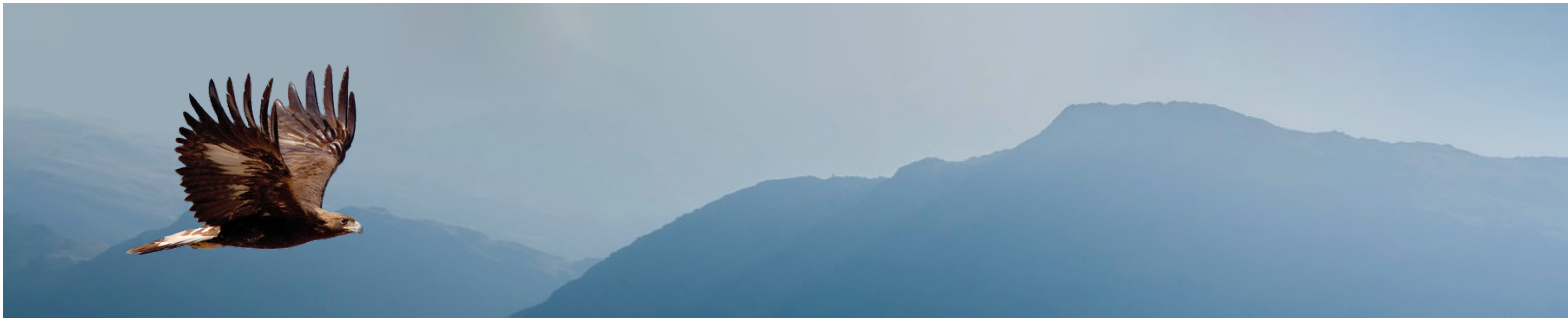

Housing Markets Teeter as Rates Rise

The consensus that interest rates will stay elevated worldwide for the foreseeable future threatens to upend housing markets. As mortgage costs surge, home values are set to decline sharply in many countries.

With central banks aggressively hiking rates to combat inflation, a new monetary regime has emerged. Markets are betting that rates will remain "higher for longer" even if growth suffers.

This has dramatic implications for housing. Some borrowers enjoy fixed rate mortgages, insulating them from rate hikes. But purchases depend on new buyers facing much higher financing expenses.

In the US, the average 30-year fixed mortgage rate hit 8% in October, the highest since 2000. This has propelled the monthly payment on a typical mortgage to nearly 60% of average earnings, up from just 33% in mid-2021.

It strains belief that housing can remain aloft with such ratios. According to the Bank for International Settlements, real house prices in 12 advanced economies dropped 10% between early 2022 and mid-2023. If rates follow current market expectations, real prices may fall another 14% by end-2025.

With a plateau at slightly above present rates, the peak-to-trough real price decline could reach 35%. For context, the global financial crisis triggered a 13% slide.

The UK faces similar dynamics. The average 2-year fixed mortgage rate tripled over the last year to around 6%. Affordability has cratered, with the price-to-income ratio rising to its least affordable level since records began in 1999.

Warnings abound that Britain is primed for a housing downturn. Analysts at Deutsche Bank forecast a 12% real price drop through end-2023. This would surpass the peak falls of around 9% during the financial crisis and early 1990s recession.

Parts of Europe look precarious too. The Netherlands already endured a real price correction nearing 12% into mid-2022. Rising rates could inflict further declines, especially given high household debt levels.

In Sweden, household debts topped 190% of disposable income this year. With such indebtedness, the housing market is acutely sensitive to higher interest costs. Price slides will weigh on consumer spending and banks as collateral values erode.

Even markets accustomed to boom-bust swings face fresh risks. New Zealand has experienced one of the world's most overheated property sectors, prompting aggressive tightening by its central bank.

As mortgage rates approach 7%, home values in Auckland have retreated 7% from last year's peak. But with affordability still stretched, analysts see scope for an eventual 20% drop or more if rates remain elevated.

Housing is central to financial and economic stability. With markets looking precarious, policymakers should stand ready to cushion market corrections and rising foreclosures.

For aspiring home buyers, patience may be rewarded as prices descend from unsustainable heights back in line with fundamentals. But realizing the dream of homeownership could require stomaching some turbulence first.