

Further growth still expected in German residential house prices



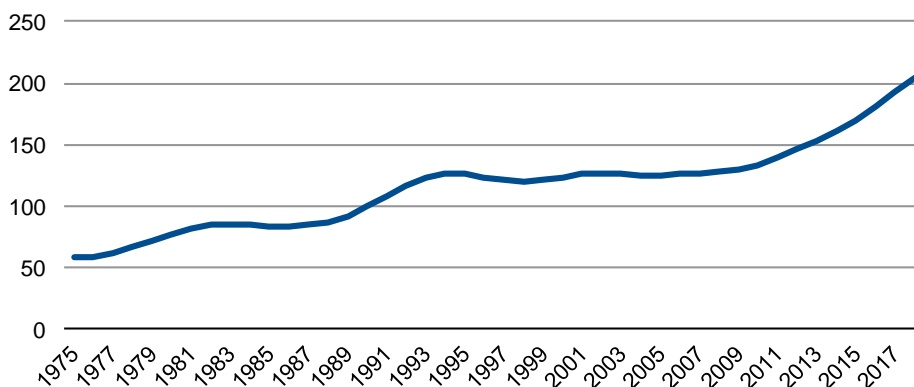
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Decelerating growth is not an indication of the start of a material deterioration in prices for German housing. Residential house prices are still below the long-term average if deflated using average price growth since 1975. House prices relative to income are even still cheaper compared to 2000 and earlier - although regional over-valuations exist. Credit quality of housing loans will not directly be impacted by a drop in house prices and rising rates as most borrowers lock in fixed rated mortgage loans for longer periods.

German residential house prices continued to grow in 2018, even if growth rates moderated in almost all German regions, according to a study published by consultants bulwiengesa. Year on year growth fell from 6.5% a year ago to 5.8%, based on the bulwiengesa housing index (excl. multifamily homes).

The index covers 127 cities and the decline in growth was seen in almost all segments: the Big 7 cities (Berlin, Hamburg, Munich, Cologne, Frankfurt, Stuttgart, Duesseldorf), smaller cities, rural areas, urban areas, areas with low population densities; and across western and eastern Germany. In fact, the sole segment that still saw a continuing increase in growth rates was towns with 100k to 600k inhabitants. However, this was very much driven by two Bavarian cities: Erlangen with a growth rate of 9.3% and Rosenheim with of 9.2%.

Figure 1: House Price Index Residential (excl. MFH) (indexed 1990 = 100)



Source: bulwiengesa/Scope

In May 2018, Scope highlighted the fact that the price 'surge' was already decelerating in Germany's Big Seven markets. We expect growth in residential property prices to moderate further – not only for the Big 7. The German statistical office shows that until November 2018, new housing permits for single and double-family houses reduced year-on-year by 0.5% and 5.2%, respectively.

Housing prices might also moderate because of higher construction costs. With insufficient capacity, construction costs are rising (see [Scope's Corporate outlook 2019 for construction companies](#)) and we believe that in the residential segment in particular this will further reduce activity.

Scope does not believe, however, that decelerating growth is an indication of the start of a material deterioration in prices for German housing. Considering the long-term trend in German house price growth at around 3%, there is some leeway for continued growth. This view is predominantly driven by the remaining pent up demand from the very long period of stagnating growth rates in housing observed between 1994 and 2010.

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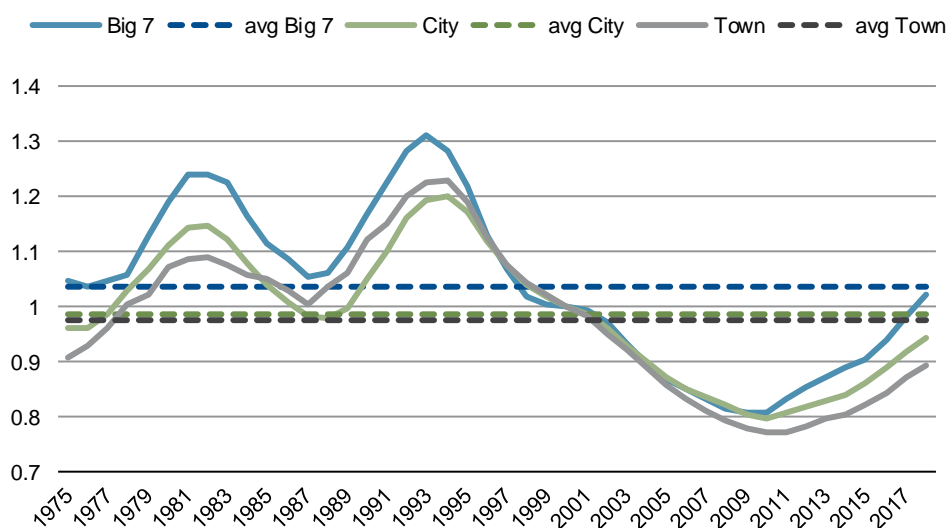


Bloomberg: SCOP

Prices at 3.5% below long-term average

In Scope's view, house prices remain sustainable. Using the average long-term growth rate as a deflator, current market values for the Big 7 cities are still 1.4% below the long-term average. This view is also evident in other segments and compares to a gap of 4.3% to the sustainable level for other Cities and as much as 8.6% for Towns. Towns and Cities would almost be at the same level if Towns in eastern Germany were disregarded. For those, the average was inflated by the eastern house price bubble following German reunification in the 1990s.

Figure 2: Deflated House Price Index by City Size (indexed 2000 = 100)

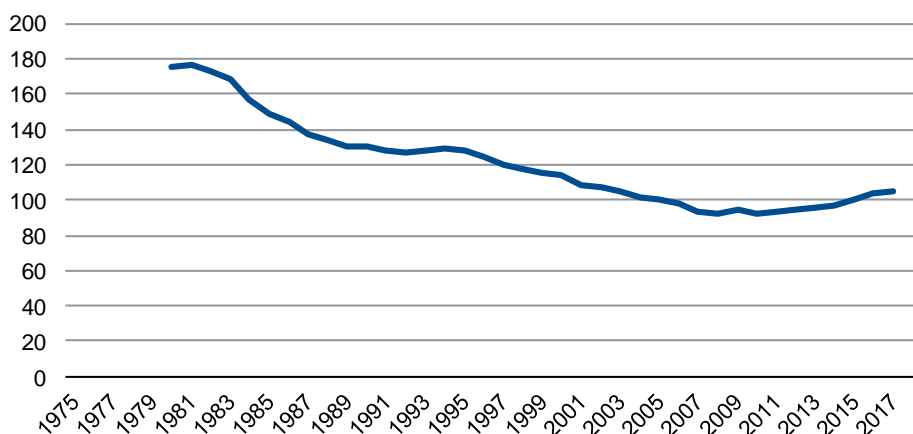


Source: bulwiengesa/Scope

Prices elevated but in most regions not over-valued

In Scope's view, overall residential price levels in Germany have become elevated but are in most regions not over-valued. This view is also supported by moderate price-to-income levels in Germany compared to other European countries. Affordability of new housing feels low compared to recent years as it has continuously decreased over the last eight years. Taking a longer-term view and relative to income, house prices are still cheaper compared to 2000 and earlier although regional over-valuations do exist, even fueled by speculative investments.

Figure 3: Price to Income German Housing



Source: OECD/Scope

Economic growth will slow in 2019 to around 1% according to the Economy Ministry, part of a wider slowdown in Europe since early 2018. Italy edged into technical recession in the fourth quarter of 2018. In Scope's [Sovereign Outlook 2019](#), we noted expectations for softer German growth in 2019, alongside limitations to growth potential at around 1.3%. Weaker consumer sentiment in the near-term, will also support a moderating house price growth in Germany.

Price declines by up to 30% in a stressed scenario

Scope expects a price decline of around 25%-30% without major variations in regional segments in a very stressed scenario. This is based on a two standard deviations shock from deflated average historical price levels. In such an environment, fire-sale discounts may further pressure distressed property values.

Affordability and credit quality to remain strong due to long interest rate fixings

However, Scope expects no material impact on the credit quality in the residential mortgage lending segment as most borrowers have locked in for longer periods (typically 10 years) the persistent low interest rates with fixed-rate mortgages. Even if interest rates rise in the medium term and market values decline, ongoing high affordability in servicing the debt will help to maintain a high credit quality.



Germany's House Price Growth Moderates

Further Growth Expected Through

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