WESTPAC ECONOMIC BULLETIN

An update on housing finances.

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Households' finances through the great re-fixing.

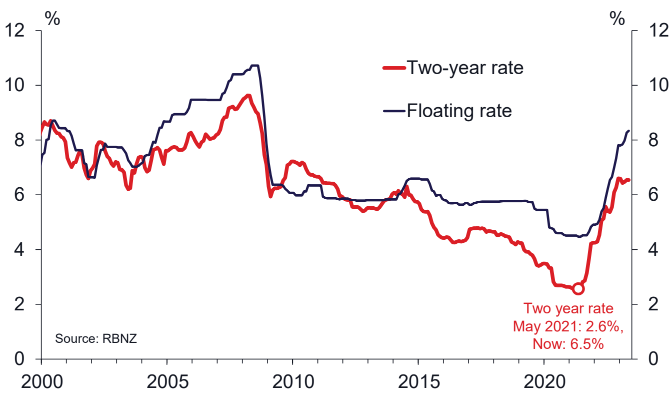
- Increasing numbers of New Zealand borrowers are now rolling on to higher mortgage rates. That's already seen household spending on debt servicing pushing higher, and we expect a further lift in interest costs over the year ahead.
- Higher interest rates are also a key reason for the sharp fall in house prices since the end of 2021. That's contributed to household wealth falling by 9%.
- The strong labour market has meant disposable income growth has remained firm. That's helped households maintain their spending levels in the face of rising interest rates and higher living costs, though many households are still doing it tough.
- Going forward, we expect the pressure on households' finances will continue to mount. And that will mean many households will need to rein in their spending.

Not only are New Zealand households grappling with the cost-of-living crisis, we're also amid 'the great re-fixing'.

Over the past year, increasing numbers of borrowers have rolled off the very low fixed mortgage rates that were on offer in the early stages of the pandemic, and on to much higher interest rates. For instance, borrowers who fixed their mortgage for two years back in May 2021 might have secured a rate of around 2.6%. But when those same borrowers go to refix now, they'll be looking at a rate of over 6%.

To put that in context, if you purchased an average priced home in most parts of the country with an 80% mortgage two years ago, the rise in interest rates could add around $900 to your monthly mortgage payments. In Auckland, where house prices tend to be higher, that rise in mortgage interest costs could be closer to $1600 per month.

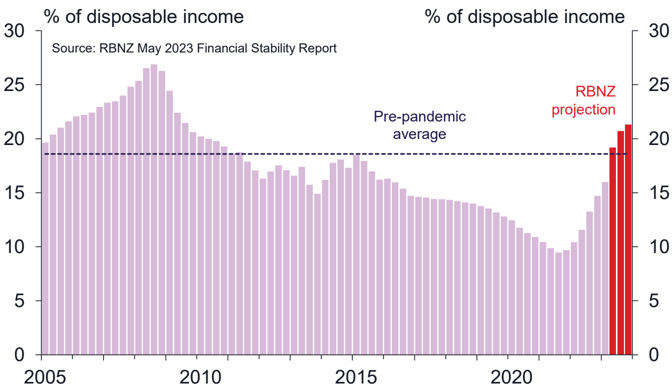
Mortgage rates



Against that backdrop, New Zealand households' spending on debt servicing is pushing higher. In fact, data recently released by Stats NZ showed that, on average, households are now spending 7.5% of their disposable income on interest payments each quarter. That's up from a low of 5% at the end of 2021.

That's still relatively low compared to prior to the pandemic when interest costs accounted for around 10% of household spending. However, we should keep in mind that these costs are not evenly shared as only around one-third of households have mortgages. Data from the RBNZ's last Financial Stability report showed that households with mortgages are already spending around 15% of their income on interest payments.

