Mōhua

Weekly Economic Commentary.

Burning down the house.

The suite of policies unveiled by the New Zealand Government last week herald the most significant changes to the residential property market in over thirty years. The proposed policies will erode the financial incentives for property investors and dramatically tilt housing market conditions in favour of owner occupiers. These changes follow rapid house price increases in recent years, which has resulted in housing affordability becoming an increasing challenge for many New Zealanders.

The major changes introduced by the Government include:

- **Removing the ability to offset mortgage costs on residential investment properties against the income earned on those properties.** This change will take effect from 1 October 2021 for properties purchased after 27 March 2021 and will be gradually phased in over the next four years for existing property owners. The Government is also looking at exceptions for new builds.
- The holding period for taxing capital gains on residential investment properties (otherwise known as the **'Bright-line test'**) has been extended from 5 to 10 years. The holding period remains at 5 years for investors who buy new builds.
- There will be additional financial assistance for first home buyers with changes in **First Home Loans and Grants** settings. Those changes include increases in income caps, as well as changes to regional price caps.
- A $3.8bn **Housing Acceleration Fund** is being established to assist with the development of infrastructure (such as pipes and roads) to support new housing.

The above policy announcements are likely to reshape the residential property market over the coming years. We have frequently highlighted that financial considerations (such as rental yields, mortgage rates and tax) have played a larger role in determining what prospective purchasers are willing to pay for housing than physical factors such as housing supply.

Up until now, the tax treatment of mortgage interest costs has given leveraged property investors somewhat of an edge over owner-occupiers. That's meant that investor demand has been a major driver of the prevailing level of house prices. In the current low interest rate environment, investors search for yield and the potential returns on rental properties (both rental yields and capital gains) has underpinned rapid increases in house prices

For leveraged investors, removing the deductibility of interest costs will dramatically lower the yield on rental properties and will significantly reduce the prices that investors are willing to pay for houses. That will be reinforced by the extension to the Bright-line test.

These changes to the tax system will dramatically tilt financial conditions in favour of owner-occupiers (and cashed up investors), who will now be the ones who determine the market price of houses. A rough calculation indicates that occupiers' average willingness to pay is about 10% below current prices, which suggests that house prices could eventually fall by that much in the long term. While that would be a large decline, it would still only bring prices back to where they were four months ago.

However, there could be a much sharper fall while the housing market realigns itself. Without interest deductibility, property investors will need to see a higher rate of return to justify their investments. That could mean higher rents, although that will be constrained by tenants' ability to pay. The more likely way is that highly-leveraged investors will sell out – at a reduced price – to owner-occupiers or less-leveraged investors. We saw similar outcomes in the UK, which began to phase out interest deductibility from 2017.

For the RBNZ, these policy changes will make hitting the inflation target more difficult. The housing market plays a key role in shaping economic conditions in New Zealand more generally, with rising house prices typically associated with increases in household confidence and spending. Economic activity is already below trend as a result of the Covid outbreak. And now with a material softening in the housing market looking likely, the recovery in demand is likely to be even more gradual.

This reinforces our expectations that OCR hikes will remain off the cards for the foreseeable future. Indeed, more monetary easing might be needed to support the economy through the transition phase, and a negative OCR is still a possibility (on this front, prior to the announcement of the changes in housing market policy, the RBNZ's February policy statement highlighted that a negative OCR is a viable policy option if needed). That's important as continued low interest rates will help to limit the downside for house prices, at least in the near term.

Reflecting the reduced likelihood of OCR hikes, the NZ dollar has fallen sharply over the past week. We've revised our forecasts down, and now expect the NZD to peak at 0.76 vs the USD (previously 0.78).

Weaker house prices will also have a dampening impact on home building activity. However, this drag may be modest. New builds remain exempt from the extension to the Bright-line test and are likely to have some tax advantages over purchasing an existing property (for instance, the Government may consider allowing interest costs on new builds to be tax deductible for a limited period, though this is yet to be confirmed). Furthermore, the weaker outlook for house prices also signals downward pressure on land prices, which are a key hurdle for many housing developments. We still expect high levels of home building over the coming years, with a large number of projects already in the pipeline and many regions still struggling with shortages of affordable homes.

