



EUROPEAN CENTRAL BANK

EUROSYSTEM

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The Role of House Prices in the ECB Macro/Financial Policy Framework

Bank of Poland Workshop

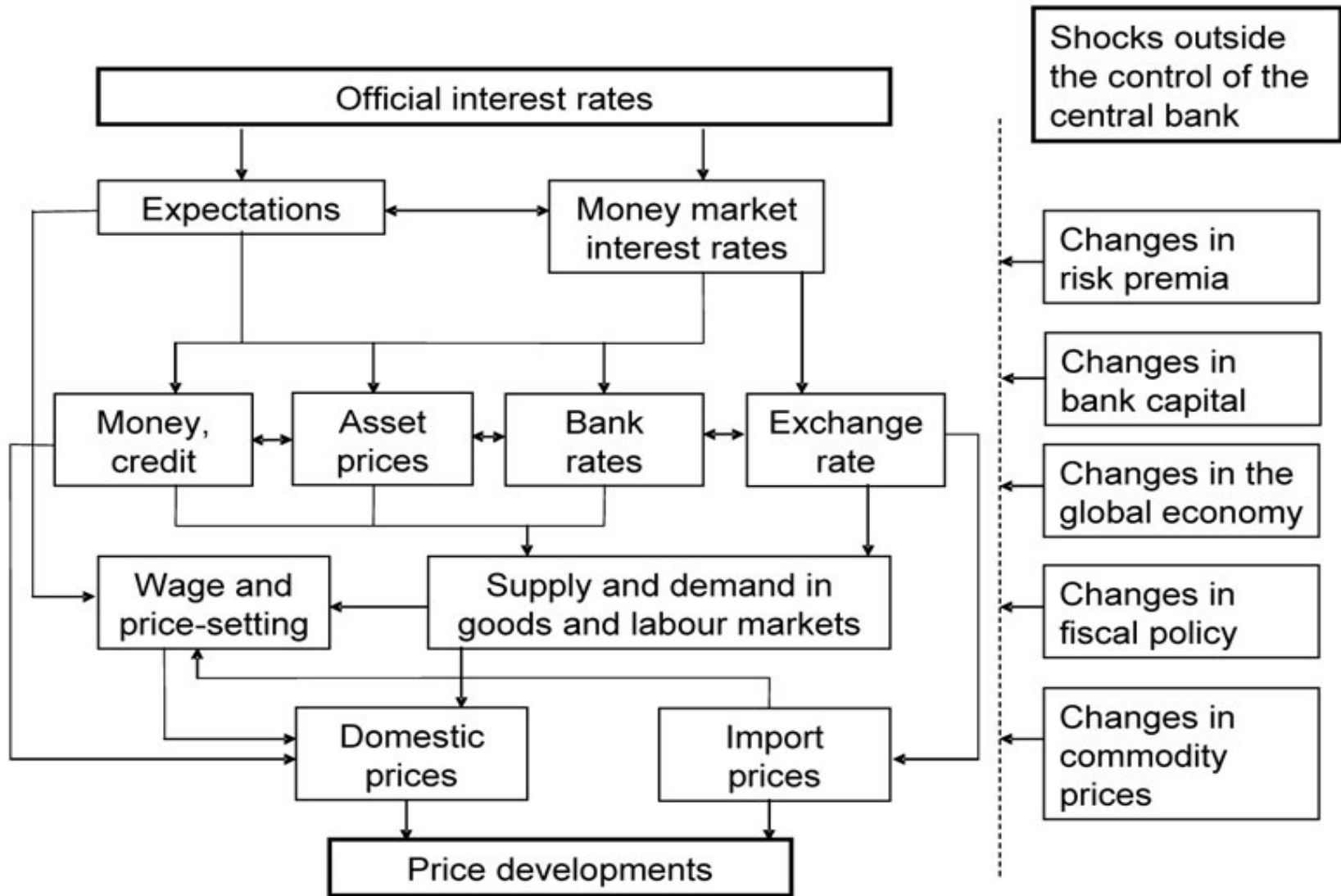
14th November 2013

*The views expressed in this presentation are solely those
of the presenter and do not necessarily reflect those of
the European Central Bank*

