

# **New Zealand Property Focus**

Passing through

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## Summary

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

## Feature Article: Passing through

The Official Cash Rate (OCR) has been cut 75 basis points over the past six months and mortgage rates have fallen. But because household deposits are an important source of bank funding (eg for home loans), banks have had to strike a balance, meaning both mortgage and deposit rates have fallen by less than the OCR has. **And as the OCR goes lower (we're forecasting a further 50 basis point reduction by August 2020), we think the pass-through to mortgage (and deposit) rates will diminish. Indeed, there's a real risk that if deposit rates go lower,** household deposit growth could slow markedly as depositors seek higher returns elsewhere. This would mean banks have a lower deposit base from which to provide new loans, reducing the positive impact to the housing market and broader economy. So even if the price of credit (ie the interest rate) is low, supply constraints (credit availability) can be a significant headwind.

## Property gauges

Evidence that the housing market is tightening up on the back of lower mortgage rates has continued to accumulate. House price inflation has accelerated, up 3.3% y/y at the national level in October. And while regional divergence remains a key theme, most regions are displaying evidence of some tightening. House sales (up 8.2% m/m) are now picking up after a prolonged period of softness, and nationwide days to sell have dropped further below their historical average (to 37). We expect the recent decline in mortgage rates will continue to provide impetus to the housing market, with annual house price inflation peaking at 5.5% in 2020 – a small upgrade since the October Property Focus. We think resurgence in the housing market weakens the case for the RBNZ to loosen LVRs next week. That said, policy, credit, and affordability headwinds are still expected to prevent the housing market from shooting to the moon once again, but that **possibility can't be** completely ruled out.

## Economic overview

The New Zealand economy continues to gradually lose momentum. Leading indicators suggest the economy will continue to gradually slow at least until early 2020, though there are early signs the decline is easing (stabilising business sentiment, lifting housing). Headwinds, including wary businesses, tighter credit availability and labour shortages look set to persist. The tailwinds of lower interest rates and a lower NZD are starting to make themselves felt, but the global situation provides significant downside risks. We expect annual growth to slow to 1.9% by early 2020, hardly a disaster but very weak on a per capita basis. In this environment, it is likely to remain a slog getting inflation pressures up in a meaningful way over the medium term. Should downside risks to the economic outlook materialise, there is plenty of fiscal headroom (should the Government choose to use it) to help lean against the wind.



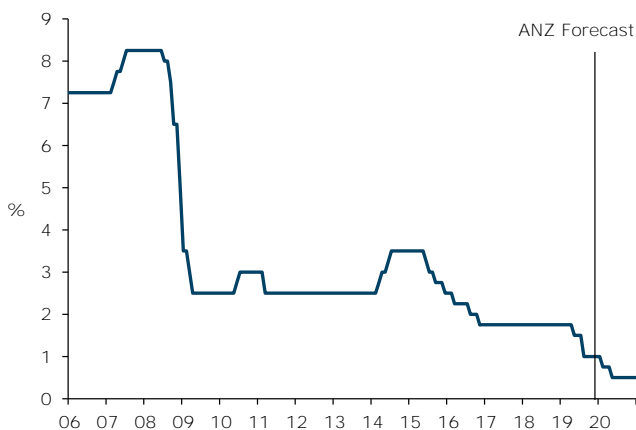
### Summary

The Official Cash Rate (OCR) has been cut 75 basis points over the past six months and mortgage rates have fallen. But because household deposits are an important source of bank funding (eg for home loans), banks have had to strike a balance, meaning both mortgage and deposit rates have fallen by less than the OCR has. And as the OCR goes lower (we're forecasting a further 50 basis point reduction by August 2020), we think the pass-through to mortgage (and deposit) rates will diminish. Indeed, **there's a real risk that if deposit rates go lower**, household deposit growth could slow markedly as depositors seek higher returns elsewhere. This would mean banks have a lower deposit base from which to provide new loans, reducing the positive impact to the housing market and broader economy. So even if the price of credit (ie the interest rate) is low, supply constraints (credit availability) can be a significant headwind.

### Passing through

The Reserve Bank of New Zealand (RBNZ) has cut the Official Cash Rate (OCR) 75 basis points to 1% over the past six months. And as GDP and inflation continues to disappoint **the RBNZ's** forecast, we expect further cuts will eventually follow. We expect 25 basis point cuts in both May and August 2020 to take the OCR to just 0.5% (figure 1).

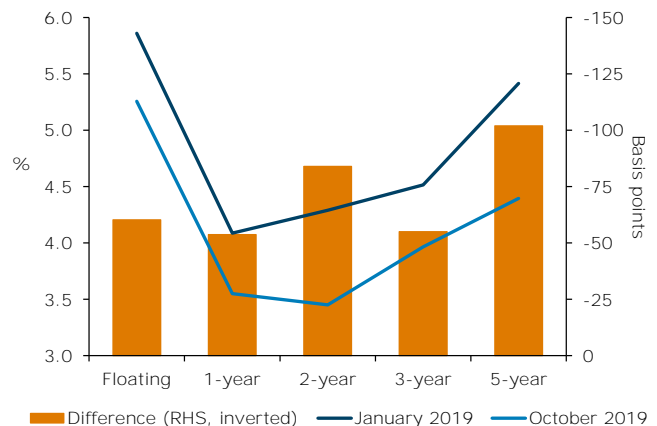
**Figure 1. Official Cash Rate**



Source: ANZ Research, Bloomberg

Mortgage interest rates have followed the OCR lower, with the average special mortgage rate offered by the main banks falling between 54 and 102 basis points across the curve in 2019 to date (figure 2). It is true that not every loan is eligible for these special rates, which generally require an LVR below 80%, and an absence of other risk factors. And while non-special rates have also fallen, they have generally done so by less. But the trend is clear across the broader market.

**Figure 2. Change in special mortgage rates in 2019**



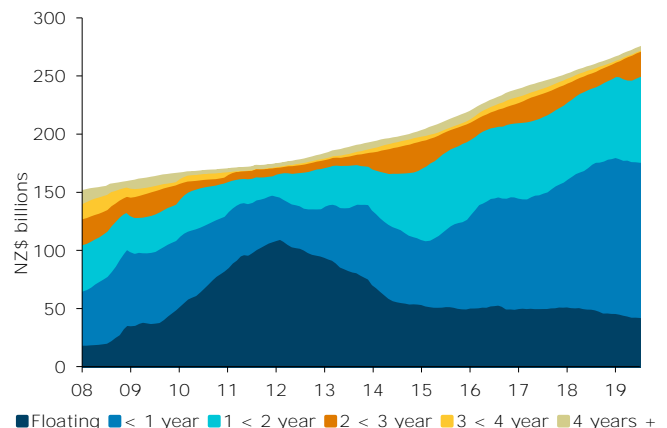
Source: ANZ Research, interest.co.nz

The above chart suggests the pass-through from the lower OCR has been quite substantial, but **it's worth** considering the composition of lending (figure 3):

- around 16% of home loans are currently on a floating rate;
- approximately 49% are fixed for less than one year;
- another 27% or so are fixed between one and two years;
- 8% are fixed between 2 and 3 years; and
- less than 1% are fixed for 4 years or more.

