

NEW ZEALAND ECONOMICS ANZ PROPERTY FOCUS

DECEMBER 2011

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SENSE AND SENSIBILITY

SUMMARY

Our monthly *Property Focus* publication provides an independent appraisal of recent developments in the property market.

THE MONTH IN REVIEW

The latest rise in house sales volumes in November is consistent with other indicators pointing to a pick-up in housing market activity. Has the worm turned? Are we on the cusp of a proper upswing? We suspect not. Fixed interest rates have fallen and are likely to remain lower for longer, and the property market has responded in a typical manner in the short-term. However, the prognosis for 2012 is still dominated by a weak global scene and the need for the national balance sheet to be repaired further. This caps any upside.

PROPERTY GAUGES

With household debt still very high, future increases in consumer spending (and house prices) seem likely to be income-driven rather than debt-driven as in the early 2000s. We still view the balance sheet constraint (debt levels, affordability) as dominating supply-demand balance measures in terms of the outlook. The former portends a slow grind for the property market ahead.

FEATURE – MEDITERRANEAN MELTDOWN

Ruptions in Europe are the Sword of Damocles hanging over the New Zealand economy. As a small, open, trading economy we are very exposed to the global economy. In this note we explain some of the key transmission mechanisms to New Zealand via the six C's: contagion, confidence, commodity prices, China, the cost of funds and the currency. We conclude New Zealand is pretty well placed to weather the storm, but we are not immune. Buckle up for a rough ride, and the property market will feel it too.

MORTGAGE BORROWING STRATEGY

With the global scene failing to stabilise and the risk profile pointed down, clouds hang over New Zealand's economic outlook. With inflation benign, the OCR looks set to stay on hold for a while yet. Our breakeven analysis suggests good value in the 6 month to 1 year rates.

REVIEW OF THE 2011 REAL ESTATE MARKET

We review trends in the housing market over the current calendar year. Overall, the market improved marginally from last year, though off a low base. The seasonally adjusted number of sales lifted in November after being relatively stable for the past six months. The median sale price has inched up but has failed to keep pace with the inflation rate. The median time to sell a house has improved modestly and currently sits just below the historical average. Section sales have failed to match the mild recovery in the house sales statistics.

THE MONTH IN REVIEW

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REINZ, HOUSE SALES – NOVEMBER

You can't beat the
smell of *home cooking*

Nationwide house sales rebounded 6.8 percent s.a. in November, reversing falls in October and September, as distractions posed by the Rugby World Cup subsided. Particularly strong sales were seen in Canterbury/Westland and Auckland, but sales volumes rose in most regions apart from Otago and Nelson/Marlborough, suggesting that **a strengthening property market may be more than just an Auckland phenomenon**. Consistent with this was a fall in the seasonally adjusted median days to sell to 38 days, below the 40+ range apparent at the start of the year, but still well above the sub 35 range when the market was at full steam back in 2007.

STATISTICS NZ, BUILDING WORK PUT IN PLACE – SEPTEMBER

The sound of silence

Weaker non-residential consent issuance resulted in a 2.3 percent fall in work put in place volumes. Consent issuance has been pointing to a large fall in non-residential activity for a while now, and it finally arrived. With reconstruction work in Canterbury facing long delays, we are likely to see non-residential construction sector activity remaining in the doldrums for a while yet. Residential construction volumes were flat, a little stronger than implied by the floor area of residential consent issuance.

STATISTICS NZ, BUILDING CONSENTS – OCTOBER

Up a touch

The number of dwelling consents rebounded 11 percent s.a. in October, partly reversing a large fall in September. In terms of floor area (a better indicator of construction activity), residential consent issuance rose 10 percent and **was up 18 percent s.a. in the three months to October**. However, dwelling consent numbers are still 40 percent below historical averages as a proportion of the housing stock. This implies a large margin of spare construction sector capacity from which a rebound will occur, assuming all our builders haven't left for Australia.

RBNZ, MORTGAGE APPROVALS – EARLY DECEMBER

A taste of things to
come

The *value* of housing approvals has been picking up over the last few months, and **is now approaching levels last seen when the housing boom was in full flight** in 2007. Approval values for early December are around 29 percent above 12 months ago. The *number* of approvals has also been increasing strongly, **with the number of approvals approaching 2009 levels**, but still below historical peaks. The number of mortgage approvals in early December was around 9 percent higher than 12 months ago.

STATISTICS NZ, MIGRATION – OCTOBER

I came, I saw, I left

The large second consecutive monthly net permanent and long-term migration outflow was driven by a fall in both PLT departures (down 3.5 percent s.a.) and arrivals (down 3.8 percent s.a.). Monthly flows are volatile but the trend is becoming clear, with an annualised net PLT outflow of 4,880 persons in the three months to October. **Annual net PLT immigration fell to a net outflow of 103 persons in October, the first annual net outflow since September 2001.**

PROPERTY GAUGES

With household debt still very high, future increases in consumer spending (and house prices) seem likely to be income-driven rather than debt-driven as in the early 2000s. We still view the balance sheet constraint (debt levels, affordability) as dominating supply-demand balance measures in terms of the outlook. The former portends a slow grind for the property market ahead.

We use ten gauges to assess the state of the property market, and look for signs that changes are in the wind.

AFFORDABILITY. For new entrants into the housing market, we measure affordability using the ratio of house prices-to-income (adjusted 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 housing.

SUPPLY-DEMAND BALANCE. We use dwelling consents issuance to proxy growth in 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.

