New Zealand Property Focus

Confidence trick

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INSIDE

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Summary

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

Feature Article: Confidence trick

Rising house prices are a mixed blessing. It tends to encourage increased spending in aggregate, with some households benefiting from wealth gains and easing collateral constraints. This boosts GDP, though usually debt as well. But for other households, higher house prices mean home ownership slips further out of reach. And the low interest rates than can be the driver of higher house prices can adversely affect older households, even if they own their own homes – they are typically savers rather than borrowers, so lose when rates fall. Currently, households are feeling pretty good on the back of the strong labour market and better economic news (at least up until recently). However, risks are looming. Deposit growth has not kept pace with strong credit demand, meaning banks' balance sheets are under pressure, and credit availability may become a headwind. And emerging global risks are in the spotlight. We expect economic impacts associated with the tragic COVID-19 outbreak to be sharp but short at this stage. However, a larger impact cannot be ruled out. Such risks could see household optimism slide. But for now, momentum is on the up.

Property gauges

The housing market has rebounded, with house prices up 7% since the middle of last year. This strength has been on the back of declines in mortgage rates and a modest increase in appetite to take on debt. Indeed, the market is tight, and we expect some modest strength in house price inflation to continue on the back of that. Previously, there was a risk was that the housing market gathered even more momentum, with house price expectations having increased. But now clouds are forming, with credit conditions likely to tighten on account of the wider bank funding gap. Although we expect annual house price inflation to increase a little further from here (to 8% y/y), headwinds will likely see the pace of growth moderate (to ~3% y/y) thereafter – with bank funding considerations expected to come to a head soon. Affordability constraints and moderating population growth will also help to keep the market in check. And as always, long-term downside risks should not be ignored.

Economic overview

The economy looked to be starting 2020 on a stronger footing, with activity indicators stabilising, the housing market stronger, and the fiscal pipeline supportive of growth. However, the worrying COVID 19 outbreak is causing significant uncertainty about the outlook. The human toll is very troubling. From an economic perspective, it is too early to know what the impact of the outbreak and associated disruption may be, but emerging developments will be watched closely. For now, we expect to see a temporary, near-term dent to growth over the first half of the year, with the economy pottering along a little above trend thereafter. Inflation is sitting comfortably near the midpoint and the labour market is strong. Given this, we see the RBNZ sitting back for now and watching how domestic and global developments unfold. Global trends will be the main driver for the New Zealand economy in the foreseeable future. The impact could be greater than we expect, but the RBNZ and Government will provide further stimulus if required.

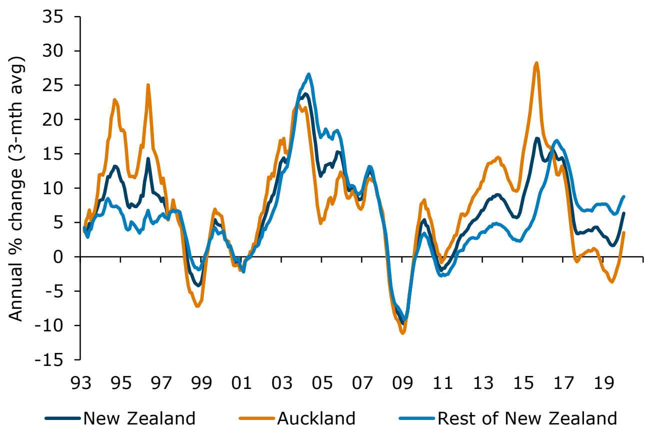
Summary

Rising house prices are a mixed blessing. It tends to encourage increased spending in aggregate, with some households benefiting from wealth gains and easing collateral constraints. This boosts GDP, though usually debt as well. But for other households, higher house prices mean home ownership slips further out of reach. And the low interest rates than can be the driver of higher house prices can adversely affect older households, even if they own their own homes – they are typically savers rather than borrowers, so lose when rates fall. Currently, households are feeling pretty good on the back of the strong labour market and better economic news (at least up until recently). However, risks are looming. Deposit growth has not kept pace with strong credit demand, meaning banks' balance sheets are under pressure, and credit availability may become a headwind. And emerging global risks are in the spotlight. We expect economic impacts associated with the tragic COVID-19 outbreak to be sharp but short at this stage. However, a larger impact cannot be ruled out. Such risks could see household optimism slide. But for now, momentum is on the up.

House price inflation has rebounded

The housing market rebounded over the second half of 2019, and that strength appears to have continued into early 2020. House prices were up 0.6% m/m (6.9% y/y) in January, with strength reasonably broad based regionally (figure 1). The market also remains tight.

Figure 1. House price inflation



Source: REINZ

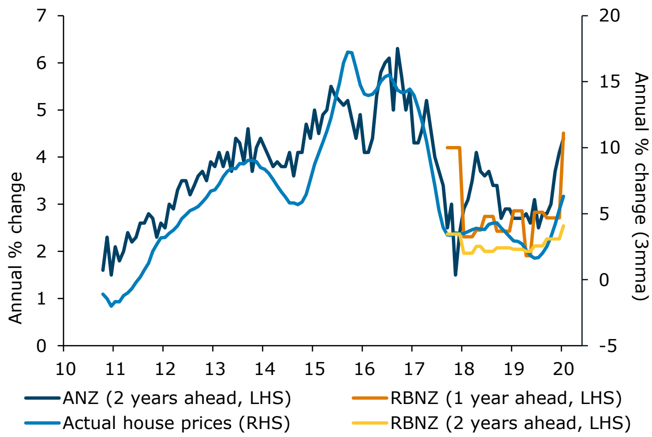
We expect house price inflation to peak at 8% y/y in the middle of this year, largely reflecting the strength we have already seen on the back of declines in mortgage rates, with more modest price increases expected over the first half of this year. The housing market is expected to moderate on account of well-known headwinds, some old, some emerging: affordability constraints, credit headwinds, slowing population growth, the continuing shadow cast by recent policy changes, and right now, the very dark cloud hanging over New Zealand's largest trading partner – though the housing market is about as far as possible from the frontline of that.

Despite these headwinds, house price expectations have risen on the back of momentum in the housing market, and these could spur the market further, as we discussed in our ANZ Property Focus last month.

The latest read from our ANZ Consumer Confidence survey reaffirms this rise in expectations (figure 2). In New Zealand, housing market developments receive a significant amount of publicity, and the news flow can spur expectations of continued increases. More generally, house price expectations (whatever they are driven by) can amplify the housing market cycle, particularly if rising expectations coincide with riskier behaviour (like purchases at low equity and/or with a lack of resilience to cash-flow interruptions such as an empty property for a period). This can amplify boom and bust cycles in the property market.

