ASB

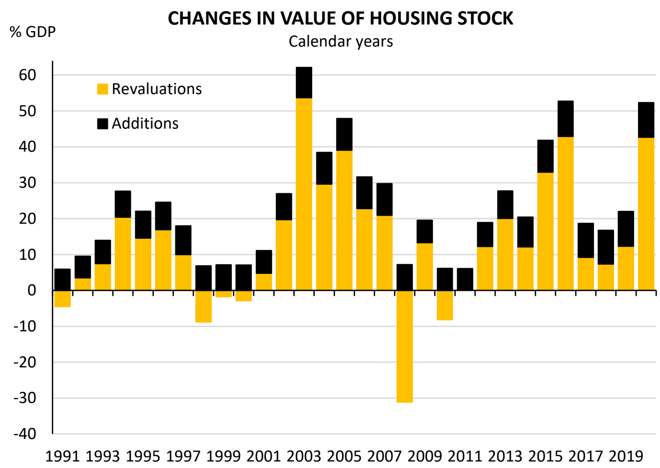
Economic Weekly

29 March 2021

Housing front and centre

Notwithstanding the global pandemic, the NZ housing market has hogged the local media headlines as well as the domestic political and market narrative. House price inflation is rampant (22% yoy and climbing). There is the view that the circa $1.5 trillion housing market has become a one-way bet, benefitting property owners and bolstering investor demand at the expense of those wanting to get onto the housing ladder. Something needed to be done.

Last week, the Government rolled out a trifecta of policies to bolster housing affordability and provision (see our take). Ultimately, we need to build more homes, but it will take time for the $3.8bn Housing Acceleration Fund to bear fruit. In the interim, the Government has moved to slow the buying demand from residential property investors, who typically account for around 30% of all property purchases and own more than 600,000 rental properties. Moves to extend the bright-line test from 5 years to 10 will effectively see a longer lock-in period for property investors and fewer property sales.



Source: RBNZ, QV, Statistics NZ, ASB

However, the policy that caught the most attention was the removal of interest rate deductibility from investor housing. Starting from October this year, deductibility will be reduced in 25% increments and will be fully phased out by April 2025. This policy will generate a significant amount of additional tax to be paid by property investors and will weigh on investor cashflows. The nationwide impacts would be in the region of $0.5-$1bn per annum according to our estimates. The impacts will uneven and will hit property investors with higher levels of debt and smaller cashflow buffers. It will lower the purchase price for dwellings that investors would be willing to pay. It could also trigger widespread increases in dwelling rents as landlords seek to recoup higher after-tax costs.

There could be more to come. In May the RBNZ will be reporting back to the Government on whether to impose debt-to-income limits and to curb interest-only mortgage lending for investors. Considering more than 40% of investor lending over the past year was interest only, the impacts on investor cashflows and demand could be sizeable.

What will be impacts of these policies be? The simple answer is that we do not know at this early stage. Our initial thinking is that house price growth will slow more sharply than we had factored in, but that the policies will not necessarily trigger outright price falls. Broader economic activity would also be weaker than it would otherwise be, while higher rents could add to NZ CPI inflation. We will be closely monitoring the housing market over the next few months with a focus on property listings, sales volumes, house prices and dwelling rents. Stay tuned.
mark.smith4@asb.co.nz

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6995	0.7153	0.7364	0.5993	FLAT/UP	0.6945	0.7300
NZD/AUD	0.9159	0.9256	0.9373	0.9805	DOWN	0.9145	0.9245
NZD/JPY	76.74	77.80	78.12	64.99	FLAT/UP	75.70	79.20
NZD/EUR	0.5932	0.6012	0.6055	0.5411	FLAT	0.5890	0.6130
NZD/GBP	0.5072	0.5168	0.5266	0.4881	FLAT	0.5050	0.5205
TWI	73.8	74.7	76.1	68.47	FLAT/UP	N/A	N/A

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

NZD Recap and Outlook

Volatility returned to domestic markets with a vengeance last week. The NZD/USD lost a bit over 2% and was by far the weakest performing G10 currency.

Most of the weakness was attributable to Tuesday's government housing announcements and attendant economic implications (lower house prices than otherwise, a softer economic picture, a shift from February to July 2022 in OCR rate hike pricing). Notably, NZD/AUD and NZD/GBP both slipped to 6-month lows.

