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Economic Research:

Europe's Housing Markets Ease Off The Accelerator

February 19, 2019

Key Takeaways

We forecast housing prices will increase further over our forecast horizon through 2021, but at a slower pace than previously. Among the European countries we cover in this report, only Italy is an exception to this trend.

Economic and financial conditions should remain broadly supportive of housing demand. Although economic momentum is abating in the eurozone and Switzerland, and is set to remain moderate in the U.K., we expect wage growth to accelerate further on the back of tight labor markets. Moreover, mortgage interest rates should edge up only slowly, as European central banks are very gradually reducing the degree of monetary accommodation.

Affordability of homeownership is likely to worsen further. In most of the countries covered in this report, however, 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. Switzerland and Belgium are another exception: affordability did not improve post the crisis.

We do not expect credit standards on housing loans to tighten anytime soon. Higher real disposable income, the only very gradual rise in interest rates, and fierce competition among banks suggest that credit standards should remain relatively favorable. The ECB's bank lending survey seems to back our view. Only Italy and Portugal are deviating from this trend.

Uncertainties surrounding Brexit are currently dampening the U.K. housing market. Potential buyers and sellers appear to be in wait-and-see mode. House price growth, transactions, and construction activity are slowing. We expect house price inflation in the U.K. to decelerate further over the first half of this year, but then to recover when, as is our base case, a deal and the transition phase are eventually implemented.

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Table 1

European Housing Market Forecasts

Nominal house prices, % change Y/Y	2016	2017	2018e	2019f	2020f	2021f
Belgium	2.5	3.6	2.8	2.8	2.3	2.0
France	1.6	3.3	2.8	2.4	2.0	2.0
Germany	6.8	4.5	4.5	3.9	3.3	3.0
Ireland	8.6	11.9	7.5	5.5	4.5	4.0
Italy	0.2	(1.2)	(0.7)	0.5	1.3	1.6
Netherlands	6.7	8.5	9.2	6.3	5.3	4.2
Portugal	7.7	10.5	7.9	5.0	4.0	4.0
Spain	4.5	7.3	6.6	4.5	3.4	3.0
Switzerland	0.4	4.0	3.5	2.2	2.0	2.0
United Kingdom	5.3	4.7	2.4	1.5	2.5	4.0

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

Monetary Policy And Interest Rate Outlook

European Central Bank: A First Rate Hike Likely In Late 2019

The ECB is slowly normalizing its monetary policy: it stopped buying additional assets at the end of December 2018, and we expect it will raise interest rates by the end of this year. Economic expansion in the eurozone decelerated significantly in 2018, reflecting temporary supply constraints, weak external demand, and the convergence of economic growth with its potential. Domestic fundamentals, however, paint a more optimistic picture, with firms continuing to create jobs, unemployment at its lowest level since 2008, and labor shortages boosting wage growth. In its December forecasts, the ECB projected a deceleration in headline inflation after the drop in oil prices, but continued to predict underlying inflation rising further to 1.5% in 2019 and 1.7% in 2020, from 1.3% in 2018. Although the ECB ended its net asset purchases, we believe it will continue reinvesting maturing securities until mid-2021, which should continue to apply downward pressure on long-term rates. Nonetheless, in December ECB President Mario Draghi indicated that eurozone growth in recent months was weaker than expected. If growth remains sluggish, this could lead to a slower normalization in monetary policy than we currently anticipate. Once the ECB releases its updated projections on eurozone growth and inflation in March, we should have more clarity on the ECB's forward guidance on interest rates. For the eurozone housing markets, the normalization in ECB policy means that buyers and sellers are likely to see borrowing costs rise, albeit gradually. By the end of in 2021, we expect the deposit rate will reach 1%.

The Bank of England: One Hike At Most In 2019

Our forecast remains predicated on the assumption that the U.K. will leave the EU after having secured a deal. Even in that scenario, we expect the Bank of England will raise its policy rate by only 25 basis points (bps), to 1%, and not do so until November this year, if at all. While the U.K.

labor market remains extraordinarily tight and wage growth has finally picked up, accelerating to 3.4% in November last year (the fastest rise since 2008), there is not much of a case for hiking rates earlier. Firstly, inflation fell to 2.1% in December, which is only marginally above the Bank of England's 2% target. Secondly, higher wage growth is unlikely to put much upward pressure on inflation in the near term, in our view: Current wage gains are not likely to result in significantly higher spending growth, since households need to deleverage after becoming net borrowers, on aggregate, in 2018. Moreover, most businesses currently still have the capacity and willingness to absorb higher wage costs, and will likely refrain from markedly raising output prices in an uncertain environment.

Swiss National Bank: Waiting For The ECB To Move First

The Swiss economy cooled off in the third quarter of last year, after strong growth in the first half of 2018. However, the soft patch seems to be nearing an end, with business climate indicators starting to pick up in December 2018. The domestic picture remains bright, with the unemployment rate at 2.4% in December--a 17 year low--and firms operating at close to full capacity. Wage growth is also set to be the strongest in 2018 since 2014. That said, headline price pressures are likely to remain low this year, especially as energy prices drop and the recent Swiss franc appreciation translates into more deflationary pressures. As such, in December the Swiss National Bank (SNB) revised its inflation expectations down to 0.5% in 2019 (in line with ours) and to 1.0% in 2020. What's more, recent uncertainties around Italy and Brexit have also provided some upward pressure on the franc. Against this backdrop, the SNB will likely keep an accommodative stance to provide support to the economy and ensure inflation expectations remain well anchored. We believe the SNB's first rate hike will follow the ECB's. Similar to the eurozone, this means that housing investors should anticipate a gradual rise in interest rates this year.

Limited Upward Pressure On Long-Term Yields

The U.S. Fed is also likely to be cautious in normalizing monetary conditions this year. We expect it will hike rates much less than in 2018, and not the before the second half of 2019. The year ahead should reveal an even tighter U.S. labor market and wage growth exceeding productivity. Interest rates for U.S. 10-year government bonds should increase somewhat, but not exceed the hikes to short-term key interest rates. The U.S. economy is likely too late the credit cycle for the yield curve to steepen. Only two factors are putting upward pressure on U.S. long-term interest rates: the financing of a larger U.S. budget deficit and central banks' reduction of their holdings in marketable U.S. treasuries. However, on the other side, demand for safe assets is strong enough to offset these pressures. Therefore, with lower growth and inflation prospects, and even if investors regain their risk appetite, we don't believe U.S. Treasury yields will go beyond 2018's peak levels.

By correlation with the U.S. bond market and given the gradual normalization in European monetary policies, long-term interest rates (10 year) in Europe should only slowly edge up. We expect German Bunds' yields will reach 0.7% on average this year and 1.3% in 2020. U.K. gilts' yields are likely to broadly follow the gradual pace of monetary policy normalization, averaging 1.9% this year and 2.7% in 2020. For Swiss franc bonds, the spillover effects of the ECB's bond-buying program are set to keep downward pressure on yields. We see the 10-year Swiss bonds at 0.3% this year and 0.8% in 2020. Given the sudden changes in global monetary policy stance (the Fed pausing on its rate hikes, ECB hesitating to increase rates, the Chinese and Indian central banks easing monetary conditions, etc.), we expect long-term interest rates to remain low.

Belgium: Price Growth Slows As Affordability Dampens Demand

Table 2

Belgian Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	2.5	3.6	2.8	2.8	2.3	2.0
Real GDP, % change	1.4	1.7	1.5	1.5	1.5	1.4
CPI inflation (%)	1.8	2.2	2.3	2.1	1.8	1.9
Unemployment rate	7.8	7.1	6.3	6.2	6.2	6.3

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

We expect that house prices in will increase by 2.8% this year and 2.3% next, from an estimated 2.8% in 2018. The resilient economy remains supportive of the housing market, while worsening affordability is weighing on demand and may dent price growth.

State Of Play

Nominal house prices increased by an annual 2.6% in third-quarter 2018, following growth of 3.6% in 2017. The housing market was supported by solid economic growth in recent years. For 2018, we expect GDP growth at 1.5%, down slightly from 1.7% in 2017. Economic activity as well as policy measures increasing labor market flexibility reduced the unemployment rate to about 6.3% last year. This in turn bolstered households' income and demand for housing.

Housing demand was also spurred by loose financing conditions. Interest rates for house purchases were at 1.9% in November last year, only slightly up from their record low in September. They continue to support demand for housing by bolstering households' borrowing capacity.

The Belgian housing market has barely seen a price correction since the global financial crisis. As a result, strong house price growth in past years weighed on affordability of residential property, leading to an overvaluation of 40% in terms of price to income, and close to 50% in terms of price to rent. Worsening affordability seems to have started dragging down demand for housing, leading to a deceleration in housing transactions over the past year.

The average loan for a house purchase increased by 2.2% until September last year compared with end-2017. Over the same period, the total volume of new loans has been stagnating. This underlines that, while households are increasingly taking up expensive mortgages to buy more expensive homes, the number of new mortgages and house purchases is actually declining. As owner-occupied residential property becomes more expensive, potential buyers are being driven out of the market.

