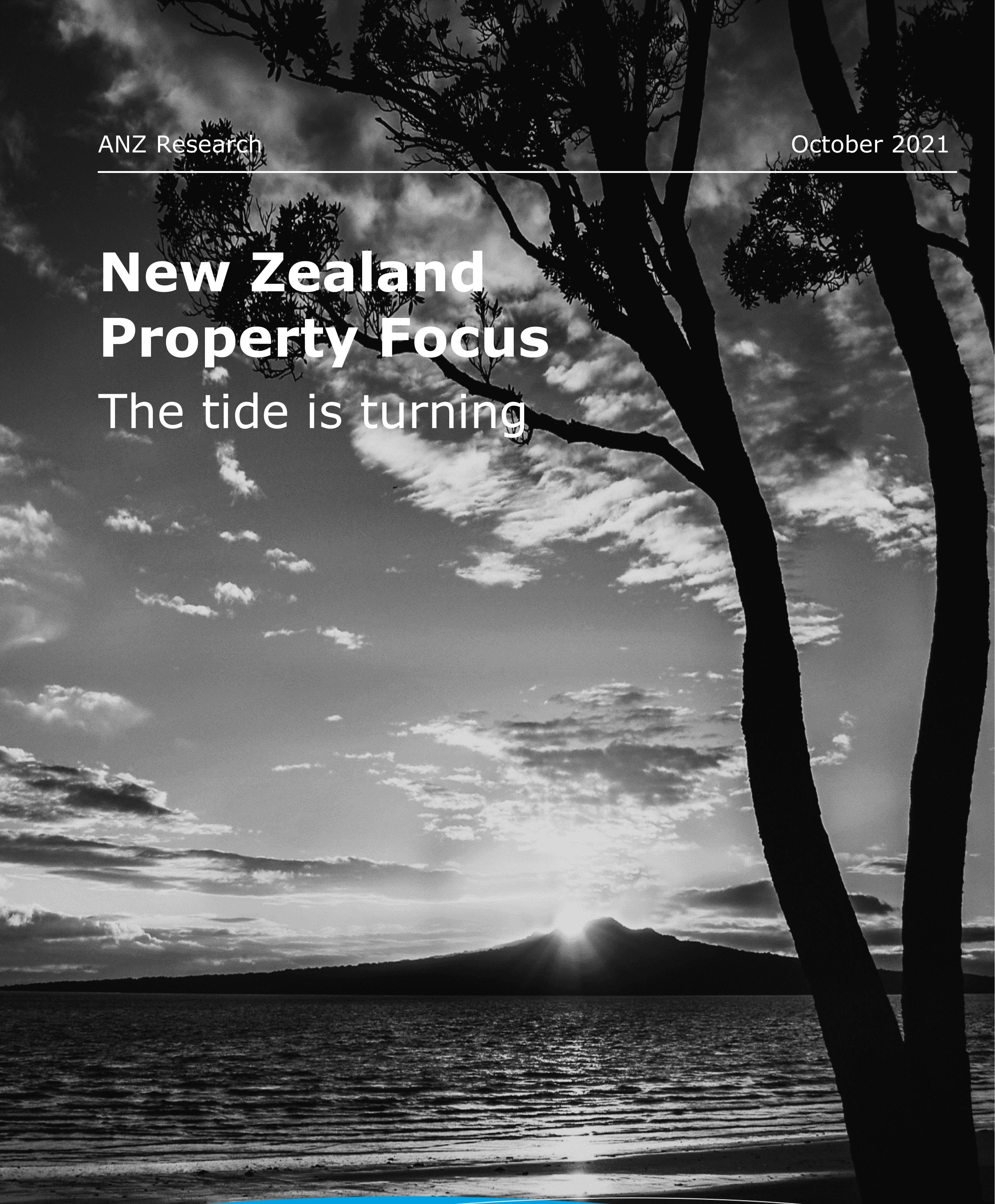
New Zealand Property Focus

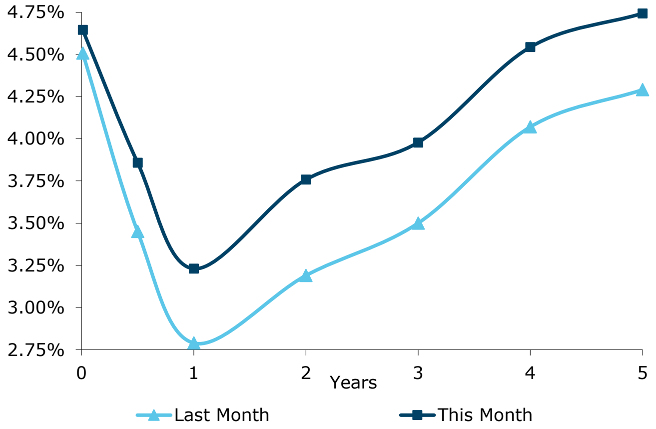
The tide is turning



At a glance

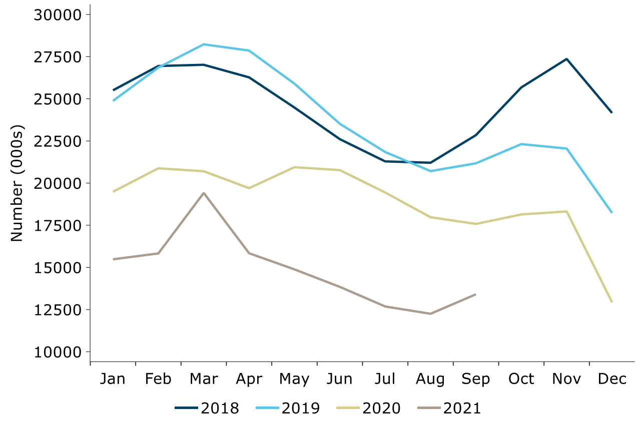
Mortgage rates are higher

Across the curve



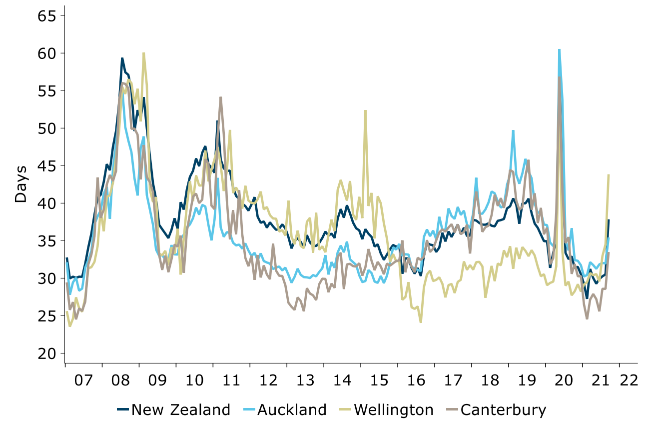
Higher listings into summer

But still at very low levels



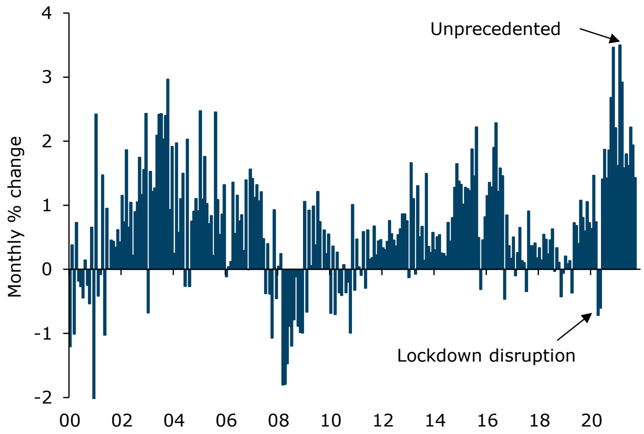
Days to sell spike on lockdown

But market still looks tight overall



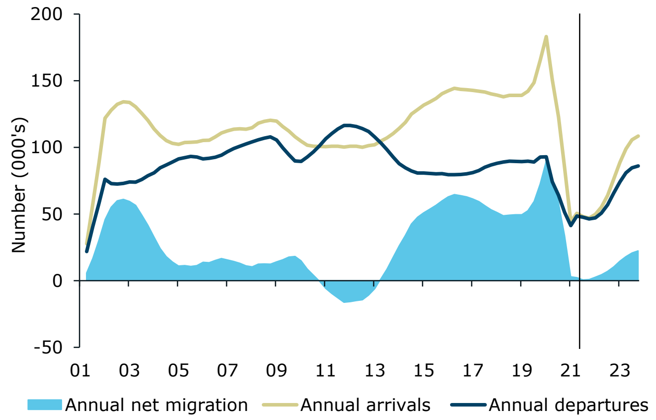
Monthly price gains solid

But past the peak



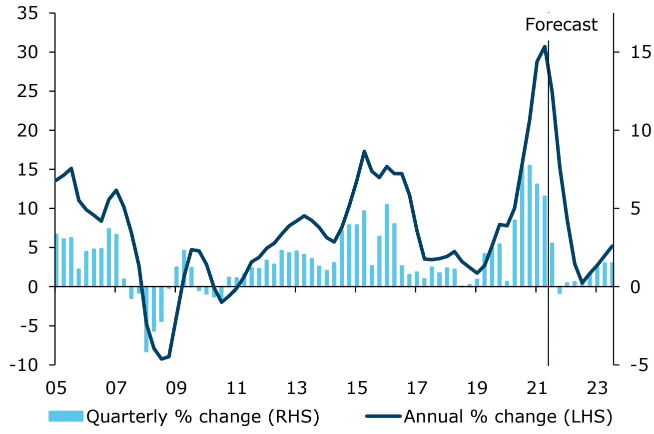
Net migration will get interesting again

As economies open up



Annual house price inflation to slow

But the pace is very uncertain



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

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ISSN 2624-0629

Publication date: 26 October 2021

Summary

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

