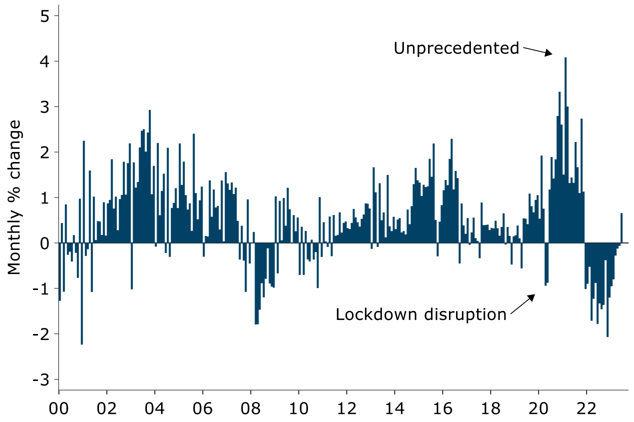
ANZ Research July 2023

New Zealand Property Focus

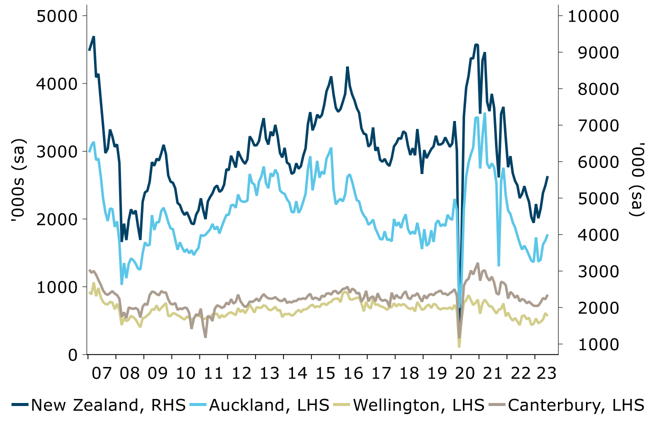
Running start

At a glance

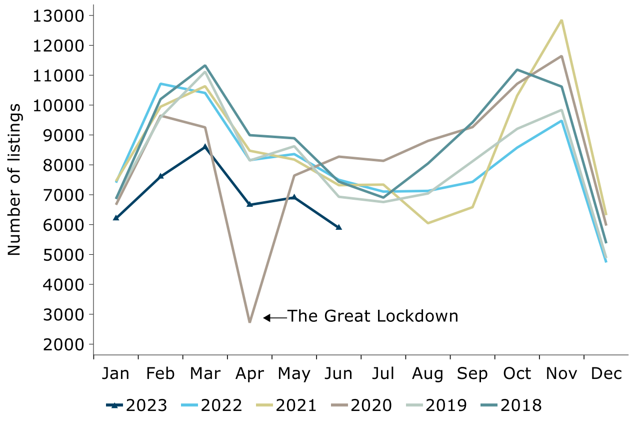
House prices broke out of an 18-month contraction in June…



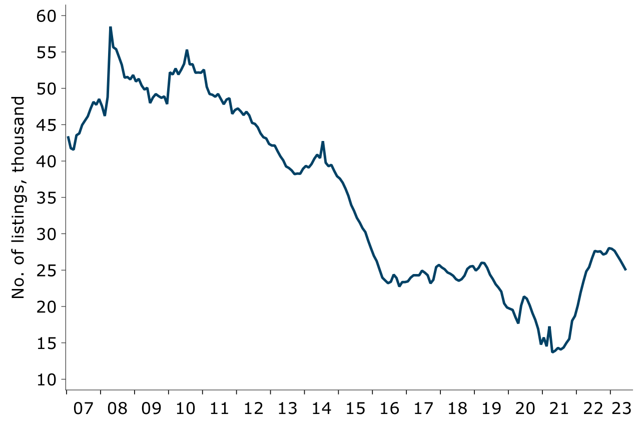
…as sales continued to recover



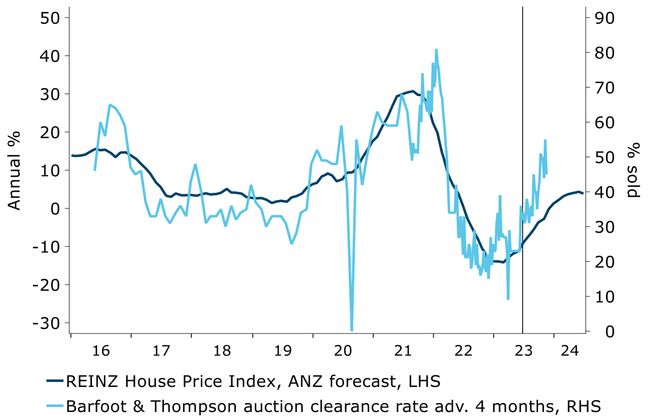
Which, combined with very weak new listings…



