ANZ RESEARCH

NEW ZEALAND PROPERTY FOCUS

June 2017

INSIDE

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WHO'S HOT AND WHO'S NOT

SUMMARY

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

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT

They say a picture is worth a thousand words, so this month's feature takes a look at regional housing markets, gauging who is hot, and who is not. The clear take-away is that Auckland is bearing the brunt of the recent slowdown in housing market activity, with numerous other regions still performing well and playing catch-up; although unsurprisingly, some are doing better than others. This Auckland underperformance is a story that will persist if the 2005-2007 experience is repeated. Capital (and people) naturally flow to regions where valuations look more attractive and the gap between Auckland house prices and the rest of the country is extreme.

PROPERTY GAUGES

The property market is softening, particularly in Auckland as the combination of a turn in the interest rate cycle, less credit, LVR restrictions and severely stretched affordability act as headwinds. There is still incremental support for prices to lift after a lull courtesy of population growth and a fundamental mismatch between supply and demand. We think the former factors will be the key influences over the coming year and expect house price momentum to remain subdued.

ECONOMIC OVERVIEW

The economy is performing solidly, though on some metrics such as GDP per capita the economic story is sub-par. Indicators points to solid momentum over the year ahead; businesses and consumers are confident and financial conditions are supportive. However, the economy does not have the capacity to accelerate sharply. Labour and credit constraints are headwinds. We are expecting economic momentum to remain solid over the years ahead.

MORTGAGE BORROWING STRATEGY

Mortgage rates are virtually unchanged since last month. The average floating rate rose 0.03% as a result of one bank lifting their rate. The mortgage curve remains tick-shaped, with the 1 month rate the low point, and in our view, the "sweet spot". Although we expect the RBNZ's next move to be a hike, and see mortgage rates on a gradually upward trajectory over coming years, this is already factored into the term structure, and we question the economic value of fixing for longer than 1 year given the increased cost. However, we acknowledge that longer terms do offer more certainty.

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

SUMMARY

They say a picture is worth a thousand words, so this month's feature takes a look at regional housing markets, gauging who is hot, and who is not. The clear take-away is that Auckland is bearing the brunt of the recent slowdown in housing market activity, with numerous other regions still performing well and playing catch-up; although unsurprisingly, some are doing better than others. This Auckland underperformance is a story that will persist if the 2005-2007 experience is repeated. Capital (and people) naturally flow to regions where valuations look more attractive and the gap between Auckland house prices and the rest of the country is extreme.

NORTHLAND

- The Northland region REINZ House Price Index (HPI) is on a steep incline reminiscent of the 2004-2006 period, when the Northland market last outperformed Auckland. In May, annual HPI growth topped 21%, the highest annual growth of any region. For comparison, house price indexes in regions outside of Auckland grew 12% in the year to May, and nationally they lifted 8%.
- Median house price growth is bettering the national average, having lifted 24% versus 12 months prior (New Zealand 9%). The region's median house price is quickly closing in on the national median, having surged 8% over the previous three months, more than double the national growth rate. Cheaper valuations and access to Auckland warrant a degree of catch-up in Northland, though regional incomes arguably don't.
- Sales volumes have fallen markedly since the middle of 2016, and are down 27% in the last year (on a three month average basis). However, Northland sales have stabilised over the last three months.
- Houses are selling quickly; at around 40 days, the median time to sell is much faster than the 100 days it took at the end of 2010.

FIGURE 1. NORTHLAND VS AUCKLAND HOUSE PRICE INDEX

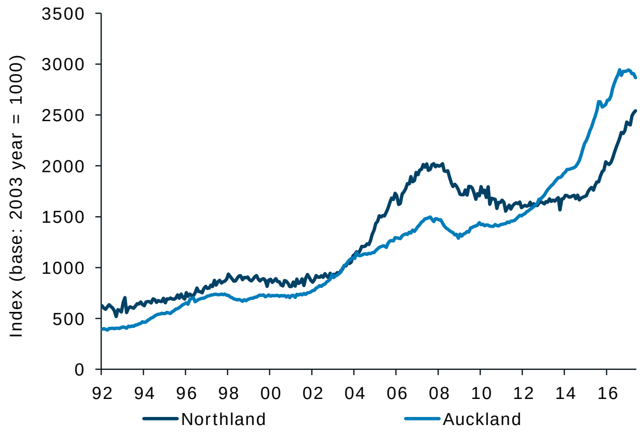


FIGURE 2. NORTHLAND VS NEW ZEALAND MEDIAN HOUSE PRICE

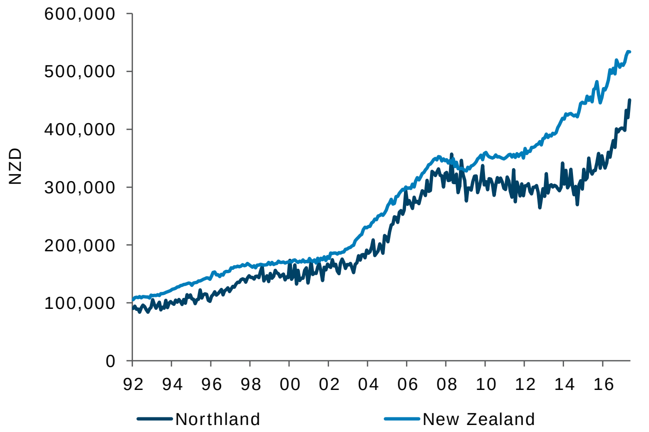


FIGURE 3. NORTHLAND VS NEW ZEALAND HOUSE PRICE INDEX

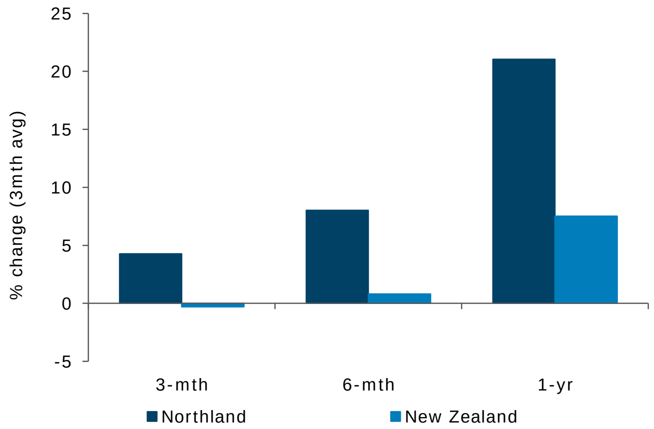
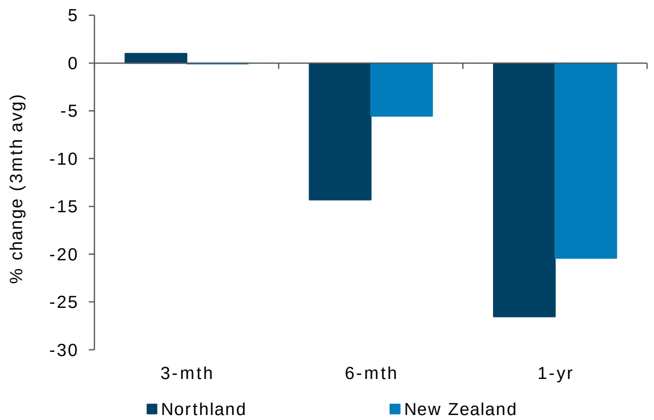


FIGURE 4. NORTHLAND VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

AUCKLAND

- Auckland house prices have been the main talking point across New Zealand's housing landscape for some time, having increased at unprecedented rates since 2011. The Auckland region HPI doubled from the start of 2011 to the end of 2016.
- Recent LVR restrictions have had a direct impact on investor lending and the HPI is now moving backwards, with prices lower than they were six months ago. When compared with the rest of New Zealand, it looks like 2004-2006 all over again, with Auckland underperforming the rest of the country.
- There is still daylight between the median sales price in Auckland and the rest of New Zealand; that's a huge incentive to buy somewhere outside of Auckland if you're an investor, and cash up and move if you're retiring.
- The volume of Auckland house sales has been thumped, down 26% since this time last year (on a three month average basis). The rest of New Zealand is down also, but by far less (-18% y/y).

FIGURE 5. AUCKLAND VS NZ EX-AUCKLAND HOUSE PRICE INDEX

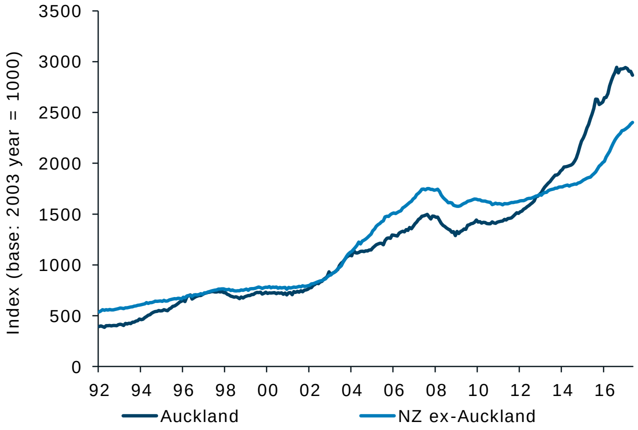


FIGURE 6. AUCKLAND VS NEW ZEALAND EX AUCKLAND MEDIAN HOUSE PRICE

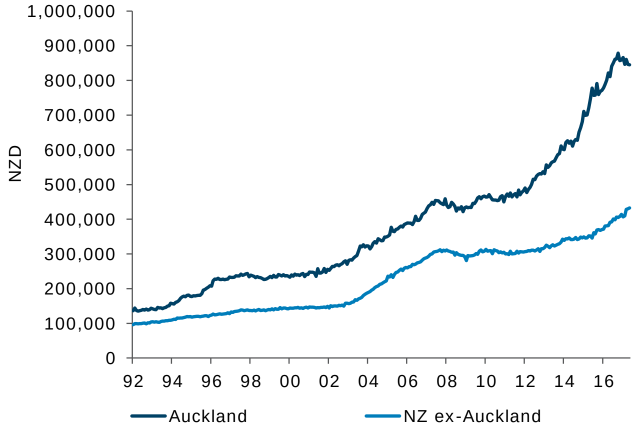


FIGURE 7. AUCKLAND VS REST OF NEW ZEALAND HOUSE PRICE INDEX

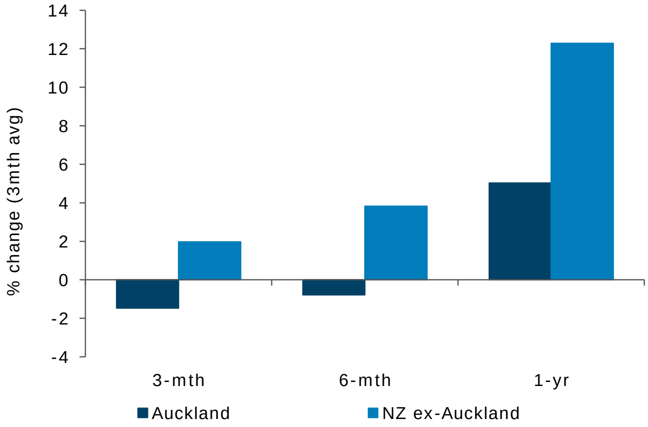
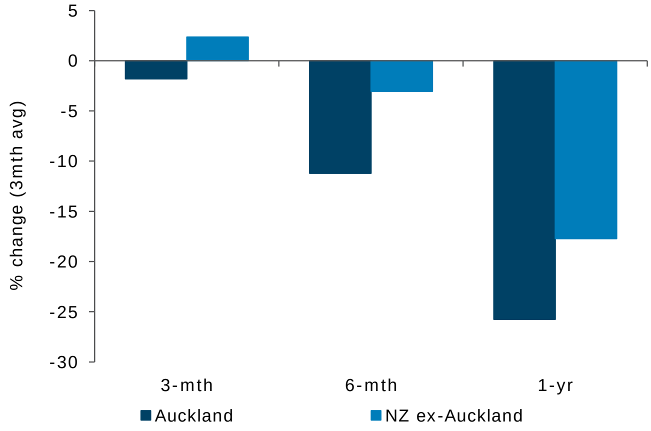


FIGURE 8. AUCKLAND VS NEW ZEALAND EX AUCKLAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

WAIKATO

- The Waikato region is outperforming on the price growth front compared to the majority of New Zealand, with an annual growth rate of 14% in May. Its close proximity to the Auckland region should not be discounted as a key driver of current price growth, but the recent recovery in global dairy prices may also be playing a part, by boosting confidence.
- The region is also quickly closing the gap on the national median sales price, having the highest growth rate over the last two years (+42% versus a national lift of 17%).
- Sales volumes (-27% y/y) are down slightly more than the nationwide figures as a whole. This may reflect the fact that Auckland investor activity is being curtailed by tougher LVR restrictions.