Overview

- 1** House prices and the transmission mechanism of monetary policy
- 2** Property prices and financial stability
- 3** House price analysis at the ECB
- 4** Recent developments in house prices in the euro area

1. House prices and the transmission mechanism of monetary policy



1. House prices and the transmission mechanism of monetary policy

- Eurosystem's primary objective is to maintain price stability (inflation measured by HICP but cost of owned-housing not yet covered)
- Changes in monetary policy stance influence money market interest rates, which in turn affect mortgage rates
- House prices are interest rate sensitive (mortgage rates and risk-free rates)
- Changes in monetary policy stance also affect expectations for house prices

1. House prices and the transmission mechanism of monetary policy

- House prices can affect economic activity via wealth effects, credit channel, residential construction etc.
- Activity in turn affects HICP inflation
- House prices can also affect HICP more directly e.g. rent component
- So, house prices contribute to the transmission of monetary policy impulses to the economy
- Substantial declines in house prices can present deflation risks and can weigh on potential growth e.g. increase in structural unemployment, reduced labour mobility as households in negative equity

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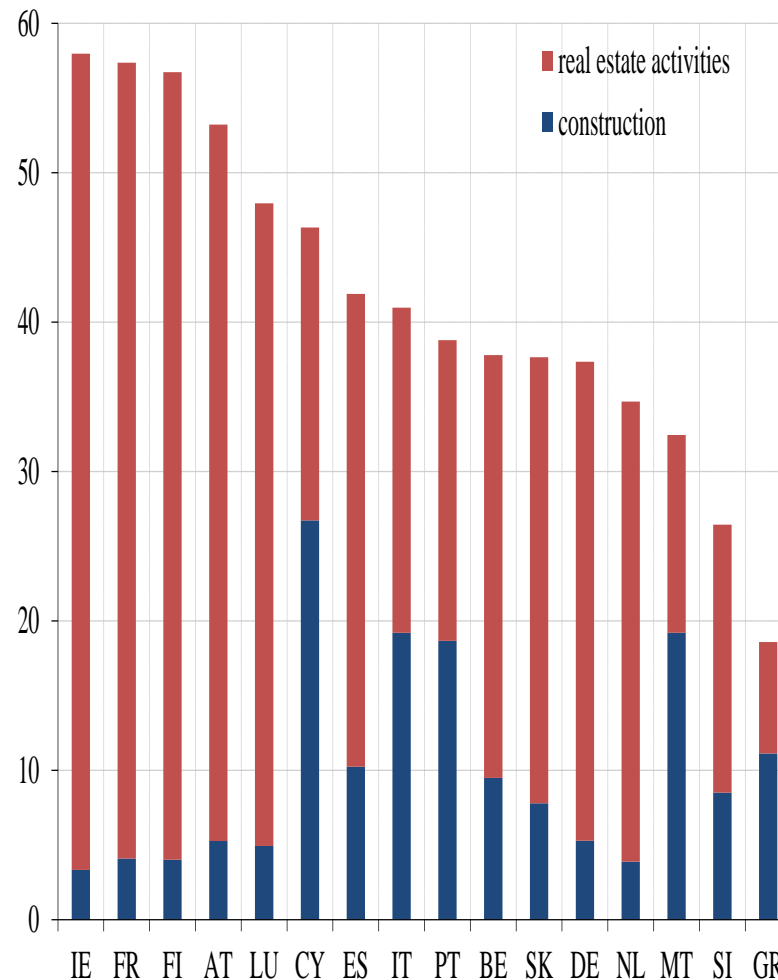
2. Property prices and financial stability

- Severe declines in house prices can also affect financial stability
- Severe house price declines may undermine banks' solvency, possibly leading to bailouts/ ins, financial market fragmentation, and disruption to monetary policy transmission
- Households' debt is mainly housing mortgage debt
- Important to monitor households' debt servicing capability, including sensitivity to interest rate and house price shocks

