



Development of residential property prices and rent prices in the Slovak Republic in the 1st quarter of 2008

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MODERATION OF THE GROWTH OF RESIDENTIAL PROPERTY PRICES

The average prices of residential property in Slovakia in the 1st quarter of 2008 increased again to the total value of 44,463 SKK/m². Compared to the 4th quarter of 2007, this represents a growth slowdown by 2.1 percentage points to 6.1%, but in

comparison with the 1st quarter of 2007, a slight acceleration by 2 percentage points to 34.5%.

The year-on-year growth of the average prices for one square meter of living space in flats in the 1st quarter of 2008 was more moderate than in the last quarters of the previous year (the average prices of flats grew by 8.3 percentage points year-on-year to 37.7% in the 4th quarter of 2007 against the 3rd quarter, while they increased by 2.6 percentage points to 40.3% in the 1st quarter of 2008 as compared to the 4th quarter of 2007). The average prices of one square meter of houses were moving up more moderately than at the end of 2007.

The average prices of individual types of flats have developed in different ways in recent years. During the last quarters, the prices per square meter of small flats (one-room and two-room flats) were considerably above the total average price of a square meter for all flats.

While the prices per square meter for the individual types of flats increased year-on-year, there was a moderate slowdown of the price growth compared to the 4th quarter of 2007 for almost all types of flats (except five-room flats).

From the regional perspective, the average prices of houses and flats per square meter in Bratislava Region (more than 59 ths. SKK/m²) are the highest ones, their value being about one third (prices of flats by almost 30 % and prices of houses by more than 40 %) above the average for the whole of Slovakia.

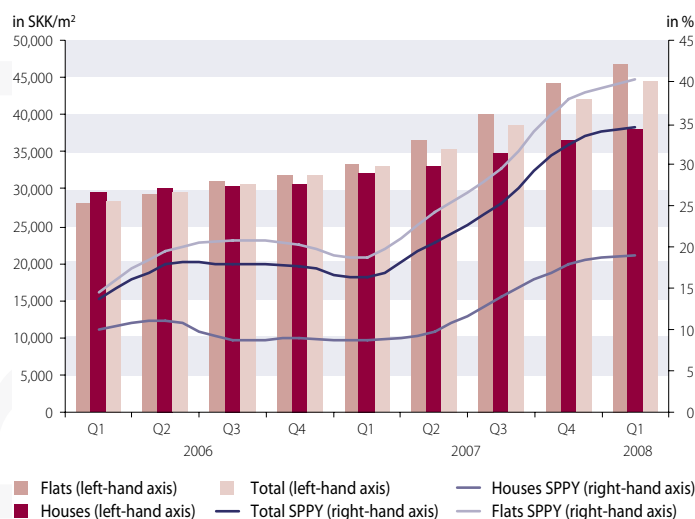
The average total prices of one square meter of residential property increased almost in all regions (except Prešov Region and Žilina Region) in the first quarter of 2008 compared to the previous quarter at a lower rate than in the 4th quarter. The year-on-year growth of the average total prices per square meter of residential property accelerated slightly in all regions in the 1st quarter of 2008. In Bratislava Region, Trnava Region, Trenčín Region and Prešov Region, a lower year-on-year growth rate of residential property as compared to the Slovak average continued. The prices of residential property in Košice Region, Banská Bystrica Region, Žilina Region and Nitra Region increased in the 1st quarter of 2008 considerably faster than the average for the whole of Slovakia. Almost in all regions (except Košice Region), the

Chart 1 Quarterly development of residential property prices



Source: NARKS, chart NBS.

Chart 2 Year-on-year development of the prices of houses and flats



Source: NARKS, chart NBS.



difference between the average prices per square meter of flats and houses increased against the previous quarter.

STAGNATION AND MODERATE DECREASE IN RENT PRICES OF HOUSES AND FLATS

In the first quarter of 2008, the average monthly rent price of residential property reached a value of about 19,800 SKK (rent prices of houses reached around 47,000 SKK/month and rent prices of flats around 17,000 SKK/month). The renting of houses represented only about one tenth of the total number of the recorded renting of residential property.

