ANZ Research

February 2021

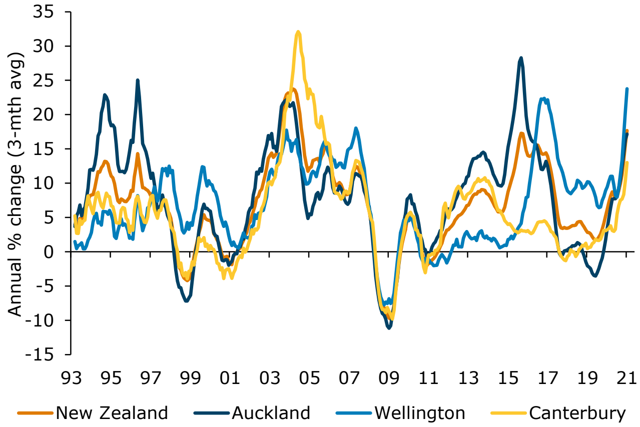
New Zealand Property Focus

Off the beaten track

At a glance

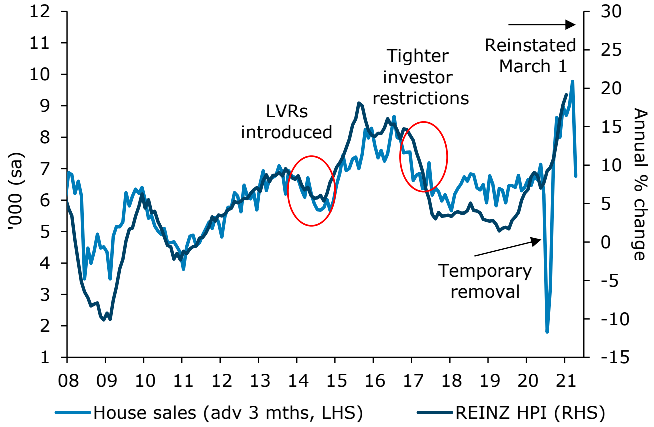
House prices continue to rise

From already high levels



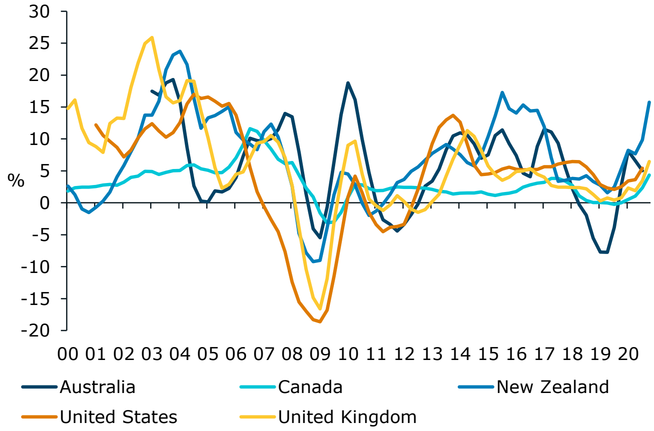
But sales more normal

Cooling may come in time



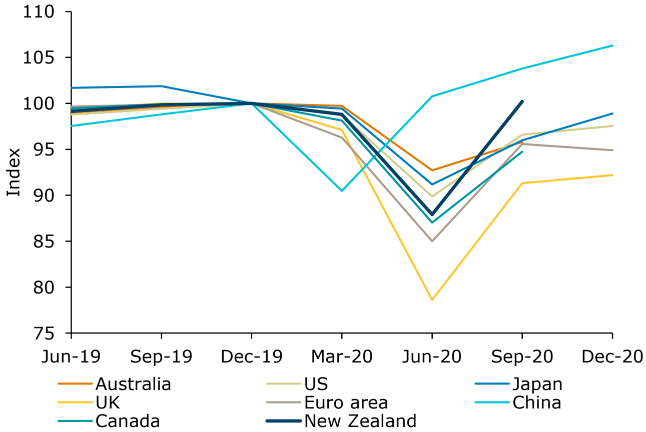
Standout performance

Our house price cycle on global stage



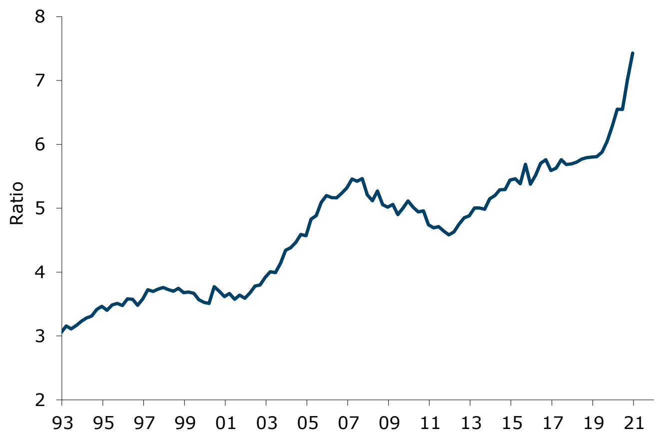
Supported by GDP bounce

On health response and policy support



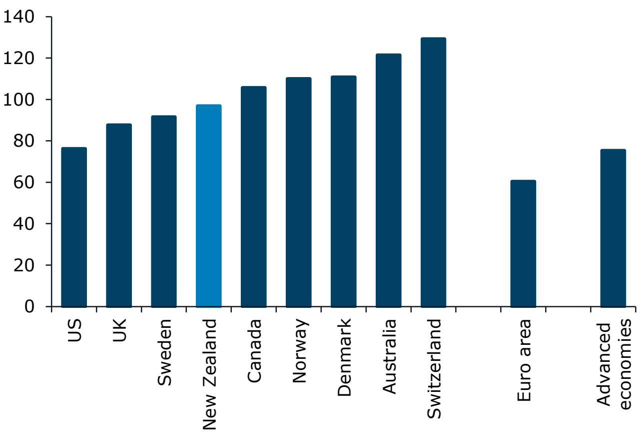
Constraints expected to weigh

House prices very high versus incomes



But vulnerability can be worse

Risk that debt to income goes higher



Source: ABS, StatCan, SPDJI, Bloomberg, BIS, REINZ, Statistics NZ, Macrobond, ANZ Research

