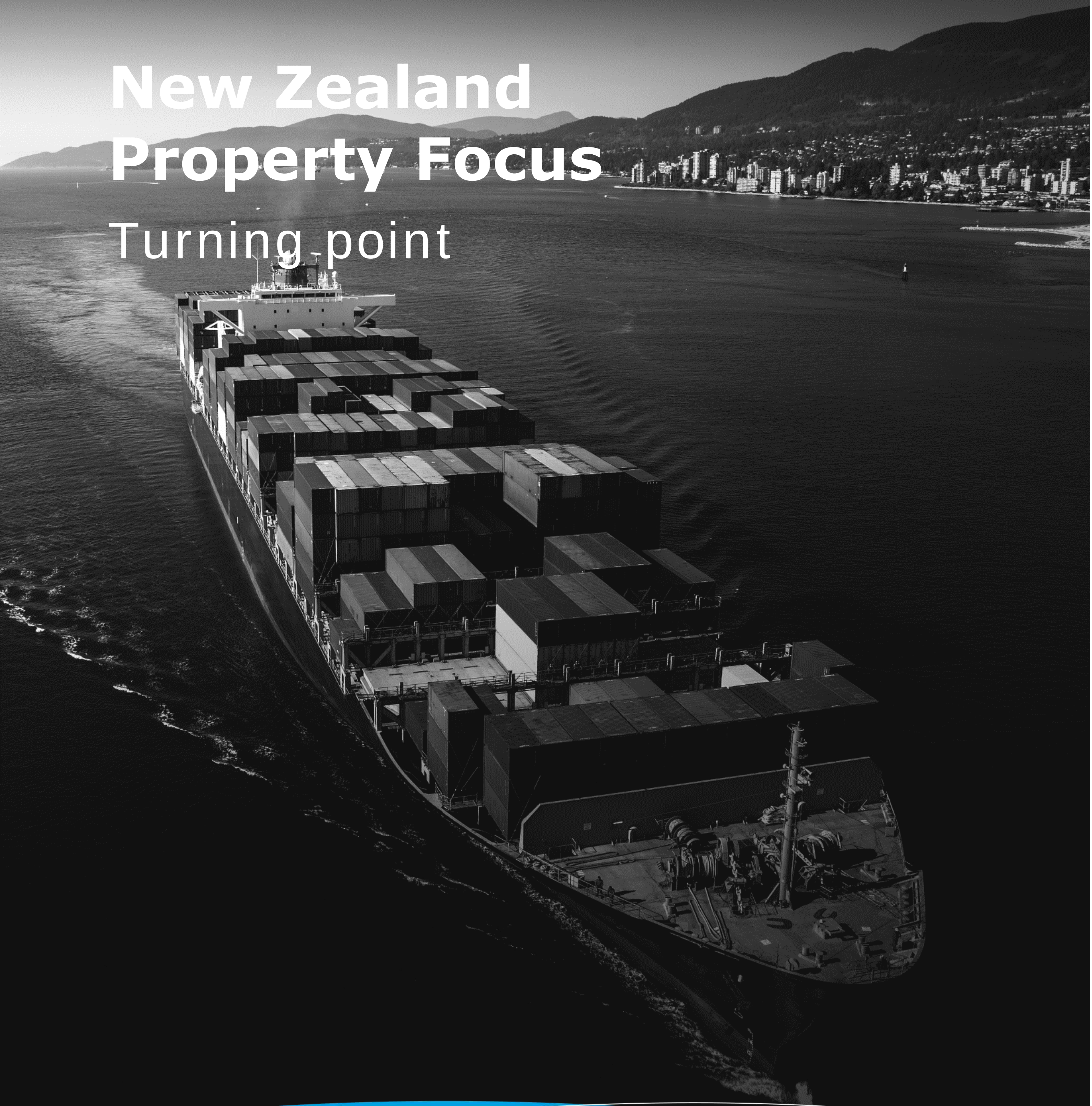
ANZ Research August 2021

New Zealand Property Focus

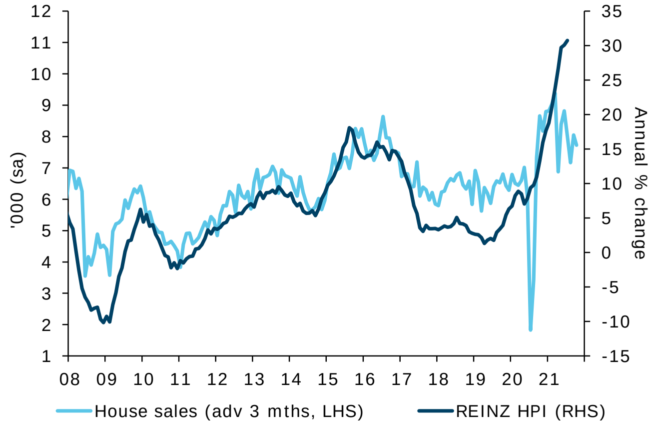
Turning point



At a glance

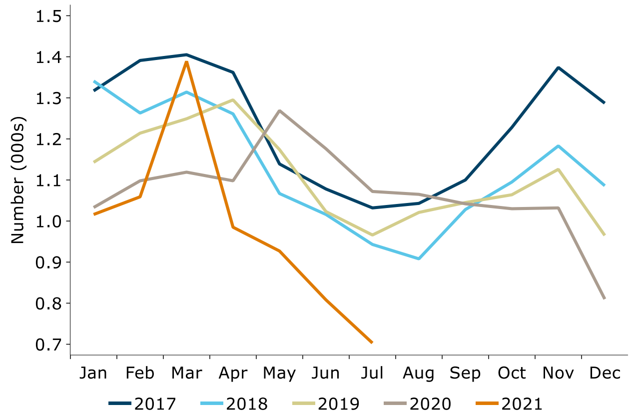
Sales down 9% y/y in July

But house price inflation remains strong



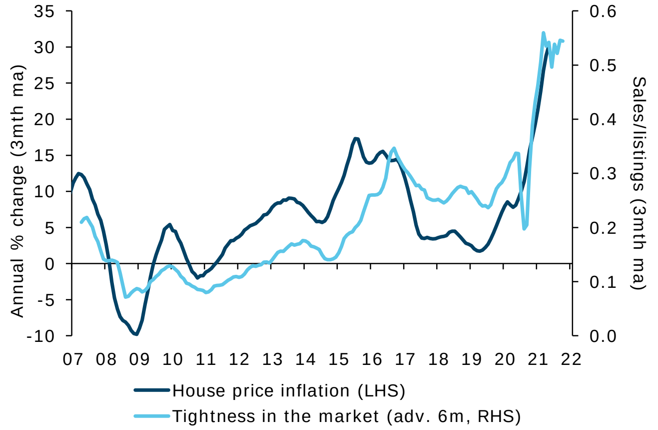
Inventory is very low

Even for winter



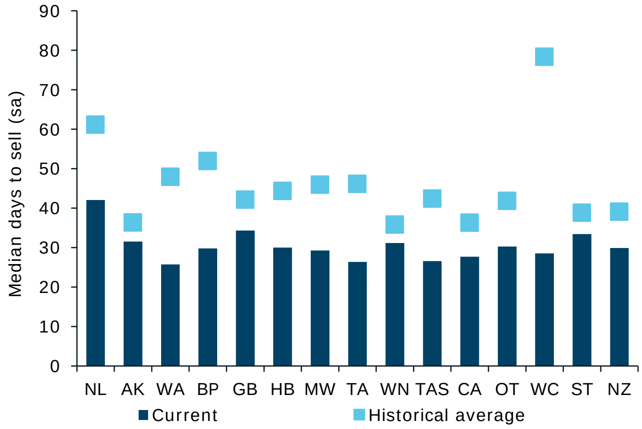
The market remains tight

Evidenced by the sales to listings ratio



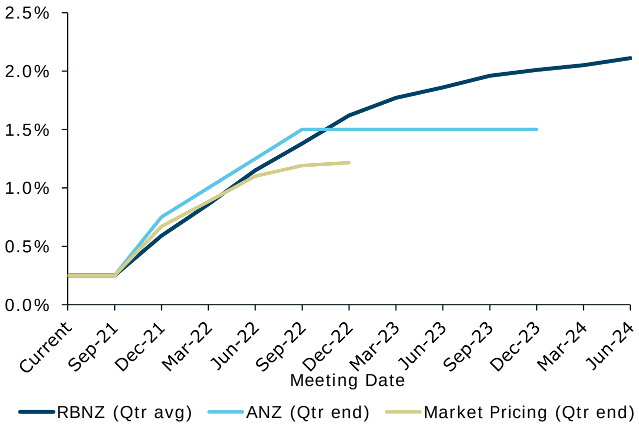
Days to sell remain low

In every region



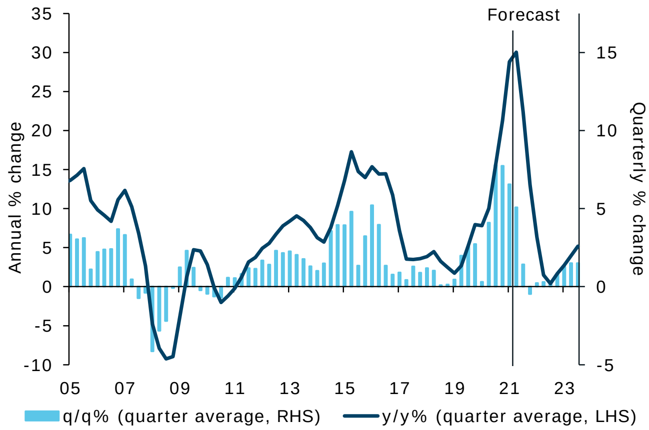
If New Zealand can beat Delta, then

Interest rates should keep rising



House price cycle at a turning point

But forecast uncertainty is high



Source: RBNZ, REINZ, Stats NZ, Macrobond, Bloomberg, ICAP, RealEstate.co.nz, 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

We think the housing market is at (or very close to) a turning point. But we're cognisant that forecasting house prices can be a lot more art than science, and that economists and government institutions alike have failed art class badly this past year or so. Indicators of market tightness are pointing to some persistence in house price pressures in the near term as very low inventories keep competition fierce. But higher mortgage rates, tax policy changes, tighter credit conditions, affordability constraints, and ongoing (but highly constrained) progress