S&P Global
Ratings

Europe's Housing Markets Are Staging A Soft Landing

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Key Takeaways

- **Monetary conditions** in the eurozone, Switzerland, and the U.K. will stay generally favorable for house buyers, as interest rates should creep up only very gradually over the next few years, from very low levels.
- **Belgium:** Low affordability and increasing mortgage rates could start to weigh on demand, after expected house price rises by 3.4% this year.
- **France:** House price rises should ease to 2.7% this year, while from next year monetary policy tightening and deteriorating affordability suggest a soft landing.
- **Germany:** Gradually improving housing supply and slowing net immigration will ease house price inflation to 4% this year.
- **Ireland:** House prices are set to grow a rapid 9.5% this year and 8.0% in 2019, while housing supply catches up with demand, and the labor market tightens even further.
- **Italy:** With the economic recovery at an early stage and unemployment still high, house prices should remain close to stable this year and only increase moderately in the next few years.
- **The Netherlands:** Supply shortages and a rapid pace of economic growth will continue to fuel a strong rise in house prices of 8.3% this year.
- **Portugal:** Strong domestic and foreign demand, as well as tight supply, should underpin 9.5% house price rises this year.
- **Spain:** Strong economic conditions should continue to support the ongoing housing market recovery, with prices growing at an annual rate of 5.6% this year.
- **Switzerland:** Regulatory measures, low affordability, and slowing net migration are keeping a lid on house prices. We expect prices to gain 1.8% this year and next.
- **U.K.:** A more adverse environment for the buy-to-let sector as well as Brexit uncertainties are contributing to a slowdown in U.K. house price growth, with prices stagnating this year and dynamics remaining softer in the coming few years.

Table 1

European Housing Market Forecasts

Nominal house prices, % change year on year	2016	2017	2018f	2019f	2020f	2021f
Belgium	2.5	3.6	3.4	2.8	2.3	2.0
France	1.6	3.3	2.7	2.0	2.0	2.0
Germany	6.8	4.5	4.0	3.5	3.0	3.0
Ireland	8.6	11.9	9.5	8.0	7.0	6.0
Italy	-0.3	-0.3	0.2	1.3	1.8	2.0
Netherlands	6.7	8.5	8.3	7.0	5.3	4.0
Portugal	7.7	10.5	9.5	7.0	6.0	5.0
Spain	4.5	7.3	5.6	4.3	3.5	3.0
Switzerland	0.4	4.0	1.8	1.8	2.1	2.0
United Kingdom	5.3	4.7	0.0	2.5	3.5	4.5

Data as of 24 Aug. 2018. f--Forecast. Sources: S&P Global Ratings, OECD, Hypoport, Wüest Partner.

Monetary Policy Outlook

European Central Bank: Heading Towards A First Rate Hike In H2 2019

In June, the ECB announced it will stop buying additional assets at the end of December 2018, paving the way for future rate hikes. The eurozone economic expansion decelerated at the start of the year, but this was linked more to some temporary factors and a pull-back from very high rates of growth rather than internal weakness. Domestic fundamentals remain strong, with a tightening labor market improving households' prospects and companies raising investment on the back of strong aggregate demand. Nonetheless, the earlier-than-expected deceleration in growth also suggests that the economy is running into capacity constraints, with labor shortage increasingly cited as a factor limiting production. The good news for the ECB is that price pressures are building as a result, with underlying price developments and expectations trending upwards, closer to the ECB's target of close to, but below 2%. Importantly, the latest projections released by the central bank point to a faster rise in inflation than six months ago, with annual headline inflation at 1.7% in 2018, 2019, and 2020. In the short term, some of the rise in inflation is linked to higher oil prices and a weaker euro, but by 2020 the ECB sees core inflation reaching 1.9%, in line with its target. As the minutes of the June meeting show, this underpins the central bank's increased confidence that the time is almost ripe for a first rate increase. So far, ECB President Mario Draghi has communicated that rates will stay at their current levels "through the summer 2019". We expect the first rate hike in Q3 2019 and a very gradual increase in its policy rate from then on. While the ECB will end net asset purchases by the end of this year, it will still reinvest maturing securities, we think at least until the end of 2020. As always, ECB messaging will be cautious and balanced so as not to confuse market expectations. For the eurozone housing markets this means buyers and sellers are more likely to anticipate a rise in borrowing costs, albeit a very gradual one.

The Bank of England: August Hike Is One And Done

The BoE adopted a more hawkish stance earlier in the year, judging that the U.K. economy was operating closer to potential than it had previously been estimating. But it then postponed the hike it had signaled for May, in view of weaker-than-expected economic performance. The fact that some of the growth momentum had reaffirmed itself by the time of the August inflation report helped support the 25-basis-point hike of the base rate--to now 0.75%--that accompanied it. But the overall mixed data that had emerged since the May meeting made it difficult, in our view, to convincingly justify the hike. Inflation especially continues to surprise on the downside, with a fall in core inflation offsetting higher energy components. Wage growth is also accelerating far less than it should given the record low unemployment rate. At the same time, the data were also not bad enough to justify yet another postponement, and the BoE still expects slack in the economy to reduce and wage growth to pick up. In our view, the BoE took the opportunity to hike, not least to address the recent reputational issue of signaling a hike but then not following through, but also to build up ammunition for loosening policy again should the Brexit process derail. With a Brexit deal likely emerging only very late this year, if at all, we don't expect any further hike this year, due to heightened uncertainty, and only very gradual tightening from 2019. As a result, monetary policy remains supportive for the housing market. Borrowing costs are set to rise, but from extremely low levels and at a very moderate pace.

Swiss National Bank: Unlikely To Move Before The ECB

The economic outlook for the Swiss economy has remained strong throughout the year, with business climate indicators still elevated and capacity utilization increasing, in spite of the economic slowdown in the rest of the euro area. The weak Swiss franc, at around 1.16 per euro since the beginning of this year, has further boosted exports and helped lift inflation to 1.1% annually in June, along with rising energy prices. That said, as underlying price pressures remain low, the SNB decreased its inflation forecast for 2020 to 1.6% from 1.9% in June. A dovish ECB also means that the franc is likely to depreciate less than originally anticipated by the SNB, thus providing less inflationary pressure. What's more, recent uncertainties surrounding Italy and Turkey have also provided some upward pressure on the Swiss franc. Against this backdrop, the central bank will remain keen to maintain an accommodative stance so as to provide support to the economic recovery and make sure inflation expectations remain well anchored. We do not anticipate any change in its policy rate in the next six quarters, and believe the first rate hike will come at the same time as the ECB in Q3 2019. Thus, housing investors in Switzerland are unlikely to anticipate a rise in borrowing costs too soon, even more so because it will take time for the central bank to move rates into positive territory.

Belgium: Affordability Pressures Could Weigh On Housing Demand

Table 2

Belgian Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	2.5	3.6	3.4	2.8	2.3	2.0
Real GDP, % change	1.4	1.7	1.6	1.6	1.4	1.3
CPI inflation (%)	1.8	2.2	2.1	2.1	1.9	1.6
Unemployment rate	7.8	7.1	6.2	6.2	5.9	5.8

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

We expect house prices in Belgium to increase by 3.4% this year and 2.8% in 2019, thus gradually slowing down from 3.6% last year. The solid economic recovery and improving labor market will continue to translate into higher household disposable income and sustained demand for housing. However, overvaluation of residential property and increasing mortgage rates are likely to weigh on demand.

Recent Trends

House price growth accelerated again last year, rising by 3.6% over the year compared to 2.6% in 2016. Price growth remained strong at an annual 3.4% in the first quarter of this year. This continued to drive overvaluation of house prices, which reached close to 50% in terms of price-to-rent and 40% in terms of price-to-income ratios. As Belgium’s house prices have barely declined following the financial crisis, overvaluation is high compared to its eurozone peers, despite relatively slower house price growth over the past few years.

Faster house price growth comes hand in hand with the country’s economic recovery. Economic growth accelerated to 1.7% last year. This and a series of labor market reforms have led to the unemployment rate declining to 7.1% last year, down from 8.5% in 2015. This has given a boost to households’ disposable income, supporting demand for housing.

Meanwhile, in the context of accommodative monetary policy, mortgage rates in Belgium have decreased since 2014, reaching a historical low of 1.91% in June this year. Low borrowing costs have fueled housing demand because they increase households’ borrowing capacity, thus also fueling price growth.

However, high prices seem to have started to weigh on housing affordability. The volume of new housing loans in the 12 months to March started to decline for the first time since 2013. Housing transactions are following the same trend: they started to decelerate in the second quarter of last year, and posted annual growth of 1.7% in the first quarter of this year, compared to the peak of 13.6% in March 2017. These might be first signs of a slowdown translating into a deceleration of house price growth.