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Summary

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

Housing market overview

The market remains hot, with lower interest rates now more than fully capitalised into house prices. A speculative dynamic appears to be at play in some cases, with some buyers very stretched. The recent run-up in debt alongside house price increases make households more vulnerable to changes in incomes and interest rates. The RBNZ has moved to reinstate tighter loan-to-value restrictions but this will only have marginal impacts. We expect the housing market will cool in time as affordability and credit constraints bite, but timing is difficult to gauge. It is possible we continue to see momentum propel the market for some time, but that only increases the risk of a more marked cooling and could pull forward eventual interest rate hikes, even if they currently look to be a long way off. See Housing Market Overview for more.

Feature Article: Off the beaten track[1]

Globally, housing markets have generally beaten expectations through the COVID-19 crisis, in part due to a policy response that has been large and synchronised. But the New Zealand housing market has been an outlier, supported by – and contributing to – our strong economic recovery to date, which has been underpinned by our successful health response and effective fiscal and monetary policy. Relative to history, the recent episode has been different too. Although the current housing upturn shares some similarities with the 2000s, maintaining momentum for such an extended period appears unlikely this time around. While momentum can be self-propelling to some extent, acute housing unaffordability, very high debt levels, macro-prudential policy tightening and credit constraints look set to weigh in time, with a slowing in the rate of housing price inflation expected. However, it may take time for the market to turn and, until that happens, affordability and debt levels could become even more stretched. See Feature Article: Off the beaten track for more.

Mortgage borrowing strategy

Mortgage rates are again little changed since our last edition. Whilst that gives the impression of calm, behind the scenes, financial markets are anything but calm, with 5- and 10-year swap rates up around 0.8% and 1.2%pts respectively since November. This has been driven by changing expectations for RBNZ policy (we and the market no longer expect OCR cuts) and growing confidence in a post-vaccine bounce in global growth and inflation. Despite the more assured outlook here, OCR hikes are still a long way off, and that should keep 1- to 2-year mortgage rates low. But longer-term mortgage rates could rise if wholesale rates rise further. Those looking for longer-term certainty may thus wish to consider fixing for longer. See Mortgage Borrowing Strategy for more.

[1] With many thanks to Augustine Lee for his work on this topic during his time in ANZ Research.

Housing market overview

Summary

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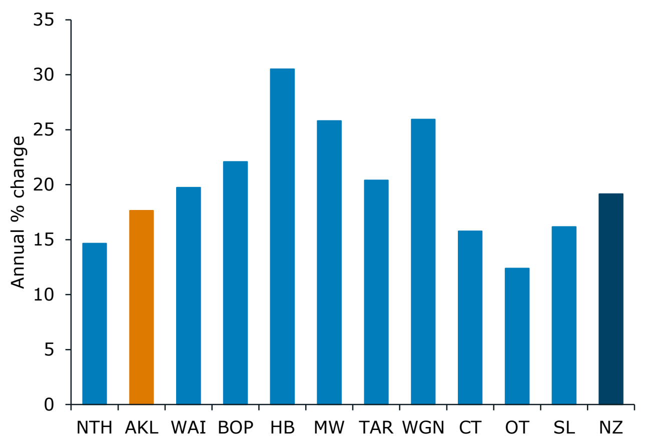
Higher and higher

House prices rose another 1.8% m/m nationwide in January, following strong momentum through the second half of last year that culminated in a record-breaking December quarter (with prices up a whopping 8.8% q/q). Annual house price inflation is now running at 19% y/y (figure 1), with particularly strong price rises in Hawke's Bay (31%), Manawatu-Whanganui (26%) and Wellington (26%) over the past year. Housing markets across the country remain very tight, with homes still selling far faster than historic norms. The vibe out there remains frenetic, with fear of missing out and media reports stoking the hot market and putting upward pressure on house price inflation expectations.

Figure 1. Annual house price inflation



Source: REINZ

Lower interest rates within a supply-constrained market are a key contributor to recent increases in house prices, alongside a speculative dynamic in some cases. It appears a continuation of capital gains and super-low interest rates are widely expected, and some first home buyers have taken on very high debt levels relative to incomes. Meanwhile, investor demand has been very strong, with improving equity positions supporting purchasing power.

More vulnerable

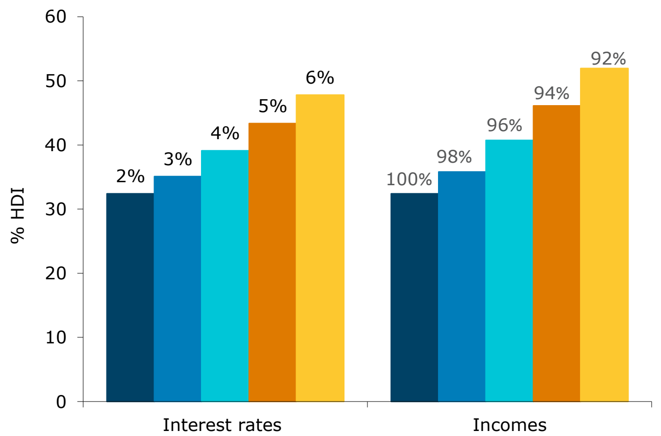
For most households, mortgage payments are currently very manageable, but vulnerability has increased and pockets of pressure could emerge. Currently debt-servicing costs are sitting at about 32% of incomes nationwide (40% for Auckland). This is based on an average-income household purchasing the median house at the current minimum mortgage rate (2.3%), assuming they can jump the (very high) hurdle and cobble together a deposit.

That share now sits a little above where it did pre-COVID (31% and 39% for Auckland), which tells us that lower mortgage rates have now been more than fully capitalised into higher house prices and affordability may be starting to reach its limits. Some households appear to be assuming that the recent falls in mortgage rates are a permanent fixture, rather than a temporary response to the recent crisis. But interest rates are expected to rise, even if gradually and not for some time yet. A mortgage is a long-time commitment.

