



Emerald Lakes, Tongariro National Park

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Early days yet

The state of the housing market, and the new restrictions on high loan-to-value ratio (LVR) lending, were a consistent theme last week. The Reserve Bank gave its first formal assessment of the restrictions in its six-monthly *Financial Stability Report*; supplemented with other data released over the week, the general impression is that at this early stage they are playing out much as we expected.

The *Financial Stability Report* (FSR) reiterated that New Zealand's financial system is in good shape, but with growing imbalances in the housing market presenting the greatest risk. House prices and household debt levels are now rising again from what were already seen as elevated levels, following a modest downward correction after the Global Financial Crisis. While a shortage of housing has played some role – particularly in Auckland and Christchurch, where house prices have risen fastest – the RBNZ is increasingly coming around to the view that demand for houses as accommodation does not adequately explain the surge in prices.

There was much interest in the RBNZ's assessment of its new restrictions on high-LVR home loans, which were rapidly developed and implemented in the six months since the last FSR. From 1 October, banks are required to limit home loans with a loan-to-value ratio above 80% to no more than 10% of their new lending. The limit will apply on average over a six-month window (October to March) initially, then a three-month rolling window after that.

At this early stage there's little evidence on the impact of these restrictions, other than to confirm that they are binding. Weekly mortgage approvals have fallen 10-15% below year-ago levels since the start of October, whereas they were running slightly ahead of year-ago levels in August and September. The share of new lending at over-80% LVRs was tracking lower as of September (and in fact has been declining since late 2012), but remained above the 10% limit. Finally, a survey of real estate agents showed a steep drop-off in interest by first home buyers in October and November, although interest by

Early days yet continued

investors has held up. That fits with our view that the LVR limits could create quite favourable conditions for investors, who are better positioned to muster up a large enough deposit.

Of course, the issue is not whether the LVR restrictions are having an impact on the housing market – it would be startling if they didn't – but whether the impact is any more or less than what the RBNZ had already budgeted for. The forecasts in the September *Monetary Policy Statement* assumed that the LVR restrictions would be equivalent to a 30 basis point rise in interest rates; even with this effect, the RBNZ saw the need for a series of OCR hikes from around April next year.

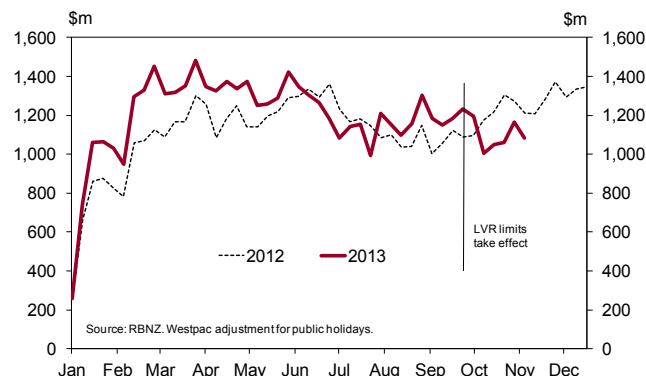
Moreover, the RBNZ has made it clear that a slower rate of house price inflation will be the ultimate measure of success for the LVR restrictions (since 'financial stability' in itself is unmeasurable). And on that front, there is no supporting evidence to date, nor did we expect there to be. Given the lag from loan approvals to house purchases, we didn't expect to see an impact on housing turnover until at least the November figures; from there, the historic lag between house sales and prices suggests that we won't have a clear sense of the impact on house prices until early next year.

The REINZ house sales figures for October support our view. Sales fell by 3% in seasonally adjusted terms – which still left them at their second-highest level in six years. Meanwhile, the stratified price index rose 1.4% for the month and 9.9% on a year earlier, the fastest annual increase in six years.

It's important to remember that the LVR limits are not the only factor coming to bear on the housing market at the moment. Fixed-term mortgage rates have already risen substantially in the last few months, all but eliminating the gap between current house prices and the 'fair value' implied by our Investment Value model. We're expecting house price growth to slow to 6.5% over next year, with higher interest rates providing some offset to the strengthening economy and rising net inward migration.

