ANZ Research

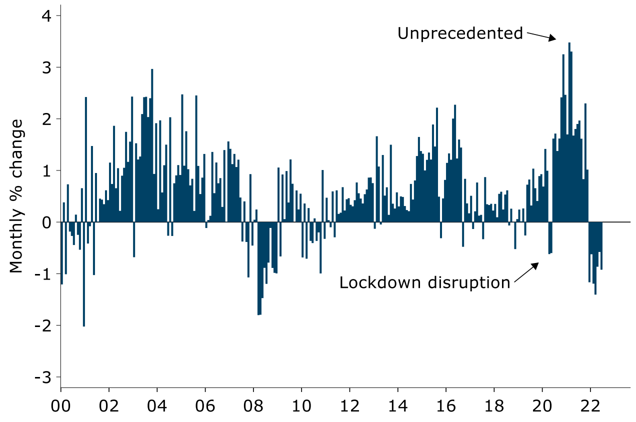
July 2022

New Zealand Property Focus

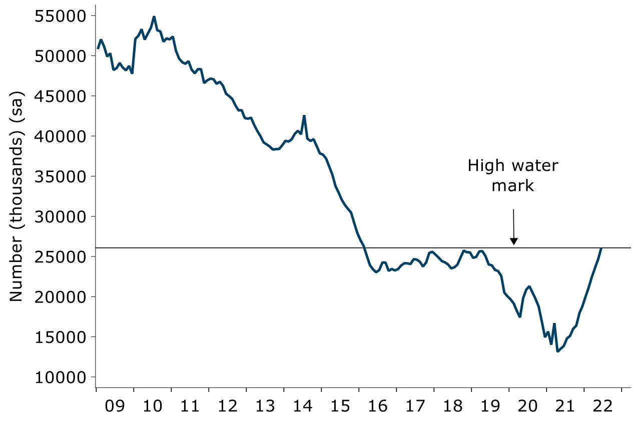
Hardening headwinds and soft landings

At a glance

The housing market remains firmly in retreat, and it's still loosening

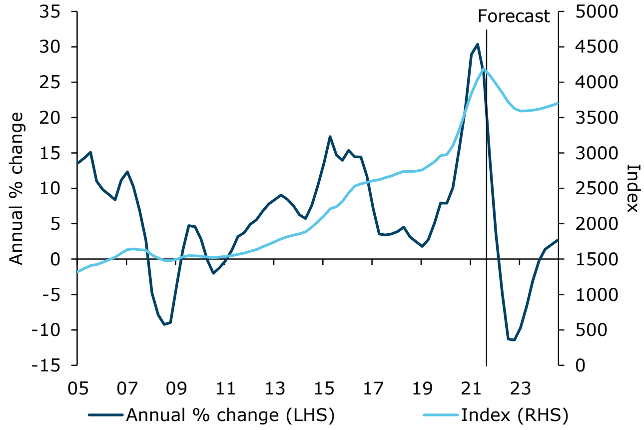


Slipping sales have pushed inventories to a 6-year high

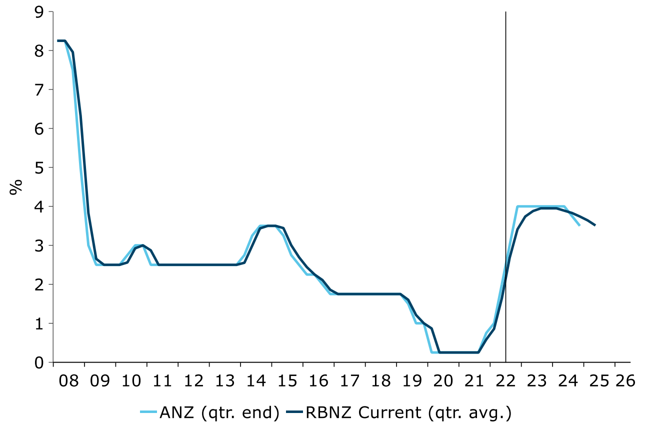


Slowing population growth is dragging on the demand pulse

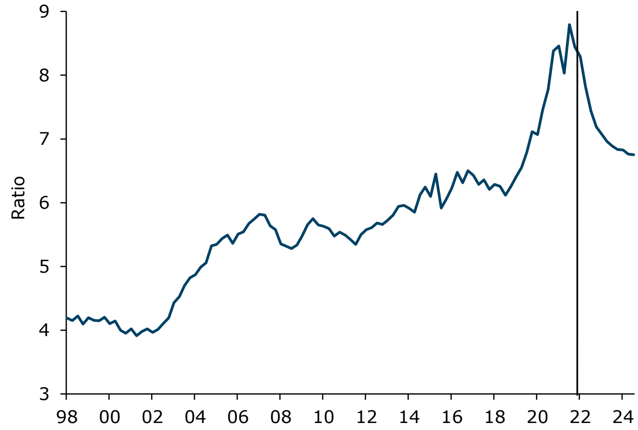
We now expect a 15% fall in house prices (previous: -12%)



…reflecting an upgrade to how high we think the OCR needs to go



At least house prices to incomes show affordability is improving



Source: RBNZ, REINZ, Stats NZ, The Treasury, CoreLogic, Macrobond, Bloomberg, ICAP, ANZ Research

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Summary

Our monthly *Property Focus* publication provides an independent appraisal of recent developments in the residential property market.

Housing market overview

The NZ Q2 CPI figures suggest high underlying ("core") inflation may stick around longer than previously thought. And with the labour market still tightening (from already record-tight levels), the RBNZ has plenty of work to do in order to prevent a damaging wage-price spiral. We've added a further 0.5% points to our expectation for how high the OCR will need to go (now 4%), and that means higher mortgage rates – and more downward pressure on house prices – than otherwise. We've downgraded our house price forecast to reflect this, with a peak to trough decline of 15% now pencilled in (previously -12%). But forecasting uncertainty remains high. See our Market Overview.

