NEW ZEALAND ECONOMICS
ANZ PROPERTY FOCUS

OCTOBER 2013

INSIDE

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PULLING THE LeVeR

SUMMARY

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

THE MONTH IN REVIEW

The housing market remains buoyant, with house sales picking up in September and average days to sell still low. Building consents continue to lift from historical lows, albeit at too slow a rate to absorb increasing demand from surging migration. Mortgage lending continues to pick up, but the more timely weekly mortgage approvals data has eased as high-LVR lending restrictions begin to bite.

PROPERTY GAUGES

Our property gauges continue to send mixed signals. Strong migration is exacerbating the demand and supply-demand imbalance. However, rising mortgage rates are negatively impacting housing affordability and have dampened activity. The one-off jump in activity prior to the LVR rule changes has to be discounted. Weekly mortgage approvals for October are indicating a slowdown in activity but we need at least another month of broader real estate metrics to fully assess the immediate impact of the change to LVR regulations. Stay tuned.

ECONOMIC BACKDROP

The economy is firmly into an economic expansion: that's a step up from recovery. The drivers are not hard to identify: global dairy prices are sky-high, the Canterbury rebuild is gaining pace, and the Auckland housing market is responding predictably to near-record low mortgage rates and housing shortages. Under the bonnet, small microeconomic initiatives are adding lustre to the picture. After years of restraint and cost-cutting, NZ firms and households are raring to go. But risks and vulnerabilities remain. The national balance sheet is still weak and one of the economy's biggest challenges over the coming years will be expanding its supply-side capacity so resource constraints don't bite too early.

MORTGAGE BORROWING STRATEGY

Although ANZ has made changes to the way it publishes its mortgages rates, there has been no change in rates available to borrowers with at least 20 percent equity. However, low-equity borrowers will have noticed a step up in rates. Regardless of segment, most borrowers will find it hard to overlook 6 month and 1 year fixed rates – as has been the case for some time. Not only are these the lowest rates on offer in each segment, we also expect the Reserve Bank to lift the OCR in more of a measured fashion than is currently priced into breakevens.

FEATURE ARTICLE: THE 2013 PROPERTY INVESTORS SURVEY

Many of New Zealand's property investors have banked some good returns over the last couple of years, particularly those in Auckland. According to the ANZ's annual survey of property investors (compiled in conjunction with the NZ Property Investors' Federation), the good times are generally expected to continue. Growth in property values over the next year was anticipated by 92 percent of respondents, with a median increase of 4 percent expected. Yet on average investors expect their property values in five years time to have increased by less than 10 percent, reflecting a degree of realism that will be comforting for the Reserve Bank. While the housing market in Auckland is running hot at present, the Reserve Bank is on the warpath, interest rates are rising – particularly for low-equity borrowers – and housing affordability constraints will inevitably kick in at some point. Investors would do well to focus on the long-term big picture rather than target short-term gains.

THE MONTH IN REVIEW

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REINZ, HOUSE SALES – SEPTEMBER

Lodging **V**olumes **R**ebound

Sales volumes rebounded 2.6 percent in September, following a 3.2 percent drop in August. The trend in nationwide sales volumes is still strong, with volumes about 5 percent higher in the three months to September, and 19 percent up on a year ago. The September jump may be attributable to buyers and vendors attempting to beat the 1 October introduction of high-LVR lending restrictions. The median days to sell eased 1 day to 34 days, the lowest for a September month since 2006. Tight inventory is underpinning prices, with house prices rising 0.4 percent in September and annual house price inflation lifting to 9.8 percent. Regional divergences remain, with annual house price inflation at 17 percent for Auckland and 11 percent in Christchurch, as opposed to just 0.6 percent in Wellington.

STATISTICS NZ, BUILDING CONSENTS – AUGUST

Lucky – **V**igorous **R**ebuild

Residential consent numbers rose 1.4 percent in August, with the less volatile ex-apartment issuance consent issuance up 0.8 percent. The trend in residential issuance remains upwards, but is flattening, with the seasonally adjusted number of consents up just 2.7 percent over the three months to August. Despite recent increases, August residential consent numbers were still 18 percent below historical averages as a proportion of the housing stock. Residential issuance in Canterbury climbed to 4,881 (47 percent above historical averages) as a consequence of the Canterbury rebuild. Auckland annual consent numbers are climbing, but at 5,616, are still 24 percent below historical averages.

RBNZ, HOUSEHOLD CREDIT GROWTH – AUGUST

Loan **V**alues **R**ecovering

Mortgage lending increased 0.5 percent in August. The annual growth in mortgage lending has been steadily increasing since it touched a low of just 1.1 percent in November 2011. The latest annual increase is 5.7 percent, which represents the strongest rate of growth since October 2008. That rate of growth is in excess of income growth, which tells us households are starting to build up bigger debt burdens again. That's one reason high-LVR lending restrictions are in place.

STATISTICS NZ, EXTERNAL MIGRATION – SEPTEMBER

Long-term **V**oyagers **R**eturning

A net migration inflow of 2,740 persons in September was the strongest monthly net inflow in a decade. On its current trajectory the net permanent and long-term migration inflow remains on track to move well above 20,000 persons in the 2013 calendar year, which would be the highest net inflow since 2009. The relative strength of the NZ economy appears to be the major draw-card behind the turnaround, acting to keep would-be emigrants off the plane (PLT departures plummeted 8.7 percent to 5,270, and are 26 percent down annually). Compounding this was a 1 percent sa rise in PLT arrival numbers (8,010), which are 11 percent higher than a year ago. The net PLT outflow to Australia has continued to taper off, with a net loss of only 25,303 migrants to Australia, as opposed to a net outflow of around 40,000 persons a year ago.

