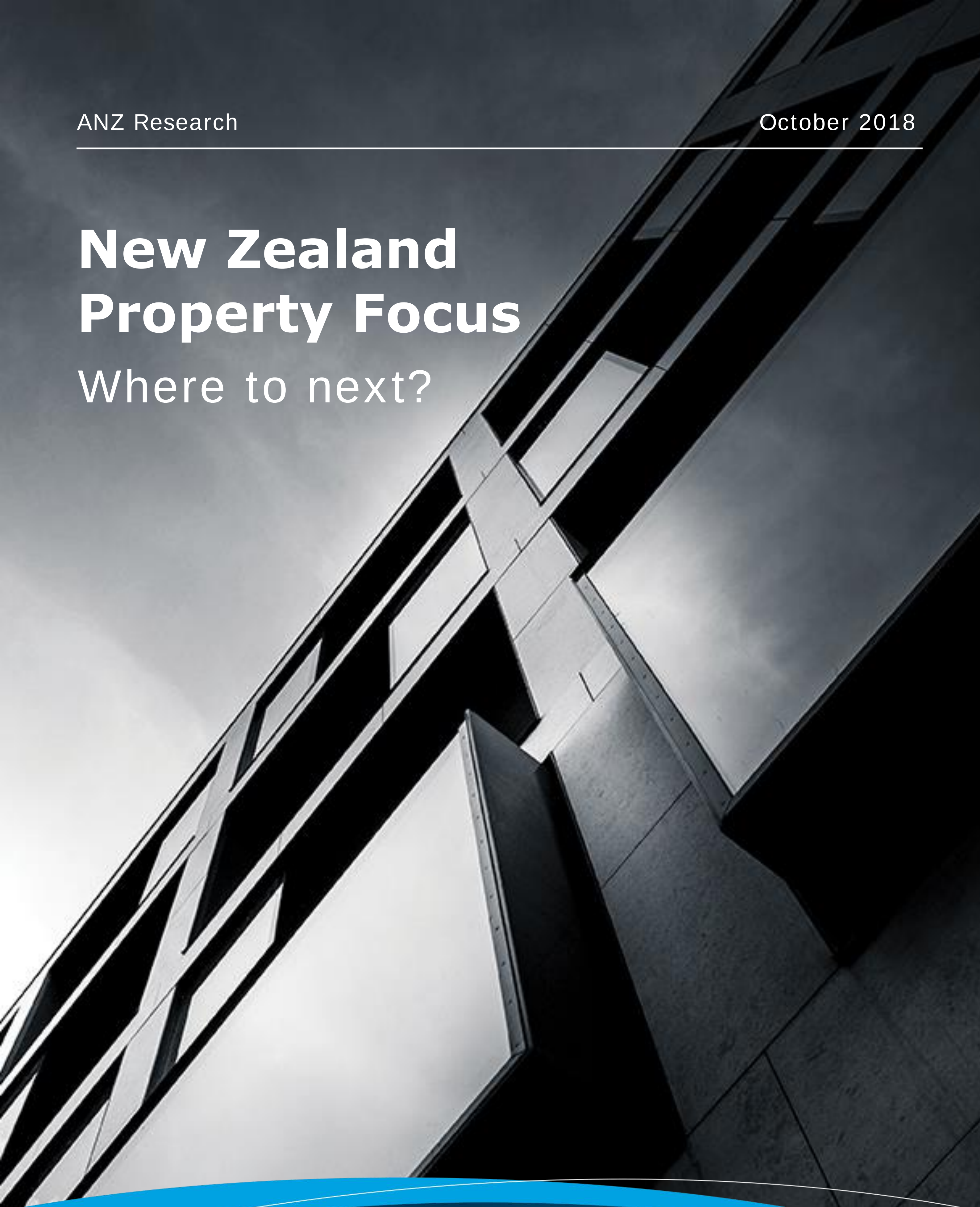

New Zealand Property Focus

Where to next?

This is not personal advice. It does not consider your objectives or circumstances. Please refer to the Important Notice.

INSIDE

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Summary

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

Feature Article: Where to next?

This month we update our views on the outlook for the housing market. A number of offsetting forces are buffeting the market, but the balance of those forces may be changing. Our central view is that the market will see some volatility in coming months, especially in light of policy changes, but that an overarching theme of softness will prevail – with house price inflation expected to be modest. However, we'd emphasise that the outlook is very uncertain at present, and is subject to a number of important risks on both sides. Recent falls in mortgage rates could lend further support to the market, particularly given market tightness in certain regions. But on the other hand, policy changes could see a significant departure of investors from the market, recent softness could see expectations reassessed, and/or the migration outlook could be weaker than expected. On balance, we see risks as tilted to the downside. And in that environment, we expect that the RBNZ will ease loan-to-value restrictions a little at the November FSR. This will provide a boost to the market, but the effect is not expected to be large.

Property Gauges

The housing market has experienced a period of softness in recent months. The Auckland market has been weak, while pockets of pressure remain in other markets. The outlook is uncertain at present and policy changes look set to cause some volatility in the data, which may make the property market pulse difficult to gauge. Nonetheless, we expect that an overarching theme of softness will persist, with a number of headwinds acting on the market. In our view, a rebound does not appear particularly likely, despite a number of supportive factors still in play. Given this outlook, we expect that the RBNZ will ease macro-prudential policy at the November FSR, but continued caution should see policy settings remain "tight" for some time.

Economic Overview

Risks to the economic outlook have increased, both domestically and from offshore. Data from business surveys highlight the risk of a growth wobble, but this hasn't been reflected in hard data – at least not yet. We do not expect that the cycle is about to roll over, but think that acceleration from here will be challenging to achieve. We continue to see GDP growing at around 2½-3% y/y. Based on this expectation, we suspect it will be difficult to maintain inflation near the midpoint of the RBNZ's target band. CPI inflation was stronger than expected in Q3, but broad-based inflation pressures are lacking. The RBNZ have made it clear that OCR hikes are off the table until they see core inflation above the target midpoint. Given this, we expect that a cautious tone will be maintained by the RBNZ, with the OCR on hold for the foreseeable future.

Summary

This month we update our views on the outlook for the housing market. A number of offsetting forces are buffeting the market, but the balance of those forces may be changing. Our central view is that the market will see some volatility in coming months, especially in light of policy changes, but that an overarching theme of softness will prevail – with house price inflation expected to be modest. However, we'd emphasise that the outlook is very uncertain at present, and is subject to a number of important risks on both sides. Recent falls in mortgage rates could lend further support to the market, particularly given market tightness in certain regions. But on the other hand, policy changes could see a significant departure of investors from the market, recent softness could see expectations reassessed, and/or the migration outlook could be weaker than expected. On balance, we see risks as tilted to the downside. And in that environment, we expect that the RBNZ will ease loan-to-value restrictions a little at the November FSR. This will provide a boost to the market, but the effect is not expected to be large.

Recent market developments

Forces on the housing market have been broadly offsetting…

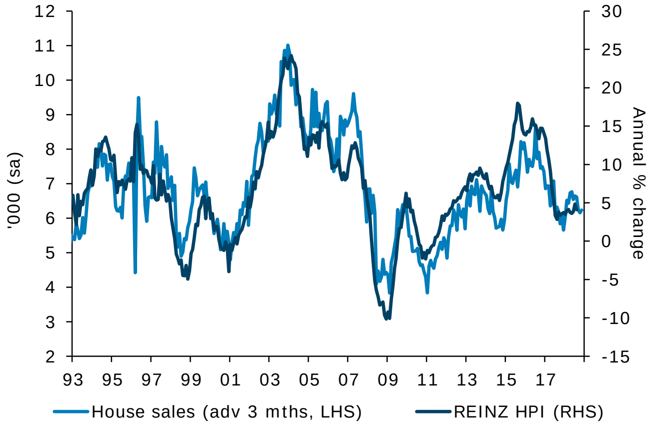
Over 2018 to date the housing market has been affected by a number of factors that have been broadly offsetting. Immigration has been strong, there was pent-up demand from first-home buyers, and interest rates have been low. But headwinds have been acting on the market too. Credit conditions have been tight, with banks prudent and loan-to-value restrictions in effect. Investors have been wary in light of proposed policy changes. And affordability constraints have been biting, with house prices at eye-watering levels in Auckland particularly. This has seen house price inflation in Auckland underperform the rest of New Zealand, with a catch-up dynamic at play.

