Auckland Economic Quarterly

Chief Economist Unit

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David Norman – Chief Economist
david.norman@aucklandcouncil.govt.nz
021 516 103

What's really happening to house prices

- No single factor has led to house price flattening. Interest rates, loan-to-value ratios on investors and tighter control on money flows internationally have all played a role.
- The new government's planned ban on foreign buyers, tighter migration policies, and Kiwibuild programme will have a limited impact on prices over the next two to three years at least.
- These factors will mean softer prices, but with an underlying shortfall of at least 43,000 dwellings, there is little reason to expect a sharp price fall.

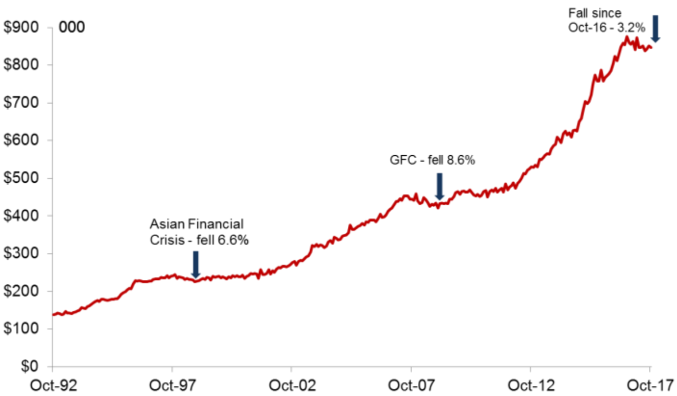
How big is the fall (so far)?

Not big. The peak in Auckland house prices appears to have been in late 2016, once seasonal factors are accounted for. House prices always rise sharply in March, and always fall sharply in January, for instance.

Once we account for these seasonal effects, prices have fallen around 3.2% in the year since October 2016.

This is not in any way "crash" territory, but certainly a market adjustment. Could we see more of a decline? It is possible. But bear in mind the extent of falls we've seen in recent periods of much greater economic instability.

Seasonally-adjusted Auckland median house price



source: REINZ; Chief Economist Unit, Auckland Council

The aftermath of the Asian Financial Crisis saw prices fall 6.6% in Auckland, while the Global Financial Crisis induced an 8.6% decline. Each of these events was followed by a period of flat prices, something that would be quite welcome in Auckland today.

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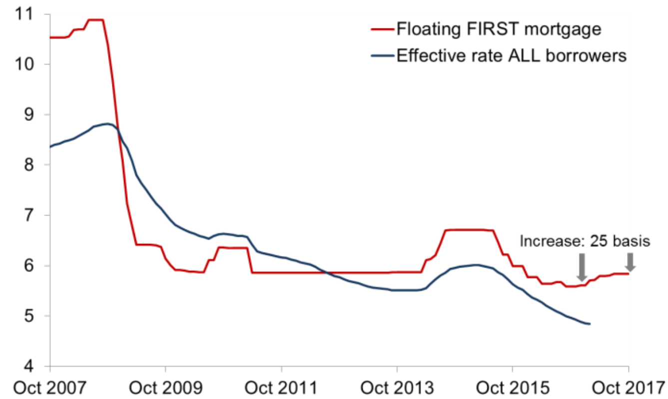
Are higher interest rates causing the slowdown?

Is the main reason for the slowdown in Auckland house prices because interest rates are higher than a year ago? Short answer: Not to any great extent.

The Reserve Bank's Floating first mortgage new customer housing rate has risen just 0.25 percentage points since the absolute bottom of 5.59% it hit in August 2016. This is the weighted average of floating interest rates extended to all ***new*** customers, which are often First Home Buyers (FHBs). We also know that:

- most people fix a large proportion of their loan at a much lower rate
- most people can only buy a house with equity of at least 20%, at which point a much lower mortgage rates kick in.

Mortgage rates since the GFC, %



Source: Reserve Bank of NZ; Chief Economist Unit, Auckland Council

This means that the weighted average rate at which ***all*** buyers (FHBs, investors and people moving to a different home) borrow is much lower – around 4.85% in January 2017 (the blue line in the graph). Unfortunately, the Reserve Bank has stopped publishing this dataset, so we can't show how this has changed in the last nine months.

But the shape of the graph suggests that even as floating first mortgage rates stabilised, overall effective mortgage rates continued to fall. At worst, effective mortgage rates today are likely to be about the same as they were in July 2016, near the all-time low.

At the margins, some buyers will be put off by the risk of higher mortgage rates. But with the Official Cash rate unlikely to be raised any time soon, and with wholesale borrowing rates for banks overseas falling again, the role of rising interest rates as a primary driver of weaker house prices is small.