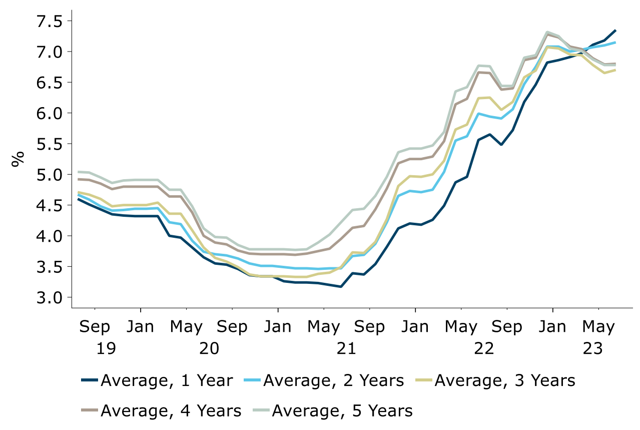
…continues to push inventories lower.



Auction clearance rates suggest our near-term forecast is a little soft…



…but slightly higher mortgage rates in June may contain this risk



Source: REINZ, RBNZ, Barfoot & Thompson, realestate.co.nz, Macrobond, ANZ Research

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Contact

Sharon Zollner, Miles Workman, or David Croy for more details.

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Summary

Our monthly *Property Focus* publication provides an independent appraisal of recent developments in the residential property market.

Property Focus

House prices broke out of an 18-month downtrend in June, rising 0.7% m/m (sa). This was on the slightly stronger side of our expectations. We remain cautious about the outlook, and suspect that the running start to the upturn had some one-off factors nudging it along. But not all the data we monitor concurs. Auction clearance rates in particular suggest our forecast for around 3% growth in house prices over H2 is a touch soft. That may well be true, but we can't lose sight of the broader economic backdrop: the RBNZ is seeking to engineer a looser (and more sustainable) labour market (ie higher unemployment) in order to tame CPI inflation, and if it doesn't achieve this with the OCR at 5.5% it will hike by more. Our expectation is that CPI inflation will prove harder to tame than the RBNZ currently anticipates, pushing it back into hiking mode come November. That's likely to lead to renewed upwards pressure on mortgage rates later in the year, and could even see housing headwinds dominate tailwinds as we head into 2024. See the Property Focus section.

Mortgage borrowing strategy

Mortgage rates out to 3 years are higher this month, adding to rises seen in June. The main driver of higher mortgage rates has been the gradual rise in wholesale interest rates over May and June, with the bellwether 2yr swap rate up around 0.5%pts since early May. The shape of the mortgage curve (on average across the big-4 banks) is now a lot smoother, with floating marking the high point, 6mth and 1yr rates broadly on a par with one another, and the 5yr the low point. Borrowers thus must decide whether they want to benefit from lower forward rates that are built into the term structure or pay more in the hope that mortgage rates may fall more later. We still expect one more OCR hike, and don't think the RBNZ has fully slayed inflation, but this is now partly priced into markets. We do see scope for mortgage rates to fall over the latter part of the next 12 months, but they may not fall as fast as breakevens require them to for it to be cheaper to fix for a shorter period now, and re-fix later, as opposed to fixing for 2-3 years now at rates that are much lower than 6-12mth rates. Either way, borrowers need to fully understand the risks. Spreading borrowing over several terms can help smooth costs. See our Mortgage Borrowing Strategy.

Property Focus

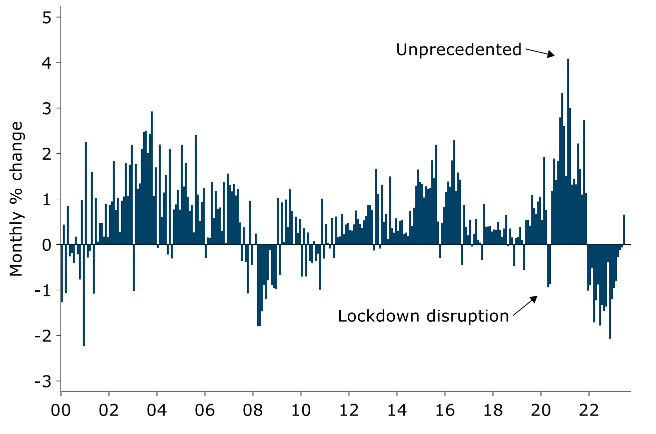
Summary

House prices broke out of an 18-month downtrend in June, rising 0.7% m/m (s.a.). This was on the slightly stronger side of our expectations. We remain cautious about the outlook, and suspect that the running start to the upturn had some one-off factors nudging it along. But not all the data we monitor concurs. Auction clearance rates in particular suggest our forecast for around 3% growth in house prices over H2 is a touch soft. That may well be true, but we can't lose sight of the broader economic backdrop: the RBNZ is seeking to engineer a looser (and more sustainable) labour market (ie higher unemployment) in order to tame CPI inflation, and if it doesn't achieve this with the OCR at 5.5% it will hike by more. Our expectation is that CPI inflation will prove harder to tame than the RBNZ currently anticipates, pushing it back into hiking mode come November. That's likely to lead to renewed upwards pressure on mortgage rates later in the year, and could even see housing headwinds dominate tailwinds as we head into 2024.

