6

FROM	Lamorna Rogers, Macro-Financial Department
TO	Macro-Financial Committee
DATE	12 February 2014
SUBJECT	**LVR Effectiveness Monitoring Report**
CONSIDERATION	Discussion

Summary

Banks, in aggregate, are easily meeting the speed limit, although some of the smaller banks could be more challenged.

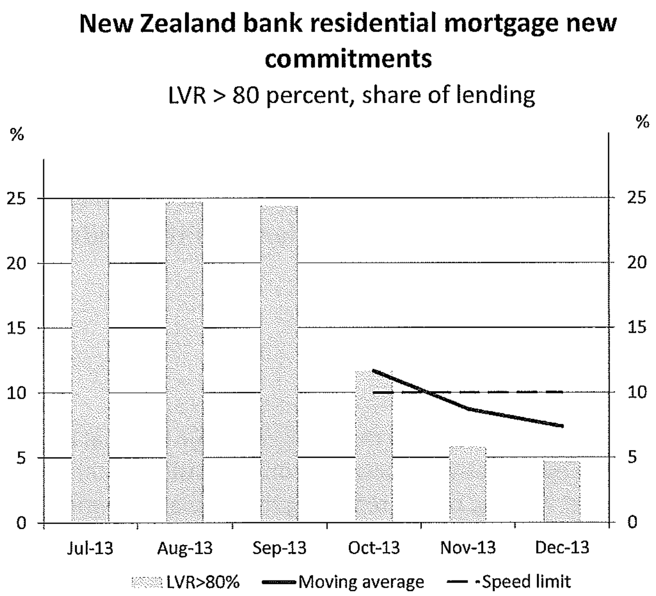
Overall, developments in the housing market have been broadly consistent with our expectations for the LVR policy, with a decline in house sales and some early indications that house price inflation is cooling.

New commitments present something of an anomaly, but we are leaning towards thinking that this is more reflective of the newness of the data series than underlying activity.

Speed limit compliance

1. Banks, in aggregate, have quickly brought their average high-LVR lending share below the 10 percent speed limit introduced in October. Despite making far less use of exemptions than initially expected, the system high-LVR lending share (October to December, after exemptions) is now 7.4 percent, providing a buffer of around 2½ percent (Figure 1). We expect that banks have now largely run down their pre-approval pipelines, so they should not materially weigh on banks' future lending behaviour. Discussions with banks suggest that as they become more confident in their forecasting of LVR shares (and thus their ability to meet compliance requirements) they may relax their internal buffer

Figure 1: High-LVR lending



requirements.[1] Both of these factors point to a possible modest increase in the high-LVR lending share in coming months.

2. At the bank level, however, some non-majors are still running above the speed limit. While banks have another three months to meet their initial compliance requirement, this could be challenging for banks with very small lending books. These questions are being addressed at an institutional level by PSD's supervisory oversight team.

Effectiveness of LVR restrictions

3. When we implemented LVR restrictions, our primary objective was to mitigate the risk of excessive growth in housing credit and house prices. The resilience objective was relevant but not decisive. As such, our published metrics for 'success' revolved around the likely impact on housing lending and house prices (Table 1).

Table 1 : Impact of LVR restrictions in first year (relative to no LVR restrictions)[2,3]

	Housing loan approvals	New housing commitments	Housing credit	House sales	House prices
Estimate	--	8 ppts reduction in growth	1- 3 ppts reduction in annual growth	3 – 8 ppts reduction in level	1 - 4 ppts reduction in annual growth
3 month-ended growth, sa					
- Sep 2013	9.0%	8.1%	**1.5%**	7.8%	**2.7%**
- Dec 2013	-9.4%	-11.7%	**1.3%**	-11.7%	**1.7%**
3 months APC, sa					
- Sep 2013 vs Sep 2012	**6.2%**	**14.3%**	6.2%	**11.2%**	9.3%
- Dec 2013 vs Dec 2012	**-9.4%**	**-0.5%**	6.3%	**-1.6%**	9.6%

