ANZ Research

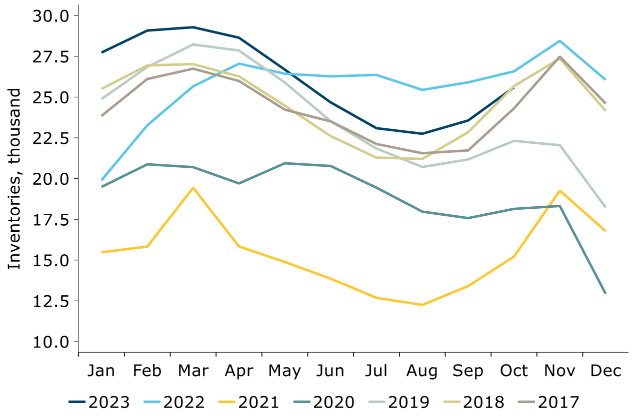
November 2023

New Zealand Property Focus

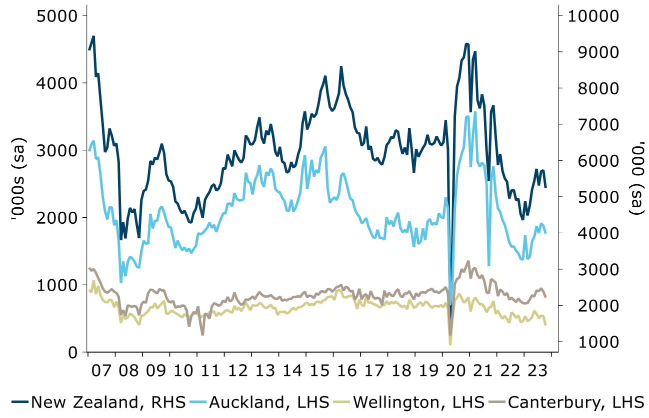
A spring chill

At a glance

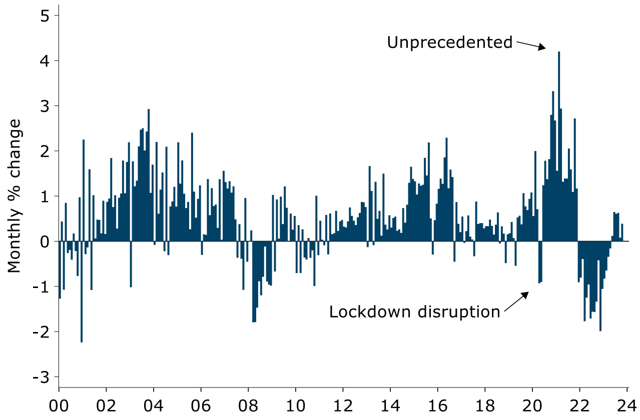
Inventories are piling up…..



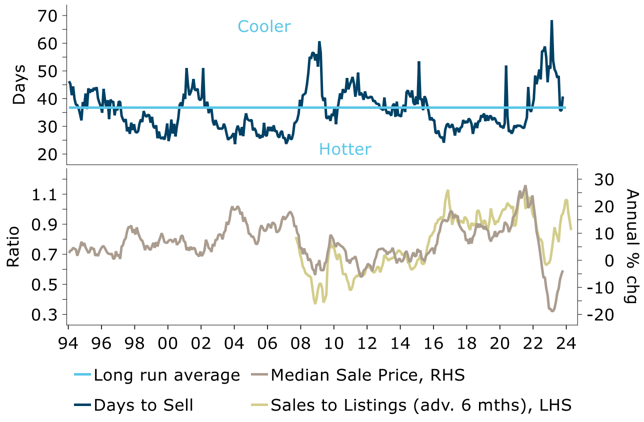
…and sales have dipped recently



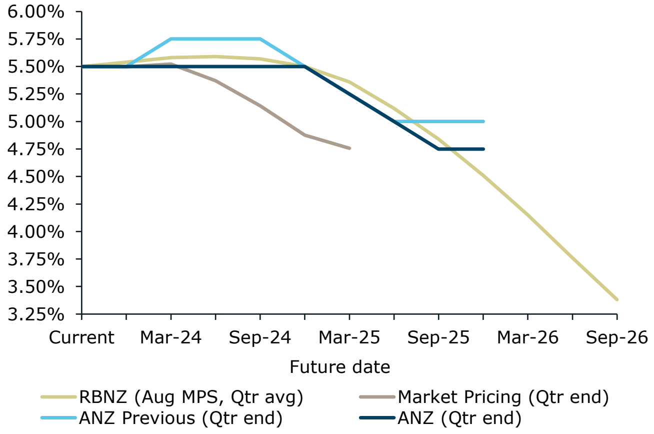
House prices are struggling to get momentum, perhaps due to the election…



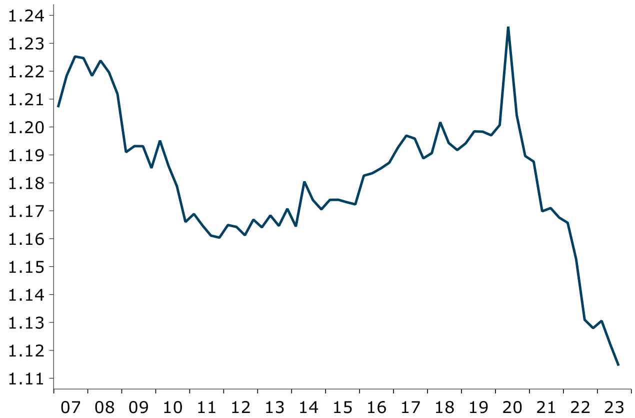
…and the Wellington market is sluggish, perhaps due to expected public service cuts