FIGURE 9. WAIKATO VS AUCKLAND HOUSE PRICE INDEX

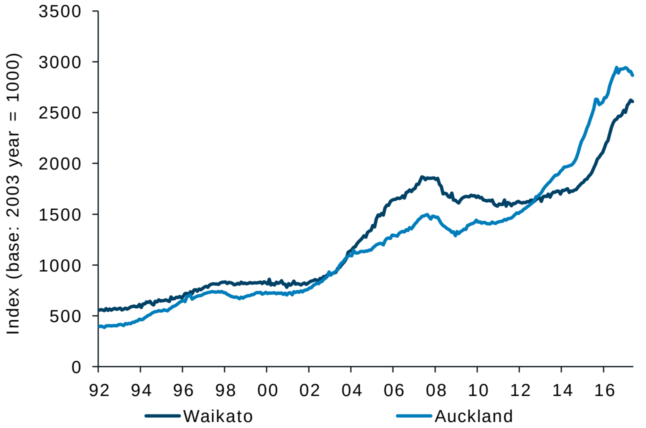


FIGURE 10. WAIKATO VS NEW ZEALAND MEDIAN HOUSE PRICE

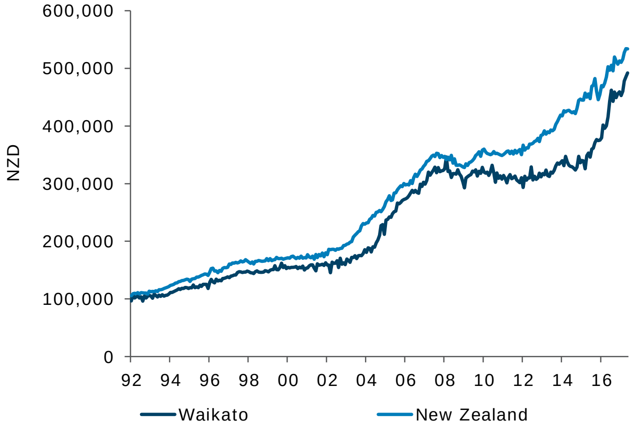


FIGURE 11. WAIKATO VS NEW ZEALAND HOUSE PRICE INDEX

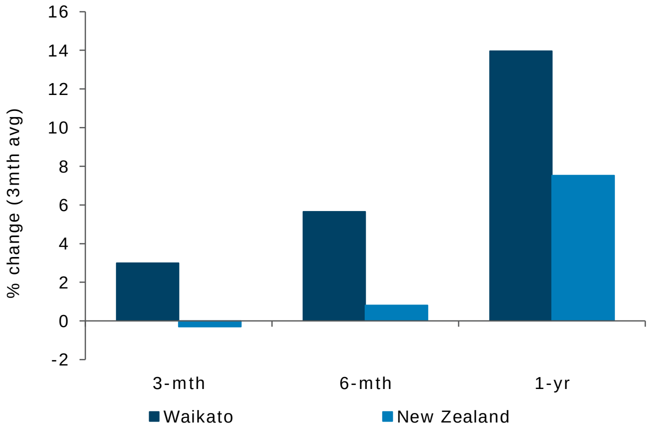
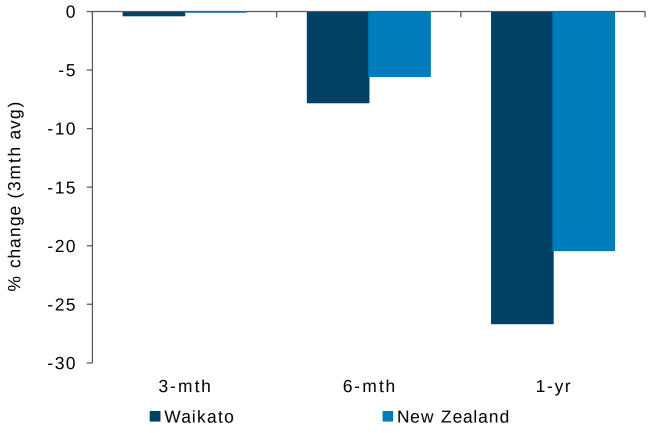


FIGURE 12. WAIKATO VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

BAY OF PLENTY

- The Bay of Plenty regional HPI has increased 57% since the region took off in the middle of 2014. National growth (heavily influenced by Auckland) for the same period was 42%. Marketing campaigns for 'the Bay' drew on the lifestyle aspect, which has seen migration to the area boom. Additional positive factors also include a buoyant construction sector, the region being central hub for the very strong kiwifruit sector, increased port activity, and the fact the region is a tourism hotspot.
- The median sale price for the Bay of Plenty has caught up to the national average after falling behind in 2009.
- Over the past 12 months, sales volumes have fallen by a similar magnitude to the rest of New Zealand. However, there have been more positive movements in the past three months.
- Although sales have dropped, at around 40 days, the median time to sell in the region is much less than usual (the average median is 54 days).

FIGURE 13. BAY OF PLENTY VS AUCKLAND HOUSE PRICE INDEX

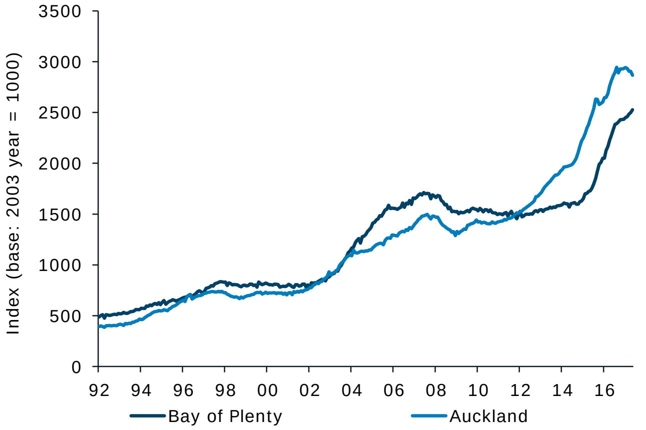


FIGURE 14. BAY OF PLENTY VS NEW ZEALAND MEDIAN HOUSE PRICE

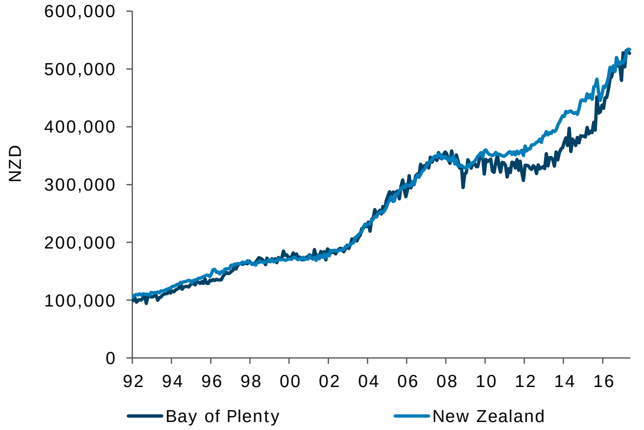


FIGURE 15. BAY OF PLENTY VS NEW ZEALAND HOUSE PRICE INDEX

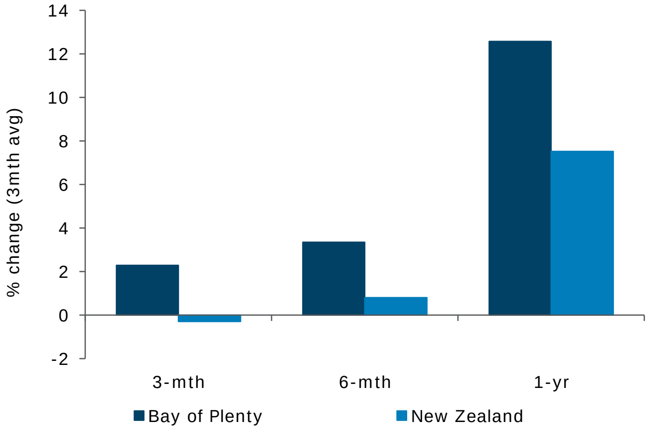
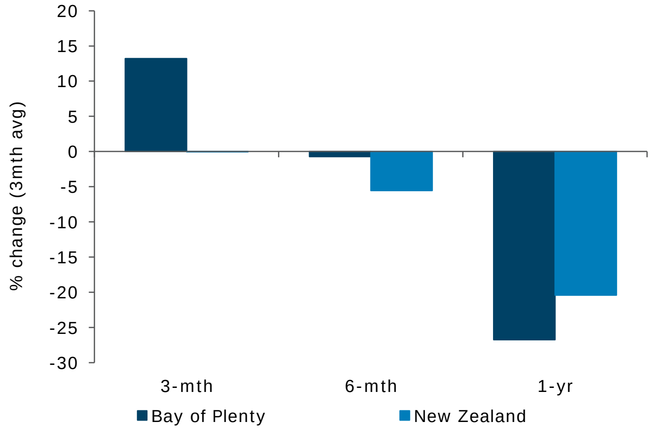


FIGURE 16. BAY OF PLENTY VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

HAWKE'S BAY

- The Hawke's Bay HPI continues its recent surge, growing at a rate of 20% over the last year compared to 8% for all of New Zealand.[1] Population growth has been a significant factor, reinforcing a degree of catch-up to narrow the unsustainably wide price differential that had opened up to Auckland in particular.
- The median sales price still sits well below the national average. Median prices have lifted by 19% in the last year, although this measure has stuttered in the last couple of months on a seasonally adjusted basis.
- Sales volumes have fallen by a similar magnitude to the rest of New Zealand over the past 12 months. However, the 10% bounce over the last three months is a positive turnaround.

