

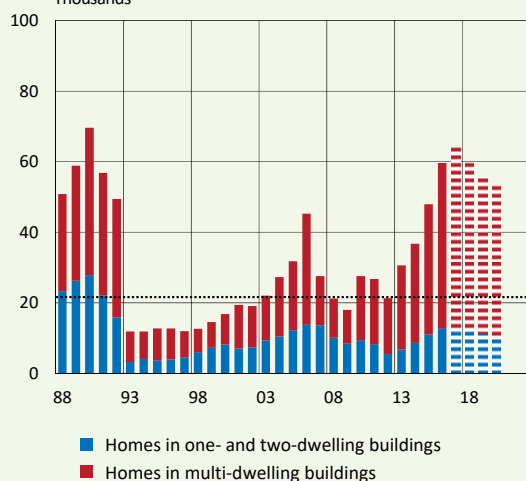
## ARTICLE – Reduced housing construction is subduing GDP growth

Housing investment has been an important driving force in the economic upturn of recent years and housing construction has now reached a historically high level. Recently, housing prices have fallen. Even if the fall in prices is small, so far, in comparison with price rises in recent years, it will contribute towards dampening housing investment in the period ahead and will thereby affect general demand in the economy. However, the Riksbank deems that demand for housing is sufficiently high to justify the assessment that there will only be a modest reduction in housing construction. Housing prices are expected to stabilise during the year before rising slightly in 2019 and 2020. Even so, this assessment is highly uncertain as it is difficult to identify the driving forces behind variations in housing construction and housing prices.

### Rapidly growing housing investment is an important factor in the economic upswing

The number of housing starts has increased sharply in recent years and in 2017, construction on just under 65,000 homes is judged to have been started. This is the highest number of housing starts in a single year since 1990 and can be compared to an average for the period 1995–2012 of just over 20,000 homes per year (see Figure 4:17).

**Figure 4:17. Housing starts, 1988–2020**  
Thousands



Note. The number of housing starts 2017–2020 constitutes the Riksbank's forecasts. Broken line refers to the mean value from 1995–2012.

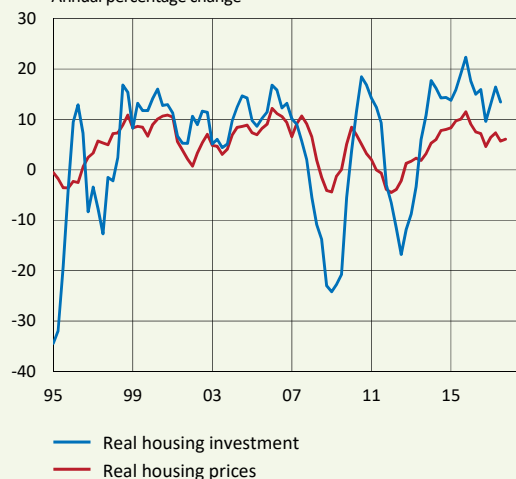
Sources: Statistics Sweden and the Riksbank

On average, it takes about 1–2 years for a housing construction start to be completed and, in the National Accounts, this is recorded as a housing investment during the production time.<sup>18</sup> The development of housing investment

thereby reflects the development of the number of housing construction starts, but with a certain time lag. Even though housing investment forms a relatively small proportion of GDP, the rapid increase in new construction has made a clear impression in the increasingly strong economic activity in Sweden in recent years (see Figure 4:5). Over the same period, housing prices have continued to increase rapidly.

Since the autumn of 2017, housing prices have decreased and, in December, prices were just under 6 per cent lower than at their highest point in August.<sup>19</sup> Historically, housing prices have covaried with housing investment and housing investment's share of GDP has also

**Figure 4:18. Housing investment and housing prices**  
Annual percentage change



Note. Housing prices are the Property price index deflated with the CPIF.

Sources: Statistics Sweden and The Riksbank

increased significantly in recent years (see Figure 4:18 and Figure 4:20). This has led to a discussion concerning how the decline in prices may affect the development of housing

<sup>18</sup> New builds constitute two-thirds of housing investment, while reconstructions and conversions make up about 25 per cent. The remaining portion of housing

investment is made up of expenditure for the construction of holiday homes and ownership transfer.

