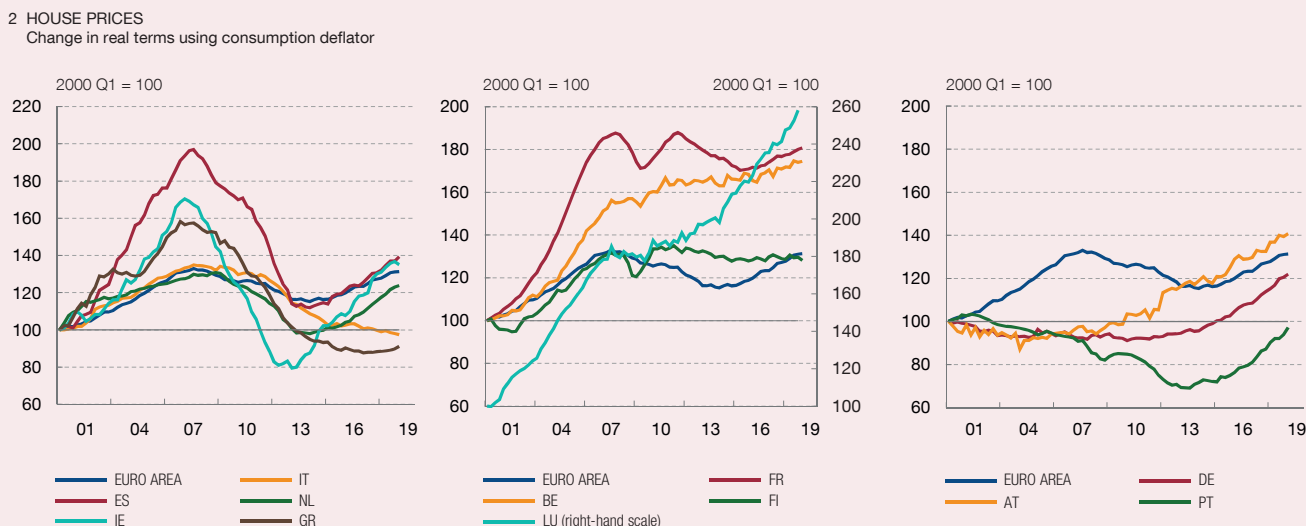
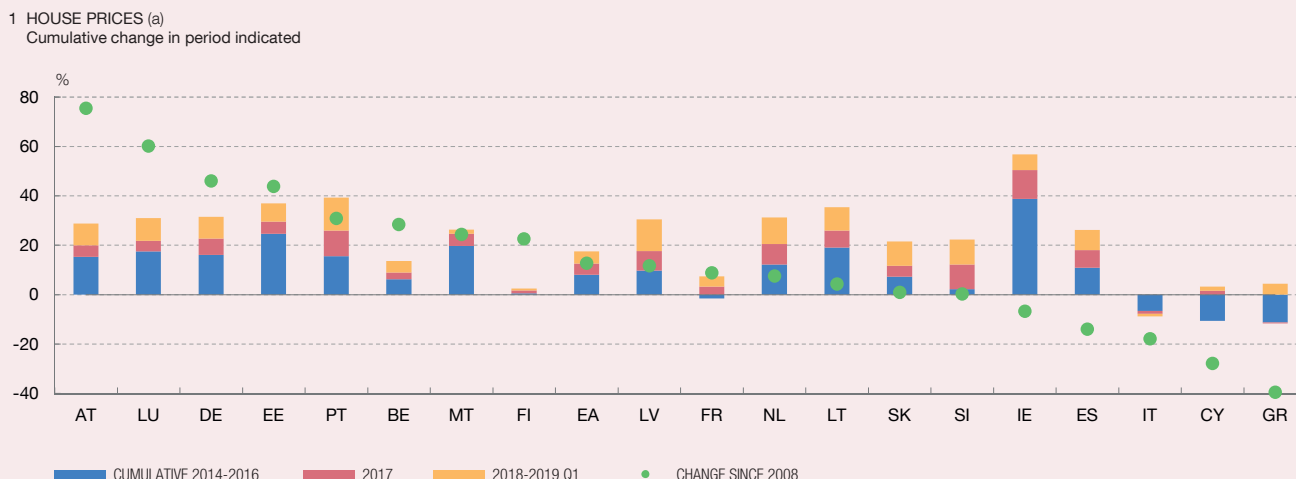


