New Zealand Property Focus

A new lease on life

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INSIDE

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Summary

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

Feature Article: A new lease on life

Rental inflation has been trending higher recently, with policy changes aimed at making property investment less attractive playing a role. Rental affordability has not worsened in aggregate, but some households will nonetheless be feeling the pinch. Going forward, waning population growth is likely to see pressure on rents subside somewhat. Yet with the pipeline of policy changes continuing, including possible extension of capital income taxation, rental inflation is likely to remain solid as investors attempt to maintain returns. Overall, we expect the recent trend of rental inflation outpacing house price inflation to continue for a while yet. Headwinds are expected to continue to act on the market for existing housing, while property investors attempt to recoup some yield by increasing rents.

Property gauges

House sales rebounded in January, with easing in loan-to-value ratio restrictions perhaps playing a role. But looking thorough volatility, the trend in sales has been fairly flat since mid-2017. House prices firmed through the end of the year, with falls in mortgage rates providing a boost. But this firming is expected to be short-lived, with price pressures expected to be limited by headwinds. Demand pressures are not building as they once were, though there is some uncertainty about the impulse from migration. Meanwhile, banks are prudent, investors are wary, and expectations of buyers and sellers are adjusting to be more in sync, especially with affordability constraints being felt. The pipeline of proposed Government policy changes (and associated uncertainty) could add to a more challenging outlook, and increases in bank capital requirements could see credit conditions tighten, if implemented.

Economic overview

Global growth is slowing and downside risks are at the fore, leading to increased caution from central banks. Encouragingly, our commodity prices have been defying gravity, with no signs that waning Chinese demand is flowing through to demand for our exports – at least not yet. The RBNZ has signalled a more cautious tone, though OCR increases are still expected eventually based on their current projections. We, on the other hand, think that the next move in the OCR is more likely to be down than up. This reflects a more pessimistic view of the domestic growth outlook. We think the economy will need a further nudge from monetary stimulus to push inflation closer to target and see the labour market remain near maximum sustainable employment. In terms of risks, ructions in markets or worsening global conditions could see a cut eventuate sooner, but upside risks to inflation could see the RBNZ hold off cuts for longer than we currently expect.

Feature Article: A new lease on life

Summary

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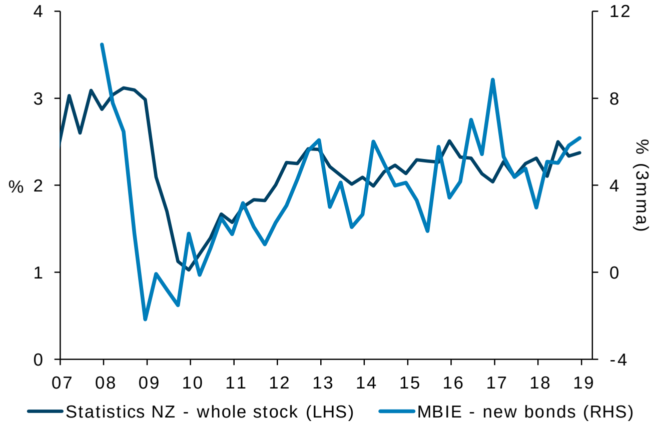
Rental inflation has accelerated

The pace of rental inflation has been trending higher in recent years. Based on the Consumer Price Index (CPI), there has been a gradual but unremarkable uptrend – reaching 2.4% y/y at the end of 2018 (figure 1). However, CPI data aggregates rents across the entire rental stock (both private and government-provided), masking a recent acceleration in rents faced by those who are entering the rental market or moving properties. MBIE data capture rents charged on new tenancy bonds lodged in the private rental market. Based on this data, rental inflation has accelerated to 6% y/y in recent months, after moderating over 2017.

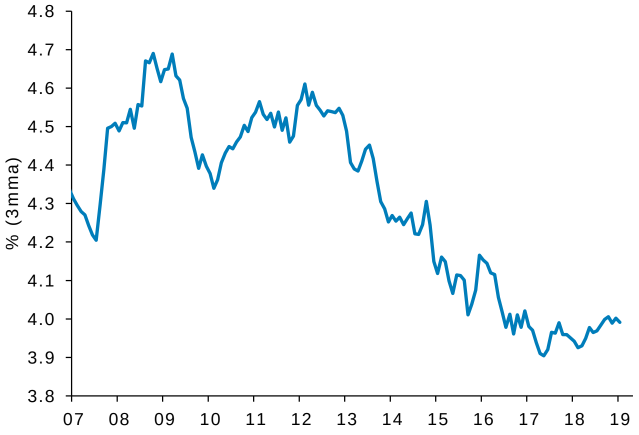
Rental inflation is determined by current demand and supply of physical housing, taking into account policy settings and costs associated with property investment. Over recent years, there has been pent-up demand for housing, on account of strong population growth. The resulting pressures on the housing stock saw rental inflation peak at almost 9% y/y in 2016. However, since then, the impetus has waned on account of abating migration inflows. Indeed, newly released data from Statistics NZ suggests that migration flows may have declined more than previously thought, though this data is subject to revision and relatively untested.

Figure 1. Rental inflation in New Zealand



Source: MBIE, Statistics NZ

Figure 2. Rental yields (annual)



Source: MBIE, REINZ

With pent-up demand providing less of an impetus, the uptrend in rental inflation over the past year likely reflects the evolving policy landscape. The calculus for property investment is gradually changing. The bright-line capital gains test has been extended from two years to five, ring-fencing of losses has been proposed, and changes to landlord obligations are underway. Meanwhile, the prospect of a capital gains tax looms large. All of these changes will make property investment less profitable. As a result, landlords have more incentive to push up rents to maintain yields.

Rental yields – returns relative to house prices – have indeed nudged up a touch recently (figure 2). This reflects the recent increase in rental inflation, while house price inflation has been running at more modest rates of around 3% y/y (REINZ). House prices and rents often move differently. Houses are long-lived assets that provide a stream of imputed or actual rents, meaning that house prices capture both current and future demand and supply of housing. Relative to rents, house prices are also affected by expectations of population growth, the responsiveness of future housing supply, credit availability and interest rates.

Feature Article: A new lease on life

The recent nudge up in rental yields has occurred after a trend decline over the past decade, consistent with the fall in interest rates over this time. As interest rates fall, future benefits associated with home ownership become more attractive (both relative to other investments and due to lower mortgage costs). As a result, house prices rise and rental yields fall (even if rents themselves are unchanged or increasing). Up until recently, with interest rates in a holding pattern, rental yields were fairly flat.

