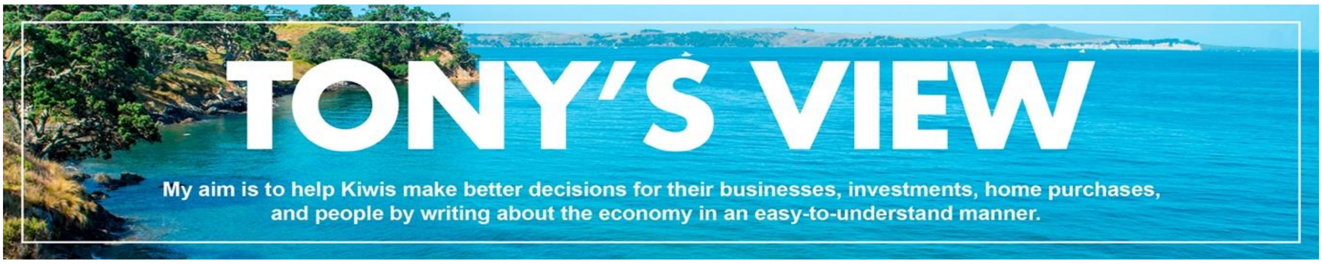

Input to your Strategy for Adapting to Challenges

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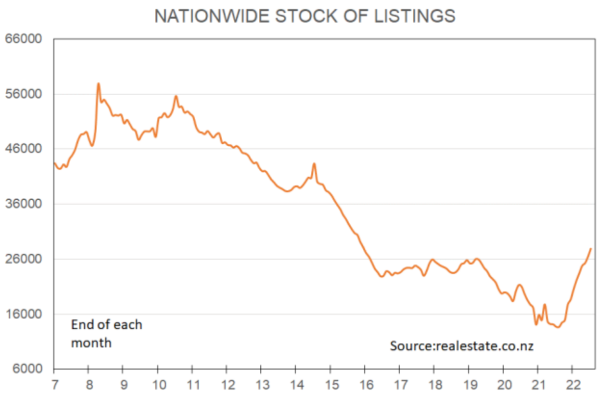
The endgame begins

In the first half of last year, I wrote that the endgame for the boom in houses prices had started, whether you considered the boom to have commenced in 1992, 2012, or mid-2020. The factors in play were new tax rules hitting investors, tightening of LVR rules, prices getting excessively high, then rising interest rates from mid-2021.

But it took a while for house prices to stop rising as a new surge in FOMO on the back of the stock of property listings falling to a record low occupied people's minds.



The view I've been giving since early this year is that prices will fall for a while and at some stage before the end of the year we will enter the endgame for this period of price declines.

I've specifically noted that I won't feel we have entered such a period until we see a decent amount of wallowing in the pessimism of two factors in particular.

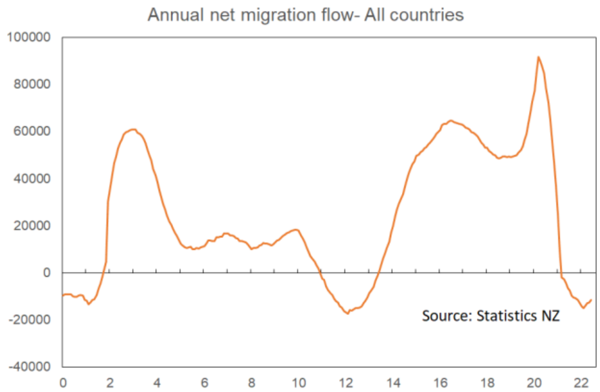
One of those factors is talk of an over-supply of housing, largely with regard to Auckland. We have reached that stage now with a media focus on the view by one set of forecasters that such an over-supply may appear next year.

It is not the technical position of there being an over-supply or under-supply which matters – partly because if the market functions and prices are free to adjust (as they are with housing) then there is never an under or over-supply situation We simply get price changes.

What matters is the general discussion of an over-supply and the view people will take that this means there is no hurry needed to buy a house and prices will decline. We're about there now. The over-supply talk will start with Auckland but eventually extend to other parts of the country –

especially once the locals realise the special pandemic population surge they have just enjoyed will not continue.

The other factor I have mentioned as needing to be in place before I will call the endgame underway is widespread talk of a brain drain. That ball is rolling though not in a forceful manner as yet. There is growing awareness of not just the net loss for the past year of over 11,000 people, but the fact that flows have been negative for over a year.

