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Economic Research:

Europe's Housing Market Will Chill In 2021 As Pent-Up Pandemic Demand Eases

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SENIOR ECONOMIST

Marion Amiot

London

+ 44(0)2071760128

marion.amiot@spglobal.com

Boris S Glass

London

+ 44 20 7176 8420

boris.glass@spglobal.com

EMEA CHIEF ECONOMIST

Sylvain Broyer

Frankfurt

+ 0049 69 33 999 1

sylvain.broyer@spglobal.com

ECONOMIST

Sarah Limbach

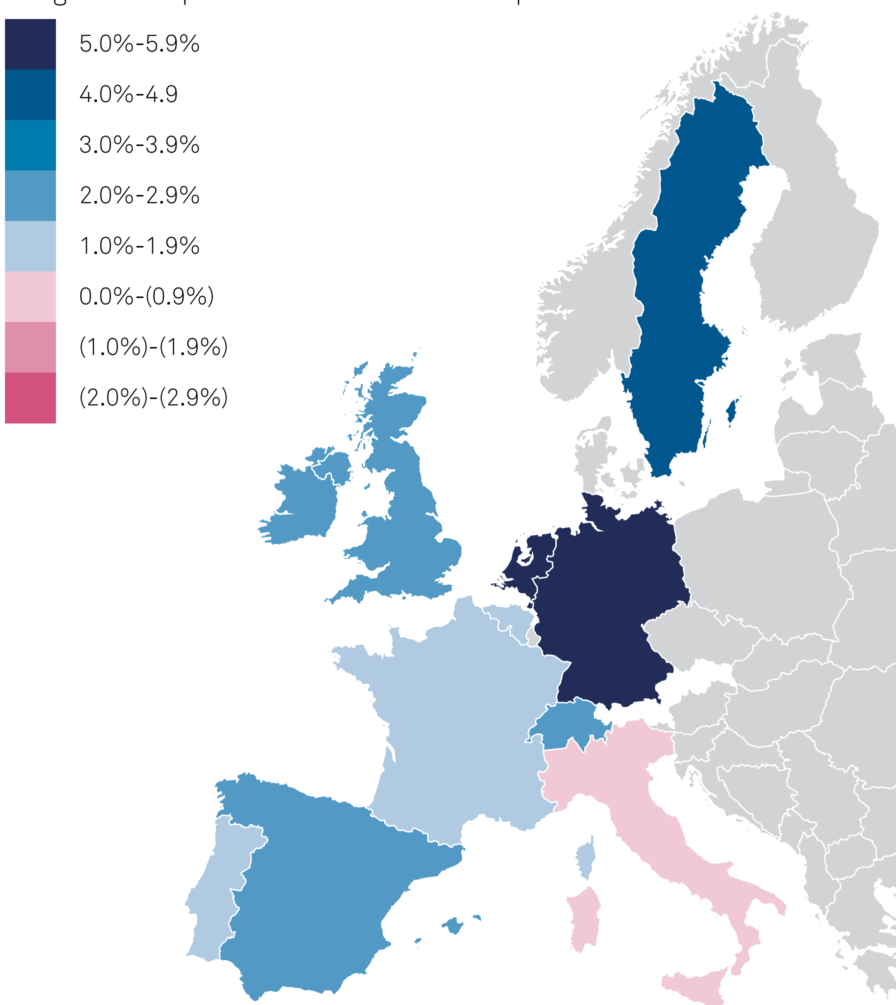
Paris

+ 33 14 420 6708

Sarah.Limbach@spglobal.com

S&P Global Ratings' Forecast For European Housing Price Growth For 2021

% change fourth-quarter 2021 versus fourth-quarter 2020



Source: S&P Global Ratings.

Key Takeaways

- Europe's housing prices should grow more slowly in 2021 after a strong 2020, as pent-up demand from lockdowns last year is absorbed, affordability worsens, and economic activity remains subdued.
- Prices in 2020 were more dynamic than in 2019 because of strong demand and worsening constraints on supply--despite the biggest economic contraction in decades.
- We see reinvigorated demand for housing and housing price growth beyond 2021 after a likely easing of pandemic-related restrictions toward end-2021. This should pave the way for a sustained recovery in the economy and employment.