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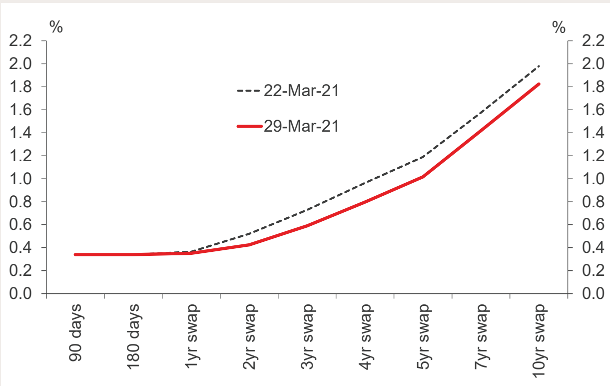
Fixed vs Floating for mortgages.

We expect that floating rates, and shorter fixed-term rates, will be stable over the coming months. The Reserve Bank will not respond to a temporary spike in inflation. Longer-term fixed rates may rise sooner, in response to a large increase in wholesale fixed rates over the past few months.

We expect mortgage rates to rise over the course of the coming years. Based on our forecasts, taking a longer-term fixed rate (from three years to five years) will prove less expensive for borrowers than taking a short-term rate now and refixing later.

NZ interest rates



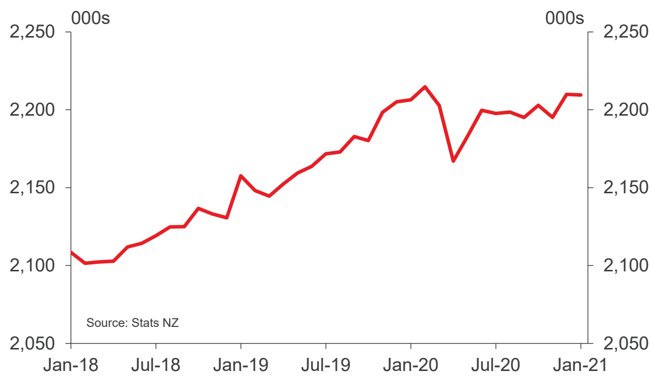
The week ahead.

NZ Feb employment indicators

Mar 29, Last: 0%

- The monthly employment indicator is a relatively new release, based on data from income tax filings. It provides a less detailed but more timely snapshot of employment trends compared to the quarterly surveys.
- The number of filled jobs held up surprisingly well in January, on top of a strong 0.7% rise (seasonally adjusted) in December. Jobs were up 0.1% on the same time last year.
- We don't have a clear sense of how the February results will turn out - the weekly snapshots haven't been available recently. However, the absence of international tourists will have had a more noticeable impact on activity over summer, and we expect this to show through in the employment figures over the coming months.

NZ Monthly Employment Indicator filled jobs

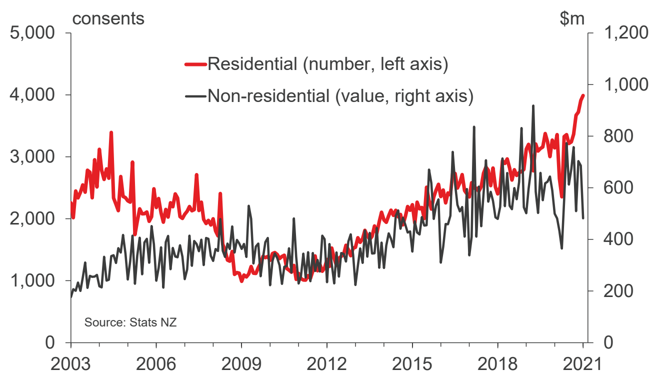


NZ Feb residential building consents

Mar 30, Last: +2.1%, Westpac f/c: -5.0%

- Consent issuance started the year on firm footing, rising by 2.1% in January. That followed strong gains over the past year, with annual residential consent numbers at their highest level since 1974.
- We expect that consent numbers will fall by 5% in February. That's due to an expected easing in the lumpy apartment consents category, which rose strongly in January. That would still leave issuance at very elevated levels.
- Despite recent changes in housing market policy, we expect strong home building activity over the coming year with a large amount of work already in the pipeline.

