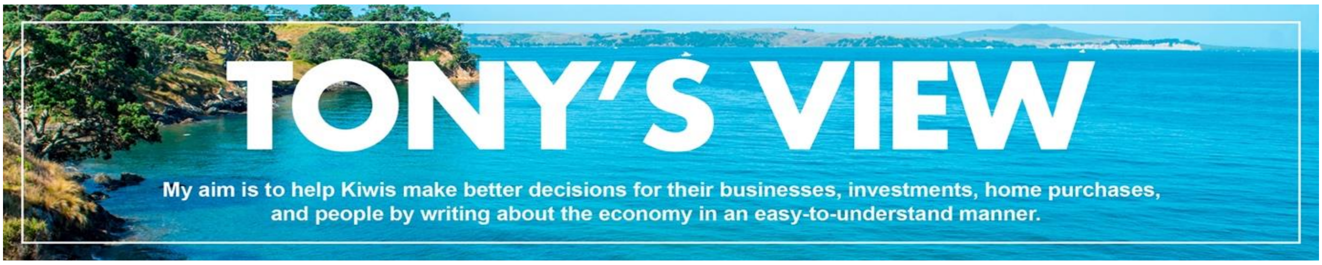

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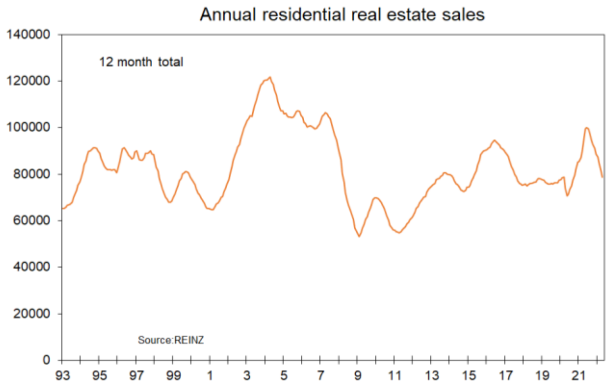
Negative commentary

I took a call from a journalist the other day on the issue of whether house price forecasts by us economists drive house price changes. I'd been expecting such an enquiry for a few weeks on the basis of comments coming through in my monthly survey of real estate agents undertaken with REINZ. In the survey three weeks ago a high number of agents attacked the media for painting a gloomy picture of the real estate market and house prices, and one or two mentioned economists. The main focus was however the media – maybe they were being polite.

The placing of blame on the messengers is a sigh that there is true weakness in the market, that agents are struggling to convince buyers they should make a purchase or up their offer, and that agents are increasingly fearful of deep weakness in their already falling commission revenue.

Their blame is misdirected, but their fears are valid. Already the annual number of dwelling sales recorded by licensed real estate agents has fallen from 100,000 in June last year to 78,800 in April. The chances are annual sales will decline to 65,000 and possibly lower.

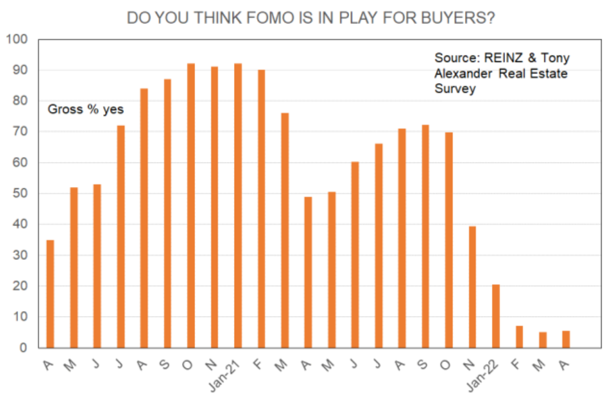


This is not just because of the turning in the cycle but because of some key characteristics of the current economy and housing market.

First, job security is high. The number of property owners who will feel they need to sell their property and either rent or downgrade to a lower priced property is going to be very small this cycle. People facing interest rate stress will easily be able to pick up extra work if they want it, and their chances of being made redundant are unusually low. There will be very few distressed owner-occupier sellers this cycle.

