Box 2

## REAL ESTATE DEVELOPMENTS IN THE EURO AREA AND THEIR IMPACT ON LOANS TO THE PRIVATE SECTOR

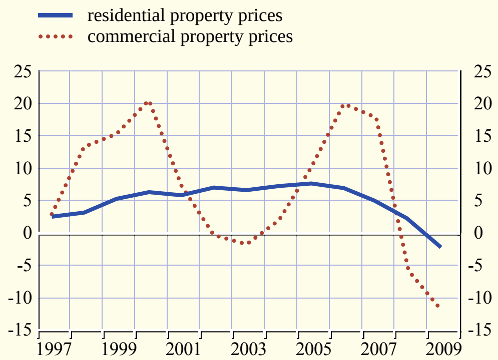
The impact that the housing market has had on the annual growth of loans to the private sector in recent years has been widely acknowledged. This impact is typically measured in terms of the contribution that loans to households for house purchase make to the annual growth of total loans to the private sector. This box adopts a wider perspective, looking at the contribution made by a broader-based estimate of all loans related to real estate. This perspective is particularly relevant in the context of the current unwinding of past buoyancy in the real estate sector, as reflected in the evolution of both residential and commercial property prices (see Chart A).[1]

### A working definition of the impact of real estate on private sector loans

Developments in the real estate market have an impact on MFI loans to the private sector that goes beyond their impact on loans to households for house purchase. In particular, the levels of activity in the industries most closely related to the real estate market, such as construction and those described here as "real estate activities" (which include buying, selling, renting and intermediation), are typically correlated with real estate cycles. Consequently, an examination of the overall impact that real estate developments have on loans to the private sector requires the adoption

**Chart A Commercial and residential property prices**

(annual percentage changes)




Sources: Jones Lang LaSalle and ECB calculations.

1 See also Box 9, entitled "Recent housing market developments in the euro area", in this issue of the Monthly Bulletin.

of a wider perspective, considering not only loans to households for house purchase, but also loans to non-financial corporations engaged in broader real estate activities.

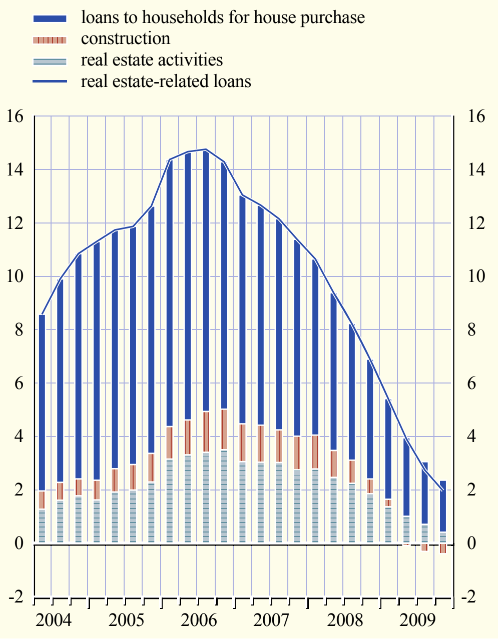
Estimates of loans to euro area non-financial corporations by industry are available on a quarterly basis.[2] These estimates include details of the construction industry and real estate activities. However, in those statistics real estate activities are combined with other activities which are not related to the real estate market (such as other business and administrative services), so this box uses an estimate, based on estimates of national data available for some euro area countries, to separate real estate activities from the rest.[3] As regards loans to the construction industry, the aggregate used includes not only loans related to building projects, but also loans related to civil engineering activities, as no further breakdown is possible on the basis of available data. In the remainder of this box, loans granted to the construction and real estate sectors, together with loans for house purchase, are used to approximate the overall contribution made by "real estate-related loans" to private sector loans.

### The relative importance of loans for house purchase in real estate-related loans

Of the three components of real estate-related loans, loans to households for house purchase are the most important, accounting for more than two-thirds of growth from 2004 to 2009. Real estate activities account for most of the remaining third, while the contribution made by loans to non-financial corporations in the construction sector is relatively minor (see Chart B).[4,5] All components have contributed to the slowdown observed in recent years (with construction even making a negative contribution towards the end of the period under consideration). However, loans to households for house purchase have been the main driver in absolute terms.

**Chart B Real estate-related loans and their components**

(annual percentage changes; contributions in percentage points)




Source: ECB.
Note: "Real estate-related loans" comprise loans to households for house purchase and loans to non-financial corporations engaged in construction and real estate activities.

