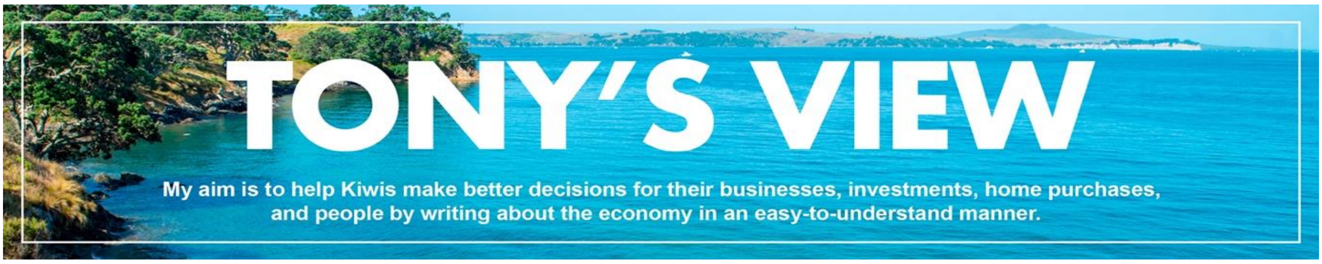

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ISSN: 2703-2825 19 September 2024
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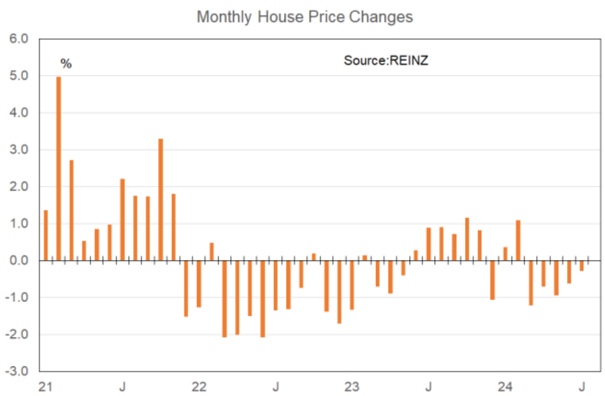
Real estate activity

This week REINZ released their monthly data. One of the main things we can see from their numbers is that the pace with which prices are falling on average around the country has slowed and may even have stopped.

In August their nationwide House Price Index was unchanged from July after falling 0.3% in July, 0.6% in June, and 0.9% in May. The graph here shows the waning strength of the monthly decline towards the far right.

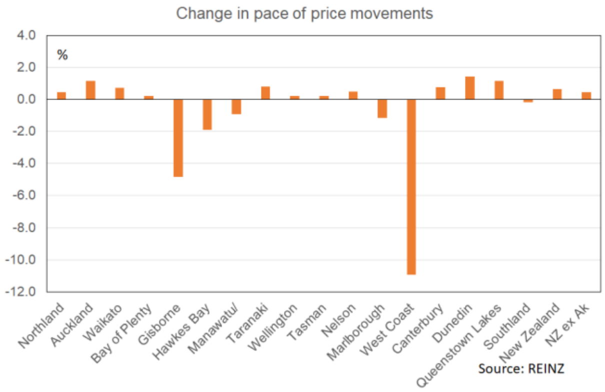


At this stage, given the strong rises in most of the measures gathered in my surveys of real estate agents and mortgage brokers I expect average prices to start consistently rising each month very shortly. Are they already in fact trending up anywhere?

It's no good doing my usual calculation of the most recent three months versus the previous three months as the big declines 2-3 months ago cover up the more recent improvement. That calculation shows a three month nationwide decline of 1.7% from 1.2% in the three months to May.

But if we just average the monthly change in the past three months, we get -0.3% versus -1% in the three months to May and that seems to be the best way to see what is happening right at this moment.

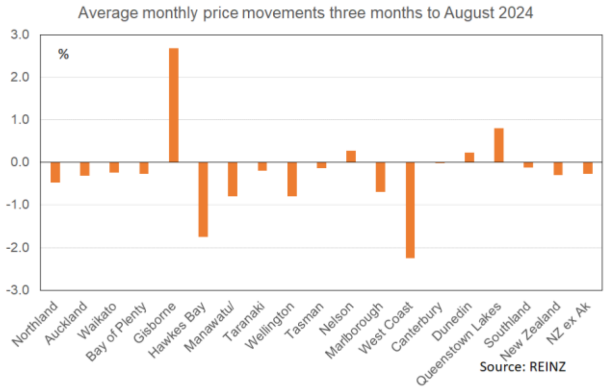
This following graph shows the difference between these calculations and nationwide for instance gives an observation of +0.7% being the -0.3% less the -1.0%. The positive orange column means price movements are improving nationwide.



