ANZ Research

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# New Zealand Property Focus

## Credit where it's due

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## Summary

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

## Feature Article: Credit where it's due

Credit availability is a significant determinant of housing market developments and the economic cycle. Lending has generally been conservative this cycle, but from 2016, reduced credit availability contributed to cooling in the housing market and loss of economic momentum. Credit has been less of a constraint recently; the housing market and GDP growth are being held back by other headwinds. And banks' funding positions have been favourable, conducive to continued prudent lending supportive of the housing market and ongoing economic growth, albeit below trend. Nonetheless, some businesses and farms are facing challenges on this front, and waning deposit growth poses the risk that credit becomes a more significant constraint once more. Adding to that, proposed (and probable) changes to bank capital requirements, if implemented, would impact both the price and availability of credit, with potentially quite significant implications for the economy, including for the housing market.

## Property gauges

House prices have firmed over the past six months, particularly in the regions, with falls in mortgage rates providing a boost. But we expect the recent firming to be short-lived. House sales fell in February, after the easing in loan-to-value ratio restrictions provided a temporary boost in January. Looking thorough volatility, the trend has been fairly flat since mid-2017. From here, housing market activity and price pressures are expected to be limited. Demand pressures are not building as strongly as before, with a lower (but uncertain) impulse from migration. And headwinds are also evident; bank prudence, investor wariness, and affordability constraints. Tighter credit conditions may emerge if proposed increases in bank capital requirements are implemented. Proposed Government policy changes, and the uncertainty associated with these, are also expected to see the market remain contained.

## Economic overview

Evidence of a slowdown in global growth continues to accumulate, and the risks of a sharper slowdown have increased. Weaker growth momentum has been broad-based across New Zealand's trading partners. Central banks have responded to support growth, with easier policy expected going forward. The RBNZ has signalled a more cautious tone, with the next move in the OCR more likely to be down. We are picking November for the first move, with risks skewed towards a cut earlier than this. We expect that capacity pressures will wane as domestic growth continues to underwhelm and the economy will need a further boost from monetary stimulus to push inflation closer to target and see employment remain near its maximum sustainable level. It is possible that inflation might improve more than we expect from here, but worsening global conditions and weaker growth domestically are currently more pressing concerns.

# Feature Article: **Credit where it's due**

## Summary

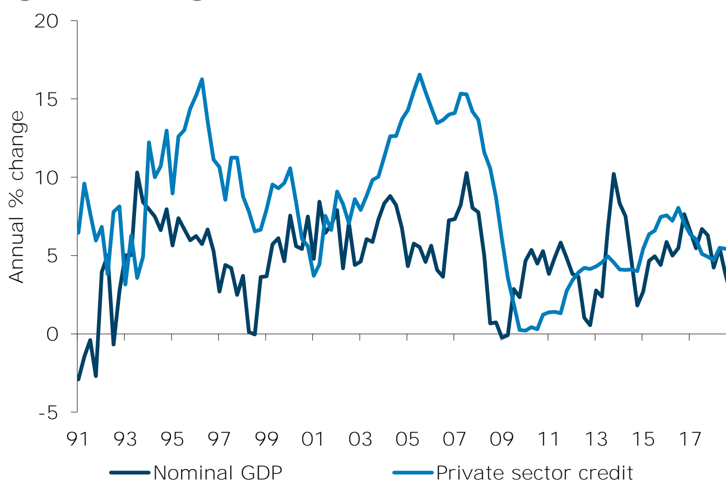
Credit availability is a significant determinant of housing market developments and the economic cycle. Lending has generally been conservative this cycle, but from 2016, reduced credit availability contributed to cooling in the housing market and loss of economic momentum. Credit has been less of a constraint recently; the housing market and GDP growth are being held back by other headwinds. And banks' funding positions have been favourable, conducive to continued prudent lending supportive of the housing market and ongoing economic growth, albeit below trend. Nonetheless, some businesses and farms are facing challenges on this front, and waning deposit growth poses the risk that credit becomes a more significant constraint once more. Adding to that, proposed (and probable) changes to bank capital requirements, if implemented, would impact both the price and availability of credit, with potentially quite significant implications for the economy, including for the housing market.

## Credit availability is important

Credit availability is an important determinant of housing market developments and the economic cycle more broadly. Much attention tends to be paid to the price of credit – interest rates – and their role in stimulating or reining in economic activity. But non-price credit conditions – whether credit is available and on what terms – matter too. They generally receive much less attention because they are less visible and easily measured, but if credit is not accessible or is available only on very stringent terms, then the price of credit becomes secondary. If this occurs, then some households cannot purchase homes, some businesses cannot invest or access working capital loans, and the economy can struggle to fire. Credit is the oil in the economic engine.

Credit conditions and economic growth are inter-related. When demand is strong, it encourages households and businesses to borrow; conversely when households and businesses can borrow freely, it stimulates demand. This reverse causality is very difficult to disentangle in practice. The relationship between credit growth and GDP can be seen in figure 1. Over the 1990s and 2000s, credit growth grew in excess of nominal GDP growth, due to financial liberalisation and a trend decline in interest rates. More recently, credit growth has been more contained, and GDP and credit growth have moved more in sync.

**Figure 1. Credit growth and nominal GDP**




Source: Statistics NZ, RBNZ

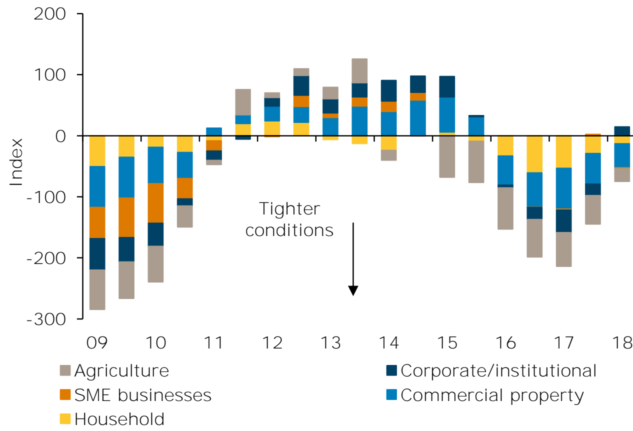
## Lending has been conservative this cycle

Lending has generally been conservative this cycle. Credit growth has been modest relative to history, with lending standards becoming more stringent in the wake of the global financial crisis and again in recent years after a brief loosening (figure 2). Households and businesses have also been perhaps a bit warier about taking on new loans, given that debt levels are already high. This caution – on the part of both banks and borrowers – has been reflected in less debt being associated with housing turnover since 2009 (figure 3).

As a result of both experience during the global financial crisis and subsequent tighter regulation (the introduction of the core funding ratio, which requires banks to generate 75% of their funding from more stable sources like deposits), banks have significantly reduced their reliance on less stable sources of funding – particularly foreign short-term wholesale debt funding markets. As a consequence of this, banks have looked to

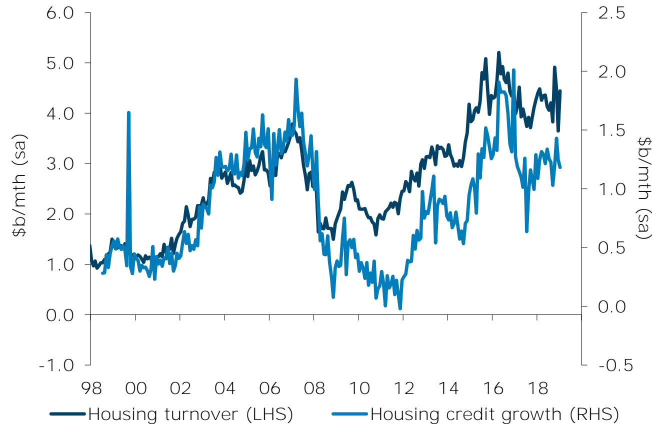
keep the difference between the amount of new lending taking place and the funding they receive via deposits in check, since this "funding gap" must be filled by relatively more expensive (and stable) sources of funding. The upshot is that banks' funding positions have become more important in determining the amount of credit available.

