S&P Global Ratings

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Economic Research:

European Housing Markets: Better Days Ahead

July 17, 2024

Key Takeaways

- We revised upward our housing price forecasts for 2024, especially for Belgium, Portugal, and Spain. This is because housing prices were more resilient at year-end 2023 than we expected, while housing loans recovered faster than they did in previous cycles.
- We believe the faster-than-expected recovery in housing loans mainly results from the strong European labor market. That said, unit labor costs are high by historical standards and the labor market is cooling.
- Although we think housing markets in most European countries have bottomed out, we continue to forecast a moderate increase in nominal housing prices over 2024-2027. After the rate cuts, structural factors will continue to drive housing demand, while easing supply constraints will prevent sharp price increases.

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Our short-term housing price forecasts improved. We revised upward our price forecasts for 2024 for most European countries, especially Belgium, Portugal, and Spain. This is because the European labor market was more resilient than we expected, meaning prices were more resilient at year-end 2023 than we anticipated and housing loans recovered faster than they did in previous cycles. On the other hand, we continue to expect a moderate rebound in prices over the medium term. Our forecast for 2027 is in line with that for 2026 (see table 1). Our forecasts are based on our expectations of slow population growth, a robust European labor market, and real interest rates that remain stable over the long term.

Table 1

S&P Global Ratings economists' nominal price forecasts

	Year-over-year change in Q4 in nominal house prices (%)						Change compared with previous forecasts (%)				
	2022	2023	2024	2025	2026	2027	2022	2023	2024	2025	2026
Germany	-3.6	-7.1	-0.3	0.5	2	2	0	-1.7	0.7	0	0
France	4.7	-3.9	-2.5	1	1.5	2	0	-2.4	1	-0.5	-0.5
Italy	2.7	1.8	-3.7	-1.5	1	1	0	1	0.2	-0.5	0
Spain	5.5	4.4	4	3	2.4	2	0	3.4	4.3	1.5	0.4
Netherlands	5.7	0.2	0.1	0.8	1.7	1.9	0.3	2	2.1	-0.2	-0.6
Belgium	4.6	3.3	1.5	1.5	1.4	1.4	-0.2	3.9	1.9	0.5	0
Portugal	11.2	7.8	3.5	3.5	3	3	-0.1	6.5	3.2	1.5	0.6
Switzerland	5.5	1.6	0	1.5	2	2.6	0	1.9	0.5	0	0
U.K.	9.3	-1.7	1.4	2.3	2.6	2.9	0.3	-0.2	0.4	0.2	0
Ireland	8.6	3.1	5.8	4.1	3.2	3.2	0	1.3	4.5	2	1
Sweden	-3.6	-2.9	0.6	2.1	2.7	2.7	0	2.8	2.1	0.1	0.1

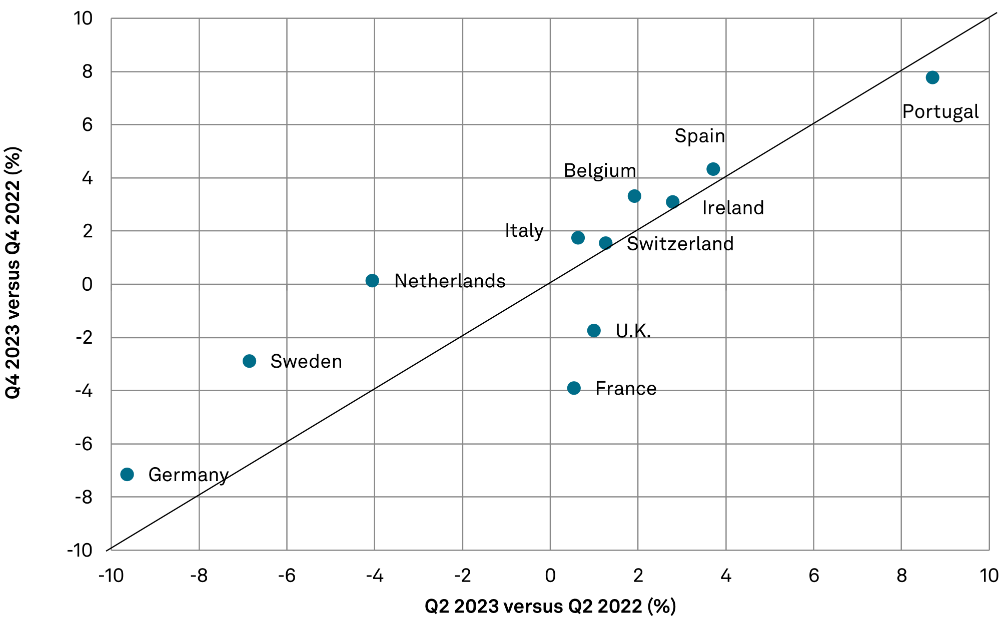
Data as of July 2024. Sources: OECD, S&P Global Ratings.

