New Zealand Property Focus

What do you expect?

This is not personal advice. It does not consider your objectives or circumstances. Please refer to the Important Notice.

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Summary

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

Feature Article: What do you expect?

House prices have rebounded a bit more rapidly than we – or the RBNZ – expected. Monetary policy is working, though rising house prices are most definitely a mixed blessing for the economy. We have upgraded our forecast, with house price inflation now expected to reach 8% y/y, supporting our revised call for the OCR to remain at 1% this year. There is some upside risk to that 8% number – the market is tight and house price expectations have increased – but we think a number of headwinds will keep the market in check.

Given the current low interest rate environment, house prices could prove volatile. The RBNZ will be watching financial stability risks closely when setting macro-prudential policy to ensure a growth-positive pick-up in housing does not come with a risky speculative dynamic.

Property gauges

The housing market has rebounded, with house prices up 6% over the second half of 2019. Further strength is expected in the short term, on the back of lower mortgage rates, and with population growth continuing, supply tight and headwinds easing a little. The effects of policy changes are still being felt and the election will provide some uncertainty, but credit is now less of a constraint and there appears to be renewed confidence from market participants. We expect house price inflation to reach 8% y/y before moderating, with affordability constraints, moderating population growth, and prudent bank and buyer behaviour keeping the market in check. But house price expectations have increased and the market is tight, posing further short-term upside risk to the outlook. And as always, longer-term downside risks should not be ignored.

Economic overview

The economy decelerated over 2019, but has now entered 2020 on a stronger footing. Forward-looking activity indicators point to a tentative turning point in growth and the medium-term outlook is looking more assured. We expect that GDP will grow around trend on average over the next few years, supported by fiscal spending, recent strength in the housing market, the high terms of trade and low interest rates. Some spare capacity has emerged on the back of the recent growth slowdown, but this is expected to be comfortably absorbed, keeping inflation near target and the economy near full employment. Headwinds remain, so it's not a picture of stellar growth by any means. But the RBNZ now has some breathing space, with its targets looking achievable based on recent developments. We now see the OCR on hold for the foreseeable future. Downside risks have not gone away, especially on the global front, but OCR cuts look unlikely in the short term. Our full set of forecasts will be updated in our ANZ Quarterly Economic Outlook on 28 January.

Feature Article: What do you expect?

Summary

House prices have rebounded a bit more rapidly than we – or the RBNZ – expected. Monetary policy is working, though rising house prices are most definitely a mixed blessing for the economy. We have upgraded our forecast, with house price inflation now expected to reach 8% y/y, supporting our revised call for the OCR to remain at 1% this year. There is some upside risk to that 8% number – the market is tight and house price expectations have increased – but we think a number of headwinds will keep the market in check.

Given the current low interest rate environment, house prices could prove volatile. The RBNZ will be watching financial stability risks closely when setting macro-prudential policy to ensure a growth-positive pick-up in housing does not come with a risky speculative dynamic.

Expectations are crucial for house prices…

Expectations matter – a lot. In economics that's always true, but particularly for housing, because houses are an asset. Houses (and, more importantly, the land under them) are long-lived assets, and the price of a house captures the value to its owner cumulated over the long term. House prices are affected by expectations for a range of underlying drivers (interest rates, population growth, and the like), potentially a long way into the future. And these effects can add up, especially if a change is expected to be persistent.

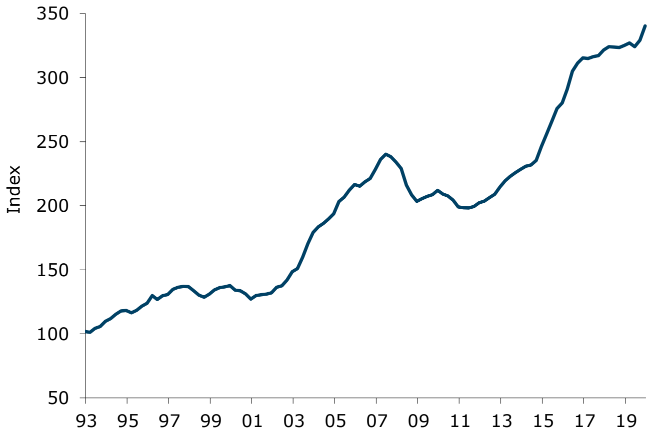
In determining the price a buyer is willing to pay, the value over the lifetime of the asset is translated into today's terms. What's it worth to me now? The relevance for the current price of things that may happen in the future diminish based on how far in the future we're talking. Expected conditions a year from now are more important than conditions 10 years in the future, which are obviously much more uncertain (and we may be run over by a bus in the meantime). And the extent to which future returns from owning a house are "discounted" also depends on the returns expected from other assets over the same timeframe, which are themselves partly determined by the expected path of interest rates.

Suppose interest rates – and general asset returns – are expected to be low for a long time. A given rate of future rental returns will look relatively attractive compared to say, term deposit interest rates, making you willing to pay more for that house today. On top of that, lower interest rates also make it easier to service more debt. It's something of a double whammy. It's fair to say that expectations of interest rates are very important.

Supply constraints are also crucial. In the long run, a change in interest rates (or other demand factor) may be expected to elicit a supply response. And higher house prices and low interest rates do tend to encourage house building. But housing supply is constrained (especially land supply, due to zoning, regulation, and other constraints) and any increase in new building doesn't tend to be enough. As a consequence, lower interest rates will predominantly be reflected in higher house prices.

New Zealand house prices are likely also underpinned by expectations for continued population growth (a key driver of demand) and favourable tax treatment of capital gains. Expectations that these conditions and frameworks will continue in the future are baked into the price today. All of these factors help to explain the upward trend in real house prices over time (figure 1) – notwithstanding the cyclical ebb and flow around that trend.

Figure 1: Real house prices



Source: REINZ, Statistics NZ

…especially when interest rates are low

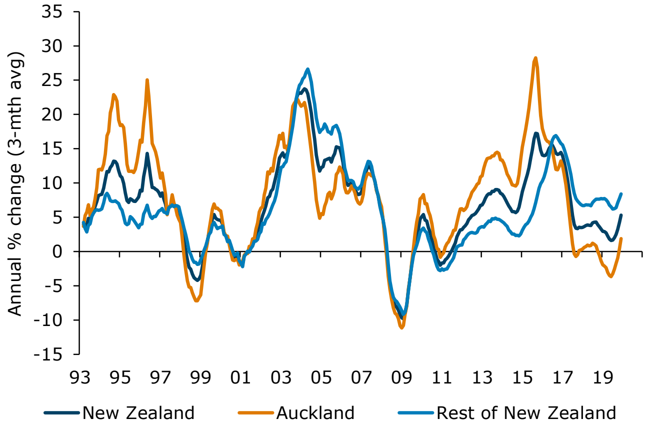
Interest rates have trended steadily down over many years (figure 2). This, in the context of supply constraints, has contributed enormously to house price increases in recent decades. And that's partly because of expectations – whether buyers are consciously expecting interest rates to fall or just due to the power of experience; a deeply ingrained societal expectation that you "can't lose" when investing in housing.

