



## ECONOMIC RESEARCH DEPARTMENT

### Spain: the housing market picks up slightly

- The housing market has begun to recover since early 2014. Apparently it will continue to benefit from a buoyant environment in the months ahead.
- Job growth has fuelled an increase in the number of potential home buyers, and households will continue to benefit from advantageous financing conditions.
- House price increases should remain limited however. High household debt, taxation and less favourable demographics should prevent an overly strong rebound in prices.

The Spanish economy was hard hit by the bursting of the housing market bubble. Real house prices plunged 38% between 2007 and 2013, and residential investment declined by more than 50% between year-end 2006 and spring 2014. Today, as the Spanish economy recovers, the housing market is picking up as well. Residential property prices rose 2% in the year to Q3 2015<sup>1</sup> (see chart 1). It looks like house prices will continue to trend upwards in the quarters ahead, lifted by this buoyant environment. The ongoing economic recovery and job growth should boost the number of potential home buyers. Households will also continue to benefit from advantageous financing conditions. Yet persistently high household debt and the decline in the Spanish population should nonetheless place a damper on the upturn in house prices.

#### Growth rebounds

Spain should benefit from growth of nearly 2.6% this year (after +3.2% in 2015), despite the slowdowns reported by some of its Asian and South American trading partners. Indeed, the country has several strengths. Companies will continue to benefit from years of efforts to boost competitiveness and the strong resilience of eurozone demand, notably in France and Germany, its main trading partners (accounting for 15.4% and 10.8% of merchandise exports, respectively, in 2015). Improved corporate profitability, advantageous financing conditions and the need to renew capital stock are also factors that should support investment. With nearly 550,000 job creations in 2015, employment is also expected to continue rising in this environment (see chart 2).

<sup>1</sup> Nominal housing prices rose 3.6% in 2015 (after +0.3% in 2014).

#### ■ Slight rebound in the housing market

House price index (1997=100)

— Nominal index; — Real index

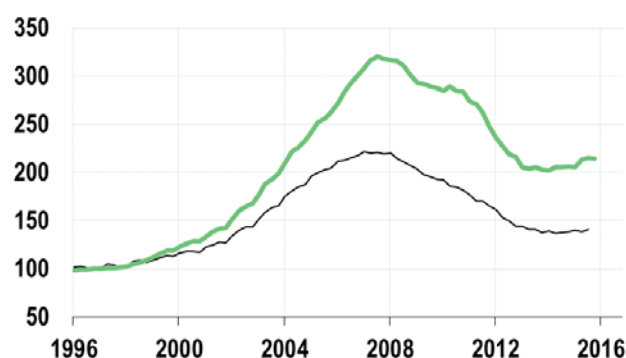


Chart 1 Sources: BIS, Bank of Spain

#### ■ Job creations, at last!

— GDP (EUR bn); — Employment (millions) (RHS)

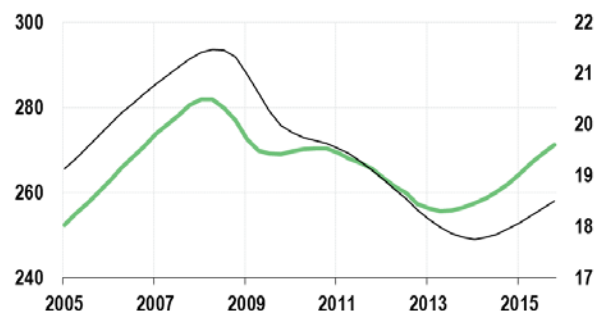


Chart 2 Source: INE

#### Upturn in house purchasing power

By increasing the number of potential house buyers, job creations are an important factor. The increase in house purchasing power is also a key factor.



The increase in gross disposable income (+2.6% y/y in Q3 2015<sup>2</sup>) combined with the decline in consumer prices (-0.7% expected in 2016 according to our estimates, after -0.6% in 2015), will lead to a new increase in household purchasing power this year.

Purchasing power will also get a boost from the past decline in house prices. House prices have declined much more sharply than gross disposable income in recent years, reducing the effort households need to make to become homeowners. This can be seen in one of the Bank of Spain's indicators: the ratio between the average price of a 93.75m<sup>2</sup> non-subsidised residency and median gross household income. According to this indicator, only 6.3 years of revenues were needed to acquire a home in Q3 2015 compared to 9 years before the housing market bubble burst in Q3 2007<sup>3</sup> (see chart 3).

