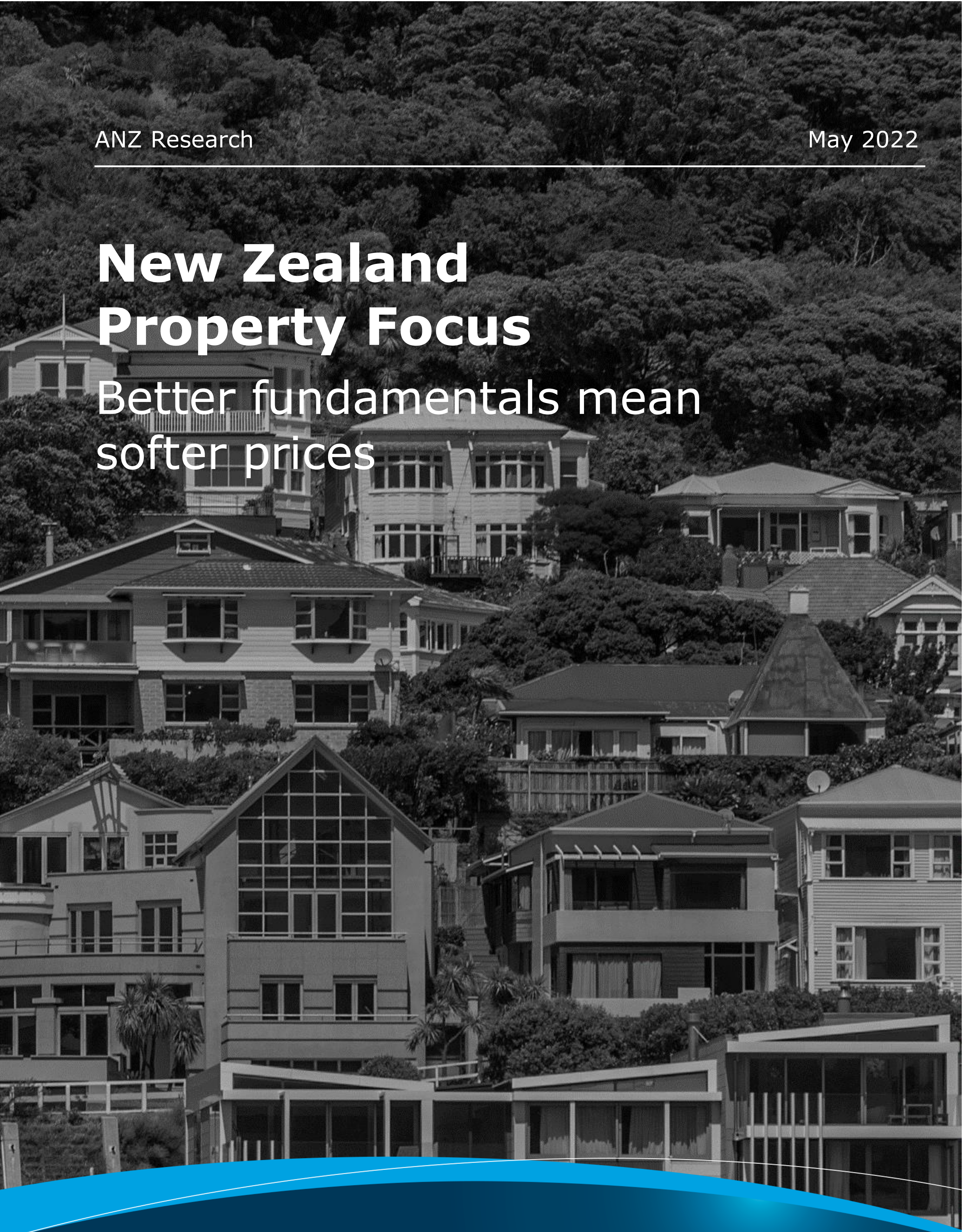
ANZ Research

May 2022

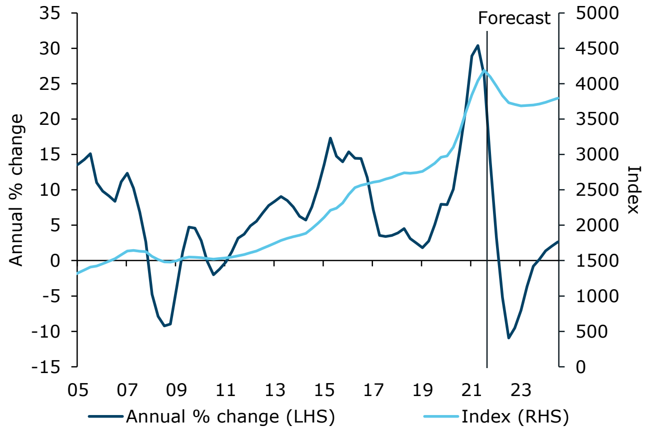
New Zealand Property Focus

Better fundamentals mean softer prices

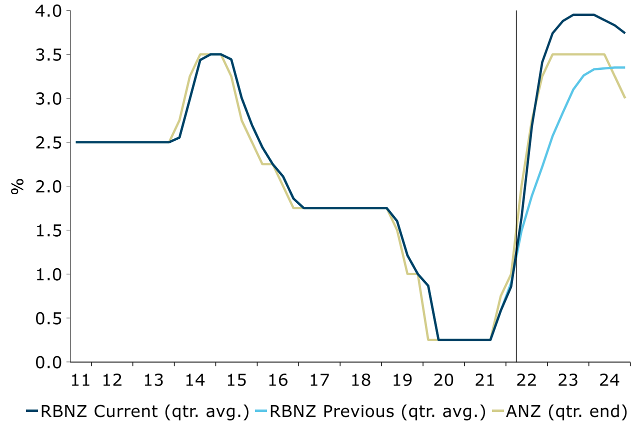


At a glance

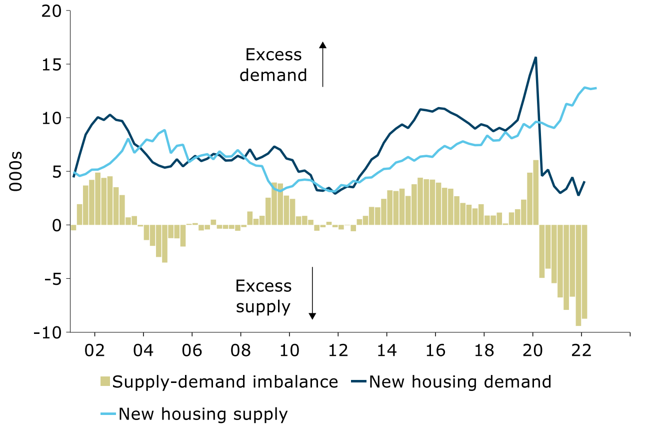
We've downgraded our house price outlook a touch



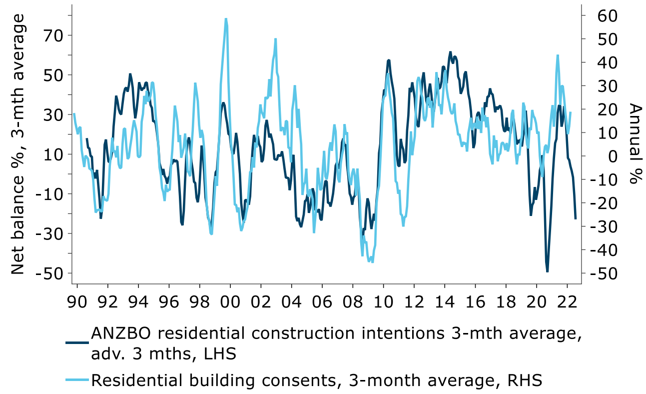
With an 11% fall over 2022 reflecting front-loaded OCR hikes



And a slower recovery reflecting significant housing supply catch up

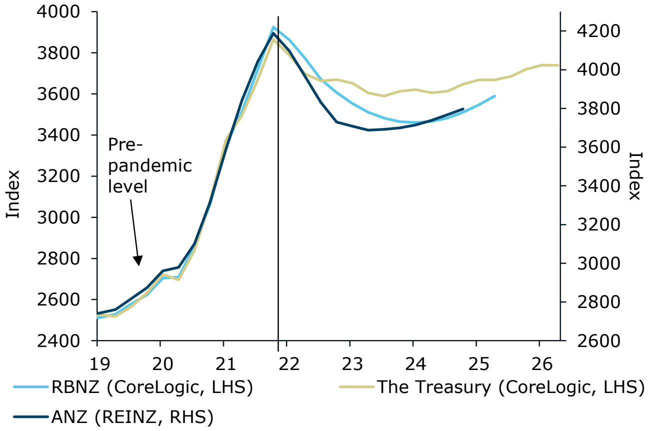


However, residential construction risks are clearly to the downside



Source: ANZ, Stats NZ, Bloomberg, Macrobond, ANZ Research

House price forecasts vary across forecasters…



… but are all different shades of the same soft landing:

- Our forecast would see the REINZ House Price Index trough 28.3% above its pre-pandemic (Q4 2019) level
- The RBNZ's forecast would see the CoreLogic House Price Index trough 32.0% above its pre-pandemic level, and
- The Treasury's forecast would see the CoreLogic House Price Index trough 36.4% above its pre-pandemic level.

Source: RBNZ, REINZ, Stats NZ, The Treasury, CoreLogic, Macrobond, Bloomberg, ICAP, ANZ Research

Contact

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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.

