New Zealand Property Focus

Taking the temperature

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CONTRIBUTORS

Sharon Zollner
Chief Economist
Telephone: +64 9 357 4094
E-mail: Sharon.Zollner@anz.com

Miles Workman
Senior Economist
Telephone: +64 4 382 1951
E-mail: Miles.Workman@anz.com

Michael Callaghan
Economist
Telephone: +64 4 382 1975
Email: michael.callaghan@anz.com

ISSN 2624-0629

Publication date: 24 June 2019

Summary

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

Feature Article: Taking the temperature

Regional divergence is a key feature of the New Zealand housing market. The Auckland and Canterbury regions, where market slack is most evident, have experienced the weakest house price inflation over the past year. But these two regions did start the housing market party early this cycle, with strong house price inflation in Canterbury following a collapse in supply after the 2011 Christchurch earthquakes, and strength in Auckland also picking up as the strong migration cycle and foreign buyer interest added to price pressure in the supply-constrained region. But since then, an evolving demand-supply balance – brought about by lifting construction activity, LVR restrictions, other regulatory and tax changes, cooling foreign interest, and in Auckland at least, binding affordability constraints – have seen these regional housing markets cool. Meanwhile, although we have seen a slight softening in recent months, the housing market remains relatively tight in other regions, supported by low mortgage rates, population growth, and – versus Auckland – better affordability. We expect this regional catch-up dynamic to continue, which in aggregate should keep things pretty steady.

Property gauges

National house price growth has softened since the peak in mid-2015. In recent years weakness in Auckland has stood in stark contrast to most other regions, which maintained strong growth rates, until recently. House price inflation outside of Auckland is now also waning. House sales fell further in May, after the easing in loan-to-value ratio restrictions provided a temporary boost at the start of the year. House prices and market activity are expected to remain subdued from here. The market faces several headwinds: banks are cautious and LVR limits remain binding; investors are wary of policy changes; affordability constraints are biting; and the impact of the locking out of foreign buyers is still working its way through. That said, some tailwinds have also emerged recently, including falls in fixed mortgage rates and the exclusion of a capital gains tax, which should help to stabilise the market.

Economic overview

Global growth concerns have continued to build. A fall in global trade and slowing activity (particularly manufacturing) is now weighing on the inflation outlook and keeping central banks in the spotlight. The theme of 'lower for longer' interest rates is once again at the fore. We're expecting rate cuts by both the Reserve Bank of Australia and the US Federal Reserve over the next year. Closer to home, while New Zealand commodity export prices have so far been fairly resilient to the global slowdown, slowing domestic momentum has persisted. We think further stimulus from the RBNZ will prove necessary to help support employment and inflation. But provided the global economy keeps it together, New Zealand's outlook is hardly bleak. A bit more government spending over the next year or so alongside some additional monetary stimulus should help put a floor under the slowdown and support a gradual growth recovery from the second half of this year.

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Summary

Regional divergence is a key feature of the New Zealand housing market. The Auckland and Canterbury regions, where market slack is most evident, have experienced the weakest house price inflation over the past year. But these two regions did start the housing market party early this cycle, with strong house price inflation in Canterbury following a collapse in supply after the 2011 Christchurch earthquakes, and strength in Auckland also picking up as the strong migration cycle and foreign buyer interest added to price pressure in the supply-constrained region. But since then, an evolving demand-supply balance – brought about by lifting construction activity, LVR restrictions, other regulatory and tax changes, cooling foreign interest, and in Auckland at least, binding affordability constraints – have seen these regional housing markets cool. Meanwhile, although we have seen a slight softening in recent months, the housing market remains relatively tight in other regions, supported by low mortgage rates, population growth, and – versus Auckland – better affordability. We expect this regional catch-up dynamic to continue, which in aggregate should keep things pretty steady.

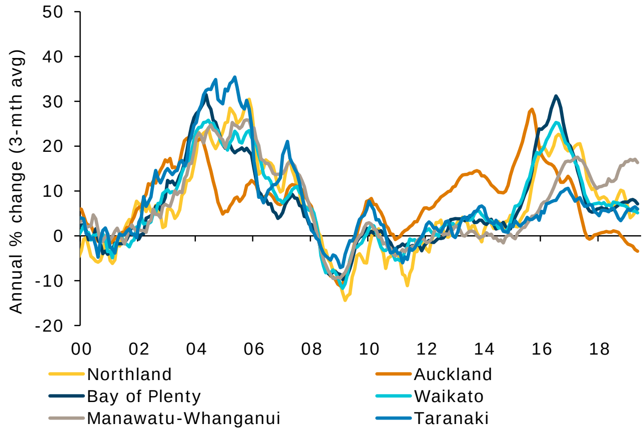
Zooming in by region

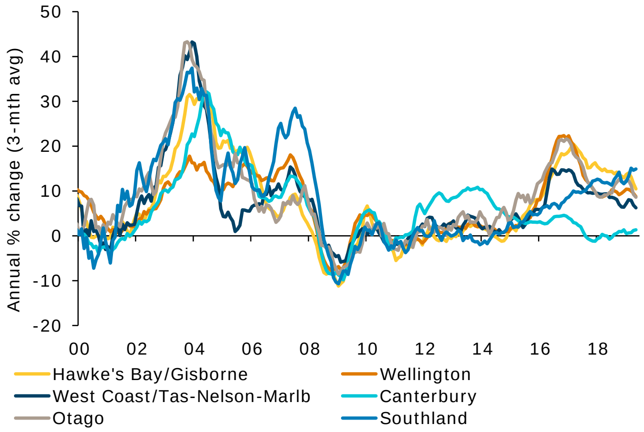
A key feature of the New Zealand property market at present is the stark divergence between housing markets across the regions. Early in this housing market cycle, strength was led by Canterbury and Auckland regions. Strong house price inflation in Canterbury followed a collapse in supply after the 2011 Christchurch earthquakes. Strength in Auckland picked up as the exceptionally strong migration cycle and foreign buyer interest added to price pressures in the supply-constrained region, with annual growth peaking at 28% in 2015.

In the years that followed, greater supply brought on by the construction boom, LVR restrictions, and binding affordability constraints (particularly in Auckland), saw these regional housing markets cool. Thereafter, a halo effect took hold in the regions just outside of Auckland, with housing market activity accelerating – boosted by regional LVR restrictions that prompted Auckland property investors to look further afield. Years later, regions outside of Auckland and Christchurch are continuing to outperform, with low mortgage rates, population growth, and – versus Auckland – better affordability continuing to support.

This regional divergence remains evident in the data flow. Housing market slack is most prevalent in Auckland and Canterbury. Auckland house prices have fallen 3.4% over the past year, while prices in Canterbury have been flat for the past two years. Of the other regions, some are still experiencing double-digit price increases while others are cooling more noticeably. It's time for an update, with our last "hot or not" regional round-up being seven months ago.

Figure 1 and 2. House price inflation by region





Source: REINZ

Taking the temperature

In this section we assess the degree of heat in each regional housing market using five key metrics. Regions deemed 'hot' are experiencing strong demand, with conditions that appear favourable to sellers. By contrast, markets that we identify as 'cool' are not experiencing significant demand relative to supply. In these markets, conditions appear more favourable for buyers than generally seen over history. Broadly speaking, markets that are 'hot' are conducive to above-average price pressures, whereas markets that are cooler are likely to experience below-average price pressures. A summary map can be found on page 8.

