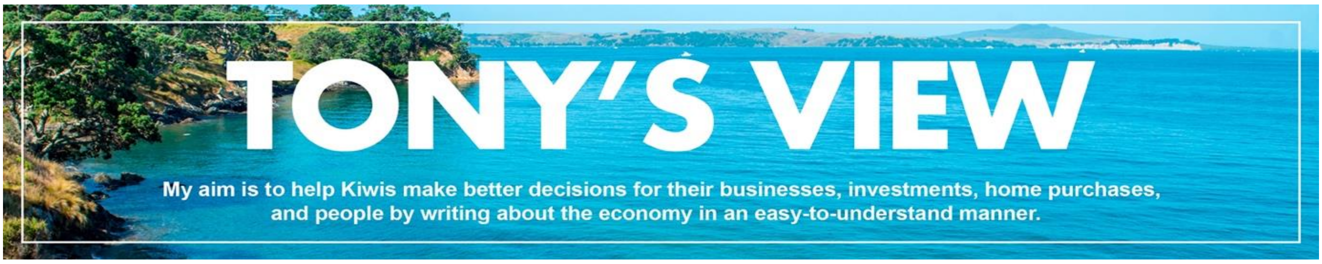

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Is it a good time to buy a house?

This past week I have had two journalists call up with the same question. Do I think it is a good time to buy a house? The question is actually fairly silly and to understand why try answering this question instead. Is now a good time to eat a cake?

That all depends on many things. Are you trying to gain weight? If so, then eat away. Are you celebrating something like a birthday? Chomp down. Are you trying to fit into your old clothes? Do you have a date coming up? Are you diabetic? Are you hungry?

There is no single answer. It all depends on what your position, plans, and desires are and the same goes for house buying. Who exactly am I supposed to be answering the question for? Not myself that's for sure because the last thing I need is another house to maintain and if you're buying and selling in the same market then the cycle doesn't really matter.

I default to assuming that we are not talking about an investor but about a young first home buyer who has a deposit saved up and meets current bank lending rules. Most other people would also default to such an assumption – but that is where the biggest divergence between me and them may emerge. People are basically taught from the time they can read a newspaper to thinking about housing in terms of price movements.

They learn that buying before prices go up is a good thing. We like good things. They learn that buying before prices fall is a bad thing. We try to avoid bad things.

The vast majority of people seeing a question regarding whether it is a good time to buy a house, default to thinking it is a question about where prices are expected to go.

But I've bought a small number of houses over my years (all for family reasons, not one as an investment) and apart from the first one bought in September 1987 when gripped by FOMO fresh upon returning to NZ specifically to make a purchase, I never gave a single thought to where the price cycle was at for the others.

I had no view on whether prices were going up or down and instead just focussed on the family-related need which I was looking to fulfil. My intended term for holding the property was always very long, and I only once gave thought to what my return might be if I treated it like an investment.

I would suggest first home buyers adopt the same approach. You are buying something in which you probably intend raising a family. You are buying something which historically in New Zealand has risen in price by about 7% per annum on average. Whatever happens in the next 2-3 years it is very unlikely that you will be selling and realising a loss – though if you do then your deposit could be wiped out and that may be the case for some unfortunate people "having" to sell now and in the near future who made their purchase last year.

If you bought your first home last year with the plan to sell this year – what were you thinking?

My advice to first home buyers is to recognise these specific things about the current state of the housing market and changes I see coming up. I don't have a view on how much prices are going to change in the next one, two, or five years, although over ten years and longer I expect average gains of perhaps 5% a year or thereabouts.

Would I buy a house at the moment if the family-related factors which drove me in the past came around again? Yes. I'd not try to pick the bottom in prices.

Interest rate levels

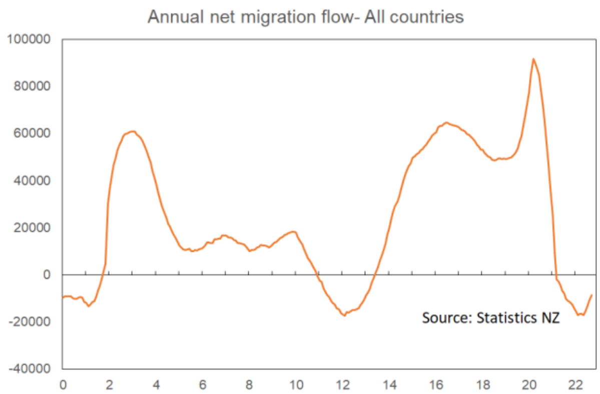
Interest rate levels and expectations for where they are going traditionally have a big impact on housing markets. Rates have just risen, and some buyers have been scared back. More will be scared off now in coming months as a result of the small extra rises in rates to come because of yesterday's 0.75% rise in the official cash rate to 4.25% and the expressions of concern about inflation made by the Reserve Bank.

