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Economic Research:

House Prices Are Still Falling In Most European Markets As The Recession Bites

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Economic Research:

House Prices Are Still Falling In Most European Markets As The Recession Bites

House prices will keep falling in most European markets this year as the recession takes its toll on employment and lowers consumer confidence. However, some countries are suffering harsher market declines than others, while a few are already in recovery mode. Spain's housing market is still experiencing the sharpest slump. Standard & Poor's forecasts that prices there will fall by 8% this year and again by 5% in 2014 (see table 1), amid 27% unemployment rates and a lack of solvent demand to absorb excess supply. Spain's "bad bank" SAREB, which holds 30% of the country's repossessed housing stock, will in our view disinvest it only gradually over the next two to three years so as not to precipitate a market collapse. An acceleration of this disinvestment process could in our opinion easily push house price declines into double digits in 2013-2014.

Troubled housing markets are not confined to the so-called periphery of Europe. We forecast that The Netherlands' housing market will see the second-heaviest price falls this year of 5.5%, precipitated by recent changes in fiscal and credit regulations, falling economic growth, higher unemployment, and falling purchasing power. Nevertheless, we believe the country will be able to stem the market decline to just 1% next year and that prices will bottom out in 2015 as the economy gradually improves. The French residential market will see the third-heaviest price declines of 4% this year and again next year, although it is proving more resilient than we predicted earlier in the year. Low interest rates and supportive lending policies imply a softer landing in France over the next 18 months.

Overview

- We forecast that residential real estate prices will stay depressed in most European markets this year and next, owing to weak economic conditions.
- We expect Spain will suffer the heaviest price declines (8.0%) this year, followed by The Netherlands (5.5%), France (4.0%), Portugal (3.5%), and Italy (3.0%).
- The German housing market, by contrast, is continuing its steady rise at 3% this year, and we now predict the U.K. market will also rise by 2.5%, while the Belgian market will just stay in positive territory.

Meanwhile, Germany's residential retail market continues to buck the trend. A better-than-European-average economic outlook, low interest rates, and strong national and international demand for homes as a safe capital investment, will continue to drive up prices by 3% this year and next, according to our forecast. We still consider this a normalization, however, because the market did not experience a boom over the past 20 years. Furthermore, the affordability ratio, measured as house prices to income, still finds the German housing market undervalued by close to 20%. The U.K. is also staging a stronger recovery than we previously expected, boosted by improved availability of mortgage credit and a brighter outlook for the economy, and in spite of affordability ratios that suggest homes are still overvalued. We have therefore lifted our forecasts for U.K. house price rises to 2.5% this year and 2.0% in 2014 (from 1.5% and 1.0%, respectively, in our previous report published in May).

The longer term prospects for European property markets beyond the current economic weakness appears brighter, in our opinion. A shortage of housing supply, coupled with rising populations, should underpin prices.

Table 1

European Nominal House Prices % Change Year On Year

	2009	2010	2011	2012	2013f	2014f
Belgium	1.1	5.8	2.0	1.4	0.5	1.5
France	(4.2)	7.7	3.7	(1.9)	(4.0)	(4.0)
Germany	1.5	2.9	6.8	3.6	3.0	3.0
Ireland	(19.1)	(11.0)	(15.8)	(6.1)	(0.9)	0.0
Italy	(3.4)	(1.4)	(2.8)	(4.6)	(3.0)	(1.0)
Netherlands	(5.0)	(1.0)	(3.4)	(7.3)	(5.5)	(1.0)
Portugal	(0.6)	1.6	(0.9)	(2.7)	(3.5)	(0.5)
Spain	(6.6)	(3.3)	(7.1)	(10.5)	(8.0)	(5.0)
U.K.	0.3	3.8	(0.5)	2.3	2.5	2.0

f--Forecast. Sources: S&P, OECD.

Belgian Property Prices Are Stabilizing

The housing market in Belgium is likely to stagnate this year and grow only marginally in 2014 amid a weak economic outlook. Gloomy income and employment prospects are limiting demand for new dwellings, although a shortage of housing should prevent a slump in the longer term. We forecast that house prices will rise only marginally by 0.5% this year and by 1.5% in 2014 (see table 2).

Recent trends

Market statistics provided by Belgian notaries show that the average price for a standard home in Belgium increased by 1.1% over the first half of 2013, while the average price for an apartment stagnated. These statistics also indicate that transactions stabilized in the second quarter of 2013 after falling 5.1% year on year in the first quarter, suggesting that Belgian households remained reluctant to spend in the first half of 2013.

Tougher access to mortgage lending markets has also eroded housing demand. Mortgage credit growth, although still positive, slowed in May this year (see chart 1). Total outstanding mortgage credit increased by just 4.0% year on year, from the double-digit growth experienced before the 2008 global financial crisis. Nevertheless, banks are still extending credit. Historically low interest rates, with average rates on new loans averaging about 3.4% in May 2013, are supporting households' capacity to borrow. Still, as prices soften, activity in the construction sector is slowing. Cumulative dwelling permits over the past 12 months fell by 10% in April 2013 on a year earlier to 44,651.

Future trends

We expect very little growth in house prices in nominal terms, and negative growth in real terms over the next few quarters. In the short term, we think that consumer concerns over job security will continue to curtail Belgian households' purchasing intentions. Consumers are still pessimistic about the country's economic performance and their own finances for the coming 12 months. The June consumer confidence indicator provided by the National Bank of Belgium rose slightly to -18 in June--for the third consecutive month--but remains eight points lower than in June

2012. Given the expected rise in unemployment both this year and next, we anticipate only a slight improvement in household confidence and thereby in home purchasing intentions.

Over the longer term, however, we don't expect a downturn in Belgium's housing market. The ratio of house prices to incomes suggests homes are still among the most affordable in the eurozone (European Economic and Monetary Union). The affordability ratio was 47% above its long-term average in March 2013. Three factors are limiting a market downturn, in our view. First, Belgian household debt is still moderate at 55% of GDP in December 2012, which is well below the European average of 65%. This is because large down-payments helped households keep up with price increases in boom years. Second, low interest rates are still supporting household borrowing capacity. Third, inelastic supply and high demand should continue to broadly underpin Belgium's housing market. On the demand side, demographic trends are fueling demand. The population has expanded by 10% since 1991, and between 2007 and 2020 it should increase at a higher pace at an annual average of 0.75%, according to the Federal Planning Bureau. Furthermore, estimates by the Organization for Economic Cooperation and Development (OECD) suggest that the supply of new homes is not keeping pace with house price variations. While real residential property prices have expanded by 85% since 1997, new housing investment grew by only 20% over the same period. This shows that growing demand tends to lead to higher prices rather than an expansion of construction.