The OCR has probably peaked, but there's still a risk of more hikes



Rental affordability is improving as income growth outpaces rent rises



Source: REINZ, Stats NZ, RBNZ, Macrobond, ANZ Research

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ISSN 2624-0629

Publication date: 28 November 2023

Summary

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

Property Focus

House prices rose in October, with the REINZ house price index rising 0.4% m/m (ANZ seasonal adjustment), a touch weaker than we expected (figure 1). It's not just house prices that were on the weaker side this month; the forward indicators of sales and new listings showed that there's perhaps some further softness to come. Accounting for the starting point surprise, and adding a little more election inertia into our near-term view, we have revised down our 2023 house price forecast and now expect house prices to fall 0.4% in 2023 (3-month moving average), versus a 0.2% rise previously. If momentum doesn't recover after the election-related dust has settled, our 2024 forecast is on thin ice for a downgrade too (we'll get our first post-election read in December). This month we changed our Official Cash rate forecast and now expect the next move on the OCR to be lower, albeit with cuts one quarter later than previously (Q1 2025). However, insofar as markets anticipate cuts, fixed mortgage rates are likely to fall before then. See the Property Focus section.

Mortgage Borrowing Strategy

Average fixed mortgage rates are little changed this month, but the changes that have been seen have all been very small increases. This has likely been catch-up in the wake of significant rises in wholesale rates throughout the year. But wholesale rates now look to have peaked, with financial markets now coming to the view that the RBNZ is done tightening, and the next move will be a cut. Whether wholesale interest rates have fallen enough for fixed mortgage rates to fall remains to be seen, but unless we see a sharp turnaround in wholesale rates, there is a good chance that mortgage rates have peaked. While we do think that markets have gotten a bit ahead of themselves, that's what they tend to do late in the cycle, and that isn't likely to change much even if the RBNZ (and other global central banks) continue to warn that cuts are likely to be some way off. Choosing the right fixing strategy at turning points is tricky, but signs that inflation is easing, and the economy is rolling over may give borrowers who fix for a shorter period some comfort that mortgage rates will be lower when they go to re-fix when their current fixed term ends. See our Mortgage Borrowing Strategy.

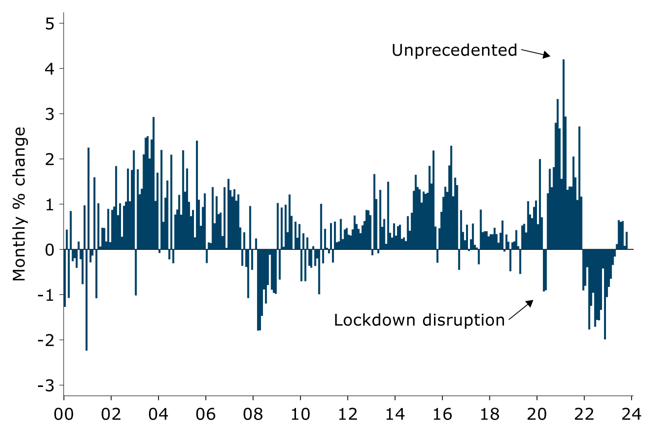
Summary

House prices rose in October, with the REINZ house price index rising 0.4% m/m (ANZ seasonal adjustment), a touch weaker than we expected (figure 1). It's not just house prices that were on the weaker side this month; the forward indicators of sales and new listings showed that there's perhaps some further softness to come. Accounting for the starting point surprise, and adding a little more election inertia into our near-term view, we have revised down our 2023 house price forecast and now expect house prices to fall 0.4% in 2023 (3-month moving average), versus a 0.2% rise previously. If momentum doesn't recover after the election-related dust has settled, our 2024 forecast is on thin ice for a downgrade too (we'll get our first post-election read in December). This month we changed our Official Cash rate forecast and now expect the next move on the OCR to be lower, albeit with cuts one quarter later than previously (Q1 2025). However, insofar as markets anticipate cuts, fixed mortgage rates are likely to fall before then.

House prices rose in October, but the market cooled

House prices picked up in October, with the REINZ house price index rising 0.4% m/m (ANZ seasonal adjustment), a touch weaker than we expected (figure 1). The last two month's increases were below historical average increases, but nonetheless show that the housing market has managed to avoid recommencing its downward slide.

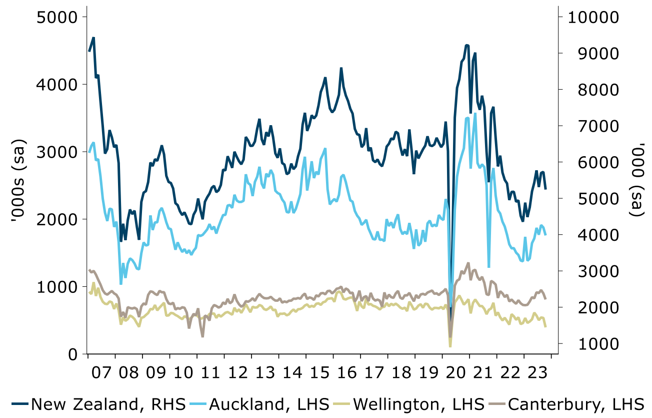
Figure 1. Monthly house price inflation



Source: REINZ, Macrobond, ANZ Research

It's not just house prices that were weaker than we expected this month; the forward indicators of sales and new listings showed that there's perhaps some further softness to come. House sales ticked down in October across all major markets (figure 2). House sales have a tendency to be volatile month-to-month, but we will be watching closely to see if this resumes 2022's trend of a weakening housing market, or whether it's just a hiatus awaiting policy certainty.

