



## German house prices – how robust is the recovery?

The prices for residential properties in Germany are likely to continue rising moderately for the foreseeable future. An increasing number of transactions suggests that the correction following the boom has truly been completed. However, rising interest rates will largely neutralize the positive effect of higher incomes.

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### Real estate prices have been rising for one and a half years ...

The prices for residential properties – measured by the monthly data from Europace which show a high correlation with the quarterly data from the Federal Statistical Office – have steadily increased over the past one and a half years (title chart). Although there have been occasional minor setbacks in the subcomponents for existing and new construction properties, the trend also points upwards for both subcategories. However, the prices for existing properties and thus overall real estate prices are still lower than their peak in the spring of 2022.

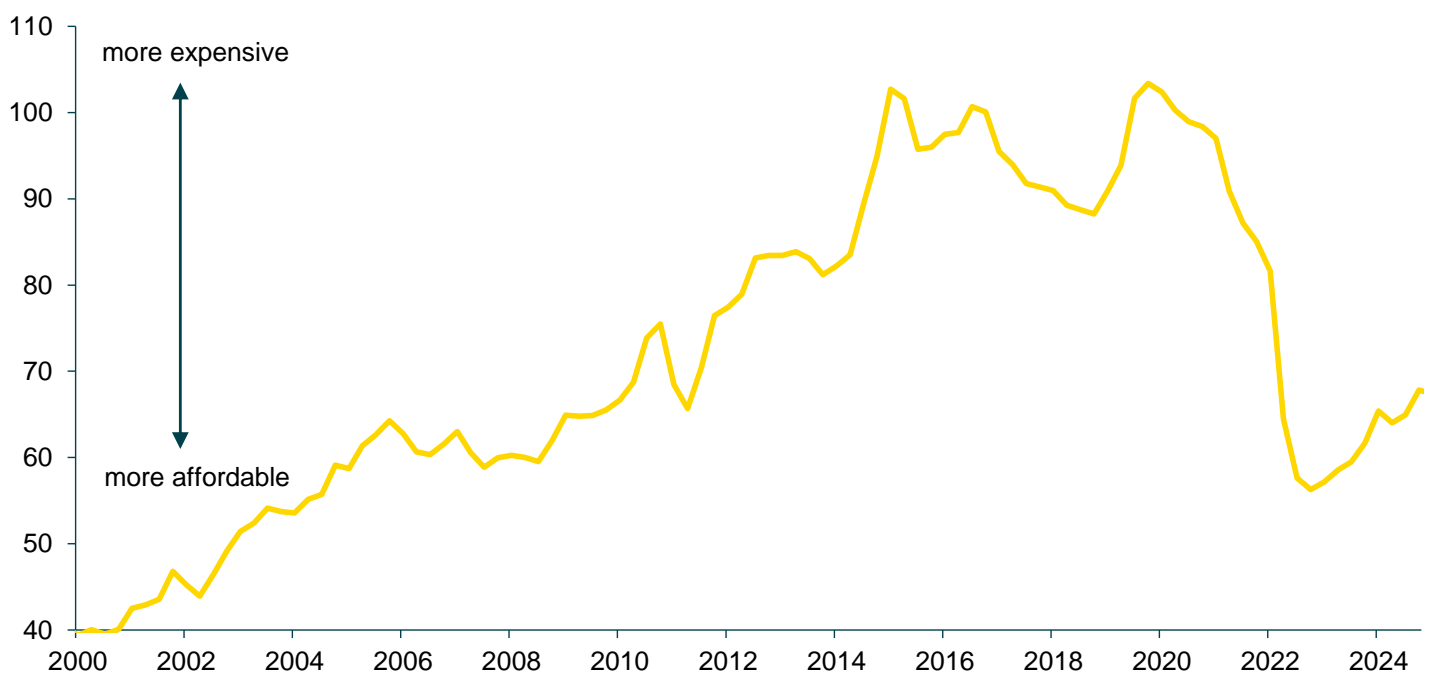
### ... as lower interest rates and higher incomes ...

One reason for the recovery in real estate prices was the improved financing conditions. Currently, mortgage interest rates are around 3.6%, which is lower than their interim peak of about 4% at the end of 2023. At the same time, the disposable incomes of households increased by an average of 5% per annum in 2023/24. This rise was significantly higher than consumer prices, resulting in an annual increase of about 1½% in real wages.

Together, these two factors have made it easier for buyers to finance a property again. Our affordability index, which relates disposable incomes to the amount of a hypothetical debt service (interest and repayment), has partially recovered from the decline caused by the sharp increase in mortgage interest rates between early 2020 and spring 2022 (Chart 1). As a result, homes are still significantly harder to finance for buyers than during the ECB's zero and negative interest rate policy period. However, they are similarly affordable as they were in the years 2006 to 2010, when a long-term rise in house prices began.

