HOUSING MARKET REPORT

2020

JUNE

‘Using our skills, we may be able to build stairs out of the stones which block our way.’

Count István Széchenyi

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(June 2020)

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The housing market represents a key area at the level of individual economic operators (households, financial institutions), as well as at the level of the national economy. Housing market developments are closely related to financial stability issues and fundamentally determine the short- and long-term prospects of economic activity. Overall, it can be stated that the housing market is intrinsically linked to every area of the national economy. Housing market developments, in particular the volatility of housing prices, influence the savings and consumption decisions of the household sector through its financial position, and, moreover, influence the portfolio, profitability and lending activity of financial institutions through the stock of mortgage loan collateral.

The 'Housing Market Report' aims to provide a comprehensive view of current trends on the Hungarian housing market and to identify and present the macroeconomic processes that influence housing market supply and demand. With this publication, the Magyar Nemzeti Bank regularly presents the relevant developments on the Hungarian housing market on a semi-annual basis.

The property market and within that the housing market is of key importance for the Magyar Nemzeti Bank in relation to fulfilling its primary tasks, based on inflation and economic considerations as well as financial stability factors. The development of the property market supply directly influences economic growth, while oversupply and inadequate supply can also have serious consequences for financial stability. Housing price appreciation improves the financial status of households, prompting them to increase consumption, which influences both economic growth and inflation. Price appreciation also boosts the lending capacity of financial institutions by reducing their expected losses, which again invigorates the economy through lending growth. The correlation between the mortgage loan market and housing prices deserves particular attention: during business cycles, a mutually reinforcing relationship can develop between bank lending and housing prices.

The 'Housing Market Report' provides a deeper insight into the factors behind market developments and the system of interactions between individual market agents by presenting a complex, wide-ranging array of information. The housing market already features in the publications of central banks, both in Hungary and at the international level, but typically from the perspective of the main topic of the respective publication. Consequently, the 'Housing Market Report' represents a unique central bank publication at the international level as well, due to its integrated presentation of the macroeconomic and financial stability factors of the property market. The information used by the publication includes the following:

- *The presentation of the macroeconomic environment influencing the housing market is based on the information contained in the MNB's Inflation Report.[1] Key statistical variables relating to the housing market include changes in the volume of gross value added, and developments in real income and unemployment, as well as changes in the yield environment.*

- *The analysis of current housing market developments primarily relies on the information provided by the Hungarian Central Statistical Office. Information on changes in housing market turnover and housing prices can be divided into the differences between new and used housing market developments. In addition to this, data on the regional heterogeneity of the housing market are also used.*

- *The experiences and proposals of the market participants and general government actors, with the contribution of the Housing and Real Estate Market Advisory Board (hereinafter: LITT) to shed light on the broader questions of the housing market trends.*

- *The analysis of the residential mortgage loan market primarily relies on the balance sheet data of credit institutions and the interest statistics collected by the MNB; information on the qualitative features of lending developments collected in the Lending Survey[2] is also used.*

[1] Magyar Nemzeti Bank, Inflation Report: http://www.mnb.hu/en/publications/reports/inflation-report
[2] Magyar Nemzeti Bank, Lending Survey: https://www.mnb.hu/en/financial-stability/publications/lending-survey

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1 Executive Summary

In the first quarter of 2020, the coronavirus pandemic reached the Hungarian housing market already in a decelerating state and caused significant upheaval in the market conditions. In 2019 several signs implied that the ascending phase of the Hungarian housing market, lasting since 2014, had come to end. According to the MNB's house price index, quarter-on-quarter house prices stagnated on a national average in the last quarter of 2019, while a decrease of 2 per cent was measured in Budapest, which has been unprecedented for years. As a result, the annual growth rate of house prices declined materially, to 16.2 per cent nationwide and to 14.1 per cent in Budapest. According to preliminary data, in the first quarter of 2020 deceleration continued; the annual growth rate of house prices fell to 12.3 per cent and 9.5 per cent nationwide and in Budapest, respectively. In addition to the declining price dynamics, in 2019 the number of housing market transactions fell by 10.4 per cent compared to 2018, while Budapest registered an even larger, 25.6 per cent fall. In addition, at the end of 2019, the discount available to customers in the course of a market bargain significantly rose, primarily in Budapest, which may indicate declining demand.

Supply of new homes continued to rise in 2019; the number of newly completed homes was up by 19.5 per cent compared to 2018. However, looking ahead, there are a number of signs implying a decline in the supply of new homes. This is primarily due to the ending of the preferential VAT rate at the beginning of 2020, as a result of which, there are already signs of decline in development activity; furthermore, the coronavirus pandemic may also hinder home constructions. The number of new building permits issued decreased already in 2019 by roughly 4.3 per cent, and to an even larger degree, by 27 per cent in annual terms, in the first quarter of 2020. In the first quarter of 2020 the number of homes in the newly announced projects in Budapest was one of the lowest in the current cycle, which indicates the slackening of the home development activity in the period ahead.

In the first quarter of 2020, the spread of the coronavirus pandemic and the restrictive measures implemented at the end of March due to safety reasons, resulted in an abrupt and drastic fall in market activity. In March, the number of sales transactions, in annual terms, fell by 29 and 38 per cent nationwide and in Budapest, respectively, which was mostly attributable to the drop in the number of transactions observed in the last week of the month. Following this, in April the number of transactions fell by 58 and 70 per cent, respectively, in annual terms. The pandemic made its impact felt also on the rental market immediately. Based on market data, compared to the end of February, by the end of April the number of flats for rent in Budapest rose by 22 per cent. According to the experts of the Housing and Real Estate Advisory Board (hereinafter: LITT), a large number of dwellings, which had formerly been rented out short term to tourists, may have been redirected to the long-term rental market. The average asking prices for flats to let also declined in most districts of Budapest, particularly in the downtown districts. On the supply side, the pandemic may primarily cause a delay in the completion of construction, and result in even fewer new developments in the long run. Construction is further decelerated by the scarcity of imported materials and also by the reorganisation of the work processes for safety reasons.

Until 2019, the macroeconomic fundamentals painted a favourable picture; however, the temporary rise in unemployment together with the cautiousness of the population may exert material impact on the housing market. According to the experts of the LITT, households' confidence appears to have weakened already in the short run, which – depending on the protraction of the current situation – may take years to be reinstated. In the first quarter of 2020, banks tightened their lending conditions both for housing projects and loans to households. Access to credit, in addition to the income position of households, may be key to the maintenance of the housing market demand. Stability of house prices is supported by the fact that due to the moratorium on loan instalments, also urged by the MNB, those in stretched liquidity situations are not necessarily forced to sell their property.

The preferential VAT rate, announced by the Government, applicable in the brownfield zones may support the market of new homes, the positive impacts of which are likely to appear already from 2022. On the whole, we expect the completion of new homes to decline in 2020 and 2021 to 18,500 and 15,500 homes, respectively, while the decline may stop in 2022 and 16,000 new homes may be completed.

2 Special topic: The impact of COVID-19 on the Hungarian housing market

The spread of the coronavirus in March curbed the activity of the Hungarian real estate market abruptly and significantly. In the last week of March, following the implementation of curfew measures, the number of housing market transactions amounted to merely 42 per cent of the year-on-year figure. The decline in housing market activity continued in April; during the month, the year-on-year decline registered in the number of transactions in Budapest and at national level amounted to 70 and 58 per cent, respectively. The direct impacts of the pandemic appeared almost immediately on the rental market as well. In the entire Budapest market the number of properties for rent rose by 22 per cent by the end of April compared to the stock at end of February. In line with this, rents decreased by 9 per cent on average, but in several downtown districts, mostly characterised by short-term letting to tourists, the decline in rents was as high as 15-20 per cent. House price indices based on data from housing agents still stagnated in April on a monthly basis both in Budapest and on national average. However, the growth rate of prices decelerated further during the pandemic; by April 2020 the annual dynamics of house prices decreased from 16.2 per cent, recorded at the end of 2019, to 8.7 per cent on a national average and from 14.1 per cent to 6.0 per cent in Budapest.

Looking ahead, the impact of the current trend on the housing market may be significant depending on the length of the pandemic. In recent years, the macroeconomic fundamentals supported the supply side of the housing market, but under a protracting crisis the macroeconomic developments determining the housing market may turn. The members of the LITT believe that the two most important questions for the continuance of housing market demand are the development of the income position of households and the access to loans. On the supply side of the housing market, the pandemic may primarily result in delayed completion of constructions and – looking ahead – in the start of even fewer new developments despite the expected decrease in construction costs.

Chart 1
Direct impacts of COVID-19 on the Hungarian housing market

The coronavirus pandemic caused housing market activity to decline abruptly and drastically. The impact of the crisis situation first appeared in the housing market demand, which became apparent, among other things – in addition to the decline in online searches – in the fall in transactions (see Chart 3). The decline in demand was triggered partly by the fact that due to the cautiousness of households, willingness to view listed properties substantially declined, which was further exacerbated by the epidemiological measures implemented in the last week of March. In the medium term, the negative income and wealth effects of the pandemic – and consequently fewer eligible borrowers – may result in the stabilisation of demand at a lower level (Chart 1). The members of the LITT believe that after the pandemic, housing market demand will be essentially determined by two factors, namely, the changes in the households' income position and the availability of financing (see Box 1).

On the supply side of the housing market, sellers have not yet reduced asking prices materially, but declining activity and further delays may be expected in new home developments. It points to a stagnation in the current supply of used homes that certain sellers may take a wait-and-see position for the time being due to the uncertainties

Chart 2
Indirect impacts of COVID-19 on the Hungarian housing market

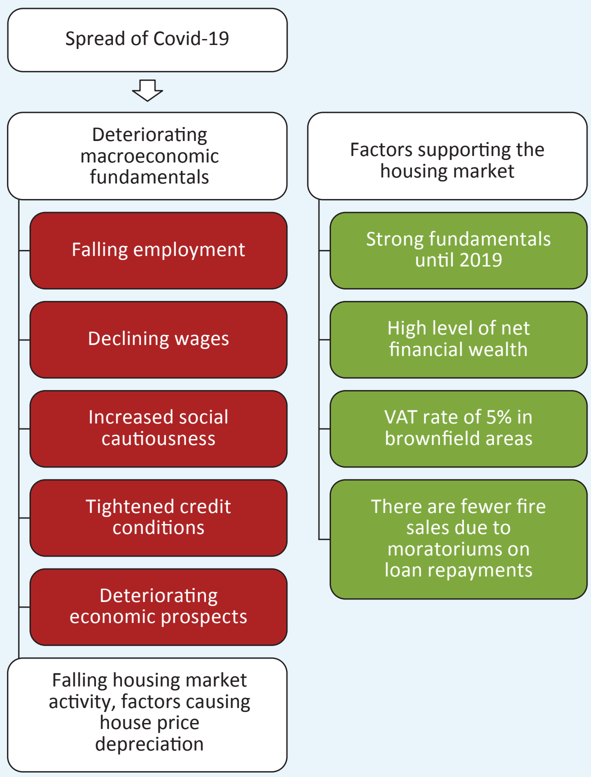
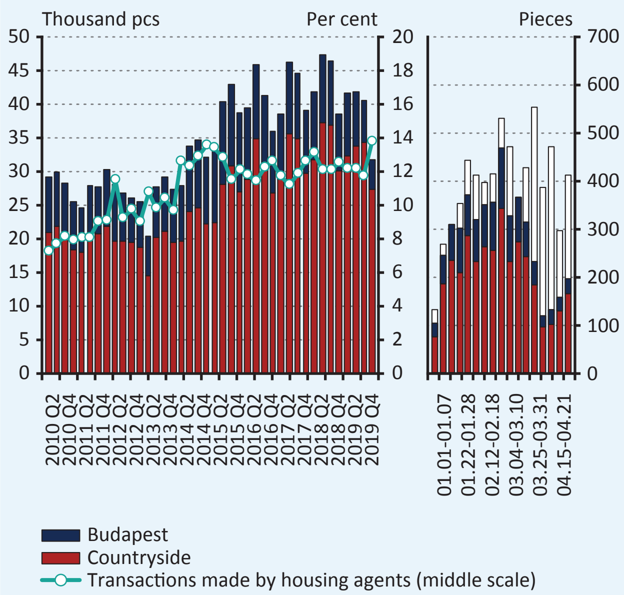


Chart 3
Number of housing market transactions (left-hand chart) and housing agent transactions (right-hand chart)



Note: On the right-hand side the transparent column shows the agents' transactions on a national level in 2019 compared to the transactions in 2020.

Source: MNB, housing agent database.

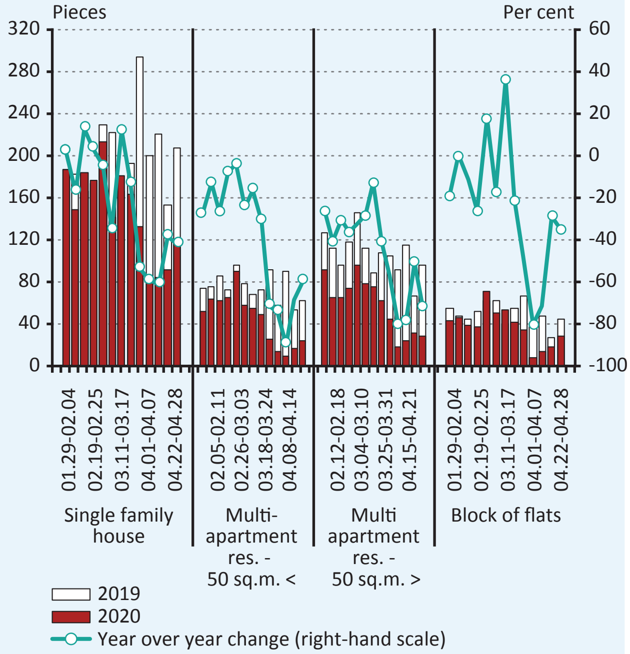
of the long-term effects of the pandemic. The adjustment of asking prices in response to the falling demand may take place only gradually. This may be somewhat offset by the actors who anticipate a long-term freeze of the market, and thus are willing to sell their property even below the current market price. In respect of the properties in development, the pandemic passes through to the housing market through the temporary stoppage of the supply chains and thereby the shortage of imported materials, which – together with the reorganisation of the work processes to make them safer – may lead to delays in construction in the coming months. Construction of new homes may be further hindered by the fact that although demand for new dwellings declined as a result of the pandemic, according to the members of the LITT developers are less interested in investing under a VAT rate of 27 per cent, irrespective of the pandemic.

The direct impacts of the pandemic have already manifested themselves in the rental market through the rising supply and falling rents. Since the beginning of March a large number of dwellings, formerly offered to tourists, appeared in the long-term rental market, which resulted in falling rents in Budapest (see Chart 6). Looking ahead, a more significant decline in rents may be expected upon the renegotiation of the rental contracts, which is typically due in the summer months. A major decline in rents may also reduce the value of properties purchased for investment purposes and this impact may pass through to the sales price of other properties.

The impact on the housing market may be significant depending on the length of the pandemic. In the past years, the favourable labour market conditions, rising real wages, the high level of savings, favourable financing environment and the government measures aimed at home starters supported the demand side of the housing market. However, upon a protracting crisis the macroeconomic trends pointing to a price rise may turn (Chart 2). For the time being, the labour market is surrounded by major uncertainty; however, looking ahead the number of people in employment is likely to decrease. The slowdown in economic growth and the decline in enterprises' earnings potential may be accompanied by lower wage dynamics, which may increase the cautiousness of the population, thereby curbing household investments. The deterioration of economic prospects and the decrease in banks' risk tolerance generated changes in the financing environment as well, both on the buyers' and developers' side.

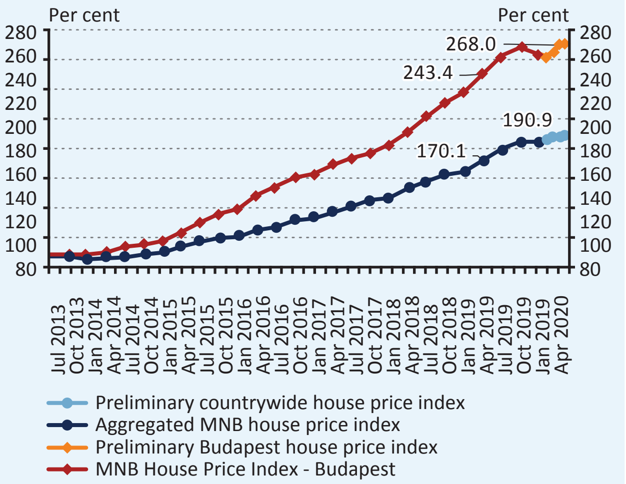
The number of transactions substantially fell following the isolation measures. In the first quarter of 2020, the number of transactions declined by 28 per cent in Budapest and by 19 per cent nationwide in annual terms, which was

Chart 4
Number of transactions concluded by housing agents by property type



Source: MNB, housing agent database.

Chart 5
MNB house price index for the country and Budapest, and preliminary monthly house price indices (2010 average = 100%)



Note: Preliminary monthly house price indices are based on 3-month smoothed averages. Highlighted index points in the chart: March 2019 and March 2020.

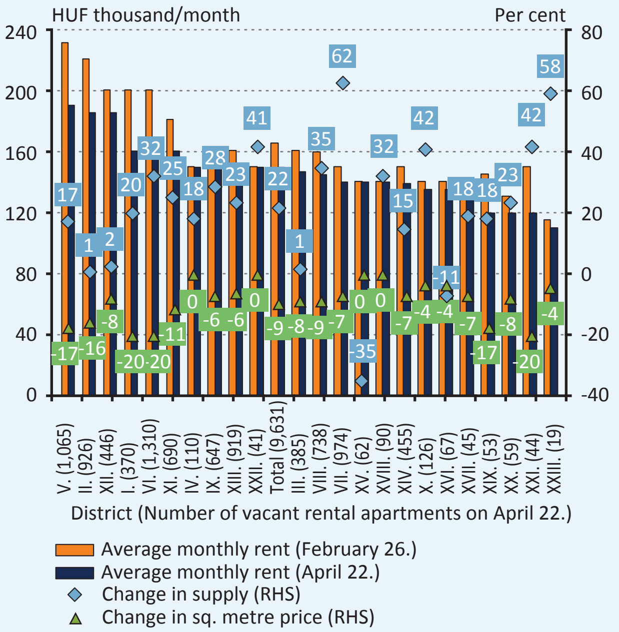
Source: MNB, housing agent database.

greatly attributable to the spread of the pandemic in March. In parallel with the rise in the number of cases, housing agents concluded fewer and fewer transactions (Chart 3). In March, the number of realised transactions nationwide and in Budapest fell short of that registered a year ago by 29 per cent and 38 per cent, respectively. During the last week of March, following the curfew measures' entry into force, the decline registered in Budapest and nationwide was 64 per cent and 58 per cent, respectively, in annual comparison. In April, the decline in the number of transactions continued; the year-on-year decline registered during the month in the number of transactions in Budapest and nationwide amounted to 70 and 58 per cent, respectively. The demand decreasing impact of Covid-19 significantly strengthened home buyers' bargaining position. The median bargain rate in April, as a percentage of the last asking price, was 5.6 per cent in Budapest and 6.0 per cent in the rural areas, which exceed the values registered in March by 1.9 and 1.7 percentage points, respectively.