Mortgage borrowing strategy

Floating mortgage rates have largely followed the OCR higher over the past month, up 45 basis points from our last edition. The average 1-year special rate offered by the major banks has been broadly stable, down 3 basis points to 5.33%. The 4- and 5-year rates are unchanged, but there has been some switching in the curve between 2 and 3 years: the 2-year is 16 basis points lower at 5.59%, while the 3-year is 15 basis points higher at 5.99%. With 136 basis points difference between the lowest point on the curve (6 months at 5.26%) and the highest (5 years at 6.62), the curve remains steeply upward-sloping, meaning fixing for longer is relatively expensive. However, that's not a recent development and the steepness is consistent with the broader risk that central banks (including the RBNZ) may need to be even more aggressive if inflation continues to surprise to the upside. See our Mortgage Borrowing Strategy.

Housing market overview

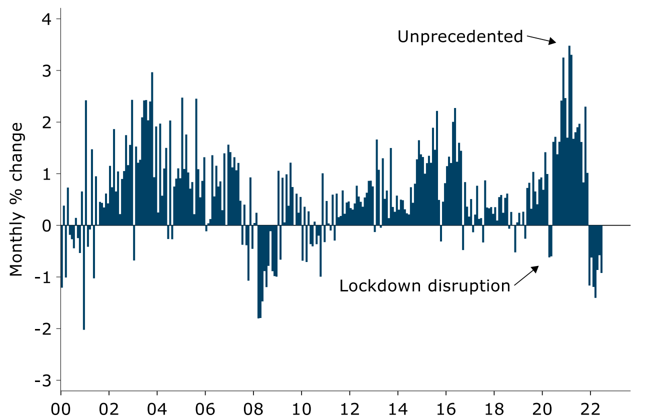
Summary

The NZ Q2 CPI figures suggest high underlying ("core") inflation may stick around longer than previously thought. And with the labour market still tightening (from already record-tight levels), the RBNZ has plenty of work to do in order to prevent a damaging wage-price spiral. We've added a further 0.5% points to our expectation for how high the OCR will need to go (now 4%), and that means higher mortgage rates – and more downward pressure on house prices – than otherwise. We've downgraded our house price forecast to reflect this, with a peak to trough decline of 15% now pencilled in (previously -12%). But forecasting uncertainty remains high.

