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91st East Jour Fixe

Housing markets in Austria and CESEE: homing in on prices, affordability and financial stability

Compiled by Antje Hildebrandt with input from Elias Farnleitner, Mathias Lahnsteiner, Tomáš Slačík and Karin Wagner[1]

Housing markets in Austria and Central, Eastern and Southeastern Europe (CESEE) may be at a turning point given economic slowdown, high inflation, tighter financing conditions and elevated uncertainty among households and businesses. The 91st East Jour Fixe[2] of the Oesterreichische Nationalbank (OeNB) on June 27, 2023, brought together academics and policymakers for an exchange of views on recent house price developments and burgeoning financial stability risks linked to housing markets. The workshop also highlighted potential policy measures that might serve to address the eroding affordability of housing for many households whose budgets are already stretched by rising living and housing costs.

In her introductory remarks, *Birgit Niessner*, Director of the OeNB's Economic Analysis and Research Department, emphasized the topicality of housing market issues in view of the current uncertainty about future housing market developments. In her keynote, *Laura Valderrama*, Senior Economist at the International Monetary Fund (IMF), highlighted that – despite the recent cooldown – house prices in Austria and CESEE remain overvalued by about 15% to 20%. Thus, they are farther above equilibrium values than house prices in other parts of Europe, where overvaluation has started to go down. However, housing affordability in Austria and CESEE has not only been dented by strong house price growth, which meanwhile has outpaced the growth of households' income and rents, but also by rising mortgage rates. The latter also affect households' ability to service their debt. Potential financial stability risks emerge from the fact that three out of four mortgages in CESEE have variable rates. At the same time, the room for maneuver for CESEE households is limited, as the amount of income they spend on essential consumption is almost double that observed in other European countries. Against this background, Valderrama showed that rising lending rates and costs of living could have a significant impact on households if no policy support is provided. According to IMF simulations, in the most severe scenario the share of vulnerable households reaches 60% in CESEE while more than 50% of mortgage debt is at risk. As a result, up to nearly half of CESEE households would have to adjust their spending by 7% on average. Yet, low-income households that are disproportionately affected might need to cut their consumption by twice as much. Despite the relatively harsh impact of a potential, adverse shock on households and the fact that banks in the region are exposed to household loans to a significant degree, the average impact of such a shock on the banking system appears to be manageable. Nonetheless, according to the IMF's assessment, a house price correction by 20% could reduce bank capital by up to 200 basis points in some countries. Against this backdrop of financial stability risks, Valderrama accentuated that policy measures could ease

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[2] *The presentations and the workshop program are available at 91st East Jour Fixe of the Oesterreichische Nationalbank – Oesterreichische Nationalbank (OeNB).*

the impact of higher living costs and rising debt repayments and thus shield households from financial distress. However, unlike previous, wide-spread practice, these measures should be well targeted. She went on to point out that shielding low- and middle-income households, i.e. the bottom income tercile in Austria and the bottom two income terciles in CESEE, could be more cost efficient. The ensuing discussion focused on the preferential treatment of green mortgages and the possible taxation of those profits that largely drive inflation.

Julia Wörz, Head of the OeNB's Central, Eastern and Southeastern Europe Section, chaired session 1, which discussed the question "Where are house prices headed?" In her introductory statement, she pointed out that house prices had moderated in most CESEE countries in the second half of 2022, following a prolonged period of price rises. Referring also to the role loan market developments play in this context, she concluded that house prices currently seem to be at a turning point.

The first speaker in this session, *Michael Klien*, Senior Economist at the Austrian Institute of Economic Research (WIFO), focused on the Austrian real estate market and its driving forces. He presented webscraped house price data for Austria that make it possible to identify mismatches between real estate supply and demand. Given that the number of listed properties increased sharply in recent months, Klien concluded that housing demand has decreased considerably as interest rates have gone up and lending standards have tightened. He also noted that nominal listing prices have remained relatively stable, which results in a decline in real house prices. The share of new entries in the property listing data base has decreased, which might indicate that sellers follow a "wait and see" approach.