The fall in the number of sale and purchase transactions can be observed at all property types. The major decline in the number of transactions after the curfew measures' entry into force could be observed at all property types. The largest, about 72 per cent, decline occurred in the number of transactions related to dwellings with a floor area over 50 square metres during the last week of March, but the number of sale and purchase transactions was halved compared to last year's figures also for the rest of the property types. The most drastic decline in April was observed also in the case of dwellings with floor area over 50 square metres; during the first two weeks of the month the market of this type of dwellings almost fully dried up. The lowest decline was measured in April in the case of family houses, but even here the number of transactions fell by almost 50 per cent in annual terms (Chart 4).

Despite the fall in demand, in April the house price indices calculated on the basis of housing agents' data stagnated for the time being. At the end of 2019 the price rise halted in Budapest; the roughly 2 per cent quarter-on-quarter decline in house prices has been unprecedented for years. In the fourth quarter, the annual price dynamics in Budapest fell to 14.1 per cent and on national average to 16.2 per cent. Based on the data provided by the housing agents, the decline in house prices in Budapest continued in January 2020 as well, followed by a moderate rise in February and March. Despite the major fall in demand, in April the house price indices calculated on the basis of agents' data stagnated for the time being (Chart 5). However, the annual price dynamics clearly shows the signs of continuing deceleration. By April 2020, the growth rate of house prices fell to 8.7 per cent on a national average and to 6.0 per cent in Budapest.

Chart 6
Change in the average monthly rent and supply of residential properties to let in Budapest by districts



Source: ingatlan.com.

Due to the decline in tourism, several dwellings, formerly let for the short term, were diverted to the long-term rental market. Since the appearance of the coronavirus pandemic in Hungary, the number of dwellings for rent significantly rose in Budapest, primarily in the downtown districts, where the dwellings for short-term letting, formerly popular with tourists, are typically located. Based on the market data, by the end of April the number of properties for rent rose from fewer than 7,900, registered at the end of February, by 22 per cent to 9,600. However, in some districts the number of dwellings for rent rose by 40 per cent in two months. Average rents also decreased in most districts of Budapest. The largest, roughly 20 per cent, decrease was observed in Districts I, VI and XXI, and in District V, popular with tourists, rents also fell by more than 17 per cent since the end of February (Chart 6). Experts expect further decrease in rents in the summer months, since the rental agreements are usually renegotiated in summer, which – considering the present bargaining position of tenants – points to a decrease in rents. Considering the demand side of the rental market, inquiries related to dwellings for rent fell by roughly 15 per cent in annual terms; however, at the end of April, market participants already reported significant pick-up in the number of inquiries related to dwellings for rent.

Box 1
Opinion of the members of the LITT on the impact of the coronavirus and the short- and medium-term prospects of the housing market

Below we summarise the **expert opinions voiced at the section meeting of the Housing and Real Estate Market Advisory Board (LITT) held on 6 May 2020** with special regard to the **impact of the coronavirus pandemic on the Hungarian housing market**.

Rental market

The markets of dwellings for rent and for sale responded differently to the pandemic. In Budapest, under a rising number of dwellings for rent a decline in rents was observed, where the rate of the decrease in the downtown districts of Budapest – the most typical area of tourist accommodation operated in private homes – was as great as 20-30 per cent. The process took place in a relatively short time, as the decrease became stable by the end of April. At the same time, no decrease was observed in the rents in the towns of county rank; moreover, in these towns interest in dwellings for rent have already returned to the pre-pandemic levels. Looking ahead, in the demand of the rental market of Budapest, typically the period from the end of July to the end of August is regarded as a seasonal peak, which can be linked to the new wave of demand generated by the students newly admitted to the higher education institutions of Budapest not residing in Budapest appearing in the market. This year this will happen only if higher education restarts from September in the same form as before the pandemic. A remark was made that the present decline will have a lasting impact on residential apartment rent-outs to tourist as accommodation (AirBnb) and many flats will appear on the long-term rental market or will be offered for sale.

Housing demand and house prices

A decrease in demand was observed in the first two months of 2020 in the market of homes for sale, the year-on-year rate of which is between 20 and 30 per cent. Demand was even lower in March and April after the isolation and restrictive measures had entered into force; some of the market participants mentioned a decline in demand of 75-90 per cent, mostly at the new home developments under construction. The plunge proved to be temporary in this case as well, since market participants usually reported positive signs about May, albeit the level of demand is unlikely to return to the pre-pandemic level for quite a while. Despite the decrease in demand, sellers typically have not reduced their asking prices; for the time being they are characterised by a wait-and-see attitude and the assessment of the situation. Developments in the households' income position and labour market expectations are key to the continuance of the demand in the housing market, and the availability and conditions of financing under declining income trends may become more important after the pandemic. Based on expert opinions, in the first quarter of 2020, roughly half of the buyers relied on bank financing, but borrowers typically applied for smaller amounts. When discussing the fall in demand, some market participants expected a decline in house prices of 15-20 per cent in Budapest for 2020.

Fostering demand to mitigate the decrease in prices

In relation to the anticipated fall in house prices, experts also emphasised negative wealth effect, which also has a negative impact on economic growth through the decline in household consumption. The mitigation of the decline in house prices is also facilitated by fostering demand, in respect of which the following measures were proposed: exemption from the duty on onerous transfer of property for 2 years; increasing the Home Purchase Subsidy (HPS) amount by 25-30 per cent for 2 years; reducing interest rates on housing loans; fostering bank financing through credit guarantee institutions; and personal income tax allowance connected to loan instalment, a scheme also applied in the past. At the same time, some experts believed that we must prepare for a crisis of roughly 2 years and thus the fall in prices is unavoidable. Under decreasing rents some of the investors will appear as sellers after a while, and thus the growth in supply will inevitably entail a decline in prices.

Presence of investors in the housing market

In Budapest the ratio of purchases for investment was 27 per cent in March and 35 per cent in April – compared to the year-on-year level of 40-50 per cent – which suggests that investors' interest has not disappeared in full, but has declined. Compared to previous periods the ratio of investors interested in cheaper properties increased; however, sellers are not yet ready to reduce prices. On the sellers' side, the appearance of investors is not typical in Budapest. In the rural areas, in March and April investors were present in 29 and 24 per cent of the purchases, respectively; however, here they also played a role in sales, with a share of 9 per cent in March and 4 per cent in April. In Budapest 45 per cent of the sellers sold their homes due to moving to a larger flat. Taken together, investors perceive the impact of the pandemic as a short-term crisis, which is supported by the fact that for the time being they are not present on the selling side. Nevertheless, following the termination of the state of emergency, depending on the economic trends and expectations, they may appear in the market. On the whole, compared to other investment products real estate is a stable safe haven, which is proved by the experiences gained to date from the present crisis. The members of the LITT found it unlikely that the former level of investment demand would return to the housing market before the end of the year even under favourable developments. In terms of the stability of house prices they emphasised the importance of the moratorium on payments, due to which even those in a stretched financial situation are not compelled to sell, which generated major price falls during the 2008 crisis. The activity of buyers for investment purposes may partly offset the negative impacts – such as the expected rise in unemployment or the lending constraints characterising crisis periods – on demand, but in an economic environment characterised by recession presumably only a limited number of people can afford this.

Supply of new homes

A decline in the supply of new homes in Budapest can also be observed, since compared to the more than 7,000 new homes seen in previous quarters, at the end of March only 6,600 new homes were on offer. Moreover, in the first quarter of 2020 there was a larger decline in the number of homes in the already launched developments than before. The members emphasised that since these were data from the end of March and these declines yet reflected the impact of the coronavirus pandemic to a lesser degree; thus the main reason for the contraction of the new home market is the resetting of the VAT rate on new homes to 27 per cent. As a result of the pandemic the average asking price of new homes fell by 2 per cent in April. The general opinion was that under a VAT of 27 per cent no new home can be sold – apart from a few exceptions – and the pre-sale, necessary for financing the developments, cannot be realised either. Experts regarded the presence of the coronavirus as an impact concealing the latter problem, since it is difficult to separate the negative impact of the VAT increase and the pandemic on demand. All this may lead to the maintenance of the unfavourable regulation. They took a stand on a VAT of 5 per cent, recommended earlier, and the introduction of a 4 per cent sectoral tax, to increase the supply of new homes. The members welcomed the preferential, 5 per cent VAT rate applicable to housing developments implemented in brownfield zones and brownfield areas, announced on 16 April 2020. Under the preferential VAT rate and decreasing construction costs developers can make a profit on building homes in brownfield areas; however, it is important that local governments should also support such housing developments by proper regulation, and on the other hand, falling demand also makes the realisation of these developments doubtful. Part of the LITT members believe that there is already a confidence crisis, and it takes at least two years for the confidence of buyers to return to the previous level. During this period developers must operate under reduced demand, which represents higher risk on the survival of the smaller actors, i.e. those building 50-100 homes. It should be regarded as a warning that after 2008 it took until 2015 for the confidence of households to return in respect of long-term housing investments. At the same time it is good news that foreign currency loans no longer burden households and the balance sheet of banks.

General survey of the construction sector

It was mentioned in relation to the current situation of construction that new orders were continuously decreasing, and thus a collapse is likely to take place in the performance of the sector. In recent years the construction market was overheated, which led to exaggerated pricing by smaller construction firms and to a rise in the price of building materials as a result of which some of the materials were characterised by the German price level. At present the distributors of building materials already reduced prices and there is also a price decrease of over 10-15 per cent at the manufacturers. The price of reinforcing steel, one of the most important base materials for contractors, fell by 10 per cent in the past months. In the case of imported building materials the depreciation of the forint in the past period was an unfavourable development for pricing, but the degree of the decline in prices, mostly denominated in euros, already exceeded the degree of the price effect of the exchange rate depreciation. Among the enterprises linked to construction it can be perceived at the firms participating in the preparatory works (design offices) and in the early phase of construction (demolition, earthwork, foundation) that it already takes greater efforts to win an order. This is due to the fact that too few new developments start, while the enterprises participating in the finishing, contractors' works, for the time being perceive the threat to a lesser degree as the works in progress still absorb their capacities. The impact of decreasing material costs on the construction fees is somewhat absorbed by the energetics requirements effective from 2021, the weakening of the exchange rate and the low labour force efficiency. On the whole, upon the halt of the economy for 2-3 months, a decrease of 15 per cent may be expected in the construction costs, but some of the experts expect a longer crisis and a 40-per cent fall in construction costs. The decreasing demand generates increasing competition among construction companies, which improves the bargaining position of developers vis-à-vis contractors. The pandemic typically caused delays in the construction of buildings and home constructions. This is due to the fact that the work processes built on each other are carried out by smaller groups, it is necessary to separate the working areas of the large number of subcontractors to a greater degree and the replacement of imported products by materials manufactured in Hungary takes time. As regards the availability of building materials, upon the appearance of the crisis first fast stockpiling was observed, but this stopped by early May, which implies that fears of shortage of material stopped. In agreement with the principals, import materials that were more difficult to procure were/are replaced at most places by domestic products. The production of Hungarian building material manufacturers is continuous, delivery is guaranteed, but transportation difficulties continue to slow down deliveries.

Financing

In parallel with the economic downturn, banks' financing conditions were tightened both for buyers and development loans, which is attributable to the increased risks related to employment on the buyers' side and to the construction (availability of materials and labour, longer construction time) on the developers' side. At present there is a settled market on the developers' side, with well capitalised actors. The households' credit demand appearing in the bank branches materially declined in parallel with the spread of the pandemic, i.e. between the end of March and mid-April, and since the end of April – as a result of the measures related to the branch services – it started to recover. Several experts were of the opinion that in Hungary in the coming period the construction of new homes will be determined by the availability of housing loans, which could be fostered by the regulator through loan guarantee and/or central bank mortgage bond purchase programmes and the reduction of credit costs. There was also an opinion that at present there are no such schemes in the financing of buyers that would provide the buyer with steady financing during the period of the development. By aligning it with the scheduled financing of the development, it would be possible to make scheduled disbursements to retail customers. Due to the absence of such products, at present it is difficult to stimulate the new home market, since the disbursement of loans will be due only in 1-2 years.

Rental market and FGS Go

The actors of the real estate market are of the opinion that the construction of tenement flats is conditional upon proper demand, authorisation of efficient buildings, appropriate financing both in terms of price and financing ratio, adequate rents and lower construction costs. There is strong demand for tenement flats, and the realised developments would represent affordable and long-term dwelling alternative for, amongst other, young career starters, through broadening the supply and thereby reducing the rents. Affordable and secure dwelling may as well give rise to favourable demographic impacts through the families' decision to have children earlier. In a potentially declining economic environment, under decreasing demand for new homes, the building of tenement flats on a market basis would be also a good opportunity for maintaining developments and preventing the shrinkage of construction capacities. However, of the factors important for the realisation, experts see the availability of proper financing as a bottleneck. The MNB's Funding for Growth Scheme Go!, announced in April 2020, supports the financing of tenement flat developments by favourable interest conditions, but many find the financing ratio of about 50 per cent, available at the banks along the risk management guidelines, too low for creating incentives for investors and developers. At present banks tend to assess tenement projects based on cash flow rather than on the value of the collateral. As a bridging solution it was proposed to elaborate a loan guarantee scheme in order to realise the first tenement flat projects and to create the market. The financing of tenement flats would create an opportunity for banks to place funds for long term; in several countries this loan product represents one of the largest volumes in the banks' portfolio. Tenement buildings may be favourable also in terms of loan-to-value ratio, as it has a large turnover in many countries and real estate funds are keen on buying them. Its characteristics that permits alternative utilisation is that the flats of tenement buildings can be sold individually as well, should utilisation through rental not work due to any reason. However, this is conditional upon insisting on maintaining the possibility of division both in legal (real estate register) and technical terms during the implementation and the financing.

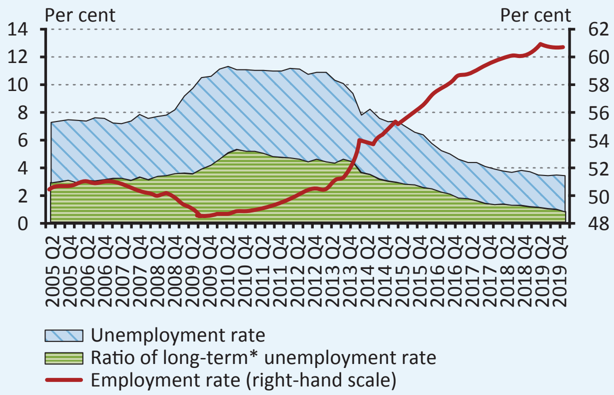
Experts believe that the feasibility of cost-efficient tenement buildings is primarily hindered in technical and regulatory terms by the high number of parking lots (parking spaces) to be built. According to the experts' opinion, the tenement flat tenants' demand for parking space is roughly one third of the parking space requirements of those buying a home. Furthermore, the parking problems of the districts in Budapest are not resolved either if the construction authorities prescribe a ratio of 1:1 for the number of dwellings and parking spaces for each development, since the parking problems often occur not in the development environment. It was mentioned that if the construction of parking lots had not been expected by the authorities, developers would build garages anyway, but only in the quantity that satisfies buyers' needs based on the experiences. It is important to take into consideration buyers' needs also in the case of tenement blocks, since in order to reduce the risks of investors and bank financing, the possibility of selling the tenement flats individually should be preserved.

3 Macroeconomic environment

Although in the second half of 2019 the strong underlying wage setting trends still supported further growth in the households' disposable income, wage dynamics materially slowed down at the beginning of 2020. The outflow of housing loans continued at a brisk rate in 2019. Despite the favourable income trends, home purchase intention of households decreased, and from the second half of last year housing market demand gradually declined; moreover, in the first quarter of 2020 the number of transactions considerably fell. The labour market problems generated by the coronavirus pandemic result in deteriorating income trends, which may lead to further decrease in housing market demand in the months ahead.

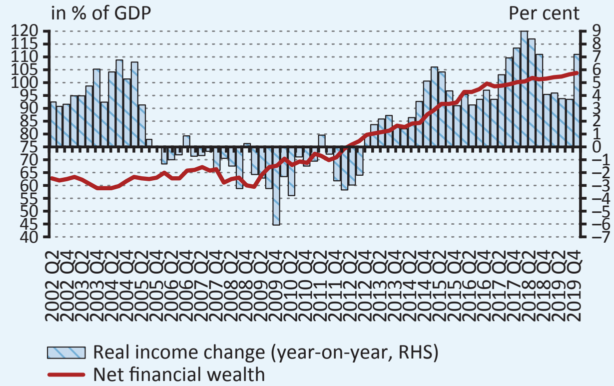
In the past two quarters housing market supply materially broadened, but the adjustment of the sector is still slower compared to the previous real estate market cycle. The number of building permits issued substantially decreased during the previous two quarters, which projects a deceleration in supply. The lengthening of the construction time as a result of the coronavirus pandemic also impacts housing market supply negatively.

Chart 7
Unemployment and employment



*Note: * Unemployed for more than 1 year.*
Source: HCSO.

Chart 8
Changes in households' financial assets, liabilities and real income



Source: HCSO, MNB.