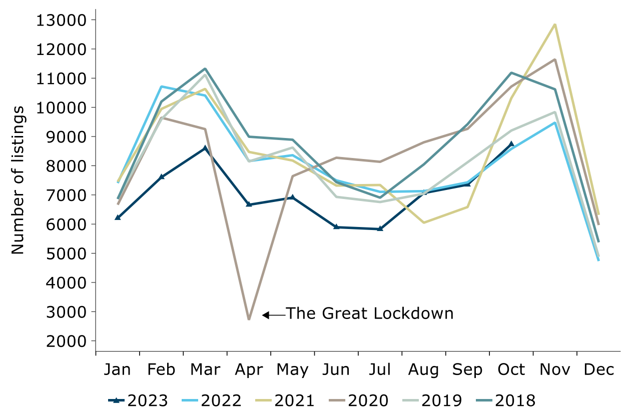
Figure 2. House sales



Source: REINZ, Macrobond, ANZ Research

Also indicating weakness ahead, new listings are (just) above year-ago levels for the first time this year (figure 3). All else equal, this extra supply will make it more difficult for house prices to rise meaningfully over the next few months.

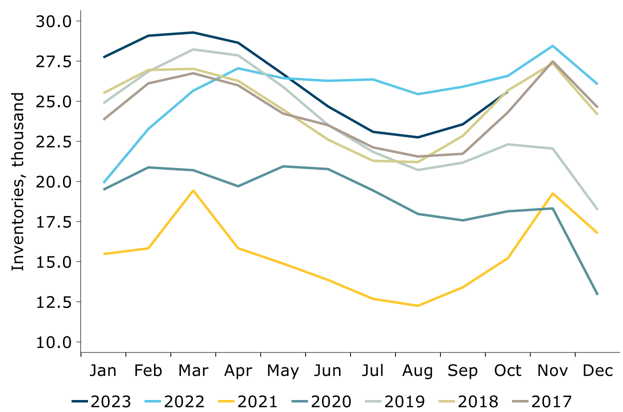
Figure 3. New listings by year



Source: REINZ, Macrobond, ANZ Research

This lift in listings is on top of an already large stock of inventories, which needs to decline before meaningful rises in house prices are likely (figure 4).

Figure 4. Inventories by year

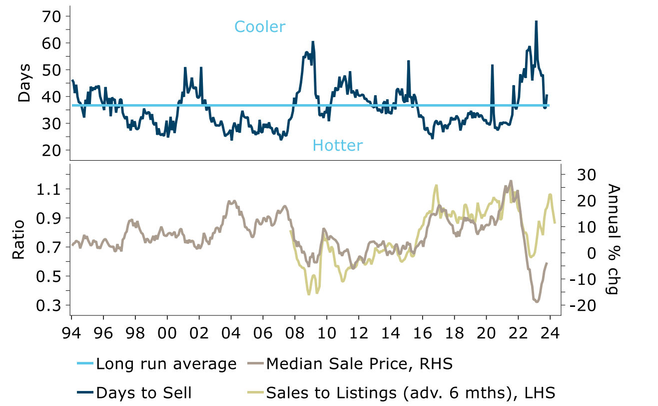


Source: REINZ, Macrobond, ANZ Research

Wellington woes

The Wellington housing market was especially weak in October, with house sales at multi-decade lows (excluding during COVID lockdown), house prices in the city declining 2.0% m/m, and days to sell rising 5 days from 36 to 41 (figure 5). The city's economy is highly reliant on demand from the public service. Some government ministries have already begun the process of downsizing to achieve the outgoing government's 1-2% baseline cuts across the public service, with others implementing hiring freezes. We suspect these are already having a negative effect on the Wellington housing market, with potentially more to come. The coalition agreements didn't outline specific targets for headcount reduction, but the direction was clear.

Figure 5. Wellington housing market tightness

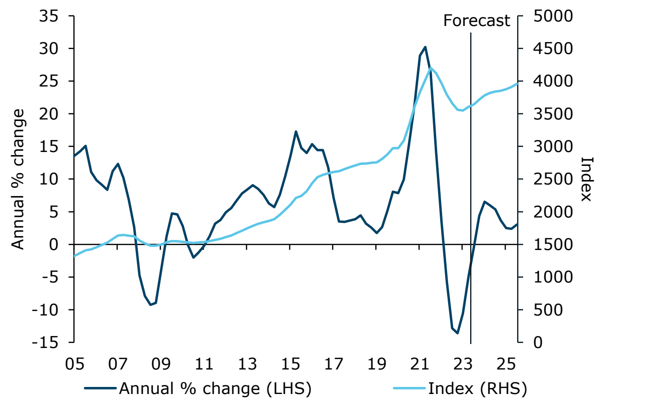


Source: REINZ, Stats NZ, Macrobond, ANZ Research

Forecast tweak

Nationally, house prices are still a long way below their peak. We're forecasting it'll take years to re-attain those levels (figure 6). The weakness in some of the forward-looking indicators and some technical seasonal adjustment factors (see technical box) have prompted us to make a small downwards revision to our outlook for November and December. We now expect house prices to fall 0.4% in 2023 (3-month moving average), versus a 0.2% rise previously.

