ANZ Research

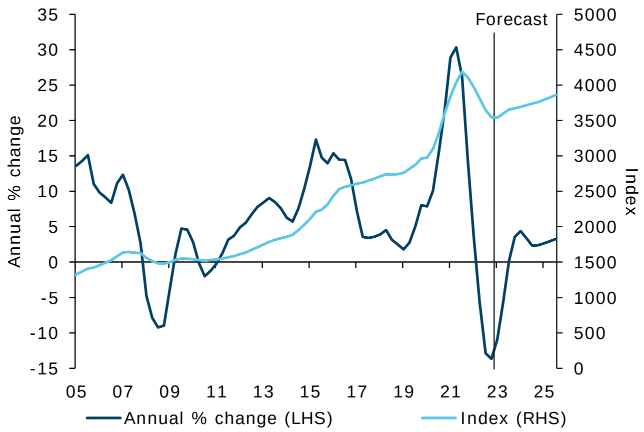
May 2023

New Zealand Property Focus

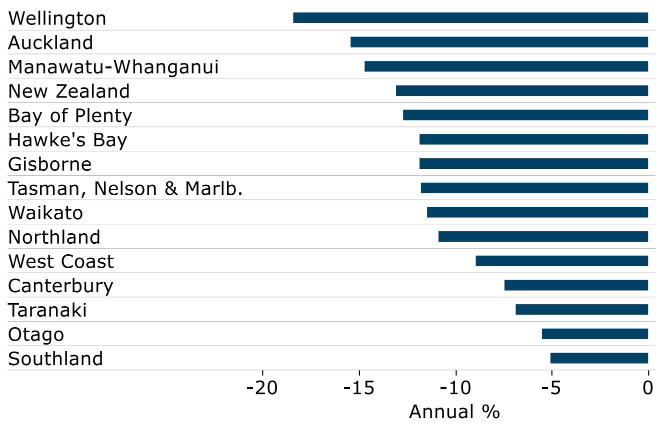
On the floor, ready to floor it?

At a glance

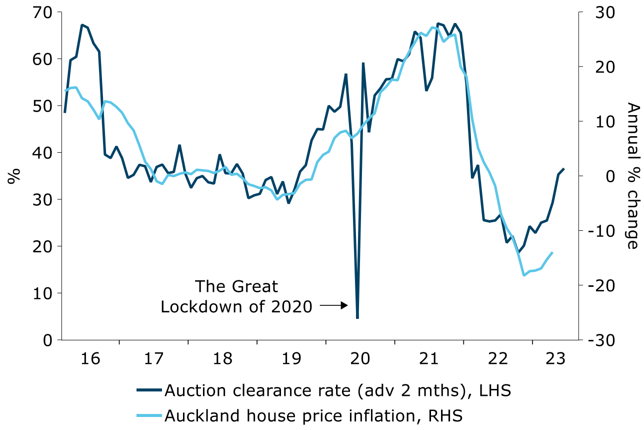
We've revised up our house price forecast: the floor is here...



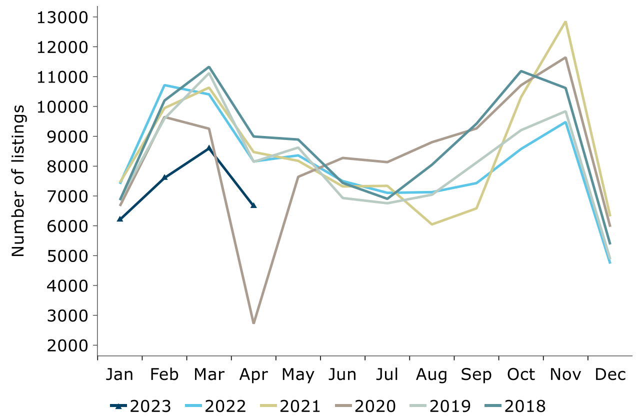
...but that doesn't mean prices will stop falling in every region. Some "catch-down" is expected.



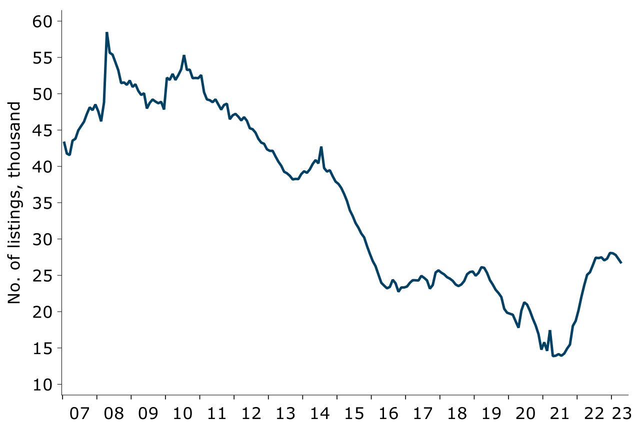
The Auckland pulse has turned...



