NEW ZEALAND ECONOMICS
ANZ PROPERTY FOCUS

JANUARY 2016

INSIDE

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BATON CHANGE TO THE REGIONS

SUMMARY

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

THE MONTH IN REVIEW

The RBNZ left the OCR on hold, but noted that rates may move lower in 2016. We are not seeing enough to justify a further easing in policy but the risks are obvious. December REINZ data showed some modest recoil, with the Auckland housing market considerably less buoyant than prior to the introduction of regulatory changes in October, whilst markets in other regions are heating up, supported by historically low mortgage interest rates, relaxed LVR criteria and the “ripple” impact of earlier Auckland house price strength. Dwelling construction activity is strengthening, but booming net immigration implies a moving target for housing demand. Credit growth has followed the housing market and households are re-leveraging, although mortgage approvals look to have plateaued.

PROPERTY GAUGES

Auckland house prices remain stretched relative to both incomes and rents, but have held up well thus far, supported by historically low fixed mortgage interest rates, tight dwelling supply, and booming net immigration. Housing markets in other regions have similar supports but milder affordability headwinds, and look set to continue to outperform Auckland.

ECONOMIC OVERVIEW

The economy ended 2015 on a positive note, and leading indicators augur well for 2016. While we expect solid growth over 2016, the risk profile is elevated. Global nuances and signals are poor, with China and commodity prices at the epicentre. The risk profile remains skewed towards the OCR falling further still.

MORTGAGE BORROWING STRATEGY

There have been minimal moves in carded rates of late, with longer-term fixed rates marginally higher since our last edition. Lower wholesale rates suggest scope for lower mortgage rates, but offsetting this are higher funding costs and we expect tension between these two as 2016 progresses. The cheapest part of the curve by some distance is for the one to two year tenor, where rates are historically very low and offer the best value. We continue to have a preference for the two-year rate, which offers greater certainty at a historically low rate and offers slightly higher protection if pressures in credit markets filter through into fixed-term rates. With potential OCR cuts and no OCR hikes on the horizon, longer-term rates don’t offer the same value at present.

FEATURE ARTICLE: THE PROPERTY MARKET IN PICTURES

House sales volumes and price growth slowed sharply in Q4 last year as the impact of regulatory changes to slow investor demand took effect. Nationwide prices (particularly Auckland) look stretched relative to incomes and rents, although historically low mortgage interest rates have kept debt servicing costs at more manageable levels. Despite record net immigration and tight inventories, the slowdown looks more acute in the Auckland market. Other regions, however, are benefitting from historically low mortgage interest rates and the ‘ripple impact’ of earlier Auckland house price strength. Strong population growth has contributed to rising dwelling “shortages” in Auckland and while dwelling construction activity is strengthening, booming net immigration implies a moving target for housing demand. Mortgage approvals have plateaued of late and suggest that the nationwide market will remain in something of a holding pattern, with housing credit growth likely to plateau, albeit at reasonably elevated levels.

THE MONTH IN REVIEW

The RBNZ left the OCR on hold, but noted that rates may move lower in 2016. We are not seeing enough to justify a further easing in policy but the risks are obvious. December REINZ data showed some modest recoil, with the Auckland housing market considerably less buoyant than prior to the introduction of regulatory changes in October, whilst markets in other regions are heating up, supported by historically low mortgage interest rates, relaxed LVR criteria and the "ripple' impact of earlier Auckland house price strength. Dwelling construction is trending up, but booming net immigration implies a moving target for housing demand. Credit growth has followed the housing market and households are re-leveraging, although mortgage approvals look to have plateaued.

RBNZ OCR REVIEW JANUARY

RBNZ acknowledge inflation risk profile and signals that it may ease further

The RBNZ left policy unchanged, as widely expected. However, its concern over the global outlook and ability of inflation to return to its target range within a comfortable timeframe has increased. Whereas its easing bias in December was conditional, a more explicit bias is now evident, with the Bank noting that "some further policy easing may be required over the coming year to ensure that future average inflation settles near the middle of the target range." We are still watching the C's (China, currency, commodity prices, core inflation, cost of funds, credit growth and confidence). Some of those we can tick as being problematic and justifying a lower OCR now (cost of fund increases, low export prices, China) but we are not seeing enough across the board to justify further cuts yet.

REINZ, HOUSE SALES – DECEMBER

Two-speed housing market, with the regions now outperforming Auckland

After dropping sharply over the past few months, nationwide sales volumes bounced in December, lifting a seasonally adjusted 8.1%. That said, volumes are still down 3% versus their recent September peak and annual growth has slowed to 3.5%. Auckland sales volumes rose a seasonally adjusted 14% in the month, but are still 19% below September levels. Seasonally adjusted sales volumes rose solidly in Hawke's Bay, Manawatu, Taranaki, Wellington and Otago, with eight of 12 regions now experiencing annual sales growth of over 18%. After rising for three consecutive months, the median 'days to sell' eased back to 33.4 days from 34.7 in November, suggesting the nationwide market has reasonable momentum. Prices from the REINZ Stratified House Price Index posted a 0.6% sa rise (-1.4% 3m/3m), with annual inflation slowing to 12.6%. Auckland prices rose 1.0% in December (-2.4% 3m/3m) with annual growth at 14.2%. Across other regions, solid price increases were seen in Wellington (3.0% m/m), regional South Island (2.6% m/m) and regional North Island (1.1% m/m). Christchurch prices fell 1.7%.

STATISTICS NZ, BUILDING CONSENTS – DECEMBER

Residential consent issuance hits 11 year high

Residential dwelling consent numbers rose 1.8% m/m sa, with the number of single-dwelling housing consents lifting 3.4%. Over 2015, a total of 27,132 residential consents were lodged – the highest in 11 years. The trend in issuance was also at an 11-year high, with increases in most regions.

STATISTICS NZ, EXTERNAL MIGRATION – NOVEMBER

Another record for net PLT immigration inflows

There was another record monthly net inflow of 6,260 PLT migrants (sa) in November, with the annual inflow hitting a record high of 63,659 persons. The pace of net inflows has continued to accelerate, running at over 72k on a three-month average basis.

RBNZ, HOUSEHOLD CREDIT GROWTH – NOVEMBER

Mortgage lending strong; approvals growth slowing

The value of mortgage lending to households rose 0.7% sa in November (+8.5% 3m/3m), with annual credit growth strengthening to 7.5%. That's in excess of income growth and signals leveraging-style behaviour is back in vogue.

RBNZ, MORTGAGE APPROVALS – MID-JANUARY

Approval values and numbers are 18% and 10% higher than this time last year respectively. Approval numbers are still 10% below historical averages for this time of year, and point to a levelling off in increases in mortgage credit.

