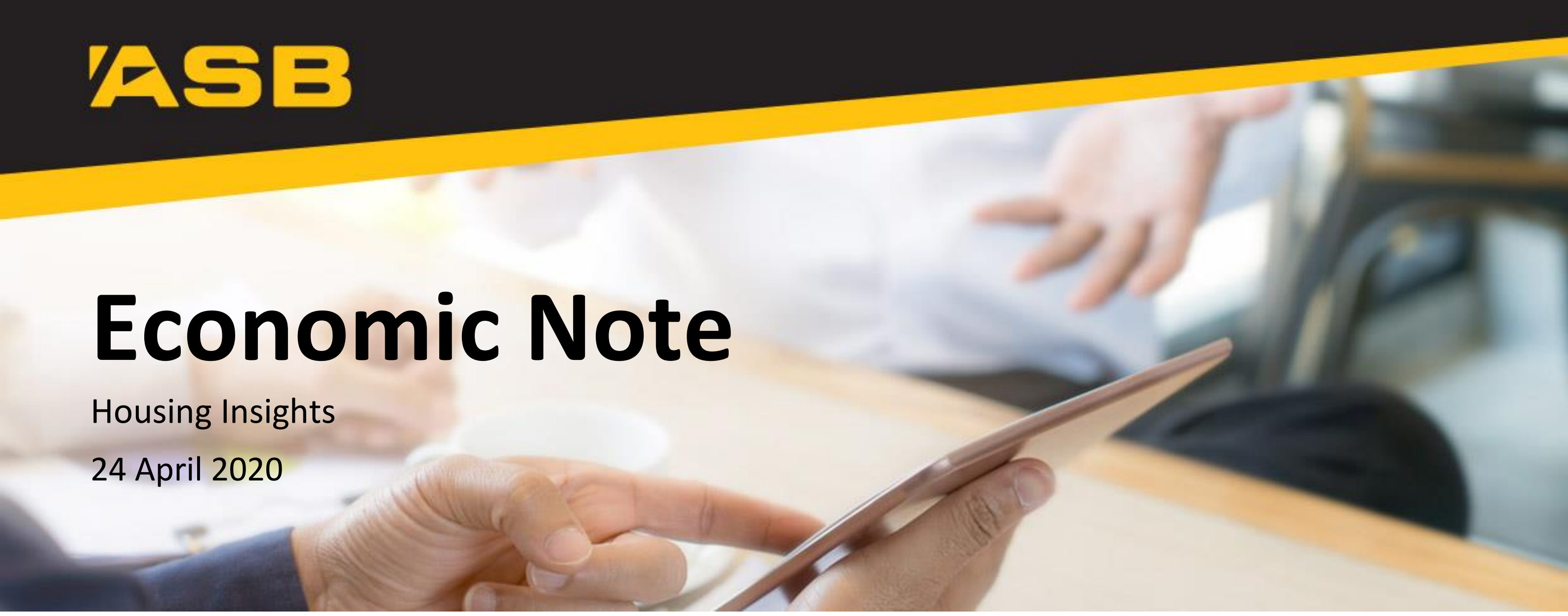

Economic Note

Housing Insights

24 April 2020

Thinking about the new normal for housing

- NZ's housing market will emerge from lockdown into some big headwinds
- House prices are likely already falling, but estimating how far/fast they fall is difficult
- We provide our thoughts on the key factors to consider
- We're left comfortable with our view of a 5-10% fall in house prices from here

Summary and key take outs

As NZ's period of Level Four lockdown slowly (oh so slowly) draws to a close, we run through the various crosswinds impacting on NZ's housing market, and assess their implications for our house price view.

There are various headwinds to consider, including a deteriorating labour market, falling net migration, and likely modest declines in residential rents. However, government and RBNZ support will help limit the downside to some extent, and let's not forget there will be regional differences too.

