

Box 4

RECENT HOUSING MARKET DEVELOPMENTS IN THE EURO AREA

Euro area residential property price inflation continued to ease in early 2008, thereby extending a moderating trend that has been evident over the last three years, following strong growth in the period leading up to 2005. This box reviews recent developments in residential property prices in the euro area, relates their evolution to selected housing demand and supply factors, and assesses the likely prospects for house prices.¹

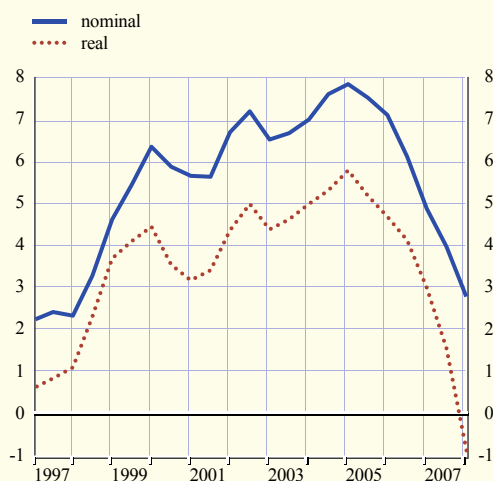
The most recent data indicate a continued steady downward trend in the growth rate of euro area residential property prices in the first half of 2008.² In annual terms, house price growth in the euro area is estimated to have declined steadily from a peak of 7.7% in the first half of 2005 to 2.7% in the first half of 2008 (see Chart A). The currently subdued growth in house prices contrasts with the strong average annual growth rate of 6.6% witnessed over the period from 1999 to 2005 (see the table below). Adjusted for HICP inflation, the recent slowdown in euro area house price growth was even more marked, with this measure of house price inflation falling from 5.7% in the first half of 2005 to -0.8% in the first half of 2008. This more marked movement, however, was exacerbated by the impact of volatile commodity price movements on euro area HICP.

1 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.

2 It should be noted that there is high data uncertainty in assessing house price developments on account of, in particular, issues related to coverage, quality control and representativeness.

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 the growth of nominal residential property prices. The euro area residential property price aggregate is calculated from national series covering more than 90% of euro area GDP for the whole period.

Considerable cross-country heterogeneity continued to underlie the evolution of aggregate euro area house prices (see the table below). Available country data indicate that the speed and magnitude of the ongoing moderation in house price inflation broadly corresponded to the strength of the increases seen at the country level in preceding years. While a marked slowdown in residential property price growth was recorded for most euro area countries thus far in 2008, it is only in Ireland, Spain, Malta and Finland that house prices have shown signs of falling in comparison with their level a year earlier.

For the euro area as a whole, the recently slowing momentum of house price growth was associated with a moderation of housing demand, related in part to movements in housing demand fundamentals. In particular, “crude” housing affordability – defined as the ratio of households’ disposable

income to the house price index – has generally fallen over the past decade, against the background of strong house price increases. As indicated in Chart B, it was only in 2007 that

Latest data on nominal residential property prices in the euro area

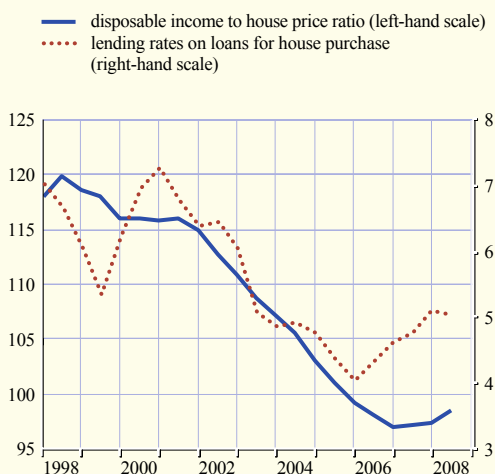
(annual percentage changes)

	Weight	Average annual change 1999-2005	2006	2007	2008	2008		2008			
						first half	second half	Q1	Q2	Q3	Q4
Belgium ¹⁾	3.7	9.4	11.1	9.2	..	..	..	..	..	..	..
Germany ²⁾	27.2	-0.9	0.2	0.2	..	..	..	..	..	..	..
Ireland ²⁾	2.1	12.2	13.4	0.9	-9.4	-9.0	-9.8	-8.6	-9.4	-10.0	-9.7
Greece ²⁾	2.5	9.5	12.2	3.6	..	..	..	..	..	..	..
Spain ²⁾	11.5	13.8	10.4	5.8	0.7	2.9	-1.4	3.8	2.0	0.4	-3.2
France ¹⁾	21.1	11.2	12.1	6.6	..	3.7	..	4.3	3.0	0.8	..
Italy ²⁾	17.3	7.5	5.8	4.9	4.2	4.5	3.9	..	..	..	..
Cyprus ²⁾	0.2	-	10.0	15.0	..	..	..	..	..	..	..
Luxembourg ²⁾	0.4	11.1	..	..	..	..	..	..	..	..	..
Malta ²⁾	0.1	10.8	3.5	1.1	-2.7	-1.7	-3.8	-0.7	-2.7	-3.2	-4.4
Netherlands ¹⁾	6.3	7.8	4.6	4.2	2.9	3.7	2.2	4.2	3.1	2.8	1.7
Austria ^{2),3)}	3.0	0.7	4.0	4.1	..	1.0	..	2.1	-0.2	0.7	..
Portugal ²⁾	1.8	2.9	2.1	1.3	..	3.1	..	2.3	4.0	4.8	..
Slovenia ¹⁾	0.4	-	13.9	..	..	..	..	-	-	-	-
Slovakia ¹⁾	0.5	-	16.8	23.9	..	32.8	..	34.5	31.2	19.9	..
Finland ¹⁾	2.0	..	7.4	5.9	0.9	3.2	-1.4	3.7	2.7	0.6	-3.4
Euro area	100	6.6	6.5	4.3	..	2.7	..	..	..	..	..