Housing price dynamics remain uneven across Europe. While the price correction accelerated in France in the first half of 2024, it slowed in Germany and Sweden, where the correction had been most pronounced in 2023. While housing prices have stabilized in the Netherlands, they continue to increase steadily in about half of the countries we cover in this report, with Portugal and Spain taking the lead (see chart 1). These differences, which are based on several demand and supply factors, often reflect idiosyncrasies. Contributing factors include:

- Mortgage financing, with variable-rate mortgages being more sensitive to changing financing conditions than fixed-rate mortgages;
- Housing stock and housing quality;
- Construction costs, demographics, the labor market, public housing subsidies, and overvaluations during the COVID-19 pandemic; and
- Housing types. New builds continue to sell at higher prices, while the prices of existing homes decline further. Stricter thermal insulation standards and the sharp increase in construction costs due to high material and labor costs contribute to this dichotomy. Notable exceptions at year-end 2023 included Germany and Italy, where the prices for new and existing homes are falling, and the Netherlands and Portugal, where the prices for new and existing home prices are rising.

Chart 1

House price dynamics remain uneven across Europe
Change in nominal housing prices



Q--Quarter. Sources: Eurostat, S&P Global Ratings.

Outliers Germany And Portugal

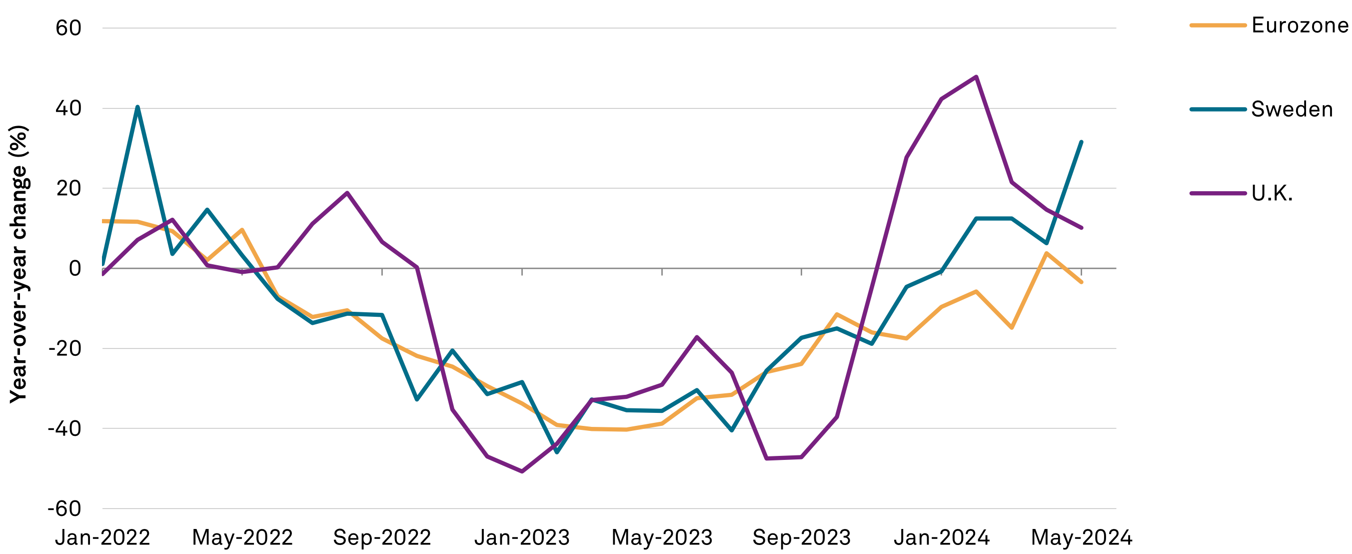
German real estate prices in 2023 declined more than we expected. This was despite the low share of variable-rate financing, a large population influx, the very tight labor market, and because of significant overvaluations during the pandemic. In contrast, prices in Portugal increased beyond our expectations, despite the large share of variable-rate financing, and because of foreign buyers' appetite, and the modernization of the housing stock. Italian house prices in 2023 were more in line with our expectations. Despite demographic challenges and rising real interest rates, they did not contract, thanks to government measures to support housing investments. In Sweden, prices corrected significantly last year due to a sharp rise in mortgage rates, a high proportion of variable-rate financing, and a still elevated price-to-income ratio.

