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House prices to rise more slowly due to interest rate hike and uncertainty

Dutch Housing Market Quarterly
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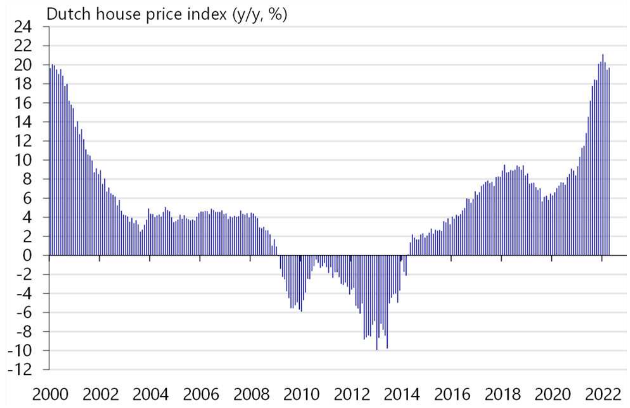
- **House prices are currently still rising fast in the Netherlands, but we expect higher interest rates and a weakening economy to cool down the market for owner-occupied homes**
- **The Dutch house price index is expected to average out 16.1% higher y/y in 2022, followed by a 4.5% y/y rise in 2023**
- **We are not ruling out a decline of home prices, but in our baseline estimate we expect prices to remain high for the time being. This is because we anticipate that unemployment will remain low despite a mild recession and that capital market rates - from which mortgage rates are derived - will fall somewhat again**
- **Of course, capital market rates may stay high for longer, or even rise further. The recession may also hit worse and lead to more unemployment. In these instances we expect the housing market lose momentum faster than we currently anticipate, and house prices are likely to decline in those scenarios**
- **The number of transactions has already dropped significantly and for all of 2022 we expect 189,000 home sales. For 2023, we assume 197,000 sales. The number of homes for sale has also been rising in recent months**

Housing market is losing steam

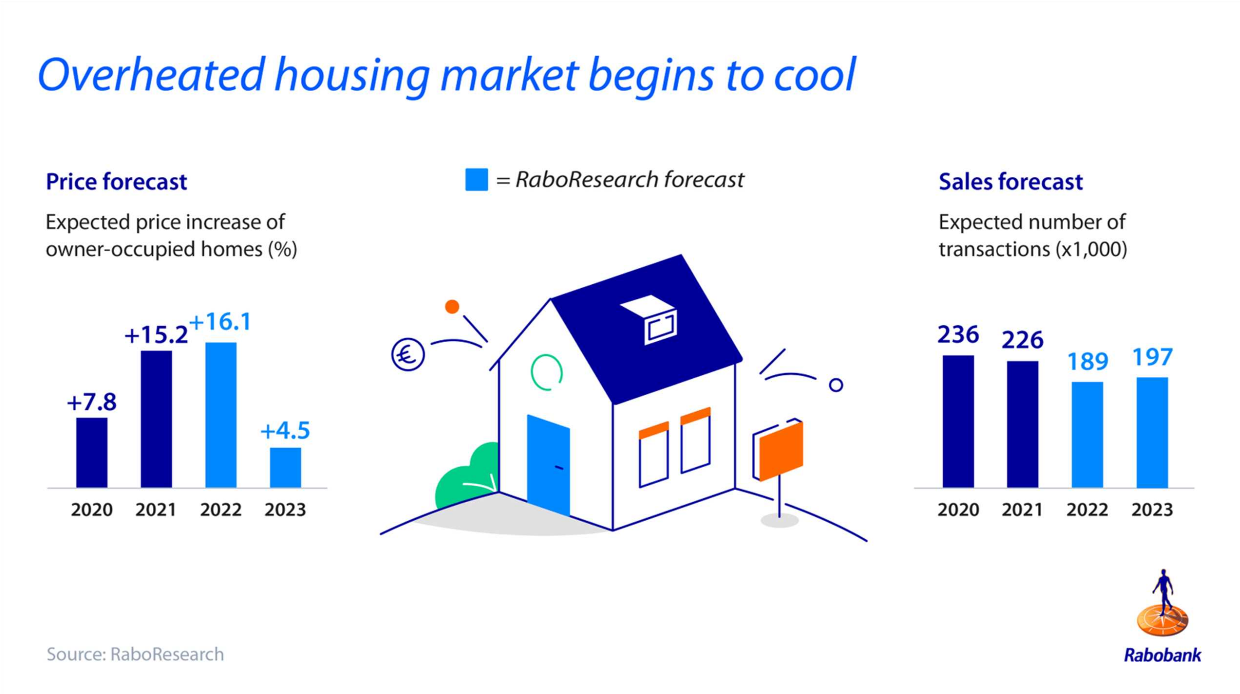
But at the moment there is still a sharp rise in prices