**Figure 2. Credit conditions reported by banks**




Source: RBNZ

**Figure 3. Credit associated with housing turnover**



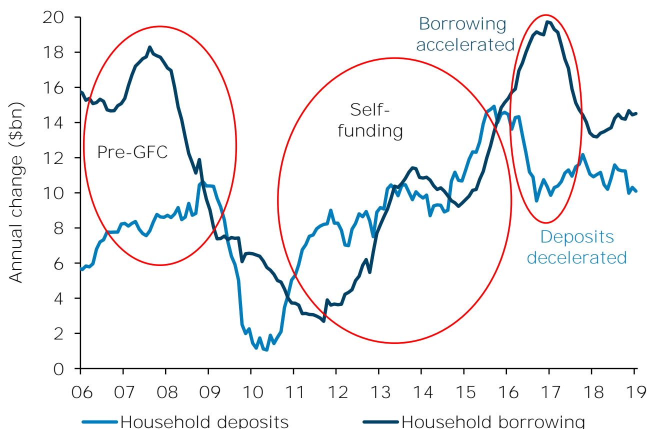

Source: RBNZ, REINZ

In reality, conservatism borne of experience has played a more important role than the funding policy changes. Banks' core funding ratios, at 88%, are well above the regulatory minimum. Macro-prudential policy has also contributed to more conservative lending standards, with the imposition of loan-to-value ratios coming into effect from 2013.

The housing market and economic momentum have both cooled since 2016, with reduced credit availability playing a role. This tighter credit reflected both the tightening in investor loan-to-value ratio restrictions at this time and a desire on the part of banks to narrow their funding gaps (figure 4). Prior to 2016, borrowing accelerated, consistent with strength in the housing market over that time. Deposit growth kept pace, so this was not a problem. But by 2016, banks funding gaps had widened considerably, exacerbated by accelerating deposit growth. As a result, banks sought to rein in new lending and credit growth fell markedly.

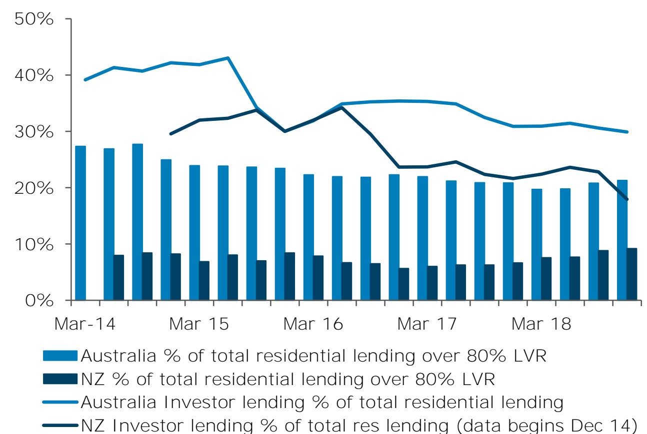
Macro-prudential policy tightening has led to a reduction in more risky types of lending in particular. For example, the share of mortgage lending going to investors has fallen markedly since 2016. However, lending has generally been much more conservative in New Zealand this cycle when compared with Australia. Policy changes have also seen a reduction in high-risk lending in Australia, but lending to investors and low-deposit borrowers has nonetheless been much higher over the ditch. This is one reason why the Australian mortgage market is experiencing a credit squeeze at present. This reduction in credit availability is contributing to weakness in the housing market there, exacerbated by an oversupply of apartments in some pockets. These dynamics are not playing out in New Zealand at present.

**Figure 4. Banks' funding gap**




Source: RBNZ

**Figure 5. Higher-risk lending – NZ and Australia**




Source: APRA, RBNZ

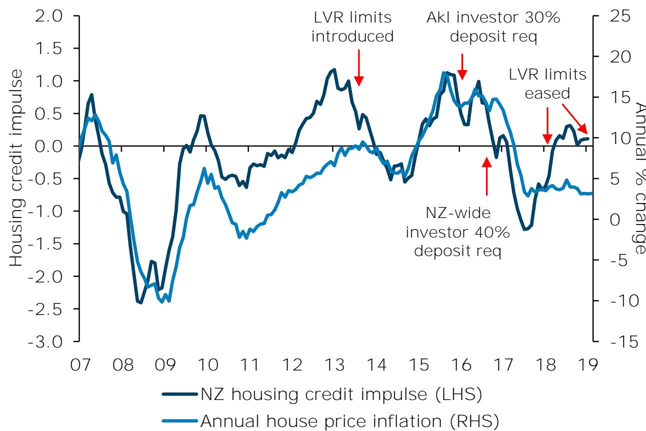
## Credit appears to have been less of a constraint recently…

Although banks remain prudent in their approach to lending, credit availability by some measures appears to have become less of a constraint recently – in direct contrast to developments in Australia. Banks' funding positions have been favourable of late, conducive to modest growth in new lending – supportive of the housing market and economic growth.

However, figure 6 shows that while the housing credit impulse has improved, house price inflation remains subdued. This softness reflects a number of other headwinds, including affordability constraints, waning population growth impetus, and investor wariness, particularly in light of ongoing (and proposed) government policy changes, including in the area of tax. And on the credit side, it appears anecdotally that banks are running a tougher ruler over borrowers' incomes versus expenditure metrics.

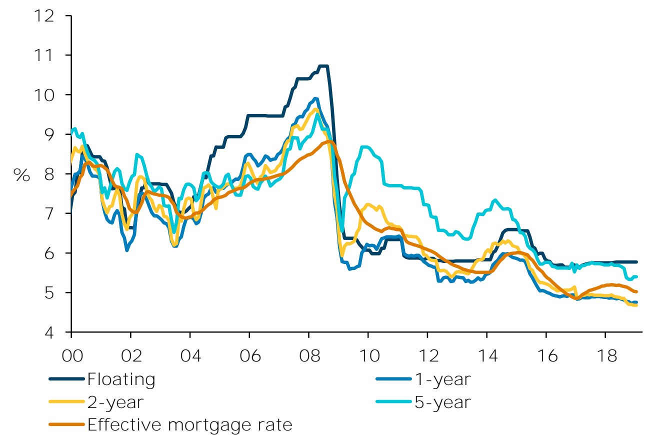
These other demand and supply headwinds mean that while investor loan-to-value ratio restrictions had a significant effect when implemented, these no longer appear to be much of a constraint in practice. Investor demand has waned, and there are now other bank-imposed constraints on riskier lending that are biting more. As such, we expect the recent easing in loan-to-value ratio restrictions will provide only a small boost at best. Indeed, the share of lending to investors has continued to decline in the past few months, despite the recent easing in LVR restrictions.