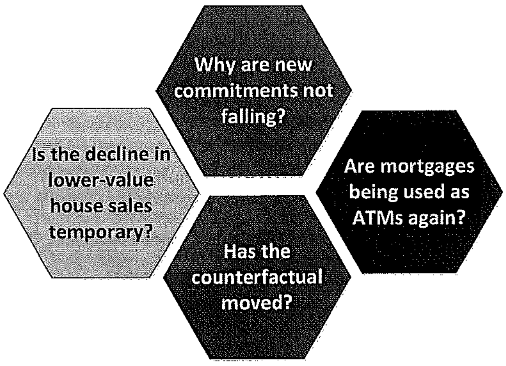
4. To date, we remain broadly comfortable with the impact of LVR restrictions. Housing market indicators suggest some slowdown in activity, and the upwards momentum in house prices appears to be abating, notwithstanding some compositional changes. Developments in housing credit are trickier to read; as foreshadowed in the LVR data release, we have a number of puzzles with which we are grappling (Figure 2).[4] However, with the December credit data suggesting that housing credit growth is starting to lose momentum, and loan approvals falling sharply, the balance of the evidence is tilting towards LVR

---

[1] Banks have indicated that they could run internal buffers ranging from 1 – 4 percent.
[2] The estimates were prepared on the basis of total housing credit; growth numbers are reported for banks' housing credit, reflecting the regulatory perimeter of LVR restrictions.
[3] We have included the new commitments numbers for completeness but have little confidence in their reliability. They are likely to be distorted by the jump in new commitments immediately prior to the implementation of LVR restrictions, and problems in seasonally adjusting such a new series.
[4] Refer "Macro-Financial Policy Take Outs" section of December LVR Monthly Survey Stats Insight.

restrictions starting to bite. The LVR new commitments data remain something of an anomaly, but this may be more reflective of problems in reading a volatile and recently introduced data series, than any real disconnects.