Katarzyna Rzentarzewska, Chief CEE Macro Analyst at Erste Bank in Vienna, highlighted that, due to (post-)pandemic reallocations, the average growth dynamics of CESEE house prices doubled over the last two years compared to the 2015–2020 period. However, interest rates on loans at least doubled in 2022, thus cooling off demand. Higher costs of credit affected demand for loans and borrowers' eligibility for mortgages, resulting in a slowdown of house price growth in the second half of 2022. In Rzentarzewska's view, the housing market correction in Czechia, Hungary and Poland was – most likely – short lived amid rising expectations of monetary easing and tight labor markets.

Adám Banai, Executive Director at Magyar Nemzeti Bank, drew attention to signs of house price overvaluation in many EU member states after years of rising house prices. Regarding Hungary, he pointed out that we have to differentiate between substantial house price dynamics in Budapest and other big cities on the one hand and more muted house price growth in smaller towns on the other hand. He does not expect a strong house price decrease, as enough money is available on the market. Banai illustrated that Hungarian house prices saw a strong adjustment of overvaluation compared to real economic fundamentals in the second half of 2022. At the end of his presentation, he discussed the issue of energy efficiency and heating with regard to the housing market. In this context, he noted that the relative value of gas-heated properties with high energy consumption has decreased slightly. In the ensuing discussion, a consensus seemed to be emerging among speakers that a strong correction of house prices is not to be expected – neither in CESEE nor in Austria. Other issues raised during the discussion included the role of institutional investors and differing developments in various market segments (price levels, regional heterogeneity, flats with different heating systems, etc.).

Session 2 dealt with potential financial stability risks emanating from housing markets and was chaired by *Jan Klacso*, Head of the Financial Stability Research Section at Národná banka Slovenska, who started out by reminding us that housing has become a key topic in financial stability discussions in general and for the broader public in Slovakia in particular, given the country's unusually high homeownership rate, high number of mortgage loans and underdeveloped rental market. As long as labor market developments remain stable, however, he said he did not expect significant housing market corrections to take place in Slovakia.

Frauke Skudelny, Principal Economist at the European Central Bank (ECB), identified key vulnerabilities of European housing markets, namely house price overvaluation, household indebtedness, loose lending standards and high variable interest rate loans. Resilient factors, on the other hand, comprise savings and low unemployment rates. All these factors combined with current shocks (namely high inflation and high interest rates) could result in a higher probability of default and loss given default on banks' residential real estate loans, credit losses on mortgage loans, lower consumption and credit losses on other loans. Turning to macroprudential policy, Skudelny showed that countries have been active in this field since end-2021, e.g. regarding the (re)building or calibration of capital buffers or the adjustment of borrower-based measures. Skudelny explained the three-year (medium-term) horizon of the European Systemic Risk Board's forward-looking assessment in a baseline scenario compared to an adverse scenario. She argued that there could be a disorderly correction of house prices followed by a materialization of risks in the adverse scenario, which is more prevalent for households with high indebtedness. In the baseline scenario, by contrast, there could be an orderly correction, which could even be beneficial to financial stability. She stated that the adverse scenario was not likely but still possible. Overall, the forward-looking assessment is characterized by a high degree of uncertainty, and cross-country differences depend on present vulnerabilities and the policy measures taken to mitigate risks.