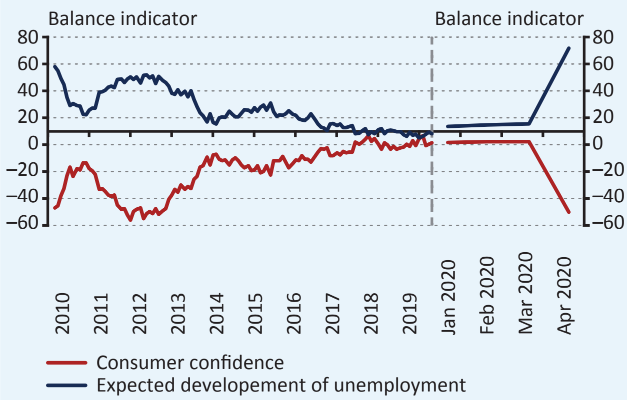
3.1 HUNGARIAN HOUSING MARKET DEMAND

Households' income rose further in the second half of 2019, accompanied by favourable labour market trends and lending environment. However, from the second half of the year demand in the Hungarian housing market declined, and in line with this the rise in house prices decelerated on an annual basis. Unemployment increased moderately in the first quarter of 2020 and the growth rate of wages also decelerated, which projects less favourable income trends. The impacts of the coronavirus pandemic on Hungary may appear in the second quarter data, at the earliest.

The deterioration in labour market prospects points to a decline in housing market demand. Labour demand already slowed down in the second half of last year and the tightness of the labour market also decreased. The growth in employment has practically stopped (Chart 7). In the first quarter of 2020 there was only a slight increase in the unemployment rate, since a large number of those who lost their jobs did not look for a job actively, but became inactive in the labour market. At the same time, decrease in employment was already stronger in the first quarter (decreased by 56,000 people). The more unfavourable labour market environment projects a deterioration in households' income prospects, which may give rise to a decrease in willingness to invest and in housing market demand.

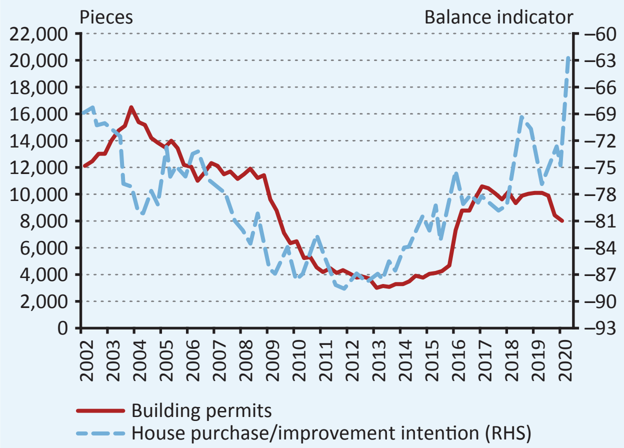
Due to the uncertainty caused by the pandemic and the deteriorating income prospects, households' cautiousness may strengthen. Dynamic growth in households' disposable real income continued in the second half of last year (Chart 8). Households' net financial wealth was at a historic high and it steadily exceeded 100 per cent as a percentage

Chart 9
Consumer confidence and unemployment expectations



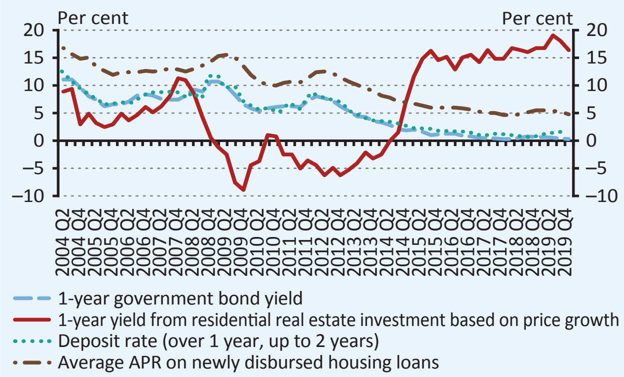
Source: European Commission, Hungarian Economic Research Institute.

Chart 10
Changes in building permits issued and households' motivations for home purchases/upgrades



Note: Seasonally adjusted data.
Source: HCSO, MNB.

Chart 11
Changes in yield premium realisable on home buying through value appreciation, and in deposit yields



Note: The yield realizable on housing investments is calculated exclusively based on the growth rate of the MNB house price index.
Source: Government Debt Management Agency, MNB.

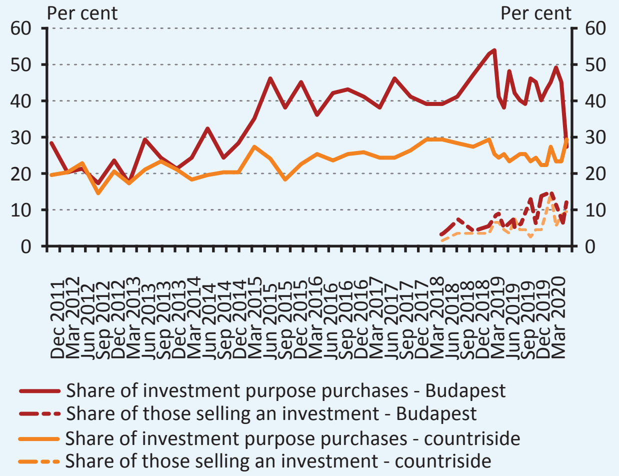
of GDP, which was also supported by the advance saving linked to households' home building and home improvement plans. The continued growth in lending for housing and consumption purposes – including the prenatal baby support loans – made a substantial contribution to the expansion of the Hungarian housing market. However, this year the deterioration in the labour market environment worsens income prospects. At the beginning of the year, growth dynamics of wages slowed down, which – according to our expectations – may continue also in the period ahead. The rising unemployment resulting from the coronavirus will also have a negative impact on households' incomes. The expected decrease in the growth rate of housing loans points to further decline in housing market demand. Uncertainty, as a result of the pandemic, rose among households as well (Chart 9), and thus the role of the cautiousness factor may strengthen, which may result in higher savings and decreasing household investments.

In the second quarter of this year, the willingness of households to buy or improve their homes increased. Based on surveys, the ratio of households planning to buy a home or improve their existing home in the next 12 months materially increased. The growth may be attributable to the fact that part of the households scheduled certain improvement works for the period of the restrictive measures, which is also evidenced by the increased turnover in building materials. However, the number of building permits substantially declined. In the first quarter 7,032 building permits were issued, which is the lowest value since the first quarter of 2016 (Chart 10). The fall in the number of building permits issued projects a decline in home construction.

Favourable financing conditions may help maintain housing market demand after the end of the coronavirus pandemic. The low interest environment supports housing market demand through the favourable interest rates on housing loans and by diverting savings to the real estate market (Chart 11). According to market experts with the passing of the pandemic the availability of adequate financing to households will be key to the recovery of housing market demand.

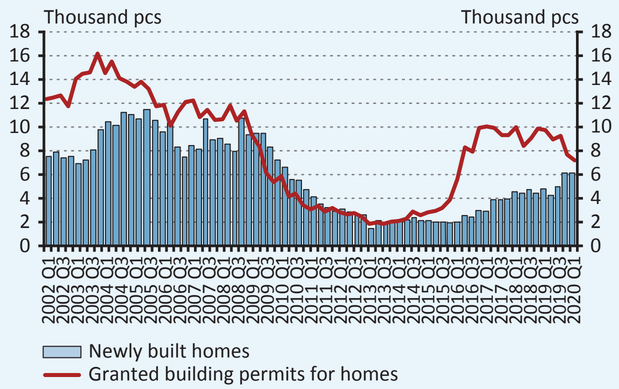
In March, the ratio of buyers for investment purposes significantly decreased in Budapest. In parallel with the appearance of the coronavirus pandemic, in March 2020 the number of transactions substantially declined in the housing market in Budapest, and within the sale and purchase transactions the ratio of those buying for investment purposes also fell. While in previous years the ratio of investors within the transactions in Budapest was steadily between 40 and 50 per cent, according to market surveys it fell to 27 per cent in March. The standstill of foreign

Chart 12
Share of buyers for investment purposes and sellers of investments in Budapest and in the countryside



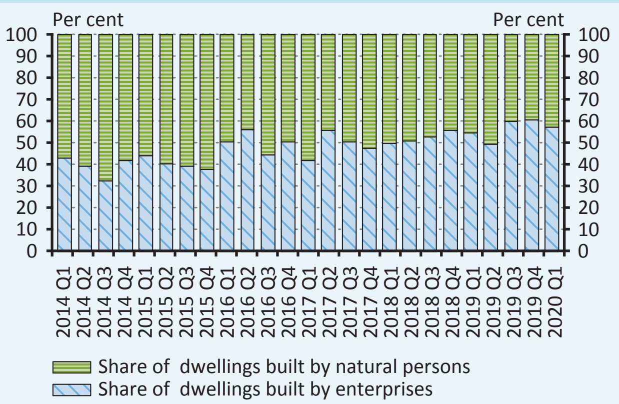
Source: Duna House.

Chart 13
Number of building permits issued and number of new completions



Note: Seasonally adjusted data.
Source: HCSO, MNB.

Chart 14
Distribution of new completions by developer



Source: HCSO.

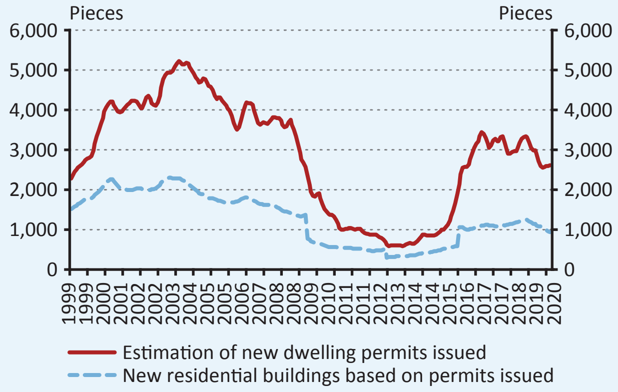
tourism and the uncertainty in the coming period resulting from the pandemic significantly reduced the appeal of flats let for short term. However, in March the former buyers for investment purposes did not yet appear among the sellers in large numbers, and thus presumably most of the investors took a wait-and-see position for the time being (Chart 12).

3.2 HUNGARIAN HOUSING MARKET SUPPLY

In the previous housing market cycle housing market supply responded to increasing demand by material expansion; however, in recent years the significant growth in demand was not followed by a growth of similar degree in supply. The more moderate home construction trends than seen in previous periods, were also hindered by the scarcity of construction capacity and skilled labour. The spread of the coronavirus in Hungary resulted in lower demand in the housing market in March and April, while supply materially rose in terms of new completions in the first quarter, when the impacts of the pandemic prevailed to a lesser degree. Based on the latest figures, the role of the labour force, as a factor hindering production, decreased, while insufficient demand, financial constraints and a shortage of material increasingly hamper production as perceived by the enterprises. The pandemic may contribute to the postponement of construction and through that to a decline in supply, which is an unfavourable development for economic growth as well (Box 2).

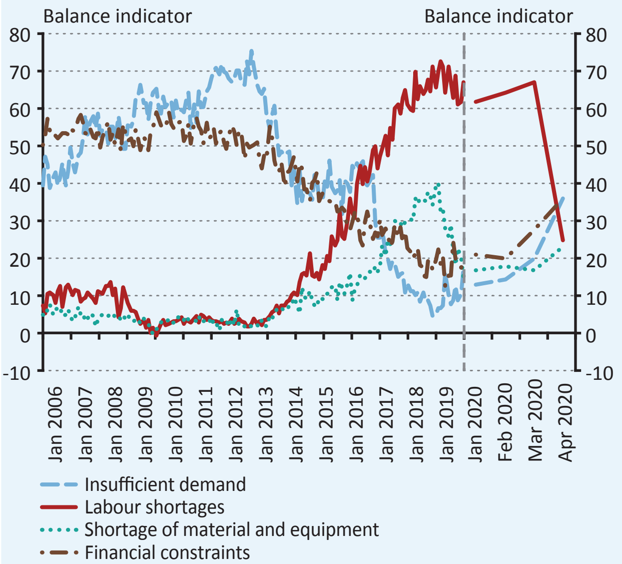
In the past two quarters housing market supply substantially increased year on year, but looking ahead there are signs of decrease. Supply in the real estate market typically reacts to changed demand only with delay. The upswing of the supply side of the housing market, observed until the first half of 2019, and in parallel with this the rise in the price level and yield realisable on property investment entailed the gradual adjustment of supply, which – together with the introduction of the preferential VAT rate for new homes from 2016 – resulted in a rise in the volume of home constructions. In 2019, the number of completed dwellings rose further, but fewer new housing projects were launched by property developers than in previous years. In the first quarter of 2020, there was a 30 per cent increase in the number of completed dwellings year on year (Chart 13). However, the outstanding growth is partly attributable to the delay in construction. Due to the coronavirus pandemic interruptions may occur in the transportation of building materials, and the pandemic may give rise to further delays in construction. However, due to the return of workers formerly working abroad, the available domestic labour force may increase to some extent. The number of building permits issued fell by 25 per cent in the past half-year, which projects a decline in home constructions in the coming years.

Chart 15
Development of the monthly number of new homes and residential buildings to be constructed, based on the number of issued construction permits



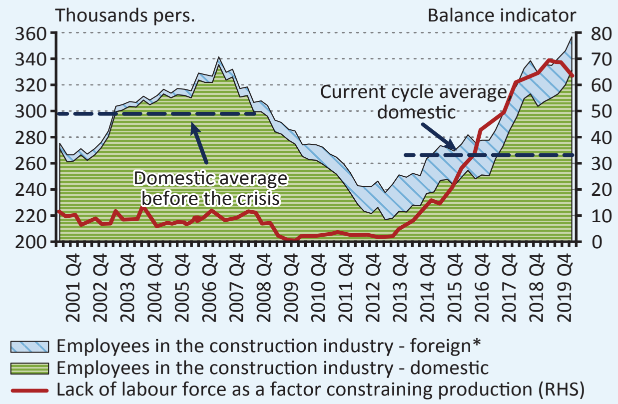
Source: MNB estimate based on HCSO data.

Chart 16
Constraints on construction output



Source: European Commission.

Chart 17
Number of employees in the construction industry



*Note: *Based on employees with household in Hungary.*

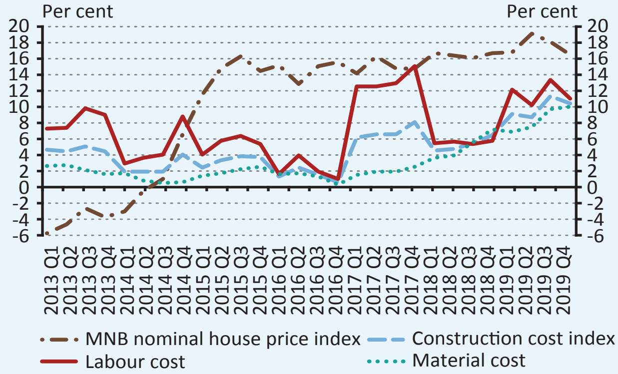
Source: HCSO, MNB.

As a result of the greater intensity of property developer activity, which is one of the major drivers of supply in the housing market, the proportion of companies within new buildings increased in previous years. While homes built by natural persons accounted for the bulk of the newly built stock at the beginning of the housing market cycle that commenced in 2014, the supply-side response to favourable demand conditions spurred a sharp increase in the number of homes built by companies. While in 2014 over 60 per cent of home builders were natural persons, by 2018 more than one-half of new completions had been built by companies. In the past three quarters the ratio of homes built by enterprises remained at a stable high level and it was close to 60 per cent (Chart 14). In the ascending phase of the housing market cycle, the number of building permits issued breaks away from the number of residential buildings to be constructed, since more homes are built in gated communities or in buildings hosting multiple homes. Following the peak of the cycle, the number of building permits starts to decline and comes close to the number of residential buildings to be constructed, which implies declining real estate developer activity. From last year, the number of new residential buildings to be constructed has already shown a decreasing trend and the number of new dwellings to be built also declined (Chart 15).

The growth in the supply side of the housing market is increasingly hindered – besides the decreasing demand resulting from the pandemic – by the shortage of base material and financial constraints. In a survey published by the European Commission, the respondent construction companies regarded labour force as the factor hindering production the most in the previous years; however, in April the role of labour force substantially decreased. Meanwhile financial constraints, shortage of material and equipment, and insufficient demand became more important (Chart 16). As a result of the pandemic, it became more difficult to procure imported building materials due to the interruptions in transportation. An additional negative impact of the coronavirus is that demand conditions worsened; in the past two months the ratio of companies experiencing insufficient demand increased. In addition, an increasing number of respondents mentioned financial constraints as a factor hindering production.

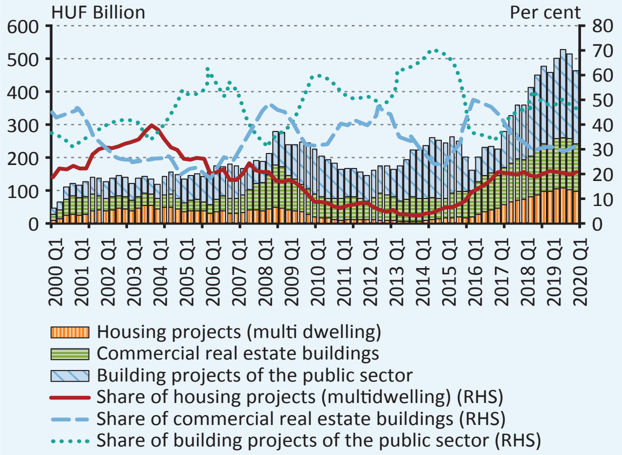
As a result of the pandemic, the number of Hungarian construction workers abroad may decrease. A large number of construction workers have engaged themselves to work abroad, which in recent years contributed to the scarcity of the construction sector's labour market capacities. The number of employees in construction has been continuously rising for one and a half years, while the number of people employed abroad is slightly decreasing since the second

Chart 18
Annual increase in home construction costs and nominal house prices



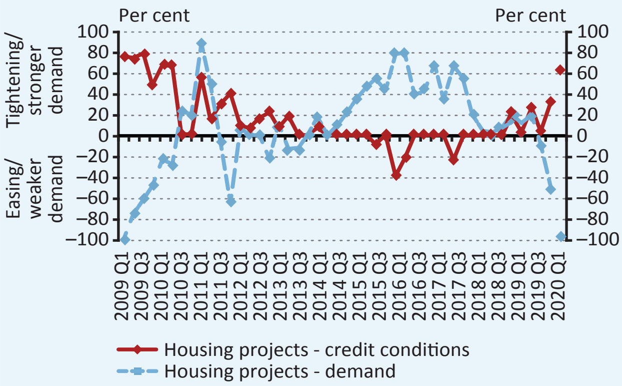
Source: HCSO.

Chart 19
Performance of construction by sectors and share of individual sectors



Note: In the case of newly built projects, based on the amount used for building in the respective period. Home constructions do not include family houses. Commercial property constructions: hotel, office, wholesale and retail, transportation and communication, industrial, warehouse and agricultural buildings. Public sector: educational, healthcare and other buildings, and civil engineering projects together.
Source: EBI Building Activity Report.