**Figure 6. Credit impulse and house prices**




Source: ANZ Research, RBNZ, REINZ

**Figure 7. Mortgage rates**

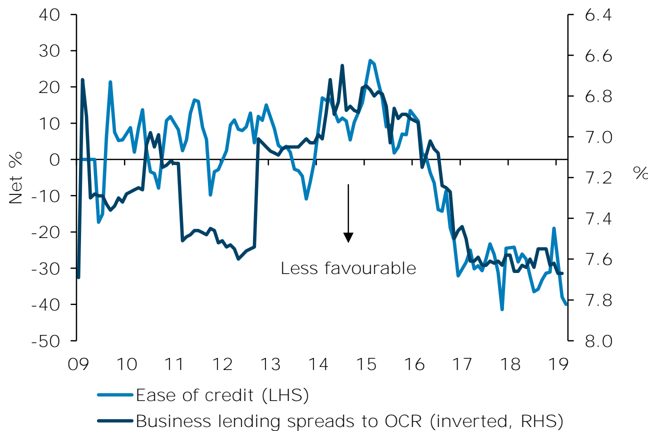



Source: ANZ Research, RBNZ

Recent declines in mortgage rates have provided a small boost to the housing market (figure 7), and this may continue, on the back of increased competition on the part of banks to attract high-quality mortgage borrowers in the context of somewhat softer housing demand. The regulatory backdrop (where mortgages have lower risk weightings and hence require less capital to be held against it) also encourages residential mortgage lending in favour of other lending.

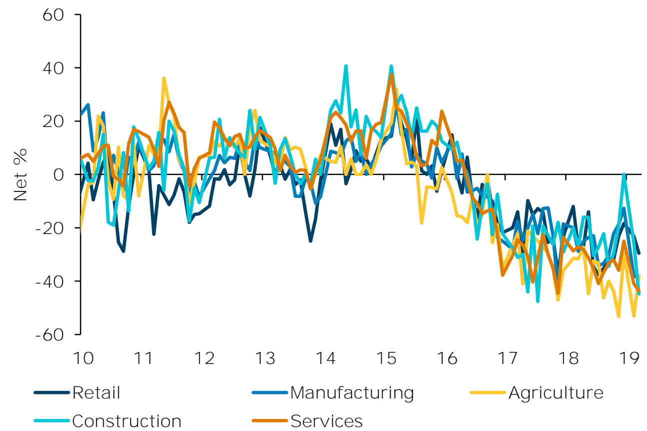
After the tightening in credit conditions through 2015-2017, banks are reporting less of a tightening bias than previously across a range of sectors (figure 2, above). But nonetheless, businesses are reporting that it is difficult to get credit on favourable terms and lending spreads are still wide (figure 8) – particularly for those in the agriculture sector (figure 9). So while credit is less of a headwind than it was, it still remains a constraint in certain segments – and may be weighing on business investment. Economic growth has moderated and is now tracking a bit below 2½% y/y. So while credit is not a significant constraint at present, it certainly isn't putting the wind up the economy's sails either – and we expect credit growth will be capped by continuing prudence on the part of banks.

**Figure 8. Firms' experienced credit conditions**




Source: ANZ Research, RBNZ

**Figure 9. ANZBO ease of credit by sector**




Source: ANZ Research

## ...but credit is likely to become a headwind

**While banks' funding positions** have been supportive of continued modest credit growth, banks will be wary that the gap could start to widen significantly once more. Deposit growth has moderated significantly in recent months, posing the risk that banks rein in their lending (figure 10). Since the middle of last year, total NZD deposit growth has softened from a 3-month annualised rate of 8% y/y to just 4% in January. A portion of this moderation has been due to a pull-back in non-resident deposits, which may be a consequence of the foreign buyer ban. However, growth in resident deposits – including those from households – has pulled back too. Household deposit growth has softened from a 3-month annualised rate of 8% y/y in the middle of last year to 3%, with particular softness seen since November.

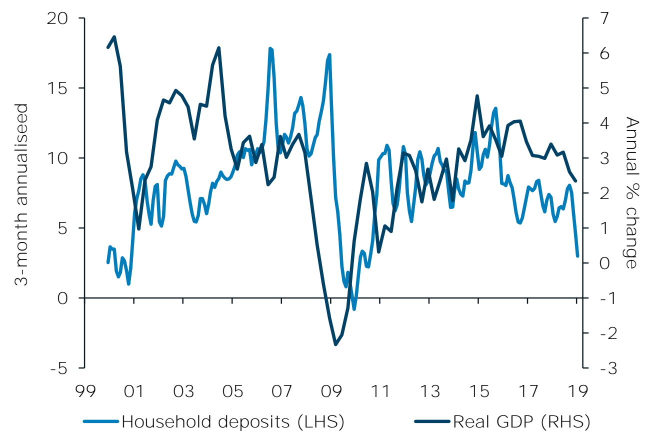
Deposit growth tends to move in sync with housing turnover to a degree, since sellers have more equity than buyers on average. However, house sales have been fairly stable, looking through recent monthly volatility. One possible contributor to the recent softening in deposit growth is softer GDP growth. We expect that GDP will continue running close to or a little below 2½%, consistent with continued modest deposit growth and a recovery in coming months. However, with deposit growth having moderated, there is a risk that wider funding gaps could lead to a pull-back in lending growth that could stifle the economy.

While we expect deposits will lift in the short term, the risk of persistently weak deposit growth should not be discounted. Over history, periods of persistently weak deposit growth have tended to be associated with periods of economic weakness (1999 and 2008 are notable examples – figure 11). It is certainly not our central expectation that this sort of dynamic is playing out, and deposit growth does not tend to be a leading indicator for economic growth in any case, but the possibility cannot be ruled out that we are missing something regarding **the household sector's situation**. For this reason, deposit growth bears watching in coming months.

**Figure 10. Banks' funding gap (quarterly)**

Source: RBNZ

**Figure 11. Household deposits and GDP growth**




Source: RBNZ, Statistics NZ

# Feature Article: **Credit where it's due**

Adding to the possibility that credit becomes more of a headwind going forward, the RBNZ has proposed changes to bank capital requirements that, if implemented, would potentially have significant impacts on the cost and availability of credit, with flow-on effects to the economy more broadly.

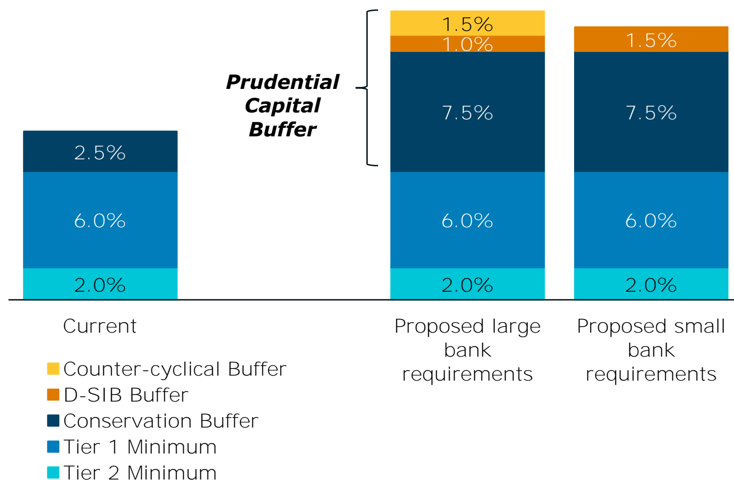
Banks fund themselves in two ways: through equity (capital) and debt (including deposits), where equity is the stake held by the bank's owners or shareholders. Banks are required to fund a minimum proportion of their operations through equity and the RBNZ is proposing that this proportion be increased significantly (figure 12).

Equity is more expensive than debt funding, and bank margins would need to increase to cover this cost and dilution of existing capital, even assuming that bank shareholders would be willing to accept lower returns. A higher cost of credit would be reflected in higher lending spreads (including mortgages), meaning retail interest rates lift relative to wholesale rates. Banks would still need deposit growth, so we expect there would only be a small effect on deposit margins, though the OCR would likely need to fall to compensate, so lower returns would impact depositors too. We estimate that the impact on credit spreads could be 50bps or more in aggregate.