In addition to the LVR limits, the *Financial Stability Report* put a substantial emphasis on debt servicing to income ratios (DSRs)

Weekly mortgage approvals by value, main banks



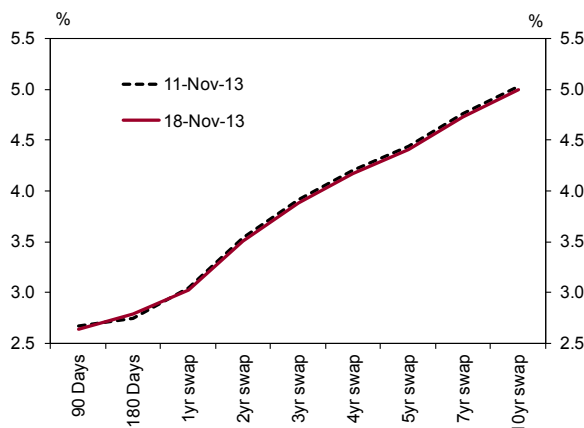
for home loans. While DSRs are low at the moment, that's entirely due to record-low interest rates; as interest rates go up, rising debt servicing costs could leave some borrowers in distress. While the *FSR* is not intended as a guide to monetary policy, the focus on debt servicing is consistent with the RBNZ's recent statements on monetary policy – which have been increasingly explicit that interest rates will be going up from next year.

To the extent that higher interest rates and LVR restrictions have an impact on house prices, they are also likely to have knock-on effects on consumer spending, which has been picking up since the start of this year. The latest data on this matter was mixed. Over the September quarter, retail sales (adjusted for inflation) rose by just 0.3%, following a 1.5% jump in the June quarter. While this was softer than electronic card spending figures had suggested, it was consistent with the drop in the Westpac-McDermott Miller consumer confidence survey over that period. However, more recent figures – a 1.1% rebound in card spending in October, and a rise to a six-year high in the monthly ANZ-Roy Morgan consumer confidence survey – suggest that the softness in retail sales in the September quarter may prove to be normal variation within an upward trend.

Fixed vs Floating for mortgages

We are now indifferent between fixing and floating. In our view, interest rate markets are now "fairly priced". We expect short-term rates to rise substantially over the next three years. The level of long-term fixed rates, which are higher than short-term rates, is in tune with that expectation. This means we can discern no obvious interest rate advantage in any particular term. The decision can be treated as a risk management choice according to individual circumstances.

NZ interest rates

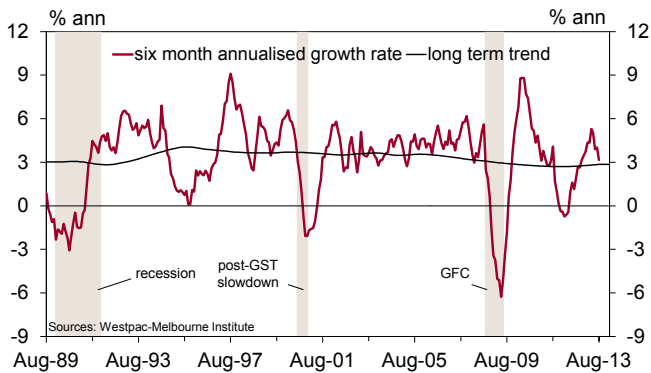


Aus Oct Westpac-MI Leading Index

Nov 20

- Westpac and the Melbourne Institute are introducing significant changes to the Westpac-Melbourne Institute Leading Index this month. Following an extensive review, a redesigned Index is being rolled out with several changes that improve the accuracy, timeliness and stability of the measure.
- Whereas the existing Index would have seen a Sep reading released in Nov, the new Index will be a reading for Oct drawing on some component data up to Nov. As well as this significant improvement in timeliness, historical analysis shows the new index is demonstrably quicker at detecting turning points in the economic cycle and has a reduced reliance on quarterly components, meaning it will be less susceptible to revisions. A full information report and back history of the new index will be published with the release.

Westpac-MI Leading Index

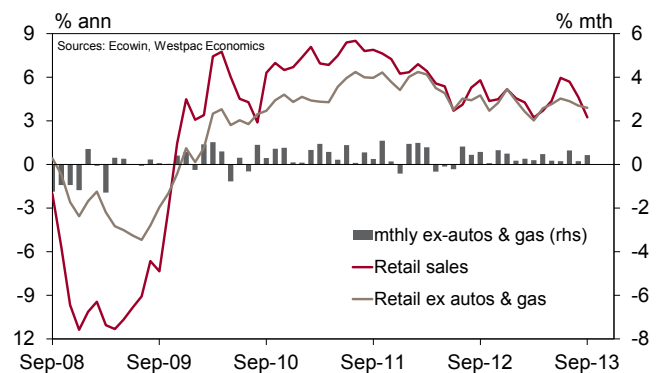


US retail sales stalled in Oct

Nov 20, Last: -0.1%, WBC 0.0%

- Retail sales fell 0.1% in Sep, led by auto's -2.2%. Apparel posted a further decline of 0.5% and department stores resumed their slump after a one-off rise in Aug. Most other storetypes posted modest/moderate gains; flat gasoline sales were an exception. Ex autos/gas, core retailing rose 0.4%. Slower income growth and lower confidence make it unlikely that sales pace could be maintained.
- Recent job market gains and the ready availability of vehicle loans should be supportive of household spending. However, the ongoing structural impediments to growth (substantial household sector debt and fiscal restraint) continue to restrict growth to sporadic bursts.
- Auto sales fell again, slightly, in Oct; and gasoline prices eased. Falling sales here should offset a modest further core retail rise.