RECENT DEVELOPMENTS IN HOUSE PRICES IN EURO AREA COUNTRIES

Euro area real estate markets have performed strongly in recent years which, among other factors, has been reflected in significantly higher house prices. The improvement in economic activity and, particularly, in labour market conditions has driven demand for residential assets. Likewise, the setting of very low interest rates has

provided a further stimulus to housing demand as a consumer good - due to the improvement in affordability measures - and as an investment. Together with these demand factors, other supply or more structural factors, such as demographic ones, have also shaped the performance of house prices in certain countries.¹

Chart 1
APPRECIATION OF HOUSING IN THE EURO AREA



SOURCES: Bank for International Settlements, Eurostat and European Central Bank.

a Nominal data. Data referring to Luxembourg, Cyprus and Malta are until 2018 Q4.

1 See ECB (2018), "The state of the housing market in the euro area", Economic Bulletin, No. 7. For an analysis of the significance of structural and institutional factors in an international comparison, see N. Geng (2018), "Fundamental Drivers of House Prices in Advanced Economies". Working paper 18/164. International Monetary Fund.

RECENT DEVELOPMENTS IN HOUSE PRICES IN EURO AREA COUNTRIES (cont'd)

There are several reasons which make it advisable for economic policymakers to closely monitor real estate market dynamics. On one hand, the sector is highly significant for economic performance² and it may give rise to risks to financial stability. In the specific case of Spain, the Banco de España performs regular monitoring in its financial stability reports and, in particular, to determine the countercyclical capital buffer. On the other, the path of prices and housing affordability conditions may have important social implications. This box focuses on recent developments in house prices and in credit in euro area countries.

Housing has appreciated by more than 18% in nominal terms in the euro area since 2014, as shown by Chart 1.1. This upward trend has been widespread, except for in Italy, Greece and Cyprus. In several euro area economies (such as Luxembourg, Austria and Belgium) prices have reached levels which are clearly higher than those before the crisis of 2008.

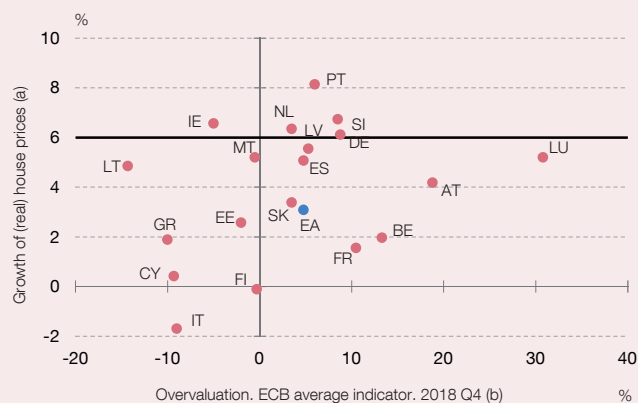
More recent data, however, point to a slight slowdown. House prices in the euro area grew by 4% year-on-year in 2019 Q1, compared with an average year-on-year rate of

4.8% in 2018. Nevertheless, house price growth remains robust in many countries and Italy is the only euro area member to post year-on-year declines in residential real estate values in the first quarter (0.8%). Thus, in the first quarter house prices increased by 9% year-on-year in Portugal, by 8% in the Netherlands and Slovenia, and by around 7% in Germany and Spain. They were clearly slowing down in some economies, such as Ireland and Austria, where the year-on-year increase stood at approximately 4% in the first quarter, following average gains of 10% and 7% during 2018. In terms of the average of the last four quarters, Germany, the Netherlands, Portugal, Ireland and Slovenia exceeded year-on-year growth of 6% in real terms, which is the threshold used by the European Commission as an alert mechanism for examining the presence and gravity of imbalances in the real estate market (see Chart 2.1).³

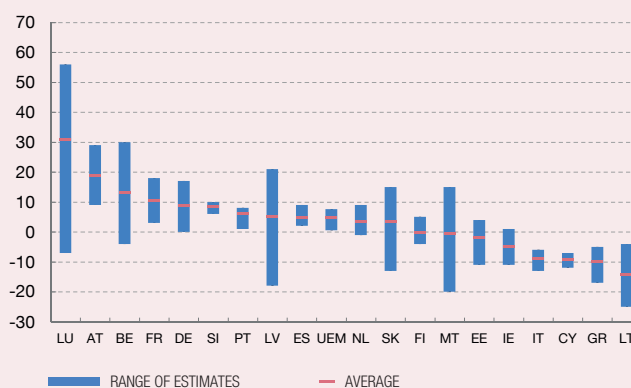
Considering a longer time frame, clearly different situations can be seen across countries. For instance, in Italy, Spain, the Netherlands, Ireland and Greece house prices fell sharply during the crisis, by more than 40% in real terms in certain

