New Zealand Property Focus

Collateral damage

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INSIDE

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Summary

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

Feature Article: Collateral damage

With the country under Level 4 lockdown, the property market is eerily quiet. It's a highly uncertain time. We can't predict exactly what will happen for the property market from here; it will depend crucially on how the COVID-19 outbreak evolves. But at this stage we expect the following:

- The economic impact will be enormous. We expect GDP will be 8-10% lower this year, affecting household incomes and some firms' viability.
- Property market data will be all over the place in the period ahead, with liquidity thin, uncertainty huge, and economic activity volatile.
- It may take a while for trends to become evident. But demand pressures will be significantly curbed on the other side of this.
- Financial pressures will increase with many people in limbo. Construction firms and the like will incur significant delay costs, in particular.
- Credit is likely to be constrained, but we expect the financial system will function smoothly.
- Reduced income prospects and a fundamental shift in the supply-demand balance will see rents under downward pressure.
- House prices will fall significantly. We expect to see a drop of 10-15% at this stage, with downside risk.
- Commercial property could be even more affected than residential, given its clear links to business activity.

Economic overview

We are in the midst of an unprecedented health crisis. New Zealand is making encouraging progress at curbing the COVID-19 outbreak on our shores, but the human impact worldwide remains troubling. Lockdown measures have been necessary, and effective. However, the economic impact will be large, with a sharp recession underway. We currently expect GDP to fall 22% over the first half of this year, and 8-10% over 2020. There will be an initial but incomplete rebound with a protracted recovery from there. Over the long-term, the economy will likely be reshaped to some degree, with some industries shrinking and new opportunities arising. The Government will need to provide stimulus for quite some time, with more spending in the pipeline. We think the RBNZ will need to roughly double its quantitative easing programme. See this section inside for a brief explanation of how that works.

Mortgage borrowing strategy

Mortgage rates continue to fall, with average special rates offered by the major banks now at all-time lows at every duration. The average 1-year rate is now close to 3%, having fallen the most in recent weeks. With the RBNZ now pursuing quantitative easing in a bid to drive down long-term wholesale interest rates, there is less incentive to fix to "hide" from possible increases. Equally, with the RBNZ committed to keeping the OCR on hold, choosing floating on the expectation that floating rates may fall has limited appeal. With a big gap between average floating and 1-year rates, we favour the 1-year term in this low-rate environment we now find ourselves in.

Feature Article: Collateral damage

Summary

With the country under lockdown, the property market is eerily quiet. Sales aren't happening for the most part, settlements are being delayed, residential building has ceased for now, and people are not moving houses. It's a highly uncertain time. We can't predict exactly what will happen for the property market from here; it will depend crucially on how the COVID-19 outbreak evolves. But at this stage we expect the following:

- The economic impact will be enormous. We expect GDP will be 8-10% lower this year, affecting household incomes and some firms' viability.
- Property market data will be all over the place in the period ahead, with liquidity thin, uncertainty huge, and economic activity volatile.
- It may take a while for trends to become evident. But demand pressures will be significantly curbed on the other side of this.
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- Reduced income prospects and a fundamental shift in the supply-demand balance will see rents under downward pressure.
- House prices are likely to fall significantly. We see a drop of 10-15% at this stage, with downside risk.
- Commercial property could be even more affected than residential, given its clear links to business activity.

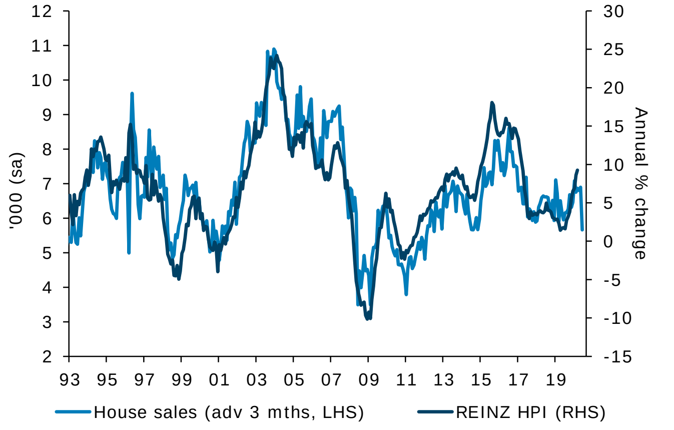
In lockdown

The country is under lockdown, and so too is the property market. The lockdown is necessary for health reasons, but is also the best thing we can do for the economy. Although uncertainty is extreme, the experience of other countries strongly suggests that the longer-term economic pain would be far worse if we had not adopted an early and strict lockdown strategy. But it must also be said: a very large economic slump is unavoidable.

The current period of quiet in the property market is occurring under an enormous cloud of uncertainty and significant volatility can be expected. Fewer purchases and new tenancies will mean lower market liquidity and greater price volatility. Trends in the market will be difficult to disentangle for some time, even once activity resumes. But there will be enormous implications across market segments.

The Real Estate Institute of New Zealand (REINZ) housing market data for March showed the very early stages of the current lockdown. House sales dropped 18% (figure 1), reflecting the lockdown coming into effect late in the month. Prices eked out a small 0.3% gain. In April, the impacts on the housing market will be much more stark, with the market having ground to a halt.

Figure 1: House prices and sales

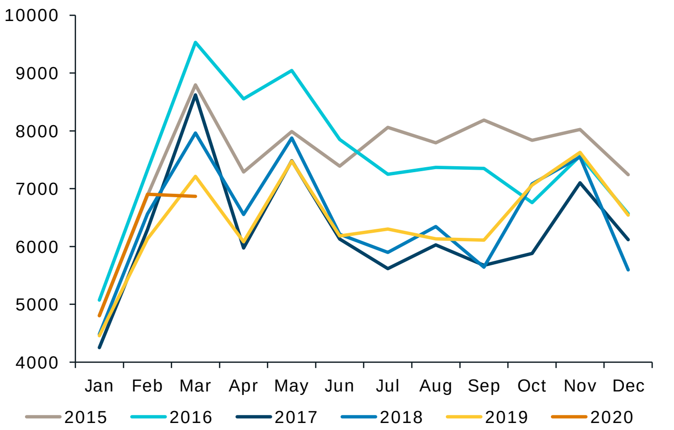


Source: Statistics NZ, ANZ Research

Sales and settlements grind to a halt

House sales have effectively stalled, though there will be some exceptions. Real estate has not been deemed an essential service, and open homes and private viewings cannot take place in person. REINZ has advised that these can occur via online virtual tours or video conferencing software, so a small amount of real estate activity can take place. In fact some sales are occurring through virtual auctions. And we hear there is some increased buying interest from returning kiwis. But on the whole, not much will be happening for now. It's unfortunate timing for the industry since this is generally a busy time of year (figure 2).

Figure 2: House sales over the year



Source: REINZ, ANZ Research

Feature Article: Collateral damage

It is possible that we see some sales contracts entered into, particularly if they were already in the pipeline. But it's hard to imagine much more than that if people can't see the properties they are looking to buy. Section transactions are probably more likely to occur than other types of sales, and some private sales may go ahead (though if flouting of restrictions is involved, that would make them technically unlawful).

The New Zealand Law Society recommends that settlements be delayed until the lockdown is lifted. And property lawyers will be amending clauses in existing contract to that effect, with many settlements perhaps not taking place until after entering Alert Level 2 or below. This requires mutual agreement between both parties. That uncertainty will be another deterrent.

Technically, property settlements can still go ahead, but very few are likely to take place at the moment. Land Information New Zealand has indicated that settlement (including vendor and buyer identification and witnessing document signing) can occur with the use of video conferencing. That means that there will be exceptions where settlements can go ahead if everything is in place, such as for sections where all necessary paperwork is completed and moving isn't required. Overwhelmingly, though, settlements will be delayed, since people cannot move or vacate properties, inspections cannot take place, and getting paperwork signed is difficult.