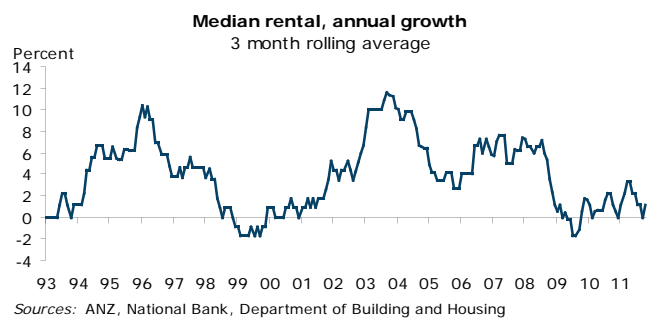
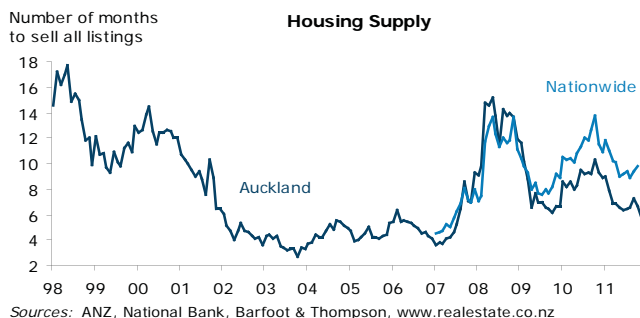
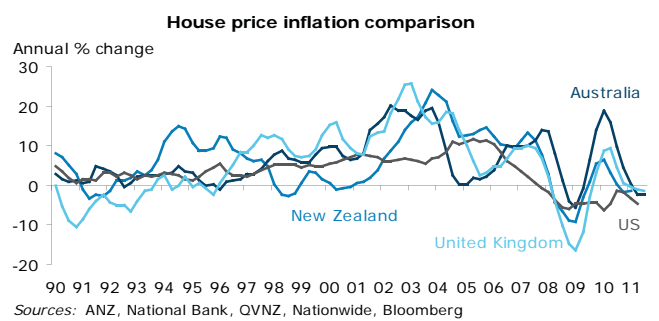
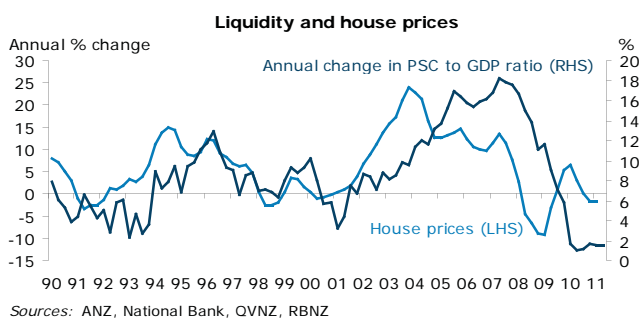
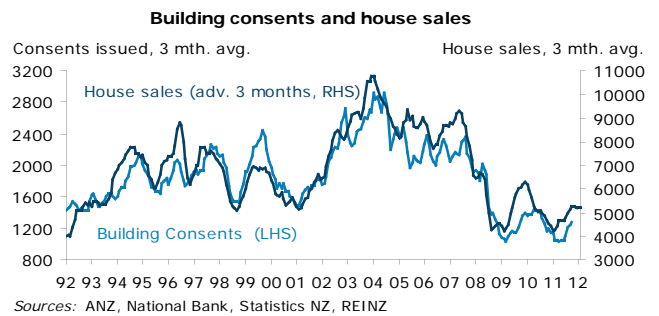
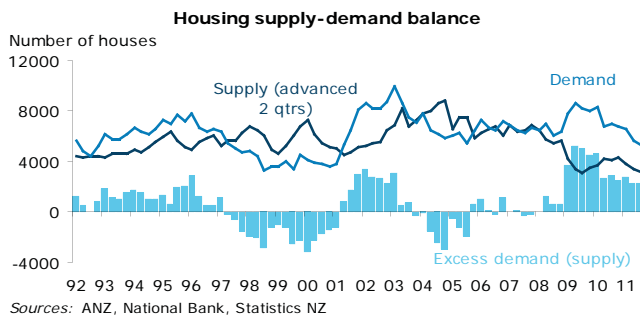
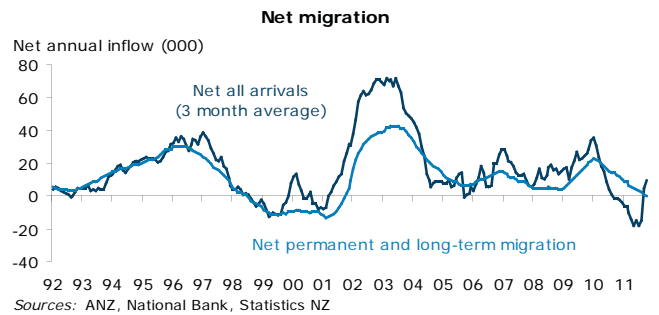
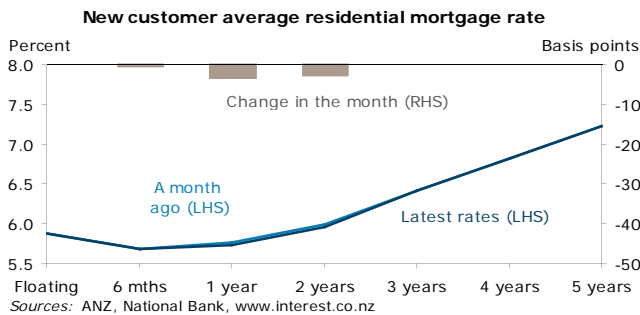
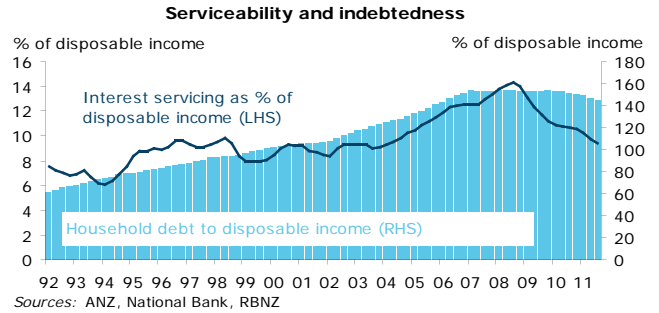
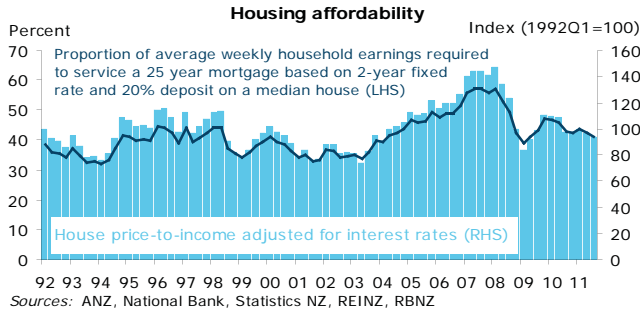
GLOBALISATION. We look at relative property price movements between New Zealand, the US, UK and Australia in recognition of the important role that globalisation is playing in NZ's property cycle.