Our view over 2018 has been that the offsetting forces acting on the market would see house sales tracking in recent ranges with stability in price pressures until the balance of those forces changed. On balance, we have viewed risks as being tilted towards the downside. We also expected that continued tightness in regional markets, contrasted with increased buyer wariness towards the Auckland market, would see regional divergences continue. The housing market has largely been tracking in line with our expectations (figure 1).

…but following recent stability we have seen a period of softness

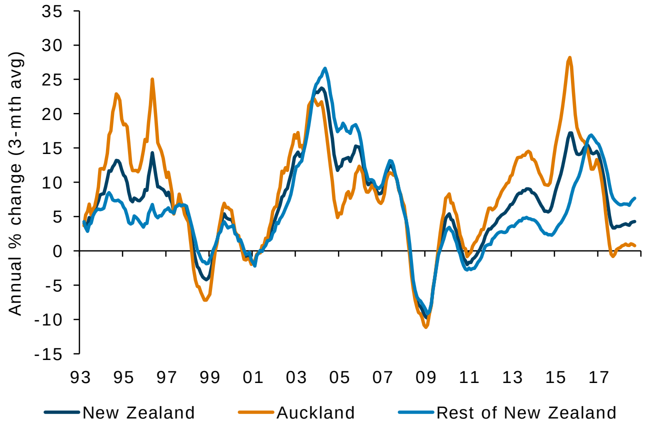
After a period of stability, we have seen a period of softness in the housing market in recent months. House sales have taken a step down – falling 14% since May, with a 9% m/m fall in the month of September – and house price inflation has been modest through the middle of the year, increasing just 0.8% over the past six months. The weakness has been concentrated in Auckland, with prices there having fallen 2% since February and sales down 16% since May. But in September, sales fell 10% in the rest of the country, with declines recorded in all regions. The Auckland market has continued to underperform (figure 2).

Figure 1. House sales and house price inflation



Source: REINZ

Figure 2. House price inflation by region



Source: REINZ

Feature Article: Where to next?

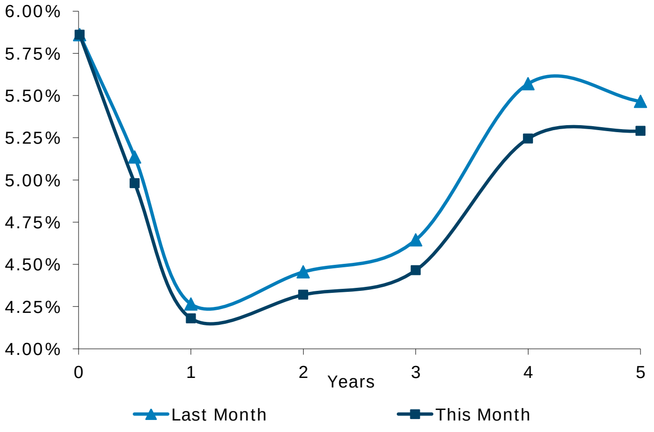
It is unclear how recent developments will balance out

As we expected would eventually happen, the balance of offsetting forces in the housing market appears to be changing. A number of developments have occurred that are relevant to the market with implications for the outlook from here. Given these developments, it is timely for us to update our views.

Here's a summary of recent developments affecting the housing market:

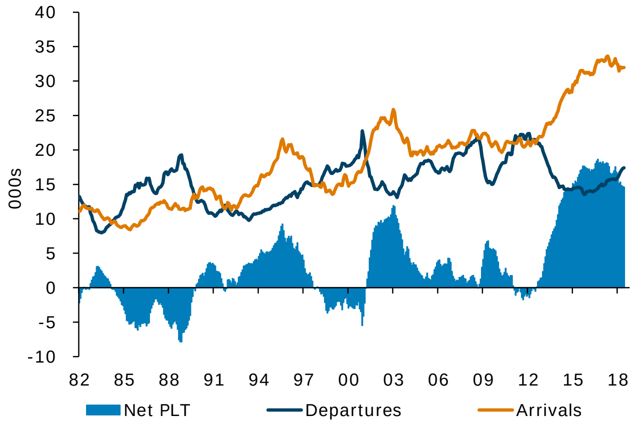
- Mortgage rates have fallen across the curve, especially at the long end (figure 3), with 3- to 5-year rates falling 40-50bps over the past two months. This reflects falls in long-term wholesale interest rates since the middle of this year, with market expectations that the OCR will remain low for longer.
- Immigration flows have continued to moderate gradually (figure 4). In quarterly terms, net permanent and long-term migration has declined from 17,600 in January (3-month sum) to 14,400 in September. And with the economic outlook looking less assured, there is a risk the cycle turns more quickly than expected.

Figure 3. Average mortgage rates



Source: interest.co.nz, ANZ Research

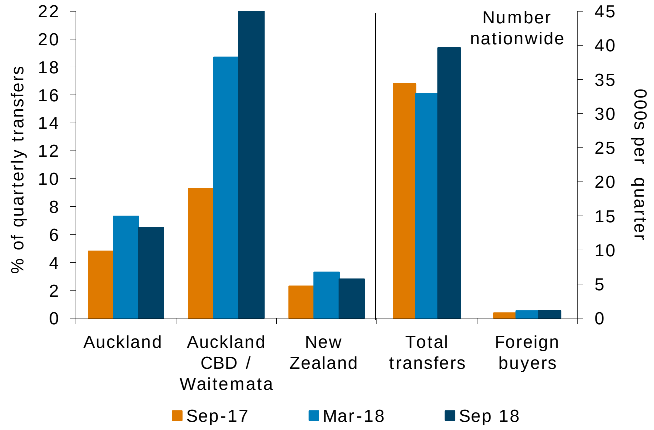
Figure 4. Net migration inflows (quarterly)



Source: Statistics NZ

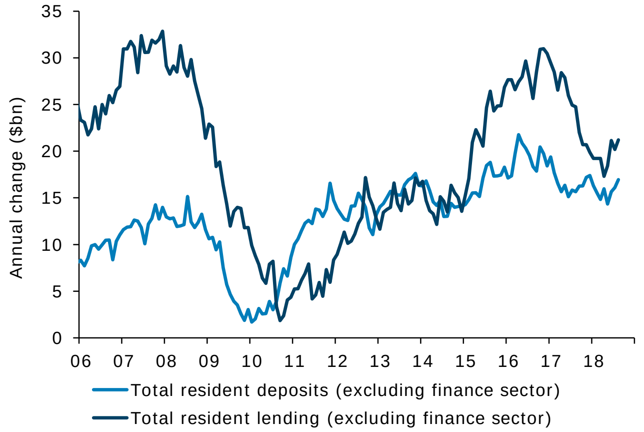
- The foreign-buyer ban came into effect on October 22. There appears to have been an increase in foreign buyer activity in the lead-up to the ban (figure 5), meaning underlying weakness in recent months may be understated. While foreign buyers comprise a small share of overall buyers, we expect to see some reduction in sales now that the ban has come into effect.
- Other policy changes are also proposed, leading to a general sense of wariness amongst investors. Consultation is also taking place on standards for rental properties, after legislation was passed late last year. And a number of other policy changes have been proposed, like a capital gains tax, which is currently under review by the Tax Working Group.
- Generally, the housing market has been weaker than historical relationships would suggest since mid-2016, reflecting bank prudence, affordability constraints and investor wariness. It appears unlikely that lending growth will reaccelerate away from deposit growth (figure 6).