Table 1

S&P Global Ratings' European Housing Market Forecasts

	2019	2020e	2021f	2022f	2023f
Belgium	4.8	2.5	1.8	2.4	2.2
France	3.9	4.0	1.5	2.0	2.0
Germany	6.4	6.9	5.3	4.9	4.5
Ireland	0.8	1.0	2.7	4.5	4.0
Italy	0.2	0.5	-0.5	0.5	1.0
Netherlands	6.5	8.0	5.2	4.3	3.4
Portugal	8.9	6.1	2.6	4.7	4.2
U.K.	0.6	6.7	-2.3	0.5	3.3
Spain	3.7	1.6	1.4	4.3	3.6
Sweden	3.9	10.1	4.5	2.7	3.5
Switzerland	2.4	3.5	2.0	2.0	2.0

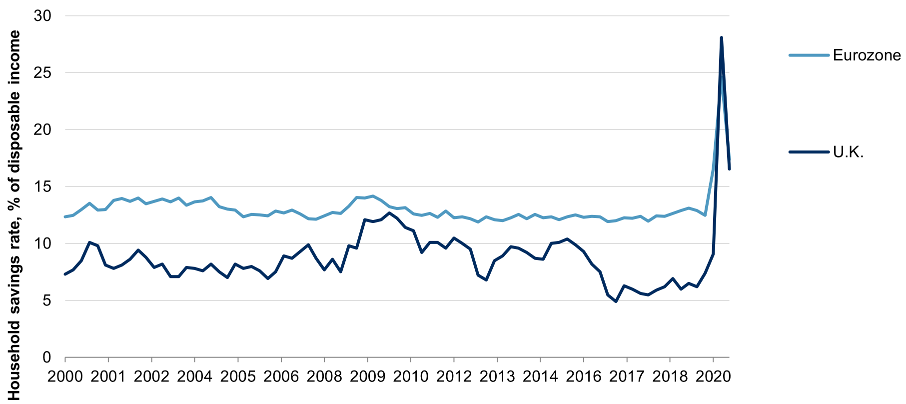
Note: Year-on-year annual growth in the fourth quarter. e--Estimate. f--Forecast. Sources: OECD, S&P Global Ratings.

Pandemic policy measures in Europe were likely the most effective in keeping demand afloat in the housing market. For that reason, housing prices grew forcefully in 2020. And that, S&P Global Ratings believes, also explains why they should recede in 2021.

By protecting workers' jobs and income, short-time work and furlough schemes removed most of the uncertainty and income losses associated with an economic downturn, which usually reduce demand for housing. As a result, savings climbed to unprecedented levels last year, and this was mostly for forced rather than precautionary reasons because shops and leisure activities were closed (see chart 1). In addition, savings rose the most for higher earners, that is, those more likely to be or step on the property ladder, fueling demand for housing (see chart 2). In addition, some countries deployed measures targeting the housing market. For example, the U.K temporarily but significantly raised the threshold above which buyers have to pay stamp duty to £500,000 from £125,000. And in Sweden, the amortization requirement for mortgages was suspended for most buyers. Both measures boosted house price growth in the second half of 2020 but will also lead to a correction when they are removed this year (in April and September, respectively).

Chart 1

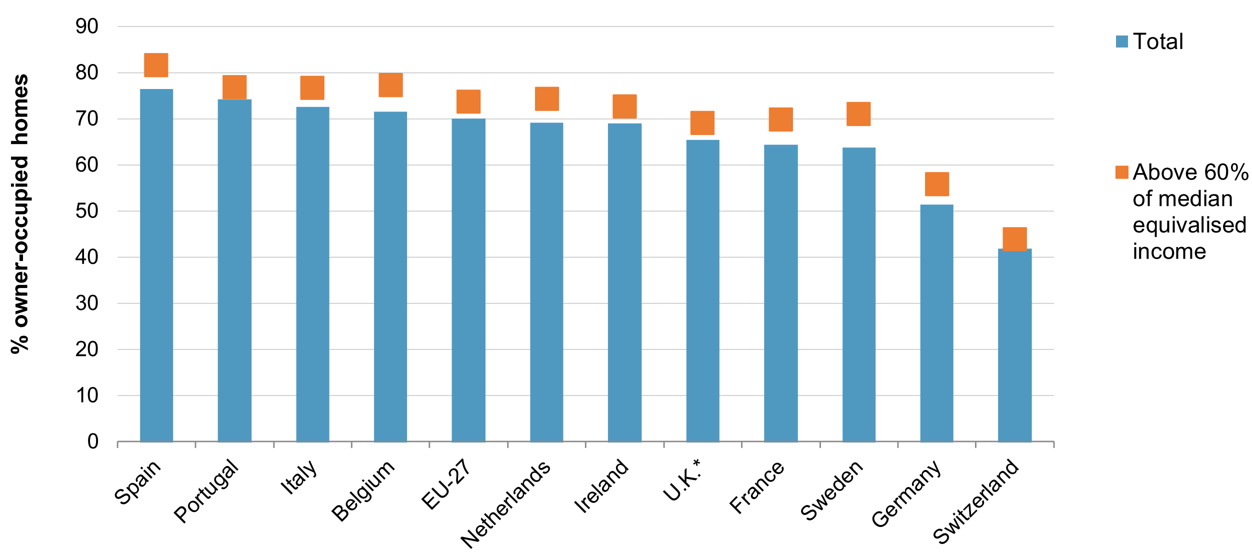
European Households Have Never Saved So Much As In 2020



