Double-digit house price growth this year, despite increased uncertainty

Dutch Housing Market Quarterly
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- **Existing owner-occupied homes are expected to become 17.3 percent more expensive on average this year, followed by 5.5 percent in 2023**
- **Since 1977, house prices have not risen as fast as they do now; in January of this year, sold homes were on average as much as EUR 75,000 more expensive than they were a year ago**
- **The war in Ukraine does not lead to a turnaround in the housing market but does have indirect effects through its economic impact**
- **As the economy slows down and interest rates stop falling, we expect home price growth to slow down in the coming years**
- **Exuberant house price growth indicates overheating of the market. It is, however, uncertain whether bubble formation is also occurring. Overheating does increase the likelihood of bubble formation**

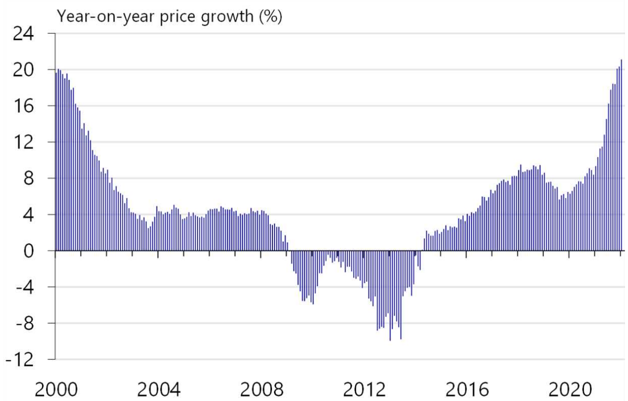
Dutch housing market continues to break price records

Property price growth still accelerating

Never before have house prices risen so fast. In January 2022, the Statistics Netherlands (CBS) price index of existing owner-occupied homes was no less than 21.1 percent higher than in the same month one year earlier (Figure 1). This far surpassed the previous record, from February 2000. At that time, house prices grew by 20.1 percent on an annual basis. On a monthly basis, the increase of 3.1 percent was the highest that CBS has measured since the introduction of the price index in 1995.

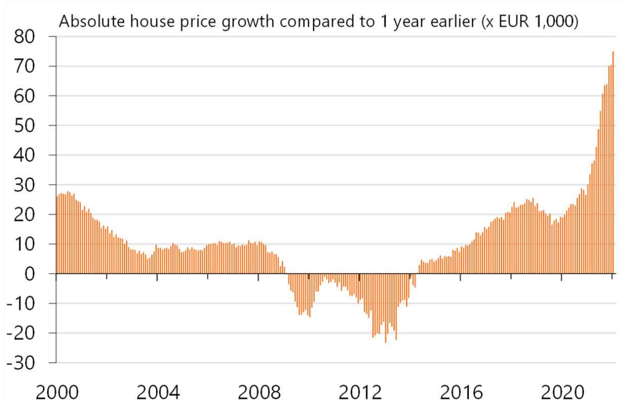
Thus, although real estate agents have been reporting a declining number of viewings (in Dutch only) for some time, property prices continue to rise inexorably. In euros, an average sold home became an estimated EUR 75,000 more expensive between January 2021 and January 2022 (see Figure 2). The previous record – EUR 28,000 price increase in one year, also established in 2000 – was broken just over a year ago. So it has taken twenty years to match the record set in 2000, and then just one more year for it to nearly triple. This illustrates the current market frenzy, with homes rapidly becoming unaffordable for households that do not already own a home.

Figure 1: Rise in house prices breaks record from 2000



Source: CBS/Land Registry

Figure 2: Average sold home has become EUR 75,000 more expensive in a single year



Source: CBS/Land Registry, edited by RaboResearch

House price growth expected to slow down this year

Despite the high house price growth of recent months, we expect growth to gradually slow down later this year. The economy is growing less exuberantly than in recent years and capital market interest rates have not been falling for some time. Because unemployment is low and the housing market remains very tight, there remains upward pressure on house prices.

For 2022, we forecast an average house price growth of 17.3 percent, and for 2023 a growth of 5.5 percent. The high house price growth since our previous forecast has led to a substantial adjustment compared to our previous Quarterly Report. In that report we still assumed an average house price growth of 12.4 percent in 2022.

