ANZ RESEARCH

# NEW ZEALAND ECONOMICS
## ANZ PROPERTY FOCUS

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# AMBER ALERT

## SUMMARY

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

## CHIEF ECONOMIST CORNER

Markets are set for a tumultuous period following the UK EU referendum result. Society has sent a message against globalisation and economic integration; that's negative for microeconomic policy settings and ultimately growth. A key issue now is whether Brexit spills over into wider Europe and Asia. We suspect it will, and from there likely into emerging markets, which means Asia and that's hugely relevant for New Zealand. Global growth will be lower, although we are coy about making sweeping assessments at this early stage. What we know is that a) the global economy is already vulnerable; and b) steps against globalisation and integration are negatives that need to be reflected in asset valuations. For New Zealand, this represents a challenging backdrop of which to be mindful. Heading into a period of heightened uncertainty New Zealand doesn't look as vulnerable as it did prior to the Asian Crisis or GFC. But we are on alert. At this stage, we expect the domestic impact to be small; New Zealand continues to have a number of positive forces in its favour – excellent momentum being one of them. But it is a moving feast and outside of direct trade linkages and capital flows we are watching our 6 C's; contagion risks, confidence, cost of funds, commodity prices, the currency and China. It would be unwelcome and problematic to see a direct flow on into three or more.

## THE PROPERTY MARKET IN PICTURES

Across-the-board strength is the only way to describe housing market activity. The market is hot. In fact, it is so strong that some of the associated increases in credit and debt accumulation risk becoming problematic.

## PROPERTY GAUGES

Historically low mortgage interest rates, existing dwelling supply at a record low in relation to sales and strong net immigration continue to support the nationwide housing market. However, existing house prices are becoming increasingly stretched relative to both incomes and rents, in Auckland especially.

## ECONOMIC OVERVIEW

Economic prospects remain sound, subject to a few caveats on the global scene. Financial conditions and confidence gauges are flagging 3% GDP growth on offer. Tourism is booming, migration is strong and the construction sector is running at such a pace it is now hitting capacity constraints. However, the outlook contains a greater-than-normal degree of uncertainty. A continuation of current borrowing trends and housing gains will raise the probability of a correction in the coming years. Dairy challenges remain, but they look manageable. The key risk remains the global scene.

## MORTGAGE BORROWING STRATEGY

Mortgage rates are generally unchanged or slightly lower compared to last month, with the reduction in average rates largely reflecting competition at particular points on the curve. One and two year rates remain the most competitive. The New Zealand economy (housing) hardly needs lower rates but the global scene looks set to drive rates lower. Given our expectation that further OCR cuts are pending (over time), these remain our preferred points on the curve. On balance, we favour the one year, which is short enough to enjoy potentially lower rates in future, but dramatically lower than floating or 6 month rates. The prospect of a lower OCR and an extended period of low interest rates globally lessen the attractiveness of fixing for longer.

# CHIEF ECONOMIST CORNER

## FROM LEADERSHIP TO POPULISM

Markets are set for a tumultuous period following the UK EU referendum result. Society has sent a message against globalisation and economic integration; that's negative for microeconomic policy settings and ultimately growth. A key issue now is whether Brexit spills over into wider Europe and Asia. We suspect it will, and from there likely into emerging markets, which means Asia and that's hugely relevant for New Zealand. Global growth will be lower, although we are coy about making sweeping assessments at this early stage. What we know is that a) the global economy is already vulnerable; and b) steps against globalisation and integration are negatives that need to be reflected in asset valuations. For New Zealand, this represents a challenging backdrop of which to be mindful. Heading into a period of heightened uncertainty New Zealand doesn't look as vulnerable as it did prior to the Asian Crisis or GFC. But we are on alert. At this stage, we expect the domestic impact to be small; New Zealand continues to have a number of positive forces in its favour – excellent momentum being one of them. But it is a moving feast and outside of direct trade linkages and capital flows we are watching our 6 C's; contagion risks, confidence, cost of funds, commodity prices, the currency and China. It would be unwelcome and problematic to see a direct flow on into three or more.

## SCENE SETTING

**Track the performance of the economy over time and you see a strong correlation with the global economy.** Where it goes, New Zealand follows. The same applies for the property market. **So anything that sets off global unease needs to be respected and monitored.**

**Markets have been sideswiped by the UK EU referendum result that saw a majority vote for exit.** It is a vote that is being seen as society kicking back against the status quo and establishment. The week started badly for markets, and while a semblance of calm has returned, most are bracing for more volatility ahead.

- Equity markets have tumbled. The Euro Stoxx 50 is close to 7% below its pre-vote level. The FTSE 250 is down close to 8%. Pressure has spread into the US and Asia, with the S&P 500 and Nikkei down 2% and 4½% respectively. The MSCI World Index is 3½% off its highs.
- Global financial stocks, in Europe particularly, were hit hard.
- The GBP/USD has gone from just under 1.50 prior to the result to 1.34 at the time of writing. The NZD/GDP has surged to 0.53.
- Volatility has risen, safe-haven buying has been apparent into the likes of bonds (taking yields for some even further into negative territory), gold prices have lifted and other commodities have fallen. It is all symptomatic of a sharp risk-off move.

**Now some perspective of the moves seen is needed.** Stocks were up solidly during the preceding week and have performed reasonably well over the year. Markets will be markets and there are ups and downs to contend with. Markets were betting on 'remain'. An exit decision was always going to see a violent immediate reaction.

**Why is society kicking back?**

- The after-effects of the GFC are still being felt through higher (than pre-GFC) unemployment rates. Major economic events tend to bring profound pressures on society.
- Growing income inequality. We have asset price inflation but no wage inflation. Housing affordability is a key driver of income inequality too. The gap between the haves and the have-nots continues to widen.
- Some distrust of economic and political institutions.
- A failure to see the benefit of so-called trickle-down economics. A rising economic tide (growth) is supposed to lift all boats. The past decades have seen the global economy embrace integration and globalisation. Yet many are still searching for the rewards and only see migrants taking jobs or jobs being shipped offshore.
- A belief that the benefits of the so-called recovery after the GFC have gone to Wall Street as opposed to Main Street.
- An urban/rural divide, where perception is that central government is looking after the former and ignoring the latter. You can see that in New Zealand, with an Auckland versus the rest mentality.
- Technology is profoundly changing lives. It provides opportunity but also threatens jobs.

