

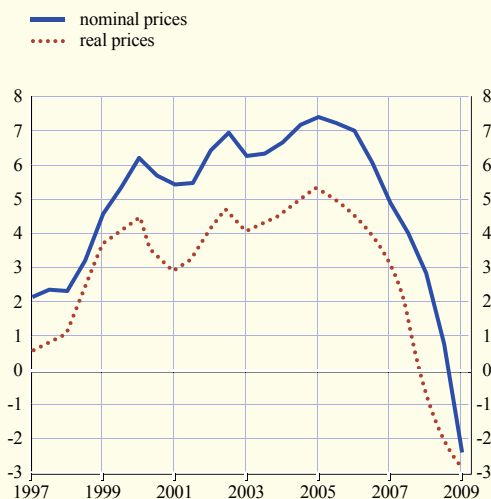
### Box 3

#### RECENT HOUSING MARKET DEVELOPMENTS IN THE EURO AREA

Euro area residential property prices fell in the first half of 2009, after growth moderated following strong price increases in the period to 2005. This box reviews recent developments in residential property prices in the euro area, examines selected housing supply and demand factors, and assesses the prospects for house prices.<sup>1</sup>

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.

According to the latest data,<sup>2</sup> in the first half of 2009 euro area house prices fell at an annual rate of 2.4% in nominal terms and 3.0% in real terms, i.e. deflated by the HICP (see Chart A). This contraction – the first on record since 1982 – follows a period of slower growth that began after the strong price increases recorded between 1999 and 2005 (when the average annual increase was 6.4%; see the table). Over the period 1999-2008 the cumulative increase in euro area nominal house prices was in excess of 60%.

Residential property prices fell year on year in the first half of 2009 in a majority of euro area countries. The sharpest drops were observed in Ireland, Spain, France, Malta and Slovenia. Generally, the countries experiencing the most pronounced corrections are those that exhibited the strongest house price increases in the period to 2005. Available country data for the third quarter of 2009 point to a further contraction in residential property prices.

1 For a detailed analysis of indicators of housing supply and demand, 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 regarding the data used to assess house price developments. This stems, in particular, from issues related to coverage, quality control and representativeness.

### Residential property prices (nominal) in the euro area

(annual percentage changes)												
	Weight (%)	1999-2005, average annual change	2006	2007	2008	2008		2009	2009			
						H1	H2	H1	Q1	Q2	Q3	Q4
Belgium <sup>1)</sup>	3.7	7.5	11.8	9.3	4.8	5.8	3.9	-0.6	1.0	-2.2	-1.5	..
Germany <sup>2)</sup>	27.0	-0.9	0.2	0.7	0.2	..	..	..	..	..	..	..
Ireland <sup>2)</sup>	2.1	12.2	13.4	0.9	-9.4	-9.0	-9.8	-10.4	-9.8	-11.1	-12.9	..
Greece <sup>2)</sup>	2.5	9.5	12.2	4.6	2.6	2.6	2.7	..	..	..	..	..
Spain <sup>2)</sup>	11.7	13.8	10.4	5.8	0.7	2.9	-1.4	-7.6	-6.8	-8.3	-8.0	-6.3
France <sup>1)</sup>	21.1	11.2	12.1	6.6	1.2	3.7	-1.1	-8.1	-6.9	-9.3	-8.0	..
Italy <sup>2)</sup>	17.1	6.9	5.8	5.0	4.2	4.5	4.0	3.1	..	..	..	..
Cyprus <sup>2),3)</sup>	0.2	-	10.0	15.0	..	..	..	..	..	..	..	..
Luxembourg <sup>2)</sup>	0.4	11.1	10.8	10.1	..	..	..	..	..	..	..	..
Malta <sup>2)</sup>	0.1	10.8	3.5	1.1	-2.7	-1.7	-3.8	-7.9	-9.9	-6.0	-2.5	..
Netherlands <sup>1)</sup>	6.3	7.8	4.6	4.2	2.9	3.7	2.2	-1.5	-0.3	-2.8	-5.1	..
Austria <sup>2),4)</sup>	3.0	0.7	4.0	4.1	1.3	1.0	1.6	4.6	4.3	4.9	..	..
Portugal <sup>2)</sup>	1.8	2.9	2.1	1.3	3.9	3.1	4.7	1.5	2.7	0.3	-0.8	..
Slovenia <sup>1)</sup>	0.4	-	17.6	22.6	3.1	5.8	0.5	-8.4	-7.0	-9.8	-10.9	..
Slovakia <sup>1)</sup>	0.6	-	16.8	23.9	..	32.8	..	..	..	..	..	..
Finland <sup>1)</sup>	2.0	..	6.4	5.5	0.6	3.0	-1.8	-4.5	-5.6	-3.5	0.2	..
Euro area	100.0	6.4	6.5	4.4	1.8	2.8	0.8	-2.4	..	..	..	..

