

Box 5

Residential property price developments in the euro area

In March this year the ECB published a report entitled “Structural factors in the EU housing markets”. Residential property prices are an important input into the analysis of risks to price stability. This box reviews most recent euro area residential property price developments, whose dynamics remained relatively strong on the basis of evidence available up to early 2003.

Statistical background

The residential property price index for the euro area is calculated by the ECB as the average of the annual growth rates of national indicators, weighted by 2001 GDP shares. The Eurosystem has decided on a set of target definitions aimed at harmonising, as much as possible, information on property prices across EU countries. The selection of national residential property price data is based on the degree of market coverage in each country, the methods used for quality adjustment, the quality of the data source and the sample size. Nevertheless, both the methods employed for the compilation of residential property price indicators and the coverage of the data still vary considerably from country to country. The differences between the available property price indices concern several aspects: market coverage (geographical coverage, type of property, mortgage/cash transactions), quality adjustment (i.e. methods used to adjust for differences in the characteristics of the property transacted between periods), data sources (tax records, mortgage applications, real estate agents, newspapers), index construction, and weighting. This suggests that, while the euro area residential property price index may be used to analyse longer-term developments, both the more specific short-term changes in the index and the level of the annual growth rates have to be treated with a considerable degree of caution.

Euro area developments

Data available for 2003 (referring mainly to the first quarter) show that residential property price increases remained strong in the euro area as a whole. As Chart A shows, the annual rate of increase in residential property prices in the euro area has remained at around 7% over the last four years. However, this increase must be seen in the light of subdued residential property price growth in the five years prior to this period (1994-1998), of around 1½% on average.

In the light of the caveats mentioned above concerning measurement difficulties, it is worthwhile to assess whether the development of overall residential property prices in the euro area, as measured by the above-mentioned index, is closely followed by alternative classifications (e.g. new or existing residential property prices, residential property prices in large urban areas). In this regard, price developments for both new and

Chart A: Euro area residential property prices

(annual percentage changes; annual data)

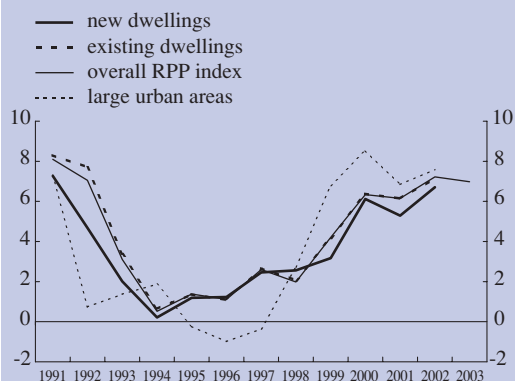


Source: ECB calculations based on non-harmonised national data.

Note: Data for 2003 refer to the first quarter.

**Chart B: Residential property prices (RPP)
– alternative coverage classifications**

(annual percentage changes; annual data)



Source: ECB calculations based on non-harmonised national data. Proxies are used in some instances where available data do not meet target definition.

Note: Data for 2003 refer to the first quarter.

dynamics observed between 1997 and 2001; the relatively low levels of interest rates since 1998, particularly in comparison with earlier levels; a possible shifting of investment from stock markets into residential property in the light of the poor stock market performance between 2000 and 2002; and developments in financial intermediation markets (i.e. financial liberalisation and a higher degree of integration of the housing credit market with the rest of the financial system), which may have increased the sensitivity of residential property prices to interest rates as credit constraints are reduced.

Developments at the country level

Although almost all euro area countries have experienced an increase in residential property prices since 1999, the extent of the observed price changes has varied largely from country to country, resulting in marked differentials. Compared with the euro area average, Spain, Ireland, the Netherlands, Greece and France observed above-average price increases between 1999 and 2002, with the differential widening in Spain and declining in the Netherlands and Ireland (Chart C). By contrast, in Austria and Germany residential property price changes remained below the euro area average rate between 1999 and 2002.

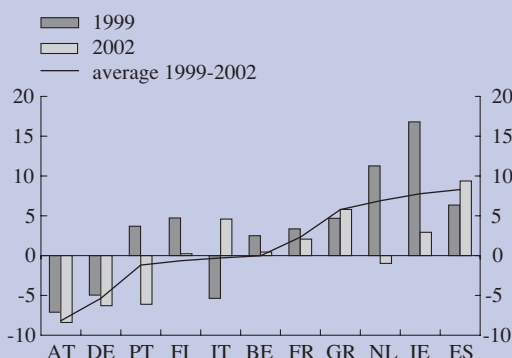
Considering the potential reasons for cross-country diversity in these price developments, longer-term determinants of these prices related mostly to the local character of housing markets (differences in the provision of financing for the purchase of residential properties, different tax incentives and subsidies related to residential property, divergent transaction costs and zoning laws, etc.) and to demographic trends are the most relevant. Moreover, the extent of interest rate changes differed significantly across euro area countries in the late 1990s. This has possibly contributed to the observed differences in residential property price developments. In particular, the move to Stage Three of EMU led to a large decline in interest rates in Ireland, Spain, Greece and Portugal, i.e. countries where, with the exception of Portugal, the increase in residential property prices clearly exceeded the euro area average. In most other euro area countries, including Germany and Austria, the scope for stimulative convergence effects was much lower.

existing dwellings have been broadly similar (see Chart B). Different dynamics can be observed in large urban areas. Although the profile is broadly similar, it appears that the amplitude of movement over the cycle, i.e. both on the upside and the downside, is larger than for non-urban areas. This is hardly surprising, particularly during the upswing, when supply constraints in large urban areas (e.g. limited land availability) can give rise to stronger increases in property prices than in less populated areas.

Although country-specific factors are undoubtedly important for understanding residential property price movements, a number of common factors appear to be driving the relatively strong development in property prices observed in the euro area since 1998. These factors include the lagged consequence of strong growth and employment

Chart C: Differences in residential property price changes across euro area countries

(percentage points, calculated as annual percentage changes relative to euro area average)



Source: ECB calculations based on non-harmonised national data.