



OECD-IMF Workshop on Real Estate Price Indexes

RECENT HOUSE PRICE DEVELOPMENTS: THE ROLE OF FUNDAMENTALS

by

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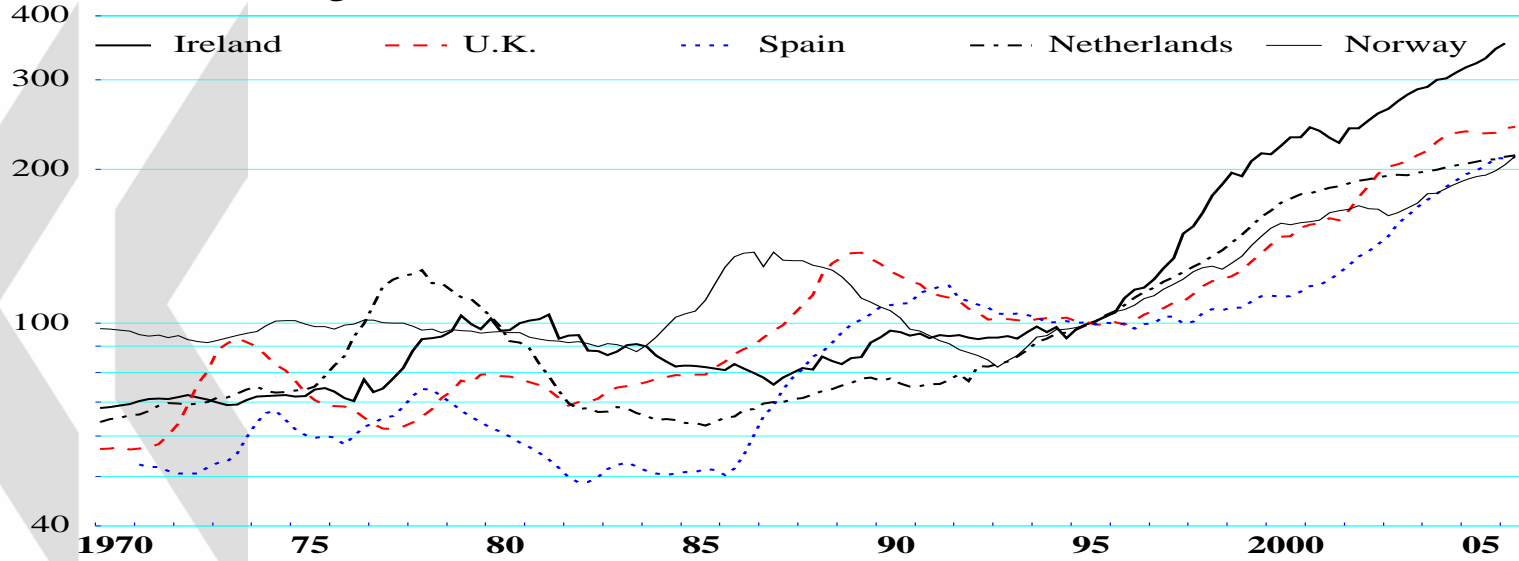
OECD Economics Department

This run-up in house prices is different

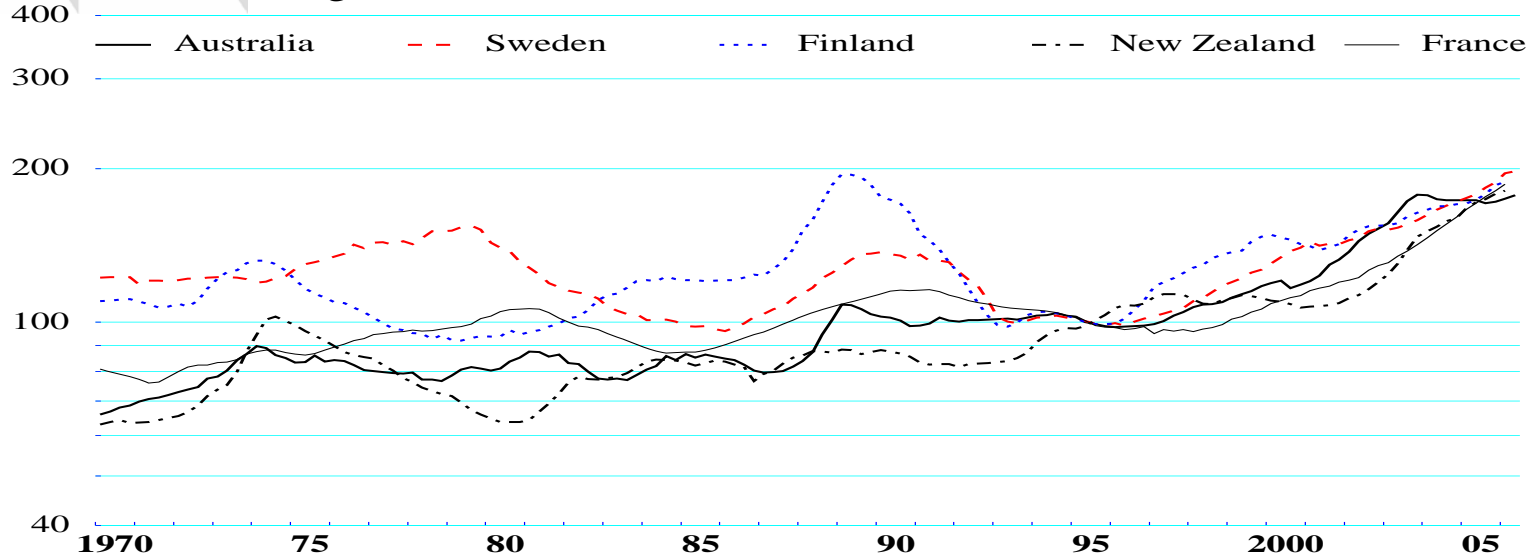
- Here are the features that make it unique:
- *The increases have pushed house prices above previous peaks almost everywhere*
- *The duration of the run-up has been longer than before*
- *This house price cycle has become disconnected from the business cycle*
- *The number of countries experiencing large and sustained increases this time is also without precedent*