RBNZ, MORTGAGE APPROVALS – MID OCTOBER

Lower **V**olumes **R**eported

The number of mortgage approvals fell to its second-lowest level in six months. The number of approvals has been consistently below the same time last year for the past few months, with the average value of approvals also easing.

PROPERTY GAUGES

Our property gauges continue to send mixed signals. Strong migration is exacerbating the demand and supply-demand imbalance. However, rising mortgage rates are negatively impacting housing affordability and have dampened activity. The one-off jump in activity prior to the LVR rule changes has to be discounted. Weekly mortgage approvals for October are indicating a slowdown in activity but we need at least another month of broader real estate metrics to fully assess the immediate impact of the change to LVR regulations. Stay tuned.

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

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

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

INTEREST RATES. Interest rates affect both the affordability of new houses and the serviceability of existing mortgage payments.

MIGRATION. A key source of demand for housing.

SUPPLY-DEMAND BALANCE. We use dwelling consents issuance to proxy growth in supply. Demand is derived via the natural growth rate in the population, net migration, and the average household size.

CONSENTS AND HOUSE SALES. These are both key gauges of activity in the property market.

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

GLOBALISATION. We look at relative property price movements between New Zealand, the US, UK and Australia in recognition of the important role that globalisation is playing in NZ's property cycle.

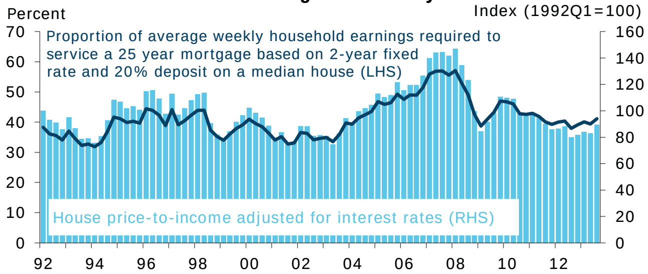
HOUSING SUPPLY. We look at the supply of housing listed on the market, recorded as the number of months needed to clear the housing stock. A high figure indicates that buyers have the upper hand.

RENTAL GROWTH. We look at growth in the median market rent as an indication of whether it is a better time to buy versus rent, and how rental yields are shaping up for the property investor.

Indicator	Level	Direction for prices	Comment
Affordability	Pinched	↔/↓	Rising prices and mortgage rates have hit affordability.
Serviceability/ indebtedness	Falling	↔	Turn in interest rates has dented serviceability.
Interest rates / RBNZ	Niggly	↔	Six and twelve month fixed mortgage rates have been pared back but 3 year and beyond have ticked up.
Migration	Not leaving	↑	Migration inflows are starting to get some traction, with Canterbury and Auckland net inflows strengthening.
Supply-demand balance	Gap widens	↔/↑	Jump in demand to a 4-year high has further outstripped supply.
Consents and house sales	Surfs up	↔/↑	Volume of house sales reached a 6-year high in the September quarter.
Liquidity	On the up	↔	Credit growth relative to size of economy has lifted to a three-year high.
Globalisation	View from the top	↔/↓	Australia, US and UK are where NZ was a year ago.
Housing supply	Frantic	↔/↑	Reliving the frothy days of 2007.
Median rent	Balanced	↔/↓	Rental growth eases to 16-month low of 3.1 percent, below long-term average of 3.8 percent.
On balance	**Breathless**	↔/↑	**Supercalifragilisticexpialidocious.**