**That's more than 90% of loans** that are either floating or fixed for less than 2 years. Overall, when weighted by their fixed-term proportion, special mortgage rates have fallen 63 basis points so far in 2019. With the OCR down 75 basis points, this suggests the degree of pass-through **hasn't** been 1:1.

**Figure 3. Proportion of loans on fixed terms**

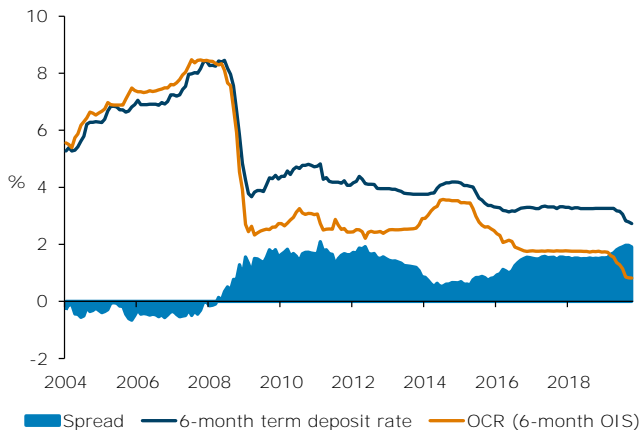


Source: RBNZ

Likewise, the pass-through to deposit holders also **hasn't been** 1:1, with the spread between deposit rates and the OCR widening as the OCR has been lowered (figure 4).



**Figure 4. Deposit OCR spread**



Source: Bloomberg

This is not a coincidence. To understand why the lower OCR **hasn't** been passed on mechanistically, it's important to understand how banks fund their lending.

### Bank funding 101

Broadly speaking, banks' business model isn't too different to that of a retailer. Like a retailer, banks buy something (in this case, money), add a mark-up (to cover expenses, tax and profits), and on-sell it. Banks 'buy' money from savers (ie pay interest to term deposit holders) and investors (ie pay a coupon to bond holders) and that provides the **lion's share** of capital out of which they can 'sell' to (write loans for) customers for house purchases, businesses and the like.

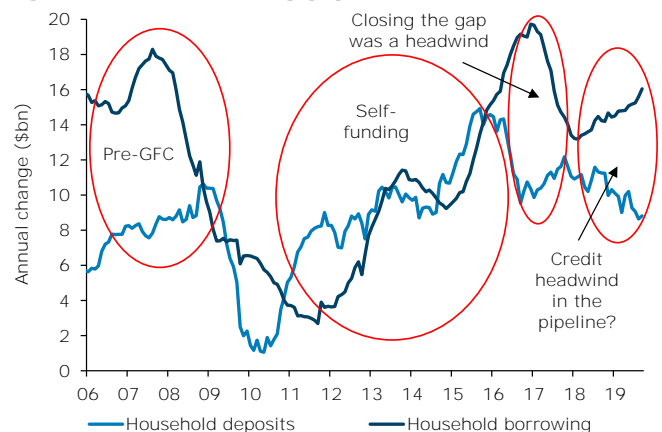
While this is very much an over-simplification, the main point is the same, regardless of how complicated you decide to make it. That is, in order to sustainably lower the price at which they 'sell' money (eg interest rates on mortgages), banks need to lower the price at which they 'buy' money, to at least some extent (eg the interest rate on term deposits). And if banks are paying a lower 'price' for money, they might not be able to get as much of it as they would like, given others are in the market to 'buy' that money too (ie depositors could take their money somewhere else – to another bank or out of the banking system entirely).

This means, rather than just mechanistically passing on the lower OCR to both savers and borrowers, banks need to consider how savers might respond. While borrowers want OCR cuts to be passed on in their entirety, those relying on interest income certainly do not. And if lower rates cause savers to take their money out of term deposit and into **equities (for example), that's a lower** household deposit base that banks can use to write new loans.

Anecdotally, we've been hearing more and more that as interest rates have fallen, some people (particularly the elderly) have been cutting back their spending owing to falling interest income. And that suggests the search for yield is likely intensifying.

In fact, household deposits data suggests lower interest rates may already be deterring households from putting their money in the bank on deposit. Meanwhile, credit growth has trended in the opposite direction. This widening 'funding gap' can be a problem for banks and would-be borrowers alike.

**Figure 5. Banks' funding gap**



Source: RBNZ, ANZ Research

As shown above, prior to the Global Financial Crisis (GFC), New Zealand banks were less dependent on **household deposits**. That's because they were heavily dependent on short-term foreign wholesale debt. In fact, **about 50% of banks' funding** was done in short-term money markets overseas. That didn't seem to be a problem. But when the GFC hit, these markets abruptly dried up, leaving banks without access to funding. This highlighted that funding 'rollover risk' was greater than had been previously realised.

Subsequently, the RBNZ introduced 'core funding ratio' requirements to limit the mismatch between the amount of funding that can be assumed to stay in **place for at least one year ('core' funding such as** term deposits and long-term wholesale debt), and the core lending business of the bank that needs to be funded on a continuing basis (eg mortgages).

That is entirely sensible as a risk-mitigation strategy. But as a result, banks have become more dependent on domestic deposits to fund their lending. That means that **households' appetite** to put their money in the bank matters more for borrowers than it used to, **as it will affect banks' ability to grow their lending**. And with a gap between deposits and credit growth recently opening up again, credit conditions appear poised to tighten. Banks could attempt to close the gap by competing more heavily for deposits (ie higher deposit and therefore mortgage rates) and/or



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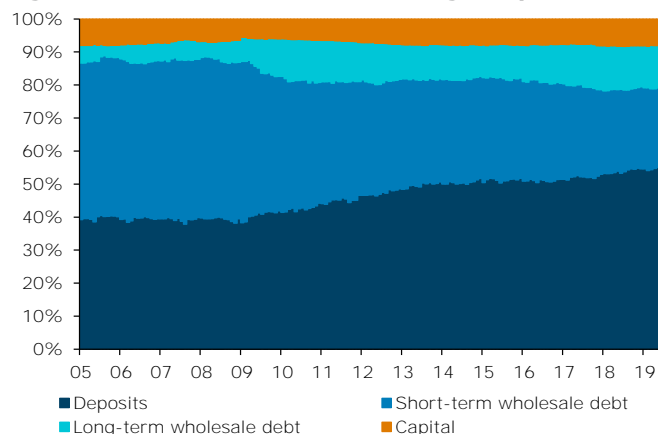
slowing the pace of lending growth. Both of these strategies will weaken the impact of a lower OCR on the housing market (while certainly not negating it).

This is the big picture simplification, but in practice it **should be noted that household deposits aren't the only game in town** when it comes to bank funding, and that the OCR is only part of bank funding costs. Depending on what else is going on in financial markets, there are other reasons why the pass-through from changes in the OCR into mortgage rates may not be 1:1. Overall, banks can fund their lending from:

- deposits from households and corporates;
- short-term wholesale debt (eg commercial paper issued overseas or domestically);
- long-term wholesale debt (ie corporate bank bonds issued overseas or domestically); and
- capital (ie equity from shareholders).

But as figure 6 shows, deposits now account for the lion's share.

