

Weekly Commentary

19 November 2018



Glow Worm (*Arachnocampa Luminosa*)

Here we go

Falling mortgage rates have grabbed headlines recently with some fixed-term mortgage rates near the historic lows of 2016. Looking forward, the housing market will get a boost, albeit a temporary one. Indeed, October housing market data suggests this may already be in train. The RBNZ should be fairly comfortable with this and will be contemplating loosening LVR restrictions further. This could be announced as soon as the November Financial Stability Report, and will offer further support to house prices.

Fixed mortgage rates fell over the last few months on the back of lower wholesale rates following the Reserve Bank's more dovish tone. Competition amongst banks has pushed some fixed-term mortgage rates even lower this week in some cases to record lows.

Since August we have been predicting that lower mortgage rates would provide a temporary fillip to the housing market. Now signs of a bit more life in the housing market are coming through. October REINZ data showed a 9.3% jump in house sales in the month, leaving sales up 15.5% on a year ago. In reality, the true lift is likely to be even larger. REINZ house sales data tends to be revised upward over time, as sales data continues to trickle in from real estate agents after the data is first released.

In addition to this lift in sales, there was a drop in the average number of days taken to sell a house. This fell from 38.2 to 37.2 (seasonally adjusted), taking this measure to its lowest level since May. This adds further weight to our view that activity in the housing market has perked up.

House prices remained relatively subdued in October, up 0.4% in the month and 3.8% higher than a year ago. Scratching beneath the surface, it's clear that there has been a modest acceleration in house price growth recently

with average growth over the last three months noticeably higher than the three months prior.

Much of the acceleration in both activity and prices is coming from Auckland and Canterbury. Yet even with the most recent improvement, annual house price growth in Auckland of -0.4% is much weaker than remainder of the country at 7.9%. It's even further behind current hotspots like Otago and Southland where annual house price inflation is running at 11.6% and 15.1% respectively.

Rising sales are a reliable sign that price inflation will soon accelerate. We remain of the view that quarterly house price growth will pick up noticeably in the first quarter of next year.

But we are also at pains to emphasise that the anticipated near-term boost to the housing market will be only a temporary shot in the arm. There appears to have been little direct impact from the foreign buyer ban in the October data. However, over a longer horizon, restrictions on foreign buyers combined with the extension of the Bright Line test is set to make housing a less attractive investment proposition. Next year, the changes to rules around the tax deductions for property investors are set to impact the market. In addition, the debate surrounding capital gains

Here we go continued

tax (or any other tax changes) is likely to intensify with the release of the Tax Working Group's final recommendations (slated for February 2019) and as the 2020 election draws closer. Combined with an eventual lift in mortgage rates and slowing population growth, we think this will see annual house price inflation slip into negative territory by mid-2020.

Short term gyrations aside, the slowdown in the housing market over the course of 2018 (unsurprisingly) coincided with a slowdown in credit growth. Mortgage lending grew 6% in the year to September, slightly slower than the 6.4% growth the year earlier, and a significant step down on the 9.1% growth in mortgage lending in the year to September 2016.

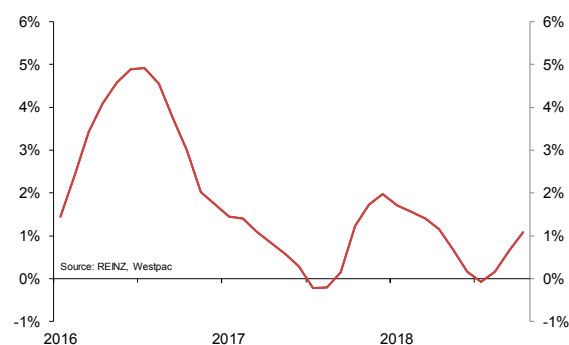
This slowdown in credit growth will be one factor considered by the RBNZ as it ponders whether the current LVR settings remain appropriate. In a speech last week titled "Financial Stability – risky, safe or just right?" Deputy Governor Geoff Bascand said "we expect to gradually ease the [LVR] policy in coming years." We think that the RBNZ could ease the LVRs at the November Financial Stability Review, due on the 28 November, as their concerns about financial stability have eased already.

