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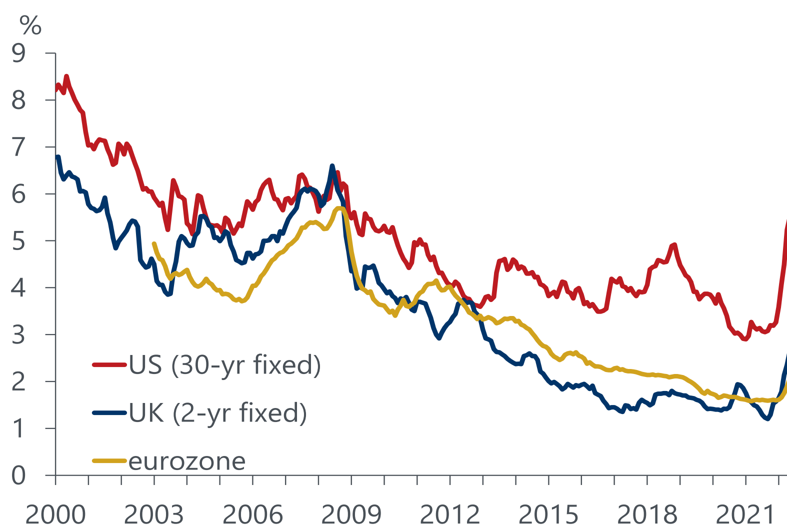
Research Briefing | Global

Surging rates push some housing markets to the brink

- **The ongoing surge in mortgage rates in advanced economies threatens to push some housing markets into steep downturns. Housing prices are already flat or falling in many economies, including the US, and downward pressures are set to intensify as bank credit standards tighten and recessions start to bite.**
- **Mortgage rates have surged to almost 7% in the US from around 3% in less than a year, and big increases have also occurred in the UK and the eurozone. Significantly, house prices have now started falling in the US, while steeper declines have been underway for a few months in markets like Canada and New Zealand.**
- **Other indicators are also worrying. Mortgage approvals and applications are dropping rapidly in some markets, and bank credit standards for mortgages in the US, UK, and eurozone are tightening. A further significant tightening is likely in the months ahead.**
- **One positive factor is that mortgage debt-to-income ratios in some large markets, such as the US and UK, are lower today than in 2007. But other markets, such as Norway, Sweden, and Canada, have seen substantial rises in leverage. Real estate in China is also in a steep downturn.**
- **Overall, this is the most worrying housing market outlook since 2007-2008, with markets poised between the prospect of modest declines and much steeper ones. Among key factors determining which scenario may come to pass include the scale of any rise in unemployment and the degree of exposure to floating mortgage rates or to fixed rates resetting at much higher levels.**
- **Risks vary considerably across economies based on a range of indicators. Markets most at risk include Canada, New Zealand, the Netherlands, and Australia. In these markets, price increases since 2019 have been large, valuations are elevated, debt levels are high, and floating-rate debt is often prominent. More sheltered markets include Italy and France.**

Chart 1: Mortgage rates are surging



Source: Oxford Economics/Haver Analytics. Dotted lines=estimates

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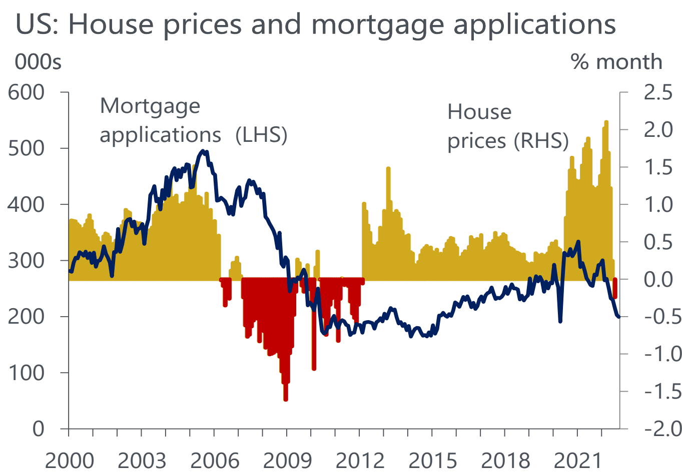
In our last analysis of global housing markets, we noted that rising interest rates, high valuations, and squeezed real incomes posed serious challenges for global housing markets. The situation has worsened further since then, and we now face a potentially significant downturn in world housing markets. Risks look especially acute in a subset of markets, with some of these risks already starting to crystallise.

The biggest change in recent months has been the steep rise in global interest rates, including mortgage rates. US mortgage rates are now approaching 7%, the highest level since 2002, up from 3.2% less than a year ago. In the eurozone and UK, we estimate mortgage rates have more than doubled since April/May based on recent movements in swap rates (**Chart 1**).

