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Economic Research:

European Housing Markets Continue To Heal As Mortgage Rates Stay Low

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Economic Research:

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Housing market activity will continue to expand in almost all major European countries this year, fueled mainly by the continuing economic recovery and very favorable mortgage financing conditions. Real GDP grew by 1.5% for the year as a whole in the eurozone and by 2.2% in the U.K, with domestic demand the main driver. Labor market conditions also continued to improve: Eurostat reported unemployment in the eurozone fell to 10.3% in January, from 10.4% a month earlier. The dip may look modest, but it brings the jobless rate to its lowest level in four years. In absolute terms, unemployment is down 1.5 million from a year earlier. Meanwhile, mortgage interest rates have continued to trend down to historically low levels to 2.28% in December 2015 from 2.55% on average in December 2014. We expect the European Central Bank's (ECB's) accommodative monetary stance, leading to historically low sovereign bond yields and mortgage interest rates, will spur improvements in all housing markets.

Many property markets are nevertheless susceptible to global economic headwinds that could dampen the fragile economic recovery and have a knock-on effect on house prices, especially in the periphery countries. From the beginning of the year, turmoil in the European financial markets on the back of uncertainties surrounding global economic growth have led investors to become risk averse and to turn to safer assets, such as core European bonds. In contrast, credit growth in periphery countries remains exposed to a spike in bond yields. Growing concerns about the strength of the banking sector in these countries, together with a widening in spreads--although still moderate--in the periphery sovereign bond market, could weaken the recovery in loans, household investment, and ultimately in the housing market. However, we think the euro area is today equipped with a number of stronger rescue mechanisms. Besides, the ECB is likely to take further action in the event of a tightening in financial and monetary conditions.

Overview

- We forecast house prices will rise or stay flat in all major European housing markets this year and next amid favorable lending conditions.
- Housing markets in Germany, the U.K., and Ireland will see the strongest growth, each rising by 5% this year, helped by growing economies.
- Prices in Spain and Portugal could rise by 2.5%, and in Italy by 1.5%, although we think market recoveries in these countries could be particularly susceptible to financial market headwinds.
- France is the only market in which we foresee no growth this year, although we see prospects for a return to 3% growth in 2017.

We expect the biggest house price gains this year will be in the U.K., Germany, and Ireland, which we forecast will rise by 5%. House price inflation in the U.K. is underpinned by rising real incomes, falling unemployment, and a persistent structural shortfall of supply in key regions, helped in addition by low mortgage rates. Government measures to mitigate the shortage and address deteriorating affordability for first-time buyers are unlikely to significantly slow this upward momentum, in our view. In Germany, low unemployment and growing disposable incomes on the back of lower energy prices are adding to good borrowing conditions. Institutional investors are also attracted by German residential properties, which they consider a safe haven to protect the value of their assets in an uncertain environment offering low returns. In Ireland, economic growth that is strongly outpacing the eurozone average, with real GDP forecast to rise 4.2% this year, is underpinning the market. House prices in the Netherlands should also grow robustly by 3% this year, on the back of lower interest rates, prospects of rising household incomes, and good market affordability.

Only in France do we expect house prices will see no gain overall, not least because the market is still expensive, with prices to incomes still well above their long-term average. Prices are nevertheless now stabilizing thanks to attractive borrowing conditions and signs that the economy is recovering. We forecast that Belgian house prices, which have also stagnated in recent years, will remain sluggish over the next two years in the context of fiscal consolidation, which is forcing regional governments to cut aid related to housing.

Housing markets and Spain, Italy, and Portugal, among those most deeply affected by the 2008/2009 financial crisis, are also benefitting from economic improvements and supportive monetary conditions. We forecast house price gains of 2.5% this year for Spain and Portugal, and a 1.5% rise in Italy. Political uncertainties in Spain and in Portugal following the recent general elections could nevertheless slow the housing recovery this year.

Meanwhile, prices in Switzerland are continuing their soft landing following strong inflation over the past decade. The market has nevertheless remained resilient to Swiss National Bank's regulatory measures to curb credit growth and we expect prices to appreciate by 1.5% this year.

Table 1

European Housing Market Forecasts

	2013	2014	2015e	2016f	2017f
Nominal house prices, % change yoy					
Belgium	1.1	1.0	0.0	1.0	2.0
France	-1.9	-2.5	0.0	0.0	3.0
Germany	5.0	2.8	4.8	5.0	4.5
Ireland	6.3	16.2	6.6	5.0	4.0
Italy	-4.9	-3.6	-1.0	1.5	3.0
Netherlands	-4.3	2.0	3.5	3.0	3.0
Portugal	0.5	2.1	3.6	2.5	2.5
Spain	-6.3	1.8	4.5	2.5	4.0
Switzerland	4.7	0.4	2.3	1.5	1.5
U.K.	5.5	10.0	7.0	5.0	3.0

e--Estimate. F--forecast. Sources: S&P, OECD, Hypoport

Belgian House Prices Stay Stagnant On Cuts To Mortgage Tax Relief

House prices in Belgium have stagnated in real terms for the past five years, after increasing by more than 50% since

2000. We expect the market will remain sluggish over the next two years in the context of fiscal consolidation, which is forcing regional governments to cut aid related to housing. The Flanders region cut mortgage tax relief on home loans in 2015, and Wallonia will follow suit in 2016, followed by Brussels in 2017. We nevertheless believe that the impact coming from these changes in taxation will be more limited than we previously expected because the economic recovery in Belgium is gaining momentum and financial conditions remain extremely favorable.

Recent trends

The Belgian residential property market presented a contrasted image last year. While prices continued to stagnate, and even turned negative in real terms, home sales and lending volumes have remained dynamic. According to the Royal Federation of Belgian Notaries, the average price for a standard home remained stable in 2015 (+0.1%), and the average price for a flat rose by 1.9%. Meanwhile, transactions increased by 6.4% and new housing loans surged by 23.5%. The dynamic overview nevertheless conceals some nuances. The very positive loan production numbers were above all due to refinancing loans. Households have taken advantage of historically low mortgage interest rates to renegotiate their contracts. Excluding refinancing, new housing loans only grew by a meager 1.5%. This mediocre performance was, however, better than we anticipated in our last report in July 2015. Late 2014 was marked by a rush in Flanders to purchase houses ahead of less attractive fiscal rules that took effect on Jan. 1, 2015. Home sales had surged by about 40% year on year in the region in Q4 2014 and mortgage statistics reflected similar developments (housing loans amounted to €6.5 billion in December compared with an average of just €2 billion in the previous months). By our reasoning, changes in the housing taxation regime in Flanders (that reduced tax relief on interest payments and capital redemptions for mortgages signed after Jan. 1 2015) were likely to trigger a fall in house prices throughout Belgium, reflecting much deteriorated market affordability--the loss for a household could be equivalent to 10%-15% of the average loan amount for higher-income households.

However, a further drop in mortgage interest rates last year prevented prices from falling, in our view, by increasing households' borrowing capacity for monthly repayments. An increase in the average loan amount was used to offset much of the loss of revenue generated by the Flanders housing taxation. Interest rates for new housing loans dropped 30 basis points to 2.4% in December last year after decreasing 90 basis points (bps) in 2014, while the average mortgage loan amount rose 4% to €145,000 in 2015. A rise in deflation fears in the middle of 2014, along with expectations that ECB would respond by initiating a policy of quantitative easing sent the Belgian 10-year government bond yields to 0.5% in March 2015 from 2.5% one year earlier. From the beginning of the year, however, turmoil in the European financial markets on the back of uncertainties on global economic growth led investors to become risk averse and to turn to safer assets such as core European bonds. As a result, the Belgian 10-year yield slid to 0.6% mid-February.

Future trends

Two conflicting forces will shape the housing market this year and next. On the positive side, a moderate economic recovery, along with falling unemployment, and extremely favorable financing conditions will underpin higher housing prices. Yet, more changes in the housing taxation regime in Wallonia in 2016 and the Brussels region in 2017 will continue to weigh on activity.

The economic recovery continued at a moderate pace in the first half of 2015 before losing some momentum since the summer against a backdrop of weaker global demand. The Paris terrorist attacks in November and repercussions in

Belgium didn't hamper consumer and business confidence at the end of 2015. However, the turmoil in financial markets and concerns about the weakness in emerging markets may cause some disruption to economic activity at the beginning of the year. Yet, we consider that economic fundamentals and recent reform efforts suggest the economy should continue to recover. We expect GDP will grow by 1.4% this year and 1.6% in 2017 (see table 2). Falling energy prices and shrinking unit labor costs are boosting profit margins and, together with easy financing conditions and rising capacity utilization, should support investment. The upside for private consumption is likely to be contained by wage moderation. But the more recent fall in unemployment (to 7.9% in December from 8.8% a few months earlier in April), which we think will be extended this year, is likely to provide a boost to household spending. Next year, domestic demand should slow, as fiscal policy is set to tighten, while the contribution from net exports should become positive, as exports benefit from the increased cost competitiveness.

Meanwhile, we expect ECB monetary policy will ease further this year and remain accommodative over the forecast horizon to 2017 because we anticipate inflation will remain well below the central bank's target of below but close to 2%. As a result, we expect sovereign bond yields will remain at historically low levels, hence weighing on mortgage interest rates. With new housing taxation reducing market affordability, households' borrowing capacity will be more sensitive to changes in interest rates.

Indeed, the Walloon region has announced its intention to reform its housing program by scrapping mortgage tax relief on home loans signed after Jan. 1, 2016, and replacing it by "housing cheques". According to ING, an investment bank, this could lead to a loss for a household equivalent to 15%-20% of the average loan amount. Similarly, the end of the housing bonus in Brussels from 2017 and its replacement by a reduction in registration fees will result in a loss ranging from 10% for high-income earners to 25% for low-income households on a typical loan amount.

As a net result, we expect house price growth will remain modest this year and next, as the persisting low interest rate environment should support household investment in real estate and therefore limit price adjustments. More fundamentally, the average Belgian house is less costly by international comparison. According to numbeo.com, Belgium ranks merely the 14th most expensive country in terms of house prices. An apartment in the city center costs on average €2,690 per square meter, against €5,400 in France, or €4,600 in the U.K. In Brussels, the cost is €3,300 against €6,400 in Paris and €11,100 in London.

Table 2

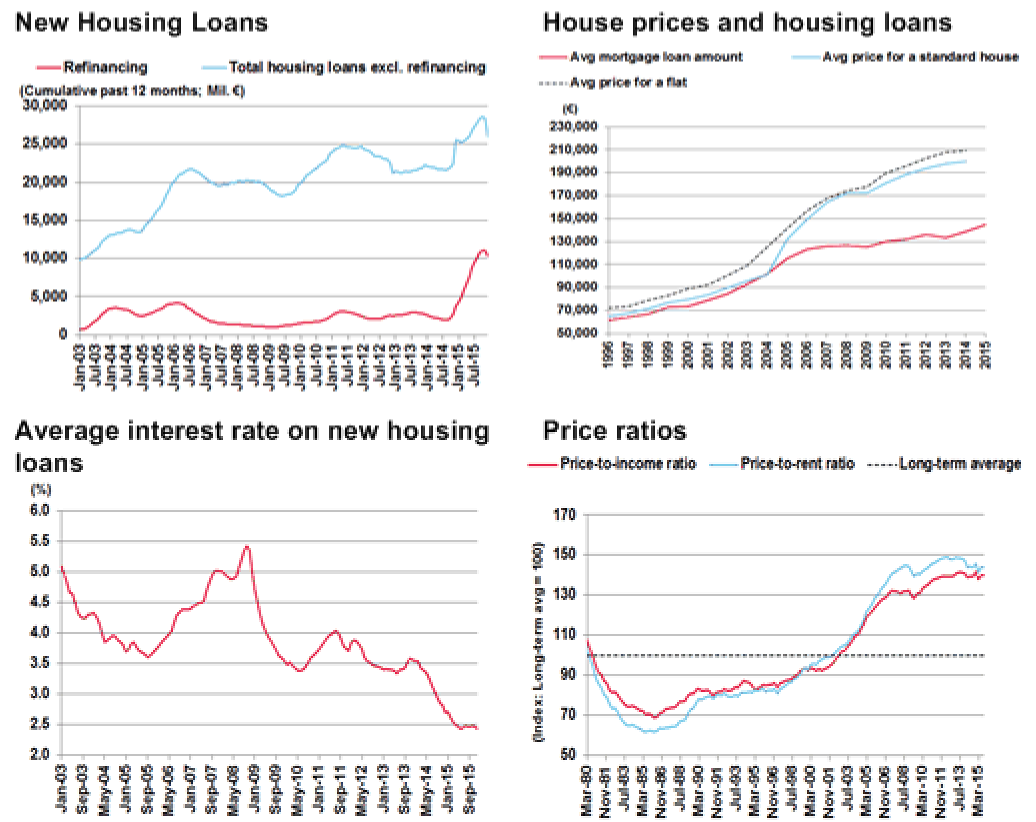
Belgian Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	1.1	1.0	0.0	1.0	2.0
Real GDP (% change)	0.0	1.3	1.4	1.4	1.6
CPI inflation (%)	1.2	0.5	0.6	1.5	1.7
Unemployment rate (%)	8.4	8.5	8.3	7.5	7.1

Sources: S&P, Eurostat, Banque Nationale de Belgique, OECD, Statistics Belgium.

