Housing Affordability Index: Q3 2023

Affordability on the road to recovery

- Affordability continued to decline, but the bottom has been reached.
- Apartments still unaffordable in Tallinn and Vilnius.
- Interest rate burden remains heavy, but there are first signs of rates inching down.

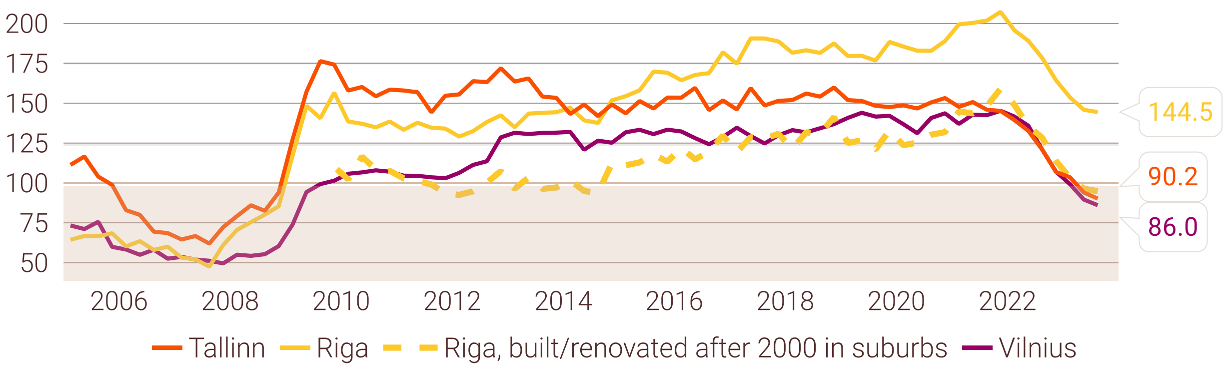
Housing affordability continued to decline in the third quarter of 2023, albeit at a slower pace. The good news – we expect that after 10 consecutive interest rate increases, the ECB hiking cycle is done, and the first tentative signs of lower mortgage rates were already observed as the 6-month EURIBOR peaked in October and has been slowly declining thereafter. Housing is still unaffordable in Tallinn and Vilnius, while Riga remains somewhat resilient, largely thanks to the comparatively low and declining prices of Soviet-era apartments, which make up the majority of Riga's market. The Riga apartments that were built or renovated after 2000, however, are unaffordable for average earners.

Market activity remains muted, with transaction numbers and reservations at relatively low levels. Consumer confidence, shaken by high inflation and the subsequent higher interest rates, remains below the long-term average in Latvia and is especially downbeat in Estonia. This is different in Lithuania, where households feel rather upbeat and optimistic. Estonian households are more worried about losing their jobs and the future financial situation than their Baltic neighbours. As the primary housing market has become out of reach for most households, reflected in scarce demand, real estate developers are resorting to discounts and diverse marketing strategies to attract buyers. As a result, price growth in the primary market continued to slow down in Q3, while prices in the secondary market decreased.

Looking ahead, the high-interest rate environment is unlikely to persist, as economic slowdown is observable across numerous EU countries. Economic weakness and clear disinflation trends will likely allow the ECB to declare victory over inflation and start cutting rates in April next year. We forecast that the policy rate will gradually decrease, reaching 2.5% at the end of 2024. With such changes, both housing affordability and market activity should improve. However, we do not expect a very rapid recovery in the number of transactions, and prices are expected to be stable throughout 2024.

Analysts:
Marianna Rõbinskaja, marianna.robinskaja@swedbank.ee, +372 888 79 25
Oskars Niks Mālnieks, oskars.niks.malnieks@swedbank.lv, +371 2635 1604
Vytenis Šimkus, vytenis.simkus@swedbank.lt, +370 687 17870

Baltic Housing Affordability Index



Sources: Swedbank Research & Macrobond

Example: A housing affordability index value of 86 means that the average net wage of a household is 14% lower than minimally required to afford an apartment of 55 m^2.

