focus

From Housing Gloom to **Housing Boom**

Back in April, economists were grabbing news headlines with predictions of sharp house price declines. The housing market typically does not do well in a recession, and closed borders shut the door on demand from new migrants. Economists, however, could not have been more wrong.

In October we saw house prices hit record highs in every region of the country. Why was economists' pessimism so misplaced?

In our view, the strength of house prices is largely explained by five factors:

Record low mortgage rates

Government support for jobs and income

A greater desire to "nest"

A surge in Kiwis returning home in the early stages of the pandemic

An acute shortage of available houses

FORSYTH BARR

Record low mortgage rates

The Reserve Bank of New Zealand has followed central banks around the world in slashing interest rates. Mortgage rates are at unprecedented lows. The average two-year fixed mortgage rate is 2.6% per annum, down from 3.5% at the beginning of the year.

Unsurprisingly, there is a strong link between lower interest rates and higher house prices. Borrowers can afford to take out larger mortgages. Investors are willing to pay more for property because returns on other assets, including term deposits and bonds, are lower.

The *Cost of Servicing a Mortgage* chart on the right shows the cost to a home buyer of servicing an 80% mortgage on the average New Zealand house. As mortgage rates have fallen, house prices have risen. Since 2008 the cost of servicing the mortgage as a proportion of income has been broadly stable (although, of course, the deposit required has continued to increase).

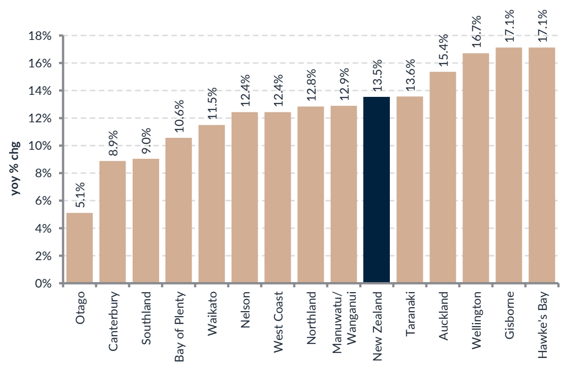
Government support for jobs and incomes

In a typical recession people lose jobs and incomes fall. That leads to heightened caution from households, and potentially even distressed home sales. But this time the government has supported jobs and incomes with wage subsidies and expanded unemployment benefits. Unemployment has also been much better than most economists forecast. Most jobs that have been lost are in the service sector where people are more likely to be younger, lower-wage earners and NOT homeowners. Borrowers have also been allowed to suspend mortgage payments – at the peak in June around 11% of all home loans were on deferred or reduced payment plans. By the first week of November this was down to 2%.

A greater desire to "nest"

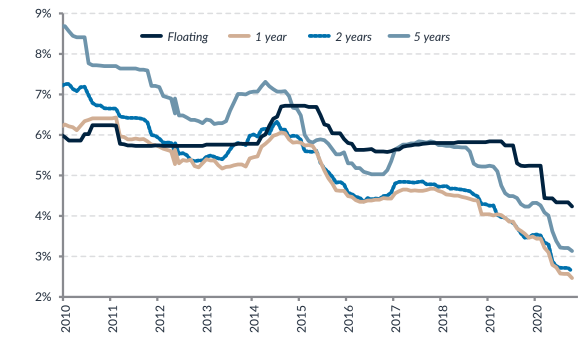
Most people have spent a lot more time at home this year. For many that has motivated an upgrade of furnishings and appliances, a kitchen or bathroom renovation, or a desire to move homes. Spending on anything associated with housing has boomed. People are looking for more space either nearby or further afield – internationally there is evidence more people are shifting from the inner city to the suburbs, or from major centres to the regions (the New York apartment market is weak, but suburban and regional prices have been strong). We are hearing similar anecdotes in New Zealand.