FIGURE 17. HAWKE'S BAY VS AUCKLAND HOUSE PRICE INDEX

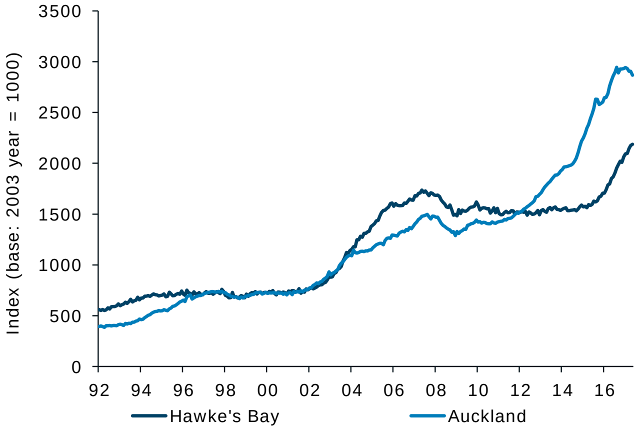


FIGURE 18. HAWKE'S BAY VS NEW ZEALAND MEDIAN HOUSE PRICE

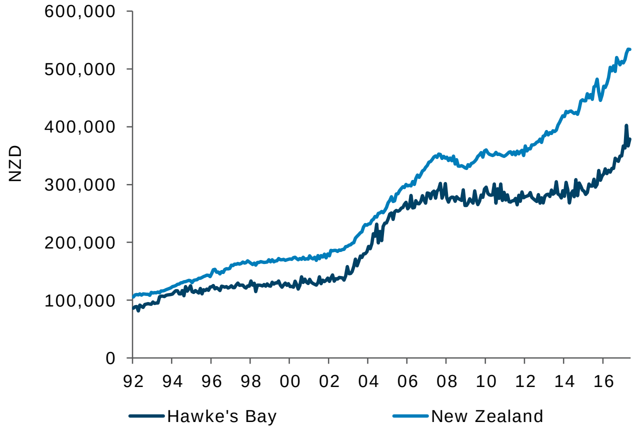


FIGURE 19. HAWKE'S BAY VS NEW ZEALAND HOUSE PRICE INDEX

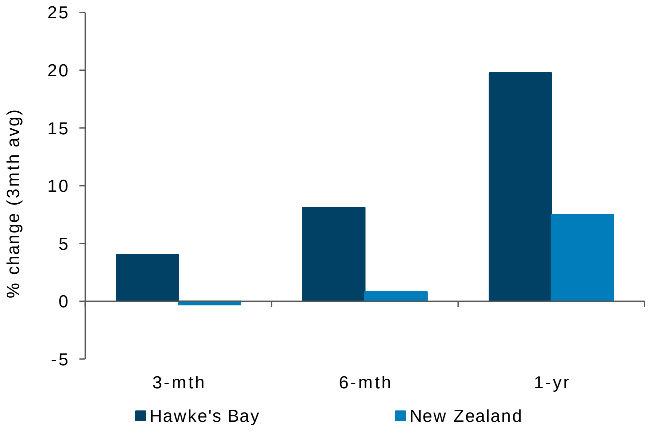
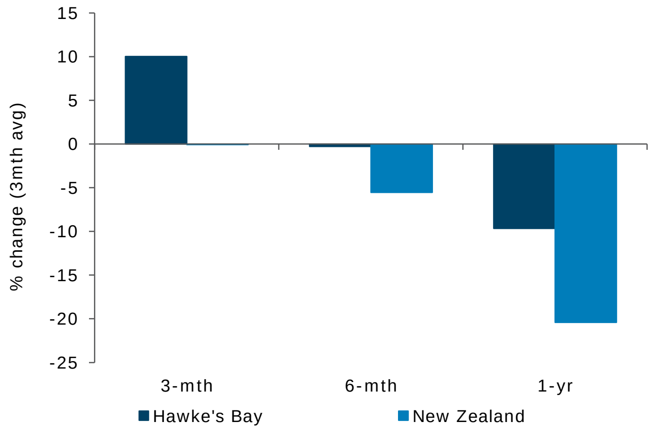


FIGURE 20. HAWKE'S BAY VS NEW ZEALAND SALES



Source: ANZ, REINZ

[1] Note the Hawke's Bay HPI includes the Gisborne region.

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

MANAWATU-WHANGANUI

- Regional house price growth is outperforming other regions at present, with the regional HPI lifting 17% over the 12 months to May. That compares with Auckland's 5% y/y growth and other regions at 12% y/y.
- The median sales price has started to lift after flat lining from 2007. However, it remains only around half of the national median price, reflecting lower incomes and relatively unfavourable demographics in the region.
- The median time it takes to sell has continued to trend lower and remains below its historical average.
- Sales volumes in the last year are holding up well compared other regions.

FIGURE 21. MANAWATU-WHANGANUI VS AUCKLAND HOUSE PRICE INDEX

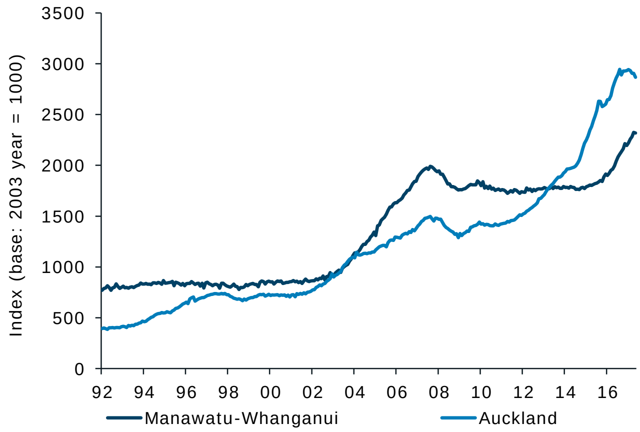


FIGURE 22. MANAWATU-WHANGANUI VS NEW ZEALAND MEDIAN HOUSE PRICE

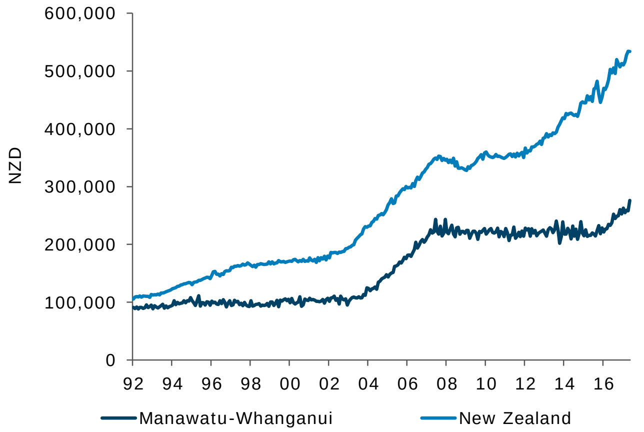


FIGURE 23. MANAWATU-WHANGANUI VS NEW ZEALAND HOUSE PRICE INDEX

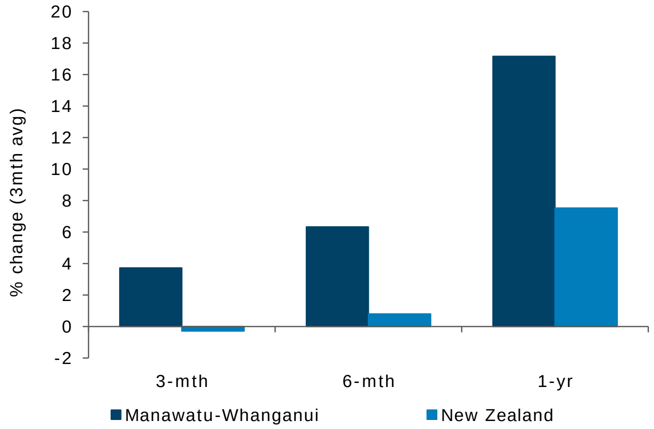
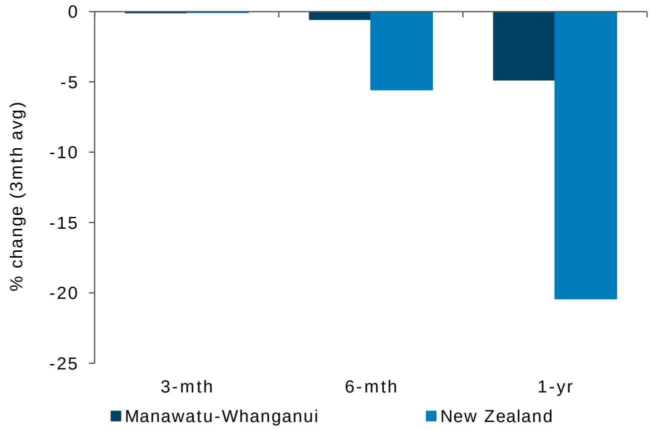


FIGURE 24. MANAWATU-WHANGANUI VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

TARANAKI

- Regional HPI growth over the last year is well ahead of Auckland, but sitting behind that of many other regions. That said, prices over the three months to May have ticked up a little, with growth of 1.4% (versus -0.3% nationally).
- However, the region is yet to join the median price party with any real gusto. The median sales price remains well below the national average ($350k vs $530k). Higher incomes across the region mean property is at the cheaper end of house-price-to-income ratios, but tougher times in the energy sector appear to be taking a toll.
- Sales volumes have taken a hit over the year, having falling 16% in the last 3 months alone.

FIGURE 25. TARANAKI VS AUCKLAND HOUSE PRICE INDEX

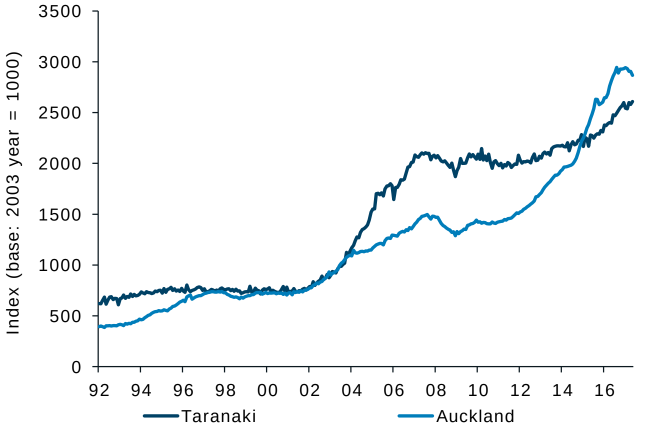


FIGURE 26. TARANAKI VS NEW ZEALAND MEDIAN HOUSE PRICE

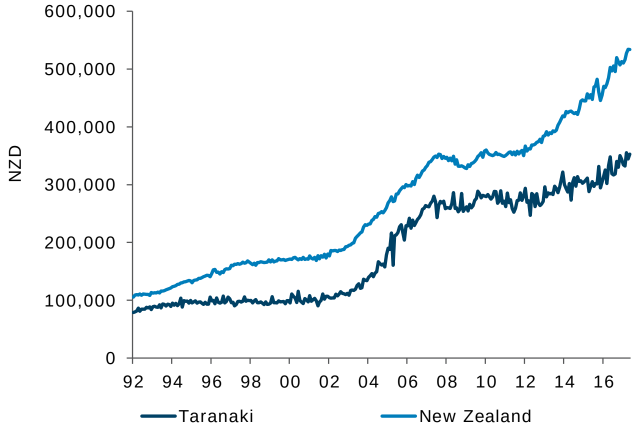


FIGURE 27. TARANAKI VS NEW ZEALAND HOUSE PRICE INDEX

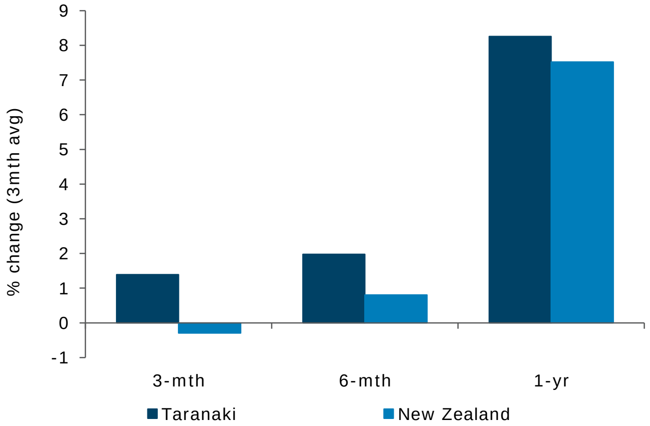
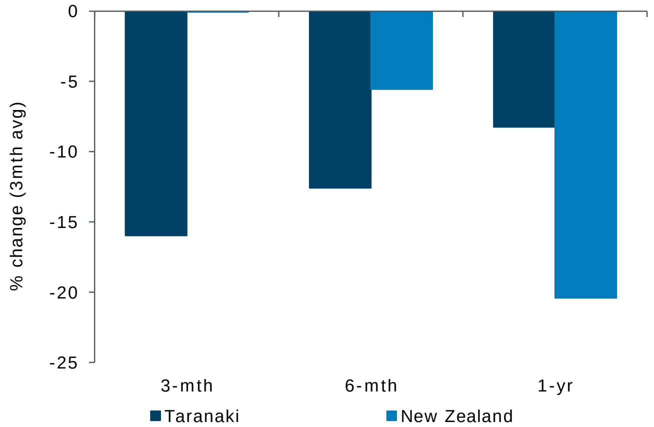


FIGURE 28. TARANAKI VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

WELLINGTON

- After flat-lining for eight years from 2007, the Wellington market finally joined the party and has become turbo-charged from a price growth point of view. The region's HPI is up 36% in two years, which compares with Auckland's 21% growth and regions outside of Auckland at 28%.
- The median sale price has recently come into line with the national average, for the first time since 2013. It has been growing on a much steeper trajectory than national prices of late. The capital's median house price has lifted 15% y/y, easily the fastest of the main centres.
- Although sales volumes are down 14% y/y (on a three month average basis), they are still holding up well compared to other regions.
- At around 30 days, the median number of days to sell a house in Wellington is sitting around historic lows.