The RBNZ's proposed changes will also affect the profitability of lending to various sectors differently, as banks seek to raise capital. Mortgage lending would become more attractive relative to commercial and agricultural lending, as it requires relatively less capital. This means that retail borrowing rate increases are likely to be larger for businesses and those in the agricultural segments. In addition to the price effect, higher capital requirements would also potentially impact the availability of credit to these sectors, particularly at the riskier end. This could impact business and agriculture sector confidence and investment.

This hit to the productive economy implies impacts on GDP beyond the price effects described above. And while these changes would tend to incentivise mortgage lending at the expense of business and agricultural lending, the property market would likely not be immune. It may be just less negatively impacted, depending on how things pan out. And less growth in other sectors would impact GDP and employment, with flow-on effects to the housing market.

**Figure 12. RBNZ proposed capital requirements**




Source: RBNZ

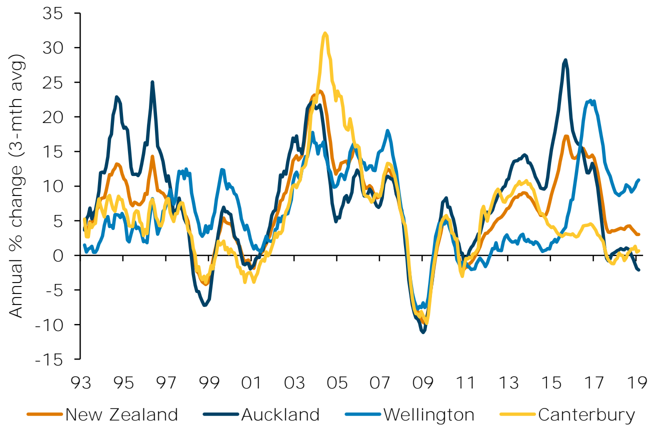
Separate from these sectoral rebalancing effects, a broader retrenchment in the availability of credit to the New Zealand economy is also possible if margins cannot be recouped and lending in the New Zealand market no longer generates an acceptable return on equity for shareholders of the major New Zealand banks (the Australian parent banks, in practice). All capital provision has an opportunity cost, and if risk-adjusted returns able to be generated elsewhere outdo those on offer in New Zealand, that is where the capital will go.

As we have emphasised, availability of credit is sometimes much more important than the price (just look at what is happening in Australia at the moment). And a retrenchment in credit availability could have more severe economic impacts than increased lending margins, which can in theory be offset by monetary policy (as long as the OCR doesn't run out of headroom, which is a real risk should New Zealand suffer a marked downturn during the transition period). Although mortgage lending is likely to be favoured throughout the transition, reduced credit availability would likely act as a significant headwind to the housing market, while also dragging on other sectors and the economy more broadly.

In our view, rebalancing effects and impacts on broader credit availability from the proposed changes may be even more important than the impact on retail interest rates. Overall, while there is uncertainty about the exact size and composition of these effects, we estimate that the impacts on the economy would be sizeable, and would include dampening impacts on both housing market turnover and house price inflation.

All up, while credit availability does not appear to be too much of a constraint on the economy at the moment, we think it is very likely that it will become a greater one. Potential credit headwinds affecting the price and availability of credit are one reason – among many – underpinning our call that the OCR will need to be lowered in time.

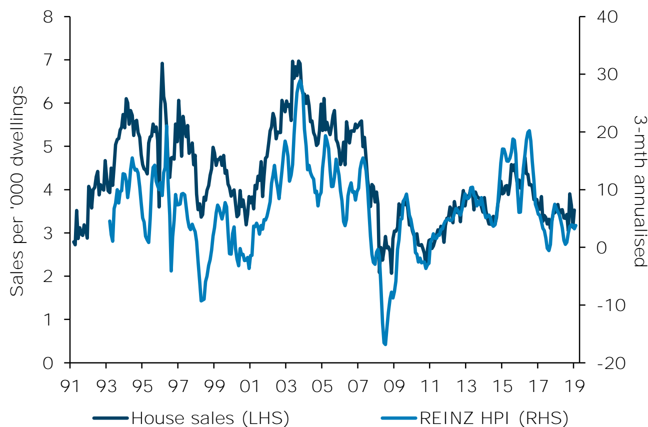
**Figure 1. Regional house price inflation**




Source: ANZ Research, REINZ

House prices increased 0.7% m/m in February, to be 1% higher over the past three months, aided by declines in mortgage rates in the latter half of 2018. However, annual house price inflation continues to moderate, reaching 3.0% y/y (3mma) in February, down from 4.2% in September. We expect the recent firming will prove short-lived and that headwinds weighing on the market will see prices continue their gentle descent, though regional divergence is expected to remain evident. In Auckland, prices rose 0.5% m/m in February to be down more than 2% over the year (3mma). In the rest of New Zealand, prices were up 0.9% (8.2% y/y). Strength has been particularly apparent in Wellington (11% y/y), Manawatu-Whanganui (17%), Hawke's Bay (14%), Otago (13%) and Southland (13%).

**Figure 2. REINZ house prices and sales**

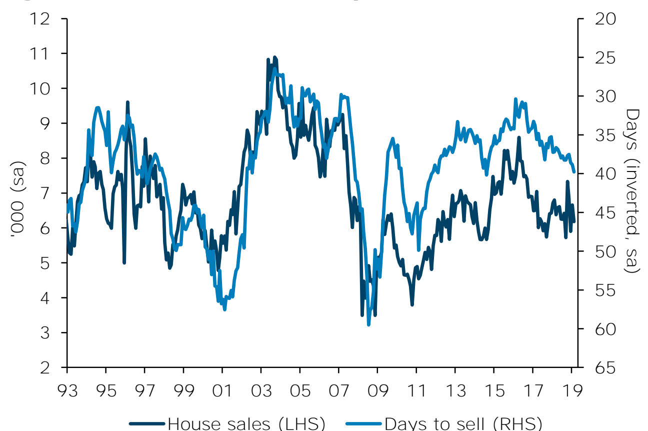



Source: ANZ Research, REINZ

Sales volumes and prices tend to be closely correlated, although at times tight dwelling supply can complicate the relationship.

Seasonally adjusted house sales fell 7% in February, after an eager start to the year (up 13% in January). The data remain whippy, but the January lift was likely boosted by the RBNZ's relaxation of LVR restrictions, which we expected would only provide a temporary boost. House sales remain at a low level, consistent will low house price inflation. On the whole, sales have been oscillating around a flat level to be 6% lower than a year ago (3mma).

**Figure 3. Sales and median days to sell**

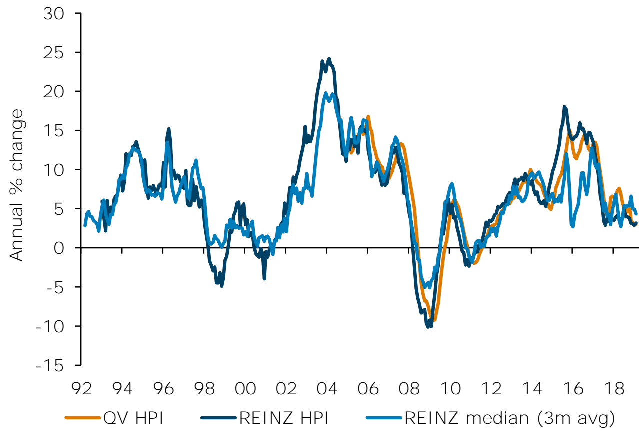



Source: ANZ Research, REINZ

How long it takes to sell a house is also an indicator of the strength of the market, encompassing both demand and supply-side considerations. Larger cities tend to see houses sell more quickly, but deviations in a region from its average provide an indicator of the heat in a market at any given time.

