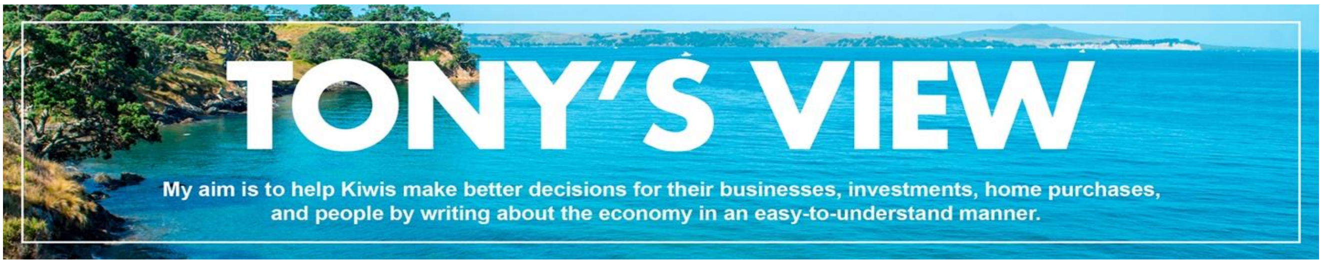

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Auckland housing not munted

Just in case you haven't figured out how I go about my analysis or perhaps the focus I take, let me state it clearly. I seek to go beyond just reporting the data and what it implies to picking where sentiment, popular discussion and cycle-related developments will go well before they arrive.

For instance, that meant highlighting the benefits of forsaking the 2.19% one-year fixed mortgage rate candy last year and favouring the then more expensive five-year fixed rate of 2.99%. That latter rate now sits at about 5.8% and the best published one year rate is around 4.5%.

It meant highlighting the approaching rise in residential property development failures due to various causes – as are being discussed and highlighted in the media now with a lot more to come.

It meant describing the end-game as starting in the housing market price boom over a year ago. And it meant warning businesses about the additional tightening of the labour market coming along from the absence of a flood of Kiwis coming back "home" and a likely brain drain.

Here's another warning of what lies ahead so that when this particular ball gets rolling you can keep things in perspective, see the wood for the trees as it were, and not end up making some bad decisions which will see you missing out on something you really want.

The fundamentals for house prices and house construction in Auckland have shifted to the downside. Such is the nature of cycles. It is not just that interest rates are rising, Auckland's population is shrinking, people are moving to the regions, the brain drain will hit harder than in other parts of the country, and there are more news-worthy examples of developers falling over naturally appearing in our largest population location than anywhere else in the country.

Sometime later this year there will be discussion leading to a community conclusion that Auckland no longer has a housing shortage. It will be based not just on the population decline but on the boom in new house supply whereby consent numbers sit near 21,000 for the past year compared with less than 4,000 ten years ago.

It will be based on the evidence of falling prices surely reflecting an over-supply.

People will ask where all the buyers will come from to purchase the flood of townhouses being built, and the extra flood to come from central government altering planning rules and from hefty extra money going into developing vitally needed infrastructure.

Sentiment will be further affected by people remembering what they discussed in Auckland house price cycles before the GFC – the role played by migration flows. Before the GFC people in Auckland swore black and blue that Auckland's cycle was driven by migration flows. This comment and belief are likely to return once the migration flows get worse. People will be looking for a simple way of understanding why house prices are falling and that is likely to be what they will seize on – along with the supply boom.

But once these developments bloom and people talk about over-supply like they used to talk incorrectly about Chinese being the sole factor behind soaring prices, attention will quickly shift to failing pre-sales for developers. Journalists will ferret out examples of banks pulling or denying development finance.

People will start to believe that the situation in some quarters will be dire, that prices will be flat to falling for years, and they will start to think there is no point buying. Some of the fools who in earlier years told young people to keep renting rather than buy will emerge again from the woodwork.

They will be wrong – again.

Much as this interesting community psyche thing is going to come along, Auckland will still be in a situation where prices are high and will stay high, and the benefits from purchasing a new build will remain. Here are some reasons why if I were a now frustrated buyer starting to think about choosing to purchase nothing for a few years rather than not being able to make said purchase, I would think again and remain in the market.

Note, this is not an article akin to that from November 2012 where I listed 19 reasons why Auckland house price would keep rising. I reviewed that list in the context of the current housing situation in my OneRoof weekly column last week.

