

Does a Rise in Mortgage Interest Rate Necessarily Increase the Burden of Buying a House?

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Abstract :

In this paper, we demonstrate that although the housing price and house price-to-income ratio can undergo a very large rise, the burden of repaying a mortgage might decrease due to a reduction in the interest rate. In order to check if burden on house buyers increases or decreases, we suggest calculating and depicting "equal repayment curves". These curves represent a borrower's equal periodical repayment given that house prices and mortgage interest rates vary. The curves enable us to compare the burden of buying a house during a certain time period compared to a bench mark point in time. Using Israeli data, we calculated a house price indexed to income and showed that although nominal house prices during the period 2003:1-2011:4 increased by more than 66%, the burden on house buyers did not increase. These results contradict the idea held by many that reducing the interest rate necessarily makes buyers worse off due to increased house price-to-income ratio.

Key Word :

Mortgage; Interest rate; Housing price; JEL classification code: R210

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