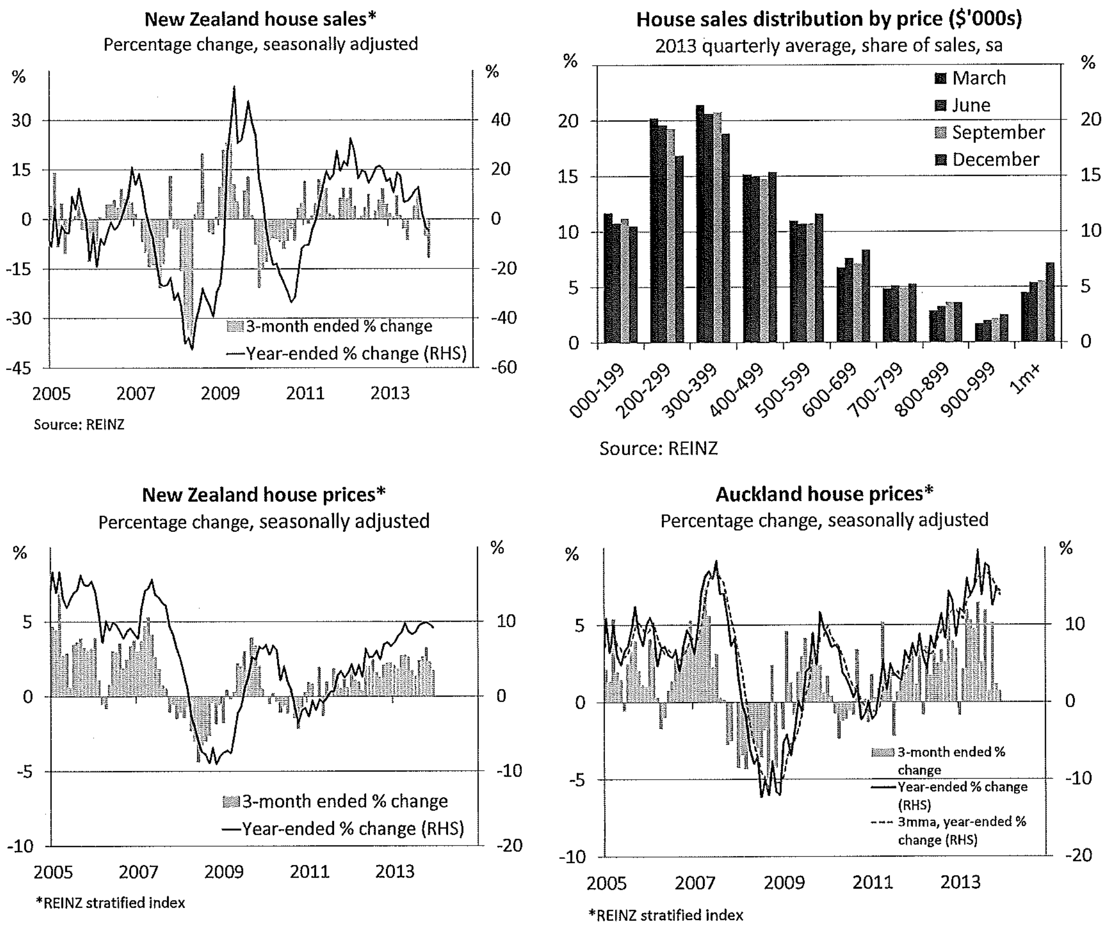
Figure 2: Housing puzzles



Housing market

5. By number, seasonally adjusted nationwide house sales fell by 11.7 percent over the three months to December (Figure 3). This saw year-ended sales contract by 4.6 percent, compared to growth of 13 percent over the year to September. The price distribution of house sales has changed markedly since the introduction of LVR restrictions, with the share of sales falling in the lower price brackets, and broadly rising in the $400,000 plus price brackets.

Figure 3: Housing market indicators

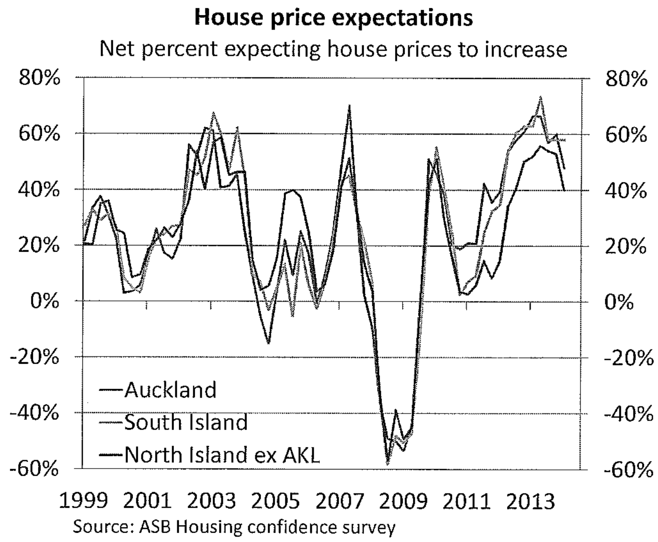


6. House price growth is also down, with nationwide house prices growing 1.7 percent over the three months to December compared to 2.7 percent in the three months to September. This is despite the distributional changes, which are likely attributable to the current relative absence of first home buyers (who buy at the lower end of the market), and which would be distorting measured house

prices (see accompanying MFC memo).[5] Prior to the introduction of LVR restrictions, house price growth had been particularly strong in Auckland, but the Auckland market now appears to be slowing. On a three-month moving average basis, growth peaked at 17.2% in August, and fell to 13.9% in December.

7. The softening is also reflected in the outlook for house prices. 12.5 percent of real estate agents expected house prices to increase in the December BNZ-REINZ residential market survey, the lowest reading since December 2011, and a sharp fall from the 51 percent reading in September. This evidence of softening expectations is also reflected in the latest [embargoed] data from the ASB Housing confidence survey.[6] The share of respondents expecting house prices to increase has fallen throughout the North Island, including a decline in Auckland from 66 percent in the first half of 2013, to 48 percent in January 2014 (Figure 4). Given that one of the aims of LVR restrictions is to short circuit any unwelcome feedback loops between house price expectations, house prices and credit growth, this is an encouraging development.

Figure 4: House price expectations



Housing lending

8. The weakness in the housing market is starting to come through in housing lending data. This is particularly evident in the first stage of the lending process. The value of new loans approved fell by a seasonally adjusted 9.4 percent over the three months to December (Figure 5 overleaf). Growth was flat over the year to December 2013, compared to 13.4 percent growth in approvals over the comparable period in 2012.

