Economic Research:

Europe's Housing Markets Lose Speed As The Economy Weakens

September 24, 2019

Key Takeaways

We forecast housing prices will continue to rise over the next two years, but at a slower pace than up to now. Among the 10 European housing markets we cover in this report, we forecast only Italy will experience house-price declines this year and in 2020.

Looser financing conditions should be broadly supportive of housing demand. Monetary easing measures by the ECB and SNB and delayed interest rate hikes by the BoE should keep borrowing rates lower for longer. However, the economic slowdown will hit job creation.

Affordability of homeownership is likely to worsen further. Nevertheless, in most of the countries covered in this report, housing is still more affordable than prior to the 2008-2009 financial crisis, when price-to-income ratios reached historical peaks. Germany is an exception: affordability had improved in the years preceding the crisis, and is still better than its long-term average.

In the U.K., Brexit uncertainty is dampening activity and dragging on house-price expansion, mainly in London. We expect house prices to see no growth overall this year but to recover over the next two years in the event of a deal. In a disruptive no-deal Brexit, we would expect U.K. house prices to drop significantly.

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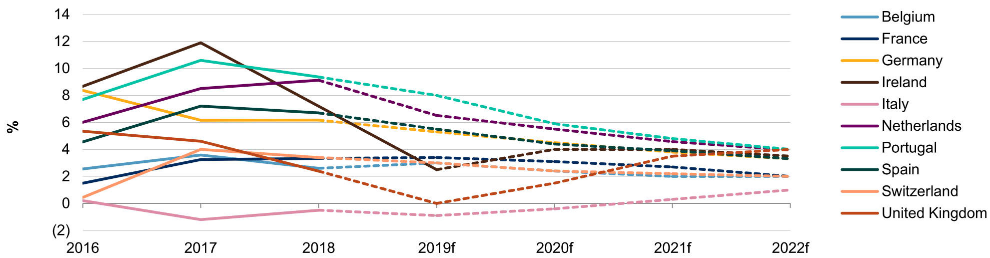
Chart 1

House-Price Inflation Is Slowing
Nominal house prices, y/y change



Sources: S&P, OECD, Hypoport, Wüest Partner.

Monetary Policy And Interest Rates Outlook

European Central Bank: Prepare for looser financing conditions

The ECB unveiled another set of easing monetary policy measures in September in the face of increasing headwinds to growth and muted inflationary pressures. The recession in the manufacturing sector that precipitated the global economic slowdown is only showing some tentative signs of respite. Although unemployment is at its lowest since the financial crisis and services activity remains robust, the weakness in industry is translating into less job creation. This is especially the case in countries like Germany and Italy, which are reliant on exports for growth. They have been oscillating in and out recessionary territory since the end of 2018. Finally, core inflation is still hovering around 1%, well below the ECB's below but close to 2% target. Weaker economic activity is unlikely to push up prices. As a result, the ECB has unveiled a wide-ranging policy-easing package. It cut the deposit rate by 10 basis points (bp), announced the resumption of net asset purchases by €20 billion per month from November, and eased the banks refinancing conditions' terms. It also introduced a tiering system for bank deposits, and adjusted its forward guidance to say that interest rates are unlikely to go up and quantitative easing (QE) is unlikely to stop before it sees a meaningful convergence of core inflation to the inflation target of 2%. Given a worsening economic outlook, we now even expect the ECB to cut the deposit rate by another 10bp in December. We think the ECB will not be in a position to raise rates before 2022. From the perspective of the eurozone housing markets, more easing means that buyers and sellers are likely to see their borrowing costs decrease and remain at historical lows until the mid-2022, if not longer.

Bank of England: Next hike moves to the second quarter of 2020

The Bank of England reiterated at its September meeting that in the event of a smooth Brexit, interest rates would likely have to rise faster than markets currently still expect, very much in contrast to its peers in the eurozone and the U.S. This would be required to counterbalance inflationary pressures from excess demand that would likely build up. But the bank also revised downward its short-term economic outlook, giving more weight to the impact of global trade tensions as well as to a generally weaker global economic environment. Moreover, it signaled that any policy action would have to wait until Brexit has happened, which could now be only at the end of January 2020. The path of inflation also doesn't warrant any intervention in the near term, in our view. After a temporary deceleration in August to 1.7%, inflation should approach the 2% target again in the coming months, partly owing to weaker sterling. Similarly, the current political turmoil and a potential further Article 50 extension would prolong uncertainty, which in turn would continue to weigh on investment, pushing the next hike back even further, even if a Brexit deal will ultimately be reached, so that we currently do not expect interest rates to rise before the second quarter of 2020.

Swiss National Bank: High FX market interventions point to potential easing

The Swiss economy is also suffering from weakness in the manufacturing sector. This is exacerbated by exporters' weaker competitiveness due to a strengthening franc, which is seen as a safe haven currency in a world of high uncertainty. For now, the unemployment rate remains low at 2.3% and services-sector activity is holding up quite well. However, headline price pressures are still low. The Swiss National Bank (SNB) is now forecasting inflation at 0.2% for 2020, and the strengthening of the Swiss franc since then means that Switzerland is importing deflation. Against this backdrop, the central bank is set to keep an accommodative stance to provide support to the economy and make sure inflation expectations remain well anchored. We have already seen rising foreign exchange intervention from the SNB in the markets and higher exemption of negative rates for bank deposits, hinting at possible further easing if necessary going forward. We believe the SNB will definitely wait for the ECB to move first before tightening policy. As in the eurozone, this means that housing investors will anticipate rates to stay lower for longer.

Lower long-term interest rates for longer

Long-term government bond yields in the U.S., the U.K. and the eurozone are now about 100bp below the peak reached at the end of 2018. Besides a sudden reversal in monetary policies--the ECB signalized further accommodation after the Fed announced readiness to cut rates--and another deceleration in world growth, a spike in political uncertainties was among the key drivers of lower government bond yields over the summer. The appointment of a pro-Brexit government in the U.K. as well as another round of trade tensions between China and the U.S. led investors to rush into safe assets. German 10-year government bonds went negative again to the record low of -0.6%. The ECB public sector purchase program and the deleveraging of Germany have shortened the amount of German Bunds available to buy on the market by about €500 billion since 2015. As the ECB will resume its purchase program in November, and because German bunds are a benchmark for other euro government bonds, it seems difficult to imagine that European government bond yields can increase significantly in a foreseeable future.

Table 1

European Housing Market Forecasts

Nominal house prices, % change Y/Y	2016	2017	2018e	2019f	2020f	2021f	2022f
Belgium	2.6	3.6	2.6	3.0	2.4	2.0	2.0
France	1.5	3.2	3.3	3.4	3.1	2.7	2.0
Germany	8.4	6.2	6.2	5.3	4.5	3.8	3.3
Ireland	8.7	11.9	7.2	2.5	4.0	4.0	3.5
Italy	0.2	(1.2)	(0.5)	(0.9)	(0.4)	0.3	1.0
Netherlands	6.0	8.5	9.1	6.5	5.5	4.6	4.0
Portugal	7.7	10.6	9.4	8.0	5.9	4.8	4.0
Spain	4.5	7.2	6.7	5.5	4.4	3.9	3.3
Switzerland	0.4	4.0	3.4	3.0	2.4	2.2	2.0
United Kingdom	5.3	4.6	2.4	0.0	1.5	3.5	4.0

Y/Y--Year on year as of fourth-quarter. e--estimate. f--Forecast. Sources: S&P Global Ratings, OECD, Hypoport, Wüest Partner.

Belgium: Home Prices Are Still Growing, Stretching Affordability

Table 2

Belgian Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal House Prices, % change y/y	2.6	3.6	2.6	3.0	2.4	2.0	2.0
Real GDP, % change	1.5	1.7	1.4	1.1	1.3	1.4	1.4
CPI inflation (%)	1.8	2.2	2.3	1.6	1.7	1.8	1.9
Unemployment rate	7.8	7.1	6.0	5.7	5.8	5.7	5.7

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Banque Nationale de Belgique, OECD.

Despite stretched affordability, we expect favorable economic and financing conditions will support house price growth. We forecast prices will rise by 3.0% this year and 2.4% in 2020.

State of play

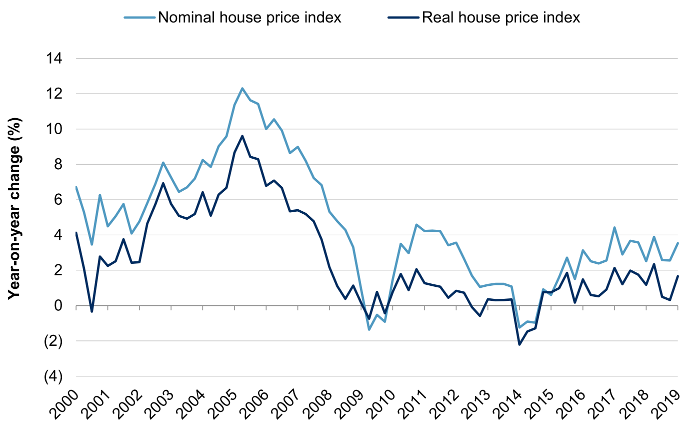
House prices increased by an annual 3.5% in the first quarter, accelerating from 2.6% last year, but below their 2017 growth rate of 3.6%. Favorable economic conditions supported the housing market over the past years, with GDP growing 1.4% 2018 and an annual average of 1.3% in the first half of this year. This helped the unemployment rate decrease to 5.6% in June 2019. Loose financial conditions have also supported demand for housing, as mortgage interest rates reached their all-time low of 1.8% in June. Net of inflation, interest rates were close to zero on average over the first half of the year. Contrary to other eurozone countries, the Belgian housing market barely saw a price correction after the global financial crisis. Strong price growth over the past years therefore led to increasingly overstretched affordability of residential property. In the first quarter of this year, overvaluation was 40% in terms of price to income and above 50% price to rent. Although solid wage growth resulted in a stabilization of the price-to-income ratio, the price-to-rent ratio worsened further. Since the fourth quarter of 2018, the volume of loans for house purchase picked up strongly. While the total volume of housing loans in the 12 months to March was 11% higher than in 2017, the average size of loans only increased by 3% over the same period. These data point to a surge in the number of mortgages taken up over the past six months. Transaction numbers tell the same story: after decelerating strongly over 18 months until mid-2018, they are back to annual growth rates of around 5%. Soaring construction permits in the 12 months to September 2018 should have contributed to the strong increase in transactions.