In the first four months of 2022, house prices in the Netherlands continued to rise mercilessly, setting new records (Figure 1). Despite a slowing rate of growth, up until April prices of existing owner-occupied homes were still rising by about 1 percent per month. In January, year-on-year growth even reached a provisional record, with a 21.1% price hike. This is the highest price increase measured in a single year since 1977. In the months since the rate of growth - as predicted in our previous quarterly report - has dropped to just under 20 percent on an annual basis.

Figure 1: House prices still steeply increased in first months of 2022



Source: CBS and Land Registry



House price growth to soften

We expect price growth to weaken in the coming quarters. For 2022, we forecast an average house price increase of 16.1% and for 2023 an increase of another 4.5%. This means that the expected price increase in 2022 is more than 1%-point lower than we assumed in our previous estimate. Our 2023 forecast has also been lowered by 1%-point. A significant part of the annual growth we forecast for this year has already been realized through the so-called spillover effect. If the level of house prices does not increase further compared to the latest figures from April, the annual growth rate will be 13.8%. For the rest of this year, therefore, we expect only a modest increase in house prices, just like next year.

Because of the great uncertainty around factors that are important for the housing market - think rising interest rates, high inflation and the risk that the Dutch economy will fall into a deeper recession - the uncertainty surrounding our forecast is also greater than usual. At the end of this article we discuss the risks that we currently consider to be the most important to the Dutch housing market. And we show what we predict would happen to house prices in two alternative scenarios.

House prices likely to remain high

Due to record high inflation and the sharp increase in capital market interest rates - which has also caused mortgage rates to rise - there is less demand for homes. A decline in house prices therefore cannot be ruled out. Nevertheless, we think the odds that prices will remain elevated are better than the chance that prices will fall soon. While inflation is very high in the short term, our expectation is that it will peak this year and then gradually decline again. Due to the weakening eurozone economy, the ECB's monetary policy is expected to be tightened less in the coming years than it would have been in the absence of recessionary risk. As a result, capital market interest rates - a key input for mortgage rates - may decline again slightly, although as we now foresee them they will remain higher than they have been in recent years. In addition, the Dutch economy is in relatively good shape. Although the growth of the Dutch economy will show a minus next year, the labor market is expected to remain tight for the time being, with yearly unemployment figures prognosed to remain below 4.0% (see Figure 9).

However, inflation, even if short-lived, also has a direct negative effect on house price growth. Because wage growth lags inflation, households' purchasing power declines. As a result, they have less money available to spend on housing, which is a drag on house prices. In our base scenario, however, the effect is not large enough to cause the housing market to turn around. Moreover, in the long run, higher inflation usually leads to higher nominal wage growth, which partially dampens the effect of declining purchasing power.

