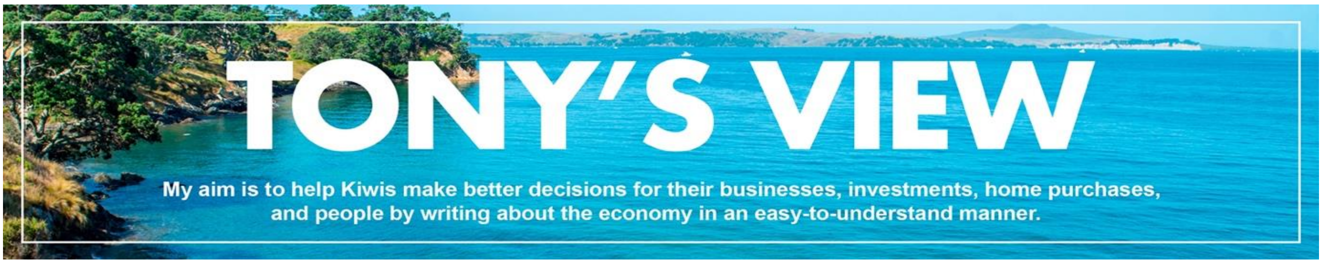

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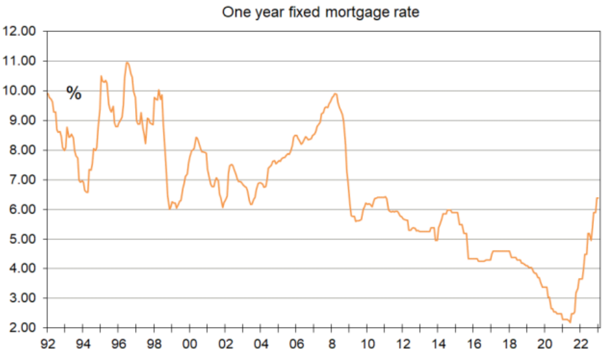
First home buyers return

Earlier this week I distributed the results of my latest monthly survey of mortgage advisers around the country undertaken with the sponsorship of mortgages.co.nz The writeup is available at the following link for those who missed it.
mortgages.co.nz & Tony Alexander Mortgage Advisers Survey - February 2023 - mortgages.co.nz

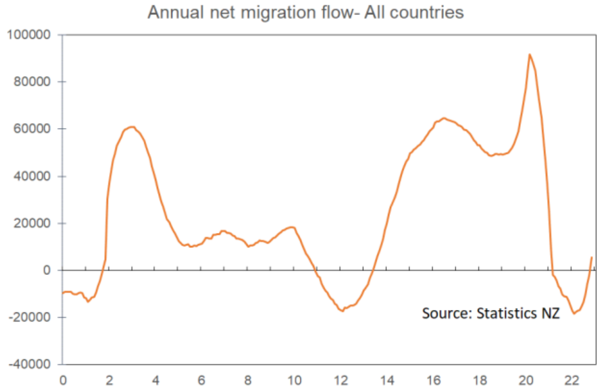
There were some significant results from the survey which continue themes appearing in my other monthly surveys recently and they are worth emphasising here. There is a strong tendency for the general public not to realise the ground is shifting under them until the more skilled operators have already taken advantage of the situation. That could be what is happening in the residential real estate market at the moment and I will explore that here.

Let's start by looking at the role being played by first home buyers. The excellent monthly data provided by CoreLogic tell us that first home buyers usually account for close to 21% of house sales in New Zealand and that proportion has recently been at a record high above 25%.

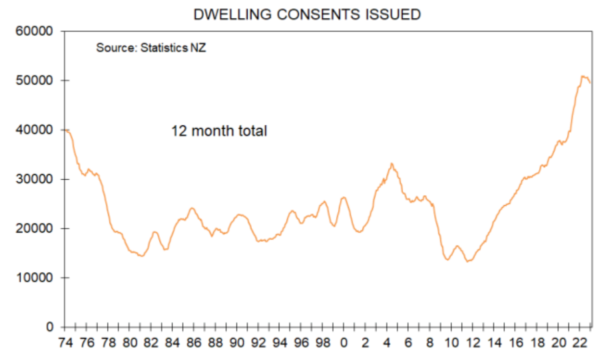
First home buyers have been struggling to gain entry into the housing market in the post-GFC era which has seen many people become investors or expand their asset holdings because of the sharp declines in interest rates.



As well we saw a strong incentive to buy property provided by the migration-driven surge in population from 2014 – 2019.



