New Zealand Property Focus

Not a straight line

At a glance

Global financial markets are **transitioning a wobbly period…**

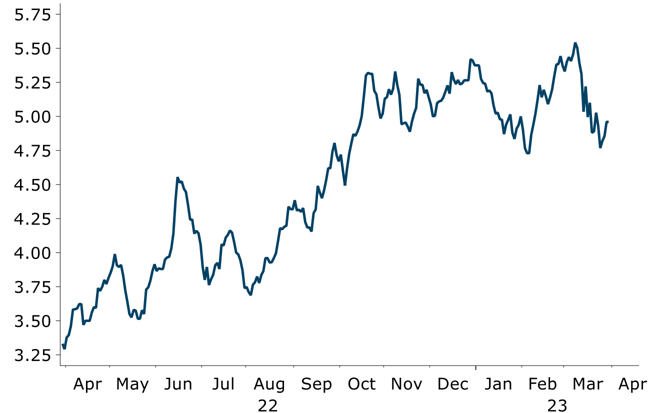
The failure of a couple of US regional banks shows the path of monetary tightening can get bumpy

Wobbles extending to Europe have also put global markets on tenterhooks

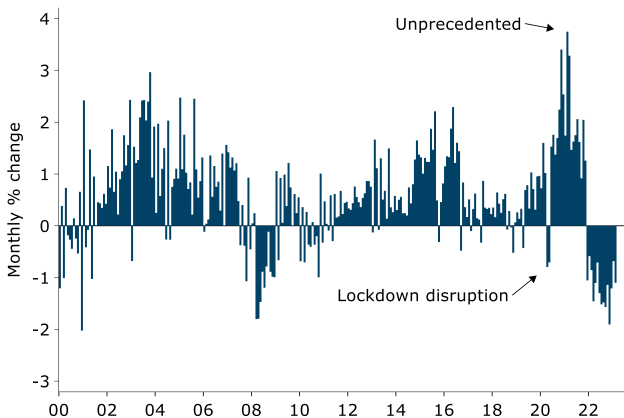
NZ banks are well capitalised, and our forecast assumes global wobbles largely resolve

…And that's contributed to volatility in NZ markets too

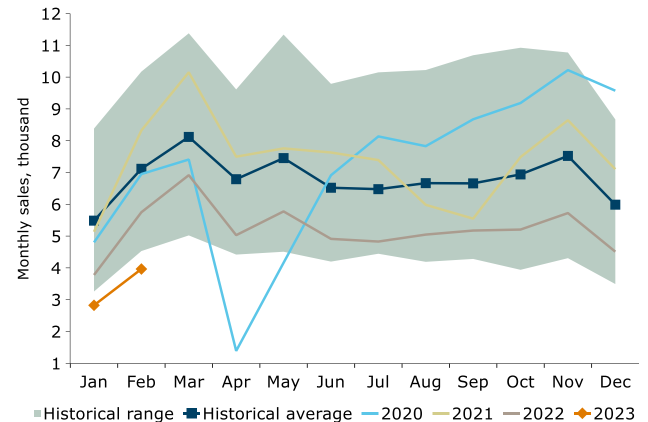
New Zealand 2-year swap rate



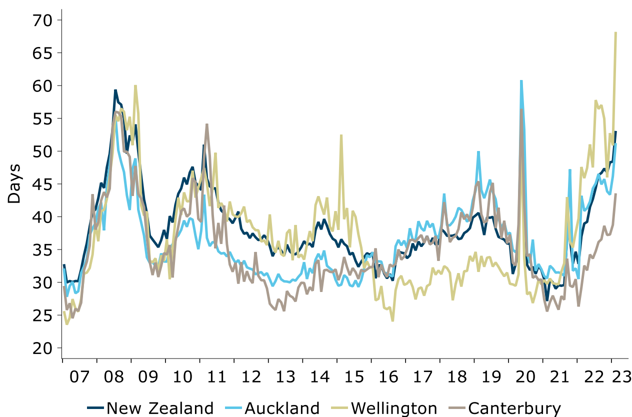
House prices remain in an orderly decline