Chart 20
Lending conditions of housing projects and changes in demand



Note: Time series of lending conditions show the net ratio, i.e. the difference between banks tightening and easing, weighted by market share.
Source: MNB, based on banks' responses.

quarter of 2019 (Chart 17). The workers returning to Hungary due to the coronavirus pandemic take on a job in Hungary to an increasing degree and thus in the next quarter the number of construction workers employed abroad may decrease.

According to the data of HCSO, the increase in home construction costs decelerated in the last quarter of 2019. The annual growth rate of house prices also declined, but it still exceeds the rise in construction costs. Last year, labour cost in construction increased at a two-digit rate, but in the last quarter the rate of increase was already slower. However, the dynamics of building material costs continued to rise (Chart 18). This year, a number of factors may have an opposite effect on the change in construction costs. The difficulties of procuring imported building materials, the replacement of those by domestic base materials, the measures taken to make the performance of work safer and the depreciation of the forint against the euro all generate extra costs for enterprises. However, the increase in construction competition due to the decrease in orders points to a decrease in construction costs, the degree of which exceeds those above.

Within construction, the new building projects are mostly dominated by the public sector. In 2019 and in the first quarter of 2020 the construction projects related to the public sector accounted for the greatest part of construction performance. In 2019, the amount spent on the construction of new educational and healthcare buildings, and civil engineering investments linked to the public sector accounted for 49 per cent of the total amount spent on new building projects in construction. The ratio of commercial property investments was 30 per cent, while that of condominium home constructions was roughly 21 per cent. After 2016, i.e. the period of preferential VAT rate, condominium residential property investments substantially rose and their ratio within newly built construction projects also increased. However, in addition to the recovery of the housing sector, commercial property investments and the public sector also increased their activity, and thus in recent years the ratio of residential property projects has not exceeded 20 per cent substantially (Chart 19).

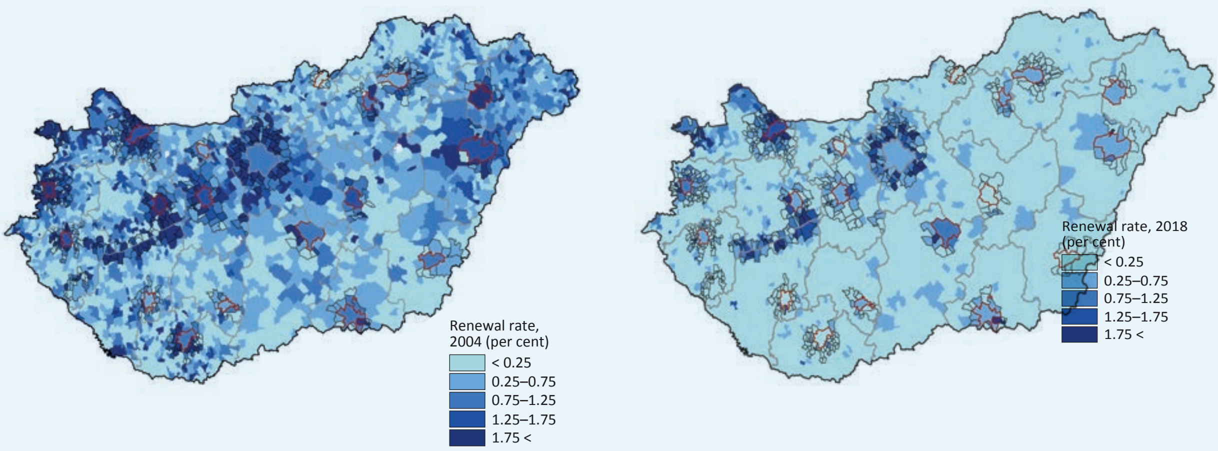
Under the tightening of credit terms, demand for housing projects fell at the beginning of 2020. During 2019, demand for commercial property loans typically rose; within that time the borrowing requirement of housing projects increased to a lesser degree than that of the other sub-segments. In parallel with this, 20 per cent of banks in net terms tightened the conditions of access to credit several times. However, in the first quarter of 2020, the coronavirus pandemic and the preventive measures generated major changes in this market as well: one third of banks tightened the conditions in all segments, but demand fell materially only in the case of housing projects (about half of the banks observed a decline, Chart 20). Looking ahead to the next half-year, all respondent institutions anticipate further decline in demand for the financing of housing projects; shopping centres, logistics centres and office buildings will be also affected by the decline, accompanied by major tightening of credit terms.

Box 2

Renewal of the housing stock and impact of home constructions on GDP

The number of new home completions shows a continuously rising trend since 2014. In 2019, roughly 21,100 new homes were completed nationwide, which is the highest value in the past ten years. However, looking ahead we may expect a decline in new completions in the coming years. Nevertheless, the number of new homes completed in 2019, i.e. at the peak of the current housing market cycle, resulted in a merely 0.4 per cent renewal of the housing stock, which may be deemed low both in a historical and international comparison. At the peak of the previous home construction cycle, in 2004, 44,000 new homes were completed, which represented a renewal rate of 1.1 per cent. In 2019, the renewal rate was 1.4, 1.4, 1.1 and 0.74 per cent in Poland, Austria, Slovakia and in the Czech Republic, respectively. In addition, in the current cycle, new home constructions appear in a strongly concentrated form, primarily in the capital and its agglomeration, in the agglomeration of Lake Balaton, and also in the agglomeration of large towns in the north-west of Hungary, such as Győr and Sopron. Large numbers of new home completions are also observed in the area of Kecskemét and Szeged. By contrast, in 2004 home constructions appeared much more diversely and steadily in Hungary (Chart).

Renewal rate of housing stock by settlements in 2004 (left) and in 2018 (right)

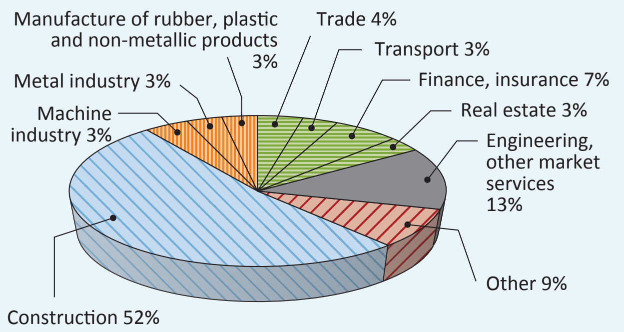


Source: HCSO.

Keeping the number of dwellings built at a high level and thereby – also including renovations – the adequate renewal of the Hungarian housing stock would be of utmost importance due to two main reasons. (1) The housing stock of Hungary is aged, its energy efficiency is low, and a large part of it is in need of renovation. (2) The construction sector makes a major contribution to economic growth through home construction and renovation works.

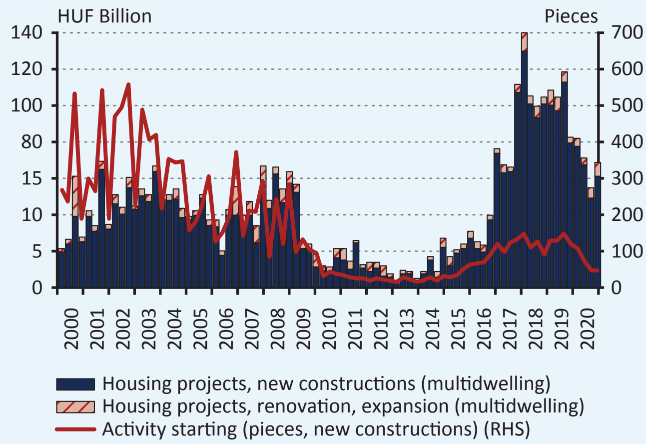
According to the survey conducted by the Hungarian Central Statistical Office (HCSO) in 2015, 81 per cent of the domestic housing stock had been built before 1990, i.e. it is older than 30 years. Besides, based on the HCSO's data, 61 per cent of the residential properties are in need of renovation, where 37 per cent of the dwellings have already been through certain improvements, but additional works would be needed. In addition, 63 per cent of the rented

Share of economic sectors from value added of residential real estate building



Source: MNB estimation based on HCSO data.

Total volume and number of new construction projects in each year in the housing segment



Source: EBI Construction Activity Report.

private flats and 72 per cent of the local government tenement flats would need modernisation.

Last year construction output grew at an outstanding rate, with a major contribution by the construction of new homes. Construction contributed to the growth of Hungary's GDP by 1 percentage point, which is an outstanding value even in a historical comparison. According to our expectations, the new home construction cycle may have reached its peak in 2019. Last year 21,127 new homes were completed, which materially falls short of the number of homes completed in the previous housing market cycle. Based on the input-output tables (IOTs) we estimated the rate by which 10,000 new homes built additionally would contribute to GDP growth.

In our estimates the average size of a flat is 100 square metres, and the average price per square metre is HUF 450,000. Calculating with an import ratio of 23.4 per cent, the additional value added amounts to HUF 315 billion, assuming that there is no crowding-out effect vis-à-vis other industries. Thus, **according to our calculations, 10,000 new homes built additionally increase the level of Hungary's 2019 GDP by 0.8-1 percentage point, and the number of people in employment by 25-30,000.**

The economic effect of newly built homes appears primarily in construction, but indirectly other industries also benefit from the generated value added. After construction (52 per cent), the share of engineering, closely related to home construction and other markets services is the highest (13 per cent). 7 per cent of the value added appears in the financial and insurance sector. In addition, real estate transactions, trade and transport as well as rubber, metal and engineering sectors also benefit from the economic impact of home constructions.

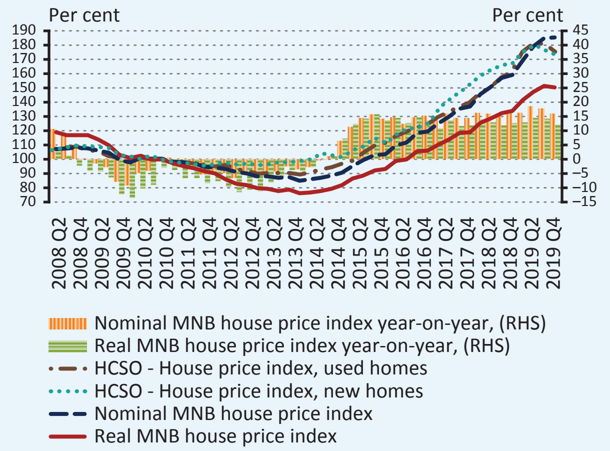
Looking ahead, based on market data, we can expect a fall in the construction of new homes in the coming years. Based on the EBI Construction Activity Report, in the first quarter of 2020 new condominium investments commenced in the amount of HUF 61 billion, which falls short of the year-on-year value by 23 per cent. All this represents 46 new projects in the first quarter, which falls short of the number of projects launched in the same period of last year by 61 per cent. However, the volume of new condominium residential property projects have set on a declining path already in 2019. Last year, newly built condominium housing investments commenced in the amount of HUF 271 billion, which falls short of the volume of projects commenced in 2018 by 33 per cent. The fall in residential property construction activity is primarily attributable to the end of the temporary period when a preferential, 5 per cent VAT applied. Namely, the VAT rate of 27 per cent would justify such high sales price at certain projects that would materially curb demand for new homes. Looking ahead, the preferential, 5 per cent VAT rate – announced by the Government and applicable to the sales and letting of new homes built in brownfield zones – may materially contribute to preventing the halt of current projects due to the pandemic and to launching a sound volume of new projects in towns in the future (see Box 3).

4 Current housing market trends

In 2019 several signs implied that the rising trend of the housing market ended, which may be exacerbated by the slowdown of the economy caused by the coronavirus pandemic filtering through from the first quarter of 2020. In the fourth quarter of 2019 house prices on a national average stagnated in nominal terms quarter on quarter, while Budapest registered a decline of 2 per cent, which has been unprecedented for years. As a result, the annual growth rate of house prices declined to 16.2 per cent nationally and to 14.1 per cent in Budapest. According to preliminary data, the dynamics of house prices decelerated further in the first quarter, to 12.3 per cent nationally and to 9.5 per cent in Budapest. In 2019, the number of housing market transactions fell compared to 2018, by 10.4 per cent at national level and in Budapest to an even greater degree, by 25.6 per cent. The increasing median bargain in the market implies a decline in housing market demand, particularly in Budapest, where this indicator rose from 2.2 per cent registered in the first quarter of 2019 to 3.6 per cent by the fourth quarter. In addition, sellers were typically compelled to reduce the list price during the advertising period to a larger degree.

In 2019, 21,100 new homes were completed, which exceeds the number of completions in 2018 by 19.5 per cent. Thus the annual renewal rate of the housing stock rose to 0.47 per cent, which is still low compared to the countries of the region. In 2019 the number of new building permits decreased already by 4.3 per cent compared to 2018, while the number of building permits issued in the first quarter of 2020 declined by 27 per cent in annual terms. The market of new homes already shows signs of recession, which is primarily due to the end of the period when the preferential VAT rate on housing applied. In the first quarter of 2020, housing developers announced the building of 1,145 new homes in Budapest, which is one of the lowest quarterly value in the real estate market cycle lasting since 2014 and the number of new homes sold also decreased by 21 per cent on an annual basis. Looking ahead, a decline in the supply of new homes may be expected, which is primarily due to the resetting of the VAT rate to 27 per cent, and the coronavirus pandemic, which appeared in the first quarter of 2020, may also curb development activity and give rise to further delays in construction. The positive impact of the 5 per cent VAT rate, applicable to the construction of new homes in brownfield zones, is expected to take effect from 2022.

Chart 21
House price developments



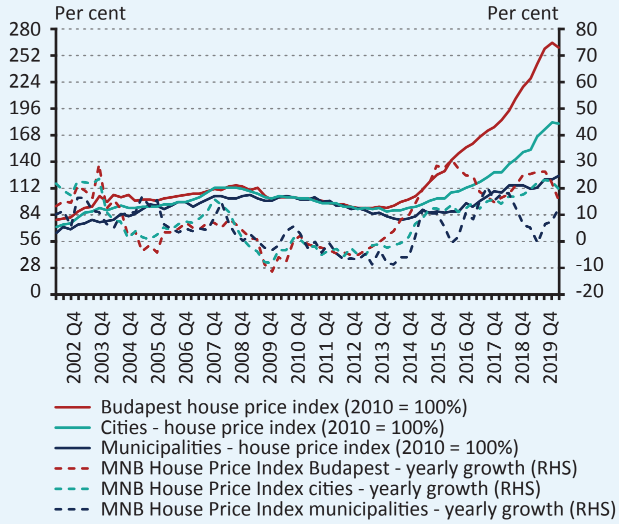
Note: For house price indices (left-hand scale) the average for 2010 = 100 per cent.

Source: HCSO, MNB.

4.1 HUNGARIAN HOUSING MARKET DEVELOPMENTS

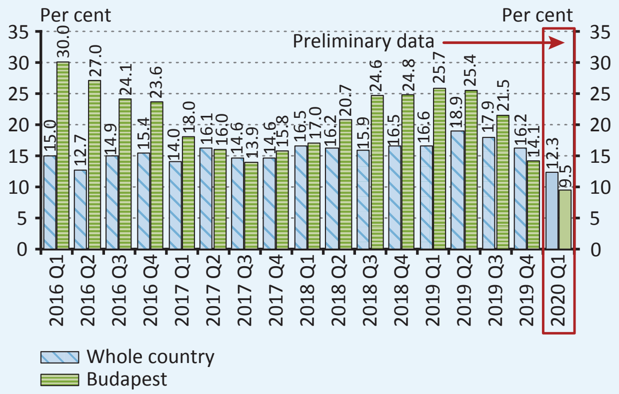
At the end of 2019 the quarter-on-quarter rise in domestic house prices stopped. The upswing in the domestic housing market, lasting since 2014, caused house prices to rise continuously. The price hike, lasting for six years, stopped quarter-on-quarter in the fourth quarter of 2019 according to several measurements, while the annual rate of the price rise materially decelerated. According to the MNB's aggregate nominal house price index, showing the change in house prices on a national average, house prices increased slightly, by 0.2 per cent in the last quarter of 2019, which practically may be regarded as a stagnation. In real terms house prices fell by 0.6 per cent at the end of the year on a quarterly basis. The annual nominal growth rate of house prices decelerated from 18.9 per cent registered in the second quarter of 2019 to 16.2 per cent (Chart 21). According to the Hungarian Central Statistical Office, the

Chart 22
The MNB's nominal house price index by type of settlement



Source: MNB.

Chart 23
Annual growth rate of aggregate and Budapest house price indices of the MNB, with preliminary calculations



Note: The preliminary national index has been calculated on a sample covering 12.3 per cent of the market turnover, and the preliminary Budapest index on a sample covering 17.4 per cent of the turnover in the capital.

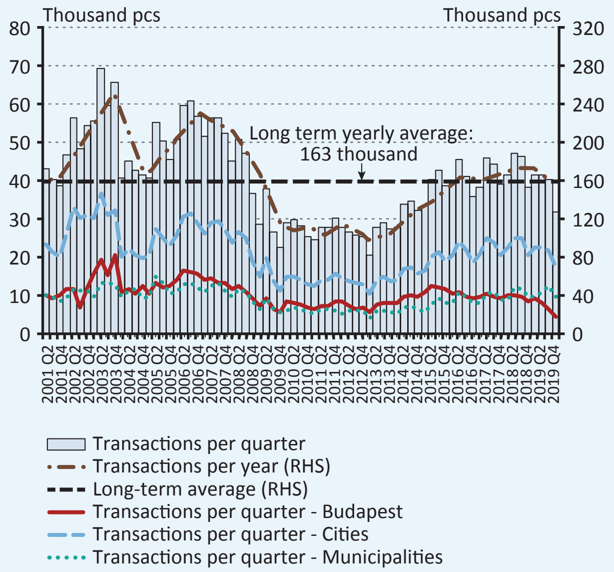
Source: Housing market real estate agent database, MNB calculations.

annual price rise of used homes fell from 20.2 per cent registered in the second quarter of 2019 to 8.7 per cent by the fourth quarter, while that of new homes decelerated from 11.8 per cent to 3.9 per cent during the same period.

