

# Housing Affordability Index: Q4 2023

## A long-awaited recovery is on the way

- Housing affordability has bottomed out.
- Interest rates for new loans likely peaked in the fourth quarter.
- The sustained rapid net wage growth is the key factor in the recovery of affordability.

Housing affordability finally started to improve in Riga and Vilnius in the final quarter of 2023. The index for Tallinn seemingly just bottomed out; however, with one-off factors removed, housing affordability also began to recover in the Estonian capital. Nevertheless, since mid-2023, only Riga's residential apartments remain affordable for the average household. A closer look reveals that apartments built or renovated after 2000 in Riga have also been beyond the reach of the average household for a while now. Conversely, the subindex for Tallinn's secondary market has regained affordability after a short dip in the third quarter.

Activity in the housing market remained muted. The number of transactions was low across the Baltics, as were reservations for new apartments. Real estate developers are cautious and trying to avoid an oversupply. General consumer confidence has improved in Latvia recently, remaining slightly below the long-term average, while in Lithuania households continue to be optimistic. Meanwhile, on the back of a prolonged recession, household confidence in Estonia has again deteriorated lately. Except for Soviet-era housing in Riga, prices generally have shown their resilience to lower market activity.

Our forecast for the start of the ECB's rate cuts was pushed back from April to June. After that, we expect rate cuts at every ECB governing council meeting, with the deposit rate falling to 2.75% at the end of this year. Wage growth, although slowing, will remain high and should outpace any possible changes in housing prices. Therefore, we expect housing affordability to continue improving in 2024, with declining rates speeding up the process in the second half of the year. Market activity is also expected to pick up more pronouncedly as potential buyers see interest rates decline.

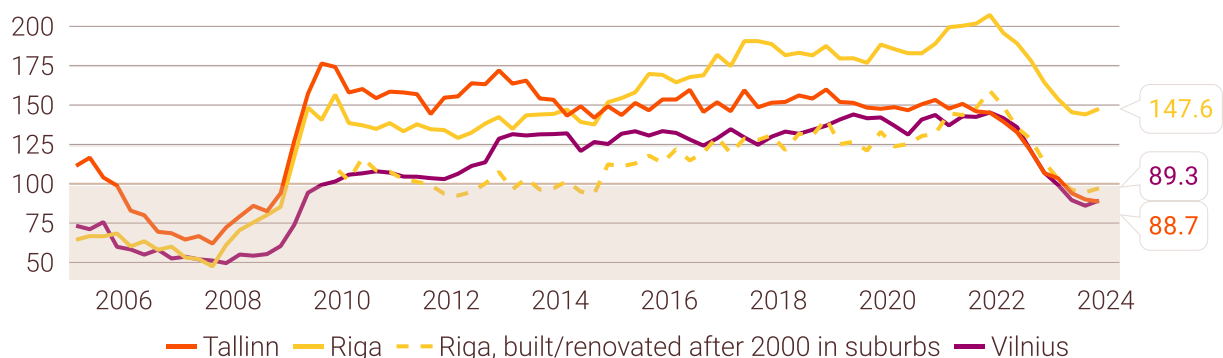
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## Baltic Housing Affordability Index



Sources: Swedbank Research & Macrobond

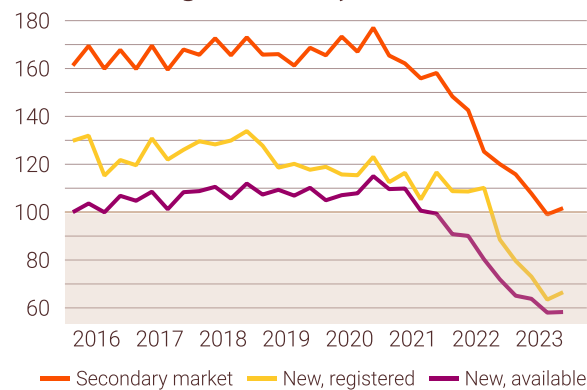
Example: A housing affordability index value of 89 means that the average net wage of a household is 11% lower than minimally required to afford an apartment of 55 m<sup>2</sup>.

