ANZ RESEARCH

NEW ZEALAND ECONOMICS
ANZ PROPERTY FOCUS

APRIL 2016

INSIDE

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A LINE-BALL CALL

SUMMARY

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

THE MONTH IN REVIEW

The RBNZ held the OCR at 2.25% and a clear easing bias was retained. Whether the OCR gets cut again is a line-ball call; housing market strength calls for no change. With the effectiveness of the high-LVR lending restrictions and government policy measures to slow investor demand looking to be waning, the door remains open to other policy action. Auckland and nationwide house prices surged to new record highs, with regions outside of Canterbury generally booming. Residential consent issuance looks to be tailing off and record annual net PLT immigration makes the construction sector response a moving target. Households are exhibiting leveraging-style behaviour, which looks set to continue for a while yet. The longer this continues, the greater the odds of a correction in the market.

PROPERTY GAUGES

Historically low mortgage interest rates, tight dwelling supply and record net PLT immigration continue to support the housing market. Despite manageable debt servicing, existing house prices are looking increasingly stretched relative to both incomes and rents, particularly in our largest city.

ECONOMIC OVERVIEW

The economy ended 2015 showing strong momentum, and while there are the usual vagaries and volatility of the data to deal with, the general message is that the economy has carried this momentum into 2016 and is expanding solidly. We are forecasting 2½-3% growth over the next three years. Amidst huge uncertainties, businesses are getting on with it, and we're backing more of the same amongst global palpitations. However, divergences are set to remain stark. Housing is booming, as are construction and tourism. Yet dairying is in the doldrums and will be for some time. The mix of growth (borrow and spend) does not look sustainable and the risk is that the low OCR (biased lower given low headline inflation and global unease) will mean more housing largesse at a time households are already heavily leveraged. A lower NZD would not go amiss.

MORTGAGE BORROWING STRATEGY

April has seen little movement in carded interest mortgage interest rates. Current borrowing costs are historically very low for the one and two year windows and continue to offer the best value, particularly with current market pricing now adequately capturing the risk profile, in our view. With no OCR hikes until 2018 by our reckoning, longer-term rates don't offer the same value at present.

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The RBNZ held the OCR at 2.25% and a clear easing bias was retained. Whether the OCR gets cut again is a line-ball call; housing market strength calls for no change. With the effectiveness of the high-LVR lending restrictions and government policy measures to slow investor demand looking to be waning, the door remains open to other policy action. Residential consent issuance looks to be tailing off and record annual net PLT immigration makes the construction sector response a moving target. Households are exhibiting leveraging-style behaviour, which looks set to continue for a while yet. The longer this continues, the greater the odds of a correction in the market.

APRIL OCR REVIEW

RBNZ leaves OCR on hold, maintains easing bias, but kept its cards close to its chest

The OCR was maintained at 2.25% and a clear easing bias was retained. While the tone of the statement was a touch less dovish than in March (when the OCR was cut 25bps) the door to a June OCR cut remains open. We see this as very much a line-ball call (we put the odds of a cut at about 60%). While inflation is currently low (and the NZD high), the combination of strong activity growth (which should lift inflation over time) and booming housing market activity urges caution.

REINZ, HOUSE SALES – MARCH

Auckland awakens, regions outside of Canterbury booming, with Wellington leading the charge

Supported by a 12% sa rebound in Auckland (-12.3% y/y), nationwide sales volumes rose 4.7% sa in March (+8.2% y/y). Sales levels for the rest of the country rose 1.6% (+21% y/y). The nationwide days to sell rose to 32.7 sa, but eased in Auckland (32 sa) and Canterbury (31 sa) and remain low in the surging Wellington market (29 sa). Nationwide prices firmed to record highs on both the REINZ median and stratified house price measures, with annual house price inflation on the latter measure firming in Auckland (+13.3% y/y), Wellington (+12.8% y/y), Other North Island (+17.7% y/y) and Other South Island (+12.7% y/y). Canterbury prices declined in March (+2.6% y/y).

STATISTICS NZ, BUILDING CONSENTS – MARCH

As trend in residential issuance levels off and cost increases continue

Residential dwelling consent numbers fell 9.8% m/m sa in March, continuing the see-saw pattern evident of late. Looking through the volatility shows a levelling off in trend issuance. In fact, the peak looks to have occurred towards the end of last year, with declines in the trend for houses (-2.2% q/q) and multi-unit dwellings (-0.8% q/q) in the March quarter. Construction cost increases showed few signs of slowing, with our estimates showing the value of residential consents per square metre (on a three-month average basis) rising at an 11.4% y/y pace. Costs have increased by one third compared to five years ago and are two thirds higher than they were a decade ago.

