

# Economic Note

Housing Insights

1 December 2021

## House prices: from hero to zero in 2022

- Supply and demand dynamics in the housing market are finally changing.
- Lofty house prices are at risk from the confluence of three big macro forces next year.
- We've updated our forecasts to take account of these risks, and now expect small falls in house prices over the second half of 2022.

### Overview

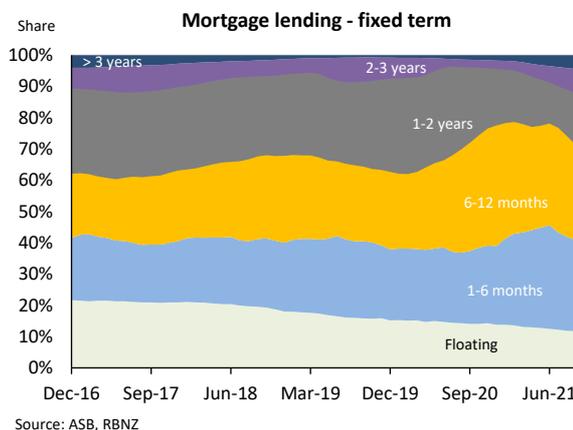
Once an asset price cycle gets going it can be hard to stop. This has certainly been true of NZ's housing market over the past two years. But the key drivers we look at are now, finally, falling into line to suggest 2022 could be quite a different year. The prospect of three macro negatives showing up around the same time compels us to increase the health warnings about the 2022 house price inflation outlook.

We now expect small falls in house prices over the second half of 2022. Given the perils of house price forecasting, the cumulative forecast fall, of around 4%, should be interpreted more as a hat-tip to the risk profile than a precise point forecast. It's also tiny in the grand scheme of the 35-40% surge in house prices since March 2020. Below, we run through the three macro factors to watch: higher mortgage rates, tighter credit conditions, and the supply response.

### #1: Higher mortgage rates

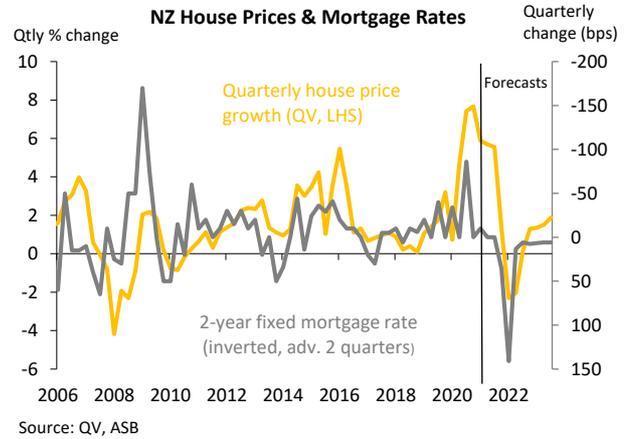
Since we asked the question "[Can we cope with higher mortgage rates?](#)" in June, fixed rate mortgage rates have roared 1 – 1½ percentage points higher. Yes, they're still at historically low levels. But we find the *speed* of interest rate movements can be just as important for short-term house price dynamics. And on this score, it's worth highlighting that the lift in mortgage rates we've seen over the past 3-6 months has been the most rapid in 16 years.

As usual, the macro impact of the 'sticker shock' from borrowers rolling onto higher mortgage rates will be dulled by the fact that borrowers don't all re-fix their rates at once. But, relative to past tightening cycles, the transmission of higher mortgage rates will be quite quick this time around. There's a heap of refixing to come over the next 12 months. We made this point in our note mentioned above and, while there's been something of a rush to fix since then, the vast majority of borrowers on shorter mortgage terms are still to do so.



For example, RBNZ data shows that there’s about 40% more mortgage debt on longer terms (2+ years) than in June, but the overall quantum of such is still very small – as shown in the above chart. The average duration of all mortgage rate debt (including floating debt) is still only around 11 months, and 60% of all fixed-rate mortgage debt (71% including floating debt) is due to reset onto new rates over the coming year.

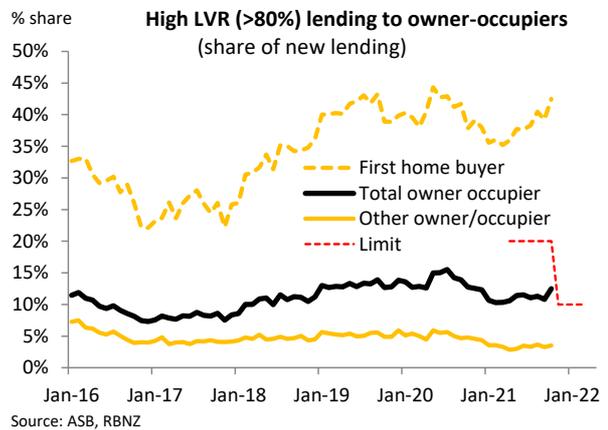
Our rough rule of thumb suggests that mortgage rate changes feed through to house prices with about a six-month lag, but the above suggests it could occur more rapidly this time around. Whatever the exact timing, the sharp adjustment we’ve seen in mortgage rates looks set to be a significant drag on house prices next year. This is the driving force behind our lower 2022 house price forecasts.



