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.

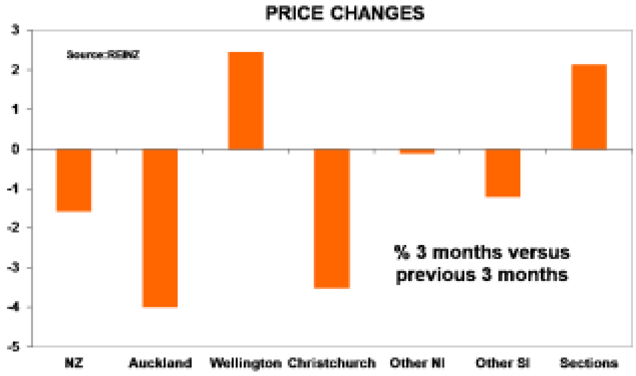
REINZ Monthly Data – Price Growth Flat or Slowing

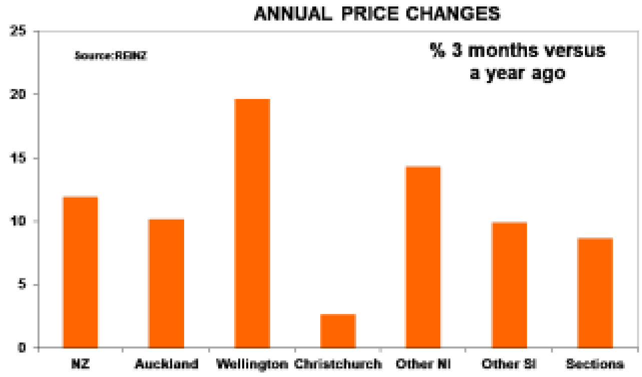
This week REINZ released their nationwide residential real estate sales data for February. Across the country as a whole their price measure which adjusts for changes in the type of property sold from month to month rose 2.7% after falling 2.9% in January.

In New Zealand you would do best not to pay much attention to monthly numbers on virtually anything as they can go all over the place. Smooth things over at least a three month period. Doing that we see nationwide prices in the three months to February fell 1.6% from the three months to November when they rose 2% and three months before that rose almost 4%.

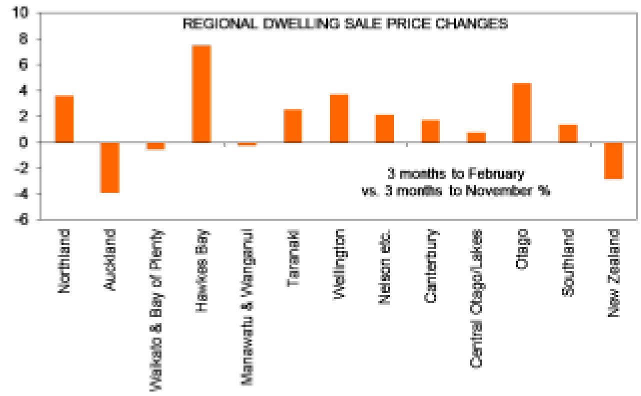
Prices on average have flattened out with a small downward bias stemming from Auckland being hit by the 40% investor deposit requirement (down 4%) while the Christchurch measure has been hit by a simple oversupply of property (-3.5%).

But slowing price growth is also evident elsewhere. Wellington prices have risen 2.5% the past three months from a 5.8% rise three months back and 3.8% three months before that. The pace of rises is slowing a bit. In the rest of the North Island prices are flat after rising 3.6% and 4.1% three and six months back. In the rest of the South Island prices are down 1.2% following 3.9% and 2% rises. Slowing to down also then.





At a slightly more disaggregated level you have to be even more careful regarding short term price changes. But if we stick with three month movements we get the following graph which uses data not adjusted for quality changes.