Interest rates have trended down predominantly as a result of a range of structural forces (a decline in the "neutral interest rate"), but monetary policy has also been highly expansionary in recent years. Long-term bond yields have dropped around 7%pts since 1993, and real house prices have more than tripled over the same period (figure 2).

Figure 2. 10-year government bond yield

Source: Bloomberg

Figure 3. House price inflation



Source: REINZ

In a low interest rate environment like the one we are in now, the benefits of owning a house in the future accrue more quickly (are "discounted" less), meaning that a small change in fundamentals can have a large impact on today's price. As a result, expectations for other demand and supply factors become even more important and can induce larger swings. The upshot is that when interest rates are low and supply is constrained, house prices are likely to be higher, but they can also be more volatile (Box A) – and more ripe for a correction (we'll come back to that later).

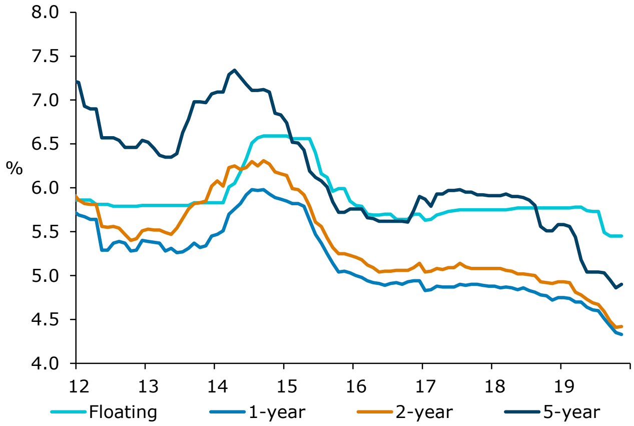
The housing market has strengthened…

The housing market has rebounded in recent months and the pick-up has been stronger than we (or the RBNZ) had expected. House prices are already eye-wateringly high relative to incomes, and mortgage rates were already pretty low before last year's OCR cuts. But thinking about houses purely as a financial asset for a moment, in the context of the low interest rate environment and the magnifying effects described above, the rapid increase from already-high levels starts to be more understandable. As yields have crept lower, housing has become more and more attractive as an asset class compared to other places to put your money, and any swing towards greater demand will be rapidly baked in.

The housing market went through a cooler period from the start of 2017 until the middle of 2019 (figure 3), particularly in Auckland, with house prices rising 7% over that 18 month period. A number of headwinds were at play: uncertainty, actual and proposed policy changes, affordability constraints and credit rationing. But conditions have turned a corner and house prices have recently rebounded, rising 6% over the second half of 2019.

Over 2019, the OCR dropped 75bps and expectations shifted to interest rates being lower for longer. Mortgage rates fell (figure 4) and financial conditions eased. Consequently, the housing market tightened. Monetary policy is clearly "working" (putting aside the question of whether rising house prices are in the long-term interests of the New Zealand economy or its inhabitants, which isn't something monetary policy can do much about). But it wasn't just interest rates driving the lift; this was against a backdrop of continued population growth (albeit easing), limited growth in housing supply, a tight labour market, and some easing in headwinds, particularly on the credit side.

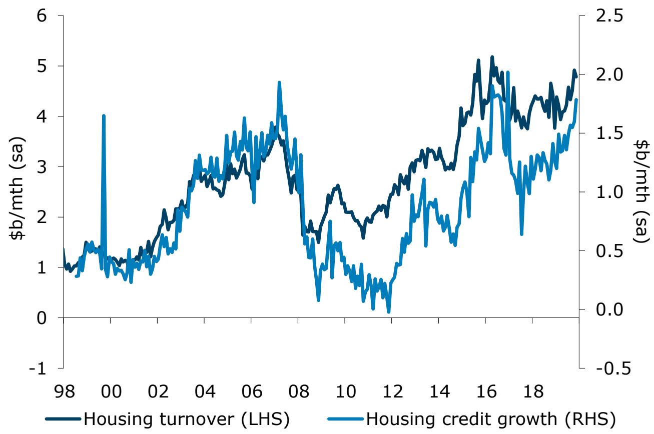
Figure 4. Mortgage interest rates



Source: RBNZ

Housing credit growth has picked up a bit more than one might have expected based on housing turnover (figure 5). Banks appear to be competing more in the mortgage lending space. This may be partly related to the RBNZ bank capital changes that have the effect of making mortgages even more attractive versus other forms of lending.

Figure 5. Housing turnover and mortgage growth

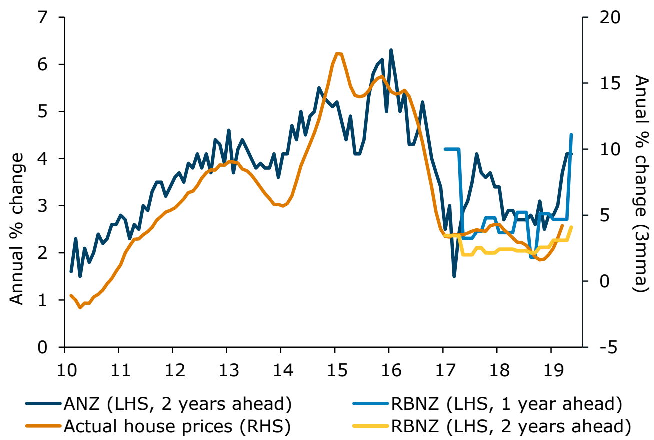


Source: REINZ, RBNZ

…and house price expectations have risen

As the housing market has lifted, surveyed house price expectations have increased (figure 6). To be fair, house price expectations often reflect recent house price developments, but that doesn't mean they don't matter. They can still add to momentum in either direction. And they can sometimes diverge in interesting ways, being too low (2015, when dairy prices crashed and many people thought the New Zealand economy would follow suit) or too gung-ho (eg 2017).

