NEW ZEALAND PROPERTY FOCUS

December 2017

INSIDE

Feature Article: New Zealand Economic Outlook 2
The Property Market in Pictures 7
Property Gauges 11
Mortgage Borrowing Strategy 13
Key Forecasts 14

CONTRIBUTORS

Sharon Zollner
Chief Economist
Telephone: +64 9 357 4094
E-mail: Sharon.Zollner@anz.com

Philip Borkin
Senior Economist
Telephone: +64 9 357 4065
Email: Philip.Borkin@anz.com

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SUMMARY

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

FEATURE ARTICLE: NEW ZEALAND ECONOMIC OUTLOOK

Some clear headwinds are being navigated right now that have increased the odds of a growth wobble, leaving the economy somewhat delicately placed. However, we are not ready to call time on the cycle just yet. The drivers of growth are shifting, and such transitions are often not smooth, but there are still enough positive forces that we expect to see growth return to broadly around trend over the next couple of years (but probably not much more). In itself, trend growth is unlikely to be enough to get domestic inflation pressures up in a sustainable fashion, but signs of more cost-push pressures from the labour market are something that we think the RBNZ will eventually respond to, albeit in a tip-toe fashion. That said, the timing of that response is highly uncertain and skewed towards later as opposed to earlier. It is admittedly a more nuanced economic story, but one that still has a positive hue to it overall.

PROPERTY GAUGES

Housing market activity has shown a few more signs of life of late, bouncing off low levels. However, our overall views have not changed. There are clear opposing forces. 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, affordability constraints and possibly more restrictive government policy changes. We continue to see prices plateauing for now.

MORTGAGE BORROWING STRATEGY

Movements in average mortgage rates were again small in the month, but the decision between fixing for one or two years is becoming a closer call in our view. The 1-year rate remains the low point and therefore offers value. But the gap to the 2-year rate has narrowed, and may be attractive for those concerned about the possibility of the OCR moving up within the next 12 months. That is actually our forecast, although we do see the risks skewed towards a later as opposed to earlier move, and see the OCR moving up only in a tip-toe fashion when hikes do get underway. Ultimately, borrowers may wish to spread risk by borrowing over a number of fixed terms.

FEATURE ARTICLE: THE ECONOMIC OUTLOOK

This month's feature article provides a summary of our December Economic Outlook publication.

SUMMARY

Some clear headwinds are being navigated right now that have increased the odds of a growth wobble, leaving the economy somewhat delicately placed. However, we are not ready to call time on the cycle just yet. The drivers of growth are shifting, and such transitions are often not smooth, but there are still enough positive forces that we expect to see growth return to broadly around trend over the next couple of years (but probably not much more). In itself, trend growth is unlikely to be enough to get domestic inflation pressures up in a sustainable fashion, but signs of more cost-push pressures from the labour market are something that we think the RBNZ will eventually respond to, albeit in a tip-toe fashion. That said, the timing of that response is highly uncertain and skewed towards later as opposed to earlier. It is admittedly a more nuanced economic story, but one that still has a positive hue to it overall.

GROWTH WOBBLE

Right now the economy is navigating some clear headwinds:

- **The housing market is soft.** While the past few months have shown some stabilisation (and even modest recovery), turnover is still low and house price growth more modest. Even though the RBNZ is now loosening its LVR restrictions, we see soft housing market activity persisting, especially with proposed measures from the new Government set to further alter the metrics and incentives for investing in residential property, but also on affordability constraints. While we actually view a cooler market as a positive thing from a medium-term growth sustainability perspective, history has taught us that a softer housing market can have broader spill-overs to confidence and spending, and we are hearing more anecdotes to that effect.
- **Growth drivers are transitioning.** Beyond the housing market, it has become clear that the likes of construction and migration (two previous key growth drivers) have peaked or are peaking. The construction sector is grappling with pressures from the 'three C's' (capacity, costs and capital constraints), which are limiting its ability to grow further. Net migrant inflows have started to ease even ahead of possible policy changes as increased departures of non-New Zealand and Australian citizens speaks to a natural cycling effect from previous strong arrivals growth. While we do expect other growth drivers to emerge eventually, such transitions can cause some wobbles.
- **Political change has caused some unease.** While we don't think the plunge in business sentiment can be solely blamed on the election outcome, it is clear that businesses are nervous about the new policy direction. Firms' own activity expectations are the weakest they have been since 2009. At a time when the economy was already facing headwinds, the risk is that heightened policy uncertainty sees firms retrench and hold off on spending, investment and hiring decisions. Sentiment can be vulnerable through periods of transition. The risk is that it can then create negative feedback effects on activity and become self-fulfilling.
- **Productivity growth is poor.** It is not a story unique to New Zealand, and it is also a typical late-cycle phenomenon, but it is hard to put a positive spin on the fact that average annual labour productivity growth has been negative since 2013 (whether calculated using hours worked, hours paid or on an FTE basis). It is a clear signal that the economy has not been firing on all cylinders and is the main reason why the economy's per capita growth performance has been mediocre to say the least.

It leaves us somewhat circumspect towards the near-term growth picture. While it is admittedly a little historical now, we see Q3 GDP growth of just 0.4% q/q, which points to a small contraction in per capita terms. Sequential growth in Q4 and Q1 is seen at just 0.5-0.6%. If our Business Outlook survey is taken at face value, then growth over early 2018 could be even weaker. Moreover, the recent run of dry weather is something that also needs to be watched, as pasture growth is now beginning to suffer. **Indeed, we are certainly left with the impression that the economy is delicately placed right now.**

BUT WE'RE NOT READY TO CALL TIME ON THE ECONOMIC CYCLE JUST YET

Given these headwinds, it would be easy to start to spout 'Chicken Little' type prognoses. But one of our key views is that any growth wobble will not turn into something longer-lasting. Yes, the economic cycle is reasonably mature; firms are telling us that finding skilled staff is still a huge problem. Statistically we are 'due' for something untoward – years ending in '8' have not been kind to the New Zealand