Strong momentum dominates housing market developments

The strong momentum of the market, where demand far exceeds, continues to dominate the picture this year. The high price growth in recent months also contributes through spillovers to a higher growth rate for the entire year 2022. Even if prices would not continue to rise for the rest of 2022 but would remain at January levels, the average house price would still be 10.9 percent higher this year than in 2021. Moreover, price growth accelerated recently, so a higher average annual growth rate can be expected. There are, however, a number of factors that could depress house price growth (over time), although uncertainty is high in some areas.

Rising mortgage interest rates won't turn the market around immediately

According to Van Bruggen Adviesgroep, the average interest rate for a mortgage with a twenty-year fixed-rate period has already risen by 0.45 percentage points (in Dutch only) this year; an increase of almost a third. With the end of the trend of falling interest rates in sight, the upward effect of this trend on house price growth is also disappearing. The fall in interest rates in recent years has enabled households to borrow more and more or, for the same mortgage loan, to have lower monthly costs. Declining interest rates also increase investor demand for homes.

The fact that mortgage interest rates are rising is not entirely out of the blue. Mortgage rates typically move with capital market rates, and these have been rising in recent months. This has to do with rising inflation, which increases the likelihood of the European Central Bank (ECB) winding down its support programs, as does the likelihood of the ECB raising interest rates.

Even if capital market interest rates rise more than expected, a major turnaround in the housing market is still not likely. House prices usually adjust slowly when fundamental factors change. Illustratively, mortgage rates in the US have risen by more than one percentage point since last summer, but the housing market there has not yet cooled down.

War does have indirect effect

The war in Ukraine is not expected to lead to a market turnaround. History shows that large impactful events, such as the 9/11 attacks and the onset of the corona pandemic, do not automatically lead to a trend change in house prices and sales. Indirectly, of course, the war does have an effect on the housing market, through its impact on the Dutch economy. Moreover, the war results in rising prices in stores and at the pump. If wages do not rise at the same pace, this will affect purchasing power, which means that, on balance, there will be less left to spend on housing.

Uncertainty over house prices high

How house prices will develop this year is surrounded by a great deal of uncertainty. This is because the economic effects of the war in Ukraine are difficult to estimate and depend heavily on the course of the conflict and the West's reaction to it.

At the moment, we anticipate that inflation will remain high for longer, but will still drop to a normal level of around 2 percent during the course of 2023. However, if inflation remains high for longer, this will put pressure on property price development. The maximum amount people are allowed to – and are willing to – borrow depends on other necessary living expenses. If those expenses increase and incomes do not rise accordingly, people will be able to borrow less and thus offer less for a house. The war in Ukraine increases the likelihood of a recession. If economic growth and unemployment figures turn out to be more negative than we assumed in our estimate, house price growth is likely to be lower.

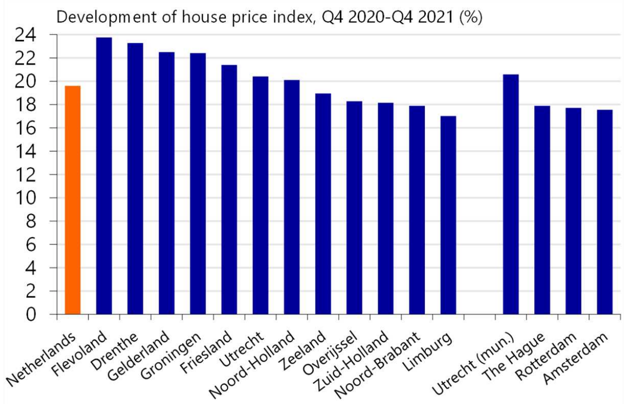
Not only is there uncertainty about how housing market fundamentals will develop, but also about the pace at which this will lead to a different rate of growth in house prices. Reversals in the housing market are difficult to predict. Deviations between house prices and the price level justified by fundamental factors can persist for decades. Although our house price model predicts a levelling off of price growth, it is conceivable that the high price increases will persist for longer because of positive market sentiments. If property prices continue to rise without the fundamental factors still justifying it, the risks increase (see the section Skyrocketing home prices, increasing risks?').

House prices rise fastest in Zeeland and northern provinces this year

Flevoland still in the lead

Flevoland was the province where house prices rose the most last year (see Figure 3). It appears to be an attractive fallback region for homebuyers from the Amsterdam and Utrecht regions, where price levels have risen sharply before. Limburg recorded the lowest increase in house prices at 17 percent.