NZ building consents

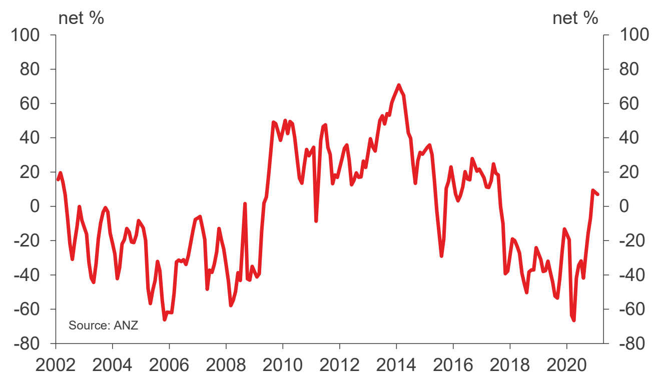


NZ Mar ANZBO business confidence (final)

Mar 31, Last: 0.0

- Overall business confidence dipped in March, as did businesses' expectations for activity in their own firms. That was largely as expected given the dialling up of Covid related health and activity restrictions in weeks before the survey.
- We don't expect much change in the headline figures when the final results of the March survey are released. However, the sectoral breakdown of the results will be of interest. While sectors like construction are booming, the services sector is being weighed down by the lack of international tourist dollars.
- It will also be worth watching the gauges of pricing intentions which have spiked higher in recent months.

NZ business confidence



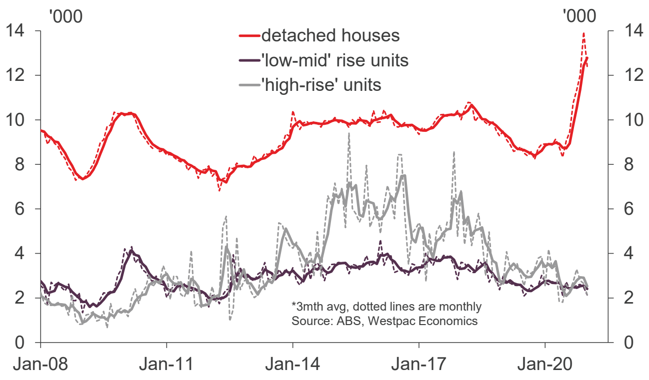
The week ahead.

Aus Feb dwelling approvals

Mar 31, Last: –19.4%, WBC f/c: –3.0%
Mkt f/c: 5.0%, Range: -12.0% to +15.0%

- Dwelling approvals retraced sharply in Jan, dropping a whopping 19.4%. However, that was after a big 43% surge in the last four months of 2020 as reopening rebounds combined with a large pull-forward in activity associated with the Federal Government's HomeBuilder scheme. Much of the Jan decline looks to be related to that scheme, which saw grants pared back from $25k to $15k at the start of 2021. The detail suggests volatility was also a factor with a steep decline in high rise units that was unlikely to be HomeBuilder related.
- The picture heading into Feb is uncertain. The HomeBuilder pull-back likely has further to run for non high rise approvals. Pinpointing the size of monthly moves is difficult but the unwind is likely to be larger than any reversal in high rise volatility or wider uplift from the surging housing market. On balance we expect approvals to decline a further 3% but there are significant risks on either side.

Aus dwelling approvals

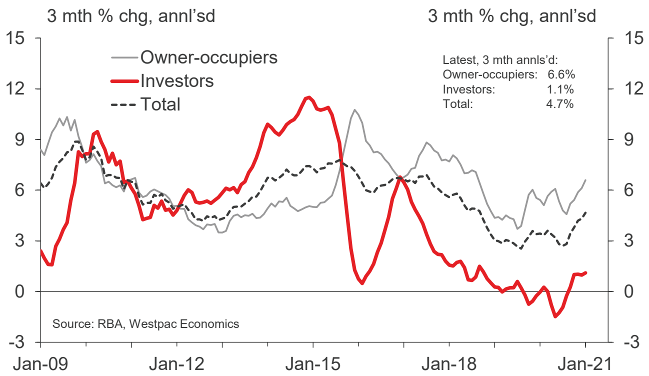


Aus Feb private credit

Mar 31, Last: 0.2%, 1.7%yr WBC f/c: 0.3%, 1.7%yr
Mkt f/c: 0.3%, Range: 0.1% to 0.5%

- Credit to the private sector is at a turning point, led by the housing upswing in response to cheap credit and government incentives to build new homes. Credit expanded by 0.2% in January after a 0.3% gain in December. We anticipate a 0.3% lift in February. This is an improvement on the 7 months April to October, when credit was either flat or fell - with a cumulative fall of 0.4%.
- Housing credit grew by 4.7% annualised over the past three months, up from a mid-2020 low of 2.7% annualised. New lending is surging, with considerable momentum in 2021.
- Business credit has been contracting - declining in 8 of the past 9 months (a 0.3% rise in December being the exception) - for a cumulative fall of 3.2%. Looking forward, prospects are for an emerging improvement over coming months against the backdrop of a rapidly rebounding economy.

