Netherlands: House price decline more likely as interest rates rise

Interest rates are rising significantly. Since the beginning of this year, mortgage interest rates have roughly doubled. Higher interest rates increase the downward pressure on house prices. And if interest rates rise faster than expected, a decline in house prices is a very realistic outcome

More downward pressure on house prices in the event of higher interest rates

Since the beginning of this year, mortgage interest rates have roughly doubled. The average 10-year mortgage interest rate for an annuity mortgage rose this year by about 1.9 percentage points, from 1.5% to 3.4%*. The increase is linked to the sharp rise in capital market interest rates. At the beginning of this year, higher expectations of inflation in the euro area and more positive expectations about the economic recovery from the coronavirus crisis led to higher interest rates. Since the war in Ukraine started, interest rates have continued to rise on balance. Inflationary pressures have increased and European governments want to borrow more money to finance higher spending on defence and energy. This has increased the upward pressure on interest rates.

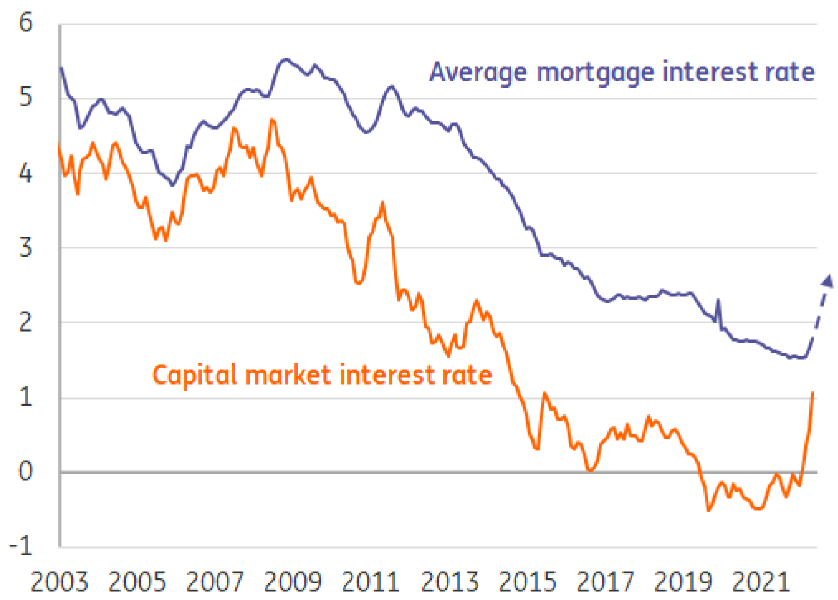
Higher interest rates put downward pressure on house prices in two ways:

• Higher mortgage interest rates increase the monthly expenses of an owner-occupied home when prices remain equal. As interest rates rise, people aiming to buy homes will tend to offer less for a house on average than at lower interest rates, in order to limit the increase in their housing costs.

• Higher mortgage interest rates reduce the maximum amount of mortgage that households can borrow. For first-time buyers in particular, the borrowing capacity is often decisive for the price they ultimately offer for a house. Higher mortgage interest rates therefore reduce the price they can offer for a property.

* Based on an unweighted average of all offered mortgage rates to 2 June 2022 inclusive (incl. changes announced at that time) for mortgages with a Loan to Value (LTV) of 100%.

Capital market interest rates and mortgage market interest rates show a similar pattern



Source: DNB, Macrobond

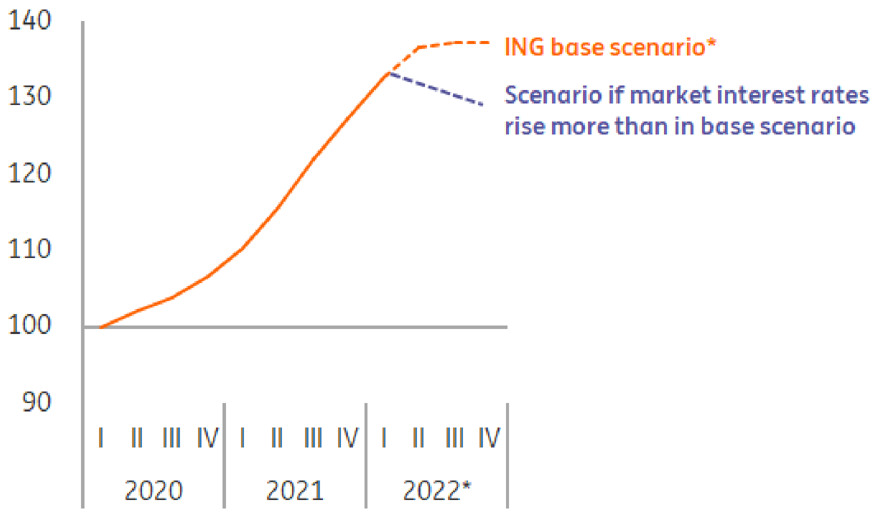
*Interest rates on newly taken out mortgages for house purchases. The moment of measurement coincides with the transfer at the notary. The recent sharp rise in current market interest rates on mortgages therefore lags behind the figures.