HPI breaks 18-month contractionary streak

At the national level, the REINZ House Price Index (HPI) lifted 0.7% m/m in June (seasonally adjusted by ANZ), marking its first monthly rise since November 2021 (figure 1). Before seasonal adjustment it was up 0.4% m/m.

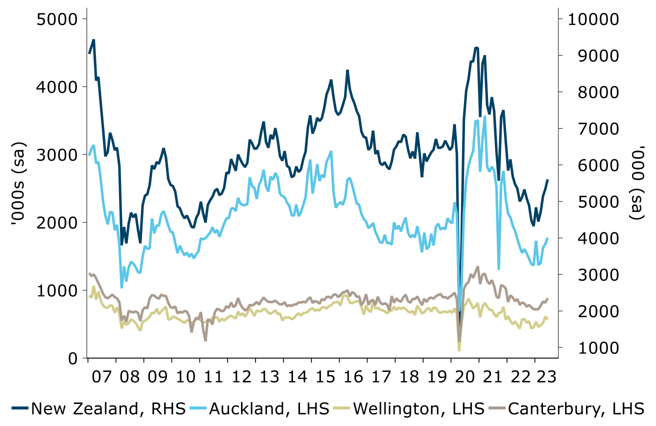
Figure 1. Monthly house price inflation



Source: REINZ, Macrobond, ANZ Research

House sales were also higher in June (after seasonal adjustment) and have been trending that way for a wee while now, having lifted around 30% since December 2022, suggesting the market is indeed warming. Sales tend to lead prices by around three months, indicating that the lift in June prices wasn't a one-off. That said, with the level of sales still below its historical average it would certainly be a stretch to call the housing market 'hot' right now. But the trajectory is certainly pointing towards warming.

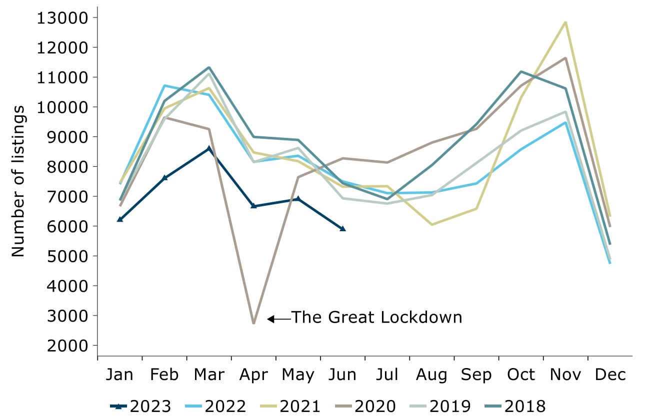
Figure 2. House sales



Source: REINZ, Macrobond, ANZ Research

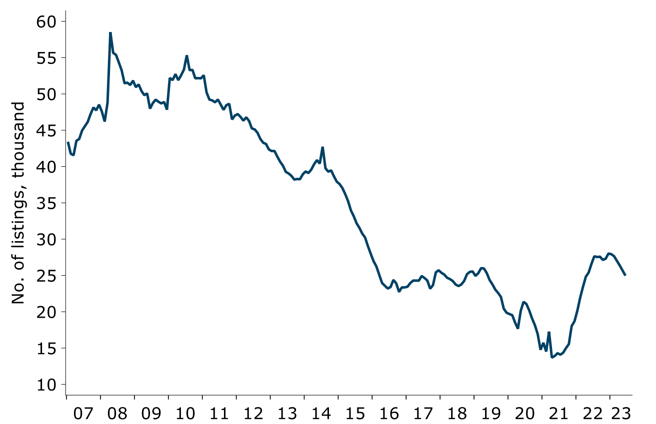
As sales have lifted, new listings have remained very subdued (figure 3). That's putting the number of available properties for sale on a tightening trajectory (figure 4), despite the fact that sales are still at subdued levels.