We should front-foot some caveats.

- Our assessment is based on a snapshot of current conditions. The balance between demand and supply is constantly evolving, and can turn especially quickly in small regional markets. Like any financial asset, past price gains are not always a good indication of what the future may bring.
- There is likely to be a lot of variation in conditions within the broad regions considered here.
- Our assessment of regional hotspots should in no way be construed as financial advice.

The metrics we use to assess the heat in each market are:[1]

1. **Days to sell:** The length of time it takes to sell a property indicates the strength of demand. 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. We use days to sell (3-month average) relative to post-1991 average.
2. **Expectations of buyers and sellers:** List prices provide a gauge of seller expectations. If sales prices are high relative to list prices (compared to their usual behaviour over history), this suggests demand is intensifying. We use the ratio of sales prices to list prices relative to post-2002 average.
3. **Sales-to-listings:** This is a metric of demand relative to supply in the market. When there are fewer listings, this can intensify price pressures. On the other hand, when new properties come online in significant numbers it can take heat out of the market. We use the ratio of sales to listings (3-month average) relative to the post-2012 average.
4. **Regional economy:** The economic performance of each region can have a bearing on how willing people are to purchase a house and how much they can afford. We consider the unemployment rate in each region, recent growth in employment, and indicators of regional activity (consents and retail trade).
5. **House prices to rents:** This measures whether the affordability of owning relative to renting is in normal ranges. When houses are expensive relative to renting, purchasing is less attractive, and rental yields tend to be low, which can dissuade investors. We use median house price to rents since 2006.

Northland (3% of sales) Overall, the market is **normal**, as it was in November, though it's cooled somewhat.

Days to sell	**Hot**	At 54 days, days to sell are 13% below the historical average of 62 days.
Expectations	**Normal**	House sale prices are hovering around list prices.
Listings	**Normal**	The sales-to-listings ratio is within familiar ranges.
Regional economy	**Normal**	Labour market indicators have softened recently after performing well since the GFC. Recent activity growth has also been soft-moderate.
Affordability	**Normal**	Affordability is starting to improve.

Auckland (28% of sales) Overall, the market is still considered to be **very cool**, and has cooled further.

Days to sell	**Very cool**	At 44 days, days to sell are 21% above the historical average of 36 days.
Expectations	**Normal**	Houses are still selling above list price, but by a bit less than historically.
Listings	**Cool**	The sales-to-listings ratio is falling from recent ranges.
Regional economy	**Normal**	Unemployment has fallen, and both activity and employment growth have been moderate.
Affordability	**Very cool**	House prices remain very high relative to rents, despite having eased recently.

Waikato (11% of sales) Overall, the market is considered to be **normal** (versus hot in November).

Days to sell	**Hot**	At 39 days, days to sell are 20% below the historical average of 49 days.
Expectations	**Normal**	Houses are selling slightly above list price.
Listings	**Normal**	The sales-to-listings ratio is close to average, but are falling rapidly.
Regional economy	**Normal**	Unemployment has fallen but employment growth has softened and activity growth continues to slow.
Affordability	**Very cool**	House prices are very high relative to rents.

[1] Varied historical averages were chosen due to data availability and long-term trends and structural breaks in the data. In some cases, measures are standardised to adjust for varying degrees of volatility in the regional series. Labour market data is combined for Hawke's Bay/Gisborne and West Coast/Tasman-Nelson-Marlborough. There is a degree of subjectivity in interpretation of the data. Sources include MBIE, REINZ, realestate.co.nz, Statistics NZ.

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Bay of Plenty (7% of sales) Overall, the market is considered to be **normal**, vs. hot in November.

Days to sell	**Hot**	At 46 days, days to sell are 14% below the historical average of 53 days.
Expectations	**Normal**	Houses are selling above list price and slightly more than the average.
Listings	**Normal**	The sales-to-listings ratio above average, hovering around recent ranges.
Regional economy	**Normal**	Unemployment has fallen but employment growth has been moderate of late. Activity growth has been soft to moderate.
Affordability	**Normal**	Prices relative to rents have been high, but have started to come down.

Gisborne (1% of sales) Overall, the market is considered to be **hot**, as it was November.

Days to sell	**Hot**	At 37 days, days to sell are 14% below the historical average of 43 days.
Expectations	**Very hot**	Houses are selling above list price, and well above normal ranges.
Listings	**Hot**	The sales-to-listings ratio is 10% above average.
Regional economy	**Hot**	Unemployment is low, employment growth has been volatile but generally strong and activity growth has been reasonable.
Affordability	**Cool**	Prices relative to rents have worsened, but are still not particularly high.

Hawke's Bay (4% of sales) Overall, the market is considered to be **very hot**, as it was in November.

Days to sell	**Hot**	At 34 days, days to sell are 25% below the historical average of 45 days.
Expectations	**Very hot**	Houses are selling well above list price and much more than usual.
Listings	**Very hot**	The sales-to-listings ratio is 20% above average.
Regional economy	**Hot**	Unemployment has fallen, employment growth has been modest and activity growth has been moderate-strong.
Affordability	**Normal**	Affordability is stable, but is not particularly high.

Manawatu-Whanganui (6% of sales) Overall, the market is considered to be **normal**, vs. hot in November.

Days to sell	**Very hot**	At 28 days, days to sell are 40% below the historical average of 47 days.
Expectations	**Normal**	Houses are selling above list price, within familiar ranges.
Listings	**Very hot**	The sales-to-listings ratio is well above average.
Regional economy	**Normal**	Unemployment is steady and employment growth is recovering, but activity growth has been moderate to strong.
Affordability	**Normal**	Affordability has worsened, but ratio still low compared to other regions.

Taranaki (3% of sales) Overall, the market is considered to be **hot**, vs. normal in November.

Days to sell	**Very hot**	At 30 days, days to sell are 37% below the historical average of 48 days.
Expectations	**Cool**	Houses are selling above list price, but by less than normal for this region.
Listings	**Very hot**	The sales-to-listings ratio is 21% above average.
Regional economy	**Normal**	Unemployment has been stable and employment growth has recovered. Activity growth is moderate.
Affordability	**Hot**	Affordability has improved.

Wellington (11% of sales) Overall, the market is considered to be **normal**, whereas in November it was hot.

Days to sell	**Normal**	At 34 days, days to sell are slightly below the historical average of 36 days.
Expectations	**Normal**	Houses are selling above list price, but by slightly less than normal.
Listings	**Normal**	The sales-to-listings ratio is slightly above the average.
Regional economy	**Normal**	Unemployment is low but employment growth stalled, and activity growth has been moderate.
Affordability	**Normal**	Affordability is stable and not particularly high.

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Tasman-Nelson-Marlborough (4% of sales) Overall, the market is considered to be **normal**, vs. hot in Nov.

