WESTPAC HOME TRUTHS

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Down, more or less.

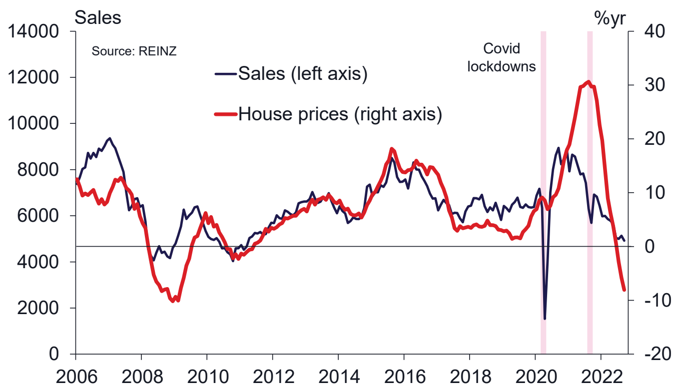
- New Zealand's housing market remains soft, with a low level of sales and a continued drop in prices.
- Higher interest rates have been the main driver of the downturn. Based on the current level of interest rates, we think that house prices still have further to adjust.
- We continue to expect a total peak-to-trough fall of 15% over this year and the next.
- New listings are falling as property owners have come to accept that they won't get the prices they would have hoped for.
- In this edition of Home Truths we take a closer look at the performance of the housing market across regions.
- Prices have come down from their peaks everywhere, but the main centres have seen the biggest falls to date.
- The stock of unsold homes has risen as demand has cooled, but there is less of an overhang in the south than in the north.

New Zealand's housing market remained soggy in September, with turnover well below average and prices continuing to fall. There is some semblance of balance returning to the market, though it's coming from a drop in supply, rather than a pickup in demand. So while that may help to stem the downward pressure on prices in the coming months, it doesn't point to a recovery any time soon.

September saw the REINZ house price index fall by 1.6% in seasonally adjusted terms, a similar pace of decline to the previous few months. While the unadjusted index fell by just 0.7% for the month, there's usually a modest uplift in prices in the final months of the year, a pattern that hasn't eventuated this time.

Overall prices are now down 11% from their peak in November last year. That's a very large fall on its own, but it simply mirrors the ferocity of the upswing in prices in the previous year or so – average prices are still only back to where they were last April.

REINZ house sales and prices

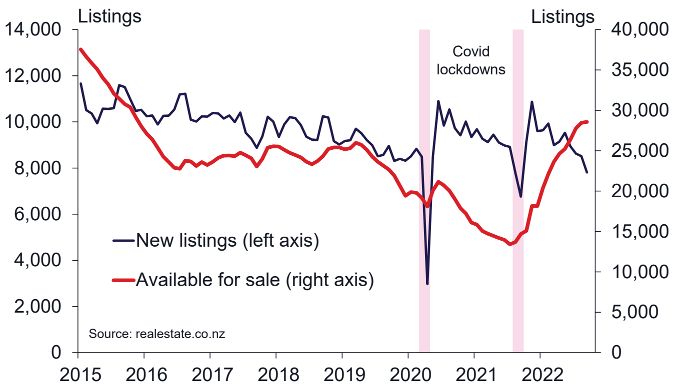


House sales were down 4% in seasonally adjusted terms in September. The usual undercount on the first release means that this is likely to be revised to more like a 1-2% decline, and suggests that sales have flattened out in the last few months. The level of sales remains very low – comparable to what we saw in the early 2010s in the wake of the Global Financial Crisis. And houses are also taking much longer to sell – a median of 49 days, compared to a low of 28 days last year.

The stock of unsold homes on the market has risen sharply over the last year, although there are tentative signs that it is plateauing. That's not because buyers are returning, though. Rather, it's because the flow of new listings is falling to match the slow pace of sales, as property owners have come to accept that they won't get the prices they would have hoped for.

That withdrawal of potential sellers tends to slow the price discovery process. Bear in mind that we only observe the values of the houses that do change hands, not the ones where the seller rejects a low offer (or receives none at all). This means that prices likely have further to adjust lower before the market stabilises.

Property listings, seasonally adjusted

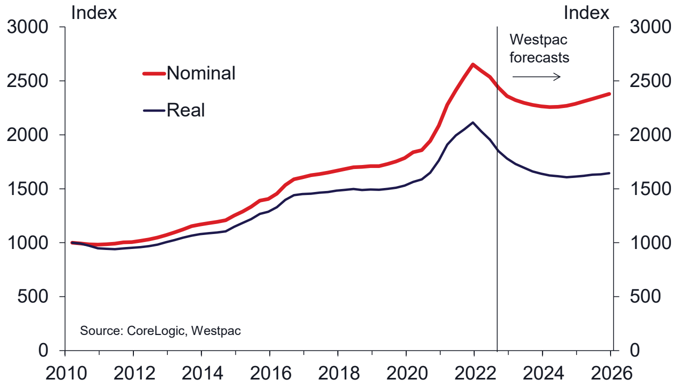


Our forecast remains for a combined 15% fall in prices over this year and next year, based on the quarterly house price index calculated by CoreLogic, which is the highest-quality measure of prices on a like-for-like basis. Note that a quarterly measure will tend to file down the peaks and troughs that we'd see in a higher-frequency measure, so our forecast equates to more like a 17% fall in the monthly REINZ index.