On top of that we saw new house construction as represented by annual consent numbers fall to the lowest level since the 1960s in 2011.

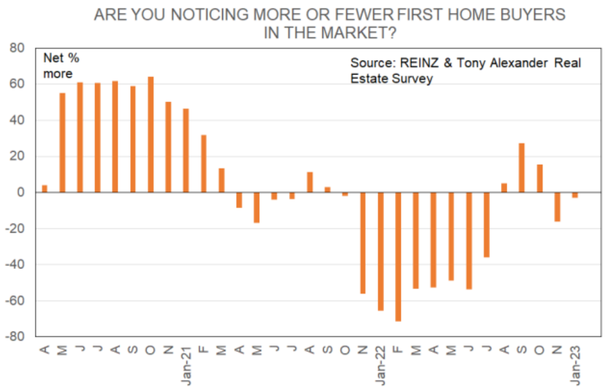


These three special factors combined to drive intense interest in the housing market, a 12-year rise in construction soon to unwind, and the surprisingly quick and extremely strong surge in house buying and prices once we all got over the initial shock of the first lockdown in March – May 2020.

Young people want to buy and apart from those who bought near the November 2021 peak in prices have seen nothing other than woe for those who reckoned renting was a better bet and holding off for the much-predicted price falls was a good idea. That period of payoff for those who did take that approach in 2021-22 is now coming to an end. The endgame for the period of falling prices is once again underway having been interrupted for over three months by the higher than expected 7.2% inflation rate announced on October 18.

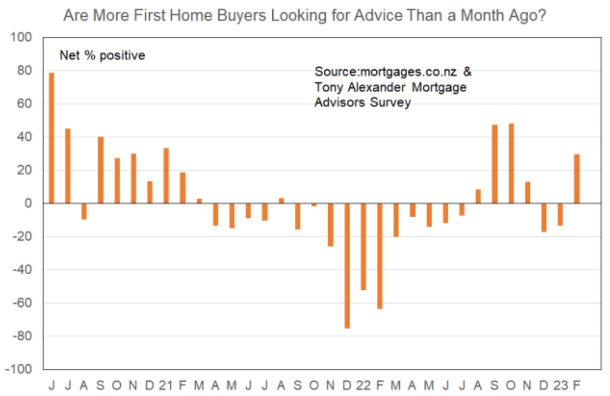
The impact of that event was greatly magnified by the Reserve Bank's record 0.75% official cash rate rise of November 23, prediction of recession, and raising of their forecast OCR peak from 4.1% to 5.5%.

As a result of the October 18 and November 23 events buyers newly ran back into the hills. Just before mid-October a net 27% of real estate agents responding in my monthly survey alongside REINZ said that they were seeing more first home buyers. That result eased to +15% come the end of October then -16% at the end of November.



However, my survey two weeks ago showed only a net 3% of agents now seeing fewer first home buyers.

More stark and more up to date are the results from my monthly survey of mortgage advisers. In mid-October a high net 48% of brokers were seeing more first home buyers. That weakened to just 13% in mid-November then -17% mid-December and -13% mid-January.



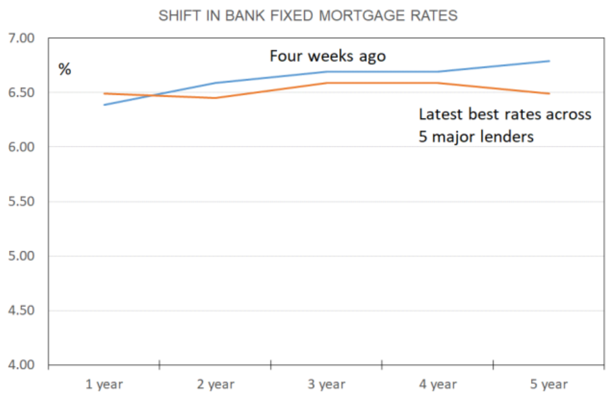
Now a net 30% of advisers say that the first home buyers are back. This is not as strong as the mid-October result but the change is substantial.

Why are first home buyers coming back?

As discussed above, these are very frustrated and very concerned people. They have never made a home purchase before, want to get on with their lives, fear insufficient wealth growth for retirement discussed in academic studies, know making an offer can involved substantial expense, know that credit has become harder to access, and know from experience that prices can run upward very quickly.