**The combination is a lethal cocktail that breeds discontent with the establishment.**

# CHIEF ECONOMIST CORNER

## WHERE TO FROM HERE?

**There is plenty of water to flow under the bridge yet.** The UK referendum result is actually non-binding in a constitutional sense. The UK parliament (which was skewed towards 'remain' ahead of the result) now has some clear soul-searching to do, although it seems highly unlikely that the Article 50 secession process of the EU treaty won't be triggered. But even once that occurs, the UK will not lose access to the EU straightaway. There is then a two-year negotiation period, which we suspect will be extended because discussions will no doubt be complicated. **All that said, the train has left the station and out will inevitably mean out.** Negotiations between the UK and EU will be fraught with tension.

**Some are saying it could eventually be a positive event for global growth by galvanising policymakers around the globe into action. We don't buy into that.** The nucleus of the outcome is society pushing back against globalisation and economic integration, which is hardly a tick for growth, and the world is already struggling on that front. Game theory tells us that self-interest dominates group-interest, so forget about the galvanisation of policymakers for the greater good.

## PANDORA'S BOX

**The bigger issue is whether, or to what degree, the floodgates open.** What's next after Brexit? Outugal? Jetaly? It could be a Who's Who of populist leaders lining up across Europe ready to follow suit. It portends less enthusiasm for reform and a step towards a more inward-looking economic focus. It could spell a pull-back from globalisation and the opening up of borders. New Zealand benefits from improving access, not restricted access. Foreign policy could turn more antagonistic and see the focus shift towards lifting labour's share of income without an emphasis on productivity (i.e. sharing, as opposed to growing, the pie). You can see similar dynamics (populism) appearing in other jurisdictions such as the United States.

**To be fair, all that is hardly going to sink an economy overnight**, as it manifests by slowly tweaking the direction of policy and the microeconomic foundations of an economy. After all, economies are like super-tankers, in that they are not easy to turn.

**However, there are a few caveats:**

- **Markets are forward looking**, so expectations of tomorrow's decisions have implications today. Markets are eying what populist-style decision making could mean and they don't like what it suggests for growth. Less growth means lower asset valuations. Lower growth in the near-term (an issue often to be looked though) can accumulate to larger amounts over time (and more of a problem). Whether there is dip or recession is largely incidental. If the pace of growth, on average, is going to be lower, asset valuations will need to reflect that.
- **The global economy is vulnerable.** There is more debt now than prior to the GFC and emerging market economies have been at the epicentre of that debt boom. The same imbalances (excess saving in the east and excess consumption in the west), misaligned currencies, and mispriced price signals remain. It doesn't take much to "tip" an economy when vulnerability is high.
- **Policymakers may say they have ammunition, but the past few episodes of priming the pump have done nothing** more than support global asset prices with little evidence of boosting real activity (though to be fair the counter-factual is that things could have been a lot worse).
- **Asset valuations are high** – and stretched in most cases.

**So Brexit does have the ability to set off a chain of events.** But it's drawing a long bow to pencil that into forecasts straight away. **Central banks will hardly sit idly by and we've heard reassuring words already. If central banks need to cut rates to restore confidence, they will.**

**For now, we're on notice and not much more.** Brexit itself will be a negative event for the near-term global growth outlook, with the associated volatility and uncertainty sufficient to ensure that. To what degree, no one is really sure. Odds of a recession in the UK are high though, and that has the potential to drag Europe's anaemic growth into 'zippo' territory and the world too. **Beyond that the lights are starting to flash amber.**

# CHIEF ECONOMIST CORNER

## FROM GLOBAL TO LOCAL

**We are not concerned about the *direct* implications of a UK exit on the New Zealand economy.** While still meaningful, the UK economy is nowhere near as large a trading partner as it once was (although it is an important market for our wine, pipfruit, lamb and tourism sectors). It takes just 3% of our goods exports. Moreover, the domestic economy has also been recording decent momentum, which gives it more resilience to global unease than if it were wavering to begin with. Now it does look likely that Europe will suffer too, which makes it more of an economic headwind (Europe receives around 12% of New Zealand's goods exports). The NZD is higher against both the euro and GBP, which makes life even tougher for exporters. That said, the combination of all the above doesn't look large enough (at this stage) to drag the New Zealand economy down. The New Zealand economy is reasonably well diversified.

**But when things start going awry globally we like to look over our 6 C's –** things beyond the most obvious linkages such as trade flows. We are watching:

- **Contagion risks**: The Brexit result is an outcome that will embolden euro-sceptic groups in other EU nations to push their own agendas and demand referenda. As such, the euro area is looking increasingly shaky. The UK and Euroland represent close to 15% of global GDP, so bad news in the region will have global consequences. Another side of contagion is whether we see shifting political sands locally. Centralist-style politics has been a key feature of the economic landscape for New Zealand for a number of years now, supporting confidence and growth. Business like stability. Whether we become "infected" with the political fragmentation we are seeing in other jurisdictions will be key to watch. The final angle is how New Zealand's structural metrics stand, as these can either exacerbate or minimise the impact of global shocks. Put simply, if you have strong structural metrics, you have greater ability to handle global unease and contagion. Looking at the current account (-3.0% of GDP), household saving, credit growth, net external debt (56% of GDP), and net government debt (26% of GDP), New Zealand looks better placed than it was prior to previous periods of global dislocation such as the GFC. The financial system is also sounder, with less reliance on short-term offshore funding. The Achilles Heel is valuation excesses across the property market and some recent household balance sheet exuberance (lower savings and accelerated borrowing). This is not the time to be binging on debt.
- **Cost of funds**: Credit spreads have widened in line with a deteriorating appetite for risk, which means there is pressure for one driver of interest rates to rise. Higher global bank funding costs are going to be particularly pertinent for New Zealand at a time when domestic credit growth is expanding faster than deposits. Either credit growth slows, deposit growth picks up, or there is more (expensive) issuance overseas. In all likelihood the RBNZ will need to cut interest rates to offset pressure on funding costs and markets do not settle down. Net on net, domestic borrowing rates could remain unchanged.
- **Currency**: The NZD fell immediately following the referendum result, as you'd expect in the first instance – acting as the shock-absorber you'd hope for, as it has done historically. However, on a TWI basis the movement has been pretty trivial and at the time of writing the TWI is over 76 compared to 75.3 at the start of last week. While rising uncertainty typically spells lower for the NZD, the allure of New Zealand's yield will only be enhanced the more global policymakers test negative yields (see the table below). German 10-year bunds yields – a key benchmark across Europe – are negative again. This means anything with a positive cashflow in front of it (NZ bonds, residential property, commercial property etc) is sought. Despite increased risk aversion and stronger headwinds for global growth, one outcome could be a higher NZD – and that won't be welcome. They say a problem shared is a problem halved. Well, that's really what happens when your currency depreciates. The pressure on the GBP and euro at present (lifting the NZD against them) is implicitly sharing their problems. It makes them more competitive and us less so.

