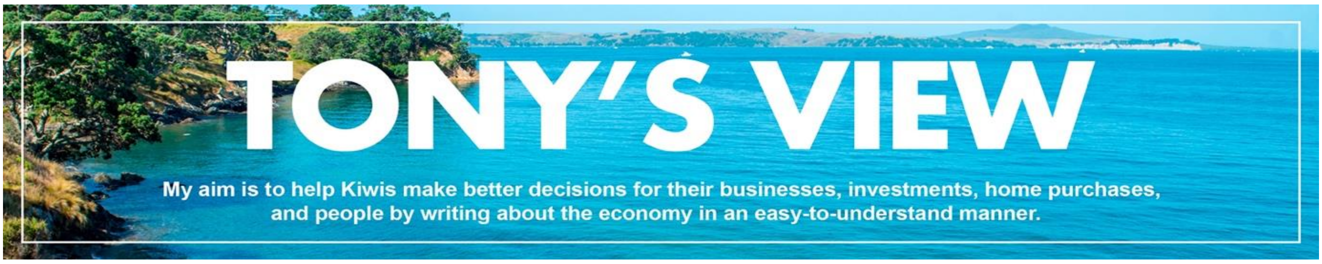

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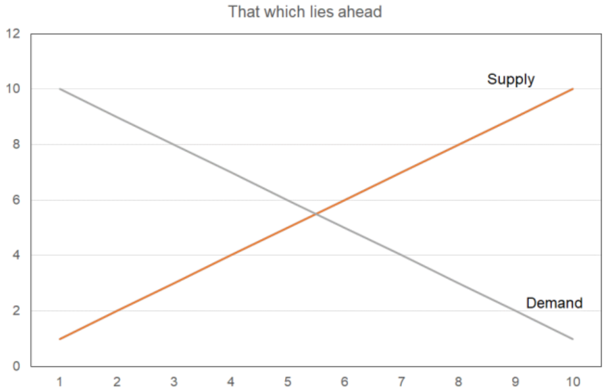
The housing shift to come

Know what this graph shows with quantities along the horizontal axis and prices on the vertical? Demand and supply curves.



The orange line rising to the right shows that as the price of a thing goes up on the vertical axis we can expect more supply to come forth – eventually. There is no time element able to be shown in this most simple of graphs which forms the bedrock basis of economics.

The grey line sloping down to the right is the demand curve and it shows demand for a thing falling to the left as the price goes up.

Where they intersect is the equilibrium. In practise you'll never see such curves. But as a way of analysing a situation it is hard to go beyond them, and when you are surrounded by many confusing elements you can do worse than sitting down with a bit of paper and drawing where the curves move as the factor you are thinking of comes into play.

Let's do that for some of the big factors coming up for New Zealand's housing market. Sorry to those who belief a permanent shift towards vastly improved housing affordability is underway. It's not happening and the rental situation is likely to turn decidedly against renters next year.

Rising net immigration

The higher the number of people added to the population from changes in people leaving versus arriving, the greater the population. We can show that as the demand curve moving out to the right. For every price there will be more people looking to buy a thing.

The outcome of this rightward shift in the demand curve is more of a thing being bought and sold and a higher average price.

Net migration inflows have soared from -16,000 seven months ago to +33,000. The demand curve is already shifting to the right but the main shift will come when people realise what is happening with our post-pandemic rate of population growth. This change has not yet entered popular consciousness.

Rising stock of delayed buyers

For many things we can shift our purchases through time. We will delay buying a car if times are tough. At the moment there are tens of thousands of people holding back from buying a property because they expect prices will fall further. This stepping back of buyers over the past year and a half is represented by the demand curve moving to the left. You will see that such a move means lower turnover of real estate and lower prices.

At some stage people's views on price risk will shift. They will decide the time is right to make a purchase and the demand curve will shift back to the right. Turnover and prices will rise. I'll be able to see this in near real-time in the many indicators gathered in my monthly surveys of real estate agents and mortgage brokers. In particular we will see it in the FOMO gauge rising. We're definitely not there yet.

Falling interest rates

The rise in fixed mortgage rates between June 2021 and the end of November has made purchasing a home too expensive for many people. This shows up as the demand curve moving to the left resulting again in lower prices and lower turnover. Worries about interest rates continuing to rise would have added to this effect.

