BNZ Weekly Overview

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Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

The Things Which Drive Housing Turnover

Basically interest rates, then credit controls, then migration, then economic/jobs growth, then housing supply growth.

Lets ignore Trumpit this week and take a look at the housing market, starting with a few things which interested people need to take into account, just for the record.

First, no forecast of a substantial decline in NZ house prices has been correct for the past four decades. When bad times come prices ease back a tad then the market sits still for a few years as sellers do nothing and an inevitable easing of monetary policy quickly reduces cash flow pressures on mortgaged people. Average prices fell 4% during the 1997/98 Asian Crisis recession and 10% during the GFC.

Second, paying attention to what rents are doing is a poor indicator of where prices will go. For years analysts have been developing models based upon what is considered a reasonable yield in the context of investments other than housing, and concluding that either rents will shoot up (they only ever rise slowly apart from some seasonal bumps) or prices will fall. But there are a lot more motivating factors involved than a simple yield comparison with equities, corporate bonds, and term deposits.

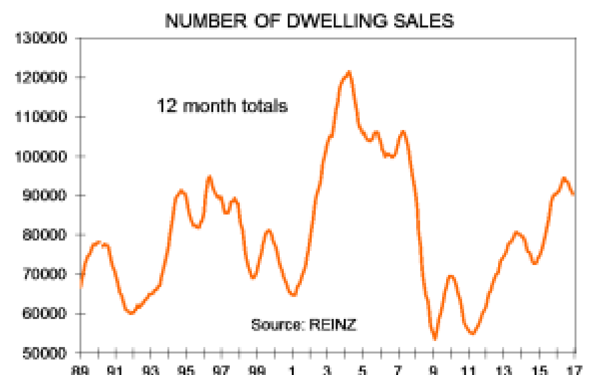
Third, people do lose money investing in residential property – and that is the irony of popular discussion about the sector. The stories of loss are invariably broad-based, semi-apocalyptic and couched in implied terms of seemingly greedy people getting their comeuppance. Those who actually lose money are usually average non-greedy but inexperienced and under-capitalised people who don't talk about it. They just quietly fade into the background partly because in an NZ cultural context it is not done to talk about failure.

Fourth, housing markets do move in cycles and we try to pick them using our forecasts of things we will outline below such as changes in interest rates, migration, supply, credit controls, employment growth, consumer sentiment etc. However as noted above, models of the housing market invariably fail and it is changes in what we sometimes call "animal spirits" which really kick a housing market up and down. Picking big changes in what average (usually poorly informed) buyers and sellers will do is often ignored by forecasters, difficult to do, but not impossible if you have been around for a few cycles or hang out with someone who has.

Lets now illustrate some of the factors which move the housing market, measured in this instance by the thing most relevant to real estate agents, mortgage brokers, bankers, decorators, lawyers and moving companies which is not price but turnover.

2004 - 2007

Back in early-2004 annual turnover by licensed real estate agents nationwide peaked at 122,000. Come the end of 2007 (before our NZ recession and the GFC) turnover had declined to 92,000. This happened in spite of the unemployment rate falling from 4.7% to 3.3%. What happened?

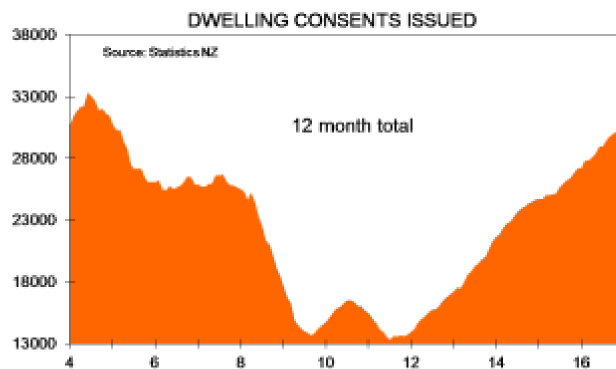


Interest rates
Rates rose with the average floating mortgage rate going from 7.2% at the start of 2004 to 10.5% come the end of 2007.

Net immigration
Flows eased with the annual net inflow falling from 43,000 in the middle of 2003 to 5,000 by the end of 2007.