Chart 2
HOUSE PRICES AND VALUATION METRICS

1 GROWTH OF REAL HOUSE PRICES AND VALUATION



2 ECB METRICS ON THE DEGREE OF HOUSING OVERVALUATION. 2018 Q4 (a)



SOURCE: European Central Bank.

a The average of the year-on-year rates of the last four quarters available is considered.
 b Estimates from four methods, two of them are based on the price-rent ratio and the price-income ratio. See, ECB (2011), "Tools for detecting a possible misalignment of residential property prices from fundamentals", Financial Stability Review, Box 3, June; and ECB (2015), "A model-based valuation metric for residential property markets", Financial Stability Review, Box 3, November. The data for Belgium and Cyprus relate to 2018 Q3.

2 In the euro area, residential investment has accounted for almost 6% of GDP and 27% of gross fixed capital formation in terms of the historical mean since 2000. These ratios were somewhat lower in 2018. Furthermore, housing is also an important determinant of consumption via wealth effects and as loan collateral.

3 See European Commission (2018), *Alert Mechanism Report 2019*, November 2018.

RECENT DEVELOPMENTS IN HOUSE PRICES IN EURO AREA COUNTRIES (cont'd)

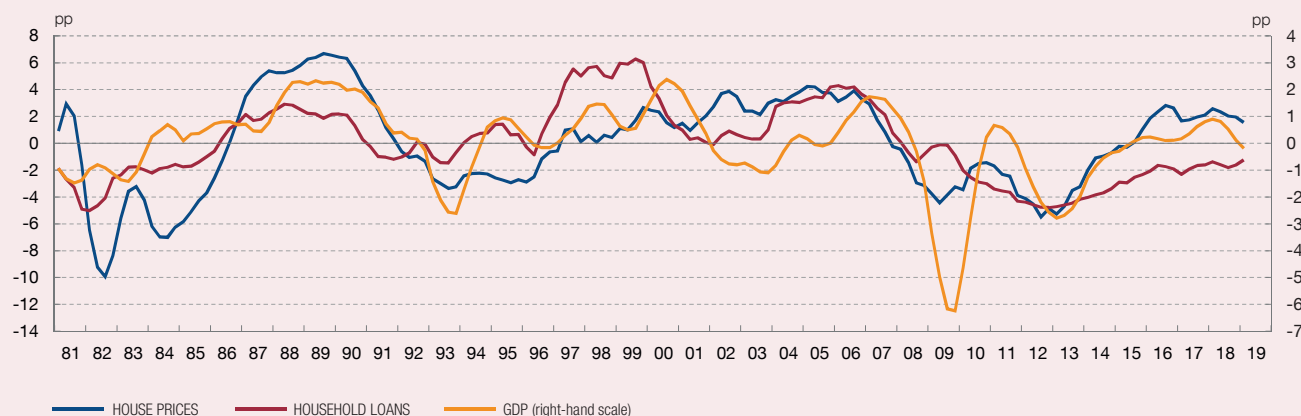
cases (see Chart 1.2). After this adjustment, prices levels tended to stabilise in Greece and Italy, whereas in Spain, the Netherlands and Ireland they once again followed an upward path, which was particularly steep in Ireland. In the second group of economies, which includes France, Belgium and Luxembourg, house prices corrected more moderately during the crisis even though they appreciated considerably before 2008. As a result, prices have reached very high levels

in some of these countries. Lastly, there is a third group of economies, which includes Germany, Austria and Portugal, where the appreciation of housing since 2014 was not preceded by strong pre-crisis price increases.

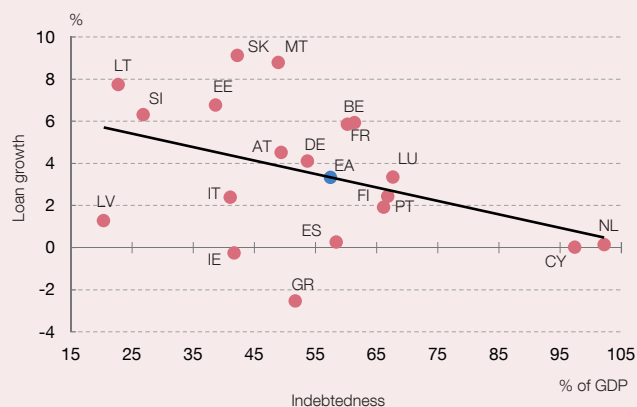
According to the various analyses available, house prices in some countries are showing signs of being overvalued with respect to their equilibrium levels.⁴ In the case of

