Revisiting our housing and mortgage rate forecast for 2018 - Squirrel

Mortgage rates

At the start of the year we said mortgage rates would stay stubbornly low and so far that's the case. We are still seeing two and three year fixed rates at historically low levels with three year rates as low as 4.60%.

There is noise that these rates will increase, given that rates are increasing in the United States. The Fed increased its rate to 1.75% in March and then to 2.00% in June. For the first time that I know of US interest rates are higher than NZ. The US 10-year Treasury rate, which is more indicative for US mortgages rates, has been on a gradual increase since late 2017 from around 2.25% to 2.90%. Meanwhile, our 10-year Government bond rate is similarly around 3.00%.

As a result, the NZD has dropped again and is back below 0.70 against the USD and the market still looks bearish. That's a bummer for those of you travelling overseas!

Inflation

Our Reserve Bank has signaled that the official cash rate in New Zealand will stay accommodative (plain speak "low") through to 2019. Inflation is still subdued and mortgage debt growth is in check. House price inflation also looks under control given much tighter credit markets and various restrictions.

Higher US rates will increase bank offshore funding costs, but this only makes up about 25% of funding. A sizeable 1% lift in offshore funding rates equates to around 0.25% increase in the overall cost of bank funding. Offsetting that, credit spreads (the premiums banks pay above Government rates) have generally been dropping.

What that means for us regular folk is that (1) you will hear a lot of talk from banks about needing to increase rates BUT (2) it won't happen and competitive pressure will keep rates where they are. By now you should be used to bank economists talking up rates. Industry profits of $5 billion are not enough…smile.

So what about house prices?

Sales volumes were subdued in the first half and we've entered a steady state, albeit with low sales activity. Outside of Auckland was going gangbusters last year with record median house prices across NZ. From my perspective, that's run its course and the whole market will follow Auckland into a semi-comatose slumber.

Prices have fallen a bit around the fringes of the market, but we haven't seen a full blown retreat. My view is we won't but sales volumes will stay low. Anyone in a forced-sale situation is likely to get burned as will builders and developers who will struggle with turnover. Interestingly, in Australia house prices (aka apartment prices) are falling in Sydney and Melbourne. Typical Australians, they partied on way longer than us and are much more exposed to apartment development.