Housing market overview

Ongoing lockdown measures in Auckland are adding noise to the housing data, but looking through that, the underlying housing pulse seems to be holding up for now. House price inflation remains elevated, but it is slowing. We're expecting that slowdown in prices to continue. This month we find ourselves adding another house price headwind to an already-lengthy list: the Government's housing density legislation, which brings additional downside risks to the price outlook, particularly over the medium term. As summer and the New Year approach, we think it'll pay to keep a close eye on the listings data and migration settings and outturns. Both could shift the dial for this house price cycle in a meaningful way. See our Market Overview.

Mortgage borrowing strategy

Mortgage rates continue to rise rapidly, with average fixed rates up between 0.41%pts and 0.57%pts over the past month. There were two main catalysts for the increases. The first was the RBNZ's decision to hike earlier this month. Not only was that the first OCR hike in seven years; the RBNZ also warned that further hikes will likely follow. This was further reinforced by the release of Q2 inflation data, which was much higher than expected, fuelling financial market fears that the OCR may have to rise a lot further. As a consequence, term wholesale rates have moved up sharply, which has in turn driven mortgage rates higher. All rates are now above 3% (on average). The 1-year rate remains the lowest; it's also the one we now prefer. It doesn't offer much time protection, but it's a lot cheaper than floating. We believe the prime opportunity to fix has now passed, with longer-term rates now much higher and significantly less attractive than they once were. See our Mortgage Borrowing Strategy.