# CHIEF ECONOMIST CORNER

**FIGURE 1: G10 SOVEREIGN BOND YIELD MATRIX**

| Country | 2-3 Year | 5 Year | 10 Year | Average |
|---|---|---|---|---|
| Switzerland | -1.08 | -0.98 | -0.52 | -0.86 |
| Germany | -0.65 | -0.53 | -0.05 | -0.41 |
| Japan | -0.28 | -0.28 | -0.18 | -0.24 |
| Denmark | -0.61 | -0.32 | 0.14 | -0.27 |
| Sweden | -0.64 | -0.19 | 0.59 | -0.08 |
| Norway | 0.42 | 0.64 | 1.11 | 0.72 |
| UK | 0.26 | 0.56 | 1.08 | 0.64 |
| Canada | 0.54 | 0.63 | 1.16 | 0.78 |
| USA | 0.56 | 0.97 | 1.49 | 1.01 |
| Australia | 1.55 | 1.62 | 2.01 | 1.72 |
| New Zealand | 2.00 | 2.03 | 2.37 | 2.14 |

Source: Bloomberg

- **Commodities**: Oil prices have fallen as you would expect when concerns over global demand increase. The global backdrop is hardly constructive for commodities in general and New Zealand is a net exporter. Watch this space.
- **Confidence**: Confidence keeps the economic wheels turning. We will be watching both our business and consumer confidence measures as a timely signal. Thankfully, the economy is facing this turbulence with high levels of confidence to begin with. It is a different matter if you're hit with a negative shock while already down in the dumps.
- **China**: It is critical for the New Zealand economy as well as many of our other key trading partners, including Australia. China is the linchpin across the entire Asian region. Weaker growth for Europe and the UK won't be good for emerging markets in general and will hasten pressure for their currencies to weaken. We expect attention to turn to emerging market economies over the coming weeks. Capital flows will favour the safe havens and that in itself is creating issues for some (such as the Bank of Japan). Our Chinese colleagues believe a further cut in China's Reserve Requirement Ratio is likely. China and Asia (and New Zealand) have been huge beneficiaries of globalisation. A move to anti-globalisation style policies won't be good for the region's growth prospects.

**Beyond the C's, we think you can throw in a big M, which stands for migration.** Expect New Zealand's numbers to hold up in an environment of Brexits, and the status quo getting trumped. Put simply, New Zealand won't look a bad place relative to all the rest! At this stage, we're not buying much into signs migration may be past its highs. Some retrenchment is to be expected given the levels reached to begin with. But certainly we think it's a stretch say that with a top in place, migration is set to go south at a rapid clip.

## THE UPSHOT

**The global economy is entering a fractured and delicate period. Uncertainty is set to remain high.**

**Whether this sets off a chain of events that drives the world into a recession remains to be seen.** All that can be safely said at present is that the risk profile is elevated and movements towards a more populist-driven model will be reflected in valuations and that's a transition that will make the global economy more wobbly than normal and prone to setbacks.

**New Zealand is not immune from such forces.** The housing market follows the economy and global scene.

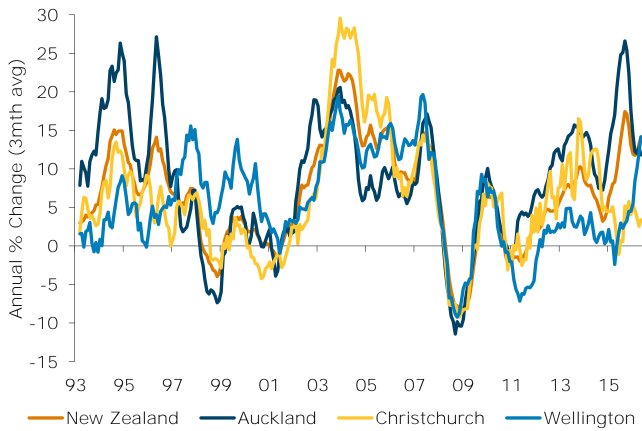
**However, there are key offsets this time around.**

- New Zealand's balance sheet is not as weak as it has been prior to previous periods of unease. When you don't have huge internal excesses it makes the economy harder to knock over.
- The RBNZ has considerable firepower to boost growth by lowering the OCR. Fiscal policy has also considerable scope to move into an expansionary stance given relatively low levels of net debt.

**So for now we'll characterise the situation as one of being on amber alert as opposed to the red variety.**

# THE PROPERTY MARKET IN PICTURES

**FIGURE 1. REGIONAL HOUSE PRICES**



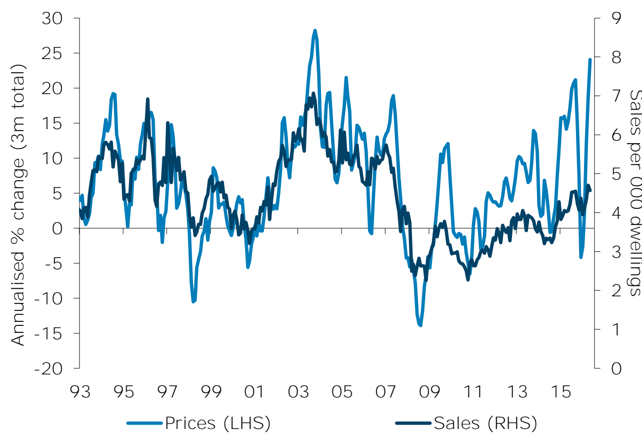

Source: ANZ, REINZ

Nationwide house prices continue to accelerate. Our preferred measure of prices (the REINZ stratified measure) showed nationwide prices rising 2.1% sa (6.0% 3m/3m) in May, with annual growth lifting to 15% y/y.

Auckland prices have recovered from a slowdown over December and January to be surging again. On a three-month average basis, Auckland prices are up 12% y/y. That's hardly a dip!

Recent growth has been dominated by a number of non-Auckland regions. On a three-month average basis, Wellington, regional North Island and non-Canterbury South Island prices are running at 14%, 20% and 11% y/y respectively. Low mortgage rates, strong net migration, a loosening in non-Auckland credit restrictions and the 'ripple effect' of previously stronger Auckland house price growth has supported other regional areas. Regions that were well behaved after the GFC are now playing catch-up.