Chart 1

Belgium Housing Market Statistics



Sources: Statistics Belgium, National Bank of Belgium, Union Professionelle du Credit.Statbel, ECB, Organization for Economic Cooperation and Development (OECD).

French House Prices Are No Longer Falling

French house prices have been stabilizing since the second half of 2015 as the economy shows signs of recovering while borrowing costs remain very low. But the market remains expensive. The fall in nominal prices between 2011 and the middle of 2015 was too modest to materially improve the market's affordability, and key ratios such as the price to incomes and price to rents remain well above their long-term average. We expect the market will stay flat this year and improve very gradually, with prices rising again in 2017 (see table 3).

Recent trends

GDP growth accelerated in 2015 to average 1.1% from 0.2% a year earlier. Yet, this performance was below the eurozone as a whole (+1.5%) and insufficient to cause a contraction in overall unemployment. France was one of the only four countries among the 28 EU member states that did not report a decline in joblessness in 2015. The economic upturn was mainly driven by private consumption, up 1.4% (0.7% a year earlier). The sharp drop in energy prices,

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coupled with more stable fiscal pressure after the sharp increase in 2013-2014, boosted purchasing power, up 1.8%.

The weak performance of the construction sector remained a drag on overall growth through most of 2015. That sector experienced several years of contraction, beginning in 2012 with housing starts down 5.7% on a year earlier. This decline moderated in 2013 (-1.8%), but 2014 saw a major recession, with starts down 10.5%. The decline continued through the first nine months of 2015, before stabilizing in the final quarter. Overall, there were 351,800 housing starts last year, down 28% from the peak of 488,800 in 2007. Among other factors, the regulatory changes introduced in 2012-2014, including a reduction in the allowance for capital gains, changes in the interest-free loan eligibility, and the introduction of rent ceilings, weighed heavily on investors' and developers' confidence. This prolonged contraction has increased the gap between supply and demand for new dwellings. Conservative estimates based on INSEE projections of demographic and sociological trends suggest that the country needs about 450,000 new dwellings per year.

Against a backdrop of a moderate recovery in overall economic growth, the resilience of the market for pre-owned housing was mainly driven by very low interest rates. In the fourth quarter, interest rates on housing loans averaged 2.22%. In December, they reached 2.20% from 2.38% a year earlier, according to Observatoire Credit Logement CSA. Very favorable rates have boosted demand for housing loans. In the year to Oct. 30, €191 billion of new loans were granted. The weight of loan renegotiations and repurchases represented 45% of total loan production over the past six months. Renegotiations increase the production of new loans without affecting trends in outstanding loans. The latter stood at €866,622 million at the end of December, up 3.6% from a year earlier, according to Banque de France data. At the same time, the term of the loans granted continued to be extensive: in the final quarter of 2015, 62.6% of loans had terms between 15 and 25 years, and 19.8% were between 25 and 30 years (compared with 18.4% on average in 2014), according to Observatoire du Credit Logement. The robust demand for loans was associated with a pickup in transactions, after a contraction in the second half of 2014. Sales of pre-owned homes amounted to 803,000 in the 12 months to December, up 15.7% from the same period a year earlier. Nominal prices were up 0.5% in the fourth quarter from Q3. Year on year, prices were stable.

Future trends

We expect the current upswing in the French economy will gather a bit more momentum this year and next. Consumer sentiment in December remained close to its eight-year peak, revealing little impact from November's terrorist attacks. Admittedly, consumer spending grew less strongly in Q4 2015 than in Q3, but we think it should strengthen again thereafter. Low inflation will further boost real disposable income, especially with the renewed plunge in oil prices, while improvements in the labor market will bolster earnings more significantly from 2017. Meanwhile, recent data suggests that weaker trade with Asia is offset by stronger euro-area demand, especially as the recovery broadens across the single monetary union in 2016. In addition, the weak euro and lower oil prices should provide support, with the euro set to soften further against the U.S. dollar in 2016-2017. Net trade should become positive for GDP growth by 2017. Finally, investment picked up more decisively in Q4 and will be an important driver of the recovery in 2016, as the outlook for domestic and external demand improves. More specifically, we expect the construction sector will recover from mid-2016, while a further easing in credit conditions favors business investment more generally.

Critical to the housing market, long-term interest rates are likely to remain very low throughout the forecast period.

The ECB's monetary stance will remain highly accommodative this year and next as its ability to reach its inflation target (close to but slightly below 2%) continues to be challenged by weak commodity prices and depressed emerging market currencies. French mortgage rates are closely tied to the 10-year sovereign bond rate (OAT). The latter averaged 0.77% over the period from Jan. 2 through Feb. 15 of this year, compared with 0.65% a year earlier. This recent and modest uptick was caused by the overall turmoil in international capital markets. We do not expect the French 10-year rate will go much beyond its current level in the coming quarters. Borrowing conditions for home buyers will therefore remain quite favorable. On the other hand, we do not expect that the recent measures introduced by the authorities will have much of an effect on the pre-owned market. The flag measure is the reintroduction from Jan. 1 of a redefined zero-interest loan ("prets a taux zero; PTZ") aimed at encouraging first time buyers. But to be eligible for an interest-free loan, buyers of a preowned dwelling need to commit to renovation work at a cost equal to at least 25% of the sales price. We think this condition is likely to be a deterrent in large cities where prices are elevated. In this respect, we note the market's affordability hasn't improved much since 2011 when prices started to decline because, in the meantime, household incomes haven't increased much. Indeed, the market has become less affordable in the past few years. According to Observatore du Logement, the average cost of buying a home was equal to 3.86 years of incomes in December 2015, down from 3.77 years a year before. On the whole, we expect the market will stabilize this year, with the number of transactions still increasing but with prices staying essentially flat. A more tangible surge in prices can be expected in 2017 as the economy continues to strengthen.

Table 3

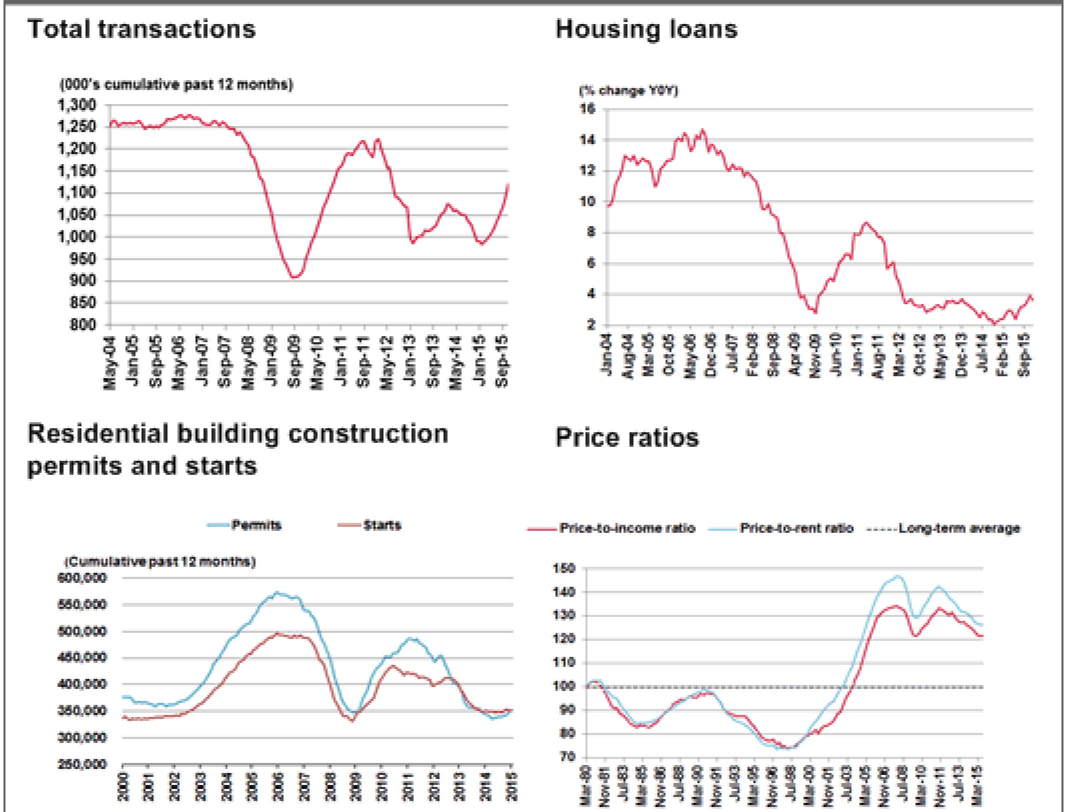
French Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	-1.9	-2.5	0.0	0.0	3.0
Real GDP, % change	0.7	0.2	1.1	1.6	1.6
CPI inflation (%)	1.0	0.6	0.1	1.1	1.4
Unemployment rate (%)	10.3	10.3	10.4	10.3	10.1

Sources: S&P, Eurostat, OECD, INSEE.

Chart 2

France Housing Market Statistics



Sources: Ministère de l'Environnement de l'Energie et de la Mer, Banque de France, OECD, INSEE (Institut national de la statistique et des études économiques).

Strong Economy And Tight Supply Keep German House Prices Rising

We expect prices in Germany's residential housing market will continue rising over the next two years, supported by structural and cyclical factors. Favorable economic fundamentals, demand overhang, and still affordable homes are all underpinning higher housing prices. What's more, expectations for even lower interest rates in the medium term have led us to revise our projections slightly upward. We now forecast prices will rise by 5.0% this year and by 4.5% in 2017.

Recent trends

German housing market growth regained momentum in 2015 after softening to some degree in the previous year. According to data from Europace AG, a transaction platform for real estate loans, house prices grew 4.8% year on year in Q4 2015 after rising by only 2.8% in Q4 2014. Despite the rise in house prices, housing market affordability, as measured by price-to-income and price-to-rent ratios, has deteriorated only slightly. Both ratios, which have trended upward since 2010, were still indicating an undervaluation ranging from 5% to 7% compared to their long-term average (1980-2015) as of September 2015.

