The FHB House Price Index 2011; assessing the first quarter of 2012; an international outlook

The FHB House Price Index

A slight decrease in the first quarter of 2012 as well

According to the latest processed figures of the FHB House Price Index, further drop in house prices occurred in Hungary in the first quarter of 2012. *Chart 1* shows the index values between 1998 and 2012 Q1 in relation to the value in 2000, while *Chart 2* indicates the annual nominal changes in the FHB index and deflated by CPI. The average index value for 2011 was 172.1, whereas the same figure for **Q1 in 2012 is 170.2**.

After a 5.1% decrease in 2010, house prices declined by 1.9% in 2011, in real terms by 5.5%. In the second half of 2011 prices dropped by a further 1.6% compared to the first half of the year and recently acquired data confirm that the **slight decrease continued in the first quarter of 2012.** House prices showed a nominal decrease of 0.4% compared to the fourth quarter of 2011 and 2.6% compared to the same period in 2011.

2011 Q1	2011 Q2	2011 Q3	2011 Q4	**2012 Q1**
174,7	172,4	170,6	170,8	**170,2**

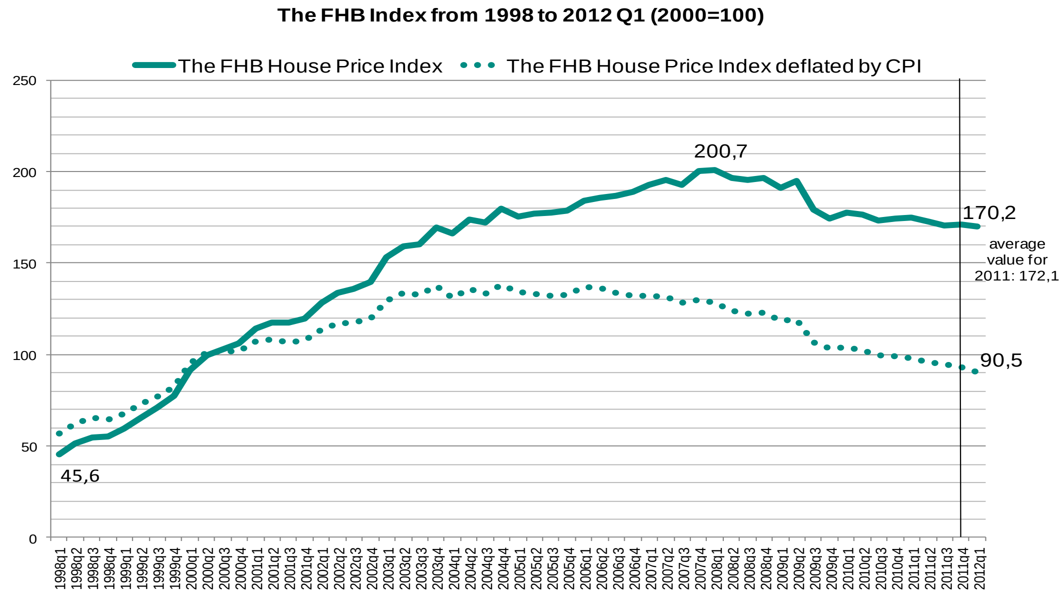


Chart 1: The FHB House Price Index from 1998 to 2012 Q1 (Source: FHB)

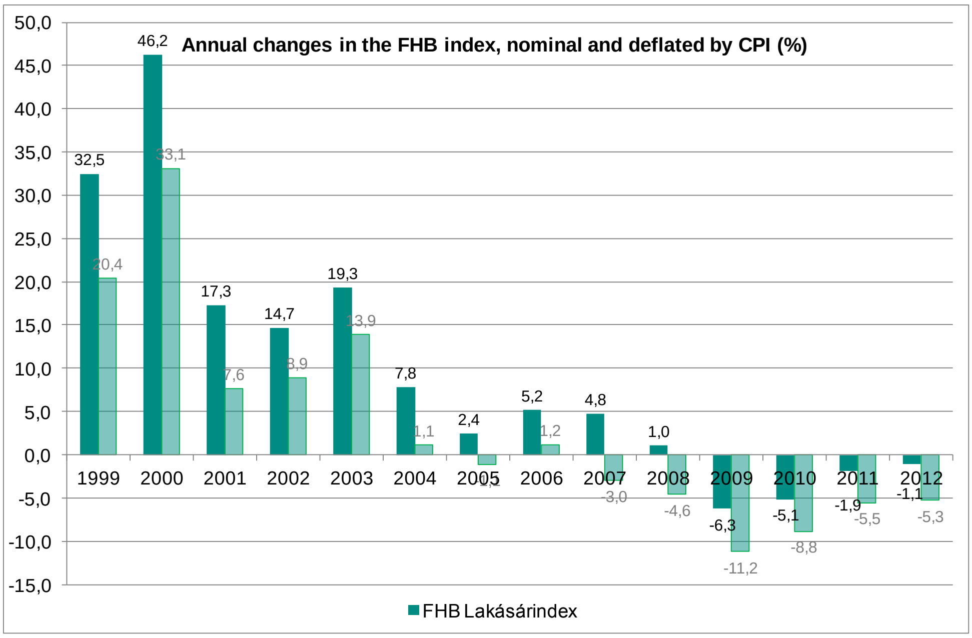


Chart 2: Annual changes of the FHB House Price Index, nominal and deflated by CPI (1999-2011, in % of the previous year,

Source: FHB)

Housing market trends

Turnover in the housing market still at a 10-year low

The **92 thousand transactions in 2011** are barely a third of the peak value of the turnover in the housing market recorded in 2003 (*Chart 3*). Based on our estimate and the preliminary data acquired from the Hungarian Central Statistical Office (KSH), without the increase in the turnover due to the final repayments at a non-market rate* it is very likely that 2011's figures would have been the lowest in the past three years. The sales and purchases show an all-time low, the market is waiting for a turn in a „hibernated" state.