Tallinn – weak confidence, muted demand, stable prices

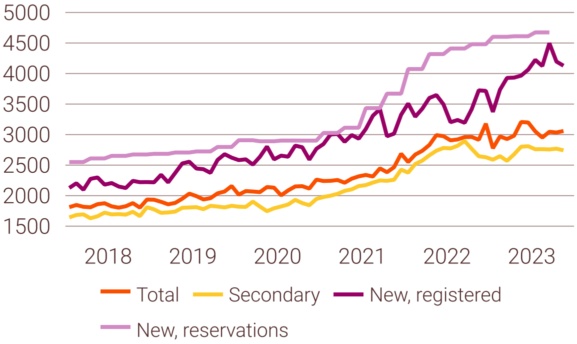
The situation in the housing market has been developing mostly sideways since spring. Activity remains subdued, as still-high borrowing costs keep investments in real estate less attractive; meanwhile, households are making their purchasing decisions carefully. General consumer confidence is suppressed by high interest rates, lost purchasing power, and worries about losing jobs and the future financial situation. On the bright side, housing affordability has started on the road to recovery.

In the third quarter, housing affordability reached the bottom. Although the affordability index shows that housing is unaffordable, it has started to improve slightly as market interest rates have been inching down since October. The apartment price-to-wage ratio is improving, mainly on the back of strong wage growth, while price corrections have so far been rather humble, in line with expectations. According to the Bank of Estonia, the overvaluation of the real estate market has diminished this year.

Prices in the secondary market have come down from their peak. However, this is barely visible in the average price statistics due to composition effects. In the third quarter, the average price in the secondary market was 2% below the peak of a year ago. According to preliminary data, the average price moved sideways in October and November.

Apartment prices in Tallinn

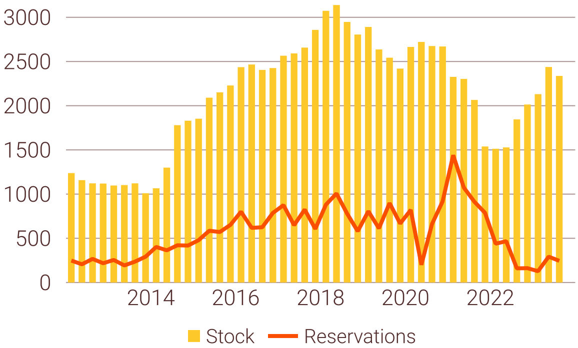
EUR/m2



Sources: Swedbank Research & Macrobond

Stock and sales of new developments in Tallinn

Number of apartments



Sources: Swedbank Research & Macrobond

In the third quarter, the average price of new apartment reservations asked by developers was 6% higher than at the same time last year (likely due to more expensive apartments in this segment); however, growth has slowed substantially. Price growth in the primary market has likely stalled at the end of the year – because demand is dampened by low affordability and weak household confidence, developers are offering some discounts to attract potential buyers in the areas where supply is larger.

Developers have been more careful with introducing new projects as reservations in the primary market continue to be scarce. The lower number of building permits since last year is signalling less new supply in the near future. However, the stock of new developments has improved significantly from the second half of last year and is currently enough to cover lower-than-usual demand. In the third quarter, reservations were three times lower than the pre-pandemic (2016-2019) average.

Interest rates have started to come down from their peak and will continue to decline next year. The demand-supply balance has improved. Some price corrections are still not ruled out, especially if unemployment continues increasing and confidence remains weak. However, the corrections are unlikely to continue for long. We expect wage growth to ease somewhat but still be solid next year. Along with decline of Euribor, the improving price-to-wage ratio will make housing somewhat more affordable next year. More improvement in affordability should take place when the ECB starts cutting policy rates in spring next year. This should give also a positive impulse on the activity if household confidence starts to strengthen. However, in the near term, activity will likely remain muted.

