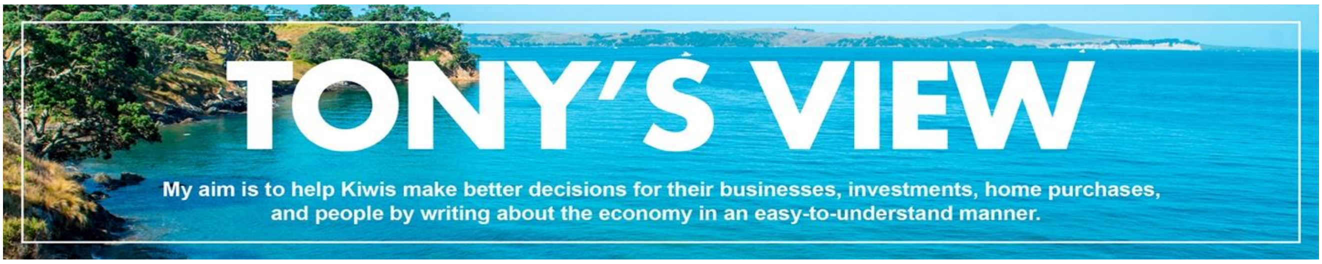


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# My housing summary

I've been making a number of presentations to the likes of mortgage brokers and real estate agents this month and the key things I've been outlining to them include the following. First, some history.

Following the Global Financial Crisis inflation rates around the world failed to lift as had been expected. The result was that interest rates stayed low and in the case of New Zealand got cut after short-lived increases in 2010 and 2014-15.

By 2019 deep worries about global deflation developed and our Reserve Bank responded by cutting the official cash rate to a record low of 1%. The low during the GFC had been 2.5%.

Record low mortgage rates towards the end of 2019 plus a net migration boom averaging 55,000 a year from 2014-19 meant that the housing market gathered fresh steam after cooling down to varying degrees over the previous 2-3 years. Thus, when Covid-19 came along strength in the housing market was at the front of everyone's minds.

As we initially worried about the pandemic's effects predictions were made and expectations built of rapidly falling house prices and house construction, soaring unemployment, and the economy taking 3-4 years to get as big as it was at the end of 2019.

House prices did fall, but only by 3% over the April – May 2020 period. They then soared 46% to the nationwide peak in November 2022.

Prices soared because the Reserve Bank adopted what they called a "least regrets" policy. They said they would deliberately take the risk of easing monetary policy too much and eventually over-stimulating the economy and inflation because that was better than not easing enough and locking in the downward deflationary spiral gripping people's minds as we entered the pandemic.

The cash rate was cut to 0.25%, LVRs were removed for almost a year, and money was eventually printed/injected into the financial system.

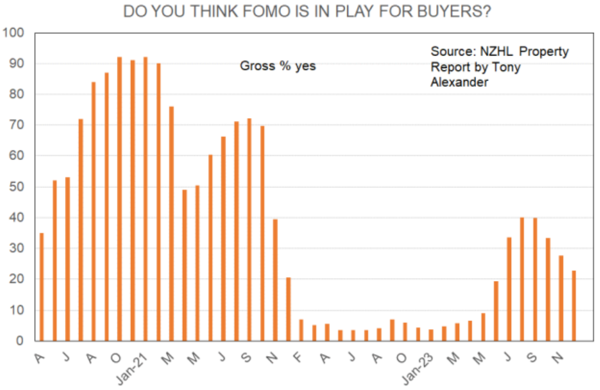
Cheap money struck a populace keen for housing exposure and extra purchasing assistance came from the wage subsidy scheme limiting the unemployment rate rise from the pre-pandemic 4% to only 5.3%.

As house prices soared and concerns about affordability for young buyers grew the Finance Minister late in November 2020 asked the Reserve Bank if they could help. They said politely "bugger off, it's not our job" – to paraphrase.

The response from the Finance Minister came in March with rule changes to progressively remove the ability of residential property owners to deduct interest expenses when calculating their tax obligations from rental earnings.

This tax change came at the same time as LVRs were restored and then strengthened for investors. The first half of 2021 also saw net migration flows turn negative, and anticipation of monetary policy eventually tightening produced rising fixed mortgage rates from the middle of the year.

But despite these negative developments the housing market only paused slightly and then took off again in the September quarter. Two factors may explain the likes of the late-2021 surge in FOMO seen in this graph.