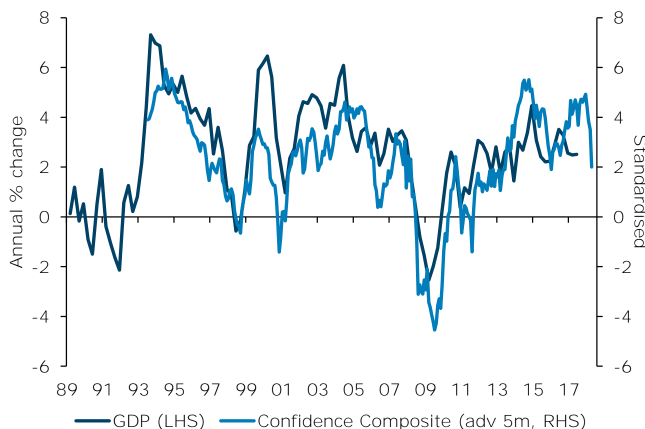
FEATURE ARTICLE: THE ECONOMIC OUTLOOK

economy, and 2018 is obviously on our doorstep. As mentioned, housing market weakness looks set to persist, and hence so too the risks of broader spill-overs to the rest of the economy. For all that though, we are not forecasting large outright falls in house prices. That would require a lift in forced sales in our view, via declining debt serviceability, which we don't expect.

There are still reasons for optimism regarding the medium-term outlook.

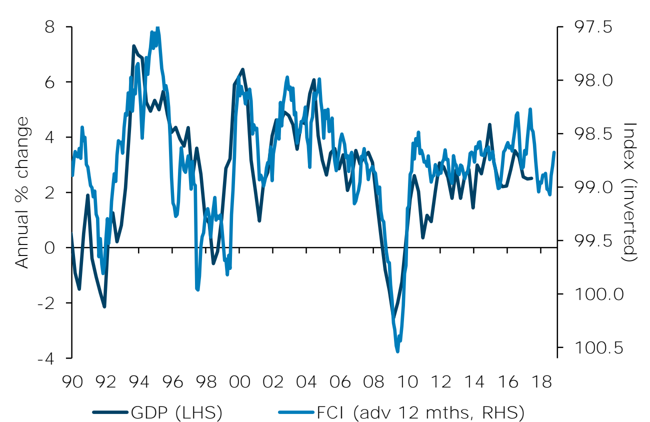
- **Financial conditions have eased.** The lower NZD, together with a record high in the terms of trade, are powerful stimulatory forces. Global liquidity conditions remain favourable and local mortgage rates have started to tick lower again (albeit only modestly). Our Financial Conditions Index is giving a signal of accelerating growth from around the second half of 2018 (figure 2).

Figure 1: Confidence Composite and GDP growth



Source: ANZ, Statistics NZ

Figure 2: Financial conditions versus GDP growth



Source: ANZ

- **Fiscal policy is set to turn far more stimulatory, at least over the next 12 months.** We believe it is underappreciated that over the past six years, fiscal drag has averaged 1.0% of GDP per year. That was necessary to return the fiscal accounts to health and rebuild the rainy day coffers. But with the starting point for the accounts now in a strong position, the new Government has options and it is clear that it plans to exercise those, even if some of the additional operating and capital expenditure is funded out of the cancellation of the previous Government's personal tax cuts. Based on the Half-year Update figures, the fiscal impulse is estimated to be 1.4% and 0.7% of GDP over 2017/18 and 2018/19 respectively.
- **The terms of trade should remain elevated.** It is currently at all-time highs and reflects both positive cyclical and structural forces. While our forecasts do have the terms of trade easing modestly over the next year, largely reflecting recent dairy price moderation (see page 7 for a broader discussion of the export commodity price outlook), the elevated level should not be underestimated in terms of its positive purchasing power benefits.
- **The global economic backdrop is solid.** Yes, there are risks in pockets of global financial markets, but right now the global economy is experiencing its strongest and most broad-based period of growth since the financial crisis (see page 6). It would be unusual for the New Zealand economy to embark on an entirely different path (figure 3, over).
- **Credit cycle headwinds should become less intense.** The RBNZ is already starting to ease back on its LVR restrictions as financial stability risks have reduced. But over the past 12 months or so, banks have restrained credit and competed more aggressively for domestic deposits as they have attempted to close a funding gap. Timely measures of that 'gap' suggest it has closed a great deal. While we are not expecting the credit flood-gates to open by any means (things like the RBNZ's review of bank capital are still lingering in the background), as a cyclical driver, credit dynamics should turn more neutral.
- **Importantly, structural metrics are in far better shape than they have typically been at this point in the cycle.** The current account deficit is contained (and is expected to remain so), net external debt levels have fallen, prudential measures have helped cool financial stability risks, and there is no over-supply of houses. These factors don't remove the possibility of a cyclical downturn. However, when imbalances are at extremes, they can certainly exacerbate swings. Those risks are relatively low right now.

FEATURE ARTICLE: THE ECONOMIC OUTLOOK

So for now we are happy to retain a broadly positive medium-term expectation, with growth returning to more or less trend rates. Notwithstanding the near-term risks, and some quarterly variability in GDP outturns, we forecast annual growth up towards 3% by the end of 2018, and averaging 2½-3% over the next couple of years overall. That is effectively the average rate of growth experienced since 2010. In other words, a 'respectable if not stellar' story, although one that arguably has more risks attached to it.

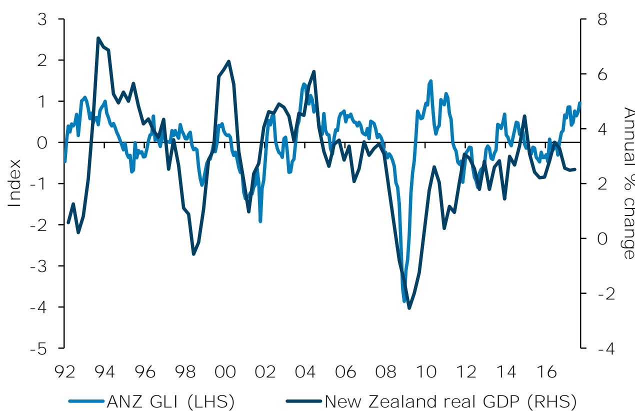
TREND, BUT NOT MUCH MORE

So we are certainly not negative overall. Growth averaging around trend is hardly a poor message. But it does mean we are less upbeat than some. Indeed, the likes of the RBNZ and Treasury see growth accelerating above trend over 2018/19. We'd of course like to share that view. However, we feel there are some factors that limit the upside to a degree.