Real house prices have generally been rising

Index, 1995=100, logarithmic scale



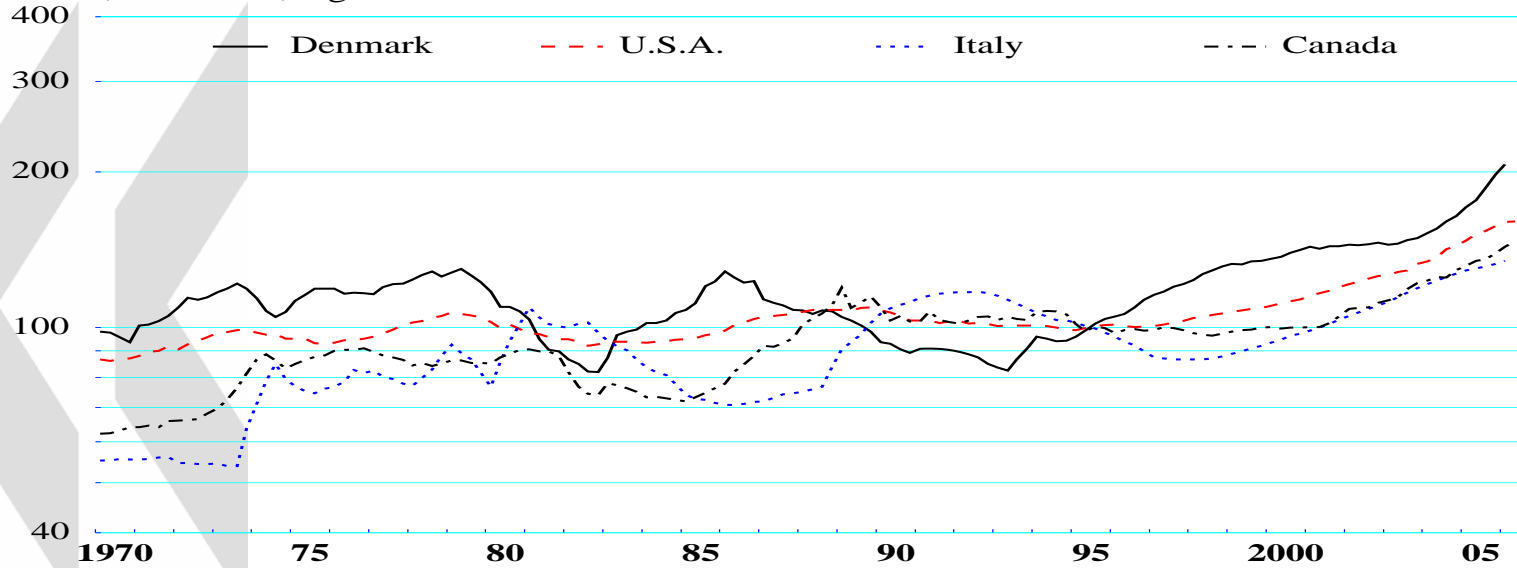
Index, 1995=100, logarithmic scale



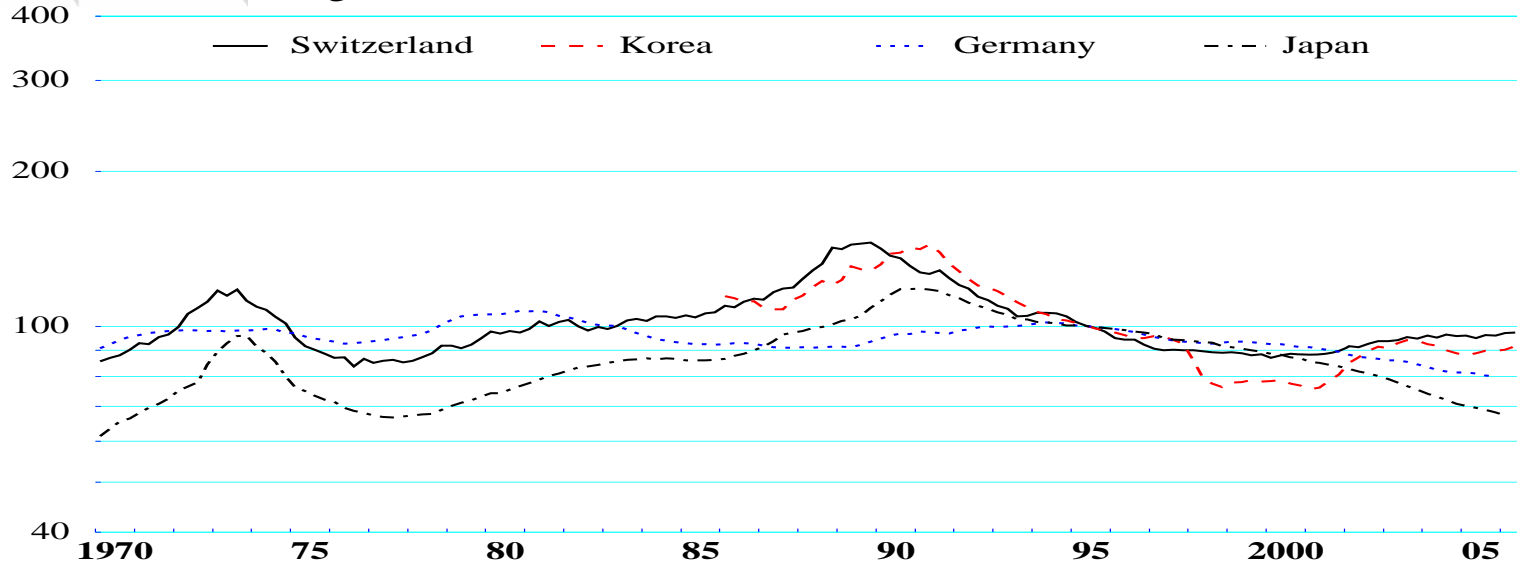
Source: National sources and OECD Main Economic Indicators.

