NEW ZEALAND PROPERTY FOCUS

October 2017

INSIDE

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THE ONCE OVER

SUMMARY

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

THE 2017 ANZ PROPERTY INVESTORS SURVEY

This year's ANZ-Property Investor Federation survey of property investors showed a greater degree of caution on the part of investors. However, investors remain optimistic about the medium to long-term value of their investments and at the time of the survey in August were still expecting quite significant increases in Auckland house prices. We suspect that price expectations have fallen and cautiousness has increased since the survey was taken, given the ongoing slowdown in the property market, particularly in Auckland.

PROPERTY GAUGES

There are clear opposing forces impacting the housing market. On the one hand, strong population growth coupled with a challenged supply backdrop argues that a fundamental supply-demand imbalance will continue to drive prices higher. Yet this is going head-to-head with a base in the interest rate cycle, tighter lending standards, LVR restrictions and affordability constraints. If it were all about a demand and supply imbalance, then rents should be rising faster than they are. Political uncertainty adds another layer of caution. We see prices plateauing for now.

ECONOMIC OVERVIEW

The economy is performing in a solid, albeit unspectacular manner. Headline growth is respectable; per capita growth and productivity growth are not. The drivers of the economic expansion are evolving (peak construction and migration, but commodity prices, fiscal stimulus and household income prospects are set to add some impetus). At the same time, there are also headwinds from housing weakness and capacity constraints. We are a little more circumspect on the near-term growth picture – and an extended period of government policy uncertainty would accentuate that – but ultimately we see GDP growth holding in a 2½ to 3% range.

MORTGAGE BORROWING STRATEGY

With average mortgage rates barely moving in the past month, our favoured views have not shifted at all. From a "lowest is best" perspective, the 1-year rate still stands out. And this is consistent with our expectation of the OCR being on hold for an extended period. Longer-term rates remain very low by historic standards and offer certainty. Some borrowers may wish to spread risk by borrowing over a number of fixed terms. The downside is that we struggle to see where inflation is going to come from to necessitate major lifts in the OCR.

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SUMMARY

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COOLING

It may be spring but the housing market appears to be cooling rapidly. Over the last 12 months or so the number and strength of headwinds for the housing market have increased. Slightly higher mortgage rates, election-related uncertainty, stretched affordability, a tougher environment to get credit, and the Reserve Bank's tighter loan-to-value ratio (LVR) requirements for investors have together had a marked effect. Property turnover has dropped sharply and house price inflation has fallen – and in fact is modestly negative in Auckland. The mood of the market has changed.

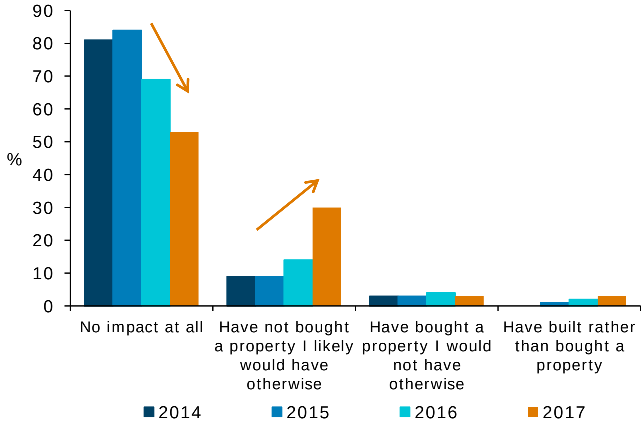
So far, it's been a very orderly adjustment, and there were certainly no signs of panic amongst the surveyed property investors within this year's ANZ-Property Investor Federation survey. Investors have done well out of housing, and it is clear that they are not going to abandon it lightly. Almost 70% of investors plan to buy again at some point, the same proportion as last year, though the urgency has declined, with fewer planning to buy in the next six months. The continued enthusiasm for property as an investment is not surprising. Most investors are planning to hold their properties for the long term. Even if they have pretty modest expectations of price growth in the near term, many of them will have assessed residential property investment to be a solid prospect over time.

With that as the context, we now turn to the specific findings of the survey for 2017.

LVR RESTRICTIONS BITE

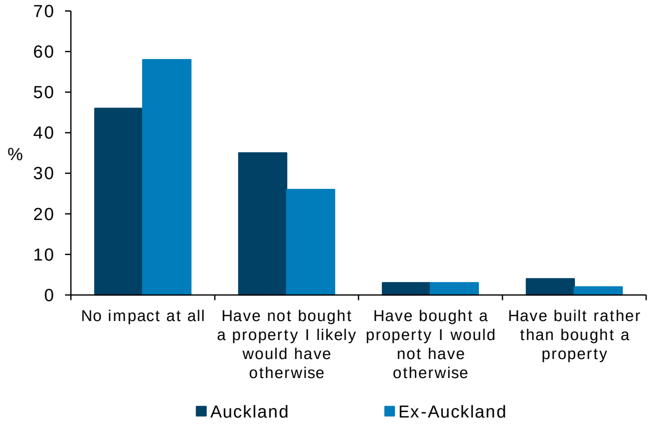
Only a smidgen over half of respondents this year (53%) said that the Reserve Bank's restrictions on high loan-to-value mortgage lending had not had a significant impact on their strategy (figures 1 and 2). In comparison, in 2014 and 2015 over 80% of investors, and in 2016 nearly 70%, had shrugged them off. Of the 47% of survey respondents who said that there had been an impact, nearly two thirds said they had not bought a property they likely would have otherwise. This proportion is up strongly. As figure 2 shows, the impact in Auckland has been particularly marked, likely reflecting both that investors in this region have been subject to restrictions for longer, and also that loan sizes are typically higher in this region, given the level of house prices.

Figure 1: Impact of LVR restrictions over time



Source: ANZ, NZPIF

Figure 2: Impact of LVR restrictions – Auckland vs. ex-Auckland



Source: ANZ, NZPIF

DEBT

Debt ratios continued to decrease (figure 3), with the falls focused outside of Auckland (figure 4). An increase in property values has helped. Indeed, more than half of the investors who said their debt ratios had fallen put this down to higher property values, with a further 17% reporting having sold down a property. Only 21% of investors reported having reduced their debt loadings through higher principal repayments.

