ANZ Research

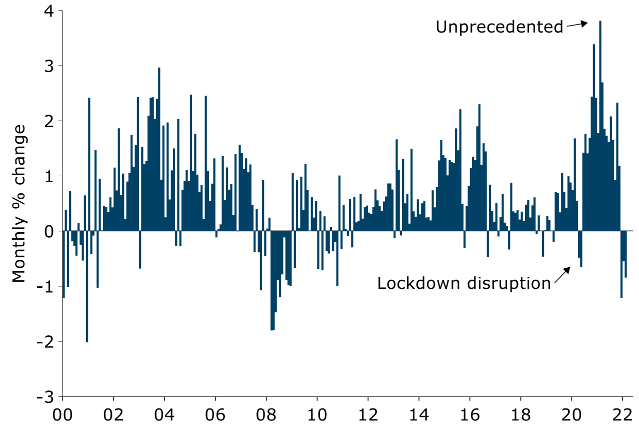
March 2022

New Zealand Property Focus

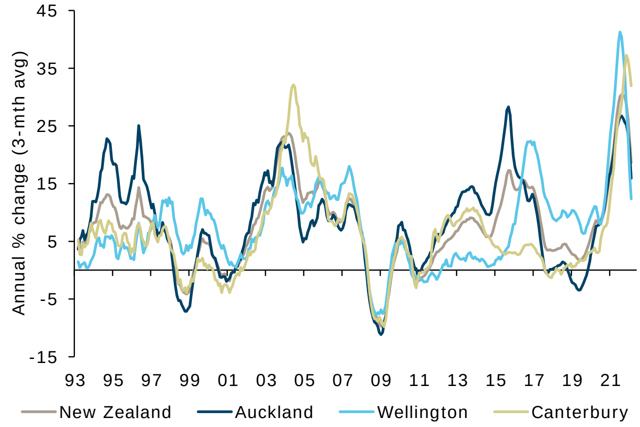
A soft landing as headwinds gather

At a glance

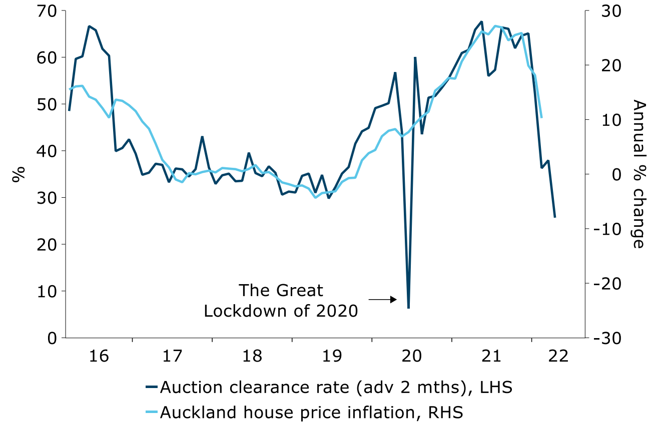
House prices have fallen 2.6% since November 2021



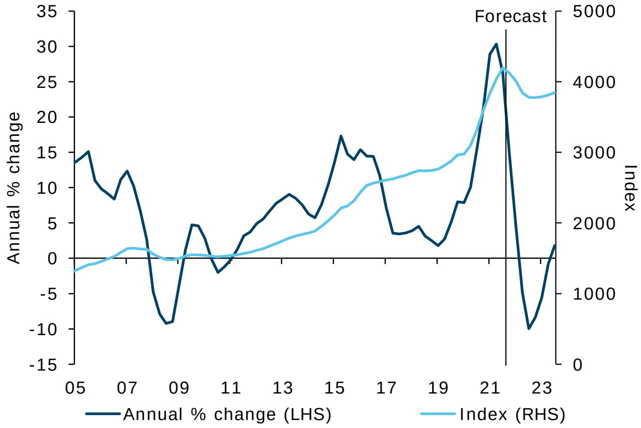
Annual house price inflation is slowing across all regions



