

## European Housing Prices: A Sticky, Gradual Decline\*



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### Key Takeaways

- *We forecast a decline--but no crash--in house prices in most European countries over 2023 and through 2024 for others, with few if any prospects of a strong rebound through 2025. That's because housing prices as well as investment are likely to suffer from rapidly rising mortgage rates.*
- *It will take time for market prices and investment to adjust fully to those higher interest rates, with some countries taking longer than others. We have found that such an adjustment could last up to 10 quarters and is typically twice as pronounced as after a low-rate regime.*
- *That said, the past has shown that housing prices in Europe are quite inelastic to decline. And today's drivers (such as limited supply, a strong labor market, high household wealth, and what appear to be shifts in preferences) may lessen the effect of rising interest rates.*

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The European housing market is likely to sag but not shake at its foundations, despite higher mortgage rates. The economy is weathering external shocks better than expected, especially to the labor market, and inflation has not peaked—but is close. So, it is not surprising that central banks in Europe have not laid down weapons. While several of them--the Swiss National Bank, the European Central Bank, and the Bank of England--have slowed down rate hikes, proceeding with steps of 50 basis points (bps) rather than 75 bps at previous meetings, they all signal more rate hikes to come this year. We now expect the ECB will raise rates until the deposit rate reaches 3%, up from 2.25% in our previous assessment (see “Economic Outlook Eurozone Q1 2023: Reality Check,” published Nov. 28, 2022). Higher ECB rates will have implications for other central banks in Europe, such as the SNB. The BoE will likely raise the bank rate to 4.0% before it pauses, despite the recession; this is higher than we were expecting before (see “Economic Outlook U.K. Q1 2023: A Moderate Yet Painful Recession,” published Nov. 29, 2022).

What’s more, even if inflation is likely to recede in second-quarter 2023 as pressures from energy costs fade, it will unlikely recede back on target before midyear 2024. Further pass-throughs from the commodities price shock are possible, especially to services and because labor costs are on the rise. Some central banks, like the ECB, believe that inflation is even going to be stickier, not reaching target before second-half 2025. This means that policy rate cuts are unlikely before late 2024. What’s more, central banks have started working passively or actively on the size of their balance sheets. The ECB will start withdrawing liquidity from the bond market as early as March 2023, by not reinvesting €15 billion per month of maturing bonds from its Asset Purchase Program (APP) portfolio. Earlier, the Swedish Riksbank announced that its asset holdings, worth Swedish krona 860 billion, would also be reduced passively, by more than half over the next few years. And the BoE has already started selling Gilts from its quantitative easing portfolio. The bottom line is that yields are likely to be further on the rise and to remain higher than before the Russia-Ukraine war and COVID-19 over our forecast horizon through 2025, which will translate into higher mortgage rates in some countries. We see benchmark German 10-year yields above 3% by 2024.

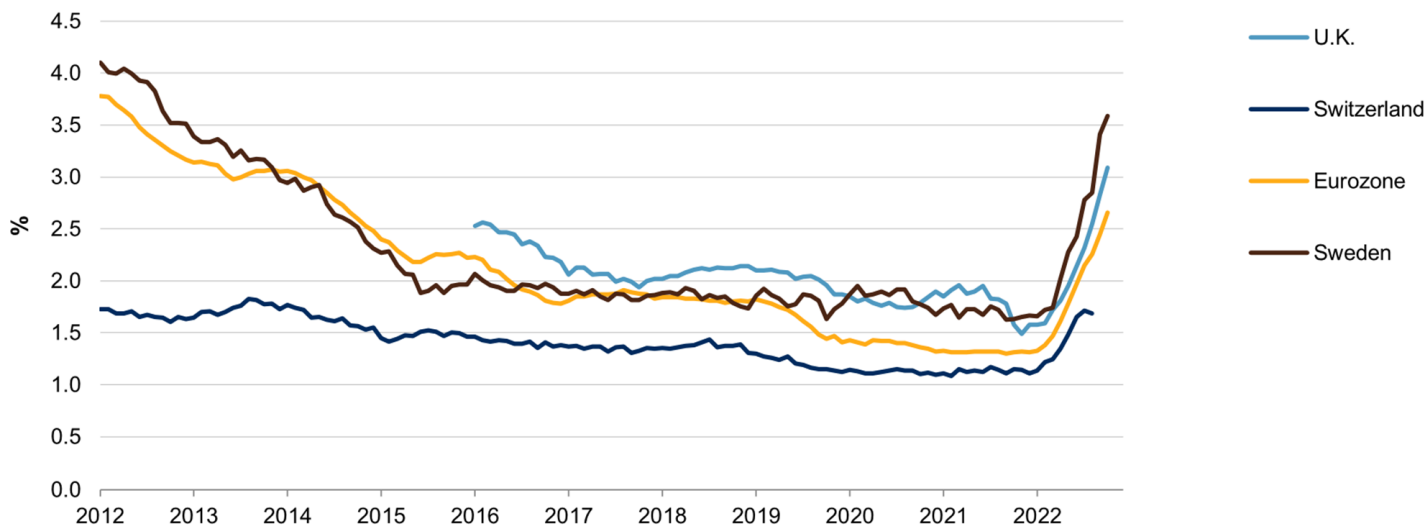
### **Housing markets started to moderate before mortgage rates started to rise**