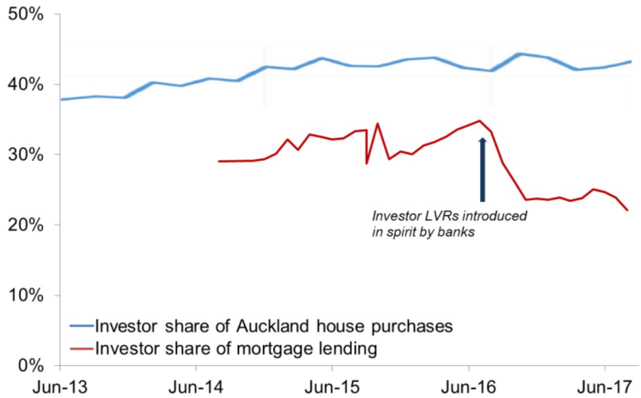
Is the slowdown from investors being shut out?

The number of house sales in Auckland has fallen sharply. All buyers (FHBs, investors, movers and so on) are buying fewer houses than before in absolute terms.

Recent coverage has argued that because investors are borrowing less money from banks, Loan-to-Value Restrictions (LVRs) are shifting the market back in favour of other buyers. The data shows this is not necessarily the case.

Combining Reserve Bank data on lending to investors with and CoreLogic data on the share of sales to investors suggests that LVRs are shutting out smaller investors, much like FHBs before them, in favour of larger, equity-rich investors.

Share of lending to investors and investor share of house purchases



Source: CoreLogic; Reserve Bank of NZ; Chief Economist Unit, Auckland Council

In fact, investors are purchasing near-record ***shares*** of dwellings sold in Auckland (at around 41 to 44% of all sales), even as money lent by banks to investors falls. Investors remain active, but it's now investors with more equity who are doing the buying. The LVRs on investors, introduced for macro-prudential reasons, have had the side-effect of clearing lower-equity investors out of the way for higher-equity investors to swoop in.

So LVRs will have removed some potential buyers at the margins, but higher-equity investors are still quite active.

Have overseas-based buyers exited the market?

Several players in the real estate sector suggest that the role of overseas based buyers in Auckland has also changed dramatically over the last 12 months, particularly with regard to buyers from China. Does this view have any validity?

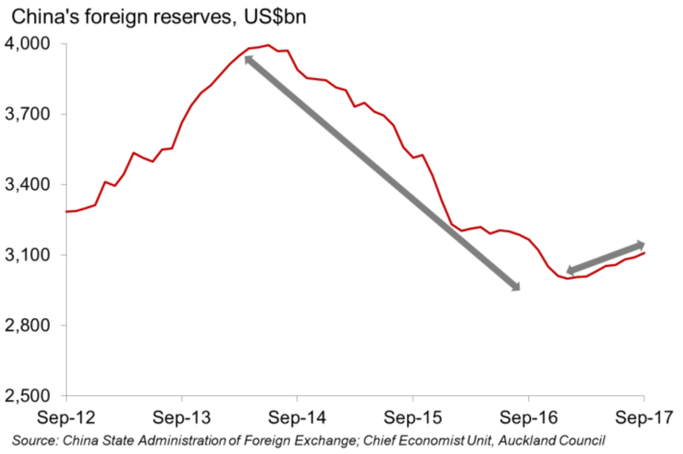
We suspect that New Zealand is a small part of the overseas investment picture for China. That said, given the sheer scale of China's economy, even a small share can make a sizeable difference in our market.

Capital controls in China tightened toward the end of 2016. In particular, access to foreign exchange for the purposes of buying overseas property is receiving greater scrutiny.[1]

After rising strongly over decades, China's foreign reserves fell by around US$1 ***trillion*** over the period from mid-2014 to the end of 2016 as funds flowed out of

[1] See here for example.

the country into investments overseas (including New Zealand property). Since tighter controls were introduced at the end of 2016, the decline in foreign reserves has been thoroughly reversed. Much less money from China is available for investment in foreign property, whether in New Zealand or any other country.



At the margins, this once again means a smaller pool of buyers in the New Zealand market.

Looking forward: role of a new government

The new government has three specific proposals that could affect prices: a ban on foreign buyers of existing homes, less immigration, and the Kiwibuild programme to build 100,000 houses in 10 years.

Although some argue that ***foreign buyer bans*** or stamp duties have no impact on house prices anyway, an economist would have to argue that at least at the margins, some foreign purchasers would be discouraged from buying by such a mechanism. But the ban's impact would be muted, as the foreign investment horse appears already to have bolted, certainly with regard to the Chinese market.