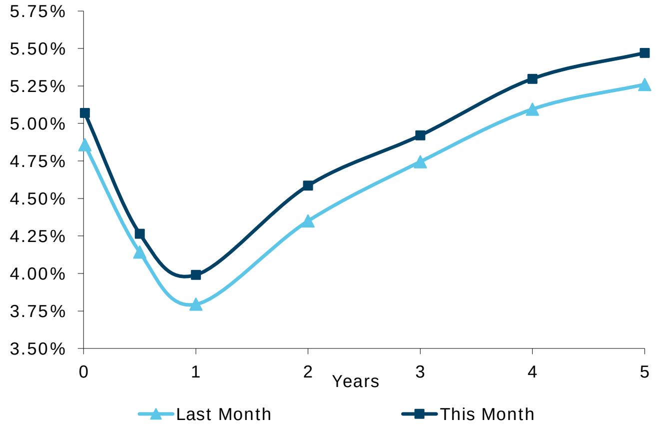
Forward indicators suggest there's more weakness to come



We've pencilled in a 10% fall in the year to December 2022...



...As OCR hikes keep upward pressure on mortgage rates



But forecast uncertainty is high:

How much will extreme CPI inflation and higher interest rates hurt households, and to what extent will the RBNZ have to ignore a softening housing (and demand) impulse as it tries to tame inflation?

Can NZ avoid rising unemployment as the economy slows?

What about animal spirits, as "fear of missing out" makes way for "I'm not paying that"?

We see risks on both sides of our forecast.

Source: RBNZ, REINZ, Stats NZ, Barfoot & Thompson, interest.co.nz, Macrobond, Bloomberg, ICAP, ANZ Research

Contact

Sharon Zollner, Miles Workman, or David Croy for more details.

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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

Recent housing data have come in broadly in line with our expectation. Looking forward, our call change for more aggressive OCR hikes and a higher OCR peak have translated into an even softer outlook for housing. We now expect house prices to fall 10% in the year to December (previous: -7%). With CPI inflation intensifying, it's our forecast that the RBNZ will continue lifting interest rates even as economic momentum (and housing) fade. That's a dynamic that may surprise some kiwis, but central banks must defend their inflation targets (and credibility) at all costs. It may not take much for our expectation for a relatively soft landing in housing to surprise on the harder side. See our Market Overview.

Mortgage borrowing strategy

Average mortgage rates are up across the board again this month, with the average 1-year rate now knocking on the door of 4% – a rate not seen since April 2019. Back then, the OCR was 1.75%, which is 0.75%pts higher than it is now. However, back then the RBNZ was in the process of cutting the OCR, whereas right now, they are lifting the OCR and are projecting that it will rise to above 3%. It is this expectation of a higher OCR in the months to come that is driving mortgage rates higher. If the OCR reaches 3%, fixed mortgage rates are likely to exceed 5%. While a slowing housing market and global economic uncertainty may temper the need for a higher OCR, we'd caution against counting on that, given inflation trends. We thus think borrowers ought to continue to brace for higher rates. Fixing for longer now still costs more, but that may be preferable to fixing at the lowest rate now, only to roll onto a much higher rate later on. But no strategy is without its risks, given heightened global uncertainty. See our Mortgage Borrowing Strategy.

Housing market overview

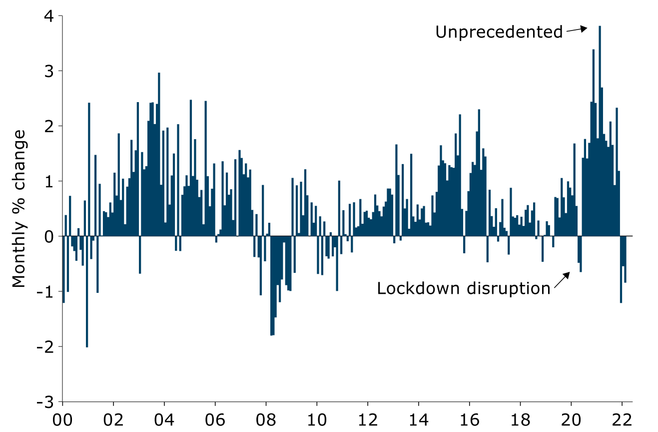
Summary

Recent housing data have come in broadly in line with our expectation. Looking forward, our call change for more aggressive OCR hikes and a higher OCR peak have translated into an even softer outlook for housing. We now expect house prices to fall 10% in the year to December (previous: -7%). With CPI inflation intensifying, it's our forecast that the RBNZ will continue lifting interest rates even as economic momentum (and housing) fade. That's a dynamic that may surprise some kiwis, but central banks must defend their inflation targets (and credibility) at all costs. It may not take much for our expectation for a relatively soft landing in housing to surprise on the harder side.