Based on days to sell a house, the housing market is still a little tight in aggregate, but less so than previously. Median time to sell a house is sitting at 40 days (sa) – right on the historical average. However, the Auckland market has considerable slack. Days to sell lengthened in February from 43 to 49 days (relative to a historical average of 36 days). Days to sell is now the longest it has been in Auckland since the 2008/09 recession. While slack at this level may not linger reflecting usual volatility in the data, it does suggest that weakness in prices may continue for a while yet. Meanwhile, markets outside Auckland and Canterbury are tight.

**Figure 4. REINZ and QV house prices**

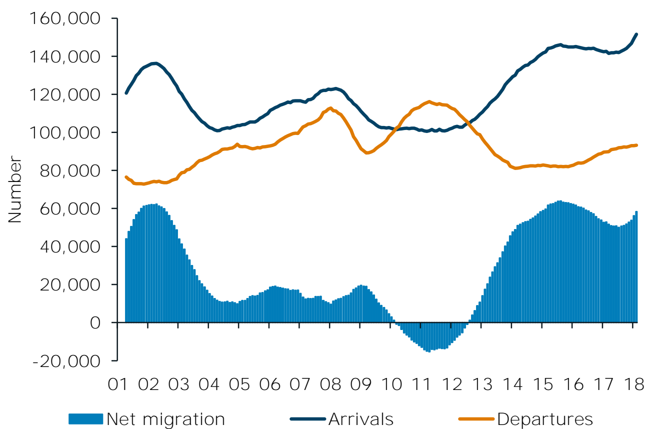



Source: ANZ Research, REINZ, QVNZ

There are three monthly measures of house prices in New Zealand: the median and house price index measures produced by REINZ, and the monthly QVNZ house price index. The latter tends to lag the other measures as it records sales later in the transaction process. Moreover, movements do not line up exactly, given differing methodologies (the REINZ house price index and QVNZ measures attempt to adjust for the quality of houses sold).

The REINZ HPI – our preferred measure – is sitting at 3.2% y/y (3mma). The QVNZ measure has moderated even further and is sitting at 3.0% y/y. The REINZ median, on the other hand, was up 5.6% y/y (3mma). Since the median does not control for composition, this may reflect high-value sales.

**Figure 5. Annual migration***




Source: Statistics NZ

* The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data

Migration flows[1] to and from New Zealand are one of the major drivers of housing market cycles. The early-1970s, mid-1990s, mid-2000s and most recent house price booms have coincided with large net migration inflows.

Seasonally adjusted monthly net inflows lifted to 6,300 in January. December's print was revised from 5,080 to 6,880, reflecting lower departures than previously published. This implies that inflows have been sitting at around 6,100 on average over the past three months, compared with an average of 4,800 over the past 12 months. On the face of it, the latest data suggest the migration cycle could be turning a corner. But Stats NZ changed their methodology recently and the data is subject to revision and relatively untested, so we would caution about reading too much into it at this stage – the story keeps changing and it could all be noise.

**Figure 6. Residential building consents**

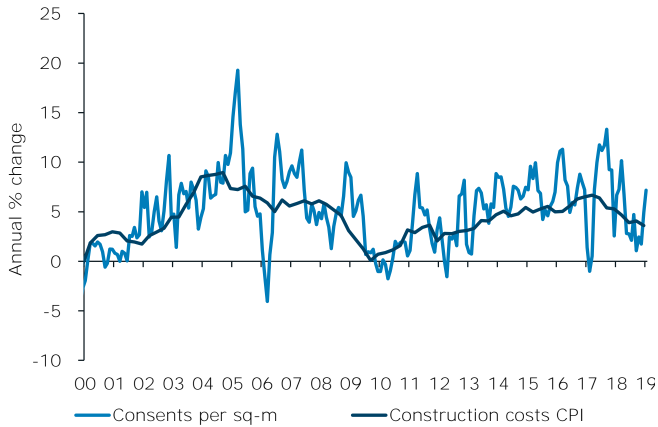
Source: ANZ Research, Statistics NZ

Residential building consents started the year on a solid note, up 16.5% m/m in January, after a 5.4% rise in December. Consents have been strong recently, but this has been driven by multi-unit dwellings which tend to be volatile. Annual consent issuance is running at 33,800, increasing above the previous mid-2000s peak (33,200). Capacity constraints are being felt, and the construction industry is faced uncertainty, profitability challenges and delays, which we expect will make it difficult for issuance to push higher.

That said, issuance remains at a high level as strong levels of home building continue. This is particularly the case in Auckland, but strength is also evident across the rest of New Zealand (though building in Canterbury remains well off its peaks).

[1] Note all references to permanent long term migration throughout this report refer to the new methodology Statistics NZ have implemented from November 2018 onwards to identify long term migration. The new data is only available from June 2014 which we have indicated with a series break. For more on this, see International migration uses new official measure.

**Figure 7. Construction cost inflation**

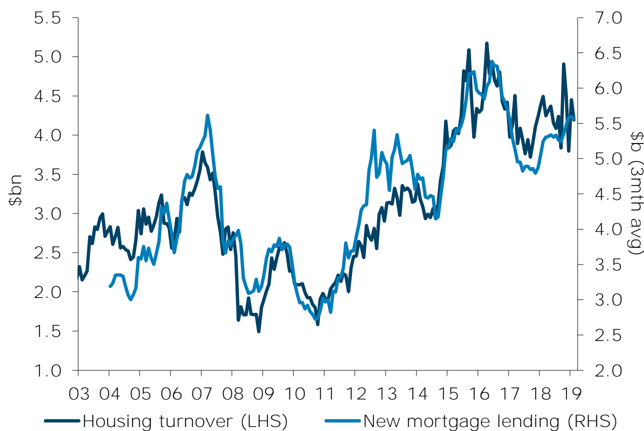



Source: ANZ Research, Statistics NZ

Construction cost inflation has softened since 2017 and this gradual deceleration may continue. Growth in the cost of consented work per square metre – a proxy for construction cost inflation – picked up to 7% y/y (3mma) in January, though it has generally been fairly weak of late. This compares with CPI construction cost inflation of 3.6% y/y in the December quarter. Construction cost inflation has been in gradual decline from its recent peak of 6.7% in March 2017.

Capacity pressures in the industry remain acute, which should continue to support price rises. But firm pessimism may lead to continued caution with regard to passing on cost increases.

**Figure 8. New mortgage lending and housing turnover**




Source: ANZ Research, RBNZ

New residential mortgage lending figures are published by the RBNZ. These are gross (rather than net) flows and can provide leading information on household credit growth and housing market activity.

New mortgage lending has been volatile of late, consistent with the recent noise in house sales. New lending fell 3.9% m/m (sa) in February after rising 9.1% m/m in January. House sales and new lending were boosted by the easing in LVR restrictions in January, but both have subsequently pulled back. From here, the outlook will depend on where the trend in sales settles. Housing turnover and new mortgage lending have been oscillating around a high level, though headwinds could see this peter off eventually.

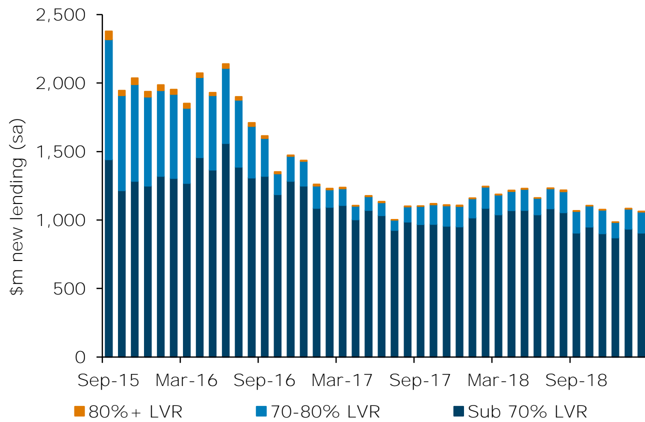
**Figure 9. New mortgage lending and housing credit**

Source: ANZ Research, REINZ, RBNZ

Household credit has been growing at a pretty consistent monthly pace since early 2017. In monthly terms, household lending increased 0.4% m/m in January. In annual terms, household credit growth is running at 5.9% y/y (3mma).