HOUSING SUPPLY. We look at the supply of housing listed on the market, recorded as the number of months needed to clear the housing stock. A high figure indicates that buyers have the upper hand.

RENTAL GROWTH. We look at growth in the median market rent as an indication of whether it is a better time to buy versus rent, and how rental yields are shaping up for the property investor.

Indicator	Level	Direction for prices	Comment
Affordability	Dipped	↓	A small improvement in affordability was registered with declining house sale prices but this may reverse in the next quarter. But the level still points lower for prices.
Serviceability/ indebtedness	Shrinking debt	↓	Household claims to disposable income have slipped to a five-year low but are still not low enough.
Interest rates	Down a smidgen	↔/↑	A slight drop in mortgage rates occurred in the past month.
Migration	Tide has turned	↓	Net annual PLT migration has turned to an outflow for the first time in nearly a decade.
Supply-demand balance	Wedgy	↔/↑	Both sides of the measure are lower and a sizeable gap persists.
Consents and house sales	Starting to lift	↔/↑	Picking up but the rolling three monthly number of house sales is flat-lining.
Liquidity	Slight increase	↑	Based on mortgage approvals, low borrowing growth may be moving up.
Globalisation	Easing	↔/↓	Global woes to the fore.
Housing supply	Upward	↔/↑	Listings rising nationwide and catching up to Auckland.
Median rent	Set to rise	↑	A steady, albeit small lift, detected.
On balance	Pressure building	↔	Signs of momentum building but global jitters on the horizon may dent the latest pick up.

PROPERTY GAUGES



FEATURE ARTICLE – MEDITERRANEAN MELTDOWN

SUMMARY

Ruptions in Europe are the Sword of Damocles hanging over the New Zealand economy. As a small, open, trading economy we are very exposed to the global economy. In this note we explain some of the key transmission mechanisms to New Zealand via the six C's: contagion, confidence, commodity prices, China, the cost of funds and the currency. We conclude New Zealand is pretty well placed to weather the storm, but we are not immune. Buckle up for a rough ride, and the property market will feel it too.

FROM EUROPE WITH LOVE

Europe and major pockets of Western Society are in a major pickle. Financial markets are now calling time on excessive levels of debt that have been accumulated over decades. A crisis in 2008 centred on the financial system has been followed by a **sovereign debt crisis in 2011 that threatens to spill over into another banking crisis**, given banks are very large holders of sovereign debt (partly, ironically, as prudential regulations often required them to be, on the assumption that sovereign debt was practically risk-free).

There are no easy or quick fixes to excessive levels of debt. When the ratio of debt to GDP is too high you have five basic options:

- **Default**, but this risks a repeat of the banking crisis in 2008, and not limited to the sovereign in question, given large cross-border holdings. And this time, **many governments are in no position to bail out their banks.** Indeed, bank bail-outs in 2008 were a contributing cause of current sovereign debt crises in some countries. The baton is about to be passed back, none too gently. With a solid whack to the head, in fact.
- **Deleverage**, with scrooge-like behaviour. The old-fashioned, morally correct remedy to excessive debt: pay it back. However, this will be **negative for economic growth and employment generation** for years. There are **political and social consequences from entitlement cuts** as well, with governments under the spotlight. The average amount of government net debt across OECD nations is 70 percent of GDP, and a host are in excess of 100 percent and running large fiscal deficits. You can't borrow indefinitely. Welcome to the "tough love" scenario, difficult for politicians who are looking to get back into office. But the main issue with the austerity solution is that in times of crisis, panicking bond investors are unlikely to grant nations in trouble the considerable time needed to put things right fairly. It's just a race for the door. In practice,

therefore, for many nations it's probably too late for structural reforms to placate markets.

- **Grow your way out**, via increasing income to get the ratio of debt to GDP down. This is challenging when Western countries' balance sheets are in need of repair and debt needs to be repaid, limiting internal demand compared with the debt-fuelled consumption binge of yesteryear. The concept of borrowing and spending your way out of a debt-fuelled consumption jam simply doesn't pass the smell test, but growing while saving more is hard. Of course you could try to get more outright income via exporting. But this relies on a) having income-generating opportunities; b) shifting resources into such opportunities quickly; and c) having buyers for one's product. It's possible to line up the ducks, but unlikely in a quick space of time. **This dilemma is more acute for those euro economies, such as Greece who are deeply uncompetitive but unable to devalue their currencies.**
- **Inflate the debt away**, typically via quantitative easing or printing money. This is difficult when deleveraging is deflationary, a lot of assets are still overvalued, and the banking system is weak. Inflation can't actually be turned on or off at will, with **the relationship between the money supply and inflation highly non-linear and unpredictable.** Japan has been trying it for decades without success. Moreover, on a point of principle, it's not central banks' job to bail out fiscally irresponsible governments. But we suspect principles are fast going out of the window.
- **Repression**, via caps on interest rates and directed lending to government by captive audiences (i.e. banks, pension funds, and fund managers). This is the "do as you are told" approach to fiscal mismanagement. It would **undermine free market principles and destroy capital markets for decades.**