Jobs growth
Net employment growth slowed down from 3.4% early in 2004 to near 1.5% by late-2007. Or we can proxy this with the annual pace of GDP growth which slowed from near 4.5% to 3.0%.

Construction
Supply growth eased. (New houses have to be sold.) The number of dwelling consents issued fell from a 12 month total of 33,000 in early-2004 to below 26,000 by the end of 2007.



Note that late in 2003 a net 22% of people in an ASB survey felt that it was a bad time to buy a house. This was 0% late in 2007. Measures of what people think give no reliable guide to where the housing market is going to go. Why? Because the overwhelming majority of people are not thinking about transacting a house so don't give a hoot really, and average consumers cannot predict asset market changes. They are the herd. They follow and can be taken advantage of by those who understand their behaviour.

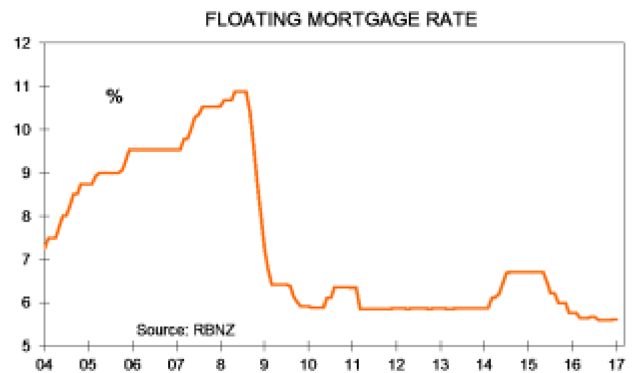
2007 - 2009

The next decent change in nationwide dwelling sales came as the GFC hit with turnover falling to just 53,000 early in 2009. Asking why this large decline happened is not interesting really because the answer is obviously the combined effects of our own recession in the first three quarters of 2008, the extra recession caused by the GFC, interest rates almost hitting 11% early in 2008, and the extreme focus on collapsing housing markets offshore.

The more interesting question is why did annual sales recover to almost 70,000 early in 2010?

2009 - 2010

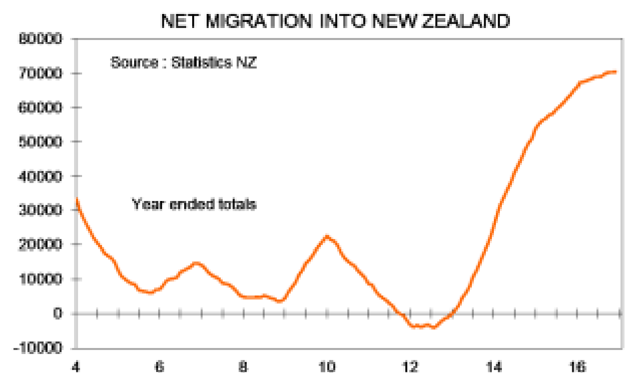
Average mortgage rates plummeted to below 6%, net migration flows jumped to almost 23,000 at the same time, and consumer confidence improved using the Westpac McDermott Miller quarterly measure to 117 from 82 mid-2008.



But as the graph on our first page shows, turnover then collapsed again back to 55,000 in early-2011. Why this big decline when things had been turning upward?

2010 - 2011

The Reserve Bank tightened monetary policy and average floating mortgage rates rose to 6.4% from 5.9%. Net migration flows fell from 22,000 to near 6,000 again. The consumer confidence reading fell from 117 to near 98, and dwelling consent numbers fell from 16,500 mid-2010 to near 13,000 mid-2011.



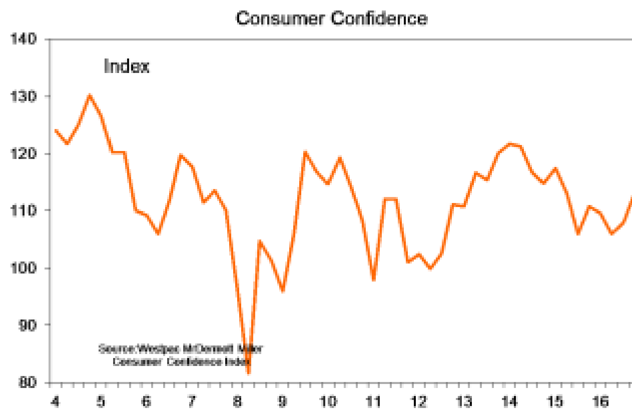
2011 - 2013

The 2009 upturn was a false recovery in housing market activity. 2010 was the reality check. So then what happened? This is where we get the really interesting stuff going on.

