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House Prices Are Raising the Roof

The pandemic has fueled a housing boom.

By Vaibhav Tandon

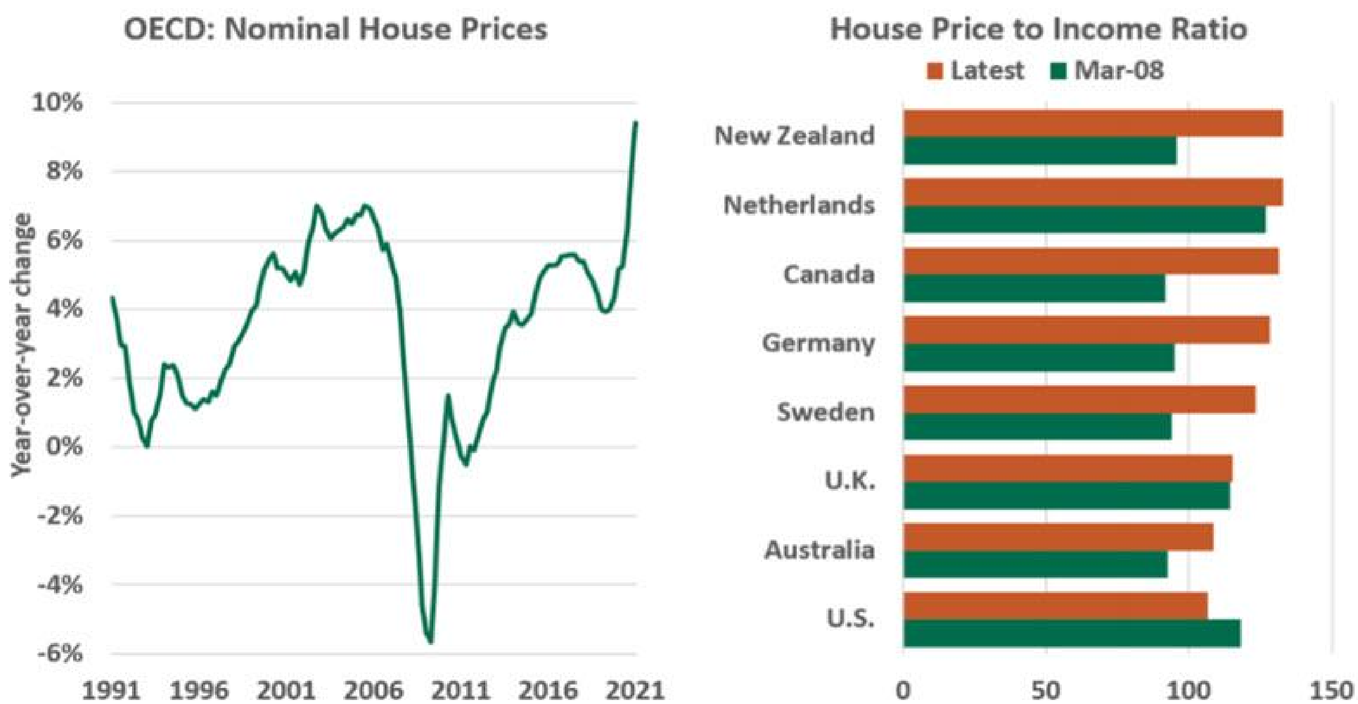
Not all economic recessions lead to a housing crash. But most take some steam out of demand for homes, due to lower income and higher unemployment. The current crisis has defied this pattern. Even as economies recorded unprecedented contractions in activity, house prices moved in the opposite direction.

Over the past year, dwelling values have been trending higher in almost all major economies. Prices in Organization for Economic Co-operation and Development countries grew 9.4% in the first quarter of 2021—the fastest pace in over three decades. Countries like Canada, the U.S., Sweden and New Zealand are among the nations which have registered double digit growth in recent quarters, with prices now at levels not seen since the height of the housing bubble 15 years ago.

Like values of other assets, house prices have been boosted by ultra-loose monetary and fiscal policies. Low interest rates have made mortgages more affordable, and savings accrued since the onset of the pandemic have provided down payments. In addition, remote working has created demand for additional space.

For new construction, supply chain disruptions have raised input costs; in the U.S., rising prices for new homes coincided with an increase in lumber prices.

Housing has been a robust asset class during the pandemic.



Source: OECD

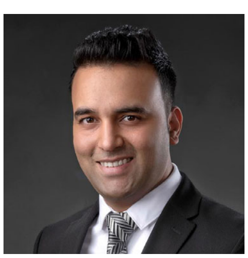
Property prices in several major economies have risen more than associated economic fundamentals. Home values are rising faster than rents and incomes, a potential sign of overheating. New Zealand, Canada, and some European economies are the least affordable markets. However, affordability in the U.S. remains below levels seen prior to the 2008 financial crisis.

Haunted by the past and the shockwaves that a housing bust can send to the financial markets, some policymakers have focused on this issue. Fed Chair Jerome Powell has called the increase in home prices "too much." New Zealand's central bank was asked by the government to "consider the impact on housing" in monetary policy decisions, and the European Central Bank has recommended inclusion of owner-occupied housing costs in the consumer price index. Some governments are looking to tighten lending rules and increase stamp duties for multiple purchases. Australian and Canadian governments were already making efforts to tame property prices before the pandemic, with the latter now seeking to levy a national vacancy tax on non-resident owners.

While the housing market is booming internationally, risks vary across nations. The Netherlands, Canada and Sweden are among the riskiest locations as households have the highest debt to income ratios among major advanced nations. A correction in prices could have a notable impact on the financial stability in these economies.

That said, we do not think we are staring at another housing crisis. Lending standards are higher than they were during the sub-prime crisis in the U.S. In the U.K., loan to income ratios remain well within central bank's limit. And bank balance sheets are more resilient than they were a decade and a half ago. Moreover, as economies return to normalcy, savings will return to pre-pandemic levels and policymakers will start turning off the tap of the stimulus that is currently driving house prices.

If there is a concern in the housing market, it is inventory. The aftermath of the 2008 crisis was a contraction of construction, during which many tradesmen left the industry. The housing sector is another example of demand exceeding supply; and with lead times for new construction lengthening, prices could continue appreciating for some time to come.



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Vaibhav Tandon is an Economist within the Global Risk Management division of Northern Trust. In this role, Vaibhav briefs clients and colleagues on the economy and business conditions, supports internal stress testing and capital allocation processes, and publishes the bank's formal economic viewpoint. He publishes weekly economic commentaries and monthly global outlooks.