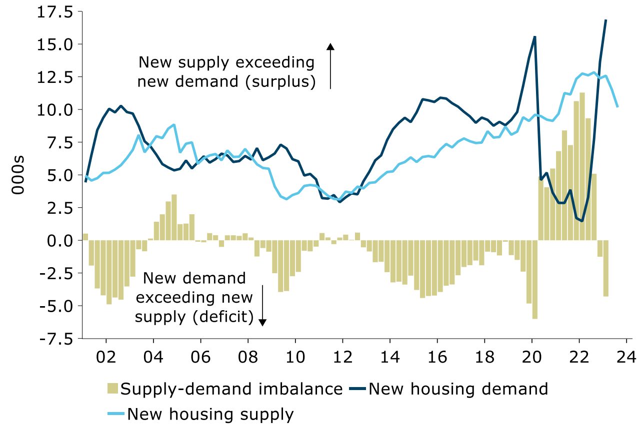
...as weak new listings across NZ...



...are pushing inventories back into a downwards trajectory.



Meanwhile, NZ once again has a widening housing deficit



Source: REINZ, Stats NZ, Barfoot & Thompson, realestate.co.nz, Macrobond, ANZ Research

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Summary

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

Property Focus

The RBNZ's relatively muted response to surging net migration and additional fiscal stimulus in the May MPS surprised us. Ultimately, for a time at least, this implies looser monetary conditions than we have been expecting. This, combined with surging net migration and the confirmed loosening in LVR restrictions from 1 June, has led us to upgrade our house price forecast. We now expect quarterly house price inflation to return to around its historical average pace over the second half of 2023 before sticky inflation (and its implications for the OCR outlook) puts renewed upwards pressure on mortgage rates. Net migration is a huge wild card for the outlook currently. The recent explosive pace alongside slowing construction activity is resulting in a rapidly widening housing deficit, adding pressure to house prices. In short, housing tailwinds now appear to be blowing a little stronger than the headwinds. But we're not convinced the RBNZ will be able to let that run. We expect the RBNZ will need to tighten monetary conditions later in the year once all has been revealed in the data. See the Property Focus section.

Mortgage borrowing strategy

Floating and shorter-term fixed rates have generally risen over the past month, but longer-term fixed rates are lower on average, with a marked reduction seen in the average 3-year rate as competitive pressures shift to that point on the curve. But it's not just competitive pressures at play; the inverted slope of the wholesale swap curve is also having an impact. Over three-quarters of a percentage point separate wholesale 1 and 3-year rates as markets bet that the RBNZ won't hike again. Fixing for 3 years is cheaper than fixing for a shorter period, and breakevens analysis shows that mortgage rates need to fall for it to work out cheaper to fix for 1-2 years, compared to 3 years. By contrast, the RBNZ's projections are signalling no change in rates for the next year or so. We are even more cautious, and still expect one more OCR hike. See our Mortgage Borrowing Strategy.

Property Focus

Summary

The RBNZ's relatively muted response to surging net migration and additional fiscal stimulus in the May MPS surprised us. Ultimately, for a time at least, this implies looser monetary conditions than we have been expecting. This, combined with surging net migration and the confirmed loosening in LVR restrictions from 1 June, has led us to upgrade our house price forecast. We now expect quarterly house price inflation to return to around its historical average pace over the second half of 2023 before sticky inflation (and its implications for the OCR outlook) puts renewed upwards pressure on mortgage rates. Net migration is a huge wild card for the outlook currently. The recent explosive pace alongside slowing construction activity is resulting in a rapidly widening housing deficit, adding pressure to house prices. In short, housing tailwinds now appear to be blowing a little stronger than the headwinds. But we're not convinced the RBNZ will be able to let that run. We expect the RBNZ will need to tighten monetary conditions later in the year once all has been revealed in the data.

RBNZ takes the pressure off...