The rise in policy rates has already led to higher mortgage rates everywhere, even more quickly in Sweden than the rest of Europe (see chart 1). In nominal terms, mortgage rates have rapidly climbed to their highest level in a decade or so. However, in real terms, adjusted for inflation in consumer prices or in construction costs, mortgage rates are still negative and likely to remain negative until mid-2024.

Residential construction is still holding up well, with an increase of more than 1% at the beginning of the fourth quarter in the eurozone and Sweden, while leveling off at a record high in the U.K. and Switzerland. But construction is a lagging indicator of the housing market given the length of time associated with housing starts. Building permits or housing starts, both forward-looking indicators, have undergone some correction from their peak, though uneven across geographies. While building permits in new residentials are down 40% from their peak in France and Sweden, they are down 25% in Germany and still increasing in Portugal (see chart 2). Housing starts in England are down 10% from their peak in the third quarter according to CLG data.

Chart 1

**Mortgage Rates Are Rapidly Rising In Europe**  
Rates on new mortgage loans

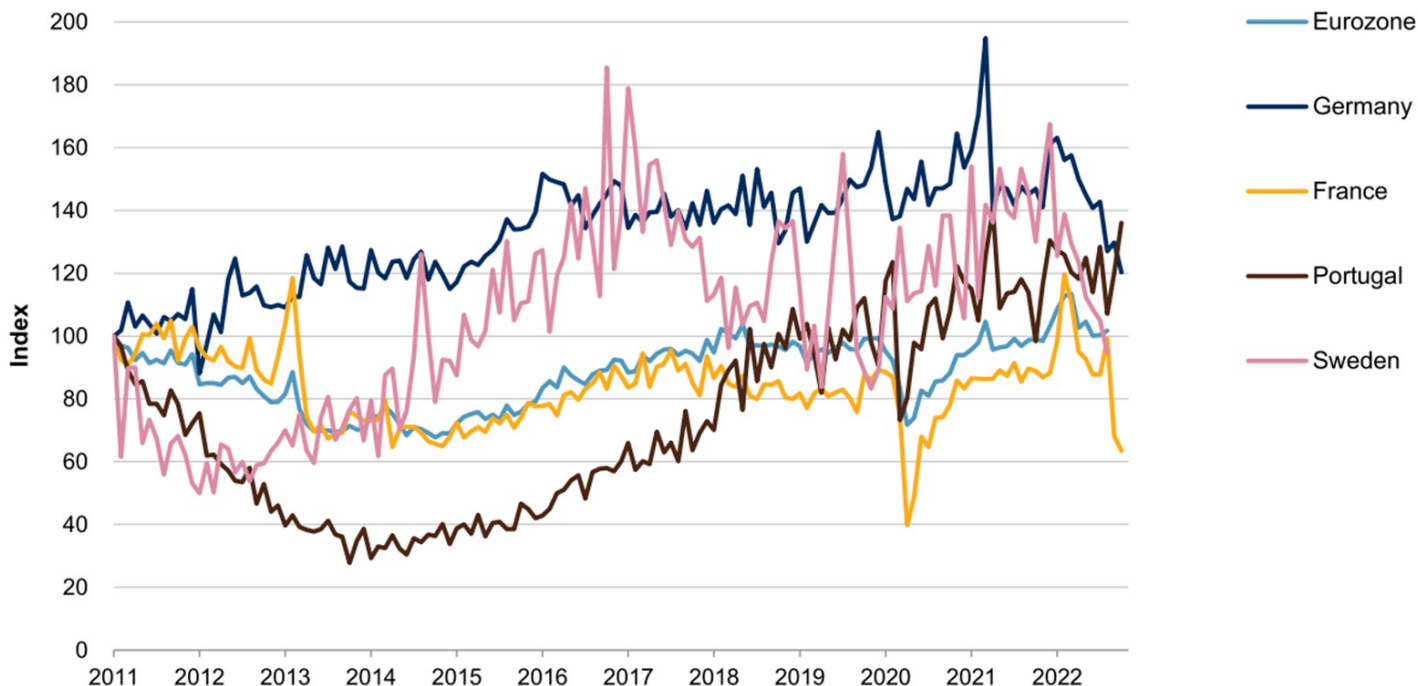


Sources: ECB, SNB, BoE, Refinitiv, S&P Global Ratings.

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Chart 2

**Building Permits For Residential Construction Have Corrected From Their Peak, Almost Everywhere In Europe**  
Index, January 2011 = 100



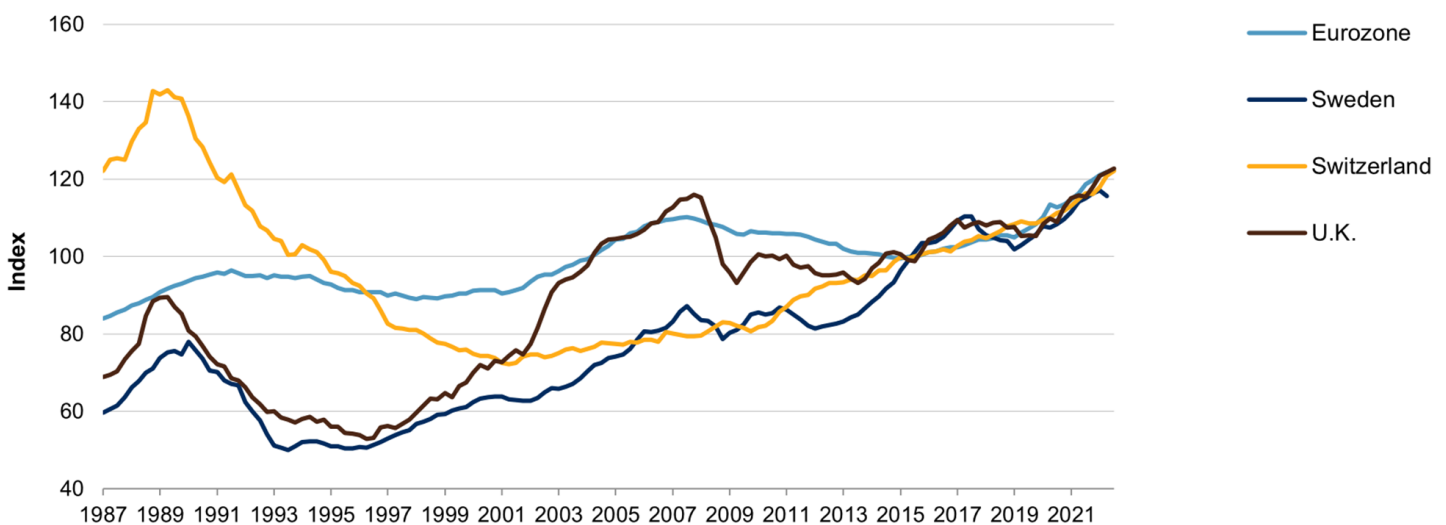
Source: S&P Global Ratings.

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Although building permits have declined, the rise in mortgage rates was not the main reason. In Europe, the peak in building permits was reached around fourth-quarter 2021, while mortgage rates did not rise markedly before second-quarter 2022. As we noted in our previous publication, “European Housing Markets: Soft Landing Ahead,” published July 13, 2022, other factors contributed to a slowdown in housing demand. Other factors were the return to office for many workers; the construction sector operating at full capacity, therefore less able to absorb additional demand; and the continuous decline in housing affordability given rapidly rising housing prices relative to income (see chart 3).

### Chart 3

#### The Decline In Housing Affordability Has Contributed To A Slowdown In Demand Price-to-income ratio



Sources: OECD, S&P Global Ratings.