What we are seeing at present is a wholesale collapse in confidence, credibility and credentials. **Restoring faith is not easy when politics is superseding economics.** In the past fortnight we've seen attempts to restore stability with coordinated action across central banks to ease strains in financial markets. This will help reduce tensions in some quarters, and buys some time. Markets responded favourably. But the fact that such action was taken highlights that **European banks are increasingly unable to fund themselves.** Until we see real progress on fiscal issues we'll remain stuck in a Groundhog Day scenario of crisis, loss of confidence, band-aid solutions, short-term relief, crisis, with little end in sight.

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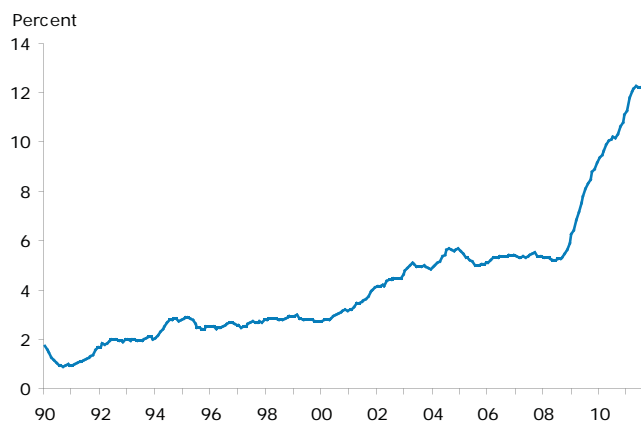
Penance beckons. The endgame is a shift lower in living standards. **Building up debt is bringing forward future consumption. The future is now here and the piper must be paid.** The only true healing process is the passage of time and hard graft. The best policymakers can do in the meantime is make sure material downside risks do not turn overly ugly, or, put another way, that the adjustment is orderly as opposed to disorderly.

IMPLICATIONS FOR NEW ZEALAND

New Zealand is highly exposed to the global economy. We will be keeping a close eye on the likely fallout here. Our watch list includes six C's.

- Contagion.** Nothing is a problem until markets decide you are a problem, and then a country can find itself stranded very quickly. Borrowing costs can quickly rise to the point that a country that had been going along seemingly just fine is suddenly insolvent. Markets are behaving like a lion hunts: the slowest animal in the herd is picked off first, with the next weakest victim then targeted. Greece is trivial. Italy is not, being the eighth biggest economy in the world. We've got our fingers, ankles and toes crossed that Europe's issues can remain contained to the periphery, but this appears unlikely. For our part, **New Zealand's sovereign debt levels remain low, but they're headed in the wrong direction.** It is imperative we stay whiter than white. To avert contagion risks the NZ Government needs to be credible in regard to fiscal plans. This means turning deficits back into surpluses, which means pumping less money into the economy. While it detracts from growth over a prolonged period, it gives global investors confidence you're on the right track.
- Confidence.** Global lead indicators have weakened of late. While we've seen some softening in New Zealand's confidence indicators, **the levels remain healthy** – for now.
- Commodity prices.** They've softened since May **but remain at historically high levels.** We are assuming this remains the case – a crucial assumption and by no means a sure thing. The demand picture looks to be softening but there is a fundamental shortage of a lot of things New Zealand produces. Fonterra just bumped up their 2012 dairy payout estimate, which is testament to the supply-side forces. Non-pastoral exports are not so lucky, and tourism is looking shaky for 2012.
- China.** China is on our watch list for three reasons. First, it's been a huge source of impetus to the New Zealand economy, leap-frogging the US to be our second largest trading partner. But **with opportunity comes vulnerability to swings in China's business cycle (and there's currently speculation of a nasty housing market bust)**, though our soft commodity export basket should be relatively immune to an investment led downturn/correction. Second, Europe is China's largest export market, so if Europe is not buying, China's export engine will wane. Third, China is huge for Australia, which is our largest trading partner, so we are exposed both directly and indirectly. **China is slowing, albeit from a gallop to a canter.** They have considerable fiscal and monetary firepower to stoke the economy's fire should things slow too dramatically. However, internal excesses could prove hard to contain if the economic bears' murmurings about an unwinding property bubble and massive non-performing loans prove correct. The jury is out.

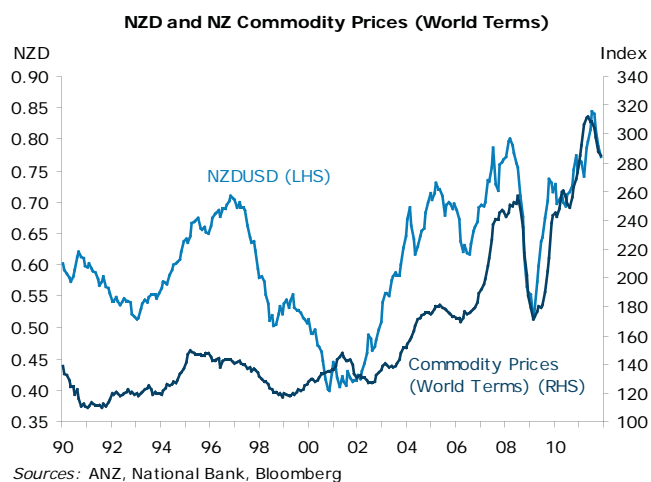
Percent of NZ exports going to China



Sources: ANZ, National Bank, Statistics NZ

- Currency.** The NZD typically acts as a "shock absorber," and is well down from its August highs. At around 75 US cents, however, the NZD is still about a quarter above post-1990 averages against the USD (9 percent above average on a TWI basis). High commodity prices provide an offset to (and a justification for) a high currency, **but the non-commodity exporting sectors of the economy, namely tourism and manufacturing, will feel the brunt.** On the whole, the currency is flip-flopping but it's doing its job. It's a safety valve pockets of Europe would love to have.