Overall, we're left broadly comfortable with our headline forecast for a 6% fall in nationwide house prices in the year to March 2021. But it's important not to give any false sense of precision here. Uncertainty abounds. What we're really talking about is a fall in nominal house prices of 5-10%.

Over 2021, we expect house prices to stabilise, before gradually recovering as the unemployment rate begins to decline. Our forecasts are for a fairly gradual recovery, but if mortgage rates continue to fall and LVR restrictions are not restored the risk is probably for a brisker upturn.

March was the peak

The latest round of housing market data were only really useful for establishing the starting point for the market prior to entering lockdown. And, on this score, March data confirmed our prior view that the NZ housing market barrelled into lockdown with a full head of steam.

Nationwide house prices hit a fresh all-time high with annual inflation rising to 9.3% yoy. Most regions shared in the gains, with some well into "boom" territory. Try Manawatu-Whanganui at 23%, Hawke's Bay at 17.2%, Gisborne at 17.2%, and Southland at 17.5% for some of the headier examples.

Moreover, February/March readings of some of the better measures of housing market "tightness" we monitor – the likes of days to sell a house and sales/listing ratios – pointed to a further worsening in the overall demand/supply imbalance, and yet more pressure on prices to rise.

NZ Housing Data		Mar-20	Month ago	Year ago
House Sales (s.a)	%mom	-18.3%	0.3%	-1.7%
	%yoy	-4.8%	12.6%	-9.4%
House Prices (s.a)	%mom	0.3%	2.1%	-0.3%
	%yoy	9.3%	8.7%	2.4%
Days to Sell (s.a)		32.5	28.7	39.0
New Listings (s.a.)	%mom	-12.8%	-0.5%	4.5%
Weeks of Inventory (s.a)		15	17	19

Sources: REINZ, realestate.co.nz

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But we now know that the housing market will emerge from lock-down in very different shape from how it went in. As such, we can almost certainly now point to March 2020 as the cyclical peak.

Stepping into the unknown

House prices are likely to be falling already. Judging the extent to which prices fall this year is very difficult though, given that we have simply never experienced a period of economic disruption like this before. What's more, the outlook for some of the macroeconomic variables we typically use as markers for house price cycles – things like unemployment, GDP growth, interest rates, and population growth – is also far from clear.

There's plenty of factors to consider. We've provided our thoughts on the key ones below.

1. **A deterioration in the labour market will be a material drag on housing demand**. We expect the unemployment rate to rise from 4% to just under 9%, and wage growth to slow sharply. Servicing existing mortgage debt will become more difficult for those affected. And even those that remain in the jobs market will be less inclined to dabble in the housing market, as the worsening labour market takes a toll on job security.

   The table provides some context around past cycles in the labour market, and how the housing market has fared each time. It goes without saying that these sorts of comparisons are difficult because there's always other things going on in the economy. But it at least provides an idea of the ballpark.

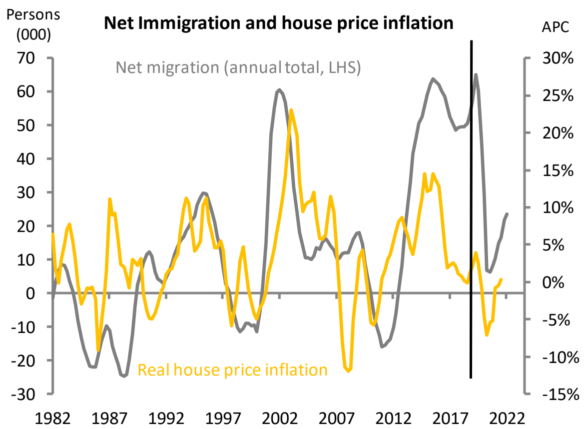
Past unemployment & house price cycles

	Unemployment cycle	House price correction (in real terms)
1991	4.2% to 11.2% (7 percentage points)	-5.0%
1998	6.2% to 7.9% (1.7 percentage points)	-5.8%
2008/09	3.3% to 6.5% (3.2 percentage points)	-11.9%
2020/21(f)	4% to 9.3%(f) (5.3 percentage points)	-7.1%(f)

   This time around, the spike in unemployment will be fairly immediate, but hopefully not as long lasting as prior cycles. In addition, record low mortgage rates and debt relief from the mortgage holiday scheme may limit distressed sales to some extent, blunting the impact from the labour market deterioration on house prices.