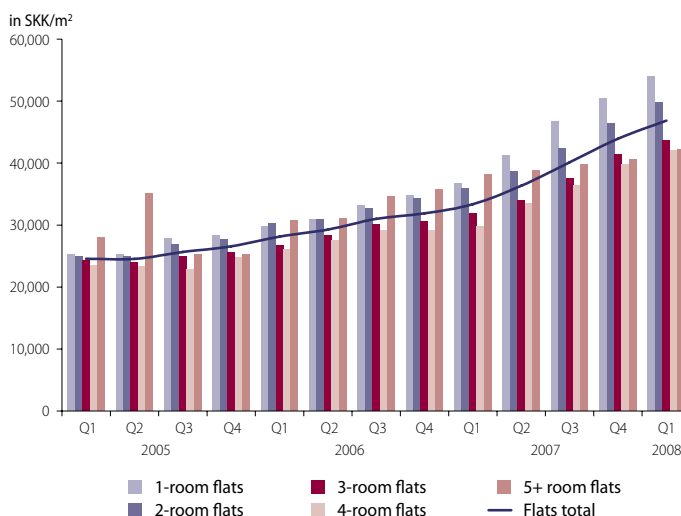
The growth of rent prices of houses in the 1st quarter of 2008 slowed down moderately as compared to the 4th quarter of 2007 and virtually stagnated for the whole of Slovakia. While the average rent prices for smaller flats were growing, albeit at a lower rate than in the previous quarter (both quarter-on-quarter and year-on-year), the rent prices of four-room and larger flats recorded a decrease in the 1st quarter of 2008 compared to the previous quarter. The rent prices of houses were also decreasing, as a result of which the total rent prices of residential property fell by almost 2% on average in the 1st quarter of 2008.

Minimum differences in the growth rates of rent prices with a tendency to stagnate were recorded in Bratislava Region and Trnava Region in the last two quarters. In the remaining regions, the average rent prices in the last two quarters were changing quite dynamically in both directions. The most considerable year-on-year changes of average rent prices for houses and flats occurred in the last two quarters in Nitra Region (from a decrease by almost 23% in the 4th quarter of 2007 to a growth of almost 6% in the 1st quarter of 2008) and in Žilina Region (from a growth by more than 50% in the 4th quarter of 2007 to a decrease by about 9% in the 1st quarter of 2008).

The quarter-on-quarter development of the average rent prices was less variable in 2007 than in the previous two years and it was oscillating relatively close to zero in both directions. The quarter-on-quarter growth reached 0.2% in the first quarter of 2008. The year-on-year changes of the average rent prices in 2007 were less considerable than one year ago and they reached positive values relatively close to zero compared to 2006. The average rent prices of houses and flats decreased year-on-year by some 2% in the first quarter of 2008.

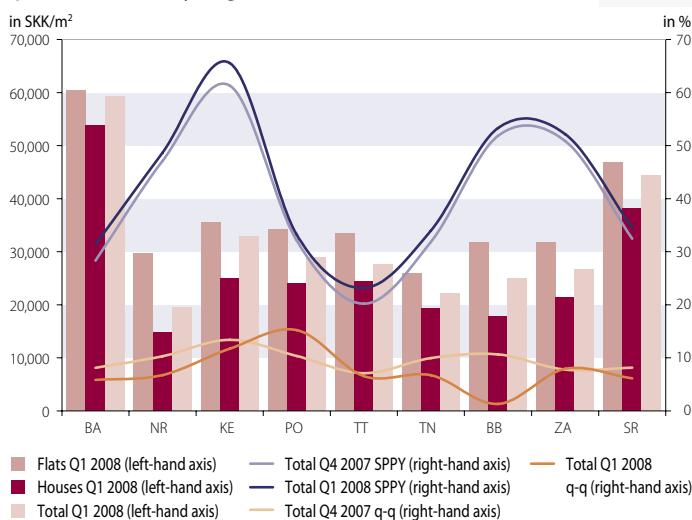
The available data imply that the average rent prices were changing in 2007 less considerably on a year-on-year basis than the average residential property sale prices. While the average rent prices basically stagnated in 2007 on a year-on-year basis, the year-on-year growth of the average sale prices showed a marked upward trend (from about 16% in the 1st quarter to more than 32% in the 4th quarter of 2007). In the 1st quarter of 2008, the year-on-year decrease in the average rent prices was accompanied by a moderation of

