ANZ Research

NZ Housing Policy Changes

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Recalibrating the demand pulse

Bottom line

- We expect today's announcements to have a meaningful impact on investor housing demand and make a decent start on the complex question of improving house supply.
- The moderation in house prices we were already expecting is likely to be sharper, and the odds of house prices falling have risen.
- The impact on the broader economy depends on the extent to which other parts of the economy are ready and able to step up to take the baton from housing. At the margin, it supports a cautious approach to OCR hikes.

The view

Today the Government announced a suite of measures it will use to address NZ's housing unaffordability crisis, including:

- Property investors will no longer be able to deduct interest costs. For new investments, this will be introduced 1 October 2021 but applied retrospectively from 27 March. For existing properties, this will be phased in over four years.
- The bright-line test will be increased from five years to ten years. However, the family home remains exempt, and it will remain at five for newly-built investment properties.
- The Government will help Kāinga Ora to borrow an extra $2 billion to boost strategic land purchases.
- The Government has introduced a $3.8bn fund to boost housing supply and infrastructure.
- Income cap increases for the Government's First Home Loan and the First Home Buyer Grant will take effect from 1 April.

Of these, the most meaningful announcement is investors no longer being able to deduct interest costs. That's at the bolder end of spectrum and was not anticipated.

Implications for housing outlook

Investors no longer being able to deduct interest costs is the most significant policy change from a housing momentum perspective – it should help take the wind out of the sails of the housing market. That's something that we were already expecting to happen in the second half of this year on the back of affordability and credit constraints, and tighter LVR settings, but today's announcements increase the risk that the house price moderation is sharper. But importantly, it increases the risk that house prices actually fall – it's very difficult for policy makers to engineer a soft landing.

On the topic of macroprudential policies, the Minister of Finance hinted that further tools could be in the pipeline (such as DTI and restrictions in interest only loans).

It’s very hard to know how investors will respond to this. The impacts might be quite slow burn, as the lengthy implementation period adds uncertainty around the shelf life of these policy changes, and the tax impact is smaller because mortgage rates are currently so low. Some may be able to recoup the higher cost by lifting rents. Some may no longer see housing as a viable or desirable investment and will look to sell. Others (without debt) will be relatively unaffected. In reality there will be a mix of reactions, which make it very difficult to gauge the magnitude of the response in aggregate. But we know this is a negative.

Stepping back, there is a lot on the policy front that’s coming to a head as affordability and credit constraints lift and supply continues to gradually ramp up. House price falls are hardly unthinkable from such a stratospheric starting point.

Broader economic impact

From a broader economy perspective, slowing housing-induced momentum shouldn’t be too concerning so long as the pipeline of planned activity is not materially dented and a pivot towards a trans-Tasman bubble (and later, generally open borders) see the key driver of underlying momentum pivot from housing to international tourism and services. Rising export prices are also providing a boost. But the economy is still pretty vulnerable this year, and the state of the housing market does have a big impact on the New Zealand economy. The counterargument to that is that if house prices were allowed to rise unchecked still further from here, the vulnerability of the economy would worsen, not improve, as the risks of a boom-bust cycle rose.

The big negative externality is the possible impact on renters – the very people the Government is trying to help into the housing market. But ultimately, rents inflation can’t exceed income growth for long.

If investors stop building houses (as some will surely threaten to do), the Government may need to ramp up its construction plans. But that’s only something that’s achievable if capacity in the industry opens up.

Given the healthy pipeline and persistent under-supply of housing in NZ, the worst case scenario probably isn’t one where residential investment tanks (and the Government lifts its home-building game in response), but one where broader economic confidence takes a hit and underlying momentum runs out of puff before international tourism finds its feet again.

Implications for monetary policy

There will also be implications for monetary policy at the margin. The Reserve Bank will certainly add a sharp housing slowdown to its “negative risks” basket, and likely revise down its house price forecasts. This will add caution around OCR hikes via less-than-otherwise housing-induced domestic momentum. But perhaps more importantly, the policy change will increase the sensitivity of landlords to higher interest rates, thereby increasing the potency of higher interest rates.

Still more to do to address the long-run issues

Today’s announcements will help take some of the wind out of the housing market’s sails, but the solution to the housing market needs to be considered from two angles: leaning against the price cycle when it gets out of hand; and addressing the fundamental problem of a lack of supply.

Tax tweaks and macroprudential policies can be affective at addressing the former, but they do nothing towards lifting supply. There’s no quick fix there, but the Housing Acceleration Fund of $3.8bn is at least a step towards rectifying the fact that local government is not able nor incentivised to provide the investment that enables large-scale green-fields or densification development in a timely manner. As long as the projects are carefully chosen to provide maximum bang for buck, it should make a meaningful difference in pockets over the next few years, and provide a case study for a desperately needed new approach to providing housing infrastructure. And unlike home-builders, there is actually some spare capacity in the infrastructure sector at present, so stuff may actually get done.

There’s still more that could be done on the housing supply side. It’s not easy, given so many vested interests and genuine trade-offs, but well thought-out supply-side reforms have the potential to make the New Zealand housing market a lot less susceptible to such dramatic house price cycles. Importantly, the Government is not done; let’s hope the focus piviots further towards supply from here. It’s not just people’s inability to put together a deposit that’s the problem. In many cities, rents are way out of line with incomes as well, and New Zealand faces a rapidly increasing homelessness problem as a result. More houses is the only answer in the end.

Stepping back, the Government faces quite the conundrum: it wants to make housing attainable to those who have been locked out. From this starting point, that’s all but impossible to do without prices going into reverse. But at the same time, New Zealand’s strong economic recovery (including the success in keeping people connected to the labour market) has been driven largely by the success of monetary policy in engineering a very strong housing market. Put that into reverse too quickly and it could put pressure on fiscal policy to do more.

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