NEW ZEALAND PROPERTY FOCUS

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CONTRIBUTORS

Sharon Zollner
Senior 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

THE POLICY PIPELINE

SUMMARY

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

FEATURE ARTICLE: THE HOUSING MARKET AND THE NEW GOVERNMENT

The new Government has made it clear that it believes the country faces a severe shortage of affordable housing, particularly in Auckland. We concur. It acknowledges that there is no 'quick fix', which we also agree with, but it intends to take a more 'active' role in addressing the problem. This includes partnering with the private sector to build 100,000 'affordable' homes including more state housing (half in Auckland), freeing up Auckland land supply, changing the taxation of investor housing, banning foreigners from purchasing existing houses, and bettering the lot of renters by improving the quality of the housing stock. Given that details of the measures proposed are yet to be finalised, the impact is difficult to estimate. But in our view, in aggregate they will at the very least contribute to keeping housing market activity and hence house prices 'on ice' for the foreseeable future.

PROPERTY GAUGES

There are clear opposing forces impacting the housing market. 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 and affordability constraints. If it were all about a demand and supply imbalance, then rents should be rising faster than they are. Political uncertainty adds another layer of caution. We see prices plateauing for now.

ECONOMIC OVERVIEW

Our views on the economic outlook have become more nuanced. While we retain a broadly constructive view of the medium-term growth picture, we have turned more circumspect near term, and see a heightened chance of a growth wobble. That wobble is not expected to turn into something longer-lasting, but it certainly marks us out as less upbeat than the likes of the Treasury and RBNZ. Above-trend growth is hard to achieve when the most cyclical part of the economy (housing) looks set to remain soft. We are still biased towards OCR hikes in time. However, the combination of growth only around trend, a soft housing market, but the likelihood of some cost-push inflation is a complicated mix, meaning there are plenty of question marks regarding the timing of hikes.

MORTGAGE BORROWING STRATEGY

It has been another month where average mortgage rates have barely moved, and so it leaves our favoured views broadly unchanged as well. From a "lowest is best" perspective, the 1-year rate still stands out. And this is consistent with our expectation of the OCR being on hold for some time yet. Longer-term rates remain low by historic standards and offer certainty. Some borrowers may wish to spread risk by borrowing over a number of fixed terms. While there are a few more signs that domestic inflation pressures are edging higher, it still does not seem like an environment where the OCR will be increased aggressively.

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INTRODUCTION

The housing market is one area where the new Government has stated that it will take a far more 'active' role, proposing a number of measures that it believes will help address what is a severe affordability problem, particularly in Auckland. The proposed policies fall into three broad categories: increasing housing supply, decreasing housing demand, and improving the lot of renters. In this article, we provide a brief roundup of the new policies that look likely to be introduced, and discuss in broad-brush terms what they might mean for the housing market.

HOUSING SUPPLY

On the housing supply front there are three main (intertwined) initiatives: KiwiBuild, boosting the number of construction workers, and increasing land supply.

1. **KiwiBuild.** In short, this policy aims to build, in conjunction with the private sector, 100,000 'affordable' new homes over 10 years, with half of them in Auckland. As part of this effort the Government aims to increase the supply of state houses by 1,000-2,000 per year. KiwiBuild activity is intended to ramp up from "a few hundred" in the first year, to the 10,000 per year target after three years. The Hobsonville Point development in Auckland will be the model, and an Affordable Housing Authority will run the show. It will initially be financed by a capital injection of $2bn, which will be recycled as the houses are sold.

   KiwiBuild would be implemented in three ways: securing planned residences in schemes such as Hobsonville Point that are already underway; buying off-the-plan units in planned developments; and creating its own development sites, particularly on Crown-owned land, and bringing in group house builders. By purchasing 30-40% of the dwellings that fit its criteria in private developments, the Government aims to ease funding constraints that are crimping building activity. Another aim is to reduce building costs through mass procurement.

2. **Boost the number of construction workers.** To ameliorate already-severe labour shortages in the construction sector, two measures are proposed. Firstly, a new KiwiBuild visa program will be introduced for residential construction firms who train a local when they hire a worker from overseas. Housing Minister, Phil Twyford, stated, "We will reduce migrants coming in but nothing will be allowed to constrain the construction industry to get workers". Secondly, the Government will introduce a Dole for Apprenticeships scheme, subsidising firms to take on 4,000 apprentices for on-the-job training, including in the construction sector.

3. **Boost land supply.** Details are yet to be released, but Labour's pre-election manifesto mentioned removing the Auckland urban limit and freeing up density controls, as well as issuing infrastructure bonds to fund new developments.

ANZ's take

The Government has advantages that private sector house-builders do not have – in particular, it does not face the same funding constraints, as it can easily fund the initiative from its own balance sheet. Mass procurement and streamlined designs should also reduce per-house building costs. However, the KiwiBuild scheme will have to directly compete with the private sector for labour, and that issue is not so easily dodged.

In our view, the new Government's plan to increase the supply of affordable housing is highly ambitious. Construction firms tell us that they are extremely busy – and large increases in construction costs confirm it. There is a chronic shortage of quantity surveyors, site supervisors and even some construction materials. Labour itself estimates that KiwiBuild will create 5,000 jobs but only (at most) 4,000 apprentices will be trained under the Dole for Apprenticeships scheme – and that is across many industries, not just construction. The gap

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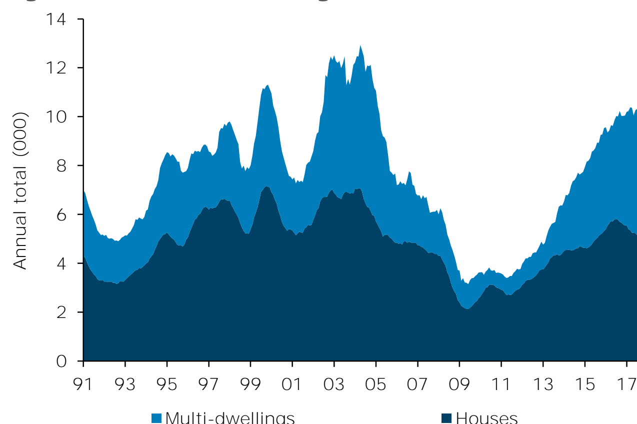
will have to be filled with migration, which runs directly counter to Labour's stated aim (and NZ First's more strongly stated aim) of reducing net migration.