In the fourth quarter of 2019 house prices in Budapest declined for the first time after a long while. In Budapest, from the beginning of 2014 – when the domestic housing market took a turn – the price of residential properties rose by almost 193 per cent in nominal terms, i.e. their value almost tripled. However, in the last quarter of 2019, already a decline of 2 per cent was measured in nominal terms in the level of house prices in Budapest, which has been unprecedented for years. As a result, the annual growth rate of house prices in Budapest materially decelerated, declining from 25.4 per cent registered in the second quarter of 2019 to 14.1 per cent by the fourth quarter. House prices in the rural towns declined moderately, by 0.4 per cent in total in the fourth quarter, reducing the annual dynamics from 22.6 per cent registered at the end of the first half-year to 18.5 per cent. In parallel with this, prices in municipalities were up by 2.4 per cent in the fourth quarter of 2019, as a result of which the annual rate of price increase rose to 11.8 per cent (Chart 22).

According to preliminary data, the decline in house price dynamics may have continued in the first quarter of 2020. According to preliminary calculations, the level of house prices may have increased again to a certain degree in the first quarter of 2020. Based on the indices calculated on the basis of the data provided by housing agents, house prices may have increased by 2.8 per cent on a national average and by 2.3 per cent in Budapest in nominal terms in the first quarter. However, with the moderate price increase quarter on quarter, the annual growth rate of the price rise may have decelerated further in 2020. According to the preliminary data, the annual growth rate of house prices in the first quarter of 2020 fell to 12.3 per cent compared to 16.2 per cent registered at the end of the year, while the rate of the annual price increase in Budapest slowed down to 9.5 per cent from 14.1 per cent registered in the fourth quarter of 2019 (Chart 23). The house price trends in the first quarter of 2020 may have been affected only to a small degree by the spread of the coronavirus in March 2020 and the restrictive measures adopted as a result of the pandemic at the end of March. As a result it may be stated that the deceleration in the Hungarian housing market has already commenced in 2019, and the pandemic exacerbates the process.

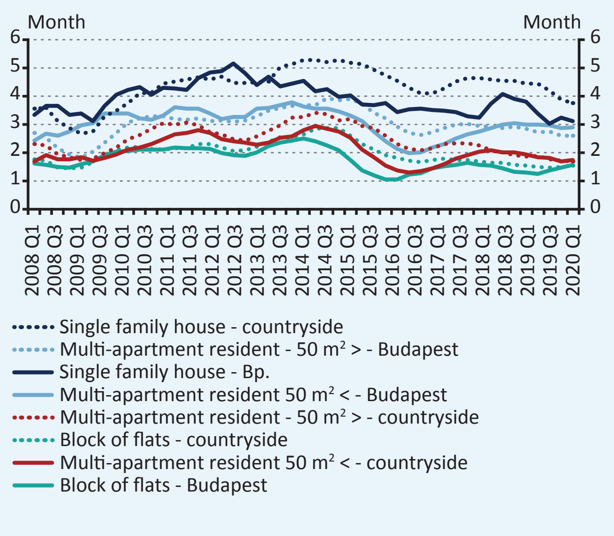
Chart 24
Quarterly and annual number of housing market transactions between individuals



Note: Taking into account only the ownership acquisitions of 50 and 100 per cent. 2019 Q1-2019 Q4 based on estimation. Long term average: 2001 Q1 – 2019 Q4.

Source: MNB.

Chart 25
Median time to sell residential property, broken down between Budapest and the provinces, and by type of property.



Note: Time from the start of advertising to the completion of sale and purchase. Annual rolling averages.

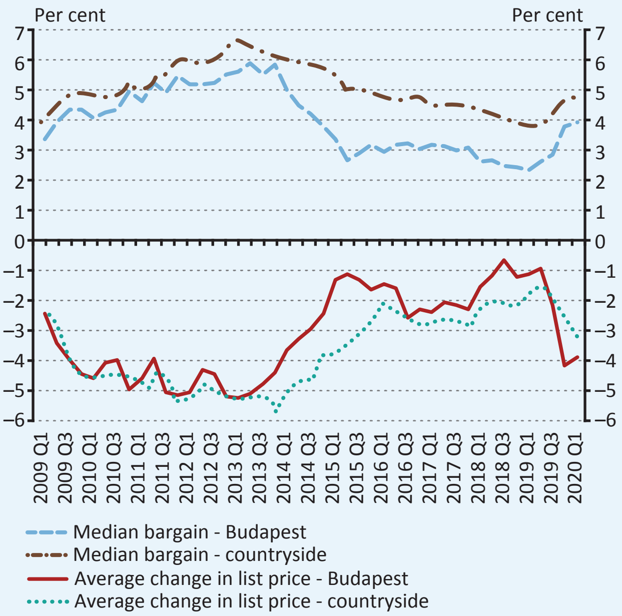
Source: MNB, housing agent database.

The number of transactions declined in 2019, which is primarily attributable to the fall in the sales and purchases in Budapest. The deceleration observed in the housing market since the end of 2019 manifested itself, in addition to the fall in the price dynamics, also in the decrease in the number of transactions. According to our preliminary estimate, in 2019 the number of housing market transactions between private individuals was 154,900, which falls short of the sale and purchase transactions registered in 2018 by 10.4 per cent, and it is below the long-term average annual number of transactions of 163,000. The change in the number of transactions varies by settlement type; compared to the rural settlements, the decline in Budapest appears to be larger, which was mostly attributable to the investment demand absorbing effect of the Hungarian Government Bond Plus (MÁP+), introduced in summer 2019 and affecting Budapest to the greatest degree and also to the vigorous rise in the price level observed in recent years. In 2019, the number of housing market transactions fell by 25.6 per cent compared to 2018, while the decline in the rural cities was only 9.4 per cent, and the number of sales and purchases in the municipalities even rose by 1.1 per cent (Chart 24).

The time needed to sell smaller dwellings materially increased. When examining the typical sale time, an increase was observed primarily at the smaller, multi-apartment residential properties in 2019. In Budapest, the median sales time of flats in panel blocks rose from 1.3 months registered in the fourth quarter of 2018 to 1.7 months by the last quarter of 2019, and to 2.0 months by the first quarter of 2020. The median sale time of flats in Budapest below 50 square metres also increased in the first quarter, from 1.8 months registered in the previous period, to 2 months. On the other hand, in rural settlements median selling time decreased on the whole in 2019. The greatest change was observed in the case of family houses, where the median number of months to sell fell from 4.4 registered at the end of 2018 to 3.5 by the end of 2019. In the first quarter, the median selling time of flats in panel blocks and of non-panel flats below 50 square metres rose in the countryside as well, which may already reflect the demand reducing effect of the coronavirus pandemic (Chart 25).

Typical bargain in the market substantially increased, and sellers reduced the list price to a greater degree also during the advertising period. In 2019, housing market conditions changed significantly particularly in Budapest. The sellers' bargaining position deteriorated compared to that of buyers, which implies decreasing demand. From the second quarter of 2019, the median bargain started to rise in the housing market of Budapest and increased

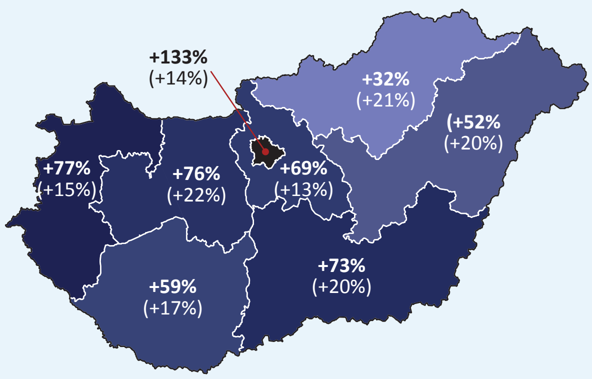
Chart 26
Median bargain in the Budapest and rural housing markets, with the average change to the list price



Note: Bargain: percentage shortfall of the transaction price compared to the last listed price. Change to list price: percentage change applied to the list price during the listing period.

Source: MNB, housing agent database.

Chart 27
Development of urban house prices by region between 2008 Q4 and 2019 Q4 (between 2018 Q4 and 2019 Q4)



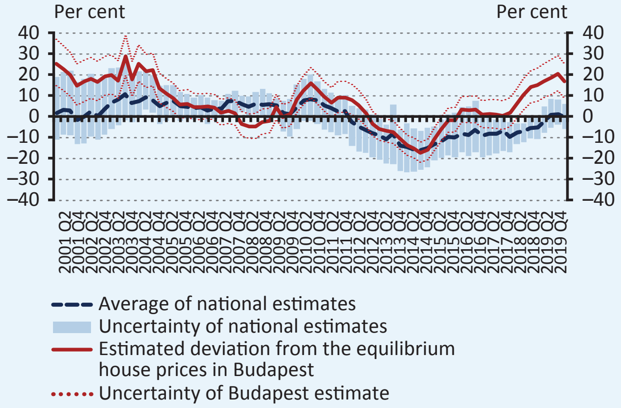
Source: MNB.

to 3.6 per cent by the fourth quarter from 2.2 per cent of the first quarter. During the same period, the median bargain rose at a smaller rate, by 0.9 percentage point, in the countryside. The fact that sellers reduce the list price during the advertising period already to a much larger degree, also implies a relative fall in demand. The average reduction of the list price in Budapest rose to 4.2 per cent by the fourth quarter from 1.2 per cent registered in the first quarter of 2019, and to 2.6 per cent from 1.8 per cent in the countryside. The higher typical bargain and the generally larger decrease in list prices persisted also in the first quarter of 2020. In Budapest, the median bargain rose to 3.8 per cent, which – to some extent – was also attributable to the market activity curbing effect of the coronavirus pandemic (Chart 26).

There are substantial disparities among the regions of Hungary concerning the long-term change in house prices. The upswing of the housing market observed in recent years and the rate of the accompanying price rise shows major disparities in the individual regions of Hungary. Compared to the end of 2008, the level of urban house prices was the highest in Budapest in nominal terms; house prices in Budapest exceeded the level registered then by 133 per cent on average. Between 2008 and 2019, the largest price rise in the housing market was registered, after Budapest, in the cities of the Western Transdanubia, Central Transdanubia and Southern Great Plain regions, with a price rise of 77, 76 and 73 per cent, respectively, followed by the cities of the Central Hungary region with 69 per cent. During the same period, the smallest price rise was registered in the cities of Northern Hungary, with 32 per cent. In the past one year, the most dynamic increase in house prices was observed in the cities of the Central Transdanubia, Southern Great Plain and Northern Great Plain regions (Chart 27).

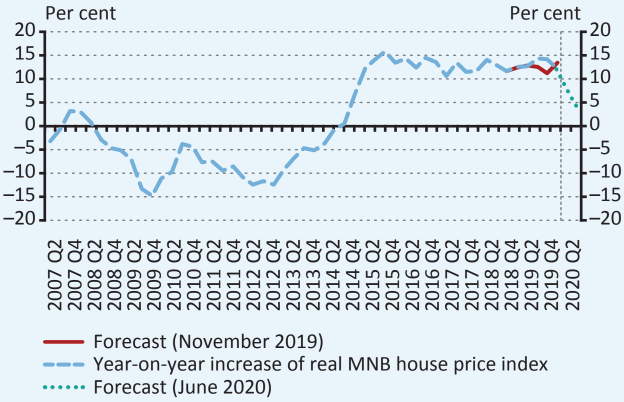
The risk of the overvaluation of house prices declined. During 2019, the continued increase in the households' real income and low unemployment supported demand in the housing market; however, by the end of the year, the growth rate of house prices significantly decelerated, and in Budapest the price level even decreased quarter on quarter. As a result of the foregoing, in the fourth quarter of 2019 the risk of the overvaluation of residential properties declined both at national level and in Budapest (Chart 28). However, it should be emphasised that in Budapest house prices still exceed the level justified by the fundamentals. Looking ahead, the risk of overvaluation will be affected – in addition to the decline in housing market demand – also by the income and labour market trends in Budapest.

Chart 28
Deviation of house prices from the estimated level justified by fundamentals, nationwide and in Budapest[3]



Source: MNB.

Chart 29
Forecast of the MNB's aggregated real house price index (annual change)



Source: MNB.

In 2020, the rise in house prices in real terms may continue at a substantially slower rate than before. This year the macroeconomic fundamentals underlying the housing market have been developing less favourably than in the previous years, which contributes to the decrease in the growth dynamics of house prices. The coronavirus pandemic exerts negative impact on the households' real earning and on the long-term unemployment rate shaping the longer-term income prospects. Despite the favourable financing environment, households' credit demand has decreased due to the uncertain economic environment, which contributes to the decrease in demand in the housing market and to the decline in the growth rate of house prices. In the second half of 2019, house prices rose in excess of previous expectations, while supply adjusted more slowly in the short run. In the last quarter of 2019, house prices rose by 12.4 per cent in real terms year-on-year, while according to our expectations, in the first quarter of this year the growth may be 8.0 per cent and in the second quarter 4.6 per cent – in line with the macroeconomic path projected in the Inflation Report March 2020 (Chart 29). According to our forecast, the dynamics of real house prices may decrease to a single-digit number, in line with the less favourable income trends and increasingly restrained demand.

In the fourth quarter of 2019, both the median sales price and the median price per square meter decreased. The median sales price of residential properties sold in the fourth quarter of 2019 amounted to HUF 15 million on a national average, which falls short of the median price registered in the previous quarter and in the fourth quarter of 2018 by 13 per cent and 12 per cent, respectively. The decrease is also attributable to the composition effect, due to the fall in the transactions concluded in Budapest. In the last quarter of 2019, the median transaction price was HUF 29 million in Budapest, HUF 14.3 million in rural cities and HUF 5.5 million in municipalities. The median prices per square metre also decreased in the fourth quarter of 2019, and amounted to HUF 273,700 at national level, HUF 622,800 in Budapest and merely HUF 72,900 in the municipalities (Table 1).

In 2019 the widening of the price gap between the county seats and Budapest stopped. As a result of the price

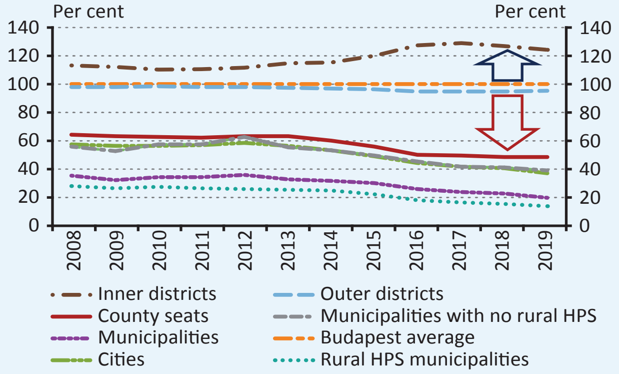
[3] The deviation of house prices from the level justified by the fundamentals is quantified based on four methodologies. In the report, we publish the minimum, maximum and average values of the results delivered by the individual methodologies. The four calculation methods are as follows: 1. Percentage deviation of the ratio of real house prices to disposable real income from the average of the indicator calculated between 2001 and 2016 2. Estimate of the long-term equilibrium of Hungarian house prices driven by macroeconomic fundamentals by means of a vector error correction model frame (VECM). For a detailed methodology, see: Tamás Berki – Tibor Szendrei (2017): *The cyclical position of housing prices – a VECM approach for Hungary*, Magyar Nemzeti Bank, OP 126. 3. Estimate of the level of Hungarian house prices driven by macroeconomic fundamentals by means of a dynamic OLS model frame. 4. Deviation of Hungarian house prices from the equilibrium by means of a structural model frame used for forecasting house prices. For more details, see: Magyar Nemzeti Bank: Housing Market Report, October 2016, Box 1. Deviation of house prices in Budapest from the level justified by fundamentals is quantified by the dynamic OLS model framework; for more details on the methodology, see: Magyar Nemzeti Bank: Financial Stability Report, May 2017, Box 2.

Table 1
Median house prices and square metre prices by type of settlement

		2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4
Median apartment price (HUF million)	Budapest	25.2	27.0	28.3	29.8	30.0	29.0
	Cities	13.0	13.5	14.5	15.0	15.0	14.3
	Municipalities	6.2	6.5	7.5	6.6	7.0	5.5
	Total	**16.0**	**17.0**	**18.2**	**18.3**	**17.3**	**15.0**
Median square metre price (HUF thousand)	Budapest	515.8	541.8	569.6	612.2	631.6	622.8
	Cities	228.7	234.3	250.0	259.2	266.0	263.1
	Municipalities	80.6	84.0	92.9	88.2	85.0	72.9
	Total	**286.0**	**301.7**	**316.4**	**318.2**	**303.3**	**273.7**

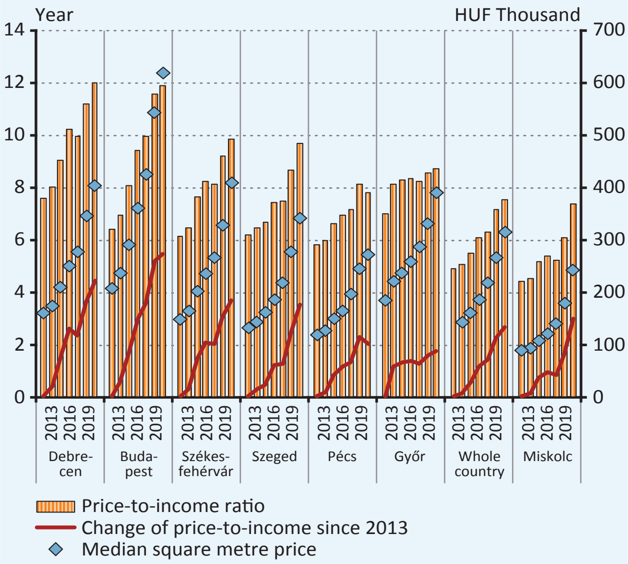
Note: Data for 2019 Q3–2019 Q4 are preliminary.
Source: MNB.

Chart 30
Average square metre price by type of settlement (average of Budapest = 100 per cent)



Source: National Tax and Customs Administration, MNB.

Chart 31
Price-to-income ratio in the regional centres of Hungary



Note: The price-to-income ratio is the ratio between the price of a 75 square metre median real property and average annual net income of the households. Average incomes are county level data.
Source: HCSO, MNB.