But a stronger USD was also part of the story for NZD/USD. All of the majors lost ground against the greenback as it continued on its surprise March resurgence. The AUD/USD fell 1.6% last week, suggesting global factors were responsible for just over ½ the NZD/USD's decline last week.

There were some big drops in interest rates last week as the market digested the Government's new housing positions. As a result, NZ-US 2-year interest rate differentials fell around 15bps to +17bps. We suspect this move will be sustained in the short term, portending reduced interest rate support for the NZD/USD in coming weeks.

However, broader fundamentals remain positive, and we haven't changed our medium-term view. Ultimately, we expect the NZD/USD uptrend to resume. NZ commodity prices are on a tear and with the global reflation/recovery trade is continuing, meaning commodity prices and commodity-sensitive currencies like the NZD/USD and AUD/USD should remain supported. Notably, recent gains in NZ commodity export prices have added 1½ cents to the 'fair-value' range of our short-term NZD/USD valuation model, which remains at 0.7100-0.7500.

In theory it should be a quieter week for domestic events this week, with just business and consumer confidence on the slate. Direction is more likely to come from offshore with the heavy-hitting duo of US Non-farm Payrolls and ISM manufacturing due for release. Further strength in these surveys could keep the USD perky and NZD/USD on the back-foot. There's also a swathe of Chinese manufacturing PMIs that will be drip-fed to markets during the week.

mike.jones@asb.co.nz

ASB foreign exchange forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)	<<actual	forecast >>					
NZD/USD	0.72	0.72	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.95	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	78	80	83	84	85	88
NZD/EUR	0.59	0.59	0.59	0.59	0.58	0.57	0.54
NZD/GBP	0.53	0.51	0.51	0.51	0.51	0.50	0.48
NZD/CNY	4.7	4.6	4.7	4.7	4.7	4.7	4.5
NZD TWI	75.1	75.1	75.2	75.4	75.5	75.5	74.6

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	0.25	0.25	0.25	0.25	UNCH	UP
90-day bank bill	0.34	0.35	0.31	0.49	UNCH	UP
2-year swap	0.44	0.49	0.48	0.55	UNCH	UP
5-year swap	1.03	1.15	1.20	0.66	UNCH	UP
10-year swap	1.82	1.93	1.99	0.99	UNCH	UP
10-year govt bond yield	1.69	1.76	1.90	1.10	UNCH	UP
Curve Slope (2s10s swaps)	1.38	1.44	1.51	0.45	UNCH	DOWN

** Current as at 9.30am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged*

Market Recap

Last week proved to be a volatile one for the NZ rates market with yields down, with more pronounced moves across longer-term maturities. Australian yields were also lower by a similar margin for longer-term yields. A decent chunk of the fall in NZ yields was due to market reaction around the Government's announcement on housing (see our take). Markets have pushed back the timing of OCR hikes, with the first 25bp move not fully priced by early 2023, about 6 months later than this time last week. Indicative of the change in market views on the direction of NZ yields, the RBNZ was only able to fully secure $362m of the (scaled down) $430m in NZ Government bonds it was to purchase. US yields were little changed compared to a week ago, but US equities (S&P500) touched fresh highs on improved optimism on the global outlook. Upward pressure on yields was dampened by central bankers downplaying the risks of higher inflation, pledging to hold rates at historic lows and emphasising the global recovery was incomplete.

Near-term interest rate outlook

There is the prospect for continued volatility in local rates market. Views on the impacts of the Government's housing policy will take time to bed in, and there could be some choppiness as markets find their way. NZDM have announced a lower profile for debt issuance over April ($300m per week), comfortably below the $430m weekly LSAP programme. We had earlier flagged the likelihood that the RBNZ would taper the LSAP and expect that the RBNZ will halt purchases altogether from 2022. Forward pricing is still for a reasonably aggressive profile for hikes beyond the next few years, with the 5-year ahead forward rate for the 5-year swap rate an elevated 2.65%. We don't expect yields to end up as high.

We also expect global markets to be quieter as we head to the Easter break. Market liquidity is likely to be thinner with the risk of outsized moves to surprise events. The offshore events calendar is lighter this week with largely second-tier global data and few central bank speeches.

