

## Box 4

## RECENT HOUSING MARKET DEVELOPMENTS IN THE EURO AREA

Housing market developments in the euro area have been moderating fairly steadily since mid-2005, following a strong expansion over the preceding years. This box reviews the recent evolution of euro area residential property prices, then relates these developments to housing demand and supply factors.<sup>1</sup>

The most recent data on euro area residential property prices suggest that a general moderation beginning in mid-2005 continued until the end of 2007. In annual terms, house price growth declined steadily from a peak of 8.2% in the first half of 2005 to 4.0% in the second half of 2007 (see Chart A). Thus, the growth rate observed recently is much lower than the average annual growth rate of 6.0% witnessed over the period 1997-2005 (see the table).

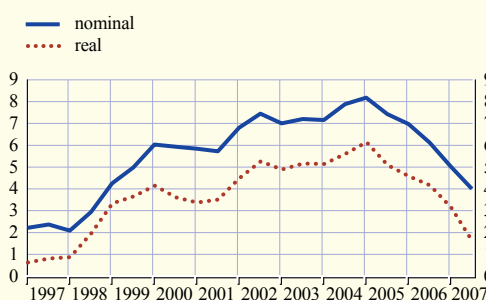
Available data for the beginning of 2008 indicate a likely continuation of this downward trend. Adjusted for HICP inflation, the recent slowdown in euro area house prices has been even more marked, with real house price inflation having fallen from 6.1% in the first half of 2005 to 1.6% in the second half of 2007.

Considerable country heterogeneity has continued to underlie the evolution of aggregate euro area house prices (see the table). Examining recent developments, available country data suggest that the ongoing moderation in euro area house price inflation has generally been most visible among those countries which have recorded relatively high residential property price rises in recent years. In particular, there has been a marked slowdown in residential property price growth rates since 2006 in Ireland (where house prices have been falling in annual terms since mid-2007) and, to a lesser extent, in Spain, France, Malta, Finland, Belgium, Italy and Austria. By contrast, house prices in 2007 were roughly unchanged or even increased compared with those recorded in 2006 for Germany, Cyprus, the Netherlands and Portugal.

The general slowdown in euro area house price inflation appears to stem to a large extent from a cooling in housing demand. One factor behind this development is the tightening in borrowing

Chart A Residential property prices in the euro area

(annual percentage changes; biannual data)



Source: ECB calculations based on national data.

Notes: Real residential property price growth is obtained by subtracting annual HICP inflation from nominal residential property price growth. The euro area residential property price aggregate is calculated from national series covering more than 90% of euro area GDP for the whole period.

<sup>1</sup> For a detailed analysis of indicators of housing demand and supply, see the article entitled "Assessing house price developments in the euro area" in the February 2006 issue of the Monthly Bulletin.

## Latest data on nominal residential property prices in the euro area

(annual percentage changes)

	Weight	Average annual change, 1997-2005	2006	2007	2007				2008
					Q1	Q2	Q3	Q4	Q1
Belgium <sup>1)</sup>	3.7	8.9	11.1	9.2	9.1	9.4	10.3	7.9	..
Germany <sup>2)</sup>	27.4	-0.7	0.3	0.3	..	..	..	..	..
Ireland <sup>2)</sup>	2.1	14.7	13.4	0.9	9.2	2.9	-1.8	-6.0	-8.6
Greece <sup>2)</sup>	2.5	10.0	12.2	..	..	..	..	..	..
Spain <sup>2)</sup>	11.6	12.0	10.4	5.8	7.2	5.8	5.3	4.8	3.8
France <sup>1)</sup>	21.1	9.4	12.1	6.6	8.1	6.8	5.7	5.7	..
Italy <sup>2),4)</sup>	17.4	6.5	6.7	5.7	6.6	..	4.8	..	..
Cyprus <sup>2)</sup>	0.2	..	10.0	15.0	..	..	..	..	..
Luxembourg <sup>2)</sup>	0.4	9.5	..	..	..	..	..	..	..
Malta <sup>2)</sup>	0.1	9.1	3.5	1.1	3.1	0.2	1.1	0.1	-0.7
Netherlands <sup>1)</sup>	6.3	9.6	4.5	..	4.6	4.3	4.9	..	..
Austria <sup>2),3)</sup>	3.0	-0.3	4.0	4.1	3.5	4.4	4.8	3.6	2.1
Portugal <sup>2)</sup>	1.8	3.9	2.1	1.3	1.3	1.1	1.3	1.7	2.3
Slovenia <sup>1)</sup>	0.4	..	..	..	..	..	..	..	..
Finland <sup>1)</sup>	2.0	6.4	7.4	5.9	6.4	6.4	6.0	4.9	3.1
Euro area <sup>4)</sup>	100.0	6.0	6.5	4.5	5.0	..	4.0	..	..