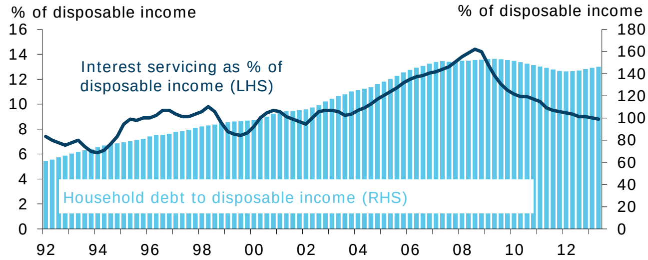
PROPERTY GAUGES

Housing affordability



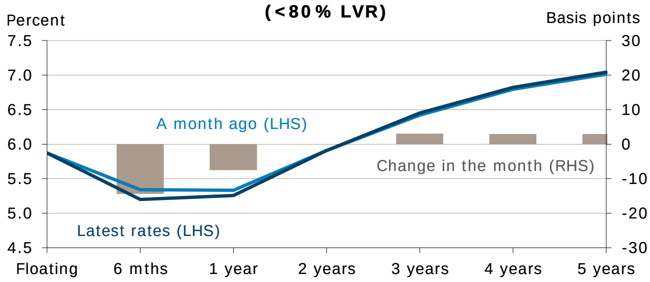
Sources: ANZ,Statistics NZ, REINZ, RBNZ

Serviceability and indebtedness



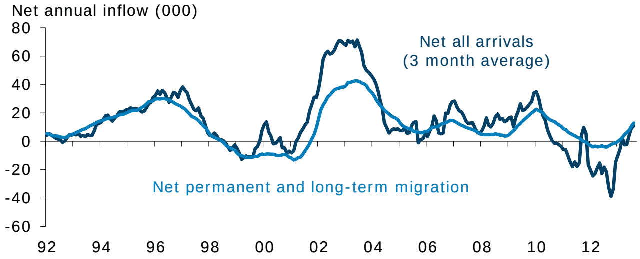
Sources: ANZ, RBNZ

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



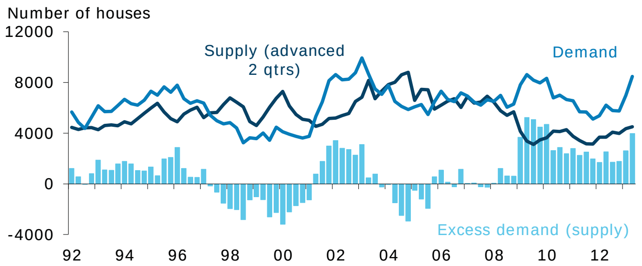
Sources: ANZ, www.interest.co.nz

Net migration



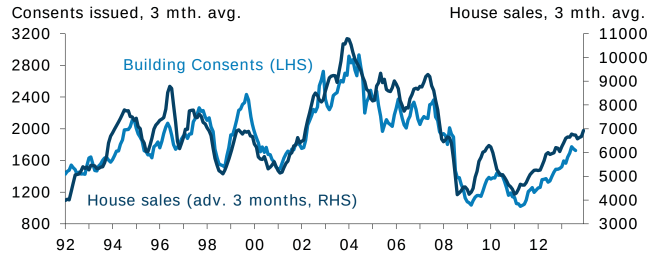
Sources: ANZ, Statistics NZ

Housing supply-demand balance



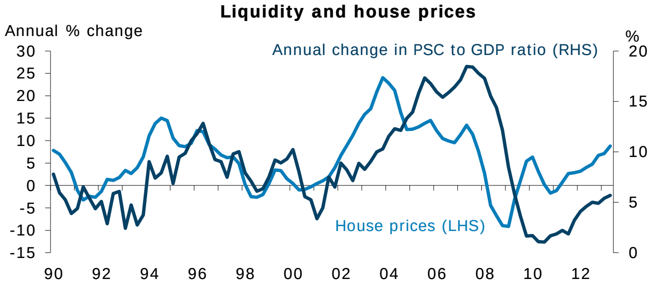
Sources: ANZ, Statistics NZ

Building consents and house sales



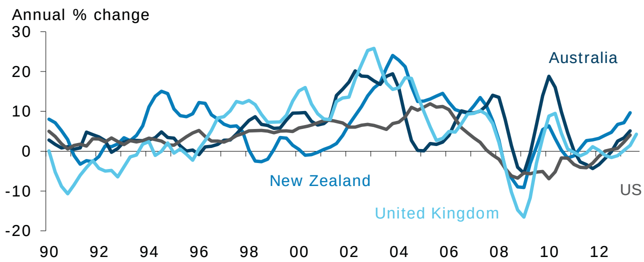
Sources: ANZ, Statistics NZ, REINZ

Liquidity and house prices



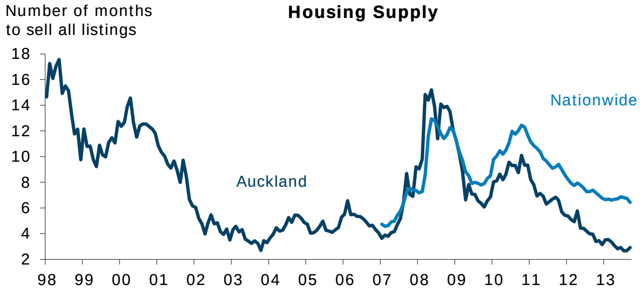
Sources: ANZ, QVNZ, RBNZ

House price inflation comparison



Sources: ANZ, QVNZ, Nationwide, Bloomberg

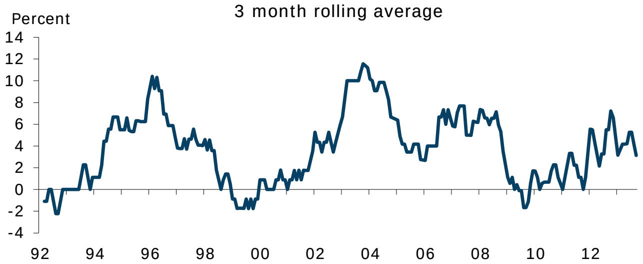
Housing Supply



Sources: ANZ, Barfoot & Thompson, www.realestate.co.nz

Median rental, annual growth

3 month rolling average



Sources: ANZ, Department of Building and Housing

ECONOMIC BACKDROP

SUMMARY

The economy is firmly into an economic expansion: that's a step up from recovery. The drivers are not hard to identify: global dairy prices are sky-high, the Canterbury rebuild is gaining pace, and the Auckland housing market is responding predictably to near-record low mortgage rates and housing shortages. Under the bonnet, small microeconomic initiatives are adding lustre to the picture. After years of restraint and cost-cutting, New Zealand firms and households are raring to go. But risks and vulnerabilities remain. The national balance sheet is still weak and one of the economy's biggest challenges over the coming years will be expanding its supply-side capacity so resource constraints don't bite too early.

