Home Economics

May 2022

Bracing for Impact

- House prices are falling but the bulk of the impact from the mortgage rate surge is yet to come.
- Faster and larger lifts in mortgage rates mean we now expect modest house price declines through to mid-2023. All told, we expect around a 12% decline. In real terms though, this would amount to a 20% correction.
- We expect a house price inflation recovery to kick in over the second half of 2023, tied to our forecasts for an upturn in net migration and flattening mortgage rates.

Welcome to Home Economics, our regular wrap on all things NZ housing. Sign up for future editions here.

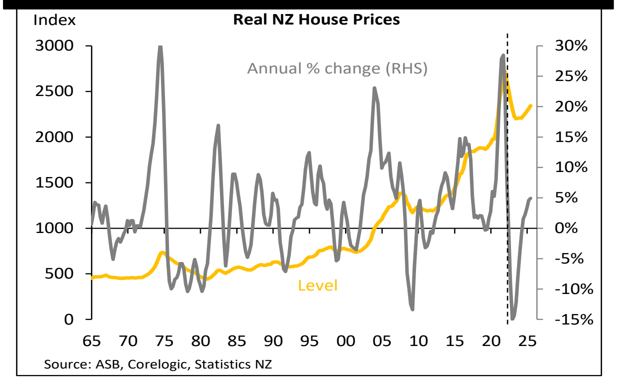
Our view

It took two years for the housing market to build up a fierce head of steam but only a few months for the pressure to be completely released. All housing market metrics are in full retreat. We flagged last year the risk that three big housing nasties could arrive at once – higher mortgage rates, tighter credit conditions, and increased supply. All three are now in play and look set to stick around. In our view, it was the credit tightening that tipped the housing market scales, and things may soon ease up a little on this front. However, the bulk of the house price impact from the mortgage rate surge is yet to come. Around 60% of all mortgages rates will be reset over the coming 12 months.

Faster and larger lifts in mortgage rates have seen us trim our house price inflation forecasts. We now expect a 9% fall in national house prices over 2022 with falls continuing into the early part of 2023. All told it's around a 12% peak-to-trough decline. For context, that would only take house prices back to where they were in early 2021, with prices still some 27% higher than the start of the pandemic. Still, in real (inflation-adjusted) terms – an increasingly relevant metric in the current environment – we're talking about a 20% correction, which would be the largest decline since the 1970s (see Chart 'o' the Month). We expect a house price inflation recovery to kick in over the second half of 2023, tied to our forecasts for an upturn in net migration and flattening mortgage rates.

Chart 'o' the Month

Bracing for largest 'real' fall since the 70s



Forecasts

ASB House Price Forecasts
(Corelogic index, annual % change)

	Jun 2022	Dec 2022	Dec 2023
Auckland	5%	-10%	-1%
Christchurch	15%	-6%	1%
Wellington	-2%	-12%	-1%
Other Regions	2%	-9%	0%
National	**4%**	**-9%**	**0%**

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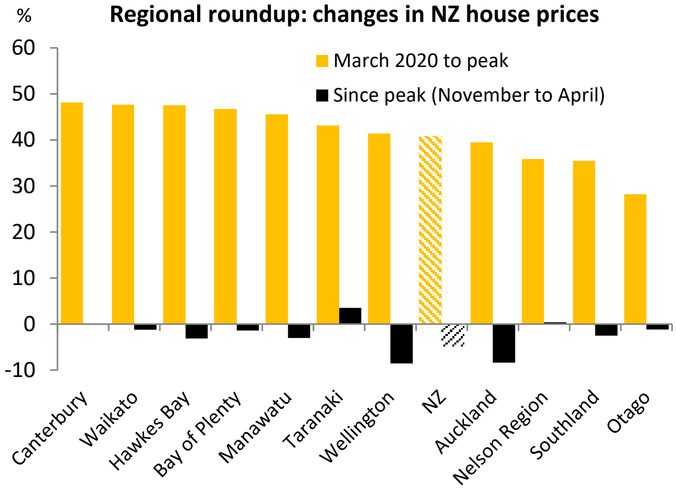
Where are we?