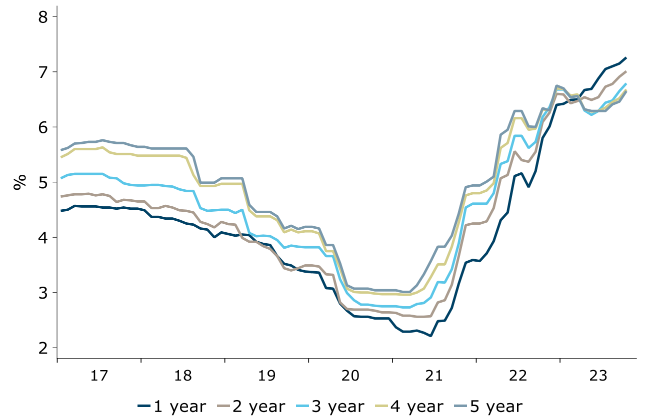
Figure 6. Our house price forecast



Source: REINZ, ANZ Research

We are waiting to see November's post-election REINZ data before making any more significant adjustments to our forecasts. It is difficult to separate election inertia from underlying housing market momentum in recent data. In the meantime, the risk is that house prices rise less than we currently expect in 2024, given recent modest further lifts in mortgage rates (figure 7), and the somewhat faster-than-expected labour market loosening. The faster-than-anticipated restoration of mortgage interest deductibility and other landlord-friendly policy changes agreed to by the new coalition Government are risks in the other direction, though difficult to quantify.

Figure 7. New mortgage interest rates



Source: RBNZ, ANZ Research

Since our October Property Focus we have had new labour market data, with unemployment rising (figure 8) as tighter monetary policy cools demand and raises unemployment. Decreased job security is likely to make would-be first home buyers more nervous about taking the plunge. But there's also a feedback loop here. Sharply rising unemployment can negatively influence credit availability too, making the outlook all the more uncertain for credit providers.

Figure 8. New Zealand unemployment (sa)

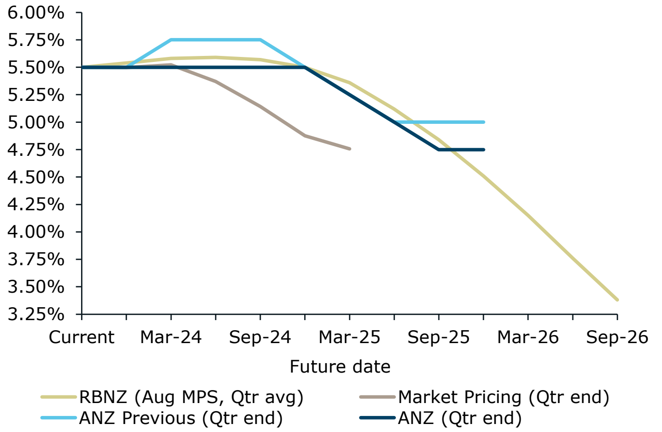
Source: Stats NZ, MBIE, Macrobond, ANZ Research

Property Focus

Mortgage rates have probably peaked, but are likely to remain high in 2024

The weaker-than-expected labour market was one of several reasons why we have changed our Official Cash Rate (OCR) call and no longer expect the Reserve Bank of New Zealand (RBNZ) to increase the OCR next year. We don't expect much relief for mortgage holders in 2024 insofar as we expect the RBNZ to keep the OCR on hold all year.

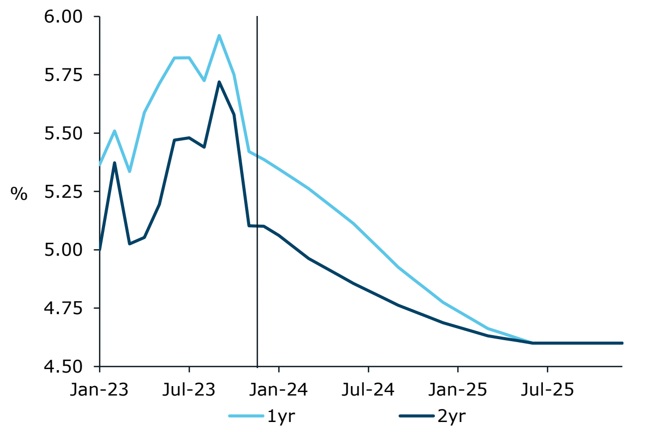
Figure 9. Our OCR forecast



Source: RBNZ, Bloomberg, Macrobond, ANZ Research

Consistent with our OCR forecast change, we have changed our forecasts for the wholesale rates that underpin mortgage rates, expecting them to peak at a lower level, but remain high for longer (figure 10). While a lower peak is good news, later cuts, all else equal, are likely to keep the housing market somewhat sluggish into 2025 by constraining prospective first-home buyers' and investors' borrowing power. That said, financial markets make up their own minds about what they think is going to happen, and to the extent they anticipate sharp or imminent cuts, that could put downward pressure on fixed mortgage rates for a time – whether the RBNZ actually delivers or not.