The slowdown continues…

House prices fell for a third consecutive month in February. That saw the annual pace of house price growth slip another 4.2%pts to a still-elevated 18.7% (3mma). That's around 12% pts slower than the cycle peak (30.4%).

Figure 1. Monthly house price inflation (sa)

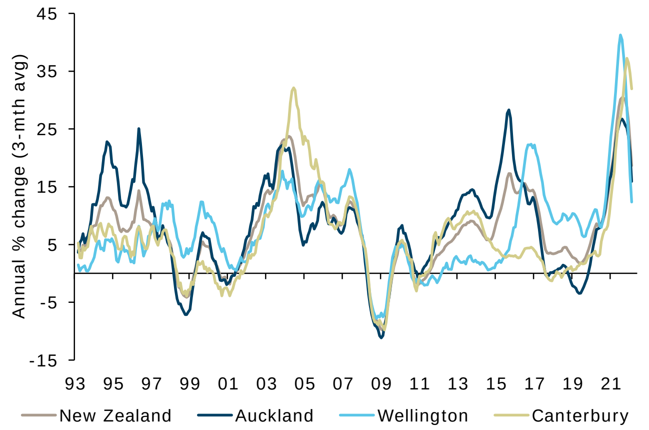


Source: REINZ, Macrobond, ANZ Research

On a month-on-month basis, there's been a bit of volatility in house price moves across regions. However, the broader trend is the same across the whole country: the market has turned. Of the main centres, annual house price inflation in Auckland was running at 15.9% in February (peak: 26.7% in August 2021), Wellington at 12.3% (peak 40.4% in August 2021), and Canterbury at 32.0% (peak: 37.2% in November 2021).

Key indicators of forward momentum suggest there's more slowing to come. The number of days it is taking for houses to sell is lifting, sales are trending lower, and listings are on the rise. Some of it might be Omicron disruption, but we suspect the majority of it represents a fundamental shift in the market.

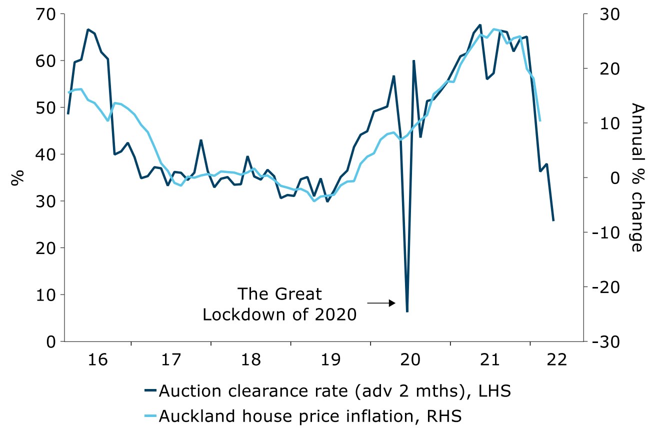
Figure 2. Annual house price inflation



Source: REINZ, ANZ Research

One of the more striking developments this past month was a very sharp drop in auction clearance rates in Auckland. At just under 26% (ANZ seasonal adjustment), this is a low second only to the Great Lockdown of 2020 (in data that starts in 2016). This points to some significant slack opening up in the market, with sellers unable to achieve their asking price on the auction platform.

Figure 3. Auction clearance rates



Source: REINZ, interest.co.nz, Barfoot & Thompson, Macrobond, ANZ Research

…as headwinds keep blowing

At this late stage of the housing cycle, housing headwinds are pretty well understood:

- Mortgage rates are lifting;
- Saving for a deposit has become much harder as the cost of living outpaces income growth;
- The CCCFA has curtailed credit availability for some borrowers. While this legislation has recently been loosened, it remains unclear how much sand has in practice been removed from the gears of mortgage lending – particularly given the housing market is a very different place

to when this legislation was first introduced. LVR settings pose another potential limit on credit availability;

- Other Government policies (such as the removal of interest deductibility for investors) have weighed;
- Affordability constraints are biting; and
- Animal spirits are evolving from FOMO (fear of missing out) to INPT (I'm not paying that).

