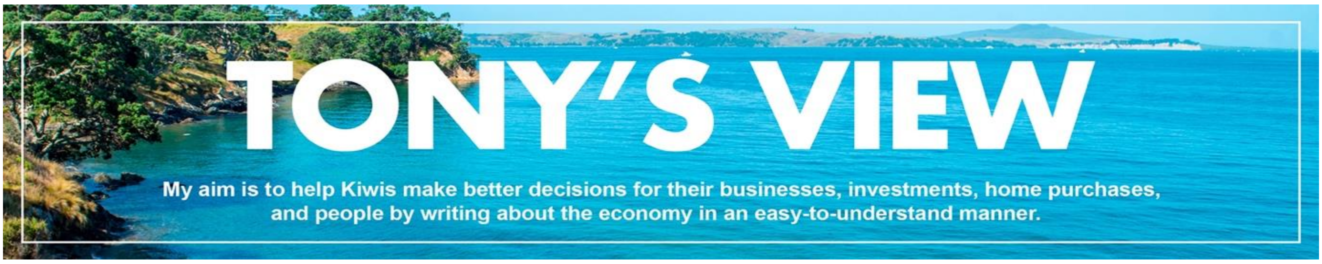


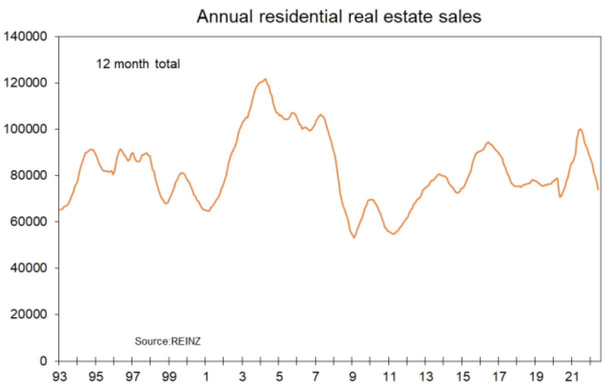
Input to your Strategy for Adapting to Challenges

Feel free to pass on to friends and clients wanting independent economic commentary

ISSN: 2703-2825
Thursday 11 August 2022
Sign up for free at www.tonyalexander.nz

When will buyers return?

Sales of properties are running around 40% down from a year ago, it is taking 13 days longer than a year back to sell a dwelling, prices have fallen 9.5% from their peak, and listings are up 104%.



This situation of deep weakness in the residential property sector has not come about because of a wave of distressed sellers. There is no evidence of a wave of investors selling ever since the tax rules were changed last year despite a special survey I ran with 3,500 responses showing plenty of owners planning to raise their rents or sell their properties. The dummy was spit but no further action taken.

Very few owners are going to end up paying a higher interest rate on their mortgage than they had to prove to the bank they could handle when they signed up for their purchase and debt 1, 2, 3 etc years in the past.

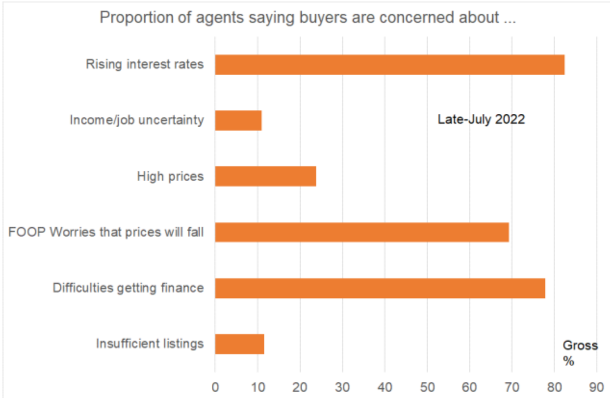
The labour market is also exceptionally tight and people owning property are likely to be feeling that if they get laid off, they can easily get another job to help service their mortgage.

So, why has the housing market slowed down and gone into reverse? Because the buyers have slipped back into the shadows. Why are they hiding out of sight? Because getting credit suddenly became a lot harder late last year, mortgage interest rose 3%+ over a very short period of time, there was a cost of living crunch, and fears of prices rising and rising disappaited.

When will the buyers return and start soaking up the growing stock of listings? To answer that it pays to have some insight into what the things are which concern buyers most of all at the moment. That is information I can get from the monthly survey of residential real estate agents nationwide which I run with REINZ.

This first following graph shows the proportion of agents in September 2021 who said buyers were worried about each of the things listed. Only 35% were worried about rising interest rates and just 22% said buyers were fearful of prices falling after they purchased. But 78% said they were concerned about insufficient listings, 56% said high prices, and 48% cited difficulties getting finance.

