ANZ Research

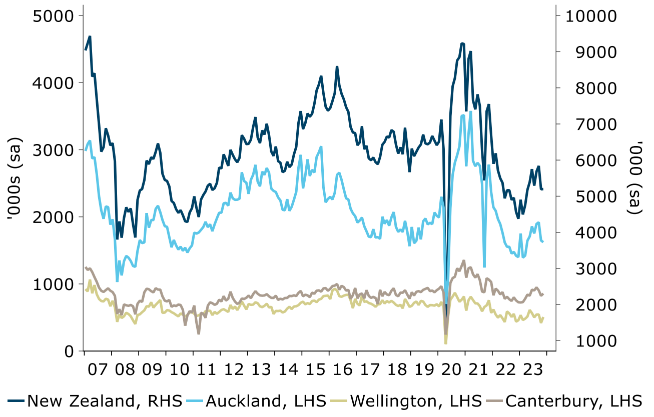
December 2023

New Zealand Property Focus

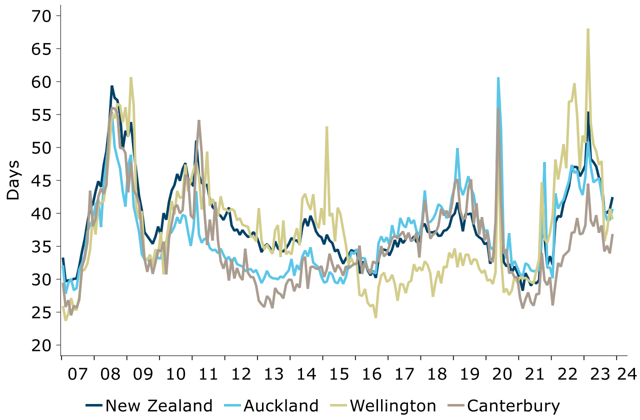
Renovation nation

At a glance

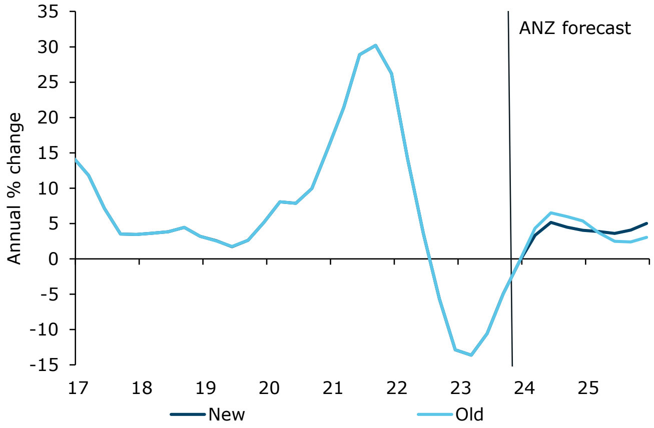
House sales are sluggish….



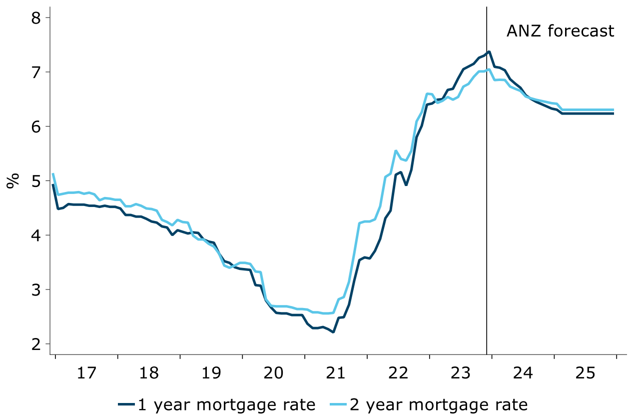
…and days to sell are rising.



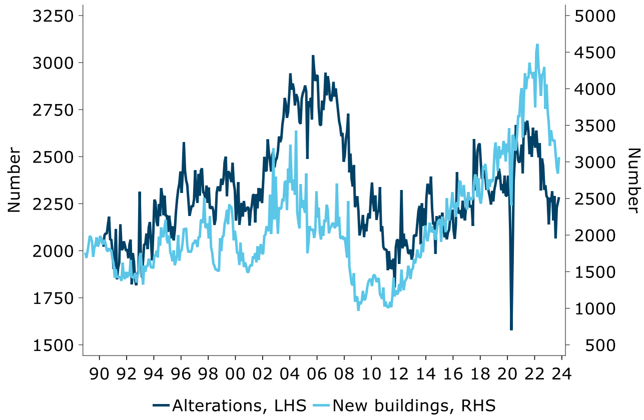
We've downgraded our house price forecast for 2024…



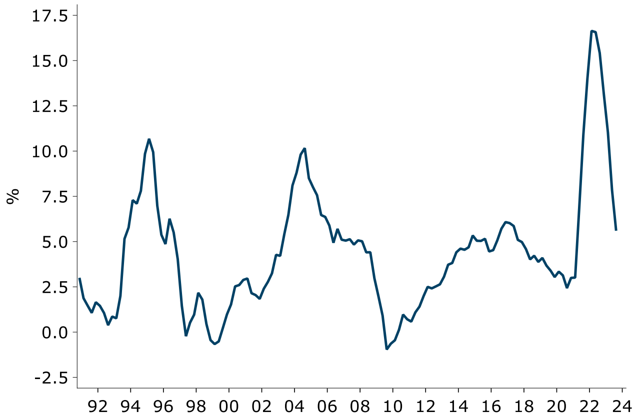
…but faster-than-expected falls in mortgage rates would stimulate demand.



