



Current and expected developments in residential property prices in Slovakia

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Questions seeking answers for the causes of the real estate boom over the last years have not yet been adequately answered; however, other questions are arising, which attempt to reveal the essence of the significant real estate market freeze in the last quarters. Despite the considerable heterogeneity of the estate markets, certain considerations can be made based on main factors affecting developments in real estate markets in general. Empirical analyses confirm the hypothesis that the determining factor of the real estate market development is the performance of the economy. This development is connected not only to the relations on demand side, but also to that on the supply side, which shape, in a concrete time and space, the local and global real estate markets and their developments.

¹ More information, for instance: *Housing Market Developments in the Euro Area and in the US. ECB, January 2009.*

The Slovak real estate market is only gradually becoming a standard market, considering its relatively late origination. This is one of the reasons why a cautious approach is required in making comparisons with, for instance, various standards of generally applicable indicators in countries with a developed market for houses and flats as well as housing as a whole. Such perspectives must be kept in mind also when comparing the development of prices for residential property in Slovakia with other countries.

GENERAL RELATIONS OF THE DEVELOPMENT OF RESIDENTIAL PROPERTY PRICES

Very turbulent development of residential property prices, not only in Europe but also on the world-wide scale, during recent years somewhat distracts attention from their similar development in the decade from the mid-80s to the mid-90s. In 1989, when average residential property prices were at the top within the framework of the euro area, their year-on-year growth represented roughly 13%; in 2005, at the time of the recent estate boom, the average prices of real estate in the euro area only increased on a year-on-year basis by less than 8% on average.

The euro area therefore recorded, in the second half of the 1980s, a significantly more dynamic growth than during recent years. The year-on-year dynamics of the growth of the average prices decelerated significantly after reaching its peak in 1989, and in 1995, it was only at a level of about one percent. This means that the year 1995 may be considered to be the beginning of the last development cycle of residential property prices in the euro area.

Several factors contributed to the dynamics of the growth in average residential property prices

over the previous years. One of the important ones may probably be the crash in the share market in 2000, after which investors were trying to transfer a huge volume of funds from securities into safer assets while real estate is also considered to be such.

A more significant revival of the real estate market appears especially in the so-called good times, when economic growth brings not only a more favourable income situation for households but also positive expectations on the part of citizens towards the future, from which follow a more significant willingness and opportunity for individuals as well as households to enter into debt. The rapid growth in the demand for particular types of real estate has also been shown in growing prices of houses and flats, as well as of commercial real estate and office premises. The policy of a greater availability of credit adopted by the central banks of large countries in the interest of the creation of positive incentives for further economic growth has also clearly contributed to the significant growth of real estate prices after 2000.

During the growth trajectory of residential property prices from 1999 to 2005, their average year-on-year growth in the euro area was about 6.6%, even though, in most countries, this growth was stronger. The correction of the year-on-year dynamics of average residential property prices downwards for the euro area as a whole for this period was caused by their year-on-year decrease in Germany (-0.9%), which dominates in the calculation of the weighted scheme based on the economic performance of specific countries within the framework of the euro area.

According to available information, in most euro area countries there was a gradual deceleration of growth from 2006, and in 2008, there



was already a year-on-year decrease in residential property prices in some countries (Ireland, Malta). This development has differed and still differs in particular countries. The new euro area member states, including Slovakia, showed, up to 2008, a significantly above-average growth in residential property prices. One of the reasons for this development is the fact that the real estate market started to function in these countries relatively late and the developers and sellers benefited thereby in recent years from the rapidly growing demand for housing, as well as from the significant growth in economic performance which followed after the entry of these countries into the EU. These real estate markets are, however, too small for their prices to be principally affected by the average prices of real estate for the euro area. These are affected, above all, by Germany, France, Italy, and Spain, which have the greatest share in the creation of the nominal GDP of the euro area (in 2006, more than 77%). The economic performance of countries is the basis for the construction of the weighting scheme for the calculation of the weighted average price of residential property within the whole euro area.