Days to sell	**Hot**	At 36 days, days to sell are 18% below the historical average of 43 days.
Expectations	**Normal**	Houses are selling within familiar ranges of list prices.
Listings	**Hot**	The sales-to-listings ratio is 11% above average.
Regional economy	**Normal**	Unemployment is low; employment growth has fallen, and activity growth has been moderate.
Affordability	**Cool**	House prices relative to renting have improved, but are still high.

Canterbury (14% of sales) Overall, the market is considered to be **very cool**, whereas in November it was cool.

Days to sell	**Cool**	At 40 days, days to sell are 10% above the historical average of 36 days.
Expectations	**Normal**	Houses are selling above list price and in normal ranges.
Listings	**Normal**	The sales-to-listings ratio sitting around average.
Regional economy	**Very cool**	Unemployment has risen slightly; employment has fallen and activity has been soft.
Affordability	**Very cool**	Prices relative to renting have been stable, but are very high.

Otago (6% of sales) Overall, the market is considered to be **normal**, whereas in November it was hot.

Days to sell	**Very hot**	At 30 days, days to sell are 29% below the historical average of 43 days.
Expectations	**Normal**	Houses are selling within familiar ranges of list prices.
Listings	**Normal**	The sales-to-listings ratio is around average.
Regional economy	**Normal**	Unemployment has fallen, but employment growth has softened and activity growth has been soft to moderate.
Affordability	**Very cool**	Affordability has worsened substantially, bit still mid-range of all regions.

West Coast (1% of sales) Overall, the market is considered to be **normal**, as it was in November.

Days to sell	**Normal**	At 65 days, days to sell are below the average of 80 days, but within normal ranges.
Expectations	**Normal**	Houses are selling below list price, but that's normal in this region.
Listings	**Very hot**	The sales-to-listings ratio is well above average.
Regional economy	**Normal**	Unemployment has been stable, employment growth has fallen, and activity growth has been moderate.
Affordability	**Very hot**	Affordability has improved and is favourable.

Southland (3% of sales) Overall, the market is considered to be **normal**, whereas in November it was very hot.

Days to sell	**Hot**	At 28 days, days to sell are 30% below the historical average of 40 days.
Expectations	**Normal**	Houses are selling above list price when they would usually sell below.
Listings	**Hot**	The sales-to-listings ratio is high for this region.
Regional economy	**Normal**	Unemployment has fallen but employment growth has weakened, and activity growth has been soft to moderate.
Affordability	**Normal**	Affordability risen but is still favourable.

In total, since November last year,

- One region, Taranaki, has improved from normal to hot due to quicker sales, improving affordability and higher sales to listings ratio.
- Eight regions have cooled enough to change category; and
- Five regions' housing markets haven't changed enough to warrant a different characterisation.

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The table below summarises developments by region.

Change in temperature

Region	Current temperature	November 2018 temperature	Change
Northland	Normal	Normal	No change
Auckland	Very cool	Very cool	No change
Waikato	Normal	Hot	Cooler
Bay of Plenty	Normal	Hot	Cooler
Gisborne	Hot	Hot	No change
Hawke's Bay	Very hot	Very hot	No change
Manawatu- Whanganui	Normal	Hot	Cooler
Taranaki	Hot	Normal	Hotter
Wellington	Normal	Hot	Cooler
Tasman-Nelson-Marlborough	Normal	Hot	Cooler
Canterbury	Very cool	Cool	Cooler
Otago	Normal	Hot	Cooler
West Coast	Normal	Normal	No change
Southland	Normal	Very hot	Cooler

The outlook

Looking ahead, there are numerous headwinds in the New Zealand housing market which should keep prices and activity contained:

- Credit growth is contained and banks are prudent in their lending.
- The RBNZ's loan-to-value ratio restrictions remain binding, particularly for investors. These restrictions were left unchanged in the RBNZ's latest Financial Stability Report.
- The RBNZ's proposed changes to bank capital requirements have the potential to put upward pressure on mortgage rates.
- Policy changes are weighing, particularly on investor demand. This includes tax changes (ring-fencing of losses and the extension of the bright-line test) and the foreign buyer ban, as well as tougher requirements for landlords.
- Affordability constraints are evident, particularly in Auckland, and robust house price inflation in other regions in recent years has seen affordability worsen.
- We estimate that net migration, while still positive, is continuing to ease. However, this is very uncertain given changes to methodology mean the effective lag for useable migration data is now about a year.

But there are also some emerging tailwinds that have become evident in recent months, which should prevent further slowing in the market over the next year:

- Substantial falls in fixed mortgage rates.
- The ruling out of a capital gains tax by the Government, which may see some investors who were waiting on the side-lines filter back into the market.
- Ongoing modest growth in household incomes.

On balance, we think that these recent tailwinds will help stabilise the housing market, rather than lead to a renewed surge in activity and prices. It is too early to see if recent declines in mortgage rates and the ruling out of capital gains have had an effect on the housing market, but the most recent REINZ housing market data (for May) pointed to slow and steady growth, which is in line with our expectations.

In terms of regional trends, we expect that the Auckland and Canterbury markets will continue to underperform other regions. In Auckland, the elevated level of days to sell suggests there is slack in the market, and that prices are unlikely to take off again any time soon. In addition, affordability constraints are particularly binding given Auckland prices remain at a high level. That said, recent modest price declines, combined with steady income growth, have seen some easing in these measures. The Christchurch situation is broadly similar. An earlier overshoot in prices, (following a period of undersupply associated with the Canterbury earthquakes), means affordability constraints are biting and that upside is limited. That means it's up to the regions outside of Auckland and Christchurch to support nationwide house price inflation. But while a little more price catch-up for the rest of New Zealand versus Auckland seems likely, there is likely to be significant variance between regions depending on variations in the economic fundamentals such as income and population growth.

Based on current conditions, the hotspots of Taranaki, Gisborne and the Hawke's Bay look set to continue to outperform for a little while yet, particularly if economic growth in these regions performs well. And broadly speaking, while regional divergence is expected to persist, we think the overall outlook is for national house price inflation to remain close to its current, lower, level for a while yet. We're forecasting annual house price inflation to hold around the 3.5% mark over the next couple of years.