FIGURE 29. WELLINGTON VS AUCKLAND HOUSE PRICE INDEX

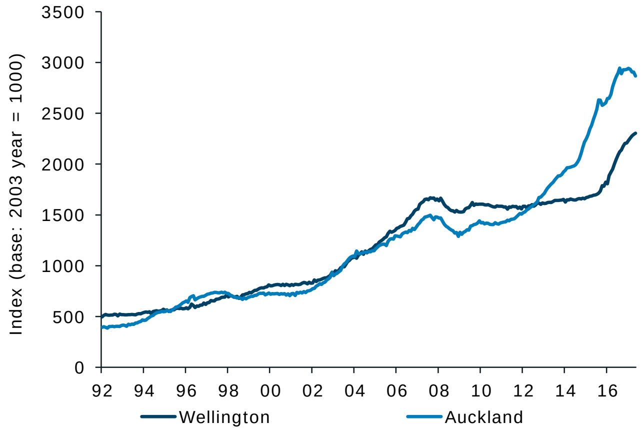


FIGURE 30. WELLINGTON VS NEW ZEALAND MEDIAN HOUSE PRICE

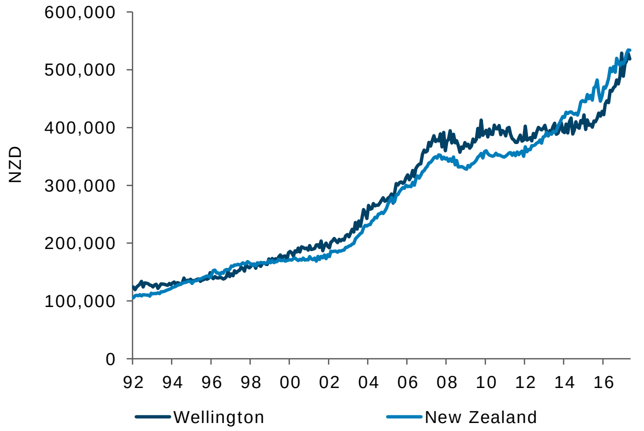


FIGURE 31. WELLINGTON VS NEW ZEALAND HOUSE PRICE INDEX

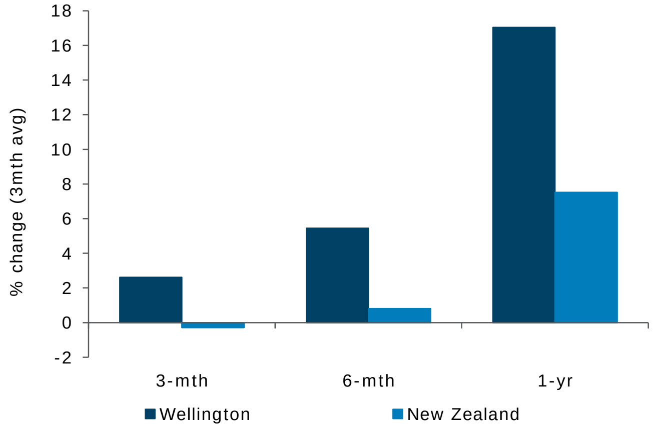
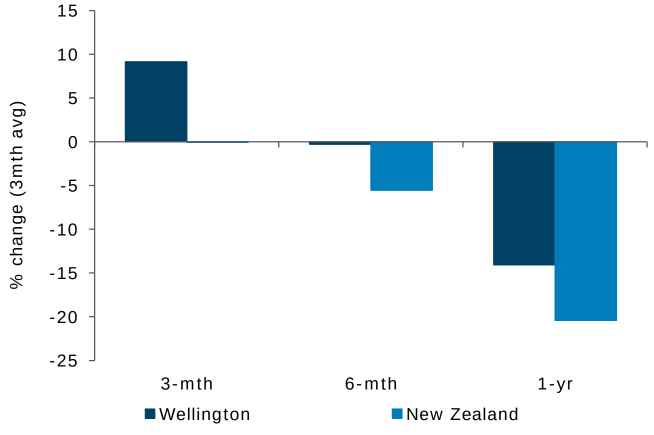


FIGURE 32. WELLINGTON VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

CANTERBURY

- Canterbury is an underperformer when it comes to lifts in house prices (which is of course not a bad thing for buyers). The HPI is up only 2.4% on last year, the slowest growth rate of all regions. This reflects that the region has had very strong growth in housing supply in recent years, and also that the earthquake rebuild effort has slowed significantly.
- The median sales price is below the national average and the gap has widened to the largest since the data began. Canterbury house prices are growing at a subdued 2.1% y/y compared to the national average of 9%.
- The median number of days to sell is creeping up towards 40 days, and has been gradually rising since the beginning of 2013.
- Sales volumes have fared reasonably well (down 14% y/y on a three month average basis) considering they fell 20% across the country over the last year.

FIGURE 33. CANTERBURY VS AUCKLAND HOUSE PRICE INDEX

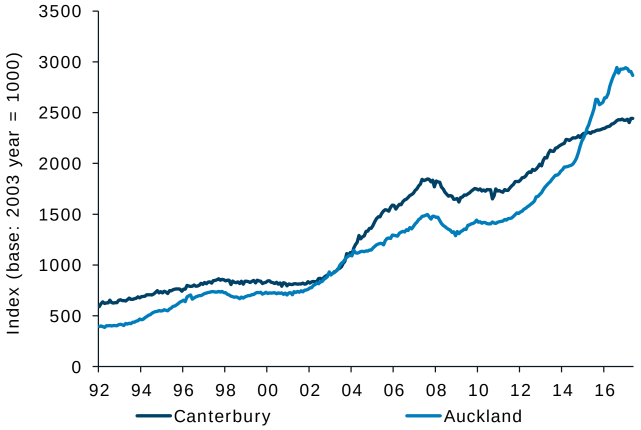


FIGURE 34. CANTERBURY VS NEW ZEALAND MEDIAN HOUSE PRICE

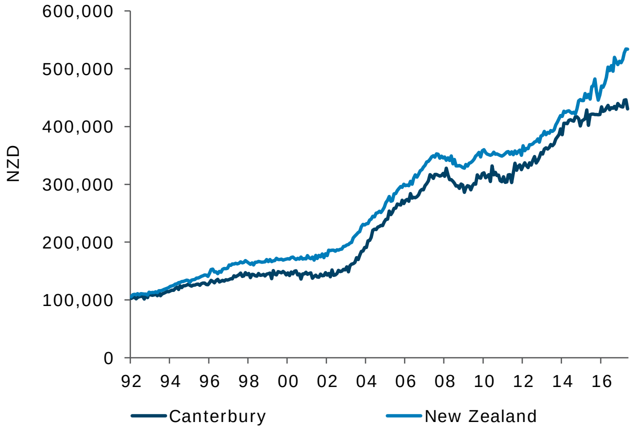


FIGURE 35. CANTERBURY VS NEW ZEALAND HOUSE PRICE INDEX

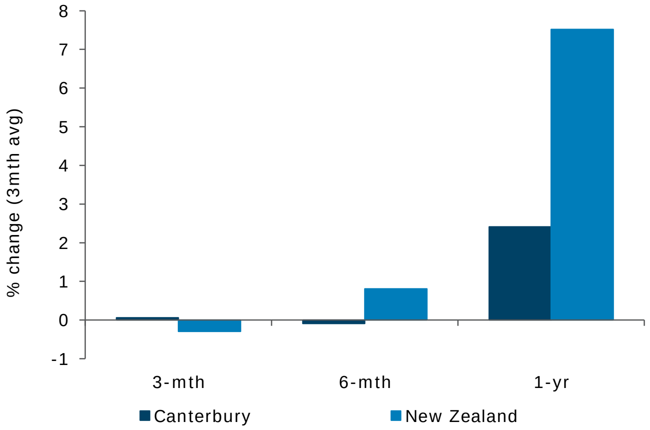
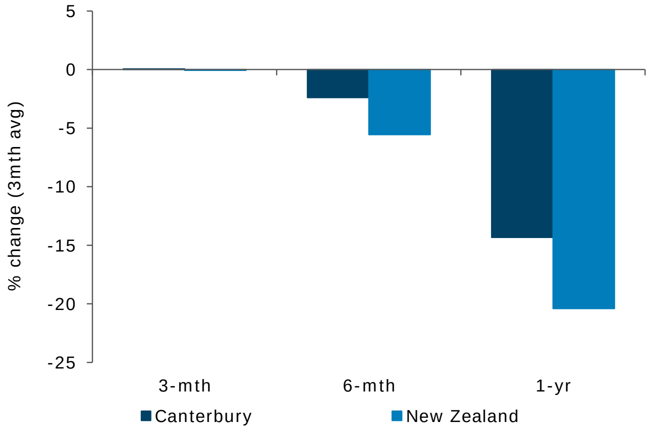


FIGURE 36. CANTERBURY VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

OTAGO

- The Otago HPI has surged 17% from 12 months prior. In the past three years the HPI has increased by 48%, outperforming both Auckland (47%) and regions other than Auckland (34%). Queenstown will be driving a fair bit of that, with the traditionally boom-bust town benefiting from both soaring tourism and very strong population growth.
- The regional median sales price is below the national average despite Queenstown prices being comparable to those in Auckland at close to $900k.
- Sales volumes have held up better than the national figures, as housing stock at the lower end of the market gain favour with buyers.
- Otago is one of only four regions where the median time to sell a house is less than 30 days at present. Time taken to sell a house in the region has been trending down since 2008.