This sentiment effect can be quite important insofar as it can to some extent become self-fulfilling. In a similar way, generalised changes in consumer and business confidence can impact spending decisions and support or weigh down the economy more broadly.

Figure 2: House prices and expectations



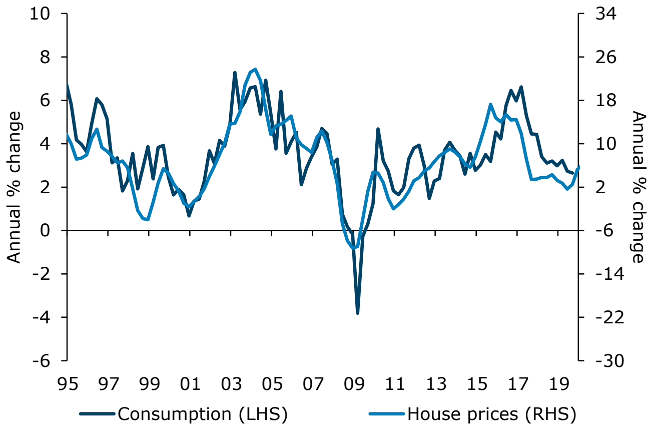
Source: ANZ Research, RBNZ, REINZ

Households think it's a good time to buy

Strength in the housing market tends to support the economy more broadly. Spending is directly affected, with higher house prices encouraging home building and renovations/additions. Broader consumption spending also tends to follow.

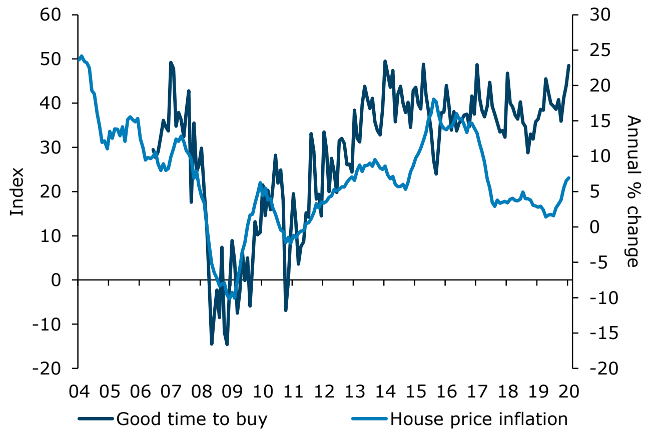
Housing market strength encourages consumption spending (figure 3) directly, with a particular impact on durables spending if building and renovations are taking place. House prices and spending can also move together because of other factors that affect both, like wage increases or population growth. The low interest rate environment over the past decade has also been supportive of consumption, with households consistently considering it a good time to buy a major household item, according to our ANZ consumer confidence survey. The recent pick up in the housing market has added further support (figure 4).

Figure 3: House prices and consumption



Source: REINZ, Statistics NZ

Figure 4: House prices and good time to buy



Source: ANZ Research, REINZ

There's a wealth effect – for some

Higher house prices boost wealth for those who own properties. Relatedly, rising asset prices boost collateral values for those home owners who are indebted, freeing up more funds to spend for those who are constrained by their ability to borrow. Higher house prices thus tend to be directly beneficial for those who own their own homes, generally those who tend to be older.

But it's discouraging for others

For others, there may be a discouraged renter effect when house prices rise, where households see house purchases as increasingly unattainable. This can hamper confidence for those who are not home owners, generally younger people.

Counterintuitively, if people are discouraged that they may never be able to buy, it is possible that this could actually contribute to increased consumption when house prices rise; rather than saving for a deposit, households might choose to spend more on other big ticket items, such as an OE.

And if the reason house prices are high is because of low interest rates, the benefits for borrowers may be more than offset in aggregate by the impact on older cohorts who rely on interest income.

The impact on confidence is complicated

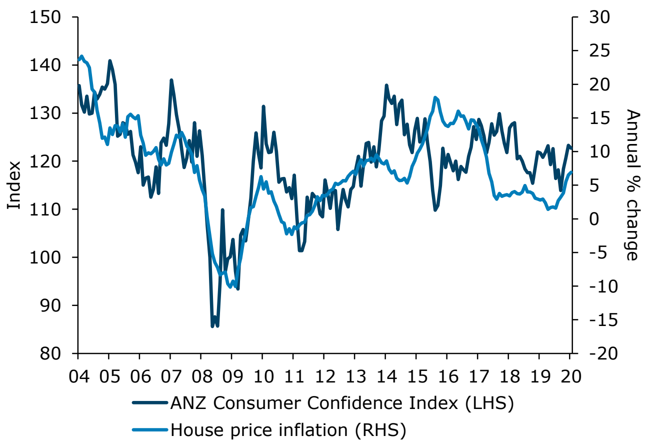
Generally, house price inflation and consumer confidence have been positively correlated over time. Some households benefit directly, as discussed. But it can also be a self-reinforcing circle; a strong housing market lifts activity and business' income and thus employment and this flows back through into better conditions for households. Of course, it all works in the opposite direction as well, but that's not nearly as much fun.

However, since 2014, house price inflation has, unusually, moved inversely with consumer confidence (figure 5). This reflects two phenomena:

- **Affordability constraints:** Young people (in the 18-24 year old cohort have been amongst the most discouraged, with rising house prices making home ownership less attainable.
- **Low interest rates:** Older people have also been amongst the most discouraged (50+). This likely reflects the double-edged sword of low interest rates weighing on their incomes and spending power.

On the other hand, households in the 25-34 year old cohort have been consistently optimistic (figure 6). Home owners in this cohort will be particularly benefiting from both low interest rates and rising house prices.

Figure 5: House price inflation and ANZ consumer confidence

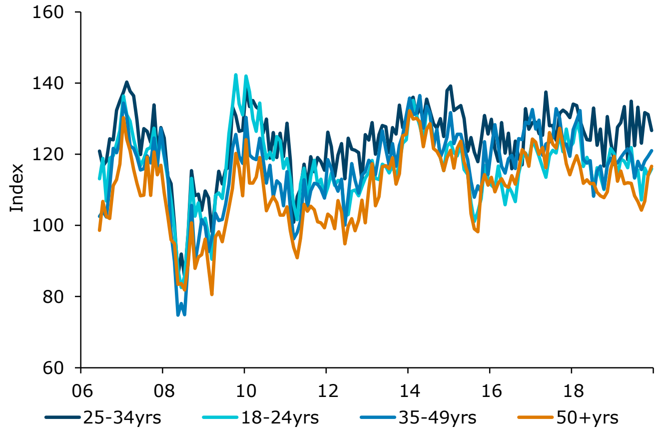


Source: REINZ, ANZ Research, Roy Morgan

Feature Article: Confidence trick

Recently, house price inflation and consumer confidence have shown signs of once more moving together– with the recent lift in confidence perhaps reflecting the strong labour market, improving wage growth, and positive news about the economic outlook, as much as it does house price inflation. Demographic changes could see this relationship continue to evolve in coming decades.

