

Box 9

RECENT HOUSING MARKET DEVELOPMENTS IN THE EURO AREA

Euro area residential property prices have exhibited a strong cyclical dynamic over the last decade. Strong price rises prior to 2005 have been followed by a steady slowdown in growth in recent years, culminating in a contraction in 2009. This box reviews the latest price developments, examines selected housing supply and demand factors, and, on this basis, assesses the outlook for house prices.¹

According to the latest data,² in the second half of 2009 euro area house prices fell by 3.1% on an annual basis, following a decline of the same magnitude in the first half of the year (see Chart A, left panel). This year-on-year decline in euro area house prices is the steepest seen since 1982 (see Chart A, right panel) and appears to form part of a correction in house prices following the strong increases recorded between 1999 and 2005 (when the average annual increase was 6.4%; see the table).

The reduction in euro area house prices has been geographically broad-based, with residential property prices falling in almost all euro area countries in 2009. Decreases in house prices in excess of 5% were observed in 2009 for Ireland, Spain, France, Cyprus, Slovenia and Slovakia. More generally, the countries experiencing the most pronounced corrections have tended to be those that exhibited the strongest house price increases in the period prior to 2005. An asset-pricing approach to assessing housing developments suggests that house prices are still relatively high compared with rents for the euro area aggregate as well as four of the five largest euro area countries, with the ratio of the euro area house price index to the rent component of the HICP index remaining elevated compared with its level a decade ago (see Chart B).³ That said, higher frequency house price data indicate that the pace of the decline appears to have abated somewhat at the end of 2009 and early in 2010, which may be an early signal suggesting that the situation could be stabilising in some countries.

1 For a detailed analysis of approaches used to assess house prices applied in the box, 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 surrounding the data used to assess house price developments. This stems, in particular, from issues related to coverage, quality control and representativeness.

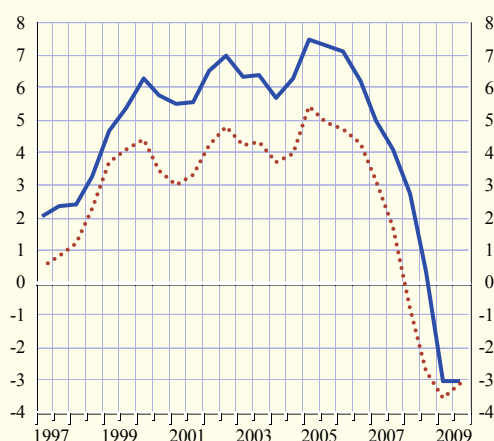
3 This ratio of house prices to rents for the euro area has also remained elevated compared with its longer-term average, which may provide a better benchmark of equilibrium valuation. See, for instance, OECD Economic Outlook, No 86, November 2009.

Chart A Euro area residential property prices

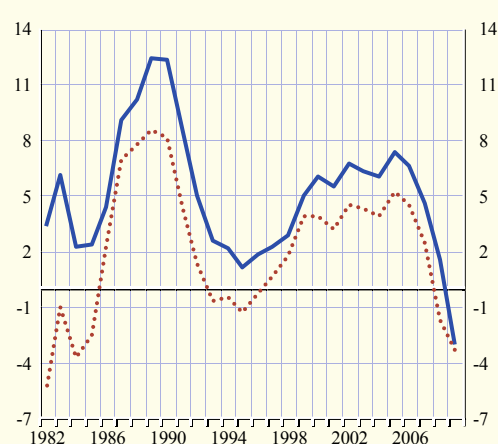
(annual percentage changes)

— nominal
 real¹⁾

a) Biannual data



b) Annual data



Source: ECB calculations based on national data.

Notes: Estimates, including ECB estimates for selected countries, cover more than 90% of the euro area. 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) "Real" residential property price growth is obtained by subtracting annual HICP inflation from the nominal growth of residential property prices.

