Covid-19: The consequences for Belgium's real estate market

The crisis has had a large impact on income growth and this will lead to downward pressure on house prices. But there are also factors that support the housing market. In all, we currently think that house prices will drop by about 2% in 2020 and remain constant in 2021

Rapid turnaround of macroeconomic situation

As a result of the Covid-19 outbreak and subsequent lockdown, the macroeconomic situation in Belgium has deteriorated rapidly over the last few weeks.

Currently, we expect economic activity to fall sharply in the first half of the year before recovering in the second half. For 2020 as a whole, we expect GDP growth to come in around -6.8%. Such an economic contraction would be more than three times as large as what we saw during the financial crisis in 2009.

Impact on real estate activity in 2020

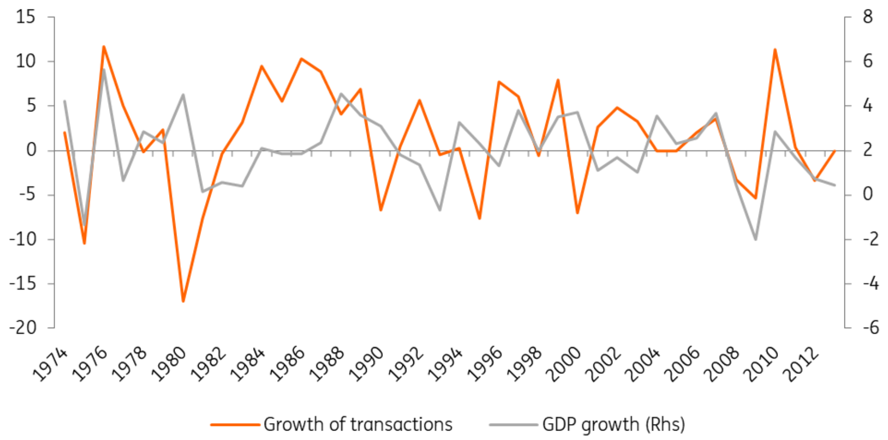
Historical data shows that there is a certain correlation between economic growth and the number of real estate transactions, but that it is not a perfect correlation.

Real estate transactions tend to recover more strongly than economic growth after a crisis and this can be explained by two factors.

Firstly, many real estate transactions are necessary. After all, people continue to move and need a roof over their heads. This can be postponed for a while, but not forever. Secondly, a deep crisis often puts downward pressure on prices, which in turn can boost activity in the market. During the 1980s real-estate crisis, this effect played an important role.

We believe the number of real estate transactions will pick up again in the second half of 2020, after a sharp decline in the first half of the year. But we also think that the number of transactions will not immediately reach pre-crisis levels. This is because the number of transactions in 2019 was artificially high due to the abolition of the tax break in Flanders.

Correlation between growth and number of transactions isn't very strong



Source: Statbel and Refinitiv datastream

Impact on real estate prices

Academic research shows that Belgian house prices, in the long run, are determined by borrowing capacity, which in turn is determined by income, mortgage lending conditions and taxation. The theory suggests people will buy the most expensive property they can afford.

Of all the factors influencing borrowing capacity, we believe income growth will be most affected by this crisis. The government has already taken some action to counter this, but it will not be possible to compensate for all income losses. Another measure taken by the government is the postponement of mortgage payments under certain conditions. This will also support the stability of the real estate market in the short run.

The figure below shows that there is a clear positive correlation between economic growth, which largely determines household incomes, and house price growth. The lower-income growth as a result of the crisis will, therefore, have a downward effect on real estate price growth. Academic research shows that, in the long term, a 1% fall in income, also lowers the borrowing capacity, and hence real estate prices, by 1%.

Positive correlation between economic growth and real estate prices

Source: Statbel and Refinitiv datastream

No significant change in credit conditions

We don't foresee significant changes in credit conditions (interest rates, maturities, repayment ratios and loan-to-value) as a result of the crisis.

As the European Central Bank aims to support lending and keep market interest rates low, we believe these measures will keep the interest rate on Belgian government bonds low. This implies that mortgage interest rates will also remain relatively low. We do stress that credit conditions, excluding interest rates, may be somewhat tighter, but that the tightening would also have taken place independently of the corona crisis.

At the beginning of 2020, we already assumed a tightening of credit conditions for mortgages, since the new macro-prudential measures of the National Bank of Belgium have been in force since 1 January 2020.

Taxes

Regarding future taxation, again, we don't expect any major changes in the short term.

Over the next few months, the emergency federal government Wilmès II will focus on managing the corona crisis. Thereafter, a new government should in principle be formed.

However, it is difficult to predict exactly when it will be formed, given the difficult formation discussions prior to the outbreak of the pandemic. New elections cannot be ruled out. All of this implies that the chance of large-scale fiscal changes in 2020 is small. In the longer term, however, the chance is higher. In particular, the way in which rental income is taxed is under pressure as the European Commission repeatedly criticised this Belgian tax.

It is possible that in the future, the tax on rental income could become less favourable, which could have an impact on investment demand for real estate.

Return on alternative investments

Apart from these long term determinants, we think that there are other factors that currently influence house prices.

The first is the return on alternative investments. If bond yields are low and/or equity markets are considered very risky, investors are attracted by real estate. We have certainly seen this in recent years and we expect this phenomenon to continue in the coming years. As a result of the ECB's policy, we do not expect any sharp increases in market interest rates, nor in government bond yields.

Equity markets will also be considered too risky by many, especially after the recent volatility, so we think investors will remain interested in real estate, which supports prices.

Trust in bricks

A second factor that may support property prices today are buyers' expectations. If everyone thinks that the property market will remain healthy, the demand for property will remain high and prices will continue to experience upward pressure. Belgians are traditionally very optimistic about the evolution of real estate prices. Our last ING international survey (IIS) showed that 57% of Belgians in 2019 think that real estate prices will never fall, while only 30% of Germans think like that about German real estate prices. A strong belief of Belgians in the stability of the real estate market therefore makes a sharp downward correction less likely. As we expect the recession will not last long, this should not, in principle, undermine the confidence of Belgians in the real estate market too much.

Conclusion

A drop in income growth will put downward pressure on property prices, but government policy should limit the income loss. Moreover, low interest rates, stable taxation, investors interest and the strong belief in the stability of the Belgian real estate market also supports property prices.

We, therefore, think house prices will fall, but the fall should be relatively modest given the sharp drop in economic growth. We expect house prices to fall by 2% in 2020 and remain constant in 2021.

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