Figure 5. Share of property transfers to non-resident buyers



Source: Statistics NZ

Figure 6. Resident funding and claims growth (bank funding gap)



Source: RBNZ

- There has been a modest increase in new listings from low levels, centred in Auckland. This, combined with a fall in sales, has led to some tentative slackening in market tightness. This may simply be a symptom of data volatility but, if sustained, it could reflect investors pulling out of the market or wariness about recent market softness on the part of sellers. Markets in regions outside Auckland remain very tight.
- More broadly, regional divergences in the market remain stark, as highlighted by anecdotes. In Auckland, where the market has been weak, there is disconnect between expectations of buyers and sellers – sellers are expecting well above council valuations, but buyers are bidding below. By contrast, the Wellington market is proving difficult to get into. Often, buyers are missing out on a number of tenders before securing a property and houses are going consistently over valuation.

Where to next?

The outlook is uncertain and we expect to see volatility…

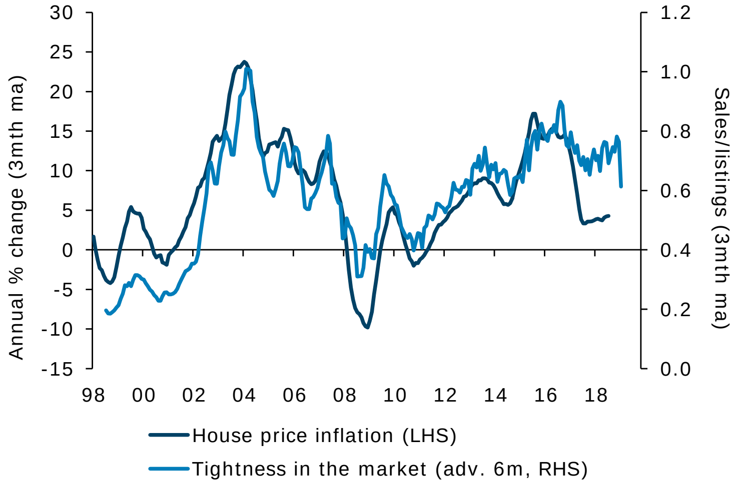
Given the range of offsetting forces that are currently at play, the outlook for the housing market is by no means clear cut. Policy changes are occurring at the same time as lower mortgage rates are flowing through to the market, while a number of offsetting headwinds and tailwinds remain in play.

There may be some bumps in the road ahead and we expect that it may be difficult to discern the underlying signal in the data as a result. Our central view is that the housing market data will show some more volatility in coming months, especially in light of the foreign-buyer ban coming into effect in mid-October. We don't want to read too much into the weak September month, but we think that the underlying soft trend in house prices and sales is telling.

…but on balance we think a theme of softness will persist

Looking through the expected volatility, on balance we expect that an underlying theme of softness will prevail with investors remaining cautious, affordability constraints biting, and sellers reassessing their expectations. House price inflation has been weaker than historical relationships (eg with net migration and interest rates) would suggest and we expect this phenomenon to persist, particularly if the recent softening in market tightness is sustained (figure 7). Overall, we expect annual house price inflation to soften gradually from here, although it may be subject to some bumps.

Figure 7. Tightness in the market and house price inflation



Source: Barfoot & Thompson, realestate.co.nz, REINZ, ANZ Research

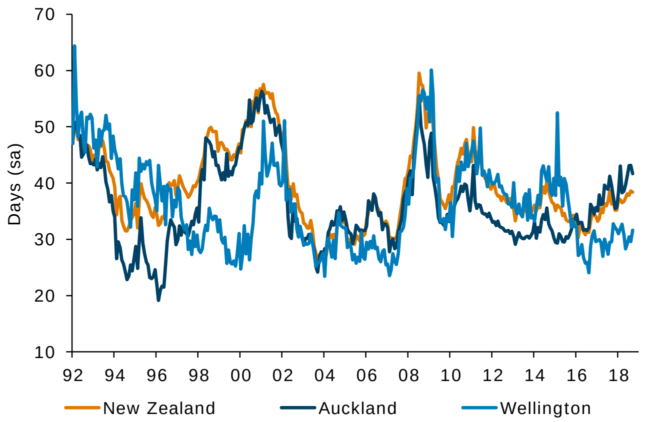
Underlying this picture, we expect regional divergences to remain stark. In particular, we expect that Auckland and Canterbury markets will remain soft, dampening the nationwide picture. Meanwhile, pockets of pressure are expected to continue in other markets.

The Auckland market accounts for 30% of New Zealand house sales and is experiencing strong headwinds:

- It currently takes 42 days to sell a house in Auckland, well above the historical average of 36 days (figure 8). This points to slack in the market, which has emerged since 2016. Moreover, the recent increase in new listings is centred in Auckland, which could signal potential further loosening in market tightness ahead.

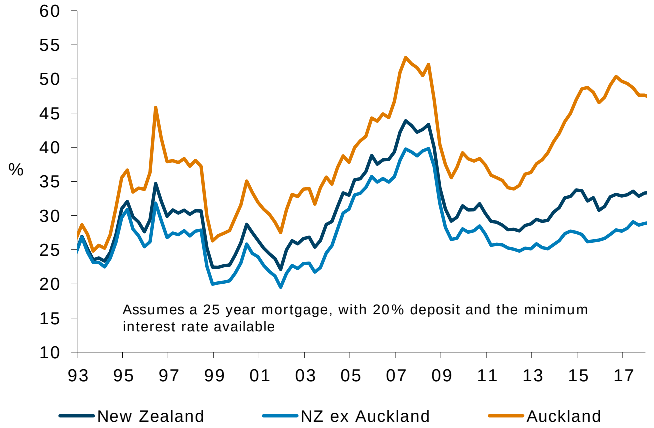
- Affordability constraints are biting acutely in the region, with house prices in Auckland 8½ times median disposable incomes. It costs about half of median disposable income on average to service a mortgage on the median house in Auckland with a 20% deposit (figure 9). This compares with 30% on average in the rest of New Zealand. Given these affordability constraints, our analysis has shown that households no longer feel good about house price increases. And households in Auckland are the least optimistic according to our ANZ-Roy Morgan Consumer Confidence Survey.

Figure 8. Median days to sell



Source: REINZ

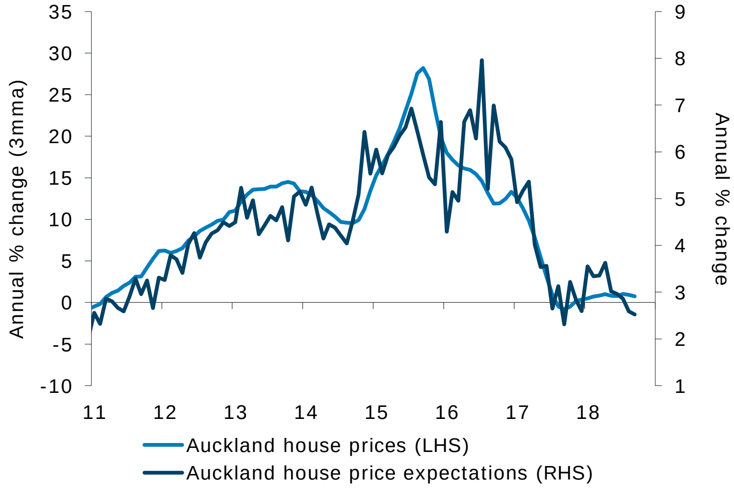
Figure 9. Mortgage repayments to income



Source: REINZ, RBNZ, Statistics NZ, ANZ Research

- The foreign-buyer ban is expected to have a stronger impact in Auckland, especially in the central part of the city, given that a larger proportion of buyers there are foreigners.
- More generally, softness in the Auckland market is expected to continue as sellers' expectations gradually adjust to the new reality. Sometimes expectations provide a signal of where house prices are heading; sometimes they lag, adapting based on what has been happening in the market. But either way, without a bounce in the short term, house price expectations from the ANZ-Roy Morgan Consumer Confidence Survey are consistent with lingering softness in Auckland (figure 10).