Miroslav Plašil, Director at the Czech National Bank, focused his presentation on his country, Czechia, where house prices were growing exuberantly but have moderated recently. According to Plašil, an orderly but not sizable price correction is expected to happen in 2024. He discussed the vicious feedback loop between property prices and debt financing, with risky loans being quite common in periods without borrower-based measures. In 2022, however, borrower-based measures helped contain credit risks in Czechia. Finally, he discussed current financial stability risks in the Czech housing market, which are mainly of a cyclical nature. Risks to financial stability in Czechia remain elevated but have been declining slowly since mid-2022, while new risks emanating from lending for housing purposes are muted because the provision of new housing loans is well below historical averages and risky loans are restricted by LTV-, DTI- and DSTI-limits as well as by a shift of credit provisions to high-income creditors. Following the presentation, several issues were raised, such as the right timing for changing borrower-based measures in an adverse scenario or the repricing of loans. The discussion also focused on the important role of microdata in calibrating macroprudential policies. In answering a question on household sentiment, Plašil argued that, while being very important, household sentiment was difficult to predict. In Czechia, moreover, sentiment regarding the housing market is rather short lived: Once people are convinced that they can afford to buy a house, they want to do so.

Chaired by *Nicola Brandt*, Head of the OECD Berlin Centre, the third and final session of the 91st East Jour Fixe focused on housing affordability in Austria and CESEE. The first speaker, *Karin Wagner*, Senior Principal at the OeNB's Research Section, presented the results of the latest Household Finance and Consumption Survey (HFCS) that contain information on households' consumption decisions and asset allocation. The findings suggest that Austria's relatively low homeownership rate, which is mostly attributable to the prevalence of social housing, has decreased even further, from 50.2% (2010) to 47.9% (2021). Moreover, it varies substantially across Austria's provinces. HFCS results also indicate that housing expenditure in Austria remained relatively stable over time, with variations based on mortgage obligations and income levels. Still, tenants in the lowest income quartile spend more than half their incomes (51.5%) on housing, which is worrying as this leaves less than half of their incomes for other consumption and living necessities. The results show how important it is to track affordability on a microdata level.

In the second presentation of session 3, *Andrejs Semjonovs*, Senior Economist at Latvijas Banka, discussed several key points on housing in Latvia. First, he noted a significant drop in total transaction numbers, which indicates a substantial increase in the stock of apartments and houses. However, the Latvian housing market showed some heterogeneity as transactions regarding old Soviet-era apartments, which are known for their energy inefficiency, remained stable. This suggests that new houses have become less affordable and that most people can only afford older apartments. Semjonovs argued that this pattern can also be seen in house prices: While overall price growth is moderating, different trends can be observed in different housing market segments. Prices for new dwellings continue to increase while prices for old dwellings are decreasing. This sharp deterioration in the affordability of new apartments and houses raises concerns, also regarding the country's long-term energy balance.

Jaime P. Luque, Professor of Real Estate at ESCP Business School, presented his study on housing policy interventions in Catalonia, Spain. Luque highlighted the global trend of implementing new rent control measures, such as in Berlin, France and California, which have sparked considerable debates. He emphasized that academic papers on rent control are rare, particularly those focusing on the regional level. This makes his study on Catalonia unique as it relies on comprehensive data covering all municipalities of Catalonia. Implemented in 2020, the Catalonian rent control law aimed to limit rent increases in areas specified as "tense housing markets" by prohibiting new contracts from exceeding the price agreed upon in previous contracts for properties already rented. Luque's data indicated a decrease (by about 5%) in rents during the first six months after the new law was implemented but also showed that the effect diminished after one year. Interestingly, the volume of property sales strongly increased in the observation period while the volume of rents decreased. The presumption is that some apartments that were available for rent before rent control was implemented could not be rented out profitably enough after the new law took effect and were sold instead. Overall, rent control had substantial distributive effects, with the poorer groups of the population bearing the brunt of the reform; subsequently, inequality increased. The key lesson learned from this study is that rent control measures do not effectively reduce rents; instead, they might devalue properties. This decline in property value negatively affects the long-term savings of the working class. Therefore, it would be more beneficial to allocate resources to supporting developers rather than to implementing rent control policies. At the end of the third session, participants discussed whether future trends such as green mortgages or energy-efficient building standards will drive house prices and how rent control measures should best be designed. Speakers also highlighted that microdata are essential in discussing issues like housing market vulnerability and the affordability of housing because in-depth knowledge is the basis for implementing targeted policy measures.