towards lifting supply are significant headwinds, and now we can throw COVID-19 uncertainty into the mix. Believe it or not, house prices can fall. While a material decline is not our central forecast (assumption), from these stratospheric levels that's certainly a risk. See our Market Overview.

Mortgage borrowing strategy

Mortgage rates are little changed on average compared to a month ago, but what little movement has occurred has been upward. As a result, the term structure of the mortgage curve remains broadly unchanged, with the 1-year marking the low point, and a spread of around 1.50%pts between the 1-year and the 5-year. In last month's edition we noted that the choice between the cheaper 1-year rate and higher 2 to 3-year rates that offered more certainty was a bit of a line call, and essentially a view on whether you thought the RBNZ might not hike as quickly as markets expected. In the event they did not hike this month, having been blind-sided by NZ being plunged back into lockdown. With the risks now skewed to fewer, not more, RBNZ rate hikes, fixing for longer looks like even more of a line call, especially with longer-term rates now higher. See our Mortgage Borrowing Strategy.

Housing market overview

Summary

We think the housing market is at (or very close to) a turning point. But we're cognisant that forecasting house prices can be a lot more art than science, and that economists and government institutions alike have failed art class badly this past year or so. Indicators of market tightness are pointing to some persistence in house price pressures in the near term as very low inventories keep competition fierce. But higher mortgage rates, tax policy changes, tighter credit conditions, affordability constraints, and ongoing (but highly constrained) progress towards lifting supply are significant headwinds, and now we can throw COVID-19 uncertainty into the mix. Believe it or not, house prices can fall. While a material decline is not our central forecast (assumption), from these stratospheric levels that's certainly a risk.

Preface

The resurgence of COVID in the community and the return to Alert Level 4 restrictions are expected to introduce volatility into housing market data over coming months. But at this early juncture we don't think this is a game changer for underlying economic momentum or the broader housing cycle. See this note for our thoughts on forecasting in this environment and how we're thinking about the current situation and the heightened risks associated with it.

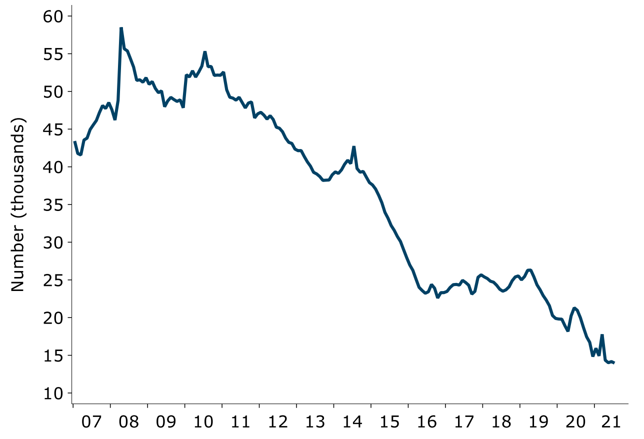
What we do expect is that lockdown measures will likely see both listings and sales fall sharply, but they should bounce back together too, keeping the degree of tightness in the market – and therefore house price pressures – relatively stable (all else equal).

