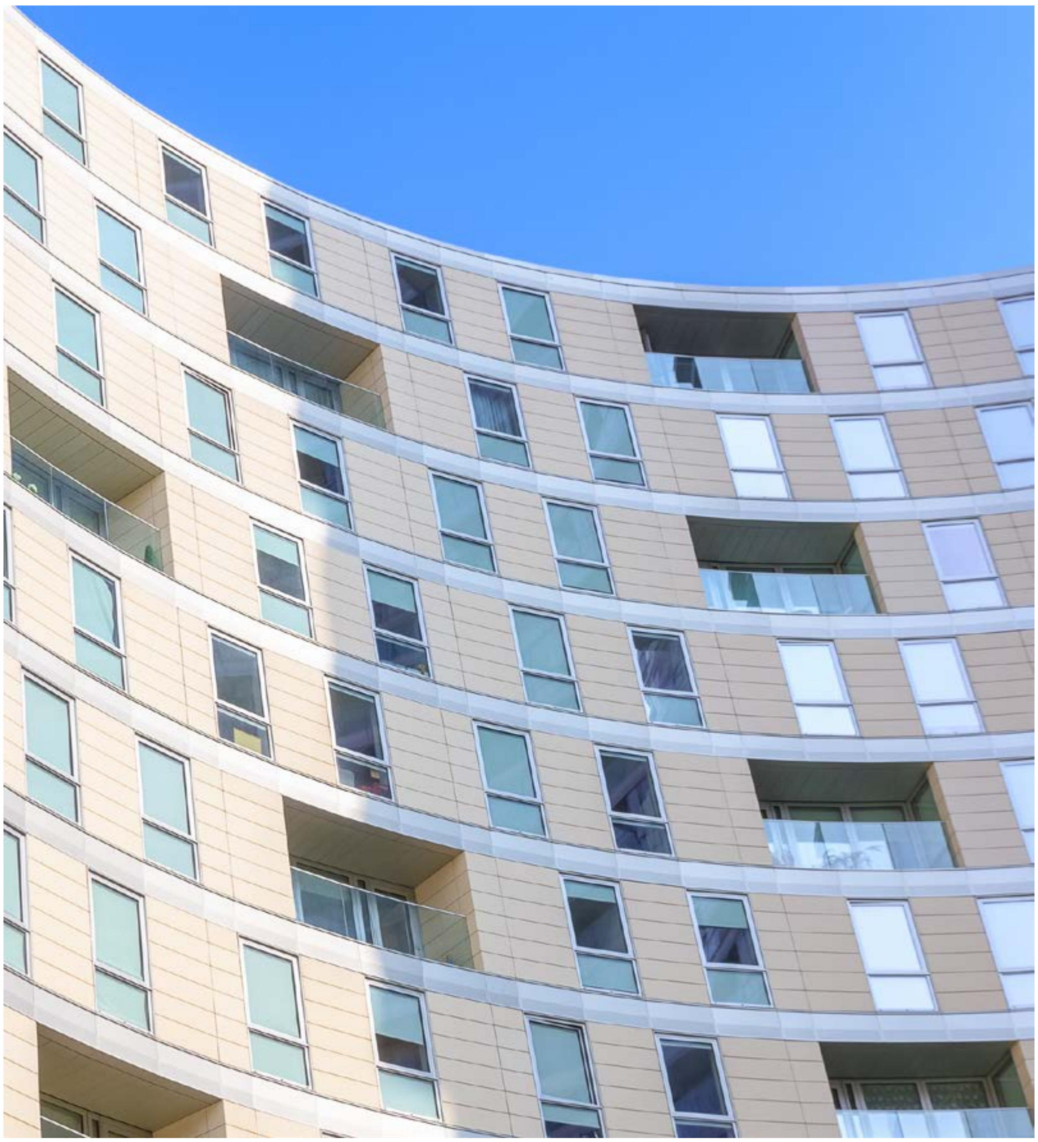
S&P Global
Ratings

Europe's Housing Markets: Soft Landing In Sight

February 7, 2018



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Europe's Housing Markets: Soft Landing In Sight

Key Takeaways

- **Monetary conditions** will stay generally favorable in the eurozone, the U.K., and Switzerland, but interest rates reached a low late last year and should start creeping up very slowly in 2018 and 2019.
- **Belgium:** Deterioration in housing affordability and further macroprudential measures to limit households' leverage will underpin a deceleration in housing price inflation.
- **France:** After an exceptionally strong year in 2017 for transaction volumes, the market is headed for a soft landing as affordability continues to deteriorate.
- **Germany:** The inflexion in housing demand points to a moderation in house price growth, in spite of a vibrant economic outlook.
- **Ireland:** The ongoing recovery, labor market strength, and housing shortages will keep house price inflation elevated.
- **Italy:** The gap between supply and demand should close gradually, resulting in a further reduction in selling time and price discounts and, ultimately, lift house prices.
- **The Netherlands:** Supply shortages and a rapid pace of economic growth will continue to fuel a strong rise in housing.
- **Portugal:** Robust economic growth and a rapidly improving labor market, foreign demand, and lack of supply will continue to underpin strong home price increases.
- **Spain:** Strong economic conditions will keep transaction volumes high, helping to reduce the stock of unsold homes.
- **Switzerland:** The stronger economy and low interest rates are supporting market activity, but regulatory measures, low affordability, and slowing net migration are keeping a lid on house prices.
- **U.K.:** Prices will suffer from Brexit headwinds, via London's elevated exposure to Brexit risk, compounded by reduced buy-to-let activity resulting from the stamp duty and less favorable tax treatment

Table 1

European Housing Market Forecasts

Nominal house prices, % change y/y	2015	2016	2017e	2018f	2019f	2020f
Belgium	1.5	2.5	4.0	3.4	2.0	2.0
France	-0.5	1.6	4.0	2.0	2.0	2.0
Germany	5.8	6.9	3.8	3.0	2.7	2.5
Ireland	6.9	8.6	11.5	8.5	6.0	6.0
Italy	-1.8	-0.3	-1.0	0.6	1.5	2.0
Netherlands	4.8	6.6	7.3	7.2	5.3	3.6
Portugal	5.1	7.7	11.0	8.5	7.0	6.0
Spain	4.4	4.5	4.0	3.5	3.0	3.0
Switzerland	2.3	1.5	2.0	1.8	1.9	2.3
United Kingdom	6.5	5.4	4.5	0.5	1.5	3.5

Data as of 31 Jan. 2018. e--Estimate. f--Forecast. Sources: S&P Global Ratings, OECD, Hypoport, Wüest Partner.

Monetary Policy Outlook

European Central Bank: Contemplating an end to its asset purchase program

The ECB finally has some solid arguments for being upbeat about the effects of its asset purchase program (APP) on the eurozone economy. Real GDP growth has accelerated through 2017 and looks to remain strong in 2018. What's more, this recovery appears geographically broad based and underpinned by all components of demand, with stronger exports, buoyant consumption, and a welcome revival in investment. The minutes of the December meeting of the ECB's Governing Council, published in early January, reveal increased confidence that economic conditions have sufficiently improved to justify early discussions about the next steps toward policy normalization. The council seems now convinced that the stronger economy is also lifting inflation prospects. Importantly, the latest projections released by the bank suggest that the output gap in the European Monetary Union is closing more rapidly than previously anticipated. We expect the ECB will gradually adjust its communication, replacing its current forward guidance on the APP with a broader reference to its overall policy stance (net stock of acquired assets, reinvestments, and forward guidance on the monthly pace on purchases). As always, the ECB's messaging will be cautious and balanced so as not to confuse market expectations. We expect that the bank will reduce again its monthly purchases (€30 billion at present) in September to bring them to an end in early 2019. Only then is it likely to start contemplating a very gradual increase in its policy rate, most likely in the second half of next year. The strong euro exchange rate presents a risk to this forecast, however. Continued appreciation could delay the end of quantitative easing to the beginning of 2019.

The Bank of England: 50-50 chance of another rate hike this year

The Bank of England reversed its accommodative stance in the second half of 2017 when it hiked its policy rate to 0.50% and indicated it was prepared to hike one more time this year if headline inflation continues to exceed its official target. The City seems to expect such a hike to occur but we are more skeptical. For one, we see the economy slowing markedly in 2018 to about 1% as households become more reluctant to cut their savings rate to support their spending despite stagnating real disposable growth. In addition, headline inflation probably peaked in the final months of 2017 just above 3% and the effects of the weaker pound are now fading. But admittedly, the outlook for sterling is likely to be a key variable in the BoE's reaction function. A renewed period of pound weakness, caused for instance by tensions in the EU-U.K. Brexit negotiations, would cause alarm at the central bank and set the stage for an additional hike.

Swiss National Bank: No change in sight

Economic growth accelerated in the second half of last year and business surveys point to a solid performance in 2018. The Swiss franc lost 5.5% in real terms between December 2016 and December 2017, boosting exports and corporate profit margins. Despite its weaker currency, the Swiss National Bank revised upward its inflation forecast only modestly at its Dec. 14 meeting, to 0.7% from 0.4% for this year, and kept its 2019 forecast unchanged at 1.1%. The central bank is keen to maintain an accommodative stance so as to provide support to the economic recovery as long as inflation expectations remain well anchored. We do not anticipate any change in its policy rate in the next six quarters.

Belgium: Demand To Cool As Housing Affordability Deteriorates

Table 2

Belgian Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal House Prices, % change y/y	1.5	2.5	4.0	3.4	2.0	2.0
Real GDP, % change	1.4	1.5	1.8	1.8	1.5	1.6
CPI inflation (%)	0.6	1.8	2.2	1.9	1.8	1.9
Unemployment rate	8.5	7.8	7.3	6.7	6.3	6.2

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Banque Nationale de Belgique, OECD.