This article is solely about why Auckland is not munted.

1. There has been a wave of Baby Boomers shifting to the regions over the past two years. This has helped produce shrinkage in Auckland's population. However, many of these people have simply brought forward their long-term relocation plans. Many who were planning to cash up in our biggest city this year, next year, and in 2024 have

already done so. We are not only not going to see a new pandemic-related wave of shifters, but a hole in normal internal migration flows.

2. The pandemic has seen many people able to work from home choose to do so in the regions rather than in congested Auckland. Now the global trend is for people to return to the office, even if only for 2-3 days a week. The pandemic-driven rush for the greenery has probably about ended and is set to partially reverse.

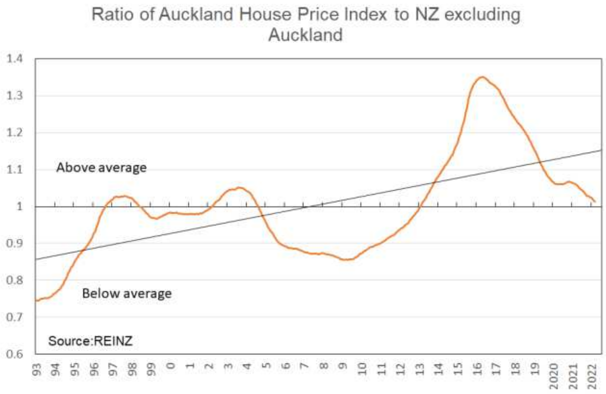
3. Auckland attracts most of the migrants from offshore. Closed borders mean there has been an artificial dampening of Auckland's population growth these past two years. That lack of immigrants is now coming to an end and although the government has changed policy to try and keep out low income earners, numbers will nonetheless build and place restored demand pressure on the Auckland housing market.

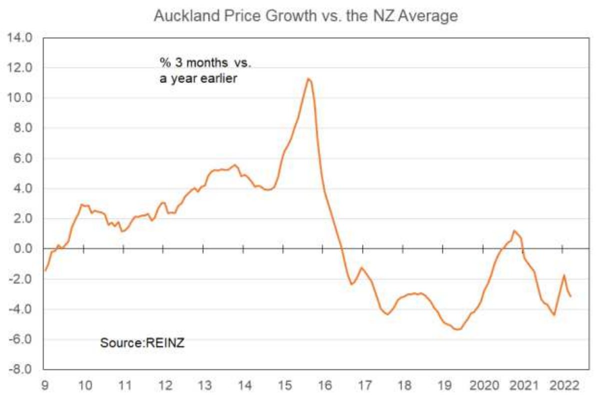
4. Most of the 165,000+ migrants able to apply for the special residency visa the government is offering live in Auckland. Some of these people will be in a position to buy a property previously denied to them as foreigners.

5. People move like fish in schools. Whereas before the view was that one needed to buy a house in Auckland as quickly as possible and never sell even if posted elsewhere in New Zealand, now that view has shifted. Only 4% of real estate agents in Auckland say that they can see buyers displaying FOMO. A net 33% feel that the city is in a buyer's market. Things will shift back. Such is the nature of cycles.

6. A large stack of frustrated buyers in Auckland likely still exists. But they are tired after fruitless searching for too long, have decided to devote some spending to enjoying themselves offshore for a while, and are so traumatised they embrace the idea that they can pull back from buying for the moment without risking missing out again. At some stage these people will re-engage – but only after we get beyond the coming perception of over-supply period.

7. Auckland is no longer over-priced compared with the rest of the country. It is not actually due for a price correction of greater magnitude than for the rest of NZ. In fact, its correction is likely to be less. The period from around 2016 through to now has been one of prices outside Auckland rising faster than in Auckland and the ratio of such prices shifting to below trend levels shown here.

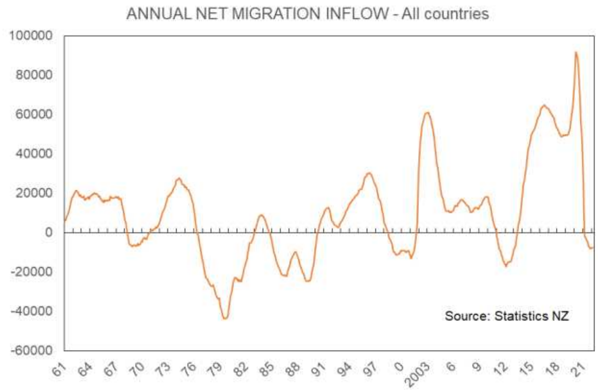




The graph cannot tell us when the shift back will happen or how rapidly it will occur. But it does suggest that banking on Auckland prices falling more than elsewhere for any extended period of time is betting against the odds.

