

Housing Affordability Index: Q1 2023

Housing affordability fell further, but the bottom is near

- Housing affordability kept decreasing; housing became unaffordable in Vilnius
- Apartment sales were down, but prices were sticky

The rapid increase in wages was insufficient to counter the negative impact of high interest rates and still-elevated prices. As a result, housing affordability fell in the Baltics at the start of 2023. The housing affordability index (HAI) value in Vilnius dipped below 100 - a reading last observed back in 2009. Housing in Tallinn was still classified as affordable, but the 100 threshold is near, and the primary market has been unaffordable for some time now. In Riga, housing affordability is the highest among the Baltic capitals, however, a downward trend is also present there. Furthermore, the apartments built after 2000 are now on the verge of no longer being affordable for the average household in Riga.

The decrease in affordability is clearly reflected in the reduced transaction count in the Baltic capitals. Both primary and secondary housing markets are experiencing the negative impact – registered purchase activity has waned, and the number of new reservations has also fallen. The weak economic environment and the loss of purchasing power, experienced for more than a year, are likely adding to the downbeat mood of potential homebuyers.

As interest rates have not peaked yet, housing affordability will likely go lower still. However, the descent will be short. The fall in housing affordability will likely end when the ECB stops hiking interest rates. Going forward, housing affordability will be supported by increasing wages, which are very likely to grow faster than housing prices this year and the next. Thus, we expect market activity to improve once the rate peak has passed; however, a swift recovery is unlikely.

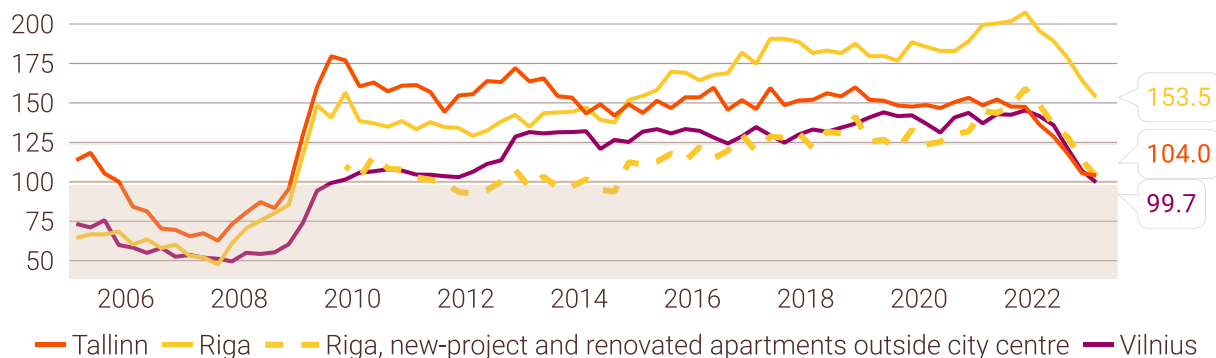
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Baltic Housing Affordability Index



Sources: Swedbank Research & Macrobond

Example: A housing affordability index value of 99.7 means that the average net wage of a household is 0.3% lower than minimally required to afford an apartment of 55 m².

Tallinn – prices are sticky

Housing affordability continued to decline in the first quarter, as rising interest rates increased the cost of borrowing. Last year's excessive demand has been wiped off, and the housing market is looking for new equilibrium. A rebalancing of supply and demand will bring a moderate price correction in the housing market this year.