Regional heatmap

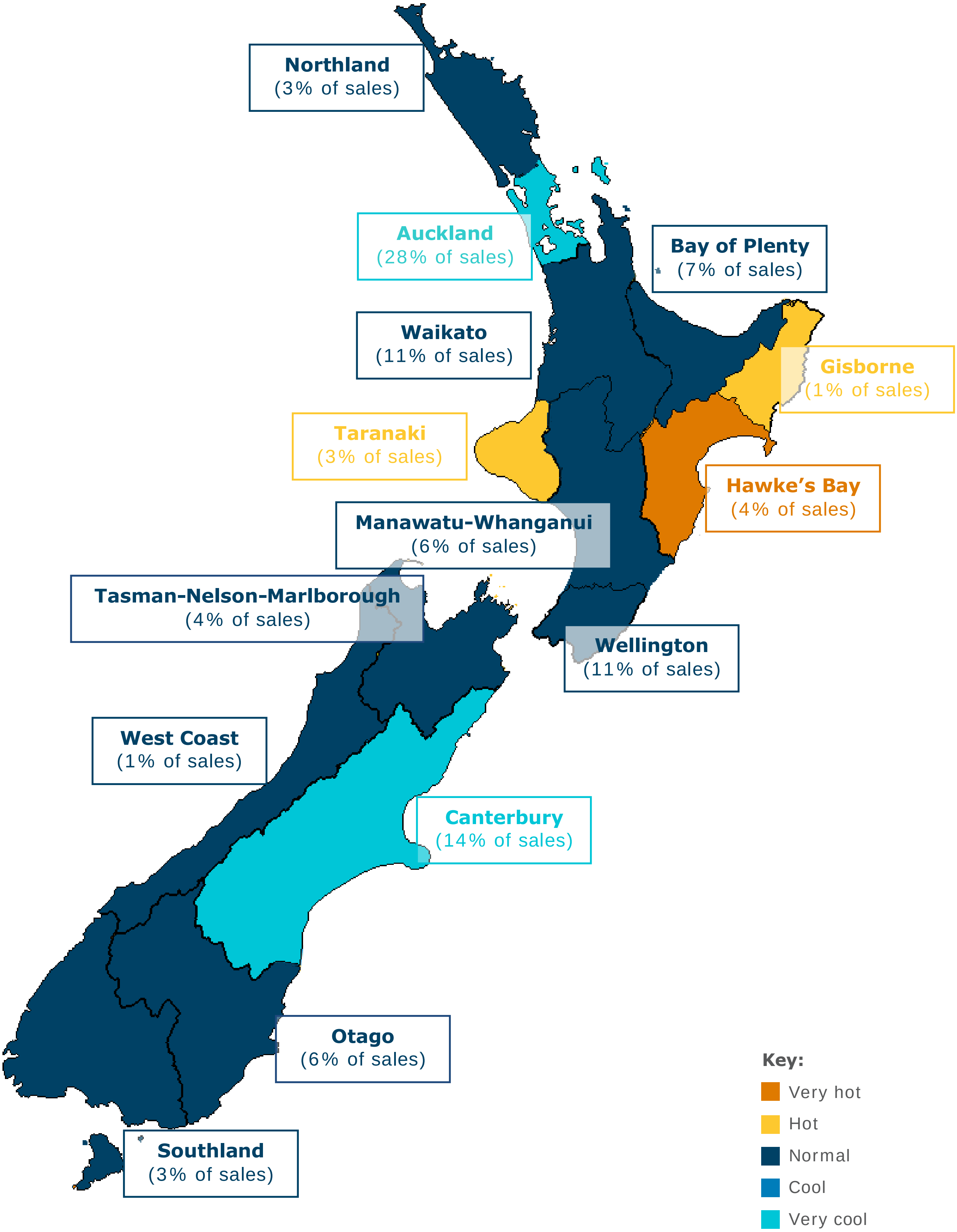
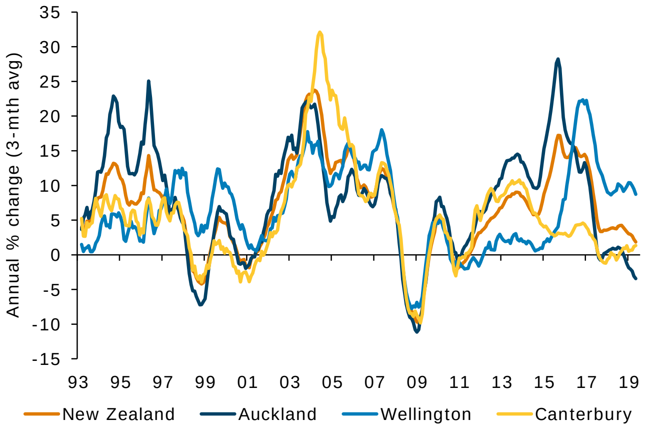


Figure 1. Regional house price inflation

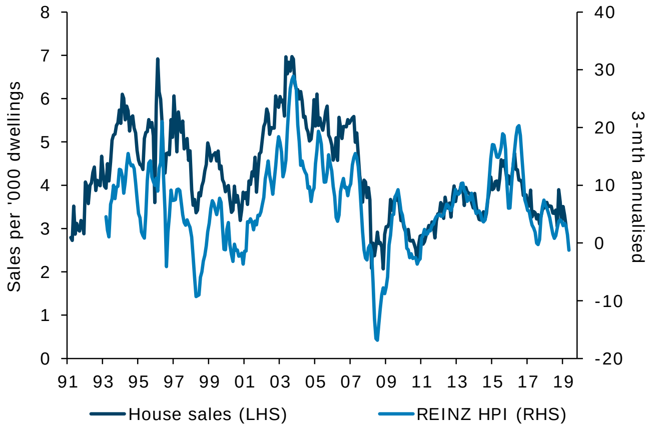


Source: ANZ Research, REINZ

House prices eked out a small 0.4% m/m rise in May after two consecutive falls. Auckland managed a similar-sized gain, only its fourth monthly rise in the last 12 months. Annual house price inflation continues to moderate, reaching 1.9% y/y (3mma) in May, having started 2019 with 3% y/y growth. We had expected the firming in prices in late 2018 would prove short-lived and that headwinds weighing on the market would see prices continue their gentle descent, and this has proven to be the case.

Regional divergence has remained evident. Auckland is the epicentre of the decline, with annual growth falling to -3.4% y/y. For the rest of New Zealand, annual growth is moderating more slowly and stands at 6.8% y/y in May.

Figure 2. REINZ house prices and sales

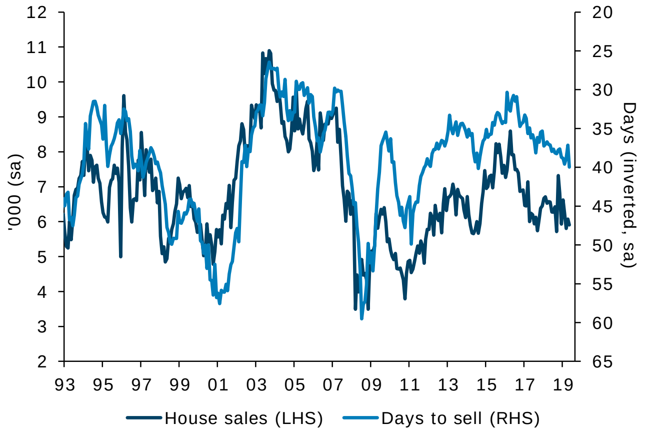


Source: ANZ Research, REINZ

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

Seasonally adjusted house sales fell 2.7% in May. The data continued to slow and the 12% 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 growth is now declining 10% y/y with Auckland falling 16% y/y, the largest decline among all regions. Surrounding areas are also feeling the pinch; sales in Northland and Bay of Plenty are the second- and third-worst performers in terms of sales, at 13% and 12% y/y respectively.