Figure 6: ANZ consumer confidence by selected age groups



Source: ANZ Research, Roy Morgan

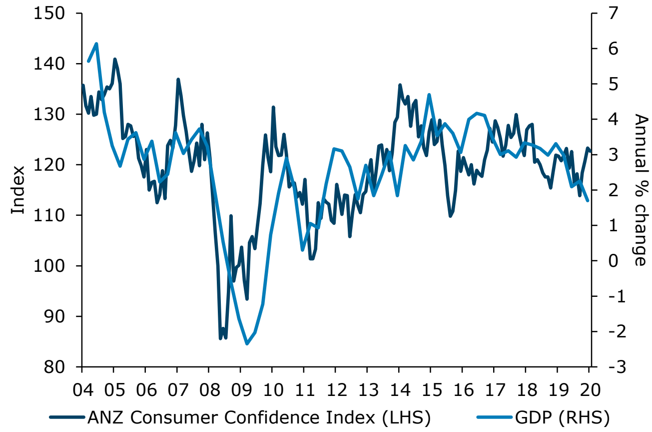
Overall, consumer confidence is sitting a bit above average, with households generally rather optimistic. Retailers generally aren't, due to strong competition, cost inflation and the ongoing move to online shopping leading to squeezed margins. Consumer confidence is not the problem. But could it become so? A number of headwinds remain, including uncertainty about the path of the economy (given global risks – more below), emerging credit constraints that for now remain largely under the radar, caution in the business community, and weather and other challenges for those in industries such as agriculture.

The path from here is unclear

Generally, buoyant (but not over-exuberant) consumer confidence such as we are seeing now would tend to be consistent with GDP growth around trend (figure 7). That has been our forecast, more or less. Consumption is a massive part of GDP, so the correlation isn't surprising. However, the path from here is unclear.

The domestic economic backdrop had improved at the start of the year. And all else equal, this would be expected to support household sentiment and spending over the coming months. In addition to recent strength in the housing market, the Government looks ready to spend, interest rates and the NZD has fallen, and activity indicators have found a floor after the marked slowdown in growth last year. All of this would point to GDP gradually improving and flowing through into consumption growth and a recovery in business spending, especially investment.

Figure 7: ANZ consumer confidence and GDP

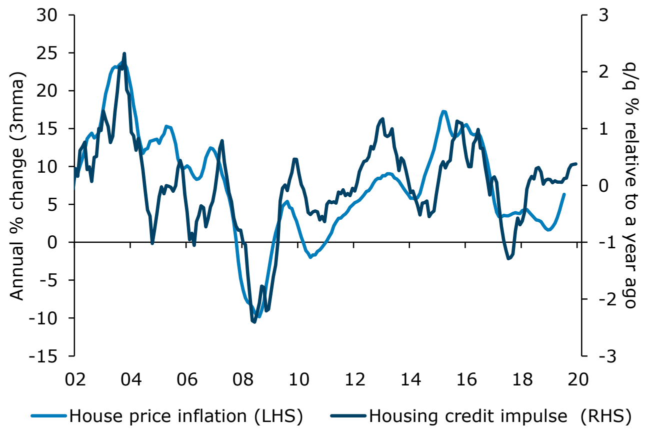


Source: ANZ Research, Roy Morgan, Statistics NZ

Credit headwinds could be in the pipeline

Despite the domestic drivers that are in place, there is a risk that credit headwinds become more of an issue going forward, which could weigh on both the housing market and the economy more broadly. Currently, the credit impulse[1] to the housing market is supportive, on the back of low mortgage rates (figure 8).

Figure 8: Credit impulse and house prices



Source: REINZ, RBNZ, ANZ Research

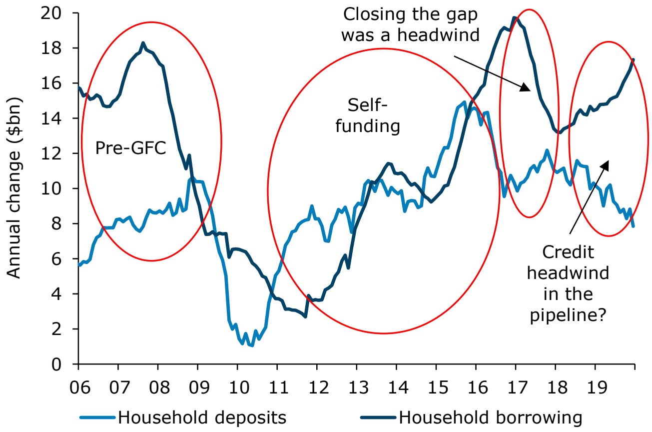
Lower mortgage rates have significantly boosted credit demand. But the increase in new lending has led to a widening in the "funding gap" – deposits in the banking system are not keeping pace (figure 9). That's a problem and it can't persist.

We think the slowdown in deposit growth reflects a move towards alternative investment products given how low term deposit rates are, reduced demand from foreigners in the housing market, and increased use of cash as a store of value. The slowdown in deposit growth is not something that can be changed much in the current environment, even if deposit rates lift a little (as they have done recently). And

[1] The quarterly % change relative to the rate a year ago, essentially a measure of momentum.

banks' scope to tap wholesale markets has its limits. This means at least some of the adjustment to bridge the gap will likely need to come from the lending side. See our ANZ Weekly Focus for more details.

Figure 9: Household lending and deposits – the bank "funding gap"



Source: RBNZ

At this stage, we expect banks to be prudent with their lending standards, which should keep the housing market in check – contributing to the moderation in house price inflation we are expecting over coming years. But credit could become a greater headwind if/when banks have to rein in their lending and/or increase both deposit and lending rates in an attempt to narrow the gap.

Overall, we expect a number of headwinds will keep the housing market contained over the medium term – the question is how much.

Global risks are in the spotlight

All that said, global risks are much more pressing at present. Developments associated with the COVID-19 outbreak are very worrying. Our thoughts are with all those who are being impacted by the outbreak.