First and foremost, **history has proven that it is difficult for the New Zealand economy to grow above trend when the most cyclical sector (housing) is expected to remain soft.** One could argue that 'this time is different' in that this housing slowdown is not the result of higher interest rates, which slow other activity at the same time as slowing housing. However, whatever the cause of the housing market cooling, changes in capital gains do affect households' actual and perceived wealth and hence willingness to spend.

In particular, we see households rebuilding precautionary saving. Household income growth has been running at a reasonable rate, and the outlook remains positive. We see the unemployment rate falling a little further to 4.4%, wage growth lifting, and secondary income sources should be boosted by some Government initiatives. However, at a time when the asset side of household balance sheets is looking less rosy, we believe that not all of that income windfall will be spent (i.e. the household saving rate will lift, figure 4) implying that consumption growth won't be as strong as it would have been otherwise.

Figure 3: ANZ Global Leading Indicator and NZ GDP



Source: ANZ, Statistics NZ

Figure 4: Household saving rate

Source: Statistics NZ, ANZ Research

Accordingly, we forecast real consumption growth to slow from today's solid rate of around 4%, averaging 2.7% and 2.5% growth in 2018 and 2019 respectively. In fact, with our forecasts having the household saving rate getting back to only around zero, we think the risk is that we are underestimating the degree of saving rebuild.

There are also a number of other factors at play that imply growth will be harder work from here:

- **There are offsets to how stimulatory fiscal policy can be.** The reality of an economy already facing capacity constraints means it is likely that private sector activity will be crowded out by increased public sector work, particularly in the construction space. In addition, the likes of increased environmental restrictions, measures targeting housing demand, migration policy changes and a more restrictive foreign investment landscape, also have the potential to offset the positive growth impact of higher public operating and capital expenditure. Simply adding the amount of new public spending to growth forecasts is too simple by half. There are a number of moving parts. But perhaps most importantly, we don't think the Government will have as much to work with as fiscal projections currently show. That will set up the likelihood of it needing to reprioritise its spending plans in order to remain within its own fiscal targets.

FEATURE ARTICLE: THE ECONOMIC OUTLOOK

- **Net migrant inflows should slow further.** We assume annual net migration slows to 45k by the end of 2019. At this stage we have not incorporated any impact of possible policy changes. While it is possible that policy changes could be growth enhancing if they get the mix right and free up resources for capacity constrained sectors, that is easier said than done. Ultimately, lower net migrant inflows put more onus on productivity growth to step up to the plate. The recent track record means it is hard to have much conviction in that occurring.
- **There is an effective current account constraint in play.** The economy's previous modus operandi of meeting a domestic saving shortfall by ramping up overseas borrowing is now facing more challenges, either through increased regulatory scrutiny of the banking sector or from warnings by credit rating agencies. In spirit, this is effectively a current account constraint (or even an external balance sheet constraint). It basically means that in order for our national investment needs to be met, the onus is more squarely on national saving (figure 5). This is in fact exactly what has been seen over recent years, with the national saving rate rising to 8.8% – the highest since 2014. We see this theme persisting (and, as mentioned, we see household saving lifting). More saving typically means less growth.

INFLATION TO LIFT ONLY GRADUALLY

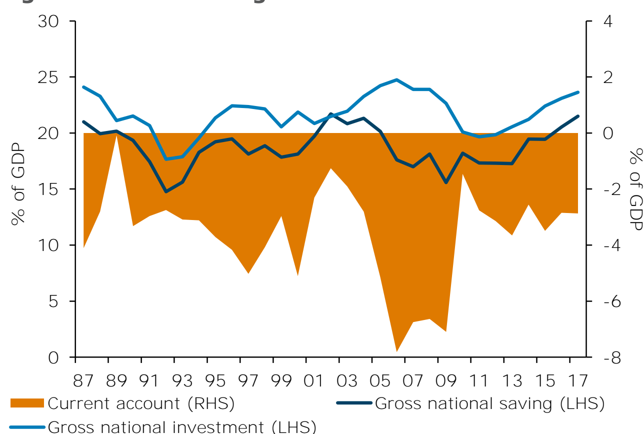
All else equal, growth around trend will not dramatically alter the domestic inflation outlook. As our Monthly Inflation Gauge attests, evidence of broad-based price pressures remains tentative and mixed. On top of this, secular global forces (technology, increased global brand penetration and winner-takes-all business models, deleveraging, and a more mobile labour force) are continuing to alter the inflation-generating process in poorly understood ways.

But we do still forecast a gradual lift in domestic inflation, in large part due to a likely lift in cost-push inflation from the labour market. With headline inflation up off lows and skill shortages prevalent, some of the traditional drivers of wage inflation were already pointing upwards (within the context of secular forces like technology continuing to have an offsetting influence). Now, in addition, some of the policies of the new Government (minimum wage hikes and possible work place relations changes) are likely to accentuate moves. We forecast annual nominal LCI private sector wage growth to lift to 2.1% by the end of 2018. There are offsetting policies from an inflation perspective, like the one year of free tertiary education, which we estimate will knock 0.2%pts off headline inflation in Q1, but the stronger wage growth backdrop should still contribute to non-tradable inflation rising towards 3% by the end of 2019.

There should be a little more tradable inflation too. While structural deflationary forces persist, the lower NZD, recent lift in global commodity prices, and some signs that global inflation is finally showing signs of lifting tentatively as labour markets tighten, should correspond into a little more imported inflation. After averaging zero since 2010, annual tradable inflation is forecast to average 0.8% and 0.9% in 2018 and 2019 respectively.