Housing market overview

Two big events have taken place since our last edition: The RBNZ hiked 50bps on 25 May (as expected), and lifted its forecast for how much higher the OCR will need to go (that was more of a surprise); and the Government released Budget 2022, which included another increase in government spending. We have since tweaked our OCR forecast to be slightly more front loaded. While we continue to expect it to peak at 3.5%, we have also centralised some of the downside risks we are seeing to our (still very uncertain) house price outlook. We now expect house prices to fall 11% in 2022 (previously -10%), with a much soggier recovery thereafter. The latter reflects very solid progress in recent quarters towards addressing NZ's housing deficit. See our Market Overview.

Mortgage borrowing strategy

Average mortgage are unchanged since our last edition of the Property Focus. That's despite the fact that the RBNZ lifted the OCR by another 0.50%pts late in the month. That signals several things. First, it shows how much was already priced in to the term structure of wholesale interest rates. Second, it demonstrates the competitive environment we are now in as lending growth slows. And third, it points to the potential for mortgage rates to catch up later if wholesale interest rates continue to rise, as they were doing as the month of May drew to a close. Although fixed mortgage rates are likely to keep rising (albeit more slowly) as more OCR hikes are delivered, the proverbial horse has likely bolted in terms of being able to get in ahead of rises. Breakevens favour fixing for shorter tenors like 1 year, but despite that, we are mindful that inflation remains high and it could be some time before mortgage rates could fall; and that affordability may constrain choices for some borrowers. See our Mortgage Borrowing Strategy.

Housing market overview

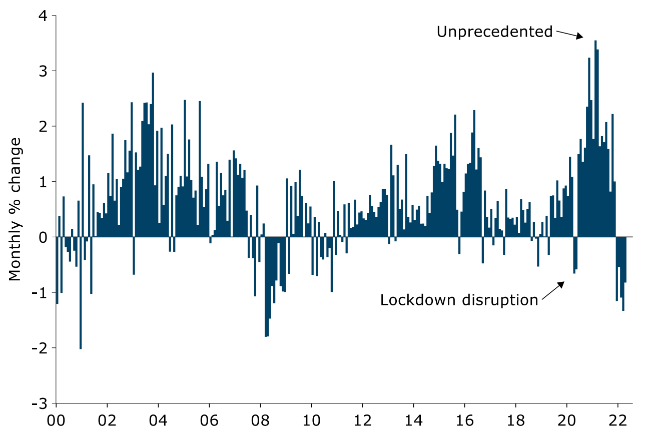
Summary

Two big events have taken place since our last edition: The RBNZ hiked 50bps on 25 May (as expected), and lifted its forecast for how much higher the OCR will need to go (that was more of a surprise); and the Government released Budget 2022, which included another increase in government spending. We have since tweaked our OCR forecast to be slightly more front loaded. While we continue to expect it to peak at 3.5%, we have also centralised some of the downside risks we are seeing to our (still very uncertain) house price outlook. We now expect house prices to fall 11% in 2022 (previously -10%), with a much soggier recovery thereafter. The latter reflects very solid progress in recent quarters towards addressing NZ's housing deficit.

Going down

The REINZ House Price Index (HPI) has been posting monthly declines since December 2021 (Figure 1, ANZ seasonal adjustment) and is now down 4.9% from its November 2021 peak. That's taken house prices back to just above their July 2021 levels. Annual house price inflation in now running at 9.8% (on a three-month moving average basis), much slower than its circa 30% pace recorded over the latter half of 2021. And in a few short months, this measure is expected to be in negative territory too.

Figure 1. Monthly house price inflation (sa)



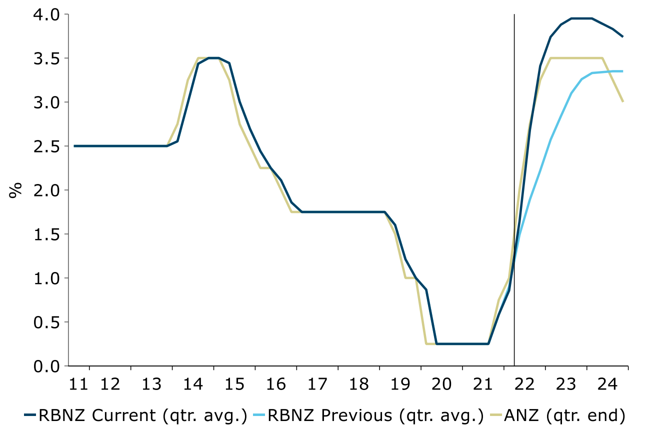
Source: REINZ, Macrobond, ANZ Research

Recent developments…

Housing headwinds are well understood, and in a broad sense, haven't changed all that much in recent months. We have, however, seen the RBNZ's inflation-targeting grit ratchet up this month, and that's led us to change our OCR call towards a little more front-loading. We now expect one more 50bp hike in July (25bps previously), but continue to see a 25bp hike in August, and each meeting thereafter to February 2023. That is, we've made no change to our expectation of how high the OCR will need to go (3.5%), but we have brought forward when we expect it to get there (February 2023 vs April 2023).