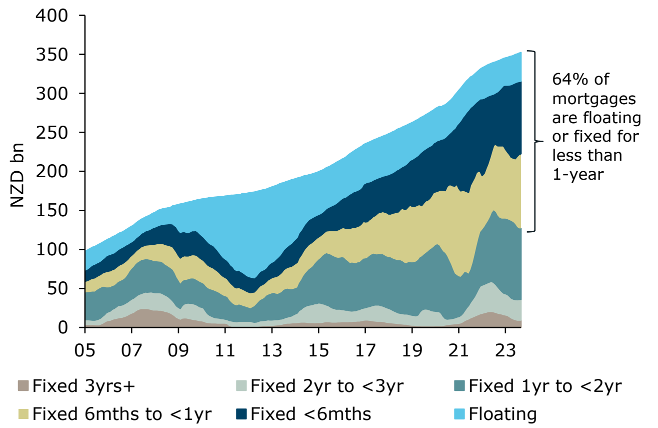
Figure 10. Wholesale interest rate forecasts for main mortgage tenors



Source: Bloomberg, ANZ Research

A majority of mortgage holders have a refixing coming up in the next year (figure 11). If market expectations for cuts strengthen from here, wholesale rates and therefore retail mortgage rates may be lower when that date comes. But of course if the inflation news turns worse again and market expectations evolve to price later cuts or even a chance of more hikes, wholesale rates could increase again. And mortgage rates depend not only on wholesale rates but also global funding costs. But whatever happens, many of these homeowners will be rolling onto a much higher rate than they were on before.

Figure 11. NZ mortgages by time to re-fix

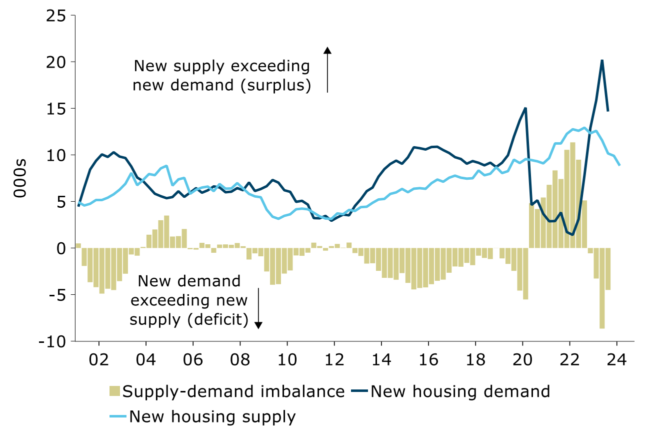


Source: RBNZ, ANZ Research

Affordability has improved somewhat

Despite recent weakness in the housing market, the fundamental balance of population growth versus new building is in dire territory. The adult population continues to grow considerably faster than we can build houses for it, due to record inbound migration and New Zealand's healthy net birth rate in the early 2000s. After making significant progress reducing our housing shortage while the border was closed, we are now expanding our housing deficit at a rapid clip, somewhat faster than pre-pandemic (figure 12).

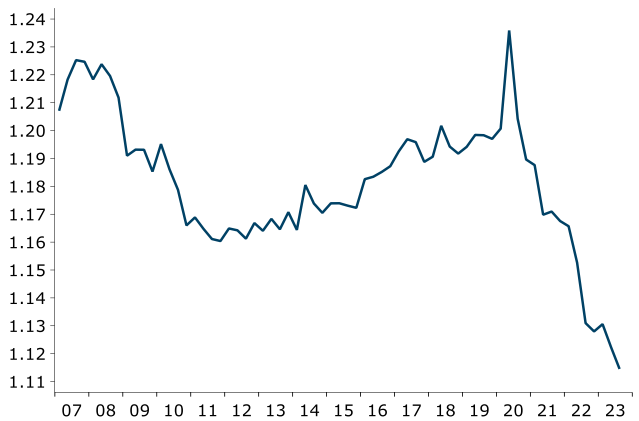
Figure 12. Net change in housing supply



Source: Stats NZ, Macrobond, ANZ Research

However, it's not all bad news for people looking for somewhere to live. Incomes have been rising faster than nationwide rents in recent months (figure 13), as business owners compete to retain and attract staff in a stretched labour market. While inflation remains high, we expect employers to factor in the rising cost of living into wage settlements to some degree, allowing renters to continue to expand their proportion of income available to spend on other things, but this dynamic will moderate as the labour market cools. Some coalition Government policies will also reduce costs for landlords and may reduce upward pressure on rents via that channel. However, strong population growth via unprecedented net migration is a solid upside risk for rents, particularly in Auckland.

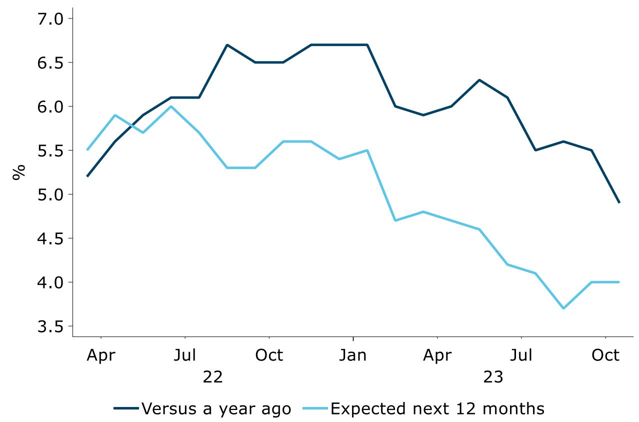
Figure 13. Rents relative to hourly earnings



Source: Stats NZ, Macrobond, ANZ Research

In the second half of next year, as the economy cools and inflation falls, we expect smaller wage rises. That is certainly what businesses are expecting (figure 14).

