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Economic Research:

Europe's Housing Market Inflation Is Losing Pace

March 2, 2020

Key Takeaways

- We expect house prices to rise more slowly in most European markets over the next three years. This is because housing markets are entering a more mature phase of the cycle in their recovery from the global financial and European sovereign debt crises for example in Spain and Ireland), or have already fully recovered. Declining affordability and softer economic growth also play a key role in decelerating price growth.
- Despite slower house-price inflation, price rises in many markets are still set to outpace pay growth, at least this year, leading to a further fall in affordability.
- Against a backdrop of generally weaker economic growth and little inflationary pressure, European monetary policy is set to remain loose for longer, and may even loosen further, notably in the eurozone. As a result, mortgage rates should remain at favorably low levels for prospective buyers, helped by increased competition among lenders in some markets, (including the U.K., Ireland, and the Netherlands).
- Among the nine western European countries covered in this report, only Italy, Ireland, and the U.K. will see an acceleration of price growth, although only moderately. Italy, where house prices have been contracting year on year since 2009, might be experiencing the start of a recovery, albeit a timid one.
- Price rises in the U.K. and Ireland in 2019 had been held back by uncertainties and risks related to Brexit and the December general elections in the U.K. The resolution of some of these risks should now underpin slightly higher house price growth in both countries.

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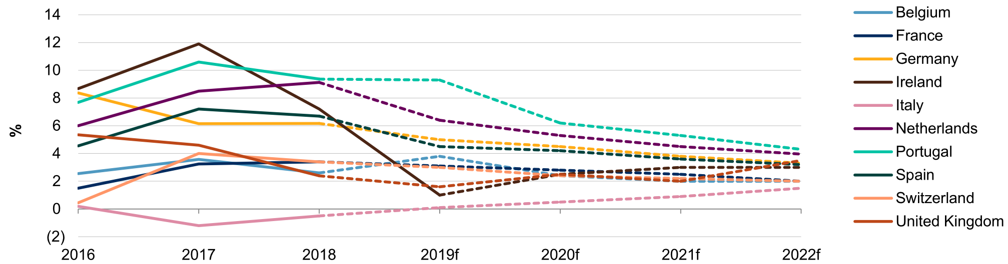
Chart 1

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



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

Monetary Policy And Interest Rates Outlook

European Central Bank: Lower for longer

European Central Bank (ECB) monetary policy is set to remain loose at least over the next three years. The eurozone economy continues to grow below its potential, and inflationary pressures remain weak. GDP growth in the fourth quarter of 2019 was below consensus at 0.1% quarter on quarter. Core inflation was just 1.2% in January, well below the ECB's now symmetric 2% target. Surveys are suggesting stabilization in economic activity. But this seems largely due to the bottoming out of the inventory cycle, especially in the car sector, and may therefore be short lived. The services sector is still the driver of growth, owing to a robust labor market. Meanwhile, global trade growth remains sluggish and the slowdown in the eurozone's largest trade partners, the U.S. and China, will likely be a drag on exports this year. This will especially be the case in China over the first quarter given the outbreak of the Covid-19 coronavirus (see "Economic Research: Resilient Domestic Demand Will Alleviate Coronavirus Consequences For Europe," published Feb. 12, 2020, on RatingsDirect). Subdued economic activity is unlikely to push up prices, thus the ECB is unlikely to look for policy tightening any time soon. If anything, we think that weaker data on growth and still-below-target inflation could lead to another deposit rate cut of 10 basis points (bps) this year. The precise timing is difficult to predict for now, as financial conditions remain good and the bar for another cut might be high in the context of the ECB strategy review. The Overnight Index Swaps (OIS) forward curve currently suggests that a cut could occur between October and December this year, which seems to us a reasonable assumption at the time of writing. In any case, it will be difficult for the ECB to keep a steady hand until the end of the year given the economic context. We also think that the ECB is unlikely to stop its current net asset purchases by €20 billion per month until the end of 2021 and raise rates before first-quarter (Q1) 2022. From the perspective of the eurozone housing markets, historically loose monetary policy means that buyers are likely to see their borrowing costs decrease and stay low until mid-2022, if not longer. Quantitative easing also means that long-term rates should remain compressed, especially for safe assets, providing real money investors such as insurance companies and pension funds another incentive to invest in housing and real estate, pushing prices up.

Bank of England: Now low for even longer

As in the eurozone, U.K. monetary policy should remain loose in the medium term. The Bank of England (BoE), like so many other central banks around the world, has moved away from earlier statements that it might need to raise rates earlier than markets were expecting. Instead, in a speech in January, Governor Mark Carney and, separately other Monetary Policy Committee members, had signaled a more dovish stance. In view of this, and in conjunction with weak data for Q4 2019, markets had expected the BoE to cut rates following its January meeting. Even though this did not happen, the BoE has not changed its new stance, in our view. We merely think that the bar for a rate cut is high, and that the data available at the time were not sufficiently firmly pointing to a deterioration of economic activity, especially considering that uncertainty in the run-up to the December general elections is likely to have played an important role in slowing activity temporarily. If the BoE was looking for an opportunity to cut rates, it has passed, at least for now. There are now indications that activity is picking up again, albeit to a modest level only, unless the government remains true to its promise of fiscal easing still this year, in which case the economy should receive more of an impetus. Unless the economy experiences a significant negative shock to confidence--and a more dramatic spread of the coronavirus could trigger such a shock--or unless the BoE sees clear signs of a downturn in activity, we do not expect the bank to cut rates. With that in mind, we are watching particularly closely whether the government will loosen its commitment to complete the negotiations with the EU by the end of the year, or whether it will stick with it. The latter case has the potential to, once more, negatively affect economic activity caused by uncertainty about the U.K.'s business model going into 2021, and could trigger the BoE to cut rates. From today's perspective and in the absence of any such shock, we expect the bank to keep rates at their current levels until at least August 2021, if not longer.

Swiss National Bank: FX market interventions battle a strong currency

Leading indicators (KOF, OECD) suggest that the Swiss economy is has stabilized. However, it is still also suffering from weak industrial activity. The manufacturing sector has shown signs of tentative recovery, but remains in contraction territory. Meanwhile, a strengthening franc—which is seen as a safe haven currency in a world of high uncertainty--is further weighing on exporters' price competitiveness and has translated into lower import price pressures. When the coronavirus shock fades, we should see less upward pressures on the franc. For now, the unemployment rate remains low at 2.3% and services sector activity is holding up quite well. However, headline price pressures are still low. The Swiss National Bank (SNB) forecasts 0.1% for this year and only 0.5% for 2021. Against this backdrop, the central bank is set to keep an accommodative stance to provide support to the economy and make sure inflation expectations remain anchored. The SNB will also remain committed to intervening in the foreign exchange markets to keep the currency from appreciating too much, and will definitely wait to see what the ECB does before announcing any additional easing measures, as well as before tightening policy. As in the eurozone, this means that housing investors will anticipate that rates will stay low for the next two years at least.

Lower long-term interest rates for longer

Concerns over global growth due to the outbreak of the coronavirus in China and dovish declarations made by the U.S. Fed and the BoE have led long-term government bond yields to ease by 30 bps in the U.S. and by 20 bps in Europe since beginning of the year. Yields are now back to their all-time lows. They are likely to hover in a close range in the coming years, as neither a strong rebound in global growth, nor overshooting in inflation, or a tightening of central banks' liquidity emerge as likely developments on the radar screen. Most developed economies are close to a steady state. And China, which accounts for about 16% of the world economy and one-third of global growth, is likely to cool down further over the next two years. Only a significant shock to the global economy and liquidity could change the current picture.

Table 1

European Housing Market Forecasts

Nominal house prices change, year on year (%)	2016	2017	2018	2019f	2020f	2021f	2022f
Belgium	2.6	3.6	2.6	3.8	2.4	2.0	2.0
France	1.5	3.2	3.4	3.1	2.8	2.5	2.0
Germany	8.4	6.2	6.2	5.0	4.5	3.8	3.3
Ireland	8.7	11.9	7.2	1.0	2.5	3.0	3.0
Italy	0.2	(1.2)	(0.5)	0.1	0.5	0.9	1.5
Netherlands	6.0	8.5	9.1	6.4	5.3	4.5	4.0
Portugal	7.7	10.6	9.4	9.3	6.2	5.3	4.3
Spain	4.5	7.2	6.7	4.5	4.2	3.6	3.2
Switzerland	0.4	4.0	3.4	3.0	2.4	2.2	2.0
U.K.	5.3	4.6	2.4	1.6	2.5	2.0	3.5

f--Forecast. Sources: S&P Global Ratings, OECD, Hypoport, Wüest Partner.

Belgium: Financing Is Favorable, Affordability Stretched

Belgian Housing Market Statistics

Table 2

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal house prices change, year-on-year	2.6	3.6	2.6	3.8	2.4	2.0	2.0
Real GDP change	1.5	2.0	1.5	1.3	1.1	1.2	1.2
CPI inflation	1.8	2.2	2.3	1.3	1.6	1.6	1.8
Unemployment rate	7.9	7.1	6.0	5.4	5.7	5.7	5.7

Note: for 2019 CPI and unemployment rate are actual numbers. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, Banque Nationale de Belgique, OECD.

