

Home Truths

14 April 2014

Comparing apples with oranges

Judging by turnover, it is clear that the housing market is still in torpor. March data from the Real Estate Institute showed that the seasonally adjusted number of house sales remained 13% below last September's level. And it is now taking distinctly longer to sell a house.

But the situation with house prices is more opaque. The Real Estate Institute of New Zealand (REINZ) reported a massive 2% increase in its House Price Index (HPI) for March. By this measure, prices are now 9.2% higher than a year ago. In stark contrast, Quotable Value's Monthly Property Value Index fell in the month of March, and was up only 0.1% over the first three months of 2014.

As far as we can tell, neither index is telling the full story.

The difficulty with measuring house prices is that the composition of sales can change in any given month. For example, if in a single month a slew of mansions happens to sell, then the median and average selling price that month will be higher than the previous month – even if house prices are actually stagnant on a like-for-like basis. The trick is to compare apples with apples by adjusting for the composition of sales each month.

The REINZ's House Price Index measures average selling prices within each suburb, so it does adjust for *where* houses are selling. That's normally good enough to give a pretty good idea about the true trend in the market. But in the current circumstances the HPI may have been skewed. The RBNZ's mortgage restrictions have drastically reduced sales of low-price houses, while leaving sales of higher-priced houses broadly unchanged. To the extent that this has created a skew to the composition of sales *within each suburb*, the HPI will be rising faster than the true trend in house prices.

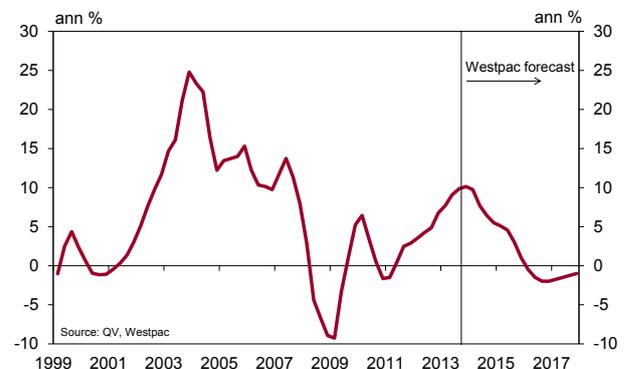
Quotable Value's index provides a more comprehensive compositional adjustment, by comparing the price of each house that sold to its official valuation. But there are two problems with the QV data. First of all, QV registers a sale only upon settlement, meaning the data reflect sales negotiations that were concluded two or three months previously. So it is possible that house price inflation has suddenly picked up, but the QV data hasn't yet registered it. The second issue is a case of bad luck. It just so happens that a technical issue affected the QV measure of Christchurch house prices in March, possibly creating a false picture of price decline in that city for the month.

So at this stage, it is impossible to tell what is really going on with house prices.

In the absence of better information, we are sticking with the same description of the market. The drivers of the recent market slowdown are obvious, and were flagged in advance in Home Truths – the RBNZ's LVR restrictions have led to a drastic reduction in lending to first homebuyers, and mortgage rates have risen sharply. From here, we anticipate a modest bounce in the market featuring higher turnover and a return to rising prices. Banks have clamped down too hard on lending to first homebuyers – as they loosen up in the near future, the market will get a little boost. But over the course of the next three years rising interest rates will become the major headwind, and will crimp house price inflation.

Beyond a brief market bounce for the next few months, we expect the housing market to enter a pervasive slowdown. We are forecasting 5.5% house price inflation this year, followed by 1% in 2015.

New Zealand annual house price inflation



REINZ housing data, March 2014

	Mar-14	Feb-14	Mar-13
House sales, number, s.a.	6172	6176	6827
Mth % chg	-0.1	-2.3	1.9
Ann % chg	-10.0	-7.6	10.9
Days to sell, sa	35.6	34.9	33.5
House Price Index (s.a.)	3941.3	3865.0	3608.5
Mth % chg	2.0	0.9	1.1
Ann % chg	9.2	8.3	8.5

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