Sources: ONS, Eurostat, S&P Global Ratings.

Chart 2

More Affluent Households In Europe Are More Likely To Own Their Home



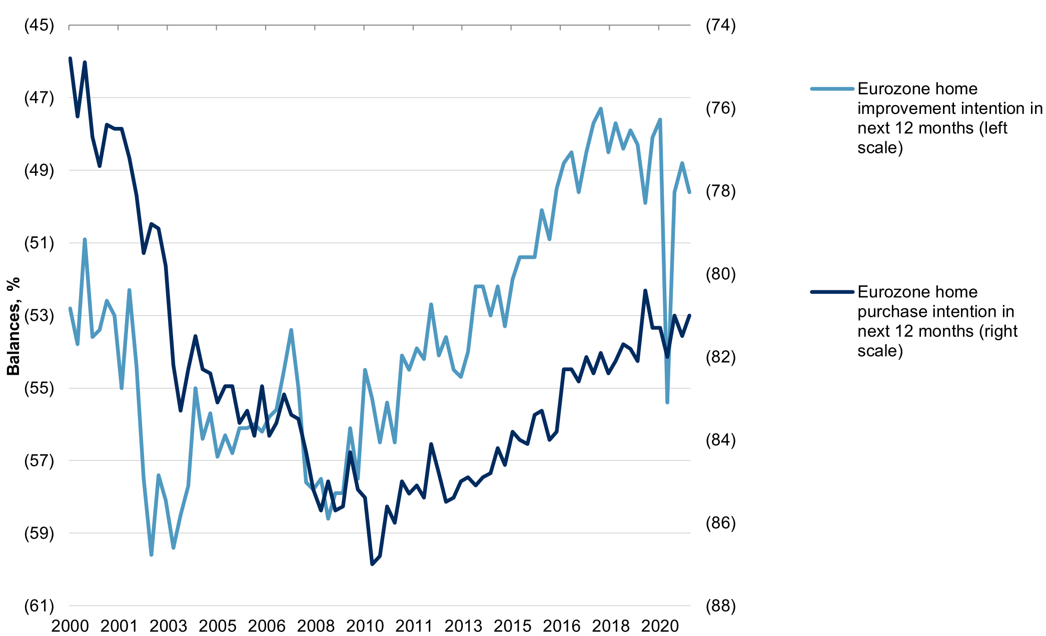
*Latest available U.K. data is for 2018. Sources: Eurostat, S&P Global Ratings.

A looser monetary policy also helped. The European Central Bank and the Bank of England reduced financing costs at the onset of the crisis, making housing investment more affordable and sustainable for homeowners. While interest rates for new loans have not decreased by much from pre-crisis levels, they did for outstanding loans. This suggests many households chose to refinance. Therefore, they improved their ability to repay their debt, reducing the probability of forced selling that would dampen prices. For investors, lower sovereign yields--partly linked to large central bank asset purchases--sent them on the hunt for higher returns in residential property markets, boosting housing demand in investor-based markets like Switzerland and Germany (see chart 2).

Spending most of their time at home, people apparently placed more value in owning a home. Price-to-rent and price-to-income ratios rose further in 2020 and are close to their all-time highs in most European markets (except Germany, Italy, and Spain). Survey data also suggests that home purchase intentions are at their highest since 2003 in the eurozone--and even at a record high in France. Consumers' intentions to improve their homes has also barely decreased from 2019 highs (see chart 3).