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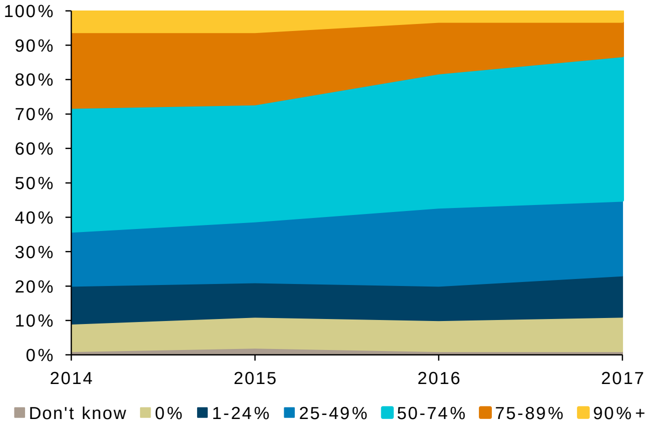
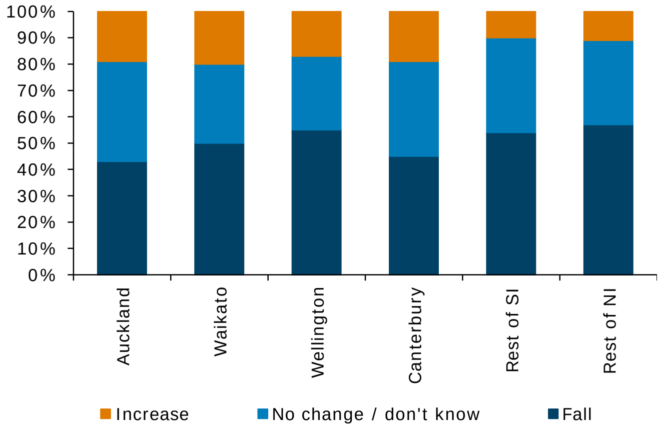
Figure 3: Leverage on investment property/ies



Source: ANZ, NZPIF

Figure 4: Changes in debt/value ratio by region



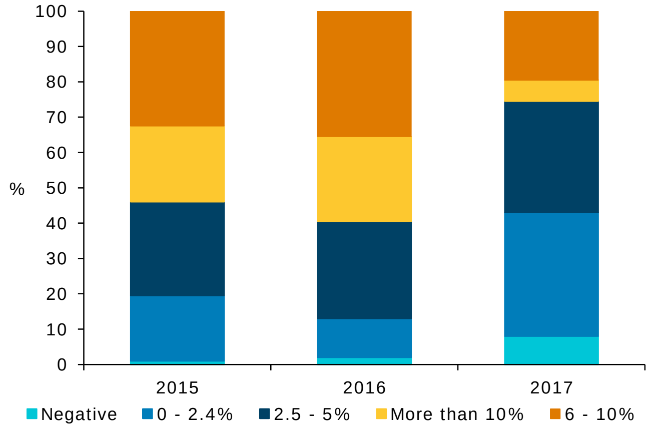
Source: ANZ, NZPIF

Investors are unlikely to be able to continue to rely on capital gains for deleveraging in the near term, especially in Auckland. It is likely that for some time at least, LVR reductions will need to be achieved the hard way, through careful management of rental income and costs. For those who are still highly leveraged, a focus on consolidation and cashflow may help ensure that unexpected developments do not result in a need to sell during a significant downturn in the market.

MORE MODEST EXPECTATIONS

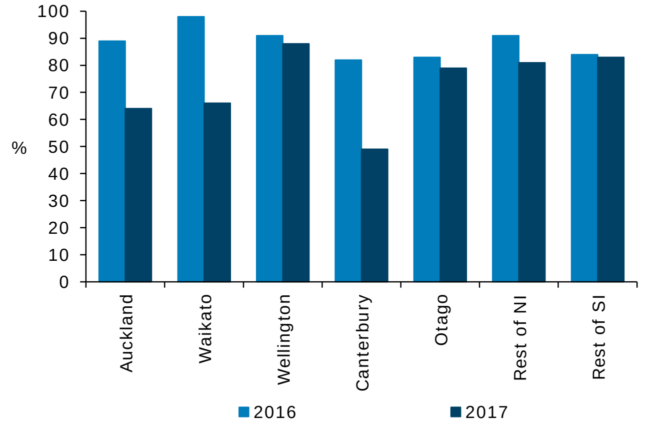
Expectations of increases in property values have eased across the country since 2016 (figure 5), with a significantly lower proportion of investors in Auckland, Waikato and Canterbury expecting property values to increase over the next 12 months (figure 6).

Figure 5: Expected change in investment property value next 12 months



Source: ANZ, NZPIF

Figure 6: Net % expecting increase in investment property value in next 12m



Source: ANZ, NZPIF

While 84% of investors in 2016 expected their property values to increase by 2.5% or more over the coming twelve months, this dropped to just over half of respondents in this year's survey. However, although expectations have moderated since last year, they still look optimistic, particularly in Auckland. The city continues to have one of the most stretched affordability ratios in the world, yet 74% of Auckland investors still expect values to rise at least 2.5% in the next twelve months. That is down from 93% last year but that number is likely to continue to ease as reality bites. At the time of the survey in August, only 10% of Auckland investors expected house prices to fall over the next twelve months. They are falling now, albeit only modestly.

Rent expectations have also moderated versus last year in most regions (figure 7). It is interesting to see the percentage of Auckland investors expecting to see rent increases over the next year dropping from 90% in 2016 to 77% this year. This perhaps reflects a realisation that net migration is topping out, and that the days of ever-higher net migration and population growth are likely over for this cycle.

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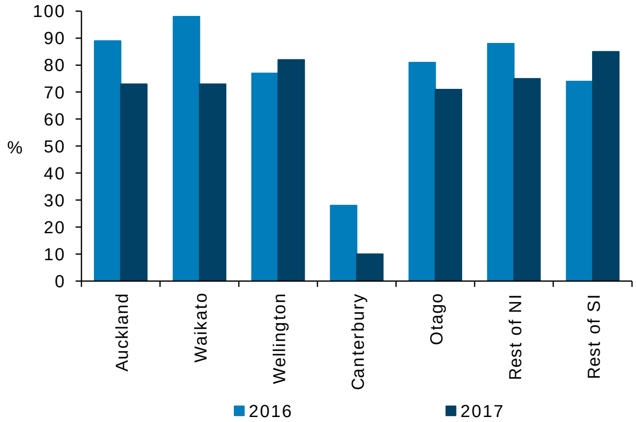
Evolving investor expectations reflect a growing awareness that the world is changing. We are late in the economic cycle, and while a second wind can never be ruled out, the boom in residential property prices appears to be ending. Most survey respondents are in a strong position as they consider their strategies in this environment. They are sitting on solid capital gains, and most are in a pretty good equity position. But we are now entering an era where cashflow is king.

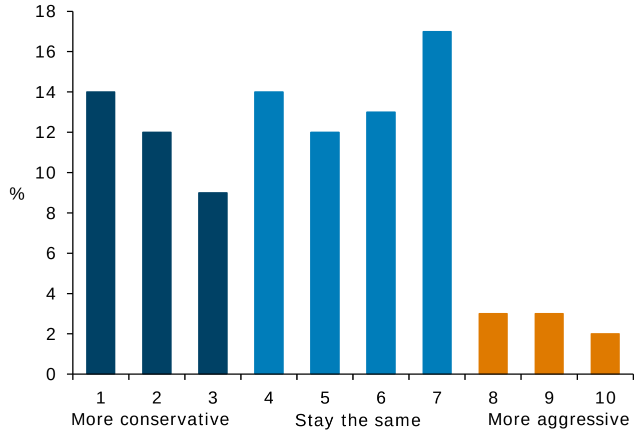
Consistent with more modest expectations regarding returns, a tilt in self-reported investment strategies is also evident. Investors were asked whether they had changed their investment strategy in the past 12 months; 20% reported they had. Those 20% of respondents were then asked to report on a scale of 1 (more conservative) to 10 (more aggressive) how their strategy had changed. The responses were strongly tilted towards the more conservative end (35% picking 1, 2 or 3 versus only 8% choosing 8, 9 or 10) (figure 8).