**Figure 6. New Zealand banks' funding composition**



Source: RBNZ, ANZ Research

### The outlook from here

It's our expectation that economic growth will disappoint the RBNZ's expectations over the medium term (figure 7), mostly because we think there are some headwinds for business investment that the RBNZ is undercooking. And while **we don't expect** growth to roll over, we think the pace of expansion **won't be sufficient for the RBNZ to be confident of** CPI inflation returning sustainably to the midpoint of the target band in an acceptable timeframe.

That said, the RBNZ has built quite a lot of weakness into their near-term forecasts already, so it is more of a slow-burn story now than it was. Accordingly, as the data flow gradually confirms our view, we expect the RBNZ to cut the OCR further. We have 25 basis point cuts pencilled in for both May and August 2020, taking the OCR to just 0.5%.

**Figure 7. GDP growth, RBNZ vs ANZ forecast**



Source: Stats NZ, RBNZ, AND Research

While this will keep mortgage rates under pressure, the pass-through is unlikely to be 1:1 from here as banks attempt to maintain household deposit growth. However, because there is so much more to mortgage rate determination (such as other funding **sources and risk appetite**), **we can't be too** precise about how much is likely to be passed on.

It isn't on most people's radar but it is possible that in the absence of further monetary easing mortgage rates could come under upward pressure.

- First, in the aftermath of the **RBNZ's November MPS hold decision**, swap rates spiked higher, putting upward pressure on bank funding costs. The longer the lift is sustained, the greater the pressure for banks to pass it on.
- Second, as shown in figure 3, a prolonged period of 1-year fixed terms being the lowest point on the curve combined with typical seasonal summer uplifts means there is a substantial volume of fixed loans coming off their fixed terms quite soon. The impacts of all these loans looking to fix at the same time could also put upward pressure on wholesale rates.
- Another upside risk to mortgage rates stems from the **RBNZ's proposed bank capital requirements** (figure 8). The RBNZ is scheduled to announce its decision on December 5. As we have [discussed earlier in the year](#), we think the proposed changes would impact both the price and availability of credit. Mortgages would be less affected than riskier types of lending, but there would nonetheless be pressure for mortgage interest rates to lift (and deposit rates to fall) relative to wholesale rates.

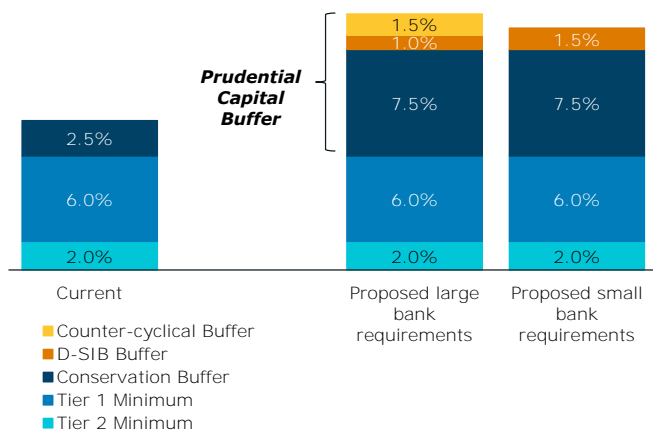




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- Deposit insurance also has the potential to impact the bank funding landscape, as it may see deposits leave banks for the highest-yielding deposit takers that are also covered by the scheme. Depending on the scope of the scheme, it may place further pressure on banks trying to attract deposit funding to enable credit growth.

**Figure 8. RBNZ proposed capital requirements**



Source: RBNZ

While the impact of future OCR cuts could be a bit more muted because of all of these impacts, we think the decline in mortgage rates to date will certainly give the housing market a boost. House prices and sales have already begun to pick up, and we expect this to persist in the months ahead. We have recently revised up our house price inflation outlook, with annual house price inflation expected to peak at 5.5% in mid-2020 (previously around 4.5%). That said, **there's a lot more to the housing market** than interest rates. Policy changes for landlords, LVR restrictions, net migration inflows, credit availability, and housing supply-side dynamics are all important. And all uncertain.

In the [October Property Focus](#), we discussed the possibility of a small loosening in LVR restrictions at the upcoming (November 27) Financial Stability Report, noting that a case can be made either way. Since then, the housing market pulse has been a little stronger than we expected, and we think this shifts the balance of probability more towards a hold in LVR restrictions for now (**but it's still a very close call**). The RBNZ will get another shot at it in May, which should be enough time for some of the dust to settle, allowing the RBNZ to make a more informed assessment. Like us, we think the RBNZ will be cognisant of the possibility that house prices could take off strongly again, and from a financial stability perspective, **that's not ideal**.

### What about negative rates?

Should downside economic risks materialise, we think the RBNZ would cut the OCR below 0.5%. In fact, a significant economic shock could see the RBNZ venture into the realm of unconventional monetary policy.<sup>1</sup> This could include taking the OCR into negative territory. However, because New Zealand banks are so reliant on household deposits and households are unlikely to accept a negative return on their savings, this limits the potential pass-through to mortgage rates. The upshot is, mortgage rates near zero or negative is very unlikely in New Zealand, even if wholesale rates entered the twilight zone.

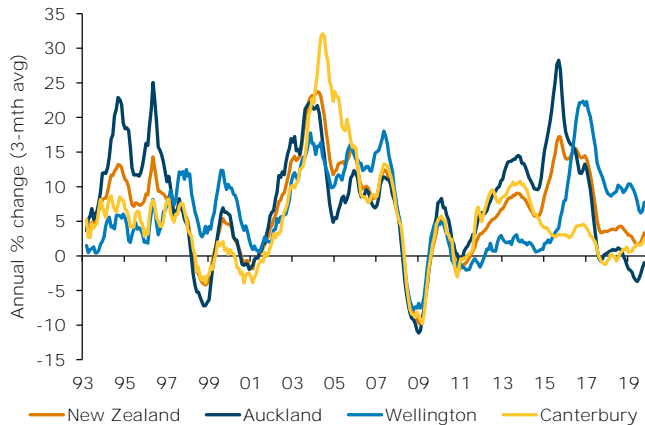
### Low for longer

All up, while we expect the RBNZ to cut the OCR further, we also think the pass-through to mortgage rates will diminish as they do. However, while funding dynamics and the regulatory landscape in New Zealand suggest **there's a natural floor in terms of** how low mortgage rates can go, the recent theme of 'low for longer' is likely to persist. And with household debt levels elevated relative to disposable incomes, any potential lift in interest rates down the track will need to be done in a very gradual manner so as to not upset the apple cart.

<sup>1</sup> For further information, see [Prospects for unconventional monetary policy in New Zealand](#)



**Figure 1. Regional house price inflation**



Source: ANZ Research, REINZ

Annual house price inflation has accelerated in recent months. Nationally, prices were up 3.3% y/y (3mma) in October, up from a recent trough of 1.6% in June. Regional divergence remains a key theme. But overall, prices have been picking up across most regions.

While we **don't expect** house price inflation to lift to double digit territory any time soon, we do acknowledge there are some upside risks to our expectation that annual house price inflation will peak at around 5.5% in 2020. Lower mortgage rates are clearly providing support, but a slowing domestic economy, prudent bank lending appetites, affordability constraints, and recent and proposed policy changes suggest upside is limited. We are not certain the RBNZ will (or should) loosen LVR restrictions later this month, **but if they do, that'll** provide an additional bump.