Second, and as I have been noting for a year now, there is and will be no wave of investors selling, much as many said they would do so as soon as the tax regime was changed at the end of March last year. Investors know that property acts as an inflation hedge and that is important during a time of high inflation.

The returns they can get from simple bank deposits are firmly negative after tax and inflation. They are largely in property investment for the long haul and rents they can earn are rising strongly – if they choose to raise them or let their property manager push them higher.



This absence of a wave of sellers is coinciding with buyers knowing time is on their side, feeling no FOMO, and diverting their spending into other areas such as weekly groceries and offshore travel.

Given this environment of dwelling sales falling away further for probably all of this year, it is unsurprising that agents and others are looking to blame the media and negative commentary for their situation. But such complaining will not change the fact that many people will have to leave the sector in the coming year or two.

But those who have seen the cycles before will remain, work their areas well building their brand, and set themselves up for good revenue growth when the cycle eventually turns – as it always does. Those leaving the sector will be able to walk through the door of the café next to their office and start work immediately – or go further down the road and pick up a job in one of the many tens of thousands of businesses looking for more staff.

Looking back again at the issue of whether commentary can drive markets. A part of me believes it does because it was the prediction from an excellent digital journalist back in late-2008 that house prices would fall 40% which drove me to jump boots and all into analysing and commenting on the housing market.

My concern back then was partly that the high profile prediction from a non-economist would unnecessarily scare people at a time when there was already talk of a new Great Depression. But it was mainly driven by the fact that New Zealand's housing market back then was in a vastly different position from those overseas experiencing substantial price declines.

We did not go into the GFC with bad bank lending, and we did not go in with excess production of houses. In fact, the much-talked about shortage of houses in Auckland started from insufficient construction in around 2004.

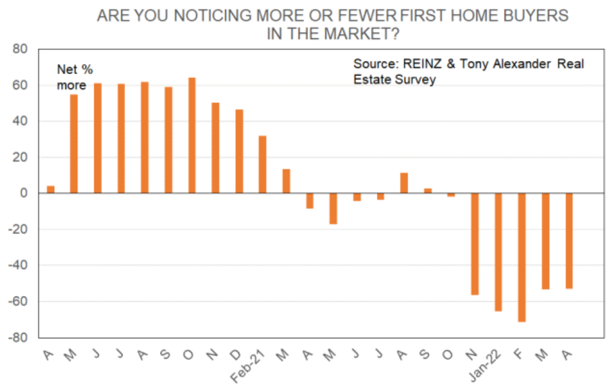
So, I do believe that certain commentary can influence the market. But such instances are rare. Consider the period from March – June of 2020. Back then as the pandemic was getting underway there were widespread predictions that NZ house prices would fall by 10% - 15%.

Instead, they jumped over 40%. That is some fairly strong proof that even if every single forecaster is predicting asset price decline the asset price can still surge upward if the fundamentals in play are strong enough.

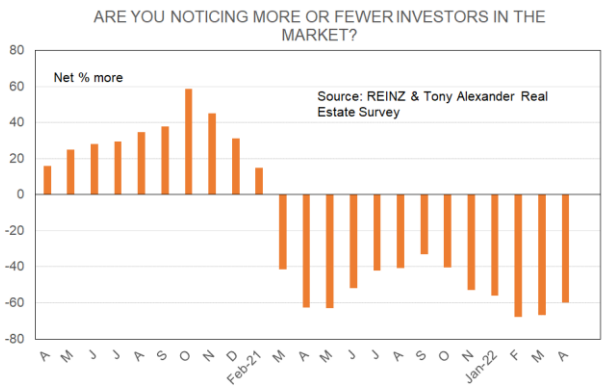
Consider also the month of November last year. Back then ANZ were still predicting modest house price gains through 2022 and Westpac only expected modest declines in the second half of 2022.

But I can see from my monthly survey of real estate agents that the market had already turned downward and continued doing so even in the absence of any great predictions of house price decline.

