ANZ RESEARCH

NEW ZEALAND ECONOMICS
ANZ PROPERTY FOCUS

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INSIDE

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GREAT EXPECTATIONS

SUMMARY

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

THE 2016 ANZ PROPERTY INVESTORS SURVEY

Confidence about buying property remains high. The proportion of investors planning to buy more properties rose to the highest since 2009, and investors are optimistic over returns (both capital gains and rental income) for both the year ahead and longer term. In terms of what is keeping property investors up at night, LVR restrictions and other regulatory changes are up there, but are trumped by the risk of damage to property, especially from methamphetamine. While the RBNZ's tightening of the LVR restrictions is certainly causing concern amongst property investors that it will cramp their style, there appears to be little concern that the restrictions could topple the housing market. Cyclical risks such as lower returns barely warranted a mention.

PROPERTY GAUGES

Affordability metrics, stretched valuations and leveraging behaviours (all warning signs) continue to go head-to-head with a market that remains with a shortage and abundant demand being fuelled by migration and low interest rates. This leaves the overall market somewhat in limbo. It is stretched valuation-wise and each nudge higher in price raises the risk profile on a correction, but not with the same level of vulnerabilities we've seen at the height of previous cycles.

ECONOMIC OVERVIEW

Momentum in the economy is strong and the expansion has some legs yet. But with the cycle entering a mature phase, key focal points and challenges will be finding skilled labour and ensuring late-cycle excesses (credit and housing) are not the precursors to a downturn. The latter requires credit growth to ease up, and this – in association with capacity constraints – is a key reason we expect GDP growth to ease from a strong to solid pace over the coming two years. A continuation of current excesses would up the ante on a correction down the track.

MORTGAGE BORROWING STRATEGY

Mortgage rates are again virtually unchanged compared with a month ago, with small tweaks to some specials but no changes to carded rates. The mortgage curve remains tick-shaped, with the low point being the 1 year. Looking ahead, we expect an OCR cut in November, but this is almost fully priced into the term structure of wholesale rates; all else equal, this suggests we won't see term rates fall by much when the cut is confirmed. Beyond that we expect the Reserve Bank (RBNZ) to maintain an easing bias, keeping a lid on interest rates. While the domestic economy says rates should be higher, inflation says otherwise, leaving markets in limbo. We prefer to target low cost 1-2 year fixed rates.

THE 2016 ANZ PROPERTY INVESTORS SURVEY

SUMMARY

The ANZ Property Investors' Federation Investor Survey provides a timely snapshot of the views of residential property investors. Key insights from this year's survey include:

- Confidence about buying property remains high. The proportion of investors planning to buy more properties rose to a net 69% of respondents, the highest since 2009, with investors optimistic over returns for both the year ahead and longer term.
- Average house price expectations have risen, reflecting that property market strength has spread around the country. Nearly 60% of investors expect price gains of at least 6% over the next 12 months.
- Auckland house price expectations are still very strong but have been overtaken by the rest of the North Island.
- Investors expect to have their cake and eat it too: rental growth expectations for the next year are also strong outside of Canterbury, with short-term growth expectations the highest in the upper North Island.
- In terms of what is keeping property investors up at night, LVR restrictions and other regulatory changes are certainly up there, but are trumped by the risk of damage to property, especially methamphetamine contamination.

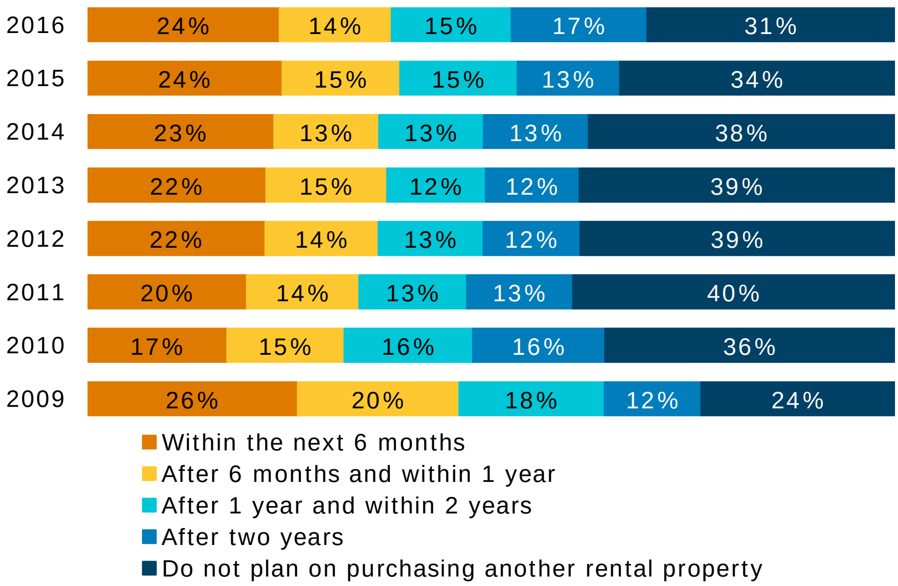
These sorts of results suggest that while the RBNZ's tightening of the LVR lending restrictions is certainly causing wariness amongst property investors that they will not be able to invest on the scale they would prefer to, there appears to be little concern that the restrictions could topple the housing market. With migration set to stay strong and interest rates set to stay low, this is understandable. Previous rounds of LVR restrictions had a very real impact on the housing market, but it was short-lived.

INVESTOR CONFIDENCE STILL PERKY

The 2016 ANZ/Property Investors' Federation survey of New Zealand residential property investors was released this month. In this article we outline a few of the key insights and offer comment.

Residential property investors remain confident and are looking to buy more properties (see Figure 1). Like last year, almost a quarter of survey respondents plan on buying another property in the next six months.

FIGURE 1: SURVEYED INTENTIONS TO BUY MORE PROPERTY



Source: NZPIF, Camorra Research, ANZ Research

THE 2016 ANZ PROPERTY INVESTORS SURVEY

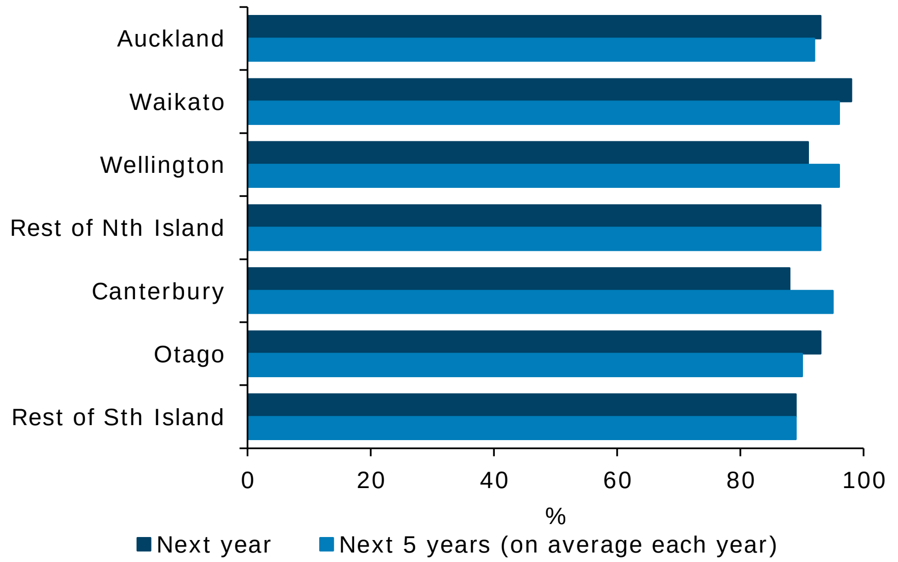
Average portfolio sizes have remained stable over the past four years. Investor strategies have also been consistent over this period. Investors continue to see property as a long-term investment, with almost 90% indicating that they intend to hold on to their property for the longer term. There was no evidence of an impact from the new "bright-line" 2-year capital gains tax test, with a small lift in the proportion of investors who were planning to renovate/develop and sell.