Delays in settlements will have financial impacts if people are paying for loans or if they are waiting for payment. For those with settlements in limbo, changes in employment positions and reduced KiwiSaver balances could mean the calculus of buying has now changed. This could result in enormous financial pressure if sufficient settlement conditions are not in place for the buyer to have an out. On the other hand, if buyers can pull the pin, vendors will be in a tricky situation, especially if they have purchases pending. Finding a new buyer may not be easy.

It may be quite some time before real estate activity can resume properly again. Given the face-to-face nature of the work, real estate and thus sales activity may well be curtailed under Alert Level 3 as well. We will find out more this week.

Building has paused

Building of houses has also pressed pause for a time. This will increase costs for those who are paying mortgages on builds under construction or where planning is underway (but land has been paid for).

The lockdown, alongside other challenges discussed in last month's ANZ Property Focus, will mean increased financial pressures for some construction firms. The supply chain is being affected by global disruption, particularly for commercial and infrastructure projects. Delays from both supply chain issues and the lockdown will add to operational costs.

Councils won't be doing much consenting, or at least there will be considerable delays. For those who have already received consent, an extension would likely be granted if requested.

We expect that building will be able to resume once we go to Alert Level 3, though we don't know for sure yet. It will be important for activity to be able to get underway quickly once it is permissible.

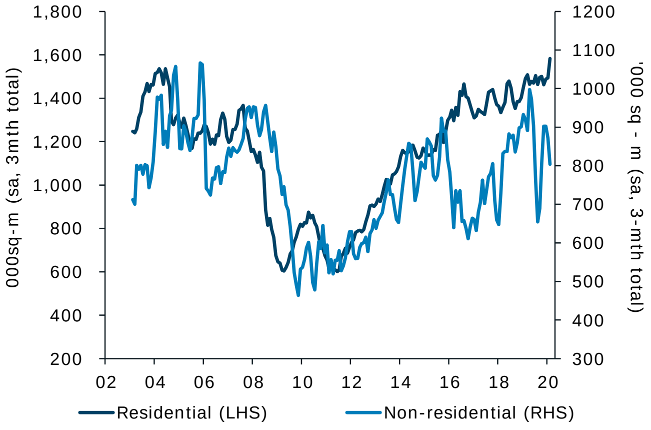
Activity lower, when it resumes

At some point, house settlements will resume and sales will eventually increase again. However, the broader economic slowdown will start to become evident then. There will be an initial bounce, but beyond that we expect to see a trend softening. Both interest from buyers and new inventory will likely be lower, and there will be fewer sales taking place until more certainty is in place and the economy starts to recover. That may not be until next year.

On the building side, there will likely be some projects that no longer go ahead, given hampered business and employment prospects, rampant uncertainty and so on. There may also be delays, since work takes time to organise and gear up again, especially since some industry participants may not be operating anymore.

Overall, building consents are likely to fall pretty dramatically. Combined with some cancellations of previously consented projects, this will see activity contract very sharply from recent highs (figure 3).

Figure 3: Building consents



Source: Statistics NZ

Property developers are particularly vulnerable when it comes to delays and issues associated with firms no longer being viable. They have to line up many sub-contractors and materials in order for a project to be completed. Costs may escalate.

Cost increases, combined with softening land values and more difficulty getting pre-sales, may see equity positions come under pressure, with credit conditions already very stringent. This may create financial pressures for some pockets of this industry.

Financial stresses to increase

More generally, financial pressures will increase for many across the economy, with household and business incomes affected, costs increasing, and many people in limbo. It could be quite some time before we enter a phase where property transactions, building and development will be able to take place normally. This understandably means people will be dealing with a significant deal of uncertainty, and possibly financial strain – potentially for quite some time.

Financial services will still be available, and banks will be working with customers where settlement is pending, bridging finance is required, or where KiwiSaver funds have reduced significantly relative to those balances prevailing at signing.

But the risk is that with activity restrictions potentially persisting, even if they are eased over time, some housing market activities could simply be canned, rather than delayed. Participants may be dissuaded from transacting due to changes in employment prospects, financial strain, or simply due to the enormous amount of uncertainty that abounds. That would add to pressures on firms in the industry and worsen the economic blow.

Debt-servicing will be more difficult for some households and firms. Wage subsidies, the mortgage deferment scheme and super-low interest rates will help cushion the blow. But nonetheless, financial stresses will be very real for some and there are significant risks that some households struggle to service their debts as ability to pay comes under pressure.

Credit growth likely to ease

The outlook for the property market – including house prices, sales, new builds and development – will depend a lot on credit conditions. It is likely that over time credit growth will decline as the housing market cools and banks operate prudently to protect their balance sheets, shareholder equity and people's deposits. It is important for banks to protect their ability to provide credit to the economy more broadly.

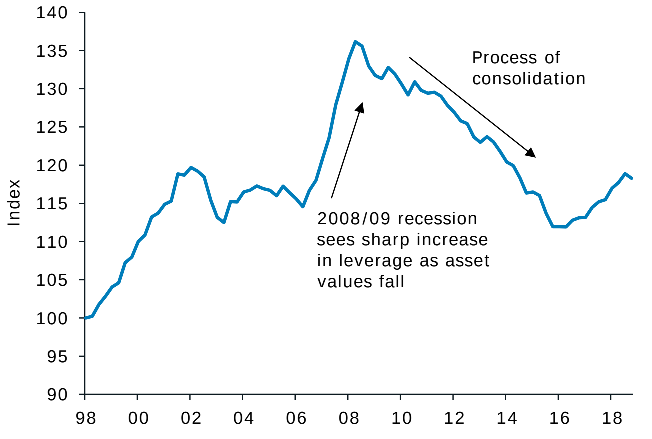
The mortgage repayment deferment scheme is useful for easing pressures on borrowers in the short term, but it is only a stop gap. Interest will still accrue, leaving debt levels higher than before. For some households the scheme will be helpful on balance, but for others it is not necessarily the best option. Some are choosing instead to move to interest-only loan repayments for a time, or extend the term of the loan. Decisions must always be made with a view to the long term. Banks will naturally play a role in helping customers making these decisions.

Risk assessments will continue to be important in determining where credit flows. In some cases, more credit will not be desired, or may not be available. As financial positions change, loan delinquencies will unfortunately increase to some extent, as they always do in downturns.

Households' financial positions will be less favourable in aggregate, due to reduced income prospects, lower house prices and debt overhang. This will affect collateral values and credit eligibility. Likewise, higher mortgage delinquencies and lower collateral values will weigh on bank balance sheets. Given the evolving risk environment, banks are likely to become more cautious about expanding credit, in order to ensure that their balance sheet remains robust.

To shore up financial positions, we also expect households and firms will embark on a period of deleveraging, as occurred after the 2008/09 recession (figure 4), and that they will be cautious about taking on more debt. On the whole, new lending is likely to be soft.

Figure 4: Household leverage



Source: RBNZ, ANZ Research

While system-wide credit growth is likely to decline, we don't expect banks to come under significant pressure. Banks have strong capital and liquidity positions to weather this crisis, along with strong risk management processes. The Government and RBNZ are also doing what they can to ensure the financial system can function smoothly and banks can lend effectively. This reduces the risk that the system gets stressed, credit is halted and significant fire-sale dynamics start to emerge. So overall, we don't expect to see a widespread credit crunch, though this cannot be ruled out as a risk.