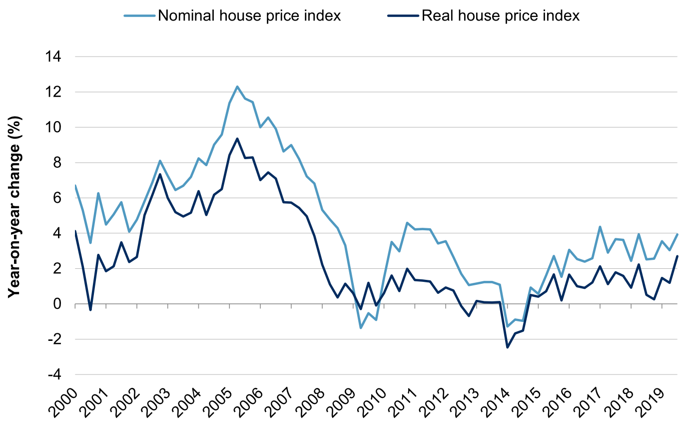
We foresee house prices expanding at 2.4% this year and 2.0% from 2021, decelerating from an estimated 3.8% in 2019. Favorable economic and financing conditions will remain supportive of price growth, while stretched affordability will weigh on demand for owner-occupied housing.

State of play. House prices increased by an annual 3.9% in Q3 2019, up from 3.0% in the second quarter and 2.6% in 2018. This reflects an acceleration in economic growth in the third quarter of 2019 to an estimated 1.3% for the year as a whole. The labor market was the main driver of economic growth, supported by reforms over the past years. The unemployment rate stood at a long-term low of 5.2% over the second half of the year. In combination with wage growth, this led to a 4% average annual increase in disposable income in 2019 through September. Favorable financing conditions also supported housing demand. Amid the ECB's accommodative monetary stance, mortgage interest rates reached an all-time low of 1.67% in November. Interest rates net of inflation rose to 1.3% in November, from negative real interest rates in Q1, due to weaker consumer price inflation. Worsening affordability, however, has started to weigh on housing demand. Contrary to other eurozone countries, the Belgian housing market barely saw a price correction after the global financial crisis. Adding strong price growth over the past years, this led to increasingly overstretched affordability of residential property. Overvaluation was 52% in terms of the price-to-income ratio and 36% in terms of price to rent, despite solid wage growth over the same period. On the supply side, a surge in construction permits for owner-occupied housing, especially in 2018, resulted in more dynamic housing transactions, rising to 6% over the 12 months to September, compared to 2.9% a year earlier. Similarly, housing loan volumes grew by around 13% over the 12 months to September, compared to 2% for the average value of a mortgage. This shows that the number of mortgage loans rather than their value is driving new lending increases.

What we expect. We foresee economic growth in Belgium slowing to 1.1% this year from an estimated 1.3% last year. Household consumption will be the main pillar of economic grow owing to rising wages and low unemployment. Mortgage interest rates are set remain low in the context of the ECB's expansionary monetary policy, also underpinning households' demand for residential property. However, we see little room for the unemployment rate to decline further, which will be less supportive of housing demand. Worsening affordability will continue to weigh on demand for housing, and overvaluation, notably compared to renting, should drive potential homebuyers out of the market for owner-occupied housing. We therefore see house prices in Belgium remaining solid, but easing. In our opinion, the recent increase in construction permits will not be sufficient to dampen supply shortages, especially in Brussels. Overstretched affordability in this area should curb demand and thus house-price growth to rates below the national average. The ECB's bank lending survey supports our view. Banks foresee households' credit demand for housing declining in the first quarter of this year, after an increase at the end of last year. Yet they expect easing credit standards after a recent period of tightening.

Chart 1.1

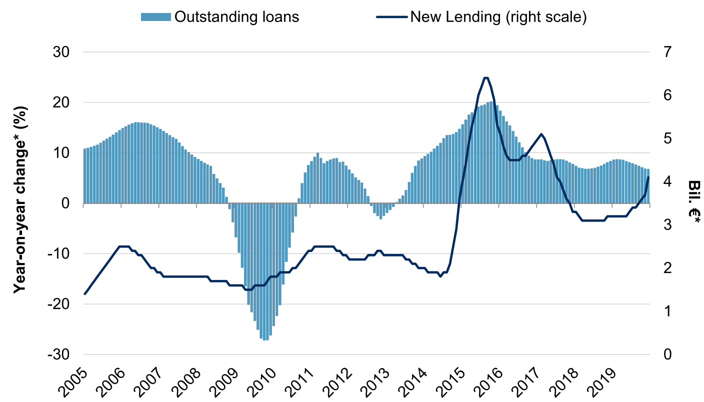
House Price Indices



Source: OECD, S&P Global Ratings.

Chart 1.2

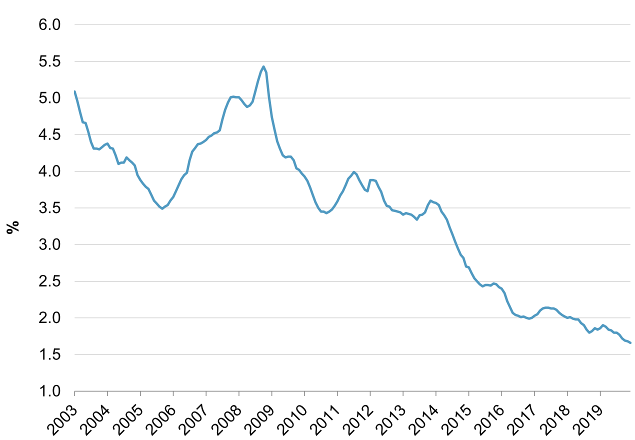
Housing Loans



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

Chart 1.3

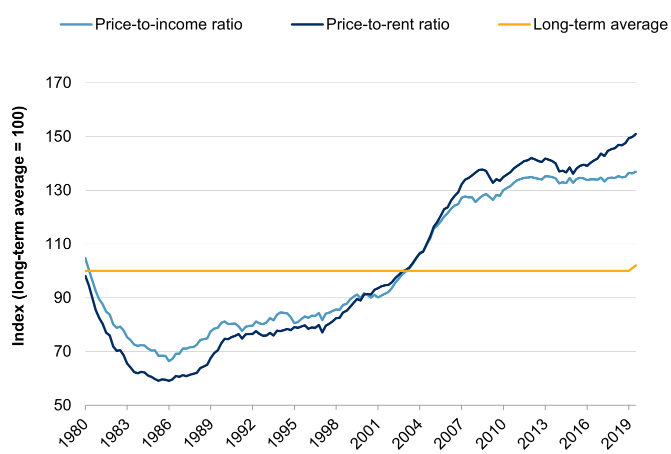
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 1.4

Price Ratios



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

France: Price Rises Ease As Household Income Growth Slows

House prices should continue to grow at a relatively steady pace, rising 2.8% this year from 2.5% last year, and gradually softening after that. Borrowing costs could drop further, but subdued economic growth will likely mean slower wage growth, which will limit strong property-price gains given a high price-to-income ratio.

Table 3

French Housing Market Statistics

(%)	2016	2017	2018	2019	2020f	2021f	2022f
Nominal house prices change, year-on-year	1.6	3.3	3.4	3.1*	2.8	2.5	2.0
Real GDP change	1.0	2.4	1.7	1.2	1.3	1.3	1.4
CPI inflation	0.3	1.2	2.1	1.3	1.1	1.4	1.6
Unemployment rate	10.1	9.4	9.1	8.5	8.3	8.1	8.0

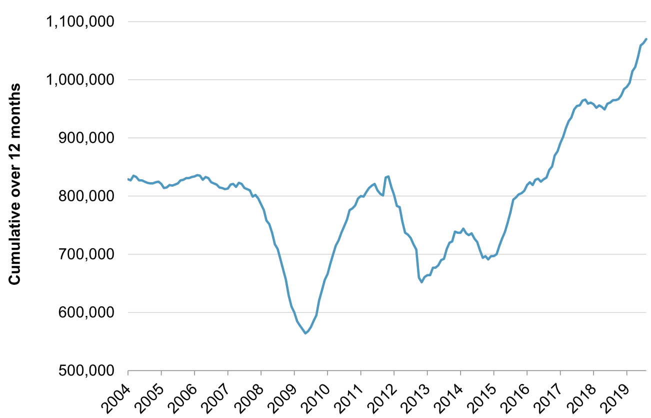
*For 2019 nominal house prices change is the forecast. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, INSEE.