Figure 7: Net % expecting increase in rental income in next 12m by region



Source: ANZ, NZPIF

Figure 8: Changing strategies

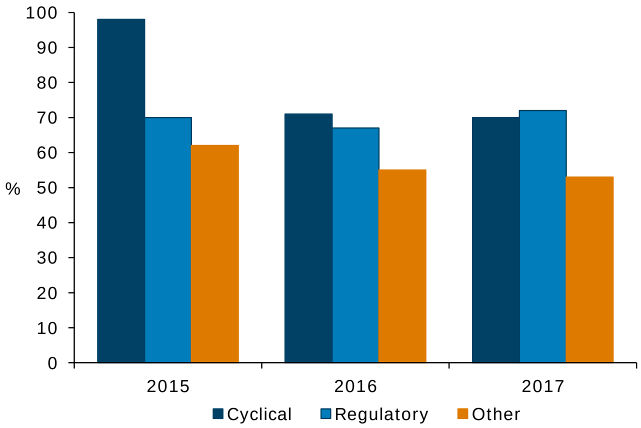


Source: ANZ, NZPIF

CONCERNS AND RISKS

It is important to note that the tilt towards more conservative strategies does not seem to be being driven by any concerns about overvalued houses or other macroeconomic factors. Analysis of survey respondents' perceived risks reveals that **compared to a couple of years ago, there is little concern about cyclical risks such as properties lying empty, tenants defaulting on rent, or property prices falling.** However, concerns relating to government regulations and tax changes have increased (figure 9).

Figure 9: Perceived risks



Source: ANZ, NZPIF

Cyclical: *Tenants defaulting, interest rate volatility, property values decreasing, property remaining vacant, rents decreasing, not meeting expected return*

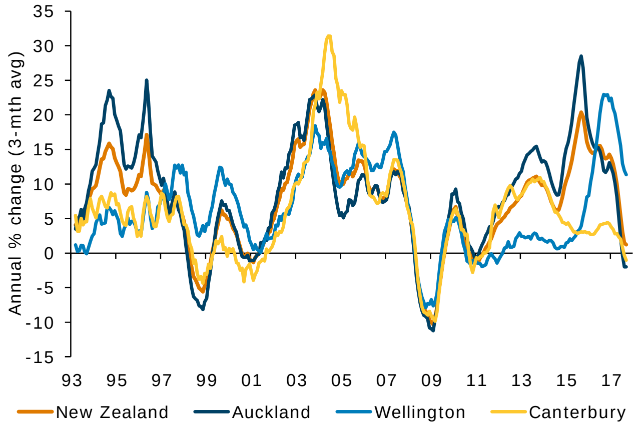
Regulatory: *Government regulations, tax changes*

Other: *Damage to property, general cost increases, insurance premiums*

All up, property investors remain upbeat, particularly about the medium to long term, and most appear to be in a good position to ride out any short-term challenges.

THE PROPERTY MARKET IN PICTURES

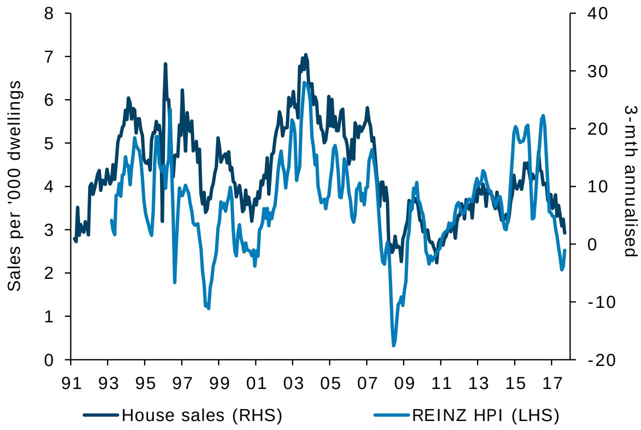
Figure 1. Regional house price inflation



Source: ANZ, REINZ

We estimate the nationwide REINZ House Price Index rose 0.9% m/m (seasonally adjusted - sa) in September. That is the largest monthly increase in close to a year, and follows a period of weak growth. In fact, prior to rising 0.5% m/m in August, prices had fallen for three consecutive months. Annual growth lifted to 2.1% y/y from 0.4% y/y in August (the chart is presented in 3-month average terms). Auckland continues to underperform, with prices down 0.7% y/y in September (although they rose 1.0% m/m). Across the rest of the country, prices lifted 0.6% m/m in September (sa) and are up 7.0% y/y. Of the major centres, Wellington is recording the strongest annual price growth of 12% y/y, although this is well off its highs.

Figure 2. REINZ house prices and sales

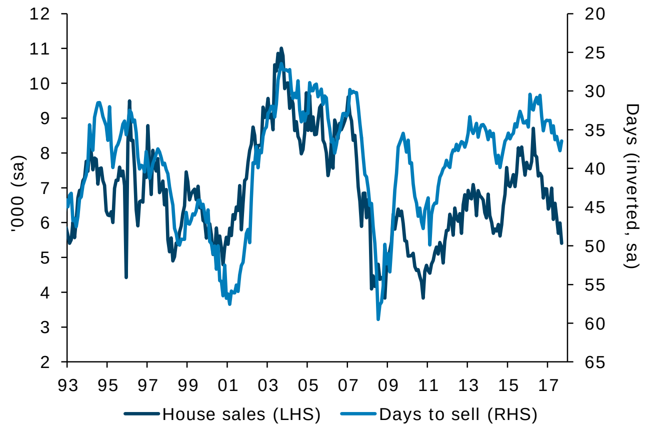


Source: ANZ, REINZ

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

National seasonally adjusted sales volumes plunged 9.8% m/m in September to the lowest level since October 2011. A number of factors will be playing a role, but no doubt election uncertainty has contributed. Sales volumes are down 26% y/y. Again, Auckland is underperforming, with turnover down 31% y/y, although every region is now experiencing turnover lower than a year ago. Excluding Auckland, sales volumes fell 8.2% m/m (sa) in September, to be down 24% y/y.