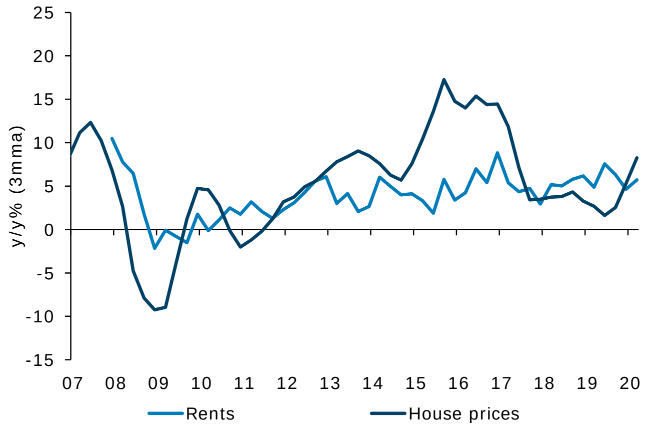
Feature Article: Collateral damage

Rents under downward pressure

Rents tend to come under pressure in downturns, but falls are rare (figure 5). However, this isn't your typical downturn and we may see more pressure than usual, with possible falls – and a lot more volatility.

Although there was an influx of kiwis returning from overseas as the crisis escalated, the balance of supply and demand in the rental market has tipped towards more supply, with many short-term rentals usually occupied by tourists now vacant. Some motel and hotel rooms may even be repurposed. For example, we know the Government is using some for border quarantines. Meanwhile, the ability to pay rent is being challenged, with the economy contracting and incomes uncertain.

Figure 5: Rental inflation and house prices



Source: REINZ, MBIE, ANZ Research

Although there will be downward pressure on rents, this will not be fully evident for a time, since people can only move in extreme circumstances and there will be little movement in new tenancies. It will be difficult for renters to leave tenancies given moving restrictions, but not impossible in some cases. Landlords, on the other hand, will have a harder time ending existing agreements – and the Government has said that rents are not allowed to increase.

We expect to see clear downward pressure in the short term when new tenancies are entered into (though this will be rare for a while) and in cases where tenants negotiate down their rents to what they can pay. Once new leases get underway, we expect more obvious downward pressure will emerge.

Generally, rental yields fall when interest rates do. But that may not occur straight away because house prices generally fall further and faster than rents. During the Global Financial Crisis rental yields actually increased for a time. The increase in yields at times like this is compensation for the increased risk of property investment during that period. But rents can't lift above what people can afford to pay, and this time rent increases are banned.

Both rents and house prices are likely to be slow to adjust for a time, making trends hard to identify. Once house prices start to increase again in the recovery phase, then rental yields will perhaps more clearly resume their downward trend.

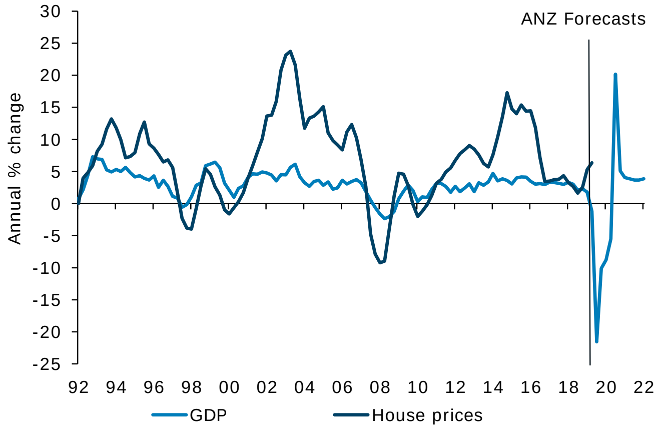
House prices to fall significantly

House prices are expected to come under pressure, as typically happens in economic downturns. It's true that interest rates are lower and there will be less supply, with fewer houses on the market and new builds not coming online as quickly. But weaker demand is likely to dominate. A number of factors will weigh:

- Regional markets exposed to tourism will be hit hard;
- The business environment is poor and income expectations will be lower;
- Unemployment is set to increase;
- Debt servicing will be difficult for some, even though interest rates are low.
- Uncertainty is enormous;
- The balance of supply and demand for physical housing will tip, dampening rental inflation;
- Mortgage delinquencies will see fire sales increase off very low levels;
- The migration outlook is likely to be weaker for quite some time;
- Expectations will shift abruptly;
- Banks are likely to be cautious; credit availability will be hampered by lower collateral values and worse income prospects;
- Households will look to deleverage and be cautious about taking on more debt.

We are seeing a considerable slump in economic activity and house price impacts are expected to be likewise significant. On the whole, we see house prices falling 10-15% over the year, compared with our expectation for a fall of 8-10% in GDP. Typically, the housing market actually responds more dramatically to downturns in GDP (figure 6), meaning there is a risk of an even greater fall, though given moves are so far outside of the usual historical range of events there is extra uncertainty.

Figure 6: House prices and GDP



Source: REINZ, Statistics NZ, ANZ Research

Commercial property may be even more affected

As with residential property, commercial rents and property prices are expected to come under significant pressure. This is especially the case with demand from businesses expected to fall – reflecting an inability to trade (and, in the near term, access) properties, a weaker economic outlook, and some firms going out of businesses. Here too, though, there is likely to be volatility, making trends difficult to discern.

Rental demand on the commercial side will likely be even more affected than the residential rental market. People still need somewhere to live, but in a lot of cases, businesses will not be using commercial properties for a time, and some firms may go out of business. The Government has announced a lengthening in the timeframes before landlords can cancel commercial leases, giving tenants some breathing space.

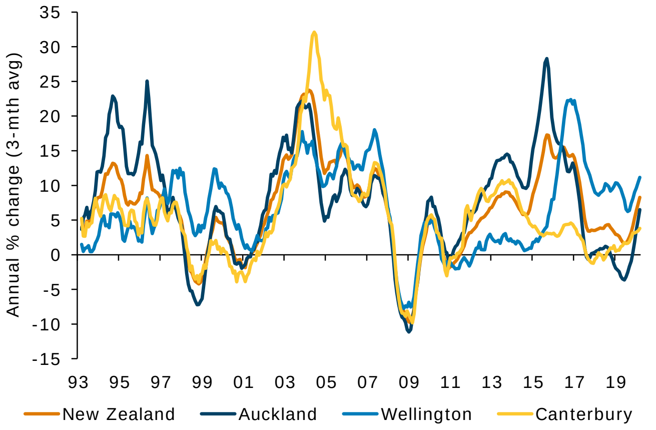
Similarly, property prices in this segment will likely be more impacted than house prices. This is consistent with previous downturns; commercial property is more connected to the economic environment, which makes sense, given its obvious link to business conditions. During the 2008/09 recession, we saw house prices fall 10%, while commercial property prices fell 30%.

There are two aspects to commercial property yields: the rent, and the property value. Commercial property was truly hot property going into this downturn, with yields at record lows as prices soared, including for small properties, as residential property investors looked to diversify. Those high prices make for a lot of downside risk from here. The risk of empty premises has increased, uncertainty is high, and credit will be much harder to come by. In downturns commercial property prices are typically sticky due to limited sales transactions, but forced sales could lead to price discovery.

There will also be downward pressure on commercial rents. The retail sector is under enormous pressure, and firms may conclude they no longer need so much office space after the great working-from-home experiment. Commercial property owners won't have a lot of bargaining power either, since demand from other tenants will have reduced. Owners may well reduce rents to ensure they get some cash flow from struggling businesses.

Overall, then, while normally one would expect downward pressure on yields in a downturn, with rents less sticky than commercial property prices, the picture is less clear-cut this time. We may see something of a race to the bottom for both commercial rents and property prices.