State of play. French housing transactions continue to reach new highs, adding up to 1.4 million in the 12 months to November 2019. Despite such dynamism, prices are rising in line with household incomes, up 3.1% annually in Q3 2019. This corroborates our view that the market is not overheating. Even if housing affordability is close to its highest since the beginning of the 2000, a high price-to-income ratio (22% above its long-term average) acts as a cap on housing prices. Housing sales remain more dynamic outside the capital. Paris' housing market suffers from limited supply, elevated prices, and less favorable demographics than second-tier French cities such as Lyon, Toulouse, or Nantes. That said, high demand relative to limited supply in Paris continues to push house-price growth above the national average, at 6% year on year in Q2 2019. Yet, this is less dynamic than Nantes and Lyon, where prices have continued to increase at close to 10% annually. Capacity in the construction sector is becoming even tighter in the context of strong housing demand. Although the economy contracted in Q4 2019, the backdrop for households remains very positive. Real disposable incomes are rising at their fastest pace since 2007 on a dynamic labor market and supportive fiscal policies. Inflation is also low (1.1% over 2019) on lower energy prices. In this environment, consumers continue to report intentions for house purchases or home improvements in February 2020 that are close to their all-time high. Decreasing borrowing costs are also boosting affordability, with the interest rate on new borrowing at 1.17% in December 2019, down from 1.39% six months ago. Households are therefore piling on more debt, with new net lending up 6.5% year on year in January. While the central bank is monitoring rising household debt, for now higher rates are not on the horizon and households are shielded by long maturity and fixed-rate mortgages. Banks' underwriting criteria have eroded, with longer loan maturities and deteriorating debt service-to-income (DSTI) ratios. In other words, a rising share of income is being allocated to debt repayments, attracting scrutiny from authorities. In recent weeks, authorities have reiterated the importance of adequate pricing of home loans to cover banks' risks and costs.

What we expect. Price expectations have continued to decrease slowly since the end of 2018, and timely data points to relatively stable price dynamics at the end of 2019. A high level of transactions, consumers' intention to buy, and robust activity in the construction sector should support house-price growth, along with continued monetary easing, feeding to even lower borrowing costs. Nonetheless, given that the house price-to-income ratio remains around 20% above its long-term average and households have already resorted to maturity extensions to improve affordability, we expect housing prices to grow only slightly faster than household income. Thus, we expect housing prices to ease as household income is set to slow on the back of weaker job creation and less supportive fiscal policy.

Chart 2.1

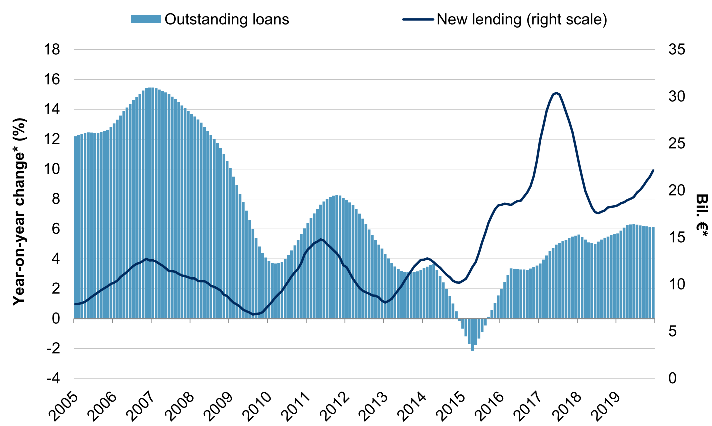
Total Existing Home Sales



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

Chart 2.2

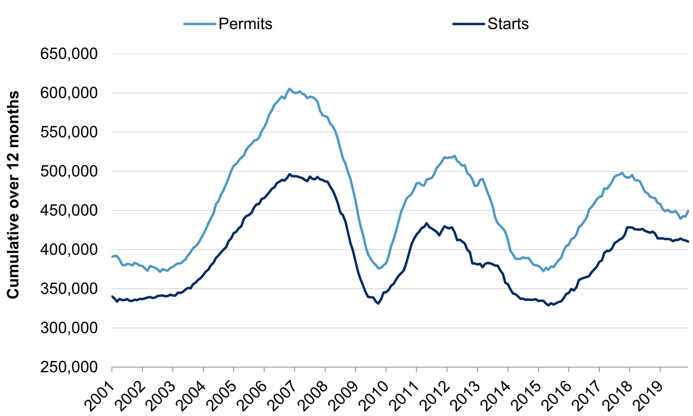
Housing Loans



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

Chart 2.3

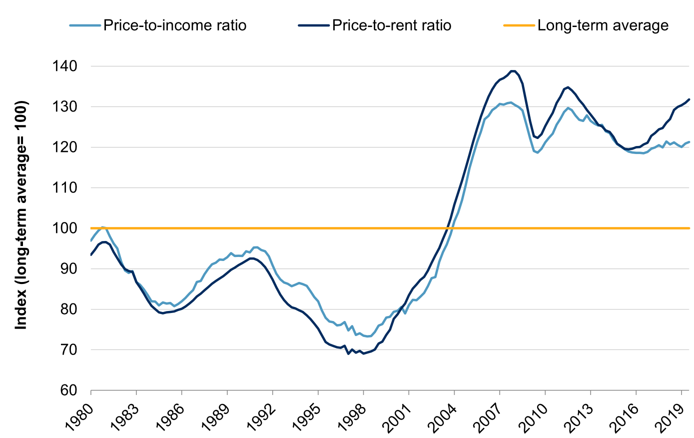
Residential Buildings Construction Permits And Starts



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

Chart 2.4

Price Ratios



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

Germany: Solid Demand, Tight Supply Still Fuels Price Rises

Table 4

German Housing Market Statistics

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal house prices change, year-on-year	8.4	6.2	6.2	5.0	4.5	3.8	3.3
Nominal house prices change, year-on-year, seven biggest cities	10.8	9.7	9.6				
Real GDP change	2.1	2.8	1.5	0.6	0.5	1.0	1.1
CPI inflation	0.4	1.7	1.8	1.4	1.4	1.5	1.6
Unemployment rate	4.2	3.8	3.4	3.2	3.3	3.4	3.4

Note: for 2019 GDP, CPI, and unemployment rate are actual. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, Hypoport, Federal Statistics Office.

We expect house-price inflation of 4.5% this year and 3.8% in 2021, from an estimated 5.3% last year. The strong labor market and favorable financing conditions will continue to boost demand for housing, while worsening affordability in big cities should dampen price growth. That said, supply will not be able to meet demand, therefore contributing to price pressures.

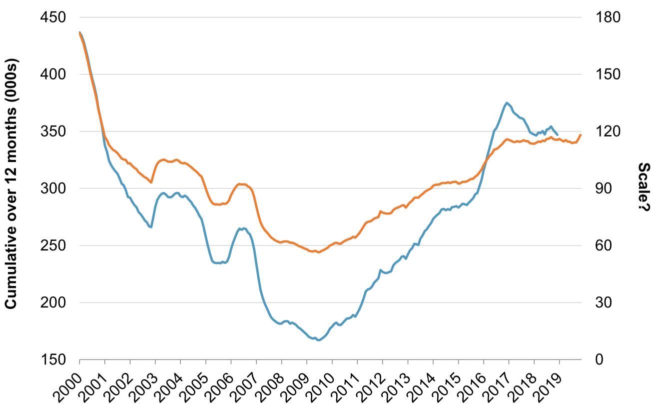
State of play. House prices increased by an annual 4.8% in Q3 2019, decelerating from 6.2% growth in 2018. Despite strong growth rates over recent years, the cost of owner-occupied residential property just surpassed its long-term average relative to renting by 3%, but is still 4% below its long-term average relative to income. The latter is partly due to strong wage growth over the same period. The solid labor market as well as loose financing conditions are key factors supporting demand for owner-occupied housing. Mortgage interest rates on outstanding loans reached a new record low of 1.26% in November amid another wave of quantitative easing by the ECB. Net of consumer price inflation, this represents a real interest rate of close to zero. This resulted into new lending of €22 billion in 2019, an increase by 9% over the previous year.

Another factor driving higher prices is a lack of supply. New housing construction remains too low for supply to catch up with demand. The construction sector faces important capacity constraints, notably for skilled workers given the tight labor market. Completed dwellings amounted to only 250,000 for the year in 2018, and housing permits in 2019 through November were 319,000--far below the annual 375,000 the coalition agreement aims for. While the lack of housing in big cities and university towns pushes up house prices, oversupply is increasing in rural areas with shrinking populations. Although statistics have not yet been released, we believe house-price growth in the seven biggest German cities decelerated further in 2019, but still outperformed the national average, a trend we expect to continue through this year and next.

What we expect. German economic performance will remain subdued this year, with GDP growth at 0.5% and 1.0% next year. The manufacturing sector is still suffering from the current global economic slowdown, especially following the effects of the outbreak of the coronavirus in China. The labor market remains a factor supportive of housing demand, with unemployment at 3.2% in December, but the unemployment rate has reached its lowest point and wage growth will be contained by economic uncertainties. In this context, consumer confidence decreased over the second half of last year and uncertainties about their future income might reduce households' willingness to invest in housing. However, financing conditions will remain supportive of housing demand, with the ECB's bank lending survey pointing to higher demand for housing loans in the first quarter of 2020. Meanwhile, the tight capacity constraints in the construction sector also suggest that the lack of housing to meet demand will continue. This is likely to be exacerbated by the cap on rents introduced in large cities, as this will disincentivize investment in housing. As prices inch higher, we expect an increasing number of potential house buyers will move out of cities into their catchment areas due to worsening affordability. This will limit pressure on the housing market in the big cities, while increasing demand and prices in the surrounding towns.