Weak house sales point to softer **prices in the near term…**



…and so does the fact that houses are taking longer to sell



We maintain our OCR and house price forecasts

House prices are expected to fall 22% from their November 2021 peak (they are currently down a little more than 16%)

The OCR is expected to peak at 5.25% in May

But we have made small tweaks to other macro forecasts reflecting recent weather impacts

Source: REINZ, Bloomberg, 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

2023 is turning out to be yet another year fated to be 'interesting' economically: January brought flooding, February brought cyclone Gabrielle, and March delivered global banking sector wobbles. This month we provide an update on how we've factored recent weather events into our outlook (spoiler alert: these are very uncertain), and also discuss the possible ways in which a global financial shock could impact the New Zealand housing market and broader economy. The potential impacts of recent financial market wobbles range from 'complete game changer' (ie if they are the beginning some something much larger) to 'a relatively small blip in the road'. Without convincing information to suggest otherwise, our forecast assumes the latter. However, even if the wheels stay firmly on, global financial market woes could well mean tighter credit conditions for a given level of the OCR, meaning it's difficult in this environment to focus only on upside inflation risks when discussing risks to our OCR call (for a peak of 5.25%). Market pricing has certainly shifted lower (a loosening in financial conditions all else equal), but that could all change in a number of days. See our Property Focus.

Mortgage borrowing strategy

Mortgage rates are little changed on average across the big-4 banks over the past month. Borrowers still face a very flat fixed mortgage curve, with just 0.21%pts separating the lowest rate (the 6.51% 2yr) from the highest rate (the 6.72% 4yr). That leaves the choice of what term to choose largely dependent on whether one thinks that wholesale interest rates have peaked (which might end up being true if a credit crunch is on the way) or will rise further (which might end up being true if inflation remains stubbornly high). Financial markets are grappling with these scenarios too; hence recent volatility. We think both scenarios are plausible. But if a credit crunch does occur, falling wholesale rates may be offset by wider funding spreads, meaning mortgage rates may not in fact fall, as we discuss on page 5. For that reason, it may be worth considering fixing a portion of debt for a little longer than usual. See our Mortgage Borrowing Strategy.

Property Focus

Summary

2023 is turning out to be yet another year fated to be 'interesting' economically: January brought flooding, February brought cyclone Gabrielle, and March delivered global banking sector wobbles. This month we provide an update on how we've factored recent weather events into our outlook (spoiler alert: these are very uncertain), and also discuss the possible ways in which a global financial shock could impact the New Zealand housing market and broader economy. The potential impacts of recent financial market wobbles range from 'complete game changer' (ie if they are the beginning some something much larger) to 'a relatively small blip in the road'. Without convincing information to suggest otherwise, our forecast assumes the latter. However, even if the wheels stay firmly on, global financial market woes could well mean tighter credit conditions for a given level of the OCR, meaning it's difficult in this environment to focus only on upside inflation risks when discussing risks to our OCR call (for a peak of 5.25%). Market pricing has certainly shifted lower (a loosening in financial conditions all else equal), but that could all change in a number of days.

Not a straight line

We'll always take the opportunity to highlight just how uncertain house price forecasts tend to be, and three months into 2023 we've already had some major events that present varying challenges to the forecast:

- Domestically, recent weather events represent a relatively small negative housing supply shock (but a huge shock in severely impacted areas), skewing the balance of risks towards higher-than-otherwise residential investment demand, rents (and CPI inflation more broadly), and interest rates. The implication for house prices is more ambiguous (we're assuming no impact) as negative supply implications meet upside interest rate risk (all else equal). Importantly, weather-related impacts do not look like they'll be a game changer for broader economic and housing momentum.
- Globally, the collapse of a couple of regional US banks and the spread of banking sector wobbles into Europe highlight that the path of global monetary tightening is unlikely to be smooth. It's too early to say how global markets will evolve, but we're keeping a watchful eye on developments. The New Zealand banking system is well capitalised and robust, but as a small open economy we can't hide from global shocks.

