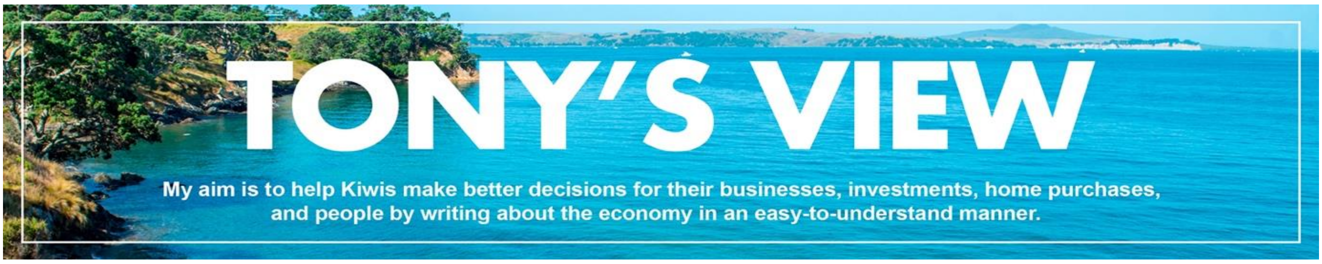

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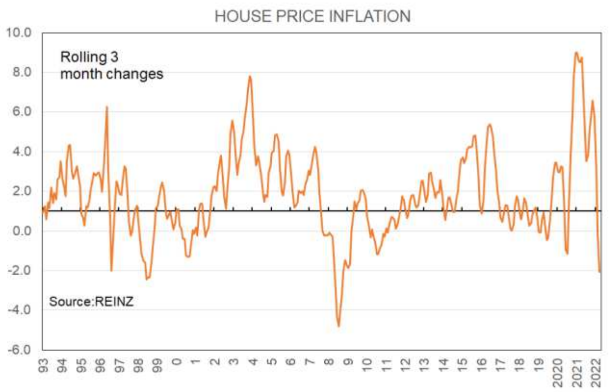
Current situation in the housing market

Here is a summary of where things are at with the housing market on average around the country at the moment.

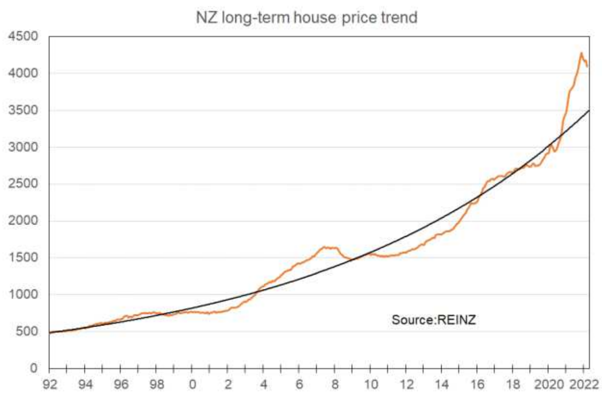
Prices are falling

Using the REINZ House Price Index we can see that prices on average in the March quarter were down by 2.1% from the December quarter which was ahead 5.8% from the September quarter (5% gain, June quarter 4.9%). The turnaround in prices therefore is at less than half the speed of the recent string of large rises and hardly something which will risk negative equity for anyone. The banks will have no worries about asset security against their loans.



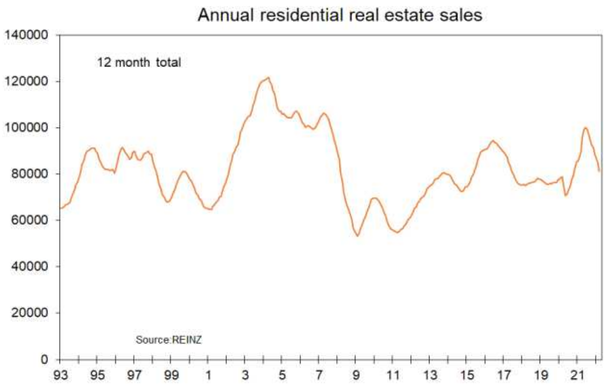
We have seen falls such as that just recorded many times in the past. The current correction is not special.

Prices are however well above where they would otherwise be without the pandemic and record low interest rates, and we will likely have flat to easing markets for the next 2-3 years. Don't believe anyone's forecasts for how much prices will change on average nationwide let alone in the region, city, or suburb you are actually in. Everyone has proved they cannot accurately predict house price changes.



