

Home Economics

March 2021

Simmer Down

- Pace of house price increases to slow from here.
- As mortgage rates bottom and LVR restrictions return.
- We don't expect outright falls in house prices. The housing shortage is easing only gradually and mortgage rates are not about to race higher.

Welcome to Home Economics, our regular wrap on all things NZ housing. If you're interested in signing up for future publications, you can do so [here](#).

Our view

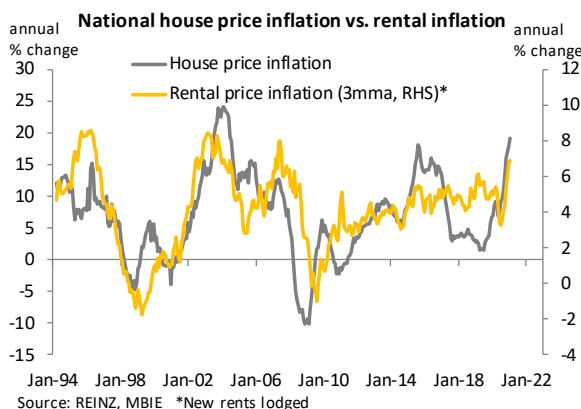
The housing market accelerated into the end of 2020, as we'd been expecting. But it now looks to us as if the momentum under house prices is finally peaking. After dining out on 2020's stimulus, the market is adjusting to reduced fiscal support and the fact mortgage rates are about as low as they will go. Credit conditions are also tightening, particularly for investors, as LVR restrictions return. Housing market activity and the pace of price gains will thus likely slow in coming months.

That doesn't mean the upturn is over. House price inflation is expected to hold a double-digit pace over the remainder of the year. A 15% expansion is forecast for the year to December (forecasts below). Still-favourable mortgage rates and short supply remain powerful tailwinds.

The outlook for 2022 is really about how quickly the residential construction boom can restore some balance to the market. Our view is that rising supply and eventual modest increases in mortgage rates will pull annual house price inflation back down to single-digit levels. At this stage we don't expect outright declines in prices.

Chart 'o' the Month

Rents join the fray



Forecasts

| ASB House Price Forecasts (QV, annual % change) | | | |
|--|------------|------------|-----------|
| | Jun 2021 | Dec 2021 | Jun 2022 |
| Auckland | 16% | 13% | 7% |
| Christchurch | 14% | 14% | 9% |
| Wellington | 21% | 14% | 8% |
| Other Regions | 24% | 16% | 8% |
| National | 22% | 15% | 8% |

Supply shortage still boosting house prices...and rents

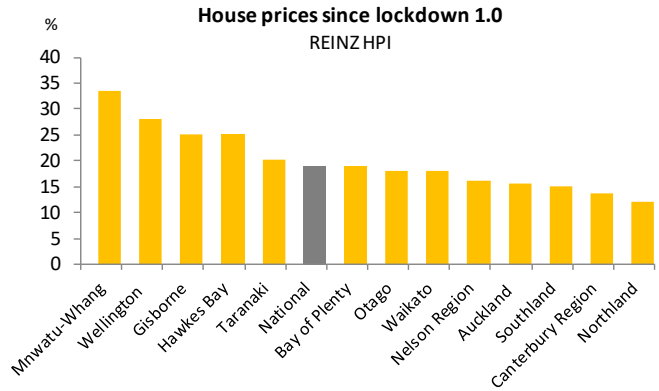
We expected the housing market to accelerate into the end of 2020 and that’s basically what we got. The pace of housing activity ran hot through the summer. Houses sold at a pace and in numbers not seen in 15 years. And while sellers scrambled to get in on the action, new listings were simply not able to keep pace with demand.

Prices soared as a result. The REINZ HPI has been increasing at an average rate of just over 2%/month since we emerged from the first lockdown in June. National house prices ended 2020 18% higher than where they began.

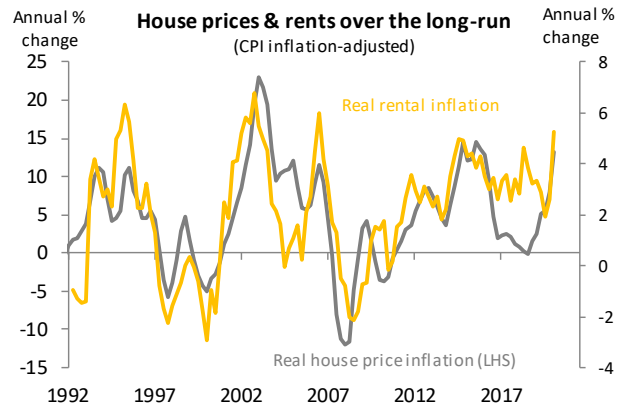
There’s been a lot of ink spilled already on the causes of the boom, so we won’t re-engage. Other than to again assert our view (see [here](#) and [here](#)) that a sluggish supply response has been a key driver, it’s not all about low interest rates.