Figure 10. House price expectations and house price inflation – Auckland



Source: REINZ, ANZ Research

The outlook is subject to important risks

While we expect an overarching tone of softness to prevail through the volatility, the outlook is particularly uncertain at present. There are a number of important risks of which to be mindful:

- Recent declines in mortgage rates could provide more of a boost than currently assumed, particularly if historical relationships reassert themselves or banks regain their appetite for riskier lending. This could see a mini resurgence in the market. However, we see other headwinds as tempering this possibility. A stronger impulse from low interest rates would be particularly likely if the RBNZ cut the OCR, but in this scenario weakness in the domestic economy would likely provide an additional headwind to the market. Potentially offsetting this, it is possible that credit conditions could be tighter than currently assumed, with the recent market slowdown in Australia and associated tightening in lending standards potentially having flow-on effects to our financial system.

- Immigration could be weaker than expected. Our view is that the migration cycle will continue easing gradually, but we see risks as being skewed to the downside. Migration cycles have a tendency to swing quite abruptly. And given the large influx of arrivals we have seen this cycle, there is a risk that those who have entered the country prove less likely to stay should the economic outlook appear less assured.
- There could be a significant departure of investors from the market, given current uncertainty and potential future policy changes, such as the possible imposition of a capital gains tax. The foreign-buyer ban could also have a larger effect than we anticipate. While foreigners comprise a small share of property transfers, they provide a source of potential demand that can no longer be tapped (eg they will not be bidding in tenders and auctions). By removing this source of demand, it is possible that a more rapid adjustment could occur in the market, with expectations of both buyers and sellers adjusting downward more quickly than otherwise.
- If firms follow through on weaker employment intentions, this could eventually feed through into consumer confidence and thereby willingness to take on debt, cooling demand. Our forecast is for households to be restrained in their spending, but a worsening in consumer confidence, significant retrenchment in spending and increased aversion towards debt and house purchases is not expected.

There are certainly risks on both sides of the ledger and a resurgence in housing market activity and price pressures cannot be ruled out. Nonetheless, on balance, it appears to us that risks to the outlook are skewed to the downside.

What are the policy implications?

We expect the RBNZ will loosen loan-to-value restrictions.

Based on recent housing and credit developments, we expect the RBNZ will ease loan-to-value ratio restrictions at the November FSR. Under current loan-to-value restriction settings banks are permitted to:

- Make no more than 15% of their residential mortgage lending to high-LVR (less than 20% deposit) borrowers who are owner occupiers.
- Make no more than 5% of residential mortgage lending to high-LVR (less than 35% deposit) borrowers who are investors.

The loan-to-value restrictions, which were originally implemented in October 2013, were always intended as a temporary, counter-cyclical measure, designed to mitigate the build-up of systemic risk in the financial system.

The RBNZ has previously set out the criteria for loosening loan-to-value ratio restrictions:

- Evidence of house price and credit growth falling to around the rate of household income growth.
- A low risk of housing market resurgence if the restrictions are eased.
- Confidence that an easing in policy will not undermine the resilience of the financial system.

Currently, housing market pressures are contained and while resurgence would certainly not be desirable, the Auckland market could perhaps benefit from a little more support. Markets outside Auckland are very tight, but it does not appear that there is a large speculative element at play that could lead to a boom-bust cycle – nationwide house price expectations are fairly contained and rental yields do not appear unsustainably low.

High-LVR lending remains low as a share of new loan commitments (figure 11) and lending standards are prudent. Credit growth remains stable and has been tracking at a consistent rate of 0.5% m/m for the past year, with no signs of a pick-up. Indeed, given recent softening in market turnover, a softening in the pace of new lending from here is possible. But importantly, house prices and household debt remain high relative to incomes, warranting continued caution with regards to financial stability risks (figure 12).

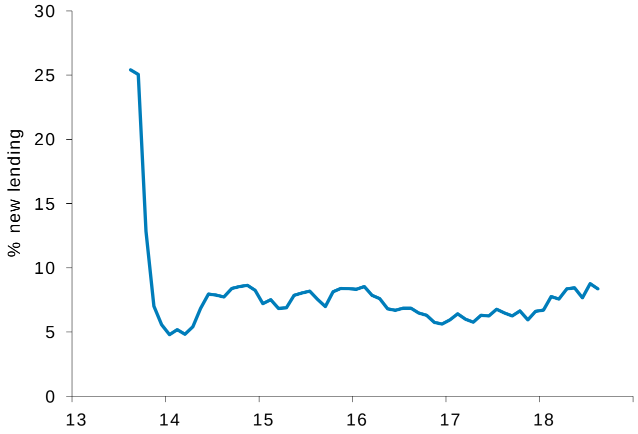
In our view, these criteria have been sufficiently met to justify a continued gradual easing in the restrictions at the FSR, especially since risks around the housing market outlook appear skewed to the downside. And given that investor demand appears particularly soft, we expect that any change would involve a marginal loosening in investor restrictions.

But any easing will be cautious and gradual

But any change will be gradual, with the restrictions expected to remain tight for some time (figure 12). In our view, a neutral level for the restriction – that neither boosts nor dampens the housing market – might be consistent with lower-deposit loans being somewhere in the realm of 15-20% of lending, as opposed to under 10% now. We expect that the RBNZ will ease the restrictions only a little, such that they are still at levels consistent with the restrictions exerting a continued dampening force on the market.

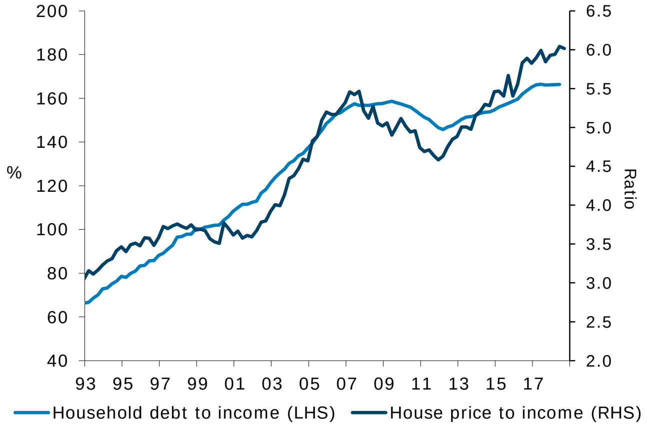
The RBNZ will want to keep the restrictions "tight" until they are satisfied that the risk of resurgence associated with further easing would be small. Given the risks associated New Zealand's high levels of house prices and household debt, they will want to be sure that there is no more fuel in the tank before taking their foot completely off the brake.

Figure 11. High-LVR lending as a share of new loan commitments



Source: RBNZ

Figure 12. House prices and household debt to disposable income



Source: RBNZ, REINZ, Statistics NZ, ANZ Research

This will reduce the need for loose monetary policy – but only at the margin

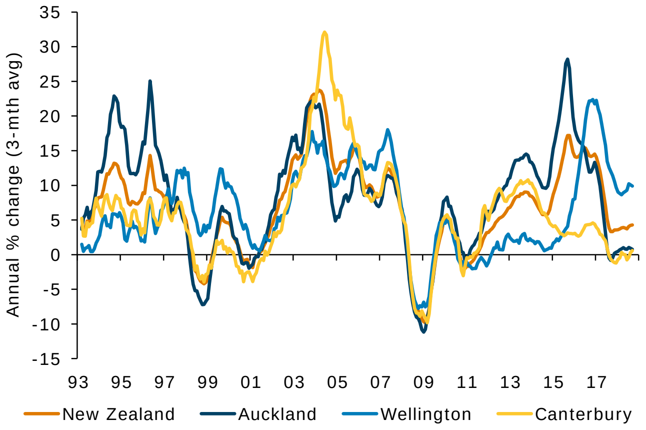
An easing in loan-to-value restrictions might reduce the need for loose monetary policy, but only at the margin. The impacts of changes in the restrictions on activity, inflation and the OCR are likely to be fairly small, particularly relative to the magnitudes of other developments that the RBNZ is contending with when weighing up the outlook for monetary policy. But even so, at the margin an easing would allow the RBNZ a little more time to watch how conditions evolve – with the OCR comfortably on hold.

