LVR restrictions to ease from start of 2018

- RBNZ to start easing LVR restrictions sooner than expected, from the 1st of January 2018.
- Q3 Terms of Trade surpass 1973 record, in part reflecting NZ's import-export mix.
- US Republicans get one step closer to tax reform after the Senate passes its version of the tax reform bill.

The RBNZ surprised us on Wednesday by announcing that the loan-to-value ratio (LVR) restrictions would be eased slightly from the 1st of January 2018. While we had been expecting the RBNZ to lay out the path for their gradual removal, given the recent easing in financial stability risks, the timing took us by surprise. With the housing market just shaking off the impacts of the election, we expected the RBNZ would wait for clarity around the timing of the new housing policies still to lessen the risk of a housing rebound. However, **the RBNZ appears confident that the risk of a resurgence in house prices remains low.**

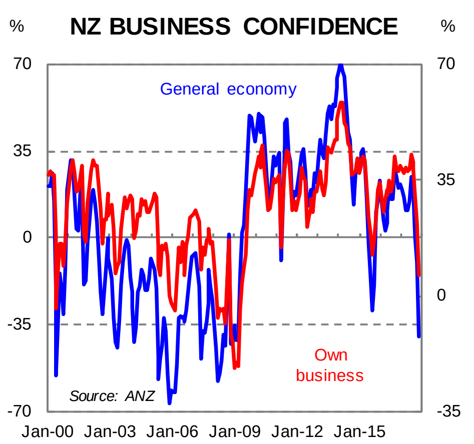
The changes will impact both owner-occupiers and investors. The RBNZ will lift the share of lending banks can lend to owner-occupiers at a LVR above 80% (i.e. less than a 20% deposit) from 10% to 15%. This will make it slightly easier for first home buyers to purchase a house if they haven't got a 20% deposit. On the investor side, the RBNZ will ease the LVR restriction to 65% from 60%, meaning that investors will be able to purchase property with a 35% deposit (previously 40%). Note that the 'speed limit' here is to remain fixed at 5%, meaning in effect few low-deposit investor loans.

Looking forward, we are likely to see further gradual easing in the LVRs. According to the RBNZ, we will **see further easing if house price and credit growth remain moderate and if we don't see any resurgence in housing market activity as a result of this LVR adjustment.** In terms the market impact, we think this **initial LVR easing is likely to contribute to a stabilising in 2018 of the mild price falls seen in Auckland and Christchurch**, though we would still expect price growth in other regions to flatten off where capacity constraints are not as tight. **We don't expect the eased restrictions to spark a return to strong house price growth.**

Last week also saw the Q3 Terms of Trade (ToT) reach a record high, after getting within a whisker of the record in Q2. The previous record was achieved in June 1973. **This record high reflects how NZ has benefitted from its import-export mix recently.** NZ has been benefitting from relatively high food (export) prices, while benefitting from relatively low (import) goods prices. Low import prices are a symptom of the global over-capacity in the manufacturing sector at the moment. On the flip side, low global agricultural capacity is supporting food prices.

Offshore, the USA was once again in the spotlight as the **Senate passed its form of the US tax reform bill over the weekend.** This takes the US one step closer to a sweeping tax reform that will also represent Trump's first key legislative victory since taking office in January. However, **the House of Representatives and the Senate must now agree on a final version before Trump can sign the bill.**

Chart of the Week: Growth outlook uncertain



Businesses have had their say and they are not happy about the new Labour Government. In the first full survey since the announcement of the new government, **the ANZ Business Outlook showed that headline business confidence plummeted to its lowest level since 2009.** Of particular concern in this release was the **sharp drop in businesses' own activity expectations, which tend to be a good predictor of growth.** If this weakness is sustained, it will suggest material downside risk to the current economic outlook.

At this stage, **the sharp drop in businesses' own expectations (if sustained) will impact Q4 growth more than Q3.** However, business confidence had already softened on general election uncertainty (before the government announcement), which is likely to have weighed on Q3 growth at the margin. While it's still some time until we will see the impact on Q4 economic growth, the Q3 GDP release is getting nearer. This week we have reads on the construction and manufacturing indicators for Q3 GDP ahead of its release in a few weeks' time (21st December).

