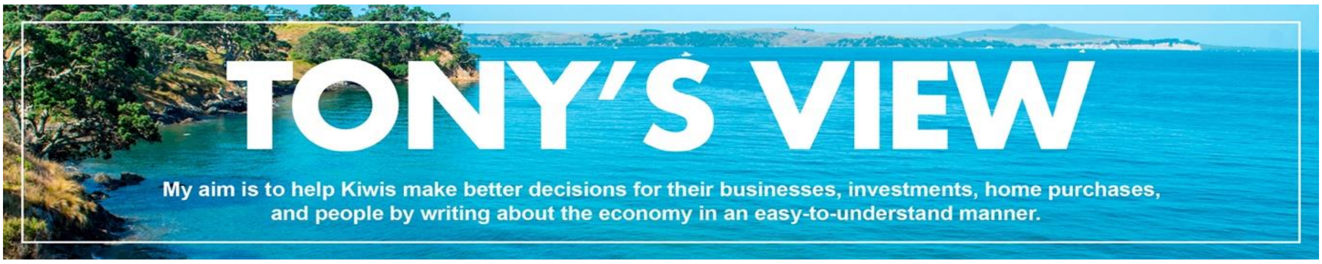

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Turning of the cycle

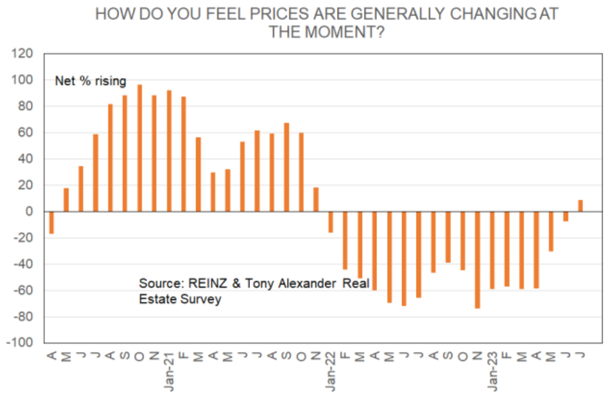
You might have noticed this past week that one of the major banks has lifted its expectation for the rise in average NZ house prices over 2024 from 2% to 8%. A Sunday newspaper just ran an article where house prices are considered highly likely to go up after the election. My pick for a while has been a 10% average house price rise over 2024 and in the end, we'll all be wrong on the up or downside because there is zero evidence any of us has a model or degree of insight good enough to accurately forecast house price changes.

The 8% forecast is important however because it is another factor which will contribute to the feeling amongst potential buyers that there is little point in standing on the sidelines any longer waiting for further declines in prices.

Price expectations change after actual prices have moved as a rule and the general public usually have the least up to date view on where things are generally headed.

As discussed elsewhere this week, we already have evidence from REINZ monthly House Price Index data that prices are already drifting back upward. Note that the REINZ have the most up to date dataset available. Others usually produce data which the media says are monthly but in fact are averaged over the previous three months – therefore not really telling us what is happening at the coalface.

Speaking of which, in my most recent survey of real estate agents we saw that a net 9% of agents now feel that prices are rising in their location.



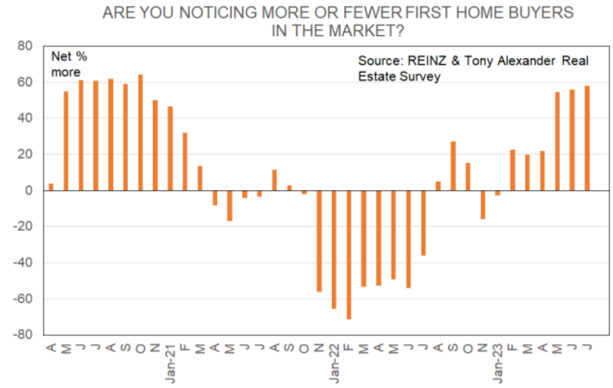
This is a turnaround from the situation in place since January 2022 when more agents have been seeing prices falling than rising.

The media are in fact behind what is already happening at the coalface.

Why is the market turning around? It is not because investors are back in the market. At a minimum those who use debt to finance their purchase are staying on the sidelines to see what happens on October 14. Having said that, long-term investors with existing good-sized portfolios will have already made their low-price purchases probably starting about a year ago, taking advantage of a handful of desperate vendors wanting to quit the sector.

These potentially multi-generational investors don't try to pick the bottom or top of the cycle. They focus on the long-term, buy for location and yield, and keep an up to date awareness of what the great unwashed are doing. These are the people who would have been selling their less desired properties earl in 2021 when things were very frenzied, and no effort had to be put in to finding a buyer of the most compromised dwelling.

The upturn in the market has been driven largely by first home buyers, as shown here.