Housing market overview

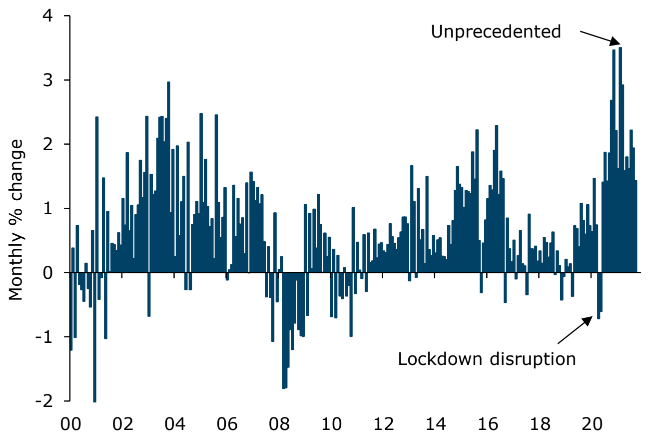
Summary

Ongoing lockdown measures in Auckland are adding noise to the housing data, but looking through that, the underlying housing pulse seems to be holding up for now. House price inflation remains elevated, but it is slowing. We're expecting that slowdown in prices to continue. This month we find ourselves adding another house price headwind to an already-lengthy list: the Government's housing density legislation, which brings additional downside risks to the price outlook, particularly over the medium term. As summer and the New Year approach, we think it'll pay to keep a close eye on the listings data and migration settings and outturns. Both could shift the dial for this house price cycle in a meaningful way.

Past the peak

The pace of monthly house price inflation is now well off its cycle peak (figure 1). Mechanically, that means annual inflation is poised to slow over coming months too.

Figure 1. Monthly house price inflation (sa)



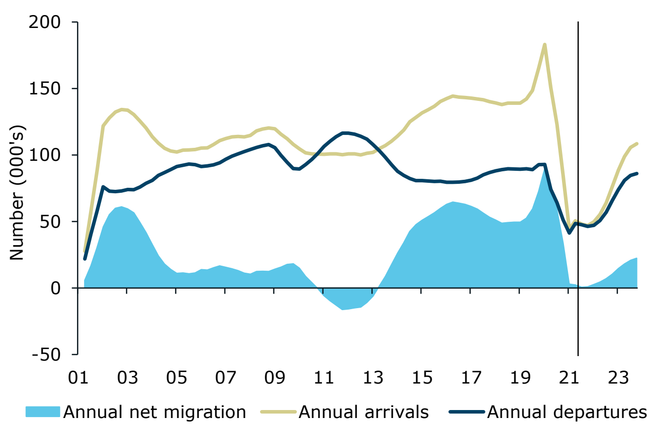
Source: REINZ, ANZ Research, Macrobond

Whether or not a soft landing will be achieved in the housing market remains an open question. But with many previous tailwinds becoming headwinds, we think it pays to be attentive to downside risks. Key wind-changes include:

- Rising interest rates, and expectations that there's more to come. Swap rates are lifting and that's putting upwards pressure on retail rates, including for mortgages (see the borrowing strategy section for more).
- LVR settings will be tightened further from 1 November.
- Adding to an already-lengthy list of housing policy changes, the Government's higher density housing legislation is a step in the right direction towards addressing housing undersupply. Hopefully, the removal of red tape and a pivot towards more multi-unit dwelling construction brings some productivity gains too. However, the benefits may take a while to accrue, as construction is extremely capacity constrained right now. Near-term impacts on the housing cycle are a little ambiguous, as expectations of future housing supply are pitted against the higher development value of land this policy brings. But the longer-run impacts are clear: more houses than otherwise means lower prices than otherwise.
- House prices are now very stretched relative to incomes, meaning affordability constraints are biting.
- As outlined last month, banks' funding gap (the gap between deposit and lending growth) suggests upward pressure on wholesale rates is unlikely to be absorbed for long. If credit demand exceeds deposit growth, rates may need to rise by more, or faster than otherwise, to restore the balance.
- Closed borders have slowed population growth markedly, meaning housing supply is catching up to demand, despite labour and materials shortages.

