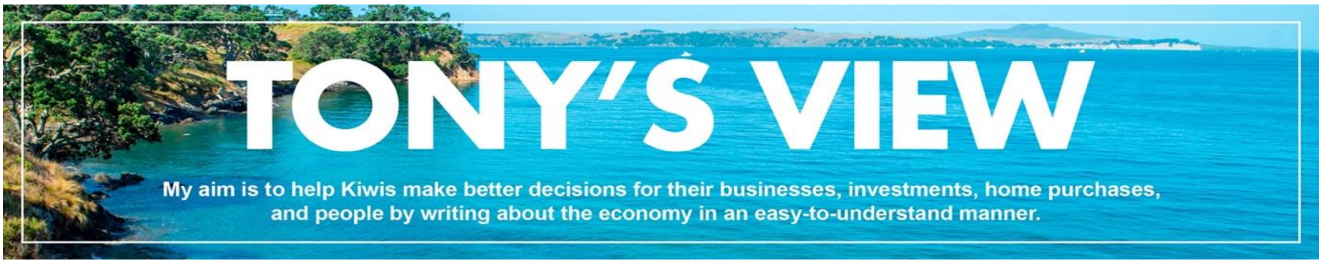

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ISSN: 2703-2825 4 May 2023

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Whipback

Almost all the weakness in NZ house prices since the excessive peak of late-2021 is now behind us. Almost. The endgame is well underway and at the moment we're really just counting the time left before a new cyclical upturn arrives.

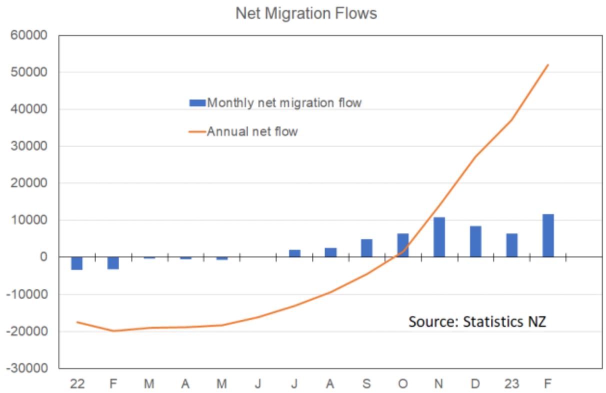
In Australia the former Federal Treasurer has described it as a "perfect storm". He is referring to their combination of record net inward migration of 650,000 expected over 2023-24, set against falling house construction because of high financing costs and the high cost of materials, sending house prices skyward. A key housing organisation has just revised upward its projection for the size of the country's housing shortfall over the next five years from 106,000 new dwellings to 175,000.

The Reserve Bank of Australia has warned that the new population surge could place upward pressure on the country's housing stock, inflation, and therefore interest rates.

Accelerating population growth

Here in New Zealand people are describing most things as being in a state of crisis, and debating when to move to Australia because citizenship is now easier to get. Attention in our country as relevant to the housing market has yet to turn to the factors which I have been highlighting here in recent months and feel the need to emphasise yet again because when the turn comes a lot of people won't understand it.

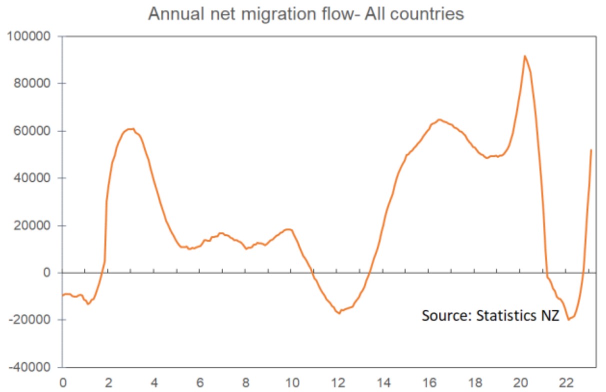
New Zealand does not face a brain drain of people sapping our population and crunching our economy. We have seen our net annual migration flow go from a loss of 20,000 people a year ago to a gain of 52,000 in the past year. That annual gain means 1% more people in the country and looks like it is going to get bigger.



More people means more demand for housing and that means both prices and rents being higher than would otherwise be the case.

At some stage the tens of thousands of people who have sat on their hands watching house prices fall and waiting for them to fall further will realise what is happening with the country's pace of population growth and then realise what it means for house prices. We are not at that point of realisation yet.