Figure 3. Sales and median days to sell

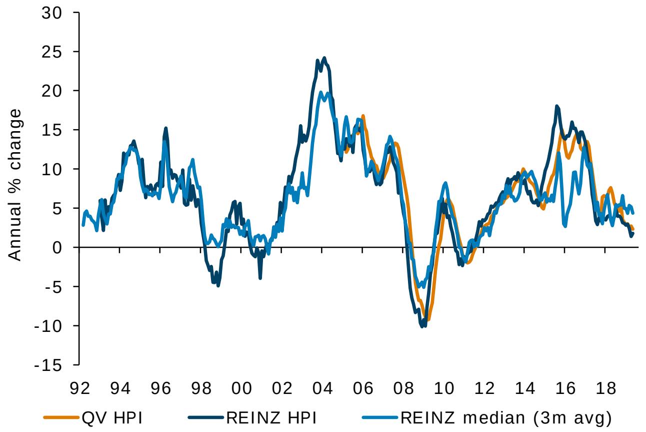


Source: ANZ Research, REINZ

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 tight housing market is losing its grip in aggregate, and is on par with the previous high in 2016. The median time to sell a house is now 40 days (sa), having just overtaken the historical average (39 days) in May. The Auckland market in particular shows signs of slack. The days to sell measure was stable in May but remained elevated at 44 – above the historical average of 36. Slack around this level suggests that weakness in prices may continue for a while yet.

Figure 4. REINZ and QV house prices

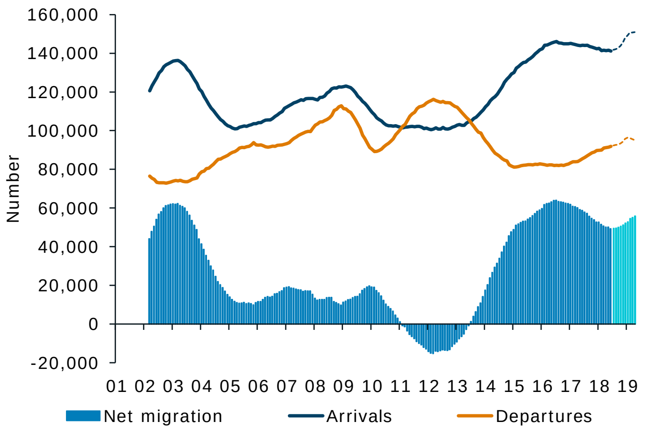


Source: ANZ Research, REINZ, QVNZ

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 1.9% y/y (3mma) in May. The QVNZ measure has moderated even further and is sitting at 2.3% y/y. The REINZ median remained within the familiar 3 to 7% range in annual growth. Since the median does not control for composition, the higher growth rate may reflect a rising proportion of high-value sales.

Figure 5. Annual migration*



Source: Statistics NZ

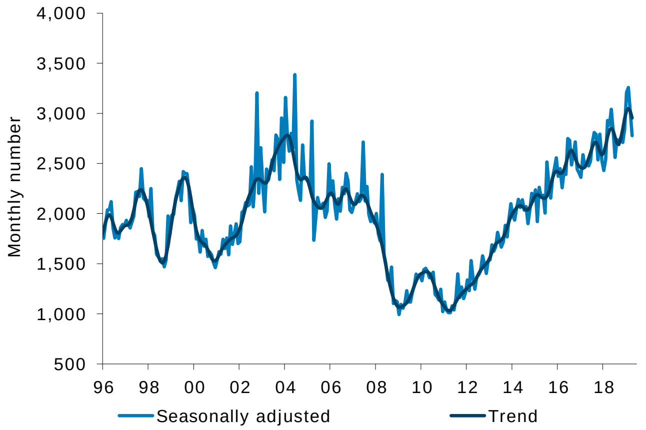
*Dotted lines show the last nine months of data, which we look through because they are subject to substantial revisions. The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data.

Migration flows 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.

Annual net migration reportedly picked up to 55,900 in May, but Statistics NZ's data is subject to substantial revision and is relatively untested, so we would caution about reading too much into it.

The earlier (more reliable) observations show annual net migration eased to 49,400 by mid-2018 from its peak of 64,000 in mid-2016. We think this process has continued, with arrivals flattening off and departures slowly lifting as earlier arrivals on temporary visas continue to cycle out. Indeed, to avoid unnecessary noise in our economic outlook we're now forecasting net migration with a nine-month lag.

Figure 6. Residential building consents



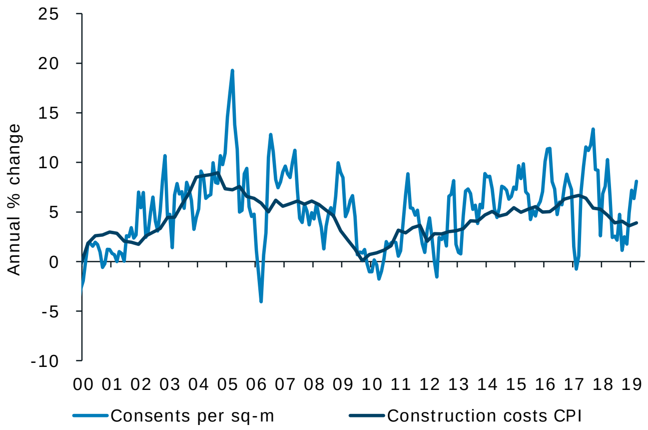
Source: ANZ Research, Statistics NZ

Residential building consents dipped in May with multi-unit dwellings and housing consents down 14% (following an 18% fall in April) and 4% respectively. The data are volatile, particularly for multi-unit dwellings, but construction firms' activity expectations have turned sour of late so we'll be watching this one closely. Annual consent issuance is still strong, running at 34,400, just above the previous mid-2000s peak (33,200). Growth in Auckland consents drove the strength, with annual consents up around the 14k mark.

Overall, housing demand remains robust, which should be supportive of further construction activity. However, capacity constraints are being felt and the construction industry is facing profitability challenges, which we expect will make it difficult for issuance to push higher.

Property Market in Pictures

Figure 7. Construction cost inflation

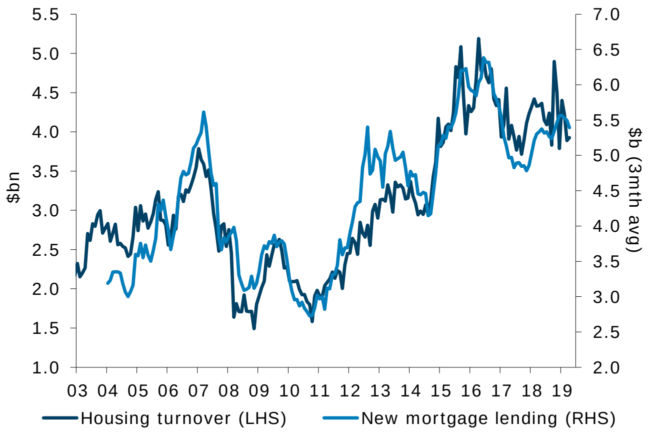


Source: ANZ Research, Statistics NZ

Construction cost inflation has softened since 2017 and we expect it to remain subdued. Growth in the cost of consented work per square metre – a proxy – eased to 7.1% y/y (3mma) in April, following a period of weakness in 2018. This compares with CPI construction cost inflation of 3.9% y/y in the March quarter. Construction cost inflation has been in gradual decline from its recent peak of 6.7% in March 2017, but appears to have found a floor.