Figure 3: Flevoland again leading the way



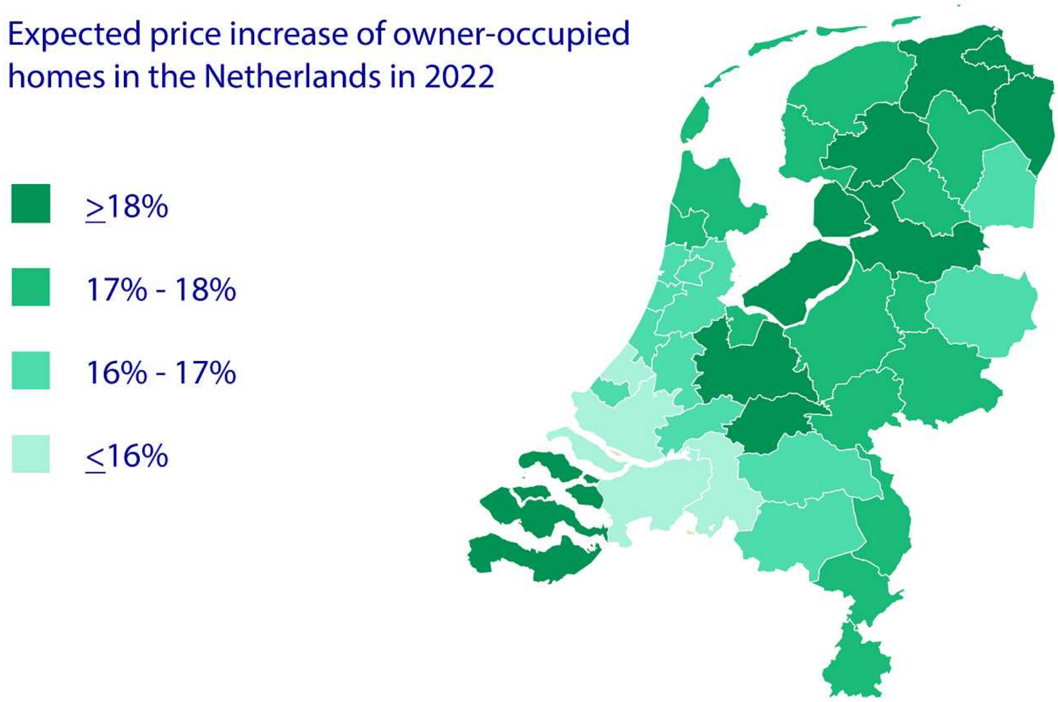
Source: CBS

Price growth in Amsterdam clearly lagged behind in recent years, but house prices are now rising rapidly there too. In the fourth quarter of 2021, existing owner-occupied houses were on average 17.6 percent more expensive than a year earlier; the rate of growth is now comparable to that of The Hague and Rotterdam.

Regional house price forecast

House prices are expected to rise most strongly this year in Zeeland and in the central and northeastern parts of the country (see Figure 4). Price growth there is expected to exceed 20 percent. In Zuid-Holland and West-Brabant, house prices are increasing least rapidly. There, growth is expected to remain at a – still substantial – 15 to 16 percent. In line with the national picture, price growth will weaken in all regions next year according to our forecast. However, we do expect house prices to continue to rise in all regions in 2023.

Figure 4: House prices growing fastest in Zeeland and Flevoland this year



Source: RaboResearch

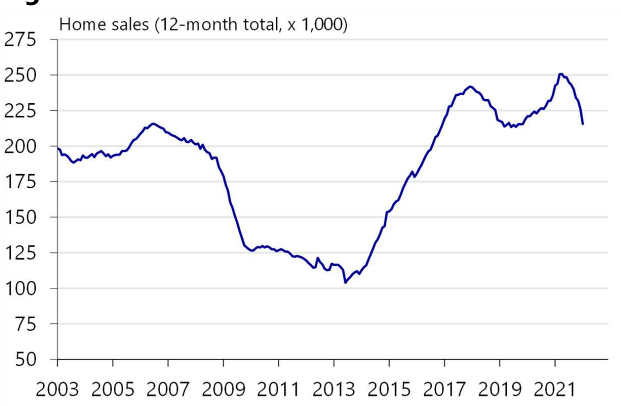
Number of transactions falls further

Continued tightness depresses number of sales

In the first month of 2022, 14,053 homes changed hands. The number of sales was 43 percent lower than in January 2021, when 24,516 houses were sold. The number of transactions was still very high that month, because young homebuyers had pushed the transfer of ownership past the turn of the year in order to take advantage of the transfer tax that had been abolished for them. Nevertheless, it has been a long time since the number of transactions was as low as last January. Such low numbers were seen mainly during the crisis years of 2008-2013.

