ANZ Research October 2019

New Zealand Property Focus

Easy does it

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Summary

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

Feature Article: Easy does it

Loan to Value Ratio (LVR) restrictions were never intended to be a permanent feature of the housing market. But, six years after their implementation in 2013, they remain a key element, contributing to less risky lending and putting downward pressure on house price inflation. Numerous tweaks to the LVR restrictions have been made in recent years, but is it time to loosen them a little more? Recent housing market outturns have been modest, particularly on the sales activity side. But there are lots of moving parts, and significant regional divergence. While household debt levels are certainly high, growth in household disposable income does looks to be running at around the same pace as housing credit growth – and above house price inflation. Both we and the RBNZ expect house price inflation to remain modest relative to previous cycles over the next few years, but frankly, a wide range of outcomes is plausible given the recent drop in mortgage rates, possible developments in credit availability, the softening economy, and policy changes. All up, we think a small loosening in LVR restrictions is likely at the upcoming November 27 Financial Stability Report.

Property gauges

The housing market has tightened a touch in recent months, although the volume of house sales remains subdued. House prices rose 2.6% y/y at the national level in September, up from 2.1% in August. Auckland house price inflation is still negative in annual terms, but a little less than previously, contracting 1.7% y/y (versus -2.6% y/y in August). Indeed, Auckland house price inflation in the September month (up 0.9% m/m) was broadly in line with that seen in the rest of the country. But housing market activity remains soft. House sales fell 0.6% m/m, but annual growth picked up to 2.7% y/y. That said, nationwide days to sell dropped from 40 days to 37, supported by a tightening in the Auckland market, with listings very low. The boost to national house prices in September may reflect support from lower mortgage rates over the past year, but still-soft activity suggests the upside is capped for now. We expect the market to remain subdued, but there is certainly a risk that lower mortgage rates drive a larger-than-expected pick-up.

Economic overview

In what's been a broad-based slowdown, the pace of headline GDP growth has almost halved from around 4% y/y in 2016 to 2.1% in June 2019. And the leading indicators are all suggesting there's more slowing to come in the near term. We expect annual GDP growth will feature a 1-handle in the first half of 2020, but are hopeful that accommodative monetary conditions, still-elevated (but easing) net migration inflows, and a buoyant household sector will put a floor under things. However, sub-par growth is inconsistent with intensifying inflation pressures over the medium term, which – alongside inflation expectations threatening to slip – will see the RBNZ cut the OCR further. We're expecting a 25bp cut in November, and two follow-up cuts in February and May next year to take the OCR to just 0.25%. But the RBNZ won't be the only central bank cutting interest rates over the year ahead. Growth among our trading partners has also been slipping. And with domestic and global risks skewed to the downside at a time when monetary policy running into conventional limits, there are increasing calls for the Government to up the fiscal-stimulus ante.

Feature Article: Easy does it

Summary

Loan to Value Ratio (LVR) restrictions were never intended to be a permanent feature of the housing market. But, six years after their implementation in 2013, they remain a key element, contributing to less risky lending and putting downward pressure on house price inflation. Numerous tweaks to the LVR restrictions have been made in recent years, but is it time to loosen them a little more? Recent housing market outturns have been modest, particularly on the sales activity side. But there are lots of moving parts, and significant regional divergence. While household debt levels are certainly high, growth in household disposable income does looks to be running at around the same pace as housing credit growth – and above house price inflation. Both we and the RBNZ expect house price inflation to remain modest relative to previous cycles over the next few years, but frankly, a wide range of outcomes is plausible given the recent drop in mortgage rates, possible developments in credit availability, the softening economy, and policy changes. All up, we think a small loosening in LVR restrictions is likely at the upcoming November 27 Financial Stability Report (FSR).

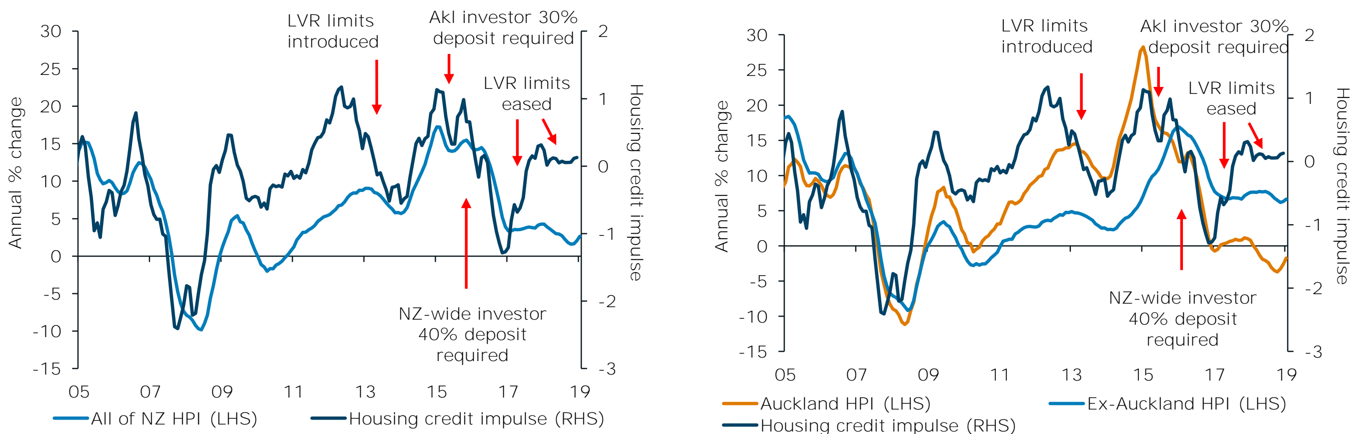
Easy does it

In October 2013, concerns about financial stability following a period of rapid house price growth (particularly in Auckland) alongside an uncomfortable lift in low-deposit loans, saw the RBNZ swing into action by imposing loan-to-value ratio (LVR) restrictions. These were designed to reduce riskier mortgage lending, mitigating the risk to the financial system (and the broader economy) from a potential house price correction down the track. Good old-fashioned rate hikes could have achieved much the same thing, of course, but in a much blunter fashion. The Reserve Bank had no need to dampen broader inflation pressures at the time (or indeed since) and so preferred a more targeted "macro-prudential" approach.

Since their implementation, LVR restrictions have been a key feature driving dynamics in the New Zealand housing market. But it hasn't exactly been a case of 'set and forget'. A number of tweaks to LVR settings have been made over the years, including regional (tightening settings for the Auckland Council area relative to the rest of the country, and subsequently loosening them), tweaking the "speed limit", and adjusting what's considered a "high-LVR" loan for both owner-occupier and investor loans.