STATISTICS NZ, EXTERNAL MIGRATION – MARCH

Strong net immigration adding to housing demand

A net inflow of 5,330 (sa) migrants was seen in March, with a net PLT inflow of 67,619 persons recorded over the last 12 months, a new record high and equivalent to 1.5% of the resident population. PLT arrivals (124k in last 12 months) have broadly outpaced departures (56k) by two to one, with signs arrival numbers may be nearing their peak.

RBNZ: FEBRUARY HOUSEHOLD CREDIT

Lending growth strong and investors returning to the market, with few signs of slowing

The value of mortgage lending to households rose 0.6% sa in February, with annual credit growth (7.9%) hitting an 8-year high. Household debt has been rising relative to incomes over the last four years and is currently at historic peaks (162.3%). Due to record-low mortgage interest rates, debt serviceability remains around historical averages.

MORTGAGE APPROVALS AND NEW MORTGAGE LENDING

RBNZ figures for March showed new lending to borrowers with less than a 20% deposit at 7.9% of total new lending, although lending to investors has increased to 35% of total new lending, which is the highest on record. Approval values and numbers have edged up since early March and were 5.3% and 14.5% higher than this time last year respectively. They point to solid rates of credit growth over the next six months.

PROPERTY GAUGES

Historically low mortgage interest rates, tight dwelling supply and record net PLT immigration continue to support the housing market. Despite manageable debt servicing, existing house prices are looking increasingly stretched relative to both incomes and rents, particularly in our largest city.

We use ten gauges to assess the state of the property market and look for signs that changes are in the wind.

AFFORDABILITY. For new entrants into the housing market, we measure affordability using the ratio of house prices to income (adjusted for interest rates) and mortgage payments as a proportion of income.

SERVICEABILITY/INDEBTEDNESS. For existing homeowners, serviceability relates interest payments to income, while indebtedness is measured as the level of debt relative to income.

INTEREST RATES. Interest rates affect both the affordability of new houses and the serviceability of existing mortgage payments.

MIGRATION. A key source of demand for housing.

SUPPLY-DEMAND BALANCE. We use dwelling consents issuance to proxy growth in supply. Demand is derived via the natural growth rate in the population, net migration, and the average household size.

CONSENTS AND HOUSE SALES. These are both 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, UK and Australia in recognition of the important role that global factors are playing in NZ'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.

RENTAL GROWTH. We look at growth in the median market rent as an indication of whether it is a better time to buy versus rent, and how rental yields are shaping up for the property investor.

Indicator	Level	Direction for prices	Comment
Affordability	Chasing your tail	↔/↓	Houses severely unaffordable in Auckland. Becoming increasingly less affordable in most regions.
Serviceability/ indebtedness	Hard work	↔/↓	Low mortgage interest rates are helping contain debt-servicing costs despite a debt-to-income ratio at a record high.
Interest rates / RBNZ	Watch & wait	↔/↑	Historically low mortgage rates supportive. Pressures on bank funding costs likely to be offset by OCR cuts going forward.
Migration	Record high	↔/↑	Regularly hitting new records, with few signs of turnaround.
Supply-demand balance	Akld vs Rest of NZ	↔/↑	Auckland shortages are growing; so are those in Wellington. Canterbury shortages have eased; more balanced elsewhere.
Consents and house sales	Catching up	↔/↑	Continued upward trend in nationwide residential issuance, although Canterbury issuance is tailing off.
Liquidity	Firming	↔	Credit is rising faster than incomes, but high debt levels should eventually cap the market.
Globalisation	In synch	↔/↓	Moderation in some global markets; Auckland one of the most expensive cities globally relative to domestic incomes.
Housing supply	Low	↔/↑	Auckland inventories just three months of sales, with market generally tightening elsewhere, notably Wellington.
House prices to rents	Squeeze	↔/↓	Rents drifting up, given strong demand. Auckland prices elevated to rents, other regions less so.
On balance	**Pushing up**	↔/↑	**Further drift above fundamentals, and risks of correction growing.**