**FIGURE 2. REINZ 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.

Following a lull over the latter part of 2015 as investor restrictions and tax changes were implemented, sales volumes have accelerated sharply. On a 3m/3m basis, sales volumes were up a strong 9.8% in May. The number of seasonally adjusted sales in May (8,282 by our estimates) is the second-highest figure in the past nine years.

As with price growth, much of the nationwide sales growth is being led by non-Auckland regions. In May, Auckland sales volumes were up just 1.2% y/y, as opposed to 22% y/y sales growth outside of Auckland.

**FIGURE 3. MEDIAN DAYS TO SELL**

Source: ANZ, REINZ

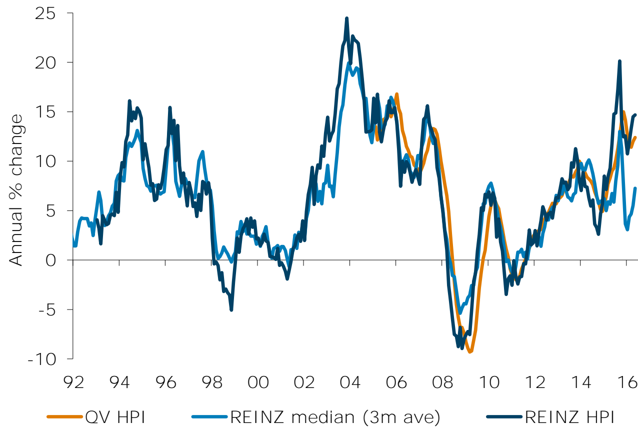
The length of time it takes to sell a house is also an indicator of the strength of the real estate market. It encompasses both demand and supply-side considerations.

Nationally, the median time to sell a house has fallen to just 30.2 days (sa), which is the lowest level since June 2007. It remains well below the historical average of 38 days.

After rising to 35 days in January, the median time to sell a house in Auckland has fallen back to 31 days. It has also fallen in the majority of other regions, with Nelson/Marlborough (25), Wellington (26), Hawke's Bay (27) and Otago (27) notable standouts.

# THE PROPERTY MARKET IN PICTURES

**FIGURE 4. REINZ AND QV HOUSE PRICES**

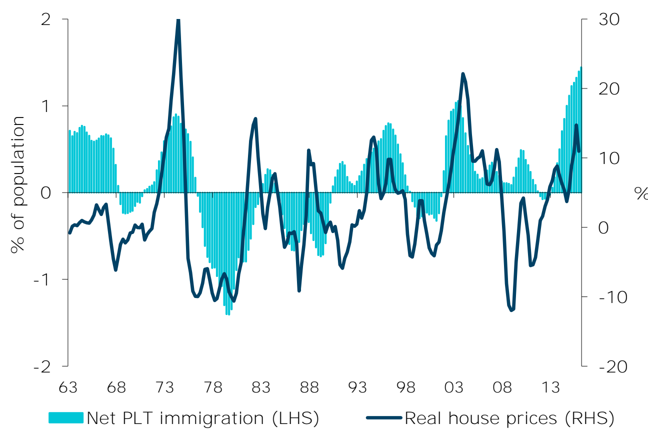



Source: ANZ, REINZ, QVNZ CoreLogic

There are three key measures of house prices in New Zealand, including the median and stratified house price measures produced by REINZ as well as 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.

After a period of more modest price growth, all three measures are showing acceleration in price growth once again. The median sale price, which topped $500K for the first time in May, is rising at 10% y/y. However, this is below both the stratified measure and the QVNZ measure of price growth (15% y/y and 12% y/y respectively), which adjust for difference in the quality of houses sold.

**FIGURE 5. NET PLT IMMIGRATION AND HOUSE PRICES**

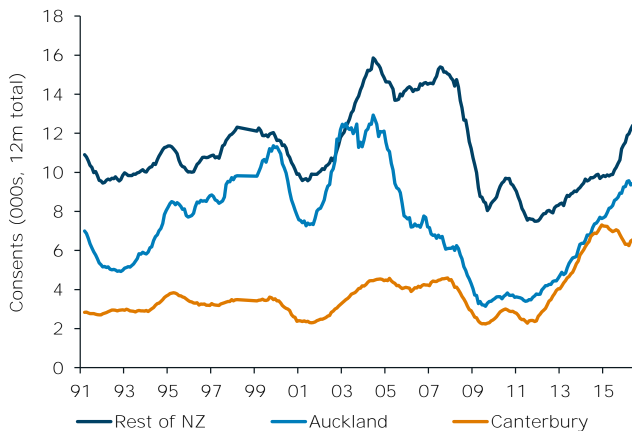



Source: ANZ, Statistics NZ, QVNZ

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 sat at 65.4K in May, which is around 1½% of the resident population. Both more arrivals and fewer departures have contributed to this large net inflow. That said, a large part of the increase over the past 12 months has been due to more arrivals. In the 12 months to May, arrivals were close to 125k, with New Zealand and Australian citizens (29%) and those on work visas (31%) making up similar shares. Students made up 22% of PLT arrivals.

**FIGURE 6. RESIDENTIAL CONSENTS**



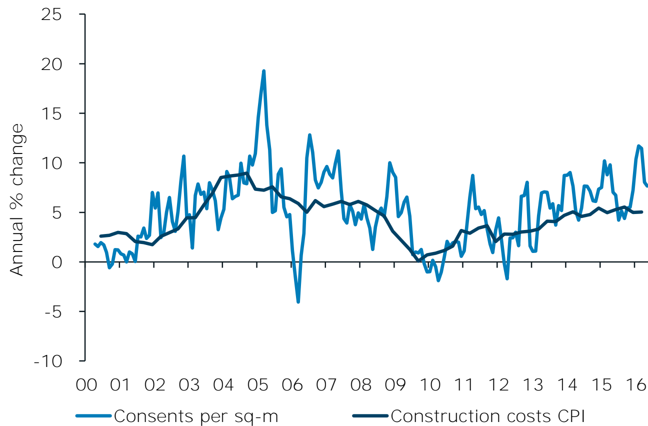

Source: ANZ, Statistics NZ

Nationwide residential consent issuance has been strengthening, with annual issuance surpassing 28K in May, the highest since 2005.

A large part of the increase has been due to the Auckland region (annual issuance of 9.4K), although there are some signs that this has begun to top out of late, perhaps due to increasing capacity constraints in the construction sector. Canterbury issuance is off its highs, but only modestly so. Nevertheless, it is consistent with other evidence suggesting that the residential component of the earthquake is past its peak. Positive trends have also been evident in the Waikato and other regional North Island areas (ex-Wellington).

