RBNZ Policy Versus Housing Bubble

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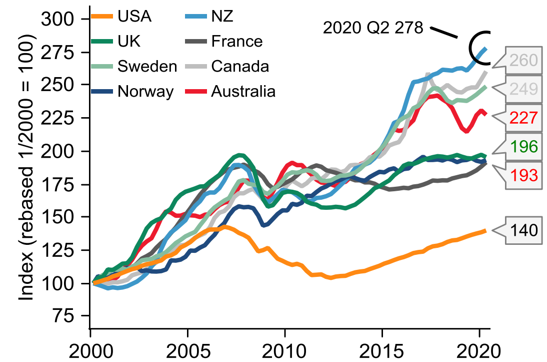
News that the New Zealand Finance Minister has asked the RBNZ to add house prices to its policy remit sparked a prompt reaction from money markets and a further push higher in the NZD. The market assumption is simply that if house prices are a formal part of the central bank's policy equation, there is no room for policy rates to move into negative territory, as market pricing has been anticipating. Markets had been pricing in the strong chance of the Cash Rate moving to –0.10% next year but have corrected rapidly over the past few weeks to reflect the belief that the target rate will remain at 0.25%.

Real House Prices, Dallas Fed Price Index



Source: Macrobond, Scotiabank FICC Strategy

NZ house prices have risen sharply, outstripping rapid gains in other countries, amid low, rates weak supply and high demand. The NZ government is concerned that the sharp appreciation in domestic house prices is fanning inequality issues. The RBNZ noted that it already gives consideration to asset prices, including house prices, when setting policy as they are important "transmission channels that effect employment and inflation".

It is notable that other governments have also tried to task their central banks with reining in rampant housing markets in recent years, with little success. This was a topic of debate between the Federal government and the Bank of Canada under Governor Carney's tenure. The political subtext here is that while policy makers may be concerned with inflated house prices, no one wants to be seen as the cause of a sharp drop in housing. Central banks have tended to urge the use of macro-prudential policies to curb house price gains, instead of the blunt force of interest rates—especially in the current regime of super low global interest rates. Indeed, the RBNZ had already indicated that it would reinstate mortgage-lending curbs that were lifted earlier this year which allowed highly-leveraged buyers back into the domestic market.

Prolonged periods of super-accommodative monetary policy settings have clearly led to inflated asset prices globally. Financial stability risks have increased significantly as a consequence. However, with key central bank remits—centering primarily on inflation, growth and jobs—still challenged, a major departure from the established policy setting goals, even in New Zealand, may be a stretch. There is little evidence that any major central bank has formally incorporated a house price variable into its policy making mix at this point and to do so might require a lot more information on domestic house price trends than is perhaps currently available. Tighter macro-prudential restrictions may be more effective than monetary policy in any case. It may be premature to rule out the notion of negative rates in NZ entirely at this point; the evolution of the global economy, rather than domestic housing, may be the ultimate arbiter of whether the benchmark rate pushes below zero in the coming year.