High interest rates mean fewer people are renovating…



… not helped by runaway construction costs.



Source: REINZ, Stats 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.

Property Focus

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Feature Article: Renovation nation

Kiwis love a good renovation. Buying a run-down villa and doing it up has been a popular project for kiwi families for decades. This month's feature article explores consenting, lending, and construction data to see how the pandemic and recent elevated interest rates have affected Kiwi's appetite for renovations. The upshot: high interest rates have squeezed people's ability to afford a do-up, with sharp rises in construction costs not helping the case for a new bathroom or kitchen. As inflation eases and interest rates decline, we expect demand for houses in need of some DIY to pick up, as first home buyers become a larger share of the market. See this month's Feature Article.

Mortgage Borrowing Strategy

Mortgage rates haven't changed very much since our last Property Focus was published, but if recent moves in wholesale rates are sustained, there's scope for falls over coming weeks. Exactly how far they fall remains to be seen (for example we note that while wholesale rates are lower, term deposit rates haven't really changed), complicating the analysis for borrowers. However, we think it makes sense to assume that the next move will be down, and to factor that into any decision to fix. Regarding fixing strategies, as with last month, our technical projections of mortgage rates (which are based on our new, lower wholesale forecasts and observed margins prevailing last month) remain below many breakeven rates, making shorter-term fixes look more attractive. We also note that 6 month and 1 year rates are the same (on average). In a falling interest rate environment, there is merit in fixing for just 6 months (as a cheap proxy for floating) and re-fixing again at expiry. Longer-term rates are cheaper and offer more certainty, but given the prospect of them falling, one would have to place a high value on certainty to fix for more than 6 months now. See our Mortgage Borrowing Strategy.

Property Focus

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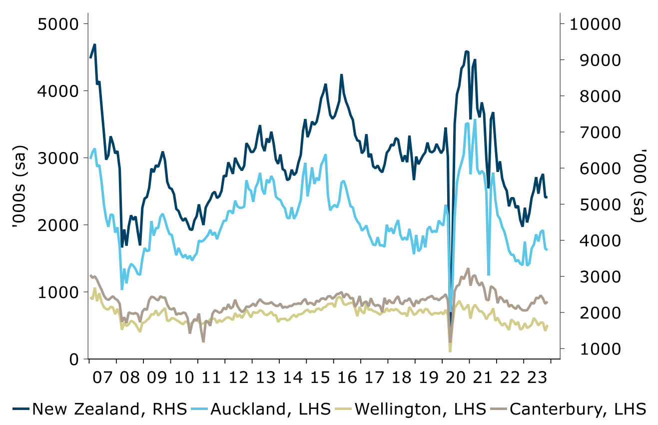
The market has remained soft post-election

House sales were lacklustre in November, with no sign of a post-election bounce (figure 1). Over the month, sales rose just 0.1% m/m, not recovering from their 11.1% m/m fall in October. We were expecting some of this fall to be the result of people waiting until the election was over, but it looks more like the slowing momentum is here to stay for a bit longer.

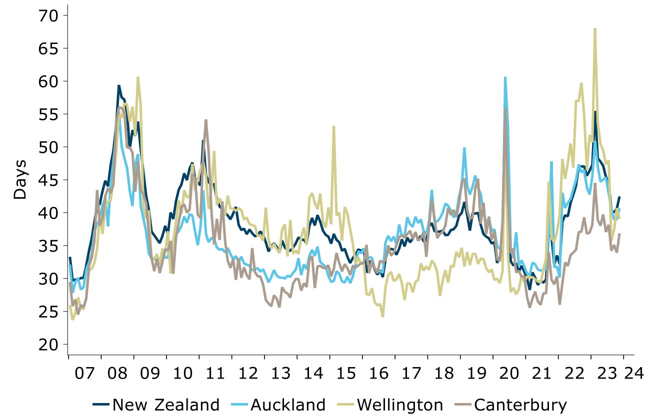
Figure 1. House sales



Source: REINZ, Macrobond, ANZ Research

Lower sales mean that houses are remaining on the market longer than previously, with days to sell rising to 42 days, after bottoming out at 40 days in September (figure 2). Days to sell tends to be a good measure of housing market momentum, suggesting the recent softness in the housing market is likely to persist over the summer.

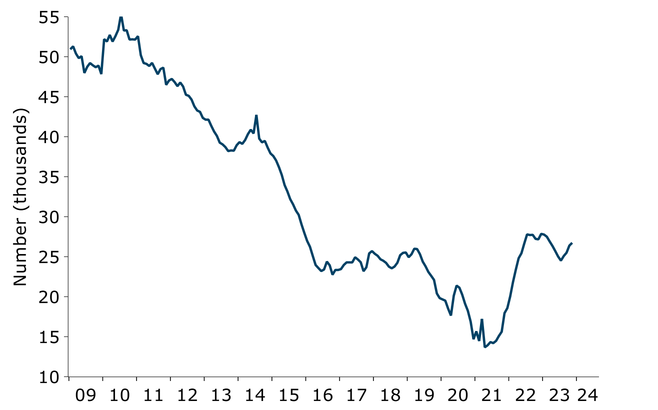
Figure 2. Days to sell



Source: REINZ, Macrobond, ANZ Research

Unsurprisingly, given it's taking longer to sell homes, inventories are rising (figure 3). Total listings bottomed out in July and have shown a decent lift over the last couple of months. While they're still below where they were when house prices were falling, the recent rise is indicative of a softening market.