PROPERTY GAUGES

Auckland house prices remain stretched relative to both incomes and rents, but have held up well thus far, supported by historically low fixed mortgage interest rates, tight dwelling supply, and booming net immigration. Housing markets in other regions have similar supports but milder affordability headwinds, and look set to continue to outperform Auckland.

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 despite recent price falls. Regions still okay, with scope to outperform.
Serviceability/ indebtedness	Hard work	↔/↓	Lower mortgage interest rates are helping contain debt-servicing costs despite growing debt to income ratios.
Interest rates / RBNZ	Regional facets	↔/↑	Recent cuts in variable and fixed rates will help support the regions. LVR changes should slow Auckland investor demand.
Migration	Record	↔/↑	New record inflows continue.
Supply-demand balance	Akld vs Rest of NZ	↔/↑	Auckland shortages are growing; Canterbury shortages are declining; the situation is more balanced elsewhere.
Consents and house sales	Catching up	↔/↑	Amidst monthly volatility, consents are trending up. More houses are needed in Auckland; Canterbury issuance has topped out.
Liquidity	Firming	↔/↑	Credit is rising faster than incomes, which provides a temporary boost. Plateauing in credit growth higher than incomes expected.
Globalisation	In synch	↔/↓	Moderation in some global markets; Auckland is one of the most expensive cities globally relative to domestic incomes.
Housing supply	Low	↔/↑	Inventory-to-sales historically low.
Median rent	Squeeze	↔	Rents picking up, led by Auckland, with further increases likely.
On balance	**Holding**	↔	**Regions strengthening and Auckland toppy.**

PROPERTY GAUGES

FIGURE 1: HOUSING AFFORDABILITY

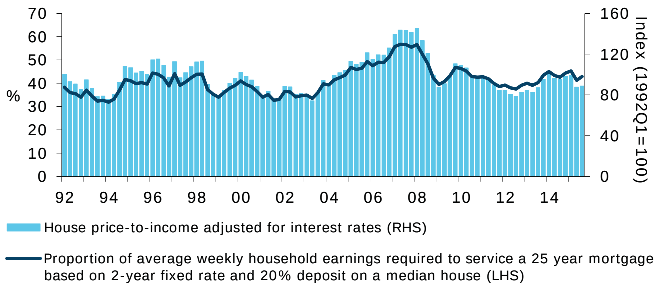


FIGURE 2: SERVICEABILITY AND INDEBTEDNESS

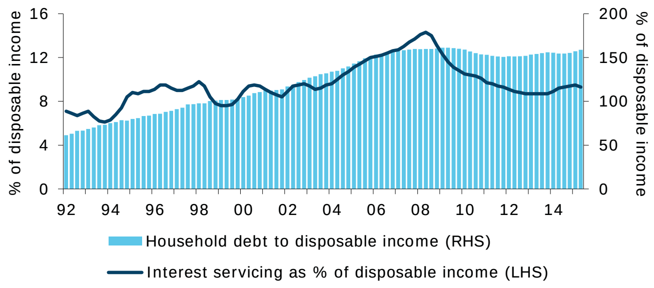


FIGURE 3: NEW CUSTOMER AVERAGE RESIDENTIAL MORTGAGE RATE (<80% LVR)