Reflecting this upward pressure on prices, construction output increased steeply. Permits for residential buildings rose considerably in the second half of last year, pointing to very robust demand. Consequently, dwelling completions also continued to increase strongly last year, after a 14% rise to 245,000 dwellings in 2014. The expansion of supply in 2015, however, is still unlikely to have filled the gap that has accumulated in recent years, especially in the largest cities. Indeed, demand for housing has been increasing strongly since 2009 and construction activity has been slow to respond, creating a supply shortage. Superior job opportunities in Germany have attracted many migrants from eastern and southern European countries in recent years, with immigrants preferring to settle in Germany's conurbations. Meanwhile, internal immigration has also boosted urban populations. Net immigration to Germany totaled 550,000 in 2014, the highest in more than 20 years. What's more, the refugee influx is likely to have propelled net immigration to Germany to a record high of well over 1 million in 2015. However, if the high number of refugees is likely to stimulate higher investment in housing construction, it won't necessarily lead to house price inflation, at least in the short term. According to the Bundesbank, their property needs are likely to be met by emergency accommodation, and later complemented by use of vacant housing. A strong demand effect on the private residential property market would only occur later and could be limited.

Meanwhile, extremely favorable financing conditions are incentivizing households to buy rather than rent. After trending up for a few months in the middle of last year, interest rates for new mortgages stabilized later last year. However, they are likely to trend downward again, as reflected by the recent fall in sovereign bond yields. Indeed, more expansionary monetary policy from the ECB to fight deflationary pressures, along with general risk aversion from investors is leading to a flight to safe assets. This is supporting government bond prices in the core countries of the eurozone, and in Germany in particular. In this context, institutional investors are also attracted by German residential properties, considered a safe haven to protect the value of their assets in an environment that is still uncertain and offers low returns. Investment in residential properties set a new record in 2015, according to CBRE, a commercial property and real estate services adviser. In the last quarter 2015 alone, €4.8 billion residential units were sold, up by 160% from the year-earlier quarter. In 2015 as a whole, 338,500 residential units were sold, an increase of 50%.

Future trends

The macroeconomic environment remains favorable. Still, subdued global demand, especially from emerging markets, is likely to limit the contribution from net exports, while continued stock market volatility since the start of the year could hit the economy by denting confidence. Germany's relatively strong trade links with emerging economies resulted in the recovery already softening in the second half of last year. Actual exports and industrial production both fell significantly in December, leading overall production downward by 0.4% in Q4 after a 0.3% fall in Q3 2015. Given the current gloom in the equity markets, the chances of a rapid rebound appear to be receding.

Domestic fundamentals nevertheless remain solid, amplified by exceptional factors, such as the recent further drop in oil prices and the high influx of immigrants. The labor market remains favorable, marked by rising employment, a low unemployment rate, and improved wage prospects. Unemployment dropped to record low of 4.5% in December 2015. Growth in real disposable incomes is also supported by the introduction of the minimum wage and the sharp drop in energy prices. Meanwhile, domestic demand could increase via additional government spending and state-financed transfer payments to refugees. According to the Bundesbank, refugee migration could raise the German economy's potential output by just under 0.5% towards the end of 2017, compared with the baseline scenario without such refugee migration. However, integration to German labor market will be key to boosting output in the longer term.

Nevertheless, the extremely loose financing conditions will remain a predominant factor supporting the rise in house prices. Germany's housing market will remain an attractive investment option as yields on fixed-income instruments dip into negative territory. Growing downside risks to the near-term outlook for GDP growth in the eurozone, in addition to deflationary pressures coming from weakness in energy prices, and the recent appreciation of the euro have increased the chances of further significant ECB policy easing in March. Given that interest rates are set to remain at record lows well into 2017, mortgage rates will also remain low. This suggests that demand will remain high and that, with supply being low, house prices will continue to rise.

However, risks of a housing bubble are not likely to materialize over our projection horizon. Over the past few years, the strong decline in interest rates did not lead to a pronounced jump in lending volumes. Banks' mortgage lending growth remains modest, although it picked up recently, rising by 3.2% year on year in November 2015 from around 2% in 2014. As a result, and relative to economic growth, mortgage loans have fallen from 39% of GDP in 2009 to around 35% in Q3 2015. This is because the housing market in Germany is structurally conservative: lenders typically demand a 30% down payment, while mortgage lending rates are usually fixed at about 10 years. Added to this, home ownership is low, at 52.5% in 2014 compared to 65% in France and the U.K. and 73% in Italy according to Eurostat. The rental market, meanwhile, is large and highly regulated. German households have typically favored rentals, although rents have also increased since 2011 in tow of higher purchase prices.

Table 4

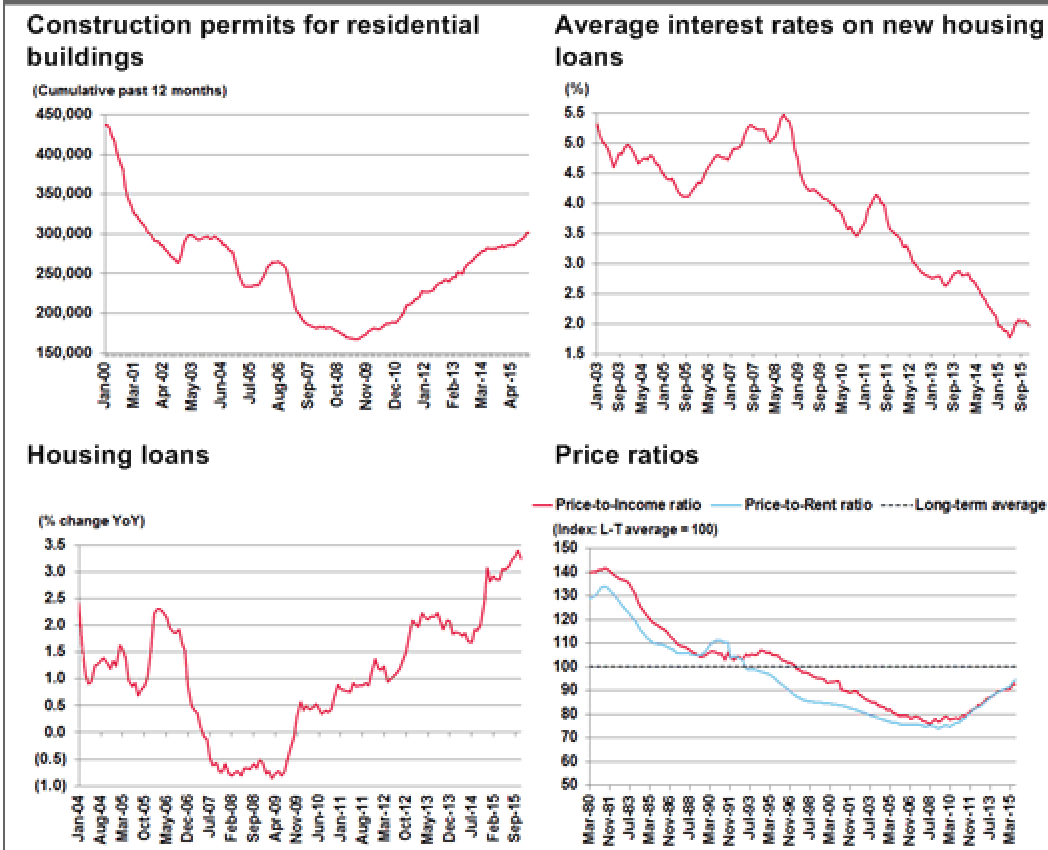
German Housing market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	5.0	2.8	4.8	5.0	4.5
Real GDP, % change	0.4	1.6	1.5	2.0	1.8
CPI inflation (%)	1.6	0.8	0.1	1.3	1.6
Unemployment rate	5.2	5.0	4.6	4.6	4.7

e--Estimate. f--Forecast. Sources: S&P, Eurostat, Hypoport.

Chart 3

Germany Housing Market Statistics



Sources: ECB, OECD, Deutsche Bundesbank.

In Ireland, The House Price Recovery Continues

Ireland's housing market has made a strong recovery since mid-2013, with prices now having risen by 35% from the financial crisis trough. We forecast price growth will stay strong in the medium term, owing to the demand-supply mismatch and strong economic performance, with nominal house prices growing by 5% this year and 4% in 2017 (see table 5).

Recent trends

Irish housing market growth decelerated strongly last year from its highs, led by a sharp easing in the pace of price increase in the capital. Dublin's residential property prices were up by only 2.6%, from more than 22% growth in 2014, while the rest of the country has lead the upward trend, with prices growing by 10%. The slower pace of price growth in Dublin mainly reveals an adjustment in house-price expectations by households, after the Irish Central Bank introduced stricter controls on mortgage lending. According to the SCSI survey, which monitors expectations and developments in the Irish housing market, the implementation of the central bank's macro prudential measures have reduced the rate of property value growth by 5%-10% overall in the Dublin region. In February 2015, the central bank introduced regulations restricting the number of high loan-to-value and loan-to-income mortgages. In contrast, the significant increases in value outside Dublin reflect a catch-up element and improving economic conditions in the country as a whole.

In 2015 Ireland cemented its position as the fastest-growing economy in the eurozone, with GDP in Q3 up 6.8% year on year, compared with an average of 1.6% for the eurozone. Although this high number hides statistical distortions (GDP for Ireland includes undistributed profits of foreign-owned multinationals that inflates output) fundamentals are strong. The recovery has been broad-based and coupled with strong job creation. The unemployment rate was down to 8.8% in December 2015 compared to 10.2% a year earlier. While the recovery started in the external sector, domestic demand has been driving GDP growth recently. It expanded by more than 8% year on year in the first nine months of 2015, with household consumption growing by 3.5% and investment by over 25%.

Meanwhile, house building activity continues to recover vigorously, but from very subdued levels. Completions grew by 14% in 2015. New housing registrations, which refer to developer activity, were 67% higher last year than in 2014. However, even if this growth is sustained next year, construction output would be about 15,000 units per year, which is still far below the estimated demand of 25,000 units. In its latest economic commentary, the Economic and Social Research Institute predicted that 25,000 residential units will be required on an annual basis in the next 15 years to meet demand. Demonstrating the supply-demand mismatch, data from Daft.ie, a property website, show that the number of residential units for sale was just 25,000 on Dec. 1, 2015, the lowest for this time of the year since 2006. Likewise, rental stock continues to fall. As of Feb. 1, there were fewer than 1,400 properties available for rent in Dublin, compared to an average of 5,200 properties between 2008 and 2012. Against this backdrop, rents are continuing to rise sharply nationwide, up 9% last year.

Future trends

Residential property availability plays a key role in the assessment of prices in the housing market. Supply shortages have emerged in many areas in Ireland, owing to the low level of house construction activity in recent years, leading to upward pressure on prices as labor market conditions improve. Given current depressed levels of housing supply, expected strong economic performance, and positive demographic trends, we think that it will be some time before the mismatch between demand and supply is rectified, hence we see house price growth staying relatively robust over the medium term. On the demand side, increasing immigration could be a supportive factor. The country has had net emigration since 2010. But since 2013 net outward migration has fallen and is estimated as 11,600 as of April 2015 from 21,400 one year earlier. If the economic recovery continues, the country could again register net positive inward migration flows. On the supply side, other constraints are still relatively limited financing available for builders and building regulations.

Added to this, rising domestic demand and consumer confidence will also support the recovery in housing, in our view. We expect that the Irish economy will continue to largely outperform the euro area overall. We expect GDP will expand by 4.2% this year, 3.2% in 2017, compared with just 1.8% and 1.7%, respectively, for the eurozone as a whole. The improving labor market, alongside rising employment and wages, should also support a continued increase in housing demand. We forecast that unemployment will drop significantly to 7.5% on average by 2017.