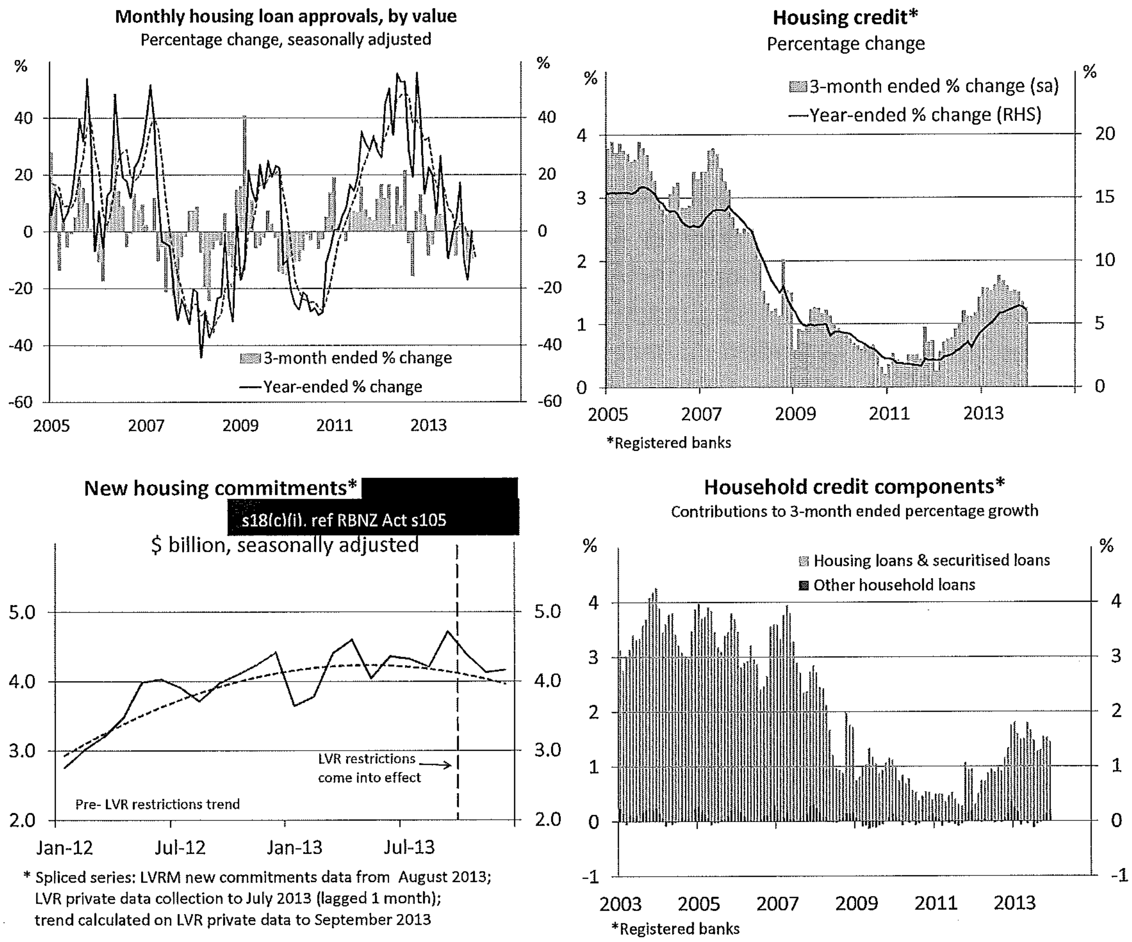
9. We now have the December housing credit (stock) data, which also suggests that registered banks' lending growth is beginning to slow. Housing credit growth has slowed from its May 2013 peak of 1.8 percent (on a 3-month-ended seasonally adjusted basis) to 1.3 percent. This loss of momentum is also starting to come through in the year-ended numbers, with housing credit growing by 6.1 percent over the year to December (down from a recent peak of 6.4 percent in the year to October). While there is some evidence that housing lending is dropping, it

[5] For a detailed discussion, refer Macro-Financial Policy note to MFC "Effect of LVR policy on composition of house sales", C. Bloor, 7 February 2014.