Are we (halfway) there yet?

The REINZ House Price Index (HPI) has fallen 6.6% from its peak in November 2021, with monthly declines ranging between -1.4% and -0.6% (figure 1, ANZ seasonal adjustment). Annual house price inflation in now running at +3.6% (on a three-month moving average basis); that's more than 25%pts slower than its recent peak. We think this measure will turn negative in August.

Figure 1. Monthly house price inflation (sa)

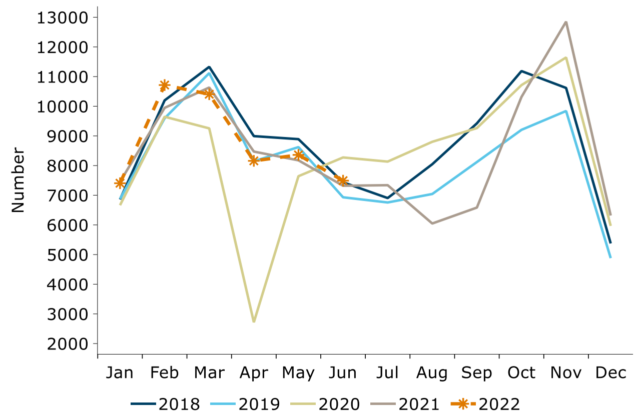


Source: REINZ, Macrobond, ANZ Research

Meanwhile, indicators of market tightness continue to ease. New listings are back to their typical seasonal pattern (figure 2), but softening sales (figure 3) mean housing inventories are rising. Inventories are now at a 6-year high, and trending higher (figure 4). Unsurprisingly, the number of days it is taking to sell a house is also trending higher (figure 5, over page).

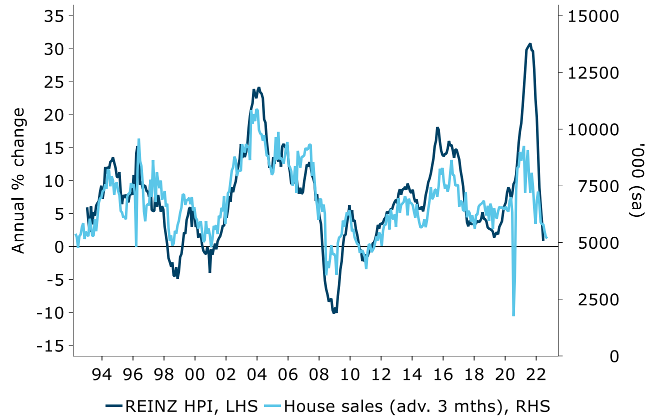
Combine slowing population growth (figure 6, over page), as negative net migration threatens to continue for a while yet, with a still-respectable level of residential investment (despite labour and materials shortages), and the resulting supply-demand balance suggests that when the market does find a floor, there could be significant limits to how much prices will lift again as the market recovers.

Figure 2. New listings each month



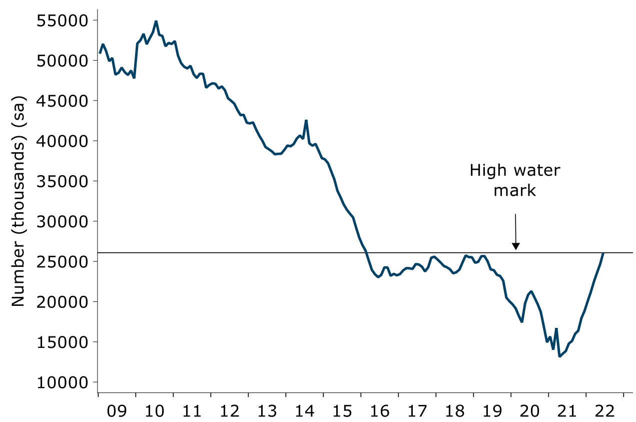
Source: RealEstate.co.nz, Macrobond, ANZ Research