But eventually monetary policy will gain traction. When the consensus view shifts to people believing interest rates have peaked they will see what their worst case debt-servicing scenario is and the solidity they gain will bring some back into the market. When rates are widely seen as likely to fall, the backlog of buyers which has been building up for a long period of time will become active – investors particularly although some are currently selling as rates rise.

We are not there yet for people feeling that interest rates are peaking. So, if I were to buy at the moment, I would feel that time is on my side to pick and choose. But I'd also want to be aware that the greater the restraint in coming months the greater the price recovery down the track.

Net migration flows

We are unlikely to see a return to the boom net migration inflow period of 2015-19 for quite some time. But the net flow numbers are coming in less bad than I expected even as many Kiwis are going offshore.



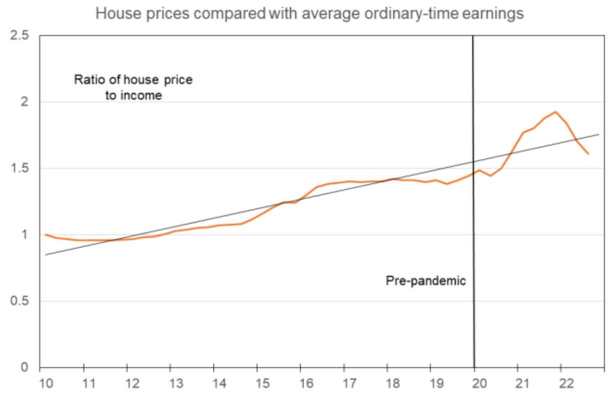
At some stage maybe late next year the general discussion will shift towards talk of net gains and an accelerating population growth rate, especially in the cities. When that happens people will do what they did when we convinced ourselves one million Kiwis would come back to New Zealand during the pandemic because we handled things so fantastically – for the initial part of the outbreak. They will look to buy property before others do.

Positive net migration inflows tend to be positive for NZ house prices.

Over-priced?

A key point I made in one of my articles last week was that people are probably not aware of what is happening with the ratio of house prices to household incomes. Everyone believes that houses are aggressively over-priced because of the pandemic effect, and they certainly were. But whereas late last year the ratio of prices to incomes was 30% above its level just before the pandemic started, now the ratio is only 8% higher.

Moreover, if you allow for the long-term tendency for the ratio to go up, then prices right now are below where the trend would suggest they "should" be.



For the moment this sort of calculation counts for little when taking interest rate hikes into account. But as each month goes by and people run their calculations, they will realise their household income will finance them into a property which a year or two before they could not attain.

Total earnings of households from wage and salary sources including overtime and extra jobs have risen by 10.4% this past year.

We have no way of knowing when this occurs or when this effect will become dominant. But I suspect it is already in play for some young buyers and couched in terms of prices having fallen quite a bit and things generally looking less horribly over-valued than before.

Bank lending rules

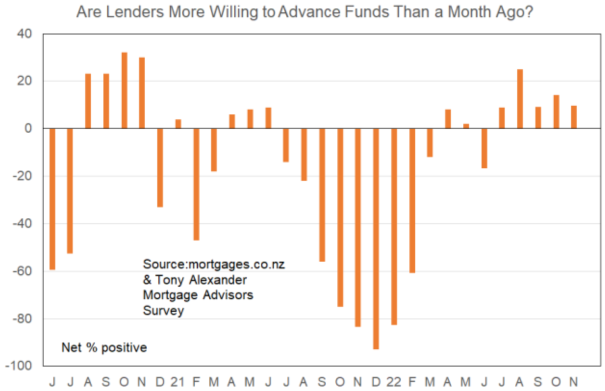
At some stage the Reserve Bank is going to ease up on the requirement from November last year that a maximum of 10% of new lending can be with low deposits.

As each month goes by the banks get more comfortable with the strictures of the CCCFA effective from December 1 last year – some of which were eased up from early July this year.

