

Box 4

RECENT HOUSING MARKET DEVELOPMENTS IN THE EURO AREA

Euro area residential property prices have exhibited pronounced cyclical dynamics over the past decade. Strong year-on-year price increases until 2006 have been followed by a steady slowdown in growth in recent years, culminating in a contraction in 2009 and slight increases in the first two quarters of 2010. With the release of the 2010 figures, the Eurosystem began compiling its residential property price indicator for the euro area at a quarterly frequency.^{1, 2} This box uses

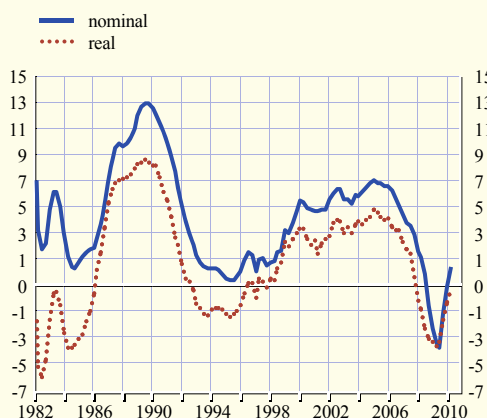
- 1 Quarterly data for Germany have been estimated by referring to adjusted early price information for apartments collected in seven big cities. For Italy, the Banca d'Italia's semi-annual residential property price indicator has been transformed into a quarterly indicator by referring to a related quarterly indicator variable. Owing to the high statistical uncertainty of these estimates, quarterly data are not published for the two above-mentioned countries, but only used as a contribution to the euro area aggregate. The quarterly euro area indicator, together with national data for the euro area countries, is available via the Statistical Data Warehouse on the ECB's website (<http://www.ecb.europa.eu>). More generally it should also be noted that there is a high degree of uncertainty surrounding the ECB's quarterly residential property price indicator, in particular with regard to coverage, quality adjustment and representativeness.
- 2 A recent Eurostat research paper provides an experimental house price index (http://epp.eurostat.ec.europa.eu/portal/page/portal/hicp/documents/Tab/Tab/METH-HPI_Research_paper_2010-12.pdf) for the euro area, which draws on data produced by the ongoing pilot project on owner-occupied housing and is supplemented by Eurosystem data. While developments in the house price index published by Eurostat are broadly similar to those of the Eurosystem's residential property price indicator, there are some differences in the short term. Given the high compilation and publication standards achieved for the Eurosystem's residential property price indicator, the ECB will continue to compile this indicator for the time being.

this new quarterly index to review the latest price developments and to examine selected housing supply and demand factors.³

According to the latest data, euro area house prices increased in the first and second quarters of 2010 by 0.3% and 1.8% year on year respectively (see Chart A). This compares with a yearly contraction of close to 3% recorded in 2009. Following strong price increases between 1999 and 2006, euro area house prices started to ease considerably between 2007 and 2008 and fell in 2009, reaching a trough in the third quarter of 2009. Since the beginning of 2010, residential property prices have gradually been increasing. However, this pattern masks divergent developments across the euro area countries (see the table), with some countries – Ireland, Greece, Spain, the Netherlands, Slovakia and Estonia –

Chart A Euro area residential property prices

(annual percentage changes; quarterly data)



Source: ECB calculations based on national data. The latest observation is for the second quarter of 2010.
Notes: Real residential property price growth is obtained by subtracting annual HICP inflation from nominal residential property price growth. See footnote 1 regarding the compilation of the nominal index.

Residential property prices (nominal) in the euro area

(annual percentage changes)