The economic impacts of the virus could be significant, in light of the unprecedented response and associated disruption. The impacts on China, the global economy, and New Zealand are highly uncertain – it is too early to know the impacts. But the direction of risk is clear.

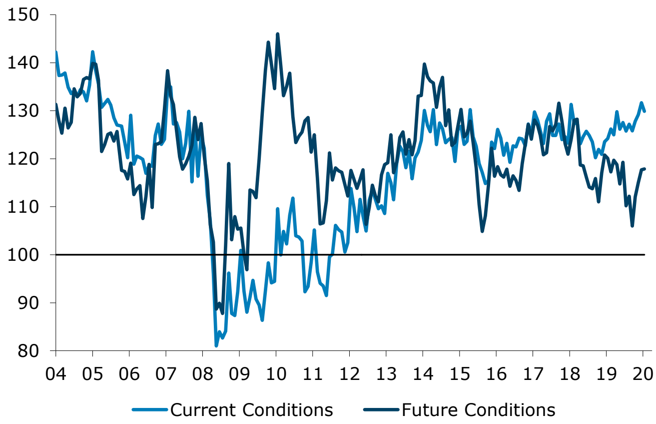
At the very least, a short, sharp hit to New Zealand's GDP can be expected, due primarily to weaker exports across both goods (dairy, meat and forestry, but more broadly as well), and services (travel, tourism and education) to China. A lower NZD, efforts to tap into new (old!) markets, and domestic demand filling the gap could help to provide some offset. But trade disruption and indirect effects on other industries could worsen the impact, with many supply chains affected.

A near-term impact is pretty much baked in, which will be difficult for all those industries affected (and their workers). History suggests a vigorous bounce-back in activity is likely once the outbreak is contained. But a larger impact cannot be ruled out, nor is successful containment a given. These risks are very difficult to quantify.

Sentiment could shift rapidly

A greater negative economic impact from the outbreak, potentially combined with a drought, could weigh on consumer sentiment directly, particularly if people are concerned about the virus spreading to (or worse, within) New Zealand. But more general economic conditions matter too, via job security, for example. This could especially be the case if business confidence started to slide, given it already has a low starting point. If downside risks were to materialise, sentiment could shift rapidly – as occurred around 2008 (figure 10).

Figure 10: Current and future conditions



Source: REINZ, Statistics NZ

At the moment, households are generally very happy about their current situation, likely reflecting good labour market conditions, the high terms of trade and low interest rates. But they aren't as gung ho about what tomorrow may bring, and they would no doubt become wary if emerging global risks started to be felt on domestic shores.

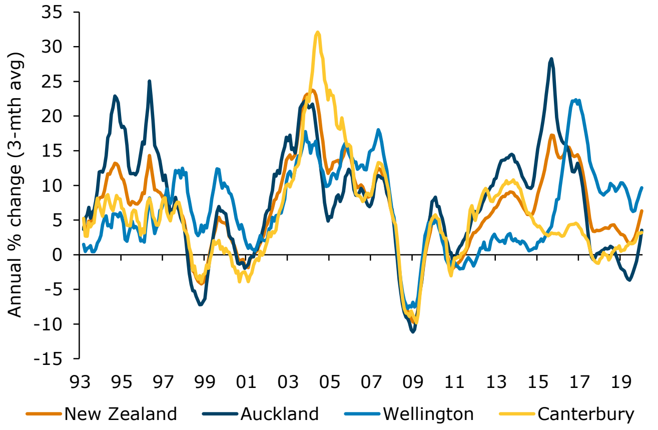
First response

If a bad scenario occurred, the NZD would fall and help to provide somewhat of a buffer for New Zealand, especially for our export sector, which would bear the brunt of such a shock. Additionally, governments and central banks around the world would stand ready to respond with stimulus if economic impacts become more severe.

The RBNZ will be watching developments associated with the outbreak closely. We think they would act quickly to shore up confidence and the outlook if they decide it's needed. They don't have a lot of conventional ammo left in terms of cutting interest rates. But there are ways they can get creative with unconventional monetary policy, though these are not without both costs and risks.

The Government has plenty of ammo now that their debt targets have been relaxed, and have indicated a willingness to spend. Increased infrastructure spending would take too long to provide a cyclical boost. But increased operating expenditure (health, education, tax cuts, and transfers) could be deployed relatively quickly. For now though, much depends on how the global situation evolves from here. The New Zealand economy is at least in a strong starting position, and that will help it weather a small near-term dent to activity.

Figure 1. Regional house price inflation



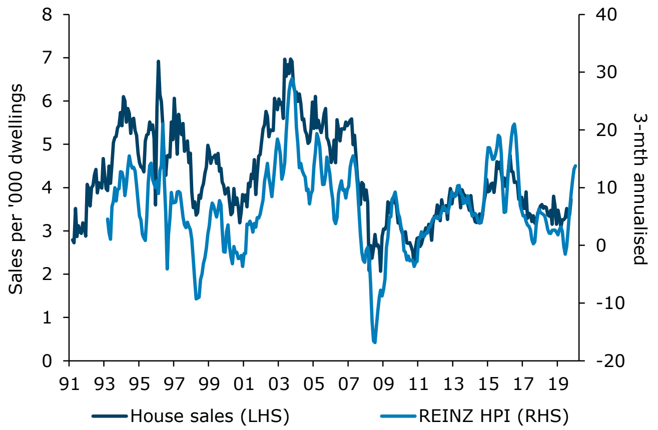
Source: ANZ Research, REINZ

House prices rose 0.6% m/m in January to be up 6.9% y/y – just above its long-run average rate of 6.8% y/y, and above where nominal GDP growth is tracking.

Outside of Auckland, house prices were up 0.8% m/m (9.1% y/y). Smaller regions continue 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 house prices up 0.3% m/m, reaching 4.3% y/y (3mma).

Falls in mortgage rates and increased appetite for debt are passing through the market, which remains tight. However, headwinds are still relevant, and tighter credit conditions may be on the horizon.