Chart 3.1

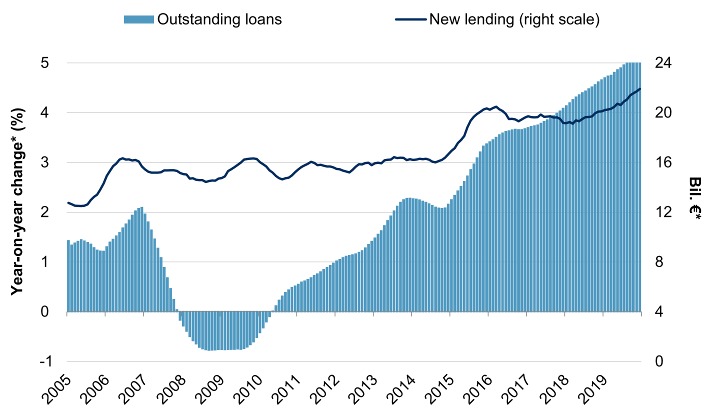
Residential Construction Permits



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

Chart 3.2

Housing Loans



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

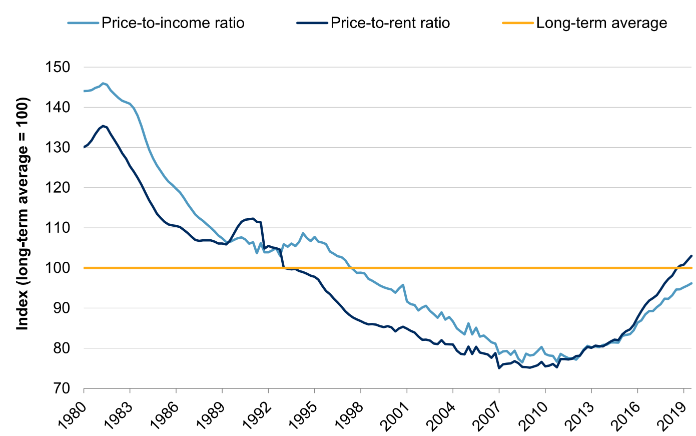
Chart 3.3

Average Interest Rate On New Housing Loans

Source: ECB, S&P Global Ratings.

Chart 3.4

Price Ratios



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

Ireland: Pent-up Demand Should Underpin Moderate Price Growth

Table 5

Irish Housing Market Statistics

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal house prices change, year-on-year	8.7	11.9	7.2	1.0	2.5	3.0	3.0
Real GDP change	3.7	8.1	8.2	5.8	2.7	3.0	3.0
CPI inflation	(0.2)	0.3	0.7	0.9	1.4	1.5	1.5
Unemployment rate	8.4	6.7	5.8	5.0	5.2	4.5	4.5

Note: for 2019 CPI and unemployment rate are actual. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Central Statistics Office.

We expect house prices to rise by 2.5% this year on the back of reduced Brexit uncertainties. Absent further Brexit turmoil, pent-up demand and a continued influx of overseas workers should stabilize price growth at 3% in 2021 and 2022.

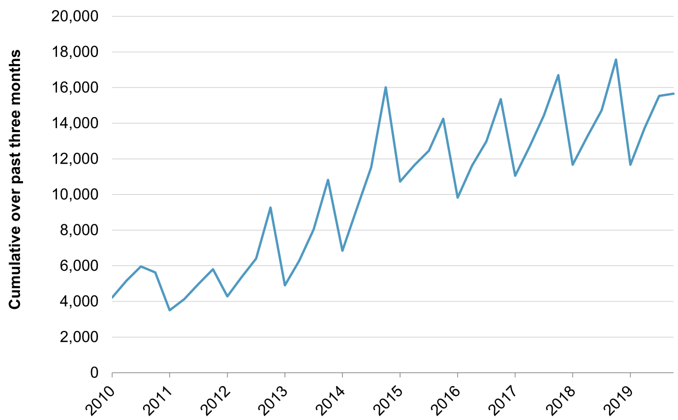
State of play. House-price inflation slowed through 2019, and was just 1% at year-end, down from 7.2% in 2018. The slowdown of the national average was mainly driven by prices falling in Dublin for the first time since 2011. This was to be expected given the late stage of the price recovery alone, but various factors added downward pressure. The central bank's prudential lending rules, in particular the 3.5x loan-to-income ratio, have been increasingly binding, especially in Dublin where the average home is currently selling for around 7x income, double the lending cap, with buyer interest increasingly turning to the surrounding commuter counties. Brexit uncertainty also likely played a role, reflected in a 13% drop in new instructions to sell, according to some estimates. Consumer sentiment also dropped throughout 2019 and has only just started to recover, with banks reporting demand weakness, especially in H2. Looking at the bigger picture, new mortgage loans have yet to recover in earnest from the financial and housing market crisis. They have been hovering around €1 billion per month since 2012 (after €2.6 billion on average during 2003-2005).) Despite only gradually easing capacity constraints and high construction costs, new supply in 2019 is estimated to have improved to above 21,000 units (just under 10,000 units only three years earlier). The pipeline remains robust, and newbuilds are increasingly reaching the open market. Transaction volumes are also continuing to increase steadily, with over 45,000 transactions in 2019, a 12% increase in the same three-year period. Unlike house prices, rents continue to rise above pay growth. This increasingly important segment has been suffering from severe undersupply, owing to high construction costs, shifting demographic trends, and the presence of the prudential rules. The much higher rents than mortgage costs illustrates the disconnect between the rental and buyer market. In a steady market, these costs should be tied closely to each other. With many small buy-to-let investors exiting, the growing presence of domestic and international institutional capital in the private rental scheme market should gradually ease pressures, especially once this translates more into construction, rather than purchase of existing stocks. However, it remains to be seen how the policies of a new government will affect housing and the rental market.

What we expect. Even if supply improves at its current pace, it will likely soften house-price growth only at the margins given pent-up domestic demand bolstered by the influx of overseas workers. Some Brexit uncertainty has also been lifted after the U.K. elections in December and

U.K. exit from the EU. This, combined with a still good--albeit slowing--pace of economic growth that we expect for the next few years, should support a pick-up of price growth to between 2%-3% over 2020-2022. However, our forecast is subject to significant risks. Should U.K.-EU trade negotiations stall, the threat of trade on World Trade Organization terms from 2021 could introduce fresh downward pressure on Ireland's house prices.

Chart 4.1

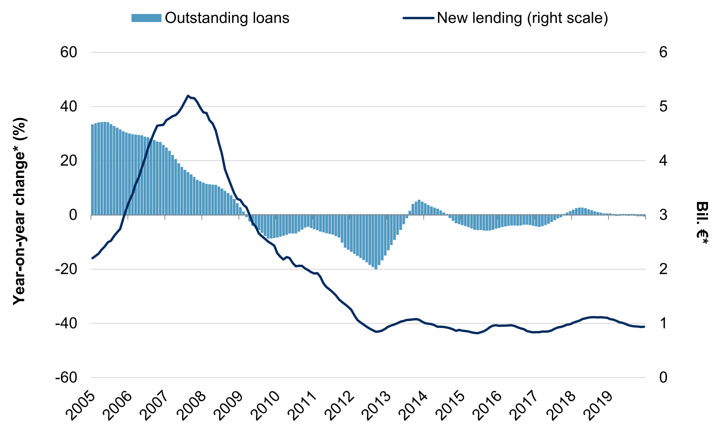
Total Transactions



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

Chart 4.2

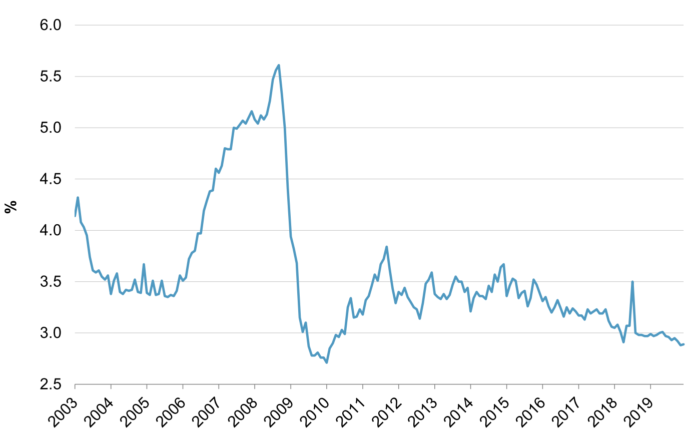
Housing Loans



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

Chart 4.3

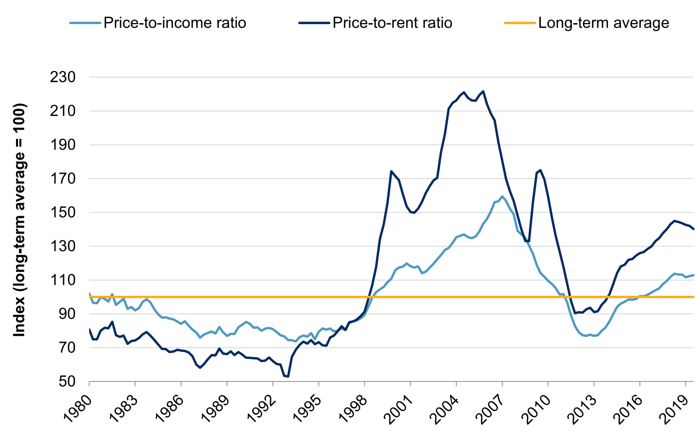
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 4.4