Real house prices have generally been rising

Index, 1995=100, logarithmic scale

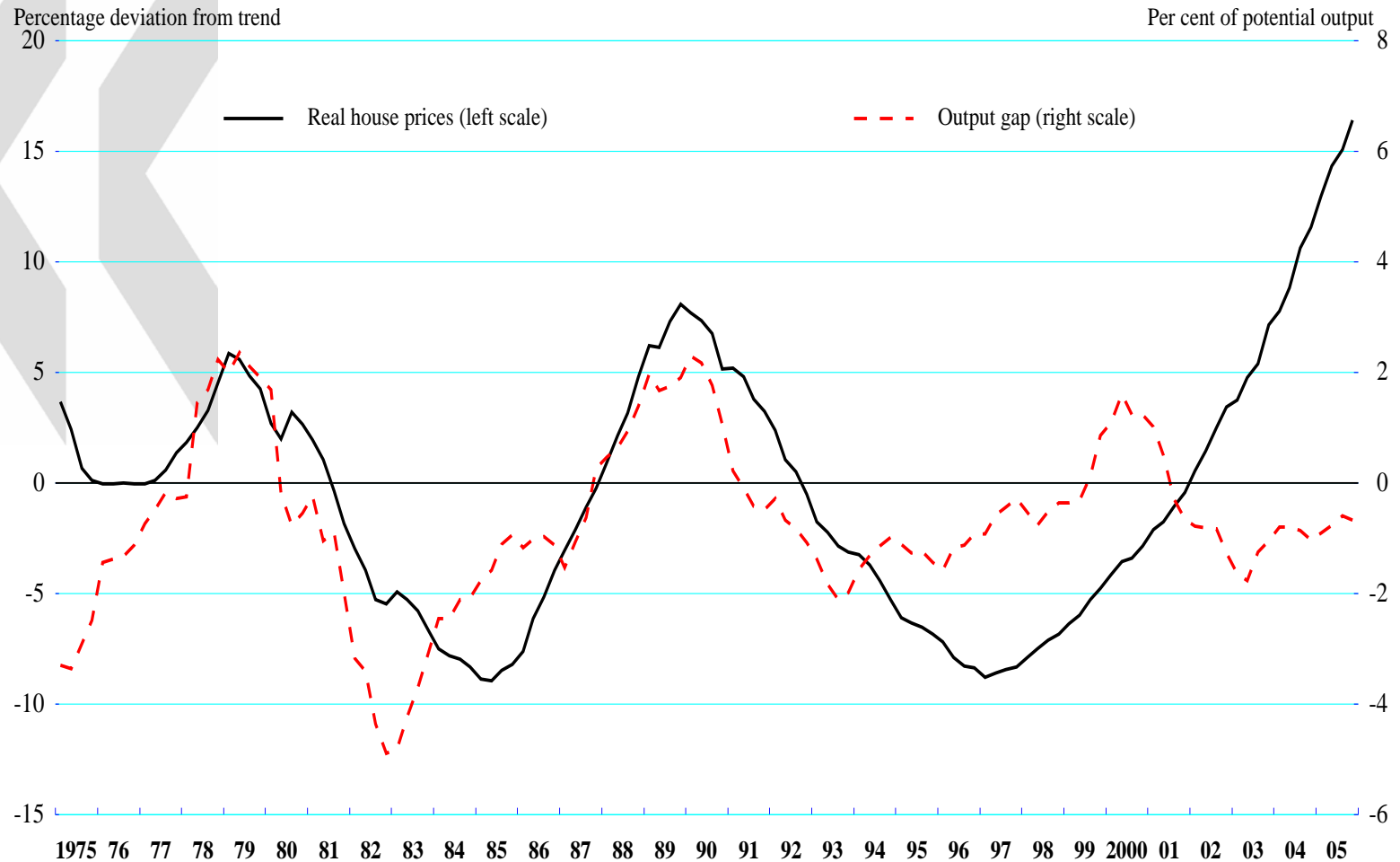


Index, 1995=100, logarithmic scale



Source: National sources and OECD Main Economic Indicators.

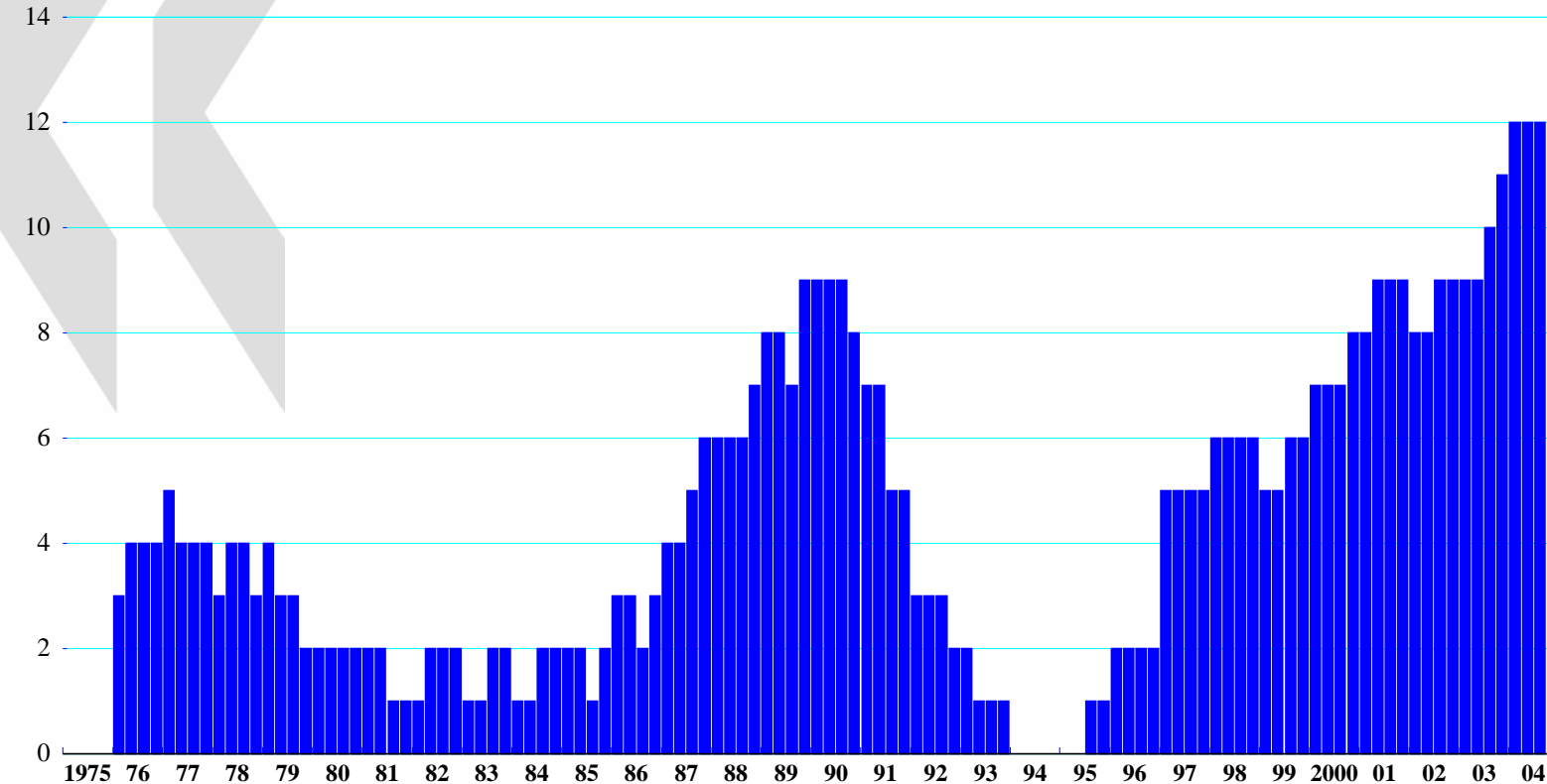
OECD Real house prices and the business cycle



Source: National sources and OECD Economic Outlook 80 database.