2. Property prices and financial stability

- Commercial property price developments very important for bank solvency
- A significant proportion of many euro area banks' assets are comprised of loans extended for investment in commercial property
- A fall in commercial property prices and rents weakens the property companies' earnings capacity
- Undermines their ability to service debt and it also lowers the value of collateral for mortgages

Percentage of loans from MFIs to NFCs, 2013Q2



2. Property prices and financial stability

- Loans for commercial property investment tend to be more volatile than many other types of lending in banks' loan portfolios, as commercial property prices strongly linked to business cycle conditions
- Commercial property price movements important for financial stability and also price stability
- Filling the statistical void: New ECB Experimental Indicator of Commercial Property Prices for EU
- To be introduced ECB Monthly Bulletin Article in February 2014, thereafter available in ECB SDW

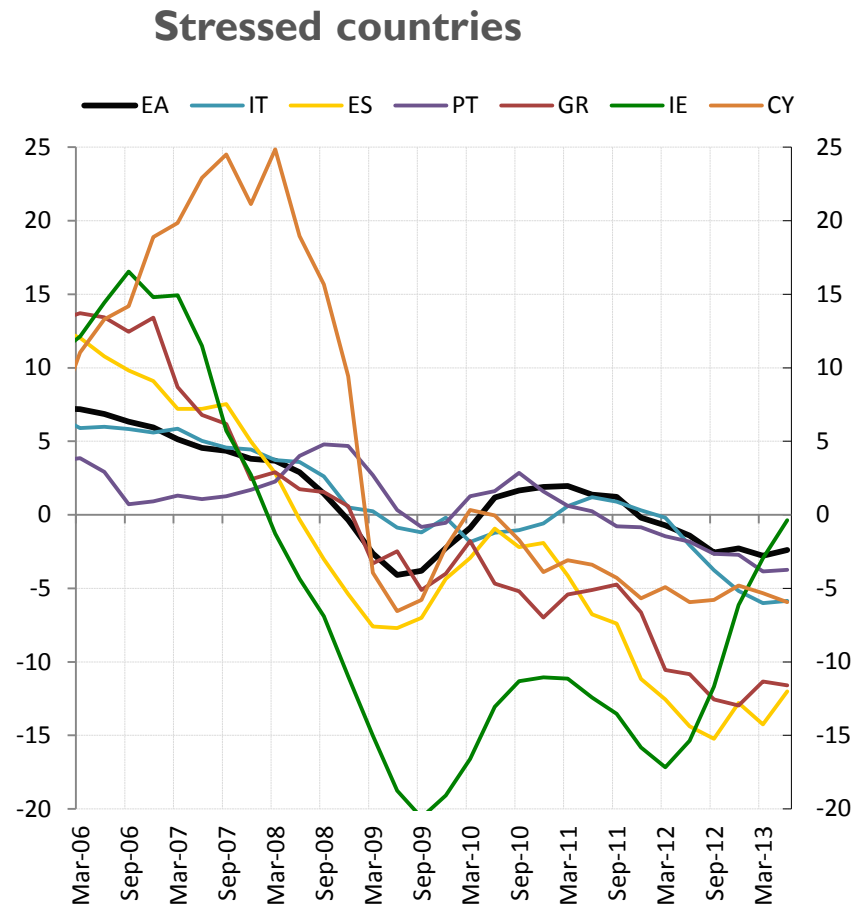
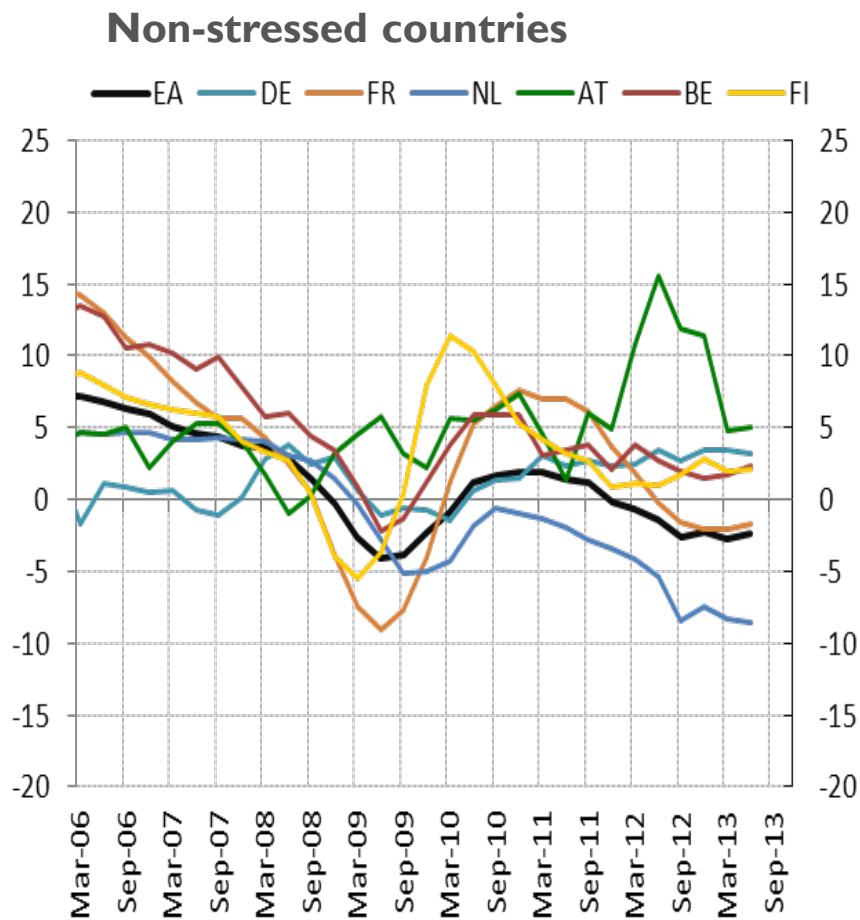
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3. House price analyses at the ECB