European Housing Prices Are About To Bottom Out

The correction in European housing prices will end earlier than we expected. After an 18-month-long contraction, growth in new mortgage loans has turned positive in the eurozone, the U.K., and Sweden. It resumes at a pace that is similar to the period before 2022, when central banks began raising interest rates. The recovery in mortgage loans coincides with the interest rate cycle (see charts 2 and 3) and happens about six months earlier than the econometric analysis of past cycles suggested. This means the maximum effect of higher rates on loan demand has materialized 12-18 months after the first rate hike. We believe the strong European labor market and the recovery in household incomes contribute to the faster-than-expected recovery in the demand for housing loans.

Chart 2

The recovery in housing credit happens earlier than we thought...
New mortgage loans

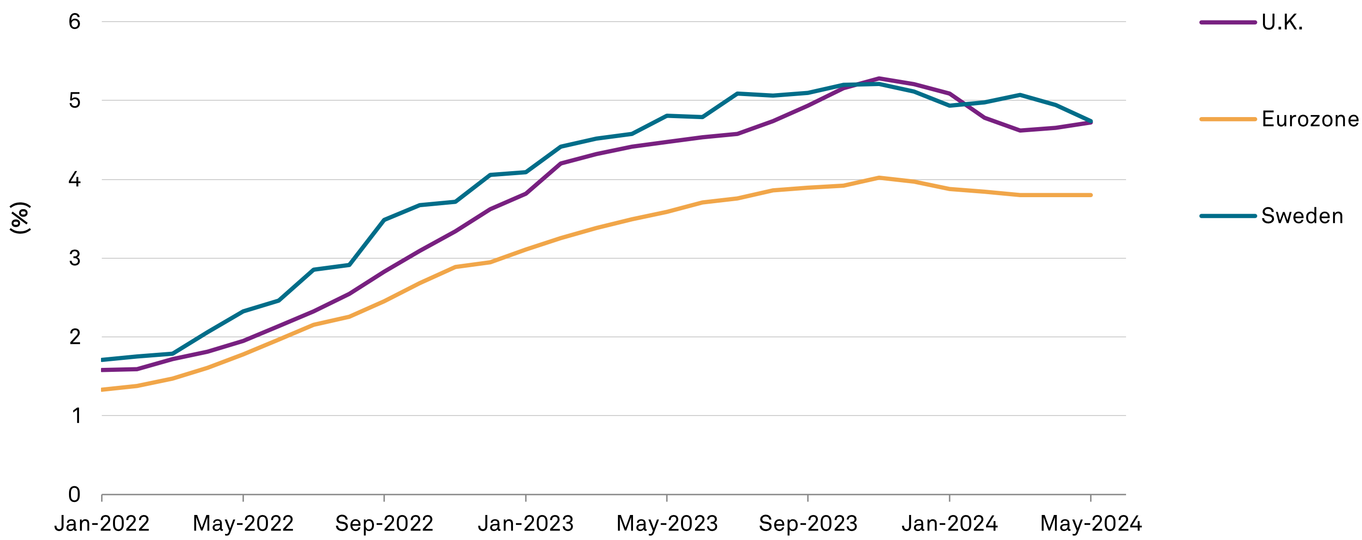


Source: S&P Global Ratings.