Figure 6: House prices and expectations



Source: ANZ Research, RBNZ, REINZ

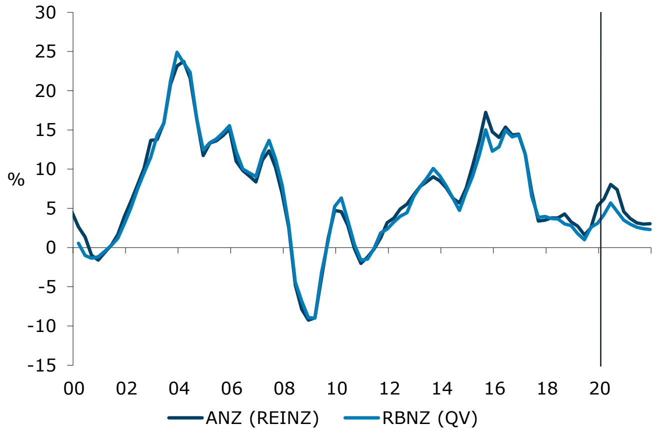
But if people expect house prices to rise, it does increase the incentive to "get in quick", and the recent lift in house price expectations highlights the risk that the housing market continues to gather momentum. At face value, these measures point to house price inflation in the realm of 10% y/y. One measure of tightness in the market (sales relative to listings) corroborates this as a risk.

We have upgraded our house price forecast

Reflecting recent developments, we have upgraded our house price forecast (figure 7). This is based on our assessment of the typical persistence in the housing market, the degree of existing tightness, credit developments and the ease of financial conditions.

We expect continued robust house price inflation through the first half of 2020. Annual house price inflation is currently sitting at 5.3% y/y (3mma), below its historical average of 6.8%. But we now expect this to reach 8% y/y in mid-2020, before moderating. This is above the RBNZ's November MPS forecast for house price inflation to peak at 5.7%.

Figure 7: House price forecasts



Source: ANZ Research, RBNZ, REINZ

Stronger house price inflation will support consumption, residential investment and GDP growth in coming years. This is one of the reasons (discussed in our recent ANZ Weekly Focus) why we no longer expect the RBNZ to cut the OCR any time soon. It is possible that house price inflation could be even stronger if current tight conditions persist. However, at this stage we think that a number of factors will keep the market in check:

- **Population growth** is easing. Changes to net migration data make recent trends difficult to discern, but we expect population growth has abated somewhat.
- **Financial conditions** are easy and supporting the market, but further OCR cuts are looking less likely and the additional boost from lower mortgage rates will eventually run its course. Credit expansion is also likely to be tempered by bank caution in the current environment.
- **Affordability constraints** are expected to weigh. Australia provides a cautionary tale, proving that prices can reach considerably more eye-watering heights, but there are limits.
- **Policy changes** targeted at reducing investor demand are still playing out, which may be exacerbated by election uncertainty. And if lending gets silly, the RBNZ may step in with tighter macro-prudential policy.

But downside risks are important

On balance, risks around our house price forecast look skewed to the upside at present. But longer-term downside risks are important. House prices can – and do – fall. A fall could occur on the back of a fundamental reassessment that the OCR could head up any time soon (seems pretty unlikely, but in the big picture we do believe inflation is sleeping, not dead) – or, more likely, if there were to be at some stage a reassessment of risk – and its price – in global credit markets. That could also push retail interest rates up abruptly via higher bank funding costs, even if the OCR were to stay low. Given that interest rates are currently so very low, such a shift in asset values could be rapid, especially if previous strength was exacerbated by speculative expectations and/or increased leverage (with debt already high).

Changes in expectations can be an innocuous part of the ebb and flow of the market, contributing to the cycles that we see time and time again over history. But if left unchecked, a speculative dynamic can become self-reinforcing – until it isn't. In such a situation, buyers may be willing to purchase a house with very low rental yields, or with very low equity, in anticipation of future capital gains. This can be highly profitable if dynamics play out as expected and prices appreciate. But it's painful if expectations turn out to be wrong.

A disorderly adjustment is more likely to occur if the market becomes risky through borrowers overextending themselves, investors relying on unsustainably low rental yields, or lenders engaging in more risky lending. Such a situation has the potential to stop the economy in its tracks, and has in some countries precipitated crises when conditions are bad enough. The Global Financial Crisis started in the US housing market.

It's reasonable to think that expectations (just like our forecasts) will need to adjust at times. No one knows the future, especially over the long run. Climate change will change the regional composition and structure of the entire market, with the main uncertainty being the question of timing. Perhaps housing supply and population dynamics will change meaningfully and house prices will be affordable again (we doubt it).

Anything is possible. And these sorts of financial stability risks are something of which the RBNZ is all too aware in setting macro-prudential policy. While we expect that LVR settings are in a holding pattern for now, a rapid increase in housing market strength combined with a risky speculative dynamic would not be left unchecked.

Box A: Higher and more volatile house prices in a low interest rate environment

Low interest rates can lead to higher – but also more volatile – house prices. House prices don't have to be volatile in a low interest rate environment, but the possibility of large shifts is heightened. We can show this arithmetically.

Table 1 considers the value of a hypothetical house, based on the present value of a constant stream of rents, taking into account the expected level of interest rates over the long term. This example is simple, but it is nonetheless illuminating.[1] We assume no expectations of capital gain, and no costs, treating the house as a pure income-generating asset. Supply is assumed to be constant. Two scenarios are considered; one with a 10% interest rate, and the other with a 5% interest rate.

Table 1: Hypothetical house value (PV)

	Low interest rates	High interest rates
Interest rate (%)	5.0%	10.0%
Rent ($/year)	26,000	26,000
Value ($)	532,609	285,796

Source: ANZ Research

Unsurprisingly, the average level of interest rates expected to prevail in the future (which here, for simplicity, is today's rate) has a significant effect on the hypothetical baseline value of the house. In this example, the house is worth around $290,000 when interest rates are high for the life of the house, and $530,000 when interest rates are low.

But more interestingly, the *responsiveness* of house prices (to anything that affects housing demand or supply, but in this simplified example we're holding almost everything constant) is larger when interest rates are low and supply is constrained.

Table 2 shows what happens when there is a small (0.2%pt) fall in interest rates, starting from a 5% or 10% baseline. The example shows that a small change in interest rates can have a significant impact on house prices if it is expected to persist – and the impact is *even more significant* when interest rates are already low. The 0.2%pt change results in a $19,000 increase in value when trend interest rates start at 5% versus a $5,000 increase when interest rates start at 10%. And it's not just in $ terms – that's a 3.6% increase when interest rates are 5%, but only a 1.8% increase in the house's value when interest rates are 10%.

[1] This is based on a simple present value calculation, assuming the lifetime of the asset is 75 years and there are no credit constraints, inflation, or costs.