Figure 3. Sales and median days to sell



Source: ANZ, REINZ

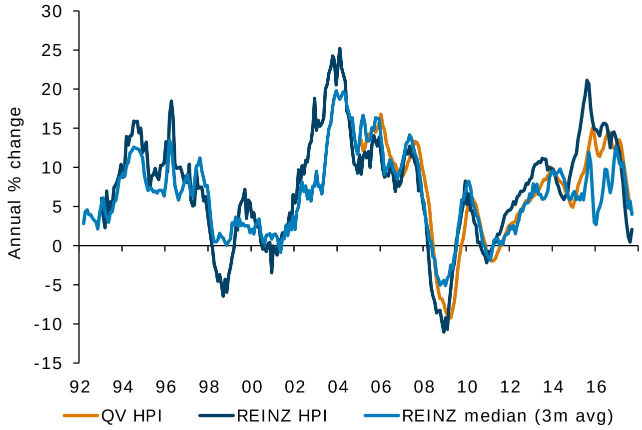
How long it takes to sell a house is also an indicator of the strength of the market, encompassing both demand and supply-side considerations. Larger cities tend to see houses sell more quickly, but deviations in a region from its average provide an indicator of the heat in a market at any given time.

Nationally, the median time to sell a house fell by 1.3 days to 36.5 days (sa) in September. While that remains below its historical average (39.6 days), it is well up from less than 31 days 12 months prior.

The median time to sell a property is below historical averages in every region except Auckland, Canterbury and the West Coast.

THE PROPERTY MARKET IN PICTURES

Figure 4. REINZ and QV house prices

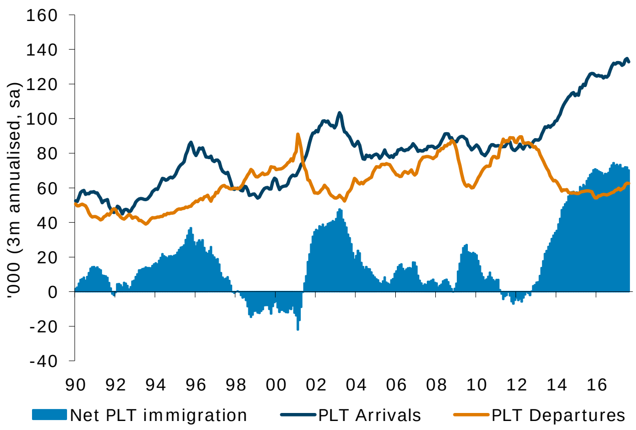


Source: ANZ, REINZ, QVNZ

There are three key 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, with the REINZ median typically more volatile as it is sensitive to the composition of sales taking place.

The REINZ median sale price fell 1.6% m/m (sa) in September, with annual growth falling to 1.0% y/y. This is weaker than the REINZ House Price Index (2.1% y/y) and the QVNZ measure of price growth (4.3% y/y). The latter two measures adjust for changes in the quality of houses sold, while the median sale price will be biased up if the lower end of the market slows more. But the trend in annual inflation in all three is pointing firmly down.

Figure 5. Net permanent/long-term immigration



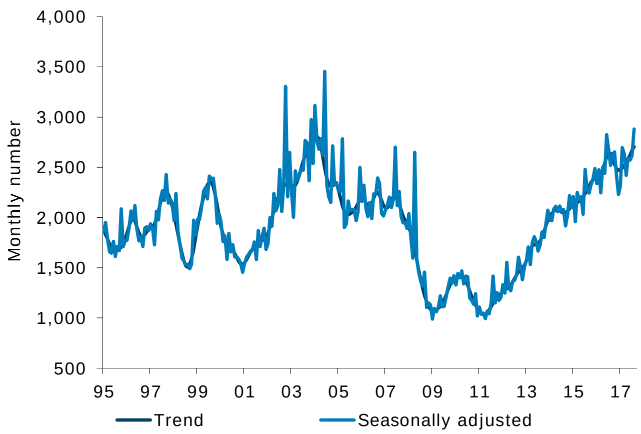
Source: ANZ, Statistics NZ

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 all coincided with large net migration inflows.

On a three-month annualised basis, net permanent and long-term migration dipped to 70.4k in August. It appears to be topping out at high levels. Although arrivals continue to rise, departures have started trending higher (off lows).

While we are perhaps reaching a "peak", net inflows are expected to remain strong. New Zealand's labour market continues to perform well, and in a world of fractured international politics (Brexit, US political uncertainty), there'll be no shortage of people with a desire to move to New Zealand.

Figure 6. Residential building consents



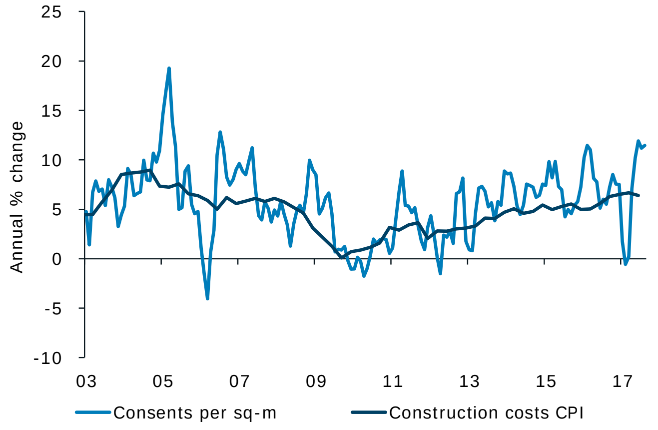
Source: ANZ, Statistics NZ

Dwelling consent issuance surged 10% m/m (sa) in August to the highest level since 2004. It was entirely due to a 38% m/m jump in multi-dwelling consents, especially in Auckland. Issuance has been volatile over recent months, and given the composition of August's increase we are cautious about extrapolating trends. When we step back, we still believe we are in an environment where annual issuance will struggle to push much above 30k.

The sector is grappling with two clear opposing forces. The demand backdrop is clear, with a housing shortage (at least in Auckland) and strong population growth requiring ongoing lifts in housing supply. However, that supply response is being challenged by capacity and capital constraints in the construction industry. And falling house prices amidst rising costs undermine the viability of development.

THE PROPERTY MARKET IN PICTURES

Figure 7. Construction cost inflation



Source: ANZ, Statistics NZ

On a three-month average basis, **the value of residential consents per square metre rose 11% y/y in August.** This proxy for construction costs had shown surprising weakness in earlier months, which we felt was likely due to the composition of issuance more than anything. The bounce-back corroborates this view.

Costs per square metre in Auckland (especially in the multi-dwelling space) have lifted especially strongly over the past year or so, and our internal anecdotes continue to highlight that capacity pressures in the construction sector are intense, with a severe shortage of labour.

Figure 8. New mortgage lending and housing turnover

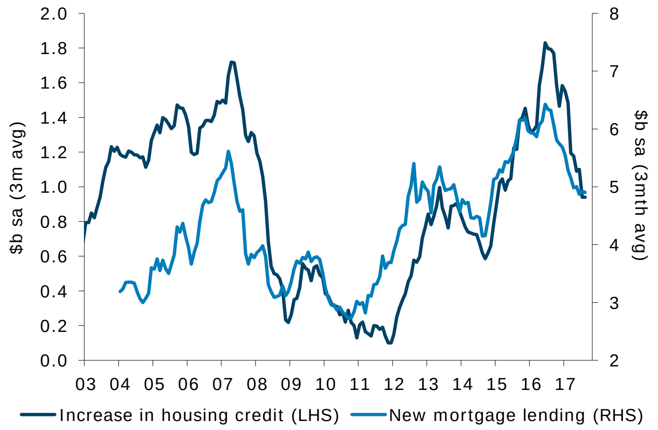
Source: ANZ, RBNZ

New residential mortgage lending figures are published by the RBNZ. They can provide leading information on household credit growth and housing market activity.

