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## PRESS RELEASE

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### **Analysis of the developments in residential property prices: is the Belgian market overvalued?**

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Close monitoring of the property market is a crucial element of macroeconomic analysis, just as it is for conducting macroprudential policy. The emergence of tensions on the mortgage market can effectively undermine financial stability, as happened in the United States during the subprime mortgage crisis, which is generally regarded as one of the precursors of the global economic and financial crisis in 2008 and subsequent years. Moreover, the experience of some European countries, notably Spain and Ireland, has shown that imbalances on the property market can cause cyclical slowdowns and cause them to spread too.

Residential property prices in Belgium have been on a clear upward trend since the beginning of the 1970s, and only two - relatively short - downturns, have been recorded, the first in the early 1980s and the second during the economic and financial crisis in 2008 and 2009. Since then, prices have continued to rise, albeit at a slower pace on average than that observed before the great recession, so they have virtually stabilised if changes in inflation are taken into account. Growth of house prices was still strong in 2015, despite the significant reduction in tax deductibility of mortgage loans (also called the 'housing bonus') in the Flemish Region. Yet, in 2016, the Bank's indicator again pointed to a sharp slowdown in price rises.

Mainly because there has been no downward correction as was the case a few years ago in a good many European countries, the rise in house prices has become a matter of concern in Belgium. To gauge whether prices are deviating from their equilibrium level, either upwards or downwards, the empirical literature lists a number of techniques that could be classified into two main categories depending on the approach used to estimate the equilibrium value of house prices. The first one, which uses the long-term average of ratios of macroeconomic variables, such as price-to-income and price-to-rent and which generally points to high degrees of overvaluation, nevertheless has some limitations and notably fails to take account of a significant number of underlying factors that can influence the property market. The second approach, which is based on econometric techniques and is considered in the article as preferable, partly overcomes these drawbacks. More precisely, it involves comparing property price trends with a number of their underlying determinants, such as household income, mortgage rates, or demographic developments.

By following this approach, the Belgian property market has not shown signs of any considerable overvaluation. Price movements can therefore be largely explained by movements in certain underlying determinants. In particular, the increase in household disposable income, together with the fall in interest rates over the previous decades, has helped improve housing affordability. House prices have also been propped up by the marked rise in the number of households as well as by property taxation, which has generally evolved in a way that should encourage access to mortgage credit. However, that has been less the case since 2015, with the devolution of more powers to the Regions and successive reforms of the housing bonus system, especially in the Flemish Region. Yet, the increase in prices did not taper off during the course of that year, leading to an even higher overvaluation of the property market. Owing to the marked slowdown in price rises in 2016, this overvaluation is nevertheless estimated to have dropped back and stabilised around 7.8 %.

It should be pointed out that a neutral valuation, i.e. a situation where property price movements are perfectly in line with market fundamentals, in no way implies that there is no risk for the property market. If one of the determinants of property prices were to deteriorate significantly, the result could be a sharp fall in prices.