Future Trends

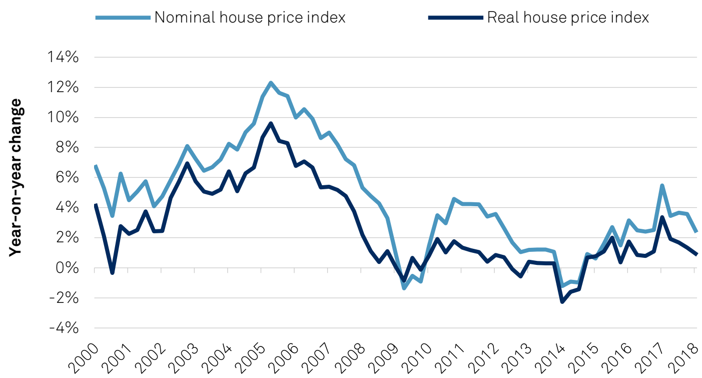
We expect the Belgian economy to grow by 1.6% this year and next. Labor market reforms and a dynamic economy will continue to translate into strong job creation. The unemployment rate should decline further to 6.2%. Higher household income will in turn support demand for housing.

We see high housing prices as the main factor weighing on demand in the Belgian housing market going forward. High house prices compared to rent and income are weighing on housing affordability. The latter is also set to deteriorate further, as mortgage interest rates will rise on the back of monetary tightening by the ECB.

Household debt compared to disposable income is much higher than most other eurozone countries. We expect macro prudential measures addressing high household debt to reduce households' borrowing capacity. On top of low affordability, this should weigh on housing demand going forward and thus mean lower upward price pressures.

Chart 1.1

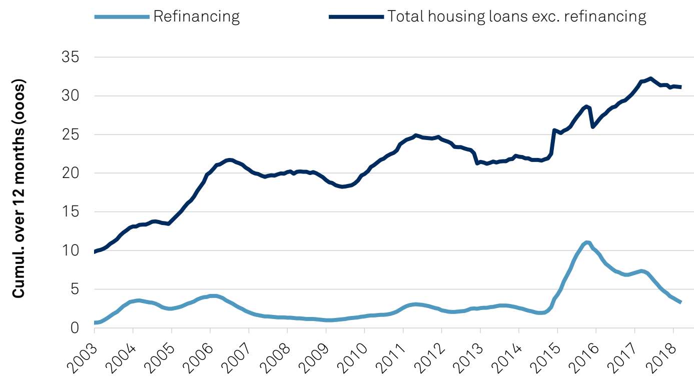
House Price Indices



Source: OECD.

Chart 1.2

New Housing Loans



Source: Statistics Belgium.

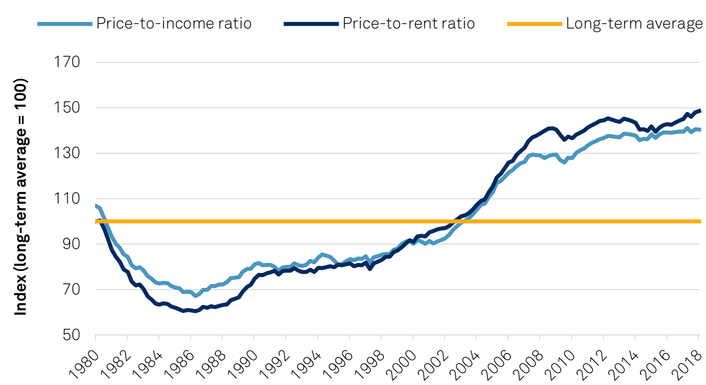
Chart 1.3

Average Interest Rate On New Housing Loans

Source: ECB.

Chart 1.4

Price Ratios



Source: OECD, National Bank of Belgium.

France: Prices Are Moderating After A Record-Breaking 2017

Table 3

French Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	1.6	3.3	2.7	2.0	2.0	2.0
Real GDP, % change	1.1	2.3	1.6	1.7	1.6	1.6
CPI inflation (%)	0.3	1.2	1.8	1.4	1.6	1.7
Unemployment rate	10.0	9.4	9.0	8.5	8.2	8.0

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

We expect house prices in France to increase by 2.7% this year, and 2.0% in 2019, as households continue to benefit from low interest rates and a resilient economy that is driving strong job creation. Monetary policy tightening from next year and a high price-to-income ratio will, however, limit any sharp gains in property prices.

Recent trends

On the face of it, the French housing market continued to perform well at the start of 2018, with housing prices rising further by 3.5% year on year in Q1, up from 3.3% in Q4. Persistently low interest rates and a tighter labor market have supported the recovery of the real estate market since 2015. Dynamic activity in and around the capital, as well as among first-time buyers, boosted the housing market recovery. However, this masks an initial slowdown in activity. Transactions decelerated by 1% between the January peak and April 2018. Most new-home sales were down by 5% year on year in Q1 2018, with the slowdown most marked in the high-priced Ile-de-France. The deceleration is also visible in lending activity, with new loans for housing purchases on a downward trend since the beginning of 2017 (down by 42% year on year in May), pointing to less dynamic housing demand. There are some signs that the supply-side has also started to adjust to this new trend, with housing starts and permits coming down from their end 2017 highs.

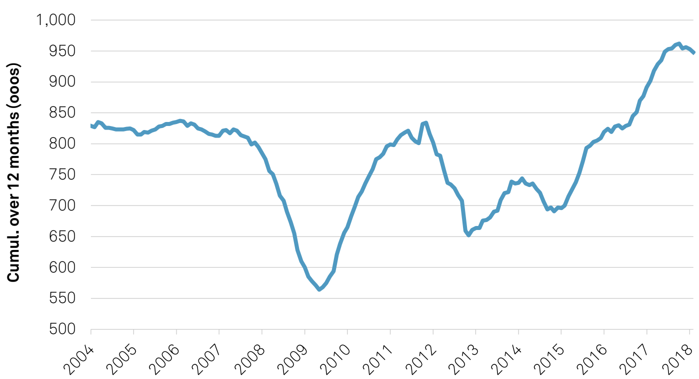
The slowdown in activity can partly be explained by fiscal incentives in place until the end of 2017, which boosted buy-to-let lending growth disproportionately. Part of the Q1 slowdown is thus just offsetting this distortion. More importantly, the macroeconomic backdrop has been less favorable for households at the start of the year. Employment growth slowed in Q1 as GDP growth experienced a soft patch. Meanwhile, higher energy, food, and tobacco prices have lifted inflation above 2% in France for the first time since 2012, weighing on household real disposable income and confidence, and thus their propensity to buy residential property. The booming market’s effect on household debt continues to be on the central bank’s watch list. Household debt has trended higher to reach 58% of GDP at the end of 2017. That said, to offset higher house prices, households have resorted to longer maturity.

Future trends

The moderation visible across the board in the French housing market suggests that a soft landing is now taking place. An elevated price-to-income ratio, still 22% above its long-term average, highlights that affordability has deteriorated for first-time buyers, who were among the big drivers of activity in 2017. A lower number of transactions and less dynamic credit growth for house purchases should translate into a slowdown in price growth this year. That said, we don't expect a sharp slowdown in the housing market, as a number of positive factors remain in place. As such, we expect a rebound in economic growth in the second half of this year, which should translate into a more dynamic labor market. Meanwhile, interest rates will remain low around their current level of 1.6% at least until mid-2019, as the ECB is not expected to raise its policy rate before Q3 2019. Beyond that, we expect rate increases to be very gradual too, preventing a sharp rise of borrowing costs to households.

Chart 2.1

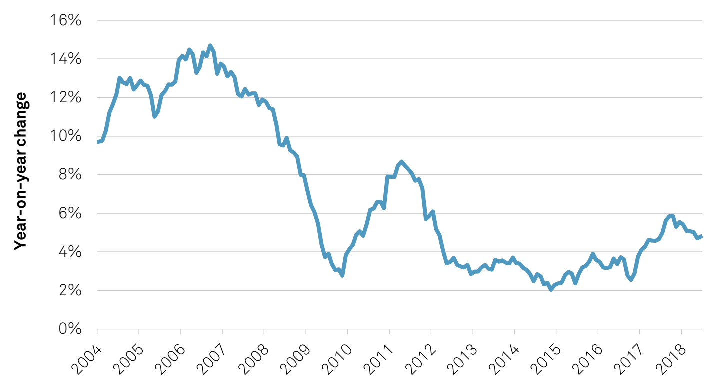
Total Home Sales



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

Chart 2.2

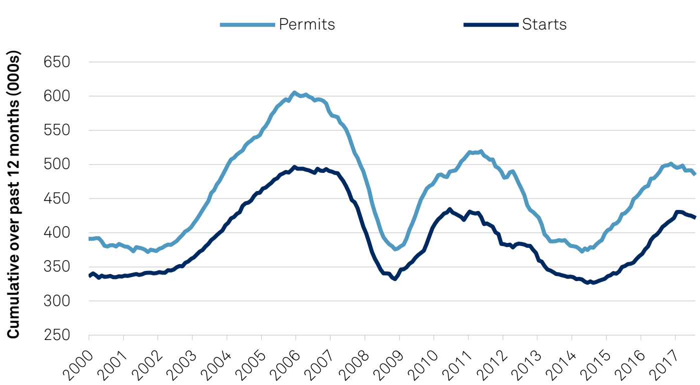
Housing Loans



Source: Banque de France.