Housing credit growth has been stable in recent months, despite housing market volatility. Banks are behaving prudently, the housing market has cooled, investors are wary, and loan-to-value ratio restrictions are expected to still have a dampening influence on credit availability, even when they are eased. Proposed tightening in banks' capital requirements would also create headwinds, if implemented. On the whole, we expect credit growth will continue to grow modestly from here.

**Figure 10. Investor lending by LVR**

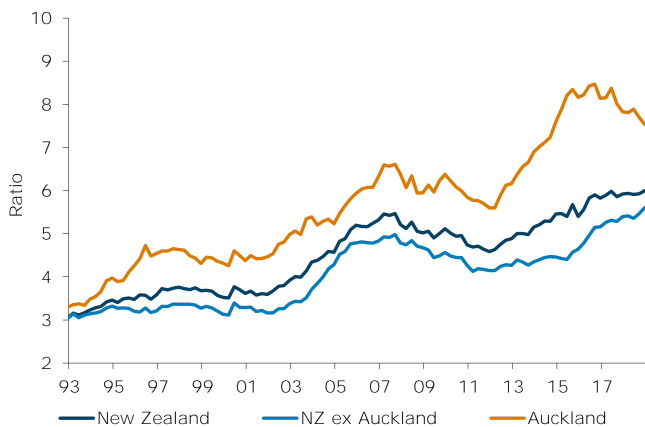



Source: ANZ Research, RBNZ

On a seasonally adjusted basis, new lending to investors fell 3.4% in February after rising 9% in January. January's rise was consistent with easing in loan-to-value restrictions and higher sales in the month. But as we expected, the boost was small, and was not large enough to offset the fall in December – with lending to investors pretty flat overall in recent months. Underlying this, investors remain wary, weighing on the housing market. About 22% of new loans were to investors in February, after a brief tick up to 27% in January.

The share of investor lending on more-risky terms remains low. The share of investor lending at loan-to-value ratios of less than 70% continues to sit at around 85%. In late-2014 it was less than half.

**Figure 11. Regional house prices to income**




Source: ANZ Research, REINZ, Statistics NZ

One commonly cited measure of housing affordability is the ratio of average house prices to incomes. It is a standard measure used internationally to compare housing affordability across countries. It isn't perfect; it does not take into account things like average housing size and quality, interest rates, and financial liberalisation. Therefore, it is really only a partial gauge as some of these factors mean that it is logical for this ratio to have risen over time.

Nationally, the ratio has been stable at 6 times income since early 2017. Auckland has seen its ratio ease from almost 9 times in Q3 last year to an estimated 7.5 times in Q4 2018, reflecting recent weakness in house prices. Elsewhere, the ratio has continued to rise; at 5.4 times incomes this is at record highs.

**Figure 12. Regional mortgage payments to income**

Source: ANZ Research, REINZ, RBNZ, Statistics NZ

Another, arguably more comprehensive, measure of housing affordability is to look at it through the lens of debt serviceability, as this also takes into account interest rates, which are an important driver of housing market cycles.

We estimate that for a purchaser of a median-priced home (20% deposit), the average mortgage payment to income nationally is 34%. However, there are stark regional differences. In Auckland it is 42% and the rest of New Zealand it is 32%. This is not far from historic highs in Auckland, despite mortgage rates being very low. Debt levels are high nationwide. And while home ownership is being made more affordable by account of low mortgage rates, households could be vulnerable in the event of even a small lift in interest rates.

# Property gauges

House prices have firmed over the past six months, particularly in the regions, with falls in mortgage rates providing a boost. But we expect the recent firming to be short-lived. House sales fell in February, after the easing in loan-to-value ratio restrictions provided a temporary boost in January. Looking thorough volatility, the trend has been fairly flat since mid-2017. From here, housing market activity and price pressures are expected to be limited. Demand pressures are not building as strongly as before, with a lower (but uncertain) impulse from migration. And headwinds are also evident; bank prudence, investor wariness, and affordability constraints. Tighter credit conditions may emerge if proposed increases in bank capital requirements are implemented. Proposed Government policy changes, and the uncertainty associated with these, are also expected to see the market remain contained.

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 debt.

**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 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, the UK, and Australia, in recognition of the important role that global factors play in New Zealand'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.

**House prices to rents.** We look at median prices to rents as an indicator of relative affordability.

**Policy changes.** Government and macro-prudential policy can affect the property market landscape.

| Indicator | Level | Direction for prices | Comment |
|---|---|---|---|
| Affordability | Unaffordable | ↔/↓ | Affordability constraints are very relevant. It is the main reason we see the Auckland market continuing to underperform. |
| Serviceability/ indebtedness | High debt, low rates OK – high rates not | ↔/↓ | Serviceability looks okay provided interest rates stay low and income growth is solid. Debt levels are high. |
| Interest rates / RBNZ | Eventual cut | ↔/↑ | We see the OCR falling by year-end, but partly to offset upward pressure on rates. Short-term mortgage rates have fallen. |
| Migration | Peaked | ↔/↑ | Migration is easing gradually, but remains elevated. We expect further softening, though new data creates uncertainty. |
| Supply-demand balance | Demand > Supply | ↔/↑ | MBIE estimates New Zealand is short 71k houses, but the build-up of pent-up demand is becoming less pronounced. |
| Consents and house sales | Shortage | ↔/↑ | We expect consents issuance will struggle to push higher, with the construction sector reaching its limits. |
| Liquidity | Set to tighten | ↔/↓ | Credit availability is very relevant. Banks have plenty of cash currently, but know they have to raise a lot more capital. |
| Globalisation | Weak | ↔/↓ | The foreign-buyer ban has stymied demand from non-residents, and the housing market is weak in Australia. |
| Housing supply | Too few | ↔/↑ | The Government is going to take a more active role, but there are still questions about crowding out other work and labour shortages. |
| House prices to rents | Too high | ↔/↓ | Rents are moving up, with pressures on the existing stock apparent. Buying remains relatively expensive. |
| Policy changes | Dampening | ↔/↓ | Government policy changes are making investors wary. Easing in loan-to-value restrictions have provided a slight offset. |
| **On balance** | **In recent ranges** | ↔/↓ | **We expect the market to remain contained, though volatility may continue in the short term.** |