Figures acquired so far regarding the first quarter of 2012 confirm our expectations that **activity in the housing market will not reach its previous level** and **the effects of state interference** (see: the introduction of a quota regulating forced sales, redesigning the National Asset Management Agency, the introduction of subsidized mortgage loans and social housing subsidy) **influencing turnover figures will be protracted and delayed.**

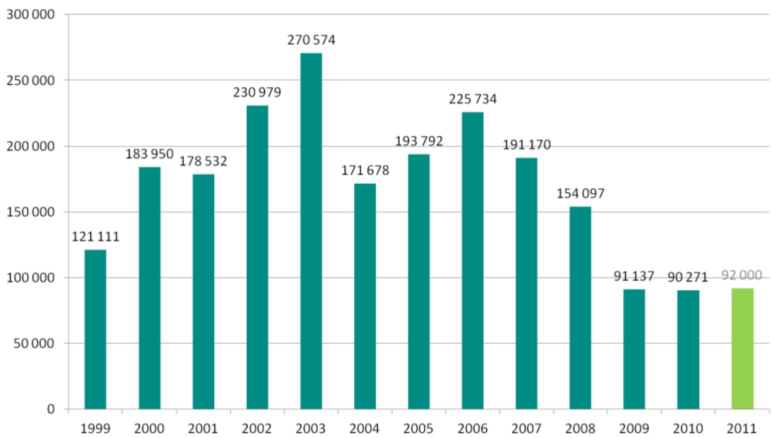


Chart 3: Estimated number of housing market transactions (1999-2011, pcs,

Source: data acquired from the Hungarian Central Statistical Office (KSH) and FHB estimates)

*the repayment of FX mortgage loans at a preferred, non-market rate; a highly controversial regulatory measure of the Hungarian state that enabled mortgage borrowers to repay their FX loans at a non-market rate.

The construction of housing units in 2012 – a low-point of the supply side

The construction of housing units has hit an all-time low. Last year 12 655 new housing units were completed in Hungary, in Budapest this number was only 3 192. **In the first quarter of 2012 a further decline of 22% occurred. Compared to the 3141 completed housing units in the first quarter of 2011, only 2444 new housing units were built.**

As the number of issued building permits very accurately indicate the number of housing units receiving occupation permits in nine months' time *(Chart 4),* **it is safe to say that the construction output of housing units can not sink significantly any lower (see: the curve flattening out in the last 3 quarters enlarged), possibly the autonomous supply during the recession hit its quarterly low-point. At the same time the slower decrease in the number of building permits indicates that no major turn in the completion of new housing units can expected before the first quarter of 2013.**

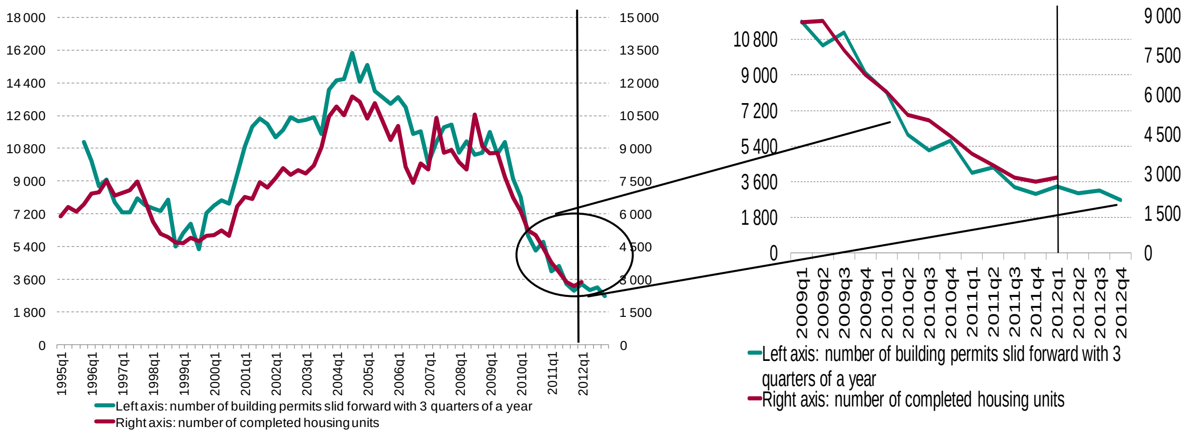


Chart 4: A forecast on the number of completed housing units (Source: Hungarian Central Statistical Office (KSH), seasonally revised figures)

The market of new and second hand housing units – close correlation

According to Chart 5 illustrating changes in the number of building permits and the turnover in the housing market, **the market of new and second hand housing units move tightly parallel to each other**. In Europe, the turnover and building permits are in positive relationship with each other, which means that where more housing units are built, the complete housing market turnover is increasing too. Based on the available data, this correlation is even tighter in countries where the home ownership ration is higher as in these cases the sale of the used or occupied property is usually a precondition for households for purchasing new-build properties or starting developments. NB: According to figures acquired in the mid 2000s, the home ownership ratio in Hungary is 92 %, which means that the dependency of new-build housing units on the second hand ones is rather high. This is shown in Chart 5.

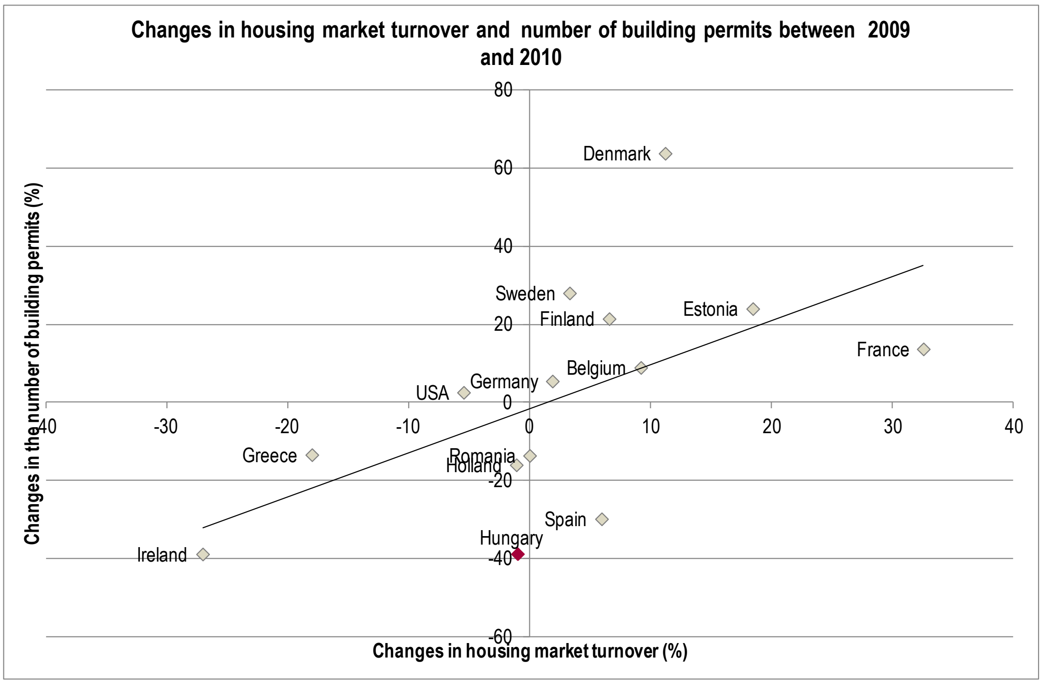


Chart 5: Changes in the turnover in the housing market and in the number of building permits between 2009 and 2010 (in %, Source: European Mortgage Federation)