Chart 2.3

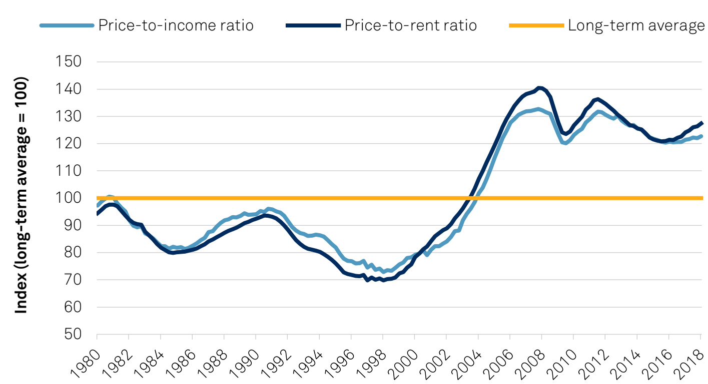
Residential Buildings Construction Permits And Starts



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

Chart 2.4

Price Ratios



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

Germany: House Price Inflation Moderates As Supply Gradually Improves

Table 4

German Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	6.8	4.5	4.0	3.5	3.0	3.0
Real GDP, % change	1.9	2.5	2.0	1.8	1.5	1.3
CPI inflation (%)	0.4	1.7	2.0	1.9	1.9	2.0
Unemployment rate	4.2	3.7	3.4	3.0	2.9	2.8

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

We expect residential property prices in Germany to increase by 4.0% this year, and 3.5% in 2019. The economic environment should remain supportive to house price growth, especially record low unemployment, but slowing net migration and rising housing supply should moderate these increases in the next few years.

Recent Trends

On the national level, house price growth eased to 4.5% last year, after it had accelerated to 6.8% in 2016. In the seven biggest cities, however, it's been a different story: although inflation eased there as well, it remained elevated at 9.4% last year, compared with 10.9% in 2016, raising concerns about affordability.

Earlier home price inflation was stoked by supply shortages. The number of new homes to come on the market is improving, up to 245,000 units in 2017, from 236,000 in 2016, but is currently still falling short of the estimated 350,000 units needed each year.

Meanwhile, demand for homes remains solid, fueled by strong economic growth and in particular a buoyant labor market. The unemployment rate fell to a historical low of 3.4% this April, while the share of underemployed workers declined further. Household incomes are improving on the back of the labor market's strength and rising wages.

Future trends

We expect the German economy to grow by 2.0% this year and 1.8% in 2019, driven largely by domestic demand (net exports will play less of a role). The favorable economic environment, especially record low unemployment rates, which should translate into higher wages already from this year, should underpin house price growth over the forecast horizon.

Financing conditions should also remain favorable. In June, mortgage rates stood at 1.9% (only slightly up from their lowest point of 1.6% at the end of 2016). Given the moderate pace of monetary policy tightening by the ECB that we expect to begin only in 2019, mortgage rates should stay relatively low over the forecast horizon.

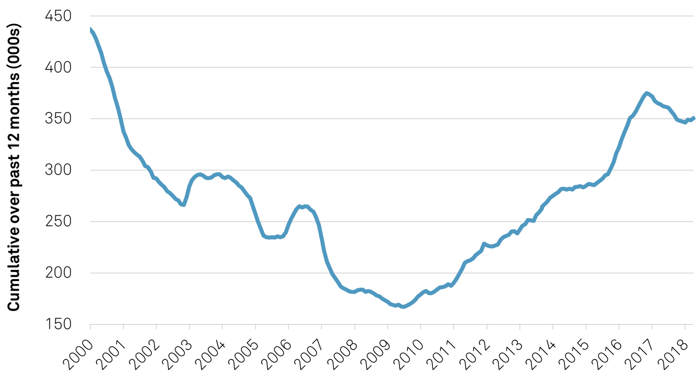
However, there are a few factors that should moderate increases in house prices in the next few years. Supply of new homes should improve further. This is supported by the fact that construction permits issued so far this year are broadly on track to meet housing needs. But as it takes time to build, and the construction sector is struggling with capacity constraints, especially to find skilled workers, improvement of supply will be gradual, translating into only moderate downward pressures on house prices.

Deteriorating affordability, especially in city centers, will also dampen national price dynamics, although price growth could accelerate in some sought-after suburbs as a result.

Unexpectedly high net immigration in the past has contributed to pressures on the housing market. The Bundesbank attributes the recently higher numbers partly to temporarily higher inflows from central and eastern European EU countries following the Brexit vote in the U.K., a destination which may have become less attractive as result. But the Bundesbank estimates that, following net migration of 500,000 in 2017, numbers will slow to 400,000 on average per year over 2018-2020, easing pressures and contributing to house price moderation.

Chart 3.1

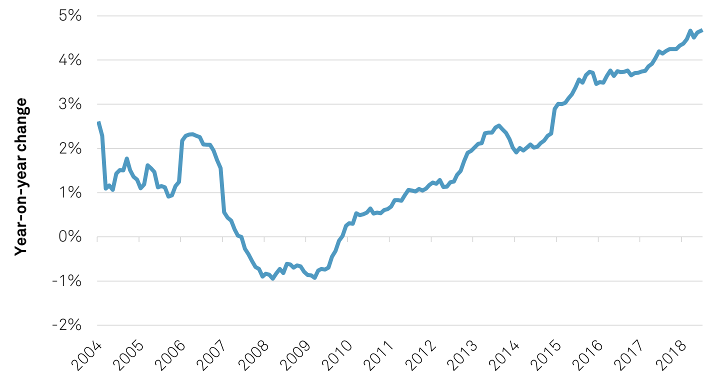
Residential Construction Permits



Source: OECD.

Chart 3.2

Housing Loans



Source: ECB.

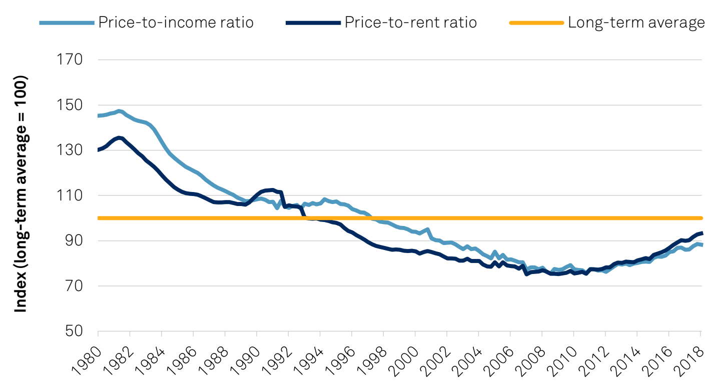
Chart 3.3

Average Interest Rate On New Housing Loans

Source: ECB.

Chart 3.4

Price Ratios



Source: OECD, Deutsche Bundesbank.

Ireland: Supply Constraints And Tight Labor Market Fuel House Price Growth

Table 5

Irish Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	8.6	11.9	9.5	8.0	7.0	6.0
Real GDP, % change	5.1	7.8	4.5	3.8	3.0	3.0
CPI inflation (%)	-0.2	0.3	1.0	1.4	1.6	1.8
Unemployment rate	8.4	6.7	5.6	4.7	4.5	4.5

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

House prices are set to grow rapidly by 9.5% this year and 8.0% in 2019, while supply catches up with demand, and the labor market tightens even further.

Recent trends

House prices have continued to increase at double-digit rates in 2018 so far. In June, they were up 12% on a year earlier. The strength of the economy remains a key supporting factor. Employment continues to grow at healthy rates and, in Q1 this year, surpassed pre-crisis peaks. In the 12 months to July 2018 alone, the unemployment rate fell a sizable 1.6 percentage points to 5.1%. This Labor market tightness is putting upward pressure on wages. At the same time, in July CPI inflation ran at a modest 0.4%, largely still due to the earlier depreciation of U.K. sterling against the euro, which, in turn, is increasing purchasing power of households.

Net mortgage lending, in value terms, continues to hover around the lowest levels since the financial crisis. Yet, this hides the fact that banks are increasingly lending again, with new loan values up 33% on a year earlier in the first half of 2017. The Central Bank has warned that this could pose risks in the future.

Increased activity by institutional investors, both domestic and international, has also underpinned house price growth. In 2017, almost one-fifth of all residential property transactions were by institutional investors, including small-scale buy-to-let buyers.