US retail sales



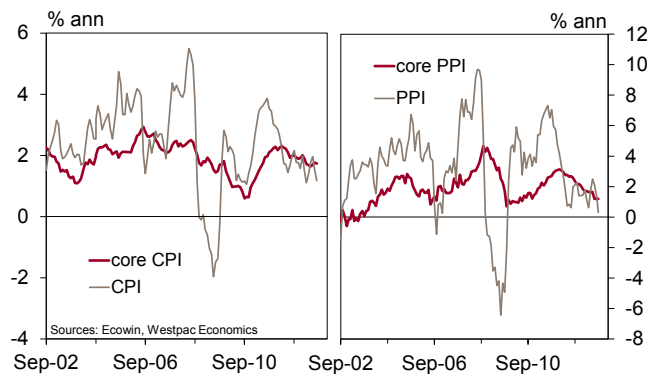
US Oct consumer and producer price indices

Nov 20, CPI: Last: 0.2%, WBC f/c: 0.0%

Nov 21, PPI: Last: -0.1%, WBC f/c: -0.2%

- The CPI rose 0.2% in Sep for an annual pace of 1.2%yr, the second slowest pace since 2010 after Apr's 1.1%yr. The core gain of 0.1% pulled the annual pace down to 1.7%yr. The detail showed flat food prices, energy up 0.8%, clothing down 0.5% (first fall since April), vehicle prices up 0.1%, and rents steady at 0.2%. The steady gasoline price decline through Oct might just be offset by a partial recovery in clothing prices and mild pressures elsewhere, leaving a flat headline and +0.1% core.
- The Sep PPI did not capture the energy price falls that resumed later in the month, but the Oct PPI certainly will. Apparel prices rose in Aug and Sep but should reverse much of that in Oct; upside risk from auto prices has diminished. These factors should see the second pair of back-to-back PPI declines (in Sep-Oct) for the year so far and a below-trend flat Oct core PPI.