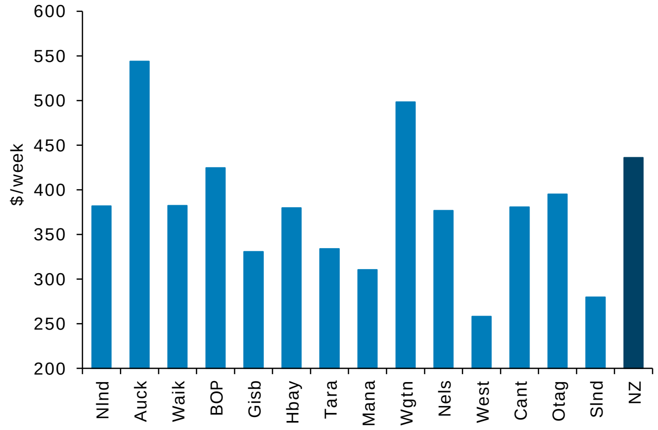
Housing costs in perspective

Approximately one-third of homes are rented in New Zealand.[1] And while the cost of renting has not increased to the same extent as the cost of purchasing a home over the past few decades, some households will nonetheless be feeling the pinch from higher rental costs.

Household income growth has kept pace with rental inflation in aggregate, meaning aggregate rental affordability has not worsened *per se*. But distribution matters, since households on lower incomes are more likely to rent than own their own home – and often spend a larger proportion of their income on housing costs. According to the Household Expenditure Survey, 47% of those who do not own their own home spent more than a quarter of their income on housing in the year to June 2018, compared with just 23% of home owners. Higher rental costs are likely seeing some renters cut back on other types of spending.

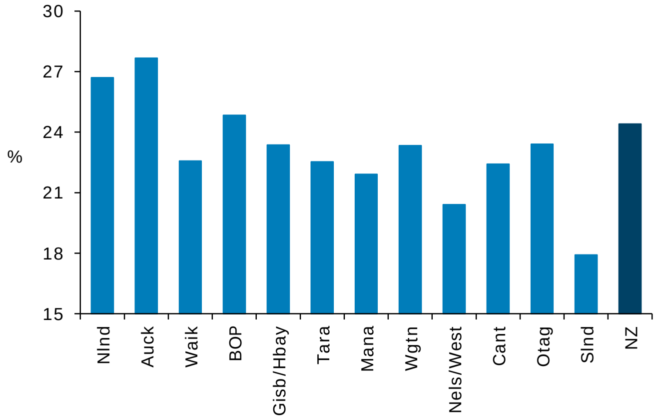
Rents – and housing costs in general – tend to be higher in urban centres, partly because incomes are higher there (figure 3). But households spend more as a proportion of their incomes there too. Higher willingness to pay likely reflects agglomeration benefits of living in these centres: more amenities, greater opportunities, and larger and more diverse communities. Depending on the region, median weekly rents comprise between 18-28% of total household incomes (figure 4). These proportions have been fairly stable over time.

Figure 3. Rents by region (January 2019)



Source: MBIE

Figure 4. Median rent to income (June 2018)



Source: MBIE, Statistics NZ

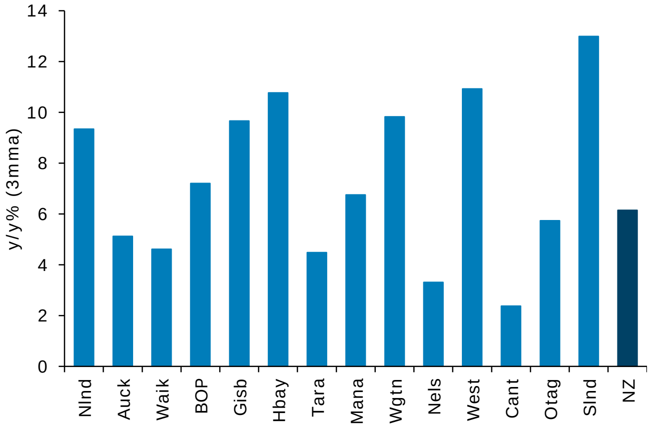
Recent developments by region

Rental inflation has varied considerably by region over the past year. Particularly strong increases have been seen in Northland, Gisborne, Hawke's Bay, Wellington, West Coast and Southland (figure 5). However, rental inflation can be volatile, especially in smaller regions – so regional comparisons like this can change quickly.

[1] Based on private dwelling estimates from Statistics NZ for December 2018.

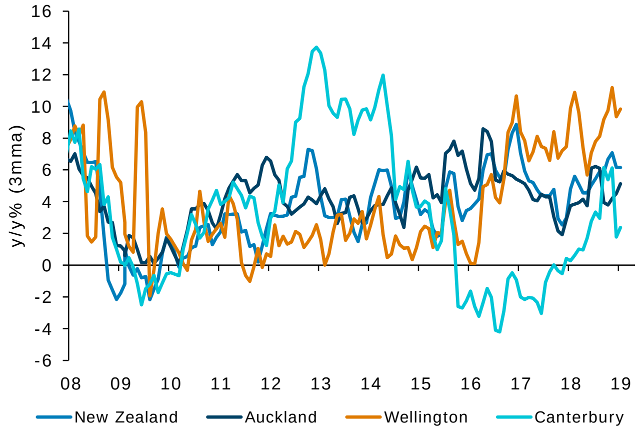
Feature Article: A new lease on life

Figure 5. Rental inflation by region (January 2019)



Source: MBIE

Figure 6. Rental inflation by region



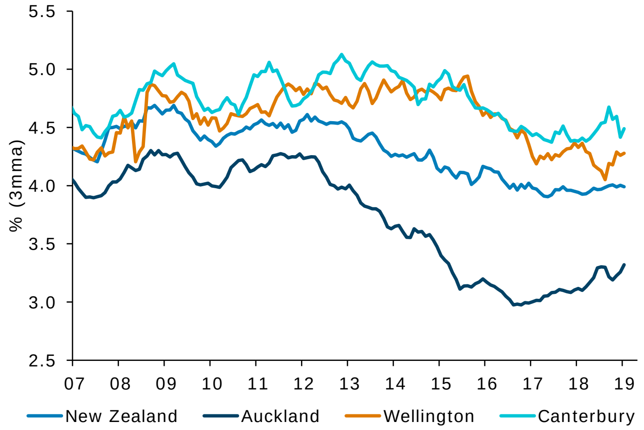
Source: MBIE

Amongst urban centres, rental inflation has been strongest in Wellington over the past few years (figure 6). This reflects solid population growth and a strong regional economic performance, while fiscal spending has been on the increase. A catch-up dynamic has also been at play; rents in Wellington grew more slowly than in the rest of the country between 2011 and 2016 – not coincidentally, a period of fiscal consolidation.