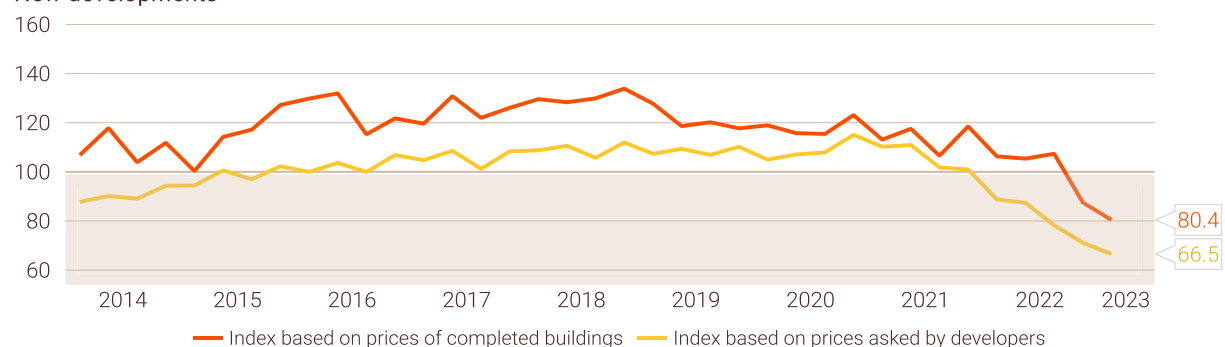
In the first quarter, net wage growth outpaced apartment price growth. We expect this trend to continue this year and the next, as wage growth is expected to remain strong. As inflation is retreating, real wages are gradually starting to grow. However, it will take considerable time for households' real purchasing power to get back to the level of 2021, before real wages started to fall.

Demand in the housing market has fallen, while supply has increased. In the first quarter, transactions in the secondary market were two-fifths below the peak at the end of 2021, but the fall was around one-fifth compared with the more usual levels seen before the pandemic. Preliminary data show that, at the beginning of the second quarter, activity in the secondary market slightly improved, likely due to seasonal factors, but was still modest. Prices are proving to be quite sticky - in the secondary market, prices are on average down by only 3% from last year's peak.

Expectedly, reservations of new developments continued to decrease and, in the first quarter, were the lowest in at least the last 13 years. Compared with the most active time on the primary market, which was at the beginning of 2021, reservations were 12 times lower. The stock of new developments offered increased somewhat in the first quarter and was more than one-third higher compared with the same time last year. Admittedly, the previously enormous demand allowed developers to sharply hike prices of new developments. On the other hand, the increased construction costs didn't leave other options for developers. This, together with rising interest rates, substantially worsened housing affordability in the primary market during the previous two years. Prices of new apartments asked by developers continued to rise compared with the fourth quarter and were higher by about half compared with the first quarter of 2021. Whereas the primary market has become unaffordable for most, developers' offers currently include some discounts besides extras to attract potential buyers.

Tallinn Housing Affordability Index

New developments



Sources: Swedbank Research & Macrobond

As interest rates will continue to rise, housing affordability will remain downbeat this year. Meanwhile, the apartment price-to-wage ratio has started to improve, and wage growth should gradually start to outpace inflation. However, some worsening of housing affordability is still likely until the ECB stops its interest rate hikes. Based on market expectations, the Euribor should reach its highest point in the second half of this year. A gradual decline of the Euribor should bring some more activity to the market and improve housing affordability next year.

Riga – apartments still affordable, but buyer behavior changes

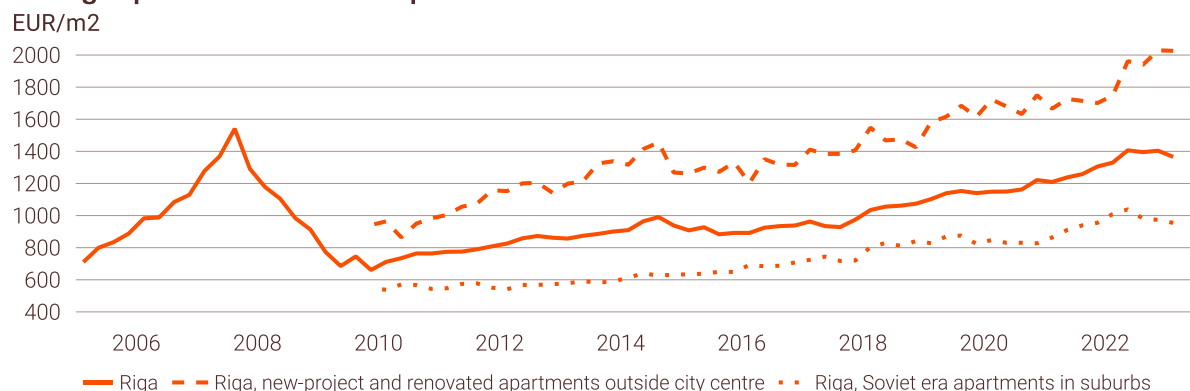
The summer is here, but the housing market in Riga feels rather chilly. People's finances are stretched thin because of the high cost of living, and any potential mortgage is looking pricier by the day. The cloud of uncertainty and high prices, along with rising interest rates, have made buyers more cautious and apartments less affordable.