Capacity pressures in the industry remain acute, which should continue to support price rises. But with construction growth slower than in recent years, and caution among firms, we don't expect construction cost inflation to surge higher from here.

Figure 8. New mortgage lending and housing turnover

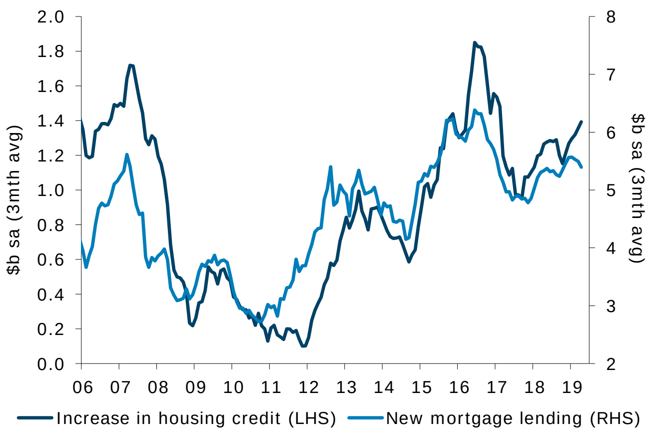


Source: ANZ Research, RBNZ

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 jumped 5% m/m (sa) in April following two similar-sized falls in three of preceding four months. 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, but headwinds may see this peter out eventually.

Figure 9. New mortgage lending and housing credit

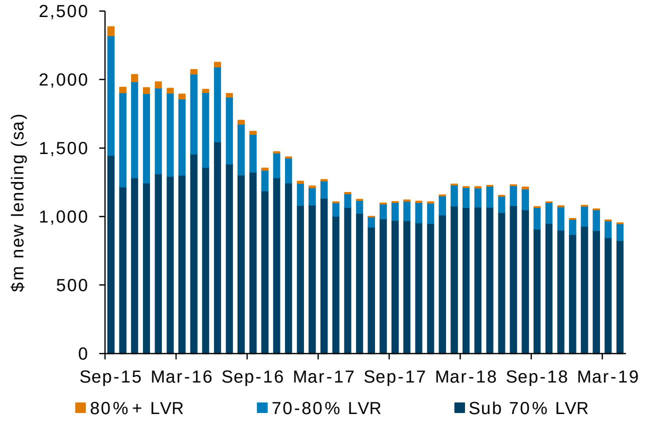


Source: ANZ Research, REINZ, RBNZ

Household credit has been growing at a pretty consistent monthly pace since early 2017. In monthly terms, household lending increased 0.5% m/m in April. In annual terms, household credit growth accelerated to 6.3% 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

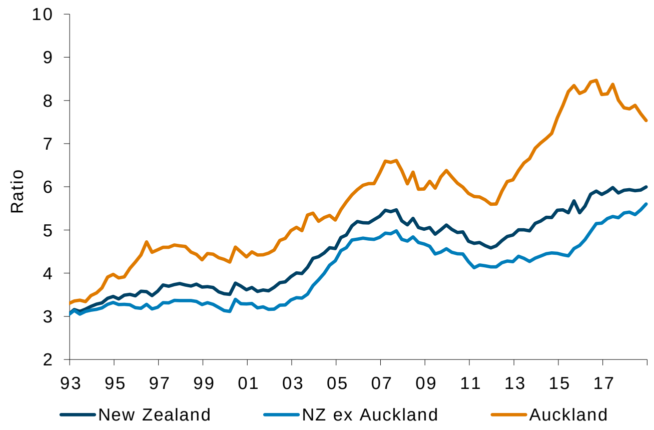


Source: ANZ Research, RBNZ

On a seasonally adjusted basis, new lending to investors fell 1.6% in April following 4% and 9% falls over February and March. The recent slowing follows a strong January rise as loan-to-value restrictions were eased in the month. But recent weakness in house sales since has more than offset the January rise – with lending to investors falling overall so far in 2019 in seasonally adjusted terms. Underlying this, investors remain wary, which is weighing on the housing market. About 18% of new loans were to investors in April, up from 17.4% towards the end of 2018.

The share of investor lending on riskier 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 about half.

Figure 11. Regional house prices to income

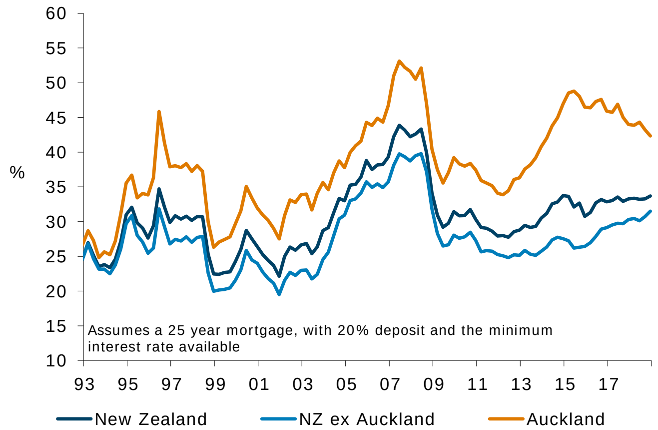


Source: ANZ Research, REINZ, Statistics NZ

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 over 8 times in 2017 to an estimated 7.5 times in Q4 2018, reflecting recent weakness in house prices. Ex-Auckland, the ratio has continued to rise; at 5.6 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 low mortgage rates, households could be vulnerable in the event of a lift in interest rates.

Property gauges

National house price growth has softened since the peak in mid-2015. In recent years weakness in Auckland has stood in stark contrast to most other regions, which maintained strong growth rates, until recently. House price inflation outside of Auckland is now also waning. House sales fell further in May, after the easing in loan-to-value ratio restrictions provided a temporary boost at the start of the year. House prices and market activity are expected to remain subdued from here. The market faces several headwinds: banks are cautious and LVR limits remain binding; investors are wary of policy changes; affordability constraints are biting; and the impact of the locking out of foreign buyers is still working its way through. That said, some tailwinds have also emerged recently, including falls in fixed mortgage rates and the exclusion of a capital gains tax, which should help to stabilise the market.

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	More cuts coming	↔/↑	We see the OCR falling further in the second half of 2019 and early 2020, 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 and the ruling out of a capital gains tax has 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

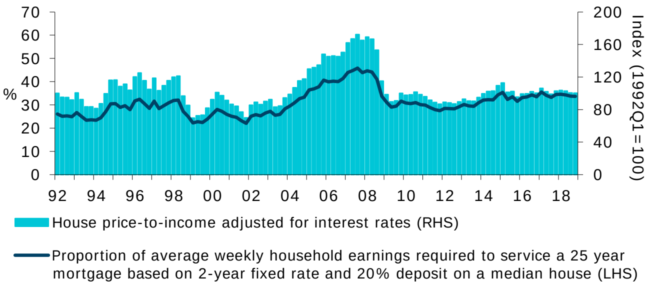


Figure 2: Household debt to disposable income

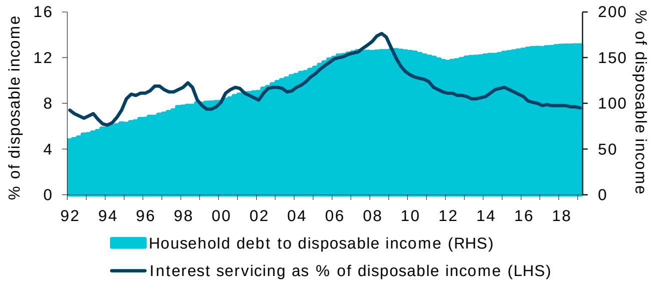


Figure 3: New customer average residential mortgage rate (<80% LVR)