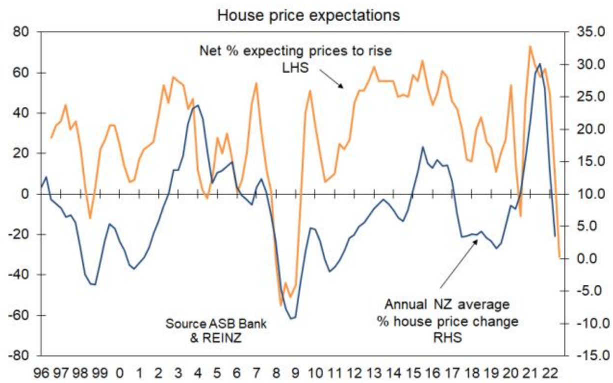


Here is an example of why more young Kiwis are going to head west – the strong incomes available in mining in Australia.

https://www.facebook.com/watch/?v=616336410003607&ref=sharing

Why are these factors important? Because by wallowing in the negative price implications of them in an environment of deep concerns about the economy, we will see vendors hanging out for a good price finally meet the market. They will capitulate to the current reality and stop holding out hoping to get the price they could have got had they sold during the silly frenzy over the second half of last year.

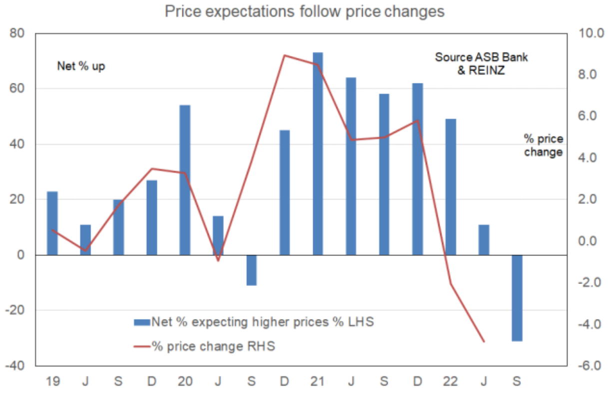
I take as one sign of the endgame starting the survey results just released by ASB showing strong expectations by respondents that house prices will decline.



The net expectation for price changes in the coming 12 months sits at -31% from 11% last quarter. Note that in the December quarter last year when prices were already falling a net 62% of respondents expected them to keep rising. And in the March quarter when again they had already been falling away, a net 49% still expected prices to go up.

People's house price change expectations alter after actual price changes, not before. I have noted in the past that this survey tends to reflect what is happening or has already happened with house prices.

We can see this as the blue columns showing expectations tending to shoot up after the red line showing quarterly house price changes has shot up. Same for down most recently.



But it is important nonetheless in signalling that people accept the housing market is vastly different from what it was before.

So, what does this mean then if we are in this so-called endgame? A key thing is, don't expect anyone to be certain about when house prices stop falling on average, when they start rising again as they have done for a couple of centuries, and the speed with which they will rise. The end of the surge last year took a lot longer to happen than I expected because of the listings plunge and FOMO surge.

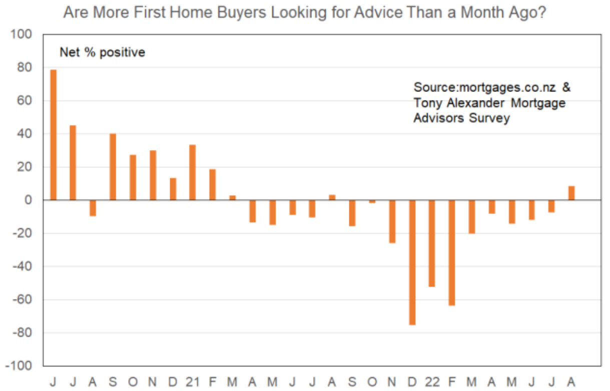
The main implication is that as each month now goes by it gets riskier to keep holding out for the absolute bottom of the cycle if you are a buyer. Yes, prices are highly likely to fall another 5% or so (meaning I don't really have a clue but 5% seems an acceptable number to most people most of the time for most things).

For buyers the environment is one in which vendors become the most compliant and willing to negotiate that they have been for many years. Sales can actually pick up because of that just as prices fall further.

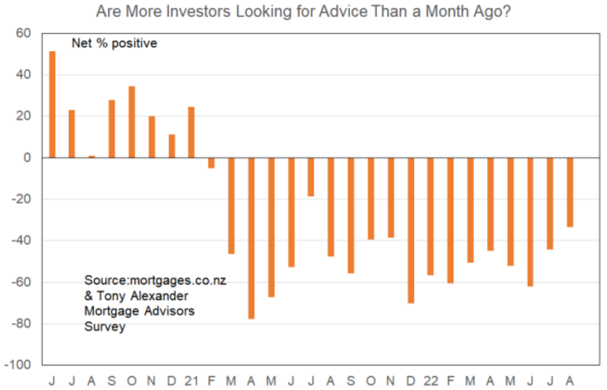
To repeat, the way I look at things does not tell me when prices rise and by how much. Instead, the approach I am taking and the stuff I am looking at encourages me to strengthen the message I am already delivering to first home buyers.

Stop trying to pick the bottom of the house price cycle and focus on what you really want – a house to raise your family in for the next one to two decades.