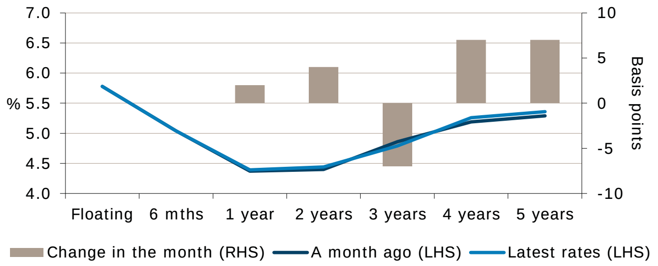


FIGURE 4: NET MIGRATION

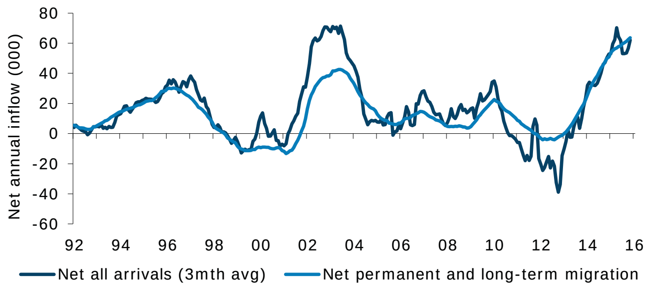


FIGURE 5: HOUSING SUPPLY-DEMAND BALANCE

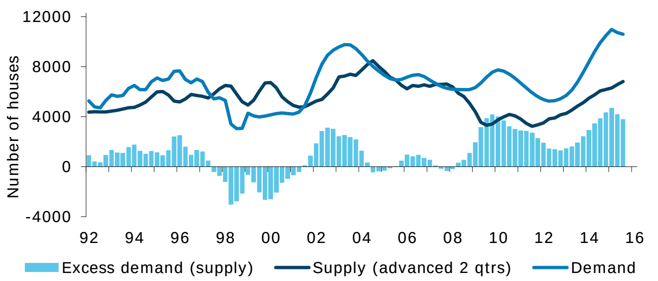


FIGURE 6: BUILDING CONSENTS AND HOUSE SALES

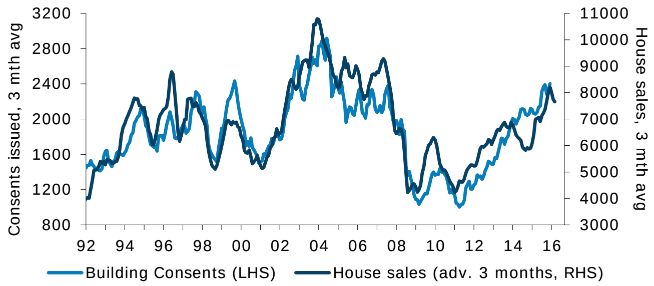


FIGURE 7: LIQUIDITY AND HOUSE PRICES

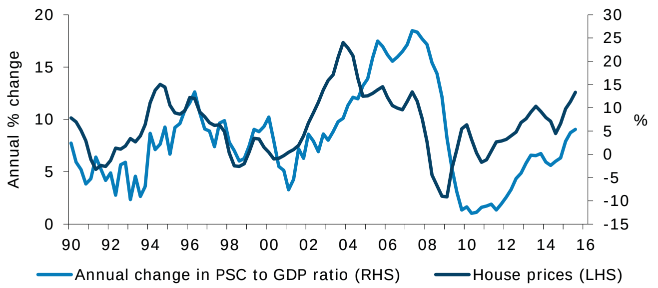


FIGURE 8: HOUSE PRICE INFLATION COMPARISON

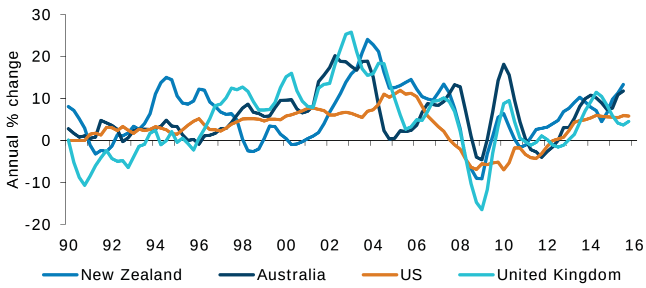


FIGURE 9: HOUSING SUPPLY

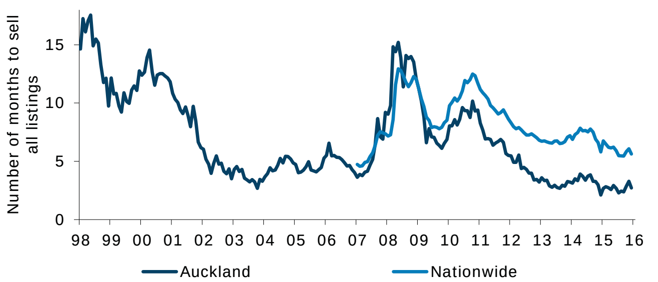
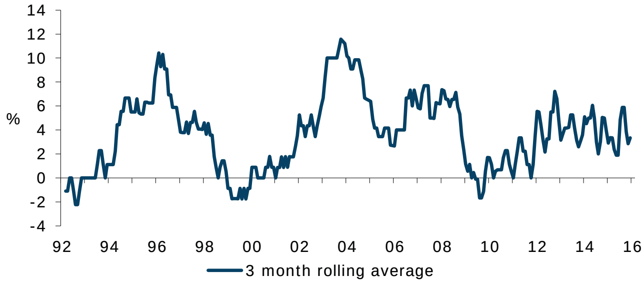


FIGURE 10: MEDIAN RENTAL, ANNUAL GROWTH



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 on a positive note, and leading indicators augur well for 2016. While we expect solid growth over 2016, the risk profile is elevated. Global nuances and signals are poor, with China and commodity prices at the epicentre. The risk profile remains skewed towards the OCR falling further still.

2015 ended on a positive note and our forward-looking indicators continue to point to above-trend growth.

Our proprietary leading indicators augur well for 2016. Confidence has lifted sharply off lows, firms' own activity expectations are recovering and our Truckometer has surged. Job ads have started to rise once again, flagging an improvement in prospects for the labour market.

Key factors supporting the economy include:

- **Notable strength in some key sectors.** Construction activity is strong. Auckland house prices have levelled off but regional house prices are starting to move higher. Tourism numbers are very strong. Migration inflows are surging.
- **A lower OCR** following the 2015 cuts, and associated loosening in financial conditions. The NZD has eased.
- **A lift in dairy prices off lows.** The outlook for the dairy payout is still poor but less of a catastrophe relative to when powder prices were trading at USD$1,500 per tonne. That's removed some of the mid-2015 extreme negativity.
- **An economy that has better microeconomic foundations and resilience.** We continue to place considerable importance on small dynamics across the economy, that whilst hard to quantify and often subjective, add to the economy's economic muscle. This includes fiscal competency and credibility.
- **Some natural "bounce"** from overcooked bearishness. The New Zealand economy is interlinked with prospects for the dairy industry but not universally dependent on it.

However, we start 2016 with a more elevated risk profile.

- **Export prices are weakening.** Dairy prices are front and centre but red meat and others commodities have tilted sharply lower of late too. Prospects for a meaningful recovery in dairy prices look to be a way out and price action across broader commodities is poor. However, a lower NZD has helped provide some offset.
- **A host of the world's problems have not been addressed post the global financial crisis.** The global economy remains on a knife-edge amid concerns over Europe (sovereign risk), commodities (heavily financialised during the boom times but with prices low now) and China, to name but a few.
- **Greater uncertainty surrounds China.** The RMB and equities are under pressure, and capital outflows are substantial. Partial indicators tell a different story growth-wise relative to official statistics. We hold concerns about how capital has been allocated (over-investment), the degree of corporate leverage and the pricing of risk.
- **The New Zealand economy continues to show evidence of borrow-and-spend style growth**, which is manageable as a temporary phenomenon but unsustainable medium-term, given the backdrop of already-high leverage and house prices.
- **A possible correction in the Auckland property market.** We put a low probability on such an outcome given housing shortages, but it's a risk nonetheless. The key challenge is restoring demand-supply balance to the market.
- **Fallout from the El Nino event**, although recent rainfall has helped alleviate this risk.

We expect reasonable GDP growth of 2.5% over the coming year but expect volatility to remain high.

Inflation remains low and although capacity is tight and there are pockets of price pressure, there is a generalised lack of inflation. Along with the fragile global scene and widening credit spreads, **the inflation outlook may warrant OCR cuts later in the year.** However, despite the downside skew to the OCR risk profile, at this stage we see no urgency for cuts, and our base case scenario has the OCR on hold over 2016.

MORTGAGE BORROWING STRATEGY

SUMMARY

There have been minimal moves in carded rates of late, with longer-term fixed rates marginally higher since our last edition. Lower wholesale rates suggest scope for lower mortgage rates, but offsetting this are higher funding costs and we expect tension between these two as 2016 progresses. The cheapest part of the curve by some distance is for the one to two year tenor, where rates are historically very low and offer the best value. Borrowers could choose to spread fixed terms across one to two year tenors to stagger roll-overs, but we continue to have a preference for the two-year rate, which offers greater certainty at a historically low rate and offers slightly higher protection if pressures in credit markets filter through into fixed-term rates. With potential OCR cuts and no OCR hikes on the horizon, longer-term rates don't offer the same value at present.

OUR VIEW

There have been minimal moves in carded mortgage interest rates since the December edition of the *Property Focus* (December 18). There have been some movements in special rates offered by the Big 4 Australasian banks, which have seen modest falls for the average carded three year rate, whilst average special carded rates are slightly higher in the four to five year space. Moves have been modest, amounting to less than 10bps on average. Average standard rates have been fractionally higher for longer maturities.