Figure 3. New listings



Source: REINZ, Macrobond, ANZ Research

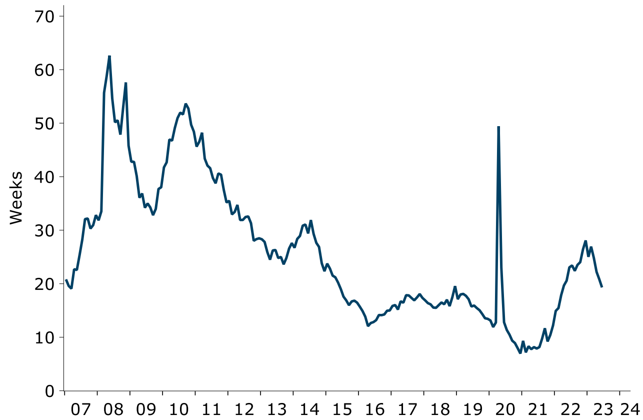
Figure 4. Number of properties available for sale



Source: Realestate.co.nz, Macrobond, ANZ Research

Another way to cut the inventories data is to express it in terms of the number of weeks of sales. At 19.3 weeks in June, this measure is well down from around 28 weeks in December 2022, also pointing to a general tightening in the market over 2023.

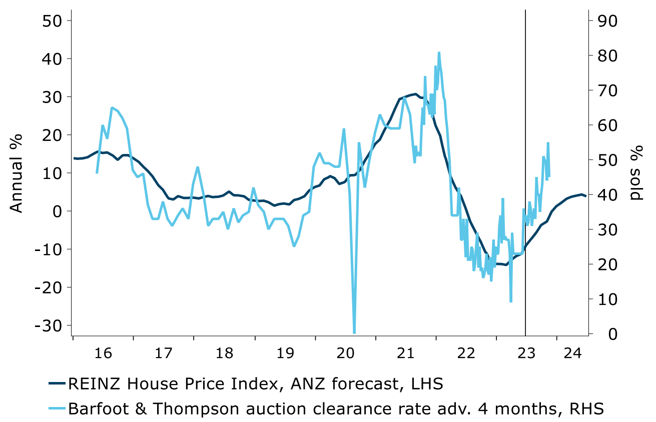
Figure 5. Inventories: Weeks of sales



Source: REINZ, Macrobond, ANZ Research

Another key indicator that has been quite useful at picking the turning point in the house price cycle is the Barfoot and Thompson auction clearance rate for Auckland. At around a third of the market, and sensitive to net migration, Auckland often leads broader trends, and right now it suggests upside risk to our forecast (figure 6). And the Reserve Bank's house price forecast is a lot more subdued than ours, and will definitely need an upgrade next month.

Figure 6. Auction clearance rates and ANZ house price forecast



Source: REINZ, Barfoot & Thompson, Macrobond, ANZ Research

More oomph or just a running start?

We've been calling a turn in the house price cycle for a little while now, and the June data confirmed it. In fact, we'd go as far as to say that the June data were stronger than our expectation. Now the question is whether this is just a noisy start to the turn, or if the upswing has a bit more oomph than we've been expecting.

As we discussed in last month's edition, there are multiple drivers of the house price cycle. But one in particular stands out for the month of June: easing loan-to-value ratio (LVR) restrictions, which took effect 1 June (as discussed in our April edition).

- For owner-occupiers, 15% rather than 10% of new lending is now allowed to be at an LVR ratio of more than 80%.
- For investors, 5% of new lending (unchanged) is now allowed at an LVR ratio more than 65%, up from 60%.

In addition to that, further tweaks have been made to the Credit Contracts and Consumer Finance Act (CCCFA) recently after it was materially tightened in December 2021. For a full history of these legislation changes, and further insight into the unintended consequences that followed, see this link. The relevant part of the story for the recent housing impulse is the second round of tweaks (announced August 2022 and put into force May 2023), which all else equal represents a relative loosening in credit conditions.

Anecdote from the coal face suggests slightly looser financial conditions stemming from changes to LVR settings and CCCFA tweaks have coincided with a small uplift in demand for borrowing. Our own modelling (presented last month) possibly undercooks the May 2023 CCCFA changes (potentially at the cost of overcooking the impact of the July 2022 changes). For LVR settings, our modelling suggests tweaks to investor LVR restrictions have meaningfully affected house price inflation over the past few years, but that changes to owner-occupier settings have tended to have less impact.

But even if the direct impact of recent policy tweaks is small, that's not to say a loosening in LVR settings for owner occupiers and CCCFA changes will have no effect on the market whatsoever. The impacts of various housing drivers are likely to be time-varying to some extent, and subject to prevailing market conditions at the time. For example, we have noted numerous times that the housing market can be influenced quite heavily by 'animal spirits' (fear of missing out, or FOMO, being one manifestation of this). Tweaks to owner-occupier LVR settings for example, while perhaps not enough to materially change the housing demand calculus for would-be buyers, could still have contributed to a change in 'mood' in June that may not have occurred during previous LVR tweaks. In other words, if market participants were just waiting for confirmation that the wind is changing direction, recent LVR tweaks may well have provided it.