Sales improved from 55,000 to 81,000 come late-2013.

First interest rates fell again with floating mortgage rates declining from 6.4% in February 2011 to 5.9% in March – the trigger being the Canterbury earthquake though even without it the RB would probably have reversed its tightening over 2010.

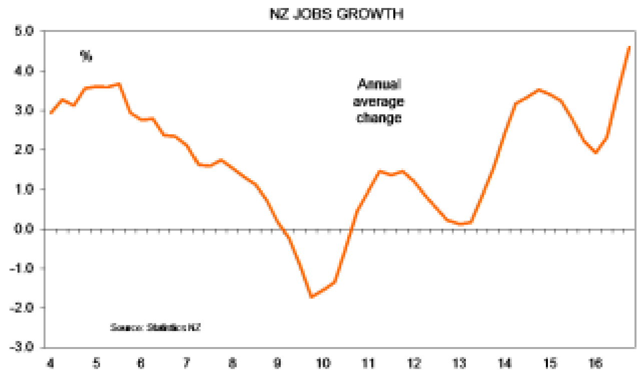
Second, consumer confidence recovered from a reading of 98 to 120 by late-2013.



Third, dwelling supply growth picked up with consents improving from 13,000 in 2011 to 21,000 by late-2013.

But that was it and it is unsurprising that many people even late in 2012 were predicting that the market would reverse and the 23% rise in average Auckland house prices over 2009-12 would not be maintained.

Net migration flows got worse falling from +6,000 to -4,000 mid-2012. And the labour market deteriorated anew with annual jobs growth slowing from 1.5% early in 2011 to 0% mid-2013.



2013 - 2014

What does this tell us? Interest rates, confidence, and construction matter a lot for turnover. So, over 2014 as the Reserve Bank raised its cash rate from 2.5% to 3.5% and floating mortgage rates rose from 5.9% to 6.7%, turnover once again eased, hitting 73,000 late in 2014 from 80,000 late in 2014.

This rise in interest rates outweighed the net annual migration inflow soaring from -4,000 in the middle of 2012 to 51,000 late in 2014, and jobs growth going from zero to 3.5%, and dwelling supply rising further to 25,000 late in 2014, and consumer confidence barely changing.

Some restraint will have come from the entirely new element injected into the mix in October 2013 – a requirement for almost all buyers to have at least a 20% deposit. In fact, annual turnover peaked at 80,677 in exactly October 2013 so this loan to valuation (LVR) factor could be more important in affecting turnover than generally considered at the time when after a short lull Auckland took off again.

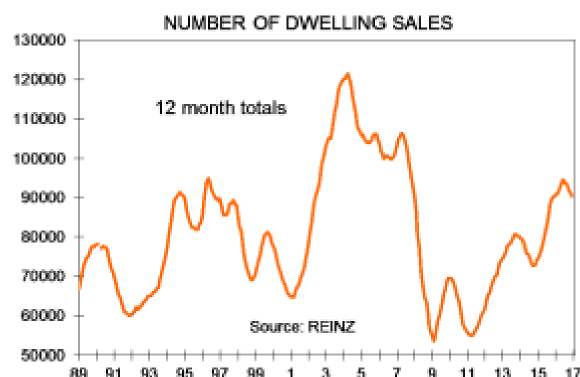
2015 - 2016

Turnover bottomed at 73,000 in October 2014 then rose to peak at 95,000 mid-2016. Why?

Over 2015 the RB completely reversed their 1% rate rise and floating mortgage rates yet again fell back to about 5.8%. So now over 2015 we have these things in action.

+Interest rates falling about 1%.
+The high net migration gain of 51,000 rising to 65,000.
+Dwelling consent numbers rising from 25,000 to 27,000.

-Jobs growth slowing from 3.5% to 2.2% but still holding strong.
-Confidence easing further to 110.



In addition, as noted, the effect of the new loan to valuation rules introduced in October 2013 faded quite quickly.