Price Ratios



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

Italy: Rising Affordability Supports A Small Price Recovery

Table 6

Italian Housing Market Statistics

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal house prices change, year-on-year	0.2	(1.2)	(0.5)	0.1	0.5	0.9	1.5
Real GDP change	1.4	1.8	0.7	0.2	0.4	0.6	0.7
CPI inflation	(0.1)	1.3	1.3	0.7	0.7	1.1	1.3
Unemployment rate	11.7	11.3	10.6	10.0	9.9	9.8	9.7

Note: for 2019 real GDP, CPI, and unemployment rate are actual. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Nomisma.

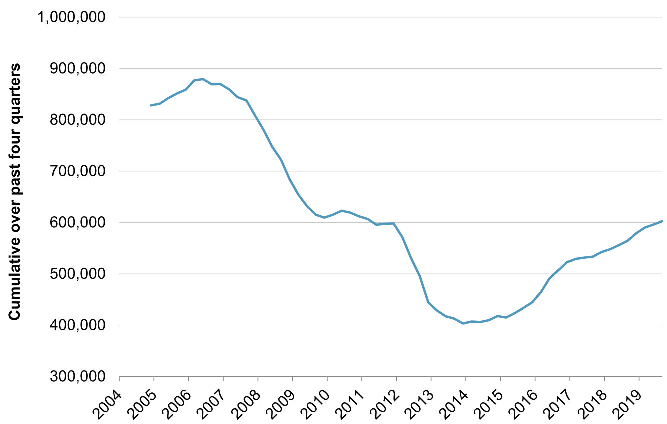
We expect house prices in Italy to be a little more dynamic this year, expanding 0.5% after 0.1% last year and contracting prices in the previous two years. A weak economy points to limited employment and income growth prospects. Elevated affordability and low borrowing costs will ensure demand holds up in the more dynamic regions so that prices rise on aggregate.

State of play. The housing market gained some dynamism at the end of 2019, posting positive in Q3 2019 (+0.4%) for the first time since 2016. Interest rates dropped significantly from 1.85% in May to 1.43% in November, following a reduction of the sovereign risk premium and additional ECB monetary policy easing. This was accompanied by loosening credit standards and sparked interest in housing. New business loans were up 49% in November, leading to further rises in transactions (they reached 600,000 in Q3 2019, their highest since 2011). Price trends reflect the country's economic divide: the south saw further contraction, while in the northern regions and Milan prices recovered in the past few quarters. Milan is outperforming the rest of the country by far, with prices up 5% annually in December 2019. On aggregate, new dwellings are in higher demand, experiencing positive price increases since the end of 2017. They were up 1.3% year on year in Q2 compared with just +0.1% for existing dwellings, especially as new housing builds are close to historical lows. Yet, confidence in the construction sector is still as high as 2006 levels. Furthermore, order books are still plentiful, pointing to ongoing dynamism in construction activity, especially as there are no signs of capacity constraints. We nevertheless view this as just the start of a timid price recovery. The Italian economy is still stuttering, hovering in and out of recession in 2019. This means that households are unlikely to see strong job gains, so limiting their income growth prospects. This is visible in the survey data with a lag. The ECB Bank Lending Survey suggests demand for housing is likely to stay flat in the next three months. Housing demand sentiment is still positive, but peaked in 2018 and has been decreasing since. Indeed, consumers' intention to purchase a home is now receded to 2014-2017 levels.

What we expect. The recent outbreak of the coronavirus is taking a toll on China's and global growth, suggesting that our Italy GDP growth forecast of 0.4% for 2020 will likely be revised downward. In our view, this will translate into a soft recovery in housing prices. Job creation has held up relatively well amid the slow growth environment and should continue to prevent any rise in unemployment. But subdued job creation will continue to drag on households' income growth prospects. That said, favorable affordability metrics will support housing demand—it has not been as affordable in Italy since 2002. Historically low interest rates and a price-to-income ratio more than 12% below its long-term average will continue to bolster housing demand in the more dynamic Italian cities and regions, such as Milan and the north. As such, expectations are starting to shift, with surveys of price sentiment pointing to further price rises. Less than 50% of respondents expect further price contraction.

Chart 5.1

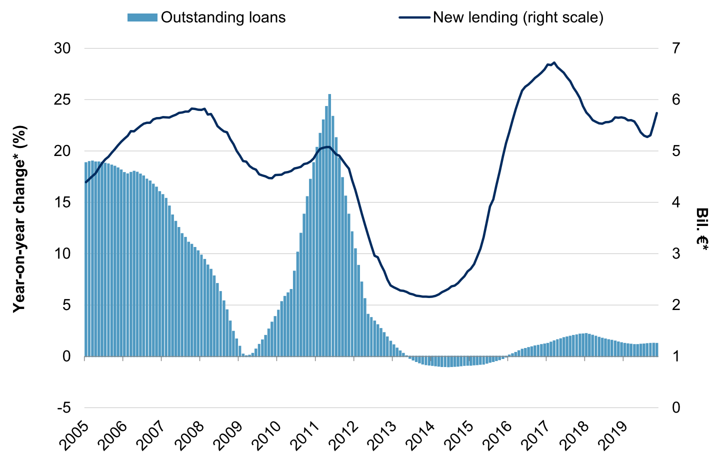
Total Transactions



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

Chart 5.2

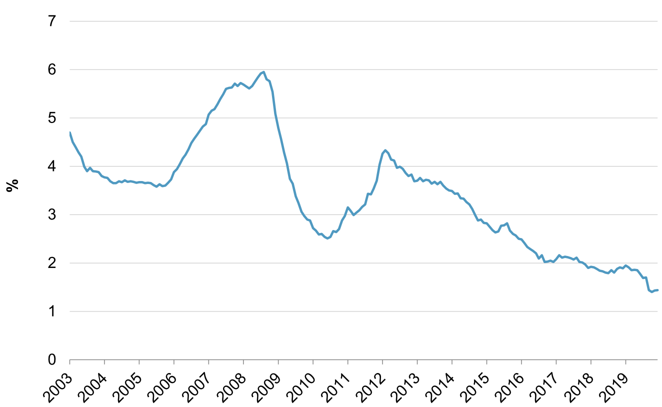
Housing Loans



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

Chart 5.3

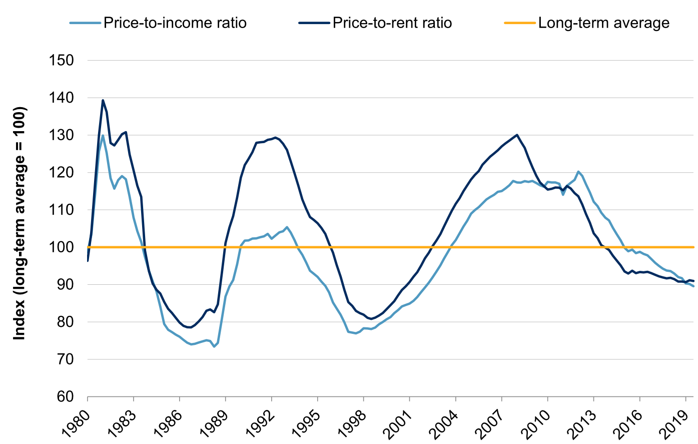
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 5.4

Price Ratios



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

Netherlands: Stretched Affordability Starts To Cap Strong Gains

Table 7

Dutch Housing market Statistics

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal house prices change, year-on-year	6.0	8.5	9.1	6.4	5.3	4.5	4.0
Nominal House Prices, % change y/y, Amsterdam							
Real GDP change	2.1	3.0	2.5	1.7	1.3	1.4	1.5
CPI inflation	0.1	1.3	1.6	2.7	1.4	1.4	1.6
Unemployment rate	6.0	4.9	3.8	3.4	3.4	3.4	3.4

Note: for 2019 real GDP, CPI, and unemployment rate are actual. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, Kadaster, OECD, CBS Statistics Netherlands.

We expect house prices to expand by 5.3% this year and 4.5% in 2021, further decelerating from 6.4% in 2019. The household sector remains strong, although we see less room for employment creation. Stretched affordability, due to strong price inflation in recent years will also dampen housing demand.