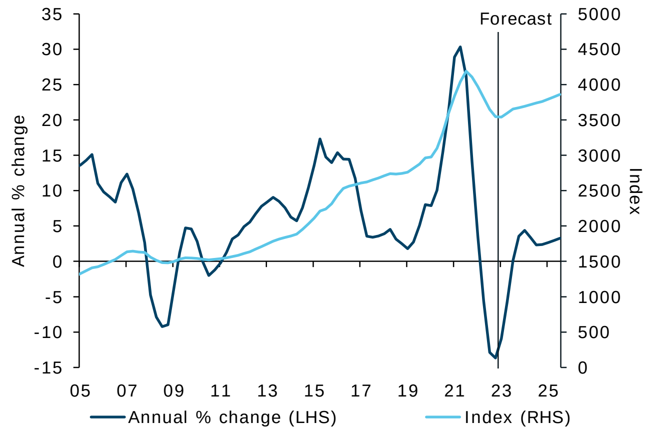
The RBNZ's May MPS was surprisingly dovish given the degree of fiscal stimulus earmarked for the year to June 2024 (see our Budget 2023 Review for more). The RBNZ's latest outlook includes a sizable offset between lower private sector investment (including residential investment) and higher government spending, and with the unemployment rate this low, it's hard to argue with that – the Government will struggle to get stuff done in the very near term without cannibalising private sector activity. But the typical transmission mechanism for this to happen without putting further upwards pressure on inflation is a higher-than-otherwise OCR. The RBNZ didn't signal this in the May MPS.

Our view is that come November, the RBNZ will need to respond to a stickier inflation impulse than they currently foresee (we've pencilled in a 25bp hike for November), but in the meantime, the May MPS has signalled the RBNZ won't take the OCR any higher than it is currently. And that could actually see fixed mortgage rates fall from here (assuming other bank funding costs and spreads remain constant).

Pressure already appears to be easing on some fixed mortgage rates (see our Borrowers Strategy for more). Combine that with net migration inflows continuing to surge and LVR restrictions easing from 1 June (see last month's Property Focus for further discussion), and it looks like housing tailwinds are now blowing stronger than headwinds. Accordingly, we think the housing market has found a floor.

We now see house prices lifting on a quarterly basis from here, with a relatively sharp turn in the very near term (up 1.6% q/q in both Q3 and Q4, which is around the historical average pace). Thereafter, we see quarterly growth in house prices slowing, with net migration inflows assumed to retrace as pent-up demand dwindles, and as sticky CPI inflation keeps upwards pressure on the OCR and wholesale rates (ie we think the RBNZ is likely going to need to make a more-hawkish pivot by November).

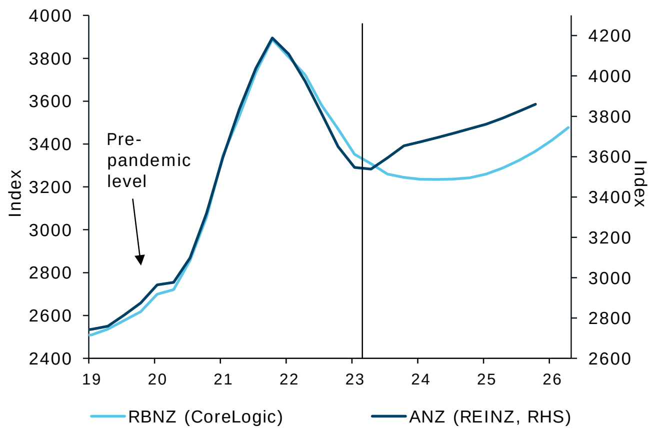
Figure 1. House price forecast



Source: REINZ, ANZ Research

Compared to the RBNZ's latest house price forecast (figure 2), ours is on the rosy side.

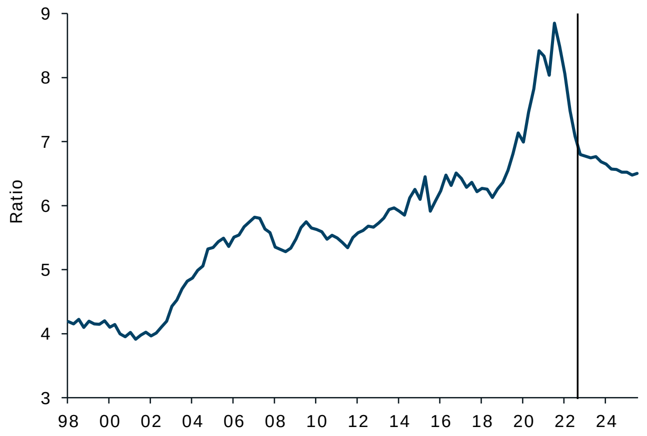
Figure 2. House price forecast vs the RBNZ



Source: RBNZ, REINZ, ANZ Research

From this starting point (house prices in April were still 22% above their pre-pandemic level), our updated forecast might seem incredibly rosy. But after accounting for nominal income growth (which has also been rosy) our house price forecast implies a relatively stable house price to income ratio going forward, with housing getting marginally more 'affordable' from here, but still ending our forecast (to December 2025) in elevated territory historically.

