NEW ZEALAND ECONOMICS
ANZ PROPERTY FOCUS

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THE LOWDOWN

SUMMARY

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

CHIEF ECONOMIST CORNER: THE WORM HAS TURNED

In the absence of a global downturn (a non-trivial risk), the lows in interest rates look behind us. The economy is strong, inflation signals are pointing more conclusively higher, global deflation risks have eased, the US Federal Reserve is set to hike rates, and attention is turning away from monetary policy keeping rates low towards expansionary fiscal policy adding to debt and yields. This does not mean a trend higher in interest rates is set to follow; there are too many vulnerabilities around the globe for that. Locally, a sizeable funding gap means credit growth needs to slow and deposit growth rise; that's incongruous with borrowing (and deposit) rates falling.

PROPERTY GAUGES

Stretched valuation and affordability metrics and tighter credit availability (particularly for investors) are going head-to-head with a market that remains short of stock, with fundamental demand being fuelled by exceptionally strong net migration and low interest rates. Thus, while the tightening of LVR restrictions are clearly impacting house sales, the question is how long-lived the impact will prove to be, and whether it will persist long enough to dent house price expectations. The Reserve Bank is rightly wary of declaring victory prematurely.

ECONOMIC OVERVIEW

Strong economic momentum is being maintained into year-end. We are projecting growth to ease from a 3½-4% pace to 3%; that's a deceleration, not a downturn. Firms are finding it more difficult to find skilled labour and credit excesses (leverage build-up) need to be tamed if a boom/bust cycle is to be averted. A by-product of slower credit growth will be more moderate housing activity. New Zealand looks on track to continue performing well amidst a wobbly global scene and international political fracas. The RBNZ is on hold and the NZD looks set to remain elevated. Earthquake challenges look manageable though will put additional pressure on resources.

MORTGAGE BORROWING STRATEGY

Although the OCR has been cut by 25bps, this merely offset a rise in funding costs, and as a result, no banks have cut their floating mortgage rates. Rises seen for some longer-term fixed rates reflect both higher funding costs and the sharp rise in wholesale interest rates that has occurred since August. We believe mortgage rates have seen their lows, and although there is real pressure for them to rise further, we caution that rises are likely to be gradual. Nonetheless, given how flat the mortgage curve is, for the first time in a long time we believe it is worthwhile considering fixing some portion of your mortgage for longer than 1-2 years.

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BUNGY CORD ATTACHED

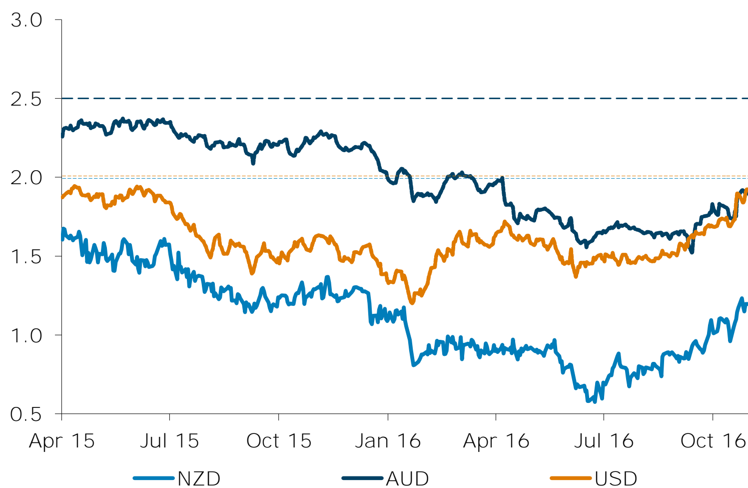
We noted in the May edition that mortgage rates had troughed and a lower OCR would not necessarily take borrowing rates lower. Now it looks like the interest rate worm has in fact turned up. Why?

Deflation risks have eased globally and this has lifted global interest rates off lows

We have seen promising – albeit tentative – signs of an uplift in inflation around the globe. Rebounding oil prices have been at the epicentre of this lift, which has helped drag global yields higher. New Zealand has followed, as local longer-term (borrowing) interest rates are heavily influenced by offshore equivalents.

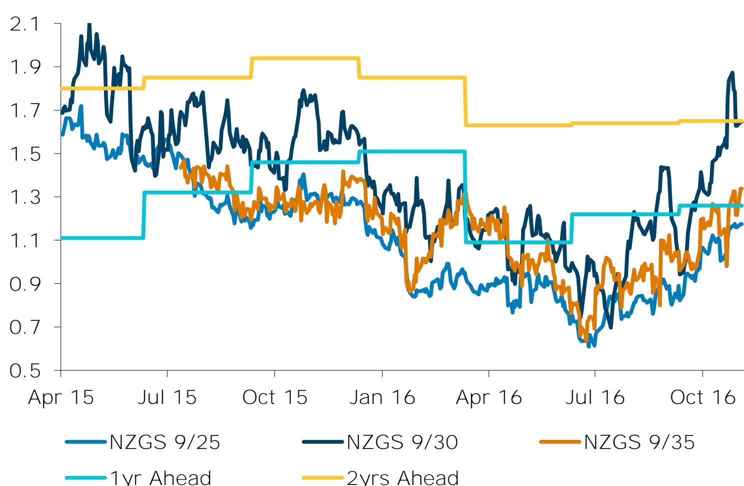
While **we are not yet seeing broad-based signs of inflation**, measures of capacity use around the world are generally rising slowly (or have stopped declining) **and it has been the dampening in deflation risks** that has helped lift global yields off their lows.

FIGURE 1: 10 YEAR INFLATION-LINKED BOND BREAKEVENS VERSUS INFLATION TARGETS



Source: ANZ, Statistics NZ, ABS, BLS, Bloomberg

FIGURE 2: NZ INFLATION-LINKED BOND BREAKEVENS VERSUS INFLATION EXPECTATIONS



Source: ANZ, Bloomberg

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Investor frustration with negative yields in Europe and Japan

Why invest in an asset with a negative yield? It was only three months ago (the end of July) that the yield on a German 10-year government bond (the "Bund") was -0.2% and the yield on the 10-year Japanese government bond (JGB) was -0.3%. **Negative yields in these countries dragged yields down around the globe.**

Yields have subsequently popped higher (while remaining extremely low!). The yield on a German 10-year Bund is now around +0.2%, and a 10-year JGB yields around 0.0%. **According to our calculations, at the end of October, 36% of benchmark G10 bonds still had a negative yield. That's down from a peak of 42%, but even so, the whole notion of negative yields – paying someone to take your money – is economic lunacy.**

FIGURE 3: PROPORTION OF G10 BENCHMARK BONDS WITH NEGATIVE YIELDS

Source: ANZ, Bloomberg

Negative yields are like defying gravity. You can do it for a while, when there's something keeping you aloft (wings and jet engines perhaps), **but it can't be sustained forever** – at least not on this planet. Negative yields only make sense if you can eke out a capital gain to compensate. Enter the central banks. **In the world of bonds, the wings and engines are the central banks – i.e. buyers prepared to buy bonds at even more deeply negative yields than those at which investors initially bought them.** This creates capital gains for bond investors, more than offsetting the negative accrual during the holding period, setting off a virtuous cycle. **But as soon as investors get any hint that central bank buying may be coming to an end (akin to the jet running low on fuel), then the gravitational pull (up for bond yields and down for the bond price plane) takes over** and steers rates towards something more sustainable. We are now at (or technically slightly past) that point. What a sustainable or appropriate level for yields may be is going to be strongly debated over coming months and years, but it certainly isn't negative.