Migration is already starting to slow after three years of powerful growth. To some extent, the opportunity to implement a policy that kept migration at a pace our infrastructure growth could handle has also bolted. The new policy could provide greater certainty on net migration levels, but much of the extra pressure on housing and infrastructure from strong migration has already eventuated.

There are three factors affecting whether ***Kiwibuild*** would bring prices down sharply. First, a large share of the 5,000 dwellings a year on average Kiwibuild hopes to build in Auckland would be in already-planned developments. In these cases, the main role of the Crown would be to buy off the plan, giving the developer's bank greater certainty that they would be able to sell what they build. Kiwibuild's goal here is to speed up development, rather than necessarily adding all-new homes that wouldn't otherwise get built eventually anyway.

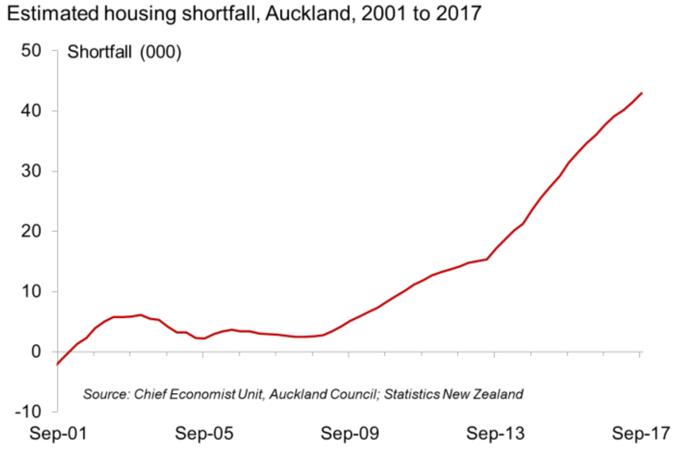
Second, Kiwibuild would take time to ramp up. The government expects it would be three years before the programme actually hits full-speed, meaning its addition to housing stock in the first few years would be limited.

Third, the sheer scale of the home-building catch-up required means Kiwibuild's new homes would be a welcome addition, but would be far from a complete solution to the housing shortfall.

What about demand for housing?

Most of our discussion thus far has focused on demand, with the exception of the role of Kiwbuild, which tackles supply. But just how big is the unmet demand?

Papers by the Reserve Bank and the Ministry of Business, Innovation and Employment have each recently concluded what we did almost a year ago – Auckland's housing shortfall is over 40,000 and growing by the day.



This is the strongest argument against a house price collapse. It's the basics of supply and demand – when something is in short supply, prices rise.

Each of the market and government factors described above will have some small impact on removing excess demand, or in the case of Kiwibuild, supporting stronger supply. But the shortfall is just too large for us to expect house prices to tumble as these factors take effect.

Auckland Economic Commentary

Harshal Chitale
Senior Economist, Chief Economist Unit

- Economic growth has slowed down – key industries are all showing signs of slower growth.
- The housing market will remain quiet with flat or slightly declining prices in the short to medium term.
- Wage growth has been weak, suggesting unemployment could fall more and that a fall in net migration may create more wage pressure.

Key trends

Net long term migration into Auckland has flattened over the last few months and was about 36,400 for the year to September 2017, which is still high in a historical context. With migration turning, the new government's proposal to reduce immigration by 20,000 to 30,000 a year may occur anyway without too much actual policy change.

We have previously highlighted that much of Auckland's recent economic success has been on the back of strong population growth. It is important to mention that simply growing economic activity does not necessarily lead to higher living standards; there has to be improvement in productivity of labour and capital to achieve those.

Given that the majority of new migrants start out in Auckland, industries primarily driven by domestic demand will be affected. We said that economic growth is likely to be slower over the medium term in our last Quarterly, and we feel even more confident about this prediction now. On the other hand, a slowdown in population growth will ease pressure on housing and infrastructure to allow some catching up on the accumulated shortages.

Population-driven demand for construction and retail services, along with tourism, have been the economic growth drivers for Auckland over the past few years. Consenting activity for both residential and non-residential buildings has slowed considerably compared to last quarter and to a year ago. There has been a significant drop in building sector confidence according to NZIER's Quarterly Survey of Business Opinion (QSBO) and the sector has reported softer demand conditions as one of the reasons for this. This is despite a shortfall of over 43,000 dwellings in Auckland.

Annual retail sales growth for the September quarter was 4.5%, down from 5.6% last quarter and 9.9% a year ago. This implies the year has seen minimal per capita real retail sales growth. Retail spending is normally boosted by people feeling wealthier in times of house price rises. As house prices flatten or decline, this induced demand due to the "wealth effect" disappears and is likely to be one of the reasons for slower retail sales growth. Any slowdown in population growth will contribute further to this.

