ANZ Research

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New Zealand Property Focus

Building headwinds

ANZ

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Summary

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

Feature Article: Building headwinds

For a number of years, construction demand has been strong; activity has ramped up to a high level and firms have been run off their feet. But recently, firms have started reporting that growth in new building work has started to drop off and the outlook is looking less assured. Pent-up demand for housing and KiwiBuild will provide a floor for activity, but that may not be enough to sustain today's very elevated levels. Construction firms' costs continue to escalate, but in the context of wariness about the demand outlook, they are finding it more difficult to increase prices, causing profitability stresses. And this comes against the backdrop of an industry already grappling with broader financial, productivity and staffing challenges. So far this cycle, such challenges have been manageable in the context of strong growth in building work, but they will be difficult to bear should demand start to wane, even if activity remains elevated as we expect. And with construction a bellwether of the economic cycle more broadly, this adds to the picture that has formed of an economy past its best.

Property gauges

Auckland house price growth continues to diverge from the regions, with softness in Auckland house prices remaining evident. Falls in mortgage rates are providing a boost to activity in the regions, but we expect the firming over the past six months to be short-lived. House sales fell further in March, after the easing in loan-to-value ratio restrictions provided a temporary boost at the start of the year. Looking through volatility, the trend has been fairly flat since mid-2017. Housing market activity and price pressures are expected to remain limited from here. Demand pressures do not appear to be building as strongly as before, but the impulse from migration is uncertain. Headwinds are evident; bank prudence, investor wariness, and affordability constraints are expected to constrain activity. Tighter credit conditions may emerge if proposed increases in bank capital requirements are implemented, and proposed Government policy changes are also expected to see the market remain contained.

Economic overview

Global growth has slowed, with a synchronised slowdown in the growth of New Zealand's trading partners, and the risks of a sharper slowdown remain evident. However, recent developments tentatively point to some stabilisation in growth momentum, particularly in China. Central banks have responded to support growth, with easier policy expected going forward, which should support growth. The RBNZ has signalled a more cautious tone, with the next move in the OCR more likely to be down. We are picking August for the first move, with risks balanced. There are signs that capacity pressures are waning 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. While cost pressures could push inflation higher, softer global conditions and a weak outlook for domestic growth are likely to dominate the RBNZ's thinking.

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Summary

For a number of years, construction demand has been strong; activity has ramped up to a high level and firms have been run off their feet. But recently, firms have started reporting that growth in new building work has started to drop off and the outlook is looking less assured. Pent-up demand for housing and KiwiBuild will provide a floor for activity, but that may not be enough to sustain today's very elevated levels. Construction firms' costs continue to escalate, but in the context of wariness about the demand outlook, they are finding it more difficult to increase prices, causing profitability stresses. And this comes against the backdrop of an industry already grappling with broader financial, productivity and staffing challenges. So far this cycle, such challenges have been manageable in the context of strong growth in building work, but they will be difficult to bear should demand start to wane, even if activity remains elevated as we expect. And with construction a bellwether of the economic cycle more broadly, this adds to the picture that has formed of an economy past its best.

Construction demand has been strong in recent years...

For a number of years, construction demand has been strong, with the Canterbury rebuild and strong housing demand in Auckland contributing in the context of a broader cyclical recovery. Building activity has now reached a very high level. Total construction work represents a sizeable proportion of economic activity in New Zealand, sitting at 12% of GDP over the past year, just shy of the highs reached during the 2000s, of around 13%.

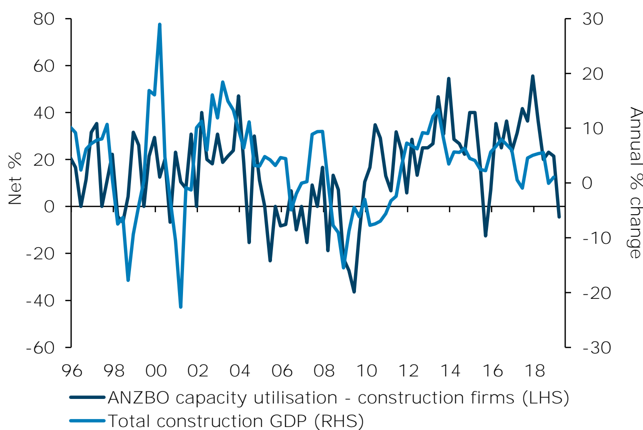
Construction activity has been boosted by a strong ramp up in residential work in particular. From 2012-2016, residential investment grew 12% per year on average. And now home building is at very elevated levels; annual dwelling consents smashed previous records over the year to February, reaching 34,300 (compared with 33,300 reached in the cycle of the 2000s). Non-residential construction has been less impressive. Although commercial and civil construction related to the Canterbury rebuild has provided a solid boost, low rates of investment more broadly have weighed, with businesses cautious and a steady stream of civil projects lacking.

As activity has reached a high level, capacity in the construction industry has become stretched and sustaining similar rates of growth going forward has naturally become more difficult to achieve. Since 2017, growth in residential investment has petered off to around 2% per annum. Resources have been under pressure, with materials and land in high demand and firms finding it very difficult to get skilled labour. Costs have escalated. Construction costs have been an isolated source of inflationary pressure this cycle – running at 4½% y/y on average since 2011, compared with broader price increases of closer to 1½%.