Figure 1. Regional house price inflation



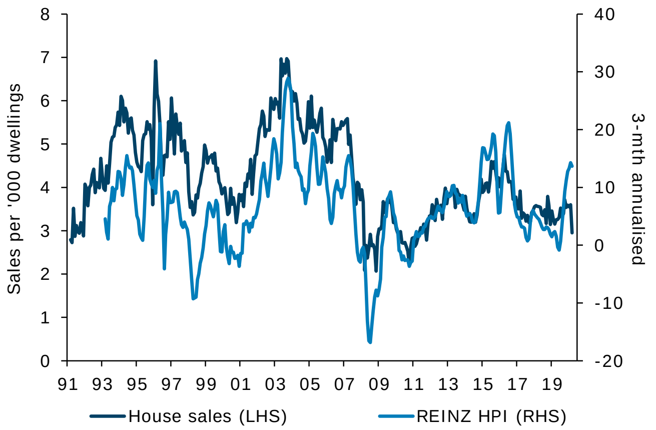
Source: ANZ Research, REINZ

House prices rose 0.3% m/m in March, accelerating to 9.3% y/y, eking out a modest gain ahead of what is likely to be a steep slide.

Strong annual growth reflects the resurgence in the housing market seen late last year. Outside of Auckland, house prices were up 10.3% y/y. Smaller regions have shown particularly strong upwards momentum.

Looking forward, house prices are expected to fall significantly, due to the considerable economic slump underway. Monetary and fiscal policy will cushion some of the blow, but it won't be enough to stop the slide. Regions exposed to tourism may be hit hard.

Figure 2. REINZ house prices and sales



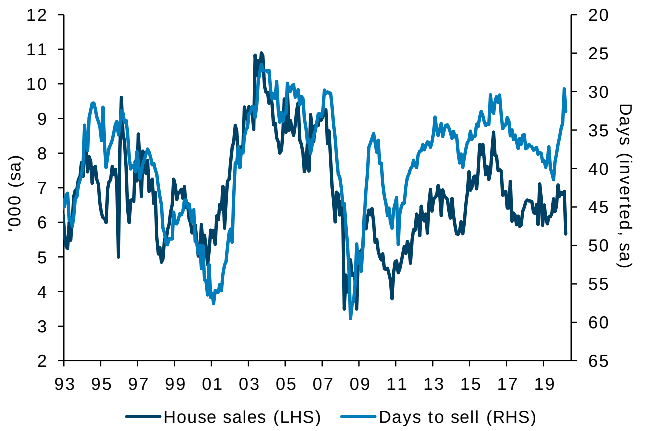
Source: ANZ Research, REINZ

Sales volumes and prices tend to be closely correlated, although at times tight dwelling supply can complicate the relationship.

House sales fell 18% m/m, with the lockdown coming into effect at the end of the month. Under Alert Level 4, sales and settlements have slowed to a mere trickle. This lack of liquidity will lead to considerable volatility in coming months, though a weaker trend is expected to become evident.

Sales fell 25% in Auckland and 17% elsewhere. Taranaki was the only region where sales rose (8%). Falls were largest in Gisborne (-47%) and West Coast (-49%). This may reflect that industries like forestry were hit first in this crisis, although smaller markets are also often more volatile.

Figure 3. Sales and median days to sell

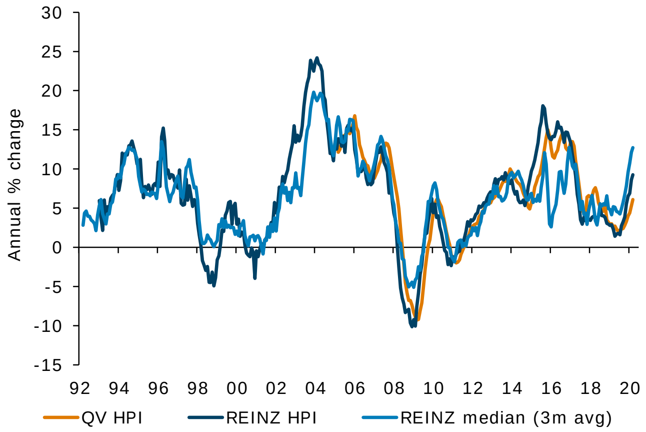


Source: ANZ Research, REINZ

How long it takes to sell a house is also an indicator of the strength of the market, encompassing both demand and supply-side considerations. Larger cities tend to see houses sell more quickly, but deviations in a region from its average provide an indicator of the heat in a market at any given time.

The number of days it takes to sell a house has generally been very low, but rose from 30 to 33 days in March. This is still well below the historical average of 39 days. But tightness in the market is easing and that is expected to continue. We expect this metric to soften quickly, with demand pulling back, incomes softer, and uncertainty rife.

Figure 4. REINZ and QV house prices

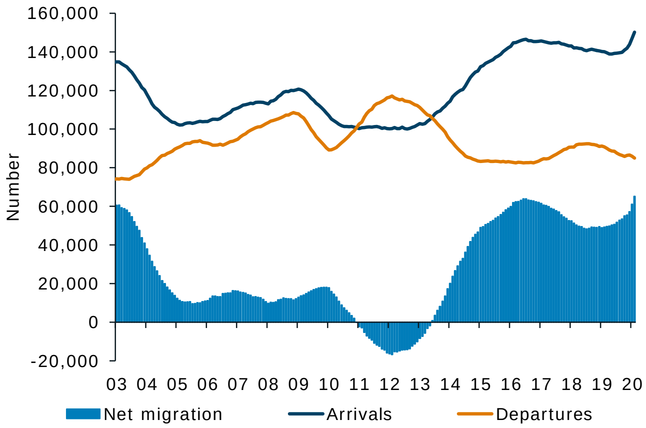


Source: ANZ Research, REINZ, QVNZ

There are three monthly measures of house prices in New Zealand: the median and house price index measures produced by REINZ, and the monthly QVNZ house price index. The latter tends to lag the other measures as it records sales later in the transaction process. Moreover, movements do not line up exactly, given differing methodologies (the REINZ house price index and QVNZ measures attempt to adjust for the quality of houses sold).

The REINZ HPI – our preferred measure – increased to 9.3% y/y in March. This is above the QVNZ measure, which came in at 6.1% y/y. The REINZ median also crept up to 12.7% y/y (3mma), up from 9.6% in December.

Figure 5. Annual migration*



Source: Statistics NZ

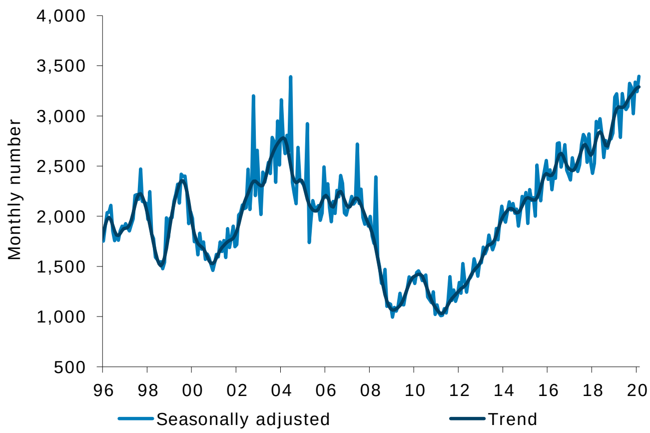
*The last 9 months or so are subject to substantial revisions.

Migration flows to and from New Zealand are one of the major drivers of housing market cycles. The early-1970s, mid-1990s, mid-2000s and most recent house price booms have coincided with large net migration inflows.

We estimate that the downward trend in migration has continued. To avoid unnecessary noise in our economic outlook we're now forecasting net migration with a lag (between 9-12 months), ie not using the most recent reported data which is volatile and revisions are extremely large.

The older, more reliable data suggest the cycle was still easing into mid-2018, before picking up heading into 2019. Border restrictions will have stopped migration in its tracks, though there will be a short-term boost from the influx of kiwis coming home.

