Poland Economics View

Housing market – Searching for the peak

- Over last three years Poland saw 25% rise in apartment prices. Demand for new housing remains strong, supported by dynamic wage growth, high consumer confidence and very low interest rates.
- In our view cyclical factors may weaken in the coming quarters as the economic growth is likely to moderate and wealthier households may be affected by higher tax burden. At the same time dwellings supply could remain high.
- However, slow growth in price-to-rent and price-to-income ratios with expected further convergence of income, moderate housing debt and the well documented structural shortage of housing suggest that in the medium term the demand will likely remain high.
- All in all, while we think apartment price growth may slow in the coming quarters, we assess the risk of a significant drop in prices is low. Such a scenario would be likely in case of a severe recession.

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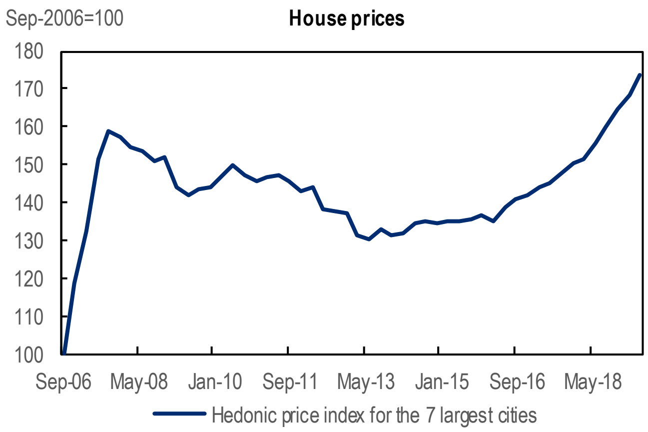
Searching for the peak

After a period of contraction in house prices in 2007-2013, followed by stabilization in 2013-2016, the recent years have seen a gradual price acceleration (Figure 1). According to the National Bank of Poland data, house prices in the biggest 7 cities increased by 25% in three years and by around 10% since the previous peak in 3Q07 in the secondary market and respectively 20-25% and 0% in the primary market. Housing market strengthening in Poland went along with developments in other European markets but the price change was smaller than on average in EU (Figure 3). This was at least partly due to improvement in supply as Poland has been one of the leaders in the EU in terms of dwellings completions as well as completions per 1000 citizens (Figure 4). Below we take a look at key factors affecting both housing demand and supply, trying to assess the likely direction of prices in the coming years.

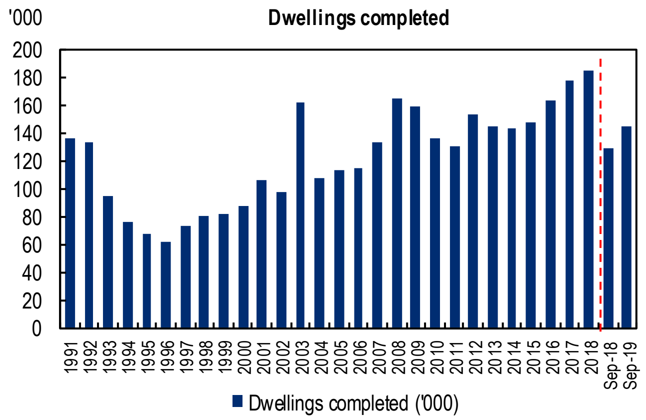
Figure 1. Average house prices in 7 biggest Polish cities increased by 25% over the last 3 years (existing stock market)



Source: NBP, Citi Research.

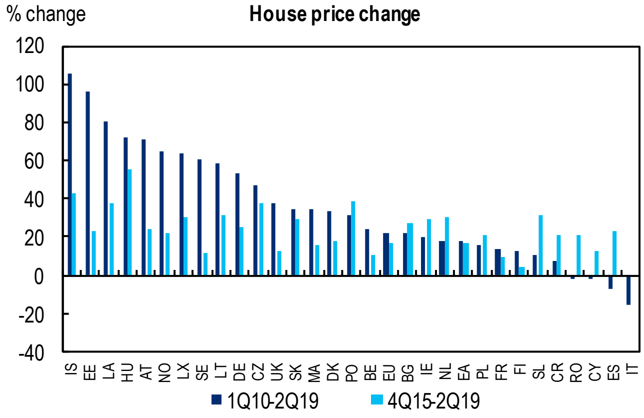
* Hedonic price indicator reflects the "pure" price change, thus correct for quality changes (e.g., increase or decrease in the share of more expensive housing in the sample); The hedonic index takes into account changes in quality of housing in the analysed sample in each quarter, thus differs from a simple average i.e. the mean price.

Figure 2. Dwellings completions reached record high in 2018 and are likely to increase further in 2019



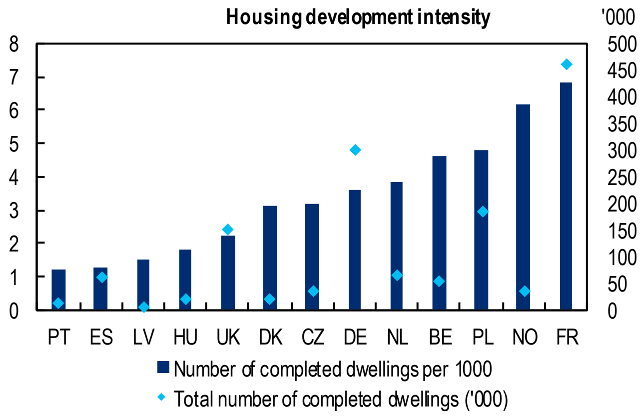
Source: CSO, Citi Research

Figure 3. House price change was rather limited as compared to other EU economies