Future trends

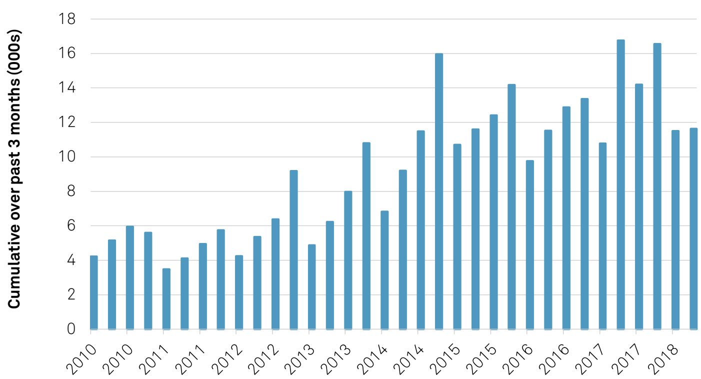
Ongoing supply shortages will continue to be a factor underpinning house price inflation. The home building sector all but vanished in the aftermath of the financial crisis. Legacy capacity constraints, in terms of investment and staff, continue to restrict how many homes can be built, even as the sector is now seeing a rapid recovery. But this comes from such low levels that even if house completions were to continue to grow at their extraordinarily strong current rates--of 30% annually in the first half of this year or an annualized 7,950 units--it would still take until early 2021 for supply to meet demand (estimated at 35,000 units per year). Nevertheless, as supply improves, excessive pressure on house prices should gradually subside.

Although we expect the economy to slow over the forecast horizon as it reaches the end of the recovery cycle, we forecast that it will continue to grow at relatively solid rates. This will also show in the labor market. Given the lack of construction workers, the sector is already now recruiting largely from abroad. Moreover, as a number of multinational companies expand their Ireland operations and increase staff, the economy as a whole, but especially Dublin, will see continued job creation, upward pressure on wages, and, hence, on house prices. This includes the effect of some financial services activity relocation from London to Dublin.

Our forecast is subject to considerable downside risks from a disruptive Brexit in March 2019, that is, a U.K. departure from the EU without a deal. This would in particular affect the significant cross-border trade in both goods and services with Northern Ireland and hence the economy as a whole. Given supply shortages, house price growth would likely only slow, but not turn negative, in the event of such a downside. The increased activity of foreign investors in the housing market would also likely mitigate the impact of reduced activity from U.K. investors.

Chart 4.1

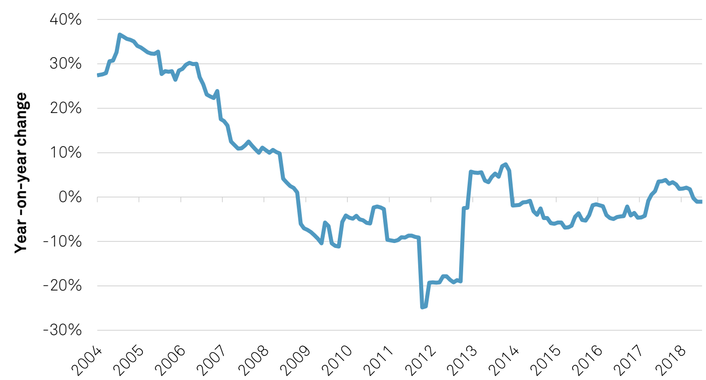
Total Transactions



Source: Property Services Regulatory Authority.

Chart 4.2

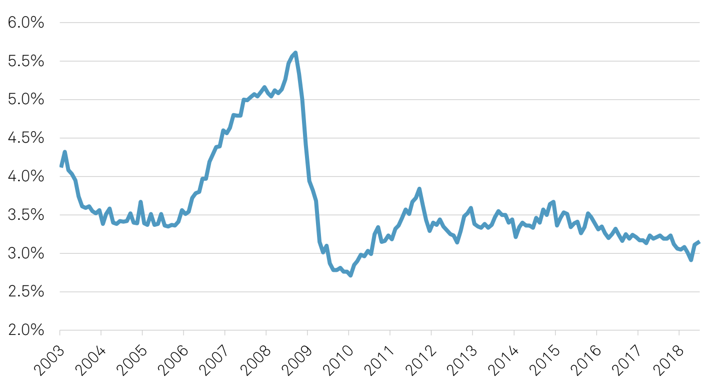
Housing Loans



Source: Central Bank of Ireland.

Chart 4.3

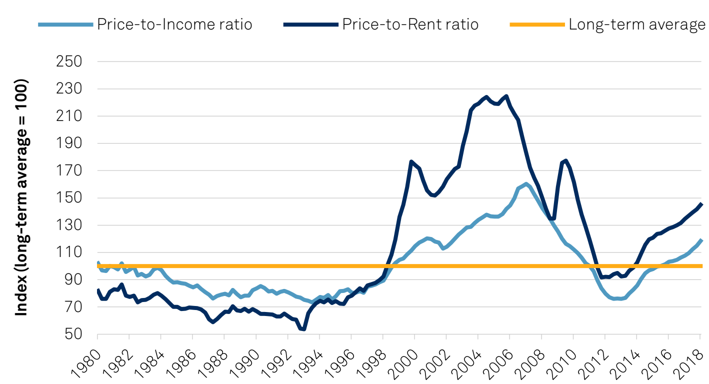
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 4.4

Price Ratios



Source: OECD, Central Statistics Office Ireland.

Italy: Improving Economy Should Lift House Prices This Year

Table 6

Italian Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	-0.3	-0.3	0.2	1.3	1.8	2.0
Real GDP, % change	1.1	1.6	1.3	1.2	1.0	0.8
CPI inflation (%)	0.0	1.5	1.3	1.3	1.6	1.8
Unemployment rate	11.7	11.3	10.9	10.6	10.2	10.0

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

We expect house prices in Italy to move into positive territory this year and increase by 0.2%, then firming up to 1.3% in 2019, as stronger economic conditions trickle down to households' income through stronger job creation. Historically low interest rates, and a price-to-income ratio now below average after five consecutive years of correction, should also favor a rise in housing demand.

Recent trends

Italian housing prices were still declining at the start of the year, suggesting that the economic recovery has yet to translate into higher housing demand. To be fair, the unemployment rate remains high, at 11.1% in Q1 2018, and GDP growth only broke the 1% mark last year, rising by 1.6%. That said, housing market indicators are improving. Confidence in the construction sector is now back at its 2008 level, with firms reporting a continuous improvement in order books and smaller price reductions. New buildings' permits rose by 11.4% last year after declining by 16% on average between 2005 and 2016. Transactions have continued to rise to reach their 2012 levels at the end of 2017. As a result, the time a property stays on the market declined further to just more than seven months in Q1.

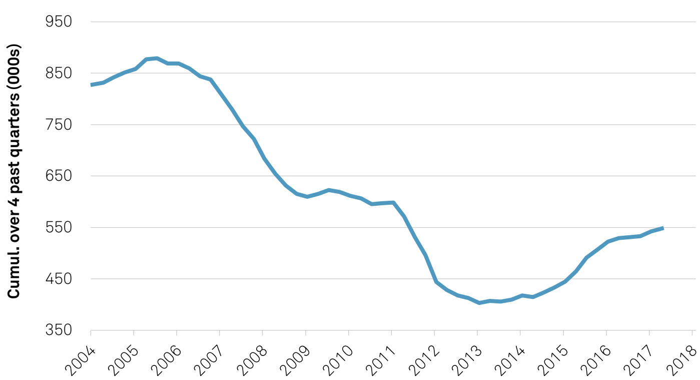
A high number of new business loans for housing purchases, which have remained close to their historical high of 2016 throughout 2017, seems to explain the pickup in property market activity. Banks continue to report easing of lending standards in the Bank Lending Survey, and the interest rates on new loans for house purchases had fallen further to 1.83% in May, compared to 1.9% in December 2017. This has incentivized households to take on more loans at a time when the economic backdrop, and thus the labor market, started to improve. Reflecting improvements in the housing market, prices for new housing were up by 1.3% year on year in March 2018, suggesting the price correction of the past five years is approaching the end.

Future trends

We expect this year to be a turning point for the Italian housing market. Economic activity should remain strong by historical standards, with GDP rising by 1.3% this year and 1.2% next. A more dynamic labor market will further raise household prospects and real disposable income, and thus boost demand for housing. Low interest rates will be another incentive for housing purchases. We should also see further easing from banks for loans for housing purchases as they continue to reduce their nonperforming loans exposure. What's more, housing affordability has improved significantly. Thanks to the prolonged drop in housing prices, the price-to-income ratio is now around 20% below its long-term average. Nonetheless, the economic recovery is still at an early stage and unemployment remains high, suggesting that prices will remain close to stable this year and only increase moderately in the next few years.

Chart 5.1

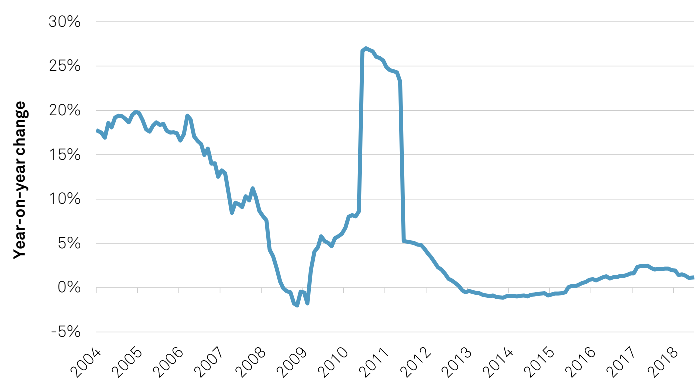
Total Transactions



Source: Agenzia del Territorio, Nomisma.