PROPERTY GAUGES

FIGURE 1: HOUSING AFFORDABILITY

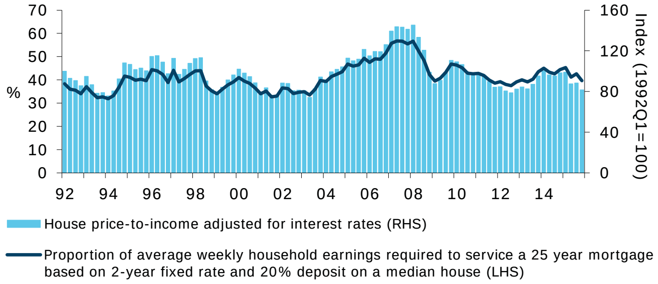


FIGURE 2: SERVICEABILITY AND INDEBTEDNESS

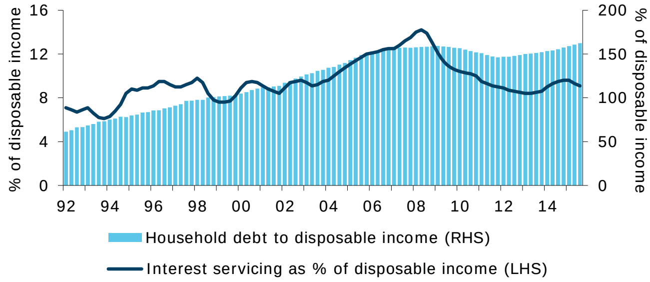


FIGURE 3: NEW CUSTOMER AVERAGE RESIDENTIAL MORTGAGE RATE (<80% LVR)