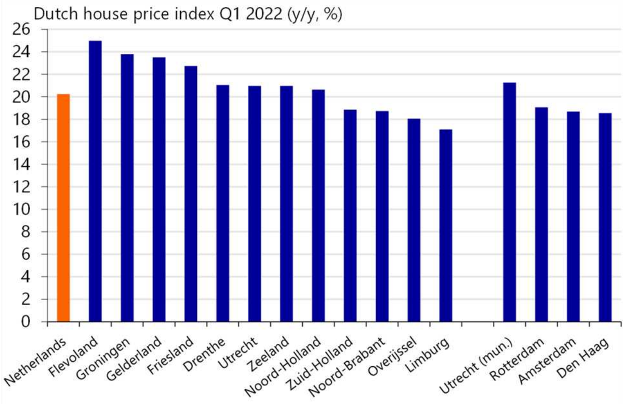
House prices rise hardest in Flevoland and Zeeland

Flevoland still in the lead

On an annual basis, Flevoland is still the province where house prices show the largest increase, with an increase of no less than 25% (see Figure 2). By now this is a familiar picture, as in 12 of the last 16 quarters this province took the lead. Due to the high house prices in regions such as Amsterdam and Utrecht, neighboring Flevoland has become more attractive to prospective home buyers. But looking at price growth on a quarterly basis, Flevoland is trailing behind Groningen and Gelderland. In these two provinces, prices increased the most in the first quarter of this year compared to the last quarter of 2021.

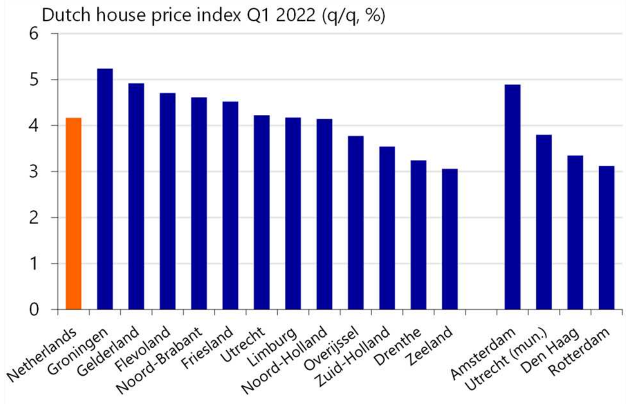
In Amsterdam, too, prices rose remarkably fast in the first quarter (see Figure 3). In recent years, the rise in house prices in the capital city clearly lagged behind other regions, but price increases are now back in line with the national picture. Last quarter, houses exchanged hands for an average of EUR 640,000, an increase of EUR 100,000 in one year. The exact reason for the rising prices in Amsterdam is not clear. Perhaps the recovery from the corona pandemic plays a role with a return of expats in need of housing.