It is not just that credit growth and house price inflation are lower than they were. Bank lending is also substantially less risky – the stock of loans with a loan-to-value ratio over 80% has fallen from 20.7% before the LVRs to 6.7% now. Furthermore, regulators in both New Zealand and Australia have prompted the banks to become more selective about who they will lend to. And the housing market is

being regulated directly by the likes of the Bright Line Test and other tax changes. The Reserve Bank will probably conclude that there is now less need for LVRs to do so much of the work in ensuring financial stability.

Any changes to the LVR rules are likely to be incremental. Banks are currently restricted to a speed limit whereby 15% of new loans can be made at a loan-to-value ratio greater than 80%. That speed limit could be lifted to 20%. The effective LVR cap on investor lending could also increase, from 65% to 70%. If this occurs, it could add further momentum to the housing market. The last loosening of the LVR rules saw system-wide high LVR lending rise quite sharply, and coincided with a distinct lift in the housing market.

REINZ house price index, three month average versus previous three months



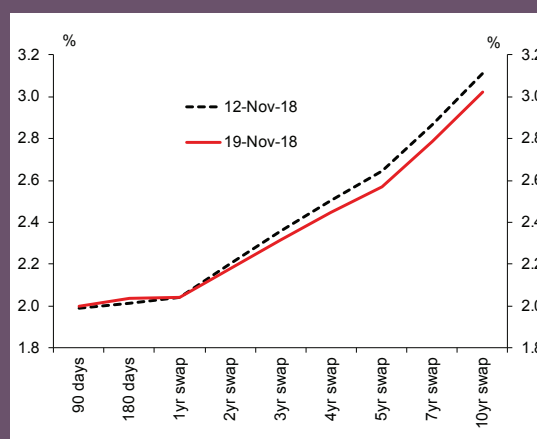
Fixed vs Floating for mortgages

Fixed-term mortgage rates have fallen as the market has adjusted to the Reserve Bank's softer stance. Looking further ahead, we expect floating and short-term fixed rates to rise gradually over the next few years, so taking a fixed rate may prove worthwhile once they have settled down.

One-year fixed rates are currently the lowest on offer, and appear to offer good value for borrowers. Longer-term fixed rates are high relative to where we think one-year fixed rates are going to go. However, longer-term rates offer security against the possibility of mortgage rates rising more rapidly than expected in the future.

Floating mortgage rates usually work out to be more expensive for borrowers than fixed rates. However, floating may still be the preferred option for those who require flexibility in their repayments.

NZ interest rates



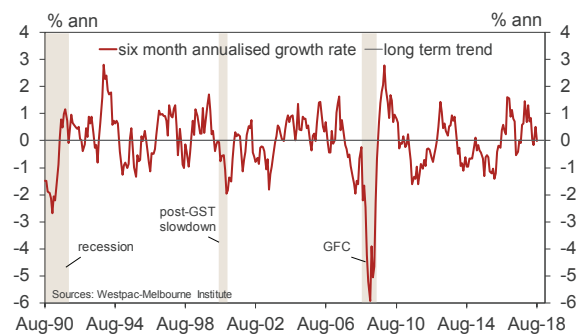
The week ahead

Aus Oct Westpac-MI Leading Index

Nov 21, Last: +0.21%

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, lifted from -0.02% in August to +0.21% in September. Despite the lift back above trend, the Index growth rate continues to point to slowing momentum heading into year end, the pace slowing from an average 0.89% read over the seven months to April to 0.13% over the five months since.
- The index will include a mixed range of component updates this month. On the negative side, the ASX200 fell sharply, down -6.1% vs -1.8% last month. However, other components mostly firmed, with the Westpac-MI Consumer Expectations Index up 4.7%; commodity prices up 3.7% in AUD terms and dwelling approvals recovering some lost ground, up 3.3% vs -8.1% in last month.