What we expect

We expect economic growth to decelerate to 1.1% this year and then pick up again in 2020 (1.3%). The labor market should remain resilient although we don't see room for further decreases in the unemployment rate. Mortgage interest rates should remain lower for longer in the context of expansionary monetary policy and thus further support demand for housing. These factors should result in solid but easing demand for owner-occupied residential property. The sharp drop in construction permits over the 12 months to April may weigh on supply and put upward pressure on prices. According to the ECB's bank lending survey, banks expect households' demand for loans for house purchases to increase in the third quarter of this year. This supports our view that the house price growth will remain strong this year before decelerating from next year, owing to worsening affordability. Important regional disparities remain: while the median price of residential property was of €236,000 in the Flemish region and €243.000 in Brussels in the first quarter of 2019, it was only €164.000 in Wallonia. Transactions in the capital have started to decrease in fourth-quarter 2018, after growth rates averaging nearly 7% since 2017. This shows that, despite the reduction in registration fees in 2017, affordability is overstretched here and potential buyers are being driven out of the market. We thus expect slower price growth in the capital to lead that of the rest of the country.

Chart 1.1

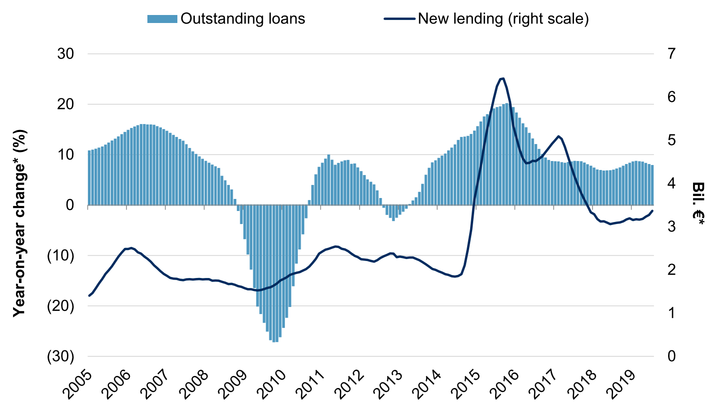
House Price Indices



Source: OECD, S&P Global Ratings.

Chart 1.2

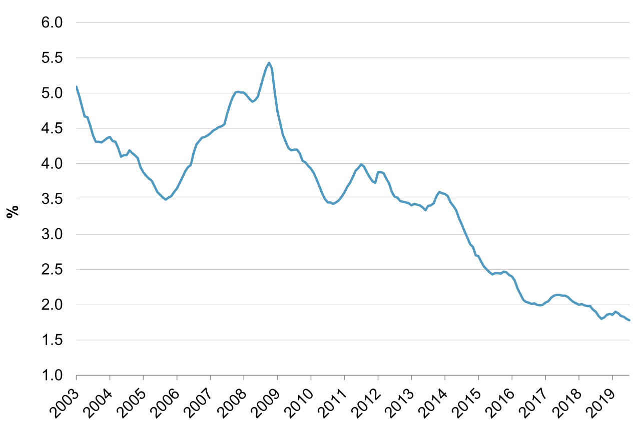
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 1.3

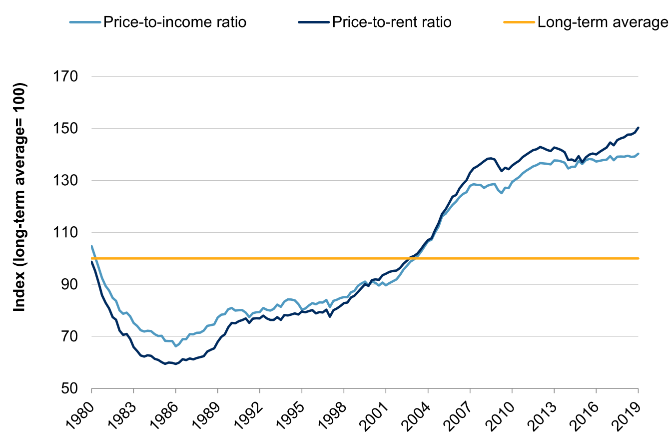
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 1.4

Price Ratios



Sources: OECD, National Bank of Belgium, S&P Global Ratings.

France: House Prices Constrained By Household Income Growth

Table 3

French Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	1.5	3.2	3.3	3.4	3.1	2.7	2.0
Real GDP, % change	1.0	2.4	1.7	1.4	1.4	1.4	1.4
CPI inflation (%)	0.3	1.2	2.1	1.1	1.1	1.1	1.5
Unemployment rate	10.1	9.4	9.1	8.8	8.8	8.7	8.7

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, INSEE.

We expect house prices to continue to grow steadily by 3.4% this year after 3.3% last year, but to gradually soften after that. Although borrowing costs will drop further with upcoming monetary policy easing, the current weaker economic environment points to less dynamic income growth. This will limit gains in property prices given an already high price-to-income ratio.

State of play

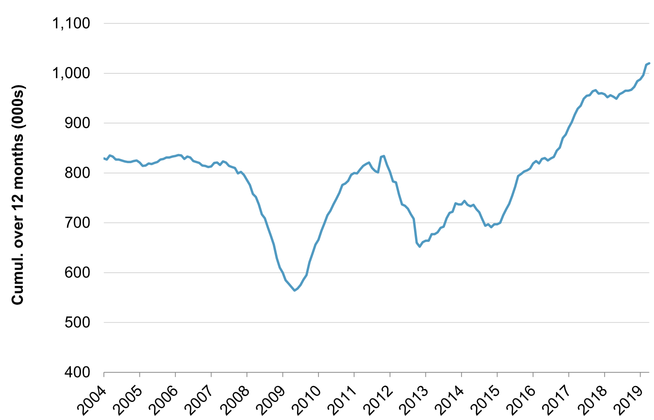
The French housing market remains dynamic, with transactions at an all-time high in May (1.3 million over the past 12 months). That said, the market is far from overheating. Given an already high price-to-income ratio, house prices are expanding more or less in line with household income. Prices were up 3% on the year in the second-quarter 2019 compared with an estimated 4% nominal household income growth. Housing sales are particularly dynamic outside Paris, reflecting more limited supply and elevated prices in the capital as well as more favorable demographic developments in cities like Lyon, Toulouse, or Nantes. Over the past year, prices have increased about 10% in Nantes and Lyon, compared with 5% in Paris. Strong demand for housing is leading to further tightening of capacity in the construction sector. In July, 45% of firms cited labor shortage as a limit to activity. This is 8 percentage points more than a year ago and likely why the number of building permits issued has continued to go down since February 2018. Meanwhile, since January, the economic backdrop has improved for French households. This year, their income is set to rise at its fastest pace since 2007. This is partly thanks to dynamic job creation--the unemployment rate is now at its lowest in 11 years, but mostly due to the government easing measures in favor of household purchasing power following protests until the start of the year. Inflation has also come down on the back of lower energy prices. As a result, consumers' intention to purchase a house in the next 12 months has shot up to an all-time high in the third quarter. Decreasing borrowing costs are also boosting housing affordability, with the interest rate on new borrowing at 1.3% in August down from 1.5% six months ago. In this environment, households are piling on more debt, with new net lending up 5% year on year in May after being down 26% in December. While the central bank is monitoring rising household debt, for now higher rates are not on the horizon and households are shielded by long-maturity and fixed-rate mortgages.

What we expect

Although price expectations have decreased slightly since end-2018, more timely data points to an uptick in house-price inflation in second-half 2019. The high level of transactions, consumers' intention to buy, and robust construction activity all point to accelerating house price rises. The ECB's upcoming easing measures should further support housing demand by fostering lower borrowing costs. Still, as the house price-to-income ratio remains around 20% above its long-term average and households have already resorted to maturity extensions to improve affordability, we expect housing prices to expand at a similar pace to household income. From 2020, house prices are likely to rise less strongly as household income growth will ease. As such, job creation will slow due to slower economic growth, and there should be fewer fiscal measures to support household income.

Chart 2.1

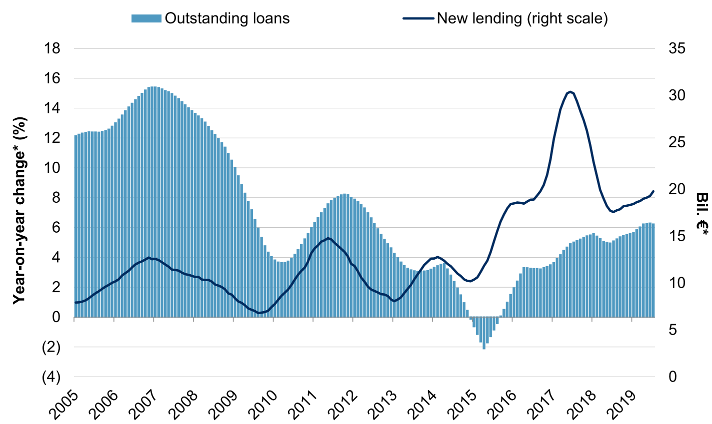
Total Existing Home Sales



Sources: Ministère de l'Ecologie du Développement et de l'Aménagement du Territoire, S&P Global Ratings.