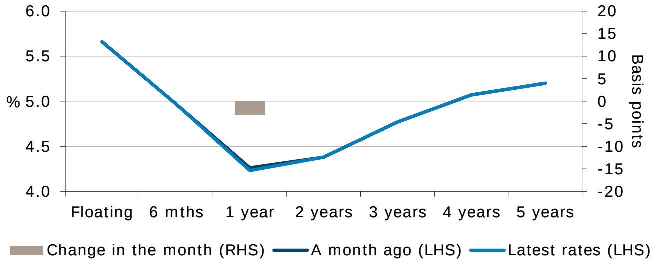


FIGURE 4: NET MIGRATION

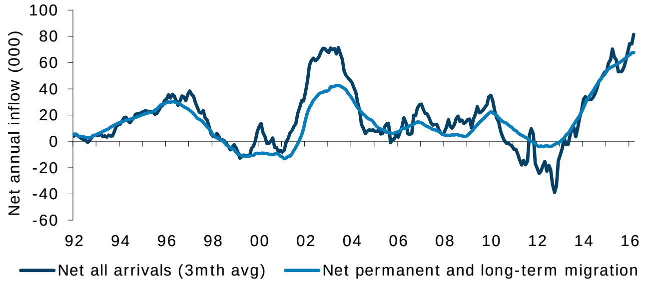


FIGURE 5: HOUSING SUPPLY-DEMAND BALANCE

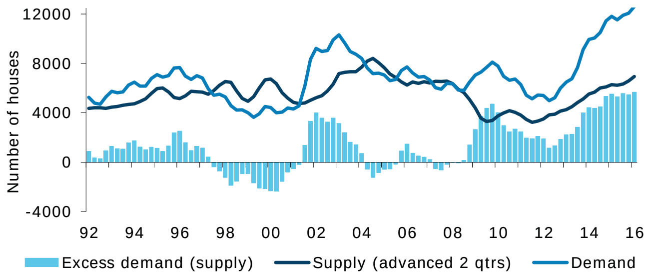


FIGURE 6: BUILDING CONSENTS AND HOUSE SALES

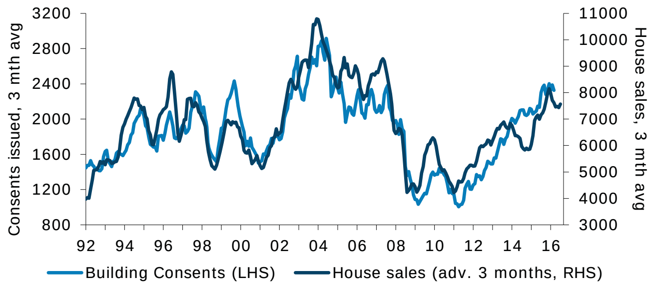


FIGURE 7: LIQUIDITY AND HOUSE PRICES

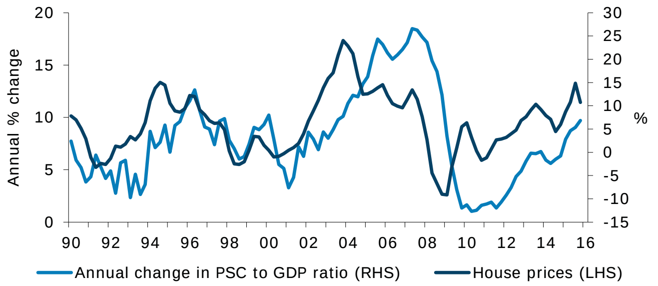


FIGURE 8: HOUSE PRICE INFLATION COMPARISON

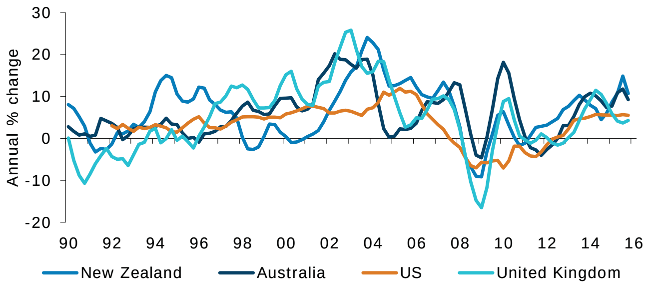


FIGURE 9: HOUSING SUPPLY

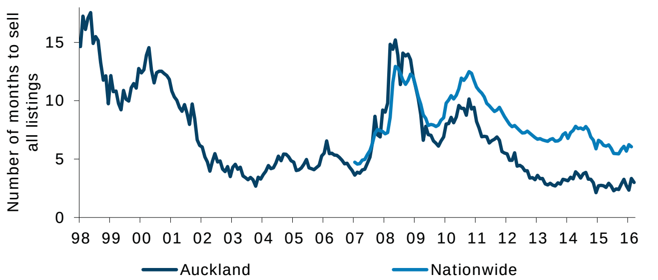
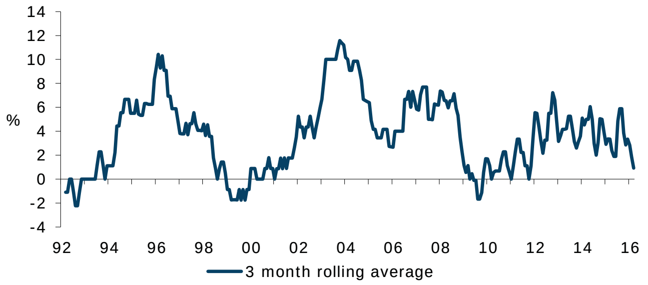


FIGURE 10: MEDIAN RENTAL, ANNUAL GROWTH



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

ECONOMIC OVERVIEW

SUMMARY

The economy ended 2015 showing strong momentum, and while there are the usual vagaries and volatility of the data to deal with, the general message is that the economy has carried this momentum into 2016 and is expanding solidly. We are forecasting 2½-3% growth over the next three years. Amidst huge uncertainties, businesses are getting on with it, and we're backing more of the same amongst global palpitations. However, divergences are set to remain stark. Housing is booming, as are construction and tourism. Yet dairying is in the doldrums and will be for some time. The mix of growth (borrow and spend) does not look sustainable and the risk is that the low OCR (biased lower given low headline inflation and global unease) will mean more housing largesse at a time households are already heavily leveraged. A lower NZD would not go amiss.

OUR VIEW

Indicators flag good momentum across the economy. Confidence is off recent highs, but is resilient overall and continues to signal solid growth. Financial conditions remain supportive on the whole. The unemployment rate is low, whilst the workforce participation rate and the employment rate are historically high, despite recent slippage. Regional house prices are surging and the Auckland residential market looks to have gotten a second (or some would say third or fourth!) wind.

The nucleus of robust growth centres around supportive monetary policy settings (the OCR is at record lows), strong construction sector activity, a booming tourism sector and record net annual PLT immigration. Firms continue to show enough confidence in the overall economic story – amidst local challenges (dairying) and global volatility – to hire and invest. We continue to back the benefits of a stronger microeconomic story too; small things that collectively add up. All in all, we expect reasonable GDP growth of around 2¾% over the coming year but with volatility to remain high.