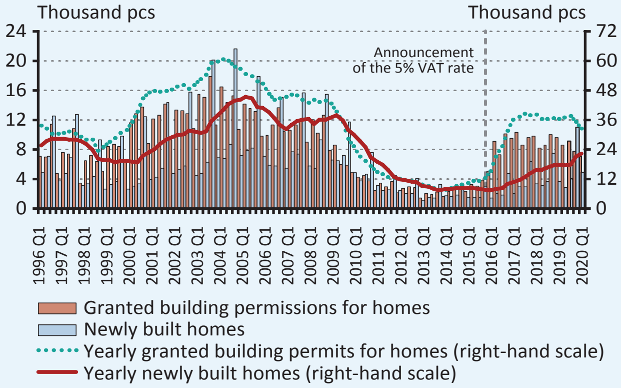
increase, which commenced in 2014, the differences in terms of the level of house prices substantially increased between Budapest and the rural, particularly the smaller, settlements. While in 2013 the average square metre prices in the county seats amounted to 63.4 per cent, 56.8 per cent and 33 per cent of the average in Budapest, in rural cities and in municipalities, respectively, due to the greater price increase in Budapest, the same ratios decreased to 48.6 per cent, 38.7 per cent and 21.8 per cent, respectively, by 2019. However, in 2019 these trends have somewhat changed, since in the country seats the average prices per square metre changed to a similar degree as in Budapest, as a result of which in these settlements the price gap did not widen further on average compared to Budapest (Chart 30).

Besides Budapest, housing affordability has also deteriorated significantly in several major rural cities, in recent years. In Hungary, the ratio of house prices to average net incomes is the highest in Debrecen and Budapest, where buying a 75 square metre home in the median price requires approximately 12 years of local average income. Among regional centres in the country, housing affordability is the highest in Miskolc, where less than 8 years of average income (below the national level) is sufficient to buy a 75 square metre home in the median price. In recent years, the value of the indicator rose the most dynamically and to the largest degree also in Budapest and Debrecen; at the end of 2019, the average income necessary for buying a typical home in Budapest and in Debrecen was by 5 and half years and 4 and half years more, respectively, than in 2013 (Chart 31).

4.2 SUPPLY OF NEW HOMES

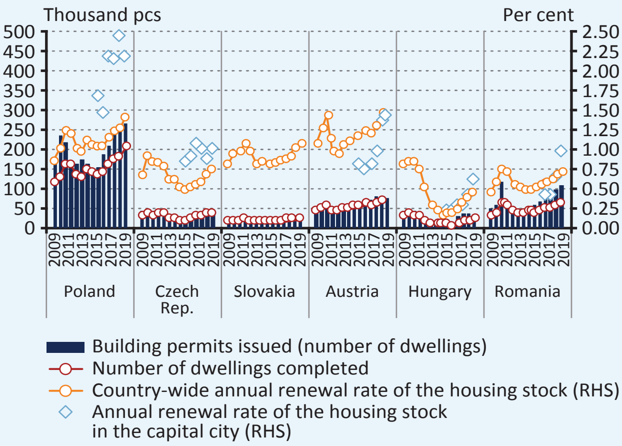
In 2019, the largest fall in the number of building permits issued was registered in towns of county rank. During 2019, building permits were issued in Hungary for 35,100 homes, which falls short of the data registered in 2018 by 4.3 per cent and by 7.6 per cent of that in 2017, regarded as a peak

Chart 32
Number of building permits issued and number of new completions



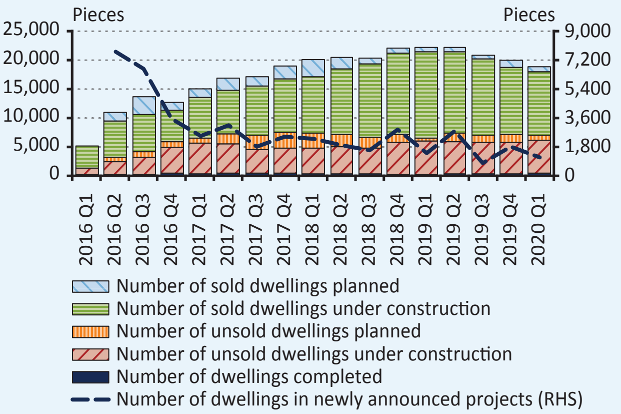
Source: HCSO.

Chart 33
Building permits issued, new completions, and housing stock annual renewal rates in countries across the region



Note: The data related to the residential building permits show the aggregate number of homes indicated in the building permits. We have no data available on the number of new completions in 2019 for Austria. For several countries, the annual renewal rate is calculated on the basis of estimates on existing housing stock.
Source: ECB, national statistical offices, MNB.

Chart 34
Availability of new homes under development in Budapest and volume of new announcements



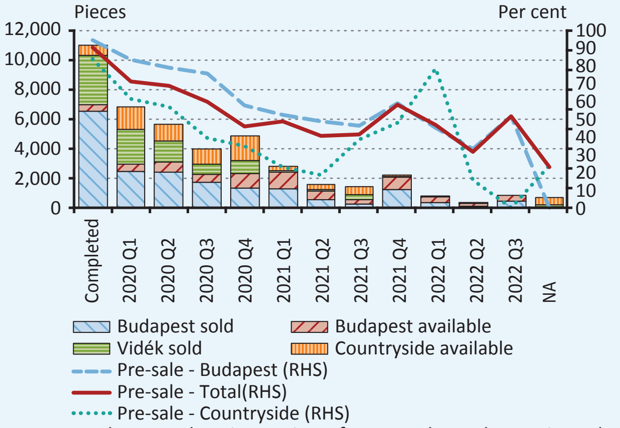
Note: Based on projects for more than 4 new homes in Budapest.
Source: ELTINGA – Housing Report.

year in terms of permits issued (Chart 32). While in Budapest the number of homes included in the issued building permits rose moderately (by 1 per cent), the towns of county rank and other towns registered a fall of 12 per cent and 10 per cent, respectively. In the villages building permits were issued for by almost 5 per cent more dwellings than in the previous year. As regards the number of completed homes, 21,100 homes were completed in 2019 nationwide, which is a 19.5 per cent growth in annual terms. Of these, 5,800 homes were built in Budapest, which is a growth of 50.7 per cent compared to 2018. The data related to villages also show an increase of 21.4 per cent. In 2019, the number of homes built in the towns of county rank and in other towns was up by 11.5 and 3.6 per cent, respectively, in annual terms. The number of homes included in the building permits issued in the first quarter of 2020 fell by 27 per cent year on year, while the number of homes completed was higher by 30.4 per cent mostly due to delays.

In 2019, the renewal rate of the Hungarian housing stock increased, but in a regional comparison Hungary's position did not improve. In the countries of the region the number of completed homes was up by 6-19.5 per cent on an annual basis, due to which the annual renewal rate rose in all of the countries. In Hungary, the number of new homes completed in 2019 equalled to 0.47 per cent of the housing stock existing at the end of 2018, which is an improvement of 0.07 percentage point compared to the ratio registered a year ago (Chart 33). Despite the almost 20 per cent growth in the number of completed homes, Hungary's position in the regional ranking of renewal rates did not improve. The growth in the housing stock in Poland and Austria is high, around 1.4 per cent, while the ratio in Slovakia is 1.1 per cent and in the Czech Republic and Romania it is around 0.75 per cent. When examining the home constructions in the capitals, compared to the growth of 0.63 per cent in the housing stock observed in Budapest in 2019, this ratio is 0.75 per cent in Bucharest, 1.02 per cent in Prague, 1.45 per cent in Vienna and 2.21 per cent in Warsaw. In the capitals under review, except for Vienna, the renewal rate of the housing stock is usually higher compared to the nationwide data.

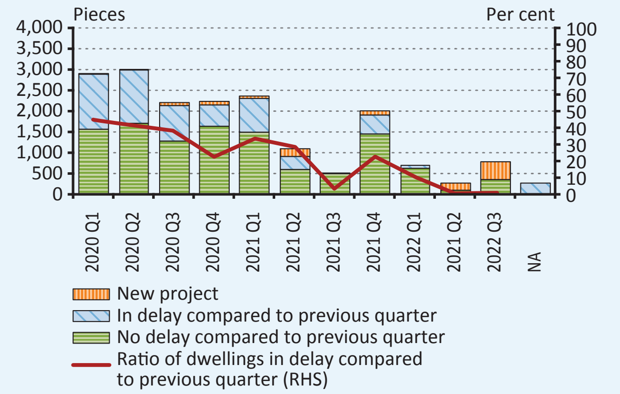
As a result of resetting the VAT rate applicable to new homes to 27 per cent, development activity declines. The number of homes under development and sales (being in the construction or design phase) in Budapest has been continuously declining since the second quarter of 2019, falling form 21,900 registered then by 16 per cent to 18,300 by the first quarter of 2020 (Chart 34). This level corresponds to the housing development activity observed at the end of 2017. Within the developments the volume of homes being in the design phase where the building has not yet commenced is continuously decreasing. Within the stock under development, the ratio of unsold dwellings

Chart 35
Breakdown of new homes under sale in Budapest and in the countryside at the end of 2020 Q1 by the quarter of expected completion



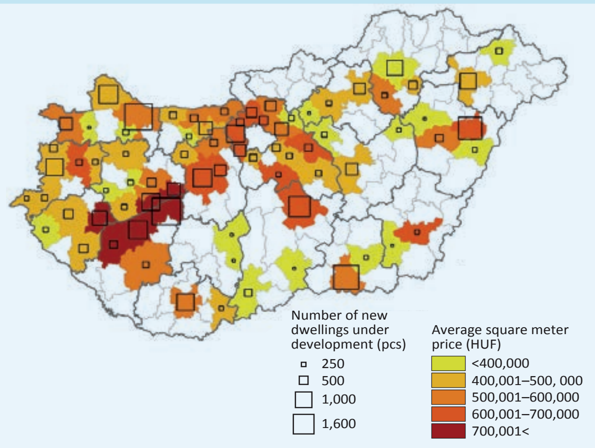
Note: Based on new housing projects for more than 4 homes in Budapest, and more than 10 homes in the provinces. Based on 2020 Q1 data. Source: ELTINGA – Housing Report.

Chart 36
Breakdown of new homes under construction and planned in Budapest at the end of 2020 Q1 by quarter of planned completion



Note: Based on projects for more than 4 new homes in Budapest. Based on 2020 Q1 data. Source: ELTINGA – Housing Report.

Chart 37
Number and average square metre price of new homes in development in Hungary



Note: Based on 2020 Q1 data. Based on projects for more than 10 new homes. Source: ELTINGA – Housing Report.

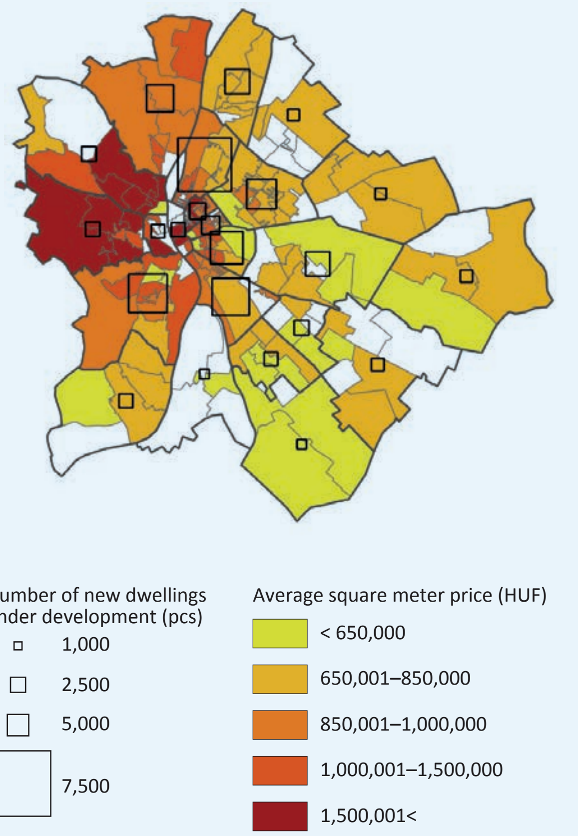
moderately rose in the previous two quarters, from 32.6 per cent registered in the third quarter of 2019 to 34.4 per cent by the end of the year and to 35.6 per cent by the first quarter of 2020. However, this rise is attributable to the contraction in housing development rather than to the increase in the available supply. The number of dwellings unsold in Budapest stagnated around 7,000 in the previous quarters. In the first quarter of 2020 the construction of 1,145 new homes was announced, which is the second lowest volume in the real estate market cycle lasting since 2014, and already reflects the impact of the VAT rate reset to 27 per cent. Since the reduced VAT rate of 5 per cent applicable to sales of new homes became effective in early 2016, developers have announced roughly 2,800 new homes on a quarterly average.

At present, housing developers plan to complete in 2021 roughly a third of the quantity of new homes as in 2020. Without the blocks comprising of 10 or fewer homes, the current plans of investors calculate with the completion of 21,100 new condominium homes in total, in 2020 (Chart 35). This corresponds to the number of homes completed in 2019 in Hungary, but due to the pandemic further delays may occur in the completions planned for 2020. Based on construction project data, developers plan to complete only 7,900 homes in 2021, which falls short of the 2020 plan by 63 per cent. In terms of the availability of new homes to be completed according to the plans, 74 per cent of the expected volume in Budapest, and half of it outside the capital has already been sold. 53 per cent and 31 per cent of the new homes to be completed in 2021 has already been sold in Budapest and in the countryside, respectively.

The volume of new completions in 2020 in Budapest was mostly increased by the delays in the previous quarters. According to the data related to the first quarter of 2020, housing developer companies plan to complete 10,500 new homes in Budapest in 2020, of which roughly 1,200 have already been completed in the first quarter (Chart 36). The number of new homes in Budapest expected for 2020 has been constantly growing in the past quarters, which is primarily attributable to delays. In the first quarter of 2019, developers calculated on the completion of only 5,900 new homes for the entirety of 2020, compared to which the growth is 77 per cent. Compared to the status as at the end of 2019, during the first quarter delays in the planned completion date were announced in respect of 32 per cent of the new homes – roughly 6,000 homes – under development in Budapest.

Condominium new home developments are concentrated in those parts of the country where economic prospects and conditions for tourism are more favourable. The

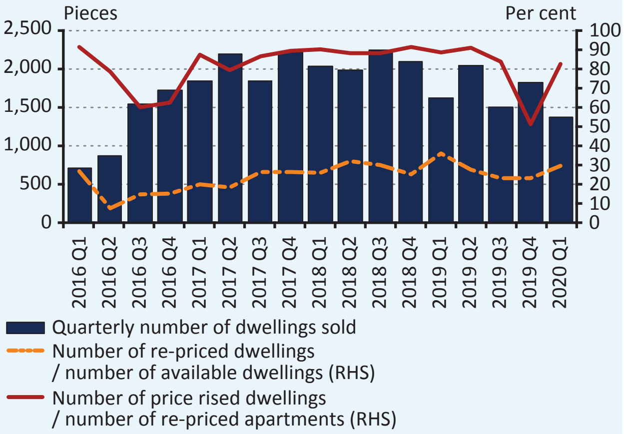
Chart 38
Number and average square metre price of new homes in development in Budapest



Note: Based on 2020 Q1 data. Based on projects for more than 4 new homes in Budapest.

Source: ELTINGA – Housing Report.

Chart 39
Number of new homes sold in Budapest, and ratio of repricing within the advertised new homes



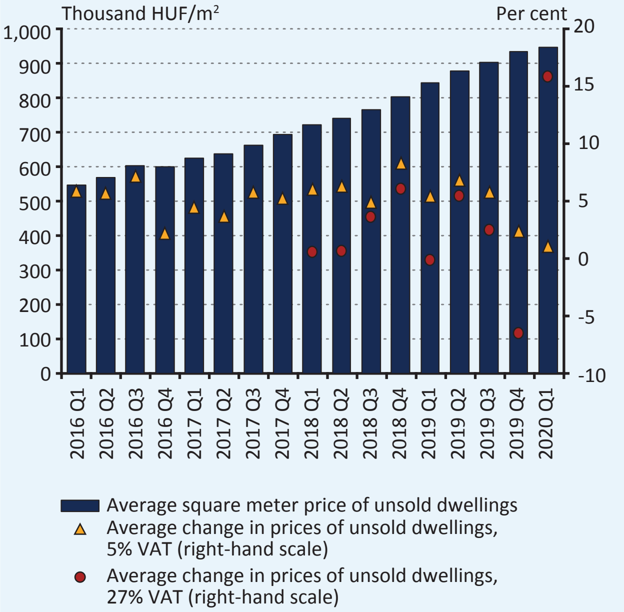
Note: Based on projects for more than 4 new homes in Budapest.

Source: ELTINGA – Housing Report.

condominium new home projects in Hungary appear in larger numbers mostly in Budapest, and in the central and northern parts of Transdanubia. Outside the capital, there are a total of approximately 17,400 new homes in projects that are either in the phase of sale, planning, construction, or have already been completed. Of that stock, 14.6 per cent is in Győr-Moson-Sopron, 13.9 per cent in Somogy, and 12.9 per cent in Pest county (Chart 37). The lowest number of new homes under development are in Tolna, Békés and Heves counties, with 0, 18 and 272 homes, respectively. 25 per cent of the new homes in the countryside are in the neighbourhood of Lake Balaton, 12 per cent in the agglomeration of Budapest and a further 51 per cent in the county seats and towns of county rank. Accordingly, 88 per cent of the new homes outside Budapest are being built in areas characterised by more favourable macroeconomic fundamentals. The list price of the homes being built in Somogy and Veszprém counties – primarily due to the developments close to Lake Balaton – is substantially higher compared to the prices in other counties, with an average list price of HUF 850,000 and HUF 839,000 per square metre, respectively. In Győr-Moson-Sopron, Pest, Csongrád and Hajdú-Bihar counties, where most new homes in the countryside are located, the average price per square metre is HUF 501,000, HUF 610,000, HUF 543,000 and HUF 621,000, respectively. Compared to the prices of new homes outside the capital, square metre prices are significantly higher in Budapest: in the first quarter of 2020, the average square metre price was HUF 2.15 million in District V, HUF 1.69 million in District XII, and over HUF 1.5 million in Districts I and II (Chart 38). In the entire market of new homes in Budapest the average list price is HUF 947,000 per square meter.