...but now the outlook is less assured

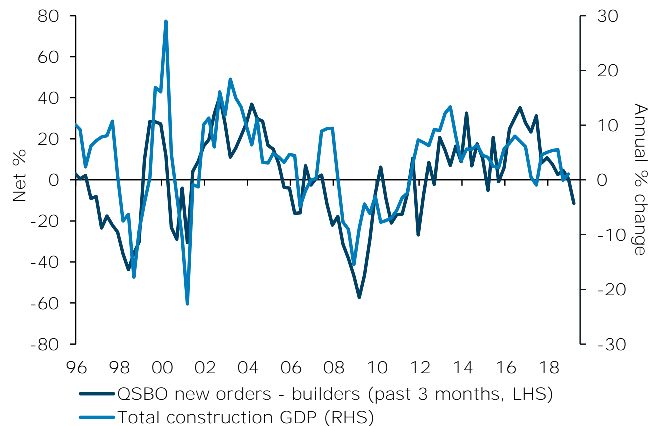
Firms appear to have adjusted to new, slower rates of growth since 2017. But more recently, surveyed measures of reported activity, expected activity, new orders and capacity utilisation from construction firms have fallen in both the ANZ Business Outlook (ANZBO) and NZIER's Quarterly Survey of Business Opinion (QSBO) – suggesting that recent lower rates of growth are now looking to be under further downward pressure (figure 1 & 2).

Figure 1. ANZBO capacity utilisation of construction firms and total construction GDP



Source: ANZ Research, Statistics NZ

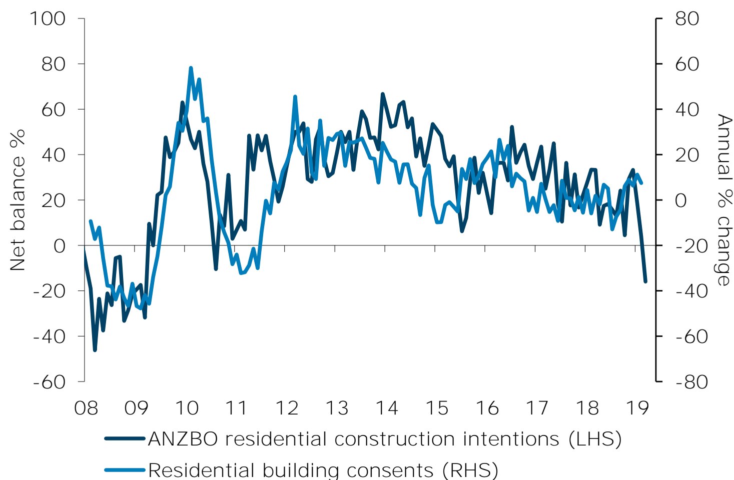
Figure 2. QSBO new orders for builders and total construction GDP



Source: NZIER, Statistics NZ

Coinciding with this, there has been a fall in intentions for both residential and commercial construction in the ANZBO, and architects report reduced work over the next year on both the residential and commercial side. However, the ANZBO suggests that the fall has been particularly pronounced on the residential side (figure 3). It is true that dwelling consent issuance has continued to increase, pointing to continued moderate growth – at least in the near term. But construction intentions suggest that firms are wary that a more pronounced slowdown may be on its way. Surveyed construction intentions can be volatile, so some kind of bounce back is likely on the cards, but as it stands this points to very subdued growth in consents from here.

Figure 3. ANZBO residential construction intentions and consents



Source: ANZ Research, Statistics NZ

We have been wary that further growth from here would be difficult to achieve, and we are forecasting continued low rates of growth in construction, with activity stabilising as a share of the economy. But recent reports from business surveys pose some risk that even current levels of building activity will be difficult to sustain in the current environment.

The housing market is expected to stay soft and population growth may be easing; pent-up demand is not building as it once was and further impetus from housing demand pressures is expected to be limited. Softness in the established housing market has not been driven by higher interest rates, the usual historical culprit, but rather has been related to credit constraints, investor wariness and affordability constraints – all of which are relevant in the home-building space. Capacity constraints – particularly constraints on the availability of land – also make continued growth difficult to achieve. High land costs, delays and uncertainty, along with other costs, which have increased over time, may also be dampening demand from customers to build.

For larger-scale developers, these sorts of issues are an even bigger concern, given the inherent risks, greater delays and sizeable financial commitments associated with larger projects. This is corroborated by anecdotes that property developers in Auckland are becoming increasingly wary about large-scale, multi-dwelling projects. This likely reflects recent generalised softness in the Auckland property market, with prices down 2.4% over the past year. The foreign buyer ban has removed a chunk of demand from the existing apartment market, and thus affected the resale value of new units. Foreign buyers are still permitted to purchase new builds. However, these projects generally require significant advanced commitment from buyers, and in the current uncertain environment – with house prices declining in the region and the industry facing difficulties – getting a critical mass of buyers may add a further challenge.

Despite these issues, the Auckland apartment market is very different from those in Australia's major cities at present, where credit constraints and apartment oversupply are exacerbating declines in house prices. ANZ Research expects that Sydney and Melbourne are in the midst of a 20% peak-to-trough house price decline. By contrast, we expect Auckland house prices to continue their recent gentle, modest correction in the face of the range of housing market headwinds described above. Nonetheless, perceived similarities with Australian capital cities may nonetheless be weighing on the outlook for building in Auckland – commitment to new projects, particularly those that will take time, requires confidence in the outlook. According to our ANZ-Roy Morgan Consumer Confidence survey, house price expectations have softened notably in Auckland – they have been sitting below 2% y/y since the end of last year, compared with a peak of 8½% in mid-2016.

Feature Article: Building headwinds

Although the outlook for building activity is looking less assured, the downside is also limited, in our view. On the residential side, pent-up demand for housing over many years means that any easing in demand will provide some avenue for those previously shut out of the market to enter, provided prices have not become out of reach. KiwiBuild initiatives will also provide a floor. It is not our view that KiwiBuild will provide a significant boost to activity; capacity constraints in the industry mean that private sector initiatives will be crowded out if demand remains elevated. However, if concerns about private sector activity come to fruition, then this would ease capacity constraints – and the extent of crowding out – with KiwiBuild standing ready to fill the gap.