Foreign Exchange Market

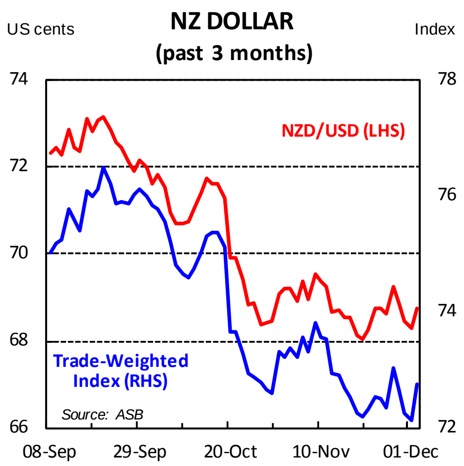
FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6873	0.6864	0.6921	0.7075	0.7091	FLAT/DOWN	0.6800	0.7100
NZD/AUD	0.9044	0.9026	0.9005	0.9572	0.9566	FLAT	0.8900	0.9150
NZD/JPY	77.52	76.44	78.90	78.94	80.76	FLAT	76	79
NZD/EUR	0.5794	0.5755	0.5936	0.6306	0.6638	FLAT	0.5550	0.5900
NZD/GBP	0.5110	0.5154	0.5295	0.5494	0.5622	FLAT/DOWN	0.5000	0.5200
TWI	72.7	72.4	73.4	76.5	78.0	FLAT	71.00	74.00

^Weekly support and resistance levels * Current is as at 9.30 am Monday; week ago as at Monday 5pm.

With no major directional drivers, much of the recent NZD TWI volatility has been due to swings in the USD. There have been periodic bouts of USD strength, reflecting the still-robust US dataflow. The passage of the tax package through the US Senate is also USD positive, although there are still a number of hurdles to clear until the tax package can be signed off into law by the President. Political scandals continue to dog the Trump administration and weigh on the USD. **The past few weeks have also been characterised by broad-based GBP and euro strength, and further progress on Brexit-related talks could continue to boost sterling. The AUD and NZD have been on the back foot due to narrowing interest rate differentials with other major currencies**, with spreads between NZ and US 10-year bonds touching record lows last week. Friday's comments by Grant Robertson reaffirmed the Government's commitment to maintaining expenditure restraint and meeting its sub 20% net public debt target had little impact on the NZD, as did the signalled relaxation by the RBNZ of the loan-to-value restrictions.

The next major milestone for the NZD is next Thursday's Fed decision and the Half Year Economic and Fiscal Update (HYEFU). Prior to that, tomorrow's RBA decision, Wednesday's Australian Q3 GDP, and US Payrolls at the end of the week could contribute to further NZD volatility as could Tuesday's Global Dairy Trade auction and the speech by RBNZ Governor Grant Spencer, entitled "Low inflation and its implications for monetary policy". Partial data for Q3 NZ GDP should reveal some pockets of strength and support the NZD, although we expect a sub-par +0.4% print for Q3 GDP. We expect the HYEFU to stick to the script and show the government accounts in a positive light, which will be NZD supportive. A December Fed hike already looks to be priced into the USD, with the focus on whether the published DOT plots will continue to signal three hikes over 2018 versus 42bps in current market pricing.

Short-term outlook:



Key data	Date	Time (NZT)	Market
RBA cash rate	5/12	4.30 pm	1.50%
GDT Dairy Auction	6/12	am	-
AU GDP, Q3, %qoq	6/12	1.30 pm	0.7
US Non-Farm Payrolls, Nov, ch	9/12	2:30am	+210k

Key Events: NZD: Q3 Building Work Put in Place (Tue), GDT Dairy Auction (Wed), Q3 Manufacturing Survey (Fri), **USD:** Services/composite PMI (Wed), Non-manufacturing ISM (Wed), ADP Employment (Thu), Non-farm payrolls (Sat). **AUD:** Services/composite PMI (Tue), Q3 Current Account (Tue), Retail Sales (Tue), RBA Decision (Tue), Q3 GDP (Wed). **EUR:** Services/composite PMI (Tue), Q3 GDP (Tue), German Industrial production (Thu). **GBP:** Services/composite PMI (Tue), Industrial production (Fri). **JPY:** Services/composite PMI (Tue), Q3 GDP (Fri). **CH:** Services/composite PMI (Tue).