But before we get too excited about the migration boom, consider this. Between 2014 and 2019 the average annual gain to our population from net migration flows was 58,000 a year. Adding 2020, 2021 and 2022 the net gain for this three year period plus the first two months of this year was 67,000. Had the pandemic not arrived the net gain might have been 3*58,000+10,000 or 184,000.



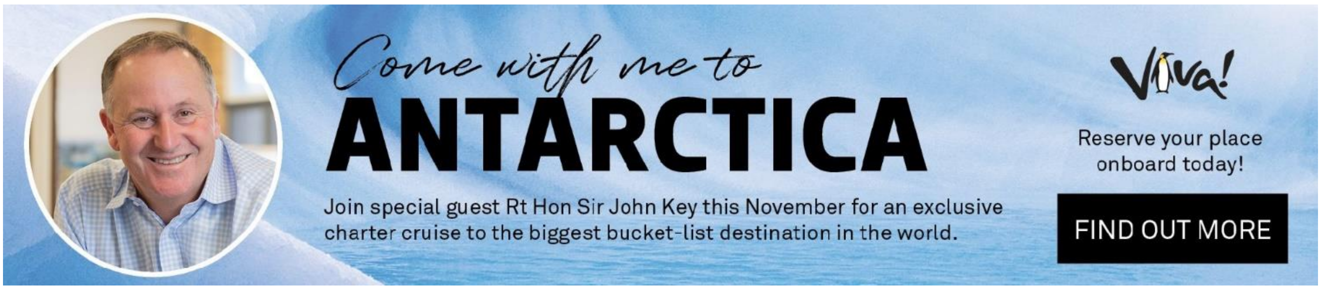
We are some 117,000 people short of where we might otherwise have been. Also, by some rough calculations, we are on track to have maybe 18,000 extra houses beyond what would have been constructed without the pandemic and boom in house prices.

So, the equation between growth in demand and growth in supply helps explain the big falls in prices since late-2021 and why it will take some time before the next frenzy appears.

Whatever calculation anyone has made about a shortage of houses in New Zealand – and such calculations are entirely subjective – that shortage is a lot less now which is a good thing. Pity about the coming house construction decline discussed below alongside the migration boom being set to erode that shortage catch up.

Interest rates have peaked

At the same time as we may be at the start of a repeat of the 2014-19 period when net migration exceeded 50,000 each year, interest rates look like they have peaked. The Reserve Bank is no longer warning of the need for higher rates to contain inflation, the latest inflation rate is 0.6% lower than they based their February 22 and April 5 0.5% rate rises on, and the economy shrank



0.6% in the December quarter rather than grew 0.7% as they had estimated.

The wholesale cost to banks of borrowing money at a fixed rate for two years to lend fixed to you and I two years is little changed from where it was before the April 5 cash rate hike. Banks which raised their lending rates following that cash rate rise may now be thinking about cutting them. One already has.

From my monthly survey of real estate agents with REINZ I can see that buyers are still highly concerned about interest rates. But at some stage people are going to acknowledge that rates have almost certainly peaked and that falls will now be occurring over the next two years. When that realisation shift happens buyers will come back into the market – or at least those who can handle current bank stress test rates of 8.5% and higher.

House construction is falling

Probably after people eventually realise what is happening with housing demand and financing costs, we will see a third realisation. This is that the pace of growth in the supply of new dwellings is easing off.

We are not facing into a repeat of the second half of the 1970s when house constructed decreased sharply over a number of years, or a repeat of the GFC when consents fell from 26,000 to 13,500. But a decline from 51,000 to perhaps 30,000 is in the offing as more builders and contractors fall over, buyers refrain from newbuilds because of stories of losses, with those losses about to be boosted.

Because house prices have fallen so much there are many people who signed up for a dwelling off the plan with a deposit of 2.5% towards 20% who now will not receive the finance which the bank promised them. A bank simply can't make a loan of $800,000 on a property which has fallen in price from the initially projected $880,000 to $750,000.

Some people face losing the deposits they laid down 18 months or so ago and once the media highlight this growing problem the unfortunate aversion of buyers towards newbuilds may grow to the detriment of all. In reality what is likely to happen is that the developers will have to discount their original selling prices under pressure from their bankers.

At some stage awareness of falling growth in the housing stock will occur and people will consider what that means for house prices over the next five years – just as is now happening in Australia.