FEATURE ARTICLE – MEDITERRANEAN MELTDOWN



- Cost of credit.** The escalation of the European debt crisis has sent shock waves through funding markets. The major local banks remain well funded, but the longer the turmoil persists, the greater the likelihood that **higher funding costs will need to be built into retail interest rates.** The cost of borrowing internationally remains expensive and is a key source of vulnerability to a nation that has a large external borrowing requirement. Little demand for credit today means little need to borrow offshore. But the longer the crisis continues – say beyond March 2012 – the more challenging the environment could become. Thankfully wholesale interest rates have fallen to compensate, so New Zealand's macro framework is providing a buffer. Key to watch in 2012 will be the local deposit market. If competition for local deposits escalates because offshore funding markets remain difficult, keeping a lid on borrowing rates will prove difficult. This is the scenario that could see the RBNZ actually having to cut the OCR.

For now, New Zealand appears reasonably well placed. We sell goods people consume, rather than materials for investment, a plus in a time of possible global recession. People still have to eat. Those selling manufactured goods, such as cars, may simply find they cannot sell their goods at all for a period. That said, prices matter, and **the risks around New Zealand's commodity prices are on the downside.** Structural factors such as the growing Asian middle class, and increasing supply disruptions from extreme weather events, should provide a base, but if global markets go into full panic mode no market will be immune. The earthquake rebuild will also provide a base for the domestic economy

over coming years, albeit a highly localised one. And, a quick reality check: no economy would willingly choose as a means of fiscal stimulus to dismantle a CBD and rebuild it – a reminder that while the stimulus will be quite well-timed, the earthquakes were a very large negative hit to the wealth of NZ.Inc.

We expect New Zealand to muddle through 2012 with a continuation of the “grumpy-growth” trajectory. This is not growth of the feel-good (consumption-based) variety, but this is the way it has to be. **New Zealand has to improve its aggregate balance sheet**, which means a structurally lower level of activity in spending-centric areas of the economy. **Welcome to the new, more sustainable “normal”.**

For the local property market, the implications of the global economic situation are four-fold.

- Beware the risk profile. It's down, not up. **Leading indicators are softening.** The property market has picked up of late but this is merely a short-term response to lower interest rates as opposed to real substance.
- A deleveraging global economy will accentuate the same dynamic here locally. Less borrowing means less house-buying. This will dampen property market-related activity in the near term, but more adjustment early and up-front means a better bounce down the line. **This is not your usual property cycle** where five boom years are followed by three years of penance. **This is an overriding structural super-cycle.** The penance will continue until the balance sheet is fixed (see our October edition on key structural indicators). In a deleveraging environment, any asset price appreciation will have to be cash-flow (as opposed to credit) driven.
- A volatile global scene with no quick fix on the horizon will keep monetary policy more accommodative for longer. This means lower interest rates. But there's a potential catch: if international funding costs do not ease, this will have to be passed on into retail rates at some point, meaning **retail rates could potentially rise even if monetary policy is on hold** for the foreseeable future. Indeed, the Reserve Bank built this into their most recent projections.
- If the New Zealand economy does outperform to a degree in a global sense, **net migration could turn around**, supporting the housing market.

In sum, buckle up for a rough ride.

MORTGAGE BORROWING STRATEGY

SUMMARY

With the global scene failing to stabilise and the risk profile pointed down, clouds hang over New Zealand's economic outlook. With inflation benign, the OCR looks set to stay on hold for a while yet. Our breakeven analysis suggests good value in the 6 month to 1 year rates.

OUR VIEW

We expect the Official Cash Rate to remain on hold for most of 2012. The combination of global fragilities, a patchy local economy, prospects for an elongated and delayed rebuild in Christchurch and a subdued inflation outlook mean there is no hurry for the RBNZ to lift the OCR anytime soon.

While we can see some signs of buoyancy emanating from pockets of the property market, which risks adding to inflationary pressure, the stark reality is that global forces are dominating.

Escalating concerns about sovereign debt in Europe and the associated flow-on to the general economy and banking sector have seen **credit costs rise materially in the past few months.** In many ways we are seeing similar dynamics to what occurred in 2008 during the Global Financial Crisis.

This has not yet flowed on to the general borrower for a couple of reasons.

- New Zealand banks have strong funding positions, a reflection of the massive growth in deposits over the past year relative to borrowing, but also regulatory changes the RBNZ has brought in over the past two years forcing banks to get more term funding on their books. This has lessened banks' reliance on short-term offshore funding, and is a key reason why the deposit curve is upward sloping. A sharp lift in funding costs takes time to flow through into the average cost of funds. The upshot is that the longer current global uncertainty prevails, the greater the chance retail borrowing rates will move up. A key benchmark we are watching is deposit interest rates. If competition intensifies for local deposits, this will put upward pressure on borrowing interest rates too.
- Wholesale interest rates have fallen, in effect offsetting the widening in credit costs.