**#2: Tighter credit conditions**

Housing credit conditions are tightening. Keen to clamp down on “risky” lending, the RBNZ has reduced the speed limit on high LVR owner-occupier lending to 10% of new lending, from 20%. Of course, this is the latest in a string of LVR restrictions.

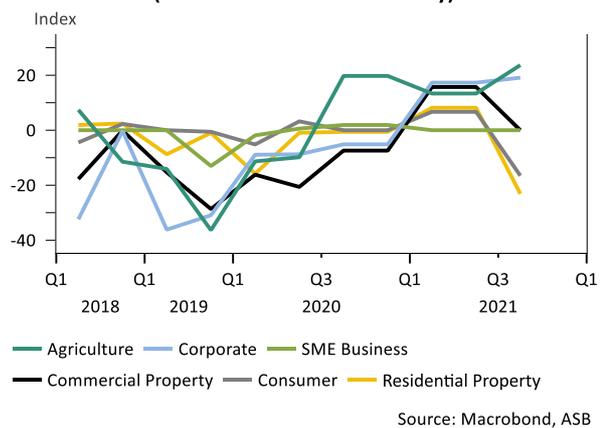
The pace of new mortgage lending has been slowing, but RBNZ data shows there’s a bit more to go. As of the latest (October) numbers, high LVR lending to owner-occupiers is still running a touch above the 10% limit. The new 10% limit applies from November, and Banks in the past have opted to maintain a buffer a few percentage points below the limit.



Some banks are also moving to impose debt-to-income limits ahead of any formal RBNZ moves to do so. This self-imposed credit rationing makes sense to the extent house price affordability metrics are highly stretched and a modest correction next year can’t be ruled out.

All of this fits with banks’ more general expectation that the availability of credit to the property sector will be reduced over the coming six months, as was signalled in the RBNZ’s credit conditions survey (which we covered [here](#), and chart opposite). This promises to restrict some of the oxygen flow to the housing market.

**Credit availability - expected change over next six months (RBNZ credit conditions survey)**



**#3: The supply response is coming**

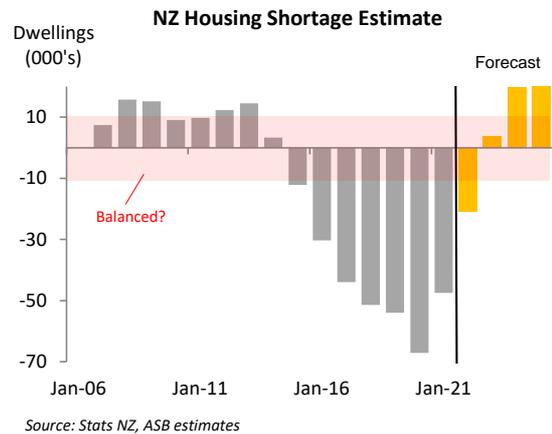
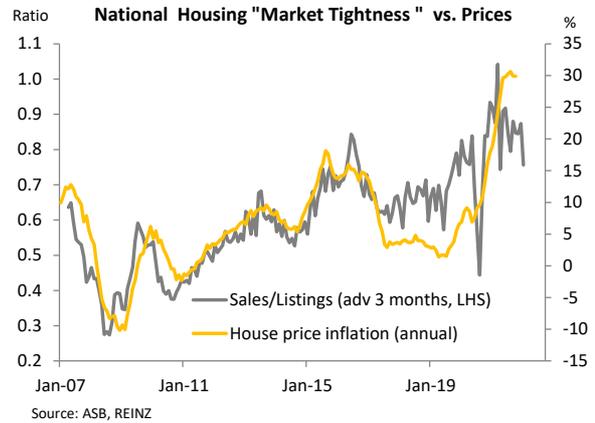
We hear you, “so is Christmas”. Waiting for the housing market supply response to arrive has been like waiting for a test win in India for our cricketers. It’s been a long time coming, but it is getting closer.

Our long-held view has been that, despite booming residential construction, the housing market would remain short of stock well into 2022. So far this has played out. Unsold inventory remains around the lowest levels on record. And short-term indicators of market balance, like the sales/listings ratio have eased only a little to date (chart opposite), implying ongoing excess demand.

Still, recent developments with respect to correcting the housing shortage have been encouraging. Big strides have been made in the COVID-era towards unwinding 10 years' worth of NZ's under-build. This is particularly so in Auckland, as covered in our recent [note](#).

We reckon NZ's housing shortage has been reduced by around a third over the past year. And, if recent trends continue, we could see the market back in a rough state of balance late next year. This gradual abatement of market tightness will help reduce the upward pressure on house prices over coming months.

The recent cross-party agreement to allow greater urban densification across the country will help enable a more flexible supply response in future. But it's not really a consideration in the current house price cycle.



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