The downsides of New Zealand's inflated house prices

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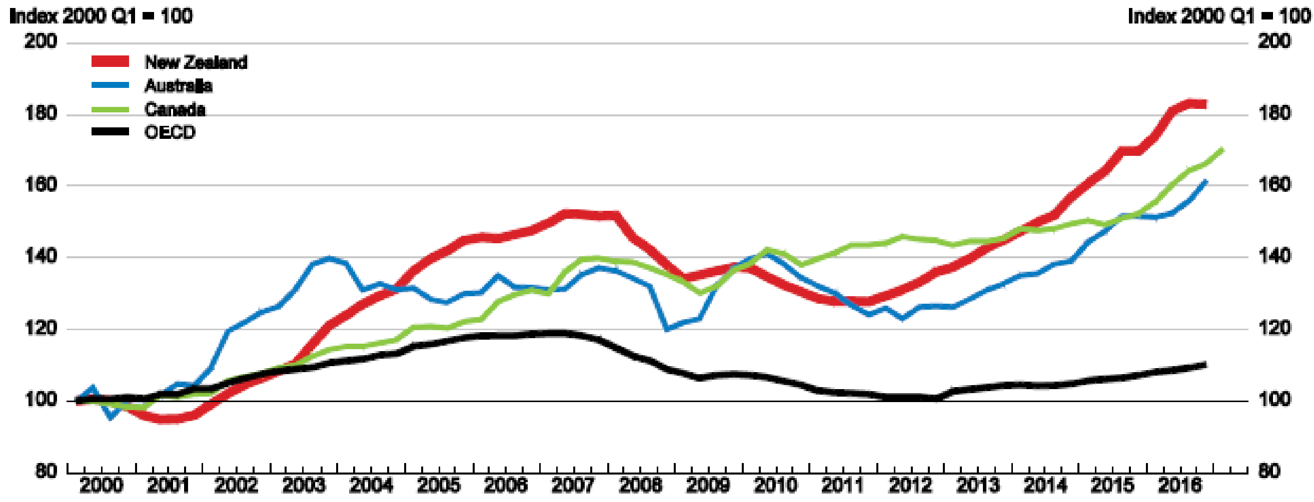
In real terms, house prices in New Zealand increased more than in any other OECD country between 2010 and 2016 (Figure 1). While house price increases have supported economic growth through wealth-induced consumption growth, they have also created a number of social and economic problems. Housing affordability has been undermined, particularly for those with low incomes: housing costs for the bottom fifth of households reached 54% of income in 2015, up from under 30% in 1990. Driven by mortgage growth, the ratio of household debt to disposable income now exceeds the level recorded prior to the global financial crisis and is high compared with other OECD countries (Figure 2). This raises financial stability risks. House price increases also undermine productivity growth by inhibiting people from moving into economically successful, highly productive urban areas.

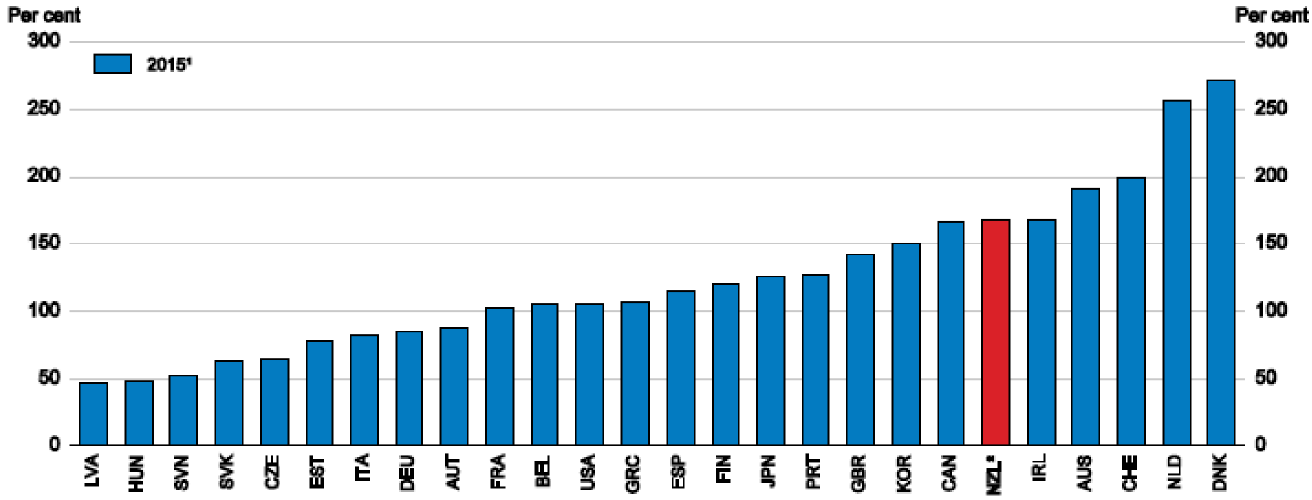
Figure 1. House price increases have outstripped those in other OECD countries

House price-to-income ratios



Source: OECD, Housing Prices database.

Figure 2. Household debt is high relative to disposable income



1. 2013 for Korea; 2016 for New Zealand, Portugal, Sweden and United Kingdom.
2. Including debt on rental properties.

Source: OECD, National Accounts - Financial Dashboard database; Reserve Bank of New Zealand (2017), Statistics on Households.

Price increases have been most pronounced in Auckland. Around half of all new migrants settle in Auckland, exceeding its (one third) share of the national population. Since 2008, new housing construction in Auckland has failed to keep pace with population growth. Prices in the rest of New Zealand, on the other hand, have risen despite little or no increase in the population-to-dwelling ratio. Throughout the country, record low interest rates have magnified house price increases.

The long-term solution, for Auckland in particular, is to address supply constraints. The recent Auckland Unitary Plan will allow greater densification and some expansion of urban development limits. However, insufficient infrastructure has constrained the extent to which densification is possible in central parts of Auckland. As in other parts of the country, infrastructure provision is primarily the responsibility of local governments, which face financial constraints and weak incentives to invest in amenities to facilitate growth. Options to broaden funding sources for public infrastructure should be explored, including more user charging, targeted property taxes, more cost-reflective developer contributions, sharing in a tax base linked to local economic activity and further recourse to alternative delivery models such as public-private partnerships. Reforms to the urban planning system are also needed – recommendations from the OECD's Environmental Performance Review and the Productivity Commission's Inquiry into Land Use Planning should be considered in order to deliver a more responsive and efficient planning system.

Relieving supply constraints takes time, however, so demand-side measures are also important to address financial stability risks. The Reserve Bank has progressively tightened restrictions on loan-to-value ratios, constraining the maximum amount that banks can lend to most customers. House price increases have moderated since the last round of tightening in October 2016. Debt-to-income restrictions, which complement loan-to-value ratios by limiting further debt as house prices increase relative to incomes, may be necessary if house price increases resume, and should be added to the Reserve Bank's toolkit following analysis demonstrating that benefits would outweigh costs.

References

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