Employment and income in households: a slight increase without significant effect on demand

Our conclusions drawn from the parallel movements of the variables are also confirmed by the economic approach. **The rate of employment,** which largely affects the demand side, **showed a 1% increase** in 2011 (*Chart 6*). However, this growth is not significant: it is due to the newly implemented community service schemes and although there are some changes in the competitive sector, they can not be considered to be permanent - yet. Due to the expectations of recovery, the positive change in the rate of employment might be fragile, a further decrease in the rate of employment in the competitive sector can not be ruled out, either. The positive effects of the new labour law and government schemes aiming to facilitate employment are possibly delayed and according to the major forecasters, this year, households' prospects for employment and income are worse than last year. *Charts 6 and 7* show the changes in income, in nominal terms and deflated by CPI. Households' **real income rose slightly** but the different layers of the population benefited from this small growth to a different extent. The **effects of changes in taxation and wages could not bring about any significant turn regarding the demand constraint**, which is quite alarming.

Chart 6: Changes in the number of employed people (compared to the same quarter of the previous year, in %, source: Hungarian Central Statistical Office (KSH))

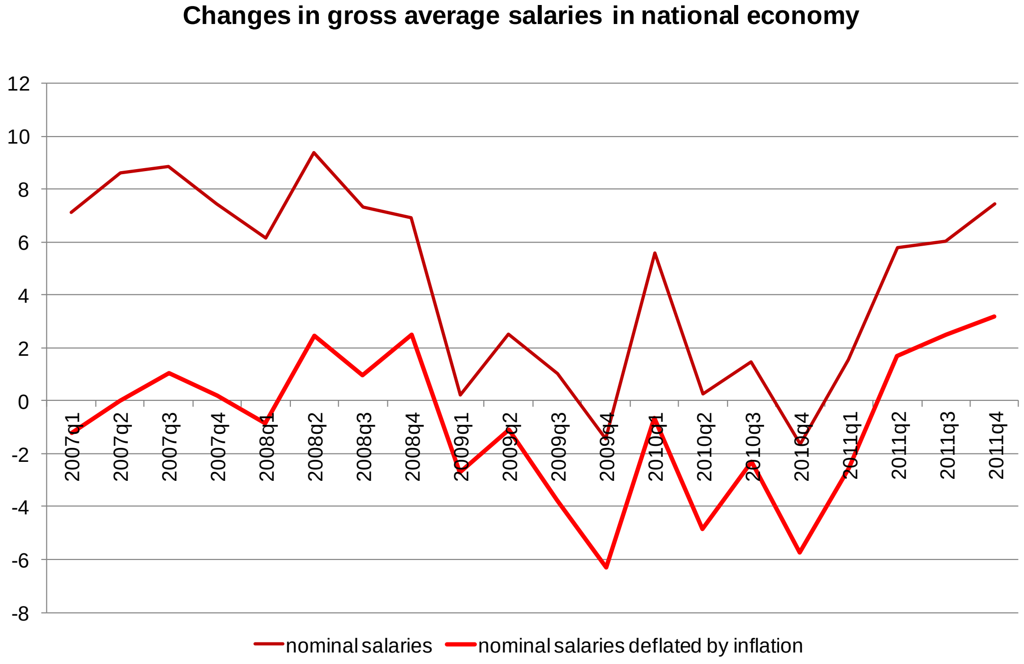


Chart 7: Changes in gross average salaries in national economy (compared to the same quarter of the previous year, in %, source: Hungarian Central Statistical Office (KSH))

The stock of retail mortgage loans are decreasing, both the supply and the demand sides are rather weak

The revival of the demand side is still hindered by the shrinking loan market. Hungarian households have been **loan-repayers** for several years *(Chart 8).* The depreciation of the Forint against the Swiss Franc increased the value of the stock but on the other hand the favourable final repayments resulted in the decrease of the stock. Prospects are not favourable either: **higher interest rates due to the high funding costs and a low demand for loans due to the deteriorating income for households will have an effect of delaying the turn**.

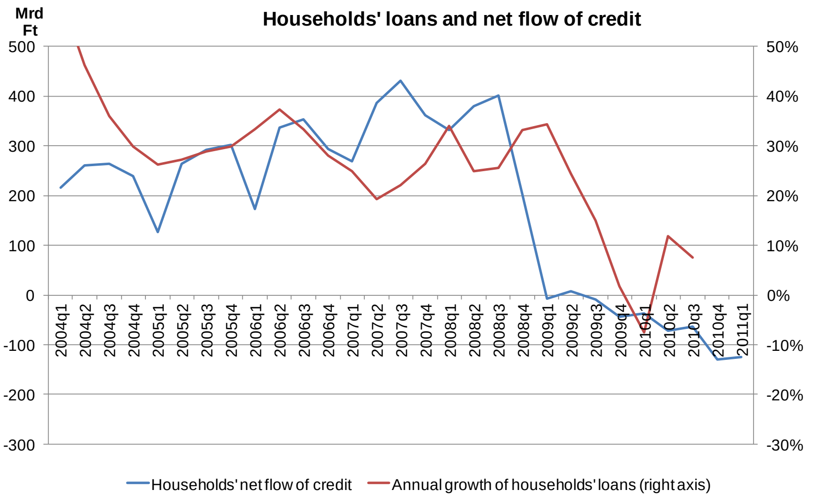


Chart 8: Stock of households' mortgage loans and the net flow of credit (source: Hungarian National Bank and FHB estimates)

European outlook

Hungary's population is not among the most indebted nations

Chart 9 shows the proportion of retail mortgage loans in relation to the GDP in European countries (darker colours indicate a relatively higher level of indebtedness). **The debt of Hungarian households in relation to the GDP is not high on international scales even after the revaluation of FX loans**. Countries having a highly developed mortgage market (the UK, France, Germany, the BENELUX states, Scandinavian countries), as well as unsustainably lending countries such as Spain, Portugal and Ireland have values higher than the average. In these states the indebtedness ratio in relation to the GDP exceeds 60%. In the four „Visegrad" countries (the Czech Republic, Slovakia, Poland and Hungary) these values are below 40 % respectively.