Cross-country coincidence of real house price increases

Number of countries



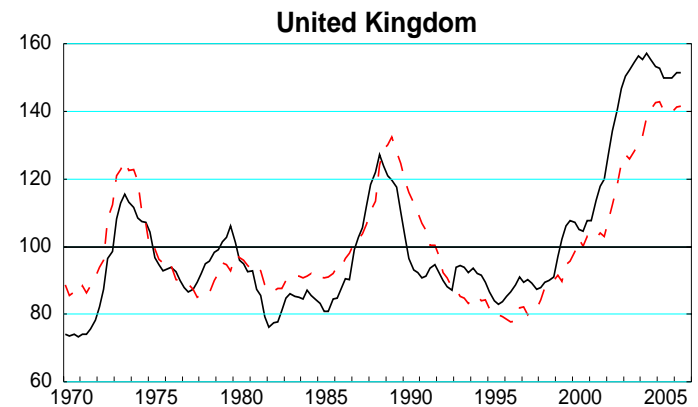
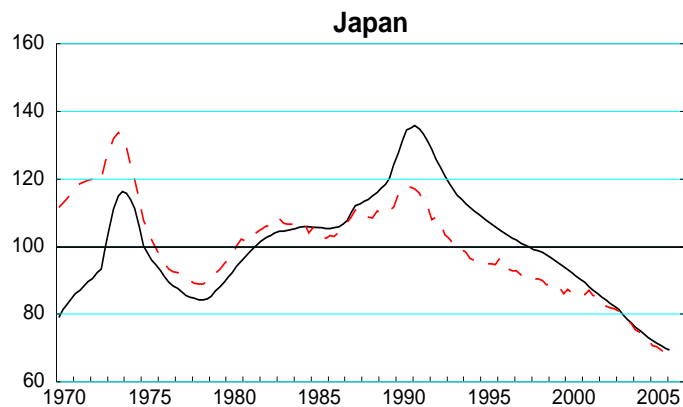
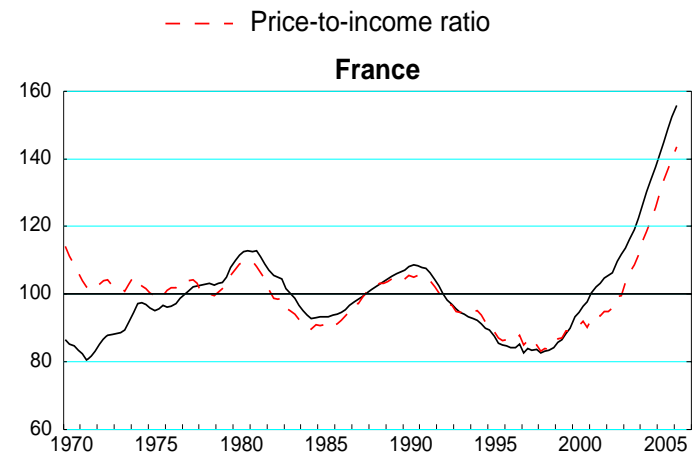
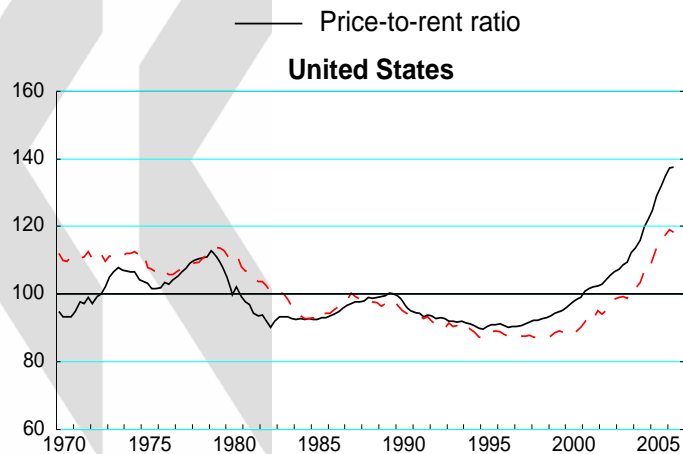
Source: National sources.

Evaluating house price developments

- While all these facts are interesting, why should the prices of such a non-traded good move in so synchronised a fashion?
- To get at this issue of “globalisation” we need to evaluate the underlying determinants of these prices
- Here we will look at two methods which will shed some light on the global nature of the process
 - *Measures of affordability*
 - *The relationship of prices to rents*

Price-to-income and price-to-rent ratios

Sample average = 100



Source: National sources and OECD calculations.