The US Federal Reserve is set to hike rates

The US Fed sets the "tone" across global interest rates. Rhetoric is strongly pointing to a December hike. Beyond that it is flagging gradual moves higher. That will keep term rates low, but not quite as low.

Attention is turning towards more fiscal policy support and less monetary policy stimulus

Monetary policy has done most of the heavy lifting post the global financial crisis, resulting in low – and even lower – yields. This has stabilised the economic patient but not driven a strong upswing around the globe. **Asset prices have soared; inflation and wages have not. The failure to lift inflation is seeing broad questions asked over monetary policy's effectiveness.**

Attention is also now being drawn to the side-effects.

- **When you make something free (eg zero interest rates) you incentivise poor choices.** What would the world look like if alcohol were free? Too much would be consumed. The same principle applies to borrowing and investing. If you make something cheap enough people will consume / invest in too much of it. It's a recipe for misallocation of funds towards unproductive uses, with associated mispricing of assets. The endgame is a piper being paid as reality reasserts itself, as it eventually must.

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- **Financial stability concerns are coming more to the fore** with leverage across governments, businesses and households still high – and having risen rapidly across emerging market economies. Housing affordability is a key issue around the globe.
- **Stimulatory monetary policy pulls growth from the future into today.** The more you pull that lever, the less growth you have for tomorrow.
- **Monetary policy is doing nothing to lift productivity growth around the globe.**
- **Loose monetary policy is driving asset price inflation but the broader environment is not conducive to lifts in wage inflation;** that's a recipe for rising income inequality and angst across society. This is precisely what we are seeing around the globe with populism coming to the fore.

Central banks are still offering huge support to the global economy via low interest rates and buying bonds. That's ongoing. **However, the key shift has been towards more questions regarding a) whether more support should be pending – the consensus is shifting to no; and b) the endgame, with no one having a clue but many fearing it could be messy.** Less (perceived) central bank demand has meant less support for bonds.

There are stronger calls for fiscal policy to stimulate and support the global economy via good old-fashioned government pump-priming. The new President-elect for the US has openly articulated the need for a massive infrastructure spend-up. That's appealing on some levels but getting fiscal policy stimulus up and running faces non-trivial challenges:

- Government debt levels across the OECD are already high (the average is around 80% of GDP).
- The Japanese experience is that Ricardian equivalence takes hold (a dollar of public spending is offset by private sector saving as people start to fear the end-game – i.e. a dollar borrowed needs to be repaid via more tax (or less future spending)!).
- There is too much self-interest globally for co-ordinated policy action, which would make it more successful.
- Programs need to be well targeted to work (otherwise they can hinder productivity and squander cash), and you need better microeconomic policy in association. Populist push-back is a handbrake on this taking place.
- It takes time to get fiscal policy injections up and running. This is particularly so for infrastructure spend-ups which typically need an extensive planning lead.

Nonetheless, the mere spectre of a transition from monetary/liquidity support to fiscal support has markets thinking about bond supply. More supply implies a lower price (i.e. higher yields). This swing from excess bond demand (low yields) to excess supply (higher yields) is exacerbated by investors' fear that yields may continue to rise. When the supply/demand balance gets upset, price swings can be self-perpetuating and brutal.

The yield on a US 10-year Treasury has risen around 100 basis points from a low of 1.35% in July to 2.36% at the time of writing. That's a major shift and has acted to drag up other rates around the globe.

Some questions are being asked of central banks – and some central banks are asking the questions themselves

Most central banks' core mandate is inflation, and inflation-targeting regimes have generally performed well over time. Low inflation = low rates. But central banks have other objectives too, and there are trade-offs to be made.

Flexibility is required; inflexible regimes break when put under stress as structural challenges come along. You need to be able to move with the times. The former Governor of the RBA, Glenn Stevens summed the situation up nicely. *"But in the end, we are living in a world in which the ability of monetary policy alone to boost growth sustainably is very likely to be a good deal more limited than we might wish. I think most people can sense this. So we need realism about how much we can expect monetary policy to do, including pushing inflation up quickly.* ***If it were the case that undershooting the target for a period while achieving reasonable growth was the 'least bad' option available, the inflation targeting framework has the requisite degree of flexibility to allow such a course."***

That's a hat-tip to not being an inflation nutter in a rigid pursuit of driving inflation back to target.

ANZ

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It's the economy stupid

We have an economy growing at 3½-4%, a falling unemployment rate, surging house prices, strong credit growth and dissipating economic risks (i.e. dairy prices have rebounded). That's a combination **that typically flags higher rates, not lower ones!**

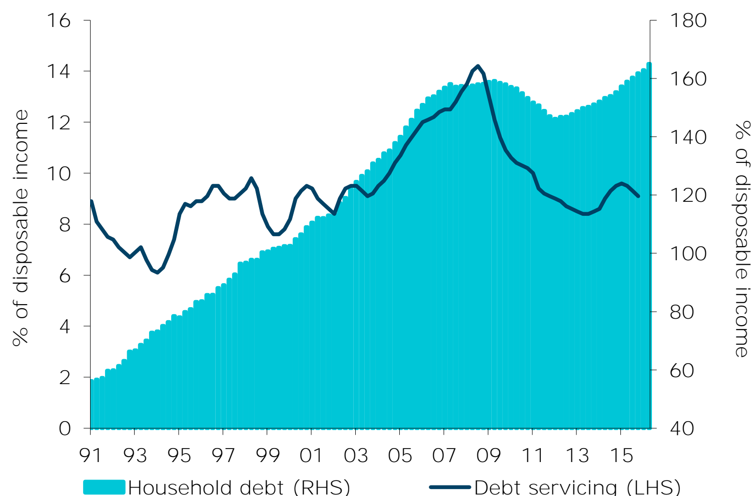
To be fair, inflation has been MIA and the RBNZ has an inflation target rather than a growth one. However, it has been the surprising strength across the broader economy that has swung attention more towards questioning the need, or desirability, of a lower OCR.

Financial stability risks have increased

In many ways, the New Zealand economy is in a better structural position than it was in the lead-up to2007/08, which is the last time economic growth was as strong and the housing market booming. The current account deficit is contained at around 3% of GDP; the nation's net external debt is a fraction of what it was then; the Government is running surpluses; and banks have more robust funding positions.

All that said, there are signs of familiar bad habits sneaking back into play. As the chart below shows, household debt as a percentage of disposable income is now higher than it was before the global financial crisis, and rising strongly. Household debt has gone from less than 150% in 2011 to 165% of disposable income now. Credit growth is outstripping income growth. A large share of new lending is at high debt-to-income ratios (though recent LVR restrictions should help to curb that).

FIGURE 4. HOUSEHOLD DEBT AND SERVICEABILITY



Source: ANZ, RBNZ

Another key financial stability risk is housing affordability; it is absurd, particularly in Auckland. Auckland house prices trade at a multiple of 9½ times incomes and first home buyers buying the median-priced house on typical terms now have to commit *half* their after-tax income to meeting minimum mortgage payments. That is not much room to move in the case of unexpected developments, whether that's ill health, job loss, pregnancy, divorce or any of the other curve balls life can throw, let alone highlighting the sensitivity to the possibility of higher future interest rates.