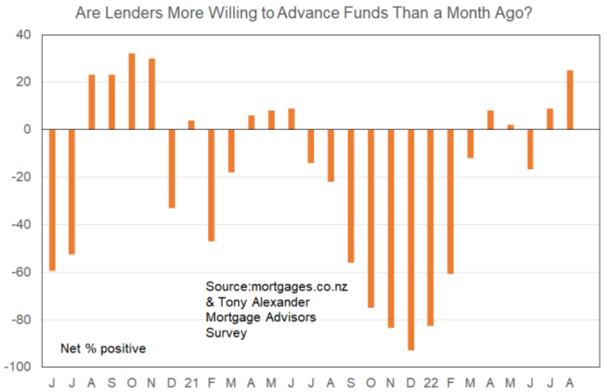
Next week I will discuss this issue again in light of the results from my monthly survey of real estate agents undertaken with REINZ. I have the results in hand but the release is not until next week. Suffice to say, first home buyers are back, as revealed already in my monthly survey of mortgage advisers.



That survey still shows that investors are stood well back from the market, but the degree to which they are not buying is easing.



The survey I run with REINZ will show easing concerns about access to finance, but not to the degree already indicated by mortgage advisers. A net 25% last month said that banks are becoming more willing to advance funds for a house purchase. The graph shows that things are quite different from early this year when the credit crunch was at its worst.



If I were a borrower, what would I do?

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.

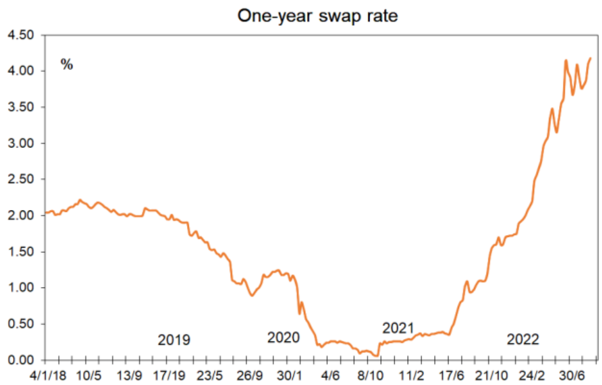
Rates rise again

Strong comments from the Federal Reserve Board Chairman on Friday night have seen bond yields and bank wholesale fixed rate borrowing costs rise strongly this past week. The Chairman indicated that the Fed. will do whatever is necessary to ensure inflation comes back to acceptable levels and that has been interpreted to mean higher interest rates for longer even as economic indicators generally, though not universally, get worse in the United States.

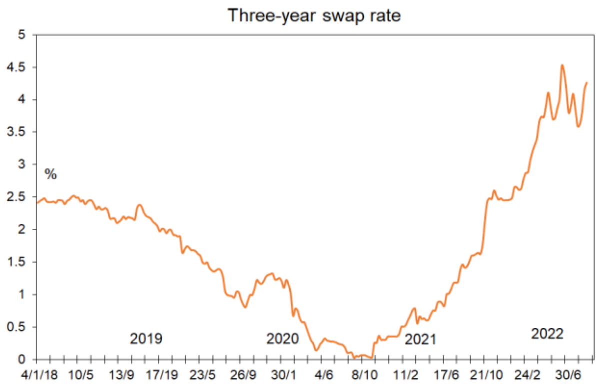
At the same time gas prices have risen again in Europe as Russia essentially ceases supply gas and expectations for both high inflation and economic pain in the UK and Europe have risen in the past weeks.

As a result, the US ten year Treasury bond yield has climbed to near 3.12% from 3.1% last week and 2.75% four weeks ago. The recent peak was 3.4% in the middle of June.

Of relevance to the ability of NZ banks to make any further cuts in their fixed mortgage rates are the local swap rates which have risen appreciably. The one year wholesale borrowing costs banks pay to lend on mortgages at a one year fixed rate has risen to 4.18% from 4.1% last week and 3.76% four weeks ago. The rate is essentially back where it was in the middle of June.



However, for the longer term swap rates things are not back to June levels. The two year swap rate has risen this week to 4.32% from 4.18% last week and 3.69% four weeks ago. The June peak was 4.5%. The five year swap rate is now at 4.14% from 4.02% last week, 3.46% a month back, and 4.5% in mid-June.



Given the deteriorating global economic outlook there is going to eventually come a point where inflation is predicted to fall away rapidly. We cannot know when that point of collective agreement will be reached. When it happens interest rates will fall quite quickly and that will feed through into lower bank fixed mortgage rates here.

But that point of substantial change in the inflation view is not imminent and the big upshot for us here is that scope for banks to discount their fixed mortgage rates further has disappeared for now. Will they raise them? I don't know, it all depends upon how they want to position themselves heading in to spring mortgage campaigns. Maybe not given the apparent tolerance for well below average margins on the one year fixed rate term.

If I were a borrower, what would I do?

Personally, I'd probably fix just for one year but for someone more risk averse having some debt locked in at a two year rate might be wise given the very large number of extremely uncertain things out there. Do not look for certainty in any of the things which feed into your decisions about what to do with your business (costs, supply chains, labour availability), or personal finances (climate change manifestations, government policy shifts, the aggressions of China and Russia).

To see the interest rates currently charged by major lenders go to www.mortgages.co.nz