Residential Property Prices

(annual percentage changes)



Source: ECB.

Note: Last observation refers to 2013 Q2.

3. House price analyses at the ECB

- Assessing house price developments for the euro area presents challenges as there is cross-country heterogeneity in
 - house price measurement
 - structural features, fiscal policy, credit availability
- Significant differences between euro area aggregate house price forecasts and aggregation of euro area country forecasts
- Need to rely on support of NCBs and ECB country experts to formulate assessments of developments in country and euro area aggregate house prices

3. House price analyses at the ECB

- **Housing markets less transparent than other asset markets**
- Due to no two houses being alike and low turnover, house prices are difficult to measure
- Important differences in definitions, coverage, length and timeliness persist in country house price indicators across the euro area
- Sometimes have trade-off of coverage versus length
- ECB residential property price indicator
- Eurostat House Price Index also available

3. House price analyses at the ECB

- **Factors explaining house prices include**
- Demand variables: real disposable income per capita, real interest rate (mortgage and risk-free rates), demographics (household formation)
- Supply variables: housing stock, construction costs
- Structural factors: planning laws, home ownership ratios, rental regulation
- Fiscal factors: transaction and property taxes, mortgage interest relief, capital gains taxes
- Financial/ prudential factors: credit, household debt, availability of credit (maximum LTVs, LTIs), foreclosures
- Other: rents, HICP/ consumption deflator, equity prices

3. House price analyses at the ECB

- Input to macroeconomic analyses/ outputs
 - Analysis and forecasting for euro area countries and euro area aggregate
 - Scenario analysis
 - Surveillance reports Monthly Bulletin boxes and articles
 - Support for country missions to stressed countries

3. House price analyses at the ECB

- Input to financial stability analyses/ outputs
 - Financial Stability Review (to be published Nov. 27th)
 - Financial Stability Quarterly Risk Assessment Reports (internal)
 - ESRB Risk Dashboard
 - Stress testing in preparation for Single Supervisory Mechanism