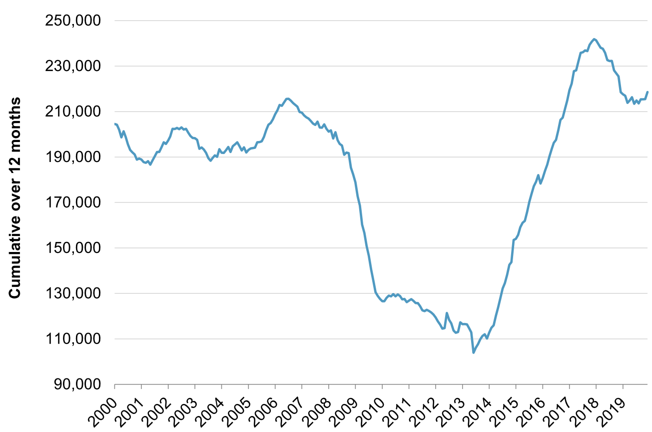
State of play. Prices increased by an annual 6.3% in Q3 2019, from 9.1% in 2018. This led to an overvaluation of owner-occupied housing by 31% over its long-term average price-to-income ratio and by 25% in price-to-rent terms. Still, overvaluation remains below its pre-crisis peak due to an important price correction following the crisis. The Dutch economy remained resilient through September last year thanks to a strong labor market. The unemployment rate fell to a new low of 3.2% in December while wage growth accelerated to an annual 3.0%. The resulting increase in households' disposable income boosted demand for owner-occupied housing. Low mortgage interest rates, another supportive factor for housing demand, reached an new all-time low of 2.1% in October. In real terms, mortgage interest rates have been in negative territory since last February. Construction permits have not met demand over the past years. Important capacity constraints, due to the tight labor market, are holding back construction to meet supply needs. What's more, legislation around nitrogen emissions in construction accentuated the decline in building permits last year. Buoyant demand over past years has exacerbated the homes' shortage, which ABF Research estimates at 300,000 housing units. This shortage is underlined by another record low of about 53,000 residential properties on sale in December 2019. In this context, the 12-month total of transactions declined last year, despite a likely one-off uptick in December.

What we expect. Favorable economic and financing conditions will continue to support demand and price increases, although to a lesser extent than in past years. We see GDP growth at 1.3% this year, from an estimated 1.7% in 2019, as the slowdown in global demand should continue to weigh on the Dutch economy, especially in the context of the coronavirus outbreak. Meanwhile, household spending will remain the main driver of growth. Employment creation should provide less support than this year--we think the unemployment rate has bottomed out--but wages should continue to rise. Besides the labor market, mortgage rates, which we see low for long, are another supportive factor of demand for owner-occupied housing.

However, stretched affordability is increasingly driving potential homebuyers out of the market. Macroprudential measures such as the cap on loan-to-value (LTV) ratios aiming to reduce households' indebtedness are also limiting households' borrowing capacity. These factors should dampen demand and house prices. The decline in transactions, which started in the 12 months to January 2018, supports this view. A slowdown in transaction data historically leads on house prices in the Netherlands. In places with more stretched affordability, notably Amsterdam, the deceleration in house price growth should be particularly pronounced.

Chart 6.1

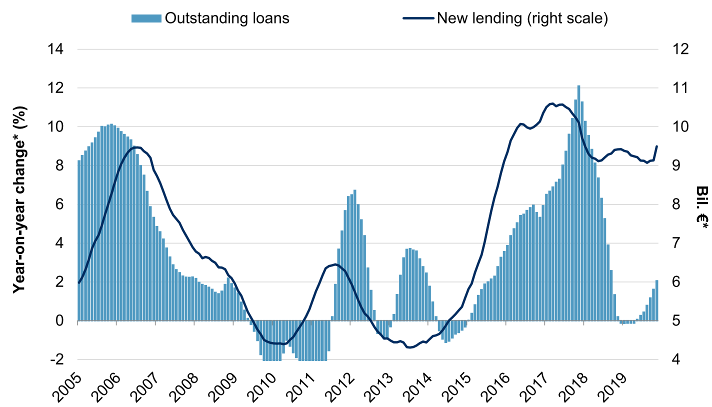
Total Transactions



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

Chart 6.2

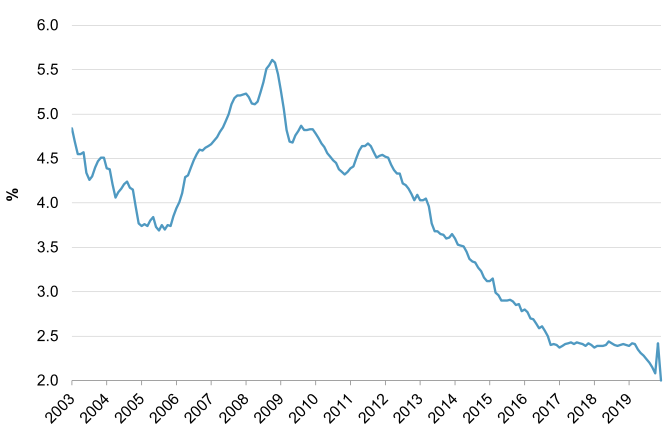
Housing Loans



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

Chart 6.3

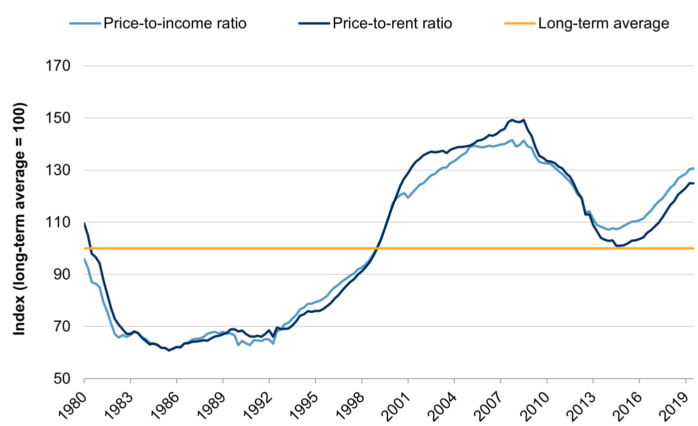
Average Interest Rate On New Housing Loans



Source: ECB, S&P Global Ratings.

Chart 6.4

Price Ratios



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

Spain: Slower Growth Will Weigh On Housing Market Activity

Table 8

Spanish Housing Market Statistics

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal house prices change, year-on-year	4.5	7.2	6.7	4.5	4.2	3.6	3.2
Nominal House Prices change year-on-year, Madrid							
Real GDP change	3.0	2.9	2.4	2.0	1.7	1.6	1.6
CPI inflation	(0.3)	2.0	1.7	0.8	1.2	1.4	1.6
Unemployment rate	19.6	17.2	15.3	14.1	13.2	12.7	12.3

Note: for 2019 real GDP, CPI, and unemployment rate are actual. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, Banco de Espana, OECD, Instituto Nacional de Estadistica (INE).

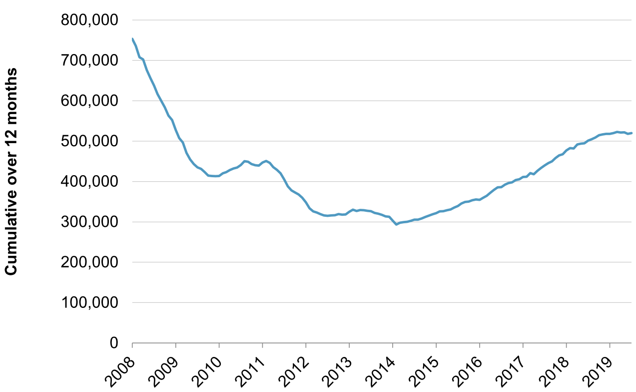
We see house-price growth decelerating further in Spain, to 4.2% this year and 3.6% in 2021, from an estimated 4.5% last year. Economic and financing conditions remain favorable, although we think employment creation should slow down somewhat. Worsening affordability in metropolitan areas will weigh on demand and ultimately house-price inflation.

State of play. In Q3 2019, house price increases slowed to an annual 4.5%, after 6.7% over 2018 in line with slowing economic growth. Spain's economy continued to slow to 2.0% in 2019, from 2.4% a year earlier. The solid labor market remained the main driver of both economic and house-price growth. The unemployment rate ended last year with a new low of 13.2% and wages increased by an average 4.7% over the year. Favorable financing conditions also drove house-price growth. Amid further monetary easing by the ECB, mortgage interest rates for new business reached a record low of 1.78% in November 2019. In real terms, interest rates have been in positive territory since end–2018 due to slow inflation, but were still low at 1.3% last November. Solid house-price growth since mid-2014 led to an overvaluation of house prices by 24% in terms of income and 42% in terms of rent. Given the strong price correction following the housing crisis in 2008, this is still more than 25% below the pre-crisis peak. The Spanish housing market is cooling following four consecutive years of double-digit growth. Transactions started to contract in the 12 months to September last year, a trend that intensified through November. As the volume of new mortgages remained stable, this points to a higher average mortgage value or a more important share of lending for house purchases.