Chart 3

...and coincides with the interest rate cycle

Rates on new mortgage loans



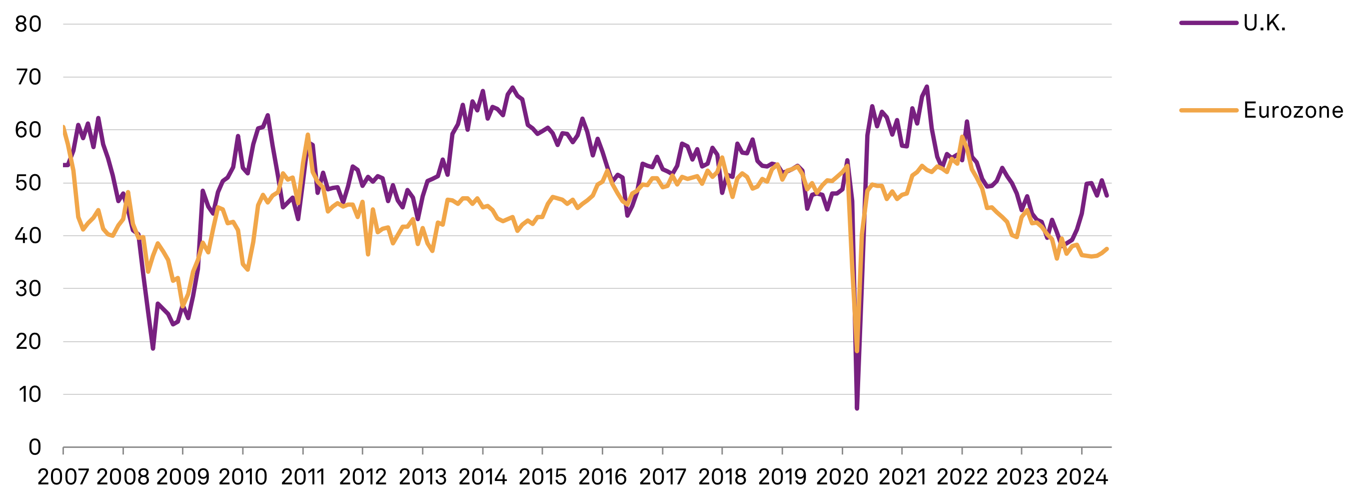
Source: S&P Global Ratings.

Housing activity has not recovered to the same extent as housing credit. That said, the housing activity indicator of the Purchasing Managers' Index for the construction sector is stabilizing at low levels for the eurozone and even reached the expansion threshold in the case of the U.K. (see chart 4). This indicator suggests that housing activity increases in Ireland, while it eases in Germany but not yet France and Italy. Similarly, the pace of contraction of building permit issuances in the first quarter of 2024 more than halved to 11% in the eurozone (from 24% in the same period in 2023) and 21% in Sweden (from 58% in the third quarter of 2023).

Chart 4

Housing activity recovers slower than housing credit

Construction Purchasing Managers' Index--Housing activity



Source: S&P Market Intelligence.

European Housing Markets Benefit From Economic Tailwinds

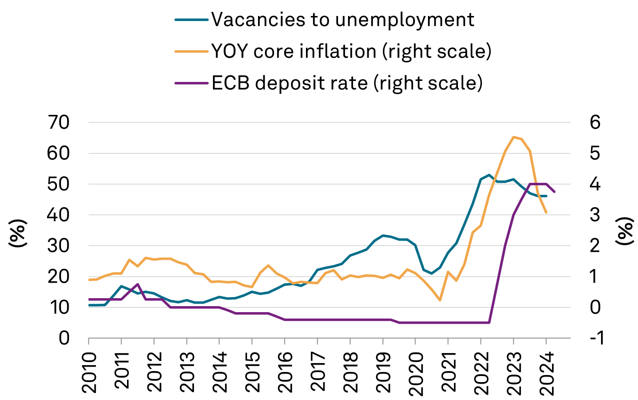
Most European economies resumed growth in the first quarter of 2024, after several quarters of stagnation or contraction. This return to growth is largely a terms-of-trade effect: The decline in energy prices and inflation, coupled with central banks' rate cuts or willingness to do so, reduced financing costs--and with inflation falling, consumer confidence is returning. Barring any new shocks, economic growth will likely continue to strengthen through 2025. We expect housing investments will pick up from 2025, when interest rates will have fallen further.

Our baseline assumptions include a continuously robust European labor market. In light of diminished productivity, labor costs--which have become the main driver of inflation--could reduce employers' willingness to hire new workers and even lead to layoffs. It is worth noting in this regard that employment rates affect housing investments and non-performing loans. For now, however, the European labor market is only cooling but not collapsing. Wage growth is slowing and unemployment rates across Europe remain close to record-low levels. We will continue to monitor the development of the European labor market closely.