Source: Eurostat, Citi Research

Figure 4. Poland is one of the leaders in the EU in terms of dwellings completions (2018)

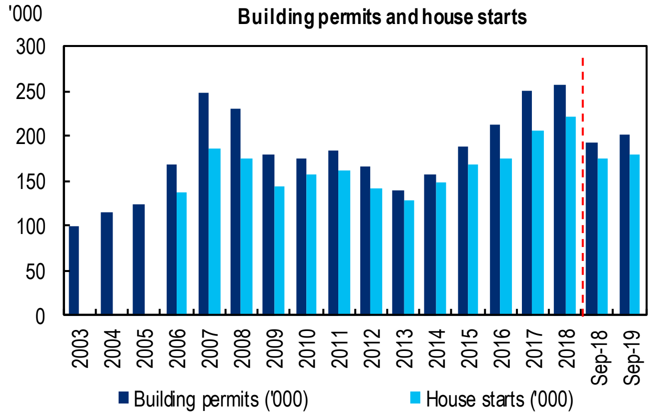


Source: Deloitte, Citi Research

Supply set to remain strong for now

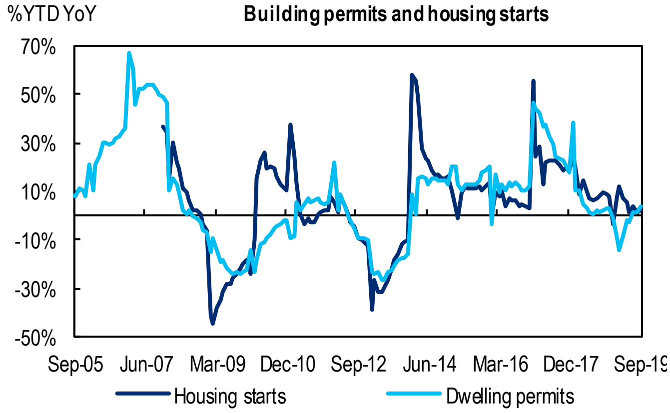
Years 2017-2018 were record strong in terms of housing starts and granted building permits and the data for first months of 2019 suggest the overall numbers this year may be even slightly higher. Also the number of dwellings under construction remains record high (Figure 8), which suggests the supply of houses is likely to rise in the coming quarters. However, the medium term outlook looks less favourable. The pace at which the number of building permits is growing has weakened since mid-2018 (Figure 6) and this signals that the number of dwelling completions will eventually decelerate. On the positive side, high margins of construction companies' (around 20%) and high yields on residential investments can encourage opening of new projects and support supply as well.

Figure 5. Building permits and house starts reached record high levels in 2018



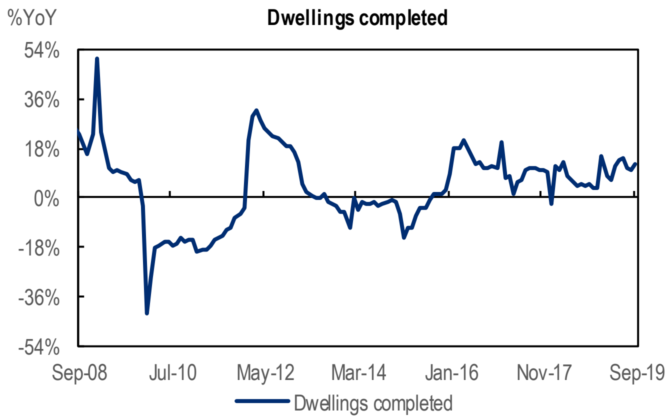
Source: CSO, Citi Research

Figure 6. … but gradually decelerated since mid-2018



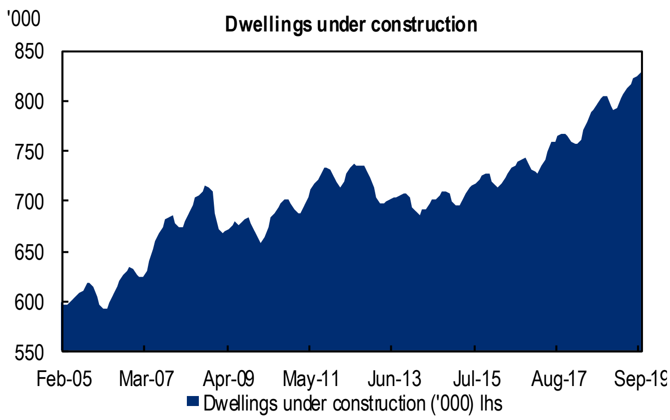
Source: CSO, Citi Research

Figure 7. Dwellings completions can be record high in 2019



Source: CSO, Citi Research

Figure 8. High level of dwellings under construction suggests supply of dwellings is likely to rise in the near term