Figure 3. House price to income



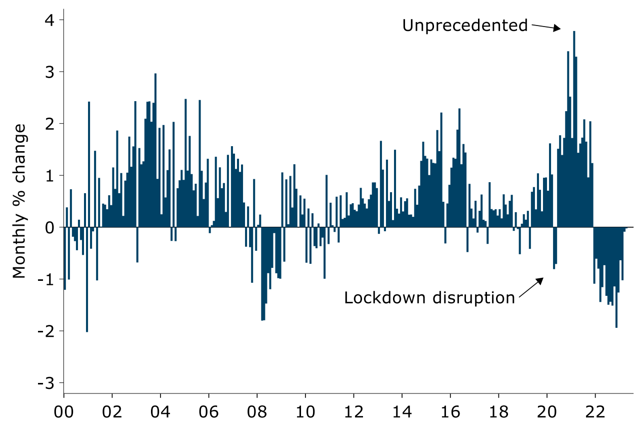
Source: REINZ, ANZ Research

...as the housing pulse beats a little faster

Recent housing data (on balance) certainly corroborate our updated view on house prices.

After making our usual seasonal adjustment, the REINZ House Price Index (HPI) was unchanged in April at the national level – that's the first month since December 2021 where the monthly change wasn't negative (figure 4). As at April, the HPI was 16% below its November 2021 peak.

Figure 4. House price index

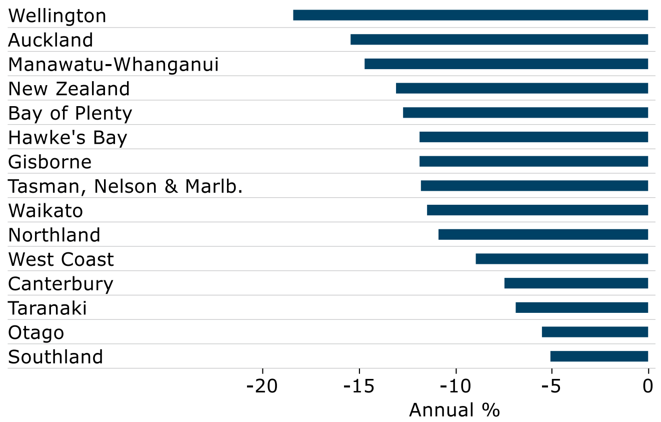


Source: REINZ, Macrobond, ANZ Research

As figure 5 shows, prices are down on an annual basis in every main region, but there is still significant regional divergence. Wellington is the clear underperformer, with prices down 18.4% y/y on a 3-month moving average basis, and Auckland not far behind at -15.4% y/y. Southland is the outperformer, with prices down 5.1% y/y. As we discussed a few months back, regional divergence can be largely explained by the following:

- The post-COVID run-up in prices (ie regions that saw larger price increases over 2020/21 have generally seen larger corrections)
- Timing (some regions saw aggressive price increases a little later than others, and therefore peaked a little later).
- Population growth. The data isn't timely by any means, but regional variances in population growth (as people move between regions) also tend to generally line up with price outcomes.

Figure 5. House price index

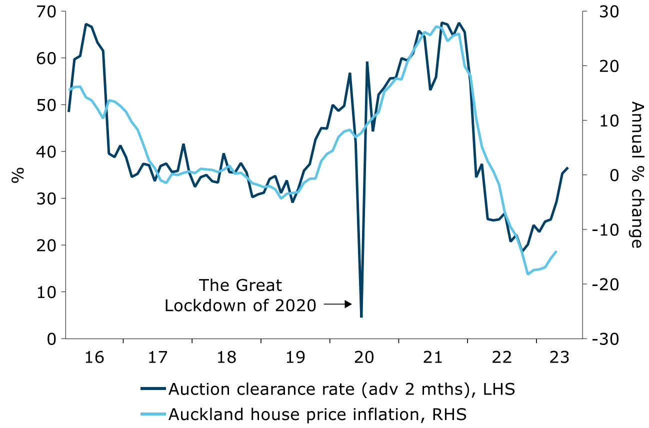


Source: REINZ, Macrobond, ANZ Research

Regional divergence isn't anything new, but what it does suggest is that a turning point in "the" housing cycle (as we are now currently predicting), will be felt across regions quite differently. For example, a significant net migration surge into Auckland, combined with the starting point for the Auckland market, suggests the turn in prices there could be much stronger than, say, in Southland, where some price 'catch-down' may yet be on the cards for a few months yet.

Auction clearance rates in Auckland certainly suggest this market is coming back to life quickly, and even suggests some upside risk to our forecast.

