

(P)HEW

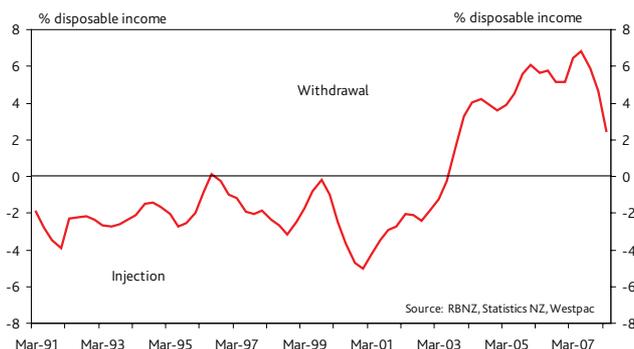
Housing equity withdrawal and its impact

- **At its peak in mid 2007, housing equity withdrawal (HEW) amounted to \$5.7bn. Perhaps 25% of that wealth effect was used to fund consumption.**
- **Changes in HEW are closely linked to housing turnover.**
- **House sales are 50% lower than a year ago and prices are sagging.**
- **HEW is being shut down extremely quickly, making for a huge downdraft for household spending and the economy in 2008.**
- **It's the change in HEW that matters most for consumption growth: HEW will not be the same drag on spending next year. HEW dynamics are one reason we expect a strong rebound in the economy's growth rate in 2009.**

Introduction

NZ housing equity withdrawal (HEW), or people tapping into the wealth gains from the housing boom, peaked at around \$5.7bn (6.8% of household disposable income) in the year to June 2007.

NZ housing equity withdrawal



With the housing market now in retreat, important questions for the NZ economy are how quickly will the HEW be shut down, and how much will this impact consumption growth?

In trying to answer these questions, we face a small problem: there is no NZ data on how households tap into their housing equity, nor how much goes toward consumption or other asset accumulation! But we won't let that stop us.

A 2004 Australian survey on household equity withdrawal and injection provides us with some useful insights as to what may be occurring in NZ.

What it is

We estimate HEW by subtracting new residential investment (including any associated transaction costs) from the change in household debt. On this basis, housing equity withdrawal occurs when the change in borrowing exceeds residential investment. And conversely, housing equity injection occurs when residential investment exceeds the net change in borrowing.¹

How it occurs

Changes in HEW occur via a few channels. The first is by the household increasing the debt on an existing property (refinancing or taking out a home-equity style loan). Secondly, households can inject equity by paying down debt or financing renovations at least partly from own funds. Finally, a household may be involved in a property transaction that involves injection or withdrawal of equity.

As it transpires, the bulk of housing equity withdrawal occurs via the last channel. That is, it typically occurs when a household which has paid down most, if not all, of its mortgage sells a property to another household which takes out a new and larger mortgage. This type of HEW partly reflects patterns of older households selling property to younger households.

¹ There are some measurement difficulties with the method used here. For example, HEW may be overestimated by the fact that land values are not included in residential investment yet households borrow to purchase both the land and structure. In addition, small businesses have the ability to borrow using a housing mortgage as collateral, which may also provide upward bias in the result. These difficulties aside, the trend will still act as a meaningful indicator of change.

For further information, questions or comments contact Brendan O'Donovan, telephone (04) 470 8250, email bodonovan@westpac.co.nz

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Guidance from Australia

The Reserve Bank of Australia commissioned a survey to gain insights into how households were withdrawing equity from the housing stock, and how the withdrawn funds were being used. The survey covered housing-related expenditures and transactions in 2004.²

Some of the key findings were:

- any aggregate series for net housing equity withdrawal or injection masks large aggregate withdrawals and injections by different types of households;
- there was significant equity withdrawal via debt refinancing;
- 11.7% of households made a net withdrawal of equity, while 30% made a net injection of equity;
- although fewer households withdrew equity than injected, in aggregate withdrawals dominated because of the much larger median values involved;
- almost three-quarters of the total value of equity withdrawn by households that withdrew equity (in net terms) was attributable to households that were involved in property transactions;
- around two-thirds of equity withdrawn was invested in other assets or used to pay down other loans.³ In contrast only a relatively small proportion of equity withdrawn was used directly to fund consumption;
- 18% of equity withdrawn was for consumption, 58% for asset accumulation, 8% to pay down debt, and 14% indicated they could not or would not say; and
- use of funds varied considerably with the method of equity withdrawal, with households borrowing against existing property much more likely to use the funds to finance consumption than were households withdrawing equity through a property transaction.