While the RBNZ's May MPS forecast (and market pricing) is more consistent with yet another 50-pointer in August, and a higher OCR peak than this (figure 2), we're expecting to see evidence by August that monetary tightening is gaining traction in terms of taming inflation. And if we're right about that, we think the RBNZ's assessment of spiralling inflation risks vs the risk of a hard landing in the economy will be looking more balanced than it does now. They'll still have a big job to do, with more hikes in store, but on balance we think the data will lead the RBNZ to re-evaluate the pace at which they need to tighten, reverting back to 25bp hikes from August onward. But it's all very much dependent on how inflation pressures evolve, and at the moment, the RBNZ is right to focus on inflation risks and talk tough. The timing for moving back to the more standard pace of +25bp per meeting will depend partly on whether the RBNZ requires actual CPI inflation to turn downward first, or whether a definitive turn in the higher-frequency indicator data will provide sufficient comfort.

Figure 2. OCR forecasts



Source: RBNZ, Macrobond, ANZ Research

Looking at the other big event of the month, Budget 2022 had only a few new policies directed at housing – hardly a surprise given the epic focus on health and climate change. Possibly the biggest piece of new housing news in Budget 2022 was the lift in some first-home grant price caps (detailed here). Many regions have seen no increase, while others have seen substantial increases, the largest being the $475k lift to $875k in Thames-Coromandel.

Other than that, Budget 2022 was, by historical standards, a very big budget. Core Crown Government expenses are forecast to be around $23.5bn higher over the next four years compared to the Treasury's December 2021 forecasts. That includes a $7bn increase in the year to June 2023.

Housing market overview

That's an extra 1.7% of nominal GDP the Government is adding to the economy over the next 12 months that wasn't expected at the start of the year. It's a non-trivial amount of money being added to an economy that's already facing significant capacity constraints. All else equal, this extra demand will add to inflation pressure, meaning the RBNZ may need to make room for government spending by hiking the OCR higher than otherwise. That's certainly consistent with the RBNZ's updated OCR forecast.

So what does it all mean for the housing market?

…add downward pressure to the house price outlook…

All else equal, higher caps on first home buyer grants will add to housing demand. However, we think this is likely to have indistinguishable impacts on house prices over the year ahead, given:

a. how far prices have already moved relative to caps (ie the increase may not bring that many additional houses into the fold for first home buyers), and

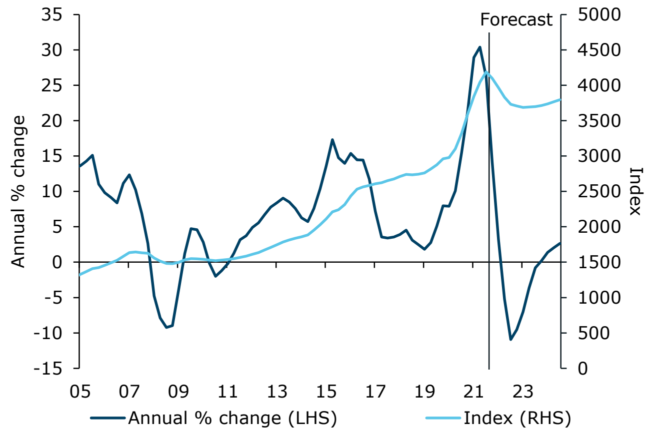
b. where general housing momentum is heading right now, with debt-servicing costs increasingly a constraint on would-be first home buyers even as house prices fall.

This development may, however, put a floor under how far house prices can fall over the medium term.

But before we get to the medium-term outlook, we first need to get through the coming cyclical forces on housing. In particular, the RBNZ's expectation that it will need to lift the OCR higher and faster than previously thought very likely means higher mortgage rates than otherwise. That's because market expectations for the OCR over coming years are just as important for fixed mortgage rates as the current level of the OCR. And those expectations are of course heavily influenced by the RBNZ's own OCR forecast. Anything that leads wholesale markets to price in a higher OCR outlook is going to put upwards pressure on fixed mortgage rates.

And that's certainly been the message from the RBNZ this month: expect higher rates, and sooner. Accordingly, we have downgraded our house price forecast a touch. We now expect house prices to fall 11% over 2022 versus our previous forecast for a 10% decline. We've also baked in a slower recovery.

Figure 3. House price forecast



Source: REINZ, ANZ Research

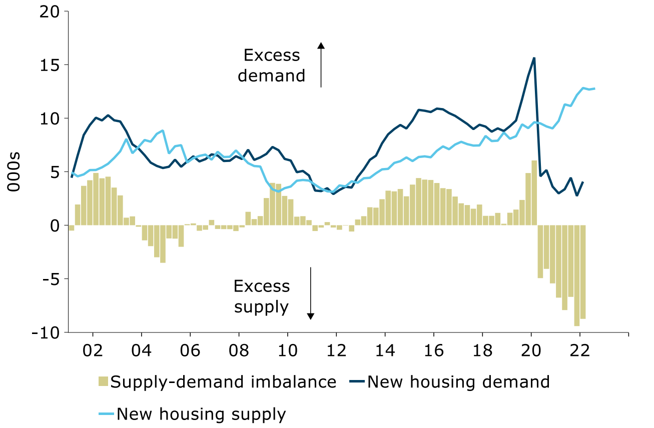
The sharper decline in 2022 simply reflects changes to the interest rate outlook. But the soggier medium-term view is a result of revisiting our estimates of the fundamentals: housing supply vs demand. On that front, downward revisions to the net migration data (and therefore the resident population) have recalibrated our understanding of how quickly the residential construction industry is eroding the housing deficit.