Figure 2: Houses in Flevoland becoming most expensive on an annual basis



Source: CBS and Land Registry

Figure 3: Prices in Groningen and Amsterdam rose most on a quarterly basis

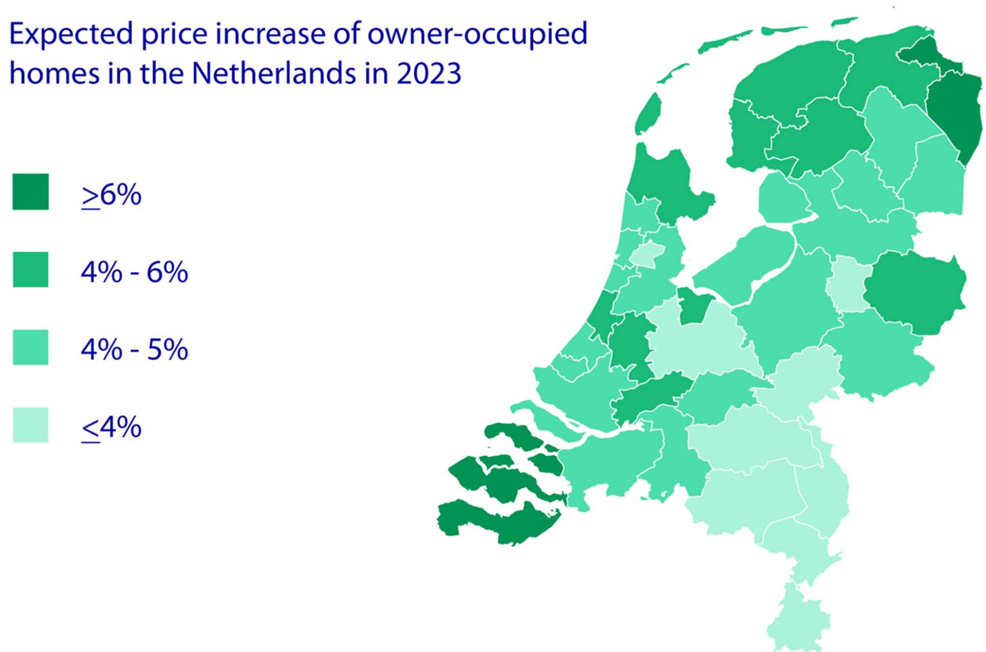


Source: CBS and Land Registry

Regional house price forecast

We expect Flevoland to remain first in terms of house price increases for this year on average (see Figure 4). Price growth in the country's youngest province is expected to average out to 21% y/y, just like in the Overig Zeeland region. In West Brabant and in parts of Zuid-Holland, house prices are growing the least. Here, price growth is expected to come to a halt at around 14 percent. Next year, we expect house prices to continue to rise in all regions.

Figure 4: Highest price increases expected this year in Flevoland and Overig Zeeland



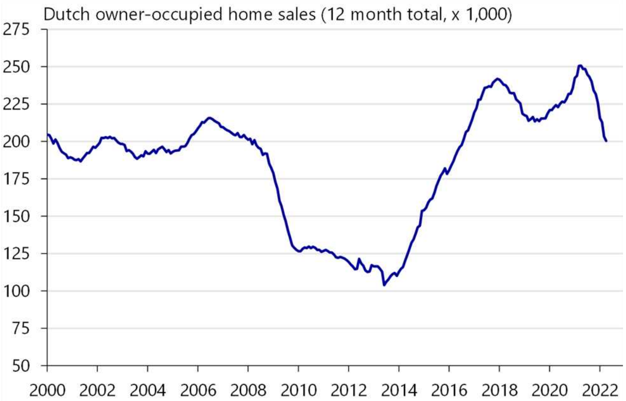
Source: RaboResearch

More supply but fewer transactions of existing owner-occupied homes

Sales down hard

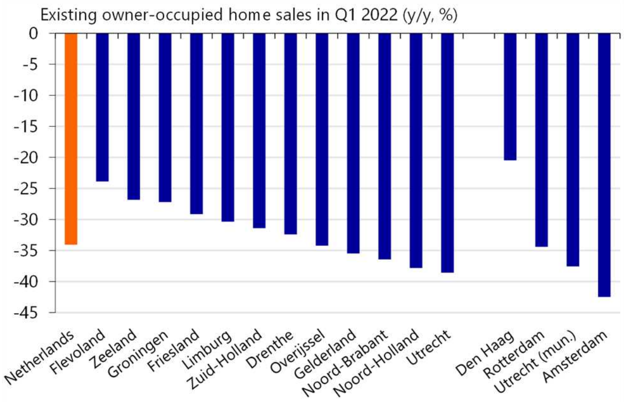
Nearly 60,000 homes changed hands in the first four months of 2022, the lowest number of sales since 2016. Compared to the first quarter of last year, when a record number of houses were sold due to changes in the stamp duty, the number of sales is more than 34 percent lower (see Figure 5). Especially in the province of Utrecht, and particularly in its capital city of Utrecht, the number of sales fell sharply (see Figure 6). Provinces where homes are still relatively affordable, such as Flevoland, Zeeland, Groningen and Friesland, showed a less sharp decline in the number of transactions.