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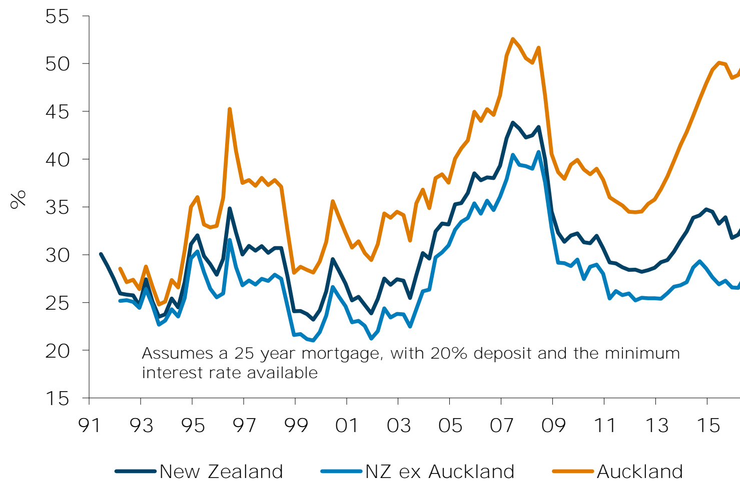
FIGURE 5. MORTGAGE PAYMENT TO INCOME RATIOS FOR NEW MEDIAN PURCHASERS



Source: ANZ, RBNZ

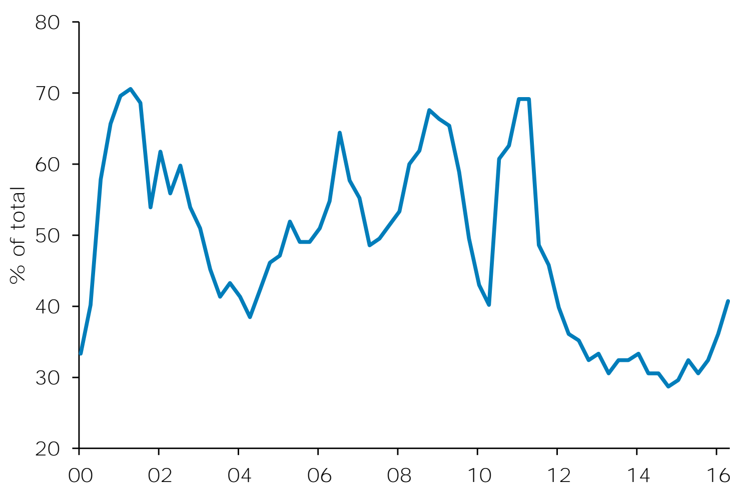
The Reserve Bank is of course well aware of these risks, and has responded with pretty strict restrictions on high-LVR and investor lending, which do seem to be now impacting on housing market activity and sentiment, which should flow through into prices in time. **But it's somewhat ironic to tighten the availability of credit via LVR-related restrictions and mooted debt-to-income limits, and then cut the OCR.** Talk about mixed messages. That's like going to AA but getting a shot of vodka on entry!

Local signals are pointing to an uplift in inflation

Headline inflation is still low. However, a lot of traditional drivers including growth, credit growth and tightness in the labour market are pointing to higher inflation, over time. A closer look at the distribution data within the CPI suggests things are starting to move. The proportion of the CPI basket with annual inflation above 2% rose to a four year high in the September quarter.

The RBNZ's recent forecasts actually have some upside scenarios for interest rates courtesy of inflation pressures returning sooner than expected. Whilst it's not the central scenario, such an outcome is far from inconceivable.

FIGURE 6. PROPORTION OF NZ CPI BASKET WITH ANNUAL INFLATION ABOVE 2%



Source: ANZ, Statistics NZ

Banks need more deposits

Money needs to come in the door before financial intermediaries can push it out the door again.

A feature of the landscape post the GFC has generally been the similar rates of growth in deposits and lending. This meant financial institutions didn't need to go looking offshore for funding, and in fact meant New

CHIEF ECONOMIST CORNER: THE WORM HAS TURNED

Zealand's reliance on offshore funding eased. That has reduced New Zealand's exposure to adverse movements in offshore credit markets.

However, credit growth is now outstripping deposit growth such as it did prior to the GFC. Credit growth is quite strong (off high levels) while deposit growth has slowed markedly. Each nudge lower in deposit interest rates makes placing money with a bank less attractive, while every nudge lower in borrowing rates makes borrowing more attractive – particularly when you overlay it with the surge in the property market we have been seeing. The "gap" is being plugged offshore. This is, in turn, putting upward pressure on offshore funding spreads and basis swap spreads, which feed into the overall cost of credit.

It's untenable to think New Zealand can continue to fill its boots with offshore funding.

- Regulatory changes here have capped the ability of banks to repeat a pre-GFC offshore borrowing binge even if they wanted to – which they don't, having learned from experience.
- Regulatory changes in the US have made traditional offshore funding sources scarcer and more expensive.
- New Zealand has received kudos from rating agencies and investors for lessening its reliance on offshore funding. That kudos could easily disappear, which would raise the price of borrowing.
- It's not in New Zealand's long-term interests to borrow and spend its way to growth for too long. That's a recipe for a repeat of the boom / bust cycles we've seen in the past.

So the landscape has banks competing more aggressively for deposits. And a key mechanism has to logically be via the price. We are starting to see term deposit rates lift already.

FALSE DAWN?

Of course, for each and every action there is an opposing one, and it certainly isn't cut and dried that yields will march incessantly higher from here.

There are some good reasons why inflation is low around the globe; the world needs to pay down debt and that's deflationary. Wage-bargaining power is being diluted by low productivity growth and the fact that low and cheap labour is abundant (partly through migration). Structural changes (think technology) are changing the profile for inflation and capital needs. The world is still stagnating, meaning insufficient demand to soak up supply. Oil prices may have lifted, but how sustainable is that in a world where electric cars are a reality?

There is no shortage of debt. Globally it's $152 trillion and 225% of global GDP. Even small movements in interest rates will hurt. The same applies in New Zealand.

Economic vulnerabilities are rife. China has massive corporate debt. Europe is dealing with structural problems. There are the obvious geopolitical hotspots. Low interest rates have brought about unproductive and mispriced capital. Low rates have protected weak zombie firms. And then we have political shenanigans. That's a lot of challenges to manage at a time policymakers' fiscal and monetary policy arsenals are looking severely depleted.

Technically, the world economy is about "due" for a correction. We tend to have downturns every 10 years – 1987 share market crash, 1997 Asian crisis, GFC (2008)…. 2017/18 is around the corner.

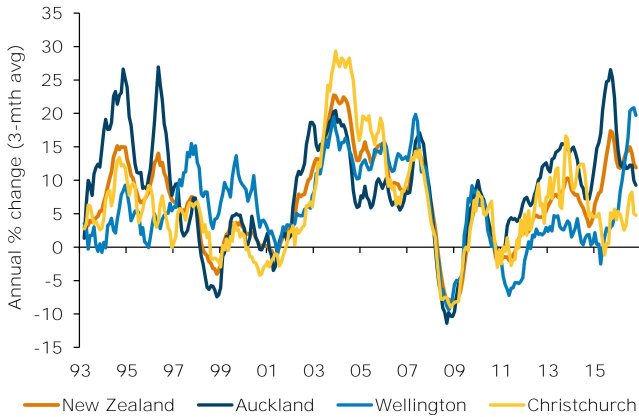
The path to lower rates for the past few years has, ironically enough, been higher rates! Higher rates typically set off a chain of events including re-pricing of risk / capital that drives declining risk appetites, weaker equities and a flight to quality. The push to lower yields and more magic monetary policy medicine eventually drives risk on… higher yields… and the spiral is in motion. This can lead to the counterintuitive situation where good news (economic data) drives bad outcomes (prospect of higher yields and a turn in risk appetites). Bad news (weak data) drives lower yields and higher valuations. But the latter part of the spiral can break if markets lose faith in monetary policy. And you'd have to say central banks are pushing their luck at present, with years of ultra-stimulatory policy having had decidedly questionable tangible benefits.