New mortgage lending bounced in August (the chart is presented in 3-month average terms). We estimate that in seasonally adjusted terms, new lending rose 6.0% m/m to $5.05bn, following falls in both June and July. In fact, this is only the fourth increase in the past 12 months, with lending still down 16% y/y.

New investor lending continues to be weak. In August, lending to investors was down 36% y/y, making up only 22% of total lending. That is the lowest share since these figures started being released in August 2014.

Figure 9. New mortgage lending and housing credit



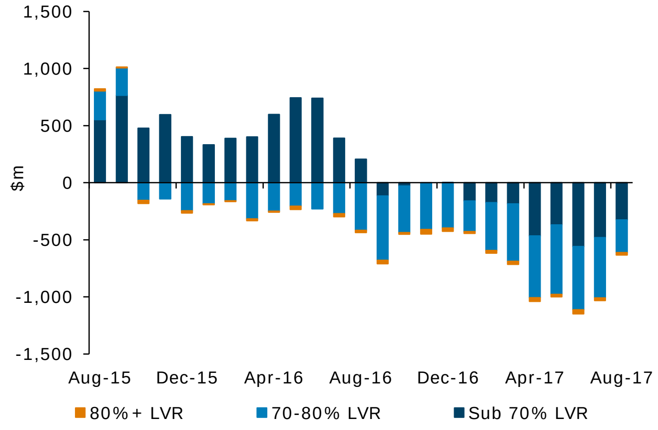
Source: ANZ, REINZ, RBNZ

Total household lending growth remained modest in August, at 0.4% m/m (sa). In three-month annualised terms, lending growth continued to ease to 5.2%, which is the softest growth since 2014 and well down from the 10% pace recorded in August 2016.

High-LVR lending restrictions, increased credit rationing by banks, and evolving expectations regarding capital gains – all are having a marked impact on both house sales and credit availability. Add in election uncertainty and we would not be surprised to see mortgage lending growth remain at this more moderate pace over the coming months.

THE PROPERTY MARKET IN PICTURES

Figure 10. Annual change in investor lending by LVR

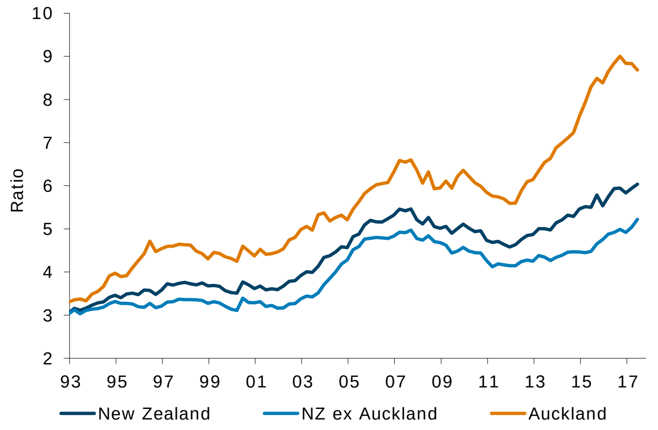


Source: ANZ, RBNZ

New lending to investors is well off its mid-2016 peak. It was down 36% y/y in August. Investors' share of overall new lending, at 22%, is well down from a peak of 35% in June 2016. This is no doubt related to the latest round of RBNZ LVR restrictions, which officially came into force on 1 October 2016, but could also reflect uncertainty around the upcoming election and the housing market outlook in general.

Related to the LVR restrictions, a larger share of new lending is on less-risky terms. In August, the share of total investor lending done at LVRs of less than 70% was 89%. That is a far greater share than in late-2014, when it was less than half.

Figure 11. Regional house prices to income

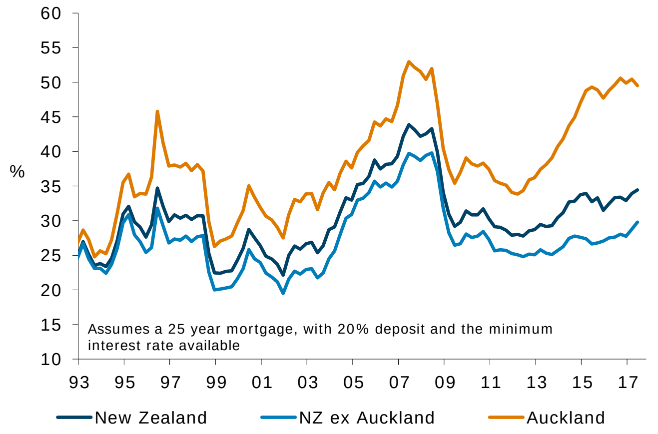


Source: ANZ, REINZ, Statistics NZ

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 broadly stable at around 6 times income for the past 12 months. Auckland, however, has seen its ratio ease from a high of 9 times in September last year to an estimated 8.7 times in the June quarter. While still extremely high, the easing reflects recent house price falls. Outside of Auckland, the ratio has continued to rise, and at 5.2 times, is now a little over where it peaked in 2007.

Figure 12. Regional mortgage payments to income



Source: ANZ, 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 around 34.5% at the moment.

However, once again there are stark regional differences, with the average mortgage payment to income in Auckland just short of 50% for new purchasers. While (just) off its highs, it is still broadly on par with the highs reached in 2007, despite mortgage rates being near historic lows currently. It highlights how sensitive some recent home-buyers in Auckland would be to even a small lift in interest rates.

PROPERTY GAUGES

There are clear opposing forces impacting the housing market. On the one hand, strong population growth coupled with a challenged supply backdrop argues that a fundamental supply-demand imbalance will continue to drive prices higher. Yet this is going head-to-head with a base in the interest rate cycle, tighter lending standards, LVR restrictions and affordability constraints. If it were all about a demand and supply imbalance, then rents should be rising faster than they are. Political uncertainty adds another layer of caution. We see prices plateauing for now.

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.