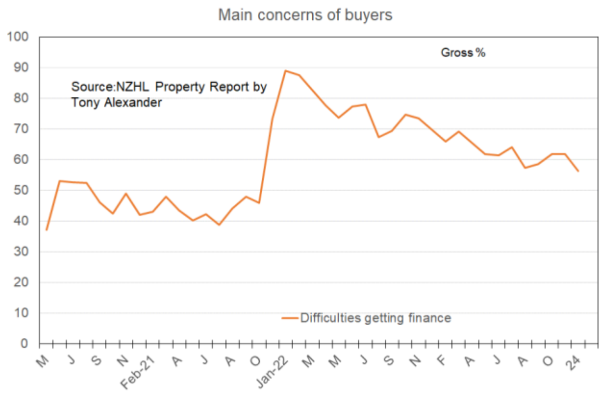



First, the stock of property listings fell to levels 73% down from a decade earlier at fewer than 13,500 listings. Second, some buyers rushed to purchase property ahead of changes planned to start for the Credit Contracts and Consumer Finance Act effective from December 1.



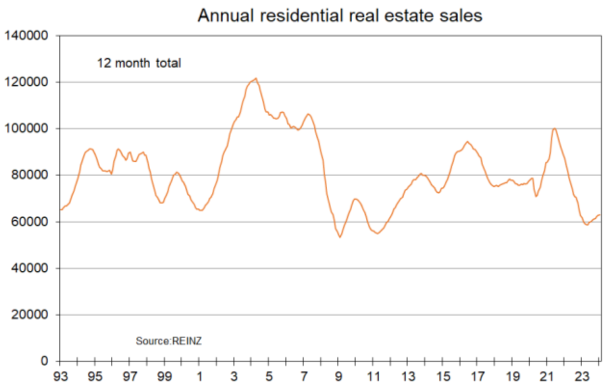
But this FOMO surge was the last desperate charge of an absurd period of house price rises. In November LVRs were tightened so banks could not have more than 10% of new lending with deposits less than 20% of the property prices. This led to widespread cancellation of existing finance preapprovals. Then in December the CCCFA changes were made.

These two bouts of credit tightening caused a large credit crunch which took frenzied and "normal" buyers out of the housing market while making consumer applications for a new loan or credit card a nightmare.

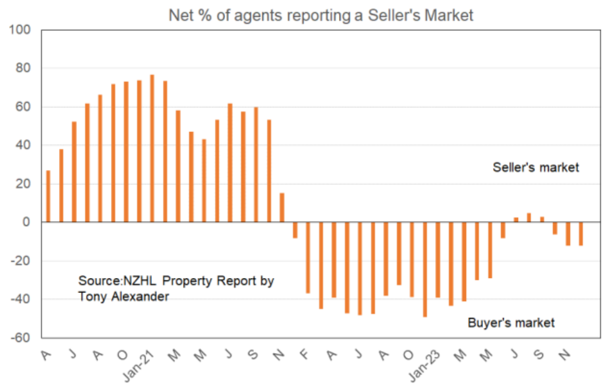





The result was a fall in average house prices of about 18% through to the middle of last year and decline in annual dwelling sales from the peak of 100,000 in the middle of 2021 to a low of 58,600 in April last year.




FOMO collapsed as seen in the earlier graph here. A strong buyers market immediately appeared as shown here.




The next change of significance came early in 2023. Young buyers began moving back into the housing market attracted by lower prices. They faced virtually no competition from investors, listings come the end of 2022 had risen above 28,000, the CCCFA rules got slightly tweaked, and with the unemployment rate at 3.4% feelings of job security were good. Strong incomes growth and larger deposits built up during the pandemic would also have helped.

The increased buying by young buyers was enough come the middle of the year for prices to start rising. So far, they have increased an average 4.1%. But the underlying pace has slowed down and the strong surge in sales during the June quarter has not been sustained.

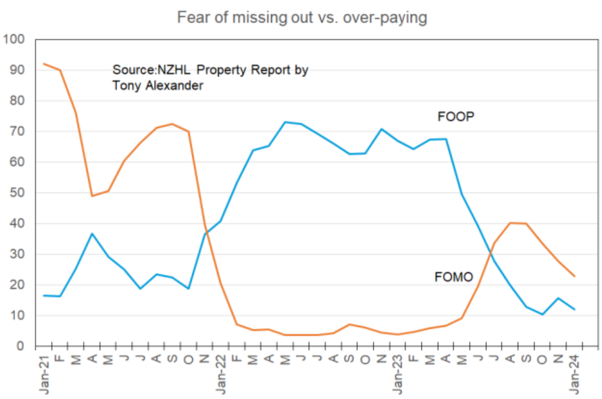


Things have flattened out for how and become somewhat patchy. Why has the upward momentum stalled for now? One reason is that investors have not joined in the buying recovery. With soaring costs for the expense of owning an investment property – especially mortgage financing, council rates, maintenance and insurance – the numbers simply don't stack up and the upward house price momentum is not "exciting" enough for these concerns to be pushed to the side.

Related to hesitancy of investors to buy despite the coming easing of interest expense deductibility rules, would have been the general election in mid-October and then the protracted coalition negotiations afterwards. By the time they were concluded people may well have decided to switch off and go on holiday. If so, then maybe some are returning to the market this month. We shall see.