Aus housing credit

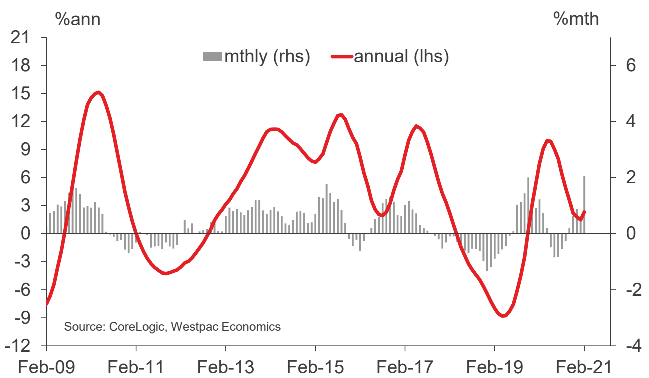


Aus Mar CoreLogic home value index

Apr 1, Last: 2.0%, WBC f/c: 2.5%

- Feb marked a significant shift in Australia's housing upturn with price gains accelerating sharply, particularly across the previously softer Sydney and Melbourne markets. The CoreLogic home value index, covering the eight major capital cities, surged 2.0% in the month, the biggest monthly gain in over 17yrs, taking prices comfortably above their pre-COVID levels and 0.7% above their previous all time high in Sep 2017.
- March looks set to go one better with the CoreLogic daily index pointing to a 2.5% increase, a 32yr high in terms of monthly gains. Sydney prices look to be up a thumping 3.3%. The latest upturn is also notably broad with all major capitals and regional areas posting strong gains – a price upswing this strong and synchronised has not been seen in many years.

Aus dwelling prices



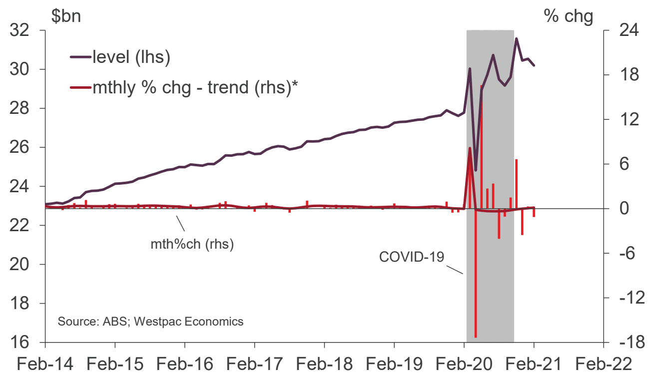
The week ahead.

Aus Feb retail trade

Apr 1, Last: 0.5%, WBC f/c: –1.1%
Mkt f/c: -1.1%, Range: -1.1% to -0.4%

- It has been a softer start to the year for retail sales, albeit coming off a strong finish to 2020. Sales surged 2.5% in the three months to Dec to be up 9.7%yr, the gain coming despite more COVID-releated disruptions late in the Dec month.
- So far, 2021 has seen a 0.3% in Jan with preliminary estimates showing a 1.1% decline in Feb. The final Feb release will include more granular detail that is likely to highlight the impact of 'mini-lockdowns' during the month in Vic and WA – sales up marginally across other states.
- Our Westpac Card Tracker shows March has seen a rebound from these disruptions but there are hints that the underlying trend in retail may be starting to soften as 'catch-up' activity wanes and reopening sees consumers shift spending back to non-retail categories.