Given the capacity constraints being faced by the construction sector, it seems inevitable that there will be a degree of "crowding out" of private sector construction activity by the increased government-led activity. The Reserve Bank is assuming this will be around 50% but acknowledge it is highly uncertain. Whatever the number, the 'true' additional housing supply in Auckland is likely to be considerably smaller than 50,000 houses, even if that ambitious target is reached, in that some houses will not be built by the private sector that would have been otherwise. However, the mix of houses likely to be produced by a profit-maximising private sector and this government initiative is not the same: the Government will likely succeed in tilting construction towards 'affordable' units.

Of course, we will never have the data on houses not built to accurately estimate the crowding out impact so will only ever be able to conjecture. However, on balance it seems likely that housing supply will indeed get a net boost from these policies, and that the largest supply boost and hence any dampening impact on house prices will be focused at the lower end of the market, as the Government intends.

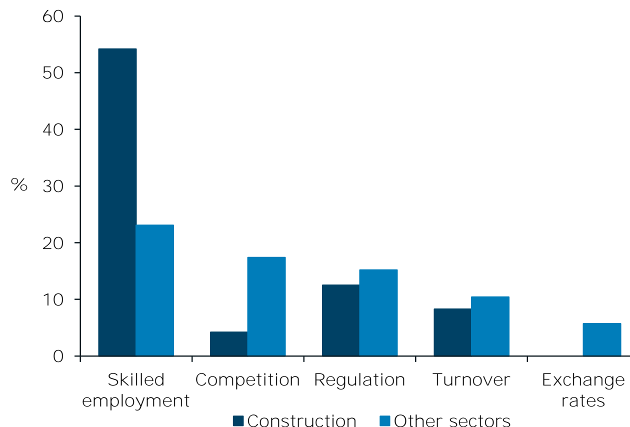
Freeing up more land for housing development should lower the price of land. However, what can sometimes be overlooked in the housing affordability debate is the fact that the ongoing cost of living in far-flung housing is much higher, particularly for transport. The necessary infrastructure – roading, water, electricity, schooling, etc – is also much more expensive compared to intensification of existing housing areas. The Government also intends to free up densification controls but will run smack into the same spirited opposition that has beleaguered the Auckland City Council in its efforts to increase Auckland housing supply. All up, a worthy goal, but not an easy one.

Figure 1: Auckland dwelling consent issuance



Source: ANZ, Statistics NZ

Figure 2: Top 5 problems facing businesses



Source: ANZ

HOUSING DEMAND

On the demand side there are three main initiatives.

1. **Reduce net migration.** Strong population growth has been a key source of increasing housing demand, and the Government has agreed with NZ First to aim to reduce annual net migration from the current run-rate of around 70,000 by 20,000-30,000. In particular, "low quality international education courses" will be targeted. However, no specific details have been released about which visas will be cut beyond this. This is not surprising: it is not simple, as the agriculture, aged care and construction sectors cry out for workers. Indeed, there have subsequently been suggestions in the media that the new Government may prefer to "wait and see" what happens with the migration cycle before taking any action, as it appears it may have already turned.
2. **Ban foreign buyers from purchasing existing houses.** It appears, with the exception of Singapore, that this policy aim can indeed be achieved without necessitating the renegotiation of our free trade agreements, by reclassifying existing homes as "sensitive land".

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3. **Reduce the tax advantages of housing investment.** The Government has announced it intends to extend the 'bright line test' for income tax on capital gains from 2 to 5 years, and ring-fence tax losses on investor property. We may also see more tax initiatives come out of the Tax Working Group in time.

ANZ's take

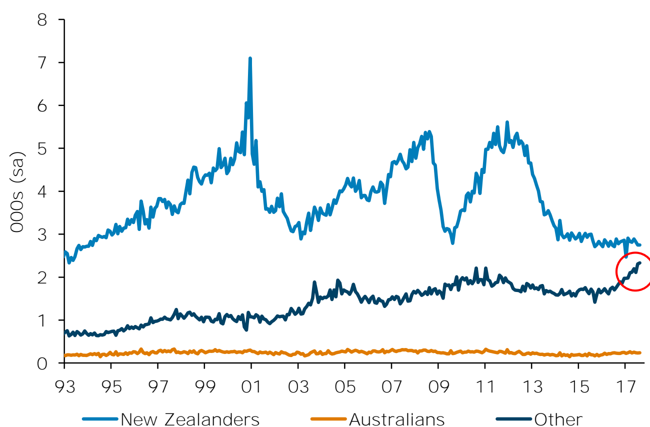
Migration: In our view, net migrant inflows already look to have peaked, with arrivals stabilising at the same time as departures are lifting off low levels. The lift in departures has largely been of non-New Zealand or Australian citizens, reflecting a natural cycling effect as those who arrived on work or student visas a few years ago now are choosing to – or having to – leave. Even without building in an explicit allowance for the Government's changes, we are assuming net migration will fall to about the new Government's target by end-2019 simply on macroeconomic factors.

But with regards to the changes mooted, we are actually far more interested in the mix of migrants and potential visa changes than the numbers themselves, given net migration is pushed around almost as much by departures as arrivals, and targeting a specific number for net migration is difficult. If the Government does indeed succeed in its aim of better matching migrant skills with employers' needs, this could even arguably be growth-enhancing, at least on a per capita basis. But it's a tough thing to do.

All else equal, with the average persons per house across the country around 2.7, and around 3 in Auckland, lowering migration by 20-30k would lower household formation rates by perhaps around 10k per year. But it depends on the mix of migrants. If it is fewer students and temporary workers, then it is likely to have quite a different impact on housing demand than if we were to see a fall in the well-heeled coming in under the investor category, for example.

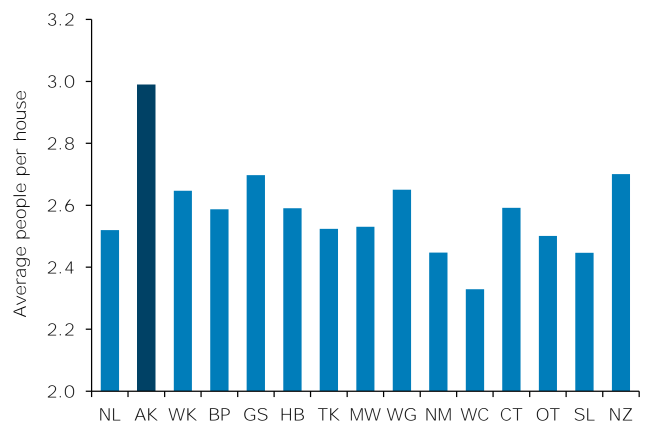
Lower net migration is a clear negative for housing demand. If it results in fewer construction workers arriving it would also be a negative for housing supply growth, but the Government appears aware of this risk and keen to ensure this does not occur. On balance, in our view the migration change is consistent with delaying the next upswing in housing, rather than implying that house prices are likely to fall.