2. **A collapse in net migration will also hit demand.** The NZ border is closed and we have assumed it will remain largely shut for the rest of the year. Consequently, annual net migration is set to slow sharply over the coming 12 months and it will be some time before it recovers.

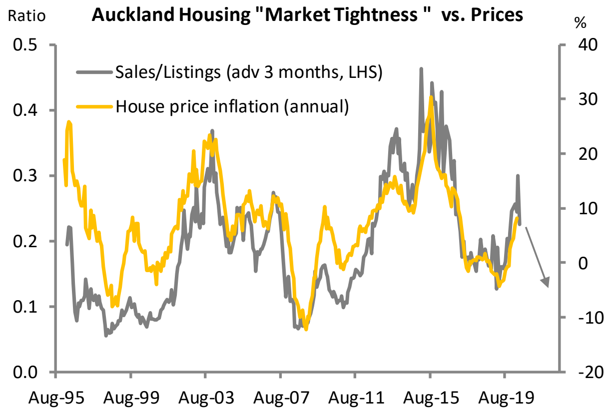
   Given the strong cyclical link to NZ house prices, falling net migration will present another headwind for housing demand. We admit, though, that the relationship hasn't been as close as usual over the past few years (see chart opposite).



Source: QV, Statistics NZ, ASB

3. **Housing supply will fall too.** The last 12 months have seen much of the country plagued by a shortage of housing supply. Indeed, the failure of supply to respond much at all to the surge in demand was the key driver behind the 'mini' house price boom of the past 6-9 months. Looking ahead, even as lockdown restrictions ease, we suspect supply will retrench further as prospective vendors opt to wait for better market conditions before listing. We've seen the first signs already with new listings falling 13% mom in March according to realestate.co.nz data.

Still, demand is going to fall by more. Thus, the period of excess demand that prevailed for much of 2019 will quickly become a distant memory. We've previously flagged the house sales/listings ratio as an excellent arbiter of overall housing demand vs. supply, and hence the near-term direction for prices. As per the chart opposite, the sales/listing ratio for Auckland (for which we have the best data) has already turned lower and will likely continue to do so in the months ahead.



Source: ASB, Barfoot & Thompson; REINZ

4. **There will be sectoral differences**. Those regions heavily exposed to the hardest hit sectors of the economy will underperform. The most obvious region in this regard is Queenstown, and the broader Southern Lakes region, which is being affected by the devastation wrought on our tourism sector. The associated decline in population growth, and increase in available housing supply, will add to the pressure on prices to fall.

We expect Auckland prices to fall slightly further than the national average (forecast table is below). The Auckland market features a much higher percentage of investors and is also relatively more reliant on inward migration and offshore buyers. We expect investors to pull back from the market quite quickly (at least initially), and the border closure will likely bring to a halt the small amount of offshore buying that remained after 2018's foreign buyer ban.

ASB Regional Heatmap

	Sales (s.a)	Prices	Days to Sell	Rents		Inventory
	%3m/3m	%yoy	Dev from avg	%yoy	Yield (%)	Dev from avg
Auckland	-0.6	8.2	-3	1.2	2.9	-30%
Canterbury	-5.6	4.1	-8	0.5	3.9	-33%
Wellington	-6.0	11.8	-9	8.4	3.9	-57%
Northland	-10.5	7.7	-10	5.4	3.7	-54%
Waikato	-9.9	10.3	-20	5.2	3.5	-57%
Hawke's Bay	0.9	17.2	-17	7.8	3.9	-72%
Bay of Plenty	-7.6	7.1	-20	7.1	3.5	-68%
Gisborne	-2.0	17.2	-13	13.1	4.8	-69%
Manawatu-Whanganui	2.0	22.9	-24	11.9	4.0	-67%
Taranaki	-3.9	12.1	-24	11.1	4.4	-32%
Nelson/Tasman	-20.6	8.1	-11	6.3	3.3	-35%
Marlborough	-3.1	8.1	-21	8.9	4.0	-63%
West Coast S.I.	-10.9	8.1	-32	7.8	7.9	-39%
Otago	-12.6	13.1	-15	8.0	4.0	-44%
Southland	-17.9	17.5	-12	9.8	3.8	-41%

