

Insight

Is there a housing shortage?

Housing has been a key driver of the economy over recent years, both in creating strong growth and the recent recession. Recent house price, house sales and building consents data suggest the cycle is turning up, although there is considerable uncertainty around the sustainability of the recovery.

A key point of contention is whether there is a shortage of housing. There is a considerable divergence of views among commentators. Our analysis suggests the rate of home building has kept pace with underlying demand and there is no shortage at present.

But comparing the current exceptionally low rate of homebuilding with the growth in underlying demand suggests pressures could emerge.

Housing supply is sluggish...

Construction of new homes has been slowing over the past year. This is clearly illustrated in building consents, which has practically halved from a peak annual trend rate of 27,000 in 2007 to 14,000 in August 2009.

Given construction activity lags consent issuance by around six months, the rate of new home building will stay anaemic through to early 2010.

...in contrast to strong population growth

While the rate of new home builds has slowed, New Zealand has been experiencing relatively strong population growth, with population growth of 47,000 in the year to June 2009 (compared to 44,000 in the year to June 2007). This translates to an increase in households.

Following some years of close balance between population driven demand and supply, supply is now undershooting demand – at least temporarily.

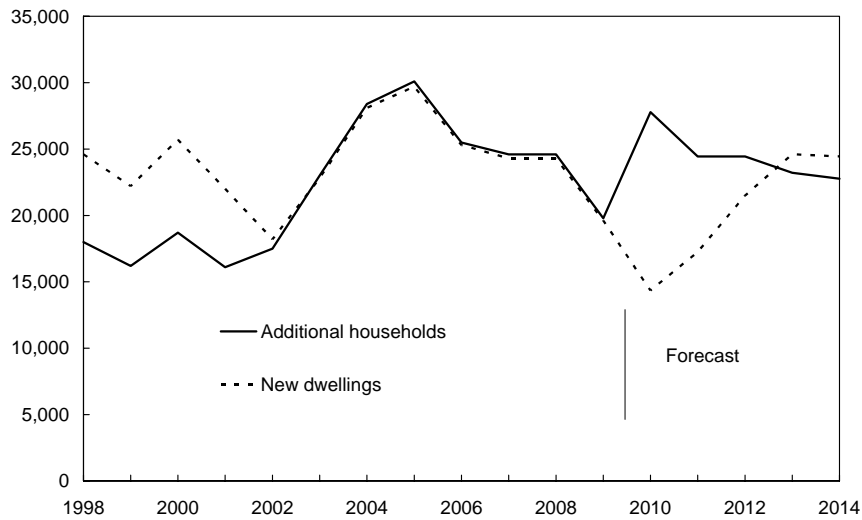
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Figure 1 Housing supply and demand

Number, annual



Source: NZIER, Statistics New Zealand

Notes: (1) Additional households are the forecast increase in the population, adjusted for falling household size in line with demographic trends

(2) New dwellings are projected as forecast new dwelling consents with a six month lag from consent issue

Short term implications and likely responses

A potential short term misalignment between the availability of additional dwellings and demand from population growth is not necessarily a cause for concern. The construction industry cannot respond overnight to increased demand, but more homes will be built eventually to meet demand. The near term implications may be seen in:

- larger households than otherwise
- rising rents or house prices.

Changes in household composition can affect housing demand

The demand for housing is more nuanced than just being driven by population growth. Demand for housing is driven by household formation. This is a function of population growth and changes in the household size.

The average New Zealand household is becoming smaller (from 3.0 people in 1966 to 2.67 in June 2009), and hence the number of households is increasing more rapidly than the population. This is being accelerated by changes in household composition, because of trends towards families with fewer children, more marriage breakups and more elderly people living independently.

If household size were to continue falling at its trend rate over the next five years, the combination of this and population growth means that we would expect to see an additional 125,000 households. But we forecast only 100,000 new dwellings to be built. This suggests a looming shortage of housing.

However, household formation can vary significantly around long term trends, influenced by economic circumstances and housing availability. For example, young adults may choose to live with parents instead of flatting. In the early part of this decade new building did not keep pace with a rapid increase in migration-led population growth. Household size rose and rents rose rapidly to equilibrate demand against constrained supply.

If the household size were to stabilise temporarily (as it has done in past recessions) or permanently, we estimate the additional demand to be for around 90,000 to 105,000 dwellings. This is around our forecast of the growth in dwellings.

So, a housing shortage?

House prices have been rising recently. However, this appears to reflect a mismatch specifically in the real-estate market with not enough homes for sale compared to demand. If the mismatch was a physical imbalance between demand and supply we would expect to see rents rise rapidly. This has not been happening in the New Zealand market – rent bond data show rents have been dropping.

That suggests that there is no housing shortage at present. There is a potential for a shortage over the coming years if home building does not lift beyond current forecasts. If this happens we can expect to see rents rise again. Any such excess demand is likely to be managed in the short term by an increase in household size, as tends to happen when economic circumstances are tough or when rents rise.