US price inflation



Data calendar

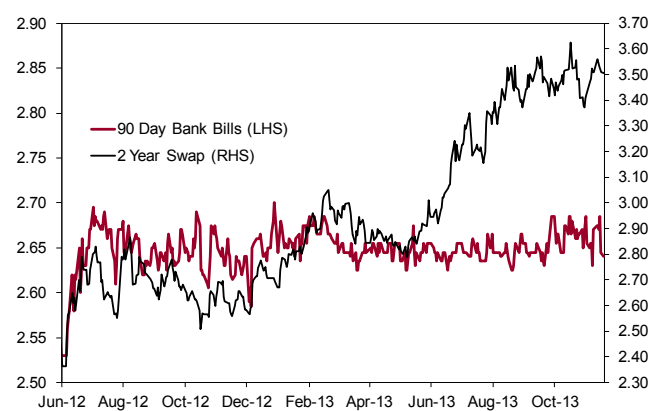
		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Oct Performance of Services Index	55.6	–	–	Both manu and services indices consistently strong over 2013.
Chn	Oct new property prices %net bal	84.3%	–	–	A last flurry in tier 1 cities ahead of controls biting?
Eur	Sep exports	1.0%	–	–0.5%	Exports tend not to sustain a rise into the next month.
UK	Nov house prices %yr	3.8%	–	–	Rightmove index of asking prices.
US	Nov NAHB housing market index	55	56	55	Upswing since late 2011 has stalled recently.
	Sep TIC data \$bn	–8.9	–	–	Net long-term TIC flows.
	Fedspeak	–	–	–	Plosser.
Tue 19					
Aus	RBA meeting minutes	–	–	–	Recent minutes have given critical insight into RBA's policy intentions.
Eur	Sep construction output	0.5%	–	–0.7%	Construction fell 1.8% in Germany.
Ger	Nov ZEW analysts' expectations	52.8	54.0	51.0	Oct reading highest since Q2 2010. But current situation index slipped
US	Q3 employment cost index	0.5%	0.5%	0.5%	Labour market not strong enough to generate wage/costs pressures.
	Fedspeak	–	–	–	Evans and Kocherlakota
Can	Sep wholesale sales	0.5%	0.3%	–	Autos led Aug sales gain.
Wed 20					
NZ	GlobalDairyTrade auction	–1.8%	–	–	Prices may fall further as milk supply surges post-drought.
	Q3 producer prices (outputs)	1.0%	–	–	Dairy and petroleum prices sharply higher, electricity cheaper.
Aus	Oct Westpac-MI Leading Index	–	–	–	Redesigned Index being launched; see preview box.
	RBA Assist. Governor Debelle	–	–	–	Discussant at the CIFR Forum, 11:30am AEDT.
Ger	Oct producer prices %yr	–0.5%	–0.6%	–	Declining in annual terms for most of the past six months.
UK	Nov BoE minutes	–	–	–	Inflation report guidance suggests possible tightening by late 2014.
US	Oct CPI	0.2%	0.0%	0.0%	Energy prices to reverse Sep gain, apparel prices to recover some of
	Oct CPI core	0.1%	0.1%	0.1%	Sep fall, pressures elsewhere mild.
	Oct retail sales	–0.1%	0.1%	0.0%	Auto sales down slightly; gasoline sales down on price; and cautious
	Oct retail sales ex autos & gas	0.4%	0.4%	0.1%	core retail sales growth after Sep's rise. A flat overall outcome.
	Sep business inventories	0.3%	0.3%	–	Inventories made significant contribution to Q3 GDP growth.
	Oct existing home sales	–1.9%	–2.5%	–2.0%	Pending sales down four months running June-Sep.
	FOMC minutes	–	–	–	Evolution of tapering debate continues.
	Fedspeak	–	–	–	Chair Bernanke in Washington; also Bullard.
Thu 21					
Aus	RBA Governor Stevens	–	–	–	The Australian Dollar: Thirty Years of Floating, ABE Dinner, 20:05 AEDT.
Chn	Nov HSBC manufacturing PMI - flash	50.9	50.8	–	Activity indicators look sound, jump in Oct stocks the main worry.
Eur	Nov PMI factory adv	51.3	51.6	51.5	Holding in mildly expansionary territory; rate cut may boost sentiment
	Nov PMI services adv	51.6	51.8	51.9	a little. Composite PMI fact/ser was 51.9 in Oct.
	Nov consumer confidence advance	–14.5	–	–	Has risen every month since December last year.
UK	Nov CBI industrial trends	–4	0	–	Total orders index.
	Oct PSNCR £bn	–0.6	–	–	Public sector net credit requirement. PSNB ex int'v'ns –£11.1bn in Sep.
US	Initial jobless claims w/e 16/11	339k	–	330k	Always potential for distortion in weeks including public holidays.
	Oct PPI	–0.1%	–0.2%	–0.2%	Energy prices down sharply, apparel likely to fall, less upside risk from
	Oct PPI core	0.1%	0.1%	0.0%	vehicle prices. Core trend now just 0.1%.
	Nov Philadelphia Fed factory survey	19.8	15.0	–3.0	Can out-performance relative to NY, Richmond Fed surveys persist?
	Fedspeak	–	–	–	Lacker and Bullard.
Fri 22					
NZ	Oct net migration	2740	–	2600	Annual inflow to head above 20,000 by year-end.
Aus	2012-13 annual state accounts	–	–	–	State annual national accounts, includes state GSP estimates.
Ger	Nov Ifo business climate index	107.4	10.7	107.5	Stalled in recent months as recovery struggles to gain traction.
	Q3 GDP final	0.3% a	0.3%	0.3%	More detail behind Q3 growth slowdown.
US	Nov Kansas City Fed factory index	6	5	3	Holding in expansionary territory after turn-of-year slump.
Can	Sep retail sales	0.2%	0.5%	–	Food and clothing sales gained in Aug, autos slipped.
	Oct CPI %yr	1.1%	0.9%	–	Core rate was 1.3%yr in Sep.