Riga – fall in affordability has softened

Housing affordability in Riga appears to be bottoming out, with the index value decreasing by only 1% from the last quarter, following nearly two years of a steep decline. A minor reduction in the average apartment price and a continued strong increase in net wages helped to rein in the affordability drop. However, the expected monthly payment for new loans remains substantial in terms of year-on-year comparison and marginally above the previous quarter.

Looking at the housing market activity more closely, we observe a decrease in quarter's transaction count from the corresponding quarter last year across all segments, as high interest rates and high apartment prices are deterring buyers. Moreover, the situation appears grimmer when considering that new apartment reservations have fallen by more than one-third since last year. Also, buyers now wait until construction is finished before purchasing. We do not foresee a substantial uptick in market activity soon, as market conditions will improve only gradually. This also implies that transaction count in the upcoming quarters most likely will be lower than a year ago respectively.

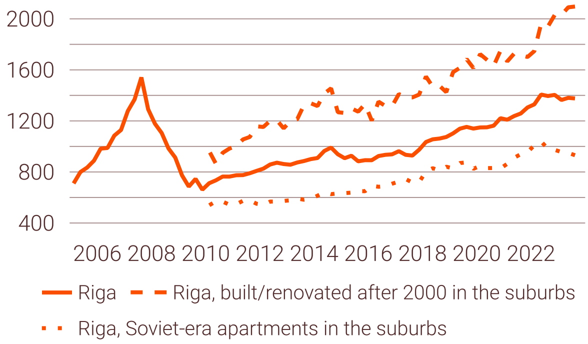
Similarly, there is a continued decline in the average price of apartments, primarily influenced by the ongoing decrease in the prices of the less energy efficient Soviet-era apartments. In contrast, those flats built or renovated after 2000 are experiencing year-on-year price growth, and prices in the primary market have continued to increase. Meanwhile there are instances in which developers are employing various tactics to attract buyers – ranging from offers of "free" parking spaces and built-in kitchens to extravagant vacations in distant destinations. This approach is likely temporary, developers want to foster demand without cutting prices or creating lower price expectations. Construction costs seem to have levelled off but remain high.

Those that are unable to afford an apartment in the primary market are now opting for the relatively cheaper secondary market. An alternative option being renting, which is still more prevalent among younger individuals. Furthermore, there is an increasing change in preferences of young adults as they now wait before settling down and buying. Renting gives them added flexibility and possibility to switch apartments frequently. Lower demand for apartment purchases and willingness to avoid any downtime costs due to empty, unsold apartments, also forces real estate developers towards the previously-less-active rental market. They occasionally forgo trying to sell the apartments, and instead put an entire building up for rent.

Looking ahead, a continued net wage increase, paired with interest rate reductions, will aid the gradual return of affordability. However, a more marked improvement will be observed only at the end of 2024, when monetary policy will be firmly on the path of rate declines.

Average apartment transaction price

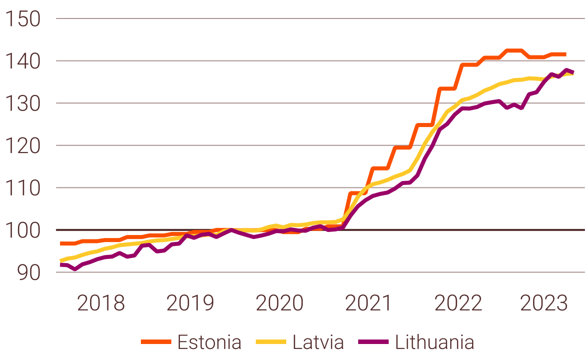
EUR/m2



Sources: Swedbank Research & Macrobond

Construction costs: residential buildings

Index (12.2019=100)