Source: CSO, Citi Research

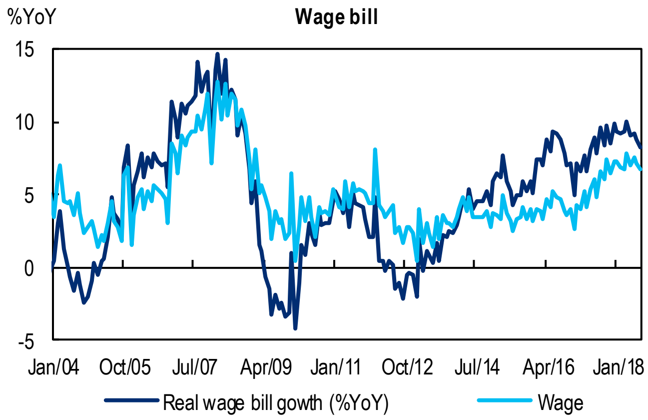
The supply could be potentially affected by new laws or regulations. In mid-209 the previous parliament approved an amendment of bill regulating farm land turnover and was considering changes in regulation on protection of buyers' rights and spatial planning. The first approved bill will likely increase the supply of land available for purchase by real estate developers, potentially easing land supply limits within cities boundaries. The second bill would be aimed to strengthen further the house buyers rights through introduction of Developers Guarantee Fund. Special housing custody accounts were already introduced with previous changes to the developers bill, where client payments are deposited on the special custody account and are transferred to the real estate company only after change in ownership rights (closed accounts) or with gradual finalization of works (open accounts). New amendment is supposed to introduce an additional insurance fund protecting the rights of the house buyers with commissions paid by the developer companies of up to 5% of buyer payment in case of open accounts and up to 1% for closed accounts. All approved and planned changes to the developers bill rather contribute to higher costs of real estate developers and potentially higher house prices. This could also boost supply before the introduction of the new law and decrease supply afterwards. The third bill would force construction companies to change their type of building permits, which could also accelerate house starts before the introduction of the law. However, the parliamentary elections (October 2019) mean these works on two new laws were discontinued and it is unclear when the new parliament decides to restart works or what will be the final shape of new regulations. Nevertheless, the potential impact of all regulations in the current version considered would increase the supply of dwelling completions in short and medium term and decrease it in the more distant future.

Cyclical demand remains solid

Housing demand has been supported by strong wage growth and low interest rates and only partly offset by gradual tightening in lending standards. In 2007-2015 there was a gradual recovery in housing affordability (Figure 10) amid initial decline and further stabilization of house prices accompanied by accelerating wages and wage bill growth. A mix of record-low unemployment and interest rates boosted demand for housing. However, the mortgage lending growth stayed moderate and significantly lower as compared to pre-2008 period of housing market boom (Figure 13). This stemmed partly from macroprudential measures and regulations introduced after 2008, which eliminated FX mortgage loans and increased required equity stake in house purchase with new limits for LtV at 80-90% versus more than100% over a decade ago. Moreover, banks were gradually tightening lending standards. All in all, moderate mortgage lending growth and high share of cash purchases (Figure 17) allowed for relatively moderate growth in prices.

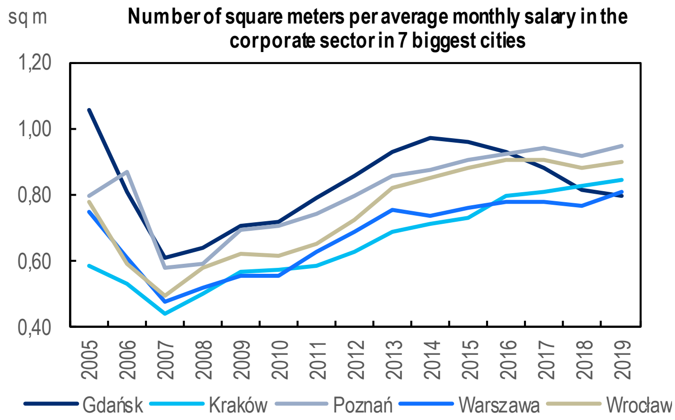
There are several factors suggesting that while the demand for houses should remain robust in the coming quarters, its cyclical component is likely to weaken from the current high level. On the positive side, the situation in the labour market remains tight and our forecasts point to sustained strong wage growth. Moreover, future demand will be supported by prospects of central bank interest rates staying at record low levels for long time. Polish central bank remains determined to keep rates unchanged as it tries to strike a balance between above-target inflation and slowing economic growth. We also expect the demand from institutional investors to hold until there is significant compression of yields versus other asset types. Finally, housing debt in Poland amounts to 20% of GDP which is significantly below EU average of 40%, which leaves room for further lending-fueled growth in housing demand. However, the reason why we think the demand may be on balance somewhat weaker than in recent quarters is related to expected economic slowdown. The economy has passed its cyclical peak and although the unemployment rate is set to remain low, the overall consumer sentiment may soften. Also, strong wage growth is likely to be a result of higher minimum wage, which – in our view – is not likely to lead to significantly stronger demand for houses. In turn wealthier households will be negatively affected by planned tax system changes.

Figure 9. Real wages are expected to grow at a fast pace, though mostly due to wage increases among low-income households



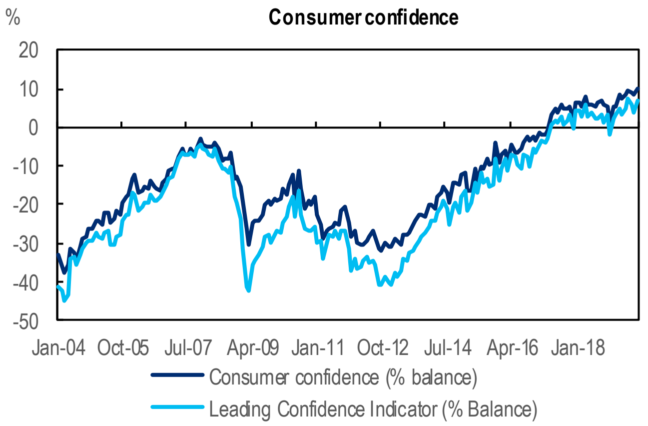
Source: CSO, Citi Research

Figure 10. Affordability index for Poland – average monthly wage divided by average price of 1m2 of a house – historical series