Figure 3: Departures by citizenship



Source: ANZ, Statistics NZ

Figure 4: Average number of people per household (2013)



Source: ANZ, Statistics NZ

Banning foreign buyers: It is very difficult to know what the impact on the housing market of banning foreign buyers will be, for the simple reason that no one knows what their impact on the housing market has been to date. There is a lamentable lack of data on this front (a lack which the new Government intends to remedy), and the data that is available is partial at best (showing that in the three months to June, 3% of net property transfers were to buyers who declared a foreign tax residency status). In addition, despite a number of countries (including Australia) having similar restrictions, there has been a lack of empirical work done overseas on their impact. One of the difficulties (and anecdote certainly appears consistent with this) is that these measures do not stop the ability of non-residents to channel money through to the likes of resident relatives.

Another thought to bear in mind is that while the policy might take some pressure out of house prices during boom times, it may come with its own risks. According to the Rider Levett Bucknall Crane Index, Sydney currently has around 350 cranes, versus 28 in New York. Lend Lease, a very large Australian construction

company, stated in its 2016 annual report that 40% of its apartment sales were to foreigners. In short, by forcing foreign purchasers to buy new builds, the risk of overbuilding in boom times could be exacerbated. Housing oversupply is a factor that can worsen downturns considerably.

While we wouldn't rule out some negative impact from this policy on market sentiment in the near term, we suspect it will not make much difference in this cycle, as it appears from anecdote that would-be buyers from China especially are already being stymied by tighter capital controls by Chinese authorities aimed at reducing the amount of money leaving the country. However, it might make a difference next cycle.

Tax changes: This set of policies is aimed squarely at property investors, and in particular buy-and-flip 'speculators' as opposed to those in for the long haul.

The two announced tax measures, ring-fencing investor property losses from other income and extending the bright-line test to five years, go some way to reducing housing's tax advantage over other forms of investment, which, from a macroeconomic perspective, would be better levelled out. Over half of New Zealand Household wealth is held in housing, meaning this sector is hugely important for the economic cycle.

All else equal, the tax changes will reduce the attractiveness of housing investment, and hence should result in a one-off fall in the equilibrium price of a given investor property. What is less clear is what the transition to a new equilibrium with a more balanced household investment portfolio might look like. This will of course depend on the state of the housing cycle at the time – reducing the speed of an upswing and exacerbating a downturn will look and feel very different. In order to reduce the risk of giving the housing market a solid kick when it's already down, negative gearing will be gradually phased out over five years, with loss deductibility reducing by 20% a year.

It is difficult to know how large the impact may be. Labour estimates the bright-line test change will raise an additional $150m of tax revenue. What will be impossible to measure is the extent to which the policy succeeds in reducing the buy-and-flick speculative behaviour during housing upturns that arguably contributes to rapid house price appreciation.

Analysis of capital gains taxes in other countries generally conclude that they have a one-off negative impact on prices but little ongoing impact on the magnitude of house price cycles. A beefed-up income tax on capital gains isn't quite the same thing as a capital gains tax but a similar conclusion seems reasonable.

Similarly, a number of OECD countries have ring-fencing in some shape or form, but the Reserve Bank concluded that "there is no clear evidence that ring-fencing such losses is associated with less pronounced housing cycles in other countries".[1] At the micro level, the impact is likely to be largest on the most highly leveraged investors, and in particular late entrants.

The tax changes are aimed at improving housing affordability by reducing investor demand for housing and freeing up properties for first-home buyers. However, as always, the law of unintended consequences may bite. In particular, with the proposed tax changes it is possible the supply of rental properties may fall (a risk the Reserve Bank also noted, "perhaps at the margin"), which could worsen housing affordability for renters (as well as putting upward pressure on interest rates as the Reserve Bank responds to inflation pressure). Rental inflation has been surprisingly low for a number of years, so it would be bold to forecast it roaring into life any time soon. But it is fair to say that tilting house purchases away from investors towards first-home buyers may put some upward pressure on rental inflation (particularly combined with the anticipated increase in student numbers resulting from the new policy of one free year of tertiary study).

IMPROVING TENANTS' LOT

The Healthy Homes Bill seeks to amend the Residential Tenancies Act 1986 to allow MBIE to set heating, insulation, ventilation and drainage standards for landlords. The bill proposes that the requirement to meet the standard would apply to all new tenancy agreements within a year of the Act coming into force, and all tenancies within five years.

[1] RBNZ *Bulletin Vol 69 (2): Supplementary Stabilisation Instruments – Executive Summary*

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ANZ's take

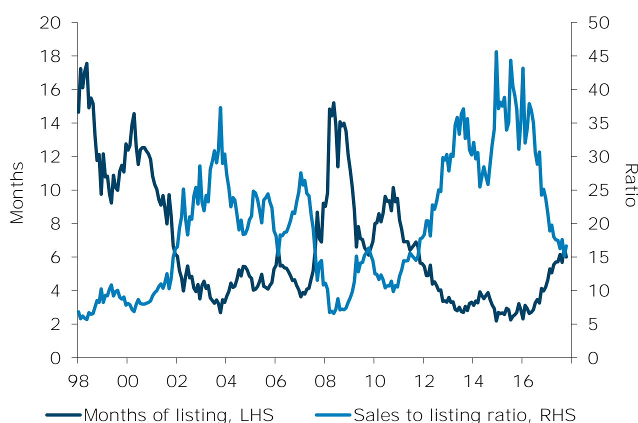
As housing affordability has worsened, the New Zealand home ownership rate has fallen. Damp, cold houses are known to adversely affect health. In that light, it is difficult to argue with the aims of the bill. However, the measures will increase costs for landlords and could therefore have a negative impact on the supply of rental housing and an upward impact on rents.

IN SUM – WHAT DOES IT MEAN FOR THE HOUSING MARKET?