Sources: Swedbank Research & Macrobond

Vilnius – lower affordability, smaller apartments

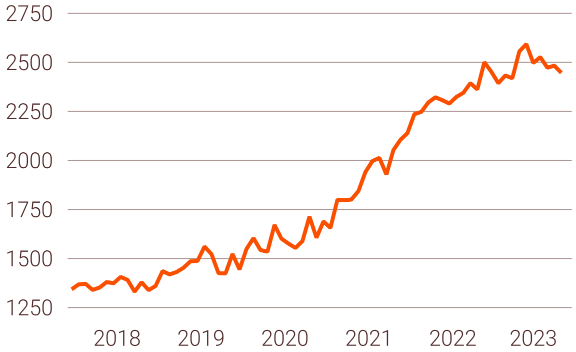
The housing market in the Lithuanian capital has remained subdued, as housing affordability in the third quarter fell to the lowest level since 2009. Low affordability weighed on market activity, which declined 10% even compared with the rather low sales last year. In general, prices have been quite resilient: they have dropped only in some segments, while in the primary market sellers are opting to provide additional benefits (e.g., parking space) instead of reducing the prices outright.

The average price in the primary market is still increasing, but this growth continues to be overstated due to lagging recognition of previously made reservations. Developers claim that reservation prices are unchanged for the year, but various discounts and special offers to lure in customers are becoming more common. The secondary market, which better reflects current markets trends, is already in a mild price correction. Over the past six months, prices have declined; they were about 5% below the peak in October.

Even though prices have been resilient to reduced demand so far, households are nonetheless reacting to less favourable conditions. Since interest rates started rising, the average size of apartment sold declined sharply, as larger and more expensive flats became out of reach for a typical household. Lower affordability not only reduces market activity but also shifts the market structure toward smaller or otherwise cheaper segments.

Secondary market prices

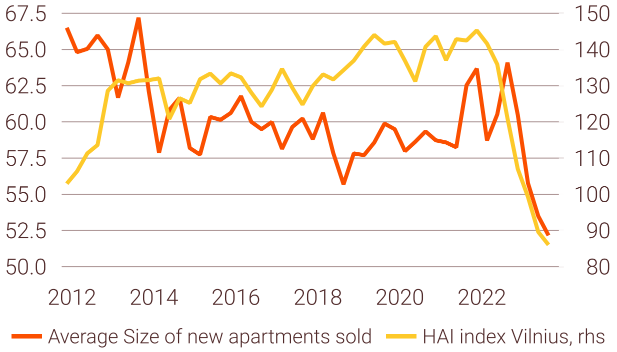
EUR/Square Meter



Sources: Swedbank Research & Macrobond

Apartment size and housing affordability

sq. meters, index(rhs)



Sources: Swedbank Research & Macrobond

We expect demand in the housing market to remain low for at least a couple of quarters. We are past the bottom in housing affordability - it should start recovering gradually over the next year. In the near term, wage growth will outpace apartment price appreciation. But, more important, we forecast the ECB to start cutting rates in April 2024. Better financing conditions will improve housing affordability somewhat and give a slight boost to market activity in the second half of 2024. However, affordability will remain significantly lower than the decade average.

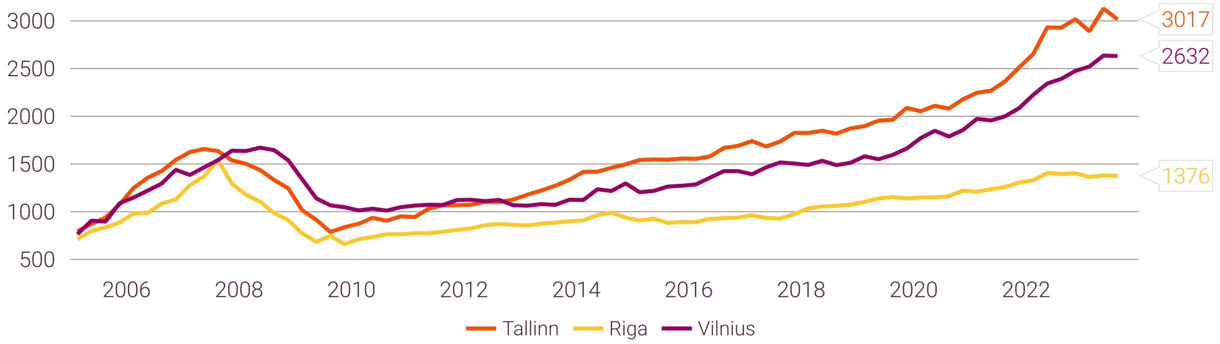
In the meantime, we expect a slight price correction to continue in the secondary market, where prices are more demand sensitive. Low market activity will drag on secondary market prices for at least a couple more quarters. Meanwhile, prices of newly built flats are likely to remain stable, with correction possible in some of the more stretched segments. Inventory levels hover around a normal level, while future supply is going to decline, as permit issuance is down 30% since last year.

