

MAY 2010

Homeowners are set to follow in Australia's footsteps and flock to floating mortgage rates as interest rates continue to rise, according to New Zealand Funds Management.

Investment strategist, David Wilson, says New Zealand lenders are commanding higher interest rates for fixed term mortgages due to the more positive economic environment and also, in part, to the recent increase in demand for funds internationally following the European country debt crisis.

Previously in New Zealand fixed, rate mortgages were lower than floating rate mortgages as New Zealand had a negative yield curve. "That situation is now reversing," Wilson says. "Economically, fixed term mortgage rates offer borrowers certainty and borrowers should expect to pay a premium for this certainty. This means fixed rate mortgages are now likely to remain higher than floating rate mortgages."

Wilson also believes property investors and homeowners are likely to face further constraints and costs on borrowing into the future as the Reserve Bank moves to increase the effectiveness of monetary policy on the property market.

On 1st April, all registered banks were required to seek 65% of their funding from core and stable sources such as consumer deposits or debt instruments with greater than a year to maturity. In 2012, that core ratio will increase to 75%. The average core funding ratio for banks in the past 12 years has been between 55 - 65%.

This move will put increased pressure on banks to increase their core funding and impose further constraints on property lending. "The Reserve Bank is expecting this move to act as an automatic stabiliser and temper lending in an easy credit environment. This means banks will only be able to increase their balance sheet by increasing core funding."

The combination of increasing interest rates through the official interest rate and implementing stricter prudential policy via the hiked core funding ratios is designed to act in tandem to curb speculative aspects of the housing market.

Similar moves are being implemented around the world, in particular China which grew 11.9% in the first quarter of 2010. "The Chinese Government is becoming concerned at the level of growth and, in particular, property speculation getting out of control"

Measures are being implemented in China to increase the minimum down payment of mortgages for those buying a second house and even higher for investors seeking to buy a third house or more.

"Quite clearly, China is targeting the speculative pace of the housing market," Wilson says. "These announcements could well spook financial markets, however, they do highlight that economic growth is recovering and that central banks are beginning to remove the significant stimulus they have injected into the economy over the past year. So it can also be taken as a positive sign that the markets in general are recovering."

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