There are still a lot of moving parts, so it is impossible to be definitive about the impact of the new policy measures on the housing market. That said, the direction of the impact of the changes is consistent. Compared with the counterfactual the new policies are likely to mean:

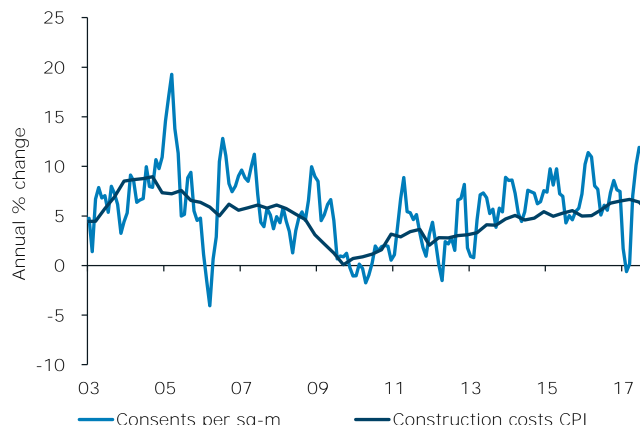
- A lower equilibrium price for investor housing.
- Weaker sentiment in the near term (partly related to uncertainty).
- House prices flat for longer. A more marked fall in house prices cannot be ruled out, although it is certainly not our expectation. The fact a degree of shortage still exists, at least in Auckland, should continue to underpin prices. The one thing we are watching closely though is market listings. They are currently very low across the country, but if they start to rise (perhaps as investors look to exit) then a weaker price story could develop.
- Accordingly, the LVR restrictions may be eased earlier than otherwise – we may find out more on this possibility at the RBNZ's Financial Stability Report next week.
- Increased housing supply at the affordable end, though possibly at the expense of growth in supply in other segments of the market, given capacity constraints in the construction sector.
- Ongoing pressure on construction costs, particularly in Auckland, as the already-full pipeline gets another injection. However, whether this will flow through to broader inflation pressures is questionable, given it has failed to do so thus far.
- At the margin, perhaps more upward pressure on rental inflation due to both landlords trying to mitigate the impact of reduced capital gains expectations, and reduced supply of rental housing.

Figure 5: Auckland sales to listing ratio



Source: ANZ, Barfoot & Thompson

Figure 6: Construction cost inflation



Source: ANZ, Statistics NZ

Clearly the risks around the housing market are tilted to the downside at present, for all that the Reserve Bank identified risks on both sides in its recent *Monetary Policy Statement*. But in our view it would take an increase in forced sales to drive a significant market correction, particularly at a time when a shortage still exists in Auckland; the measures proposed here look unlikely to be sufficient. While there is certainly a risk of modest price falls given a possible impact on sentiment, the downside is somewhat limited unless we were to see a sharp negative shock to the economy (for example originating offshore) that changed the economic outlook in a significant way.

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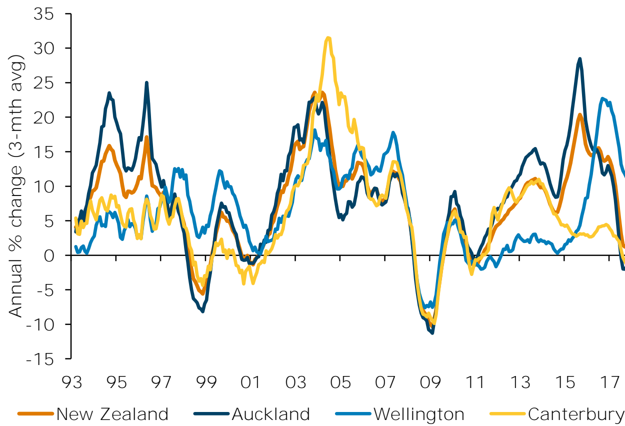
Figure 1. Regional house price inflation



Source: ANZ, REINZ

We estimate the nationwide REINZ House Price Index was broadly unchanged in seasonally adjusted terms in October (0.1% m/m). That follows a 0.7% m/m gain in September and 0.9% m/m lift in August, with three consecutive falls prior to that. Annual growth dipped to 1.6% y/y, from 2.3% y/y in September (the chart is presented in 3-month average terms). Auckland continues to underperform, with prices down 1.2% y/y in October (although they rose 0.4% m/m). Across the rest of the country, prices dipped 0.1% m/m in October (sa) but remain up 6.5% y/y. Of the major centres, Wellington is recording the strongest annual price growth of 11% y/y, although this is well off its highs.

Figure 2. REINZ house prices and sales

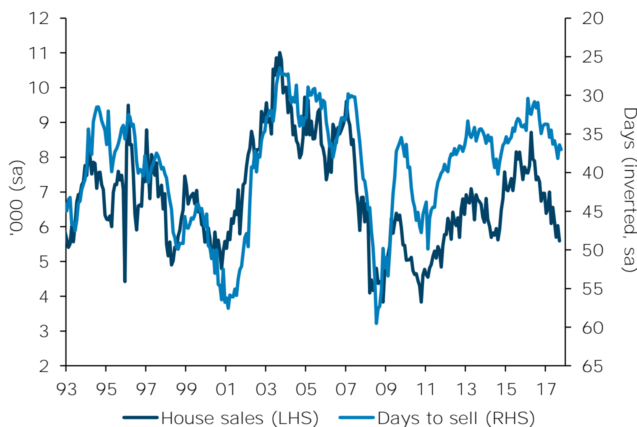
Source: ANZ, REINZ

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

National seasonally adjusted sales volumes lifted modestly (2.0% m/m) in October. However, that is only a partial bounce from September's 7.4% m/m fall, which took turnover to the lowest level since October 2011.

A number of factors will be playing a role in contributing to low levels of turnover, but no doubt election uncertainty has contributed. Sales volumes are down 15% y/y. Again, Auckland is underperforming, with turnover down 20% y/y, although every region (with the exception of Gisborne and Southland) is now experiencing turnover lower than a year ago. Excluding Auckland, sales volumes fell 1.2% m/m (sa), to be down 13% y/y.

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 0.6 days to 37.0 days (sa) in October. While that remains below its historical average (39.6 days), it is well up from less than 31 days 12 months prior.