The rate of VAT was reset to the general rate of 27 per cent for homes that had no building permit on 1 November 2018, under a decreasing sales trend. In Budapest 6,900 new homes were sold in 2019, which represents a decrease of 16 per cent compared to the peak in 2018 (when 8,300 homes were sold). In the first quarter of 2020, 1,400 new homes were sold in Budapest, representing a decrease of 21 per cent compared to the quarterly average of 2019 and 15 per cent compared to the first quarter of 2018. The number homes sold was less than 1,400 in the second quarter of 2016 for the last time. Looking ahead, due to the presence and spread of the coronavirus pandemic, sales are expected to decrease further in the second quarter, this is also corroborated by the experience of the LITT members. Last year, within the supply of unsold homes, the ratio of homes repriced in the respective period fell from 35 per cent registered in the first quarter to 23 per cent by the last quarter, and in parallel with this the ratio of homes, within the repriced stock, that became more expensive also showed a declining trend. In the first quarter of 2020, the ratio of both the repricing and the homes getting more

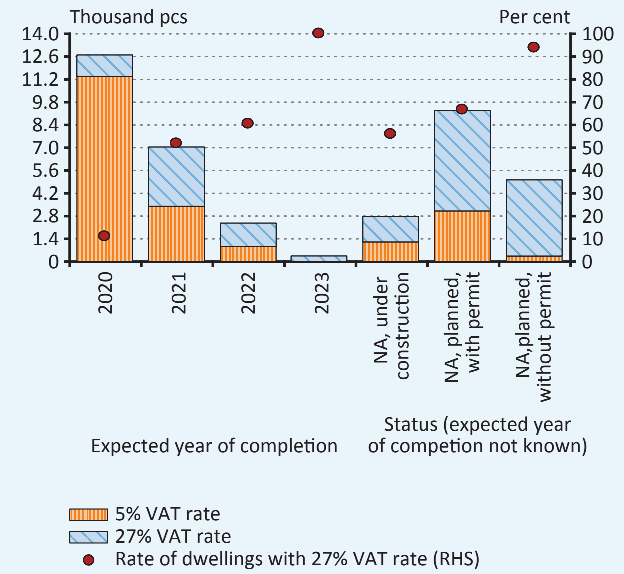
Chart 40
Average square metre price of the new home supply in Budapest and price changes by VAT rate



Note: Based on vacant, unsold homes in projects for more than 4 new homes.

Source: ELTINGA – Housing Report.

Chart 41
Distribution of new homes under development and preparation in Budapest by the relevant VAT rate and the planned quarter of completion



Note: The VAT rate applicable at the time of sale relates to instalments paid after 31 December 2019. Based on 2020 Q1 data.

Source: ELTINGA – Building Permit Monitor.

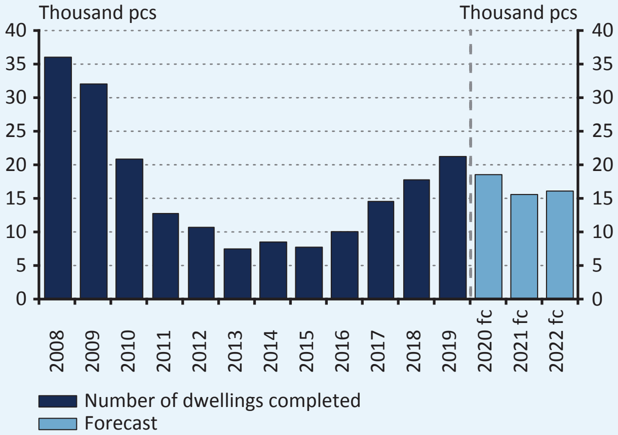
expensive, once again rose close to the previous levels. The decrease observed in the second half of 2019 in the ratio of repricing and price raising and the rise in early 2020, is attributable to the termination of the preferential 5 per cent VAT on housing at the end of December 2019 (Chart 39).

The increase of the VAT on housing to 27 per cent resulted in a price increase of 16.4 per cent on average compared to the prices at the end of 2019 on the affected projects in Budapest. In the first quarter of 2020, the average square metre price of the unsold new homes in Budapest rose to HUF 947,000, which corresponds to a growth of 12.5 per cent in an annual comparison and 73 per cent compared to the price level four years ago. In the periods before the fourth quarter of 2019, the rate of the average price change of repriced new homes in Budapest was typically a raise of 5-10 per cent. However, in the fourth quarter, the price of repriced homes subject to VAT at 27 per cent, fell by 7.6 per cent, followed by a growth of 16.4 per cent in the first quarter of 2020 (Chart 40). This is because developers tried to sell off the homes subject to VAT at 27 per cent at the end of the year even at discounted price, but in January the prices were adjusted to the general VAT rate.

In the case of new homes to be completed after 2020, the decrease in demand caused by the pandemic may result in the stoppage of certain developments. The preferential VAT rate of 5 per cent may be still applied to the purchase price instalments paid after 31 December 2019 for a large part, i.e. 89 per cent, of the new homes to be completed in 2020 in Budapest. Progressing in the scheduling of completions, the number of homes with building permits issued before 1 November 2018, subject to preferential VAT, is running out. In 2021 and 2022 already 52 per cent and 60 of the homes planned to be completed, respectively, will be subject to the general value added tax rate of 27 per cent (Chart 41). The spread of the coronavirus pandemic in Hungary generated a major fall in housing demand and in the realised sale and purchase transactions from the second half of March 2020. The LITT members already reported favourable developments in May, but if compared to the situation before the outbreak of the pandemic the demand returns to a lower level, certain housing projects, with low pre-sale ratio, but already subject to VAT at 27 per cent, may as well stop. However, looking ahead, the preferential VAT rate, applicable in the brownfield zones, may provide substantial support to the market of new homes (Box 3).

According to our expectations, the new home construction cycle may have reached its peak in 2019, in line with the underlying household income trends and the growth dynamics of households' investments. In 2020 we expect a fall in the completion of homes. According to our expectations – also considering delays in projects under

Chart 42
Number of new completions nationwide, with forecast



Source: HCSO, MNB.

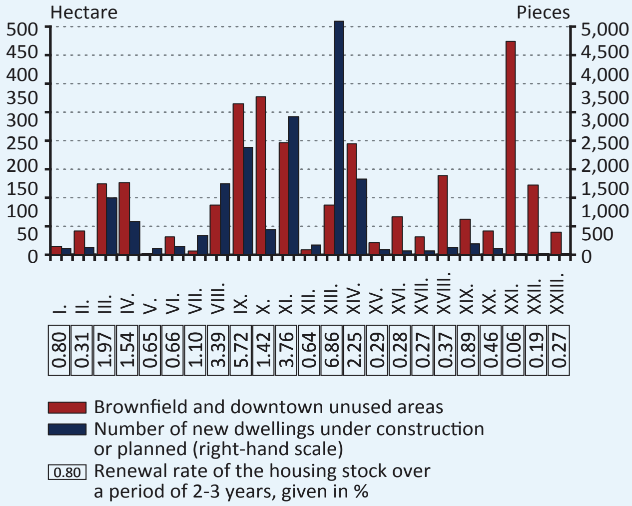
development – compared to the 21,100 completions of new homes in 2019, in 2020 the completion of 18,500 new homes may be realised. Thereafter, looking ahead, there will be a further decrease in the completion of new homes, attributable to the fewer new condominium developments resulting from the resetting of the VAT rate to 27 per cent, the housing projects in their initial phase, which potentially may stop due to the coronavirus pandemic and the tightening of the energetics requirements from 2021. Large decline may be primarily expected in home construction by enterprises. The construction of family houses is characterised by two opposite effects: the family protection measures support, while the deterioration of the labour market and income prospects as a result of the pandemic, together with the uncertainty, have a negative effect on constructions. The effects of the preferential, 5 per cent VAT, applicable to developments implemented in brownfield zones may manifest themselves in 2022, at the earliest, due to the 1.5-2 year lead time of property developments. The measure may help prevent further decline in the development of new homes in 2022. Due to the pandemic, the decreasing number of permits observed in the past two quarters and the decreasing number of residential projects under construction, overall, we anticipate 15,500 new completions in 2021 and 16,000 in 2022 (Chart 42).

Box 3
Introduction of the preferential VAT rate on housing in brownfield zones and its expected impact on the new housing market

The period of the temporary, 5 per cent VAT applicable on new homes since 2016 was terminated at the end of 2019. Until 31 December 2023 those housing projects may be sold at a VAT rate of 5 per cent for which the final building permit was issued until 1 November 2018. In recent years, in parallel with price increase in the housing market, the price of newly built homes also substantially increased, as a result of which demand for new homes had already decreased in 2019, and the number of new homes sold in Budapest decreased by 16.4 per cent compared to 2018. The resetting of the VAT rate to 27 per cent curbs development activity overall, since due to the passing of the higher VAT on the buyers, demand may substantially decrease. On the other hand, if the sales price is left unchanged, the profit of developers may be exhausted.

Based on the announcement made by the Government in April, a VAT rate of 5 per cent, instead of 27 per cent, will apply to the sales and letting of new homes in brownfield zones. When this report was prepared the details of the announcement were yet unclear, but the conclusion that may be drawn preliminarily is that the preferential VAT applicable to homes in brownfield zones may exert material positive impact on the market of newly built homes in the years ahead. Brownfield areas are lands, typically in the inner area of towns, that have been previously used, but have subsequently become vacant, derelict or underutilised and are often strongly contaminated by industrial or construction waste (when preparing this report the final, statutory definition has not yet been published). The areas of brownfield zones typically have already built out transport infrastructure, but the start of developments is hampered by the costly remediation. However, the possibility of applying the preferential VAT rate may make these areas competitive compared to the greenfield investments. The advantage of brownfield housing developments is that the respective town can develop on its existing area, there is no need for large-scale infrastructural investments and – contrary to the outward expansion of the town –travel and commuting time of the population does not increase.

Brownfield areas and new housing development activity in the districts of the capital



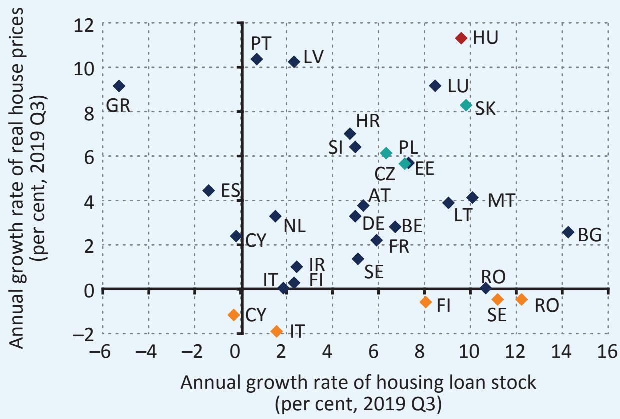
Note: Data for brownfield and downtown unused areas based on the Brownfields Cadastre update completed in December 2018. The existing housing stock of the districts of the capital is data from the beginning of January 2019.

Source: ELTINGA – Housing Report, Budapest Főváros Városépítési Tervező Kft., HCSO.

Overall, the introduction of the preferential VAT rate applicable in brownfield areas may support the market of new homes from two sides. On the one hand, due to the spread of the coronavirus pandemic and the deterioration in the macroeconomic environment, the launch of projects already in the preparatory phase may be questionable under a VAT rate of 27 per cent; the preferential VAT rate may help implement these projects. On the other hand, looking ahead, more new developments may start than under a VAT rate of 27 per cent. In addition, since the preferential rate may be applied also to the letting of homes built in brownfield zones, it may foster the building of tenement blocks.

According to a survey performed in 2018, in Budapest the brownfield and downtown underutilised areas amounted to 2,945 hectares, comprising of 3,507 plots, or – when grouping the plots constituting one unit – 323 groups of plots. The largest number of brownfield areas, i.e. 16 per cent of the stock in Budapest, are located in District XXI (467 hectares), but there are also significant brownfield areas in District X (346 hectares) and in District IX (329 hectares) (Chart). When examining the new housing developments in progress in Budapest, the renewal rate of the housing stock is the lowest in Csepel, the district with the largest brownfield area. The new homes expected to be completed here in the next 2-3 years correspond to only 0.06 per cent of the existing housing stock. In Districts XIII, XI, IX, XIV and VIII – characterised by buoyant home construction activity – the homes to be completed in the coming periods amount to more than 2 per cent of the existing housing stock. The improvement of the brownfield areas located here under the preferential VAT rate on housing helps prevent a drastic fall in renewal rates and keep them at a favourable level in the future.

Chart 43
Annual increase in real house prices and the housing loan stock in European comparison



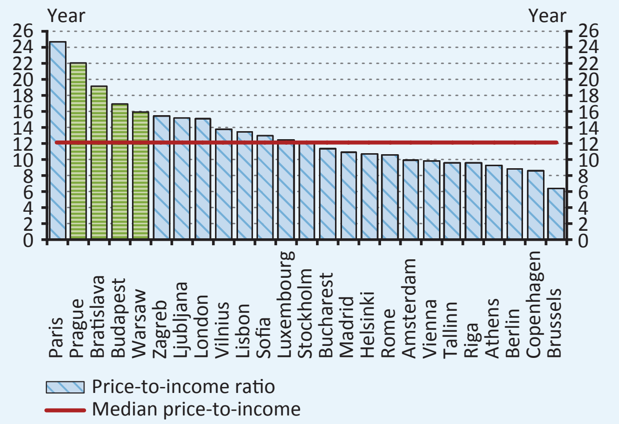
Note: The rate of increase in house prices is based on quarterly data from 2019 Q2 in the case of Cyprus and Luxembourg. Visegrad countries are indicated in green, Hungary in red. 2019 Q1 data are indicated in yellow.

Source: BIS, ECB, MNB.

4.3 AN INTERNATIONAL OUTLOOK ON HOUSING MARKET TRENDS

Last year most European countries were still in the expansion phase of the housing market and credit cycle. In most European countries, along with the rise in prices, the portfolio of housing loans is growing on annual terms. In 2019 Q3, Greece, Spain and Cyprus experienced a year-on-year decline in housing lending in parallel with an increase in house prices. In Sweden, Romania, Italy and Finland the expansion of lending in the first quarter of 2019 was still realised under decreasing real house prices, but in the third quarter the growth in outstanding lending was already accompanied by a minor increase in house prices. In terms of the property market and credit cycle, Hungary stands out among the countries under review by achieving a growth rate of almost 10 per cent in the housing loans and a two-digit annual house price dynamics in real terms (Chart 43).

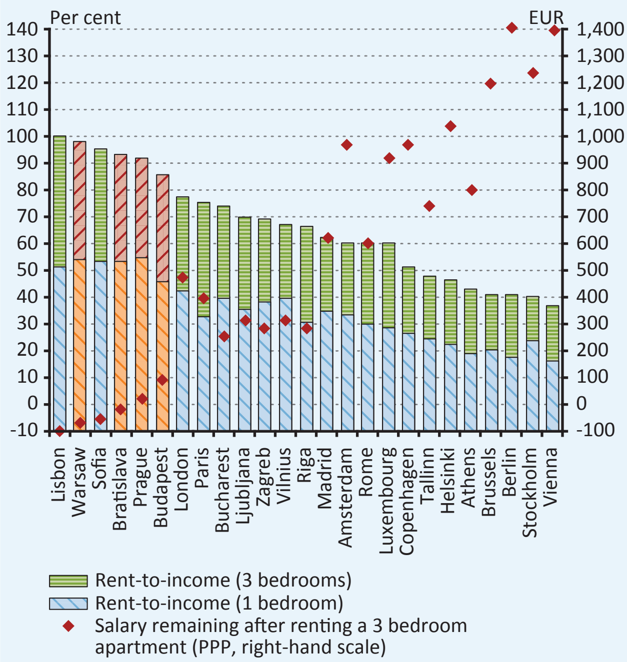
Chart 44
Price-to-income ratios in European capitals



Note: The price-to-income ratio is the ratio of the median house prices to the national average wage. Capitals of the Visegrad countries are marked with a different colour. Calculations based on 90 square metre homes.

Source: Eurostat, numbeo.com.

Chart 45
Rent-to-income ratios in European capitals



Note: The remaining income is the disposable amount after paying the rent for a 3-room sublease, calculated at purchasing power parity. Capitals of the Visegrad countries are marked with a different colour.

Source: Eurostat, numbeo.com.

Based on the ratio of house prices in Budapest to national earnings, Budapest is among the more expensive capitals in Europe. Of the European capitals, it is the most difficult to buy property on the average national income in Paris. In France, a person with an average income can buy a property of 75 square metres of median price level in the capital on almost 25 years' income on average. Budapest is the fourth least affordable capital in Europe; a property of 75 square metres of median price level in the capital may be bought on the average income of 17 years. Among the capitals of the other Visegrad countries, properties are the least affordable in Prague. Currently, in terms of housing affordability the situation appears to be the most favourable in Brussels, where on average households need less than 6.5 years of income to buy a home of their own. This is far below the European median of 12 years (Chart 44).

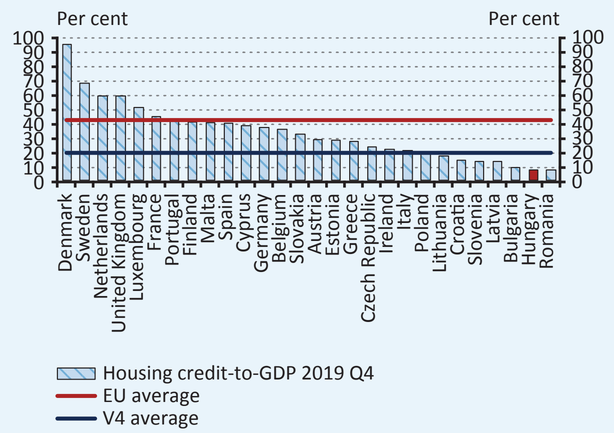
The problem of housing affordability can also be observed in the rental market in Budapest. As a percentage of net income, rents in Budapest are currently the sixth highest among European capitals. In Budapest, the average rent for a typical 3-bedroom home is 87.2 per cent of an average net wage in Hungary (Chart 45). The value of the indicator is even higher in the rest of the Visegrad countries: 98.8 per cent in Warsaw, 94.0 per cent in Bratislava and 92.9 per cent in Prague. We get a similar picture on housing affordability when examining the disposable income at purchasing power parity remaining at the respective tenant after paying the typical rent for a three-bedroom flat from an average wage. The Visegrad countries are among the countries in a less favourable situation in this comparison as well. This shows that while in Budapest a disposable income of merely EUR 170, calculated at purchasing power parity, remains after paying the rent for a 3-bedroom flat, in Vienna and Berlin this amount exceeds EUR 1,300.

5 Features of the residential mortgage loan market

Although the volume of households' borrowing for housing purposes grew in 2019 as well, there is still plenty of room for the deepening of residential mortgage lending, since credit penetration is still low by international standards. The affordability of home purchase on credit worsened during the year, but in the fourth quarter, as a result of the stagnation of house prices and their fall in Budapest, it returned to the level observed at the end of last year. The ratio of those buying a home on credit stabilised below 50 per cent within the total number of housing market transactions. Within new loans, the role of loans used for building and buying new homes increased, while that of used homes slightly decreased. The rise in the volume of new loans is attributable to the continuing increase in the contracted amounts, while the number of loan contracts fell by 10 per cent in 2019 year on year. The volume of new housing loans reached a historic high in nominal terms, but in real terms it still falls short of the value registered in 2008, and it entails materially lower risks.