Figure 2. REINZ house prices and sales



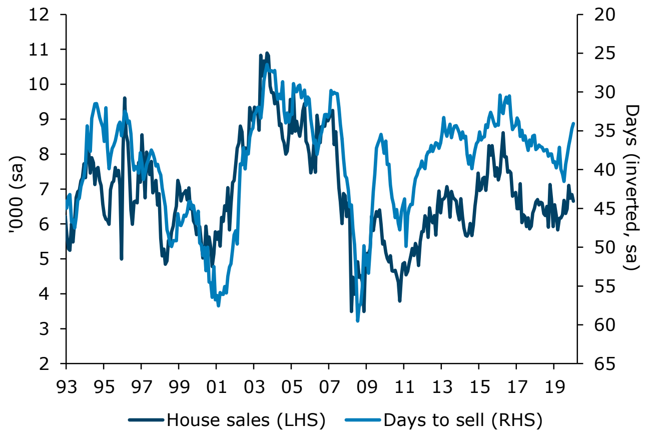
Source: ANZ Research, REINZ

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

Across the country, house sales fell 2.8% m/m in January to be up 1.5% y/y (3mma). We saw Auckland sales rise again, now up 18% y/y (3mma), a notable contrast to the almost 15% decline seen over the year to May 2019. Generally, strong price pressure is coming off the back of moderate levels of sales, though these can bounce around from month to month.

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

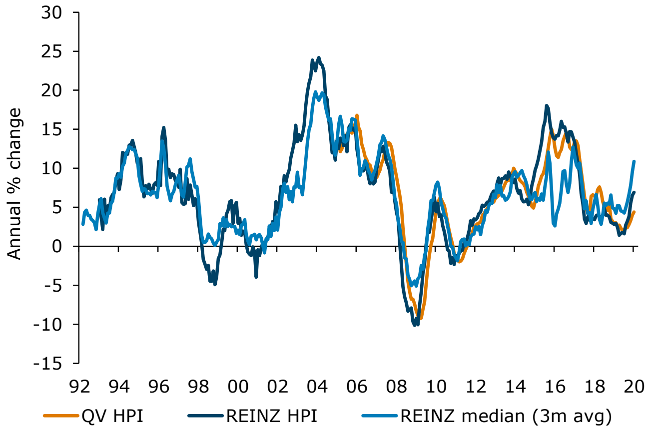


Source: ANZ Research, REINZ

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.

The number of days it takes to sell a house continues to decline nationally, dipping from 35 to 34 days in January. This is well below the historical average of 39 days, with the market very tight overall. Market tightness is broad based across all regions, except Auckland where the market is close to normal; days to sell in Auckland is 37 days, just a little above the historical average of 36.

Figure 4. REINZ and QV house prices

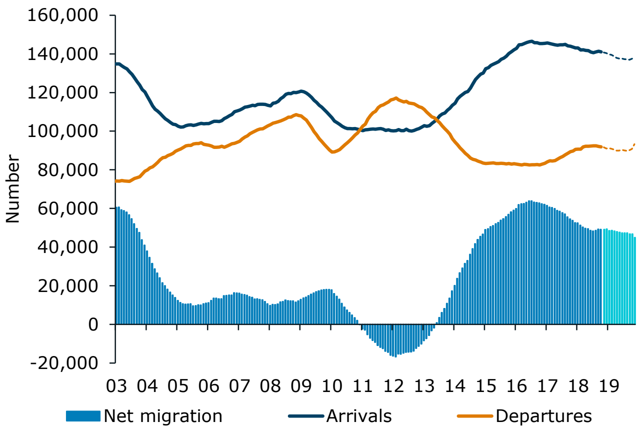


Source: ANZ Research, REINZ, QVNZ

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 to 6.9% y/y in December. This is above the QVNZ measure which came in at 4.4%. The REINZ median also crept up to 11% y/y (3mma), up from 9.5% in December.

Figure 5. Annual migration*



Source: Statistics NZ

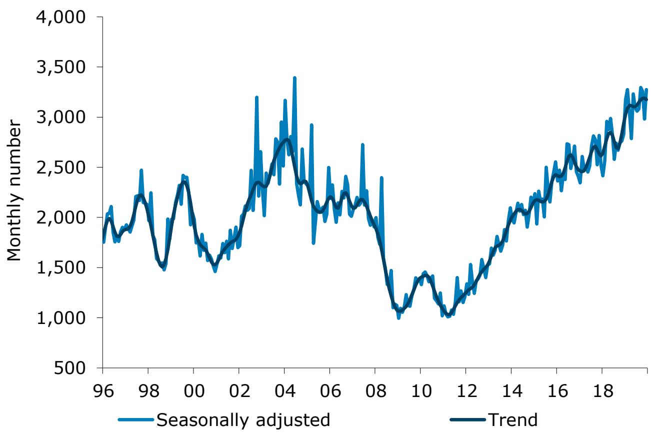
*Dotted lines show the last nine months of data, which are subject to substantial revisions.

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.

We estimate that the downward trend in migration has continued. 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

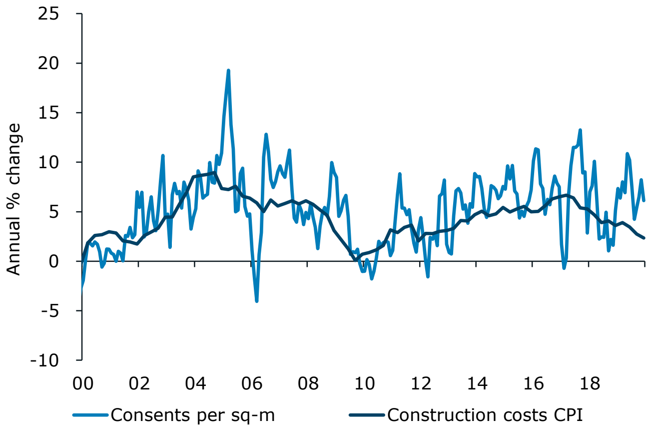


Source: ANZ Research, Statistics NZ

Residential building consents lifted 9.9% m/m in December, up from an 8.4% fall in the month prior. These data tend to be volatile, largely driven by fluctuations in apartment consents. Annual consent issuance has risen slightly, now at 37,550. Auckland consents are continuing to support this with annual consents coming in at just under 15.5k for December (a 2.3% jump on last month). The rise in Canterbury's annual consents is persisting, albeit at a slower rate this month.

Ongoing housing demand should continue to support construction activity. Capacity constraints and profit challenges remain issues, however, making it difficult to see any substantial further rises in issuance.

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 6.1% y/y (3mma) in December, a slight fall from the 8.2% increase seen in November. Moreover, CPI construction cost inflation settled at 2.4% y/y in the December quarter.

The construction industry is still facing capacity pressures, which are helping to drive price increases. Notably, we've seen slower construction growth in recent years and firms feeling cautious about the pipeline of work, so we wouldn't expect construction cost inflation to rise too much further from here.