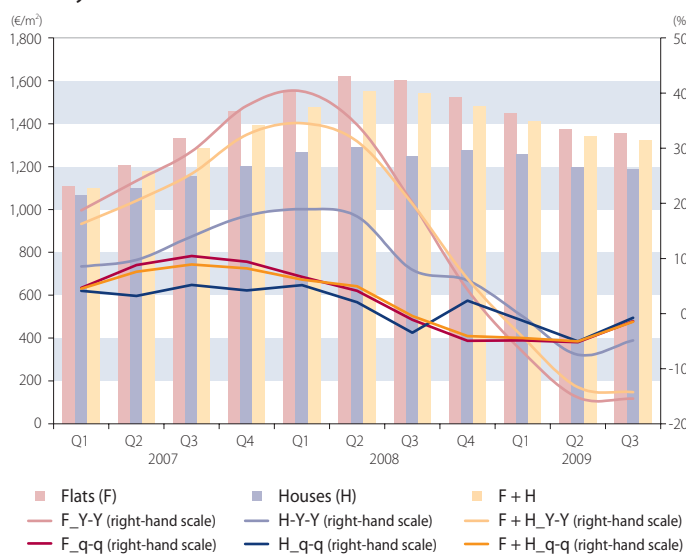
According to the data from particular countries and the considerations of the ECB from the beginning of 2009, a year-on-year decrease in average residential property prices was expected this year in most euro area countries and there was a similar outlook for 2010 as well. This consideration is based on the general assumption that a more permanent revival of economic activity in the euro area may be expected only in 2010, which may, however, more principally affect the real estate market and prices of houses and flats only with a certain time delay.

CURRENT DEVELOPMENT OF RESIDENTIAL PROPERTY PRICES IN SLOVAKIA

The trend for the absolute decreases in aggregate residential property prices from mid-2008 did not end in Slovakia in the third quarter of 2009 either. The average price per 1 m² of a residential area currently reached the value of €1,322, which represented roughly its level in the third quarter of 2007. The average residential property price thereby decreased in the third quarter of 2009 when compared to the second quarter of 2009 by 1.5% and by 14.3% on a year-on-year basis.

In the third quarter of 2009, when compared to the second quarter of 2009, the quarter-on-quarter decrease was attenuated but there was a further deepening of the decrease in average residential property prices on a year-on-year basis, even though slighter than in the previous quarter. This can be considered to be a certain indication of the gradual stabilisation of the Slovak real estate market as well as crystallisation of the equilibrium level of average residential property prices with regard to the development of basic economic fundamentals. The development in the Slovak real estate market in the next quarters will also depend on them to a decisive extent.

Chart 1 Development of prices of houses and flats in Slovakia in recent years



Source: NARKS, chart of the NBS.

The development of the average residential property prices in Slovakia is still being determined by the development in average prices of flats rather than of houses. In the third quarter of 2009, the average price per square metre of flats reached the value of €1,354 per m², which meant, when compared to the previous quarter, a decrease of 1.3% and of more than 15% on a year-on-year basis. The average price per square metre of houses reached €1,187 per m², which represented a quarter-on-quarter decrease of less than one percent and a year-on-year decrease of almost 5%.

The quarter-on-quarter but especially the year-on-year development of average prices for a square metre of residential area of flats was much more variable in recent years than the development of the average prices of houses. For instance, the variation range between the maximum year-on-year growth in average prices of flats (40.3% in the first quarter of 2008) and their current year-on-year decrease (-15.4% in the third quarter of 2009) is several times greater than the variation range of the year-on-year growth in average prices of houses (8.6% in the first quarter of 2008 and -4.9% in the third quarter of 2009). As a result of the current more equal development in the average prices of houses than flats, the relatively similar deceleration of the quarter-on-quarter decrease in average prices of houses and flats is currently demonstrated by a much more significant year-on-year decrease in the average prices of flats than houses.

According to available information, in the third quarter of 2009, when compared to the previous quarter, the decrease in average prices per 1 m² of a residential area of almost all types of flats decelerated; only the average prices of four-room flats increased on a year-on-year basis (2%). The average prices of small-scale flats decreased on



a quarter-on-quarter basis the least (-1.4%) and the average prices of five-room and larger flats the most (-5.6%). A comparison of the average prices of particular types of flats on a year-on-year basis signals the persistence of relatively more significant decreases, especially for smaller flats (one-room -20.2%, two-room -17.2%) when compared to larger flats (four-room -7.7%, five-room and larger -2.6%). This is largely the result of the fading of the basic effect of the more rapid growth in the average prices of smaller flats than of larger ones over the last few years.