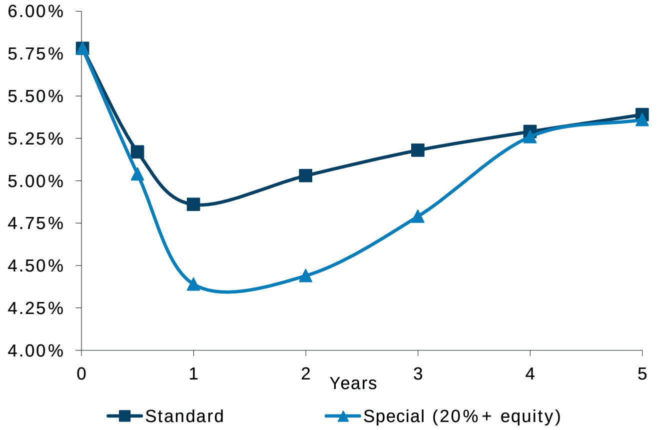
The lowest part of the curve is for one to two year fixed rates, particularly for mortgage specials, with average rates around multi-decade lows. Average borrowing rates have fallen by around 50bps over 2015 (to around 5.50%), once again the lowest rate in decades.

Retail rates are now facing pressure from two sides: the potential for the RBNZ to cut rates, which wholesale markets are putting reasonable odds on, but higher funding (credit) costs internationally. The latter is a sticking point for a fall in fixed mortgages rates to under 4 percent.

So what should borrowers do? **This will largely depend on individual circumstances**, but our breakeven analysis is useful in comparing various options. **For those able to access specials, one and two-year terms (top table) remain the cheapest by some distance.** Borrowers could choose to spread fixed terms across both tenors to stagger rollovers, but because of the **additional certainty afforded, we have a preference for locking in a greater proportion for two years, offering greater protection should fixed rates move up.**

Locking in for terms longer than two years would provide more certainty, but borrowers would be paying for the privilege. Of standard rates, the one-year fixed rate looks preferable, given it would have to rise from around 4.86% to around 5.20% to make it more attractive to fix for two years. With the OCR potentially moving down and not set to go up until mid-2017 by our reckoning, this seems unlikely, but we're watching domestic deposit rates for signs of funding pressures.

AVERAGE CARDED MORTGAGE RATES^
Current rates



Special Mortgage Rates		Breakevens for 20%+ equity borrowers			
Term	**Current**	**in 6mths**	**in 1yr**	**in 18mths**	**in 2 yrs**
Floating	5.78%				
6 months	5.04%	3.74%	4.47%	4.52%	5.32%
1 year	4.39%	4.10%	4.49%	4.92%	5.49%
2 years	4.44%	4.51%	4.99%	5.48%	6.08%
3 years	4.79%	5.02%	5.55%	5.76%	5.97%
4 years	5.26%	5.34%	5.60%		
5 years	5.36%	*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	5.78%				
6 months	5.17%	4.55%	5.12%	5.29%	5.41%
1 year	4.86%	4.83%	5.20%	5.35%	5.48%
2 years	5.03%	5.09%	5.34%	5.45%	5.55%
3 years	5.18%	5.25%	5.43%	5.54%	5.63%
4 years	5.29%	5.36%	5.52%		
5 years	5.39%	*may be subject to a low equity fee			

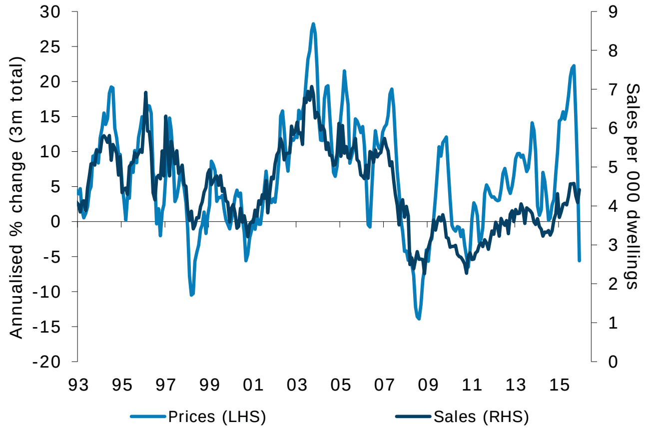
^Average of carded rates from ANZ, ASB, BNZ and Westpac. Sourced from interest.co.nz

FEATURE ARTICLE: THE PROPERTY MARKET IN PICTURES

SUMMARY

This month we provide an updated graphical summary of recent property market trends. It shows that house price growth and volumes slowed sharply in Q4 last year as the impact of regulatory changes to slow investor demand took effect. Nationwide prices (particularly Auckland) looked stretched relative to incomes and rents, although historically low mortgage interest rates have kept debt servicing costs at more manageable levels. Despite record net immigration and tight inventories, the slowdown looks more acute in the Auckland market. Other regions, however, are benefitting from historically low mortgage interest rates and the 'ripple impact' of earlier Auckland house price strength. Strong population growth has contributed to rising dwelling "shortages" in Auckland and while dwelling construction activity is strengthening, booming net immigration implies a moving target for housing demand. Mortgage approvals have plateaued of late and suggest that the nationwide market will remain in something of a holding pattern, with housing credit growth likely to plateau, albeit at reasonably elevated levels.

FIGURE 1. HOUSE PRICES AND SALES

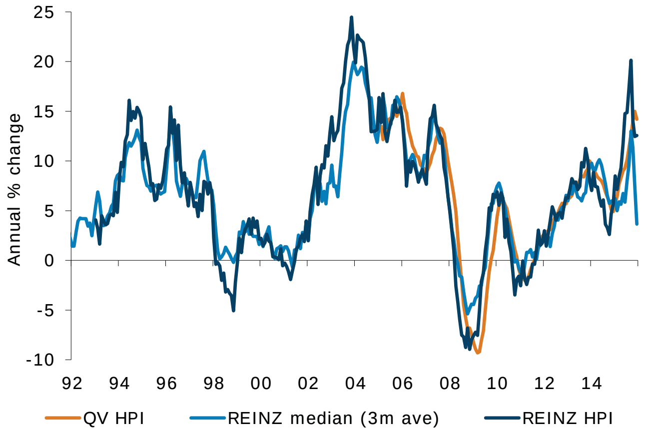


Source: ANZ, REINZ

Sales volumes and prices tend to be closely correlated, although tight dwelling supply has seen a correspondingly greater ramping-up of prices over the last five years or so.

Sales volumes were down 6.7% in the December quarter (+3.4% y/y), with volumes down 11% over the October/November period followed by an 8% December rise. Volumes remain at historical averages as a proportion of the dwelling stock. Sales volumes fell 21.7% 3m/3m in Auckland (18.8% y/y). Quarterly sales growth also slowed in other upper North Island centres, but accelerated in Wellington, Otago and Southland. Prices fell 1.4% in Q4, driven by a 2.4% 3m/3m fall in Auckland, with prices rising in Wellington (+1.8% 3m/3m) and other North Island centres (+3% 3m/3m). Prices in the South Island have flat-lined over the last three months.