Rents in Canterbury have moved out of step with the rest of the country, reflecting region-specific issues following the Canterbury earthquakes. Following the earthquakes, rental inflation increased strongly as a result of physical housing shortages. Rental inflation has since been subdued (and fallen at times) as the housing stock has been replenished and the rebuild workforce has gradually declined.

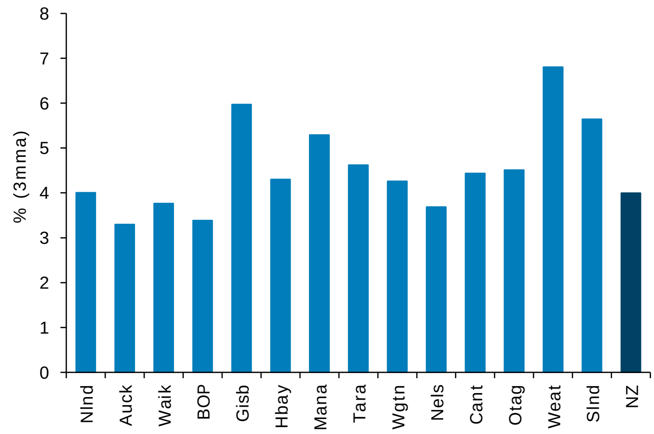
Rental inflation in Auckland has grown steadily since 2011, generally in the realm of 4-6% y/y. This is well below the very strong rates of house price inflation over the same time, which peaked at almost 30% y/y in 2015. Divergence in house price and rental inflation resulted in a large fall in rental yields over this time, especially compared to the fall in the country as a whole (figure 7). This fall highlights that strong house price inflation in Auckland over the 2011-2016 period reflected much more than simply demand and supply for physical shelter. Expectations of capital gains played an important role. Willingness to accept lower rental yields likely reflected expectations of future strong rates of population growth, in the context of unresponsive housing supply, being capitalised into house prices. However, it appears that this adjustment in rental yields overshot, with these having subsequently started to creep higher recently.

Figure 7. Rental yields (annual)



Source: MBIE, REINZ

Figure 8. Rental yields (annual, January 2019)



Source: MBIE, REINZ

As a general observation, rental yields are often lower in areas where house prices are high relative to incomes, where capital gains are expected to be higher, and where market liquidity risks are lower – that is, it doesn't take a year to sell (figure 8). For example, rental yields in Auckland and surrounding regions tend to be quite low, while more isolated regions like Westland and Southland have relatively high rental yields, even though rents themselves are comparatively low in dollar terms.

The outlook from here

For the rental market, there are a number of offsetting forces that make the outlook somewhat uncertain. Population growth is waning – and we expect it will continue to do so – which would tend to result in less upward pressure on rents, all else equal. Adding to that, the pipeline of new homes coming on stream will help to relieve demand pressures, though scope for building activity to increase further from here seems limited due to capacity constraints.

But continued moderation in population growth may not be enough to see rental inflation subside. Policy changes are expected to become increasingly important, impacting dynamics in the rental market. The ongoing debate and uncertainty surrounding the potential imposition of a capital gains tax will add to this, following the Tax Working Group's Recommendation to expand taxation of capital income last week. More generally, the ongoing pipeline of policy changes will move the market further in the direction of making property investment less attractive, thereby encouraging higher rents.

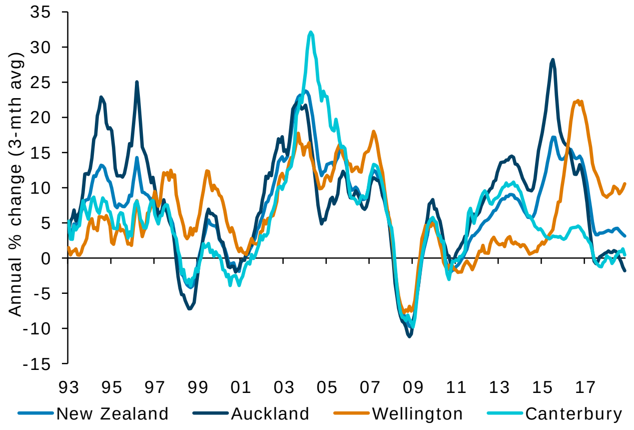
These policy changes, if implemented, would likely result in some uplift in rental yields, as landlords look to cover increased costs and make up for reduced prospects of capital gains. But a key question is the extent to which adjustment in yields occurs through higher rents or lower house prices. We expect it would be a combination of both. The impact on rents is uncertain, but it could be significant. We think rental inflation will continue to grow at solid rates, if not increase further.

On the other hand, a capital gains tax would add to the myriad of factors keeping house price inflation contained. Headwinds are building more generally in the market for purchasing existing homes, and we expect that house price inflation will continue to moderate (figure 9). Bank prudence, investor wariness and affordability constraints are weighing on the market, as well as other policy changes such the Healthy Homes Bill, the banning of foreign buyers, and the ring-fencing of losses on rental properties from a tax perspective. And a more challenging outlook for credit in light of proposed increases in bank capital requirements may also dampen the outlook, if implemented.

All up, a capital gains tax would be an additional headwind to the existing property market at the margin. But it is not a game changer from the perspective of housing affordability, especially since the family home would be excluded. Over time, the mix of overall returns from property would adjust to the new policy, and the home ownership rate may rise – but only a little. And it is important to note that there are significant hurdles to it actually being implemented (see our ANZ Weekly Focus for more details).