3. House price analyses at the ECB

- ECB Working Papers e.g. topics such as
 - Forecasting/valuation framework for house prices
 - Modelling house prices and the macroeconomy
- ECB Occasional Papers
 - e.g. Structural Factors in EU Housing Markets (2003)
- ECB Workshops/ Conferences
 - e.g. Commercial Property Prices in 2012 (Joint with IMF/BIS/Eurostat/OECD)
- Eurosystem's Household Finance and Consumption Survey
 - contains micro data on wealth, income and consumption that allows assessing household's sensitivity to interest rates and house prices

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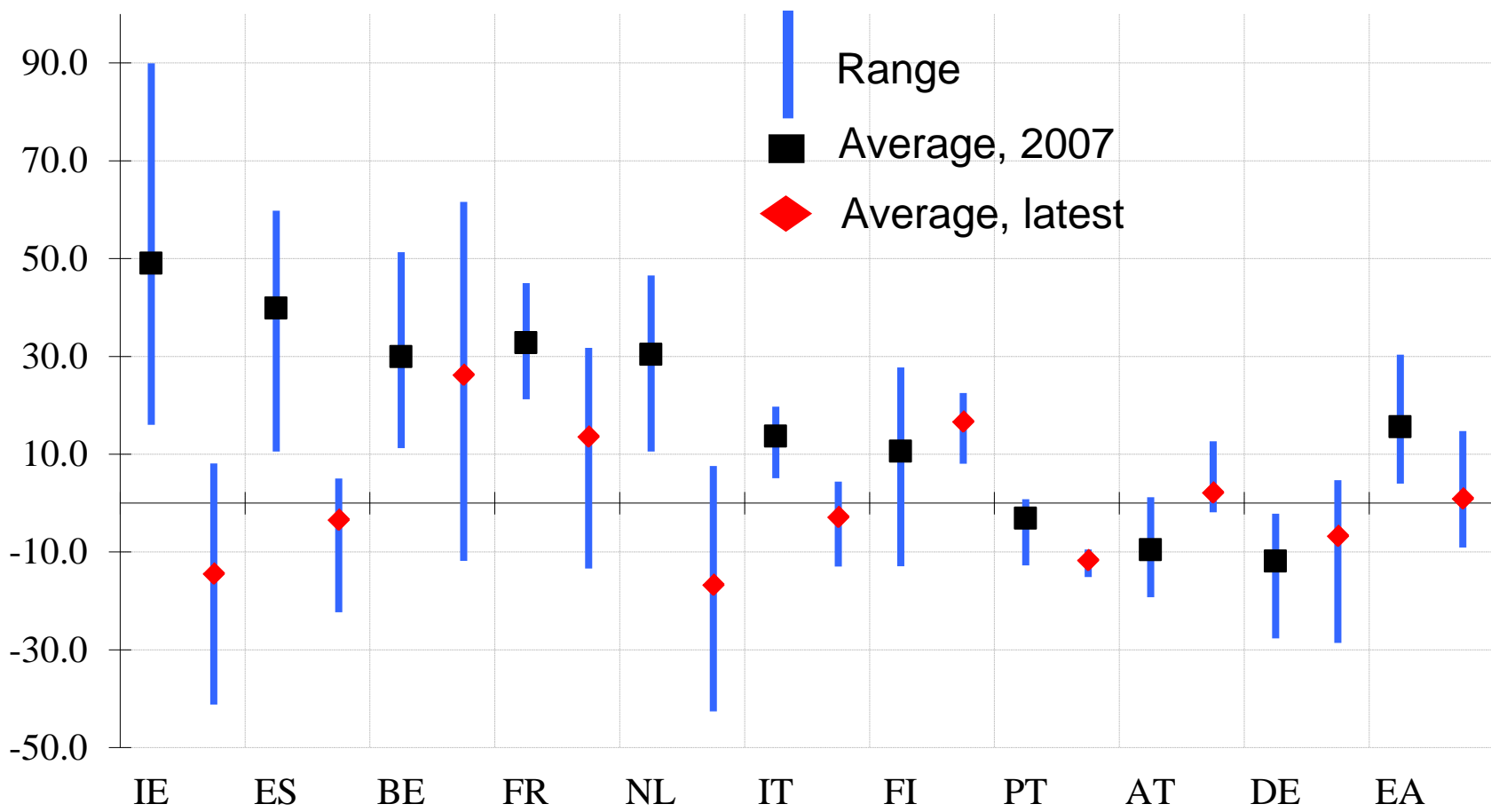
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4. Recent developments in house prices in the euro area