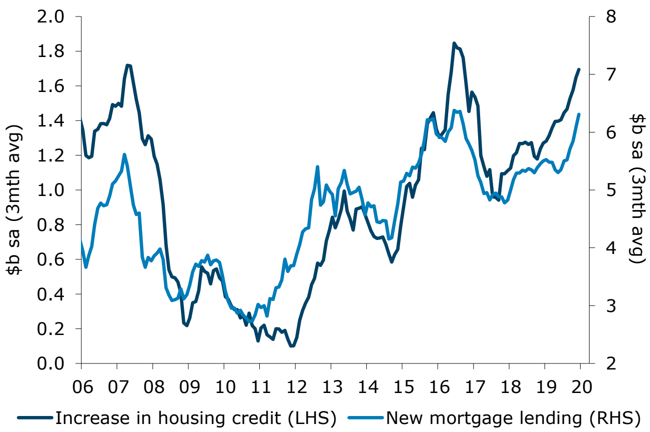
Figure 8. New mortgage lending and housing turnover

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 the value of new house sales. New mortgage lending increased 7.2% m/m (sa) in December; this was a jump from a reading of -1.3% in November. Greater lending is being propped up by recent strong housing turnover. If housing market strength persists, we could continue to see new mortgage lending rise. On the other hand, a widening bank funding gap on the back of weak deposit growth, could see credit availability becomes a headwind to the housing market and the domestic economy.

Figure 9. New mortgage lending and housing credit

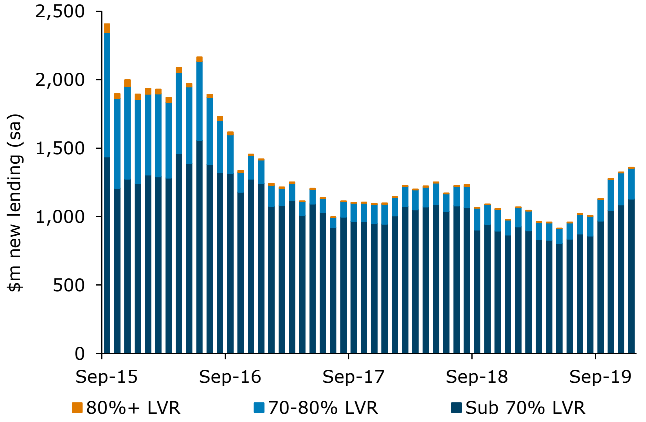


Source: ANZ Research, REINZ, RBNZ

Household credit has been growing at a relatively steady pace for the past year or so. In December, we saw this trend continue, with house lending rising 0.6% m/m. This rounds year-on-year growth up to 6.5%, compared to 5.9% in December 2018.

Any acceleration from here will, be tempered by bank prudence coupled with the recent widening in the bank funding gap, unless deposit growth starts to increase. For now, credit demand is being supported by recent declines in mortgage rates, and tightness in the housing market has boosted the value of properties being transacted. Moreover, there has been a bit more debt associated with housing market turnover, given attractive mortgage rates, along with decent rental yields for investors.

Figure 10. Investor lending by LVR

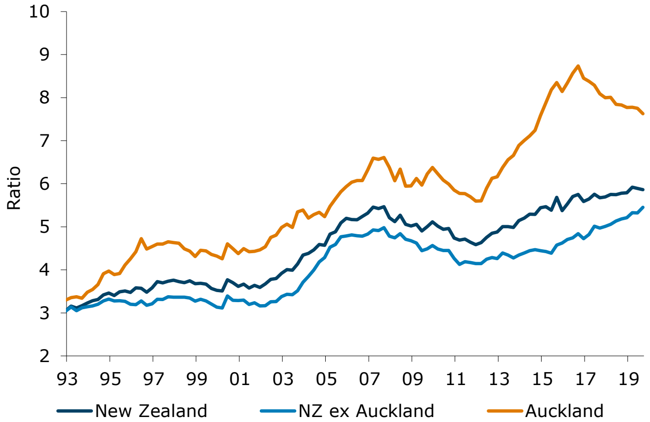


Source: ANZ Research, RBNZ

Lending to investors was up 36.9% y/y in December, on the back of the rebound in the housing market in the second half of last year. This is a shift from the 17.9% decline in August, reflecting the pace of recovery, with investors active in the New Zealand housing market. However, these data can be noisy. New lending to investors as a percentage of the total has remained relatively stable at 19.9%. This is much below the near-35% peaks seen in 2016.

The share of riskier lending remains stable, with LVR restrictions remaining in place for the time being. The share of investor lending at loan-to-value ratios of less than 70% has barely shifted in recent times, sitting comfortably at 85%. In late-2014 it was around 50%.

Figure 11. Regional house prices to income

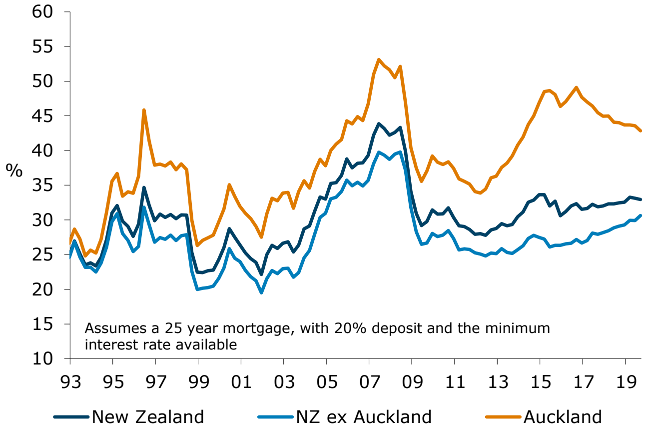


Source: ANZ Research, REINZ, Statistics NZ

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 7% since the middle of last year. This strength has been on the back of declines in mortgage rates and a modest increase in appetite to take on debt. Indeed, the market is tight, and we expect some modest strength in house price inflation to continue on the back of that. Previously, there was a risk was that the housing market gathered even more momentum, with house price expectations having increased. But now clouds are forming, with credit conditions likely to tighten on account of the wider bank funding gap. Although we expect annual house price inflation to increase a little further from here (to 8% y/y), headwinds will likely see the pace of growth moderate (to ~3% y/y) thereafter – with bank funding considerations expected to come to a head soon. Affordability constraints and moderating population growth will also help to keep the market in check. And as always, long-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 higher mortgage rates are possible if bank lending is reined in.
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 constrained, with the funding gap having widened. This presents an emerging headwind.
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, but clouds have emerged, with credit conditions expected to weigh.**