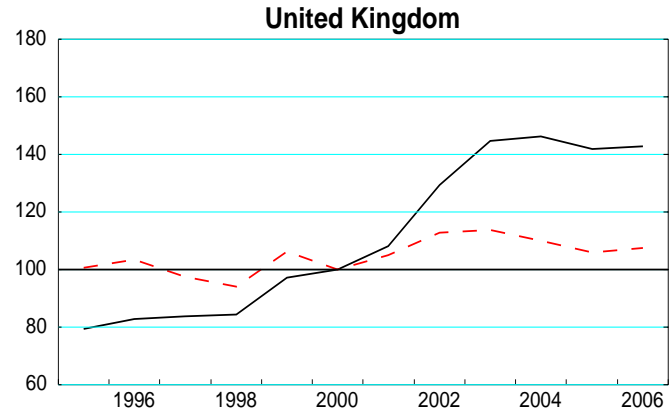
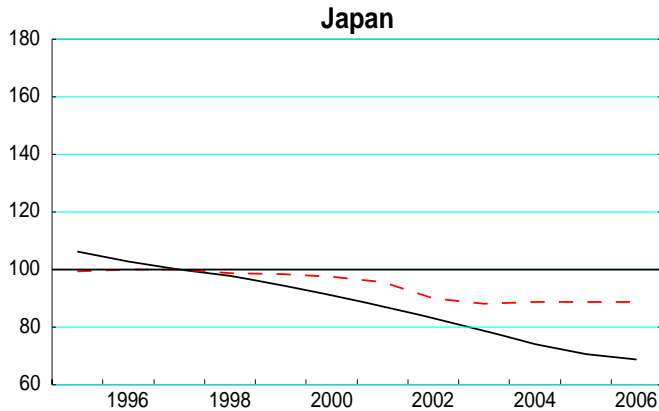
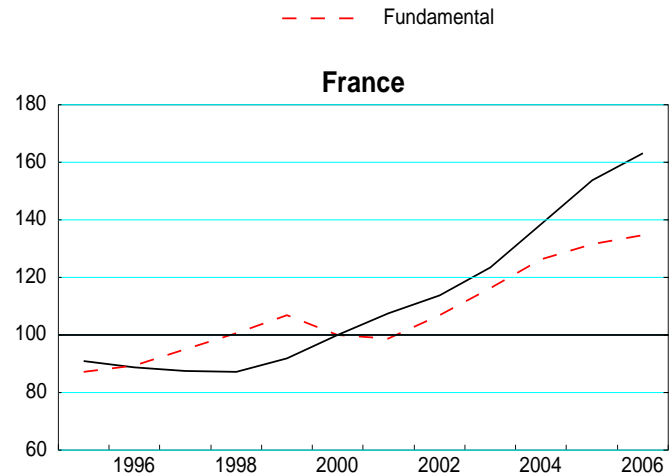
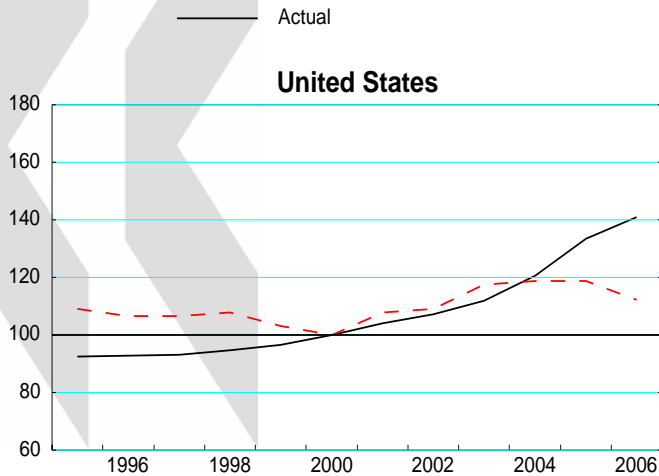


Measures of affordability

- Prices have increased faster than disposable income
- At the same time, houses seem to have become more affordable
 - *Mortgage debt (% of disposable income) has risen almost everywhere*
 - *But the cost of carrying the mortgage has, for the most part, fallen and offset the rise in mortgage debt*

Price-to-rent ratios: actual and fundamental

Long-term average = 100



Source: National sources and OECD calculations.

The message from price-to-rent ratios

- *These measures are meant to answer the question: is purchasing a house worth it?*
- *Measures used to evaluate high price-rent ratios take account of interest rates, taxes, depreciation, expected capital gains, etc*
- *They generally show more overvaluation than affordability measures*

Other factors

- There are a number of other factors that affect prices which are more country specific and non-global in nature

Demand factors:

- *Population*
- *Mortgage market developments*
- *Speculation*

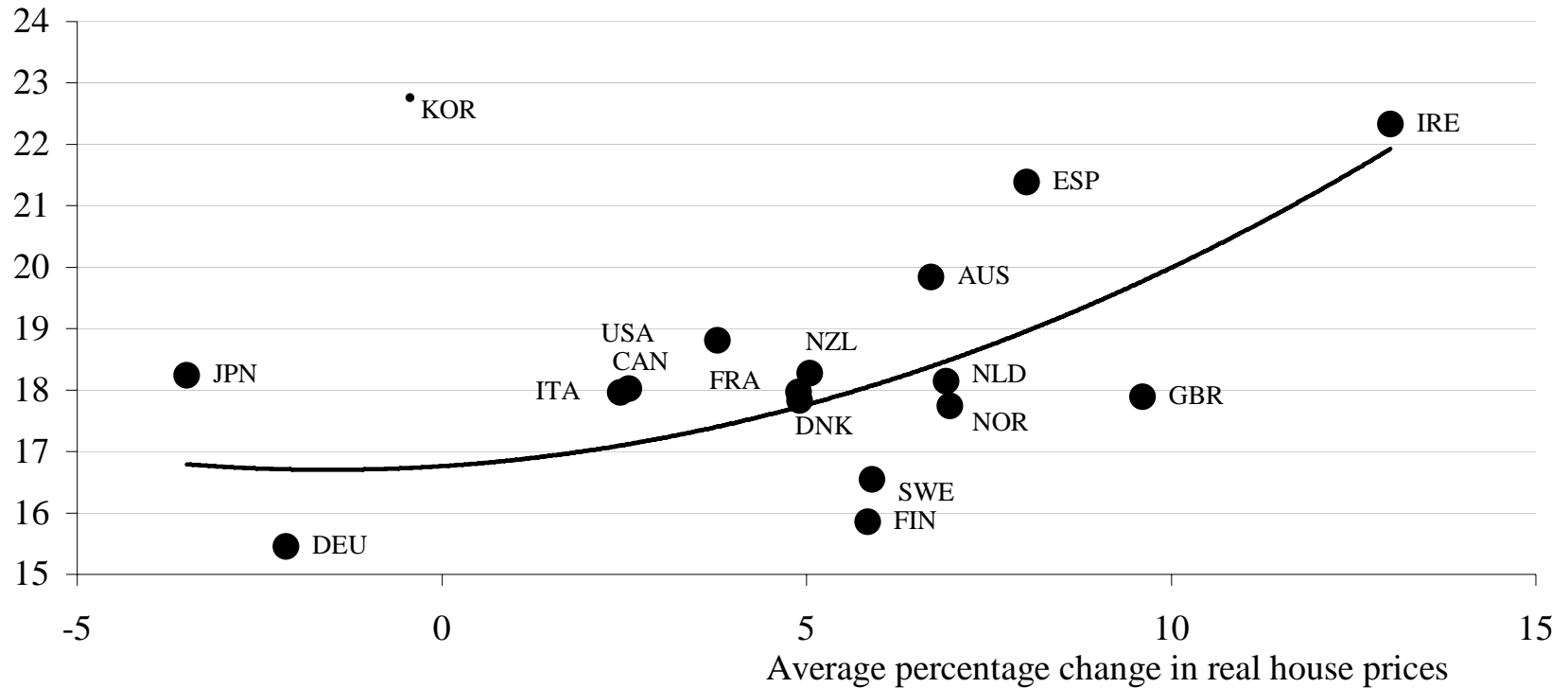
Supply factors:

- *Zoning and other regulations*
- *Housing investment response*

Population and house prices

1995-2004

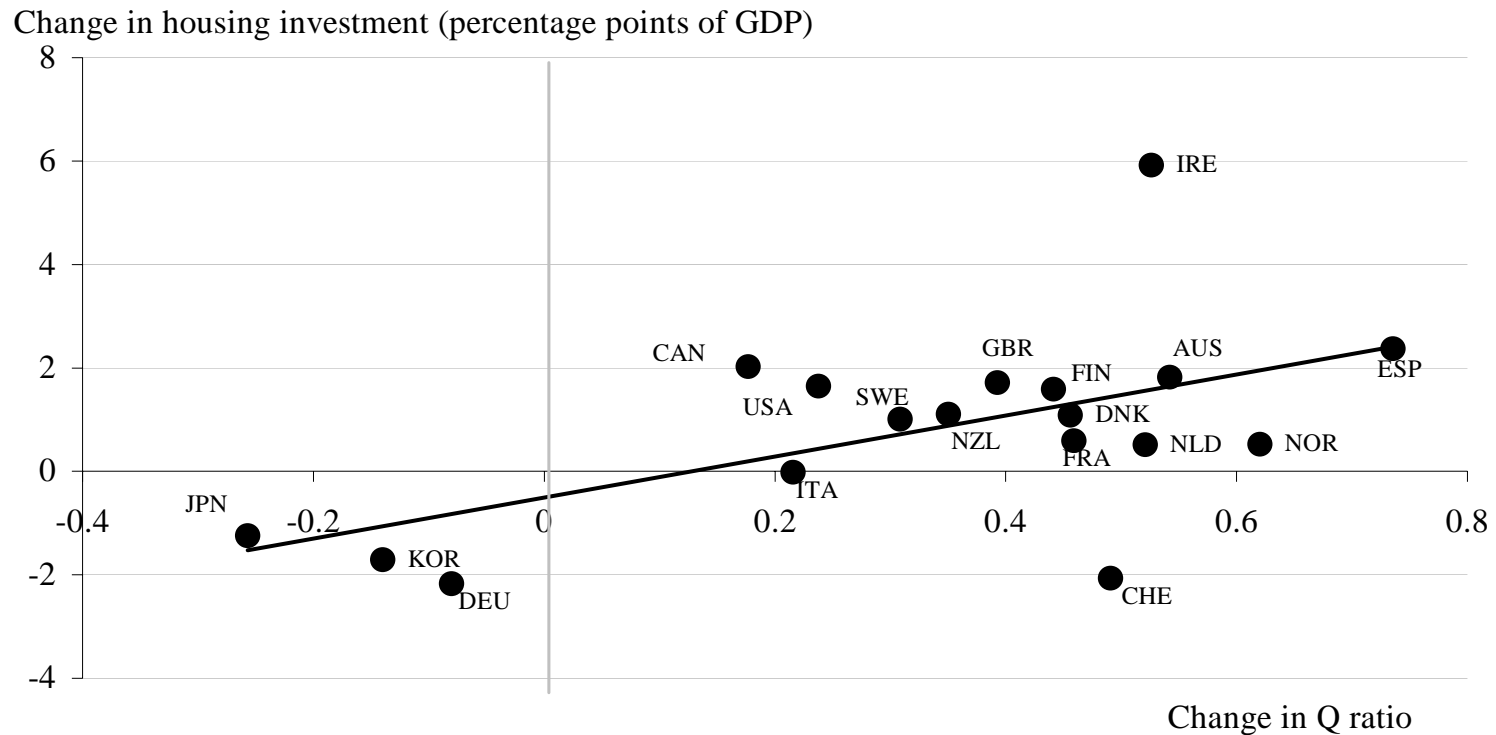
Population at household formation age (per cent of adult population)



Source: National sources and United Nations.