Speakers: RBNZ: Spencer (Tue). **ECB:** Mersch (Wed). **BOJ:** Masai (Wed).

Medium-term outlook:

Last Quarterly Economic Forecasts

We updated our FX forecasts in early November, to reflect the weaker NZD following the outcome of the NZ General Election and growing likelihood of a US fiscal tax package being delivered. In NZ, **political uncertainty associated with a change in Government has weighed on the NZD,** but we expect this to have mostly a fleeting impact.

The NZD is expected to remain supported by the historically high Terms of Trade and relatively high interest rates. We expect the NZD/USD to recover to 0.72 cents by early 2018 and climb to 0.75 by the end of 2018.

NZD recovery is also expected against the euro, which is expected to average between 0.60 and 0.61 over the coming year. The NZD/AUD fell following the Labour-NZ First coalition announcement and we expect the **NZD/AUD will average between 0.90 and 0.91 over the next year.** With EU-UK Brexit negotiations weighing on the UK economic outlook, the NZD is expected to remain elevated against the GBP.

We expect the NZD/GBP to average between 0.53 and 0.54 until the end of 2018. We expect the **NZD/JPY to average around 78-80 level over the next couple of years, with the yen supported by** low US Treasury yields, and no indication of further BOJ easing.

Interest Rate Market

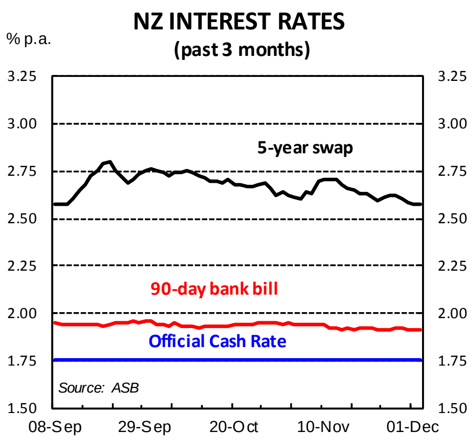
Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	1.75	FLAT
90-day bank bill	1.91	1.91	1.94	1.95	2.04	FLAT
2-year swap	2.14	2.17	2.17	2.21	2.30	UP
5-year swap	2.58	2.63	2.61	2.70	2.85	UP
5-year benchmark gov't stock	2.31	2.40	2.39	2.46	2.56	UP
NZSX 50	8189	8160	8065	7500	6898	UP

^Weekly support and resistance levels * Current is as at 9.30am Monday; week ago as at Monday 5pm.

US 10-year government bond yields edged slightly higher over the week, but continued to trend in a recent range between 2.3-2.4%. **Meanwhile, 2-year government bond yields continue to rise as expectations for a rate hike from the Fed grows**. The end of the week resulted in mixed influences for US bond markets. **The US Senate passed an overhaul of the US tax code, which is seen as positive** for equities and bond yields, but this news was **over shadowed by political developments** as former US National Security Adviser Michael Flynn pleaded guilty on Friday to lying to the FBI about his contacts with Russia.

Meanwhile, NZ interest rates did not follow the US moves higher and fell over the past week. At the start of the week, the lower rates followed the lead from weaker Australian Government bond yields. However, by the end of the week as Australian yields recovered some ground, the **very weak NZ business confidence reading continued to weigh on NZ yields.** The fall in NZ Government bonds saw a **narrowing in the spread between NZ and US 10-year government bonds to just 31 basis points on Friday**; such a small spread level is very rarely seen.