The Belgian housing market is set to benefit further from a supportive economic backdrop in 2018. From 2019, a deceleration in economic growth and a slower rate of job creation will dampen housing demand. Additional macroprudential measures to limit households' leverage, a less favorable mortgage tax regime, and the gradual tightening of monetary policy will limit the affordability of housing investments. This should rein in house prices, which we expect to rise by 3.3% in 2018--after an estimated 3.9% in 2017--slowing down to 2.3% in 2019 as the rise in interest rates contributes to dampening housing affordability.

Recent trends

Some signs of cooling demand appeared in the Belgian housing market in the second half of 2017. House prices moderated, rising by 3.5% annually in the third quarter of last year, down from 5.4% in the first quarter. After three years of strong job creation, employment growth started to decelerate in the second half of last year, lessening tailwinds to household real disposable income. As a result, housing sales transactions dipped, and were down by more than 1% on the year in June 2017. In the ECB's bank lending survey, banks also reported a decrease in demand for loans for house purchase. As such, lending growth decelerated. After reaching a peak in June, new lending for house purchases decelerated to 6.2% annual growth in the third quarter, from 13.7% in the first quarter.

That said, by historical standards, the Belgian housing market remains quite dynamic. New mortgage lending in September remained close to its all-time high at €20.2 billion, up from €19.4 billion the year before. Following a relatively stable decade, where house prices grew in line with inflation, the sharp decline in interest rates since 2014 has raised households' borrowing capacity, giving a boost to housing market activity. Mortgage interest rates remain close to their historical lows, at 2.04% in November 2017.

However, house prices in Belgium didn't experience a sharp correction following the crisis. Although they have only risen by 9% in the past three years, indicators such as price-to-income and price-to-rent ratios point to a 40% to 50% overvaluation of housing prices. This and persistent high household debt has prompted the National Bank of Belgium to extend its macroprudential measures last year to tame potential risks in the housing market, which is likely to have contributed to slowing demand.

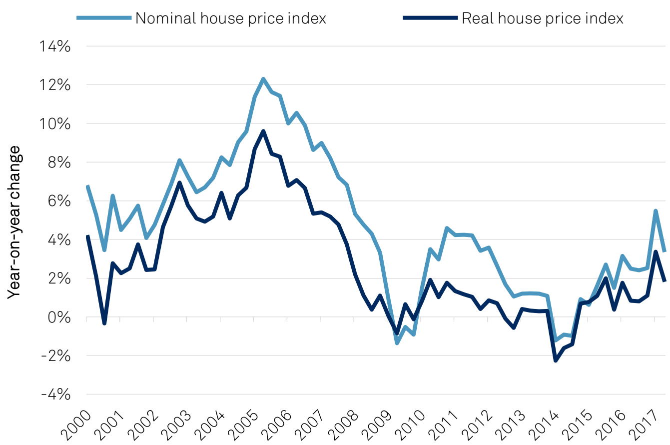
Future trends

Broad-based dynamism in the Belgian economy is expected to extend into 2018, with GDP growth to reach 1.8% and only decelerate slightly to 1.5% in 2019. Rising capacity pressures and a more flexible labor market, thanks to recent reforms, will push the unemployment rate below 7%, lower than its pre-crisis level. This will continue to boost household confidence and consumption. Buoyant regional and global trade will continue to lift exports this year and next, benefiting the manufacturing sector. In turn, the acceleration in aggregate demand will give support to investment spending, ensuring that the economic expansion remains broad based.

In this context, the main adverse development for the Belgian housing market is the normalization of monetary policy, with interest rates to rise in 2019 along with tighter borrowing conditions triggered by the central bank's macroprudential policies. Household debt and debt servicing ratios remain high, while house prices are, relatively speaking, more overvalued than the eurozone average. This makes Belgian consumers more sensitive to a rise in borrowing costs. Demand and thus house price growth are likely to moderate from 2019.

Chart 1.1

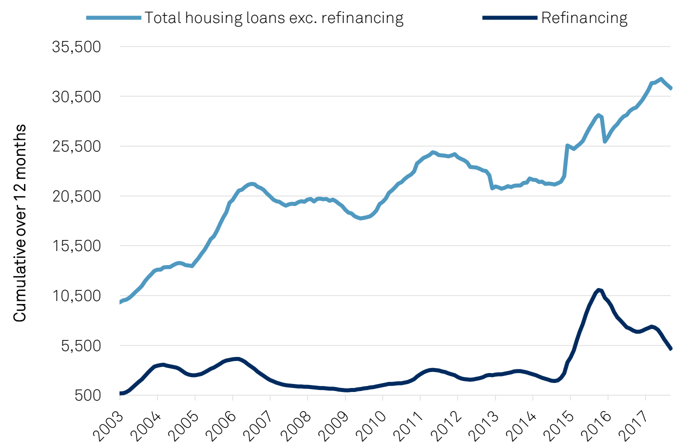
House Price Indices



Source: OECD.

Chart 1.2

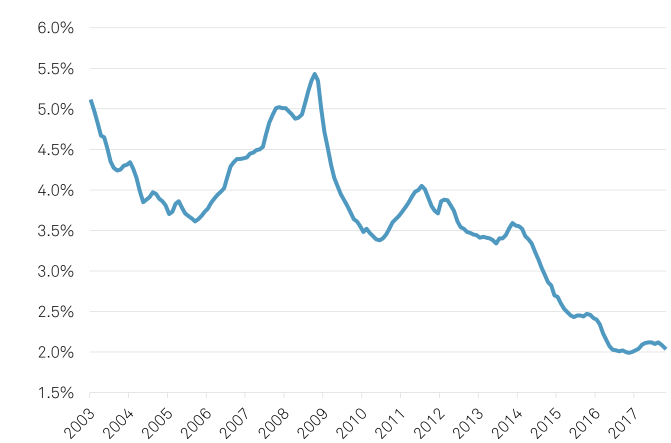
New Housing Loans



Source: Statistics Belgium.

Chart 1.3

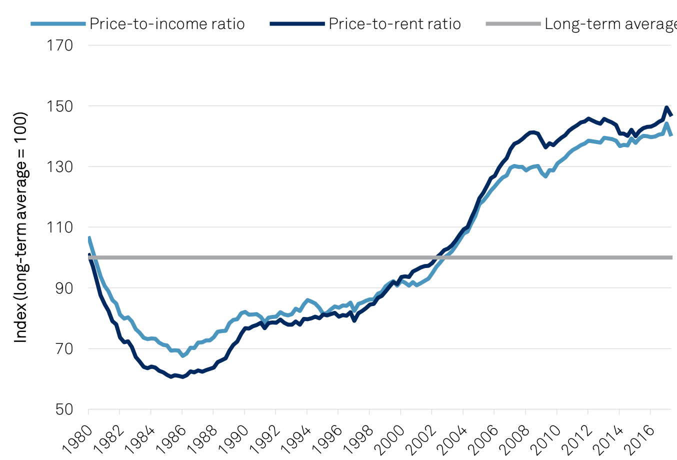
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 1.4

Price Ratios



Sources: OECD, National Bank of Belgium.

France: Soft Landing After An Outstanding Year

Table 3

French Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	-0.5	1.6	4.0	2.0	2.0	2.0
Real GDP, % change	1.0	1.1	1.8	1.8	1.7	1.6
CPI inflation (%)	0.1	0.3	1.2	1.4	1.2	1.6
Unemployment rate	10.4	10.0	9.6	9.2	8.9	8.6

e--Estimate. f--Forecast. Sources: S&P, Eurostat, OECD, INSEE.

Recent trends

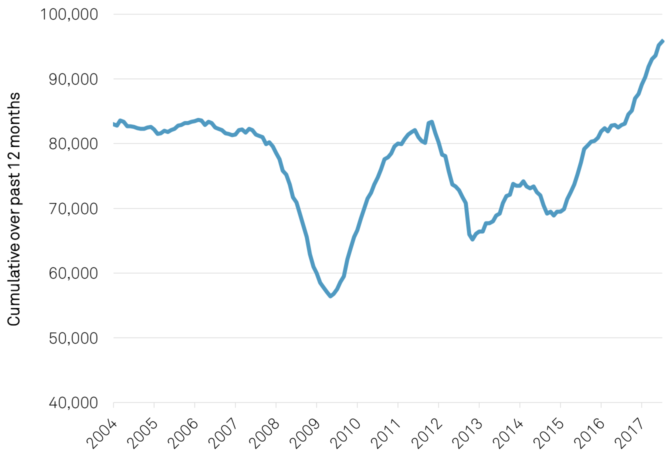
The year 2017 was a record for the French residential real estate market. Transactions reached a record high of 958,000 sales in the 12 months to October, and 15.6% above the previous year's level. The previous record in 2011 (850,000 transactions) has been broken. By contrast, the proportion of buy-to-let investors continued to decline to 21% of the transactions from 30% in 2012. This reflects in part the growing importance of short-term rents: Paris for instance is now the largest market for Airbnb. For 2017 as a whole, the French solicitors association predicts that a million sales will be reached. This level of activity reflects essentially three factors: Persistently low interest rates, a recovering economy, and a bounce in potential buyers' confidence after the election of Mr. Emmanuel Macron as president in June. First-time buyers were back en masse: 417,000 acquired a previously owned dwelling, fueling the market. Price trends have reflected this feverish market activity. Prices increased 3.9% in the 12 months to September, with the greater Paris area outperforming at 5.8%. Average rates on housing loans reached 1.57%, barely above the bottom reached in November 2015 (1.31%). To offset higher prices, the average loan duration continued to rise to 219 months, six months more than a year earlier and 50 months more than in 2003. The French central bank expressed initial concerns about the booming market's effect on household debt. At the end of June, household total debt was €1.300 trillion or 58% of GDP (2 percentage points more than in 2016), of which €1.000 trillion were housing loans. Total debt increased by a yearly average of 3.9% since 2008, exceeding disposable income growth.