Indicator	Level	Direction for prices	Comment
Affordability	Unaffordable	↔/↓	Affordability constraints are clearly relevant. It is the main reason the Auckland market is underperforming, in our view.
Serviceability/ indebtedness	High debt and low rates okay. High rates not.	↔/↓	Looks okay so long as interest rates stay low and the unemployment rate keeps trending lower.
Interest rates / RBNZ	Slow ascent	↔/↓	The case can be argued that the OCR is not moving for a long time. We're still favouring a couple of OCR hikes eventually.
Migration	Peaking	↔/↑	In the political crosshairs, but looks to have peaked anyway. Any fall to be gradual.
Supply-demand balance	Demand > Supply	↔/↑	We need to be building 35-40k plus dwellings, not ~30k.
Consents and house sales	Shortage	↔/↑	Dwelling consent issuance ultimately flat-lining around 30k annualised.
Liquidity	Tight	↔/↓	Credit rationing still apparent, although closure of bank funding gap suggests a little more wriggle room.
Globalisation	Mixed bag	↔	Non-resident buyers no longer that influential. Other big global housing markets cooling a little too.
Housing supply	Too few	↔/↑	Fewer builders + higher construction costs + less credit + pressure on margins = supply struggles to keep up.
House prices to rents	Too high	↔/↓	Rents are not moving up much. That suggests the argument that housing shortages are the key market driver is fiction.
On balance	**Flat-lining**	↔	**Positives offsetting the negatives, leaving the market in limbo. Auckland weaker as affordability bites more.**

PROPERTY GAUGES

Figure 1: Housing affordability

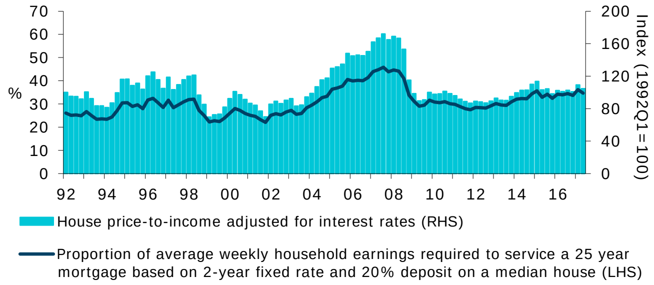


Figure 2: Household debt to disposable income

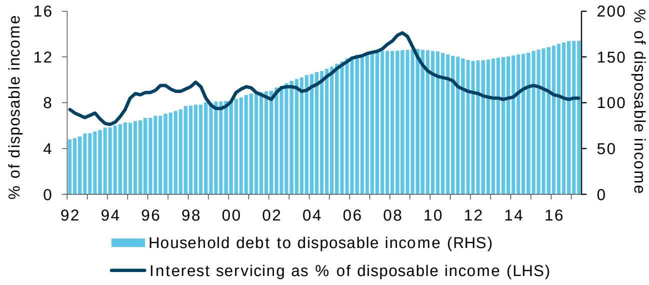


Figure 3: New customer average residential mortgage rate (<80% LVR)

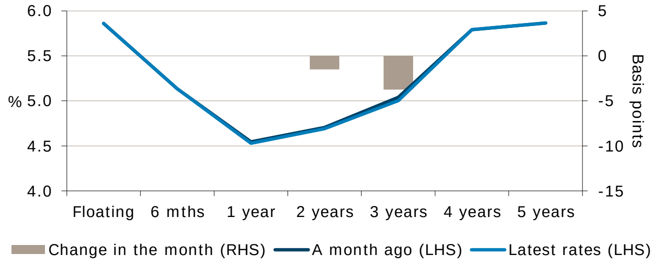


Figure 4: Net migration

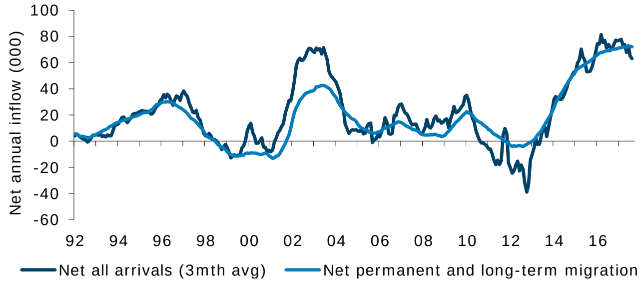


Figure 5: Housing supply-demand balance

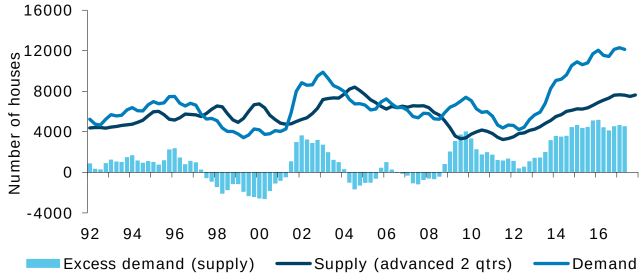


Figure 6: Building consents and house sales

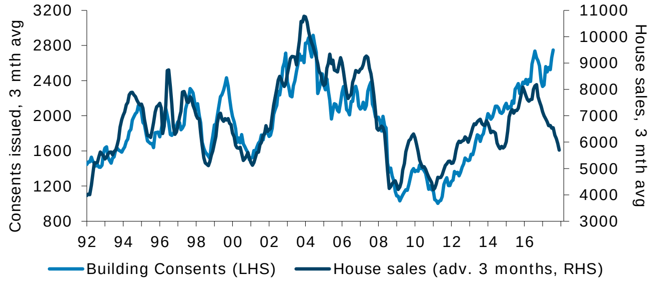


Figure 7: Liquidity and house prices

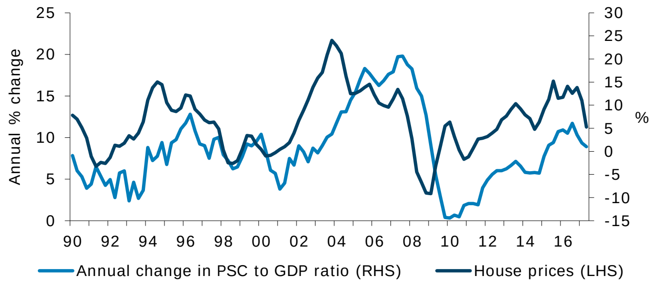


Figure 8: House price inflation comparison

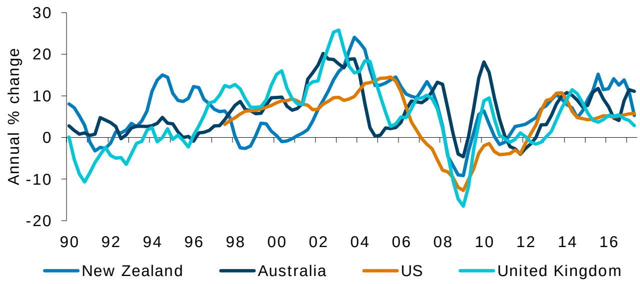


Figure 9: Housing supply

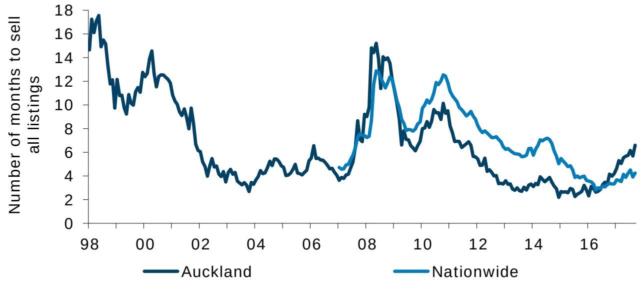
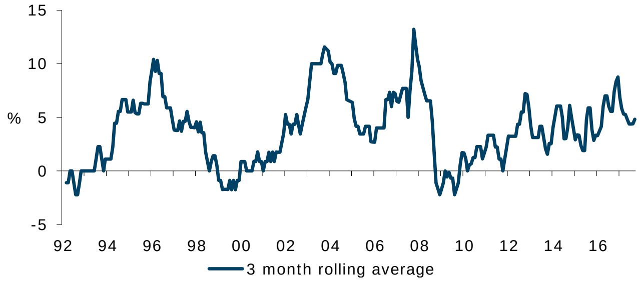