Short-term outlook:



Week Ahead: The tone for this week will likely be set by the US interest rate reaction to the weekend's events (once US markets open on Monday), including the US Senate passing its tax reform agenda. **US political developments could also generate some market volatility throughout the week**, including recent developments into the Russia investigation but also the **requirement by US Congress to pass a short-term spending bill by Friday to avoid a partial US shutdown**. The main economic focus will be on **US employment indicators** at the end of the week. Leading indicators point to a decent 200,000 increase in Non-farm Payrolls, but with the US economy at full employment for several months now the market will likely remain most sensitive to average earnings growth.

Some Australasian volatility is possible this week. In NZ, **Acting RBNZ Governor Grant Spencer delivers a speech** at Tuesday lunch time. Then over in Australia key events include the RBA rate announcement (the RBA is widely expected to leave its cash rate unchanged at 1.5%) and **Australian Q3 GDP** (market consensus currently 0.7%).

Medium-term outlook:

Last Quarterly Economic Forecasts

The Reserve Bank of New Zealand (RBNZ) kept the Official Cash Rate (OCR) on hold at 1.75% in November, and maintained a neutral policy outlook. The growth outlook was broadly in line with the August MPS, but the short-term trajectory for inflation was higher. The key development with the Monetary Policy Statement (MPS) is the inclusion of assumptions around some key government policy changes. The assumptions, whilst preliminary, largely focus on policy shifts that are likely to have the most significant impact on the inflation outlook. The published interest rate path signalled a slightly earlier start to OCR hikes (H1 2020 instead of H2), but with just 50bp of hikes till the end of 2020. We expect the RBNZ will have to move sooner than this, with policy tightening starting in 2019, but for a gradual path of policy tightening and a historically low OCR endpoint this cycle.

Meanwhile, the new Government announced that is instigating a two-stage review of the Reserve Bank Act. We expect key recommendations to include adding a dual mandate, including employment alongside price stability. A shift to a formal committee for policy decisions is highly likely. **The changes are unlikely to change the average level of NZ interest rates over the longer term.** Provided that the employment target is a worded one, rather than an explicit numerical target, **we also see few implications for monetary policy operations over the cycle.** RBNZ comments during the November MPS media conference suggest RBNZ staff share a similar view. But the target changes will be an added consideration next year for the RBNZ, along with the Government policy changes the RBNZ is already starting to factor in.

Local long-term interest rates are expected to drift up in tandem with global counterparts. With ASB now expecting three Fed hikes by the end of 2018 (and the possibility of a fourth), upside risks are building. Low global inflation, however, and a downward global risk profile suggest that the drift up will be gradual, with a historically low endpoint.

Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Australia Company Operating Profits, Q3, %qoq	04/12	1:30 pm	-4.5	0.1	2.5
UK Markit Composite PMI, November, Points	05/12	10:30 pm	55.8	55.8	55.6
Australia Current Account Deficit, Q3, $bn	05/12	1:30 pm	-9.6	-8.7	-7.8
Australia Retail Trade, October, %mom	05/12	1:30 pm	0.0	0.3	0.2
Reserve Bank of Australia Interest Rate Announcement	05/12	4:30 pm	1.5	1.5	1.5
Eurozone Markit Composite PMI, November, Points	05/12	10:00 pm	57.5	57.5	57.4
Australia GDP, Q3, %qoq	06/12	1:30 pm	0.8	0.7	0.5
Australia Owner-Occupier Loan Value, October, %mom	08/12	1:30 pm	-2.1	-	-1.0
Japan Current Account, October, ¥bn	08/12	12:50 pm	2271	1731	1,750
US Non-farm Payrolls, November, change	09/12	2:30 am	261	199	200

We expect some rebound in **Australian company operating profits** after Q2's 4.9% slide. Profits remain robust especially in light of feeble economy-wide wage growth.

We expect a narrowing in **Australia's current account deficit** in Q3 from Q2's 9.6bn current account shortfall.

Some rebound in **Australia's retail trade** is anticipated after September's disappointingly flat outcome. The dismal September result followed relatively solid results of the previous few months. Retail spending continues to be undone by the lowest wage growth in decades and diffident consumer sentiment. We expect a modest increase of around 0.2% in October.