FIGURE 37. OTAGO VS AUCKLAND HOUSE PRICE INDEX

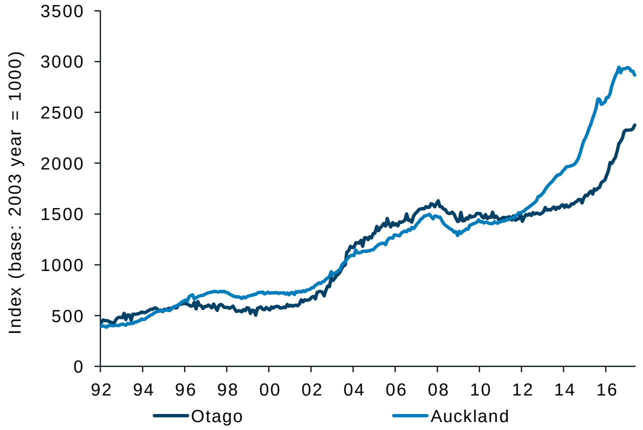


FIGURE 38. OTAGO VS NEW ZEALAND MEDIAN HOUSE PRICE

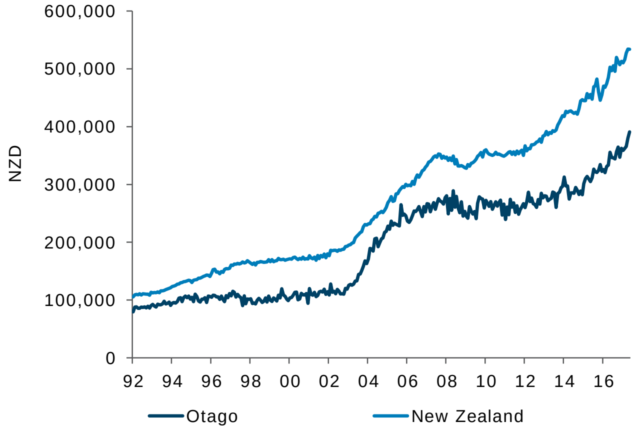


FIGURE 39. OTAGO VS NEW ZEALAND HOUSE PRICE INDEX

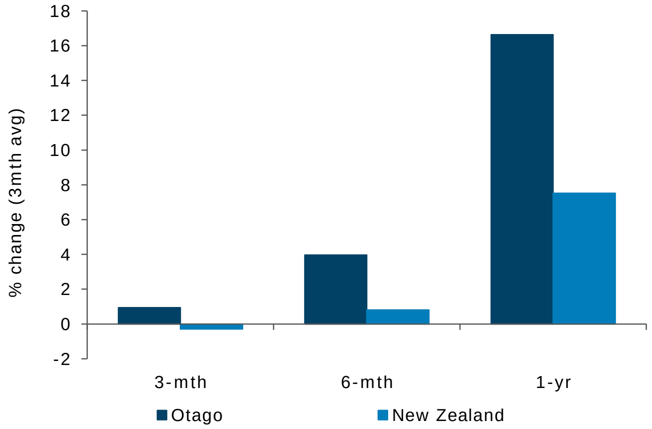
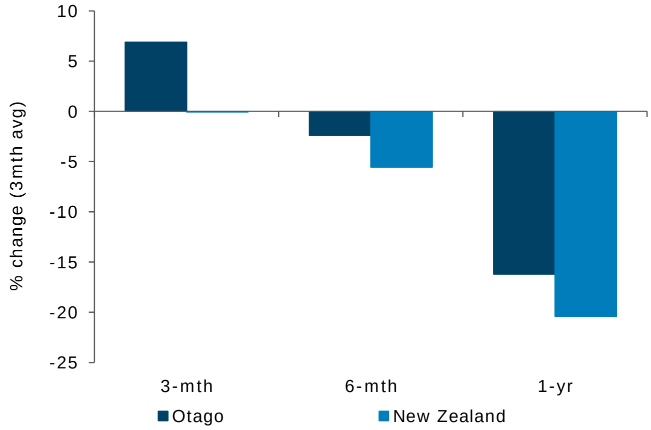


FIGURE 40. OTAGO VS NEW ZEALAND SALES



Source: ANZ, REINZ

CHIEF ECONOMIST CORNER: WHO'S HOT AND WHO'S NOT?

SOUTHLAND

- After surging from 2002 to 2007, but then remaining largely stagnant for the next seven years, the Southland HPI is starting to show signs of life again. Prices were up 11% y/y in May. That is respectable, although largely mirrors the rate of growth of regions outside of Auckland.
- The median sales price is well below the national average and among the lowest in the country, reflecting the region's distance from the major population and employment centres and demographic challenges.
- Sales volumes have fallen 26% y/y (on a three month basis), underperforming the rest of the country.

FIGURE 41. SOUTHLAND VS AUCKLAND HOUSE PRICE INDEX

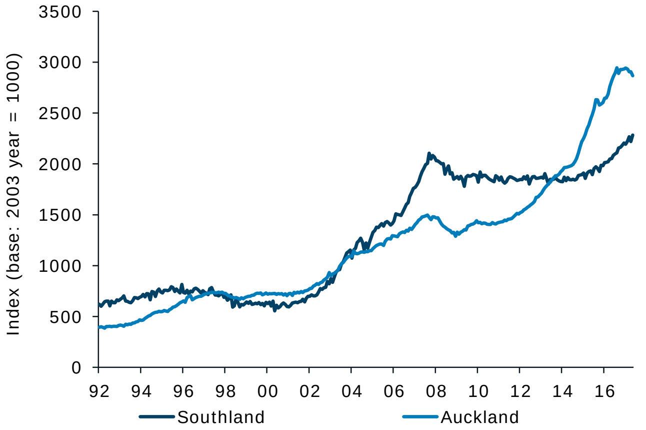


FIGURE 42. SOUTHLAND VS NEW ZEALAND MEDIAN HOUSE PRICE

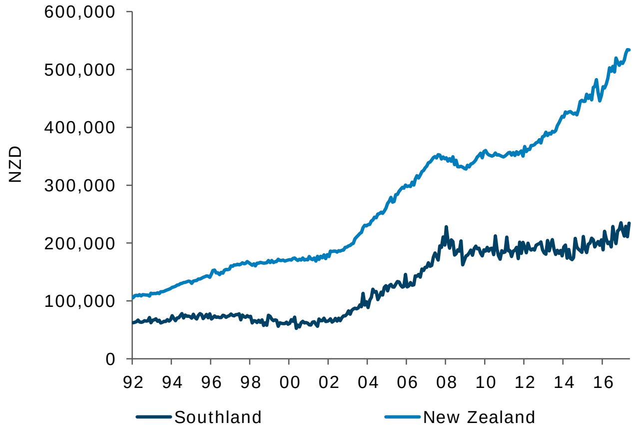


FIGURE 43. SOUTHLAND VS NEW ZEALAND HOUSE PRICE INDEX

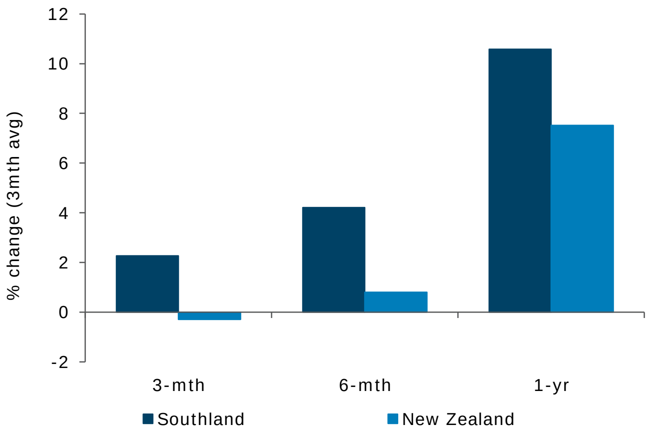
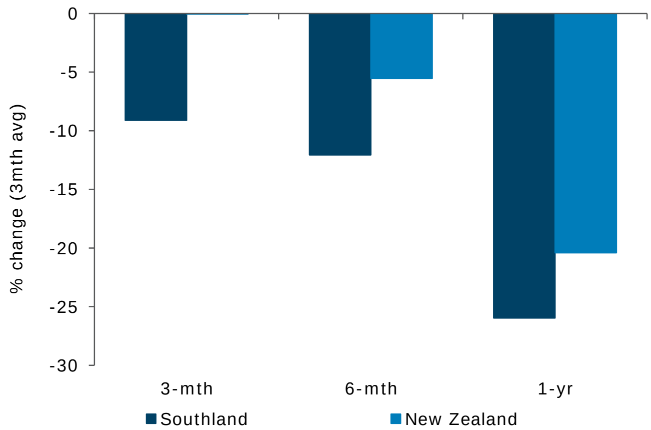


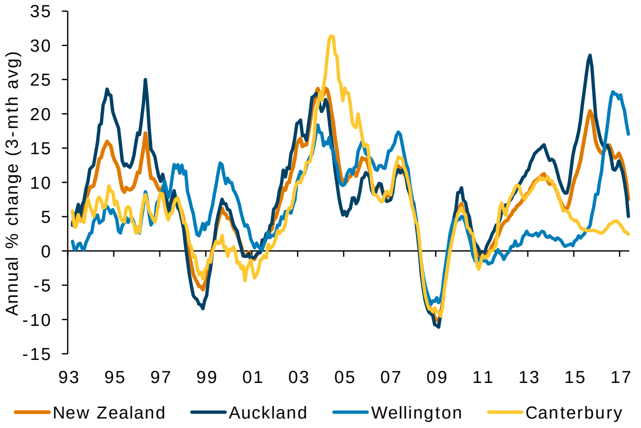
FIGURE 44. SOUTHLAND VS NEW ZEALAND SALES



Source: ANZ, REINZ

THE PROPERTY MARKET IN PICTURES

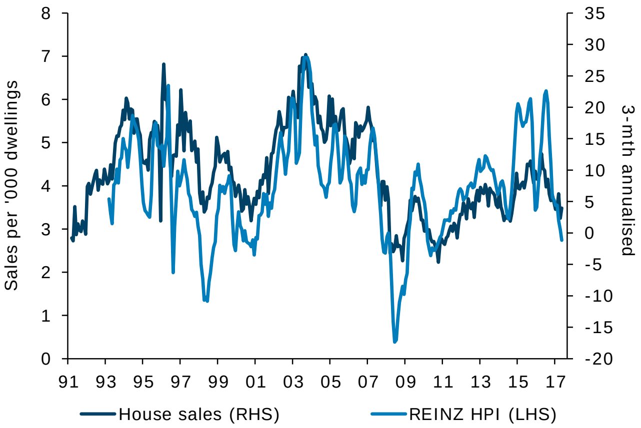
FIGURE 1. REGIONAL HOUSE PRICES



Source: ANZ, REINZ

According to the REINZ House Price Index, nationwide house prices fell 0.7% m/m (sa) in May, which saw annual growth fall to 5.0% (the chart is presented in 3-month average terms). That is the softest annual growth since early 2012. Of the main urban centres, price growth easily remains the strongest in Wellington (+15% y/y). In Auckland and Canterbury, prices are up just 1.8% and 2.4% respectively on a year ago. Excluding Auckland, national prices are running at an 11% y/y pace.

FIGURE 2. REINZ HOUSE PRICES AND SALES

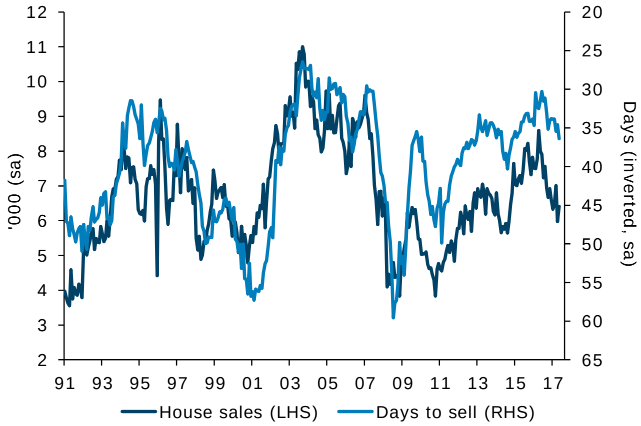


Source: ANZ, REINZ

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

After plunging 15% in April, seasonally adjusted sales volumes rebounded 7.4% m/m in May. The timing of Easter and poor weather was blamed for April's weakness, but as volumes only partly recovered in May, there are clearly other factors contributing. Overall, a weakening trend remains, with sales volumes down 20% y/y. In Auckland, sales volumes are 30% lower than a year ago, although other regions have not been spared from the weakness, with ex-Auckland sales down 15% y/y.