**Figure 2. REINZ house prices and sales**



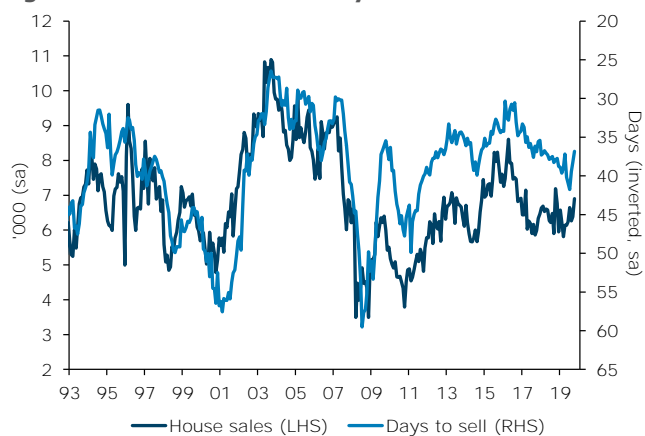
Source: ANZ Research, REINZ

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

House sales rose a solid 8.2% m/m in October (seasonally adjusted, ANZ estimate) to be down 0.1% y/y (3mma). However, the annual figure likely understates recent strength as growth in October 2018 (up 22% m/m) was bolstered by the foreign buyer ban. This will be dropping out of the annual calculation now.

**All up, while there's a little bit of noise to be looking** though, the recent lift in sales volumes suggests that housing market activity is indeed picking up.

**Figure 3. Sales and median days to sell**



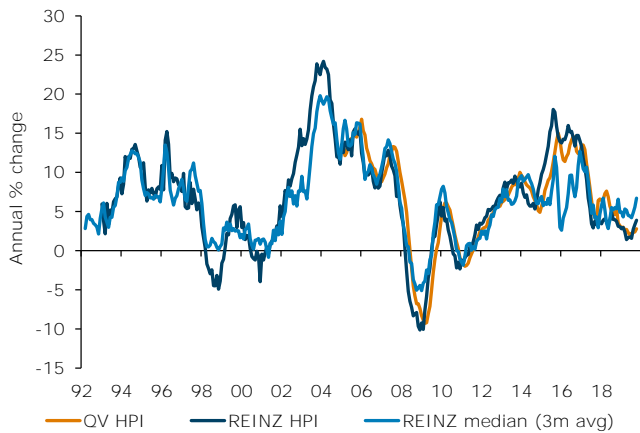
Source: ANZ Research, REINZ

How long it takes to sell a house is also an indicator of the strength of the market, encompassing both demand and supply-side considerations. Larger cities tend to see houses sell more quickly, but deviations in a region from its average provide an indicator of the heat in a market at any given time.

The number of days taken to sell a property declined further in October – at 37, it's **below its historical** average, suggesting the market is 'tight' on balance. **That said, days to sell aren't running below average** in all regions. Auckland, Northland, and Canterbury are above their historical average, but in Auckland and Canterbury a downward trend is at play. Further strength from here could see these two regions characterised as 'tight on balance' too.



**Figure 4. REINZ and QV house prices**

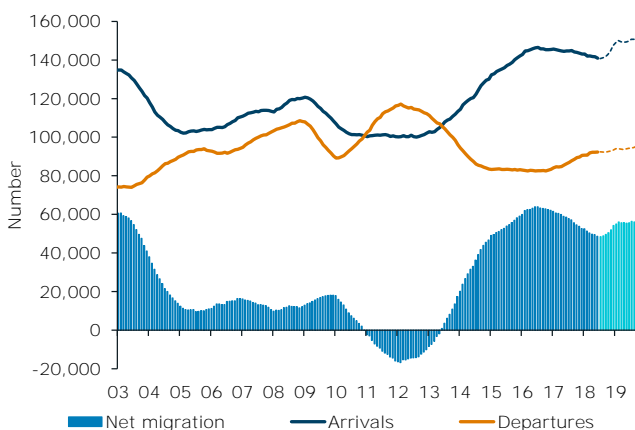


Source: ANZ Research, REINZ, QVNZ

There are three monthly measures of house prices in New Zealand: the median and house price index measures produced by REINZ, and the monthly QVNZ house price index. The latter tends to lag the other measures as it records sales later in the transaction process. Moreover, movements do not line up exactly, given differing methodologies (the REINZ house price index and QVNZ measures attempt to adjust for the quality of houses sold).

The REINZ HPI – our preferred measure – is sitting at 3.3% y/y (3mma) for October. The QVNZ measure has ticked up for a fourth consecutive month to 2.8% y/y, and the REINZ median lifted for a third consecutive month to 6.7%.

**Figure 5. Annual migration\***



Source: Statistics NZ

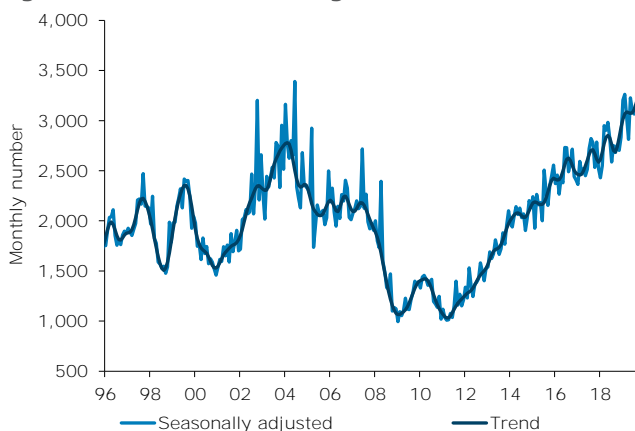
\*Dotted lines show the last nine months of data, which are subject to substantial revisions. The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data.

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

Annual net migration reportedly levelled off at around 53,500 in September but Statistics NZ's data is now subject to substantial revision. To avoid unnecessary noise in our economic outlook we're now forecasting net migration with a lag (between 9-12 months), ie not using the most recent reported data.

The older, more reliable data suggest the cycle was still easing into mid-2018. We think a gradual easing trend will set in for the rest of 2019 and beyond.

**Figure 6. Residential building consents**



Source: ANZ Research, Statistics NZ

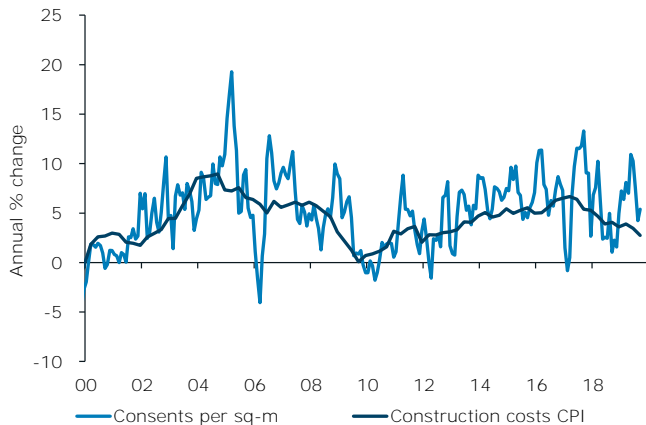
Residential building consents lifted a robust 7.2% m/m in September, led by volatile multi-unit dwellings. **Given construction firms' activity expectations have turned sour of late, we'll be watching this one closely.** Annual consent issuance is still very strong, running at 36,410, well above the previous mid-2000s peak (33,200). Growth in Auckland consents continues to provide impetus, with annual consents up over the 14k mark, and still rising. The trend in Canterbury consents turned a corner in early 2018 following a sustained period of weakness.