Judging by the 12-month total number of home sales, the number of transactions seems to have been falling slowly but surely for some time (see Figure 6). This does not automatically mean that the market is tilting. Given the intense bidding war and the rapid selling time, the decline in the number of transactions seems to be primarily the result of the tremendous tightness in the housing market.

Figure 5: Fewer sales

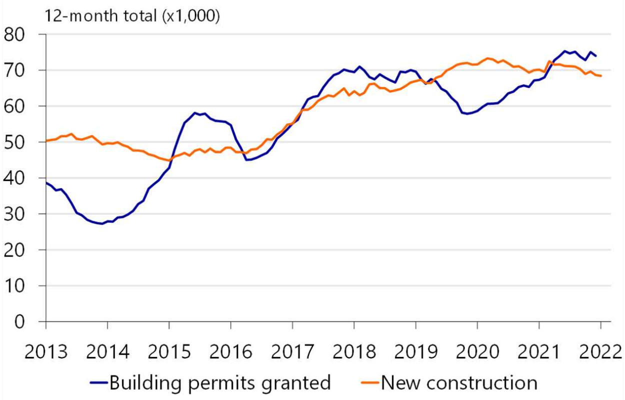


Source: CBS

Expected number of home sales

Due to the lack of supply and the persistently low number of new constructions (see Figure 6), we expect only 191,000 transactions of existing owner-occupied homes this year. That is 35,000 fewer than in 2021, when more than 226,000 existing owner-occupied homes changed hands. For 2023, we expect 198,000 transactions. Our expectations are therefore virtually unchanged from our December estimate. Even then we predicted a sharp decline in the number of transactions, which is increasingly clearly reflected in the figures.

Figure 6: Building permits for new construction still far from 100,000 homes per year



Source: CBS

Skyrocketing home prices, increasing risks?

Growing concerns about the Dutch housing market

Since 2015 - when we still had the crisis fresh in our minds - the Dutch housing market has been showing signs of overheating. This started locally, in a number of large cities in the Randstad, and then spread to other housing market regions. Strongly rising house prices, combined with the borrowing behavior of Dutch homebuyers, are resulting in vulnerabilities in the Dutch housing market, according to institutions such as De Nederlandsche Bank and the European Systemic Risk Board. Compared to other countries, buyers in the Netherlands borrow relatively much in relation to the value of the purchased home. Concerned voices are also heard in the media. The current high house prices are said to be unsustainable. At some point the bubble may (or will) burst (in Dutch only) some think.

Overheating or bubble?

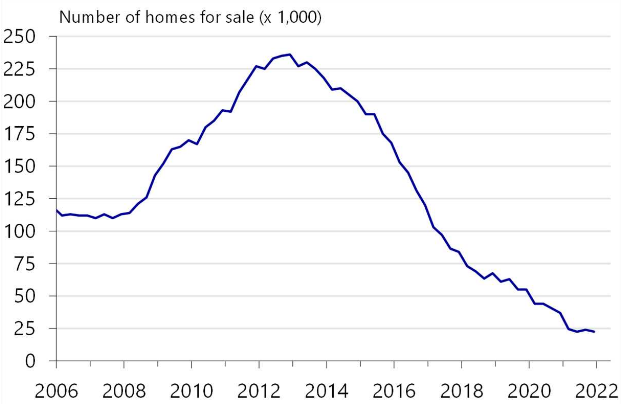
The Dutch housing market is overheated

Although overheating and bubbles are often used as synonyms, they are different things (in Dutch only). Overheating involves a very tight market where demand far exceeds supply. Typical for an overheated market is that prices rise hard, the supply of homes for sale falls hard and buyers tumble over each other to buy homes. Overheating is about the *trend* in house prices, and not necessarily about the *level* of house prices.

The situation in the Dutch housing market is a classic example of overheating. Not only has the growth of house prices not been as high as it is now since 1977, but the number of homes for sale is at an all-time low (see Figure 7). According to the NVM tightness indicator, consumers could choose between only 1.3 homes in the fourth quarter of 2021. It is not known whether the shortage has ever been greater, but in any case, homebuyers in the overheated market of around 2000 had considerably more choice (in Dutch only) than they do now. Homes are also being sold at a record average pace of 23 days.