FIGURE 3. SALES AND MEDIAN DAYS TO SELL



Source: ANZ, REINZ

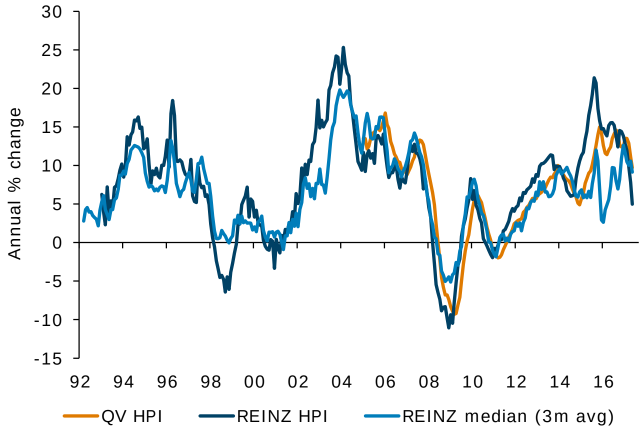
How long it takes to sell a house is also an indicator of the strength of the market, encompassing both demand and supply-side considerations. Larger cities tend to see houses sell more quickly, but deviations in a region from its average provide an indicator of the heat in a market at any given time.

Nationally, the median time to sell a house rose to 36.4 days (sa) in May. While that remains below its historical average (39.6 days), it is the highest it has been since late 2014 and well up from its mid-2016 lows of close to 30 days.

The median time to sell a property is below historical averages in every region with the exception of Auckland, Canterbury and the West Coast.

THE PROPERTY MARKET IN PICTURES

FIGURE 4. REINZ AND QV HOUSE PRICES

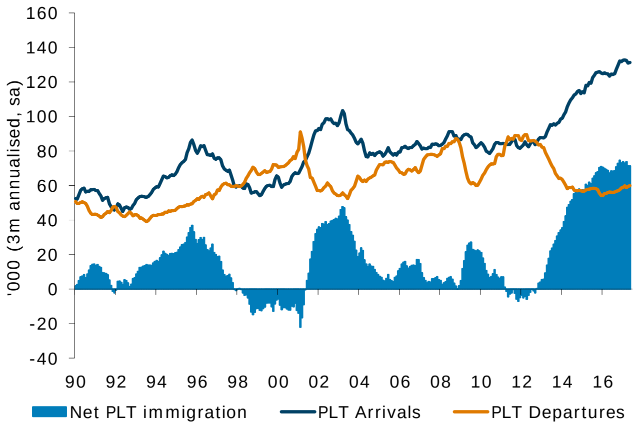


Source: ANZ, REINZ, QVNZ

There are three key 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, with the REINZ median typically more volatile as it is sensitive to the composition of sales taking place.

The REINZ median sale price dipped 0.1% m/m (sa) in May and is up 6.2% y/y. This is now a little stronger than the REINZ House Price Index (5.0% y/y) and a little lower than the QVNZ measure of price growth (9.7% y/y). The latter two measures adjust for changes in the quality of houses sold.

FIGURE 5. NET PERMANENT/LONG-TERM IMMIGRATION



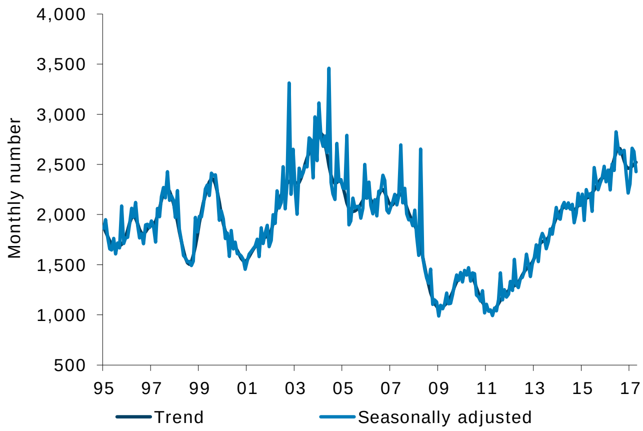
Source: ANZ, Statistics NZ

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 all coincided with large net migration inflows.

On a three-month annualised basis, net permanent and long-term migration was 71.4k in May. This is still near record levels and over 1½% of the resident population. More arrivals and fewer departures have both contributed to this large net inflow, although over the past 12 months or so, the former has been the dominant factor.

Migration inflows are expected to remain strong. New Zealand's current strong labour market (particularly relative to Australia, by far the most relevant comparator) will lure people home. In a world of fractured international politics (Brexit, US political uncertainty), there'll be no shortage of people with a desire to move to New Zealand.

FIGURE 6. RESIDENTIAL BUILDING CONSENTS



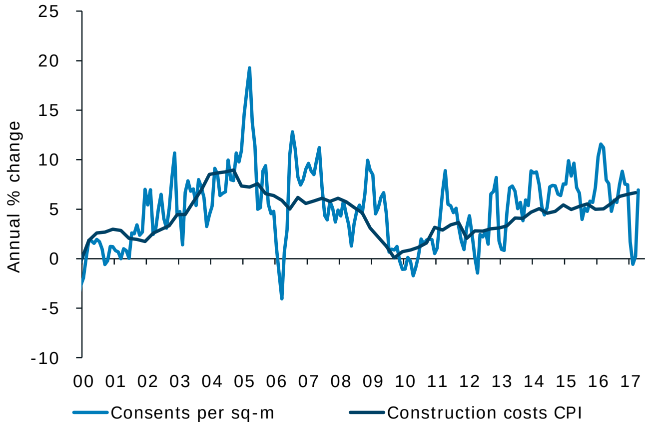
Source: ANZ, Statistics NZ

Seasonally adjusted dwelling consent issuance fell 7.6% m/m in April, with Statistics NZ highlighting the timing of Easter (and reduced processing days) this year as a factor behind the fall. That may be true, but the fall in the month continues a trend evident for some time now, where issuance has struggled to push much above the highs seen in mid-2016.

The sector is grappling with two clear opposing forces. The demand backdrop is clear, with a housing shortage (at least in Auckland) and strong population growth requiring ongoing lifts in housing supply. However, that supply response is being challenged by capacity and capital constraints in the construction industry.

THE PROPERTY MARKET IN PICTURES

FIGURE 7. CONSTRUCTION COST INFLATION



Source: ANZ, Statistics NZ

On a three-month average basis, **the value of residential consents per square metre rose 6.9% y/y in April.** This proxy for construction costs had shown surprising weakness in previous months, which we felt was likely due to the composition of issuance more than anything. The bounce-back corroborates this view.

Costs per square metre in Auckland (especially in the multi-dwelling space) have lifted especially strongly of late, and our internal anecdotes continue to highlight that capacity pressures in the construction sector are intense, with a severe shortage of labour.

FIGURE 8. NEW MORTGAGE LENDING AND HOUSING TURNOVER

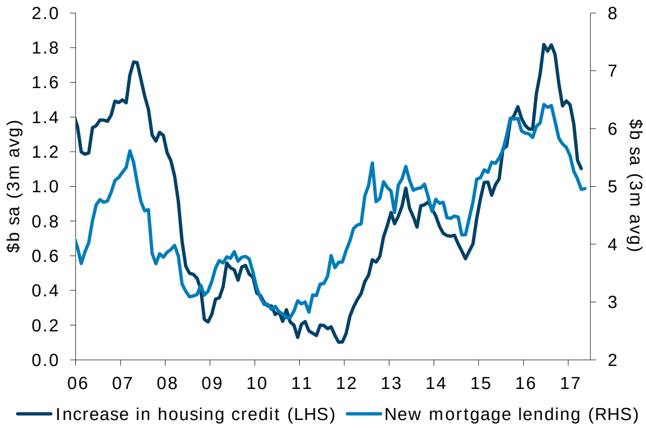
Source: ANZ, RBNZ

New residential mortgage lending figures are published by the RBNZ. They can provide leading information on household credit growth and housing market activity.

New mortgage lending lift in May (the chart is presented in 3-month average terms). We estimate that in seasonally adjusted terms, new lending rose 10% m/m to $5.05bn, which followed a 13% m/m plunge in April. Overall, new lending is down 17% y/y, with the fall mirroring the fall in the value of housing turnover.

New investor lending continues to be weak. In May, lending to investors was down 40% y/y, making up 25% of total lending. Conversely, new lending to first home buyers was up 1.9% y/y, making up 14% of the total.

FIGURE 9. NEW MORTGAGE LENDING AND & HOUSING CREDIT



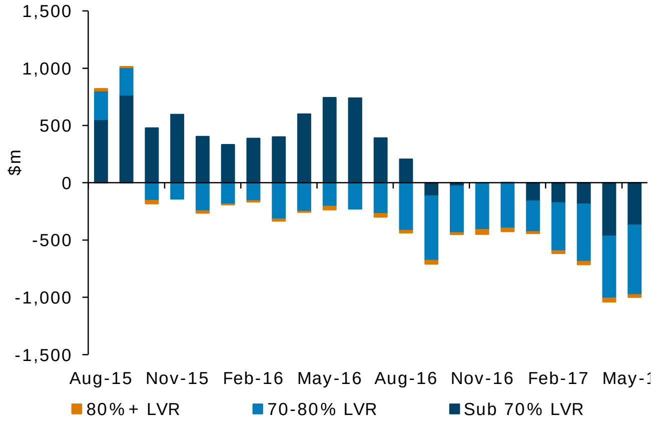
Source: ANZ, REINZ, RBNZ

Growth in the overall stock of mortgages has continued to cool, after a period of strong growth. For the fourth consecutive month, total housing credit rose 0.5% m/m in April, with the 3-month annualised pace of growth easing to 6.3%, the softest since mid-2015 and well down from the 10% pace recorded in August 2016.

The latest tightening of the high-LVR lending restrictions – together with increased credit rationing by banks – appear to be having a marked impact on both house sales and credit availability. Add in recent modest increases in mortgage rates (and widespread expectations of more to come), and we expect to see mortgage lending growth remain at this more moderate pace over the coming months.

THE PROPERTY MARKET IN PICTURES

FIGURE 10. ANNUAL CHANGE IN INVESTOR LENDING BY LVR

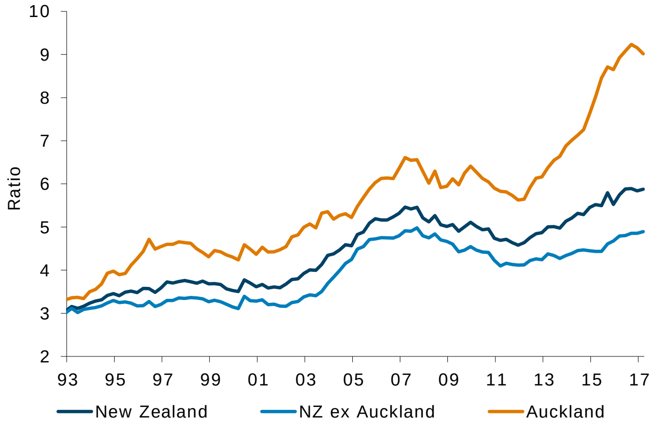


Source: ANZ, RBNZ

New lending to investors is well off its mid-2016 peak, down 40% y/y in May. Investors' share of overall new lending, at 25%, is well down from a peak of 38% in June 2016. This is no doubt related to the latest round of RBNZ LVR restrictions, which officially came into force on 1 October 2016 but influenced lending decisions in the months prior.

Related to this, a larger share of new lending is on less-risky terms. As a share of total investor lending, lending done with LVRs of less than 70% made up over 90% of new lending in May, versus just over half in 2014.