Future trends

The year 2017 was in many ways an exception, and the housing market is now likely to regulate itself back closer to long-term averages. Last year was special in the sense that the relief following the presidential elections, strong economic growth, and very favorable credit conditions provided a one-time boost to the market that is very unlikely to happen again. The rise in house prices was the strongest since 2012 and there are early signs that the trend is now leveling off. Meanwhile, the growth in housing loans also seems to have slowed in the final months of last year. First-time buyers are reporting increased difficulty in entering the market given the deteriorated affordability. We anticipate the market will experience a soft landing in the coming year and a half. Prices should continue to increase, but much less than last year, and it should be primarily concentrated in the largest cities, such as Paris. Similarly the trend in transactions should level off as deteriorated market affordability hits demand. We are not predicting a market crash, far from it, but a return to less exceptional conditions is now in train.

Chart 2.1

Total Home Sales



Sources: Ministère de l'Ecologie du Développement et de l'Aménagement du Territoire.

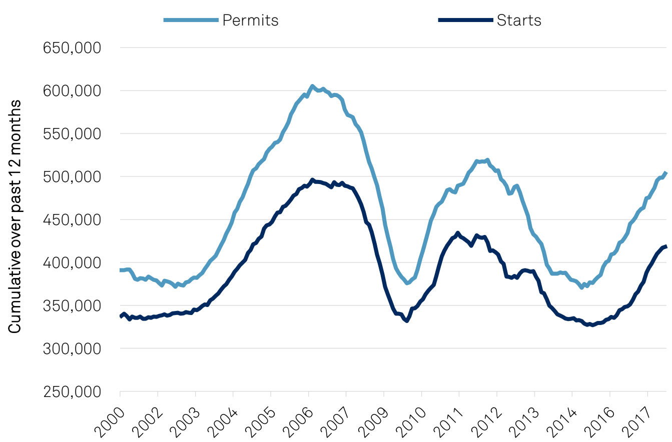
Chart 2.2

Housing Loans

Source: Banque de France.

Chart 2.3

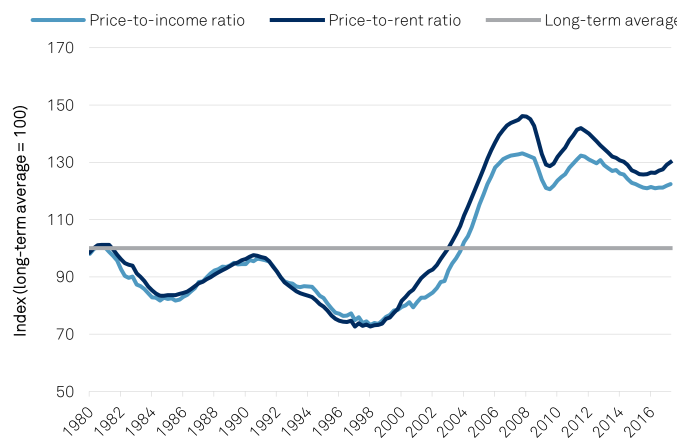
Residential Buildings Construction Permits And Starts



Sources: Ministère de l'Écologie, du Développement Durable et de l'Énergie.

Chart 2.4

Price Ratios



Sources: OECD, INSEE (Institut National de la Statistique et des Etudes Economiques).

Germany: Housing Prices Are At A Turning Point

Table 4

German Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	5.8	6.9	3.8	3.0	2.7	2.5
Real GDP, % change	1.5	1.9	2.5	1.9	1.7	1.5
CPI inflation (%)	0.1	0.4	1.6	1.9	2.1	2.0
Unemployment rate	4.6	4.2	3.7	3.3	3.2	3.2

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Hypoport, Federal Statistics Office.

We expect house prices in Germany to rise by 3% this year and 2.7% in 2019, slowing down from an expected 3.4% in 2017. The economic and monetary policy backdrop both remain favorable to households' financial prospects. However, the strong rise in real house prices since 2010, along with less buoyant immigration prospects, have started to slow housing demand, showing up in a moderation in lending and construction permits.

Recent trends

Last year is likely to mark a turning point for the German housing market. After an overheating phase, house prices started to cool off, rising by an annual 3.7% in June 2017, down from 6.9% in December 2016. Signs of cooling demand are apparent in the construction sector. Capacity pressures seem to have started to come down despite a stretched housing supply, which was trying to catch up with dynamic demand in recent years. The sharp rise in building permits issued since 2009 has also started to reverse since the beginning of 2017 and is showing up in a less dynamic rise in construction orders for residential buildings. New business lending growth also eased significantly last year, and the ECB Bank Lending survey shows stable housing loan demand in fourth-quarter 2017.

Part of the inflexion in the housing prices owes to slower net immigration after two years of strong inflows, but mostly to a deterioration of housing affordability. Price-to-income and price-to-rent ratios have risen strongly since the trough. In mid-2017, the price-to-income ratio was 12% higher than at its lowest point in 2009. The Bundesbank has also warned of overvaluation of residential property of around 15% to 30% in cities, as house price growth has gone beyond what macroeconomic determinants, such as household real disposable income and interest rates, would suggest. In recent years, the risks of housing price bubbles have risen especially in metropolitan areas, where both housing supply shortages and employment growth have been among the strongest. On aggregate, however, loan-to-value ratios remain relatively steady and credit standards have not eased considerably, suggesting that price overheating is not yet a cause of concern.

Although price growth has decelerated, housing prices have continued to rise faster than household real disposable incomes. Overall demand has remained strong, backed by the buoyant economic cycle and unemployment numbers reaching new lows. At the same time, supply has continued to fall short of the rising housing needs. The completion of residential units has likely risen to 300,000 in 2017, which despite being its highest since the start of the cycle, is below the 350,000 units needed according to official figures, thus putting upward pressure on prices.

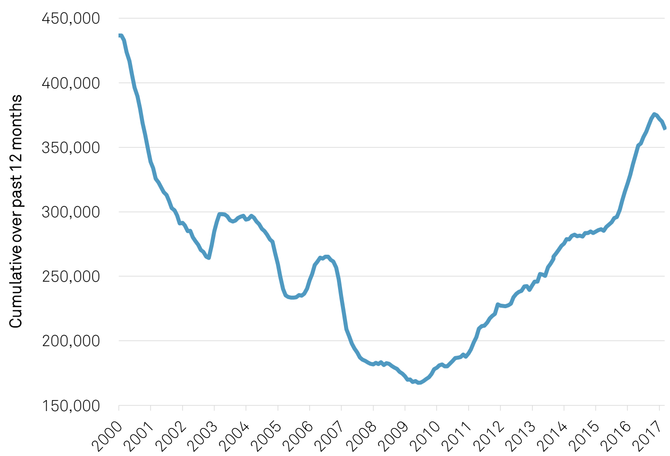
Future trends

Activity is booming in Germany, with sentiment indicators still breaking records in January 2018. We expect economic growth to have reached 2.5% in 2017--a six-year high--and only slow down marginally to 1.9% this year and 1.7% in 2019, as economic momentum carries over. With GDP rising at a fast pace, we should see further falls in the unemployment rate to 3.3% this year from an expected 3.7% last year. Wage pressures are also starting to build up, lifting household purchasing power. Against this positive economic backdrop, demand will remain strong by historical standards and is likely to give further support to house prices.

Nonetheless, the recent inflexion in construction activity and housing prices point to a moderation in price increases from this year. Data revisions also suggest that house prices have not risen as much as thought in the past. Although interest rates are still close to historically low levels, they have inched up marginally last year and the recent rise in bond yields suggest this uptick will continue and gain traction with the ECB's first rate hike at the end of 2019. This limits the scope for improvements in housing affordability, especially given the very dynamic rise in housing prices in recent years. Supply constraints will remain a problem, even if the gap between supply and demand is widening at a slower pace.

Chart 3.1

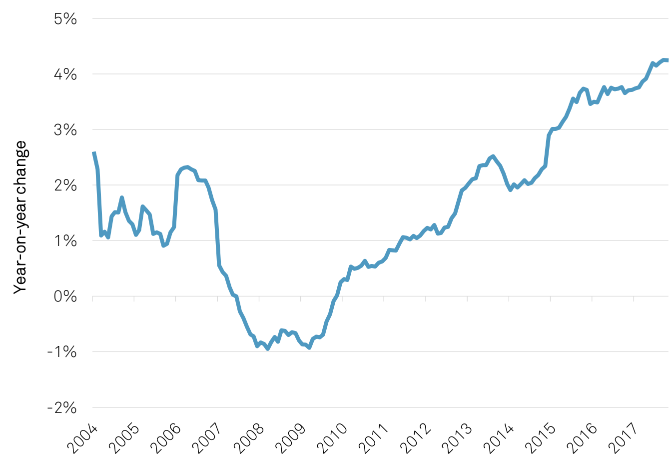
Residential Construction Permits



Source: OECD.

Chart 3.2

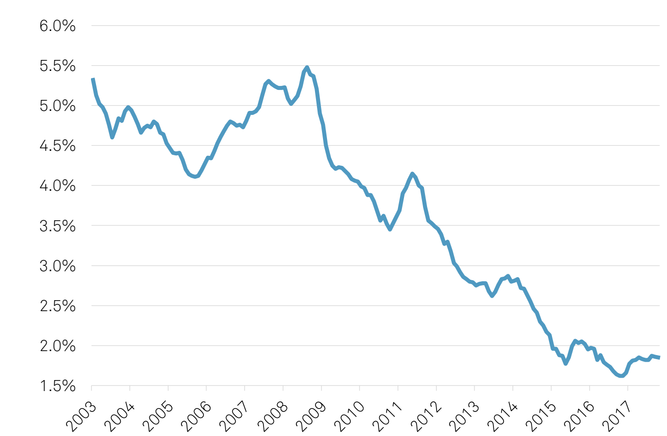
Housing Loans



Source: ECB.