Table 2: Small change in interest rates

	Low interest rates -0.2%pts		High interest rates -0.2%pts	
Interest rate (%)	5.0%	4.8%	10.0%	9.8%
Rent ($/year)	26,000	26,000	26,000	26,000
Value ($)	532,609	551,574	285,796	291,067
Change ($)		18,964		5,271
Change (%)		3.6%		1.8%

Source: ANZ Research

Likewise, table 3 shows that a $20 increase in weekly rent (that is expected to be permanent) results in an increase in the price of $11,000 when interest rates are 10%, but a $21,000 increase when interest rates are 5%. In this case the percent increase in house prices is the same (4%) but the outcome in the low interest rate example is still worse from a housing affordability perspective.

Table 3: Small increase in weekly rents

	Low interest rates +$20/week		High interest rates +$20/week	
Interest rate (%)	5.0%	5.0%	10.0%	10.0%
Rent ($/year)	26,000	27,040	26,000	27,040
Value ($)	532,609	553,914	285,796	297,227
Change ($)		21,304		11,432
Change (%)		4.0%		4.0%

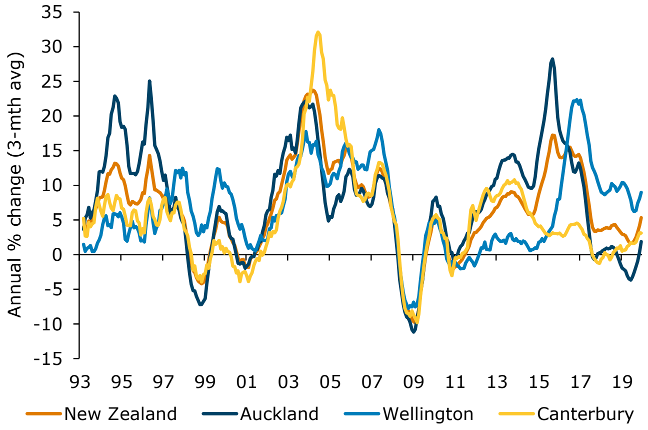
Source: ANZ Research

As a consequence of this mathematical quirk, tweaks in monetary policy may have a more potent impact on asset prices, including house prices, when interest rates are low.[2] The RBNZ is looking to stabilise the economy in a cyclical sense, treating the trend in interest rates and its structural drivers as given. But when interest rates are structurally low, this means changes in the OCR could have a larger effect on house prices, meaning outcomes may be non-linear.

On the other hand, other structural forces may mean that the impact of monetary policy is attenuated in a low interest rate environment. For example, responsiveness of credit demand may be lower because debt levels are already high. So far, the RBNZ has found that the impact of monetary policy has not diminished as interest rates have fallen. But with interest rates close to zero, it's hard to say how things will evolve in such unchartered territory. And at some point, of course, interest rates will simply not be able to be cut any further. Click here to return to main text.

[2] There are other mathematical realities that reinforce this effect. When inflation and nominal interest rates are low, borrowers can load themselves up with far more real debt relative to future incomes than when inflation and nominal interest rates are high, under the same serviceability rules. That's because with high inflation, today's nominal wage is a poor proxy for future earnings.

Figure 1. Regional house price inflation



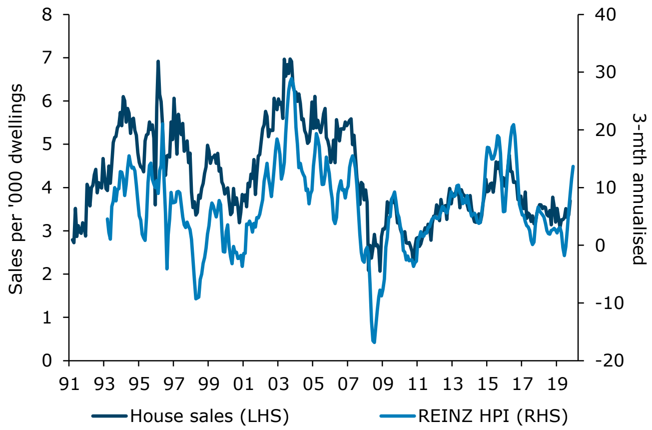
Source: ANZ Research, REINZ

Annual house price inflation rose again in December, up 5.3% y/y (3mma) nationally – below its long-run average of 6.8% y/y but similar to where nominal GDP growth is tracking.

Smaller regions are continuing to show greater upwards momentum relative to main centres, with Southland, Manawatu/Whanganui and Hawkes Bay leading the charge. The Auckland market continues to improve, with annual house price inflation firmly back in positive territory at 1.9% y/y (3mma).

Much of the recent pick-up in house prices can be attributed to low mortgage rates making it an attractive time to buy. At the same time, population growth continues (albeit easing), supply is slow, and headwinds have eased, especially on the credit side.

Figure 2. REINZ house prices and sales



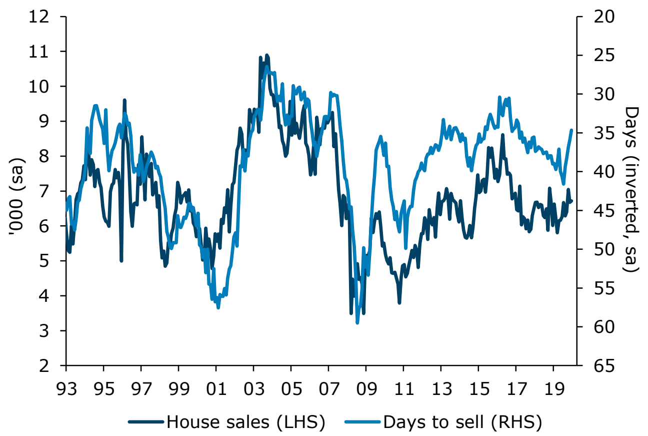
Source: ANZ Research, REINZ

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

Across the country, house sales edged up a modest 0.7% m/m in December to be up 3.3% y/y (3mma). We saw Auckland track up this month, now at 13.3% y/y (3mma), a notable contrast to the almost 15% decline seen over the year to May 2019. Bay of Plenty endured similar growth to Auckland, but the rest of the country recorded softer increases in house sales.

Overall, the level of house sales looks contained relative to history, but this is being seen alongside low listings – making the market tight and contributing to price pressures.

Figure 3. Sales and median days to sell

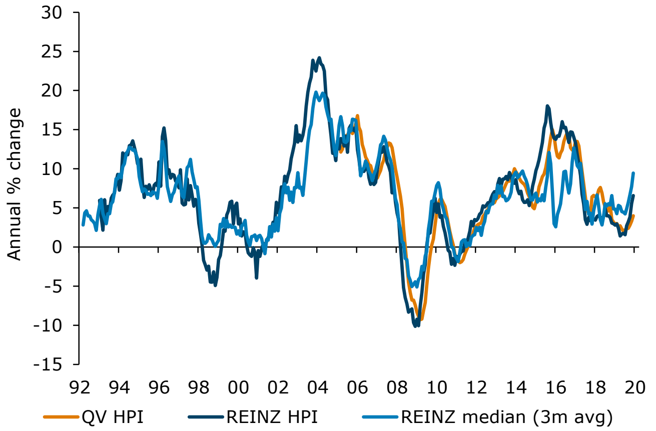


Source: ANZ Research, REINZ

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.