More generally, we expect the effect of an easing in the restrictions on the housing market would be small, especially if it is gradual and targeted at investors. There would likely be an increase in demand at the margin, as some low-deposit buyers enter the market, which would lead to an increase in sales and prices, all else equal. But the magnitude of the effect depends on how binding the constraint currently is – that is, how many marginal buyers are currently locked out of the market. With the housing market soft, property investment less attractive and pent-up demand appearing to have waned (especially in Auckland), we suspect the constraint is not particularly binding at present.

A slight easing in investor loan-to-value ratio restrictions took place at the start of 2018. This loosened the 5% limit on lending to investors with deposits of less than 40%, applying it instead to deposits of less than 35%. This saw the share of investor loans with deposits less than 30% increase from 11% to 15% of investor lending, with a small bump in house sales. We would expect to see a similar (or smaller) effect for a similar-sized loosening in the restrictions (say, applying the investor restriction to deposits of less than 30%). But overall, any easing is expected to be small relative to the initial imposition of the investor restrictions in 2016, which is estimated to have reduced house prices by 2.7% in Auckland.[1]

[1] Armstrong, Skilling & Yao (2018).

Figure 1. Regional house price inflation

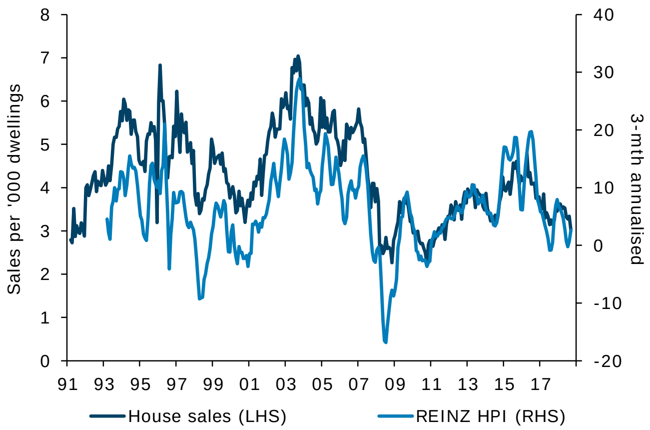


Source: ANZ, REINZ

House price inflation has been soft through the middle of the year. The REINZ house price index rose 0.7% q/q in Q3, with a 0.5% m/m increase in the month of September. This follows a soft June quarter. Annual house price inflation is running at 4.3% y/y (3mma), but over the past six months house prices have risen only 0.8%.

Auckland house prices rose in September, after six months of declines. Auckland house prices increased 0.5% m/m in September to be up 0.8% y/y (3mma) – the first monthly gain since February. Outside of Auckland, house prices increased 0.5% m/m, with annual house price inflation running at 7.7% y/y (3mma).

Figure 2. REINZ house prices and sales

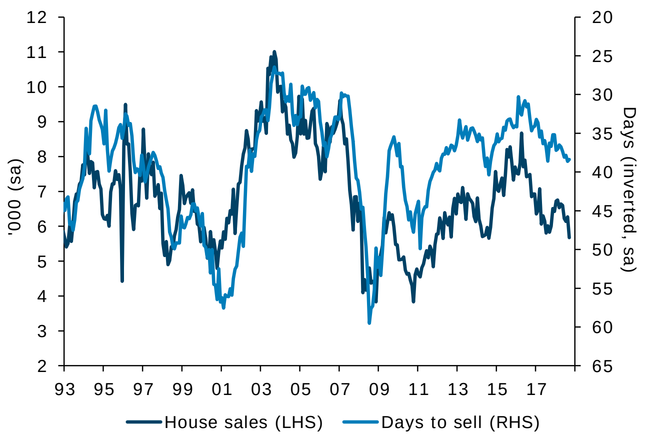


Source: ANZ, REINZ

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

House sales have weakened in recent months. We estimate that seasonally adjusted house sales fell 9.4% m/m in September, with declines in the number of sales across all underlying regions. This is a large monthly move and we may see some bounce-back in coming months. Nonetheless, this comes on the back of a downward trend in housing market activity. Sales are 2.5% higher than a year ago (3mma), on the back of increases through the second half of 2017. But to put it in context, there has been a 16% decline since early in the year.

Figure 3. Sales and median days to sell

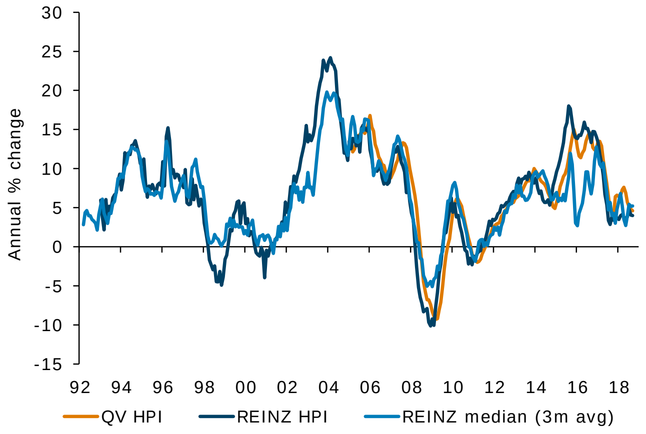


Source: ANZ, REINZ

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 38 days in September (sa). Days to sell in Auckland fell slightly from 43 to 42 days, while it lengthened from 35 to 38 days outside of Auckland. Outside Auckland and Canterbury, days to sell remain below average, despite increases across a number of regions in the month of September.

Figure 4. REINZ and QV house prices

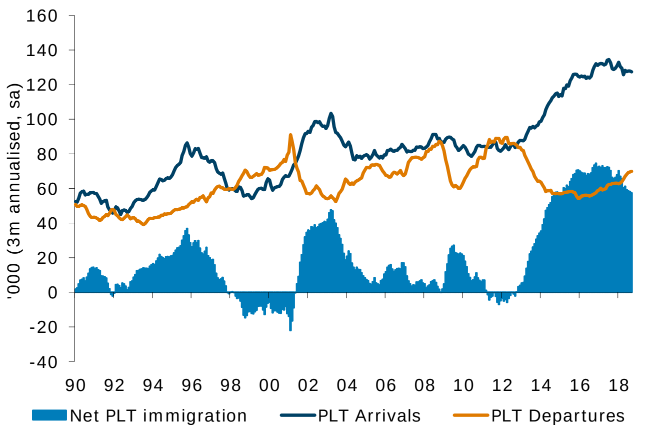


Source: ANZ, REINZ, QVNZ

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 0.7% m/m (sa) in September. Annual growth is running at 5.2% y/y (3mma). The QVNZ measure of price growth has moderated to 4.6% y/y, converging to the more timely REINZ data. The REINZ HPI – our preferred measure – is sitting a touch below the other two series (4.3% y/y 3mma).

Figure 5. Net permanent/long-term immigration

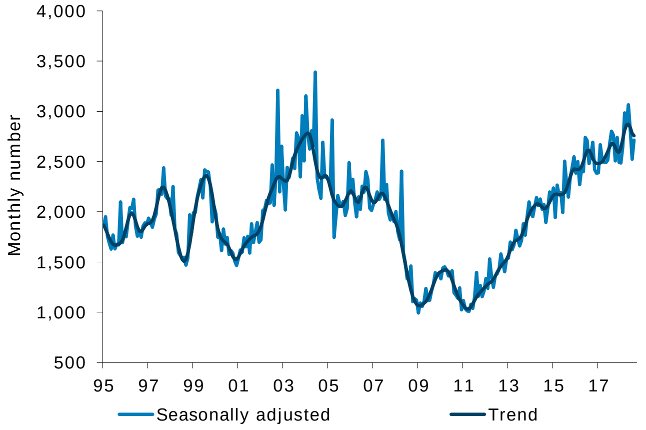


Source: ANZ, Statistics NZ

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.