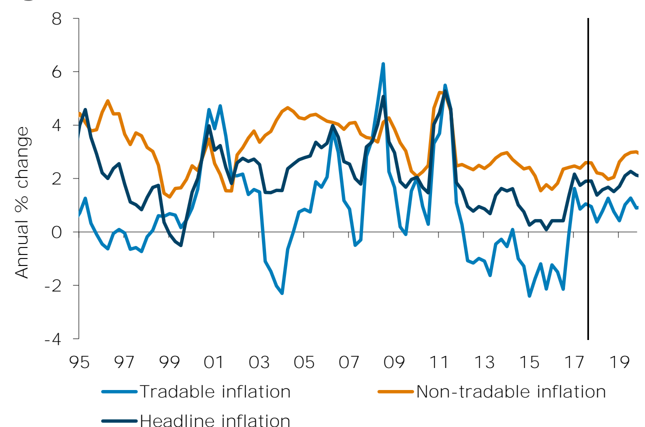
Overall, headline inflation should sit around 2%. We see headline inflation averaging 1.5% in 2018 and 2.1% in 2019 (figure 6). **That leaves us with a bias towards the next move in the OCR being a hike.**

Figure 5: Gross saving and investment



Source: Statistics NZ, ANZ Research

Figure 6: CPI inflation



Source: Statistics NZ, ANZ Research

FEATURE ARTICLE: THE ECONOMIC OUTLOOK

But the timing of moves is highly uncertain. We have pencilled in a hike from late-2018. However, we see the risk skewed towards later than this. What is certainly clear is that when hikes do eventually get underway, policy will be tightened in a tip-toe fashion. A lower neutral rate (perhaps only around 3%), means the tightening cycle will be a modest one.

INTERNATIONAL OUTLOOK

Our global growth forecasts again depict a steady and reasonably positive picture heading into 2018, although it is arguably 'as good as it is going to get'. While we are positive overall, some tests are looming, and in particular the impact of a turn in the global liquidity cycle and the impact on asset prices at a time when many households appear more vulnerable.

PRIMARY OUTLOOK

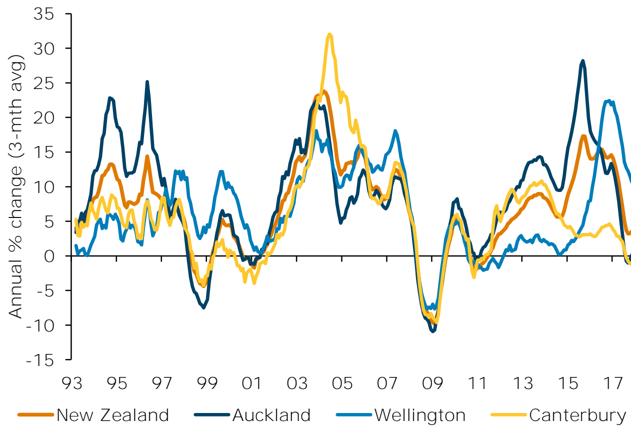
Dairy markets look tentative heading into the first half of 2018, but most other sectors look steadier at what are currently historically high farm-gate prices. While local supply conditions are set to improve for most sectors they remain constrained by historical standards.

FINANCIAL MARKETS OUTLOOK

Near-term stability, before a gradual lift from around the middle of 2018, remains our overarching view on New Zealand short- and long-term interest rates. Consistent with our broader global forecasts, moves in New Zealand rates are forecast to be modest. Perhaps with the exception of against the AUD, where we see some modest downside, the NZD is expected to strengthen a little on most crosses out to the middle of 2018. However, as financial market volatility picks up on a more pronounced turn in the global liquidity cycle, we expect this to put the NZD back on the defensive again.

THE PROPERTY MARKET IN PICTURES

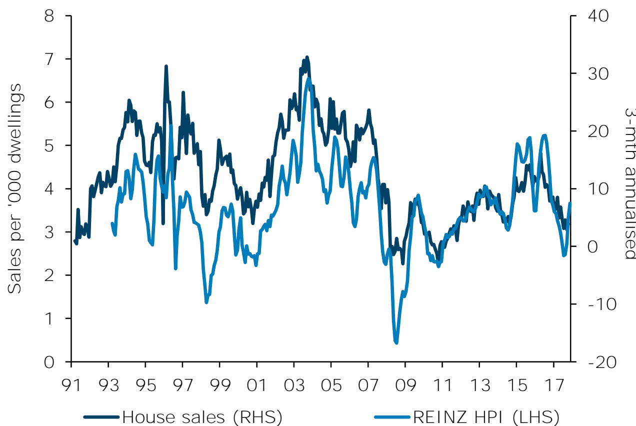
Figure 1. Regional house price inflation



Source: ANZ, REINZ

We estimate the nationwide REINZ House Price Index rose for a fourth straight month in seasonally adjusted terms in November, lifting 0.7% m/m. That is about the average pace of monthly increase seen over the past four months. It saw annual growth hold steady at 3.5% y/y (the chart is presented in 3-month average terms). Although Auckland prices have actually risen a little more than the rest of the country over the past three months (2.1%), they are up only 0.4% y/y. Across the rest of the country, prices rose 0.7% m/m in November, and are up 6.7% y/y. Of the major centres, Wellington is recording the strongest annual price growth of 9.7% y/y.