Chart 2.2

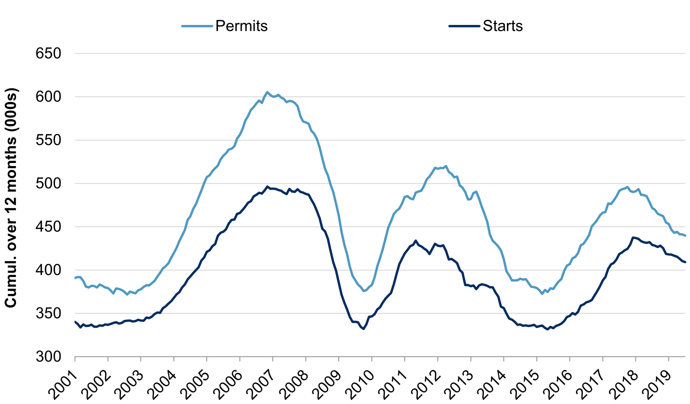
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 2.3

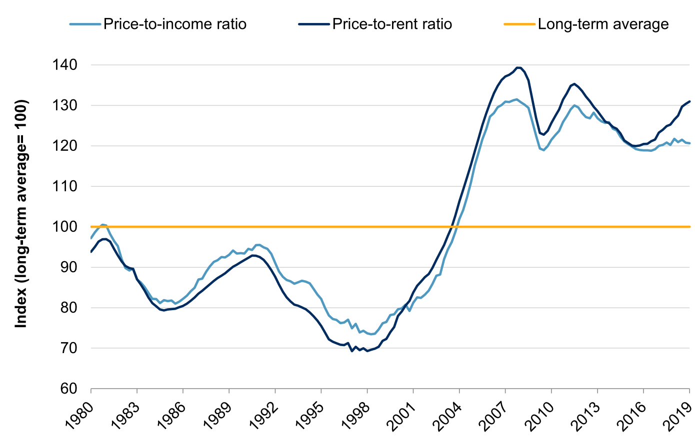
Residential Buildings Construction Permits And Starts



Source: Ministère de l'Écologie, du Développement Durable et de l'Énergie, S&P Global Ratings.

Chart 2.4

Price Ratios



Source: OECD, INSEE (Institut National de la Statistique et des Etudes Economiques), S&P Global Ratings.

Germany: Tight Labor Market Supports Continued House Price Rises

Table 4

German Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	8.4	6.2	6.2	5.3	4.5	3.8	3.3
Real GDP, % change	2.2	2.5	1.5	0.6	1.1	1.2	1.1
CPI inflation (%)	0.4	1.7	1.9	1.4	1.7	1.8	1.9
Unemployment rate	4.2	3.8	3.4	3.2	3.2	3.1	3.0

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Hypoport, Federal Statistics Office.

We expect house prices to increase by 5.3% this year and 4.5% in 2020, decelerating from 6.2% in 2018. The tight labor market will continue to underpin housing demand, but worsening affordability may drive out some potential buyers. Construction activity will not match demand, contributing to price pressures.

State of play

House price rises decelerated to an annual rate of 5.0% in Q1 2019, from 6.2% the previous two years. Strong price gains of recent years has worsened affordability of owner-occupied housing. The price-to-rent ratio just exceeded its long-term average in Q4 2018, its highest since 1992. Owing to resilient wage growth, the price-to-income ratio is still 6% below its long-term average. Meanwhile, interest rates on new housing loans reached a new all-time low of 1.57% in June. In real terms, mortgage interest rates averaged 0.1% in the first half of the year. Solid household disposable income growth due to a tight labor market, and low borrowing costs are fueling demand for owner-occupied residences, as the rising volume of new housing loans indicates. They totaled €21 billion in the 12 months to June 30, 6% higher than in the previous 12 months.

House price increases have been highest in the seven largest cities, at 9.6% in 2018, slowing from 9.7% in 2017 and 10.7% in 2016. As affordability deteriorates in big cities, potential house buyers are increasingly moving out to their catchment areas--which may relieve demand and price pressures in cities.

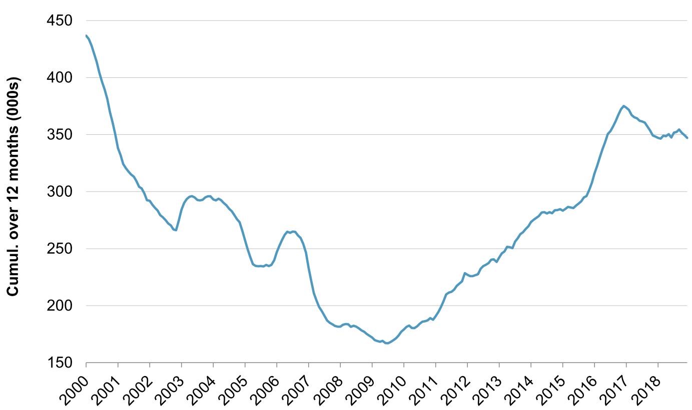
What we expect

Subdued external demand is weighing on Germany's economic outlook. Nonetheless, the strong labor market, characterized by a record low unemployment rate and dynamic wage growth will continue to support domestic demand. This should keep house-price growth strong, although less so given we see employment creation slowing. What's more, interest rates will remain low as the ECB extends its expansionary monetary stance. This will support households' purchasing power and housing demand. The ECB bank lending survey indicates increased housing demand in Q3. Capacity constraints led to fewer completed dwellings last year, especially with respect to skilled workers. We see future completions slowing further, as construction permits in the first half were lower than in 2018. The number of new residential buildings will thus not close the gap between demand and supply, underpinning house price growth.

Deteriorated affordability due to recent price increases should dissuade some potential house buyers and favour renting, which remains the favorite housing option for Germans. We think this will help slow house price growth, especially in big cities that have seen steeper price rises over the past year and now face worse affordability. Consumer confidence also declined amid the country's economic weakness, pointing to less dynamic demand for housing. Finally, net immigration, which has been another factor fueling demand for housing, continues to shrink, according to Bundesbank estimates.

Chart 3.1

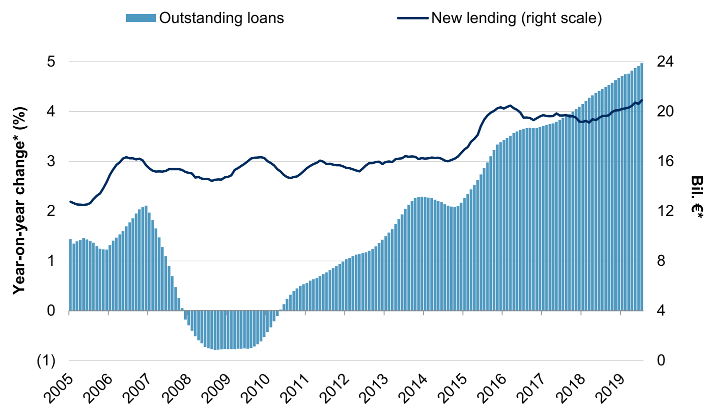
Residential Construction Permits



Sources: OECD, Industry and Services Statistics (MEI), S&P Global Ratings.

Chart 3.2

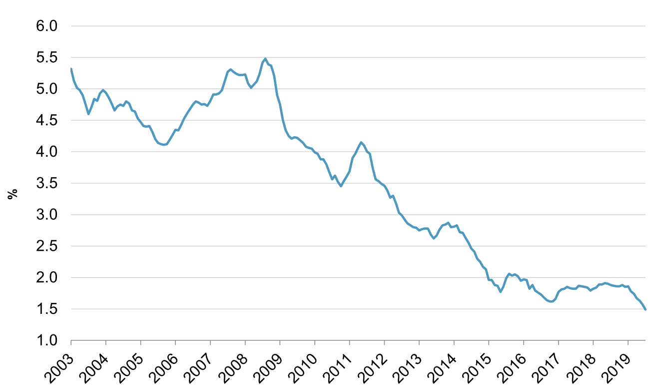
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 3.3

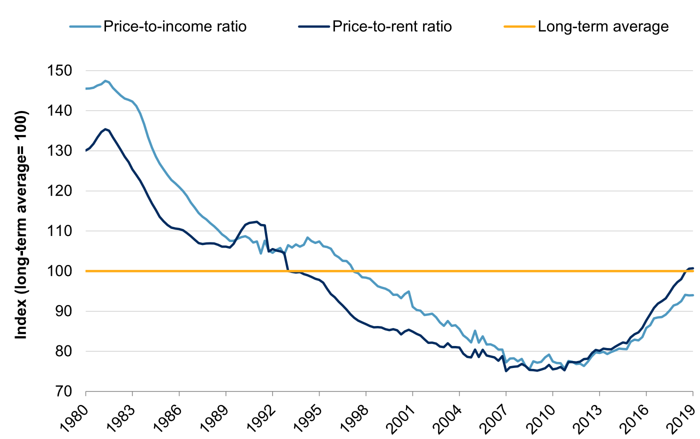
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 3.4

Price Ratios



Source: OECD, Deutsche Bundesbank, S&P Global Ratings.

Ireland: Price Recovery Slows To More Reasonable Pace

Table 5

Irish Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	8.7	11.9	7.2	2.5	4.0	4.0	3.5
Real GDP, % change	5.0	7.2	6.7	4.0	3.4	3.0	3.0
CPI inflation (%)	(0.2)	0.3	0.7	1.0	1.4	1.5	1.5
Unemployment rate	8.4	6.7	5.8	5.2	5.0	4.5	4.5

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. N/A--Not available. Sources: S&P Global Ratings, Eurostat, OECD, Central Statistics Office.

Following the recent slowdown, we expect prices to rise more moderately, provided a disruptive Brexit is avoided. We forecast price rises of 2.5% this year, after a 7.2% rise in 2018.