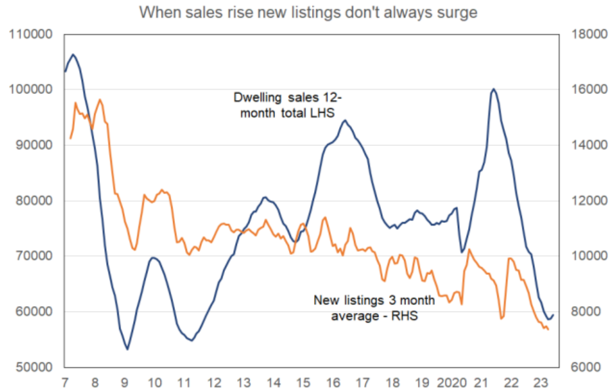
The first home buyers came back into the market as things showed signs of flattening out in the September quarter last year. Then they went back into the shadows following the higher than expected inflation number released on October 18 last year and subsequent extra 1% boost to fixed mortgage rates.

They are now buying – if they can get the finance. There are plenty who might have a good deposit, but their income is not high enough to allow them to purchase what they want and meet bank debt servicing limits with test interest rates near 9%.

This tells us something important. In 2024 when interest rates are easing at a pace we can't reasonably predict, these very frustrated and by then quite desperate buyers will enter the market as soon as the numbers allow. That is a wave to come on top of extra buyers encouraged by rising rents driven by strong migration-driven population growth.

Then there are those people who will look to bring purchases forward because of falling listings. The stock of listings falls when sales rise as they are now doing, and the experience of 2021 teaches us that low listings drive FOMO and higher prices.

And don't be thinking that rising sales will bring a lot of extra fresh listings to the market. This next graph shows annual sales as the blue line and new listings received each month by realestate.co.nz as the orange line. There is a weak at best relationship between changing sales and changing fresh listings.



Worries about property availability next year will help drive prices higher (yes, I fully anticipate that at some stage my forecast for price rises will go above 10%), but this factor will also shorten the period during which residential construction is weakening. I'll discuss that another day. Suffice to say, for builders, keep an eye on listings stocks as a guide to whether your region will experience a short or long period of activity decline relative to others. With Wellington's listings now halved from August last year, the construction decline will be shorter than almost everywhere else.

For your guide, here is a list of reasons why first home buyers have entered the market – if they can – this year.

Lower house prices

Prices have fallen on average by 18% or so since the ridiculous peaks of late-2021. The ratio of prices o incomes is lower than it was and from that point of view rather than debt servicing, properties are more affordable.

Strong real wages growth

Average wages have risen 22% since the end of 2019 while cumulative inflation adds up to 18%. The real purchasing power of people on average incomes has increased and given that young people have a high tendency to change jobs and that changing jobs tends to deliver above average wage rises, incomes of potential home buyers will have risen more than this comparison implies.

Job security

The unemployment rate remains low at 3.6%. Although this is up from 3.2% last year the degree of job security which young people feel is likely to be the highest for any recession which New Zealand has experienced.

Deposit growth

Young people have been holding off from buying for two and a half years. Over that time they will have grown the size of their deposits, especially because of the period during which spending on offshore travel was not possible.

Rents rising

There is a push factor behind the shift of young people to buying their first dwelling. Rents have continued to rise during the period when house prices have been falling. With accelerating population growth and investors cutting back on their provision of properties for rent, further firm rent rises are likely. This strengthens the incentive to seek home ownership.

Strong listings

The stock of properties listed for sale has increased from fewer than 14,000 in the middle of 2021 to now over 24,000. There is a greater range and number of properties on offer for young buyers to select from. However, listings are falling, and it is likely that there is growing awareness of this.

Interest rates have peaked

Most of us have said this before, this this time around it looks likely that fixed mortgage rates have in fact peaked out for this cycle. The Reserve Bank have explicitly stated that they do not plan raising interest rates any further. Young buyers can now see their worst case scenario for debt servicing and that may be encouraging a few to move their purchase forward in time.

Credit controls eased

In recent months tweaking of both the Loan to Value Ratio rules and the CCCFA have improved the availability of credit. It would be impossible to say with any proof that credit has become easy to obtain. But it is more available than through 2022.

Aversion for now to new builds

Unfortunately for builders, the recent attention paid to loss of deposits by some people who signed up for new builds will have understandably scared many young people away from buying off the plan. Such buying will eventually return. But for now this new-build aversion means buyers have shifted towards searching amongst dwellings which already exist and are available for purchase.

Passage of time

Time has passed, babies have been born, living in the home of one's parents has probably become less pleasing, and we are probably entering a catch-up period of buying by those who in ordinary circumstances would already have made a purchase.

In case you missed it

On Tuesday I released the latest results from my monthly survey of mortgage advisors. Key points to note are these.

- First home buyers remain the main driving force behind improving activity levels.
- High test mortgage rates are preventing many potential buyers from being able to make a debt-funded purchase.
- The market overall is improving, but the upturn is only mild.

[mortgages.co.nz & Tony Alexander Mortgage Advisers Survey - August 2023 - mortgages.co.nz]

If I were a borrower, what would I do?

I have the view that weakness in China will prompt monetary policy easing earlier than the late-2024 date pencilled in by the Reserve Bank and that a further rate rise is not necessary. So, if I were borrowing, I'd have a mix of 12,18, and 24 month terms.

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.