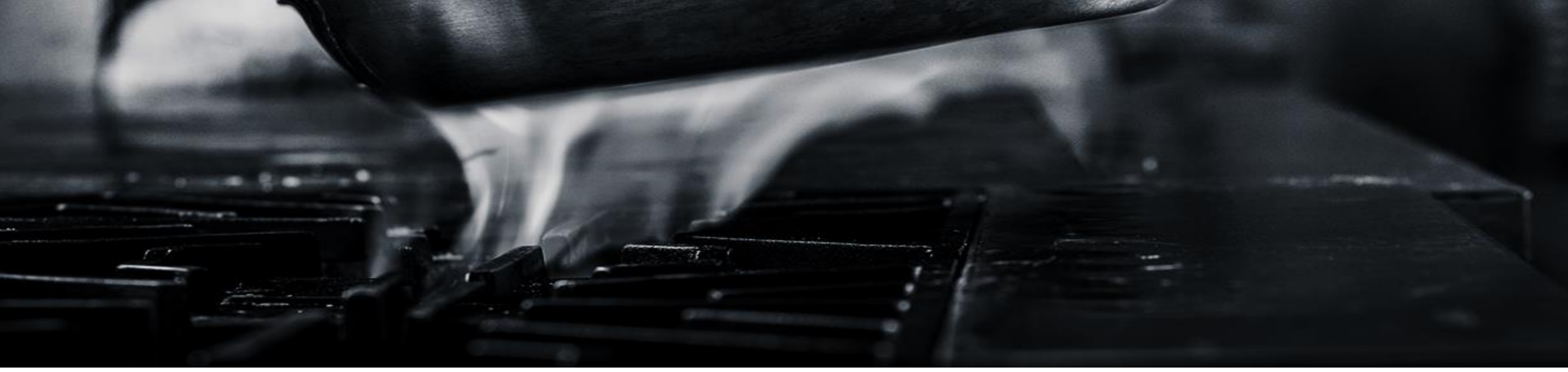
New Zealand Property Focus

Hot or not



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INSIDE

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Summary

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

Feature Article: Hot or not

This month we take a closer look at housing market performance across different regions in New Zealand. Weakness in the Auckland and Canterbury markets have weighed on the nationwide picture, with these regions comprising 42% of house sales combined. But a number of other regions have experienced strong price gains recently. Based on a number of metrics, we identify Gisborne, Manawatu-Whanganui, Tasman-Nelson-Marlborough and Otago as hotspots, while exceptional heat is being seen in Southland and Hawke's Bay. In addition, Bay of Plenty, Waikato and Wellington markets are also running hot, just not as hot as they have been. Conditions can change quickly and the outlook is uncertain, but all else equal, strong demand in these markets appears conducive to further regional price increases. This delayed cycle relative to Auckland is not unusual for the New Zealand housing market. On the whole, we expect that the nationwide market will remain contained. But regional divergence is expected, with hotspots expected to continue to outperform while headwinds blow strongest in Auckland and Canterbury.

Property gauges

The housing market is navigating a period of volatility. The foreign-buyer ban came into effect in mid-October, stymying demand, even if only a small portion of buyers are affected. And a number of offsetting forces are at play. Mortgage interest rates have fallen recently, which is expected to provide a boost to the market in the short term. Population growth remains supportive, though continues to ease gradually. But a number of headwinds are acting on the market, including bank prudence, investor wariness and affordability constraints – and these are expected to see the market remain contained. Given this outlook, we expect that the RBNZ will ease loan-to-value ratio restrictions at the November FSR, but continued caution should see settings remain "tight" for some time.

Economic overview

Despite challenges, the New Zealand economy has shown considerable resilience. The unemployment rate unexpectedly fell to 3.9% in the September quarter and resources in the economy are stretched. A number of factors are expected to continue to support growth, but headwinds remain and GDP is expected to grow between 2½-3%– a little below where we see trend. With resources in the economy stretched, conditions are in place for wage and price inflation to increase, but only gradually. We expect the OCR to remain on hold for the foreseeable future and see risks to this view as balanced. If inflation picks up more quickly than expected, then a hike may be required. But if the economy underperforms, then more monetary stimulus may be needed.

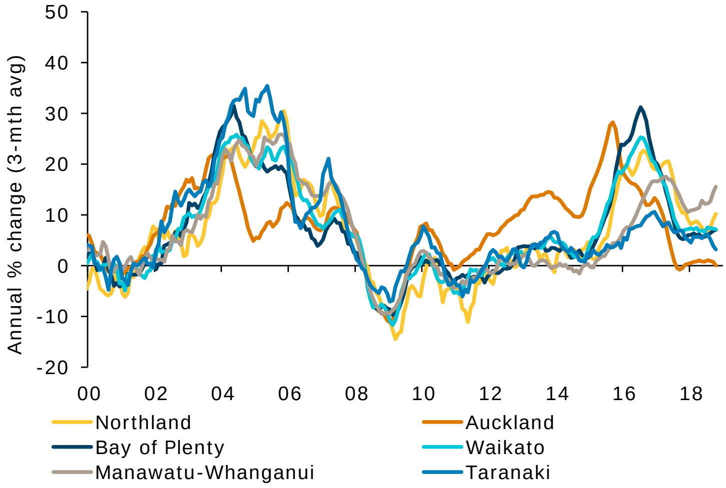
Summary

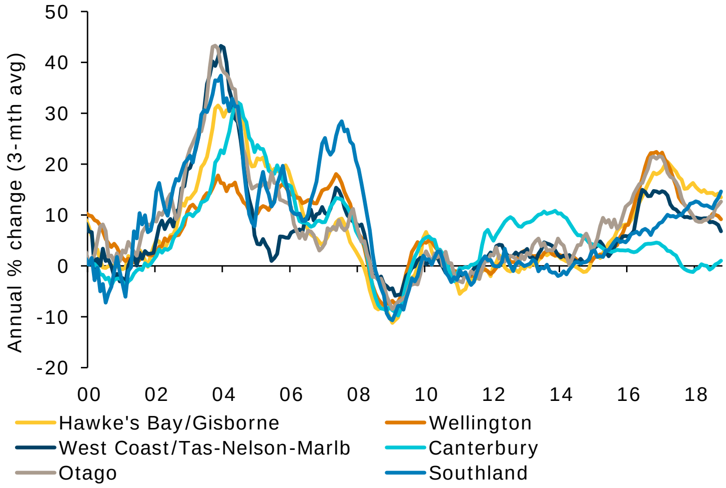
This month we take a closer look at housing market performance across different regions in New Zealand. Weakness in the Auckland and Canterbury markets have weighed on the nationwide picture, with these regions comprising 42% of house sales combined. But a number of other regions have experienced strong price gains recently. Based on a number of metrics, we identify Gisborne, Manawatu-Whanganui, Tasman-Nelson-Marlborough and Otago as hotspots, while exceptional heat is being seen in Southland and Hawke's Bay. In addition, Bay of Plenty, Waikato and Wellington markets are also running hot, just not as hot as they have been. Conditions can change quickly and the outlook is uncertain, but all else equal, strong demand in these markets appears conducive to further regional price increases. This delayed cycle relative to Auckland is not unusual for the New Zealand housing market. On the whole, we expect that the nationwide market will remain contained. But regional divergence is expected, with hotspots expected to continue to outperform while headwinds blow strongest in Auckland and Canterbury.