It's now clear that the NZ house price inflation cycle peaked around November of 2021.



Source: ASB, REINZ

As the chart shows, there were some modest regional differences through the boom, but for the most part the rising market tide floated all boats. From the time COVID arrived on our shores in March 2020, to the market peak around November, national house prices boomed 40%.

They've since backed off around 5% which, in the context of the boom, is small fry. Notably, those places where house prices became the most overstretched during the upswing – Auckland and Wellington – have experienced the largest declines to date. House prices in both big cities are down around 8.5% from the November peak.

Our Regional Heatmap below shows that broader housing market indicators are also looking a tad frosty in the big cities, with some lingering heat still blowing through some of the regional centres.

ASB Regional Housing Market Heatmap

	Sales (s.a)	Prices	Days to Sell	Rents		Inventory
	%3m/3m	%yoy	Dev from avg	%yoy	Yield (%)	Dev from avg
Auckland	-15.5	2.7	11	4.0	2.5	1%
Canterbury	-8.9	19.9	-4	8.7	3.2	-43%
Wellington	-20.3	-4.2	12	5.0	3.4	37%
Northland	-2.5	16.7	-19	1.0	3.1	-69%
Waikato	-10.2	13.7	-15	5.0	2.7	-41%
Hawke's Bay	-20.2	4.0	-9	11.9	3.3	-21%
Bay of Plenty	-5.1	11.9	-17	9.3	2.9	-47%
Gisborne	-30.9	4.0	2	15.3	3.3	-43%
Manawatu-Whanganui	-21.8	3.9	-11	11.3	3.6	-19%
Taranaki	-12.4	13.8	-15	11.3	3.5	-41%
Nelson/Tasman	-2.0	10.5	-1	-0.5	2.7	-36%
Marlborough	-21.9	10.5	-13	7.3	3.7	-56%
West Coast S.I.	-12.9	10.5	-46	15.1	9.3	-78%
Otago	-6.7	9.1	-6	7.1	3.2	-14%
Southland	-21.4	9.4	-7	12.2	3.8	-27%

Brrr

Sizzling

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

Where are we going? The three nasties

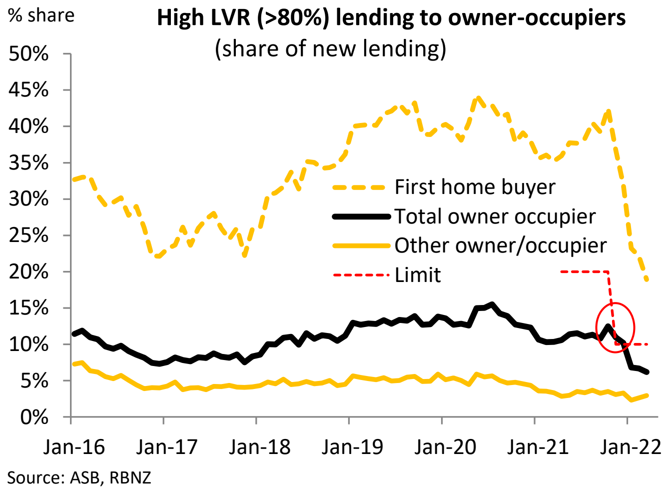
1) Credit freeze should thaw

Rather than mortgage rate shock, it looks as if a strangling of credit supply was the thing that finally pulled the rug from under the housing boom.

We'd previously flagged that banks were running over the RBNZ's incoming LVR speed limits last year, and would thus have to pull-back on new lending to high-LVR owner-occupiers. This subsequently occurred, with some banks stopping lending to this segment altogether for several months.

Unanticipated lending restraints/delays related to changes to the CCCFA Act amplified the credit squeeze, which has since been confirmed in RBNZ borrowing stats. The value of new mortgage commitments fell 12% from November to February (seasonally-adjusted data).