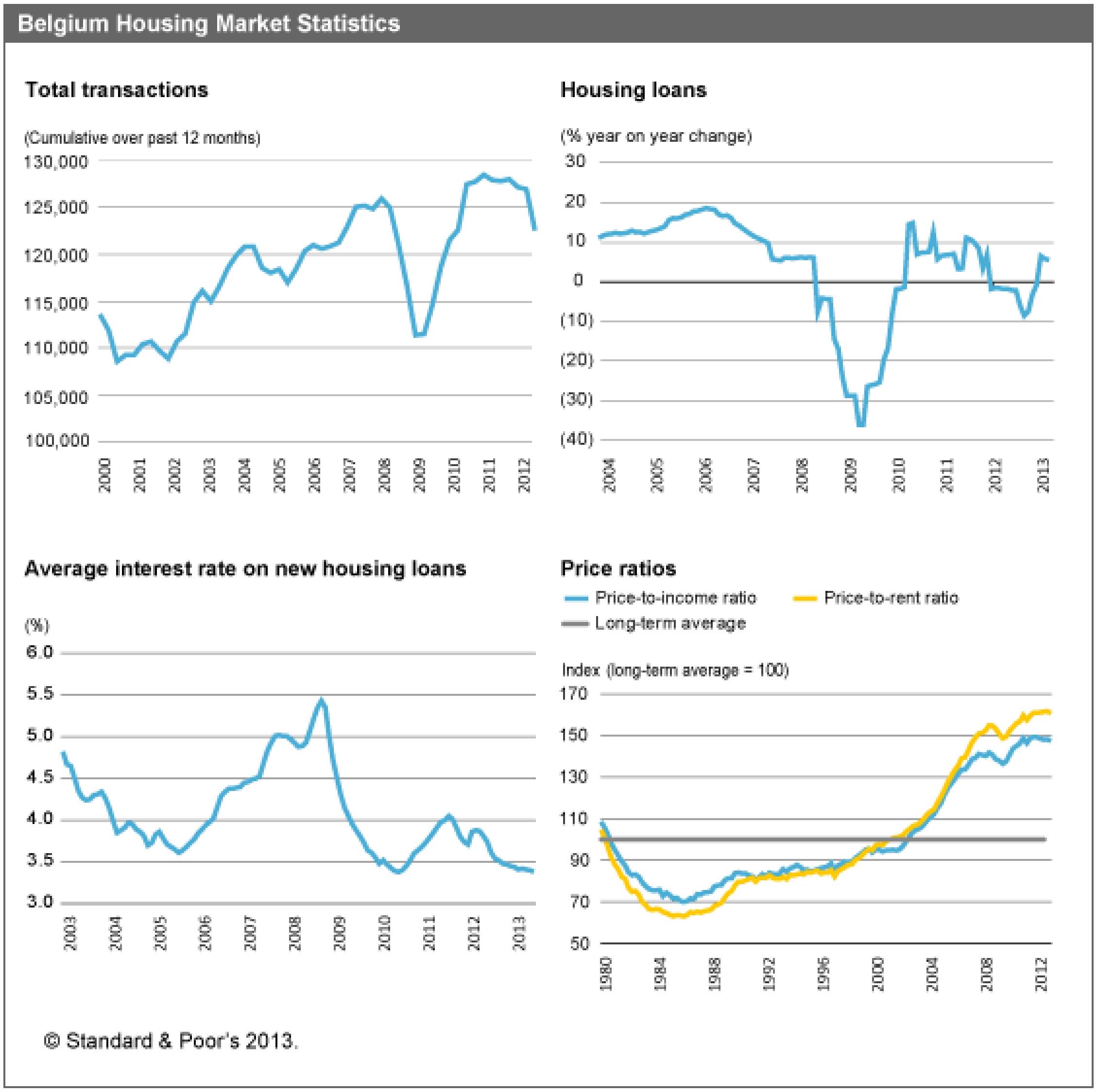
Table 2

Belgian Housing Market Statistics

	2009	2010	2011	2012	2013f	2014f
Nominal house prices (% change year on year)	1.1	5.8	2.0	1.4	0.5	1.5
Real GDP (% change)	(2.8)	2.4	1.8	(0.3)	(0.4)	0.6
CPI inflation (%)	0.0	2.3	3.3	2.6	1.3	1.5
Unemployment rate	7.8	8.2	7.2	7.6	8.0	8.0

f--Forecast. Sources: S&P, Eurostat, Banque Nationale de Belgique, OECD, Statistics Belgium.

Chart 1



Sources: Statistics Belgium, ECB, Organization for Economic Cooperation and Development (OECD), National Bank of Belgium.

France Faces A Protracted Slowdown In House Prices

In spite of weak economic conditions, the French housing market is proving a little more resilient than we predicted earlier this year. We have therefore slightly revised our forecasts for 2013 and 2014, and now expect declines of 4% in both years, compared with the 5% declines we projected in our May report (see table 3 and "Recession Keeps House Prices In The Dumps In Most European Markets," published on May 7, 2013, on RatingsDirect).

Recent trends

Transactions in the French residential real estate market continued to shrink at double-digit rates through the first half of this year. Yet, this still appears to be a relatively soft correction given the sharp rise experienced between the third quarter of 2009 and the first quarter of 2012 (see chart 2)--a surge that was unique at the time in Europe. Similarly, prices have been sliding, but still at a relatively modest rate. They fell by 1.5% in the 12 months to March 2013 and remain very close to the historical peak reached in September 2011.

Several factors explain the French housing market's resilience, in our opinion. First, interest rates on housing loans reached new historical lows in the first half of this year, at an average of 2.9% in June, according to the Observatoire Credit Logement. In the face of still positive demographic trends, these attractive interest rates on extended loan durations that average 16.8 years are still supporting the market. Second, French financial institutions have remained keen to back the housing market. Although the rate of growth in housing loans has slowed markedly since the end of 2012, it remains positive and was up 2.8% year on year in May. Third, the number of new dwellings remains insufficient to correct the structural imbalance between supply and demand for housing, at just under 500,000 in annualized terms. This also explains why the purchase of existing housing stock continues to be attractive.

Future trends

These supporting factors suggest to us that a housing market correction in France will be slow and gradual. We nevertheless we do not consider recent price declines to be just a temporary adjustment. Overall, economic conditions remain very weak. We expect real GDP to contract by 0.3% this year and unemployment to rise through the end of 2014 (see table 3). Tight fiscal policies, including substantial increases in income taxes, are likely to prompt households to protect their savings at a time when lenders are lowering their loan-to value ratios. This means that first-time buyers with only modest savings will continue to struggle to enter the market. The end of zero-interest rate loans at the end of 2012 will make it even more difficult for potential buyers in the lower income range. What's more, the French residential market remains expensive by historical standards. As of March 2013, the price-to-income ratio was only 3.5% lower than the all-time high reached in December 2007. This indicates to us that the French market is only at the very beginning of a correction phase. Still, supportive market factors, such as low interest rates and the imbalance between supply and demand are preventing a swifter decline in prices. This is why we have modestly cut our projections for price declines this year and next. More limited price declines over the next 18 months imply a soft landing, extending beyond 2014.