# THE PROPERTY MARKET IN PICTURES

**FIGURE 7. CONSTRUCTION COST INFLATION**

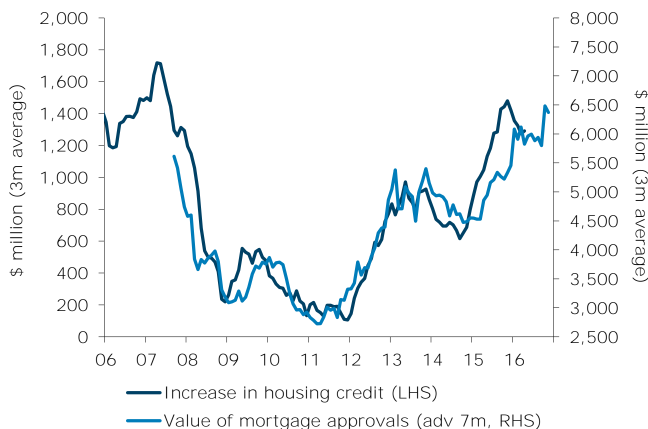



Source: ANZ, Statistics NZ

On a three-month average basis, the value of residential consents per square metre was up 7.6% y/y in May. While this is a little lower than in recent months, it is still strong. Looking through the volatility, an upward trend is apparent, and this is consistent with the upward trend seen in the construction cost component of the CPI. In fact, it highlights that possibility that annual CPI construction costs inflation could begin to accelerate again after a period of stability around 5% y/y.

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

**FIGURE 8. MORTGAGE APPROVALS & HOUSING CREDIT**



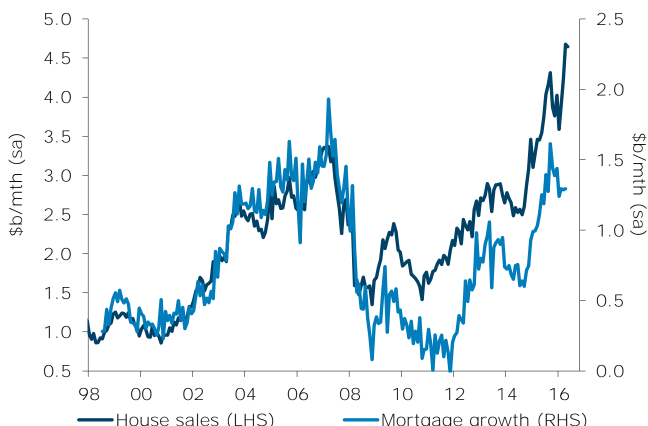

Source: ANZ, RBNZ

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.

After a period of flat growth over the final part of 2015, approval values have surged again over recent months, signalling another acceleration in housing credit growth – from already elevated levels.

**FIGURE 9. HOUSE SALES AND MORTGAGE GROWTH**




Source: ANZ, REINZ, RBNZ

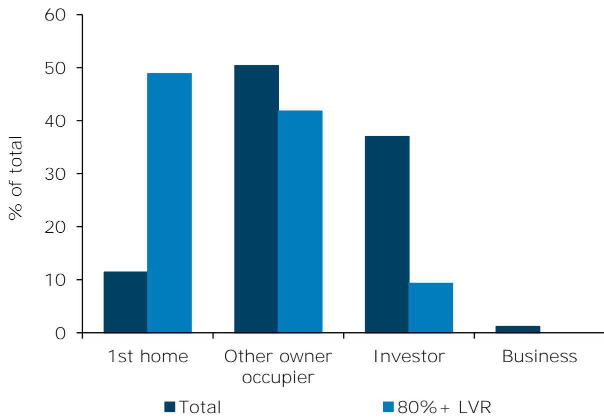
Despite house sales values being at all-time highs, mortgage borrowing levels are below pre-GFC peaks, though rising strongly.

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 credit accelerating strongly and the household sector currently dis-saving.

# THE PROPERTY MARKET IN PICTURES

**FIGURE 10. NUMBER OF NEW RESIDENTIAL MORTGAGES BY BORROWING TYPE**



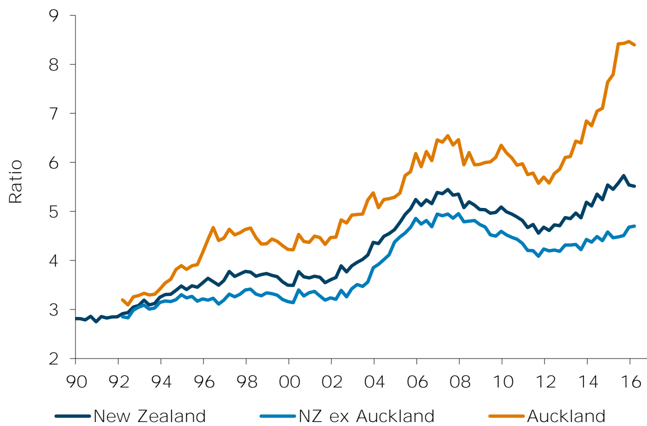

Source: ANZ, RBNZ

Despite the further tightening of lending restrictions to Auckland investors in November 2015, investor lending has been increasing as a share of total new residential mortgage lending. In May, new lending to investors grew at a 36% y/y pace and made up over 37% of total new lending, which is the highest share since this data started being released in August 2014. It is also close to 5%pts above the share 12 months prior.

That said, this lending is being done with reasonable levels of equity. Investors made up less than 8% of total lending with an LVR greater than 80%.

But new data also shows that of new lending to investors, 55% is on interest-only terms.

**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 around 5½ times, 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 over 8 times, suggesting a severely unaffordable market. Elsewhere, the ratio is around 4.7 times, which is below 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 30% at the moment. It has even fallen a little of late due to recent mortgage rate falls.

However, once again there are stark regional differences, with the average mortgage payment to income in Auckland close to 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 only a small lift in interest rates.

# PROPERTY GAUGES

Historically low mortgage interest rates, existing dwelling supply at a record low in relation to sales and strong net immigration continue to support the nationwide housing market. However, existing house prices are becoming increasingly stretched relative to both incomes and rents, in Auckland especially.

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.