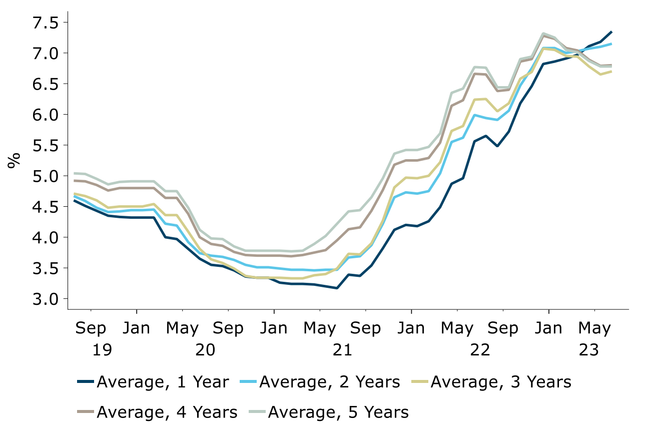
June was also the first full month of data since the RBNZ called a halt to rate hikes. This likely had an impact on perceived interest rate risk, which can also influence the broader housing vibe, with some households now potentially viewing current mortgage rates as a worst-case scenario. Our own OCR call disagrees, but views on the outlook differ, with some expecting the next move to be a cut, and others (like us) expecting it to be a hike.

Whether or not we're entering a new FOMO-style state in the housing market is yet to be revealed, but our money is on this *not* being the case, or at least, that it will not persist. Significant housing headwinds remain, with housing still very unaffordable relative to history, the unemployment rate set to rise, and more recently, some renewed upward pressure on mortgage rates. So while it's possible that June prices received a larger bump than we anticipated from the tweak to LVR settings, recent CCCFA changes, and the RBNZ declaration of a cessation of hostilities, at this stage we don't think this points to stronger housing momentum persisting into the medium term.

Recent changes to mortgage rates corroborate this view. As figure 7 shows, 3-, 4-, and 5-year standard mortgage rates had been trending lower over 2023 until May, as the 2-year moved broadly sideways. On the other hand, the 1-year rate (typically a relatively popular term) has continued to trend higher over 2023. Whether or not this recent mix of mortgage rate changes has been a tailwind, headwind, or neutral is somewhat uncertain. But what is clear is that over the past month or so, most mortgage rates have shifted higher.

Between May and June the average standard 1-year mortgage rate (published by the RBNZ) lifted 17bps, 2-year +5bps, 3-year +5bps and 4-year up 1bp. The 5-year rate was stable at 6.78%. Bottom line: if there was a tailwind for housing from dropping fixed mortgage rates, it faded in June.

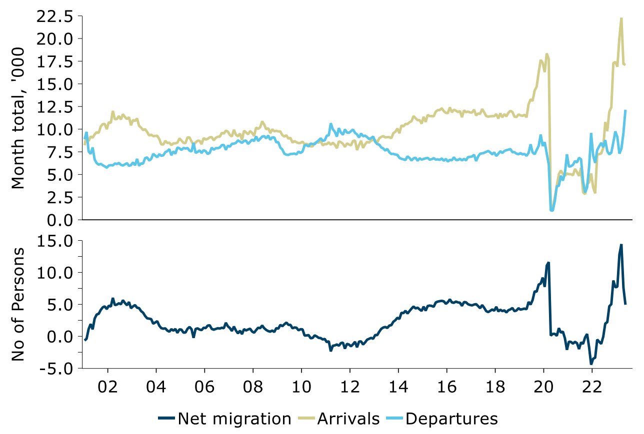
Figure 7. Average standard mortgage rates



Source: RBNZ, Macrobond, ANZ Research

Speaking of softer tailwinds, the net migration release for the month of May provided further evidence that the recent surge in net inflows (which ultimately has meant New Zealand is no longer building enough houses to keep up with population growth), has indeed turned a corner. Departures picked up strongly in May, which we suspect reflects the fact that the New Zealand summer is in the rear-view mirror (why not enjoy the summer months at home before embarking on a new adventure?). Meanwhile, arrivals came in well below the extremely high levels recorded earlier in the year, possibly reflecting pent-up demand being worked through in the context of a softening New Zealand labour market. All in all, net migration was still at very high levels in May, but the migration impulse to housing demand is no longer growing.

Figure 8. Monthly migration



Source: Stats NZ, Macrobond, ANZ Research

Putting it all together, we're comfortable with our view that the upside surprise we saw in the June housing data is unlikely to be the harbinger of a string of upward surprises from here – tailwinds have lost a little bit of steam in recent months.