OVERVIEW

There is still a large number of major offsetting influences affecting the economy. Our nationwide balance sheet is weak, with a large debt overhang. Fiscal austerity is crimping growth. The currency is overvalued. Working against this is a large (and not fully tapped) resource endowment, with the New Zealand economy currently the beneficiary of a once-in-a-generation terms of trade boost. Financial conditions – in the form of low interest rates – are accommodative, supporting domestic demand. The Auckland property market is on fire, and in need of 30,000 more houses. Throw in the $40bn Canterbury rebuild and signs of strengthening construction sector activity filtering through into the wider economy, and the scene is set. Economic indicators are becoming increasingly in agreement that **New Zealand's economic momentum is lifting and the expansion is broadening.**

While we can look at the obvious drivers, small nuances cannot be overlooked. Businesses have made substantial progress in the past few years driving efficiencies: they're now raring to go. The Government is doing the basics well. We've seen fiscal prudence – the books are getting back into good health, welfare reform, a plan attacking housing affordability, asset sales *et al*. It's not defining in itself, but gives the impression New Zealand is on the right path. It all adds to that feel-good factor.

This growth is being led by the pro-cyclical parts of the economy, which are recovering from multi-year lows. Investment activity is picking up, and prospects for the construction sector and manufacturing are looking a whole lot brighter. Even the sluggish labour market is finally showing some signs of life, benefiting both the services sector and consumer spending. A mild winter has set the scene for some of the growth lost from the early 2013 drought to be made up, but this is more dairy-centric. Export commodity prices are at historically high levels, with dairy incomes set to lift by more than $4bn versus the previous season – hardly small change. Tell-tale signs of the improving mood are widespread. Business and consumer confidence is high, with sentiment for most major sectors strengthening.

What could possibly go wrong? A few things, is the answer.

- **The NZD is still overvalued**, and is threatening to choke off a burgeoning export sector recovery.
- **Our commodity prices are not invulnerable.** Global supplies of dairy products are currently tight, but there will be a supply response. In addition, 'eyeball econometrics' suggests that global prices for New Zealand's commodities benefited from the three rounds of US quantitative easing (QE), and it would be optimistic to assume no downdraft once QE 'tapering' begins.
- **Borrow and spend behaviours of old could re-emerge.** That would boost growth in the near term but we'd pay for it down the track. The Reserve Bank of NZ has some concerns about recent developments with regard to financial stability: they've slapped on loan-to-value ratio housing lending restrictions as a reminder to settle down. We'll be watching the agri space closely. The historical experience has been that lifts in dairy prices find their way into land values (and inflation). The RBNZ won't want a bar of that. **New Zealand is still deeply indebted from a borrowing binge last decade.**
- **The inflation genie could be let out of the bottle**, necessitating a monetary policy response. With the demand side of the picture looking very solid, one of New Zealand's greatest challenges over the coming year will be expanding its supply-side capacity. A failure to do so would mean resource constraints will bite earlier.

There are always going to be challenges, but stepping beyond these, the outlook is pretty good. We simply need to recognise that maintaining an economic expansion is not just about generating sufficient demand. It's also about creating sufficient supply-side capacity to meet the demand as recoveries broaden, such as now. This is where attention needs to be turning more rapidly.

MORTGAGE BORROWING STRATEGY

SUMMARY

Although ANZ has made changes to the way it publishes its mortgages rates, there has been no change in rates available to borrowers with at least 20 percent equity. However, low-equity borrowers will have noticed a step up in rates. Regardless of segment, most borrowers will find it hard to overlook 6 month and 1 year fixed rates – as has been the case for some time. Not only are these the lowest rates on offer in each segment, we also expect the Reserve Bank to lift the OCR in more of a measured fashion than is currently priced into breakevens.

OUR VIEW

Mortgage rates for borrowers with at least 20 percent equity have not changed in the past month. However, there has been a technical change to the way rates are published. Whereas in the past rates were advertised as either carded or special rates, with the latter typically only available to borrowers with at least 20 percent equity, **we now publish carded rates and low-equity rates explicitly.** What were our old discounted rates have been essentially become standard for borrowers with at least 20 percent equity, and we now publish low-equity rates. The chart to the right demonstrates the changes.

New Reserve Bank restrictions on high-LVR lending came into effect on October 1st. Banks must also hold more capital against high-LVR mortgage lending. The consequences are two-fold: **less credit volumes into the high LVR segment, and at a different (higher) price.**

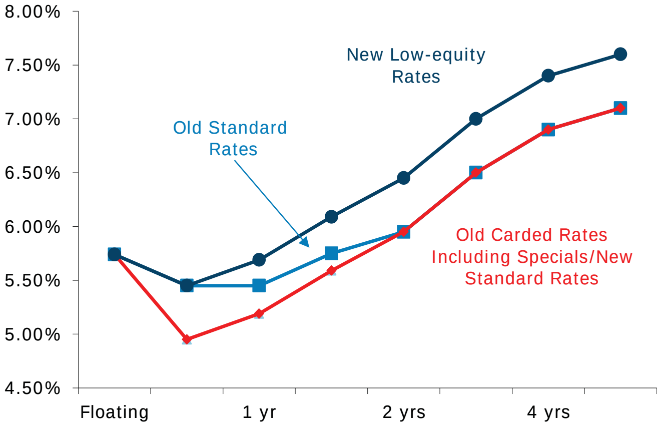
Regardless of whether one is a standard borrower or a low-equity borrower, **the lowest rate in both segments is the 6 month rate, followed closely by the 1 year rate.** Given our expectation that the RBNZ will start lifting the OCR in early 2014, **we see little merit in selecting floating** unless one is able to negotiate a significant discount – and that is only likely to apply to borrowers with a substantial deposit.