Market activity continued declining at the start of the year. In the first three months of 2023, the number of transactions fell by 11% compared with the previous year and by 6.6% compared with the previous quarter. The buyer behavior in the primary market has changed. Buyers are currently less interested in reserving apartments that are still in the development stage and prefer to wait until the project is completed. However, the supply of apartments continues to increase, as ongoing projects initiated previously are being completed. The decline in market activity is not limited to the more expensive primary market. Soviet-era apartments, which are the most affordable housing option in Riga, have seen transaction numbers decline since the middle of last year.

The average annual price growth for apartments in Riga in the first quarter slowed to 2.7% over the year, but, having peaked in December, prices fell by 2.7% over the quarter. The year-on-year growth is primarily driven by the 16% increase in prices of apartments built or renovated after 2000. If we zoom-in even more, we see the primary market is still registering very strong price developments. Prices of completed transactions in the primary market mostly reflect reservations that were done at least a year ago. Construction costs today are levelling off but are markedly above the levels seen this time last year. Therefore, despite lower activity, even reservations made today are around 25% more expensive compared to pre-war. Soviet-era apartments, which account for around 60% of transactions in the market, have seen declining prices since mid-2022. They now seem to have stabilised; however, a further correction is still possible, as transactions are still on a downward trend amid sluggish demand.

Overall, 2023 is expected to be a relatively quiet year for the housing market in Riga. Apartment prices are projected to experience moderate growth, with price corrections in certain segments. The number of transactions is expected to remain below pre-war levels, but not falling under the pre-pandemic levels. Buyers may tend to postpone purchases as long as interest rates continue to rise. Rapidly rising wages will help to revive market activity, as soon as the impact of interest rates begins to diminish - likely towards the end of the year.

Average apartment transaction price



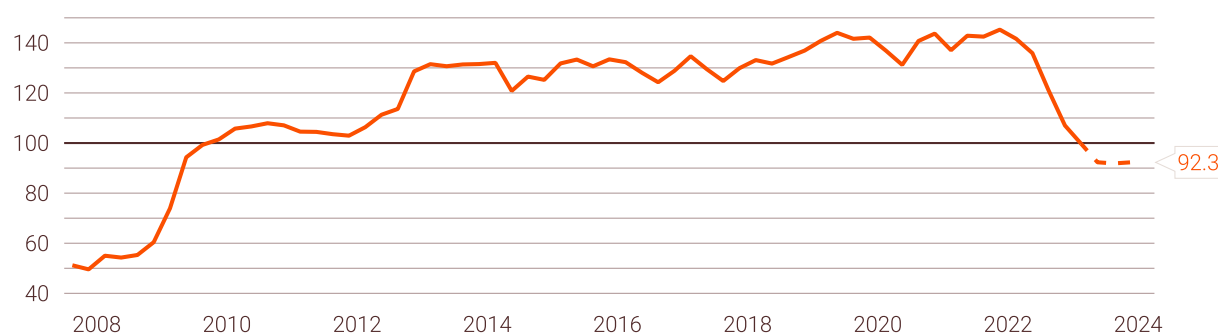
Sources: Swedbank Research & Macrobond

Vilnius – unaffordable, but still resilient

A slow period in the Vilnius housing market continues. The sharp increase in interest rates made homes unaffordable to many households. Naturally, the limited ability to buy homes, coupled with the prevailing economic uncertainty, depressed market activity. So far, prices have surprised with their resilience, but a mild price correction is still likely.

Market activity remained sluggish in the first quarter. Sales of older apartments fell by a further 5% and were down more than 35% since the peak at the end of 2021. For several quarters now, developers have been reporting very weak consumer interest and sales in the primary market. However, during March-May, reservation numbers recovered from about 100 per month to about 250. Sales in the primary market are still weak but no longer disastrously low. Despite the slow market activity, prices remain sticky. Apartment prices have essentially been moving sideways since last summer. In the primary market, prices are not falling: developers are in a strong enough financial position and for now stick to luring clients by providing additional benefits (like free parking spots) rather than offering price discounts. In the secondary market, prices declined by -1% over the quarter. The secondary market is more responsive, and the current price movement might signal more declines to come.