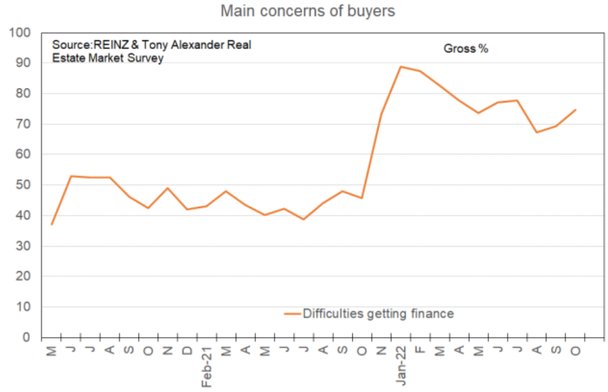
The passage of each month and the existence of quite low lending volumes caused by low real estate turnover will bring more and more concern from banks about meeting sales/profit targets. Additional easing of lending criteria will occur.

Add in the improvement in accessing government assistance and we are on a track now of slowly improving lending criteria.

I can measure this slow improvement in the responses to my monthly survey of mortgage advisers with mortgages.co.nz



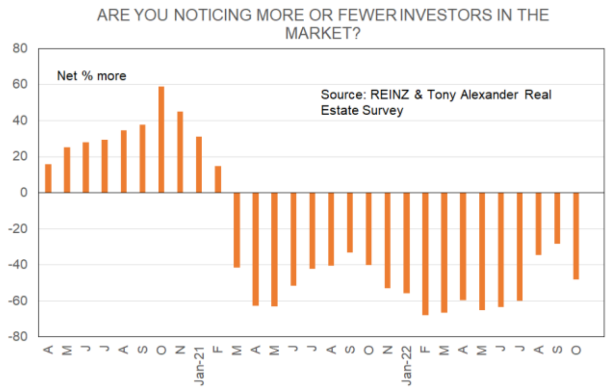
But borrowers are not themselves feeling this easing in criteria as yet. They remain worried about credit availability – though a small improving trend is in place. Too small to get excited about however.



General election effect

It seems reasonable to expect that ahead of the general election late next year people will exercise caution about big spending decisions. But if the polls suggest a National-dominated government then investors will start buying before then in anticipation of regaining their ability to deduct interest costs from their rental streams when calculating taxable incomes.

For now, the investors are hiding in the hills.



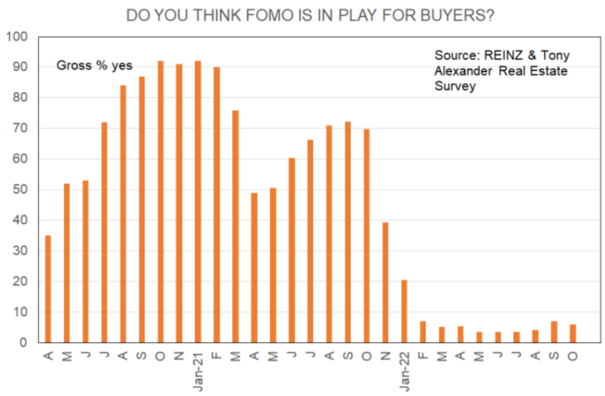
Recession talk

Plenty of people are out there scaring the chooks with stories of an upcoming recession. If you

hear such talk your brain will flash up a black and white photo of people queuing for a handout in the Great Depression. You'll be cautious and feel encouraged to delay your home purchase.

But I don't believe we will have a recession even though the Reserve Bank is forecasting one next year, and if we do it will be like the one the United States just had this year – GDP technically falling for two quarters in a row but the labour market not radically weakening.

At some stage the recession talk in NZ will fade through 2023 and that will see the black and white photos replaced with the return of FOMO – whatever colour that may be. Orange - because this is the only graph of it in New Zealand.

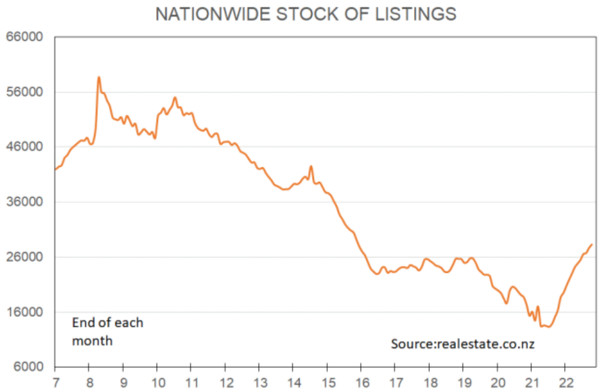


But this does not seem likely before the middle of 2023 given the inflation fight will be going on for some time.

