HOUSE MORTGAGE INTEREST COSTS

Since 1995, when the inflation target came into force, house mortgage interest costs have fallen almost continuously. In that this item constitutes around one-tenth of the CPI, its downward trend has been an important cause of the slow CPI increases in recent years.

Dwelling costs are a major component of private consumption. Rents and other prices in this sector are therefore important for the development of inflation. Dwelling costs for owner-occupied housing, however, are not directly observable and have to be estimated instead. Actual prices are available for some of the items here (for example site leasehold fees, repairs, sanitary services, refuse collection and property tax) but the capital cost (interest payments) is more difficult to measure at an aggregated level. With the method used by Statistics Sweden, house mortgage interest costs are contingent on three factors: the capital stock, the level of interest rates and interest subsidies. The capital stock is calculated so as to represent the value of all owner-occupied housing in Sweden. The capital cost for this stock is calculated by applying the interest rate to the total stock (even though some houses are not mortgaged). Interest subsidies are then allowed for by reducing the capital cost by the total amount received by home-owners in the form of state subsidies.

The house mortgage interest rate is calculated as the average of the fixed and variable rates, weighted to correspond to the breakdown of the total loan stock between these rates at the turn of the preceding year. The two categories of original fixed interest period (two and five years) are taken into account by computing the average interest rate for a given month as the simple average of the rates for new loans in each of the latest 24 and 60 months, respectively. This allows implicitly for advance redemption and so-called compensation for interest rate difference.

The value of the capital stock is based on the most recent registered purchase prices. Price movements are therefore reflected in the capital stock only to the extent that houses are sold. This means that changes in the capital stock can reflect turnover as well as price movements. One consequence is that years with falling house prices can still give an increase in the capital stock.

At the current mortgage rates and interest periods, a permanent fall (increase) of 1 percentage point in the flexible rates has the effect of immediately reducing (increasing) the 12-month change in interest costs by about 2 percentage points; this effect lasts for twelve months and is accordingly transitory. The effect on annual CPI inflation is then around 0.2 percentage points. The effect disappears after one year because the entire stock of loans at flexible rates is affected immediately. A change of 1 percentage point in the fixed mortgage rates likewise affects the change in interest costs by 2 percentage points and inflation by 0.2 percentage points but instead of being immediate, these effects culminate after approximately one year. Their duration is dependent in the interest periods: the longer these are, the longer the lag before the entire stock of fixed interest loans has been renewed at the new interest rates and the more drawn-out the effect. With the current structure of loans, the greater part of the effect will persist for five years.

The major changes in interest costs in recent years must be considered exceptional. Confidence in the low-inflation policy has been strengthened appreciably, with the result that since January 1995 fixed five-year mortgage rates have fallen more than 5 percentage points. During 1996, moreover, the Riksbank lowered the repo rate almost 5 percentage points, which led to a similar drop in the flexible mortgage rates. From the example above it will be seen that the interest rate movements which are plausible once inflation target credibility has been established have a limited impact on the change in the CPI. Future effects will therefore most probably be smaller than before.