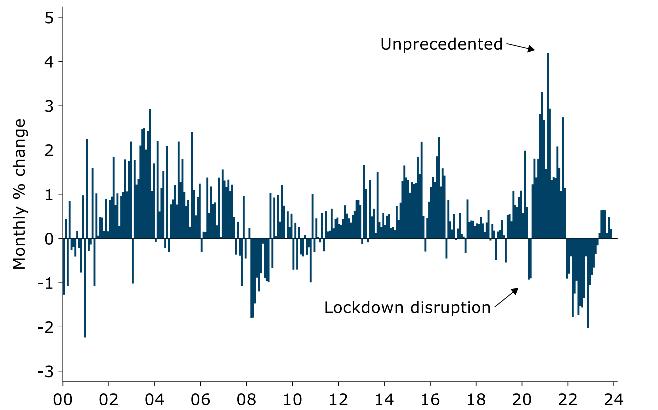
Figure 3. Lifting inventories



Source: REINZ, Macrobond, ANZ Research

House prices rose just 0.2% m/m in November (figure 4), below their historical average of 0.5% m/m and weaker than the run of 0.6% rises seen in winter.

Figure 4. House prices

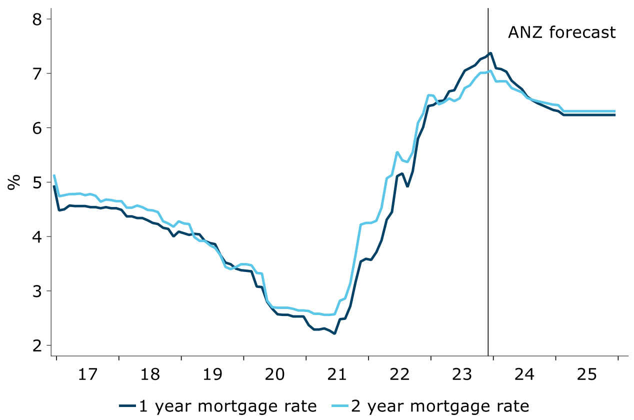


Source: REINZ, Macrobond, ANZ Research

We're expecting this 'new normal' of softness to continue through the summer months as unemployment rises.

Fixed mortgage rates are likely to fall over the summer (figure 5), assuming recent softness in wholesale markets persists. This has the potential to enable some more first home buyers to get into the market as serviceability costs ease. Investor demand may also pick up, as the government reintroduces interest deductibility.

Figure 5. Our mortgage rate forecasts

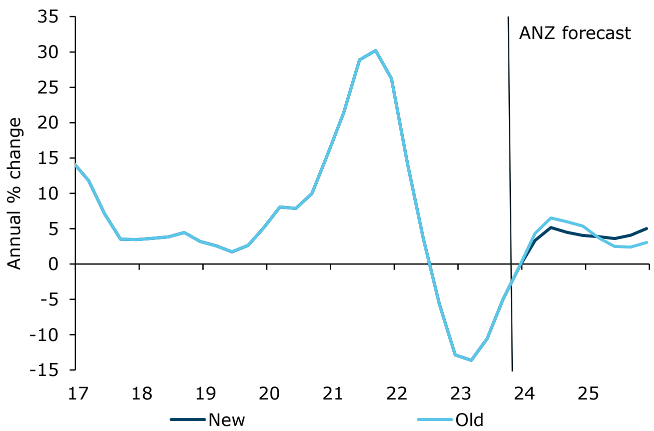


Source: REINZ, Macrobond, ANZ Research

We've downgraded our house price forecast for 2024

The softness in forward indicators for the housing market has caused us to revise down our outlook for house prices over 2024. We now expect house prices to post a 4% lift over 2024, versus our previous forecast for a 5.3% lift (figure 6).

Figure 6. Our updated house price forecast



Source: REINZ, ANZ Research

In the very near term, weak sales, high listings and a cooling economy are expected to keep house price growth subdued at around current growth rates (about 0.3% m/m), weaker than previously assumed. However, tailwinds are expected to arrive by the middle of next year, including falling fixed rates, lagged effects from migration putting pressure on the rental market, and government policy changes, especially the reintroduction of interest deductibility. We expect these to support house price inflation back towards long-run averages (about 0.5% m/m) and are expecting house prices to rise 5% over 2025, although forecasts this far out can best be described as guesstimates.

As always, the outlook for house prices is highly uncertain and there are a number of factors that could cause house prices to rise by more or less than we are expecting.

Front of mind in the 'more' risk camp:

- government policy changes to support the housing market may happen earlier or prove more potent than we currently expect; and
- mortgage rates could fall more quickly than we are expecting, due to global rate dynamics for example, or if the RBNZ cuts the OCR in 2024, rather than in 2025 as we currently expect (though if that were due to a weaker economic outlook as opposed to just good news on the inflation front it may not be a net positive for house prices).

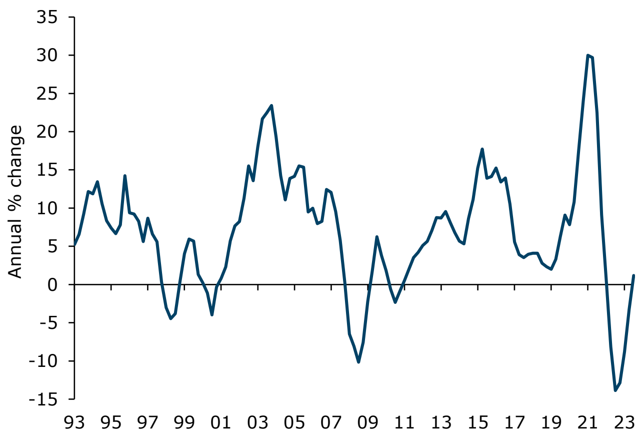
Notable risks in the 'less' camp:

- migration or the labour market more broadly slows more than we are currently expecting; and
- demand from first home buyers and investors increases less than we expect.