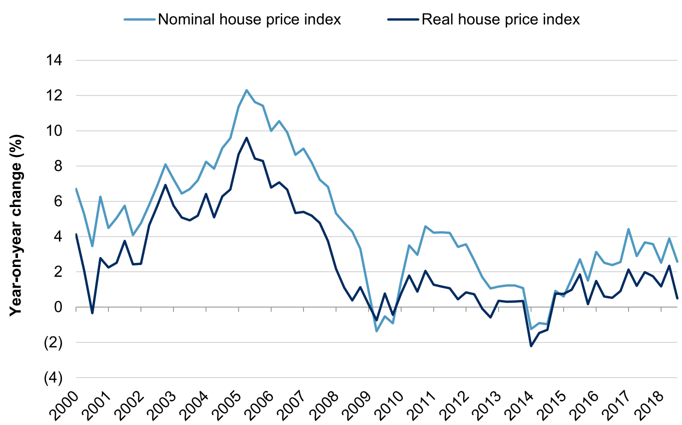
What We Expect

We expect Belgian economic growth of 1.5% this year and next, supported by the domestic sector. The low unemployment underlines that the labor market remains tight. This should lead to further wage increases and support consumer spending. Therefore, Belgium's economic outlook remains supportive of the housing market, and we should see prices increase further, though at a slower pace. Overvaluation should continue to push potential house buyers out of the market, but less demand will ease upward pressures on house prices.

According to the ECB's January 2019 bank lending survey, banks expect credit demand from Belgian households to remain stable over the first quarter of this year. This underlines our view that we might continue to see a stable volume of new housing loans, while the amount of the average loan goes up. Risks stem from high indebtedness of households and their vulnerability to increasing mortgage interest rates in the context of tightening financial conditions.

Chart 1.1

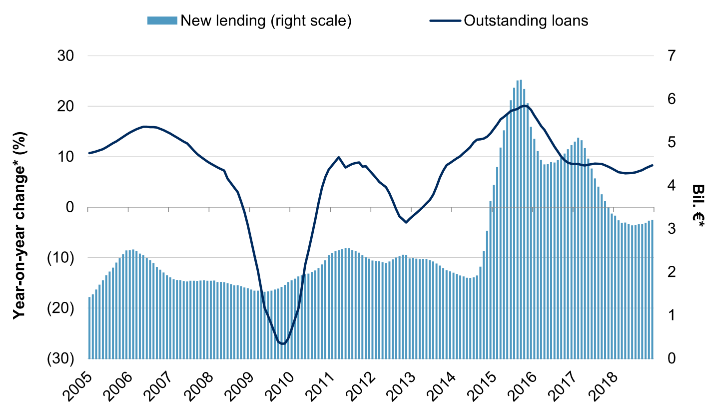
House Price Indices



Source: OECD.

Chart 1.2

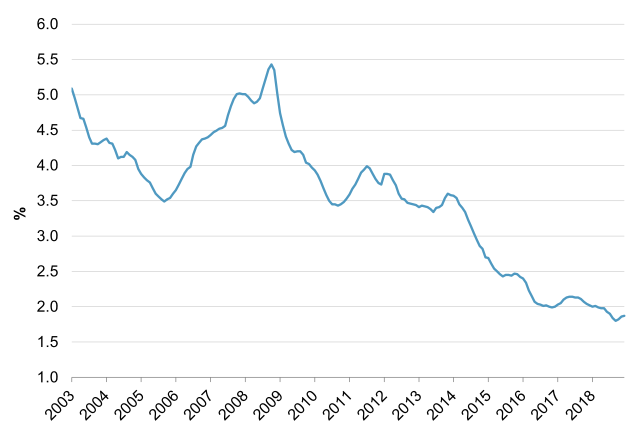
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 1.3

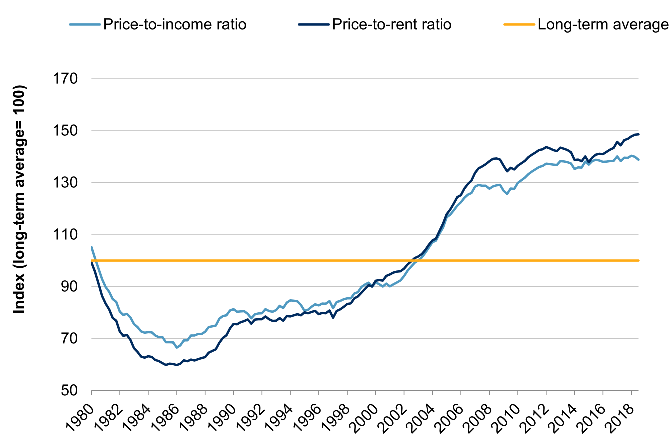
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 1.4

Price Ratios



Sources: OECD, National Bank of Belgium.

France: Prices To Moderate With Rising Borrowing Costs

Table 3

French Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	1.6	3.3	2.8	2.4	2.0	2.0
Real GDP, % change	1.1	2.3	1.6	1.6	1.6	1.5
CPI inflation (%)	0.3	1.0	1.9	1.5	1.5	1.7
Unemployment rate	10.1	9.4	9.2	8.9	8.7	8.5

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

We expect house price growth in France to slow to 2.4% this year and 2.0% in 2020, from 2.8% in 2018. Households will continue to benefit from historically low interest rates and a resilient economy that keeps creating jobs. However, monetary policy tightening from the end of this year and a high price-to-income ratio will limit any sharp gains in property prices.

State Of Play

The housing market softened in 2018, with housing prices decelerating to 2.8% year on year in June 2018, from 3.3% in December 2017. This reflects a stabilization in housing sales and lending growth for house purchases as the government has cut back on fiscal incentives to buy homes. We continue to forecast a soft landing rather than a dramatic turnaround. As such, housing sales remain at a historical high (1,338 thousand homes were sold in the past 12 months) and new housing loan growth has been recovering since August 2018, after decreasing for a year. Construction activity remains buoyant, and firms are increasingly reporting supply as their biggest constraint to activity, with 42.5% of firms citing labor shortages. This also explains a declining number of construction permits and housing starts since the beginning of 2018. Yet, wide geographic disparities remain, with sharper price increase in Paris than France as a whole.

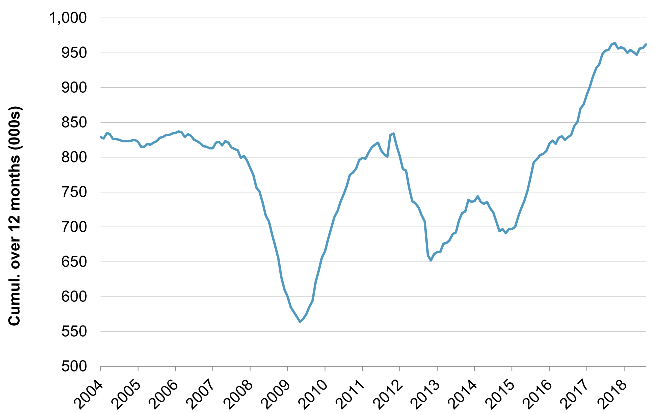
Meanwhile, consumers faced a less favorable economic backdrop in 2018 than in 2017. Growth and job creation slowed, while inflation was at its highest in seven years. However, consumers' intention to purchase a house in the next 12 months has remained stable since the start of 2017 and at a much higher level than during the pre-crisis period. Households continue to benefit from robust job creation, up 0.8% year on year as of third-quarter 2018, in spite of slowing economic activity--and from low borrowing costs. Interest rates on new loans stood at a historical low of 1.5% last November, and credit conditions are still easing according to the ECB's bank lending survey. In this environment, the French central bank continues to watch for the risks of rising household debt, which stood at 59% of GDP in second-quarter 2018.

What We Expect

Price expectations are levelling off according to surveys, pointing to further moderation in prices. The current slowdown in transactions, as well as lending and building growth should support this trend. Borrowing costs are also set to rise as the ECB starts lifting rates at the end of this year, which should worsen affordability and make house purchases less attractive, especially in the context of a high price-to-income ratio. Although the latter has been broadly stable over the past four years, it remains 20% above its long-term average. Moreover, households have already significantly extended loan maturity to improve affordability, contributing to the risk of building further imbalances even if most of the existing stock of home loans is largely at fixed rates until end maturity. We continue to expect a mild slowdown in price growth. Economic activity will remain supportive of job creation in France and households will see their real disposable income rise faster this year on the back of lower inflation, faster wage growth, and lower taxes.