Migration has been on hold this past year or so as a driver of economic activity and housing demand. Closed borders have slowed net migration to a snail's pace. But as the rest of the world (and New Zealand) opens its borders to the vaccinated, this could be something worth keeping a close eye on – particularly if NZ is slower than the rest of the world in letting migrants back in, and/or introduces significantly tighter inward migration policies on the other side of this. Both of those possibilities represent potential downside risks to our migration assumption that net inflows will gradually lift from early- to mid-2022 (figure 2). Net migrant outflows are possible, particularly if more kiwis start making the jump across the Tasman or further afield at a time when inflows from elsewhere are weak. If that were to happen, the fundamental housing supply-demand imbalance could be rectified much sooner.

Figure 2. Net migration



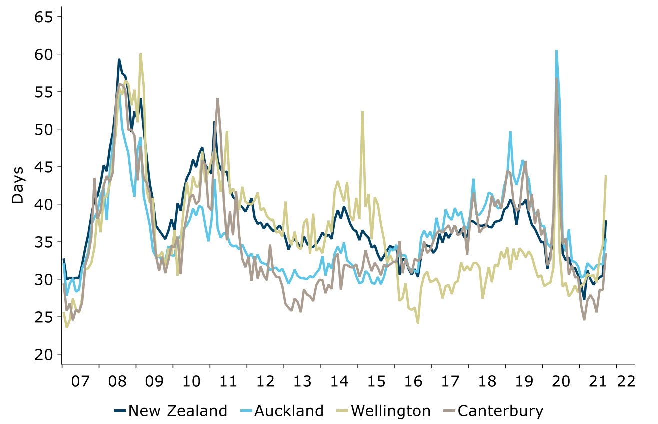
Source: Statistics NZ, ANZ Research

Housing market overview

Trying to gauge the underlying housing impulse is difficult when the data is plagued by lockdown volatility. And data for Auckland definitely has its fair share of that. Auckland house sales fell 46.4% m/m in September (ANZ seasonal adjustment). Outside of Auckland, sales were up 4.2% m/m, suggesting the market is still getting on with it as best it can. Overall, we'd expect sales to bounce back as restrictions are eased, but the timing here remains very uncertain.

The number of days it takes to sell a house is generally a decent barometer of tightness in the market, but lockdown is adding noise to that indicator too (albeit not as much as the Great Lockdown of 2020, figure 3).

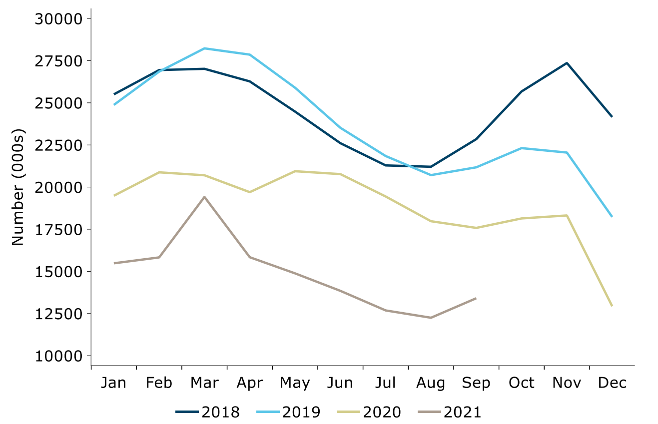
Figure 3. Median number of days it takes to sell a house



Source: REINZ, Macrobond, ANZ Research

Looking through the noise, we continue to assess the market to be "tight". Anecdote suggests housing demand and confidence are holding up at a time when the number of properties available for sale remains very low, despite the small seasonal uptick in September (figure 4).