What we expect. We see economic growth in Spain at 1.7% this year, further decelerating from 2.0% in 2019. Household consumption will remain the main contributor to growth, supported by employment creation and rising wages. Although we think that employment creation will slow down amid weaker economic growth, the unemployment rate should decrease further. Together with resilient wage growth, this will support households' demand for housing. We see mortgage rates staying low due to the ECB's accommodative monetary stance. Inflation should pick up this year, resulting in low real interest rates. Although investment in construction increased to 10% of GDP, supply is failing to meet demand in metropolitan areas such as Madrid and Barcelona, thus pushing already high prices further up and exacerbating stretched affordability. Ultimately, this should weigh on demand and price growth, despite supportive economic and financing conditions. Slowing transactions already mirror the consequences of increasingly tight housing markets, therefore decelerating house-price growth. In this context, the important regional disparities will intensify. The ECB's BLS also points to tightening credit standards for housing loans in Q4 2019. As a result, more potential house buyers might exit the market. Indeed, the BLS also shows that credit demand for housing loans declined in the second half of last year.

Chart 7.1

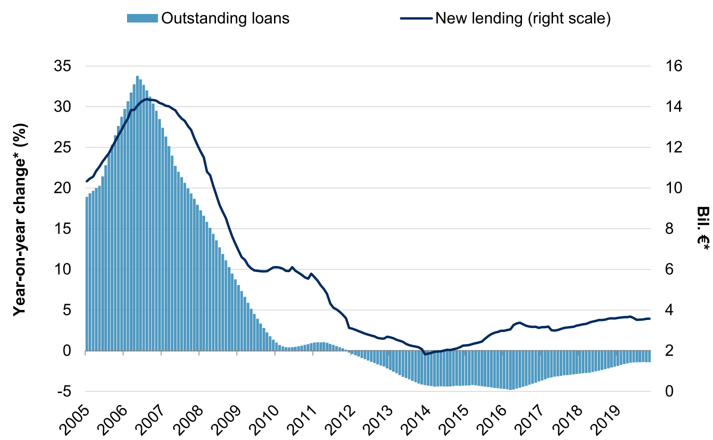
Total Transactions



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

Chart 7.2

Housing Loans



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

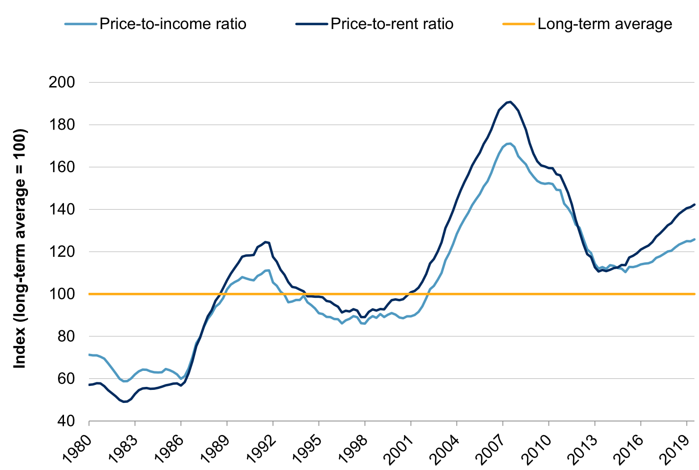
Chart 7.3

Average Interest Rate On New Housing Loans

Source: ECB, S&P Global Ratings.

Chart 7.4

Price Ratios



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

Switzerland: Weaker Growth Means A Slower Housing Market

Table 9

Swiss Housing Market Statistics

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal House Prices change, year-on-year	0.4	4.0	3.4	3.0	2.4	2.2	2.0
Real GDP change	1.6	1.6	2.6	1.3	1.1	1.4	1.5
CPI inflation	(0.4)	0.5	0.9	0.4	0.2	0.5	0.6
Unemployment rate	3.3	3.1	2.6	2.3	2.5	2.5	2.4

Note: for 2019 real GDP, CPI, and unemployment rate are actual. CPI--Consumer price index. f--Forecast. Sources: S&P Global Ratings, Eurostat, OECD, Department for Communities and Local Government, Wüest Partner.

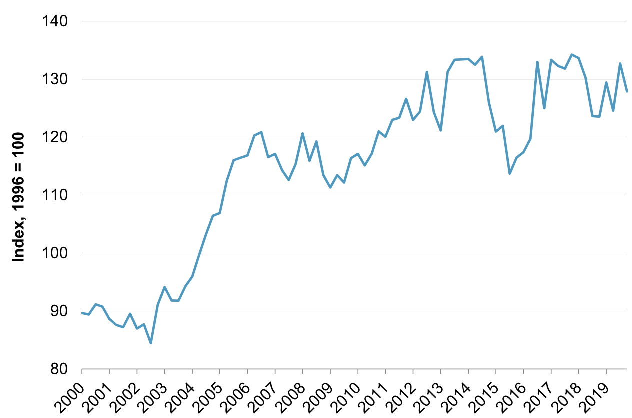
We forecast house-price growth will decelerate to 2.4% this year and 2.2% in 2021, from 3.0% last year. The market's dynamism will continue to be affected by below-potential economic growth. But full employment, investor search for yield in the Swiss rental market, and limited residential housing supply mean only a slow decline in prices.

State of play. The weaker economy has started to feed through to slightly less dynamic housing markets in Switzerland. In Q3, house-price growth eased to 3.3% annually from 4.4% in Q1. The slowdown remains very mild, as the economy is still operating at full employment, which supports household income. The unemployment rate is still hovering close to 2.3%, its lowest since 2002. Meanwhile, inflation eased to 0.2% at the end of 2019, providing an additional boost to consumers' purchasing power, while historically low interest rates are supporting affordability. Interest rates decreased further to 1.26% for a 10-year fixed term in November 2019, from 1.35% in May. In this low-rate environment, mortgage-lending growth is dynamic, rising 2.8% year on year in 2019. The rental market, which is also key because most Swiss do not own their homes, has also picked up. Swiss government bond yields fell further into negative territory in H1 2019 and are set to remain low amid monetary policy easing. Thus, long-term investors are seeking higher returns in the housing market, where the prime yield is close to 2% in major cities, according to Wuest and Partner--close to 3pp higher than returns on the Swiss government debt. Housing prices remain more dynamic in the northern and western regions, as well as in larger agglomerations, due to cities' attractiveness for employment. Market trends differ, with housing prices easing markedly in Geneva, while they have been more dynamic in Zurich and Berne in 2019. With investors turning to housing for yields, the number of vacant units remains high in the housing market, working as a limiting factor for rents. This, and an increased supply of flats, likely explains why prices in the rental segments are still contracting. Nonetheless, the house price-to-income and price-to-rent ratios are at their highest since the beginning of the 1990s, having risen more than 40% since 2001. As a result, household debt continues to increase, at 110% of GDP in Q3 2019, suggesting that macro prudential measures such as the countercyclical capital buffer will remain in place for now.

What we expect. We expect the housing market to continue to lose some steam towards year-end, due to the economic slowdown, especially in the context of the coronavirus, which is likely to delay the tentative recovery of the manufacturing sector. Nonetheless, households are more likely to see their incomes expand less quickly than to fall, given full employment. Besides, in an environment of uncertainty and low for very long interest rates in Europe, bond yields will remain low in Switzerland, supporting investor demand for housing. Positive net migration is also a factor. Overall, we expect house price rises to gradually slow over the next few years, as the high price-to-income ratio will limit household affordability over the long term, even if interest rates remain low.