## Tallinn – despite depressed confidence, revival is on the way

Although the housing affordability index fell in the final quarter last year, this was due to the registration of a higher number of new apartments in total transactions. The bottom of housing affordability was left behind in the third quarter, and the recovery is on the way. Demand is subdued, as affordability is poor and general household confidence remains weak. However, as the start of rate cuts gets closer, housing affordability will improve more markedly and is likely to bring some revival in market activity.

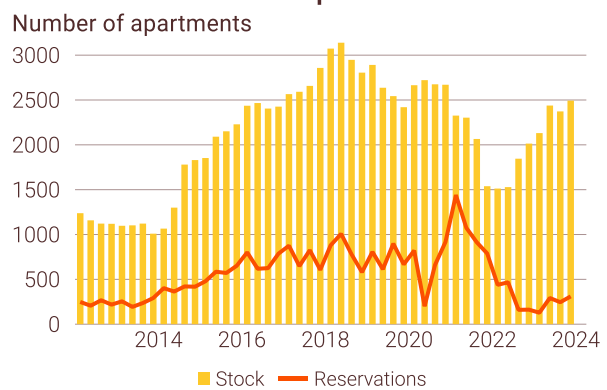
Secondary market apartments again became affordable at the end of the year. Housing affordability has risen with the improvement in the apartment price-to-wage ratio. Although market interest rates have been inching down from the October peak, the improvement has mainly been on the back of still-strong wage growth, while prices have proved resilient to lower levels of demand. In the last quarter, secondary market price growth was 2.5% over the year. According to preliminary data, activity in the secondary market was somewhat better in the first two months of this year compared with a year earlier.

**Tallinn housing affordability index**



Sources: Swedbank Research & Macrobond

**Stock and sales of new apartments in Tallinn**



Sources: Swedbank Research & Macrobond

Meanwhile, the affordability of new developments available for sale was roughly unchanged from the previous quarter, remaining out of reach for many. The average price growth of new apartments for sale slightly accelerated in the fourth quarter and was 7% higher than a year ago, likely due to more expensive apartments in this segment and a VAT tax increase beginning in 2024.

The stock of new apartments has normalised and is close to the levels last seen in 2019, before large supply-demand imbalances took place. Low affordability and weak household confidence are holding back demand, as reservations in the primary market continued below 2016-2019 average levels in the last quarter. However, the decline in the number of building permits since 2022 is signalling fewer new projects in the near future, as developers are avoiding the introduction of too much new supply.

Household confidence continued to deteriorate at the start of the year from already-low levels, as households are increasingly worried about job losses and their future financial situation due to the prolonged recession. We expect an uptick in unemployment to be more visible in Estonia than in the rest of the Baltics, but this is unlikely to rise more than 1-2 percentage points; employment will remain high.

This year, we will see an improvement in the housing affordability index; however, this will be more pronounced in the second half of the year, when the ECB will enter the phase of cutting interest rates. We expect wage growth to ease somewhat this year but still be over 7% and to outpace apartment price growth, contributing to an improvement of the price-to-wage ratio. Improving housing affordability, along with recovering confidence, should gradually increase activity this year. In addition, the decision of the Bank of Estonia to ease credit standards beginning in April might allow some households to make purchases previously unavailable.

## Riga – turning the corner

After two long years filled with a considerable amount of uncertainty and soaring prices, housing affordability finally ticked up in Riga. This was largely thanks to the sustained rapid increase in net wages in the fourth quarter, which offset the minor quarter-on-quarter rise in the average housing price and the rise in the interest rate for new housing loans. Despite the index's relatively modest change from the third quarter, it serves as a good harbinger of a more pronounced recovery coming this year.