Appendix

	Tallinn, Estonia	Riga, Latvia	Riga, new-project and renovated apartments, Latvia	Vilnius, Lithuania
Average apartment transaction price, EUR/m2, y/y %	3.0	-1.4	8.1	10.0
Annual change in the average mortgage interest rate, basis points	295	279		294
Average monthly net wage, EUR, y/y %	9.0	10.6		10.6
Months to save for a down payment, months	33.3	20.4	31.0	34.3

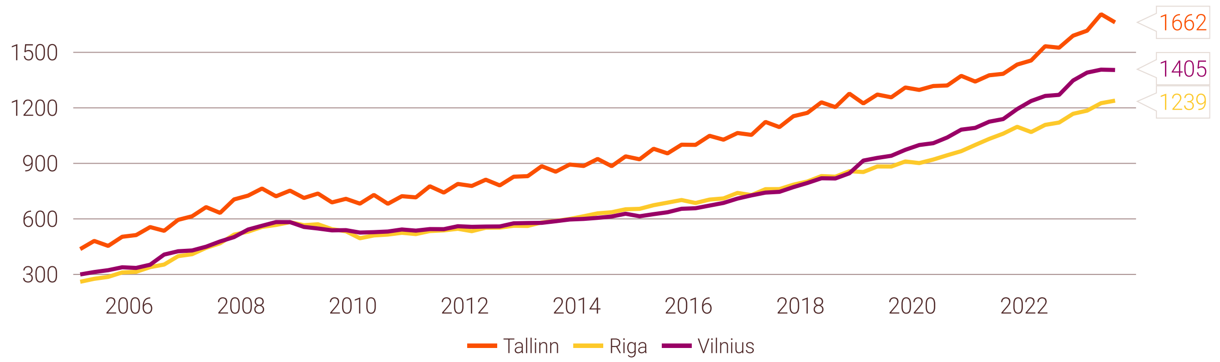
Sources: Swedbank Research and Macrobond