Westpac-MI Leading Index

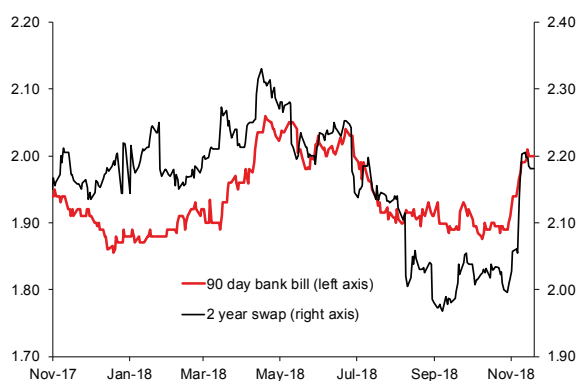


New Zealand forecasts

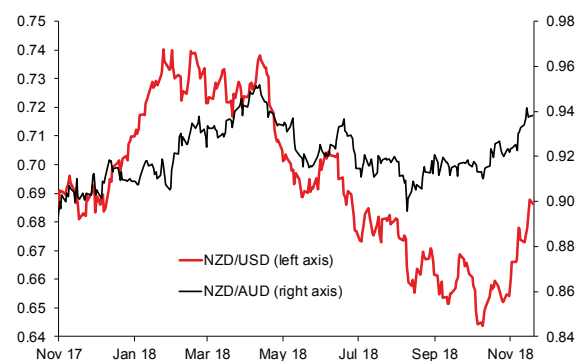
Economic Forecasts	Quarterly				Annual			
	2018			2019				
% change	Jun (a)	Sep	Dec	Mar	2017	2018f	2019f	2020f
GDP (Production)	1.0	0.7	0.7	0.7	2.8	2.8	3.1	2.9
Employment	0.6	1.1	0.1	0.2	3.7	2.4	1.2	1.7
Unemployment Rate % s.a.	4.4	3.9	4.3	4.4	4.5	4.3	4.2	4.0
CPI	0.4	0.7	0.5	0.4	1.6	2.1	1.4	1.8
Current Account Balance % of GDP	-3.3	-3.5	-3.5	-3.2	-2.9	-3.5	-3.4	-2.9

Financial Forecasts	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.95	2.00	2.10
2 Year Swap	2.10	2.20	2.30	2.45	2.60	2.75
5 Year Swap	2.50	2.70	2.90	3.05	3.15	3.25
10 Year Bond	2.70	2.90	3.10	3.25	3.35	3.40
NZD/USD	0.66	0.64	0.63	0.61	0.62	0.63
NZD/AUD	0.92	0.90	0.90	0.90	0.89	0.88
NZD/JPY	75.2	73.0	72.5	69.5	69.4	69.3
NZD/EUR	0.58	0.58	0.57	0.56	0.56	0.56
NZD/GBP	0.52	0.52	0.51	0.49	0.49	0.49
TWI	72.6	70.9	70.2	68.3	68.5	68.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 19 November 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.90%	1.85%	1.82%
60 Days	1.95%	1.90%	1.86%
90 Days	2.00%	1.94%	1.90%
2 Year Swap	2.18%	2.06%	2.04%
5 Year Swap	2.57%	2.39%	2.40%

NZ foreign currency mid-rates as at 19 November 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6862	0.6645	0.6553
NZD/EUR	0.6015	0.5827	0.5712
NZD/GBP	0.5349	0.5094	0.5049
NZD/JPY	77.45	75.19	73.88
NZD/AUD	0.9382	0.9238	0.9250
TWI	75.04	72.71	72.13