We nevertheless don't expect the recent increase in house prices to stay as strong this year as in 2015. Although volumes of approved housing loans picked up again in Q3 2015 after falling in the first half of last year, the revival in the Irish mortgage market still has some distance to go. First, these loan levels are still low by historical standards and the imposition of prudential ceilings on new mortgage lending are reducing the number of eligible first-time buyers, therefore tempering the recovery in the property market. Besides, more generally, the Irish banking sector is still suffering from the after-effects of the financial crisis. While mortgage arrears are now falling, the share of loans in arrears remains very high (12.3% of total mortgages for principal dwelling houses in Q3 2015). Meanwhile, caution among banks and low profitability means that low policy rates are not translating into lower borrowing costs. Interest rates for new mortgages were 3.4% in December 2015, more than 1 percentage point above the eurozone average. Lastly, although the stock of outstanding household debt has continued to decline strongly since 2009, households are still highly indebted, which debt at 167% of disposable income in Q2 2015, surpassed only by Denmark and the Netherlands in the EU.

Table 5

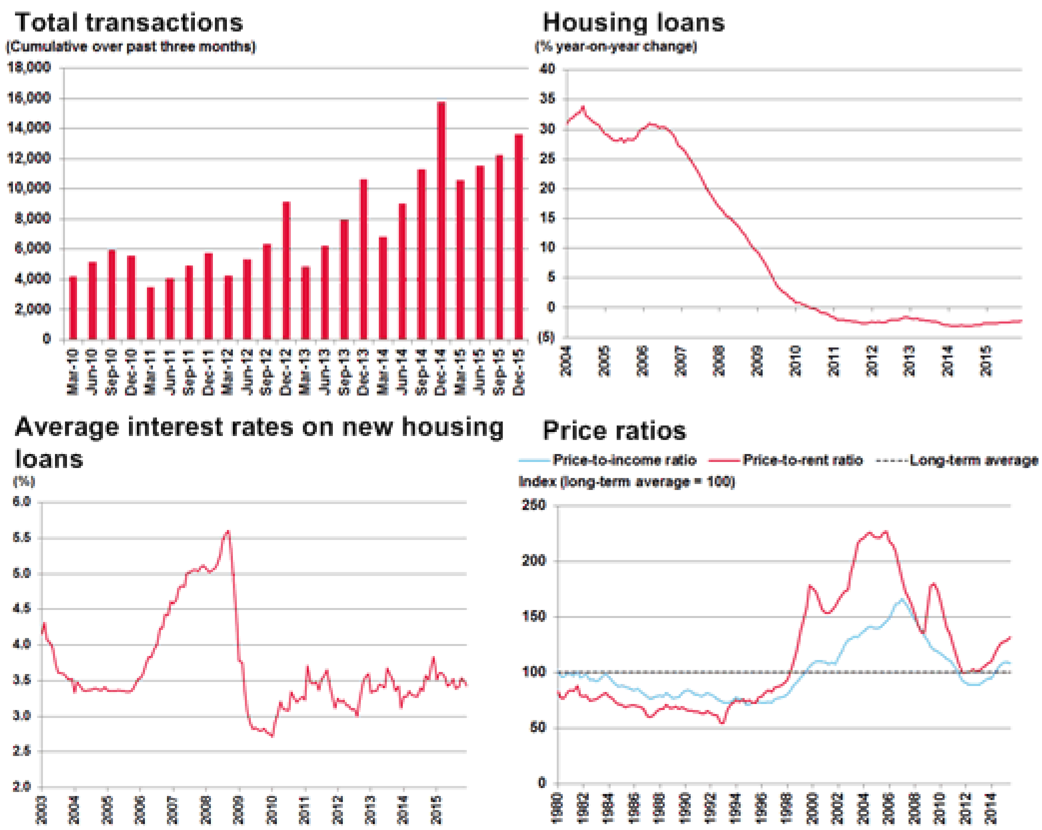
Ireland Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	6.3	16.2	6.6	5.0	4.0
Real GDP, % change	1.4	5.2	5.8	4.2	3.2
CPI inflation (%)	0.5	0.3	0.0	1.2	1.4
Unemployment rate	13.1	11.3	9.4	8.0	7.5

e--Estimate. f--Forecast. Sources: S&P, Eurostat, OECD, Central Statistics Office.

Chart 4

Ireland Housing Market Statistics



Sources: Property Services Regulatory Authority, Central Bank of Ireland, Organisation for Economic Co-operation and Development, Central Statistics Office Ireland, European Central Bank.

Italy's Fragile Recovery Could Help The Housing Market Return To Growth This Year

We expect home prices will start to rise gradually in Italy this year as the economic recovery, even if not stellar, will likely progress and credit conditions remain favorable. The ECB is likely to take further action in the event of a tightening in financial and monetary conditions especially in the periphery. We see scope for the housing market to grow in 2016, with a 1.5% year-on-year rise (see table 6).

Recent trends

The continued deterioration in the housing market began easing by the third quarter of 2015. House growth stabilized in the third quarter last year, while annual price growth continued to ease, falling at a slower pace of 2.3% after losing 4% in Q3 2014. The slower pace of decline was brought about by an increase in home sale transactions, which rose 3% year on year to about 417,000 in Q2 2015. The number of homes changing hands is nevertheless still 50% lower than the peak level reached in June 2006, reflecting the still precarious state of the market. The increase in home sales was also accompanied by a rise in confidence in the construction sector, which rose to its highest since July 2008 in September 2015, suggesting that developers are more confident in a recovery in the housing market. Investment in residential construction, which has been almost continuously in decline since mid-2008, has started to stabilize since the start of last year, but has not really picked up yet.

The gradual improvement in Italy's residential property market reflects the slow recovery in the domestic economy. Although Italy experienced a recession for 3.5 years, real GDP only grew by 0.6% last year. The Italian recovery even lost momentum in the second half of last year, with the economy expanding by just 0.1% in Q4, after a subdued 0.2% rise in Q3. The outturn for Q4 was lower than expected, with the hard data much weaker than the survey evidence. The breakdown of the national accounts was not yet available, but it seems likely that private consumption was the main positive factor behind this expansion. The national consumer confidence indicator was at its historical high in January, pointing to improving momentum behind household spending. Gradual improvement in the labor market continues to support the recent improvement in both consumer confidence and spending, helped by the recent retreat in global crude-oil prices, further bolstering household purchasing power.

Taking advantage of more positive economic prospects and the easing in financial conditions, the demand for mortgage loans expanded markedly last year. New housing loans doubled last year, while loan renegotiations surged by about 240% over the same time. Households are benefiting from a rapid decline in mortgage interest rates, which fell 35 bps in 2015. Italy has been the main beneficiary of the loosening in credit standards on loans. According to the latest ECB Bank Lending Survey, the economy reported a net easing in credit standards on housing loans in Q4 last year. This was not just owing to more bank competition and lower risk perception, but also to a decline in the cost of funds. Italy has been benefitting from relaxed sovereign bond yields since last year as the ECB has been buying Italian debt under its quantitative easing programme.

Future trends

Credit growth in Italy remains exposed to a spike in bond yields. Growing concerns about the strength of the banking sector in the country, together with a widening in spreads--although still moderate--in the Italian sovereign bond market since the beginning of the year, could weaken the recovery in loans, household investment, and ultimately in the housing market. However, we still expect a slow recovery in prices over the forecast horizon, as economic growth is expected to gain momentum and as the ECB is likely to react to a tightening in financial conditions. However, should the Italian banking sector's woes continue or intensify, there is potential for a sizable tightening in credit conditions, putting downside risk to our projections.

We think the residential property market will continue on the path of recovery. However, the momentum of the pick-up in the real estate sector is likely to be modest at first, with households still careful, taking into consideration their past real income losses together with Italy moving out of a recession after 3.5 years in contraction. We forecast economic growth will firm to 1.3% in 2016 and 1.4% in 2017, as low oil prices and a fiscal policy stimulus are supportive for a cyclical recovery, and are more than offsetting headwinds from the global backdrop. By providing various tax cuts to businesses and households in 2016, the aim for the government is to maintain economic momentum at a time when the global economy is struggling. Italian households, for their part, should not disappoint: the improvement in the labor market, both recent and to come, combined with the continued moderation in inflation that we expect, will naturally act as consumption enhancers. Istat's recent labor market update showed that the unemployment rate fell by one percentage point to 11.4% in December, the lowest print in three years.

Another supporting factor is the fact that the real estate market itself shows no signs of overvaluation. The price-to-income ratio, a good indicator of affordability, has declined markedly from its 2009 peak and is now in line with its long-term average (see chart 5). Similarly, the price-to-rent ratio indicated a market undervaluation of 6% as of September 2015.

However, and since the start of the year, credit spreads for Italian banks have widened sharply, while bank equity prices have fallen to lows not seen since August 2012. New concerns are adding to existing nervousness about the large stocks of non-performing loans in the Italian banking system, which according to our estimates represented more than 21% of total domestic loans last year. Regulatory changes to implement the EU's Bank Resolution and Recovery Directive, which took effect in January 2016, aiming to protect taxpayers from the costs of future banking system crises and introduce bail-ins for holders of bank equity, junior and senior debt, as well as large depositors (above €100,000) has made it more difficult for the Italian government to create a bad bank to clear banks' balance sheets. The high level of NPLs is likely to remain the main constraint on lending supply activity. Besides, yield spreads on Italian government bonds jumped to 150 bps over German Bunds on Feb. 17, up from about 95 bps at the same period last year. While these levels are low by crisis standards, they are rising even though the ECB is buying the debt of the country in large volumes under its quantitative easing program. The central bank has been successful so far in closing the spread between corporate lending rates in Italy and those in Germany. We think the turmoil in sovereign and bank bond markets in Italy could reopen spreads, leading to a more subdued recovery in credit and in the housing market.

Table 6

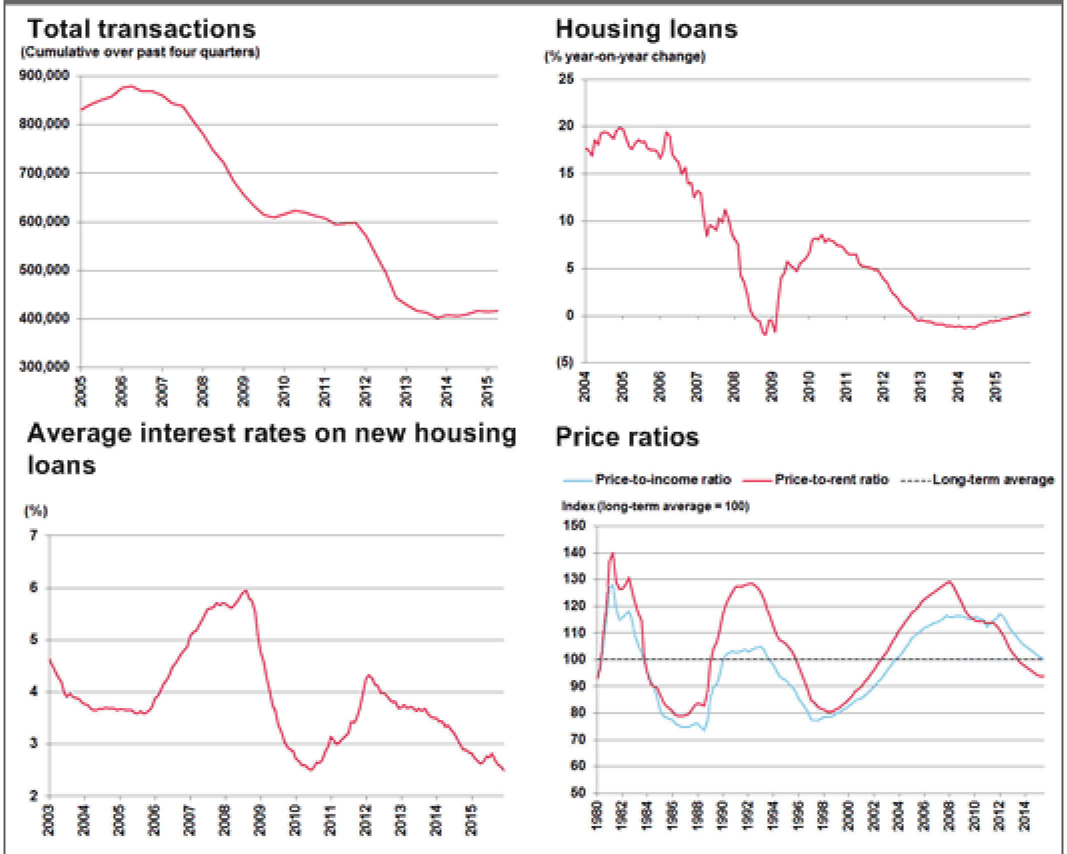
Italian Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	-4.9	-3.6	-1.0	1.5	3.0
Real GDP, % change	-1.7	-0.4	0.6	1.3	1.4
CPI inflation (%)	1.3	0.2	0.1	0.8	1.2
Unemployment rate (%)	12.2	12.7	11.9	11.8	11.3

e--Estimate. f--Forecast. Sources: S&P, Eurostat, OECD, Nomisma.