We can see that things are improving in Northland, Auckland, Waikato and Bay of Plenty, but still getting worse in Gisborne, Hawke's Bay, and Manawatu-Wanganui. We also see improvement in Taranaki, Wellington, Nelson, Tasman, Canterbury, Dunedin City, and Queenstown Lakes. But there is still a worsening of price changes in Marlborough, West Coast, and slightly in Southland.

We are at a turning point in the house price cycle and one thing we all have learned from past cycles is that not all regions turn at the same time. So I make no extrapolation from the graph into what prices are likely to do for the coming year let alone the cycle overall. All we can see is where opportunities for buyers seeking a market still in their pricing favour may lie and where buyers may need to be more willing to meet improving vendor price expectations.

For completeness, this graph shows average monthly house price changes for the three months to August.

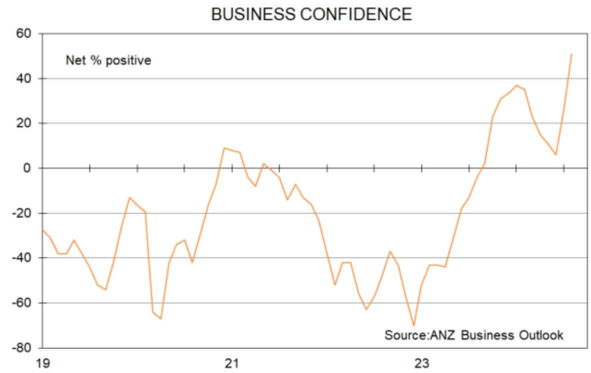


Because I am interested in the turning of the price cycle, I see little point in discussing how prices compare with a year ago. That tells us about the past year as a whole and not what has been happening since interest rate confidence improved which is what we're all mainly interested in now.

With regard to that confidence element, as noted here in recent week's the upticks in sentiment measures since interest rate worries shifted have been quite severe.

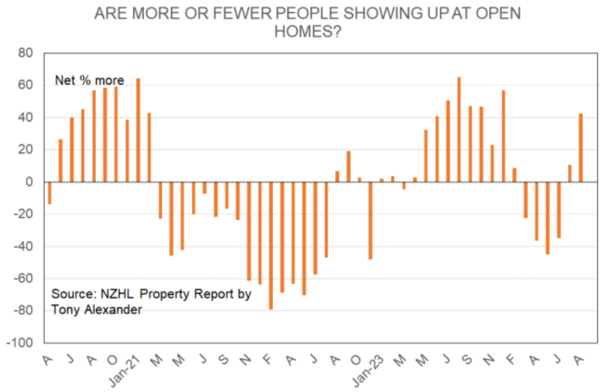
For instance, the net proportion of people planning to raise their spending levels in the next 3-6 months has gone from -42% three months ago to -13% now. Last year exactly the same shift to reduced pessimism happened, but it took seven months.

The ANZ's monthly Business Outlook Survey has recorded a two-month surge in confidence about the economy over the coming year to a net 51% positive from just 6%.



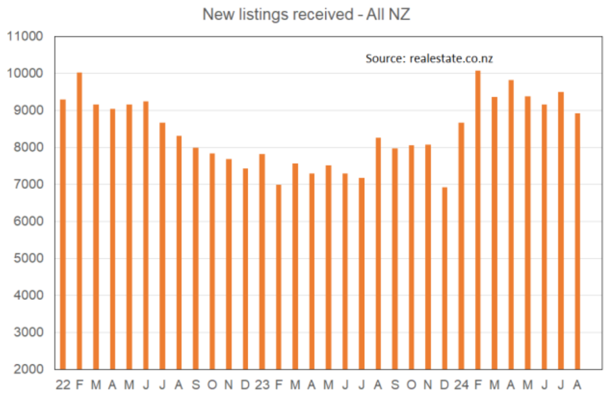
The many measures I glean from my monthly survey of real estate agents have also soared. But these focus on what agents are seeing rather than just what they or the buyers are feeling. In that regard I feel there is a solidity to the real estate market recovery which is not necessarily apparent in the rest of the economy as yet.