Property gauges

Figure 1: Housing affordability

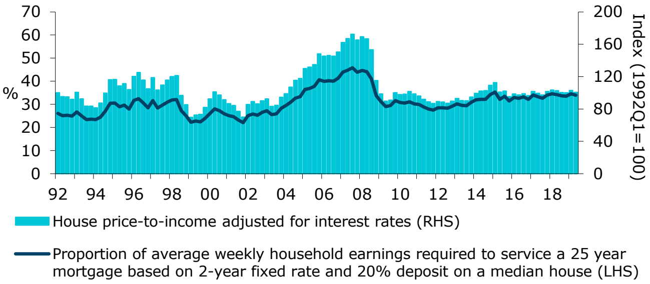


Figure 2: Household debt to disposable income

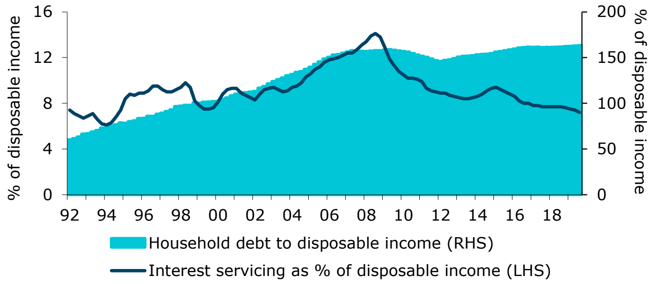


Figure 3: New customer average residential mortgage rate (<80% LVR)

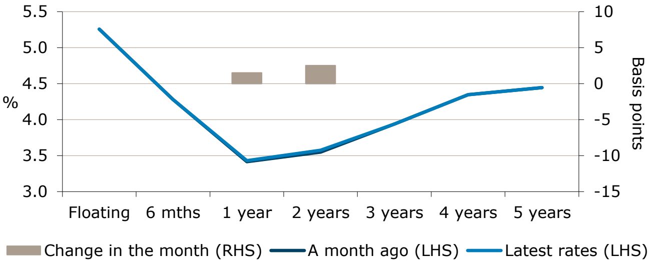


Figure 4: Annual migration*

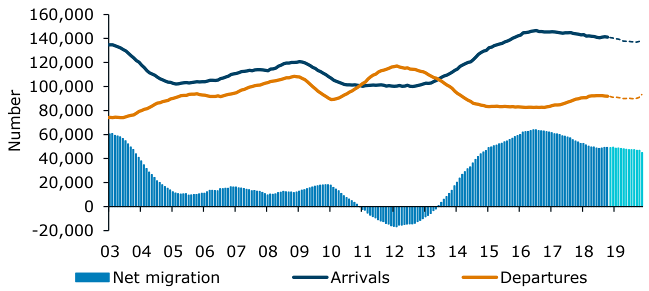


Figure 5: Housing supply-demand balance

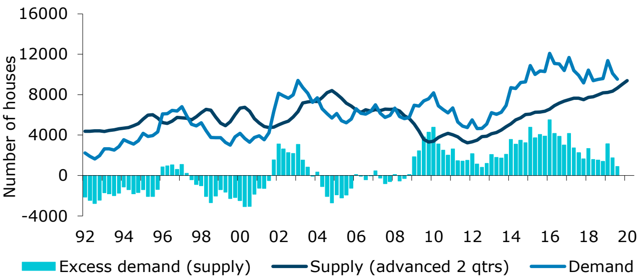


Figure 6: Building consents and house sales

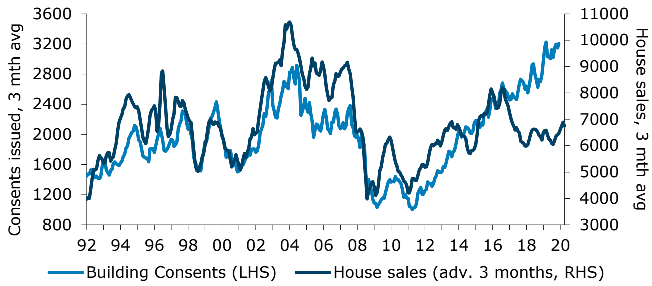


Figure 7: Liquidity and house prices

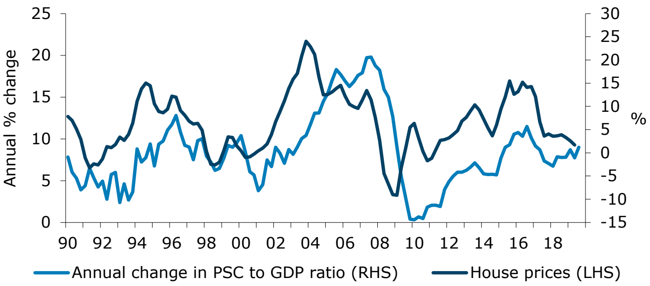


Figure 8: House price inflation comparison

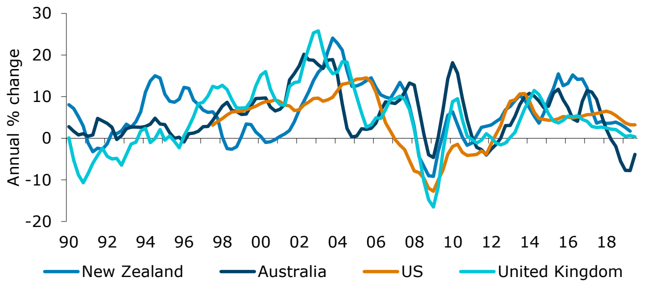


Figure 9: Housing supply

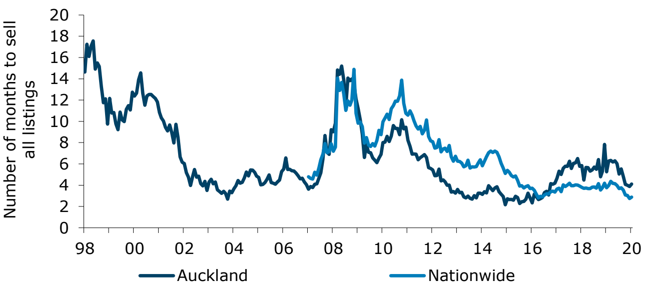
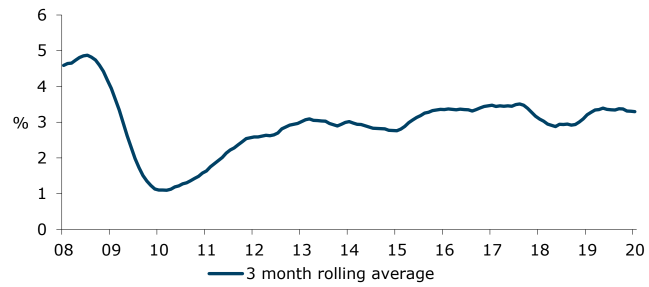


