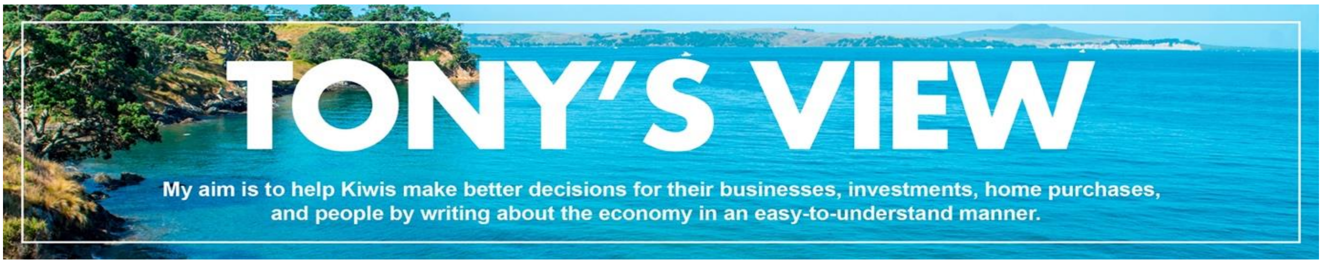

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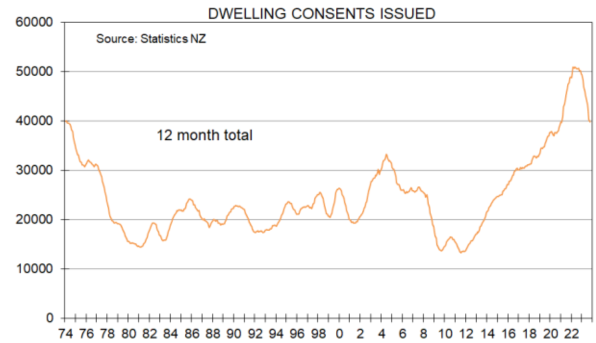
House price changes in 2024

Happy New Year everyone and welcome to 2024. Let's start with a run-through of some of the key factors which lie behind my view that average house prices this year will rise by somewhere close to 10% - meaning maybe a tad less and maybe a tad more.

To do this I'll repeat a version of the exercise I was emphasising in my analysis and commentary over much of the second half of 2023. That involves thinking about the likely pressure on house prices in terms of direction and magnitude with reference to the supply side of the equation and the demand side.

On the supply side of housing we have this. The number of consents issued for the construction of new dwellings rose from a multi-decade low of 13,500 in 2011 to a peak over 51,000 in May of 2022. Since then numbers have fallen to 39,900 in the year to October 2023 with numbers in the three months to October 28% lower than a year ago.

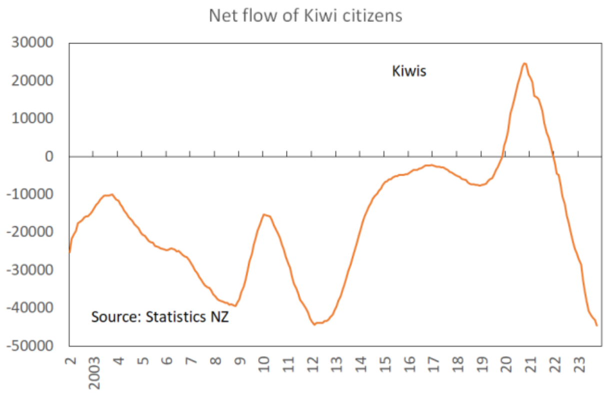


The annual total looks headed for maybe 30,000. Growth in supply is happening, but it is becoming smaller for now and it pays to note that the actual net addition to the country's near 1.9 million number of dwellings is less than the consent numbers suggest. By one estimate only 80% of consents these days lead to actual construction as compared with over 95% in the past. Also, much more housing these days involves demolition of one or two existing dwellings to allow erection of townhouses.

New supply is falling and if nothing else was changing this would tell us that there is upward pressure on prices. It pays to note also that the

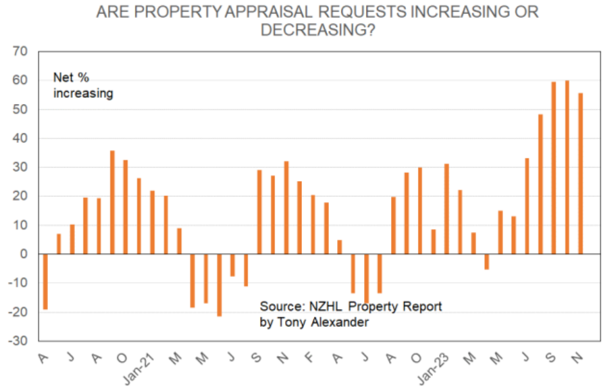
cost of construction keeps going up for a wide variety of reasons often related to desires to improve the quality of new housing stock and simple bureaucracy in action.