Chart 2.1

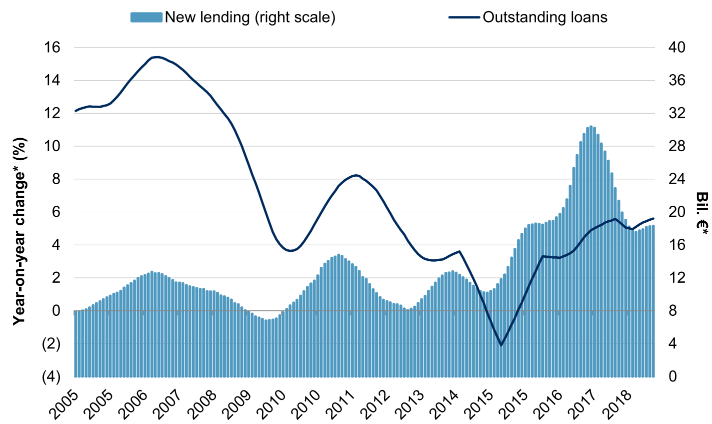
Total Home Sales



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

Chart 2.2

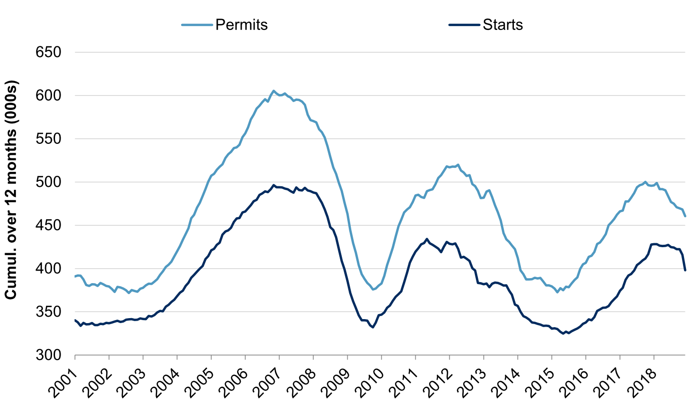
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 2.3

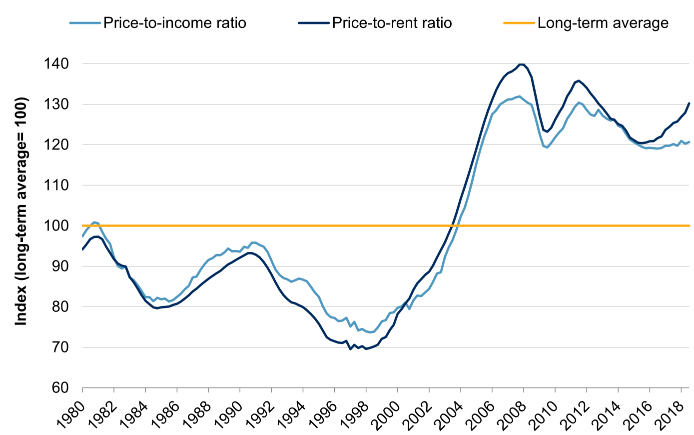
Residential Buildings Construction Permits And Starts



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 Prices Decelerate On Increasing Supply

Table 4

German Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	6.8	4.5	4.5	3.9	3.3	3.0
Real GDP, % change	2.2	2.5	1.6	1.6	1.4	1.3
CPI inflation (%)	0.4	1.7	1.8	1.8	1.8	1.9
Unemployment rate	4.2	3.8	3.4	3.0	3.0	3.0

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

We expect that house prices will increase by 3.9% this year and 3.3% next, following an estimated 4.5% last year. Germany's strong labor market supports demand for housing, and supply is improving, but shortages remain.

State Of Play

We estimate that house prices increased by 4.5% in 2018, supported by considerable supply shortages, as well as rapidly rising wages and disposable household income.

Mortgage rates remained supportive of housing demand in the second half of 2018, with an average nominal interest rate of 1.9% in December. Due to the pickup in consumer price inflation since last May, real rates turned negative. In this context, new lending for house purchases increased nearly 10% over the 12 months to November.

Following decades of sluggish house price growth, relative prices remain below their long-term average, despite recent acceleration. In terms of price to income, house prices are 19% higher than at their long-term low in 2007/2008; in terms of price to rent, they increased 26%.

What We Expect

We estimate German economic growth of 1.6% in 2018, and expect it will remain stable this year. On the back of low unemployment and rising wages, we forecast further increases in housing demand. Our view is supported by the ECB's bank lending survey, according to which banks expect demand for housing loans in the first quarter of 2019 to increase at a solid pace, although they do not expect further loosening in credit standards for housing loans. We think mortgage interest rates will gradually increase as the ECB normalizes its monetary policy, but remain relatively attractive through 2021.

Despite the German government's commitment to build additional housing, the increase in construction permits (1.9% over 2018 until October) is not on track to meet strong demand. Capacity constraints--and especially the lack of skilled workers in the context of record low unemployment--are limiting investment in the construction sector and pushing up construction prices, which rose 4.4% on average in 2018. This prevents closure of the supply-demand gap, resulting in climbing house prices.

While strong immigration inflow in recent years has contributed to high demand for housing, we believe pressure from immigration should ease in the next years. The Bundesbank estimates that following net immigration of 400,000 in 2018, the lowest value since 2012, numbers should gradually decrease.

Deteriorating affordability has started to push households out of the owner-occupied housing market--especially in the seven-largest German cities, where prices increased significantly more sharply than the national average. First-time buyers are increasingly moving out of the largest cities into smaller surrounding towns, where we therefore see price growth accelerating. On a national level, we should see strong, though decelerating, growth in house prices.

Chart 3.1

Residential Construction Permits

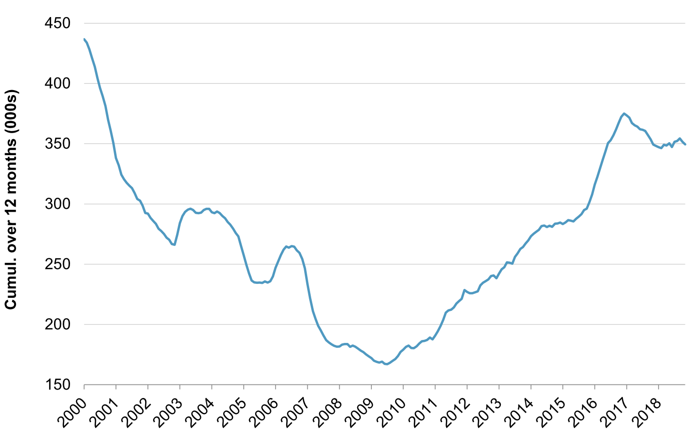
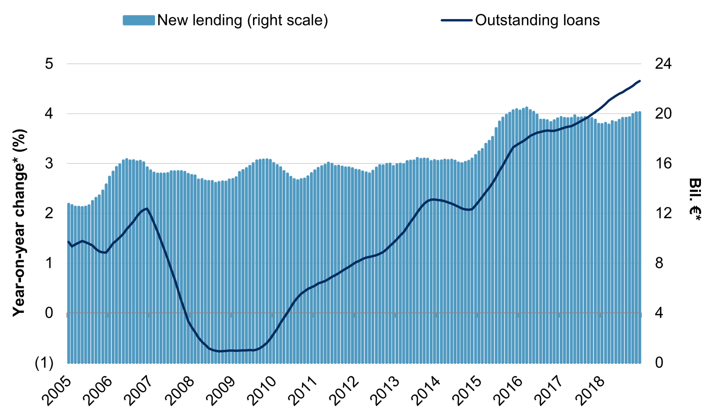


Chart 3.2

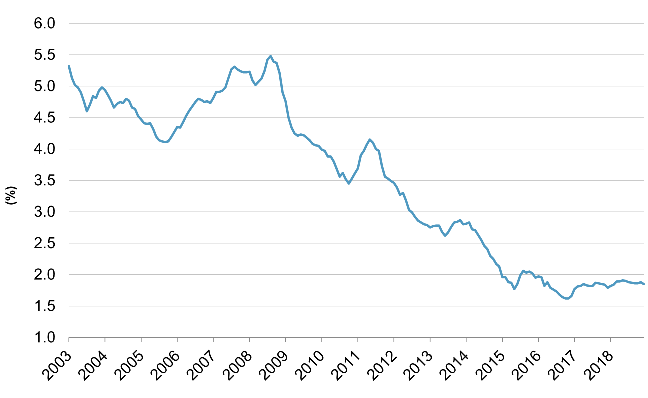
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 3.3

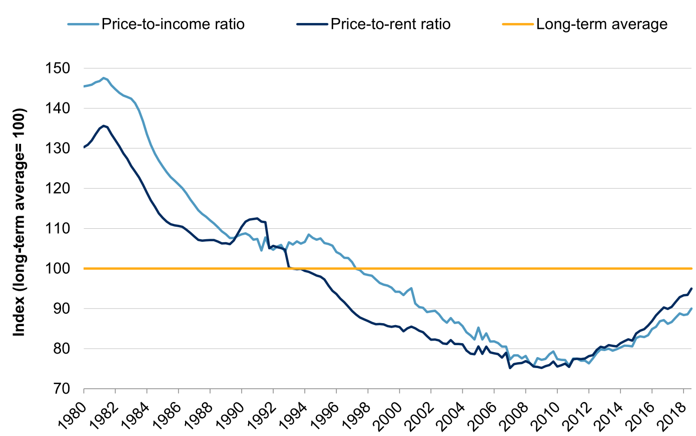
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 3.4

Price Ratios



Source: OECD, Deutsche Bundesbank.

Ireland: Home Prices Soften On Easing Growth And Improving Supply

Table 5

Irish Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	8.6	11.9	7.5	5.5	4.5	4.0
Real GDP, % change	5.1	7.8	5.0	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

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

We expect house price growth will moderate to 5.5% this year and 4.5% in 2020 from an estimated 7.5% in 2018, as the economic recovery levels off, macroprudential lending rules remain in place, and supply gradually catches up with demand. A no-deal Brexit poses downside risks.

State Of Play

The combination of supply shortages and a strong economic recovery has been pushing up the price of Irish homes, which rose a staggering 30% over 2016-2018.

The economy, as a whole, is doing rather well. Household consumption recovered to pre-crisis levels by early 2016, and employment did the same last year. While pay growth in some sectors, such as banking, has markedly accelerated amid efforts to retain staff, average wage growth has yet to pick up more strongly. Still, the large-scale movement of households into employment has boosted income growth across the economy to 5% a year on average over 2015-2018.

The homebuilding sector is recovering rapidly, but remains encumbered by years of underinvestment, a protracted but improving planning process, and limited access to funding. In addition, labor shortages, along with cost inflation, are limiting the sector's capacity to build sufficient housing to match needs. We estimate that just under 19,000 houses were completed in 2018, and that it could take until 2020, if not longer, before the sector reaches the government's target of building 35,000 dwellings per year.