2016 - 2017

Turnover peaked at 94,633 in the year to June 2016. It has so far fallen to 90,432. Why the decline? Floating mortgage rates are basically unchanged but fixed rates have risen 0.5% - 1.0% so there is some restraint there though probably not all that much because the problem for buyers is not interest rate cost but getting a loan in the first place.

Credit controls were tightened again effective in de facto sense from July 2015 when investors nationwide were required to have a 40% deposit.

At this point we could stop this article and note this. If you want to forecast how busy people in the housing market such as real estate agents and mortgage brokers will be, concentrate foremost on forecasting interest rates, then credit controls, then migration flows, then look at economic growth/jobs growth, and dwelling supply growth. Don't try and forecast consumer confidence changes because no-one can.

But there are some other important dynamics in play. Here are the main ones which we have been highlighting here over the past few years.

Capitulation To No Market Crash

People put off buying houses in 2007 because interest rates were too high. Same for 2008 and then the economy went into recession. Then the GFC struck and people predicted 40% price declines. Potential buyers then kept holding off from buying over 2010 as borrowing costs went up again. Then they held off because people were still forecasting falling prices, jobs growth was low, and there was disbelief that Auckland's price gains would be sustained.

But from somewhere around 2012 (best guess) these delayed buyers realised that they had missed out on bargains and were at growing risk of missing out buying anything affordable. So they started moving into the market to catch up on buying they had been delaying since 2007. Many are still unfortunately trying to catch up.

Capitulation To A Housing Shortage

At about perhaps the same time people began to accept the strengthening commentary that Auckland had a housing shortage. They pulled back from demanding that analysts calculate how great the shortage was and just accepted it existed. And figuring out the logical price implications they started buying to profit from an expectation of higher prices.

Capitulation To Low Interest Rates

At best guess, over the period 2014-15 investors who had been holding out for a decent rise in simple bank term deposit rates to more acceptable levels gave up hoping. They saw our central bank cutting rates, they saw low inflation, they read about deflation worries offshore, and they listened to analysts speaking about the impact of things like new technologies on inflation over the long-term.

Giving up hope of getting desired yield from term deposits and bonds these investors started piling into the housing market. The number of them doing so has been compounded by two things. First, the Baby Boomer cohort is entering retirement. Second, they are looking for something delivering income for three decades of semi and full retirement, not just ten or 15 years. Third, they are able to service a mortgage they might need to take out to buy a rental property (long-term tenants or Airbnb) because more and more of them are still working.

We have highlighted that back in 1998 only 5.8% of people aged 65 years of age and older were in work, but now that stands at 23.6%. This

proportion seems sure to go higher especially now that the labour market is so tight.

Capitulation To A Structural Migration Shift

This effect has further to go. Back in late-2012 we warned people that Auckland housing had recovered during a period of weak migration flows and that a further boost would come when the cycle with Australia turned. We thought all-country flows would go from -4,000 to perhaps +35,000. Instead the annual gain now stands at 71,000. All forecasts so far of a peak have proven wrong.

We have shifted to highlighting that while this net gain won't be sustained, there is a long-term shift in net migration flows underway. In the ten years ending in 1986 the average annual net migration flow for New Zealand was a loss of 17,000 people. In the ten years to 1996 it was a gain of 3,000. In the ten years to 2006 it rose to a gain of 11,000. In the ten years to 2016 the gain averaged 22,000.

The migration trend for NZ is upward and it is hard to imagine anything other than that the deteriorating political and social environments offshore will keep Kiwis here and encourage more to return home.

2017 -

So what lies ahead?
+ Net migration inflows may soon ease a bit, but people have probably not yet adjusted their thinking regarding the housing impact of a trend shift in net flows.

+ Consumer confidence levels have increased recently and are well above average.

+ Annual dwelling consent numbers now sit at 30,000 and will probably go higher but not rapidly given the shortage of builders, shortage of materials, and new shortage of finance for developers. In the three months to December consent numbers in Auckland were down 1% from a year ago, Canterbury down 23%, and the rest of NZ up 12% but this is the slowest pace in one and a half years and down from 32% six months earlier.

+ Many investors have yet to reach the stage of truly solidifying their retirement income numbers and as these Baby Boomers do they will structurally further lift demand for housing investments – as will medical and lifestyle advances pushing out life expectations.