LVR restrictions were not initially meant to be a permanent feature of the housing market, but the RBNZ has in recent years sounded keen on keeping them in the toolbox, and simply easing them to non-binding levels when they aren't required. This would mean that they are good to go next time round without the RBNZ once more needing to obtain political permission to implement them. We are gradually moving towards that non-binding point, though we aren't there yet – over the past couple of years as housing pressures have softened, the RBNZ has gradually eased LVR restrictions for both owner occupiers and investors (figure 1).

Figures 1 and 2. House prices and credit impulse



Source: REINZ, RBNZ, ANZ Research

At the current juncture, LVR settings differ depending on whether the loan is secured by a residential investment property or an owner-occupied property. Investor loans are typically more highly leveraged and are thought to carry a higher risk to financial stability. For example, a larger proportion of property investors in the market may increase house price volatility due to trader-like incentives to exit the housing market as the cycle turns, and/or a higher rate of mortgage defaults and hence fire-sales in times of trouble, if rental incomes deteriorate or other cash-flow hiccups occur. Investor loans are therefore more restricted by current LVR settings.

Feature Article: Easy does it

A "high-LVR" investor loan is currently defined as a loan exceeding 70% of the property's value, meaning investors looking to borrow who have a 30% deposit (or more) won't be constrained by this policy. For new investor loans where the deposit is less than 30% (ie an LVR greater than 70%), a "speed limit" is applied to control how quickly this riskier form of lending can grow. Currently, the speed limit is set at 5% of new loans, meaning banks can provide high-LVR loans to a total portfolio of no more than 5% of the total new loans they write over either a three-month or six-month period (depending on bank size).

For owner-occupiers, high-LVR loans are currently defined as a loan exceeding 80% of the property's value. The speed limit here is 20% of new loans. There are also some circumstances where exemptions may apply, such as for new builds, so as to not stifle the already-constrained supply side that has contributed to rapid house price inflation to start with. See the RBNZ's LVR page for further details.

It's important to note that LVR restrictions were never intended to be a solution to New Zealand's housing affordability woes. That's the Government's problem to address, not the Reserve Bank's. While LVRs can be viewed as a "social policy" insofar as they help insure society against financial stability risks, they are an inadequate instrument for addressing supply-side constraints (following a period of rapid migration-induced population growth for example), or wealth distribution (ie the winners and losers from growth in asset values). And these aren't the Reserve Bank's job.

Have LVR restrictions had much of an impact on the housing market?

Whether LVR restrictions have had much impact on the housing market is a tougher question to answer than you might think. First, LVR policy settings have been repeatedly adjusted since their implementation. And second, they haven't been the only difficult-to-quantify factor influencing house prices this cycle. In our May 2019 Property Focus, we discussed how low interest rates and population growth no longer do a great job at explaining house price inflation, as the lengthy list of government policy changes (both actual and proposed), affordability constraints, and macro-prudential policy all appear to have had a moderating effect on house prices.

Disentangling these difficult-to-quantify drivers from the typical macro-economic drivers is a tricky business. While acknowledging these difficulties, the RBNZ have done their best to do just that, publishing several papers on this very topic.[1] Their most recent analysis concludes that house prices and credit growth have indeed been weaker than otherwise, and that, overall, LVR policies may have reduced house price pressures by almost 50%.

LVR restrictions have certainly had a clear impact on the composition of new lending. Since their introduction in 2013, the high-LVR share of loans has fallen from around 21% of mortgage lending to around 7% currently (figure 3). As a share of total new lending, lending to investors has fallen from close to 35% in mid-2016 (its recent peak), to around 19% currently.

Figure 3. High-LVR share of mortgage lending

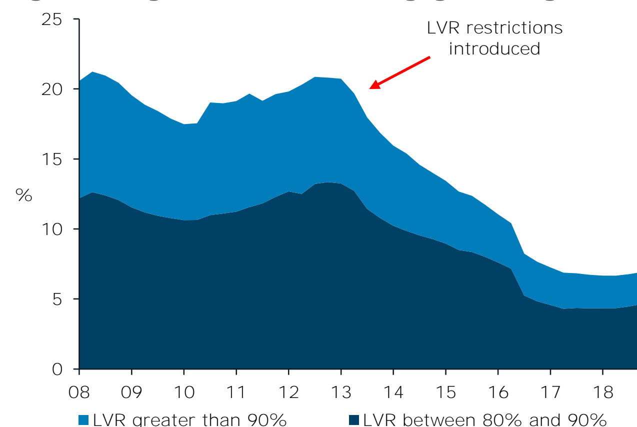
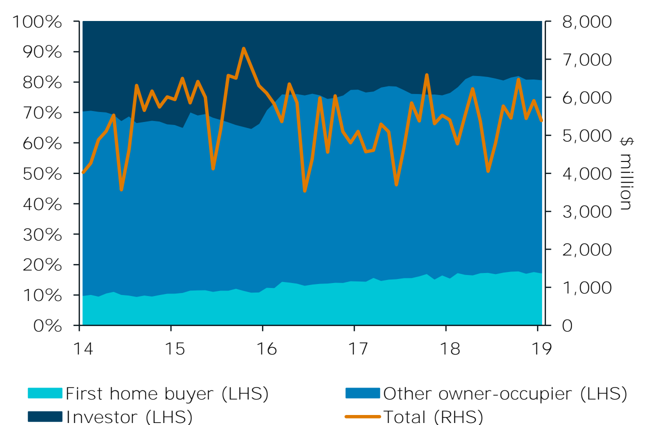


Figure 4. Share of new lending by borrower type



Source: RBNZ

[1] See How has the LVR restriction affected the housing market: a counterfactual analysis and Loan-to-Value Ratio Restrictions and House Prices.

Is it time to loosen LVR restrictions a little more?

The May 2019 Financial Stability Report (FSR) made it clear that before the RBNZ will loosen the LVR restrictions further, there must be:

- Evidence that house price and credit growth is set to remain at "sustainable levels" – perhaps around the rate of household income growth.
- A low risk of housing market resurgence once LVR restrictions are eased.
- Evidence that banks are maintaining prudent lending standards.
- Confidence that a further easing in LVR restrictions won't undermine the resilience of the financial system.

Regarding house price and credit growth, recent outturns have indeed been modest. But with listings so constrained (particularly in Auckland) it wouldn't take much extra demand to cause a meaningful tightening, and as has been the case for some years, there is a great deal of regional divergence in housing markets. But starting with the big picture, growth in household disposable incomes (based on our quarterly proxy measure) looks to be running at around the same pace as housing credit growth – and above house price inflation (figure 5). So things are moving in the right direction. However, at 164.4% of disposable incomes, household debt remains record high. While low interest rates mean that servicing that debt is generally manageable (in a system sense, at least) any hit to household incomes (eg higher unemployment) would hurt, and that's a key risk to which the RBNZ is likely to remain highly attentive to for a long while yet (figure 6).