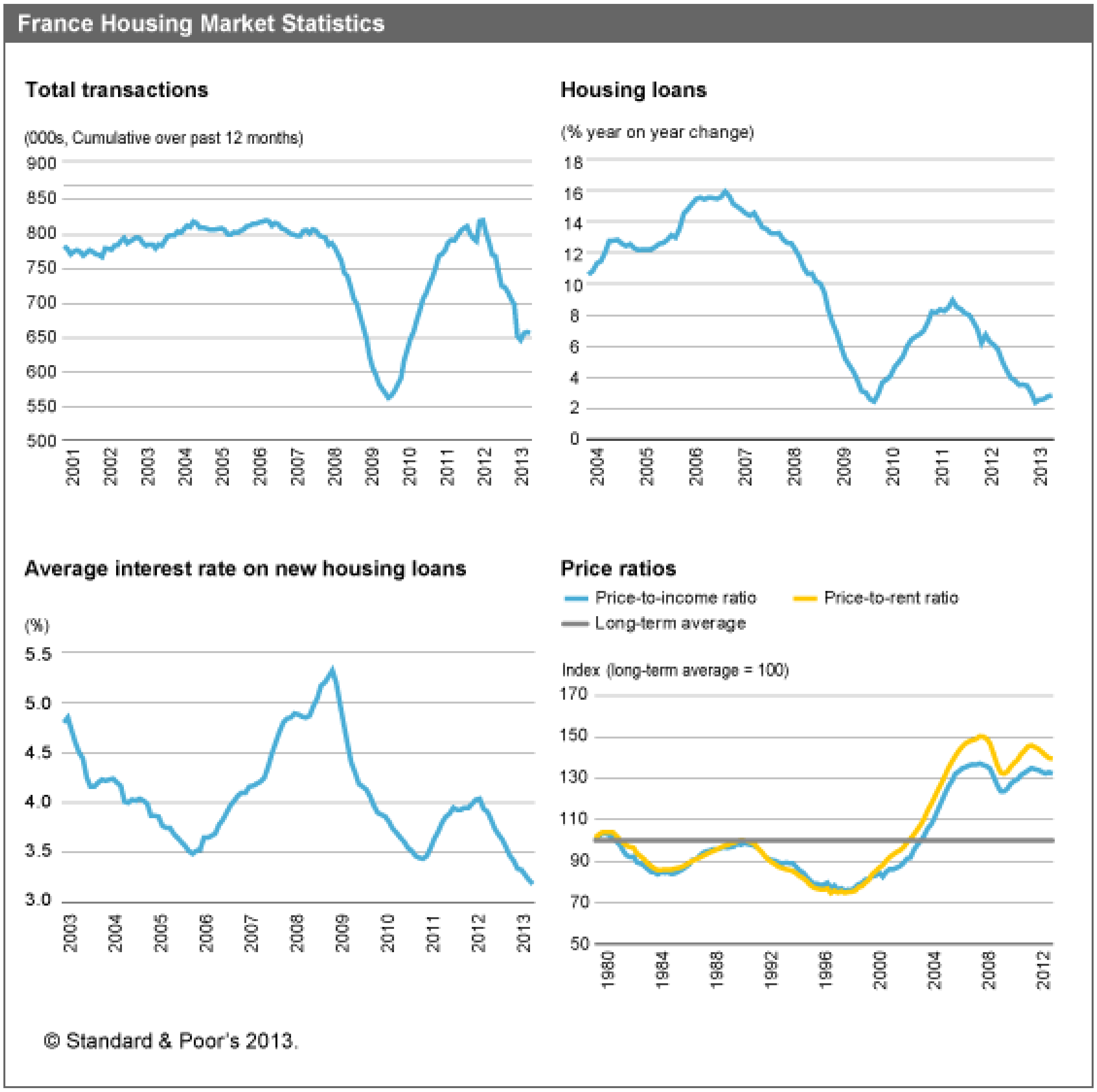
Table 3

French Housing Market Statistics

	2009	2010	2011	2012	2013-f	2014-f
Nominal house prices (% change year on year)	(4.2)	7.7	3.7	(1.9)	(4.0)	(4.0)
Real GDP, % change	(3.1)	1.7	2.0	0.0	(0.3)	0.6
CPI inflation (%)	0.1	1.7	2.3	2.2	1.0	1.5
Unemployment rate	9.5	9.7	9.6	10.3	11.2	11.5

f--Forecast. Sources: S&P, Eurostat, OECD, INSEE.

Chart 2



Sources: Ministère de l'Ecologie du Développement et de l'Aménagement du Territoire, ECB, OECD, INSEE (Institut National de la Statistique et des Etudes Economiques), ECB.

German Residential Prices Are Still Gaining Momentum

Residential real estate will continue to appreciate in Germany, in our view. A favorable income and employment outlook, coupled with low interest rates and strong national and international demand for homes as a safe capital investment, will continue to drive up prices. We forecast price rises of 3% this year and again in 2014 (see table 4). We nevertheless see this upward trend as a normalization rather than overheating given that, until recently, Germany's housing market had been stagnant for two decades.

Recent trends

Preliminary OECD estimates for the first quarter indicated an acceleration in home price rises. Residential property prices rose by 5.1% year on year in March after gaining 3.6% the previous quarter. Residential construction is benefiting from this upturn. Total dwelling permits climbed 10.6% in April, bringing the number of permits delivered to 251,737 units over the past 12 months (see chart 3).

Various factors are driving the surge in demand and consequent expansion of housing supply, in our view. The German economy continues to perform above the European average, and rising incomes due to persistently increasing employment and strong wage growth are underpinning consumer demand. In turn, as demand for housing surges, buyers increasingly expect that prices will stay on the rise. High immigration is underpinning demand for housing, mainly in the largest cities, where prices have climbed much faster than in Germany as a whole. Added to this, financial conditions are becoming more flexible. Financing costs are at an historical low, which is increasing household borrowing capacity. Average interest rates on new housing loans were just 2.71% in May, boosting mortgage lending growth. Home purchase loans rose by 2.3% in May from the previous year, the fastest rate of growth since 2003-2004. Added to this, uncertainty on the capital markets in light of the European debt crisis is pushing up demand for residential property. This is because investors are increasingly turning to nonfinancial assets, primarily residential property, because they consider it a safe haven.

Future trends

We think that fundamentals will continue to support a further rise in the German residential market. We forecast that real GDP will grow by 0.4% this year in real terms and by 1.4% next year (see table 4). As we expect unemployment to fall slightly and stay low at 5.5% in 2013 and 2014, households' optimism about their financial situation is likely to rise, so boosting their willingness to make major purchases.

So far, we consider the positive development in property prices as a normalization rather than a bubble. Although demand for residential property loans in Germany has risen considerably over the past two years, it remained moderate compared with the 1990s. Given banks' cautious lending practices, we believe that credit growth will stay contained in the future. Furthermore, the affordability index, measured as price to income, still finds the German housing market undervalued by 18%. The price-to-rent ratio points to a more moderate undervaluation of 16.5%.

Table 4

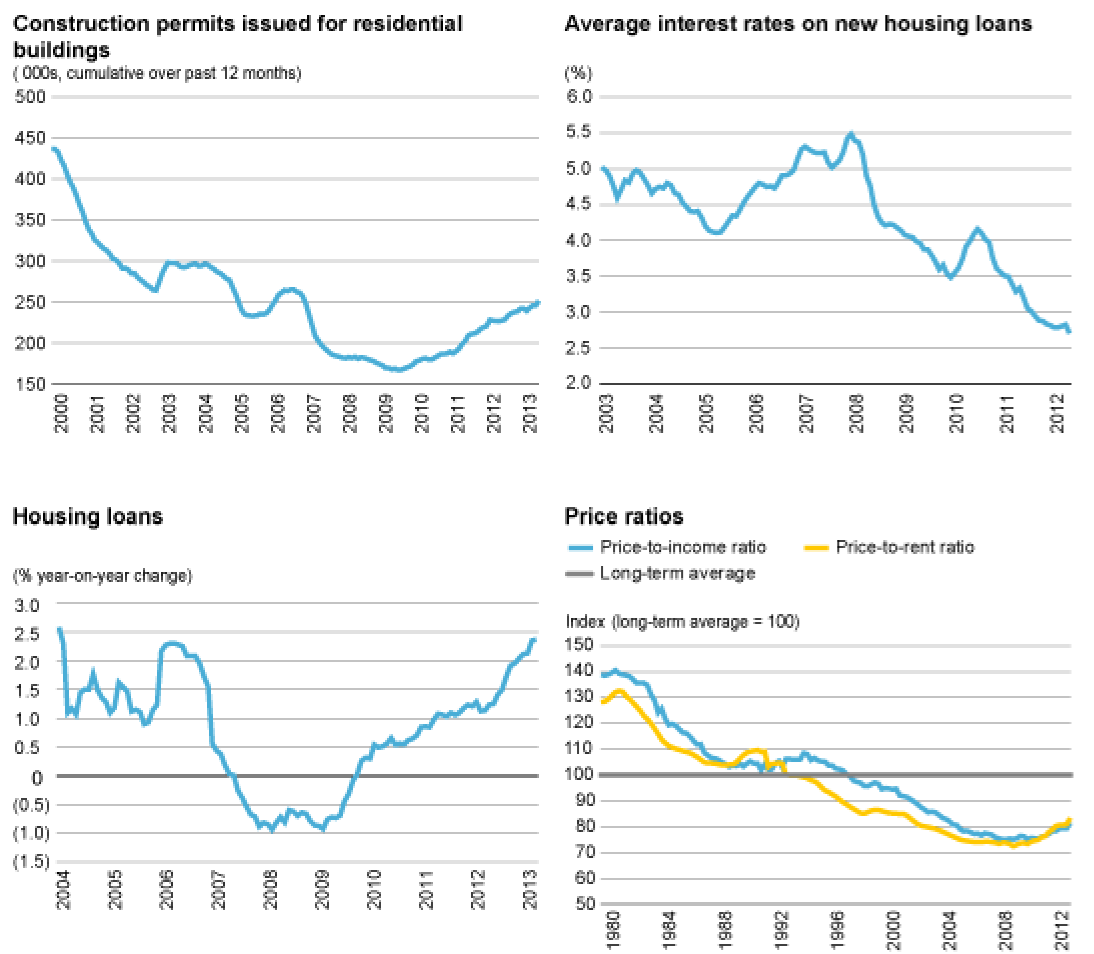
German Housing Market Statistics

	2009	2010	2011	2012	2013f	2014f
Nominal house prices (% change year on year)	1.5	2.9	6.8	3.6	3.0	3.0
Real GDP, % change	(5.08)	4.2	3.0	0.7	0.4	1.4
CPI inflation (%)	0.2	1.2	2.5	2.1	1.4	1.7
Unemployment rate	7.8	7.1	6.0	5.5	5.5	5.5

f--forecast. Sources: S&P, Eurostat, OECD, Deutsche Bundesbank.

Chart 3

Germany Housing Market Statistics



Sources: ECB, OECD, Deutsche Bundesbank.