What is happening now? There is growing acceptance that fixed mortgage rates peaked two months ago and talk that worries about banking sector stability and banks cutting credit access will slow world growth and inflation from here on. That has already resulted in wholesale borrowing costs falling and scope is growing for some fixed rate cuts down the track.

The combination of people no longer expecting higher interest rates and instead thinking about them falling means a rightward shift in the demand curve bringing greater turnover and higher house prices. This is something set to come along in coming months.

Note that negative housing commentary built around the refixing of existing mortgage interest rates from 3.5% to 6.5% or so is essentially irrelevant. These changes are for people who already have a house and very few of them will be in the market for another. The media seem to miss this.

Falling house construction

New dwelling consent numbers are now running almost 20% down from a year earlier and in seasonally adjusted monthly terms are on a steep slide. New house supply will continue to rise but the new supply in the coming year will be a lot less than in the past year. Same for the year beyond March 2024.

Reduced supply is represented by the orange supply curve shifting to the left. This means reduced turnover and higher prices.

We are not there yet because most people are not aware of what is about to happen in the residential construction sector. But this factor will really come into play when people also realise what is happening with the net migration flows. One curve shifts to the left, the demand curve to the right and the price response can be strong. We are not there yet.

Job security

If people feel secure in their jobs, they are more likely to buy a house. If job security falls, they will feel less secure. As the unemployment rate rises in the coming year feelings of job security are likely to decline and that means a leftward shift of the demand curve bringing lower turnover and lower prices.

Note however that for many people this shift has already occurred in response to the Reserve Bank's prediction of recession and forecast of the unemployment rate going to almost 6%. But that forecast is likely to be aggressively cut at some stage and people's feelings of job security will improve.

Balancing off these two pressures on job security feelings is impossible so this is unlikely to be much of a driving force in the housing market until the unemployment rate starts falling from its peak somewhere too far down the track to really be relevant to any of my discussion here.

Rents rising

The pace of rent rises currently is not that high. But landlords are showing rising intentions of increasing their rents and we know what accelerating population growth, more foreign students, and the return of short-stay holiday-makers will do to rental availability and therefore average rents.

Whatever the numerical outcome for rent rises the key thing to keep in mind is this. While house prices have been falling since December 2021 and continue to do so, rents have continued to rise. The equation some people run of renting versus buying is shifting more in favour of buying and will take a step jump in doing so when interest rates are seen to be on a good downward track.

This effect is represented as the demand curve shifting out to the right for home ownership. That means higher turnover and higher prices.

Credit availability

Banks are bit by little bit easing up their willingness to lend for home purchases. This easing is partly driven by low house sales causing lending targets to be badly missed. As lending willingness slowly grows more people will find themselves able to make a purchase. This is represented by the demand curve shifting out to the right.

Stock availability

There are many reasons why the stack of people delaying their purchase has grown and grown. One is increased numbers of properties on the market allowing buyers to feel they can stay on the side lines and jump in whenever they want somewhere down the track.

But at some point, the high number of property listings will decline. The second half of 2021 showed us what can happen when listings are low – prices can soar and FOMO (fear of missing out) jump up even in the face of rising interest rates, investor tax changes, the return of Loan to Value Ratio rules and net migration outflows.

When stocks start falling the return of some buyers feeling the clock is ticking on good availability will cause the demand curve to shift out to the right bringing higher turnover (and accelerating decline in listings) alongside rising prices.

Vendor selling

Offsetting the holding off of buyers since the end of 2021 has been a similar holding back of vendors. One thing discouraging people from listings their property has been concern about being a weak seller in a buyer's market, and high job security removing a perceived "need" to sell. The vast majority of borrowers can comfortably handle higher mortgage rates because their debt has reduced over the years, they have a job, they can pick up extra hours of work or additional employment in a strong economy, and/or take in a boarder easily as accommodation is tight.

When market conditions change and vendors feel they are not the weakest partner in the property transaction, some will bring their properties to the market. This is represented by the supply curve shifting to the right and means higher turnover but lower prices.