Supply has also responded

1995-2004



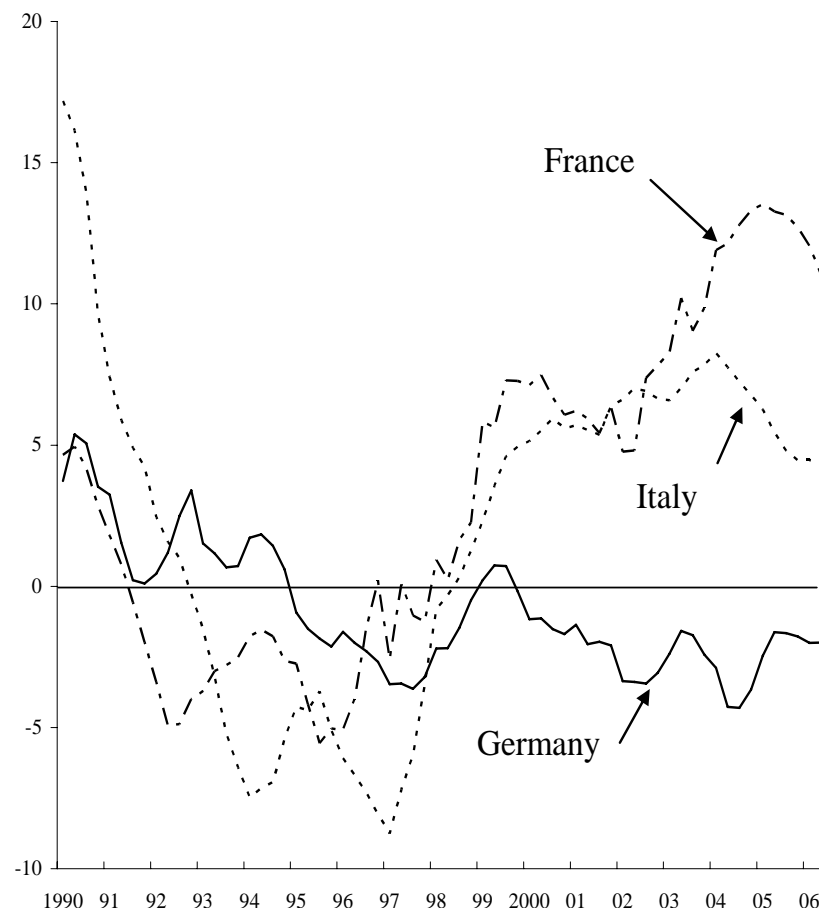
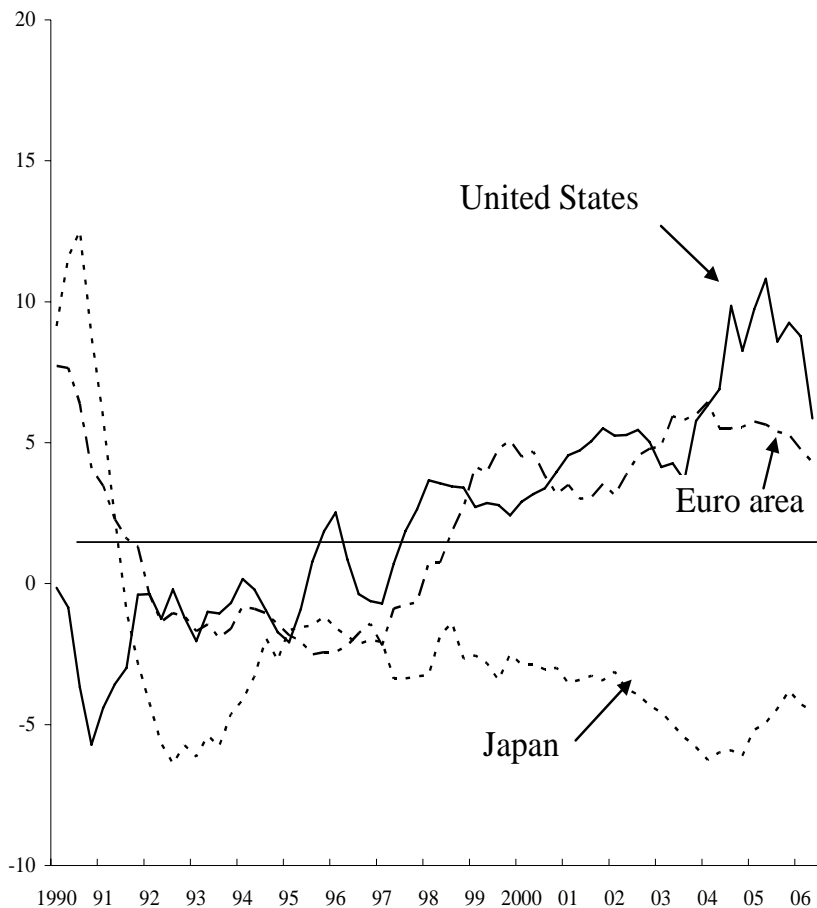
Note: The Q ratio is defined as nominal house prices divided by the housing investment deflator.

Can't help but ask: what would a decline look like?

- *If interest rates back up, then prices would be affected*
- *In the past, when prices have reversed, the drops, in real terms, have been large*
- *The current low level of inflation would play a role in determining the length of the adjustment period since it is “real” prices that need to adjust*

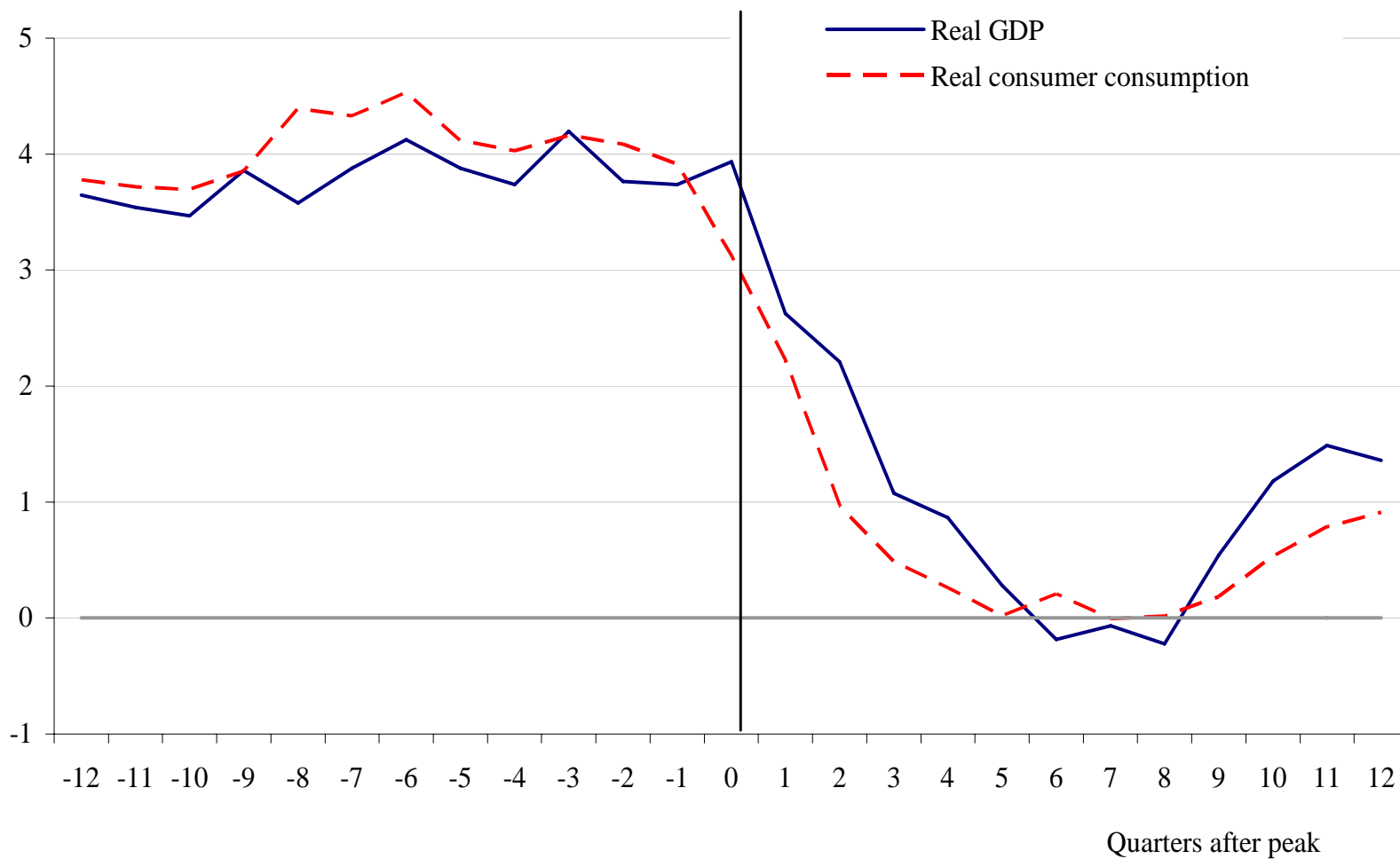
Real house prices now tend to decelerate