<sup>19</sup> According to the seasonally adjusted HOX price index for all housing.

investment in the years ahead and, ultimately, the consequences for GDP growth.

### Imbalances in the housing stock take time to correct and may create variations in prices and construction

In Sweden, as in many other countries, developments on the housing market have historically been characterised by large variations in both construction and prices (see Figure 4:18).

Variations around the long-term trends for price and construction mainly depend on the fact that it takes time for the supply of housing to adapt to a change in demand.<sup>20</sup>

Among other reasons, this is due to it taking a long time to plan and complete housing projects. Moreover, the number of new builds only make up a small part of the total housing stock and very large changes in new construction may thus be needed to correct an imbalance in the stock.<sup>21</sup>

Furthermore, a consequence of rigidities in the adjustment of housing supply is that periods may occur when new construction and housing prices fall even though demand for housing in the stock does not change. If, for example, there is an increase in demand, housing prices rise as the number of new builds cannot directly satisfy the higher demand. The higher prices provide an incentive to builders to build more which gradually reduces the imbalance between demand and supply in the stock. Housing prices fall back and the incentive to build decreases.

A change in housing demand can thus give rise to relatively large variations in construction and prices. As construction affects GDP growth, this will be important from the perspective of economic activity. Housing prices affect the confidence of households and companies in economic development and are also a key factor from a financial stability perspective. The rising housing prices have contributed to high indebtedness, not least because housing often acts as collateral for household indebtedness. This has made households vulnerable to changed economic conditions.

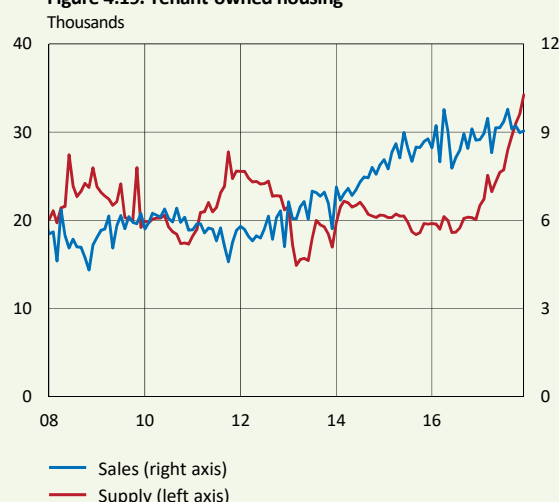
### The Riksbank's forecast is that housing construction will decrease in the years ahead

The forecast for housing construction (housing investment) is based on an assessment of the development of demand and supply in the period ahead, as well as on estimates of possible imbalances in the initial housing stock.

The Riksbank deems that housing construction, at least in the years following the financial crisis, was lower than the

long-term demand for housing, considering that several fundamental demand factors developed strongly.<sup>22</sup> This contributed to rapidly rising housing prices. The price rise, in turn, contributed to the number of new builds rising to historically high levels in recent years. Over the last year, turnover of tenant-owned homes has been relatively stable, but supply has continued to rise (see Figure 4:19).<sup>23</sup> This can be interpreted as a decrease in the deficit of housing, which has caused a certain decline in prices over the second half of 2017.<sup>24</sup>

Figure 4:19. Tenant-owned housing



Note. Supply of tenant-owned housing comprises the number of advertisements during the month on the online residential property trading website, Hemnet. Sales comprise the number of reported sales according to the independent housing price statistics supplier, Mäklarstatistik.