Tight

Broadly speaking, July housing data were more of the same: the market remains very tight. Prices lifted 2.0% m/m (ANZ seasonal adjustment), a slight acceleration from June's read of 1.8% m/m but still a little slower than the average monthly pace recorded over the summer. Annual house price inflation is now running slightly above 30% y/y (3-month moving average), and continues to outstrip income growth by a significant margin, meaning housing continues to become more and more unaffordable by the month. We wrote about housing unaffordability in a little more detail in last month's edition.

Properties available for sale are at an historic low (in data that begins in 2007, figure 1), and that's been keeping competition at open homes pretty fierce.

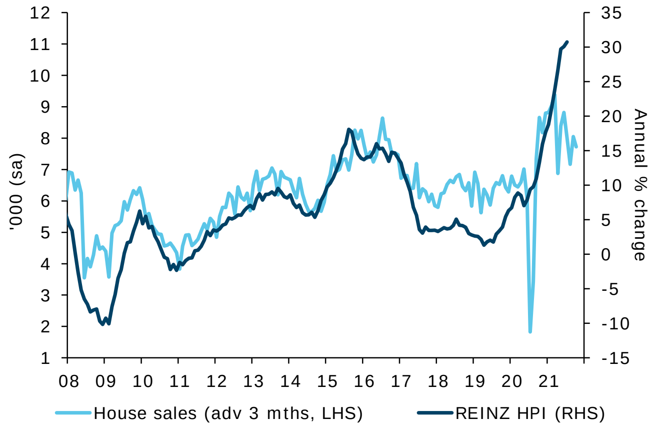
Figure 1. Properties available for sale



Source: Realestate.co.nz, Macrobond

Sales fell 4% m/m in July (ANZ seasonal adjustment), to be down 9% y/y (3-month moving average). While weakening sales typically signal softer price pressures are in the pipeline (usually with a lag of around three months, figure 2), prices have so far been slow to get the memo.

Figure 2. House price inflation and sales

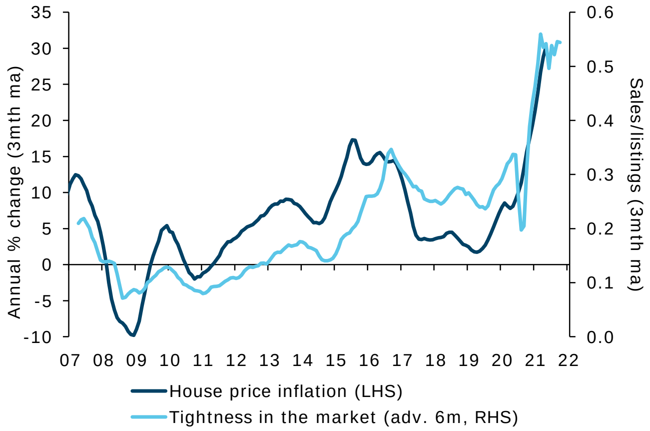


Source: REINZ, Macrobond, ANZ Research

One way to gauge near-term price pressures is to look at the ratio of sales to listings. This indicator of market tightness tends to provide a steer on house price momentum about 5-6 months ahead. At the national level, this is pointing to house price inflation pressures going broadly sideways over the next few months. And given the way inventories have been trending, this is a very plausible scenario, despite the RBNZ signalling that interest rate hikes are coming. COVID-19 cases alone are unlikely to derail that, though obviously there will be a sharp drop and then bounce-back in the near-term sales data.

Housing market overview

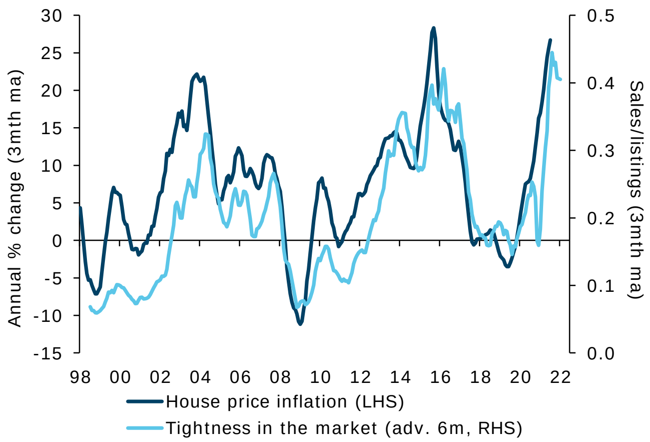
Figure 3. Tightness in the market (all of NZ)



Source: Realestate.co.nz, REINZ, Macrobond, ANZ Research

Given the Auckland house price cycle can lead the national market, it also pays to keep a close eye on developments there – we also have a little more history with the Barfoot and Thompson data to compute this gauge of market tightness (Figure 4). This indicator is showing a clearer sign that tightness in the Auckland market has peaked, but with listings in Auckland very low (and falling), the risk that price pressures remain elevated in the very near term is also significant.