Figure 3. House sales and prices



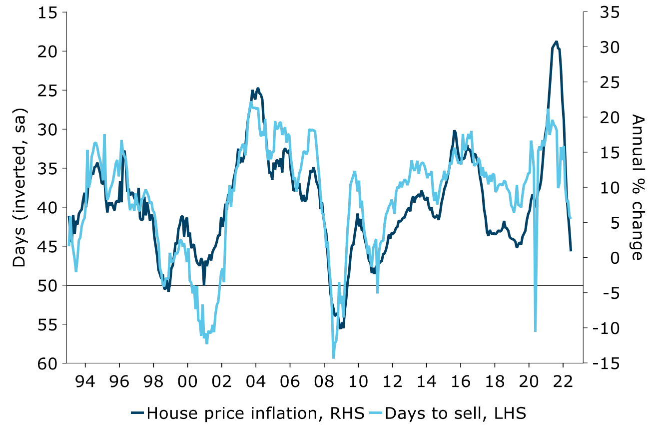
Source: REINZ, Macrobond, ANZ Research

Figure 4. Properties available for sale



Source: REINZ, Macrobond, ANZ Research

Figure 5. Number of days to sell a house



Source: REINZ, Macrobond, ANZ Research

Figure 6. Population growth and house prices

Source: Stats NZ, Macrobond, ANZ Research

All up, the suite of housing indicators we monitor is still very much on an easing trajectory, with no "floor" to speak of yet in sight. And it's not just the data telling us this; anecdotes from the coal face currently seem unified in suggesting the housing market is firmly in retreat.

That said, recent data hasn't been surprising us to the downside, relative to our forecasts. In fact, the average pace of monthly house price declines since November (around -1% per month), has been slightly smaller than the 1.1-1.2% declines we had pencilled in. Given the ridiculously high starting point for house prices, we'd say the correction to date has been relatively orderly. Meanwhile, however, headwinds to the medium-term outlook have only intensified of late, suggesting house price declines have further to go than we thought previously. And while we don't want to give the impression that we are able to accurately forecast the house price outlook to the nearest percentage point (no one has been able to consistently do that), we do need to acknowledge the higher interest rates outlook in our forecast.

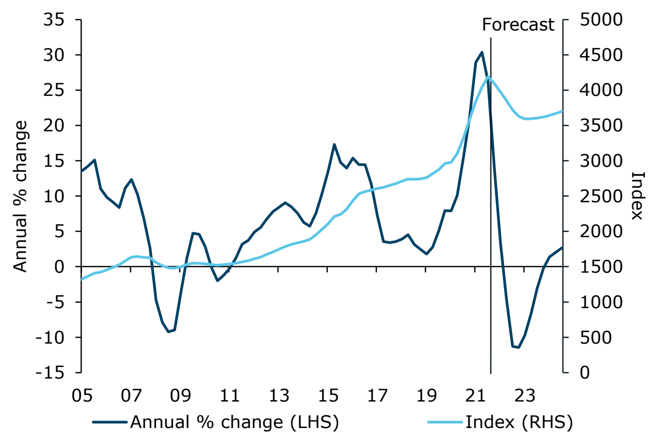
Higher OCR, lower house prices

It might sound a little strange, but the most important recent data for the housing market outlook was the Q2 CPI inflation release. That's because these data suggest underlying inflation pressures are stronger, and very likely more persistent, than we (or the RBNZ) previously thought. And with the labour market as tight as it currently is, and getting tighter, the pressure on the RBNZ to do more is intensifying. We now expect the RBNZ will continue to deliver 50bp hikes all the way to a peak of 4% by the end of the year. That's a full 50bps higher than our previous forecast OCR peak.

All else equal, (and looking through the ebbs and flows of wholesale rates markets), this means higher-than-otherwise mortgage rates, and therefore weaker-than-otherwise housing demand. Overall, we think our OCR call change is worth another 3%pts or so in terms of how much house prices are likely to fall, if it comes to pass, and are accordingly now forecasting a peak to trough decline of 15% (figure 7).