Figure 5. Growth in housing credit, house prices and household disposable incomes

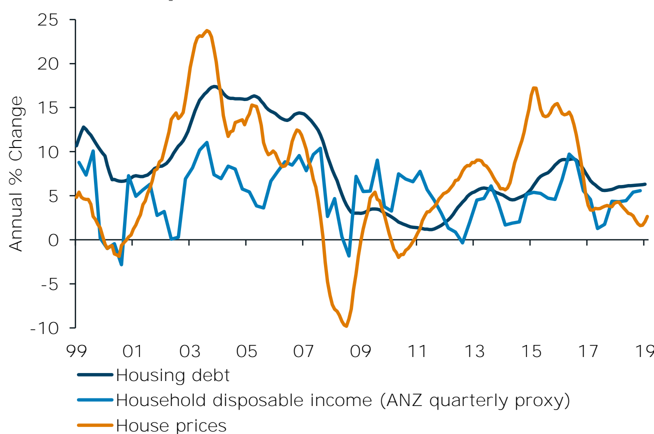
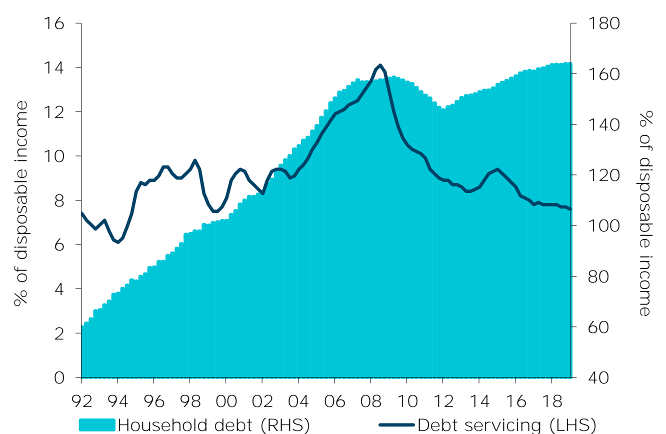


Figure 6. Household debt and serviceability

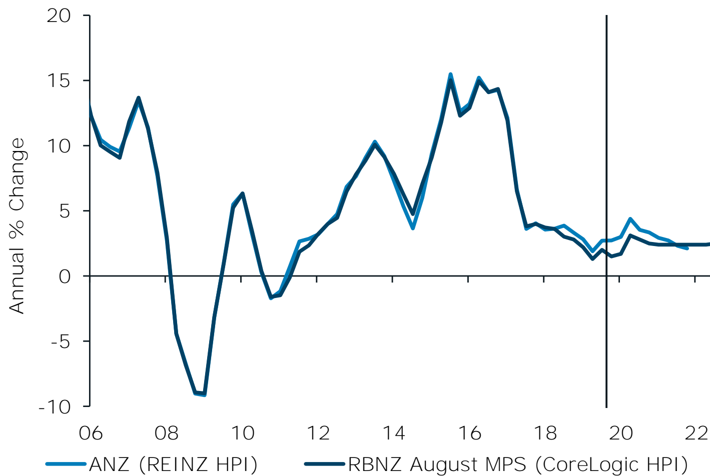


Source: RBNZ, Statistics NZ, ANZ Research

However, although growth in credit and house prices has been contained recently, that doesn't mean this will continue. And that's what really matters when it comes to evaluating whether or not there's a low risk of resurgence in the housing market once LVR restrictions are eased – and therefore being confident that lower LVR restrictions won't undermine the resilience of the financial system. After all, loosening the LVR restrictions might not cause a resurgence in the housing market, but it could well exacerbate a surge unhelpfully.

So is a housing resurgence around the corner? One certainly can't rule it out. There are already differing views out there on the New Zealand housing market outlook, and in particular around the question of how much the recent fall in mortgage rates will translate into higher house price inflation. We're forecasting annual house price inflation will pick up to a little under 4.5% by mid-2020, but that it'll moderate thereafter to average around 3% over the next couple of years (figure 7). In the latest Monetary Policy Statement in August, the RBNZ was also forecasting relatively subdued house price inflation in the years ahead.

Figure 7. House price inflation



Source: REINZ, ANZ Research

But it's fair to say our and the RBNZ's forecasts appear to be some of the more temperate views out there, and we acknowledge there are risks on both sides to this view. Indeed, there are a number of offsetting forces at play in the housing market at present to account for, and it is far from certain which side will win:

- **Lower mortgage rates**. Still a powerful channel. But that said, if this housing cycle has taught us anything, it's that interest rates aren't the be-all end-all when it comes to house price inflation. Indeed, at times, house price inflation has slowed considerably while mortgage rates have been falling. Affordability constraints are a factor too and the data suggest that in Auckland at least, incomes have a bit of catching up to do before households can (should?) pile on more debt and start bidding house prices up once more. And let's not forget the likely upcoming credit headwinds, as banks try to broadly match lending growth with growth in household deposits (a tricky business in this low interest rate environment), and the likely implementation of the RBNZ's bank capital proposals. The price of credit (the interest rate) quickly becomes less relevant if credit availability tightens up.
- The ongoing **housing supply and demand imbalance** should put a floor under things. There's still a lot of pent-up demand out there. But risks of weaker-than-expected population growth and ongoing housing supply catch-up will cap the upside.
- One shouldn't overlook what's going on in **the broader economy**. While the labour market is tight the outlook for employment is softening, caution among households is threatening to intensify, and the global backdrop is weakening.
- Lastly, and probably most importantly for the housing market outlook, is **the lengthy list of recent actual and potential policy changes**, including the banning of foreign buyers, extension of the bright-line test, increased tenant rights and healthy homes standards (not a bad policy, but negative for investor demand), and the ring-fencing of tax losses. On balance, we believe policy changes have contributed significantly to the recent slowing in house price inflation – and that is likely to persist. That said, the policy landscape hasn't been all bad for housing demand – the KiwiBuild reset includes some first home buyer demand policy tweaks.

Given everything that's affecting the housing market at present, it is far from a given that lower mortgage rates combined with a slight easing in LVR restrictions will trigger resurgence in the housing market, but it can't be ruled out either. The housing market is notorious for second winds after all. House prices in Sydney and Melbourne are now picking up solidly. Those markets looked out for the count only a year ago, and household debt in Australia is around 190% of disposable income. Party on.