As at Q1 2022, we estimate new housing supply had exceeded new demand by almost 55,000 dwellings since the borders were closed. And if Q1's pace has continued in Q2 2022, then as we go to print, the industry will have caught up by more than 60,000 houses. We estimate the housing deficit before the pandemic was somewhere between 70,000 and 90,000[1] houses. That means at the current pace of building, NZ could, for the first time in a very long time, have a housing market that's broadly in equilibrium in terms of the demand and supply fundamentals (at least in terms of the overall number of dwellings. There will always be some mismatches in terms of the type/size and location of dwellings).

Indeed, it's entirely possible that in a few quarters, it might start looking like the New Zealand housing market is at risk of entering "oversupply" territory – not a bad thing when it comes to ensuring there are roofs over the heads of our most vulnerable, but not a good thing for recent first home buyers who may not see the market value of their property return to the level they paid for it for a very long time.

[1] In May last year, our housing deficit estimates ranged between 30,000 and 140,000 dwellings. The results are very sensitive to assumptions regarding depreciation rates, the average number of people per dwelling, and what point in history you deem the market to have been in equilibrium. These are just a few of the factors that make housing shortfall estimates highly uncertain.

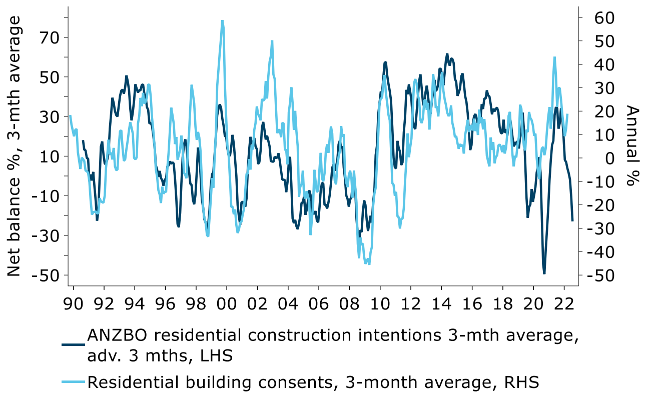
Figure 4. Housing supply vs demand



Source: Stats NZ, Macrobond, ANZ Research

As always, there are big risks around the outlook for both supply and demand. Residential construction activity could slow abruptly, halting progress in its tracks. In fact, while building consents have been elevated, a sharp slowdown would be consistent with what businesses are saying in our Business Outlook (figure 5). Time will tell whether consents follow construction intentions lower, or whether the fall in the latter is mostly to do with supply disruptions.

Figure 5. Residential construction intentions vs building consents

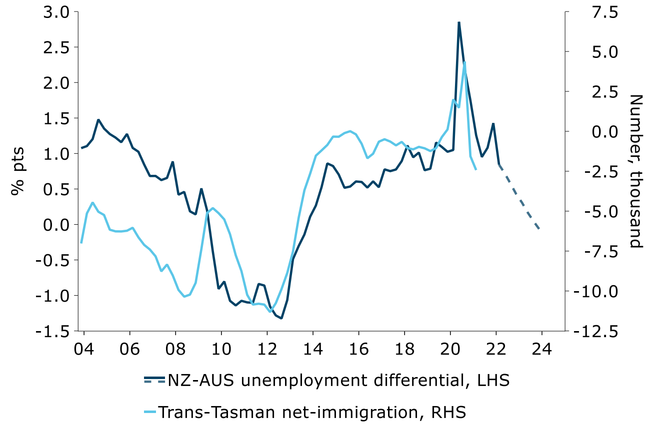


Source: ANZ, Stats NZ, Bloomberg, Macrobond, ANZ Research

Source: Stats NZ, Macrobond, ANZ Research

Conversely, population growth could surprise as our borders reopen. The Australian labour market is very tight, which combined with New Zealand's high cost of living and relatively low real incomes, could drive a large net outflow of kiwis across the ditch (figure 6). If we don't plug that gap with arrivals from elsewhere, the supply-demand balance could improve much faster than we expect, putting further downward pressure on house prices. Our expectation is that annual net migration will begin to lift very gradually towards the end of 2022, touching 20,000 by the end of 2023 and stabilising around 30,000 over 2024. That's about half as many net arrivals as the 2015-2019 era.