Could the RBNZ actually cut the OCR? We wouldn't rule it out but will make two observations. First, if they do cut it'll be because the economy is headed into recession and asset prices are heading backwards: be careful what you wish for. Second, the December *MPS* projections included a downside scenario for the global economy, not quite as bad at 2008 but not far off it. The 90-day interest rate profile was flat. This implies **the hurdle to an OCR cut is reasonably high.**

Regular readers will be aware of our break-even analysis which we use to highlight the trade-offs between floating and fixed mortgage interest rates. Of course, as we stress regularly, cost is only one part of the equation. Certainty has a value. However, we find breakeven analysis useful as it helps us determine **where mortgage interest rates need to go in order to make fixing beneficial**, and then compare those levels to our forecasts or expectations

Over the past few months the hurdle to fixing has fallen because fixed lending rates have dropped. That is, you need to expect less of a rise in the floating rate to make the fixed rate attractive.

Mortgage Rates		Breakevens			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.74%				
6 months	5.75%	5.83%	6.39%	6.39%	6.99%
1 year	5.79%	6.11%	6.39%	6.69%	7.17%
18 months	5.99%	6.20%	6.59%	6.91%	7.40%
2 years	6.09%	6.40%	6.78%	7.15%	7.61%
3 years	6.45%	6.80%	7.20%	7.58%	8.02%
4 years	6.85%	7.21%	7.62%		
5 years	7.25%				

Let's say perhaps that we were choosing between two likely alternatives – the 6 month and the 1 year mortgage rate. Based on a 1 year horizon, our table shows that the 6 month rate only needs to be 5.83% or more in 6 months time for it to be cheaper to fix for 1 year. That's not much given that the 6 month rate is 5.75% right now. On that basis, **the premium to fix for 1 year seems small – especially as we do not expect the RBNZ to be lifting the OCR until December 2012.** Obviously the premium to fix for 6 months is also small – as the rate is just 0.01% above floating. However, when we look at longer horizons, we see that mortgage interest rates need to move up a little more quickly to justify fixing. Breakevens would thus seem to support shorter fixed terms. Of course, if we see the RBNZ cut the OCR – a low probability outcome but one with a positive probability – the best place to be would be floating, assuming no widening in bank margins. But as we pointed out, this is no longer a trivial assumption.

What about flexibility? The main risk here is that floating mortgage rates fall after you fix, or you are fixed when a special comes out, or your fixed rate expires just as mortgage interest rates are starting to rise. There is no way to predict this, but it is probably obvious that the longer you fix for, the less flexibility you have. We like the savings that floating offers, but **when we consider breakevens and flexibility, we believe there is value to be had in being fixed for 6 months and 1 year.**

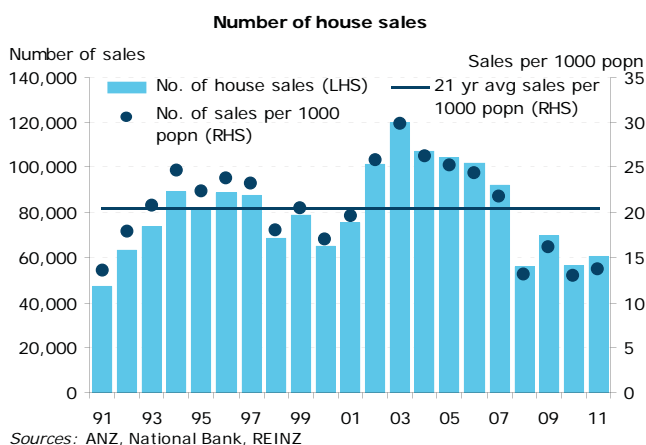
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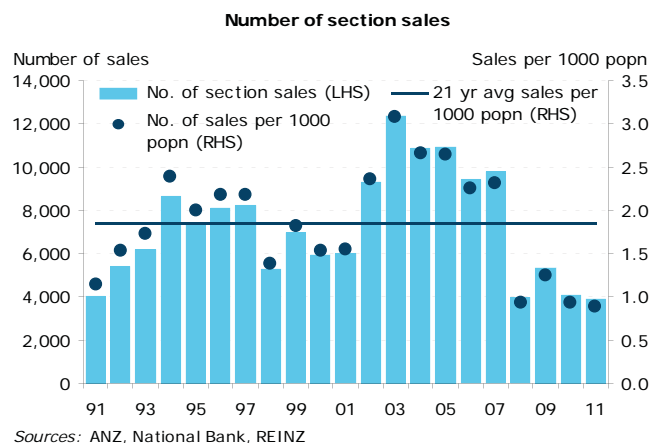
NUMBER OF SALES

The total number of house sales for 2011 (including a projection for December) is 60,900, up 8.2 percent on the 2010 calendar year. Since May 2011, the seasonally adjusted number of sales has been in excess of 5,000 per month. The last time that sales hit this threshold was back in April 2010. **Sale numbers hit a 25-month high of 5,408 (seasonally adjusted) in November.** To compare over the past two decades we have adjusted the number of sales for the population. This is represented as the blue dots in the chart below. In the current year, there have been 13.75 sales per 1000 persons, **just two-thirds of the long-run average and under half of the peak recorded in 2003.** On a regional basis the highest number of house sales per capita was measured in Central Otago Lakes (20.3), Nelson/Marlborough (16.6), and Otago (16.3). At the other end of the scale were Northland (8.2), Waikato/BOP/Gisborne (11.2), and Manawatu/Whanganui (11.9).