| | Weight (percentage) | 2008 | 2009 | 2009 | | 2010 H1 | 2009 | | | | 2010 | | |
|---------------------------|------------------------|------------|-------------|-------------|-------------|------------|-------------|-------------|-------------|-------------|------------|------------|-------|
| | | | | H1 | H2 | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| Belgium ¹⁾ | 3.8 | 4.9 | -0.4 | -0.6 | -0.1 | 4.9 | 0.9 | -2.2 | -1.4 | 1.2 | 3.8 | 6.0 | 5.6 |
| Germany ²⁾ | 26.7 | 1.0 | 0.0 | - | - | - | - | - | - | - | - | - | - |
| Ireland ²⁾ | 1.8 | -9.1 | -13.7 | -11.3 | -16.1 | -17.9 | -11.0 | -11.6 | -13.8 | -18.5 | -18.9 | -17.0 | -14.8 |
| Greece ³⁾ | 2.6 | 1.7 | -3.7 | -2.9 | -4.6 | -3.3 | -3.3 | -2.5 | -5.1 | -4.0 | -1.8 | -4.7 | -4.3 |
| Spain ²⁾ | 11.7 | -1.5 | -6.7 | -7.6 | -5.7 | -1.9 | -7.6 | -7.7 | -7.0 | -4.4 | -2.9 | -1.0 | - |
| France ¹⁾ | 21.6 | 1.2 | -7.1 | -8.1 | -6.2 | 3.9 | -6.9 | -9.3 | -7.9 | -4.4 | 1.6 | 6.2 | 8.6 |
| Italy ²⁾ | 16.9 | 2.6 | -0.4 | -0.2 | -0.6 | -0.3 | - | - | - | - | - | - | - |
| Cyprus ^{2),4)} | 0.2 | 13.0 | -6.0 | - | - | - | - | - | - | - | - | - | - |
| Luxembourg ²⁾ | 0.4 | - | - | - | - | - | - | - | - | - | - | - | - |
| Malta ²⁾ | 0.1 | -2.7 | -5.0 | -7.9 | -2.0 | 2.4 | -9.9 | -6.0 | -2.5 | -1.4 | 4.5 | 0.5 | - |
| Netherlands ¹⁾ | 6.3 | 2.9 | -3.3 | -1.5 | -5.1 | -3.2 | -0.3 | -2.8 | -5.1 | -5.0 | -4.3 | -1.9 | -0.6 |
| Austria ^{2),5)} | 3.1 | 1.2 | 3.6 | 4.6 | 2.6 | 5.5 | 4.3 | 4.9 | 3.4 | 1.9 | 5.7 | 5.3 | 5.0 |
| Portugal ²⁾ | 1.8 | 3.9 | 0.4 | 1.5 | -0.7 | 1.4 | 2.7 | 0.3 | -0.8 | -0.6 | 1.3 | 1.6 | - |
| Slovenia ¹⁾ | 0.4 | 3.1 | -8.2 | -8.4 | -8.0 | 2.6 | -7.1 | -9.8 | -10.9 | -5.0 | 1.1 | 4.1 | - |
| Slovakia ¹⁾ | 0.7 | 22.1 | -11.1 | -8.9 | -13.3 | -6.0 | -4.3 | -13.4 | -14.3 | -12.3 | -8.3 | -3.7 | -1.3 |
| Finland ¹⁾ | 1.9 | 0.6 | -0.3 | -4.5 | 4.1 | 10.9 | -5.5 | -3.6 | 0.4 | 7.9 | 11.4 | 10.3 | 7.8 |
| Estonia ⁶⁾ | - | - | - | - | - | -4.5 | - | - | - | - | -8.2 | -0.5 | - |
| Euro area | 100.0 | 1.3 | -2.9 | -3.1 | -2.7 | 1.0 | -2.6 | -3.7 | -3.9 | -1.5 | 0.3 | 1.8 | - |

Sources: National sources and ECB calculations.

Notes: Weights are based on nominal GDP in 2009. Quarterly data for Germany and Italy are not reported owing to the high statistical uncertainty in the construction of the indices – see footnote 1.

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

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

3) All flats; whole country.

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

5) Up to 2000, data for Vienna only.

6) Existing flats; whole country.

³ For a detailed analysis of indicators of housing supply and demand, see the article entitled “Assessing house price developments in the euro area”, *Monthly Bulletin*, ECB, February 2006.

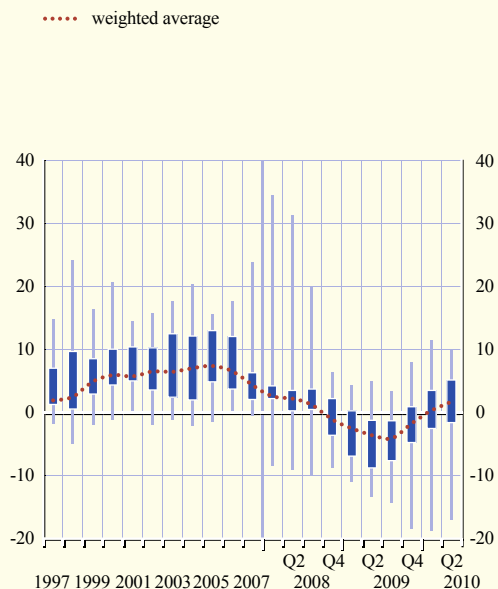
continuing to record declining house prices in the second quarter of 2010 (on a yearly basis). The largest annual house price increases in the second quarter of 2010 were seen in Belgium, France and Finland and appear to have been driven by developments in large residential areas (including the Brussels, Paris and Helsinki regions).

The above-mentioned geographical dispersion is confirmed when considering the minimum-to-maximum measure of dispersion of house price changes across the euro area countries, which has remained elevated since 2007 (see Chart B). Moreover, this suggests a somewhat more heterogeneous development of house prices during their initial moderating phase, characterised by temperate falls in some countries and steep declines or increases in others. At the same time, cross-country heterogeneity of house price developments appears to be persistent over time, as signalled by a fairly similar magnitude in the interquartile ranges (where 50% of the house price distribution is concentrated). 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 for several euro area countries, with the ratio of the euro area house price index to the rent component of the HICP index remaining somewhat elevated compared with its level a decade ago⁴ (see Chart C). That said, the euro area index abated somewhat in the course of 2009, with signs of further stabilisation in the first half of 2010.

4 This is not, however, an overvaluation measure which would require a comparison with long-term averages of the house price-to-rent ratio.

