Property Focus

New Zealand

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Open partnerships
Open possibilities

Riding the Big Dipper

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Summary

- Our monthly Property Focus publication is aimed at providing investors and prospective homeowners with an independent appraisal of recent developments in the property market, as well as our favoured mortgage borrowing strategy. In this issue, the feature article is on the ANZ Property Investor Survey.

The month in review (page 2)

- All the thrills and spills of a fairground ride. After over-indulging on housing and hot dogs, an unscheduled ride on the real estate roller coaster has left property market participants feeling decidedly sick. It's hardly going to get better, as we've just stumbled on to a seat on the labour market ghost train.

Property gauges (page 3)

- The fortune teller's crystal ball reveals that the majority of the property gauges are pointing to a further contraction. The growing number of houses for sale, weak sales volumes and sticky house prices suggest that vendors are yet to fully adjust their price expectations.

Economic backdrop (page 5)

- Domestic gauges continue to paint a sombre picture for the NZ economy. Business and consumer confidence have dropped to levels seen in prior recessions. Weakness in the housing market has clearly broadened and is set to be a significant drag on GDP growth over 2008.

Mortgage borrowing strategy (page 6)

- With the economy slowing more rapidly, we recommend targeting one year borrowing rates.

Feature article – The ANZ Property Investors Survey (page 7)

- The latest ANZ Property Investors Survey highlights concerns regarding high interest rates and how this has dampened investors' expectations to buy a property shortly. Investors are less optimistic about growth in property prices, which is not surprising given that a lot more investors expect property prices to fall over the coming year, relative to the previous year.

Key forecasts (page 9)

The month in review

All the fun of the fair:

All the thrills and spills of a fairground ride. After over-indulging on housing and hot dogs, an unscheduled ride on the real estate roller coaster has left property market participants feeling decidedly sick. It's hardly going to get better, as we've just stumbled on to a seat on the labour market ghost train.

Corkscrew Roller Coaster

> **REINZ housing data – April.** House sales rose by 13 percent in seasonally adjusted terms in April. This follows a whopping 32 percent fall in March (the early Easter this year causing unusual monthly volatility). Averaging across March and April shows house sales down 27 percent from February, and 49 percent down from a year earlier. The median number of days to sell a house rose to 44 days (45 in seasonally adjusted terms) and the median sale price fell to $345,000, taking annual growth to -1.1 percent - the first time annual house price growth has turned negative since early 2001.

Vortex

> **Barfoot and Thompson house sales – April.** House sales rose by 7.8 percent, but this was a very small rebound given the early Easter induced slump of 23 percent in March. To try and adjust as best we can for the early Easter effect, we can average house sales over March and April, and compare that with last year. Doing this paints a worse picture, with sales 54 percent lower from a year ago and down 20 percent from February levels. Listings continue to rise, and based on current sales level, imply 14 months worth of housing stock on Barfoot's book. Compare that with the 4 months of supply a year ago, and it is no wonder that it's now a buyer's market.

Helter Skelter

> **Household Labour Force Survey – March quarter.** The 1.3 percent fall in employment was the largest quarterly drop since March 1989, with the unemployment rate lifting to 3.6 percent. The weakness was reasonably widespread, with full-time and part-time employment falling 1.7 percent and 1.1 percent respectively.

Gravitron

> **Building Consents – March.** Residential dwelling consents continue to fall, dropping 9.1 percent in March. On an ex-apartment basis, which is typically less volatile, consent issuance fell a whopping 13.7 percent. On a trend basis, dwelling consents have posted their ninth consecutive monthly fall. In contrast, commercial consent issuance remains elevated. At this stage, there still looks to be a reasonable pipeline of commercial construction activity, although we do note that the trend has fallen for eight consecutive months.

Ghost Train

> **External Migration – March.** NZ gained a net 490 people from net migration in March, the strongest increase in six months. Annualising the last three month's net migration data show a net inflow of 3,360 people. For the 12-months to March 2008, net migration gains of 4,678 people were recorded, still well down from the 14,000 plus recorded in early 2007. The monthly increase in net migration was due to a drop in NZ resident permanent departures. It is still too soon to be confident that we have seen the bottom of net migration flows. The monthly data is volatile, and the departures figures can swing wildly from month to month.

Assessment

Step right up, test your strength. Come on son, ring the bell with the hammer.