Sources: National sources and ECB calculations.
Note: Weights are based on 2006 nominal GDP.
Definitions:
1) Existing dwellings (houses and flats); whole country.
2) All dwellings (new and existing houses and flats); whole country.
3) Up to 2000 data for Vienna only.

Chart B “Crude” housing affordability and borrowing conditions

(index: 2005 = 100; percentages per annum)

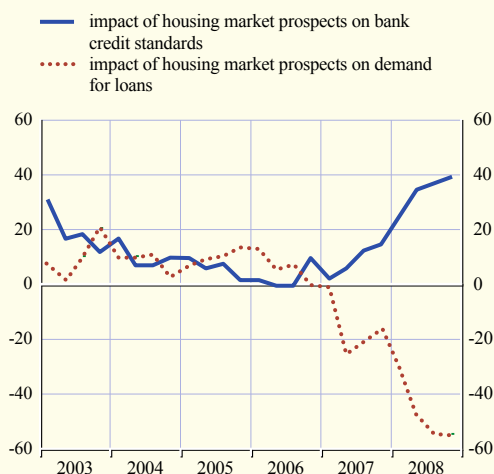


Sources: Eurostat and ECB calculations.

Notes: “Crude” housing affordability is defined as the ratio of households’ nominal disposable income to the nominal house price index. Lending rates are calculated as the rate on loans to households for house purchase with an initial rate-fixation period of over five and up to ten years.

Chart C Survey evidence of the impact of housing market prospects on loans to households for house purchase

(net percentages)



Sources: ECB bank lending survey.

Note: The net percentages refer to the difference between the sum of the percentages of banks responding “tightened/decreased considerably” and “tightened/decreased somewhat” and the sum of the percentages of banks responding “eased/increased somewhat” and “eased/increased considerably”.

decelerating house price inflation contributed to some degree of stabilisation of this measure of affordability after many years of steady decline. Given, however, that the acquisition of housing is mainly debt-financed, borrowing conditions may also have affected housing affordability adversely over recent years. Borrowing conditions have generally tightened for households since early 2006, reflecting a general increase in the nominal interest rates applied to loans to households for house purchase (see Chart B). This followed a general decline in borrowing costs over previous years, which had helped to offset the steady fall in crude housing affordability. The latest ECB bank lending survey suggests that there was a further net tightening of credit standards for loans to households for house purchase in the last quarter of 2008.³ The responses to the bank lending survey suggest that housing market prospects have led to both tightening bank credit standards and lower demand for loans since early 2007 (see Chart C). Indeed, the annual growth rate of household loans for house purchase has steadily declined from a peak of over 12% in mid-2006 to only 1.7% in December 2008.

In the context of the slowdown in both house prices and housing demand, there have been signs of a rapidly receding housing supply. In particular, real residential investment in the euro area has moderated markedly, falling from an annual growth rate of 6.1% in the first quarter of 2007 to a contraction of 3.3%, in annual terms, by the third quarter of 2008 (see Chart D). This also contributed to a decline in the share of resources devoted to housing construction in the economy, as illustrated by the fall in the ratio of nominal housing investment to nominal GDP from a historically elevated level. Building permits, which are often used as a leading indicator, suggest that weak residential investment will persist in the coming months, as the number of permits contracted sharply, by more

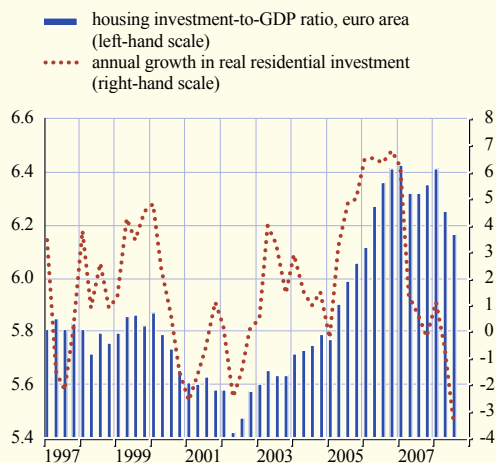
³ See Box 3, entitled “The results of the January 2009 bank lending survey for the euro area”, in this issue of the Monthly Bulletin.

than 20% in annual terms, in the third quarter of 2008. Looking ahead, housing investment growth is expected to continue to moderate from the levels witnessed in recent years.

All in all, a subdued evolution of euro area house prices is likely to persist for some time to come. Against the background of the generally strong expansion of house prices over the last decade and a sharp weakening of activity, housing demand and supply dynamics would suggest that euro area house price inflation is likely to moderate further. Moreover, historical experience suggests that, in the short term, house prices may sometimes overshoot or undershoot their long-term trend as frictions and lags in the adjustment of the housing supply imply a dominant role for potentially volatile housing demand.⁴

Chart D Residential investment in the euro area

(percentage of GDP; annual percentage changes)



Sources: Eurostat and ECB calculations.

⁴ As indicated in ECB, "Structural factors in EU housing markets", 2003, the long-term development of house price inflation can be expected to exceed that of inflation for the economy as a whole, given – all else being equal – the scarcity of land that can be exploited for construction purposes and the fact that productivity in new home construction is lower than that for the overall economy. This may, however, be tempered by other factors such as demographic change, which would also be expected to strongly influence the long-term development of house prices.