And although debt-servicing costs are similar to where they were, the increase in debt that has gone alongside the house price run-up has made households more vulnerability to changes in interest rates and incomes. Pre-COVID, a hypothetical interest rate of 5% would have seen the aggregate debt-servicing share of income increase to around 35% and 45% in New Zealand and Auckland. Now those figures sit around 45% and 55%. Sensitivity to income shocks or job loss has increased too.

With interest rates expected to increase only very gradually from here, debt-servicing costs are likely to remain contained (figure 2). But individual households must take into account their own circumstances, including risks of income reduction or job losses, and be mindful that interest rates will likely move higher eventually.

Figure 2. Aggregate debt-servicing costs to income sensitivity to interest rates and aggregate incomes



Source: REINZ, Statistics NZ, RBNZ, ANZ Research

Housing market overview

The RBNZ is well aware of the vulnerabilities associated with the recent housing market upturn, which increases financial stability risks should an adverse shock arise. As such, the RBNZ has moved to reinstate loan-to-value restrictions at even tighter settings than they were before they were suspended last year.

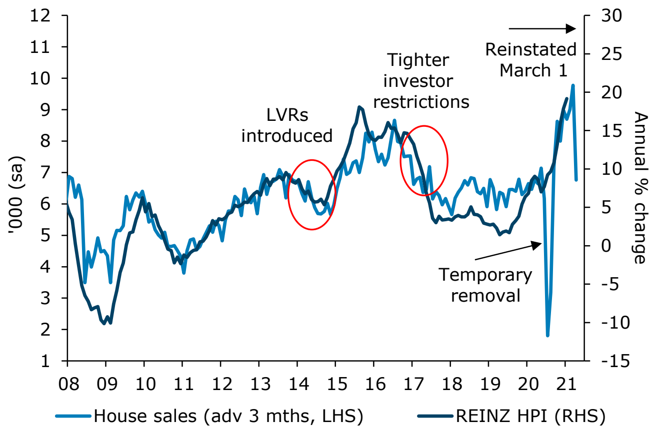
Banks have moved ahead of the changes to tighten credit availability to investors and we may start to see this flowing through into housing market activity in coming months. Overall, the RBNZ estimates that the restrictions could shave 1-2 percentage points off house price inflation. While this is helpful in curbing financial risks, housing market impacts will be only at the margin when considered relative to the fact that house prices have risen 2.4% on average each month over the past six months. Addressing the long-term issues associated with unaffordable house prices requires much bigger, structural policy changes.

Cooling in time

We expect to see a cooling in the housing market in time, given recent developments appear unsustainable, but timing is hard to gauge. Interest rates have been more than fully capitalised into house prices, but incomes have gone sideways. We assume that house price inflation will revert to historical averages this year as affordability and credit constraints reach their limits. From there house prices could see a period of sub-par increases or even stabilise. Or, it's possible that the speculative dynamic has further to run, but that would increase the risk of a more marked cooling later.

We have started to see a moderation in sales activity (figure 3), which could signal the beginning of this expected cooling. January sales were up 1.8% on last year, but have returned to much more normal levels, compared with the lofty heights reached last year. The market remains tight, and it is possible we are simply seeing volatility on the back of disrupted seasonal patterns. We will wait to see where the dust settles.

Figure 3. House sales and prices



Source: REINZ

Nothing lasts forever

Encouragingly, the broader economic outlook looks brighter than previously. Recent community cases of COVID-19 are a reminder of still-significant risks, but businesses are faring better than anyone expected and unemployment is much lower than forecast. Given that, the RBNZ can hold tight and keep policy settings (and interest rates) where they are. Eventually, interest rates are expected to rise, though this is expected to be a long way off. Still, the possibility that the housing market remains strong for longer increases the risk of a sooner (or more abrupt) shift in interest rate settings. See our recent ANZ NZ Insight for more on the return to more normal interest rate settings.

Housing market indicators for January 2021 (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	$639,942	22.4	7.2	14.6	7.3	215	-23%	42
Auckland	$1,033,205	14.9	5.0	17.6	7.2	2,811	-25%	31
Waikato	$656,181	9.7	3.0	19.7	7.1	751	-19%	26
Bay of Plenty	$755,776	12.8	3.3	22.1	12.4	478	-17%	34
Gisborne	$504,934	18.1	5.5			50	-22%	32
Hawke's Bay	$683,775	26.1	11.4	30.5	12.5	148	-47%	25
Manawatu-Whanganui	$525,623	25.5	12.5	25.8	19.6	300	-26%	24
Taranaki	$499,440	23.9	3.8	20.4	8.0	162	-26%	21
Wellington	$854,601	27.5	6.7	25.9	12.9	484	-40%	29
Tasman, Nelson & Marlborough	$685,000	18.3	7.7			129	-44%	33
Canterbury	$521,064	9.7	3.4	15.8	5.8	995	-32%	26
Otago	$620,705	14.7	1.5	12.4	9.8	309	-37%	28
West Coast	$283,723	12.4	8.9	15.8	5.8	67	-7%	31
Southland	$378,698	10.9	4.2	16.2	8.4	171	-17%	26
New Zealand	**$751,726**	**19.1**	**5.4**	**19.2**	**8.8**	**6,761**	**-31%**	**30**

Feature Article: Off the beaten track

Summary

Globally, housing markets have generally beaten expectations through the COVID-19 crisis, in part due to a policy response that has been large and synchronised. But the New Zealand housing market has been an outlier, supported by – and contributing to – our strong economic recovery to date, which has been underpinned by our successful health response and effective fiscal and monetary policy. Relative to history, the recent episode has been different too. Although the current housing upturn shares some similarities with the 2000s, maintaining momentum for such an extended period appears unlikely this time around. While momentum can be self-propelling to some extent, acute housing unaffordability, very high debt levels, macro-prudential policy tightening and credit constraints look set to weigh in time, and that will likely slow the rate of housing price inflation. However, it may take time for the market to turn and, until that happens, affordability and debt levels could become even more stretched.