+ Booming tourism means good returns can be made buying properties and listing them on Airbnb. This reduces the stock available for long-term renters and by pushing up rents will act to encourage more buying for yield.

But

- Strong as the labour market is, jobs growth seems certain to slow down because of a shortage of people. However growth near 2% still looks likely and that will support market activity.

- We don't expect the Reserve Bank to raise its cash rate until May next year. Fixed and some floating rate borrowing costs have already risen to reflect higher borrowing costs offshore and in the NZ retain deposit market. However, these rate rises appear to have generally gone under the radar of a media still wrongly fixated on official cash rate changes.

- Credit controls. The Reserve Bank has cut the official cash rate to try and boost the pace of economic growth and inflation. But by doing so they have boosted housing turnover and prices and increased the risk that should something nasty like a foot and mouth outbreak come along, the banking sector and the economy would take big downturns. To mitigate that banking risk they have sought to restrict lending growth (while encouraging it through rate cuts) by introducing the loan to value ratio (LVR) requirements.

The evidence to date is that a 20% limit across all buyers shuts largely just first home buyers out of the market. A 30% limit for investor housing purchases has little impact. A 40% limit however has helped curtail investor demand in Auckland. But investors have simply flocked to the regions as they started doing after the 30% limit appeared because their deposits stretch further than in Auckland.

If Auckland rebounds then the 40% will probably rise to 50%. We'll see. The chances of that happening continue to get smaller and smaller but are not yet zero.

Add all these factors up and what do you get? A strong market for 2017 because the OCR is not expected to go up until 2018 and meantime firm support will continue to come from strong migration flows, a strong economy, shortages of houses continuing (worsening in fact) in Auckland and investors still snapping up what they can in the regions.

Assuming societies in the US and Europe do not tear themselves apart, rate rises over 2018 will make that year more interesting/challenging, especially as investors belatedly look at rising supply in the regions and then look at regional population growth projections. That is where the risks of price corrections lie – not in Auckland.

Have a happy 2017.

If I Were A Borrower What Would I Do?

I'd look at a mixture of floating and three year fixed. Regarding floating, we don't expect the Reserve Bank to raise the official cash rate until May 2018. Come the end of 2018 we currently forecast the rate will have reached 2.5% from the current 1.75%, then come the end of 2019 we reckon a rate of 3.5% is likely. Currently.

What that means is that making the these days bold assumption of no moves to alter bank margins and no changes in funding costs relative to the official cash rate, floating mortgage rates won't start rising until May next year. Come the end of 2019 they will sit near 7.5% from near 5.8% now.

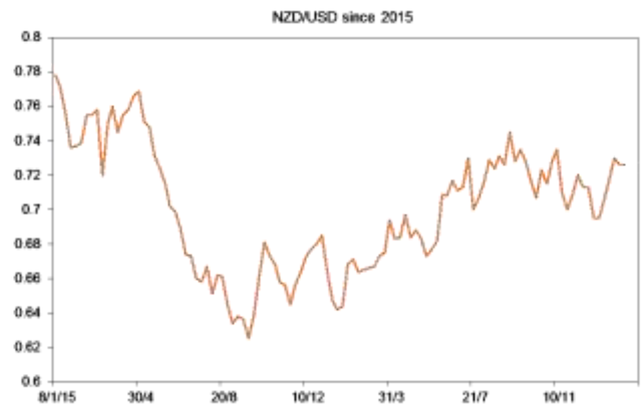
How long will rates sit near 7.5% and will they go higher? These things defy predictability given the way so many things have changed as a result of the GFC and the huge uncertainties surrounding the global growth and inflation outlooks. These uncertainties stem from unknowables surrounding the US Presidency, European elections, Brexit, Russian expansionism, Chinese expansionism, Middle East tensions (Iran, Syria, Israel – the list goes on).

To repeat the warning we have been giving here since about 2009. DO NOT decide upon your mixture of floating and fixed interest rates by placing heavy reliance upon any particular set of interest rate forecasts. Most forecasts have been wrong since 2008. Explicitly recognise high uncertainty by spreading your risk across a range of terms if possible.