What We Expect

Mortgage lending is increasing again, up 1.3% year on year as of November 2018, and banks are able and willing to lend more, having worked off some legacy issues from the crisis. Supply and competition could also benefit from new players, including pension funds, entering the mortgage market in 2019. In addition, we expect a very gradual tightening of monetary policy by the ECB. As a result, financing conditions for home purchases should be favorable over our forecast horizon.

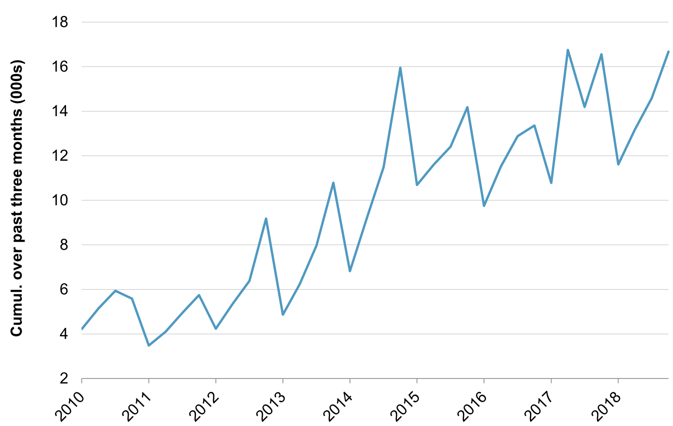
At the same time, we expect the economic recovery to start softening, with employment growth decelerating to more normal rates. Although scope remains for further tightening of the labor market, and robust pay growth as a result, this still means household income growth should slow. House price growth will also moderate, as macroprudential lending rules, in particular caps on loan-to-income ratios, become increasingly binding.

We note that current house price growth is not being spurred by excess credit; recent lending growth comes from levels close to post-crisis lows, and prudential lending rules, introduced in 2015, have just been reaffirmed by the central bank. Given builders' capacity constraints, the risk of an oversupply of homes to the market anytime soon is small. Moreover, pent-up demand as well as demand from robust natural population growth and relatively strong, positive net inward migration should provide a floor to any significant price growth deterioration.

We base our outlook for Irish housing sector on the assumption that the U.K. will leave the EU with a deal in place. As such, our forecast is subject to downside risks from a disruptive no-deal Brexit.

Chart 4.1

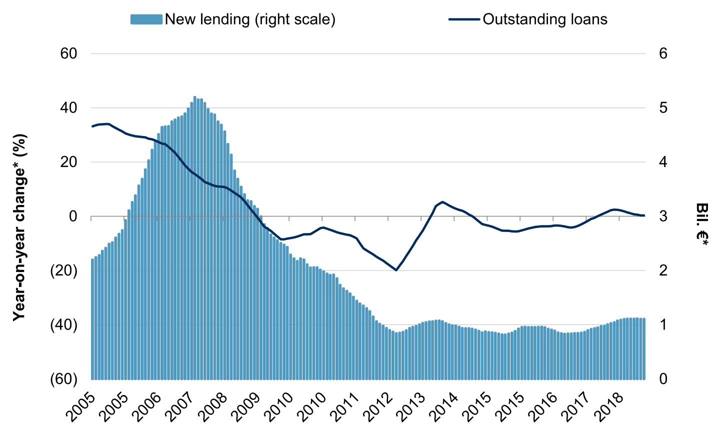
Total Transactions



Source: Property Services Regulatory Authority.

Chart 4.2

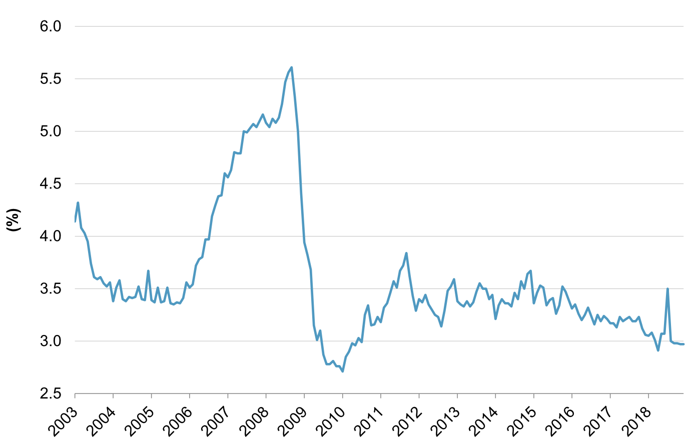
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 4.3

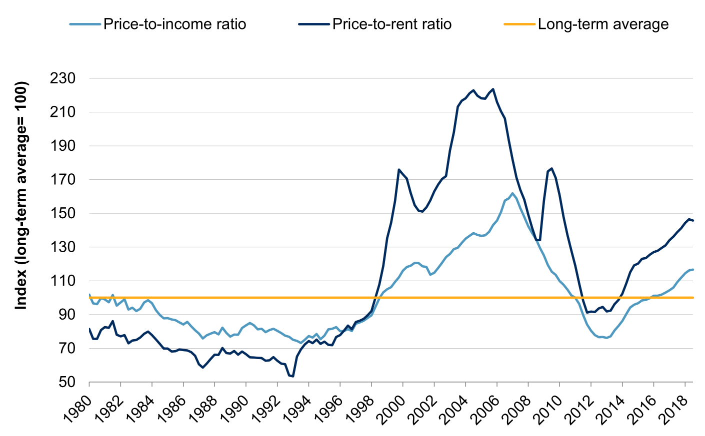
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 4.4

Price Ratios



Source: OECD, Central Statistics Office Ireland.

Italy: Economic Slowdown Delays House Price Recovery

Table 6

Italian Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	0.2	-1.2	-0.7	0.5	1.3	1.6
Real GDP, % change	1.3	1.6	1.0	0.7	0.9	0.8
CPI inflation (%)	0.0	1.3	1.3	1.2	1.4	1.6
Unemployment rate	11.7	11.3	10.5	10.2	10.0	9.8

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

We expect house price growth in Italy to gradually return to positive territory, inching up to 0.5% in 2019 and then firmly to 1.3% in 2020, as economic activity regains strength following a slowdown at end-2018 and boosts job creation. Housing demand should also rebound, with interest rates remaining low, but edging up, as credit standards tighten and the price-to-income ratio remains well below its long-term average.

State Of Play

After close to five years of consecutive contraction, housing prices stabilized at negative 0.2% year on year in June 2018, reflecting a continuous improvement in demand since 2008. Nonetheless, abundant supply has kept price growth negative. Although last year construction confidence was at its highest since the pre-financial crisis, firms do not yet report any supply constraints to activity. This reflects what seems to be a less dynamic market than in the pre-crisis years. The number of new residential dwellings in September 2018, although on a slight upward trend, still represents less than 20% of its 2005 peak. We continue to see signs of strengthening demand, with consumer intentions of home purchases at its highest level since 2009. New lending for house purchases has also been rising again since July 2018 (after weakening since the beginning of 2017), and demand for housing loans continues to strengthen according to the ECB's most recent bank lending survey. More robust demand is also visible in the increase in transactions, which were up 5.8% year on year as of September.

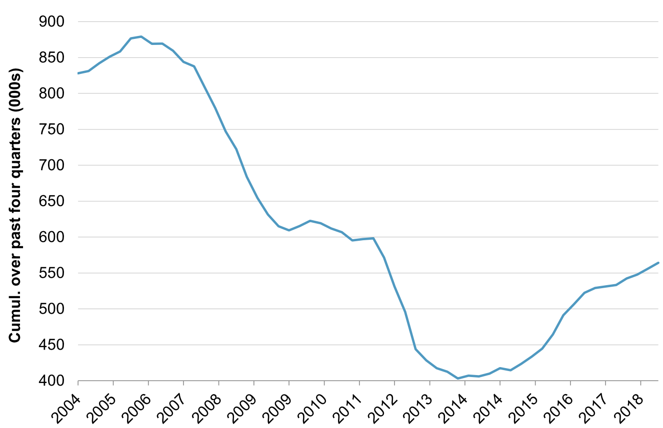
However, the slowdown in economic activity at the end of 2018 appears to have weighed on the housing market, which has yet to recover. Household prospects worsened as a result of a fall in job creation, while affordability declined as banks passed on higher funding rates to customers. The ECB's bank lending survey shows a tightening in credit conditions for housing purchases. Interest rates for housing loans have been on an upward trend since July 2018. Construction and consumer confidence indicators point to a slowdown in housing activity at the end of 2018, which is also visible in slower growth in new residential dwellings and a renewed contraction in new lending growth in November. Construction production for fourth-quarter 2018 reveals that construction activity likely subtracted around 0.1 percentage points from GDP growth.

What We Expect

We expect Italy's economic activity will recover in 2019, although our GDP forecast of 0.7% growth for 2019 now appears a bit optimistic. Thus, we expect the housing market to see only a temporary slowdown and return to recovery. The rebound in economic activity should lead to job creation and improved real disposable income, which should ultimately boost housing demand. Affordability indicators are still supportive of housing demand. Interest rates, although rising, remain low at 2.27%. Meanwhile, the price-to-income and price-to-rent ratio are around 10%-15% below their 20-year average, after several years of price decline. Thus, we expect 2019 to be a turning point for the Italian housing market, with prices likely to move into positive territory. In the longer term, Italy's potential growth and wealth gains remain relatively low, and the working age population is set to decline from 2020, capping housing demand.