Figure 6. Trans-Tasman net migration and relative unemployment



Source: ABS, Stats NZ, Macrobond, ANZ Research

Overall, we'd characterise the risks to construction as being to the downside, and the risks to migration as being skewed towards a negative net outflow (at least in the near term). From a housing supply-demand perspective, these risks are offsetting.

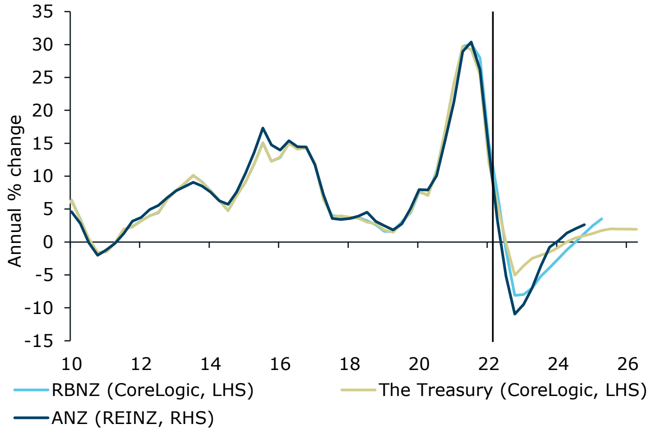
The way things are heading, and based on our current forecasts, it's looking like housing supply will be in balance with demand by Christmas (give or take 6 months). All else equal, that would dampen house price inflation over the medium term. However, the market will also remain heavily influenced by the likes of interest rate settings, net migration, and policy changes etc.

It's still a "soft landing", with downside risks

We're not the only ones who have updated our house price forecasts this month. Both the NZ Treasury and the RBNZ have published their usual suite of forecasts, including house prices. So how does our outlook compare?

Forecast comparisons are complicated by the fact that both the Treasury and the RBNZ forecast the CoreLogic HPI, while we forecast the REINZ HPI. However, the two measures do tend to move together, so rather than being a case of comparing apples with oranges, it's more a case of comparing a Granny Smith with a Braeburn. Figure 7 compares forecasts for annual house price inflation. Our expectation for an 11% decline over 2022 is a tad weaker than the RBNZ's (-8.1%) and quite a bit weaker than the Treasury's (-5.0%).

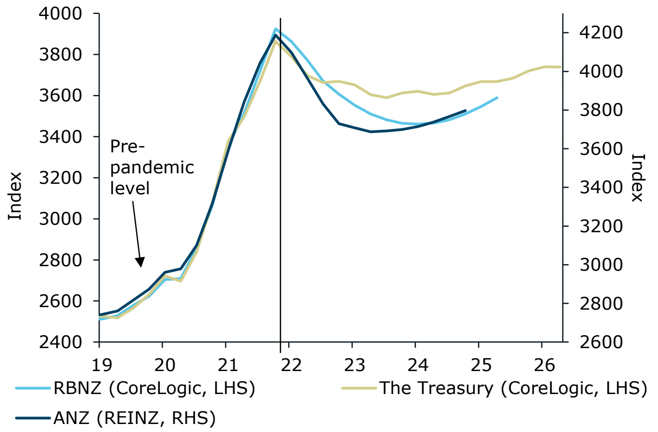
Figure 7. House price forecasts



Source: The Treasury, RBNZ, ANZ Research, CoreLogic, REINZ

However, comparing growth rates can be a little misleading given varying assumptions about the persistence of house price declines. That's why it's worth zooming in on the level (figure 8).

Figure 8. House price forecast (index)



Source: The Treasury, RBNZ, ANZ Research, CoreLogic, REINZ

The common theme across these forecasts is that they are all various shades of the same soft landing:

- Our forecast would see the index trough 28.3% *above* its pre-pandemic (Q4 2019) level in early 2023, with a peak (Q4 2021) to trough decline of 12.0%.
- The RBNZ's forecast would see the index they forecast trough 32.0% above its pre-pandemic level in early 2024, with a peak (again Q4 2021) to trough decline of 11.8%.
- The Treasury's forecast would see the index trough 36.4% above its pre-pandemic level in the second half of 2023, with a peak to trough decline of 7.1%.

So all up, the Treasury's forecasts are the most optimistic, while our and the RBNZ's forecasts are broadly similar – we just expect it all to happen a little sooner than the RBNZ does.

Lastly, we think it's important to note that similarities across forecasts does not make them any more likely to be correct. This is a highly uncertain forecasting environment, and the risks of a harder economic and housing landing are very real. We have no doubts about the ability of monetary tightening to get inflation under control, it's just a question of how high rates need to go to do it, and how much economic (including housing) damage that may require. But even as the RBNZ is working that out, there's a very real risk that the key data they're watching (core inflation, inflation expectations, and the labour market) changes tack too late (given it can be quite lagged) to avoid a hard landing. That risk materialising certainly feels more likely right now than the housing market surprising our forecast to the upside.