To say that the economy has stalled is an understatment – it is increasingly unfolding significantly more and more to the downside. Housing is leading the way. However, a weak housing market is almost becoming yesterday's news as weakness broadens to other areas such as retailing. Last week's employment figures showed sectors closely linked to the housing market shedding jobs (construction, business services, retail).

The issue at this juncture remains when this slower growth dynamic will eventually dampen inflationary pressure. While no-one likes to see or talk about a higher unemployment rate, it an unfortunate precursor to getting inflation and interest rates down.

Property gauges

The fortune teller's crystal ball reveals that the majority of the property gauges are pointing to a further contraction. The growing number of houses for sale, weak sales volumes and sticky house prices suggest that vendors are yet to fully adjust their price expectations.

Psst! Hey, Bud. C'mere. Wanna see into the future?

We use eight gauges to assess the state of the property market and whether warning signs are emerging.

> **Affordability.** For new entrants into the housing market, we measure affordability using the ratio of house prices-to-income (augmented for interest rates), and mortgage payments as a proportion of income.

> **Serviceability / indebtedness.** For existing homeowners, serviceability relates interest payments to income while indebtedness is measured as the level of debt relative to income.

> **Interest rates.** Interest rates affect both the affordability of new houses and the serviceability of existing mortgage payments.

> **Migration.** A key source of demand for new housing.

> **Supply-demand balance.** We use dwelling consents issuance to proxy supply. Demand is derived via the natural growth rate in the population, net migration, and the average household size.

> **Consents and house sales.** These are both key gauges of activity in the property market.

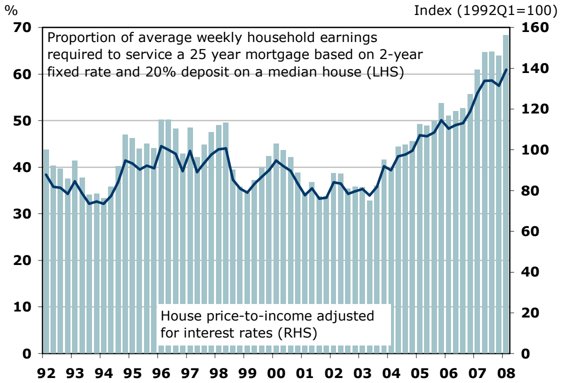
> **Liquidity.** We look at growth in Private Sector Credit relative to GDP to assess the availability of credit in supporting the property market.

> **Globalisation.** We look at relative property price movements between New Zealand, the US, UK and Australia in recognition of the important role that globalisation is playing in NZ's property cycle.

The housing market is unequivocally weak. Compositional aspects with house sales have played havoc with the recent monthly figures making them incredibly volatile and difficult to interpret. Nevertheless, the underlying picture is one of softness, with no signs of the housing market bottoming out yet. The growing number of houses for sale, the low volumes of houses actually sold, and the rather sticky house price level (despite down from a year ago levels) suggest that vendors are yet to fully adjust their price expectations to match market reality.

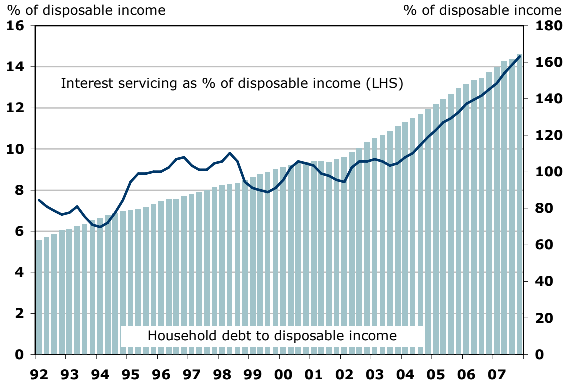
Indicator	Level	Direction for prices	Comment
Affordability	Expensive	↓	Despite house prises easing, affordability is still at extremely expensive levels due to high mortgage rates.
Serviceability / indebtedness	High	↓	Household indebtedness and the debt servicing burden keep hitting new highs and show no signs of consolidating yet.
Interest rates	High	↔/↓	Fixed-term mortgage rates have nudged lower, but off extreme levels. There is not too much to smile about when the cheapest rate on offer is still in excess of 9 percent!
Migration	Medium	↔/↓	The migrants are still arriving but you can now sometimes count the net monthly inflow on your fingers and toes.
Supply-demand balance	Neutral	↔	Close to balance.
Consents and house sales	Consents easing, sales softening	↓	The big dipper.
Liquidity	High	↓	Credit criteria tightening.
Globalisation	Not that cheap	↔	It's a small world after all.
On balance		↓	**Guests who are prone to motion sickness should not ride.**