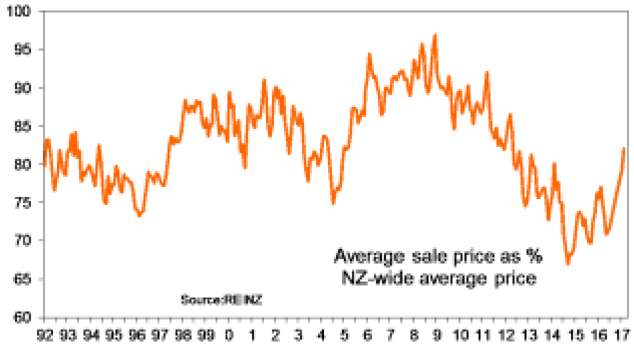


Looking deeper we can see the pace of price rises is slowing everywhere except Hawkes Bay, Otago, and Central Otago Lakes.

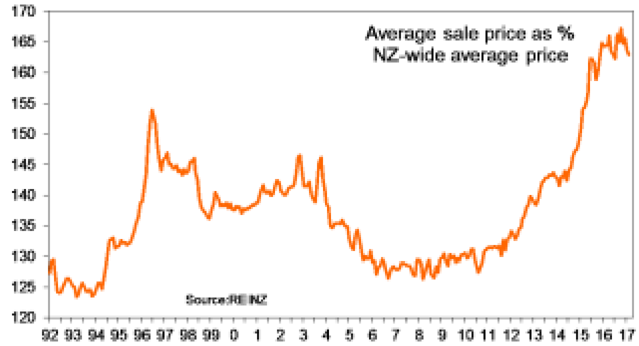
For your guide, we shall this week undertake an exercise we run about once a year which involves publishing graphs showing how the average sales price in each region compares with the NZ average. You can use the graphs to make up your own mind as to whether a region is looking fully priced or perhaps still has some catch-up to do.

Enjoy but don't get too fixated on data points or previous exact peaks and troughs. Each region has unique characteristics and the trick is to think in terms of changes. Are there reasons why Taranaki now is more different from before than other regions are different from before and so on. Everything changes, but its the relative changes which matter.