The number of moving parts means it would be too simplistic to look at what happened following past LVR loosening to gauge how much a small easing in LVR restrictions will bump up house prices. It's fair to say there is perhaps a little more uncertainty than is typically the case for the housing market outlook more broadly. Perhaps the path of least regrets for the RBNZ on pure financial stability grounds is to hold the LVRs steady until after the dust settles and it's a little clearer how all of the above is netting out. But on the other hand, a bit of housing strength wouldn't go amiss in helping the RBNZ get the economy's animal spirits going again, and helping get CPI inflation back up to the midpoint of the target band. Must be tempting to give it a little more rein.

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From a broader economic perspective, the housing market matters – a lot. A lift in housing activity and prices is likely to spur a little more consumption and residential investment spending, and possibly keep household sentiment buoyed (amongst those who own a house, at least – not so much for millennials). And based on the forward-looking growth indicators we're monitoring, it looks like the economy could use a bit of a kick.

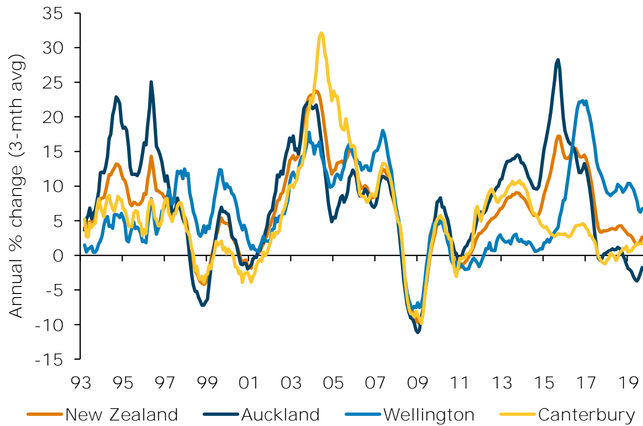
It's fair to say that LVR restrictions have likely eroded the ability of lower interest rates to stimulate economic activity. That's just one manifestation of the trade-offs between financial stability policy and monetary policy that have become more acute as debt levels have increased – and that's a global phenomenon. On the one hand, the RBNZ wants to stimulate economic activity to ensure it meets its inflation and employment objectives ("wake up, go and spend" was the instruction at the August Monetary Policy Statement press conference). But on the other it is mandated to make sure this stimulus doesn't come at a cost to the stability of the financial system ("a material portion of New Zealand households… have high debt levels" was the warning at the May FSR).

In the end, a case could be made either way: loosen LVR restrictions a little at the November Financial Stability Report, or wait and see where things sit after the dust settles following recent mortgage rate moves. But if we had to make a call either way, we think a small loosening is more likely. In the worst case scenario the RBNZ could naturally change course – the May 2020 FSR would be the next obvious opportunity. But no doubt they'd rather get it right first time. Wouldn't we all, but with everything that's going on, anyone who tells you they know with great confidence where the housing market is headed over the next 12 months may not be an entirely disinterested observer.

If the RBNZ does decide to loosen, we don't expect this to have a significant impact on house price inflation. But it could result in higher household leverage, so 'easy does it' is the likely approach from here.

Property Market in Pictures

Figure 1. Regional house price inflation

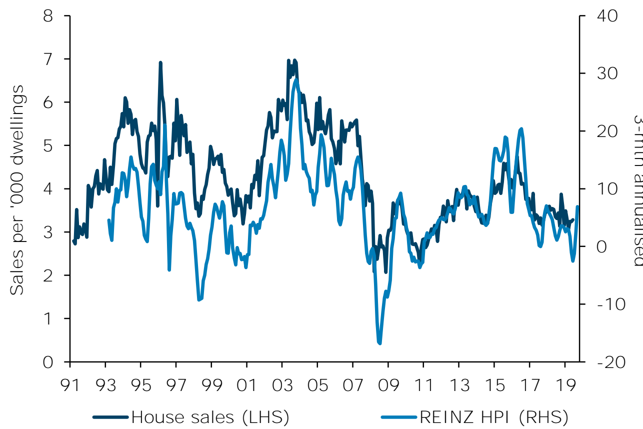


Source: ANZ Research, REINZ

Annual house price inflation has slowly turned following some recent solid monthly prints. Nationally, prices were up 2.6% y/y (3mma) in September; the third consecutive rise. We don't expect momentum to gather too much pace from here as low mortgage rates are balanced out by a slowing domestic economy and prudent bank lending appetites. That said, we are conscious of the risk that low rates and potential easing of LVR restrictions might spur the market more than we anticipate.

While different growth rates are evident across regions, all the main centres have experienced an uptick from recent lows. Auckland house price inflation is still negative, but is now contracting 0.7% y/y, well above the 4.4% y/y decline in April. Growth in Wellington prices rose to 7.9% y/y, while prices in Canterbury rose to 1.7% y/y.

Figure 2. REINZ house prices and sales

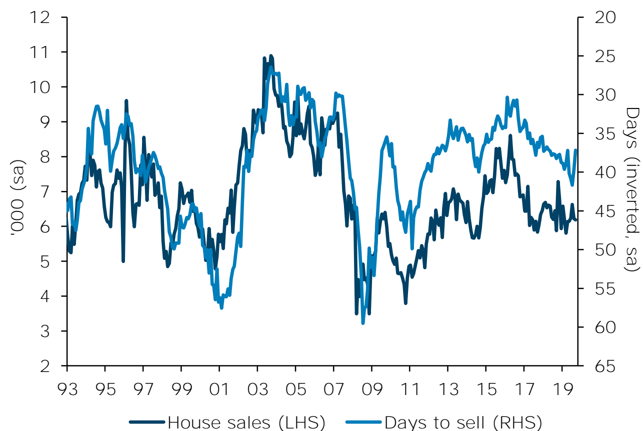


Source: ANZ Research, REINZ

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

House sales fell 0.6% m/m in September (seasonally adjusted, ANZ estimate) following August's 6.1% decline. Annual growth rose for a fifth consecutive month, now sitting at 2.7% y/y, though it's largely a story of Auckland versus the rest. House sales in Auckland recovered from a 15% y/y decline only four months ago to be up 7% y/y. On the other hand, outside of Auckland sales are flat at around year-ago levels.