8. Net migration flows are cyclical. We are due for weakness for a couple of years or so related to people seeking work in Australia and not coming back if they are already there because of the opportunities which abound. They may look at New Zealand but will see discussion of a growing list of things in crisis, increasing youth crime, gun crime, a soaring cost of living, and lots of things described each week as being in crisis.

Come 2024-25 the cycle is likely to turn back towards the positive again. Such is the nature of cycles.



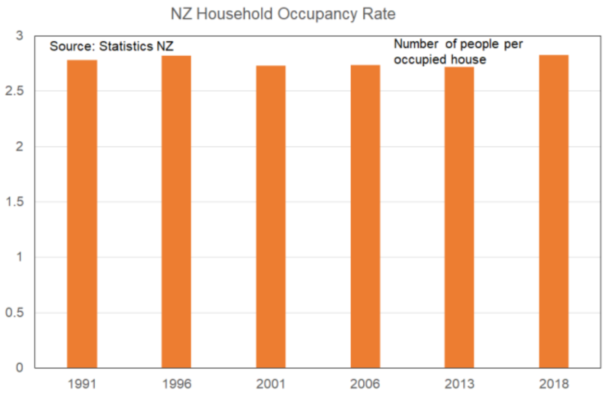
9. Falling house prices generate their own buyer weakness. That is, whatever causes prices to start falling may not matter beyond the initial decline because housing is an asset and people as a rule do not like buying an asset to which they assign a high probability of price decline in the near future. Such is the nature of asset/house price cycles. But at some point, worries about further decline will subside – probably over 2023-24 – and buyers will re-emerge. Catch-up buying will occur, and FOMO will leap. We've all seen it happen before and it will happen again.

10. Periods of extreme construction weakness and extended "over-supply" periods in the past have been associated with recession and high unemployment. But the unemployment rate is at a record low of 3.2%, and demand for staff is extremely high. Job security which is vital to under-pinning willingness (and ability) to take out a mortgage to purchase a property is unusually high and likely set to stay that way.

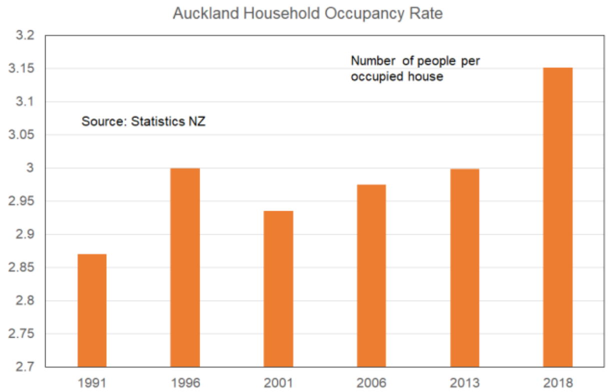
11. When the discussion of potential property over-supply blossoms, it will hide the fact that shortages still exist of both social housing and

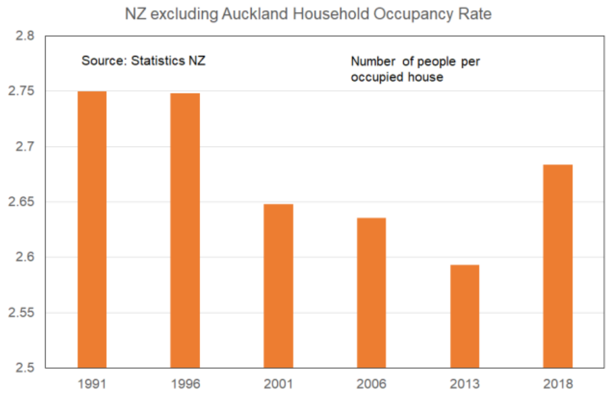
entry-level housing. Through the OECD the average proportion of housing stock devoted to social housing stands at around 8%. New Zealand is below 4%. State housing agency Homes & Communities is going to be an active buyer of properties on an opportunistic basis alongside planned developments for a necessarily great number of years. Yes, they are that slow. Ask any developer who has worked with them.

