Home Economics

October 2020

Housing shortage sustaining house price momentum

- Blink and you would've missed it. The housing "correction" is behind us.
- A more severe housing shortage, a less gloomy outlook for the labour market, and the RBNZ's effective "green light" for asset price cycles all promise to keep house prices rising at a rapid clip over the coming 12 months. Flat-lining net migration and some roll-back of policy support will slow rather than stall the market next year.
- We have materially upgraded our forecasts. We now expect annual house price inflation of 9% by year end, and have flipped the small negative we had in for June 2021 to an 11% positive annual increase.

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.

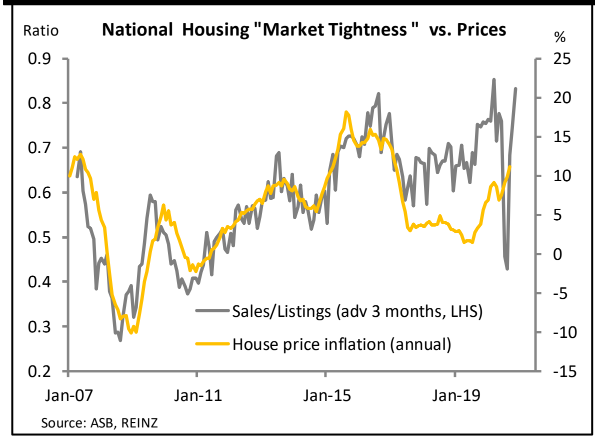
Our view

It now looks as if the April/May falls in house prices were merely a blip rather than the start of a new downtrend. House prices bounced out of lockdown in impressive fashion and short-term indicators point to few signs of the market about to slow down.

What happened to the house price correction everyone was talking about? We think the unusual nature of the 2020 recession and the fact the housing shortage now looks more severe than first thought are two key reasons for the market's resilience. And with the labour market outlook now looking much less gloomy and the RBNZ seemingly actively egging the market on, we think house price inflation will hold up at near double-digit growth rates at least through the first half of 2021.

Chart 'o' the Month

Tight market = high prices



Forecasts

ASB House Price Forecasts
(QV, annual % change)

	Dec 2020	Jun 2021	Dec 2021
Auckland	8.7%	10.4%	7.7%
Christchurch	6.0%	10.2%	7.7%
Wellington	10.8%	11.8%	7.2%
Other Regions	9.8%	12.2%	9.3%
National	**9.1%**	**11.3%**	**8.4%**

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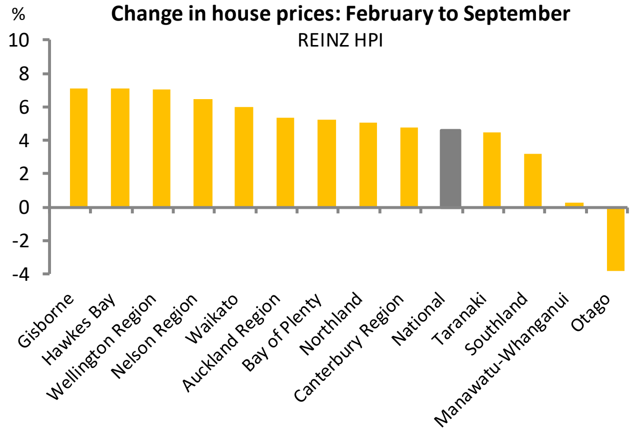
What happened to the housing downturn?

Blink, and you would have missed it. House prices fell a cumulative 2.3% through the lockdown months from March to May. But rather than this being the start of a new trend, it now looks as if that it was a merely blip in the housing uptrend that began around this time last year.

Since May, national house prices have rebounded over 6% to a fresh record high. And the short-term indicators that we monitor point to few signs of the market about to slow down anytime soon. We have revised up materially our house price forecasts as a result (forecast table above).



Source: ASB, REINZ

Going into lockdown, most pundits and government agencies forecast a material housing market correction to accompany NZ's deepest ever economic recession. We were among them, albeit we were the least pessimistic, calling "just" a 6% fall in prices. Predictions of house price declines well into double-digit territory were commonplace.