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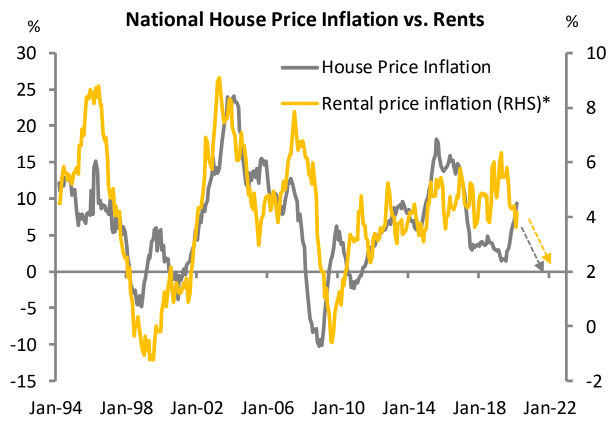
Sizzlin

Sources: ASB, Corelogic, REINZ, MBIE, realestate.co.nz

Those regions exposed to some of the more well-placed sectors, like the primary industries for example, will fare *relatively* better. We're thinking here of the likes of Hawke's Bay, Waikato, Taranaki, Southland, and Canterbury. The heatmap above (March data) provides a sense of the starting point for relative regional performance prior to COVID-19 disruptions.

5. **Residential rents are likely to fall**. The Government has banned increases in residential rents for the next six months. Most will simply remain unchanged for an extended period but some will be forced lower reflecting the big hit to household incomes and the likely strong increase in the supply of rental accommodation. This will include, for example, Airbnb accommodation that is no longer servicing the tourism sector. In aggregate, rents are likely to fall modestly.



Source: REINZ, MBIE *New rents lodged

The causation between house prices and rents runs in both directions. But we have assumed that a circa 5%

fall in new rents will add to the downward pressure on house prices, as existing and prospective property investors are dissuaded from buying, or indeed sell existing property, on the basis of reduced housing earnings capacity. As shown in the chart, rents fell around 10%yoy in both the 1998 and 2009 housing corrections.

6. **Market mechanics are going to be impaired for some time.** Houses can still be bought and sold during NZ's Level 4 lockdown, but April data will still show the pace of house sales slowing to a trickle. The move to Alert Level 3 will help to thaw out the market a little, but not a lot. Current guidelines are that open homes will still be off limits. It was confirmed on Tuesday that private home viewings will be possible with the appropriate safety precautions. Auctions will likely continue to be avoided in favour of one-on-one negotiations.

   Given some of these restrictions, we suspect both sellers and buyers will probably just wait until we go down to Level 2 to transact, except in circumstances where a sale needs to be made (i.e. distressed sales). And even when the market does creak back to life it's going to be slow going. There will be a backlog of lockdown settlements/sales to attend to first, and we'll be right on the cusp of winter – the quietest period for the market. We also won't have a good idea about how the market is shaping up for some time. Housing activity will be so subdued through April and May that readings on house prices will be largely meaningless until at least June.

7. **Australian house prices are falling.** We've flagged a few times before (see here) the statistically significant link running from Australian house price cycles to those in New Zealand. The correlation is particularly strong between the Sydney and Auckland markets. Our CBA colleagues expect Australian property prices to fall 10% over the next six months. On past form, this points to the risk of something similar for NZ.