Houses sold faster in December than they have since early 2017, demonstrating that our housing market is indeed tightening. Now at 34.7 days nationally, days-to-sell is well below its historical average (of 39 days). Indeed, days-to-sell is close to or below average across all regional housing markets, indicating broad based tightness across the country.

Figure 4. REINZ and QV house prices

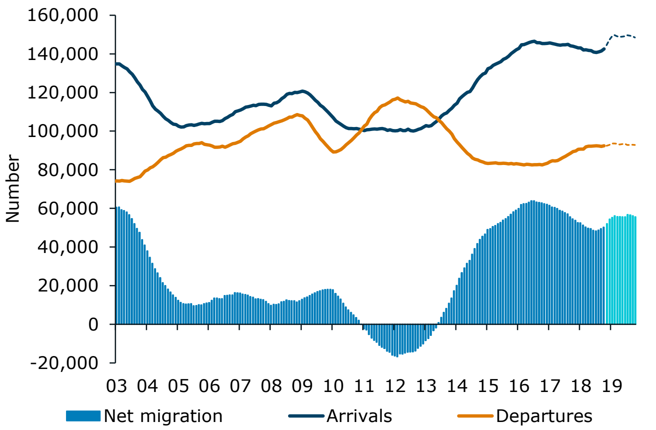


Source: ANZ Research, REINZ, QVNZ

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 – increased again in December and is now sitting at 6.6% y/y. This is above the QVNZ measure which came in at 4%. The REINZ median also crept up to 9.5% y/y (3mma) this past month, up from 7.7% in November.

Figure 5. Annual migration*



Source: Statistics NZ

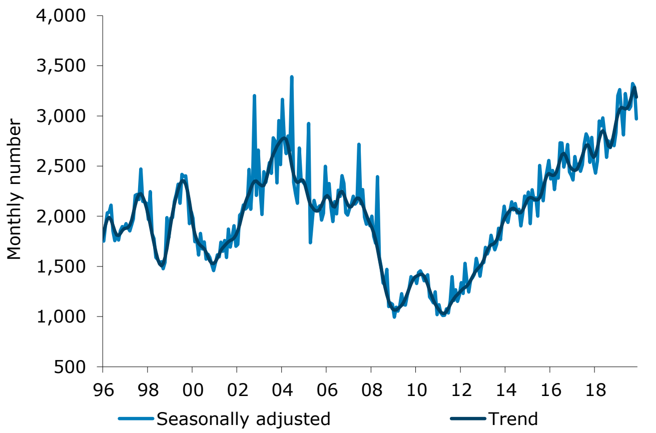
*Dotted lines show the last nine months of data, which are subject to substantial revisions.

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 at around 55,600 in October but Statistics NZ's data is subject to substantial revision (with those signalled this week expected to see recent figures downgraded). To avoid unnecessary noise in our economic outlook we're now forecasting net migration with a lag (between 9-12 months), ie not using the most recent reported data.

The older, more reliable data suggest the cycle was still easing into mid-2018, before picking up heading into 2019. We think a gradual easing trend will set in beyond 2019.

Figure 6. Residential building consents

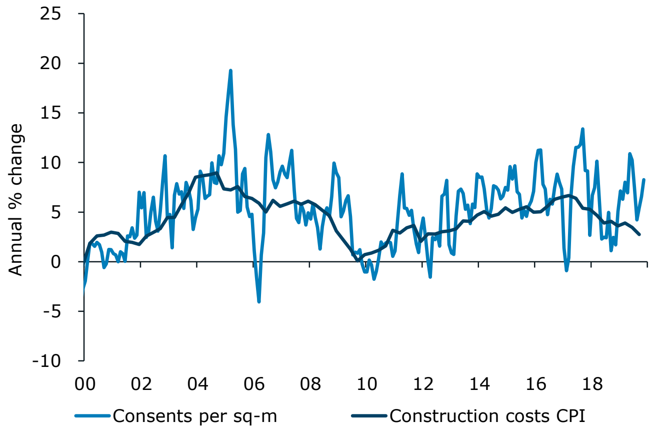


Source: ANZ Research, Statistics NZ

Residential building consents were down 8.4% m/m in November, though these data are noisy, driven by volatile apartments. Annual residential consent issuance, however, remains strong at just over 37,000. This is driven predominantly by consistently strong issuance in Auckland, where annual consents are up above 15k per year. Canterbury consents continue to tick up since a dip in late 2018, now issuing 5.3k consents per 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

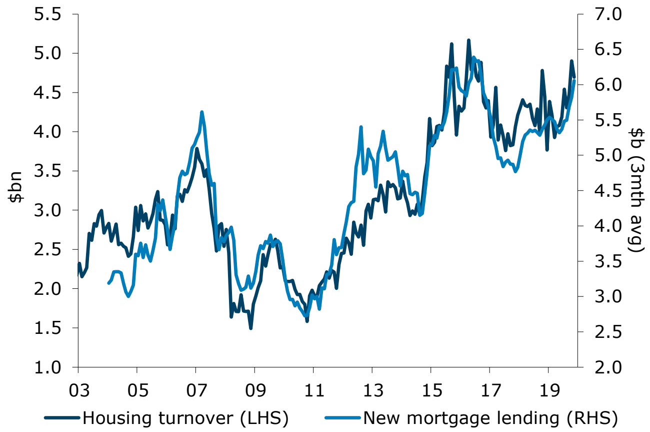


Source: ANZ Research, Statistics NZ

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 – was at 8.3% y/y (3mma) in November. This continues the steady rise experienced throughout the latter end of 2019 - after the dip down to 4.2% in August. In comparison, CPI construction costs eased 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 significantly higher from here.

Figure 8. New mortgage lending and housing turnover

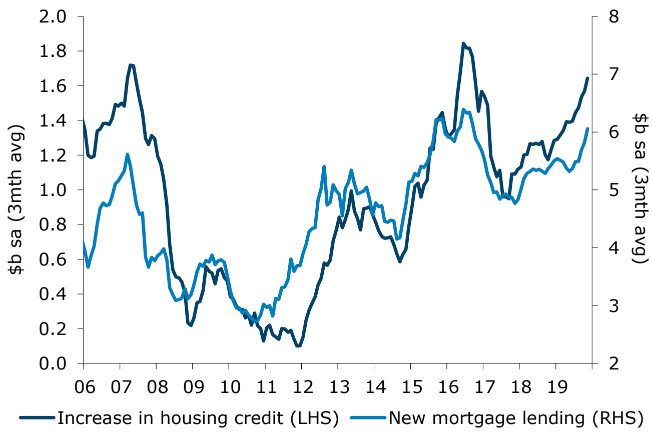


Source: ANZ Research, RBNZ

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 mortgage lending declined 1.3% m/m in November. This follows a 4.3% rise in the month prior. These data can be choppy. But mortgage lending remains at a high level, on the back of elevated nominal housing turnover. Recent strength in the housing market is expected to remain supportive.