Feature Article: Making headway (for now)

Housing market indicators for April 2022 (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	$756,337	12.2	-0.6	16.8	0.0	154	-15%	41
Auckland	$1,171,850	4.6	-5.7	2.7	-5.1	1,895	-2%	41
Waikato	$844,658	16.3	0.8	13.8	0.1	550	-1%	39
Bay of Plenty	$903,622	11.7	1.4	11.9	-1.4	349	-5%	42
Gisborne	$694,942	-1.1	2.2	3.9	-2.8	32	+2%	41
Hawke's Bay	$772,080	1.1	-0.2	3.9	-2.8	150	-8%	43
Manawatu-Whanganui	$577,812	-1.4	-3.8	4.0	-2.5	247	-7%	40
Taranaki	$628,467	15.1	6.2	13.6	0.9	140	-11%	33
Wellington	$929,737	7.0	-2.5	-4.3	-5.4	510	+4%	47
Tasman, Nelson & Marlborough	$805,636	11.4	1.9			172	-20%	37
Canterbury	$692,997	21.0	3.3	20.0	0.2	818	-7%	31
Otago	$656,643	-5.3	1.4	9.0	0.7	340	-4%	42
West Coast	$366,678	30.3	-0.7	10.5	0.0	36	+11%	27
Southland	$456,985	13.3	6.0	9.3	-1.3	139	+27%	38
New Zealand	**$877,829**	**9.0**	**-1.9**	**6.4**	**-3.0**	**5,445**	**-7%**	**38**

Mortgage borrowing strategy

This is not financial advice about any product or service. 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. Please refer to the Important Notice.

Summary

Average mortgage are unchanged since our last edition of the Property Focus. That's despite the fact that the RBNZ lifted the OCR by another 0.50%pts late in the month. That signals several things. First, it shows how much was already priced in to the term structure of wholesale interest rates. Second, it demonstrates the competitive environment we are now in as lending growth slows. And third, it points to the potential for mortgage rates to catch up later if wholesale interest rates continue to rise, as they were doing as the month of May drew to a close. Although fixed mortgage rates are likely to keep rising (albeit more slowly) as more OCR hikes are delivered, the proverbial horse has likely bolted in terms of being able to get in ahead of rises. Breakevens favour fixing for shorter tenors like 1 year, but despite that, we are mindful that inflation remains high and it could be some time before mortgage rates could fall; and that affordability may constrain choices for some borrowers.

Our latest sampling of mortgage rates offered by the "big-4" banks shows no change from last month. While that may sound surprising, we doubt that anyone was *not* expecting the RBNZ to deliver a 0.50%pt lift in the OCR this month. Accordingly, key rates like the 2-year wholesale ("swap") rate are not significantly higher now than they were at the end of April. Closer inspection reveals that short-end swap rates did rise in the days after the hike, but that largely unwound an earlier fall, muting the month-to-month change. However, as May drew to a close, swap rates had started to rise again, and if this trend continues, we could well see higher mortgage rates in due course.

Regular readers of our research will be aware that we expect another 1.50%pts of OCR hikes before this cycle is in. This is discussed in more detail on page 4. Although that sounds daunting, financial markets and most forecasters expect it, and it is therefore now mostly priced into the term structure of interest rates. What that means is that as with this month, mortgage rates (especially fixed rates) are unlikely to rise nearly as quickly as the OCR in coming months. But we do still expect mortgage rates to keep rising gradually.

But even if wholesale swap and mortgage don't rise by much, with inflation up here and the RBNZ threatening to take the OCR to 4%, they seem equally unlikely to fall a long way. Slower lending growth has potential to intensify competition, but thus far, what we have seen is mortgage rates holding steady as wholesale rates have risen, rather than outright lower mortgage rates.

Given how steeply upward sloping the mortgage curve is (as has been the case for some time), there is no easy way to "lock in" any real advantage. Fixing for longer costs progressively more, and breakevens show that there is no financial gain to be had unless one thinks some much stiffer mortgage rate rises are coming. Put another way, the proverbial horse has bolted on those looking to beat rate rises.

Take, for example, the choice between fixing for 1 year or fixing for 2 years. For the latter to be cheaper than a pair of back-to-back 1-year fixes, the 1-year rate will need to rise to 5.95% in a year's time. That's a rise of 1.43%pts from the current 1-year rate of 4.52%. That could happen, but it does seem like a big ask. A 1-year mortgage that high is consistent with an OCR of around 4%, and we don't think it'll get there, though the RBNZ does (we are forecasting a peak of 3.5%).

All borrowers need to arrive at their own judgements regardless of our forecasts, but it's a mathematical fact that shorter-term fixed mortgage rates will need to rise a long way before it becomes financially worthwhile to fix for longer. That said, certainty is likely to appeal to many borrowers, especially those on a budget. At the moment, both 2 and 3-year mortgage rates are below 6%. If borrowers can't afford rates above that level, and they don't expect rates to fall, adding some 2 and 3-year fixes and staggering expiry dates is a way to protect against an upside surprise and smooth costs.