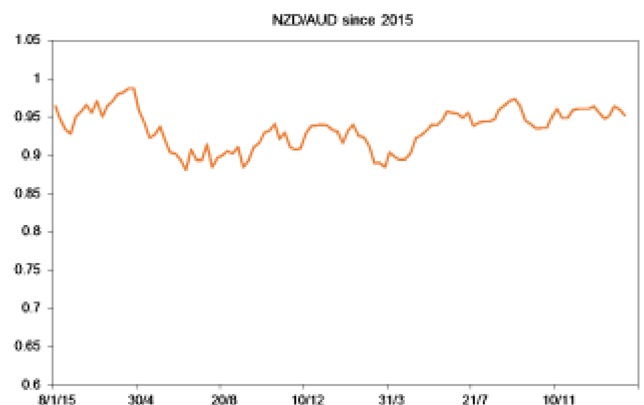
This morning the Reserve Bank undertook their first official review of the cash rate in three months and as was universally expected left the rate unchanged at 1.75%. They weakened the easing bias in their commentary in response to the improved outlook for the global economy and higher NZ inflation expectations. But this pulling back from warning of further rate cuts was less than the markets had been expecting. NZ growth is tracking as they expected.

NZD

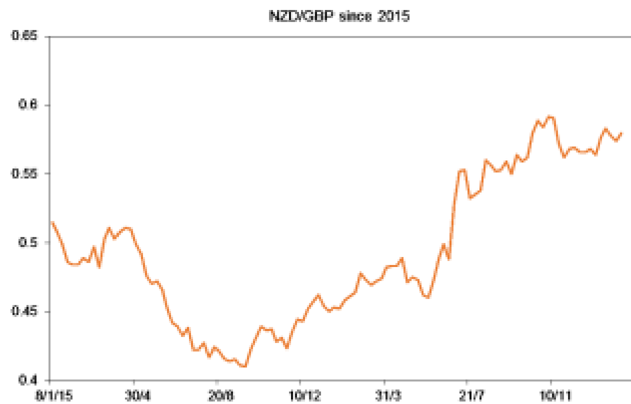
Same old. The NZD sits currently near US72.0 cents, down 0.5 cents from a week ago. On the crosses no big changes have happened.



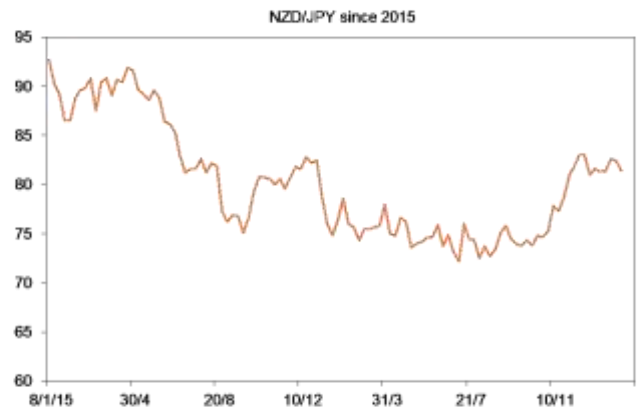
Personally I consider the NZD to have a very strong level of support with capacity to go higher against most currencies and in particular the USD and AUD. The former because the new administration appears intent on lowering the greenback in order to suppress imports and boost exports (good luck because these days the strong interconnectedness of exports with imports means the effect of currency change on trade balances is a lot less than a few years back.)



Against the Aussie dollar NZD appreciation looks likely on the basis of better economic performance here, more stable politics, better government accounts. Parity seems likely – but we have said this a few times over the past two and a half decades and so far been wrong every single occasion.



Against the British Pound NZD movement will be driven a lot by how views on the impact of Brexit develop. The GBP could easily rise firmly if things continue to look good economically as they have so far - to the surprise and disappointment probably of Remainers. Against the Euro NZD movement will be influenced strongly by how elections go in various countries over the coming two years, the extent therefore to which Europe moves to embrace nationalism (again), the timing of the ending of the ECB's still ongoing money printing exercise, and whether economic growth can get onto a good self-sustaining path in more countries than just Germany. Watch also for the return of the Greek debt crisis.



So many developments offshore make the NZ economy, society, and currency look very good.

If I Were An Investor ...I'd see a BNZ Private Banker

The text at this link explains why I do not include a section discussing what I would do if I were an investor.
http://tonyalexander.co.nz/regular-publications/bnz-weekly-overview/if-i-were-an-investor/

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