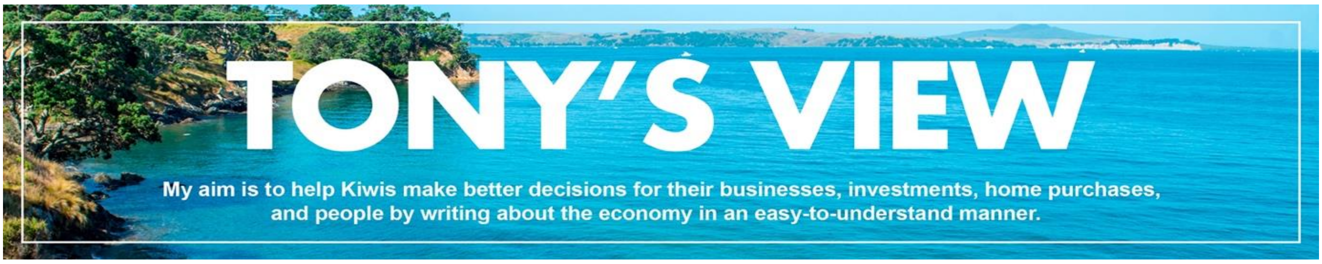

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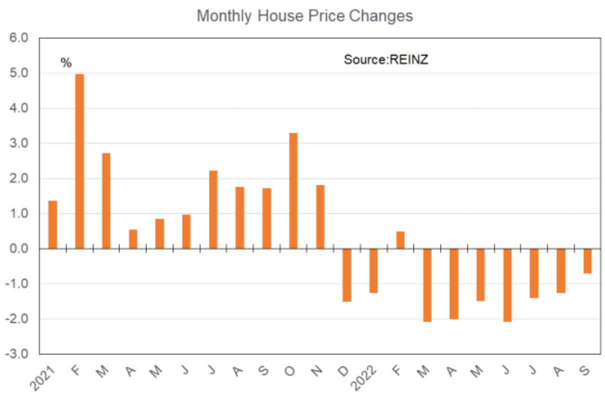
Endgame underway

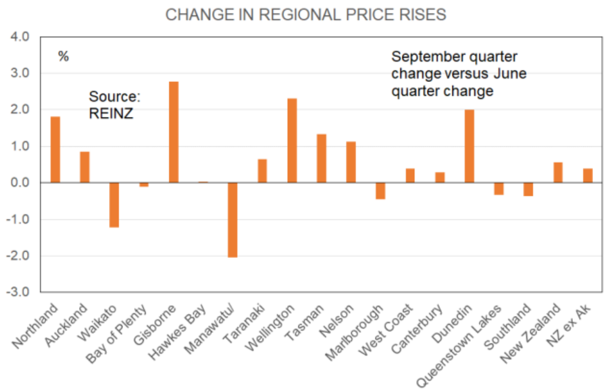
The REINZ released their monthly data this week on the state of the residential real estate market around New Zealand. Perhaps the most interesting result is confirmation of a slowing in the pace with which house prices are falling in New Zealand. On average in September according to the REINZ's House Price Index average house prices fell by just 0. 7% in the month.

This followed a fall of 1.3% in August, 1.4% in July, and 2.1% in June. Monthly changes are shown in the following graph. Note that we are still below the zero line, so no-one can claim that the downward phase of the cycle has ended and we are going up again.

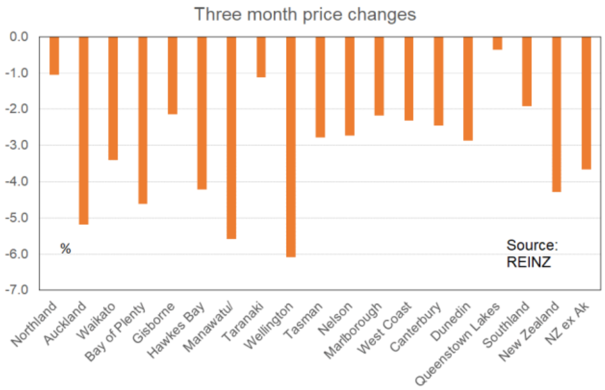


But as noted over two months ago, we are in the endgame for the period of a falling residential real estate market around the country and these latest data back up my survey results showing the return of first home buyers and reduced withdrawal of investors.

