

Home Truths

16 September 2013

Judging by this month's Real Estate Institute data, the housing market is trucking along in the same fashion as it has all year. Market turnover did dip slightly in August, but that comes after a sharp lift in July so it probably just represents normal volatility in the data. Meanwhile, house prices continued to march higher, especially in Auckland. The nationwide rate of annual house price inflation has reached 9.5%. This is a trend that has been in place for so long that we've all gotten used to it. But we suspect a change may be in the wind, as we argue below.

REINZ housing data

	Aug-13	Jul-13	Aug-12
House sales, number, s.a.	6730	6789	6091
Mth % chg	-0.9	4.0	-0.7
Ann % chg	8.5	14.7	16.2
Days to sell, sa	35.1	34.0	36.1
House Price Index (s.a.)	3752.7	3702.0	3424.3
Mth % chg	1.4	0.6	0.6
Ann % chg	9.5	8.6	6.1

The first edition of Home Truths, published in July 2012, gave the following prognosis for the housing market:

"Prices are now trending up from Bluff to the Cape, and record-low mortgage rates are playing a clear role. Given the state of the market and the likelihood that mortgage rates will stay low for a while yet, house prices can be expected to continue rising all year. But we don't expect the current situation to last forever. When mortgage rates rise, the housing market will cool."

Since that time, Home Truths has consistently argued the case for ongoing house price inflation, at least in the near term, on the basis of low mortgage rates. Equally, Home Truths has consistently warned that eventually interest rates would rise, and when they did, the housing market would cool.

The moment of rising interest rates has been reached, earlier than anticipated. Over the past month, fixed mortgage rates have risen very sharply. Fixed mortgage rates are now sufficiently high that they could take some of the wind to come out of the market's sails, although rates are not yet high enough to presage an actual reduction in house prices as in 2008.

An additional dynamic here is the Reserve Bank's recently invoked Loan-to-Value Ratio (LVR) mortgage lending restrictions, which will crimp the ability of first homebuyers to participate in the market. As we've mentioned previously, these restrictions can be expected to slow the housing market over a period of three to six months.

Higher interest rates and the LVR restrictions have prompted Home Truths to change tack – we now anticipate a gradual cool-off in the housing market. The first symptoms of a slowdown would be a small reduction in turnover, a lengthening of the average time to sell, and an increase in the number of properties available on the market. We'd expect those symptoms to emerge around November this year.

A couple of months after that, we would expect weaker price action to emerge. The nationwide average rate of house price inflation is currently running around 9% per annum. That figure might start dropping towards the mid single-digits over the course of many months.

We must reiterate that Home Truths is not calling for a reduction in house prices at this stage, or a wholesale capitulation of the market. We are not suggesting that the last word in the house price cycle of the 2010s has been uttered. But we do think there is reason to prepare for a period in which the market is not quite so hot, starting around November this year.

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