Sales are falling

The annual number of dwelling sales peaked at just over 100,000 in June last year. Now the total is 81,300 for the year to March. This is slightly below the average number of annual sales for the past two decades of 84,000.

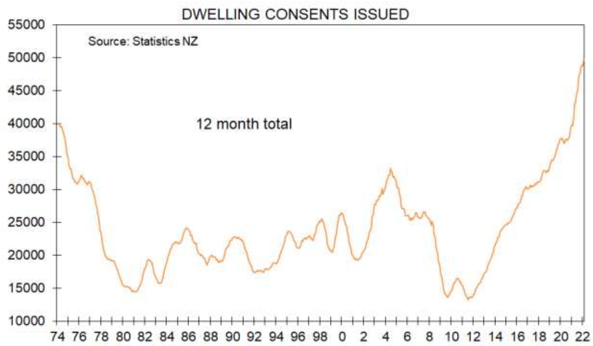


Note however that with dwelling consents at record levels a lot of sales direct by developers are not being captured in the numbers. We have no idea regarding development pre-sales. Actual turnover will be unusually higher than the reported data covering licenced real estate agent activity.

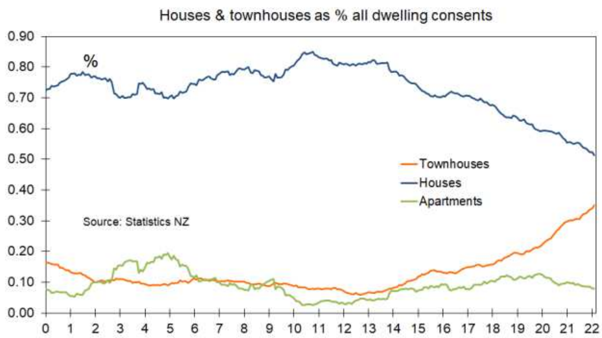
Sales are still falling in seasonally adjusted terms and a retreat towards 65,000 is possible.

New house supply is booming

The number of consents issued for new dwellings to be built stood at 49,700 in the year to February. This was a 25% rise from a year earlier, 88% above the ten year average, and the highest annual total on record.



An increasing proportion of dwellings being built are townhouses.



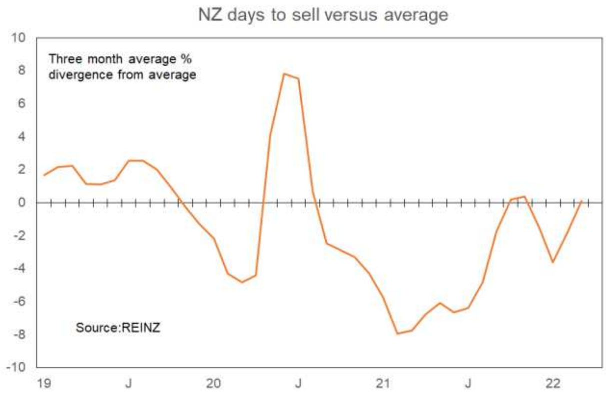
However, there are signs we are at a peak with seasonally adjusted consent numbers down by 2.3% in the three months to February after easing 0.2% in the three months to November.

Question: We are here in NZ for the lifestyle and not the money. Does that lifestyle involve a townhouse in Auckland? The relative boom in townhouse supply will push up standalone house prices from a simple supply point of view, development potential, and because the image Kiwi expats have of how they will live if returning to NZ probably involves a house and yard – not something like the accommodation they have been living in offshore the past few years when accommodation was not the priority.

Quality of townhouse construction, facilities, and location is going to become very important in the next few years.

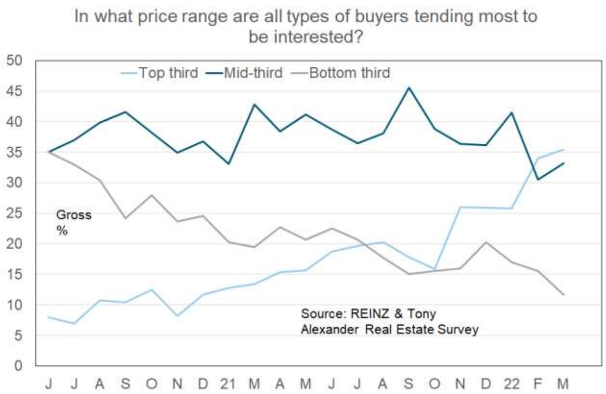
Taking longer to sell

The average number of days taken to sell a property was 36 in March compared with 28 in March last year, 36 in March 2019, and 34 in March 2018. Things have shifted from the speed of sale being slightly below average for most of the past year and a half to just average in the past three months.