Medium-term outlook

We expect the OCR to gradually start moving up from mid next year (August 22), with risks of a slightly later start to RBNZ tightening. The OCR is expected to reach 1.25% in March 2024, slightly below neutral levels. Our bias is for shorter-term yields to edge up over the next few years and for the yield curve to flatten, with longer-term NZ yields to peak at historically-low levels. mark.smith4@asb.co.nz

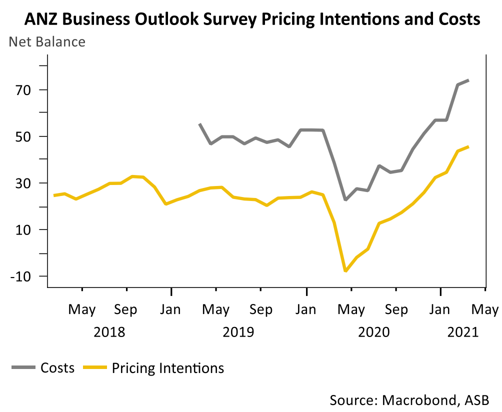
ASB interest rate forecasts (end of quarter)	Dec-20 <<actual	Mar-21 forecast >>	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.75
NZ 90-day bank bill	0.27	0.30	0.30	0.30	0.30	0.35	0.90
NZ 2-year swap rate	0.28	0.40	0.50	0.60	0.70	0.80	1.20
NZ 5-year swap rate	0.54	1.00	1.10	1.20	1.30	1.40	1.80
NZ 10-year swap rate	0.98	1.80	1.85	1.90	1.95	2.00	2.20
NZ 10-year Bond	0.99	1.65	1.70	1.75	1.80	1.85	2.05

Domestic Events

Data	Date	Time (NZT)	Market	ASB
ANZ business outlook survey, March, own activity	31/03	1:00 pm	-	-
ANZ consumer confidence, March, headline	1/04	10:00am	-	-

ANZ Business Outlook preliminary March results point to steady business confidence over March, with own activity expectations dipping in early March but remaining unchanged on a seasonally-adjusted basis. Of late, cost pressures have sharply increased, putting upward pressure on pricing intentions. We will be closely monitoring pricing metrics from the survey for clues on how transitory (or persistent) this potential spike in inflation will be.

Consumer confidence is expected to remain below historical averages (119). With the hit to consumer incomes from weaker inbound tourism likely to be acute given the time of year, consumers' assessments of their current financial position are likely to remain weak. The housing boom and light at the end of the COVID-19 tunnel are expected to underpin positive consumer assessments over the economic outlook and their own financial position (holding at around historical averages). This should help prop up consumer spending, which looks set to modestly rise over 2021 despite a soft start to the year. The ANZ survey would have been conducted prior to the Government's housing announcement and will likely show a continued firming in house price growth expectations to a record high.



Major International Events for the week ahead

Data	Date	Time (NZT)	ASB
Eurozone CPI, March, %mom	30/03	10:00 pm	-
Australia Private Sector Credit, February, %mom	31/03	1:30 pm	0.2
Australia Building Approvals, February, %mom	31/03	1:30 pm	-5.0
UK Current Account Balance, Q4, $bn	31/03	7:00 pm	-
Australia CoreLogic Dwelling Prices, March, %mom	01/04	1:30 pm	3.0
Australia Trade Surplus, February, $bn	01/04	1:30 pm	9.0
Australia Retail Trade, February, %mom	02/04	1:30 pm	-1.1
US ISM Manufacturing Index, March, points	02/04	2:45 am	62.5
US Non-farm Payrolls, March, 000s	02/04	1:30 am	500

** Forecasts and commentary originally published by CBA Global Markets Research Friday 26 March at 1:20 pm*

We expect **Australia's private sector credit** to lift by 0.2% in February. Housing credit growth is likely to be the driver with new lending for housing on a strong upward trend. Growth in business and personal credit is likely to be soft. The focus from here is very much on housing credit - the extent to which it further accelerates and what potential implications it may have for macro-prudential policy measures.