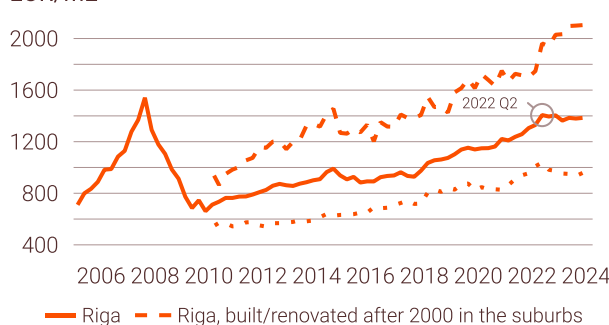
Even though housing affordability was no longer deteriorating, market activity remained subdued at the end of last year. The number of transactions was slightly lower than the levels seen in 2022, both for 2023 overall and for the fourth quarter year-on-year. The only category showing a year-on-year increase in the fourth quarter was that of Soviet-era apartments. At the same time, the number of reservations for new apartments was still approximately one-fourth to one-third lower than at the end of 2022. Real estate developers are expecting market activity to pick up when potential buyers see a steady decline in euro interbank offered rates (EURIBOR). However, given that nearly 60% of transactions in Riga's secondary market (and slightly over 20% in the primary) in 2023 were completed without a mortgage, it's clear that other factors, such as geopolitical risks and the overall state of the economy, play a major role. Lastly, the recent legislative changes will also dampen market activity this year. Since January, there has been a new levy on banks, which finances support to mortgage holders, effectively resulting in a 30% cut in the mortgage rate. Only those mortgages that were taken till the end of October 2023 qualify for this support; therefore, mortgage holders now have more incentive to hold on longer to their existing property.

The weighted-average apartment price was below 2022 levels for most of last year, including the final quarter. The key drag on the overall price level came from the Soviet-era apartment sector, which takes up the majority of Riga's residential real estate market, whereas prices in other market segments increased year-on-year in the fourth quarter. Compared with the third quarter, there was a general uptick in prices across all segments.

In the primary market, the stock of unsold apartments rose noticeably during 2023. Prices were still high – approximately one-fourth to one-third higher than the values at the end of 2022. The financial situation of real estate developers generally remains solid – there is no rush to sell “at-any-cost.” Furthermore, construction costs for residential apartments are still rising, albeit at a slower pace. Thus, notable price corrections are unlikely. Nevertheless, in some cases, apartment prices are being individually renegotiated or indirectly reduced by marketing campaigns.

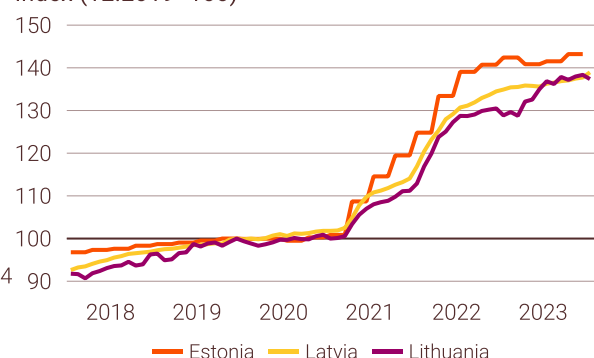
Riga's housing affordability will likely continue to increase in the upcoming quarters, but a more rapid pickup is expected in the second half of 2024, as interest rates decline. Until then, any changes to the average housing price should be offset by the still-solid net wage growth.

**Average apartment transaction price**  
EUR/m<sup>2</sup>



Sources: Swedbank Research & Macrobond

**Construction costs: residential buildings**  
Index (12.2019=100)



Sources: Swedbank Research & Macrobond

## Vilnius – Gradually tilting towards buyers' market

The housing affordability index bottomed out and then improved marginally at the end of the year. Interest rates on mortgages peaked in October, and housing prices continued to slow, while wage growth kept a fast pace -all contributing to slightly better housing affordability. Nonetheless, the decade-low affordability continued suppressing apartment sales, as buyers were waiting for better buying conditions.