Stabilisation of house prices in the event of a slight rise in interest rates

In its base case scenario for the housing market, ING Research expects house prices to stabilise over the rest of this year rather than a decline*. The starting point is a slight further increase in interest rates in the remainder of the year amounting to around 20 basis points. However, the uncertainty surrounding the course of the war in Ukraine and its impact on the Dutch economy is very great. This could mean that interest rates will rise more sharply than we currently anticipate.

* Average prices are still up 13.0% on an annual basis. Between January and April, house prices had increased by 5.2%. Last year's strong increase in house prices is also still reflected in this year's annual average increase.

House price drop possible if interest rates rise faster than expected



Source: CBS (Statistics Netherlands), estimate by ING Research
*assumption: market interest rates will rise this year by about 20 basis points

Further rise in interest rates increases chances of a decline in house prices

A faster than expected rise in mortgage interest rates makes a decline in house prices more realistic, as the negative effects of higher interest rates on the affordability and borrowing capacity of people aiming to buy homes should increase.

The two examples below illustrate the effect of a further one percentage point increase in mortgage interest rates on monthly mortgage expenses and borrowing capacity.

1. Higher mortgage costs due to interest rates increasing by 1%

Assuming a mortgage of €429,000 (the average house price in April), an interest rate increase of one percentage point would increase net monthly expenses by about €115*. The mortgage costs remain the same with a mortgage of €395,000. That is about 7.5% lower than the current average house price. In addition to the direct effect of higher interest rates on total monthly expenses, there is another adverse effect on homeowners. While interest costs increase, the amount they pay off each month on their mortgage actually decreases in the early years of the term. In the event of higher interest rates, homeowners build up equity in their homes or other wealth less quickly. At the current interest rate and with an annuity mortgage of €429,000, the monthly repayment in the first year is about €705. At an interest rate that is one percentage point higher, this amount decreases by about €105 per month to €600.

2. A lower maximum borrowing capacity as well

Higher interest rates also reduce the maximum borrowing capacity of households. To take out an annuity mortgage of €429,000, a single earner would need a gross annual income of approximately €84,000 at the beginning of this year, based on the NIBUD lending standards*. A further increase in mortgage interest rates by one percentage point would mean that the same single earner could borrow approximately €20,000 less. Without equity, this translates directly into a drop in the price that this person aiming to buy a home can bid for.

* Assuming an interest rate of 3.44% now on a ten-year annuity mortgage without Dutch National Mortgage Guarantee.

Exact price effect is difficult to predict

The exact price effect of higher interest rates on the housing market is difficult to predict. However, it is clear that higher interest rates have a negative effect on house prices. At the same time, many other factors also play a role (sentiment, income development, lending standards, etc.). Furthermore, people aiming to buy homes can limit the direct effect of higher interest rates on monthly mortgage expenses in several ways. In response to higher mortgage interest rates, they may, for example:

1. choose mortgages with a shorter term, as these mortgages have lower interest rates on average. This helps to limit the increase in monthly mortgage expenses. However, the future interest risk increases in this case.

2. choose repayment-free mortgages, to reduce monthly mortgage expenses. Homebuyers who do this miss out on mortgage interest relief and accrue home equity at a slower pace.

3. make use of what is known as the 'meeneemregeling' (portability arrangement). With this scheme, people who move up the housing ladder can take the interest rate of their old mortgage with them to their new mortgage. So people who agreed to their previous mortgage at a lower interest rate than the current one can thus limit the increase in their housing costs.

Author

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com