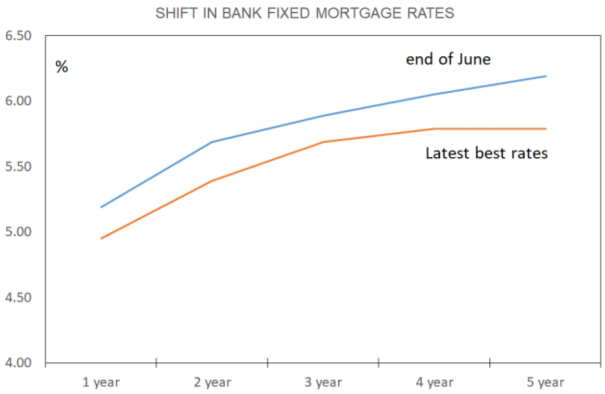
This is the situation now. 82% say buyers are worried about high interest rates, 78% cite worries about getting finance, and 69% cite worries of prices falling. Only 11% say listings are a worry and a still low 11% say employment is a concern, unchanged from September.



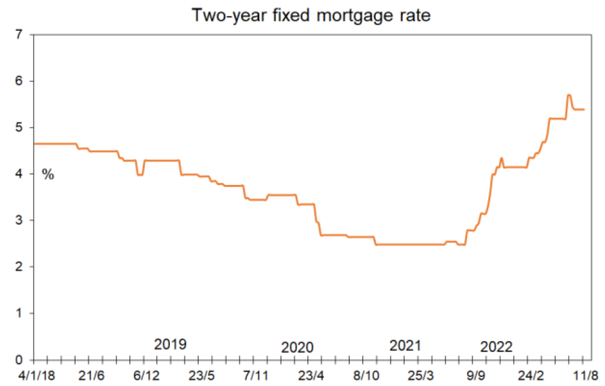
So, the big concerns are interest rates, financing, and price declines. The first two of these areas are improving, the last will follow before the end of the year also and could even be changing a tad right now.

Interest rates

Fixed mortgage interest rates have started to decline. This may not receive much attention in the media for some time because the focus will be on the cash flow implications of rate changes for those who fixed at low rates last year and are now rolling into something higher.



But those people are not hesitant home buyers. They already have a house and a mortgage, and their spending plan changes have almost no relevance for the residential real estate market. Instead, it is the buyers in the shadows that are relevant here and over time they will realise that we have already seen the peaks for almost all fixed lending rates for home buyers.



The Reserve Bank is still set to take the official cash rate from the current 2.5% to a probable peak of 3.5%. But fixed rates reflect market expectations of monetary policy and not where the cash rate sits at the moment. Those market expectations are for monetary policy to be easing by the end of 2023 with cuts continuing through 2024. Hence big falls in bank wholesale borrowing costs recently and the partial pass-through into their fixed lending rates.

These rate cut expectations reflect early signs of inflationary pressures easing off and worries about recessions in the likes of the United States and Europe increasing recently.

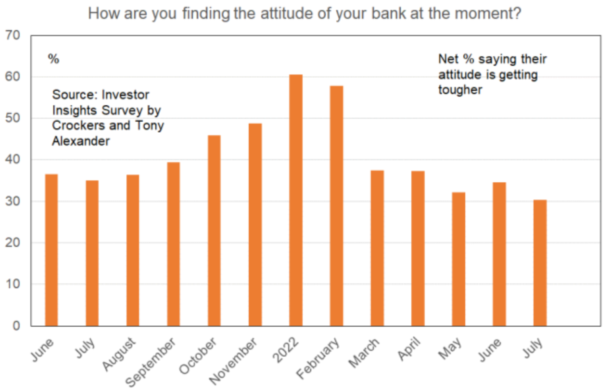
International oil prices are down along with prices for minerals and food. Shipping costs are easing and supply chains functioning slightly better. A measure of online consumer prices in the US is now falling, the pace of rents growth here in New Zealand is easing, consumer inflation expectations have fallen in the ANZ's monthly gauge, and the Reserve Bank's Survey of Expectations held amongst market analysts has also just eased marginally.

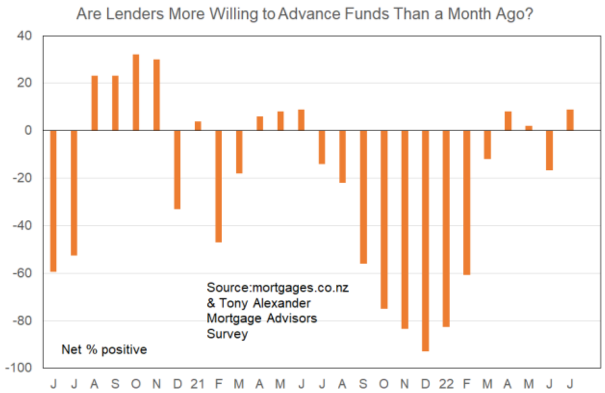
High inflation numbers will be with us for well into 2023. But the direction of change outside countries which allowed themselves to become dependent on Russian gas is turning downward.