Chart 5

Italy Housing Market Statistics



Sources: Agenzia del Territorio, Nomisma, European Central Bank, Organisation for Economic Co-operation and Development

The Netherlands Is Seeing A Robust House Price Recovery

We expect house prices in the Netherlands will grow robustly by 3% per year over the coming two years, on the back of lower interest rates, prospects of rising household incomes, and good market affordability. This follows a heavy adjustment by the market between 2009 and 2013, when prices fell by 20%.

Recent trends

The housing market continued to recover last year after five years of decline between 2009 and 2013. House prices are gathering momentum, growing 3.5% last year, after 2.0% in 2014. Reflecting this positive outturn, home sales' volumes continued to recover: 178,000 houses changed hands in 2015, up 16% from previous year. Annual total transactions were, however, down from the peak reached in November, but we expect the weakness will be only temporary. The government did not introduce any major policy measures on Jan.1, 2016. Therefore, house sales were not brought forward to the fourth quarter as has been that case in the past few years (see chart 6). Meanwhile, the number of residential properties on sale is shrinking, according to the home search website huizenzoeker.nl, to 151,000 in January this year from a peak of 235,000 in November 2012, suggesting that the bargaining power is shifting toward sellers. Higher household confidence in the housing market is also leading to more dynamic building activity. Building permits for rental and owner-occupied properties rose to around 55,000 in 2015, the highest level for years. However, The Netherlands needs to build between 80,000 and 90,000 homes every year to meet rising and changing demand for houses, according to ABF research. The shortage in supply should support house prices over the medium term.

Three factors are supporting this acceleration in growth: improving affordability in recent years, the continued slide in interest rates, and the robustly recovering economy. Market affordability stayed good in 2015 even it slightly deteriorated in the second half of the year. Prices have fallen 20% since the peak (34% in real terms), and as a result price affordability indices have adjusted markedly. The price-to-rent ratio was just 4% above its long-term average in the third quarter of 2015 because purchase prices have fallen while rents have risen. Investors have been more interested in the rental market as the returns on rented housing are becoming more attractive following a series of government measures to stimulate private rental and make it more transparent. The price-to-income ratio has also declined but is still 15% above its long-term average.

Lower mortgage interest rates are also lifting households' borrowing capacity and to some extent offsetting the slower growth in households' income. Average interest rates on new loans for house purchases decreased 40 bps to historically low levels, reaching 2.78% in December 2015 (see chart 6). Expansionary ECB monetary policy, low inflation, and still modest economic growth are pushing sovereign bond yields down in the Netherlands. As a result, new lending for house purchases surged 56% in 2015 and mortgage refinancing was up 63%.

The third reason house prices are rising is that the economic recovery has been more robust than previously expected. Real GDP expanded by 1.9% last year. Rising employment and low inflation are contributing to faster growth of real disposable incomes, which is having a positive knock-on effect on the residential property market. The unemployment rate fell to 6.6% in December from a peak of 7.9% in February 2014, while real disposable incomes rose by 2.7% in Q3 2015. Improved chances of finding a job are supporting consumer confidence and releasing pent-up demand from potential buyers.

Future trends

We have lifted our house prices forecasts for the Netherlands to reflect downward trends in interest rates, housing shortages especially in Amsterdam and the three other large cities, and our expectation that the economic outlook should remain resilient to an uncertain international environment. Negative factors, such as high debt levels and credit-restricting measures, are nevertheless still weighing on the recovery.

We expect the Dutch economy to grow by 2.0% in 2016. We have slightly revised down our growth estimate in light of unexpectedly meager GDP growth in Q2 and Q3 2015 and the further scaling down of gas production this year. Much of the growth should be driven by domestic demand. A rise in real income, not least due to the tax cut amounting to €5 billion growth in employment, and low inflation should help private consumption to rise. A further increase in house prices, coupled with higher consumer confidence, should further aid this growth. Household spending and investment should continue to contribute the most, while the contribution of exports is likely to remain minimal, as in 2015. The major downside risk emanates from global uncertainties—the collapse in commodity prices and growing uncertainties about emerging markets' medium-term prospects--that could erode business confidence and delay investment decisions.

Key to the housing market, long-term rates are likely to remain very low throughout the forecast period. The ECB's monetary stance will remain highly accommodative this year and next as its ability to reach its inflation target (close to but slightly below 2%) continues to be challenged by weak commodity prices and depressed emerging market currencies. Dutch mortgage rates are closely tied to the 10-year sovereign bond rate. The latter averaged 0.41% over the period Feb. 1 through Feb. 17 this year, compared with 0.7% on average last year. This recent decline was caused by uncertainty in international capital markets and a flight to safe assets. We do not expect the Dutch 10-year rate will go much beyond its current level in the coming quarters. Borrowing conditions for home buyers will therefore remain very favorable. On the other hand, mortgage regulation changes would weigh more on loans granted for homes. Policy changes included a reduction in the maximum amount that home buyers may borrow on the basis of income, and the implementation of a maximum loan-to-value (LTV) ratio or loan-to-income on properties. Since Jan. 1, 2016, the LTV ratio has fallen to 102% and is likely to decline further to 100% by 2018, suggesting that potential home buyers will need to put aside extra funds to pay additional fees and taxes related to buying a home. Furthermore, the maximum rate at which home owners can deduct interest will fall by half a percentage point per year from 51.5% in 2015 to 38% in 2042. Hence, borrowing to buy a house will become less attractive. Another factor capping house prices is the need for households to deleverage. The Netherlands has, with Denmark, the highest share of outstanding residential mortgage debt to GDP in the EU. The high level of mortgage indebtedness was encouraged by favorable tax treatment, such as deductibility of mortgage interest and the rise of the securitization industry in the 1990s. For the time being, the large decline in interest rates has largely cushioned the impact these credit-restricting measures, but is unlikely to be of the same magnitude this year.

Table 7

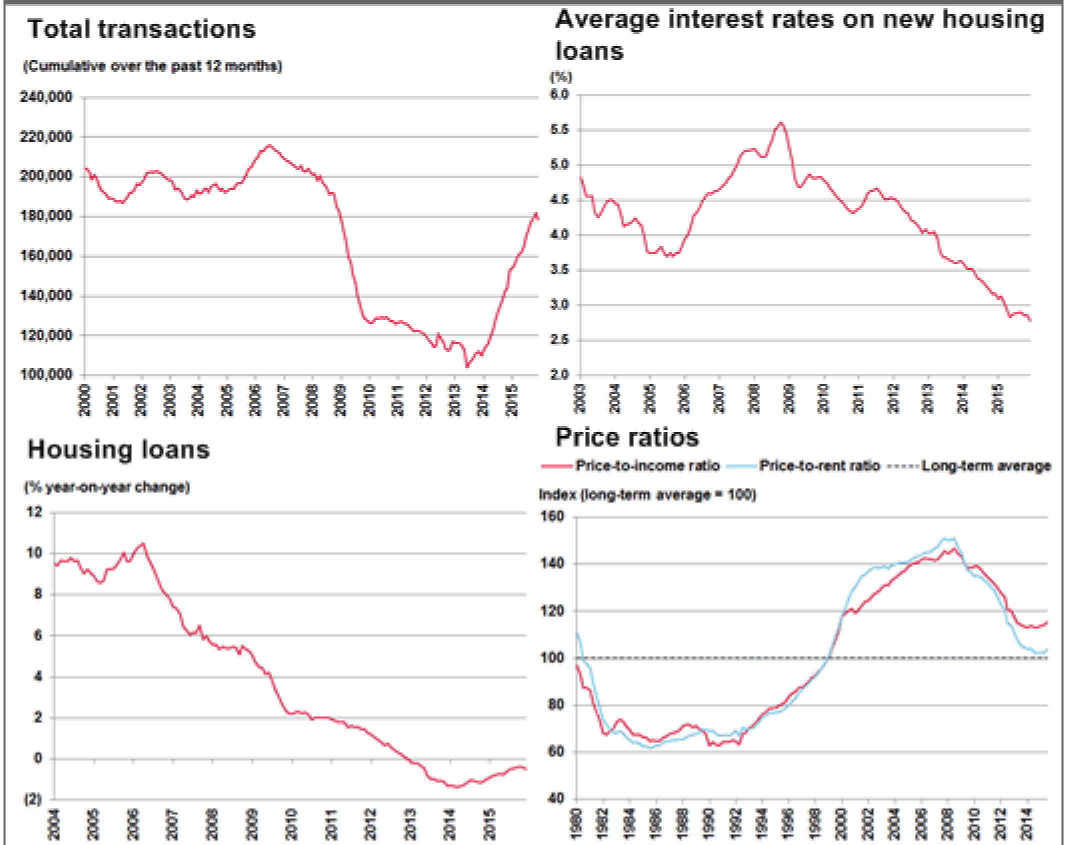
The Netherlands Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	-4.3	2.0	3.5	3.0	3.0
Real GDP, % change	-0.4	1.0	1.9	2.0	2.1
CPI inflation (%)	2.6	0.3	0.2	0.9	1.2
Unemployment rate (%)	7.3	7.4	6.9	6.7	6.4

e--Estimate. f--Forecast. Sources: S&P, Eurostat, Kadaster, OECD, CBS Statistics Netherlands

Chart 6

Dutch Housing Market Statistics



Sources: Central Bureau of Statistics Netherlands, European Central Bank, De Nederlandsche Bank, Organisation for Economic Co-operation and Development, and Kadaster.

Prices In Portugal Are Steadily Improving

Economic recovery and continued incentives to attract wealthy foreign buyers is still helping to lift house prices in Portugal. Nevertheless, the economy still faces structural challenges and investment would be susceptible to global economic headwinds. Overall, we expect prices to rise by 2.5% this year and by the same amount in 2017 (see table 8).

Recent trends

Residential property prices grew at their highest pace in December 2015 and recorded an annual growth of 4.5%, according to INE statistics. Prices grew strongly in populous and tourist regions, such as Algarve (+7.8% in December) Lisboa (+5.3%), and R.A. Madeira (+6.6%), and at a slower pace in less popular regions such as Centro (+0.7%). The RICS Portuguese Housing market survey showed that sales activity leveled off in December. However, forward-looking indicators remained generally positive. Respondents are projecting prices will rise by around 2% next year. Meanwhile, the national confidence indicator, a barometer of near-term price and sales expectations, remained steady and positive for the third consecutive month, pointing to sales resuming their upward trend in the near future.

The housing market recovery is backed by strong interest from foreign buyers. The strong sterling pound has helped generate confidence in the market because U.K. buyers have traditionally been among the most in the region. Tax incentives such as "the golden visa" scheme or the non-habitual residents' tax regime, mainly attractive for retired workers and high-net-worth individuals, are also helping. The government scheme granting five-year residency permits to non-EU citizens who buy properties of at least €500,000 attracted €1.6 billion in property purchases from foreign investors between October 2012 and January 2016, according to the Immigration and Borders Service. Eighty percent of the 2,853 permits have been issued to Chinese citizens. This trend is, however, on the decline: 1,500 resident permits were issued in 2014, but only 766 in 2015.