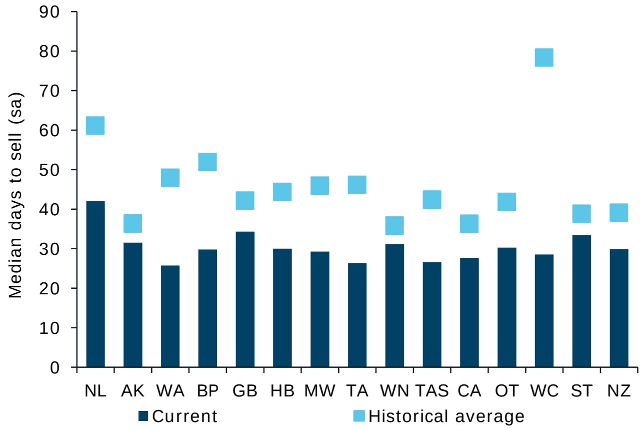
Figure 4. Tightness in the market (Auckland)



Source: Barfoot and Thompson, Macrobond, ANZ Research

The median number of days it takes to sell a property relative to its historical average is also a decent barometer for market tightness. At the national level, this indicator has been running close to 30 in recent months – well below its historical average of 39. On this metric, there isn't a single region in NZ where the market isn't tight by historical standards (figure 5).

Figure 5. Median days to sell a house relative to average



Region codes are as follows. NL: Northland; AK: Auckland; WA: Waikato; BP: Bay of Plenty; GB: Gisborne; HB: Hawke's Bay; MW: Manawatu-Whanganui; TA: Taranaki; WN: Wellington; TAS: Tasman, Nelson and Marlborough; CA: Canterbury; OT: Otago; WC: West Coast; ST: Southland; NZ: New Zealand.

Source: Barfoot and Thompson, Macrobond, ANZ Research

When it comes to forecasting house prices, these gauges of market tightness provide a useful indication of the starting point and momentum into the very near term. At face value, they suggest market tightness (and price pressures) are no longer intensifying, but that the market remains tight in an absolute sense. That suggests we're close to a turning point for house prices. However, these indicators provide very little insight when it comes to the timing and degree of moderation into the medium term.

Forecasting house prices is more judgement-based than you might think

Fair to say, no one's house price forecast accuracy has been anything to write home about over the past year or so. Rewind the clock a little more than a year, and our forecast for double digit house price declines stands in stark contrast to the +30% y/y house price inflation that actually came to pass.

So why were we (and pretty much every other forecaster) so wrong about the house price outlook? The answer to that question lies in how the underlying factors that influence housing evolved relative to our expectations at the time, and how the macroeconomic and health policy response turned out to be a much stronger stimulatory cocktail than anyone imagined.

Just take a minute to think about the economic situation as it was in the first half of 2020. Business and consumer confidence had fallen through the floor; commodity prices (a signal for global demand) had plummeted; NZ's largest export earner (international tourism) was closed for business for the foreseeable future; and a hefty chunk of the economy had just been switched off under one of the world's most stringent lockdowns (NZ's Alert Level 4). All up, the income shock associated with all of this looked like it was going to be the largest seen in a generation. And the view at the time was that the NZ business cycle needed all the help it could get to offset the income shock and prevent a blowout in unemployment. And all the while, the possibility of frequent and/or prolonged Alert Level restrictions (along with the assumption that they were more economically damaging than we now believe) hung over the economy's head in such a threatening fashion that the prospect of a recovery in business confidence (a key ingredient for investing and hiring) seemed slim. But as we now know, the economy's evolution has been much less dire than all this.

Perhaps the main ingredient of the recovery that we underestimated was just how successful New Zealand would be at containing outbreaks and avoiding lockdown. That allowed for higher-than-otherwise economic freedom and mobility, boosted confidence, and thus made the transmission of fiscal and monetary policy much more powerful than we assumed. But once momentum changed direction, there was so much volatility in the data and lingering virus uncertainty that it took a while for economists and government institutions to centralise it in their outlooks. And we now find ourselves in that same situation again, where much depends on just how successful we are at eliminating COVID in the community, and the data is going to be all over the show.

