Westpac Institutional Bank

Credit Check

1 May 2014

This Credit Check takes a look at how the RBNZ's high-LVR lending restrictions have been performing, and how they might evolve.

When the Reserve Bank introduced its high-LVR lending restrictions in October, it had the specific aim of reducing risky (low-equity) mortgage lending to 15% of total new mortgage lending (10% after exemptions are subtracted), and the broader aim of slowing credit growth and the housing market.

Measured against the first aim the restrictions have done their job, and then some. As of March, high-LVR lending has fallen to just 4.8% of new mortgages, compared to the projected 15%.

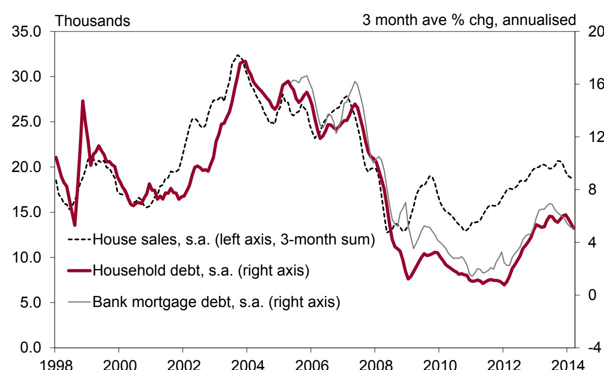
Measured against the RBNZ's broader aim of slowing overall credit growth, the impact of the LVR restrictions has, if anything, been a bit more modest than what was intended. The RBNZ had projected that household credit growth would slow by 1-3 percentage points. Since September, bank mortgage loans have grown at an annualised rate of 5.1% - down from 6.3% growth over the previous year. The slowdown in total household credit growth has been more modest, with some sign of leakage into the non-bank sector and a noticeable pickup in consumer lending in the last six months or so. (Non-bank mortgage lending rose a stunning 15% over the December quarter, after years in the doldrums.)

But there's a broader sense that the policy is working, in the sense that there is little sign at the moment of the stronger economy spilling over into a renewed upsurge in debt-fuelled spending, in the way it did in the mid-2000s.

Importantly, households have stopped leveraging up, despite stronger economic growth and much stronger confidence. Back in early 2013 there was a rising concern that household debt was once again growing faster than incomes. But on the RBNZ's latest estimates, the ratio of household debt to disposable income stabilised in the second half of 2013.

What's more, total system credit – including commercial and farm loans – grew at an annualised rate of just 3.5% over the first three months of this year, well below the growth rate of the nominal economy. Business lending remains halting. Lending to the 'property and business services' sector (which includes professional property investors) had been a brightish star, but this seems to have slowed again in the March quarter. And loan growth to the agri sector has very clearly slowed since late last year, even as farmers' incomes and bank deposits have surged. That suggests that farmers as a group have taken advantage of a bumper season to pay off existing debt, rather than gear up again.

House sales and household credit growth



The upshot is that we wouldn't be surprised to see the RBNZ recalibrate the speed limit soon, simply to achieve its original 15% target. That could happen as soon as this month.

As interest rates rise, credit growth may remain subdued without the need for LVR restrictions. So the Reserve Bank may also start firming up its communication about eventual exit from the policy. (There were already hints in that direction in a speech by Deputy Governor Spencer back in March.)

That said, any discussion of exit will probably still be fairly halting and tentative. Household credit growth has slowed, but not spectacularly, and a loosening of the LVR restrictions is likely to give the housing market a 'second wind' later this year. With mortgage rates rising and house prices already looking stretched, it's been our view for some time that this second wind will turn out to be temporary. But the Reserve Bank will probably take more convincing.

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