The year in review

To wrap up our last edition for 2023, we reflect on the year that's been. Over the year, house prices rose 1.2% (assuming our December forecast is correct).

Figure 7. House price annual changes



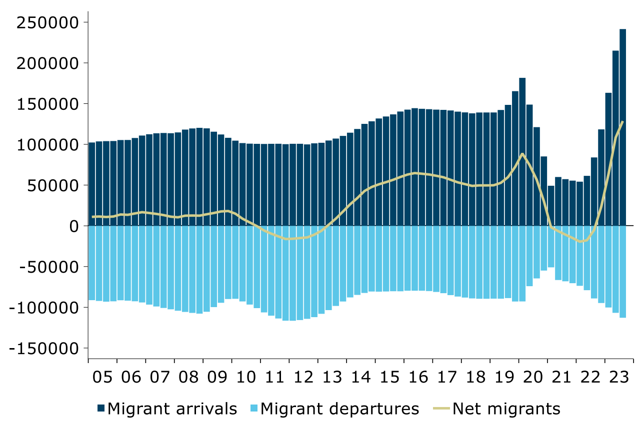
Source: REINZ, Macrobond, ANZ Research

The majority of house price falls occurred over 2022, with the market bottoming out in April this year as mortgage rate increases ran out of puff. In the first four months of the year house prices fell 2%, much less than the 13.9% fall notched up over 2022. While the second half of this year has been more buoyant, we certainly wouldn't characterise it as 'strong'.

The house price recovery arrived earlier than we anticipated; we had expected house prices to fall over 2023. Overall economic conditions have remained volatile, with subdued growth, high interest rates and persistent inflation. Against this backdrop, house prices have performed as strongly as could have reasonably been expected.

The big story for house prices that we didn't foresee at the start of the year was the scale of the surge in net immigration. Over the last year, New Zealand has seen 128,900 net migrants arrive, with a staggering 245,600 people migrating to New Zealand (figure 8). If all those people lived in the same place, that city would be the fourth largest in New Zealand, behind Wellington.

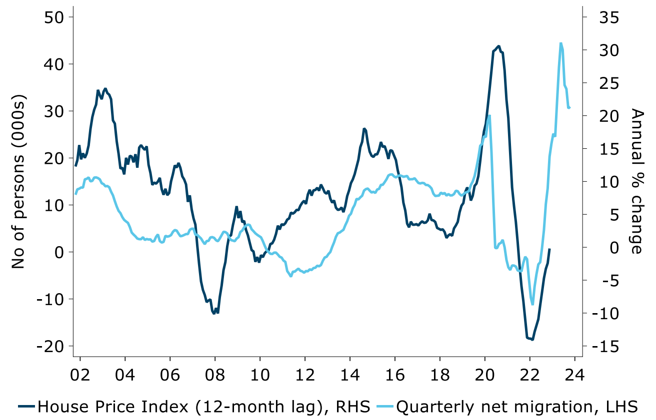
Figure 8. Migration



Source: Stats NZ, Macrobond, ANZ Research

House prices bottomed out about the same time migration was peaking. Migration is likely to remain intertwined with house prices over 2024, as house prices tend to increase more when net migration is high, especially in Auckland. Even if only a small proportion of migrants are in a position to buy a house soon after arriving, upward pressure on rents does represent an increase in the investor value of housing, all else equal.

Figure 9. Net migration and house prices



Source: Stats NZ, Macrobond, ANZ Research

It's inevitable 2024 will bring more unforeseen events. Very few people predicted the scale of this year's migration surge, last year's explosive inflation or 2020's pandemic. While we hope that 2024 will have less surprises, we live in interesting times and further curveballs seem likelier than not. We can't guarantee our outlook (or anything close to it) will actually pan out, but it's the picture we see as consistent with our overall economic views: a relatively sluggish, patchy economy as sticky inflation pressures forces the RBNZ to keep the economy on a pretty short leash for some time yet.

Housing market indicators for November 2023 (based on REINZ data seasonally adjusted by ANZ Research)

	Median house price			House price index		Sales		Average days to sell
	Level	Annual % change	3-mth % change	Annual % change	3-mth % change	# of monthly sales	Monthly % change	
Northland	$670,003	-7.9	-2.0	-2.6	0.8	138	-7%	62
Auckland	$1,017,806	-0.8	2.3	0.3	1.2	1,622	-2%	41
Waikato	$743,930	-2.9	0.8	-3.1	1.4	510	+3%	52
Bay of Plenty	$808,836	-4.8	0.1	-0.7	-0.5	317	+3%	49
Gisborne	$553,429	-15.4	-8.3	-0.3	1.1	24	-1%	42
Hawke's Bay	$669,680	-0.7	-0.4	-0.3	1.1	155	-10%	42
Manawatu-Whanganui	$521,174	-7.7	-4.1	-3.6	0.6	250	+9%	44
Taranaki	$555,611	-8.7	-1.5	-0.2	1.1	125	-8%	43
Wellington	$778,442	-1.0	-0.2	0.3	1.4	508	+21%	39
Tasman, Nelson & Marlborough	$701,843	-2.8	0.5			165	+12%	49
Canterbury	$686,028	5.3	1.3	1.7	0.8	856	+4%	37
Otago	$644,745	-5.4	-1.4	1.1	-0.4	298	-12%	46
West Coast	$387,576	-5.9	3.1	-3.8	0.1	33	-14%	30
Southland	$429,020	-8.0	-0.3	-0.9	0.8	132	+3%	49
New Zealand	**$770,294**	**-1.9**	**-0.1**	**-0.2**	**1.2**	**5,196**	**0%**	**42**

Feature Article: Renovation nation

Summary

Kiwis love a good renovation. Buying a run-down villa and doing it up has been a popular project for kiwi families for decades. This month's feature article explores consenting, lending, and construction data to see how the pandemic and recent elevated interest rates have affected Kiwi's appetite for renovations. The upshot: high interest rates have squeezed people's ability to afford a do-up, with sharp rises in construction costs not helping the case for a new bathroom or kitchen. As inflation eases and interest rates decline, we expect demand for houses in need of some DIY to pick up, as first home buyers become a larger share of the market.