Low inflation and weak wage growth give the Reserve Bank of Australia plenty of time to ponder price and growth outlooks. We expect no change from the current 1.5% cash rate. Modest jobs growth has put some downward pressure on the national unemployment rate. But wages are not expected to fuel inflation anytime soon, given considerable spare capacity in the jobs market currently.

We expect a modest 0.5% rise in **Australia's Q3 GDP** after the previous 0.8% lift. Annual growth is poised to lift 2.8% from Q2's 1.8%pa. Government spending on infrastructure, some rebound in non-mining business investment, solid export volumes, and modest consumer spending activity are likely to be the key drivers of Q3 growth.

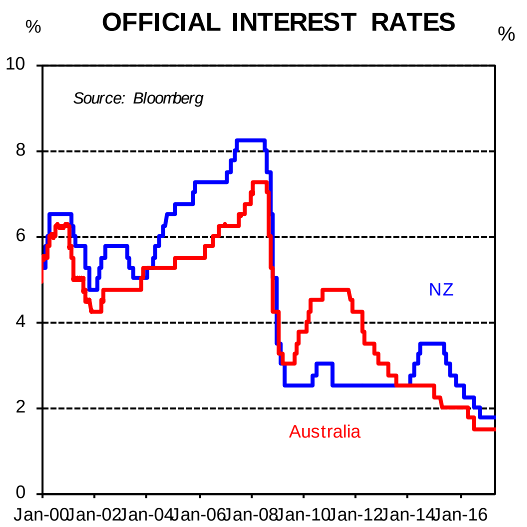
We expect declines in both, the volume and value of **Australian housing loans**, particularly to investors. Recent APRA-driven changes to investor-related lending guidelines and mortgage rates are slowing overall lending growth. House prices have already peaked in Sydney for the current cycle, and are likely to be nearing the peak in Melbourne.

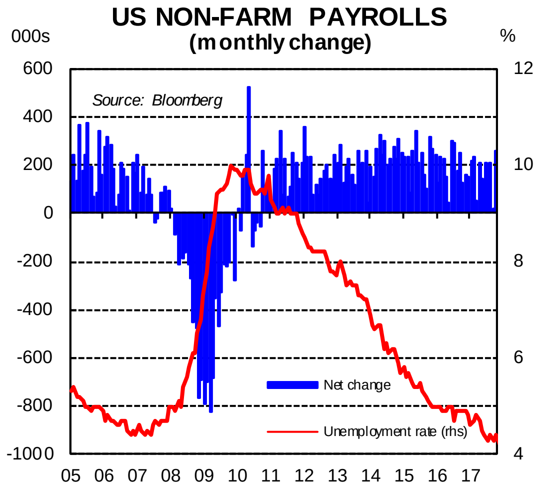
Already-released customs trade data suggest **Japan's current account** surplus expanded significantly in July.

We anticipate the **UK's November composite PMI** will print at levels around 55.6 points, indicating a relatively strong performance in manufacturing and services, while offsetting a poor construction performance.

We anticipate the **Eurozone's November composite PMI** will print at levels around 57.4 points, indicating an increasingly robust pace of economic expansion in the Eurozone.

The lift in **US** jobless claims suggests growth in **Non-farm Payrolls** decelerated modestly to 200,000 in November. This is still a very strong increase in Payrolls and would be enough to push the unemployment rate down to a new low of 4.0%.