The past decline in house prices coupled with mixed financial market performances and low yields on deposits are also likely to favour real-estate investments. This decline bolstered the return on real-estate assets as measured by the rent/price ratio. At 4.6% in Q3 2015, it is approaching the long-term average of 4.9% (see chart 4). Households have regained confidence thanks to the decline in the unemployment rate and will be more likely to take risks and purchase real-estate assets. Households have already been taking advantage of the decline in mortgage lending rates since year-end 2014 (2.43% for new loans in January, down from 3.32% in January 2014) and from the decline in real interest rates since early 2015. They should continue to benefit from the advantageous financing conditions created by the European Central Bank's very accommodating monetary policy.

All these factors should support a rebound in residential loans, which continued to decline in January (-4.2% year-on-year), and an upturn in house prices. According to the ECB's Bank Lending Survey, the proportion of banks reporting an increase in home loan demand increased again in Q4 2015.

### Downward pricing pressures

Nonetheless, the increase in house prices should be limited. The Spanish economy still shows the scars of the bursting of the previous housing market bubble<sup>4</sup>. The volume and ratio of doubtful household loans are still high, even though they have been declining since Q2 2014. The doubtful loan ratio was 5.9% in Q3 2015 (vs. 7.1% in Q1 2014) and 5.1% for residential loans (vs. 6.3% in Q1 2014). This should encourage banks to remain cautious.

The persistently high level of household debt, nearly 75% of which are mortgage loans, continues to place a damper on the market's rebound, and to curb any sharp increases in house prices. Household debt has been reduced by nearly 20% since year-end 2008, but the ratio with gross disposable income was still near 108% in Q3 2015, nearly 10 points higher than the eurozone average (see chart 5).

<sup>2</sup> Four-quarter moving average

<sup>3</sup> The long-term average house price to household revenue ratio is 5.4.

<sup>4</sup> Real house prices doubled between 1997 and 2007.

### ■ Past price declines have positive impact

— Ratio of average house prices to median gross household income; — Long-term average

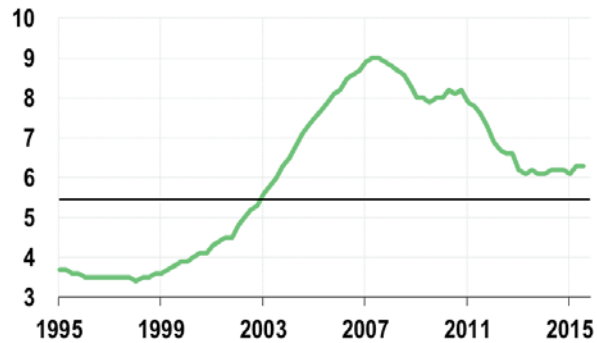


Chart 3 Source: Bank of Spain

### ■ Higher returns on real-estate investments

— Gross rental return; — Yield on 1 and 2-year time deposits by households; --- 10-year government bond yield; --- Return on IBEX 35 index (RHS)

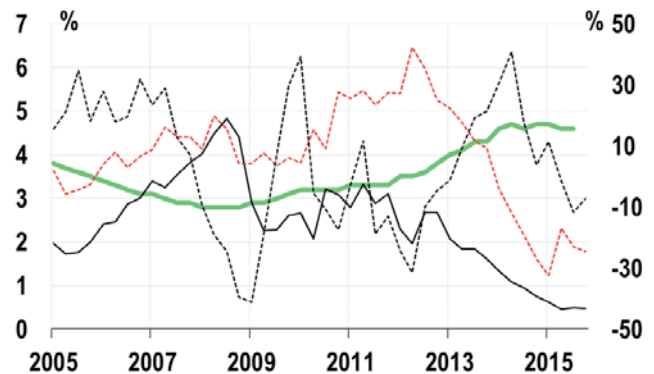


Chart 4 Source: Bank of Spain

Since 1 January 2013, households are no longer able to deduct interest payments on mortgage loans from their revenues, and taxation is less advantageous than before the crisis. Spain hopes these measures will help contain any surges in house prices. Introduced to encourage first-time home ownership<sup>5</sup>, the deduction of mortgage interest payments ended up sustaining the previous upward cycle in the 2000s. A study by the Complutense University of Madrid suggests that house prices would have been between 27% and 36% lower at year-end 2007 if the deduction of interest payments had been eliminated in 2000<sup>6</sup>.