Stock of listings

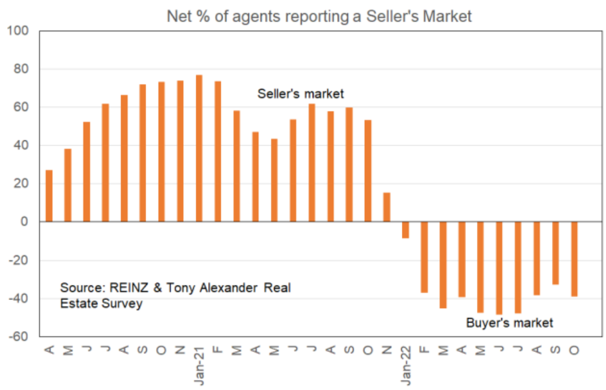
There are 72% more properties listed for sale now than a year ago. When combined with far fewer buyers in the market this means that those who are buyers can pick and choose to a degree not possible for many years. Listings are at a six year high. It looks like those listings will go higher now that the interest rates are set to go higher.

That means more choice for buyers for longer and reduces the need to hurry.



But it pays to note that the stock of listings is still 34% lower than a decade ago and 20% less than the average since 2007.

At some stage the surge in listings caused by a buyer's strike will reverse. We don't know when this will happen. But the risk is that a young buyer basing their willingness to consider a purchase on the popular stuff they are reading online will enter the market only when the discussion is once again about rising prices and shortages developing. By then it will be too late and we will be back in a seller's market again and not the current buyer's market.



So, if I were a young buyer and I qualified for a mortgage, would I buy now? Yes, as long as I stayed focussed on a long-term hold. I would find three suitable properties and get the vendor agents to work their sellers for free on my behalf to see who can come up with the best deal.

But am I not worried about prices falling after I buy? No. I see little chance of a massive sustained surge in house supply even though inroads into shortages are being made. I see net migration flow turning positive earlier than I previously thought, and construction costs continue to rise. And even if prices do fall further, which I believe they will, the passage of time will do what it has always done in the NZ housing market. Deliver rising prices which improve the deposit one is able to come up with for the next purchase in one's life cycle.

If I were a borrower, what would I do?

The Reserve Bank yesterday raised its official cash rate by 0.75% which was largely expected. They also increased their projected peak for the cash rate from 4.1%. But at 5.5% that peak is ahead of market pricing before the decision which was 5.1%. Note however that pricing was at 5.5% a few weeks back immediately after the higher than expected 7.2% inflation outcome for the year to September.

The Reserve Bank does not project the cash rate going back below 5% until the first half of 2025 and the words of the Reserve Bank make it very clear that they are concerned about the inflation outlook. There was no hint of the caution starting to creep into the comments being made by central bankers offshore regarding not wanting to tighten too much.

The Monetary Policy Committee which sets the official cash rate discussed taking the cash rate up by 1.0% but decided that 0.75% is enough for now.

Of importance in the comments made by the Reserve Bank were references to the way household spending is remaining "robust" despite rising debt servicing costs, falling house prices, and low consumer confidence. They noted the support for spending coming from the strong labour market delivering firm wage rises for those shifting employer.

They noted the role being played by high household savings, alongside the stronger than expected recovery in inbound tourism. Noting the shortage of staff to serve foreign visitors they pointed out the risk of extra inflation because of this problem.

Because of the extra tightening in monetary policy now deemed necessary by the insufficient crunching of consumer spending, a recent lift in inflation expectations, and higher than expected inflation recently, the Reserve Bank now feel that they need to put the economy into recession.

Whereas in August they saw the economy growing in every quarter going forward, they now project shrinkage from the June quarter of 2023 through to the March quarter of 2024. And whereas in August they projected the unemployment rate going to a peak of 5% come the start of 2025, now they see a peak of 5.7% from the same time.

With the official cash rate now headed towards 5.5% it seems reasonable to expect that the one year swap rate at which banks borrow to lend fixed will rise from the recent 5% to around 5.5%. On that basis the one-year fixed mortgage rate looks like heading towards 6.5% assuming banks continue to tolerate below average margins.

This will clearly exert some extra downward pressure on house prices as more people choose to sell because they signed up at a much lower rate and their bank only made sure they could service a rate of 6%.

The turning point therefore for New Zealand's housing market now looks to be something coming in Winter rather than Autumn as I was previously thinking.

If I were borrowing currently, I would still favour a mixture of one and two year fixed rates.

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

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.