CAPITAL ECONOMICS

GLOBAL ECONOMICS UPDATE

Stabilisation in housing markets likely to be temporary

- **The downturn in the housing market appears to have paused in many countries in recent weeks. However, we doubt that this marks the bottom of the market. With higher interest rates yet to take their full effect, and affordability generally still stretched, we think that house prices have further to fall.**
- **House prices over the last two or three months have flattened out or risen in a number of countries, including Canada and Australia where prices were previously falling sharply.** (See Chart 1.)
- **There has also been some better, albeit patchy, news on mortgage demand.** In March, mortgage applications rose in Australia, while mortgage approvals picked up decisively in the UK. (See here.) And mortgage applications in the US seem to have bottomed out, even if the rise seen at the end of last year has since been reversed. (See here.) Home sales have also picked up in some places; they jumped in Canada in April (see here), as did US new home sales in March (see here).
- **Various factors could explain this improvement in housing markets. First, borrowers seem to be coping well with higher interest rates, which in part reflects the resilience of labour markets.** As a result, there are still relatively few forced sellers, which has kept supply and new listings low. (For example, see here for the US and here for Australia). Second, while new mortgage rates have continued to rise in many countries, **the fall in new mortgage rates since the start of the year in the US and particularly the UK (as the "Truss premium" has unwound) may have supported those markets.** (See Chart 2.) **Third, house prices have already fallen a long way in many countries** – for example, some 15% in New Zealand – which, other things equal, will have improved affordability considerably. **Fourth, the rebound in net migration in some countries, most notably Australia and Canada, could be boosting housing demand.**
- **Despite these factors, we doubt that the recent stabilisation/improvement in housing markets will last long in most places. Even after the falls in house prices seen so far, affordability measures are still very stretched.** True, interest rates are close to a peak and the interest rate cuts that we expect will help to improve affordability. But they may not bring affordability all the way back to more sustainable levels. And if interest rates are slower to fall than we expect, then even bigger house price falls will be needed. We think that in the UK, for example, if mortgage rates rose to 5% and stayed there until the end of next year, house prices would need to fall by 20% (rather than our current forecast of 8%). (See here.)
- **Moreover, credit conditions are tightening in the aftermath of the banking troubles earlier this year.** Recent credit conditions surveys in the US and Canada showed banks tightening the availability of the mortgage finance. And while the latest UK survey showed that the availability of mortgage credit was unchanged in Q1, lenders expected it to decrease over the next three months.
- **And economies are yet to feel the full impact of the rise in interest rates; we judge that only about half of the impact of rising rates has fed through.** (See here.) Accordingly, economic growth will remain weak this year and unemployment is likely to rise. This will dampen sentiment and reduce buying power in the housing market, as well as prompting some more forced sellers.
- **Accordingly, we do not think that housing markets are at a turning point yet.** Admittedly, the risks to our forecast are now to the upside. And in the case of Canada, where the turn-around in data has been particularly strong, we have scaled back our expectation of further falls and now expect a peak-to-trough fall of 16%, rather than 23%. (See Chart 3 & here.) **But in most places, we still think that further falls in house prices are likely.** (See Chart 4.)

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Chart 1: Nominal House Prices (Jan. 2020=100)

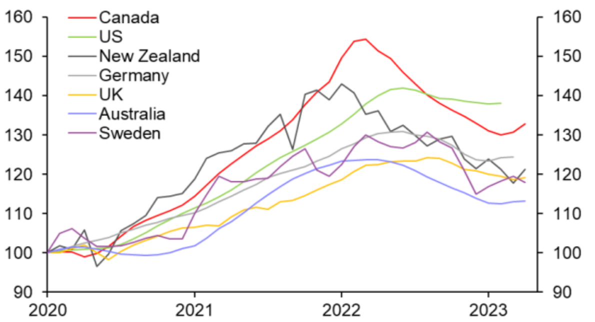


Chart 2: Interest Rates on New Mortgages (%)

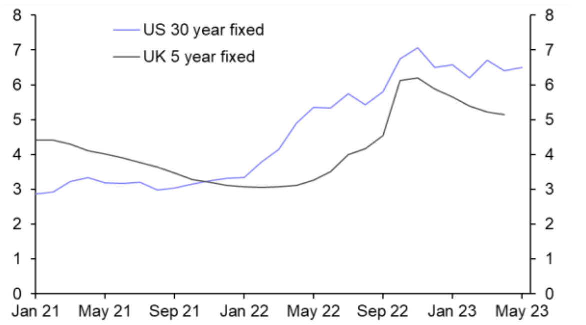


Chart 3: Canada Sales-to-New Listings & House Prices

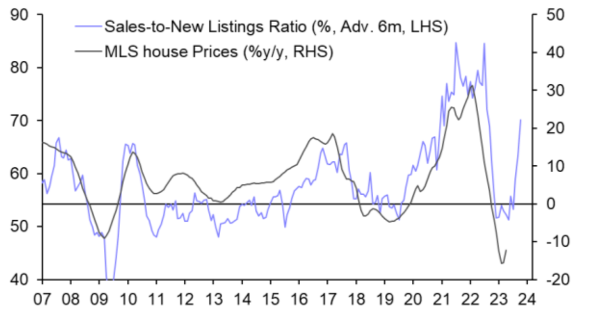
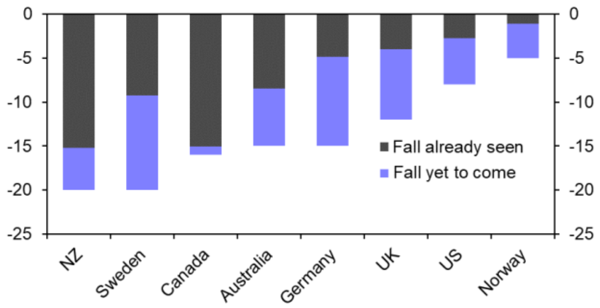


Chart 4: % Peak to Trough Fall in House Prices 2022-24



Sources: Refinitiv, CREA

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