Chart 8.1

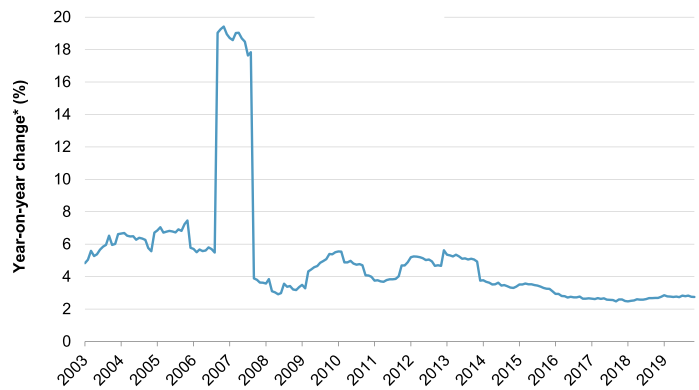
Housing Construction



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

Chart 8.2

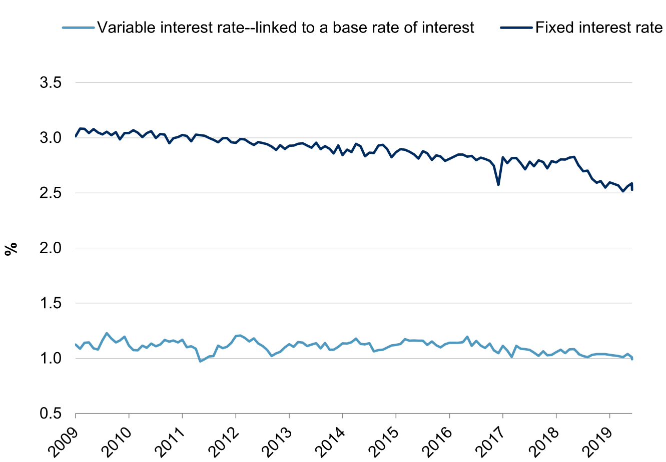
Housing Loans



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

Chart 8.3

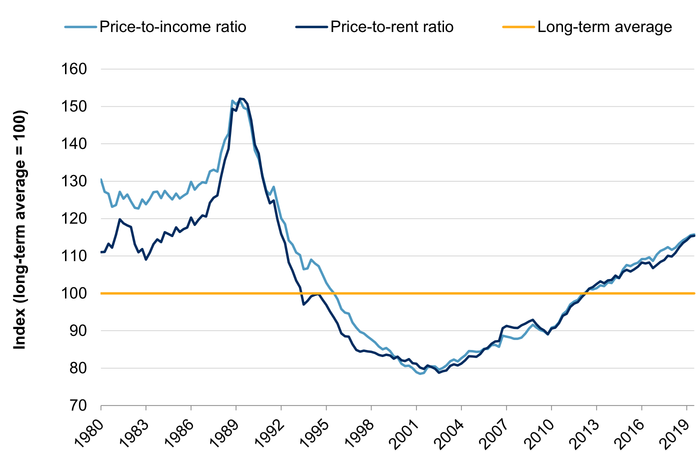
Average Interest Rates On Housing Loans



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

Chart 8.4

Price Ratios



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

United Kingdom: Market Moves Sideways

Table 10

U.K. Housing Market Statistics

(%)	2016	2017	2018	2019f	2020f	2021f	2022f
Nominal house prices change, year-on-year	5.3	4.6	2.4	1.6	2.5	2.0	3.5
Real GDP change	1.9	1.9	1.3	1.4	1.0	1.7	1.6
CPI inflation	0.7	2.7	2.5	1.8	1.6	1.7	1.9
Unemployment rate	4.9	4.4	4.1	3.9	4.1	4.4	4.5

Note: for 2019 real GDP and CPI are actual. Sources: S&P Global Ratings, Eurostat, OECD, Department for Communities and Local Government, ONS.

Our baseline forecast for U.K. house-price growth of around 2.5% on average over 2020-2022 is subject to fresh Brexit risks and could also change if the government were to materially alter its housing policies in the March 11 budget.

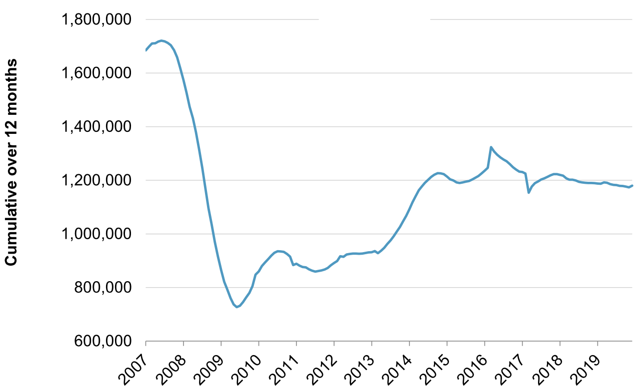
State of play. The U.K. housing market has recently shaken off some of the sluggishness that characterized most of 2019. Annual house price growth accelerated to 2.2% in December, up from its 2019 low of 0.7% in July, and latest survey data suggest renewed and broader-based dynamism going into 2020. Importantly, the price decline in prime London locations that was behind much of the slowdown in the overall national index could now have bottomed out, provided there are no fresh setbacks to confidence. Market observers attribute the renewed momentum largely to the conclusive outcome of the December general election that resolved some near-term Brexit uncertainties and, at the same time, reduced the likelihood of other downside risks. Other factors also suggest that some of the housing market's lackluster performance in H2 last year was indeed due to a temporary postponement of activity. The labor market continues to go from strength to strength; pay growth is outpacing inflation; and borrowers continue to benefit from record-low mortgage rates, owing to low base rates and competition among lenders. Conversely, demand has been suffering as smaller buy-to-let (BTL) investors continue to exit the market because of the less favorable tax relief for BTL properties. Any remaining relief is due to be phased out entirely by April this year (unless the government changes this in its forthcoming budget). Affordability also remains stretched, although it has been improving somewhat in past years. The average U.K. home is selling at just under 8x the average income. Affordability is considerably worse in London (13x), and the Southeast (10x). On the supply side, the provision of new homes to the market, although improving, has yet to catch up with pre-crisis levels, and the 10% decline of housing starts in the first half of 2019 is a setback in that recovery. The supply of housing from the residential construction sector is now less competitive than prior to the crisis, when there were many more small and medium-sized homebuilders that had a greater incentive to sell quickly.

What we expect. We forecast nominal house price growth of 2.5% in 2020 (lifted by a base effect) and 2.0% and 3.5% in 2021-2022. The dynamism in evidence at the beginning of the year may be relatively short-lived. Once the catch-up effect has faded, we expect price growth to moderate again. Still, currently expected market dynamics could change if the government introduced material new measures for the housing market in its forthcoming budget. A still-high degree of pent-up demand should underpin a minimum level of price growth, barring any significant shock. For example, failure to reach agreement on the form of the U.K.-EU relationship from January

2021, or EU-U.K. negotiations evolving in a way that increases that risk materially, could depress buyer confidence and put renewed downward pressure on prices before the end of the year.

Chart 9.1

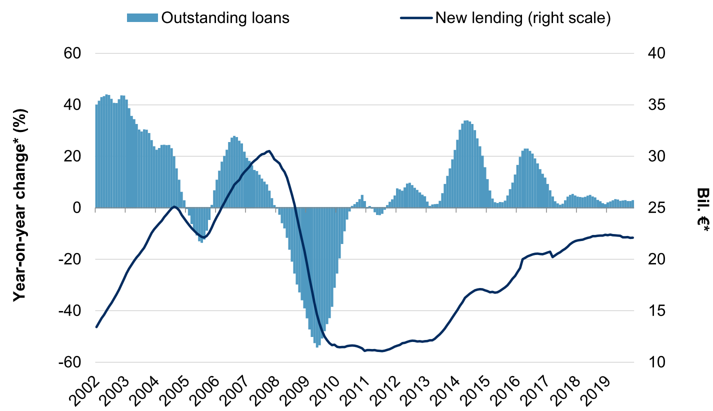
Residential Property Transactions Above £40,000



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

Chart 9.2

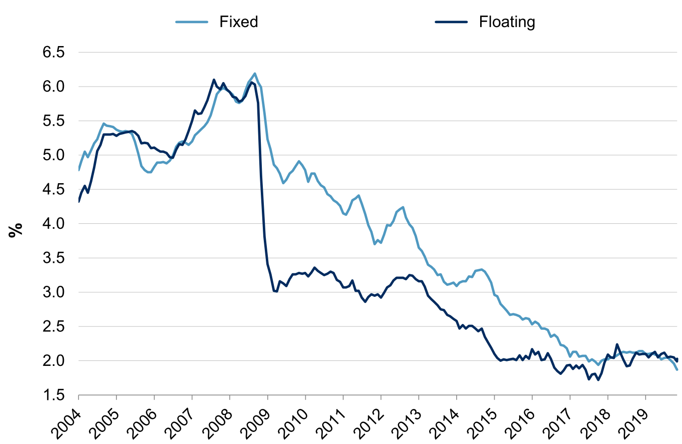
Housing Loans



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

Chart 9.3

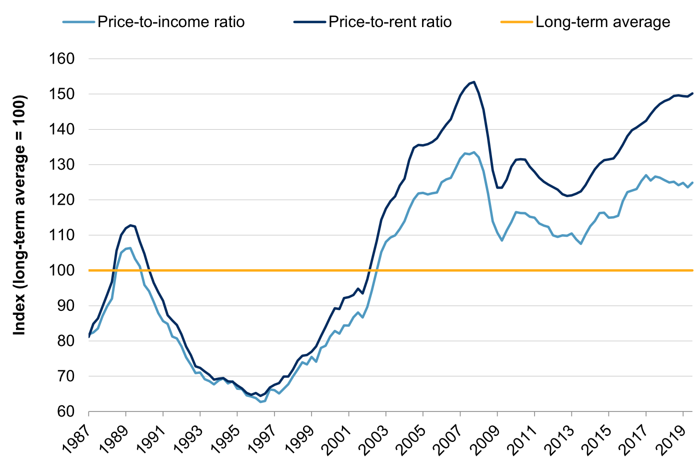
Mortgage Interest Rates On New Business--Banks



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

Chart 9.4

Price Ratios



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

This report does not constitute a rating action.