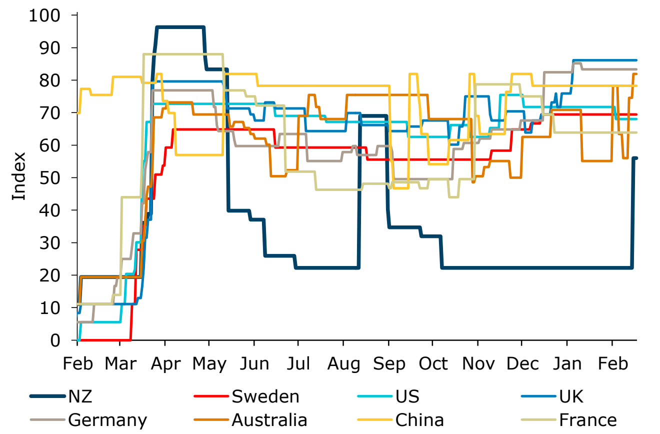
Globally, housing has weathered the pandemic remarkably well

The onset of the COVID-19 pandemic changed the economic outlook dramatically both here and abroad. When we looked down the barrel of this crisis it was unclear how large the economic fallout would be – all we knew was that it wasn't going to be pretty. There was enormous uncertainty surrounding virus developments, the duration and impact of lockdowns, how people would respond to uncertainty and lower incomes, and how effectively the Government and RBNZ would be able to cushion the blow.

Forecasts for GDP and other economic variables were revised down dramatically in early 2020 when the virus hit – including forecasts for the housing market. Incomes were expected to experience a massive blow, unemployment was forecast to rise dramatically, and house prices were widely expected to fall – as has tended to be the case in previous downturns. During the initial (level 4) lockdown, house prices declined very slightly, largely reflecting the market's inability to function over that time. Those declines now seem like a distant memory.

Since coming out of the initial lockdown, GDP has recovered strongly in New Zealand and the housing market has boomed. The defining feature of New Zealand's economic outlook over the course of 2020 was our success at eliminating community transmission of COVID-19. Because of this, New Zealand was well placed to weather the economic impact of lockdown. Disruption here was not prolonged and the immediate fiscal response was rapid and generous, cushioning incomes. We have since been able to live and operate relatively freely (figure 1) and have begun our economic recovery far sooner than in other countries that continue to count a severe human and economic cost.

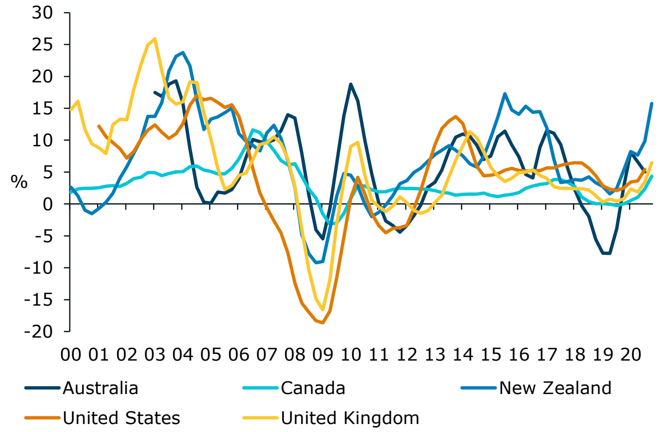
Figure 1. Oxford stringency index



Source: Oxford University

Yet there is more than just our COVID success underlying the housing market boom. Despite continuing community transmission and rolling lockdowns in other countries, robust housing markets have been a global phenomenon. Over the second half of 2020, solid house price increases have been seen in a range of countries that we typically compare ourselves to – although not to the same extent as in New Zealand (figure 2).

Figure 2. Selected global housing markets



Source: ABS, StatCan, REINZ, SPDJI, Nationwide, Bloomberg, Macrobond, ANZ Research

Policy response has been large and synchronised

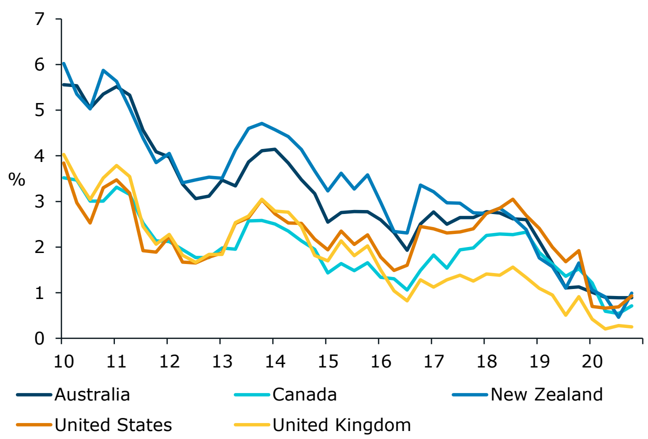
The most striking theme underpinning global housing markets has been the large and synchronised policy response, particularly monetary policy.

To the extent that there was conventional headroom available, policy rates were lowered, and many central banks – including our own – used unconventional monetary policy measures to drive interest rates down further. Here in New Zealand, the Official Cash Rate was lowered from 1% to 0.25% in an emergency move in March 2020 and the Large Scale Asset Purchase Programme ("quantitative easing", or "QE") was introduced a week later. Additionally, the Reserve Bank removed LVR restrictions and undertook a range of measures to ensure credit was able to flow freely in the financial system. More recently, the RBNZ has also introduced a bank Funding for Lending Programme to facilitate further downward pressure on mortgage rates.

Globally, a swift and sizable monetary response was implemented to support economic recoveries and shore up the outlooks for unemployment and inflation. As a result, central bank balance sheets increased significantly as asset purchases were conducted, suppressing financial market yields (see our ANZ November Property Focus for an explainer on how these unconventional tools work). This boosted liquidity in the financial system and saw global bond yields fall in sync (figure 3).