I think what we can say for the first time in a few years is that the Australian house price cycle has now shifted to be in advance of our own and no longer behind.

Then there is more.

Back to the short-term accommodation pool

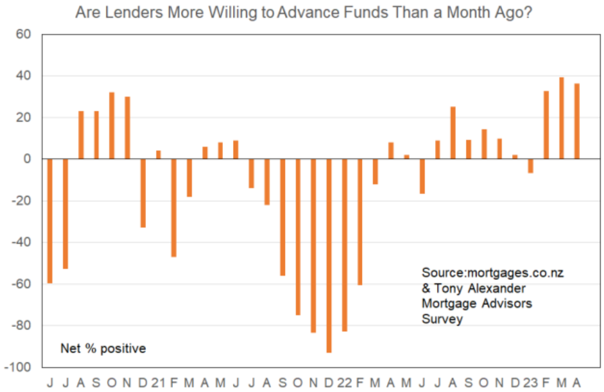
At some stage people will realise that there is new upward pressure on rents. Properties are being shifted from the long-term rental pool into short-term accommodation for tourists. The returns are much higher than for having a regular tenant and without the many hassles relating to inability to raise rents more frequently than once a year, inability to gain quick resolution of disputes as rules increasingly favour tenants, and not as much risk of damage.

Part of the rental stock is going back to foreign students, and I will be fascinated to see what this does particularly to the inner city apartment market in Auckland over the next few years. Rising demand yet lack of supply growth is likely to eventually create an interesting rent then prices response for those who have held through the recent tough times.

With some new pressure on rental property availability and upward pressure on rents, more people are going to be questioning renting versus buying now that prices are well down.

Lending rules

In recent months banks have been slowly improving their willingness to lend to those people able to make the numbers work with test rates of 8.5%+. Treatment of expenses has been altering with banks reacting to a situation where they are failing to meet their sales targets and getting worried about losing market share as some $170bn worth of fixed rate debt comes up for rate renewal in the next 12 months.



That easing of lending rules will now be assisted from June 1 with the Reserve Bank set to let banks have up to 15% of their new lending with deposits less than 20% of valuation from owner occupiers.

Listings shortage

There is no shortage of listings at the moment with the stock at the end of April of 25,800 well ahead of less than 14,000 in the middle of 2021. But stock levels are now down 11% from their December peak and when dwelling sales pick up history tells us stocks will decline.

The risk is that at some stage the current prevalent belief that listings aplenty exist and there is no risk of shortage will disappear. Given the way we have been triggered to act since the start of the pandemic when we hear the word "shortage", the impact on the growing queue of people who have delayed their home buying will be interesting to watch. We'll be able to track this through the FOMO measure in my monthly survey of real estate agents.

In case you missed it

On Friday I released the results of my monthly survey of residential property investors sponsored by Crockers Property Management. The main results were a net 13% of landlords now saying it is easy to get good tenants from a net 6% six months ago saying it was hard. This is the strongest result since March last year.

A record 82% of landlords say they intend putting their rents up (the average reading is 75%), and the average rise planned is 6%. This equals the average rise planned in the past but is up from 5.3% in December and the highest since July last year. Rent pressures are appearing.
[04-crockers-tony-alexander-investor-insight-april-2023.pdf]

Yesterday I released results from my monthly survey of real estate agents with REINZ. For three months now about a net 22% of agents have said they are seeing more first home buyers. But investors remain absent, prices are still strongly seen as falling, and auction attendance is weak. Things are no longer getting worse but apart frm first home buyers being early movers, the survey does not support any strong claim as yet that the market is decidedly turning.
Tony-Alexander_Report_May-2023.pdf (tonyalexander.nz)

If I were a borrower, what would I do?

Bank wholesale funding costs have gone up about 0.2% this week in response to the unexpected 0.25% rate rise in Australia plus the still very strong labour market data released here yesterday. Fixed mortgage rates for 3-5 years have already fallen 0.7% from their peaks in anticipation of inflation coming under control and monetary policy being eased through 2024. But the one and two year rates remain high because they are more closely associated with where the official cash rate is right now and is expected to be shortly.

If I were borrowing, I would grit my teeth and pay the one or two year rate (only the latter if the deal was sweet) and not touch the 3-5 year rates with a bargepole.

I discuss rates a lot more in Tview Premium with lots of useful graphs to help your decision-making process.

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.