State of play

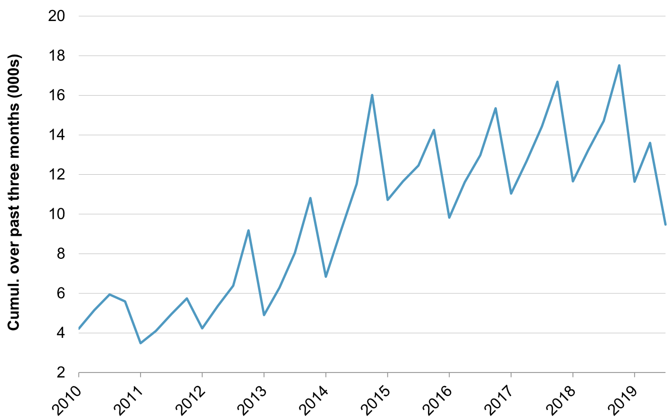
Irish home-price inflation has been softening for more than a year. In July, prices were just 2.3% higher than the year before, when they had risen by 10%. However, we do not see a great risk of prices contracting significantly over the forecast horizon. Rather, we think the recovery cycle of prices since the crisis is approaching a more normal growth pace, dampened also by the Central Bank of Ireland's lending caps being increasingly reached, notably in Dublin. Worries about the potential economic consequences of a no-deal Brexit are playing an increasing role nationwide, but are offset, to some extent, by the steady influx of overseas workers, particularly to Dublin. Output from the homebuilding sector, which collapsed after the 2008 crisis, continues to improve. However, it remains encumbered by years of underinvestment, a protracted but improving planning process, the elevated cost of housebuilding, and limited access to development finance. Analysts also note that planners and developers have yet to fully recognize and adapt to demographic changes and the urbanization of the labor market. Rather than building houses for larger families that still dominate current developments, more apartments catering to younger and smaller households are required. The current shortage of these types of homes have led to high rental costs, making it difficult for these households to save for deposits to buy, even though mortgage costs would be cheaper than rent. The Irish economy is very open to the rest of the world, in particular the U.K., and as such not immune to the current downturn in global trade and weaker demand from the U.K. Overall, however, the economic environment remains relatively supportive to housing demand, with earnings still outpacing inflation and unemployment at a record low. This has supported the recent pickup in mortgage approvals.

What we expect

Our forecasts assume a smooth Brexit. In that case, house price growth should stabilize at 3.5%-4.5% in the next few years, well below the unsustainable recovery pace of the past three years, but still above income growth, while regions outside of Dublin continue to catch up. Prices in Dublin, which contracted marginally in July, should be more muted, and could turn negative again, particularly at the higher end of the market, provided the central bank maintains its prudential lending rules, especially relating to loan-to-income ratios. Although supply should improve further, it will only gradually ease demand pressures. Moreover, with the ECB policy rate now staying low for even longer, mortgage rates should stay low. Rental yields are between 5% and 7%, according to some industry estimates, which is well above borrowing costs, especially for international and institutional investors with easier access to finance. This will support the build-to-let and buy-to-let markets and, hence, support prices over the next few years. In a no-deal Brexit, Irish home prices would suffer, along with the wider economy. However, demand from the expected further expansion of operations of formerly U.K.-headquartered businesses should provide a buffer, especially in Dublin.

Chart 4.1

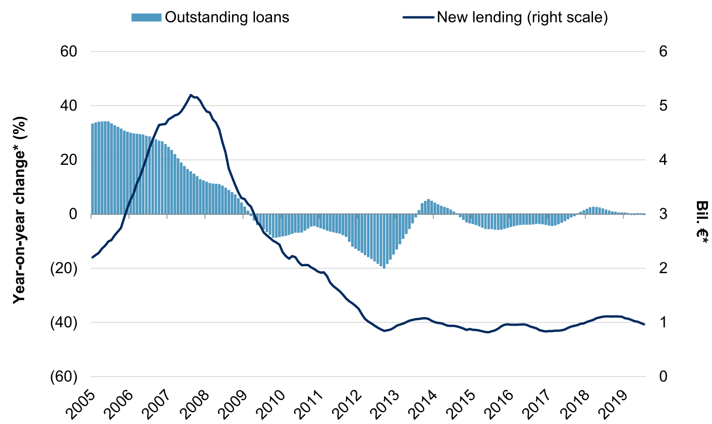
Total Transactions



Source: Property Services Regulatory Authority, S&P Global Ratings.

Chart 4.2

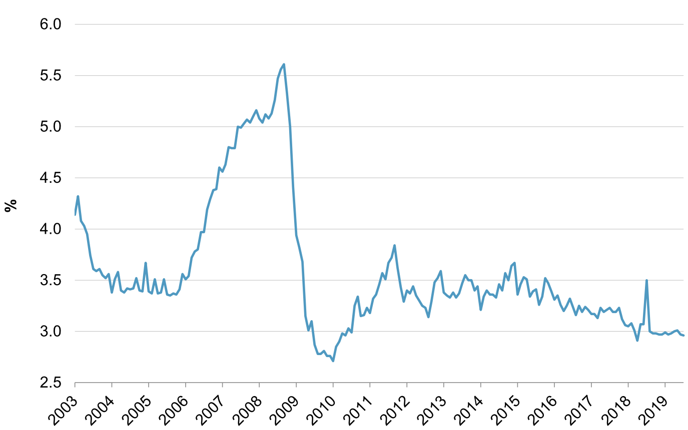
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 4.3

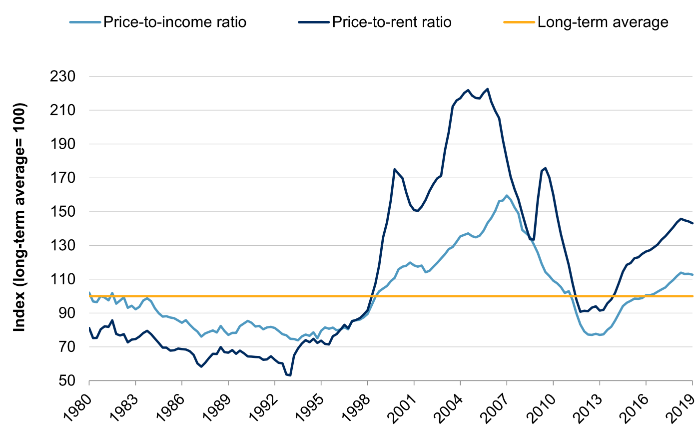
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 4.4

Price Ratios



Source: OECD, Central Statistics Office Ireland, S&P Global Ratings.

Italy: Economic Stagnation Prolongs House-Price Contraction

Table 6

Italian Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	0.2	(1.2)	(0.5)	(0.9)	(0.4)	0.3	1.0
Real GDP, % change	1.2	1.8	0.7	0.1	0.5	0.7	0.8
CPI inflation (%)	(0.0)	1.3	1.2	0.8	1.0	1.2	1.4
Unemployment rate	11.7	11.3	10.6	10.3	10.1	10.0	9.9

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Nomisma.

We expect house prices in Italy to contract further by 0.9% this year and 0.4% in 2020. The environment of economic stagnation bodes ill for employment and income growth prospects. Nonetheless, favorable affordability metrics and low borrowing costs will ensure that demand holds up in the more dynamic economic regions and that the overall fall in housing prices therefore remains mild.

State of play

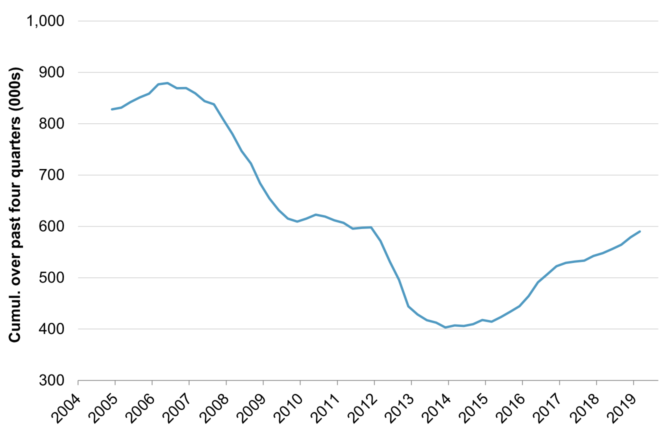
With the Italian economy hovering in and out of recession, households have seen income prospects deteriorate, feeding into a renewed deceleration in house prices. Prices were down 0.8% annually in the first quarter of 2019 after -0.5% in December. Old dwellings and homes in the southern regions are pulling down prices, but there are some brighter spots behind the overall contraction. Prices for new dwellings have been rising since the end of 2017 and were up 1.7% year on year in Q1, as new housing supply remains close to historical lows. Prices have also started to recover in more dynamic regions of the industrial north, such as Lombardia, Veneto, and Emilia Romagna. In Milan, they rose by close to 4% year on year in July. Housing sales have also increased further, to reach its highest since end-2011 (590,000 in the past 12 months). Nonetheless, the slowdown in economic activity is leading to weaker construction activity--visible in lower order books. In the south, on top of economic weakness, negative demographic developments are weighing the on housing market. Prices have dipped faster, in Naples and Palermo by 2% and 4%, respectively, year on year in July, the fastest since early 2018. Banks have continued to pass on higher funding rates to customers, thus denting affordability. The ECB bank lending survey shows tightening credit conditions for households since Q1 2019 has led to weakening demand for credit. New lending for house purchases has been decreasing since January and was down by 21.7% year on year in June. These factors explain why consumers' intention to buy a house declined in Q3, after reaching its highest point since 2004 in Q2.

What we expect

We expect the economy to remain stagnated this year, leading to another year of weakness for housing markets, which is likely to extend into 2020. For now, job creation has only slowed marginally. Households are therefore only looking at less dynamic income growth prospects rather than a loss of wealth. This means they will not have to sell their homes to pay back their loans, suggesting the drop in housing prices will be mild. As such, price expectations are relatively stable. For those in employment, affordability metrics are supportive of housing demand. Housing has not been as affordable since early 2002 in Italy. Following several years of price decline, the price-to-income and price-to-rent ratio are around 10%-15% below their 20-year average. Meanwhile, interest rates are back at 2.17% in June, their lowest since 2018. They should decrease further given that the recent drop in the Italian sovereign yield and the expected ECB rate cut should translate into lower financing costs for banks. This should ensure that demand holds up in the more dynamic economic regions and that the overall fall in housing prices therefore remains mild.