Overall, housing demand should be supportive of further construction activity. However, capacity constraints are rife and profit challenges are ongoing, which we expect will make it difficult for issuance to push too much higher.





**Figure 7. Construction cost inflation**

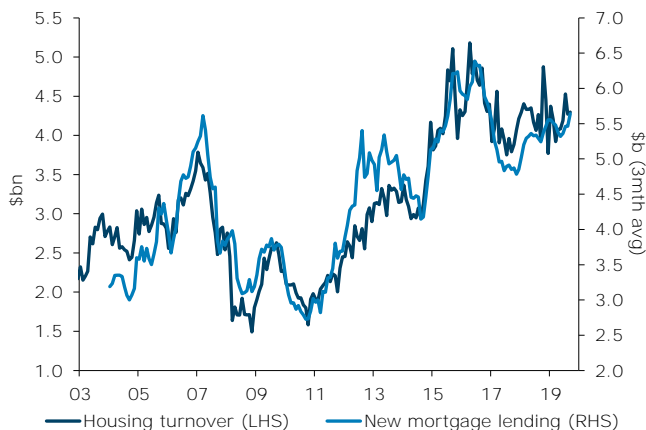


Source: ANZ Research, Statistics NZ

Construction cost inflation has softened since 2017 and we don't expect it to reach the dizzying heights (6.7% y/y) achieved over 2016-2017 in this cycle. Growth in the cost of consented work per square metre – a proxy – was 5.4% y/y (3mma) in September, but has been particularly volatile of late. CPI construction cost inflation eased further to 2.8% y/y in the September quarter.

Capacity pressures in the industry remain acute, which should continue to support price rises. But with construction growth slower than in recent years, and caution among firms regarding the pipeline of work, we don't expect construction cost inflation to surge higher from here.

**Figure 8. New mortgage lending and housing turnover**



Source: ANZ Research, RBNZ

New residential mortgage lending figures are published by the RBNZ. These are gross (rather than net) flows and can provide leading information on household credit growth and housing market activity.

New mortgage lending moves closely with new house sales. New lending rose 9.4% m/m (sa) in September, although the data can be volatile: this was off the back of a 6.9% decline in August. That said, annual growth ticked up to 7.1% in September from 3.1% in August. From here, any further loosening of the LVR restrictions might provide a boost, if delivered, but credit headwinds may see this peter out eventually.

**Figure 9. New mortgage lending and housing credit**



Source: ANZ Research, REINZ, RBNZ

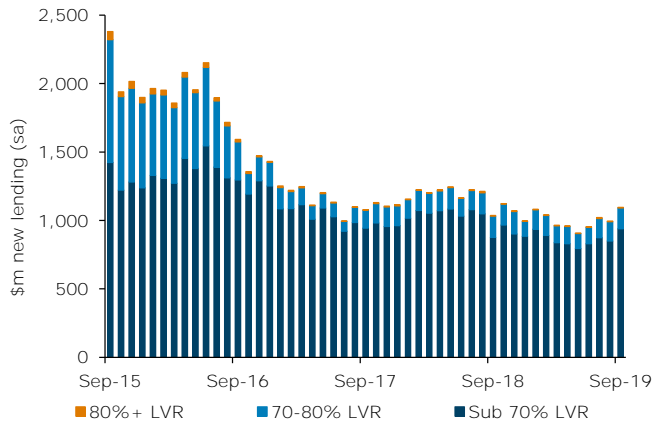
Household credit has been growing at a relatively steady pace for the past year or so. In seasonally adjusted terms, household lending lifted 0.5% m/m to be up 6.2% y/y in September.

There are tentative signs that housing credit growth is gradually accelerating as the housing market picks up. However, given banks are expected to continue behaving prudently, investors are wary, and loan-to-value ratio restrictions are expected to still have a dampening influence on credit availability (even if loosened slightly), we think the upside is capped.

**Proposed tightening in banks' capital requirements** would also create headwinds, if implemented. On the whole, we expect credit growth will continue to grow modestly from here.



**Figure 10. Investor lending by LVR**

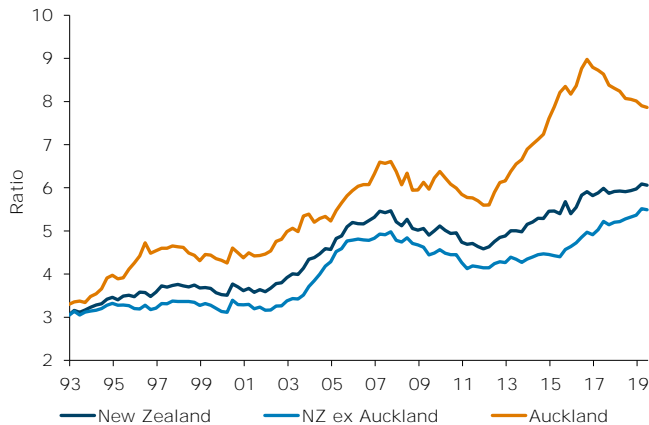


Source: ANZ Research, RBNZ

On a seasonally adjusted basis, new lending to investors was up a solid 14% in September to be up 5.9% y/y. Looking though the monthly volatility, new lending to investors has been trending broadly sideways over 2019. Underlying this, investors remain wary, which is weighing on the housing market. About 19% of new loans were to investors in September, down from an average of 22% over 2018 and well below 2016 peaks of almost 35%.

The share of investor lending on riskier terms remains low. The share of investor lending at loan-to-value ratios of less than 70% is sitting above 85%. In late-2014 it was about half.

**Figure 11. Regional house prices to income**

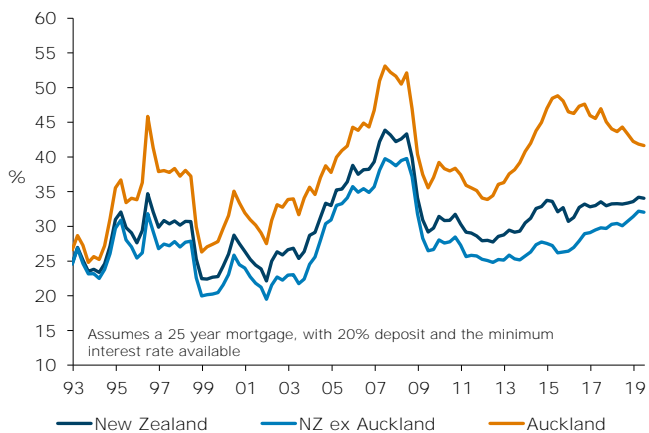


Source: ANZ Research, REINZ, Statistics NZ

One commonly cited measure of housing affordability is the ratio of average house prices to incomes. It is a standard measure used internationally to compare **housing affordability across countries. It isn't perfect;** it does not take into account things like average housing size and quality, interest rates, and financial liberalisation. Therefore, it is really only a partial gauge as some of these factors mean that it is logical for this ratio to have risen over time.