Hot or not

Since 2016 the nationwide housing market has cooled, led by a softening in the Auckland housing market. But the nationwide picture masks a divergent picture. Both Auckland and Canterbury have seen prices go sideways since then, with these regions comprising 29% and 13% of house sales respectively. Meanwhile a number of other regional housing markets are running hot and have experienced strong house price inflation of late. Over the past year, strong house price gains have been seen in Northland, Hawke's Bay, Manawatu-Whanganui, Otago and Southland (figures 1 & 2). House price inflation is also solid in Bay of Plenty, Waikato and Wellington, but price pressures have moderated in these regions since 2016.

Figures 1 and 2. House price inflation by region





Source: REINZ

Feature Article: Hot or not

Taking the temperature

In this section we assess the degree of heat in each regional housing market using five key metrics. Regions deemed 'hot' are experiencing strong demand, with conditions that appear favourable to sellers. By contrast, markets that are identified as 'cool' are not experiencing significant demand relative to supply. In these markets, conditions appear more favourable for buyers than generally seen over history. Broadly speaking, markets that are hot appear conducive to above-average price pressures, provided conditions do not shift, whereas markets that are cooler look conducive to below-average price pressures. A summary map can be found on page 8.

Our assessment is based on a snapshot of current conditions. But we should front-foot some caveats:

- The balance between demand and supply is constantly evolving, and can turn especially quickly in small regional markets. Past house price gains are not always a good indication of the future.
- There is likely to be a lot of variation in conditions within the broad regions considered here.
- Our assessment of regional hotspots should in no way be construed as financial advice.

The metrics we use to assess the heat in each market are:[1]

1. **Days to sell:** The length of time it takes to sell a property indicates the strength of demand. 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. We use days to sell (3-month average) relative to post-1992 average.
2. **Expectations of buyers and sellers:** List prices provide a gauge of seller expectations. If sales prices are high relative to list prices (compared to their usual behaviour over history), this suggests demand is intensifying. We use the ratio of sales prices to list prices relative to post-2002 average.
3. **Sales-to-listings:** This is a metric of demand relative to supply in the market. When there are fewer listings, this can intensify price pressures. On the other hand, when new properties come online in significant numbers it can take heat out of the market. We use the ratio of sales to listings (3-month average) relative to the post-2012 average.
4. **Regional economy:** The economic performance of each region can have a bearing on how willing people are to purchase a house and how much they can afford. We consider the unemployment rate in each region, recent growth in employment, and indicators of regional activity (consents and retail trade).
5. **House prices to rents:** This measures whether the affordability of owning relative to renting is in normal ranges. When houses are expensive relative to renting, purchasing is less attractive, and rental yields tend to be low, which can dissuade investors. We use median house price to rents since 2006.

Northland (4% of sales) Overall, the market is **normal**.

Days to sell	**Very hot**	At 49 days, days to sell are 21% below the historical average of 62 days.
Expectations	**Normal**	Houses are selling below list price, but that's normal in this region.
Listings	**Hot**	The sales-to-listings ratio is 17% above average.
Regional economy	**Normal**	Unemployment is low, but employment growth has softened recently and activity growth is soft.
Affordability	**Cool**	Affordability relative to renting has worsened, but not substantially.

Auckland (29% of sales) Overall, the market is considered to be **very cool**.

Days to sell	**Cool**	At 40 days, days to sell are 11% above the historical average of 36 days.
Expectations	**Cool**	Houses are selling above list price, but not much compared with history.
Listings	**Very cool**	The sales-to-listings ratio is 20% below average.
Regional economy	**Normal**	Unemployment is low, and employment and activity growth have been soft-moderate.
Affordability	**Very cool**	House prices are very high relative to rents.

[1] Varied historical averages were chosen due to data availability and long-term trends and structural breaks in the data. In some cases, measures are standardised to adjust for varying degrees of volatility in the regional series. Labour market data is combined for Hawke's Bay/Gisborne and West Coast/Tasman-Nelson-Marlborough. There is a degree of subjectivity in interpretation of the data. Sources include MBIE, REINZ, realestate.co.nz, Statistics NZ.

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Waikato (11% of sales) Overall, the market is considered to be **hot**.

Days to sell	**Hot**	At 41 days, days to sell are 17% below the historical average of 49 days.
Expectations	**Hot**	Houses are selling above list price, but usually they don't.
Listings	**Hot**	The sales-to-listings ratio is 12% above average.
Regional economy	**Hot**	Unemployment is low and employment growth has been moderate, but activity growth has been soft-moderate.
Affordability	**Cool**	Affordability relative to renting has worsened, but not substantially.

Bay of Plenty (6% of sales) Overall, the market is considered to be **hot**.

Days to sell	**Hot**	At 46 days, days to sell are 13% below the historical average of 53 days.
Expectations	**Hot**	Houses are selling above list price and more than usual.
Listings	**Hot**	The sales-to-listings ratio is 12% above average.
Regional economy	**Hot**	Unemployment is low and employment growth has been moderate, but activity growth has been soft-moderate.
Affordability	**Cool**	Affordability relative to renting has worsened, but not substantially.

Gisborne (1% of sales) Overall, the market is considered to be **hot**.

Days to sell	**Normal**	At 39 days, days to sell are 9% below the historical average of 43 days.
Expectations	**Normal**	Houses are selling above list price, but in normal ranges.
Listings	**Very hot**	The sales-to-listings ratio is 21% above average.
Regional economy	**Very hot**	Unemployment is low, employment growth has been strong and activity growth has been moderate-strong.
Affordability	**Hot**	Affordability relative to rents is favourable, but has worsened.

Hawke's Bay (3% of sales) Overall, the market is considered to be **very hot**.

Days to sell	**Very hot**	At 33 days, days to sell are 29% below the historical average of 46 days.
Expectations	**Very hot**	Houses are selling well above list price and much more than usual.
Listings	**Hot**	The sales-to-listings ratio is 13% above average.
Regional economy	**Very hot**	Unemployment is low, employment growth has been strong and activity growth has been moderate-strong.
Affordability	**Normal**	Affordability relative to renting has worsened, but is not particularly high.

Manawatu-Whanganui (5% of sales) Overall, the market is considered to be **hot**.

Days to sell	**Very hot**	At 30 days, days to sell are 29% below the historical average of 48 days.
Expectations	**Hot**	Houses are selling above list price and a bit more than usual.
Listings	**Hot**	The sales-to-listings ratio is 16% above average.
Regional economy	**Hot**	Unemployment is low and employment/activity growth has been moderate-strong.
Affordability	**Hot**	Affordability relative to rents is favourable, but has worsened.

Taranaki (3% of sales) Overall, the market is considered to be **normal**.

Days to sell	**Very hot**	At 37 days, days to sell are 23% below the historical average of 48 days.
Expectations	**Normal**	Houses are selling above list price, but in normal ranges.
Listings	**Hot**	The sales-to-listings ratio is 19% above average.
Regional economy	**Normal**	Unemployment is a bit elevated, activity growth has been soft-moderate, but employment growth has been strong.
Affordability	**Normal**	Affordability relative to rents is about normal compared to recent history.