[6] Note that the ASB data has not yet been publicly released, so should not be shared more widely at this point. Release date is expected to be around 12 February.

will need to weaken further to hit our forecast of ~2% lower housing credit growth.

Figure 5 : Housing lending indicators



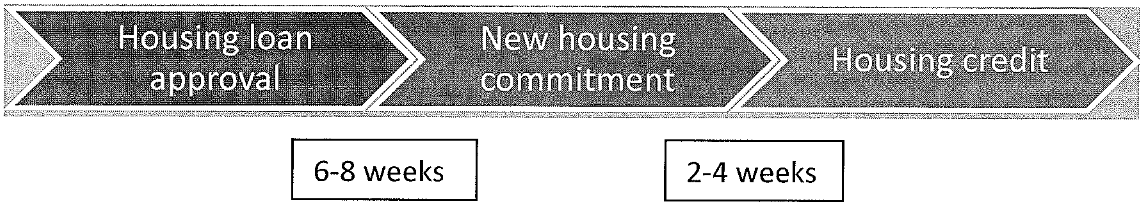
10. Other lending by households picked up over the December quarter, but this is not unusual in the lead up to Christmas, and is in line with the reported improvements in consumer sentiment. Should other lending continue to grow however, it could be an indication of households resorting to unsecured lending to get around LVR restrictions.

11. The evidence of weakness in both housing loan approvals, and housing credit, adds an extra dimension to the task of interpreting the residential mortgage new commitments data. Although new commitments have fallen since September, the extent of the fall is likely exaggerated by the bringing forward of activity in the lead up to LVR restrictions i.e. after factoring this in, the fall is still not as strong as in the other lending measures. We had thought that lags might account for much of the seeming lack of impact of LVR restrictions on realised housing lending.[7] However, given that, time-wise, mortgage commitments sit between mortgage approvals and mortgage drawdowns (which then hit the housing credit numbers), this explanation seems less plausible (Figure 6).

---

[7] Refer "Macro-Financial Policy Take Outs" section of December LVR Monthly Survey Stats Insight.

Figure 6: Mortgage origination process



12. Instead, the inconsistency between the new commitments data and other measures of housing lending and housing market activity could well reflect problems in interpreting short-term movements in the data. There is strong seasonality in the housing market, and our rudimentary seasonal adjustment of the short new commitment series may not be picking this up properly; the data are also quite volatile, which could be masking the impact of LVR restriction (for instance, if more customers are choosing to switch banks at present, boosting gross commitments but leaving net credit unaffected); we also know that banks have been refining their reporting progressively since July, so this could be distorting results.[8]

Potential leakages

13. Non-bank lending institutions (NBLIs) reduced their housing lending by around \$7 million over the December quarter, with a \$49 million increase over December by Redacted: OIA section 18(c)(i), referring to RBNZ Act s105 largely offset by a \$31 million dollar fall following [redacted]. The \$7 million aggregate decrease is small both in terms of NBLIs' stock of housing lending (\$5.9 billion) and overall housing lending (\$200 billion).

14. Liaison with Redacted: OIA section 18(c)(i), referring to RBNZ Act s105 indicates that the uptick in lending is in line with their earlier stated objective of increasing their New Zealand lending book Redacted: OIA section 18(c)(i), referring to RBNZ Act s105 [redacted] state that they are on target to achieve this, and are carefully managing the mix of low-LVR to high-LVR lending as part of this process (their weighted average LVR is typically 70 – 75 percent). They have also said that they will provide some proprietary data on their New Zealand housing lending, which should help in monitoring any changes.

[8] In the medium-term, we are planning an LVR stock data collection, which will allow reconciliation of the stocks and flows of new housing lending. This could help shed light on these sorts of puzzles,, particularly if it includes a split between new lending and redraws.

15. Other types of household lending e.g. credit card and other unsecure lending, by NBLIs increased by 2.4 percent over the December quarter, driving all of the increase in NBLI household credit growth (Figure 7). This is the largest quarterly increase since December 2005, but may not necessarily reflect increased avoidance behaviour e.g. funding of deposits via unsecured lending. Given the recent improvement in consumer confidence, it could equally be driven by buoyant consumer spending, particularly given that it is during the pre-Christmas period.

Figure 7: Non-bank lending to households