Chart B Dispersion of residential property price growth rates in the euro area

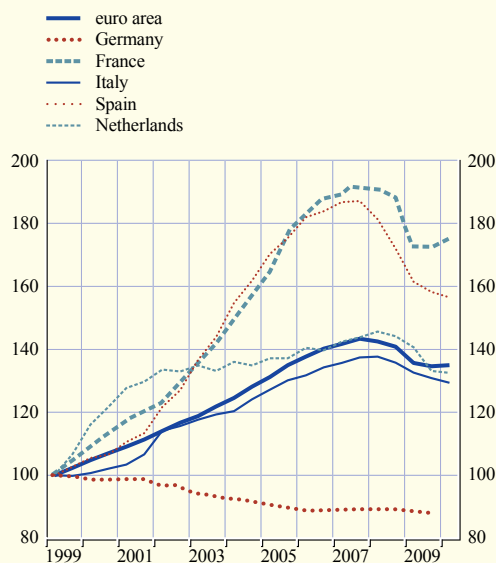
(annual percentage changes; maximum, minimum, interquartile range and weighted average; quarterly data)



Source: ECB calculations based on national data. The latest observation is for the second quarter of 2010.
Note: The interquartile range (represented by the blue bars) lies between the 25% and 75% mark of the distribution range.

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

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



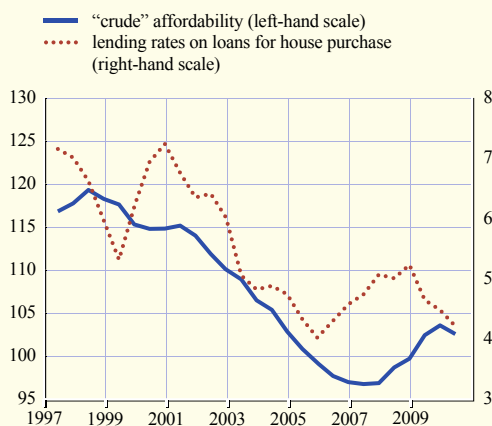
Sources: Eurostat and ECB calculations.

Recent trends in house prices have been characterised by a contracting housing supply and muted demand developments. Euro area housing demand conditions in the first half of 2010 generally continued to improve, as impediments to obtaining credit dissipated. More specifically, an often-cited basic measure of housing affordability, namely the ratio of household nominal disposable income to the nominal house price index (“crude” affordability), albeit declining slightly in the first half of 2010 (owing to positive house price inflation), has increased overall since the end of 2007 (see Chart D). More generally, housing affordability still remains, according to this crude measure, about 10% lower than it was in 1999. However, continued improvements in borrowing conditions, given the decrease in nominal interest rates on loans to households for house purchase, contributed to improved demand conditions in the first half of 2010. In addition, the latest ECB bank lending survey suggests that, for the first time in more than two years, there was no further net tightening of credit standards on loans to households for house purchase in the third quarter of 2010 (0% compared with 10% in the first and second quarters of 2010). Against this background, the annual growth rate of loans to households for house purchase in the euro area continued to steadily increase, from a trough of -0.6% in September 2009, up to 3.6% in October 2010. While this factor is indicative of improving housing market prospects, the annual growth rate of these loans is much more subdued than that seen in the peak of the latest house price cycle in mid-2006, when it stood over 12%.

On the supply side, the contraction in real housing investment continued to abate, reaching -4% year on year in the second quarter of 2010, compared with -12% in the first quarter of 2009 (see Chart E). Looking forward, available indicators for construction production in the euro area for the third quarter of 2010 point to weak prospects for residential investment and to a high degree of heterogeneity across euro area countries. However, building permits, which are often used as a leading indicator for housing investment a few months ahead, tentatively suggest improved prospects for residential investment.

Chart D “Crude” housing affordability and borrowing conditions

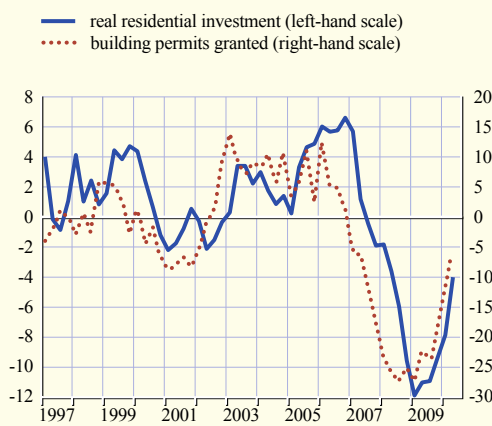
(index: 2005 = 100; percentages)



Sources: Eurostat and ECB calculations.
 Notes: Euro area lending rates on loans for house purchase refer to a maturity of over five and up to ten years. “Crude” housing affordability is defined as the ratio of nominal household disposable income to the nominal house price index.

Chart E Residential investment and building permits granted in the euro area

(annual percentage changes)



Sources: Eurostat and ECB calculations.

All in all, housing supply and demand developments suggest that the contraction in nominal euro area house prices witnessed in 2009 came to an end in the first two quarters of 2010. Still, housing activity and house price increases are expected to continue to exhibit more moderate dynamics compared with the pre-2009 developments in view of the continued need for adjustment in some euro area countries in order to correct for past excesses.