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Wellington (11% of sales) Overall, the market is considered to be **hot**.

Days to sell	**Hot**	At 31 days, days to sell are 15% below the historical average of 36 days.
Expectations	**Very hot**	Houses are selling well above list price and much more than usual.
Listings	**Normal**	The sales-to-listings ratio is 8% above average.
Regional economy	**Hot**	Unemployment is a bit elevated; employment growth has been moderate, and activity growth has been soft-moderate.
Affordability	**Cool**	Affordability relative to renting has worsened, but not substantially.

Tasman-Nelson-Marlborough (4% of sales) Overall, the market is considered to be **hot**.

Days to sell	**Hot**	At 36 days, days to sell are 17% below the historical average of 43 days.
Expectations	**Normal**	Houses are selling a little above list price and in normal ranges.
Listings	**Hot**	The sales-to-listings ratio is 16% above average.
Regional economy	**Hot**	Unemployment is a bit elevated; employment growth has been moderate, and activity growth has been moderate-strong.
Affordability	**Cool**	Affordability relative to renting has worsened, but not substantially.

Canterbury (13% of sales) Overall, the market is considered to be **cool**.

Days to sell	**Cool**	At 41 days, days to sell are 12% above the historical average of 36 days.
Expectations	**Normal**	Houses are selling above list price and in normal ranges.
Listings	**Cool**	The sales-to-listings ratio is 1% below average.
Regional economy	**Cool**	Unemployment is a bit elevated; employment growth has been soft and activity has been soft-falling.
Affordability	**Normal**	Affordability relative to renting has worsened, but is not particularly high.

Otago (6% of sales) Overall, the market is considered to be **hot**.

Days to sell	**Very hot**	At 31 days, days to sell are 27% below the historical average of 43 days.
Expectations	**Hot**	Houses are selling above list price and a bit more than usual.
Listings	**Hot**	The sales-to-listings ratio is 19% above average.
Regional economy	**Normal**	Unemployment is a bit elevated and activity growth has been soft, but employment growth has been strong.
Affordability	**Hot**	Affordability is favourable, but has worsened.

West Coast (1% of sales) Overall, the market is considered to be **normal**.

Days to sell	**Normal**	At 68 days, days to sell are below average (80), but volatility is normal.
Expectations	**Normal**	Houses are selling below list price, but that's normal in this region.
Listings	**Very hot**	The sales-to-listings ratio is 40% above average.
Regional economy	**Normal**	Unemployment is a bit elevated; employment growth has been moderate and activity growth has been soft-moderate.
Affordability	**Very hot**	Affordability relative to rents has improved and is very favourable.

Southland (3% of sales) Overall, the market is considered to be **very hot**.

Days to sell	**Very hot**	At 25 days, days to sell are 39% below the historical average of 40 days.
Expectations	**Very hot**	Houses are selling well above list price when they would usually sell below.
Listings	**Very hot**	The sales-to-listings ratio is 24% above average.
Regional economy	**Normal**	Unemployment is a bit elevated and employment growth has been soft, but activity growth has been moderate.
Affordability	**Hot**	Affordability relative to rents has been flat and favourable.

The outlook

There are a number of offsetting forces buffeting the nationwide housing market at present. Population growth has been strong, although it is easing gradually. And financial conditions are supportive of continued demand, especially with mortgage rates having fallen further recently. But a number of headwinds are also at play:

- Banks are being prudent in their lending practices, so while mortgages are cheap, careful serviceability assessments are being applied.
- The RBNZ's loan-to-value ratio restrictions are binding, particularly for investors.
- And investors are a bit wary in light of policy changes (including possible tax changes, letting fees ban, Healthy Homes bill etc), while demand from foreign buyers has been abruptly stymied by the ban that came into effect in mid-October.

On the whole, we expect that the housing market will remain contained in light of headwinds, with house price pressures expected to ease gradually from here. In this context, we expect that the RBNZ will ease loan-to-value ratio restrictions at the November Financial Stability Review (November 28). This will provide a little more support for the market. However, given the tailwinds outlined above, a resurgence cannot be ruled out. We expect any easing will be cautious and gradual.

We expect the Auckland and Canterbury markets will remain weak. The Canterbury market has experienced a significant rebuild-related cycle, and affordability constraints are weighing there. The acute shortage created by the Canterbury earthquakes led to a significant run-up in prices. Effectively, prices overshot and this is now dampening the market, especially with new supply coming on-stream. At the same time, broader economic activity in the region is not as buoyant as it was.

In Auckland, affordability constraints are acute and weighing heavily on the market, with prices having reached eye-watering levels. Given the rapid run-up in prices seen in Auckland, expectations of strong future demand appear to have already been capitalised into prices to some degree. However, this appears to have run its course, with buyers no longer willing to pay significantly above list price and expectations of sellers slowly adjusting. Investor demand is also being particularly affected by the foreign buyer ban, with foreign purchases of homes concentrated in the Auckland region.

But outside of Auckland and Canterbury, we expect that regional markets will see continued strong growth, supporting nationwide house price inflation, especially in certain pockets. This is likely to see continued catch-up of prices in the rest of New Zealand to those in Auckland, although to varying degrees depending on the performance of different markets (and regional incomes). Based on current conditions, the hotspots of Southland and Hawke's Bay look set to outperform, particularly if growth in these regional economies performs well. Other regions have conditions that appear conducive to continued robust house price growth, including Gisborne, Manawatu-Whanganui, Tasman-Nelson-Marlborough and Otago. And conditions in Bay of Plenty, Waikato and Wellington look favourable, although not to the extent that has been seen in recent history. These markets are not running as hot as they once were, and recent moderation may be sustained.

Conditions can – and will – change rapidly, and this will have a bearing on the outlook for regional house price inflation going forward. Strong demand in particular regions may encourage property owners to sell, leading to greater listings and tipping the balance to more supply, thus alleviating price pressures. Much also depends on the composition of economic growth, which affects regional economies differently. Population changes will also be important, given both external and internal migration flows. These sorts of movements can have significant bearing on the outlook for housing demand, but data on regional migration is unfortunately scant.

The only thing content is change; all housing markets ebb and flow. But breaking it down by region certainly goes a long way to demonstrating 'the' New Zealand economy and 'the' New Zealand housing market are averages that mask a great range of outcomes.