Debt/value ratios decreased for a second year, with the main reported reason being higher house prices. The proportion of investors with LVRs over at least 90% halved from 6% to 3%. It is encouraging that the sector on average has not leveraged up significantly, but given it was due to increases in house prices rather than debt reduction it is probable debt-to-income ratios have not improved to the same extent – if at all.

Property investors are very optimistic about the price outlook for both the year ahead and further out. Nearly 60% of investors expect price gains of at least 6% over the next 12 months (versus 51% last year).

Given the recent runaway increases in prices in the regions around Auckland, it is perhaps not surprising that investors in the North Island have the highest expectations for value increases during the next year, with Waikato leading the charge. Canterbury investors have the most conservative short-term expectations but think values will increase at a greater rate over the longer term (Figure 2).

FIGURE 2: PERCENTAGE EXPECTING ANNUAL PROPERTY VALUE INCREASES BY REGION



Source: NZPIF, Camorra Research, ANZ Research

But the higher prices go of course, the harder it is for them to keep going up. Given that Auckland has one of the most stretched affordability ratios in the world, any further house price increases from here ups the ante on a correction to bring affordability metrics back into line. While impossible to pinpoint a date, we need to consider candidates for a turn. We could see an outright fall in house prices courtesy of higher interest rates or an economic recession (likely global-led). Conversely, we could see a stagnation of house prices while incomes catch up. The latter would obviously be a preferable adjustment path and that is the path New Zealand has followed before. But with low inflation worldwide it's difficult to envisage inflation and incomes doing the work at the moment. Were we to see a deep recession, the widespread belief that New Zealand (or at least Auckland) house prices never fall too far could be sorely tested. While owner-occupier property prices tend not to correct downward too far (people just take their house off the market and stay put), the same cannot be said for land prices, apartments or investment properties, which do tend to move in line with the economic cycle.

Housing supply is of course the other half of the equation. The Government is pushing on all the strings it can find in order to get more Auckland housing supply on stream as quickly as possible. Excluding new builds from the LVR restrictions was also aimed at encouraging housing supply. However, there are numerous roadblocks to house-building on a scale that would rapidly dent house price inflation:

THE 2016 ANZ PROPERTY INVESTORS SURVEY

- With net migration so strong, the construction sector is running to stand still;
- Capacity constraints and resulting cost increases in the construction sector;
- Low productivity growth within the construction sector;
- Infrastructure needs in association with new houses;
- Banks reaching their self-imposed limits on exposure to the property development sector, and a dearth of funding for finance companies to plug the gap. Put simply, lending on housing is more risky at this juncture of the cycle, despite the market still showing a shortage;
- Regulation, including the Resource Management Act;
- Land banking and land prices more generally;
- Consumer attitudes and expectations regarding what their first home should be;
- Strong opposition to intensification in some areas.

That's a non-exhaustive list but still quite a catalogue!

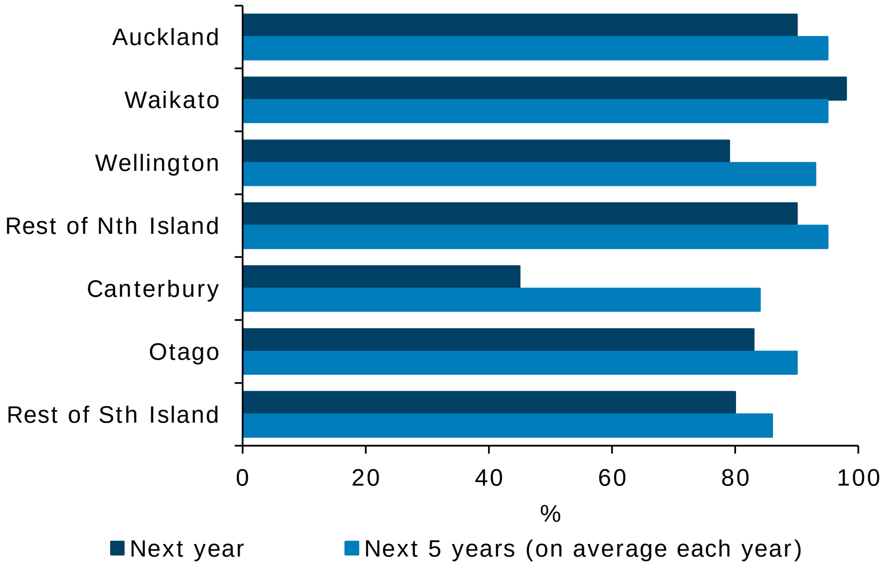
Evidence is now mounting that the tighter loan-to-value ratio restrictions that have just come into effect are cooling the housing market. House sales are down nearly 10% versus a year ago and houses are taking longer to sell (though the market is still incredibly tight). Typically, house prices follow sales with a 3-6 month lag. House price inflation is already easing and we expect it to continue to do so. Given this, investors' house price expectations look overcooked.

That said, **previous rounds of LVR restrictions proved to have relatively short-lived impacts on the housing market**, so investors may be assuming the same will occur this time. Nearly a third of investors say that the restrictions have impacted on their strategy in the past 12 months (versus 16% the year before), and nearly half of these investors said they have not bought a property they would otherwise have done. Nearly 30% say they are less likely to buy another property in the next 12 months than they would have been otherwise. But **bullish house price inflation expectations suggest that investors are not extrapolating from how LVR restrictions have affected their own decisions to how they may impact on the broader market.** Their concern is obviously that restrictions might stop them jumping on the bandwagon, but there's little concern that the bandwagon might be slowing down or heading for a cliff as a result of those measures. As long as net migration stays high and interest rates low, they may well be proven right. But a near-term decline in house price inflation is now baked in, given the recent fall in sales. And given the extreme affordability stretch, yet another surge down the track is far from a given.

Investors also expect increases in rental income, particularly in Auckland where there is a genuine housing shortage as a result of exceptionally strong net migration. Other regions haven't experienced the same level of population growth, but with a strong economy and labour market, landlords appear confident they can charge more and still find a tenant. The only region bucking this trend is Canterbury, where investors have more modest expectations with regards to rental growth as the earthquake rebuild effort starts to slow (Figure 3).