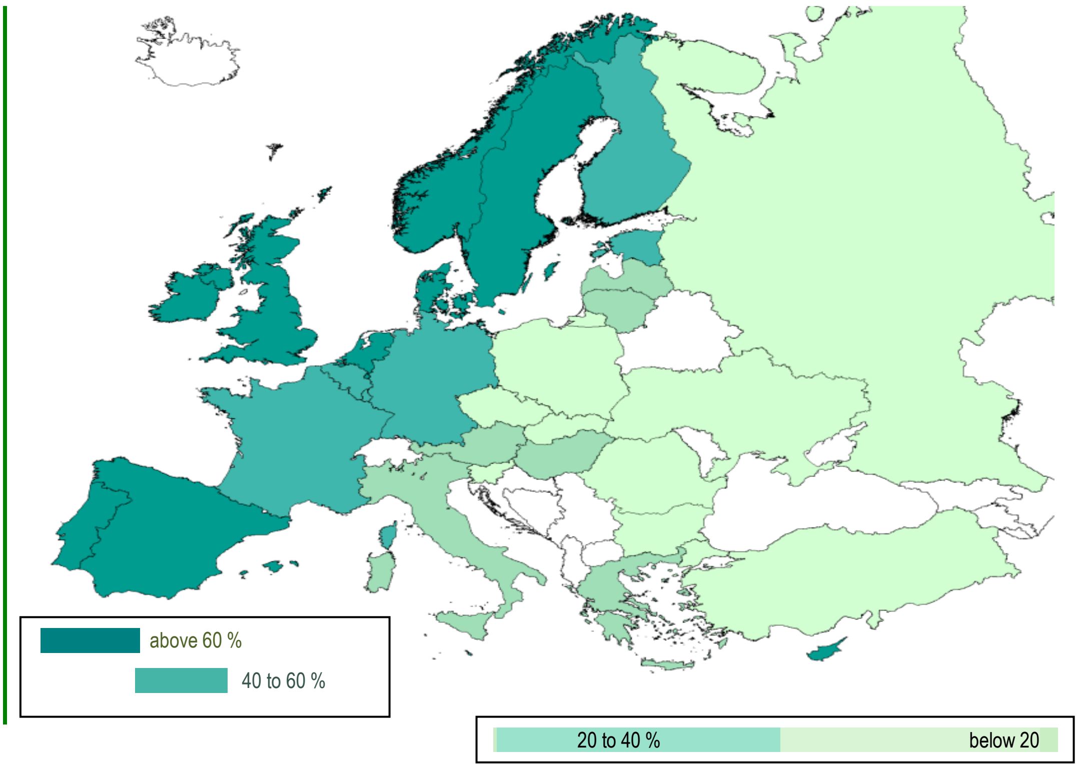


Chart 9: Retail mortgage loans in relation to the GDP (2010, in %, source: European Mortgage Federation)

The same correlation can be examined based on the economic development of the different countries. According to the relationship between the retail mortgage loans in relation to the GDP and the difference expressed in percentage from the EU average measured in purchasing power parities, **there is a positive relationship between the development of a country and the degree of its indebtedness,** which means that the more developed a country is the more indebted the households are. Besides the countries having a more developed financial service sector and capital market as well as the unsustainably lending countries such as Spain, Portugal and Ireland, the Baltic states are relatively highly indebted compared to their economic development (that is they are located above the trend line in *Chart 10*). However, the „Visegrád" countries are less indebted (they can be found below the trend line).

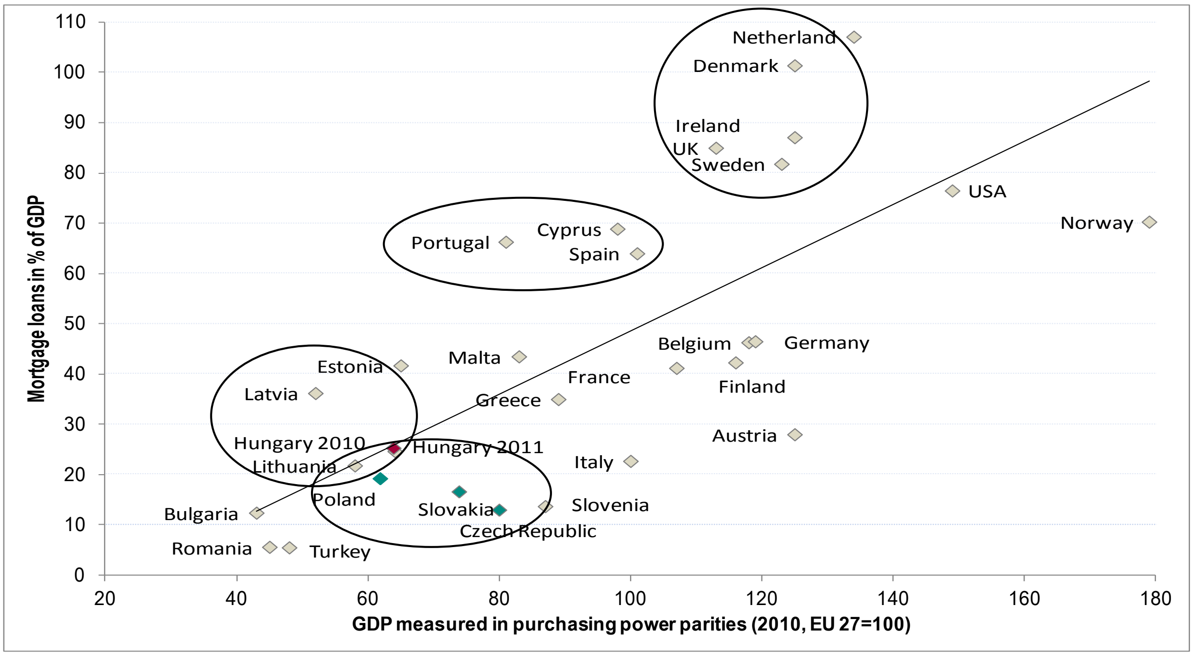


Chart 10: Retail mortgage loans in relation to GDP and GDP measured in purchasing power parities - EU average (2010, in %, source: European Mortgage Federation and Eurostat)

The high level of interest rates of loans in Hungary is a consequence of the macroeconomic situation, real interest rates of loans are not outstanding

Chart 11 shows the nominal interest rates of mortgage loans in Europe. The nominal interest rates of mortgage loans in Hungary are the second highest in Europe (with Russia topping the chart). Besides the „Visegrád" countries (Poland, Slovakia and the Czech Republic), Bulgaria and Romania can also be found in the top part of the list.