However, downside risks are evident. These include:

- The global scene. The RBNZ is more openly expressing concern (it was a key reason it cut rates in March) and we share those concerns. We expect volatility to remain high. China is front and centre. We are not fully buying into the recent recovery in some indicators (equities, emerging markets and commodities such as oil). The US economy is looking solid though.
- Sustained low dairy prices into the 2016/17 season. The coming season is shaping up as another negative cash-flow year. We expect farm values to correct 25% from their highs.
- House prices are extended in relation to incomes and rents. While a material correction is hard to envisage given supply shortages and jobs growth, we are watchful.
- Financial conditions have tightened compared to a year ago given the softer terms of trade outlook (circa 10% falls over 2016), and high NZD. Credit spreads are also vulnerable to periodic widening.
- Signs of borrow-and-spend behaviour are re-emerging. As a share of disposable income, household debt is now higher than prior to the GFC (162% compared to 159%) though the debt servicing burden is lower courtesy of low interest rates.

Some upside risks are notable too. Net annual PLT immigration (at close to 70k) is very strong. Capacity constraints are emerging in some sectors (i.e. construction, tourism and accommodation). A lack of skilled labour is a key issue for some sectors (and regions).

The NZD looks set to remain elevated. Solid performance relative to peers, a wide interest rate differential and central banks that are actively trying to weaken their own currencies are helping to keep the NZD up.

The door to a June OCR cut remains open, and that remains our forecast for now. But we see this as very much a line-ball call (we put the odds of a cut at about 60%). Yes, reasons for cutting exist (dairy, NZD strength amidst currency games from other central banks, low inflation expectations, funding cost pressures, and the likely return of global financial market turbulence). But when weighed against a domestic economy that is still operating near trend, evidence that core inflation is stabilising and capacity pressures intensifying, re-leveraging behaviour evident and housing markets booming, we remain of the view that additional easing may not be in the best interests of the economy.

MORTGAGE BORROWING STRATEGY

SUMMARY

April has seen little movement in carded interest mortgage interest rates. Current borrowing costs are historically very low for the one and two year windows and continue to offer the best value, particularly with current market pricing now adequately capturing the risk profile, in our view. With no OCR hikes until 2018 by our reckoning, longer-term rates don't offer the same value at present.

OUR VIEW

April has seen little movement in carded mortgage lending rates offered by lenders. Our estimates show that the average rates for both standard and special rates from the 'Big 4' Australasian banks were broadly unchanged compared to our previous edition.

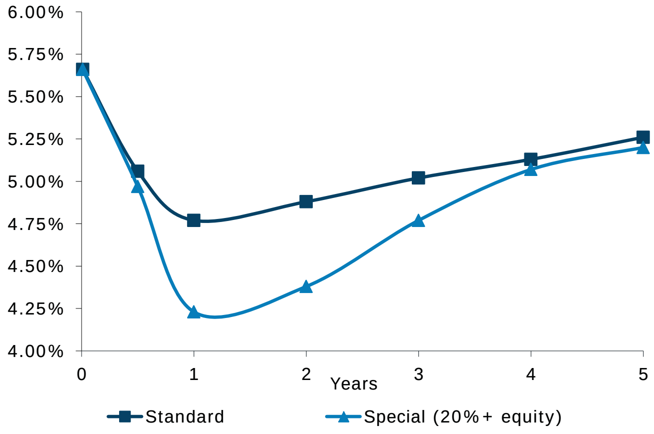
Movements in variable carded mortgage interest rates have not matched the 25bps OCR cut, but have broadly tracked moves in wholesale interest rates since the March Monetary Policy Statement. Our estimates suggest the average variable rate from the 'Big 4' banks has fallen by about 12bps, compared to the circa 15bps fall in short-term wholesale interest rates. Whilst longer-term wholesale interest rates are broadly unchanged since the March *MPS*, fixed carded rates have fallen by around 10bps on average for special rates and by around 15bps on average for standard terms since then. Movements in wholesale interest rates are only one input into mortgage funding. We note that credit spreads are likely to remain volatile and subject to swings in global sentiment.

The lowest part of the curve remains one to two year fixed rates, particularly for mortgage specials, with average rates around multi-decade lows. Average carded rates are below (or at) current average effective borrowing rates on existing lending (around 5.28%).

According to our breakeven analysis, **one and two-year terms remain the standout for those accessing specials and for standard rates.** Borrowers could choose to spread fixed terms across both tenors to stagger rollovers, but we have a preference for locking in a greater proportion for one year on the basis that these are the lower rates offered. We expect that any increases in funding costs will be broadly offset by lower wholesale interest rates as the OCR is cut.