For the development of average prices per 1 m² of residential area of houses, sales in standard houses rather than in villas are decisive, specifically with regard to the minimum share of transactions in villas in the total sales of houses. Even despite the growing average prices of villas in the third quarter of 2009, when compared to the previous quarter (6.8%), the aggregate quarter-on-quarter development of the average prices of houses was slightly negative (-0.7%) with a relative stagnation in the average prices of standard houses. On a year-on-year basis, in the third quarter of 2009, average prices of a square metre of a residential area of standard houses (-4.8%), as well as of villas (-3.9) thereby decreased.

From the beginning of 2004 to the third quarter of 2008, the values of indicators such as the population, total amount of credit provided to households, and the value of residential mortgages, volume of time deposits, and GDP value correlated most significantly to average residential property prices. Even after taking into account data for the next quarters, a strong dependence persists among the above variables, with the understanding that, while in the case of most of the indicators there has been a certain attenuation of the dependence monitored, but in the case of GDP, the rate of correlation with the average prices of

houses and flats has remained unchanged (0.89).

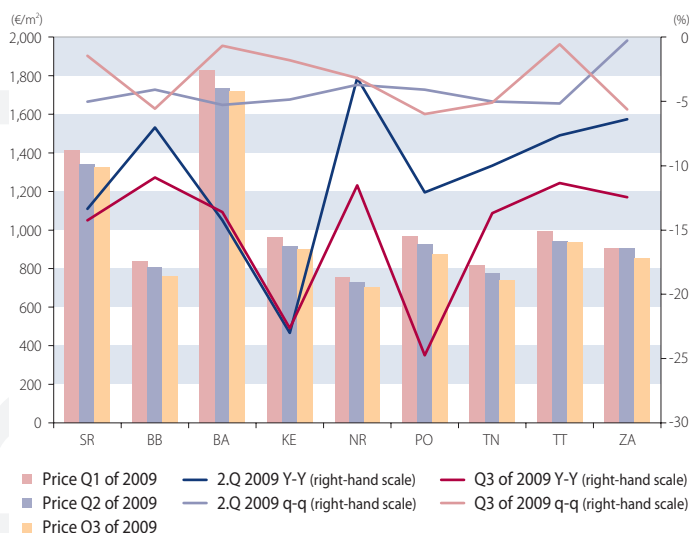
The decelerated decrease in the average prices of houses and flats in the third quarter of 2009 when compared to the previous quarter was accompanied, on the one hand, also by a slower decrease in average prices of monthly rents, and, on the other hand, by a slower growth in average prices of building plots than in the second quarter of 2009. On a quarter-on-quarter basis, average prices of monthly rents of flats decreased more significantly (-4.0%) than for houses (-1.6%). On a year-on-year basis, prices of houses decreased by 16.0% on average and prices of flats by 8.4%. The average price per 1 m² of a building plot reached almost €115 per m² in the third quarter of 2009. When compared to the second quarter of 2009, it increased by less than 2% and on a year-on-year basis, by almost 29%. The development in the average prices of monthly rents as well as average prices of building plots is differentiated considerably from the regional perspective.

REGIONAL VIEW OF THE DEVELOPMENT OF RESIDENTIAL PROPERTY PRICES IN SLOVAKIA

The nature of the Slovak estate market, as well as the calculation of average residential property prices, is determined, to a decisive extent, by their development in the Bratislava region. The growing supply and only slowly reviving real interest in satisfying the housing in this region are the causes of the persisting and fluctuating aggregate decrease in average prices for houses and flats during the last quarters for Slovakia as a whole. Average residential property prices in the Bratislava region decreased in the third quarter of 2009 to €1720 per m², which was the same value as reached in the third quarter of 2007. A similar more significant decrease in average prices of houses and flats was also recorded in the Košice region. In other regions, current average residential property prices are at the level of the turn of 2007 and 2008. Despite the more significant decrease, the average prices for a square metre of a residential area of residential property in the Bratislava region are still more than two times higher than in half of the other Slovak regions (except for the Trnava region, Košice region, and Prešov region).