Regional heatmap

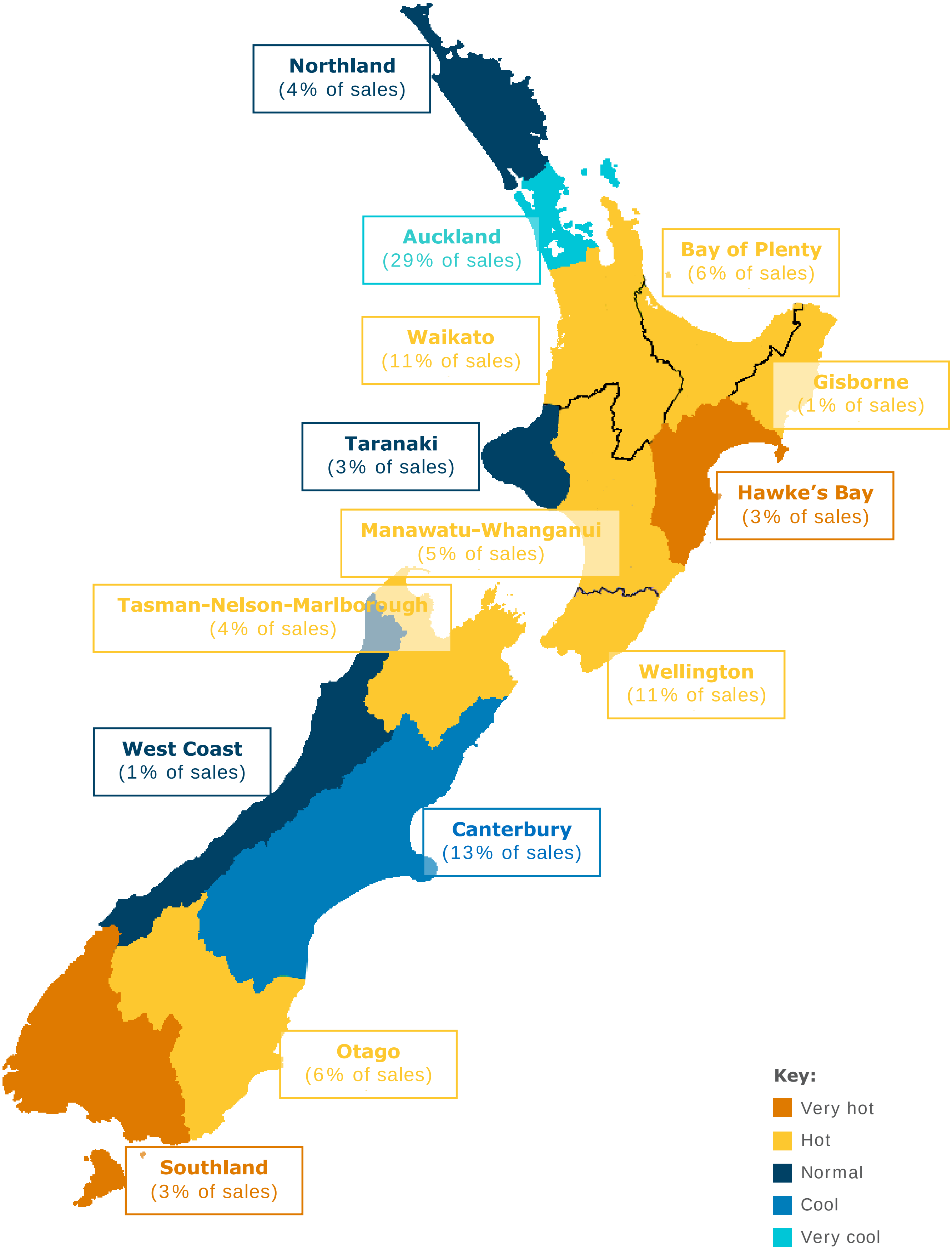
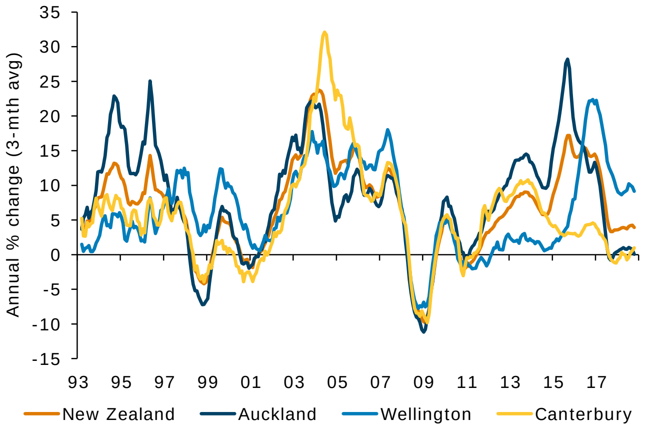


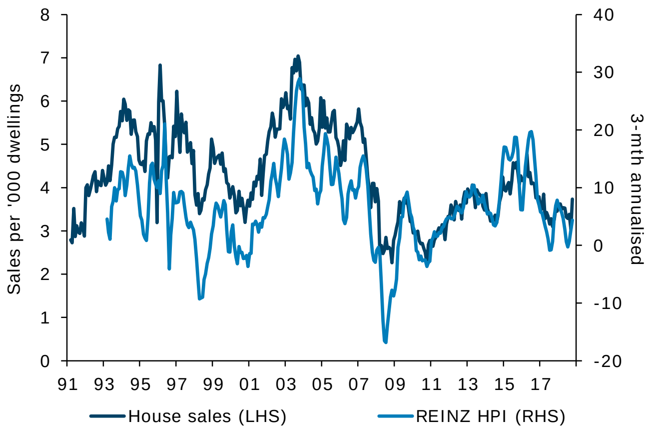
Figure 1. Regional house price inflation



Source: ANZ, REINZ

House price inflation was soft through the middle of the year, but price pressures look to have picked up a little into year end. The REINZ house price index rose at a moderate monthly rate of 0.4% m/m in October, after increasing 0.7% q/q in Q3 and 0.2% in Q2. It is possible that recent declines in mortgage rates have contributed to the recent tick up, although there are a lot of offsetting forces at play. Prices are up 1.1% over the past three months. Increases are concentrated outside of Auckland with prices up 1.9% over the past three months and 0.8% in October. In Auckland house prices have been flat (over the past three months but also in October). Annual house price inflation continues to ease gradually and is running at 3.9% y/y (3mma), down from 4.2% in September.

Figure 2. REINZ house prices and sales

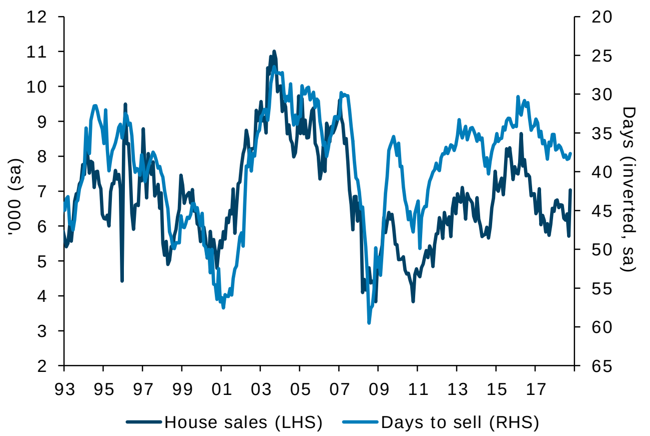


Source: ANZ, REINZ

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

House sales have been volatile of late. House prices fell 6% between January and August, then fell 10% m/m in September. In October, we estimate that seasonally-adjusted house sales bounced a whopping 23% m/m, reaching their highest level since early 2017 in the largest monthly increase since 1996. Monthly house sales can be volatile, but particularly around policy changes, with the foreign-buyer ban coming into effect in mid-October. Some payback in November looks highly likely. In trend terms, sales are seeing more modest 1.4% m/m growth. Given recent volatility, we will need to bide some time to see where the trend settles.