Figure 5: Number of sales per year down sharply



Source: CBS and Land Registry

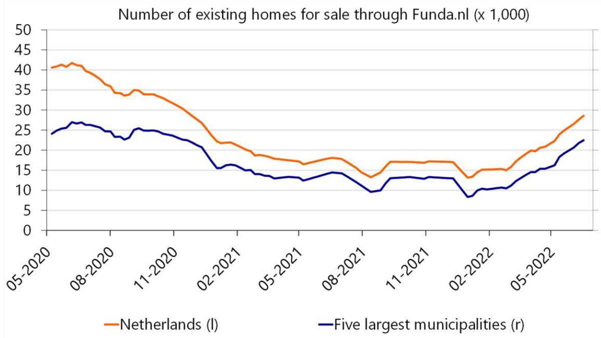
Figure 6: Regionally up to 40 percent fewer sales



Source: CBS and Land Registry

The low number of sales may have to do with the smaller supply of homes for sale last winter. The number of existing houses for sale on housing website Funda.nl reached a low point at the end of 2021 (see Figure 7). Moreover, figures from broker association NVM show that the selling time did not change much during this period, making it plausible that it was mainly a lack of supply that led to fewer houses being sold. We are now seeing the number of houses for sale rise again. This may indicate that the housing market is gradually becoming more balanced and therefore less overheated than was the case in recent years. But increased uncertainty also seems to have contributed to the increased supply. By selling their homes quickly, some homeowners may be hoping to get ahead of a possible decline in house prices. With demand for homes still high, we expect many of these homes to be sold as well. Especially if the rise in capital market interest rates – and therefore probably also the rise in mortgage rates – does not continue much further.

Figure 7: Few homes for sale at end of 2021, but supply rising rapidly



Note: Concerns homes with a usable area of at least 25 square meters Source: Funda.nl, RaboResearch

Sales expectations

We expect 189,000 existing owner-occupied homes to change hands this year. That is 16.5 percent less than last year. For next year, we assume 197,000 transactions. The recovery in that year is mainly due to more supply of homes.

The number of houses for sale has increased proportionately quickly in recent months, although the market is still tight (see Figure 7). At the beginning of June, some 27,500 existing houses were available on Funda.nl throughout the Netherlands. That's more than half as many as a year ago. In time, this could be a boost to the number of sales because we assume that there will continue to be a relatively high demand for owner-occupied houses, while there is now more supply.

We do not expect a substantial contribution from new construction to the growth in the number of housing transactions in the coming years. In the first quarter of this year, only 16,600 permits for new homes were granted, 13 percent less than in the same quarter last year. The production of new-build homes is under pressure due to uncertainty about future construction costs and the still lingering nitrogen crisis.

As was the case at the turn of the year in 2020/2021, we expect that the increase in the maximum purchase price for the stamp duty exemption (from EUR 400,000 to EUR 440,000) will lead to the postponement of some transactions until after the turn of the year. This will depress the number of transactions in 2022, but the effect is unlikely to be a massive effect as in 2020/2021.

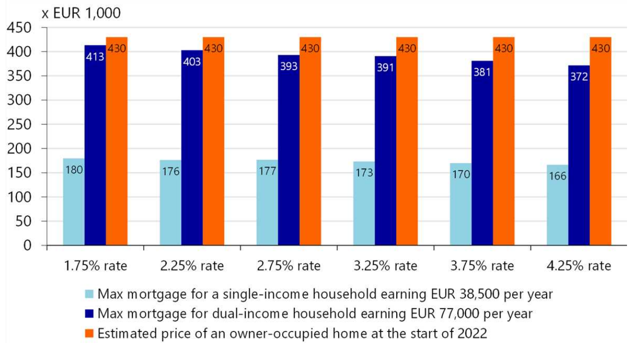
Risks

The expectations for home prices and sales that we have described above are based on the forecasts that we currently have of capital market interest rates, the growth of the Dutch economy, and unemployment. However, the uncertainty surrounding our forecasts is high, as there are many factors that could interfere with this estimate. We discuss the most important ones below.

