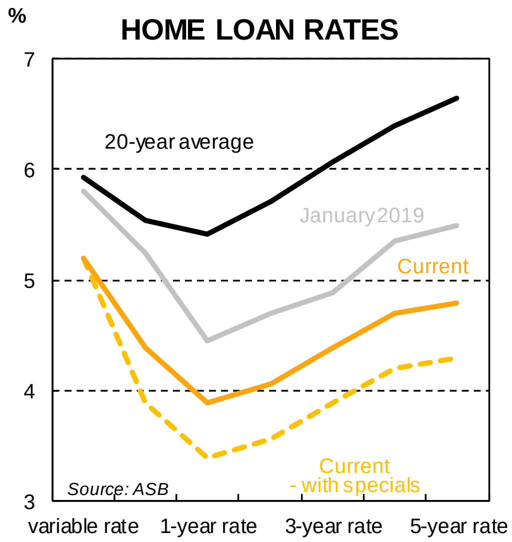
# Home Loan Rate Report

19 February 2020

## Mortgage rates could be as low as they'll get

- The Reserve Bank of New Zealand (RBNZ) cut the Official Cash Rate (OCR) to a record low 1.0% last August. Since then it has maintained that developments do not warrant more policy stimulus despite risks to the outlook (including the coronavirus).
- Mortgage interest rates appear to have hit their lows in late 2019. From now on, we expect mortgage rates to gradually rise unless the RBNZ changes its view and cuts the OCR again. The RBNZ seem less likely to lower the OCR any further (their eventual move could be a hike). Regulatory changes could also provide upward impetus.
- Borrowers can lock in very low interest rates now, but should plan to deal with higher interest rate costs as fixed terms mature. Our forecasts suggest fixing in the 1- to 2-year horizon and then rolling over on similar terms is likely to be the cheapest option over a 5-year time horizon.

### Mortgage Interest Rate developments




**Mortgage interest rates over various tenors have fallen between 0.6% and 1.2% over the past 18 months.** Mortgage interest rates are influenced by a number of factors, including the RBNZ's OCR setting, developments in domestic and global fixed-interest markets, and other influences on bank funding costs. The global interest rate backdrop, concerns over the NZ economic outlook, and the 0.75% of OCR cuts by the RBNZ delivered last year combined to push domestic interest rates lower. NZ wholesale interest rates reached record lows in October 2019 and mortgages reached the current low levels soon afterwards. Since then, improved global market sentiment and the reluctance of the RBNZ to cut the OCR further have pushed NZ wholesale interest rates above those October lows. Carded mortgage interest rates have barely budged since last November.

The RBNZ held its first OCR Review for 2020 on 12 February and retained the 1% OCR setting that has been in place since last August. The RBNZ's economic outlook (even with a minor coronavirus impact incorporated) suggested little need for further OCR cuts. Beyond the recent threat of the coronavirus, the RBNZ has become more optimistic about the economy's prospects over recent months. The RBNZ appears confident that it has stimulated the economy enough to meet its inflation and employment objectives.

ASB economists no longer think that the RBNZ will cut the OCR, unless the impacts of the coronavirus prove to be

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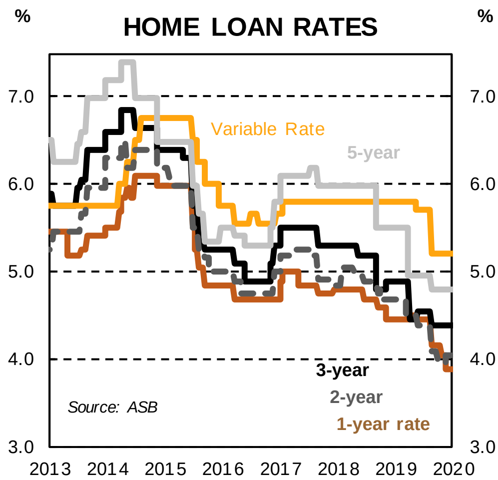
much larger and more prolonged than the short, sharp impact viral outbreaks tend to have. So in a nutshell, the current 1% OCR setting looks like the bottom for this interest rate cycle. However, we do not expect the domestic and global economies to be sufficiently strong to justify the OCR moving up anytime soon. We have the first OCR hikes pencilled into our 2022 forecasts and expect a historically-low OCR endpoint of 2.25% by 2024.