Figure 3. Sales and median days to sell

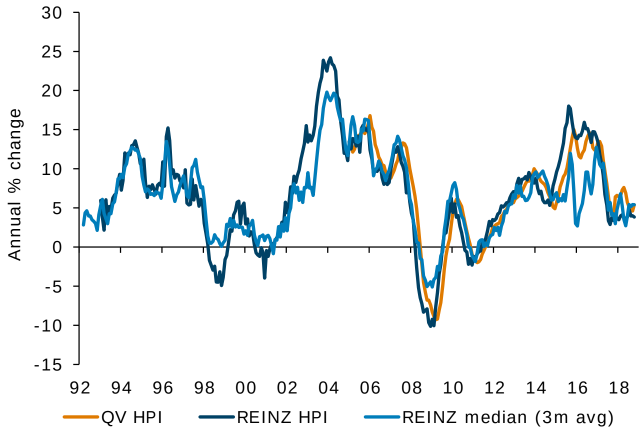


Source: ANZ, REINZ

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.

Based on days to sell a house, markets outside Auckland and Canterbury remain tight. Nationwide the median time to sell a house was flat at 38 days in October (sa). Days to sell in Auckland fell a little further to 37 days in October and have averaged 40 days over the past three months – pointing to some continued slack. Outside Auckland and Canterbury, days to sell remain below average.

Figure 4. REINZ and QV house prices

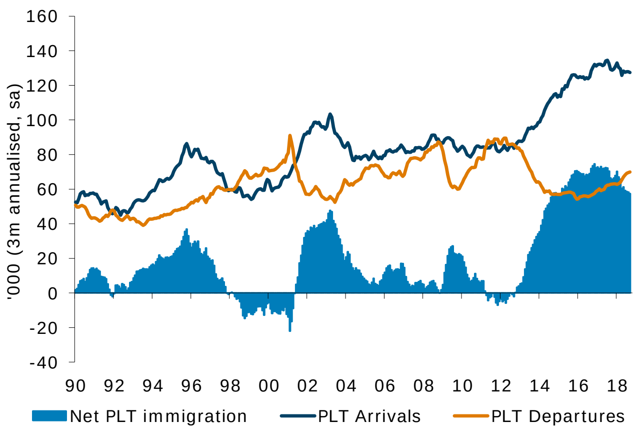


Source: ANZ, REINZ, QVNZ

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 median sale price increased 1.2% m/m (sa) in October, with annual growth running at 5.4% y/y (3mma). The QVNZ measure of house price growth has also ticked up to 5.4% y/y. The REINZ HPI – our preferred measure – is sitting below the other two series at 3.8% y/y (3.9% y/y, 3mma).

Figure 5. Net permanent/long-term immigration

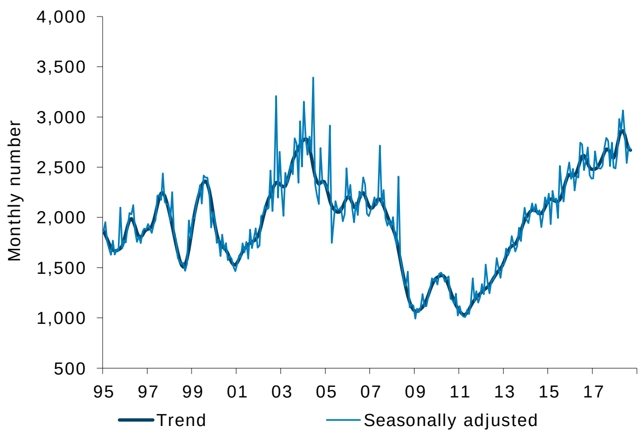


Source: ANZ, Statistics NZ

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 coincided with large net migration inflows.

Permanent and long-term migration is easing gradually from high levels, but it remains a slow grind. Permanent and long-term net migration monthly inflows fell by 350 to 4,640 in September (seasonally adjusted), with arrivals flat and departures lifting. At 62,700, annual net inflows are now down 13.4% since the cycle peaked in July 2017. In our view, risks to the migration cycle are skewed to the downside. How rapidly the migration cycle eases is a key source of uncertainty for the property market and economic activity generally.

Figure 6. Residential building consents



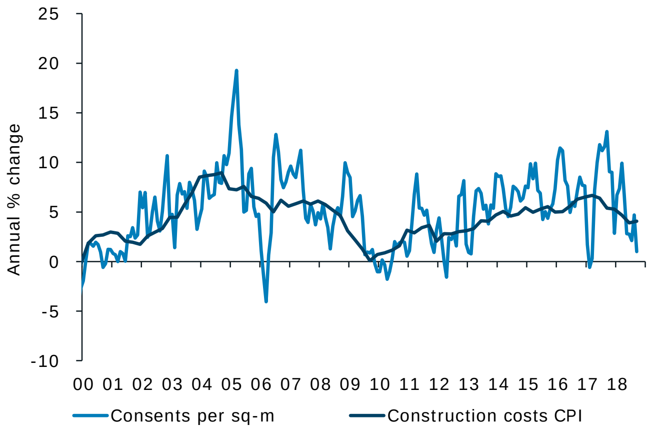
Source: ANZ, Statistics NZ

Dwelling consents fell 1.5% m/m in September, with a 5.4% fall in multi-dwelling consents and a 0.9% increase in consents for stand-alone dwellings. Over the September quarter, the number of residential consents are down 12% q/q (floor area is down 10% q/q). This follows strong consent issuance in the June quarter and points to a modest softening in residential investment into the end of the year.

Consents have generally been volatile in recent months, but the trend continues to drift south, which presents a potentially worrying signal. Activity remains at high levels and that is expected to continue, but the industry is grappling with challenges and delays, which may make it difficult for building work to push higher.

Property Market in Pictures

Figure 7. Construction cost inflation

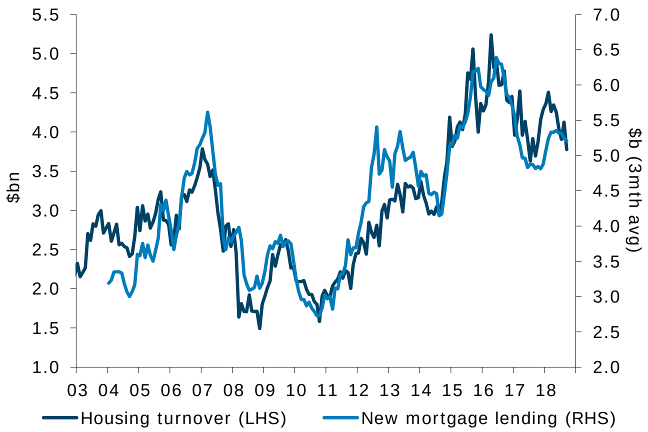


Source: ANZ, Statistics NZ

Construction cost inflation may be softening. Growth in the cost of consented work per square metre – a proxy for construction cost inflation – moderated to 1% y/y (3mma) in September. The CPI inflation measure of construction costs was 4.1% y/y in the September quarter, but is down from the recent peak of 6.7% in March 2017.

It remains to be seen whether this moderation is sustained, but it is consistent with anecdotes that suggest momentum in building cost inflation is waning. Nonetheless, capacity pressures remain acute, which should continue to support price rises. But firm pessimism may result in increased caution with regards to passing through cost increases.