Ireland's Housing Market Is No Longer In Free Fall, But Recovery Is A Long Way Off

The Irish housing market has started to stabilize after prices slumped by more than 50% over the past six years. We forecast house prices will decline by just 0.9% this year and stay flat in 2014 (see table 5). Nevertheless, the high number of mortgages in arrears and low demand suggest that prices in Ireland may recover only slowly.

Recent trends

After 16 quarters of negative double-digit growth, housing prices posted a more moderate decline of 2.9% in March 2013. Since then, the decline has been slower. Nevertheless, the aggregate figure hides a wide divergence between Dublin and the rest of the country. While the capital's housing market seems to be recovering, according to local real estate offices, prices in the rest of the country, and especially western regional housing markets, are still falling.

The Property Services Regulatory Authority indicates that transactions were up 0.4% for the country as a whole in the second quarter of 2013 on the previous year (see chart 4). However, at about 6,400 per quarter, transactions are still below par.

The construction sector, too, is still anemic. However, scarce supply is helping the market to stabilize by eroding the overhang of unoccupied properties. Only 607 new units were completed in May, and 8,202 over the past year, compared with the peak of 90,000 units completed in 2006.

Future trends

We believe the Irish property market will stabilize over the next two years. Price-to-income and price-to-rent ratios are hovering around their long-term average, indicating that prices have reached an equilibrium point. Economic recovery in 2013 and 2014 should also support demand for housing. We expect real GDP to gain 0.9% this year and 1.9% next year, while unemployment should slowly decline to 14.0% in 2014 from 14.7% in 2012 (see table 5).

Still, latest data on mortgage arrears, repossessions, and restructures for the period ending March 2013 show that 12.3% of private residential mortgage accounts for principal dwellings were over 90 days in arrears, up from 11.9% in December 2012. Arrears on buy-to-let properties were even higher, at 19.7%. The combined outstanding balance of these mortgages in arrears is €26.7 billion. A revised code of conduct for mortgage arrears unveiled by the Central Bank of Ireland should make it easier for banks to repossess homes. Yet, since these changes are likely to incentivize banks to work through the mortgage resolution process more quickly, it could nonetheless hamper the nascent stabilization in house prices if banks put repossessed properties up for sale on a massive scale.

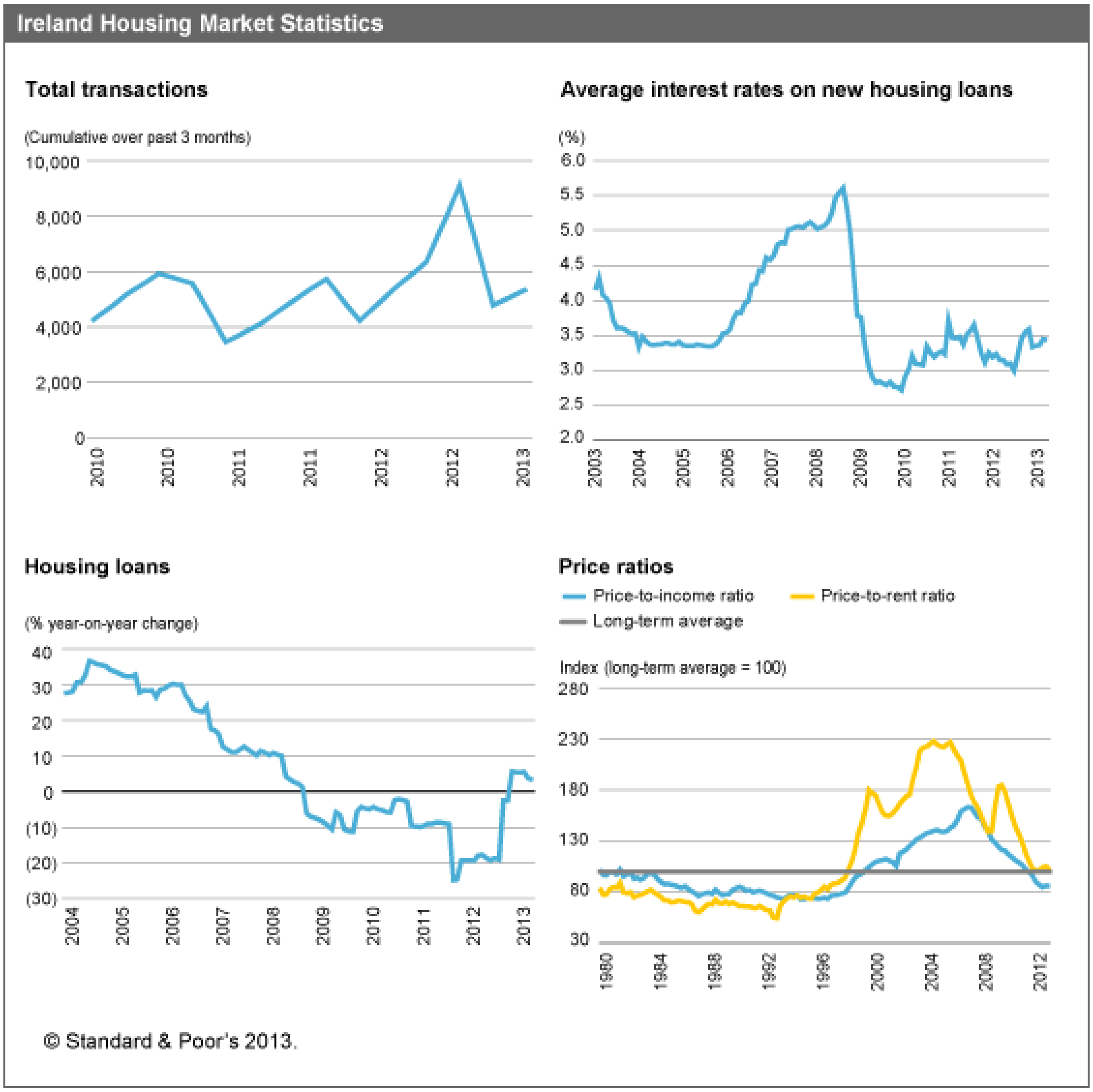
Table 5

Irish Housing Market Statistics

	2009	2010	2011	2012	2013f	2014f
Nominal house prices (% change year on year)	(19.1)	(11.0)	(15.8)	(6.1)	(0.9)	0.0
Real GDP, % change	(6.4)	(1.1)	2.2	0.2	0.9	1.9
CPI inflation (%)	(1.7)	(1.6)	1.1	2.0	1.2	1.8
Unemployment rate	12.0	13.9	14.7	14.7	14.5	14.0

f--Forecast. Sources: S&P, Eurostat, OECD, Central Statistics Office.

Chart 4



Sources: Property Services Regulatory Authority, ECB, OECD, Central Statistics Office Ireland.

In Italy, A Weak Economy Is Dragging Down Prices

Italy's residential real estate market continues to show signs of significant weakness, owing to the poor domestic economic environment. Our forecast for house prices nevertheless remains unchanged from our second-quarter housing outlook. We believe they will fall by 3% in 2013 and by 1% in 2014 (see table 6).

Recent trends

According to data from the observatory of the real estate market of the Italian Revenue Agency, house sales fell by about 26% in 2012, which is slightly above half the peak recorded in 2007. Meanwhile, nominal prices declined by 4.6% (and by 6.8% in real terms) in the 12 months to December 2012, according to Nomisma, an economic research

Institute. In our opinion, this market downturn reflects primarily the negative conditions in the domestic economy. The unemployment rate rose to 10.6% last year, from 8.4% in 2011, and has continued to climb in 2013 to 12.2% in May. Household real disposable incomes fell by 5.5% in the final quarter of 2012 on a year earlier, and the decline continued, although less rapidly (by 2.4%) in the first quarter of this year, according to ISTAT, the Italian statistical office.

Households somewhat offset this drag on their consumption by drawing on their savings in 2011 and 2012. However, the latest data suggest the savings ratio is now stabilizing. It was 9.5% in the first quarter of 2013. Tight credit conditions have added to real estate market woes. Home loans were down 0.8% year on year in May (see chart 5). That said, the real estate market itself does not show signs of a significant overvaluation. It is less leveraged than most other European markets, with outstanding mortgages equivalent to 23.4% of GDP at the end of 2012 versus 40.4% in the eurozone on average. The price-to-income ratio, which provides a good indicator of how affordable the market is, has come down markedly from its 2009 peak, and now stands close to its long-term average (see chart 5).