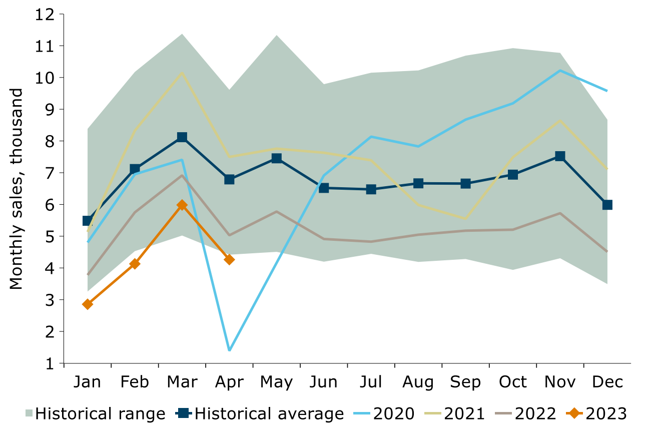
Figure 6. Auction clearance rates and house price inflation



Source: REINZ, Barfoot & Thompson, Macrobond, ANZ Research

However, a more pessimistic signal is the fact that sales, which provide around a three-month lead on prices, remain very weak. Sales posted their second-weakest read ever in April – beaten only by the Great Lockdown of 2022. The market isn't exactly 'steamy'.

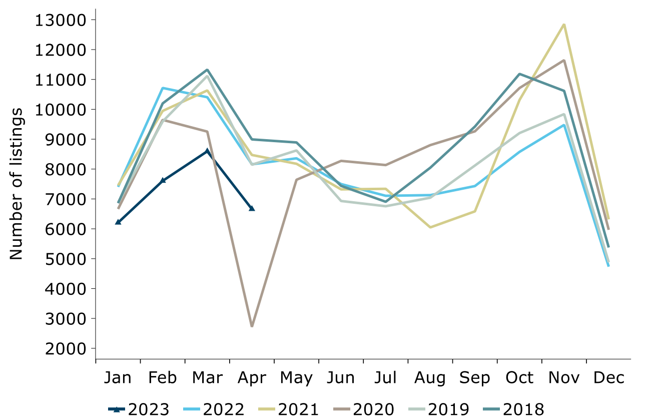
Figure 7. Monthly sales relative to history



Source: REINZ, Macrobond, ANZ Research

But while sales are low, new listings are also very weak (figure 8), and that's helping to keep the market relatively tight. Low levels of new listings also suggest that households and investors aren't being forced (at least *en masse*) to sell up because of rate rises. If unemployment were to rise sharply, that would be a different story.

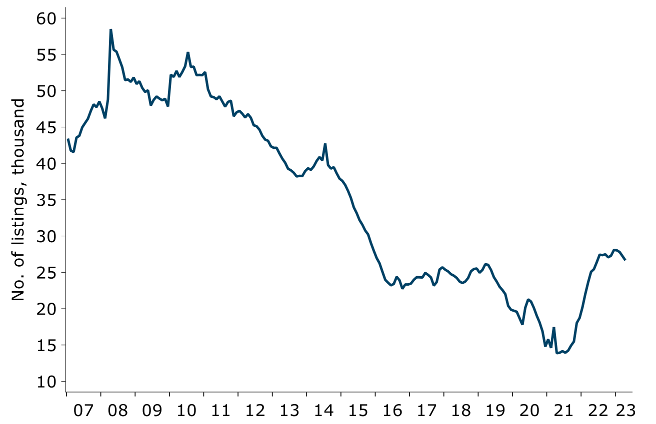
Figure 8. New housing and apartment listings



Source: REINZ, Macrobond, ANZ Research

Putting it all together, we are seeing a tentative tightening in the market, with the number of properties available for sale off recent highs. It's certainly not in 'shoot for the moon' territory, but we're watching the trajectory closely (figure 9).

Figure 9. Properties available for sale



Source: REINZ, Macrobond, ANZ Research

Policy changes will matter too. The LVR changes could provide a near-term shot in the arm, but even more important is the future of the deductibility of interest payments on investment properties when calculating expenses for tax purposes. It's uncertain whether the risk in practice is that the non-deductibility policy staying will cause a flurry of sales, or whether the policy going will cause a rush of purchases. But either way it's potentially a big driver of the market this year.

But there's a more fundamental supply and demand story than the question of what's going on in the market for existing houses. New supply vs new demand (aka 'the fundamentals') also appear to be changing rapidly.