THE 2016 ANZ PROPERTY INVESTORS SURVEY

FIGURE 3: PERCENTAGE EXPECTING ANNUAL RENT INCREASES BY REGION

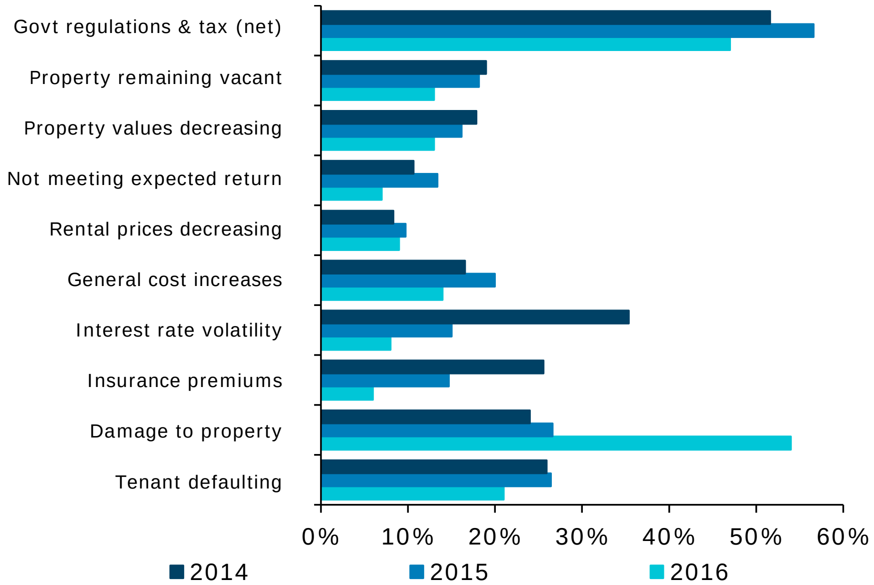


Source: NZPIF, Camorra Research, ANZ Research

In terms of the concerns property investors have, property damage was the number one for 54% of respondents, with methamphetamine damage cited as a concern by 38% of investors. In the Waikato, more than 60% cited it as a key risk of being a landlord. **Government regulations/tax was number two (47%)**, with LVR restrictions no doubt front-of-mind here.

Tellingly, cyclical/economic risks barely rated a mention when respondents were asked to identify their key risks. This reflects a strong – possibly overly strong – degree of confidence in housing as an investment currently. The risk that tenants default on payments, that the property remains vacant, that property values could fall, that they may not meet their expected return – all these concerns were less of an issue compared to the previous year's survey, with only a small minority concerned about each of them. Interest rate volatility is, not surprisingly, hardly a concern – 8% cited it versus over a third two years ago. The re-jig of the insurance market also appears to have washed through, with only 6% citing insurance premiums as a concern versus nearly 40% in 2013.

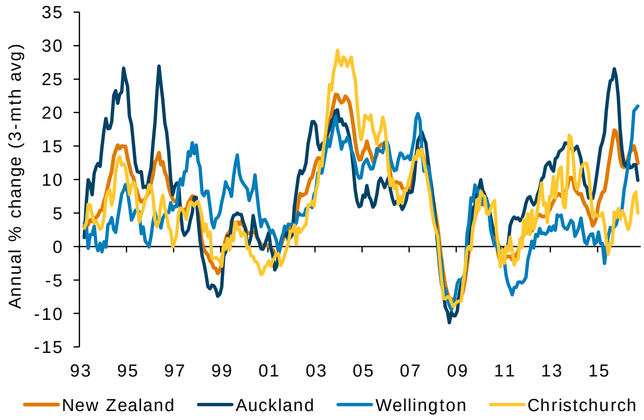
FIGURE 4: RESIDENTIAL PROPERTY INVESTORS' PERCEIVED RISKS



Source: NZPIF, Camorra Research, ANZ Research

THE PROPERTY MARKET IN PICTURES

FIGURE 1. REGIONAL HOUSE PRICES

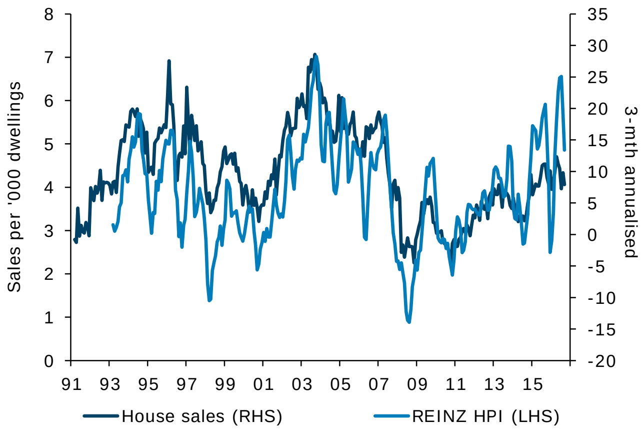


Source: ANZ, REINZ

Nationwide house prices rose in September, but momentum is softening. Our preferred measure of prices (the REINZ stratified measure) showed nationwide prices rising 1.3% sa (1.7% q/q) in September, although this only partially reverses a 2.2% drop in August. In annualised terms (3-month average), price growth has cooled to a still-strong 13% pace, although this is down from the 25% growth rate recorded in June and July.

Across the regions, Auckland annualised (3-month average) price growth is close to the nationwide rate at 13%, while it is close to 25% in Wellington. South Island prices, excluding Christchurch, are running at 15% annualised pace.

FIGURE 2. REINZ HOUSE PRICES AND SALES



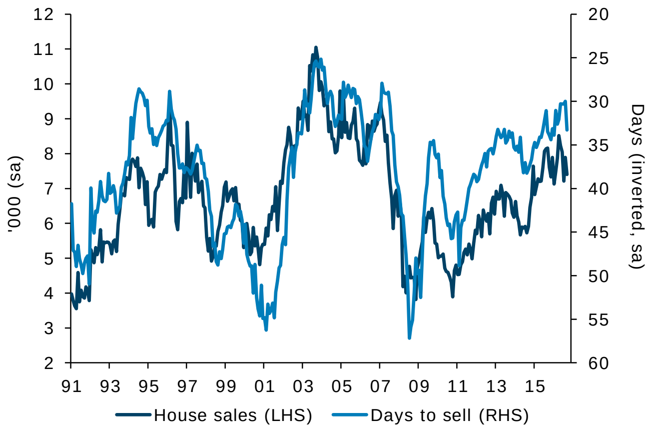
Source: ANZ, REINZ

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

Seasonally adjusted sales volumes fell 6.2% m/m in September, which is the fourth fall in the past five months. Compared with a year ago, volumes are now down 9.3%. This weaker trend is relatively broad based across the country, although particularly pronounced in Auckland, where volumes are down 23% y/y. Excluding Auckland, nationwide sales volumes are 0.9% lower than a year ago.

The weaker trend in sales activity does hint at a continuation of the recent moderation in house price going forward. That said, with some of it likely due to a lack of available property listings, there are still some price-supportive elements to it.