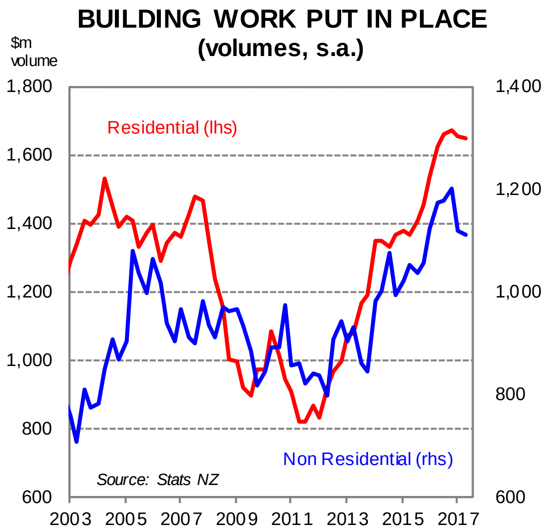




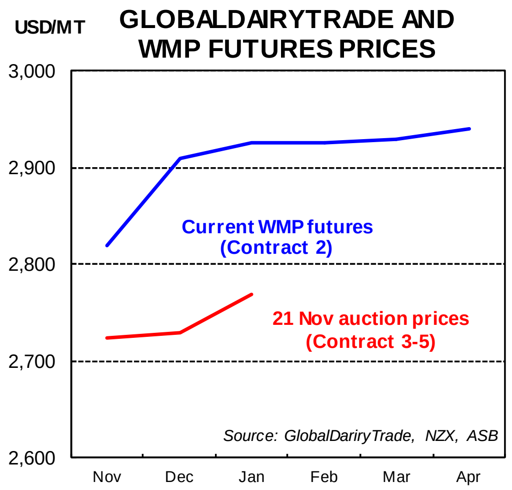
NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Building Work Put in Place, volumes, Q3, %qoq	05/12	10:45 am	-0.5	-	+2.8
GlobalDairyTrade Auction, whole milk powder, % change	05/12	overnight	-3.4	-	0 to +2
Economic Survey of Manufacturing, Q3, sales volumes, %qoq	08/12	10:45 am	1.0	-	-

The survey of building Work Put in Place is a key input into GDP. **We expect a 2.8% increase in building activity volumes in Q3.** Residential building activity is expected to increase 1.6% as building activity gradually recovers from H1 2017's dip. Consent data point to strong residential activity in Wellington and Auckland. We expect non-residential activity to lift a robust 4.6%, following unexpected weakness over the previous two quarters.



We expect prices to lift a touch at the **GlobalDairyTrade auction** overnight Tuesday. A fortnight ago, whole milk powder (WMP) prices decreased by 3.4%, after falling by a similar amount in the auction prior. **At the current juncture, futures pricing suggests WMP will rise by between 3% and 5%.** However, we discount the signal given by futures prices as they have overstated auction results over recent months. Nonetheless, WMP auction volumes have reduced by 20% from the previous auction as NZ production slows on a seasonal basis. With this in mind, **we expect a WMP price rise in the 0% to 2% range.**



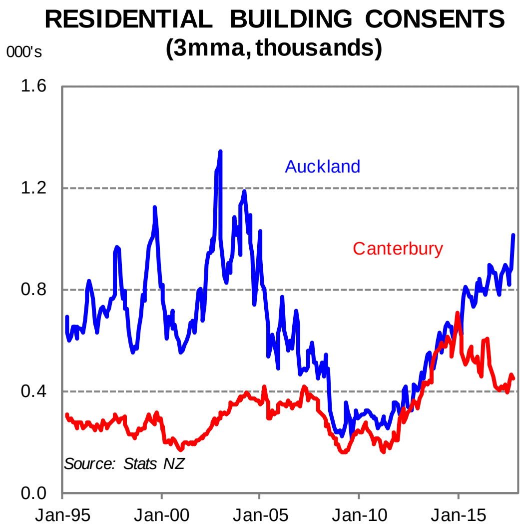
We use sales and inventory data from the Economic Survey of Manufacturing as an indicator for the ex-meat and dairy manufacturing production component of GDP. Non-primary manufacturing activity has been supported by strong construction activity and growth in other investment demand. The **manufacturing PMI survey points to strong non-primary manufacturing production growth, although we are cautious at taking these survey readings at face value.** Meanwhile, we expect meat and dairy-related manufacturing production to fall in Q3, driven by declining dairy production volumes and lower meat slaughter.