Housing Affordability



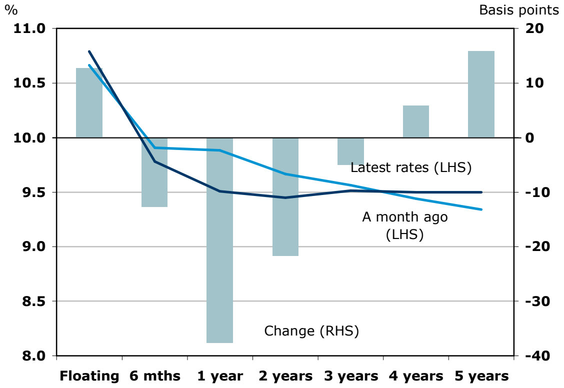
Sources: ANZ National Bank, Statistics NZ, REINZ, Reserve Bank

Serviceability and indebtedness



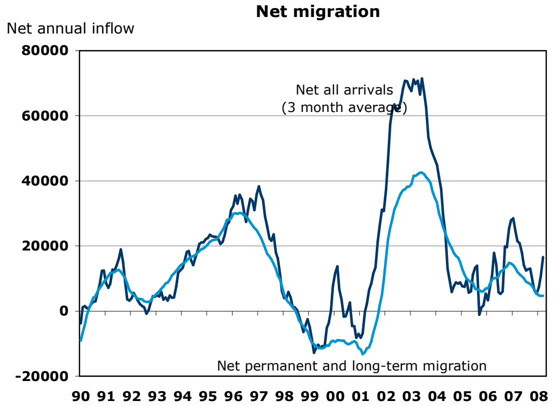
Sources: ANZ National Bank, Reserve Bank

New customer average residential mortgage rate



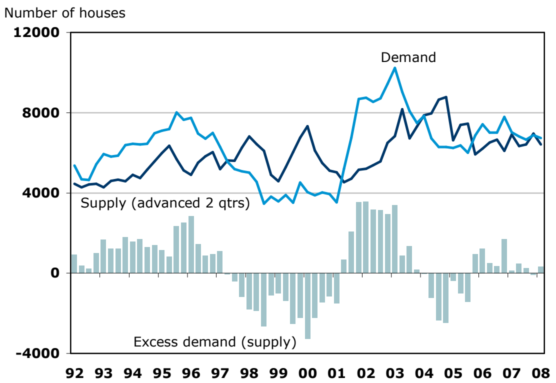
Sources: ANZ National Bank, Reserve Bank, www.interest.co.nz

Net migration



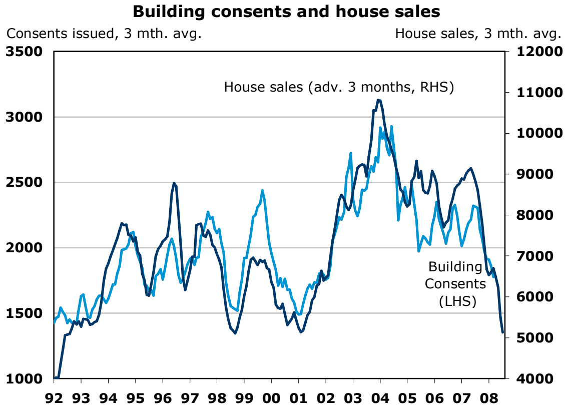
Sources: ANZ National Bank, Statistics NZ

Housing supply-demand balance



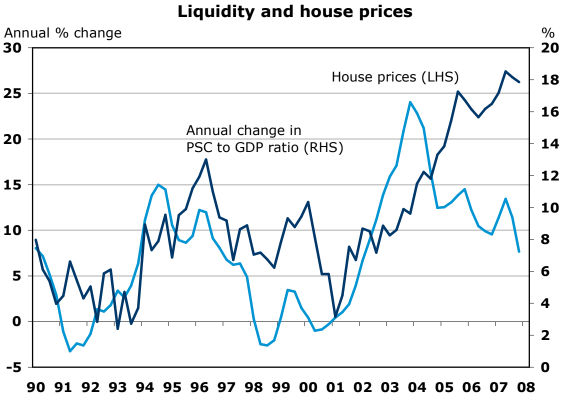
Sources: ANZ National Bank, Statistics NZ