Future trends

The outlook for the real estate market remains heavily dependent on future trends in the Italian economy as a whole. We anticipate that the ongoing recession will extend to the beginning of next year, followed by a period of weak growth. Unemployment should continue to rise over the next two years, in our opinion. And even though the residential market does not appear particularly overvalued, we forecast that prices this year are likely to continue the slide they started in 2009 and, to a lesser degree, in 2014. We also see some further downside risks. In particular, a new phase of increased volatility on the sovereign debt markets, accompanied by a spike in sovereign bond yields, could potentially further destabilize the real estate market and precipitate steeper price declines.

Table 6

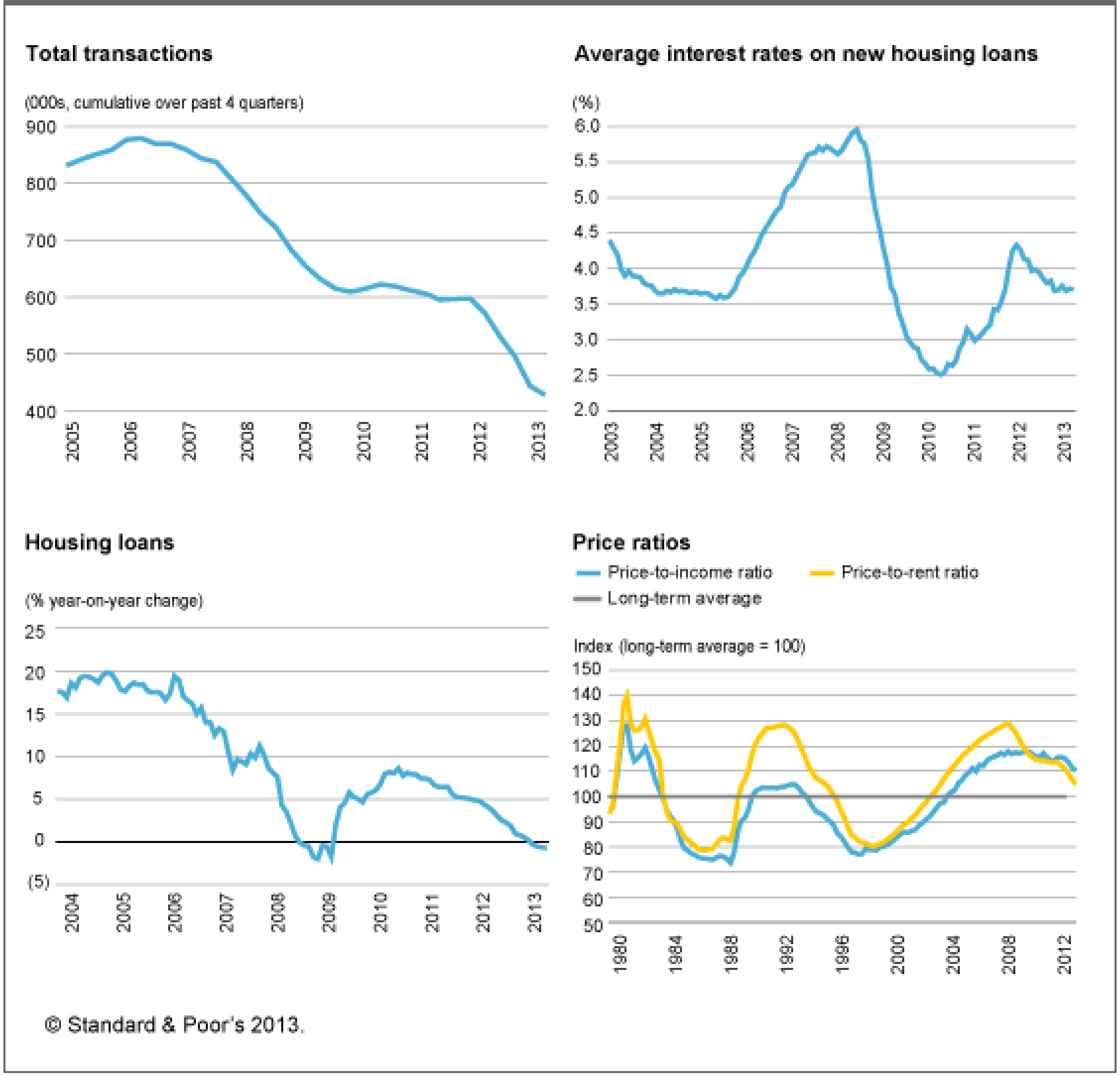
Italian Housing Market Statistics

	2009	2010	2011	2012	2013f	2014f
Nominal house prices (% change year on year)	(3.4)	(1.4)	(2.8)	(4.6)	(3.0)	(1.0)
Real GDP, % change	(5.5)	1.7	0.4	(2.4)	(1.9)	0.5
CPI inflation (%)	0.8	1.6	2.9	3.3	1.6	1.5
Unemployment rate	7.8	8.4	8.4	10.6	12.0	12.5

f--Forecast. Sources: S&P, Eurostat, OECD, Nomisma.

Chart 5

Italy Housing Market Statistics



Sources: Agenzia del Territorio, Nomisma, ECB, OECD.

The Netherlands' Housing Market Slump Continues

The decline in house prices is continuing apace in The Netherlands so far this year. In the first three months of 2013, prices were 8.3% down on a year earlier. They have tumbled more than 18% since their 2008 peak. We see few signs of improvement this year. Transactions are still very depressed as the deteriorating economic situation and uncertain employment prospects are damaging consumer confidence and purchasing intentions. While uncertainties about credit regulations, and in particular about tax deductibility of mortgage interest payments, have now largely been clarified, market participants are likely to be slow to adjust to the new regulations. We therefore don't expect prices to stabilize in the short term. That said, we believe the rate of home price declines will ease in 2013 to 5.5% before stabilizing to minus 1% in 2014 (see table 7).

Recent trends

Residential property prices fell faster by 2.5% in the first quarter of 2013, after a much slower decline of only 0.2% in fourth-quarter 2012. We believe this is because buyers rushed to take advantage of more generous fiscal treatment for home purchases before the year-end deadline. Similarly, transactions fell by 11.6% in the first five months of this year compared with the previous year to 37,977. The number of transactions is currently only half those seen between 2000 and 2006.

Latest Central Bank data indicate that lending for house purchases also weakened again in the first months of 2013. Housing loans granted by Dutch monetary financial institutions expanded by just 1.2% when adjusted for securitization. This is because of low demand as well as credit tightening. Households have remained cautious because their borrowing capacity is limited by deteriorating incomes on the back of increasing unemployment and continuing austerity measures. Interest rates on mortgages continue to be supportive, however, declining to about 3.8% on average in May (see chart 6).

Future trends

We expect prices to keep falling this year, but that the decline will decelerate next year. The adjustment to new credit regulations, decline in purchasing power, and rise in unemployment will keep households very cautious. Prospects for a near-term recovery in the Dutch economy are therefore limited, in our view. We expect real GDP will contract by 0.8% this year, while we forecast a modest recovery in 2014, with growth of 0.6%.

In 2015, however, we believe prices should bottom out if, as we expect, affordability improves and the economy turns more positive. The price-to-rent ratio was only 12% above its long-term average in March 2013, which is a return the levels of 1999 (see chart 6). The price-to-income ratio is still 28% above its long-term average, where it was in 2001. In the longer term, the fall in the supply of new homes, in addition to the steady increase in the number of households, should help to stabilize the market.