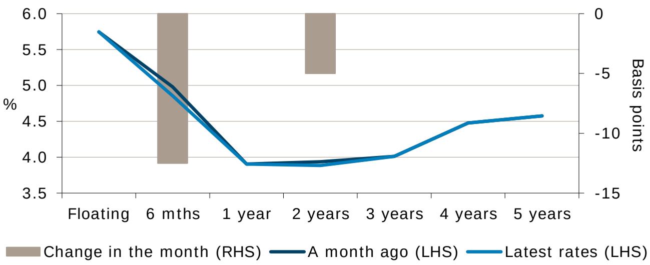


Figure 4: Annual migration*

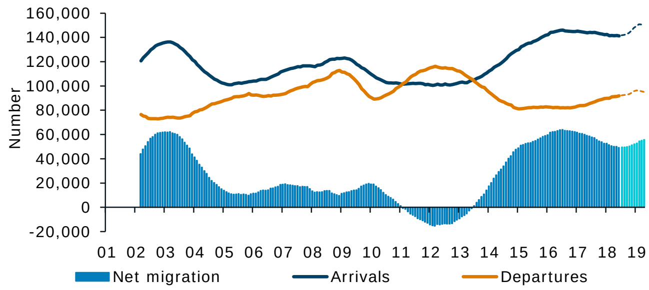


Figure 5: Housing supply-demand balance

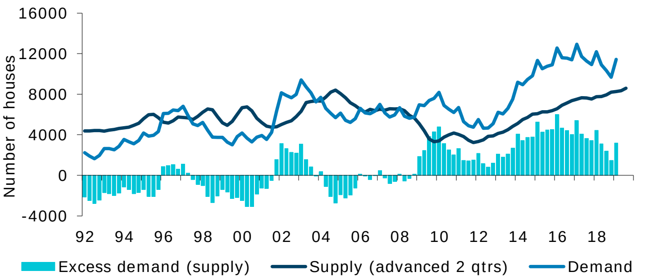


Figure 6: Building consents and house sales

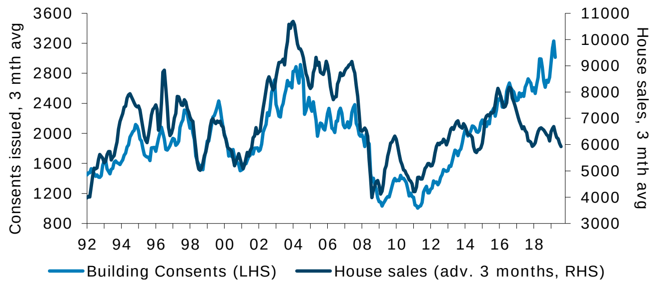


Figure 7: Liquidity and house prices

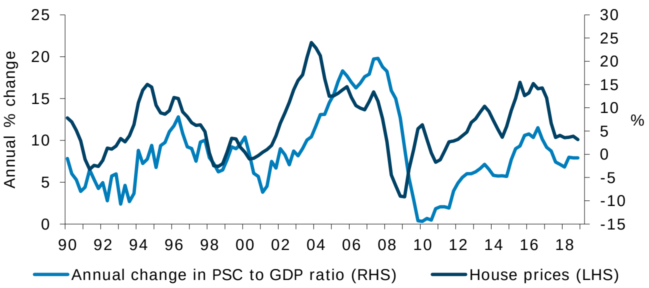


Figure 8: House price inflation comparison

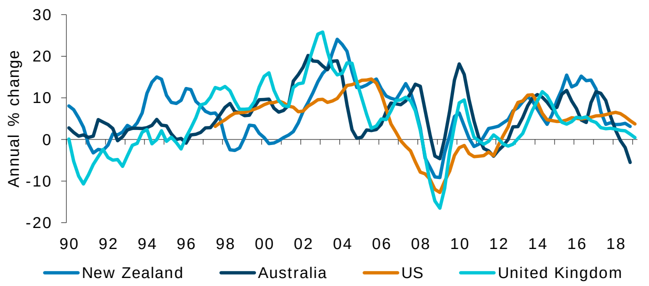


Figure 9: Housing supply

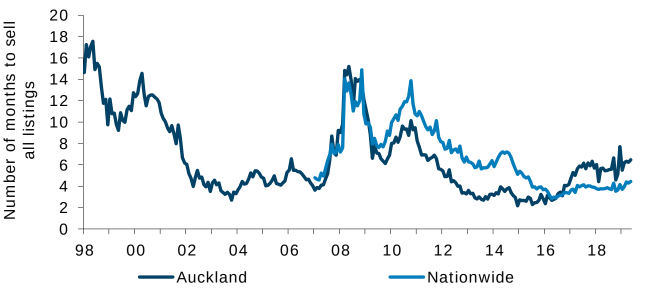
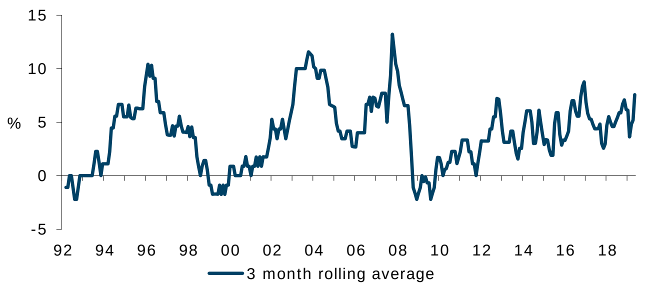


Figure 10: Median rental, annual growth



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

* Dotted lines show the last nine months of data, which we look through because they are subject to substantial revisions. The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data.

Economic overview

Summary

Global growth concerns have continued to build. A fall in global trade and slowing activity (particularly manufacturing) is now weighing on the inflation outlook and keeping central banks in the spotlight. The theme of 'lower for longer' interest rates is once again at the fore. We're expecting rate cuts by both the Reserve Bank of Australia and the US Federal Reserve over the next year. Closer to home, while New Zealand commodity export prices have so far been fairly resilient to the global slowdown, slowing domestic momentum has persisted. We think further stimulus from the RBNZ will prove necessary to help support employment and inflation. But provided the global economy keeps it together, New Zealand's outlook is hardly bleak. A bit more government spending over the next year or so alongside some additional monetary stimulus should help put a floor under the slowdown and support a gradual growth recovery from the second half of this year.

Our view

Global developments over the past few months are painting an increasingly cloudy picture for the outlook. Annual growth in global trade has fallen sharply, with global industrial production following suit. Uncertainty over trade access and global demand continues to weigh on sentiment – all this against a backdrop of still-subdued price pressures in many economies.