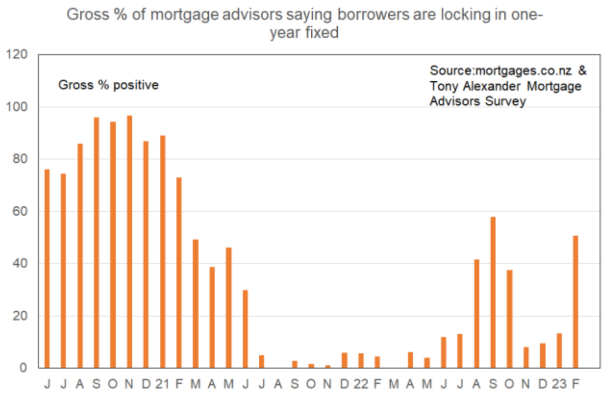
They are biased towards making a purchase when they can and impediments to doing so are being removed.

First, views on interest rates are shifting away from the horror scenarios fed to people by the media from November 23. Banks have been cutting the two year and beyond fixed rates recently. Articles have appeared containing reduced predictions for further rises in the official cash rate.

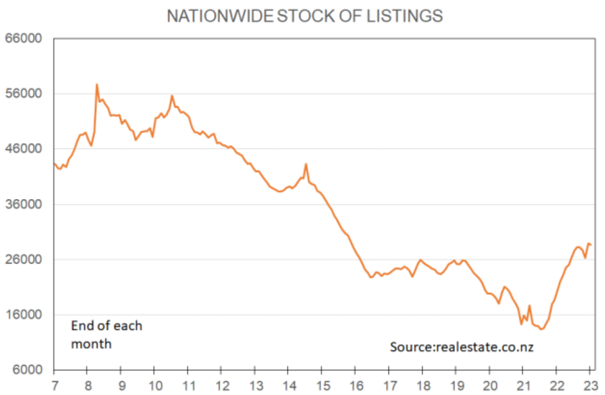


Fears of crushing interest rates are fading and expectations of falls are growing. That explains why my latest survey of advisers shows 51% of advisers saying borrowers prefer fixing only one year as compared with just 13% four weeks back.

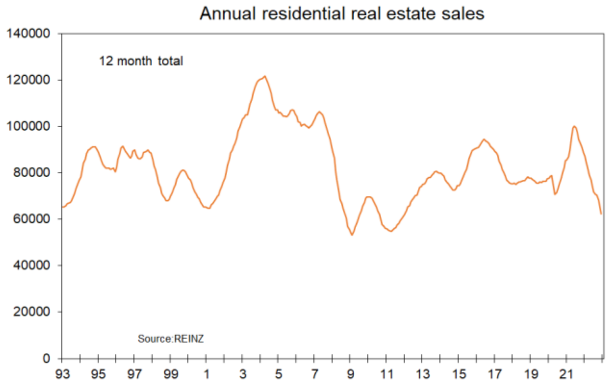
The preference for two years has fallen from 78% to 46%.



Second, we are in the best environment for a generation when young people can make a purchase and not face intense competition from investors. Few people are attending open homes let alone auctions. There has also been a strong lift in the number of properties listed as available for purchase from only 13,500 in mid-2021 to over 28,000 at the end of January according to data from realestate.co.nz

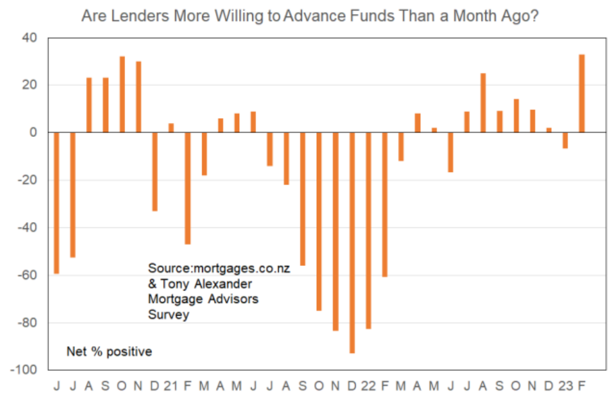


Third, banks are not meeting their sales targets now that dwelling sales are falling away. They have solidly pulled back from financing new developments and need to find business to offset that lost revenue which has been a good source of profit growth since 2012.



Banks are easing up their lending criteria and my mortgage adviser survey is the only measure available in New Zealand showing this happening.

