

Like any monster, Ireland's property ogre must feed constantly to survive. Last year, the housing boom gorged itself on the hapless first-time buyer. What made new homebuyers such a great source of nutrition is that so many of them were willing to borrow the full cost of their new homes and repay these loans over the rest of their working lives. Presumably, expectations that house prices were going to continue to soar panicked many buyers into getting onto the property ladder quickly at almost any cost.

The Annual Housing Statistics Bulletin for 2006 released during the week by the Department of the Environment makes for disturbing reading. It revealed that one in three new homebuyers last year took out a 100 per cent mortgage. What's more, the number of first-time buyers taking out loans with little or no deposit doubled in 2006 from the year before. Nearly two thirds of all new home mortgages were over 31-35 years or longer. The typical first-time buyer was aged 30, which means that the bulk of new buyers will still be paying off their mortgages as they approach retirement. So much for saving for old age!

All this new borrowing drove the outstanding level of residential mortgage debt to an eye-popping €123 billion in December, equivalent to 82 per cent of GNP. Two years earlier the figure stood at €77 billion. If the degree to which new homeowners had to stretch themselves to buy property last year doesn't convince you that the housing market has overheated badly, then nothing will.

One feature of last year's borrowing spree was the heavy reliance on 100 per cent mortgages. When house prices were rising rapidly, these mortgage products might have seemed like a good idea. But with house prices falling, borrowers who bought a home with no deposit are facing the grim spectre of negative equity. Indeed, some new borrowers almost certainly already have mortgage balances that exceed the value of their homes. To be sure, most households have ample equity in their homes and could probably withstand substantial declines in house prices without suffering negative equity. However, a significant number of new homeowners are highly leveraged and could lose all of their home equity if house prices continue to fall.

The other striking feature was the increased reliance on 35-year mortgages. These products allow homebuyers to borrow more, but those extra funds come at an enormous (and possibly not fully understood) cost.

Consider a couple looking to borrow the full value of a property who decide that the highest monthly mortgage repayment they can afford is €2,000 (excluding mortgage interest relief). By signing a 25-year loan, the couple could borrow roughly €335,000 at current interest rates and buy a property for that price. But if they opted for a 35-year loan, they could borrow an additional €50,000 without exceeding their monthly limit. The larger loan would be spread out over a longer period of time.

The extra €50,000 could no doubt buy a nicer home, but the borrower pays through the nose for the upgrade. Total interest payments over the life of the 25-year loan amount to €267,000. For the 35-year loan, the interest damage is €457,000, significantly more than

the cost of the property. For borrowers, there are few things more dangerous than to ignore the principle of compound interest.

Interest rates matter enormously for these calculations. Before the European Central Bank started to hike interest rates in December 2005, the couple with €2,000 to put toward a mortgage each month could have borrowed €410,000 on a 25-year loan. That figure has dropped to €335,000 at current interest rates, and will fall another €17,000 by the end of this year if interest rates go up twice more as financial markets expect. The blow to affordability from rising interest rates and the knock-on effect on house prices should be obvious. Obvious, that is, to everyone except the economic commentators who, this time last year, seemed to think that rapidly increasing house prices and rising interest rates were perfectly consistent. Five minutes with a simple calculator would have told them differently. Anecdotes point to an increase in late payments on mortgages recently, albeit from low levels.

For hard-pressed new homeowners, there is little relief in sight on the interest rate front. Another increase in rates is certain in either September or October, with the distinct possibility of an additional hike by year end. Contrary to what some people are saying, there appears little chance at this stage that interest rates will fall in 2008. Of course everyone is entitled to their opinion about what the ECB might do next year, but the most reliable measure of financial market expectations--those derived from overnight indexed swaps (don't ask!)--show that traders are not expecting any interest rate cuts next year. The fat days are over for Ireland's housing market. The ECB is starving the beast.

*Alan Ahearne is a former senior economist at the Federal Reserve Board in Washington DC. He currently lectures in economics at the Cairnes School of Business and Public Policy at NUI Galway.*