Chart 3

Home Purchase Intentions In Europe Are At Their Highest Since 2003



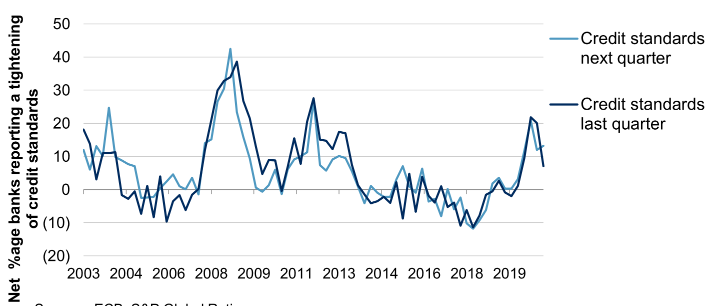
Sources: European Commission, S&P Global Ratings.

Meanwhile, the 2020 lockdowns exacerbated supply constraints in most countries, adding another source of upward pressure on prices. In most places, construction activity was initially put on hold as one of the measures to reduce COVID-19 transmission. As a result, eurozone construction activity fell an annual 30% in April 2020 and has yet to recover fully. Because new housing could not meet growing needs, the gap helped sustain relatively high price rises--particularly in larger European cities and countries like Germany, Sweden, and the Netherlands.

That said, as the impact of the pandemic on European economies starts to diminish, some of the housing market's unusual supports of 2020 are likely to fade. Therefore, we believe housing market prices will grow slower in 2021. To start with, the market is likely to absorb a large part of the pent-up demand for housing generated by the early 2020 lockdowns. Second, affordability will become more of a concern for homebuyers. That's because economies will unlikely reach pre-COVID-19 levels until mid-2022, which won't lead to a full recovery in employment before 2023. Household income will therefore rise slowly (see "The Eurozone Can Still Rebound In 2021 After Lighter LockdownsDec. 2, 2020). Adding to that, price-to-income and price-to-rent ratios already point to overvaluation in most markets, and banks have started tightening standards to contain credit risk (see charts 4 and 5). Financing costs are also unlikely to decrease much further, as central bank rates are already close to or just below 0%. Finally, markets where holiday flats are an important driver of residential property--such as Spain and Portugal--are likely to see weaker demand in 2021 because of still limited international travel.

Chart 4

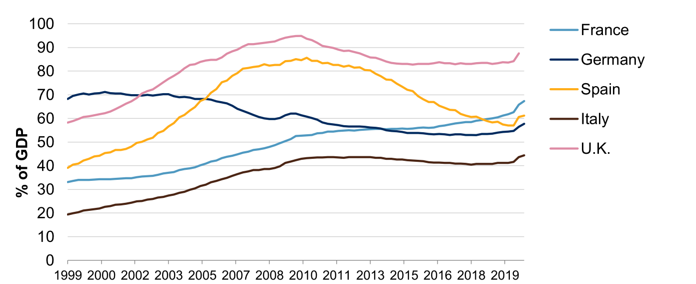
European Banks Are Tightening Credit Standards To Limit Credit Risk



Sources: ECB, S&P Global Ratings.

Chart 5

European Household Debt Increased A Bit As Economic Activity Slowed



Note: The rise in debt to GDP is mostly linked to a drop in economic activity rather than a sharp rise in indebtedne

Sources: Eurostat,ONS, S&P Global Ratings.

Looking out further into 2022 and 2023, when we expect that most countries will increasingly relax social-distancing restrictions, European housing markets are likely to regain some strength. Labor markets will heal as the economy recovers, supporting household income and job prospects. Meanwhile, the return of tourism should also lift prices in countries dependent on the sector. With central banks unlikely to tighten their monetary policy in the next three years, the search for yield will continue to generate investor demand in large cities and investor-based markets, especially in Germany where housing prices are still catching up with the rest of Europe. Finally, structural changes in a post-pandemic housing world are possible, but in terms of regional trends, we still expect cities to remain attractive to homeowners. Even if working from home is more widespread, large cities are still the center of economic activity, with better job prospects and infrastructure--especially for health and leisure--all important determinants of housing demand.

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

This report does not constitute a rating action.