Home Loan Rate Report

22 November 2018

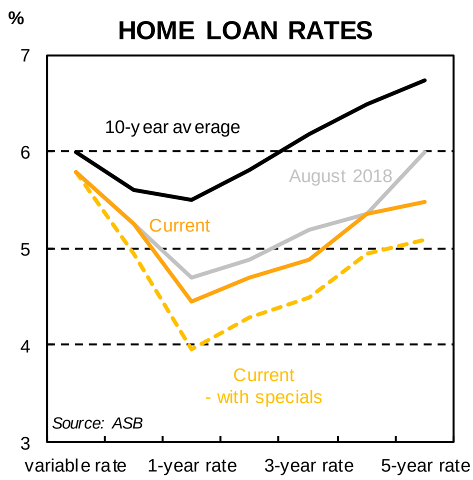
Low for longer

- We expect floating and short-term fixed mortgage interest rates to remain around current levels well into 2019.
- The tick-shaped curve and our expectations of a mild RBNZ tightening cycle suggest shorter-term fixed rates should continue to offer good value.
- There are a number of forces influencing mortgage interest rates at present, with downward pressures on rates prevailing over recent months. Nonetheless, borrowers should still plan to deal with higher interest rate costs in the future.

Mortgage Rate Outlook

Fixed mortgage rates have dipped across the majority of terms since our last Home Loan Rate Report in August. Mortgage rates are influenced by a number of factors, but spring home loan campaigns and a period of lower funding costs were the key drivers of the recent shift lower.

Outside of these movements, the main themes largely remain intact. We continue to expect the RBNZ to leave the Official Cash Rate (OCR) on hold for a considerable period of time. A cautious RBNZ and heightened downside risks to the medium-term growth outlook now suggest that the OCR will remain on hold for even longer. We expect the next OCR move (upwards) to occur in August 2020 (previously February 2020). The ultimate consequence of these changes is that **floating and shorter-term fixed mortgage rates should now remain relatively stable through 2019**. Further, when the RBNZ does start lifting the OCR, any increases are expected to be only modest in relation to historical norms and this should limit the uplift in local short-term rates. We expect the OCR to peak at only 2.75%.



Our bias also remains for longer-term mortgage rates to drift up, given gradual increases to the OCR and the drift higher in global longer-term interest rates. US longer-term interest rates remain elevated and higher offshore rates tend to influence domestic tenors longer than the 2- to 3-year fixed rate.

There is a risk that mortgage interest rates move up sooner (and by more) than what we expect. The catalyst could be the OCR moving up earlier and faster that what our forecasts assume, or the lift in global rates feeding though into higher local longer-term yields sooner than expected.

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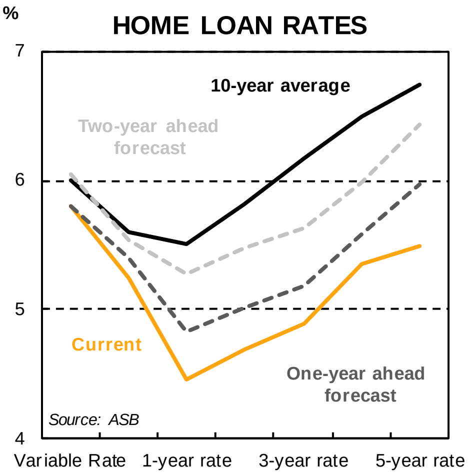
Please refer to the important disclosures at the end of this document.

The RBNZ's LVR lending restrictions and borrowers

The RBNZ eased its LVR restrictions at the start of 2018. Investors are now required to have a 35% deposit (was 40%) but the 'speed limit' (amount of lending exceeding the LVR restrictions) remained unchanged at 5%. Owner-occupiers' deposit requirements remain fixed at 20%, while the 'speed limit' has eased to 15% from 10% of new lending. The RBNZ has an opportunity to revist the topic this November within its 6-monthly Financial Stability Report. The restrictions will eventually be changed – the tool was not designed to be permanent. However, it's important for borrowers to note that we expect the process of offering "specials" on lending with higher equity (i.e. in excess of the LVR restrictions) 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.**

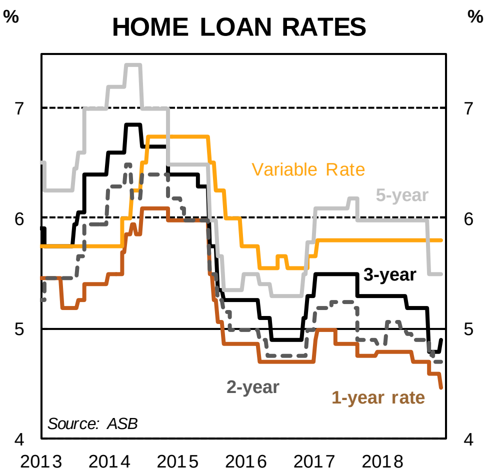


Identifying the best strategy

Kiwis love a bargain and would like to always secure the best deal for their mortgage. This is easier said than done given the number of domestic and global influences impacting on domestic mortgage interest rates - sometimes the crystall ball gets a little cloudy! The lowest carded rate on offer may initially appear cheaper, but this can quickly change. Personal preferences for certainty and flexibility are also 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 is "tick-shaped", with 1- to 2-year fixed rates lower than both the variable and 5-year rate. The 1-year carded rate on offer by most main banks, is roughly 130 basis points (bps) below the floating rate, at or near record lows. At the other end of the curve, 5-year rates are circa 100bps higher than 1-year rates, with rates around 5.5%.

As a result, borrowers can currently obtain some certainty and a lower rate, by fixing for short terms. While the future is inherently uncertain, our forecasts suggest rolling a 1-year fixed rate is likely to be the cheapest option over a 5-year time horizon. Furthermore, carded 1- to 2-year fixed rates are unlikely to approach the current floating rate until about 2021/2022. As such, splitting the mortgage into different terms, or a mix of floating and short-term fixed mortgages, is a strategy for keeping some flexibility while locking in some interest rate certainty**.**



The caveat to this view would be if mortgage interest rates move up more aggressively than what we assume. Borrowers who place a high premium on certainty and stability should consider locking in part of their mortgage for longer terms. For example, the current carded 3-year rate is about 90bps below the floating rate (specials are about 130bps lower).

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.

Some advantages and disadvantages of the various mortgage rates:

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	5.80/5.80	→	↗
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	• Lowest rate currently • Provides some certainty	• Less of a hedge against interest rate increases	4.45/3.95	→	↗
2-year fixed	• More certainty than short-term rates • Relatively low current rate	• Less of a hedge against interest rate increases	4.69/4.29	→	↗
3-year fixed	• Certainty for a relatively low cost • More protection from interest rate increases	• Potentially more expensive than rolling shorter terms	4.89/4.49	→	↑
5-year fixed	• Certainty for a long time	• Most expensive fixed rate on offer • Fixing for short terms likely to be a cheaper option over next	5.49/5.09	→	↑

*** 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 rates 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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