Chart 5.1

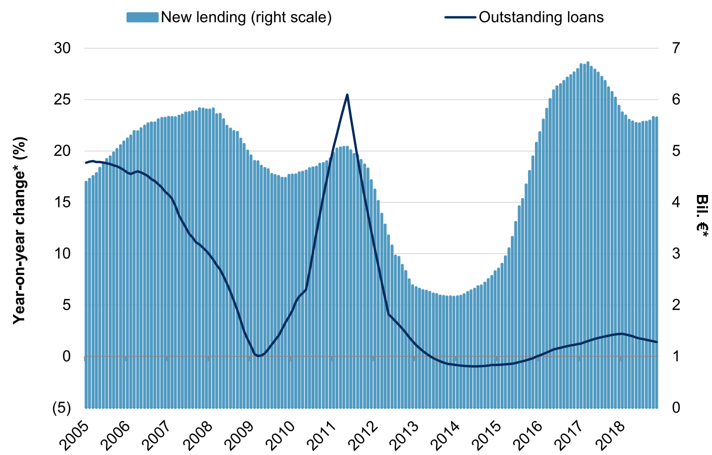
Total Transactions



Sources: Agenzia del Territorio, Nomisma.

Chart 5.2

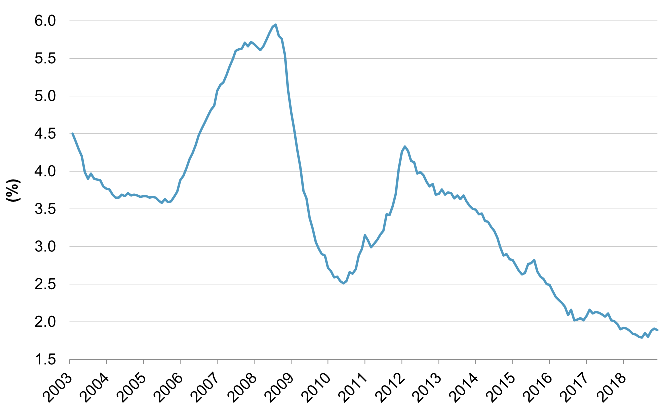
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 5.3

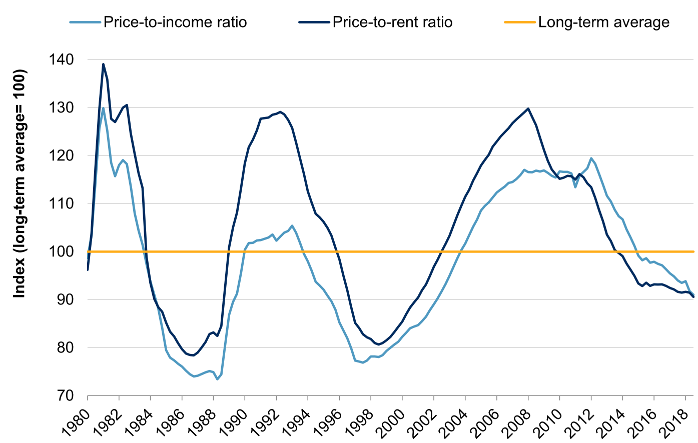
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 5.4

Price Ratios



Sources: OECD, Nomisma.

Netherlands: Worsening Affordability May Cap Strong Price Inflation

Table 7

Dutch Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	6.7	8.5	9.2	6.3	5.3	4.2
Real GDP, % change	2.1	3.0	2.6	1.9	1.9	1.6
CPI inflation (%)	0.1	1.3	1.6	1.9	1.8	1.7
Unemployment rate	6.0	4.9	3.9	3.8	3.8	4.0

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

We expect that house price growth will remain strong at 6.3% this year and 5.3% in 2020 (down from an estimated 9.2% in 2018), supported by solid economic conditions and a resilient labor market. Worsening affordability and slowing transactions might lead to decelerating price growth.

State Of Play

House prices increased by an annual 10.2% in third-quarter of last year, up from 8.5% in 2017 and exceeding their pre-crisis peak in third-quarter 2008. Compared with the long-term average, prices are now overvalued by 21% in terms of price to rent and by 27% in terms of price to income.

Strong economic growth, which translated into a buoyant labor market, has supported the Dutch housing market over the past four years. We estimate GDP growth of 2.6% for 2018, a small deceleration from 3.0% in 2017.

Still-favorable financing conditions have also helped demand for housing through affordable mortgages. In December 2018, interest rates for house purchases stood at 2.4%, barely up from their lowest point in January, while the acceleration in consumer price inflation means that real interest rates are at a historical low.

In addition to strong demand, low supply has further contributed to the rise in house prices. Following the housing market crisis in 2013, construction in the residential real estate sector dropped. Despite government efforts, like the National Housing Agenda, to increase housing construction, and an increase in construction permits since mid-2016, supply lags behind demand. Therefore, the number of properties for sale has fallen to about 70,000 in 2018 from 230,000 in September 2013. This has translated into a deceleration in housing transactions, and even a decline since June last year.

What We Expect

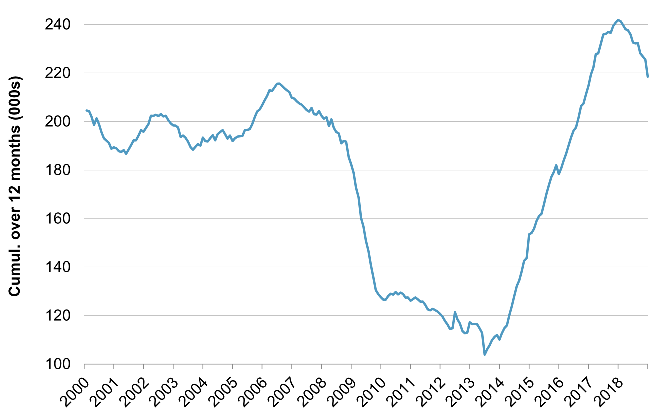
We expect solid, but decelerating GDP growth of 1.9% this year. The labor market should continue to support household income, with unemployment decreasing and wage growth accelerating further next year. This should support housing demand and price growth, which will remain above growth in households' disposable income and thus weigh further on affordability.

Construction permits have slowed again over the past year, barely increasing by 1% over the 12 months to October. Capacity constraints in the construction sector, notably linked to low unemployment, will likely continue to limit construction activity. The supply-demand gap will therefore persist and put upward pressure on housing prices.

However, we think that house price growth has peaked. Growth in housing transactions decelerated since mid-2017, and turned negative since June 2018. Historically, a deceleration in transactions often precedes a deceleration in housing prices. What's more, consumer confidence has declined over the same period as housing transactions. Worsening affordability will turn potential buyers away from the market. The resulting decline in demand should ease upward pressure on house prices.

Chart 6.1

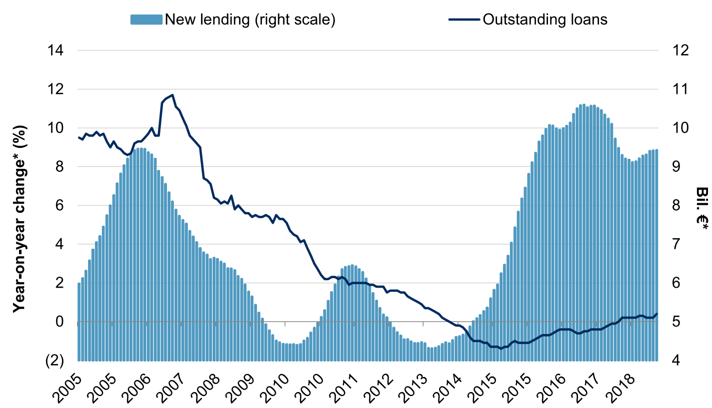
Total Transactions



Source: Central Bureau of Statistics Netherlands.

Chart 6.2

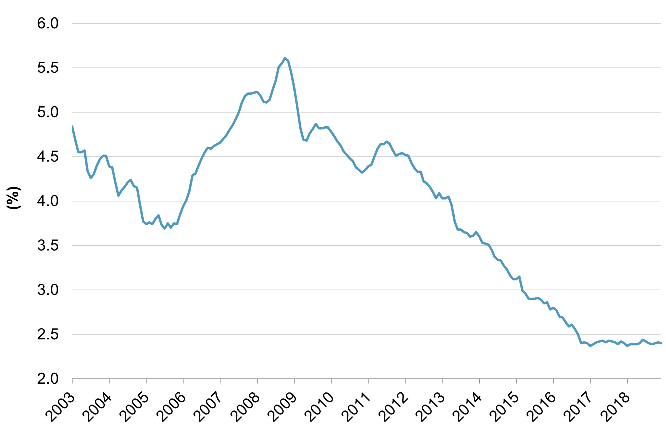
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 6.3

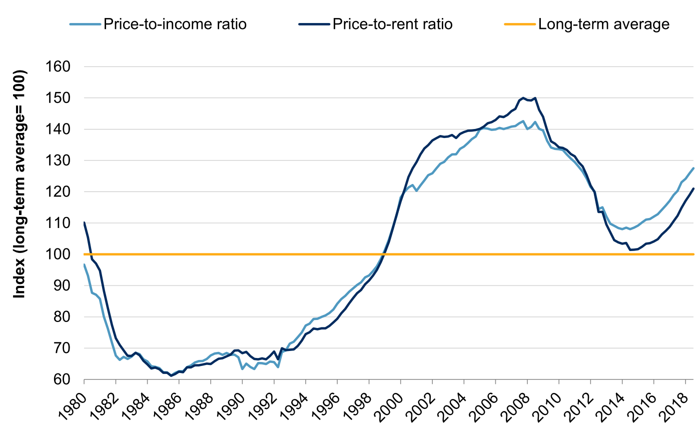
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 6.4

Price Ratios



Source: OECD, Kadaster.