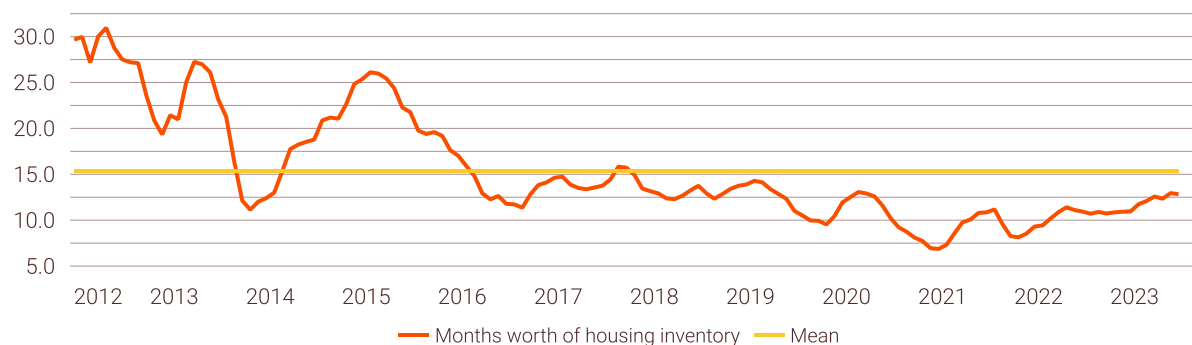
According to the official registry, annual price growth in Vilnius slowed to 6.9% at year's end, while the repeat house sales index showed an even lower 4.5% annual growth. Most developers point to unchanged or slightly lower prices than last year, even though online listing prices started climbing again. Overall, the changing market composition and various schemes to lure buyers are clouding the underlying price trends.

The number of finalised apartment sales rebounded somewhat in the fourth quarter, but was still close to a five-year low. The beginning of 2024 offered no good news, with activity 10-15% below last year's already-low level. In the primary market, although reservations have rebounded to around 200 per month, they are still just half of the 2019 level of sales in the primary market.

Low primary sales allowed the stock of unsold housing to rise in Vilnius. A post-pandemic surge of demand led to a big shortage of housing, but since the middle of 2022, the number of unsold apartments rose from 3,000 to nearly 5,000 – closer to normal levels. There is currently an inventory of around 12 months' worth of sales. If inventory continues to grow, there is an increased chance of broader discounts. Due to low affordability, a brief oversupply of apartments is possible. Yet, developers are actively trying to avoid oversupply - housing starts have halved compared with a year ago. While the market balance is slightly tilting towards a buyers' market, a significant correction of housing prices remains unlikely.

### Months to sell all current housing stock in Vilnius

months, 6m ma



Sources: Inreal, Swedbank Research & Macrobond

Wage growth will average around 8-10% and will outpace apartment price growth, leading to a slight increase in housing affordability over the next two quarters. A more significant improvement will arrive in the second half of the year when the ECB initiates a rate-cutting cycle. Market activity will likely start recovering only towards the end of the year.

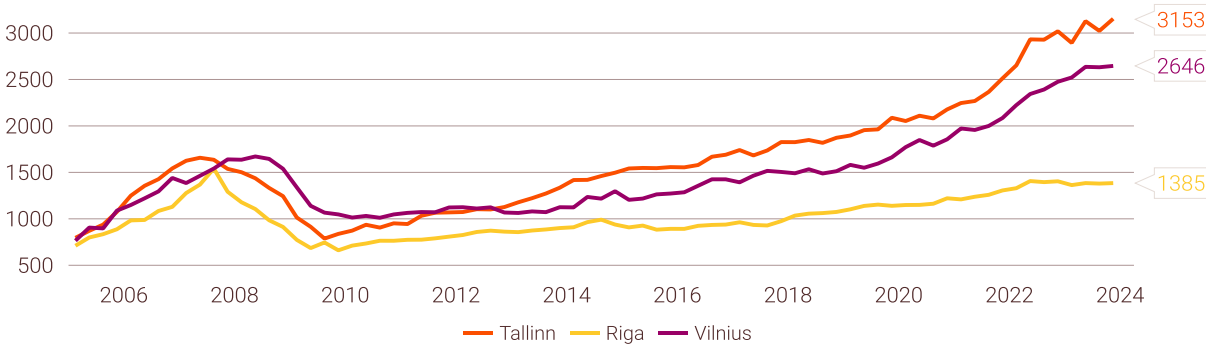
In the medium term, housing market fundamentals are looking solid. Significantly increased migration flows are boosting demand for housing. Events like the German troop deployment in Lithuania will also contribute to demand. Current migration trends warrant an increase in annual construction; otherwise, there might be a structural housing shortage in several years' time.