FIGURE 2. REINZ AND QV HOUSE PRICES



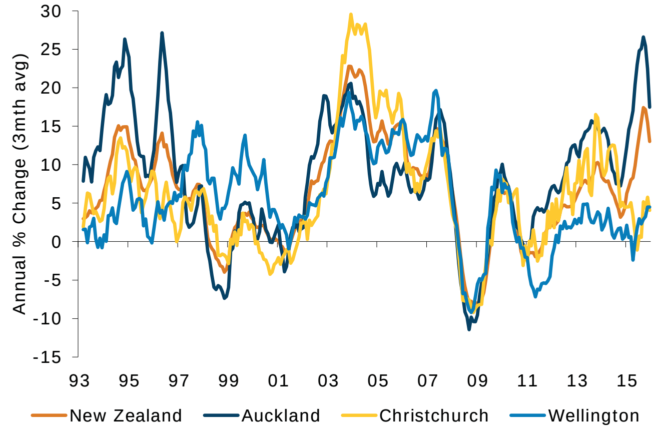
Source: ANZ, REINZ, CoreLogic

There are three key measures of house prices in New Zealand, including the median and stratified house price measures produced by REINZ as well as the monthly QVNZ house price index published by Property IQ. Movements do not line up exactly, given differing methodologies, with the REINZ median typically more volatile as it is sensitive to the composition of sales taking place.

Annual nationwide house price inflation is slowing, albeit to varying degrees. The median sale price of houses sold by REINZ rose just 3.3% over 2015 compared to the 12.6% annual increase for prices from the stratified House Price Index. Like the latter, the QVNZ house price index (+14.2% y/y) adjusts for differences in the quality of houses sold, but it tends to lag as it records sales later in the transaction process.

FEATURE ARTICLE: THE PROPERTY MARKET IN PICTURES

FIGURE 3. REGIONAL HOUSE PRICES



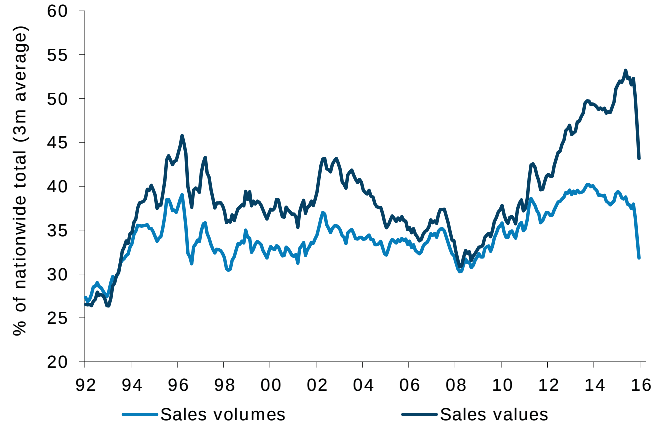
Source: ANZ, REINZ

House prices are falling in Auckland (-2.4% q/q sa on the REINZ stratified measure), as affordability constraints and the impact of new taxation criteria and tighter speed limits to slow investor demand hit home.

Low mortgage interest rates, high net immigration and the 'ripple effect' of stronger Auckland house prices have supported other regional areas. Annual house price inflation has strengthened to 7.9% in Wellington and 14.9% y/y in other North Island areas over the last 12 months. Double-digit increases in median sales prices were evident in the upper North Island and Hawke's Bay.

Christchurch prices were up close to 6% over 2015, with prices in the remainder of the South Island up 11% y/y.

FIGURE 4. SHARE OF AUCKLAND VALUES AND VOLUMES



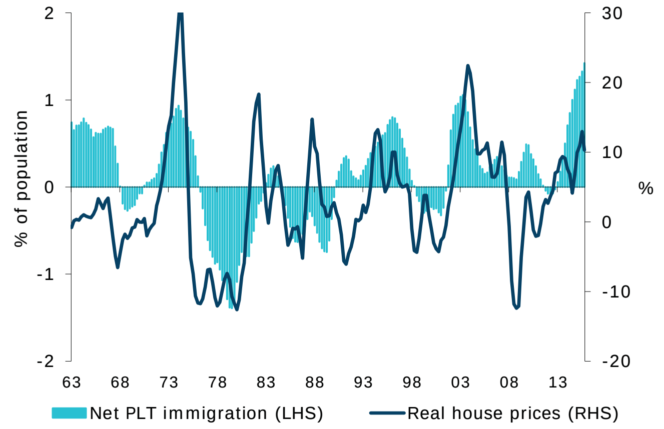
Source: ANZ, Statistics NZ, CoreLogic

This chart shows the ratio of Auckland sales volumes (REINZ measure) to the nationwide total, alongside the implied value of Auckland housing transactions relative to the nationwide total (the number of house sales multiplied by the average value of property sold as proxied by the REINZ stratified House Price Index).

Auckland's sales volumes fell to about one-third of nationwide sales volumes in Q4, a six year low. This was due to the steep falls in Auckland sales volumes (-22% q/q, 19% y/y) as compared to a 2.6% q/q rise in the rest of the country (+19% y/y).

The Auckland share of the value of the national housing transactions fell to a four-year low in Q4 (43%). The value of Auckland property transactions fell 23% in Q4 versus an 11% rise for the rest of the country.

FIGURE 5. NET PLT IMMIGRATION AND HOUSE PRICES



Source: ANZ, Statistics NZ, CoreLogic

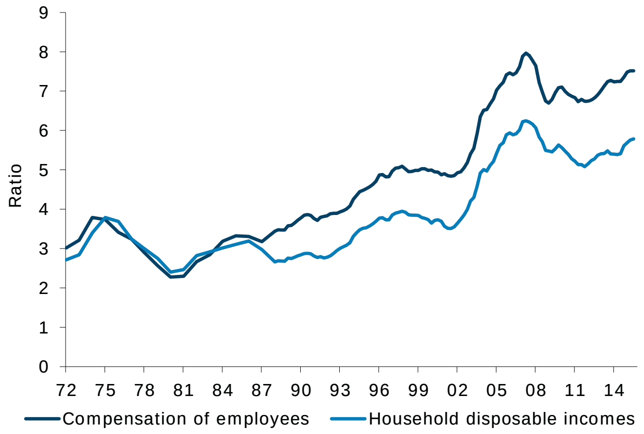
Migration flows to and from New Zealand are one of the major drivers of housing market cycles. The early-1970s, mid-1990s and mid-2000s booms coincided with large net migration inflows.

Annual net PLT immigration rose to 63,260 persons in the 12 months to November, a record high and equivalent to around 1.4% of the resident population. Around 90% of the increase over the past 12 months has been due to more arrivals, led by more arrivals of students, those on work visas and returning kiwis.