Figure 3. Sales and median days to sell

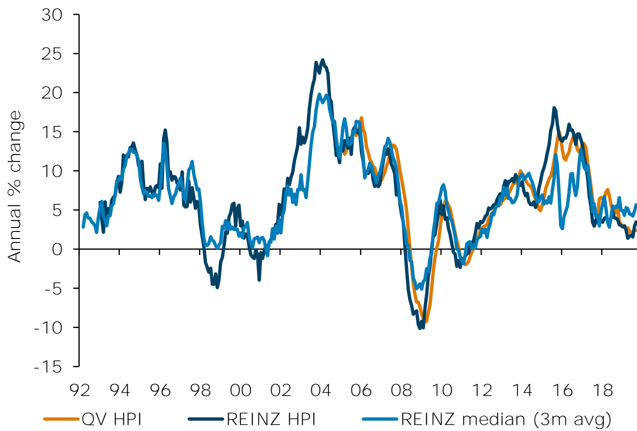


Source: ANZ Research, REINZ

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.

It has been taking longer to sell houses since early 2016, indicating continued rebalancing in the previously tight housing market. However, recent months have seen a turnaround in the days taken to sell a property, particularly in Auckland, which hit 49 days in February this year but was back at 41 days in September. This indicates that constrained supply is seeing the market tighten despite what are still pretty modest sales.

Figure 4. REINZ and QV house prices

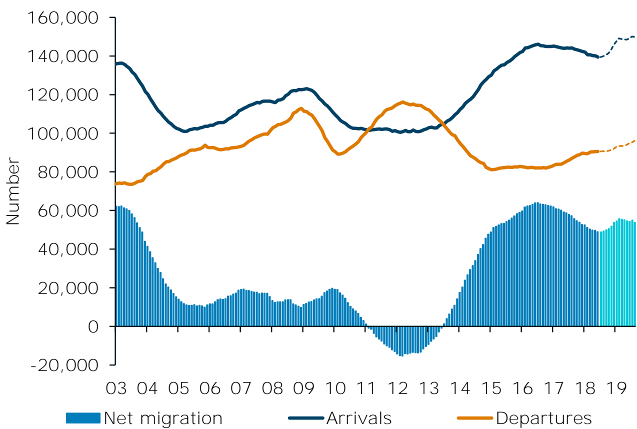


Source: ANZ Research, REINZ, QVNZ

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 2.6% y/y (3mma) in September. The QVNZ measure has ticked up for a third consecutive month at 2.4% y/y. The REINZ median remained within recent ranges, with annual growth of 5.7%.

Figure 5. Annual migration*



Source: Statistics NZ

*Dotted lines show the last nine months of data, which 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 levelled off to 53,800 in September but Statistics NZ's data is now subject to substantial revision. To avoid unnecessary noise in our economic outlook we're now forecasting net migration with a nine-month lag, ie not using the most recent nine months of reported data.

The older, more reliable data suggest the cycle was still easing towards the end of 2018 and has now settled in a range just above 50k. We think a gradual easing trend will set in for the rest of 2019 and beyond.

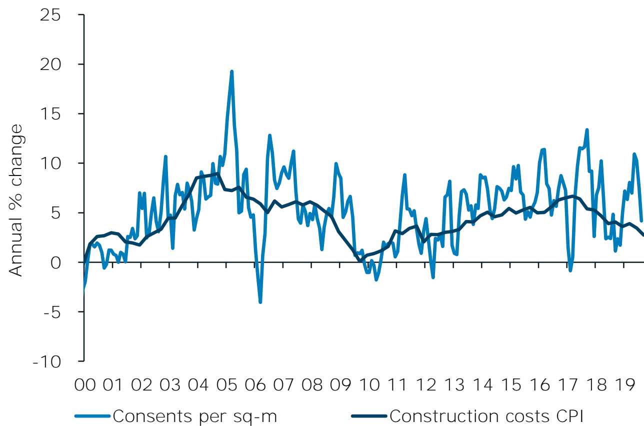
Figure 6. Residential building consents

Source: ANZ Research, Statistics NZ

Residential building consents stabilised in August at high levels. The data are volatile, particularly for multi-unit dwellings. Given construction firms' activity expectations have turned sour of late, we'll be watching this one closely. Annual consent issuance is still very strong, having breached 35,000 for only the second time in September. Growth in Auckland consents continues to provide impetus, with annual consents up over the 14k mark, and still rising. Canterbury consent issuance has turned around following a slump, rising 12% since the same time last year.

Overall, housing demand should be supportive of further construction activity. However, capacity constraints are rife and profit challenges are ongoing, which we expect will make it difficult for issuance to push too much higher.

Figure 7. Construction cost inflation

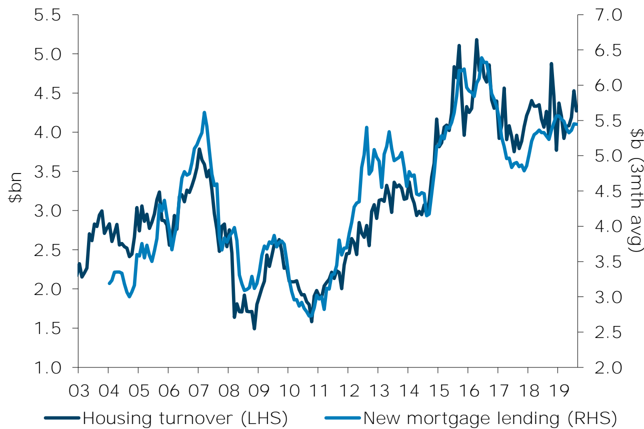


Source: ANZ Research, Statistics NZ

Construction cost inflation has softened since 2017 and we don't expect it to reach the dizzying heights (6.7% y/y) achieved over 2016-2017 in this cycle. Growth in the cost of consented work per square metre – a proxy – eased to 4.2% y/y (3mma) in September, following a period of weakness in 2018. Likewise, CPI construction cost inflation eased further to 2.8% y/y in the September quarter.

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 regarding the pipeline of work, we don't expect construction cost inflation to surge higher from here.