8. **Government/RBNZ support will limit the downside:**

   - **The mortgage deferral scheme** will help limit distressed sales from those that might have otherwise struggled to meet mortgage payments due to loss of income during the lockdown period. Take-up to date has been relatively small – we estimate around 6% of mortgage holders have applied – but will undoubtedly increase as unemployment begins to rise.

   - The RBNZ is consulting on completely **relaxing loan-to-value restrictions** for 12 months. In contrast to some commentators, we'd argue this move is not about supporting house prices – house prices are going to fall steeply regardless. It's more about keeping bank lending to households flowing. If LVR restrictions aren't relaxed there would be a risk that borrowers seeking fresh funds, including those taking a mortgage holiday (thereby capitalising interest onto the loan), could knock up against the LVR restrictions as their housing equity position worsened. Some have also flagged the risk that the dropping of the LVR restrictions could fuel another investor-driven property boom. We think the risk of such is small. The RBNZ has said they will monitor lending activity closely over the next 12 months and can quickly reinstate the restrictions if necessary. We also think banks will be reluctant to let the high LVR lending cat get out of the bag in the current climate.

   - **Mortgage rates are at record lows**. With wholesale interest rates continuing to fall and wholesale funding costs easing up a little, downward pressure on mortgage rates will remain in place for some time. Falling mortgage rates are usually a powerful tailwind for the housing market, but in the current cycle we expect this 'stimulus' will be more about preventing a deeper correction. Low mortgage rates will also help speed the housing recovery in 2021.

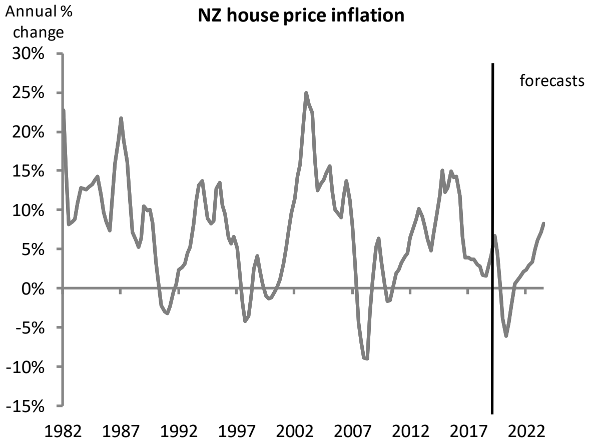
Weighing up the crosswinds

So where does all of that leave us in terms of our view for house prices?

Overall, we're left broadly comfortable with our headline forecast for a 6% fall in nationwide house prices in the year to March 2021 (more detail in table below). But it's important not to give any false sense of precision here. Uncertainty abounds, and the confluence of factors hitting the housing market is unprecedented. What we're really talking about is a fall in nominal house prices of 5-10%.

Of the factors above, the likely increase in unemployment over the remainder of the year does point to some risk of a larger fall in house prices. This is especially so if the labour market deteriorates more than we expect. Providing some offset, we note that some of the bigger house price corrections we've seen in the past have been accompanied by large net outflows of migrants. We're not expecting that this time around, even if it's because people are effectively banned from leaving (for the time being at least). There's also the supportive impact of government and RBNZ relief measures to consider, the magnitude of which we haven't seen in past cycles.

Over 2021 we expect house prices to stabilise, before gradually recovering as the unemployment rate begins to decline. Our forecasts are for a fairly gradual recovery, but if mortgage rates continue to fall and LVR restrictions are not restored the risk is probably for a brisker upturn.



Source: QV, ASB

ASB House Price Forecasts (annual % change)			
	June 20	Dec 20	End 2021
Auckland	3.6%	-4.2%	0.5%
Christchurch	2.3%	-2.7%	1.0%
Wellington	8.2%	-1.1%	0.5%
Other Regions	4.8%	-4.6%	0.5%
National	**4.5%**	**-3.9%**	**0.6%**

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