The driver of the housing market's decline remains the same as it has been for the last year: higher mortgage rates. As the country emerged from the first Covid lockdown, record-low interest rates – and the widespread belief that they would remain low for years to come – helped to turbocharge the property market through much of 2020 and 2021. But even in that time, it was becoming apparent that low interest rates were no longer warranted, and that the legacy of Covid was not recession but inflation.

The housing market is now in the process of reversing that stimulus-driven surge in prices. Our forecast of a 15% fall is consistent with prices returning to their pre-Covid level in real (adjusted for inflation) terms. Of course, that reversal is being aided by the fact that inflation has picked up sharply over the last year, and it's expected to remain high for a while longer.

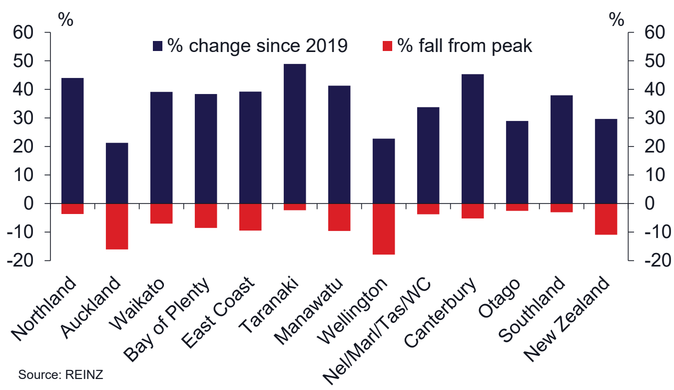
House price forecasts



Town and country – a look at housing markets across the motu.

Higher interest rates are a fairly blunt tool, so not surprisingly the trend of low sales and falling prices has been broadly repeated across the country. Even so, there have been some notable differences in regional performance, as the chart below shows. For one thing, there's a notable split between the main centres and the rest. The biggest price falls have been in Auckland (down 16% from last year's peak) and Wellington (down 18%). And other cities have tended to do worse than their surrounding regions, with Hamilton down 10%, Christchurch down 7% and Dunedin down 8%.

House price changes by region



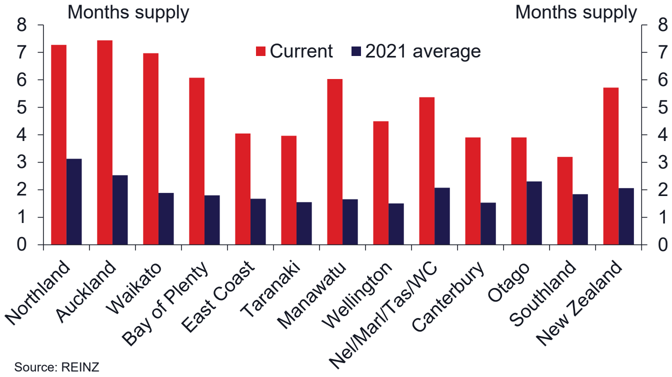
Auckland's relatively large decline is understandable. Investors have tended to play a more prominent role in the Auckland market. Consequently, last year's reintroduction of loan-to-value restrictions and the changes to the tax treatment of property investors will have had a greater impact on demand for houses in Auckland than in other regions. Another factor is that Auckland has been almost alone in seeing a fall in its population over the last year or so – the usual inflow of foreign migrants has been largely turned off, while the usual flow of Aucklanders to other parts of the country has continued.

While the headwinds for Auckland are all too apparent, it's less clear why Wellington has actually found itself at the bottom of the table. Part of the reason is that it saw one of the most overheated run-ups in house prices over 2020 and 2021, but that itself requires an explanation. One plausible explanation we've heard is that demand was driven by enthusiasm for small-scale property development – buying sections with single homes, removing them and replacing them with multiple townhouses. This kind of development certainly has its place in the market – indeed, it's played a major part in addressing Auckland's housing shortage. But in Wellington's case, over-enthusiasm may have led people to pay top dollar for sections that are fairly marginal in terms of their redevelopment potential.

Outside the main centres, house prices have also come off their peaks in recent months, but to a smaller degree. And of course, everywhere you go, prices are still much higher than they were before the pandemic and the period of ultra-low interest rates. Interestingly, prices have barely fallen in the Queenstown-Lakes district, despite being the region that was hardest-hit by the border closure over the past couple of years. With the international tourist market now returning rapidly, it's hard to argue that the pain for the region's property market still lies ahead of it.

As for where we might see the first signs of recovery, one way to gauge this is the size of the overhang of unsold homes. On this basis, the upper North Island looks to be the most out of balance – for instance, Auckland has around seven months' worth of sales currently on the market, compared to about 2.5 months last year. In contrast, the central and lower South Island looks well placed – not only have these regions seen relatively smaller price falls to date, but the supply of homes on the market appears more manageable.

Stock to sales ratio by region



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