Figure 10: Median rental, annual growth



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 looked to be starting 2020 on a stronger footing, with activity indicators stabilising, the housing market stronger, and the fiscal pipeline supportive of growth. However, the worrying COVID-19 outbreak is causing significant uncertainty about the outlook. The human toll is very troubling. From an economic perspective, it is too early to know what the impact of the outbreak and associated disruption may be, but emerging developments will be watched closely. For now, we expect to see a temporary, near-term dent to growth over the first half of the year, with the economy pottering along a little above trend thereafter. Inflation is sitting comfortably near the midpoint and the labour market is strong. Given this, we see the RBNZ sitting back for now and watching how domestic and global developments unfold. Global trends will be the main driver for the New Zealand economy in the foreseeable future. The impact could be greater than we expect, but the RBNZ and Government will provide further stimulus if required.

Our view

The COVID-19 outbreak is dominating current thinking about the outlook. The human impact is tragic, and our greatest sympathies lie with those personally affected. It is too early to fully assess what the economic impacts of the virus will be; it is enormously uncertain.

We will be keeping close tabs on how the outbreak and associated disruption impacts global growth, China's growth and the domestic backdrop. For New Zealand, the economic impact of the SARS coronavirus in 2003 was not as bad as initially feared, but we are dealing with different circumstances this time round and New Zealand's trade exposure to China is much larger. Certain sectors of the economy are already experiencing pressure, such as meat, forestry and tourism, while other industries will be dealing with a lot of uncertainty. Our hope is that the virus will be contained soon and that impacts will short lived. But we cannot rule out a larger impact.

Prior to the outbreak, the domestic outlook was looking more positive. House price inflation was stronger than expected, and will contribute to stronger spending.

Credit demand has encouraged strong growth in new mortgage lending. However, deposit growth has not kept pace, making it difficult for banks to fund new lending without increasing their reliance on wholesale funding. We think that bank prudence will weigh on housing market activity from here in light of that. We see house price inflation moderating in coming quarters, with some risk that credit becomes an even greater headwind.

The Government has announced a boost to fiscal spending of $12 billion, which will support growth and provide certainty. $8bn of this spend has been allocated already, with most of the focus in transport infrastructure. We expect to see details of the remaining spend roll-out as we head towards the election in September. These projects, of course, do not happen overnight so it doesn't do much for short-term growth. But it will provide welcome assurance to those in the industry, and boost GDP over a longer-term horizon. Moreover, with the Government taking a more relaxed approach to its debt targets, more promises could be in the pipeline – and those promises could be in areas that can generate a more short-term sugar hit.

Activity indicators have shown a reasonably broad-based stabilisation recently following the slowdown in growth last year. It is expected that GDP growth troughed at 1.7% y/y in December 2019. We had been expecting a gradual recovery in growth through 2020. But we now expect to see a near-term, temporary impact to GDP growth from the COVID-19 outbreak, due to weaker production in our export-facing sectors and disruption to supply chains in other industries. We are currently assuming that the impact will be temporary, with a recovery later in the year as activity resumes.

Our expectation is that the RBNZ will remain on hold with the OCR at 1% for now. It appears that the 75bps worth of cuts over the past year have done their job. Inflation and the labour market are sitting in comfortable positions relative to the RBNZ's targets, giving them scope to be patient.

Headline CPI came in at 1.9% y/y in Q4, sitting right by the RBNZ's midpoint target. This was supported by strong domestic inflation, with non-tradable inflation coming in at 3.1% y/y.

The labour market is strong, with good employment prospects spurring spending. Being late in the cycle and with capacity constraints reaching their limits, businesses are having issues securing skilled labour. In theory, this would push wage inflation upward. But we are seeing wage inflation increasing only very gradually, with businesses wary that any costs will be difficult to pass through to consumers.

Nonetheless, global risks are in the foreground and this will weigh on the RBNZ's thinking. We expect they will cut the OCR if required. And the NZD will provide an important buffer in the face of global risks. Plus, the Government is ready to spend if the outlook takes a turn for a worse. Let's hope all that won't be necessary.

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 January 2020 (based on REINZ data)

	Median house prices		No of sales (sa)	Mthly % chg	Avg days to sell (sa)
	Ann % chg	3mth % chg			
Northland	5.4	3.6	206	-8%	51
Auckland	8.7	4.9	2,121	+1%	37
Waikato	8.7	6.1	693	0%	39
Bay of Plenty	17.7	4.6	524	-1%	44
Gisborne	20.6	1.5	46	-12%	23
Hawke's Bay	22.3	3.4	247	+4%	28
Manawatu-Whanganui	24.2	3.5	412	+23%	26
Taranaki	9.1	0.7	163	+3%	23
Wellington	10.1	2.7	691	+1%	29
Tasman, Nelson and Marlborough	5.4	7.0	187	-24%	41
Canterbury	8.2	2.1	925	-6%	36
Otago	19.3	6.5	305	-24%	33
West Coast	43.1	14.0	45	+8%	38
Southland	28.0	4.1	140	-17%	23
New Zealand	**11.7**	**4.9**	**6,650**	**-3%**	**34**

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	1.7	1.6	2.0	2.3	2.5	2.9	3.1
CPI Inflation (Annual % Chg)	1.5	1.7	1.5	1.9(a)	2.2	2.1	2.0	1.7	1.9	2.0
Unemployment Rate (%)	4.1	4.0	4.1	4.0(a)	4.1	4.1	4.1	4.0	3.9	3.9
House Prices (Annual % Chg)	2.7	1.6	2.5	5.3(a)	6.1	7.9	7.3	4.6	3.7	3.1
Interest rates (RBNZ)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Official Cash Rate	1.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
90-Day Bank Bill Rate	1.6	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Floating Mortgage Rate	5.7	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
1-Yr Fixed Mortgage Rate	4.6	4.4	4.3	4.3	4.3	4.4	4.4	4.4	4.4	4.4
2-Yr Fixed Mortgage Rate	4.7	4.5	4.4	4.3	4.3	4.4	4.4	4.4	4.4	4.4
5-Yr Fixed Mortgage Rate	5.0	5.0	4.9	4.6	4.6	4.7	4.8	4.8	4.8	4.8

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

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