Figure 14. Reported actual and expected wage increases

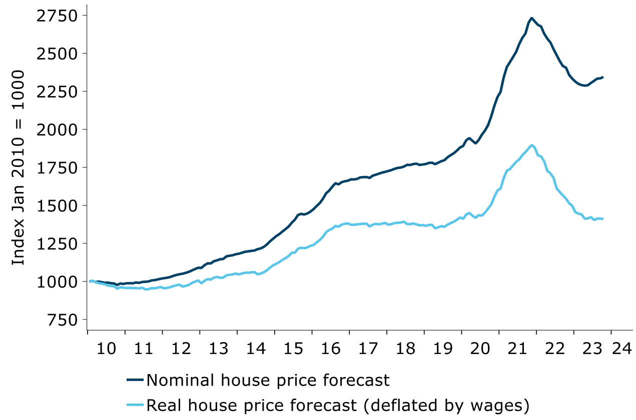


Source: Macrobond, ANZ Research

Potentially this could lead to a resumption of the upward trend in rents as a share of incomes, particularly if we continue to build at a snail's pace compared to population growth.

It's a similar story for homeowners, with houses now back to their pre-pandemic levels of affordability (relative to incomes). However, we certainly wouldn't characterise house prices as 'affordable', especially given serviceability constraints. But strong wage growth has provided a material offset for some and we've undone the damage done to housing affordability during the COVID period (figure 15).

Figure 15. House prices deflated by wages



Source: REINZ, Stats NZ, Macrobond, ANZ Research

And that's been achieved with very little blood on the floor and a very modest proportion of buyers put into negative equity compared to if house price falls had done all the work with income growth steady. That's the dirty little secret of high inflation – it does grease the wheels of relative price adjustments, and an adjustment in house prices relative to wages was most certainly needed.

Housing market indicators for October 2023 (based on REINZ data seasonally adjusted by ANZ Research)

	Median house price			House price index		Sales		Average days to sell
	Level	Annual % change	3-mth % change	Annual % change	3-mth % change	# of monthly sales	Monthly % change	
Northland	$682,279	-6.9	0.1	-7.7	-1.1	155	-7%	64
Auckland	$1,020,046	-3.8	1.7	-2.6	1.6	1,759	-6%	38
Waikato	$750,560	-4.5	1.0	-4.5	0.8	490	-5%	43
Bay of Plenty	$822,299	-1.3	-1.0	-1.7	0.3	301	-12%	43
Gisborne	$584,812	-3.6	5.1	-3.4	1.1	24	-30%	55
Hawke's Bay	$681,073	-3.9	0.3	-3.4	1.1	173	-1%	43
Manawatu-Whanganui	$526,080	-5.0	-2.4	-3.4	1.3	221	-24%	43
Taranaki	$568,593	-2.6	-0.4	-1.9	0.0	134	-8%	48
Wellington	$780,373	-4.7	0.9	-3.4	2.0	395	-26%	41
Tasman, Nelson & Marlborough	$723,899	-8.6	2.0			147	-31%	56
Canterbury	$676,394	3.3	1.5	0.2	1.3	809	-10%	34
Otago	$657,245	-0.7	-6.0	0.2	2.3	331	+3%	43
West Coast	$346,561	2.2	-3.5	-3.3	0.5	37	-1%	51
Southland	$433,291	2.4	1.5	-1.6	2.1	128	-7%	51
New Zealand	**$785,596**	**-2.9**	**0.6**	**-2.6**	**1.4**	**5,241**	**-8%**	**40**

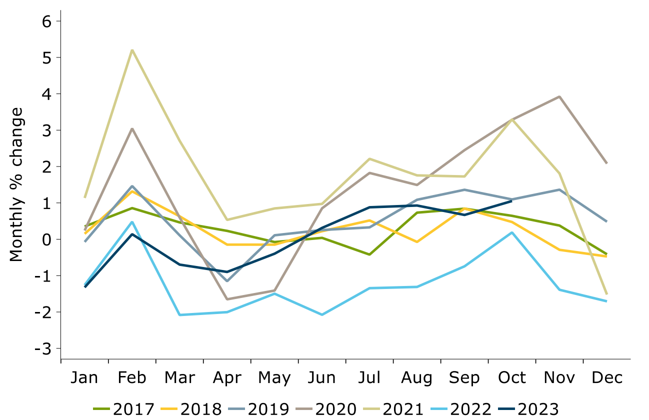
Technical box: Seasonal adjustment methods

Seasonal surprises

Our estimate that seasonally adjusted house prices rose 0.4% in October differs from the estimates of some other institutions. For example, the New Zealand Treasury[1] estimate that house prices *fell* 0.4% m/m. So what's going on? The following section provides a technical explanation of the intricacies of seasonal adjustment for interested readers.

