

Spain

Housing Adjustment: Are We Nearly There?

- **Recent data on housing supply and demand in Spain show some tentative signs of stabilisation** at the beginning of 2014, after nearly seven years of downward adjustment. Data released this week showed that the number of house transactions rose by 5.9% YY in Apr 14, after surging by 22.8% in March. In the past two years, transactions stabilised at around an average monthly level of 25K (excluding the temporary rise due to the change in mortgage interest deductibility in Q1 13), or 60% lower than 2007 levels, but they showed a modest rise to 27K in Jan-Apr 14 (see Figure 1). Bank lending surveys indicate that mortgage lending standards have stopped tightening, although the number of mortgaged dwellings is still falling sharply (-21% YY in Q1 14). On the supply side, housing permits have risen by 30% YY in the past six months, albeit from record-low levels (only 8% of the prevailing average in 2007), while housing completions are still falling at a fast pace (-40% YY, see Figure 2). We reckon that modest improvements in housing demand are likely to lead to a slowdown in the pace of contraction in house prices, while tentative signs of stabilisation in construction activity should reduce the negative drag on real GDP growth in the coming quarters.
- **House prices (according to the INE data) have indeed fallen by “only” 1.6% YY in Q1 14** – slowest pace of decline since Q2 10 – easing markedly relative to Q4 13 (-7.8% YY, see Figure 3). The price adjustment is still somewhat faster based on other measures of house prices (Ministry of Housing’s data reported -3.8% YY in Q1 vs. -4.2% YY in Q4 13). House prices are now growing in four out of the 17 regions, including Madrid (1.9%), the Basque Country (1.4%), Cantabria (1.4%), and Balearic Islands (0.2%). According to this measure, prices are now 37.2% lower than their peak in 2007.
- **Some further adjustment in house price still lies ahead, in our view.** Measured against household income or housing rents, house prices remain some 6-10% above their long-run average, according to OECD data (see Figure 4). Other episodes of post-bubble price adjustments in the US and Ireland have seen these ratios falling well below their historical norms (by 15-20%) before house prices stabilised. Moreover, housing affordability as measured by the Bank of Spain has worsened significantly since Q1 13, after the government abolished the tax deductions for mortgage interest payments. And potential demand for housing is much lower than in pre-crisis times, as population growth is now negative (-0.9% in 2013) and it is projected to remain so over the next decade. While income stabilisation may help speed up the adjustment, we reckon another 5-10% house price drop is probably on the cards, implying at least another year before prices reach the bottom. The end of the housing adjustment is getting closer, but with the still-large stock of unsold houses (recent estimates put it at around 0.6 million), we still reckon a pickup in prices and activity is not to be expected any time soon.

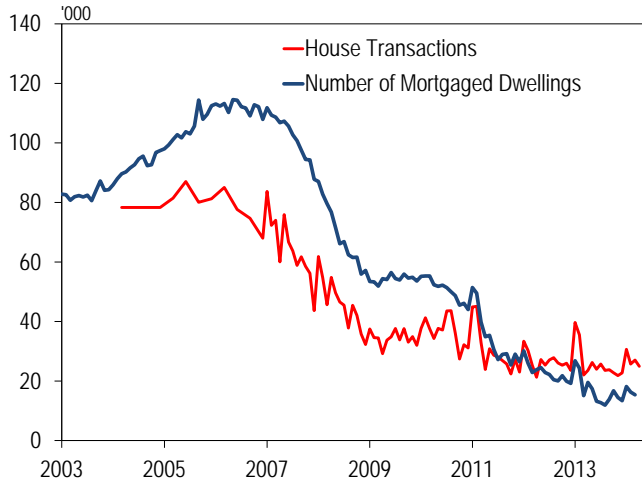
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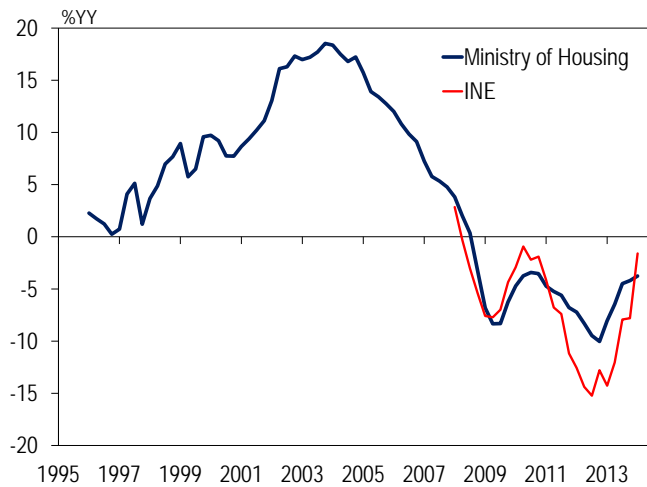
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Figure 1. Spain – Housing Demand Indicators, 2003 - Apr 2014