Another supply factor to consider is house selling by the net flow of a record 45,000 Kiwis offshore last year. Some of the 71,000 gross going offshore will have owned homes. But these people tend to be in the younger age group and will not be placing a property on the market.

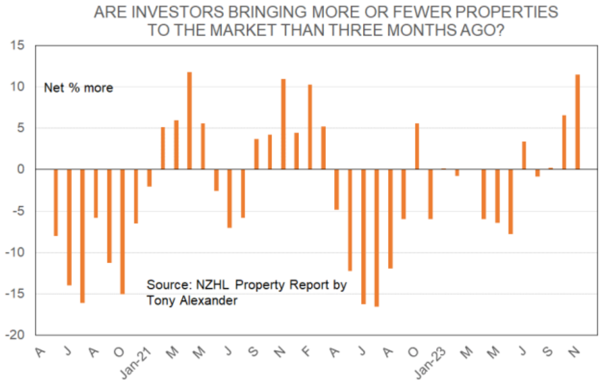


What about potential supply from existing homeowners? The thing to keep in mind here is that very few people selling a home do not also buy one. Therefore the net impact on the housing market will be small. However, this does not mean there are not times when a wave of selling can appear with people willing to then go renting for a while.

I can get a couple of selling gauges from the monthly survey of real estate agents I've been running for almost four years now, currently sponsored by NZHL. I ask agents if more people are coming forward to get appraisals of their existing property. A net 56% at the end of November said they were seeing more such requests.



As the graph shows this is a high reading. Therefore, we can probably anticipate still reasonable levels of listings in the first part of 2024. This conclusion is helped by the net 11% of agents saying that they are seeing more investors looking to sell. Again, the graph shows this reading is high.

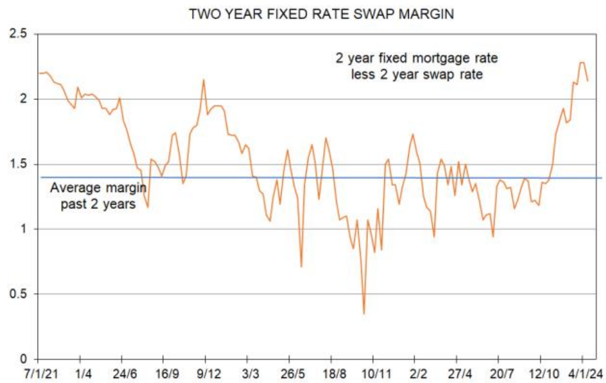


Now let's switch to the demand side of the housing equation. A big driver of housing demand this year will be falling interest rates. Don't for a second believe that we can reliably estimate when monetary policy starts easing let alone by how much the official cash rate will be cut. There are too many uncertainties in play regarding the strength of the economy this year and the speed with which inflation falls and the Reserve Bank develops concerns that it might be keeping policy too tight.

But it's actually worse than that for anyone wanting to be tricky and try to ride falling rates down in an optimal manner. Even if we knew exactly when the OCR would be cut and how rapidly we'd still struggle to accurately predict fixed mortgage rate declines. This is because these rates are heavily influenced by developments in monetary policy expectations in the United States.

Then, on top of that we cannot predict when banks will actually alter their fixed lending rates in response to falls in their funding costs. But this is where confidence regarding fixed rate falls early this year can be somewhat justified.

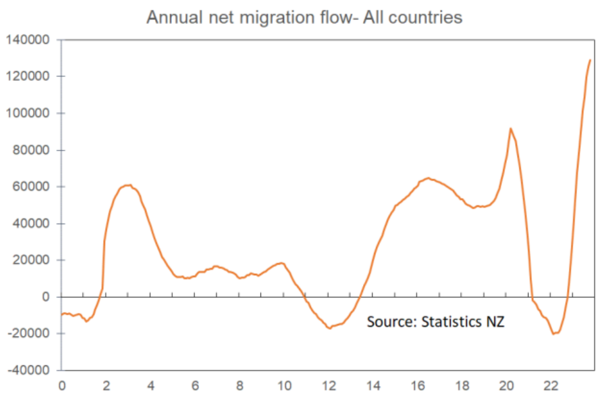
The following graph shows the margin between the wholesale cost to a New Zealand bank of borrowing money at a fixed rate for two years – the swap rate – and the best two year fixed rate being offered by the top lenders.



The margin is well above the average for the past two years. Scope exists for the two year rate to be cut perhaps 0.75% at the moment. But such a decline is fairly unlikely given that the Reserve Bank has almost certainly let banks know that it would not be happy if they reacted to the decline in swap rates by aggressively cutting rates just yet. They will need to see solid data regarding easing in wage pressures and business pricing intentions.

Regardless, the odds heavily favour fixed rates falling at an unpredictable and unsteady pace through 2024 and this will entice more people into the housing market.

A second substantial factor boosting housing demand is the record high net migration boom of 129,000 in the year to November. This gain is likely to ease – maybe even halve – over this year. But the boost to our population will nonetheless be strong and people need somewhere to live.