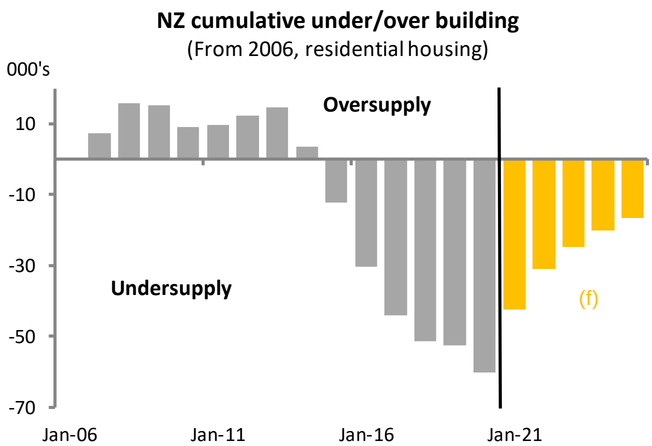
So why was this time different?

The last four times NZ experienced or skirted economic recession, annual house price inflation in NZ went negative. This time appears to be different. Why?

We think there are two key factors. First, this recession was different. It was an (entirely appropriate) orchestrated recession that was necessary to save lives. It was short, and very sharp. But because of the economic pain imposed by lockdown, an enormous amount of stimulus was unleashed as life support. Much of this stimulus was either directed at, or found its way into, the housing market.

The massive scale of such is something we've not seen in past recessions. The combined effects of the wage subsidy, mortgage-holiday scheme, the removal of the LVRs, and steep cuts to mortgage rates effectively changed the game. In past recessions, economy-wide job losses have led to forced selling of houses, with this jump in supply crunching house prices. To date, we've actually seen the opposite. Measures of housing inventory are back down to outrageously low levels. For example, September figures from realestate.co.nz show national listings close to the lowest level on record, equivalent to just 12 weeks' worth of sales. The long-run average is 28 weeks' worth.

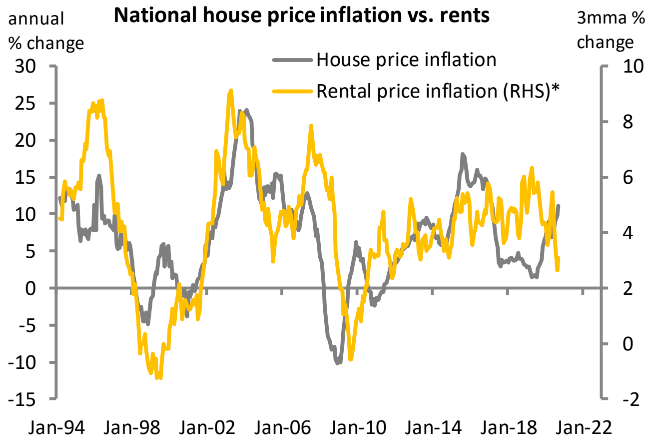
This speaks to the second factor we believe is behind the housing resurgence, a more severe housing shortage. It now looks as if the shortage that developed over the past five years was larger than most appreciated. We've updated our estimates of such to reflect Stats NZ's recently upgraded population estimates. The upshot is that NZ's long-running residential construction under-build has produced a shortage of around 60-65k houses, around twice what was previously assumed.



Source: Statistics NZ, ASB

Getting a precise estimate on this sort of stuff is impossible due to data quality issues. But our larger housing shortage estimates reconcile more readily with the sheer strength in housing activity and prices we're witnessing now. All the stimulus noted above has simply exacerbated this position of excess demand and the tightness of the market that is now evident. In short, there's a scramble for houses.

The fact rents haven't really fallen to the extent expected is another factor confirming the tightness of the market. Average rents on new tenancies are down only 1-2% since February. In some regional hot spots (see Regional Heatmap below), rents have actually risen meaningfully.



Source: REINZ, MBIE *New rents lodged

It's worth noting, NZ's recent experience in all of this is not unique. Most of the developed world has experienced surprise housing strength in the face of COVID's various challenges. As *The Economist* notes, house prices rose in eight out of ten high and middle-income countries during lockdown. And most of these countries are suffering noticeably worse health and economic conditions than NZ.

ASB Housing Market Heatmap - September

	Sales (s.a)	Prices	Days to Sell	Rents		Inventory	
	%3m/3m	%yoy	Dev from avg	%yoy	Yield (%)	Dev from avg	
Auckland	130.0	11.4	-1	1.5	2.9	-43%	Brrr
Canterbury	91.4	7.7	-7	2.3	3.7	-50%	
Wellington	84.5	14.5	-9	2.5	3.4	-63%	
Northland	120.0	10.3	-22	2.9	3.5	-71%	
Waikato	111.6	11.8	-19	5.4	3.3	-63%	
Hawke's Bay	82.0	15.8	-16	6.2	3.7	-72%	
Bay of Plenty	119.5	9.1	-17	3.4	3.3	-68%	
Gisborne	41.3	15.8	-10	14.3	3.2	-25%	
Manawatu-Whanganui	97.0	11.8	-24	8.1	3.8	-77%	
Taranaki	76.4	12.8	-23	5.4	3.8	-56%	
Nelson/Tasman	154.1	10.7	-10	-0.6	3.0	-65%	
Marlborough	80.5	10.7	-23	5.5	3.9	-63%	
West Coast S.I.	64.9	10.7	-31	13.9	8.7	-52%	
Otago	93.3	4.1	-10	3.0	3.8	-20%	
Southland	69.9	13.1	-10	10.6	4.5	-61%	Sizzling