The migration cycle 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

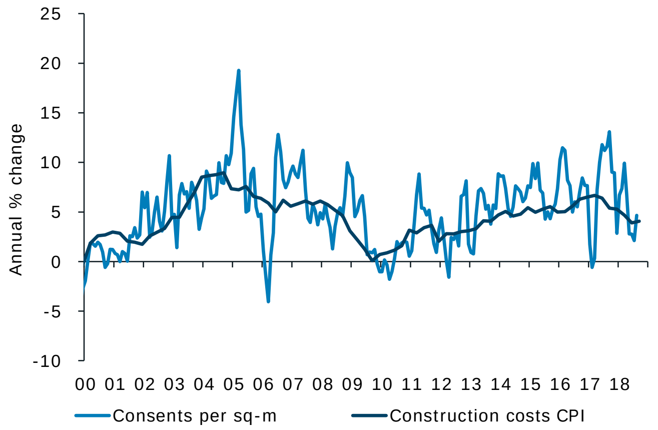


Source: ANZ, Statistics NZ

Consent issuance has been volatile of late. But in trend terms, growth has been softening. Dwelling consent issuance increased 7.7% m/m in September, after falling in the two months prior. Consents have been volatile of late and a bounce was expected. Multi-dwelling consents rose 22.5% m/m, after falling 30% over the previous two months.

Dwelling consents are trending down at a rate of 1.5% per month – in stark contrast to the upward trend seen earlier in the year, at 3.3% per month in February. It is unclear whether this trend will continue; housing demand remains strong, but construction-industry challenges may be limiting activity.

Figure 7. Construction cost inflation

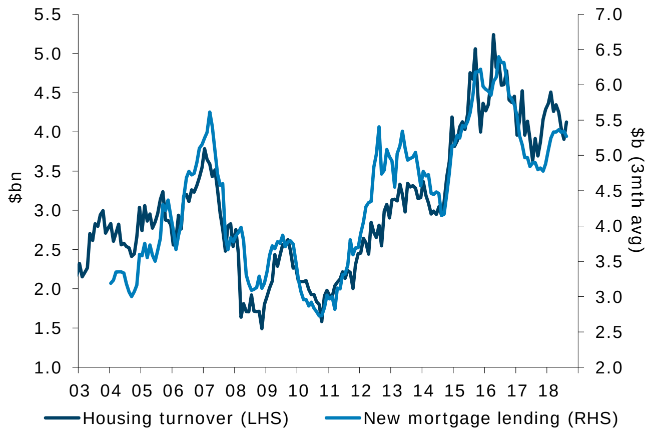


Source: ANZ, Statistics NZ

Construction cost inflation may be stabilising. Growth in the cost of consented work per square metre – a proxy for construction cost inflation – has moderated, but rose 4.7% y/y (3mma) in August. The CPI inflation measure of construction costs ticked up to 4.1% y/y in the September quarter, but is down from the recent peak of 6.7% in March 2017.

Some anecdotes suggest that momentum in building cost inflation is waning, but nonetheless it remains supported by capacity pressures, which continue to see it running at a moderate pace. We expect continued pressure on costs, but firm pessimism may lead to some challenges and wariness regarding passing through cost increases.

Figure 8. New mortgage lending and housing turnover

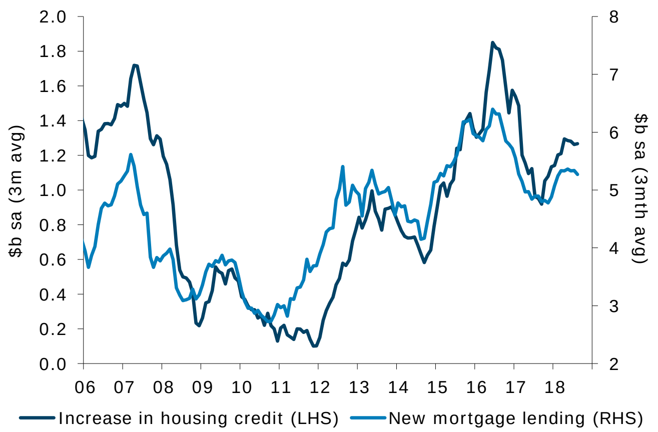


Source: ANZ, RBNZ

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 in recent months. New mortgage lending fell 2.2% m/m in August in seasonally adjusted terms (3mma). This moderation in lending is consistent with softer housing market turnover, and that trend may continue in coming months on the back of weaker sales. Since mid-2016, the share going to investors has fallen (from 35%). But more recently, the composition of lending has been stable, with approximately 25% going to investors, 15% to first home buyers, and 60% to other owner occupiers.

Figure 9. New mortgage lending and housing credit

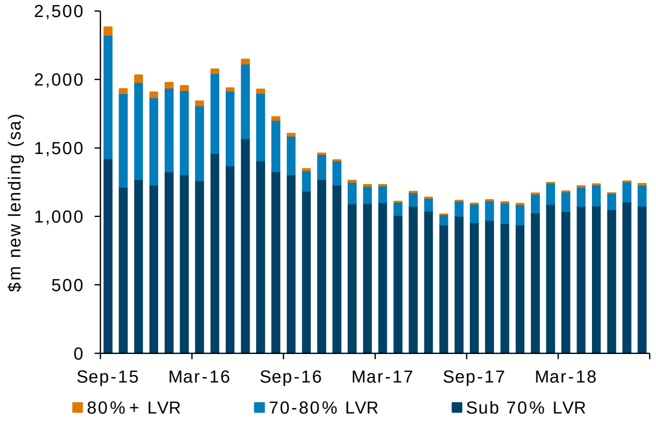


Source: ANZ, REINZ, RBNZ

Household credit growth has been growing at a consistent monthly pace since early 2017. Household lending increased 0.5% m/m in August. In annual terms, credit growth is stable at 6.0% y/y.

Housing credit growth has moderated in line with new mortgage lending. It is possible that credit growth could soften further in coming months if the recent weakness in house sales is sustained, but our central expectation is that it continues to grow modestly. Banks are behaving prudently, loan-to-value ratio restrictions are in effect, and investors are wary, all contributing to the step-down in house sales that we have seen of late.

Figure 10. Investor lending by LVR

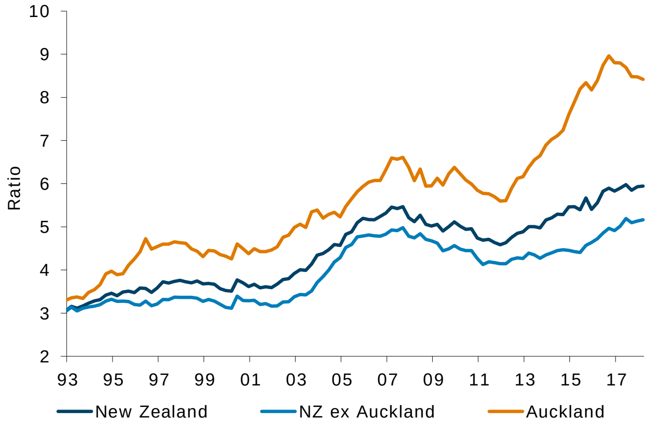


Source: ANZ, RBNZ

On a seasonally adjusted basis, new lending to investors increased 2.4% m/m in July. But looking through monthly volatility, new lending to investors has been broadly flat since late 2016 – increasing about $1.2bn per month. This is 40% below the $2bn of new lending per month seen through H1 2016. This lower pace of lending relates, at least in part, to the impact of loan-to-value ratio restrictions (which came into force in October 2016 and were loosened marginally at the start of the year).