Chart 3.3

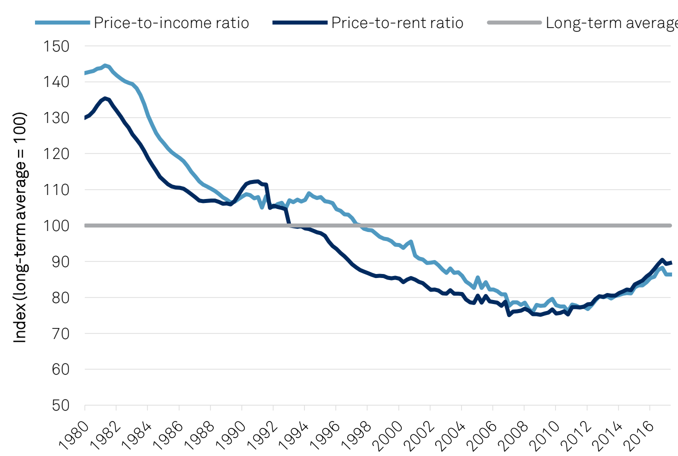
Average Interest Rates On New Housing Loans



Source: ECB.

Chart 3.4

Price Ratios



Sources: OECD, Deutsche Bundesbank.

Ireland: Supply Shortages And A Strong Labor Market Sustain House Price Growth

Table 5

Irish Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	6.9	8.6	11.5	8.5	6.0	6.0
Real GDP, % change	25.6	5.1	3.4	2.6	2.0	2.0
CPI inflation (%)	0.0	-0.2	0.5	1.2	1.5	1.8
Unemployment rate	9.4	7.9	6.5	5.3	4.7	4.5

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Central Statistics Office.

Recent trends

Irish house price inflation accelerated to double-digit rates in 2017, rising to an estimated 11.6% year on year in the fourth quarter, up from 8.5% a year earlier.

Price growth was supported by two main factors: First, by very solid economic growth overall, but in particular the sustained recovery in employment and a fall in the unemployment rate to 6.2% in December, compared with 7.5% a year earlier. This is accompanied by a moderate acceleration in wage growth, which still translates into robust increases in purchasing power, as inflation is close to zero. Second, it continues to be supported by a pronounced and persistent shortage of supply that had built up following the crisis, when the homebuilding sector collapsed.

It is true that the residential construction sector is now seeing a remarkable recovery, with output in the sector, in volume terms, up 39% year on year in third-quarter 2017, according to official statistics. But the improvement comes from such low levels that it would take another four years' growth at these rates to regain pre-crisis levels. As a result, completions, albeit growing fast, are still far from satisfying pent-up demand. Demand for housing is also being fed by positive net immigration on the back of an improving economy.

Although banks are increasingly able and willing to lend, and net mortgage lending (in value terms) has returned to growth as of April 2017, here as well, activity started from very low levels and remains, in historical perspective, very muted. The fact that still more than 50% of all transactions are cash purchases, twice as much as in normal times, illustrates how far the housing market is still away from normalization.

Future trends

We expect strengthening of the labor market to continue in the medium term. This should continue to support demand for housing, but also help with further deleveraging of household debt, which stood at 142% of disposable income in the second quarter of 2017 (latest data), still higher than in most EU countries, but already substantially down from its 210% peak. Although the central bank has now relaxed deposit rules for first-time buyers to 10% for the total value of the property (compared with 10% on the first €220,000, and 20% on any remainder), this is unlikely to add much to the house price momentum, not least because banks are approaching prudential regulatory loan-to-income caps in their books.

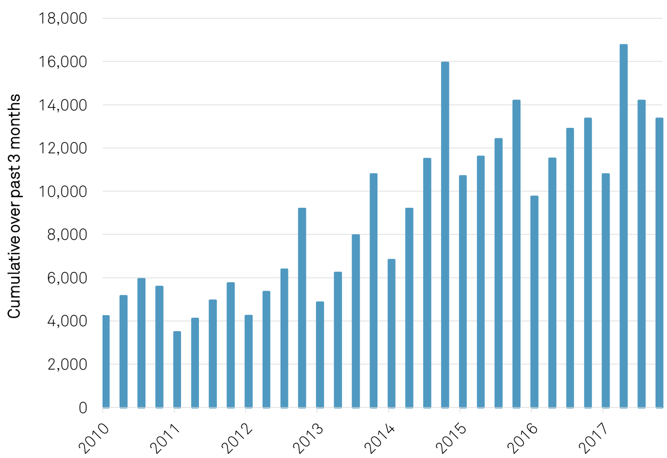
On the supply side, the construction sector has only just started to recover. The resulting capacity constraints, along with high building and development cost in conjunction with planning impediments, which the Society of Chartered Surveyors Ireland says makes development currently viable only for very limited types of housing, should continue to restrain supply coming on the market.

The government has introduced several measures to remedy the shortage in its November budget, in particular the allocation of €750 million from the Ireland Strategic Investment Fund to a new agency, Home Building Finance Ireland. The aim is to provide funding for residential developers who find it difficult to access the market at competitive terms, a legacy from the 2007-2008 crisis. The government says the amount would be sufficient to fund 6,000 homes, but developers still have to overcome capacity constraints, high construction costs, and planning impediments. For this reason, it is unclear how many of these units will actually be build and, if, how quickly. The same applies, in principle, to a planned extension of the social housing stock. All of this means that the shortage, in particular of affordable housing, is to persist over the medium term and will remain a key driver of sustained house price growth.

Given Ireland's tight links with its largest trading partner, the U.K., our forecast is subject to Brexit-related risks. Should the U.K. government fail to secure a transition phase and crash out of the EU without a trade deal, Irish trade with the U.K. would likely suffer, including residential investment in Ireland originating in the U.K. In that case, our forecast for house prices would likely be substantially lower.

Chart 4.1

Total Transactions



Source: Property Services Regulatory Authority.

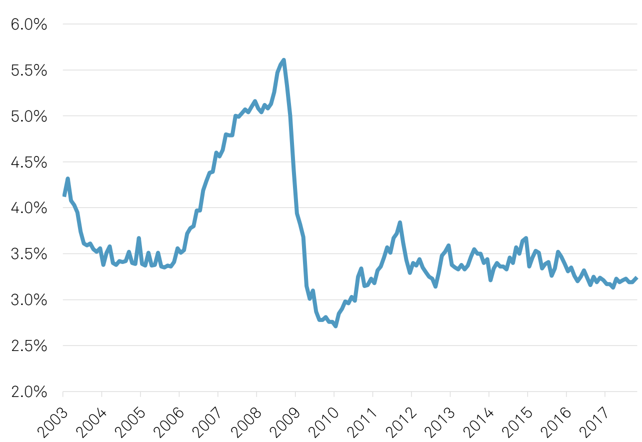
Chart 4.2

Housing Loans

Source: Central Bank of Ireland.

Chart 4.3

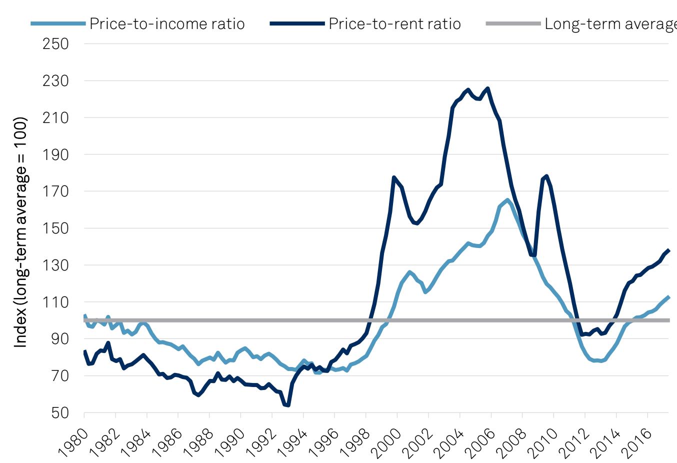
Average Interest Rates On New Housing Loans



Source: ECB.

Chart 4.4

Price Ratios



Source: OECD, Central Statistics Office Ireland.

Italy: Better Economic Conditions Are Yet To Lift House Prices

Table 6

Italian Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	-1.8	-0.3	-1.0	0.6	1.5	2.0
Real GDP, % change	0.9	1.1	1.6	1.5	1.3	1.2
CPI inflation (%)	0.1	0.0	1.5	1.3	1.7	1.9
Unemployment rate	11.9	11.7	11.3	10.8	10.4	10.0

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Nomisma.

Recent trends

Positive economic developments and record-low interest rates have helped the Italian housing market, but have not been sufficient to lift prices yet. Economic growth has picked up, to an estimated 1.6% in 2017, which is below the eurozone average, but a significant improvement compared with Italy's past performance. The unemployment rate is trending down, but remains in the double digits, at 10.8% in December. Home sales transactions continue to rise, up by 5% in the 12 months to September 2017, albeit the pace of growth has slowed compared with 2016. Among other positive signs in the housing market, we note a reduction in the price discount that owners have been accepting to sell their property, to 10.2% on average in the third quarter of 2017, from 13% a year ago, according to Banca d'Italia. The average time necessary to sell a residential property also decreased over this period, to 7.5 months from 8.9 months. The market for existing residential properties is still sliding, however, with prices falling by 1.3% year on year in third-quarter 2017. The market for new properties fared better, as prices in this segment edged up by 0.6% year on year. However, the share of new properties in all home sale transactions was only 19% in 2017, down from 34% in 2010. Investment in new residential buildings is recovering gradually, but was still almost 30% lower in third-quarter 2017 than a decade ago. Overall, we estimate that home prices in Italy fell by 1% in 2017.

Italian banks have made a progress in repairing their balance sheets, but the level of nonperforming exposures (NPEs) on their books remains high, at 17% of customer loans at the end-2017, according to our estimates. This hinders credit creation. Mortgage lending remains subdued, with net lending growth stabilizing at 2% year on year, despite record-low interest rates that fell to below 2% in October. This reflects stricter lending criteria and lower valuations of new mortgages, compared to expiring house loans issued at the time when house prices were at peak levels.