Abrupt rises in mortgage rates can only have strong negative impacts on markets and could cause a 'confidence shock' effect for a generation of borrowers unaccustomed to large rises in mortgage rates and perhaps conditioned to expect low rates to last indefinitely.

Prices and activity are indeed starting to weaken notably in several key markets. In the US, the Case-Shiller measure of house prices fell month-on-month in July for the first time since 2012, representing a huge shift of momentum after two years of sharp monthly increases. Meanwhile, mortgage applications have collapsed by a third since the start of this year and are now well below pre-pandemic levels (**Chart 2**).

Chart 2: US house prices are starting to drop



Source: Oxford Economics/Haver Analytics

Price declines are also visible in several other markets. Most notably, prices in Canada, which has long been flagged by us as a risky market, dropped by around 7% from February to August. In New Zealand, some price measures suggest falls of 5%-6% in the three months to August. In all, the latest data show prices falling in nine of the eighteen advanced economies we monitor, and data lags probably mean that most markets are now seeing falling prices.

As well as higher mortgage rates, housing prices are also coming under pressure from tightening bank credit standards. On average across the US, eurozone, and UK, a net 16% of banks tightened mortgage credit in the latest surveys and this negative balance looks likely to get a lot bigger in the next round of surveys given recent rises in global interest rates and declines in broader asset values.

There is a strong historical link between movements in credit standards and real house prices in advanced economies (recent literature also emphasises the importance of credit conditions), and prices are already reacting strongly to the shift from loosening standards to tightening ones that has occurred over the last few quarters (**Chart 3**). The prospect of even tighter mortgage credit standards in the coming months looks like very bad news for housing markets.

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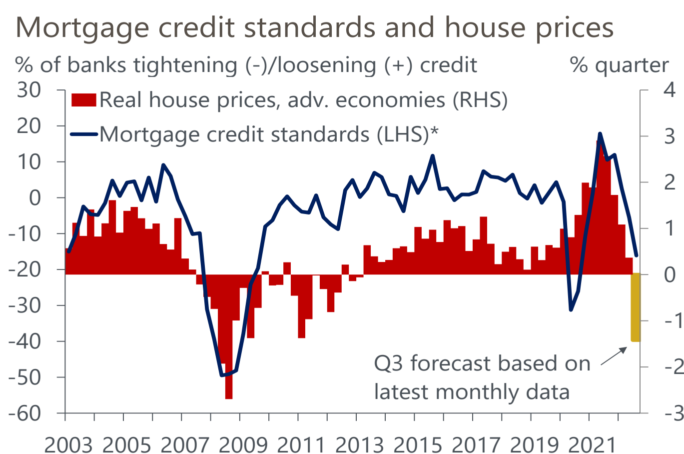
Chart 3: Mortgage credit standards are tightening in advanced economies



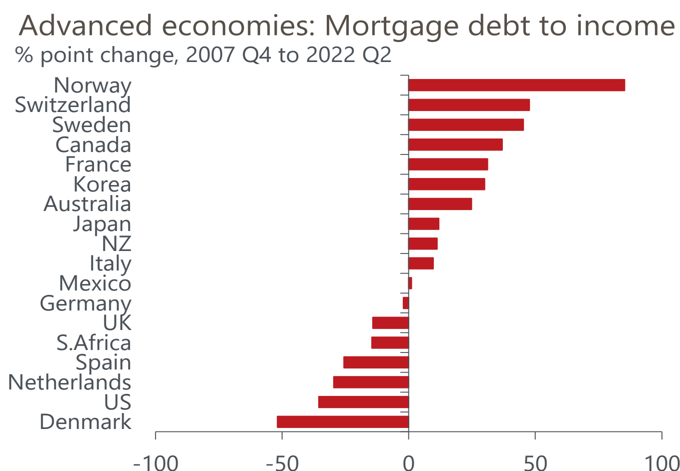
*Source: Oxford Economics/Haver Analytics * Average of US, UK and eurozone*

How worried should we be? One positive factor is that mortgage debt relative to income in some key markets is lower than it was just before the global financial crisis (GFC). In the US, the mortgage debt-to-income ratio in Q2 2022 was 35ppts lower than in Q4 2007, in Spain it was 25 ppts lower and in the UK 14 ppts lower. In Germany, it has barely shifted, and remains relatively low. But the situation is different in other markets, where a large volume of additional leverage has built up in the low interest rate environment since the GFC. Rises of 25 ppts or more are visible since Q4 2007 in Australia, Korea, France, Canada, Sweden, Switzerland, and Norway. In most of these cases debt was already high in 2007 (**Chart 4**).