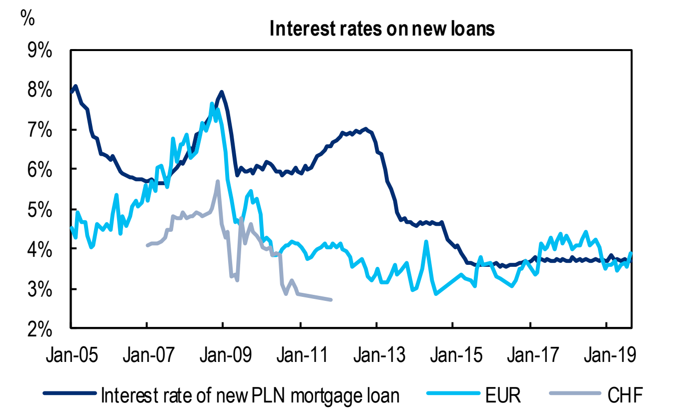
Source: NBP, CSO, szybko.pl, Citi Research

Figure 11. Consumer confidence reached record high levels



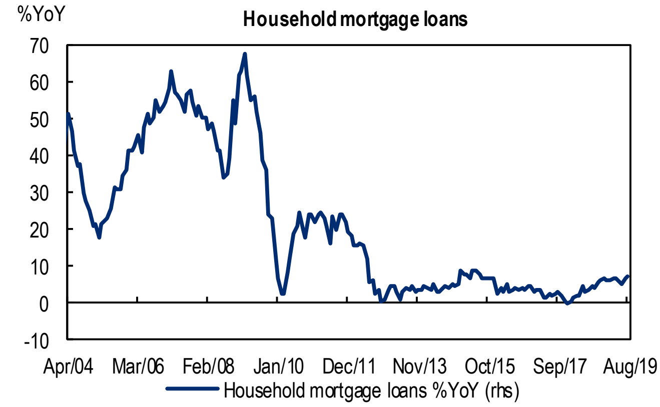
Source: CSO, Haver, Citi Research

Figure 12. Interest rate on new mortgage loan in PLN remains stable at historical lows



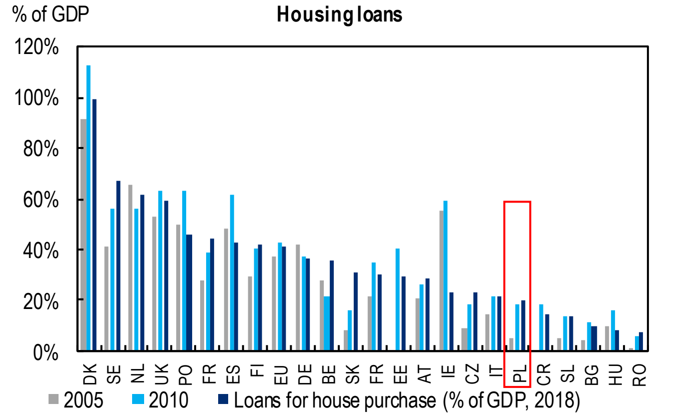
Source: NBP, Citi Research

Figure 13. Despite low rates and increasing wage bill mortgage loans growth has remained moderate



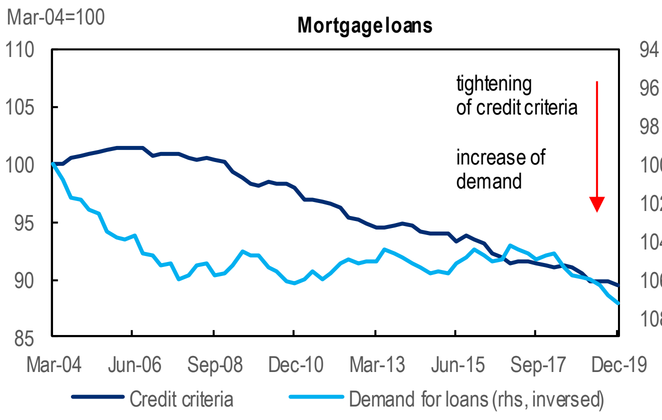
Source: NBP, Citi Research

Figure 14. Loans for house purchase in relation to GDP are low as compared to other EU countries



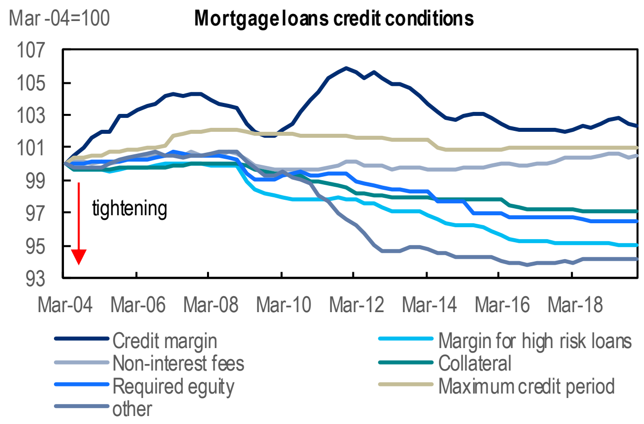
Source: ECB, Haver, Citi Research

Figure 15. Banks have gradually tightened credit criteria ...



