Estonian housing market: after housing boom

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Objective

- Housing market perspectives in Estonia
- Suggestions
Structure

- Research about housing market
- Housing market today
- Credit institutions loan activity to the real estate sector (housing loans)
- Conclusions
IMF World Economic Outlook, April 2003, “When Bubbles burst”

- Equity price busts occurred on average every 13 years, lasted for 2 1/2 years, and were associated with GDP losses of about 4 percent of GDP.

- Housing price busts were less frequent, but lasted nearly twice as long and were associated with output losses that were twice as large, reflecting greater effects on consumption and banking systems, which are typically heavily exposed to real estate.
Gallin (2003), model of housing demand

- \( Qd = D(Y; N; W; UC; \Theta d) \) where
- \( Y \) - income;
- \( N \) - population;
- \( W \) - wealth;
- \( UC \) - user cost;
- \( \Theta d \) - other demand shifters

The user cost of capital, in turn, depends on the price of housing; mortgage rates, \( m \); income and property taxes, \( \tau y \) and \( \tau p \); maintenance and depreciation, \( \delta \); and expected capital gains, \( cg \):

- \( UC = \pi \left[ (1 - \tau y)(m + \tau p) + \delta - cg \right] \)
Callin (2003) model of housing supply

- $Q_s = S(P;C; \Theta_s)$,

where

- $P$ - price of housing;
- $C$ - cost of new construction;
- $\Theta_s$ - other supply shifters
Housing is a major component of wealth.

Household’s behaviour is difficult to measure and they are not always fully rational when they making financial decisions.
Dynan and Kohn (2007)

- used regression models of the (potential) determinants of debt-income ratios
- they identify increases in real estate prices as the key driver of US household indebtedness
According to the data of Global Property Guide

Estonia was 2006 the leader of the global house price boom

Estonia was followed by Denmark, Norway and Ireland
The global economic and financial crisis has had a considerable impact on the Estonian economy.
Purchase and sales transactions of dwellings 1998-2010

Number of purchase-sale contracts of ownership of dwellings

Value of contracts of ownership of dwellings, EUR mln

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The accelerated price increase in housing sector and high demand was mostly driven by:

- High economic growth leading to an increase in disposable income
- The rapid expansion of credit to the private sector
- A low ratio of living-space per capita and deteriorating housing stock
Housing market today

- In 2004–2006 demand for housing was greater than supply
- Since the beginning of 2007 supply started to grow rapidly
- 2008 supply has been greater than demand
Average gross monthly wages and average price for a square metre of a two-room apartment in Tallinn

Average prices per square meter of 2-room apartments in Tallinn
Average monthly gross wages
Number of square meters of a two-room apartment in Tallinn obtainable for average gross monthly wages

Number of square meters of 2-room apartment in Tallinn obtained for average gross monthly wages

2000 2001 2002 2003 2004 2005 2006 2007 2008 2009

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Problem for households

House or flat is mostly the largest investment of Estonian households.

Increasing house prices result in greater housing wealth and also made it possible to borrow more using housing wealth as collateral.
- Econometric model what was constructed 2007 by using 8 different economic indicators (Kolbre, Kallakmaa 2007)
- Total volume of housing loans has increased as a result of low interest rate and tight competition in banking sector
Loans granted by groups of customers

(Bank of Estonia)

Loans granted by groups of customers (1997-2010, EUR m)

- Commercial households
- Households

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Overdue loans and overdue housing loans
Don't worry – left and right scales are different!
Access to credit and credit constraints (1)

- The real wages continued the falling trend
- No more unrealistic expectations
- Housing living cost are growing (thermal energy etc)
Access to credit and credit constraints (2)

- No more “customer-friendly” credit conditions
- Parent banks might have difficulties in raising external funds because of situation in global financial markets

This is supply-side constraints - less loan money for the Estonian market
Conclusions (1)

- Most of housing loans were taken in economic growth conditions and full employment expectations
- Despite of global finance crisis Estonian Banking system is still stable
Conclusions (2)

- The bottom of the Estonian real estate market is approaching, although the shape of this bottom is expected to be flat.
Conclusions (3)

- Households with repayment difficulties should sell their property or change it for affordable variant
- To build up the “building society” system
Thank you!