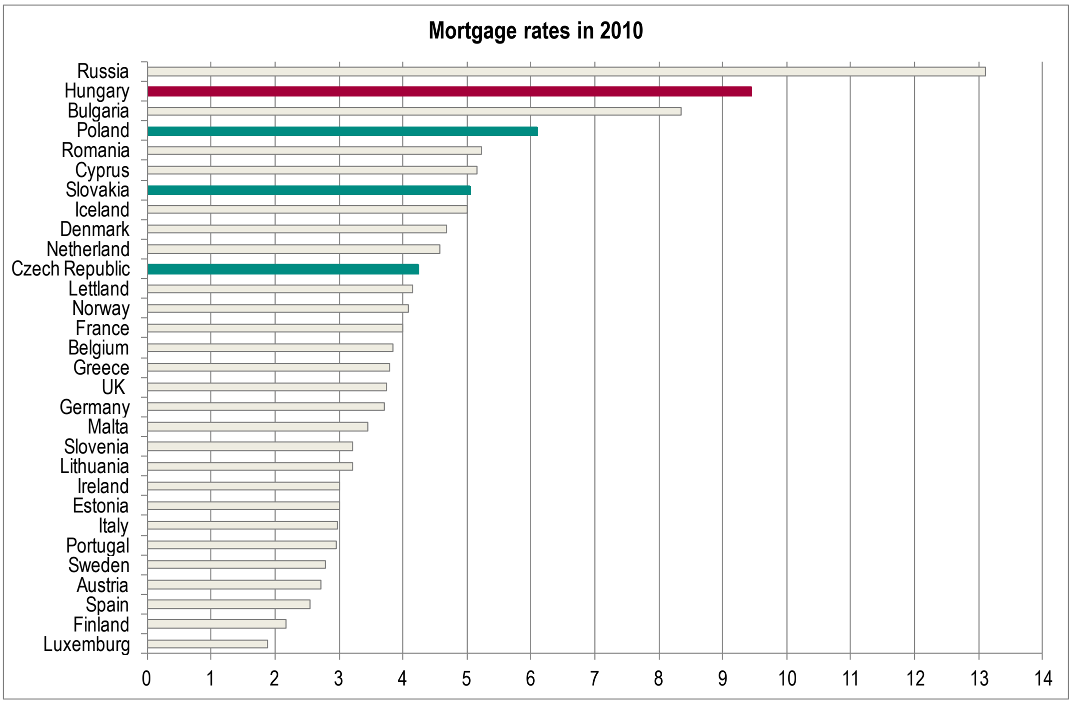


Chart 11: Nominal interest rates in Europe (2010, in %, source: European Mortgage Federation)

To make the picture more subtle, we can compare the real interest rates to the rate of the government's debt service in relation to the GDP (*Chart 12*). A higher debt service rate is in a positive correlation with the real interest rates in the mortgage market meaning that real interest rates are higher in countries that have a more indebted government. Considering this relationship, in the case of Hungary **real interest rates, however, can not be considered to be outstanding on a European scale** compared to the macroeconomic situation of the country. As the interest burden determining the budgetary position is closely linked to the costs of resources and thus to interest rates, it can be stated that the main reasons for this order (see Chart 11) are **a higher risk surcharge and higher funding costs due to the macroeconomic situation**.

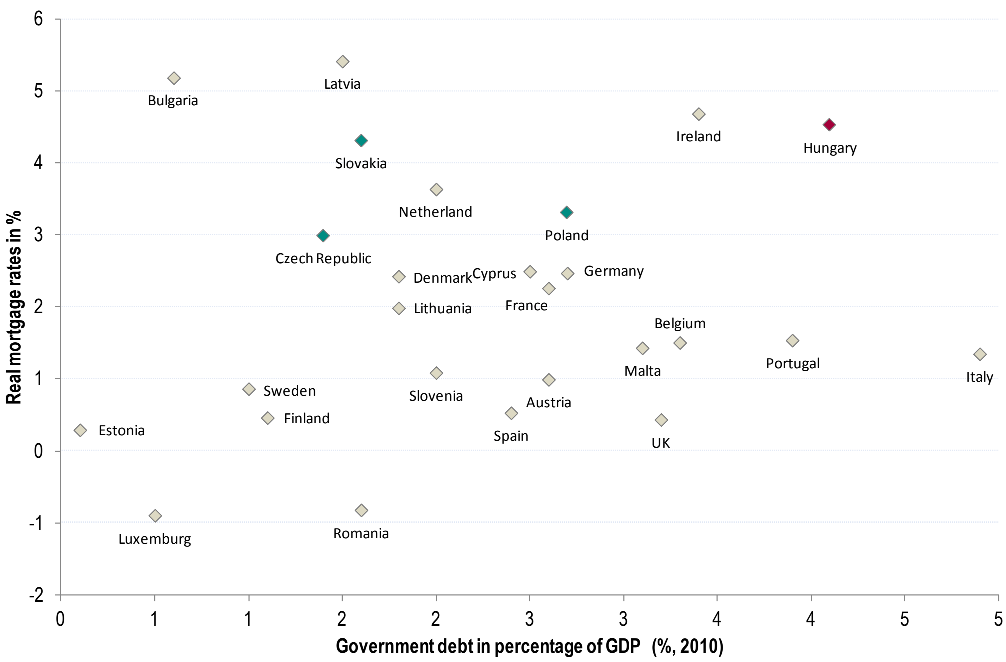


Chart 12: Real interest rate of mortgage loans and the debt service of governments in relation to the GDP (2010, in %, source: European Mortgage Federation)

The whole of the construction industry is rather sensitive to recovery with the housing unit construction market being even more sensitive within the sector

According to *Chart 13*, which illustrates the correlation between the construction industry output and the pace of real GDP growth, **the construction industry is in a procyclic relationship with the real GDP**. If the whole economy grows, construction industry output will also rise. It must also be highlighted that – besides the construction industry being rather sensitive to recovery - **the extent of the change in the construction industry is rather more volatile than that of the real GDP confirming the fact that the sensitivity of the construction industry among the other industries is outstanding**. While paces of growth ranged between -4% and 10% in 2010, for the construction industry these figures fell between -30% and 20%. Turkey had the most outstanding figures of growth, while Greece and Ireland were at the rear. Hungary shows average values on a European scale: a 1.5% GDP growth with a 10% decline in the construction industry.