Update on weather-related impacts

We discussed some of the potential impacts of recent weather events on the housing market last month, hoping that by the time the March Property Focus was due, we'd have a clearer picture of what this might mean for the outlook. But alas, the implications are only slightly less murky than a month ago. We have, however, attempted to incorporate some impacts into our macroeconomic forecasts. These include:

- a little more economic activity over the next couple of years than otherwise (as demand to repair, rebuild and replace damaged property provides a bump). This includes a little more residential investment activity than otherwise, but this is only a small offset to the impact of higher interest rates on construction.
- A wider-for-longer current account deficit, driven largely by the fact that the cyclone has wiped out hundreds of millions in export earnings and imports of goods will be higher as damaged property from laptops to cars are replaced. But again, these impacts are not enough to change the broader narrative that the current account deficit will narrow as services exports (chiefly tourism and education) continue to recover.
- A bit more CPI inflation over the year ahead, with risks tilted towards this being a little more persistent than expected.
- And, all else equal, fresh upside risks to the interest rate outlook (ie if the inflationary implications become more entrenched in wage and price setting behaviour, the RBNZ will need to respond).

When it comes to the housing market, given the affected regions represent only a small share of the national market, the upside interest rate risks could end up dominating. That is, NZ-wide housing outcomes could end up softer than otherwise should upside CPI inflation risks materialise, causing CPI to become more entrenched and therefore warranting a response from the RBNZ. While higher rates might sound like a double whammy for those hit hardest by recent weather events, the rebuild will require economic resource (labour and materials), and at the moment there isn't much spare to go around. The higher OCR will free up resource for the eventual rebuild by reducing residential construction demand more broadly.

For more detail on these impacts, see this Forecast Update note. The elevator pitch: impacts are still rather uncertain, but compared to the broad economic cycle (and uncertainty around this) these events do not appear to be a game-changer at the national level. Impacts will, however, be very acute across those regions most impacted.

Global financial markets have become a little wobbly. How could that impact NZ housing?

Financial market volatility has lifted sharply in recent weeks in the wake of bank collapses in the US and as contagion later spread to Switzerland. Policy makers and regulators alike have stepped up to contain systemic risk in the financial system, but it's still too early to know if this saga is near being contained, or if further wobbles are yet to come. Whether or not the current situation significantly worsens depends on whether we see wobbles among globally systemically important banks, and/or if these events lead to a broader shock to confidence in the financial system.

For NZ housing (and the economy more broadly), the potential impacts of these events stem largely from two channels: the direct and indirect impacts on credit conditions, and the direct and indirect impacts on the real economy (with plenty of overlap between the two). But as we highlight below, there are many moving parts and potential offsets (depending on the magnitude of the shock – which is still unknown).

Credit conditions: Housing and residential construction sit at the more interest-rate-sensitive end of the spectrum. But it's not just the OCR that determines credit conditions for these (and other) pockets of the economy. Changes in the pricing of risk can move the dial, and global financial market wobbles can be the catalyst for adjustment, impacting not only domestic risk perceptions, but also the 'risk premium' a small open economy tends to acquire when it's flapping in the winds of global markets.

In reality, risk is priced across many different dimensions, such as specific business risk, financial risk, exchange rate risk, liquidity risk, and other country-specific risks (such as a country's net external position). Another way to think about this is that changes in risk perceptions can:

- impact the cost that banks have to pay when they source funding to lend to their customers;
- impact the availability of that funding (meaning a lower-than-otherwise supply of credit for a given level of demand); and
- impact how banks allocate credit (for example, if a certain industry is facing significant challenges to its longer-run viability, banks may not deem it feasible to extend credit to that industry).

We are now deep within the realm of the RBNZ's regulatory framework, such as bank capital requirements, which are designed to keep the system resilient through events such as these. But there's no such thing as a free lunch: higher bank capital requirements, for example, can curtail credit allocation to 'riskier' projects, and increase bank funding costs (ie credit is harder to get than otherwise and may come at a higher cost to the borrower). But NZ regulators have decided that's a cost worth paying, and now, as the global financial system wobbles, NZ will hopefully see some benefit via a lower-than-otherwise susceptibility to contagion. For more on how the RBNZ ensures financial stability, visit their website.

All in all, the credit conditions channel means that for a given level of the OCR, credit conditions may be tighter than otherwise when an adverse financial shock comes along. This might manifest in higher-than-otherwise interest rates (eg via higher funding costs), or lower-than-otherwise credit availability (or both).