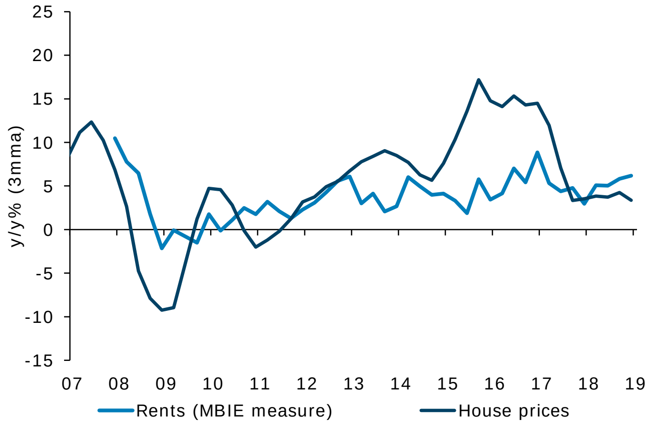
Overall, we expect to see some gradual uplift in rental yields in the next while, with the recent trend of rental inflation outpacing house price inflation expected to continue (figure 10). Over the medium term, a potentially offsetting factor that could dampen rental yields (but not rents themselves) is the possibility of lower interest rates. If the OCR falls as we expect, then (all else equal) this could result in lower rental yields than otherwise as house price inflation rises. At this point, we may see rental yields flat-line or resume their decline.

Figure 9. House price inflation by region



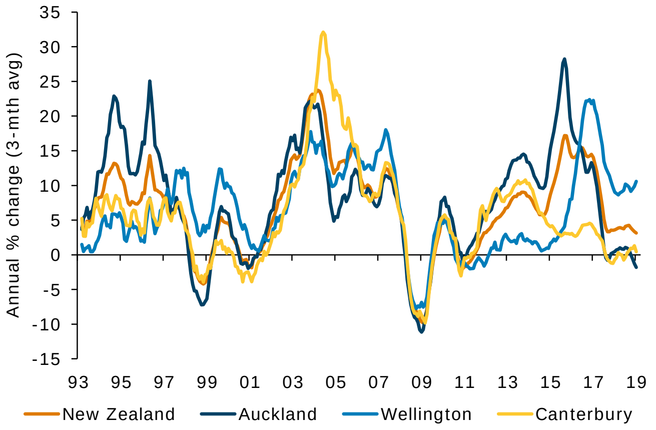
Source: REINZ

Figure 10. Rental and house price inflation (annual)



Source: MBIE, REINZ

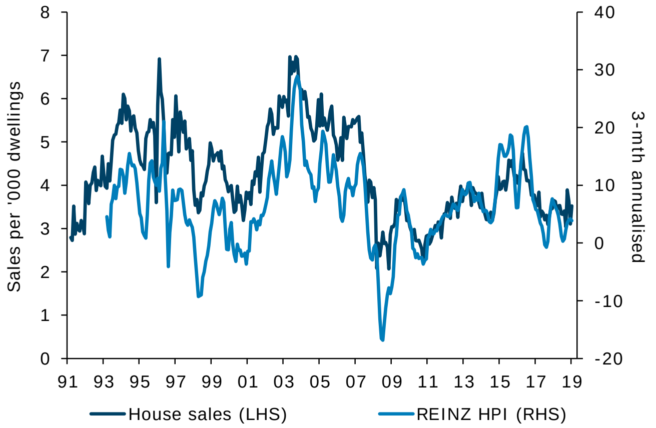
Figure 1. Regional house price inflation



Source: ANZ, REINZ

House prices increased 0.3% m/m in January, after firming 1% q/q in Q4, aided by declines in mortgage rates in the latter half of 2018. Annual house price inflation continues to moderate, reaching 3.1% y/y (3mma) in January, down from 4.2% in September. We expect the recent firming will prove short-lived and that headwinds weighing on the market will see prices continue their gentle descent, though regional divergence is expected to remain evident. In Auckland, prices fell 0.4% m/m in January to be down 2% over the year (3mma). In the rest of New Zealand, prices were up 0.8% (8.1% y/y). Strength has been particularly apparent in Wellington (11% y/y), Manawatu-Whanganui (17%), Hawke's Bay (14%), Otago (13%) and Southland (12%).

Figure 2. REINZ house prices and sales

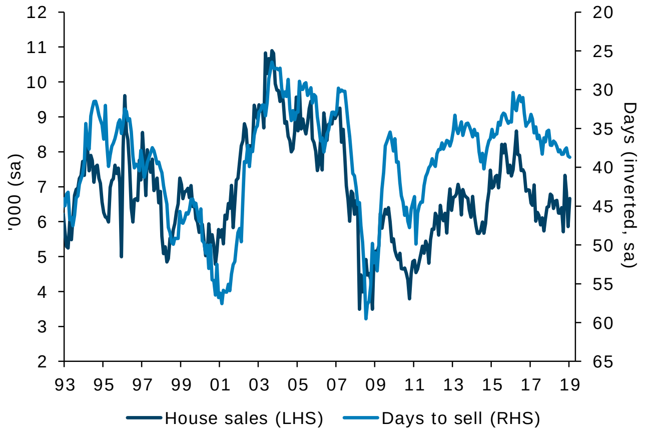


Source: ANZ, REINZ

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

Seasonally adjusted house sales increased 14% in January, reversing fall of 14% in December. House sales have been very volatile of late, and January's increase reflects continuation of that volatility. That said, the RBNZ's loan-to-value ratio restrictions were eased at the start of January, so may be providing a boost to the market. We expect the boost from this policy change to be small. On the whole, sales have been oscillating around a flat level to be 1% lower than a year ago (3mma).

Figure 3. Sales and median days to sell

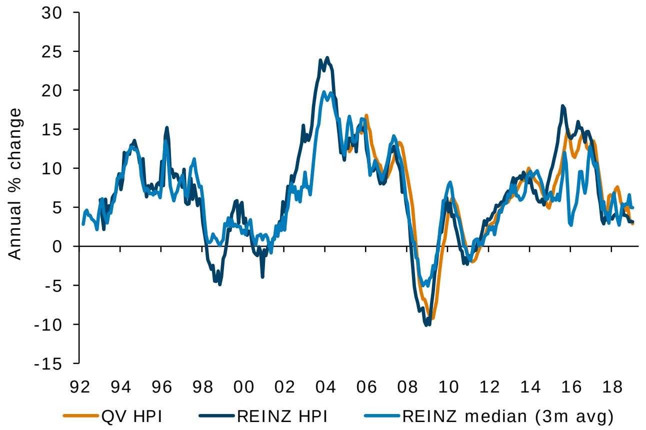


Source: ANZ, REINZ

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

Based on days to sell a house, the housing market is still a little tight in aggregate, but less so than previously. Median time to sell a house is sitting at 39 days (sa) – just below the historical average of 40 days. However, the Auckland market has considerable slack. Days to sell lengthened further in January from 41 to 43 days (relative to a historical average of 36 days), which points to continued softness in prices. Meanwhile, markets outside Auckland and Canterbury are tight.

