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PRESS RELEASE

End of the crisis in the housing markets?

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The events of recent years have clearly demonstrated the importance of housing market developments for economic activity and financial stability.

From the mid-1990s, dynamic housing markets made a leading contribution to maintaining strong economic growth in most of the advanced economies. Low interest rates, financial innovations, flexible credit conditions and demographic factors fuelled demand for housing and led to substantial increases in house prices and residential investment. The house price boom was strongest in the United Kingdom, Spain, Ireland and France. Wealth effects – plus, in some countries, mechanisms such as equity withdrawal - then stimulated private consumption expenditure. Generally speaking, in comparison with previous upward phases, the latest cycle was notable for its exceptional duration, scale and geographical distribution.

In the middle of the last decade, housing markets became increasingly overheated, and ultimately, problems in the subprime segment of the American housing market from 2006 onwards led to a downward correction in that market and triggered the financial and economic crisis that plunged the global economy into the deepest recession since the end of World War II. The housing market bubbles also burst elsewhere. In contrast to what happened in the upward phase of the cycle, there was noticeably less synchronisation in the price movements. In a number of countries (Belgium, Finland and France) the market now seems to have bottomed out. Conversely, in other countries (Ireland, Spain, the Netherlands, the United States and the United Kingdom), prices are still falling.

This article uses a number of simple indicators to examine the degree to which house prices are under- or overvalued. Taking account of the current extremely low level of interest rates (interest-adjusted-affordability), the present level of house prices in most countries seems fairly close to the equilibrium level. However, these simple methods have their limitations, and the results must therefore be interpreted with due caution. There are also a number of global factors (normalisation of the interest rate level, possibly sustained negative impact of the crisis on potential growth, consolidation of public finances) and country-specific risk factors which could impede a future housing market recovery.

The crisis has undeniably highlighted a need for better supervision and stricter regulation of the financial sector. At international level, a number of initiatives have already been taken and several international institutions have recently made recommendations for the reform of housing policy and the operation of the housing and mortgage markets. The sovereign debt crisis that hit the euro area in 2010 also led to stronger economic governance in the European Union. In the preventive phase of this mechanism, the risks are to be assessed annually on the basis of a warning signal that operates via a scoreboard with a small number of indicators, including one relating to the housing sector.

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