The migration inflows have been strongest in Auckland and Canterbury, which together have accounted for around three quarters of PLT inflows.

FEATURE ARTICLE: THE PROPERTY MARKET IN PICTURES

FIGURE 6. HOUSING STOCK TO LABOUR & HOUSEHOLD INCOMES



Source: ANZ, Statistics NZ, CoreLogic

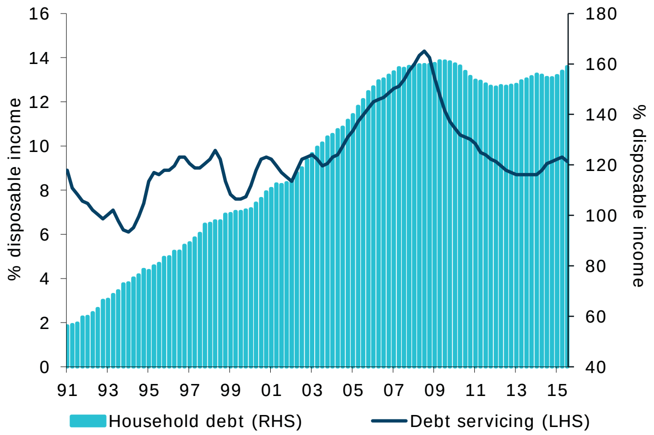
Strengthening house prices have pushed up the value of the nationwide housing stock to six times household incomes and roughly eight times labour incomes.

The chart uses data up to (and including) Q3, 2015, and does not capture price falls over Q4.

The drift up in the house price to income ratio has coincided with the shift lower in mortgage interest rates, enabling households to take on more debt.

The data in the chart is up to 2015Q3, the point at which prices looks to have peaked. Just as well, given a slowing outlook for household income growth, due to low dairy incomes, lower employment growth, and low wage inflation.

FIGURE 7. HOUSEHOLD DEBT AND DEBT SERVICING



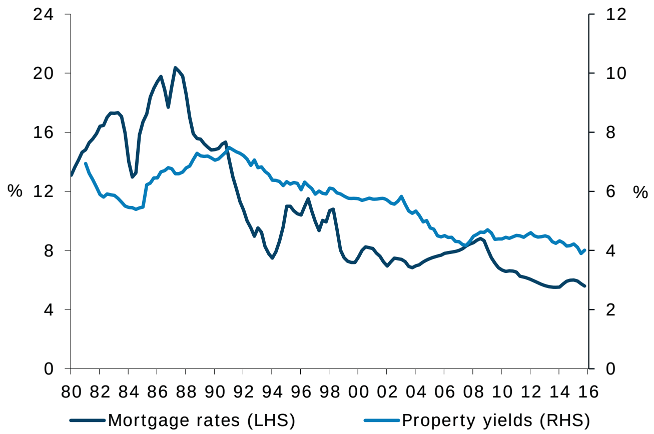
Source: ANZ, RBNZ

Household credit growth is currently running at an 8% annualised rate, well above the (slowing) growth rate of household incomes. After troughing in early 2012, household debt is approaching 160% of household incomes, a six-year high.

The rise in debt has been dampened by further falls in mortgage interest rates, which are sitting at multi-decade lows.

Debt holdings are not distributed evenly, even amongst the more than half of owner-occupier households who have an outstanding mortgage.

FIGURE 8. MORTGAGE INTEREST RATES AND RENTAL YIELDS



Source: ANZ, CoreLogic, MBIE, Statistics NZ

Nationwide rental yields (expressed as the ratio of annual rental payments to house sales prices) have trended lower since the early 1990s, and are hovering around record lows.

The nationwide rental yield is around 4%, around half what it was in the early 1990s. The fall in yields has coincided with a shift lower in nominal mortgage interest rates, which has helped households to service more debt.

Auckland yields are below the nationwide average, whilst yields are generally above the nationwide average for other regions, including Canterbury.

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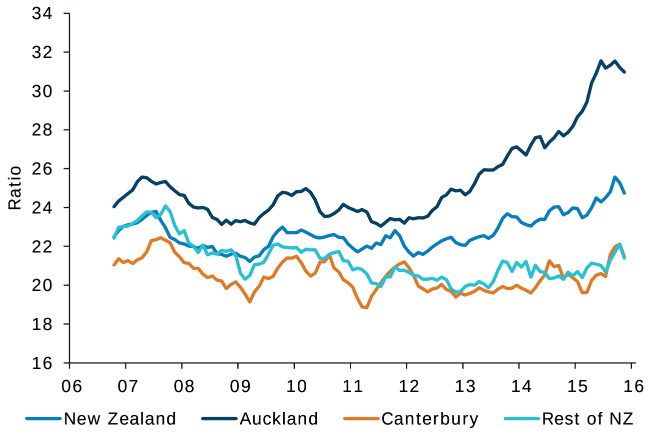
FIGURE 9. MEDIAN HOUSE PRICES TO ANNUAL RENTS



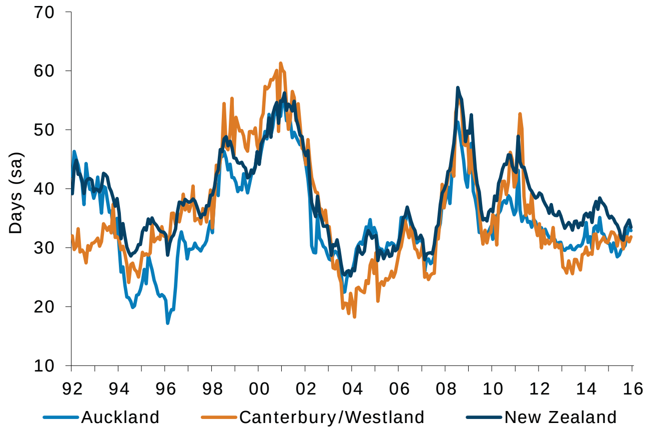
Source: ANZ, REINZ, MBIE

The nationwide median dwelling price of an existing dwelling peaked just below 26 years of rental payments in September, and is now on the way down. This mostly reflects lower house prices, with still-moderate rates of rental inflation.

Stronger growth in Auckland rents (around 6% y/y) and lower house prices have seen the ratio for Auckland fall, although gross rental yields of just over 3% are well below that of current mortgage interest rates.

House prices do not look stretched relative to rents for Canterbury and the remainder of the country.