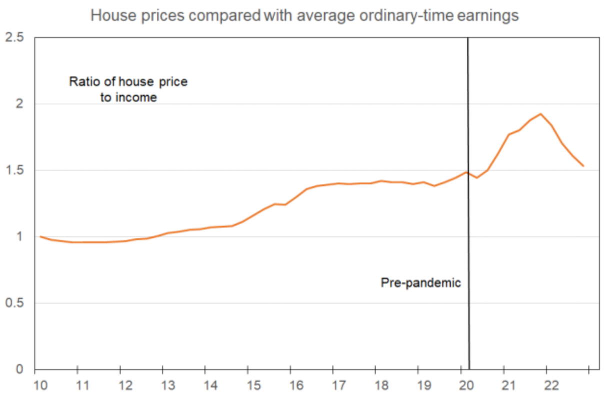
A record net 33% of mortgage advisers have said that they seeing banks becoming more willing to lend. In mid-January a net 7% were seeing things tightening up.



Fourth, it is politically correct to believe in New Zealand that real wages are falling, everyone is getting poorer, and we're all stuffed. This has been the case since the legitimate challenges of the 1970s but is now pushed as a matter of policy by much of the media.

But with a highly deregulated labour market New Zealand has seen a strong and logical response of average wages to the tight conditions in the labour market.

Since the March quarter of 2020 while average house prices have risen by 20% and the Consumers Price Index has gained 14%, average hourly ordinary time earnings have gone up by 16%. Wages growth has exceeded CPI growth and the 15% pullback in prices since late-November means the ratio of prices to wages is almost back to where it was immediately pre-pandemic.



Affordability as measured by ability of income to meet mortgage repayments at current interest rates plus a stress test margin is worse than average. But as measured by house price versus income things are now essentially back where they were three years ago.

This is the third time we have seen a unilateral move of first home buyers back into the residential real estate market in three years. The first head of the pack event happened in the waning weeks of the first nationwide lockdown. The second happened in the September quarter of last year.

This time around the chances are good that the surge won't fade away like last year. But this surge also won't be a repeat of what happened in 2020 when FOMO went through the roof in an extraordinary buying frenzy. Lending rules are much tighter than back then (when LVRs were removed) and interest rates are some 3%+ higher.

Now what?

So, the first home buyers are back. What happens next? Some investors will follow just as they did the previous two times. But again, this won't be a repeat of the 2020-21 free for all - especially given the tight LVR rules for investors (40% deposit) and tax changes. But therein lies a growing fear which first home buyers may have. If National win this October's general election the return of interest expense deductibility for investors will lead to higher demand from them.

But even if they don't win the anticipation of falling debt servicing costs and the fact most investors plan a very long-term hold for their property means we could easily see a lift in investor buying pre-election.

For your guide, because it has not yet entered popular consciousness I have not mentioned the surprisingly quick turnaround in net migration flows. But that price-stimulating impact is set to grow in strength through 2023.

Also, as outlined in last week's commentary, it is not certain that the country will enter recession this year. Scaling back soon of official predictions for where the unemployment rate is headed will start to reduce fears of job loss and expectations of further price declines.

These are early days yet for buyers pulling back from the shocked state they were pushed into by the events of October 18 and November 23. And history tells us that we have no hope of predicting what average house prices will do over the coming month let along the next one, two, or five years.

But the tide is turning and I will be intensely watching new insights which I get every week from my surveys. But something I'll be paying special attention to in the next few months is changes in the stock of properties listed for sale. My belief is that the fall in listings to a record low in the middle of 2021 accounted for the surprising extra 11% rise in prices back then towards the November 2021 peak.

There is a sensitivity out there to talk of listings shortages. If such talk returns, then we will see my FOMO gauge going back up and the window of opportunity for first home buyers to purchase will close.

If I were a borrower, what would I do?

Personally I would not fix longer than one year. Inflation is surprising on the high side again in the United States and bank funding costs here have increased quite a bit in the past fortnight. Scope for new cuts in NZ fixed mortgage rates in the near future are now very low. The track down for rates will be slow this year and through 2024 but I would be prepared to fix one year and look to refix 12 months down the track to take advantage of falls which are likely to occur.

As regards the impact of the cyclone and Auckland flooding, there is in the short term a depressing impact on growth. But inflation will get lifted from supply chain and production interruptions, and then get upwardly biased again as reconstruction kicks in. Therefore, while the Reserve Bank will discuss the weather events and their impact at the rate review next Wednesday, they will remain strongly focussed on the hard task still remaining of getting inflation back towards 2%.

A repeat of the 0.5% official cash rate cut which immediately followed the Christchurch earthquake of 2011 should not be expected.

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.