Over the next few months buyer concerns about interest rates are going to fall away.

Access to finance

As noted last week, various gauges from my monthly surveys tell us that the credit crunch was at its worst very early this year.





Competition between banks for mortgage business is strong, and for the moment they are fighting that competition with cashback offers. Eventually they will back away from such costly incentives and revert to discounted lending rates plus greater willingness to lend generally.

Beyond that there is a good chance that when house prices have gone down another 5.5% and the Reserve Bank then considers them to be "sustainable", that there will be an easing of LVR regulations.

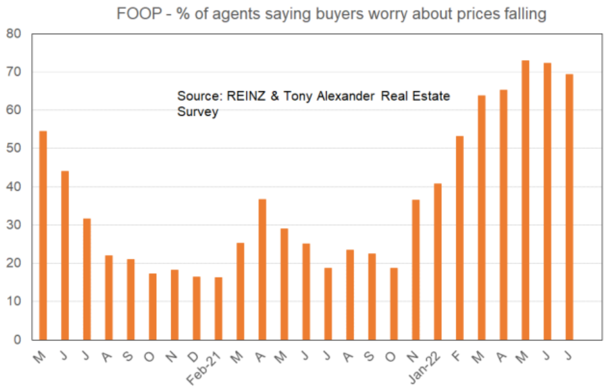
Credit availability is likely to improve bit by bit for home buyers from here on out.

Worries about falling prices

It will take some time for these concerns to fall away. But as each month passes and average prices go lower, more and more potential buyers will give thought to how close we might be to prices bottoming out and how much prices have pulled back from their ridiculous heights of late last year.

At some point buyers generally will lose their price fall fears, or just ignore them in the interests of securing a property from the large number of listings.

The measure of price decline worries which I derive from my monthly survey of residential real estate agents has in fact eased for two months in a row now.



But the decline from 73% to 69% is very small and not enough for me to yet feel confident saying that we have passed peak FOOP – fear of over-paying.

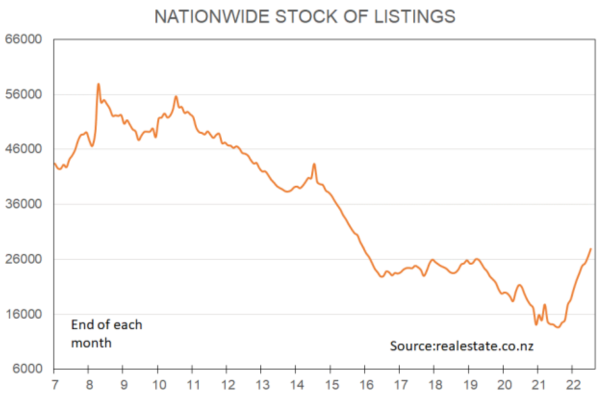
The challenge to first home buyers

One interesting thing to consider is that in coming weeks we may see first home buyers increasingly challenged to give thought to what matters to them. Do they hold off from buying because they want to avoid the last 5% fall in prices and buy at the bottom so they can feel clever? Or do they want a house in which to raise a family?

Last year they scrambled to find anything (unsuccessfully) when the stock of property listings was at a record low below 14,000. Now, listings are double what they were a year ago, and it is a buyer's market in which home hunters can increasingly pick and choose.

Why would you not look to buy now when

- prices are down 10%, (a lot more in some locations)
- vendors are increasingly open to offers,
- banks are increasingly eager to lend and may trade cashbacks for discounted fixed rates,
- there are twice as many properties to choose amongst than last year,
- you have a job and can probably shift voluntarily to another one for higher wages if you wanted given the extreme unsatisfied business demand for staff,
- there is a greater chance of finding a property which meets your anticipated needs than at any other time since 2015,
- migrants have yet to return in numbers, and
- investor buyers are sitting back waiting to see what happens with the election and not competing against current active buyers?



Also, keep in mind that construction costs are only going to keep going up. A reader for instance this week emailed me the builder's estimate of the extra cost if they were to voluntarily meet the incoming new insulation standards ahead of time. The total build cost (excludes the section) rises 4%.

"The house concerned is a pretty standard 3 bedroom home, about 180 square metres, so not big by todays standards. The build cost is circa $580-$600k, so slightly over $3,000 PSM.

Extra for Thermal Heart Aluminium	$17,765
Extra for double batts in ceiling	$2,873
Extra for Low E	$3,306
150 x 50 framing at ranch sliders	$431"

The three main factors causing concern for buyers and making them stay back in the shadows will ease as we head into Christmas. All that is really in doubt is the speed of the easing and the lag in months between the buyers coming out of the shadows and average house prices moving back up slightly again over 2023.

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.

