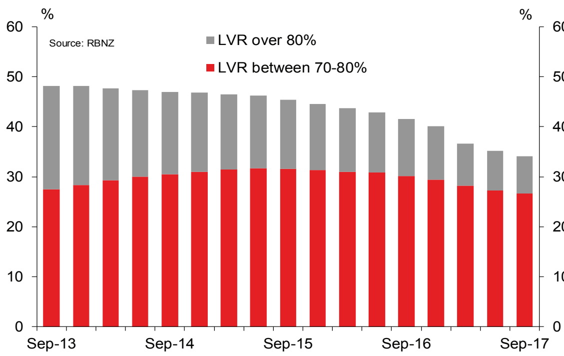
RBNZ eases lending restrictions a little

RBNZ Financial Stability Report, November 2017

29 November 2017

- The Reserve Bank has announced a modest loosening of the loan-to-value limits for housing lending, taking effect next year.
- Risks to the financial system have diminished as house price and credit growth have slowed. The RBNZ is prepared to ease the lending restrictions further if these metrics remain in check.
- A range of new Government policies are aimed at cooling housing demand, diminishing the risk of a resurgence in house prices next year.
- Today's announcement presents a small upside risk to our housing forecasts, but we still expect house prices to remain subdued in coming years.

Share of outstanding mortgages by LVR



This morning the Reserve Bank released its six-monthly *Financial Stability Report*. The report concluded that risks to New Zealand's financial system have diminished in a number of areas, as property prices have cooled and banks have toughened their lending standards.

The main point of interest from today's report was the review of the restrictions on loan-to-value ratios (LVRs) for housing lending, which the RBNZ had signalled at its recent *Monetary Policy Statement*. The RBNZ announced that from the start of next year, the restrictions will be loosened as follows:

- For lending to owner-occupiers, the 'speed limit' - the permitted share of loans above an 80% LVR - will be raised from 10% to 15%.
- For lending to investors, the LVR limit will be raised from 60% to 65%. (The RBNZ allows for up to 5% of lending to be above this ratio, to cover errors and unusual circumstances, but it's understood that the effective 'speed limit' is zero.)

Importantly, the RBNZ also indicated that it is prepared to ease the LVR restrictions further, as long as housing market risks remain contained. The *FSR* provided some more specific detail on the criteria that the RBNZ would use for this decision.

The first is that the RBNZ would like to see house price and credit growth being more in line with household income growth, which has been in the ballpark of 4% in recent years. House prices in the three months to October were up 1.5% on a year ago, though they were up 7% outside Auckland. Housing lending was up 6.4% in the year to September, but on a monthly basis it's been running at closer to 5% recently. The RBNZ would be broadly comfortable with these figures, but it would be wary of any acceleration from here.

The second criterion is that the RBNZ would want to see a continued decline in the high-LVR share of loans on bank balance sheets (as shown in the chart to the left). That seems like a fairly easy hurdle: the LVRs of existing loans tend to decline over time as the principal is repaid, so there would have to be a significant surge in new lending before it exceeded the replacement rate.

The easing announced today is fairly modest, compared to where LVRs have come from over recent years (see the box below). That said, we recognise that changes in lending restrictions do matter for house prices over the short term. In particular, for investors with large housing portfolios, even a small easing in the LVR limits could free up a substantial amount of housing equity that they could then borrow against to buy more houses.

The momentum in house prices has actually turned positive again in the last few months. We wouldn't be surprised to see a further near-term bounce, as buyers look to get in ahead of the foreign buyer restrictions and the extension of the bright-line test for capital gains. The easing of the LVR restrictions will provide further support for house prices over the near term.

However, we still expect a subdued housing market over the course of the next few years. The new Government has announced a range of policies aimed at cooling housing demand. Each of them on their own might have only a small impact on prices, but together they could add up to something significant.

In our recent quarterly *Economic Overview* we forecast a 2% fall in house prices over 2018, with an assumption that the RBNZ would be ready to loosen the LVR limits by the middle of next year. The fact that the RBNZ has acted sooner than we expected – and is likely to ease the restrictions further next year – means that there's some upside risk to our housing forecasts. But we still think that that the combined impact of Government and RBNZ policies will be negative for house prices next year.

The RBNZ noted that it still favours adding debt-to-income ratio limits to its suite of macro-prudential tools. Public consultation has ended, and the RBNZ published its response to submissions last week. The RBNZ has indicated that this tool will be considered as part of the review of its Memorandum of Understanding with the Minister of Finance, which was due to be reviewed after five years (i.e. by May 2018).

Michael Gordon
Senior Economist

Changes to LVR restrictions

Before the introduction of LVR limits in October 2013, about a quarter of new lending was done at an LVR of above 80%.

October 2013: A 10% 'speed limit' for the share of new lending at LVRs above 80%.

October 2015: Investor lending in Auckland capped at a 70% LVR. The speed limit for owner-occupier loans raised to 15% outside Auckland, but retained at 10% in Auckland.

October 2016: Distinctions between Auckland and elsewhere are removed. All investor lending capped at a 60% LVR. Speed limit for owner-occupier loans lowered again to 10%.

January 2018: Investor lending cap raised from 60% to 65%. Speed limit for owner-occupier loans raised again to 15%.

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