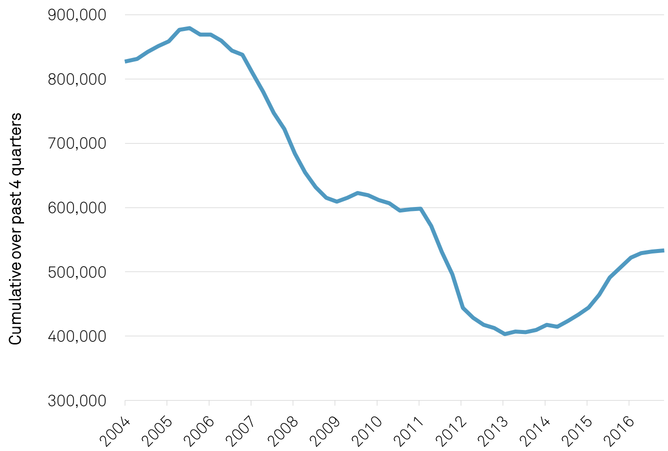
Future trends

We forecast GDP growth of 1.5% this year, amid better conditions in the banking sector, ongoing solid expansion globally and regionally, and improved sentiment. Better economic conditions and still low interest rates should support housing demand, and, given still subdued residential investment, reduce excess housing supply. The gap between supply and demand should close gradually, resulting in a further reduction in selling time and price discounts and, ultimately, lift house prices.

Upcoming elections in March could lead to a period of uncertainty, which may weigh on the economy and the housing market. In the medium term, the growth outlook depends on the effectiveness of the new government in implementing further reforms.

Chart 5.1

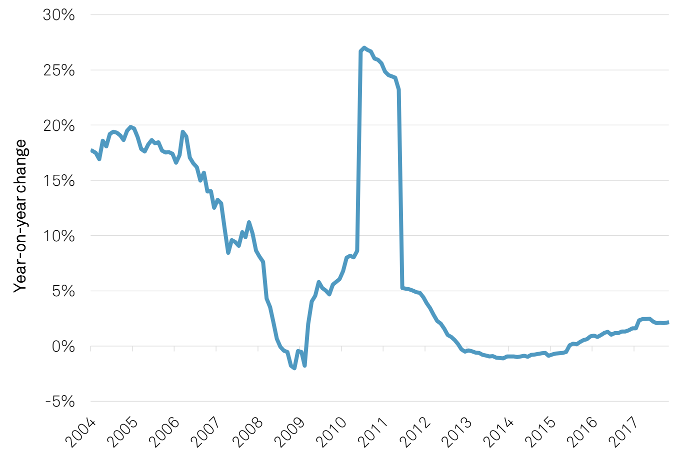
Total Transactions



Sources: Agenzia del Territorio, Nomisma.

Chart 5.2

Housing Loans



Source: ECB.

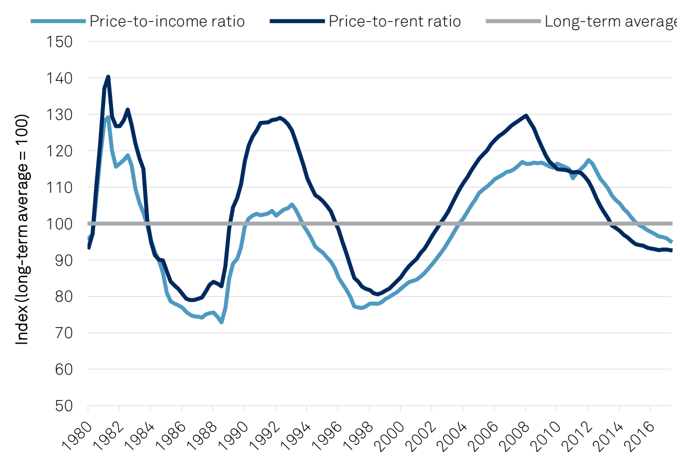
Chart 5.3

Average Interest Rates On New Housing Loans

Source: ECB.

Chart 5.4

Price Ratios



Sources: OECD, Nomisma.

The Netherlands: The Housing Market Is Running At Full Speed

Table 7

Dutch Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	4.8	6.6	7.3	7.2	5.3	3.6
Real GDP, % change	2.3	2.1	3.1	2.1	1.9	1.8
CPI inflation (%)	0.2	0.1	1.3	1.5	1.9	2.0
Unemployment rate	6.9	6.0	4.9	4.5	4.3	4.0

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Kadaster, OECD, CBS Statistics Netherlands.

The housing market in the Netherlands continues on a path of sharp recovery, with house prices rising by around 8.5% last year--their fastest pace since 2002. The outlook for 2018 remains favorable thanks to the rapid pace of economic growth, low borrowing costs, and a supply shortage. But as housing affordability deteriorates, some leading indicators are starting to point toward cooling demand. We see house prices increasing marginally less rapidly at 7.0% annually in 2018 and then decreasing to 5.0% in 2019 and 3.6% in 2020 as the rise in interest rates starts to bite housing affordability.

Recent trends

Last year marked the recovery of house prices to their 2010 levels with house prices rising by up to 8.2% annually in November. As in the rest of the eurozone, dynamism in the Dutch housing market is underpinned by a rapid economic recovery and rising consumer confidence thanks to a strong labor market. That said, the key factor behind the current rise in house prices is the supply shortage, which is especially tight in big cities. Following the crisis, construction companies and municipalities had revised down their housing needs projection, making them now too slow to respond to rising demand. While still on an upward trend since 2013, building permits have not yet reached the pre-financial crisis average and the construction sector is increasingly constrained by capacity pressures. The number of properties for sale has decreased by 60% since the trough of the housing market in 2013.

With house prices rising at their fastest pace since the start of the decade, house affordability started to deteriorate last year. The recovery in households' real disposable income has been much more modest than that of house prices. Meanwhile, mortgage interest rates stabilized at around 2.4 % last year, preventing further gains in housing affordability. The price-to-rent and price-to-income ratios point to a 10% to 20% overvaluation. Although this is down from 50% in 2007, it has started to feed into cooling demand. The number of sales has stabilized around 240,000 in the past 12 months and mortgage uptake has decreased, with new lending down by 14% annually in November.

Future trends

The Dutch economy is expected to have outperformed most of its eurozone peers in 2017, with GDP rising above 3%. Although 2017 is likely to mark a peak in the economic recovery, the outlook remains favorable with strong domestic and external demand pointing to 2.1% GDP growth this year and 1.9% in 2019. Households' sentiment and spending continues to be bolstered by the strong labor market recovery. The number of employed workers has topped its pre-crisis peak in 2017, feeding into more dynamic wage growth, and giving a boost to households' real disposable income. Meanwhile, the recovery in world trade last year has revived Dutch exports, raising capacity pressure in manufacturing. Manufacturing PMI reached an all-time high in November last year, pointing to dynamic business investment in 2018. Robust economic growth should lead to further falls in the unemployment rate to about 4.5% by 2018, raising households' finances prospects.

With economic growth running above trend, the housing market will continue to be underpinned by strong household demand. Demographics will also help with the number of households to increase by 62,500 a year until 2020. The supply shortage will remain a key driver of housing prices. Capacity pressures are high in construction, with one-third of construction firms reporting an order book too large and too slow of a rise in building permits to respond to the housing shortage. The current ratio of houses for sale to houses sold is around five compared with 50 in 2013 during the trough of the housing market, pointing to further price pressures.

From 2019 onward, cooling demand, triggered by an overvaluation of housing prices and an expected rise in interest rates, should trigger a deceleration in housing prices. Further tightening in mortgage underwriting standards--such as a gradual reduction in loan-to-value ratios and less of a fiscal incentive to further reduce household indebtedness--is also likely to reduce sentiment in the housing market.

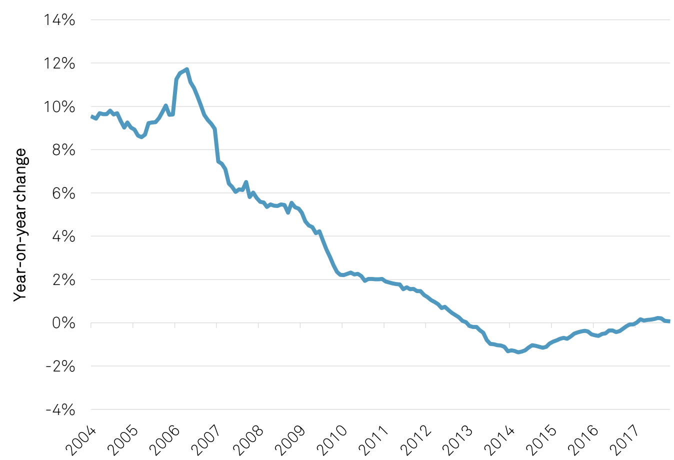
Chart 6.1

Total Transactions

Source: Central Bureau of Statistics Netherlands (CBS).

Chart 6.2

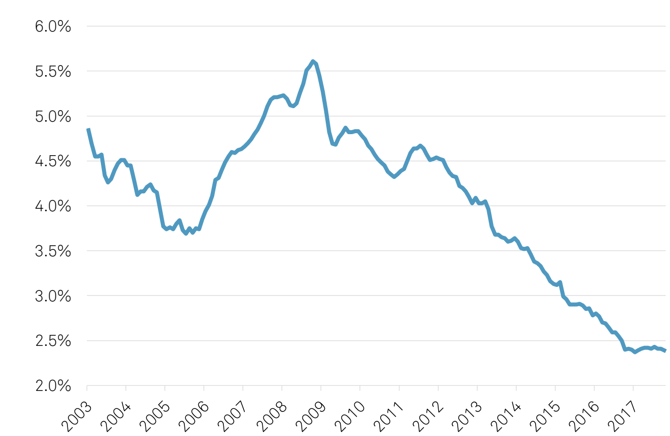
Housing Loans



Source: De Nederlandsche Bank.