By the same token, with our view of the risk profile more broadly compatible with what is factored into market pricing, risks of further falls in rates have eased and it is possible that we are approaching the lows of this cycle.

CARDED MORTGAGE RATES^



Special Mortgage Rates		Breakevens for 20%+ equity borrowers			
Term	**Current**	**in 6mths**	**in 1yr**	**in 18mths**	**in 2 yrs**
Floating	5.66%				
6 months	4.97%	3.49%	4.46%	4.61%	5.36%
1 year	4.23%	3.97%	4.53%	4.98%	5.55%
2 years	4.38%	4.48%	5.04%	5.38%	5.76%
3 years	4.77%	4.91%	5.35%	5.55%	5.75%
4 years	5.07%	5.16%	5.44%		
5 years	5.20%	#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	5.66%				
6 months	5.06%	4.48%	4.94%	5.05%	5.23%
1 year	4.77%	4.71%	4.99%	5.14%	5.30%
2 years	4.88%	4.92%	5.15%	5.26%	5.38%
3 years	5.02%	5.08%	5.25%	5.38%	5.51%
4 years	5.13%	5.21%	5.38%		
5 years	5.26%	*may be subject to a low equity fee			

As such, there is value in locking in for longer, although we note that borrowers will be paying a significant premium to lock in for terms longer than two years. Our breakeven analysis shows fixed rates would have to rise by close to 140bps in two years' time to make it more attractive to fix for four years rather than two. Given that we do not expect OCR hikes until well into 2018 this implies certainty comes at a high cost.

^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 March 2016 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)	Comment
Northland	9.8	-3.1	249	+8%	39	Days to sell at 10-year low. Sales volumes +37% y/y.
Auckland	12.4	2.3	2,476	+12%	32	Days to sell at 6m low, record median sales price ($820k)
Waikato/BOP/Gisborne	22.1	3.5	1,476	+5%	33	Record median sales price, sales volumes +27% y/y.
Hawke's Bay	13.9	2.8	254	-7%	34	Days to sell below historical averages (47).
Taranaki	3.4	-2.0	374	+13%	34	Days to sell at 9-year low, sales volumes +31% y/y.
Manawatu/Whanganui	-1.8	1.5	146	-17%	38	Median price 4% off highs, 2nd highest days to sell in regions.
Wellington	8.1	2.9	914	+7%	29	Record median price, lowest days to sell of regions.
Nelson/Marlborough	14.4	4.1	280	-1%	33	Record median sales price, sales volumes +19% y/y.
Canterbury/Westland	2.0	1.8	1,007	+8%	31	Days to sell at 4-month low. Sales volumes +17% y/y.
Central Otago Lakes	21.9	17.9	135	+8%	33	Median sales price at record high.
Otago	8.0	0.0	323	+8%	31	2nd lowest days to sell of regions, sales volumes +36% y/y.
Southland	14.5	0.5	169	+4%	38	Days to sell back above historical averages (36).
NEW ZEALAND	3.2	2.5	7,740	+5%	33	Days to sell well below historical averages (37), sales volumes -2.8% 3m/3m (6.9% y/y), record median price ($495k).

Key forecasts

	Actual			Forecast						
Economic indicators	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
GDP (Ann Avg % Chg)	3.3	2.9	2.5	2.4	2.6	2.7	2.8	2.7	2.5	2.4
CPI Inflation (%)	0.4	0.4	0.1	0.4(a)	0.4	0.5	1.0	1.4	1.4	1.7
Unemployment Rate (%)	5.9	6.0	5.3	5.5	5.5	5.4	5.3	5.2	5.2	5.1
	Actual			Forecast (end month)						
Interest rates (carded)	Feb-16	Mar-16	Latest	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Official Cash Rate	2.50	2.25	2.25	2.00	2.00	1.75	1.75	1.75	1.75	1.75
90-Day Bank Bill Rate	2.6	2.3	2.3	2.1	2.1	1.9	1.9	1.9	1.9	1.9
Floating Mortgage Rate	5.8	5.7	5.7	5.4	5.4	5.2	5.2	5.2	5.2	5.2
1-Yr Fixed Mortgage Rate	5.0	4.8	4.7	4.6	4.6	4.5	4.5	4.5	4.6	4.6
2-Yr Fixed Mortgage Rate	5.2	5.0	4.9	4.8	4.7	4.5	4.5	4.6	4.7	4.7
5-Yr Fixed Mortgage Rate	5.8	5.6	5.5	5.4	5.4	5.4	5.4	5.5	5.6	5.6

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