Aus monthly retail sales

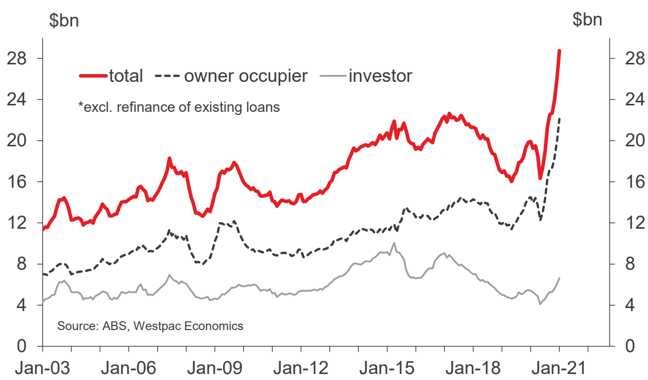


Aus Feb housing finance approvals

Apr 1, Last: 10.5%, WBC f/c: 2.0%

- Housing finance approvals continued to surge strongly in Jan, up 10.5%mth to be up 44%yr. We had expected to see a meaningful drag from construction-related approvals as a pull-forward associated with the Federal government's HomeBuilder scheme unwound. Instead, construction-related approvals posted another big gain with other approvals also lifting.
- Pinpointing the timing is clearly difficult but a meaningful HomeBuilder-related drag still looks very likely near term. That said, the wider market upturn is going from strength to strength in 2021, with turnover and prices both sustaining strong gains early in the year. How these two forces resolve in the Feb month is uncertain – we suspect housing finance approvals will still post a small 2% gain overall but there are significant risks to either side.

Aus new finance approvals*

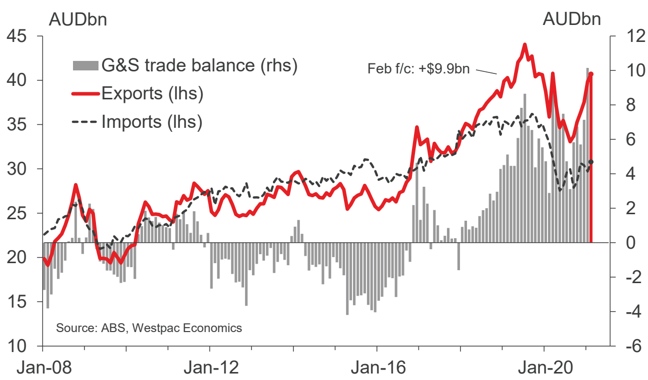


Aus Feb trade balance, $bn

Apr 1, Last: 10.1, WBC f/c: 9.9
Mkt f/c: 9.5, Range: 7.1 to 10.8

- In January, the surplus hit a record high of $10.1bn and we expect it to hold around this level in February, at $9.9bn.
- Export earnings are forecast to rise by 2.1% in the month, much of which is price - with commodity prices up by over 3% in the month.
- Imports are up an expected 3.6%, representing a resumption of the upward trend / recovery - reversing the temporary dip over the past two months.
- The dominant force currently is the sharp lift in commodity prices, notably for iron ore, which is boosting export earnings. On our figuring, export earnings in February will be up 26% on a year ago, well in excess of the 7% rise in imports. Commodity prices are up over the year, +30% in USD and +12% in AUD.

Aus trade balance

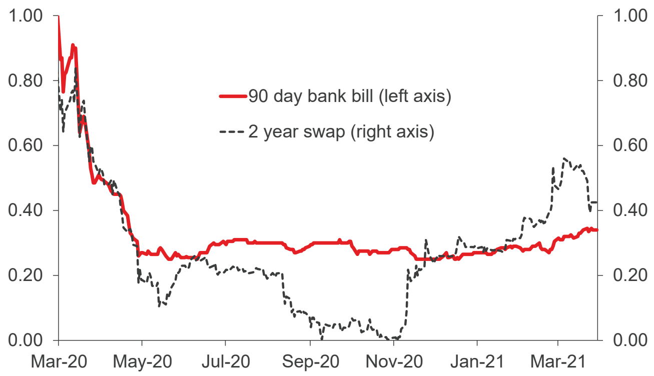


New Zealand forecasts.

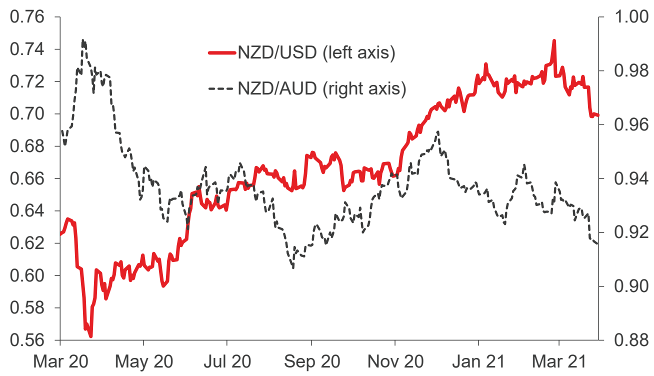
Economic forecasts	Quarterly				Annual			
	2020	2021						
% change	Dec (a)	Mar	Jun	Sep	2019	2020	2021f	2022f
GDP (Production)	-1.0	-0.4	1.9	0.1	2.4	-2.9	3.8	3.8
Employment	0.6	-0.1	0.2	0.4	1.3	0.7	1.0	3.0
Unemployment Rate % s.a.	4.9	5.0	5.1	5.0	4.1	4.9	4.9	4.2
CPI	0.5	0.8	0.6	0.6	1.9	1.4	1.9	1.0
Current Account Balance % of GDP	-1.0	-1.4	-2.1	-2.6	-3.3	-1.0	-2.7	-2.8