Appendix

	Tallinn, Estonia	Riga, Latvia	Riga, new-project and renovated apartments, Latvia	Vilnius, Lithuania
Average apartment transaction price, EUR/m2, y/y %	4.5	-1.4	3.7	6.9
Annual change in the average mortgage interest rate, basis points	196	196		175
Average monthly net wage, EUR, y/y %	8.6	10.4		8.8
Months to save for a down payment, months	33.5	19.7	29.9	33.1

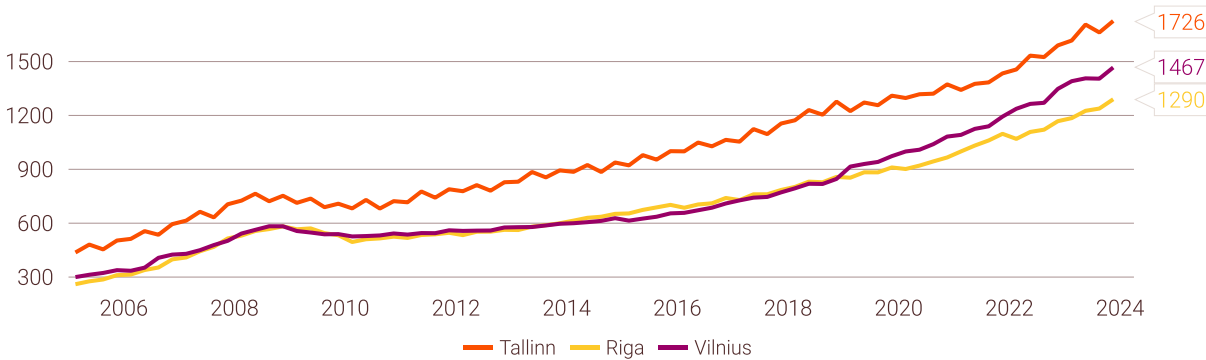
Sources: Swedbank Research and Macrobond