Chart 5.1

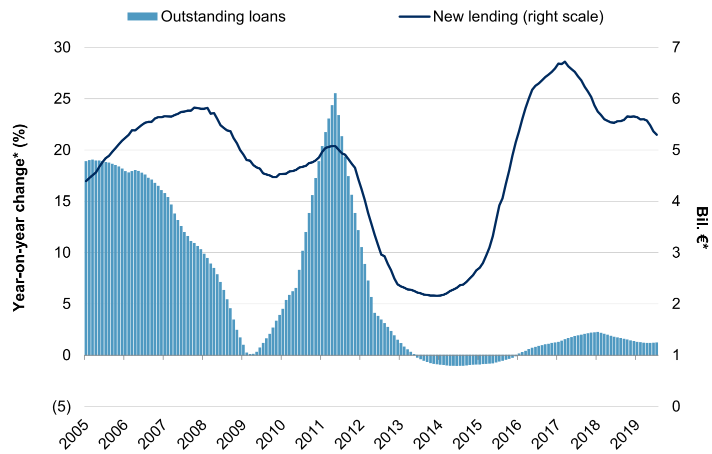
Total Transactions



Sources: Agenzia del Territorio, Nomisma, S&P Global Ratings.

Chart 5.2

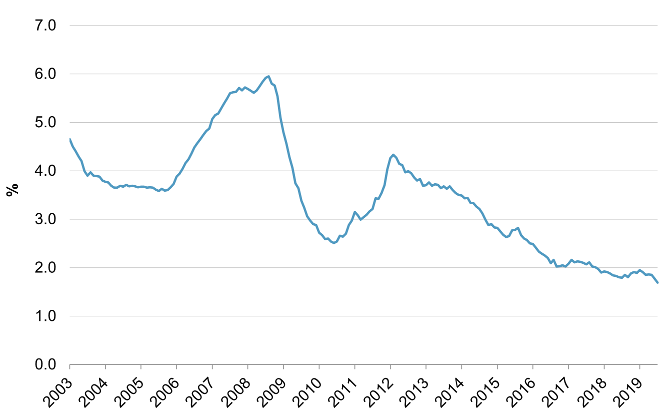
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 5.3

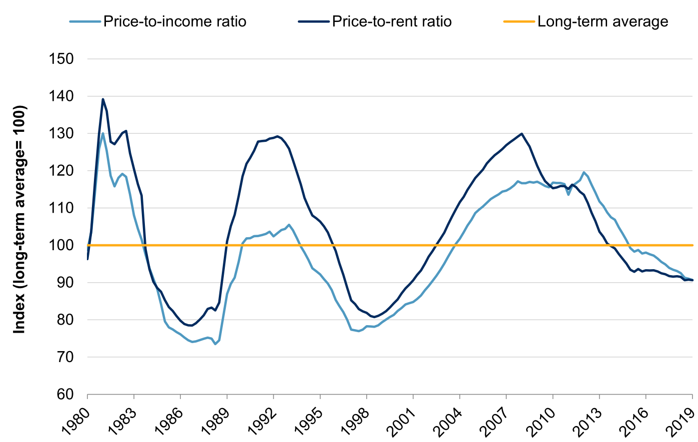
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 5.4

Price Ratios



Sources: OECD, Nomisma, S&P Global Ratings.

Netherlands: Price Rises Slow On Worsening Affordability And Weaker Growth

Table 7

Dutch Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	6.0	8.5	9.1	6.5	5.5	4.6	4.0
Real GDP, % change	2.1	3.0	2.6	1.7	1.6	1.5	1.4
CPI inflation (%)	0.1	1.3	1.6	1.8	1.1	1.8	1.8
Unemployment rate	6.0	4.9	3.8	3.3	3.2	3.2	3.2

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Kadaster, OECD, CBS Statistics Netherlands.

We expect house prices to grow strongly at 6.5% this year and 5.5% in 2020. This marks a deceleration from 9.1% in 2018, as worsening affordability and weaker growth weighs. The price slowdown in Amsterdam should be sharper than in the rest of the country.

State of play

House prices increased by an annual 8.2% in Q1 this year, down from the third-quarter 2018 peak of 10.1%. Affordability has continued to worsen on strong house price growth. In Q1, the house price-to-rent ratio stood 24% above the long-term average and overvaluation in terms of income was 28%. Yet, house prices remains clearly below their pre-crisis levels--18% lower in terms of rent and 10% in terms of income. Solid economic growth (3.0% in 2017 and 2.6% in 2018) since 2014 led to a buoyant labor market. The unemployment rate decreased to 3.4% in July. More jobs are resulting in higher household disposable income, boosting demand on the housing market. Low mortgage interest rates have also supported demand for owner-occupied residential property. Nominal interest rates reached a new historical low of 2.28% in June. Real interest rates even turned negative as consumer price inflation picked up from February. Also underpinning strong price increases is short supply due to sluggish construction activity since the housing market crisis in 2013. The number of properties on sale fell from 230,000 in July 2014 to about 60,000 over the first half of the year, as construction did not follow the pick-up in demand. The government initiated housing construction plans to increase supply, but this has not been sufficient to meet demand.

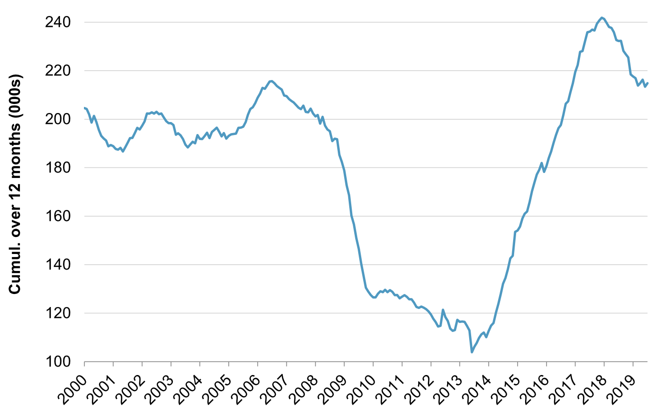
What we expect

We expect economic growth in the Netherlands to decelerate to 1.7% this year and 1.6% in 2020. Nonetheless, it will be high enough to translate into a further decline of the unemployment rate this year and next, boosting household income, and thus continuing to translate into robust demand for housing. Meanwhile, supply shortages are set to aggravate further, adding to the upward pressure on house prices. Construction permits have fallen over the 18 months amid considerable capacity constraints on the labor market. Worsening affordability started to drive potential buyers out of the market, especially in the capital.

Macroprudential measures aiming to reduce households' indebtedness and vulnerability will also soothe demand for housing and consequently price pressures. The Dutch government limited the loan-to-value ratio to 100% and plans to reduce the generous mortgage interest deductibility by three percentage points by 2020. Transactions have decelerated since mid-2017 and declined following their peak in the 12 months to December 2017. We think that house prices will continue to slow down because a deceleration in transactions is historically a harbinger for a deceleration in prices. Given sluggish growth in the first half of the year and stretched affordability, we expect the deceleration in prices in Amsterdam to exceed that of the rest of the country, seeing rises of 8.2% this year and 5.7% next, from 12.4% in 2018.

Chart 6.1

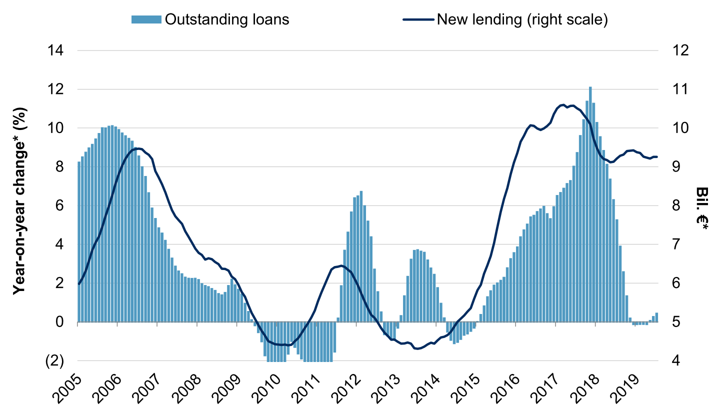
Total Transactions



Source: Central Bureau of Statistics Netherlands (CBS), S&P Global Ratings.

Chart 6.2

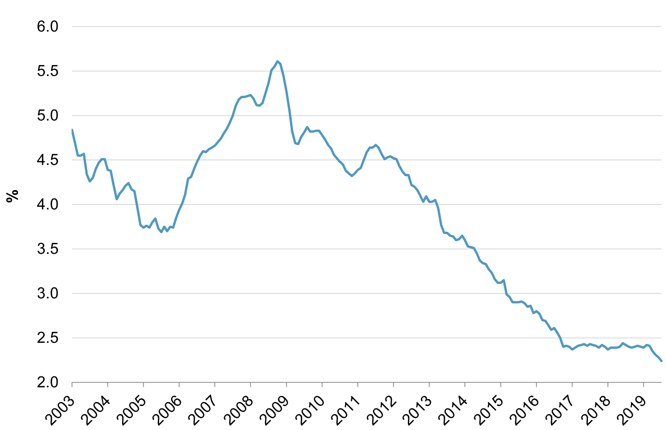
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 6.3

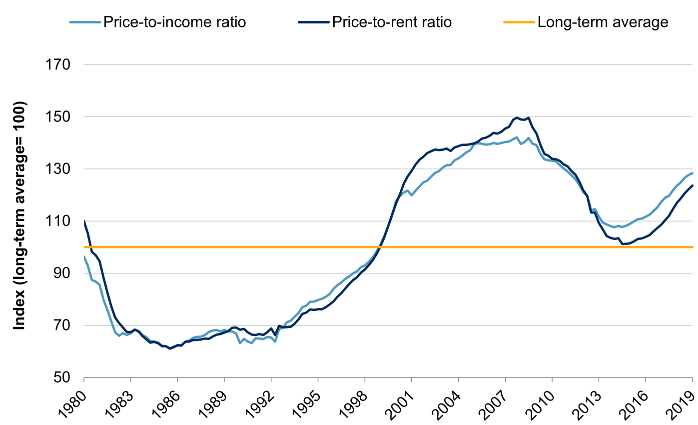
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 6.4

Price Ratios



Source: OECD, Kadaster, S&P Global Ratings.