Figure 6. Residential building consents

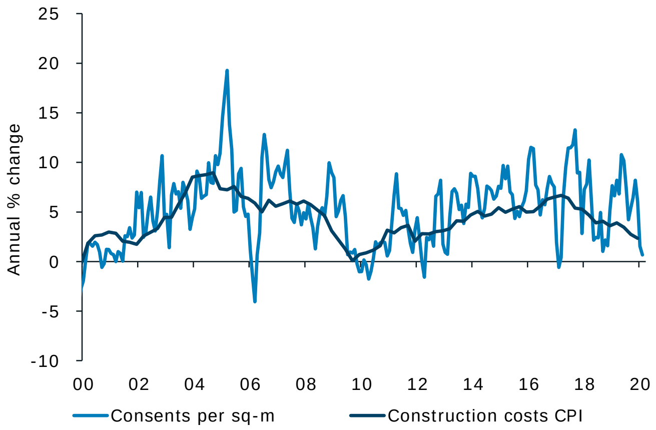


Source: ANZ Research, Statistics NZ

Residential building consents rebounded 4.7% m/m in February, after a 2.8% fall in the month prior. These data tend to be volatile month-to-month, largely driven by fluctuations in multi-unit consents. Annual consent issuance has risen since 2012, but momentum appears (tentatively) to be slowing as it approaches 38k. Auckland consents have been strong but have come under pressure in recent months. The gentle rise in Canterbury's annual consents is persisting.

Building has hit pause for now. But from here, we expect to see weaker demand for new building, with income disruptions and weaker sentiment weighing. Supply chain and work disruptions will also impact activity when it restarts. It's hard to see building consents heading higher in that environment.

Figure 7. Construction cost inflation



Source: ANZ Research, Statistics NZ

Construction cost inflation has softened since 2017, and will likely soften further from here with demand weak.

Growth in the cost of consented work per square metre – a proxy – continued its recent decent to reach 0.7% y/y (3mma) in February; it's lowest growth rate in almost three years. This data is extremely volatile (largely due to the different types dwellings being consented).

Typically, in times of economic strain and uncertainty, big-ticket items such as house builds take a backseat as households hunker down and ride out difficult times. The economic downturn and weaker housing demand will apply downward pressure on construction costs.

Figure 8. New mortgage lending and housing turnover

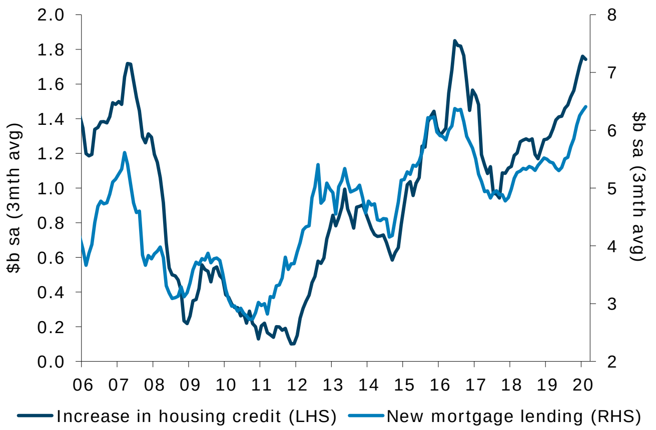
Source: ANZ Research, RBNZ

New residential mortgage lending figures are published by the RBNZ. These are gross (rather than net) flows and can provide leading information on household credit growth.

New mortgage lending moves closely with the value of new house sales. New mortgage lending eased 1.6% m/m (sa) in February, but these can be volatile.

Firm cash flow and labour market strain will impact households' willingness and ability to purchase houses and take on more debt. And we expect banks will be prudent in their lending decisions. Overall, we expect new lending growth will soften, with these data expected to come under pressure post February.

Figure 9. New mortgage lending and housing credit

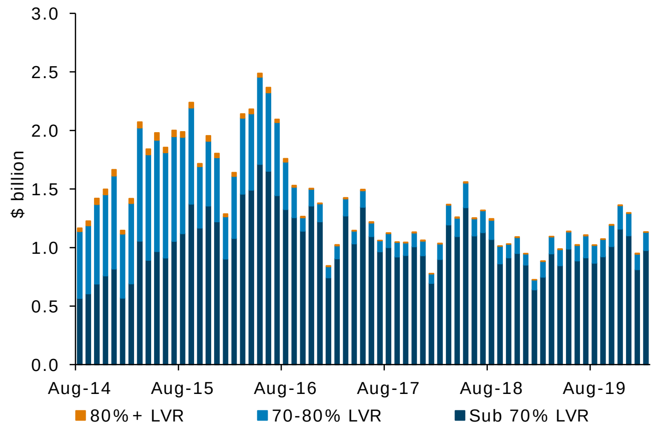


Source: ANZ Research, REINZ, RBNZ

Household credit has been growing at a relatively steady pace for the past year or so. The pace of growth has slowed over the last four months. We suspect housing credit growth may be topping out.

The outlook for credit will be affected by a number of forces. Many firms are reporting extreme difficulty and job cuts have materialised, with more to come. This alongside declining house prices, and prudent behaviour from lenders and borrowers, will limit growth in housing credit. Debt-servicing will become more difficult for some, though the OCR at new lows will cushion the blow. Providing a partial offset, some households and firms will be using credit to bridge the gaps in their earning power, meaning credit may increase for a time in some pockets. Overall, credit growth is expected to soften from here.

Figure 10. Investor lending by LVR

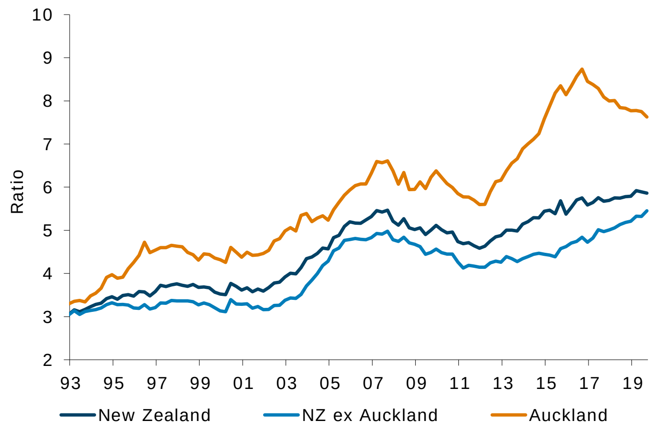


Source: ANZ Research, RBNZ

Lending to investors was down 5% m/m in February (seasonally adjusted, ANZ estimate), following solid monthly outturns since mid-2019. New lending to investors as a percentage of the total eked out a small gain to 20.3% (from 20.2% in January). This is well below the near-35% peaks seen in 2016.

The share of riskier lending remains stable, with LVR restrictions remaining in place to limit their impact for the time being. The share of investor lending at loan-to-value ratios of less than 70% has barely shifted in recent times, with a slight m/m rise to 86%. In late-2014 it was around 50%. Demand from investors is likely to be just as affected as demand from other buyers – perhaps more – so we see their share stable to lower from here.

Figure 11. Regional house prices to income

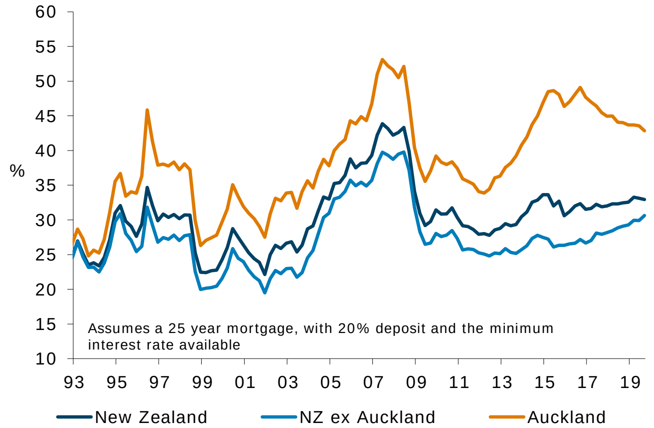


Source: ANZ Research, REINZ, Statistics NZ

One commonly cited measure of housing affordability is the ratio of average house prices to incomes. It is a standard measure used internationally to compare housing affordability across countries. It isn't perfect; it does not take into account things like average housing size and quality, interest rates, and financial liberalisation. Therefore, it is really only a partial gauge as some of these factors mean that it is logical for this ratio to have risen over time.