Figure 9. New mortgage lending and housing credit



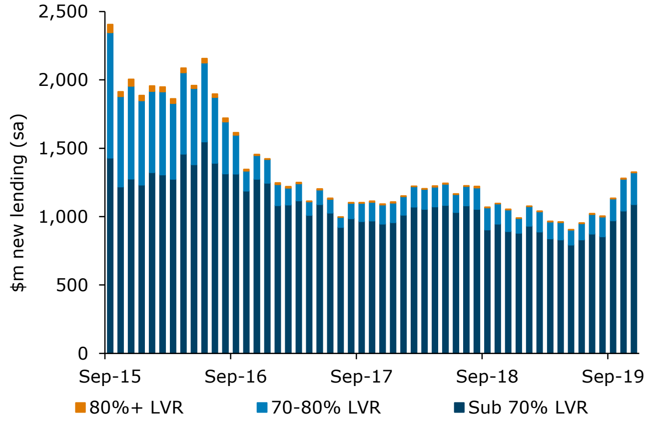
Source: ANZ Research, REINZ, RBNZ

Household credit has been growing at a relatively steady pace for the past year or so. In November, household lending increased 0.6% m/m, bringing annual growth up to 6.3% y/y.

We expect that as the market gains traction housing credit growth will follow. Banks appear to be competing a bit more in the mortgage lending space, easing credit headwinds. But continued low appetite for risk will put a dampener on any acceleration. As would tighter LVR restrictions if a resurgence in the housing market was coupled with a significant move towards more risky lending.

Property Market in Pictures

Figure 10. Investor lending by LVR

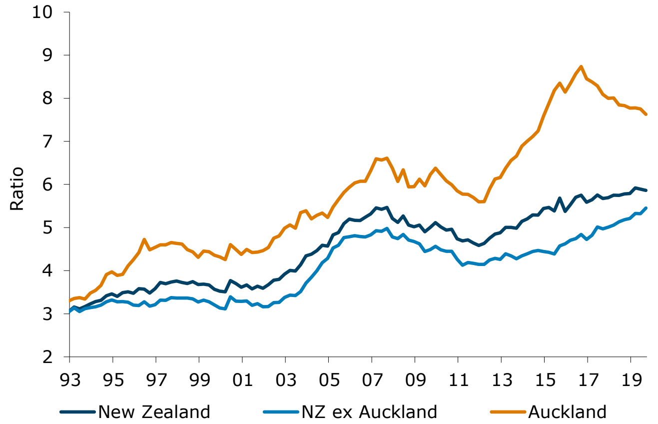


Source: ANZ Research, RBNZ

New lending to investors rose almost 25% y/y in November, a far cry from the 17.9% decline only three months prior. This shows a real renewed interest from investors and provides notable stimulus in the housing market. As a percentage of total new loans, lending to investors increased slightly this month, now sitting at just over 20%. This remains significantly below the near-35% peaks we saw back in 2016.

The share of riskier investor lending remains low, with banks wary of new capital requirements and LVR restrictions playing their role. The share of investor lending at loan-to-value ratios of less than 70% is stable at 85%. In late-2014 it was around 50%.

Figure 11. Regional house prices to income

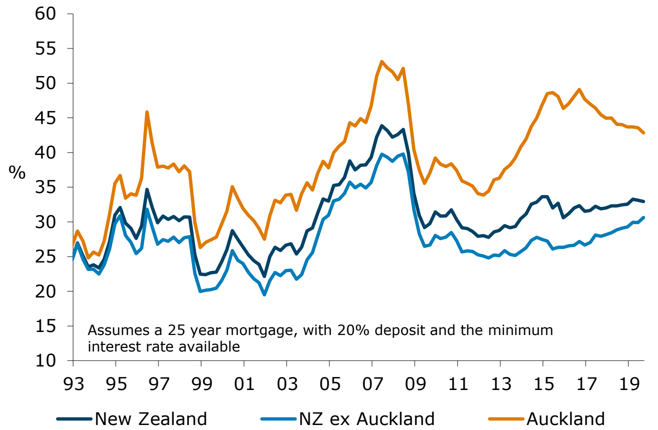


Source: ANZ Research, REINZ, Statistics NZ

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 7.6 times in Q3 2019, reflecting house prices easing 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 31%, having eased a little on the back of lower mortgage rates. In Auckland it is 41%, with gradual easing from recent highs continuing. In the rest of New Zealand it is 29%, having gradually increased on the back of house price rises. Although servicing is currently manageable, households could be vulnerable in the event of a lift in interest rates or reduction in income.

Property gauges

The housing market has rebounded, with house prices up 6% over the second half of 2019. Further strength is expected in the short term, on the back of lower mortgage rates, and with population growth continuing, supply tight and headwinds easing little. The effects of policy changes are still being felt and the election will provide some uncertainty, but credit is now less of a constraint and there appears to be renewed confidence from market participants. We expect house price inflation to reach 8% y/y before moderating, with affordability constraints, moderating population growth, and prudent bank and buyer behaviour keeping the market in check. But house price expectations have increased and the market is tight, posing further short-term upside risk to the outlook. And as always, longer-term downside risks should not be ignored.