Chart 3
HOUSE PRICES AND CREDIT GROWTH IN EURO AREA COUNTRIES

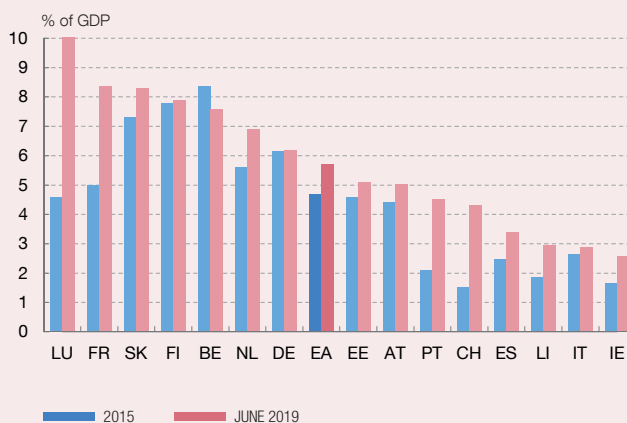
1 GDP, HOUSE PRICES AND LOANS IN REAL TERMS (a)
Year-on-year growth in deviations from historical average



2 INDEBTEDNESS AND HOUSEHOLD LOANS (b)



3 NEW LOANS FOR HOUSE PURCHASE
Excluding renegotiated loans. Cumulative twelve-months (c)



SOURCES: Eurostat and European Central Bank.

- a Expressed in real terms by using consumption deflator for household loans and house prices.
- b Data referring to 2019 Q1. Loan growth expressed in terms of year-on-year rate of change.
- c Renegotiated loans are excluded because they do not involve additional contributions of funds.

4 For a description of the various methodologies, see ECB (2011), “Tools for detecting a possible misalignment of residential property prices from fundamentals”, *Financial Stability Review*, June; and ECB (2015), “A model-based valuation metric for residential property markets”, *Financial Stability Review*, November.

RECENT DEVELOPMENTS IN HOUSE PRICES IN EURO AREA COUNTRIES (cont'd)

Spain, the Banco de España's estimates indicate that average house prices are not far off their equilibrium value.⁵ Assessing the level of house prices with respect to their fundamentals, their equilibrium levels or certain historical benchmarks is surrounded by major uncertainty, as shown by the different results of the various methodological approaches (see Chart 2.2). Furthermore, national estimates may conceal contrasting situations in regional or local housing markets.⁶ This type of indicators, as part of a broader analysis which also included an analysis of developments in lending, in 2016 led the European Systemic Risk Board (ESRB) to issue warnings on medium-term vulnerabilities in the residential real estate sector in eight EU countries,⁷ including Austria, Belgium, Luxembourg, Finland and the Netherlands in the euro area.

A characteristic of the current expansionary cycle of house prices and of economic activity in the euro area is that it has been accompanied by more moderate growth of mortgage lending than that suggested by past historical patterns (see Chart 3.1). Despite the setting of historically low interest rates, the deleveraging process in certain

countries is constraining the increase in the stock of credit (see Chart 3.2). Specifically, insofar as developments in this variable are determined by new loans and by repayments, a high volume of repayments could be masking the vigour of new loans. In fact, if the volume of new loans for house purchase is considered in isolation, it can be seen that loan origination has been more buoyant across the board since 2015 (see Chart 3.3). However, in more highly indebted countries or in those which have recently undergone deleveraging processes such as the Netherlands, Cyprus, Spain, Ireland and Portugal, the increase in new loans has not resulted in a significant rise in the aggregate stock of debt in the sector.

In short, the real estate market in the euro area is performing strongly with sustained price rises in numerous countries. These developments justify, particularly in the current low interest rate setting, authorities having to monitor the performance of the residential property market, given its close ties to the economic cycle and the credit cycle, and its social implications. This has already led to several countries applying macroprudential measures.⁸

5 See the *Financial Stability Report*, Spring 2019. See specifically Chart 1.4.B.

6 See ECB (2017), "Residential real estate prices in capital cities: a review of trend", Box 3. *Financial Stability Review*, May

7 See ERSB (2016), "Vulnerabilities in the EU residential real estate sector", November.

8 See ERSB (2019), "A review of Macroprudential Policy in the EU in 2018", April.