Auckland Slowdown?

Keith Rankin, 17 August 2015

Has the Auckland housing market turned? I went to a neighbourhood auction yesterday. Solid large 1950s' house on 1,000 square metres of land, sunny section, view over city from front of house, handy to train and to the expanding New Lynn retail and commercial hub.

There was only one bidder, ethnically Asian but not Chinese, most likely buying the property as a family home. The sale went through by negotiation at below the reserve price, and probably a full $100,000 less than the vendor and spectators were anticipating. (It sold for less than the average asking price identified in Auckland housing market 'continues to go mad' last month in the *NZ Herald*.) I noticed only two Chinese-looking people in attendance, both attending just like regular kiwis, spectators rather than bidders. A few months ago, a similarly specified property at Hobsonville Point sold for well over a million dollars.

The signs are there. Indeed Bill English has picked up on them. (See Auckland house median drops $20k, and Bill English: Auckland property prices may fall. English notes that housing markets in similarly affected overseas cities have slowed recently, and that Auckland can be expected to follow that pattern.) So far the statistics show that the already grossly inflated central suburbs are leading the slowdown, and that the former Waitakere City has experienced a 29% increase in prices. My story above suggests that the slowing market may have spread to Waitakere City, at least for the kinds of properties – simple freehold title, lots of land – that are clearly most attractive to speculative buyers.

Nevertheless we have been told that the Auckland market would ramp up this year, until October when new tax changes and lending rules take effect. This *Herald* story from yesterday carries the subtitle Frantic buyers try to get ahead of the competition with early high bids. Another reason cited for expected extra activity this year has been lower interest rates.

The right-wing ideological line is that there has been no housing bubble, just a sudden (eg from 2012) shortage of houses that is driven mainly by increased net migration into Auckland. If that was the case, there would have been much more interest in this house in my neighbourhood. Sure the property was outside the price range of regular kiwi first-home buyers. But it should have been well within the price range of such migrants who are allegedly paying well over a million dollars for inferior properties only slightly closer to Auckland's centre. (In the Hobsonville case, the property was considerably further away.)

Let's look at the issue from the point of view of a Chinese-resident property 'investor'. The capital gain is determined as much by exchange rate movements as by house prices in the various countries that such investors might by eyeing up. The biggest world financial story in recent months has been the spectacular rise of the $US against other currencies. With, until last week, the Chinese renminbi largely indexed to the $US, the renminbi has also been appreciating against almost all of the world's currencies. In New Zealand's case, from April until early August, the $NZ was down about 20% against the renminbi. A house in Epsom or Milford, bought by a Chinese buyer in April and funded in renminbi, will a week ago have been worth 25% less as an asset held by that person or fund. Last week's devaluations of the renminbi will have eased such losses, and may be understood as an important reason why the devaluations have taken place.

So the rising $US may have had a significant impact on Chinese 'investment' patterns, at a time when the Chinese stockmarket was also in a critical state. In these situations, we would expected a 'flight to cash' in China, and away from all financial purchases which looked to capital gain as a source of return. (We remind ourselves that the leaked Barfoot and Thomson data that Labour released, suggesting huge foreign Chinese participation in our housing market, covered the period February to April. That is now looking like the high tide mark for such activity.)

These patterns of activity can be self-fulfilling. Thus a sudden reversal of Chinese money coming into New Zealand in April and May will have been a major cause of the falling New Zealand dollar, and the falling $NZ will have been a significant cause of capital loss to Chinese buyers, reinforcing a growing distaste in China for these types of property acquisition.

My conclusion is that very recent developments in the Auckland property market do not support the right-wing view that city council restrictions on land supply and immigration are by far the major reasons for the dramatic upturn in the Auckland property market from 2012. These developments do support the view that circumstances in foreign financial markets have been the principal drivers of real estate prices in world cities with minimally regulated markets. Now that those circumstances have changed, especially in China, we may be seeing changes in our market that we are not yet prepared for. When you 'invest' for capital gain, and the capital gains appear to be drying up, then the supply of assets on financial markets increases, as the holders of these assets seek to sell at the top of the cycle. Make no mistake, the Auckland real estate market has become a financial market in recent years, rather than a housing market.

What now? My gut feeling is that we may be seeing a correction rather than the beginning of a crash. That's not to say that a crash is not coming sometime, just that I believe that the low $NZ is going to be generally positive for the tradable sector in New Zealand. My sense is that regional New Zealand, outside of the dairy-intensive provinces, will see a revival that will be reflected in their real estate markets. In Auckland I think that there will be a movement away from selling by auction, and that properties will take longer to sell. Banks will be afraid to enforce sales of overleveraged properties. I think that, as capital gain dry up, multiple property owners will look to rental income as their principal source of return on their 'investments'.

The danger for 2016 and 2017, in Auckland, may be a tendency towards rack-renting, with over-committed house-owners being reluctant to maintain their properties properly, while also keeping properties 'sort of' on the market, meaning the owners will sell at short notice if the right offer is made. I also sense that some landlords may sack their rental property managers, in favour of cutting costs through managing their properties themselves.

In a wider sense, the global deflation which has eased in the first half of this year, is likely to reassert itself. The global economy this year seems not unlike that of 1926 or 1927, when almost all countries adopted export-focused policies, in which unsettled 'investors' toggled between real estate, stockmarket, and foreign assets, in which automation was displacing labour, and in which inequality was the deep underlying problem.