Interest rates and inflation

Due to historically high inflation, capital market interest rates have risen sharply in the past six months, with mortgage rates in their wake. The direct impact of rising interest rates on the monthly costs for homeowners is limited, because many homeowners opt for a long fixed-interest period. But potential homebuyers – first-time buyers and those moving on – can generally borrow less and thus offer less when interest rates rise. To illustrate, a couple earning twice the typically most earned income can borrow about EUR 30,000 less due to the recent interest rate hike (see Figure 8). Potential buyers can limit the effect on their borrowing capacity to some extent by opting for an interest rate fixation period of ten years instead of twenty or thirty years. The latter periods have a lower interest rate, but there’s not much difference. The gap between sales prices and incomes has therefore widened considerably, and that is an important reason why we expect house prices to rise less rapidly in the coming quarters than in recent quarters.

Figure 8: Higher mortgage interest rates, lower loans



Source: CPB, Nibud, RaboResearch

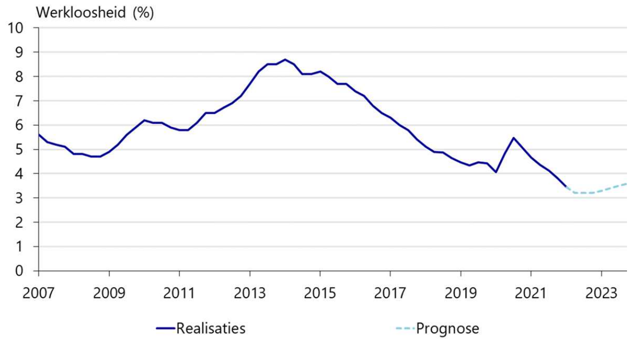
In the estimates we assume that capital market interest rates will decline somewhat again later this year. These interest rates play an important role in the level of interest rates on new residential mortgages. There is a great deal of uncertainty about the future course of capital market interest rates, and this is therefore a major risk for the housing market. This is because inflation is still very high and has risen further in recent months in the rest of the eurozone. If capital market rates remain high for longer than expected, or even rise further, this is expected to put more downward pressure on house prices and sales.

High inflation also poses a risk to the housing market by eroding household incomes. With rising prices, households' costs of necessary expenses are increasing much faster than incomes are rising. As of January 1, 2023, this will probably also be reflected in the new Nibud standards that prescribe how much someone can borrow for a house. These take into account the cost of necessary expenses and a minimum package of other expenses. Higher inflation is offset by higher nominal wage growth, which means households can actually spend more on housing. On balance, we expect that the decline in purchasing power - taking into account the faster rise in nominal incomes - will mean that households will be able to borrow approximately 1 percent less.

Recession risk

Another important factor of uncertainty in our estimate is the macroeconomic outlook. High inflation not only erodes household purchasing power, but also erodes corporate profitability. Together with global supply problems and the war in Ukraine, this is expected to lead to a mild recession. Nevertheless, we assume that unemployment will rise only moderately because many sectors are struggling with staff shortages (see Figure 9). This is one of the reasons why we expect the housing market to cool, but the demand for owner-occupied homes to remain relatively high. If unemployment unexpectedly rises more quickly because the Dutch economy shrinks more than anticipated, sentiment on the housing market may shift, resulting in significantly fewer home sales and perhaps even falling house prices.