Figure 10: Median rental, annual growth



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

ECONOMIC OVERVIEW

SUMMARY

The economy is performing in a solid, albeit unspectacular manner. Headline growth is respectable; per capita growth and productivity growth are not. The drivers of the economic expansion are evolving (peak construction and migration, but commodity prices, fiscal stimulus and household income prospects are set to add some impetus). At the same time, there are also headwinds from housing weakness and capacity constraints. We are a little more circumspect on the near-term growth picture – and an extended period of government policy uncertainty would accentuate that – but ultimately we see GDP growth holding in a 2½ to 3% range.

OUR VIEW

The economy is growing in a solid, albeit unspectacular manner. Our confidence composite remains elevated and the unemployment rate is trending lower. Headline GDP growth looks quite respectable. However, growth in per capita terms is far more modest and productivity growth remains disappointingly weak.

Some growth headwinds are currently being navigated. Some of these headwinds reflect natural late-cycle forces (difficulties finding skilled staff) while others reflect a necessary curbing of financial stability risks (housing excesses). Activity has also been dampened as banks have paid close attention to a sizeable funding gap. Credit growth has slowed as a result, although this has also helped to mitigate boom-bust risks. The weaker housing market, and the risks that this slowdown transmits across the wider economy, and heightened policy and political uncertainty, are immediate challenges that also need to be navigated. We are watchful.

These headwinds leave us a little more circumspect towards the near-term growth picture. History has taught us to be mindful of broader negative spill-overs from housing. Right now, those spill-overs look moderate, although job ads are falling in Auckland and recent retail spending trends have been soft. Irrespective of coalition outcomes, some degree of policy change is likely – society is demanding it. Change is not necessarily a bad thing, but it can be unsettling. The key is how it is communicated.

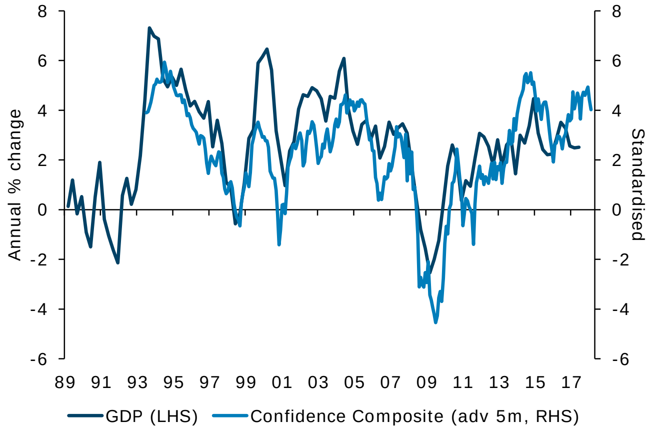
It is occurring at the same time as the economy's growth drivers are transitioning. Construction activity has peaked as the sector grapples with capacity, capital and cost pressures. Net migrant inflows have also topped out and face greater political scrutiny. Visitor arrivals growth has slowed. Yet broader activity growth should be supported by the likes of reasonable household income growth prospects, what is shaping as a large fiscal impulse, and the benefits of a near-record high in the terms of trade (the ratio of export prices to import prices).

Transitions are not always smooth, but we remain broadly constructive on the growth outlook overall. We see GDP growth holding in a 2½-3% range over the coming couple of years. That is broadly around trend.

Encouragingly, late-cycle excesses are less apparent than we've tended to see historically. The current account deficit is in check, net external debt is historically low and inflation is contained. Risks exist (household debt and Auckland housing), but late-cycle excesses are being more actively managed than they've been before.

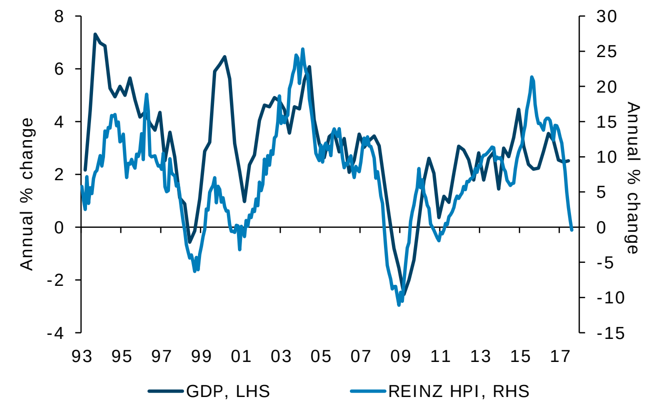
We remain biased towards OCR hikes in time. This is based on a belief that wage growth lifts modestly, the NZD falls as the global liquidity cycle turns and fiscal policy turns expansionary. However, it is hardly a conviction view. In fact, near-term risks mean the case for cuts can be made, although the hurdle for such action is high.

Figure 1. GDP vs Confidence Composite



Source: ANZ, Roy Morgan, Statistics NZ

Figure 2. House prices vs real GDP growth



Source: ANZ, Statistics NZ, REINZ

MORTGAGE BORROWING STRATEGY

SUMMARY

With average mortgage rates barely moving in the past month, our favoured views have not shifted at all. From a "lowest is best" perspective, the 1-year rate still stands out. And this is consistent with our expectation of the OCR being on hold for an extended period. Longer-term rates remain very low by historic standards and offer certainty. Some borrowers may wish to spread risk by borrowing over a number of fixed terms. The downside is that we struggle to see where inflation is going to come from to necessitate major lifts in the OCR.

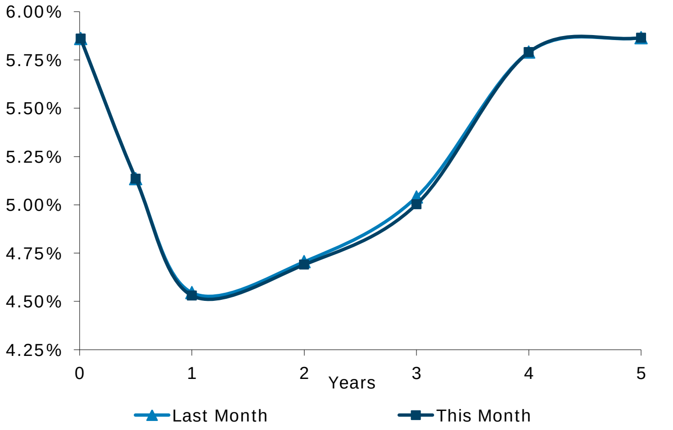
OUR VIEW

Average mortgage rates have barely moved in the past month. Rates in the 1-3 year space did fall, but we are talking about moves of less than 0.05%pts. The level and term structure of the "tick-shaped" mortgage curve is pretty much as it has been since January.