Chart 3 Development of the prices of individual types of flats



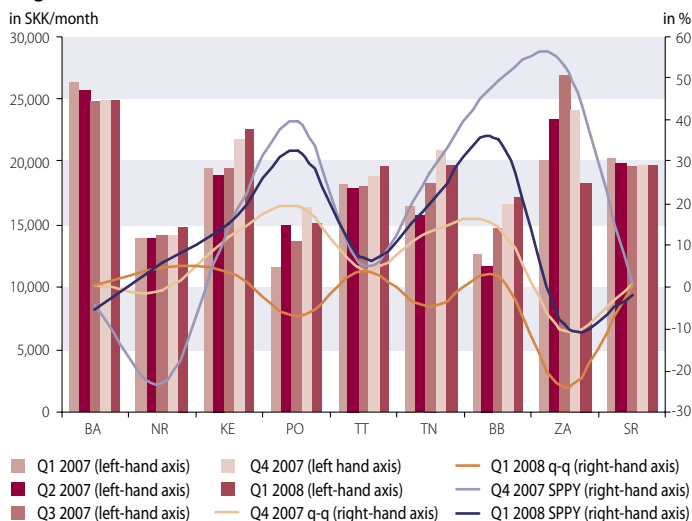
Source: NARKS, chart NBS.

Chart 4 Development of the prices of houses and flats in the 1st quarter of 2008 by Regions



Source: NARKS, chart NBS.

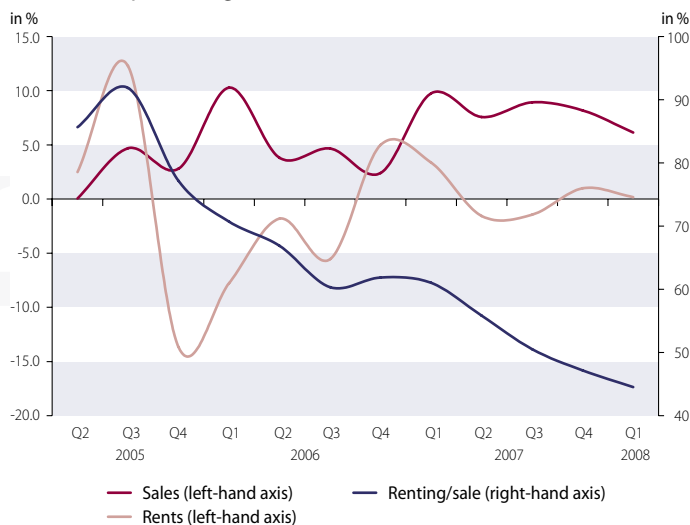
Chart 5 Development of rent prices of residential property by Region



Source: NARKS, chart NBS.



Chart 6 Quarter-on-quarter development of sale and rent prices and of their percentages



Source: NARKS, chart NBS.

Chart 7 Year-on-year changes of sale and rent prices of residential property



Source: NARKS, chart NBS.

¹ For more details see e.g. the article *Asset price bubbles and monetary policy*. In: ECB Monthly Bulletin, April 2005.

the year-on-year growth of the average residential property prices as compared to the previous quarter. It is a result of a quarter-on-quarter slowdown of residential property prices, which started in the 4th quarter of 2007 and continued also in the 1st quarter of 2008 (from 8.9% in the 3rd quarter of 2007 to 8.2% in the 4th quarter of 2007 and 6.1% in the 1st quarter of 2008).

SELECTED MONETARY POLICY ASPECTS OF THE CURRENT DEVELOPMENT OF RESIDENTIAL PROPERTY PRICES

The considerable growth of residential property prices in 2007 provoked a discussion not only among people interested in satisfying their need for or improving housing, but also among real estate market professionals. Considerable incentive also came from the mortgage crisis in the USA, in connection with which a dynamic growth of

prices in Slovakia started to be associated with the formation of a price bubble on the real estate market.

For an objective assessment of the adequacy of the residential property price development, a simple comparison of certain selected partial indicators is not sufficient, but the price development has to be assessed primarily in relation to the development of the basic macroeconomic fundamentals. Real property price bubbles can be assumed, if the development of asset prices is based on unrealistic expectations that substantially deviate from the current and expected social and economic development of the society.

The situation in Slovakia in the last years is characterized by a favorable economic environment, setting the stage for a growth of the rate of employment, for the improvement of the purchasing power of the population, as well as an enhancement of the opportunities to acquire housing using one's own or credit resources. The said factors, along with other social and demographic characteristics of the society, generate a housing demand growing faster than the current housing offer. The existing mismatch between the demand and offer on the real property market is the main reason for growing house and flat prices over the last years in Slovakia.