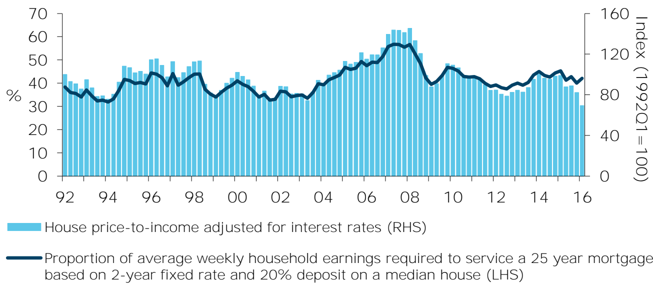
**HOUSE PRICES TO RENTS.** We look at median prices to rents as an indicator of relative affordability across the regions.

| Indicator | Level | Direction for prices | Comment |
|---|---|---|---|
| Affordability | Chasing your tail | ↔/↓ | Houses severely unaffordable in Auckland. Becoming increasingly less affordable in most regions. |
| Serviceability/ indebtedness | Hard work | ↔/↓ | Low mortgage interest rates are helping contain debt-servicing costs somewhat, despite a debt-to-income ratio at a record high. |
| Interest rates / RBNZ | Watch & wait | ↔/↑ | Historically low mortgage rates supportive. Pressures on bank funding costs likely to be offset by OCR cuts going forward. |
| Migration | Record high | ↔/↑ | At record annual high, but likely to be close to peaks. |
| Supply-demand balance | Akld vs Rest of NZ | ↔/↑ | Auckland shortages are growing; so are those in Wellington. Canterbury shortages have eased; more balanced elsewhere. |
| Consents and house sales | More to do | ↔/↑ | Annual issuance at 11-year high. Auckland issuance at 9.4k is too low to meet population needs. Canterbury issuance tailing off. |
| Liquidity | Firming | ↔ | Credit is rising faster than incomes, but already-high debt levels should eventually cap the market. |
| Globalisation | In synch | ↔/↑ | NZ houses expensive to us but cheap to everyone overseas. |
| Housing supply | Low | ↔/↑ | At just three months of sales, a record low nationwide, with the regions catching up to Auckland. |
| House prices to rents | Squeeze | ↔/↓ | Rents drifting up, given strong demand. Auckland prices elevated to rents, other regions less so. |
| **On balance** | **Pushing up** | ↔/↑ | **Regionally broad-based strength, with Auckland valuations stretched.** |

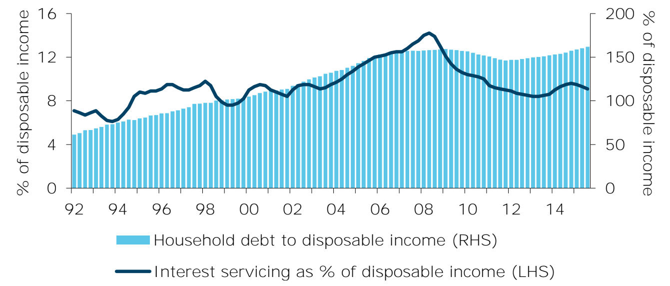
ANZ

# PROPERTY GAUGES

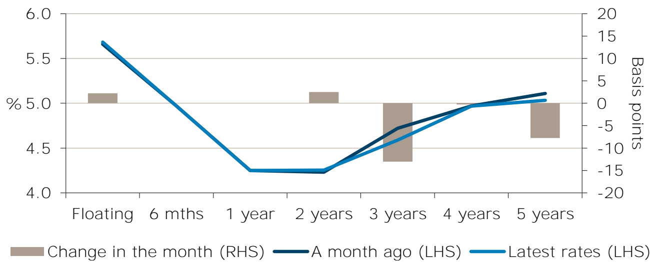
### FIGURE 1: HOUSING AFFORDABILITY




### FIGURE 2: SERVICEABILITY AND INDEBTEDNESS

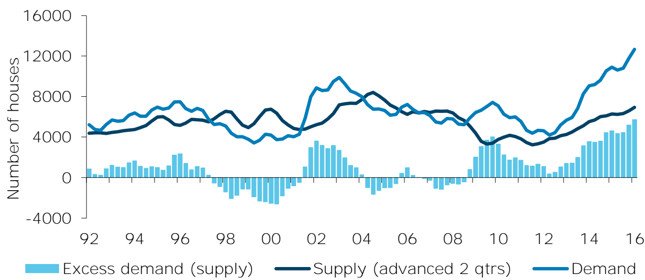



### FIGURE 3: NEW CUSTOMER AVERAGE RESIDENTIAL MORTGAGE RATE (<80% LVR)



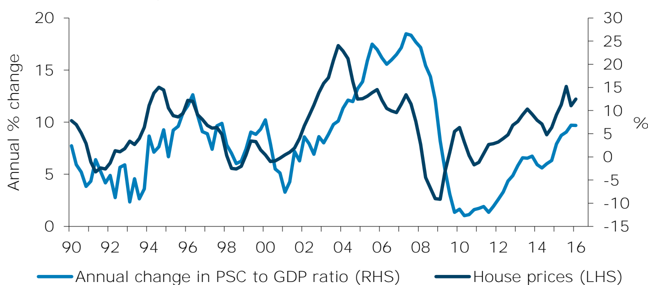

### FIGURE 4: NET MIGRATION

### FIGURE 5: HOUSING SUPPLY-DEMAND BALANCE

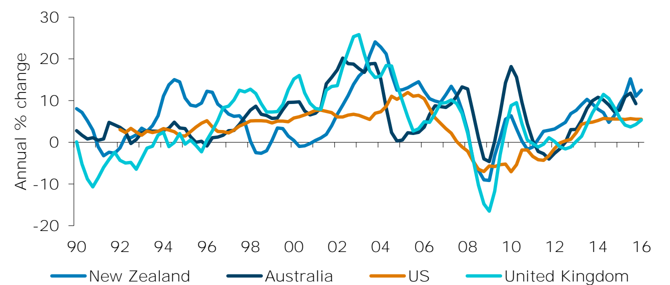



### FIGURE 6: BUILDING CONSENTS AND HOUSE SALES

### FIGURE 7: LIQUIDITY AND HOUSE PRICES

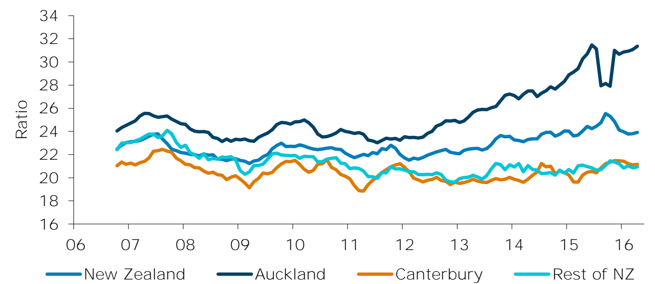



### FIGURE 8: HOUSE PRICE INFLATION COMPARISON




### FIGURE 9: HOUSING SUPPLY

### FIGURE 10: MEDIAN HOUSE PRICES TO RENTS




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

# ECONOMIC OVERVIEW

## SUMMARY

Economic prospects remain sound, subject to a few caveats on the global scene. Financial conditions and confidence gauges are flagging 3% GDP growth on offer. Tourism is booming, migration is strong and the construction sector is running at such a pace it is now hitting capacity constraints. However, the outlook contains a greater-than-normal degree of uncertainty. A continuation of current borrowing trends and housing gains will raise the probability of a correction in the coming years. Dairy challenges remain, but they look manageable. The key risk remains the global scene.