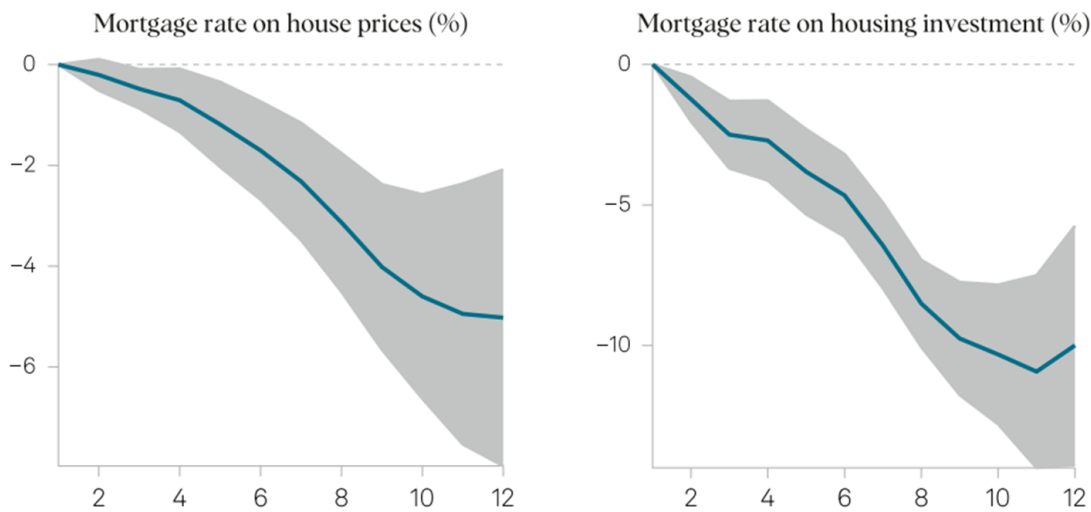
### The adjustment to higher interest rates will take time

Housing prices so far have barely adjusted to higher interest rates. Probably reflecting supply constraints more than softening demand, housing prices continued to increase at a sustained pace over the first half of 2022 to average 10% year on year in the 12 countries we cover (see chart 5). These price increases are far higher than we were expecting.

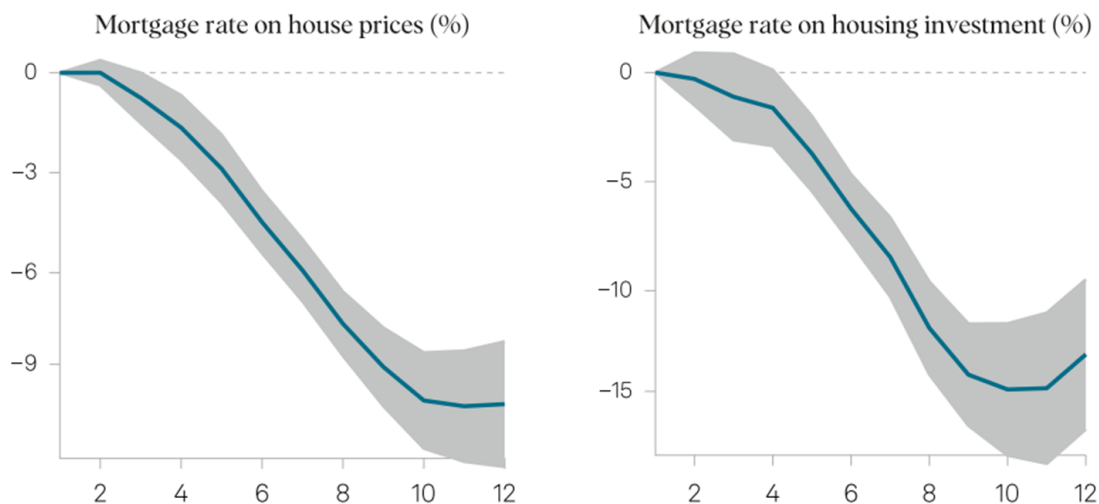
However, the momentum might change and revert significantly in the years to come. Our estimations suggest that it takes nine to 10 quarters for a shock to mortgage rates to feed completely through to housing prices and housing investment (see the box below for details). After two and a half years, we find that a 100 bps increase in mortgage rates is associated a 5% fall in housing prices and depresses investment by 10%--all other things being equal (see charts 4a-d). What's more, we find evidence that the adjustment of prices and investment tends to be twice as pronounced when interest rates increase from a very low level, as is the case now, than when rates are already high before the shock occurs (see charts 4a-c).