#### Chart 1 - Affordability: Properties remain relatively expensive

Affordability Index: disposable income per capita in relation to the amount of debt service (interest payments and repayment)



Source: Bundesbank, Federal Statistical Office, Commerzbank Research

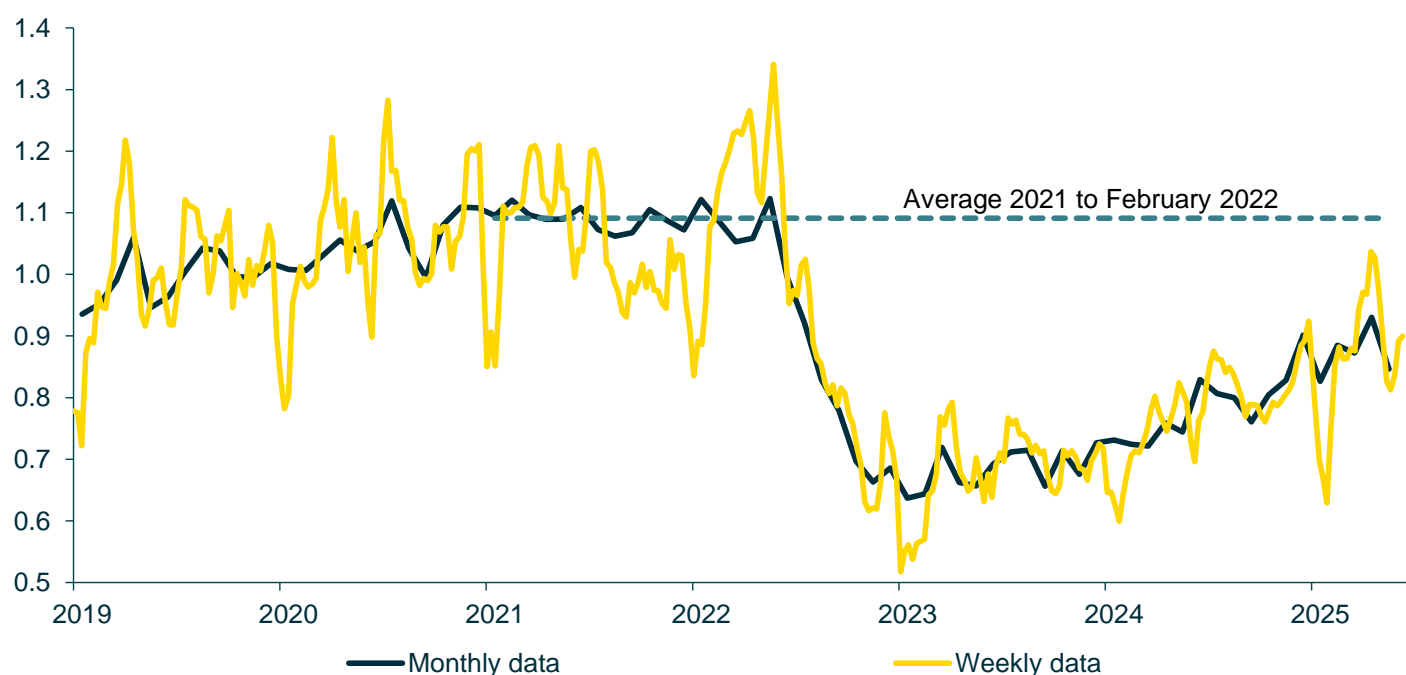


## ... stimulated demand

This slightly improved affordability has evidently been sufficient to stimulate demand again. The number of newly concluded mortgage loans, which had plummeted sharply in 2022 due to the massive interest rate shift by the ECB, has been rising again since the beginning of last year (Chart 2). Currently, the number of real estate transactions is still about 20% below the level prior to the commencement of interest rate hikes. Furthermore, in the ECB's Bank Lending Survey, commercial banks are reporting a continuous increase in demand for mortgages.