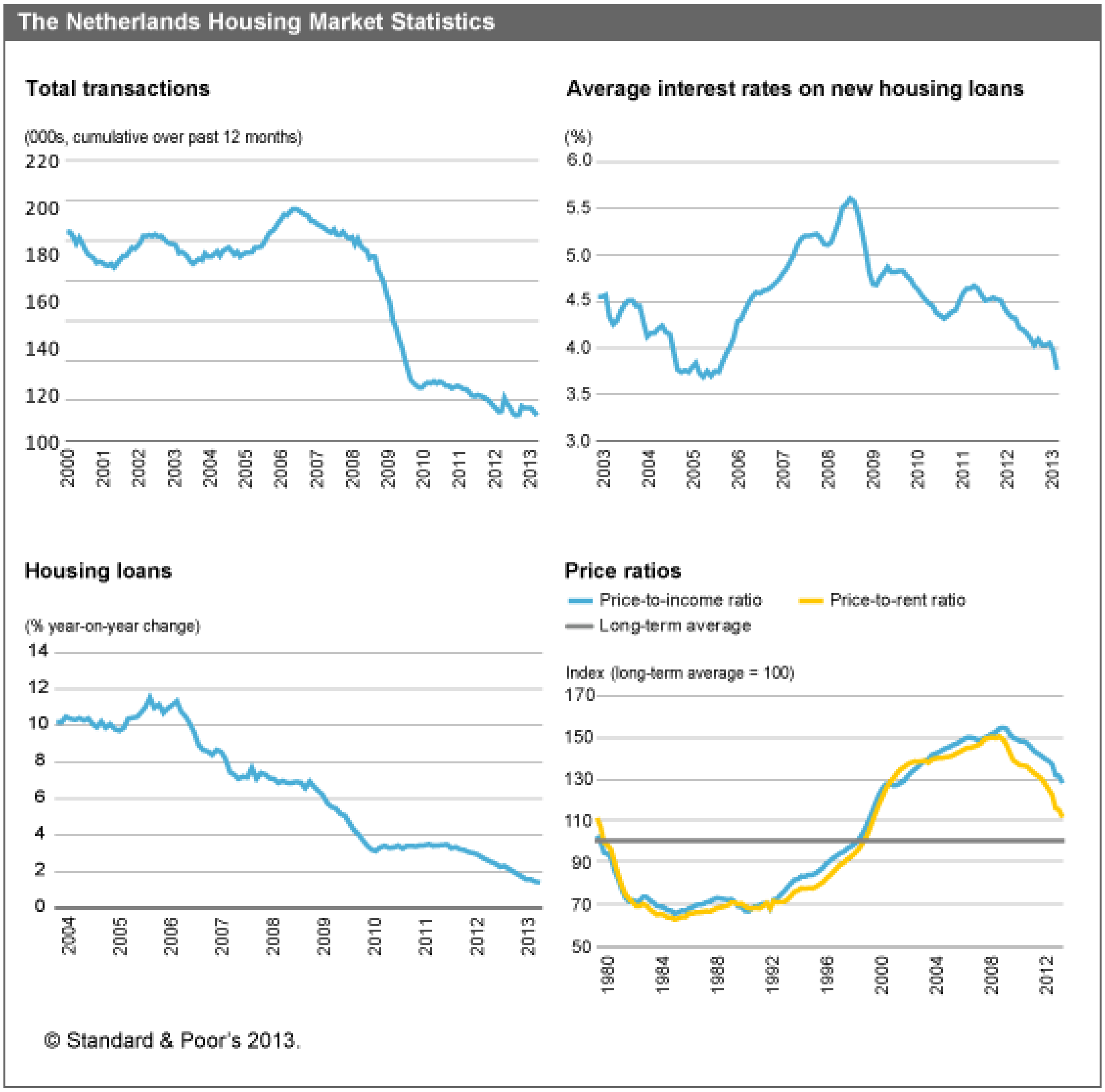
Table 7

The Netherlands Housing Market Statistics

	2009	2010	2011	2012	2013f	2014f
Nominal house price (% change year on year)	(5.0)	(1.0)	(3.4)	(7.3)	(5.5)	(1.0)
Real GDP, % change	(3.7)	1.6	1.0	(1.0)	(0.8)	0.6
CPI inflation (%)	1.0	0.9	2.5	2.8	2.8	1.4
Unemployment rate	3.7	4.5	4.4	5.3	6.9	7.2

f--Forecast. Sources: S&P, Eurostat, Kadaster, OECD, CBS Statistics Netherlands.

Chart 6



Sources: Central Bureau of Statistics Netherlands (CBS), ECB, OECD, Kadaster, De Nederlandsche BANK 8dnb9.

Portugal's Recession Drags Down Home Prices

Portugal's real estate market is still sliding amid weak economic conditions. Yet, Portugal is escaping a more significant slump because house prices hardly increased in real terms between 1990 and the beginning of the global financial crisis in 2007. We forecast that house prices will contract by 3.5% this year, which is a heavier fall than in the past four years, not least because of a high number of repossessions on the market. However, we forecast that declines will slow to 0.5% in 2014 (see table 8) as Portugal's economic conditions improve somewhat.

Recent trends

The Portuguese economy remains in a severe recession. Private consumption contracted by 5.6% in real terms last year. Real disposable incomes have declined strongly, due in part to substantial increases in direct taxation.

Meanwhile, unemployment is likely to continue to rise from 16% in 2012 to 18% this year. Furthermore, as uncertainties remain over the duration of fiscal austerity measures, households have a strong incentive to keep saving as a precaution. Added to this, total household debt in Portugal is high by European standards, at 93% of GDP at the end of last year. We therefore expect consumption to contract again this year by about 2%. The Central Bank of Portugal predicts in its Spring 2013 Economic Bulletin a slightly heavier decline in consumption than we do for 2013 of 3.8%. It notes that its projection implies that total private consumption in 2014 would be close to that of the year 2000.

Yet, in spite of such weak conditions, home prices haven't fallen considerably over the past few years--they have decreased by 5.3% since the peak of March 2011. This is because there was no major surge in transactions and prices in the years preceding 2007. Although nominal prices fell by 3.8% year on year in the first quarter of this year, they've dropped by only 5.6% from their September 2010 historical peak. Home loans have declined steadily since the end of 2011, while the proportion of nonperforming loans as a percentage of total loans had risen steadily to 2.1% as of May 2013, according to Portugal's central bank.

Future trends

We forecast that Portugal's real GDP will contract 2.1% in 2013 before experiencing a very mild recovery of 0.6% growth in 2014 (see table 8). Against this backdrop, we expect the real estate market to remain weak. Tight lending by financial institutions, and continued declines in disposable incomes, will offer few incentives for house purchases. Meanwhile, banks are increasing the number of repossessed houses they put on sale at discounted prices in 2013. Real estate agencies estimate as many as 10,000 repossessed homes will be offered this year, after 6,000 in 2012--equivalent to 22% of total sales. This surge in supply is likely to depress prices in the short term.

Nevertheless, the market may benefit over the longer term from more positive structural factors. We note in particular that the affordability index (price to income) reached an all-time low in the first quarter of this year, and that it is comfortably below its long-term average (see chart 7).

