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10th August, 2016

Attention:
Head, Macro Financial Department
Reserve Bank of New Zealand
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Submission in response to:
Consultation Paper: Adjustments to restrictions on high-LVR residential mortgage lending

I am making this submission as an individual. There are no privacy reasons to withhold anything of this submission in response to Official Information Act inquires with the exception of my name.

As a private individual who has made two previous submissions on macro-potential changes, I have given these policies some thought and attention in the past. However, the short time frame for the new LVR policy's formal implementation, and the Governor's instructions to the trading banks to implement the policy immediately, make it obvious that this consultation is on a matter which has been predetermined.

As this consultation is so evidently a sham undertaken to meet statutory requirements, I'm going to take this submission as an opportunity to “speak truth to power” and put forward the contention that these “temporary” LVR controls are increasing distortions and favouring one group over another. Their rational more likely lies in the personal bias of the current Governor rather than the stated reasons given. In a democratic society policy choices which advantage one group over another are what we vote for, and should not be exercised by unelected officials such as the Governor of the RBNZ. Additionally these policies are likely to undermine the efficiency of the financial system.

It is worth repeating that the Reserve Bank has a statutory obligation to operate monetary policy to achieve and maintain price stability within an 1-3% band with an agreed target of 2% inflation. It also required to assist in the functioning of a sound and efficient financial system. Nothing in this requires the targeting of house prices or restriction of price increases, which has been justified as promoting a sound financial system. Clearly the RBNZ has been failing at its primary target for the past 4 years. It has introduced macro prudential policies which have perhaps made a very safe financial system slightly more safe, but with a likely reduction in efficiency. With an increasing likelihood of unintended consequences our financial system may in fact be less stable after these measures are introduced.

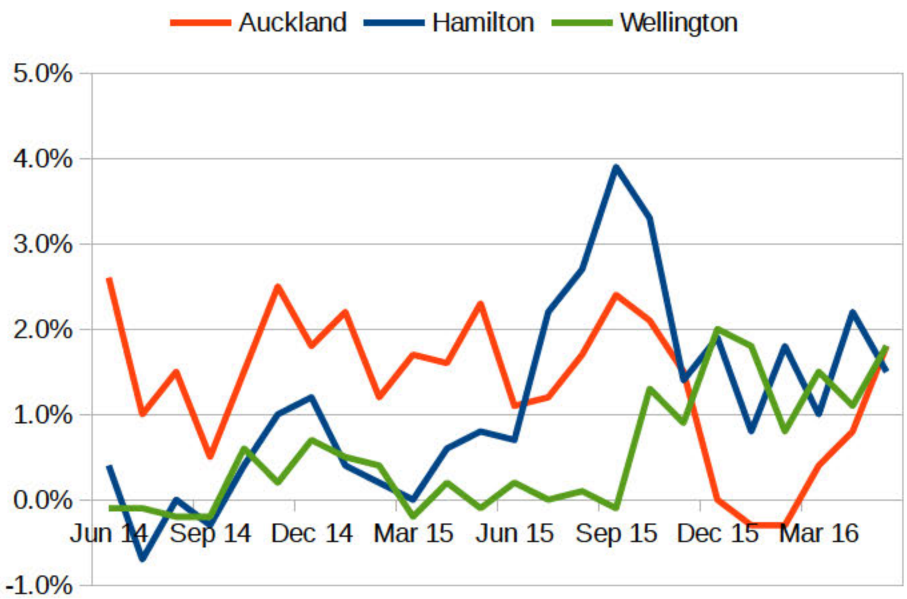
Let us remember that our financial system came through a near doubling of nationwide house prices during the 2000s, the worst global recession since the Great Depression, and a 15% decline in the housing market with little difficulty. The Reserve Banks own stress tests show the system is very resilient. So why this focus on stopping Auckland and Christchurch property markets from rising? Certainly the previous Governor was not overly concerned with rising house prices unless a 'wealth effect' flowed through to inflation, and introduced no macro-prudential tools despite a larger increase in property values.

Not long after the current Governor took office, in early 2013 the RBNZ began discussing increasing the risk weighting for housing loans for larger investors. What followed later was the first macro prudential measure to restrict high LVR lending. Then higher risk weighting were put onto investor loans. Finally in 2015 investors were restricted to 70% LVR in Auckland and high LVR restrictions loosened outside Auckland. How would the subsequent conversation go... “Oops, that caused a boom outside Auckland, better reverse the policy outside Auckland and tighten LVRs everywhere now, especially for investors which is easier politically”. As each intervention has failed more interventions are piled on in the hope that housing prices will slow or stop. Perhaps the old homily “when you are in a hole, stop digging” should be considered.