From the regional perspective, the decrease in average residential property prices continued in the third quarter of 2009 in all the regions. When compared to the previous quarter, average prices per square metre of a residential area in the Bratislava and Trnava regions decreased the least. By contrast, average residential property prices in the regions of Banská Bystrica, Prešov, and Žilina decreased the most. The quarter-on-quarter decrease in average prices per 1 m² of a residential area of houses and flats was fairly variable in the last quarters in most of the Slovak regions. A relatively stable decrease in average residential property prices was recorded in the last two quarters only in the Nitra region and Trenčín region.

Chart 2 Development of average residential property prices in the 2nd and 3rd quarters of 2009 by regions



Source: NARKS, chart of the NBS.



Given the significant variability of the quarter-on-quarter development of average residential property prices in individual Slovak regions in the last quarters, the current quarter-on-quarter deceleration of the decrease in average residential prices in most of the Slovak regions may not be considered to be a permanent sign of the stabilisation of their basic economic fundamentals yet. This also applies in full to the economically more developed regions, such as the Bratislava region, Trnava region, and Žilina region, where an important position is held by the automobile industry, monitored by the whole of society more closely.

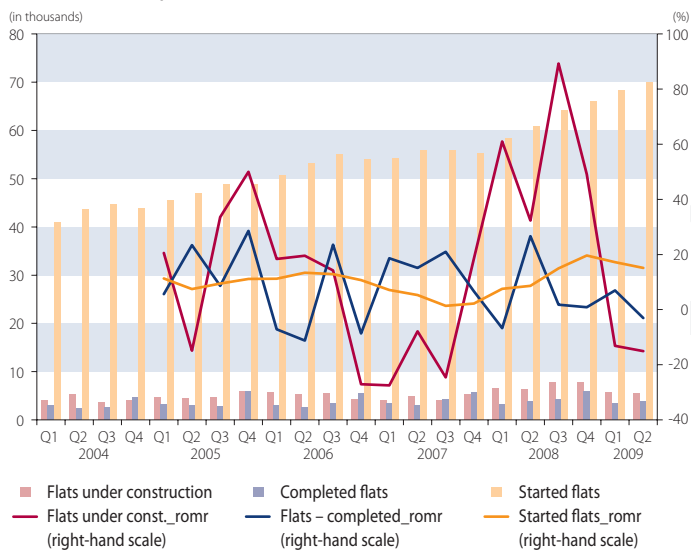
In the third quarter of 2009, when compared to the second quarter of 2009, the year-on-year decrease in residential property prices was deepened in most regions (excluding the Bratislava and Košice regions). One of the reasons is also the basic effect of the ongoing growth in average residential property prices in several regions in the third quarter of 2008, while in the Bratislava and Košice regions, there was already a more significant decrease in prices at that time. On a year-on-year basis, average residential property prices decreased in the third quarter of 2009 most in the Prešov region (-24.7%) and least in the Banská Bystrica region (-10.9%). In the case of the Prešov region, it is also largely a result of the basic effect of the continuing significant growth in average residential property prices one year ago.

POSSIBLE DEVELOPMENT OF RESIDENTIAL PROPERTY PRICES IN SLOVAKIA

When considering the possible development of residential property prices within a short as well as longer time-horizon, it is necessary to take into account global external effects, as well as the whole range of domestic demand and supply factors which principally affect the nature of the current estate market in Slovakia.

A decisive general assumption for revival of the real estate market is the creation of the necessary conditions and provisions more permanently sustainable economic growth in the global sphere, which is of vital importance for the functioning of smaller, substantially open economies such as the Slovak economy. An essentially important condition for more permanently sustainable economic growth is generally a functional financial system, which helps in funding the economic activities of entrepreneurial entities as well as the objective needs of individuals and households. It was right in this part of the production chain, which used to be called the life-blood of economic growth, that serious discrepancies appeared over the last few years, which led to the global financial crisis and thereafter also to the strong economic depression. The situation thus incurred has resulted in the intensive attempts of world and European authorities to increase the regulation of the financial markets², which may ultimately result, in addition to the expected increase in their safety, in a complication for the availability of credit resources, and this may also lead to a certain inhibition of

Chart 3 Development of residential construction in Slovakia



Source: Statistical Office of the SR, chart of NBS.

activities in the real estate market.

