

The end of the global house price boom

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Weighed down by the credit crunch and high inflation, the global house price boom has ended, according to the latest Global Property Guide survey of house price indicators.

Only 13 countries in which dwelling price indices are regularly published saw prices rise during the year to end Q1 2008, while 21 countries saw dwelling prices fall in real terms, i.e., after adjusting for inflation.

In most countries where house prices are not falling, they are clearly losing momentum.

The biggest house price fall was in Latvia (Riga), down -38.2% by May 2008 from a year earlier, after adjusting for inflation.

US prices also fell during the year to end of Q1, by anything from -4.2% to -18.1%, after inflation, depending on which index is used.

In Europe, significant real house price falls took place during the year to end-Q1 2008 in Ireland (- 13.2%), Luxembourg (-5.8%), Portugal (-4.3%) and Malta (-4.9%).

UK house prices were only slightly down at end-Q1 from a year earlier, the house price crash having begun in earnest in early 2008. House prices fell during the first quarter by between - 0.7% to -2.1% (inflation-adjusted), depending on the index used.

In Japan, the housing market is now losing momentum once again. The urban land price index for 6 major cities was up only 4.1% year-on-year (y-o-y) to H1 2008 in nominal terms (2.9% after inflation), down from 7.8% over the same period in 2007 (7.9% after inflation). The national index for Japan fell by 0.7% y-o-y to H1 2008 (-1.9% after inflation).

Inflation woes

In nominal terms, 28 countries saw their housing prices rise during the year to end-Q1 2008, while only 6 saw prices fall.

However when property prices are adjusted for inflation, the picture looks entirely different. Skyrocketing oil, food and commodity prices have pushed inflation up around the world.

In Ukraine for instance, nominal house price growth was sharply down from 79.5% in the year to Q1 2007, to 18.2% in the year to Q1 2008. But when adjusted for inflation, property prices actually fell by -6.4% y-o-y.

In real terms, property prices fell y-o-y to end-Q1 2008 in Norway, Spain, Greece, South Korea, New Zealand, Indonesia, South Africa, Israel, Estonia and Lithuania, despite nominal price rises in all these countries.

House-price booms elsewhere

On the other hand, strong house price increases were observed in a handful of emerging economies. Ahead of the pack was China (Shanghai), with an enormous 40.5% nominal house price surge during the year to the end of Q1 2008.

Other countries with impressive nominal house price increases y-o-y to end-Q1 2008 were Bulgaria (31.6% y-o-y), Hong Kong (31.1% y-o-y), and Singapore (29.8% y-o-y). Strong house price gains also took place in Cyprus, Australia and Taiwan.

Again, when adjusted for inflation, many of these price rises look much less impressive. The world's top-performing housing market (after inflation) was not China or Hong Kong or Singapore, but Slovakia, where real house prices rose by 29.3%.

Causes of the downturn

There were arguably three main factors behind the end of the housing boom:

- After a very long boom, house prices had become stretched in many countries. The main indicator of this is the price/rent ratio, which compares the relationship between the buying price of a dwelling, with its rental price.

As the boom progressed, buying prices become high (in relation to rents and financing costs) in many countries, leading to decisions by some buyers to rent instead of buying. Mortgage-holders also came under extreme pressure as interest rates rose. A key lesson is the critical importance of monitoring price/rent ratios, to ensure that house prices valuations stay within reasonable limits. (Declaration of interest: The Global Property Guide produces comprehensive price/rent ratio estimates, globally).

- Inflationary pressures forced central banks to raise interest rates. This particularly impacted European countries where mortgage loans were primarily made on variable interest rate terms. Countries with heavily indebted households are also vulnerable when interest rates increase.

In developing countries, the overall economy (which strongly sways the mood of the housing market) is sometimes very sensitive to interest rate changes or to direct intervention by the monetary authorities. In some countries, mere threats of interest rate hikes are enough to shake the stock market and scare away foreign investors. But conversely, developing countries typically have smaller mortgage markets, reducing the impact on housing markets.

- Unsound regulatory and banking practices in the US and elsewhere led to over-lending by mortgage providers which, when these unsound loans began to go bad, caused a financial crisis. The bad news spread both by a panic contagion effect, and because many banks outside the US turned out to be more exposed than initially expected.

Prospects

Inflation remains an extremely challenging problem for the world's central banks. In addition, the financial shocks to the world's banking systems resulting from house price falls remain to be worked through (historically, most banking system collapses around the world have been caused by falling house prices).

Until these financial systems feel more confident that their problems are behind them, loan volumes are likely to fall. Therefore, it seems likely that the world's house price momentum will continue to go down.

Economics Team:

Prince Christian Cruz, Senior Economist
Phone: (+632) 750 0560
Cell: (+63) 917 735 2228
Email: prince@globalpropertyguide.com

Publisher and Strategist:

Matthew Montagu-Pollock

Phone: (+632) 867 4220

Cell: (+63) 917 321 7073

Email: editor@globalpropertyguide.com

Address:

Global Property Guide
www.globalpropertyguide.com
5F Electra House Building
115-117 Esteban Street
Legaspi Village, Makati City
Philippines 1229
info@globalpropertyguide.com

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