## OUR VIEW

**We expect the economy to perform well over the coming years.** Existing momentum (the base) is strong. Confidence is high. Financial conditions, despite the high NZD, are supportive. The lagged impact of prior cuts in the OCR is still flowing into the economy. Housing and construction activity is surging. A feel-good factor is apparent. Migration inflows look to have peaked but at incredibly strong levels. More people equals more spending. An array of smaller sectors also continue to track well, including pipfruit, information technology, education and kiwifruit, to name just a few.

**When an economy has good base momentum, success can breed more confidence and success.** Firms invest and hire. People employed go out and buy goods and services. Firms are forced to expand capacity to keep up with demand. An economic expansion ensues.

**The economy is perhaps doing a little too well right now.**

- **Constraints are becoming more apparent, most notably in the building industry.** Auckland would like to be building more houses to address shortages, but there are manpower and resource availability issues. Firms are finding it more difficult to find and attract the right staff.
- **Housing strength now risks turning into full-blown largesse and much more of a problem.** There is no doubting the froth and overvaluation in Auckland. Regions are playing catch-up but off a lower base. Valuation excesses in themselves need not be problematic. However, we are now seeing clears signs of exuberance via deteriorating structural metrics. Household debt (163% of income) is now higher than prior to the GFC, although admittedly debt-servicing levels are lower due to lower interest rates. Debt brings forward activity; it needs to be paid back. Some of the recent enthusiasm for debt is healthy, reflecting that people have a greater belief in New Zealand's economic future. That said, extended house prices, rapid debt accumulation and less saving (households are running down the precautionary saving buffer) are worrying signs that need to be monitored. Or put a different way, another two years of strong credit growth, rapid house price appreciation and debt accumulation would up the ante on a correction in 2018.
- **Economic strength is reflected in a stronger NZD.** This makes life more difficult for the export sector, which is the earning backbone of the economy; you need to earn dollars to spend them. The RBNZ has cut the OCR 125bps in the past year or so, yet the NZD remains elevated. Part of this reflects incredibly low (and in some cases negative) interest rates overseas, which make New Zealand's low interest rates look high! However, some of the currency strength simply reflects decent economic performance. The currency is, after all, the share price of NZ.Inc, and the company is doing well.

**Locally, we can point to another negative cash-flow year for the dairy sector, extended house prices and borrow-and-spend behaviour as economic risks that need monitoring. Yet they all look manageable.**

**The key risk to the economy stems from offshore (as noted in Chief Economist Corner).** Time and time again it's been global developments that materially alter the direction for the economy. So we are on notice once again. **The risk remains that Brexit sets off a chain of events that ultimately stymies the Asian region, which is hugely relevant for the New Zealand economy.**

**The RBNZ is facing a delicate balancing act.** The direction of the economy, housing and credit growth – as barometers driving medium-term inflation – suggest the low for interest rates has been seen. The counter is low inflation (and the fact it's been low for a long time), high NZD, rising bank funding costs and global wobbles. **We are siding with the former, but fully expect a macro-prudential policy response towards housing in association. Cutting the OCR without having a mechanism to ease the excesses in place risks creating an economic problem down the track.**

# MORTGAGE BORROWING STRATEGY

## SUMMARY

Mortgage rates are generally unchanged or slightly lower compared to last month, with the reduction in average rates largely reflecting competition at particular points on the curve. One and two year rates remain the most competitive. The New Zealand economy (housing) hardly needs lower rates but the global scene looks set to drive rates lower. Given our expectation that further OCR cuts are pending (over time), these remain our preferred points on the curve. On balance, we favour the one year, which is short enough to enjoy potentially lower rates in future, but dramatically lower than floating or 6 month rates. The prospect of a lower OCR and an extended period of low interest rates globally lessen the attractiveness of fixing for longer.

## OUR VIEW

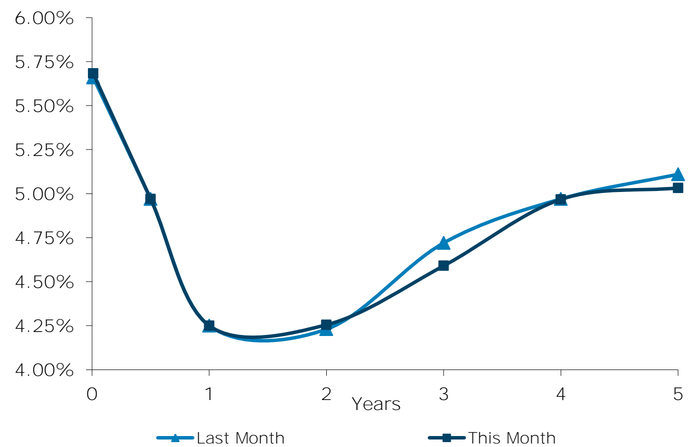
**Mortgage rates are little changed this month, with small falls in the 3 and 5 year rate generally reflecting increased competition at those points on the curve.** As has been the case for some time, the most striking feature of the term structure of both mortgage curves (specials and high-LVR) is that they are "tick-shaped", with the low point being 1-2 years.

At face value, this makes those points the most attractive. **But we also see the 1 year point as the most strategically attractive point on the curve** for the simple reason that for both types of borrower, the 1 year rate is dramatically lower than floating or 6 months, yet is sufficiently short enough to benefit from likely future OCR cuts. As we note in the economic overview section of this document, while the domestic economy is fairly robust and not in need of an OCR cut, the global outlook remains fragile and the high NZD and low inflation backdrop have scope to bring the RBNZ back to the rate cut table over time.