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 19					
NZ	Oct BusinessNZ PSI	53.9	-	-	Business have reported a slowdown since mid-2018.
UK	Nov Rightmove house prices	1.0%	-	-	Economic uncertainty continues to weigh on price growth.
US	Nov NAHB housing market index	68	67	-	Builders remain positive, despite clear loss of momentum.
	Fedspeak	-	-	-	Williams in moderated Q&A.
Tue 20					
Aus	RBA minutes	-	-	-	Further colour on board members' views.
	RBA Governor Lowe speaks	-	-	-	"Trust and Prosperity", CEDA dinner Melbourne 7:20 pm.
UK	BOE Gov Carney	-	-	-	Testimony to Parliament on the Inflation Report.
US	Oct housing starts	-5.3%	2.0%	-	Recent weakness likely beginning of clear downtrend...
	Oct building permits	1.7%	-0.8%	-	... with build-to-let activity leading the way.
Wed 21					
NZ	GlobalDairyTrade auction	-2.0%	-	-	NZ milk production growth still strong, may weigh on prices
Aus	Oct Westpac-MI Leading Index	0.21%	-	-	Momentum lifted in Sep but has slowed since start of year.
UK	Oct public sector net borrowing, £b	3.3	5.3	-	Borrowing requirements have been surprising to the downside.
US	Oct durable goods orders	0.7%	-2.1%	-	Underlying business investment trend moderate not strong.
	Initial jobless claims	216k	-	-	Very low.
	Oct leading index	0.5%	0.1%	-	Pointing to above trend but slowing growth.
	Nov Uni. of Mich sentiment final	98.3	98.3	-	Well above average.
	Oct existing home sales	-3.4%	1.0%	-	Partial reversal of Sep decline.
Thu 22					
Eur	Nov consumer confidence prelim.	-2.7	-3.0	-	Sentiment eased back but still above average.
	ECB minutes	-	-	-	Account of October meeting.
	ECB speak	-	-	-	Weidmann, Knot and Visco speak in Florence.
US	Thanksgiving day	-	-	-	Public holiday.
Fri 23					
NZ	Oct net migration	4640	4800	-	The downtrend in annual migration is continuing.
Eur	Nov Markit manu ^f PMI flash	52.0	51.7	-	Softened back to trend...
	Nov Markit services PMI flash	53.7	53.5	-	... but there were some one-offs in Q3.
US	Nov Markit manu ^f PMI flash	55.7	55.9	-	Still pointing to robust momentum...
	Nov Markit services PMI flash	54.8	55.0	-	... across the economy.
Sun 25					
Eur	EU summit	-	-	-	Agreement to formalise Brexit terms?

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	2019f	2020f
Australia						
Real GDP % yr	2.5	2.6	2.2	3.3	2.7	2.8
CPI inflation % annual	1.7	1.5	1.9	2.0	1.7	1.7
Unemployment %	5.8	5.7	5.5	5.1	5.0	4.8
Current Account % GDP	-4.7	-3.1	-2.6	-2.4	-2.5	-3.3
United States						
Real GDP %yr	2.9	1.5	2.3	2.9	2.5	1.7
Consumer Prices %yr	0.1	1.4	2.1	2.4	2.0	1.9
Unemployment Rate %	5.3	4.9	4.4	3.9	3.6	3.6
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	1.4	0.9	1.7	0.9	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.8	2.5	1.9	1.5	1.5
United Kingdom						
Real GDP %yr	2.3	1.9	1.8	1.2	1.2	1.4
China						
Real GDP %yr	6.9	6.7	6.9	6.4	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	3.9	4.5	4.3	4.1	4.1
World						
Real GDP %yr	3.5	3.2	3.8	3.8	3.6	3.5

Forecasts finalised 9 November 2018

Interest Rate Forecasts	Latest	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	1.94	1.98	1.93	1.91	1.90	1.90	1.85	1.83
10 Year Bond	2.68	2.70	2.80	2.80	2.90	2.80	2.70	2.60
International								
Fed Funds	2.125	2.375	2.625	2.875	3.125	3.125	3.125	3.125
US 10 Year Bond	3.11	3.25	3.40	3.50	3.60	3.30	3.10	3.00
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	0.00	0.20

Exchange Rate Forecasts	Latest	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
AUD/USD	0.7266	0.72	0.71	0.70	0.68	0.70	0.74	0.74
USD/JPY	113.40	114	114	115	114	112	109	106
EUR/USD	1.1336	1.13	1.11	1.10	1.09	1.10	1.16	1.22
AUD/NZD	1.0651	1.09	1.11	1.11	1.11	1.13	1.14	1.11

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