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

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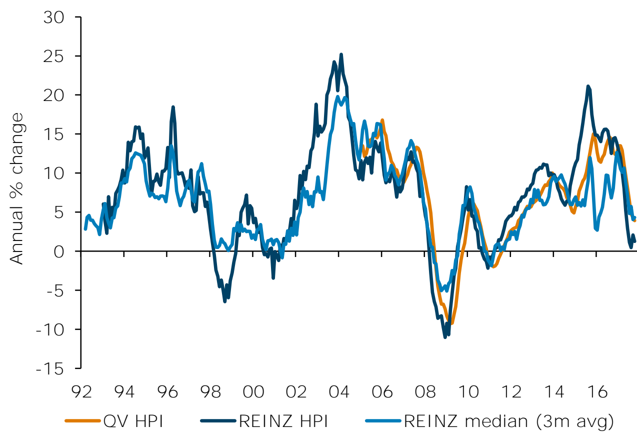
Figure 4. REINZ and QV house prices

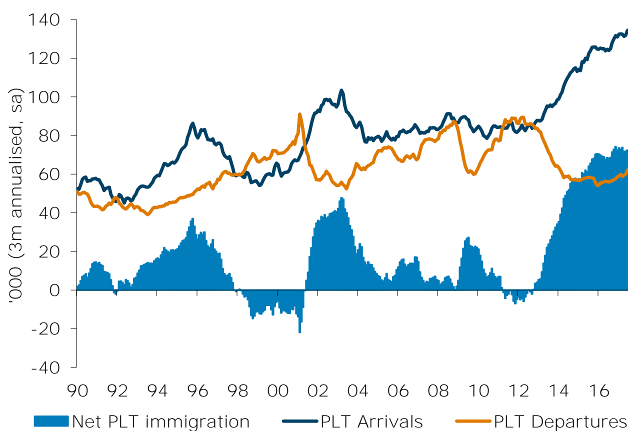


Source: ANZ, REINZ, QVNZ

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 rose 1.1% m/m (sa) in September, with annual growth lifting slightly to 3.8% y/y. This is stronger than the REINZ HPI (1.3% y/y) but similar to the QVNZ measure of price growth (3.9% y/y).

Figure 5. Net permanent/long-term immigration



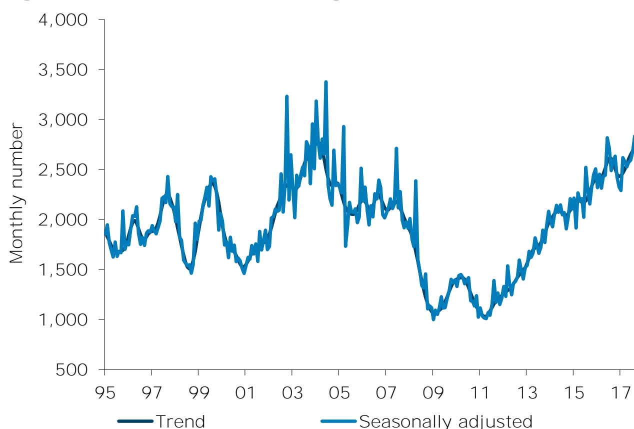
Source: ANZ, Statistics NZ

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 eased 2.3% m/m (sa) in September. This follows a 5.9% m/m increase in August, which was the highest level since 2004. At face value, underlying trend measures do appear to have improved, with the nationwide measure running at a 0.8% m/m pace. However, when we step back, we still believe we are in an environment where annual issuance will struggle to push much above 30k (it is currently 30.8k).

The sector is grappling with two clear opposing forces. The demand backdrop is clear, with a housing shortage (at least in Auckland) and strong population growth requiring ongoing lifts in housing supply. However, that supply response is being challenged by capacity and capital constraints in the construction industry. And falling house prices amidst rising costs undermine the viability of development.

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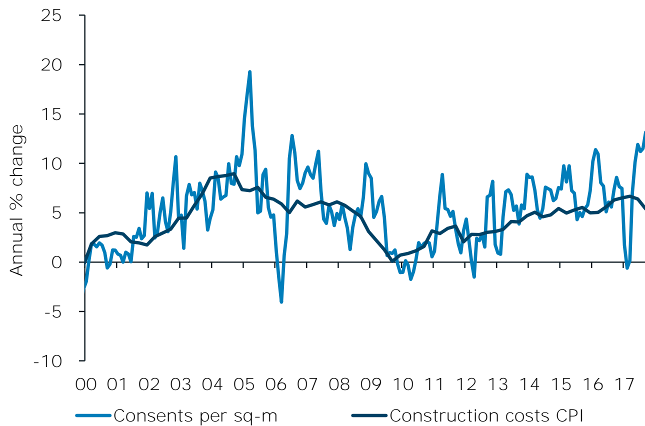
Figure 7. Construction cost inflation

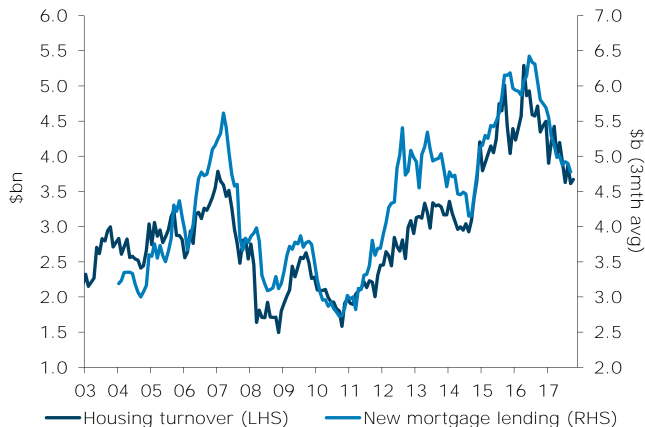


Source: ANZ, Statistics NZ

On a three-month average basis, **the value of residential consents per square metre rose 13% y/y in September.** This proxy for construction costs had shown surprising weakness in earlier months, which we felt was likely due to the composition of issuance more than anything. The bounce-back corroborates this view. In fact, it has accelerated sharply.

But interestingly, 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 assess 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 was weak in September (the chart is presented in 3-month average terms). We estimate that in seasonally adjusted terms, new lending plunged 9.6% m/m to $4.5bn, which is the lowest level since September 2014. It is the eighth fall in the past 12 months, and sees new lending down 22% y/y.

New investor lending continues to be soft. In September, lending to investors was down 32% 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 ticked a little higher in September, at 0.5% m/m (sa). It is at the margin really, but it is the strongest monthly growth in three months. In saying that, three-month annualised growth (5.0%) is the softest since early 2015.

High-LVR lending restrictions, increased credit rationing by banks, and evolving expectations regarding capital gains – all are having a marked impact on both house sales and credit availability. Add in election uncertainty and we would not be surprised to see mortgage lending growth remain at this more moderate pace over the coming months.