Figure 2. REINZ house prices and sales



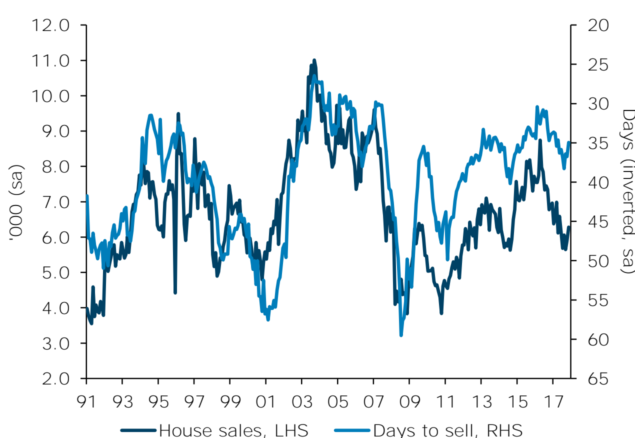
Source: ANZ, REINZ

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

National seasonally adjusted sales volumes lifted by 6.4% m/m in November. That is the third increase in the past four months, pointing to the market showing some tentative signs of life. That said, volumes are still down 8.8% y/y and are 28% lower than the mid-2016 high.

From a regional perspective, Auckland continues to underperform, with turnover falling 0.8% m/m (sa) in November, to be down 16% y/y. That compares with an 8.3% m/m (sa) lift in sales volumes across the rest of the country. Compared with a year ago, the regions experiencing positive annual growth at present include Gisborne, Taranaki, Wellington, Tasman/Marlborough and Canterbury.

Figure 3. Sales and median days to sell



Source: ANZ, REINZ

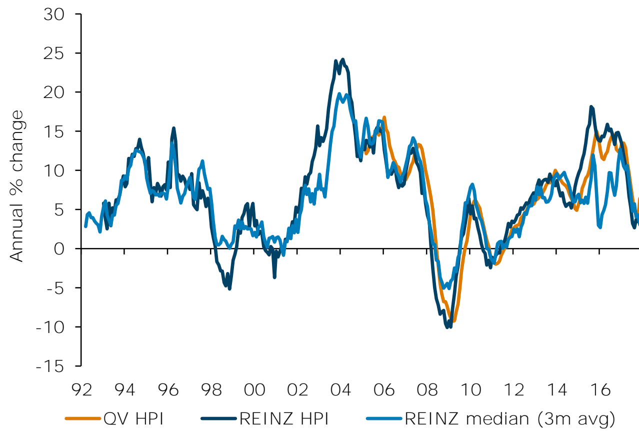
How long it takes to sell a house is also an indicator of the strength of the market, encompassing both demand and supply-side considerations. Larger cities tend to see houses sell more quickly, but deviations in a region from its average provide an indicator of the heat in a market at any given time.

Nationally, the median time to sell a house fell by 1.8 days to 35.0 days (sa) in November. That is the shortest period since April and is down from over 38 days only three months ago. It is below the historical average of 39.6 days, but is still higher than the low of 30.8 days seen in mid-2016.

The median time to sell a property is now below historical averages in every region except Canterbury.

THE PROPERTY MARKET IN PICTURES

Figure 4. REINZ and QV house prices

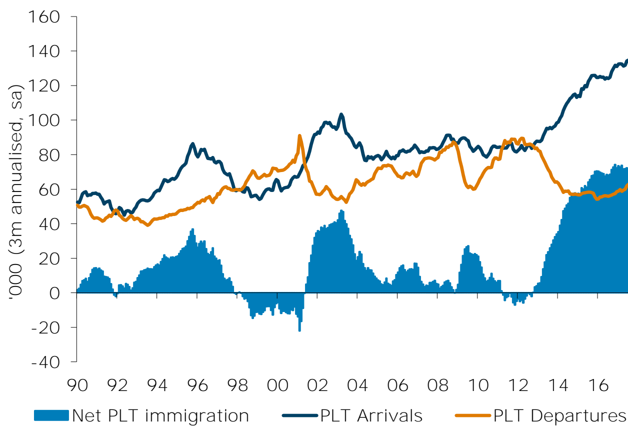


Source: ANZ, REINZ, QVNZ

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 (the REINZ house price index and QVNZ measures attempt to adjust for the quality of houses sold).

The REINZ median sale price fell 0.3% m/m (sa) in November, with annual growth steady at 4.0% y/y. This is a little stronger than the REINZ HPI (3.5% y/y) but below the QVNZ measure of price growth (6.8% y/y).

Figure 5. Net permanent/long-term immigration



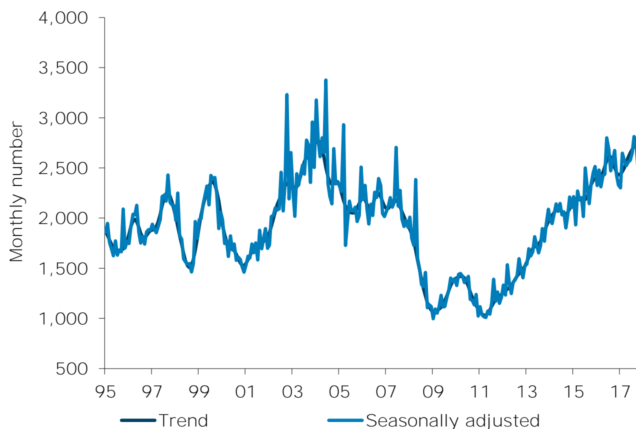
Source: ANZ, Statistics NZ

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.

Recently, net migrant inflows have begun to slow. On a three-month annualised basis, net inflows fell below 65k in October for the first time since mid-2015. The combination of falling arrivals and rising departures is driving this slower pace of net inflows.

Ahead of any possible policy changes, the increase in departures of non-New Zealand and Australian citizens (due to a natural cycling effect as previously large numbers of arrivals leave) already speaks to a likely "peak" in net migration.