Breakeven tables tell a similar story for both sets of borrowers – albeit at a higher level for low-equity borrowers. Just as low-equity rates are higher by 0.5 percent, so are all breakevens.

The tables tell a story of rising rates. 1 year-ahead breakevens, for instance, are between 0.6 and 1.1 percent above current rates. Similarly, 2 year-ahead breakevens are between 1.2 to 1.8 percent higher than current rates, and 3 year-ahead breakevens are 1.7 to 2.4 percent higher. What that means is that **rates need to rise in order for it to be worthwhile to fix.** The fact that breakevens need to rise by much more for the shorter terms does tend to make **shorter-term fixed terms look more attractive.** For example, if one is tossing up between the 1 year rate at 5.19 percent or the 2 year rate of 5.95 percent, you'd only be better off fixing for 2 years if you were confident the 1 year rate will rise by 1.1 percent over the next year. We think that's something of a line call when we consider our forecasts which have the RBNZ on hold until March, and the lifting the OCR by roughly 0.75 percent per year for the next few years. Accordingly, **we find it hard to overlook 6 month and 1 year rates.**

We would, however, caution that **fixing does bring certainty, which is of considerable value for some borrowers.** Borrowers just need to be aware that certainty comes at a cost.

ANZ Mortgage Rates



Sources: ANZ

Carded Mortgage Rates		Breakevens for 20% + equity borrowers			
Term	**Current**	**in 6mths**	**in 1yr**	**in 18mths**	**in 2 yrs**
Floating	5.74%				
6 months	4.95%	5.43%	6.39%	7.03%	7.33%
1 year	5.19%	5.91%	6.71%	7.18%	7.60%
18 months	5.59%	6.28%	6.92%	7.41%	7.70%
2 years	5.95%	6.54%	7.16%	7.53%	7.85%
3 years	6.50%	6.99%	7.47%	7.71%	7.87%
4 years	6.90%	7.26%	7.58%		
5 years	7.10%				

Low-Equity Rates		Breakevens for Low equity borrowers			
Term	**Current**	**in 6mths**	**in 1yr**	**in 18mths**	**in 2 yrs**
Floating	5.74%				
6 months	5.45%	5.93%	6.89%	7.53%	7.83%
1 year	5.69%	6.41%	7.21%	7.68%	8.10%
18 months	6.09%	6.78%	7.42%	7.91%	8.20%
2 years	6.45%	7.04%	7.66%	8.03%	8.35%
3 years	7.00%	7.49%	7.97%	8.21%	8.37%
4 years	7.40%	7.76%	8.08%		
5 years	7.60%				

FEATURE ARTICLE: THE 2013 ANZ PROPERTY INVESTORS SURVEY

SUMMARY

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KEY POINTS FROM THE 2013 SURVEY

An online survey of 1,368 New Zealand property investors was conducted over a three week span in July and August. The survey has been compiled for several years and provides a useful yardstick for property investor sentiment. The survey consists of questions relating to investors' property portfolios, house price and rent expectations, their use of property managers, their investment strategy, sources of information, insurance cover, and investment property finances.

Investor profiles

Half of the investors were small investors with one to three properties. A further quarter were medium investors with four to six properties. These proportions were consistent with last year. The percentage of small-scale investors responding, which had declined from 62 percent in 2011 to 52 percent in last year's survey, remained fairly steady at 50 percent. Full-time investors with 10 or more properties increased from 6 percent in 2011 to 9 percent in 2012, and were 11 percent of respondents this year.

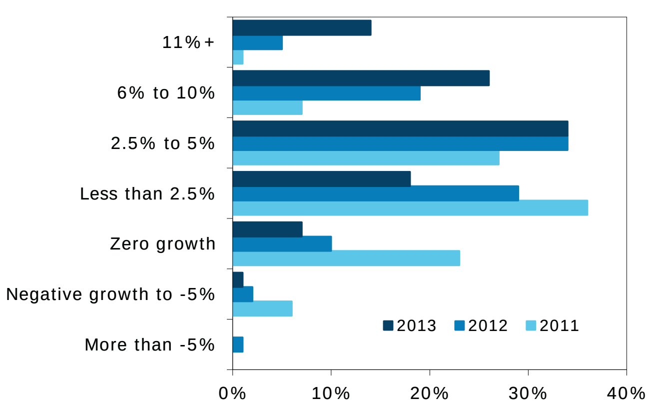
There were very few changes in property ownership structure compared to last year. Owning a property in your own name is the most common property ownership structure, with 42 percent of responses opting for this structure (up from 39 percent). Ownership via a "look through" company was the next most popular ownership structure, with 32 percent of investors adopting this structure (up from 31 percent). Owning a property in a family trust was unchanged at 29 percent.

Forty five percent of property investors use a property manager for at least one of their investment properties. This is the highest proportion since the start of the survey. A further sixteen percent of investors would consider using a property manager.