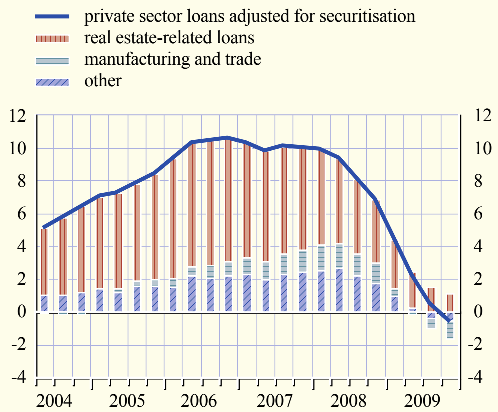
2 See Box 5, entitled "Developments in MFI loans to non-financial corporations by industry", in the December 2009 issue of the Monthly Bulletin.
3 Loans to non-financial corporations engaged in real estate activities are calculated as a percentage of total loans to non-financial corporations engaged in real estate, other business and administrative services for those euro area countries that provide country-level estimates solely for real estate activities. This is then used to estimate loans for real estate activities at the euro area level. This assumes that the share of loans to non-financial corporations engaged in real estate activities is the same in the other countries.
4 The distinction between construction and real estate activities is not straightforward, given that firms that are classified as belonging to the construction sector on the basis of their main activity could also be involved in real estate activities.
5 Shifts in loan dynamics can affect the relative contributions of those three components as a result of differences in the typical maturities of the three types of loan.

### The relative importance of real estate-related loans in private sector loans

Chart C shows that real estate-related loans are the main contributor to loans to the private sector. In 2006, at the peak of the most recent loan cycle, these loans contributed around 7 percentage points to the overall growth rate of 10%. The remainder was accounted for by (i) loans to non-financial corporations engaged in manufacturing, trade and other activities, and (ii) loans to households for purposes other than house purchase, which contributed around 1 and 2 percentage points respectively. Since then, the contribution made by real estate-related loans has declined steadily, being responsible for approximately half of the overall decline in the annual growth rate of loans to the private sector. However, in more recent quarters, at least, the strength of the overall deceleration can be explained mainly by the contraction in loans to non-financial corporations engaged in manufacturing and trade. Loan flows to non-financial corporations engaged in these relatively cyclical activities declined dramatically following the intensification of the financial crisis at the end of 2008 and were negative for most of 2009.

**Chart C Loans to the private sector and the contribution made by real estate-related loans**

(annual percentage changes; contributions in percentage points)




Sources: ECB and ECB calculations.
Notes: "Real estate-related loans" comprise loans to households for house purchase and loans to non-financial corporations engaged in construction and real estate activities. "Manufacturing and trade" comprises loans to non-financial corporations engaged in: manufacturing; the repair and installation of machinery and equipment; and wholesale and retail trade. "Other" comprises loans to non-financial corporations engaged in other activities and loans to households for purposes other than house purchase.

### The contribution made by real estate-related loans conceals strong differences across countries

The data on real estate-related loans at the euro area level conceal significant heterogeneity at the country level – in terms of both the individual countries' contributions and their evolution over time – as a result of considerable differences in the housing market developments of the various countries. Indeed, some countries accounting for a relatively small share of euro area GDP accounted for a disproportionately large share of the growth observed for real estate-related loans as of 2004, before experiencing stronger unwinding later on. Meanwhile, others accounting for a relatively large share of GDP experienced more modest developments throughout the period under consideration. To illustrate these patterns, euro area countries have been divided up on the basis of the growth rates of real estate-related loans in 2006, resulting in three groups (i.e. countries exhibiting strong, moderate and weak growth) of similar sizes in terms of their share of overall outstanding amounts.[6] In 2006, the strong growth group contributed around 9 percentage points to the overall growth rate of 15%, with the moderate and weak growth

6 2006 has been chosen as the reference year on the grounds that it represented the peak of the most recent cycle in real estate-related loans. The strong growth group comprises Ireland, Spain, Greece, the Netherlands and Slovenia; the weak growth group comprises Germany, Austria and Portugal; and the remaining countries make up the moderate growth group. Estimates of real estate-related loans for individual euro area countries are subject to greater uncertainty and are not published by the ECB.

groups contributing around 5 and 1 percentage points respectively. The contribution of the strong growth group has declined markedly ever since (standing close to zero in the fourth quarter of 2009), accounting for more than half of the reduction observed in the annual growth rate of real estate-related loans (see Chart D). The contributions of the moderate and weak growth groups have also declined (albeit to a much lesser extent), falling to around 2 and 0.5 percentage points respectively. In fact, these two groups have underpinned the growth observed for real estate-related loans in the last few quarters.

**Chart D Cross-country heterogeneity in real estate-related loans**

(annual percentage changes; contributions in percentage points)


Sources: ECB and ECB calculations.
Notes: "Real estate-related loans" comprise loans to households for house purchase and loans to non-financial corporations engaged in construction and real estate activities. Countries are allocated to the strong, moderate and weak growth groups on the basis of the growth rates recorded in 2006 at the country level. The three groups had similar shares of outstanding amounts in that year (each accounting for around one-third).

Overall, this box has shown that, while the impact of real estate activity on private sector loan growth comprises more than just the contribution of loans for house purchase, such loans account for the largest share of real estate-related loans. The moderate recovery currently being observed for loans for house purchase should thus be supportive of the overall growth of loans to the private sector, especially if it were to trigger or coincide with a recovery in the growth of loans to non-financial corporations engaged in construction and real estate activities.