Notable in this regard is that, alongside rapidly rising house prices, rents are now also lifting fast (chart opposite). Our smoothed measure of such based on MBIE bond data shows annual rental inflation running at almost 7%. There’s massive variability across regions – as shown in our Regional Heatmap – but 6 of the 15 regions we monitor are currently experiencing double-digit annual increases in rents.

The factor common to both soaring rental and house price inflation is a housing stock that is still running short of demand.



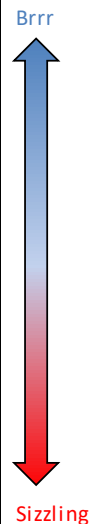
Source: REINZ, ASB



Source: QV, MBIE, Stats NZ, ASB

| ASB Housing Market Heatmap - January data | | | | | | | | | | |
|---|-------------|------|--------|--------------|--------------|-----------|--------------|------|-----------|--------------|
| | Sales (s.a) | | Prices | | Days to Sell | | Rents | | Inventory | |
| | %3m/3m | %yoy | %yoy | Dev from avg | %yoy | Yield (%) | Dev from avg | %yoy | Yield (%) | Dev from avg |
| Auckland | 9.9 | 17.7 | 17.7 | -2 | 8.7 | 3.0 | -58% | 8.7 | 3.0 | -58% |
| Canterbury | 6.1 | 15.7 | 15.7 | -4 | 7.0 | 4.2 | -73% | 7.0 | 4.2 | -73% |
| Wellington | -12.3 | 26.0 | 26.0 | 1 | 3.6 | 3.6 | -59% | 3.6 | 3.6 | -59% |
| Northland | 4.5 | 14.7 | 14.7 | -18 | 2.8 | 3.1 | -82% | 2.8 | 3.1 | -82% |
| Waikato | -3.2 | 19.8 | 19.8 | -17 | 5.6 | 3.4 | -77% | 5.6 | 3.4 | -77% |
| Hawke's Bay | -12.7 | 30.7 | 30.7 | -17 | 10.7 | 3.4 | -78% | 10.7 | 3.4 | -78% |
| Bay of Plenty | -4.8 | 22.1 | 22.1 | -13 | 6.5 | 3.1 | -83% | 6.5 | 3.1 | -83% |
| Gisborne | 14.2 | 30.7 | 30.7 | -6 | 4.4 | 4.1 | -80% | 4.4 | 4.1 | -80% |
| Manawatu-Whanganui | -11.3 | 26.0 | 26.0 | -17 | 13.3 | 3.8 | -85% | 13.3 | 3.8 | -85% |
| Taranaki | -2.0 | 20.5 | 20.5 | -23 | 10.2 | 4.0 | -79% | 10.2 | 4.0 | -79% |
| Nelson/Tasman | -15.3 | 16.0 | 16.0 | 0 | 7.6 | 3.1 | -67% | 7.6 | 3.1 | -67% |
| Marlborough | -22.5 | 16.0 | 16.0 | -17 | 16.6 | 4.3 | -70% | 16.6 | 4.3 | -70% |
| West Coast S.I. | 23.5 | 16.0 | 16.0 | -55 | 9.7 | 8.4 | -84% | 9.7 | 8.4 | -84% |
| Otago | 2.5 | 12.6 | 12.6 | -5 | 10.6 | 3.7 | -63% | 10.6 | 3.7 | -63% |
| Southland | -0.2 | 16.2 | 16.2 | -5 | 12.2 | 4.2 | -73% | 12.2 | 4.2 | -73% |

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



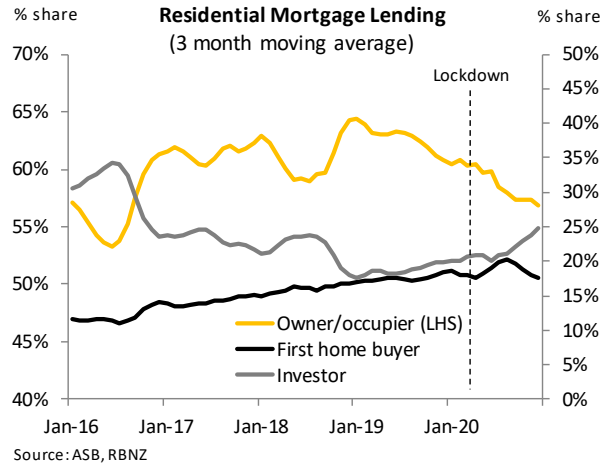
Below, we assess the impact of recent developments for our housing market view.