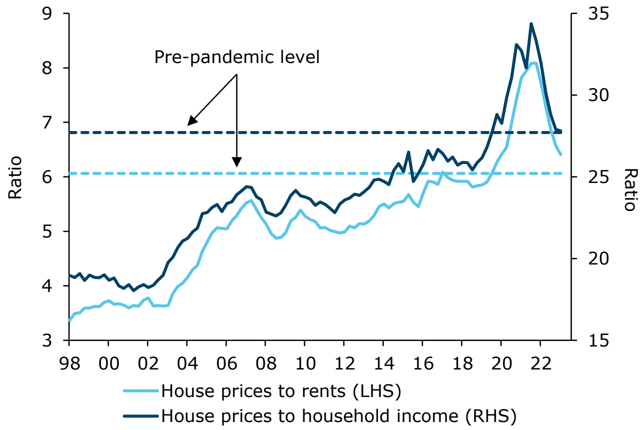
Our updated forecast essentially banks the starting point in June, and maintains the previous outlook we had pencilled in previously. That is, we expect house prices to rise around 3% over the second half of the year, boosted by strong (but easing) net migration and the LVR limit tweak. But as we get into 2024, we think the reality of higher-for-longer interest rates will set in, and that still-stretched affordability and rising unemployment will culminate in a very subdued pace of expansion in house prices. And we certainly couldn't rule out a few more monthly declines in house prices along the way.

A line in the sand

To round out this month's edition, if June was truly the turn in the house price cycle, then we can say the following about the recent downturn:

- House prices fell almost 17% from their peak in November 2021 on a nationwide basis.
- At the trough (May), house prices were still around 21% above their pre-pandemic (December 2019) level. That is, they gave up less than half their nominal gains.
- House prices relative to incomes in Q2 2023 were roughly where they left off ahead of the pandemic. The recent correction in house prices, combined with persistent (and robust) growth in household incomes has seen this ratio improve from both ends. Importantly, this ratio is still very high relative to history. But the COVID-era bump has been completely unwound.
- House prices relative to rents are almost back at pre-pandemic levels (figure 9).

Figure 9. House prices to incomes rents



Source: Stats NZ, REINZ, Macrobond, ANZ Research

All up, the recent downturn in the market, which now appears to be over, has done little else than bring the real price of housing relative to incomes back to the broader relative levels that prevailed prior to the pandemic. There has been no fundamental shift between supply and demand dynamics (New Zealand now has a widening housing deficit), and housing is still unaffordable relative to history.

The RBNZ commented in its July Monetary Policy Review that house prices are now looking "sustainable". But that's not the same thing as "affordable". According to this note, the RBNZ interprets sustainable house prices to be "the level that house prices should move towards based on the medium-term outlook for the underlying drivers of the housing market. These drivers include household incomes, demand from population growth, housing supply responsiveness, tax settings, and interest rates."

Conversely, it's the price of housing relative to income that determines 'affordability'. As the RBNZ notes, 'in a market with low supply responsiveness and restricted land supply, house prices can be unaffordable, but sustainable. When supply is more responsive and land is readily available for development, the sustainable house prices are likely to be lower and more affordable.' This gets nicely at the crux of NZ's housing affordability problems, suggesting (as we have noted uncountable times) that the appropriate policy response to housing unaffordability is a supply response.

Property Focus

Housing market indicators for June 2023 (based on REINZ data seasonally adjusted by ANZ Research)

	Median house price			House price index		Sales		Average days to sell
	Level	Annual % change	3-mth % change	Annual % change	3-mth % change	# of monthly sales	Monthly % change	
Northland	$691,890	-4.9	3.0	-9.3	-3.6	132	(-4%)	58
Auckland	$999,730	-12.6	0.4	-10.6	0.0	1,774	(+5%)	46
Waikato	$739,421	-12.4	-2.9	-10.9	-1.7	537	(+2%)	51
Bay of Plenty	$839,612	-6.9	4.3	-7.8	-0.1	341	(0%)	55
Gisborne	$593,267	-7.7	-2.2	-9.3	-1.5	34	(+60%)	50
Hawke's Bay	$698,711	-0.8	6.8	-9.3	-1.5	177	(+8%)	54
Manawatu-Whanganui	$546,229	-6.6	3.2	-10.5	-1.6	256	(+12%)	51
Taranaki	$582,966	-1.2	-4.8	-4.7	0.3	127	(+11%)	43
Wellington	$780,606	-9.9	2.8	-10.6	-0.1	568	(-7%)	49
Tasman, Nelson & Marlborough	$693,083	-14.9	-2.7			185	(-3%)	56
Canterbury	$659,550	-4.6	0.0	-6.1	0.4	885	(+8%)	37
Otago	$664,359	-13.7	-0.1	-3.1	1.5	326	(-6%)	51
West Coast	$398,003	35.2	6.4	-5.8	-1.5	36	(+13%)	55
Southland	$426,536	-5.3	-0.2	-1.3	0.5	129	(-2%)	36
New Zealand	**$779,693**	**-8.2**	**0.8**	**-9.0**	**-0.4**	**5,604**	**(+5%)**	**47**