FIGURE 3. SALES AND MEDIAN DAYS TO SELL



Source: ANZ, REINZ

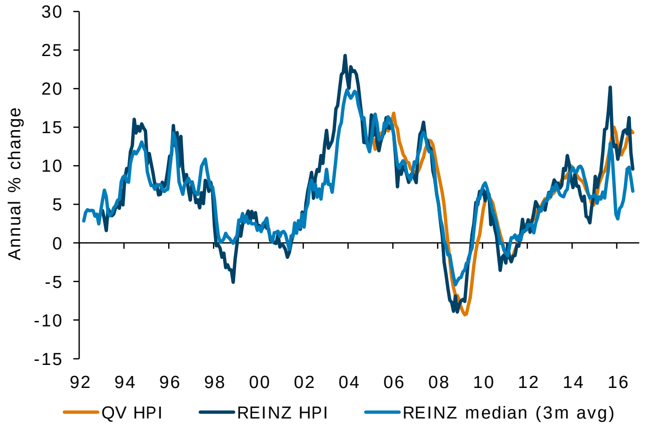
The length of time it takes to sell a house is also an indicator of the strength of the real estate market. It encompasses both demand and supply-side considerations.

Nationally, the median time to sell a house rose by 3.3 days in September to 33.3 days (sa). While this is still well below the historical average of 38 days, it is an eight month high and does suggest that while weaker sales activity is in part due to a lack of supply, softer demand may also now be contributing.

Over the past 12 months, the median time to sell a house has risen most dramatically in Auckland (+4.3 days) – though that is off a very low level. Average days to sell are still quite a lot lower than they were in the likes of Taranaki, Manawatu, Hawke's Bay and Southland.

THE PROPERTY MARKET IN PICTURES

FIGURE 4. REINZ AND QV HOUSE PRICES

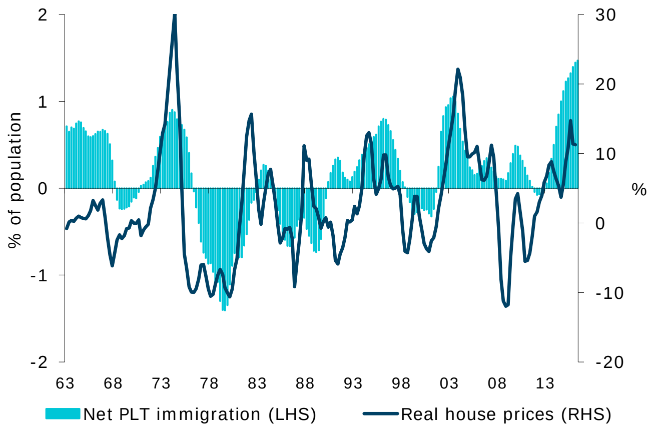


Source: ANZ, REINZ, QVNZ CoreLogic

There are three key measures of house prices in New Zealand: the median and stratified house price measures produced by REINZ, and the monthly QVNZ house price index published by Property IQ. 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 (which reached a new record high of $520K in seasonally adjusted terms) **was up 6.0% y/y in September.** This remains below both the REINZ stratified and the QVNZ measure of price growth (9.6% and 14.3% y/y respectively), which adjust for difference in the quality of houses sold.

FIGURE 5. NET PLT IMMIGRATION AND HOUSE PRICES



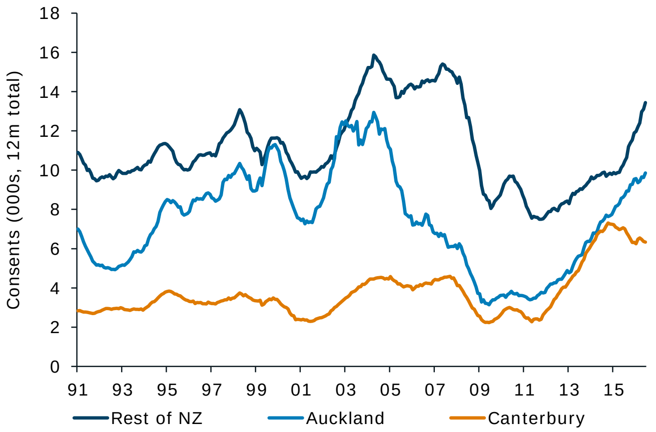
Source: ANZ, Statistics NZ, QVNZ

Migration flows to and from New Zealand are one of the major drivers of housing market cycles. The early-1970s, mid-1990s and mid-2000s booms coincided with large net migration inflows.

On a three-month annualised basis, net permanent and long-term migration rose to a strong 70.6K in September, which is around 1½% of the resident population and close to all-time highs. More arrivals and fewer departures have both contributed to this large net inflow.

We are not expecting annual net inflows to ease back to the long-run average of around 15K any time soon. Due to its economic outperformance, perceived safety and political ructions elsewhere, New Zealand will remain an attractive destination for migrants.

FIGURE 6. RESIDENTIAL CONSENTS



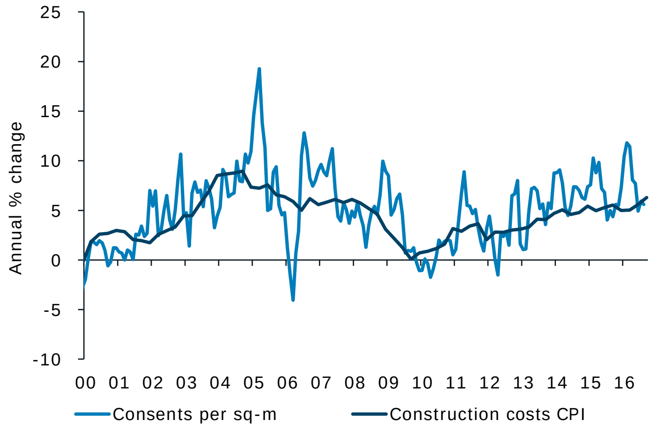
Source: ANZ, Statistics NZ

Nationwide residential consent issuance has been strengthening. On a three-month annualised basis, total issuance was running at close to 33K in August, which is the strongest since mid-2004.

A large part of the increase has been due to the Auckland region (annual issuance of 9.9K, which is the highest since mid-2005), although growing capacity pressures may slow the ascent from here. Canterbury issuance continues to ease off its highs, which is consistent with other evidence suggesting that the residential component of the earthquake is past its peak. Positive trends have been clearly evident in the likes of Wellington and other regional North Island areas. In fact, issuance in these regions is now accelerating strongly.