Financial forecasts	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Cash	0.25	0.25	0.25	0.25	0.25	0.25
90 Day bill	0.30	0.30	0.30	0.30	0.30	0.30
2 Year Swap	0.40	0.40	0.40	0.45	0.50	0.55
5 Year Swap	1.00	1.00	1.05	1.10	1.15	1.20
10 Year Bond	1.65	1.70	1.75	1.80	1.90	2.00
NZD/USD	0.72	0.73	0.74	0.76	0.76	0.75
NZD/AUD	0.91	0.91	0.90	0.89	0.89	0.89
NZD/JPY	78.5	80.3	82.1	85.1	84.4	83.3
NZD/EUR	0.60	0.60	0.60	0.61	0.60	0.59
NZD/GBP	0.51	0.52	0.52	0.54	0.54	0.53
TWI	74.5	74.9	75.0	76.1	75.8	74.7

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 29 March 2021

Interest rates	Current	Two weeks ago	One month ago
Cash	0.25%	0.25%	0.25%
30 Days	0.26%	0.26%	0.26%
60 Days	0.30%	0.29%	0.29%
90 Days	0.34%	0.32%	0.31%
2 Year Swap	0.43%	0.53%	0.48%
5 Year Swap	1.02%	1.18%	1.20%

NZ foreign currency mid-rates as at 29 March 2021

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6992	0.7177	0.7238
NZD/EUR	0.5927	0.6008	0.5998
NZD/GBP	0.5068	0.5156	0.5192
NZD/JPY	76.69	78.23	77.14
NZD/AUD	0.9156	0.9252	0.9385
TWI	73.71	75.16	75.57

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
NZ	Feb employment indicators	0.0%	–	–	Hit to summer tourism is expected to weigh on jobs.
UK	Feb net mortgage lending £bn	5.2	–	–	Pushed above pre–Covid levels on stronger housing turnover.
US	Mar Dallas Fed index	17.2	–	–	Should improve in line with other regional mfg surveys.
	Fedspeak	–	–	–	FOMC's Waller to speak on Fed independence.
Tue 30					
NZ	Feb building permits	2.1%	–	–5.0%	Easing after strong Jan result, annual rate still elevated.
Aus	Weekly Payroll Jobs and Wages	–	–	–	For the week ending 13 March.
Eur	Mar economic confidence	93.4	95.0	–	Will be crimped by extended lockdowns.
US	Jan FHFA house prices	1.1%	1.3%	–	House price growth remains robust but softer home sales...
	Jan S&P/CS home price index	1.3%	1.2%	–	...point to potential for a moderation.
	Mar consumer confidence index	91.3	96	–	Will continue to be supported by rollout and reopening.
	Fedspeak	–	–	–	FOMC's Quarles and Williams to speak.
Wed 31					
NZ	Mar ANZ business confidence	0.0	–	–	Back around average levels, pricing pressures elevated.
Aus	Feb dwelling approvals	–19.4%	5.0%	–3.0%	Approvals still unwinding 40% HomeBuilder pull-forward.
	Feb private credit	0.2%	0.3%	0.3%	Emerging improvement – led by housing upturn.
Chn	Mar non–manufacturing PMI	51.4	52.0	–	Official PMIs should continue to improve...
	Mar manufacturing PMI	50.6	51.2	–	... as China's outperformance continues.
Eur	Mar CPI %yr	0.9%	1.4%	–	Anticipating a transitory increase on base effects.
UK	Q4 GDP	1.0%	–	–	Final estimate; expected to remain unchanged.
US	Mar ADP employment change	117k	500k	–	Initial claims point to ongoing labour market recovery.
	Mar Chicago PMI	59.5	60.0	–	Business barometer sitting around a two year high.
	Feb pending home sales	–2.8%	–2.7%	–	Follows a softer print in new home sales.
Thu 01					
NZ	Apr ANZ consumer confidence	113.1	–	–	Confidence remains low, but has been rising.
Aus	Mar CoreLogic home value index	2.0%	–	2.5%	Shaping as strongest monthly gain in 32yrs.
	Feb retail sales	0.5%	–1.1%	–1.1%	COVID mini-lockdowns hit Vic and WA. Rest up slightly.
	Feb housing finance	10.5%	–	2.0%	HomeBuilder unwind to moderate strength in other segments.
	Feb trade balance $bn	10.1	9.5	9.9	To hold near record high – rising commodity prices supportive.
	Mar AiG PMI	58.8	–	–	Manuf'g sector brisk expansion on sharp economic rebound.
Chn	Mar Caixin China PMI	50.9	51.3	–	To reflect China's growth outperformance.
US	Initial jobless claims	684k	–	–	Fell sharply last week; looking for downtrend to continue.
	Feb construction spending	1.7%	–0.8%	–	Led by strength in residential construction.
	Mar ISM manufacturing	60.8	60.5	–	Mfg surveys have seen strong prices paid/new orders growth.
	Fedspeak	–	–	–	FOMC's Harker to discuss Community Banks and Fintech.
Fri 02					
NZ	Good Friday	–	–	–	Public holiday, markets closed.
US	Mar non–farm payrolls, '000	379	600	–	Moderate to strong gains in payrolls throughout 2021...
	Mar unemployment rate	6.2%	6.0%	–	... to see u/e tend down towards 5% over the year.
	Mar average hourly earnings %mth	0.2%	0.2%	–	Labour market slack to suppress earnings growth.