Since the mid-1990s New Zealand may have built houses in numbers proportionate to population growth, as represented by the absence of a soaring occupancy rate nationwide.



But this has not been the case in Auckland where the occupancy rate has gone from 2.87 in 1991 to 3.15 in the 2018 census. The NZ-wide numbers are 2.78 and 2.82 respectively. The houses have been built outside of Auckland for one thing. Second, they have been predominantly in the middle and upper price bands compared with earlier years.





Summary

It is not always the case that shortages are real. They are a matter of perception. If I think that there will be a shortage of toilet paper, I will rush out to buy some. But there was never a shortage during the pandemic – just some emptied shelves for a while as supermarket operators waited for their replenishment orders to be delivered from the well-stocked warehouses.

The same thinking applies to over-supplies. If I think something is in excess supply I will delay my purchase timing, rundown existing stocks if I have such, expect prices to fall, and prices probably will fall because buyers have stood back. But lag times between planning and construction are long and getting longer in housing. The more we step back as buyers now and the more that developers put projects on hold, the greater will be the whip back the other way when sentiment shifts towards there not really being an over-supply.

Note that the longer the period of over-supply discussion goes on, the greater will be that whipping back when it arrives because the greater will be the number of people wanting to buy who have decided to sit on their hands.

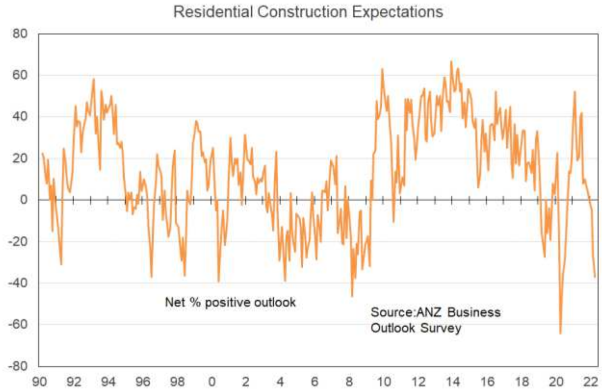
My message in this little article is probably of interest to home buyers or real estate agents. But it is aimed at home builders. You face many pressures at the moment associated with resource shortages. When buyers stepping back get added to the mix more so from late this year, some of you will struggle to keep up cash flows.

But such is the nature of cycles and house building cycles in particular. The large builders doing well at the moment with good brand reputation have been through such cyclical periods before. They will recognise that as some of the newbies get weeded out over the next two years their own brands will emerge even stronger, especially if their financing model has strong reliance on private equity as opposed to non-mainstream financiers.

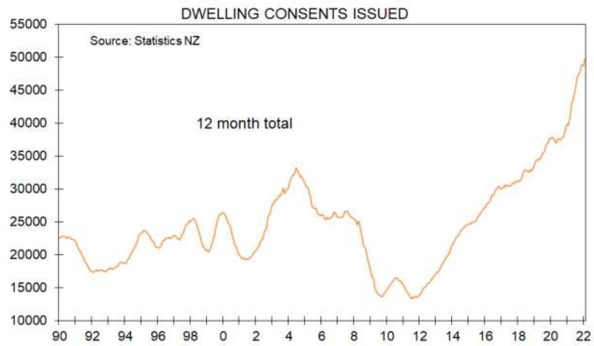
The coming period of over-supply talk – whenever it truly arrives – will not change the underlying fundamentals for Auckland. This is our biggest city. It offers agglomeration benefits not available elsewhere and is where migrants both foreign and expat will come to in greater proportions than for the rest of the country.

The coming combination of negative/subdued population growth at the same time as a construction boom will pass.

For your guide, last week ANZ released their monthly Business Outlook Survey. It showed that a net 37% of respondents in the house building sector expect reduced levels of activity over the coming 12 months. Outside of the initial pandemic shock to -64% that is the worst reading since the GFC.



We have been in this position many times before as the above graph shows. But we have not been at such extreme levels of construction activity since the 1970s. The risk of a correction is high and graphs like this will feed into the coming over-supply phase.