## Chart 4

## A 100bps Increase In Mortgage Rates Depresses Houses Prices By 5% And Investment By 10% After Two-And-Half Years



## Estimations Suggest That The Impact On Prices Is Twice As Large In A Low Interest Rate Environment

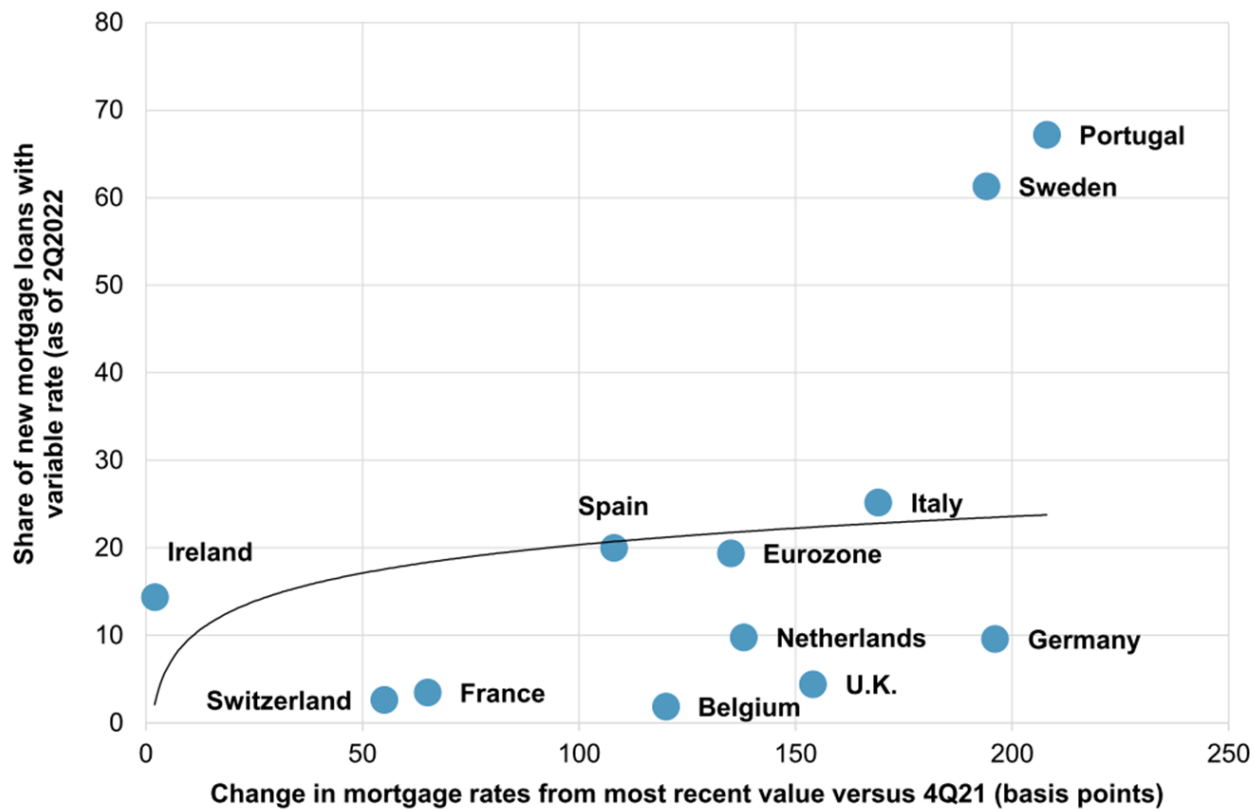


Note: The grey area corresponds to the 90% confidence interval. Sources: OECD, Refinitiv, Eurostat, S&P Global Ratings.  
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The impact of higher interest rates on housing prices and investment may also vary from country to country, reflecting differences in housing markets in Europe, for example, the way they are financed. Logically, one would imagine that the repricing of housing will be more severe and swifter in countries where the share of mortgages at variable rates is high and where the rise in interest rates is the largest. This probably leaves Sweden and Portugal more exposed to a rapid adjustment in prices than other markets we cover (see chart 5).

Chart 5

## Real Estate Market Conditions Vary From One Country To Another



Source: S&P Global Ratings.