The tightness is also evident in the very intense bidding war. Homes are increasingly being sold (far) above asking price. Although that picture is colored by the fact that some of the sold homes are offered with a "bid from price". To get a leg up in the bidding process, buyers are also taking more and more risks. By refraining from making a resolutive condition for financing or a structural inspection, they try to outbid other homebuyers.

Figure 7: Historical tightness



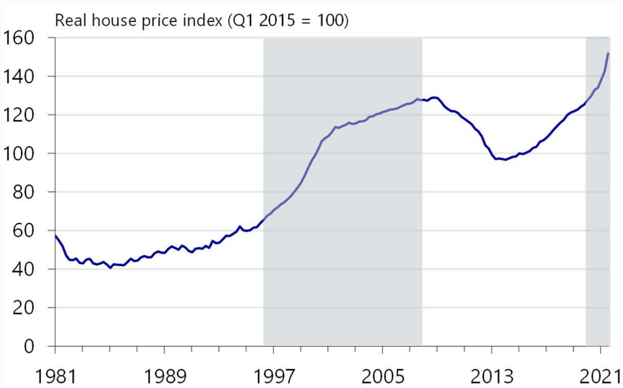
Source: NVM

Bubble cannot be ruled out

Is there a bubble forming in the Dutch housing market? We speak of a bubble when house prices are (much) higher than is justified on the basis of underlying fundamental factors, such as income growth, unemployment, inflation and interest rates. Bubble formation is difficult to measure because the fundamental value of homes is not known. This fundamental value is in fact determined by a large number of factors, while from a scientific point of view much remains unclear about the exact contribution of these factors. It is therefore often only afterwards (in Dutch only), when house prices fall, that it becomes clear that there was a bubble.

Several institutions argue that house prices in the Netherlands are increasingly detached from underlying fundamentals. For example, the European Systemic Risk Board and the Federal Reserve Bank in Dallas. The Dallas Fed has developed an indicator for 'exuberant house price growth' for this purpose, which catches on when real house price growth is above a certain critical value for five consecutive quarters (see Figures 8a and 8b).

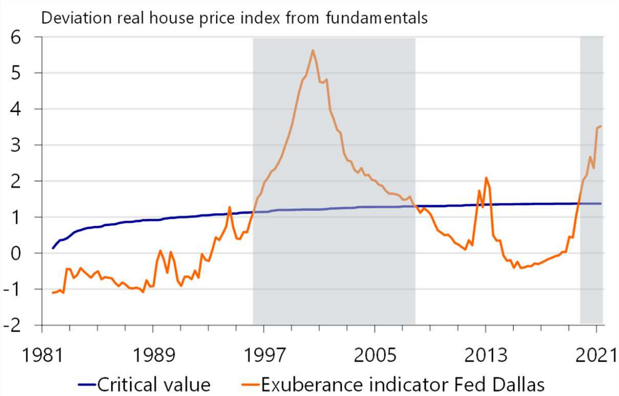
Figure 8a: House prices increasingly decoupled from economic factors



Note: Periods of exuberant house price growth are shaded gray.

Source: Federal Reserve Bank of Dallas.

Figure 8b: Long periods of exuberant house price growth



Note: Periods of exuberant house price growth are shaded gray.

Source: Federal Reserve Bank of Dallas.

However, exuberant house price growth does not necessarily mean bubble formation. After all, factors such as the lack of new construction and increasingly restrictive land-use policies are not taken into account in the model used by Fed Dallas, nor are changed housing preferences. Since the 1980s, more and more people in the Netherlands, just as in many other countries, have begun to appreciate the city again. Because space to build more houses is scarcer in cities than in the countryside, this is accompanied by a higher pressure on house prices. In addition, since the corona pandemic, people are more often looking for larger houses with a garden. And they are also prepared to dig deeper into their pockets for such a home, as can be seen from the price development of semi-detached houses, for example.