Figure 4. REINZ and QV house prices

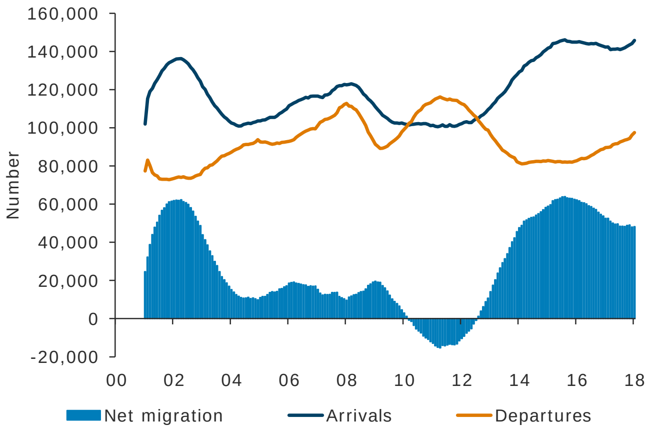


Source: ANZ, REINZ, QVNZ

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 3.1% y/y (3mma). The QVNZ measure has moderated even further and is sitting at 2.9% y/y. The REINZ median, on the other hand, was up 4.9% y/y (3mma). Since the median does not control for composition, this may reflect high-value sales.

Figure 5. Annual migration*



Source: Statistics NZ

* The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data

Migration flows[2] 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.

Seasonally adjusted monthly net inflows lifted from 3,310 in November (revised up from 2,480) to 5,080 in December. Annual net inflows lifted slightly, though remain well below the peak in mid-2016. On the face of it, the latest data suggest the migration cycle could be turning a corner. But Stats NZ changed their methodology recently and the data is subject to revision and relatively untested, so we would caution about reading too much into it at this stage – it could all be noise.

Figure 6. Residential building consents

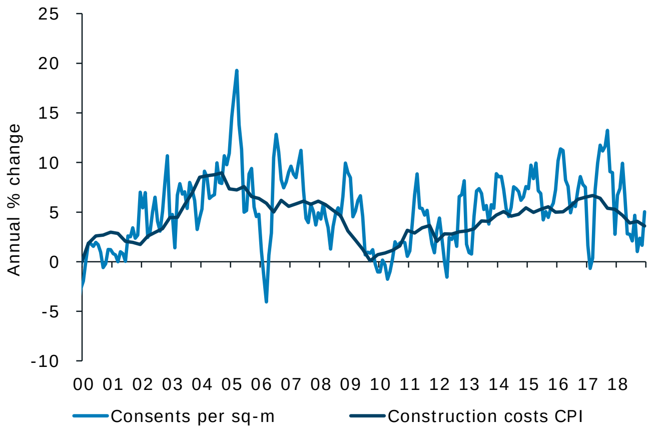
Source: ANZ, Statistics NZ

Residential building consents finished the year on a solid note, up 5.1% m/m in December, after a1.9% fall in November. Consents have been volatile of late, but appear to have broadly stabilised a touch below recent peaks. Annual consent issuance is running at 32,900, remaining shy of mid-2000s previous peak (33,200). Capacity constraints are being felt, and the construction industry is faced uncertainty, profitability challenges and delays, which are making it difficult for issuance to push higher.

That said, issuance remains at a high level as strong levels of home building continue. This is particularly the case in Auckland, but strength is also evident across the rest of New Zealand (though building in Canterbury remains well off its peaks).

[2] Note all references to permanent long term migration throughout this report refer to the new methodology Statistics NZ have implemented from November 2018 onwards to identify long term migration. The new data is only available from June 2014 which we have indicated with a series break. For more on this, see International migration uses new official measure.

Figure 7. Construction cost inflation

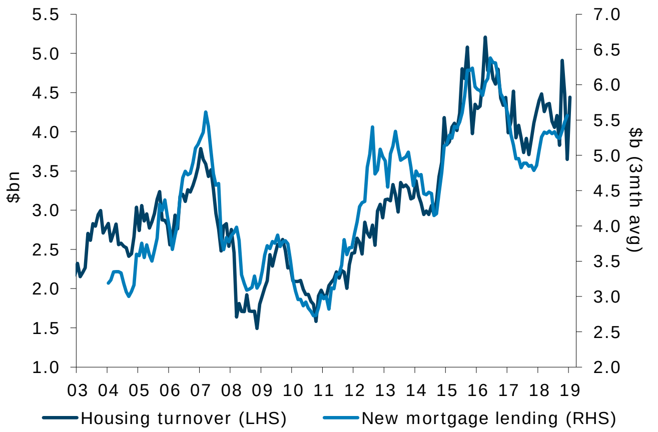


Source: ANZ, Statistics NZ

Construction cost inflation has softened and this gradual deceleration may continue. Growth in the cost of consented work per square metre – a proxy for construction cost inflation – picked up to 5.0% y/y (3mma) in December, though it has generally been fairly weak of late. This compares with CPI construction cost inflation of 3.6% y/y in the December quarter. Construction cost inflation has been in gradual decline from its recent peak of 6.7% in March 2017.

Capacity pressures in the industry remain acute, which should continue to support price rises. But firm pessimism may lead to continued caution with regard to passing on cost increases.

Figure 8. New mortgage lending and housing turnover

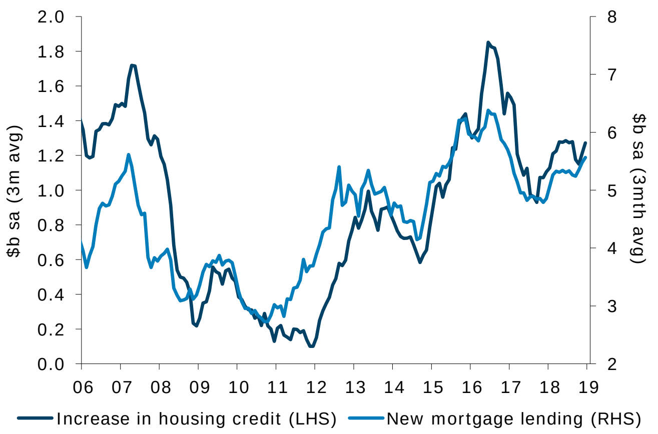


Source: ANZ, RBNZ

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 has been volatile of late, consistent with the recent noise in house sales. New lending fell 6.2% m/m (sa) in December, following a 1.7% fall in November. This is not surprising on the back following the sharp pull-back in house sales in December. House sales rebounded in January and this will likely to be mirrored in new lending. From there, the outlook will depend on where the trend in sales settles. It appears they are oscillating around a high level, though headwinds could see this peter off eventually.