House prices have a seasonal pattern: they tend to rise more in summer (Christmas disruption aside) than they do in the winter (figure 16).

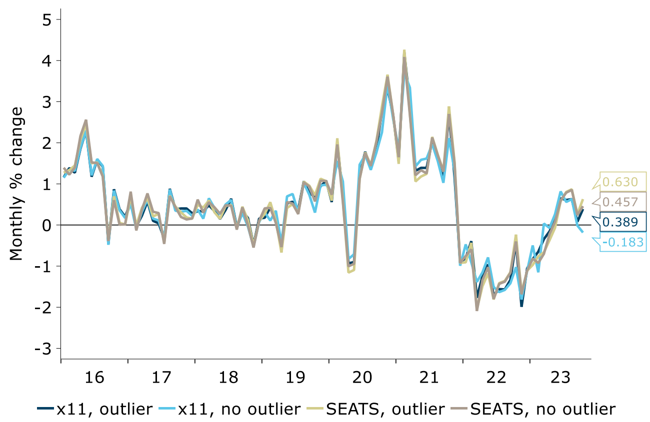
Figure 16. Monthly changes in New Zealand house prices



Source: REINZ, Macrobond, ANZ Research

The are two widely used seasonal adjustment methods: the moving average x11 method and the ARIMA (Autoregressive Integrated Moving Average) model-based SEATS (Signal Extraction ARIMA seasonal adjustment). Each method has the choice to treat for outliers, resulting in a total of four options (figure 17). We use the x11 method and treat for outliers, which is common practice.

Figure 17. Different seasonal adjustment methodologies

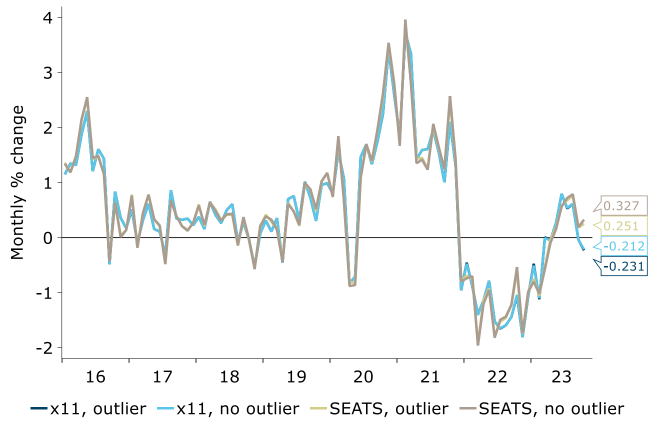


Source: REINZ, Macrobond, ANZ Research

While all options do a good job of extracting the signal from the seasonal noise, they can result in quite different estimates for the change in house prices in any given month, such as this October. In recent estimates, removing outliers reduces volatility.

Treating for outliers in the x11 methodology changes the seasonally adjusted m/m estimate from -0.2% to 0.4%. Further investigation reveals this is mainly due to the impact of the data from the period prior to 2000, which features a reasonably large outlier of unusually weak house prices in October 1999. Investigation reveals that it is indeed the choice of whether to treat for outliers that makes the difference rather than the choice of method: the SEATS method produces a similar result to x11.

Figure 18. Different seasonal adjustment methodologies using data from 2000 onwards



Source: REINZ, Macrobond, ANZ Research

These are only four different approaches among a myriad of options available when adjusting data for seasonality. Others may select a different seasonal adjustment approach and results may differ, explaining some of the different numbers you may see reported in media.

Over the whole year, it comes out in the wash: each method averages out to the almost identical annual percentage changes, but they can result in differences in monthly or quarterly analysis. In our Property Focus we look at a range of measures so we don't get too caught up in month-to-month volatility. This enables us to produce forecasts and analysis that take into account the big picture.

[1] Fortnightly Economic Update - 17 November 2023

Mortgage borrowing strategy

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Summary

Average fixed mortgage rates are little changed this month, but the changes that have been seen have all been very small increases. This has likely been catch-up in the wake of significant rises in wholesale rates throughout the year. But wholesale rates now look to have peaked, with financial markets now coming to the view that the RBNZ is done tightening, and the next move will be a cut. Whether wholesale interest rates have fallen enough for fixed mortgage rates to fall remains to be seen, but unless we see a sharp turnaround in wholesale rates, there is a good chance that mortgage rates have peaked. While we do think that markets have gotten a bit ahead of themselves, that's what they tend to do late in the cycle, and that isn't likely to change much even if the RBNZ (and other global central banks) continue to warn that cuts are likely to be some way off. Choosing the right fixing strategy at turning points is tricky, but signs that inflation is easing, and the economy is rolling over may give borrowers who fix for a shorter period some comfort that mortgage rates will be lower when they go to re-fix when their current fixed term ends.

Fixed mortgage rates have barely changed over the past month, but the changes that have been seen have all been small increases. Many of those tweaks occurred before the recent fall in wholesale interest rates, and it is possible that we see mortgage rates come down in time if wholesale rates remain low or go lower over the summer. This month's RBNZ Monetary Policy Statement will be crucial in that regard, and that'll set the tone. As we noted in our Preview, we expect a pause, so a sudden rise in interest rates seems unlikely. However, we're not confident that they'll go so far as to condone the recent dramatic shift on financial market expectations, with markets now pricing in 25bp of OCR cuts by August and a further 31bp (ie. 56bp in total) by next November.