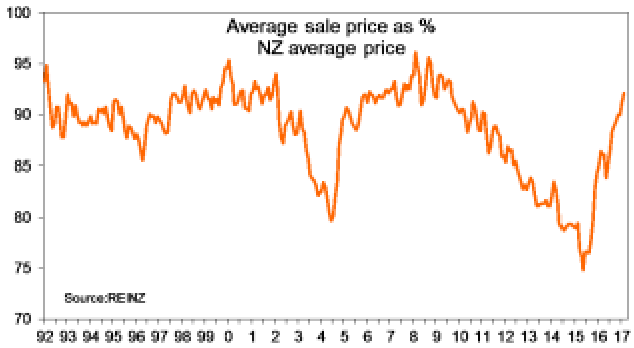
NORTHLAND



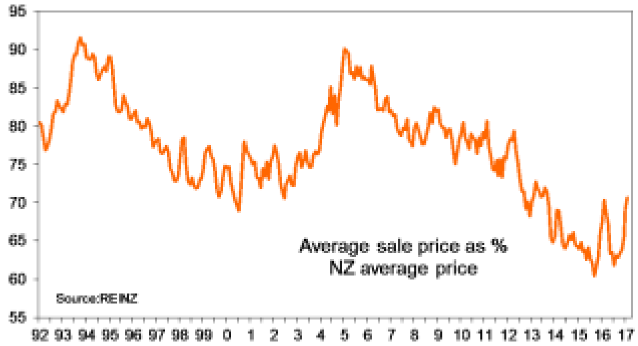
AUCKLAND



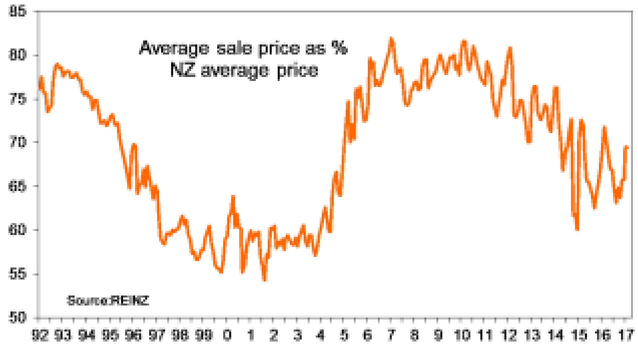
WAIKATO/BAY OF PLENTY



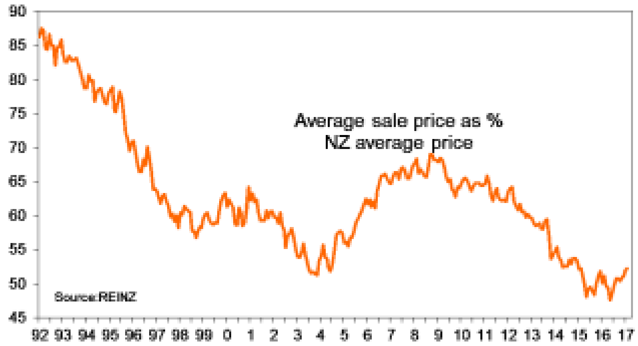
HAWKES BAY



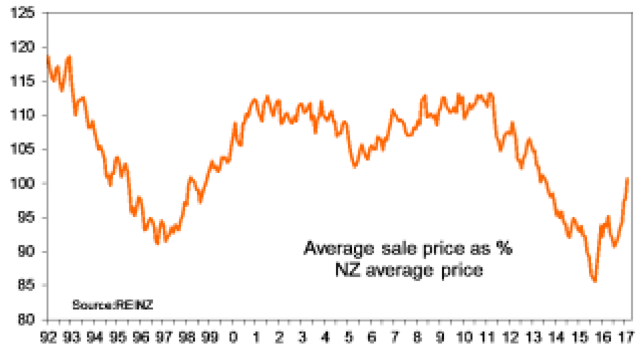
TARANAKI

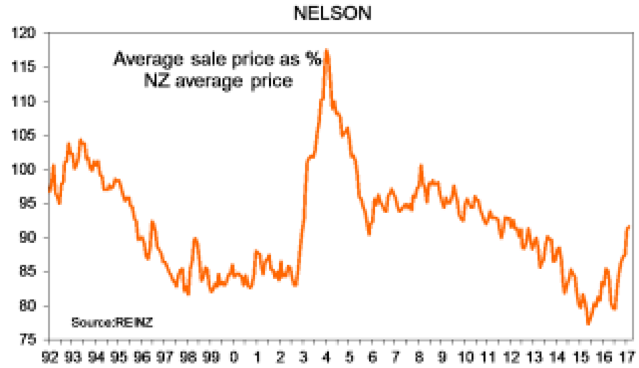


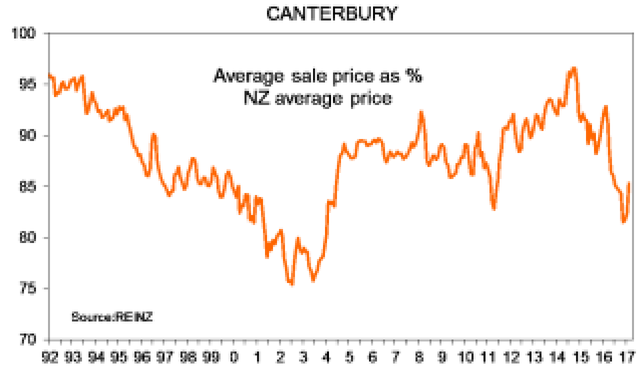
MANAWATU/WANGANUI

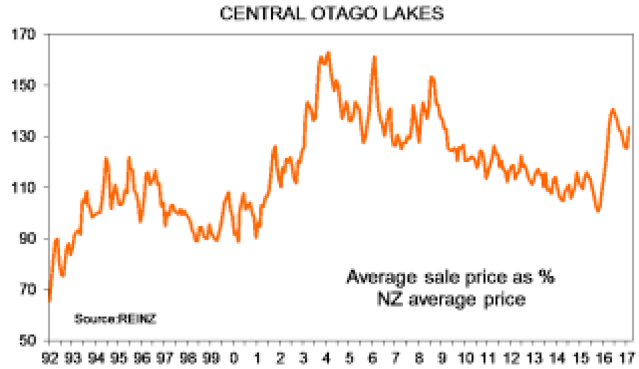


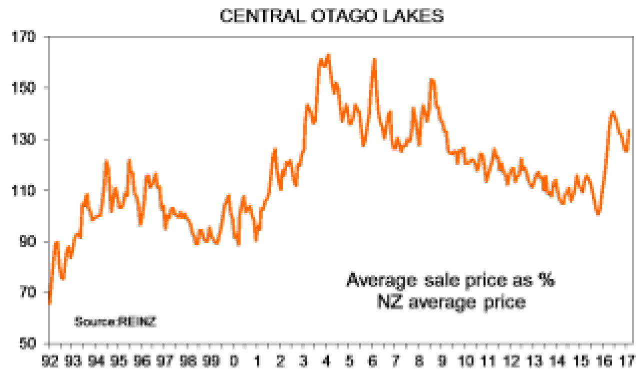
WELLINGTON

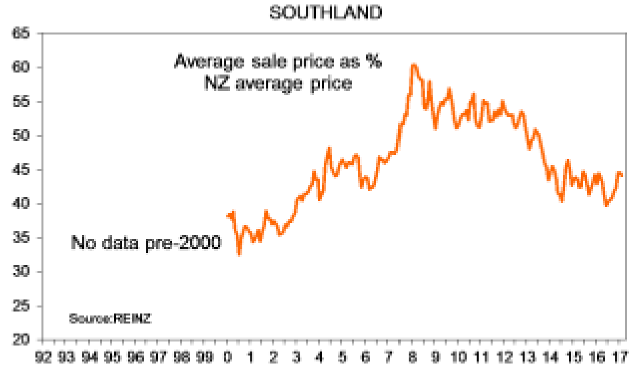












The Power of FOMO

Housing markets move in cycles. The Auckland cycle has peaked and now will probably sit flattish with small rises for a few years, and over the coming year other locations in NZ will reach the same point. The two key forces causing the flattening are the 40% deposit requirement preventing many investors from buying, and average prices finally reaching a new temporary equilibrium.

The market has not flattened because of rising interest rates, recession, a migration collapse or supply surge (the US situation from 2006, Ireland, Spain, Portugal).

But what is it that happens when a cycle peaks? To answer that think about two of the many factors we highlighted as driving strong house prices rises in recent years – FOMO and catch-up buying (along with stock shortages, weak construction, structurally lower borrowing costs and returns on term deposits, lengthening life expectancy, structurally higher average net immigration, structurally higher building standards, costs, and dwelling sizes etc.) FOMO stands for fear of missing out which is not the same as greed.

We have long pointed out that a lot of people put off buying in 2007 because interest rates were too high, in 2008 because of recession, in 2009 because of the GFC and incorrect predictions of price collapses, in 2010 because of continuing beliefs that banks were not lending and a still weak labour market, in 2011 and 2012 because the way prices were rising defied comprehension for many people. They thought rises would reverse. Then at some point that year people realised they had been putting off buying for a number of years and prices were going up while stock on the market seemed not to be as great as they hoped.