After the two pieces of UK & Ireland “evidence” supplied to support the contention that investor loans are riskier, no further research or evidence has been presented, only comments like “Our view on the riskiness of investor lending is shared by other banking regulators.” Why has no research been done on distressed sale history in NZ to see if investors do default more than owner-occupiers? The lack of rigour and the paucity of research provided for justification for these measures, points us to the real rationale here. After all, is it really convincing that such an institution as the Reserve Bank, staffed with very well educated and responsible personnel would back such major changes with so little intellectual rigour? Even the high-school level cost-benefit summary in the consultation document demonstrates the lack of rigour and proper research behind these changes.

It is far easier to believe that Governor Wheeler arrived with a pre-conceived notion based upon his US experience that house price rises are bad, cause crashes, and so they and property investors should be restrained. Evidence and rigour have been ignored as RBNZ staff have fallen into line, not wanting to or being able to challenge the Governor on his beliefs. The Governors public refusal to acknowledge any mistake (even in hindsight) in the raising and reversal of the OCR during 2014/15 illustrates the difficulties in making such a challenge by staff. It looks like one official is driving massive changes to the NZ banking system based on his personal agenda. These changes are favouring one group over another, the groups varying as policy leaps from one intervention to another, even as they all fail to achieve the implied objective of halting property price rises. Another supporting point to this argument lies with the inconsistency of excepting new builds from the policy. If investor lending is so risky, why are new builds exempted from the LVR limits? The only logical reason is that the real rational for all of these measure is to "stop the market" and new builds will increase supply and thus help achieve this aim.

What kind of unintended consequences of these macro-prudential measures have already occurred? Certainly the introduction of Auckland investor restrictions in mid-2015 clearly initiated a boom in the property markets of nearby Hamilton and Tauranga, followed a few months later by Wellington (see chart). Whether or not this is considered a problem after years of relative stability in real estate prices outside Auckland and Christchurch is questionable. What is not questionable is that the introduction of further investor LVR restrictions for the whole country now might well have negative implications for people living the many smaller centres where prices have been stable to lower since 2007. So here we see the irony of these new LVR policies being introduced in part to deal with the unintended consequences of the last round of LVR policies.



Another consequence is that if the new policy remains entrenched then it will reduce the proportion of investor properties available to rent around the country. During the next few years the policy will advantage the group of first home buyers who are ready to purchase. After that time the decline in rental property supply will raise rents, which in turn will make it harder for first home buyers (who are mostly renters first) to save their deposits, but it will boost inflation at that time. And of course overseas and larger investors who will not be disadvantaged by the new policy, will also benefit at the expense of newer or younger investors.

The RB is now clearly failing around reactively with obliviously no overarching theory behind what is trying to be achieved (or we would not be on policy number three). Clearly the goal is to stop house price rises despite the lack of a stability rational, while efficiency is ignored. Another obvious consequence will be rise in non-bank lenders which in time may well make the overall financial system less stable. Newvertheless, no doubt when Auckland property prices cease to rise, victory will be claimed. The resulting efficiency problems will become evident when prices decline, as I suspect there has been even less rigour put into how these “temporary” LVR policies will be unwound, compared to the paucity of analysis given to support their initial implementation.

There should be a publicly declared process for unwinding, with clear conditions set out for the removal or modification of the LVR restrictions, otherwise at we will continue to see hapless individuals wrong footed by these ah-hoc measures to influence the housing market. The RB should make explicit under what conditions the LVR limits will be relaxed. If not, the Reserve Bank risks creating the very “crash” scenario it purports to want to avoid. For example, let us say Auckland housing prices turn in 2018 and start falling due to new supply arising out of the Unitary Plan. Prices fall 10%, do the LVRs get relaxed by 20%? If not, then nothing changes and further price falls may well occur as equity shrinks and confidence collapses, and new building along with it. I really hope someone has given some thought to this, or one of the greatest unintended consequence of these macro prudential controls will that the inevitable bust cycle will see in larger price falls and greater economic risks for New Zealand than was necessary.

Oh, and if it is not clear... I oppose the policy changes .

Kind regards

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