Sources: National data and ECB calculations.

Note: Weights are based on euro area nominal GDP in 2007.

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

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

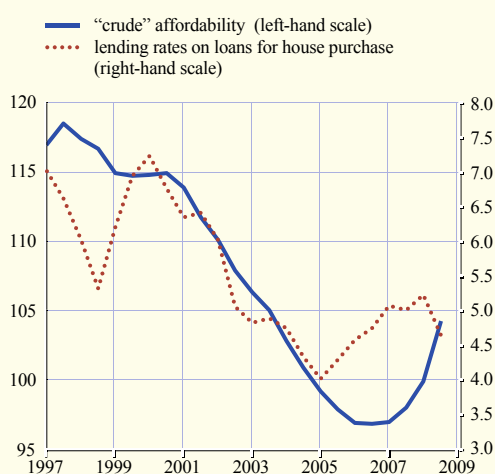
3) The property price index is estimated by the Central Bank of Cyprus using data on valuations of property received from several MFIs and other indicators relevant to the housing market.

4) Data to 2000 are for Vienna only.

The moderation in euro area house prices has been associated with subdued developments in both housing supply and demand in the euro area. One demand determinant is affordability, which can be assessed with the widely used “crude” or narrow housing affordability measure – defined as the ratio of household nominal disposable income to the nominal house price index. This measure, which had fallen since end-2001 as income growth did not keep pace with house price increases, began to increase at the end of 2007, mainly as a result of lower house price inflation, and continued its upward movement in the first half of 2009, indicating an improvement in affordability (see Chart B). Borrowing conditions also improved in the first half of 2009, with a decrease in nominal interest rates on loans to households for house purchase. According to the latest bank lending survey for the euro area, in the last quarter of 2009 the net percentage of banks reporting a tightening of credit standards for loans to households for house purchase continued to decrease (falling to 3%, as compared with 28% in the first quarter of 2009). In line with these developments, the annual growth rate of loans to households for

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 household 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.

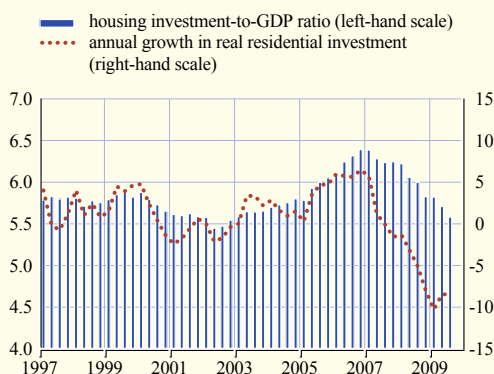
house purchase in the euro area has recently levelled off, but at a level considerably lower (1.5% in December 2009) than the peak of over 12% reached in mid-2006. All in all, income and credit developments suggest that euro area housing demand will remain subdued in the coming months, despite some tentative signs of stabilisation.

In an environment of subdued housing demand and lower prices, there have also been signs of a rapid decline in housing supply in the euro area. Real housing investment has been shrinking since mid-2007. Real residential investment in the euro area has fallen steadily in year-on-year terms, declining from a peak growth rate of 6.5% in the last quarter of 2006 to a contraction of 8.3% in the third quarter of 2009 (see Chart C). This has also contributed to a decline in the share of resources in the economy devoted to housing construction, as illustrated by the fact that the ratio of nominal housing investment to nominal GDP has fallen. Building permit issuance, which is often used as a leading indicator for housing investment, suggests that this weakness will persist in the coming months, as the number of permits issued has continued to fall sharply, contracting at an annual rate of close to 25% in the third quarter of 2009.

Against the background of the recent contraction in activity and employment, housing supply and demand dynamics suggest that euro area house prices are likely to continue to moderate for some time to come. This is also consistent with indications from an asset-pricing approach applied to housing. Under this approach, the ratio of the euro area house price index relative to the euro area rent component of the HICP index remains somewhat elevated (see Chart D). This also supports the expectation of a further correction in house prices.

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

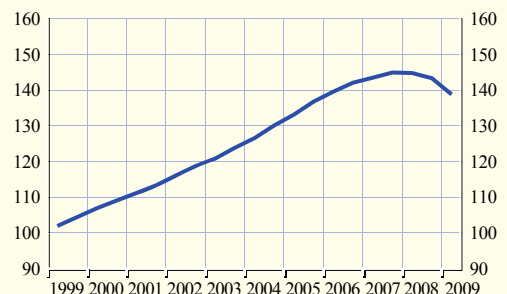
(percentages of GDP; annual percentage changes)



Sources: Eurostat and ECB calculations.

**Chart D House price/rental yield ratio in the euro area**

(index: 1996 = 100; percentages; biannual data)



Sources: Eurostat and ECB calculations.