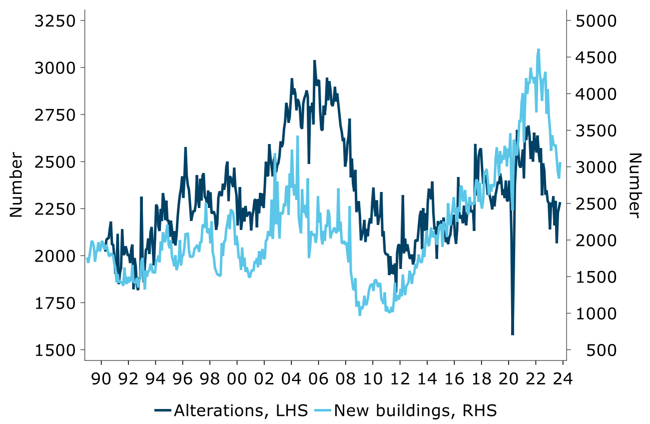
Doer upper

Renovating houses has long been a popular project for kiwis, given a ready supply of malleable old wooden houses with ever-more expensive land under them. This month's feature article explores consenting, lending, and construction data to see how the pandemic and recent elevated interest rates have affected Kiwi's appetite for renovations.

Consents for renovations are well down from their peaks, as elevated interest rates, the high cost of living and steep rises in construction costs mean finding the cash required to do up a home has gotten considerably more challenging. Lower construction activity is exactly what the Reserve Bank has wanted to see, as they encourage everyone to "cool their jets" and spend less via the blunt tool of higher interest rates.

That said, consent numbers for renovations have fallen less than for new dwellings (figure 1). New dwelling consents have fallen around 30% from their peak (the 'spec build' component of new housing supply dried up as house sales tanked), while those for alterations have fallen only around 15%.

Figure 1. Consents of alterations and new dwellings

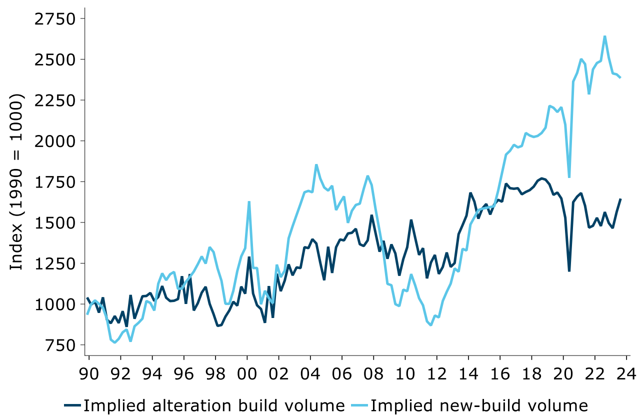


Source: Stats NZ, Macrobond, ANZ Research

Even at their recent peak, consents for alterations were still below their pre-GFC level despite an ageing housing stock and considerable population growth. Regulatory changes are one likely source of this dynamic, as some renovations that previously would have required a consent no longer do so, such as some renovations that do not require plumbing.

But looking at building work put in place data indicates this isn't the whole story. After adjusting for construction cost rises, it appears that kiwis haven't grown their renovation appetite much since 2014. Insofar as New Zealand has a limited amount of capacity in the construction sector, new builds and alterations have to compete for resources, and the house-building boom in recent years has been spectacular. That will inevitably have crowded out renovations. The rapid and large increase in house prices over the COVID era saw developers pay more for a limited supply of tradies and materials than people doing home alterations were willing to pay. It certainly became common knowledge over 2021-22 that it was a pretty hopeless time to try to get anything built to a reasonable budget or timeframe, and some of the recent lift in alteration consents is likely to be activity deferred from that period.

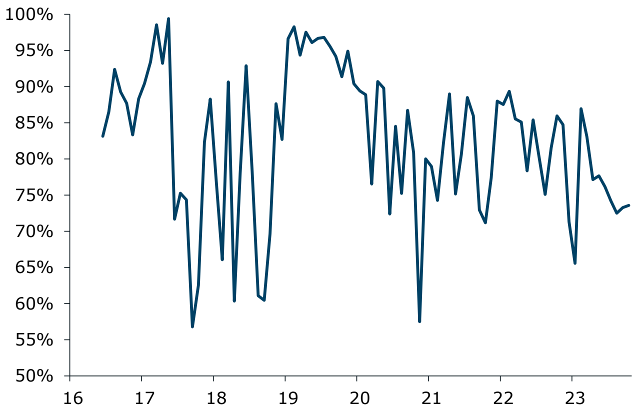
Figure 2. Implied volume of completed alterations & new builds



Source: Stats NZ, Macrobond, ANZ Research

One complication to throw into the mix is that not everyone who gets a consent to do an alteration on their home actually ends up doing the job. Many projects are cancelled due to unexpectedly high cost estimates or a change in life circumstances. While we don't have the data split out for renovations directly, recent low completion rates within 2 years for all consented residential work in Auckland indicates a relatively high number of shelved projects, likely for both for new dwellings and alterations.