Mortgage borrowing strategy

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Summary

Mortgage rates out to 3 years are higher this month, adding to rises seen in June. The main driver of higher mortgage rates has been the gradual rise in wholesale interest rates over May and June, with the bellwether 2yr swap rate up around 0.5%pts since early May. The shape of the mortgage curve (on average across the big-4 banks) is now a lot smoother, with floating marking the high point, 6mth and 1yr rates broadly on a par with one another, and the 5yr the low point. Borrowers thus must decide whether they want to benefit from lower forward rates that are built into the term structure or pay more in the hope that mortgage rates may fall more later. We still expect one more OCR hike, and don't think the RBNZ has fully slayed inflation, but this is now partly priced into markets. We do see scope for mortgage rates to fall over the latter part of the next 12 months, but they may not fall as fast as breakevens require them to for it to be cheaper to fix for a shorter period now, and re-fix later, as opposed to fixing for 2-3 years now at rates that are much lower than 6-12mth rates. Either way, borrowers need to fully understand the risks. Spreading borrowing over several terms can help smooth costs.

Fixed mortgage rates out to 3 years moved up again over the month of July, with rises of 0.15%pts to 0.25%pts seen alongside slight falls in 4yr and 5yr rates. Although these moves lagged the rise in wholesale interest rates that occurred over May and June, that was the main driver of the increases. Indeed, to put mortgage rises in context, the 2yr swap rate has risen by around 0.5%pts since early May.

As we have noted several times in this column over recent months, we are becoming increasingly confident that the worst is likely behind us, in terms of how much scope there is for mortgage rates to rise. Inflation is moderating (here and abroad) and the RBNZ has signalled that it believes that policy is sufficiently restrictive to bring inflation back to target. And although we still see upside risks and have one more OCR hike in our forecasts in November, the hurdle to an earlier hike is high. And we are confident that we are nearer to the end than the beginning of the cycle (especially as another hike is about half-priced into markets). But even so, whether we see another hike is probably less important than the question of how soon we see cuts, as that is likely a pre-condition for lower mortgage rates, which some in the media are calling for, and borrowers are understandably hoping for.

And that's a good segue into the choices faced by mortgage borrowers right now. That's because the downward or "inverted" mortgage curve is already building in an expectation of lower rates in the future. Borrowers can access a lower rate just by fixing for longer, but that of course means that they won't enjoy any falls in rates that may (or may not) come along while they are fixed. The trick is fixing for long enough to be able to benefit from the downward-sloping mortgage curve, but not for so long that you're completely locked in if interest rates do fall. Right now, while we do see scope for mortgage rates to fall (particularly over the back half of the next 12 months), our projections don't have them falling as quickly as they need to make fixing for 6 or 12mths (and then rolling for a further 6-12 months) cheaper overall than fixing for 2 or 3 years. We need to stress too that uncertainty is high, not least because the economic and policy cycle is at, or nearing, a turning point. So even if one has a strong view, it may be appropriate to hedge risks, and stagger borrowing over several terms. This can smooth costs (and aid sleep!).

Anyway, back to the maths, our breakevens show that the 1yr rate needs to fall from its current 7.21% to 6.38% in 1 year's time (and then on to 5.89% in 2 years' time) for back-to-back 1yr fixes to be cheaper than fixing for 2 (or 3) years. That could happen, but it's a more aggressive fall that we are projecting (based on where we see wholesale rates going). If it's a line call, it may be more appealing to lock that in by fixing for 2-3 years instead of 1 year – it all depends on your risk tolerance. It's also worth noting that 6mth is a lot cheaper than floating, yet it's a good proxy for floating, especially if like us, you don't expect wholesale term interest rates to change much over the next 6 months.

Figure 1. Carded special mortgage rates^

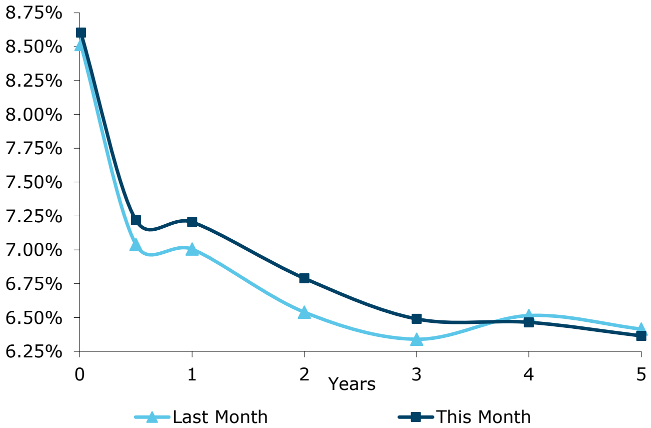

Table 1. Special Mortgage Rates

		Breakevens for 20%+ equity borrowers			
Term	Current	in 6mths	in 1yr	in 18mths	in 2 yrs
Floating	8.60%				
6 months	7.22%	7.19%	6.85%	5.91%	6.04%
1 year	7.21%	7.02%	6.38%	5.97%	5.89%
2 years	6.79%	6.50%	6.13%	6.02%	6.14%
3 years	6.49%	6.35%	6.22%	6.08%	6.08%
4 years	6.47%	6.31%	6.16%		
5 years	6.37%	#Average of "big four" banks			

^ Average of carded rates from ANZ, ASB, BNZ and Westpac.