Demand pressures on the Slovak real property market are also fostered by a relatively late creation of conditions for a free flat market, which has also contributed to the high growth rate of house and flat prices over the last years. The Slovak real estate market has been also significantly influenced by its internationalization after Slovakia's EU accession in 2004.

The complex of positive demand factors motivates developer companies to invest free, but also borrowed funds in various real estate segments as a result of arising opportunities for an interesting realization of the funds used this way. Since the offer aspect is considerably determined also by the time necessary for building the real property, demand factors generally appear to be decisive for the development of residential property prices in the short run.

There are various approaches to the identification and evaluation of a financial disequilibrium or of price bubbles¹. One group of possibilities is provided by selected simple indicators, such as real property prices, rent prices, disposable household income, the value of loans, GDP, yields of various asset types, suitable relative indicators created thereof, as well as their trends etc. (price/rent, price/income, loan/income, loan/GDP, residential price development/development of alternative yields of various assets). Another group of possibilities is constituted by model approaches to comparative evaluation of housing investment and investment in other assets, as well as influences of various factors on the development of residential property prices (the hedonic method etc.).

The affordability of housing is a quite frequently used relative indicator for the evaluation of the



adequacy of the residential property price development in a society. It is the ratio of the level of household nominal disposable income to the level of residential property prices². Ignoring the methodological differences in the construction of the appropriate relative indicator in the individual countries (mainly as regards the availability of data for equally defined input indicators), let us try to compare the trends of housing affordability in euro-area countries and in Slovakia.

The following charts enable some generalizations. The development of disposable income of the households in the euro-area in recent years signals an intensifying negative correlation with the development of residential property prices, as a result of which the development of the affordability of housing in the euro-area has been relatively strongly indirectly proportional to the development of residential property prices in recent years. The permanent year-on-year growth of residential property prices in the euro-area from the second half of the 90s to the first years of the new millennium has not been assessed as a real estate bubble by the ECB. The development of the evaluated indicators has probably differed considerably in the individual euro-area countries, which has been also associated with the different development trends of their economies.

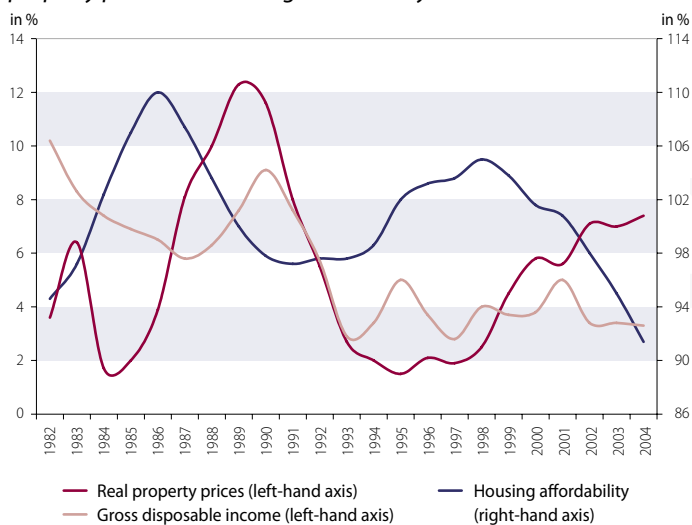
In Slovakia, too, it was possible, primarily over the course of 2007, to observe a considerable lagging of the disposable income growth of households behind the development of residential property prices, as a result of which the affordability of housing is being reduced. However, this contrasted with the permanent interest of households in obtaining housing. The apparent paradox can be partly explained by the fact that the amount of debt of Slovak households is relatively low on average and under optimistic expectations of growing income, they are ready to finance the necessary housing by means of loans. The increasing availability of housing loans also motivates the households to such behavior. The resulting effect is an ongoing growth of housing demand and thereby also pressure on a further growth of residential property prices.

The development of residential property prices in 2007 has incited discussion on a possible real estate bubble also in Slovakia. According to analysts, signs of a certain overheating of the real property market, primarily in the Bratislava Region, were signaled by some partial indicators in 2007. In general, however, no risk of a real estate bubble has been identified³.

In evaluating the adequacy of the development of real property prices in Slovakia, one has to take into account also the fact that the real property market is quite young and the existing data time series can also contain certain specific influences, which are not present in standard markets. Therefore, caution is in place when generalizing knowledge and using it in various comparisons.

A simple comparison of the available data on the development of average total prices of one

Chart 8 Year-on-year development of disposable income, real property prices and housing affordability in the euro area



Source: ECB, chart NBS.