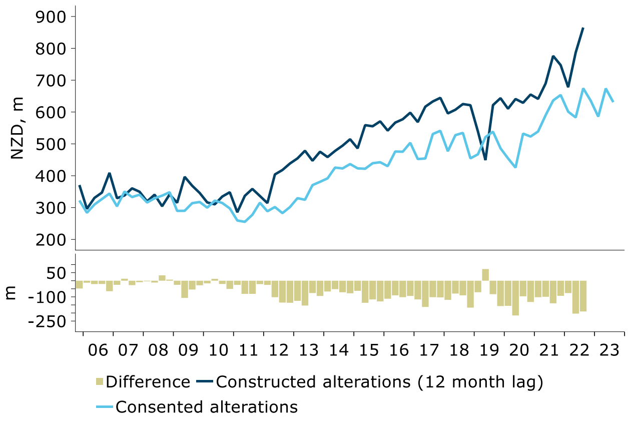
Figure 3. Auckland consents completed within 2 years



Source: Auckland Council, ANZ Research

However, in spend terms at least, the data indicate that non-completions for alterations have been outweighed by a larger spend on renovations that don't require a consent, such as a simple do-up of a kitchen or bathroom. These smaller projects make up at least one fifth of the total spend on home renovations and likely more, given we don't have data on what proportion of renovation consents are never completed (figure 4 – we have assumed it takes about 1 year on average after consenting to finish a renovation).

Figure 4. Dollar value of new renovations

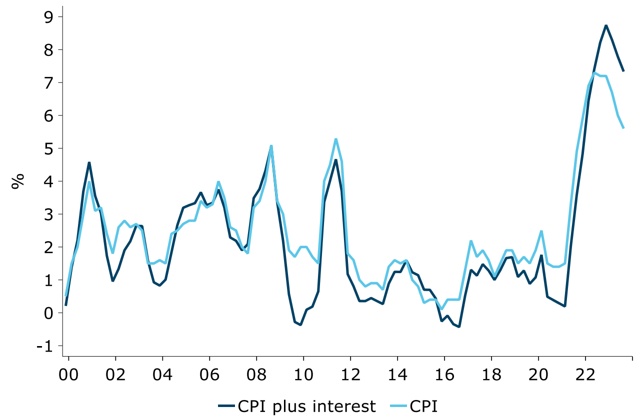


Source: Stats NZ, Macrobond, ANZ Research

High mortgage rates are stopping renovations in their tracks

The elevated cost of living and in particular the lift in interest rates has been one factor squeezing people's ability to afford a renovation. After adding back interest costs, consumer price inflation peaked at 8.75% (figure 5) and will have been much higher again for those homeowners with a large mortgage. First home buyers with a large mortgage are often the very people who most want to do a renovation, but are likely least able to afford it.

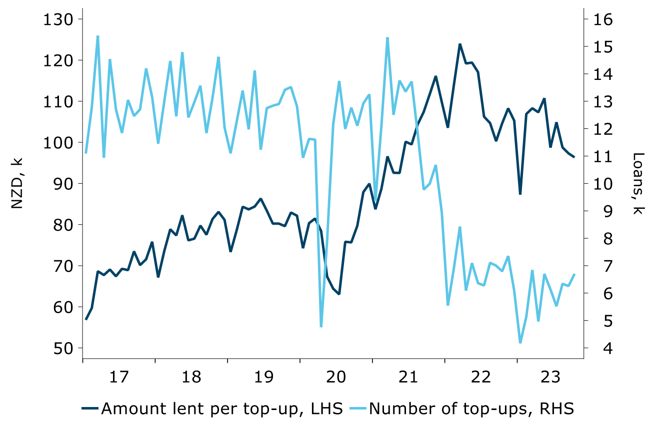
Figure 5. Inflation, with interest costs added



Source: Stats NZ, Macrobond, ANZ Research

Often, people fund the cost of a renovation through adding a bit more onto their mortgage, something which is much harder to do with mortgage rates starting with a 7. High interest rates and less appetite for borrowing generally (no doubt impacted by falling house prices) have caused the number of people topping up their mortgage to more than halve since 2021, to around 6000 people (figure 6). This isn't just reflective of renovations; people top up their mortgages for all sorts of things including to buy a second property, car or boat. Those who are still doing top-ups are willing to add around $100,000 on average to their mortgage, up from around $80,000 pre-pandemic, but well off its peak of $120,000.

Figure 6. Number of mortgage top-ups and dollar amount

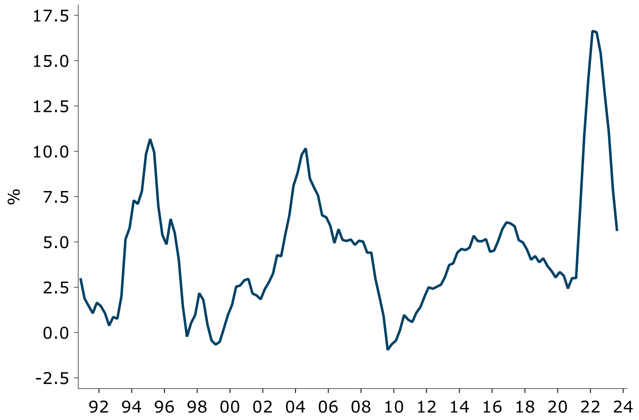


Source: RBNZ, Macrobond, ANZ Research

The cost to renovate has skyrocketed

Since the start of the pandemic, the cost of doing a renovation has increased drastically. Implied construction cost inflation peaked at 16.6%, more than double the peak rate of CPI inflation (figure 7, over). Construction cost increases are now in retreat, but we don't see the price to add an extension onto a house falling any time soon.