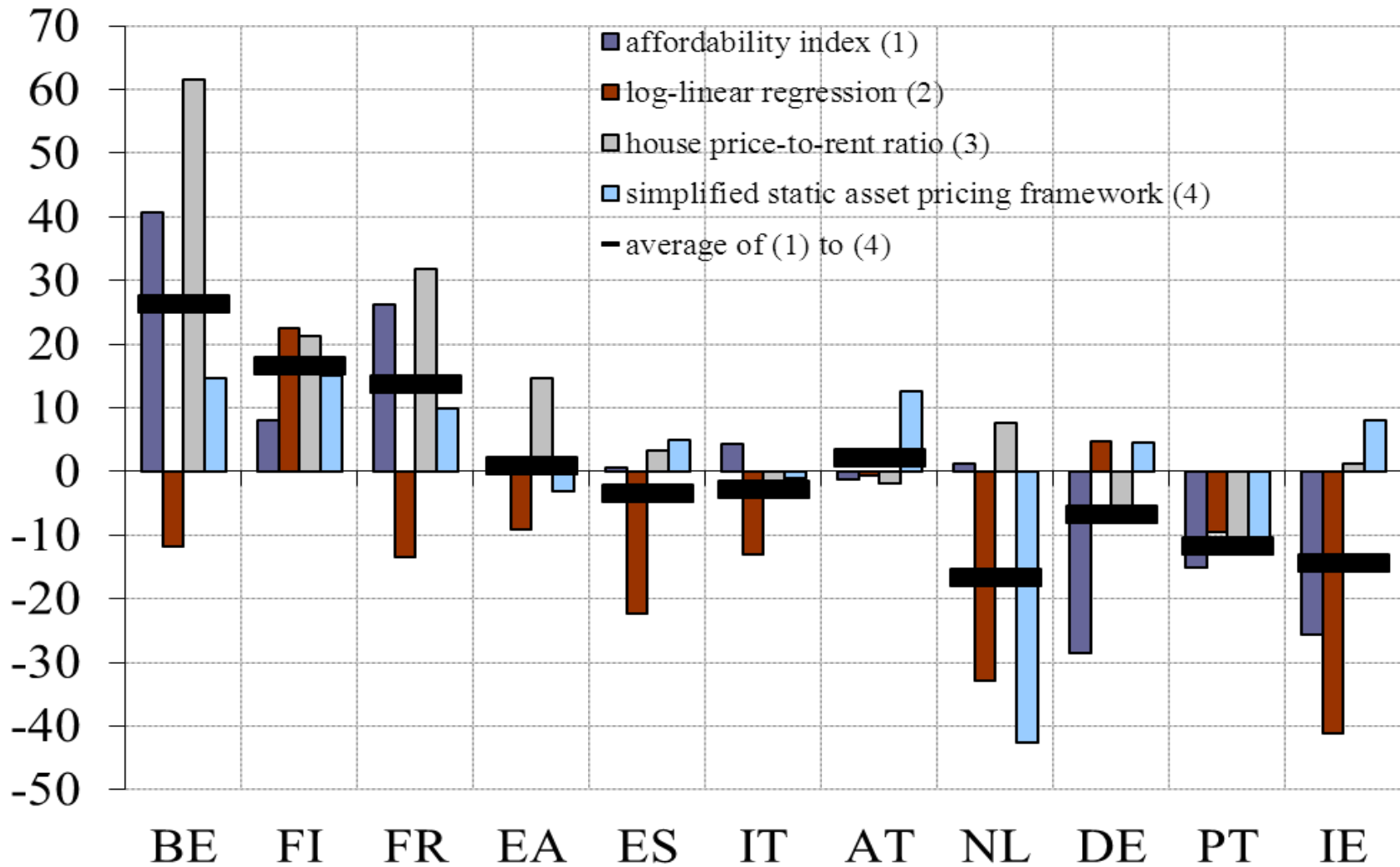
| Residential property prices (nominal) in the euro area | | | | | | |
|---|---------------|-------------------|-------------|-------------|-------------|-------------|
| year-on-year change, % | | | | | | |
| | Weight | 1999- | 2012 | 2013 | 2013 | 2013 |
| | (%) | 2011, avg. | | Q1 | Q2 | Q3 |
| Belgium | 3.8 | 6.5 | 2.5 | 1.7 | 2.4 | - |
| Germany | 26.7 | - | 3.0 | 3.4 | 3.3 | - |
| Estonia | 0.2 | - | 8.0 | 7.8 | 12.0 | - |
| Ireland | 1.8 | 3.1 | -12.8 | -3.0 | -0.4 | - |
| Greece | 2.6 | 5.1 | -11.7 | -11.3 | -11.6 | - |
| Spain | 11.7 | 6.5 | -13.7 | -14.3 | -12.0 | - |
| France | 21.3 | 7.4 | -0.5 | -2.0 | -1.7 | - |
| Italy | 17.0 | 4.4 | -2.8 | -6.0 | -5.9 | - |
| Cyprus | 0.2 | - | -5.4 | -5.3 | -5.9 | - |
| Luxembourg | 0.4 | - | 4.2 | 4.2 | 5.1 | - |
| Malta | 0.1 | 5.2 | 0.5 | -0.6 | 1.1 | - |
| Netherlands | 6.4 | 4.1 | -6.3 | -8.3 | -8.5 | -4.5 |
| Austria | 3.1 | 2.2 | 12.4 | 4.8 | 5.0 | - |
| Portugal | 1.9 | 2.2 | -2.2 | -3.8 | -3.7 | -3.5 |
| Slovenia | 0.4 | - | -6.9 | -4.3 | -4.6 | - |
| Slovakia | 0.7 | - | -1.1 | 0.4 | 0.2 | - |
| Finland | 1.9 | 4.7 | 1.6 | 1.9 | 2.2 | 1.1 |
| Latvia | - | - | 3.7 | 16.8 | 6.3 | - |
| Euro area | 100.0 | 4.1 | -1.7 | -2.8 | -2.4 | - |