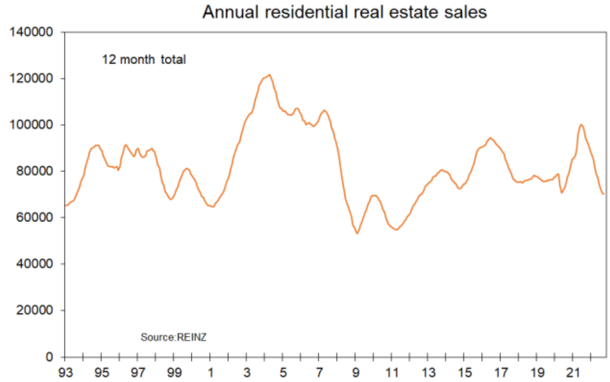
For the September quarter average NZ prices fell by 4.3% which was slightly better than the 4.8% fall over the June quarter. This means there was a 0.5% "improvement" in the nationwide price change. This data point is shown in the following graph on the far right side.



Most regions returned a better price change in the September quarter than the June quarter – shown as their orange bars being above the zero line. But some got worse, including Manawatu-Wanganui and Waikato. The actual September quarter price changes for each region are shown here. Prices have been going down in all regions recently.



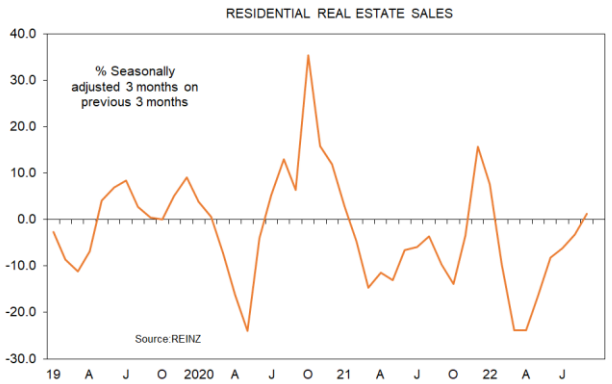
What about sales? Are they declining at a slowing pace also? At the nationwide level the answer is yes. The annual number of dwelling sales has fallen to just over 70,100 from 70,800 in August, 94,400 a year ago, and the frenzy peak of 100,100 in June last year.



In rough seasonally adjusted terms over the September quarter sales rose by 1.3% after falling 8.2% in the June quarter and 24% in the March quarter. The rolling three month s.a. change is shown in the following graph.

It shows the frenzy period of late-2020, the weakness from early-2021 as investors backed off and first home buyers wondered what was happening, then the latter group jumping back in for a while as listings numbers fell to record low levels and FOMO went back up.

Then the graph shows the weakness from early this year as the two key elements of the credit crunch hit in November and December and FOMO collapsed.

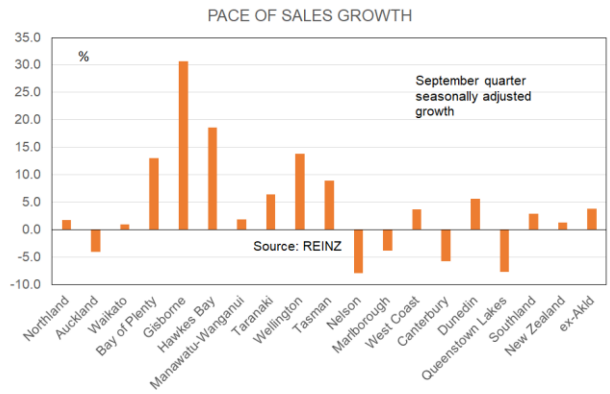


Now, as noted some three or so months back, the endgame is underway involving the pace of price declines slowing and now sales starting to recover slightly.