Building consents and house sales



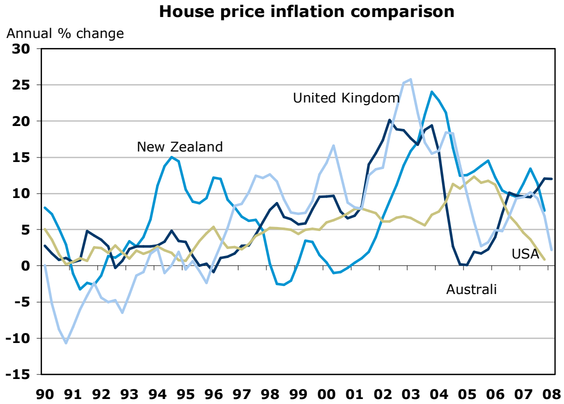
Sources: ANZ National Bank, Statistics NZ, REINZ

Liquidity and house prices



Sources: ANZ National Bank, QV, Reserve Bank

House price inflation comparison



Sources: ANZ National Bank, QV, Nationwide, Bloomberg

Economic Backdrop

Domestic gauges continue to paint a sombre picture for the NZ economy. Business and consumer confidence have dropped to levels seen in prior recessions. Weakness in the housing market has clearly broadened and is set to be a significant drag on GDP growth over 2008.

Wet 'n (not very) Wild.

Our core economic view

The economy is slowing rapidly. Weakness in the housing market, that started in Q2 2007, is diffusing into the broader economy. The retail sector is the latest pocket to show considerable weakness.

Business and consumer sentiment has plummeted, and suggest the economy is stagnant – at best. Technically we appear to be heading backwards.

Positives, such as pending fiscal largesse, infrastructure investment and high commodity prices remain. Although they are being dwarfed by tight financial conditions, which are consistent with sub-1 percent growth.

Keep all parts of your body inside ride unit at all times.

Households will face the greatest challenges over the coming 12 months as the combination of tight financial conditions, squeezed disposable income from price increases of core staples, re-priced credit risk, and a turn in the property cycle bite. Unlike previous downturns, we expect this cycle to be relatively more elongated and the economy to be weaker for longer at the trough. Households are facing a long overdue period of consolidation and de-leveraging. Precautionary savings need to be improved. Housing dominates the balance sheet, and with house prices set to fall in excess of 10 percent, we'll see some balance sheet stress. If will be a painful process in some areas, but also a necessary adjustment before the next upswing will begin.

Next year's tax cuts will temper the economic slowdown but we struggle to see it providing a boost. Weakness in the property market is now simply too extensive and broad based.

Face forward and remain seated until the ride comes to a complete stop.

The housing market and construction sector look set to be a significant drag on GDP growth over 2008. Although non-residential consent issuance remains elevated, it is unlikely to be enough to offset the weakness in the residential sector. As a result, the construction sector as a whole looks set to be a significant drag on economic prospects over 2008.

The positive spin on the weak prognosis being faced by the economy over the coming year is that it is all an inevitable part of rebalancing. Growth within the economy has been too spending-centric for too long. Relative price signals such as high borrowing rates and deposit rates are fostering such rebalancing away from spending and towards saving. The weakening in the economy will eventually reduce pressure on resources and thus deflate inflation pressures. Interest rates and the currency will fall. Such forces will eventually underpin another upswing. Yet facing significant imbalances, such as a huge current account deficit and weak household balance sheets, the "adjustment" at the trough is set to last a while yet. The piper will be paid.

Offshore developments

Palace of Illusions… "The Strangest Show on Earth."

Around the globe, we've seen a welcome improvement in sentiment in the belief (or hope) that the worst of the credit market turbulence is behind us. Central banks are working hard to stabilise sentiment. Equities have tracked up, and credit spreads have narrowed, albeit off panic-driven levels. Exposures to poor performing derivatives and assets continue to be disclosed, and in some instances we have seen moves to recapitalise balance sheets. At this stage it remains too early to say with confidence the worst has past. Short-term interbank interest rates remain elevated. Until we see a sustained narrowing, we suspect sentiment will remain prone to wild swings.

Mortgage borrowing strategy

With the economy slowing more rapidly, we recommend targeting one year borrowing rates.

Our view

Hurry, hurry, step right up and win your girl a cuddly toy.