# Property gauges

**Figure 1: Housing affordability**

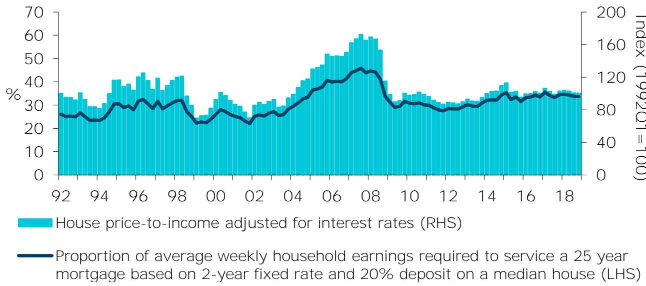



**Figure 2: Household debt to disposable income**

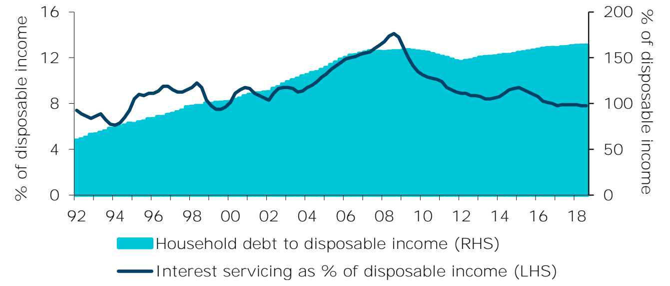



**Figure 3: New customer average residential mortgage rate (<80% LVR)**

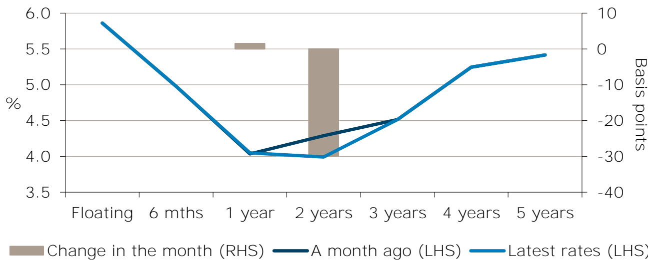



**Figure 4: Annual migration***

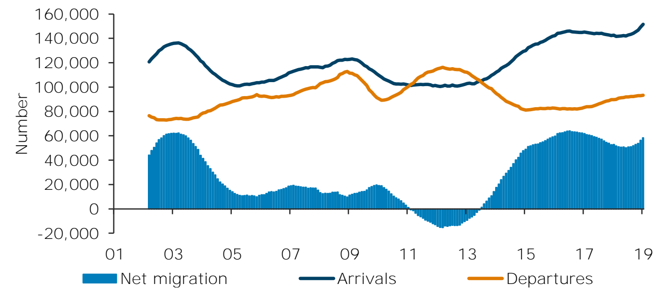



**Figure 5: Housing supply-demand balance**

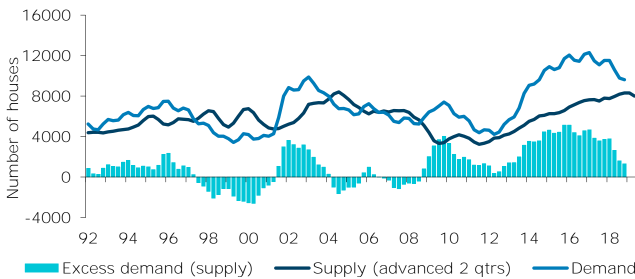



**Figure 6: Building consents and house sales**

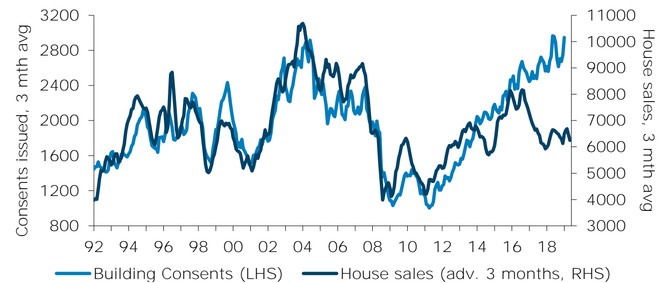



**Figure 7: Liquidity and house prices**

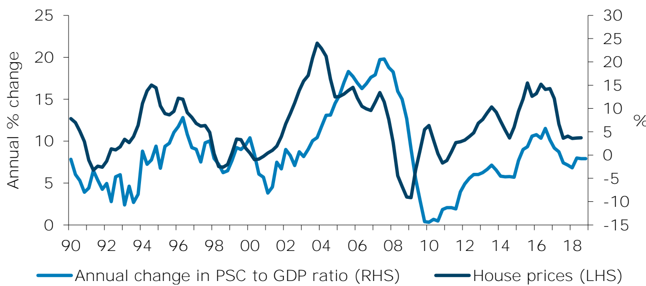



**Figure 8: House price inflation comparison**

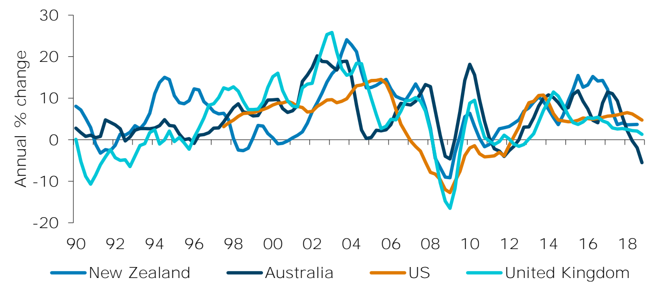



**Figure 9: Housing supply**

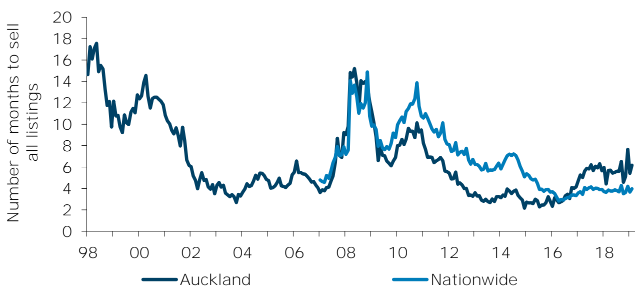



**Figure 10: Median rental, annual growth**

Source: ANZ Research, Statistics NZ, REINZ, RBNZ, QVNZ, Nationwide, Bloomberg, Barfoot & Thompson, MBIE

* The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data

# Economic overview

## Summary

Evidence of a slowdown in global growth continues to accumulate, and the risks of a sharper slowdown have increased. Weaker growth momentum has been broad-based across New Zealand's trading partners. Central banks have responded to support growth, with easier policy expected going forward. The RBNZ has signalled a more cautious tone, with the next move in the OCR more likely to be down. We are picking November for the first move, with risks skewed towards a cut earlier than this. We expect that capacity pressures will wane as domestic growth continues to underwhelm and the economy will need a further boost from monetary stimulus to push inflation closer to target and see employment remain near its maximum sustainable level. It is possible that inflation might improve more than we expect from here, but worsening global conditions and weaker growth domestically are currently more pressing concerns.

## Our view

Evidence of a slowdown in global growth continues to accumulate, and the risks of a sharper slowdown have increased. Weaker growth momentum has been broad-based across New Zealand's trading partners, and a strong rebound in activity is not expected in the near term. Several key uncertainties appear to have weighed on consumption and investment decisions; the China-US trade negotiations, Brexit, and the effect of previous tightening in Chinese credit growth.

Partly offsetting the deteriorating outlook, support has been provided by more stimulatory policy settings globally. Central banks have turned more cautious: the Fed is now firmly on hold, the ECB has rekindled its easing program, the PBOC has been easing policy, and the RBA has struck a more cautious tone. This has also helped support a rebound in financial markets and the prices of risky assets.

Domestically, the New Zealand economy lost momentum in the second half of 2018. GDP data for the fourth quarter showed growth continuing to moderate, slipping from 2.6% to 2.3% y/y. The underlying details of the release had some bright spots, such as strong growth in services industries, but a continued deceleration in growth remains clear. Residential investment is at high levels and continues to eke out gains, though we expect growth to be limited, given capacity constraints and challenges in the construction industry. Net exports provided a slightly positive contribution, but with imports high (supported by domestic demand) we don't see this lasting.

Near-term GDP indicators point to ongoing softness. However, it remains to be seen whether this eventuates in actual outcomes and we are assuming in our forecasts that some of these leading indicators are overstating the loss of momentum. The effects of the global slowdown are also yet to be fully felt in New Zealand. To date, New Zealand commodity prices have remained remarkably resilient, in part reflecting supply dynamics, although lower world interest rates will add upward pressure to the New Zealand dollar.

