A Capital Gains Tax on Housing? Sporadic 4

The Reserve Bank is required not just to manage notes and coins issuance and try to keep inflation between 1% and 3% on average, but also

"In pursuing its price stability objective, the Bank shall implement monetary policy in a sustainable, consistent and transparent manner, have regard to the efficiency and soundness of the financial system, and seek to avoid unnecessary instability in output, interest rates and the exchange rate."

It is the "unnecessary instability in output" etc. bit which occupies the mind of the central bank currently in the form of disruption which could happen if the highly valued Auckland housing market was to dip strongly. The RB are concerned that if something were to come along and cause prices to fall sharply that because the fall could be large bank capital bases may be eroded and the curtailment of general credit availability would slam the economy. Wanting to avoid that situation is something we would all consider highly desirable.

To work toward mitigating the extent of any future price correction the RB Deputy Governor in a speech yesterday said

"While there are difficult issues and trade-offs to consider in this area, the Reserve Bank would like to see fresh consideration of possible policy measures to address the tax-preferred status of housing, especially investor related housing."

He did not come right out and say there needs to be a capital gains tax but that is the interpretation we all take and which it seems valid to adopt. With this high level "call" for a CGT will one be introduced in the next few years? No. Here is why.

1. The current National-led government oppose it, went into the last election saying one would not be introduced, and instead rightly are focusing on the underlying cause of rapidly rising house prices in Auckland – the supply shortage we started writing about in 2008.

2. Labour appear now to be backtracking away from their previous policy of introducing a CGT with one of the past three leaders noting last year that it was probably not a good idea to go into the general election promising to introduce a range of new taxes.

3. This is exactly the wrong point in the housing cycle to introduce a CGT. Why? Prices are already very high. If something bad happens and they start falling banks will suffer capital base erosion (write-offs) if property owners sell or walk away and the losses are imposed upon the banks. Would a CGT increase or decrease the chances that a property owner sells? Because a loss would be as tax deductible as a gain is taxable the hip pocket impact of selling would be less than without a CGT. Therefore a CGT would lead to more houses being placed on the market in the event of a decline and this would accentuate the extent to which prices go down.

The time to introduce a CGT is when the market has been stable for some time or is at the bottom of the cycle, not where it is now.

4. There are capital gains taxes in most foreign jurisdictions including Australia and across the Tasman in particular the tax is not preventing either sharply rising prices in Sydney or the Reserve Bank of Australia from expressing increasing concern about those rising prices.

In discussing Auckland housing yesterday and the many factors pushing prices higher, the Reserve Bank effectively gave the green light to more investors jumping into the Auckland housing market rather than scaring some away. How? By noting that essentially there is nothing that can be done in the next two to three years to alter the supply shortage in Auckland. Here are some of the comments contained in the Deputy Governor's speech.

"Supply-side policy solutions are unlikely to yield quick results. The proposed RMA reforms could significantly improve the planning process but could take years to be felt in new supply. Greenfield developments will inherently be slow to deliver new stock. A release of resources from the Christchurch rebuild is likely to be a couple of years away."

"There are practical difficulties in using migration policies to influence the housing cycle. Monetary policy, which in past cycles has been supportive of financial stability objectives, cannot be used currently to dampen housing demand."

It would not be unusual for people to pay no attention to warnings from the Reserve Bank and calls for something to happen. Repeated calls during high points in our currency cycle over the years have had almost no impact on the willingness of people to buy the Kiwi dollar. Home buyers have to date ignored all previous warnings from the RB regarding Auckland house prices and kept on buying. Shots across the bow ahead of key wage negotiations many years ago seemed not to have much impact on union demands for wage rises.

More specifically, those investors who ignored the description by Federal Reserve Bank Chairman Alan Greenspan of the US sharemarket displaying "irrational exuberance" back in late-1996 subsequently gained as the Dow Jones Industrials Index rose from 6,400 to 11,500 at the end of 1999.

Oh, and on a different topic, just in case there remain some people still thinking LVR rules might be relaxed in the near future, as we warned late last year when excitement about such was growing, the chances of any easing are slim to nil.

"The existing LVR restrictions on mortgage lending helped to moderate the market for a year and they continue to constrain risk in the banks' balance sheets. With the current overheated housing market in Auckland, it would not make sense to remove these restrictions in the near term. To do so would invite a further surge in credit-based demand for housing. When conditions warrant, however, it will be appropriate to ease or modify the incidence of the LVR policy."

When might the rules be eased? Only when the market could handle the unleashing of potentially tens of thousands of frustrated young buyers. That will be when our economy is next in recession. We cannot predict when that will be.

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3. China is Important to us. http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-3-April-13-2015.pdf
2. Kiwi/AUD parity – mainly a function of AUD weakness. http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-April-8-2015.pdf
1. Implications of interest rates staying low for a long time. http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-April-7-2015.pdf

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