For instance, a net 42% of agents say that they are seeing more people attending open homes and a net 12% say more people are at auctions. Two months ago these readings were -35% and -37% respectively.

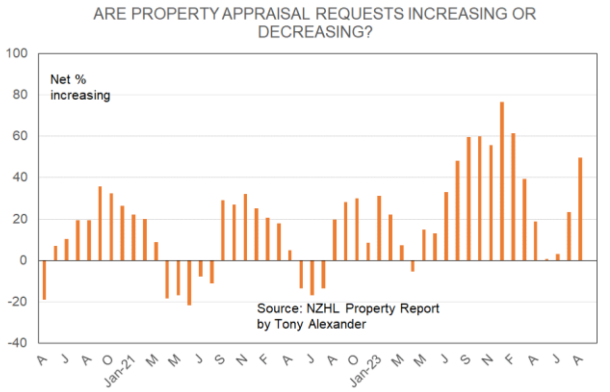


But before anyone over-extrapolates this surging buyer interest into newly soaring prices, it pays to remember what happened when the market turned for the better last year. Sellers eventually appeared in droves.

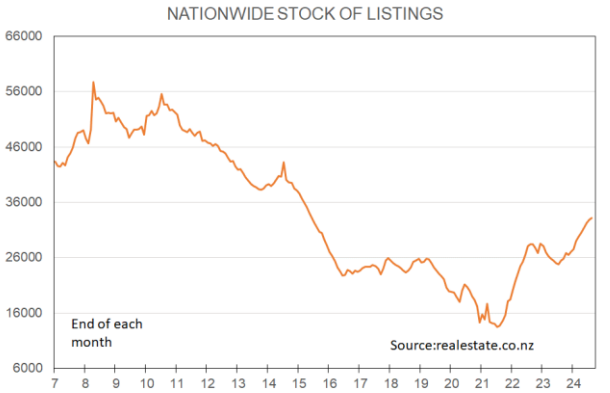
In January and February this year the number of fresh property listings received by agents around the country soared in seasonally adjusted terms by 25% and 16% respectively.



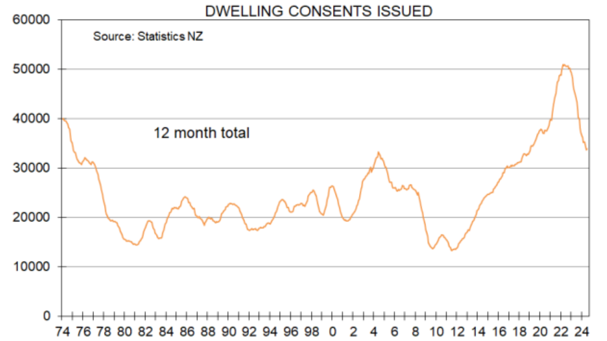
From my real estate agent survey with NZHL a net 50% of agents from just 3% two months ago say that they are receiving more requests for property appraisals.



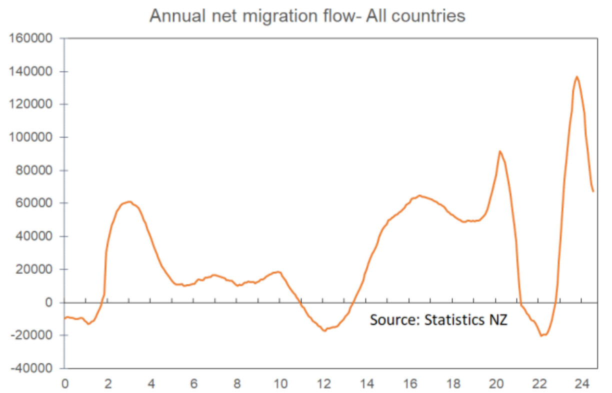
So, both demand and supply are rising at the same time. And it pays to remember that the stock of listings is about 30% higher than a year ago and at the highest level since 2015.