FIGURE 10. MEDIAN DAYS TO SELL



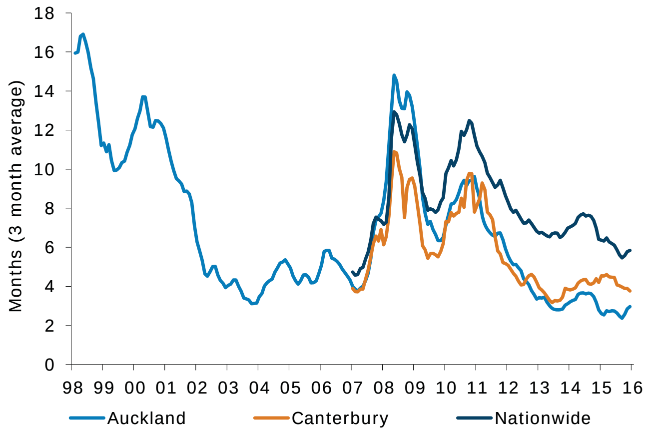
Source: ANZ, REINZ

The length of time it takes to sell a house is an (inverse) indicator of the strength of the real estate market. It encompasses both demand and supply-side considerations.

Nationwide, the median time to sell a house has been edging up since last August (31.3) and reached 33.4 days in December. This remains above post-1990 averages (38.1).

The days to sell have climbed from a 2015 high of 28 in Auckland to 33 by December, Canterbury (32) and Otago, but remain below both nationwide and historical averages. The days to sell are hovering around multi-year lows for Wellington (33), Hawke's Bay (36), Northland (41), Taranaki (30), Southland (34) and Otago (30).

FIGURE 11. HOUSING SUPPLY (SEASONALLY ADJUSTED)



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

Slowing sales activity and broadly constant property listings have resulted in a slight tick-up in nationwide inventories to 5.8 months of sales, although this is well below decade averages (8.2).

Housing supply is lifting from low levels in Auckland and Canterbury. Despite this, it would take just 2.5 months of sales in Auckland and 3.7 months of sales in Canterbury to clear inventories.

Inventory-to-sales ratios have fallen sharply of late in Wellington (2.5), the Waikato/BOP (3.9 months), and Otago (4.3). They remain above historical averages for Northland (9.3), and Manawatu/Whanganui (6.2).

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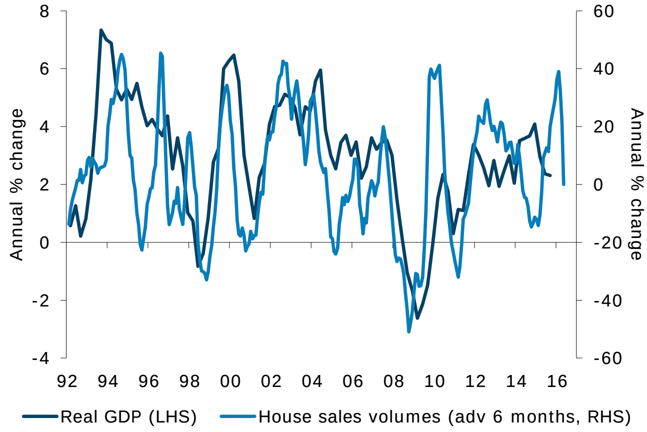
FIGURE 12. HOUSE SALES AND GDP



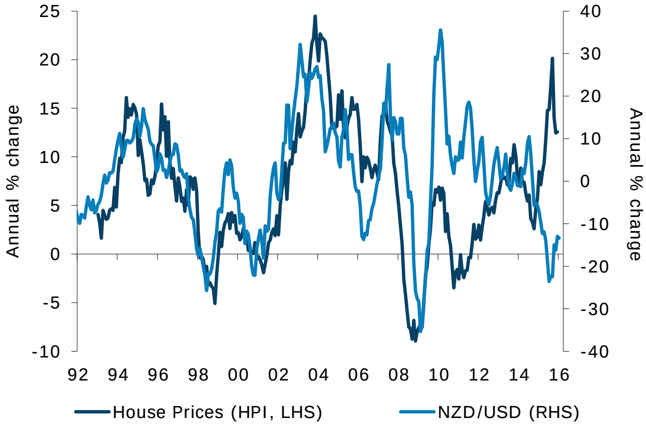
Source: ANZ, REINZ, Statistics NZ

Housing market activity has traditionally been closely correlated with movements in economic activity. Rather than indicating that the housing market is a major driver of economic activity, it is more likely that both are impacted by common determinants, including immigration, interest rates, and cyclical dynamics.

House sales volumes fell 6.6% in Q3, as October changes by the Government to cool demand from local and overseas investors and the November RBNZ tightening of LVR criteria for the purchase of investor properties took effect.

Property market activity is slowing, but is not pointing to a slump in nationwide activity.

FIGURE 13. HOUSE PRICES AND THE NZD

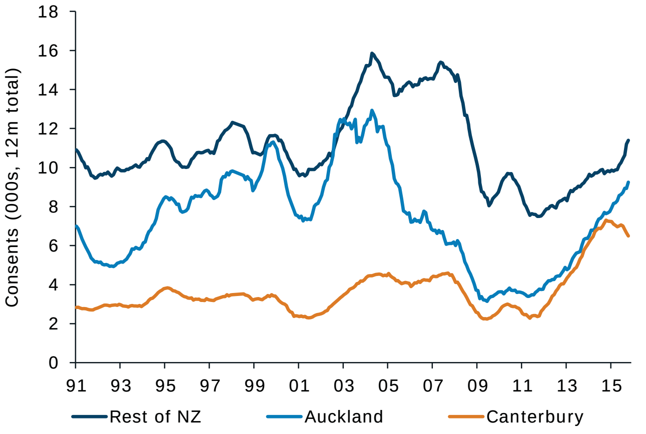


Source: ANZ, REINZ, Bloomberg

There is historically a positive correlation between housing market activity/house price inflation and the NZD. Correlation is not causation, however, with both house prices and the NZD influenced by common elements.

Accordingly, the two can diverge. Low global interest rates have supported global housing markets, but there are also other influences affecting the exchange rate. High domestic interest rates have not been sufficient to prevent NZD/USD falls, but they are likely to have helped keep the NZD TWI elevated.

FIGURE 14. RESIDENTIAL CONSENTS



Source: ANZ, Statistics NZ

Nationwide residential consent issuance is strengthening, with the trend and annual consent numbers issued (27,132) hitting 11-year highs in December.

The nationwide growth has largely been led by Auckland, where issuance is around decade highs (9,300). Positive trends are also evident in the Waikato and regional North Island, with more modest outcomes elsewhere. Canterbury issuance is now broadly flat-lining and looks to be past its rebuild "peak".

In Auckland, trend issuance is currently annualising at close to 11k, which is encouraging, although this does not look sufficient to make inroads into reducing housing "shortages" given demographic demand pressures.