THE UPSHOT

Just because rates have bounced off lows, it is not clear that the path from here is an incontrovertible trend higher. **Interest rates are going to remain low by historical standards for a long time. However, in the absence of a global economic meltdown – which is a pretty sizeable risk, to be fair – the lows for New Zealand borrowing and deposit rates do look like they are in. And that's not a bad thing.**

THE PROPERTY MARKET IN PICTURES

FIGURE 1. REGIONAL HOUSE PRICES

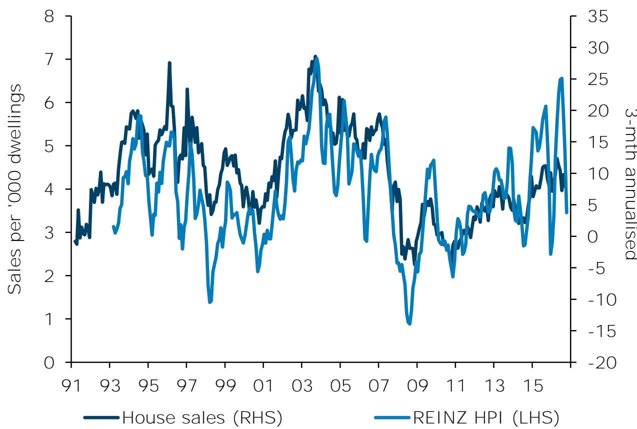


Source: ANZ, REINZ

Nationwide house prices barely moved in October, with momentum softening. Our preferred measure of prices (the REINZ stratified measure) showed nationwide prices rising 0.1% sa in October, but down on a quarterly basis (-0.8% q/q). In annualised terms (3-month average), price growth has cooled to just 4%, well down from the 25% growth rate seen in June/July.

Across the regions, Auckland annualised (3-month average) price growth is the weakest at 3.6%, while South Island prices, excluding Christchurch, are running at 17% annualised pace. Wellington has cooled dramatically by this measure, dropping from 24% in September to 7.5% in October after two price falls in the past three months.

FIGURE 2. REINZ HOUSE PRICES AND SALES



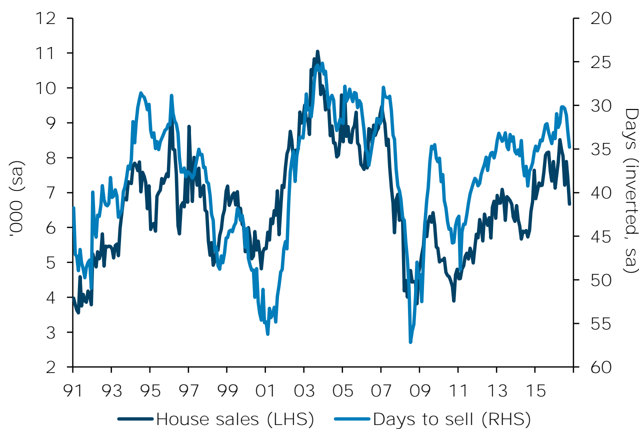
Source: ANZ, REINZ

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

Seasonally adjusted sales volumes fell 9.1% m/m in October, the fifth fall in the past six months. Volumes were 14% lower than October last year. This weaker trend is relatively broad-based across the country, although particularly pronounced in Waikato, where volumes are down 25% y/y. Excluding Auckland, nationwide sales volumes are 13% lower than a year ago.

The markedly weaker trend in sales activity hints at a continuation of the recent moderation in house price growth going forward. That said, with some of it likely due to a lack of available property listings, there are still some price-supportive elements to it.

FIGURE 3. SALES AND MEDIAN DAYS TO SELL



Source: ANZ, REINZ

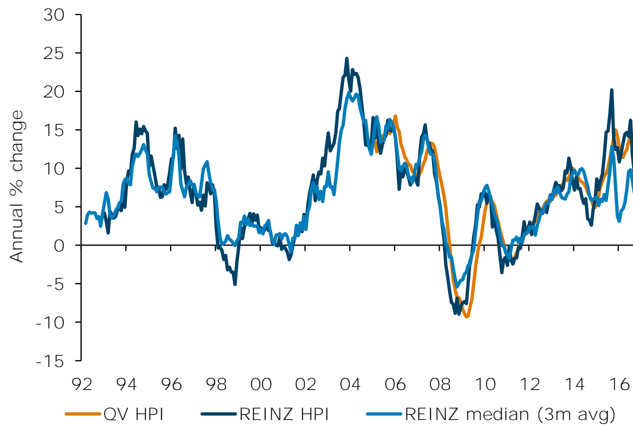
The length of time it takes to sell a house is also an indicator of the strength of the real estate market. It encompasses both demand and supply-side considerations.

Nationally, the median time to sell a house rose by 1.8 days in October to 34.8 days (sa). While this is still below the historical average of 38 days, it is the slowest since February 2015 and does suggest that while weaker sales activity is in part due to a lack of supply, softer demand is also contributing.

Over the past 12 months, the median time to sell a house has risen most dramatically in Taranaki (+12.7 days). Average days to sell are still quite a lot lower than they were a year ago in Northland, Manawatu, Hawke's Bay and Nelson/Marlborough.

THE PROPERTY MARKET IN PICTURES

FIGURE 4. REINZ AND QV HOUSE PRICES

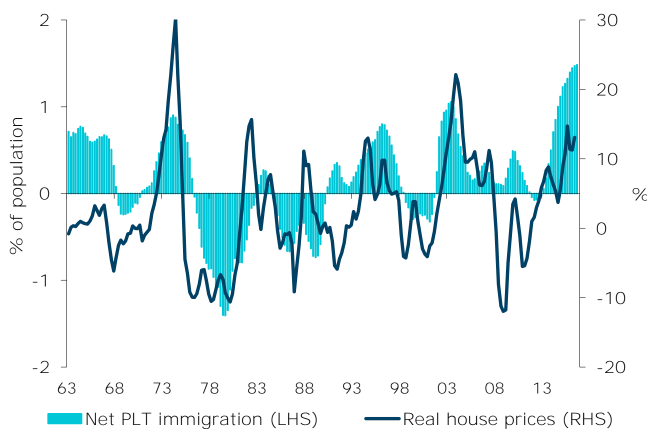


Source: ANZ, REINZ, QVNZ CoreLogic

There are three key measures of house prices in New Zealand: the median and stratified house price measures produced by REINZ, and the monthly QVNZ house price index published by Property IQ. 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, with the REINZ median typically more volatile as it is sensitive to the composition of sales taking place.