Average apartment price
EUR/m2



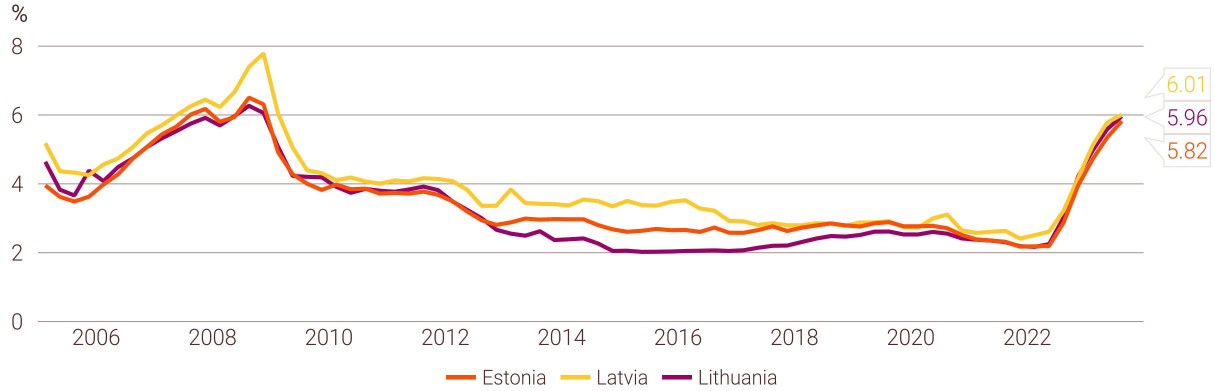
Sources: Swedbank Research & Macrobond

Average monthly net wage
EUR



Sources: Swedbank Research & Macrobond

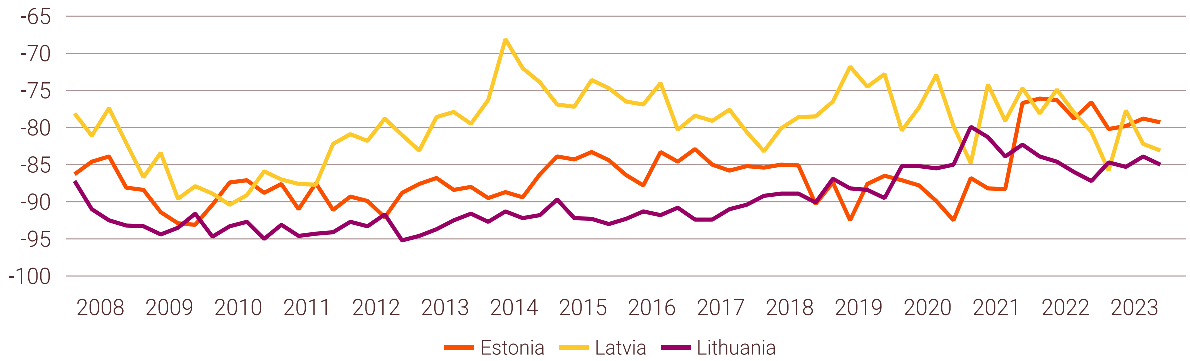
Annual percentage rate of charge for new mortgages to households



Sources: Swedbank Research & Macrobond

Consumer confidence to purchase or build a house

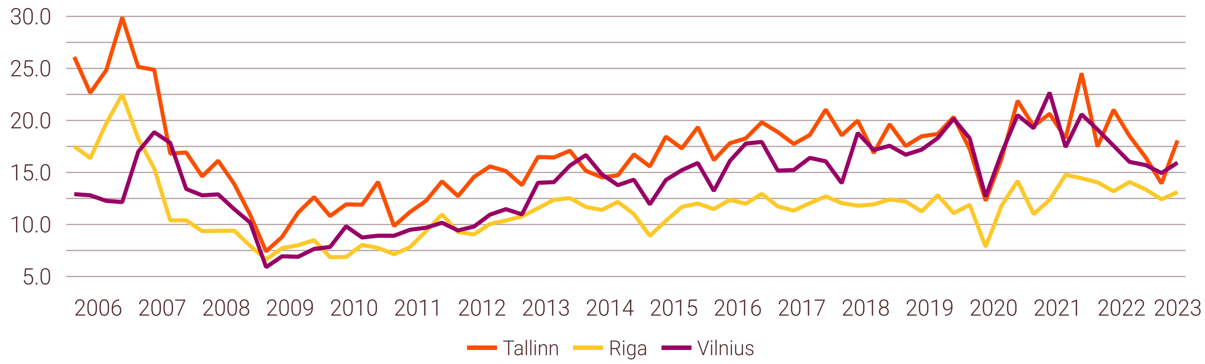
Baltics, over the next 12 months



Sources: Swedbank Research & Macrobond

Transaction activity

Transaction count per 10K residents, residential apartments



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 m^2: three-month average apartment transaction price per m^2 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 m^2.
- 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.

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

where AverageINC – household income,
NINC – household income that satisfies the norm,
PMT – monthly mortgage payment.

HAI of apartments built/renovated after 2000 in the suburbs

The calculation of HAI of apartments built/renovated after 2000 in the suburbs (i.e., outside city centre) for Riga is intended to improve the comparability of affordability levels across the three capitals. This is because it considers types of apartments more commonly purchased in Tallinn and Vilnius.