Residential property prices (nominal) in the euro area

(annual percentage changes)

	Weight	1999-2005 Average annual change	2006	2007	2008	2009	2009		2009				2010
							First half	Second half	Q1	Q2	Q3	Q4	Q1
	%												
Belgium ¹⁾	3.7	7.5	11.8	9.3	4.8	-0.3	-0.6	-0.1	0.9	-2.1	-1.4	1.2	..
Germany ²⁾	27.0	-0.9	0.2	0.7	1.0	-0.2	..	..	..	..	..	..	..
Ireland ²⁾	2.1	12.0	13.6	-0.5	-9.1	-13.7	-11.3	-16.1	-11.0	-11.6	-13.8	-18.5	-18.9
Greece ²⁾	2.5	9.5	13.0	6.2	1.5	-4.7	-4.1	-5.2	-4.2	-4.1	-5.2	-5.3	..
Spain ²⁾	11.7	13.8	10.4	5.8	0.7	-7.4	-7.6	-7.1	-6.8	-8.3	-8.0	-6.3	-4.7
France ¹⁾	21.1	11.2	12.1	6.6	1.2	-7.1	-8.1	-6.2	-6.9	-9.3	-7.9	-4.4	..
Italy ²⁾	17.1	6.9	5.8	5.0	2.6	-0.5	-0.3	-0.7	..	..	..	..	..
Cyprus ^{2),3)}	0.2	-	10.0	15.0	13.0	-6.0	..	..	..	..	..	..	..
Luxembourg ²⁾	0.4	11.1	10.8	10.1	..	..	..	..	..	..	..	..	..
Malta ²⁾	0.1	10.8	3.5	1.1	-2.7	-5.0	-7.9	-2.0	-9.9	-6.0	-2.5	-1.4	..
Netherlands ¹⁾	6.3	7.8	4.6	4.2	2.9	-3.3	-1.5	-5.1	-0.3	-2.8	-5.1	-5.0	-4.3
Austria ^{2),4)}	3.0	0.7	4.0	4.1	1.3	..	4.6	..	4.3	4.9	3.4	..	..
Portugal ²⁾	1.8	2.9	2.1	1.3	3.9	0.4	1.5	-0.7	2.7	0.3	-0.8	-0.6	..
Slovenia	0.4	-	17.6	22.6	3.1	-8.2	-8.4	-8.0	-7.1	-9.8	-10.9	-5.1	..
Slovakia ¹⁾	0.6	-	16.8	23.9	22.1	-11.1	-8.9	-13.3	-4.3	-13.4	-14.3	-12.3	..
Finland ¹⁾	2.0	..	-	5.5	0.6	-0.3	-4.5	4.1	-5.5	-3.6	0.4	7.9	11.3
Euro area	100.0	6.4	6.6	4.5	1.5	-3.1	-3.1	-3.1	..	..	..	..	..

Sources: National sources and ECB calculations.

Note: Weights are based on nominal GDP in 2007.

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

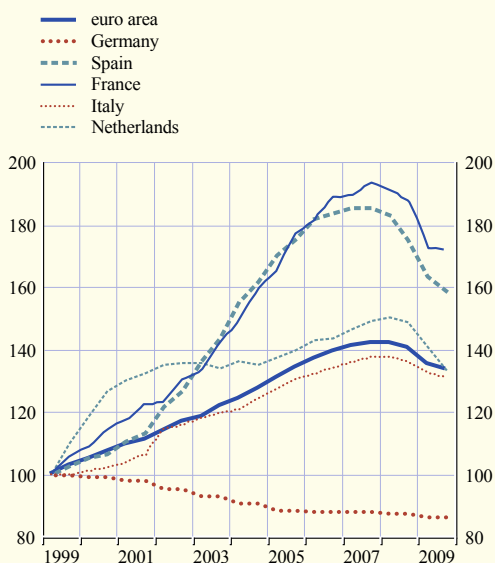
2) All dwellings (new and existing houses and flats); whole country.

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 up to 2000 cover Vienna only.

Chart B House price/rental yield ratio in the euro area and selected euro area countries

(index: 1999 = 100; percentages; biannual data)



Sources: Eurostat and ECB calculations.