Personally, I wouldn't get too hung up on a view that sales will now trend upward. There are too many worrying factors in play including the war in Europe, upwardly biased interest rates, negative migration outflows, high cost of living increases, and talk of offshore recession.

But I'd be prepared to say that we are about near the bottom for month to month seasonally adjusted sales levels – and yes, that means the Spring effect is taken into account. That is what seasonally adjusted means.

Have sales risen on a seasonally adjusted basis in all regions? Almost, as shown here. The sales recovery is concentrated from Bay of Plenty down to the bottom of the North Island plus Tasman.



I could for the record run through data on the Days to Sell measure here. But I do not consider it all that useful when talking about turning points in the housing cycle so will give it a miss. Suffice to say, on average in September nationwide it took 47 days to sell a house compared with 37 a year earlier.

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.

Monetary policy

As more and more people with mortgages roll onto higher rates than the record or near-record ones they have been on, thoughts and discussion will do what they have done in the past when debt servicing costs go up. People will put forward suggestions for avoiding paying the new higher rates.

Some will suggest that higher inflation should be tolerated. That means they want the cost of living for average Kiwi families not to rise by 2% a year but by maybe 4%. That's hardly a positive outcome. Also, acceptance of higher inflation means savers will demand higher interest rates on average to compensate for the loss in purchasing power of their money.

Eventually interest rates go up because of higher inflation not because of an attempt to fight it and the discussion then starts again. Maybe 6% would be good.

Meanwhile higher inflation causes businesses to focus on price changes rather than product development and productivity growth (standard of living growth) suffers.

Some people will suggest borrowing in foreign currencies where interest rates are lower. We haven't heard much of that this time around because interest rates are rising sharply in other countries as well. Also, no offshore bank is going to lend money to you unless it can take your house as security and they won't be able to enforce that unless they have a presence here which means they would need a New Zealand banking licence and have to meet all the same rules and regulations imposed by the Reserve Bank as other banks – including the matching of NZ dollar lending with NZ dollar funding.

But maybe you could borrow offshore at a lower interest rate somehow. Doing so would entail taking a risk of higher repayments should the NZ dollar fall away as happened in the 1980s and cost many businesses accessing unhedged offshore funding their viability.

You could hedge the currency risk – but not very far in advance so any sustained currency weakness will still hit you. Plus, the cost of hedging is roughly the difference in interest rates here versus offshore. So, any borrowing cost gain is simply wiped out.

Aha you might say. The Kiwi dollar is currently very low and surely it must rise. Maybe. If you believe that then you'd be better off completely separating your mortgage and that view by simply dealing in foreign currencies. Good luck. As the casino managers in Las Vegas say to anyone who wants to come to their town with a system for winning. Welcome.

But let's say somehow you could beat the rise in interest rates through means other than the one I told you all about a year and a half ago – fixing for five years at 2.99%. What would then happen?

The aim of the Reserve Bank when raising interest rates is that mortgage rates go up and borrowers cut back on their spending. Caution rises on the part of those selling goods and services to these people and they tend to restrain their price rises even if costs have gone up.

If you find a way to subvert the impact of a higher official cash rate, then the Reserve Bank will simply have to find another way to screw household spending. Usually that will mean taking the official cash rate even higher. This is relevant if for instance banks do not pass on higher wholesale funding costs into their mortgage rates. The Reserve Bank will hit them with even higher cash rates until they do.

Ultimately, the gauge of monetary policy tightness is not the official cash rate but the average level of new mortgage rates.

Are their alternatives to raising interest rates to crunch our spending, scare us into our shells, and get inflation down? No options are realistic. Changing tax rates would do it. But those rates are set by politicians and history tells us that these people take the election cycle into account when setting monetary policy and the outcome is higher inflation and higher interest rates along with lower economic growth.

Over the past three decades when I have written sentences like that I have almost always added in a comment about higher volatility in the economy. But the very poor performance of our central bank in implementing monetary policy since 2004 has directly driven enhanced volatility in our economy, incomes etc. They have become as bad as the politicians of the 1970s.