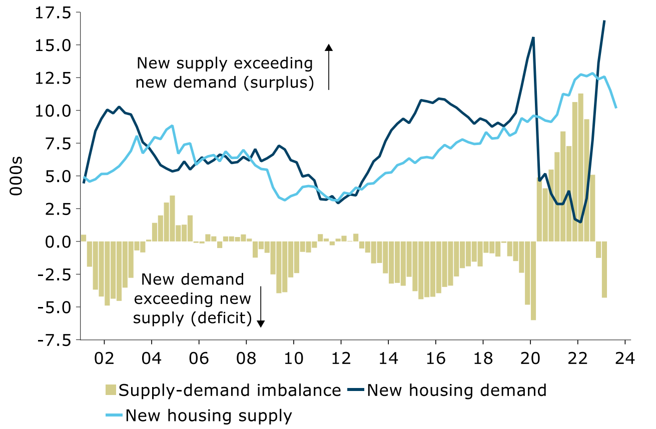
New Zealand has a widening housing deficit

With net migration surging to new highs and the residential construction sector slowing on the back of rising interest rates, new demand for housing is now significantly outstripping new supply. In other words, New Zealand has a widening housing deficit.

By our estimates New Zealand's 'housing deficit' had largely been eroded by the third quarter of 2022. That is, based on our assumptions around people per dwelling and depreciation of the housing stock, New Zealand – for the first time in a long time – had roughly enough houses for its population (albeit not always in the right places, with some regions like Tauranga and Queenstown still well short).

However, new demand for housing outstripped new supply in both Q4 2022 and Q1 2023. Together, over these two quarters alone, the shortfall between new housing supply and demand has come in at around 5,500k dwellings, taking the net migration numbers at face value. And with net migration showing no signs of letting up yet (though we assume it will soon), that deficit is likely to keep widening for a while.

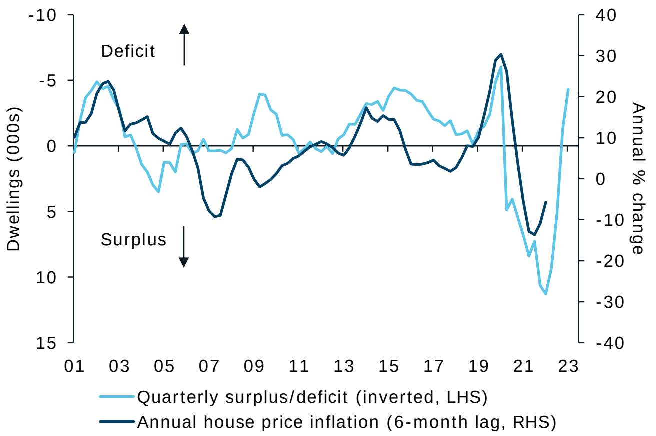
Figure 10. New housing demand vs new supply



Source: Stats NZ, Macrobond, ANZ Research

Plotting the quarterly new supply and demand balance against house price inflation (figure 11) certainly suggests house prices could turn quite quickly from here, especially if we also see a slowing fixed mortgage rate headwind. However, it's important to note that mortgage rates are still a lot higher than before (even if some fixed rates do drift lower) and that affordability (both in terms of serviceability and the price level relative to incomes) is hardly at a level that screams 'bargain'. That is, affordability constraints should prevent the market from really taking off.

Figure 11. New housing demand vs new supply



Source: Stats NZ, REINZ, ANZ Research

Net migration is a wild card and is notoriously difficult to forecast. But its influence on economic outcomes can be quite meaningful. Our forecast is for net migration to ease from recent extremely high levels. Clearly, persistently strong net inflows would present upside risks to our housing outlook. April net migration figures are out on 13 June, and with that data in tow, we're hoping to investigate migration impacts on housing a little further in next month's edition.

All up, we may be calling this a floor for house prices, but the outlook is no more certain than previously. A sharp deterioration in household incomes for example (ie if monetary tightening has sharper teeth than we expect) is a big downside risk that could lead to a sharp rise in forced sales. But there are upside risks too (eg migration). Then there's the upcoming election, which adds significant uncertainty around housing policy (interest deductibility being a big one), not to mention the potential implementation of DTI restrictions by the RBNZ from early 2024 (if the RBNZ deems that necessary). Our forecast strikes a balance through all these risks (assuming the status quo for housing policy), but the middle ground between potentially extreme scenarios doesn't always turn out to be a good forecast. Time will tell.

Housing market indicators for April 2023 (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	$672,866	-9.4	-5.0	-10.9	-3.8	131	+9%	73
Auckland	$991,451	-14.9	-1.2	-13.9	-2.2	1,492	+11%	45
Waikato	$738,025	-12.7	-2.4	-11.6	-2.4	465	0%	57
Bay of Plenty	$829,598	-8.0	-1.5	-12.7	-1.8	334	+6%	60
Gisborne	$632,095	-6.0	-5.8	-12.1	-1.5	36	+5%	48
Hawke's Bay	$737,751	-2.7	2.4	-12.1	-1.5	186	+19%	52
Manawatu-Whanganui	$560,705	-4.0	-2.1	-15.3	-3.7	245	+2%	47
Taranaki	$576,374	-8.8	-5.3	-6.8	-2.4	124	+6%	48
Wellington	$776,351	-14.6	-3.8	-16.3	-2.5	493	+6%	52
Tasman, Nelson & Marlborough	$680,170	-14.7	-0.8			171	+2%	58
Canterbury	$664,488	-3.0	1.4	-6.2	-1.2	785	+6%	39
Otago	$667,446	2.9	0.0	-3.3	0.0	326	+9%	50
West Coast	$377,263	7.7	-3.7	-9.1	-2.6	36	+16%	76
Southland	$424,024	-6.5	-0.6	-4.0	-1.8	126	+21%	48
New Zealand	**$772,580**	**-10.8**	**-1.5**	**-11.9**	**-1.9**	**4,903**	**+7%**	**49**