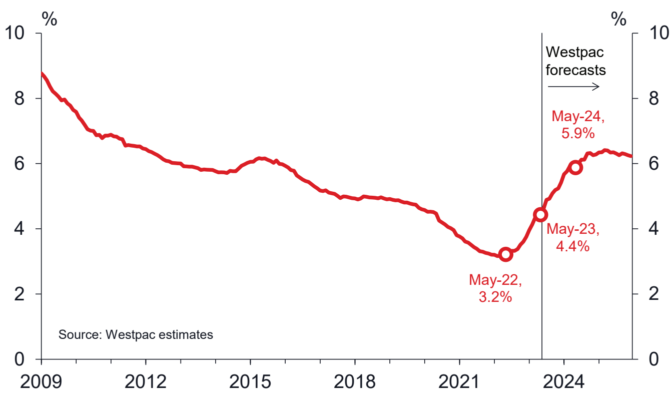
Spending on interest costs (households with mortgages)



Second, and something that will be very important for the economy over the coming year, is that the full impact of interest rate hikes is let to be felt. With 90% of New Zealand mortgages fixed for a period, the pass through of rate hikes has been gradual. In fact, accounting for the extent of mortgage rate fixing, we estimate that the average mortgage rate households are actually paying has only risen by around 120 bps to date (as a comparison, the OCR has risen by 525bps since late 2021).

Over the coming year around 50% of all mortgages will come up for repricing and will expose increasing numbers of borrowers to higher rates. As a result, the average mortgage rate that households are paying is set to rise by a further 150 bps.[1] The RBNZ estimated that households with mortgages could see the share of their incomes spent on interest costs rising to over 20% by the end of this year.

'Effective' average mortgage rate*



* The effective mortgage rate is an estimate of the average interest rate borrowers are paying on all outstanding mortgages. It adjusts for the fact that most mortgages are on fixed rates that are only periodically renegotiated, rather than paying the interest rates that are currently on offer.

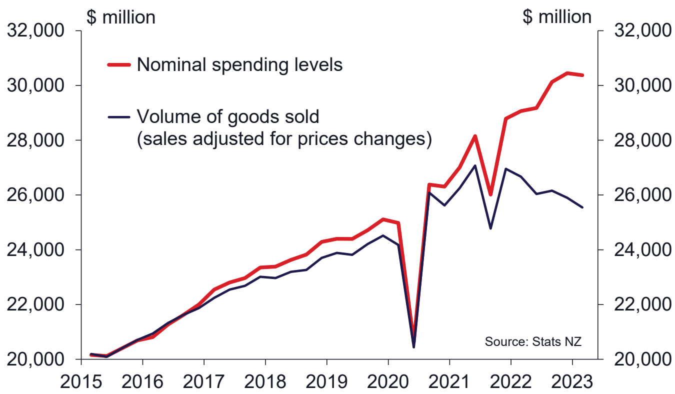
Household incomes up, but prices charging higher.

But it's not all bad news. Our estimates indicate that household incomes have also been pushing higher, rising by around 6% over the past year. That reflects the strength in the labour market, which has seen wages rising at a rapid pace over the past few years.

The solid growth in disposable incomes over the past year has seen household spending continuing to rise at a brisk pace, with nominal household spending levels up around 9% over the past year. That continued growth in spending does point to resilience in spending appetites in the face of the other headwinds currently buffeting New Zealand households.

However, as we've noted before, a big chunk of the rise in spending has been due to the 6.7% increases in household living costs over the past year. Adjusting for higher prices, the amount of goods that New Zealand households have been taking home has effectively remained flat over the past year even as we've splashed out more cash. And some of the increase in overall household spending has been on outbound tourism, which for the most part does contribute to the local economy.

Retail spending



The other impact of those strong price rises is that savings rates have started to ease back. New Zealand households are now saving around 1% of their disposable incomes, down from over 2% last year. This might imply a reduced buffer to support spending in future.

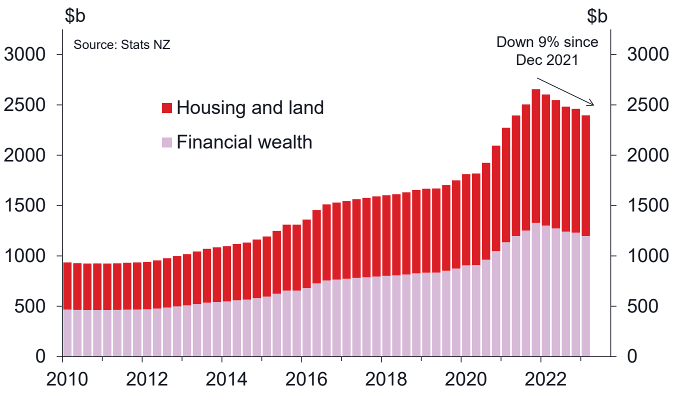
Wealth levels continuing to drop.