THE PROPERTY MARKET IN PICTURES

FIGURE 7. CONSTRUCTION COST INFLATION

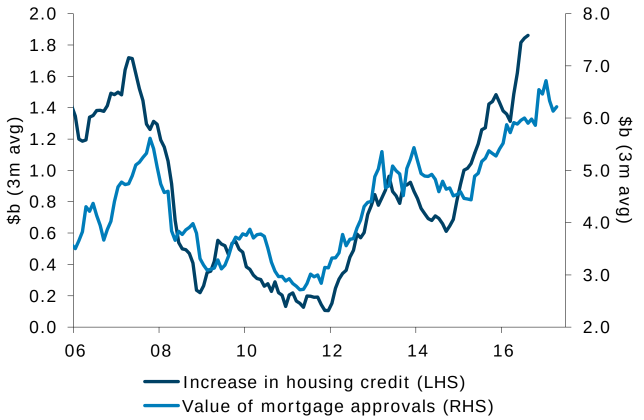


Source: ANZ, Statistics NZ

On a three-month average basis, **the value of residential consents per square metre was up *only* 5.6% y/y in August, which is below the strong rates of growth experienced earlier in the year.** However, because it is a volatile measure, we are not reading much into it at this stage. In fact, is fully consistent with the upward trend seen in the construction cost component of the CPI, which sat at 6.3% y/y in Q3 (7.9% y/y for Auckland).

Our internal anecdotes continue to highlight that capacity pressures in the construction sector are reasonably intense, and not limited to any one region. Forward books are generally full, and in some cases work is reportedly being turned away. Difficulty finding the appropriate staff (or any staff) is a common theme in the sector.

FIGURE 8. MORTGAGE APPROVALS & HOUSING CREDIT



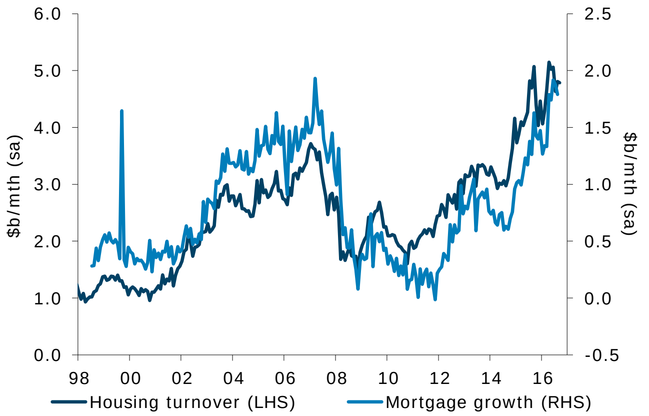
Source: ANZ, RBNZ

Weekly housing loan approval figures are published by the RBNZ (although they will be discontinued shortly and have been replaced by an alternative measure). These tend to provide leading information on the state of household credit and housing market activity.

The mid-2015 surge in approvals preceded the strengthening in mortgage borrowing and housing market lift as investors rushed to get into the market prior to the looming Government and RBNZ regulatory changes.

Approvals values, while at a strong level, have eased modestly off their highs of late and signal that a peak in housing credit growth may be close at hand.

FIGURE 9. HOUSE TURNOVER AND MORTGAGE GROWTH



Source: ANZ, REINZ, RBNZ

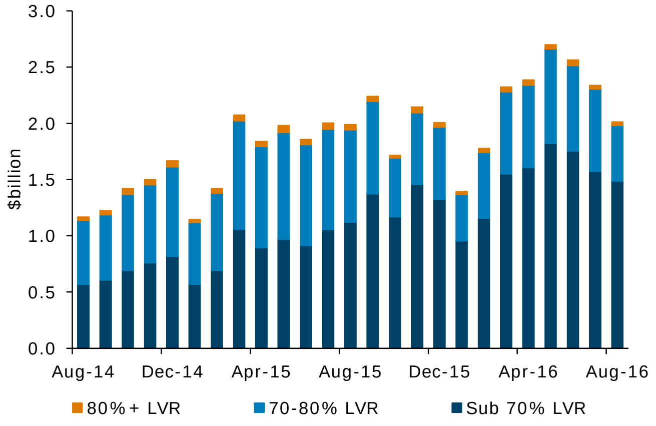
The overall stock of mortgages has been growing strongly, with a 3-month annualised pace of over 10% in August. However this is not as strong as, say, the lift in house sales values, which have effectively been at all-time highs.

The high-LVR lending restrictions that have been in place since October 2013 have played a role in slowing the pick-up in mortgage borrowing. They have since been tightened twice more (in November 2015 and October 2016), which should see mortgage borrowing growth moderate further.

But a key element explaining why mortgage borrowing growth has been more contained than the past is that existing mortgage holders are using current low interest rates to maintain regular payments and reduce principal.

THE PROPERTY MARKET IN PICTURES

FIGURE 10. INVESTOR LENDING BY LVR

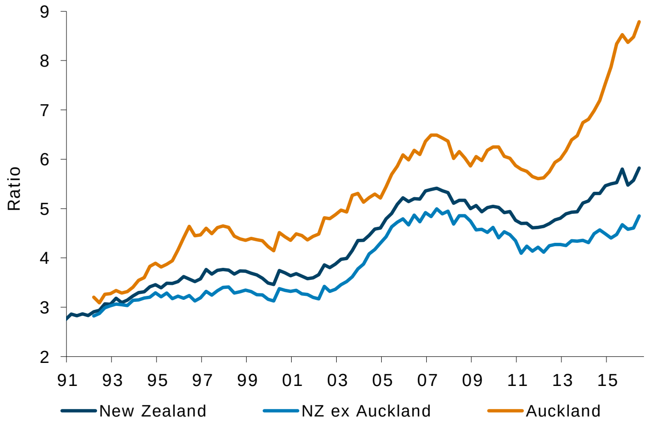


Source: ANZ, RBNZ

There are now some signs that the growth in new investor lending has begun to cool, which is no doubt related at least in part to the latest round of RBNZ LVR restrictions (which banks largely implemented ahead of the official 1 October start date). In August, new investor lending was up just 1.2% y/y, making up 32.9% of total new lending – the lowest share since October 2015.

As a share of total investor lending, lending done with LVRs in excess of 70% made up 26% of the total in August. This is down from 33% in July and over 50% in mid-2015. Moreover, 52% of new investor lending was on interest-only terms, which is the lowest share since February.

FIGURE 11. REGIONAL HOUSE PRICES TO INCOME

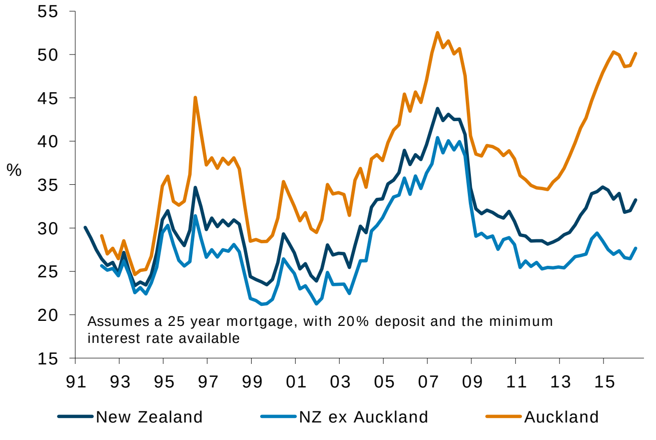


Source: ANZ, REINZ, Statistics NZ

One standard measure of housing affordability is the ratio of average house prices to income. It is a common measure used internationally to compare housing affordability across countries. That said, 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 sits just below a ratio of 6, which is slightly above the previous highs recorded prior to the GFC. However, there is a stark regional divide. We estimate the average house price to income in Auckland has now risen to close to 9 times, suggesting a severely unaffordable market. Elsewhere, the ratio is around 5 times, which is back where it peaked prior to the financial crisis.