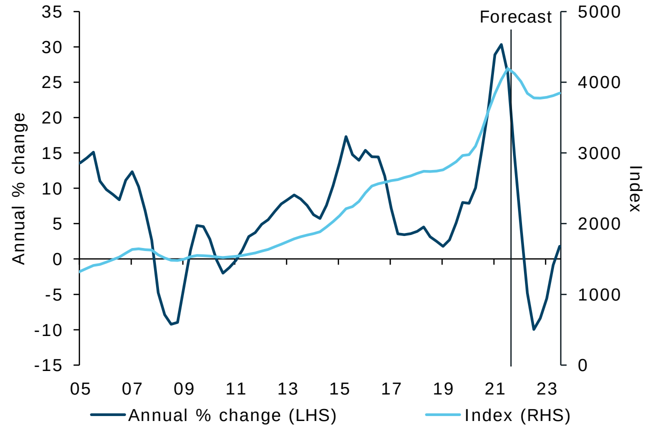
So far, house prices have fallen 2.6% (sa) at the national level since November 2021. And while it's very uncertain just how much further prices might fall, we think there's more weakness to come.

Down 10?

In last month's edition, we were forecasting a 7% decline in house prices in the year to December 2022. However, since then CPI inflation pressures have intensified, and lower excise taxes on petrol will shave only a small amount off the peak (in exchange for elongating it as they are re-imposed). We think multi-decade highs for inflation are going to make the RBNZ pretty worried about their inflation-targeting credibility. Accordingly, we now expect the RBNZ to adopt more aggressive rate hikes, with the OCR to reach a high of 3.5% by April 2023 (previously 3.0%), turbo-charged by a couple of 50 basis point hikes in the near term. All going to plan, that will prevent inflation expectations from becoming unanchored and head off the potential for a damaging wage-price spiral (which would necessitate an even more aggressive monetary policy response later on, if it were to occur).

A higher interest rate outlook means stronger headwinds for the housing market. We now expect house prices to fall 10% in the year to December 2022. That's a similar-sized contraction as the one following the Global Financial Crisis. But given the very strong starting point, we'd still call this a soft landing – something that's quite evident when you look at the implied house price level (figure 4). Indeed, our house price forecast would still leave house prices up a whopping 30% come December 2022 compared to December 2019 (ie pre-pandemic). In that light, our relatively pessimistic forecast seems rather optimistic.

Figure 4. House price forecast



Source: REINZ, ANZ Research

So what's preventing us from forecasting a much greater decline, say 20% or even 30%? The answer is household incomes. We're simply not forecasting a household income (employment) shock that would necessitate the forced sale of properties and exacerbate the downturn. However, it is entirely possible that our outlook regarding household incomes and broader economic momentum is on the optimistic side, and that the path towards taming inflation passes through a more marked economic slowdown than we are forecasting. This is where the RBNZ's inflation-targeting grit may well be tested over the coming year or so.

Relative to the past few business cycles, this time may be a little different for housing market participants. In the past, a waning demand impulse (and softening housing market) was likely enough to halt inflation pressures and for the RBNZ to achieve its targets. But this time inflation has so much strength and persistence that the RBNZ will likely need to continue hiking despite softening housing and demand. That is, if housing market participants think the RBNZ have their back and will act to prevent house prices from falling too much, they may be unpleasantly surprised (if inflation remains well in excess of the 1-3% target band for too long that is). It's all very uncertain, but we think this is a risk well worth outlining.

Housing market overview

Housing market indicators for February 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	$760,482	18.0	7.8	22.6	2.8	180	+11%	43
Auckland	$1,203,031	8.3	1.6	10.3	-0.8	2,023	-4%	43
Waikato	$840,558	17.6	4.6	21.3	0.7	579	+1%	35
Bay of Plenty	$938,799	12.8	4.8	17.5	1.7	406	+10%	38
Gisborne	$685,331	21.0	7.8	13.5	-0.2	41	-5%	38
Hawke's Bay	$810,526	19.0	-0.8	13.5	-0.2	170	-8%	48
Manawatu-Whanganui	$612,775	12.9	-0.5	14.5	0.9	217	-21%	46
Taranaki	$652,391	27.4	5.2	20.3	3.2	113	-23%	32
Wellington	$941,494	10.4	3.0	7.3	-1.9	488	-22%	47
Tasman, Nelson & Marlborough	$791,147	16.7	2.6			181	-1%	33
Canterbury	$704,089	28.5	3.1	29.5	3.6	875	+14%	29
Otago	$794,598	24.0	4.0	15.2	0.2	311	-3%	38
West Coast	$345,603	17.5	13.4	16.3	1.2	34	+12%	36
Southland	$490,869	24.6	5.5	14.3	2.0	143	+1%	36
New Zealand	**$897,504**	**13.4**	**4.4**	**14.2**	**-0.3**	**5,765**	**-3%**	**37**