Housing affordability in Vilnius and projections index



Sources: Swedbank Research & Macrobond

HAI forecast assumes 11-10% net wage growth, no further housing appreciation and current market expectations for interest rates.

Housing affordability dipped below 100 in the first quarter, and currently housing in Vilnius is unaffordable for many people. However, affordability should stabilise over the coming quarters. Prices are not expected to increase (and most likely will fall somewhat) this year; at the same time, nominal wage growth is still above 10%. Because the ECB is approaching the end of the monetary tightening cycle, a further deterioration of affordability due to rising interest rates will be limited. Over the second half of the year, housing affordability should improve slightly but will remain much lower than in the 2018-2021 period.

The outlook for the housing market is not too bright in the near term. Over the next year, high rates will keep market activity low. Peaking rates and bottoming affordability could revive some demand, but the general economic environment remains challenging. The economy is in a recession, and the recent pickup in unemployment is worrying: a further weakening of the labour market could pose a risk. The inventory of apartments is being rebuilt and is approaching normal levels (around 4,000 apartments are available for sale in the primary market); if the buildup continues above this level, it might result in downward pressure on prices. However, developers are anticipating a supply risk – permit issuance is down 30% from a year ago.

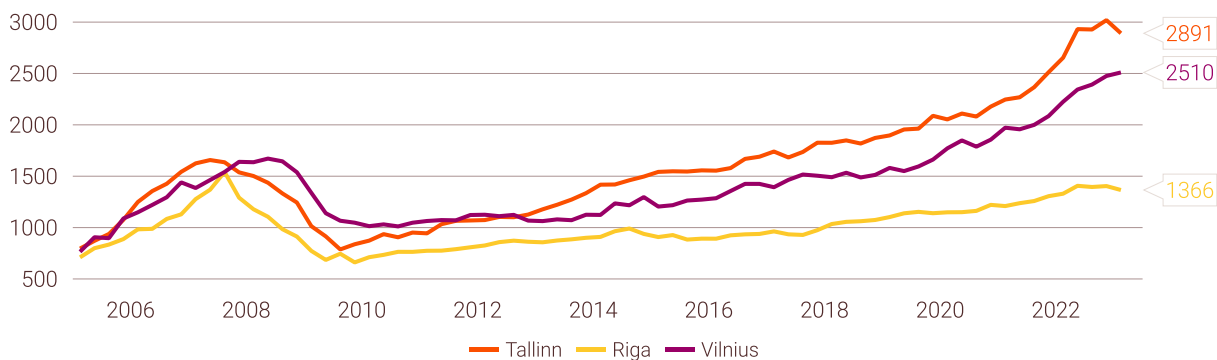
Appendix

| | Tallinn, Estonia | Riga, Latvia | Riga, new-project and renovated apartments, Latvia | Vilnius, Lithuania |
|--|------------------|--------------|--|--------------------|
| Average apartment transaction price, EUR/m ² , y/y % | 8.9 | 2.7 | 16.0 | 12.8 |
| Annual percentage rate of charge for new mortgages to households, basis points | 250 | 261 | | 280 |
| Average monthly net wage, EUR, y/y % | 13.6 | 10.8 | | 12.4 |
| Months to save for a down payment, months | 32.8 | 21.1 | 31.4 | 33.1 |