Chart 5.2

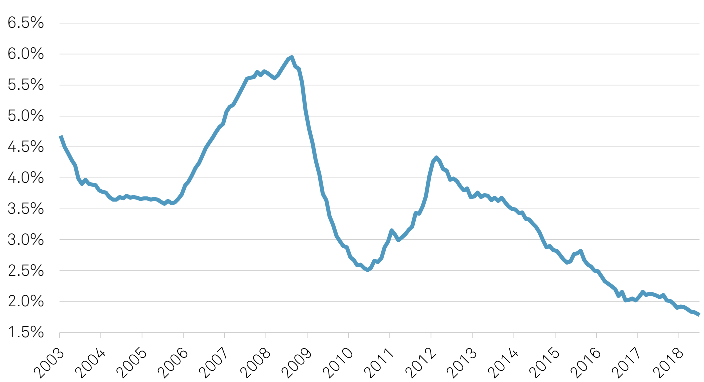
Housing Loans



Source: ECB.

Chart 5.3

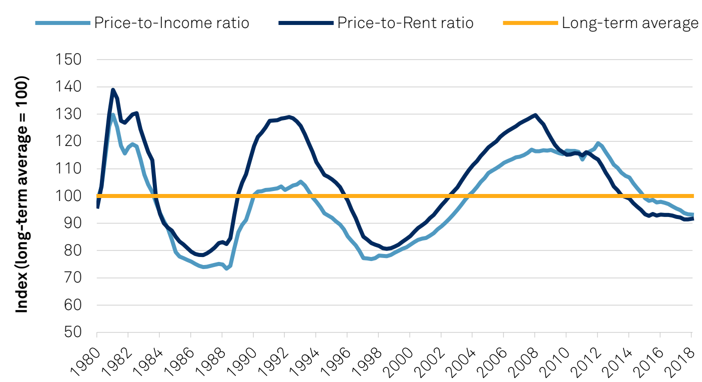
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 5.4

Price Ratios



Source: OECD, Nomisma.

Netherlands: Tight Housing Supply Keeps Upward Pressure On Prices

Table 7

Dutch Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	6.7	8.5	8.3	7.0	5.3	4.0
Real GDP, % change	2.1	3.3	2.7	2.3	1.8	1.5
CPI inflation (%)	0.1	1.3	1.6	1.7	1.8	1.9
Unemployment rate	6.0	4.9	3.9	3.7	3.5	3.5

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

We expect prices on the Dutch housing market to increase strongly by 8.3% this year and 7.0% in 2019. Price pressures will ease only slightly from 2017 as a strong economy and labor market continue to support demand for housing. In this context, supply constraints will drive up prices in the short term. But from 2019, price pressures should ease further as worsening affordability limits demand while higher new construction relaxes the supply constraint.

Recent Trends

House prices increased by 8.5% in 2017 and continued to accelerate to 9.3% annually in the first quarter of 2018. Compared to their long-term average, prices are overvalued by 17% in terms of the price-to-rent ratio and 26% in terms of price-to-income ratio. While this is below the 2007 peak, when overvaluation stood at 40%-50%, it shows that the housing market has heated up since its crisis in 2013.

Strong economic growth has bolstered housing market activity. Last year GDP rose by 3% annually, its highest since the recovery, and growth remained strong in the first two quarters of this year. Strong activity has resulted in a buoyant labor market, with the unemployment rate reaching a record low of 3.9% in the second quarter. Job creation has supported a rise in households' income and thus fueled demand for housing. Meanwhile, low mortgage rates have also continued to lend support for housing investment, even though they have increased slightly from their historical low of 2.37% in January to 2.44% in June in anticipation of monetary tightening.

Low supply is another key driver behind the strong increase in house prices. Construction has lagged behind the pickup in demand. As a result, the number of properties on sale had decreased to 76,000 in June this year from 230,000 in September 2013. This translates into housing transactions slowing down this year following a steep acceleration between mid-2013 and end-2017. Encouragingly, there was a small uptick in properties on sale in June from the lowest point in May. This may be the first sign of relaxing supply constraints through construction building laid out in the National Housing Agenda.

Future Trends

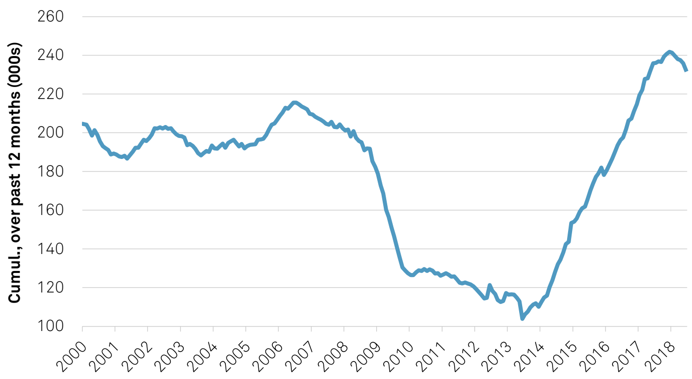
We foresee the Dutch economy growing by 2.7% this year and 2.3% in 2019, which is slower than last year but still above that of most other eurozone countries. We expect household consumption and investment to remain the main drivers of growth. A strong economy should further support job creation and thus demand for housing and house price growth.

As house prices continue to increase at a faster pace than household income, we expect housing affordability to deteriorate further. A pickup in mortgage interest rates as monetary policy becomes tighter will further weigh on affordability and demand.

Construction permits for dwellings over the 12 months to May have increased by 9% annually. New construction has also accelerated, with new dwellings in the first half of this year nearly 7% higher year on year. However, capacity constraints in the construction sector limit the scope for further acceleration in construction activity. Therefore, we expect the increase in housing supply to remain below demand over the next few years, thus continuing to put upward pressure on prices.

Chart 6.1

Total Transactions



Source: Central Bureau of Statistics Netherlands (CBS).

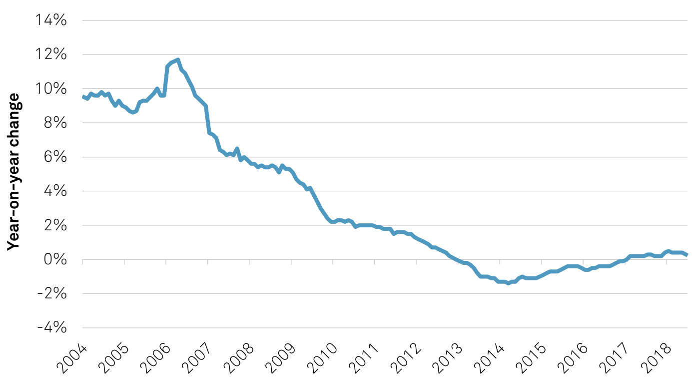
Chart 6.2

Housing Loans

Source: De Nederlandsche Bank.

Chart 6.3

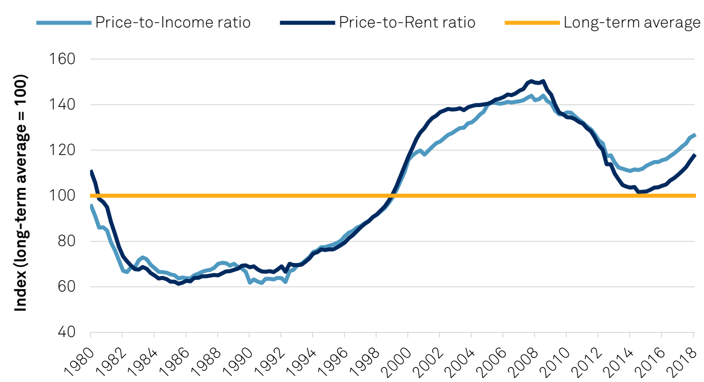
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 6.4

Price Ratios



Source: OECD, Kadaster.

Portugal: Prices Soar On Tight Supply And Strong Demand

Table 8

Portuguese Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	7.7	10.5	9.5	7.0	6.0	5.0
Real GDP, % change	1.6	2.7	2.3	1.9	1.8	1.8
CPI inflation (%)	0.6	1.6	1.5	1.6	1.8	1.8
Unemployment rate	11.1	9.0	8.0	7.0	6.8	6.6

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

Strong domestic and foreign demand, as well as tight supply, are underpinning strong house price increases in Portugal. We expect prices to rise 9.5% this year, but we forecast price pressures will gradually ease amid slower growth, the rising cost of borrowing, and deteriorating affordability.