Also, keep in mind that compared with previous housing cycles this one is characterised by a structurally higher level of house construction. Going into the GFC annual dwelling consent numbers nationwide were about 27,000. They fell to 13,500 come 2011 which was the lowest total since the 1960s. This time around numbers have gone from 51,000 a couple of years ago to 34,000 and will probably bottom out near 30,000 driven mainly by falling consents for townhouses. If I recall rightly Treasury assumed 32,000 in the May Budget.



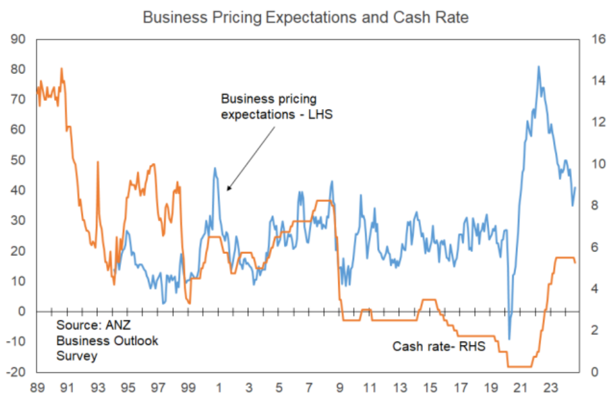
Also, note that net migration flows are falling away rapidly. However that these flows are impossible to accurately forecast so a year from now we could just as easily be surprised by a still high net inflow as a big negative one.



Finally, watch out for excessive optimism about where mortgage rates are headed. Falls are underway with more to come. But I remain concerned that business pricing plans are still much too high.

A net 42% of businesses still say they plan raising their prices in the coming year whereas the average level consistent with 2.3% inflation for the past three decades has been 26%.

This next graph shows the cash rate level as the orange line and the pricing intentions measure as the blue line. If these expectations go back to average, then the experience since the GFC ended would suggest a cash rate near 3% is a perfectly reasonable expectation.



However, the post-GFC global environment was one of inflation failing to spark as expected, resulting eventually in deflation concerns come 2019 which encouraged the Reserve Bank to cut the cash rate to 1%. This was lower than the GFC's 2.5% level despite firm economic growth and a near 4% unemployment rate.

Are we still in such a deflation-risk environment? If you feel the answer is yes, then expecting the cash rate to fall potentially below 3% while the pace of economic growth in NZ accelerates is not an unreasonable expectation.

But if you feel the deflation risk is removed by factors such as

- climate change costs,
- supply chain difficulties,
- rising central and local government charges,
- reduced money printing (perverse but it seems to work that way), and
- lower productivity growth,

then a sub-3% OCR seems like a brave call without recession returning.

If I were a borrower, what would I do?

Wholesale interest rates have decreased by amounts less than 0.1% this week, mainly in response to lower rates in the United States as expectations grew of the Federal Reserve commencing their easing cycle with a big bang 0.5% rate cut rather than the previously expected 0.25%.

In the event, last night they did cut the rate by 0.5% with their focus seeming to have shifted a lot towards concerns about the weak labour market and meeting their dual mandate of low inflation and firm employment.

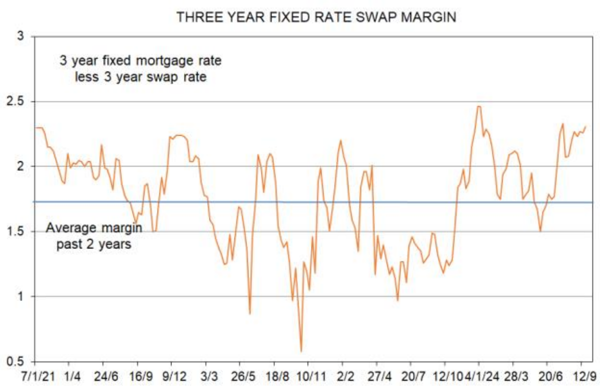
The NZ one-year swap rate which forms a base from which banks add other costs and a margin to get their one year fixed mortgage rates fell to around 4.17% from 4.25% last week and 5.25% at the start of this year.

The three year swap rate has edged down to near 3.48% from 3.53% last week and 4.3% at the start of the year.

This graph shows the three year swap rate from 1995. Ignore the observations before the GFC as there was a structural decline in interest rates around that time. I have also blotted out 2019-21 because rates then were unusually low due to worries about deflation and then the pandemic.