Mortgage borrowing strategy

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Summary

Average mortgage rates are up across the board again this month, with the average 1-year rate now knocking on the door of 4% – a rate not seen since April 2019. Back then, the OCR was 1.75%, which is 0.75%pts higher than it is now. However, back then the RBNZ was in the process of cutting the OCR, whereas right now, they are lifting the OCR and are projecting that it will rise to above 3%. It is this expectation of a higher OCR in the months to come that is driving mortgage rates higher. If the OCR reaches 3%, fixed mortgage rates are likely to exceed 5%. While a slowing housing market and global economic uncertainty may temper the need for a higher OCR, we'd caution against counting on that, given inflation trends. We thus think borrowers ought to continue to brace for higher rates. Fixing for longer now still costs more, but that may be preferable to fixing at the lowest rate now, only to roll onto a much higher rate later on. But no strategy is without its risks, given heightened global uncertainty.

Our view

Average fixed mortgage rates quoted by the big-four banks continue to rise, with increases of between 0.17 and 0.25%pts seen over the past month. The cheapest rate (the 1-year) is now 3.99%, having been as low as 1.99% at the height of the COVID crisis.

As has been the case throughout the crisis (and as we come out of the other side of it), the one observable aspect of the term structure of mortgage rates is that it has generally cost more to fix for longer (if we exclude floating and 6-month terms, which have had less appeal in a rising interest rate environment, given the tendency of the 1-year rate to be lower). As such, choosing a term has not been easy for some time. Had there been a realistic chance that mortgage rates might fall, for example, fixing for a shorter time would not just cost less now, but cost less in the long run too.

However, ahead of what we forecast to be rising wholesale interest rates for some time yet, what most borrowers face is a choice between moderately higher costs now, or a mixture of lower costs now but possibly much higher costs later. Ultimately, what borrowers choose is likely to be guided by one's appetite for risk and/or desire for certainty.

As we get further along the rate-rise cycle (which will ultimately be driven by the outlook for inflation), it is worth asking; is this the "top" in terms of where mortgage rates go? Given our expectation that the RBNZ will lift the OCR by a further 1% by June, and our expectation that global rates continue to rise, we don't think it is. But that's not guaranteed – a slowing housing market (or global economy) could, for instance, lessen the need for OCR hikes. But we wouldn't bank on that, given the inflationary backdrop.

At this juncture, going through some simple budget analysis is likely to be useful for borrowers who are worried about affordability. As an example, if you can comfortably afford 4.59%, but feel like you might need to make harder choices if your mortgage rate exceeded 5%, you might prefer a 2 or 3-year term over the cheaper 1-year, given that the OCR could be at 3% when it's time to re-fix in a year's time, by which time fixed mortgage rates may all be back above 5%.

Adding breakeven analysis to the mix could also help, as it gives you something to compare future expectations with. Let's consider, for example, the choice between a 3.99% 1-year fixed rate or a 4.59% 2-year rate. Over a 2-year horizon, back-to-back 1-year fixes will end up being cheaper if the 1-year rate is below 5.18% in a year. If you think mortgage rates will keep rising, and share our (and the RBNZ's) view that the OCR is headed to above 3%, you might see 5.18% as very possible, in which case you may prefer to opt for the added certainty of a 2-year rate. That'd cost more now, but it may work out cheaper in the long run. But there are no guarantees, and borrowers need to be comfortable with the choices they make.