New Zealand forecasts

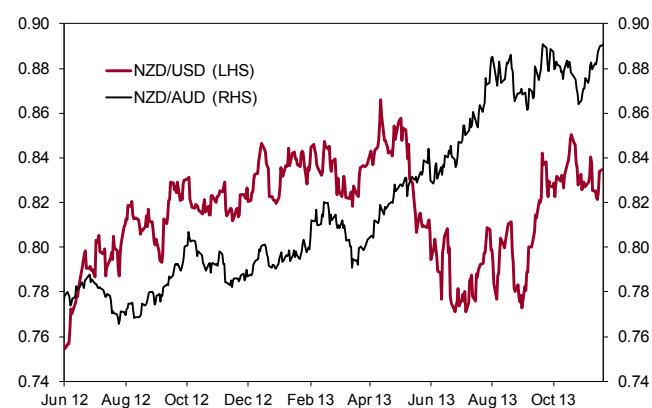
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.7	3.0	3.8	1.4	2.7	2.8	3.8
Employment	1.0	0.4	2.6	2.7	1.5	-1.4	3.8	2.8
Unemployment Rate % s.a.	6.8	6.2	5.6	5.1	6.3	6.8	5.7	5.0
CPI	1.6	0.9	1.3	2.2	1.8	0.9	1.5	1.9
Current Account Balance % of GDP	-3.8	-4.5	-3.8	-4.9	-3.6	-4.7	-3.9	-4.4

Financial Forecasts	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Cash	2.50	2.50	3.00	3.25	3.50	3.75
90 Day bill	2.65	2.90	3.25	3.50	3.75	4.00
2 Year Swap	3.50	3.70	3.90	4.10	4.40	4.60
5 Year Swap	4.50	4.60	4.70	4.80	4.90	5.00
10 Year Bond	4.60	4.70	4.75	4.80	4.85	4.90
NZD/USD	0.85	0.84	0.82	0.79	0.77	0.76
NZD/AUD	0.89	0.90	0.91	0.91	0.90	0.90
NZD/JPY	82.5	80.6	77.9	74.3	71.1	70.4
NZD/EUR	0.63	0.63	0.64	0.64	0.64	0.63
NZD/GBP	0.52	0.52	0.51	0.51	0.50	0.48
TWI	78.5	78.3	77.8	76.3	74.7	74.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 18 Nov 2013

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.50%	2.50%
30 Days	2.65%	2.66%	2.66%
60 Days	2.65%	2.66%	2.67%
90 Days	2.64%	2.66%	2.68%
2 Year Swap	3.51%	3.44%	3.55%
5 Year Swap	4.41%	4.30%	4.45%

NZ foreign currency mid-rates as at Monday 18 Nov 2013

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8348	0.8250	0.8491
NZD/EUR	0.6187	0.6117	0.6205
NZD/GBP	0.5178	0.5180	0.5250
NZD/JPY	83.74	81.45	83.09
NZD/AUD	0.8902	0.8744	0.8779
TWI	77.92	76.79	78.14

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
Australia						
Real GDP % yr	1.4	2.5	2.4	3.7	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.4	2.6
Unemployment %	5.6	5.2	5.2	5.3	5.8	6.4
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.6	-3.0
United States						
Real GDP %yr	-3.1	2.4	1.8	2.8	1.6	1.6
Consumer Prices %yr	-0.3	1.6	3.1	2.1	1.5	1.7
Unemployment Rate %	9.3	9.6	8.9	8.1	7.5	7.3
Current Account %GDP	-2.7	-3.0	-2.9	-2.7	-2.5	-2.6
Japan						
Real GDP %yr	-5.7	4.9	-0.5	1.9	1.8	1.7
Consumer Prices %yr	-1.3	-0.7	-0.3	0.0	-0.2	0.1
Unemployment Rate %	5.2	5.1	4.5	4.3	4.3	4.3
Current Account %GDP	2.8	3.6	2.0	2.1	2.0	2.0
Euroland						
Real GDP %yr	-4.4	1.9	1.6	-0.6	-0.5	-0.1
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.2
Unemployment Rate %	9.5	10.0	10.1	11.7	12.4	13.0
Current Account %GDP	-0.2	-0.1	0.0	0.9	1.0	1.0
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	0.2	1.1	0.9
Consumer Prices %yr	2.2	3.2	4.0	2.8	2.3	1.8
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.5	-1.9	-3.8	-2.5	-1.5

Forecasts finalised 8 November 2013

Interest Rate Forecasts	Latest	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
Australia						
Cash	2.50	2.50	2.25	2.00	2.00	2.00
90 Day Bill	2.58	2.60	2.35	2.10	2.10	2.10
10 Year Bond	4.21	3.75	3.60	3.40	3.80	4.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.70	2.35	2.40	2.40	2.80	3.00
ECB Repo Rate	0.25	0.25	0.25	0.25	0.25	0.25

Exchange Rate Forecasts	Latest	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
AUD/USD	0.9347	0.96	0.94	0.92	0.92	0.90
USD/JPY	100.24	97	96	95	94	93
EUR/USD	1.3454	1.38	1.34	1.31	1.31	1.28
AUD/NZD	1.1275	1.13	1.12	1.11	1.11	1.11

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