Figure 9. New mortgage lending and housing credit

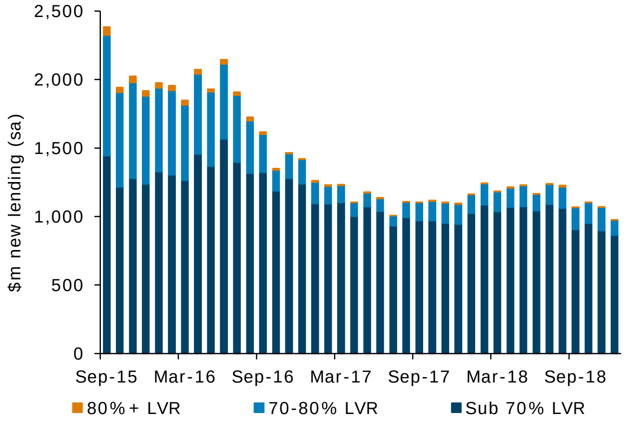


Source: ANZ, REINZ, RBNZ

Household credit has been growing at a pretty consistent monthly pace since early 2017. In monthly terms, household lending increased 0.4% m/m in December. In annual terms, household credit growth is running at 5.4% y/y (3mma).

Housing credit growth has been stable in recent months, despite housing market volatility. Banks are behaving prudently, the housing market has cooled, investors are wary, and loan-to-value ratio restrictions are expected to still have a dampening influence on credit availability, even when they are eased. 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

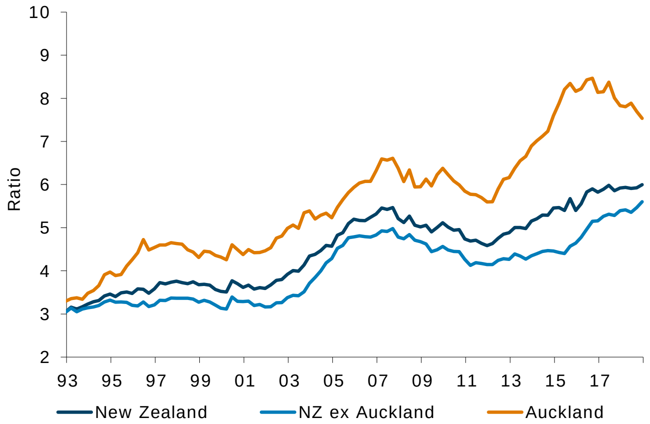


Source: ANZ, RBNZ

On a seasonally adjusted basis, new lending to investors fell 8.6% in December, consistent with the fall in house sales seen in the month. A rebound on the back of higher sales is expected in January, especially given the easing in loan-to-value restrictions. But overall we do not expect the impact to be large, with investor wariness weighing on the housing market at present. Around 20% of new loans have been to investors recently, down from 23% in the middle of the year.

The share of investor lending on less-risky terms remains low. In December, 86% of total investor lending was at loan-to-value ratios of less than 70%. In late-2014 it was less than half.

Figure 11. Regional house prices to income

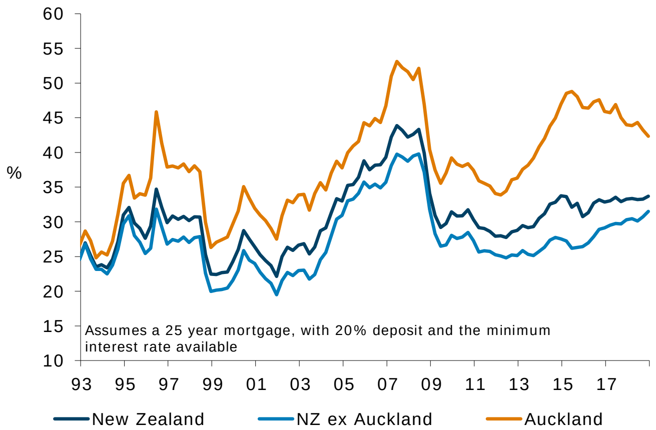


Source: ANZ, REINZ, Statistics NZ

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

Nationally, the ratio has been stable at 6 times income since early 2017. Auckland has seen its ratio ease from almost 9 times in Q3 last year to an estimated 7.5 times in Q4 2018, reflecting recent weakness in house prices. Elsewhere, the ratio has continued to rise; at 5.4 times incomes this is at record highs.

Figure 12. Regional mortgage payments to income



Source: ANZ, REINZ, RBNZ, Statistics NZ

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

We estimate that for a purchaser of a median-priced home (20% deposit), the average mortgage payment to income nationally is 34%. However, there are stark regional differences. In Auckland it is 42% and the rest of New Zealand it is 32%. 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 account of low mortgage rates, households could be vulnerable in the event of even a small lift in interest rates.

Property gauges

House sales rebounded in January, with easing in loan-to-value ratio restrictions perhaps playing a role. But looking thorough volatility, the trend in sales has been fairly flat since mid-2017. House prices firmed through the end of the year, with falls in mortgage rates providing a boost. But this firming is expected to be short-lived, with price pressures expected to be limited by headwinds. Demand pressures are not building as they once were, though there is some uncertainty about the impulse from migration. Meanwhile, banks are prudent, investors are wary, and expectations of buyers and sellers are adjusting to be more in sync, especially with affordability constraints being felt. The pipeline of proposed Government policy changes (and associated uncertainty) could add to a more challenging outlook, and increases in bank capital requirements could see credit conditions tighten, if implemented.