Pressure on the European labor market has eased sufficiently for core inflation to recede and central banks to cut rates (see charts 5 and 6). The Swiss National Bank, De Nederlandsche Bank, the Riksbank, and the European Central Bank (ECB) have already cut rates, while the Bank of England (BoE) will likely follow suit, potentially in August 2024. That said, the rate cutting cycle will be moderate and gradual, considering that GDP growth and inflation are expected to return to their respective targets only by June 2025. We foresee another two rate cuts from the ECB this year and three more in 2025. In comparison, we expect three rate cuts from the BoE this year and five more in 2025. The ECB's deposit rate and the BoE's base rate could bottom out at 2.5% and 3.0%, respectively.

Chart 5

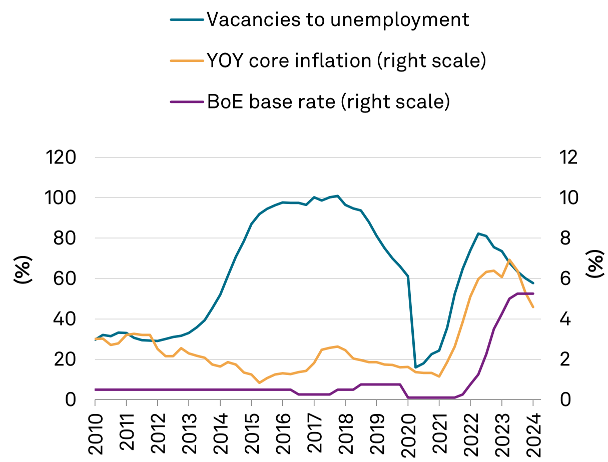
Easing labor markets could lead to more rate cuts from the ECB...



ECB--European Central Bank. YOY--Year over year.
Source: S&P Global Ratings.

Chart 6

...and probably also from the BoE



BoE--Bank of England. YOY--Year over year.
Source: S&P Global Ratings.