Sources: Swedbank Research and Macrobond

Average apartment price

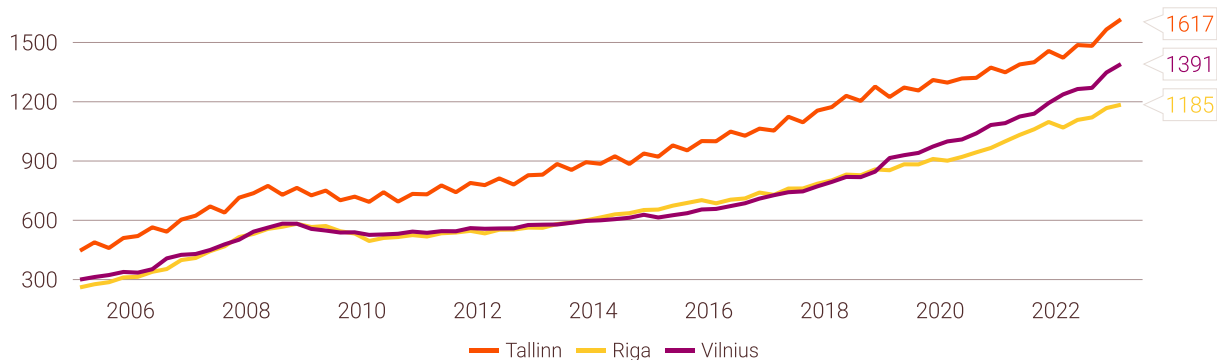
EUR/m²



Sources: Swedbank Research & Macrobond

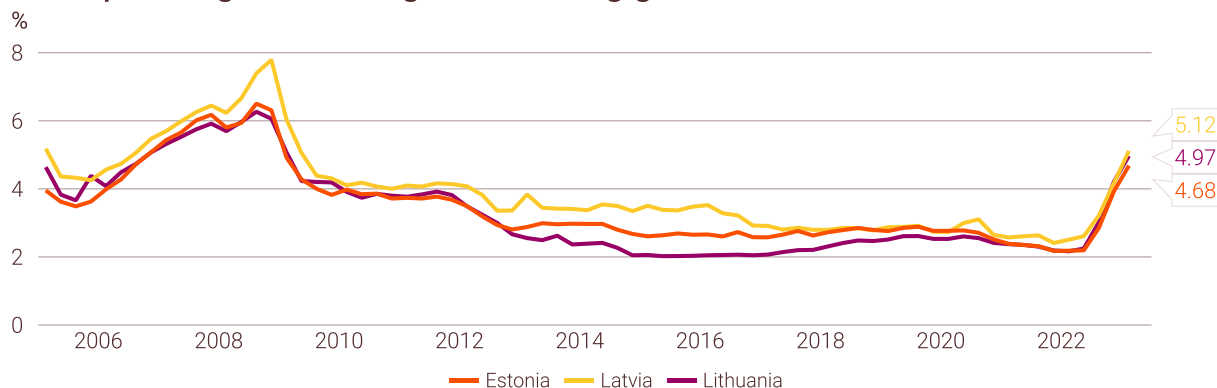
Average monthly net wage

EUR



Sources: Swedbank Research & Macrobond

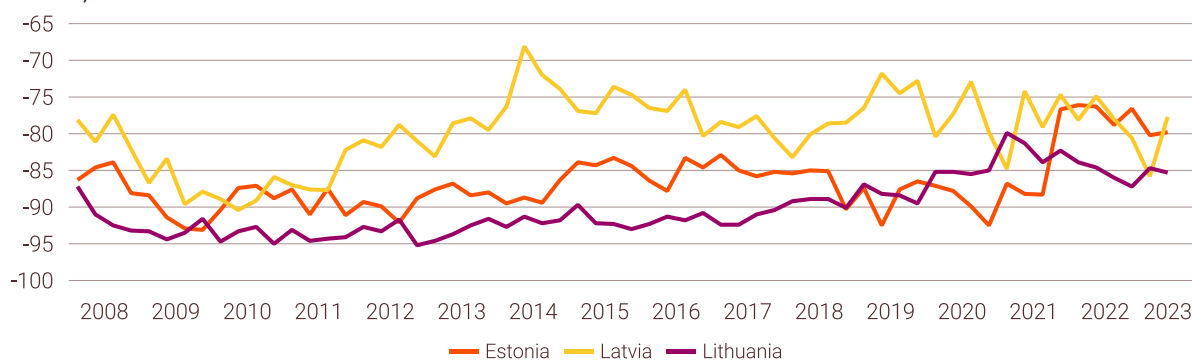
Annual percentage rate of charge for new mortgages to households