The improving sentiment on the housing market is starting to be reflected in construction activity. The total number of construction permits issued in the 12 months to October 2015 was up 16% to a modest 7,800 units from the same period in 2014. This is, however, still well below the 65,000 recorded in the year 2007. Meanwhile, completions of new family housing units continue to fall, although the pace is easing. The number of dwellings completed declined by 23% year on year in September of 2015.

The ECB's very accommodative monetary stance is creating very favorable financial conditions in Portugal and reviving the mortgage market. New housing loan increased by 80% in 2015 and reaching volumes not seen since 2011, while mortgage interest rates fell by 80 bps in 2015. However, Portugal's still fragile banking system struggles to accommodate the correction of the economy's high dependency on external funding and investment. Banks remain dependent on the ECB to roll over debt maturities (for 6% of their assets as of December 2015) previously funded by external investors. Meanwhile, it is still holding a large stock of nonperforming legacy assets (13% of domestic loans in 2015 according to our estimates), which is hampering the supply of credit. Hence, annual growth of net housing loans is still negative, at -3.9% in December 2015.

More fundamentally, however, the housing market is benefiting from positive structural factors. As part of the Economic Adjustment Programme agreed with the European Commission, ECB, and IMF, housing rental market reforms have made the market more dynamic, with rental contracts being gradually upgraded to near-market rates. These legal changes are also attractive for investors, especially in large cities, such as Lisbon or Porto. Since 2011, rents have been rising, while at the same time purchase prices have declined. As a result, the price-to-rent ratio is very low compared to the long-term average, suggesting that the market may be undervalued by 22% as of September 2015. In the same period, the price-to-income ratio, a good indicator of affordability, indicates a market undervaluation of 19%.

Future trends

We expect the economy will continue its recovery this year after growing 1.4% last year. We anticipate real GDP to grow 1.7% in 2016 and in 2017. With the domestic economy improving, the key drivers remain in place for the housing market to continue its recovery over the next two years. While we continue to be optimistic about the upward trend, considerable risks remain. The housing market needs continued support from credit to maintain the momentum.

The headwinds from the current turmoil in financial markets and the weaker growth outlook in many economies (including the eurozone) could weigh on investment and exports in Portugal. Portuguese bonds have been recovering in recent days after a major sell-off in mid-February. While this trend was common to the eurozone periphery, Portugal was the most affected. At one point, the spread over the German bund was well over 100 bps higher than at the end of January, while the equivalent Spanish and Italian spreads jumped by around 30 bps-40 bps. This is because political uncertainty over potential budget shortfalls, the partial reversal of certain reforms, and a weakening outlook have raised concerns in the marketplace about the soundness of the fiscal path. Should the Portuguese sovereign bond market woes remerge or intensify, there is potential for a sizable tightening in credit conditions, putting downside risk to our projections.

More structurally, the economy still faces several challenges in the medium term. Despite the recent improvement, Portugal has a long way to go before it achieves a full recovery. GDP is still 6% lower than in early 2008. Moreover, we expect the economy will remain constrained over the medium term. Unemployment, although falling, is still high at 11.8% in December 2015. Although low inflation has some positive implications for competitiveness, it also increases the economy's considerable debt burden. We think households could be reluctant to take on more debt, particularly in an environment of still high unemployment. Housing policy in Portugal has allowed households for many decades to buy a home by conferring mortgage subsidies, helped push up home ownership from 52% in 1981 to 75% in 2015, according to eurostat.

Table 8

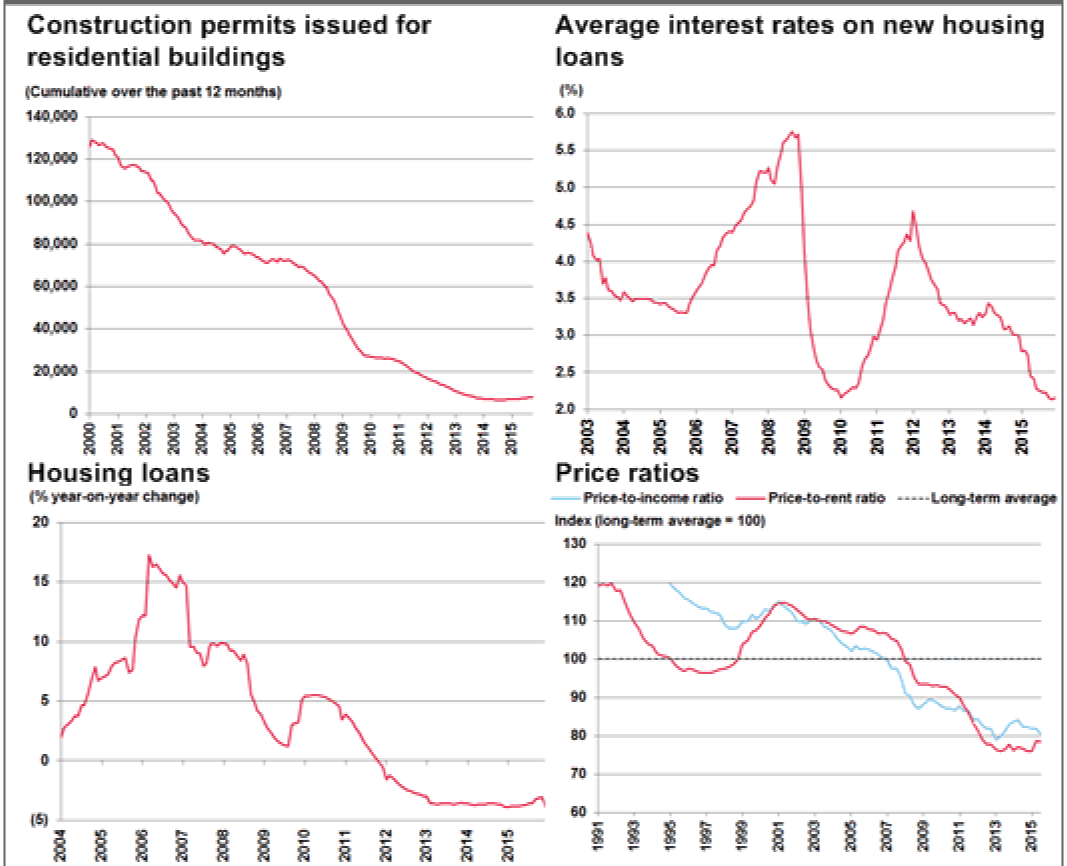
Portuguese Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	0.5	2.1	3.6	2.5	2.5
Real GDP, % change	-1.1	0.9	1.4	1.7	1.7
CPI inflation (%)	0.4	-0.2	0.5	1.2	1.5
Unemployment rate (%)	16.4	14.1	12.6	11.3	10.2

e--Estimate. f--Forecast. Source: S&P, Eurostat, BIS/private sector.

Chart 7

Portugal Housing Market Statistics



Sources: Organisation for Economic Co-operation and Development, European Central Bank.

Political Uncertainties Could Slow Spain's Housing Market Recovery

Robust economic growth, a fall in unemployment, and growing interest from foreign buyers should underpin Spain's housing market recovery over the coming two years, in our view. However, political uncertainty following the inconclusive December 2015 election results could weigh on the market recovery by raising mortgage rates and lowering consumer confidence. Overall, we forecast house prices will rise at a slower pace this year, by 2.5% (see table 9).

Recent trends

Economic growth remained solid throughout 2015, leading Spain to outperform its neighbors by a fair margin. Real GDP grew 0.8% in the final quarter, at the same rate as was observed in Q3. Full-year growth was 3.2%, the fastest pace in eight years, while the eurozone as a whole grew by 1.5%. Consumer spending has been a key source of growth, expanding 1% in the third quarter, as very low inflation boosted purchasing power. We estimate that real disposable incomes grew by a strong 2.4% last year, from 0.6% in 2014. Fixed investment benefited from very favorable financial conditions and, reflecting stronger domestic demand, rose about 6% last year. Even more comforting, Spanish exports had a robust performance despite a weaker non-European trade environment. They rose 6%, outperforming most of Spain's regional peers.

The strong pickup in economic activity translated into a marked improvement in the labor market. For 2015 as a whole, full-time employment has increased by 501,700 while the number of part-time employees increased by 23,300, bringing the unemployment rate down to 20.7% by year-end from 23.6% a year earlier. The rise in employment was broadly distributed across sectors, with 421,500 additional jobs in the service sector, 50,800 in agriculture, 28,100 in construction, and 24,600 in industry. Approximately 66% of the new jobs were with temporary contracts.

Robust economic growth and falling unemployment (admittedly from very high levels) have underpinned the recovery in the residential real estate market. The improvement has been particularly visible in the transaction numbers. In the 12 months to December, sales were up 11.1%, compared with 2% over the same period a year earlier. As in other eurozone countries, Spanish buyers took advantage of the very low mortgage rates. In December, mortgage rates reached an all-time low of 1.98%, according to ECB data. But attractive rates and better economic conditions were not the only factors behind the recovery in the Spanish housing market. According to figures from the Ministry of Public Works, sales to foreign buyers increased year on year in the latest quarter of last year by 17.2%. The nationality with the greatest volume of home purchases was the British, with 19.8% of the total. French buyers accounted for 8.1% of sales to foreigners, Germans 7.6%, and Belgians 6.4%. On the other hand, sales to Russian buyers have dropped from 9% in 2013 to less than 4%, on the back of a much weaker ruble exchange rate against the euro and a weaker Russian economy.

Strong sales contributed to the continued decline in the stock of unsold homes, a legacy from the pre-2008 boom years in the construction sector, which left the country with a massive over-supply of dwellings. According to official figures, unsold new housing stock at the end of 2014 amounted to about 540,000 units, down 17.5% from the pre-crisis peak. While on a national average, 2.1% of Spain's housing stock is unsold, this proportion is higher in provinces that are major tourist areas, where there is a higher proportion of second homes. By contrast the provinces with a ratio of unsold housing below the national average include Madrid, Barcelona, and Valencia.

Home prices continue to recover, increasing 4.5% in the year to Q3. But at the end of September 2015 they still stood 33% below their September 2007 peak. This strong correction has allowed the affordability ratio to improve markedly in the the past seven years. At the end of last year, the price-to-income ratio was back to levels very close to its long-term average.

Future trends

The economic outlook for the coming two years remains positive. Consumer demand growth should remain close to 3%, fueled by strong job creation and purchasing power gains. Owing in particular to income tax cuts, disposable incomes should grow by about 3.1% in nominal terms in 2016. Meanwhile, exports should continue to expand at a good clip despite a challenging global environment, as Spain is benefitting from increased competitiveness and a weak euro. Finally, capital formation has been recovering after years of contraction as domestic and foreign sales prospects have been improving.

Yet, despite this positive economic background, political uncertainties may somewhat complicate the housing market's prospects. The general elections in December put an end to the two-party system that has dominated Spanish politics for decades. The ruling conservative Popular Party won overall, but fell far short of obtaining a majority of seats. Given the highly fragmented new parliament, forming a government has proven very difficult. On Feb. 2, the PSOE leader Mr. Pedro Sanchez was invited to form a new government, with a vote of investiture scheduled for March 3. At the time of writing, it remains highly unclear whether Mr. Sanchez will succeed in achieving an absolute majority at the first vote and a simple majority at the second, as required by the constitution to become prime minister. If not, the parliament would have two months to elect a prime minister before the king has to call new elections, which would take place two months later, in late June. So it appears likely that political uncertainties will remain high through the first half of the year. Researchers at Stanford University have developed a set of economic policy uncertainty indices for each major country (see "Measuring Economic Uncertainty," http://www.nber.org/papers/w21633). In the case of Spain, the index has reverted to levels close to the peaks observed during the 2011-2012 sovereign crisis since the December elections. We believe the political uncertainties could affect the housing market in two ways. First, they could widen the gap between Spanish bond yields and German yields as markets become worried that a deadlock in the country could affect its fiscal prospects. Higher yields would translate into higher mortgage rates. Second, they could more broadly weigh on business and consumer confidence, causing large spending decisions to be delayed. Overall, we expect prices will experience a smaller rise this year of 2.5%, than in 2015 (4.5%).