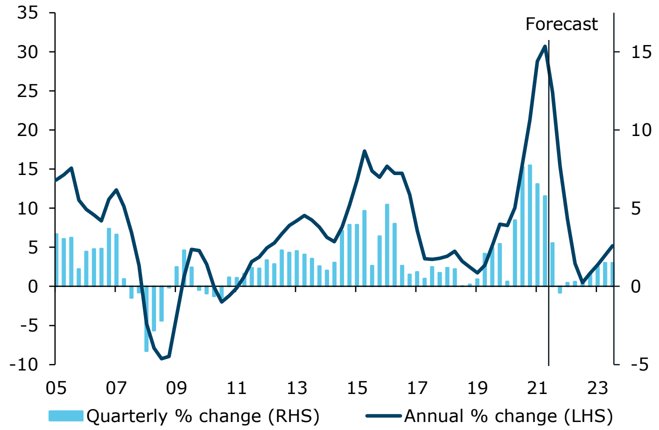
Figure 4. Properties available for sale



Source: Realestate.co.nz, ANZ Research

We'll be keeping a close eye on the listings data as we head into summer. Listings should lift in line with seasonal patterns, but if enough sellers attempt to sell "at the peak' all at the same time, house prices could adjust a little more dramatically than our expectation (figure 5).

Figure 5. House price forecast



Source: REINZ, ANZ Research

As we've noted in past editions, forecasting house prices can be a bit of a mug's game. Accounting for the structural and cyclical impacts of policy changes isn't straightforward, particularly when there are multiple "policy shocks" occurring over different time horizons. The RBNZ has recently made the assessment that house prices are above their sustainable level, but that doesn't necessarily mean they will "correct". Rather, house prices could simply rise more slowly than incomes over the next few years (or decades more like), eventually bringing the level to something more sustainable.

Our house price forecast has a few negative months of house price inflation built in (as rates rise and listing increase over the summer), but this isn't enough to shift annual inflation into the red – although that's a very real possibility.

Based on the growing list of headwinds to house prices, we're still comfortable with our characterisation that risks are skewed to the downside. For the broader economy, the implications of a sharper-than-expected moderation in house price inflation would depend on how it affects household confidence and spending, as well as construction activity. The high starting point for house prices means even a double-digit decline (eg 10%) would only take prices back to where they were in March this year.

Housing market overview

Housing market indicators for September 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	$665,171	18.9	-1.0	33.5	6.6	174	+2%	38
Auckland	$1,159,722	20.5	4.1	25.7	5.4	1,369	-46%	35
Waikato	$778,626	21.9	4.8	33.3	5.7	614	+3%	35
Bay of Plenty	$878,935	24.1	4.4	37.3	6.3	385	+9%	41
Gisborne	$599,361	9.1	-11.8	36.9	5.4	45	+66%	47
Hawke's Bay	$782,977	31.5	1.1	36.9	5.4	208	+20%	39
Manawatu-Whanganui	$622,369	35.2	4.5	46.2	3.7	314	+28%	41
Taranaki	$525,867	10.8	-1.6	30.0	4.1	151	+8%	40
Wellington	$854,350	13.9	-1.1	35.1	3.9	697	+13%	44
Tasman, Nelson & Marlborough	$763,600	22.5	2.5			205	+11%	41
Canterbury	$653,580	30.6	9.4	36.2	9.2	894	-2%	33
Otago	$708,018	18.5	1.6	28.4	5.6	357	+0%	38
West Coast	$272,928	11.5	-2.3	25.9	3.4	30	-31%	31
Southland	$434,622	28.2	2.2	25.5	3.7	159	+38%	30
New Zealand	**$803,142**	**15.5**	**3.6**	**30.5**	**5.8**	**5,757**	**-10%**	**38**

Mortgage borrowing strategy

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Summary

Mortgage rates continue to rise rapidly, with average fixed rates up between 0.41%pts and 0.57%pts over the past month. There were two main catalysts for the increases. The first was the RBNZ's decision to hike earlier this month. Not only was that the first OCR hike in seven years; the RBNZ also warned that further hikes will likely follow. This was further reinforced by the release of Q2 inflation data, which was much higher than expected, fuelling financial market fears that the OCR may have to rise a lot further. As a consequence, term wholesale rates have moved up sharply, which has in turn driven mortgage rates higher. All rates are now above 3% (on average). The 1-year rate remains the lowest; it's also the one we now prefer. It doesn't offer much time protection, but it's a lot cheaper than floating. We believe the prime opportunity to fix has now passed, with longer-term rates now much higher and significantly less attractive than they once were.