Portugal: Strong Foreign Demand Underpins Price Rises

Table 8

Portuguese Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	7.7	10.6	9.4	8.0	5.9	4.8	4.0
Real GDP, % change	1.9	2.8	2.1	1.8	1.6	1.5	1.5
CPI inflation (%)	0.6	2.7	1.2	1.0	1.4	1.5	1.7
Unemployment rate	4.9	4.4	7.0	6.2	6.0	5.8	5.8

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. Source: S&P Global Ratings, Eurostat, OECD.

We see house prices continuing to grow strongly at 8.0% this year and 5.9% next. This is nevertheless below 9.4% in 2018, as slower economic growth and worsening affordability weigh on domestic demand, although foreign demand should remain strong.

State of play

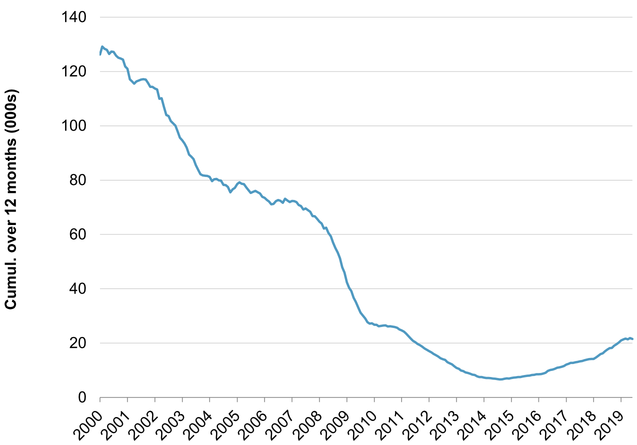
House prices increased by an annual 9.2% in Q1 2019, from 9.4% last year and 10.6% in 2017. This has weighed on affordability of owner-occupied housing as incomes have risen at a slower pace. The sharp correction following the global financial crisis is well behind us, with the price-to-income ratio rising above its long-term average in Q1 2019. However, house price rises and residential property transactions now point to the Portuguese housing market losing some steam. Housing market transactions increased by an annual 13% in Q1--a deceleration compared to buoyant sales over the past five years. Along with deteriorating affordability and stricter credit standards for housing loans, this might result from stricter regulations on short-term rentals, dissuading domestic and foreign investors. The Portuguese economy's recovery over the past five years supported the labor market and thus fueled domestic demand for residential property. The unemployment rate declined to 6.5% in July, its lowest since 2002. Yet, the pace of job creation has been slowing since April last year, posting 1.3% over the 12 months to July, from an average 3.0% in 2018. Meanwhile, favorable financing conditions have underpinned demand for housing. The mortgage interest rate reached an all-time low of 1.3% in May, and averaged 0.6% net of inflation over the first half of the year. Foreign demand has been another important driver of the Portuguese housing market. Despite price increases over the past years, residential property in Portugal remains relatively inexpensive for foreigners, attracted by the favorable climate, tax incentives, and non-habitual resident programs such as the "golden visa" scheme for non-European buyers.

What we expect

Economic growth should decelerate to 1.8% this year and 1.6% next year, from 2.1% in 2018. Although we see the unemployment rate decreasing further, the pace of employment creation should continue to slow down. Also, Portuguese banks have tightened credit standards again in Q2 and Q3 this year to comply with macroprudential measures introduced by Banco de Portugal. This should further soften growth in new housing loans. Amid deteriorating affordability and despite low mortgage interest rates, we see local demand for housing easing. Owner-occupied foreign demand, however, should stay strong and support the residential property market. The number of completed dwellings is not keeping pace with demand, which should maintain the gap between supply and demand and hold up price growth over the next few years. There are important regional disparities in terms of prices: coastal areas, attracting the bulk of foreigners, are leading, followed by Lisbon. The city of Porto saw the strongest annual price increase last year (15.6%), and several other areas also outpaced the capital. Given the role of foreign demand on price growth, we expect these disparities to widen further. Stricter regulation for short-term rentals in Lisbon should dissuade potential investors from the buy-to-let market, which has surged over the past years, especially for short-term rentals.

Chart 7.1

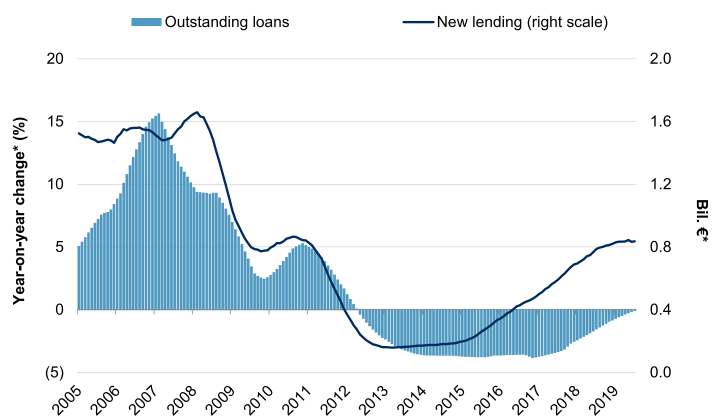
Construction Permits Issued Residential Buildings



Source: Statistics Portugal, S&P Global Ratings.

Chart 7.2

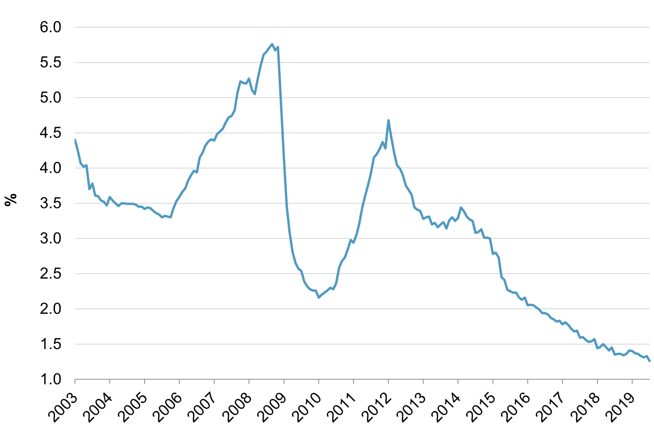
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 7.3

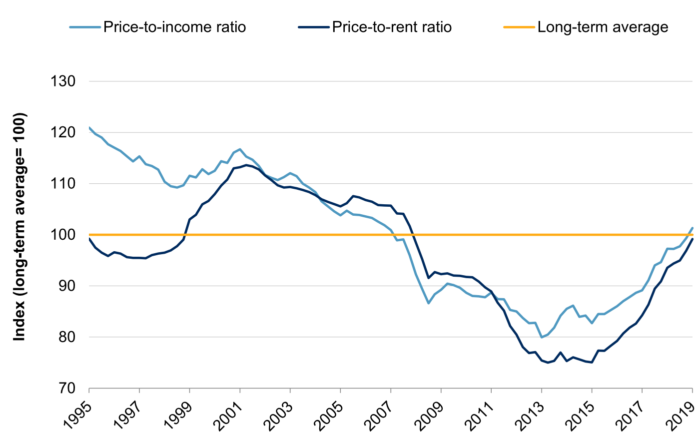
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 7.4

Price Ratios



Sources: OECD, ECB, S&P Global Ratings.

Spain: Price Inflation Slows Slightly As Affordability Worsens

Table 9

Spanish Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	4.5	7.2	6.7	5.5	4.4	3.9	3.3
Real GDP, % change	3.2	3.0	2.6	2.3	1.9	1.7	1.5
CPI inflation (%)	(0.3)	2.0	1.7	1.0	1.5	1.5	1.7
Unemployment rate	19.6	17.2	15.3	13.8	13.0	12.3	11.9

Y/Y--Year on year. CPI--Consumer price index. e--estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, Banco de Espana, OECD, Instituto Nacional de Estadistica (INE).

Resilient economic conditions and expansionary monetary policy should housing demand and prices, but worsening affordability will weigh. We therefore expect house-price inflation to decelerate to 5.5% this year and 4.4% in 2020.

State of play

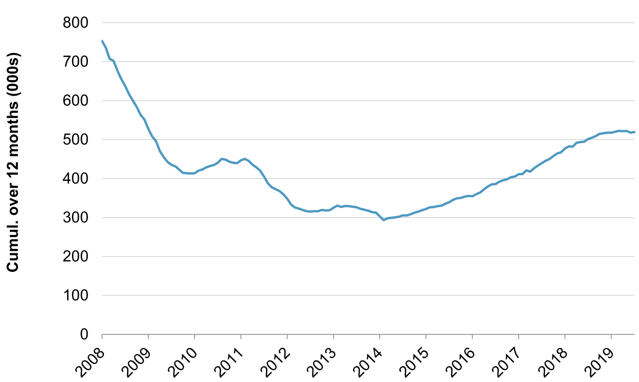
House prices increased by an annual 6.9% in Q1 this year, slightly higher than in 2018 (6.7%), but lower than in 2017 (7.3%). The Spanish economy is resisting the downturn in the eurozone, growing by an annual 2.3% in H1. The unemployment rate is back to late-2018 levels, employment growth is solid, and consumer confidence continues to support the housing market. Low mortgage rates helped further, averaging 2.1% in the first half of 2019, and 1.0% in real terms. This led to an overvaluation of house prices of 29% in terms of price-to-income ratio and 41% in price-to-rent ratio. However, due to the strong fall in prices following the housing crisis in 2008, affordability is still not overstretched on the national level, and both price-to-income and price-to-rent ratios remain 26% below their peak. Meanwhile, transactions continued to increase, but at a much lower rate. In the 12 months to May, they were up 5.3%, compared with 15.8% for the same month a year earlier. This shows that the oversupply in housing is disappearing and the housing market is becoming tighter. Important regional disparities persist: a square meter in Madrid costs more than three times that in Extremadura, a region that still posted negative house price growth in Q1. This compares to more than 8% annual growth in the capital's region or 6% in Catalonia.