Figure 1. Carded special mortgage rates^

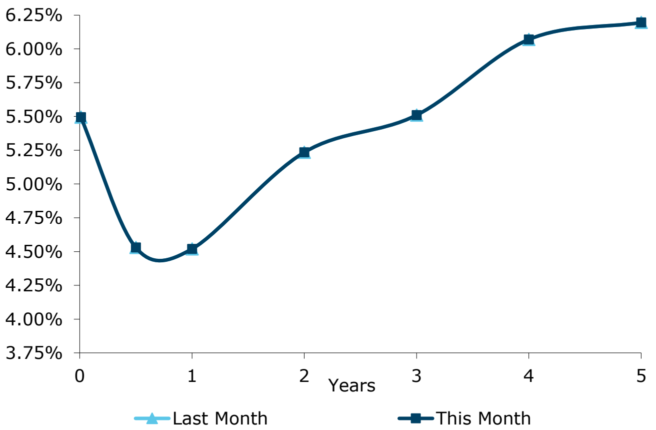


Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.50%				
6 months	4.53%	4.51%	5.62%	6.29%	5.92%
1 year	4.52%	5.06%	5.95%	6.10%	6.06%
2 years	5.24%	5.58%	6.01%	6.47%	6.91%
3 years	5.51%	6.00%	6.59%	6.76%	6.84%
4 years	6.07%	6.33%	6.61%		
5 years	6.20%	#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 Rate (%)													
Mortgage Size ($000)	3.50	3.75	4.00	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75
200	231	237	243	250	256	263	270	276	283	290	297	304	311	319
250	289	296	304	312	320	329	337	345	354	363	371	380	389	398
300	346	356	365	375	385	394	404	415	425	435	446	456	467	478
350	404	415	426	437	449	460	472	484	496	508	520	532	545	558
400	462	474	487	500	513	526	539	553	566	580	594	608	623	637
450	520	534	548	562	577	592	607	622	637	653	669	684	701	717
500	577	593	609	625	641	657	674	691	708	725	743	761	778	797
550	635	652	669	687	705	723	741	760	779	798	817	837	856	876
600	693	711	730	750	769	789	809	829	850	870	891	913	934	956
650	750	771	791	812	833	854	876	898	920	943	966	989	1,012	1,036
700	808	830	852	874	897	920	944	967	991	1,015	1,040	1,065	1,090	1,115
750	866	889	913	937	961	986	1,011	1,036	1,062	1,088	1,114	1,141	1,168	1,195
800	924	948	974	999	1,025	1,052	1,078	1,105	1,133	1,160	1,188	1,217	1,246	1,274
850	981	1,008	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233	1,263	1,293	1,323	1,354
900	1,039	1,067	1,095	1,124	1,154	1,183	1,213	1,244	1,274	1,306	1,337	1,369	1,401	1,434
950	1,097	1,126	1,156	1,187	1,218	1,249	1,281	1,313	1,345	1,378	1,411	1,445	1,479	1,513
1000	1,154	1,186	1,217	1,249	1,282	1,315	1,348	1,382	1,416	1,451	1,486	1,521	1,557	1,593

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

	Actual			Projections						
Interest rates	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Floating Mortgage Rate	4.5	4.9	5.1	5.6	6.7	7.4	7.6	7.6	7.6	7.6
1-Yr Fixed Mortgage Rate	2.7	3.6	3.9	4.7	4.9	5.2	5.2	5.2	5.1	5.0
2-Yr Fixed Mortgage Rate	3.1	4.3	4.5	5.4	5.4	5.3	5.2	5.1	5.0	4.9
5-Yr Fixed Mortgage Rate	4.0	4.9	5.1	6.5	6.3	6.2	6.1	6.0	5.8	5.8

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23
GDP (Annual % Chg)	17.9	-0.2	3.1	2.4	0.3	4.7	2.6	2.6	2.4	2.0
CPI Inflation (Annual % Chg)	3.3	4.9	5.9	6.9(a)	6.8	6.1	5.3	4.5	4.0	3.2
Unemployment Rate (%)	4.0	3.3	3.2	3.2(a)	2.9	2.9	2.9	3.0	3.2	3.3
House Prices (Quarter % Chg)	7.0	5.2	3.6	-2.1(a)	-3.2	-3.4	-2.7	-0.6	-0.6	0.1
House Prices (Annual % Chg)	28.9	30.4	26.2	14.1(a)	3.2	-5.2	-11.0	-9.5	-7.0	-3.7

Interest rates	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Cash Rate	0.25	0.75	1.00	2.00	2.75	3.25	3.50	3.50	3.50	3.50
90-Day Bank Bill Rate	0.65	0.97	1.61	2.77	3.27	3.52	3.60	3.60	3.60	3.60
10-Year Bond	2.09	2.39	3.22	4.00	4.25	4.25	4.10	4.10	3.85	3.85

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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