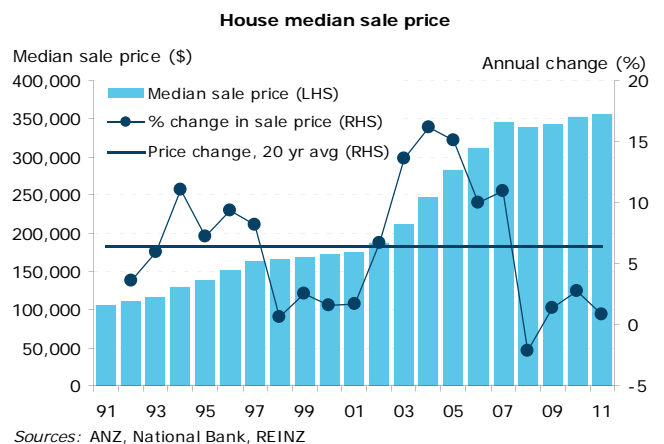
A similar analysis for section sales reveals a parallel profile to house sales. One notable difference is that **this year's section sales are slightly weaker than last year's total.** In April 2011 section sales numbered only 259, seasonally adjusted – the lowest monthly figure since November 2008. Monthly

sale numbers have improved somewhat, hitting an 18-month high of 390 in September. On a regional basis the lowest number of section sales per capita was in Manawatu/Whanganui and the Bay of Plenty (both 0.5 sales per 1000 population). The largest number of section sales, per head of population, was in the West Coast (2.0 sales per 1000 population) and Nelson/Marlborough (1.8). We would expect that the number of section sales in Canterbury would record stronger growth than other localities, as the region rebuilds. To date, this trend is not evident.



MEDIAN SALE PRICE

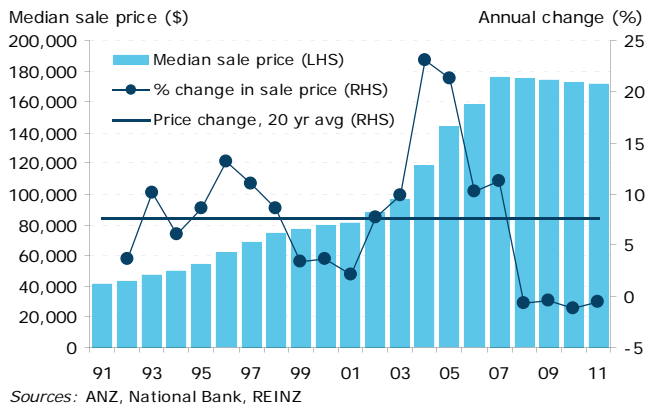
The median house price for 2011 (including a projection for December) was \$355,100, a lift from \$352,500 in 2010 (up 0.7 percent). This is a modest rise and reflects a fall in ten of the twelve regions. Excluding a 2.4 percent rise in Auckland, **the figure would be 0.2 percent weaker.** Historically, prices have risen by an average 6.4 percent per year since 1990. Of course this is a nominal figure, with inflation averaging 2.3 percent over the same period, translating into a 4.1 percent rise in real house prices on average per annum. On a regional basis, the largest falls in median house prices were measured in Taranaki (-3.6 percent) and Hawke's Bay (-2.5 percent).



REVIEW OF THE 2011 REAL ESTATE MARKET

House prices, nominally anyway, have recovered about 70 percent of their ground lost since the 2007 peak, remaining some 3 percent lower than September 2007 levels. In comparison, section prices have failed to recover, and have continued to drift lower. The nationwide median measure of section prices **masks some large movements at a regional level**. Median section prices on the West Coast fell 40 percent, with double-digit falls also measured in Gisborne and Wellington. Offsetting these was a 39 percent increase in section prices in Southland, with double-digit rates of increase also measured in Hawke's Bay, Otago and Taranaki. Some of these large movements are likely to be due to compositional factors.

Section median sale price



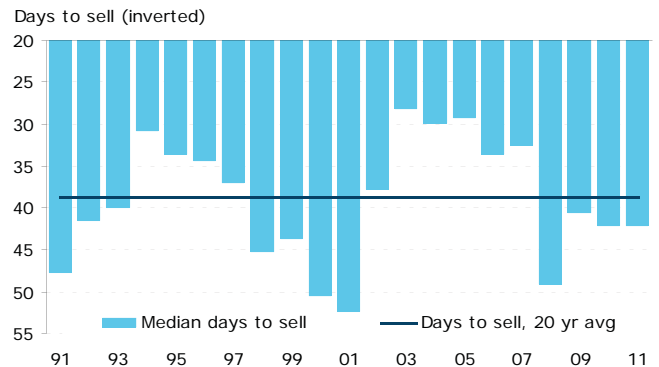
DAYS TO SELL

Over the current calendar year, the median number of days to sell a house was unchanged at 42, but the median days to sell have been below 40 since August. This compares to an average over the past two decades of 39 days, with a range between 28 and 52 days. Auckland recorded the shortest time to sell a house, at 36 days. This was unchanged from a year earlier. **All regions except Central Otago Lakes (-3 days) recorded a lengthening in the time to sell in 2011, relative to 2010.** The longest was in Northland, which lengthened by nearly a fortnight, to 76 days. Other areas to record a time to sell of 60 days or longer were Central Otago Lakes (64 days) and Taranaki (60 days). Recent nationwide monthly data has **dropped to just below the long-term average (39 days) in November**.

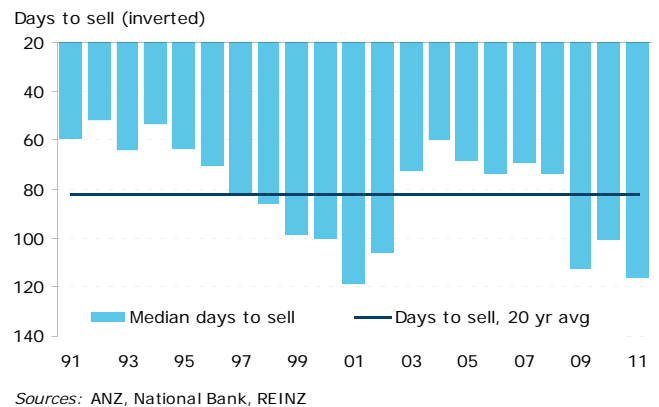
The median time to sell a section has remained stubbornly high. The average 116 days recorded in 2011 is a full month longer than the historical average of 82 days and only 3 days less than the peak 119 days recorded in 2001. The time to sell a section was the longest in Gisborne (278 days) and Nelson/Marlborough (219 days). Auckland and

Canterbury recorded the shortest time to sell a section (99 and 93 days, respectively).