Sales shifting to the top end

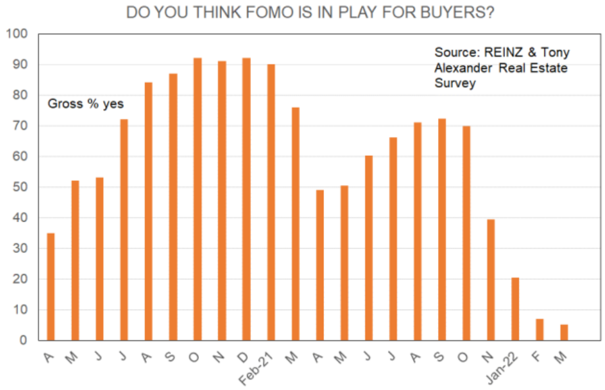
With many investor buyers taken out of the market by tax changes, and first home buyers struck by the credit crunch, an increasing proportion of sales is occurring in the upper price brackets.

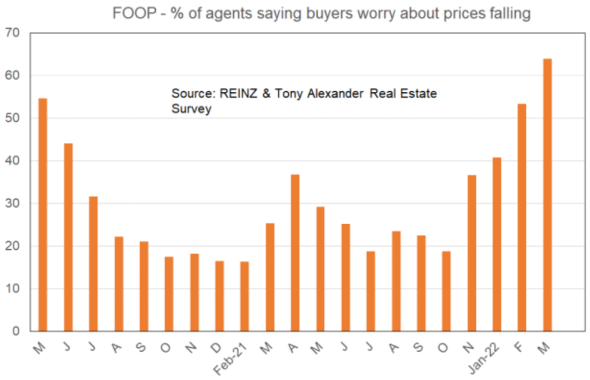


This development will partly reflect the strong state of the economy keeping many people "aspirational" and supporting incomes of SMEs. The rising share accounted for by higher priced properties is shown by the rising light blue line in the previous graph.

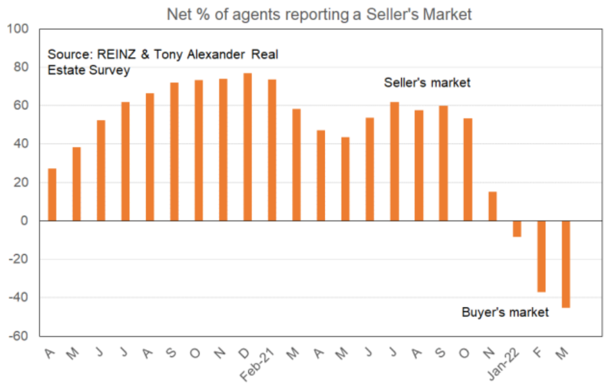
FOMO no more

Fear of missing out has disappeared and been replaced to some extent by fear of over-paying – FOOP.



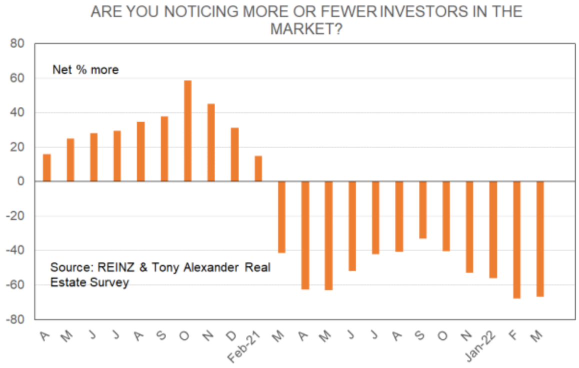


These shifts are associated with the country moving solidly into a buyer's market.