Figure 1. Carded special mortgage rates^

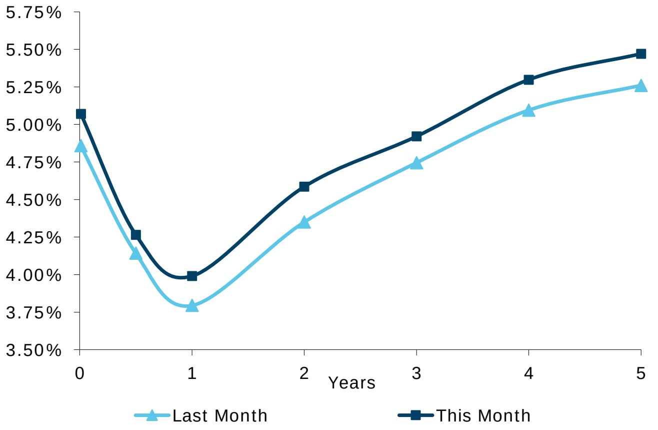

Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.07%				
6 months	4.27%	3.72%	5.23%	5.13%	5.42%
1 year	3.99%	4.47%	5.18%	5.28%	5.59%
2 years	4.59%	4.87%	5.39%	5.64%	6.01%
3 years	4.92%	5.25%	5.73%	5.87%	6.06%
4 years	5.30%	5.52%	5.84%		
5 years	5.47%	#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 (%)													
	2.75	3.00	3.25	3.50	3.75	4.00	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00
200	213	219	225	231	237	243	250	256	263	270	276	283	290	297
250	266	273	281	289	296	304	312	320	329	337	345	354	363	371
300	319	328	337	346	356	365	375	385	394	404	415	425	435	446
350	372	383	393	404	415	426	437	449	460	472	484	496	508	520
400	426	437	450	462	474	487	500	513	526	539	553	566	580	594
450	479	492	506	520	534	548	562	577	592	607	622	637	653	669
500	532	547	562	577	593	609	625	641	657	674	691	708	725	743
550	585	601	618	635	652	669	687	705	723	741	760	779	798	817
600	638	656	674	693	711	730	750	769	789	809	829	850	870	891
650	692	711	730	750	771	791	812	833	854	876	898	920	943	966
700	745	766	787	808	830	852	874	897	920	944	967	991	1,015	1,040
750	798	820	843	866	889	913	937	961	986	1,011	1,036	1,062	1,088	1,114
800	851	875	899	924	948	974	999	1,025	1,052	1,078	1,105	1,133	1,160	1,188
850	904	930	955	981	1,008	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233	1,263
900	958	984	1,011	1,039	1,067	1,095	1,124	1,154	1,183	1,213	1,244	1,274	1,306	1,337
950	1,011	1,039	1,068	1,097	1,126	1,156	1,187	1,218	1,249	1,281	1,313	1,345	1,378	1,411
1000	1,064	1,094	1,124	1,154	1,186	1,217	1,249	1,282	1,315	1,348	1,382	1,416	1,451	1,486

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

	Actual			Projections						
Interest rates	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23
Floating Mortgage Rate	4.5	4.5	4.9	5.1	6.1	6.7	7.2	7.4	7.7	7.7
1-Yr Fixed Mortgage Rate	2.2	2.7	3.6	4.0	4.8	5.2	5.3	5.3	5.3	5.3
2-Yr Fixed Mortgage Rate	2.6	3.1	4.3	4.6	5.1	5.4	5.4	5.4	5.4	5.4
5-Yr Fixed Mortgage Rate	3.6	4.0	4.9	5.5	5.6	5.7	5.9	5.9	6.1	6.1

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23
GDP (Annual % Chg)	17.9	-0.2	3.1	2.3	0.0	4.1	1.8	2.1	2.3	2.4
CPI Inflation (Annual % Chg)	3.3	4.9	5.9	7.1	7.4	6.4	5.7	4.5	3.4	2.9
Unemployment Rate (%)	4.0	3.3	3.2	3.1	3.0	2.9	2.9	2.9	3.0	3.0
House Prices (Quarter % Chg)	6.7	5.2	3.9	-1.8	-2.7	-4.2	-1.7	0.0	0.3	0.6
House Prices (Annual % Chg)	28.9	30.3	26.2	14.6	4.6	-4.8	-10.0	-8.4	-5.6	-0.8

Interest rates	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23
Official Cash Rate	0.25	0.25	0.75	1.00	2.00	2.50	3.00	3.25	3.50	3.50
90-Day Bank Bill Rate	0.35	0.65	0.97	1.92	2.52	3.02	3.27	3.60	3.60	3.60
10-Year Bond	1.77	2.09	2.39	3.00	3.20	3.30	3.65	3.75	4.00	4.00

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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We welcome your questions and feedback. Click here for more information about our team.

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