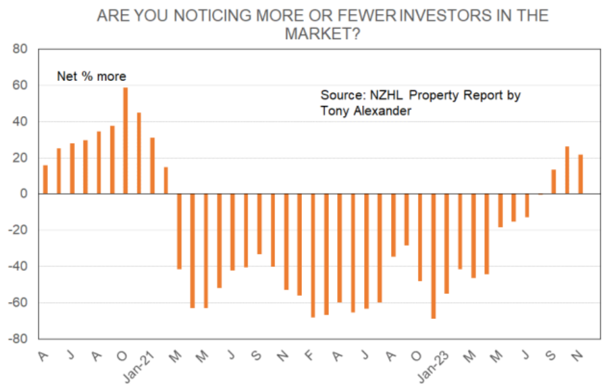


The pressures which will manifest themselves largely in the rental market will push up rents and encourage more people to become investors while also encouraging people to favour home ownership over renting.

A third demand factor in play this year will be the restoration of investors' ability to deduct 80% of their interest expenses from rental income for tax purposes from April 1. This is probably as good as the 100% coming in a year later for most investors and as the imposition of deductibility changes in March 2021 contributed to a substantial decline in investor buying we should anticipate higher demand as we advance through 2024 and as interest rates in particular decline.

We cannot predict when investors will really return in numbers but can note that some were already doing so well ahead of last year's general election.

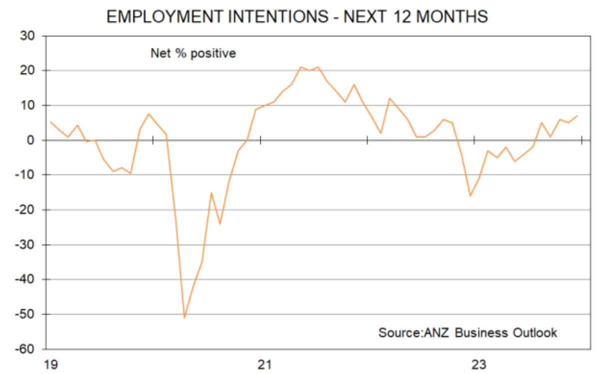
My most recent real estate agent survey with NZHL shows a net 22% of agents noticing more investors in the market. Again, the graph shows this reading to be relatively high.



The unemployment rate currently sits at 3.9% but looks set to approach 5% maybe late in the year as the labour market has a lagged response to very tight monetary policy over 2022 and 2023. While consumer confidence through the year is likely to gyrate upwards the widespread discussion about rising unemployment and the weak economic outlook will make many people cautious about committing to a home purchase.

Will this effect be large? I suspect not. While 2024 will involve business closures in many sectors as the many pressures of the past few years prove too much for some, the underlying concern of employers is insufficient staff numbers and choice – not happiness about an ability to easily pick and choose employees. Staff shortages exist alongside excesses in some sectors and employment opportunities are likely to remain strong.

In fact, in the ANZ's last Business Outlook Survey for 2023 a net 7% of businesses said that they plan hiring more people in the coming year. This was the strongest result since April 2022 and well up from a net 16% intending to lay people off at the end of 2022.



Jobs growth is likely to remain positive this year and improve over 2025 so the degree of house buyer despondency regarding ability to service a mortgage will likely be low.

These are the main factors in play. There are plenty of others but these are the ones likely to dominate and which lie behind my view of accelerating price rises on average. Again, as was noted for interest rates above, don't expect accuracy with regard to predictions of when house price inflation accelerates, let alone when this will happen for any particular part of the country.

But then this shouldn't matter really for most people given the time period over which almost everyone envisages holding a property for.

In case you missed it

Nothing these past three weeks.

If I were a borrower, what would I do?

At some stage this year the Reserve Bank will capitulate to the market view and positioning and signal that monetary policy will ease considerably before their latest predicted date of the first half of 2025. When they do that rates will rally a tad more than they already have and banks are likely to cut mortgage rates more than they are likely to have already done.

There is currently considerable scope for banks to cut their mortgage rates based on falls in wholesale borrowing costs. However, with the Reserve Bank making it clear late last year that they would not welcome a round of mortgage rate cuts the banks are likely to enjoy well above average margins for a considerable period of time, as discussed in this week's lead article.

For your guide, the cost to banks of borrowing money at one year fixed to lend one year fixed currently sits near 5.35% from 5.7% at the start of November. The best available one year fixed mortgage rate has gone up from 7.25% to 7.35% producing a margin blowout.

The three year swap rate banks pay has fallen to near 4.5% currently from 5.35% at the start of November and the best three year fixed mortgage rate has fallen from 6.85% to 6.75%.

The first review of monetary policy this year happens on February 28. That is well over a month from now and come that time we are likely to have extra data in hand showing inflation measures tracking in the right direction. However, the extent of inflation decline is unlikely to be enough to allow the Reserve Bank to bring forward their pick for policy easing. But at the review after that on April 10 some change is quite possible.

If I were borrowing at the moment I would either float and wait for lower rates or do what I tend not to favour because of the hassle and fix for just six months.

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.