Portugal: Home Prices Ease After Several Years Of A Housing Boom

Table 8

Portuguese Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	7.7	10.5	7,9	5,0	4,0	4,0
Real GDP, % change	1.6	2.7	2.3	1.9	1.7	1.7
CPI inflation (%)	0.6	1.6	1.2	1.5	1.7	1.8
Unemployment rate	11.1	9.0	7.3	6.5	6.0	5.8

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

We anticipate that house price growth in Portugal will abate to 5% this year, and 4% in 2020-2021, from a peak of 12% in the first quarter of 2018. Economic and financial conditions remain broadly supportive, while interest from international buyers is likely to remain strong. However, the market is facing headwinds from regulatory measures and deteriorating affordability.

State Of Play

Annual home price growth slowed to 8% in third-quarter 2018, from 12% in the first quarter. Regulatory measures and deteriorating affordability have taken some steam out of the market. Over the past two quarters, Portuguese banks have tightened credit standards for housing loans to comply with the macroprudential measures introduced by Banco de Portugal. Annual growth in new housing loans decelerated to 12% in August-October 2018, from close to 30% in previous months, despite very low mortgage interest rates that stabilized at 1.4%. On a net basis, however, mortgage lending finally started to increase in October 2018. Previous price increases above disposable income growth are gradually eroding the affordability for local buyers. Meanwhile, new legislation came into force in October last year, tightening regulations on short-term rentals. Investment in this lucrative segment has been driving the housing boom, especially in Lisbon.

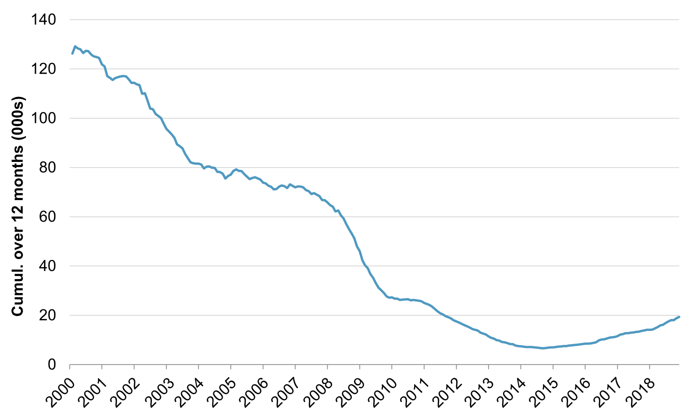
Activity in the housing market nevertheless remained dynamic, with the number of residential property sales increasing by 18% year on year in third-quarter 2018. Steady economic growth, accompanied by employment gains and rising household income, continues to underpin local demand for housing. The unemployment rate declined to 6.7% in December, amid rising workforce participation. The pace of job creation has slowed, however, to 2.1% in the third quarter, from above 3% throughout 2017. Meanwhile, foreign demand remains an important market factor. Portuguese residential properties are still relatively inexpensive, while special incentives remain in place for foreigners, such as a non-habitual resident program, or "golden visa" scheme for non-EU buyers. Strong house price growth over the past few years spurred a recovery in housing investment that is moving ahead at a brisk pace, with the number of completed dwellings enterting the market up more than 50% in the third quarter of 2018 year on year. Still, this is only a fraction of dwellings completed before the crisis, and supply-demand imbalances persist.

What We Expect

We expect that economic growth will ease to below 2% over the next few years, reflecting the maturing economic cycle and constraints from the high indebtedness of the private and public sector, as well as slow productivity growth. While the labor market should continue to improve, gains in employment are likely to be smaller. Coupled with deteriorating affordability and tighter credit standards, this suggests a softening of local demand for housing. Attesting to this trend, the ECB's bank lending survey points to a weakening of housing loan demand in the next quarter. Stricter regulations on short-term rental may deter some domestic and international investors. Still, with other factors that stimulate the interest of international buyers largely intact, foreign demand should continue to support the market. The gap between supply and demand is likely to persist over the next few years, underpinning house price increases.

Chart 7.1

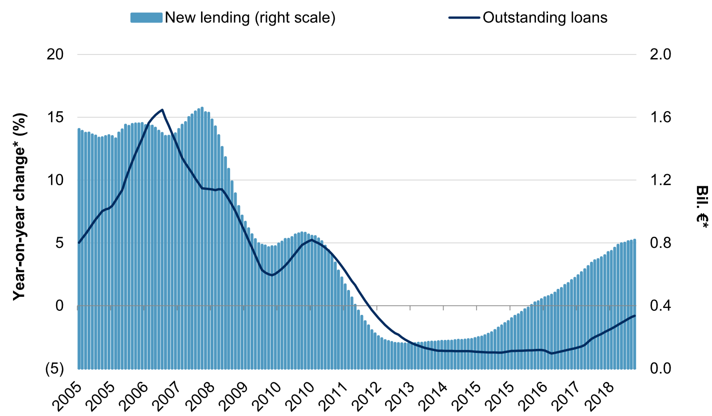
Construction Permits Issued Residential Buildings



Source: Statistics Portugal.

Chart 7.2

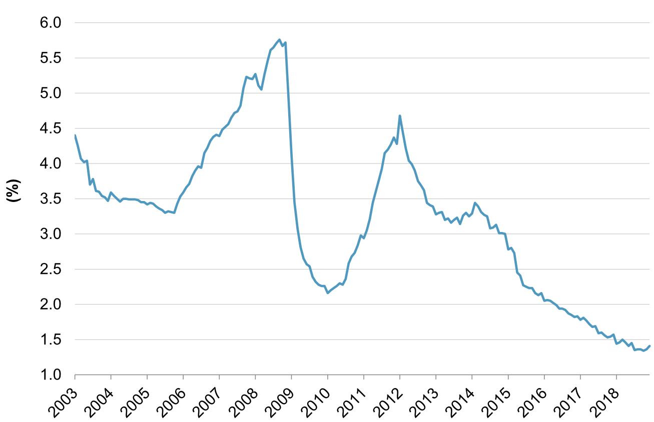
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 7.3

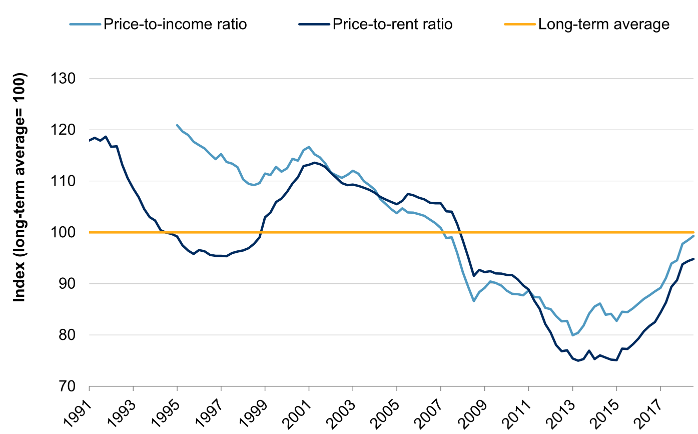
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 7.4

Price Ratios



Sources: OECD, ECB.

Spain: Resilient Economy Supports Housing Market Rebalancing

Table 9

Spanish Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	4.5	7.3	6.6	4.5	3.4	3.0
Real GDP, % change	3.2	3.0	2.6	2.3	2.1	1.8
CPI inflation (%)	-0.3	2.0	1.9	1.9	1.7	1.8
Unemployment rate	19.7	17.2	15.4	14.1	13.0	11.9

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

We expect house prices to increase by 4.5% this year and 3.4% next, decelerating from 6.6% in 2018. Economic conditions remain supportive of housing demand, although to a lesser extent than in past years. We expect affordability to worsen due to higher prices and tighter monetary policy.

State Of Play

House prices increased by an annual 7.2% in third-quarter 2018, stable from 2017. Since 2015, strong economic growth and broad structural reforms have significantly reduced unemployment and bolstered household income and consumer confidence. This has helped the housing market rebalance, with higher demand for housing reducing the oversupply resulting from the pre-crisis construction bubble, and putting upward pressure on house prices.

Due to the strong drop in house prices in the aftermath of the housing crisis, affordability is still not overstretched: the price-to-income ratio is still 29% below its 2007 peak, although 25% above its long-term average. Low interest rates for house purchases (2.0% in November) continue to support mortgage affordability. Given the rebound in inflation between May and October 2018, real interest rates were even negative during this period. Strong demand increased transactions by 12% in the 12 months to October 2018.

Strong regional disparities remain: while selling a property in Madrid takes 3.6 months, it takes 16.1 in Salamanca. These dynamics are also reflected by price developments, with Madrid house prices up 14% annually in fourth-quarter 2018, according to Tinsa, a real estate company.