At the end of October 2021, a net 2% of agents said that they were seeing fewer first home buyers. At the end of November, despite the absence of forecasts of imminent house price declines, a net 56% said that they were observing fewer first home buyers in the market. The latest reading is a net 53% seeing fewer such buyers. The withdrawal of these buyers happened before forecasts turned firmly downward and commentary radically altered.

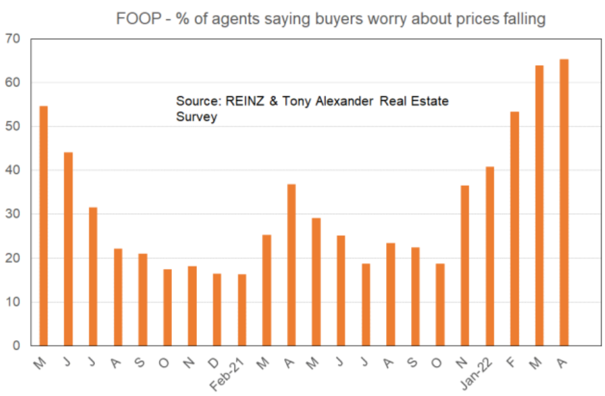


The same goes for investors but the change there occurred right after the late-March 2021 tax changes announced by the government.



The gross proportion of agents saying that buyers were displaying FOMO – fear of missing out – was 70% at the end of October but just 39% come the end of November. It is now just 6%.

In contrast, at the end of October only 19% of agents said that buyers were worried about prices falling. Come the end of November that was 36%. At that time there were no data in fact showing prices going down and as noted above forecasts of price changes had yet to shift decidedly to the negative. The proportion is now 65%.



Forecasts of substantial house price declines only happened after prices had started to turn and after buyer sentiment had already soured. Therefore, the argument cannot be successfully made that price decline predictions have driven prices downward. And after all, every such prediction of price corrections since 2011 has been wrong – 100% in error. So, it would be very surprising if the general public were to ascribe much credibility to price decline predictions anyway.

I take the increasing concern which residential real estate agents have about the negative housing market commentary which now dominates as a sign that they see little hope of revenue improvement this year. Their reaction is natural. But if they think any decision by the media or economists to refrain from making negative comments would help them, they are very much mistaken.

The negative fundamentals for the housing market remain in the ascendancy. I noted over a year ago that we had entered the end-game for the boom. Now we are out of that end-game and into the actual decline itself. The next shift will be to the market plateauing.

Are we near that plateau stage yet? No. But I can see amongst the strewn entrails of my surveys that the speed of decline in some sentiment and intentions measures is slowing. In mathematical terms, the second derivative is turning positive, but the slope is still downward for now.

My current best pick for the plateau being reached is in the first half of next year.

Some Budget comments

As a rule, I keep commentary on the Budget to a minimum because there is a plethora of information and discussion already readily available to anyone who is interested. My focus is mainly one of asking a small number of questions.

First, are the economic growth numbers used by Treasury reasonable? They have growth averaging 2.1% per annum for the next five years with a fall to just 0.7% growth in the year to June 2024 then slow recovery to 1.6% then 2.5%. These numbers are reasonable in light of surging energy costs, slowing world growth, and rising interest rates. They are down from predictions of 2.2%, 2.3%, then 2.3% made in December.

The prediction of 90-day bank bills close to 3.5% from mid-2023 versus 3.1% before is reasonable though I suspect falls from 2024/25 whereas Treasury have no declines. The expectation of the unemployment rate rising to 4.8% mid-2025 might be on the high side. The forecast of house prices falling only 2.5% in the year to June 2023 then 0.4% after that before rising slightly, looks a tad optimistic.

Overall, the numbers are acceptable.

Second, does the fiscal track look sustainable? Net debt is predicted to peak at 19.9% of GDP mid-2024 (41% of GDP old measure) then ease off. This looks reasonable. Surpluses are predicted from 2024/25 and that seems fine with no issue for credit rating agencies.

Third, does the Budget lead me to change the outlook I had for the economy before the Budget was read? No. There is more money for health, climate change, and infrastructure with spending not blowing out deficits or requiring higher taxes. Basically, the government is spending positive fiscal surprises seen in recent fiscal updates and resulting projections rather than banking them to accelerate debt reduction and provide more ability to handle the next big shock.