Nationally, the ratio has been stable at around 6 times income since early 2017. Auckland has seen its ratio ease from 9 times in 2016 to an estimated 7.6 times in Q3 2019, reflecting house prices easing from recent highs. Excluding Auckland, the ratio has continued to rise; at 5.5 times incomes this is at record highs, and about where the national average peaked last cycle.

Figure 12. Regional mortgage payments to income



Source: ANZ Research, REINZ, RBNZ, Statistics NZ

Another, arguably more comprehensive, measure of housing affordability is to look at it through the lens of debt serviceability, as this also takes into account interest rates, which are an important driver of housing market cycles.

We estimate that for a purchaser of a median-priced home (20% deposit), the average mortgage payment to income nationally is 31%, having eased a little on the back of lower mortgage rates. In Auckland it is 41%, with gradual easing from recent highs continuing. In the rest of New Zealand it is 29%, having gradually increased on the back of house price rises. Although servicing is currently manageable, households could be vulnerable in the event of a lift in interest rates or reduction in income.

Property gauges

The housing market will be affected by the enormous slump underway. Volatility is very likely in coming months, but a weaker housing demand impulse is expected to become evident, as typically happens in economic downturns. At this stage, we expect house prices to fall 10-15% this year, with downside risk. Weaker incomes, unemployment and uncertainty will weigh. Debt servicing will be difficult for some, even though interest rates are low. Banks are expected to be prudent with new lending, and households cautious about taking on more debt. Regional markets exposed to tourism will likely be hit hard, and expectations may shift abruptly.

We use ten gauges to assess the state of the property market and look for signs that changes are in the wind.

Affordability. For new entrants into the housing market, we measure affordability using the ratio of house prices to income (adjusted for interest rates) and mortgage payments as a proportion of income.

Serviceability / indebtedness. For existing homeowners, serviceability relates interest payments to income, while indebtedness is measured as the level of debt relative to income.

Interest rates. Interest rates affect both the affordability of new houses and the serviceability of debt.

Migration. A key source of demand for housing.

Supply-demand balance. We use dwelling consents issuance to proxy growth in supply. Demand is derived via the natural growth rate in the population, net migration, and the average household size.

Consents and house sales. These are key gauges of activity in the property market.

Liquidity. We look at growth in private sector credit relative to GDP to assess the availability of credit in supporting the property market.

Globalisation. We look at relative property price movements between New Zealand, the US, the UK, and Australia, in recognition of the important role that global factors play in New Zealand's property cycle.

Housing supply. We look at the supply of housing listed on the market, recorded as the number of months needed to clear the housing stock. A high figure indicates that buyers have the upper hand.

House prices to rents. We look at median prices to rents as an indicator of relative affordability.

Policy changes. Government and macro-prudential policy can affect the property market landscape.

Indicator	Level	Direction for prices	Comment
Affordability	Unaffordable	↓↓	Affordability constraints are relevant. It's hard to see people buying super-expensive houses when the outlook is bleak.
Serviceability/ indebtedness	Jobs in jeopardy	↓↓	Serviceability is fine, but job security isn't. Debt levels are high, incomes are expected to be lower, and uncertainty is rife.
Interest rates / RBNZ	Flat	↔/↑	The OCR is set to remain at 0.25% for at least 12 months. Funding costs will matter for mortgage rates too though.
Migration	Peaking	↔/↓	Migration has been moderating. It could increase in the short term, with kiwis coming home, but will likely soften with borders closed.
Supply-demand balance	Shifted	↓	The balance has shifted to more supply, with short-term rentals coming available.
Consents and house sales	Turn	↓↓	The market is under pressure, which may see transactions and new projects dry up, with prices moving lower.
Liquidity	Relief	↔	The outlook is uncertain. Delayed capital changes will provide relief, but funding pressure and credit constraints are still possible.
Global forces	Weak	↓↓	The global slowdown will weigh on housing markets around the world, with sentiment and incomes under pressure.
Housing supply	Unclear	↔	While the market has been playing catch up, a shift in the demand-supply balance could see less need than previously thought.
House prices to rents	Too high	↔/↓	Buying remains relatively expensive. Low interest rates are suppressing yields, but incomes will be under pressure.
Policy changes	Dampening	↔/↑	Policy changes have been a headwind. But the Government's COVID-19 response will help cushion the economic blow.
On balance	**Down**	↓↓	**House prices are expected to be under significant downward pressure, eventually recovering when the economy does.**

Property gauges

Figure 1: Housing affordability

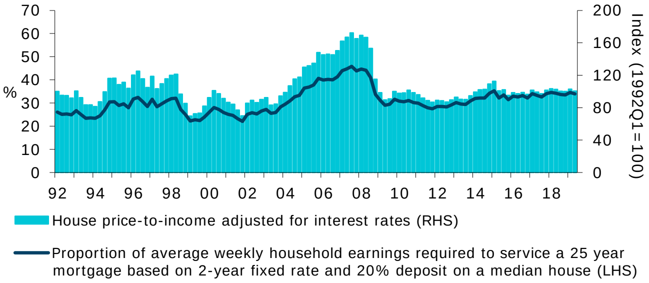


Figure 2: Household debt to disposable income

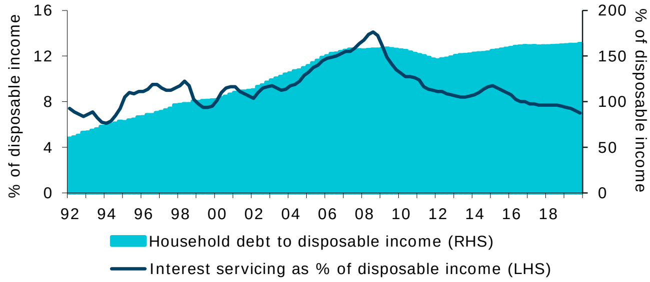


Figure 3: New customer average residential mortgage rate (<80% LVR)