Figure 6. Residential building consents



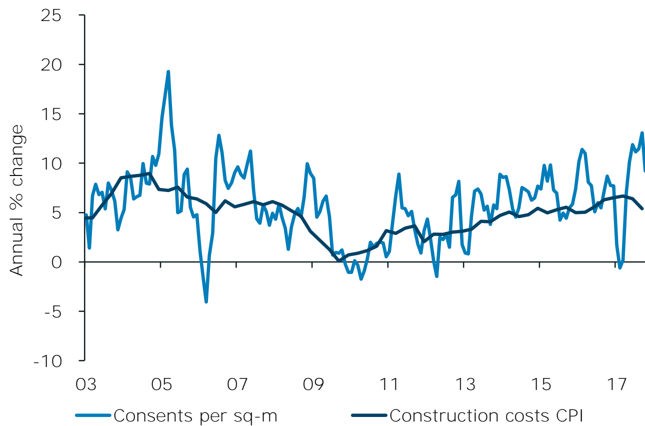
Source: ANZ, Statistics NZ

Dwelling consent issuance fell 9.6% m/m (sa) in October. This follows a 2.5% m/m fall in the previous month. In October, issuance for 'houses' fell 2.9% m/m (sa), while more-volatile multi-dwelling consents plunged 21.8% m/m (sa). From a floor-area perspective, we estimate issuance rose 2.6% (sa) m/m after falling 13% in September.

When we step back from monthly volatility, we still believe we are in an environment where annual issuance will struggle to push much above 30k (it is currently 30.6k). While the demand picture remains solid, and strong population growth requires ongoing lifts in housing supply, that supply response is being challenged by the '3 Cs' (capacity, costs and credit). We don't see these pressures easing any time soon.

THE PROPERTY MARKET IN PICTURES

Figure 7. Construction cost inflation

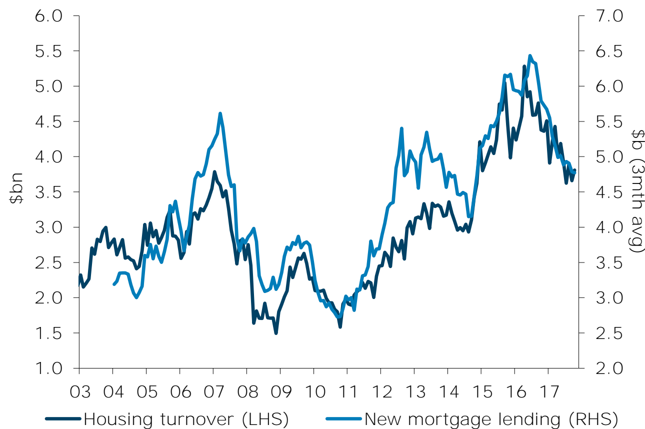


Source: ANZ, Statistics NZ

On a three-month average basis, **the value of residential consents per square metre – a proxy for construction cost inflation – rose 9.2% y/y in October.** This is down from over 13% in September, but remains elevated.

Notably, the implied measure of construction costs from the CPI has started to ease, falling to 5.4% y/y in Q3, from 6.4% y/y in Q2. It is going to be interesting to see whether, with house price growth cooling, construction cost inflation can continue to run at its earlier strong pace.

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 modestly in October (the chart is presented in 3-month average terms). We estimate that in seasonally adjusted terms, new lending rose 3.6% m/m after plunging 9.6% m/m to $4.6bn in September, which was the lowest level since September 2014. The lift in October was only the fourth increase in the past 12 months. New lending remains down 14% y/y.

New investor lending continues to be soft, although is perhaps stabilising. In October, lending to investors was down 15% y/y, making up only 23% of total lending. That is well below the 35% share seen in mid-2016.

Figure 9. New mortgage lending and housing credit

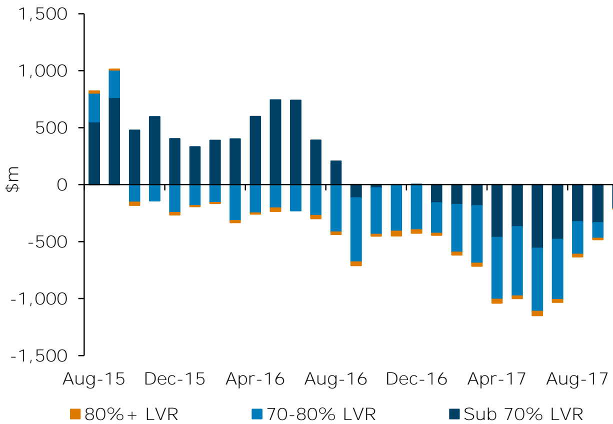
Source: ANZ, REINZ, RBNZ

Total household lending growth was steady in October, at 0.5% m/m (sa). It is up off its lows, but is the same pace of growth as experienced in September. In three-month annualised terms, growth, at 5.1%, is holding reasonably steady, at effectively the softest pace since early 2015.

High-LVR lending restrictions, increased credit rationing by banks, and evolving expectations regarding capital gains – all are having an impact on both house sales and credit availability. While we do not envisage the rate of housing lending growth slowing significantly further from here, we expect the more moderate pace of lending growth that is now occurring to persist for the foreseeable future.

THE PROPERTY MARKET IN PICTURES

Figure 10. Annual change in investor lending by LVR

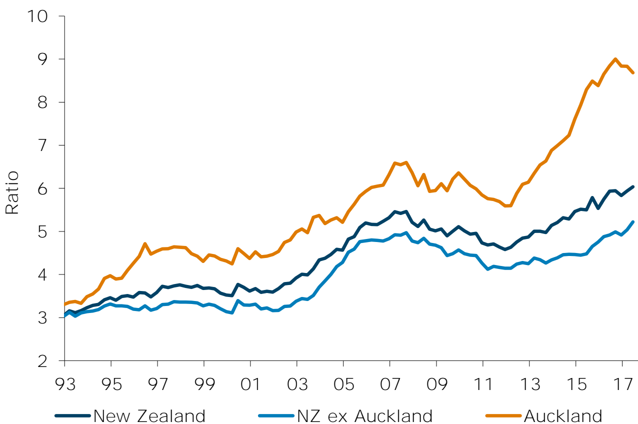


Source: ANZ, RBNZ

New lending to investors is well off its mid-2016 peak, and was down 15% y/y in October, but is showing signs of basing. Investors' share of overall new lending, at 23%, is well down from a peak of 35% in June 2016. This lower share no doubt relates, at least in part, to the impact of the RBNZ's latest round of LVR restrictions (which came into force in October 2016). While the RBNZ has recently announced that these restrictions will be eased modestly (from 1 January 2018), the easing is best defined as a tweak at this stage.