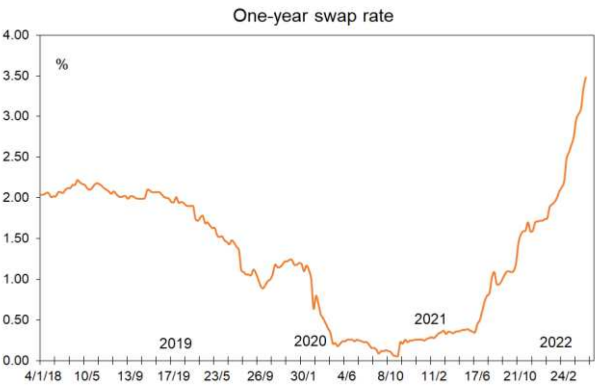
If I were a borrower, what would I do?

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 creep higher

Wholesale interest rates which form the base from which banks calculate the cost of lending money to you and I edged higher this week in anticipation of this morning's tightening of monetary policy in the United States, the actual tightening in Australia, and anticipated tightening here.

The one year swap rate at which banks borrow fixed one year to lend fixed one year (they do not fund fixed rate loans with floating rate borrowing) rose to 3.48% from 3.34% last week and 1.75% at the start of the year. This time a year ago this borrowing cost for banks was 0.4%.



The three year swap rate this week edged up to 4.1% from 3.9% last week, 2.5% at the start of this year, and 0.7% a year ago. The five year

swap rate has risen to 4.15% from 2.92% last week, 2.6% at the start of this year, and 1.15% a year ago.

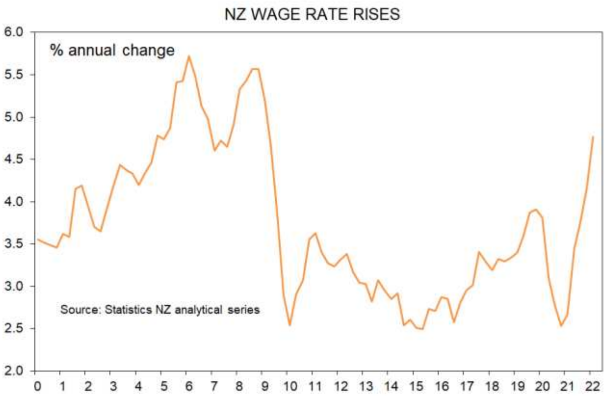
In Australia the Reserve Bank has just engaged in one of the biggest about faces on monetary policy ever seen. The Governor up until recently has criticised the financial markets for pricing in rising rates in response to higher inflation and insisted he would not raise rates until 2024.

But whatever analysis he was using has proven to be very poor and this week the RBA raised their cash rate from a record low of 0.1% to 0.35% and signalled more rate rises lie ahead. The move was more than generally anticipated, and this added to an upward shift in our own interest rates in wholesale markets this week.

In the United States the Federal Reserve have kicked off their move away from excessively loose monetary conditions with a 0.5% rise in the funds rate to 0.75%. The move was expected and further 0.5% rises are anticipated at the next couple of meetings. But the Chairman ruled out 0.75% changes and that has caused some easing back in US short rates.

On the local front there was no impact on rates from yesterday's labour market numbers. With the Omicron wave running through the economy at the same time as staff are simply not available it is not surprising that there was no net jobs growth for the second quarter in a row and that the unemployment rate held steady at 3.2%.

The measure of wages growth which I follow increased 1.3% in the March quarter whereas it rose 0.7% in the March quarter of 2021. The annual change has lifted to a 13 year high of 4.8% from 4.2% in calendar 2021 and 2.7% a year ago.



Wages growth is responding to the tight labour market. But it would be hard to run the case that wages growth is picking up in response to the lift in inflation to very high levels. That may or may not happen and if it does then that will likely elicit extra monetary policy tightening from the Reserve Bank.

My view is that by the time wages growth is starting to reflect higher inflation the inflation rate will be already easing off. We shall just have to wait and see.

All up, no local or offshore developments this week have altered the common outlook for additional tightening of NZ monetary policy. But my view remains that the official cash rate will peak at 3.0% rather than the 3.25%+ pencilled in by the Reserve Bank and the over 4% factored into swap rates. It looks like illiquid conditions in the swap rates market (not many offshore institutions wanting to lend at fixed rates) helps account for the unusual pricing currently being seen.

My current expectation for the one-year fixed mortgage rate in May 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	5.00	4.91	5.39	3 yr
2025	4.25	4.75	5.55	4 yr
2026	4.00	4.60	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 4.91%, four years 4.75%, and five years 4.60%.

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 would 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.

Links to publications

Tony's View Spending Plans Survey

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Business Survey

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