Monetary policy works in a number of ways. One key channel is by boosting asset values, including house prices. Through this and other channels, monetary policy has been undeniably effective at stimulating the economy, with flow-on effects to consumption, construction and confidence. At the same time, other policies have ensured that bank funding has been plentiful and encouraged credit flow – further bolstering the housing market.

Figure 3. Selected global 10-year government bond yields



Source: Macrobond, BoC, RBNZ, Fed, BoE, Bloomberg, Macrobond, ANZ Research

In New Zealand, building activity was already very strong going into the crisis. Post-lockdown, the construction industry has been grappling with capacity constraints and a further increase in demand. Housing spending and confidence has also been supported. That boost in momentum for these pockets has helped to offset underperforming industries like tourism, retail, and services where conditions are more difficult, and could worsen from here. These same offsets have been evident in other countries, though to smaller degrees. That reflects the challenge other countries have in offsetting the impacts of longer lockdowns and greater social and economic disruption.

Globally, governments have also embarked on a synchronised fiscal policy response too. Fiscal policy is providing financial support for those whose livelihoods and jobs are being affected by the crisis, though the size and impact of this has varied by country. To the extent that policies have supported incomes, these measures have helped cushion global housing markets.

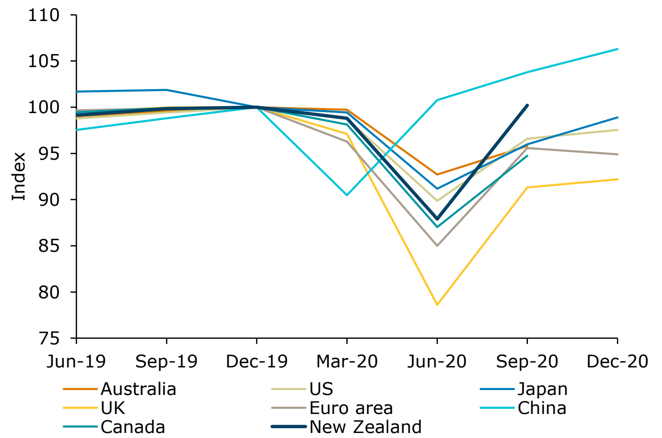
New Zealand's housing market has had additional support

In New Zealand, fiscal measures to support incomes have been particularly potent, in part due to the relatively short duration of our lockdowns. These measures included the wage subsidy, COVID-19 Income Relief Payment, and other measures to support affected businesses and workers. These policies were expensive and unsustainable on a long-term basis. However, they were able to smooth household incomes through the lockdown phase of the crisis and keep people in employment. The net effect has been the avoidance of a vicious feedback loop in which incomes, employment and spending could have plummeted and been more permanently affected.

With incomes largely intact, the economy was well positioned to bounce back when the restraints were removed. So far, New Zealand has seen a swift recovery in GDP from lockdown-induced disruption (figure 4), with fewer job losses than in other countries (figure 5) – contributing to the stand-out performance of New Zealand's housing market. Income support, the fall in interest rates and mortgage deferment schemes all worked in tandem to shore up cash flow and confidence, supporting housing demand and spending more broadly.

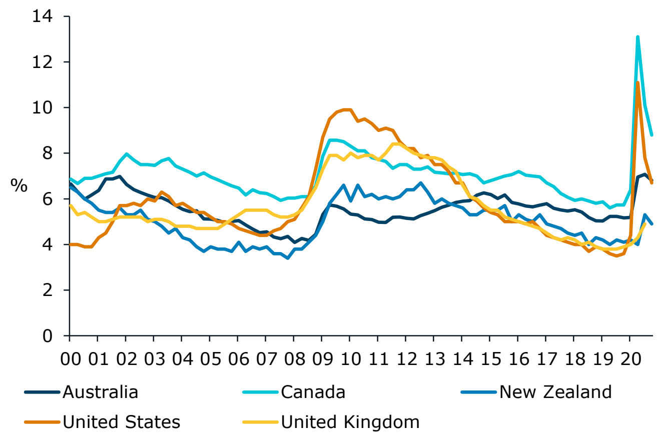
Overall, these policies have been more effective than expected – proving an effective stop-gap. That reflects a successful health response and rather generous schemes being in place. We haven't come out completely unscathed. Some firms and workers have endured tremendous challenges resulting from the closed border. And we are not out of the woods yet.

Figure 4. GDP levels (Q4 2019= 100)



Source: Macrobond, Stats NZ, ANZ Research

Figure 5. Selected unemployment rates



Source: ABS, StatCan, Stats NZ, BLS, ONS, Bloomberg, Macrobond, ANZ Research

Note: The UK unemployment rate is artificially low because the 5.3m people on furlough are not technically defined as unemployed, masking the true impact of COVID-19 on jobs.

While the virus remains rampant globally, there is always a risk that the return of COVID-19 community transmission could see activity disrupted again. The most recent community cases identified this week (in mid-February) are a reminder of that.

So far, relative to other countries, we have been exceptionally fortunate in terms of both health and economic outcomes. However, if required, we still do have fiscal ammunition to pull out a powerful policy offset in the form of the wage subsidy if required.

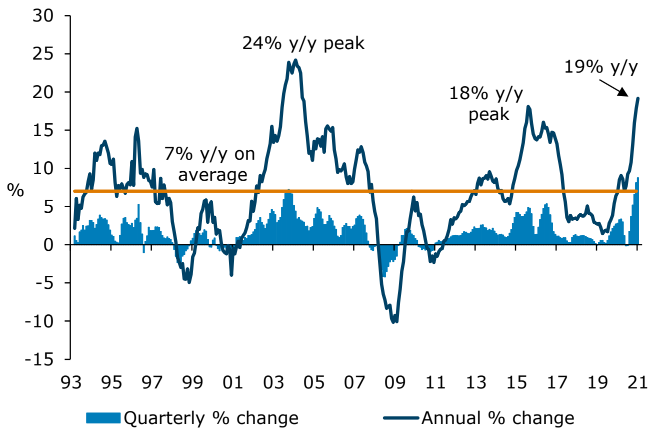
Strength in our market has been record breaking

Momentum in New Zealand's housing market has been extraordinary, exacerbated by tightness in the market, with very low listings, an emerging speculative dynamic, and rising house price expectations.