Property values

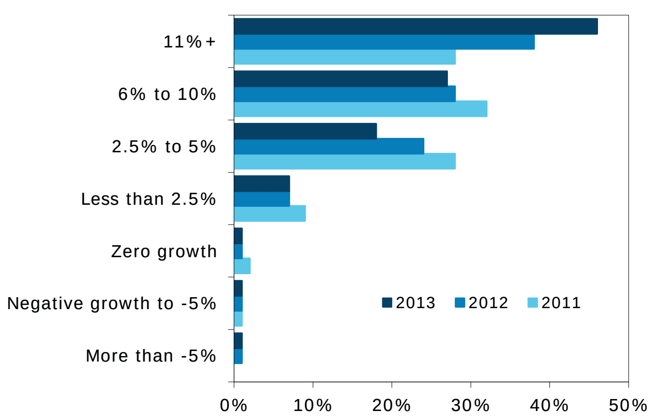
Growth in property values over the next year was anticipated by 92 percent of respondents, up from 87 percent last year and 71 percent in 2011. The median increase expected has risen to 4.3 percent versus 3.1 percent last year. The average rate investors expect their property value to have increased by in five years time remains modest at 6 to 10 percent. The Reserve Bank will likely be reassured to see that **investors are** not extrapolating a stellar year, but are **on the whole remaining realistic about their potential long-term gains.**

Property values - next year



Sources: ANZ

Property values - next 5 years



Sources: ANZ

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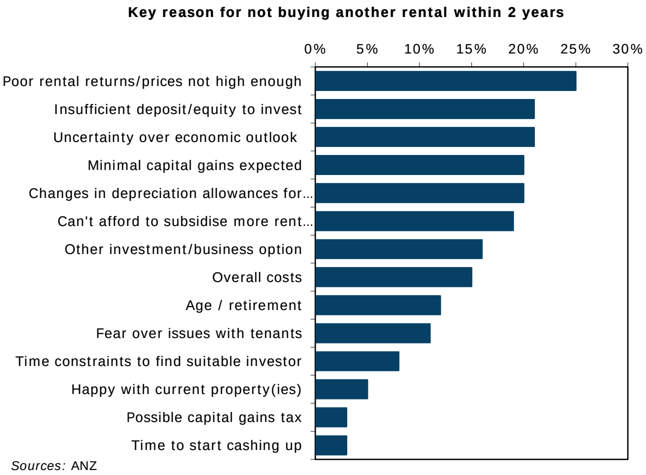
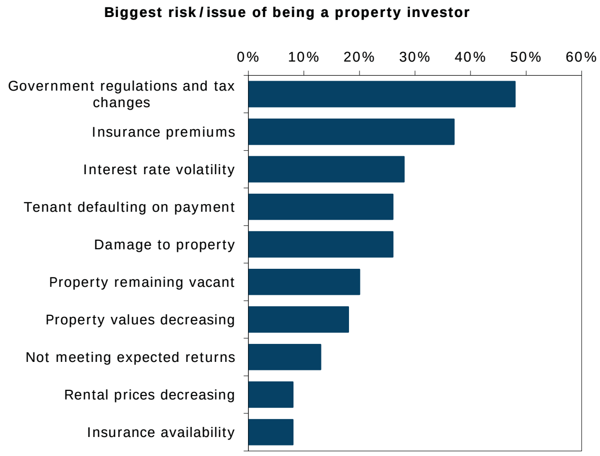
Since last year **there has been no change in investors' expected level of annual percentage growth in their investment property rents** in the short-term (next year) and longer-term (five years time). It appears Auckland housing shortages are not yet translating into elevated rent expectations.

The timeframe within which investors intend to buy their next rental property has not changed since 2012. **Approximately half intend to purchase another property within the next two years**, and around 4 in 10 do not plan on purchasing another rental property.

The main reasons why some investors do not plan on buying another rental property in the next two years are exactly the same as in 2012, including 'poor rental returns', a lack of money to invest i.e. 'insufficient deposit or equity', and 'uncertainty over the economic outlook'.



Sources: ANZ



Sources: ANZ

The main risk or issue of being a property investor continues to be 'government regulations and tax changes'. In fact, a greater proportion of investors mentioned this in 2013 than in 2012. **This year a greater proportion of investors also mentioned that 'insurance premiums' and 'interest rate volatility' are the main risks to investors. We agree.** The move to sum insured dwelling insurance has seen premiums rise for most, while the Reserve Bank has made it very clear that they expect to raise the Official Cash Rate next year. A smaller proportion of investors than last year think the biggest risks/issues to investors are 'tenants defaulting on payments', 'property remaining vacant', 'property values decreasing', and 'not meeting expected return'. These are all cyclical indicators, and the decline in these concerns is consistent with the broadening of the housing market upturn through the country.

Debt / value ratio

One in every ten property investors is completely debt free. Around 6 in 10 investors have debt that is 50 percent or more of their properties' value. These results are similar to last year, with 20 percent of investors saying their debt-to-value ratio has increased, and 41 percent saying it has decreased over this period. **Increasing property values were the main reason cited for improved debt-to-value ratios, rather than reductions in nominal debt.** This makes the improvement in debt burdens less comforting for the Reserve Bank than actual debt repayment would be, from a financial stability point of view.