### Chart 2 - Number of real estate transactions with a moderate upward trend

Real estate transactions approximated by the number of newly concluded mortgage contracts, weekly data and seasonally adjusted monthly data, Index 2019=1



Source: Federal Statistical Office, Schufa, Commerzbank Research

## For the time being, hardly any tailwind from interest rates and income

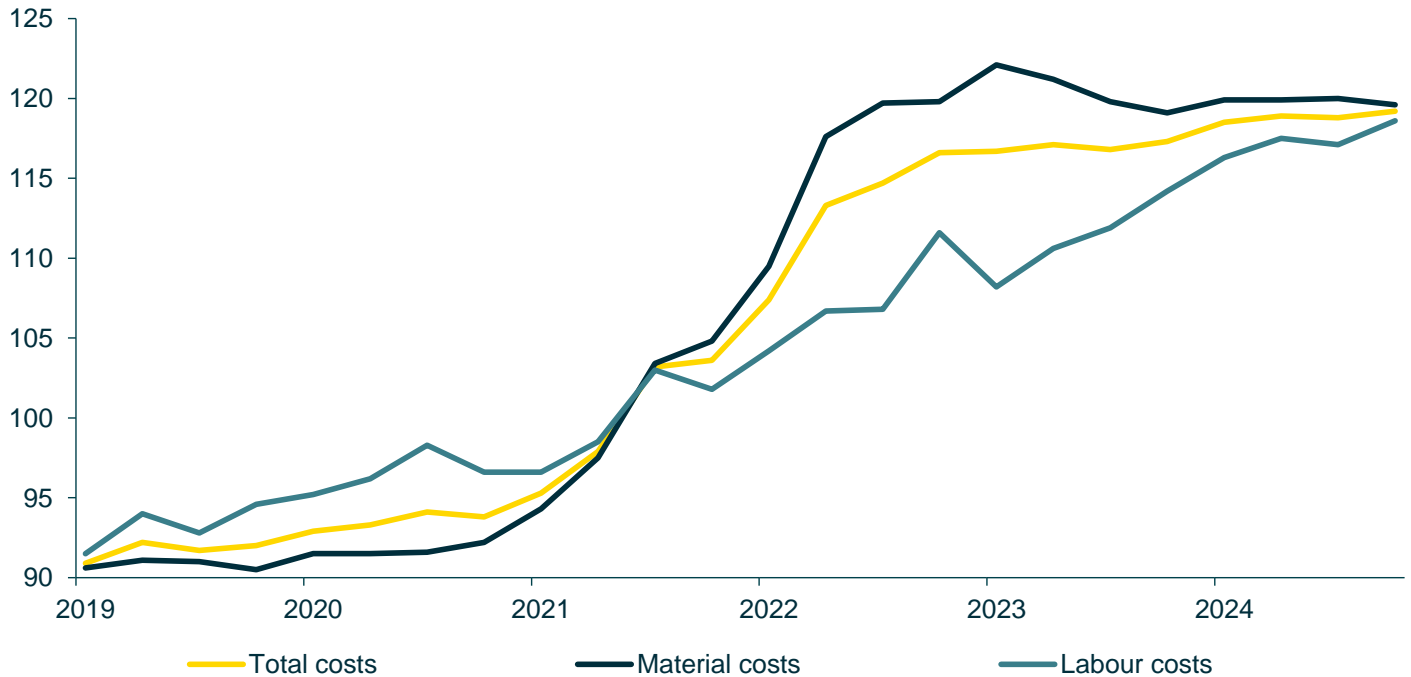
This year and next year, the affordability of real estate is unlikely to improve significantly. After the ECB rate cuts end, which we expect in fall, yields are likely to slowly increase again. The inflation rate in the eurozone is not expected to fall as much as currently priced in by markets. Additionally, a likely economic improvement and notably more expansionary fiscal policy, especially in Germany, will cause a significant increase in the supply of government bonds. Therefore, we anticipate that interest rates for 10-year mortgage loans will be at 3.6% by the end of this year and will rise to 4% next year. At the same time, incomes are expected to increase by 3½ % this year and by 3% next year, which will likely be just enough to offset the negative impact of higher interest rates on affordability. Consequently, a significant improvement in affordability and a resulting price boost, like that seen in the years following the financial crisis, are not expected.

## Significantly higher construction prices suggest more expensive new buildings, ...

Nevertheless, we expect prices to continue to rise moderately this year. Factors pointing to this include general inflation and the significantly increased construction costs in recent years. Following a sharp rise, especially during 2021 and 2022, these costs were more than 25% higher than before the pandemic (Chart 3). Initially, material costs increased significantly mainly due to temporary supply problems, but over the past two years, labor costs have risen sharply due to the general and markedly higher wage increases.