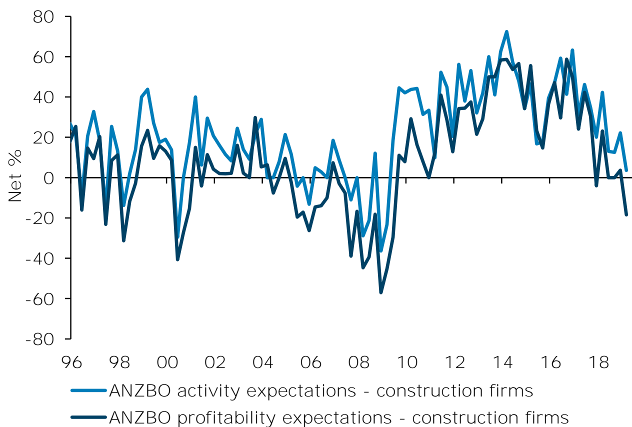
Initiatives to improve the availability of land as part of the KiwiBuild programme are promising in terms of both helping to increase scope for building and improving long-term housing affordability. However, freeing up new land inevitably takes time and the durability of demand is a more pressing consideration for the industry right here and now. Other constraints and issues also appear to be more binding for the industry at present, particularly financial and labour constraints. And as such, the scope for increased land availability to spur activity seems limited, especially in the short term.

In the commercial and infrastructure space, businesses are wary about investment, which is likely to keep growth contained, and there is a lack of civil projects in the pipeline. But that need not be the case. Following high rates of population growth in New Zealand in recent years, an infrastructure deficit has opened up. While the Government remains set on fiscal prudence, some loosening in the purse strings could be justified to meet these infrastructure needs. Indeed, it would be prudent to have some worthwhile projects well along the planning process, ready to fill the gap should activity start to soften.

Firms are facing a **financial squeeze…**

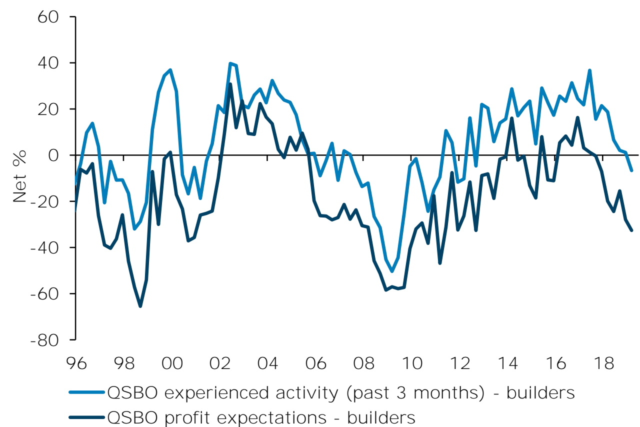
While pent-up demand and KiwiBuild might provide a floor under any decline in activity, any drop in demand will result in increased financial pressure for firms. As such, concern about the pipeline of activity appears to have directly contributed to firms' profitability concerns (figure 4 & 5).

Figure 4. ANZBO own activity and profitability expectations – construction firms



Source: ANZ Research

Figure 5. QSBO experienced activity and profitability expectations– builders



Source: NZIER

Productivity has been low in recent years and firms have been relying on continued increases in turnover to bolster profitability. As resource pressures in the industry have intensified, this has encouraged new entrants into the industry, but some of these may not be profitable during times of lower demand.

Margins are already reported to be squeezed, with costs that have risen quickly in a number of quarters: materials, compliance, insurance and labour costs. Yet this has not resulted in any acceleration in output cost inflation (figure 6). And in fact, building firms reported that they have dropped their prices in the latest QSBO (figure 7). Although these data can be volatile, this is consistent with a recent slowing in construction cost inflation, perhaps reflecting a desire to shore up demand in the current environment. Rising costs without price increases (or even price declines) only adds to profitability concerns, which have the potential to become widespread. Construction activity relies on a smoothly-run supply chain, depending on a number of involved parties who are financially invested in the process, so profitability concerns amongst a small number of firms can have significant flow-on effects for commitment and delivery of projects if those in the industry are worried about the ability of other firms to meet their commitments.

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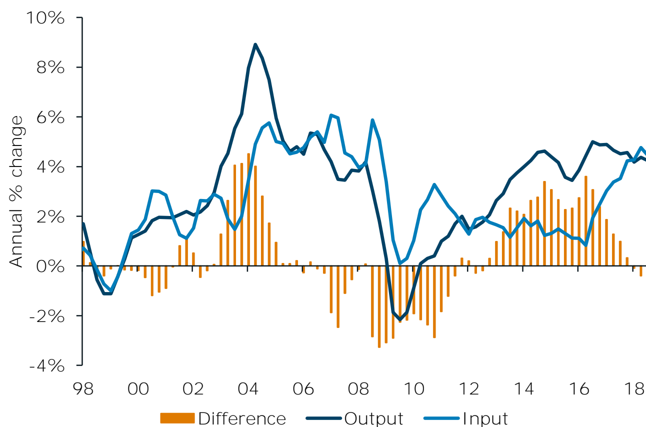
It isn't just profitability concerns that have led to financial strains; delays are also contributing to pressures. Although it might be possible for a firm to cover the costs of a project at the outset, the longer projects are delayed, the greater the operational costs involved and the greater the scope for cost escalation and cash-flow pressures. And when projects are procured on small margins, this leaves little buffer for the unexpected. Such uncertainty magnifies the risks associated with being in business and limits the number of projects that firms can take on, given uncertainty about when they will be able to deliver. Again, this has consequences for the whole supply chain, both in terms of flow-on delays, but also in terms of risks and rising costs.