The REINZ median sale price (which in September reached a new record high of $519k in seasonally adjusted terms) **was up 11.0% y/y in October.** This remains below both the REINZ stratified and the QVNZ measure of price growth (14.4% and 12.7% y/y respectively), which both adjust for differences in the quality of houses sold.

FIGURE 5. NET PLT IMMIGRATION AND HOUSE PRICES



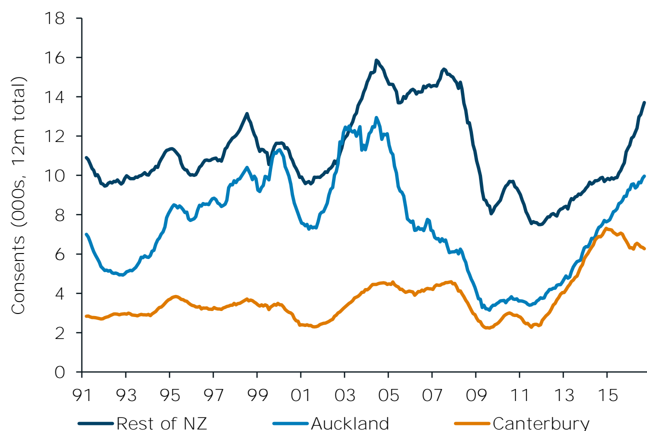
Source: ANZ, Statistics NZ, QVNZ

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.

On a three-month annualised basis, net permanent and long-term migration rose to a strong 72.7k in October, which is around 1½% of the resident population and at all-time highs. More arrivals and fewer departures have both contributed to this large net inflow.

We are not expecting annual net inflows to ease back to the long-run average of around 15k any time soon. Due to its economic outperformance, perceived safety and political ructions elsewhere, New Zealand will remain an attractive destination for migrants.

FIGURE 6. RESIDENTIAL CONSENTS



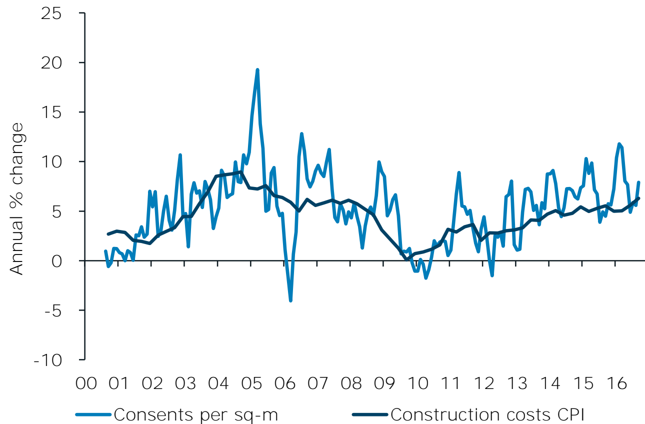
Source: ANZ, Statistics NZ

Nationwide residential consent issuance has been strengthening. While on a three-month annualised basis, seasonally adjusted total issuance eased to 31.5k in September, down from 32.7k the previous month, to put it in context, the previous reading was the strongest since mid-2004.

A large part of the increase has been due to the Auckland region (annual issuance of 10K, which is the highest since mid-2005), although growing capacity and credit pressures may slow the ascent from here. Canterbury issuance continues to ease off its highs, consistent with other evidence suggesting that the residential component of the earthquake is past its peak. Issuance in Wellington and other regional North Island areas has accelerated strongly, though the pace of growth now appears to be flattening off.

THE PROPERTY MARKET IN PICTURES

FIGURE 7. CONSTRUCTION COST INFLATION

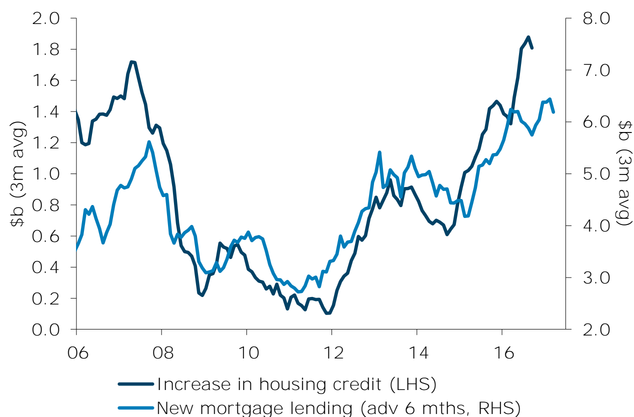


Source: ANZ, Statistics NZ

On a three-month average basis, **the value of residential consents per square metre was up 7.9% y/y in September, which is an increase on the previous month but below the strong rates of growth experienced earlier in the year.** However, because it is a volatile measure, we are not reading much into it. The broad upward trend is consistent with the trend seen in the construction cost component of the CPI, which sat at 6.3% y/y in Q3 (7.9% y/y for Auckland).

Our internal anecdotes continue to highlight that capacity pressures in the construction sector are reasonably intense, and not limited to any one region. Forward books are generally full, and in some cases work is reportedly being turned away. Difficulty finding staff is a common theme in the sector.

FIGURE 8. NEW MORTGAGE LENDING & HOUSING CREDIT



Source: ANZ, RBNZ

New residential mortgage lending figures are published by the RBNZ. They tend to provide leading information on the state of household credit growth 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 regulatory changes.

Approvals values, while at a strong level, have eased modestly off their highs of late and signal that a peak in housing credit growth may be close at hand.

FIGURE 9. HOUSE TURNOVER AND MORTGAGE GROWTH

Source: ANZ, REINZ, RBNZ

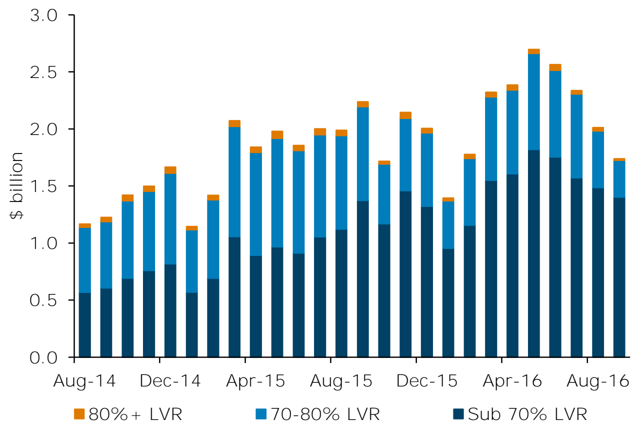
The overall stock of mortgages has been growing strongly, with a 3-month annualised pace of over 10% in September. However, this has not been keeping pace with the lift in house sales values, which have effectively been at all-time highs.

The tightening of the high-LVR lending restrictions as of 1 October appears to be having a marked impact on both house sales and credit availability, and we accordingly expect to see mortgage borrowing growth moderate further.

But a key element explaining why mortgage borrowing growth has been more contained than the past is that existing mortgage holders are using current low interest rates to maintain regular payments and reduce principal.