None of the three big spending areas will change the growth path for the economy over the short or medium term. Long-term better infrastructure will provide scope for better growth – but it won't drive it. That is up to the private sector to generate.

In that regard, there is nothing in the Budget which will much alter the brain drain, including the special handouts to help some people handle the sharp cost of living increases underway due to the pandemic and Russia's invasion of Ukraine.

The extensions to the fuel levy discount and half-price public transport are temporary therefore will not change long-term consumer plans. Same for the $350 in the hand to some 2.1 million people.

The additional money for social housing is clearly good given the deficiency of such in NZ and removing/raising price caps for government housing assistance are logical and well overdue moves which will assist some young buyers.

Extension of apprenticeship subsidies for another year is good, and in theory the extra funding for a plethora of Industry Transformation Plans will be good. But reading the words used to describe what they will do makes one think of the game boardroom bingo.

All up, for health, infrastructure and climate change the Budget is good. But nothing leads me to alter my outlook for the economy, labour market and struggles for businesses sourcing staff, interest rates, brain drain, or house prices and construction.

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.

Monetary policy tightening

Next week the Reserve Bank will review the official cash rate again and it is highly likely that they will lift it 0.5% as they did last month and the rate will move to 2.0%. The financial markets have already priced in a movement of the cash rate to just under 4% next year so it would take a surprise 0.75% rise next week to give any additional upward push to wholesale borrowing costs facing banks.

The increases in those costs from this time a year ago have driven the strong front-loading of mortgage rate rises this time around. This has contributed already to an early turning of house prices and I believe is helping to suppress household spending very early on in the cycle. These early shifts stand in contrast to the situation the last time monetary policy was on a sustained tightening cycle from 2005 to 2008.

Back then house prices did not start falling until two and a half years after the first rate rise. This time it has taken about six months if we measure this using mortgage rate changes. It seems silly to do this measurement from the first OCR rise in October given the pricing in of such an increase from far earlier in the year.

The economy last time around remained strong until the start of 2008 when it went into recession

largely because the central bank was too complacent about inflation.

This time around their complacency now that they have started the cycle is not there, but that does not alter the fact that they and other central banks failed in their key task because they left monetary conditions too weak for too long. Now, an accelerated catch-up is underway.

In the United States this week sharemarkets have fallen anew in response to some weak earnings reports and a deepening feeling that the Fed. needs to aggressively raise interest rates more quickly because of inflation sitting above 8% and extra shocks expected down the line from events offshore.

Higher short to medium term US rates will place upward pressure on rates here. But the dynamics of all of this can start to get very confusing for us economists let alone the person in the street.

The more aggressive the rate tightening now, the greater the hit to the US economy and inflation and the shorter the time period to interest rates going back down. The key thing underway then becomes a potentially quick flattening of the yield curve and inversion with short rates above long rates.

We are probably going to have an inverse curve in New Zealand before the end of the year and from three years and beyond the level may not be much above the current swap rates near 3.7%.

What about this afternoon's Budget? Is there any meaningful relevance to the interest rates outlook and your potential hedging decisions there? Not really.

The Budget is primarily an accounting exercise and proof of adherence to fiscal principles. In that regard it is extremely vital as a check on governments losing fiscal control as National did in the early-1980s and Labour did ahead of the changeover to National in 1990 and 2008. They will probably do so again in the Budget of the election year during which they see a high chance of losing.

Wholesale borrowing costs facing banks are on somewhat of a roller coaster ride currently in response to fluctuations in expectations for inflation and the pace of policy tightening in the United States. The movements down this week have taken rates broadly back to where they were a month ago, except for 90-day bank bills relevant to funding floating rate mortgages. They have risen to around 2.2% from 1.9% four weeks ago as we have got closer to the next OCR rise.

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?

I would fix two years at the longest. In a few months I can see myself opting for fixing one year not because the rate will be cheap but in anticipation of being able to ride rates lower from probably 2024. That will be too big a call for most people, and it is likely most will stick with fixing for two years for quite some time now.

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

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