Government and regulatory changes

The number of investors who see 'government regulations and tax changes' as a risk for property investors continues to rise sharply. In 2010, just 12 percent rated this as a risk. This year, the percentage of investors rating this as the biggest risk had risen to a whopping 48 percent. While the Government does continue to tinker with the tax rules around property investing, it seems likely that a number of respondents have considered the Reserve Bank's new speed limits on high loan-to-value ratio (LVR) mortgage lending to be a "government regulation".

The survey was taken just before the final details of the Reserve Bank LVR policy were announced, but the changes had been well signalled. Uncertainty about the impacts was therefore the main message.

FEATURE ARTICLE: THE 2013 ANZ PROPERTY INVESTORS SURVEY

However, there were also some interesting take-outs. Around half of all investors did not think that speed limits on high loan-to-value ratio housing lending would impact their property investment strategy in the next 12 months. 16 percent of investors indicated it would change their strategy in some way, and a further 20 percent indicated that they would need to know the extent and nature of the limits before they could make a judgement.

Interestingly, **half of all investors did not think that limits on loan-to-value ratio lending would affect their expected capital values across their property portfolio.** A further quarter were unsure whether or not there would be an impact. Almost one quarter did think limits on loan-to-value ratio lending will affect expected capital values across their property portfolio, but of some concern to the Reserve Bank, perhaps, not all thought the impact would be negative. Most thought the impacts would be relatively small (+/- 5 percent). Overall, **more of the investors who expected an impact thought their property values would increase (almost 5 in 10), than decrease (around 3 in 10)!** The reason given was that their property portfolio is focused at the more affordable end of the spectrum, and people would be forced to trade down in terms of what they could buy for a given deposit, lifting demand for lower-end properties.

Insurance and the Canterbury earthquakes

The proportion of investors who have specialist landlord insurance cover has remained relatively unchanged over the years (around 6 in 10 investors have such cover). However, there continues to be a rise in the proportion of investors who have examined the insurance cover they have for their residential investment property/properties due to the Canterbury earthquakes (6 in 10 investors now say they have done so).

Earthquake awareness continues to drive investor concern about insurance cover. In 2011, 37 percent of investors said they had re-examined their insurance cover for their residential investment properties as a result of the Canterbury earthquakes. This increased to 48 percent in 2012, and to 61 percent this year. This may reflect an element of compulsion as insurers change to sum insured policies. **Insurance premiums as a key risk rose from 23 percent last year to 37 percent of investors expressing concern.** Almost 3 in 10 investors say the Canterbury earthquakes have caused them to reassess the attractiveness of being a property investor. Around half of these investors say the reason is that property investment is now less attractive because of higher insurance premiums. A small proportion of Canterbury investors noted that it was now more attractive due to higher rental returns.

THE UPSHOT

This survey suggests that despite some rapid increases in the value of residential property, especially in the Auckland market, and to a lesser extent Christchurch, **investors on the whole continue to take a prudent approach to the management of their portfolios.** Inexperienced investors may believe that prices only ever go up. The more experienced investors, who form the majority of the respondents to this survey, know better. Many will have managed their properties through the correction in the New Zealand market in 2008 and 2009 and the challenging wider economic downturn. Accordingly, despite media hype about increases in the value of residential property, **investor expectations of short and medium-term increases in property values and rents remain reassuringly modest.**

These expectations are realistic in view of Reserve Bank initiatives to let some air out of the property market, slow price increases, and reduce the risks to the financial system and the broader economy that would accompany a speculative bubble. **The announcement of restrictions on high loan-to-value ratio (LVR) mortgage lending is just the Reserve Bank's first move in a game they are determined to win.** If these restrictions do not slow the rate of housing-related credit growth and house price inflation, the Reserve Bank will look at other macro-prudential options, and/or raise the Official Cash Rate more aggressively.

Housing affordability continues to be an issue, particularly in Auckland, where **house prices, relative to both incomes and rents, are overvalued. Partly this reflects housing shortages** after years of under-building. The Housing Accord between the Government and Auckland Council is an attempt to address this by freeing up land and streamlining the consent process for new developments. In time this could help ensure Auckland houses become more affordable, but supply is likely to remain constrained for years, as population growth implies a moving target. Importantly, however, **this does not imply that Auckland housing prices can only go up in coming years.** There is no guarantee that prices will not overshoot and then correct in a nasty fashion. This is the Reserve Bank's concern.

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Investor concern about interest rate volatility has increased substantially since last year. This makes sense, as the era of very low interest rates appears to be gradually coming to an end. In addition to the Reserve Bank's actions, in a connected world our interest rates and exchange rate will be affected by what happens elsewhere, particularly in the US. As the US Federal Reserve starts to wind down the latest (and largest) round of quantitative easing, a policy used to stimulate its economy on-and-off since 2009, **longer-term retail interest rates in New Zealand are likely to rise.** While the global economy still faces huge challenges, the New Zealand economy continues to move from recovery to expansion. Commodity prices have held up, the positive growth impacts of the Christchurch rebuild are kicking in, manufacturing is picking up, and the labour market is gradually strengthening. High levels of confidence across both businesses and consumers are feeding through into a broadening upturn across sectors. **An economic expansion and a stronger housing market typically go hand in hand, though higher interest rates are the hook.**