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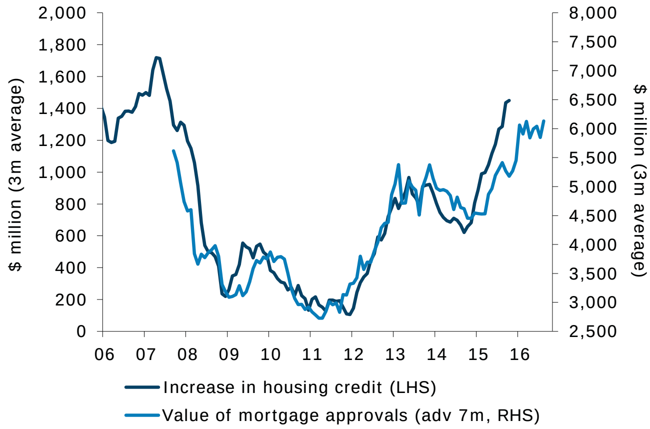
FIGURE 15. MORTGAGE APPROVALS & HOUSING CREDIT



Source: ANZ, RBNZ

Weekly housing loan approval figures are published by the RBNZ. These tend to provide leading information on the state of household credit and housing market activity.

The mid-2015 surge in approvals preceded the strengthening in mortgage borrowing and housing market lift as investors rushed to get into the market prior to the looming Government and RBNZ changes.

Approval values have essentially flat-lined over recent months and signal a plateauing in housing credit growth, albeit at reasonably elevated levels.

FIGURE 16. HOUSE SALES AND HOUSING CREDIT

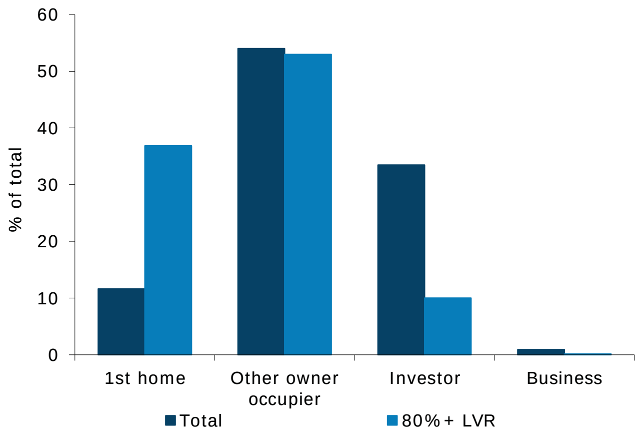
Source: ANZ, REINZ, RBNZ

Despite house sales values being close to record highs, mortgage borrowing levels are below pre-GFC peaks. Households have tidied up their act somewhat, and many have used the period of low mortgage interest rates to retire debt faster by keeping mortgage repayments unchanged.

The LVR lending restrictions that have been in place since October 2013 have also played a role in slowing the pick-up in mortgage borrowing. They were tightened in November for Auckland investors (deposit requirement now 30%) but relaxed in other areas (up to 15% of new lending could be for borrowers with less than a 20% deposit).

Despite this, there are signs that borrowers are starting to revert back to bad habits, with the aggregate household sector currently dis-saving.

FIGURE 17. NUMBER OF NEW RESIDENTIAL MORTGAGE LENDING BY BORROWING TYPE



Source: ANZ, RBNZ

New lending for borrowers with less than a 20% deposit has been below the 10% speed limit since November 2013. The November tweaks described above, in conjunction with Government measures to tighten up the tax treatment for investor properties, have helped slow the Auckland market. Relaxed LVR speed limits outside of Auckland have helped further support prices in the regions.

It is early days, but already the share of loans to first home buyers has climbed to 12% of new housing loans, with the value of lending to investors with less than 30% equity ($688m) considerably lower than in March 2015 peaks ($1,016m).

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 December 2015 (based on REINZ data)

	House prices (ann % change)	3mth % change	No of sales (sa)	Mthly % change	Avg days to sell (sa)	Comment
Northland	19.7	3.0	259	-3%	41	Days to sell at 9-year low.
Auckland	13.5	-1.5	2,536	+14%	33	Sales volumes -22% 3m/3m.
Waikato/BOP/Gisborne	10.7	2.1	1,465	+2%	37	Median price 2.6% below peak, volumes -6.9% 3m/3m.
Hawke's Bay	13.1	2.5	284	+11%	36	Median price at record high, volumes +5.2% 3m/3m.
Taranaki	4.2	2.2	321	+9%	35	Days sell at 6-year low, volumes +2.5% 3m/3m.
Manawatu/Whanganui	1.1	4.7	200	+10%	30	Volumes +2% y/y, days to sell around decade low.
Wellington	5.1	1.5	936	+19%	33	Days to sell at 6-year low, median price at record high.
Nelson/Marlborough	11.5	0.2	254	-5%	32	Record median prices, sales volumes +1.9% 3m/3m.
Canterbury/Westland	5.4	-0.3	931	-1%	32	Prices 3% below April peaks, volumes +0.3% 3m/3m.
Central Otago Lakes	20.9	-1.3	139	-12%	43	Days to sell at 5-month high, volume growth slowing.
Otago	11.8	0.0	305	+12%	30	Volumes +7.3% 3m/3m, days to sell steady, prices flat.
Southland	14.1	2.8	184	-2%	34	Days to sell at 3-year low, prices 8% below peaks.
NEW ZEALAND	3.2	-5.4	7,956	+8%	33	Sales volumes -6.6% 3m/3m, days to sell at 3-month low.

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	2.4(f)	2.2	2.2	2.3	2.5	2.6	2.7	2.8
CPI Inflation (%)	0.4	0.4	0.1	0.4	0.4	0.5	1.0	1.4	1.4	1.7
Unemployment Rate (%)	5.8	5.9	6.0(f)	6.1	6.0	5.9	5.8	5.7	5.6	5.5
	Actual			**Forecast (end month)**						
Interest rates (carded)	**Nov-15**	**Dec-15**	**Latest**	**Mar-16**	**Jun-16**	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**
Official Cash Rate	2.75	2.75	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.75
90-Day Bank Bill Rate	3.0	2.8	2.8	2.7	2.7	2.7	2.7	2.7	2.8	3.0
Floating Mortgage Rate	6.0	6.0	5.7	5.8	5.8	5.8	5.8	5.8	5.8	6.0
1-Yr Fixed Mortgage Rate	5.0	4.8	4.6	4.8	4.9	5.0	5.1	5.3	5.3	5.6
2-Yr Fixed Mortgage Rate	5.3	5.0	4.7	4.9	5.0	5.1	5.1	5.3	5.3	5.5
5-Yr Fixed Mortgage Rate	5.7	5.7	5.6	5.7	5.7	5.8	5.8	5.8	5.9	5.9

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