Stats NZ's latest update also revealed that the level of household wealth fell by $42bn in the first three months of the year. That was the fifth consecutive quarter of decline in household wealth levels, with a total drop of 9% since the end of 2021. That decline has mainly been due to the 17% fall in house prices since interest rates started rising in late 2021.

1 Note that increase in debt servicing costs is just due to borrowers rolling off earlier low fixed mortgage rates and onto the rates that are currently on offer – we're not making any claims about what will happen to interest rates going forward.

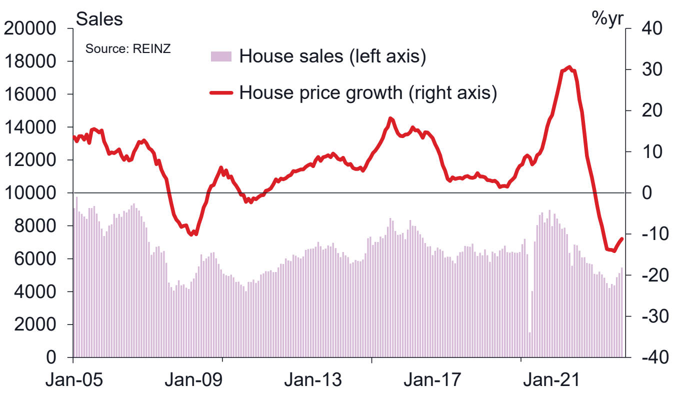
That's a particular concern for those families who first entered the housing market in the past couple of years. Many of those families will now be looking at higher debt servicing costs, while the value of their homes has fallen since taking out a loan. In addition, they will not have had the chance to rebuild their savings since purchasing a home. More generally, lower levels of household wealth might also discourage future spending.

Household wealth



That said, it does look like the housing market is now finding a base. With signs that borrowing costs are close to their peak and population growth surging, the past few months have seen earlier declines in both house prices and sales flattening off. Looking ahead, while we don't expect further material house price falls, we don't expect to see house prices rising sharply given the current contractionary level of interest rates.

House prices and sales

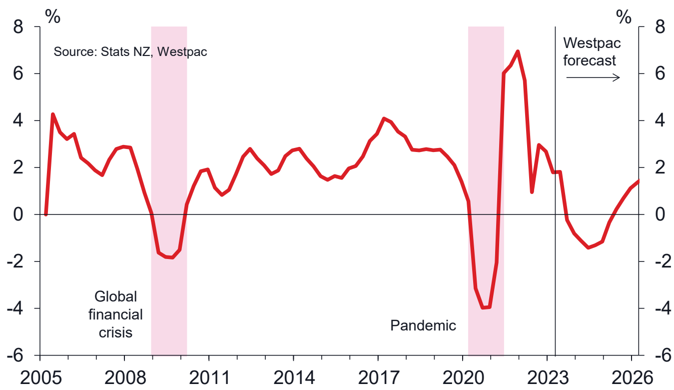


The squeeze on households' finances set to continue.

Going forward, we expect the pressure on households' finances will continue to mount. That's mainly due to the continued rise in debt servicing cost. At the same time, even though inflation is starting to ease, cost of living pressures remain intense. Those pressures are being felt by every family across the country. However, they've been especially tough for those families on lower incomes due to the large increases in the prices for necessities, like food and utilities. Such families will also typically have smaller savings buffers that they can draw upon.

Those mounting financial pressures will see per capita household spending falling by around 2% over 2023 and 2024 combined. And with household spending accounting for around 60% of total economic activity, that will be a significant drag on economic growth.

Per capita household spending (annual average growth)



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