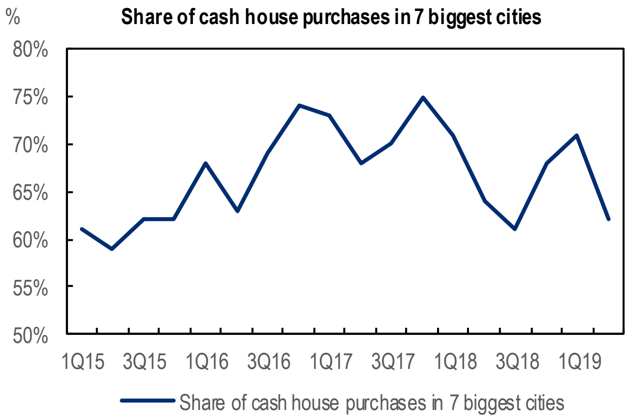
Source: NBP, Citi Research

Figure 16. ... and credit conditions in the last few years



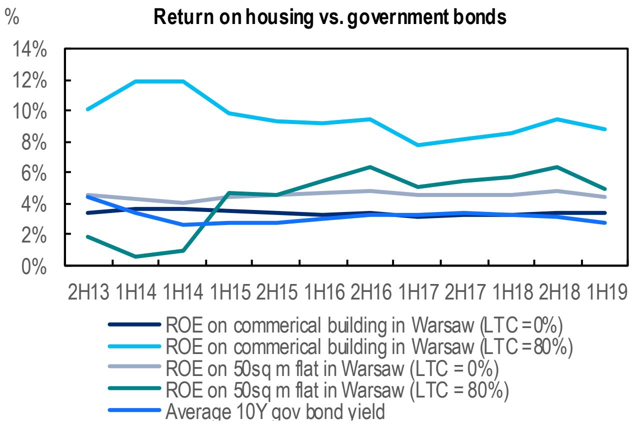
Source: NBP, Citi Research

Figure 15. Cash purchases were high in the last few years



Source: NBP, Citi Research

Figure 16. Yields in residential market has remained high



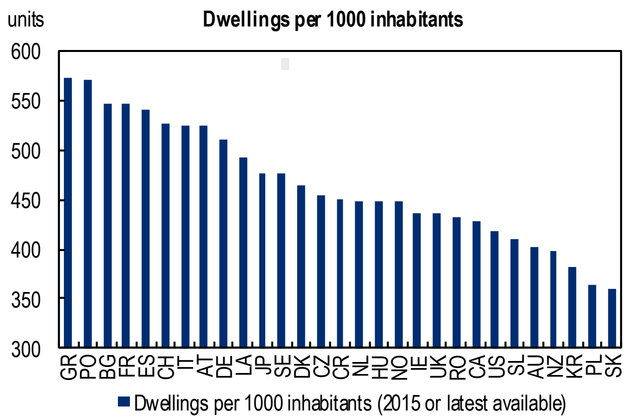
Source: NBP estimates, Citi Research

Structural shortage still present

As far as long term house price trends are concerned the key factor is that Poland still suffers from structural shortage of housing. The shortage in housing is reflected in high overcrowding rate (Figure 19) and respectively low number of rooms per person. On both metrics Poland ranks much worse than most EU countries. According to National Census in there were 13.5mn apartments in Poland in 2011 with a similar number of households, which gave approximately 1 flat per household. According to Central Statistical Office's (CSO) data out of 13.5mn apartments stock around 1mn was uninhabited then. Probably a better proxy of housing market *saturation* is the number of apartments per 1000 inhabitants. That ratio in Poland was around 363 in 2015 and 390 in 2019 according to our estimates. This is still significantly below the EU average of ~480 and remains one of the weakest results among EU countries. Furthermore, in our view if the ratio of dwellings per inhabitant was to increase to the EU average level, then additional 2.8mn additional dwellings would need to be built. With completions rate equal to 10Y average at 155k per year it would take almost 20 years to fill the gap.

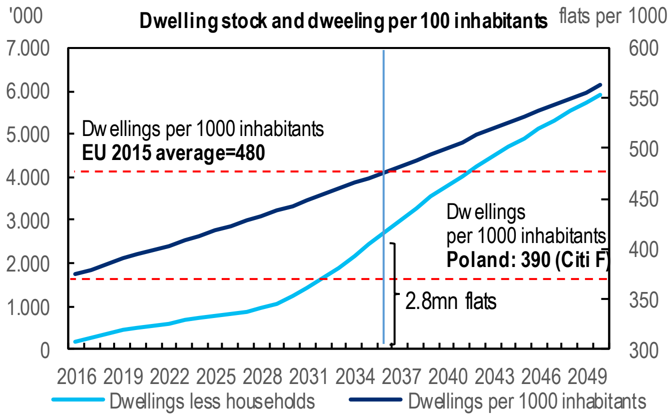
Demographic changes are unlikely to ease housing market pressures anytime soon. In the long term there could be two factors that might partly limit demand for new housing but we believe their impact will be limited. First, demographic projections show a faster decline in population, potentially by more than1mn until 2035. Second, the number of young people entering the productive age, starting first jobs and thus generating new demand for apartments is likely to fall[1]. The reason why we believe the impact of these two factors might not be decisive is due to expected increase in the number of households and a potential further inflow of immigrants and return of emigrants. The former trend would be a reflection of demographic and cultural changes which translate into a higher number of single-person and single-parent households. According to Polish Central Statistical Office – an institution preparing demographic projections - the number of households will increase by around 100k per year until 2027 and will start to decline only after 2030.