It is also the case generally that the prevalence of floating rate mortgage debt is lower today than it was just before the GFC. This means households face less of an immediate shock from rising mortgage rates, reducing the risk of forced sales that would drive prices down faster.

However, we would note in this context that the average maturity of fixed-rate mortgages in some markets is quite low. This means much more debt will be subject to (often significantly) higher rates over the next year or so than might first appear to be case. For example, in New Zealand, on top of 12% of mortgages being floating rate, a further 40% of fixed rate deals are set to mature in a year. In the UK around half of fixed rate mortgages have a maturity of up to two years. In Australia, around 60% of loans are variable rate, but three-quarters of fixed rate mortgages are estimated to be set to mature by the end of 2023. In Sweden, half of mortgages have floating rates, and the other half have short-term fixed rates of 1-5 years.

Chart 4: Some markets have deleveraged, others leveraged up



Source: Oxford Economics/Haver Analytics

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In addition, a steep real estate downturn is under way in China, which is something that didn't occur in the GFC. House prices are around 8% down from their peak of a year ago and residential housing starts have halved. This downturn poses quite a serious threat to Chinese and regional growth given the strong backward linkages of the real estate sector to key industries like construction, steel and building materials.

Overall, the outlook for housing markets looks the most worrying since 2007-2008. In our view, housing markets are poised between the prospect of modest declines and much steeper ones of 15%-20%.

One key factor determining which of these scenarios comes to pass is developments in unemployment. While unemployment remains low, there is a reasonable chance that price downturns could be limited, with markets instead 'freezing' at low levels of transactions. But as recessions bite, unemployment will start to increase, raising the risks for housing markets by potentially creating a wave of forced sales and foreclosures, where steep discounts are common. If unemployment were to rise sharply, the dangers to housing markets would be amplified considerably.

Other important determinants of the trajectory of house prices include an economy's exposure to floating rate mortgage debt and to fixed rates resetting at much higher levels, housing valuations, debt levels, and recent price trends. If we look across a range of risk indicators covering these factors, updating our analysis from June, we can see that risks to global housing markets generally have risen, but they vary considerably across economies.

Our analysis suggests that Canada, New Zealand, the Netherlands, and Australia are most at risk. In these economies, price rises from Q4 2019 to Q2 2022 were generally high, valuations are elevated, debt levels are high, and floating rate debt is prominent so that rising interest rates will quickly pass through to household finances (in some cases, floating rate debt has increased lately, like Canada where some 50% of recent mortgages have been floating rate). In all these economies, prices have also already started to fall.

Among the largest global economies, the US looks most at risk given very high recent price rises, the particularly steep rise in borrowing costs (actual and forecast), and elevated valuations. Offsetting factors include a low share of floating rate mortgage debt and more modest debt levels than in some other markets. We recently estimated that a 15% fall in house prices in the US over four quarters would wipe out two-thirds of the housing equity accumulated since the start of the pandemic and reduce real GDP growth in the US in by 0.8 ppts in 2023.

Markets less at risk include Japan and European markets like France and Italy. Recent price rises in these economies have generally been more modest, valuations look less elevated, and debt levels are lower. France and Italy also have quite low shares of floating rate debt, implying some insulation from the immediate impact of rising mortgage rates (**Chart 5**).

Chart 5: Housing markets ranked by risk factors

	Price change Q4 2019 to Q2 2022, %	Price change, latest* %	Rate hikes Q4 2021 to peak, % point	Estimated valuation vs. trend, % **	Floating rate share in debt %	Mortgage debt to income, %	Households with mortgage %
Canada	56	-2.4	3.5	12.5	33	130	39
NZ	38	-1.3	3.0	16.0	12	113	67
Netherlands	39	-0.1	2.3	16.8	18	178	49
Australia	30	-0.4	2.6	6.5	60	177	32
US	42	-0.2	4.3	14.7	14	64	40
Norway	26	0.6	2.8	2.1	93	123	50
Sweden	32	-0.2	2.0	2.2	47	164	43
Korea	26	-0.2	2.0	5.7	65	85	37
Denmark	22	0.3	1.5	5.1	31	197	38
Germany	33	-0.3	2.3	9.1	13	74	18
Spain	6	-0.9	2.3	8.5	55	66	24
UK	22	0.0	2.9	3.2	17	99	31
Mexico	20	0.9	4.3	3.9	95	12	9
Japan	15	0.3	0.0	11.5	56	71	28
Switzerland	7	0.2	1.5	-1.4	33	197	33
S.Africa	9	0.5	3.0	-2.1	95	42	8
France	17	0.4	2.3	3.8	5	90	24
Italy	8	0.8	2.3	3.9	37	33	10

* Monthly or quarterly/3 ** Average of price and price-rent ratio versus filtered trends

Source: Oxford Economics