From a "lowest is best" viewpoint, the 1-year rate remains favoured. It has been the lowest point on the curve for some time now. It is also reinforced by our expectation that the OCR is on hold for an extended period. While the latest CPI figures for Q3 did come in a little stronger than the RBNZ's expectations, the forward-looking inflation picture is far more mixed, especially now that we have become a little more circumspect on the near-term growth backdrop. While it is true that we still have OCR hikes within our forecasts (from late 2018), it is hardly a conviction view, and the risk is that the OCR remains on hold for longer yet. And even so, if and when hikes do eventuate, they are likely to be in a tip-toe fashion, which keeps the "value" in rolling short-dated hedges.

Breakeven analysis shows that certainty can be provided for a modest cost, at least in the front part of the curve. For instance, the average two-year special rate is only 16 bps above the 1 year rate. The 1 year rate would need to rise by 32 bps (from 4.53% to 4.85%) over the next year in order for it to be cheaper fixing for 2 years at 4.69% than rolling two 1-year terms. **That's not a huge rise in the 1 year rate. So certainty looks "cheap".** There is a more notable step-up between the 2 year and 3 year (31bps); the breakeven on a 2 year at 4.69% versus a 3 year at 5.00% is 5.24%. While not out of the question, that extent of lift in the 2-year would require either more confidence that the OCR is moving up or the global inflation pulse is shifting. There are plenty of question marks around both dynamics right now.

Carded special mortgage rates^



Special Mortgage Rates		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.86%				
6 months	5.14%	3.93%	4.77%	4.93%	5.47%
1 year	4.53%	4.35%	4.85%	5.20%	5.63%
2 years	4.69%	4.77%	5.24%	5.99%	6.89%
3 years	5.00%	5.44%	6.21%	6.44%	6.65%
4 years	5.79%	5.91%	6.20%		
5 years	5.87%	#Average of "big four" banks			

Standard Mortgage Rates		Breakevens for standard mortgage rates*			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.86%				
6 months	5.21%	4.68%	5.61%	5.17%	5.88%
1 year	4.95%	5.14%	5.39%	5.52%	6.03%
2 years	5.17%	5.33%	5.71%	6.03%	6.57%
3 years	5.45%	5.73%	6.17%	6.37%	6.67%
4 years	5.87%	6.06%	6.35%		
5 years	6.07%	*may be subject to a low equity fee			

Some borrowers may wish to spread their borrowing over a number of fixed terms. That makes sense from a risk-management perspective, and having a number of tranches rolling over more regularly does smooth interest expenses. We're also mindful that we do still expect rates to ultimately rise rather than fall – even if we think the rise will occur later rather than sooner. That may leave some borrowers feeling a bit nervous, and make them more inclined to select a longer term. **These are all valid considerations**, even if, as noted, a pure cost emphasis would shift the focus towards the 1 year and possibly some in the 2 year part of the curve.

^ Average of carded rates from ANZ, ASB, BNZ and Westpac. Sourced from interest.co.nz

KEY FORECASTS

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

Mortgage Size ($'000)	Mortgage Rate (%) 4.00	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25
200	243	250	256	263	270	276	283	290	297	304	311	319	326	333
250	304	312	320	329	337	345	354	363	371	380	389	398	407	417
300	365	375	385	394	404	415	425	435	446	456	467	478	489	500
350	426	437	449	460	472	484	496	508	520	532	545	558	570	583
400	487	500	513	526	539	553	566	580	594	608	623	637	652	667
450	548	562	577	592	607	622	637	653	669	684	701	717	733	750
500	609	625	641	657	674	691	708	725	743	761	778	797	815	833
550	669	687	705	723	741	760	779	798	817	837	856	876	896	917
600	730	750	769	789	809	829	850	870	891	913	934	956	978	1,000
650	791	812	833	854	876	898	920	943	966	989	1,012	1,036	1,059	1,083
700	852	874	897	920	944	967	991	1,015	1,040	1,065	1,090	1,115	1,141	1,167
750	913	937	961	986	1,011	1,036	1,062	1,088	1,114	1,141	1,168	1,195	1,222	1,250
800	974	999	1,025	1,052	1,078	1,105	1,133	1,160	1,188	1,217	1,246	1,274	1,304	1,333
850	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233	1,263	1,293	1,323	1,354	1,385	1,417
900	1,095	1,124	1,154	1,183	1,213	1,244	1,274	1,306	1,337	1,369	1,401	1,434	1,467	1,500
950	1,156	1,187	1,218	1,249	1,281	1,313	1,345	1,378	1,411	1,445	1,479	1,513	1,548	1,583
1000	1,217	1,249	1,282	1,315	1,348	1,382	1,416	1,451	1,486	1,521	1,557	1,593	1,630	1,667

Housing market indicators for September 2017 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	14.0	4.0	192	+1%	43
Auckland	0.0	-0.7	1,582	-10%	40
Waikato	4.5	0.4	552	-6%	38
Bay of Plenty	7.5	-2.1	413	-13%	40
Gisborne	15.7	-3.5	54	+11%	33
Hawke's Bay	18.4	8.4	187	-14%	29
Manawatu-Whanganui	8.3	1.6	336	-4%	30
Taranaki	3.6	1.3	177	+15%	45
Wellington	10.5	-1.1	611	-11%	28
Tasman, Nelson and Marlborough	4.8	-2.2	186	-13%	28
Canterbury	-3.2	-2.4	742	-10%	36
Otago	5.9	2.1	351	-5%	33
West Coast	-16.4	-2.4	35	-8%	108
Southland	10.6	4.5	143	-8%	31
NEW ZEALAND	**1.0**	**-1.0**	**5,406**	**-10%**	**36**

Key forecasts

	Actual			Forecasts						
Economic indicators	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**
GDP (Ann Avg % Chg)	3.0	3.0	2.7	2.5	2.6	2.7	2.8	2.9	2.9	3.0
CPI Inflation (Annual % Chg)	1.3	2.2	1.7	1.9(a)	1.6	1.2	1.7	1.9	2.1	2.2
Unemployment Rate (%)	5.2	4.9	4.8	4.8	4.7	4.6	4.5	4.4	4.4	4.3
Interest rates (RBNZ)	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**
Official Cash Rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.25
90-Day Bank Bill Rate	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.1	2.3	2.5
Floating Mortgage Rate	5.7	5.8	5.9	5.9	5.9	5.9	5.9	5.9	6.1	6.4
1-Yr Fixed Mortgage Rate	4.9	5.1	5.1	5.0	5.1	5.1	5.1	5.2	5.4	5.5
2-Yr Fixed Mortgage Rate	5.1	5.3	5.3	5.3	5.3	5.3	5.4	5.5	5.7	5.7
5-Yr Fixed Mortgage Rate	5.9	6.3	6.3	6.3	6.3	6.3	6.4	6.6	6.7	6.8

Source: ANZ, Statistics NZ, RBNZ

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