The spread on credit default swaps (or CDSs) – which are actively traded by market participants looking to hedge against the default of a particular borrower – can provide useful signals, as they tend to move up and down with actual funding spreads. These have widened for many banks around the world in the wake of recent banking wobbles in the US and Europe, but as figure 1 shows, so far the impact on Australasian banks has been pretty mild. Some widening has occurred, but spreads have only unwound gains seen since the end of last year. But the jump was sudden and we will be watching spreads very closely over coming months.

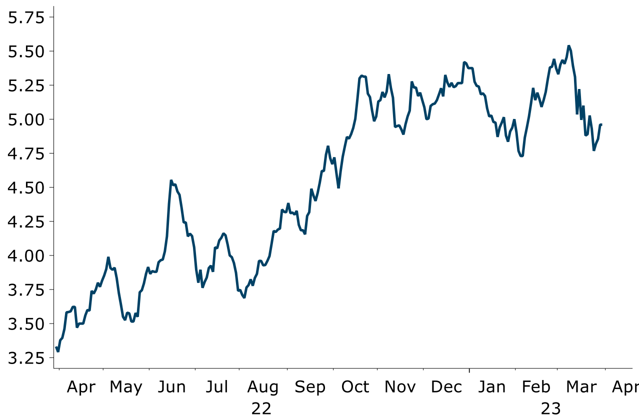
Figure 1. ANZ's 5yr USD CDS spread

Source: Bloomberg, ANZ Research

On the flip side, financial market wobbles can cause wholesale markets to reassess the outlook for monetary policy. And that makes a lot of sense:

- financial conditions could be about to become tighter than otherwise, meaning the OCR won't need to go as high to get the same desired impact, and/or
- the probability of a 'tail end' (high impact, low probability) financial shock is deemed greater, and if it were to materialise (in a deflationary way), rate cuts could be on the cards.

Figure 2. New Zealand 2yr swap rate (the base rate which most banks use to price 2yr fixed mortgages)



Source: Bloomberg, Macrobond, ANZ Research

But what happens if NZ remains relatively isolated from these global events and/or they get resolved relatively quickly without creating a meaningful and sustained tightening in financial conditions? That would mean that the repricing in wholesale markets that we've seen recently (figure 2) isn't justified, and in fact has been a relative easing in monetary conditions versus what the RBNZ is trying to engineer. In this scenario this should correct in time, with markets expecting a higher OCR once it's clear inflation pressures are set to remain too high for too long and the RBNZ will deal to that, but in the interim we're left with interest rates taking longer than they should to get to appropriately restrictive levels, possibly meaning that rates need to stay high for longer. So on the one hand, a financial shock (if it is meaningful and sustained) may mean the OCR doesn't have to do as much work as otherwise, but if the financial shock turns out to be small and contained (ie not really a 'shock' so much as a 'scare'), it may mean the OCR has to do more (because adaptive wage and price setting behaviour has been given more time to get under the fingernails of the economy).

Real economy impacts: Credit conditions certainly influence the real economy in a direct sense, as the price or availability of credit changes the calculus of borrowing for households and businesses. However, financial market wobbles can have indirect economic impacts too, including hurting household and business confidence, and thus further reducing appetite to hire, invest, and spend.

On its own, the 'confidence channel' can be a very potent driver of economic outcomes, but when it extends to include a generalised pessimism around the underlying health of the financial system, it can become extremely potent – that's when it can start to further impact bank funding (eg a run on bank deposits), and in extreme cases, bank solvency. Even if such problems remain far from our shores, they could have significant impacts on NZ's national income. A large global financial market shock could lead to a "hard landing" for the global economy and a sharp decline in demand for New Zealand's exports, resulting in a decline in the terms of trade (the ratio of export prices relative to import prices) and hindering the international tourism recovery. That would be a very unwelcome development from an external balance perspective. New Zealand's current account deficit is already raising eyebrows among sovereign credit rating agencies, who may eventually officially declare NZ as a higher credit risk than previously (a ratings downgrade).

So what does it all mean for the housing outlook?

