Economic Note

Housing Insights

26 August 2020

Lower mortgage rates…higher house prices

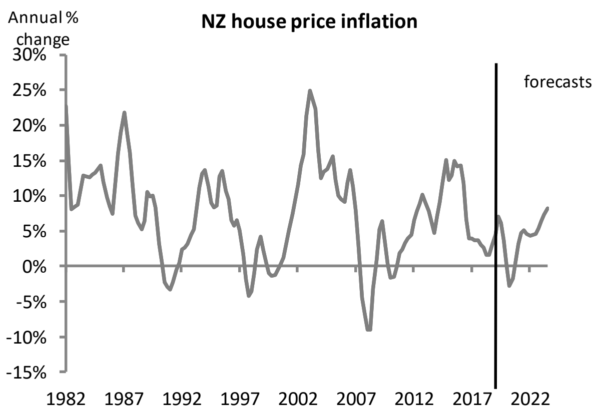
- We lower our mortgage rate forecasts
- And lift our house price forecasts
- We now expect national house price inflation to fall 2.8% by March, milder than the 6% fall previously forecast

Summary

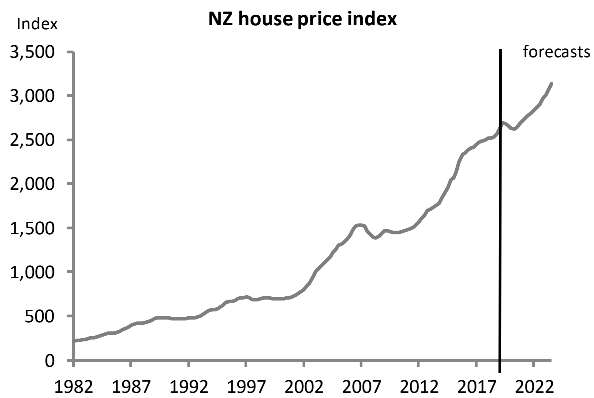
A lot has changed over the past few weeks. The NZ economic recovery has hit another speedbump in the form of a shift up in NZ's COVID Alert Levels. Fiscal authorities have extended support measures, and the Reserve Bank is forcing NZ interest rates lower with renewed vigour. We've changed our interest rate call and now expect the Reserve Bank's cash rate to be slashed into negative territory next year. Our mortgage rate forecasts have had a good clip as a result.

These developments have relevance for the housing market. We've updated our view accordingly. Our previous forecast for a 6% fall in house prices (itself one of the least pessimistic around when it was made) has been upgraded to 'just' a 2.8% fall by March 2021. Our view on regional performance remains broadly unchanged with Auckland underperforming, Canterbury outperforming, and a mixed picture amongst the regions thanks to COVID's disparate sectoral impacts (see forecast table on Page 3). Should our view pan out, it would mark a much shorter and shallower house price correction relative to the last cycle. This reflects the extraordinary support measures rolled out this time around.

We think the risk to our view is for a larger cycle. Essentially, a bigger upswing over the coming six months, giving way to a bigger downswing thereafter.



Source: QV, ASB



Source: QV, ASB

Mortgage stimulus will keep coming

The biggest driver of our forecast upgrade is the change to our interest rate view, a view that is now the consensus.

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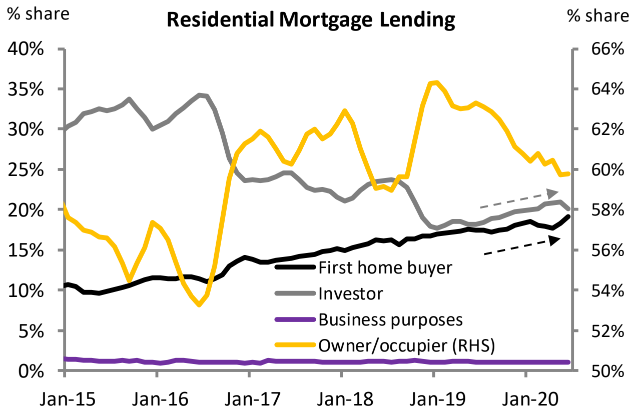
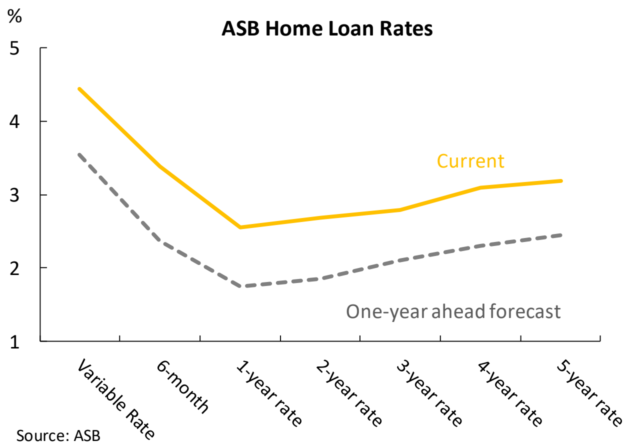
We expect the RBNZ to lower the OCR to -0.5% in April next year. The bizarre concept of negative interest rates is getting plenty of press, but bear in mind it will only be a phenomenon for wholesale interest rate markets. Retail interest rates like mortgage rates are very unlikely to go negative. This has been the experience in the offshore jurisdictions that have adopted negative policy rates.