But as we've outlined numerous times before, house price forecasts are riddled with uncertainty at the best of times. Given the added degree of uncertainty around the economy right now, as interest rates go higher, inflation remains on a tear, and borders reopen, it's fair to say the housing market outlook could easily experience a sharper "correction" than we are forecasting. While a 15% fall in house prices may sound like a lot, it's coming off a circa 45% post-COVID gain. It can therefore be interpreted as very much a soft landing. Our forecast implies that prices will trough almost 25% above their pre-pandemic (December 2019) level. We continue to see significant downside risk to our forecast, but it would take a sharper deterioration in the labour market than we are expecting. The two are closely linked.

Figure 7. House price forecast



Source: REINZ, ANZ Research

Housing market overview

At least housing affordability is improving

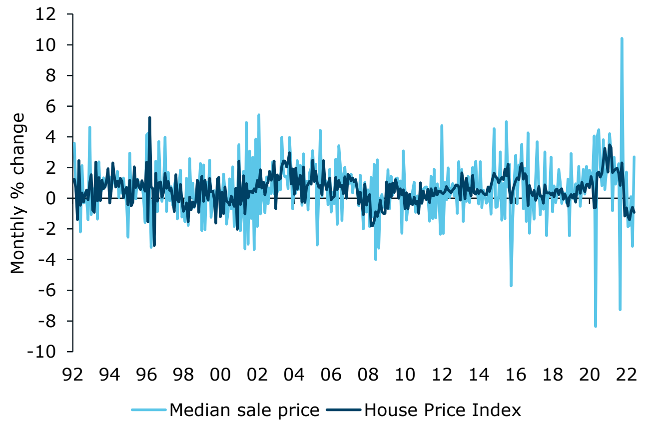
From the perspective of how to go about improving housing affordability, a relatively soft landing in house prices combined with a labour market that's operating at its maximum sustainable level is about as good as it gets. It's not quick, but a rapid house price crash would take a lot of jobs with it, and thereby hit the income side of the affordability equation (with lots more ugly side-effects besides).

The tricky part for the RBNZ is laying the path for the labour market so it can travel from its current "too tight, too inflationary, not sustainable, and therefore susceptible to crash at some point" position to the Goldilocks zone. That's "maximum sustainable employment", defined by the RBNZ as "the highest use of labour resources that can be sustained over time without creating a sustained acceleration in inflation". And while that likely means a higher unemployment rate than currently, it also means less pressure on CPI inflation – which is currently well outpacing household income growth and sending households backwards in "real" terms. The challenge, of course, is to not oversteer, and send the labour market straight past Goldilocks and into a vat of cold, congealed porridge.

The ratio of house prices to household incomes is the best way to assess housing affordability, but there are a few different sources and cuts of the household income data that can feed into this calculation. We annualise median household weekly income, and grow this over the forecast horizon based on our forecast for hourly earnings.

We also have to move away from our preferred measure of house prices (the REINZ House Price Index (HPI), which is adjusted for the composition of houses sold) to the much more volatile median sale price, in order to get a sensible estimate. But as figure 8 shows, growth rates in the HPI and the median sale price do tend to trend together.

Figure 8. House price forecast



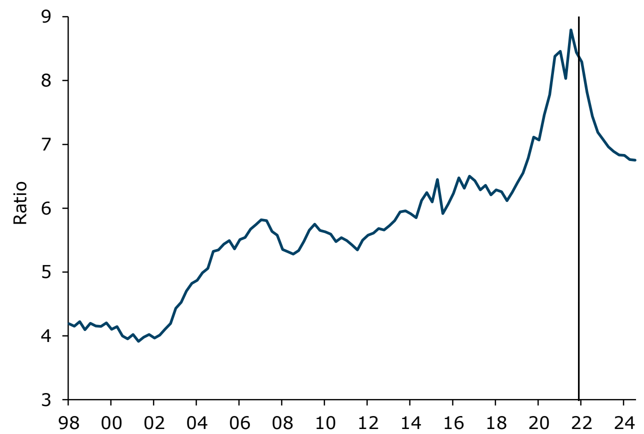
Source: REINZ, ANZ Research

Regardless of the income or price measure you use, the change in the ratio tells much the same story: housing affordability deteriorated in the lead-up to the pandemic, but engaged the hyper-drive in the post-pandemic era. Fortunately, falling house prices and a tight labour market mean it's now on an improving trajectory. But how much will it improve?