We forecast two more OCR cuts this cycle, and beyond that, an elongated period of low interest rates. **Despite the increased certainty offered by longer term rates** (which are all generally at historic lows), **we see limited appeal in them** given the additional cost and our expectation that it will be a long time before the generalised level of interest rates rises. Margin pressure (read higher credit costs) could push mortgage rates up irrespective of where the OCR goes, but we would expect such a development to lead to more OCR cuts to offset the impact, reducing the potential for mortgage rates to rise.

**Breakeven analysis supports fixing 1 or 2 years.** It shows that one would need to expect mortgage rates to rise reasonably sharply over the next two years for it to be worthwhile fixing for 4 or 5 years. For example, if a borrower eligible for specials is considering fixing for 2 years or 4 years, if the 2 year is selected, the 2 year rate would need to rise by 1.42%pts to 5.68% in 2 years' time before one would have been better off fixing for 4 years. We see the likelihood of that as remote. **Breakevens also favour the 1 and 2 year over the 6 month**, with 6 month forward breakeven rates well below current 6 month and 1 year rates. **Each borrower will place a different emphasis on the cost versus certainty trade-off, and it is worth repeating that long-term rates are at historic lows**. **But we do believe the "lower for longer" interest rate environment makes longer term rates less attractive.**

**SPECIAL CARDED MORTGAGE RATES^**




| Special Mortgage Rates | | Breakevens for 20%+ equity borrowers | | | |
|---|---|---|---|---|---|
| Term | Current | in 6mths | in 1yr | in 18mths | in 2 yrs |
| Floating | 5.68% | | | | |
| 6 months | 4.97% | 3.53% | 4.26% | 4.26% | 5.09% |
| 1 year | 4.25% | 3.89% | 4.26% | 4.68% | 5.26% |
| 2 years | 4.26% | 4.29% | 4.76% | 5.17% | 5.68% |
| 3 years | 4.59% | 4.75% | 5.21% | 5.37% | 5.55% |
| 4 years | 4.97% | 5.00% | 5.23% | | |
| 5 years | 5.03% | #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 | 5.68% | | | | |
| 6 months | 5.06% | 4.49% | 4.97% | 4.83% | 5.16% |
| 1 year | 4.77% | 4.73% | 4.90% | 5.00% | 5.23% |
| 2 years | 4.84% | 4.86% | 5.06% | 5.17% | 5.35% |
| 3 years | 4.97% | 5.02% | 5.20% | 5.33% | 5.50% |
| 4 years | 5.09% | 5.18% | 5.35% | | |
| 5 years | 5.23% | *may be subject to a low equity fee | | | |

*^ 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 May 2016 (based on REINZ data)

| | House prices (ann % chg) | 3mth % chg | No of sales (sa) | Mthly % chg | Avg days to sell (sa) | Comment |
|---|---|---|---|---|---|---|
| Northland | 4.0 | 0.8 | 313 | +18% | 45 | Sales volumes up 60% y/y; the highest level since 2003. |
| Auckland | 7.3 | 4.6 | 2,817 | 0% | 31 | Volumes up just 1.2% y/y, but days to sell at an 8m low. |
| Waikato/BOP/Gisborne | 19.8 | 6.9 | 1,551 | -6% | 29 | Record median sales price and 20% y/y growth. |
| Hawke's Bay | 7.4 | -0.5 | 270 | -21% | 27 | The lowest days to sell since 2003. |
| Manawatu-Whanganui | 7.6 | 1.1 | 386 | -3% | 32 | Days to sell at 9-year low, sales volumes +36% y/y. |
| Taranaki | 15.9 | 5.9 | 178 | -2% | 39 | Another record median sale price, with growth of 17% y/y. |
| Wellington | 12.7 | 6.5 | 838 | -6% | 26 | 2nd lowest days to sell of regions, volumes 15% y/y. |
| Nelson-Marlborough | 10.0 | 3.8 | 281 | -6% | 25 | Sales volumes +19% y/y, lowest days to sell of regions. |
| Canterbury/Westland | 8.5 | 1.5 | 955 | -8% | 31 | A new record median sale price. Volumes +9% y/y. |
| Central Otago Lakes | 36.8 | 17.9 | 168 | +8% | 30 | Median price growth +37% y/y the fastest of the regions. |
| Otago | 4.3 | 1.6 | 336 | -4% | 27 | Sales volumes +33% y/y. |
| Southland | 1.9 | 1.5 | 210 | -5% | 37 | Days to sell around average (36). Sales volumes 29% y/y. |
| NEW ZEALAND | 9.8 | 5.7 | 8,282 | -3% | 30 | Days to sell well below historical averages (37), volumes +14% y/y, median prices at all-time highs. |

## Key forecasts

| | Actual | | | Forecasts | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Economic indicators** | **Sep-15** | **Dec-15** | **Mar-16** | **Jun-16** | **Sep-16** | **Dec-16** | **Mar-17** | **Jun-17** | **Sep-17** | **Dec-17** |
| GDP (Ann Avg % Chg) | 2.9 | 2.5 | 2.5 | 2.6 | 2.8 | 2.8 | 2.7 | 2.5 | 2.5 | 2.5 |
| CPI Inflation (Annual % Chg) | 0.4 | 0.1 | 0.4 | 0.5 | 0.6 | 1.1 | 1.6 | 1.5 | 1.7 | 2.0 |
| Unemployment Rate (%) | 6.0 | 5.4 | 5.7 | 5.5 | 5.4 | 5.4 | 5.3 | 5.2 | 5.2 | 5.1 |
| **Interest rates (carded)** | **Apr-16** | **May-16** | **Latest** | **Sep-16** | **Dec-16** | **Mar-17** | **Jun-17** | **Sep-17** | **Dec-17** | **Mar-18** |
| Official Cash Rate | 2.25 | 2.25 | 2.25 | 2.00 | 2.00 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 |
| 90-Day Bank Bill Rate | 2.4 | 2.4 | 2.4 | 2.2 | 2.1 | 2.0 | 2.0 | 2.0 | 2.0 | 2.1 |
| Floating Mortgage Rate | 5.7 | 5.7 | 5.7 | 5.4 | 5.4 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 |
| 1-Yr Fixed Mortgage Rate | 4.9 | 4.9 | 4.9 | 4.8 | 4.8 | 4.7 | 4.9 | 5.0 | 5.1 | 5.3 |
| 2-Yr Fixed Mortgage Rate | 5.1 | 5.0 | 5.1 | 5.1 | 5.1 | 5.2 | 5.3 | 5.3 | 5.5 | 5.7 |
| 5-Yr Fixed Mortgage Rate | 5.7 | 5.4 | 5.5 | 5.7 | 5.7 | 5.8 | 5.9 | 5.9 | 6.0 | 6.1 |

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