Shouting “bugger, should have listened to that bloke whatshisname with the hair”, people started jumping into the market catching up on buying delayed from 2007 onward and that gave the market an extra push at the same time as migration flows turned strongly.

This is like an inventory cycle in the general economy causing an acceleration in the pace of GDP growth. When businesses realise that a lift in growth is causing inventories to get dangerously low they boost production above normal levels to rebuild stocks – catch-up production. This gives an extra boost to growth which is why coming out of a recession an economy’s growth rate can easily exceed 5% per annum for a short time.

Once the market got extra momentum from this buying other people who had no plans to make a purchase started looking at the way prices had risen and realised they could have made nice capital gains by buying virtually anything in Auckland. They felt regret for not doing so and the drive to eradicate the stress that engendered led them to jump into the market lest they miss out on more price rises and felt even sillier. The fear of missing out factor kicked in along with the desire not to feel silly again (they are two slightly different things which psychologists could do a far better job of explaining than myself.)

The scramble for any piece of dirt or roof-supporting walls able to accommodate a human got under way. The FOMO part of the cycle is the most dangerous part because it is when people will undertake less than usual rational thinking and borrow sometimes dangerously high amounts of money to get anything almost irrespective of its price or condition. Primal urges take over.

The appearance of FOMO is one factor behind the Reserve Bank’s decision to introduce LVRs from October 2013. They worked to weed out the most undercapitalised and inexperienced people from the market. The LVRs have very usefully helped prevent a boom-bust cycle.