Economic activity is clearly slowing considerably faster than the Reserve Bank was expecting in March. Although recent speeches from Governor Bollard have acknowledged the markedly weaker domestic growth profile this year, he remains sanguine about the prospects for New Zealand's major trading partners (an area where we are more circumspect) and worried about inflation pressure. Where we also appear to differ from the Reserve Bank is in our assessment of the flow-on impact of a turn in the global credit cycle. Just as the credit cycle "leaned against" the Reserve Bank's attempts to slow the economy on the way up, the danger is that the Reserve Bank fails to recognise the significance of the credit channel as a driver of slower momentum as the credit cycle flows through.

However, weak growth by itself is not a sufficient prerequisite for the Reserve Bank to change their stance. They need to be sure it will translate into less inflation. Previous cycles tell us that non-tradable inflation turns sharply when growth slows sharply. But the link between the two resides in the labour market, which needs to turn in order for medium-term inflation pressure to ease. We've already seen a small nudge up in the unemployment rate, and believe the same in the June quarter will lead the Reserve Bank to alter their view towards medium-term inflation pressure. In the meantime there remains a fair degree of short-term inflation pressure coming from areas such as petrol.

We continue to look for rate cuts from the September quarter, and believe the real risk at this juncture is that the easing cycle is very aggressive, with movements down in 50 basis point clips. However, as we stated last month borrowers need to be aware that this is likely to be slow to filter through to fixed lending rates, given the altered credit environment and higher risk premium global investors are demanding to fund our savings shortfall.

Themes we favour in the current environment

Or should that be "Themeparks we favour"?

Relative to last month, we now favour shortening up the duration of borrowing. The one year part of the curve now looks the "sweet" spot. We've previously recommended a chunk of borrowing be locked for five years. We are inclined to step aside from this for now, given the shape of the fixed rate borrowing curve.

> **Borrowers should continue to have a degree of diversification.**

> **The 1 year part of the curve, and even shorter duration borrowing, looks to be the sweet spot at this juncture.**

Feature article – The ANZ Property Investors Survey

When you wish upon a star.

The latest ANZ Property Investors Survey highlights concerns regarding high interest rates and how this has dampened investors' expectations to buy a property shortly. Investors are less optimistic about growth in property prices, which is not surprising given that a lot more investors expect property prices to fall over the coming year, relative to the previous year.

The Investors and their Portfolios

Makes no difference who you are.

Each year, the ANZ, in conjunction with the NZ Property Investors Federation (NZPIF), survey New Zealand property investors to gleam an understanding of property investors, the profile of portfolios held, and of other issues related to property investment. We report on the more interesting findings from this year's survey.

During March and April, 428 property investors completed this year's survey. The survey consists of questions relating to investors' property portfolios, their use of property management, their investment strategy, sources of information, and the Property Investors' Association.

Most of the investors surveyed are 'seasoned investors', with 81 percent purchasing their first investment property 3 or more years ago. On average, property investors who responded to the survey have 5 properties. The median is 3 properties. The majority (88 percent) do not own commercial property. Six in every ten investors are members of their local Property Investors Association.

The NZ Property Magazine is the most preferred source of information for monitoring the property market (71 percent), followed by the Property Investors' Association (34 percent) and newspapers (28 percent).

Consistent with increasing property values, the value of investment portfolios has been increasing steadily. The median value of property investment portfolios is now $1,100,000. The median equity reported this year is $500,000, higher than that held in previous years.

The median gross yield this year is the same as in the 2007 and 2006 surveys (5 percent). However, the number of respondents reporting a gross yield under 5.1 percent has increased, from 51 percent in the 2007 survey to 65 percent this year.

Key Issues

Frontierland

Overall, key issues for investors in this year's survey have been high interest rates, low returns, and potential policy/legislation changes. Low rents and high interest rates are key reasons for not purchasing in the next 12 months. Concerns regarding high interest rates are much more prominent this year than last year, with more investors saying that interest rate volatility is the biggest risk for property investment (18 percent, compared with 11 percent in 2007).

The most concerning potential change to legislation reported by investors is in regard to taxation changes or changes to LAQC rules (28 percent), ring-fencing (20 percent), and the possibility of a capital gains tax (19 percent).