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 takes into account the likes of interest rates, which are an important driver of housing market cycles.

We estimate that the average mortgage payment to income nationally is around 33% at the moment. Despite rising house prices it has fallen below its highs due to recent mortgage rate falls.

However, once again there are stark regional differences, with the average mortgage payment to income in Auckland around 50%. That is near the highs reached in 2007 despite mortgage rates being at historic lows currently. It highlights how sensitive some Auckland borrowers would be to even a small lift in interest rates.

PROPERTY GAUGES

Affordability metrics, stretched valuations and leveraging behaviours (all warning signs) continue to go head-to-head with a market that remains with a shortage and abundant demand being fuelled by migration and low interest rates. This leaves the overall market somewhat in limbo. It is stretched valuation-wise and each nudge higher in price raises the risk profile on a correction, but not with the same level of vulnerabilities we've seen at the height of previous cycles.

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 existing mortgage payments.

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 across the regions.

Indicator	Level	Direction for prices	Comment
Affordability	Still extended	↔/↓	House prices out of whack with incomes.
Serviceability/ indebtedness	Mixed bag	↔/↓	High debt and low rates is okay. High debt and rising rates wouldn't be.
Interest rates / RBNZ	Troughing	↔	Low inflation says lower rates whereas the strong growth says higher. This is a sign that rates are around their low point.
Migration	No let up	↔/↑	In a world of Brexit and American politics migration will not subside. Government is tightening up though.
Supply-demand balance	Too few houses	↔/↑	Rising consents but still not keeping pace with underlying demand.
Consents and house sales	More builders please	↔/↑	Consents are rising but just not fast enough.
Liquidity	Rationing	↓	LVR restrictions being applied, debt to income limits may be next, and banks are tightening credit at the top of the cycle.
Globalisation	Auckland vs Sydney	↔	Auckland is out of control but not in a global context.
Housing supply	Catch-up	↔/↑	Chasing a fast-moving target in part fuelled by strong migration.
House prices to rents	Extreme	↔/↓	The yield doesn't stack up; pray for continued capital gain.
On balance	**A slow rate of appreciation**	↔	**A rubber band that is taut valuation-wise but a market still in short supply.**

PROPERTY GAUGES

FIGURE 1: HOUSING AFFORDABILITY

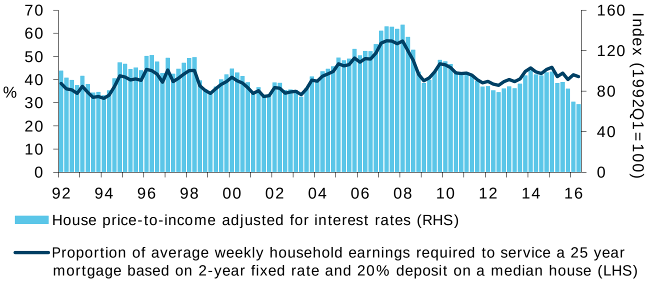


FIGURE 2: SERVICEABILITY AND INDEBTEDNESS

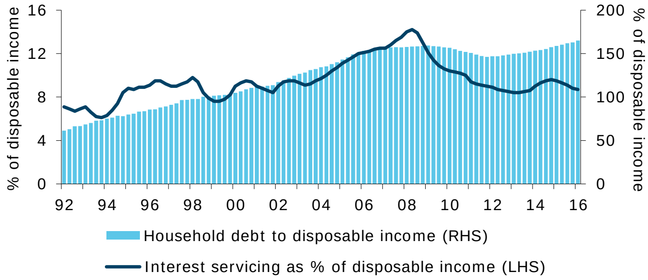


FIGURE 3: NEW CUSTOMER AVERAGE RESIDENTIAL MORTGAGE RATE (<80% LVR)