Data Recap: weekly recap

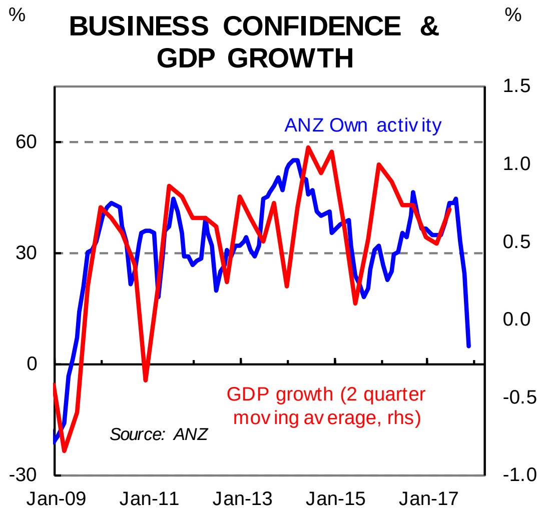
Data	Date	Actual	Market forecast	ASB Forecast
RBNZ Financial Stability Report	29/11	-	-	-
Residential Building Consents, Oct, %mom	30/11	-9.6	-	-
ANZ Business Outlook Survey, Nov, headline unadjusted	30/11	-39.3	-	-
RBNZ Credit Aggregates, Oct, household, %mom	30/11	0.5	-	-
Terms of Trade, Q3, %qoq	1/12	0.7	-	0.5

From January 1st the RBNZ will lift the share banks can lend to owner-occupiers at a LVR above 80% (i.e. less than a 20% deposit) from 10% to 15%. This will make it slightly easier for first home buyers to purchase a house if they haven't got a 20% deposit. **On the investor side, the RBNZ will ease the LVR restriction to 65% from 60%**, meaning that investors will be able to purchase property with a 35% deposit (previously 40%). Beyond the first easing of the restrictions, **further easing will depend on the RBNZ being comfortable that financial stability risks will remain contained.**

Residential building consents fell for the second consecutive month in October, sliding 9.6% mom. Seasonally-adjusted, it appears that Auckland building demand was relatively resilient in October, rising 2.7% mom and following the previous month's 11% fall. While we remain upbeat about the housing construction outlooks in Auckland and Wellington, there may be some near-term weakness as a result of uncertainty from the change in Government. In particularly, property developers may choose to wait on the sidelines for more details around the KiwiBuild programme and how that could affect demand for future developments.

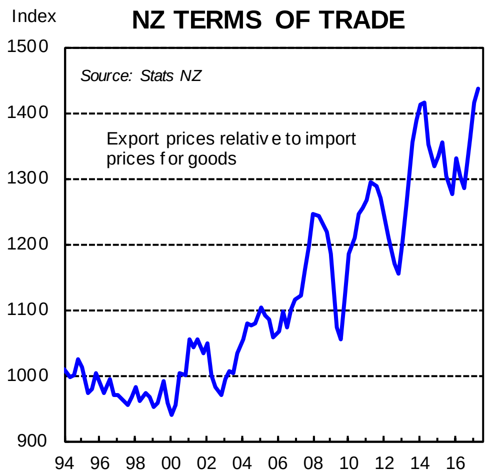


Business confidence plunged in November, the first business confidence survey since the new Government was announced. A fall in headline confidence is unsurprising given general business confidence was negative during the tenure of the previous Labour Government (and despite strong economic performance). The clear message is that businesses are not happy about the change in Government, although historically business confidence is weaker under Labour Governments regardless of underlying economic performance. However, the fall in own-activity views is concerning and, if sustained, will suggest material downside risk to the economic outlook. The plunge in businesses' expectations for 'own activity' over the next 12 months – to a measly +6.5 in November – is the **lowest level of own activity confidence recorded since the Global Financial Crisis.** We tend to place a lot of weight on weaker own-activity outcomes as this series is generally a good predictor of economic growth.