Mortgage borrowing strategy

This is not financial advice about any product or service. The opinions and research contained in this document are provided for information only, are intended to be general in nature and do not take into account your financial situation or goals. Please refer to the Important Notice.

Summary

Floating and shorter-term fixed rates have generally risen over the past month, but longer-term fixed rates are lower on average, with a marked reduction seen in the average 3-year rate as competitive pressures shift to that point on the curve. But it's not just competitive pressures at play; the inverted slope of the wholesale swap curve is also having an impact. Over three-quarters of a percentage point separate wholesale 1 and 3-year rates as markets bet that the RBNZ won't hike again. Fixing for 3 years is cheaper than fixing for a shorter period, and breakevens analysis shows that mortgage rates need to fall for it to work out cheaper to fix for 1-2 years, compared to 3 years. By contrast, the RBNZ's projections are signalling no change in rates for the next year or so. We are even more cautious, and still expect one more OCR hike.

Mortgage rates have again moved in both directions over the past month, with floating, 6-month and 1-year rates all higher, and longer-term rates generally lower. As was the case last month, the lowest point on the curve is the 3-year, continuing the trend seen this year where the cheapest rate on the curve has gotten longer. This not only reflects competitive pressures, but also the fact that wholesale 3-year rates are so much lower than comparable 6-month and 1-year rates, making it easier for banks to offer more attractive rates there.

Although the cheapest mortgage rate isn't much higher than the OCR, accessing it means fixing for longer. While that provides more certainty (which borrowers may value, given how rapidly rates have risen over the past two years), financial considerations are important too. It thus always pays to crunch the numbers and compare the alternatives.

Breakeven analysis is a useful tool in that context. As our table below shows, fixing for a shorter term now (and then rolling into a new rate when that term ends) is only likely to be cheaper in the end if mortgage rates fall. That may well happen – after all, we have already seen some rates fall this year. But as table 1 shows, they'd need to fall by quite a bit. Let's say, for example, that you are considering fixing for 1 year at 6.77% or 2 years at 6.51%. The latter will end up being cheaper over a 2-year horizon if the 1-year rate falls by 0.53% (from 6.77% to 6.24%) over the next year, but more expensive if rates don't fall that far. Similarly, the 1-year rate would need to fall a further 0.83% (from 6.24% to 5.41%) for it to be cheaper to fix for a string of three back-to-back 1-year terms compared to fixing today for 3 years at 6.14%.

As we noted earlier, rates could fall, but if they don't, fixing for a shorter period is likely to cost more. And betting on lower rates would be in opposition to the RBNZ's projections that signal no change in policy for another year or so, and our own expectation that more hikes may be needed.

Mortgage margins have narrowed over the past year or so as credit growth has slowed and competition among banks for the smaller lending pie has intensified. That has helped slow the rise in mortgage rates as wholesale rates have risen. Indeed, although the OCR has risen by 5.25%pts since 2021, the cheapest mortgage rate has risen only about 3.93%pts. That's not all margin compression – some of it reflects the inverted wholesale curve – but with margins already at the tight end of ranges, mortgage rates may be more sensitive to wholesale rates going forward.

And on that score, while we are comfortable that most of the rise in wholesale interest rates this cycle is behind us, we think it is too soon to expect rates to fall in any meaningful way. All of this is incorporated in our mortgage rate projections, which imply a tad more upside followed by modest falls. But not only are the falls in our projections less than what's implied by our breakeven tables; they are also conditional on inflation falling, rather than re-accelerating, and an assumption that margins remain broadly steady.

As always, given the uncertainty, borrowers may want to consider dividing their mortgage into chunks, lessening the potential for regret down the track.

