

RECENT HOUSING MARKET DEVELOPMENTS IN THE EURO AREA

Euro area house price growth continued to ease in 2008, thereby continuing on a moderating trend, following strong price increases 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 prospects for house prices.¹

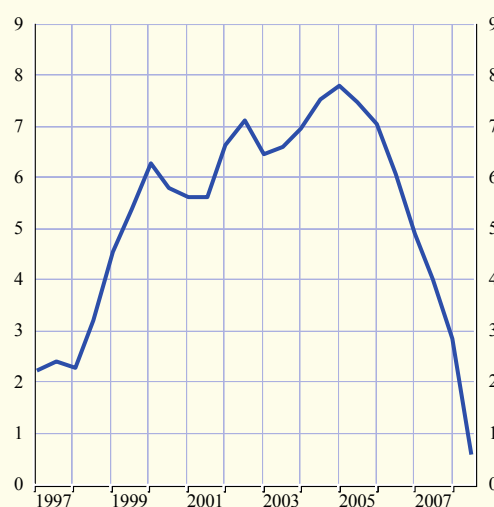
The most recent data indicate a continued steady downward trend in the growth rate of euro area residential property prices in the second half of 2008.² According to the latest available data, annual house price growth in the euro area stood at 0.6% in the second half of 2008, substantially below the peak of 7.7% in the first half of 2005 (see Chart A). More generally, house price growth has fallen considerably below the average increase of 6.6% per annum recorded over the period 1999-2005 – a house price appreciation of nearly 50% in cumulative terms (see table).

A marked slowdown in residential property price growth was recorded for most euro area countries in 2008 and early 2009, with the latest available data pointing to an outright year-on-year decline in house prices recorded in at least six countries (see table). More generally, the data appear to suggest that countries that exhibited the strongest house price increases in the years up to 2005 tend to be those that are currently experiencing the most pronounced correction.

The slowing momentum of euro area house price growth has been associated with a moderation in both housing demand and supply in the euro area. A widely used demand factor is the “crude” or narrow housing affordability measure – defined as the ratio of households’ disposable income to the house price index. As real per capita income did not keep pace with house price growth in the euro area, it led to a fall in the measure over the period 1998-2006 (see Chart B). While this basic measure of affordability has recently improved somewhat, borrowing conditions for households have generally tightened since early 2006 – reflecting a general increase in the nominal interest rates applied on loans to households for house purchase until the latter

Chart A Residential property prices in the euro area

(annual percentage changes; biannual data)



Source: ECB calculations based on national data.

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

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 a high degree of uncertainty in the data used to assess house price developments stemming, particularly, from issues related to coverage, quality control and representativeness.

Residential property prices in the euro area

(annual percentage changes)

	Weight %	1999-2005 average annual change	2006	2007	2008	2008		2008				2009
						first half	second half	Q1	Q2	Q3	Q4	Q1
Belgium ¹⁾	3.7	9.4	11.1	9.2	-	-	-	-	-	-	-	-
Germany ²⁾	27.0	-0.9	0.2	0.7	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	-9.8
Greece ²⁾	2.5	9.5	12.2	4.6	2.6	2.6	2.7	1.7	3.5	2.4	2.9	-
Spain ²⁾	11.7	13.8	10.4	5.8	0.7	2.9	-1.4	3.8	2.0	0.4	-3.2	-6.8
France ¹⁾	21.1	11.2	12.1	6.6	1.2	3.7	-1.1	4.3	3.0	0.8	-3.0	-6.6
Italy ²⁾	17.1	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	-0.3
Austria ^{2),3)}	3.0	0.7	4.0	4.1	1.3	1.0	1.6	2.1	-0.2	0.7	2.5	4.3
Portugal ²⁾	1.8	2.9	2.1	1.3	3.9	3.1	4.7	2.3	4.0	4.8	4.7	2.7
Slovenia	0.4	-	-	-	-	-	-	-	-	-	-	-
Slovakia ¹⁾	0.6	-	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	100.0	6.6	6.5	4.4	1.7	2.8	0.6	-	-	-	-	-

Sources: National sources and ECB calculations.

Note: Weights are based on 2007 nominal GDP.