Figure 17. Number of dwellings per 1000 inhabitants



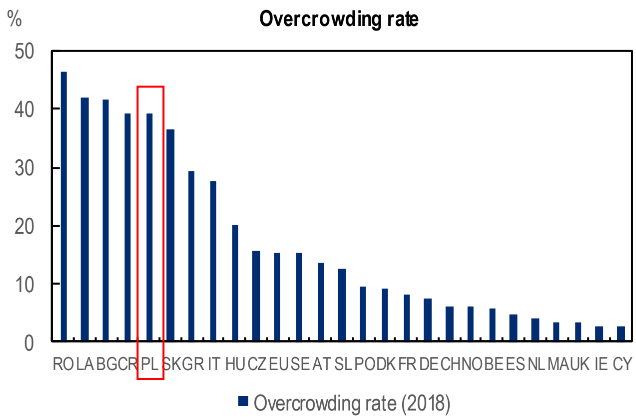
Source: OECD, Citi Research

Figure 18. Dynamics of number of apartments vs. population size



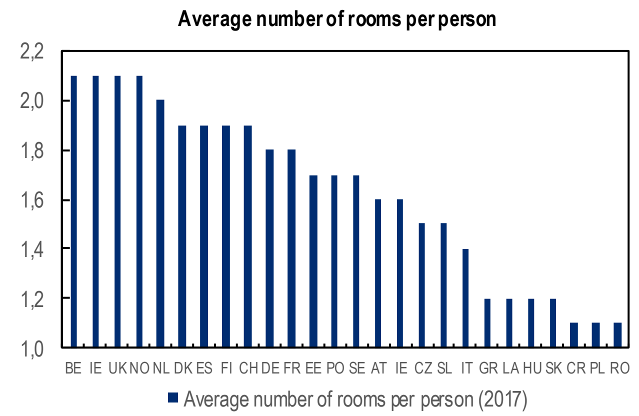
Source: CSO, OECD, Citi forecast, Note: Projections based on assumption of annual net new dwelling completions of 155k, CSO data and CSO forecasts on the number of households and size of population.

Figure 19. Overcrowding rate is high in Poland…



Source: Eurostat, Citi Research; *The overcrowding rate is defined as the percentage of the population living in an overcrowded household. A person is considered as living in an overcrowded household if the household does not have at its disposal a minimum number of rooms equal to: one room for the household; one room for each single person aged 18 or more; one room per pair of single people of the same gender between 12 and 17 years of age; one room for each single person between 12 and 17 years of age and not included in the previous category; one room per pair of children under 12 years of age.

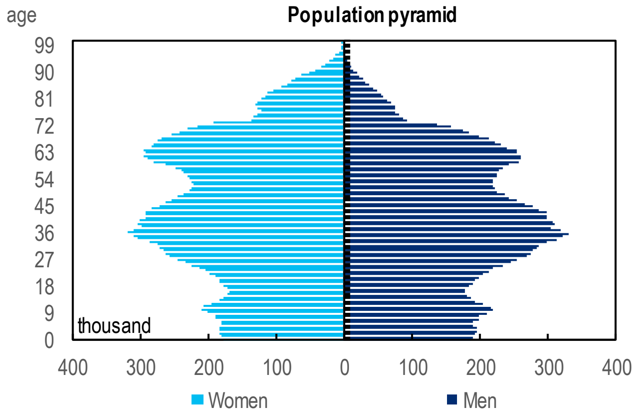
Figure 20. … which is reflected in small number of rooms per person



Source: Eurostat, Citi Research

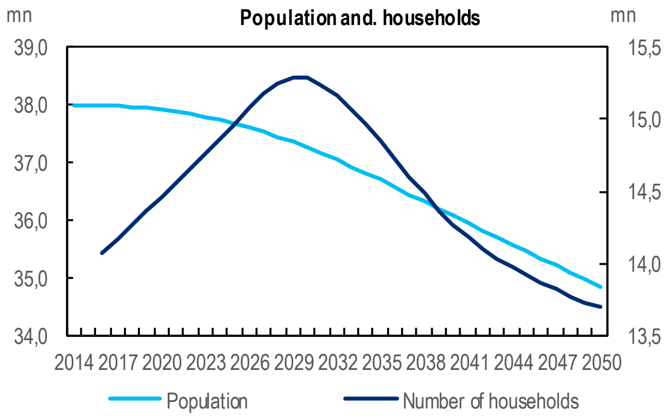
[1] In 2006-2007 when the residential market was booming this was accompanied by historically high number of young people aged 22-25 years (around 1.8-2bn). Currently, the number of population aged 22-25 years is lower at 1.7bn. Looking at the population pyramid forecasted by the CSO it is likely to decline further in the following years to around 1.6mn in 2020 and 1.4mn in 2025.

Figure 21. Population pyramid (2019 forecast based on 2014 CSO model)



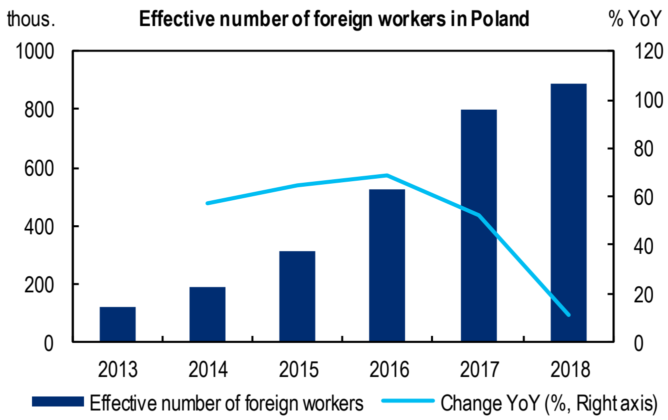
Source: CSO estimates, Citi Research

Figure 22. Population size vs. number of households (mn)