All variables and assumptions, except for the average apartment transaction price, remain the same.

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 m^2 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 m^2 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.

IMPORTANT INFORMATION

This report (the "Report") has been compiled by analyst(s) at Swedbank Macro Research, a unit within Swedbank Research that is part of Corporates & Institutions ("Swedbank Macro Research"). Swedbank Macro Research is responsible for preparing reports on economic developments in the global and domestic markets. Swedbank Macro Research consists of research departments in Sweden, Norway, Estonia, Latvia, and Lithuania.

What our research is based on

Swedbank Macro Research bases its research on a variety of aspects and analysis, for example, a fundamental assessment of the cyclical and structural economic, current or expected market sentiment.

Distribution & recipients

This Report is distributed by Swedbank Macro Research within Swedbank AB (publ) ("Swedbank"). Swedbank is under the supervision of the Swedish Financial Supervisory Authority (Finansinspektionen). In no instance is this Report altered by the distributor before distribution.

In Finland this Report is distributed by Swedbank's branch in Helsinki, which is under the supervision of the Finnish Financial Supervisory Authority (Finanssivalvonta).

In Norway this Report is distributed by Swedbank's branch in Oslo, which is under the supervision of the Financial Supervisory Authority of Norway (Finanstilsynet).

In Estonia this Report is distributed by Swedbank AS, which is under the supervision of the Estonian Financial Supervisory Authority (Finantsinspektsioon).

In Latvia this Report is distributed by Swedbank AS, which is under the supervision of The Financial and Capital Market Commission (Finanšu un kapitāla tirgus komisija).

In Lithuania this Report is distributed by "Swedbank" AB, which is under the supervision of the Central Bank of the Republic of Lithuania (Lietuvos bankas).

This Report is not intended for physical or legal persons who are not clients of Swedbank or any savings bank in cooperation with Swedbank, or who are citizens of, or have domicile in, a country in which dissemination is not permitted according to applicable legislation or other decisions.

This Report or any information in it is not for release, publication, or distribution, directly or indirectly, in or into the United States or any other jurisdiction in which such distribution would be unlawful or would require registration or other measures.

In the United Kingdom this Report is addressed to and directed only at, and should only be relied upon by, persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "Order"), persons who are high net worth entities falling within Article 49(2)(a) to (d) of the Order or are persons to whom it may otherwise be lawful to communicate the Report to (all such persons being referred to as (Relevant Persons"). No other person should act or rely on this Report and persons distributing this Report must satisfy themselves that it is lawful.

Limitation of liability

All information, including statements of fact, contained in this Report has been obtained and compiled in good faith from sources believed to be reliable. However, no representation or warranty, express or implied, is made by Swedbank with respect to the completeness or accuracy of its content, and this Report is not to be relied upon as authoritative and should not be taken in substitution for the exercise of a reasoned, independent judgment by you.

Be aware that statements regarding future assessments comprise an element of uncertainty. You are responsible for such risks alone and Swedbank recommend that you supplement your decision-making with material, which is assessed to be necessary.

Opinions contained in this Report represent the analyst's present opinion only and may be subject to change. In the event that the analyst's opinion should change or a new analyst with a different opinion becomes responsible for Swedbank Macro Research's coverage, Swedbank will endeavour (but does not undertake) to disseminate any such change, within the constraints of any regulations, applicable laws, internal procedures within Swedbank or other circumstances.

Swedbank is not advising or soliciting any action based upon this report.

To the extent permitted by applicable law, no liability whatsoever is accepted by Swedbank for any direct or consequential loss arising from the use of this report.

Conflicts of interest

In Swedbank Macro Research, internal guidelines are implemented in order to ensure the integrity and independence of the research analysts. All research reports are independent and based solely on publicly available information.

Producer

Produced by Swedbank Macro Research.

Swedbank C&I, Swedbank AB (publ), SE-105 34 Stockholm.

Visiting address: Malmskillnadsgatan 23, 111 57 Stockholm.