Chart 9 Year-on-year development of disposable income, real property prices and housing affordability in Slovakia



Source: ŠÚ SR, chart NBS.

square meter of houses and flats in Slovakia in recent years implies that, in absolute terms, the growth of average residential property prices continued also in the 1st quarter of 2008. In comparison with the previous quarter, there was a moderate growth slowdown in the 1st quarter of 2008 and the growth rate fell off year-on-year, which can be a sign of the beginning of the certain stabilization in the Slovak real property market.

In recent years, Slovakia faced a contradictory development in residential property prices and rent prices. Growing house and flat prices are accompanied by a gradual stagnation or decrease of rent prices, as a result of which the percentage of the average rent price has been gradually decreasing from about 86% in the first quarter of 2005 to 46% in the 1st quarter of 2008. A comparison of the data for the last two quarters implies that the gap between the development of the av-

² For more details see e.g. the article *Assessing house price developments in the euro area*. In: ECB Monthly Bulletin, February 2006.

³ See e.g. Kremský, P. – Rojko, M.: *Slovensko uprostred bytovej bubliny*. In: *www.eTrend*, 19.3.2008



⁴ For more details see e.g. the report *Owner-Occupied Housing - Results of the second stage of the pilot*. Eurostat, Luxembourg, March 2008, as well as the *Technical Manual on Owner-occupied Housing - Draft 1.5*, Eurostat, Luxembourg February 2008.

erage residential property prices and average rent prices increased year-on-year in the 1st quarter of 2008, although less considerably than in the 4th quarter of 2007 (by 4.9 percentage points or by 11.1 percentage points). The gradual stopping of the growth of the gap between residential property prices and rent prices is confirmed by the fact that when gradually comparing the development between these two prices over the last two quarters, their difference is decreasing. This could be a signal that a moderate deterioration of the availability of loans will re-increase the demand for underletting.

The prices of residential property and asset prices in general are important information for ensuring the primary objective of monetary policy – price stability. Although central banks do not set target in the area of asset prices themselves, they have to pay adequate attention to them, because asset prices are on of the transmission channels, by means of which economic activity and the total macroeconomic level of the country is influenced.

Monetary policy enables to influence asset prices rather indirectly. One of the possibilities is to carry out cautious monetary policy, while tolerating a growing or high growth rate of real property prices over a certain short period of time in exchange for an enhancement of the assumption of preservation of price and economic stability in the long run. However, in critical situations the central bank can also have the price bubble burst, e.g. by means of a considerable change of the basic interest rate.

An important institute, which also has an indirect impact on price and financial stability, is banking supervision. Banking supervision is constituted by a set of instruments that can contribute to the elimination of the risks of asset price deformation e.g. by helping to keep the conditions of granting of loans for a possible acquisition of various types of assets in adequate limits.

For several years, intense both theoretical debates and practical verification of the possibility to include expenditure related to habitation in one's own houses and flats in the calculation of the harmonized index of consumer prices, which represents one of further instruments of indirect

impact of monetary policy on price stability. According to recent information, a pilot project of the Eurostat (HICP-OOH) created for this purpose with the support of the ECB has entered its final stage and it is expected that it will be completed at all statistical offices of all EU member states in December 2009. A working version of the technical manual is already available; the manual contains a uniform methodology both for including the expenditure related to dwelling in the HICP and for the construction of independent price indexes for all residential property, for new real property and for existing real property, and of a price index for building lots⁴.

A regular monitoring of real property prices on an official basis is one of important steps for a gradual creation of a database that will provide a sufficient time series of necessary data for analytical methods, enabling not only the subsequent detection of possible real property bubbles, but also e.g. the determination of the probability of the formation of such bubbles in the individual regions.

SUMMARY

In the 1st quarter of 2008, the growth of residential property prices continued in Slovakia, but their growth rate moderated, which can be a signal of the beginning of a certain stabilization in the Slovak real property market.

In 2007, some partial indicators showed signs of a certain overheating (primarily in Bratislava Region) of the real property market. In general, however, no risk of a real estate bubble has been identified in Slovakia.

A comparison of data for the last two quarters implies that the growth of the gap between residential property prices and rent prices is gradually ceasing.

Over the course of 2008, a continuing moderate growth of the average residential property prices and a gradual slowdown of the growth rate can be expected. The development of residential property prices will decisively influence the development of demand and offer factors, the demand factors seeming to be decisive for the development of residential property prices in the short run.

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