Chart 6.3

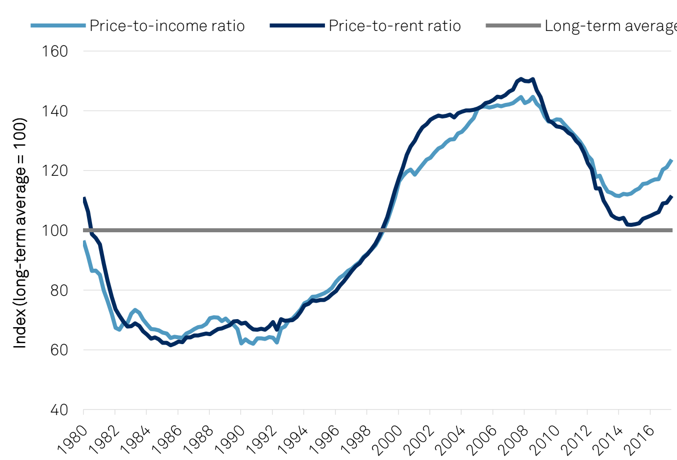
Average Interest Rates On New Housing Loans



Source: ECB.

Chart 6.4

Price Ratios



Source: OECD, Kadaster.

Portugal: A Robust Recovery And Foreign Demand Are Driving A Boom

Table 8

Portuguese Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	5.1	7.7	11.0	8.5	7.0	6.0
Real GDP, % change	1.8	1.5	2.8	2.3	2.0	1.8
CPI inflation (%)	0.5	0.6	1.4	1.5	1.7	1.8
Unemployment rate	12.6	11.2	9.5	9.0	8.7	8.5

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD.

Robust economic growth and a rapidly improving labor market, low interest rates, foreign demand, and lack of supply continue to underpin strong home price increases in Portugal. We anticipate 8.5% house price growth this year, after an estimated 11% in 2017.

Recent trends

Activity in the Portuguese housing market remains buoyant. The number of transactions rose by 19.5% year on year in the first nine months of 2017, after 18.5% growth in 2016. Transactions for existing properties, which now account for close to 85% of the market, are driving activity. Residential property sales in this segment rose by more than 20%, while the market for new properties is recovering at a more measured pace, with transactions up 7% in the first three quarters of 2017.

Home price growth accelerated to 10.4% year on year in third-quarter 2017, from 8% in the first half of the year. Both existing and new properties saw rapid price increases, by 11.5% and close to 7%, respectively. The combination of firm housing demand and lack of supply is fueling home price inflation. Portugal enjoys robust economic growth, accompanied by rapid improvements in the labor market. Real GDP growth accelerated to 2.8% in 2017, according to our estimates. Strong job creation helped to reduce the unemployment rate to 7.8% in December 2017, the lowest level since 2008. At the same time, mortgage interest rates are still trending down, averaging 1.53% in October. New mortgage lending continues to grow at a brisk pace, rising by 44% year on year in the first 10 months of 2017, similar to 2016. Lending for house purchases is still contracting on a net basis, however.

Foreign demand remains an important driver of the housing boom, as affordable house prices, mild climate, and special incentives continue to attract foreign buyers. The Portuguese residential property market remains relatively inexpensive. The median price per square meter in Lisbon, for example, stood at €2,256 in third-quarter 2017, according to the National Institute of Statistics. Prices are higher in some sought-after areas of the capital. Special incentives for foreigners include a favorable nonhabitual residents tax regime, and the "golden visa" scheme that gives a resident permit to non-EU nationals who buy a property for at least €500,000. About €3 billion was invested into Portuguese real estate property via the "golden visa" program from its launch in October 2012 until November 2017. While economic recovery has broadened to the residential construction sector, housing supply remains constrained. Housing investment is recovering from rock-bottom levels, with the number of completed dwellings up by 18% in the first half of 2017, after 40% growth in the second half of 2016. However, this is still only a fraction of dwellings completed before the crisis.

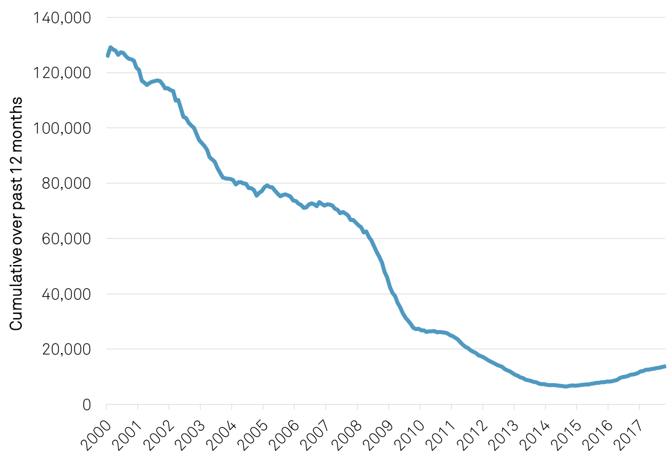
Future trends

We expect growth to remain solid in 2018, thanks to past structural reforms and a favorable external environment, but ease gradually over next few years, to below 2% by the end of the decade. This reflects constraints from the high indebtedness of the private and public sector, and slow productivity growth.

The Portuguese housing market should remain dynamic in the next few years, underpinned by a positive economic outlook, steady job creation, and rising household income, as well as continuing interest from foreign buyers. Price inflation should slow gradually, as economic growth moderates and interest rates start to rise. At the same time, we expect foreign demand to remain strong over the forecasting horizon. The recovery in housing investment is moving ahead, but from a very low base, and the gap between supply and demand is likely to persist over the next few years, supporting prices. We expect home price growth of 8.5% this year, slowing to 6% by 2020.

Chart 7.1

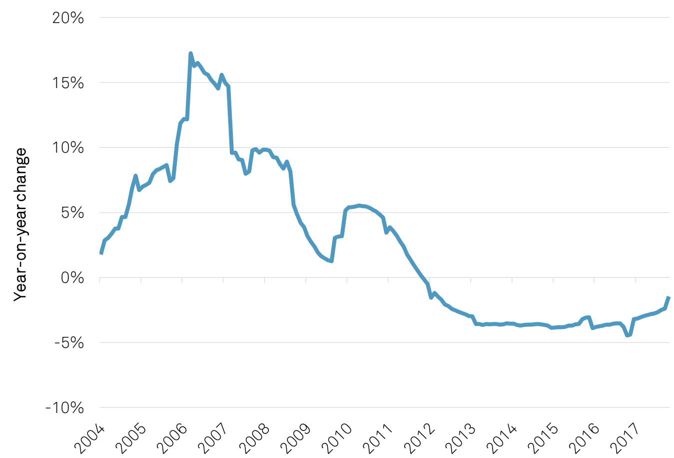
Residential Construction Permits



Source: Statistics Portugal.

Chart 7.2

Housing Loans



Source: ECB.

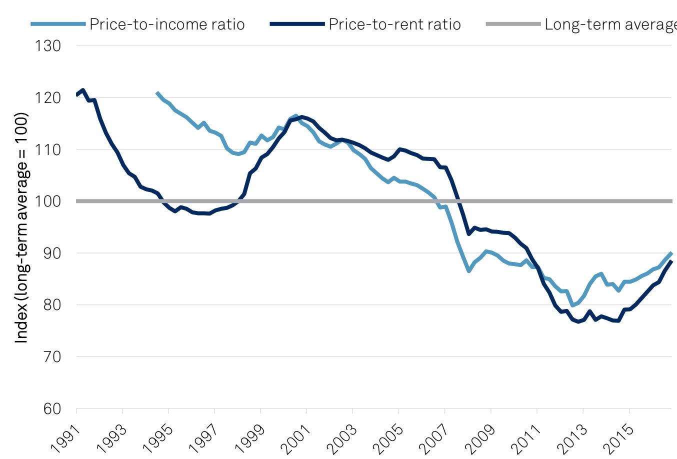
Chart 7.3

Average Interest Rates On New Housing Loans

Source: ECB.

Chart 7.4

Price Ratios



Sources: OECD, ECB.

Spain: Strong Economic Growth, Increased Political Uncertainties

Table 9

Spanish Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	4.4	4.5	4.0	3.5	3.0	3.0
Real GDP, % change	3.4	3.3	3.1	2.7	2.1	1.8
CPI inflation (%)	-0.6	-0.3	1.9	1.5	1.5	2.0
Unemployment rate	22.1	19.6	17.2	15.6	14.5	13.6

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Banco de Espana, OECD, Instituto Nacional de Estadistica (INE).

Recent trends

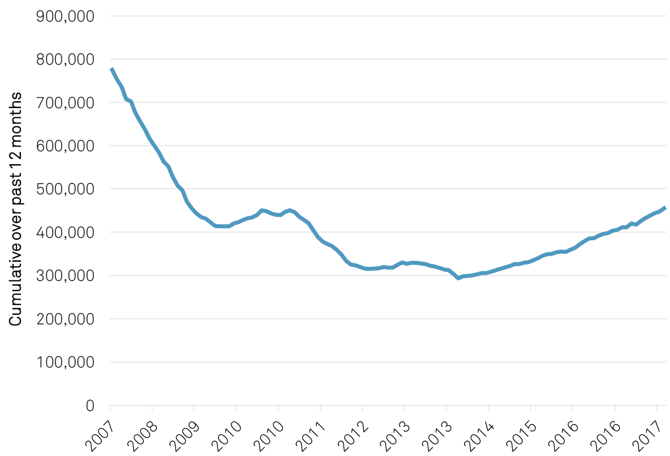
The Spanish economy continued to outperform through 2017. Real GDP growth was 3.1% according to our most recent estimates, after 3.3% in 2016. Private consumption has been a key pillar of growth as strong job creation, combined with low inflation, has boosted purchasing power. Meanwhile, Spain has continued to take advantage of its improved competitiveness and the surge in global trade, leading to another year of strong export growth (5.3% in real terms). Investment growth (4.8% in 2017 versus 3.3% a year earlier) has reflected stronger demand from abroad and sentiment in the corporate sector continued to be positive. Against this backdrop of buoyant economic performance, the residential real estate market continued to recover from the post-2008 contraction (a drop of 37% in prices between third-quarter 2007 and the trough in first-quarter 2014). According to Tinsa, a real estate company, average prices rose 4.2% year on year in the final quarter of 2017. The city of Madrid overtook Barcelona with an annual increase of 17% against 14.8% for the capital of Catalonia where prices dropped 1.7% in the last three months of 2017. On average, sales took 8.6 months to complete compared with 9.1 months a year earlier. Transactions amounted to 455,000 over the first 11 months of the year from 375,000 a year earlier. Purchases by foreigners remained significant at around 17% of the total, from 10% on average for 2006-2013. U.K. citizens remained the main foreign buyers but their purchases declined through the year. Bank lending provided continued support. Interestingly, the proportion of loans with a fixed interest rate at more than 10 years has been rising since 2016 in a market that until then was traditionally at variable rates. The process of absorbing the large stock of unsold dwellings inherited from the pre-crisis construction boom has been moving slowly because a mismatch persists between the regions where housing demand is the strongest and those where the unsold houses are concentrated.