Another restraining factor for the continuation of the mid-2023 upturn will have been rises in bank fixed mortgage rates through to mid-November despite the absence of a monetary policy change since May.

My survey of real estate agents sponsored by NZHL tells us that while FOMO has eased off FOOP – fear of over-paying – has remained low. People don't expect price falls, but they also don't feel there is much need to hurry up and make a property purchase.




But as we progress through this year and 2025 these four factors – discussed here previously – will be recognised and become effective in eliciting that feeling of haste – FOMO.

### Falling house construction

The annual number of consents issued for the construction of new dwellings has fallen from a record 51,000 in May last year to just over 37,000 now. Consents in the past three months were 27%

lower than a year earlier and we may finish this year below 32,000.



At some stage people will figure out the price and purchase choice implications of falling house construction and the growing list of construction businesses collapsing. Talk of shortages will arise one day and as we all learnt during the pandemic, if we think something may be in short supply we rush to stock up on it as soon as we can. This FOMO surge will propel the property market forward, especially when people ask themselves what is happening with housing demand at a time of falling growth in supply. To whit…

**Strong population growth**

Courtesy of a net migration inflow of 126,000 in 2023 New Zealand's rate of annual population growth has lifted to just under 3%. The long-term average is about 1.2%.

The extra 145,000 or so people in the economy need 50,000 houses to live in. Add in 15,000 houses needed just to replace deteriorating housing stock and we need consent numbers approaching 65,000. Let's say 60,000.

But only two-thirds of that number will have been built last year if we use an 80% completion from consent rate.

The net migration gain this year is likely to be well down on last year's 126,000 people. But even if things weaken to the average of 55,000 experienced from 2014 – 2019 it will be touch and go if enough houses get built.

**Investor tax rule changes**

The return of ability to deduct 80% of interest expenses from rental income after April 1 this year and 100% a year after that will bring investors back into the property market and discourage some from selling. But initially the flow will likely be on the small size because the numbers to make a profit look tight. The true return of investors may have to wait until this fourth substantial factor starts kicking in.

**Falling interest rates**

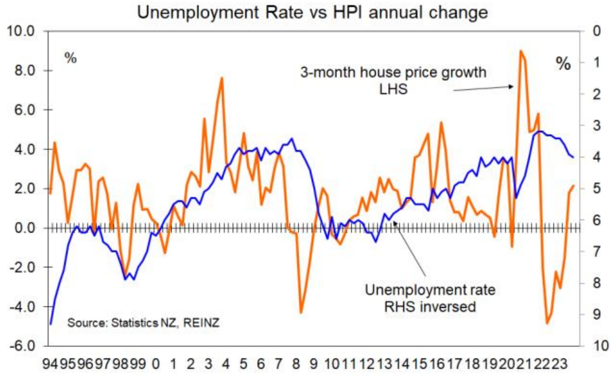
At some stage, probably before the end of the year, the Reserve Bank will start cutting the official cash rate. The resulting fall in actual borrowing costs and associated expectations of further declines will bring extra buyers into the housing market and discourage some sellers.

We can't really know when rates start falling and the speed they will decline at. But when the falls happen possibly the final condition for a strong upturn in the housing market will have been met and the various factors will feed on each other upward.



One other factor worth mentioning is that at some stage there will be further tweaking or rewriting of the CCCFA regulations. But we don't know when. Also, in the middle of the year when Debt to Income rules commence, LVRs will be eased.

What about rising unemployment? This will have a calming effect in some quarters. But the correlation between the unemployment rate and house price inflation is not good, as shown here.




Overall, New Zealand's housing sales and price cycles hit their lows in the middle of last year. Construction will probably reach its low next year. Buyers for the moment feel little need to hurry, especially with interest rates at high levels. But at some stage the factors discussed here will coalesce to produce a firm pace of price rises.

If you think any of us have the ability to pick exactly when the market will hit its straps you're dreaming.

Just one extra thing to note. I am hearing that banks are discounting fixed rates below their advertised rates to a greater extent than has been the case for a while.

## In case you missed it

My monthly survey of mortgage brokers with mortgages.co.nz showed the following main things.

- While first home buyers are active others and particularly investors remain cautious.
- Banks are slowly easing their lending criteria still but not overly competing for business in general.
- Some buyers are awaiting much greater clarity on how the debt to income (DTI) regime will work and where interest rates are headed. New confusion has appeared in this space.

mortgages.co.nz & Tony Alexander Mortgage Advisers Survey - February 2024 - mortgages.co.nz

## If I were a borrower, what would I do?

Rates edged up a bit this week, but the moves were nothing major. Markets are largely on hold to see if the review of NZ monetary policy next week justifies the 30 point jump in swap rates a couple of weeks ago.

If I were borrowing at the moment I would probably take a mix of 6 and 12 month rates.

**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.**