ANZ

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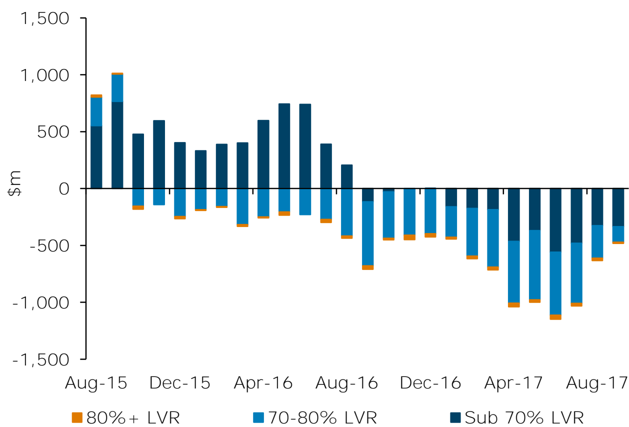
Figure 10. Annual change in investor lending by LVR

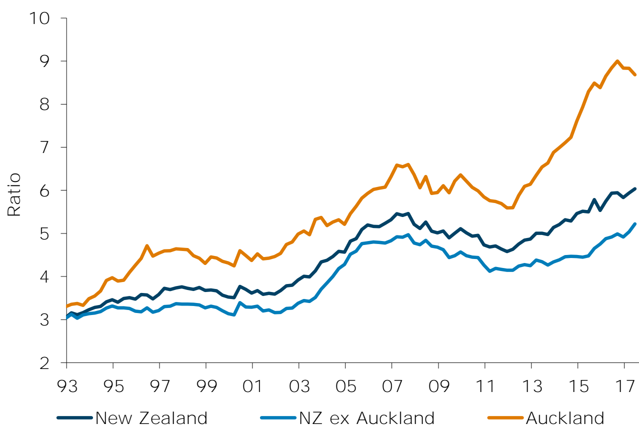


Source: ANZ, RBNZ

New lending to investors is well off its mid-2016 peak. It was down 32% y/y in September. Investors' share of overall new lending, at 23%, is well down from a peak of 35% in June 2016. This is no doubt related to the latest round of RBNZ LVR restrictions, which officially came into force on 1 October 2016, but could also reflect uncertainty around the upcoming election and the housing market outlook in general.

Related to the LVR restrictions, a larger share of new lending is on less-risky terms. In September, the share of total investor lending done at LVRs of less than 70% was 88%. That is a far greater share than in late-2014, when it was less than half.

Figure 11. Regional house prices to income

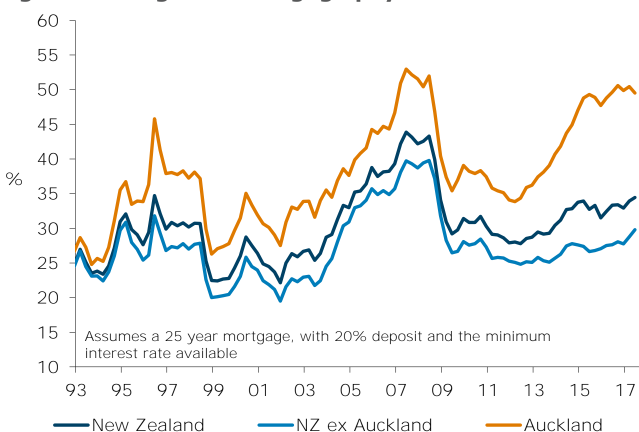


Source: ANZ, REINZ, Statistics NZ

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.

ANZ

PROPERTY GAUGES

There are clear opposing forces impacting the housing market. 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 and affordability constraints. If it were all about a demand and supply imbalance, then rents should be rising faster than they are. Political uncertainty adds another layer of caution. We 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	↔/↑	In the political crosshairs, but looks to have peaked anyway. Any fall to be gradual.
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 are 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 more.**

ANZ

PROPERTY GAUGES

Figure 1: Housing affordability

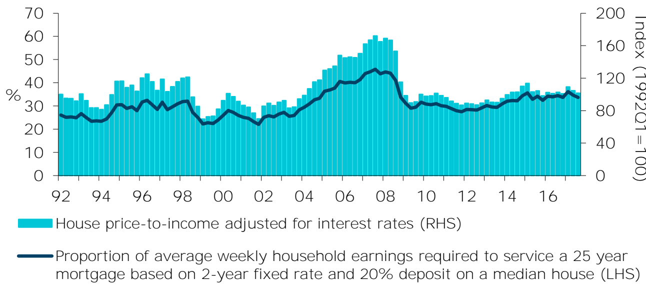


Figure 2: Household debt to disposable income

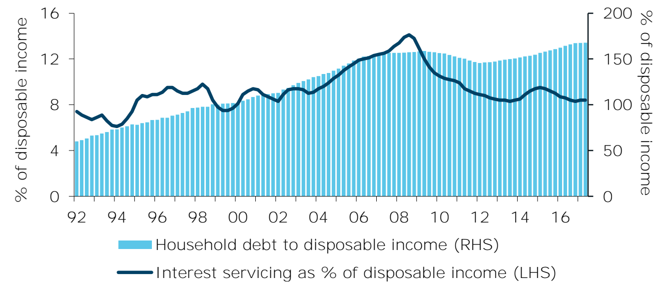


Figure 3: New customer average residential mortgage rate (<80% LVR)