Figure 8. New mortgage lending and housing turnover

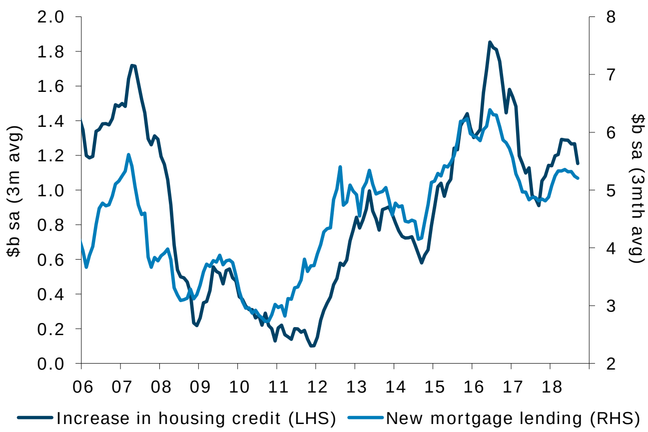


Source: ANZ, RBNZ

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 has moderated a little over the past few months, falling 0.7 m/m in September in seasonally adjusted terms (3mma). This moderation in lending is consistent with softer housing market turnover, and that trend may continue, depending on where the trend in sales settles. There was a tick up in new lending to first home buyers in October, from 15% to 17% of new lending. This came at the expense of investor lending, which ticked down from 23% to 21% of new lending in October.

Figure 9. New mortgage lending and housing credit

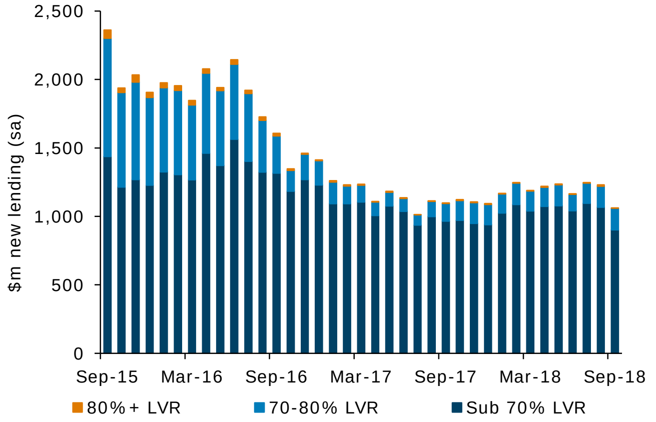


Source: ANZ, REINZ, RBNZ

Household credit has been growing at a pretty consistent monthly pace since early 2017. In monthly terms, household lending increased 0.4% m/m in September. In annual terms, household credit growth is broadly stable at 5.9% y/y.

Housing credit growth has softened in line with new mortgage lending. There could be a temporary tick up in credit growth if loan-to-value ratio restrictions are eased a little at the November FSR. Nonetheless, banks are behaving prudently, investors are wary, and loan-to-value ratio restrictions are expected to still have a dampening influence, even if they are eased. On the whole, we expect credit growth will continue to grow modestly.

Figure 10. Investor lending by LVR

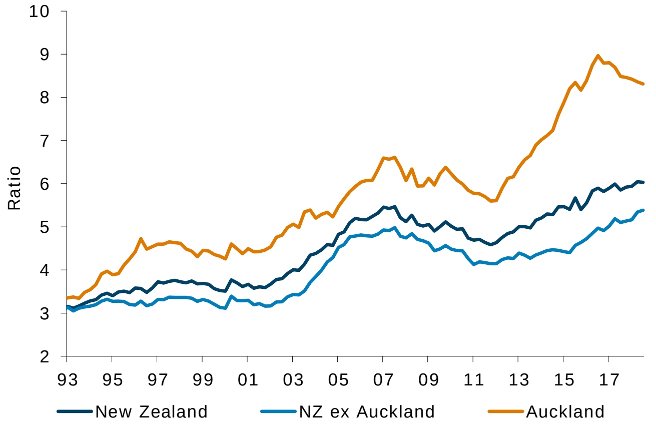


Source: ANZ, RBNZ

On a seasonally adjusted basis, new lending to investors fell 8% in September, taking a step down after recent stability. It is possible that we see the RBNZ ease loan-to-value ratio restrictions at the November FSR, which could see new lending to investors increase, given that the restrictions have been binding on the market. The pace of new lending to investors is around 45% below the $2bn of new lending per month seen through H1 2016.

While investor lending has taken a small step down, the share of lending on less-risky terms has been stable at elevated levels. In September, the share of total investor lending at loan-to-value ratios of less than 70% was 85% (seasonally adjusted). In late-2014 it was less than half.

Figure 11. Regional house prices to income

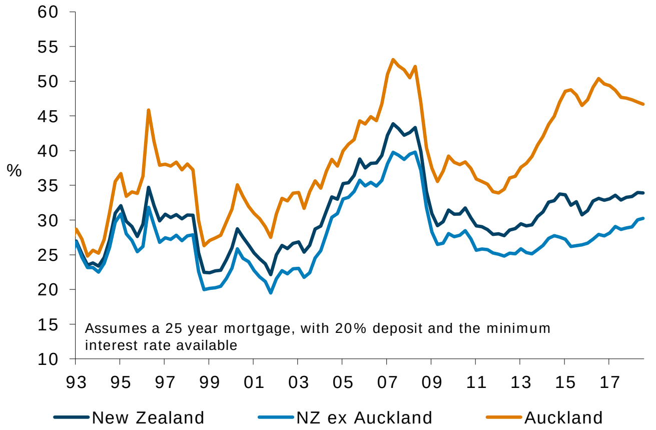


Source: ANZ, REINZ, Statistics NZ

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 stable at around 6 times income since early 2017. Auckland has seen its ratio ease from 9 times in Q3 last year to an estimated 8.3 times in Q3 2018. While still extremely high, the easing reflects the recent moderation in house price growth. Outside of Auckland, the ratio has continued to rise; at 5.4 times incomes this is at record highs.

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%. However, there are stark regional differences. In Auckland it is 47% and the rest of New Zealand it is 30%. While (just) off its highs, this is still 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

The housing market is navigating a period of volatility. The foreign-buyer ban came into effect in mid-October, stymying demand, even if only a small portion of buyers are affected. And a number of offsetting forces are at play. Mortgage interest rates have fallen recently, which is expected to provide a boost to the market in the short term. Population growth remains supportive, though continues to ease gradually. But a number of headwinds are acting on the market, including bank prudence, investor wariness and affordability constraints – and these are expected to see the market remain contained. Given this outlook, we expect that the RBNZ will ease loan-to-value ratio restrictions at the November FSR, but continued caution should see settings remain "tight" for some time.