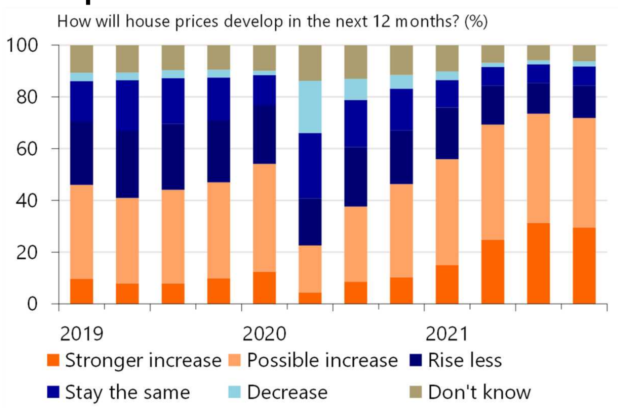
Overheating increases risk of bubble formation

What is certain though, is that the risk of bubble formation increases when the market is overheated. And that is because, during a period of overheating, households' expectations about future house prices become increasingly disconnected from macroeconomic factors and the actual tightness of the housing market. Homebuyers base their expectations about future house price increases largely on the price increases they have seen in the recent past. Such so-called *adaptive expectations* can lead to a self-reinforcing process, whereby high house price increases trigger new price increases. And that can eventually lead to a bubble.

The decline in interest rates and economic growth are currently softening, while housing prices are still breaking record after record. This fits perfectly into the picture of adaptive expectations, although it may also be related to other factors such as changed housing preferences. Since 2021, a large majority of people expect even further house price increases (see Figure 9). Although, according to the Eigen Huis market indicator (in Dutch only), almost 73 percent of Dutch consumers consider it a (very) unfavorable period to buy a house, this is mainly due to the lack of supply and the worsening affordability of houses. Few households still consider it an unfavorable period to buy a house for fear of a collapsing market.

Although house prices are rising very fast, the question of whether there is a bubble forming cannot be answered unanimously. But whether there is a bubble or not, the strong price increases we are seeing now are worrying because they could be the result of adaptive expectations and we do not know to what extent they are still supported by fundamental factors. In our house price estimate, we assume that price growth is flattening. But if current price growth persists, the implication is that the risks to housing market price growth are increasing rapidly. This could lead to a correction in the future.

Figure 9: More and more people expect stronger house price increases



Source: Own Home Market Indicator, MBE TU Delft

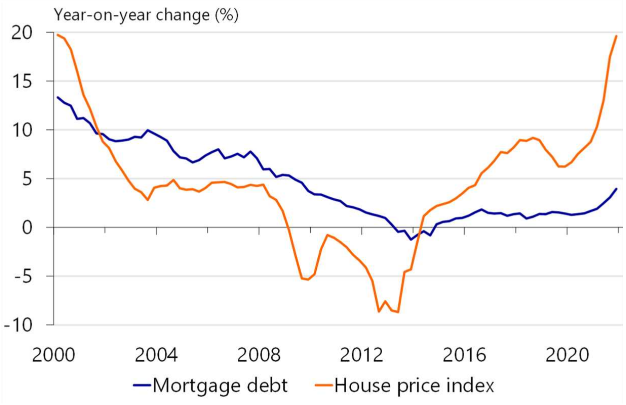
We are in better shape than in 2008

When house prices start to fall, it has a big impact on households and the economy. People are less likely to put their homes up for sale when house prices fall, because they are unwilling to take losses. This affects the dynamics of the housing market. The risk of residual debt also increases, because after a price drop some houses are worth less than the mortgage on them. Households with relatively high (and partly redemption-free) mortgage debts are particularly vulnerable in this respect. Falling house prices also have consequences for the economy. After all, when the wealth in the bricks evaporates, people keep their hand on the purse strings.

But the likelihood of residual debt with falling house prices is a lot lower now than it was between 2008 and 2013. Because mortgage interest relief on interest-only mortgages was curtailed in 2013, homeowners are repaying more and more. For recent first-time buyers, the risks are greatest because they have built up little surplus value. But they usually have an annuity-based mortgage. Recent homebuyers - especially first-time buyers in the higher segment – are, however, increasingly opting for a combination mortgage with a part of the loan repayment-free (in Dutch only).

Moreover, there seems to be no question of a credit-driven bubble. For example, total mortgage debt has risen significantly less fast than house prices in recent years (see Figure 10). Homebuyers are increasingly using equity to buy homes, which is reducing the amount of mortgage required. The fact that the sharp rise in home prices has been less driven by debt is positive for the risks for households, mortgage lenders and the economy as a whole.

Figure 10: Mortgage debt rising less explosively than house prices



Source: CBS

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