Home Loan Rate Report

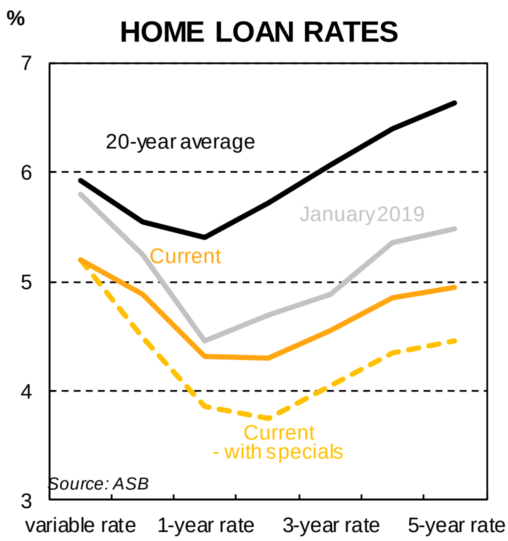
16 August 2019

Mortgage rates edge even lower

- The RBNZ cut Official Cash Rate (OCR) to a record low 1.0% in August, and could cut it again in the future.
- Floating rates swiftly dropped after the RBNZ's surprise 0.5% OCR cut in August.
- Interest rates for shorter-term mortgages had dipped lower this year, and eased further in the wake of the RBNZ's August cut.
- Longer-term mortgage interest rates had already been falling prior to this year's RBNZ rate cuts. The significant dip in these rates occurred between 2017 and early 2019.
- Borrowers can lock in very low interest rates now, but should still plan to deal with higher interest rate costs over the long run.

Mortgage Interest Rate Outlook

Mortgage interest rates have dipped by between 0.4% and 1.2% over the past year. 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 net influence on mortgage interest rates from both here and abroad has been downward, and this is expected to continue over the coming months. Indeed, NZ wholesale interest rates are currently hovering around record lows.



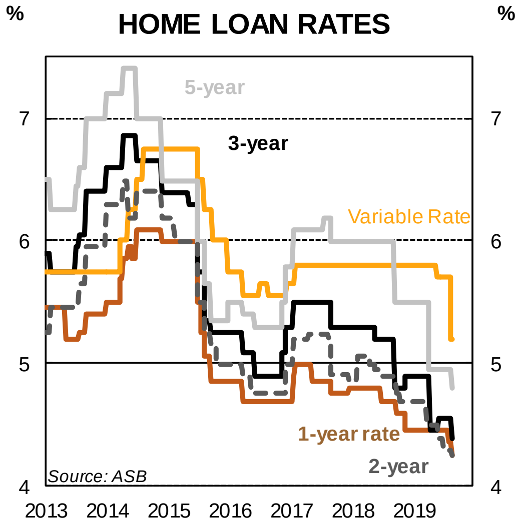
The RBNZ cut the Official Cash Rate (OCR) to a record low of 1.0% in August. We forecast a further 0.25% cut in November, but timing will be heavily influenced by global risks, which are fluid at present. The RBNZ's forecasts are still implying an easing bias (i.e. highlighting the most likely next move for the OCR is down).

The consequence of these developments is that **floating and fixed-term mortgage rates should remain very low through 2019 and 2020**, with the possibility of another OCR cut meaning they could dip slightly further from current levels. But we stress there are a number of forces at play, and we don't expect mortgages to move in lock-step with any future OCR moves.

Longer-term wholesale interest rates have fallen significantly over the past year as stubbornly low inflation and increased risk aversion has weighed down longer-term interest rates. Influential offshore interest rates have also been falling this year.

Chris Tennent-Brown – Senior Economist (649) 301 5915 chris.tennent-brown@asb.co.nz
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz.

We expect longer-term interest rates to remain at historically-low levels over the year ahead, but also think the big moves down have already occurred. Influences on longer-term mortgage interest rates from 2-5 years include a myriad of domestic and global influences as well as expectations of RBNZ OCR settings rates. Most of these influences have provided downward pressure to NZ carded longer-term fixed mortgage interest rates for over a year now. These forces look set to continue over the coming months, and we may see some minor rate adjustments to mortgage rates. However, we don't expect to see major drops in the longer-term mortgage rates based on our latest forecasts for the various influences. For one thing, it's also not all about mortgages – banks have so far been reluctant to aggressively cut most term deposit rates in the wake of the large August OCR cut, as they still need to attract savers to invest. Term deposits make up the major part of banks' funding for mortgage lending. Accordingly, the competitive pressures to attract term deposits are an opposing force on mortgage rates, contrasting the downward pressure from the lower OCR and lower wholesale interest rates that prevail at the moment. Whilst borrowers are happy about the low interest rates they are now paying, savers are frustrated by the corresponding drop in their fixed-interest income over recent years. If, when, and by how much mortgage rates can fall in the future will in part be a function of where term deposit rates settle.