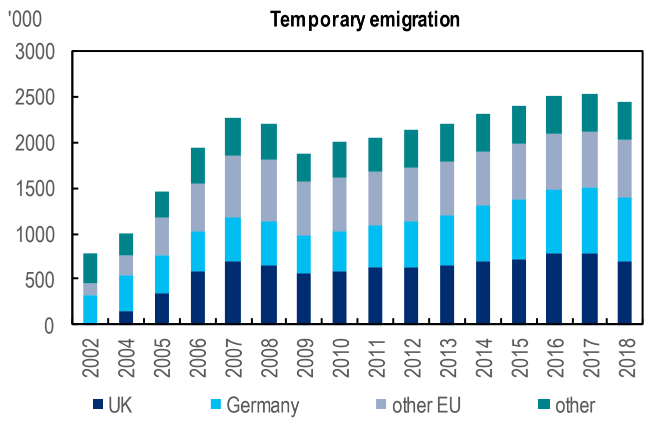
Source: CSO estimates, Citi Research

Figure 23. Increase in immigration in the last few years boosted to demand for housing but migrant inflows started to weaken



Source: CSO, Citi Research

Figure 24. Potential return of emigrants due to Brexit could also increase demand for housing

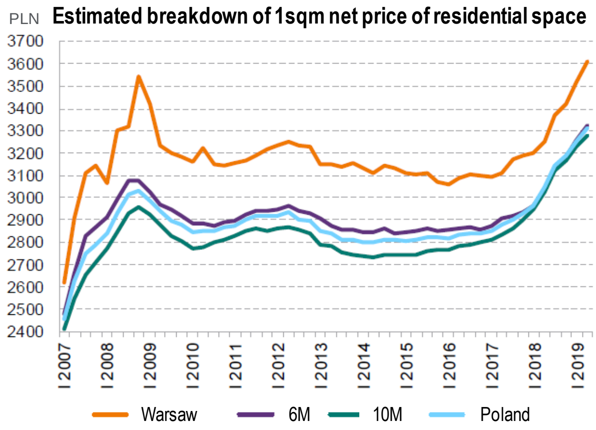


Source: CSO estimates, Citi Research *Temporary emigration: above 3 months but without formal unregistering from Polish residency

Implications for prices

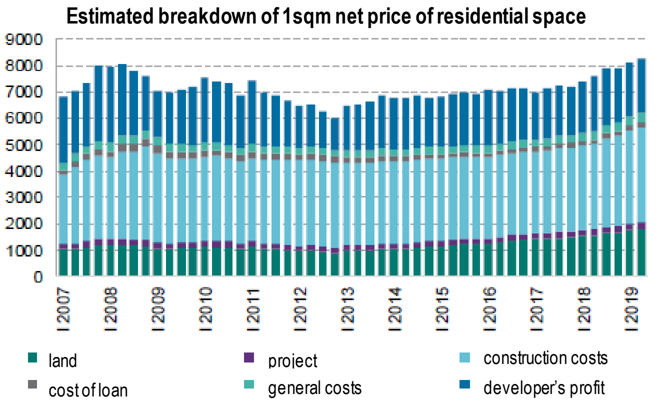
The housing boom over last three years has boosted expectations of future house price increases and contributed to a rise in the share of house purchases for investment purposes. In our view from the cost side, house prices should be supported by strong increase of wages in the construction sector and higher prices of land purchased. However, there is a risk that actual price performance may fall short of expectations in the short term (up to two years) as we expect a mixture of higher supply of new apartments, marginal economic slowdown and possibly higher tax burden for wealthier households. Those factors could weigh on house prices in the coming quarters. However, the medium/long term prospects (beyond two years) appear more favourable for the housing market. The well documented structural shortage of housing in Poland and expectations of gradual income convergence towards EU levels justify expectations of sustained strong demand for housing. With this in mind we think the risk of significant decline in house prices is limited and we expect them to continue upward trend in the long term.

Figure 25. Rising construction costs …



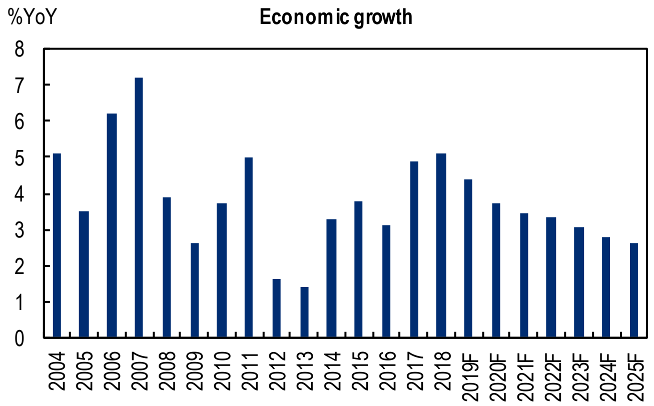
Source: NBP estimates, Citi Research

Figure 26. … and higher price of land could support prices in the short term but could also push margins lower …