Our forecast for a 15% fall in house prices alongside above-average growth in household incomes over the next couple of years (due to the tight labour market) sees the ratio of house prices to incomes dropping from a peak of almost 9 times income, to 6.75 times income by the end of the forecast. That's better, but still higher than the pre-pandemic read of around 6.5 times (which was already considered unaffordable).

There are obviously a huge number of variables on both the demand and supply side that will go into determining whether, and how, housing affordability continues to improve from there. But there's a pretty stark choice: house prices underperform relative to incomes over a long period (or more dramatically over a shorter period), or housing remains unaffordable for decades, with all the societal implications that brings.

Figure 9. Median house price to median household income



Source: REINZ, ANZ Research

All up, a housing market in retreat is a double-edged sword, depending on what side of the fence you sit: locked out, or hoping for a capital gain. It's particularly bitter for very recent first-home buyers who are seeing both their interest cost rise (on a high level of debt) and their house value drop below what they paid. But there are indirect economic implications of falling house prices too:

- lower demand for residential construction and durables consumption;
- lower demand for labour in the above industries;
- reduced household wealth and housing equity; and

Housing market overview

- negative consumer and business sentiment implications.

These suggest it might be hard to achieve consecutive years of solid household income growth while house prices are falling. But if we are in for a hard landing in both housing and the broader economy, the still-high starting point suggests housing has a lot further to fall than aggregate incomes likely will.

But it’s also worth noting that if we do see a harder landing in housing than we (or the RBNZ) expect, there is no guarantee that this will be enough to take the pressure off core CPI inflation. That’s because once CPI inflation really gets going, it can have persistent implications on wage and price setting behaviour, causing high inflation to linger. If that were to happen, the RBNZ’s job will be harder, and they may need to continue hiking even as the housing market softens more than expected. The inflation data and outlook will remain a key variable of interest for the housing market for a while yet!

Housing market indicators for June 2022 (based on REINZ data seasonally adjusted by ANZ Research)

	Median house price			House price index		# of monthly sales	Monthly % change	Average days to sell
	Level	Annual % change	3-mth % change	Annual % change	3-mth % change			
Northland	$718,702	0.0	-6.7	8.9	-2.3	148	-2%	46
Auckland	$1,169,415	0.7	-3.6	-1.5	-3.8	1,718	+0%	43
Waikato	$849,072	14.3	0.2	6.5	-0.7	512	+10%	41
Bay of Plenty	$922,273	8.7	-0.8	3.1	-2.1	307	-5%	53
Gisborne	$650,480	2.6	-1.4	-1.2	-2.7	31	-24%	38
Hawke’s Bay	$719,393	-1.1	-4.7	-1.2	-2.7	151	-10%	61
Manawatu-Whanganui	$588,597	-0.8	-0.4	-3.0	-3.6	227	-7%	48
Taranaki	$600,366	-0.2	-1.9	8.2	0.6	131	-13%	38
Wellington	$869,206	-4.0	-3.5	-12.1	-7.0	461	-8%	48
Tasman, Nelson & Marlborough	$813,619	11.0	2.4			184	+0%	41
Canterbury	$703,656	22.1	1.4	15.3	-1.0	839	-3%	33
Otago	$761,207	13.5	-4.9	4.9	0.3	329	-2%	46
West Coast	$299,467	4.0	-0.3	3.4	-1.8	40	+67%	28
Southland	$453,389	6.2	1.3	7.3	-1.4	114	-5%	37
New Zealand	**$867,154**	**4.6**	**-2.9**	**0.9**	**-2.9**	**5,181**	**-1%**	**41**

Mortgage borrowing strategy

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Summary

Floating mortgage rates have largely followed the OCR higher over the past month, up 45 basis points from our last edition. The average 1-year special rate offered by the major banks has been broadly stable, down 3 basis points to 5.33%. The 4- and 5-year rates are unchanged, but there has been some switching in the curve between 2 and 3 years: the 2-year is 16 basis points lower at 5.59%, while the 3-year is 15 basis points higher at 5.99%. With 136 basis points difference between the lowest point on the curve (6 months at 5.26%) and the highest (5 years at 6.62), the curve remains steeply upward-sloping, meaning fixing for longer is relatively expensive. However, that's not a recent development and the steepness is consistent with the broader risk that central banks (including the RBNZ) may need to be even more aggressive if inflation continues to surprise to the upside.