Figure 8. New mortgage lending and housing turnover

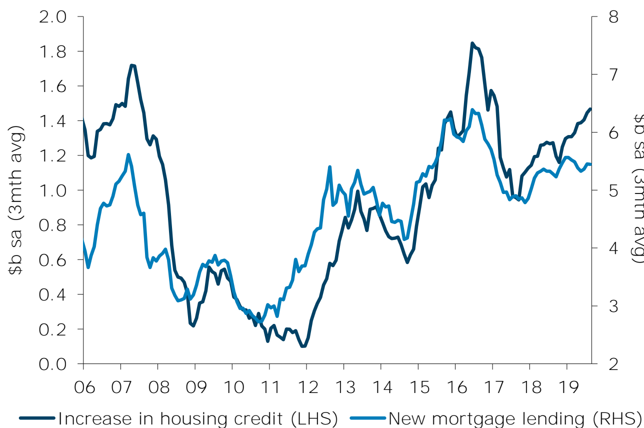


Source: ANZ Research, RBNZ

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 moves closely with new house sales. New lending fell 7.1% m/m (sa) in August, although the data can be volatile; annual growth has found a new range for most of 2019 (currently 3.1% y/y). 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

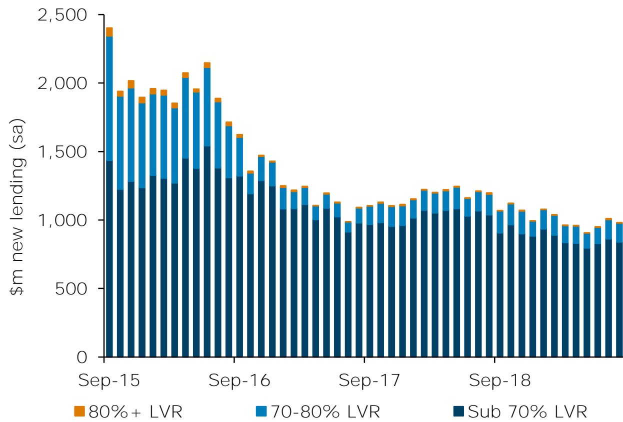


Source: ANZ Research, REINZ, RBNZ

Household credit has been growing at a relatively steady pace for the past year or so. In seasonally adjusted terms, household lending lifted 0.6% m/m to be up 6.0% y/y in August.

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. Proposed tightening in banks' capital requirements would also create headwinds, if implemented, and the outlook for the labour market is looking more wobbly. On the whole, we expect credit growth will continue to grow modestly from here.

Figure 10. Investor lending by LVR

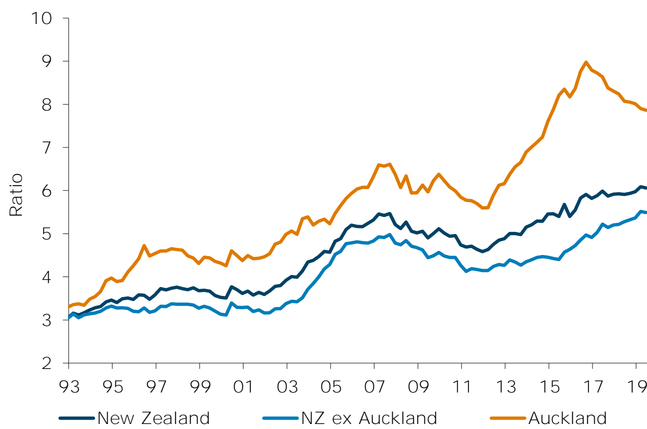


Source: ANZ Research, RBNZ

On a seasonally adjusted basis, new lending to investors was flat in August. Investor lending is down 18% y/y. New lending to investors has been relatively soft over 2019 to date. Underlying this, investors remain wary, which is weighing on the housing market. About 19% of new loans were to investors in August, down from an average of 22% over 2018 and well below 2016 peaks of almost 35%. It will be interesting to see the impact of the new record low in the OCR.

The share of investor lending on riskier terms remains low. The share of investor lending at loan-to-value ratios of less than 70% is sitting above 85%. In late-2014 it was about half.

Figure 11. Regional house prices to income

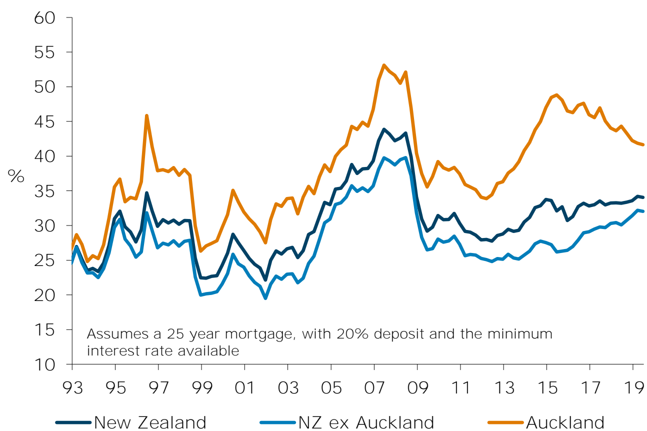


Source: ANZ Research, REINZ, Statistics NZ

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 around 6 times income since early 2017. Auckland has seen its ratio ease from 9 times in 2016 to an estimated 7.9 times (revised from previous estimate) in Q2 2019, reflecting easing house prices from recent highs. Excluding Auckland, the ratio has continued to rise; at 5.5 times incomes this is at record highs, and about where the national average peaked last cycle.

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 44% and the rest of New Zealand it is 31%. 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

The housing market has tightened a touch in recent months, although the volume of house sales remains subdued. House prices rose 2.6% y/y at the national level in September, up from 2.1% in August. Auckland house price inflation is still negative in annual terms, but a little less than previously, contracting 1.7% y/y (versus -2.6% y/y in August). Indeed, Auckland house price inflation in the September month (up 0.9% m/m) was broadly in line with that seen in the rest of the country. But housing market activity remains soft. House sales fell 0.6% m/m, but annual growth picked up to 2.7% y/y. That said, nationwide days to sell dropped from 40 days to 37, supported by a tightening in the Auckland market, with listings very low. The boost to national house prices in September may reflect lower mortgage rates, but still-soft activity suggests the upside is capped for now. We expect the market to remain subdued, but there is certainly a risk that lower mortgage rates drive a larger-than-expected pick-up.

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 started with Auckland; several other regions have joined the party.
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 to just 0.25% by May 2020, but pass-through to retail rates is likely to diminish with each cut.
Migration	Peaked	↔/↑	Migration remains elevated. Latest data suggests net inflows are holding up, but the data is prone to very large revisions.
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. The housing market is weak, but tentatively recovering 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

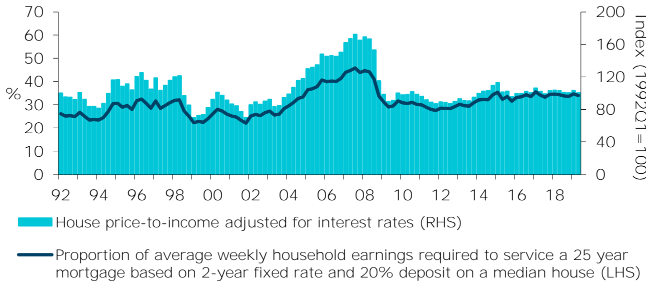


Figure 2: Household debt to disposable income

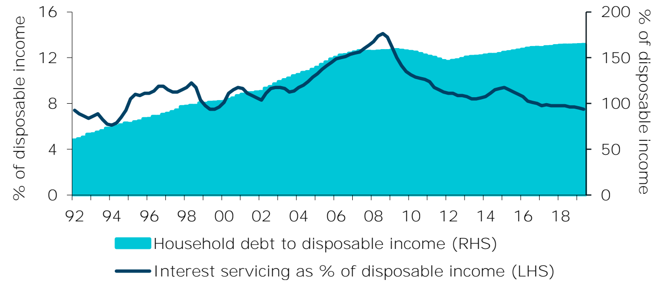


Figure 3: New customer average residential mortgage rate (<80% LVR)