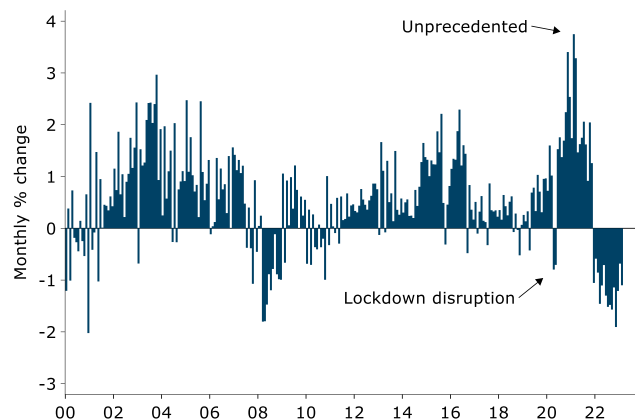
At this early stage, it could mean nothing, it could be a complete game changer (for both housing and the broader economy), or it could end up being something in between. Our current working assumption is closer to the 'nothing' camp, but the 'somewhere in between' scenario is looking more and more possible.

But for now, we're not factoring any impacts into our forecasts, and maintain both our OCR call (for a peak of 5.25% come May – although we are no longer characterising near-term risks as 'clearly to the upside'), and our house price assumption for a 22% peak-to-trough decline.

The recent housing data pulse remains broadly consistent with our view:

- Prices fell a further 1.1% m/m in February (figure 3), marking a 15th consecutive monthly decline that's so far taken prices a little more than 16% below their late 2021 peak.

Figure 3. House price index

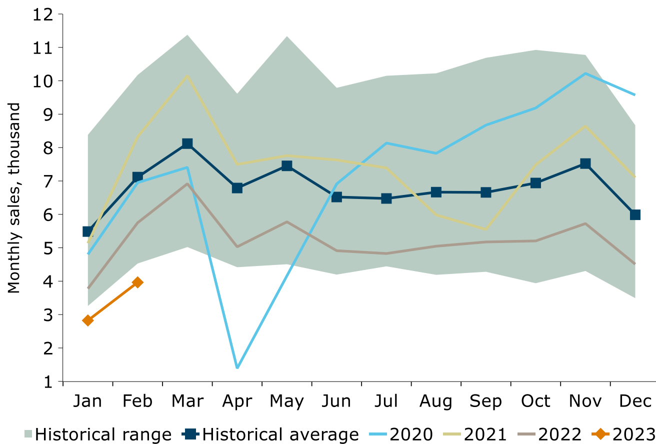


Source: REINZ, Macrobond, ANZ Research

- Sales contracted 11.4% m/m on a seasonally adjusted basis. Sales tend to provide around a three-month lead on prices, and the fact that both

January and February recorded their weakest-ever level of sales (figure 4) for these months (in data going back to the early 1990s), suggests price momentum isn't about to turn a corner.

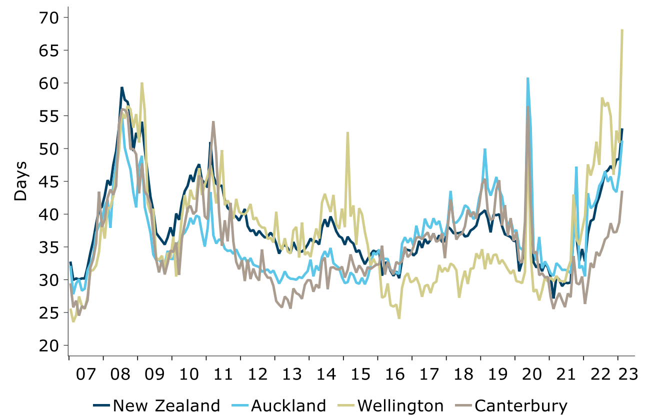
Figure 4. Unadjusted sales vs historical range



Source: REINZ, Macrobond, ANZ Research

- The number of days it takes to sell a house can be a good indicator of how much heat is in the market, and at 53 days in February (seasonally adjusted) the signal is ice cold! And it's not just cyclone/flooding impacts: look at Wellington (figure 5).