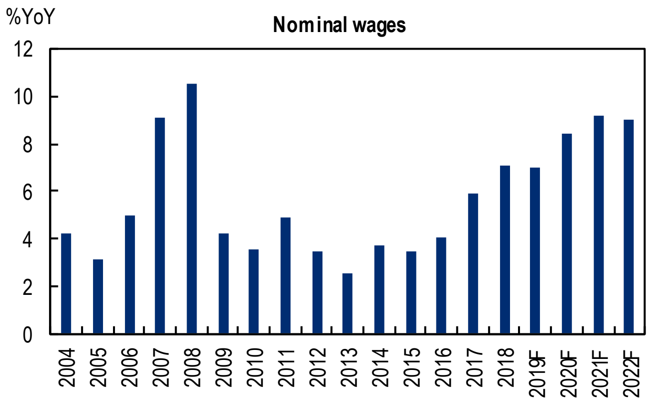
Source: NBP estimates, Citi Research

Figure 27. … as stronger supply and slower GDP could weaken price pressure



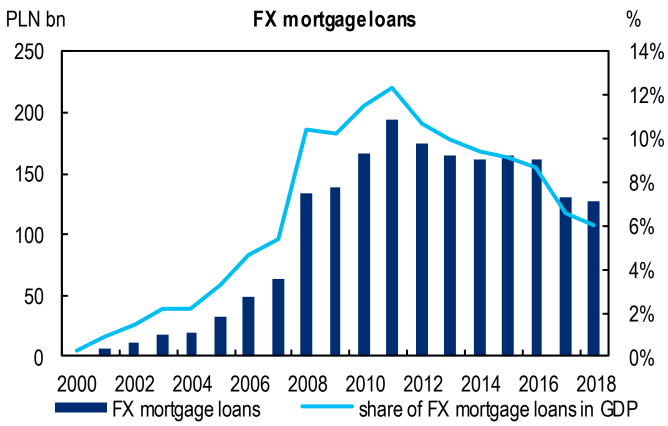
Source: CSO, Citi Research

Figure 28. In our view increase in minimum wage growth will affect mainly low income earners with smaller impact on housing demand



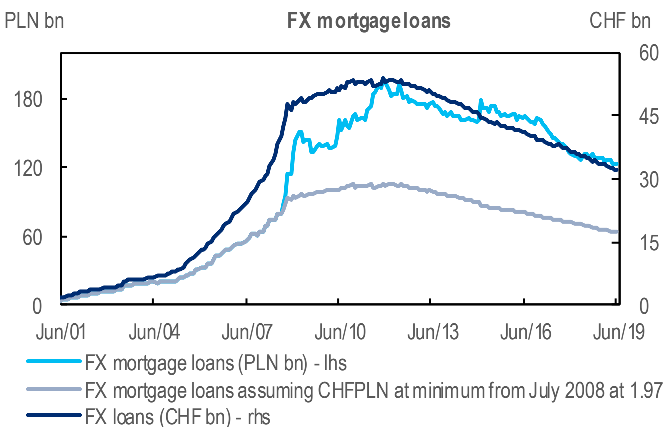
Source: CSO, Citi Research

Figure 29. FX mortgage litigations could potentially weaken loan supply



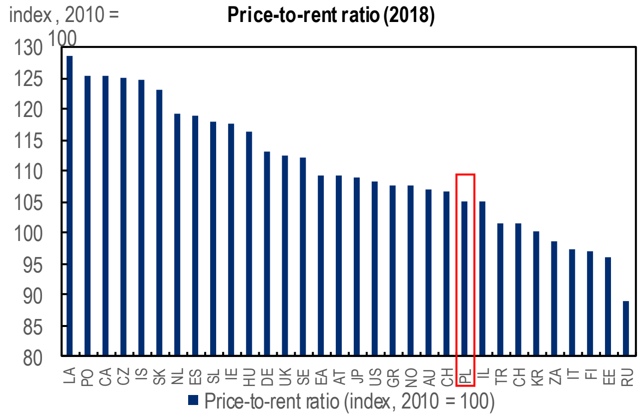
Source: NBP, CSO, Citi Research

Figure 30. … posing risk for the banking sector and GDP growth



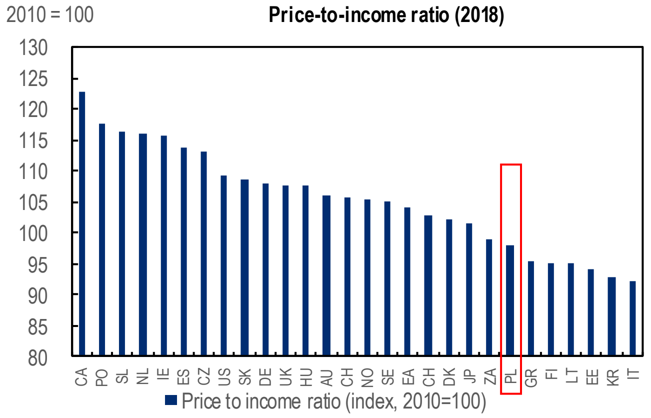
Source: NBP, CSO, Reuters, Citi Research

Figure 31. House price growth was balanced as prices were rising only slightly stronger than rents …



Source: IMF, OECD, Citi Research

Figure 32. … and less than income



Source: IMF, OECD, Citi Research

Conclusions

We believe that after recent increase in both demand and supply housing market activity is likely to decelerate but structural demand and prospects for pickup in prices remain solid for the next few years. Still historically strong labour market conditions, record low interest rates and still low mortgage debt levels should support the market and maintain space for more apartments price increases in the next years. Demand will be also supported by continued demand from financial investors. Macroprudential measures and tightening of credit policy by banks will be stabilizing force for the market. In the next decade the housing market demand will be supported by structural shortage in dwellings and demographic changes. We do not expect a significant drop in prices unless there is a severe recession.

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