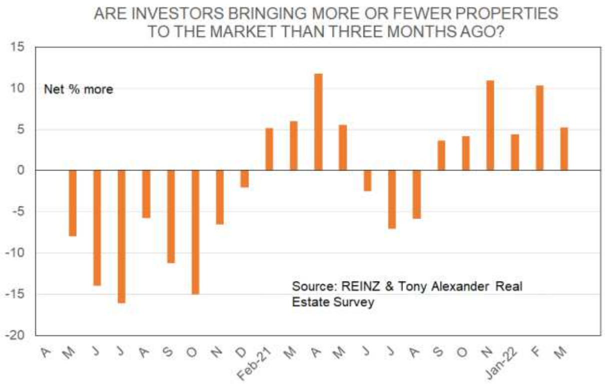
Investor buyers less abundant

Investors stood back from making fresh purchases immediately after the March 23, 2021, tax announcement. They remain out of the market but cashed up investors are slowly accounting for a greater proportion of all purchases according to the data from CoreLogic.



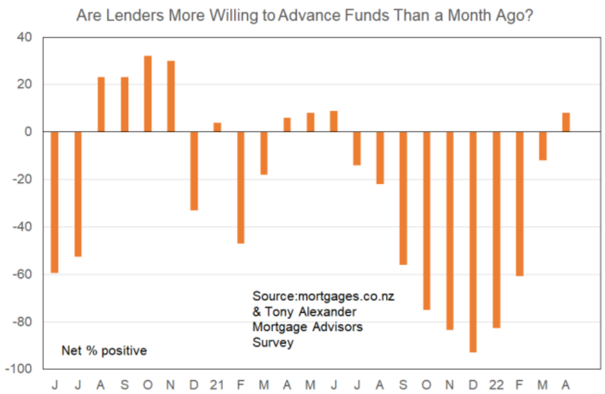
No wave of investor selling

There is no rush of investors to get out of residential property – not with turbulence in share prices and predictions of bear markets, rapidly rising interest rates offshore aimed at slowing economic growth and crunching household incomes and business profits, and high inflation. The number of investors selling is up, but not all that much.



The credit crunch is easing

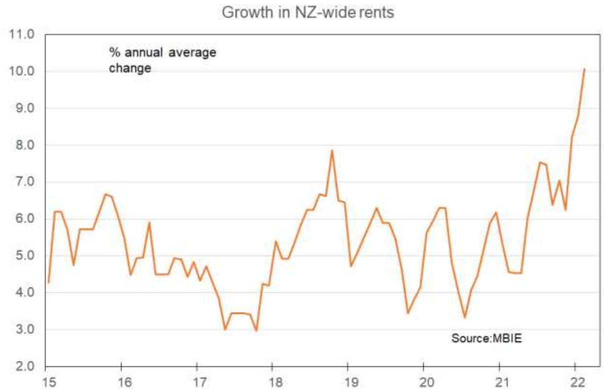
A key factor contributing to falling prices has been a collapse in credit availability due to tightening of rules around LVRs, DTIs, and CCCFA.



But my latest survey of mortgage advisers with mortgages.co.nz shows perceptions of changes in bank lending willingness have turned positive.

Rents are rising rapidly

According to data included in new rental bond lodgements with MBIE, the average level of weekly rents in February was 10% higher than a year earlier. The following graph smooths things out by comparing 12 months with the previous year. No wonder landlords are not selling their properties in response to tax changes and rising interest rates relevant to those with mortgages.



Summary

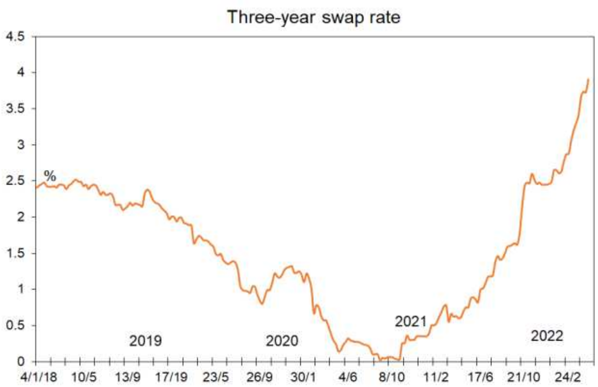
The NZ housing market is correcting back down from unsustainable heights under the influence of higher interest rates, investor tax changes, rising supply, reduced credit availability, and diversion of spending offshore. But there is underlying price support preventing big declines on average from rising rents, soaring construction costs, worsening construction delays and bottlenecks, some easing of the credit crunch, and fresh concerns about returns on non-property assets.

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.

Rates go higher

Wholesale borrowing costs facing banks have risen quite strongly over the past week. The three year rate at which banks borrow funds to then lend fixed three years for instance has climbed to a seven and a half year high of 3.91% from 3.73% last week, 2.5% at the start of the year, and 0.6% a year ago.