Our view

The sharp rise in mortgage rates seen over the past month has taken interest rates up to levels where we think it is now less likely to be worthwhile fixing for more than 1 year if the intention is to save money over the long run. To put it bluntly, the "horse has bolted", and we think it will now be very difficult for borrowers to get ahead of likely upcoming rises in mortgage rates. This was possible earlier in the year, and we flagged the opportunities then. But the mortgage curve is now so high and so steep that paying fixed for 2 years or more will likely only be cost effective if rates rise very sharply – and more sharply than we expect.

To illustrate this point, consider the choice between 1 and 2-year. At the moment, the average 1-year rate is 3.23% and the average 2-year rate is 3.76%. If you consider a 2-year time horizon, two simple strategies to compare might be (1) fix for 2 years; or (2) fix for 1 year and then re-fix for 1 year in a year's time. You could also combine 6-month and 18-month terms, but for now we'll just consider 1-year and 2-year terms. The question then becomes: where might the 1-year rate be in a year? We expect it to rise, but it's by how much that matters, if one views it purely from a cost perspective (and ignores other considerations like fluctuating payments and the value of certainty).

As our breakeven table shows, if you fix for 1 year now at 3.23%, then as long as the 1-year rate is below 4.29% in 1 year's time, when you could re-fix for another year, you'll end up better off than having fixed for 2 years now (in terms of overall interest expense over a 2-year time horizon). That's a fairly big increase to expect (+1.06%pts), particularly given that the 1-year rate has already risen by 1.04%pts since June, when it was 2.19%. To be clear, we expect the OCR to rise by another 1.5%pts over the next year. But that's already priced in, and that's why the 1-year wholesale (swap) rate is around 1.5% and the wholesale 2-year wholesale rate is around 2%.

That being the case, we are only likely to see 1-year mortgage rates rise by more than what is implied by our breakevens if the RBNZ is forced to hike by more, eg if inflation really gets out of hand. But that's not what we expect right now. And while inflation risks are very real, the picture could change abruptly. As Alert Level restrictions drag on, downside risks to growth and employment are building – and we're about to find out how robust the housing market is to higher rates. We could easily see the economy stall, with the RBNZ pausing or even reversing hikes, potentially leaving those who have fixed for longer regretful.

Being fixed for longer does provide certainty, and that has real value. Those who can't afford to take the risk of higher rates and who, for example, know that they can afford to pay up to 4% but not more, may wish to fix now for, say, 3 years. But that does bring with it an immediate cost (compared to 1-year) and on current projections, may cost more over time. In the end, it will depend on how much risk you're comfortable with.