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 is the main reason we see the Auckland market continuing to underperform.
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	Eventual cut	↔/↑	We see the OCR falling by year-end, but partly to offset upward pressure on rates. Short-term mortgage rates have fallen.
Migration	Peaked	↔/↑	Migration is easing gradually, but remains elevated. We expect further softening, though new data creates uncertainty.
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, and the housing market is weak 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 could provide an offset, but only a little.
On balance	**In recent ranges**	↔/↓	**We expect the market to remain contained, though volatility may continue in the short term.**

Property gauges

Figure 1: Housing affordability

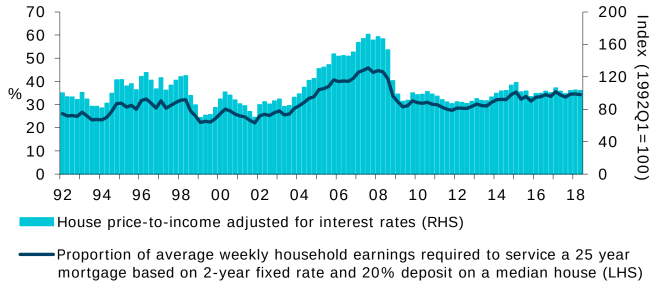


Figure 2: Household debt to disposable income

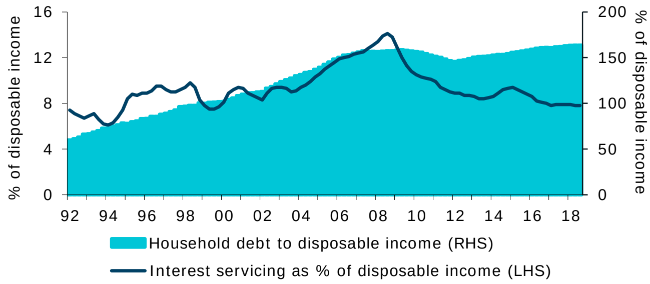


Figure 3: New customer average residential mortgage rate (<80% LVR)

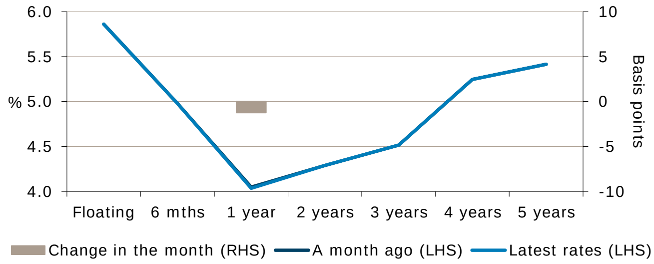


Figure 4: Annual migration*

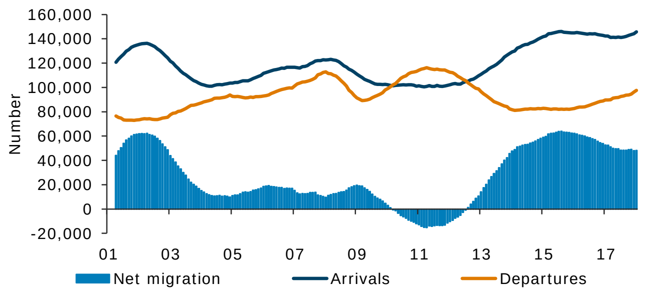


Figure 5: Housing supply-demand balance

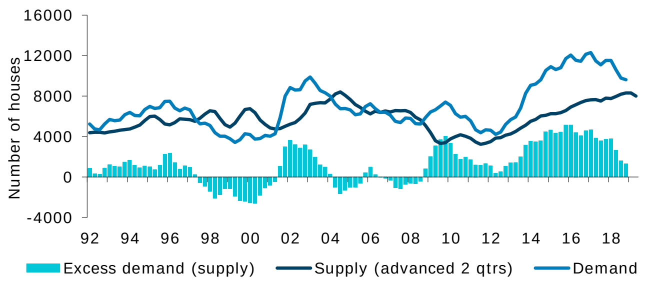


Figure 6: Building consents and house sales

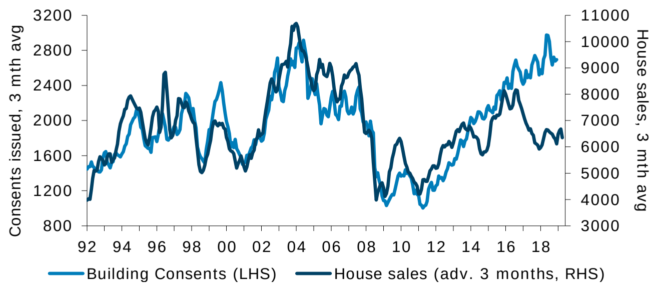


Figure 7: Liquidity and house prices

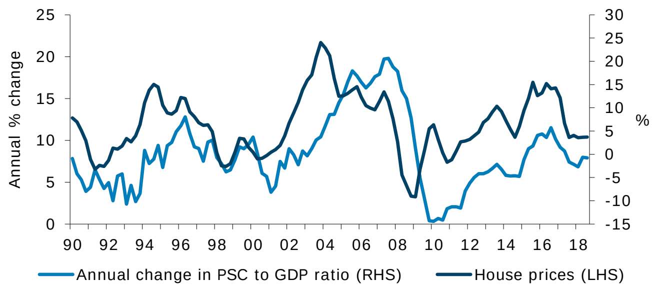


Figure 8: House price inflation comparison

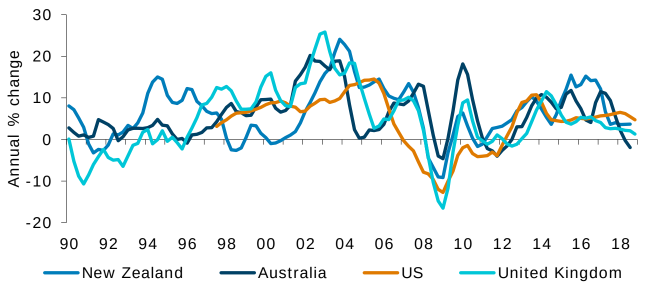


Figure 9: Housing supply

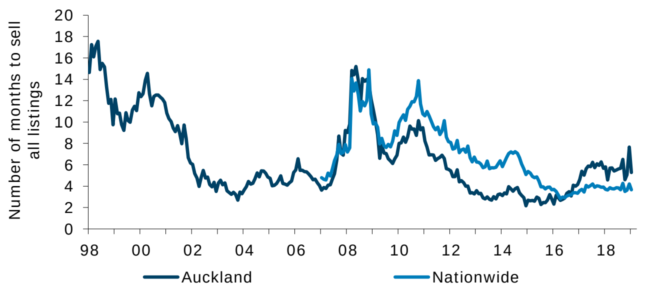
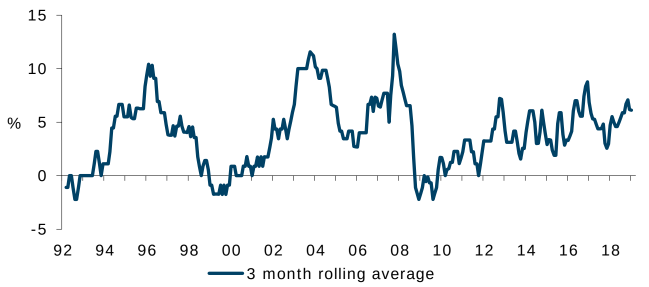