Year-on-year percentage change



Source: National sources and OECD Economic Outlook database.

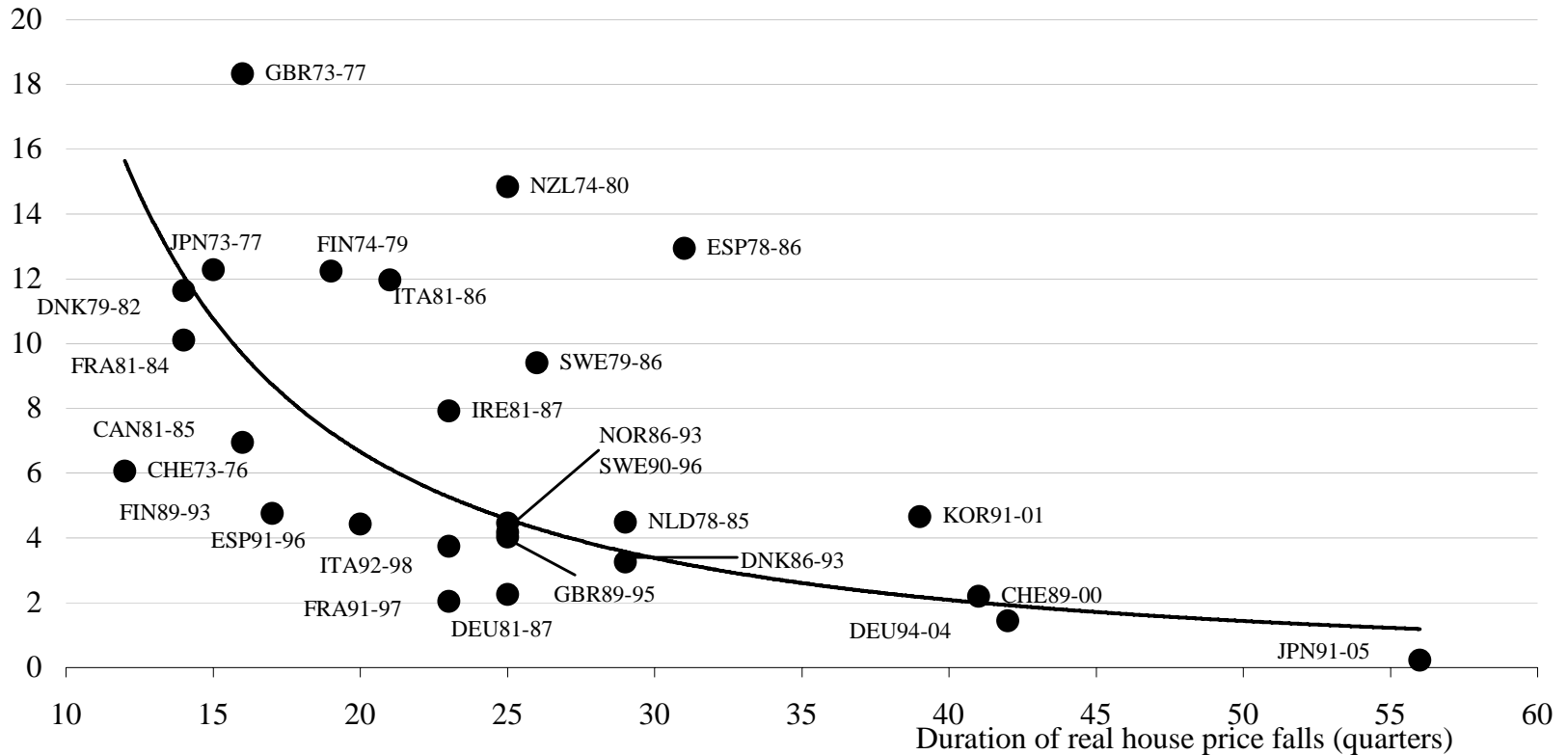
House prices and economic growth



Source: National sources and OECD Economic Outlook 78 database..

Inflation and real house price adjustment

Average annual
Inflation rate



Source: National sources and OECD Economic Outlook 78 database..

OECD Economics Department's recent working papers on house prices

● **Cross-country studies:**

- House prices and economic activity (Nathalie Girouard and Sveinbjörn Blöndal, No 279 - January 2001)
- Housing Markets, wealth and the business cycle (Pietro Catte, Nathalie Girouard, Robert Price and Christophe André, No 394, June 2004)
- Recent house price developments: the role of fundamentals (Nathalie Girouard, Mike Kennedy, Paul van den Noord and Christophe André, No 475, January 2006)
- Are house prices nearing a peak? A probit analysis for 17 OECD countries (Paul van den Noord, No 488, June 2006)

● **Country / area-specific studies:**

- Tax incentives and house price volatility in the Euro Area: Theory and evidence (Paul van den Noord, No 356, June 2003)
- Modelling cyclical divergence in the euro area: the housing channel (Paul van den Noord, No400 September 2004)
- Housing prices and inflation in the Euro Area (Boris Cournède, No 450, October 2005)
- Ireland's housing boom: What has driven it and have prices overshot? (David Rae and Paul van den Noord, No 492, June 2006)
- The Danish housing market: less subsidy and more flexibility (Espen Erlandsen, Jens Lundsgaard and Felix Huefner, No 513, September 2006)
- Finland's housing market: reducing risks and improving policies (Laura Vartia, No 514, September 2006)