Figure 6. Construction producer price indices for inputs (excluding labour and capital) and outputs



Source: Statistics NZ

Figure 7. QSBO builders increasing prices and construction cost inflation

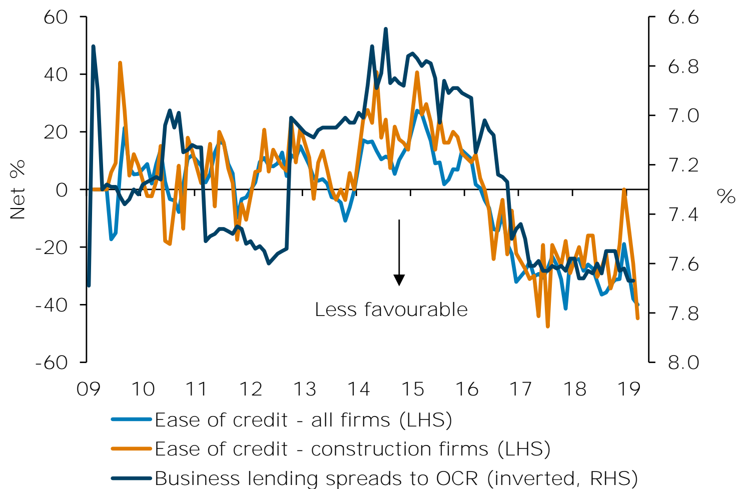
Source: NZIER, Statistics NZ

Credit constraints make these sorts of financial challenges difficult to manage, particularly for firms who are reliant on working capital finance to manage risks and cover operational costs associated with delays. For some firms in the industry, credit has been a constraint for some time (figure 8). However, the impact of credit conditions is much broader than those experienced by builders and the like – credit availability for developers, investors and potential home owners also have impacts on the pipeline of work.

As discussed in last month's ANZ Property Focus, lending standards have been quite conservative this cycle and credit availability has been a constraint for some. Banks have been prudent in their lending, particularly since 2016. This has resulted in higher lending spreads and a tightening up in in the volume of credit availability, with more conservative serviceability assessments and terms. Regulation has also played a role, with the introduction of loan-to-value ratio restrictions in 2013 and their application to investors in 2016, which proved to be quite binding.

Going forward, credit is also expected to become more of a headwind with deposit growth having slowed recently, putting pressure on bank funding positions, but also as a consequence of the RBNZ's proposed changes to bank capital requirements. If implemented, the changes would make credit more expensive and make it less readily available, particularly for commercial loans, which have historically been riskier and therefore require more capital to be held against them.

Figure 8. Credit conditions faced by firms



Source: ANZ Research, RBNZ

…against a back drop of other challenges

The prospect of increased financial challenges – with greater uncertainty about turnover, margin squeeze and continued or increasing credit constraints – comes against the backdrop of an industry already struggling with productivity and staffing challenges. Productivity is a challenge that has plagued the industry for a long time; **"multi-factor productivity"** – how well the industry uses a given amount of both capital and labour – has declined 0.2% per year on average between 1990 and 2011.[1] In broad terms, this implies that we are still building houses and other structures in the same way we were in the 1980s.

To achieve higher rates of activity and meet demand, many firms have had to throw labour at the problem. Construction is already fairly labour intensive, so this has resulted in labour shortages for a range of firms. Some have used migrant labour to meet demand, but skilled labour is nonetheless difficult to come by. Increasing wages is one solution and this has contributed to rising costs. But even so, it is difficult to ensure that a suitable pipeline of labour will be available without adequate people available who have suitable training, and on-the-job management and entrepreneurial experience. Both the Government and industry participants have indicated a desire to rectify structural issues in the construction industry in the recently-announced construction sector accord, but clear policy initiatives are lacking. These problems do not have easy solutions.

Concerns would intensify if demand were to wane

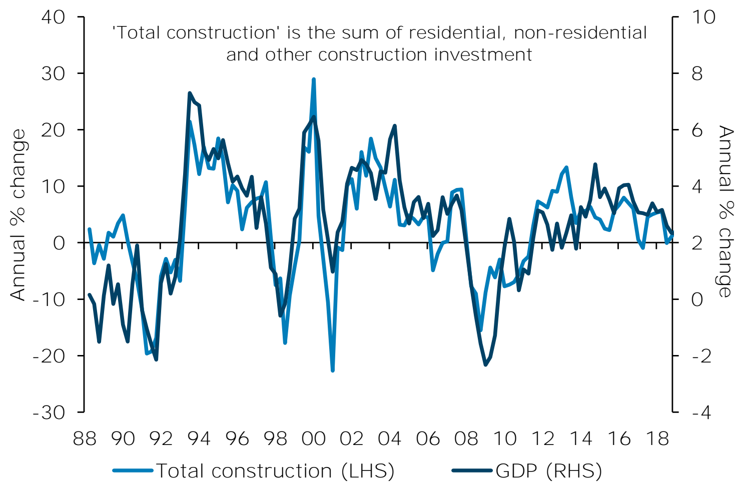
In light of the financial and broader challenges described above, it is no wonder that there have been a number of high-profile cases of firms in the construction industry experiencing significant financial difficulty, despite recent high levels of activity. These provide timely cautionary tales for an industry that may face more difficult times ahead. So far this cycle, firms in or connected to the industry have generally been able to wear such challenges, in the context of increasing or high levels of demand. But those same challenges could become difficult to bear in an environment of less rapidly growing – let alone slowing – activity.