The above scenario shows how a few forecast assumptions (ie the length, intensity, and impacts of alert level restrictions) can determine the shape of the entire forecast profile. And if that assumption proves incorrect, outcomes can be wildly different from those expected. While we (and others) did work hard to emphasise the degree of uncertainty around the outlook (something we're still doing), this period will likely go down in history (touch wood) as being the biggest forecast "miss" of our time.

When it comes to forecasting house prices (or anything, for that matter), there is certainly no single model of "truth". All models are nothing more than an extremely simplified representation of a market, and what you put in largely determines what you get out. It's important to remember that while some models might work well most of the time, they are probably going to be pretty rubbish when the Big Stuff happens, which is precisely the time when everyone wants accurate forecasts. The correlations between variables you're taking advantage of might not be all that stable in such conditions.

In other words, models of the market are not the market and economists need to maintain a healthy scepticism of the forecasts they are producing, particularly during a significant shock such as COVID-19.

Indeed, it's easy to develop house price models based on economic forecasts of key variables such as population growth, interest rates, income growth, and growth in the number of dwellings (for example). But forecasts of these variables are likely to be wrong to some extent, and more likely to be more wrong when you're doing this in the midst of a crisis.

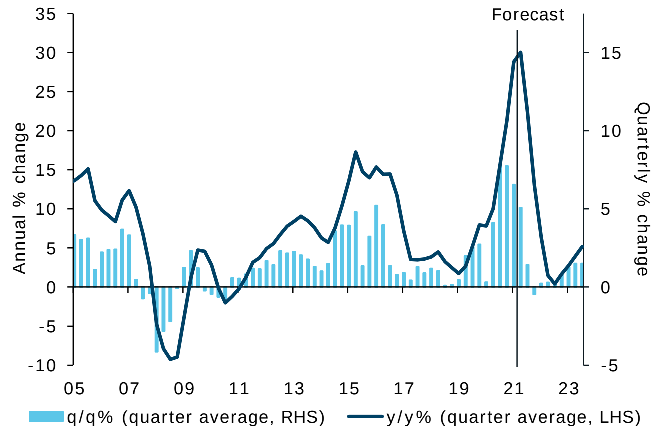
Further, there are many other forces that influence housing that are not easily quantified, such as "animal spirits", macro-prudential policy settings (eg LVR restrictions), tax policy changes (eg the removal of interest deductibility for investors), and compositional changes (eg the dominance of returning New Zealand citizens in recent net migration). While we do attempt to isolate and estimate the impacts of these harder-to-quantify influences, there is no way to fully capture them in the data or consider them together in a statistically robust model. That means we need to lean on supplementary analysis to inform our qualitative judgements that overlay our model-based forecasts – and each time we do this introduces new assumptions and uncertainties.

Knowing what's in the forecasting sausage hopefully helps demonstrate just how uncertain anyone's house price forecast is, particularly at times like these. No one has perfect foresight (but, dangerously, 20/20 hindsight can create that illusion) and no one has a perfect model of the real world. But as long as decisions that affect tomorrow need to be made today, there will always be demand for forecasts. Our job as economists isn't to "sell" the one true outlook; it's to present a central view, highlight the assumptions that feed into it, and express the uncertainties around it to help people make better-informed decisions. With that in mind, let's turn to our highly uncertain – like everyone else's – outlook.

Are house prices going to fall?

Our central forecast (assumption) is that annual house price inflation will moderate fairly quickly from spring as rising mortgage rates, tax policy changes, tighter credit conditions, affordability constraints, and ongoing (but highly constrained) progress towards lifting supply more than offset the fundamental issue plaguing the New Zealand housing market – not enough houses. We've even pencilled in a few months of negative house price moves over the summer months as listings are assumed to lift in line with seasonal patterns. This forecast, however, also assumes that NZ's housing deficit, relatively solid household income growth, and still relatively low mortgage rates in an absolute sense is enough to prevent annual house price inflation from turning negative (figure 6). Relative to some forecasts, such as the RBNZ's, that's a little on the optimistic side.