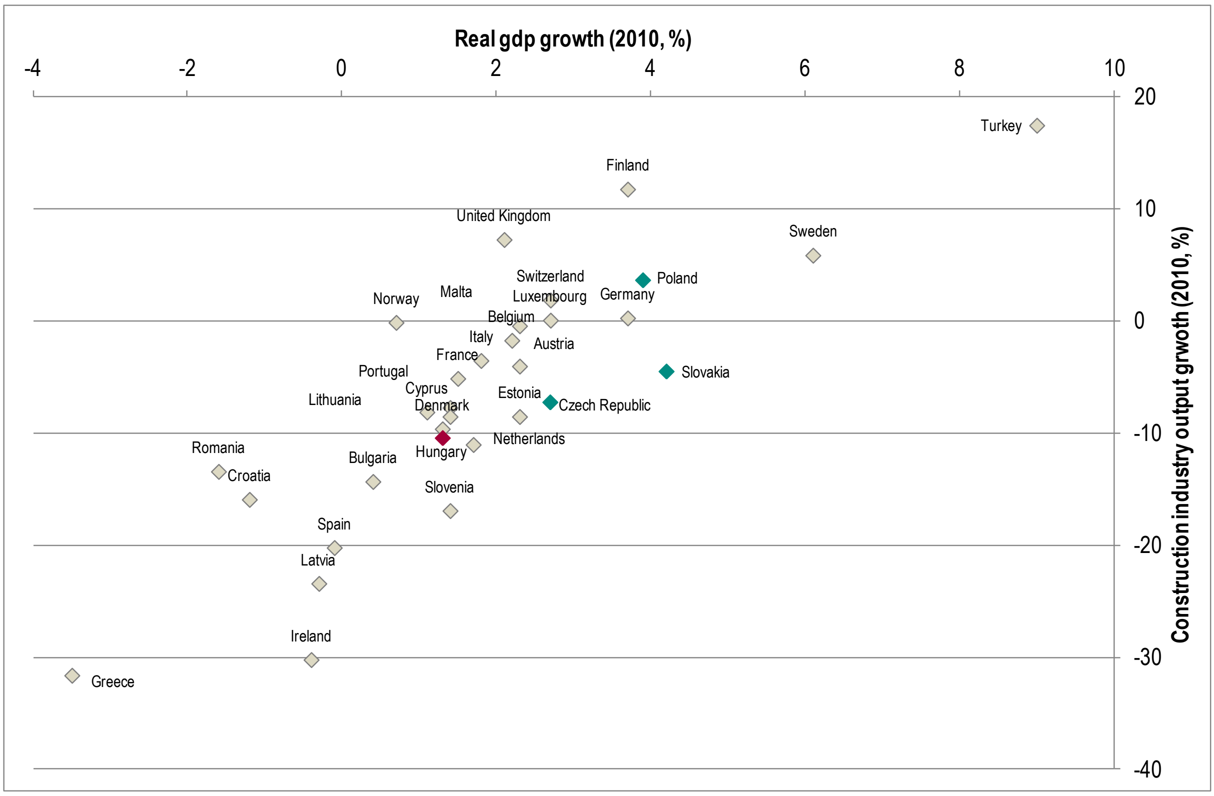


Chart 13: Changes in the output of the construction industry and real GDP growth (2010, in %, source: Eurostat)

The picture in the housing unit construction industry is rather similar to the output of the whole construction industry based on *Chart 14*, which shows the relationship between the changes in the number of building permits and real GDP growth. The **housing unit construction sector is more pro-cyclic compared to the whole construction sector**: in the fastest growing Turkey the number of issued building permits nearly doubled compared to the previous year, while in Ireland the number of building permits more than halved than a year before. In Hungary the number issued permits decreased relatively more than the average (by nearly 40%).

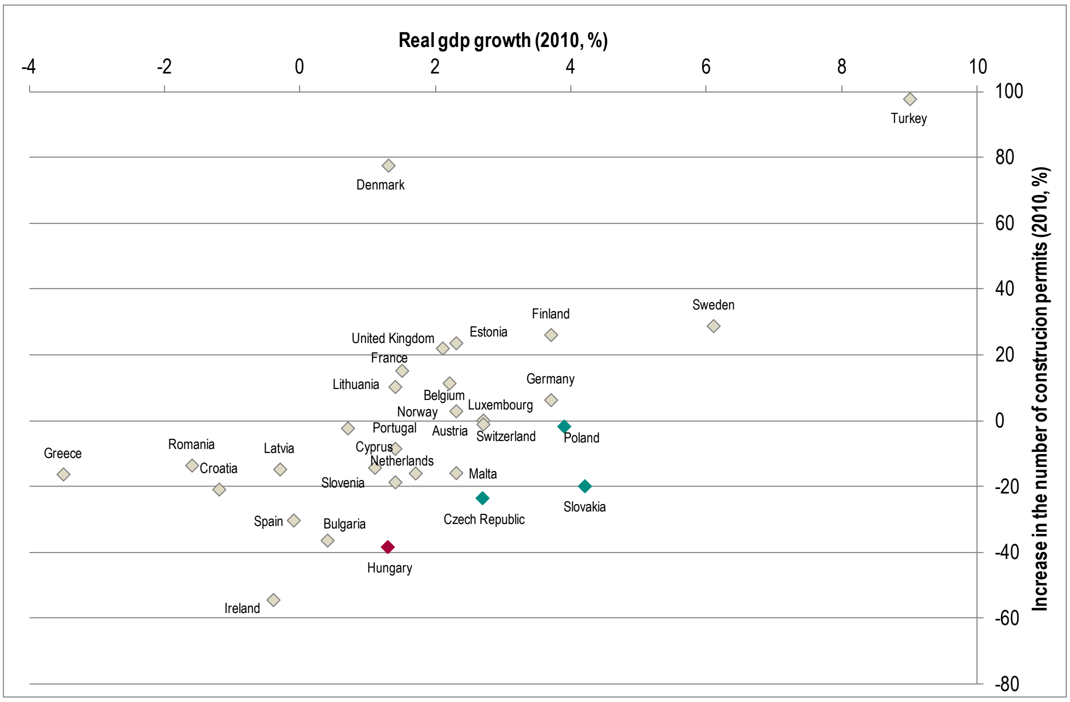
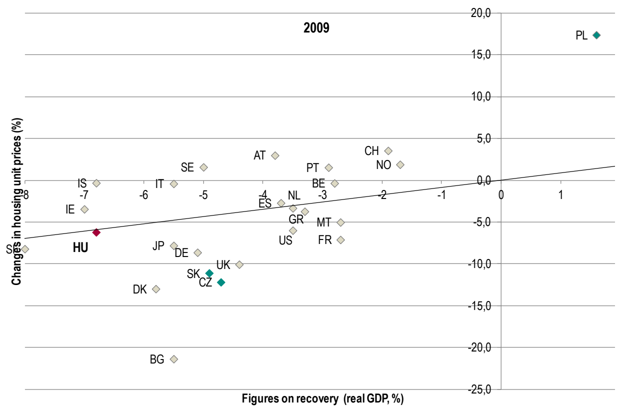