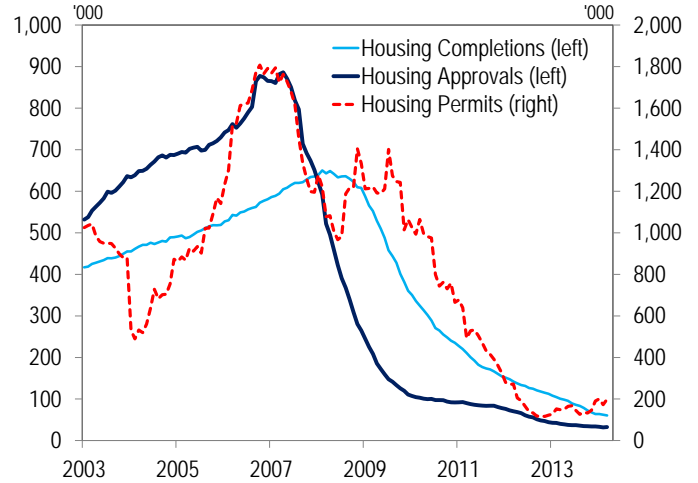
Note: Number of mortgaged dwellings is seasonally adjusted by Citi Research.
Source: Bank of Spain, Ministry of Housing, and Citi Research

Figure 3. Spain – House Price Index (%YY), 1995 - Mar 2014



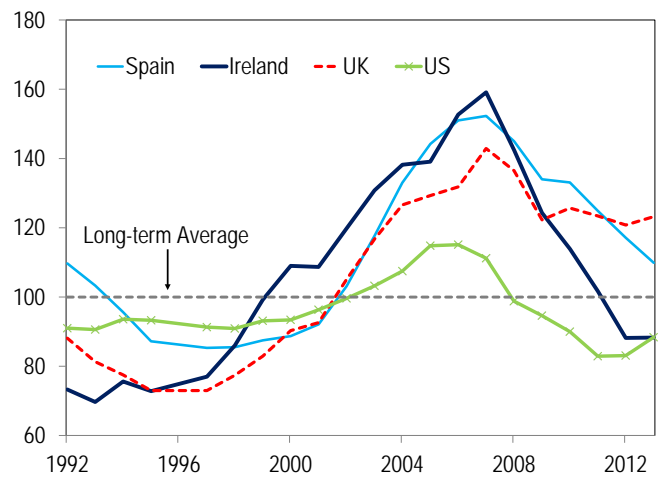
Source: INE, Ministry of Housing, and Citi Research

Figure 2. Spain – Housing Activity Indicators, 2003 - Mar 2014



Note: 12-month sum
Source: Bank of Spain, Ministry of Housing, and Citi Research

Figure 4. Selected Countries – House Prices to Income Ratio (Long-Term Average = 100), 1992-2013



Source: OECD, and Citi Research

Appendix A-1

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