Figure 5. Median number of days to sell



Source: REINZ, Macrobond, ANZ Research

All up, there simply isn't enough concrete information in recent developments to move the dial on our housing outlook. And the housing market data continue to evolve consistently with our forecast. But the risk that the housing market (or the broader economy for that matter) doesn't go the way we expect is growing. Whether that's slightly tighter credit conditions than otherwise (for a given level of the OCR) or something much nastier is yet to be determined. Economic cycles don't tend to end in a soft controlled way, but they also don't tend to end in a predictable way.

Housing market indicators for February 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	$689,435	-8.6	-5.0	-12.3	-5.8	109	-13%	74
Auckland	$1,013,343	-15.2	-4.1	-16.9	-4.1	1,290	-23%	51
Waikato	$768,141	-7.3	-2.4	-10.8	-3.0	379	-16%	62
Bay of Plenty	$798,890	-15.2	-4.6	-12.3	-3.3	242	-15%	63
Gisborne	$564,489	-18.7	0.4	-11.2	-2.8	23	-33%	46
Hawke's Bay	$662,875	-17.4	-4.4	-11.2	-2.8	118	-24%	62
Manawatu-Whanganui	$535,599	-11.4	-2.9	-15.9	-4.1	214	-15%	56
Taranaki	$568,285	-12.3	-0.8	-8.0	-2.6	114	+2%	61
Wellington	$745,781	-20.5	-5.0	-20.3	-4.5	443	-17%	68
Tasman, Nelson & Marlborough	$730,643	-7.5	-3.8			153	-8%	59
Canterbury	$653,442	-6.9	-1.0	-8.9	-1.9	673	-2%	44
Otago	$677,670	-13.8	-1.1	-6.2	-2.8	246	-16%	59
West Coast	$282,129	-16.7	-13.7	-8.5	-2.1	27	-17%	38
Southland	$432,625	-9.6	-3.4	-6.0	-2.2	94	-15%	49
New Zealand	**$766,955**	**-13.9**	**-3.1**	**-14.2**	**-3.6**	**4,139**	**-11%**	**53**

Mortgage borrowing strategy

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Summary

Mortgage rates are little changed on average across the big-4 banks over the past month. Borrowers still face a very flat fixed mortgage curve, with just 0.21%pts separating the lowest rate (the 6.51% 2yr) from the highest rate (the 6.72% 4yr). That leaves the choice of what term to choose largely dependent on whether one thinks that wholesale interest rates have peaked (which might end up being true if a credit crunch is on the way) or will rise further (which might end up being true if inflation remains stubbornly high). Financial markets are grappling with these scenarios too; hence recent volatility. We think both scenarios are plausible. But if a credit crunch does occur, falling wholesale rates may be offset by wider funding spreads, meaning mortgage rates may not in fact fall, as we discuss on page 5. For that reason, it may be worth considering fixing a portion of debt for a little longer than usual.

Once again, fixed mortgage rates are little changed since last month. Although we have seen wholesale interest rates fall, they have been extremely volatile and have yet to settle down. And in the meantime, credit spreads have started to widen to a greater or lesser extent depending on where in the world one is. What that means is that one cannot count on retail lending rates falling just because swap rates and government bond yields are lower.

Of note, most banks have not lifted their floating rates in the wake of the RBNZ's 0.50%pt increase in the OCR in February. Whether there are catch-up increases in floating rates when the RBNZ next lifts the OCR remains to be seen, but with only around 10% of mortgage debt on floating rates, it's unlikely to make much of a difference to the average household.

Because the next two OCR hikes are now largely priced in (and expected by markets and analysts, including ourselves), if the RBNZ does hike by 0.25%pts in both April and May, that in itself won't drive wholesale rates up much. For that to happen, the RBNZ would need to signal that more hikes will likely be needed than are priced in – and markets would have to believe it. At this point, markets are dubious on both fronts, thanks mostly to the recent bout of global bank wobbles.

All of this matters a great deal for borrowers. We say that because with little separating the lowest fixed rate (6.51% for 2yrs) from the highest fixed rate (6.72% for 4yrs), it isn't likely to be cost that drives the decision about what term to select, but rather a view on the likely direction of rates in the future. Of course that's always true, but in an environment where there's a big difference in rates, the playing field does get tilted one way or the other. Not currently, making it a pretty clean punt on the future direction of rates. It also makes breakeven analysis pretty dull, so we won't discuss it in any detail.

