

Portugal and the future of housing

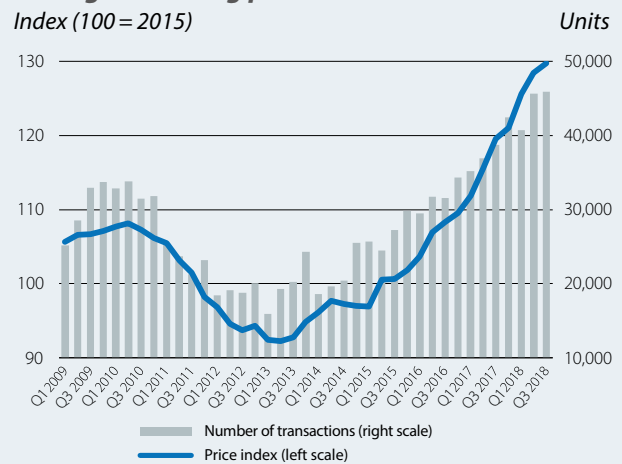
The real estate sector is of the utmost importance to the Portuguese economy. Real estate and construction activities account for 7.3% of total employment and the construction sector was responsible for 8.1% of Portugal's GDP in 2018. In addition, housing is the main asset of households: in 2017, real estate accounted for 48% of total family wealth. In light of its importance, below we analyse the recent developments in the sector and its future outlook.

In the last five years, the housing sector has experienced great changes, with a strong upturn in real estate transactions and a rise in housing prices (which have amassed an increase of around 40% since 2013, as seen in the first chart). Broadly speaking, this rise in housing prices has been the result of the conjunction of a low supply of real estate property and significant growth in demand. On the supply side, the sharp fall suffered by construction activity in the last financial crisis held back new construction of homes and has made it difficult for the supply to meet the increased demand (in fact, during the last five years, over 80% of transactions involved existing properties).

On the demand side, one factor that has led to a boost has been common among most countries in the euro area: the environment of low interest rates with which the ECB has stabilised and stimulated the European economy in recent years. This is because, indirectly, the lower yield of financial assets that led to this environment facilitated an increase in the demand for housing for investment purposes. Another of the factors that galvanised the demand for housing in Portugal is related to the recent tourism boom. The strong growth in tourism activity has intensified demand for real estate among investors, which contributed to the boom in the real estate market through the growth in tourist accommodation and the restoration of buildings. Finally, the dynamics witnessed in the real estate market in recent years have also been influenced by demand for real estate among non-residents, especially under the Golden Visa scheme adopted in 2012, which stimulated the demand for housing by granting tax benefits to non-residents who purchase a property.

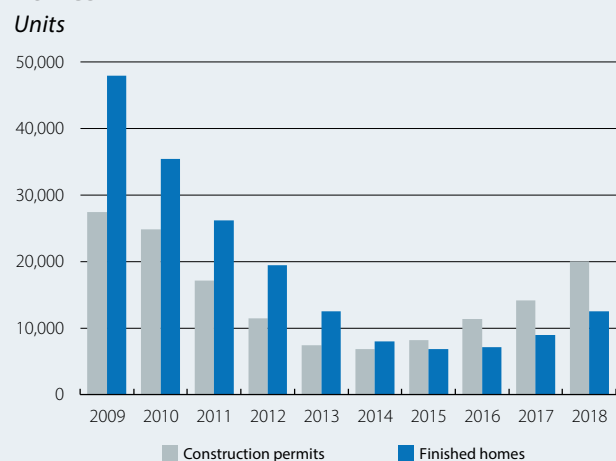
Over the next few years, a moderation in demand is expected due to the slowdown in tourist activity, while the financial conditions will remain in accommodative territory. As such, the combination of the slowdown in demand and a greater buoyancy on the supply side (which, as shown in the second chart, can be seen in the increase witnessed since 2015 in both new construction permits and in the number of homes already completed) will contribute to a moderation in price growth.

Portugal: housing prices and transactions



Source: CaixaBank Research, based on data from the National Statistics Institute of Portugal.

Portugal: construction permits and finished homes



Source: CaixaBank Research, based on data from the National Statistics Institute of Portugal.

What has been the trend in households' purchasing capacity and what can be expected in the medium term?