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 is the main reason we see the Auckland market underperforming over the next few years.
Serviceability/ indebtedness	High debt, low rates OK – high rates not	↔/↓	Serviceability looks okay provided interest rates stay low and income growth is solid. Debt levels are high.
Interest rates / RBNZ	On hold	↔/↑	We see the OCR on hold for the foreseeable future, with risks broadly balanced. Mortgage rates have fallen.
Migration	Peaked	↔/↑	Migration is easing gradually, but remains elevated. We expect further softening and see risks as skewed to the downside.
Supply-demand balance	Demand > Supply	↔/↑	MBIE estimates New Zealand is short 71k houses, with a shortage of 45k in Auckland. Pent-up demand is supporting price increases.
Consents and house sales	Shortage	↔/↑	We expect consents issuance will struggle to push higher, with the construction sector reaching its limits.
Liquidity	Tight	↔/↓	Credit availability is very relevant. Closure of the bank funding gap means there is wriggle room, but prudence will be maintained.
Globalisation	Weak	↔/↓	The foreign-buyer ban has stymied demand from non-residents, the housing market is weak in Australia and global rates are on the rise.
Housing supply	Too few	↔/↑	The Government is going to take a more active role, but there are still questions about crowding out other work and labour shortages.
House prices to rents	Too high	↔/↓	Rents are moving up, with pressures on the existing stock apparent. Buying remains relatively expensive.
Policy changes	Dampening	↔/↓	Government policy changes are making investors wary, but easing in loan-to-value restrictions could provide a partial offset.
On balance	**In recent ranges**	↔/↓	**We expect to see some gradual softening in price pressures and volatility may continue in the short term.**

Property gauges

Figure 1: Housing affordability

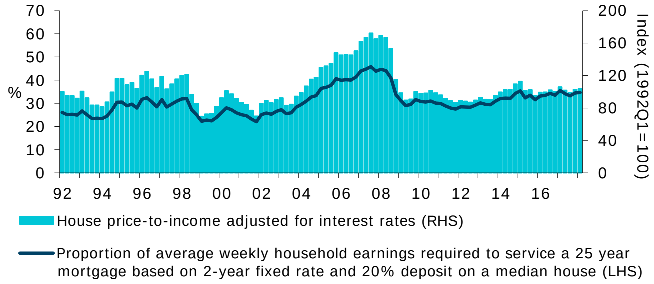


Figure 2: Household debt to disposable income

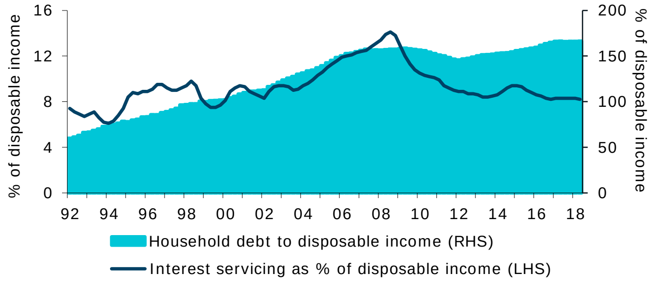


Figure 3: New customer average residential mortgage rate (<80% LVR)

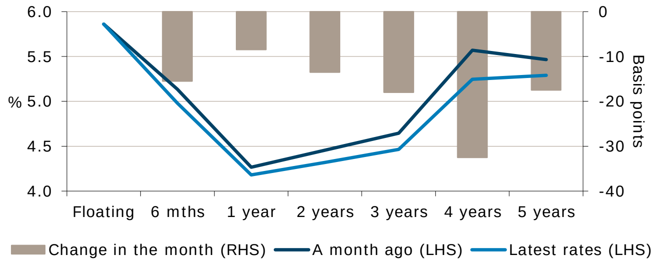


Figure 4: Net immigration

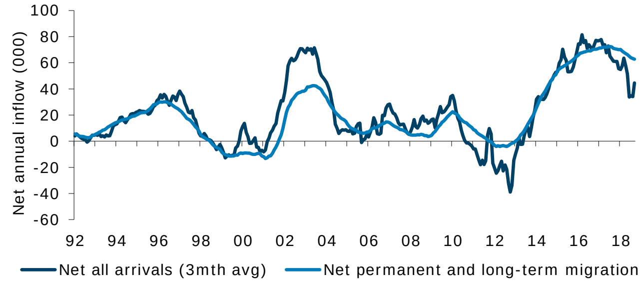


Figure 5: Housing supply-demand balance

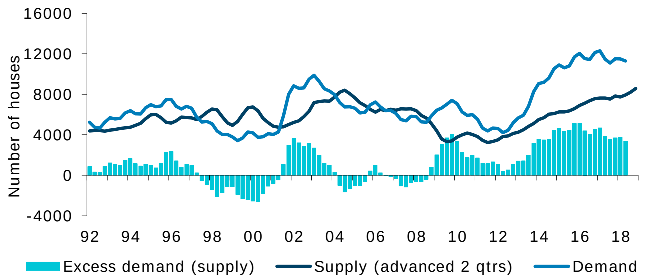


Figure 6: Building consents and house sales

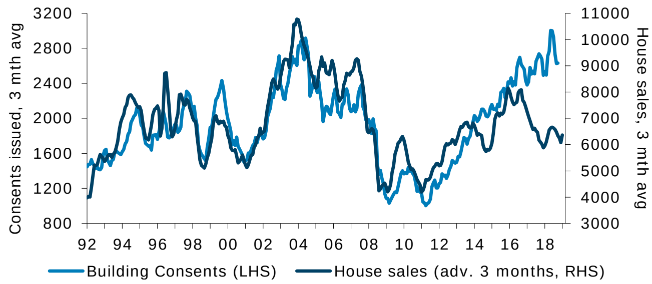


Figure 7: Liquidity and house prices

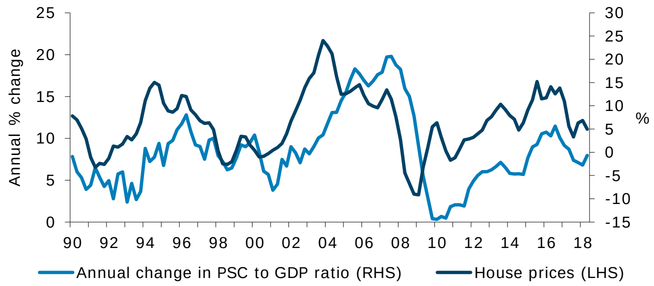


Figure 8: House price inflation comparison

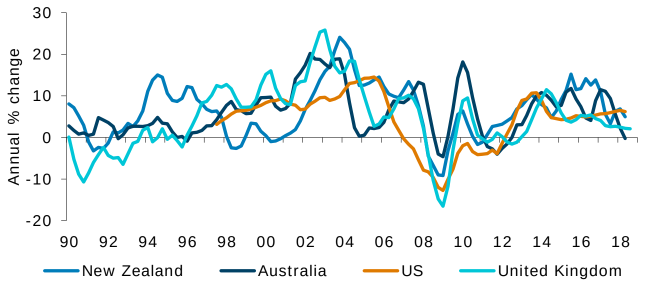


Figure 9: Housing supply

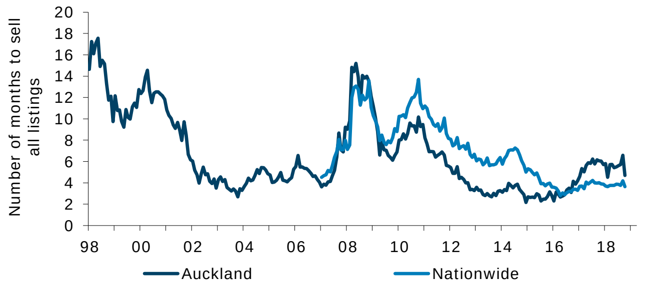
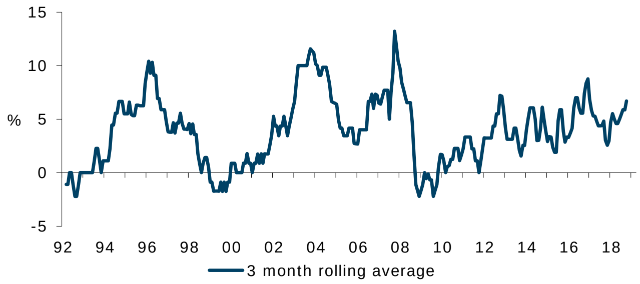