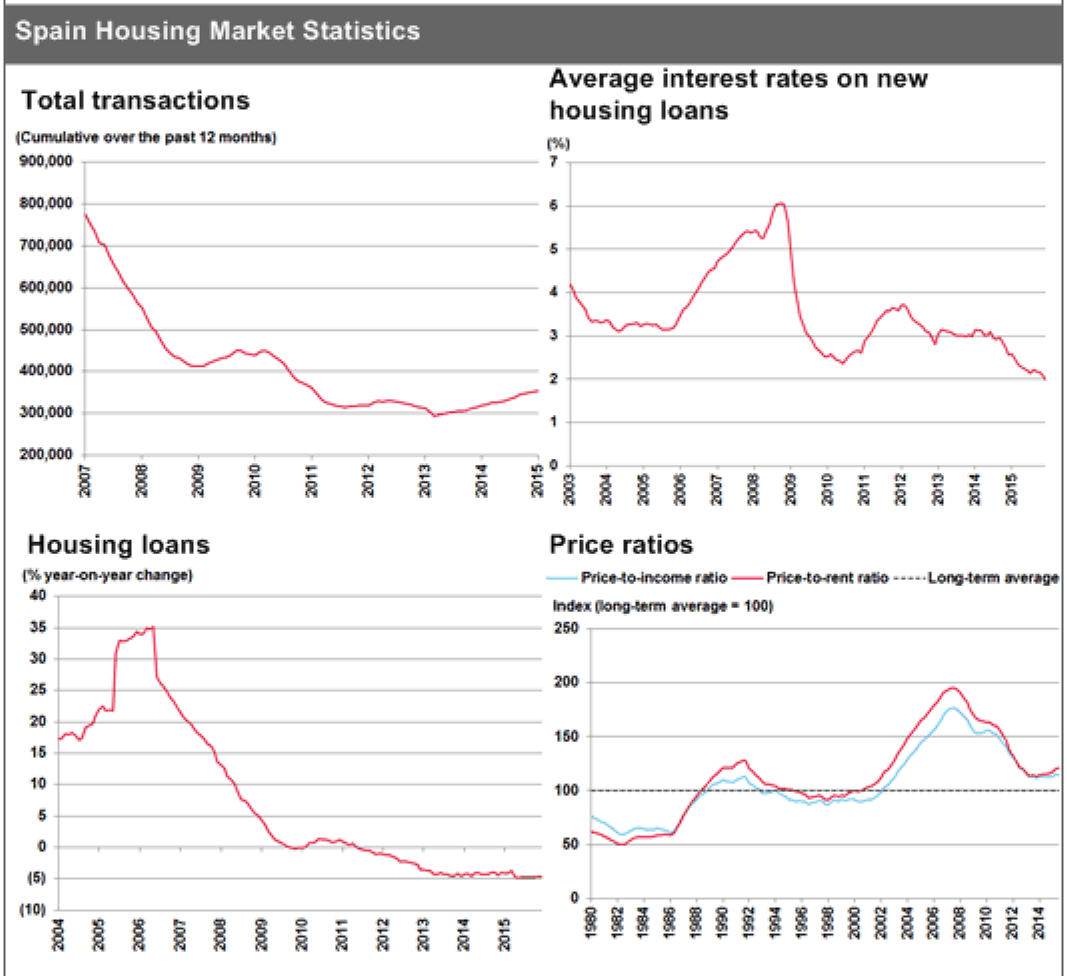
Table 9

Spain Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	-6.3	1.8	4.5	2.5	4.0
Real GDP, % change	-1.7	1.4	3.2	2.7	2.4
CPI inflation (%)	1.5	-0.2	-0.6	0.8	1.3
Unemployment rate (%)	26.1	24.5	22.1	20.5	19.2

e--Estimate. f--Forecast. Sources: S&P, Eurostat, Banco de Espana, OECD

Chart 8



Switzerland's Housing Market Is Seeing A Soft Landing

House price momentum in Switzerland will likely stay moderate this year and next, as it has been since 2015. Average residential real estate prices have increased by more than 40% since 2006 on the back of immigration, rising employment and incomes, low borrowing costs, and a lack of performing investment alternatives. However, stricter mortgage regulations initiated since 2012, limited affordability, have started to cool market increases in recent years. We forecast price rises of 1.5% both in 2016 and 2017.

Recent trends

Switzerland's housing market slowdown continued in 2015, with prices growing by 1.3% on average in 2015 compared to 2.2% on previous year after an average of 5% between 2008 and 2013 according to Swiss National Bank (SNB) statistics. However, the trend differs between regions and market segments. High prices and tougher lending conditions are reducing market affordability and incentivizing buyers to turn to more affordable segments and regions.

For instance, single family home prices, which grew the least in the past few years, are now regaining some momentum. Prices rose by 2.3% year on year in the final quarter compared to a 0.4% rise in Q4 2014. In contrast, owner-occupied apartment price rises slowed to 1.6% in Q4 2015 from 1.8% in Q4 2014, while rental apartment prices posted no growth. Similarly, house prices grew the fastest in the regions where they had growth least in the past eight years, such as the Northwestern Switzerland and the Berne area (up 3.1% and 4.7%, respectively). By contrast, regions that had experienced the sharpest increases, saw house prices fall, as was the case in the Lake Geneva area, where prices declined by 2.4% on average last year.

Several conflicting factors are shaping the Swiss market. While slower economic growth, tougher lending conditions, and reduced affordability are dampening demand for housing, continuing record low mortgage rates and negative interest rates on a large number of assets appear to be making it more attractive to purchase residential properties.

The SNB's decision to abandon the exchange rate ceiling in January 2015 had a clearly negative impact on the economy. Real GDP, which grew close to 2.0% in 2014, is likely to have clocked a growth rate of 0.8% last year. This is because export prices and margins declined strongly, hitting business investment and labor-intensive sectors. Unemployment rose slightly to 3.4% in Q4 2015 against 3.2% in Q4 2014. Employment in tourism, consumer services, and manufacturing has been hit. Meanwhile, retail sales were down 3.4% in December, also because Swiss consumers tend to shop more in France and Germany and buy imported goods. Recent indicators don't yet suggest that the economy has moved into a clear recovery. The manufacturing Purchasing Managers Index (PMI) moved slightly above the 50 threshold at 50.4 in December before edging down to just 50 in January, suggesting a return to growth. However, the employment sub-index remains in contraction, not boding well for housing demand.

Nevertheless, extremely low borrowing costs continue to support the real estate resilience. Declining mortgage interest rates are raising households' borrowing capacity and bolstering decisions to buy. Switzerland has one of the lowest home ownership ratios among developed countries, with 44% owning their own home. Mortgage interest rates are historically low: fixed-interest five-year rates reached 1.29% last December, down from 1.36% in June. However, regulatory measures introduced by supervisory authorities over the past few years have created more obstacles to households seeking home ownership. The Swiss regulator's initiatives to curb credit-driven house price inflation included tighter guidelines for granting new mortgages, compulsory amortization, and higher regulatory risk weights for mortgage lending above certain loan-to-value ratios since July 2012, which aim to narrow the range of potential buyers. However, the SNB's recent macro prudential measures to cool the residential property market are reducing the number of people able to undertake a credit. This is evident in the decelerating growth in mortgage volumes for private households, reported at just 3.1% year on year in December 2015, compared to 3.4% in December 2014 and an average of 5% between 2011 and 2013.

Future trends

The favorable financing environment and a more favorable economic outlook this year and in 2017 is likely to keep house price growth in positive territory. This is regardless of the stricter mortgage regulatory measures, and uncertainty about future demand as the anti-immigration initiative continues to harbor downside risks. For now, latest data show that cumulative net migration between January and September 2015 stood at nearly 59,000, only slightly lower than that recorded the previous year. This is mainly due to growth in employment, which has remained solid. Assuming there is no significant change by the end of the year, this would make net migration of resident foreigners

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lower than in 2014, but only slightly off the average for recent years.

We expect that Swiss GDP will grow by just 1.1% in 2016 as a whole after an expansion of 0.8% in 2015. This is significantly lower than our projections for eurozone growth of 1.8% in 2016 and 1.5% in 2015. However, in the past few weeks as global markets have become very volatile, the Swiss franc strengthened to €1.088 on Feb. 24 from €1.11 at the beginning of the month. Against a background of investor risk aversion and likely further interest rate reductions by the ECB, the franc may gain further ground. But the SNB will be willing to keep the Swiss franc euro exchange rate ranging between 1.07 and 1.10, even if it requires increased intervention. In 2017, as we anticipate the impact of the exchange rate shock will fade and as global demand gathers pace, we expect growth to pick up to 1.9%.

Interest rates should remain at an extremely low level by historical standards over the forecast horizon, supporting demand for owner-occupied housing. This is because Switzerland's monetary policy is closely tied with that of the eurozone. Against a backdrop of increased global market turmoil, persistent low inflation in the eurozone and risks of second-round effects of subdued headline inflation, the ECB Governing Council is likely to ease its monetary policy further in March. We still expect a further reduction of the deposit rate, currently at -0.30%, to combat the appreciation of the euro. Besides, the ECB has extended its bond purchase program until March 2017. To prevent an appreciation of the Swiss franc against the weakening euro, the SNB is likely to keep its very accommodative stance unchanged until at least the end of the ECB's asset purchase programme, hence not before 2017. Until then, upside potential for long-term rates is limited. In the current environment, characterized by very low and even negative returns, the yield differentials between real estate investments and fixed-rate bonds could remain large, thus boosting the incentives for investments in properties. Yields on 10-year Swiss government bonds have been trending in negative territory since July 2015, reaching -0.3% in mid-February.

Table 10

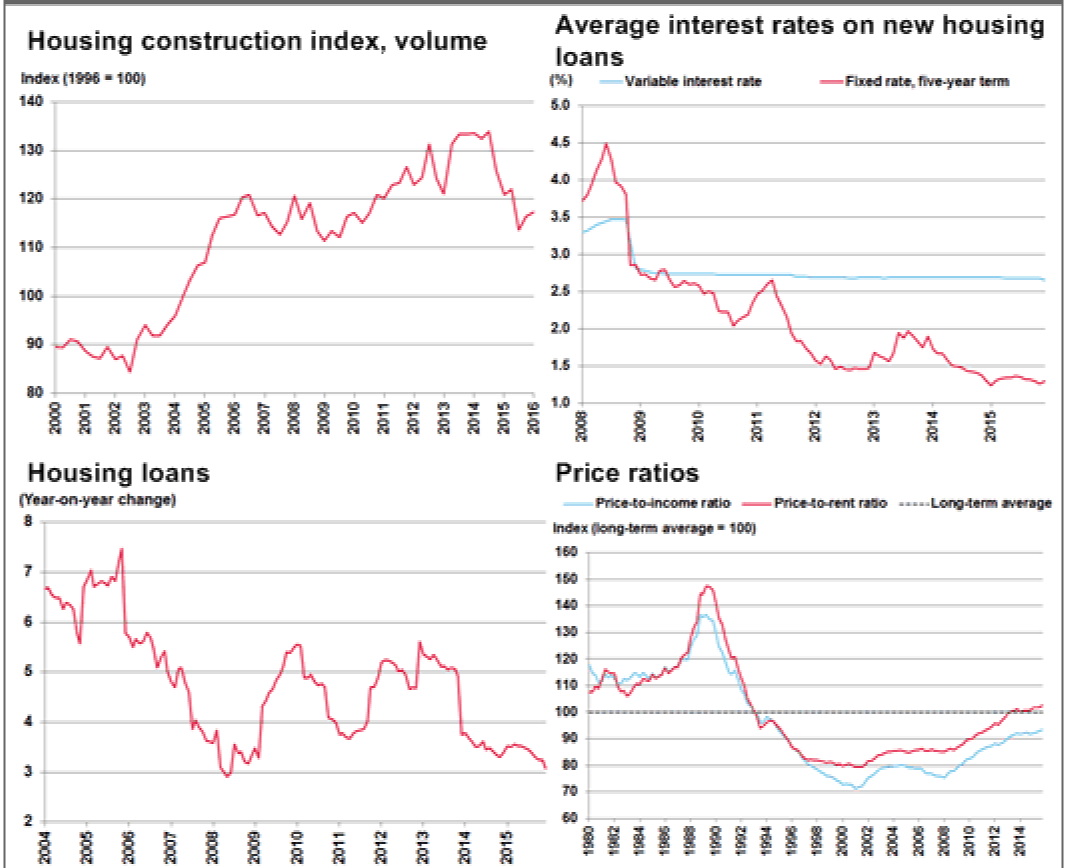
Swiss Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	4.7	0.4	2.3	1.5	1.5
Real GDP, % change	1.9	1.9	0.8	1.1	1.9
CPI inflation (%)	-0.2	0.0	-1.1	-0.3	0.4
Unemployment rate	3.2	3.2	3.3	3.4	3.3

e--Estimate. f--Forecast. Sources: S&P,OECD, SNB, State Secretariat for Economic Affairs.