The consequence of these developments is that **floating mortgage rates should remain very low through 2020**. **We expect fixed-term mortgage interest rates to remain at historically-low levels over the year ahead too, but the large falls have already occurred, and we think the low point in longer-term mortgage interest rates is now.** And the upward pressure we discuss in this report means that we could start to see some increases in fixed-term mortgage interest rates over the year ahead. Influences on longer-term mortgage interest rates include a myriad of domestic and global influences as well as expectations of RBNZ OCR settings. Most of these influences provided downward pressure last year. Now the downward pressure on both wholesale rates and mortgages has likely come to an end. **Unless the outlook deteriorates, and the RBNZ cuts the OCR, we don't expect to see significant drops in longer-term mortgage interest rates. We expect increases to the OCR in a few years' time and the associated higher wholesale interest rates** to start to push NZ mortgage interest rates higher over the coming years.

On 5 December the RBNZ announced the new regime for bank capital requirements. The RBNZ has significantly increased bank capital requirements (as had been signalled). The changes are to be phased in over seven years, and could potential deliver significant increases in bank borrowing costs in the future (more discussion on this is below). **As such, we think it is prudent for borrowers carrying debt for longer than the next couple of years to budget on mortgage interest rates being higher than they are now.** However, with all this talk about higher interest rates, borrowers will be pleased to know we still expect mortgage interest rates to eventually settle at levels that remain below the long-run averages of the past 20 years.

## The RBNZ's LVR lending restrictions and borrowers

**The RBNZ eased its LVR restrictions at the start of 2019, and left the restrictions unchanged in its May and November 2019 Financial Stability Reports.** Most investors are required to have a 30% deposit (was as high as 40% in 2017) and the 'speed limit' (amount of lending exceeding the LVR restrictions) remained at 5%. Owner-occupiers' deposit requirements remain fixed at 20% for the majority of loans, while the 'speed limit' (amount of lending outside this limit) has eased to 20% from 15% of new lending (was initially 10%).

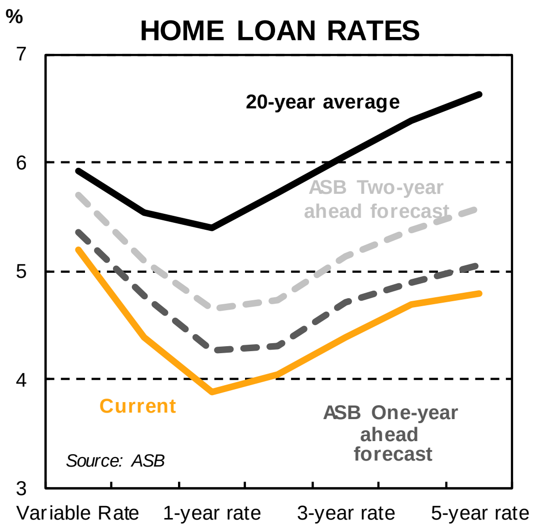
Our view and the view of the RBNZ is that the loan-to-value ratio (LVR) restrictions on housing lending have been effective in reducing some of the risks associated with high household indebtedness. Having the LVR restrictions has helped keep the nationwide property market on more of an even keel despite the sizeable recent falls to carded mortgage interest rates, the housing catch-up evident in a number of regional centres and the Government's decisions to shelve the Capital Gains Tax earlier last year.

The RBNZ is likely to remain wary and alert to the possibility that housing market risks could quickly re-emerge. **However, our view is that the LVR restrictions will be gradually reduced over time given they were not designed to be permanent and that they provide another barrier to home ownership for first-home buyers.** The RBNZ has made relaxing the LVR restrictions conditional on whether credit and house price growth remain low and on banks continuing to maintain prudent lending standards.

It is also important for borrowers to note that we expect the process of offering "specials" for higher-equity lending (i.e. equity in excess of the LVR restriction thresholds) to remain in place in one form or another. **Borrowers should** monitor these "specials", and discuss the options with their mortgage providers when deciding what to do with their mortgage.**

## Bank capital requirement changes expected to push mortgage interest rates up

**The RBNZ has announced significantly-increased capital requirements for locally-incorporated banks in NZ.** The main motivation for this is to bolster NZ financial system resilience. Higher capital requirements will likely increase the overall cost of NZ bank funding and result in higher customer borrowing interest rates. The changes will start to take effect from July, and be phased in over a seven-year period. **Our mid-point estimate is that the changes will add around 55bps (0.55%) to customer borrowing rates over the longer term (assuming all the impact is borne by borrowers).** This is significantly above the 20bp impact assumed by the RBNZ. It is important to note that the **impact on customer interest rates is likely to be uneven and dependent on the perceived riskiness (and hence required capital) of the type of lending.** As such, mortgage interest rate increases for high-equity borrowers are likely to be more modest than our central estimates, whilst low-equity borrowers could face steeper increases.