In our view, the above was a key reason for some of the abrupt weakness in various housing indicators through the summer/early autumn. But it should be less of an impediment in coming months, reducing the negative impulse to the housing market, at least from this source. Higher-LVR owner-occupier lending is now comfortably back below the RBNZ's speed limit (chart opposite), meaning banks have room to expand lending to this sector again. The Government has also signalled that the some of the lending restrictions in the CCCFA Act changes will be eased.

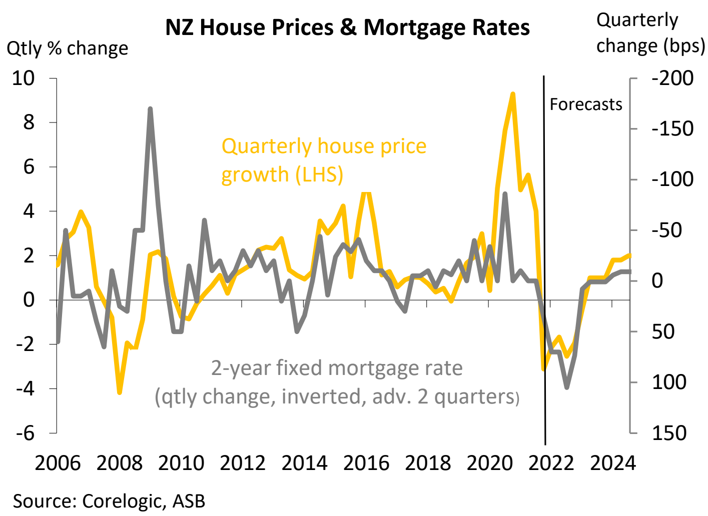


2) Biggest impact of mortgage rate surge still to come

If the downward pressure on the housing market from a thawing in credit conditions is about to abate, the pressure from higher mortgage rates will, if anything, increase from here.

We find that the impacts from changes in mortgage rates take some time to fully work through to house prices. It's an inexact science, but our rough rule of thumb of about a six-month lag worked well during the house price upswing (see chart).

The large and rapid increases in mortgage rates over the second half of last year will be starting to fully impact the market around now, with the impact ramping up as the year goes on. The sheer speed with which mortgage rates have risen – amongst the fastest pace on record – will pose big headwinds for house prices over the second half of this year.

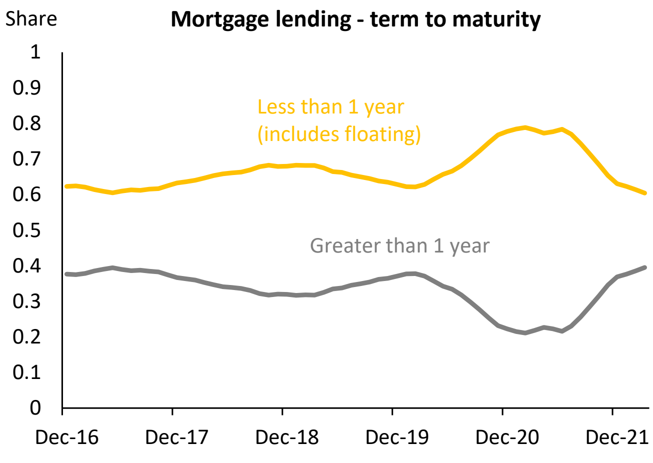


We first flagged in mid-2021 households' heightened sensitivity to higher mortgage rates. This has reduced a little since, but around 60% of all mortgage rates are still due to be reset over the coming 12 months (data include floating mortgages). Almost all will ratchet onto significantly higher rates.