Annual mortgage credit growth slowed to a 2-year low as election-related uncertainty weighed on the housing market. Consumer credit growth continued to strengthen, with the 7.7% annual growth rate the firmest in 12 years. Given the housing market is unlikely to firm up quickly, we expect mortgage credit growth to continue slowing over the remainder of 2017 and into 2018. Business credit has showed surprising resilience given the softening tone of recent business sentiment. **We expect increasing caution over investment plans to temporarily weigh on businesses' demand for credit until election-related uncertainties subside.**

The Terms of Trade (ToT) lifted 0.7% over the September quarter to an all-time high. The previous high had stood since the June quarter of 1973. The 0.7% lift was in line with our expectations for a 0.5% rise. However, the result was a touch softer than market expectations of a 1.3% rise. Both export and import prices were softer than expected over the quarter. Looking at export prices, both dairy and meat prices posted modest declines, in contrast to our expectations for modest rises.



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast Market	Forecast ASB
Mon 4 Dec	13:00	AU	Melbourne Institute Inflation	Nov	m%ch	0.3	~	~
	13:30	AU	Inventories	Q3	q%ch	-0.4	~	0.1
	18:00	JN	Consumer confidence index	Nov	Index	44.5	~	~
Tue 5 Dec	10:45	NZ	Volume of all buildings	Q3	q%ch	-0.5	~	2.8
	11:00	AU	CBA Australia PMI services	Nov	Index	53.0	~	~
	13:30	AU	BoP current account balance	Q3	$bn	-9.6	~	-7.8
	16:30	AU	RBA cash rate target	Dec	%	1.50	1.50	1.50
Wed 6 Dec	13:30	AU	GDP	Q3	q%ch	0.8	~	0.5
Thu 7 Dec	05:00	NZ	QV house prices	Nov	y%ch	3.9	~	~
	13:30	AU	Trade balance	Oct	$mn	1,745	~	1,900
Fri 8 Dec	10:45	NZ	Manufacturing activity volume	Q3	q%ch	1.0	~	~
	12:50	JN	GDP	Q3 F	q%ch	0.3	~	~
	14:30	CH	CPI	Nov	y%ch	1.9	1.8	~

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast Market	Forecast ASB
Mon 4 Dec	09:30	UK	Markit/CIPS UK construction PMI	Nov	Index	50.8	~	~
	10:00	EC	PPI	Oct	m%ch	0.6	~	~
	15:00	US	Factory orders	Oct	%	1.4	0.3	~
Tue 5 Dec	09:00	EC	Markit Eurozone composite PMI	Nov F	Index	57.5	~	~
	09:30	UK	Markit/CIPS UK composite PMI	Nov	Index	55.8	~	~
	10:00	EC	GDP	Q3 F	q%ch	0.6	~	~
	13:30	US	Trade balance	Oct	$bn	-43.5	-44.8	~
	15:00	US	ISM Non-Manufacturing Composite	Nov	Index	60.1	59.0	~
Wed 6 Dec	10:30	EC	ECB Executive Board member Yves Mersch speaks in Frankfurt					
	13:15	US	ADP employment change	Nov	000	235.0	175.0	~
	13:30	US	Nonfarm productivity	Q3 F	%	3.0	3.2	~
Thu 7 Dec	08:30	UK	Halifax house price 3mths/year	Nov	%	4.5	~	~
	13:30	US	Initial jobless claims	Dec	~	~	~	~
	20:00	US	Consumer credit	Oct	$bn	20.8	17.0	~
Fri 8 Dec	09:30	UK	Industrial production	Oct	m%ch	0.7	~	~
	09:30	UK	Visible trade balance	Oct	£mn	-11,253	~	~
	13:30	US	Change in nonfarm payrolls	Nov	000	261.0	198.0	200
	13:30	US	Unemployment rate	Nov	%	4.1	4.1	4.1
	15:00	US	Uni. of Michigan sentiment	Dec P	Index	98.5	97.8	~

ASB Economics & Research			Phone	Fax
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659	(649) 302 0992
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657	
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853	
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778	
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915	
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661	
Publication and Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660	

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@ASBMarkets

ASB Economics
ASB North Wharf, 12 Jellicoe Street, Auckland