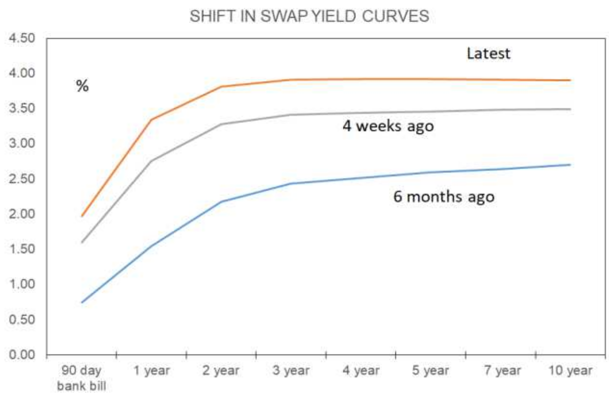


The rises up until recently we can comfortably put down to expectations of our central bank taking its cash rate up from the old record low of 0.25% to somewhere above 3%. But the more recent surge at a time when inflation here has printed lower than expected, consumer and business sentiment measures are very weak, and spending is being reined in, we can put down largely to enhanced expectations of monetary policy tightening in the United States.

The NZ yield curve which faces banks as they borrow to lend at fixed rates to you and I for our mortgages is flattening out. What this means for instance is that compared with a month ago the one year swap rate banks borrow at has risen by 0.6%. But the three year rate has risen 0.5% and the five year rate 0.45%.

The difference is even more stark for changes over the past two weeks at 0.31%, 0.17%, and 0.16% for the 1, 3, and 5 year swap rates respectively.

The following graph doesn't show the yield curve change in the past fortnight, but it does show something to keep in mind as you read what I write further on below. Just because the curve flattens out at around two and a half years does not mean that is where the whole thing peaks.



The curve can stay flat and shift higher and lower as expectations for the extent of policy tightening alter.

Currently the margin between borrowing to fix five years and lending five years fixed by a bank is about 0.5% below the two-year average. I make that calculation using the best five year rate offered by the main lenders I track of 5.79%. (Remember the 2.99% of last year?)

My best guess is that this five year rate will peak around 6.25%.

Virtually no-one will be fixing their mortgage rate for five years now. Some are opting for three years and the best rate I track there is sitting at 5.39% from 2.65% a year ago. The margin currently is about 0.7% below average so maybe this rate peaks a smidgeon over 6% also.

The one year fixed rate margin is currently around 0.8% below average. The best published rate on offer from the lenders I track is 4.49%. That suggests a starting point for a peak in the one year fixed mortgage rate of about 5.3% assuming margins get restored.

But competition between lenders currently evidenced by a tendency to tolerate low margins for far longer than I would have expected leaves me picking a peak of maybe 5.5% when we allow for additional increases in the one year swap rate yet to arrive.

If I'm wrong the rate will probably peak slightly higher, somewhere between the April 2023 and April 2024 dates included in my forecast table below. It's all just guesswork anyway as we cannot know how margins will change over what time period, and I know from experience over three and a half decades that picking where the cash rate will peak in a cycle is also just guesswork.

A key question is how long will someone still rolling their mortgage at a one year fixed rate have to tolerate high rates? Again, that is just guesswork. But I expect to see monetary policy easing from around the middle of 2024.

My current expectation for the one-year fixed mortgage rate in April each year is shown in the first column of the table below. I focus on that rate because there are many people who have fixed one-year repeatedly since 2009 and the strategy has worked very well.

The second column shows what the one-year rate will average over the next 2-, 3-, 4-, and 5-year periods. The last column shows the current best 2 – 5-year fixed rates charged by the lenders I track.

	Forecast 1 year rate	Rolling average rates	Current fixed	
2022	4.49		4.49	1 yr
2023	5.25	4.87	5.19	2 yr
2024	5.25	5.00	5.39	3 yr
2025	4.25	4.81	5.55	4 yr
2026	4.00	4.65	5.79	5 yr

If these forecasts prove correct (I'd give that a 10% probability), rolling one-year fixed will deliver an average rate for the next two years of 4.87%, three years 5.00%, four years 4.81%, and five years 4.65%.

If I were a borrower, what would I do?

Personally, I wouldn't fix longer than two years and if I were more brave than I am I might revert to the optimal strategy from 2009 up until mid-2020 which was to blindly roll one year every year.

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

Tview Premium contains more interest rates discussion and graphs than included in Tony's View.

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