Amidst the slowdown in global growth and trade, the burden has again fallen on central banks to provide stimulus to support their respective economies. Over 2017 and 2018, global growth was solid and central banks were either 'on hold' or tightening policy. But the tide has now turned and 'lower for longer' interest rates are again the theme globally.

The Reserve Bank of Australia cut their cash rate to 1.25% in early June, and appears very open to the possibility of more rate cuts. Underlying inflation in Australia remains stubbornly low and slowing domestic growth, along with remaining slack in the labour market, suggests that more work needs to be done to ensure that inflation moves sustainably higher. We expect two more rate cuts by the RBA this year, taking the cash rate to a fresh low of 0.75%.

The Federal Reserve has also come under renewed pressure to ease policy, with signs of softening growth and faltering inflation pressures setting up the Fed to move back into easing mode. We expect two rate cuts over the next year, reversing some of the interest rate buffer the Fed had built up over the past few years.

Turning to the domestic picture, economic growth continues to muddle along. To date, the New Zealand economy has been relatively unaffected by the slowdown in global activity. Commodity prices are down a little, as are tourist numbers, but offsetting this, the NZD is also down. However, given the global economic backdrop is looking a bit fragile and regulatory concerns continue to weigh, we think exporters are going to remain cautious. And that suggests the usual transmission from solid export earnings (on the back of the lower NZD and elevated world commodity prices) to the rest of the economy is likely to be a little more muted than at previous points of the cycle. Deleveraging seems more likely than increased spending.

Overall, the New Zealand economy has been losing steam for a while now, with annual growth slowing from around 4% in late 2016 to 2.5% by Q1 2019. And we think this slowdown has a little further to run. However, we think there are enough supports out there to prevent growth from falling off a cliff (unless something drastic happens). We expect annual growth to trough in the middle of this year, before economic momentum gradually builds, pushing annual growth towards 3% by the end of 2021 as further OCR cuts lend a hand.

But this pick-up in growth will be hard won. The tailwinds of lower interest rates, recent NZD depreciation, a tight labour market, and a little extra fiscal stimulus still need to contest with stubbornly low business sentiment (which we suspect is weighing on investment and employment decisions), slowing population growth, chronic weak productivity growth and a softer housing market.

All up, the New Zealand economy is doing alright, but risks are heightened (particularly global risks). For the Reserve Bank, we expect that an economy just muddling through isn't going to cut it when domestic inflation is not yet where it needs to be. Forward-looking indicators are not yet able to say which is more likely between the RBNZ's forecast for a strong pickup in growth and our outlook for a more modest recovery. But by November, we think the evidence will be clear that growth is struggling to accelerate and that the RBNZ will cut the OCR in November, followed by another in February. Further, we believe the tolerance on the part of the Reserve Bank for any downside surprises on growth or inflation will be extremely limited, meaning risks are skewed towards an earlier move.

Key forecasts

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

Mortgage Size ($'000)	Mortgage Rate (%) 3.50	3.75	4.00	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75
200	231	237	243	250	256	263	270	276	283	290	297	304	311	319
250	289	296	304	312	320	329	337	345	354	363	371	380	389	398
300	346	356	365	375	385	394	404	415	425	435	446	456	467	478
350	404	415	426	437	449	460	472	484	496	508	520	532	545	558
400	462	474	487	500	513	526	539	553	566	580	594	608	623	637
450	520	534	548	562	577	592	607	622	637	653	669	684	701	717
500	577	593	609	625	641	657	674	691	708	725	743	761	778	797
550	635	652	669	687	705	723	741	760	779	798	817	837	856	876
600	693	711	730	750	769	789	809	829	850	870	891	913	934	956
650	750	771	791	812	833	854	876	898	920	943	966	989	1,012	1,036
700	808	830	852	874	897	920	944	967	991	1,015	1,040	1,065	1,090	1,115
750	866	889	913	937	961	986	1,011	1,036	1,062	1,088	1,114	1,141	1,168	1,195
800	924	948	974	999	1,025	1,052	1,078	1,105	1,133	1,160	1,188	1,217	1,246	1,274
850	981	1,008	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233	1,263	1,293	1,323	1,354
900	1,039	1,067	1,095	1,124	1,154	1,183	1,213	1,244	1,274	1,306	1,337	1,369	1,401	1,434
950	1,097	1,126	1,156	1,187	1,218	1,249	1,281	1,313	1,345	1,378	1,411	1,445	1,479	1,513
1000	1,154	1,186	1,217	1,249	1,282	1,315	1,348	1,382	1,416	1,451	1,486	1,521	1,557	1,593

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

	Median house prices		No of sales (sa)	Mthly % chg	Avg days to sell (sa)
	Ann % chg	3mth % chg			
Northland	-2.2	-2.6	197	+6%	56
Auckland	1.3	-1.4	1,518	-8%	44
Waikato	6.7	-0.2	673	0%	42
Bay of Plenty	0.9	-1.0	446	+18%	47
Gisborne	53.7	9.1	59	+1%	35
Hawke's Bay	9.4	4.0	251	+3%	31
Manawatu-Whanganui	14.0	3.8	356	-5%	29
Taranaki	3.0	-0.9	184	+5%	32
Wellington	5.4	-1.4	714	+8%	35
Tasman, Nelson and Marlborough	7.0	-2.2	280	+28%	36
Canterbury	0.1	-0.4	827	-2%	40
Otago	7.9	2.3	384	+9%	29
West Coast	-13.2	-3.0	35	-18%	46
Southland	17.1	7.2	170	+10%	27
New Zealand	**3.2**	**-0.6**	**5,907**	**-3%**	**40**

Key forecasts

	Actual				Forecasts					
Economic indicators	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
GDP (Ann % Chg)	2.7	2.5	2.5	2.1	2.3	2.3	2.3	2.5	2.5	2.6
CPI Inflation (Annual % Chg)	1.9	1.9	1.5	1.8	1.4	1.5	2.1	1.9	1.9	1.9
Unemployment Rate (%)	4.0	4.3	4.2	4.3	4.3	4.4	4.4	4.3	4.3	4.3
House Prices (Annual % Chg)	4.3	3.3	2.7	3.1	3.3	3.5	3.7	3.7	3.5	3.0
Interest rates (RBNZ)	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Official Cash Rate	1.75	1.75	1.75	1.50	1.50	1.25	1.00	1.00	1.00	1.00
90-Day Bank Bill Rate	1.9	2.0	1.9	1.7	1.6	1.4	1.2	1.2	1.2	1.2
Floating Mortgage Rate	5.8	5.8	5.8	5.5	5.5	5.3	5.0	5.0	5.0	5.0
1-Yr Fixed Mortgage Rate	4.8	4.8	4.7	4.7	4.6	4.4	4.3	4.3	4.3	4.3
2-Yr Fixed Mortgage Rate	4.8	4.7	4.6	4.8	4.8	4.7	4.6	4.7	4.7	4.7
5-Yr Fixed Mortgage Rate	5.4	5.4	5.3	5.2	5.5	5.4	5.4	5.4	5.4	5.4

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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This document has been prepared by ANZ Bank New Zealand Limited, Level 26, 23-29 Albert Street, Auckland 1010, New Zealand,
Ph 64 9 357 4094, e-mail nzeconomics@anz.com, http://www.anz.co.nz