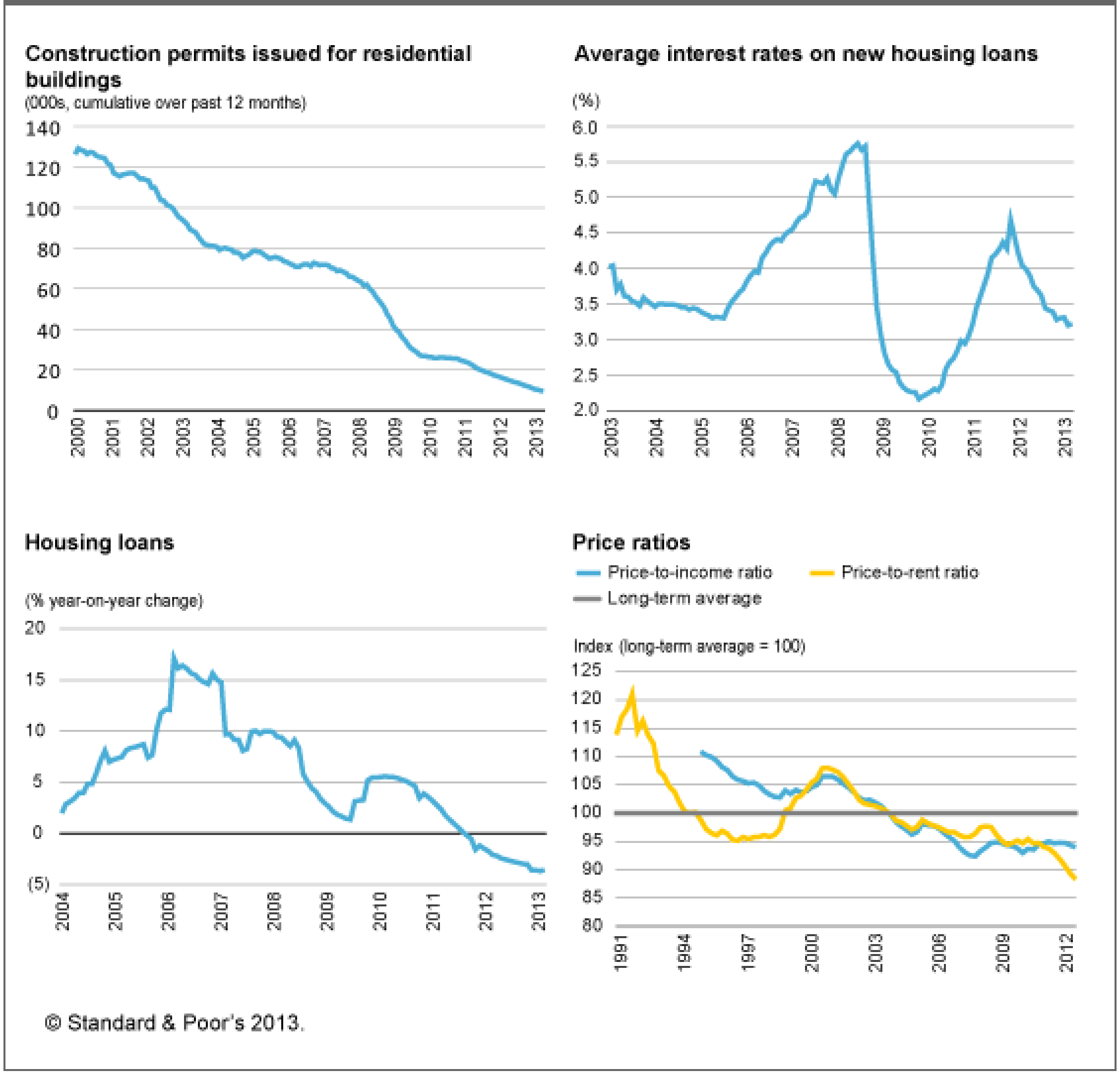
Table 8

Portuguese Housing Market Statistics						
	2009	**2010**	**2011**	**2012**	**2013f**	**2014f**
Nominal house prices (% change year on year)	(0.6)	1.6	(0.9)	(2.7)	(3.5)	(0.5)
Real GDP (% change)	(2.9)	1.4	(1.6)	(3.2)	(2.1)	0.6
CPI inflation (%)	(0.9)	1.4	3.6	2.8	0.8	1.0
Unemployment rate	10.6	12.0	12.9	15.6	18.0	18.5

f--Forecast. Source: S&P, Eurostat, BIS/private sector.

Chart 7

Portugal Housing Market Statistics



Source: OECD, ECB.

In Spain, An Excess Of Unsold Homes Will Keep The Market Depressed

The slump in house prices in Spain looks set to continue as the economy remains in the grip of a severe recession, despite some signs of stabilization at very low levels in the second half of this year. Supply continues to significantly exceed demand, as SAREB, Spain's "bad bank" has started to sell some of the repossessed properties that were transferred to it. The speed at which SAREB releases this stock of properties for sale will likely influence the real estate price outlook over the coming years. Nevertheless, our house price projections assume that a lack of solvent demand will significantly constrain SAREB's room for maneuver in releasing properties onto the market. We expect real estate prices to decline by 8% this year and by 5% next year (see table 9).

Recent trends

Spain's economy remained in recession in the first half of this year. Recent consumer confidence, retail sales, and purchasing managers' indices point to a slight improvement in the second quarter, supporting our economic forecast of a gradual stabilization over the coming 12 months. Nevertheless, fundamentals driving the residential real estate market remain unfavorable. The unemployment rate reached an all-time high of 27.1% in the first quarter. Household debt is only slowly declining, to 80.5% of GDP in the final quarter of last year from a peak of 87.3% in third-quarter 2009. The stock of unsold home remains very high, at about 635,000 at the end of 2012. The banks and SAREB have become the prime owners of those unsold homes, with about 30% of the total.

Prices were down by 8.2% year on year in the first quarter. They have declined by 28.4% since the peak in March 2008. Yet, the affordability index, measured by price to income, has hardly improved, owing to fast-rising unemployment and low wage settlements that are weighing on disposable income growth (see chart 8). Meanwhile, housing loans have declined continuously since the beginning of 2011.

Future trends

The pace at which SAREB can sell off repossessed homes will be a key influence on home price movements over the next few years. SAREB has a total stock of 55,700 dwellings, and an additional 30,000 units of usable space, such as parking and storage spaces. It was granted 15 years to dispose of its property stock. SAREB's preliminary announcements suggest it aims to put up for sale about 45,000 units over the next five years. Yet, the limited number of transactions completed since the beginning of the year suggests that it will be difficult to reach this target. There is still a lack of solvent demand to absorb the excess supply. We expect that SAREB and the other banks with significant housing portfolios on their balance sheets will disinvest very gradually over the next two to three years so as not to precipitate a market collapse. However, it will not be easy to manage this process. Considering that many of the homes on SAREB's and other financial institutions' balance sheets have already depreciated in value, if they were to accelerate the disinvestment process, we believe price declines in 2013-2014 could easily reach into double digits.