Sources: Swedbank Research & Macrobond

Consumer confidence to purchase or build a house

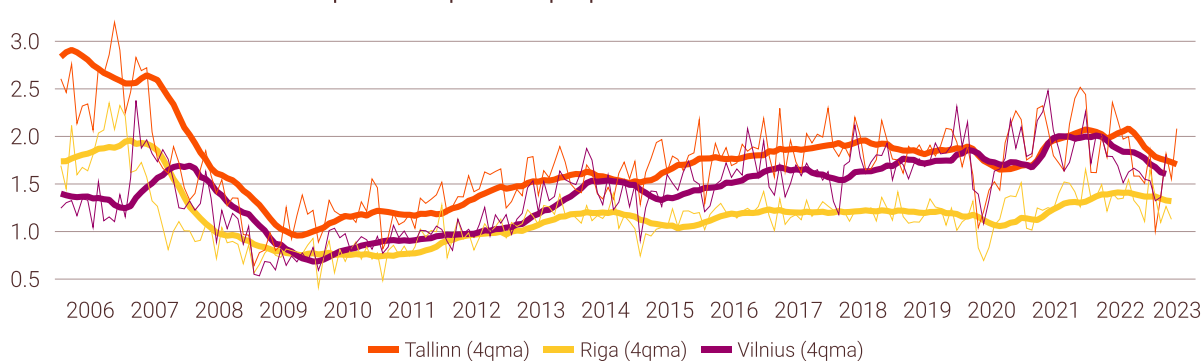
Baltics, over the next 12 months



Sources: Swedbank Research & Macrobond

Housing market activity in the Baltics

Number of transactions with apartments per 1000 people



Sources: Swedbank Research & Macrobond

Baltic Housing Affordability Index: Methodology

Objective

The Baltic housing affordability index (HAI) measures the degree to which households can afford buying an apartment with a mortgage loan in the Baltic capitals.

Norm (the main assumption)

Household monthly mortgage payments do not exceed 30% of household income.

Variables

- Average apartment price per m²: three-month average apartment transaction price per m² in Baltic capitals.
- Household income: 1.5 of average monthly net wages in Baltic capitals.
- Mortgage interest rate: three-month average annual percentage rate of charge (including interest rate and other related charges) for new housing loans to households, issued in euros, in the Baltics.

Other assumptions

- Average apartment size: 55 m².
- Down payment: 15% of total apartment price.
- Term: 30 years.
- Saving rate for down payment: 30% of household income.

Calculation of HAI

The HAI shows actual household income in relation to the income that meets the norm. Thus, if the HAI equals 100, a household uses 30% of its income to service mortgage payments. If the HAI exceeds 100, the household has higher income than required to satisfy the norm. And if the HAI is below 100, the household does not have sufficient income to fulfil the norm.

$$\text{HAI} = \frac{\text{AverageINC}}{\text{NINC}} \times 100, \text{ where } \text{NINC} = \frac{\text{PMT}}{30\%}$$

where AverageINC – household income;

NINC – household income that satisfies the norm; and

PMT – monthly mortgage payment.

HAI of new-project and renovated apartments

The calculation of HAI of new-project and renovated apartments for Riga is intended to improve the comparability of affordability levels across the three capitals because it considers new-project and renovated apartments – types of apartments more commonly purchased in Tallinn and Vilnius. It takes into account housing affordability in newly built and renovated apartments (i.e., those done after 2000 outside the city centre).

All variables and assumptions, except for the average apartment transaction price, remain the same. That is, for the calculation of HAI for new-project and renovated apartments, the average apartment transaction price of newly built and renovated apartments (i.e., those done after 2000) outside the city centre is used.

The new index and associated apartment price variable are represented by a yellow dashed line in the graphs of the report.

Limitations

The HAI provides an indication of the average household situation, not that of a particular household. Household income and mortgage interest rates faced by a particular household may differ from those presented in the report. The HAI accounts for mortgage costs but excludes taxes and subsidies, including property tax and interest deductions. It also does not consider other household expenses that could affect the household's ability to service mortgage payments, such as rent, lifestyle, or existing liabilities. The HAI does not provide any direct guidance for business decisions, including lending and interest rate decisions.

The average apartment price per m² reflects past transactions and does not necessarily indicate the potential affordability or price of apartments in the future. Differences in apartment segment structure and the physical condition of newly built apartments at the time of purchase might affect the comparability of the average apartment price per m² across the Baltic capitals.

The HAI is of an informative nature and reflects macroeconomic developments, rather than banks' decisions and lending policies or the potential behaviour of individual households.

Change of data

A data revision was made in the fourth quarter of 2019 for Riga. The history of wages, prices, and transaction counts was changed in 2011.

Frequency

Quarterly.

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