Related to the LVR restrictions, a larger share of new lending is on less-risky terms. In October, 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

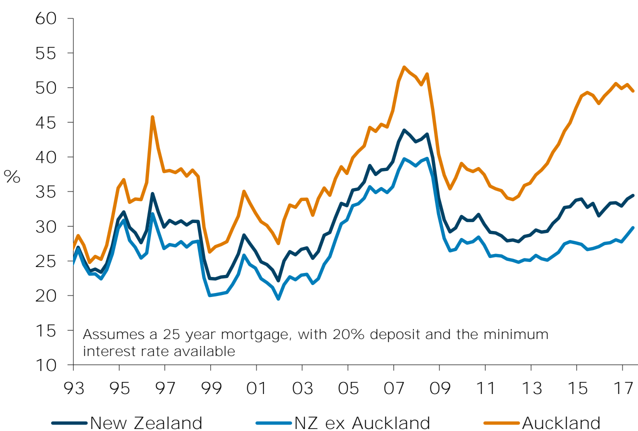


Source: ANZ, REINZ, Statistics NZ

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

Housing market activity has shown a few more signs of life of late, bouncing off low levels. However, our overall views have not changed. There are clear opposing forces. 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, affordability constraints and possibly more restrictive government policy changes. We continue to 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 as 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	↔	Appears to have peaked even ahead of potential policy changes. But not set to fall sharply.
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	↔/↑	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 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 harder.**

ANZ

PROPERTY GAUGES

Figure 1: Housing affordability

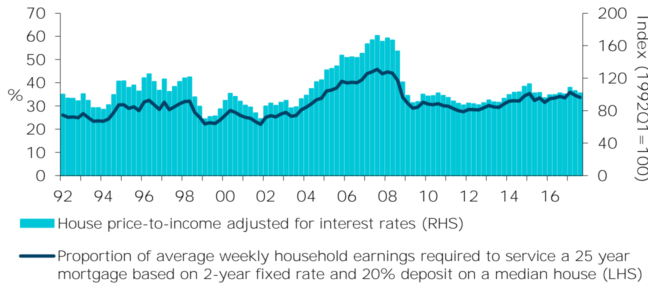


Figure 2: Household debt to disposable income

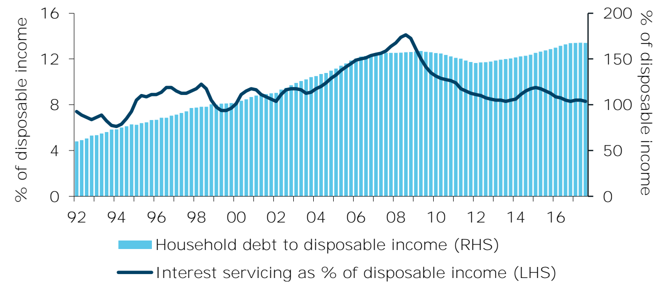


Figure 3: New customer average residential mortgage rate (<80% LVR)