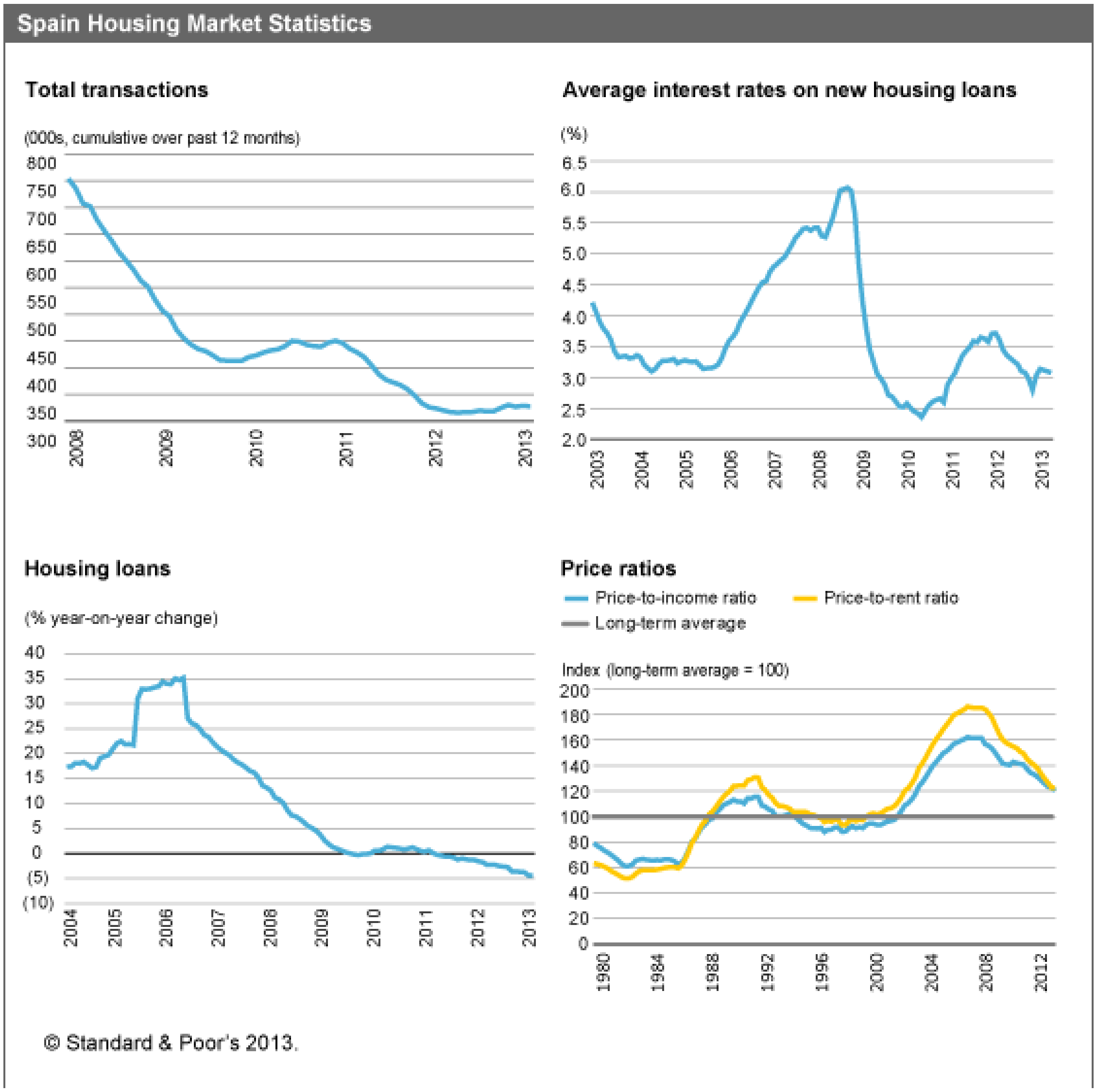
Table 9

Spanish Housing Market Statistics

	2009	2010	2011	2012	2013f	2014f
Nominal house prices (% change year on year)	(6.6)	(3.3)	(7.1)	(10.5)	(8.0)	(5.0)
Real GDP, % change	(3.7)	(0.3)	0.4	(1.4)	(1.5)	0.6
CPI inflation (%)	(0.2)	2.1	3.1	2.4	1.6	1.4
Unemployment rate	18.0	20.1	21.7	25.1	27.2	27.0

f--Forecast. Sources: S&P, Eurostat, Banco de Espana, OECD.

Chart 8



Sources: Instituto Nacional de Estadistica (INE), ECB, OECD, Banco de Espana.

The U.K. Housing Market Stages A Recovery

Declining mortgage interest rates and improved confidence in the economy appear to be driving up prices for U.K. homes. Although affordability ratios suggest homes are still overvalued, a shortage of supply of new homes is keeping prices high. We have therefore lifted our forecasts for house prices, and now expect that they will rise by 2.5% this year and by 2.0% in 2014 (see table 10), from 1.5% and 1.0%, respectively, in our second-quarter forecast.

Recent trends

In March 2013, prices rose by 2.2% year on year cross the U.K., according to OECD estimates. This nevertheless represented a 0.5% decline, when adjusted for inflation. The overall market seems to have been boosted by both the Bank of England's Funding for Lending Scheme and the government's Help to Buy scheme, which have helped lower

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the cost and improve the availability of mortgage credit. The average interest rates for new lending declined to 2.90% in May, from 3.25% in October 2012 (see chart 9). As a result, mortgage lending is rising quickly. Mortgage lending approvals jumped in May by 19.7% on the previous year to 58,242. This is nevertheless still barely one-half of the numbers seen in 2006-2007. Transactions also rose in May this year, up 9.0% on a year earlier. Consumer confidence in the U.K. rose in June. Britons are less pessimistic about the economy and their ability to make major purchases. The monthly survey by Gfk, a market research company, of consumer confidence rose to minus 21 in June, its highest since October 2010. Yet, although house sales are trending upward, they are still 45% below 2007.

Future trends

We believe the U.K. housing market is staging a recovery, although activity is still low by historical standards. Strong demand for housing, boosted by improved mortgage availability, is likely to continue to push prices higher.

On the supply side, the low number of new homes being built in the U.K. will also support prices. In the three months from February to April 2013, construction output decreased by 4.7% on the same period of last year. Plans for housing associations to increase their programs are constrained by fiscal austerity in the public sector. This suggests that the gap between demand and supply will continue to widen. The house price-to-income (affordability) ratio suggests that prices are still 25% above their long-term average. But the lack of supply is preventing this adjustment from taking place.

Table 10

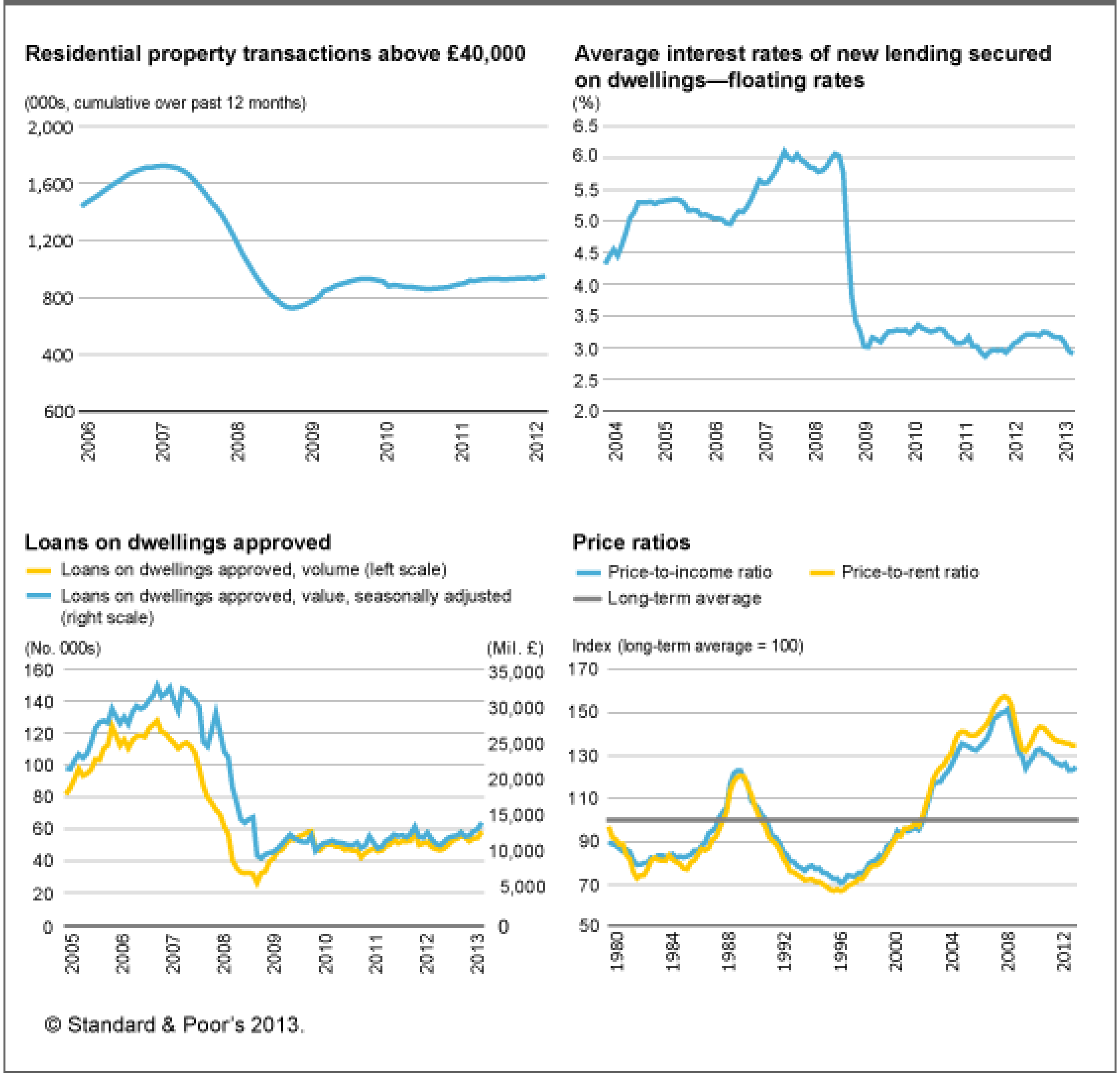
U.K. Housing Market Statistics

	2009	2010	2011	2012	2013f	2014f
Nominal house prices (% change year on year)	0.3	3.8	(0.5)	2.3	2.5	2.0
Real GDP, % change	(4.0)	1.8	1.0	0.3	0.8	1.2
CPI inflation (%)	2.2	3.3	4.5	2.8	2.7	2.3
Unemployment rate	7.5	7.9	8.0	8.0	8.1	8.0

f--Forecast. Sources: S&P, Eurostat, OECD, Department for Communities and Local Government.

Chart 9

U.K. Housing Market Statistics



Sources: HM Revenue & Customs, Bank of England, OECD, Department for Communities and Local Government.

Related Criteria And Research

- Recession Keeps House Prices In The Dumps In Most European Markets, May 7, 2013
- The Eurozone Economy Shows Signs Of Stabilization, But Recovery Is Still Some Way Off, June 26, 2013