In the December quarter, house prices rose 7.7% q/q – the strongest pace since RBNZ data began in 1992. Recent price rises have been reminiscent of the early 2000s; so far the upturn has been shorter, but it has been sharper (figure 6).

The experience of the 2000s shows us that momentum in the housing market can be difficult to stop in its tracks, especially when expectations become self-fulfilling and risk aversion reduces. In the early 2000s, New Zealand house prices increased for 26 consecutive quarters (March 2001 to September 2007) to be up 217%.

Figure 6. New Zealand house price inflation



Source: REINZ

Could we be seeing a similar episode to the 2000s here?

The current housing upturn shares similarities with the upturn of the 2000s. Back then, as now (table 1), lower interest rates played a role, risk aversion was low, credit was readily available, the issues of inadequate supply that plague our market now were fast developing, and a speculative, self-reinforcing dynamic was evident. However, there are noteworthy differences between now and the 2000s.

- Unlike in the 2000s, **interest rate increases do not appear imminent**. Although cost-push inflation pressures are significant, that's the kind of inflation central banks prefer to look through, and there are still plenty of challenges ahead. Interest rates look set to be supportive of the market for a while yet, whereas the upturn of the 2000s was met by a steep rise in interest rates to keep inflationary pressures under control. Down the track, the market will have to adjust to a gradual return to more normal monetary policy settings. That means higher interest rates eventually, even if they are expected to remain very low by historical standards. But normalisation isn't likely to be on the cards until the RBNZ's targets are firmly in view and downside risks have abated, meaning continued easy settings over the remainder of 2021 at least. On our current forecasts, the RBNZ doesn't embark on policy normalisation until 2023, but upside risks could see this brought forward.

- **Immigration, a historic driver of New Zealand property prices, is very weak**, in stark contrast to the 2000s. Anecdotally, the return of some cashed-up Kiwis may have been a support to parts of the market but, ultimately, current rates of population growth do not suggest a sustained worsening in the supply-demand balance as was seen in the 2000s. Instead, the rate of building is already very high and looks set to outpace population growth – an encouraging development given the legacy of underbuilding and lack of supply responsiveness that would take years, and bold policy changes, to correct.
- Greater **regulation and market forces** now represent a greater "handbrake" as well, helping to contain frothiness in the market. Banks are not reliant on flighty short-term funding and are now required to hold higher levels of capital, which means expanding lending is costlier than it was in the 2000s. There are greater limits on lending to riskier portions of the mortgage market, particularly with loan-to-value restrictions returning 1 March. And banks are naturally more cautious than in the 2000s when it comes to the likes of servicing assessments – partly due to the global experience then, but also given the fact that house prices and debt are already high. Indeed, debt-to-income levels are much higher than ever before.
- Incomes are not growing at anywhere near the same rates as they were in the early 2000s. **Unemployment is expected to rise** further whereas it remained very low in the 2000s.

Table 1. The 2000s and now

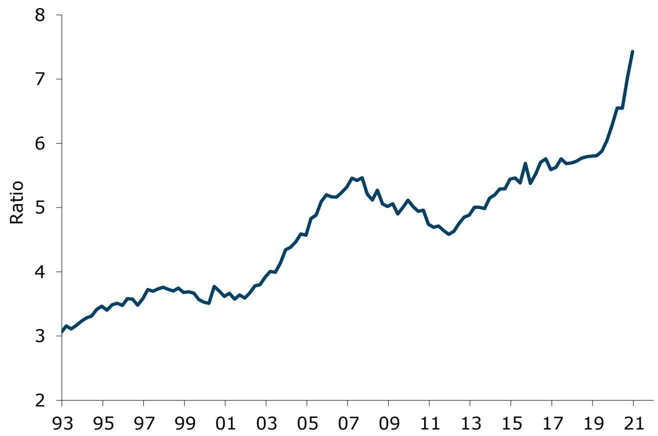
	2000s – cycle very sustained	Now – sustainability more questionable
Global housing cycle	A bit less synchronised	Synchronised, so far
Global policy settings and timing	Some differences	Very synchronised • Lower interest rates • Abundant liquidity • Expansionary fiscal policy
Monetary and fiscal policy	Expansionary (OCR range: 4.75 to 8.25%) Room to move (in response to upturn and eventual downturn)	Expansionary (OCR at 0.25%) Interest rates at the conventional lower bound Government debt more of a constraint globally (although not such an issue in NZ)
Household debt	On the rise, increased significantly	Extremely high and rising
Risk pricing and risk	Risk pricing very low	Risk pricing extremely low, though risk itself is abundant, meaning markets are vulnerable to factors like an inflation rise
Credit availability / conditions	Abundant credit, conditions too relaxed globally	Credit readily available, but post-GFC regulatory and market changes now a handbrake
Speculative dynamic	Self-sustaining momentum evident, reinforced by solid economic backdrop and easy financial conditions	Evident, but looks less sustainable given incomes, credit settings and affordability constraints
Prudential settings	Relaxed	Tighter, NZ macro-prudential settings set to tighten further
Interest rates	Increased globally into contractionary territory, curbing the market, with eventual housing market turn in 2007	Set to be low for a long time globally, keeping conditions easy, though the prospect of a gradual return to more normal conditions does loom
Global economy	Generally doing very well, high-growth phase	Under significant strain and uncertainty, less so in NZ but still challenging outlook – bigger scope for a drop in income to be a catalyst for market turn
Inflationary pressures	Increasing, driven by demand-side, capacity pressures	Generally weak, but pockets of growth-negative, cost-push inflation possible
NZ immigration	Very strong	Very weak
NZ building	Slow to respond	Operating at very high levels

Source: ABS, StatCan, REINZ, SPDJI, Nationwide, Bloomberg, Macrobond, ANZ Research

Feature Article: Off the beaten track

At some point, the acute and worsening unaffordability of housing must weigh on the rate of house price inflation. That is especially given the unsustainable disconnect between soaring house prices and stagnant income growth (figure 7). Credit constraints are expected to be a headwind at some point too given income prospects, an expected slowdown in deposit growth, and broader bank prudence expected to weigh.