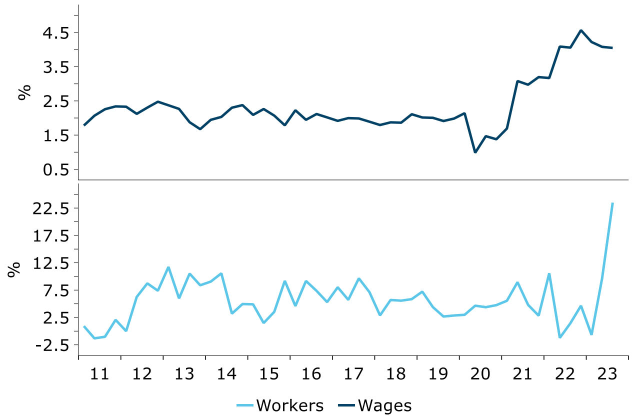
Figure 7. Implied construction costs



Source: Stats NZ, Macrobond, ANZ Research

It's not just the costs of buying materials for fitting-out a new kitchen that's increased. Most renovations, even DIY jobs, will use some specialist labour such as plumbers or electricians. Acute labour shortages meant that during 2021 and 2022 wages in the construction industry were increasing about 4% per year. The recent high immigration has meant there are 40,000 more people employed in construction than a year ago (a 23% y/y rise!), which should help make tradies easier to find.

Figure 8. Construction sector: yearly increases in wages and number of workers



Source: Stats NZ, Macrobond, ANZ Research

Where to from here?

Falling discretionary spending, including on things such as renovations, is an important part of monetary policy transmission. CPI construction costs have been booming, with insatiable demand for hardware and materials not able to keep up with supply chains. The RBNZ needs construction cost inflation to fall, and less demand for new bathrooms is part of bringing that about. Data indicates the higher interest rates are working to cool the economy and reduce inflation, as the Reserve Bank requires.

However, this does not necessarily mean prices for construction materials or the invoice from your tradie will decline; rather it means the prices will stop going up as quickly, allowing time for your income to catch up. While demand for renovations are only a small piece of the puzzle for overall demand, it all helps in the battle against high inflation.

One interesting wildcard is the dramatic turnaround in builders' expectations for residential building activity in the next 12 months (figure 9). This likely reflects two related things: house prices finding a floor, and exceptionally strong net migration. The RBNZ is between a rock and a hard place here: reducing construction activity is part of the plan to bring construction costs down, but not building enough houses to keep up with soaring population growth will result in upward pressure on rents and house prices. Whether builders' rosier expectations are warranted or not is yet to be seen, but they do have a pretty good track record of picking the direction of consents and ultimately residential building activity, though the question doesn't ask about whether it's anticipated new builds or renovations that underlie expected activity.

Figure 9. ANZBO expected residential building activity and house consents

Source: Stats NZ, Macrobond, ANZ Research

All up, while builders might be getting a little ahead of themselves, we do expect the current fall in demand for renovations will only be temporary, while the economy goes through a period of low spending and high interest rates. Next year we expect fixed mortgage rates to fall, albeit not to anywhere near their record lows in 2020. Lower mortgage rates will make it easier for first home buyers to purchase a home to renovate or for existing homeowners to afford to top-up their mortgage, meaning more people are likely to think about doing up their kitchen or bathroom or finally getting around to completing that deck.

Mortgage borrowing strategy

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Summary

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Wholesale interest rates have fallen dramatically over the past month, with bellwether rates like the 2yr swap rate down around 35bps (from around 5.15% when we last published to around 4.80% now). This hasn't happened because of anything the RBNZ has done – indeed, they hinted that they may need to hike again if inflation doesn't fall quickly. Rather, it's happened on the back of global moves, and in the wake of soft New Zealand GDP data that came with revisions that suggests that growth has in fact been a lot weaker than official data had been saying, and that we could be in recession again. The so-called 'starting point surprise' (in terms of what the data said versus the RBNZ's forecasts) was certainly large, and coming as it did the same week that the Federal Reserve (the US central bank) said that they're done hiking, the consequent reaction in financial markets was large.

Although slow growth and the prospect of recession isn't a prospect likely to be relished by many, if there is one positive for borrowers, it's lower interest rates. Even though a little caution is required, especially with term deposit rates (a key component of bank funding) holding up, we do see scope for term mortgage rates to fall, and that's the overarching theme heading into Christmas.

Regular readers will recall that we tend to pin many of our judgements on breakevens – essentially asking ourselves how far rates need to fall for one strategy – say fixing for 1 year – to be better than, say, fixing for 2 years. We generally read the results with an eye on our projections. Like last month, breakevens tend to be above our projections, and all else equal, that suggests that fixing for a shorter period will be cheaper in the long run. They show, for example, that fixing for 1 year and then re-fixing for another year at expiry will be cheaper than fixing for 2 years so long as the 1yr rate falls below 6.71% in a year's time. That isn't guaranteed (we are talking about the future!), but it seems likely given our projections for 1 year from now, based on our wholesale rate forecasts. Of course, fixing for shorter offers less time certainty, and is thus riskier, but cautious borrowers can always spread their risk over several terms.