The RBNZ's February MPS forecast for growth above 3% y/y this year is looking hard to achieve. Currently, the economy is coming up against constraints, but we expect that these will start to wane as headwinds build. With capacity past its peak and inflation still not quite where it needs to be, it will be difficult to sustain inflation at the 2% target over the medium term without further monetary stimulus. We see the OCR lower in time.

Consistent with our view, the RBNZ now concurs that the next move in the OCR is more likely to be down. They switched to an overtly dovish bias rather than a neutral tone at the March OCR Review, acknowledging that risks are skewed to the downside. We have pencilled in the first cut for November this year, with two follow up cuts expected over 2020. But we see risks skewed towards the first move being earlier than this. It is possible that growth could strengthen form here, or that cost pressures could see firms start to increase prices more than we expect, and that this could delay the timing of eventual cuts. But domestic headwinds and global risks are clearly more pressing concerns at present that could see us calling cuts earlier. We will be watching the global and domestic data flow carefully for confirmation that these risks are coming to fruition. Ultimately, though, it seems clear that cuts are just a matter of time.

# Key forecasts

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

| Mortgage Size ($'000) | 4.00 | 4.25 | 4.50 | 4.75 | 5.00 | 5.25 | 5.50 | 5.75 | 6.00 | 6.25 | 6.50 | 6.75 | 7.00 | 7.25 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 200 | 243 | 250 | 256 | 263 | 270 | 276 | 283 | 290 | 297 | 304 | 311 | 319 | 326 | 333 |
| 250 | 304 | 312 | 320 | 329 | 337 | 345 | 354 | 363 | 371 | 380 | 389 | 398 | 407 | 417 |
| 300 | 365 | 375 | 385 | 394 | 404 | 415 | 425 | 435 | 446 | 456 | 467 | 478 | 489 | 500 |
| 350 | 426 | 437 | 449 | 460 | 472 | 484 | 496 | 508 | 520 | 532 | 545 | 558 | 570 | 583 |
| 400 | 487 | 500 | 513 | 526 | 539 | 553 | 566 | 580 | 594 | 608 | 623 | 637 | 652 | 667 |
| 450 | 548 | 562 | 577 | 592 | 607 | 622 | 637 | 653 | 669 | 684 | 701 | 717 | 733 | 750 |
| 500 | 609 | 625 | 641 | 657 | 674 | 691 | 708 | 725 | 743 | 761 | 778 | 797 | 815 | 833 |
| 550 | 669 | 687 | 705 | 723 | 741 | 760 | 779 | 798 | 817 | 837 | 856 | 876 | 896 | 917 |
| 600 | 730 | 750 | 769 | 789 | 809 | 829 | 850 | 870 | 891 | 913 | 934 | 956 | 978 | 1,000 |
| 650 | 791 | 812 | 833 | 854 | 876 | 898 | 920 | 943 | 966 | 989 | 1,012 | 1,036 | 1,059 | 1,083 |
| 700 | 852 | 874 | 897 | 920 | 944 | 967 | 991 | 1,015 | 1,040 | 1,065 | 1,090 | 1,115 | 1,141 | 1,167 |
| 750 | 913 | 937 | 961 | 986 | 1,011 | 1,036 | 1,062 | 1,088 | 1,114 | 1,141 | 1,168 | 1,195 | 1,222 | 1,250 |
| 800 | 974 | 999 | 1,025 | 1,052 | 1,078 | 1,105 | 1,133 | 1,160 | 1,188 | 1,217 | 1,246 | 1,274 | 1,304 | 1,333 |
| 850 | 1,035 | 1,062 | 1,089 | 1,117 | 1,146 | 1,174 | 1,204 | 1,233 | 1,263 | 1,293 | 1,323 | 1,354 | 1,385 | 1,417 |
| 900 | 1,095 | 1,124 | 1,154 | 1,183 | 1,213 | 1,244 | 1,274 | 1,306 | 1,337 | 1,369 | 1,401 | 1,434 | 1,467 | 1,500 |
| 950 | 1,156 | 1,187 | 1,218 | 1,249 | 1,281 | 1,313 | 1,345 | 1,378 | 1,411 | 1,445 | 1,479 | 1,513 | 1,548 | 1,583 |
| 1000 | 1,217 | 1,249 | 1,282 | 1,315 | 1,348 | 1,382 | 1,416 | 1,451 | 1,486 | 1,521 | 1,557 | 1,593 | 1,630 | 1,667 |

Mortgage Rate (%)

## Housing market indicators for February 2019 (based on REINZ data)

| | House prices (ann % chg) | 3mth % chg | No of sales (sa) | Mthly % chg | Avg days to sell (sa) |
|---|---|---|---|---|---|
| Northland | 12.0 | -1.1 | 161 | -16% | 50 |
| Auckland | -0.7 | 0.2 | 1,681 | -12% | 49 |
| Waikato | 5.4 | 4.6 | 647 | -9% | 47 |
| Bay of Plenty | 7.2 | 4.0 | 456 | -5% | 43 |
| Gisborne | 24.3 | 6.4 | 51 | +6% | 37 |
| Hawke's Bay | 6.3 | -2.6 | 230 | -4% | 33 |
| Manawatu-Whanganui | 23.1 | 3.9 | 379 | +5% | 26 |
| Taranaki | 10.0 | 1.2 | 172 | -9% | 28 |
| Wellington | 16.2 | 2.4 | 702 | +4% | 31 |
| Tasman, Nelson and Marlborough | 10.1 | 1.7 | 254 | +46% | 46 |
| Canterbury | 1.6 | -0.4 | 834 | -8% | 45 |
| Otago | 14.1 | 0.5 | 337 | -6% | 29 |
| West Coast | 5.3 | 4.5 | 44 | +1% | 87 |
| Southland | 21.2 | 5.2 | 178 | -5% | 35 |
| **New Zealand** | **5.6** | **1.1** | **6,178** | **-7%** | **40** |

## Key forecasts

| | Actual | | | | Forecasts | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Economic indicators | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 |
| GDP (Ann % Chg) | 3.2 | 2.6 | 2.3 | 2.4 | 2.2 | 2.4 | 2.5 | 2.5 | 2.5 | 2.6 |
| CPI Inflation (Annual % Chg) | 1.5 | 1.9 | 1.9 | 1.6 | 1.7 | 1.3 | 1.4 | 1.8 | 1.8 | 1.8 |
| Unemployment Rate (%) | 4.4 | 4.0 | 4.3 | 4.3 | 4.3 | 4.2 | 4.2 | 4.2 | 4.2 | 4.2 |
| House Prices (Annual % Chg) | 3.7 | 4.2 | 3.4 | 3.4 | 2.7 | 3.1 | 3.3 | 2.6 | 2.4 | 2.2 |
| Interest rates (RBNZ) | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 |
| Official Cash Rate | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 1.50 | 1.00 | 1.00 | 1.00 |
| 90-Day Bank Bill Rate | 2.0 | 1.9 | 2.0 | 1.9 | 1.9 | 1.8 | 1.6 | 1.2 | 1.2 | 1.2 |
| Floating Mortgage Rate | 5.8 | 5.8 | 5.8 | 5.8 | 5.8 | 5.8 | 5.5 | 5.0 | 5.0 | 5.0 |
| 1-Yr Fixed Mortgage Rate | 4.9 | 4.8 | 4.8 | 4.7 | 4.8 | 4.7 | 4.6 | 4.4 | 4.4 | 4.4 |
| 2-Yr Fixed Mortgage Rate | 4.9 | 4.8 | 4.7 | 4.8 | 4.7 | 4.8 | 4.7 | 4.6 | 4.7 | 4.7 |
| 5-Yr Fixed Mortgage Rate | 5.7 | 5.4 | 5.4 | 5.6 | 5.5 | 5.6 | 5.7 | 5.7 | 5.7 | 5.7 |

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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