THE PROPERTY MARKET IN PICTURES

FIGURE 10. INVESTOR LENDING BY LVR

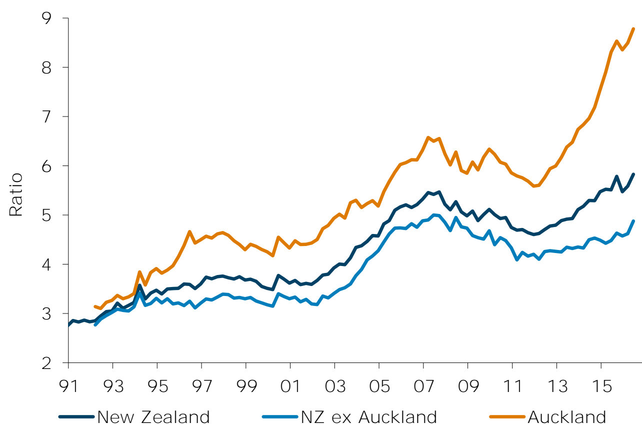


Source: ANZ, RBNZ

There are now clear signs that the growth in new investor lending is cooling. This is no doubt related to the latest round of RBNZ LVR restrictions (which banks largely implemented ahead of the official 1 October start date). In September, new investor lending was down 22.3% y/y, making up 29.8% of total new lending – the lowest share since October 2015.

As a share of total investor lending, lending done with LVRs in excess of 70% made up 19% of the total in September. This is down from 33% two months earlier and over 50% in mid-2015. Of new investor lending, 54.5% was on interest-only terms, a tick upwards from 52.3% in August. The volume of interest-only investor lending continues to fall, just not as rapidly as total investor lending.

FIGURE 11. REGIONAL HOUSE PRICES TO INCOME

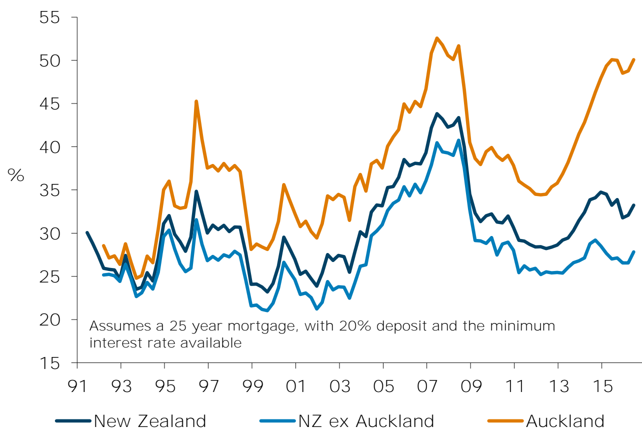


Source: ANZ, REINZ, Statistics NZ

One standard measure of housing affordability is the ratio of average house prices to income. It is a common measure used internationally to compare housing affordability across countries. That said, 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 sits just below a ratio of 6, which is slightly above the previous highs recorded prior to the GFC. However, there is a stark regional divide. We estimate the average house price to income in Auckland has now risen to close to 9 times, suggesting a severely unaffordable market. Elsewhere, the ratio is around 5 times, which is back where it peaked prior to the financial crisis.

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 takes into account the likes of interest rates, which are an important driver of housing market cycles.

We estimate that the average mortgage payment to income nationally is around 33% at the moment. Despite rising house prices it has fallen below its highs due to recent mortgage rate falls.

However, once again there are stark regional differences, with the average mortgage payment to income in Auckland around 50%. That is near the highs reached in 2007 despite mortgage rates being at historic lows currently. It highlights how sensitive some Auckland borrowers would be to even a small lift in interest rates.

PROPERTY GAUGES

Stretched valuation and affordability metrics and tighter credit availability (particularly for investors) are going head-to-head with a market that remains short of stock, with fundamental demand being fuelled by exceptionally strong net migration and low interest rates. Thus, while the tightening of LVR restrictions are clearly impacting house sales, the question is how long-lived the impact will prove to be, and whether it will persist long enough to dent house price expectations. The Reserve Bank is rightly wary of declaring victory prematurely.

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 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 across the regions.

Indicator	Level	Direction for prices	Comment
Affordability	Still extended	↔/↓	House prices out of whack with incomes.
Serviceability/ indebtedness	Mixed bag	↔/↓	High debt and low rates is okay. High debt and rising rates wouldn't be – and rates have started to move.
Interest rates / RBNZ	Troughed	↓	With the RBNZ finished with cutting and global yields rising, rates have likely troughed, short of a global accident.
Migration	No let-up	↔/↑	In a politically uncertain world migration will not subside quickly. Government is tightening up though.
Supply-demand balance	Too few houses	↔/↑	Rising consents still not keeping pace with underlying demand, and now the trend is under threat from tighter credit availability.
Consents and house sales	More builders please	↔/↑	Consents are rising but just not fast enough.
Liquidity	Rationing	↓	LVR restrictions being applied, debt-to-income limits may be next, and banks are tightening credit at the top of the cycle.
Globalisation	Auckland vs Sydney	↔	Auckland is out of control but not in a global context.
Housing supply	Catch-up	↔/↑	Chasing a fast-moving target fuelled in part by strong migration.
House prices to rents	Extreme	↔/↓	The yield doesn't stack up; pray for continued capital gain.
On balance	**A slow rate of appreciation**	↔	**A rubber band that is taut valuation-wise but a market still in short supply.**

ANZ

PROPERTY GAUGES

FIGURE 1: HOUSING AFFORDABILITY

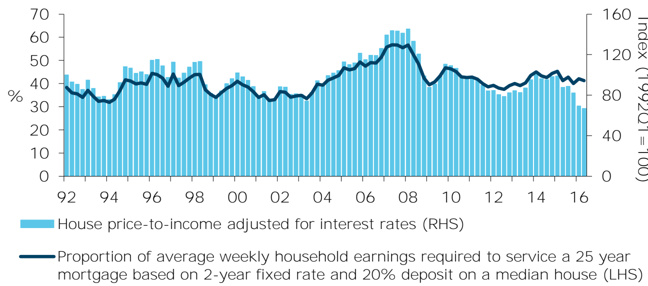


FIGURE 2: SERVICEABILITY AND INDEBTEDNESS

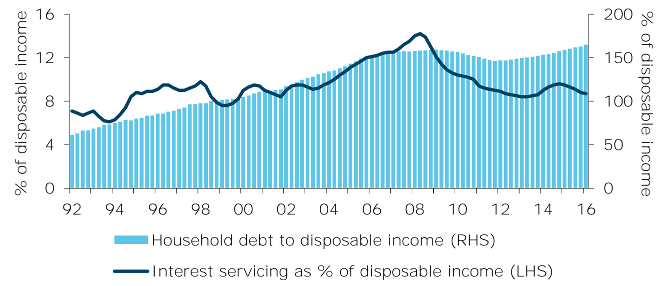


FIGURE 3: NEW CUSTOMER AVERAGE RESIDENTIAL MORTGAGE RATE (<80% LVR)