That said, markets generally have a tendency to outrun the RBNZ once it thinks the top is in, so the RBNZ would have to be very 'hawkish' (aggressive about inflation risks) if it wanted to drive wholesale rates higher, and they probably don't have enough justification to ratchet up the rhetoric given the recent data has suggested easing inflation risks (and markets probably wouldn't believe them!).

On that score, recent data has led us to revise our OCR forecasts, which no longer envisage another hike this cycle. We're not guaranteeing that the RBNZ won't tighten again – they could if the economy re-accelerates. But although they aren't out of the proverbial woods yet, the tempo of recent data has started to go their way in the battle against inflation, and we now think they'll spend much of 2024 on hold, which suggests a good chance that mortgage rates have now peaked. We are forecasting the first cut in November 2024, but that's a year away, and in the meantime, we are likely to see volatility, as market expectations for OCR cuts ebb and flow.

So, the big picture is one of mortgage rates probably having peaked but meaningful cuts probably a bit further down the track than markets currently expect. What is one to do in that situation? At a high level, it is likely to make people more comfortable choosing a shorter fixed term, but as always, we think breakeven analysis is a good place to start. Let's compare, for example, fixing for 1 year versus fixing for 2 or 3 years, noting that if you fix for 1 year, you'll need to roll that fix when it matures. As our table shows, the 1yr rate needs to fall from its current rate of 7.40% to 6.70% in a year's time (and then fall to 6.42% in 2 years' time) for back-to-back 1-year fixes to be cheaper than fixing for 2 years at 7.05% (or 3 years at 6.84%). That's close to (if anything a bit above) what our projections have mortgage rates going, suggesting all are valid strategies. A mixture of them would spread roll-over risk, which has real value. Finally, we'd note that fixing for 6 months is a good, cheaper alternative to floating, as they tend to move together.

Figure 1. Carded special mortgage rates^

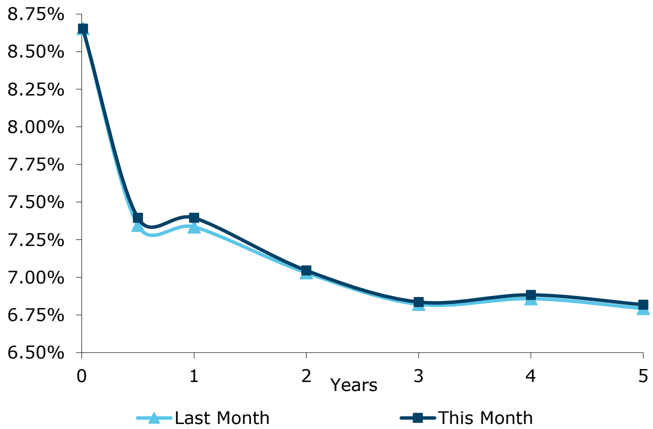

Table 1. Special Mortgage Rates#

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	8.65%				
6 months	7.40%	7.39%	6.69%	6.70%	6.52%
1 year	7.40%	7.04%	6.70%	6.61%	6.42%
2 years	7.05%	6.83%	6.56%	6.63%	6.72%
3 years	6.84%	6.77%	6.71%	6.70%	6.67%
4 years	6.88%	6.78%	6.67%		
5 years	6.82%	#Average of "big four" banks			

Source: interest.co.nz, ANZ Research.

Key forecasts

Weekly mortgage repayments table (based on 30-year term)

	Mortgage Rate (%)													
2Mortgage Size ($000)	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	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Floating Mortgage Rate	8.0	8.5	8.6	8.7	8.7	8.7	8.7	8.7	8.4	8.2
1-Yr Fixed Mortgage Rate	6.5	6.9	7.2	7.3	7.1	6.9	6.7	6.6	6.5	6.4
2-Yr Fixed Mortgage Rate	6.5	6.5	6.9	6.9	6.8	6.7	6.6	6.5	6.4	6.4
3-Yr Fixed Mortgage Rate	6.6	6.3	6.7	6.8	6.7	6.6	6.5	6.5	6.5	6.4
5-Yr Fixed Mortgage Rate	6.6	6.3	6.5	7.0	7.0	6.9	6.8	6.7	6.7	6.6

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
GDP (Annual % Chg)	2.4	2.2	1.8	0.6	1.5	1.7	0.9	0.8	0.8	1.0
CPI Inflation (Annual % Chg)	7.2	6.7	6.0	5.6(a)	4.8	4.1	3.7	2.8	2.5	2.4
Unemployment Rate (%)	3.4	3.4	3.6	3.9(a)	4.3	4.7	4.9	5.0	5.1	5.2
House Prices (Quarter % Chg)	-3.5	-2.7	-0.3	1.5(a)	1.1	1.9	1.8	1.0	0.5	0.3
House Prices (Annual % Chg)	-12.9	-13.6	-10.6	-5.0(a)	-0.4	4.3	6.5	6.0	5.4	3.7

Interest rates	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Official Cash Rate	4.75	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.25	5.00
90-Day Bank Bill Rate	5.23	5.71	5.74	5.57	5.48	5.38	5.25	5.10	4.92	4.68
10-Year Bond	4.20	4.62	5.31	5.10	5.10	5.00	5.00	4.85	4.75	4.70

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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Last updated: 18 April 2023

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