International forecasts.

Economic Forecasts (Calendar Years)	2017	2018	2019	2020f	2021f	2022f
Australia						
Real GDP %yr	2.4	2.8	1.9	-2.4	5.2	3.6
CPI inflation %yr	1.9	1.8	1.8	0.9	2.6	2.1
Unemployment rate %	5.5	5.0	5.2	6.8	6.0	5.3
Current account % of GDP	-2.6	-2.1	0.7	2.5	3.7	1.8
United States						
Real GDP %yr	2.3	3.0	2.2	-3.5	5.3	4.4
CPI inflation %yr	2.1	2.4	1.9	1.2	1.8	1.9
Unemployment rate %	4.4	3.9	3.7	8.1	5.7	4.5
Current account % of GDP	-2.3	-2.3	-2.6	-2.5	-2.4	-2.4
Japan						
Real GDP %yr	2.2	0.3	0.7	-5.5	2.2	2.2
Euro zone						
Real GDP %yr	2.6	1.8	1.3	-6.8	4.2	3.9
United Kingdom						
Real GDP %yr	1.9	1.3	1.5	-10.5	5.0	5.5
China						
Real GDP %yr	6.9	6.8	6.1	2.3	10.0	5.7
East Asia ex China						
Real GDP %yr	4.7	4.4	3.7	-2.6	5.0	4.9
World						
Real GDP %yr	3.8	3.5	2.8	-3.2	5.9	4.7
Forecasts finalised 10 March 2021						

Interest rate forecasts	Latest	Jun–21	Sep–21	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22
Australia								
Cash	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW	0.03	0.02	0.02	0.02	0.04	0.06	0.08	0.10
10 Year Bond	1.66	1.85	1.85	1.90	2.05	2.20	2.35	2.50
International								
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.63	1.65	1.70	1.80	1.95	2.10	2.25	2.40

Exchange rate forecasts	Latest	Jun–21	Sep–21	Dec–21	Mar–22	Jun–22	Sep–22	Dec–22
AUD/USD	0.7613	0.79	0.80	0.82	0.85	0.85	0.84	0.82
USD/JPY	109.26	109	110	111	112	111	111	110
EUR/USD	1.1780	1.20	1.21	1.23	1.25	1.26	1.27	1.27
GBP/USD	1.3762	1.40	1.40	1.41	1.41	1.41	1.42	1.42
USD/CNY	6.5429	6.40	6.30	6.20	6.15	6.10	6.05	6.00
AUD/NZD	1.0922	1.10	1.10	1.11	1.12	1.12	1.12	1.11

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