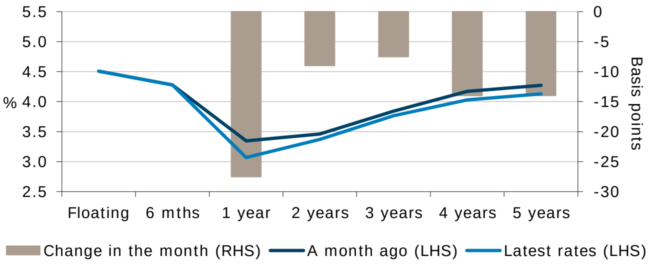


Figure 4: Annual migration*

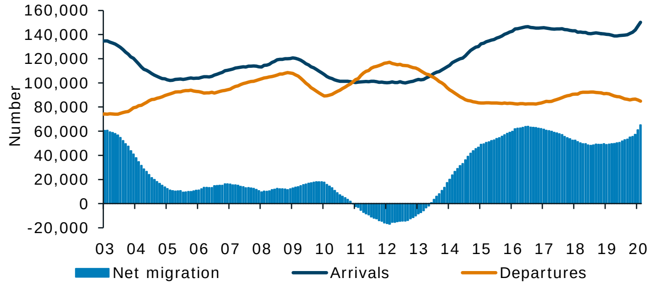


Figure 5: Housing supply-demand balance

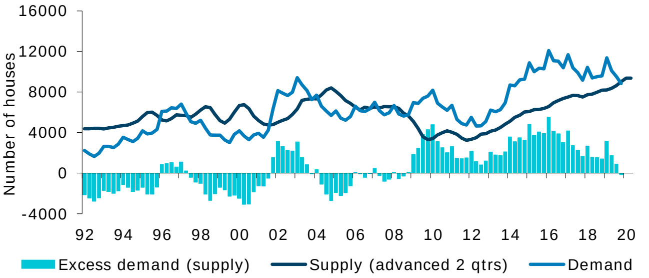


Figure 6: Building consents and house sales

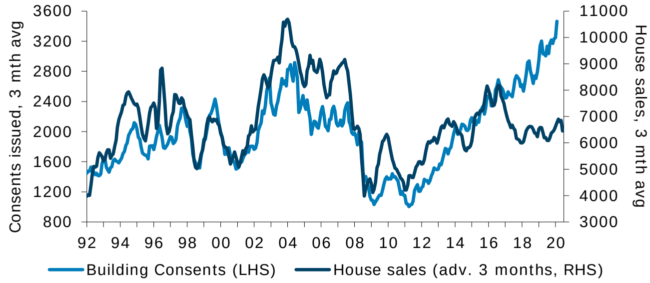


Figure 7: Liquidity and house prices

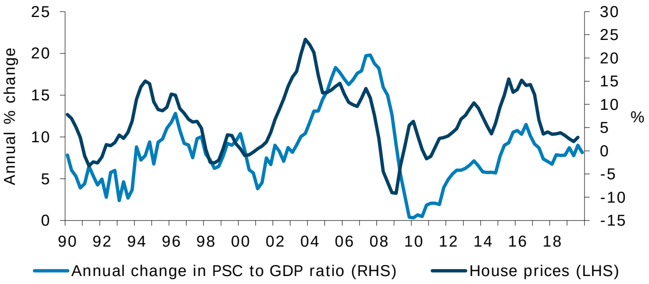


Figure 8: House price inflation comparison

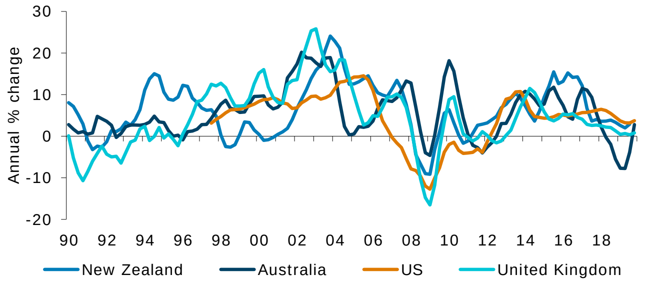


Figure 9: Housing supply

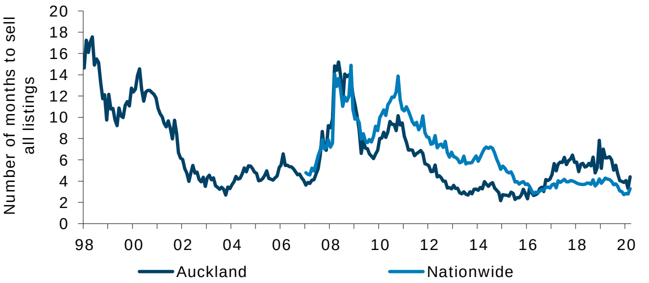
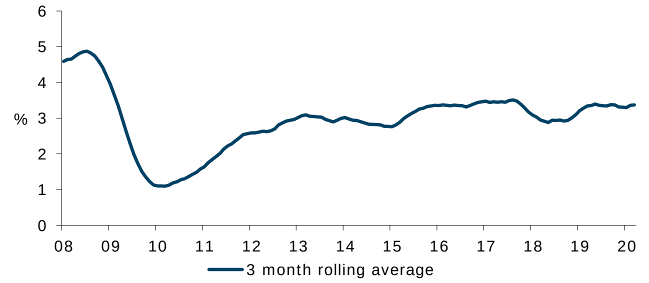


Figure 10: Median rental, annual growth



Source: ANZ Research, Statistics NZ, REINZ, RBNZ, QVNZ, Nationwide, Bloomberg, Barfoot & Thompson

* Dotted lines show the last nine months of data, which we look through because they are subject to substantial revisions. The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data.

Economic overview

Summary

We are in the midst of an unprecedented health crisis. New Zealand is making encouraging progress at curbing the COVID-19 outbreak on our shores, but the human and economic impact worldwide is very troubling. Lockdown measures have been necessary, and effective. However, the economic impact will be large, with a sharp recession underway. We currently expect GDP to fall 22% over the first half of this year, and 8-10% over 2020. There will be an initial but incomplete rebound with a protracted recovery from there. Over the long-term, the economy will likely be reshaped to some degree, with some industries shrinking and new opportunities arising. The Government will need to provide stimulus for quite some time, with more spending in the pipeline. We think the RBNZ will need to roughly double its quantitative easing programme.

Our view

The economy is experiencing a deep slump, brought about by the sharp – but necessary – lockdown measures in place to curb the outbreak of COVID-19.

The economic impact is enormous, and inevitable. But going hard and going early, while painful now, is the best way to ensure that the impact is not worse, and more permanent. We only want to do this once.

For that reason, we expect that restrictions will be eased only very cautiously from here. The low current number of cases means we have a more appealing range of options compared with other countries around the world where the impact has been more grim, but the head start could be easily squandered if we go too fast and see cases lift strongly once more.

The outlook is extremely uncertain, depending on the path of the outbreak and the restrictions on activity. At present, we expect GDP to fall 22% over the first half of this year, and 8-10% over 2020 as a whole, with unemployment expected to rise to 11%. We are assuming some easing in lockdown conditions in coming weeks, but that some degree of restrictions (including border closures) will remain in place for this year at least.

Although we expect to see an initial bounce in activity when businesses can resume, the recovery from there is expected to be slow. Households and businesses will look to shore up their financial positions, uncertainty will weigh, and income prospects will be unclear for a time. This will impact spending and investment.

When the recovery does get underway, this is likely to be driven by a recovery in net exports. New Zealand is in a fortunate position in that demand for some of our exports – specifically, food – has held up. This is supportive of export revenues, the terms of trade, and incomes more broadly. That said, weak global demand is expect to weigh on export prices to some degree. But on the whole our export sector is expected to do well compared to other industries, and other countries.

Government will play a crucial role well into the recovery. A number of important steps have been taken to cushion the economic blow. We've seen the introduction of the wage subsidy scheme and other initiatives to support business cash flow. Household income support has increased, including benefit and superannuation payments. And lending schemes for businesses and mortgage deferment options have been introduced.

A lot more is expected too. So far, initiatives have been focused on damage control, but eventually they will pivot to rebuilding. Some policies will only make sense to stimulate the economy once activity and spending is underway again. Government debt is expected to rise significantly from here to pay for the spend and as revenues take a hit (lower tax take).

Likewise, the RBNZ will need to provide further – and long-lasting – support to the economy. After cutting the OCR to 0.25%, the RBNZ has moved to quantitative easing, along with initiatives to support the financial system.

Broadly, quantitative easing (called the Large-Scale Asset Purchase Programme, or LSAP) works like this:

- The RBNZ purchases assets (primarily Government bonds at this stage) in significant quantities.
- This makes these bonds easier to sell, suppressing borrowing costs for those (like the government) issuing these bonds.
- Reduced yields encourages existing holders of these bonds to buy other higher-yielding ones, which in turn adds to demand in other markets. This creates beneficial spill-overs, suppressing other yields (eg on corporate debt).
- This lowers interest rates in financial markets more broadly, easing costs for a wide range of borrowers and supporting the economy.

So far, $33bn of bond purchases have been announced, but we expect that this will roughly double to $60bn in due course based on our economic forecasts. Government and RBNZ balance sheets will be large for a long time.

Over the long term, the economy will be reshaped to some degree. Eventually new opportunities will emerge, but it will likely be a difficult road ahead. Look out for our ANZ Quarterly Economic Outlook next week for more on what might be in store.