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	Fine, so long as rates stay low	↔/↓	Serviceability looks okay and has improved of late as mortgage rates have fallen. But debt levels are high.
Interest rates / RBNZ	Flat	↔/↑	The OCR looks set to remain on hold, but further global easing and bank competition could weigh on retail rates.
Migration	Peaking	↔/↑	Migration remains elevated, but we think it may be moderating. The data are prone to very large revisions.
Supply-demand balance	Demand > Supply	↔/↑	MBIE estimates New Zealand is short ~70k houses. Land supply is constrained. But pent-up demand is not ballooning quite so much.
Consents and house sales	Shortage	↔/↑	Consent levels are high, which is encouraging for supply. But a big change in the market is needed for houses to be more affordable.
Liquidity	Relief	↔/↑	Banks are less constrained than previously thought so headwinds have dissipated. But prudence should keep things in check.
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	↔/↓	Buying remains relatively expensive. Affordability constraints are relevant for buyers. Lower interest rates are suppressing yields.
Policy changes	Dampening	↔/↓	Policy changes are a headwind, albeit a bit less than before. We are watching as the election campaign unfolds.
On balance	**In recent ranges**	↔/↑	**Short-term strength is expected, with upside risk. But we are wary that gravity may come calling over the long term.**

Property gauges

Figure 1: Housing affordability

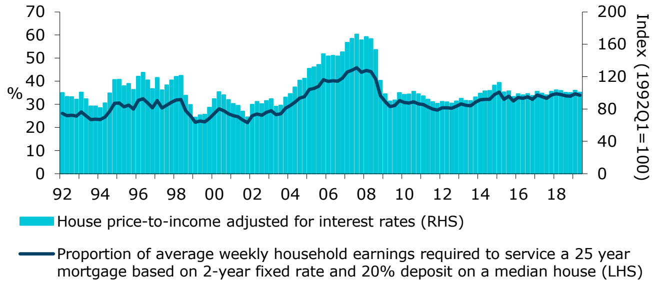


Figure 2: Household debt to disposable income

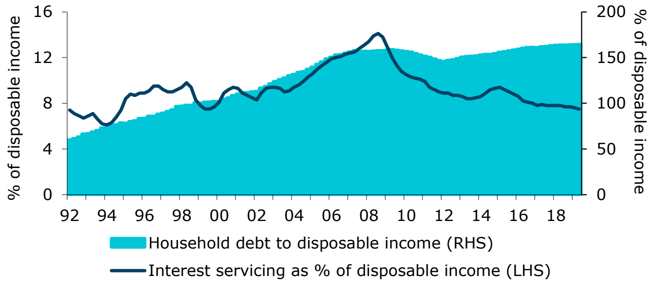


Figure 3: New customer average residential mortgage rate (<80% LVR)

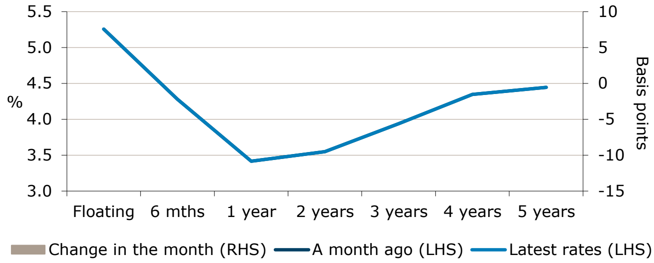


Figure 4: Annual migration*

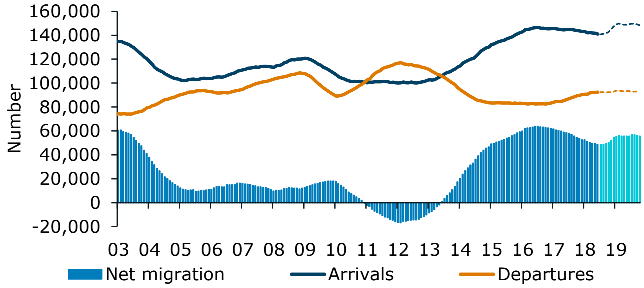


Figure 5: Housing supply-demand balance

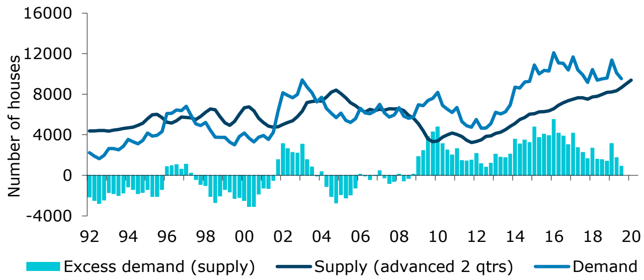


Figure 6: Building consents and house sales

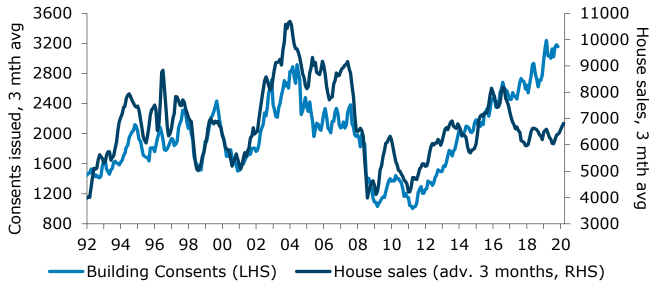


Figure 7: Liquidity and house prices

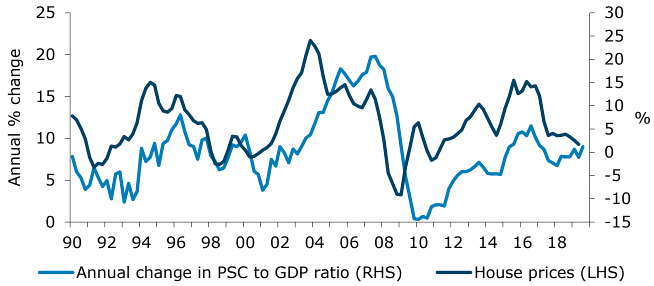


Figure 8: House price inflation comparison

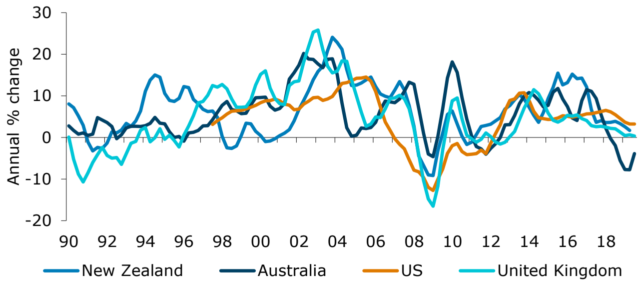


Figure 9: Housing supply

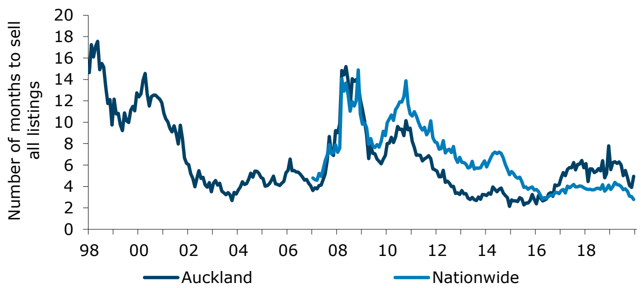
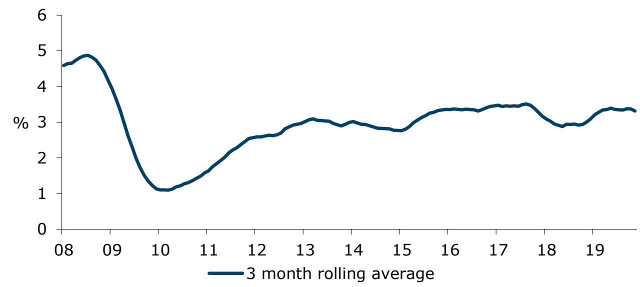