Tourism growth has slowed, as evidenced by annual guest nights in Auckland, which grew just 0.4% for the year to September, compared to 3.4% a year ago. This has been led by falling domestic guest nights and a slowdown in international guest nights growth.

The profile of international visitors has also changed significantly over the last 12 months. Visitor arrivals at Auckland airport from China declined slightly for the year to September, after 2 years of strong growth (34% and 20% annually in the 2015 and 2016 September years respectively). Arrivals from Japan and Korea showed much slower growth than a year ago.

However, there has been strong growth from other markets over this period. For the year to September, Auckland airport showed a 22% increase in visitor arrivals from the United States, 17% from the U.K., 17% from Canada, 14% from Germany. At 5.6%, visitor arrivals from our biggest visitor market, Australia, also showed solid growth.

Employment and wages

Auckland's labour market added about 20,000 jobs in the September quarter but the increase in labour force participation rate meant that the unemployment rate at 4.6% was marginally higher than the last quarter. It was still well below the 5.3% figure a year ago.

At 2.4%, nominal wage growth for the year to September was only slightly higher than inflation, which means that even though many businesses have reported difficulty in finding staff, this is not yet being reflected in wage growth. This mismatch suggests that the economy has more room to reduce unemployment further before we see wage growth.

Firms have reported strong hiring intentions for the next quarter despite weaker demand conditions in the QSBO so we don't see employment generation as a big issue for Auckland in the next few months.

Housing

About 10,300 residential dwellings were consented for the year to September, with attached dwelling types now accounting for a little over half of all the dwellings consented. While this figure is better than a year earlier, these consents take up to 18 months to deliver, and in the year to September we estimate Auckland added about 40,000 people. At a ratio of three people per dwelling, Auckland needed to add about 13,000 homes to its stock just to keep up with population growth. Instead the housing shortfall keeps heading up.

House sales volumes have been declining steadily and at about 22,500 for the year to September, they are about 21% lower than a year ago. The September median house price, at $848,000, is largely unchanged on what it was a year ago (and is down year-on-year to October as we go to print).

Credit is not easy to come by for new developments and the building industry has been experiencing higher rates of capacity utilisation than its long run average, according to the QSBO. These challenges will pose an obstacle to ramping up housing supply. With the supply shortfall, we do not expect house prices to fall substantially, especially with short and medium term interest rates holding relatively steady.

Data analyst
Ross Wilson - Analyst, RIMU

Indicator	Latest	Last quarter	12 months ago	5-year average	Rest of NZ latest
Employment indicators					
Annual employment growth (%pa)	5.5%	4.2%	8.7%	4.6%	3.5%
Unemployment rate (%)	4.6%	4.5%	5.3%	5.7%	4.6%
Unemployment rate among 20 to 24 year olds (%)	9.5%	9.6%	9.2%	10.3%	0.0%
Unemployment rate among 15 to 19 year olds (%)	21.5%	18.7%	23.5%	23.0%	0.0%
Earning and affordability indicators					
Annual nominal wage growth (%pa)	2.4%	1.2%	1.7%	2.2%	2.5%
Annual geometric mean rent growth (%pa)*	1.9%	4.2%	3.4%	3.8%	4.0%
Geometric mean rent to median household income ratio (%)*	27.3%	28.1%	29.0%	29.2%	26.0%
Annual median house price growth (%pa)*	0.0%	2.4%	8.2%	10.2%	1.2%
Mortgage serviceability ratio (relative to Dec-06)	-6.9%	-8.0%	-12.1%	-2.8%	*NA*
Construction					
Annual new residential building consents growth (%pa)	2.9%	7.4%	14.9%	18.5%	3.0%
Annual m2 non-residential building consent growth (%pa)	8.7%	14.8%	68.2%	14.7%	10.4%
International connections					
Annual guest night growth (%pa)	0.4%	2.3%	3.4%	3.2%	3.1%
Annual net migration	36,404	36,650	32,768	25,252	34,582
Confidence					
Annual retail sales growth (%pa)	4.5%	5.6%	9.9%	6.4%	4.2%
Quarterly Survey of Business Opinion (net optimists)	2.3%	15.4%	29.1%	27.1%	6.6%
Westpac Consumer Confidence*	114.6	113.5	113.3	117.2	112.4

*Sources: Chief Economist Unit, Auckland Council; Statistics New Zealand; Ministry of Business Innovation and Employment; Real Estate Institute of New Zealand; New Zealand Institute of Economic Research; Westpac; Reserve Bank of New Zealand. * Rest of New Zealand figures are for all of New Zealand including Auckland. Data is not seasonally-adjusted.*

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