What we expect

We forecast economic growth of 2.3% this year, decelerating to 1.9% in 2020. The labor market will continue to support house-price growth, although employment creation should slow. Despite investment construction at 11% of GDP (compared to 9.7% in 2013), solid demand should drive the oversupply in housing down and hold up price growth. Mortgage rates, having increased from 1.9% to 2.1% over the past year, should stabilize at historically low levels on the back of expansive monetary policy. We see inflation picking up next year, helping to keep real interest rates low and support demand for housing. We expect demand for housing to remain strong on the back of favorable economic conditions and low interest rates, but to soften as affordability worsens. As a result, house-price growth will remain strong but decelerate. The ECB's bank lending survey shows that, following increases in demand over more than five years, banks expect household demand for mortgages to remain stable in third-quarter 2019. What's more, banks expect to tighten their credit standards. Both factors should result into a deceleration of housing transactions and ultimately prices. The total volume of new loans is set to remain broadly stable, with the average value of mortgages increasing while their number decreases. Especially in metropolitan areas such as Madrid, new construction will not be enough for supply to catch up with demand. Consequently, housing shortages will worsen in these areas and price growth will remain above the national average. Worsening affordability and increasing mortgages will leave households in these areas particularly vulnerable once interest rates increase.

Chart 8.1

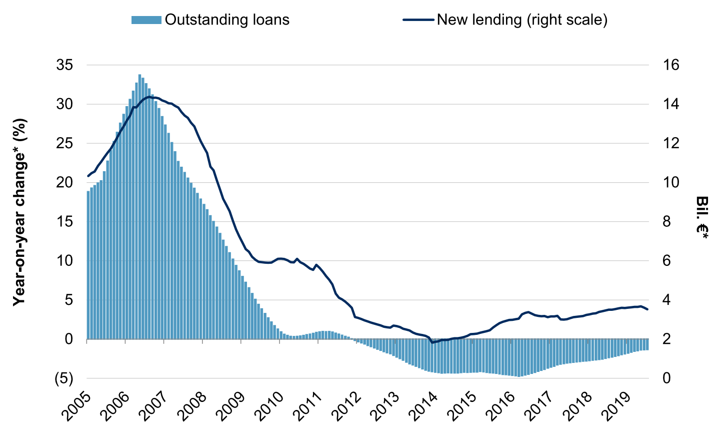
Total Transactions



Source: Instituto Nacional de Estadistica, S&P Global Ratings.

Chart 8.2

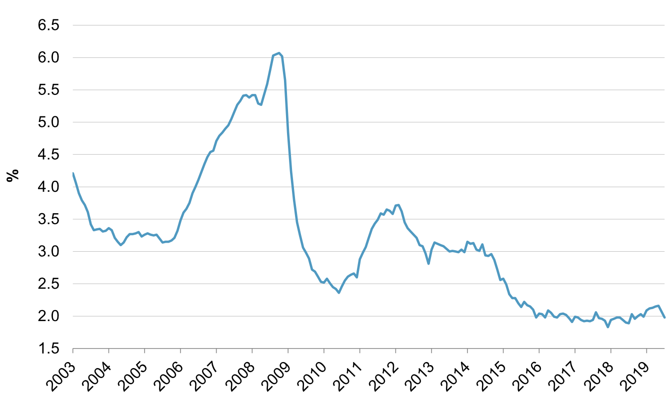
Housing Loans



*Based on 12-month moving average. Source: ECB, S&P Global Ratings.

Chart 8.3

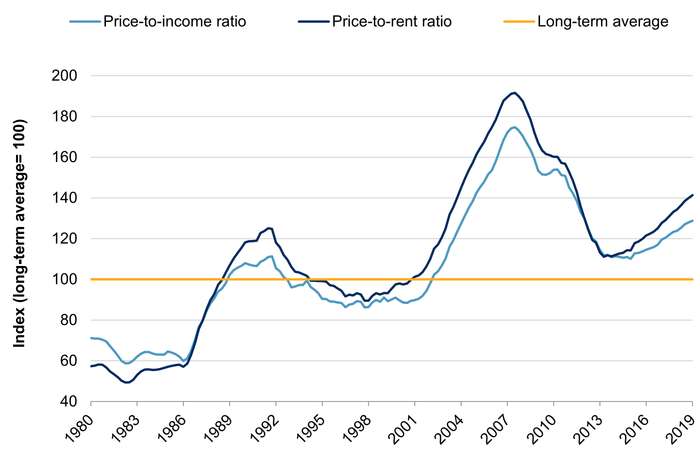
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 8.4

Price Ratios



Source: OECD, Banco de Espana, S&P Global Ratings.

Switzerland: Economy Provides Headwinds To Housing Market

Table 10

Swiss Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	0.4	4.0	3.4	3.0	2.4	2.2	2.0
Real GDP, % change	1.6	1.6	2.6	1.3	1.4	1.4	1.4
CPI inflation (%)	(0.4)	0.5	0.9	0.7	0.6	0.7	0.9
Unemployment rate	3.3	3.2	2.6	2.7	2.8	2.8	2.8

Y/Y--Year on year. CPI--Consumer price index. e--Estimate. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Department for Communities and Local Government, Wüest Partner.

Renewed dynamism in the housing market at the start of the year is likely to slow again in the face of economic slowdown. Yet, we expect price growth to decelerate only marginally to 3.0% this year from 3.4% in 2018, as the economy remains in full employment and investors search for yield in the Swiss rental market.

State of play

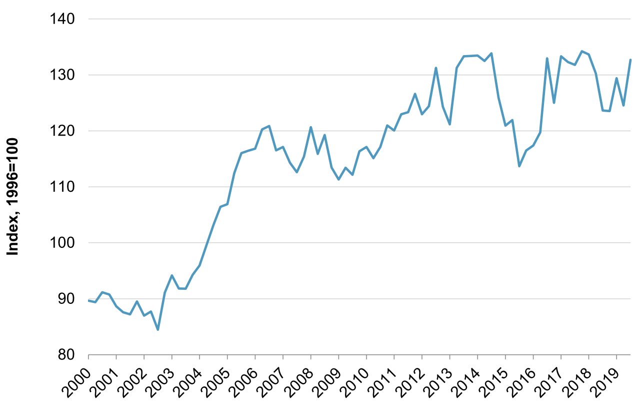
After a period of weakness in 2018, the Swiss housing market regained dynamism in the first half of this year. Prices were up by 4.4% annually in Q2, their fastest pace since 2012. This dynamism has translated into more robust residential construction activity, now almost back to its 2017 peak. Job creation has supported homeowners' income. At 2.3%, the unemployment rate is at its lowest since 2002. Low inflation has also contributed to consumers' rising purchasing power, while historically low interest rates are supporting affordability. Interest rates have decreased further to 1.35% for a 10-year fixed term in May, from 1.71% six months earlier. As a result, mortgage-lending growth accelerated to 2.8% year on year in the first half of this year. Meanwhile, as most Swiss do not own their homes, developments in the rental market are also key. Here demand has also picked up. With more government bond yields falling into negative territory, long-term investors are seeking higher returns in the housing market. The prime yield is close to 2% in the major Swiss cities, according to Wuest and Partner. As in many other European countries, housing prices have been more dynamic in larger agglomerations, linked to more employment and thus better demographic trends. Yet, market trends have differed between the big cities. Berne and Geneva experienced faster price rises than Zurich in 2018, reflecting already high prices in Zurich but also lower rental yields. With investors turning to housing for yields, the number of vacant units is still rising in the housing market, putting a cap on rents. This and an increased supply of flats likely contributed to falling prices in the owner-occupied apartment segments. Nonetheless, the house price-to-income and price-to-rent ratios are up more than 40% since 2001. As a result, household debt remains high, at 129% of GDP at the end of 2018, suggesting that macro prudential measures, such as the countercyclical capital buffer, will remain in place for now.

What we expect

The recent dynamism in the housing market is likely to lose some steam toward the end of the year as the economic slowdown provides some headwinds to activity. Employment expectations are already weakening on the back of slower economic growth. Nonetheless, households are more likely to see their income grow less quickly than drop, as the economy remains in full employment. Besides, in a context of uncertainty and renewed central bank loosening in Europe, bond yields will remain low in Switzerland, supporting investor demand for housing, while positive net migration continues to contribute to a rising population. Overall, we expect house prices to rise by 3% at the end of 2019 and gradually slow from there, as a high price-to-income ratio limits household affordability over the long term, even if interest rates remain low.

Chart 9.1

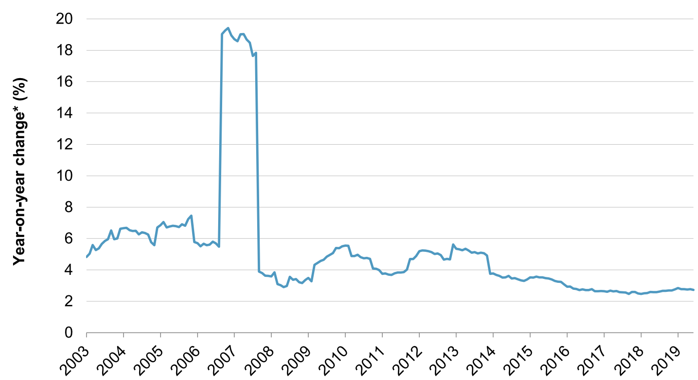
Housing Construction



Source: Credit Swiss, Swiss Contractor's Association, S&P Global Ratings.