Figure 1. Carded special mortgage rates^

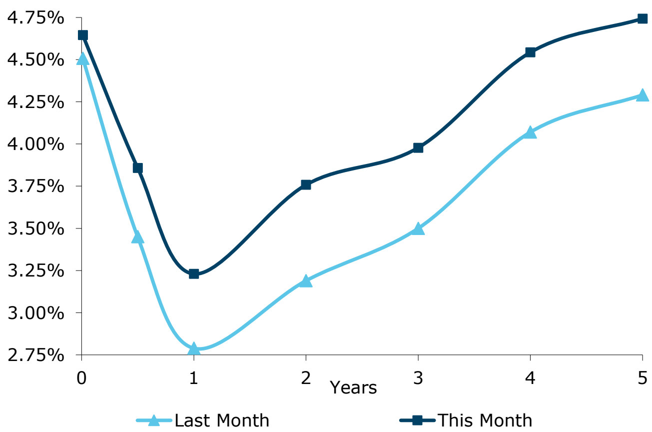

Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	4.65%				
6 months	3.86%	2.60%	4.16%	4.41%	4.31%
1 year	3.23%	3.38%	4.29%	4.36%	4.42%
2 years	3.76%	3.87%	4.35%	4.80%	5.33%
3 years	3.98%	4.33%	4.98%	5.19%	5.40%
4 years	4.54%	4.74%	5.12%		
5 years	4.74%	#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 (%)													
	2.50	2.75	3.00	3.25	3.50	3.75	4.00	4.25	4.50	4.75	5.00	5.25	5.50	5.75
200	207	213	219	225	231	237	243	250	256	263	270	276	283	290
250	259	266	273	281	289	296	304	312	320	329	337	345	354	363
300	310	319	328	337	346	356	365	375	385	394	404	415	425	435
350	362	372	383	393	404	415	426	437	449	460	472	484	496	508
400	414	426	437	450	462	474	487	500	513	526	539	553	566	580
450	466	479	492	506	520	534	548	562	577	592	607	622	637	653
500	517	532	547	562	577	593	609	625	641	657	674	691	708	725
550	569	585	601	618	635	652	669	687	705	723	741	760	779	798
600	621	638	656	674	693	711	730	750	769	789	809	829	850	870
650	673	692	711	730	750	771	791	812	833	854	876	898	920	943
700	724	745	766	787	808	830	852	874	897	920	944	967	991	1,015
750	776	798	820	843	866	889	913	937	961	986	1,011	1,036	1,062	1,088
800	828	851	875	899	924	948	974	999	1,025	1,052	1,078	1,105	1,133	1,160
850	879	904	930	955	981	1,008	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233
900	931	958	984	1,011	1,039	1,067	1,095	1,124	1,154	1,183	1,213	1,244	1,274	1,306
950	983	1,011	1,039	1,068	1,097	1,126	1,156	1,187	1,218	1,249	1,281	1,313	1,345	1,378
1000	1,035	1,064	1,094	1,124	1,154	1,186	1,217	1,249	1,282	1,315	1,348	1,382	1,416	1,451

Mortgage rate projections (historic rates are special rates; projections based on ANZ's wholesale rate forecasts)

	Actual			Projections						
Interest rates	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Floating Mortgage Rate	4.5	4.5	4.5	5.0	5.3	5.8	6.3	6.3	6.3	6.3
1-Yr Fixed Mortgage Rate	2.3	2.2	2.7	3.4	3.7	4.0	4.1	4.1	4.1	4.1
2-Yr Fixed Mortgage Rate	2.6	2.6	3.1	3.9	4.1	4.2	4.2	4.2	4.2	4.2
5-Yr Fixed Mortgage Rate	3.0	3.6	4.0	4.7	4.8	4.9	4.9	4.9	4.9	4.9

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
GDP (Annual % Chg)	0.1	2.9	17.4	-4.2	4.1	2.9	1.2	9.8	2.9	3.4
CPI Inflation (Annual % Chg)	1.4	1.5	3.3	4.9(a)	5.5	5.8	5.1	3.9	3.2	2.5
Unemployment Rate (%)	4.8	4.6	4.0	4.0	4.0	3.9	3.9	3.8	3.8	3.9
House Prices (Quarter % Chg)	7.6	7.7	6.5	5.8(a)	2.8	-0.4	0.2	0.3	0.3	0.8
House Prices (Annual % Chg)	15.6	21.3	28.8	30.7(a)	24.8	15.4	8.5	2.9	0.5	1.7

Interest rates	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Official Cash Rate	0.25	0.25	0.25	0.75	1.00	1.50	2.00	2.00	2.00	2.00
90-Day Bank Bill Rate	0.35	0.35	0.65	1.00	1.52	2.02	2.10	2.10	2.10	2.10
10-Year Bond	1.81	1.77	2.09	2.50	2.65	2.75	2.75	2.80	2.80	2.80

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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Last updated: 15 October 2021

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