From among the domestic impacts, it is necessary to focus the attention, in addition to the weakened mutually linked demand factors related to the decreased performance of the Slovak economy, on the currently significantly growing demand as a result of cumulated reserves of available houses and flats over the last few quarters, in which there has been a relative freezing of the real estate market in Slovakia.

From the beginning of 2008, the number of started flats began to grow and the number of completed flats remained at the level of the previous year. For 2008 only, there was thereby a significant accumulation of under construction by almost 15,000 flats, representing a considerable potential for possible growth in the housing supply during the next quarters. This fact will clearly be beneficial, within a short-term horizon, for individuals and households interested in housing, in the form of the opportunity to select higher quality housing for relatively lower prices than one year ago, for instance.

The currently stagnating or slightly reviving demand for housing is not caused by an adequate satisfaction of housing needs in Slovakia but it is a result rather of a relatively significant deepening of the negative expectations of citizens mainly in the second half of 2008, related to the worsened performance of the economy and growing unemployment³. The demand for housing in Slovakia, thus temporarily postponed, primarily depends, therefore, on the rapidity of the consolidation of the Slovak economy and a more significant growth in the positive expectations of citizens, by which their potential and willingness to solve the their own housing needs through credit sources will grow.

The right credit sources and the significant improvement in their availability were the important factors which have contributed to the

- 2 One of the currently discussed measures is a substantial increase of the required share of own funds of interested parties in applying for credit sources for the procurement of residential property.
- 3 Even though the consumer confidence indicator (summary characteristics calculated as an arithmetic average of balances of the expected development of economy, unemployment, and expected development of the financial situation and savings in own household) slightly improves from the beginning of 2009, comparison with the same period of the last year sounds positively only for to the expected financial situation in households, while the other three components of the indicator recorded a negative development. In total, the consumer confidence indicator was, in September 2009, still by 14.8 percentage points less favourable than in September 2008.
- 4 More information in: National Bank of Slovakia: Slovak Financial Sector Analysis for the 1st Half-Year of 2009, p. 8-9.



huge dynamisation of the real estate market and growth in residential property prices in Slovakia in recent years. The gradual implementation of stricter standards for credit from 2007 has not discouraged the real estate parties interested in resolving their housing needs either. In the first half of 2009, the making of credit standards stricter gradually attenuated; however, they are also fixed quite strictly now, which contributes to the fact that acquiring credit for housing in Slovakia is relatively low risk⁴.

A positive signal for the real estate market is the fact that, after the gradual reduction in the volume of new residential loans from mid-2008, from the second quarter of 2009, its resumed growth is recorded, even though the current volume is still at a level lower than one year ago. The low basic interest rate also creates a certain assumption for a potential improvement in credit conditions for parties interested in residential loans in commercial banks, which may contribute to a slight increase in the demand for housing. The truth, however, is that Slovak commercial banks have responded, for instance, to the last change in the basic interest rate roughly with a quarter-point shift when compared to other euro area countries and the prices of Slovak mortgages are currently two percentage points above the euro area average (about 4%). The current credit conditions in Slovakia are set for suitably solvent interested parties.

From the monitoring of the influence of the current development of selected demand and supply factors on the conditions and development of the Slovak real estate market and after taking into account professional opinions on the expected trend of the development of the real estate market and average residential property prices in the euro area, it may be expected during the coming quarters that the supply of houses and flats will in general exceed the demand for housing for a certain period of time.

In the last quarter of 2009, a slight decrease in prices for houses and flats should still continue with a high probability. With an increased attempt by developers to implement completed investments by the end of the calendar year, in the 4th quarter of 2009 there may be even a higher quarter-on-quarter decrease in average prices per 1 m² of a residential area of residential property than in the previous quarter. In relation with that, and based on the accepted assumption of a roughly three-percent average quarter-on-quarter decrease in average residential property prices, an average year-on-year decrease of more than 11% would be recorded in 2009, when compared to the previous year.