Some firms will be well placed to deal with such risks. There are examples of profitable and efficient firms in the industry performing well that would be able to deal with more challenging times and grow their market share. But some other firms that are less well placed, particularly those that are less efficient, less well managed, or that are new to the industry. Any pockets of pressure that develop could have flow-on effects down the supply chain, and also into other industries that are involved in meeting construction demand, such as manufacturing, related services industries, and retail and wholesale trade of textiles, appliances and furnishings.

Construction activity is closely connected to cycles in the established housing market and spurs a range of complementary spending (in durable goods, for example) and investment (such as on buildings, works and infrastructure). These connections with the broader economy are a key reason why construction is generally a bellwether of the economic cycle more broadly (figure 9).

[1] See Productivity Commission (2013)

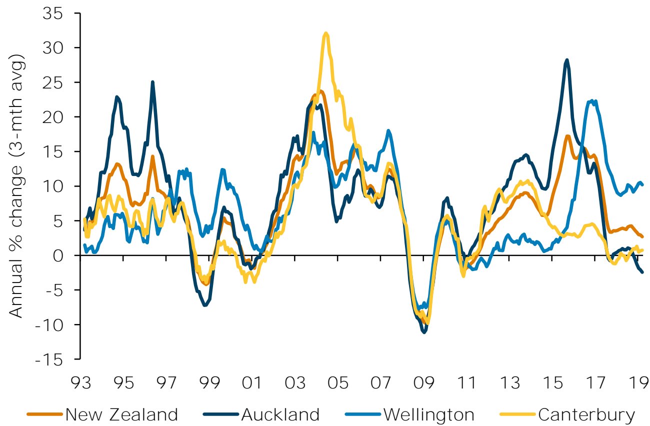
Figure 9. Construction and aggregate GDP growth



Source: Statistics NZ

All up, we expect that construction activity will struggle to push higher from here, with only very modest rates of growth expected. Construction activity is expected to be stable as a share of overall economic activity, and is not expected to boost growth as it did earlier this cycle – adding to the picture we see of an economy past its best. With this and a number of growth drivers having waned and headwinds building, acceleration in economic growth is already looking difficult to achieve. And the possibility that construction activity softens meaningfully from here, while not our view, does pose the risk of a more meaningful drag on economic growth.

Figure 1. Regional house price inflation



Source: ANZ Research, REINZ

House prices fell 0.3% m/m in March (driven by weakness in Auckland prices), to be 0.8% higher over the past three months. Annual house price inflation continues to moderate, reaching 2.7% y/y (3mma) in March, down from 4.2% in September. We had expected a firming in prices over the past six months would prove short-lived and that headwinds weighing on the market will see prices continue their gentle descent. Regional divergence is expected to remain evident. In Auckland, prices fell 0.9% m/m in March to be down 2.4% over the year (3mma). In the rest of New Zealand, prices were up 0.4% (7.6% y/y). Strength has been particularly apparent in Manawatu-Whanganui (17%), Southland (15%), Hawke's Bay (13%), Otago (11%), and Wellington (10% y/y).

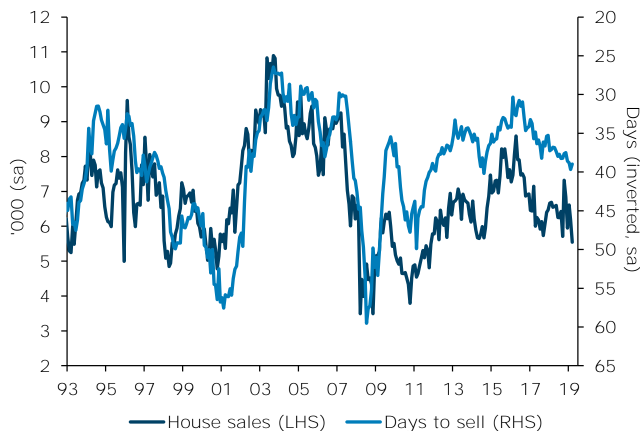
Figure 2. REINZ house prices and sales

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 10% in March, following a 7% fall in February. The data have been soft and the 13% January lift –boosted by the RBNZ's relaxation of LVR restrictions – has now been fully reversed. 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 5% lower than a year ago (3mma).

Figure 3. Sales and median days to sell

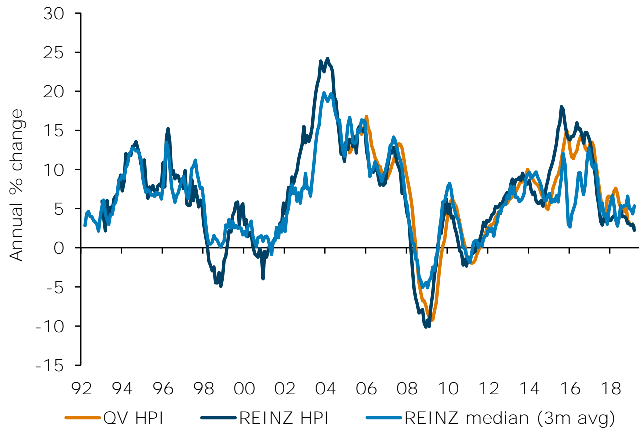


Source: ANZ Research, REINZ

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), slightly below the historical average. However, the Auckland market has more slack. Days to sell shortened in March from a post-GFC high of 49 days, but remain elevated at 44 – above the historical average of 36. Slack around this level suggests 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