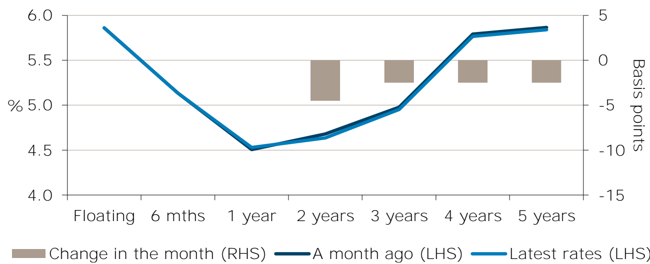


Figure 4: Net migration

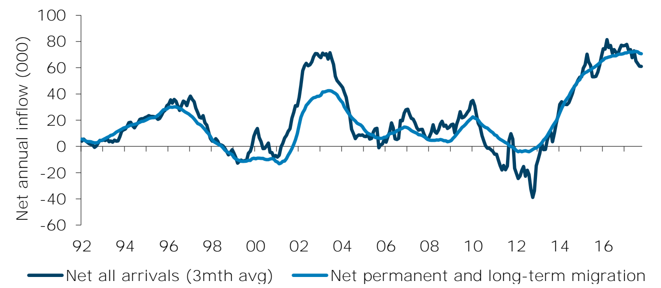


Figure 5: Housing supply-demand balance

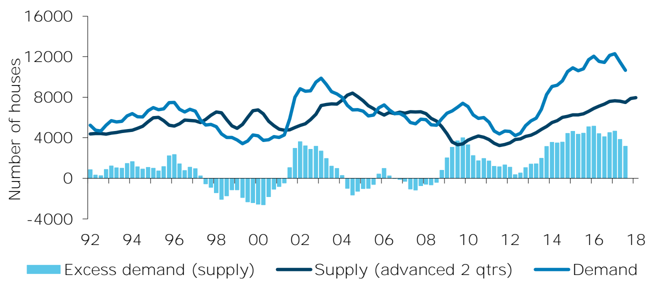


Figure 6: Building consents and house sales

Figure 7: Liquidity and house prices

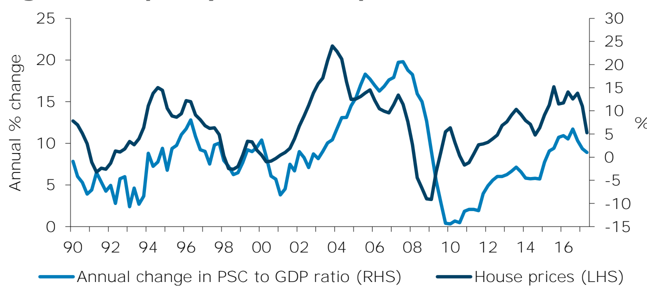


Figure 8: House price inflation comparison

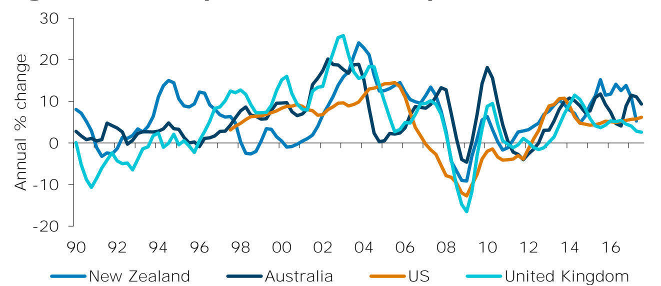


Figure 9: Housing supply

Figure 10: Median rental, annual growth

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

MORTGAGE BORROWING STRATEGY

SUMMARY

Movements in average mortgage rates were again small in the month, but the decision between fixing for one or two years is becoming a closer call in our view. The 1-year rate remains the low point and therefore offers value. But the gap to the 2-year rate has narrowed, and may be attractive for those concerned about the possibility of the OCR moving up within the next 12 months. That is actually our forecast, although we do see the risks skewed towards a later as opposed to earlier move, and see the OCR moving up only in a tip-toe fashion when hikes do get underway. Ultimately, borrowers may wish to spread risk by borrowing over a number of fixed terms.

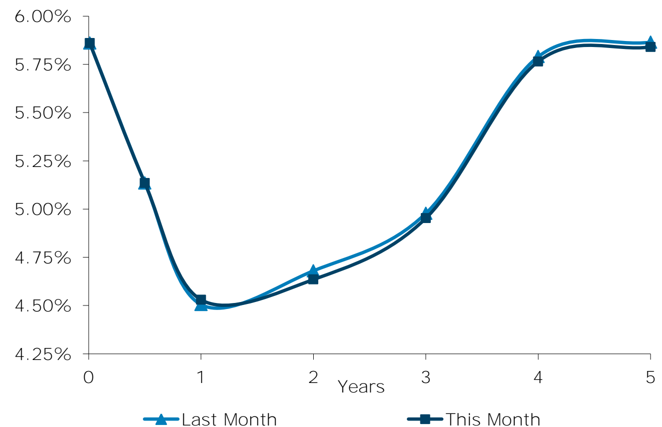
OUR VIEW

Changes in average mortgage rates were once again small in the past month. There were some small falls in the 2-5 year space, but 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.

The 1-year rate remains the low point on the curve, and continues to offer value. But the gap to the 2-year rate is narrowing, which makes the decision between fixing for either one of two years a closer call. When we eye our forecasts for the monetary policy outlook, we do have the OCR rising gradually from late next year on an expectation of a little more cost-push inflation emerging from the labour market. That potentially could sway a borrower more towards the 2-year rate. However, there is plenty of uncertainty regarding the timing of future hikes, and we see the risks skewed more towards a later move as opposed to earlier. What's more, when hikes do get underway, what is clear is that the OCR will only be lifted gradually. That keeps the "value" in rolling short-dated hedges.

But breakeven analysis supports this closer call between the 1 and 2-year rates at present. For instance, the average two-year special rate is only 11bps above the 1 year rate. The 1 year rate would need to rise by only 21bps (from 4.53% to 4.74%) over the next year in order for it to be cheaper fixing for 2 years at 4.64% 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 4.64% versus a 3 year at 4.95% is 5.16%. 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%	4.69%	4.79%	5.43%
1 year	4.53%	4.31%	4.74%	5.11%	5.59%
2 years	4.64%	4.71%	5.16%	5.94%	6.90%
3 years	4.95%	5.40%	6.18%	6.41%	6.64%
4 years	5.77%	5.89%	6.17%		
5 years	5.84%	#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%	4.65%	5.61%	5.15%	5.90%
1 year	4.93%	5.13%	5.38%	5.53%	6.05%
2 years	5.16%	5.33%	5.71%	6.04%	6.58%
3 years	5.45%	5.73%	6.18%	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 and 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 November 2017 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	7.9	-2.7	198	0%	47
Auckland	0.3	1.4	1,742	+2%	35
Waikato	4.9	-2.2	614	+3%	38
Bay of Plenty	10.5	2.0	396	+5%	40
Gisborne	14.2	5.9	59	+3%	33
Hawke's Bay	18.8	2.2	232	+13%	31
Manawatu-Whanganui	12.7	0.5	371	+17%	36
Taranaki	1.7	4.9	189	+8%	36
Wellington	8.7	0.1	731	+9%	32
Tasman, Nelson and Marlborough	19.2	3.6	80	-61%	21
Canterbury	2.9	3.3	926	+28%	37
Otago	17.2	4.1	374	+23%	31
West Coast	-14.1	2.9	27	-6%	41
Southland	14.4	-2.9	156	+13%	37
NEW ZEALAND	4.5	0.7	6,281	+10%	35

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	2.4	2.4	2.3	2.3	2.5	2.7	3.0
CPI Inflation (Annual % Chg)	1.3	2.2	1.7	1.9(a)	1.9	1.4	1.6	1.7	1.5	1.7
Unemployment Rate (%)	5.2	4.9	4.8	4.6(a)	4.7	4.6	4.5	4.5	4.4	4.4
Interest rates (RBNZ)	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**	**Jun-19**
Official Cash Rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.25	2.25
90-Day Bank Bill Rate	2.0	2.0	2.0	2.0	2.0	2.0	2.1	2.3	2.5	2.5
Floating Mortgage Rate	5.8	5.9	5.9	5.9	5.9	5.9	5.9	6.1	6.4	6.4
1-Yr Fixed Mortgage Rate	5.1	5.1	5.0	5.1	5.1	5.2	5.2	5.4	5.5	5.5
2-Yr Fixed Mortgage Rate	5.3	5.3	5.2	5.3	5.4	5.4	5.5	5.7	5.8	5.8
5-Yr Fixed Mortgage Rate	6.3	6.3	6.3	6.3	6.4	6.4	6.6	6.8	6.8	6.8

Source: ANZ, Statistics NZ, RBNZ

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Ph 64 9 357 4094, e-mail nzeconomics@anz.com, http://www.anz.co.nz