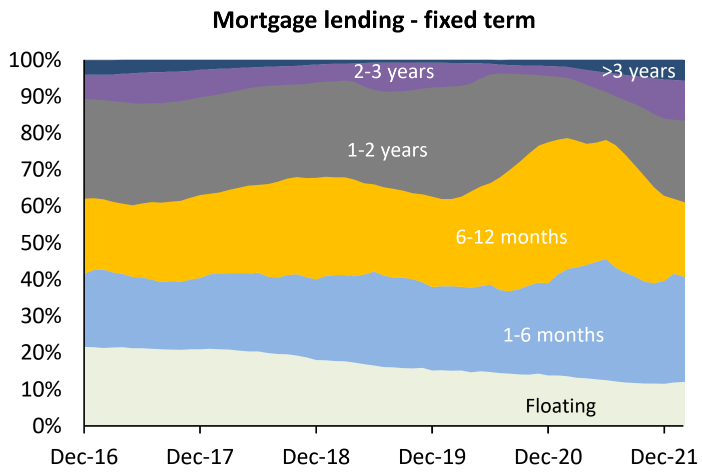
The charts below show that the average term of mortgage borrowing has been gradually increasing from the low point of mid-2021. But the majority of mortgage debt is still on relatively short terms. For example, just 16% of debt is on fixed-rate terms of two years or longer. This means there's a bunch of rate shock on the cards for the coming 12 months. As an example, a household rolling off a one-year fixed mortgage rate set a year ago at 2.3% will face a new rate for an equivalent term of over 5%.

We don't expect these higher rates to lead to widespread mortgage distress and forced sales. The employment market is extraordinarily tight and labour incomes are strong with wage growth set to step up. But the rate shock will syphon a bunch of extra disposable income out of kiwis' wallets this year, hitting discretionary retail spending hard.

Much higher mortgage rates also change the calculus for prospective new home buyers, or those looking to trade up. The 'test' rates banks use to assess debt serviceability are where the rubber hits the road. These are rising fast in line with the broader mortgage rate trend. Banks are now testing on rates north of 7%, up from an average of 6.3% in the middle of last year.



Source: ASB, RBNZ



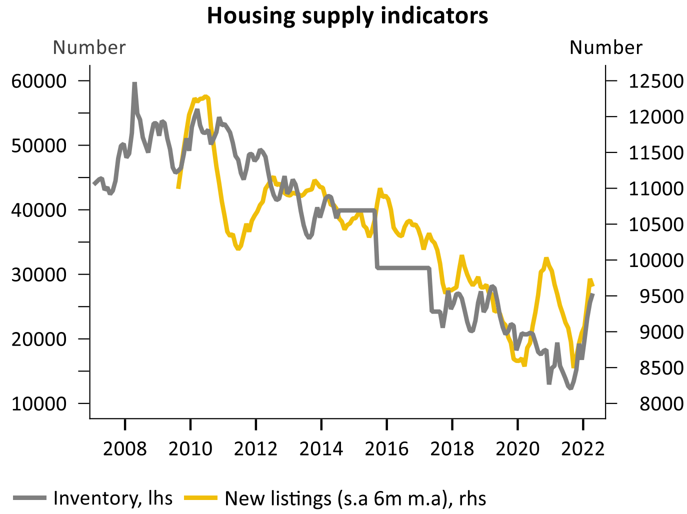
3) Supply response arrives on schedule

We've repeatedly emphasised the role of scarce supply in the housing boom (see for example here and here). Our view as far back as 2020 was that it wouldn't be until this year that we'd see a material housing supply response, and that it would be a key factor in turning around the market.

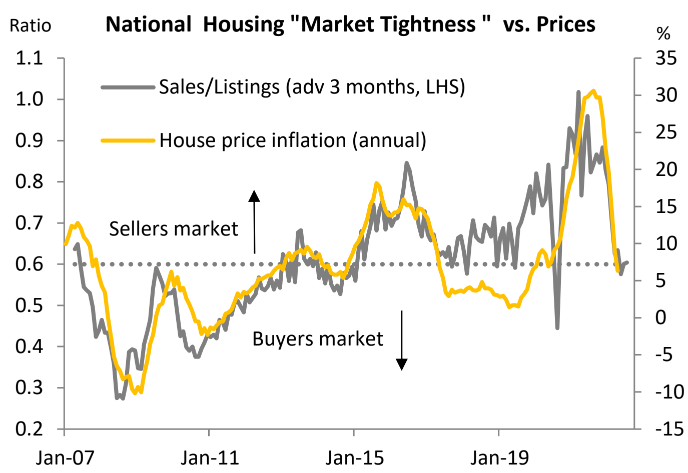
An increase in supply wasn't the straw that broke the housing boom's back, but it is now clearly playing a supporting role in releasing pressure from the market. The latest (April) data from realestate.co.nz show the number of unsold homes listed in NZ has almost doubled since mid-2021, to about 25,000. This has come about via both an increase in the pace of new listings, and a slower pace of house sales. Mostly it's been the latter.