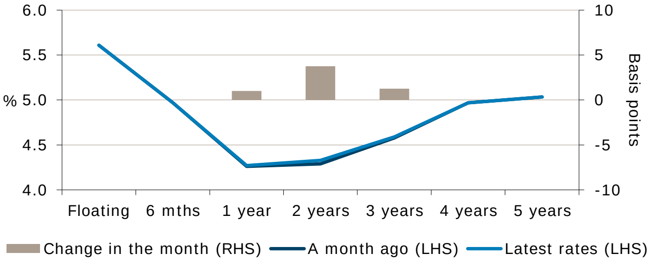


FIGURE 4: NET MIGRATION

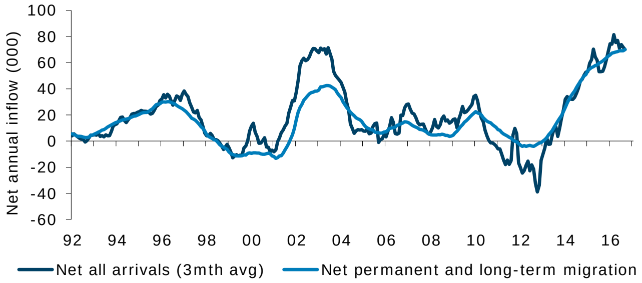


FIGURE 5: HOUSING SUPPLY-DEMAND BALANCE

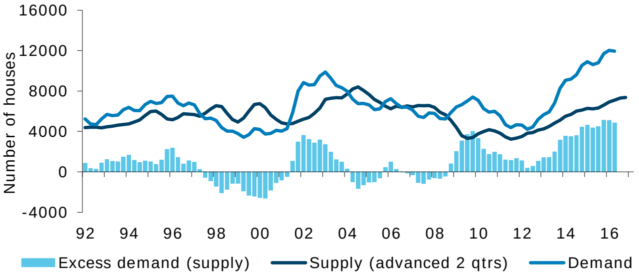


FIGURE 6: BUILDING CONSENTS AND HOUSE SALES

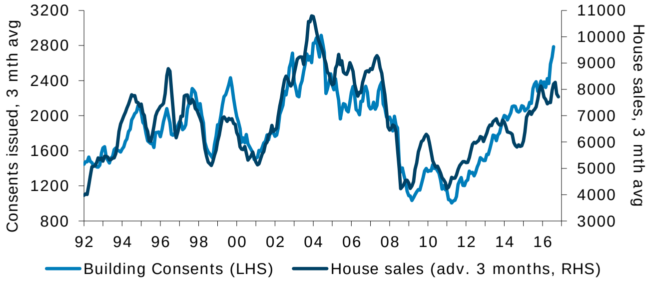


FIGURE 7: LIQUIDITY AND HOUSE PRICES

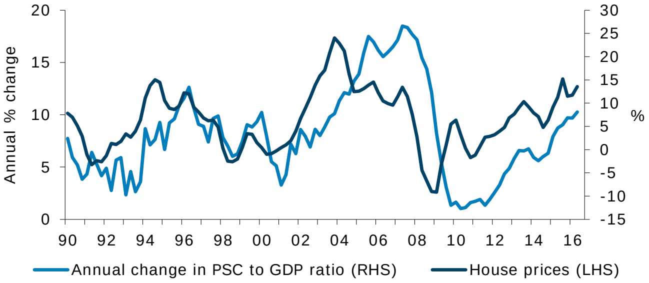


FIGURE 8: HOUSE PRICE INFLATION COMPARISON

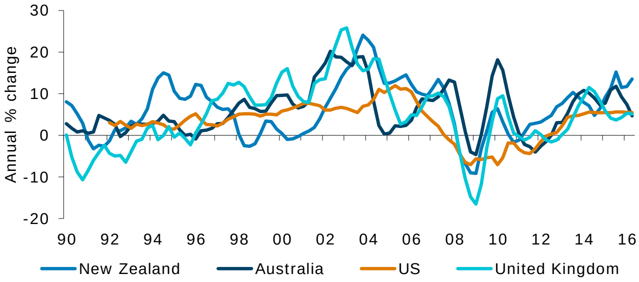


FIGURE 9: HOUSING SUPPLY

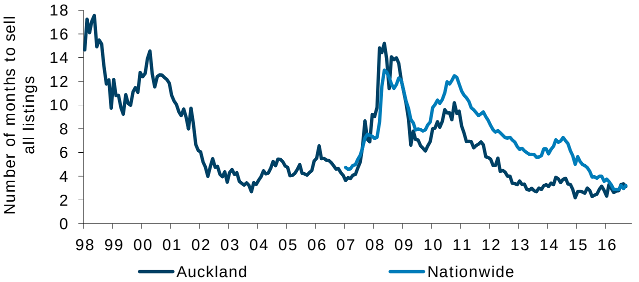
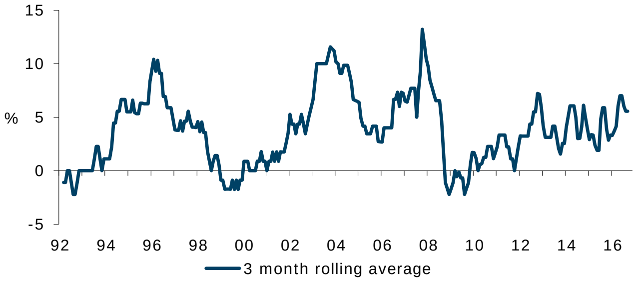


FIGURE 10: MEDIAN RENTAL, ANNUAL GROWTH



Source: ANZ, Statistics NZ, REINZ, RBNZ, QVNZ, Nationwide, Bloomberg, Barfoot & Thompson, www.realestate.co.nz, Department of Building and Housing.

ECONOMIC OVERVIEW

SUMMARY

Momentum in the economy is strong and the expansion has some legs yet. But with the cycle entering a mature phase, key focal points and challenges will be finding skilled labour and ensuring late-cycle excesses (credit and housing) are not the precursors to a downturn. The latter requires credit growth to ease up, and this – in association with capacity constraints – is a key reason we expect GDP growth to ease from a strong to solid pace over the coming two years. A continuation of current excesses would up the ante on a correction down the track.

OUR VIEW

Momentum across the economy is strong and forward indicators suggest this decent growth performance has some legs left in it yet. The underlying drivers of this strong growth picture (construction, tourism, net migration, non-dairy agriculture, strengthening labour market, low interest rates, housing etc) are now reasonably well appreciated, and by and large we expect them to continue. Moreover, firms also continue to display a 'just get on with it' attitude, where success is breeding more success, which fits in with the theme of the economy's microeconomic fundamentals being in good health.

Our forecasts have annual growth tracking around a 3½% pace for roughly the next 18 months before slowing towards 3% in late 2017. Conditions for consumption (the labour market and asset prices) and investment (low rates, infrastructure needs, housing shortages, capacity constraints) are supportive. While the NZD and commodity prices are restraining some pockets of the export community (i.e. dairy), the export sector continues to perform well.

Two key issues going forward will be capacity and balance sheet constraints, with both expected to eventually slow the economy from its current pace.

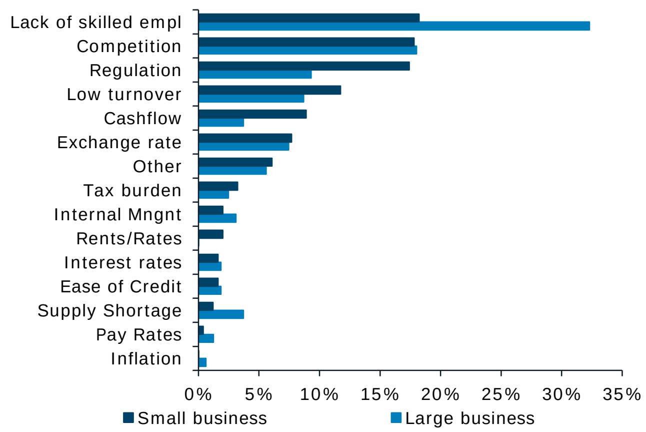
Capacity constraints are evident and will act as a natural handbrake. Finding the right staff is becoming the biggest issue for businesses economy-wide, according to surveys such as our Small Business Microscope. Capacity utilisation is sitting near historic highs. Importantly, though, we expect such constraints to spur additional investment from firms.

The economy is at a delicate juncture where pre-2008 style behaviours and late cycle excesses are coming to the fore. We have housing largesse and housing affordability (that are both economic and social issues), rapid credit growth, debt accumulation and signs of deteriorating structural metrics (savings). That's classic late-cycle euphoria which has typically led to a bust.

This 'party' can either continue, which risks a hangover in the future and a boom/bust cycle, or it can be reined in. Our forecasts – critically – assume the latter. Credit growth slows (that means some credit rationing), spending runs in line with incomes, house price growth cools and the current account balance remains in check. The RBNZ is being active via loan to ratio restrictions and banks are also taking a more conservative stance. Unfortunately a by-product of such an approach will be casualties on the investment front and we are already seeing projects cancelled, which ironically will exacerbate supply imbalances in the housing market.

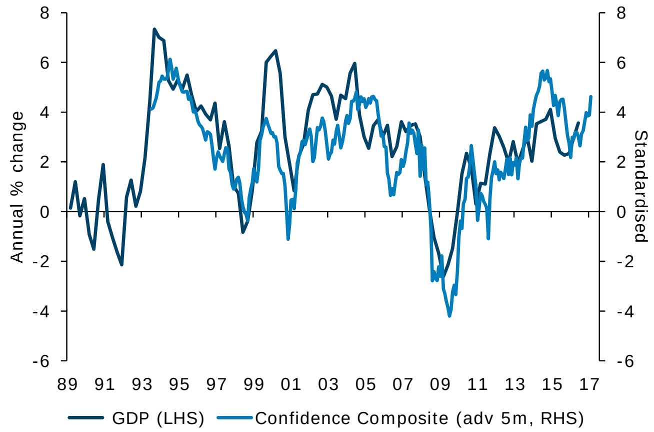
We are expecting an elongated steady rate of growth as opposed to massive swings in the cycle.