Figure 1. Carded special mortgage rates^

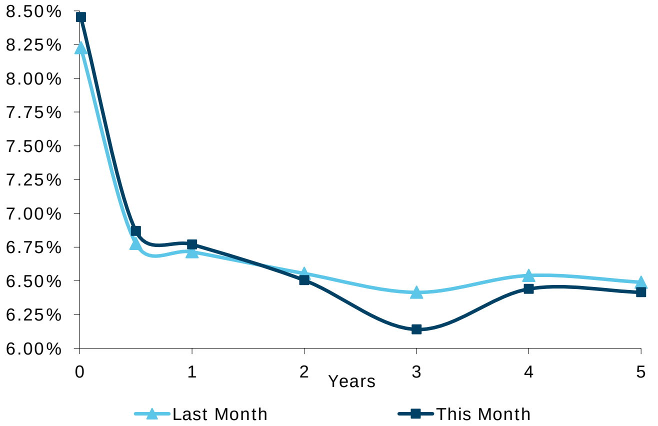


Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	8.45%				
6 months	6.87%	6.67%	6.50%	5.98%	5.59%
1 year	6.77%	6.59%	6.24%	5.79%	5.41%
2 years	6.51%	6.19%	5.83%	6.00%	6.38%
3 years	6.14%	6.19%	6.33%	6.30%	6.36%
4 years	6.44%	6.37%	6.33%		
5 years	6.42%	#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 30-year term)

Mortgage Size ($000)	Mortgage Rate (%)													
	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00	8.25	8.50	8.75
200	262	269	277	284	292	299	307	315	323	330	338	347	355	363
250	327	336	346	355	364	374	384	393	403	413	423	433	443	454
300	393	404	415	426	437	449	460	472	484	496	508	520	532	544
350	458	471	484	497	510	524	537	551	564	578	592	606	621	635
400	524	538	553	568	583	598	614	629	645	661	677	693	709	726
450	589	606	622	639	656	673	690	708	726	744	762	780	798	816
500	655	673	691	710	729	748	767	787	806	826	846	866	887	907
550	720	740	760	781	802	823	844	865	887	909	931	953	975	998
600	786	807	830	852	875	897	921	944	968	991	1,015	1,040	1,064	1,089
650	851	875	899	923	947	972	997	1,023	1,048	1,074	1,100	1,126	1,153	1,179
700	917	942	968	994	1,020	1,047	1,074	1,101	1,129	1,157	1,185	1,213	1,241	1,270
750	982	1,009	1,037	1,065	1,093	1,122	1,151	1,180	1,209	1,239	1,269	1,299	1,330	1,361
800	1,048	1,077	1,106	1,136	1,166	1,197	1,227	1,259	1,290	1,322	1,354	1,386	1,419	1,452
850	1,113	1,144	1,175	1,207	1,239	1,271	1,304	1,337	1,371	1,404	1,438	1,473	1,507	1,542
900	1,178	1,211	1,244	1,278	1,312	1,346	1,381	1,416	1,451	1,487	1,523	1,559	1,596	1,633
950	1,244	1,278	1,313	1,349	1,385	1,421	1,458	1,495	1,532	1,570	1,608	1,646	1,685	1,724
1000	1,309	1,346	1,383	1,420	1,458	1,496	1,534	1,573	1,613	1,652	1,692	1,733	1,773	1,814

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

	Actual			Projections						
Interest rates	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Floating Mortgage Rate	6.7	7.8	8.0	8.5	8.5	8.7	8.7	8.7	8.7	8.5
1-Yr Fixed Mortgage Rate	5.2	6.4	6.5	6.8	6.9	6.8	6.7	6.4	6.1	5.8
2-Yr Fixed Mortgage Rate	5.6	6.6	6.5	6.7	6.7	6.5	6.2	6.0	5.7	5.6
5-Yr Fixed Mortgage Rate	6.0	6.8	6.6	6.6	6.5	6.4	6.1	6.1	6.0	6.0

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
GDP (Annual % Chg)	0.4	6.4	2.2	2.9	1.6	-0.4	-0.4	-0.8	-1.0	-0.4
CPI Inflation (Annual % Chg)	7.3	7.2	7.2	6.7(a)	6.1	5.9	5.2	4.7	4.0	2.8
Unemployment Rate (%)	3.3	3.3	3.4	3.4(a)	3.5	4.0	4.4	5.0	5.2	5.3
House Prices (Quarter % Chg)	-3.3	-4.0	-4.3	-2.8(a)	-0.2	1.6	1.6	0.5	0.6	0.6
House Prices (Annual % Chg)	3.6	-5.6	-12.9	-13.7(a)	-10.9	-5.7	0.1	3.6	4.4	3.4

Interest rates	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Cash Rate	3.00	4.25	4.75	5.50	5.50	5.75	5.75	5.75	5.75	5.50
90-Day Bank Bill Rate	3.85	4.65	5.23	5.60	5.77	5.85	5.85	5.85	5.68	5.43
10-Year Bond	4.30	4.47	4.20	4.50	4.40	4.30	4.00	4.00	4.00	4.00

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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