Tony Alexander: Will house prices recover in 2023?

Housing Market off to a worrying start as confidence in the economy plunges

ANALYSIS:

The new year of 2023 is upon us and after a short, and for some rain-soaked, break we enter back into the game of picking where house prices are headed. By now I would hope that all bar the most misguided realise that none of us has the ability to accurately predict the extent to which house prices will move up or down over a cycle, and we only know when the tops and bottoms are after they have happened.
Back in the early days of the pandemic the common pick for everyone was that house prices would fall sharply. Instead, here in New Zealand after easing just 3% over April and May 2020 they soared by 46%. Since the November 2022 peak of prices at silly levels driven by rampant FOMO, we have seen falls recorded on average nationwide of 13.7%.

Prices now sit 22% above where they were when we went into the first lockdown. Over that almost three-year period of time average private sector hourly earnings have risen by about 16%. So, the ratio of average house prices to incomes by this particular measure is now just 4% above early-2020 levels after being 30% above late in 2021.

I mention this shift because just as the risk over 2021 and 2022 was people over-hyping how high prices would go, now the risk is people become excessively pessimistic about how much they will fall. Incomes are rising to meet falling house prices and soon affordability will be better than pre-pandemic – until we take mortgage rates into account. They are now at above average levels.

Back in early-2020 the popular one-year fixed mortgage rate was around 3.4%. Now it is near 6.4%, which exceeds the 5.3% average for the decade ending in 2018. That average is a better gauge of “normal” than any calculation including the period 2019-21 for two reasons.

First, in 2019 fears about deflation caused the Reserve Bank to cut its official cash rate to a record low of 1% and all the talk was about negative bank deposit rates. Second, over 2020 and 2021 worries about a pandemic-induced depression caused our central bank to ease monetary policy even further and keep things too loose for too long.

Independent economist Tony Alexander: “There is no rush of people to sell property and the overwhelming market dynamic remains a lack of buyers.” Photo / Fiona Goodall

Nonetheless, comparisons with averages aside people are scared partly by where mortgage rates are now but more by where they might head. That fear is encouraging some people, mainly investors, to plan some rationalisation of their holdings – to be weak sellers in a falling market. That is not a good position to be in and evidence to date is that many people wanting to sell are not doing so unless negative cash flows are so bad they have no other choice.

The nationwide stock of listings at the end of December stood at 28,900 which represents a 54% rise from the end of 2021 and is the highest stock level since late-2015. But new listings fell in seasonally adjusted terms by almost 5% in December and were 27% fewer than December 2021. There is no rush of people to sell property and the overwhelming market dynamic remains a lack of buyers.

If you’re going to make a personal pick for when house prices stop falling, you need to therefore take a view on when the buyers return. Stronger than expected net migration inflows will help, as will high job security and rapidly improving affordability in terms of house prices versus income. But the key is interest rates. You will need to make a prediction for when they start falling.

My view is that we are at the peaks for fixed rates of two years and beyond while floating rates are set to rise up to another 1.25% and the one-year rate could creep higher by 0.25% or so. But with most people fixing just one year and the Reserve Bank clearly needing to see inflation solidly trending down, it doesn't seem reasonable to believe yet that people will be thinking in terms of buying then riding a coming trail of falling interest rates downward until the middle of the year at the earliest.

Then again, we are in a data-driven phase of the interest rates cycle, so keep an eye out for the next NZ inflation number which comes out on January 25. Given recent widespread inflation forecasting errors it could easily be higher or lower than expectations.

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