Figure 6. House price outlook



Source: ANZ Research, REINZ

But we do have some sympathy for weaker house price forecasts than our own. Given the stratospheric starting point and the lengthy list of housing headwinds, risks are skewed towards a sharper cyclical downturn than we've pencilled in. But even a 10% drop in house prices from July levels would only erase 5-6 months of recent house price gains – that doesn't seem unmanageable in the grand scheme of things. And from a housing affordability perspective, it's possibly the only way to achieve progress in a reasonable time horizon – see July's Property Focus for further discussion.

For the broader economy, the implications of such a decline would very much depend on how it affects household confidence and spending, as well as residential construction activity. Housing is a key driver of growth momentum in the NZ economy, but it's not the only driver. Key export commodity prices are high, there is a little more fiscal stimulus in the pipeline, and perhaps most importantly the labour market is close to, or even exceeding, full employment, with wage pressures rising. So while downside housing and COVID risks remain, there is a robustness to the NZ economy that suggests policy makers don't need to be too concerned about a small house price wobble. But something more significant, if it threatened the broader economic recovery, could stop OCR hikes in their tracks. Indeed, COVID isn't the only reason for policy makers to tread cautiously, with the global growth outlook and market sentiment looking decidedly wobblier.

Housing market indicators for July 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	$707,164	26.7	5.0	24.8	5.2	241	+4%	42
Auckland	$1,193,238	27.8	5.5	27.9	4.5	2,730	-6%	32
Waikato	$742,985	19.0	2.7	32.4	7.3	751	-3%	26
Bay of Plenty	$849,181	25.9	2.7	34.2	5.5	457	-7%	30
Gisborne	$641,159	29.4	-0.1	35.4	4.7	61	+39%	34
Hawke's Bay	$760,526	32.7	4.1	35.4	4.7	195	-4%	30
Manawatu-Whanganui	$589,585	31.6	4.6	48.5	5.7	339	-3%	29
Taranaki	$553,270	19.5	7.2	34.9	7.3	181	-7%	26
Wellington	$893,496	23.4	4.6	40.2	6.2	688	-5%	31
Tasman, Nelson & Marlborough	$744,027	22.9	4.8			222	-10%	27
Canterbury	$602,389	24.5	5.0	28.6	7.1	1,054	-10%	28
Otago	$686,664	21.9	1.6	24.4	4.3	377	-5%	30
West Coast	$298,939	27.4	2.8	26.9	4.9	57	-5%	29
Southland	$422,693	16.5	4.2	25.4	2.6	160	-2%	33
New Zealand	**$839,943**	**25.2**	**3.6**	**30.8**	**5.7**	**7,724**	**-4%**	**30**

Mortgage borrowing strategy

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Summary

Mortgage rates are little changed on average compared to a month ago, but what little movement has occurred has been upward. As a result, the term structure of the mortgage curve remains broadly unchanged, with the 1-year marking the low point, and a spread of around 1.50%pts between the 1-year and the 5-year. In last month's edition we noted that the choice between the cheaper 1-year rate and higher 2 to 3-year rates that offered more certainty was a bit of a line call, and essentially a view on whether you thought the RBNZ might not hike as quickly as markets expected. In the event they did not hike this month, having been blind-sided by NZ being plunged back into lockdown. With the risks now skewed to fewer, not more, RBNZ rate hikes, fixing for longer looks like even more of a line call, especially with longer-term rates now higher.

Our view

What a difference a month makes. When we penned this column a month ago, we were confident that the RBNZ would have lifted the OCR by 0.25%pts by now. Markets were even more confident, and in fact, the conversation going into the RBNZ's decision last week was whether they might hike 0.50%pts, rather than 0.25%pts. In the event, with the decision coinciding with the first day of the new lockdown, the RBNZ decided to stand pat, rather than rattling the cage of an already rattled population. But they made it clear it was a temporary reprieve, and that their view on the appropriateness of rate hikes had not changed.

At this juncture, one question is at front of mind, and that is: does last week's decision by the RBNZ change the outlook from here? Put another way, what are the chances that the RBNZ's plans to normalise policy (ie lift the OCR back toward the 2% mark that it sees as a "neutral" setting) are again interrupted by Delta? The short answer: nobody really knows. The path of the economy depends on the path of Delta, and we think it pays to keep an open mind.

What we know is that the RBNZ would like to hike the OCR soon. That's clear from their projections, which have the OCR rising from its current level of 0.25% to 0.75% by year end, and onwards and upwards to over 2% by the end of 2023. However, this is predicated on an assumption that the economy's recovery from last year's COVID shock is a good guide for this time. In practice, the outlook is finely balanced between two very different but possible states of the world. We wrote about this last week in an Insight titled "Lockdown and the economic outlook".

