Home Loan Rate Report

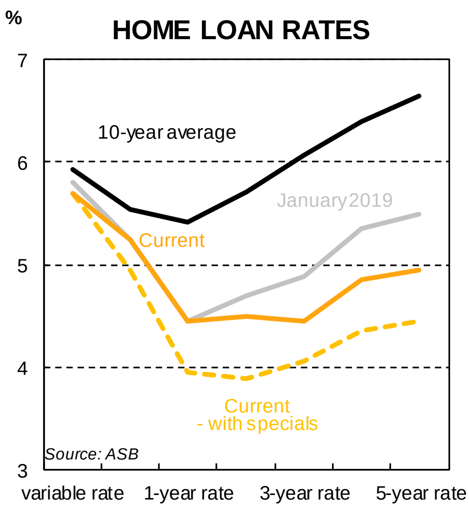
30 May 2019

How low can they go?

- The RBNZ cut Official Cash Rate (OCR) to a record low 1.5% in May, and could cut it again over the year ahead.
- Carded interest rates for shorter term mortgages have generally dipped this year, and could ease further.
- Longer-term carded mortgage interest rates have declined by more than short-term interest rates, and are expected to stay low this year.
- Borrowers can lock in very low interest rates now, and should still plan to deal with higher interest rate costs over the long run.

Mortgage Interest Rate Outlook

Carded fixed mortgage interest rates have dipped across the majority of terms this year. Mortgage interest rates are influenced by a number of factors, including the RBNZ's OCR setting, and 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 this year, 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 1.5% in May. We continue to expect a follow-up OCR cut in August, to 1.25%, but feel the risks are skewed to a later move. The RBNZ's current OCR outlook is measured and looks to be highly data -dependent and event contingent rather than depicting a sense of urgency. The May OCR forecasts, showed only a 50% chance of a further cut.

We believe the OCR outlook is fluid. It will crucially depend on the tone of forthcoming domestic data, the NZD and developments in the global economy. We still view risks to the OCR outlook as being downwards and have pencilled in a 25bp cut in August (to 1.25%).

The consequence of these developments is that **floating and shorter-term fixed mortgage rates should remain low through 2019**, with the possibility of another OCR cut meaning they could dip slightly further from current levels.

Longer-term wholesale interest rates have fallen by a greater extent and the yield curve in NZ (and abroad) has flattened as stubbornly low inflation and increased risk aversion has weighed down longer-term interest rates. We expect longer-term interest rates to remain at historically-low levels over the year ahead. Influences on longer-term

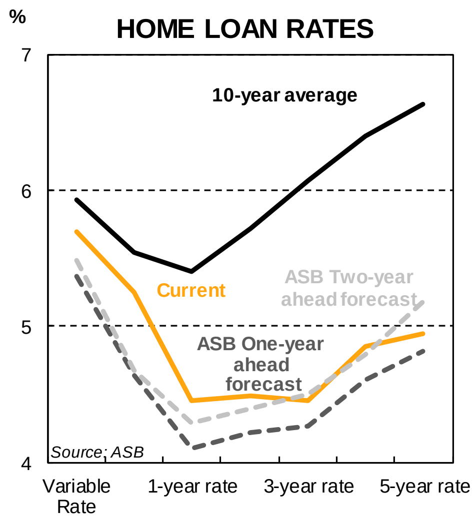
Chris Tennent-Brown – Senior Economist (649) 301 5915 chris.tennent-brown@asb.co.nz
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz.

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 this year. These forces look set to continue over the coming months. However, we think borrowers should still plan to deal with higher interest rate costs over the long run, even though in the near term the bias is for slightly lower rates.

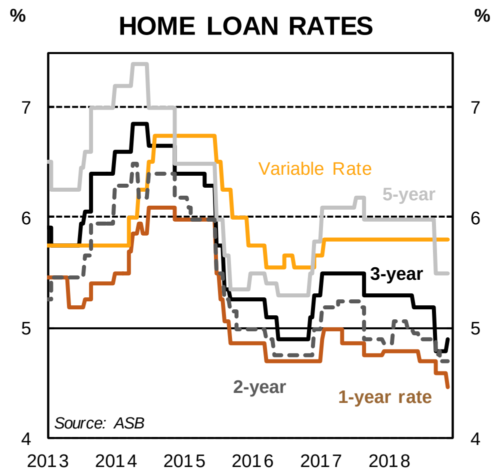
In other words, despite our bias for slightly lower interest rates over the year ahead, over the long run we still expect gradual increases to the OCR and higher wholesale interest rates to gradually push NZ mortgage interest rates higher. **We think it is prudent for borrowers carrying debt for longer than the next couple of years to budget on higher mortgage interest rates.** However, we expect mortgage interest rates to eventually settle at levels that remain below decade averages.

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 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 are 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 have 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.

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 currently analysing feedback on its proposals and 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 carded rate on offer varies from the main banks, but is in this 1-2 year tenor, and is roughly 1.3% below the floating rate, and at or near record lows. Three year carded fixed rates are arund 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%s higher than 1-year rates, with rates around 5.5%. 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 over 1% below the floating rate (and some specials are around 1.6% to 1.8% 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	• Short-term fixed rates currently cheaper	5.70/5.70	↘	↑
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	5.25/4.95	↘	↑
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	4.45/3.95	↘	↑
2-year fixed	• More certainty than short-term rates • Lowest rate available currently	• Less of a hedge against interest rate increases	4.39/3.89	↘	↑
3-year fixed	• Certainty for a relatively low cost • Protection if rates rise earlier than expected	• Potentially more expensive than rolling shorter terms	4.55/4.05	↘	↑
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	4.95/4.45	↘	↑

*** 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.

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 5957
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
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets

Disclaimer

This document is published solely for informational purposes. It has been prepared without taking account of your objectives, financial situation, or needs. Before acting on the information in this document, you should consider the appropriateness and suitability of the information, having regard to your objectives, financial situation and needs, and, if necessary seek appropriate professional or financial advice.

We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this document. Any opinions, conclusions or recommendations set forth in this document are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by ASB Bank Limited. We are under no obligation to, and do not, update or keep current the information contained in this document. Neither ASB nor any person involved in the preparation of this document accepts any liability for any loss or damage arising out of the use of all or any part of this document.

Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. ASB does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met.