### Demographic decline crimps housing demand

Spain has long had a birth rate below the population replacement rate of 2.1 children (1.27 children per woman of

<sup>5</sup> Spain has one of the highest home ownership rates in the European Union (78.8% in 2014 vs. 52.5% in Germany according to Eurostat).

<sup>6</sup> "Tax incentives and the housing bubble: the Spanish case", by Jorge Meliveo, June 2014, Universidad Complutense de Madrid



childbearing age in 2013 according to Eurostat). Its population increased rapidly in the 2000s mainly due to the arrival of new migrants. Net immigration contributed to 90% of the 15.7% increase in the total population between 2000 and 2011 (i.e. more than 4 million individuals). It also fuelled demand for housing. The situation changed dramatically with the collapse in economic activity as of 2008 (-9.3% between Q2 2008 and Q2 2013), especially in the construction sector (down nearly 50% between Q2 2008 and 2014), which has a high number of immigrant workers. The total number of jobseekers increased by more than 4.5 million between Q2 2007 and Q1 2013. More than a quarter of the total active population - and nearly 40% of the active non-resident population - were unemployed in Q1 2013. The downturn in the job market was accompanied by a sharp decrease in the active population (-592,000 since Q3 2012). Some workers became discouraged and withdrew from the job market. Demographics were also hard hit. Spanish residents and especially non-residents preferred to leave Spain. According to Eurostat, Spain reported a net outflow of emigrants of nearly 102,000 in 2014, after 251,531 in 2013, which reduced its population by 395,000 since 2012 (see chart 6).

Although this movement has lost momentum, it is highly unlikely to be reversed in the short term, despite the rebound in growth. According to our estimates, GDP is unlikely to return to pre-crisis levels before year-end 2017. Unemployment is currently at 4.78 million in Q4 2015 (20.9% of the active population), and despite an expected decline, it is bound to remain high over the long term.

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### Households still have heavy debt loads

Households debt ratio (% gross disposable income)  
— Spain; — Germany; - - - France ; - - - Eurozone

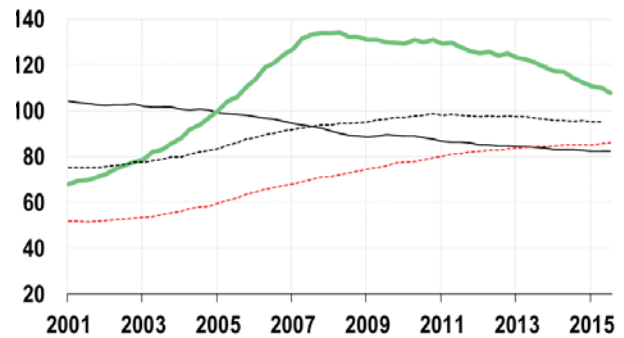


Chart 5 Source: Bank of France

### Contracting population

Thousands  
— Net immigration; — Natural change in population; — Total population (RHS)

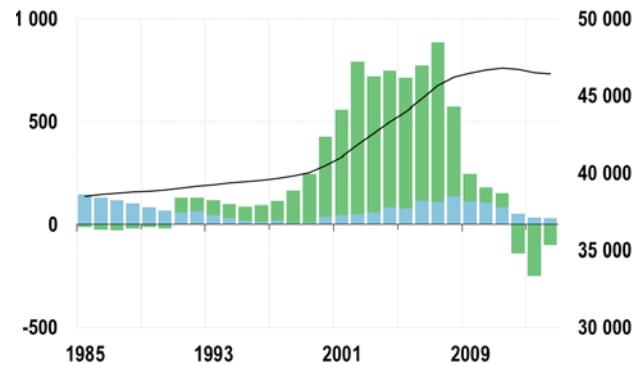


Chart 6 Source: Eurostat

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