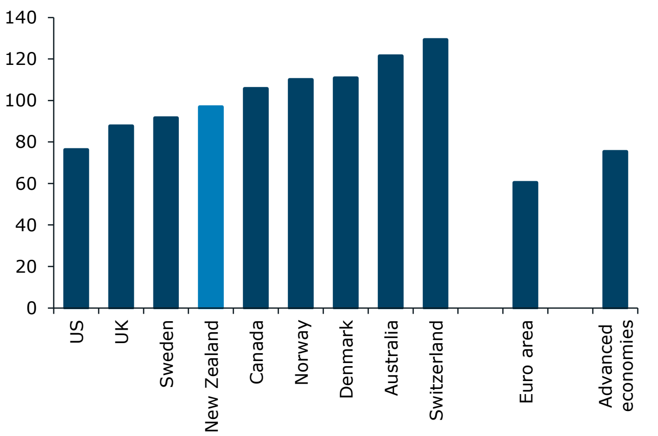
Figure 7. House price to income



Source: REINZ, Statistics NZ, ANZ Research

Nonetheless, the housing market is difficult to forecast and history tells us that it can be a hard beast to rein in once it gets going. It is possible that the current stimulatory environment sees momentum persist. This could see households become even more stretched, increasing the risk of a significant future correction. The starting point for household debt was already extremely high going into this, but comparisons with other countries show that these positions could get even worse (figure 9). There may be structural differences (such as lower interest rates) across these economies that mean higher debt levels are more sustainable. But the upshot is that it is entirely possible the housing market roars on for some time yet before these metrics act as a constraint, especially if urgent structural policy changes are not made.

Figure 9. Household debt to GDP (Q2 2020)



Source: BIS

Momentum expected to slow, but outlook uncertain

The housing market is being affected by offsetting forces and the outlook is highly uncertain. On balance, we think that current strength will not be sustained for an extended period like it was in the 2000s. Indeed, we may be starting to see the housing market start to cool, with sales returning to more normal levels in January (see Housing Market Overview), but it is too soon to tell.

We may see some continued short-term momentum but, over time, fundamental factors like income growth, affordability considerations, weak population growth, strong building, and credit constraints look set to weigh – with the rate of house price inflation expected to slow. Indeed, the re-imposition of loan-to-value restrictions could be a catalyst for a slowing in momentum, with the RBNZ expecting it will shave 1-2 percentage points from house price inflation and calm "irrational exuberance". An eventual normalisation in monetary policy settings will reduce some of the current support to the market too – though that is a story for down the track.

Globally, the synchronisation in the housing market cycle across countries may not last either, and we cannot look to other countries to know what will happen next. Although global housing markets have moved similarly of late, it is reasonable to expect that outcomes will become more divergent as the initial synchronised boost from monetary stimulus wanes.

To varying degrees, conditions in many economies look set to get worse before they get better. Risks remain abundant. Economic recovery should provide support once the pandemic is under control, but the threat of eventual normalisation of financial conditions is starting to loom large as asset price overvaluations (whether housing or global equities) start to look more extreme. It is hard to know how these forces will balance out over time and across countries, especially if the paths to recovery and policy normalisation vary.

New Zealand is likely to continue to forge its own path, given the country-specific factors that have played a role in our recent outperformance. But given our expectation that house price inflation will slow in time, some convergence to the more moderate rates of growth seen in other countries seems likely. To the extent that growth is credit fuelled, that is probably not a bad thing.

Mortgage borrowing strategy

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Summary

Mortgage rates are again little changed since our last edition. Whilst that gives the impression of calm, behind the scenes, financial markets are anything but calm, with 5- and 10-year swap rates up around 0.8% and 1.2%pts respectively since November. This has been driven by changing expectations for RBNZ policy (we and the market no longer expect OCR cuts) and growing confidence in a post-vaccine bounce in global growth and inflation. Despite the more assured outlook here, OCR hikes are still a long way off, and that should keep 1- to 2-year mortgage rates low. But longer-term mortgage rates could rise if wholesale rates rise further. Those looking for longer-term certainty may thus wish to consider fixing for longer.

Our view

Average mortgage rates are once again little changed since last month. We have seen a slight decline in the average 1-year rate, which remains the lowest rate.

Recent economic data has been better than expected, and the more assured outlook now means that we no longer see the need for OCR cuts. While that reduces the scope for floating and shorter-term fixed mortgage rates to go lower, it does not imply that they will go higher. Despite the better economic data flow and more vigorous rebound out of COVID, there is enough uncertainty and risks to the downside to suggest that the OCR will remain low for some time – likely at least until the end of next year. That's the message we expect from the Reserve Bank at the February Monetary Policy Statement, and it suggests that short-term mortgage rates will remain low, giving borrowers the opportunity to fix for 1-2 years in coming months at rates similar to those on offer at present.

With the OCR on hold for the foreseeable future, we remain confident that borrowers will be able to enjoy low mortgage rates for some time. That's because 1-2 year rates don't typically move too far during periods of OCR stability, and banks are continuing to compete for business at the short end of the curve.

However, borrowers who want to fix for a longer period in order to lock in some certainty may wish to look to longer-term fixes now, mindful that wholesale 4- to 5-year interest rates (the building blocks of 4 to 5-year mortgage rates) have risen sharply. We started leaning in this direction last month, having noticed that global long-term interest rates – which have more of an influence on local long-term rates than the OCR does – were rising. They have continued to rise, and 5 and 10-year swap rates are now 0.80% and 1.20% above where they were in November.