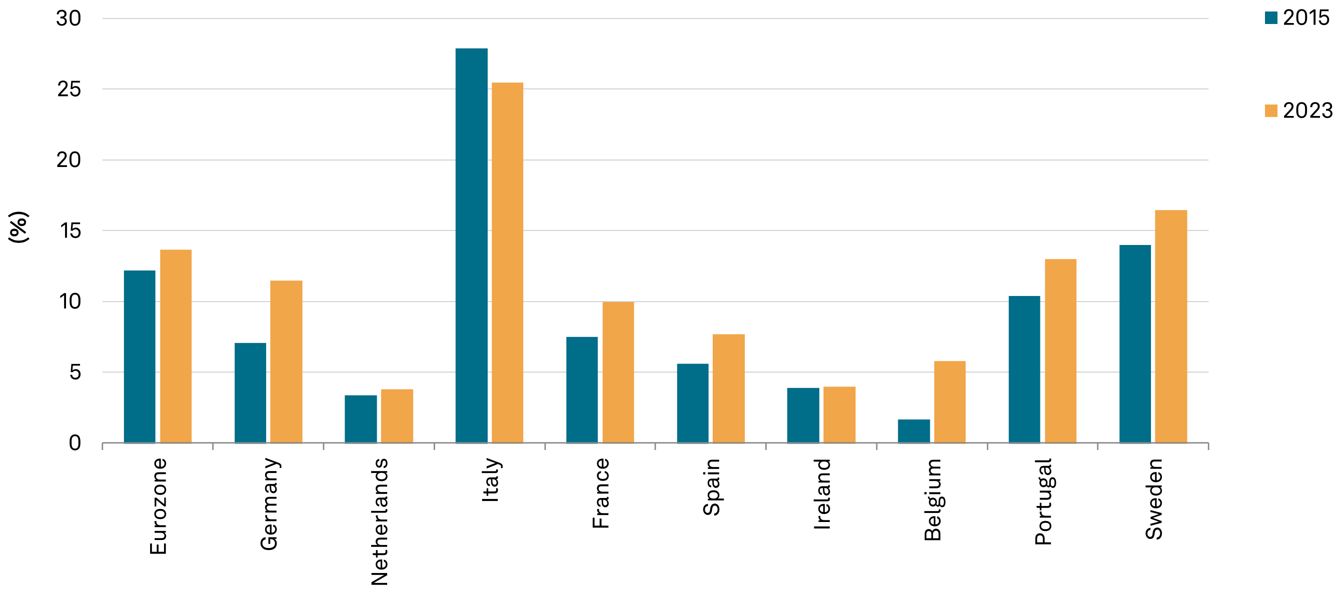
The Demand Is There

We continue to expect a moderate rebound in housing prices over the forecast horizon. Mortgage rates will probably continue to fall as central banks cut rates but will remain higher in real terms than they were before the pandemic. Real wages are set to rise further over the forecast horizon but we expect less job creation. It will therefore take some time for the link between house prices and household income to normalize, after it suffered from the double shock of the pandemic and the energy crisis. Still high relative prices, positive real interest rates, and the prospect of slower job growth offset the benefits of falling nominal rates and rising purchasing power. Together, these factors will translate into a subdued, albeit improving, house-buying demand across Europe over the next 12 months.

Structural housing demand exists. In most countries covered in this publication, the share of households living in overcrowded properties has increased over the past decade (see chart 7). Additionally, increasingly stricter thermal building regulations will continue to shift demand from existing to new homes. All this suggests that housing demand will increase moderately. On the supply side, construction costs have eased significantly, compared with the peak they reached in 2022, but remain higher than before the pandemic, mainly due to staff shortages (see chart 8). We expect the combination of these demand and supply factors will lead to a moderate rebound in prices.

Chart 7

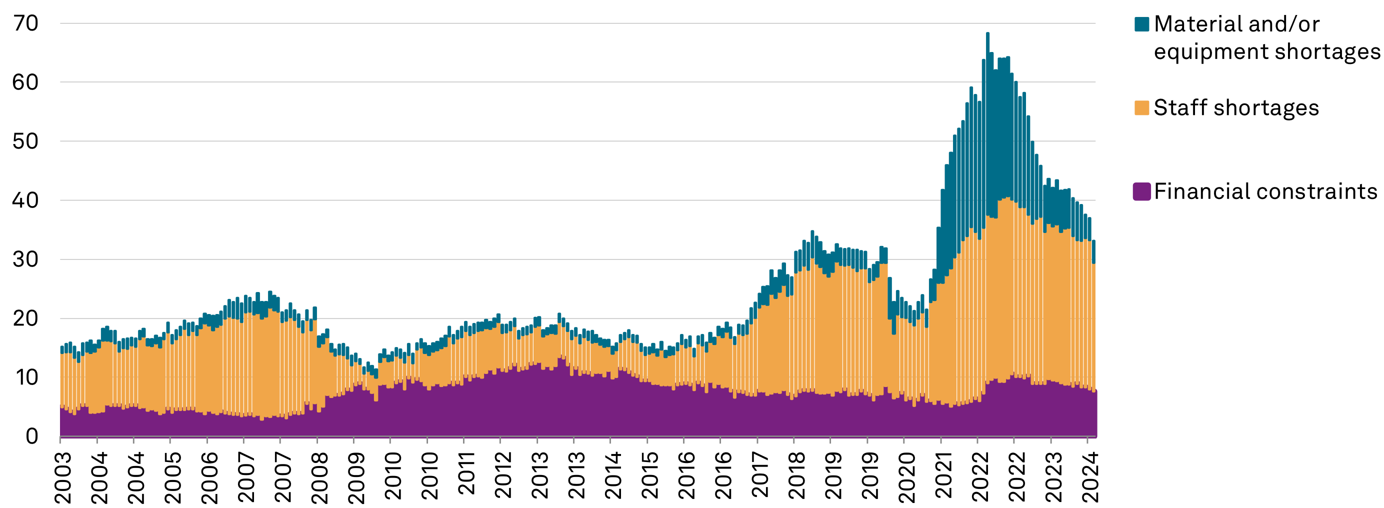
Share of households living in overcrowded homes



Sources: Eurostat, S&P Global Ratings.

Chart 8

Supply factors limiting construction have eased across the eurozone



Sources: European Commission, S&P Global Ratings.

Related Research

- Economic Outlook Eurozone Q3 2024: Growth Returns, Rates Fall, June 24, 2024
- European Housing Prices: A Sticky, Gradual Decline, Jan. 11, 2023

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This report does not constitute a rating action.