FIGURE 1. BIGGEST PROBLEM FACING BUSINESSES



Source: ANZ

FIGURE 2. CONFIDENCE COMPOSITE VERSUS GDP



Source: ANZ, Roy Morgan, Statistics NZ

MORTGAGE BORROWING STRATEGY

SUMMARY

Mortgage rates are again virtually unchanged compared with a month ago, with small tweaks to some specials but no changes to carded rates. The mortgage curve remains tick-shaped, with the low point being the 1 year. Looking ahead, we expect an OCR cut in November, but this is almost fully priced into the term structure of wholesale rates; all else equal, this suggests we won't see term rates fall by much when the cut is confirmed. Beyond that we expect the Reserve Bank (RBNZ) to maintain an easing bias, keeping a lid on interest rates. While the domestic economy says rates should be higher, inflation says otherwise, leaving markets in limbo. We prefer to target low cost 1-2 year fixed rates.

OUR VIEW

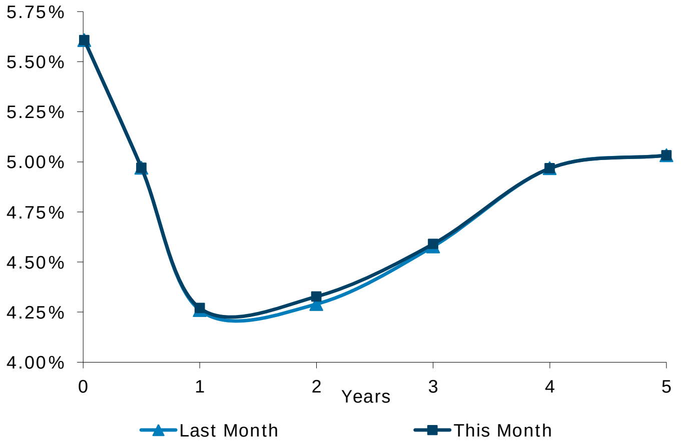
Mortgage interest rates are basically unchanged compared to last month, with the only changes seen being minor tweaks to some special rates. The mortgage curve thus remains tick-shaped. Looking ahead, we may see some "softening" of the tick shape when the RBNZ delivers the next OCR cut next month. **OCR cuts are normally followed by cuts to carded floating rates.**

However, we would caution against expecting the full 25bps cut to be passed through to the floating rate. Credit growth is outstripping deposit growth and lower retail rates will only exacerbate that. There seems a floor below which it's hard to take deposit rates, which has implications for borrowing rates too. While we would expect the current average floating rate of 5.61% to fall, it is unlikely to fall by enough to completely remove the tick shape (noting that the gap between the floating rate and the 1 year rate stands at 0.64%pts).

We still see limited value in pursuing a strategy of being floating in the expectation that the OCR will keep falling and rates will play catch-up. The 1 and 2 year points are not only already pricing in an expectation of an upcoming OCR cut, but they are also where competition is the most intense, and they remain our preferred tenors.

We believe longer-term rates are at their respective cycle lows too. At face value this suggests that there is value in considering them. Despite their increased cost, they do offer more certainty. **From a pure cost perspective, we prefer the 1 and 2 year**, but equally, we recognise that some borrowers may value certainty beyond that.

CARDED SPECIAL MORTGAGE RATES^



Special Mortgage Rates		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.61%				
6 months	4.97%	3.57%	4.36%	4.41%	4.98%
1 year	4.27%	3.96%	4.39%	4.70%	5.12%
2 years	4.33%	4.33%	4.75%	5.14%	5.61%
3 years	4.59%	4.75%	5.20%	5.35%	5.50%
4 years	4.97%	5.00%	5.22%		
5 years	5.03%	#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	5.61%				
6 months	5.06%	4.49%	4.92%	4.82%	5.18%
1 year	4.77%	4.70%	4.87%	5.00%	5.26%
2 years	4.82%	4.85%	5.06%	5.19%	5.37%
3 years	4.97%	5.02%	5.20%	5.33%	5.51%
4 years	5.09%	5.18%	5.35%		
5 years	5.23%	*may be subject to a low equity fee			

Breakeven analysis generally also supports selecting the 1 or 2 year. Consider for example the choice between 6 months and 1 year. Back-to-back 6 month terms might be cheaper if the 6 month rate falls in six months, but it'd have to fall a long way (from 4.97% to 3.57%) before you start saving money over the full 12 months. That seems unlikely in our view. By contrast, breakevens for 1 and 2 year rates generally rise (beyond 6 months), suggesting that it is only worth selecting a longer term if you think interest rates will rise. We believe broad-based rises are a while away, and as such, we prefer to stick with low-cost 1-2 year rates for the time being.

^ 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 2016 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	15.2	10.0	271	-4%	35
Auckland	7.2	4.7	2,411	-1%	35
Waikato/BOP/Gisborne	17.5	7.3	1,274	-9%	32
Hawke's Bay	15.1	4.5	258	-1%	31
Manawatu-Whanganui	6.9	6.2	383	-7%	30
Taranaki	14.1	-2.0	191	0%	32
Wellington	16.2	3.6	870	-1%	27
Nelson-Marlborough	21.5	7.0	264	-8%	30
Canterbury/Westland	3.0	-0.2	996	+2%	33
Central Otago Lakes	41.3	3.1	163	+3%	29
Otago	5.3	-1.1	275	-12%	23
Southland	0.4	5.7	214	-10%	29
NEW ZEALAND	**6.3**	**3.1**	**7,403**	**-5%**	**33**

Key forecasts

	Actual			Forecasts						
Economic indicators	**Dec-15**	**Mar-16**	**Jun-16**	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**
GDP (Ann Avg % Chg)	2.5	2.5	2.8	3.1	3.4	3.5	3.5	3.5	3.2	3.0
CPI Inflation (Annual % Chg)	0.1	0.4	0.4	0.2(a)	0.8	1.2	1.1	1.6	1.7	1.8
Unemployment Rate (%)	5.0	5.2	5.1	5.1	5.0	5.0	5.0	4.9	4.9	4.8
Interest rates (carded)	**Mar-16**	**Jun-16**	**Latest**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**
Official Cash Rate	2.25	2.25	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75
90-Day Bank Bill Rate	2.3	2.4	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Floating Mortgage Rate	5.7	5.7	5.7	5.6	5.6	5.6	5.6	5.6	5.6	5.6
1-Yr Fixed Mortgage Rate	4.9	4.9	4.9	4.9	5.0	5.0	5.0	5.1	5.1	5.1
2-Yr Fixed Mortgage Rate	5.1	5.1	5.1	5.1	5.1	5.2	5.2	5.2	5.3	5.4
5-Yr Fixed Mortgage Rate	5.7	5.6	5.6	5.7	5.7	5.7	5.8	5.9	6.0	6.1

Source: ANZ, Statistics NZ, RBNZ

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