Expectations

Tomorrowland

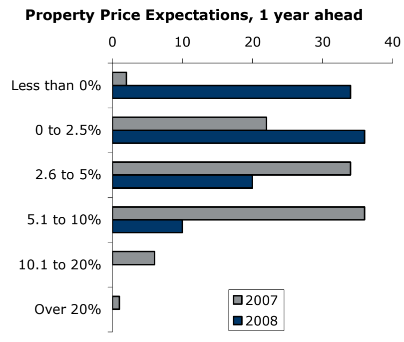
This year fewer investors indicated that they plan to buy in the next 12 months (up 10 percentage points, from 51 percent in 2007 to 61 percent this year). Key reasons for not purchasing are rents being too low against the cost of property (55 percent) and high interest rates (53 percent). Concern regarding interest rates is much more prominent this year. Interest rates are clearly a concern for investors, with 38 percent saying (unprompted) that this is currently a big issue for them. Like in the previous survey, the perceptions of are that the main risk for investors is government regulation. However there has been an *increase* in the number of investors who see interest rate volatility as a risk, and a *decrease* in the number who see vacant properties and lower than expected returns as the biggest risks.

Adventureland

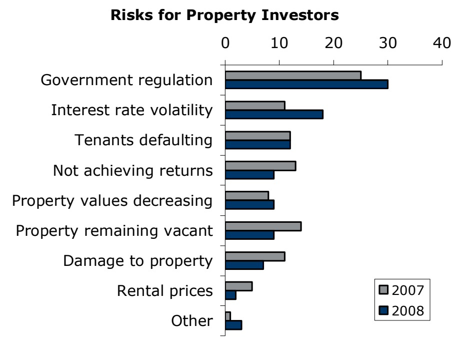
In contrast to the 2007 survey, investors are less optimistic about growth in property prices over the next 12 months (70 percent of investors expect less than 2.5 percent growth in prices). However, growth expectations over the long-term are largely consistent with previous surveys.

Nearly all investors expect growth in property rents over the next year, the next 5 years, and the next 10 years. Most investors expect 2.6 to 10 percent growth in rents over the next 10 years.

Compared to 2006, fewer investors have made a property purchase in the last 12 months (40 percent, compared to 49 percent in 2006). Also, fewer investors plan to purchase another property in the next 12 months (39 percent plan to buy in the next 12 months compared to 49 percent in 2007).



Source: ANZ. NZPIF



Source: ANZ. NZPIF

The Upshot

Fantasyland

A key message from the survey was that a lot more property investors expect property prices to fall over the coming year relative to the previous year. One in three investors now expect prices to fall this year, compared with a negligible number last year. Reality appears to have sunk in, although that also means two-thirds still expect prices to rise, a rather optimistic proportion in our eyes.

We also noted that confidence towards house prices over the next five years was broadly unchanged on the prior year, with 70 percent expecting average growth of 2.5 to 10 percent. Once again we found this a little rich. History has shown housing cycles to be 5 to 6 years of boom and 4 years of flat growth. Participants appear to be banking (betting) on a very short and sharp cycle. Considering the past six years have been the biggest boom in our history, we are wary of such a sudden turnaround.

Give a little whistle.

The economy has another period of adjustment to traverse before the inflation genie is back fimly in its bottle. Large falls in recent employment and retailling statistics go some way toward meeting this objective. But it was the speed of the turnaround that caught many commentators by surprise. A by-product of this has been that financial markets have brought forward their expectations of an easing in the Official Cash Rate to September. And potentially the Reserve Bank could move sooner that this. While substantial inflationary pressure remains, which is being exacerbated by high oil prices, the pace of economic deceleration represents a considerable headwind to such cost-push forces. We would not rule out a June interest rate cut. While the hurdle to lower rates is extremely high, the pace of deceleration in the economy should give the Reserve Bank confidence that medium-term inflation pressure will ease.

Statistical Annex

Weekly mortgage repayments table (based on 25 year term)