The flat curve and the lack of a significant financial incentive to fix for longer or shorter leaves mortgage borrowers in the same pickle as financial markets, which are weighing up different future scenarios for the future. One plausible scenario is that recent financial instability blows over, either because markets calm down, or because central bank liquidity facilities and other interventions work. If that happens, it may not be long before we're debating how much higher the OCR needs to go to bring inflation back down, like we were a few weeks ago. Remember, inflation isn't licked yet; for that reason, we can't dismiss this scenario.

The other (main) scenario sees financial instability start to spill over into the real economy, potentially sowing the seeds of a credit crunch. This is the scenario that has gripped market attention this month. And of note, it's likely to be associated with lower interest rates as central banks unwind last year's hikes (cuts are actually already priced into the term structure of most markets, including New Zealand). But while that may sound like good news for borrowers, this scenario might also be associated with wider credit spreads, which could partly or fully offset lower wholesale rates. And for that reason, even though most of the hikes we now expect are priced in, it may still be worth thinking about fixing for a little longer than otherwise.

Figure 1. Carded special mortgage rates^

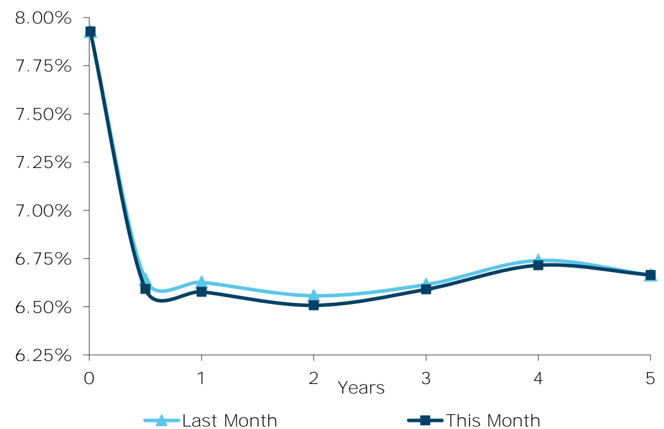

Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	7.93%				
6 months	6.59%	6.56%	6.50%	6.37%	6.71%
1 year	6.58%	6.53%	6.44%	6.54%	6.76%
2 years	6.51%	6.54%	6.60%	6.73%	6.92%
3 years	6.59%	6.66%	6.76%	6.76%	6.77%
4 years	6.72%	6.70%	6.69%		
5 years	6.67%	#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	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Floating Mortgage Rate	5.9	6.7	7.8	7.9	8.6	8.8	8.8	8.8	8.8	8.8
1-Yr Fixed Mortgage Rate	5.1	5.2	6.4	6.6	6.4	6.3	6.1	6.0	5.8	5.7
2-Yr Fixed Mortgage Rate	5.6	5.6	6.6	6.5	6.4	6.2	6.1	5.9	5.8	5.6
5-Yr Fixed Mortgage Rate	6.3	6.0	6.8	6.7	6.6	6.6	6.5	6.4	6.4	6.3

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	7.3	6.7	6.6	5.8	4.7	4.0	2.7
Unemployment Rate (%)	3.3	3.3	3.4	3.4	3.5	4.0	4.5	5.0	5.2	5.3
House Prices (Quarter % Chg)	-3.2	-4.1	-4.3	-3.3	-3.8	-2.9	-0.1	0.4	0.6	0.6
House Prices (Annual % Chg)	3.6	-5.6	-12.9	-14.1	-14.5	-13.5	-9.7	-6.3	-2.0	1.5

Interest rates	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Official Cash Rate	2.00	3.00	4.25	4.75	5.25	5.25	5.25	5.25	5.25	5.25
90-Day Bank Bill Rate	2.86	3.85	4.65	5.27	5.35	5.35	5.35	5.35	5.35	5.35
10-Year Bond	3.86	4.30	4.47	4.15	4.15	3.75	3.50	3.50	3.75	4.00

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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