Source: interest.co.nz, ANZ Research

Key forecasts

Weekly mortgage repayments table (based on 30-year term)

	Mortgage Rate (%)													
Mortgage Size ($000)	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00	8.25	8.50	8.75
200	262	269	277	284	292	299	307	315	323	330	338	347	355	363
250	327	336	346	355	364	374	384	393	403	413	423	433	443	454
300	393	404	415	426	437	449	460	472	484	496	508	520	532	544
350	458	471	484	497	510	524	537	551	564	578	592	606	621	635
400	524	538	553	568	583	598	614	629	645	661	677	693	709	726
450	589	606	622	639	656	673	690	708	726	744	762	780	798	816
500	655	673	691	710	729	748	767	787	806	826	846	866	887	907
550	720	740	760	781	802	823	844	865	887	909	931	953	975	998
600	786	807	830	852	875	897	921	944	968	991	1,015	1,040	1,064	1,089
650	851	875	899	923	947	972	997	1,023	1,048	1,074	1,100	1,126	1,153	1,179
700	917	942	968	994	1,020	1,047	1,074	1,101	1,129	1,157	1,185	1,213	1,241	1,270
750	982	1,009	1,037	1,065	1,093	1,122	1,151	1,180	1,209	1,239	1,269	1,299	1,330	1,361
800	1,048	1,077	1,106	1,136	1,166	1,197	1,227	1,259	1,290	1,322	1,354	1,386	1,419	1,452
850	1,113	1,144	1,175	1,207	1,239	1,271	1,304	1,337	1,371	1,404	1,438	1,473	1,507	1,542
900	1,178	1,211	1,244	1,278	1,312	1,346	1,381	1,416	1,451	1,487	1,523	1,559	1,596	1,633
950	1,244	1,278	1,313	1,349	1,385	1,421	1,458	1,495	1,532	1,570	1,608	1,646	1,685	1,724
1000	1,309	1,346	1,383	1,420	1,458	1,496	1,534	1,573	1,613	1,652	1,692	1,733	1,773	1,814

Mortgage rate projections (historic rates are special rates; projections based on ANZ's wholesale rate forecasts)

	Actual			Projections						
Interest rates	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Floating Mortgage Rate	7.8	8.0	8.5	8.6	8.9	8.9	8.9	8.9	8.6	8.4
1-Yr Fixed Mortgage Rate	6.4	6.5	6.9	7.3	7.3	7.1	6.8	6.5	6.2	6.1
2-Yr Fixed Mortgage Rate	6.6	6.5	6.5	6.8	6.5	6.3	6.1	5.8	5.7	5.7
3-Yr Fixed Mortgage Rate	6.7	6.6	6.3	6.4	6.3	6.1	5.9	5.7	5.6	5.6
5-Yr Fixed Mortgage Rate	6.8	6.6	6.3	6.6	6.3	6.1	5.9	5.8	5.8	5.8

Source: RBNZ, ANZ Research

Economic forecasts

	Actual			Forecasts						
Economic indicators	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
GDP (Annual % Chg)	6.6	2.3	2.2	1.1	-0.5	0.0	0.4	0.3	0.7	1.2
CPI Inflation (Annual % Chg)	7.2	7.2	6.7	6.0(a)	5.8	5.2	4.8	4.3	3.2	2.8
Unemployment Rate (%)	3.3	3.4	3.4	3.5	*Under review*					
House Prices (Quarter % Chg)	-4.2	-3.5	-3.1	-0.4(a)	1.4	1.6	0.5	0.6	0.6	0.6
House Prices (Annual % Chg)	-5.6	-12.8	-13.7	-10.7(a)	-5.6	-0.6	3.1	4.1	3.3	2.3

Interest rates	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Official Cash Rate	4.25	4.75	4.75	5.50	5.75	5.75	5.75	5.75	5.50	5.50
90-Day Bank Bill Rate	4.65	5.23	5.71	5.77	5.85	5.85	5.85	5.68	5.43	5.43
10-Year Bond	4.47	4.20	4.62	4.75	4.50	4.25	4.00	4.00	4.00	4.00

Source: ANZ Research, Statistics NZ, RBNZ, REINZ

Contact us

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Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 9 357 4094
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Henry Russell
Economist

Macroeconomic forecasting, economic developments, labour market dynamics, inflation and monetary policy.

Telephone: +64 21 629 553
Email: henry.russell@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

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