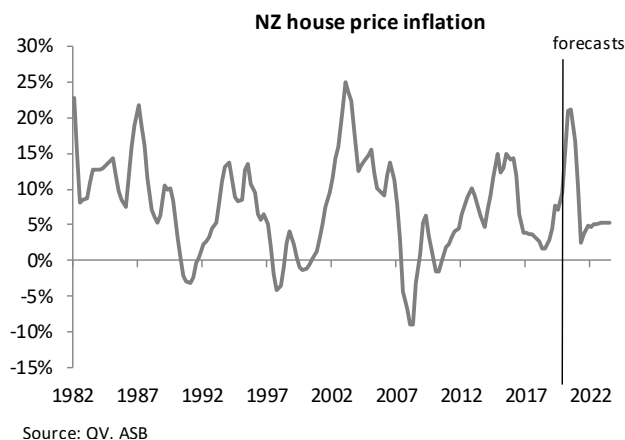
[analysis](#) suggests additional cash flow expenses for a typical investor of around \$5000 p.a. once the policy is fully phased in. This will flip some investors into a cash-flow negative situation. The macro-implications are some combination of upward pressure on rents, cost absorption, and a reduced preparedness amongst investors to pay up for houses. It's the latter point that is important given investors have been the marginal buyer in recent times.

Still, we're not buying into some of the more dire predictions for house prices as a result of the changes. It's important to remember some of the supportive factors:

- Housing fundamentals haven't changed. Mortgage interest rates remain around the lowest levels on record and the housing shortage is far from resolved. We estimate NZ is now finally building enough houses to start eroding the shortage, but it is still going to be some years before the market reaches a state of balance.
- A rush to sell properties by investors, which is something that would trigger an abrupt correction in prices, is unlikely in our view. Given the strong capital gains of recent years, the tax liability under the existing bright-line test involved in selling would be far larger than the cash flow hit from remaining in the market and losing interest deductibility. Moreover, in the current low-yield environment, asset allocation is a headache. Where would investors park all the cash from property sales?
- Reinforcing the above, capital gains have been the most compelling part of housing investment in recent years. The average annual capital gain for the median NZ house over the past 1, 5, and 10 years has been 145k, 66k, and 43k respectively, miles more than the cash flow hit mentioned above. Expressed another way, the median house in NZ would only have to experience an annual capital gain of around 0.7% to "pay" for the impact of the cash flow hit for the average investor. However, we do acknowledge past (capital gains) performance is not an indicator of the future, and the loss of deductibility is a cash expense that must be paid, whereas capital gains exist on paper.
- Investors tend to be more active in lower price brackets and RBNZ data suggest investor activity is slightly more pronounced in Auckland than elsewhere. Those parts of the market might be expected to underperform in the short term while other parts are less affected.
- The four-year phase-in period for the changes to interest rate deductibility on already-held properties will blunt the immediate impacts and afford investors plenty of time to assess. Some parts of the proposals are also still out for consultation and may end up being watered-down.

All of this fundamental analysis and spreadsheeting is one thing, but it is still going to be sentiment that wins out in terms of where prices go in the short term. Predicting sentiment is impossible.

Our best guess is that the additional house price gains we had forecast for the next 6 months will no longer occur. That is, we've flat-lined our house price forecasts for Q2 and Q3, after which growth slowly resumes. This forecast track effectively also allows for a scenario in which prices experience outright falls for a few months before recovering a little. Our annual house price inflation forecast for calendar 2021 is now 10% (from 15%) and calendar 2022 has been nudged down to 5% (from 8%).



ASB Economics & Research

Chief Economist
Senior Economist
Senior Economist
Senior Economist
Senior Economist, Wealth
Economist
Data & Publication Manager

Nick Tuffley
Jane Turner
Mark Smith
Mike Jones
Chris Tennent-Brown
Nat Keall
Judith Pinto

nick.tuffley@asb.co.nz
jane.turner@asb.co.nz
mark.smith4@asb.co.nz
mike.jones@asb.co.nz
chris.tennent-brown@asb.co.nz
nathaniel.keall@asb.co.nz
judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 301 5957
(649) 301 5657
(649) 301 5661
(649) 301 5915
(649) 301 5720
(649) 301 5660

www.asb.co.nz/economics

 [@ASBMarkets](https://twitter.com/ASBMarkets)

Disclaimer

This document is published solely for informational purposes. It has been prepared without taking account of your objectives, financial situation, or needs. Before acting on the information in this document, you should consider the appropriateness and suitability of the information, having regard to your objectives, financial situation and needs, and, if necessary seek appropriate professional or financial advice.

We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this document. Any opinions, conclusions or recommendations set forth in this document are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by ASB Bank Limited. We are under no obligation to, and do not, update or keep current the information contained in this document. Neither ASB nor any person involved in the preparation of this document accepts any liability for any loss or damage arising out of the use of all or any part of this document.

Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. ASB does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met.