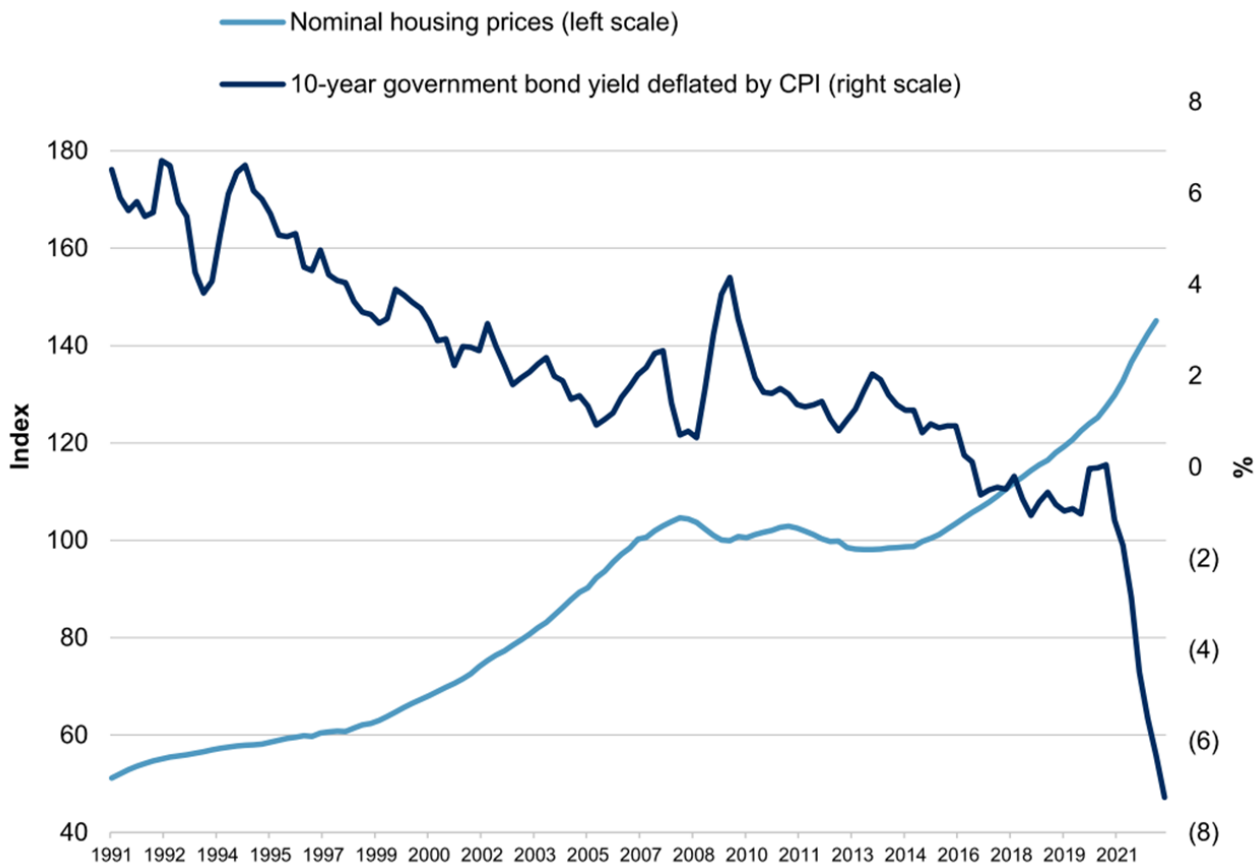
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That said, although property prices, investment, and the level of interest rates are directly linked, European house prices have proved to be inelastic to declines when interest rates rise. Instead, a small correction followed by a long period of price stagnation has occurred (see chart 6). This indicates that other factors are at work.

Chart 6

**Eurozone Housing Prices Are Quite Inelastic To Decline**

Housing prices during previous episodes of rising interest rates



Source: OECD, S&amp;P Global Ratings.

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**Interest rates are not the only driver of housing markets**