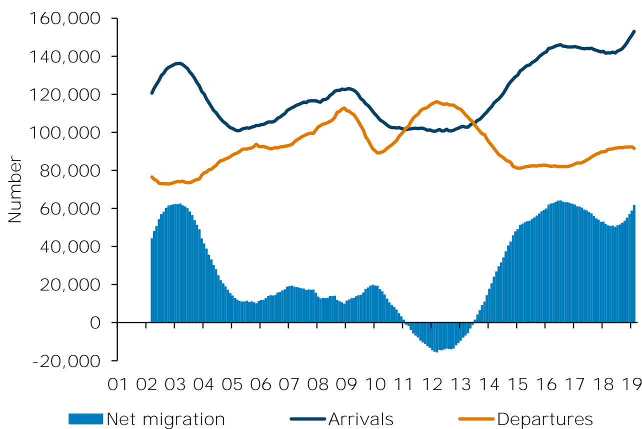


Source: ANZ Research, REINZ, QVNZ

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 2.7% y/y (3mma). The QVNZ measure has moderated even further and is sitting at 2.6% y/y. The REINZ median, on the other hand, was up 5.3% 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[2] 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 6,600 in February. Annual net migration reportedly picked up to 61,600 in February, around 2,400 shy of its record-high in June 2016. Surprisingly, revisions to net migration data this month (a consequence of last year's change to the outcomes-based collection methodology) didn't change the face-value story from what last month's data were showing. That is, the net migration cycle has turned a corner and annual inflows are trending higher. However, we remain sceptical. Statistics NZ's data is subject to revision and relatively untested, so we would caution about reading too much into it at this stage.

Figure 6. Residential building consents

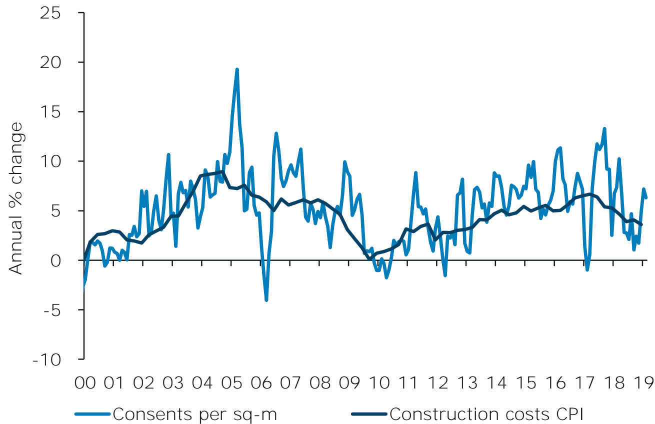
Source: ANZ Research, Statistics NZ

Residential building consents started the year on a solid note, up 1.9% m/m in February, retaining a strong 13.6% rise in January. 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 34,500, pushing 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).

[2] 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. For more on this, see International migration uses new official measure.

Figure 7. Construction cost inflation

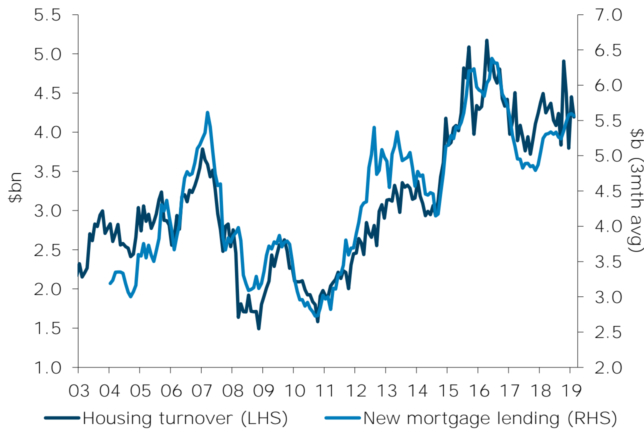


Source: ANZ Research, Statistics NZ

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 6% y/y (3mma) in February, 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