Chart 9

Switzerland Housing Market Statistics



Sources: Credit Suisse, Swiss Contractors' Association, Swiss National Bank, Organisation for Economic Co-operation and Development.

U.K. Prices Still Rising On Tight Supply And Favorable Financing

Conditions for ongoing robust gains of U.K. residential property prices remain intact: Rising economy-wide real incomes, falling unemployment, and a persistent structural shortfall of supply in key regions is likely to underpin price increases, helped in addition by favorably low mortgage rates. Government measures to mitigate the shortage and address deteriorating affordability for first-time buyers are unlikely to significantly slow this upward momentum. After an estimated increase of 7% in 2015, we forecast U.K house prices will rise 5% this year, before slowing somewhat to 3% in 2017 (see table 11).

Recent trends

The U.K. economy saw a relatively quick and robust recovery from the 2008/2009 financial crisis, with average annual GDP growth of 2% over the period 2010-2015, compared with only 0.8% for the eurozone. Despite the robust recovery in terms of GDP growth, however, unemployment stayed stubbornly high, at around 8%, until mid-2013, when it started its dramatic decline to 5% in Q4 2015, the lowest since 2005. Yet, when it eventually came, the labor market recovery was jobs-rich but cash-poor, with earnings' growth not accelerating in line with tighter labor market conditions.

Despite intermittent positive signals, such as when wage growth temporarily accelerated in Q4 2014 and Q1 2015, the broad picture of an employment-rich but wage-poor labor market appears to still apply. This is at least suggested by more subdued year-on-year wage growth of the regular component of average weekly earnings at the end of last year, which was 2%, down from 2.7% in the previous two quarters (total pay slowed even more). At the same time, unemployment, on the claimant count measure, fell to 2.2% in January, the lowest since 1975.

Yet, rising employment, falling inflation, and the moderate acceleration of wage growth translated into a more robust growth of economy-wide real incomes. This, in combination with the key ingredient of low mortgage rates (both two-year fixed and floating rates remaining just below 2%), as well as the persistent shortage especially in London and the South East, helped U.K. house prices ultimately regain momentum. They rose by 10% in 2014, and a further estimated 7% in 2015, according to mix-adjusted house prices data from the Office for National Statistics (ONS), after a lackluster average of only 2.9% a year in 2010-2013.

Moreover, the search for yields in a low interest rate environment has boosted the now sizable buy-to-let market (BTL). The Council of Mortgage Lenders (CML) estimates that BTL mortgages now make up 16% of the total stock of all outstanding mortgages. Increased BTL activity is likely to have contributed to the house price recovery.

Future trends

Favorable financing conditions in the form of low mortgage rates are set to prevail in the medium term. In fact, mortgage rates which are tightly linked to the Bank of England's (BoE) policy rate are now likely to stay lower for longer than initially expected. The hike that we and the markets had expected for Q4 2015 at the time of our previous report in July last year, did not materialize, and it now looks like the first hike since the BoE cut its rate to the all-time low of 0.5% six-and-a-half years ago may now only come in Q2 2017. The BoE's so-called forward guidance is still in place. Forward guidance means central banks communicate to the markets under which conditions they are likely to raise rates and at what pace. The BoE's key condition is a strong pickup in economic activity to a degree that this significantly reduces the slack in the economy. The symptoms of this are, apart from strong GDP growth, robust and sustained wage growth, and an acceleration of core inflation (an inflation measure that strips out the more volatile prices such as fuel).

None of these conditions for a first rate hike were satisfied at the end of last year. GDP growth in 2015 turned out lower than expected at 2.2% and, more importantly, lower than the level necessary to significantly reduce the slack in the economy. Despite the temporary strong boost in pay growth, the slowdown at the end of last year was "significantly more pronounced than anticipated", according to the BoE's Monetary Policy Committee (MPC). Furthermore, core inflation remained at 1.5% throughout 2015, well below the 2% target, and markets still expect inflation will not exceed 1.5% in the 24 months ahead. Crucially, according to the Monetary Policy Summary released after the Feb. 3 decision to leave the policy rate unchanged at 0.5%, the BoE does not expect GDP growth to exceed average rates this year, and expects wage growth to continue to turn out moderate. As a result, while conditions for a first hike may gradually move in the right direction this year, they are, in our opinion, unlikely to trigger a first hike before mid-2017 when improvements should become more sustained. The BoE also iterated in February that any future hikes will be moderate and more spaced out over time than in previous cycles. Incidentally, the low risk of surprise hikes of the BoE's policy rate in the medium term allows lenders to offer extremely low fixed-term mortgage rates. As a result, the market has shifted from the traditional flexible rates toward fixed rates, accounting for around 80% of gross new mortgage lending in the past three years.

All this means that mortgage rates should stay relatively low even well beyond 2017, keeping mortgages more affordable, which in turn should underpin house price growth. At the same time, macro prudential measures in place since mid-2014 that limit the share of mortgages with a loan-to-income ratio of 4.5x and above to 15% of the big lenders' residential mortgage portfolio should help keep house price inflation in check, despite upward pressures.

Moreover, some policy measures, already in place or forthcoming, are likely to exert some downward pressure on residential property prices, but they are unlikely to bring the housing market recovery to an end. One such measure is the new 3% stamp duty on the purchase of second homes and BTL properties that will come into force from April this year as part of the government's effort to improve market access for first-time buyers. The likely rush of buyers to benefit from current stamp duties until the end of March may see property prices (and transactions) rise in Q1 this year, followed by a temporary stagnation or even decline. For the year as a whole, though, prices should still gain around 5%, as they pick up again in the second half of the year, underpinned by strong demand from first-time buyers and those looking to upgrade to a bigger primary home, both groups being unaffected by the new tax.

The BTL market's momentum is likely to slow beyond this year. The government's plans to lower the tax relief on profits from BTL property are to be fleshed out later this year, and should come into force from 2017. Furthermore, as of February this year, in an effort to curb illegal immigration, the government requires landlords to verify that prospective tenants have the right to rent in the U.K. These measures may further reduce the appeal of BTL investments and may exert downward pressure on residential property prices.

However, one of the key drivers of U.K. residential property prices remains demand that persistently outstrips supply, especially in key regions, such as London and the South East of England. In the financial year 2014/2015 (latest data) 150,000 permanent homes were completed in the U.K., in line with the average over the previous five years. While new housing starts in the past two financial years of 160,000 and 165,000, respectively, indicate supply should pick up somewhat, it still falls well short of the over 200,000 new households forming each year over the next two decades that are currently projected by the Department for Communities and Local Government. This structural driver is likely to continue to exert upward pressure on house prices in the future.

Table 11

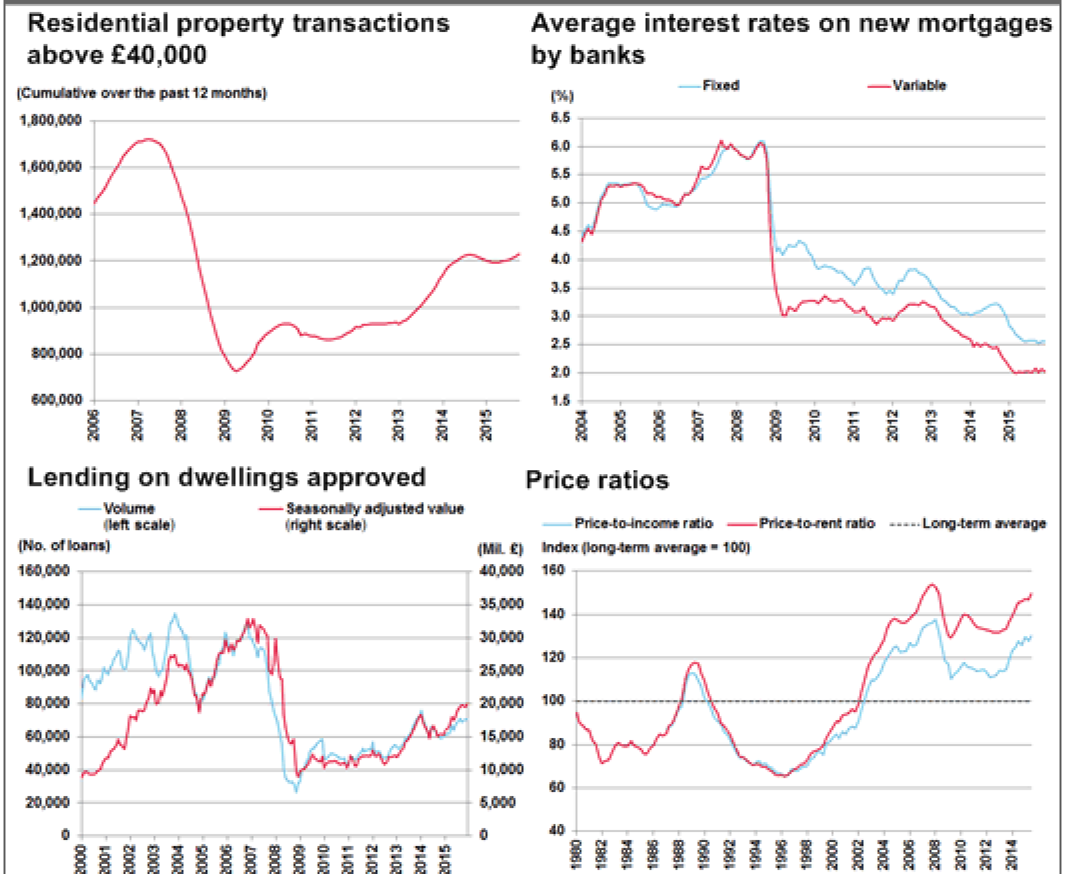
U.K. Housing Market Statistics

	2013	2014	2015e	2016f	2017f
Nominal house prices (% change year on year)	5.5	10.0	7.0	5.0	3.0
Real GDP, % change	2.2	2.9	2.2	2.4	2.2
CPI inflation (%)	2.6	1.5	0.0	1.1	1.7
Unemployment rate	7.6	6.2	5.4	5.3	5.2

e--Estimate. f--Forecast. Sources: S&P, Office for National Statistics, OECD, Department for Communities and Local Government.

Chart 10

U.K. Housing Market Statistics



Sources: HM Revenue & Customs, Bank of England, Datastream, Organisation for Economic Co-operation and Development, Department for Communities and Local Government.

We have determined, based solely on the developments described herein, that no rating actions are currently warranted. Only a rating committee may determine a rating action and, as these developments were not viewed as material to the ratings, neither they nor this report were reviewed by a rating committee.