What about giving the Reserve Bank the power to control tax rates or some other special levy hitting all people? The trouble there is that pure logic dictates that you apply such a special monetary policy tax to the people who have the greatest marginal propensity to consume from higher (and lower) income. That is those on low and middle incomes. What government is going to give the power to slam such people to an unelected body?

There's probably some constitutional problem in there as well which lies outside my sphere of knowledge.

The best weapon of all is one which perhaps only truly used to work well in Germany before the deutschemark was replaced by the Euro. The strong historical memory held by Germans of the way wealth was wiped out by high inflation between the wars meant that community support for keeping inflation low was always high. A warning from the Bundesbank regarding rising inflation risks would garner a response from business and union groups around wage and price restraint.

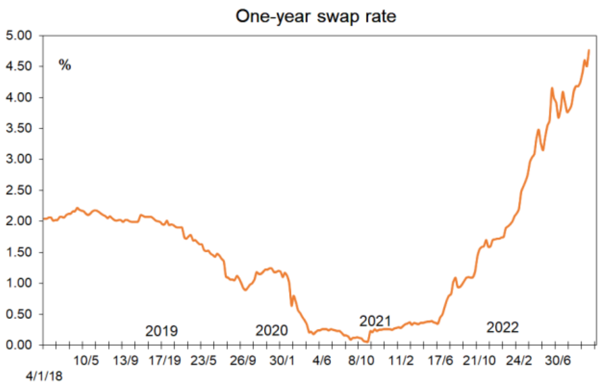
Here in New Zealand, we don't have such strong antipathy towards inflation – though that may be growing. But the Reserve Bank can nonetheless achieve some policy tightening with words of warning rather than actual rate rises if those warnings are harsh enough. This is a weapon not used by our central bank from 2004 to 2007 and the cost was them having to throw our economy into recession in 2008 to combat inflation they let get out of hand.

This time around the weapon of scary words has been better used – but not to a great degree. In fact, the most recent comments about policy risk from the RB Governor were about things being on track and it being okay that fixed rates looked like they might have peaked in June.

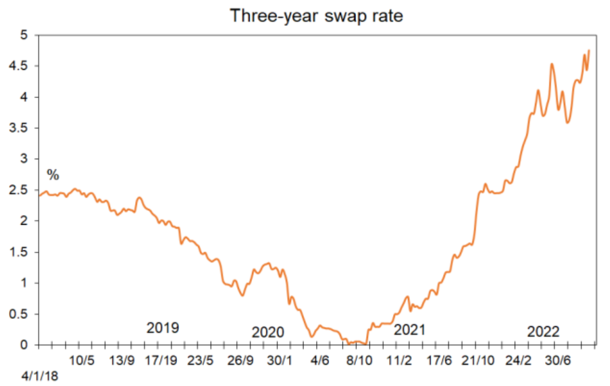
Given those comments yet the extra jump in bank borrowing costs now occurring because of developments offshore, new scary comments from our central bank are unlikely.

With regard to developments over the past week, its all bad news for borrowers. Deep concerns remain about inflation and monetary policy tightening in the United States. Oil prices have been pushed higher by OPEC's decision to cut daily output 2 million barrels. Interest rates have gone back up again in the UK amidst renewed worries about the deficit blowout initiated by the new PM and Chancellor.

The cost to banks in NZ of borrowing wholesale money at a fixed rate for one year to lend to you and I has risen to 4.76% from 4.5% last week and 4.25% a month ago.



The three year cost of money has risen to 4.75% from 4.43% last week and 4.23% a month back.



The current environment remains one of very high uncertainty – making me even happier with my decision a couple of months ago to remove my table of forecasts for the one-year swap rate and implied one year mortgage rate.

If I were a borrower, what would I do?

The more interest rates rise now the greater the speed with which they will decline somewhere down the track. I'd be willing to stay fixed one year but might have some of my debt at a two year fixed rate as well.

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