Future trends

Economic growth should remain strong this year and next but political uncertainties could have a more negative impact on business and consumer sentiment. The main risk is the impact of the Catalan crisis in the region, Spain's largest regional economic hub (20% of nominal GDP) and on the country as whole. The snap regional elections held in Catalonia on Dec. 22, 2017, were indecisive, and failed to push back the risk of Catalan independence. Barcelona has seen some of the highest property prices rises since the beginning of the recovery, but recent evidence suggests that 2018 could see Catalonia's housing market experience a downturn. By contrast, we expect transactions in the country as a whole to grow about 8% in 2018. Interest rates most likely reached a bottom at the end of last year, but will remain at very attractive levels. On the other hand, the affordability ratio, as calculated by the Bank of Spain (average property prices divided by average gross annual income), has fallen from 7.7 years at the peak of the property boom to a still-high 6.6 years in 2016. Second-hand house prices will continue to rise, albeit less rapidly than in the past two years, especially since real disposable income growth slows markedly on the back of flat nominal wages.

Chart 8.1

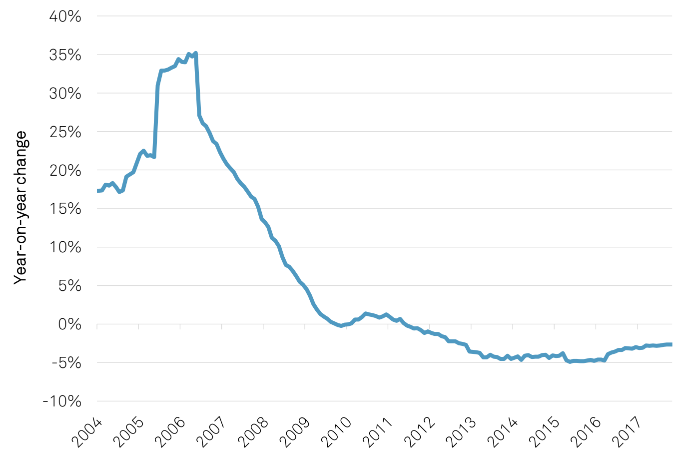
Total Transactions



Source: Instituto Nacional de Estadistica (INE).

Chart 8.2

Housing Loans



Source: ECB.

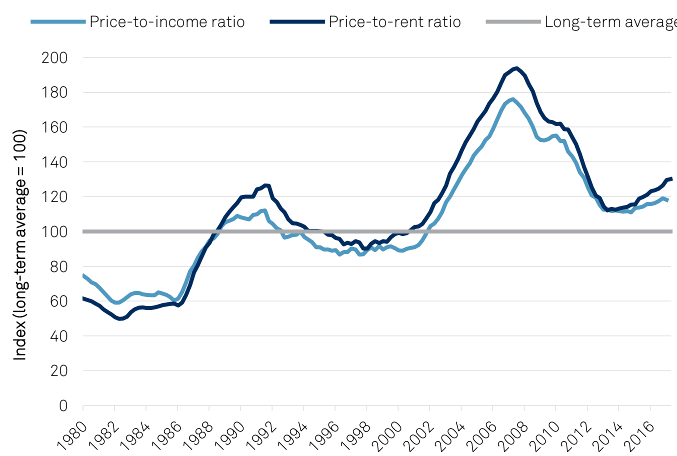
Chart 8.3

Average Interest Rates On New Housing Loans

Source: ECB.

Chart 8.4

Price Ratios



Sources: OECD, Banco de Espana.

Switzerland: Regulatory Measures And Slowing Migration Are Holding Back The Housing Market

Table 10

Swiss Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	2.3	1.5	2.0	1.8	1.9	2.3
Real GDP, % change	1.2	1.4	0.6	1.7	1.9	1.9
CPI inflation (%)	-1.1	-0.4	0.4	0.6	0.9	1.3
Unemployment rate	3.2	3.3	3.2	3.0	2.9	2.7

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Department for Communities and Local Government, Wüest Partner.

A stronger economy and low interest rates are supporting the Swiss housing market, but regulatory measures, low affordability, and slowing net immigration are keeping a lid on home prices. We expect prices for single-family homes to rise by 1.8% in 2018, after an estimated 2% in 2017. The supply-demand imbalance in the rental properties market will continue to put downward pressure on prices in this segment.

Recent trends

A pick-up in economic growth and a robust labor market have boosted demand for owner-occupied properties in Switzerland. Thanks to stronger global demand and a weaker franc, the Swiss export-oriented economy is enjoying solid growth momentum after a spell of lackluster growth. The Swiss franc depreciated by more than 5% over 2017 in trade-weighted terms and adjusted to inflation differentials with the country's trade partners, which brought the real effective exchange rate back to 2014 levels. Exports have picked up, and recent surveys signal strong sentiment among Swiss businesses. Unemployment continues to fall from already low levels, edging down to 3% in December.

Regulatory measures and low affordability are keeping a lid on house price increases. Legal directives and self-regulation by banks have limited the number of people eligible for mortgages. As a result, lending for house purchases is expanding modestly, at a stable rate of around 2.6%, despite very low mortgage interest rates.

Meanwhile, the housing market is receiving less support from immigration than in the past. Net immigration to Switzerland has further declined in 2017, by 12% over the previous year, after falling by 15% in 2016. In our view, this mostly reflects economic reasons, rather than the impact of the outcome of the referendum against "mass migration." The economic recovery in Spain and Portugal, and a strong German labor market, have reduced the relative attractiveness of employment in Switzerland.

Price dynamics remain uneven across various segments of the Swiss housing market. Prices for single-family homes rose by 2% in 2017, according to our estimates, reflecting a pick-up in demand and tighter supply, compared with other segments of the market. At the same time, the market for rental apartments is still sliding, reflecting an oversupply in this segment. Vacancies for rented properties have reached a record (2.4% in mid-2017), and asking rents are declining. Falling rents are mostly affecting larger apartments, while demand for smaller rented apartments remains strong, according to Wüest Partner. There are also regional differences: prices are falling in the south and northwest of the country, while housing markets in bigger cities are staying tight.

Future trends

We expect the economy to perform well in 2018, and forecast real GDP growth of 2.1% this year after an estimated 0.9% in 2017. All spending components should contribute to the upturn.

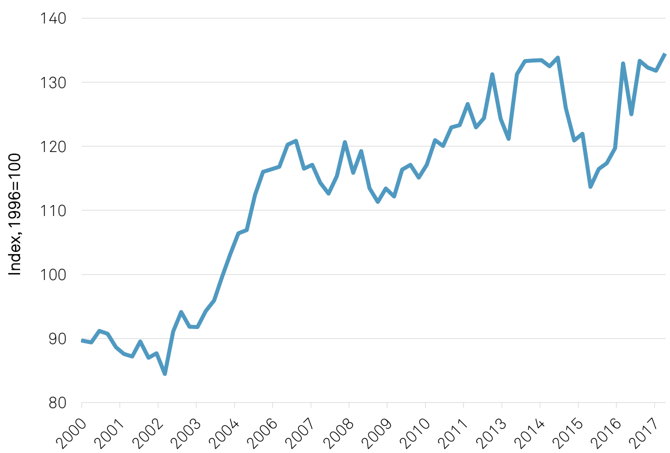
Robust global demand and a more competitive currency will boost exports and investment, while private consumption should pick up this year as unemployment declines further and confidence strengthens. We expect mortgage rates to remain at very low levels this year, and rise only very gradually over the forecasting horizon.

Although economic and financial conditions remain positive, low affordability and regulatory measures will continue to hold back the Swiss housing market. Meanwhile, improved economic conditions in the eurozone might lead to an ongoing decline in net migration to Switzerland, weighing on housing demand.

We expect diverging developments between various segments of the Swiss housing market to continue. We forecast prices of single-family homes to rise by 1.8% this year, or by 1% adjusted for inflation, and continue to increase at a similar speed in real terms over the next couple of years. Supply-demand imbalances in the rental segment are likely to persist in the next few years, limiting the upside potential of property prices in this sector.

Chart 9.1

Housing Construction



Source: Credit Swiss, Swiss Contractor's Association (SCA).

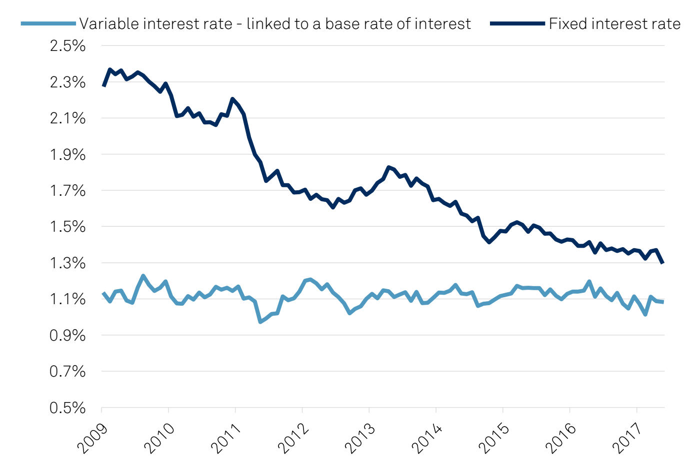
Chart 9.2

Housing Loans

Source: Swiss National Bank.