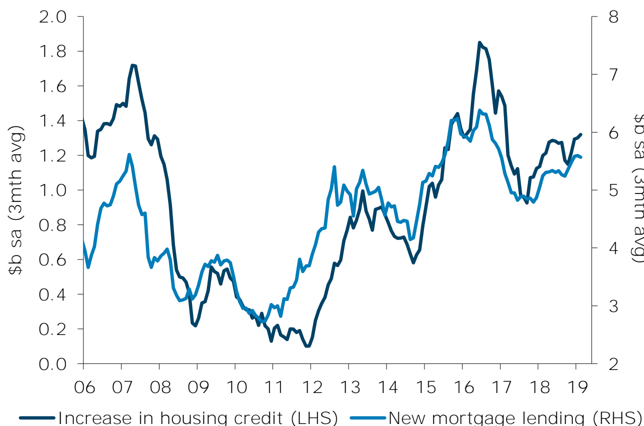


Source: ANZ Research, RBNZ

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

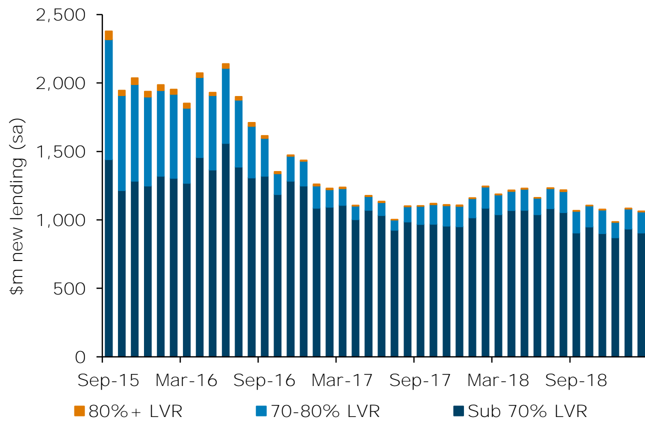


Source: ANZ Research, REINZ, RBNZ

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

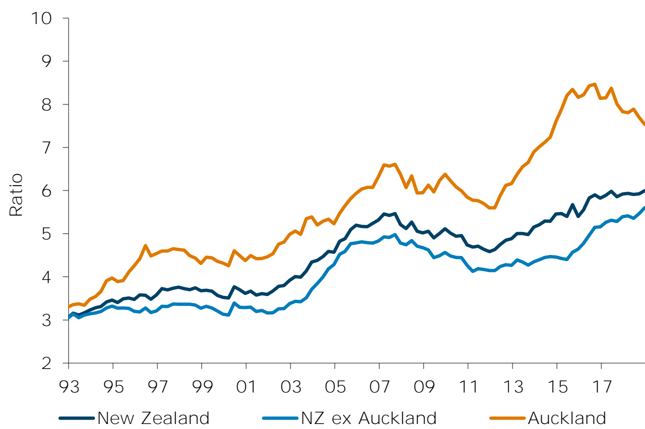


Source: ANZ Research, RBNZ

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

Auckland house price growth continues to diverge from the regions, with softness in Auckland house prices remaining evident. Falls in mortgage rates are providing a boost to activity in the regions, but we expect the firming over the past six months to be short-lived. House sales fell further in March, after the easing in loan-to-value ratio restrictions provided a temporary boost at the start of the year. Looking thorough volatility, the trend has been fairly flat since mid-2017. Housing market activity and price pressures are expected to remain limited from here. Demand pressures do not appear to be building as strongly as before, but the impulse from migration is uncertain. Headwinds are evident; bank prudence, investor wariness, and affordability constraints are expected to constrain activity. Tighter credit conditions may emerge if proposed increases in bank capital requirements are implemented, and proposed Government policy changes 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	Cuts coming	↔/↑	We see the OCR falling in the second half of 2019, partly to offset upward pressure on rates. Short-term mortgage rates have fallen.
Migration	Peaked	↔/↑	Migration 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

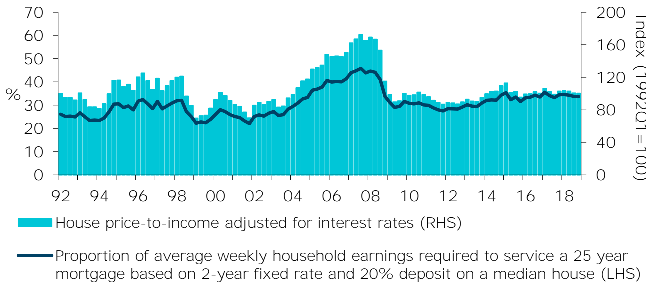


Figure 2: Household debt to disposable income

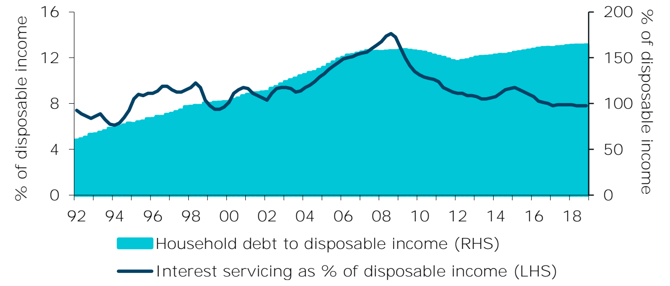


Figure 3: New customer average residential mortgage rate (<80% LVR)