Compared to some of our recent editions, changes to average fixed mortgage rates offered by the "big-4" banks have been relatively benign this month. However, floating rates, being very heavily influenced by changes in the OCR, are up 45 basis points to 6.37%. This is clearly an "outsized" move for a single month, but it's also exactly what you'd expect to see when the RBNZ is hiking so aggressively – they lifted the OCR by 50 basis points in July. Broadly, however, the signalling from the RBNZ this month regarding how high they think they may need to take the OCR over the next few meetings was unchanged. That means it wasn't a catalyst for an adjustment in forward-looking wholesale ("swap") markets, off which fixed mortgage rates are priced. In other words, market pricing for how high the OCR will need to go has been relatively stable over the past month.

We, on the other hand, have revised up our expectation for how high the OCR will peak. We now expect 50 basis point hikes by the RBNZ at every meeting from here to November – that's an additional 50 basis points overall that'll see the OCR peak at 4% in November (previous forecast peak: 3.5%).

Last month, reflecting the fact that our previous forecast for a peak OCR of 3.5% was a decent clip below market pricing, we were able to offer some consolation to borrowers in that the market looked a little overcooked, suggesting there was less scope for significant further rate increases. However, with our updated, higher OCR call, risks are now looking more balanced.

That said, stepping back to consider the more extreme risks around the rates outlook (ie more than 50 basis points or so), we find ourselves in the same boat we've been in for some time now. On the one hand, economic activity indicators are looking wobblier by the month, suggesting that the economy could be heading for a hard landing that would see labour demand weaken, taking the inflation pulse and the need for more OCR hikes down with it. But on the other hand, inflation indicators continue to surprise to the upside, and if the RBNZ doesn't get on top of this soon, high inflation may become a more persistent and damaging feature of the economy, necessitating even more aggressive hikes further down the track. Rightly, the RBNZ is more concerned with the risk of inflation spiralling out of control right now. But with monetary policy clearly working, it's hard to see this risk dominating forever.

As has been the case for a while now, while the ship to lock in low sailed a long time ago, some borrowers may still feel that despite the steep mortgage curve, it's worth paying a bit more for certainty in what's ultimately a very uncertain economic backdrop. Conversely, the materialisation of deflationary hard-landing risks could see borrowers regretting that decision in short order. Table 1 outlines the various break-evens (ie where rates would have to be in the future to make fixing today a neutral decision from a pure cost perspective), and is a good starting point for anyone looking to weigh up the risks.

Figure 1. Carded special mortgage rates^

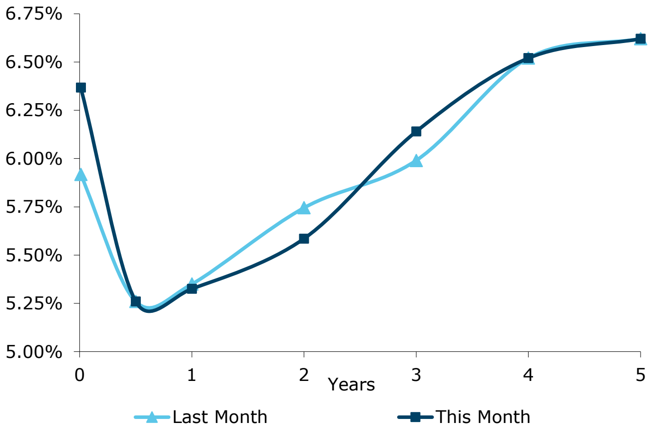

Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	6.37%				
6 months	5.26%	5.39%	6.21%	5.48%	6.97%
1 year	5.33%	5.80%	5.85%	6.23%	7.25%
2 years	5.59%	6.01%	6.55%	6.86%	7.46%
3 years	6.14%	6.51%	6.92%	7.05%	7.31%
4 years	6.52%	6.73%	6.94%		
5 years	6.62%	#Average of "big four" banks			

^ Average of carded rates from ANZ, ASB, BNZ and Westpac.