Recent trends

Annual house price growth accelerated to 12.2% in Q1 2018, from 10.5% in 2017. Prices for existing properties surged by 13%, while prices for new dwellings rose by 9.7% year on year. In Lisbon, the median value per square meter rose by 20% to €2,581. In Porto, this value was up 23%, reaching €1,379. Nevertheless, the market overall remains affordable, with the price-to-income ratio still 7% below its long-term average.

The number of transactions dropped in Q1 2018 compared to the previous quarter. However, this follows a surge in Q4 2017, and in annual terms, transactions were up 16%. Activity is concentrated on existing properties, which account for 85% of the market. The residential construction sector continues to recover, with the number of completed dwellings up 23% in Q1, year on year, after growing by 19% in 2017. Still, the number of dwellings entering the market is only a fraction of dwellings completed before the crisis.

Limited supply alongside strong domestic and foreign demand is fueling house price inflation. Robust economic growth, strong job creation, and low interest rates are underpinning demand for housing. The unemployment rate fell to 6.7% in June, the lowest level in 15 years, while labor participation has increased. Foreign demand remains an important market driver, supported by affordable prices and special incentives, such as the “golden visa” and non-habitual resident program.

New lending for house purchases rose by 25% in January-May 2018 on the same period of last year. While still strong, growth in new mortgage lending has decelerated from previous levels, which exceeded 40% in 2016 and 2017. On a net basis, mortgage lending was still down by 1%.

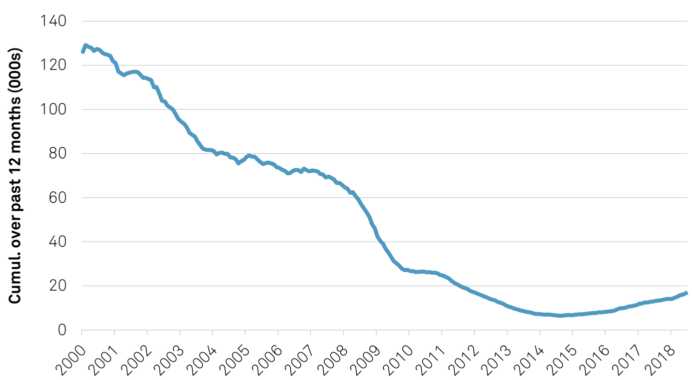
Future Trends

We expect economic growth to decelerate this year from a strong 2017, but to remain solid at 2.3%. Export growth should moderate as demand from Portugal’s trade partners slows. Further employment gains should continue to support private consumption. However, the pace of job creation is likely to slow down. We expect economic growth to fall below 2% by the end of the decade, reflecting constraints from high indebtedness of the private and public sector and slow productivity growth.

We therefore expect Portugal's housing market to stay dynamic over the next few years, supported by continuing job gains and rising household income, as well as foreign demand. The gap between supply and demand is likely to persist over the next few years, underpinning price increases. The number of permits for dwellings rose by 38% in January-April this year, compared to the same period of 2017, after growing by close to 25% last year. This should help housing supply and attenuate price pressures. However, the number of permits is rising from a low base, after a long period of declines. We nevertheless see a gradual easing of house price pressures amid slower growth, rising cost of borrowing, and deteriorating affordability. Our forecast is for house price growth of 9.5% this year, slowing to 5% by 2021.

Chart 7.1

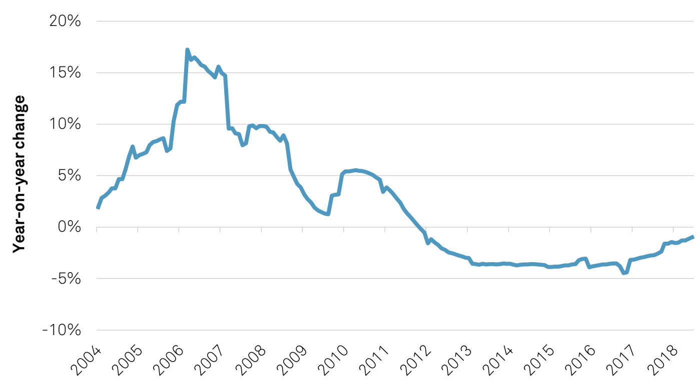
Residential Construction Permits



Source: Statistics Portugal.

Chart 7.2

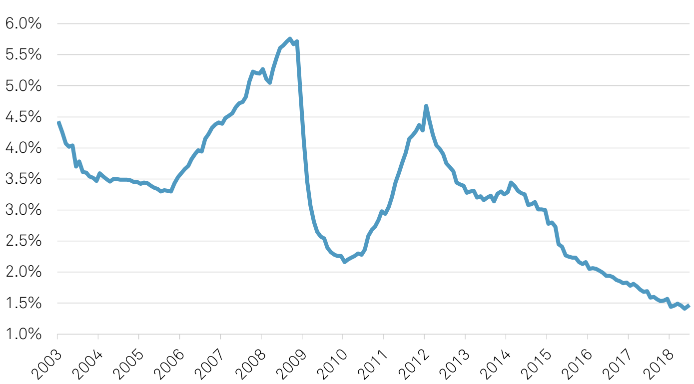
Housing Loans



Source: ECB.

Chart 7.3

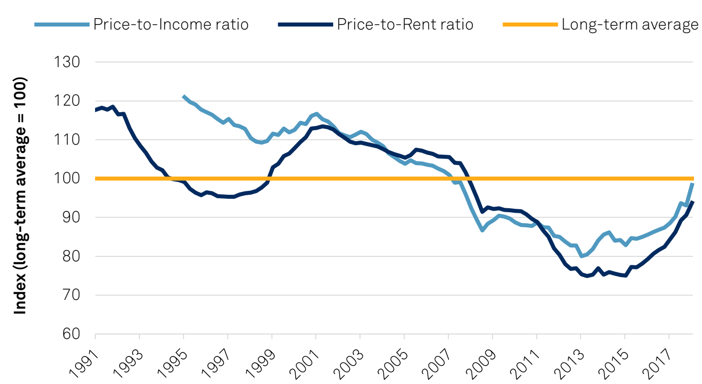
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 7.4

Price Ratios



Source: OECD, ECB.

Spain: Strong Economy Should Support A Continued Housing Recovery

Table 9

Spanish Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	4.5	7.3	5.6	4.3	3.5	3.0
Real GDP, % change	3.3	3.0	2.8	2.3	2.1	1.8
CPI inflation (%)	-0.3	2.0	1.8	1.6	1.6	1.6
Unemployment rate	19.6	17.2	15.6	14.5	13.9	13.5

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

The strong economic situation, with unemployment declining and low interest rates, is supporting the ongoing recovery of Spain's housing market. We expect housing prices to grow at an annual rate of 5.6% this year, down from 7.3% in 2017, and further decelerate to 4.3% in 2019.

Recent Trends

In the second quarter of this year, price growth slowed slightly on last year to an annual 6.4%. Despite considerable increases over the past years, nominal house prices at end-2017 were still 24% below their peak in mid-2007. Therefore, affordability remains solid on average, with the price-to-income ratio still 29% below its peak.

As sales accelerated, the average time that homes took to sell fell in the second quarter of this year to 8.0 months, from 8.3 months in Q2 2017. In May this year, housing transactions increased by an annual 15.2%, from 12.2% a year ago. As a result, the total number of dwellings on sale was of 722,035 in the three months to June, down from 782,782 in the previous quarter, according to Tinsa, a real estate company. Low mortgage rates further supported housing demand, averaging 1.95% in the first five months of the year.

There nevertheless remains a wide difference between regions in terms of demand and surplus of dwellings inherited from the pre-crisis construction boom. This has led to considerable disparities in price growth. For instance, prices in the second quarter of this year rose 15.5% year on year in the region of Madrid, while they declined by 3.4% in the region of Extremadura.

Future trends

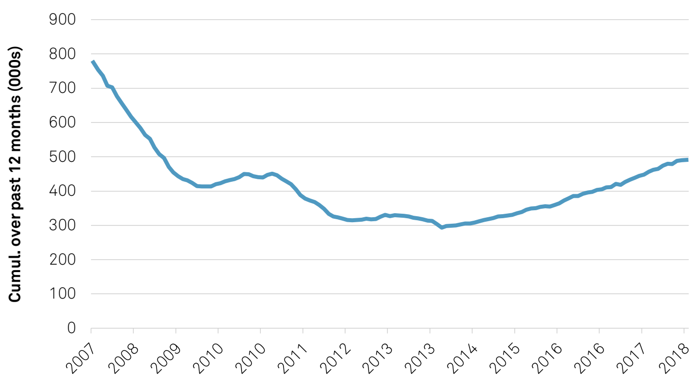
We expect GDP growth to decelerate over the next few years, but to remain strong at 2.8% this year and 2.3% in 2019. Private consumption and investment should remain the key growth impetus. This should support considerable growth in the housing market and continue to cut the oversupply. Risks stem mainly from political uncertainties, and regional divergences could also intensify. Mortgage rates are up from their lowest level in end-2017, but they remain attractive and support affordability of housing loans. The expectation of a further increase in interest rates due to tightening monetary policy should help encourage potential buyers to enter into the market ahead of further borrowing rate rises.