FIGURE 11. REGIONAL HOUSE PRICES TO INCOME

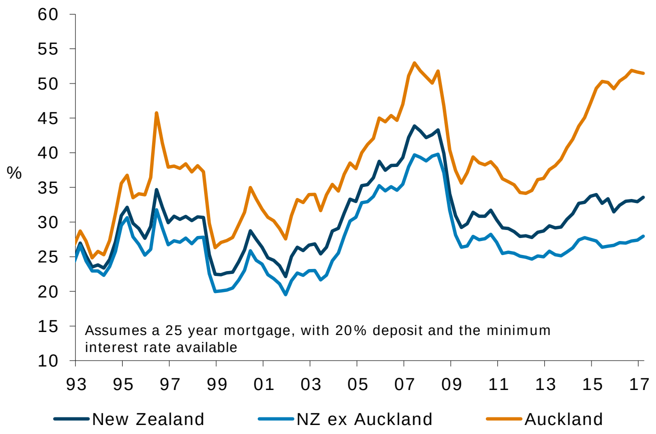


Source: ANZ, REINZ, Statistics NZ

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 sits just below 6, which is slightly above the previous highs recorded prior to the GFC. However, there is a stark regional divide. We estimate the average house price to income in Auckland sits at around 9 times, although this is off its recent high. Elsewhere, the ratio is around 5 times, which is back where it peaked prior to the financial crisis.

FIGURE 12. REGIONAL MORTGAGE PAYMENTS TO INCOME



Source: ANZ, REINZ, RBNZ, Statistics NZ

Another, arguably more comprehensive, measure of housing affordability is to look at it through the lens of debt serviceability, as this 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 around 34% at the moment.

However, once again there are stark regional differences, with the average mortgage payment to income in Auckland around 52% for new purchasers. That is on par with the highs reached in 2007 despite mortgage rates being near historic lows currently. It highlights how sensitive some recent home-buyers in Auckland would be to even a small lift in interest rates.

PROPERTY GAUGES

The property market is softening, particularly in Auckland as the combination of a turn in the interest rate cycle, less credit, LVR restrictions and severely stretched affordability act as headwinds. There is still incremental support for prices to lift after a lull courtesy of population growth and a fundamental mismatch between supply and demand. We think the former factors will be the key influences over the coming year and expect house price momentum to remain subdued.

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.

Indicator	Level	Direction for prices	Comment
Affordability	Too high	↔/↓	When an Auckland house trades at 9.5 times incomes, you are in 'unaffordable' territory. The NZ average is less bad at around 6.
Serviceability/ indebtedness	To get worse	↔/↓	Rising interest rates to bite with debt levels higher too.
Interest rates / RBNZ	On the up	↓	Rates are moving up, albeit slowly.
Migration	Elevated	↔/↑	NZ still the place everyone wants to be.
Supply-demand balance	Demand > Supply	↔/↑	Demand is outstripping supply and the latter looks to be slowing.
Consents and house sales	Shortage	↔/↑	Consents are easing up as builder supply disappears.
Liquidity	Tightening	↓	Banks are tightening up.
Globalisation	Mixed bag	↔	Auckland looks terribly expensive when benchmarked against incomes. But in absolute terms what you need to spend is still cheap compared to offshore.
Housing supply	Too few	↔/↑	Fewer builders + higher construction costs + less credit = less supply.
House prices to rents	Too high	↔/↓	Rents would be up a lot if a supply shortage was the major driver in the market.
On balance	**Flat-lining**	↔	**Interest rates to dominate direction for house prices.**

PROPERTY GAUGES

FIGURE 1: HOUSING AFFORDABILITY

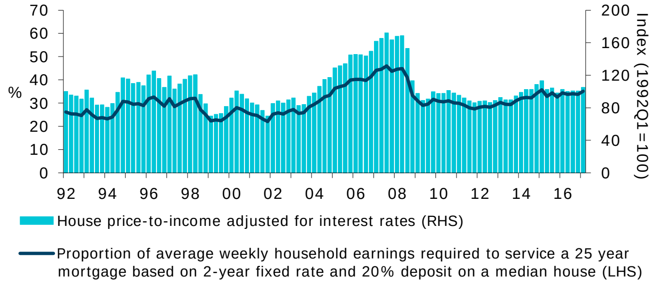


FIGURE 2: SERVICEABILITY AND INDEBTEDNESS

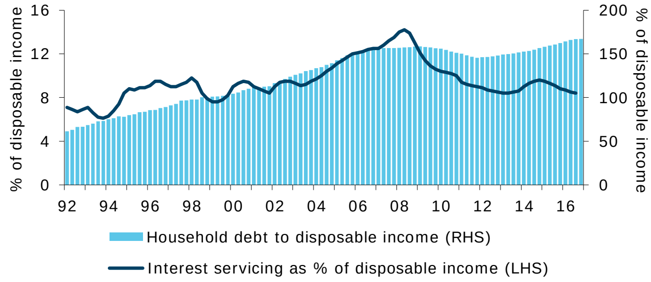


FIGURE 3: NEW CUSTOMER AVERAGE RESIDENTIAL MORTGAGE RATE (<80% LVR)

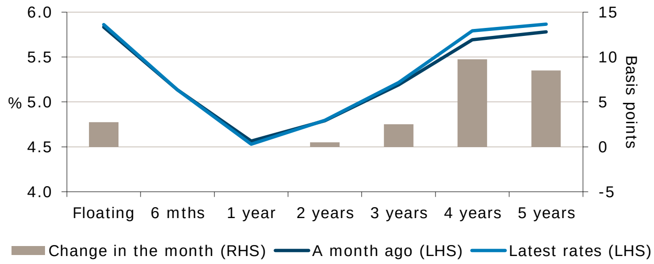


FIGURE 4: NET MIGRATION

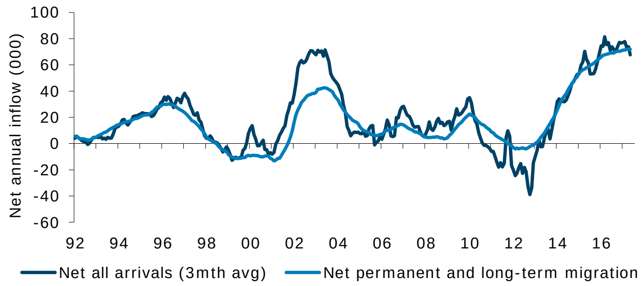


FIGURE 5: HOUSING SUPPLY-DEMAND BALANCE

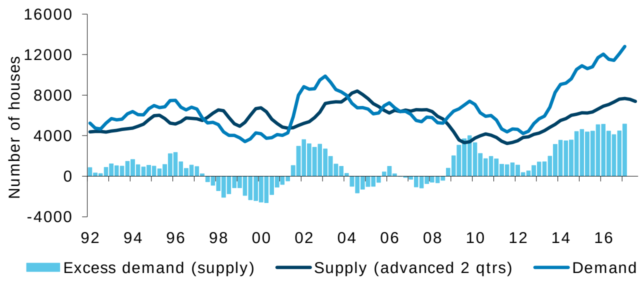


FIGURE 6: BUILDING CONSENTS AND HOUSE SALES

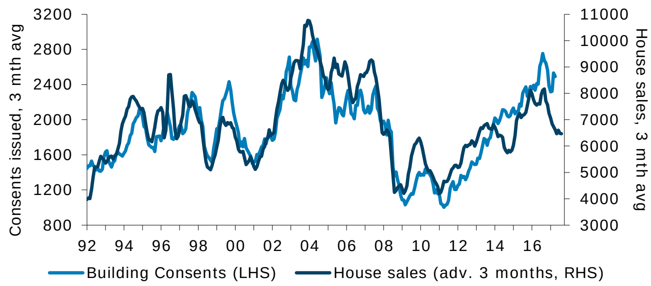


FIGURE 7: LIQUIDITY AND HOUSE PRICES

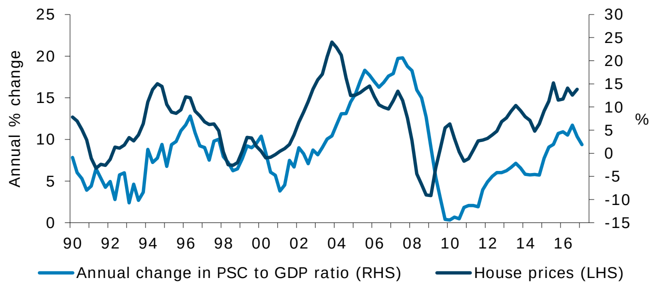


FIGURE 8: HOUSE PRICE INFLATION COMPARISON

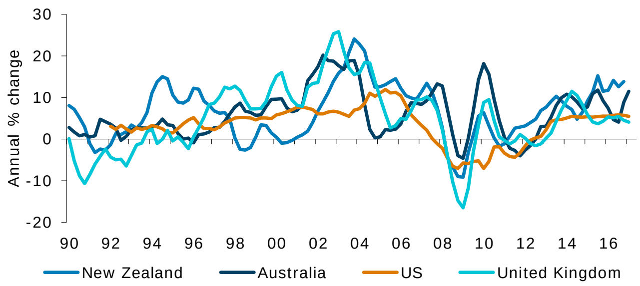


FIGURE 9: HOUSING SUPPLY

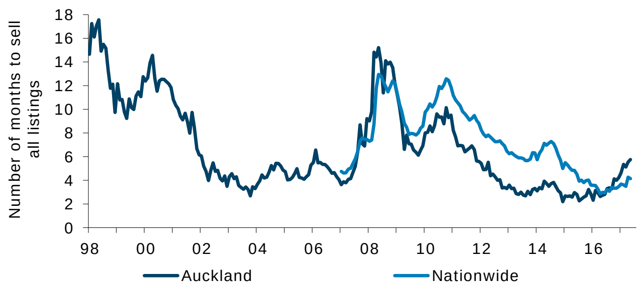
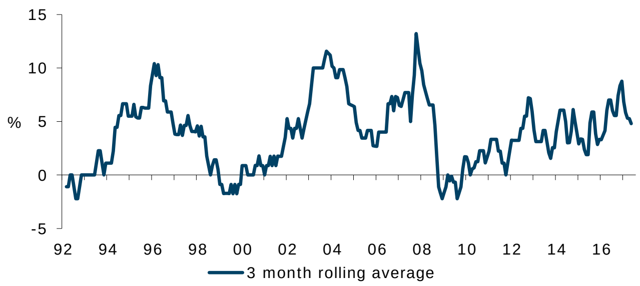


FIGURE 10: MEDIAN RENTAL, ANNUAL GROWTH



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

ECONOMIC OVERVIEW

SUMMARY

The economy is performing solidly, though on some metrics such as GDP per capita the economic story is sub-par. Indicators points to solid momentum over the year ahead; businesses and consumers are confident and financial conditions are supportive. However, the economy does not have the capacity to accelerate sharply. Labour and credit constraints are headwinds. We are expecting economic momentum to remain solid over the years ahead.

OUR VIEW

The economy is performing solidly. GDP growth of 2.5% is to be respected. There are not too many countries across the OECD achieving that.

However, on some levels, performance is sub-par. GDP per capita (population adjusted) is anaemic, and productivity growth is weak. While the economy is growing, it's through increasing inputs, as opposed to doing things smarter.

Forward indicators point to accelerating momentum. Business and consumer confidence are elevated. Our Truckometer is showing forward momentum. Commodity prices have picked up, and the terms of trade (the ratio of export prices to import prices) are the highest since 1973, delivering a huge boost to national income. Migration numbers remain strong. Tourism is booming. The dairy sector is recovering and set to be profitable again.

The economy doesn't have the capacity to accelerate sharply from here.

