

Analysis of the German property market:  
*housing bubble - real threat or hot air?*

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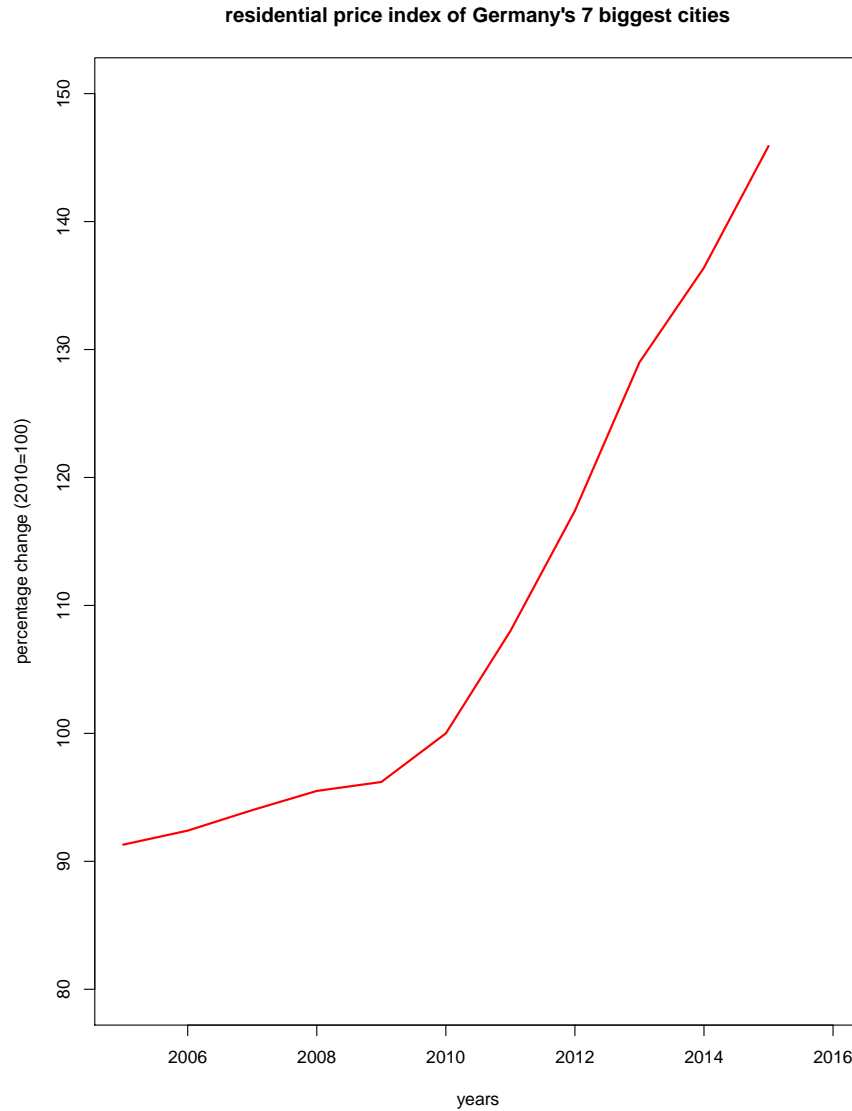
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For years, real estate prices have been rising in Germany. If prices increase faster than rents, consumer prices and income simultaneously, which is the case for Germany, it is a cause for concern. Once prices exceed rents, investments in the housing market yield a lower return. Overvalued properties exacerbate the affordability, particularly if incomes don't increase to the same extent. Despite this fact it was long time assumed that we wouldn't have to apprehend a bubble. Meanwhile, however, indications of an overheated market are evident. Responsible for the since 2010 ongoing price increases for residential properties in Germany is, in part, the expansionary monetary policy of the European Central Bank, in particular the zero interest rate policy. One of the most important components in the real estate price development is the level of interest rates. Low interest rates affect the price positively. On the one hand, home ownership currently can be financed extremely cheap since interest rates on housing loans to households are at a historically low level, on the other hand investors invest their money, due to the lack of reasonable alternatives, rather in shares or real estate. Yet, it must be taken into account that loans might become more expensive as a consequence of higher interest rates. This development won't happen in near future though, because the ECB has announced to keep base rates at a record low of 0.05 percent for an extended period of time.

Indeed, property became more expensive in the past six years in Germany by an average of 20 percent - in the seven largest cities in Germany even 46 percent(1).