Nationally, the ratio has been stable at around 6 times income since early 2017. Auckland has seen its ratio ease from 9 times in 2016 to an estimated 7.9 times (revised from previous estimate) in Q2 2019, reflecting easing house prices from recent highs. Excluding Auckland, the ratio has continued to rise; at 5.5 times incomes this is at record highs, and about where the national average peaked last cycle.

**Figure 12. Regional mortgage payments to income**



Source: ANZ Research, REINZ, RBNZ, Statistics NZ

Another, arguably more comprehensive, measure of housing affordability is to look at it through the lens of debt serviceability, as this also takes into account interest rates, which are an important driver of housing market cycles.

We estimate that for a purchaser of a median-priced home (20% deposit), the average mortgage payment to income nationally is 34%. However, there are stark regional differences. In Auckland it is 44% and the rest of New Zealand it is 31%. This is not far from historic highs in Auckland, despite mortgage rates being very low. Debt levels are high nationwide. And while home ownership is being made more affordable by low mortgage rates, households could be vulnerable in the event of a lift in interest rates.



## Property gauges

Evidence that the housing market is tightening up on the back of lower mortgage rates has continued to accumulate. House price inflation has accelerated, up 3.3% y/y at the national level in October. And while regional divergence remains a key theme, most regions are displaying evidence of some tightening. House sales (up 8.2% m/m) are now picking up after a prolonged period of softness, and nationwide days to sell have dropped further below their historical average (to 37). We expect the recent decline in mortgage rates will continue to provide impetus to the housing market, with annual house price inflation peaking at 5.5% in 2020 – a small upgrade since the October Property Focus. We think resurgence in the housing market weakens the case for the RBNZ to loosen LVRs next week. That said, policy, credit, and affordability headwinds are still expected to prevent the housing market from shooting to the moon once again, but that possibility **can't be completely ruled out**.

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

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

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

**Interest rates.** Interest rates affect both the affordability of new houses and the serviceability of debt.

**Migration.** A key source of demand for housing.

**Supply-demand balance.** We use dwelling consents issuance to proxy growth in supply. Demand is derived via the natural growth rate in the population, net migration, and the average household size.

**Consents and house sales.** These are key gauges of activity in the property market.

**Liquidity.** We look at growth in private sector credit relative to GDP to assess the availability of credit in supporting the property market.

**Globalisation.** We look at relative property price movements between New Zealand, the US, the UK, and Australia, in recognition of the important role that global factors play in New Zealand's property cycle.

**Housing supply.** We look at the supply of housing listed on the market, recorded as the number of months needed to clear the housing stock. A high figure indicates that buyers have the upper hand.

**House prices to rents.** We look at median prices to rents as an indicator of relative affordability.

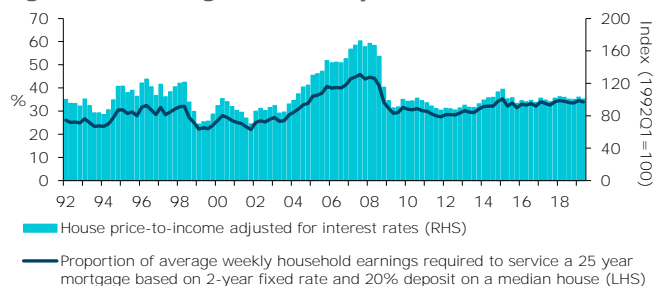
**Policy changes.** Government and macro-prudential policy can affect the property market landscape.

| Indicator                    | Level                                    | Direction for prices | Comment   |
|------------------------------|--|----------------------|---|
| Affordability                | Unaffordable                             | ↔/↓                  | Affordability constraints are very relevant. It started with Auckland; several other regions have joined the party.   |
| Serviceability/ indebtedness | High debt, low rates OK – high rates not | ↔/↓                  | Serviceability looks okay provided interest rates stay low and income growth is solid. Debt levels are high.  |
| Interest rates / RBNZ        | More cuts coming                         | ↔/↑                  | We see the OCR falling to 0.5% by August 2020, but pass-through to retail rates is likely to diminish with each cut.  |
| Migration                    | Peaked                                   | ↔/↑                  | Migration remains elevated. Latest data suggests net inflows are holding up, but the data is prone to very large revisions.                                       |
| Supply-demand balance        | Demand > Supply                          | ↔/↑                  | MBIE estimates New Zealand is short 71k houses, but the build-up of pent-up demand is becoming less pronounced.   |
| Consents and house sales     | Shortage                                 | ↔/↑                  | We expect consents issuance will struggle to push higher, with the construction sector reaching its limits.   |
| Liquidity                    | Set to tighten                           | ↔/↓                  | Credit availability is very relevant. Banks have plenty of cash currently, but know they have to raise a lot more capital.  |
| Globalisation                | Weak                                     | ↔/↓                  | The foreign-buyer ban has stymied demand from non-residents. The housing market is weak, but tentatively recovering in Australia.                                 |
| Housing supply               | Too few                                  | ↔/↑                  | The Government is going to take a more active role, but there are still questions about crowding out other work and labour shortages.                             |
| House prices to rents        | Too high                                 | ↔/↓                  | Rents are moving up, with pressures on the existing stock apparent. Buying remains relatively expensive.  |
| Policy changes               | Dampening                                | ↔/↓                  | Government policy changes are making investors wary. Easing in loan-to-value restrictions and the ruling out of a capital gains tax has provided a slight offset. |
| <b>On balance</b>            | <b>In recent ranges</b>                  | ↔/↓                  | <b>We think the upside to the medium-term outlook is capped, but a near-term pick-up is looking more likely.</b>  |

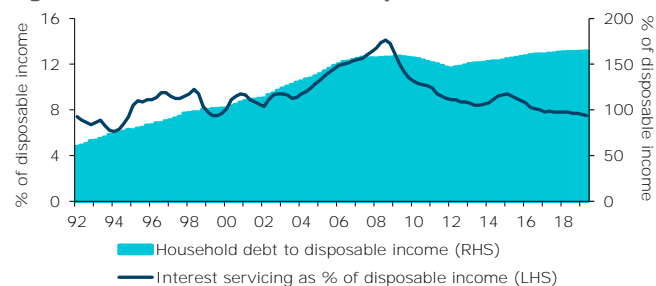


## Property gauges

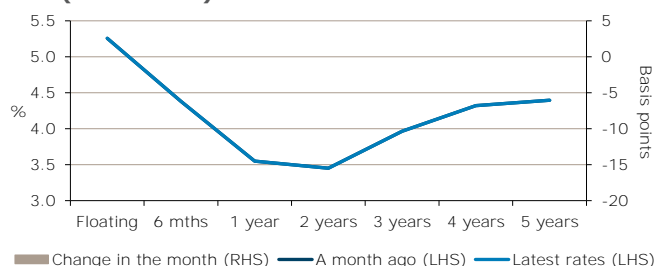
**Figure 1: Housing affordability**



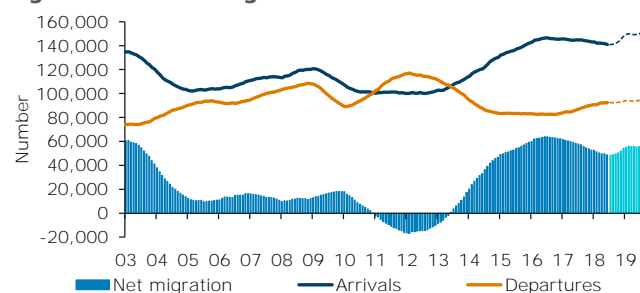
**Figure 2: Household debt to disposable income**