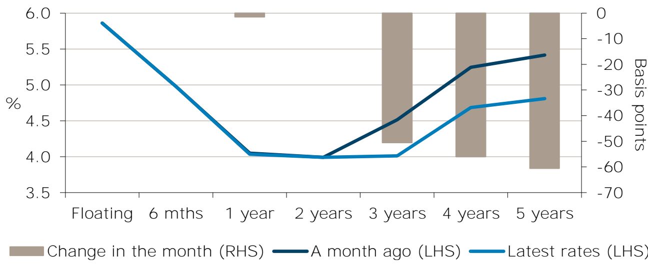


Figure 4: Annual migration*

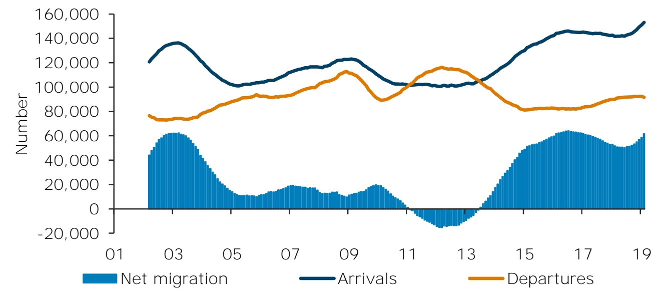


Figure 5: Housing supply-demand balance

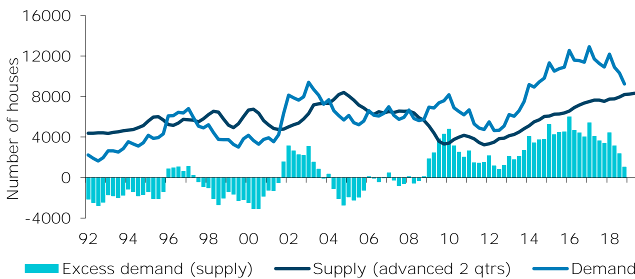


Figure 6: Building consents and house sales

Figure 7: Liquidity and house prices

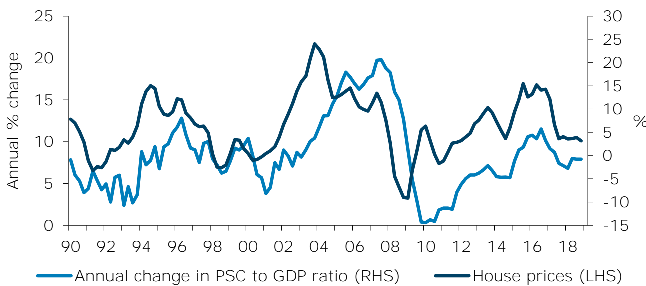


Figure 8: House price inflation comparison

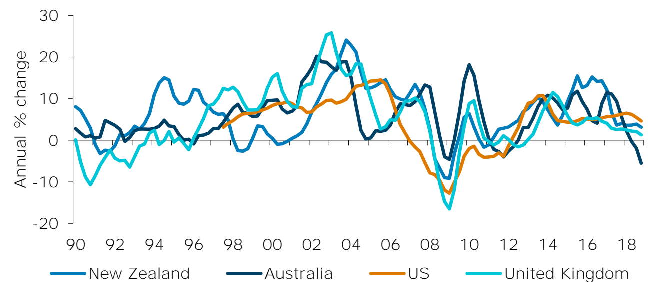


Figure 9: Housing supply

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

Global growth has slowed, with a synchronised slowdown in the growth of New Zealand's trading partners, and the risks of a sharper slowdown remain evident. However, recent developments tentatively point to some stabilisation in growth momentum, particularly in China. Central banks have responded to support growth, with easier policy expected going forward, which should support growth. The RBNZ has signalled a more cautious tone, with the next move in the OCR more likely to be down. We are picking August for the first move, with risks balanced. There are signs that capacity pressures are waning 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. While cost pressures could push inflation higher, softer global conditions and a weak outlook for domestic growth are likely to dominate the RBNZ's thinking.

Our view

Global growth has slowed, and the risks of a sharper slowdown remain evident. There has been a synchronised slowdown in the growth of New Zealand's trading partners. However, recent developments tentatively point to some stabilisation in growth momentum. But – despite the stabilisation – a strong rebound in activity is not expected in the near term. Several key uncertainties appear to have weighed on spending and investment; the China-US trade negotiations, Brexit, and the effect of previous tightening in Chinese credit growth.

Tentative signs of a stabilisation in the global dataflow have developed over the past month, led by an improvement in activity and credit data from China. PMI activity indicators have bounced higher, credit growth improved, and exports rose strongly in March. The improvement may reflect the effect of fiscal and monetary stimulus starting to flow through to activity. The US economy also shows some tentative signs of stabilisation, although euro area demand remains weak.

More broadly, support has been provided by more stimulatory policy settings globally, which has helped support a rebound in financial markets and eased financial conditions. 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. Easier financial conditions should support future growth and reduces some of the risk of a sharper deterioration.

Domestically, the growth picture remains bleak. The New Zealand economy lost momentum in the second half of 2018 and hasn't shown signs of picking up so far in 2019. 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.

Near-term GDP indicators don't suggest a rebound in growth anytime soon. Business outlook surveys, such as ANZBO and QSBO, paint a bleak picture for growth in the first quarter. But the effects of the global slowdown are yet to be fully felt in New Zealand. New Zealand commodity prices have held up remarkably well, in part reflecting supply dynamics, although lower world interest rates will add upward pressure to the New Zealand dollar.

As the RBNZ seem to have acknowledged in their March OCR Review, the 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 see signs that these are waning as growth has slowed. 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 a dovish bias at the March OCR Review and acknowledged that risks are skewed to the downside. We have pulled forward our first cut to August this year, from November, with two follow up cuts expected by early 2020. Given some recent improvements in the global data, we see the risks around our August cut call as balanced. On the domestic front, it is possible that growth could strengthen from 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 could see the RBNZ move 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)	Mortgage Rate (%)													
	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

Housing market indicators for March 2019 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	9.9	1.6	165	-2%	52
Auckland	-2.8	-1.1	1,583	-6%	44
Waikato	3.7	5.0	594	-8%	39
Bay of Plenty	1.9	0.7	414	-9%	46
Gisborne	14.4	12.1	42	-17%	35
Hawke's Bay	10.0	-0.8	221	-4%	36
Manawatu-Whanganui	15.6	6.0	367	-3%	27
Taranaki	9.8	-1.5	155	-10%	29
Wellington	5.2	1.8	641	-10%	33
Tasman, Nelson and Marlborough	9.8	3.9	241	-6%	35
Canterbury	2.0	-0.4	805	-5%	40
Otago	21.7	3.9	352	-1%	31
West Coast	-4.6	-4.3	41	-8%	87
Southland	24.7	15.6	162	-9%	30
New Zealand	**4.6**	**1.7**	**5,545**	**-10%**	**39**

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	1.7	1.3	1.4	1.8	1.8	1.8	1.8
Unemployment Rate (%)	4.4	4.0	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
House Prices (Annual % Chg)	3.7	4.3	3.3	2.9	3.3	3.5	3.5	3.5	3.6	3.4
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	1.50	1.25	1.00	1.00	1.00
90-Day Bank Bill Rate	2.0	1.9	2.0	1.9	1.8	1.6	1.3	1.2	1.2	1.2
Floating Mortgage Rate	5.8	5.8	5.8	5.8	5.8	5.5	5.3	5.0	5.0	5.0
1-Yr Fixed Mortgage Rate	4.9	4.8	4.8	4.5	4.5	4.3	4.1	4.1	4.1	4.1
2-Yr Fixed Mortgage Rate	4.9	4.8	4.7	4.4	4.5	4.4	4.4	4.3	4.3	4.3
5-Yr Fixed Mortgage Rate	5.7	5.4	5.4	5.1	5.3	5.5	5.6	5.5	5.5	5.5

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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