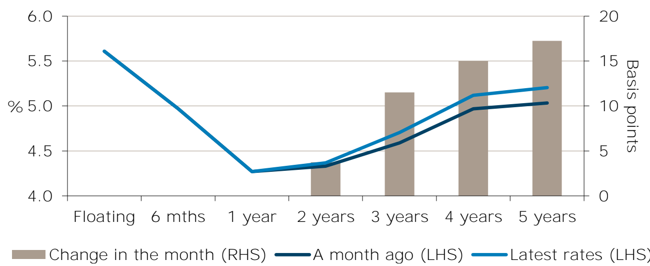


FIGURE 4: NET MIGRATION

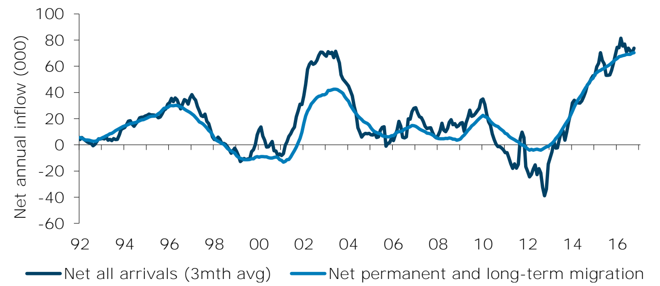


FIGURE 5: HOUSING SUPPLY-DEMAND BALANCE

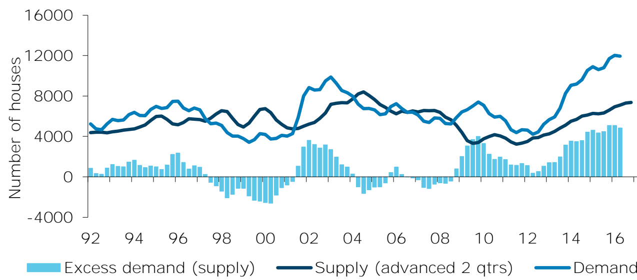


FIGURE 6: BUILDING CONSENTS AND HOUSE SALES

FIGURE 7: LIQUIDITY AND HOUSE PRICES

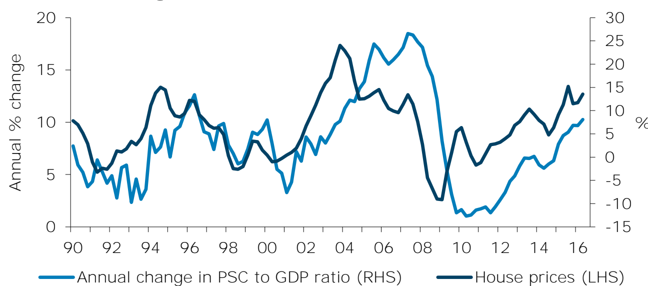


FIGURE 8: HOUSE PRICE INFLATION COMPARISON

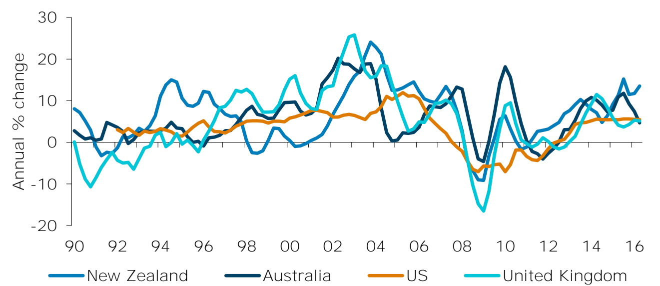


FIGURE 9: HOUSING SUPPLY

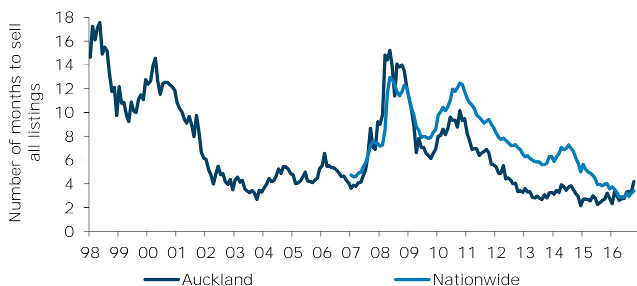


FIGURE 10: MEDIAN RENTAL, ANNUAL GROWTH

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

ECONOMIC OVERVIEW

SUMMARY

Strong economic momentum is being maintained into year-end. We are projecting growth to ease from a 3½-4% pace to 3%; that's a deceleration, not a downturn. Firms are finding it more difficult to find skilled labour and credit excesses (leverage build-up) need to be tamed if a boom/bust cycle is to be averted. A by-product of slower credit growth will be more moderate housing activity. New Zealand looks on track to continue performing well amidst a wobbly global scene and international political fracas. The RBNZ is on hold and the NZD looks set to remain elevated. Earthquake challenges look manageable though will put additional pressure on resources.

OUR VIEW

The economy continues to perform well. Strong momentum is being maintained into year-end. The nucleus of this robust economic story centres on the obvious (migration, housing, construction, tourism) but across-the-board strength across an array of sectors is also apparent. While the latest central New Zealand earthquakes certainly present challenges, we believe the economic growth implications will be modest.

We are projecting a moderation in GDP growth over 2017 with growth set to ease from a 3½-4% pace to 3%. Key signals from our suite of timely proprietary leading indicators remain positive. Our confidence composite gauge is pointing to good momentum being maintained. Job ads have now risen for 10 consecutive months. The unemployment rate is falling and income growth is running in excess of 5%. Financial conditions have tightened somewhat of late (the likes of tighter credit criteria are having an impact) and needs watching but for now continue to flag respectable momentum.

Two moderating influences over the coming year will be:

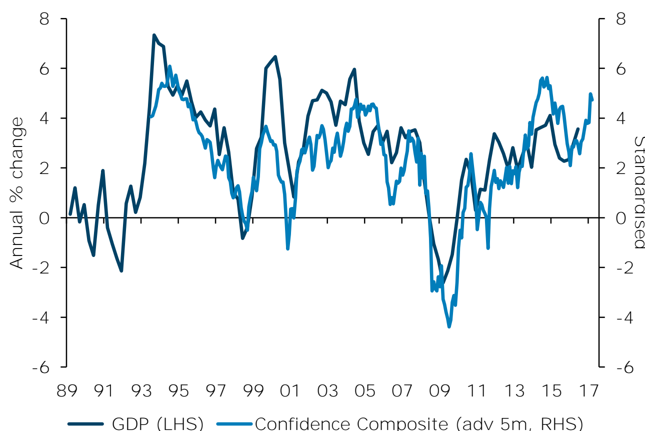
- **Capacity bottlenecks.** Firms are finding it more difficult to find skilled staff. This is particularly acute in sectors such as construction. Using the migration lever to fill the gaps faces political sensitivities.
- **The need for credit growth to slow and the credit rationing that is taking place.** This is required to ensure imbalances across the economy (offshore funding dependence, rising leverage, and a potential blowout in the current account deficit) do not foster an economic correction down the track. Housing excesses need to be monitored; another year of strong credit growth would be troubling. A side effect of slower credit growth will be less economic growth (and housing supply) but this will help reduced unnecessarily large swings in the business cycle. It's about ironing out peaks and troughs and a steadier (and less volatile) pace of growth.

Prospects for the dairy sector have improved. We expect this season's payout to be in the $5.25-5.50/kg/MS range, though current prices suggest upside. This removes a major source of downside risk and challenge.

We continue to be perplexed over the global scene. Emerging-market Asia has high leverage. Europe faces structural challenges. Market distortions are aplenty. Low interest rates are creating imbalances. The social contract between mainstream politics and the electorate is broken; it's hard to put a positive spin on the US election result. It seems unlikely to drive good policy decisions.