Figure 10: Median rental, annual growth



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

Economic overview

Summary

Despite challenges, the New Zealand economy has shown considerable resilience. The unemployment rate unexpectedly fell to 3.9% in the September quarter and resources in the economy are stretched. A number of factors are expected to continue to support growth, but headwinds remain and GDP is expected to grow between 2½-3%– a little below where we see trend. With resources in the economy stretched, conditions are in place for wage and price inflation to increase, but only gradually. We expect the OCR to remain on hold for the foreseeable future and see risks to this view as balanced. If inflation picks up more quickly than expected, then a hike may be required. But if the economy underperforms, then more monetary stimulus may be needed.

Our view

Economic momentum has softened since 2016 and the economy is grappling with headwinds. Businesses are wary about the future, rising costs are squeezing profits, and credit is a constraint for some. At the same time, population growth is slowing, construction activity is constrained, the housing market has softened, and the shine has started to come off our commodity prices. After a decade of expansion, the cycle is getting long in the tooth and growth is becoming more difficult to achieve.

And yet despite these challenges, the New Zealand economy has shown considerable resilience. GDP grew 2.8% over the year to June – only a little below where we see trend. And in the September quarter the unemployment rate fell to 3.9% – the lowest level in more than a decade. While the data can be volatile, the labour market is "tight" and it is difficult for firms to find labour. Given this strong position, the labour market looks in good stead to weather a softening in activity. Softer economic growth is expected through the second half of 2018, with businesses expected to be cautious about investing in the short term. But an improvement in business conditions is expected to see business investment improve through 2019, particularly in light of capacity constraints.

A number of factors continue to support the economic cycle. Financial conditions remain supportive, particularly for households given recent declines in mortgage rates. And the strong labour market is expected to continue to support consumption, with households judging that it is a good time to spend. Fiscal policy is also expected to boost growth, although only modestly. Moreover, the global environment remains supportive for New Zealand, with the terms of trade still elevated, despite some softening in commodity prices. On the whole, we expect to see growth of around 2½ 3% y/y over the coming few years – a robust pace and close to but a little below trend.

With resources in the economy stretched, conditions are in place for wage and price inflation to increase. But in our view, it may be difficult to sustain inflation at target over the medium term. Resource pressures are expected to linger around current levels, rather than intensify, and domestic inflation is expected to improve only gradually. Inflation is currently running at 1.9% y/y, boosted by a range of factors, including oil price increases, recent exchange rate depreciation, and increases in the minimum wage. However, the impact of these factors is expected to be only temporary. Indeed, we have seen oil prices in global markets fall considerably over the past month while the exchange rate has appreciated, both of which are expected to flow through into lower petrol prices.

Core inflation remains low and a little below the RBNZ's target midpoint. The RBNZ will continue to look through transitory influences and remain focused on the medium-term trend in inflation. In particular, the RBNZ will want to see a sustained increase in core inflation and expects to keep the OCR on hold for a considerable period to see this happen. On current projections, the RBNZ expect the OCR will be on hold until the second half of 2020.

The resilience of the labour market and strong starting point for the economy have given the RBNZ more assurance regarding the outlook for inflation and risks to the outlook are now considered balanced, rather than skewed to the downside. On the one hand, there is a risk that inflation is stronger than expected if recent factors weighing on inflation dissipate or if margin squeeze encourages business to pass through more of their costs to higher prices. But offsetting this, risks to the activity outlook remain. Firms' intentions regarding investment and hiring are very weak, which could weigh on the outlook more than expected. At the same time, the global outlook is expected to remain positive, but risks have increased that could have important implications for New Zeeland as a small, open economy.

We currently see the OCR on hold for the foreseeable future, in contrast to the RBNZ's own expectations for eventual hikes. In our view, it will be difficult to sustain inflation near target over the medium term, given the headwinds facing the economy. It is not that we literally think that the OCR will be on hold forever, but risks appear to be broadly balanced and we are not convinced that the next move is necessarily a hike. We are mindful of risks on both sides of the ledger. If inflation picks up more quickly than expected, then a hike may be required. But if the economy underperforms, then more monetary stimulus may be needed.

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 October 2018 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	17.3	3.1	247	+48%	45
Auckland	1.7	1.7	2,051	+20%	37
Waikato	4.8	0.2	741	+11%	39
Bay of Plenty	10.3	-1.1	408	-1%	45
Gisborne	1.0	5.6	60	+28%	40
Hawke's Bay	17.6	4.7	222	+10%	34
Manawatu-Whanganui	20.3	5.6	360	+20%	30
Taranaki	8.2	-0.1	179	+4%	36
Wellington	14.6	2.5	779	+30%	32
Tasman, Nelson and Marlborough	10.9	4.4	260	+39%	36
Canterbury	3.3	2.4	915	+8%	40
Otago	17.9	4.7	395	+14%	34
West Coast	-26.0	-8.5	38	+14%	86
Southland	8.8	2.1	195	+3%	26
New Zealand	**6.0**	**1.1**	**7,035**	**+23%**	**38**

Key forecasts

	Actual				Forecasts					
Economic indicators	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
GDP (Ann % Chg)	2.9	2.6	2.8	2.8	2.6	2.8	2.5	2.5	2.6	2.5
CPI Inflation (Annual % Chg)	1.6	1.1	1.5	1.9(a)	2.1	2.2	2.2	1.8	1.7	1.8
Unemployment Rate (%)	4.5	4.4	4.4	3.9(a)	4.1	4.0	4.0	3.9	3.9	3.9
House Prices (Annual % Chg)	3.6	3.9	3.7	4.2(a)	3.1	2.1	2.7	2.7	2.4	2.4
Interest rates (RBNZ)	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Official Cash Rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
90-Day Bank Bill Rate	1.9	2.0	2.0	1.9	2.0	2.0	2.0	2.0	2.0	2.0
Floating Mortgage Rate	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
1-Yr Fixed Mortgage Rate	4.9	4.9	4.9	4.8	4.8	4.8	4.9	4.9	4.9	4.9
2-Yr Fixed Mortgage Rate	5.1	5.1	5.0	4.9	5.0	5.0	5.1	5.1	5.1	5.1
5-Yr Fixed Mortgage Rate	5.9	5.9	5.9	5.6	5.7	5.7	5.8	5.8	5.9	5.9

Source: ANZ, Statistics NZ, RBNZ, REINZ

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