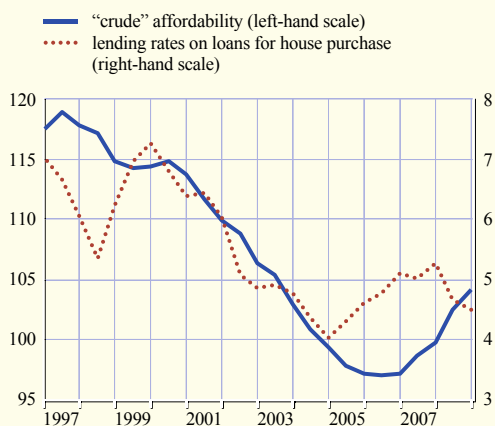
these loans has steadily increased, rising from 0.6% in September 2009 to 2.6% in March 2010. While this factor could indicate that the housing market is stabilising, the growth rate of these loans is much lower than the level seen at the peak of the last house price cycle in mid-2006,

The contraction in house prices has been associated with muted housing supply and demand developments. One demand determinant is affordability, which can be approximated using a “crude” or narrow housing affordability measure. This measure, defined as the ratio of nominal household disposable income to the nominal house price index, recorded a further increase at the end of 2009 (see Chart C), continuing the trend improvement in affordability seen since the end of 2007. It should be taken into account, however, that this improvement follows a lengthy deterioration that began in 2001 when income growth failed to keep pace with strong house price increases. In terms of credit developments related to housing, this improvement in crude affordability has recently been supported by a concurrent improvement in borrowing conditions, given the decrease in nominal interest rates on loans to households for house purchase in 2009.

At the same time, the annual growth rate of these loans has steadily increased, rising from 0.6% in September 2009 to 2.6% in March 2010. While this factor could indicate that the housing market is stabilising, the growth rate of these loans is much lower than the level seen at the peak of the last house price cycle in mid-2006,

Chart C “Crude” housing affordability and borrowing conditions

(index: 2005 = 100; percentages per annum)

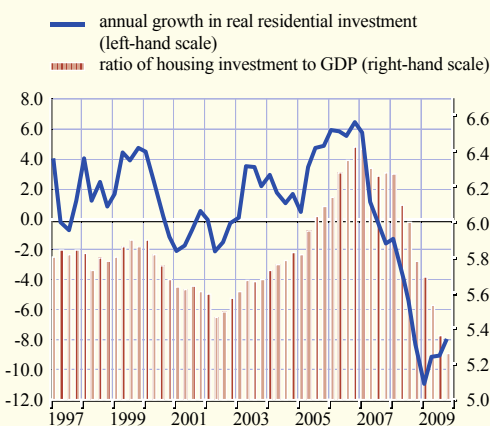


Sources: Eurostat and ECB calculations.

Notes: “Crude” housing affordability is defined as the ratio of nominal household 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 D Residential investment in the euro area

(percentages; annual percentage changes)



Sources: Eurostat and ECB calculations.

when loans grew at an annual rate of over 12%. Taken together, these income and credit developments suggest that euro area housing demand is stabilising.

On the supply side of the housing market, the contraction in real housing investment has continued to abate, while nonetheless remaining severe, in the context of the moderation in house price growth. Annual real residential investment in the euro area contracted by 8.0% in the fourth quarter of 2009. While less severe than the 11.0% reduction witnessed in the first quarter of 2009, this rate was still far from the average historical growth rate of 0.5% seen since 1996 and the peak growth rate of 6.4% recorded in the last quarter of 2006 (see Chart D). This decline in residential investment has contributed to a steady reduction in the share of resources devoted to housing construction in the economy, as illustrated by the fact that the ratio of nominal housing investment to nominal GDP fell to around 5¼% of economic resources at the end of 2009 from its elevated level of 6½% in 2006. Developments in building permits, which are often used as a leading indicator for housing investment, suggest that the gradual easing in the pace of the contraction will continue in the coming months. The number of permits issued fell by 20.8% in the last quarter of 2009, compared with a contraction of 27.6% in the first quarter of 2009.

All in all, housing supply and demand dynamics, as well as a cross-check with other valuation approaches, suggest that the contraction in euro area house prices is likely to continue in the near term, albeit possibly at a moderating pace.