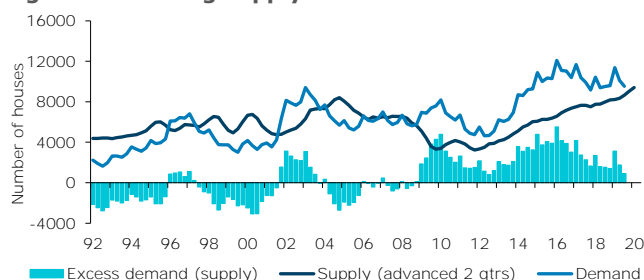
**Figure 3: New customer average residential mortgage rate (<80% LVR)**



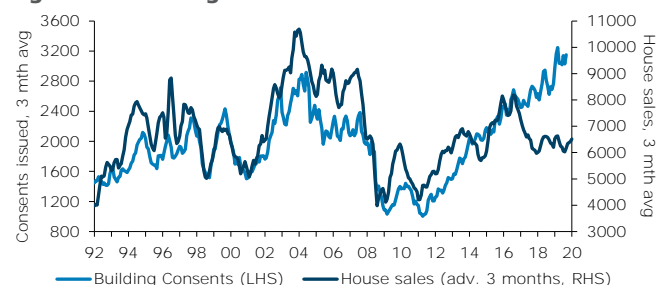
**Figure 4: Annual migration\***



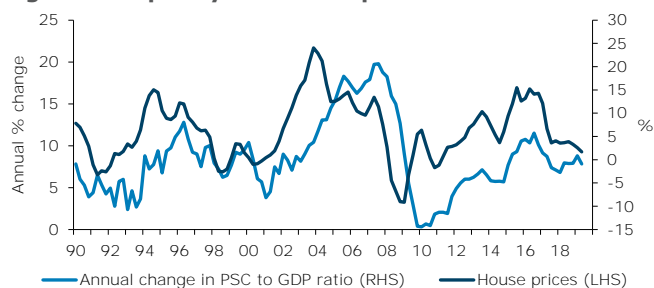
**Figure 5: Housing supply-demand balance**



**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 Research, Statistics NZ, REINZ, RBNZ, QVNZ, Nationwide, Bloomberg, Barfoot & Thompson, MBIE

\* Dotted lines show the last nine months of data, which we look through because they are subject to substantial revisions. The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data.



## Economic overview

### Summary

The New Zealand economy continues to gradually lose momentum. Leading indicators suggest the economy will continue to gradually slow at least until early 2020, though there are early signs the decline is easing (stabilising business sentiment, lifting housing). Headwinds, including wary businesses, tighter credit availability and labour shortages look set to persist. The tailwinds of lower interest rates and a lower NZD are starting to make themselves felt, but the global situation provides significant downside risks. We expect annual growth to slow to 1.9% by early 2020, hardly a disaster but very weak on a per capita basis. In this environment, it is likely to remain a slog getting inflation pressures up in a meaningful way over the medium term. Should downside risks to the economic outlook materialise, there is plenty of fiscal headroom (should the Government choose to use it) to help lean against the wind.

### Our view

The pace of economic expansion halved over the three years to June 2019. And the forward indicators we monitor suggest this subdued rate of growth will persist at least into early 2020. Beyond that, things are looking likely to improve.

We expect annual GDP growth will slow to 1.9% by the start of next year before gradually picking up over the rest of 2020.

Monetary conditions have eased substantially. We are more confident that lower interest rates will boost the housing market than business investment. However, the trade-offs between inflation targeting and financial stability are acute, with household debt and house prices already eye-wateringly high. The challenge for the RBNZ is delivering on its inflation mandate without contributing to heightened financial stability risks. And **it's for this reason that we expect** further loosening in LVR restrictions will be gradual. Given the housing market strength evident in recent data, an easing this month is now looking less likely.

In addition to low interest rates, the fundamentals for growth remain intact: household sentiment is holding up, the labour market is tight, real incomes are gradually lifting, **world prices for New Zealand's** exports are at a high level, and the lower NZD is providing exporters a further income boost.

However, much of the export price strength is owing to supply-side factors (soft global dairy production and the devastating impact of African swine fever on **China's pig population**). Meanwhile, the global data pulse remains soft. Yes, global sentiment has improved a little in recent weeks – partly as

expectations for a 'phase one' trade deal between China and the US have lifted – but the majority of global activity indicators are yet to recover.

**While we don't expect growth to roll over, we do** think the outlook is inconsistent with a sufficient build-up in inflation pressures. We do expect that the RBNZ will be disappointed by **the economy's growth** performance, particularly the response of business investment to lower interest rates.

However, now that the RBNZ have downgraded their near-term growth outlook substantially, and also revised down their estimate of how much growth is needed to generate inflation pressure, this is more of a medium-term story. We are therefore forecasting two further rate cuts in May and August next year, taking the OCR to 0.5%, with the balance of risks tilted to earlier and/or more.

One of these cuts is, as before, a placeholder for the **need to offset the impact of the RBNZ's bank capital** proposals (to be announced on 5 December). Our expectation is that this will lead to higher-than-otherwise interest rates and/or reduced credit availability. We will revise our forecasts once the details of this important policy are known in early December.

All up, **it's** still a fair assessment to say that risks to the economic outlook (both domestic and global) are skewed to the downside. Domestically (and on top of possible bank capital-induced credit headwinds), there are some signs that employment growth will disappoint in the near term. Surveyed employment intentions in the manufacturing, services, and construction sectors are all weak. And **that's a threat** to household incomes, sentiment, and spending. Likewise for the global economy, the risk remains that weakening manufacturing, trade, and business **investment spreads to what's** currently a pretty robust backdrop for households.

With monetary policy poised to approach its conventional limits, and risks to the growth outlook skewed firmly to the downside, there is likely to be increasing pressure for the Government to be ready to use its fiscal firepower to lean against the wind should things deteriorate rapidly. But unless the Government suspends or adjusts its self-imposed debt target, it looks like the bulk of any fiscal bump to growth is now in the rear-view mirror.