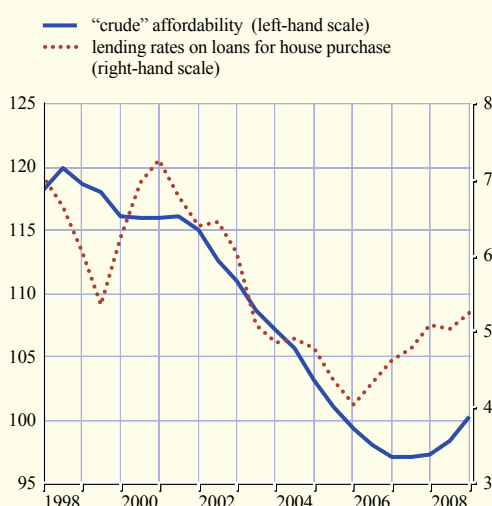
1) Existing dwellings (houses and flats); whole country.

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; percentage 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.

part of 2008 – thereby reducing housing affordability. More recently, MFI interest rates on mortgages have fallen and the latest bank lending survey suggests that, in early 2009, bank credit standards eased somewhat.³ Notwithstanding these developments in credit conditions, there has been a continued decline in the annual growth rate of household loans for house purchase from a peak of over 12% in mid-2006 to -0.2% in April 2009. Taken together, all of the developments described above suggest that housing demand is likely to remain subdued.

Within an environment of subdued housing demand, there have also been signs of rapidly receding housing supply in the euro area. The annual rate of change in real residential investment in the euro area has fallen steadily, from a peak of 6.3% in the second quarter of 2006 to -7.7% in the fourth quarter of 2008 (see Chart C). This also contributed to a steady decline in the share of resources dedicated

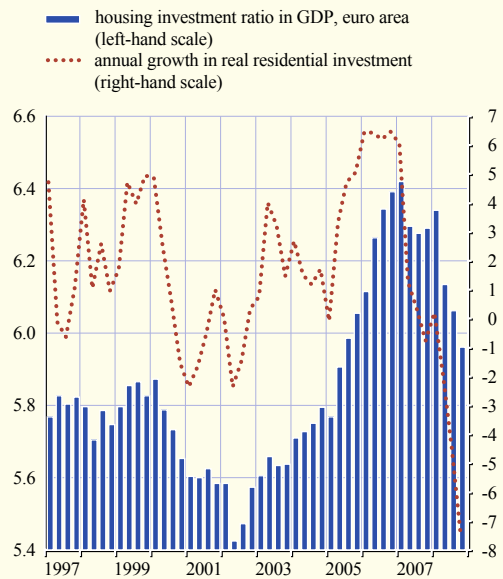
3 See Box 2, entitled "The results of the April 2009 bank lending survey for the euro area", in the May 2009 issue of the Monthly Bulletin.

to housing investment in the economy to the end of 2008. The number of building permits granted, which is often used as a leading indicator for housing investment, has continued to contract sharply and fell by an annual rate of more than 20% at the end of 2008. This suggests that the weakness in housing supply will persist for the time being.

All in all, against the background of the generally strong growth in house prices over the years leading up to 2005 and the recent weakening of activity, housing demand and supply dynamics would suggest that euro area house price growth is likely to moderate further.⁴ Meanwhile, 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.⁵

Chart C Residential investment in the euro area

(percentage; annual percentage changes)



Sources: Eurostat and ECB calculations.

- 4 This signal from a supply and demand analysis is consistent with indications from an asset-pricing approach applied to housing. Specifically, the ratio of the euro area house price index relative to the rent component of the HICP index remains somewhat elevated compared with its long-term average. In addition to the evolution of the rental yield, stable low-frequency variation in expected returns may also have contributed to large and persistent swings in euro area house prices – see Hiebert and Sydow (2009), “What drives returns to euro area housing? Evidence from a dynamic dividend discount model”, ECB Working Paper No 1019.
- 5 As indicated in “Structural factors in EU housing markets”, ECB (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 in the overall economy. This may, however, be tempered by other factors, such as demographic change, which would also be expected to influence strongly the long-term development of house prices.