Will the market fly or crash before RBNZ restrictions hit later in the year

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The latest monthly QV house price index results were released last week. No real surprises came out of that, with values continuing to increase almost everywhere across the country. Last month we produced a visualisation of value increases across the country if you want a refresher.

The latest highlights are that the top half of the North Island and Wellington are increasing at around 5.5% in the last three months. Dunedin is up 4%. Annualise those rates of increase and you can see how fast we are rising.

Meanwhile the re-acceleration of Auckland is now well and truly confirmed with values climbing there by 4.7% over the last three months, and even faster in North Shore and Manukau.

It is the combination of a nationwide increase in values, plus Auckland lifting off again that seems to have really caught the eye of the Government and Reserve Bank. Well, to be fair, they have had their eye on it for a long time now but the calls to act on it have grown louder and from more corners lately.

Pressure has been increasing on the Government to admit that there is a 'housing crisis' for which they have no answer. The Government have countered that with claims that they do have a 'comprehensive plan' which includes, amongst other things, increasing housing supply, especially in Auckland, and working with the Auckland Council.

That helps to tackle supply but they have also talked about the need to constrain demand.

Demand can come in the form of more people entering the country/Auckland, or it can come in the form of more people having access to mortgage finance.

New Zealand, along with many world economies, is currently experiencing record low interest rates. This has flowed through to mortgages, and these low interest rates are making repayments easier than they have ever been.

That particular driver is difficult for the Government to control, so they have leaned on the Reserve Bank to put in place lending restrictions.

Remember that the Reserve Bank put in place tougher lending rules for Auckland investors last November, just after the Government introduced a new 'bright line' capital gains tax came in on re-sold investor properties.

Those two efforts to slow investor activity appear to have had only a slight and short-term impact. Our buyer classification analysis, which the Reserve Bank often refer to, shows that investor activity dropped briefly immediately after those restrictions came into play, but

bounced back with a vengeance shortly afterwards. Another month on and we can see investor activity at record levels in Auckland.

Early last week the Reserve Bank announced that Deputy Governor Grant Spencer was to give a speech last Thursday evening. It was widely anticipated that they would announce the immediate introduction of further restrictions.

But they didn't. Instead they talked about options, and signalled that they would look to implement them by the end of the year. The options they outlined were not new, they had been on the table for some months. There was the option to extend the existing LVR speed limits, especially for investors. They also talked about introducing a debt to income ratio (DTI) which would limit how much people could borrow relative to their income. And finally there are requirements for retail banks to hold a higher ratio of capital for the money they lend which can lead to higher interest rates.

In addition they also used the speech as an opportunity to outline the major factors that are influencing the housing market, including housing supply, local government restrictions, migration and tax treatment for investors.

So the highly anticipated speech announcing something interesting was instead something of a fizzer for those of us that eagerly read the speech as soon as it was released.

But the media made a huge deal of it. Apparently the Reserve Bank was telling the government it needed to review its migration policy, and that it should have acted immediately to implement new rules rather than just talk about it.

I personally don't think they did suggest that the Government reconsider their migration policy, they simply stated that migration was a strong driver of the property market, and that Government should keep an eye on that.

As for not acting immediately, there are a couple of factors to consider. The speech mentioned that it was not one measure that would slow the market but a combination. While they could widen the LVR speed limits immediately, they felt that doing so would be more effective if done in combination with debt to income limits.

The Reserve Bank also said that the introduction of the debt to income ratios could not be done immediately and instead required approval of the Finance Minister, Bill English. A process that is now underway.

The other reason for not acting immediately is that it is not the Reserve Bank's mandate to slow down the property market, rather to ensure that the financial system is stable. Their assessment appears to be that the financial system could cope with a downturn in prices and so the urgency to act isn't there.

So where are we left? The Reserve Bank has clearly indicated that it is going to act before the end of the year. That means we are left with two possible scenarios.

One is that investors in particular will increase their activity in advance of the rule changes and this will add more fuel to the already blazing property fire.

The other is that people will see that rule changes are coming, and think that the market will slow right down or even decline following those changes. That being the case, market activity would drop dramatically.

Which way is it going to go? Who knows. Predicting human behaviour is damn near impossible.

Once the rules do kick in I would expect a slowdown, especially if debt to income restrictions are put in place.

The really big question is whether they would slow things down for long. Previous macro prudential measures imposed by the Reserve Bank have had only a short term impact. But this time they are talking about a combination of measures and that is where it may actually work.