Source: interest.co.nz, ANZ Research

Key forecasts

Weekly mortgage repayments table (based on 25-year term)

Mortgage Size ($000)	Mortgage Rate (%)													
	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75
200	256	263	270	276	283	290	297	304	311	319	326	333	341	348
250	320	329	337	345	354	363	371	380	389	398	407	417	426	435
300	385	394	404	415	425	435	446	456	467	478	489	500	511	522
350	449	460	472	484	496	508	520	532	545	558	570	583	596	610
400	513	526	539	553	566	580	594	608	623	637	652	667	682	697
450	577	592	607	622	637	653	669	684	701	717	733	750	767	784
500	641	657	674	691	708	725	743	761	778	797	815	833	852	871
550	705	723	741	760	779	798	817	837	856	876	896	917	937	958
600	769	789	809	829	850	870	891	913	934	956	978	1,000	1,022	1,045
650	833	854	876	898	920	943	966	989	1,012	1,036	1,059	1,083	1,108	1,132
700	897	920	944	967	991	1,015	1,040	1,065	1,090	1,115	1,141	1,167	1,193	1,219
750	961	986	1,011	1,036	1,062	1,088	1,114	1,141	1,168	1,195	1,222	1,250	1,278	1,306
800	1,025	1,052	1,078	1,105	1,133	1,160	1,188	1,217	1,246	1,274	1,304	1,333	1,363	1,393
850	1,089	1,117	1,146	1,174	1,204	1,233	1,263	1,293	1,323	1,354	1,385	1,417	1,448	1,480
900	1,154	1,183	1,213	1,244	1,274	1,306	1,337	1,369	1,401	1,434	1,467	1,500	1,534	1,567
950	1,218	1,249	1,281	1,313	1,345	1,378	1,411	1,445	1,479	1,513	1,548	1,583	1,619	1,655
1000	1,282	1,315	1,348	1,382	1,416	1,451	1,486	1,521	1,557	1,593	1,630	1,667	1,704	1,742

Mortgage rate projections (historic rates are special rates; projections based on ANZ's wholesale rate forecasts)

	Actual			Projections						
Interest rates	Dec-21	Mar-22	Mar-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Floating Mortgage Rate	4.9	5.1	5.9	6.9	8.0	8.1	8.1	8.1	8.1	8.1
1-Yr Fixed Mortgage Rate	3.6	3.9	5.1	5.5	5.6	5.6	5.6	5.5	5.4	5.3
2-Yr Fixed Mortgage Rate	4.3	4.5	5.6	5.6	5.8	5.6	5.5	5.4	5.4	5.3
5-Yr Fixed Mortgage Rate	4.9	5.1	6.3	6.8	6.4	6.2	6.1	6.0	6.0	5.9

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
GDP (Annual % Chg)	-0.2	3.1	1.2	0.3	4.8	2.7	3.4	2.0	1.7	1.0
CPI Inflation (Annual % Chg)	4.9	5.9	6.9	7.3(a)	7.0	6.4	5.3	4.4	3.3	2.8
Unemployment Rate (%)	3.3	3.2	3.2	2.9	2.9	2.9	3.0	3.2	3.3	3.4
House Prices (Quarter % Chg)	5.3	3.7	-2.3	-2.9	-3.2	-3.5	-2.5	-1.0	0.1	0.2
House Prices (Annual % Chg)	30.4	26.2	14.1	3.6	-4.7	-11.3	-11.4	-9.7	-6.6	-3.1

Interest rates	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Cash Rate	0.75	1.00	2.00	3.00	4.00	4.00	4.00	4.00	4.00	4.00
90-Day Bank Bill Rate	0.97	1.61	2.86	3.93	4.10	4.10	4.10	4.10	4.10	4.10
10-Year Bond	2.39	3.22	3.86	4.25	4.00	4.00	3.75	3.75	3.75	3.75

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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