Sources: National sources and ECB calculations.

4. Recent developments in house prices in the euro



4. Recent developments in house prices in the euro area



Thank you!

- **EU Macroeconomic Imbalances Procedure** includes Alert Mechanism Report based on scoreboard
- The Scoreboard includes house prices with rationale *“Monitoring real asset prices is important as booms and busts in housing markets affect the real economy through a variety of channels and can be an important source of macroeconomic imbalances.”*
- Measured as year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%
- As part of economic reading, nominal house prices, statistical valuations, residential construction also considered

- Monetary policy only part of the policy mix
- Structural policy e.g. supply can be made less rigid by making planning permissions process more efficient
- Fiscal policy e.g. less tilted towards owned housing by rowing back on mortgage interest relief
- Prudential/supervisory regime important as mortgage lending can be important driver of price booms

Understanding house price developments: key features

- Housing markets have some distinguishing features
- No two houses are fully alike (e.g. location will always differ) and low turnover of individual houses
- Price can be multiple of buyer's income and cost of transaction is high (e.g. tax, legal, estate agent fees)
- Sometimes cash purchase but often largely financed by a mortgage so credit conditions crucial
- Rigid supply as takes time to secure building permit, obtain financing and construct house
- Market segmentation e.g. in cities, land less available so supply can be more rigid