Borrowing frenzy risks

New Zealand's high level of mortgage lending has been in the spotlight recently and commentators are warning that's for good reason.

Wednesday, June 22nd 2016, by Miriam Bell

Treasury secretary Gabriel Makhlouf yesterday expressed his concerns about the national impact of Auckland's high housing costs.

Speaking at the Committee for Auckland Group Summit, Makhlouf said part of the impact is the level of indebtedness.

"When New Zealand's housing debt is around $215.9 billion, a 26.6% increase in five years, nobody should be surprised the Treasury is concerned."

This housing debt is the biggest component of New Zealand's $246 billion household debt, which itself has grown 26.2% in five years.

By the beginning of 2016, the level of household debt to disposable income had risen to 163%, he said.

"This is higher than in the lead-up to the global financial crisis and is likely to go higher still, with the Reserve Bank expecting credit growth to continue to outpace income growth."

As long as households can service that debt it is not automatically a concern and current low interest rates are helping home owners pay their mortgages.

But those low interest rates have contributed to rising house prices and, in turn, Auckland's historically high debt to income ratios which leave households increasingly vulnerable, Makhlouf said.

Should the situation change – due to, for example, a rise in interest rates – that could hit households' balance sheets hard, and that would be a problem for more than the households in question.

Makhlouf said housing represents around 60% of bank balance sheets.

"In the event of a downturn, the high levels of debt across the banking sector and significant level of indebtedness of individual households could have knock-on effects that might cause serious losses of confidence and financial disruption.

"In short, inflated Auckland house prices are a risk to New Zealand's financial stability and the economy more generally."

The Treasury Secretary is far from the only commentator to raise the red flag about banks' mortgage lending recently.

University of Auckland property lecturer Michael Rehms told the Property Institute conference last week that mortgage lending was easy money for banks and for property buyers.

"In 1984, 13.5% of New Zealand bank lending was for mortgages. In 2016, it is 51.9%. That is an indication of where banks are choosing to put their money these days."

In his view, the banks' competition for market share of mortgage lending has also helped to drive housing debt levels and house prices up.

Rehms said that, in the US, it would not be possible to make the size of housing loan, based on a $50,000 deposit, which you can in New Zealand.

"The structural changes in house prices come down to the amount of debt people are taking on compared to their income."

The problem with this is that it is all based on the assumption that house prices will always go up, but that is a major mispricing of risk, he said.

“Debt has multiplied since the GFC. What is likely to happen when something jars the system this time round? I don’t know, but it isn’t going to be pretty.