Over the long run we still expect eventual increases to the OCR and higher wholesale interest rates to gradually push NZ mortgage interest rates higher over the coming years. The RBNZ's proposed increase in the amount of capital banks hold against their lending will also be an upward influence on the cost of borrowing in the future (more discussion on this is below). **We think it is prudent for borrowers carrying debt for longer than the next couple of years to budget on higher mortgage interest rates in the longer term.** However, we expect mortgage interest rates to eventually settle at levels that remain below 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 Financial Stability Report. 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%, while the 'speed limit' has eased to 20% from 15% of new lending (was initially 10%).

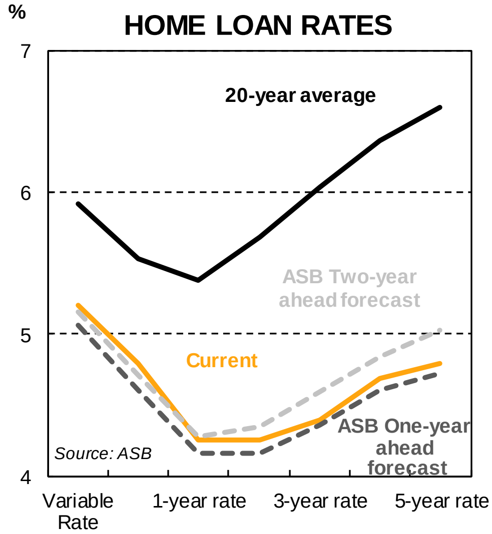
The view of the RBNZ is that the loan-to-value ratio (LVR) restrictions on housing lending have been successful in reducing some of the risk associated with high household indebtedness. Maintaining the current settings seems to be a prudent move, given that the buoyancy in some provincial housing markets, the fact that the OCR has been cut to a record low (and mortgage interest rates have eased), with the Government's decisions to shelve the Capital Gains Tax potentially helping to support investor demand. Many regional housing markets outside of Auckland remain robust and the RBNZ is alert to the possibility that housing market risks could quickly re-emerge.

Our view is that the LVR restrictions will eventually be changed. The tool was not designed to be permanent. The RBNZ has made relaxing the LVR restrictions conditional on whether credit and house price growth remains low and if banks continue to maintain prudent lending standards. Watch this space later in the year.

It is 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 threshholds) to remain in place in some form. **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 could push mortgage interest rates up

The RBNZ has proposed to significant increase 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 range of estimates is wide, with our central estimates suggesting about a 50-75bp (or 0.5%-0.75%) impact on customer interest rates over the longer term. The impact on customer interest rates will be uneven and will depend 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. We will know more over the course of the year – the RBNZ is set to announce what it will do towards the end of November, with the changes to be phased in from next April.



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 flexability 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 borowing 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 beween the main banks, but is in the 1-2 year tenor, and around 1% below the floating rates, and at or near record lows. Three-year carded fixed rates are also near record lows and are not much higher than 1-2 year terms. At the other end of the curve, 5-year rates are circa 0.6% higher than the lowest 1- and 2-year rates, with rates all well 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 (based on carded rates and assuming the OCR is cut again) suggest rolling a 1-year fixed rate is likely to be the cheapest option over a 5-year time horizon. **The caveat to this view would be if mortgage interest rates don't fall further, or worse, move up more aggressively than what we assume over the coming years. Borrowers who place a high premium on certainty and stability should consider locking in part of their mortgage for longer terms.** The current carded 3-year rate is 0.8% below the floating rate (and some specials are around 1.3% lower than floating rates). **Splitting the mortgage into different terms, or a mix of floating and fixed-term mortgages, is a strategy for keeping some flexibility while locking in some interest rate certainty**.

The table on the page below 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 • Fix at any time • Additional principal repayments easy	• Fixed rates are currently cheaper	5.20/5.20	↘	↑
6-month fixed	• Cheaper than floating rate • Short-term certainty • Can re-fix fairly quickly	• Less flexibility than floating • Less of a hedge against interest rate increases	4.79/4.29	↘	↑
1-year fixed	• Cheaper than floating rate & 6-month rate • Short-term certainty • Can re-fix fairly quickly	• Less of a hedge against interest rate increases	4.25/3.75	↘	↑
2-year fixed	• More certainty than short-term rates • Lowest rate available currently	• Less of a hedge against interest rate increases	4.19/3.69	→	↑
3-year fixed	• Certainty for a relatively low cost • 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 • Fixing for short terms expected to be a cheaper option over next 5 years	4.79/4.29	→	↑

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.

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 5957
Senior Economist	Mike Jones	Mike.jones@asb.co.nz	
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
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics **@ASBMarkets**

Disclaimer