Higher supply and cooling demand have tipped the market balance back towards buyers. This can be clearly seen from our favourite indicator of market tightness – the sales/listing ratio (chart opposite). It's quickly tumbled back to roughly "neutral" levels. That is, it's currently neither a buyers' nor sellers' market. But the rapid evaporation of the excess demand prevailing through 2019-2021 has completely removed the upward pressure on prices.

We expect additional housing supply to come on stream ahead. We're now 5 years into a residential construction boom, and this supply bulge should increasingly show up



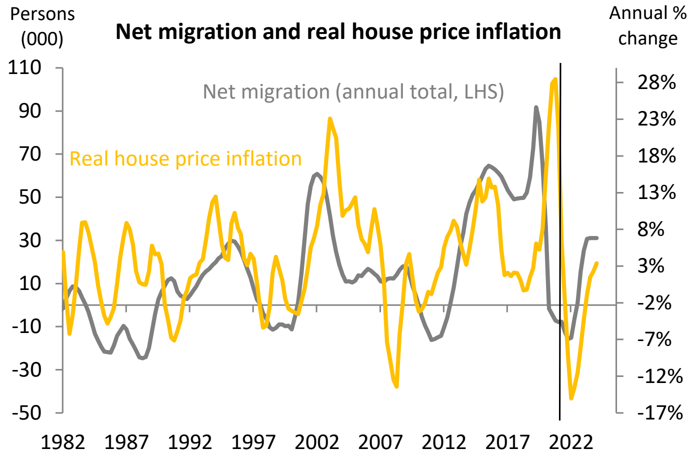
Source: Macrobond, ASB



Source: ASB, REINZ, realestate.co.nz

in higher inventory and new listings numbers (regardless of whether new homes and townhouses are purchased "off the plan"). The housing shortage that has plagued the market over the past 5 years has been rapidly, if not completely, eroded thanks to new construction outpacing plunging population growth.

Still, the expected return of positive net migration in 2023 warns against getting too negative on the medium-term house price outlook. Our assumption of a turning in the house price cycle, and it is no more than an assumption, is closely tied to our expectations of the same in the migration cycle. This is analogous to the 2008 experience where solid inward migration helped pull house price inflation out of its post-GFC slump.



Source: Corelogic, Statistics NZ, ASB

We've allowed for a mild house price inflation recovery over the second half of 2023, tied to our forecasts for an upturn in net migration and flattening mortgage rates. The table below summarises the various drivers of house price inflation and their impact on our view.

House Price Driver	Current	Next 18 months	Comment
Mortgage Rates	🔴	🔴🔴	We find mortgage rates to be a strong driver of house prices, with around a six-month lead. Mortgage rates are rising at the fastest pace in decades and this will weigh heavily on house price inflation over H2 2022.
Population Growth	🔴	🟡	We expect inward migration to turn more negative over the remainder of this year. A recovery in mid-to-late 2023 should help steady the negative trend in house price inflation.
Housing Supply	🔴	🔴	Booming construction/slowing population growth is helping to reduce NZ's housing shortage.
Labour market	🟢	🟢	NZ's labour market is extremely tight. We expect further falls in the unemployment rate from here and for wage inflation to accelerate.
Housing Policies	🔴	🟡	Policies that have starved the housing boom of credit have been the most effective in curtailing the upswing. The RBNZ expects debt-to-income ratios to be ready as an extra tool by mid-2023 but, at this stage, we don't expect them to be deployed.

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