Mortgage Size ($'000)	Mortgage Rate (%) 7.50	7.75	8.00	8.25	8.50	8.75	9.00	9.25	9.50	9.75	10.00	10.25	10.50	10.75
100	170	174	178	182	186	190	194	197	201	205	210	214	218	222
150	256	261	267	273	279	284	290	296	302	308	314	320	327	333
200	341	348	356	364	371	379	387	395	403	411	419	427	435	444
250	426	435	445	455	464	474	484	494	504	514	524	534	544	555
300	511	522	534	545	557	569	581	592	604	616	629	641	653	666
350	596	610	623	636	650	664	677	691	705	719	733	748	762	777
400	682	697	712	727	743	758	774	790	806	822	838	855	871	887
450	767	784	801	818	836	853	871	889	907	925	943	961	980	998
500	852	871	890	909	928	948	968	987	1007	1027	1048	1068	1089	1109
550	937	958	979	1000	1021	1043	1064	1086	1108	1130	1153	1175	1198	1220
600	1022	1045	1068	1091	1114	1137	1161	1185	1209	1233	1257	1282	1306	1331
650	1108	1132	1157	1182	1207	1232	1258	1284	1310	1336	1362	1389	1415	1442
700	1193	1219	1246	1273	1300	1327	1355	1382	1410	1438	1467	1495	1524	1553
750	1278	1306	1335	1364	1393	1422	1451	1481	1511	1541	1572	1602	1633	1664
800	1363	1393	1424	1454	1485	1517	1548	1580	1612	1644	1676	1709	1742	1775
850	1448	1480	1513	1545	1578	1611	1645	1679	1713	1747	1781	1816	1851	1886
900	1534	1567	1602	1636	1671	1706	1742	1777	1813	1849	1886	1923	1960	1997
950	1619	1655	1691	1727	1764	1801	1838	1876	1914	1952	1991	2029	2069	2108
1000	1704	1742	1780	1818	1857	1896	1935	1975	2015	2055	2095	2136	2177	2219

Housing market indicators for April 2008 (based on REINZ data)

	House prices (Ann % change)	3mth % chng	No of sales (s.a.)	Mthly % chng	Avg days to sell (s.a)	Comment
Northland	12.2	-0.3	101	(-24%)	53	Sale numbers take a ride on the ghost train
Auckland	-0.4	-2.1	1,420	(+11%)	42	Recent prices mimic the sword swallower's blade
Waikato/BOP/Gisborne	0.8	-0.5	671	(+15%)	55	Annual price growth is lost inside the maze of mirrors
Hawke's Bay	-1.8	-2.0	179	(+7%)	61	Days to sell causes more yells than the scream machine
Taranaki	-2.2	-1.3	168	(+35%)	43	Sale numbers pay a visit to the kissing booth
Manawatu-Wanganui	3.9	-1.9	228	(+21%)	54	House prices jumping about in the bouncy castle
Wellington	-0.8	2.6	569	(+14%)	42	Will this be the next region to be hit in the coconut shy?
Nelson-Marlborough	1.9	-0.8	209	(+28%)	44	More G-forces than even the Gravitron can produce
Canterbury/Westland	-3.2	-0.9	677	(+3%)	43	Annual price growth is the duck in the shooting gallery
Otago	3.5	-1.7	228	(+11%)	44	The fortune teller's tarot cards are not looking great
Central Otago Lakes	5.6	9.3	68	(-15%)	78	House prices in a game of dodgem cars with other areas
Southland	30.7	-3.0	175	(+26%)	38	A drop following strong gains proves to be a lucky dip
NEW ZEALAND	-1.1	-0.5	4,715	(+13%)	45	A white-knuckled ride on the real estate roller coaster

Key forecasts

	Actual			Forecast						
Economic indicators	Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec 09
GDP (ann avg % chg)	2.7	3.1	3.1(e)	2.5	1.8	0.8	0.3	0.4	0.7	1.2
CPI inflation (%)	1.8	3.2	3.4	3.3	3.7	3.4	3.1	2.8	2.7	2.6
Unemployment rate (%)	3.5	3.4	3.6	3.8	4.0	4.2	4.3	4.5	4.7	4.8
	Actual			**Forecast (end month)**						
Interest rates	Mar 08	Apr 08	Current	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec 09
Call rate	8.7	8.6	8.3	8.3	8.0	7.5	7.0	6.5	6.0	6.0
90-day bank bill rate	8.9	8.9	8.7	8.7	8.2	7.6	7.1	6.5	6.2	6.2
Floating mortgage rate	10.6	10.7	10.8	10.8	10.6	10.1	9.6	9.1	8.6	8.6
1-yr fixed mortgage rate	9.9	9.9	9.5	9.5	9.4	8.8	8.3	7.9	7.6	7.6
2-yr fixed mortgage rate	9.6	9.7	9.4	9.4	9.4	8.9	8.3	7.9	7.7	7.7
5-yr fixed mortgage rate	9.3	9.5	9.5	9.5	9.4	9.0	8.4	7.9	7.6	7.6

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