For property investors, a continued focus on improving the sustainability of their investments makes sense. While the housing market in Auckland is running hot at present, **the Reserve Bank is on the warpath, fixed mortgage interest rates are rising, and housing affordability constraints will inevitably kick in at some point.** The bigger the overshoot, the uglier the potential correction. **Investor confidence should remain tempered with prudent attention to business fundamentals.**

KEY FORECASTS

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

Mortgage Size ($'000)	Mortgage Rate (%)													
	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00	8.25
200	270	276	283	290	297	304	311	319	326	333	341	348	356	364
250	337	345	354	363	371	380	389	398	407	417	426	435	445	455
300	404	415	425	435	446	456	467	478	489	500	511	522	534	545
350	472	484	496	508	520	532	545	558	570	583	596	610	623	636
400	539	553	566	580	594	608	623	637	652	667	682	697	712	727
450	607	622	637	653	669	684	701	717	733	750	767	784	801	818
500	674	691	708	725	743	761	778	797	815	833	852	871	890	909
550	741	760	779	798	817	837	856	876	896	917	937	958	979	1,000
600	809	829	850	870	891	913	934	956	978	1,000	1,022	1,045	1,068	1,091
650	876	898	920	943	966	989	1,012	1,036	1,059	1,083	1,108	1,132	1,157	1,182
700	944	967	991	1,015	1,040	1,065	1,090	1,115	1,141	1,167	1,193	1,219	1,246	1,273
750	1,011	1,036	1,062	1,088	1,114	1,141	1,168	1,195	1,222	1,250	1,278	1,306	1,335	1,364
800	1,078	1,105	1,133	1,160	1,188	1,217	1,246	1,274	1,304	1,333	1,363	1,393	1,424	1,454
850	1,146	1,174	1,204	1,233	1,263	1,293	1,323	1,354	1,385	1,417	1,448	1,480	1,513	1,545
900	1,213	1,244	1,274	1,306	1,337	1,369	1,401	1,434	1,467	1,500	1,534	1,567	1,602	1,636
950	1,281	1,313	1,345	1,378	1,411	1,445	1,479	1,513	1,548	1,583	1,619	1,655	1,691	1,727
1000	1,348	1,382	1,416	1,451	1,486	1,521	1,557	1,593	1,630	1,667	1,704	1,742	1,780	1,818

Housing market indicators for September 2013 (based on REINZ data)

	House prices (ann % change)	3mth % change	No of sales (sa)	Mthly % change	Avg days to sell (sa)	Comment
Northland	4.3	1.9	199	+14%	70	Time to sell back to a nationwide and 7-month high.
Auckland	10.6	2.0	2,767	+0%	30	Prices rise at a slowing rate with weakest 3m chg since Feb.
Waikato/BOP/Gisborne	4.6	0.9	1,045	+8%	54	The average sale price lifted to a 5-year high of $325,000.
Hawke's Bay	2.1	2.5	208	-3%	46	Time to sell drops by over 2 weeks compared to last month.
Taranaki	0.3	2.3	266	-7%	47	The joint largest drop in sales volumes in September.
Manawatu/Whanganui	6.6	2.2	192	+11%	30	The quiet achiever behind Auckland and Canterbury.
Wellington	-2.8	-1.6	700	+9%	33	Median time to sell speeds up to a 3½-year low.
Nelson/Marlborough	-2.9	5.8	252	+4%	39	Strongest 3 mth change but prices below year-ago levels.
Canterbury/Westland	13.8	1.1	839	+0%	27	The strongest annual increase in house prices.
Central Otago Lakes	-4.8	3.9	98	-3%	67	The median time to sell creeps up to a 6-month high.
Otago	4.4	2.8	231	-7%	31	Joint weakest change in the volume of house sales in Sept.
Southland	-5.5	-6.0	160	+18%	57	Largest decrease in house prices compared to a year ago.
NEW ZEALAND	7.9	1.5	6,968	+3%	34	Rush to transact before LVR speed limits came into force.

Key forecasts

	Actual			Forecast						
Economic indicators	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
GDP (Ann Avg % Chg)	2.7	2.6	2.9(f)	2.7	2.7	2.7	2.7	2.7	2.7	2.7
CPI Inflation (%)	0.9	0.7	1.4	1.6	1.7	2.0	1.8	1.9	2.1	2.3
Unemployment Rate (%)	6.2	6.4	6.2(f)	6.0	5.8	5.8	5.7	5.6	5.6	5.6
	Actual			Forecast (end month)						
Interest rates (carded)	Aug-13	Sep-13	Latest	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Official Cash Rate	2.50	2.50	2.50	2.50	2.75	3.00	3.00	3.25	3.50	3.50
90-Day Bank Bill Rate	2.7	2.7	2.8	2.8	3.2	3.3	3.3	3.7	3.8	3.8
Floating Mortgage Rate	5.6	5.6	5.6	5.6	5.9	6.1	6.1	6.4	6.6	6.6
1-Yr Fixed Mortgage Rate	5.3	5.3	5.3	5.6	6.1	6.3	6.4	6.8	6.8	6.8
2-Yr Fixed Mortgage Rate	5.8	5.8	5.9	6.0	6.1	6.4	6.5	6.8	6.8	6.9
5-Yr Fixed Mortgage Rate	6.8	7.0	7.1	7.1	7.2	7.2	7.2	7.2	7.2	7.2

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