There are many other factors in play and I invite you to shift the curves around in response to how you think the thing which interests you will **change**. I stress change because the curves only shift when things change. If there is a factor which interests you that has been around a while and will remain as substantial in the future as now, then there is no shifting of the relevant supply or demand curve. Your thing of interest has to change to be relevant to future changes in turnover and prices.

Where I sit is this.

Negatives continue to dominate and in particular the feeling buyers have that time is on their side and its best not to buy in case interest rates go a lot higher and/or they lose their job.

But new house supply is about to fall at the same time that demand rises in response to a changing outlook for interest rates. These factors will help produce an end to the downward leg of the house price cycle. The upward leg will really get going once the still growing stack of buyers holding back turns and FOMO returns. How strong will this effect be? We cannot know. But the balance of risks facing a house buyer is set to shift. When? The experience of the past few years tells us that we cannot reliably pick when the main shift will come. Good luck to those holding off buying because you think you can.

And one final point. There is a catch-up surge in home buying to come at the same time as new supply growth falls away. With investors disincentivised to continue to hold their properties the demand from owner-occupiers is going to create a fairly strong tightening up of the rental market in New Zealand. The response will be higher rents, cramming in together of people who have to rent as they cannot afford to buy, and a deepening of social inequities because the renting group are on lower incomes on average than those who own.

If I were a borrower, what would I do?

Yesterday the Reserve Bank reviewed the official cash rate and while the common expectation had been for a 0.25% rise they in fact lifted the rate 0.5% to 5.25%. This rise followed a 0.5% rise on February 22 this year and 0.75% rise on November 23 last year.

While noting that the economy is smaller than expected, they expressed concern about a number of things. These include the following.

- Employment still being above sustainable levels.
- Inflation to receive a boost from recent flooding.
- The economy to receive a boost from reconstruction, effectively offsetting a weaker world growth outlook.
- Stimulus coming from easier fiscal policy.
- Inflation sitting still uncomfortably too high.

It also looks like the Reserve Bank has become concerned that the recent declines in wholesale bank borrowing costs because of events offshore could lead to a round of reductions in retail interest rates. Therefore, they have raised the cash rate 0.5% to get those wholesale borrowing costs back up and to prevent retail rate cuts. To whit…

"However, wholesale interest rates have fallen significantly since the February Statement, and this could put downward pressure on lending rates. As a result, a 50 basis point increase in the OCR was seen as helping to maintain the current lending rates

faced by businesses and households, while also supporting an increase in retail deposit rates."

In other words, they do not actually intend that today's 0.5% rate rise leads to higher mortgage rates – but they have continued their pressure on banks to raise deposit rates.

There remains a lot of water to go under the bridge regarding inflation and we are still some ways off the Reserve Bank being able to express confidence that 2% lies not too far down the track. But some of the omens are good.

There is substantial restraint still to come from the near $170bn worth of mortgages up for rate resetting in the coming year. Near 3% cost jumps will place downward pressure on household spending.

The NZIER's Quarterly Survey of Business Opinion released yesterday showed that although business pricing plans remain much too high, capacity pressures are easing. I will discuss this more in next week's TVP but suffice to say the easing of difficulties firm face in securing skilled and unskilled labour to only just above average levels bodes well for slowing wages growth.

Global inflation is easing off slowly and new restrictions on bank lending offshore because of US bank collapses will cause some extra weakness in world growth and therefore world inflation.

And there is this to note as one thinks about how much higher the cash rate will go. We are probably at the peak now at 5.25%. In February the Reserve Bank wrote that "…monetary conditions need to tighten further…". They have now dropped that comment and written this.

"Looking ahead, the Committee is expecting to see a continued slowing in domestic demand and a moderation in core inflation and inflation expectations. The extent of this moderation will determine the direction of future monetary policy."

This week the one-year wholesale interest rate at which banks borrow to lend fixed for one year to you and I edged down ahead of the NZ rate review today but then climbed to sit this afternoon near 5.55% from 5.29% last week and 5.66% four weeks ago.

The three year rate is near 4.7% from 4.63% last week and 5.24% four weeks back.

If I were borrowing currently I'd personally just fix one year. Some debt fixed at two years may suit many people however given that uncertainties in play remain quite extreme.

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.