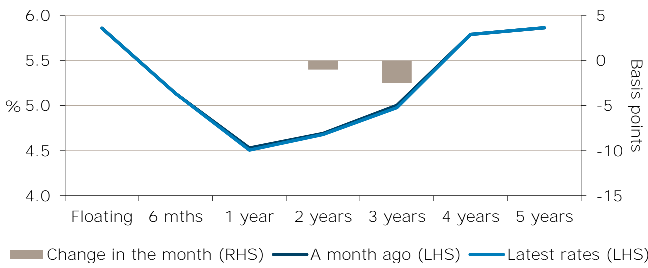


Figure 4: Net migration

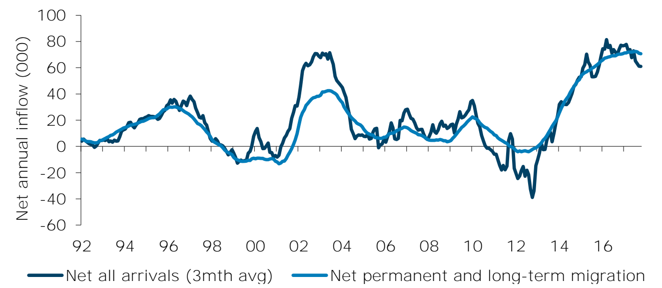


Figure 5: Housing supply-demand balance

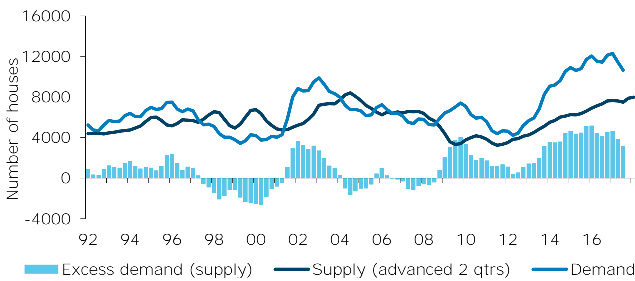


Figure 6: Building consents and house sales

Figure 7: Liquidity and house prices

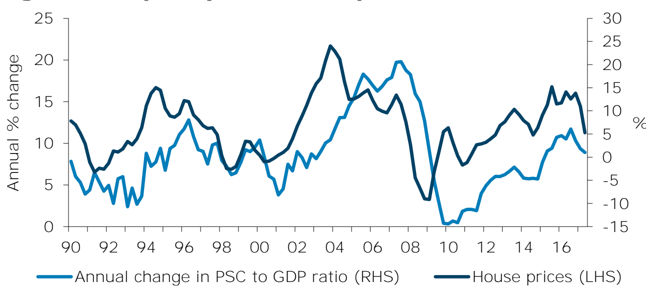


Figure 8: House price inflation comparison

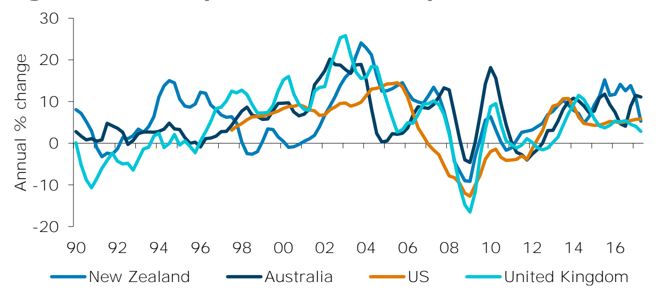


Figure 9: Housing supply

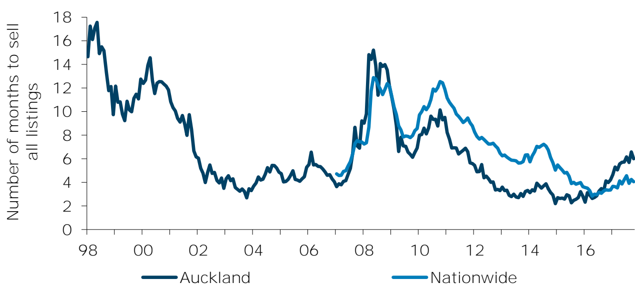
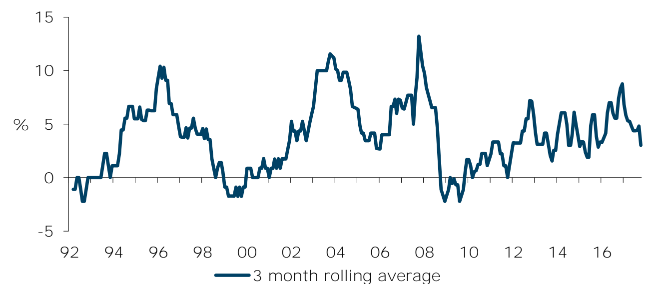


Figure 10: Median rental, annual growth



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

ECONOMIC OVERVIEW

SUMMARY

Our views on the economic outlook have become more nuanced. While we retain a broadly constructive view of the medium-term growth picture, we have turned more circumspect near term, and see a heightened chance of a growth wobble. That wobble is not expected to turn into something longer-lasting, but it certainly marks us out as less upbeat than the likes of the Treasury and RBNZ. Above-trend growth is hard to achieve when the most cyclical part of the economy (housing) looks set to remain soft. We are still biased towards OCR hikes in time. However, the combination of growth only around trend, a soft housing market, but the likelihood of some cost-push inflation is a complicated mix, meaning there are plenty of question marks regarding the timing of hikes.

OUR VIEW

The chance of the economy experiencing a near-term growth wobble has increased. Even prior to the recent period of political uncertainty, we were mindful of the economy potentially experiencing something of a growth air-pocket over the second half of 2017 and into early 2018 as it transitions in terms of some of its growth drivers while simultaneously facing headwinds from a softer housing market, a turn in the credit cycle and broadening capacity pressures. Recent data (retail spending, business sentiment, agricultural production etc) and anecdote (especially the likes of spending on big-ticket items) are all looking consistent with a wobble.

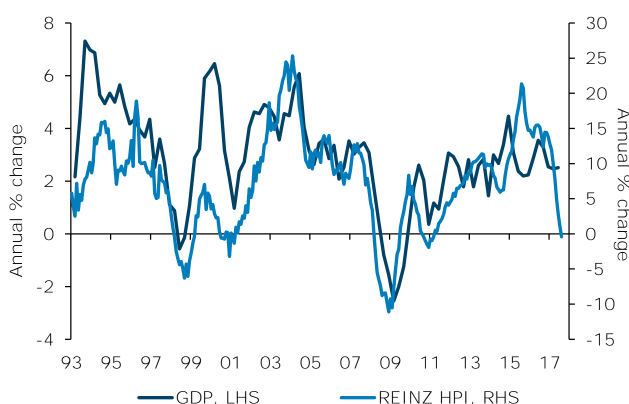
But we don't believe this growth wobble will be long-lasting. Yes, the economic cycle is reasonably mature; firms are telling us that finding skilled staff is still a huge problem. That is not something that can be resolved quickly. Housing market weakness looks set to persist, and hence so too the risks of broader spill-overs to the rest of the economy. **However, there are still reasons for optimism regarding the medium-term outlook**.

Our optimism rests on the following: Financial conditions have eased courtesy of the lower NZD and still-elevated commodity prices. Structural metrics (like the current account deficit), are in far better shape than they have typically been at this point in the cycle. When at extremes, imbalances can exacerbate any downturn. The global growth backdrop is solid, so it would be unusual for the New Zealand economy to embark on an entirely different path. And despite some previous growth drivers peaking (construction and migration), alternative growth drivers will emerge, with fiscal stimulus the obvious #1 candidate.