What negative wholesale interest rates will do though, is increase the pressure on retail interest rates to fall. The same can be said for the RBNZ's touted Funding for Lending Programme which, if introduced, would see the RBNZ lend directly to banks at rates around or below zero. We expect term deposit rates to fall, and we've slashed our forecasts for mortgage rates for all terms (chart opposite).



Source: RBNZ



Source: ASB

Falling mortgage rates provide powerful stimulus to the housing market. This seems to be especially so now that structural, or long-run, mortgage rate assumptions are being revised lower. For example, banks are bringing down the hurdle rates that they test prospective borrowers' income against. This means more can be borrowed from the bank for a given level of income. This helps more first home buyers get over the line and, as we noted in our recent Home Economics publication and can be seen from the chart above, we're seeing increased activity amongst this cohort. Investors are also becoming more active again as long-run funding cost assumptions are reduced, bolstering the relative appeal of earning a 3-5% rental yield.

Our rough rule of thumb is that falls in mortgage rates feed through to house prices with around a six-month lag. Rates have been falling most of the year and further falls are expected. RBNZ data also show that over 50% of mortgages are due to re-price onto lower rates over the coming 12 months. Accordingly, stimulus for house prices from this source will continue to flow for most of 2021.

Other supports have been extended

The wage subsidy extension and mortgage holiday scheme have both been extended. Both measures have been more successful than we first imagined in insulating the labour and housing markets from some of the broader COVID/lockdown fallout. Thus, their extension promises to keep the music playing for longer.

Economy not looking as bad

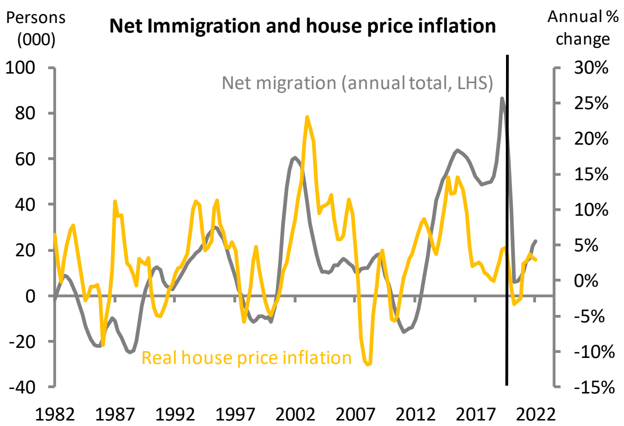
The economic outlook is looking less dire than it was 3-6 months ago. Believe it or (more likely) not, the unemployment rate is currently 4%. Yes, the second quarter labour market statistics looked a little ropey. The unemployment rate was underestimated, potentially materially so. But there's no doubt the wage subsidy and its various extensions have been very successful at limiting job losses to date. The faster-than-expected post-lockdown bounce in broader economic conditions will also serve to slow the rise in joblessness over coming months. This improvement in the, mainly short-term, labour market outlook is a positive development for NZ house prices given the strong links between unemployment, income growth, and the housing market we've discussed before.

But headwinds are still there

But we still expect a downturn. The two large headwinds that have been driving our view for house prices to ultimately fall remain in play. It's just that they are not blowing as hard, or perhaps that stimulus measures are currently providing a good enough offset.

The **unemployment rate** is rising, albeit not as quickly as we first thought. We expect it to peak around 7.5% by the middle of 2021. A rising number of job losses and a slowing in household income growth will make debt servicing more difficult and may lead to an increase in the supply of houses on the market.

Net migration has slowed sharply over the past three months and, with the borders closed for the foreseeable future, the outlook is weak. Past form suggests that this reduction in housing demand from arriving migrants can be material for long-run housing trends.



Source: QV, Statistics NZ, ASB

ASB House Price Forecasts (annual % change)			
	Sep 2020	Mar 2021	Dec 2021
Auckland	3.4%	-3.6%	3.5%
Christchurch	3.2%	-0.4%	3.5%
Wellington	4.7%	-2.3%	2.5%
Other Regions	3.8%	-3.0%	3.0%
National	**3.7%**	**-2.8%**	**3.2%**

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