## Key forecasts

Weekly mortgage repayments table (based on 25-year term)

|                        |       | Mortgage Rate (%) |       |       |       |       |       |       |       |       |       |       |       |       |       |
|------------------------|-------|-------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                        |       | 3.00              | 3.25  | 3.50  | 3.75  | 4.00  | 4.25  | 4.50  | 4.75  | 5.00  | 5.25  | 5.50  | 5.75  | 6.00  | 6.25  |
| Mortgage Size (\$'000) | 200   | 219               | 225   | 231   | 237   | 243   | 250   | 256   | 263   | 270   | 276   | 283   | 290   | 297   | 304   |
|                        | 250   | 273               | 281   | 289   | 296   | 304   | 312   | 320   | 329   | 337   | 345   | 354   | 363   | 371   | 380   |
|                        | 300   | 328               | 337   | 346   | 356   | 365   | 375   | 385   | 394   | 404   | 415   | 425   | 435   | 446   | 456   |
|                        | 350   | 383               | 393   | 404   | 415   | 426   | 437   | 449   | 460   | 472   | 484   | 496   | 508   | 520   | 532   |
|                        | 400   | 437               | 450   | 462   | 474   | 487   | 500   | 513   | 526   | 539   | 553   | 566   | 580   | 594   | 608   |
|                        | 450   | 492               | 506   | 520   | 534   | 548   | 562   | 577   | 592   | 607   | 622   | 637   | 653   | 669   | 684   |
|                        | 500   | 547               | 562   | 577   | 593   | 609   | 625   | 641   | 657   | 674   | 691   | 708   | 725   | 743   | 761   |
|                        | 550   | 601               | 618   | 635   | 652   | 669   | 687   | 705   | 723   | 741   | 760   | 779   | 798   | 817   | 837   |
|                        | 600   | 656               | 674   | 693   | 711   | 730   | 750   | 769   | 789   | 809   | 829   | 850   | 870   | 891   | 913   |
|                        | 650   | 711               | 730   | 750   | 771   | 791   | 812   | 833   | 854   | 876   | 898   | 920   | 943   | 966   | 989   |
|                        | 700   | 766               | 787   | 808   | 830   | 852   | 874   | 897   | 920   | 944   | 967   | 991   | 1,015 | 1,040 | 1,065 |
|                        | 750   | 820               | 843   | 866   | 889   | 913   | 937   | 961   | 986   | 1,011 | 1,036 | 1,062 | 1,088 | 1,114 | 1,141 |
| 800                    | 875   | 899               | 924   | 948   | 974   | 999   | 1,025 | 1,052 | 1,078 | 1,105 | 1,133 | 1,160 | 1,188 | 1,217 |       |
| 850                    | 930   | 955               | 981   | 1,008 | 1,035 | 1,062 | 1,089 | 1,117 | 1,146 | 1,174 | 1,204 | 1,233 | 1,263 | 1,293 |       |
| 900                    | 984   | 1,011             | 1,039 | 1,067 | 1,095 | 1,124 | 1,154 | 1,183 | 1,213 | 1,244 | 1,274 | 1,306 | 1,337 | 1,369 |       |
| 950                    | 1,039 | 1,068             | 1,097 | 1,126 | 1,156 | 1,187 | 1,218 | 1,249 | 1,281 | 1,313 | 1,345 | 1,378 | 1,411 | 1,445 |       |
| 1000                   | 1,094 | 1,124             | 1,154 | 1,186 | 1,217 | 1,249 | 1,282 | 1,315 | 1,348 | 1,382 | 1,416 | 1,451 | 1,486 | 1,521 |       |

Housing market indicators for October 2019 (based on REINZ data)

|                                | Median house prices |            | No of sales (sa) | Mthly % chg | Avg days to sell (sa) |
|--------------------------------|---------------------|------------|------------------|-------------|-----------------------|
|                                | Ann % chg           | 3mth % chg |                  |             |                       |
| Northland                      | 9.5                 | 6.8        | 215              | +16%        | 65                    |
| Auckland                       | 0.7                 | 0.0        | 2,090            | +6%         | 39                    |
| Waikato                        | 9.8                 | 3.3        | 712              | +4%         | 40                    |
| Bay of Plenty                  | 8.0                 | 5.2        | 544              | +13%        | 41                    |
| Gisborne                       | 37.0                | 3.2        | 48               | +19%        | 39                    |
| Hawke's Bay                    | 16.3                | 6.6        | 232              | +3%         | 30                    |
| Manawatu-Whanganui             | 21.3                | 7.1        | 360              | +6%         | 28                    |
| Taranaki                       | -0.8                | 6.3        | 148              | -15%        | 33                    |
| Wellington                     | 7.3                 | 2.2        | 695              | +2%         | 31                    |
| Tasman, Nelson and Marlborough | 10.0                | 3.8        | 254              | +26%        | 29                    |
| Canterbury                     | -0.3                | 1.0        | 918              | +2%         | 37                    |
| Otago                          | 15.3                | 7.1        | 366              | -9%         | 33                    |
| West Coast                     | 13.4                | 2.2        | 37               | -5%         | 49                    |
| Southland                      | 24.4                | 9.0        | 156              | +11%        | 23                    |
| <b>New Zealand</b>             | <b>8.1</b>          | <b>3.5</b> | <b>6,903</b>     | <b>+8%</b>  | <b>37</b>             |

## Key forecasts

| Economic indicators          | Actual |        |        | Forecasts |        |        |        |        |        |        |
|------------------------------|--------|--------|--------|-----------|--------|--------|--------|--------|--------|--------|
|                              | Dec-18 | Mar-19 | Jun-19 | Sep-19    | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 |
| GDP (Ann % Chg)              | 2.4    | 2.5    | 2.1    | 2.2       | 2.0    | 1.9    | 2.0    | 2.2    | 2.2    | 2.3    |
| CPI Inflation (Annual % Chg) | 1.9    | 1.5    | 1.7    | 1.5(a)    | 1.6    | 2.0    | 1.8    | 1.7    | 1.7    | 1.7    |
| Unemployment Rate (%)        | 4.3    | 4.2    | 3.9    | 4.2(a)    | 4.3    | 4.4    | 4.4    | 4.5    | 4.5    | 4.5    |
| House Prices (Annual % Chg)  | 3.3    | 2.7    | 1.6    | 2.6(a)    | 3.8    | 4.1    | 5.5    | 4.7    | 3.3    | 2.9    |
| Interest rates (RBNZ)        | Dec-18 | Mar-19 | Jun-19 | Sep-19    | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 |
| Official Cash Rate           | 1.75   | 1.75   | 1.50   | 1.00      | 1.00   | 1.00   | 0.75   | 0.50   | 0.50   | 0.50   |
| 90-Day Bank Bill Rate        | 2.0    | 1.9    | 1.6    | 1.2       | 1.2    | 1.1    | 0.9    | 0.7    | 0.7    | 0.7    |
| Floating Mortgage Rate       | 5.8    | 5.8    | 5.7    | 5.5       | 5.5    | 5.5    | 5.2    | 5.0    | 5.0    | 5.0    |
| 1-Yr Fixed Mortgage Rate     | 4.8    | 4.7    | 4.6    | 4.4       | 4.6    | 4.5    | 4.3    | 4.2    | 4.2    | 4.2    |
| 2-Yr Fixed Mortgage Rate     | 4.9    | 4.8    | 4.7    | 4.5       | 4.6    | 4.5    | 4.4    | 4.4    | 4.4    | 4.4    |
| 5-Yr Fixed Mortgage Rate     | 5.6    | 5.4    | 5.0    | 5.0       | 5.1    | 5.1    | 5.0    | 5.1    | 5.2    | 5.2    |

Source: ANZ Research, Statistics NZ, RBNZ, REINZ



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