Chart 9.3

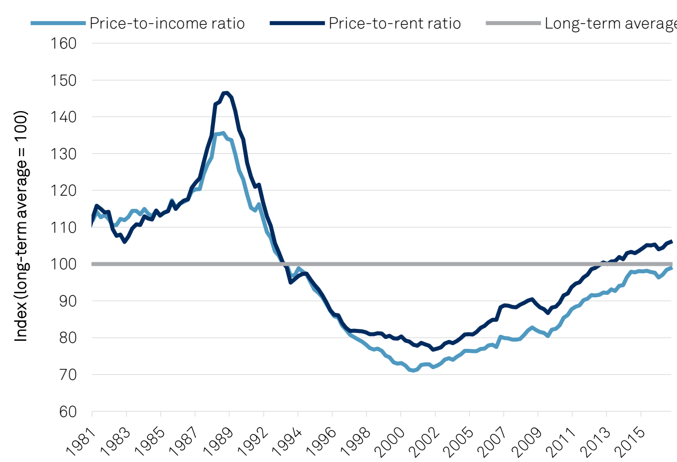
Average Interest Rates On Housing Loans



Source: Swiss National Bank.

Chart 9.4

Price Ratios



Sources: OECD, Swiss National Bank.

U.K.: Brexit And BTL Headwinds Slow House Price Momentum

Table 11

U.K. Housing Market Statistics

	2015	2016	2017e	2018f	2019f	2020f
Nominal house prices, % change y/y	6.5	5.4	4.5	0.5	1.5	3.5
Real GDP, % change	2.3	1.8	1.5	1.0	1.3	1.5
CPI inflation (%)	0.1	0.6	2.7	2.4	1.9	2.0
Unemployment rate	5.4	4.9	4.4	4.5	4.7	4.8

e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Department for Communities and Local Government, ONS.

Recent trends

U.K. house price growth continued to slow in 2017. The deceleration to 5% year on year in the final quarter of 2017, compared with 8% in the second quarter of 2016, was primarily driven by flagging interest from buy-to-let (BTL) investors that followed the introduction of a higher stamp duty on second homes. This is increasingly being compounded by the phasing out of tax deductibility of BTL mortgage payments, among other initiatives to curb this sector. Brexit uncertainties are also weighing on price growth, especially in London.

Lower demand for mortgages from BTL investors was also largely behind the 5% and 4% year-on-year drops in the number of approved mortgages for home purchase in October and November, respectively. Demand from first-time buyers (FTB) held up and it slightly improved from second and subsequent buyers, though from low levels. Lending conditions have remained favorable, with banks willing and able to lend, at highly competitive rates. New borrowers are not seeing virtually any increase in rates, following the November hike by the Bank of England to 0.5% from 0.25%. Demand remains also supported by still improving employment. At the same time, pay growth, at 2.5% year on year in the three months to November, is outpaced not only by inflation, at 3% in December, squeezing household budgets, but also by house price inflation, which means affordability continues to deteriorate, despite slowing house price growth.

Aside from price dynamics and putting things in historical context, U.K. housing market activity continues to broadly stagnate. The number of new mortgages approved, sale instructions, buyer inquiries, and stock on the market continue to move broadly sideways, with some of these measures remaining one-third below pre-crisis levels. The still very limited number of properties on the market continues to underpin prices.

Future trends

The situation of households is set to gradually improve over the forecast horizon. There are some tentative signs of wage pressure on the labor market, while inflation most likely peaked in November last year. With much more moderate house price growth expected this year and next, affordability should improve for the first time in many years for the U.K. on average, but in particular in London, where we expect weaker-than-average dynamics. Despite this welcome improvement, affordability is set to remain extremely stretched in some areas, especially in London.

In terms of supply, the positive trend of net additions to the housing stock continued in 2017 and, judging by the number of developments in the pipeline, should continue into 2018. But these improvements come from low levels and are still off the estimated number required to satisfy the U.K.'s housing needs. Moreover, as Brexit approaches, developers might delay or shelve currently planned projects, translating into slower supply growth toward the end of the forecast horizon.

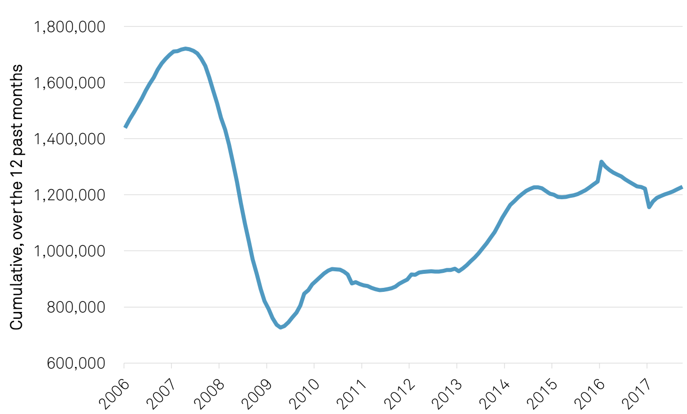
The government's housing strategy measures announced in the 2017 autumn budget are unlikely to significantly help accommodate the need for housing. For example, the stamp duty exemption for FTB up to £300,000 is likely to be largely absorbed into higher prices, rather than boosting FTB purchasing power. Incidentally, the U.K. Residential Market Survey for December suggests that the scheme has not yet translated into significantly increased demand.

Demand will continue to be supported by resilient employment and low mortgage rates, with debt servicing costs remaining at historically low levels--around 13% of disposable income, compared with around 20% pre-crisis. Against the background of falling inflation, a stronger pound, and likely upward BoE revisions to their earlier pessimistic productivity estimates based on recent gains, chances are that we won't see more than one rate hike this year. This, along with a considerable amount of pent-up demand and a limited number of properties on the market, will continue to support house price growth against the headwinds of Brexit.

Our forecast is subject to Brexit-related risks. Should it emerge during 2018 that key service sectors' access to the EU market will be more restricted post-Brexit than we assume in our forecast, this would likely affect house prices more negatively than we currently expect, especially in London where exposure is greatest. Moreover, recently issued BTL mortgages are particularly sensitive to rate hikes. Should the BoE hike substantially more over the forecast horizon than we expect, this could lead, in conjunction with regulatory and tax changes already in place, to a much more pronounced retreat of BTL investors from the market, which in turn could depress prices more than we currently forecast.

Chart 10.1

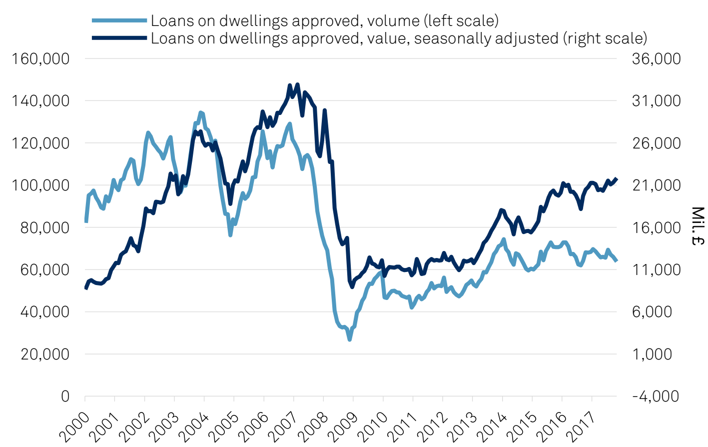
Residential Property Transactions Above £40,000



Source: HM Revenue & Customs.

Chart 10.2

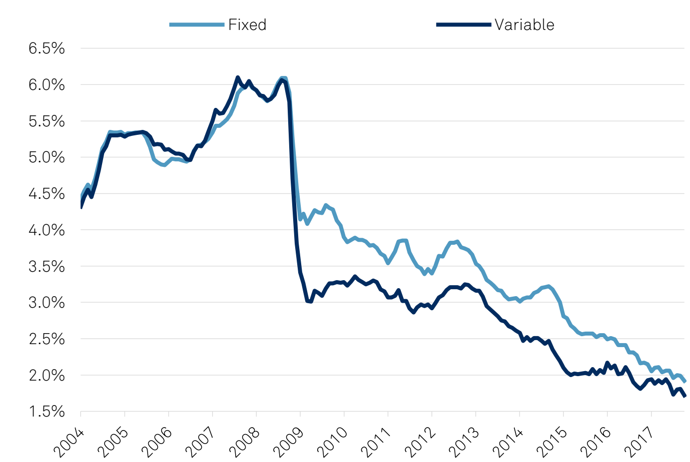
Loans On Dwellings Approved



Source: Bank of England.

Chart 10.3

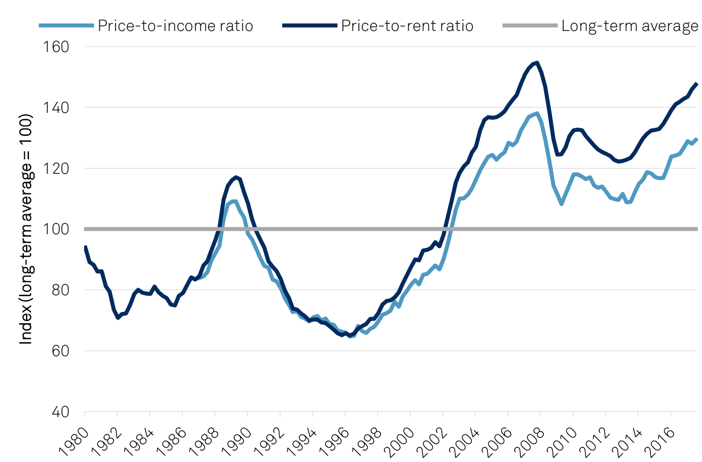
Mortgage Interest Rates On New Business - Banks



Sources: Datastream, Bank of England.

Chart 10.4

Price Ratios



Sources: OECD, Department for Communities and Local Government.