Ahead of what are likely to be some near-term falls, borrowers drawing down a new loan (or with a fix rolling over soon) may want to consider an even simpler strategy – and that's to fix for 6 months now and review it when that fix rolls off. Again, that strategy is riskier in that it offers virtually no cover if rates were to rise, but with 6-mth and 1-yr rates at the same level and 6-mth breakevens only slightly below current rates, this strategy will save money if rates fall by more than 10-25bps, which seems very plausible given recent moves in wholesale rates.

Figure 1. Carded special mortgage rates^

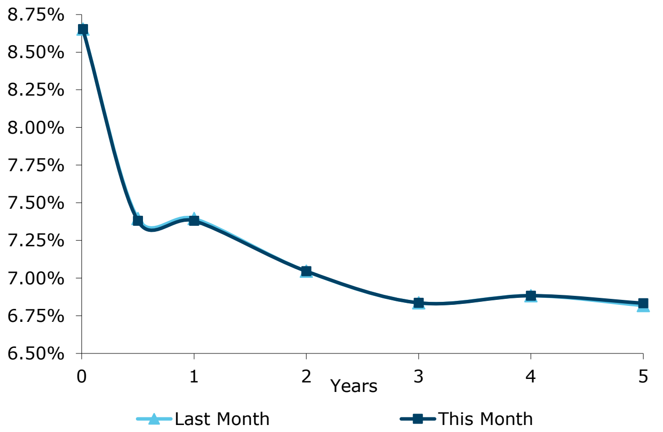

Table 1. Special Mortgage Rates#

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	8.65%				
6 months	7.38%	7.38%	7.17%	6.25%	6.52%
1 year	7.38%	7.28%	6.71%	6.39%	6.42%
2 years	7.05%	6.83%	6.56%	6.52%	6.72%
3 years	6.84%	6.77%	6.72%	6.63%	6.69%
4 years	6.88%	6.79%	6.70%		
5 years	6.83%	#Average of "big four" banks			

Source: interest.co.nz, ANZ Research.

Key forecasts

Weekly mortgage repayments table (based on 30-year term)

2Mortgage Size ($000)	Mortgage Rate (%) 5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00	8.25	8.50	8.75
200	262	269	277	284	292	299	307	315	323	330	338	347	355	363
250	327	336	346	355	364	374	384	393	403	413	423	433	443	454
300	393	404	415	426	437	449	460	472	484	496	508	520	532	544
350	458	471	484	497	510	524	537	551	564	578	592	606	621	635
400	524	538	553	568	583	598	614	629	645	661	677	693	709	726
450	589	606	622	639	656	673	690	708	726	744	762	780	798	816
500	655	673	691	710	729	748	767	787	806	826	846	866	887	907
550	720	740	760	781	802	823	844	865	887	909	931	953	975	998
600	786	807	830	852	875	897	921	944	968	991	1,015	1,040	1,064	1,089
650	851	875	899	923	947	972	997	1,023	1,048	1,074	1,100	1,126	1,153	1,179
700	917	942	968	994	1,020	1,047	1,074	1,101	1,129	1,157	1,185	1,213	1,241	1,270
750	982	1,009	1,037	1,065	1,093	1,122	1,151	1,180	1,209	1,239	1,269	1,299	1,330	1,361
800	1,048	1,077	1,106	1,136	1,166	1,197	1,227	1,259	1,290	1,322	1,354	1,386	1,419	1,452
850	1,113	1,144	1,175	1,207	1,239	1,271	1,304	1,337	1,371	1,404	1,438	1,473	1,507	1,542
900	1,178	1,211	1,244	1,278	1,312	1,346	1,381	1,416	1,451	1,487	1,523	1,559	1,596	1,633
950	1,244	1,278	1,313	1,349	1,385	1,421	1,458	1,495	1,532	1,570	1,608	1,646	1,685	1,724
1000	1,309	1,346	1,383	1,420	1,458	1,496	1,534	1,573	1,613	1,652	1,692	1,733	1,773	1,814

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

	Actual			Projections						
Interest rates	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Floating Mortgage Rate	8.0	8.5	8.6	8.7	8.6	8.6	8.6	8.6	8.4	8.1
1-Yr Fixed Mortgage Rate	6.5	6.9	7.2	7.4	7.0	6.7	6.5	6.3	6.2	6.2
2-Yr Fixed Mortgage Rate	6.5	6.5	6.9	7.1	6.9	6.7	6.5	6.4	6.3	6.3
3-Yr Fixed Mortgage Rate	6.6	6.3	6.7	6.8	6.8	6.6	6.5	6.5	6.4	6.4
5-Yr Fixed Mortgage Rate	6.6	6.3	6.5	6.8	6.7	6.6	6.5	6.5	6.4	6.4

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
GDP (Annual % Chg)	2.1	1.5	-0.6	0.0	0.4	0.1	0.7	1.1	1.3	1.6
CPI Inflation (Annual % Chg)	6.7	6.0	5.6	4.8	4.1	3.7	2.8	2.5	2.4	2.4
Unemployment Rate (%)	3.4	3.6	3.9	4.3	4.7	4.9	5.0	5.1	5.2	5.3
House Prices (Quarter % Chg)	-2.7	-0.3	1.6	1.0	1.0	1.4	0.9	0.6	0.8	1.2
House Prices (Annual % Chg)	-13.6	-10.6	-4.9	-0.5	3.3	5.2	4.5	4.0	3.9	3.6

Interest rates	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Cash Rate	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.25	5.00	4.75
90-Day Bank Bill Rate	5.71	5.74	5.63	5.57	5.38	5.10	4.88	4.55	4.55	4.55
10-Year Bond	4.62	5.31	4.53	4.60	4.60	4.50	4.50	4.50	4.50	4.50

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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