LVR restrictions to inject some restraint

We were among the first to [flag](#) the strong investor component running through the 2020 housing boom.

High loan-to-value investor lending (>70% LVR) accounted for around 8% of total residential mortgage lending in the three months to December, up from around 3% pre-COVID. Total investor lending has increased to 25% of the total (chart opposite). So it's a significant part of the market. As a consequence, the return of loan-to-value restrictions for investors (to <60% LVR by May) will see demand from this segment cool a little.

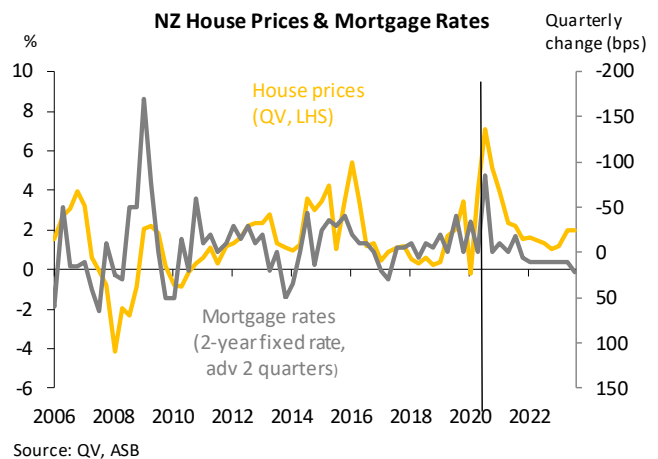
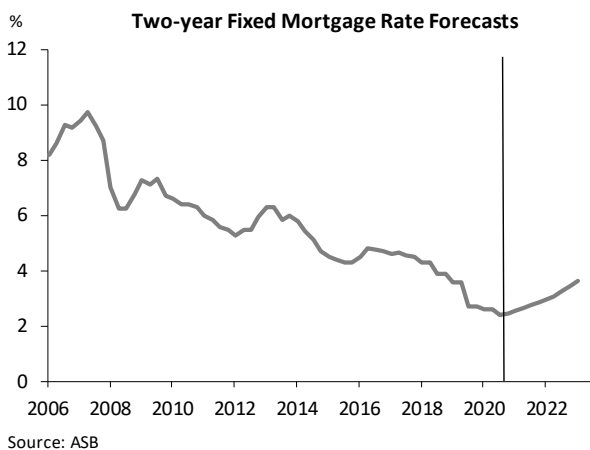
Yes, investors have built up plenty of equity through the most recent boom. But the ability to gear up is an important part of housing investors' return on equity so restricting the flow of credit to this sector will lead to a noticeable reduction in housing activity, in our view.



Mortgage rate support thinning

Developments in interest rate markets in 2021 have seen us grow more confident that the NZ house price impulse is peaking. There's not a lot more juice left in the mortgage rate pipe in our view.

We find changes in mortgage rates tend to flow through to house prices with around a two-quarter lag. Our simple mortgage rate model has actually done a good job of predicting short-term house price movements lately. The chart (below right) shows that the big fall in mortgage rates in the June (lockdown) quarter duly went on to produce a large house price impulse two quarters later in December. More recent, smaller, mortgage rate falls are expected to proffer some support for house prices over the coming 3-6 months.



But that might be about it. Wholesale interest rates are now soaring as financial markets factor in a brighter 2022 with vaccines, above-trend global growth, and less working-from-home-while-trying-to-get-kids-to-do-schoolwork. We think this trend for higher wholesale rates is here to stay. This being the case, the days of ever-lower mortgage rates are numbered. Our forecasts have fixed mortgage rates starting to turn gently higher from late 2021 (chart above), removing what has been a key source of support for the housing market over the past 12 months.

Supply is (still) coming

Residential construction is booming, and population growth has slumped. These factors have both contributed to a