NZ HOUSE PRICES: YEAR-ON-YEAR PERCENTAGE CHANGE



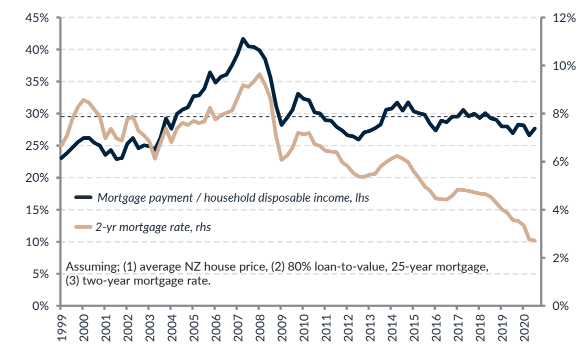
Source: REINZ, Forsyth Barr research

MORTGAGE RATES



Source: interest.co.nz, Forsyth Barr research

COST OF SERVICING A MORTGAGE



Source: REINZ, RBNZ, interest.co.nz, Forsyth Barr research

Kiwis returning home

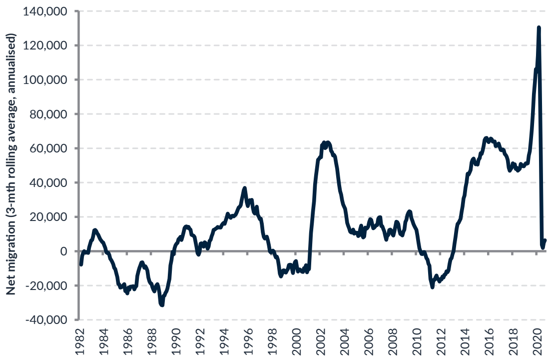
High numbers of new migrants have boosted New Zealand's housing demand since 2014. Recently, stories about scores of returning New Zealanders buying up houses have been common. This may be a tad overstated. There was a surge of returnees early in the pandemic. Since April, however, while the borders have been closed, this has reduced to a trickle. In the year ended March 2020 an estimated 95,000 net migrants entered New Zealand. In the past six months this has dropped to 2,500.

Once borders re-open we do expect migrants will return. New Zealand's brand has likely benefited from the international media's positive portrayal of our handling of COVID-19. Back in July Immigration NZ admitted to a surge of interest from potential new migrants, and more than 100,000 visa applications sitting in a queue.

An acute shortage of available houses

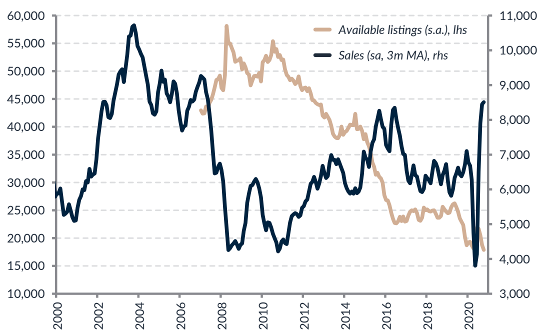
The boom in house sales (which are at levels not seen since 2007, before the Global Financial Crisis) driven by low interest rates, Kiwis returning, and nesting has been met with an acute shortage of stock. In our view, this lack of supply most likely reflects a housing shortage that's built up over many years. Restrictions on land use and other factors have meant new construction has not kept pace with demand. Lack of supply is evident throughout the country. Even those with the most basic economic education understand that when demand substantially outpaces supply prices go up.

NET MIGRATION



Source: Stats NZ, Forsyth Barr research

HOUSE SALES VS. HOUSES AVAILABLE FOR SALE



Source: REINZ, RBNZ, interest.co.nz, Forsyth Barr research

Housing has supported the economy's resilience

Housing is New Zealand's largest asset class. House prices have important flow on effects on the economy. They impact consumer confidence, construction activity, and retail sales — particularly of housing-related goods.

...We are not predicting house prices are going to fall significantly any time soon.....

During the Global Financial Crisis New Zealand house prices fell 11%, and, for the two-thirds of homeowners who have mortgages, their equity fell by more. Housing construction fell to its lowest level since World War II, and the economic recovery in the years that followed was sluggish.

This time around house prices have had the opposite effect, helping the economy to be much more resilient than most expected. (There are negatives as well, particularly over the long-term. Higher house prices contribute to higher inequality, and can drive critical workers out of expensive cities).

Can house prices continue the upward climb?

The economic outlook remains uncertain, and governments can't band aid economies forever. Furthermore, last week the RBNZ has announced it will reinstate loan-to-value ratio (LVR) restrictions on high-risk lending from March next year. What likely won't change though is New Zealanders aspirations for home ownership, ultra-low mortgage rates, and tight housing supply, which, when borders re-open, will likely all be compounded by people returning home or immigrating here. We are not predicting that house prices are going to fall significantly any time soon.

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Understanding that sudden changes in financial markets can cause concern or indicate opportunity, your Forsyth Barr Investment Adviser is available to provide you with advice and assistance at any time.

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