We are forecasting a 5% fall in **Australia's building approvals** in February. Approvals for detached houses have been running at very high levels thanks to very low borrowing rates and the Government's HomeBuilder grant scheme. But with the HomeBuilder grant reduced at the start of the year we are now seeing approvals for houses come down. Multi-unit approvals are weak with slower population growth reducing demand in this space.

The daily data are showing a very strong lift in **Australia's dwelling prices** in March. There have been gains across all the capital cities in the month.

Australia's trade surplus reached a record high last month of $10.1bn. We expect a slightly smaller surplus of $9bn in February. Partial data show both exports and imports rose in the month.

The preliminary estimate showed that **Australian retail trade** fell by 1.1% in February. Over the year retail trade is up by a strong 8.7%. Victoria and WA saw falls in spending in the month with both states experiencing short lockdowns.

Headline **Eurozone CPI inflation** printed for a second consecutive month at 0.9%yoy in February. Headline inflation will likely increase in the coming months, in part supported by the end of the temporary VAT reduction in Germany and higher energy prices. The ECB projects inflation at 1.5% over 2021.

The **UK's current account deficit** narrowed to 2.1% of GDP in Q3 2020, the smallest since Q2 2012. The UK goods and services trade deficit in Q4 2020 points to a modest widening in the current account deficit over Q4.

Already-released **US** regional manufacturing indices are consistent with a solid jump in the ISM manufacturing index. We forecast the **ISM manufacturing index** climbed to 62.5pts in March. That would take the index to its highest level since 1983.

We forecast the **US labour market** continued to recover in March. There were a number of supporting factors including rapid vaccinations and evidence of a further recovery in economic activity over the month. We forecast 500,000 new jobs were added in March and expect the unemployment rate declined to 6.0%. Nevertheless, there is still excess slack in the labour market and we expect that to remain evident via muted wage growth.

Key Forecasts

ASB NZ economic forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
	<< actual	forecast >>					
GDP real - Q%	-1.0	0.0	0.4	0.4	0.2	0.3	0.8
GDP real - A%	-0.9	0.3	13.2	-0.1	1.0	1.3	3.2
GDP real - AA%	-3.0	-2.9	2.9	2.8	3.3	3.6	2.3
NZ House Prices (QV Index) - A%	14.9	16.8	21.7	19.8	14.4	10.5	5.6
CPI - Q%	0.5	0.9	0.6	0.6	0.4	0.5	0.7
CPI - A%	1.4	1.6	2.7	2.6	2.5	2.1	2.4
HLFS employment growth - Q%	0.6	0.3	0.4	0.4	0.2	0.4	0.5
HLFS employment growth - A%	0.7	-0.1	0.6	1.7	1.3	1.4	1.8
Unemployment rate - %sa	4.9	5.1	5.0	5.1	5.3	5.1	4.8

Q% = percentage change on previous quarter

A% = percentage change since same quarter the previous year

AA% = percentage change for year ending quarter since the previous year

ASB interest rate forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)	<< actual	forecast >>					
NZ OCR	0.25	0.25	0.25	0.25	0.25	0.25	0.75
NZ 90-day bank bill	0.27	0.30	0.30	0.30	0.30	0.35	0.90
NZ 2-year swap rate	0.28	0.40	0.50	0.60	0.70	0.80	1.20
NZ 5-year swap rate	0.54	1.00	1.10	1.20	1.30	1.40	1.80
NZ 10-year swap rate	0.98	1.80	1.85	1.90	1.95	2.00	2.20
NZ 10-year Bond	0.99	1.65	1.70	1.75	1.80	1.85	2.05

ASB foreign exchange forecasts	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Mar-23
(end of quarter)	<< actual	forecast >>					
NZD/USD	0.72	0.72	0.73	0.74	0.74	0.74	0.73
NZD/AUD	0.94	0.95	0.91	0.89	0.91	0.94	0.95
NZD/JPY	75	78	80	83	84	85	88
NZD/EUR	0.59	0.59	0.59	0.59	0.58	0.57	0.54
NZD/GBP	0.53	0.51	0.51	0.51	0.51	0.50	0.48
NZD/CNY	4.7	4.6	4.7	4.7	4.7	4.7	4.5
NZD TWI	75.1	75.1	75.2	75.4	75.5	75.5	74.6

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
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 Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets