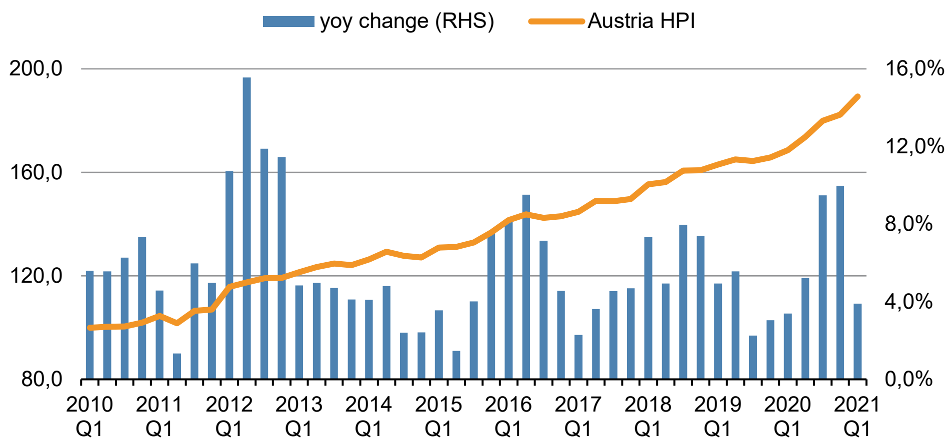
Austrian house prices: little risk of an abrupt price correction, at least for now

The pandemic has fuelled Austrian house price growth. The 12.3% year-on-year increase in the first quarter of 2021 marks the second highest since 2010. With price increases running at more than twice the growth of disposable income in the past decade, a slowdown in growth is justified. We see little risk of an abrupt price correction, though, reflecting reduced market risk for mortgage lenders, moderate household indebtedness, a functioning rental sector, and a regulator actively promoting sustainable lending standards.

Figure 1: Annual growth in Austrian house prices

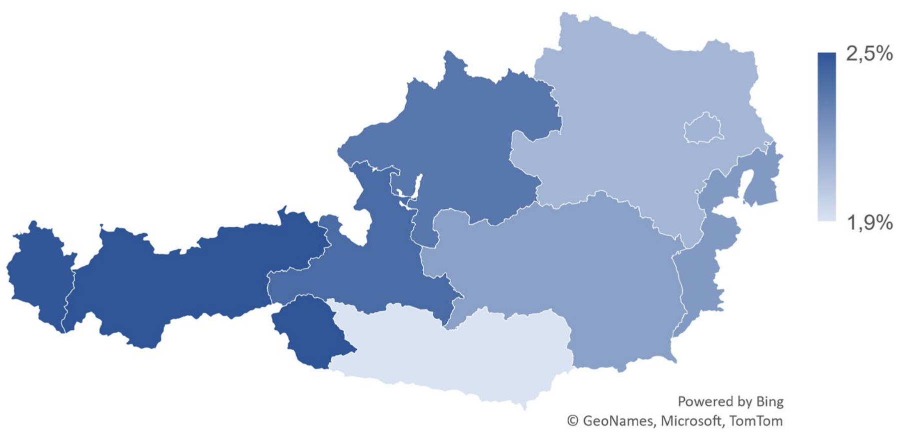


Source: Oesterreichische Nationalbank

Over the past decade, Austrian house prices have appreciated at an average annual rate of more than 5%. Over the same period, household disposable income only increased at an average annual rate of 2.2%. In the long-term, we see house price growth rates strongly above income growth as unsustainable, ultimately leading to over-valuations.

While strong house price appreciation could lead to lower indexed loan-to-value ratios in mortgage cover pools, the reduction in actual credit risk is limited. This is because in our credit analysis to achieve the highest ratings, we neutralise unsustainably high market values through increased market value declines.

Figure 2: Average increase in income 2012 -19 for Austrian regions



Source: Statistik Austria

Analysts

Reber Acar
+49 69 66 77 389-50
r.acar@scoperatings.com

Mathias Pleissner
+49 69 66 77 389-39
m.pleissner@scoperatings.com

Team leader

Karlo Fuchs
+49 69 66 77 389-78
k.fuchs.scoperatings.com

Media

Keith Mullin
k.mullin@scopegroup.com

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Scope Ratings GmbH

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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Economic outlook remains robust

We see little risk of an abrupt dip in the market, at least in the near term. While we remain cautious about the aftermath of the Covid-19 pandemic, we currently assess the damage to the Austrian economy as manageable, as unemployment remains low, and the government seems willing and able to counteract a potential insolvency wave. This has positively affected sentiment in the Austrian construction sector as evidenced by building permits in 2020 largely in line with previous years.

Remote interest rate risk through fixed rate mortgages

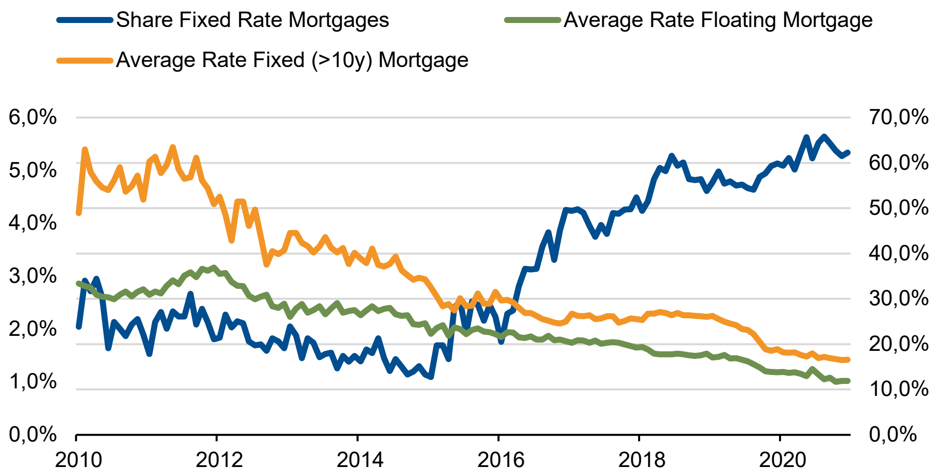
Low interest rates locked-in for longer periods…

Austrian borrowers are now more resilient against a potential increase in interest rates (once inflation returns), thanks to a transition to mostly fixed-rate mortgages. For new mortgage with fixed interest periods above 10 years, borrowers now pay annual interest of just 1.4% on average. This is insignificantly above the 1.0% paid for variable-rate mortgages. Because of this, most Austrian borrowers are choosing fixed-rate mortgage loans, which compares to only 15% in 2015.

… and substantially lower foreign-exchange exposure

In a similar manner, the risk to foreign-exchange rates, mainly the Swiss franc, has reduced over the last few years. Currently, the share of new mortgages denominated in foreign currencies is below 10%, compared to almost 40% 10 years ago.

Figure 3: Average interest rate and share of fixed-rate mortgages for new loans



Source: Oesterreichische Nationalbank

Household debt moderate, and rental market offsets pressure to borrow

Second lowest household indebtedness in Western Europe

In addition, the overall indebtedness of Austrian households has remained relatively stable in the last decade, despite the growth in house prices. As of end-2019, gross debt-to-household income stands at moderate 83%, the second lowest among western European countries.

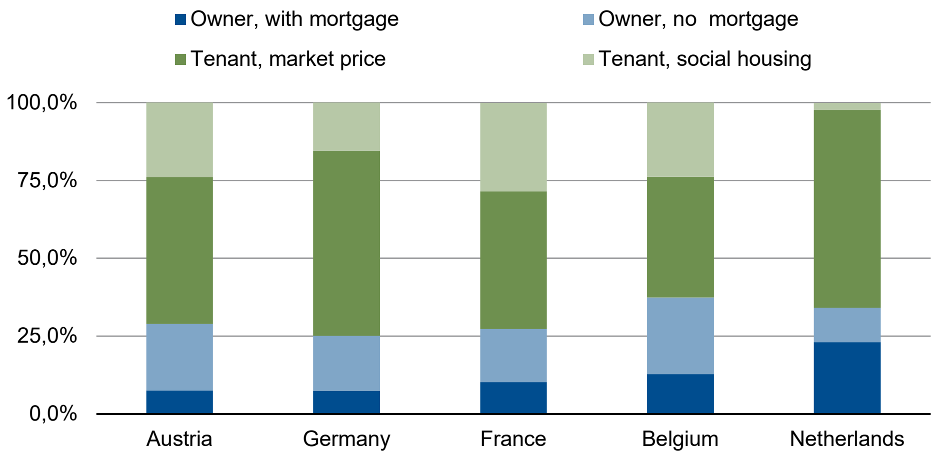
Low-income households are unlikely to borrow…

Even more assuring is the fact that the indebtedness is largely allocated to more resilient high-income households, which have remained largely unaffected by the recent Covid-19 recession (see here for related research). For households with income of less than 60% of the median, only 7.6% live in owner-occupied dwellings with an outstanding mortgage, reflecting a fully intact Austrian rental market.

… as social housing provides alternative

In our view, a functioning rental market and the provision of social housing in metropoles are key factors behind the sustainable house price growth, as evidenced by the example of Vienna, with around 80% of the population living in rented, often subsidised apartments. While in the last decade, house prices for most other European metropolitan areas have started to decouple from the rest of the country, prices in Vienna have developed largely in line with the overall market.

Figure 4: Tenure status for low-income households in Austria & peers



Source: Eurostat

Macroprudential authority closely monitors real estate sector

FMSB promotes sustainable lending standards…

We consider a credit positive the fact that the Austrian macroprudential authority has identified risks in the real estate sector and is showing its willingness to counteract if necessary. Back in 2016, the Financial Market Stability Board (FMSB) comprising members of the Ministry of Finance, the central bank (Oesterreichische Nationalbank) and the financial supervision authority (FMA), already warned of a build-up of risks in the residential real estate sector. Consequently, it started to promote its so-called 'sustainable lending standards'.

… including limits on LTV, DSTI and loan-term…

The recommendation to mortgage lenders includes a maximum loan-to-value ratio of 80%, a maximum loan term of 35 years and a maximum debt-service-to-income (DSTI) ratio of 40% of the creditor's verified and sustainable income.

… with mixed results so far

So far, the FMSB is sticking to its recommendations and refraining from hard limits. While statistics covering Austrian mortgages are rare, the authority says that LTVs and loan terms have reduced following the promotion of the lending standards, although DSTIs remain elevated.

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid
Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

111 Buckingham Palace Road
London SW1W 0SR

Phone +44020-7340-6347

info@scoperatings.com
www.scoperatings.com

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