Investor lending is also on less-risky terms. In July, the share of total investor lending at loan-to-value ratios of less than 70% was 86% (seasonally adjusted). That is a far greater share than in late-2014, when it was less than half.

Figure 11. Regional house prices to income

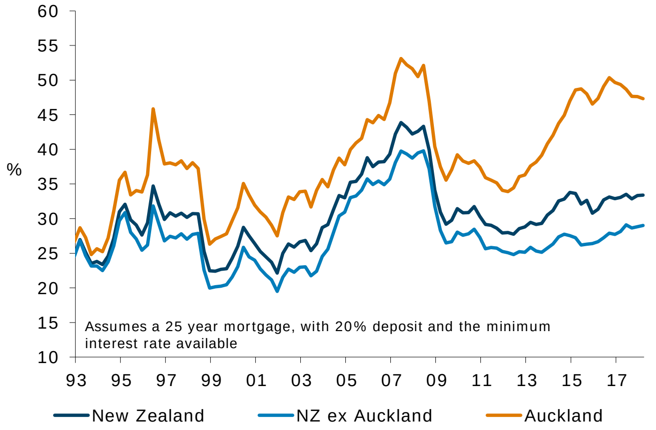


Source: ANZ, REINZ, Statistics NZ

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 has seen its ratio ease from a high of 9 times in Q3 last year to an estimated 8.5 times in Q1 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 5.2 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 33.3%. However, 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, 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 has experienced a period of softness in recent months. The Auckland market has been weak, while pockets of pressure remain in other markets. The outlook is uncertain at present and policy changes look set to cause some volatility in the coming data, which may make the property market pulse difficult to gauge. Nonetheless, we expect that an overarching theme of softness will persist, with a number of headwinds acting on the market. In our view, a rebound in the housing market does not appear particularly likely, despite a number of supportive factors still being in play. Given this outlook, we expect that the RBNZ will ease macro-prudential policy at the November FSR, but continued caution should see policy 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, but the next move in the OCR may well be down. 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	Mixed bag	↔	Non-resident buyers aren't very influential, but policy changes may dampen demand. The housing market is weak in Australia.
Housing supply	Too few	↔/↑	The Government is going to take a more active role, but there are still questions about crowding out other work and labour shortages.
House prices to rents	Too high	↔/↓	Rents are moving up, with pressures on the existing stock apparent, although these are not the only game in town.
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 there may be some bumps in the road ahead.**

Property gauges

Figure 1: Housing affordability

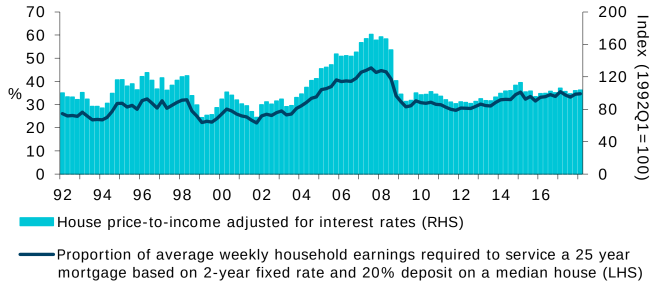


Figure 2: Household debt to disposable income

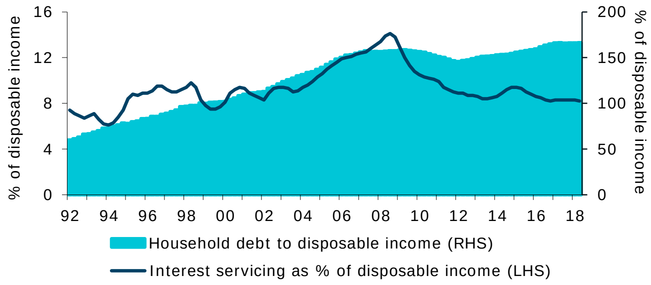


Figure 3: New customer average residential mortgage rate (<80% LVR)