So while our story is admittedly more nuanced, we are happy to retain a broadly positive medium-term outlook, with growth returning to more-or-less trend rates. Notwithstanding the near-term risks, 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 certainly not a negative picture, but does mean we are less optimistic on the growth outlook than the likes of the Treasury and RBNZ.

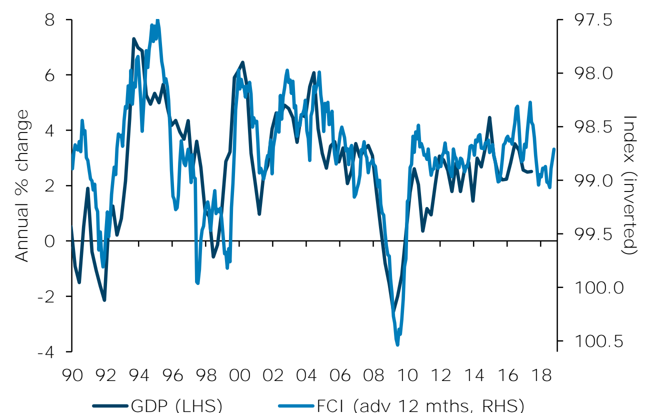
We are also still biased towards OCR hikes in time. Our more circumspect views regarding the near-term growth picture, together with expectations of soft housing market activity persisting, complicate the story. But growth around trend, together with signs of more cost push inflation from the labour market, is something that officials will eventually respond to, gradually. But plenty of questions remain surrounding timing.

Figure 1. House prices vs real GDP growth



Source: ANZ, Statistics NZ, REINZ

Figure 2. Financial conditions and GDP



Source: ANZ, Statistics NZ

MORTGAGE BORROWING STRATEGY

SUMMARY

It has been another month where average mortgage rates have barely moved, and so it leaves our favoured views broadly unchanged as well. From a "lowest is best" perspective, the 1-year rate still stands out. And this is consistent with our expectation of the OCR being on hold for some time yet. Longer-term rates remain low by historic standards and offer certainty. Some borrowers may wish to spread risk by borrowing over a number of fixed terms. While there are a few more signs that domestic inflation pressures are edging higher, it still does not seem like an environment where the OCR will be increased aggressively.

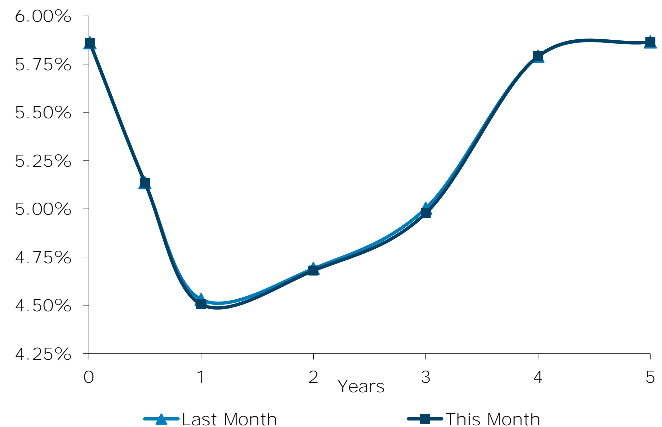
OUR VIEW

Average mortgage rates were effectively unchanged in the past month. There were some small falls in the 1-3 year space, but we are talking about moves 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.

From a "lowest is best" viewpoint, the 1-year rate remains favoured. It is reinforced by our expectation that the OCR is on hold for some time yet. While the latest CPI figures for Q3 did come in a little stronger than the RBNZ's expectations, and there are some more signs that domestic inflation pressures are edging higher (with a little more cost-push inflation likely from the labour market), the near-term growth picture is looking more mixed and housing is soft. While we are still biased towards OCR hikes in time, plenty of questions regarding the timing remain (with risks skewed towards later), and it certainly does not feel like an environment where even when hikes get underway, the OCR will be lifted aggressively. That keeps the "value" in rolling short-dated hedges.

Breakeven analysis shows that certainty can be provided for a modest cost, at least in the front part of the curve. For instance, the average two-year special rate is only 18 bps above the 1 year rate. The 1 year rate would need to rise by 35 bps (from 4.51% to 4.86%) over the next year in order for it to be cheaper fixing for 2 years at 4.68% 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 (30bps); the breakeven on a 2 year at 4.68% versus a 3 year at 4.98% is 5.21%. 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%	3.88%	4.77%	4.94%	5.42%
1 year	4.51%	4.32%	4.86%	5.18%	5.57%
2 years	4.68%	4.75%	5.21%	5.98%	6.90%
3 years	4.98%	5.43%	6.22%	6.45%	6.66%
4 years	5.79%	5.91%	6.21%		
5 years	5.87%	#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%	4.63%	5.63%	5.15%	5.90%
1 year	4.92%	5.13%	5.39%	5.53%	6.05%
2 years	5.16%	5.33%	5.72%	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 year and possibly some in the 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 October 2017 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	3.7	-3.2	197	-5%	51
Auckland	-3.3	0.5	1,709	+5%	38
Waikato	9.9	-1.0	594	+5%	40
Bay of Plenty	4.1	2.6	376	-9%	42
Gisborne	18.1	-7.3	57	+6%	37
Hawke's Bay	18.7	4.1	205	+3%	32
Manawatu-Whanganui	11.4	0.9	317	-6%	34
Taranaki	13.6	5.3	175	-2%	34
Wellington	6.5	-0.6	668	+6%	32
Tasman, Nelson and Marlborough	-0.8	-2.8	205	+8%	31
Canterbury	4.8	2.1	726	-7%	36
Otago	14.1	2.4	305	-15%	34
West Coast	23.8	6.7	28	-17%	51
Southland	1.6	-1.4	138	-7%	32
NEW ZEALAND	**4.0**	**0.9**	**5,701**	**+2%**	**37**

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	2.3	2.3	2.2	2.4	2.7	3.0
CPI Inflation (Annual % Chg)	1.3	2.2	1.7	1.9(a)	1.8	1.5	1.8	2.0	1.9	2.0
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	5.1	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	6.3	6.4	6.6	6.7	6.8	6.8

Source: ANZ, Statistics NZ, RBNZ

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