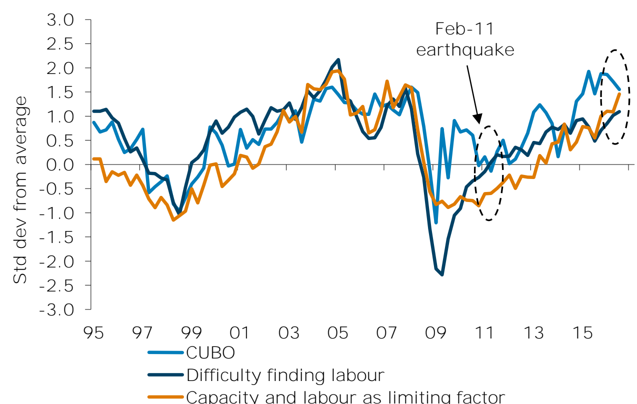
The RBNZ is expected to keep the OCR unchanged at 1.75% and the NZD looks set to remain elevated.

FIGURE 1. CONFIDENCE COMPOSITE VERSUS GDP



Source: ANZ, Roy Morgan, Statistics NZ

FIGURE 2. INDICATORS OF RESOURCE AND CAPACITY PRESSURES



Source: ANZ, NZIER

MORTGAGE BORROWING STRATEGY

SUMMARY

Although the OCR has been cut by 25bps, this merely offset a rise in funding costs, and as a result, no banks have cut their floating mortgage rates. Rises seen for some longer-term fixed rates reflect both higher funding costs and the sharp rise in wholesale interest rates that has occurred since August. We believe mortgage rates have seen their lows, and although there is real pressure for them to rise further, we caution that rises are likely to be gradual. Nonetheless, given how flat the mortgage curve is, for the first time in a long time we believe it is worthwhile considering fixing some portion of your mortgage for longer than 1-2 years.

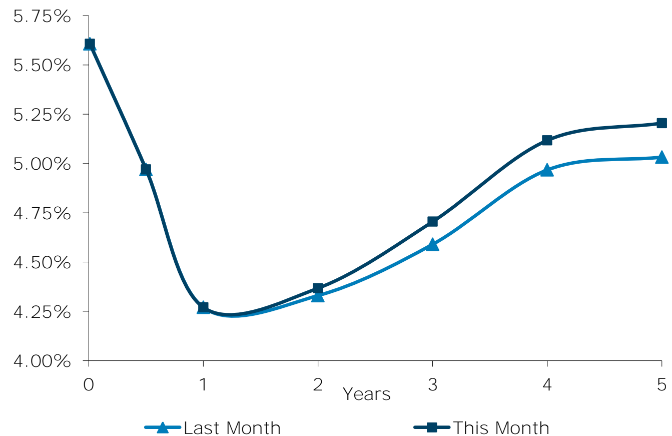
OUR VIEW

Mortgage interest rates have started moving gently higher, and we believe the lows are now in. Having fallen to half-century lows as the OCR and global bond yields collapsed, mortgage rates are now likely to be subjected to rising global interest rates as markets focus on stronger US growth and the transition away from easy monetary policy towards expansionary fiscal policy, and as a scramble for deposits pushes rates up. We discuss the wider global interest rate environment in our feature article on page 2, so we won't repeat ourselves here – but suffice to say, things have changed.

There are a number of offsetting factors that suggest we are likely to see rates move up gradually, rather than sharply (day-to-day volatility aside). Practically speaking, that means taking a different approach – not panicking. We are talking about rates rising gradually, not rates skyrocketing higher. For borrowers, this means thinking about moving away from what has been a tried and true approach over the past few years: choosing the cheapest short-term rate and rolling repeatedly. That strategy isn't likely to be as advantageous going forward.

The first question we would ask is; how cost sensitive are you? If you are, it's worth asking yourself if fixing for 4-5 years makes sense. These rates are still close to their all-time lows, are typically no more than 1%pts above the cheapest rates, and are lower than floating rates. That's not a big step-up for a large increase in certainty. This is borne out in our **breakeven analysis, which shows that 1-4 year rates wouldn't need to rise by much over the year or so before you'd start regretting not having selected a longer term.**

CARDED SPECIAL MORTGAGE RATES^



Special Mortgage Rates		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.61%				
6 months	4.97%	3.57%	4.42%	4.51%	5.21%
1 year	4.27%	3.99%	4.47%	4.86%	5.38%
2 years	4.37%	4.43%	4.92%	5.36%	5.87%
3 years	4.71%	4.90%	5.40%	5.58%	5.76%
4 years	5.12%	5.19%	5.44%		
5 years	5.21%	#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	5.61%				
6 months	5.06%	4.49%	5.04%	4.86%	5.45%
1 year	4.77%	4.76%	4.95%	5.15%	5.57%
2 years	4.86%	4.96%	5.26%	5.38%	5.58%
3 years	5.10%	5.17%	5.37%	5.52%	5.73%
4 years	5.22%	5.33%	5.53%		
5 years	5.38%	*may be subject to a low equity fee			

Of course, breakevens have been pointing higher for a while now, so that's not new. **What is new is that we no longer see scope for interest rates to go lower, as we have done for most of the year.** The RBNZ has signalled that there is a risk that the OCR goes lower, but their central expectation is that the OCR holds steady. Meanwhile, markets are already anticipating when the first hike (not cut!) will be, and global bond yields have started heading higher in the wake of US President-elect Trump's victory. So while it costs a touch more, we believe it is now worth considering fixing for a little longer. That doesn't mean fixing the lot for 5 years. It still makes sense to spread your mortgage over several terms to reduce your overall risk. But as we have likely now seen the lows, it makes sense to fix more for longer while those rates are still attractive.

^ 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 2016 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	10.2	5.9	268	-12%	45
Auckland	16.1	4.9	2,388	-9%	35
Waikato/BOP/Gisborne	21.1	3.4	1,236	-8%	38
Hawke's Bay	5.5	4.7	256	-9%	33
Manawatu-Whanganui	4.6	1.3	384	-1%	33
Taranaki	-1.8	0.0	190	-7%	41
Wellington	11.7	2.0	860	-14%	32
Nelson-Marlborough	10.2	7.6	260	-12%	25
Canterbury/Westland	1.4	-0.2	984	-17%	35
Central Otago Lakes	42.0	2.2	163	-10%	42
Otago	9.3	1.1	274	-6%	26
Southland	7.5	3.5	210	-34%	37
NEW ZEALAND	**11.0**	**1.6**	**7,339**	**-9%**	**35**

Key forecasts

	Actual			Forecasts						
Economic indicators	**Dec-15**	**Mar-16**	**Jun-16**	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**
GDP (Ann Avg % Chg)	2.5	2.5	2.8	3.1	3.3	3.4	3.4	3.4	3.2	3.1
CPI Inflation (Annual % Chg)	0.1	0.4	0.4	0.4(a)	1.1	1.4	1.4	1.7	1.7	2.1
Unemployment Rate (%)	5.0	5.2	5.1	4.9(a)	4.8	4.8	4.7	4.6	4.6	4.5
Interest rates (carded)	**Jun-16**	**Sep-16**	**Latest**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**
Official Cash Rate	2.25	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
90-Day Bank Bill Rate	2.4	2.2	2.0	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Floating Mortgage Rate	5.7	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6
1-Yr Fixed Mortgage Rate	4.9	4.9	4.9	4.9	4.9	4.9	5.0	5.0	5.0	5.1
2-Yr Fixed Mortgage Rate	5.1	5.1	5.1	5.2	5.2	5.2	5.3	5.3	5.4	5.4
5-Yr Fixed Mortgage Rate	5.6	5.6	5.8	6.0	6.0	6.1	6.1	6.2	6.4	6.5

Source: ANZ, Statistics NZ, RBNZ

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