Mortgage borrowing strategy

This is not personal advice. 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.

Summary

Mortgage rates continue to fall, with average special rates offered by the major banks now at all-time lows at every duration. The average 1-year rate is now close to 3%, having fallen the most in recent weeks. With the RBNZ now pursuing quantitative easing in a bid to drive down long-term wholesale interest rates, there is less incentive to fix to "hide" from possible increases. Equally, with the RBNZ committed to keeping the OCR on hold, choosing floating on the expectation that floating rates may fall has limited appeal. With a big gap between average floating and 1-year rates, we favour the 1-year term in this low-rate environment we now find ourselves in.

Our view

Mortgage rates have moved lower again over the past month, with the average 1-year special rate now very close to 3%. As has been the case for a long time, the 1-year rate is also the lowest rate on the curve, and average fixed rates out to five years are now 0.38-1.44% below the average floating rate.

The OCR is at 0.25% and the RBNZ has committed to keeping it at that level until at least next March. It has now also engaged in quantitative easing (buying government bonds) to drive long-term wholesale interest rates lower. That means the risk that we see fixed mortgage rates rise materially from here is low. Equally, with the RBNZ signalling a reluctance to entertain negative interest rates – which are commonplace in Europe – the odds of bank floating rates coming down any time soon are also low, given that they tend to follow the OCR.

From a pure interest rate risk perspective, this leaves borrowers in a reasonably good position: term rates don't have much scope to rise, so there's little need to pay more to fix for longer, but equally, floating rates don't have much scope to fall, so there's not much incentive to stay on floating hoping it will become cheaper. In such an environment, it's pretty appealing to simply go for the cheapest rate – the 1-year rate – and ride things out. Floating rates would certainly need to fall a long way, and quickly, for floating to be cheaper than fixing for one year. Nothing is impossible, but it seems unlikely.

One year is not a long time in the life of a 20- to 30-year mortgage, and if borrowers have followed the well-publicised practice of splitting their mortgage into chunks and rolling over each chunk sequentially, a series of 1-year fixes is likely to be the cheapest strategy overall. This has been the case for a while, and is likely to remain the case for the next few quarters. Of course, nothing is certain, so managing rollover in chunks to spread the risk makes sense.

But could there be an advantage to fixing for longer? From a valuation perspective it seems unlikely, with breakeven rates[1] pointed higher, and quantitative easing by the RBNZ attempting to do the opposite. We don't, for example, see much chance that the 2-year rate rises from 3.37% to 4.11% over the next year – as doing so would imply that the RBNZ has not been successful in easing policy. It could happen, but we don't think it will. That said, longer-term rates offer more certainty and that always has appeal.

Figure 1. Carded special mortgage rates^

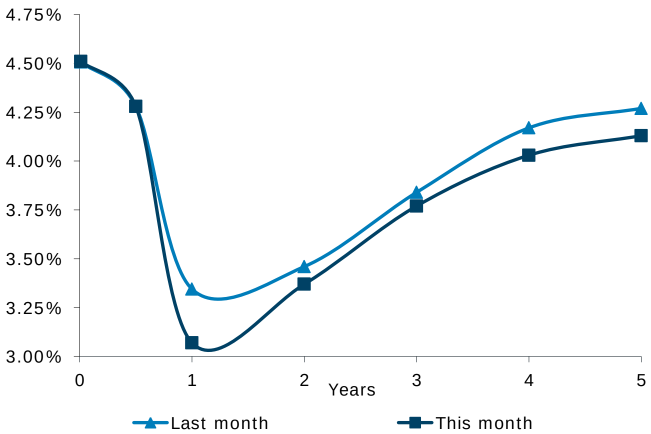


Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	4.51%				
6 months	4.28%	1.86%	3.52%	3.82%	4.36%
1 year	3.07%	2.69%	3.67%	4.09%	4.56%
2 years	3.37%	3.39%	4.11%	4.41%	4.69%
3 years	3.77%	3.83%	4.35%	4.51%	4.64%
4 years	4.03%	4.06%	4.40%		
5 years	4.13%	#Average of "big four" banks			

Table 2. Standard Mortgage Rates

		Breakevens for standard mortgage rates*			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	4.51%				
6 months	4.53%	2.97%	4.45%	3.98%	4.98%
1 year	3.75%	3.71%	4.22%	4.48%	5.18%
2 years	3.98%	4.09%	4.70%	4.87%	5.21%
3 years	4.38%	4.48%	4.88%	4.98%	5.17%
4 years	4.60%	4.66%	4.93%		
5 years	4.70%	#Average of "big four" banks			

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

Source: interest.co.nz

[1] Breakevens are future rates implied by the term structure of current interest rates. They show where shorter-term fixed rates need to be in future in order to justify (typically higher) longer-term fixed rates.

Key forecasts

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

Mortgage Size ($'000)	Mortgage Rate (%) 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	6.25
200	219	225	231	237	243	250	256	263	270	276	283	290	297	304
250	273	281	289	296	304	312	320	329	337	345	354	363	371	380
300	328	337	346	356	365	375	385	394	404	415	425	435	446	456
350	383	393	404	415	426	437	449	460	472	484	496	508	520	532
400	437	450	462	474	487	500	513	526	539	553	566	580	594	608
450	492	506	520	534	548	562	577	592	607	622	637	653	669	684
500	547	562	577	593	609	625	641	657	674	691	708	725	743	761
550	601	618	635	652	669	687	705	723	741	760	779	798	817	837
600	656	674	693	711	730	750	769	789	809	829	850	870	891	913
650	711	730	750	771	791	812	833	854	876	898	920	943	966	989
700	766	787	808	830	852	874	897	920	944	967	991	1,015	1,040	1,065
750	820	843	866	889	913	937	961	986	1,011	1,036	1,062	1,088	1,114	1,141
800	875	899	924	948	974	999	1,025	1,052	1,078	1,105	1,133	1,160	1,188	1,217
850	930	955	981	1,008	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233	1,263	1,293
900	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	1,369
950	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	1,445
1000	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	1,521

Housing market indicators for March 2020 (based on REINZ data)

	Median house prices Ann % chg	Median house prices 3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	14.0	5.2	182	-2%	56
Auckland	11.2	4.2	1,829	-25%	35
Waikato	13.4	4.0	565	-16%	32
Bay of Plenty	13.8	7.8	391	-23%	35
Gisborne	1.2	1.1	38	-47%	29
Hawke's Bay	10.4	-1.1	218	-15%	29
Manawatu-Whanganui	28.9	8.9	329	-8%	25
Taranaki	13.3	3.1	154	+8%	24
Wellington	13.3	2.4	613	-11%	29
Tasman, Nelson and Marlborough	8.3	2.4	235	-4%	28
Canterbury	6.6	3.2	782	-18%	32
Otago	11.5	3.3	319	-9%	31
West Coast	9.3	7.4	23	-49%	60
Southland	28.1	9.9	132	-12%	28
New Zealand	**13.9**	**4.2**	**5,663**	**-18%**	**33**

Key forecasts

	Actual			Forecasts						
Economic indicators	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
GDP (Ann % Chg)	2.1	2.3	1.8	-1.2	-21.6	-10.1	-8.8	-5.5	20.2	5.1
CPI Inflation (Annual % Chg)	1.7	1.5	1.9	2.3	1.8	1.4	1.0	0.9	0.9	0.8
Unemployment Rate (%)	4.0	4.1	4.0	5.4	10.7	11.1	10.1	8.7	8.6	8.3
House Prices (Annual % Chg)	1.6	2.5	5.3	8.3	4.2	-1.7	-8.5	-13.3	-8.8	-3.6
Interest rates (RBNZ)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Official Cash Rate	1.00	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
90-Day Bank Bill Rate	1.2	1.3	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4

Source: ANZ Research, Statistics NZ, REINZ

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