Median days to sell a house



Median days to sell a section



THE UPSHOT

The housing market continues to be buffeted by exceptionally strong headwinds. The global financial crisis was the catalyst that first popped the debt-fuelled bubble. Now the sovereign debt woes of Europe threaten to unseat the global economy and may pull New Zealand back into the economic mire.

Section sales tend to lead residential building consent issuance by around five months. The pick-up in section sale numbers from **a low point in April is encouraging and has started to be reflected in lifting dwelling consents.** Another big positive factor for the construction industry is the rebuild in Canterbury. This hasn't really been reflected in the real estate market statistics as yet. However, the latest (November) outturn from the Real Estate Institute points to things to come. The downside is that it will soak up resources from other parts of the country, causing shortages elsewhere and pushing up prices in the sector.

KEY FORECASTS

Weekly mortgage repayments table (based on 25-year term)

Mortgage Size (\$'000)	Mortgage Rate (%)													
	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00	8.25
200	135	138	142	145	149	152	156	159	163	167	170	174	178	182
250	202	207	212	218	223	228	234	239	244	250	256	261	267	273
300	270	276	283	290	297	304	311	319	326	333	341	348	356	364
350	337	345	354	363	371	380	389	398	407	417	426	435	445	455
400	404	415	425	435	446	456	467	478	489	500	511	522	534	545
450	472	484	496	508	520	532	545	558	570	583	596	610	623	636
500	539	553	566	580	594	608	623	637	652	667	682	697	712	727
550	607	622	637	653	669	684	701	717	733	750	767	784	801	818
600	674	691	708	725	743	761	778	797	815	833	852	871	890	909
650	741	760	779	798	817	837	856	876	896	917	937	958	979	1,000
700	809	829	850	870	891	913	934	956	978	1,000	1,022	1,045	1,068	1,091
750	876	898	920	943	966	989	1,012	1,036	1,059	1,083	1,108	1,132	1,157	1,182
800	944	967	991	1,015	1,040	1,065	1,090	1,115	1,141	1,167	1,193	1,219	1,246	1,273
850	1,011	1,036	1,062	1,088	1,114	1,141	1,168	1,195	1,222	1,250	1,278	1,306	1,335	1,364
900	1,078	1,105	1,133	1,160	1,188	1,217	1,246	1,274	1,304	1,333	1,363	1,393	1,424	1,454
950	1,146	1,174	1,204	1,233	1,263	1,293	1,323	1,354	1,385	1,417	1,448	1,480	1,513	1,545
1000	1,213	1,244	1,274	1,306	1,337	1,369	1,401	1,434	1,467	1,500	1,534	1,567	1,602	1,636

Housing market indicators for November 2011 (based on REINZ data)

	House prices (ann % change)	3mth % change	No of sales (s.a.)	Mthly % change	Avg days to sell (s.a.)	Comment
Northland	-1.8	-0.9	123	(+4%)	54	Days to sell at 18 mth low but still second slowest in NZ
Auckland	2.5	1.1	2,060	(+9%)	36	Pipped by Canterbury as the quickest place to sell
Waikato/BOP/Gisborne	-3.0	-1.6	741	(+7%)	48	Three month price change is the second weakest
Hawke's Bay	7.4	5.5	179	(+4%)	45	Second strongest annual rise in prices to a 13 mth high
Taranaki	-1.3	0.5	249	(+3%)	49	Days to sell below 50 for first time since January
Manawatu/Whanganui	3.4	4.3	159	(+11%)	52	The second highest monthly number of sales in 2 years
Wellington	-3.8	3.5	584	(+1%)	40	Median sale price \$10k weaker in the month
Nelson/Marlborough	-0.1	5.6	219	(-1%)	40	Strongest three-monthly change in sale prices
Canterbury/Westland	9.0	3.0	815	(+16%)	35	Sales numbers up strongly to hit a two-year high
Central Otago Lakes	-4.3	-5.8	80	(+9%)	70	Largest drop in prices compared to a year ago
Otago	6.5	0.2	213	(-10%)	37	Weakest number of monthly house sales since January
Southland	4.2	4.9	131	(+3%)	47	The median time to sell has ratcheted up to a 9 mth high
NEW ZEALAND	2.0	0.5	5,408	(+7%)	38	Things are starting to pick up in Canterbury

Key forecasts

Economic indicators	Actual			Forecast						
	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
GDP (Ann Avg % Chg)	1.6	1.5	1.7(f)	2.1	2.3	2.5	2.6	2.4	2.7	2.9
CPI Inflation (%)	4.5	5.3	4.6	2.5	2.3	2.1	2.5	2.6	2.6	2.6
Unemployment Rate (%)	6.5	6.5	6.6	6.4	6.4	6.2	6.1	6.0	6.0	6.0
Interest rates	Actual			Forecast (end month)						
	Oct-11	Nov-11	Latest	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.75	3.25	3.50
90-Day Bank Bill Rate	2.7	2.7	2.7	2.7	2.7	2.8	2.8	3.2	3.7	3.8
Floating Mortgage Rate	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.2	6.7	6.9
1-Yr Fixed Mortgage Rate	5.9	5.8	5.8	5.8	5.9	5.9	5.9	6.2	6.5	6.7
2-Yr Fixed Mortgage Rate	6.3	6.0	6.0	6.0	6.3	6.3	6.4	6.6	6.7	6.9
5-Yr Fixed Mortgage Rate	7.6	7.2	7.2	7.2	7.4	7.4	7.5	7.6	7.7	7.7

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