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

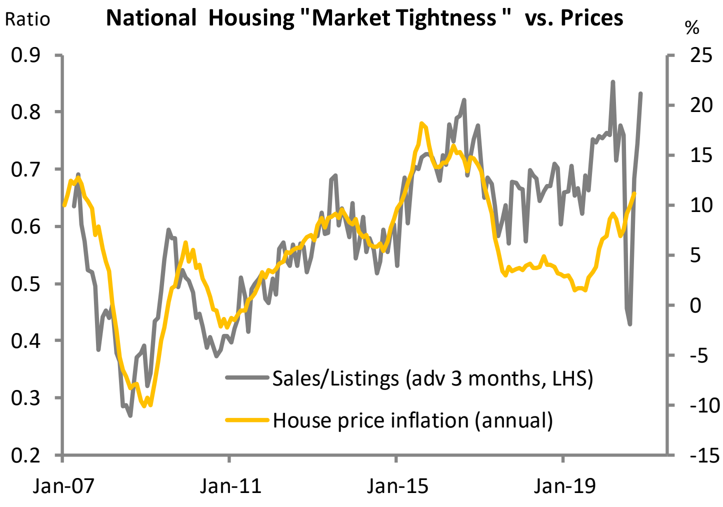
What's the view now?

Short-term

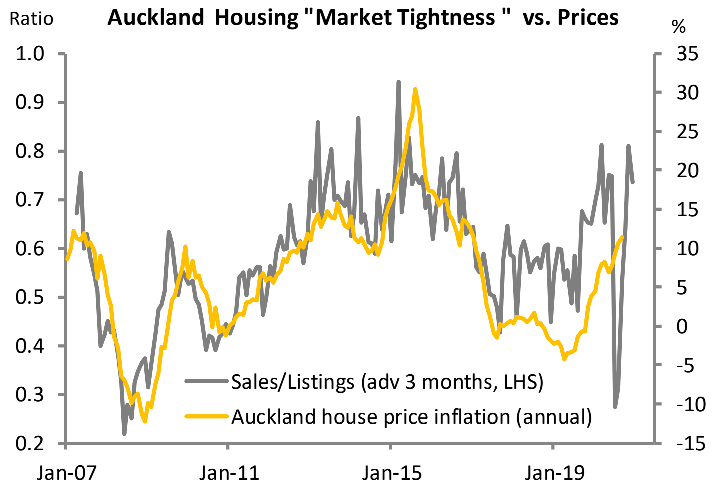
The market has tightened significantly over the past three months. This promises to keep housing market momentum humming and prices rising in the short term.

Housing turnover, at around 8000 sales/month, is running around 25% stronger than the 2019 average – the strongest pace since 2016. There's probably still some pent-up demand from lockdown in these numbers but, even allowing for this, historical relationships suggest that this amount of churn and activity is consistent with annual house price inflation in a 10-15% range.

Sales-to-listing ratios – our preferred short-term indicator – confirm this picture of market tightness. Just under 75% of new listings are selling in Auckland and just over 80% nationally. The latter ratio is around the highest it's been in over a decade. It's not surprising inventory is so low. The relationship of these ratios to house prices is, unsurprisingly, very strong in the short term.



Source: ASB, REINZ



Source: ASB, REINZ

We acknowledge the longer-term outlook remains murky, but at least in the short term it appears there is plenty of fuel in the market's tank and we'd be remiss not to bump up our short-term house price forecasts. These are now consistent with double-digit or near-double digit house price inflation continuing right through the first half of 2021.

What of election impacts? It's a non-issue this time around in our view. House prices, and the taxation of associated capital gains, are not defining issues as they have been in past elections.

Further ahead

House price cycles tend to exhibit a reasonable degree of momentum. So we expect the current upswing will run through most of next year. From there, it's about three key factors.