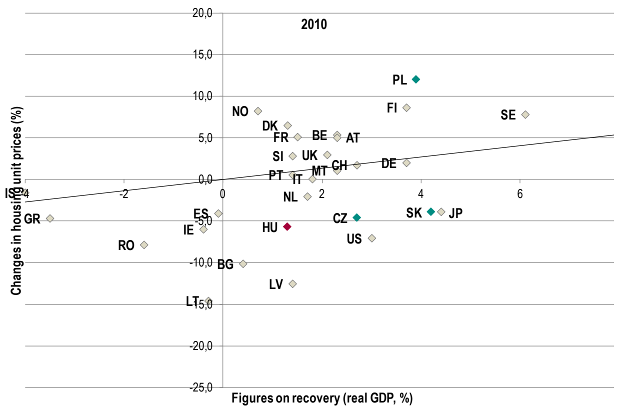
Chart 14: Changes in the number of building permits and real GDP growth (2010, in %, source: Eurostat)

The housing market follows the economic upturn very slowly, the recovery will be rather slow

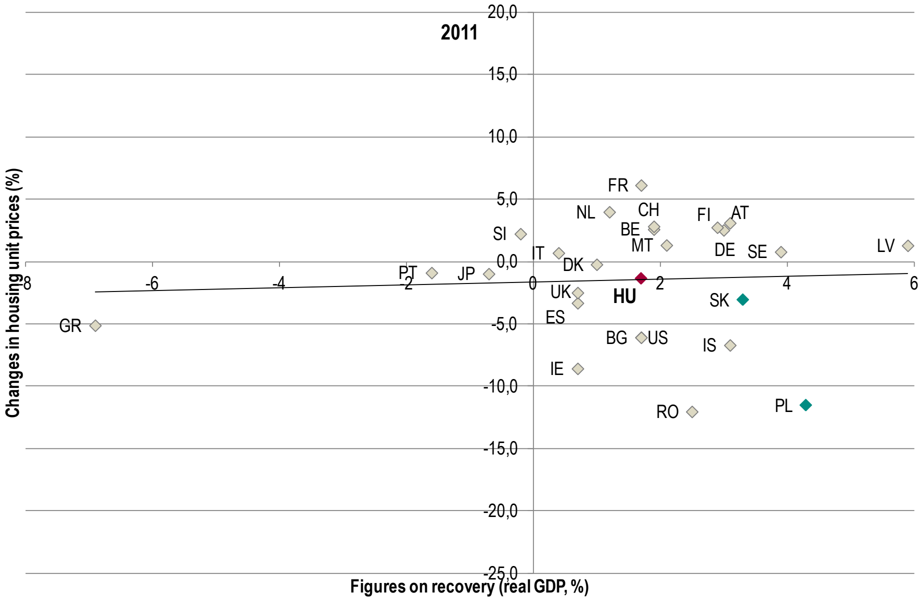
As we pointed out in **our prognosis in February**, no rapid upturn can be expected in the domestic housing market: For **2012** we forecast a period of **stagnation**, then a recovery slower-paced than the economic upturn. *Chart 15* shows the correlation between the changes in house prices and real GDP between 2009 and 2011. In 2009, after the recession set in, housing markets started to decline as well. In 2010 and 2011 the recovery picking up pulled house prices up moderately but the correlation seemed to be flattening out over the years. **Rigid prices** are typical in the recovery period, and at the same time the differences between countries are becoming bigger and bigger (see: state interference, original state of housing market, etc). **After the recession the housing market follows the economic upturn very slowly, therefore, based on international experience, a very slow recovery is expected.**



2009



2010



2011

Chart 15: Relationship between the change in the prices of housing units and the recovery period (2009-2011, in %, Source: European Mortgage Federation)

Stimuli facilitating an upturn – ways leading to a recovery

There is no wonder substance, planning a state interference requires a complex way of thinking

According to our quarterly published analyses on housing market trends, which are strictly based on a macroeconomic approach, we are confident in saying that in a period of recession everything is closely linked to macro economy, that is to say **there is no wonder substance for recovery**. Tension in the housing market can only be eased by a **fiscally sustainable, fair, predictable and efficient** state interference. A possible state interference is expected to be fiscally sustainable that is to say it should not mean an excessive burden on the budget; it must be efficient, meaning that it must have long-term effects on the housing market; it must be fair, which means that it should be based on principles of neediness. A full compliance with the expectations might be difficult as in the case of the housing market there may be a clash between the expectations (e.g.: the principles of neediness and efficiency might clash as the housing market could be revived by making the middle classes more active, however, the target group of housing schemes – especially when considering neediness - is usually not this layer of society).

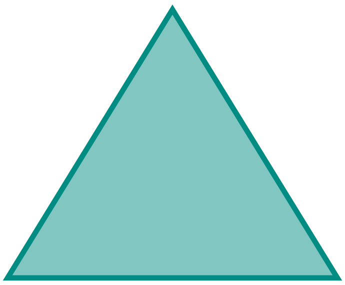


Chart 16: Expectations against the state interference

When evaluating different housing schemes during the years of recession, it is worth considering the effects from a number of aspects. In the United Kingdom the so-called **Stamp Duty Holiday** was introduced in March 2010, according to which first-time home buyers did not have to pay the 1% duty (up to a certain amount). Last autumn the government announced that the exemption would come to an end in March 2012. The measure was said to be inefficient because it did not motivate young people to make additional purchases. However, following the ceasing of the exemption, **prices showed the largest dip over the past two years.** (The fact that housing policy is a central issue in politics is confirmed by the British government's new scheme, the New Buy Guarantee, to give first-time buyers and home movers a helping hand by enabling them to buy new-build properties with just a 5% or 10% deposit, rather than the 20% typically demanded.

In Hungary, the set of tools established during the negotiations between the **Government** and the **Banking Association** aims to meet the above expectations within the given fiscal constraints to give a helping hand to those **140-150,000 debtors who are late with their payments for a period of 90 or more days.** From 1 March the prohibition of foreclosures and eviction ceased, therefore **foreclosures** regulated by the quotas set by the government were **initiated. The National Asset Management Agency (NAMA),** the reintroduction of the **social housing subsidy** and the **fixed exchange rate loan system** are all suitable for easing the accumulated tension to some extent. At the time of publication of this analysis the Banking Association and the Ministry for National Economy have set the conditions necessary to start granting the re-designed subsidised loans **by adjusting the interest rate cap of subsidised loan schemes to market conditions**. **Upon the approval of the government the lending process of the new subsidised loan schemes could commence**, which would mean the strongest incentive on the demand side to affect the housing market turnover[1].

