Eurozone housing market still searching for the bottom

High interest rates, economic uncertainty, increasing renovation costs and questions over future energy efficiency requirements continue to add downward pressure on house prices. In our view, the bottoming out will only start towards the end of the year and the recovery of the eurozone housing market will take some time to materialise

A modern housing block in Milan, Italy

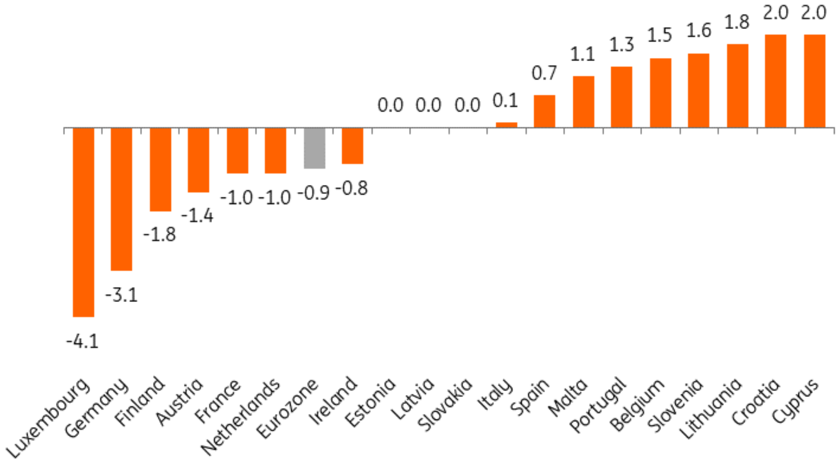
Drop in demand hinders recovery

Mortgage rates have risen sharply over the past year, resulting in a slowdown in demand for housing loans. House prices in the region have also been pushed down as sellers have adjusted their asking prices. New production of housing loans in the eurozone in the first five months of this year was more than 60% below last year's volume, and the number of housing transactions has also seen a significant drop. In the first quarter of 2023, for instance, they fell 23% in Belgium and the Netherlands compared to the previous quarter, 16% in France, and 8% in Spain. With mortgage production leading housing transactions, a further decline in the number of transactions is still to be expected.

Looking ahead, it appears unlikely that we'll see a robust recovery any time soon

Eurostat figures published last Wednesday showed that the fall in demand led to a 0.9% quarter-on-quarter drop in property prices in the eurozone, after a 1.7% QoQ fall in the fourth quarter of 2022. Looking ahead, it appears unlikely that we'll see a robust recovery any time soon. We expect demand to pick up slightly only at the end of the year, with prices following suit in the first half of 2024. Besides the negative impact of the rise in financing costs on prices, the green transition in the housing market will play an increasingly important role in price setting.

House price growth 1Q23, % QoQ



Source: Eurostat

Higher for longer means bottoming out later

About a year ago, the European Central Bank (ECB) engaged in the most aggressive interest rate hike cycle since the start of the monetary union. Interest rates for housing loans have also shot up, financing costs have risen significantly and demand for housing loans dropped sharply. While the economic outlook has weakened lately and there are increasing signs that the monetary policy transmission is working, the fear of pausing too soon is currently greater within the ECB than the fear of doing so too late.

We expect the central bank to raise policy rates by 25 basis points at both its July and September meetings. As a consequence, capital market rates will move up slightly and will only start to stabilise or begin to come down at the end of the year. Demand for housing loans will therefore be dampened for longer and may also follow a similar pattern.

Rising interest rates drive affordability to historically low levels

Higher for longer rates will keep additional pressure on *affordability through 2024*

The recent rise in interest rates has made a significant impact on the affordability of residential real estate, putting a heavier financial burden on prospective homeowners. The sharp rise in energy prices last year exacerbated the situation, leaving families with less money for mortgage payments after paying their energy bills. Consequently, many people chose to postpone their purchase plans, leading to a noticeable drop in demand for credit and downward pressure on house prices. Since interest rates will remain higher for longer, it seems likely that mortgage rates will increase somewhat further in the second half of the year, putting additional pressure on affordability.

Several factors partially mitigated the negative effects of rising interest rates on the housing market. These include a tight labour market, a pick-up in nominal wage growth after a sharp fall in real wages last year, an extension of average loan maturities and the implementation of government support measures. The sharp fall in energy prices also took some pressure off as households had to spend a smaller proportion of their income on their energy bills.

In some eurozone countries, house prices fell significantly from their peak levels. Those positive drivers, however, only offset part of the negative effect of interest rates this year. In our view, housing affordability is expected to remain low throughout 2024, mainly due to a ‘higher for longer’ interest rate environment.

Green transition as structural key driver

Looking further ahead, the role played by energy efficiency in the housing market is likely to grow. Both regulatory drivers and government investment, as well as changing consumer preferences are pulling in that direction. The surge of energy prices in 2022 and remaining uncertainty about future energy prices have made home buyers increasingly aware of the benefits of more energy-efficient homes. European and national initiatives to reduce CO2 emissions from buildings will further disrupt the market. This seems to have recently increased the price premium for energy-efficient homes compared to those which consume more energy.

Demand for energy efficiency is growing, but a lack of labour capacity and higher material prices are bottlenecks to meeting the extra demand for energy-efficient homes. Given the structural nature of labour shortages, this delays the renovation of the housing stock needed to meet the climate goals.

Overall, we expect house prices in the eurozone to fall by some 3.5% to 5% on average this year. House prices are likely to develop differently across eurozone countries, with Germany and the Netherlands seeing rather significant declines in house prices, while house prices in Belgium are only expected to fall slightly. However, there will be differences in price developments not only between countries but also between segments, with energy efficiency playing an increasingly decisive role in price-setting. The price of energy-efficient new buildings is likely to be higher, whereas older residential properties with poor energy efficiency are likely to see even greater price discounts than the new market environment already shows.

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