Figure 10: Median rental, annual growth



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

* The data prior to June 2014 is back-casted using Stats NZ's discontinued experimental data

Economic overview

Summary

Global growth is slowing and downside risks are at the fore, leading to increased caution from central banks. Encouragingly, our commodity prices have been defying gravity, with no signs that waning Chinese demand is flowing through to demand for our exports – at least not yet. The RBNZ has signalled a more cautious tone, though OCR increases are still expected eventually based on their current projections. We, on the other hand, think that the next move in the OCR is more likely to be down than up. This reflects a more pessimistic view of the domestic growth outlook. We think that the economy will need more of a nudge from monetary stimulus to push inflation closer to target and see the labour market remain near maximum sustainable employment. In terms of risks, ructions in markets or worsening global conditions could see a cut eventuate sooner, but upside risks to inflation could see the RBNZ hold off cuts for longer than we currently expect.

Our view

Global growth continues to slow and downside risks have increased. In particular, Australia and China – our two largest trading partners – are experiencing softening growth momentum. The Australian housing market continues to extend recent price declines, with credit headwinds and housing oversupply weighing on the market, particularly in major cities. This housing market weakness has the potential to weigh on household spending, particularly in the context of low income growth and high debt levels.

Chinese demand is softening (and likely more so than official data suggests). As a key trading partner, developments in China tend to have important implications for New Zealand, particularly our commodity prices. So far, our commodity prices have continued to defy gravity, in part reflecting supply dynamics. But while we expect that the outlook for our export prices remains positive, especially in a medium-term sense, further weakening in the Chinese growth picture could weigh on commodity prices going forward, particularly since these effects are sometimes seen with a lag.

Meanwhile, US-China trade tensions are dampening global growth and creating uncertainty, with the potential for more market pressure points. Brexit is another key area of uncertainty at present and European economic data has been very poor. As global risks have increased, central banks have turned more cautious: the PBOC has been easing policy, the Fed has indicated that rate rises are on hold for now, and the RBA has struck a more cautious, neutral tone.

Domestically, the RBNZ has become more cautious too, signalling that the next move in the OCR could be up or down. In the February MPS, the RBNZ indicated that it expected to keep the OCR on hold for even longer – until mid-2021 based on their projections – given some softening in the domestic outlook. The RBNZ highlighted downside global risks on one hand, and upside inflation risks on the other, with risks considered fairly balanced. The RBNZ's more cautious tone was largely as expected, though we think a case could be made for an even more dovish tone, given building risks to both the domestic and global outlook.

In our view, the economy has lost momentum and it will be a struggle for GDP to grow above trend. This will make it challenging to see inflation return to target and for the labour market to improve further. The starting point for the labour market is very positive; capacity constraints are being felt and inflation is edging up. But the economy is also grappling with a number of headwinds, and we suspect that the peak in resource pressures may be behind us. Fiscal stimulus is expected to provide a small boost, while household spending continues. But the impetus to growth from migration and construction is waning, the housing market is stable, businesses are cautious (especially about profits and availability of credit), and credit conditions look set to tighten (due to probable increases in bank capital requirements).

We expect that OCR cuts will eventually be required to see inflation return sustainably to target with the labour market remaining near maximum sustainable employment. We have pencilled in the first cut for November this year, with two follow up cuts expected over 2020.

However, we see risks on both sides, with these considered to be balanced at present. Ructions in financial markets or a more pronounced softening in global growth could see the OCR cut sooner than we anticipate – especially if commodity prices start to falter. But on the other hand, it is possible that the RBNZ could have more breathing room if inflation increases more than we currently expect. Firms are experiencing margin pressure, and this could see them start to slaw back profits through higher prices, though in our view this is unlikely without a meaningful acceleration in demand, given the overarching theme of caution amongst firms.

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 January 2019 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	14.3	1.8	195	+1%	53
Auckland	-2.4	-1.2	1,913	+24%	43
Waikato	12.8	2.9	717	+9%	39
Bay of Plenty	9.4	3.3	491	+13%	43
Gisborne	21.4	4.1	49	-19%	37
Hawke's Bay	3.4	-1.0	241	+4%	31
Manawatu-Whanganui	21.1	4.0	362	-4%	32
Taranaki	5.5	0.2	189	+29%	32
Wellington	12.4	1.0	667	+6%	33
Tasman, Nelson and Marlborough	12.9	3.7	169	-26%	42
Canterbury	-0.7	-1.2	893	+9%	43
Otago	6.3	3.8	349	-3%	32
West Coast	14.9	2.6	41	-13%	73
Southland	15.4	3.1	185	+29%	33
New Zealand	**5.8**	**1.8**	**6,664**	**+14%**	**39**

Key forecasts

		Actual					Forecasts			
Economic indicators	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
GDP (Ann % Chg)	3.0	3.2	2.6	2.5	2.5	2.2	2.4	2.5	2.5	2.5
CPI Inflation (Annual % Chg)	1.1	1.5	1.9	1.9(a)	1.6	1.8	1.3	1.4	1.8	1.8
Unemployment Rate (%)	4.4	4.4	3.9	4.3(a)	4.3	4.3	4.2	4.2	4.2	4.2
House Prices (Annual % Chg)	3.9	3.7	4.2	3.4(a)	2.7	3.1	3.3	2.6	2.4	2.2
Interest rates (RBNZ)	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Official Cash Rate	1.75	1.75	1.75	1.75	1.75	1.75	1.50	1.00	1.00	1.00
90-Day Bank Bill Rate	2.0	1.9	2.0	1.9	1.9	1.9	1.6	1.2	1.2	1.2
Floating Mortgage Rate	5.8	5.8	5.8	5.8	5.8	5.8	5.5	5.0	5.0	5.0
1-Yr Fixed Mortgage Rate	4.9	4.8	4.8	4.7	4.8	4.8	4.6	4.4	4.4	4.4
2-Yr Fixed Mortgage Rate	4.9	4.8	4.7	4.7	4.7	4.7	4.7	4.6	4.6	4.6
5-Yr Fixed Mortgage Rate	5.7	5.4	5.4	5.4	5.3	5.4	5.5	5.5	5.6	5.6

Source: ANZ, Statistics NZ, RBNZ, REINZ

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