Although we foresee price-to-rent and price-to-income ratios deteriorating further, they should remain clearly below their mid-2007 peak over our forecast horizon. The total volume of mortgages is 22% below its highest level in December 2010, and the average household spends around 17% of its income on repayments, clearly below the 30% defined by ECB as the threshold for vulnerability. We therefore think that affordability of housing will remain sound and see scope for further price increases.

We currently see the Catalan crisis as the major risk to the Spanish housing market. In the city of Madrid, where increases have been strongest, prices rose by 18.9% year on year in the second quarter, accelerating from 17% half a year earlier. In Barcelona, by contrast, dwelling prices decelerated to an annual 6%, from 14.8% half a year earlier, but started to recover from their slow down at the end of last year. Growth might further be contained by political uncertainties throughout this year.

Chart 8.1

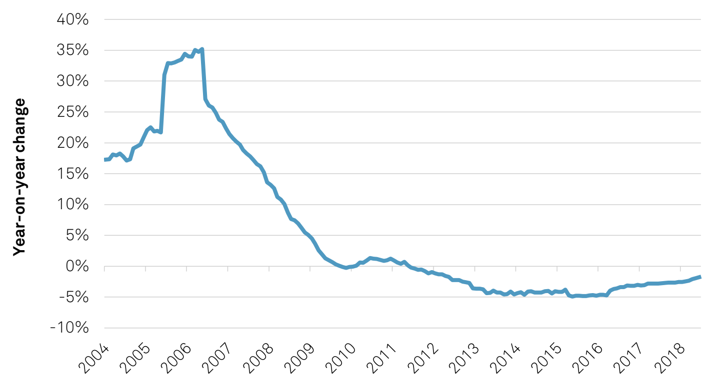
Total Transactions



Source: Instituto Nacional de Estadistica (INE).

Chart 8.2

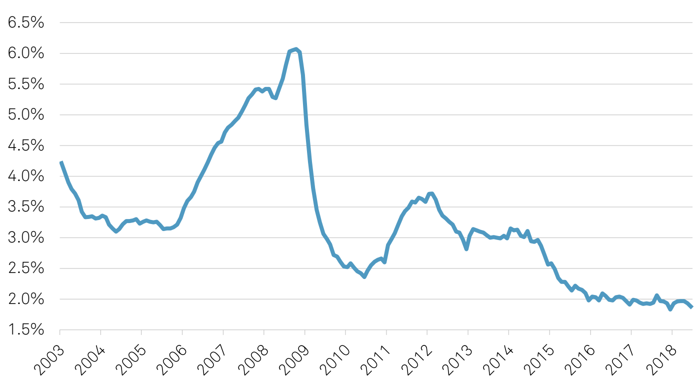
Housing Loans



Source: ECB.

Chart 8.3

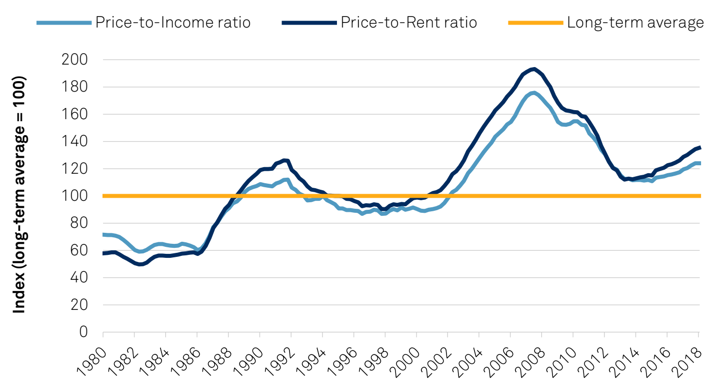
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 8.4

Price Ratios



Source: OECD, Banco de Espana.

Switzerland: Some Price Growth Moderation This Year

Table 10

Swiss Housing Market Statistics

	2016	2017	2018f	2019f	2020f	2021f
Nominal house prices, % change year on year	0.4	4.0	1.8	1.8	2.1	2.0
Real GDP, % change	1.4	1.1	2.2	1.7	1.5	1.4
CPI inflation (%)	-0.4	0.5	0.9	0.9	1.2	1.3
Unemployment rate	3.3	3.2	2.9	2.7	2.7	2.6

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

Healthy employment growth and an accommodative monetary policy are supporting the Swiss housing market, but affordability has further deteriorated in recent years. This, along with regulatory measures and an aging population are set to keep a lid on home prices going forward.

Recent trends

The real estate market further benefited from a solid economy and a healthy labor market last year, with housing prices rising by 4% year on year in Q4 2017. Low borrowing costs have also helped, as the SNB has yet to raise its rates from historical lows of -0.75%. But regulatory measures and low affordability have kept a lid on house prices. Recent developments at the start of 2018 even point to some moderation in house price growth. Nominal prices were down 0.3% on the first quarter. Granular data shows that the decline in prices in the rental market segment over the past two years has now extended to owner-occupied homes (-2.6% year on year in June), and some moderation in prices of single-family homes is also visible. Strong disparity remains across regions, with price pressures stronger in areas such as Zurich and Geneva than in more rural areas.

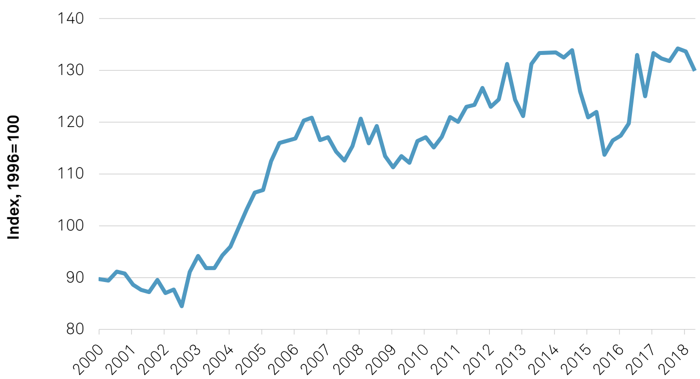
Slower price increases have been accompanied by a slight loss of momentum in construction activity. The uptick by 10bp in mortgage interest rates seems to have played a role, with the fixed mortgage rate for a 10-year term at its highest since the end of 2015 in the first half of this year. Mortgage loan growth has come down slightly as a result, to 2.5% annually on average in H1 2018 compared to 2.6% last year. More generally, poor affordability has been an increasing issue, with the price-to-income ratio now 40% higher than at its low point of 2000. In 2017, an average-income household would have needed to spend an estimated 38.4% of its income on buying an average new-build property, according to Credit Suisse, well above the 33% threshold. As a result of high housing prices, household debt is at a historical high, at 108% of GDP in Q1 2018, prompting the SNB repeatedly to warn about the risk of a housing market correction. Over the past few years, regulatory measures have been put in place to limit access to mortgages. Further measures are likely to be put in place, as the SNB issued another warning in June, noting that the number of vacant homes has been increasing.

Future trends

The Swiss economy is set to grow at around 2.2% this year, its fastest pace in four years, driven by a pickup in investment and household consumption. In this context, firms will continue to create jobs, leading to further tightening of the labor market and improving job prospects for households. This should be supportive of the housing market, especially as we see interest rates rising only next year and very gradually over the forecast horizon. Nonetheless, some factors are set to continue to dampen housing activity, especially low affordability and regulatory measures. Demographic developments are also unlikely to be supportive of the residential market. An aging population means that demand for housing will decrease, especially as home owners in Switzerland are 58 years old on average. What's more, Switzerland is set to continue seeing lower net migration because of improving labor markets across Europe. As a result, we expect house prices to slow this year, down from 4% in Q4 2017 to 1.8% by end 2018.

Chart 9.1

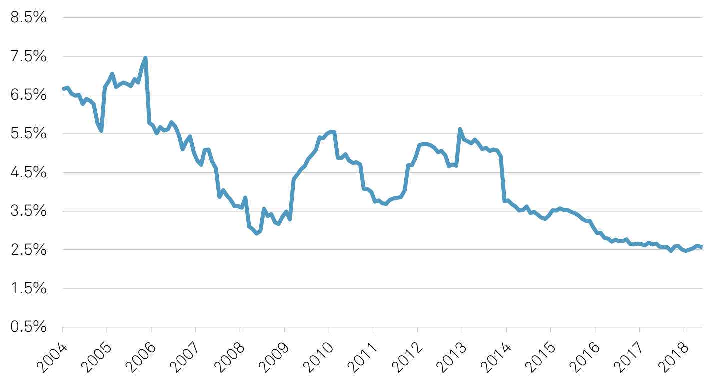
Housing Construction



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

Chart 9.2

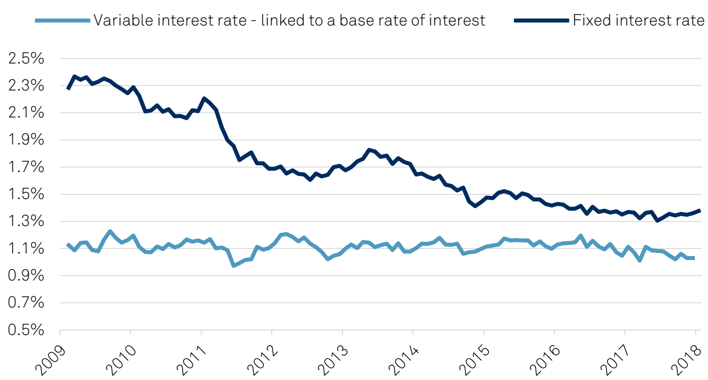
Housing Loans



Source: Swiss National Bank.