Longer term, it may still be cheaper over time to stick with a series of back-to-back 1-year fixes. That has been the experience as interest rates have fallen, but that strategy is more challenging when interest rates rise. It also offers less certainty, which many borrowers value. So fixing for now for say 4 or 5 years may be less about achieving the lowest cost over the next 4 or 5 years, but more about locking in a low long-term rate (4- and 5-year rates have never been this low).

Breakeven analysis (tables 1 and 2) shows that short-term rates need to rise fairly quickly in order to make choosing a longer-term rate cheaper over time. For example, you'd need to see the special 1-year rise from 2.29% to 2.99% over the next year for back to back 1-year terms to be cheaper than a 2-year fix at 2.64%. But breakevens for terms like 4-years rise more slowly, lowering the hurdle for considering them.

Figure 1. Carded special mortgage rates^

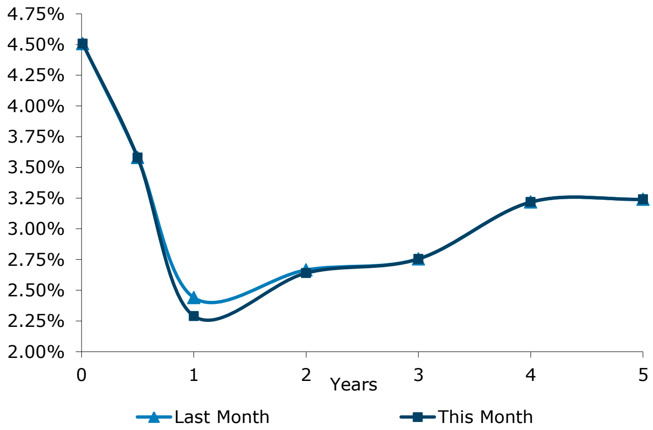

Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	4.51%				
6 months	3.58%	1.00%	2.82%	3.17%	2.93%
1 year	2.29%	1.91%	2.99%	3.05%	2.99%
2 years	2.64%	2.48%	2.99%	3.38%	3.80%
3 years	2.76%	2.89%	3.53%	3.61%	3.64%
4 years	3.22%	3.18%	3.48%		
5 years	3.24%	#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	3.88%	1.60%	3.76%	3.08%	3.39%
1 year	2.74%	2.68%	3.42%	3.24%	3.46%
2 years	3.08%	2.96%	3.44%	3.57%	3.96%
3 years	3.21%	3.27%	3.78%	3.75%	3.85%
4 years	3.52%	3.48%	3.74%		
5 years	3.54%	#Average of "big four" banks			

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

Source: interest.co.nz, ANZ Research

Key forecasts

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

Mortgage Size ($'000)	Mortgage Rate (%)													
	2.00	2.25	2.50	2.75	3.00	3.25	3.50	3.75	4.00	4.25	4.50	4.75	5.00	5.25
200	196	201	207	213	219	225	231	237	243	250	256	263	270	276
250	244	251	259	266	273	281	289	296	304	312	320	329	337	345
300	293	302	310	319	328	337	346	356	365	375	385	394	404	415
350	342	352	362	372	383	393	404	415	426	437	449	460	472	484
400	391	402	414	426	437	450	462	474	487	500	513	526	539	553
450	440	453	466	479	492	506	520	534	548	562	577	592	607	622
500	489	503	517	532	547	562	577	593	609	625	641	657	674	691
550	538	553	569	585	601	618	635	652	669	687	705	723	741	760
600	587	604	621	638	656	674	693	711	730	750	769	789	809	829
650	635	654	673	692	711	730	750	771	791	812	833	854	876	898
700	684	704	724	745	766	787	808	830	852	874	897	920	944	967
750	733	754	776	798	820	843	866	889	913	937	961	986	1,011	1,036
800	782	805	828	851	875	899	924	948	974	999	1,025	1,052	1,078	1,105
850	831	855	879	904	930	955	981	1,008	1,035	1,062	1,089	1,117	1,146	1,174
900	880	905	931	958	984	1,011	1,039	1,067	1,095	1,124	1,154	1,183	1,213	1,244
950	929	956	983	1,011	1,039	1,068	1,097	1,126	1,156	1,187	1,218	1,249	1,281	1,313
1000	978	1,006	1,035	1,064	1,094	1,124	1,154	1,186	1,217	1,249	1,282	1,315	1,348	1,382

Mortgage rate projections (fixed rates based on special rates)

	Actual			Forecasts						
Interest rates	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Floating Mortgage Rate	4.8	4.6	4.6	4.5	4.5	4.5	4.5	4.5	4.5	4.5
1-Yr Fixed Mortgage Rate	3.1	2.7	2.6	2.5	2.3	2.3	2.4	2.4	2.5	2.6
2-Yr Fixed Mortgage Rate	3.3	2.7	2.7	2.7	2.7	2.8	2.8	2.9	2.9	2.9
5-Yr Fixed Mortgage Rate	3.9	3.1	3.1	3.2	3.3	3.6	3.7	3.8	3.8	3.8

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-20	Sep-22
GDP (Annual % Chg)	-11.3	0.4	-0.3(f)	0.4	13.4	0.0	1.3	3.3	3.6	4.0
CPI Inflation (Annual % Chg)	1.5	1.4	1.4	1.2	2.3	2.2	1.7	1.6	1.5	1.5
Unemployment Rate (%)	4.0	5.3	4.9	5.2	5.5	5.5	5.3	4.9	4.7	4.5
House Prices (Quarter % Chg)	-0.1	3.7	8.1	3.5	2.0	1.0	1.0	1.0	1.0	1.0
House Prices (Annual % Chg)	7.8	9.9	15.7	15.8	18.3	15.3	7.7	5.1	4.1	4.1

Interest rates	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Official Cash Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
90-Day Bank Bill Rate	0.30	0.31	0.27	0.30	0.30	0.30	0.30	0.30	0.30	0.30
LSAP ($bn)	100	100	100	100	100	100	100	100	100	100

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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