Figure 9: Unemployment expected to remain low



Source: CBS, RaboResearch

Policy

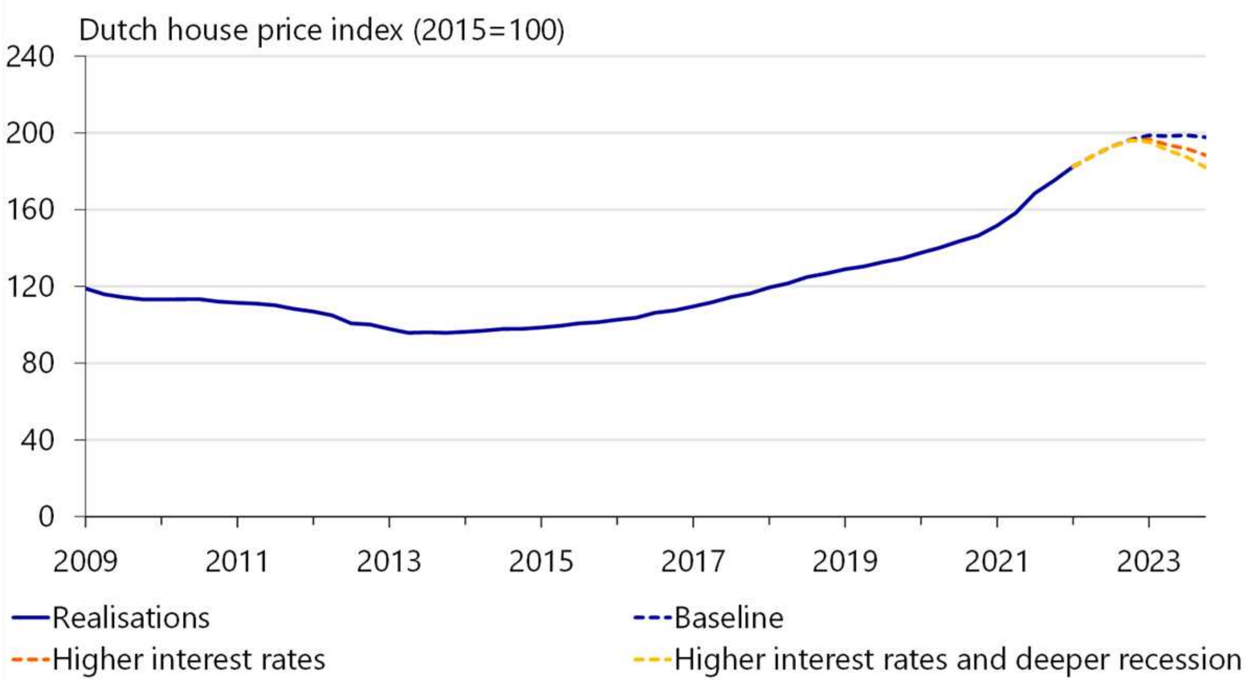
The ultimate impact of the housing market policies of the government and municipalities is still unclear. For example, national and local governments are supporting purchase subsidies, which could lead to even higher house prices. On the other hand, policymakers want to keep investors out with higher taxes, buyout protection for existing owner-occupied homes, self-occupancy requirements for new construction, and tighter regulation of rents in a large part of the unregulated rental sector. This could reduce investor demand and thus actually reduce house sales and house price appreciation. But the exact details of some of these measures – for example, how many rental properties it will apply to – are still lacking. The timing is also not completely clear. It is therefore clear that the policy will have an impact, but how great the effect will be is difficult to estimate at this time.

Box: Alternative scenarios

The figure below shows the development of house prices in the base path and two alternative scenarios. In the first scenario, the Dutch ten-year government bond rate (which at the time of writing is around 2%) rises further to 3% percent in the coming quarters and remains at this level until after 2023. In the second scenario, interest rates also rise to this higher level and, in addition, the Dutch economy enters a deeper recession than we assume in our baseline. In this scenario, unemployment rises to 5% at the end of 2023 and the size of the Dutch economy also experiences a cumulative contraction of 0.5%-points. Recovery of unemployment and GDP does not happen until after 2023.

Because of the spillover effect and because rising interest rates gradually affect the housing market, house prices in the two alternative scenarios rise by 16% year-on-year in 2022, barely less than in the baseline. But in 2023, house prices rise year-on-year by just 1.5A% if only interest rates continue to rise. Moreover, prices will start to decline quarter-on-quarter in 2023. In the scenario where the Netherlands is heading for a deeper recession, the annual figure for 2023 will be negative and house prices will decline by an average of 0.4% compared to 2022. Developments in the housing market in the coming years will therefore in our view depend heavily on interest rates and the economic outlook.

Figure 10. House price trends under alternative scenarios



Source: RaboResearch, CBS

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