Chart 9.3

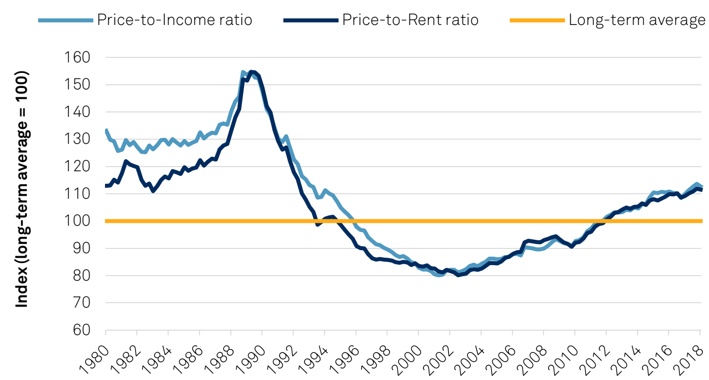
Average Interest Rate On New Housing Loans



Source: Swiss National Bank.

Chart 9.4

Price Ratios



Source: OECD, Swiss National Bank.

U.K.: A More Challenging Buy-To-Let Environment and Brexit Continue To Slow Price Growth

Table 11

U.K. Housing Market Statistics

	2016	2017	2018-f	2019f	2020f	2021f
Nominal house prices, % change year on year	5.3	4.7	0.0	2.5	3.5	4.5
Real GDP, % change	1.9	1.8	1.2	1.4	1.6	1.3
CPI inflation (%)	0.6	2.7	2.5	1.9	1.8	2.6
Unemployment rate	4.9	4.4	4.3	4.4	4.5	4.6

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

A more adverse environment for the buy-to-let (BTL) sector, if unchanged, and Brexit uncertainties, to some extent, are contributing to a slowdown in U.K. house price growth. We expect prices to stagnate at the end of this year, and to rise by just 2.5% in 2019.

Recent Trends

Volumes and values of BTL mortgages have not recovered since the first changes were introduced in early 2016, and the more recently tightened underwriting standards for BTL mortgages has continued the malaise. Some "amateur" BTL investors (with typically fewer than three properties) are leaving the market, which is also having a detrimental impact on rental supply, especially in London.

Mortgage lending to households is still moving sideways compared with historical norms, although it has improved in recent months. With banks keen to lend, this is largely a reflection of still relatively moderate demand, especially by so-called movers. There is a structural trend that some of these households, which are growing and are potentially looking to move into their second or third home, are investing in home improvements or extensions instead. Uncertainty related to Brexit is currently compounding the impact on demand from these mover households--who are typically more risk-adverse than first-time buyers.

At the same time, the stock of properties on the market has recently been increasing. This is partly because of the exit of some BTL investors, but also to some extent appears to reflect sellers’ high price expectations in an environment in which Brexit uncertainty warrants caution and affordability remains stretched.

Future trends

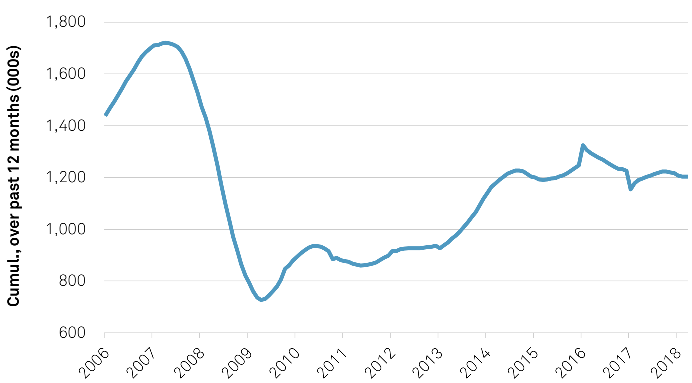
We expect these factors will continue to contribute to softer housing market dynamics over the next few years. But some factors should limit the slowdown. On the supply side, housing starts--still in the recovery phase following the financial crisis 10 years ago--appear to have slowed following the Brexit referendum in June 2016, and are likely to improve at a more moderate pace until uncertainty lifts. Borrowing conditions are set to remain favorable and mortgage lenders should remain keen to lend. Although the BoE's August hike of the base rate to 0.75% may add to mortgage costs for new borrowers, they continue to benefit from a low markup in an extremely competitive market. Moreover, around 90% of new mortgages are on fixed rates, generally over two to five years, so higher interest rates will kick in only gradually. Generally, we expect monetary tightening to be very gradual and moderate over the forecast horizon.

An unemployment rate that is currently the lowest in more than 40 years, and which we expect to deteriorate only very modestly in the next few years, will also support housing demand. Wage growth, however, is set to improve only gradually, as the remaining slack in the labor market fades. But moderate wage growth should soon still be sufficient to outpace inflation more noticeably than at present, as the impact of the earlier sterling depreciation falls off and core pressures soften. Moreover, later in the year wage growth should for the first time in years outpace house price growth, thereby easing affordability, albeit from low levels.

Our forecast is subject to significant Brexit-related downside risks. Should the U.K. experience a disruptive Brexit in March 2019 and crash out of the EU without a deal, our forecast would likely be significantly worse.

Chart 10.1

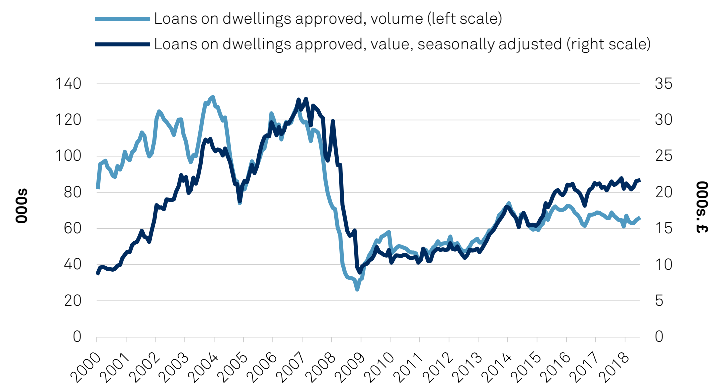
Residential Property Transactions Above £40,000



Source: HM Revenue & Customs.

Chart 10.2

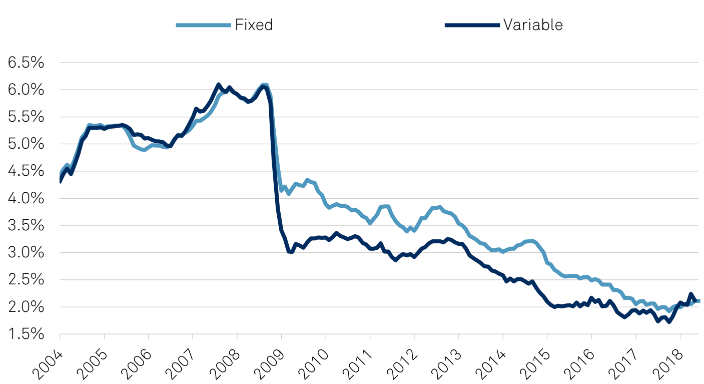
Loans On Dwellings Approved



Source: Bank of England.

Chart 10.3

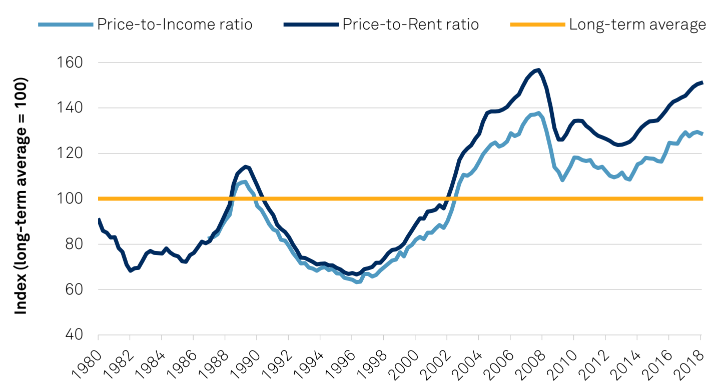
Mortgage Interest Rates On New Business - Banks



Source: Datastream, Bank of England.

Chart 10.4

Price Ratios



Source: OECD, Department for Communities and Local Government.