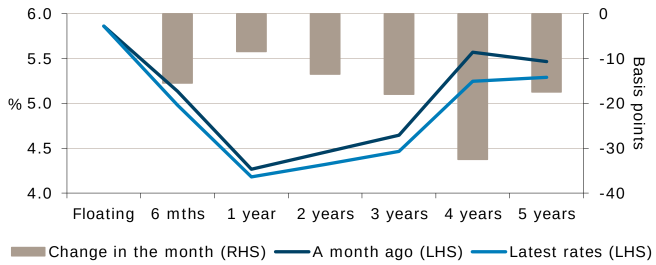


Figure 4: Net immigration

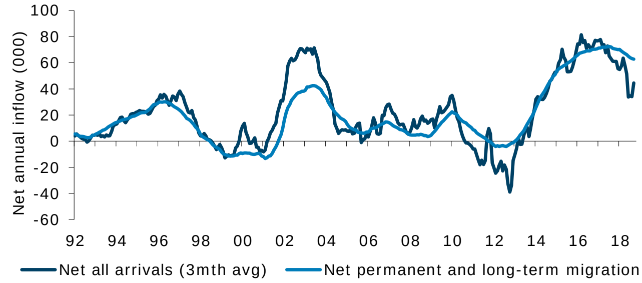


Figure 5: Housing supply-demand balance

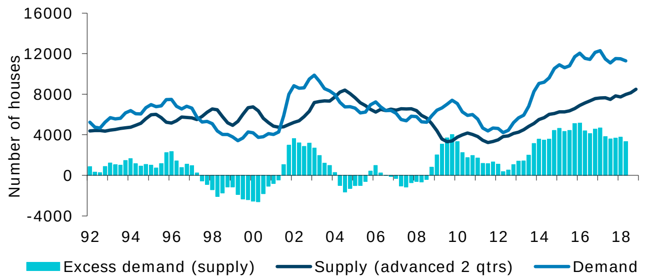


Figure 6: Building consents and house sales

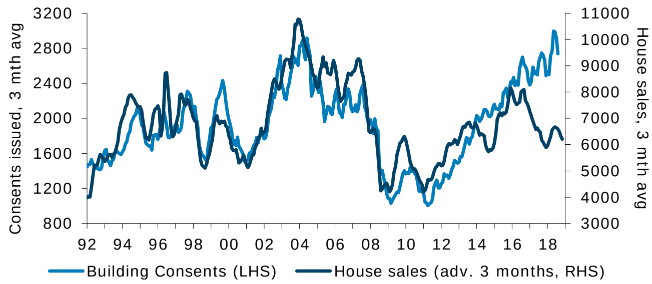


Figure 7: Liquidity and house prices

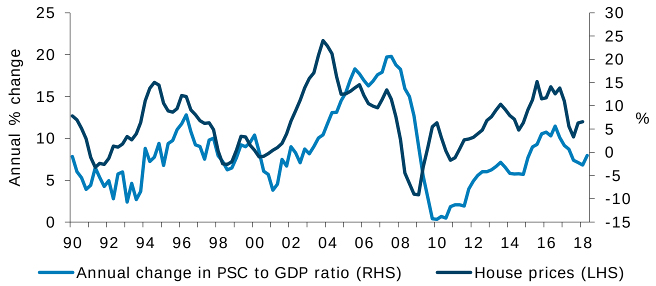


Figure 8: House price inflation comparison

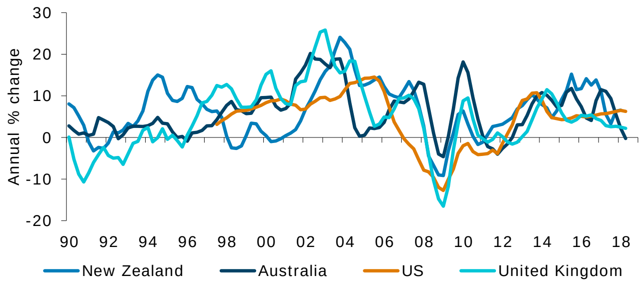


Figure 9: Housing supply

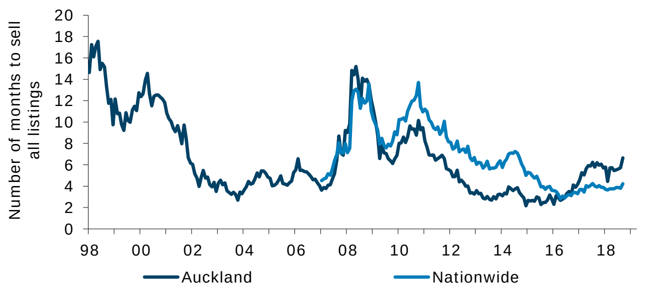
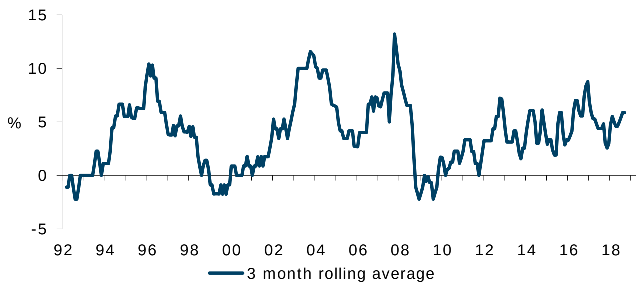


Figure 10: Median rental, annual growth



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

Economic overview

Summary

Risks to the economic outlook have increased, both domestically and from offshore. Data from business surveys highlight the risk of a growth wobble, but this hasn't been reflected in hard data – at least not yet. We do not expect that the cycle is about to roll over, but think that acceleration from here will be challenging to achieve. We continue to see GDP growing at around 2½-3% y/y. Based on this expectation, we suspect it will be difficult to maintain inflation near the midpoint of the RBNZ's target band. CPI inflation was stronger than expected in Q3, but broad-based inflation pressures are lacking. The RBNZ have made it clear that OCR hikes are off the table until they see core inflation above the target midpoint. Given this, we expect that a cautious tone will be maintained by the RBNZ, with the OCR on hold for the foreseeable future.

Our view

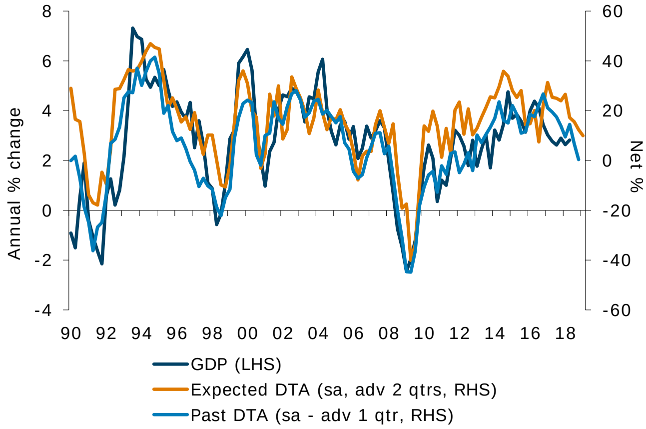
Risks to the economic outlook have increased, both domestically and from offshore. Global growth remains solid and the outlook is positive, albeit a little softer around the edges. But risks have increased and there are concerns around Chinese growth in particular, as highlighted by recent wobbles in financial markets. In New Zealand, GDP growth was strong in Q1, after having moderated since mid-2016. Nonetheless, data from business surveys highlight the risk of a growth wobble, with reported activity having softened. This tends to be a reliable, unbiased indicator of GDP growth. But softer conditions as reflected in business surveys have not been reflected in hard data – at least not yet.

The RBNZ has made it clear that they believe they need to see growth accelerate from here in order to achieve their medium-term inflation target. But we suspect this may be difficult to achieve. Engines of growth are not revving as they once were and the economy is grappling with headwinds. Businesses are wary about investing, despite resource pressures. Households are feeling the pinch. Lending growth is modest. And after a decade of expansion, the cycle is looking tired. A number of factors are expected to provide support to the growth outlook: fiscal policy is expected to be expansionary; net exports are expected to turn positive (aided by the exchange rate); we expect business conditions will improve; the OCR is low; and the terms of trade remains supportive. But nonetheless, we expect that it will be a struggle for the economy to grow at a pace above trend.

CPI inflation was stronger than expected in Q3, due to temporary factors. But broad-based inflation pressures are lacking and core inflation measures are stable and generally below the midpoint of the target band. The stronger CPI print presents a communication challenge for the RBNZ, but given risks and the lack of inflation pressure, we expect that the RBNZ will maintain its recent dovish tone at the November MPS. The RBNZ have made it clear that OCR hikes are off the table until they see core inflation above the target midpoint. And based on our expectation for 2½-3% y/y GDP growth, we expect that it will be difficult to sustain inflation there over the medium term. We are forecasting CPI inflation to increase to 2.3% y/y on account of transitory factors, but expect that it will dip back to 1.6% by the end of 2019, where it is expected to linger.

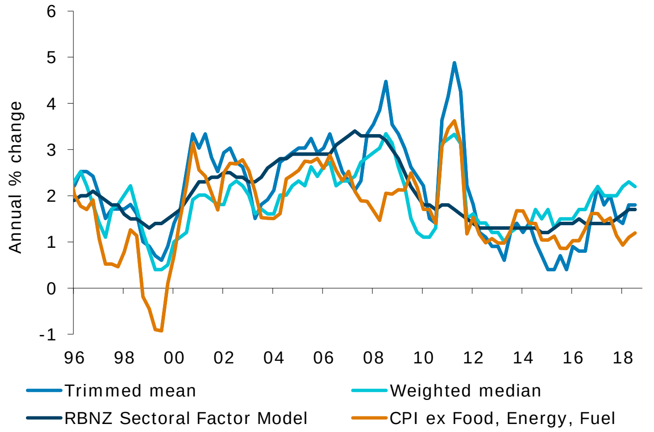
In our view, an OCR hike will not be required to offset inflationary pressure. Our central view is that the OCR will be on hold for the foreseeable future. But given both domestic and international risks, on balance we see risks as being skewed towards a cut in the OCR eventually. That said, with the recent data-flow having held up, the RBNZ has some breathing room to see how developments unfold.

Figure 1: QSBO activity indicators and GDP growth



Source: NZIER, Statistics NZ

Figure 2: Core inflation measures



Source: RBNZ, Statistics NZ

Key forecasts

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

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

Housing market indicators for September 2018 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	11.7	5.2	165	-12%	54
Auckland	-0.1	0.5	1,654	-5%	42
Waikato	8.4	1.4	649	-2%	42
Bay of Plenty	0.5	-1.7	410	-8%	48
Gisborne	26.9	4.6	45	-22%	37
Hawke's Bay	13.2	3.8	199	-11%	36
Manawatu-Whanganui	18.7	1.8	310	-20%	31
Taranaki	-2.8	2.3	171	-8%	40
Wellington	8.4	3.1	591	-14%	32
Tasman, Nelson and Marlborough	14.9	6.9	184	-12%	34
Canterbury	3.2	-0.3	821	-6%	41
Otago	4.9	-3.6	322	-18%	29
West Coast	-4.4	6.9	30	-13%	73
Southland	14.7	3.2	183	-4%	24
New Zealand	**5.8**	**0.7**	**5,676**	**-9%**	**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	2.7	2.5	2.7	2.4	2.5	2.6	2.5
CPI Inflation (Annual % Chg)	1.6	1.1	1.5	1.9(a)	2.2	2.3	2.3	1.9	1.6	1.6
Unemployment Rate (%)	4.5	4.4	4.5	4.4	4.4	4.4	4.5	4.3	4.2	4.2
House Prices (Annual % Chg)	3.6	3.9	3.7	4.3(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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