Chart 9.2

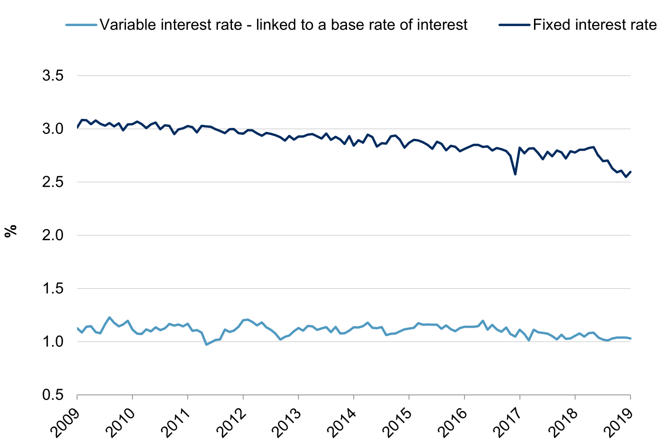
Housing Loans



*Based on 12-month moving average. Source: Swiss National Bank, S&P Global Ratings.

Chart 9.3

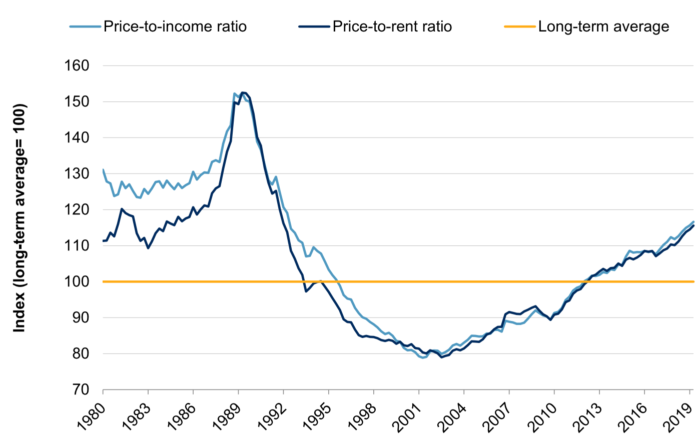
Average Interest Rates On Housing Loans



Source: Swiss National Bank, S&P Global Ratings.

Chart 9.4

Price Ratios



Sources: OECD, Swiss National Bank, S&P Global Ratings.

United Kingdom: London Drags On National House-Price Growth Amid Brexit Uncertainty

Table 11

U.K. Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f	2022f
Nominal house prices, % change y/y	5.3	4.6	2.4	0.0	1.5	3.5	4.0
Real GDP, % change	1.8	1.8	1.4	1.2	1.4	1.3	1.8
CPI inflation (%)	0.6	2.7	2.5	1.8	1.7	2.4	1.8
Unemployment rate	4.9	4.4	4.1	3.8	4.2	4.5	4.6

Sources: S&P, Eurostat, OECD, Department for Communities and Local Government, ONS.

Against the backdrop of Brexit uncertainty, we expect U.K. house-price growth to stall at the end of this year (0%), before recovering from 2020.

State of play

U.K. house prices in July were only 0.9% higher than a year earlier. The headline number, however, hides large regional differences. Many regions outside of London and the south east, especially where prices (in real terms) have yet to fully recover from the financial crisis in 2008, show ongoing improvement. It is London, where prices had long recovered, that is now dragging down the national average. With a price decline of 4.4% year on year in July, it is in particular the higher-priced segment that is suffering, as both domestic and foreign buyers and developers have become more cautious amid Brexit uncertainty. The poor price performance in London also continues to reflect the lasting impact of the less favorable fiscal treatment and tighter underwriting rules for the buy-to-let market since 2016, which is heavily focused on London. Despite the decline in London, affordability remains an issue, and prompts families to move further out, while young professionals are increasingly not even considering moving to central London as they did in the past.

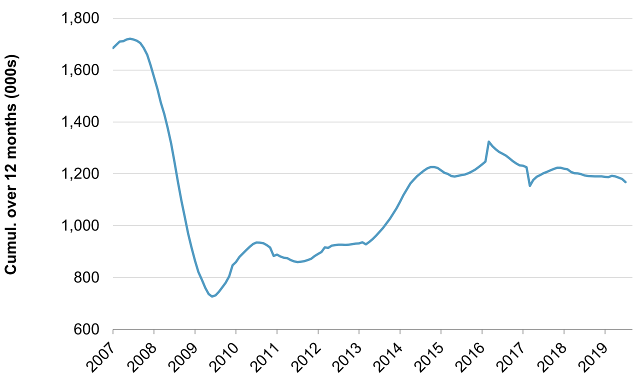
Homes are increasingly being sold at a discount from the asking price--a signal of a cooling market. Selling price expectations for the medium term have also softened recently. That said, we continue to see a series of factors that mitigate against a steep decline in house prices. While the supply of homes on the sales market is slowing, demand is holding up a little better, helped by still close to record-low mortgage rates, a robust labor market, and recently strong increases in real pay growth. In addition, despite substantially less net immigration in recent years, and increasing numbers of completed homes, supply continues to fall short of current demand.

What we expect

Not surprisingly, the future development of U.K. house prices depends to a large degree on an end to Brexit-related uncertainties and whether or not a Brexit deal is agreed. In the event of a deal, which we continue to assume in our central forecast, house prices should start to recover, although the pace of price growth may be gradual as the economy adjusts to its new business model after Brexit. In particular, household income growth, in real terms, should be positive, albeit moderately so, for several years. At the same time, borrowing conditions should remain relatively favorable. Mortgage rates especially should rise only very gradually, in line with the BoE's policy rate and added downward pressure from a highly competitive mortgage market. Shortage of supply will also remain an issue in the years to come. The outlook would change dramatically in the case of a disruptive no-deal Brexit which, in our view, could see U.K. house prices drop between 8% and 15% (from peak to trough), depending on the severity of the impact on the economy. That said, the reduction in residential construction activity that would accompany it would also translate into a further deterioration of supply for years to come.

Chart 10.1

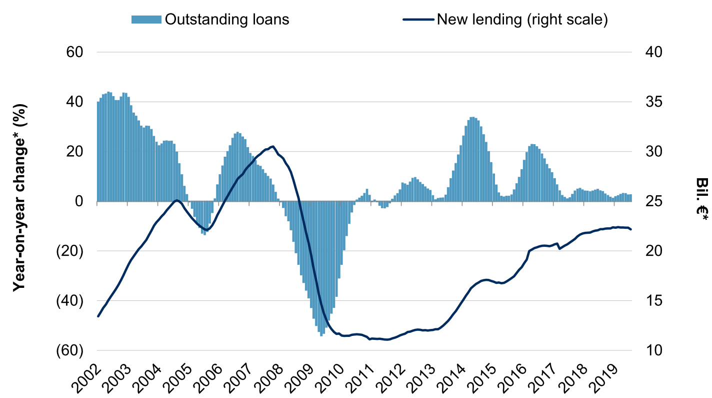
Residential Property Transactions Above £40,000



Source: HM Revenue & Customs, S&P Global Ratings.

Chart 10.2

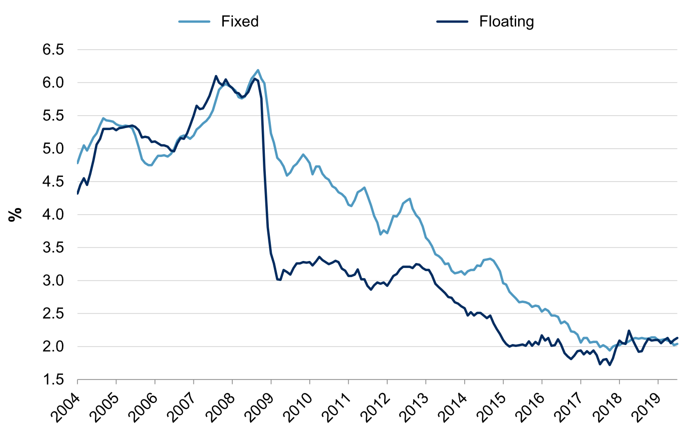
Housing Loans



*Based on 12-month moving average. Source: Bank of England, S&P Global Ratings.

Chart 10.3

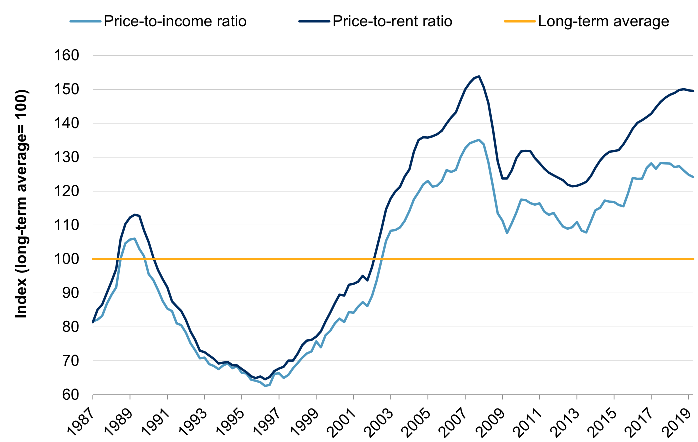
Mortgage Interest Rates On New Business - Banks



Source: Datastream, Bank of England, S&P Global Ratings.

Chart 10.4

Price Ratios



Sources: OECD, Department for Communities and Local Government, S&P Global Ratings.