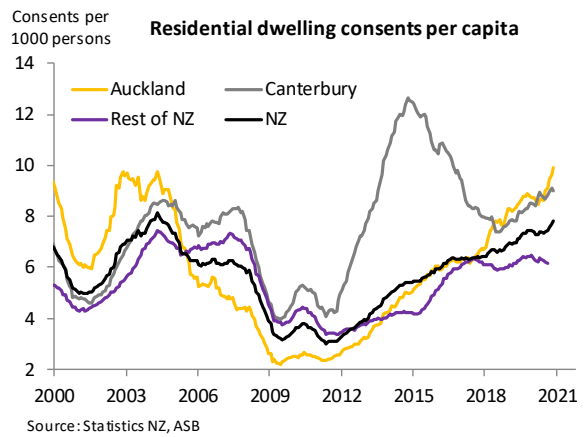
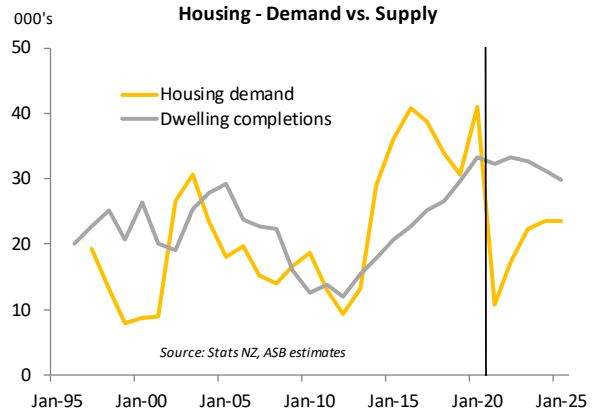
reduction in the housing shortage, but progress has been slow. The shortage built steadily over five years and will take some time to correct.

Our recent [note](#) on the Canterbury experience showed that adjustments in the supply of housing, when they come, can have a durable effect on rents and house prices.

We don't think we're feeling the effects yet. NZ-wide housing inventory is still a whopping 50% below the long-run average according to realestate.co.nz data. The shortage is particularly acute in Gisborne (75% below average), Hawke's Bay (68% below average), and Manawatu-Wanganui (70% below average). It's no coincidence that these regions have also experienced the most rapid house price gains in the country over the past year.

We think it will be late 2021 before the supply response underway starts to restore some balance to the housing market. This is implicit in our forecasts for house price inflation to cool back to single-digit levels over 2022.

Will we see house price declines? At this stage we don't think so. In our view it would take a much more aggressive either supply response or interest rate shock relative to our what we are forecasting for house prices to start falling in the next couple of years. Valuation metrics are very stretched though, so the risk has risen.



The table below summarises the various drivers of house price inflation and their impact on our view.

| House Price Driver | Current | Next 12 months | Comment |
|--------------------|---------|----------------|--|
| Mortgage Rates | ● ● | ● | We find mortgage rates to be a strong driver of house prices, with around a six-month lead. Recent cuts to mortgage rates will support the market over H1 2021 but after that support from this source will end. |
| Population Growth | ● | ● | Population growth has slowed with migration stalled thanks to the closed borders. We expect it to slowly recover in the next 12 months. |
| Housing Supply | ● | ● | Booming construction/slowing population growth is helping to reduce NZ's housing shortage, but restoring balance to the market will take time. |
| Labour market | ● | ● | NZ's labour market has proven remarkably resilient, and we think the peak in unemployment is behind us. We also expect wage growth to accelerate from here. All of which should underpin housing demand. |
| Housing Policies | ● ● | ● ? | A lot of 2020's stimulus found its way into the housing market, intentionally or not. But LVR restrictions are coming back, some fiscal support is being wound up, and the government has promised a "rolling series of measures" to combat high house prices, the details of which remain to be seen. |

What's all this about RBNZ "targeting" house prices?

The NZ Government and the RBNZ have finally agreed on what the RBNZ will do about house prices in future.


The important thing is that, in our view, this agreement won't substantially change how the RBNZ will set interest

rates in future, nor does it materially alter our current view about house price trends over the next few years. What it does do is reinforce the risk of the RBNZ unleashing some additional macro-prudential tools later this year if the housing market doesn't soon cool off a bit.

Stepping back, the RBNZ has two main jobs: 1) monetary policy (*usually* just the setting of interest rates), and 2) ensuring financial stability. House prices are now a consideration in both.

- On the monetary policy side, the two primary objectives – maintaining low and stable inflation and supporting maximum sustainable employment – remain the same. The RBNZ need only “assess the effect” of its interest rate decisions on house prices, rather than target them directly. The RBNZ thinks about house prices in its interest rate decisions already, so this is arguably a maintenance of the status quo.
- The commitment under the RBNZ’s financial stability mandate is stronger. The Bank needs to “have regard” to government policy around housing, which is essentially more “sustainable” levels of house price inflation and reduced participation from investors. The RBNZ had already decided to bring back LVR limits in March, with a further tightening of limits for investors in May. But the Finance Minister appears to have softened his stance around the RBNZ also potentially using “DTIs” (debt-to-income) limits in future, similar to those in used in the UK/Ireland. Restrictions on interest-only mortgages are also being looked at.

Our view is that there is a high chance of one or both of the above being added to the toolkit this year. Controlling house prices is not only needed from a financial stability standpoint, but will also be necessary if the RBNZ is to maintain its commitment to keep to keep monetary policy accommodative for a “prolonged period of time.”

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