What We Expect

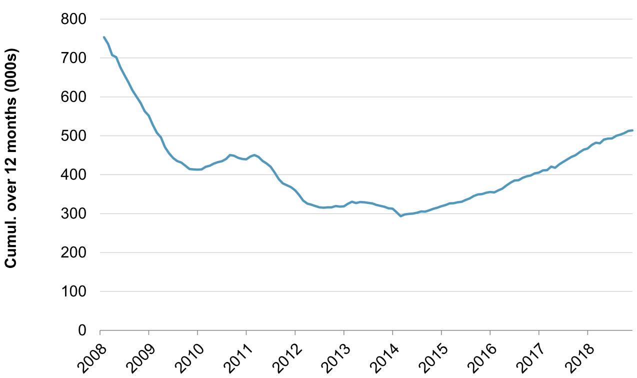
We expect economic growth to decelerate over our forecast horizon and to 2.3% this year. We see unemployment falling further and wages increasing faster over the next years.

Mortgage interest rates should increase further, in nominal and in real terms, but they will remain low by historical standards and thus continue to support demand for housing over our forecast horizon. The ECB's bank lending survey supports our view: banks expect demand for housing loans to increase over Q1 2019, and credit standards for housing loans to ease. This should translate into an increase in demand for housing. Despite the pickup in housing construction (investment in construction at 10.8 % of GDP in fourth-quarter 2018 up from 9.7% in 2013), we see the oversupply in residential property declining, and house prices increasing further. House price growth will exceed household income growth and therefore, affordability should worsen.

We see risk especially in regions with high housing demand and transactions, where new construction will not be able to keep up with demand and shortages will worsen. These areas have seen double-digit growth in prices in the past and household indebtedness is above the national average (17% of gross household income). Worsening affordability and increasing interest rates will aggravate households' vulnerability.

Chart 8.1

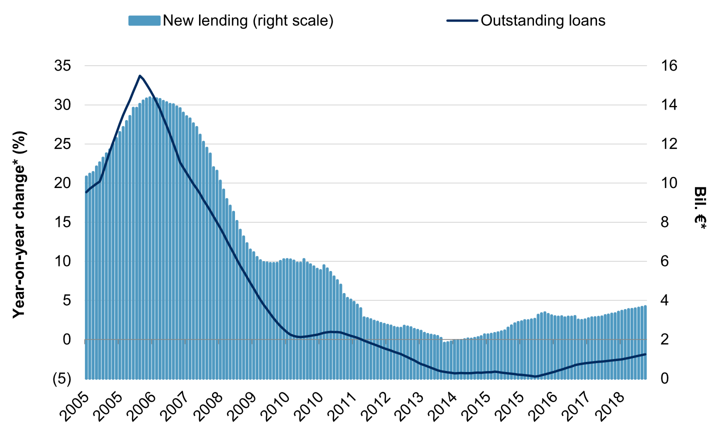
Total Transactions



Source: Instituto Nacional de Estadistica.

Chart 8.2

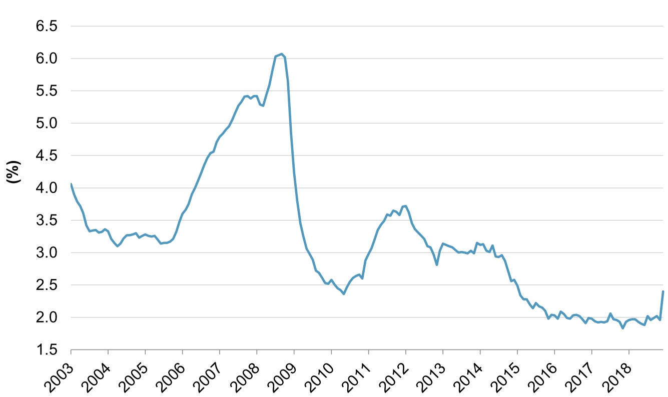
Housing Loans



Source: ECB. *Based on 12-month moving average.

Chart 8.3

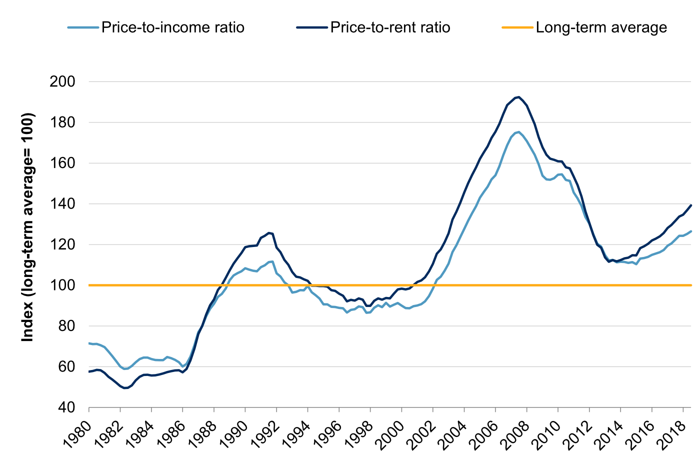
Average Interest Rate On New Housing Loans



Source: ECB.

Chart 8.4

Price Ratios



Source: OECD, Banco de Espana.

Switzerland: Price Growth Slows Amid Oversupply

Table 10

Swiss Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	0.4	4.0	3.5	2.2	2.0	2.0
Real GDP, % change	1.6	1.6	2.9	1.6	1.5	1.4
CPI inflation (%)	-0.4	0.5	1.0	0.8	1.0	1.2
Unemployment rate	3.3	3.2	2.6	2.4	2.3	2.2

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

Low affordability and oversupply have translated into decelerating prices in 2018. This, along with regulatory measures and slower population growth, will keep a lid on home prices going forward. That said, we don't expect a sharp correction in prices, since households are set to see their income prospects improve on the back of a healthy economy.

State Of Play

The housing market decoupled from the economy in 2018. While real GDP increased 1.6% in the first half of 2018, real house prices were only up 0.3% from end-2017. Nominal prices of privately owned apartments even dropped by 1.4% in the first three quarters of 2018, and declines were spread across the country. The moderation in housing prices was accompanied by a fall in construction activity. Residential construction volume was down 8% annually at end-2018, the steepest fall since mid-2015. There were some signs of house price stabilization toward end-2018, with prices of owner-occupied residential homes stabilizing in the third-quarter after four quarters of decline.

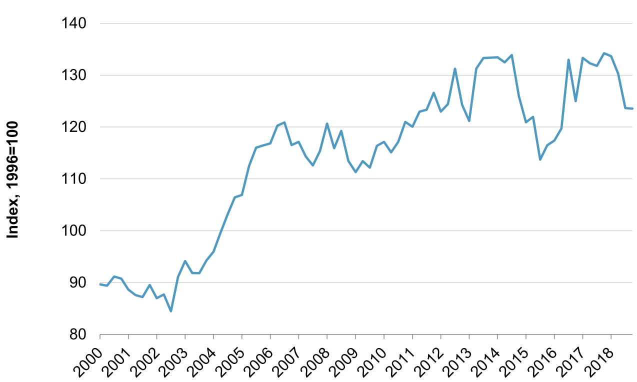
Oversupply and relatively high prices have brought about this turning point in the housing market. Since 2010 the vacancy rate of housing has been on the rise, reaching 1.62% of available housing in June 2018--a historical high--with 72,294 vacant homes on the market in 2018. Meanwhile, although the price-to-income and price-to-rent ratios are only slightly higher than their long-term average (5%-8%), they are up 40% since 2001. Thus, even if mortgage rates remain close to historical lows at 1.24% for the fixed five-year term, the affordability of housing has tended to deteriorate over the past few years. In 2017, 49% of new mortgages in the owner-occupied segment exceeded one-third of gross wage income, prompting the SNB to continue to warn of risks of more correction ahead. That said, mortgage lending continued to rise by 2.7% in October 2018. In the context of high household debt, this suggests macroprudential measures, such as the countercyclical capital buffers, will remain in place for now.

What We Expect

The high price-to-income ratio and vacancy rate will continue to dampen housing market activity and prices in the near term. That said, at this juncture, we do not expect a prolonged correction of housing prices, given a healthy economic backdrop. After a strong 2018, the Swiss economy is set to decelerate and experience growth of 1.6% this year, which is more or less in line with its potential output. Households will continue to benefit from a tight labor market, with the unemployment rate currently at its lowest since mid-2002. What's more, interest rates are likely to remain low until the end of this year, modestly improving housing demand. However, in the medium term, demographic developments are unlikely to be supportive of the residential housing market. Net migration to Switzerland has decreased and is set to remain low in the near future as labor markets have improved across Europe. The Swiss population is also aging, which means that housing demand will decrease over time, especially as the homeowners in Switzerland are 58 years old on average. As a result, we expect prices to rise only slightly more than GDP in 2019.

Chart 9.1

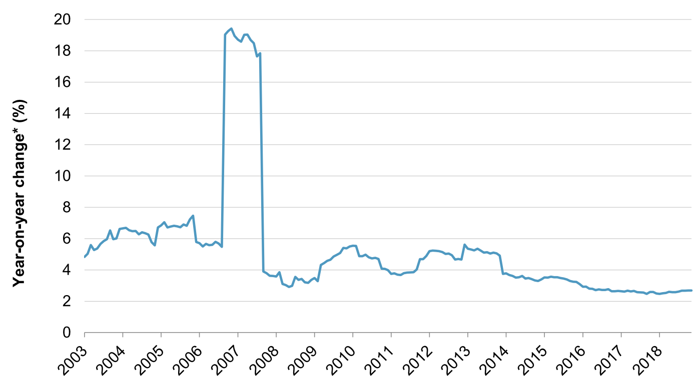
Housing Construction



Source: Credit Swiss, Swiss Contractor's Association.