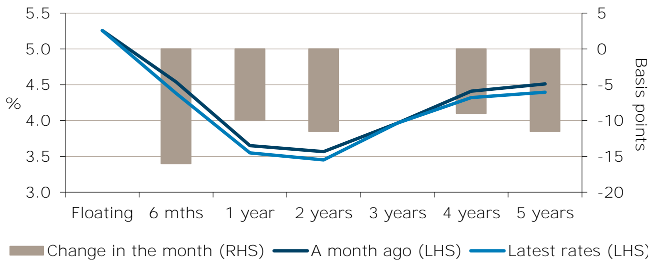


Figure 4: Annual migration*

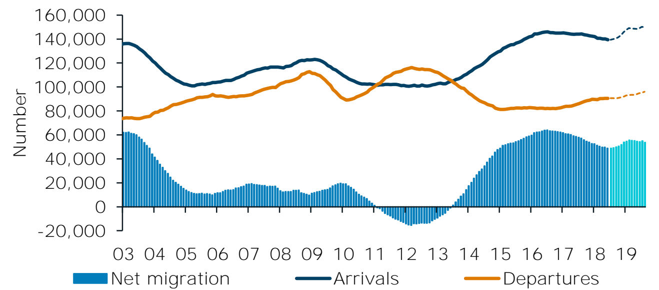


Figure 5: Housing supply-demand balance

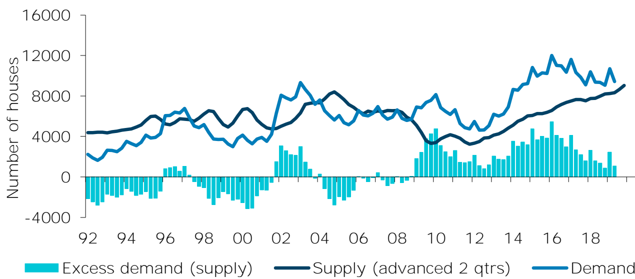


Figure 6: Building consents and house sales

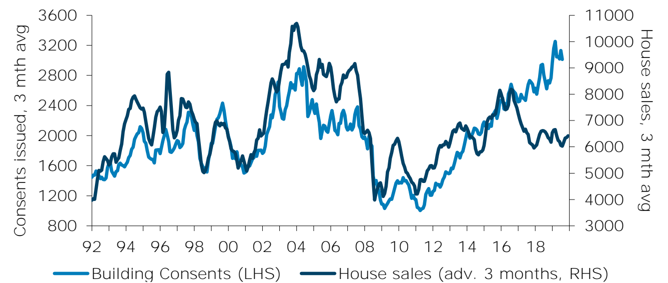


Figure 7: Liquidity and house prices

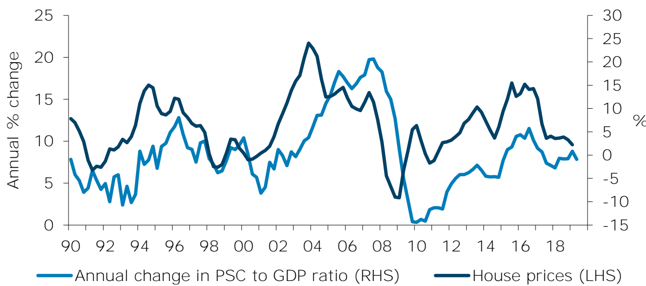


Figure 8: House price inflation comparison

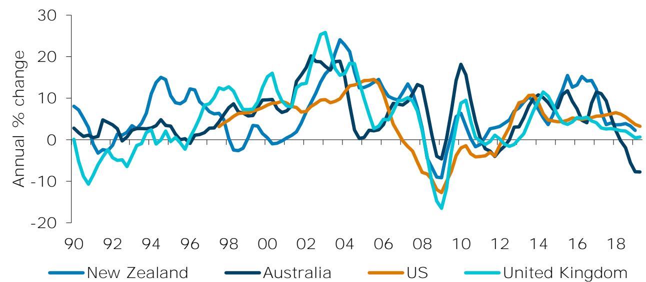


Figure 9: Housing supply

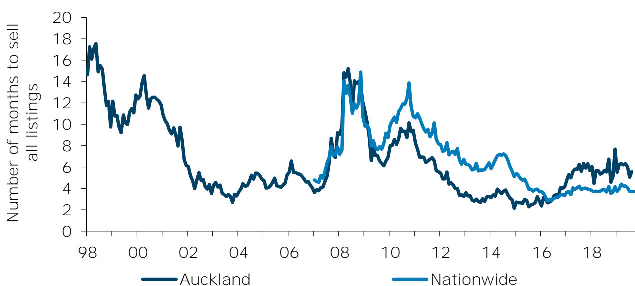


Figure 10: Median rental, annual growth

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

In what's been a broad-based slowdown, the pace of headline GDP growth has almost halved from around 4% y/y in 2016 to 2.1% in June 2019. And the leading indicators are all suggesting **there's more slowing to come in** the near term. We expect annual GDP growth will feature a 1-handle in the first half of 2020, but are hopeful that accommodative monetary conditions, still-elevated (but easing) net migration inflows, and a buoyant household sector will put a floor under things. However, sub-par growth is inconsistent with intensifying inflation pressures over the medium term, which – alongside inflation expectations threatening to slip – will see **the RBNZ cut the OCR further. We're expectin**g a 25bp cut in November, and two follow-up cuts in February **and May next year to take the OCR to just 0.25%. But the RBNZ won't be the only central bank cutting interest** rates over the year ahead. Growth among our trading partners has also been slipping. And with domestic and global risks skewed to the downside at a time when monetary policy running into conventional limits, there are increasing calls for the Government to up the fiscal-stimulus ante.

Our view

The New Zealand economy has been losing steam for a while now and leading indicators suggest this trend will continue over the second half of the year. The slowdown has been relatively gentle, but it has been persistent, with annual GDP growth having slowed from around 4% in mid-2016 to just 2.1% in June this year.