What we get left with is the current three year swap rate of about 3.5% sitting above the average since 2009 of 3.4%. I reckon it is reasonable to expect another 1% decline based on the 2009-18 experience.

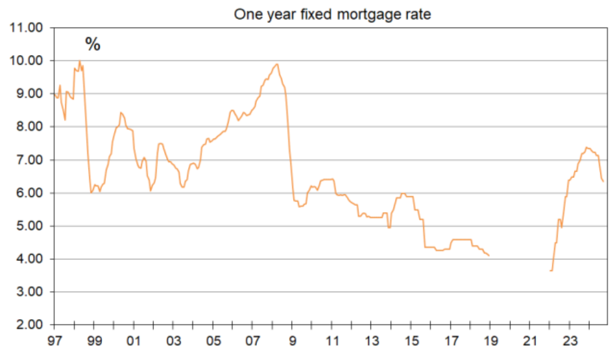
This graph shows the roughly calculated margin on three year fixed rate mortgage lending being earned by banks in NZ. There is scope for this and all other term fixed rates to decline without any further decline in wholesale borrowing costs.

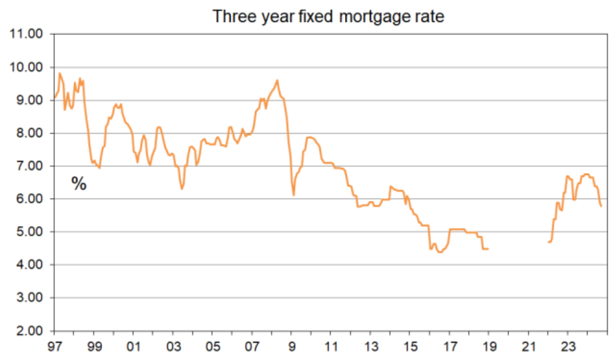


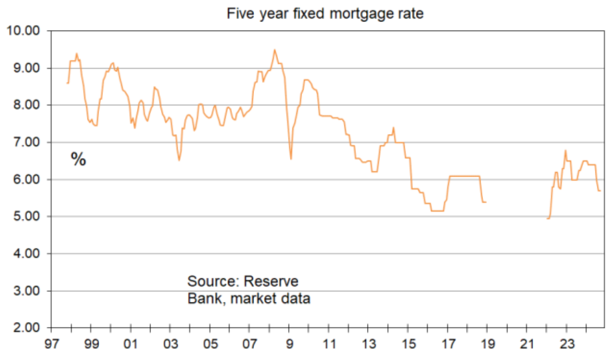
Note however that this visual calculation does not include all mortgage lending costs and especially not the upwardly trending ones in recent years of extra capital requirements, extra investment needed in technology etc. The graph can simply serve as a broad guide, and we cannot know for instance when one bank will blink and cut their rates firmly to achieve market share growth.

Based on experiences of recent years it is likely their cutting will initial be out of the limelight and this seems to be the case currently for some discounted 18 month rates being made available to customers.

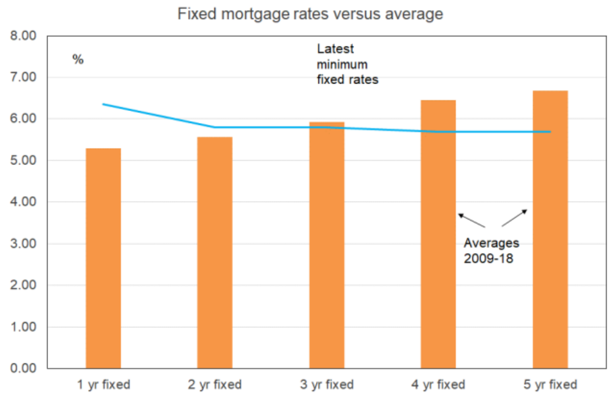
These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.







This graph shows how current rates compare with averages from 2009-19.



If I were borrowing at the moment, I would be fixing for either 6, 12, or 18 months looking to eventually fix for 3-5 years perhaps in 2026. But watch for the 3-5 year rates reaching their lows earlier than this. I am wary of business pricing practices not shifting sufficiently away from cost-plus pricing to allow the cash rate to fall below 3.5%. These are very early days in the interest rates easing cycle so do not rely strongly on anyone's rate predictions. We economists will change them right in your face as we are talking with you.

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.