Sources: National sources and ECB calculations.

Notes: Weights are based on nominal GDP in 2006.

1) Existing dwellings (houses and flats); whole country.

2) All dwellings (new and existing houses and flats); whole country.

3) Data up to 2000 for Vienna.

4) Biannual data for the euro area and Italy.

conditions since late 2005. Interest rates applied to loans to households for house purchase have generally risen over the last two years, following several years of decline. According to the latest ECB bank lending survey, a further increase in the net tightening of credit standards for loans to households for house purchase took place in the first quarter of 2008.<sup>2</sup> At the same time, as a result of years of strong house price increases, housing affordability out of actual income has fallen steadily over the past decade, which is also likely to have contributed to a softening in housing demand. As indicated in Chart B, it was only in 2007 that cooling house price inflation contributed to a broad stabilisation in the ratio of household disposable income to the house price index – a “crude” or simple measure of affordability – following many years of decline.

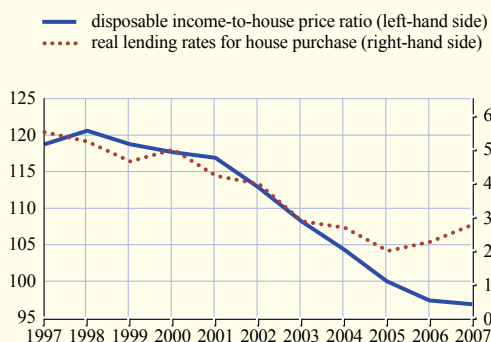
The softening of house price growth has also been associated with a cooling in housing supply. Over the course of 2007, annual real housing investment growth in the euro area moderated considerably, from a peak of 6.3% in annual terms at the beginning of 2007 to nearly zero by the end of the year (see Chart C). This has also contributed to some moderation in the share of resources devoted to housing in the economy, illustrated by the fall in the ratio of housing investment to GDP. Considerable heterogeneity is, however, evident across euro area countries in terms of housing investment, largely reflecting country heterogeneity in house price developments.

Looking ahead, the ongoing softening in euro area housing market growth is likely to persist, following the strong expansion over the last decade. House price inflation is likely to remain at more moderate levels in the euro area than the vigorous rates recorded in the years leading up to 2005. In such a context, there is a strong likelihood that the real activity counterpart to house

<sup>2</sup> See the box entitled “The results of the April 2008 bank lending survey for the euro area” in the May 2008 issue of the Monthly Bulletin.

**Chart B Housing affordability and borrowing conditions**

(index: 2005=100; percentages; annual data)

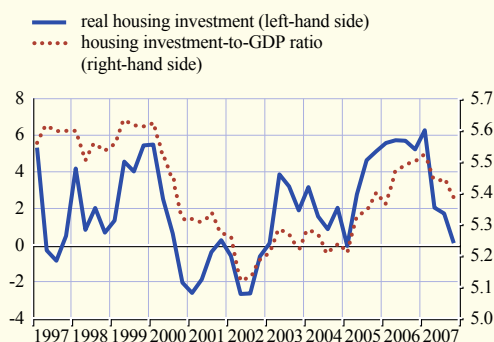


Sources: Eurostat and ECB calculations.

Notes: The narrow measure of housing affordability is defined as the ratio of nominal disposable income to the nominal house price index. Real lending rates are calculated as the rate on loans to households for house purchase with over five and up to ten years' initial rate fixation minus annual HICP inflation.

**Chart C Residential investment in the euro area**

(annual percentage changes; percentages)



Sources: Eurostat and ECB calculations.

prices, in the form of housing investment, will remain subdued. A major challenge in this latter respect will be the reabsorption of resources elsewhere in the economy, particularly in those countries where the correction in housing sector activity is most pronounced.