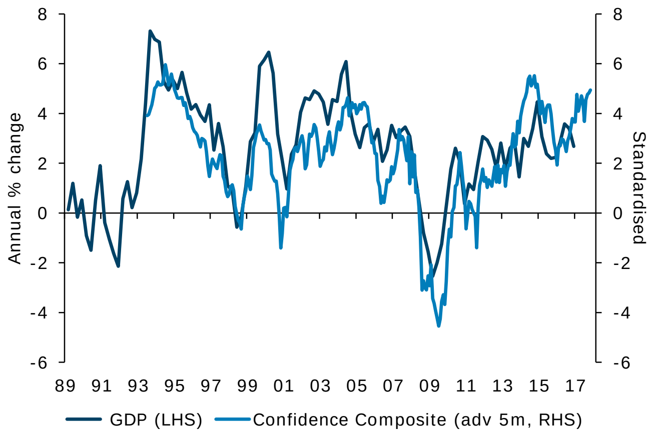
- **Skilled labour is becoming harder to find.** We still expect the unemployment rate to fall further over 2017 and wage growth to lift. There is the potential for some bow-wave demands for wage increases, given rising inflation and spill-over from industry settlements.
- **Credit is being rationed.** The credit wheels are still turning, but at a slower pace, and more in line with the pace of income growth. The economy already has high levels of debt (household debt has gone from 159% of income pre GFC to 168% now), and a continuation of those trends would up the ante on recession.
- **Key pro-cyclical parts of the economy (housing) have slowed up** in response to LVR restrictions, nudges up in interest rates and slower credit growth. There is ample demand for construction-related activity volume-wise, but the heat is being taken out of the market price-wise. Auckland house prices have fallen 3% in the past six months.

Those are late-cycle challenges, but good challenges to have. Demand is not the issue; meeting the demand is. Tempering momentum as the top or late in the cycle (such as the housing market) increases the likelihood that the economic expansion can continue for longer.

The RBNZ is expected to keep the OCR on hold until mid-2018. Outside of housing, inflation is benign. With banks lifting retail interest rates already, the RBNZ is on hold for an extended period. Increases in interest rates are expected to the gradual.

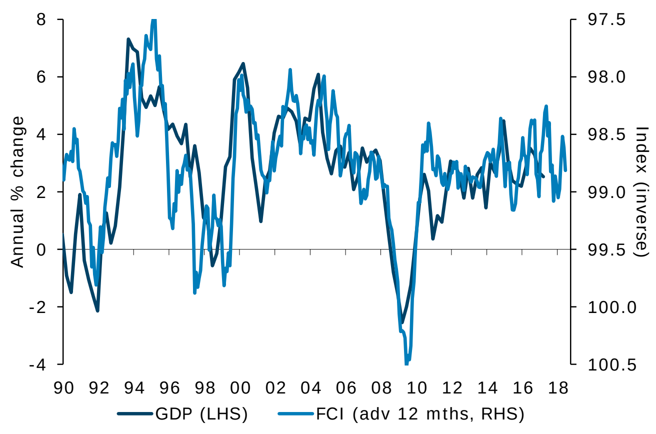
We continue to have concerns over the global scene, which presents the biggest economic risk. The resentment and anger vote continues to shape economic policy. Some central banks look to be taking a sterner tone towards asset prices (i.e. equities) and interest rates around the globe are simply too low and encouraging leveraging behaviour. Global debt levels are elevated. It's a potent mix.

FIGURE 1. GDP VS CONFIDENCE COMPOSITE



Source: ANZ, Roy Morgan, Statistics NZ

FIGURE 2. GDP VS FINANCIAL CONDITIONS INDEX



Source: ANZ, Statistics NZ, Bloomberg

MORTGAGE BORROWING STRATEGY

SUMMARY

Mortgage rates are virtually unchanged since last month. The average floating rate rose 0.03% as a result of one bank lifting their rate. The mortgage curve remains tick-shaped, with the 1 month rate the low point, and in our view, the "sweet spot". Although we expect the RBNZ's next move to be a hike, and see mortgage rates on a gradually upward trajectory over coming years, this is already factored into the term structure, and we question the economic value of fixing for longer than 1 year given the increased cost. However, we acknowledge that longer terms do offer more certainty.

OUR VIEW

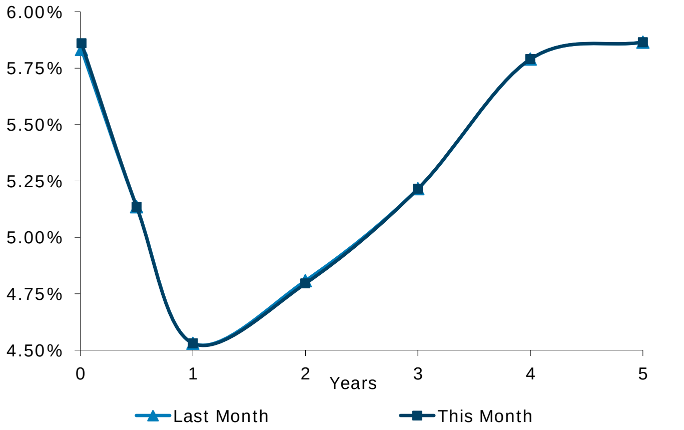
Mortgage interest rates have barely changed over the past month, but the small changes that have occurred have seen the average floating rate move up a touch. Although some banks have tweaked their fixed rates, on average they remain virtually unchanged. As a consequence, the mortgage curve remains tick-shaped.

As has been the case for many months, **the 1 year rate remains the low point in the curve**. Although there is just 0.27% separating the average 1 year (special) rate and the average 2 year rate, **that's still enough in our view to make the 1 year the more attractive choice from an overall cost perspective.** That's not simply because it is the cheapest rate, but rather is a reflection of our judgement that it is likely to be cheaper in the long run to opt for a string of back-to-back 1 year terms than fixing for a longer term.

Some readers may be surprised by this. After all, we have long been (and remain) of the view that the next move in the OCR will be up. Of late, we have also highlighted competitive pressures in the mortgage market that point to the risk of higher retail interest rates – namely a fundamental shortage of domestic savings, as we discussed last month in detail.

The key point is that we think the risk of rates rising is adequately built into the term structure. Consider, for example, the choice between fixing for 2 years or a plan to fix for back-to-back 1 year terms. As our breakeven table shows, you'd need to see the 1 year rate rise by 0.53% (from 4.53% to 5.06% over the next year) before you regretted the back-to-back option. That could happen, but it seems unlikely, given our view that the OCR will remain on hold for now (as the RBNZ reiterated in its June OCR Review). Similarly, you'd need to see the 1 year rate rise a further 1% (from 5.06% to 6.06%) over the next 2 years for three back-to-back 1 year terms to be more expensive than fixing for 3 years now. In other words, 4.53% for year 1, 5.06% for year 2 and 6.06% for year 3 will cost you the same (for a given principal amount) as 5.22% for 3 years (noting that if you plan to repay any principal, the back-to-back option will cost a fraction less). **However, it's not always about cost – certainty matters too, and long-term rates are still low by historic standards. "Rollover risk"** (i.e. the risk that rates are much higher when your existing fixed rate rolls off) is also worth thinking about. One obvious way to mitigate this is to split your mortgage into two or three separate tranches, and to roll each tranche separately.

CARDED SPECIAL MORTGAGE RATES^



Special Mortgage Rates		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.86%				
6 months	5.14%	3.93%	4.93%	5.19%	5.85%
1 year	4.53%	4.43%	5.06%	5.52%	6.06%
2 years	4.80%	4.97%	5.56%	6.13%	6.79%
3 years	5.22%	5.56%	6.21%	6.41%	6.58%
4 years	5.79%	5.91%	6.20%		
5 years	5.87%	#Average of "big four" banks			

Standard Mortgage Rates		Breakevens for standard mortgage rates*			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	5.86%				
6 months	5.24%	4.68%	5.89%	5.27%	6.01%
1 year	4.96%	5.28%	5.58%	5.64%	6.16%
2 years	5.27%	5.46%	5.87%	6.07%	6.51%
3 years	5.57%	5.81%	6.20%	6.35%	6.64%
4 years	5.89%	6.08%	6.37%		
5 years	6.09%	*may be subject to a low equity fee			

^ Average of carded rates from ANZ, ASB, BNZ and Westpac. Sourced from interest.co.nz

KEY FORECASTS

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

Mortgage Size ($'000)	Mortgage Rate (%) 4.00	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25
200	243	250	256	263	270	276	283	290	297	304	311	319	326	333
250	304	312	320	329	337	345	354	363	371	380	389	398	407	417
300	365	375	385	394	404	415	425	435	446	456	467	478	489	500
350	426	437	449	460	472	484	496	508	520	532	545	558	570	583
400	487	500	513	526	539	553	566	580	594	608	623	637	652	667
450	548	562	577	592	607	622	637	653	669	684	701	717	733	750
500	609	625	641	657	674	691	708	725	743	761	778	797	815	833
550	669	687	705	723	741	760	779	798	817	837	856	876	896	917
600	730	750	769	789	809	829	850	870	891	913	934	956	978	1,000
650	791	812	833	854	876	898	920	943	966	989	1,012	1,036	1,059	1,083
700	852	874	897	920	944	967	991	1,015	1,040	1,065	1,090	1,115	1,141	1,167
750	913	937	961	986	1,011	1,036	1,062	1,088	1,114	1,141	1,168	1,195	1,222	1,250
800	974	999	1,025	1,052	1,078	1,105	1,133	1,160	1,188	1,217	1,246	1,274	1,304	1,333
850	1,035	1,062	1,089	1,117	1,146	1,174	1,204	1,233	1,263	1,293	1,323	1,354	1,385	1,417
900	1,095	1,124	1,154	1,183	1,213	1,244	1,274	1,306	1,337	1,369	1,401	1,434	1,467	1,500
950	1,156	1,187	1,218	1,249	1,281	1,313	1,345	1,378	1,411	1,445	1,479	1,513	1,548	1,583
1000	1,217	1,249	1,282	1,315	1,348	1,382	1,416	1,451	1,486	1,521	1,557	1,593	1,630	1,667

Housing market indicators for May 2017 (based on REINZ data)

	House prices (ann % chg)	3mth % chg	No of sales (sa)	Mthly % chg	Avg days to sell (sa)
Northland	28.1	8.5	206	+2%	40
Auckland	4.3	-0.8	1,829	+3%	40
Waikato	18.4	6.0	678	+10%	39
Bay of Plenty	9.1	5.1	456	0%	37
Gisborne	31.2	-1.0	51	-9%	31
Hawke's Bay	17.8	6.3	222	-3%	29
Manawatu-Wanganui	18.5	3.0	385	+15%	33
Taranaki	1.3	4.2	155	-1%	40
Wellington	11.7	2.2	750	+9%	29
Tasman, Nelson and Marlborough	22.3	2.6	67	+17%	26
Canterbury	-1.3	1.4	859	+18%	37
Otago	9.9	4.9	413	+20%	29
West Coast	-13.5	1.6	35	+72%	193
Southland	16.4	0.9	164	+38%	35
NEW ZEALAND	**6.2**	**3.6**	**6,412**	**+7%**	**36**

Key forecasts

	Actual			Forecasts						
Economic indicators	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**
GDP (Ann Avg % Chg)	3.0	3.1	3.0	2.8	2.7	2.8	3.0	3.1	3.1	3.0
CPI Inflation (Annual % Chg)	0.4	1.3	2.2	2.0	2.2	2.0	1.7	2.0	2.1	2.2
Unemployment Rate (%)	4.9	5.2	4.9	4.8	4.7	4.7	4.6	4.5	4.4	4.4
Interest rates (RBNZ)	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**
Official Cash Rate	2.00	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.25	2.25
90-Day Bank Bill Rate	2.2	2.0	2.0	2.0	2.0	2.0	2.1	2.3	2.5	2.5
Floating Mortgage Rate	5.6	5.7	5.8	5.8	5.8	5.8	5.8	6.1	6.3	6.3
1-Yr Fixed Mortgage Rate	4.9	4.9	5.1	5.0	5.1	5.1	5.2	5.4	5.5	5.5
2-Yr Fixed Mortgage Rate	5.1	5.1	5.3	5.3	5.4	5.5	5.6	5.7	5.8	5.9
5-Yr Fixed Mortgage Rate	5.6	5.9	6.3	6.3	6.3	6.4	6.5	6.6	6.7	6.8

Source: ANZ, Statistics NZ, RBNZ

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