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Interest rate hikes and real estate prices

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Despite high valuations: House price crash remains unlikely

As stated in Bundesbank data, residential property prices in Germany have roughly doubled over the past decade. This increase was also spurred by a long phase of extremely low interest rates. This phase has now come to an end. At the turn of the year, the representative interest rate for a mortgage with a 10-year fixed interest rate was just 1%. Since then, financing costs have climbed to 2.8%, the highest since 2014 (source: Interhyp).

Does this herald a new era of falling house prices? The risks have increased, but for various reasons a price decline on a broad front is unlikely.

The mortgage rates have more than doubled since the beginning of the year

What supports the real estate market

According to the Bundesbank, the purchase price of residential real estate as a proportion of disposable income has risen by 50% since 2010. At the same time, financing costs have fallen considerably, so that annuities in relation to income have fallen significantly.

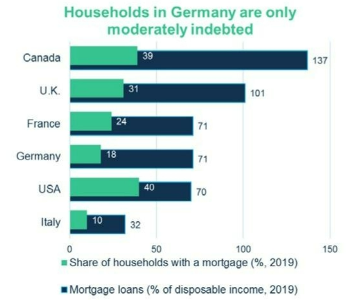
This relieving factor is now changing abruptly due to the rise in interest rates. Anyone who wants to buy a property today has to contend with both the high prices and the increased financing costs. Nevertheless, a systemic collapse is not to be expected for various reasons:

- Inflation: Real mortgage rates, i.e. adjusted for inflation, will remain negative in the coming years. It is true that some prospective buyers will be forced out of the market because of rising interest rates. But as a hedge against inflation, real estate is likely to remain in demand among others. This is all the more true as long as the high volatility of alternative forms of investment (equities, bonds) persists.

- Housing shortages remain a pressing problem in Germany, accentuated by the influx of refugees from Ukraine.
- Construction costs: Building is becoming more and more expensive. Since the end of 2020, construction costs have increased by 19%. This indirectly increases the value of existing dwellings. Supply chain problems contributed to a 4% drop in the number of new dwellings last year (293 thousand). The political target of 400 thousand new dwellings per year is a long way off. Supply remains limited.
- Debt: German households have been reducing their debt for a long time since the turn of the millennium, which has by no means been compensated for by the renewed increase since 2019. At the same time, the fixed-interest period has increased significantly. Nearly half of the housing loans issued since 2019 have an interest rate term of more than ten years. In 2010, this amount was just 30%. Borrowers' balance sheets are robust.

Germany also appears relatively robust in an international comparison (see figure). The proportion of households that have a mortgage at all is low and the level of debt is average. There is therefore no threat of an avalanche of forced sales of dwellings.

There is no question that rising interest rates will weaken market momentum. However, they alone will not trigger a house price crash.



Source: The Economist, 14.5.2022

Slowdown in market momentum for real estate, but no reason to panic

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