We expect annual GDP growth will slow to 1.9% by the start of next year before gradually picking from the second half of 2020. The fundamentals for growth remain intact: interest rates and the exchange rate are trending lower, and households remain in good stead, with the labour market tight, real incomes gradually lifting, and sentiment still at a respectable level. And while the global economy is also shedding momentum, supply-side factors, such as the African swine fever epidemic in China and muted growth in global dairy production have insulated exporter incomes from weaker global demand.

However, it's fair to say that risks to the outlook are skewed firmly to the downside. Domestically, there are some signs that employment growth will disappoint in the near term. Surveyed employment intentions in the manufacturing, services, and construction sectors are all weak, and job ads have followed**. And that's a threat** to household incomes, sentiment and spending – one of the key pillars of growth. Likewise for the global **economy, the risk that weakening manufacturing, trade, and business investment spreads to what's** currently a pretty robust backdrop for households is feeling very real at present.

But even if these risks don't materialise, the outlook for economic activity is inconsistent with building inflation **pressures. While the RBNZ's November MPS will include a stronger**-than-expected starting point for non-tradable inflation, we think their economic forecasts are ripe for another downgrade. The RBNZ needs the economy looking like **it's going to grow above trend** to be confident of achieving their CPI inflation target over the medium term, a**nd there are very few (if any) signs out there that that's about to happen. Accordingly, with** a weaker growth outlook and inflation expectation threatening to soften, we expect the RBNZ to cut the OCR in November, February and May, taking it to just 0.25%.

However, as the OCR trends lower we also expect the pass-through to retail interest rates to diminish. Since the core funding ratio rule was introduced in the aftermath of the Global Financial Crisis, banks have become more dependent on household deposits to fund housing credit. And what gets passed through to mortgage rates also generally gets passed through to deposit rates. So if households take their deposits elsewhere in search for a higher return, banks will either need to ration credit and/or raise interest rates to entice deposits back into the banking system. Still, mortgage rates have hit record lows, and we are waiting with bated breath to see the impact on the housing market. A strong rebound in housing is the main risk to our view that the OCR will continue to be aggressively cut.

All up, with monetary policy poised to approach its conventional limits, and risks to the growth outlook skewed firmly to the downside (on balance), there is likely to be increasing pressure for the Government to be ready to use its fiscal firepower to lean against the wind should things deteriorate rapidly. But unless the Government suspends or adjusts its self-imposed debt target, it looks like the bulk of any fiscal bump to growth is now in the rear-view mirror.

Key forecasts

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

Mortgage Size ($'000)	Mortgage Rate (%)													
	3.00	3.25	3.50	3.75	4.00	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.25
200	219	225	231	237	243	250	256	263	270	276	283	290	297	304
250	273	281	289	296	304	312	320	329	337	345	354	363	371	380
300	328	337	346	356	365	375	385	394	404	415	425	435	446	456
350	383	393	404	415	426	437	449	460	472	484	496	508	520	532
400	437	450	462	474	487	500	513	526	539	553	566	580	594	608
450	492	506	520	534	548	562	577	592	607	622	637	653	669	684
500	547	562	577	593	609	625	641	657	674	691	708	725	743	761
550	601	618	635	652	669	687	705	723	741	760	779	798	817	837
600	656	674	693	711	730	750	769	789	809	829	850	870	891	913
650	711	730	750	771	791	812	833	854	876	898	920	943	966	989
700	766	787	808	830	852	874	897	920	944	967	991	1,015	1,040	1,065
750	820	843	866	889	913	937	961	986	1,011	1,036	1,062	1,088	1,114	1,141
800	875	899	924	948	974	999	1,025	1,052	1,078	1,105	1,133	1,160	1,188	1,217
850	930	955	981	1,008	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233	1,263	1,293
900	984	1,011	1,039	1,067	1,095	1,124	1,154	1,183	1,213	1,244	1,274	1,306	1,337	1,369
950	1,039	1,068	1,097	1,126	1,156	1,187	1,218	1,249	1,281	1,313	1,345	1,378	1,411	1,445
1000	1,094	1,124	1,154	1,186	1,217	1,249	1,282	1,315	1,348	1,382	1,416	1,451	1,486	1,521

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

	Median house prices		No of sales (sa)	Mthly % chg	Avg days to sell (sa)
	Ann % chg	3mth % chg			
Northland	-5.9	2.0	175	-9%	69
Auckland	-0.6	-0.9	1,920	+7%	41
Waikato	5.8	-0.4	659	-3%	40
Bay of Plenty	10.0	0.6	471	-2%	44
Gisborne	11.9	-0.1	39	-31%	33
Hawke's Bay	13.2	4.2	223	+14%	29
Manawatu-Whanganui	24.4	8.0	333	-2%	27
Taranaki	15.8	5.4	170	+4%	35
Wellington	7.6	6.4	663	+2%	32
Tasman, Nelson and Marlborough	1.2	1.6	195	-14%	34
Canterbury	0.7	1.5	885	-3%	43
Otago	19.6	9.5	388	+6%	29
West Coast	-7.5	-8.4	40	-1%	100
Southland	22.0	7.0	137	0%	33
New Zealand	**6.9**	**2.6**	**6,184**	**-1%**	**37**

Key forecasts

	Actual			Forecasts						
Economic indicators	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
GDP (Ann % Chg)	2.4	2.5	2.1	2.2	2.0	1.9	1.9	2.1	2.1	2.2
CPI Inflation (Annual % Chg)	1.9	1.5	1.7	1.5(a)	1.6	2.0	1.8	1.7	1.7	1.7
Unemployment Rate (%)	4.3	4.2	3.9	4.1	4.2	4.3	4.4	4.5	4.5	4.5
House Prices (Annual % Chg)	3.3	2.7	1.6	2.6	2.7	3.0	4.4	3.5	3.3	2.9
Interest rates (RBNZ)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Official Cash Rate	1.75	1.75	1.50	1.00	0.75	0.50	0.25	0.25	0.25	0.25
90-Day Bank Bill Rate	2.0	1.9	1.6	1.2	0.9	0.7	0.5	0.5	0.5	0.5
Floating Mortgage Rate	5.8	5.8	5.7	5.5	5.2	5.0	4.7	4.7	4.7	4.7
1-Yr Fixed Mortgage Rate	4.8	4.7	4.6	4.5	4.3	4.2	4.1	4.1	4.1	4.1
2-Yr Fixed Mortgage Rate	4.9	4.8	4.7	4.7	4.6	4.4	4.4	4.4	4.4	4.4
5-Yr Fixed Mortgage Rate	5.6	5.4	5.0	5.4	5.3	5.1	5.1	5.1	5.1	5.1

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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