As a result of the coronavirus pandemic and the isolation measures, banks anticipate a substantial fall in demand for housing loans, at the same time projecting a deterioration in customers' creditworthiness, which justifies the tightening of credit conditions. According to the MNB's forecast, the disbursement of new loans may decline substantially, roughly by one third, in 2020, but the support programs (HPS, prenatal baby support loan) may underpin the outflow of credit. The MNB provided a comprehensive package of measures for supporting retail mortgage lending and residential property valuations closely related to financing by stimulating the banking system through digital solutions and its lending capacity.

Chart 46
Housing credit-to-GDP in European comparison

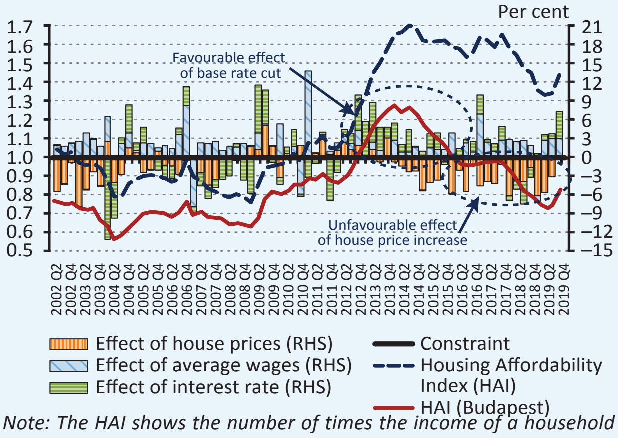


Source: ECB.

There is still significant room for the deepening of residential mortgage lending. In Hungary outstanding housing loans amounted to roughly HUF 3,700 billion at the end of 2019. However, compared to the size of the economy this still means that there is plenty of room for growth: the volume of credit institutions' outstanding housing loans as a percentage of GDP still stands at 8 per cent (Chart 46). Accordingly, the depth of mortgage lending in Hungary – in addition to Romania – is the lowest compared to the EU. The average loan-to-GDP ratio in the EU is 42 per cent, and although the Visegrad countries on the whole lag behind in this respect, the outstanding housing loans as a percentage of GDP in Slovakia, the Czech Republic and Poland is more than twice the Hungarian value. The low credit penetration is also supported by Eurostat's data related to the status of housing: in 2019 15 per cent of the population lived in a home in respect of which they had an outstanding instalment obligation, while the EU average is 27 per cent.

By the end of the year, the affordability of home purchase on credit returned to the baseline. The affordability of home purchase on credit was affected negatively by the rise in house prices throughout last year, except for the fourth quarter. In contrast, the growth in average wages, observed for years, still had a positive impact. In 2018 the impact of the interest rate level was temporarily negative since the average level of the cost of finance was raised by the headway of more expensive loans with a longer interest rate fixation period. However, this changed by 2019, since the average cost of loans with an interest rate fixation for more than one year decreased, while the composition

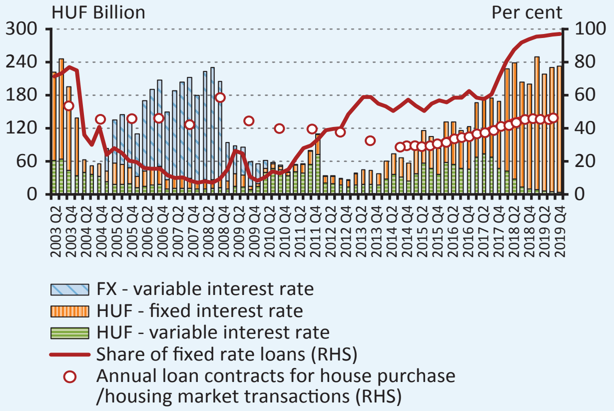
Chart 47
Housing Affordability Index (HAI)



Note: The HAI shows the number of times the income of a household with two average earnings covers the income required for the financed purchase of an average home of 65 square metres. Parameters of the loan product, except for the interest rate, are constant until maturity. LTV = 70 per cent, PTI = 30 per cent, maturity = 15 years.

Source: MNB.

Chart 48
Volume of new housing loans by interest rate fixation and denomination



Note: Fixed rate loans indicates loans with over 1 year interest rate fixation.

Source: MNB.

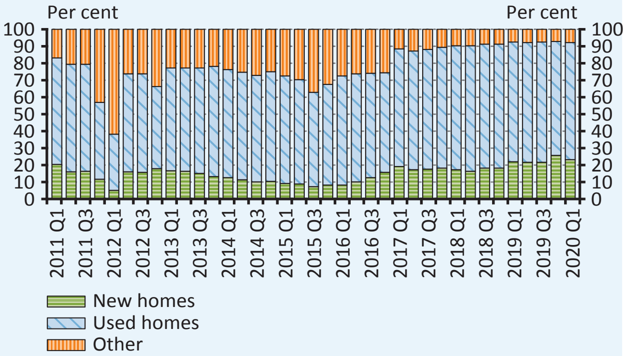
by interest period did not change materially any longer. As a combined result of the foregoing, the affordability of home purchase on credit deteriorated in the middle of the year, but it improved in the fourth quarter both in Budapest and nationwide (Chart 47). However, as a result of the worsening labour market situation, caused by the coronavirus pandemic at the beginning of 2020, further deterioration in affordability may be expected.

The ratio of those buying a home from a loan stabilised below 50 per cent. In 2019, credit institutions disbursed new housing loans in the total amount of roughly HUF 900 billion (Chart 48). This represents a nominal increase of 6 per cent compared to the previous year. Although the volume of new issuance reached its historic maximum, it should be noted that in real terms new borrowing amounts to about 80 per cent of that in 2008, and that the present loan contracts are not burdened by exchange rate risk at all, while burdened by an interest rate risk to a lesser degree than the loans taken before the global economic crisis. The volume of new loans in the first quarter of 2020 also evidences strong demand: the value of contracts concluded in a month was on the rise in March as well. However, in the remaining part of the year a decline in residential mortgage lending may be expected, considering the personal contact requirements of the administration. In view of the epidemic situation the MNB has taken several measures to support retail mortgage lending processes, promoting digital solutions.[4] In 2019, the ratio of housing market transactions realised from a loan amounted to 46-47 per cent, which represents a rise of roughly 2 per cent on an annual average compared to 2018. Thus, for the time being there is no sign of buyers on loans being squeezed out from (which could give rise to social problems), or gaining excessive ground (which could represent a stability problem) in the housing market as a whole.

The role of loans for new homes increased. In a breakdown by loan purpose, the share of loans contracted for the purchase or construction of new housing within the total issuance rose from 18 per cent to 22 per cent by mid-year, and in the fourth quarter it was on a record high at 26 per cent (Chart 49). The headway of loans for new housing was realised mostly at the expense of used homes: while in 2018 the ratio of this loan purpose was 73 per cent, in the last quarter of 2019 and in the first quarter of 2020 it fell below 70 per cent. Based on the volume of new issuance, last year the amount of loans taken for the purchase of new housing rose by 52 per cent and that of construction loans by 28 per cent, and in parallel with this the volume of new loans borrowed for used home rose by merely 1 per cent, while the amount of loans for other housing purposes decreased by 11 per cent.

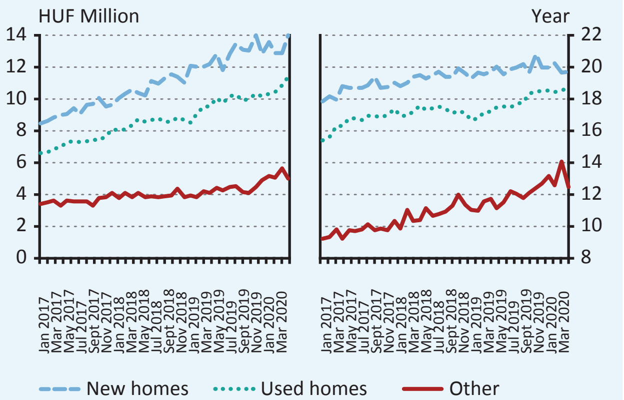
[4] In cooperation with appraisers, customers may exchange a site visit with digital solutions. It is recommended to accept the documents in electronic form as proof of the submission of the application for registration of the mortgage right. Supporting prudent database-based collateral valuation methods and defining their conditions. Possibility of disbursement of new loans without notarization.

Chart 49
Distribution of housing loan disbursements by loan purpose



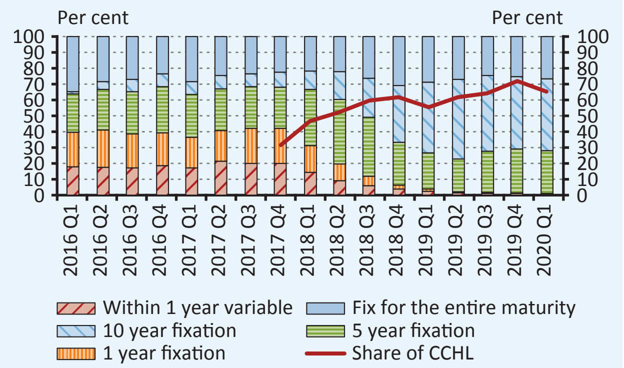
Source: MNB.

Chart 50
Average contract size and maturity of new housing loans



Note: Maturities are averages weighted by the contracted amount.
Source: MNB.

Chart 51
Distribution of housing loan disbursements by interest rate period.



Note: Share of CCHL products compared to new issues with at least 3 years of interest rate fixation (at least 5 years since Q4 2018) excluding disbursements by building societies.
Source: MNB.

Under increasing average contracted amount and maturity, the number of new contracts declined. The rise in the volume of new loan issuance is mainly attributable to the increase in the contracted amounts. The amount of loans for new housing and for used homes increased on average by HUF 1.5 million and by almost 2 million, respectively, in 2019 (Chart 50). This also appeared in the longer maturities: last year the average tenor of loans for new housing and used homes increased by half-year and almost 2 years, respectively. The rise in the contracted amount for the time being maintains the aggregated volume of issuance, while overall in 2019 by 10 per cent fewer contracts were concluded compared to 2018. However, this also developed heterogeneously by loan purpose: the number of contracts for new homes rose by 19 per cent, while contracts for used homes declined by 12 per cent on an annual level.

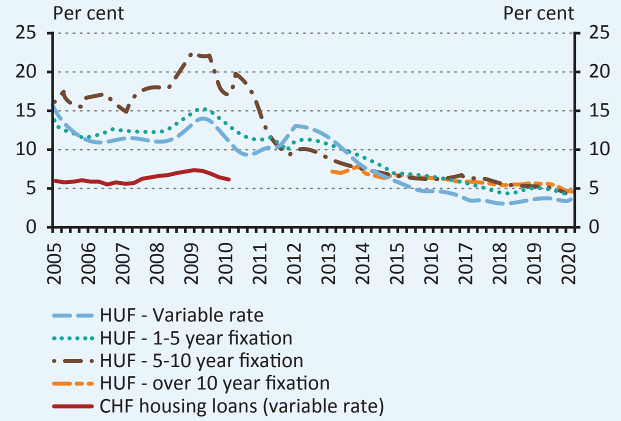
The interest rate risk of new loans is still moderate. After the debt cap rule related to the payment-to-income ratio differentiated by interest period was introduced in 2018, a major shift was observed in the interest rate fixation of housing loans. Practically this was completed by 2019: last year and also in the first quarter of this year, one quarter of the new issuance is fixed until the maturity, half of it has an interest period of 10 years, and one quarter of it is fixed for 5 years (Chart 51). The ratio of Certified Consumer-friendly Housing Loans is steadily around two-thirds within the loans that potentially may be certified, i.e. having an interest period of at least 5 years. The outstanding borrowing also shows a decreasing interest rate risk; by the end of 2019 the ratio of mortgage loans with variable interest rates within one year fell below 50 per cent.

The financing conditions of housing loans are still favourable. The average credit costs of new housing loans decreased for loans with an interest rate fixed for longer than one year in 2019. The most popular loans with interest period of 10 years registered a decrease of 1 percentage point, and after an additional decline at the end of the first quarter of 2020 the average APR amounted to 4.2 per cent (Chart 52). The decrease in interest rates is attributable to the decline in funding costs; interest rate spreads rose last year by 0.1-0.4 percentage point. Overall, the price conditions of housing loans were favourable during 2019.

Demand for housing loans is reduced both by the introduction of the prenatal baby support and the coronavirus pandemic. In 2019, the housing loan conditions of banks did not change, nevertheless banks reported in the Lending Survey increasing demand in most of the period.[5] The only exception to this was the third quarter:

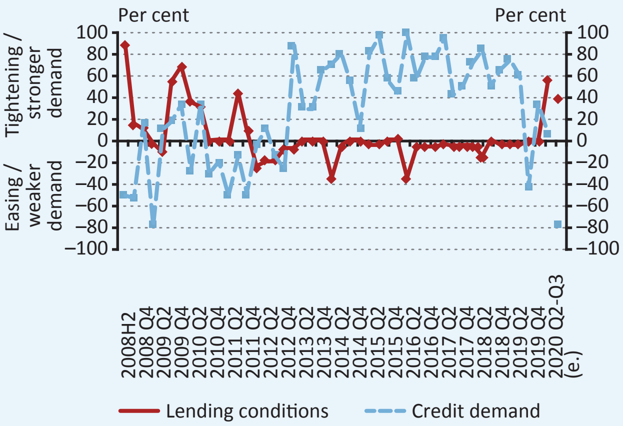
[5] For detailed results of the Lending Survey see: https://www.mnb.hu/en/financial-stability/publications/lending-survey

Chart 52
APR of new housing loans



Source: MNB.

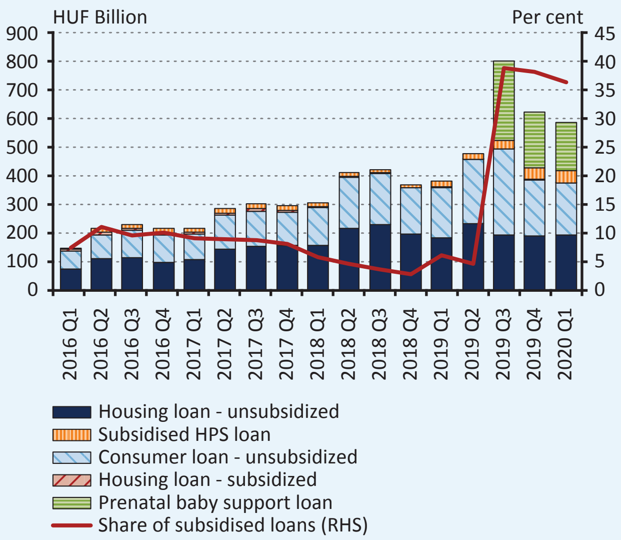
Chart 53
Changes in credit conditions and demand for housing loans



Note: Time series of lending conditions show the net ratio, i.e. the difference between banks tightening and easing, weighted by market share.

Source: MNB, based on banks' responses.

Chart 54
Role of subsidised loans in household lending



Source: MNB.

after the introduction of the prenatal baby support and the Hungarian Government Bond Plus, 40 per cent of banks, in net terms, observed a decline in the demand for housing loans (Chart 53). Although in the fourth quarter institutions experienced a rise in demand at a similar rate, in early 2020, as result of the isolation measures introduced to prevent the coronavirus pandemic, this process has halted and the vast majority of banks already anticipate a decline in the next half-year. In parallel with this, credit institutions perceive a deterioration in the clients' creditworthiness, and thus more than half of them tightened the scoring system in the first quarter. Looking ahead, further wide-ranging tightening may be expected in this area, which – in parallel with the fall in credit demand – according to our forecast, in 2020 on the whole will result in a substantially lower, roughly by one third, issuance of housing loans than before.

Subsidised lending schemes may support retail lending. Both the number and volume of the contracts concluded under the Home Purchase Subsidy Scheme (HPS) increased year on year, and 23 per cent of the new housing loans disbursed in the quarter were connected to HPS. The issuance of prenatal baby support loans since the launch of the scheme (July 2019) amounted to HUF 680 billion in total until early May, connected to roughly 70,000 loan contracts. According to the banks, one of the most frequent utilisations of the prenatal baby loans is the realisation of some housing purpose, and thus this (unsecured) loan type may also play an important role in households' housing investments. In the past three quarters, subsidised schemes accounted for 36-39 per cent of total new loans (Chart 54). Demand for prenatal baby support loan may remain strong – albeit more moderate than last year – despite the deteriorating economic environment, due to the favourable terms of the product, the state guarantee and the relatively high income of those using the scheme. Thus these schemes may materially contribute to the partial continuance of new loan disbursements.

Count István Széchenyi

(21 September 1791 – 8 April 1860)

Politician, writer, economist, minister for transport in the Batthyány government whom Lajos Kossuth referred to as 'the greatest Hungarian'. His father, Count Ferenc Széchényi established the Hungarian National Museum and Library; his mother, Julianna Festetich was the daughter of Count György Festetich, the founder of Georgikon, an institution for the teaching of agricultural sciences.

With his ideas – whose message remains relevant even today – and his activities both as a writer and a politician, István Széchenyi laid the foundation for modern Hungary. He is one of the most eminent and significant figures in Hungarian politics whose name is associated with reforms in the Hungarian economy, transportation and sports. He is also known as the founder and eponym of numerous public benefit institutions, a traveller all across Europe and an explorer of England as well as the champion of economic and political development at the time. István Széchenyi recognised that Hungary needed reforms in order to rise, and considered paving the way for a Hungary set on the path of industrialisation and embourgeoisement to be his calling in life.

Published in 1830, his Credit outlined the embourgeoisement of Hungary and summarised its economic and social programme. Count Széchenyi intended this writing to make the nobility aware of the importance of the country's desperate need for a social and economic transformation. Another work of his, Stádium [Stage of Development] (1833) listed the cornerstones of his reform programme in 12 points, including the voluntary and compulsory liberation of serfs; the abrogation of avicitas (inalienable status of noble property); the right of possession for the peasantry; and the freedom of industry and commerce. This work of Széchenyi already conveyed the idea of equality before the law and the general and proportionate sharing of taxation.

After the revolution in 1848 István Széchenyi joined the Batthyány government and as minister embarked vigorously on implementing his transportation programme.

HOUSING MARKET REPORT

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