



July News 2016

Current Interest Rates *

Rates below are the best of standard carded interest rates available and do not reflect any discounts your Adviser may be able to obtain for you or your client.

Variable	5.65%
6 Month Fixed	4.75%
1 Year Fixed	4.25%
18 Months Fixed	4.79%
2 Year Fixed	4.19%
3 Year Fixed	4.34%
4 Year Fixed	4.59%
5 Year Fixed	4.79%

* All rates subject to change without notice and not available to all borrowers.

Welcome to the July 2016 Edition

Cash Rate cuts coming, but so are new LVR limits - By Bernard Hickey

Well that escalated quickly.

Within the space of a few weeks in mid-July, the Reserve Bank was forced into an urgent introduction of a third round Loan to Value Ratio (LVRs) for rental property investors.

A combination of pressure from a Government desperate to put out the fire in the housing market and a sharp rise in the currency forced the central bank to take action earlier than it wanted.

As recently as July 7, Deputy Reserve Bank Governor Grant Spencer talked about a new round of LVR controls that “could potentially be introduced by the end of the year.” Rather than moving quickly to tighten and extend its LVR limits for Auckland investors, Spencer said the bank saw itself as part of a “team” and the Government needed to address tax incentives for investors and review migration settings. The next day Prime Minister John Key again urged the bank to “get on with it” and rejected the calls for further tax changes or a migration review.

Currency markets interpreted Spencer’s speech as signaling the Reserve Bank was willing to ignore the currency’s rise and its deflationary effects to avoid cutting interest rates. By July 10 the New Zealand dollar had sprinted up to 73 USc and was a full 8% above the Reserve Bank’s forecasts.

Such a deflationary shock would make it impossible for the Reserve Bank to nudge CPI inflation up towards the 2% mid-point of its 1-3% target range, putting intense pressure on the bank, which has failed to meet that target for more than four years.

Then on July 15 the Real Estate Institute released data showing house prices rose at an annualised rate of 25% in June, with clear signs of 30%- plus inflation in cities such as Hamilton, Tauranga and Queenstown. House sales volumes were strong outside of Auckland and the surest sign of heat was the increasing use of auctions in cities as far afield as Wellington – usually a market dominated by tenders and negotiated deals.

The final straw was weaker than expected inflation data for the June quarter. CPI inflation in the year to the June quarter was just 0.4%, which was below the Reserve Bank's 0.6% forecast.

The next day the Reserve Bank announced it would introduce a countrywide LVR limit for investors of 60% from September 1 after just 15 working days of consultation with banks. It also reversed its November easing of its speed limit for owner-occupiers outside Auckland, reducing the 15% allowance for new mortgages over the LVR limit to 10%.

Governor Graeme Wheeler said there were clear signs that the risks to financial stability were increasing across the country. "A severe fall in house prices could have major implications for the functioning of the banking system and cause long-lasting damage to households and the broader economy," Wheeler said.

But the Reserve Bank's accelerating action plan didn't end there. Within a further two days, it announced in an unscheduled economic assessment that it was likely to cut the Official Cash Rate at least once more this year, starting from August 11. It said the currency needed to decline and the rise in the New Zealand dollar since its June 9 Monetary Policy Statement had weakened the inflation outlook.

Economists said the comments meant another Official Cash Rate cut to 2.0% was all but certain on August 11, with the prospect of at least one more cut to 1.75% by the end of the year. Kiwibank's economists even said the OCR could drop below 1.5%.

Wholesale interest rates fell around 10 basis points to record lows after the July 21 statement from the Reserve Bank. The key question will be whether banks pass on those reductions in the form of lower fixed mortgage rates, or whether they will keep those gains to bolster their profit margins. The early signs from the market's biggest player, ANZ, suggest the banks will go into their shells to preserve and grow their profits and capital, rather than compete harder for business and squeeze their own margins.

ANZ CEO David Hisco surprised many on July 20 when he said the housing market and the currency were "over-cooked" and that he would like to see the Reserve Bank require investors to put up a 60% deposit, rather than 40% proposed for September 1.

He pointed out almost half of the house sales in Auckland were now going to investors, and he suggested a tightening of the rules to stop them buying.

"Taking them out of the market will be unpopular amongst investors, but it may end up doing them a favour," Hisco said. "Of course this would mean less business for us banks, but right now the solution calls for everyone to adjust," he said.

July is normally one of the quieter months of the year with home buyers on school holidays and Parliament in recess. Not this year.

The bottom line:

- House prices rose at double-digit rates in annualised terms in June as the Auckland housing 'halo effect' spread around the country.
- The Reserve Bank announced the nationwide extension of its LVR restrictions on Auckland investors, and lowered the combined threshold to 60% from 70% in Auckland and 80% elsewhere.
- Under pressure to both ensure financial stability and push inflation back up into its 1-3% target band, the Reserve Bank said it was likely to cut the Official Cash Rate at least once more in 2016 because of the currency's sharp rise through late June and early July.
- Economists see the OCR cut from 2.25% to 1.75% by the end of 2016, although banks appear reluctant to pass on any cuts in an effort to rebuild their profit margins and bolster their capital stocks.