The sector can do a lot to facilitate the recovery with innovative thinking

In the present fiscal situation, the sector can not possibly expect the state to find ways out of the recession alone. We must help the recovery of the housing market with **innovative solutions** and by being able to adapt to the new situation. Our latest service decreases the uncertainty of sellers, buyers, developers and investors making the market more transparent.

The **FHB Home-map is a free, easily accessible, graphic online database on prices** and other **important figures/data** influencing choices and/or conditions of development: **www.otthonterkep.hu.**

[1] As we pointed out in our previous analysis, the interest rate cap of the subsidised loan scheme that came into effect at the beginning of 2012 was set to a level that it would result in an insufficient margin of approximately 1 % for the banks in the current situation. The new scheme will hopefully solve this problem.

There are permanent elements in the change in the lending structure: **energy efficiency and modernisation related to it is becoming more and more important**. From the beginning of this year, it is mandatory to obtain an energy efficiency certificate, which – within one or two years' time – will make the energy efficiency of housing units a factor seriously affecting their prices. According to *Chart 17* showing the proportion of home loans according to their loan purpose, **more loans were raised for modernisation** in 2011 than for **purchasing new housing units.** Access to information and controlled quality service in this segment is crucial too: **www.e-tanusitvany.org**.

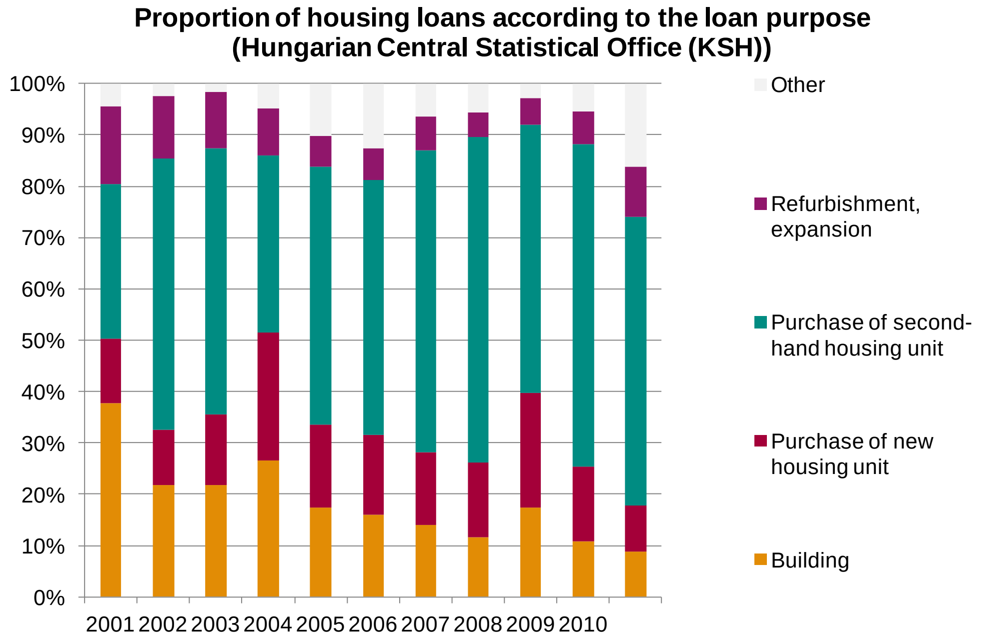


Chart 17: The proportion of home loans granted according to loan purpose (2001-2011, in %, source: Hungarian Central Statistical Office (KSH))

Our services connected to the FHB Index

The FHB House Price Index is published quarterly. Before its introduction, no other product of this kind was available in the Hungarian market. It is distinctive in terms of the measured time intervals and the quality of the underlying data, as well as its methodological foundations, which conform to international expectations. Since the introduction of the FHB Index in 2009, MNB (the Hungarian National Bank) and RICS (The Royal Institute of Chartered Surveyors) refer to it as a featured housing market indicator.

Updates to the FHB House Price Prognosis are published regularly.
The methodology behind the model rests on three pillars:
I. On the basis of international and local experience, we have identified relations between selected Hungarian macroeconomic indicators, money-market and credit market indices, transactional data of the housing market and housing prices. (We base our view of the development of the macroeconomic and financial environment primarily on the projections of the Hungarian National Bank.)
II. The FHB Banking Group has been one of the major actors among Hungarian housing market financiers for over a decade. Our operations cover the entire country, and we have access to information from the most significant real estate appraisers, which is complemented by FHB Real Estate Ltd's own professional experience. Our forecasts, therefore, include processed and verified local assessments as well.
III. With respect to the economic crisis, we do not disregard empirical facts gained from analyses of similar depressions that have affected real estate prices so far. We have, therefore, included the international experience obtained from similar crises in our model.

The FHB House Price Prognosis is now an important reference tool for people interested in the Hungarian housing market.

Our database, which covers the entire country and the methodological development of the FHB Index make FHB able to provide help to the financial sector to fulfil the collateral re-valuation obligations under Basel II (Government Decree No 196/2007 on the Management of Credit Risk and the Calculation of Credit Risk Capital Requirement). We are proud that our service has already been ordered by a number of Hungarian banks, subsidiaries of large international financial institutions. The banks will also need to comply with the strict regulations in the future, it is, therefore, useful to apply a procedure that conforms to international standards and can also be supported by documented methodology if required by authorities. For the implementation of the modern, internal valuation methodology, it is preferable to use a model that is based on transactional data and documented methodology whereby efficient and mass re-valuation becomes possible. By using this model, credit risk capital requirement can be reduced substantially, and excess capital can thus be freed. FHB Jelzálogbank Nyrt. has been using the real estate monitoring procedure – which also meets the requirements of the modern, internal valuation methodology – since 2008.

FHB also undertakes the preparation of unique research products meeting individual needs. In these, we offer local information on apartments and lots, more detailed explanations on the extent and dynamics of our prognosis as well as the analysis of the risks surrounding the realisation of the trends forecast

We are pleased to give customized offers and to respond to any inquiries.

Molnár Zsolt
Deputy Chief Executive Officer
FHB Ingatlan Zrt.Ingatlan értékelési Igazgatóság
Telephone: +36(1)452-9208
Fax: +36(1)329-0986
Mobile: +36(30)748-3913
E-mail: molnar.zsolt@fhb.hu

dr. Nagy Gyula
FHB Index project leader
FHB JelzálogbankNyrt..
Telephone: +36(1)452-5930
Mobile: +36(30)964-6087
E-mail: nagy.gyula@fhb.hu

ELTINGA*, the exclusive research partner of the FHB Index*