According to the latest data,¹ buying a home is currently the equivalent of around nine years of an average adult's gross income, one year more than in September 2016 and two more than in September 2012, when the average price of housing reached its low point.² Although the series relating to residential real estate transactions is relatively short (it began in 2009), its trend shows a decline in the accessibility of housing due to the marked growth of real estate prices in recent years.

1. September 2018 is the latest period for which there is information on households' disposable income.

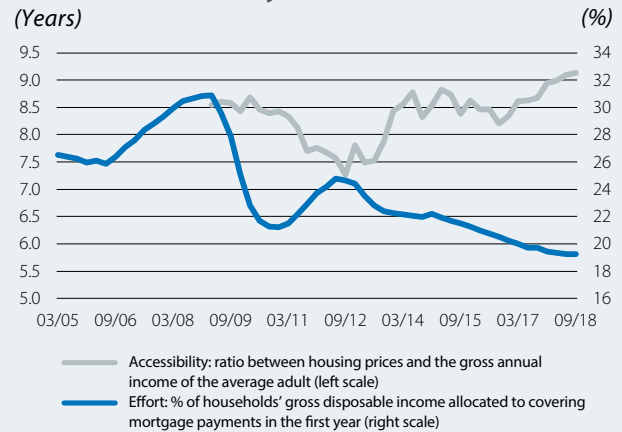
2. Data based on the statistics from the National Statistics Institute of Portugal on the number and value of transactions involving family homes.

Given that the majority of households take out a loan to buy a home, we must also analyse the trend in the so-called «mortgage effort», i.e. the percentage of the annual gross disposable income needed to cover mortgage payments during the first year. In addition to considering the trend in housing prices and in household income, this index also takes into account changes in interest rates over time. In September 2018, the mortgage effort index stood at 19.3%, below the high-points observed in 2009 (28.3% on average for the year), reflecting the impact of the marked decline in interest rates following the ECB's accommodative monetary policy (see third chart).

Over the next few years, as the ECB gradually withdraws the monetary stimulus, the effort index will no longer benefit as much from the low interest rate environment of recent years. Nevertheless, our estimates suggest that the normalisation of the ECB's monetary policy will have a moderate impact on households' mortgage effort. In particular, we estimate that if the average annual 12-month Euribor rate³ were to increase to 0.875%, the mortgage effort index would suffer a 4.1-pp rise to reach 23.4%, still below the levels observed in 2009. In fact, in order for the household mortgage effort to come close to the levels seen in 2009, the 12-month Euribor rate would need to reach around 3%, an unlikely scenario in the medium term according to the consensus of analysts' forecasts (and those of CaixaBank Research). Furthermore, these figures only show the direct impact of interest rates. However, over the next few years, households' disposable income is expected to continue to grow, driven by the improvement in the labour market, which will help to moderate the effect of higher interest rates on the effort required for households to buy a home (see fourth chart).

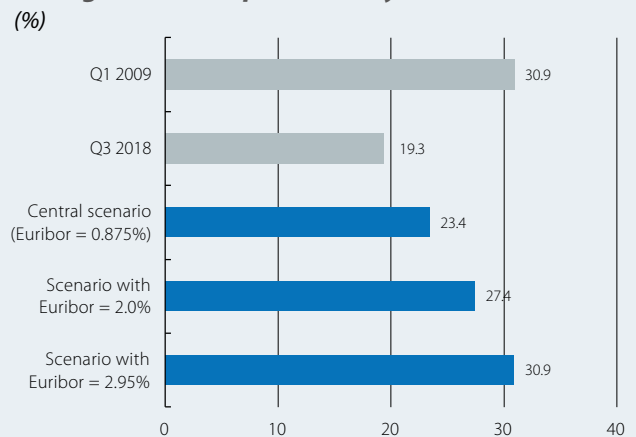
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Portugal: accessibility and effort required for households to buy a home



Source: CaixaBank Research, based on data from the National Statistics Institute of Portugal.

Portugal: effort required to buy a home



Source: CaixaBank Research, based on data from the National Statistics Institute of Portugal.

3. Since 2016, the 12-month Euribor rate has been the most widely-used index in new lending transactions for home purchases in Portugal.