Without the right to specify the exact number of the quarter-on-quarter development in individual quarters of 2010, the stagnation of average residential property prices may rather be assumed. Several reasons exist for this consideration. According to the latest prognosis of the EC and statements of other relevant international

institutions, indications of an economic revival are apparent but, the instability rate still remains high. Even if the positive indications of the Slovak performance revival are confirmed at the end of 2009, it will be a signal for only a slight revival in the real estate market in the next months. Given the considerable potential reserve of houses and flats already mentioned, supply will dominate over the prudent demand; therefore stagnation in average housing prices may rather be assumed during 2010. 2010 will probably be the year for the principal crystallisation of the Slovak real estate market.

SUMMARY

Significant turbulence in the world financial markets, accompanied by depression in most national economies, have also affected real estate markets with a significant force. The market in the segment of residential property in the euro area recorded its high point in 2005, when average residential property prices increased on a year-on-year basis by almost 8%. Since 2006, there has been a gradual deceleration in growth in the euro area and since 2008, also a year-on-year decrease in average residential property prices in certain countries (Ireland, Malta), while in particular countries, this development was and still is quite differentiated. Up to 2008, Slovakia, as a new member of the euro area, demonstrated, according to available information, a significantly above-average growth in residential property prices, also as a result of the relatively late formation of the real estate market.

With a certain time delay, there has been a gradual stagnation and even blockage of the real estate market also in Slovakia, which has been demonstrated in the rapid year-on-year decreases in average prices per 1 m² of a residential area of houses and flats during the last quarters. The average price per 1 m² of a residential area reached, in the third quarter of 2009, the value of €1,322, which represents roughly its level in the third quarter of 2007. The average residential property price in the third quarter of 2009 thereby decreased by 1.5% when compared to the second quarter of 2009 and by 14.3% on a year-on-year basis. While the quarter-on-quarter decrease has currently been attenuated, on a year-on-year basis, there has been another, even though already slighter, deepening of the decrease in average residential property prices than in the previous quarter. This can be considered as a certain indication of the beginning of a gradual stabilisation of the Slovak real estate market as well as a crystallisation of the equilibrium level of average residential property prices with regard to the development of basic economic fundamentals.

The reduced decrease in average prices of houses and flats in the third quarter of 2009 when compared to the previous quarter was also accompanied, on the one hand, by a slower decrease in average prices of monthly rents and, on the other hand, by a slower growth in the aver-



age prices of building plots than in the second quarter of 2009. On a quarter-on-quarter basis, average prices of monthly rents of flats decreased more significantly than those of houses, while on a year-on-year basis, the situation was the reverse. The average price per 1 m² of a building plot reached, in the third quarter of 2009, the value of almost €115 per m², which meant a quarter-on-quarter growth of less than 2% and growth of almost 29% on a year-on-year basis.

From the regional aspect, the decrease in average residential property prices continued in the third quarter of 2009 across all regions. When compared to the previous quarter, average prices for one square metre of a residential area in the Bratislava region and Trnava region decreased the least. By contrast, average residential property prices in the Banská Bystrica region, Prešov region, and Žilina region decreased the most. The quarter-on-quarter decrease in average prices per 1 m² of a residential area of houses and flats in the last quarters was quite variable in most of

the Slovak regions. A relatively stable decrease in average residential property prices was recorded in the last two quarters in the Nitra region and Trenčín region only.

Following on from the development of the basic economic fundamentals and the effect of selected demand and supply factors on the condition and development of the Slovak estate market, and after taking into account professional opinions on the expected trend of the development of the real estate market and average residential property prices in the euro area, it may be expected in the next quarters that the supply of houses and flats will in general exceed, for a certain period of time, the demand for housing. Based on these assumptions, stagnation or even a slight decrease in average residential property prices may therefore be assumed for the next quarters also. Relative stabilisation of average residential property prices could, theoretically, occur in the second half of 2010, but the whole of 2010 will probably rather be a year for the principal crystallisation of the Slovak real estate market.

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