So now think about the current Auckland housing market. It has flattened out. Listings are rising while sales are falling. Many investors have been pushed out of the market by the 40% deposit requirement and the cycle was simply getting tired. The FOMO factor is dying. As this year progresses people will decreasingly feel that they need to buy to avoid missing out on future gains. They will feel a lot more relaxed and if there were a good measure of community happiness it would rise in aggregate. Stress will decline.

Having said that, there will for a short time be a rise in FOMO for vendors. They will fear they have missed the peak and as they adjust their pricing expectations to get a sale the market will face some extra price weakness which will not persist. But its existence means that for the past few months and a few more to come the market will appear to lack direction with anecdotes of weakness matched by anecdotes that the weakness is temporary.

This is actually an environment in which canny buyers can take advantage of the most panicking vendors seeking to relieve their stress by flicking the thing causing it – their unsold property.

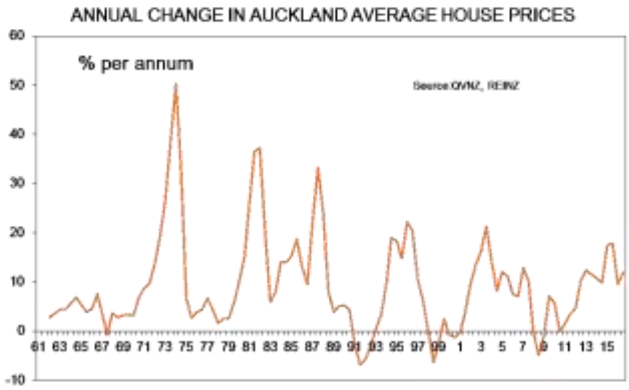
The current burst of media attention on how young people can save a house deposit will fade. But we won’t return to the 2008-2012 environment of high expectations of falling prices and that means that although attention on housing availability will decline, it won’t collapse as happened back then. From 2008-2012 five or so years of developing and implementing policies aimed at addressing housing availability issues were lost – even as the number of people classified as homeless continued to increase.

The other thing which will happen is those buyers who delayed making a purchase will be able to take their time. The stack of them will slowly get whittled away. Their stress will also decline.

These changes in FOMO and catch-up buying help drive the upward and downward legs of asset price cycles. So..

Can we predict when the next upward leg will come? That is normally difficult to do and this time around almost impossible because for the first time in some decades the cycle has peaked not because of soaring financing costs but credit supply restraints. Best guess for the next upward leg? Five years. But I wouldn’t structure anything with that timeframe in mind as it is only a guess, not a prediction. A lot of things will happen in the next year let alone the next half decade.

But what the heck. Because it is my birthday this week here is a present for you. The following graph is constructed from Quotable Value NZ data up to 2003 then REINZ data from then to now and it shows the annual change in Auckland house prices from 1962. Many people see a cycle here though the time gap between the peaks can vary a bit. Enlarge, print out and go for your life.



I look at the graph and see troughs after which strong price gains occur from
1970
1979
1983
1992
1999
2008

The gaps in years are roughly
9
4
9
7
9

The average is just over seven years which applied to the most recent trough in 2008 yields 2015 which is clearly meaningless for the current situation. Good luck.

If I Were A Borrower What Would I Do?

We expect the next NZ monetary policy change to be a tightening but that time is on the RB's side and they won't move until near the middle of next year. This morning's December quarter GDP growth of 0.4% was weaker than the markets were expecting and followed 0.8% growth in the September quarter which was revised down from 1.1%.

But the NZ economy grew by 3% over all of 2016 and the underlying rate looks to be about that. So while some people still think they might ease again we don't think the case is made for that.

Thus borrowers should budget for floating rates rising perhaps 2% from about the middle of 2018 through to the end of 2019. Run a 3% rise scenario just in case inflation finally surprises on the upside overseas and here.

Were I borrowing at the moment I would still look to take a mixture of floating and three year fixed rates. Fixed rates could continue to creep up without any change in the official cash rate, as has been the case since they started rising in November last year.

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/

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. This edition has been solely moderated by Tony Alexander. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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