Sources: Hemnet and Mäklarstatistik

The Riksbank deems that the decline in housing prices will lead to a slowdown in housing construction. However, demand for housing is expected to be sufficiently high to justify a continued high rate of housing construction from a historical perspective. In the forecast, the number of housing starts will decrease from just under 65,000 last year to just under 55,000 in 2020 (See Figure 4:17). At the same time, housing prices are expected to stabilise in 2018 before then rising slightly in the following years.<sup>25</sup>

Lower housing investment will contribute towards restraining GDP growth marginally this year, by 0.4 percentage points in 2019 and a further 0.2 percentage points in 2020 (see Figure 4:5). Housing investment's share of

<sup>20</sup> In the long term, the number of homes in the stock and prices for housing can be expected to depend on how fundamental demand and supply factors develop. Factors affecting supply include access to land, construction costs, required rates of return (competition), access to and costs for funding of housing construction. Factors affecting demand include, for example, demographics, income growth, user costs, access to credit, preferences and expectations.

<sup>21</sup> According to Statistics Sweden, the total stock of housing in 2016 amounted to about 4.8 million homes. The almost 65,000 new homes judged to have been started in 2017 thereby form less than 1.5 per cent of the stock.

<sup>22</sup> For example, the population in Sweden has increased rapidly in recent years.

<sup>23</sup> As not all housing for sale is announced on the Hemnet website, this measure of supply is an underestimate. A large part of the heavy increase in the supply of tenant-owned homes over the last year consists of newly produced tenant-owner homes.

<sup>24</sup> To the extent that the macroprudential measures of recent years have contributed towards increasing user costs, this can, to a certain degree, be expected to have contributed towards reducing demand.

<sup>25</sup> The forecast is based on the fact that reconstructions and conversions, which constitute just under 25 per cent of housing investment, covary with new construction according to historical patterns.

GDP will decrease by just under one percentage point to about 5 per cent (see Figure 4:20).<sup>26</sup>

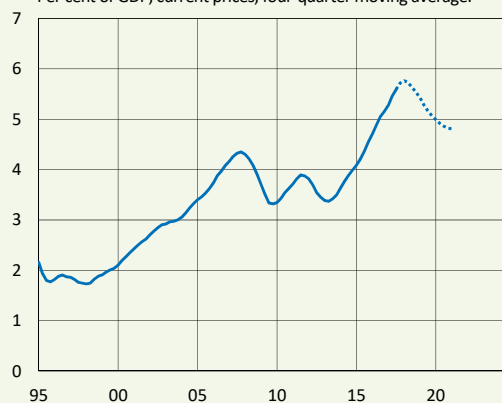
### The development of the housing market is difficult to assess

The Riksbank's forecast for housing construction and housing price development is based on a series of assessments and assumptions. The current housing stock and housing prices are deemed to a large extent to reflect the development of fundamental determinants. If, on the other hand, it should turn out that demand for housing has been driven by temporary factors such as expectations of incomes, housing costs and housing prices that are not realised, this may lead to greater falls in prices and a heavier slowdown in housing construction than the Riksbank has forecast.

An aggregate analysis of the housing market has its limitations. Housing differs, for example, depending on its geographical location, form of tenure and standard.<sup>27</sup> For the housing market to function efficiently, not only is the number of new homes important but also what kind of homes they are and where they are built. The recent price fall has primarily affected tenant-owned homes. The need of rented accommodation is deemed by many analysts, including most municipalities, to be considerable. The National Board of Housing, Building and Planning (Boverkets) suggests that the reduced construction of tenant-owned homes, combined with the increase of investment grants for rented accommodation, presented in the Budget Bill for 2018, may pave the way for the construction of more rented homes.<sup>28</sup> This could be a factor leading to less of a slowdown in housing investment in the years ahead than in the Riksbank's assessment.

**Figure 4:20. Housing investment**

Per cent of GDP, current prices, four-quarter moving average.



Sources: Statistics Sweden and the Riksbank

<sup>26</sup> The assessment of the development of housing investment in the years ahead is very similar to the one made in the Monetary Policy Report from December 2017.

<sup>27</sup> For a slightly more detailed discussion of matching on the housing market, see G. Katinic, "Perspectives on housing construction", Economic Commentary no. 2, 2018, Sveriges Riksbank.

<sup>28</sup> Boverkets indikatorer, november 2017 [Boverkets indicators, November 2017].