## Identifying the best strategy

**Everyone wants to secure the "best" deal for their mortgage.** Working out what strategy is best is easier said than done given the number of influences impacting on mortgage interest rates, and individual borrower's differing requirements for flexibility and certainty. Personal preferences for certainty and flexibility are really important considerations when choosing a mortgage rate, rather than simply opting for the lowest rate. **One of the characteristics of the mortgage borrowing curve is that it has remained "tick-shaped",** with 1- to 3-year fixed rates lower than both the variable and 5-year rate, although the curve is flatter than historical averages.

The lowest rates on offer vary between the main banks, but are generally in the 1-year tenor, over 1% below the floating rates, at or near record lows, and under 4%. At the other end of the curve, 5-year rates are circa 0.9% higher than the 1-year rates, and below 5%. The gaps between some of the special rates available and floating rates are slightly wider.

**Borrowers can currently obtain some certainty and a significantly lower rate by fixing their mortgages. While the future is inherently uncertain, our forecasts for carded rates suggest fixing at the lowest rates on offer then subsequently rolling short terms (e.g. 1- or 2- year fixed rates) is likely to be the cheapest option over a 5-year time horizon.** Mortgage interest rates could potentially move lower still, but we note that is not what our base expectation is. At this juncture our forecasts (assuming the RBNZ keeps the OCR at 1% this year) suggest floating mortgages will likely remain steady, but the longer fixed terms risk moving higher than today's levels over the coming one to two years. Current rates on offer are very low and fixing will provide some interest rate certainty over the term of the mortgage. **Borrowers could also consider splitting the mortgage into different terms to better suit their preferences for interest rate certainty versus retaining flexibility.**

**The table on the page overleaf summarises some of the advantages and disadvantages of the different mortgage terms typically on offer.** Floating and short-term fixed rates tend to suit those who prefer the ability to review their mortgage structures frequently (or those who are due to pay off debt shortly). As fixed terms get longer, they are typically preferred for their interest rate certainty.

| Term | Advantages | Disadvantages | Rate* | Short-term bias | Long-term bias |
|---|---|---|---|---|---|
| **Floating** | • Below 10-year average<br>• Fix at any time<br>• Additional principal repayments easy | • Short-term fixed rates currently cheaper | 5.20/5.20 | → | ↑ |
| **6-month fixed** | • Cheaper than floating rate<br>• Short-term certainty<br>• Can re-fix fairly quickly | • Less flexibility than floating<br>• Less of a hedge against interest rate increases.<br>• Other terms are cheaper | 4.39/3.89 | → | ↑ |
| **1-year fixed** | • Lowest rate currently<br>• Short-term certainty<br>• Can re-fix fairly quickly | • Less of a hedge against interest rate increases | 3.89/3.39 | → | ↑ |
| **2-year fixed** | • More certainty than short-term rates | • Less of a hedge against interest rate increases | 4.05/3.55 | → | ↑ |
| **3-year fixed** | • Certainty for a relatively low cost<br>• Protection if rates rise earlier than expected | • Potentially more expensive than rolling shorter terms | 4.39/3.89 | → | ↑ |
| **5-year fixed** | • Certainty for a long time | • Most expensive fixed rate on offer<br>• Fixing for short terms expected to be cheaper over next 5 years | 4.79/4.29 | → | ↑ |

*** ASB carded rate/ASB special rate (minimum of 20% equity required), at time of publishing**

**The latest ASB mortgage rates are available here.**

## Final thoughts

Just remember, **the 'best' mortgage rate is only known in hindsight.** But, with the above pros and cons for the various mortgage rates on offer we hope to give you a good platform from which to consider the interest rate options that appear most suitable for your personal circumstances.

On top of trying to minimise interest payments, a good mortgage strategy also needs to take into account an individual borrower's cash flows, tolerance for uncertainty, and the ability to deal with changes in future mortgage payments as interest rates change. Borrowers' financial circumstances can change too, and this needs to be taken into account.

**Overall, it is important for borrowers to weigh up their own priorities and make the mortgage choice that looks best aligned with their needs. Feel free to phone the ASB Home Loan Line at 0800-100-600 to talk through these issues with ASB staff. Online mortgage calculators are available here.**

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