Australian Withdrawal and Injection of Equity, 2004

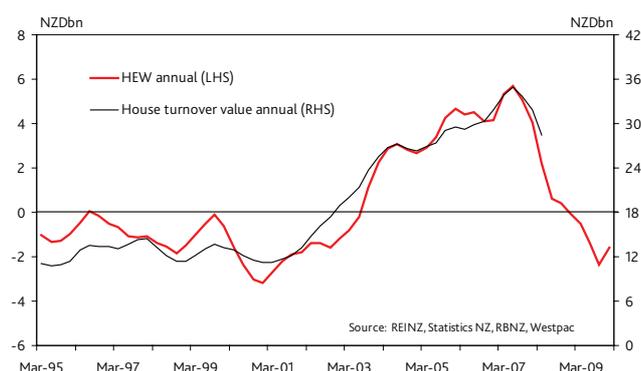
	Share of all households, %	Median amount, \$
Withdrawal of equity by increasing debt	7.3	-20,000
Injection of equity by		
– paying down debt	19.0	9,000
– renovating	6.5	14,000
Property transactors		
– withdrawing equity	4.4	-82,700
– injecting equity	4.6	55,100

Source: RBA

Applicability to NZ

If the Australian data were to hold for NZ, it would suggest that there should be a strong link between HEW and housing turnover (i.e., the number of houses sold and their value). This is exactly what we find (see Figure 2).⁴

HEW and housing turnover



NZ HEW went from a situation of net injection to large withdrawal as the number of house sales and their prices boomed in the 5 years to mid 2007.

But that has now changed with a vengeance. Our estimates of HEW show that annual HEW dropped from \$5.7bn in June 2007 to \$4.1bn in December 2007. A further \$1.8bn has been shaved off in Q1 2008. This is entirely consistent with the sharp fall in the value of housing turnover that has occurred.

In March and April 2008, the volume of house sales were around 50% below year earlier levels. After averaging between 6 and 7.5% of the housing stock over the past 5 years, the number of sales has now dropped below 4% of the housing stock. At the same time house prices have begun to retreat.

What the Australian and recent NZ experience is indicating is that HEW can expect to be, and is being, shut down extremely quickly. This is acting as a huge headwind for economic activity this year, but will be far less evident in a year's time. After all, it is the change in HEW that matters most for economic growth. While HEW is likely to go from a withdrawal of \$5.7bn in the year to June 2007 to an injection of \$2bn by mid 2009, it will then likely stabilise and no longer act as a negative for growth.

Normalising the responses to the Australian survey indicates that 21% of HEW went into consumption in 2004. NZ has a far worse saving rate and much weaker financial asset accumulation than Australia, leading us to believe that a greater proportion of our HEW has gone into consumption. A reasonable ball-park seems to be 25-30%. This suggests that⁵, over the two years

² Survey of Housing Equity Withdrawal and Injection, RBA Bulletin, October 2005

³ Of course this may well be spent at a (much) later date. However, we are most interested in changes over a relatively short period of time.

⁴ Nerd corner: both the value of housing turnover and HEW are likely to trend in line with nominal GDP so they are comparable in their raw form (i.e., they are of the same order). However, in recent times there may have been a structural increase in HEW due to financial innovation, consolidation of debt onto the mortgage, less restrictive lending criteria, lower interest rates, and economic stability encouraging additional debt accumulation.

⁵ HEW from housing turnover is likely to be retreating more quickly than other forms of HEW, which will temper the consumption impact.

to mid 2009, changes in HEW may prune \$1.9bn – \$2.3bn off consumption expenditure (i.e., around 1% p.a). We believe it is a significant factor, along with food and energy cost increases, behind the dramatic slowing in urban retail sales (to just 1.3% nominal annual growth in March 2008).⁶

Conclusion

HEW is massively influenced by changes in housing turnover. As housing turnover tumbles, so too does HEW.

Now that the RBNZ has finally succeeded in stopping the housing boom, much of their traction in slowing the consumer is coming via the shutting down of HEW. With perhaps 25 – 30% of HEW having been used to finance consumption spending, the closing of the HEW tap is a significant factor behind the evaporation of consumption growth in the cities. While falling HEW is a key channel through which the economy is enduring an abrupt transition, it will not be the drag on growth in 2009 that it is this year.

Brendan O'Donovan, Chief Economist, Ph: (64-4) 470 8250

Doug Steel, Senior Economist, Ph: (64-4) 470 8251

⁶ Retail sales in the rural-based provinces are much stronger (at around 8% annual growth) due to the income boost from the dairy cash windfall but also from the wealth effect from rural properties. Farm values have increased by 50%, or \$35bn, in the past year.