Rate review next week

Next week the Reserve Bank will review their monetary policy settings and the near universal expectation is that they will lift the official cash rate from 2.5% to 3.0% and signal that they intend pushing the rate higher in order to ensure high inflation does not become entrenched in the economy.

Fair enough. But there are two things to give thought to which at some point will surprise the markets and cause a decent shift down in wholesale borrowing costs beyond the near 0.7% or so falls which have already happened since the middle of June.

First, surprise is a valuable weapon for a central bank. Yes, they want to signal to the markets where they plan taking things. But complacency about the certainty of future rate changes can lead to excessive risk taking and greater interest rate volatility down the track. Given that the Reserve Bank is explicitly instructed to avoid instability in things like interest rates, shocking the markets now and then is useful for curbing potential for high volatility.

Second, what is it that the Reserve Bank has most recently learned about its monetary policy behaviour? They have developed a tendency to dismiss evidence on what the economy is really doing if it disagrees with what their models tell them is happening and is going to happen.

Our central bank has developed flaws under its current leadership and one of them is excessive reliance on economic models which have not worked since at least 2007. The models failed to forecast inflation in 2014-15 and again in 2017-18.

The people in the Reserve Bank are not stupid. The chances are that they are now aware of this deficiency on their part and will tend to give greater weighting to real world economic indicators. After all, this is what we all do in various aspects of our lives from learning how much we can drink and not get into trouble, to learning what tactics fail on the rugby field and adapting. I guess we're still waiting for the proper adjustments to be made in that regard.

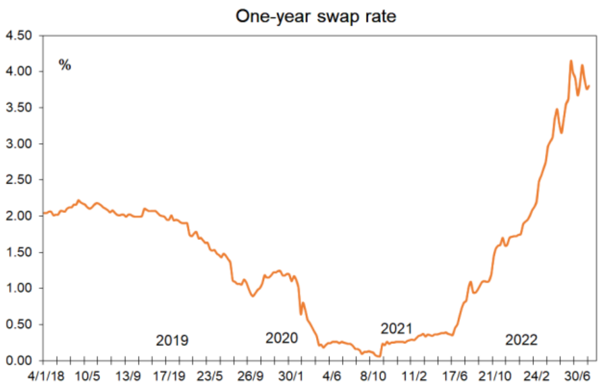
My point is that as data develop indicating easing inflationary pressures the Reserve Bank will look to pause its rate rise cycle if not in terms of actual rate changes in terms of the language they use.

Therefore, while there is a chance they soften their tone at next Wednesday's cash rate review, more probably the new wording will come through at the review after that on October 5. Also, don't completely rule out some hints appearing in a speech by one of the senior people.

After all, having messed up by loosening too much for too long last year, if the Reserve Bank messes up again by now tightening too much for too long, a wholesale replacement of senior personnel would seem in order.

This week wholesale interest rates have gone down then up then down in response to fluctuating worries about world growth altering expectations that central banks will start cutting their cash rates before the end of 2023. The inflation number out of the United States last night was much better than expected so there remains a likely downward bias to rate movements in the near future.

Currently the fixed rates facing banks for lending to customers at fixed rates look not much different from last week.



My current expectation for the one-year fixed mortgage rate in August each year is shown in the first column of the table below. I focus on that rate because there are many people who have fixed one-year repeatedly since 2009 and the strategy has worked very well.

The second column shows what the one-year rate will average over the next 2-, 3-, 4-, and 5-year periods. The last column shows the current best 2 – 5 year fixed rates charged by the lenders I track.

	Forecast 1 year rate	Rolling average rates	Current fixed averages	
2022	4.95		4.95	1 yr
2023	5.75	5.35	5.39	2 yr
2024	4.75	5.15	5.69	3 yr
2025	4.25	4.93	6.05	4 yr
2026	4.00	4.74	6.19	5 yr

If these forecasts prove correct (I'd give that a 10% probability), rolling one-year fixed will deliver an average rate for the next two years of 5.35%, three years 5.15%, four years 4.93%, and five years 4.74%.

If I were a borrower, what would I do?

I would fix one year.

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

TONY'S VIEW

My aim is to help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy-to-understand manner.

Links to publications

Tony's View Spending Plans Survey

Spending Plans Survey

Tony's View Business Survey

Business Survey

Tony's Thoughts Vlog

NZHL HOME LOANS | INSURANCE

REINZ & Tony Alexander Real Estate Survey

REINZ REAL ESTATE INSTITUTE OF NEW ZEALAND

Oneroof weekly column

OneRoof

[Handling high interest rates]

[Handling staff shortages]

[Handling high cost of living]

mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

mortgages.co.nz

Tony Alexander Regional Property Report

first mortgage trust

Crockers & Tony Alexander Investor Insights

Crockers PEOPLE & PROPERTY

[Investing Insights]

Sharesies