No end of the persistent upward trend is in sight. However, previously the price level has been very low. In an international comparison German cities are still 'cheap' and are expected to adapt to international prices. Contrary to common belief, wealth doesn't lead to higher prices but actually more affordable housing. The reason is that in poor countries you need to work more for the same living space than in richer countries. This in turn means that there the living space per capita is lower than in countries with high average incomes. The work that must be expended in large cities such as Hamburg or Munich, to afford a particular apartment size is equally to other cities such as Barcelona or Vienna. The trend of recent years is good news for people who already own real estate since their property continuously gains in value.

Figure 1:



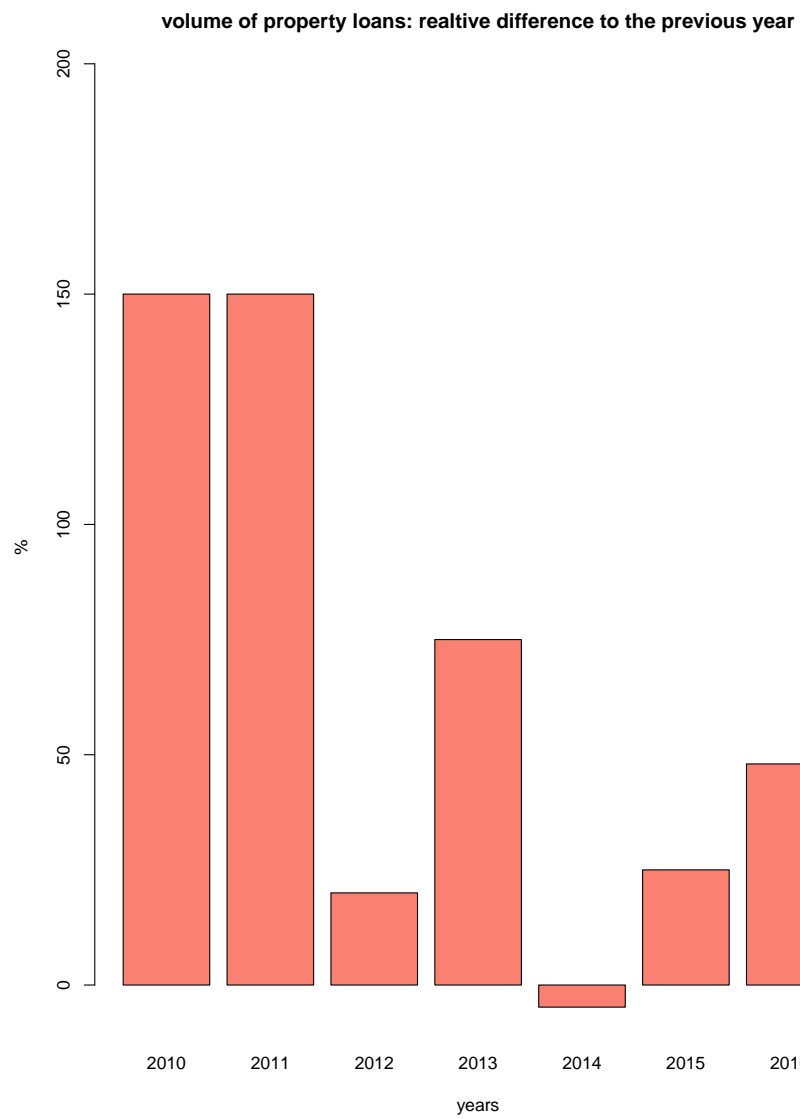
The already tense situation intensifies through two recent events: the refugee crisis and the Brexit. The wave of refugees issues, in many respects, a great challenge to Germany. Millions of people must be provided an accommodation. Especially simple apartments in already overcrowded areas of the major cities are highly demanded. The massive influx of refugees gradually causes prices to overheat. Unfortunately, a boost in demand for vacant properties in east Germany, where many landlords struggle to find buyers, is not to be expected. After the referendum in favour of a withdrawal from the EU, many investors are confident that Germany (especially

Frankfurt) will profit from this decision. Hence international investors rely on the safe Germany real estate market. This will likely push up prices for home ownership as well as office spaces.

However voices which warn against overstatements rise. The Bundesbank for instance, currently classifies the risk of a price correction and at the same time strong defaults of loans as low. So far the boom hasn't evolved into a bubble. Thus a housing bubble in Germany is highly unlikely since it would require excessive, long-lasting price deviations from its fundamental value, excessive and frivolous lending and excessive oversupply of housing. Instead, the term "price bubble" characterizes the situation in a better way. Several indicators support this theory. Whereas in other European countries the volume of credit virtually increased threefold prior to the financial crisis, property loans granted in Germany grow at a moderate level(2).

Regarding financing, Germans evidently act more conservative. They back their loan with a high equity ratio. Furthermore they use the current period of low interest rates to redeem mortgages more quickly.

Figure 2:



Nonetheless it is necessary to keep a close watch on further developments.

## References

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