In terms of where that leaves the decision to fix (and for how long), we think what we described a month ago as a line call between 1-year and 2 or 3-year is now skewed more towards the former. That's because longer-term fixed rates are higher, yet the risk that the RBNZ's plans are further derailed seem to be greater. But inflation risks remain, so it's not one-sided.

Wholesale markets are adjusting to this, and have started to re-think where the OCR may go. That does not mean that mortgage rates will fall, but if the RBNZ does get side-lined, or tighten more gradually in the future, mortgage rates might rise more slowly. That in turn also points towards sticking with the 1-year, albeit recognising that future re-fixes are likely to occur at a higher rate (which it'd be prudent to budget for now).

Crunching the numbers again, our breakeven analysis shows that for the 2-year to be cheaper than back-to-back 1-year fixes, you'd need to expect the 1-year rate to rise 0.75%pts (from 2.59% to 3.34%). To be clear, our forecasts have the OCR rising by more than that over the next year. However, we have already seen the 1-year rate rise by 0.40%pts since June (following the move higher in wholesale rates, which had anticipated a hike last week), and as noted, the outlook is now much less certain. So again, it's a line call, but perhaps one shaded more towards fixing for shorter, and/or holding off to see how things look in a few weeks.

Figure 1. Carded special mortgage rates^

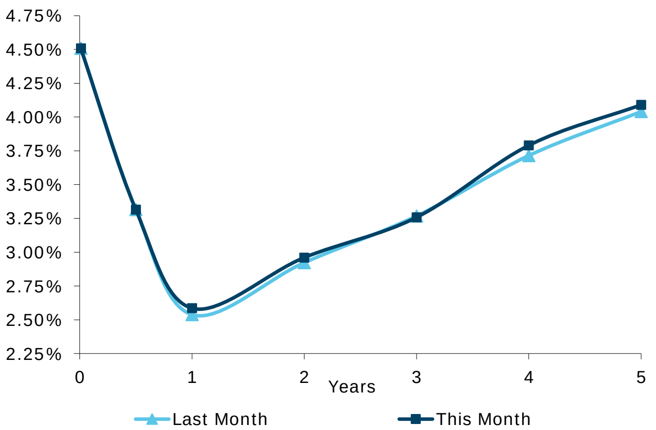

Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	4.51%				
6 months	3.32%	1.86%	3.15%	3.52%	3.70%
1 year	2.59%	2.50%	3.34%	3.61%	3.85%
2 years	2.96%	3.06%	3.59%	4.09%	4.62%
3 years	3.26%	3.56%	4.19%	4.52%	4.84%
4 years	3.79%	4.02%	4.47%		
5 years	4.09%	#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 (historic rates are special rates; projections based on ANZ's wholesale rate forecasts)

	Actual			Projections						
Interest rates	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Floating Mortgage Rate	4.5	4.5	4.5	4.5	5.0	5.2	5.5	5.7	5.7	5.7
1-Yr Fixed Mortgage Rate	2.5	2.3	2.2	2.9	3.2	3.4	3.5	3.6	3.6	3.6
2-Yr Fixed Mortgage Rate	2.6	2.6	2.6	3.4	3.6	3.7	3.7	3.7	3.7	3.7
5-Yr Fixed Mortgage Rate	3.0	3.0	3.6	3.9	4.0	4.2	4.4	4.4	4.4	4.4

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
GDP (Annual % Chg)	0.4	-0.8	2.4	15.7	2.2	4.0	3.2	3.4	3.8	3.9
CPI Inflation (Annual % Chg)	1.4	1.4	1.5	3.3(a)	4.2	4.1	3.8	3.0	2.4	2.3
Unemployment Rate (%)	5.3	4.8	4.6	4.0(a)	3.9	3.9	3.9	3.9	3.8	3.8
House Prices (Quarter % Chg)	4.1	7.8	7.7	6.6(a)	5.1	1.4	-0.5	0.2	0.3	0.3
House Prices (Annual % Chg)	10.0	15.6	21.3	28.8(a)	30.1	22.4	13.0	6.3	1.5	0.4

Interest rates	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Official Cash Rate	0.25	0.25	0.25	0.25	0.75	1.00	1.25	1.50	1.50	1.50
90-Day Bank Bill Rate	0.27	0.35	0.35	0.75	1.04	1.31	1.57	1.65	1.65	1.65
10-Year Bond	0.99	1.81	1.77	1.80	2.00	2.20	2.40	2.50	2.50	2.50

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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