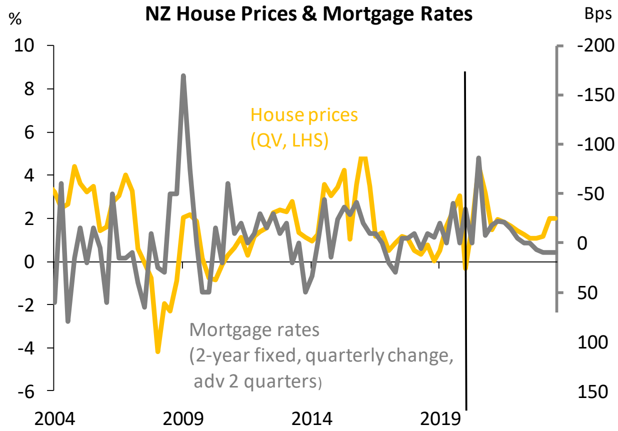
1. <u>The labour market</u>. We've been expecting a rising tide of job losses and weaker household income growth to stiffen the headwinds facing the housing market. These impacts are now expected to be less severe. The outlook for the labour market has improved, consistent with the less gloomy economic outlook more generally.

   The timeliest labour market indicators we have like Stats NZ's Monthly Employment Indicator and MBIE's Jobseeker series have remained remarkably resilient. More so than we might have expected now that the wage subsidy has ended. The latest (August) reading of the former revealed paid jobs have actually rebounded back above pre-COVID levels. The lift in jobs numbers through this period is impressive, although it has not quite kept pace with population growth. As a result, the percentage of the population unemployed is still rising. We forecast a 5.8% unemployment rate for the second quarter. Further ahead, the recent recovery in business confidence bolsters our hope that firms won't be forced to resort to another round of wide-spread layoffs. Firms' employment intentions are now consistent with roughly flat employment growth, rather than something deeply negative.

   None of this is to say we are past the worst for the labour market. We suspect there's still some right-sizing of staffing levels to the post wage-subsidy reality that will take place over the coming six months. The tourism industry faces a summer of discontent as impetus from domestic tourism fades and the usual foreign visitor high season doesn't occur. Unemployment is expected to continue rising through to around the middle of 2021, but the forecast peak in the high 6's is expected to be noticeably lower than previously expected.

2. <u>Mortgage rates</u>. We still think there's a good chance we see sub-2% mortgage rates next year. Despite the green shoots sprouting in parts of the economy, the RBNZ appears intent on pushing interest rates lower through

whatever means necessary. Direct lending to banks looks like a done deal before Christmas, and our sense is that a negative Official Cash Rate in 2021 is still more likely than not. The Bank is not particularly concerned about booming asset prices. In fact, if anything the Bank is actively encouraging asset price cycles, and recently downplayed the possible return of LVR restrictions when they are next reviewed in May. We wouldn't be surprised if this view changed by the time May rolls around.



Source: QV, ASB

Falling mortgage rates tend to stimulate house prices with a 3-6 month lag. Given recent and expected future mortgage rate cuts, we think stimulus from this source will continue to flow for most of 2021 (chart opposite).

3. Migration

Inward permanent and long-term migration has effectively stalled with the borders closed. It's down to an average of 340 people over the past five months, from an average of 9,500/month the five months before that. It's impossible to know when this might change, but it seems unlikely to change anytime soon.

Prima facie, this is a potentially important reduction in the demand for housing, and hence a negative influence on prices. However, there are two softening factors to take into account. First, the stalling in migration won't be enough to flip the housing shortage into a surplus. It will mean the shortage will ease more quickly, but it will still take some years for residential building activity to catch up. Second, past episodes of negative real house price inflation tend to coincide with negative annual net migration (i.e. people leaving NZ on net). We don't expect such a scenario in the current cycle. A long period of low net inward migration seems more likely.

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 reliable driver of house prices, with around a six-month lead. Mortgage rates rates have fallen a long way in 2020 and we forecast a sub 2% 2-year rate in 2021.
Population Growth	🔴	🔴	Falling inward migration will result in a sharp slowing in population growth. This will slow rather than stall the housing market.
Housing Supply	🟢	🟡	Housing construction ramped up over the past year, but it hasn't been enough to put a decent dent in NZ's housing shortage. We now believe this equates to around 66-65k homes.
Labour market	🟡	🔴	NZ's labour market has deteriorated but the worst has been avoided with the unemployment rate now likely to reach 'only' the high 6's.
Housing Policies	🟢	🟢	Policy-makers want asset price cycles to save us from COVID economic fallout and policies have thus been laid out to provide support. Some of these will be wound back in 2021.

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