How overheated is the German real estate market?

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Growth rates of exceptionally high residential property prices stabilised

- **House price growth** in 2nd quarter 2022 still exceptionally high, but did not increase.
  - Costs for material and labor elevated, but large contribution of price increases of building land.
- **Overvaluations in cities and in Germany** overall rose **2021** to between 15 % and 40 %.
- **More indications of price bubbles 2021** than before pandemic (BOP-HH).
Valuation methods: Standard indicators show overvaluations in cities and Germany overall
Econometric valuation models: Overvaluations increased especially outside of large cities

- **Overvaluations** 2021 particularly increased outside of cities, still considerable overvaluations in cities.
- **Widely spread overvaluations** in Germany overall **between 15% and 40%**.
- **Special effects** (pandemic induced weak development of income, additional savings in pandemic, regional relocation of housing demand…) **without noteworthy effects on overvaluation results**.
  - However, **overoptimistic expectations** of households became **more important than before**.
Risk of destabilising price developments increased in 2021 in comparison to 2019.

- Number of regions with overvaluations and overoptimistic expectations in regard to future price developments (relative to rent expectations) considerably increased.

- Thereby increased optimism of private households concerning future price development crucial.

*Source: Bundesbank calculations, Deutsche Bundesbank*
Is the boom in residential housing market in Germany abating?

- **Households** expect considerable reduction of **price growth rate** in the next 12 months (BOP-HH).
- Scarcely price decreases expected.
- **Weaker demand for residential real estate**, e.g. because of inferior income perspectives and increasing mortgage rates.
- **Expansion of supply subdued**, too, especially due to material shortages. Slowdown of construction permits since April 2022.
- **High demand for residential mortgages**, caused by e.g. considerably increased construction and restructuring costs plus motives for interest hedging.
  
  - Banks in BLS expect a distinct decline of credit demand in the third quarter 2022.
Dynamic lending increased household indebtedness while rising interest rates may have created incentives to frontload borrowing

- Increasing household indebtedness because of dynamic lending over the past decade.
  - Expectations of rising interest rates may have created incentives to frontload borrowing.
  - New lending still dynamic, some weakening more recently.

- Long interest rate fixation periods of housing loans shield borrowers from immediate exposure to rising interest rates.
  - Loans with interest rates fixed for ≥5 (≥10) years account for 80% (50%) of new lending volume (Source: MFI interest rate statistics).

- Rising unemployment may pose more significant risks.
Lending standards displayed heterogeneous dynamics while outlook is uncertain

- No substantial loosening of lending standards for housing loans during the boom.
  
  - LTV: trending upward until the outbreak of the pandemic and falling since then.
  
  - DSTI: falling interest rates more than compensated increasing prices before 2015; since then trend reversal.

- Further development of lending standards is uncertain, even though rising debt service and living costs may discourage would-be buyers from entering the market.

- Conservative income based lending standards (DTI/DSTI) will be key to keep risk in the flow of mortgages limited.
Summary and conclusions

- Exceptionally high rates of house price growth not further intensified recently.

- Overvaluations rose in 2021 to between 15 % and 40 % in cities and in Germany overall.

- Risk of destabilising price development increased in 2021.

- Recent survey results show considerable reduction of expected house price growth rate, but scarcely price decreases.

- Large share of long interest rate fixation periods of housing loans shields borrowers somewhat from rising interest rates.
Consumer expectations may stimulate demand for mortgages with looser lending standards

- About 90% of households expect further rising credit interest rates (Source: BOP-HH).

- In anticipation of further rising interest rates, households may advance borrowing.

- Most households (over 80%) do not expect significantly rising unemployment within the next 12 month.

- Income risks may be underestimated motivating borrowers to accept higher debt-to-income/debt-service-to-income ratios.