**Chart 3 - Construction costs largely stable for the past two years**

Construction cost index for residential buildings in Germany, Index 2021=100



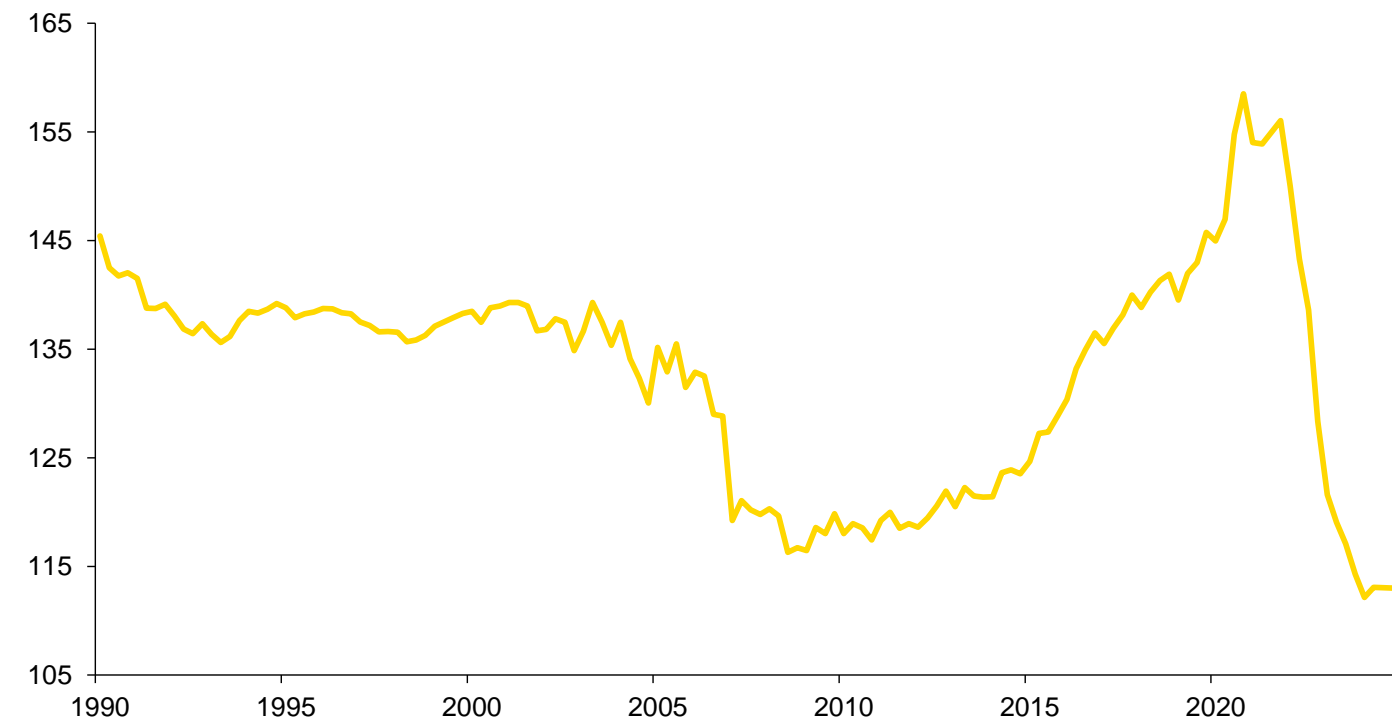
Source: Federal Statistical Office, Commerzbank Research

The higher costs have been largely passed on by construction companies to their customers, both private builders and project developers, resulting in a significant increase in construction prices. Along with the temporarily falling house prices, this has put considerable pressure on the profit margins of project developers. The ratio between house prices and construction prices, meaning the sales revenue of project developers relative to their payments to construction companies, is as unfavorable as it has ever been since reunification (Chart 4). Additionally, financing costs have also increased.



#### Chart 4 - New buildings as unprofitable as it has been for a long time

Ratio of residential property prices to construction prices, quarterly values, index 2015=100



Source: Destatis, Commerzbank Research

Against this backdrop, project developers are likely to use the rising demand primarily to improve their profit margins again. They are likely to increase prices rather than undertake more projects.[1]

#### Only moderate price increases expected

Given the stronger demand, it can be assumed that the correction in real estate prices is truly complete. However, a renewed boom is not on the horizon. This would require a significant decrease in interest rates, which we do not expect.

Therefore, it is most likely in our view that house prices will increase moderately in line with general inflation this year and next. In addition to significantly increased construction costs, this is also supported by the fact that, in the coming years, the demand for newly built housing is likely to be significantly higher than what the construction industry can deliver. This is especially true as the additional investments in infrastructure planned by the federal government will likely reduce the capacities available for residential construction.

[1] The house price index of the Federal Statistical Office is based on transaction prices, meaning the prices paid when selling (completed) houses. Therefore, in the subcategory of new construction, the prices of houses that are sold "turnkey" by project companies are primarily considered. ([back to the text](#))



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