Chart 9.2

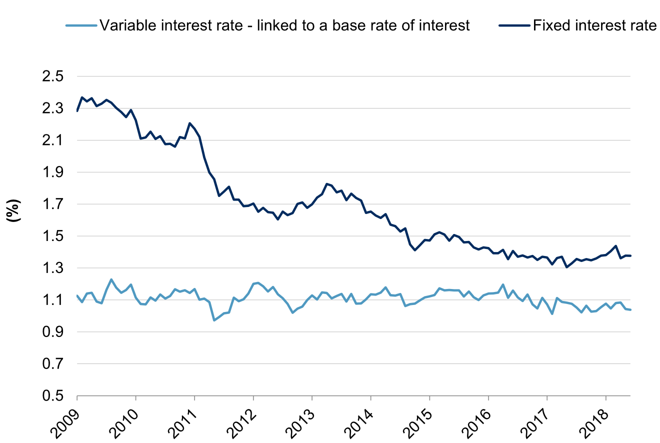
Housing Loans



Source: Swiss National Bank. *Based on 12-month moving average.

Chart 9.3

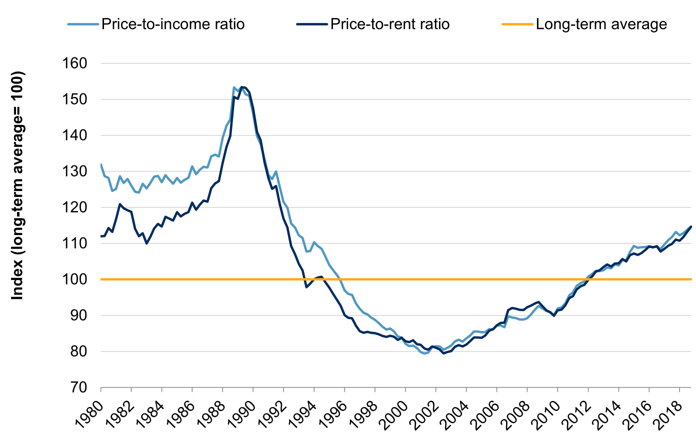
Average Interest Rates On Housing Loans



Source: Swiss National Bank.

Chart 9.4

Price Ratios



Sources: OECD, Swiss National Bank.

U.K.: Brexit Uncertainty Drags On House Price Growth And Activity

Table 11

U.K. Housing Market Statistics

	2016	2017	2018e	2019f	2020f	2021f
Nominal house prices, % change y/y	5.3	4.7	2.4	1.5	2.5	4.0
Real GDP, % change	1.8	1.7	1.3	1.3	1.5	1.3
CPI inflation (%)	0.6	2.7	2.5	1.9	1.7	2.6
Unemployment rate	4.9	4.4	4.1	4.2	4.4	4.5

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

The U.K. housing market is increasingly suffering from Brexit uncertainty. Once the U.K. secures a deal with the EU, the market should begin to recover.

State Of Play

Although national home prices have long surpassed pre-crisis levels, overall housing market activity remains muted compared with historical averages. This is in part a legacy of the 2008 crisis, but more recently also reflects the lasting impact of less favorable fiscal treatment and tighter underwriting rules for the buy-to-let market that were introduced in 2016. Uncertainty surrounding Brexit is now also weighing on the housing market, with potential sellers and buyers increasingly holding off on making decisions until there is more clarity.

As a result, annual price growth has slowed to an estimated 2.4% for 2018, down from 4.7% a year earlier. Price growth in London and the South East is now in negative territory, but the slowdown of the national index is limited as prices outside those regions are still catching up.

Building activity has also slowed. Housing starts in England started to decelerate in mid-2017, and have been falling since first-quarter 2018, without returning to pre-crisis levels. Moreover, the 160,000 units built each year remain almost 50% below the 300,000 that the government estimates are required to meet demand, although slower net migration since the referendum has eased demand. At the same time, the construction sector now increasingly suffers from labor and skills shortages, given lower net immigration.

What We Expect

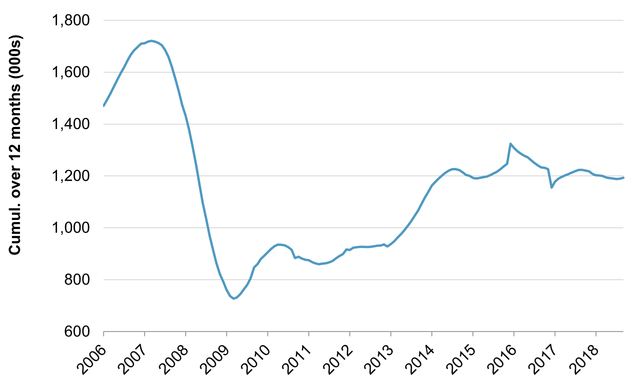
Our macroeconomic forecast is based on the assumption that the U.K. will leave the EU in an orderly manner, with a transition period in place until end--2020, though this may change as developments unfold. Current uncertainty is likely to result in price growth easing further, reaching a low, or potentially negative, point in mid-2019. That said, we expect prices will recover, reaching about 1.5% by end-2019 before accelerating to 2.5% in 2020, and 4.0% in 2020.

The tighter supply of new builds should underpin price growth over our forecast horizon. At the same time, we expect financing conditions for households to remain broadly favorable. The extremely competitive mortgage market has continued to compress mortgage rate spreads. Moreover, newly established ring-fenced banks continue to seek opportunities to deploy what, in their view, are excess retail deposits, adding to the competitive pressure. In view of this, along with the expected very gradual normalization of monetary policy, we expect mortgage rates, which are currently close to zero in real terms, to remain relatively low. Favorable financing conditions, along with robust pay growth due to the tight labor market, should underpin house price gains in 2019 and beyond. That said, the affordability of homes is likely to have reached a low in late 2018.

In the case of a disruptive, no-deal Brexit, we see house prices contracting by 6% in 2019 and a further 3% in 2020, before gradually recovering ("Countdown To Brexit: Rating Implications Of A No-Deal Brexit," Feb. 6, 2019).

Chart 10.1

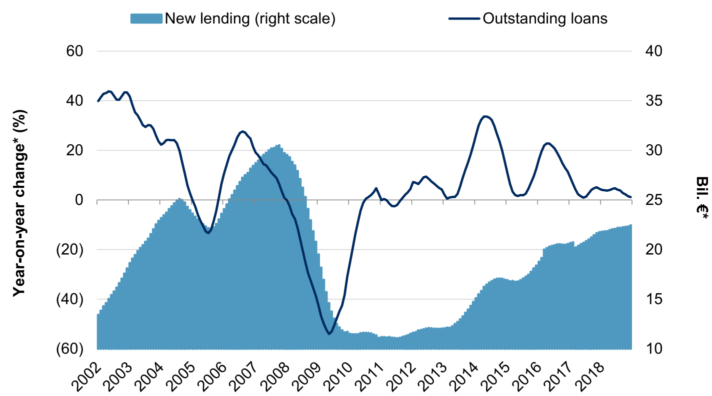
Residential Property Transactions Above £40,000



Source: HM Revenue & Customs.

Chart 10.2

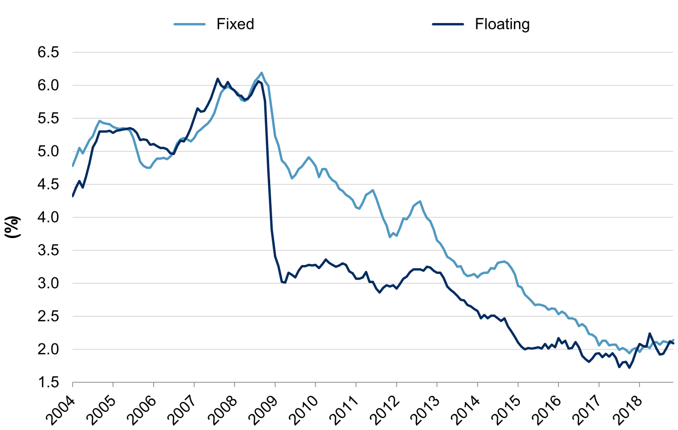
Housing Loans



Source: Bank of England. *Based on 12-month moving average.

Chart 10.3

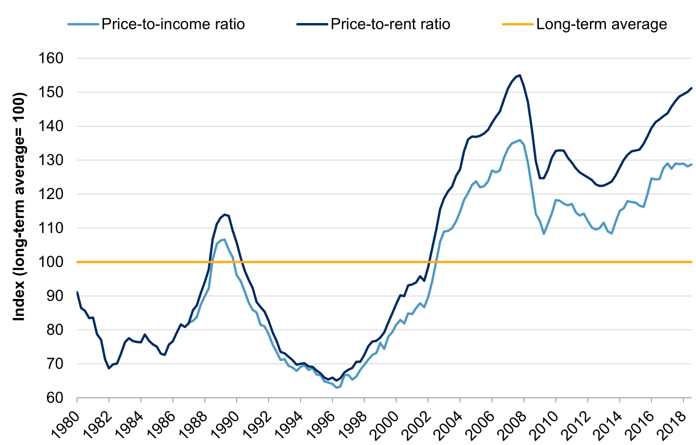
Mortgage Interest Rates On New Business - Banks



Source: Datastream, Bank of England.

Chart 10.4

Price Ratios



Sources: OECD, Department for Communities and Local Government.