The New Zealand Herald

Akl house slump, China main risks - NZIER

By Brian Fallow NZ HeraldTuesday May 27, 2014

In Auckland, the current pace of house sales suggests a moderation in house prices, says NZIER's Shamubeel Eaqub. Photo / Dean Purcell.

Sharp slowdowns in the Auckland housing market or in China are the main risks the New Zealand Institute of Economic Research sees to a recovery which is accelerating and broadening.

In its latest Quarterly Predictions the institute forecasts the economy to grow 3.5 per cent this year before slowing to around 2.5 per cent next year and the year after.

But NZIER principal economist Shamubeel Eaqub is struck by the slowdown in house sales, given how powerful a driver of the economic cycle the housing market has been in the past.

"It's not obvious that the LVR [loan to value] restrictions have been hugely successful. And mortgage rates haven't really risen even though the official cash rate has gone up," he said.

"The LVR restrictions have had an unintended consequence. Banks are competing heavily on traditional mortgages, now that highly profitable low deposit mortgages are restricted. Fixed mortgage rates have barely risen despite OCR increases.

Borrowers can reduce their interest burden by moving from floating to fixed. For example, the floating mortgage rate was 6.2 per cent in mid-May and the two-year advertised rate was 5.99 per cent."

But regardless of that, sales volumes have come off. In Auckland house sales last month were down 21 per cent on April last year, the Real Estate Institute reports.

Outside of Canterbury it has been Auckland which has leading the economy recovery. "If the housing market in Auckland is slowing what does that tell us about the recovery?"

Meanwhile, though, Auckland house prices have surged to record highs - "claxon siren levels", Eaqub calls them.

"Investor demand is driving the Auckland market. If it were demand by people wanting to live in them, rents would have also surged," Eaqub said.

"In an investor-driven market, sales and prices can turn rapidly. A sudden stop in house sales could slow economic growth and make banks more careful in lending. That would put the brakes on broader economic growth."

In Auckland, the current pace of house sales suggested a moderation in house prices, Eaqub said.

"This is the ideal path, as a sharp reduction in house prices risks destabilising confidence and non-housing parts of the economy."

But there was a risk the Reserve Bank would tighten too much and not ease when required, he said. "Over-tightening could tip the economy into recession because so many parts of the economy are still fragile."

The other key risk to the recovery NZIER sees is from a slowdown in China's economic growth rate as it transitions from growth top-heavy in investment spending and exports to growth driven by domestic consumption, while dealing with the legacy of a massive increase in credit since the global financial crisis.

The direct impact of a Chinese slowdown on New Zealand would be modest and felt mainly though lower export prices, Eaqub said.

The indirect effect, via its impact on Australia, is likely to be greater, given the greater diversity and value added of New Zealand exports across the Tasman.

Exporting manufacturers were hurting already, he said.