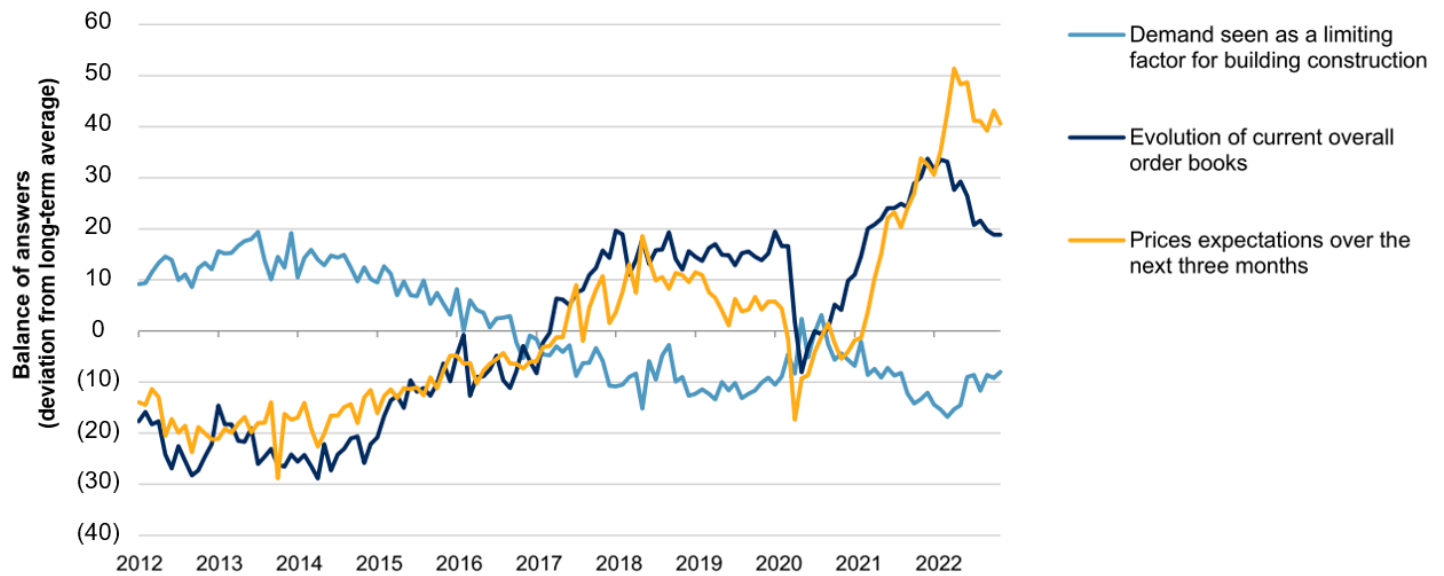
Other factors could remain positive for demand for European real estate, like today's very strong household balance sheets, underpinned by record levels of employment, wage growth, and remaining savings from government pandemic support. Current wage trends suggest household purchasing power could recover as soon as early 2024. Second, the population increase triggered by the influx of refugees from Ukraine has already increased housing demand. Furthermore, it is unclear at this stage whether households' preferences for housing have durably changed because of the pandemic. As such, the European Commission Survey suggests demand is not the main factor limiting construction (see chart 6). Finally, supply-side factors might also support high prices: spare capacity for construction is low and the need to retrofit buildings to improve energy efficiency is supporting housing investment.



## Chart 7

**Demand Is Not Seen As A Factor Limiting EU Building Construction**

Business survey of the European Commission - Construction of buildings sector



Source: EC, S&amp;P Global Ratings.

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Overall, we have revised our price forecasts downward and now project nominal declines in many countries, without the prospect of a strong rebound over the next three years (see table 1). The downward adjustment in housing prices to higher interest rates will take time and may be less than suggested by the rise in interest rates alone.

Table 1

**S&P Global Ratings Economists' Nominal House Price Forecasts**

(%)	2020	2021	2022f	2023f	2024f	2025f
Germany	8.7	12.6	4.0	(2.0)	(1.0)	1.0
France	6.3	7.0	4.5	(0.5)	0.5	1.5
Italy	1.6	4.1	1.5	(1.5)	1.0	1.0
Spain	1.7	6.3	4.1	(2.5)	(1.0)	1.5
Netherlands	8.7	18.9	4.3	(2.5)	0.0	2.0
Belgium	5.7	6.0	3.4	(2.0)	(0.5)	1.0
Portugal	8.0	11.6	6.8	(4.4)	0.5	2.0
Switzerland	5.4	8.3	5.5	0.5	1.4	1.5
U.K.	6.0	8.6	9.5	(3.5)	2.7	3.0
Ireland	0.7	13.8	8.0	(2.0)	1.0	3.5
Sweden	5.3	10.9	(4.3)	(2.2)	3.7	3.3

f--Forecast. Source: S&amp;P Global Ratings.

Note: House price inflation is reported as year-on-year growth in Q4.

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Related research: "Swedish Banks Can Weather A Housing Market Correction," published Nov. 10, 2022. ■



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