Figure 10: Median rental, annual growth



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

* 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

The economy decelerated over 2019, but has now entered 2020 on a stronger footing. Forward-looking activity indicators point to a tentative turning point in growth and the medium-term outlook is looking more assured. We expect that GDP will grow around trend on average over the next few years, supported by fiscal spending, recent strength in the housing market, the high terms of trade and low interest rates. Some spare capacity has emerged on the back of the recent growth slowdown, but this is expected to be comfortably absorbed, keeping inflation near target and the economy near full employment. Headwinds remain, so it's not a picture of stellar growth by any means. But the RBNZ now has some breathing space, with its targets looking achievable based on recent developments. We now see the OCR on hold for the foreseeable future. Downside risks have not gone away, especially on the global front, but OCR cuts look unlikely in the short term. Our full set of forecasts will be updated in our ANZ Quarterly Economic Outlook on 28 January.

Our view

Growth decelerated markedly over 2019, with global risks, business pessimism and policy uncertainty weighing. GDP growth is expected to have troughed somewhere in the vicinity of 1.8% y/y in the December quarter. As conditions deteriorated, the RBNZ moved to cut the OCR as we expected they would, with 75bps of cuts over the year.

Now as we enter 2020 the outlook is looking a little brighter and the RBNZ appears to be firmly "on hold" – able to watch developments as previous monetary stimulus passes through. Encouragingly, forward-looking near-term activity indicators point to a stabilisation in the economy. Growth appears to have reached a tentative turning point, and we expect to see gradual improvement over the coming year.

The recent deceleration in growth has seen some spare capacity in the economy open up, but only a little. And we think that this slack will be easily absorbed if the economy recovers as we expect. Inflation is currently in a good position, with previous strength in the economy having generated a gradual lift in domestic inflation. So while the recent reduction in capacity pressures might see pipeline inflation pressures reduce a little in coming quarters, it's from a good starting point, with inflation close to where it needs to be.

CPI data out this week is expected to show headline inflation at 0.5% q/q, brining annual inflation up to 1.9% – only a smidgen below target. And while some of this strength is expected to be driven by tradable prices that tend to be volatile, non-tradable inflation has been on a gentle upward march, and looks set to print above the RBNZ's November MPS expectation.

Meanwhile, the labour market is clearly tight, with employment close to its maximum sustainable level. So while some volatility in labour market outcomes is to be expected, trend deterioration in the unemployment rate from here seems unlikely, with the outlook for economic growth now looking more assured.

The Government has made it clear that more spending is in the pipeline. And while that might be difficult to ramp up, especially in the short term, the signal of willingness to spend is telling. In the Half-Yearly Economic and Fiscal Update late last year, the Government effectively called victory on its debt targets, suggesting there is scope for more spending than is currently being signalled. Combine that with the promises an election year brings, and we wouldn't be surprised to see more fiscal spending signalled from both sides of the political divide.

So the medium-term growth story has a fiscal underpinning, combined with financial conditions that remain easy. We are sceptical that business investment will respond to low interest rates with vigour, but sentiment does seem to be improving. Meanwhile, the housing market has strengthened, which will support consumption and residential investment. The labour market and terms of trade will also boost national incomes, even if the boon from high export prices is expected to be muted compared with previous cycles.

Overall, growth looks set to track around trend on average over the medium term, with inflation and the labour market comfortably near target. Risks of a precipitous slip in inflation expectations have reduced, with core inflation and inflation expectations set to track sideways. It sounds like a simple outlook, but that doesn't mean the RBNZ can simply call "job done". They have scope to watch and wait, but the outlook could change quickly as developments unfold.

Headwinds and challenges remain. We are late cycle, businesses are pessimistic, global risks have not gone away, credit and capacity constraints are relevant, and election uncertainty could weigh. The outlook is brighter, but the concerns of last year have not gone away – they are just casting less of a shadow.

Risks are aplenty, especially global, and these have the potential to change the outlook completely. And we know that the RBNZ will be willing to move quickly if required, so the path ahead may be far from boring. For now, however, the OCR looks to be firmly in a holding pattern.

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 December 2019 (based on REINZ data)

	Median house prices		No of sales (sa)	Mthly % chg	Avg days to sell (sa)
	Ann % chg	3mth % chg			
Northland	12.3	5.5	220	+10%	50
Auckland	3.4	3.4	2,033	-3%	37
Waikato	8.9	5.3	678	-7%	34
Bay of Plenty	4.0	4.2	518	+12%	43
Gisborne	21.9	3.6	50	-20%	36
Hawke's Bay	14.8	6.2	232	+2%	29
Manawatu-Whanganui	28.2	2.2	334	-10%	30
Taranaki	14.0	2.8	152	+2%	30
Wellington	11.3	1.6	670	+0%	30
Tasman, Nelson and Marlborough	12.5	7.4	243	-13%	29
Canterbury	1.0	0.5	961	+5%	36
Otago	21.5	5.0	375	+9%	31
West Coast	-13.5	11.0	30	-33%	47
Southland	32.2	1.1	170	+3%	25
New Zealand	**12.2**	**4.5**	**6,720**	**+1%**	**35**

Key forecasts

	Actual			Forecasts						
Economic indicators	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
GDP (Ann % Chg)	3.0	2.1	2.3	1.8	2.0	2.4	2.3	2.3	2.3	2.4
CPI Inflation (Annual % Chg)	1.5	1.7	1.5	1.9	2.2	1.9	1.8	1.6	1.7	1.9
Unemployment Rate (%)	4.2	3.9	4.2	4.3	4.4	4.4	4.5	4.5	4.5	4.5
House Prices (Annual % Chg)	2.7	1.6	2.5	5.3	6.2	8.0	7.4	4.6	3.7	3.1
Interest rates (RBNZ)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Official Cash Rate	1.75	1.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
90-Day Bank Bill Rate	1.9	1.6	1.2	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Floating Mortgage Rate	5.8	5.7	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
1-Yr Fixed Mortgage Rate	4.7	4.6	4.4	4.4	4.4	4.4	4.4	4.5	4.5	4.5
2-Yr Fixed Mortgage Rate	4.8	4.7	4.5	4.5	4.6	4.6	4.6	4.5	4.5	4.5
5-Yr Fixed Mortgage Rate	5.4	5.0	5.0	5.1	5.4	5.1	5.1	4.9	4.9	4.9

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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