Average apartment price  
EUR/m2



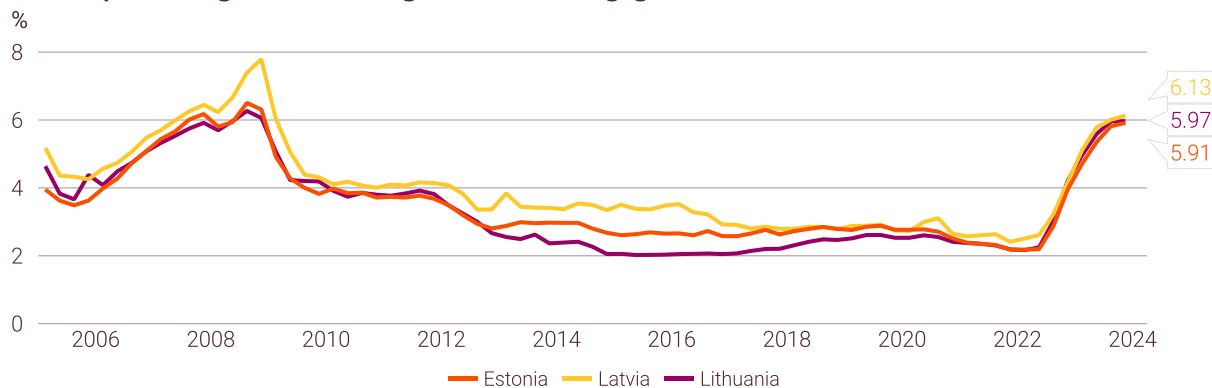
Sources: Swedbank Research & Macrobond

Average monthly net wage  
EUR



Sources: Swedbank Research & Macrobond

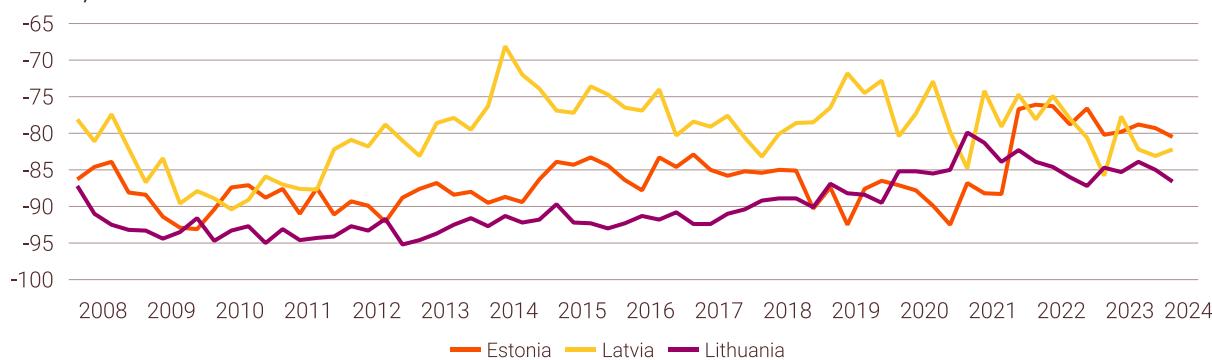
### Annual percentage rate of charge for new mortgages to households



Sources: Swedbank Research & Macrobond

### Consumer confidence to purchase or build a house

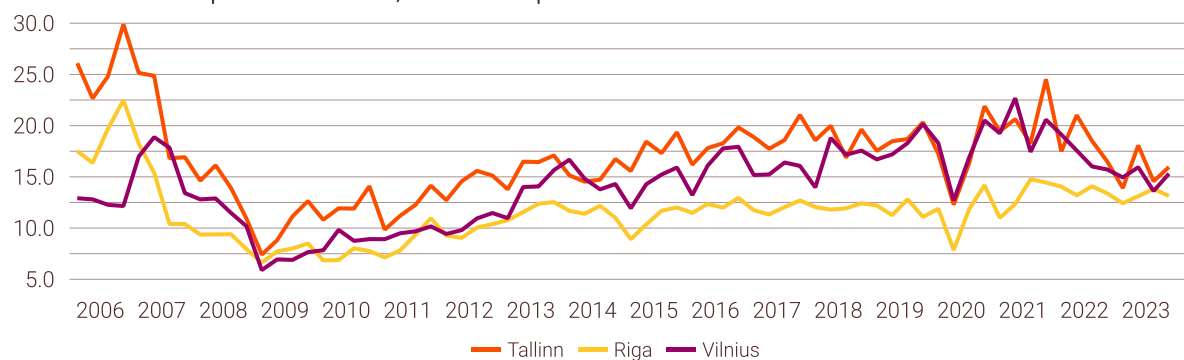
Baltics, over the next 12 months



Sources: Swedbank Research & Macrobond

### Transaction activity

Transaction count per 10K residents, residential apartments



Sources: Swedbank Research & Macrobond

# Baltic Housing Affordability Index: Methodology

## Objective

The Baltic housing affordability index (HAI) measures the degree to which households can afford buying an apartment with a mortgage loan in the Baltic capitals.

## Norm (the main assumption)

Household monthly mortgage payments do not exceed 30% of household income.

## Variables

- Average apartment price per m<sup>2</sup>: three-month average apartment transaction price per m<sup>2</sup> in Baltic capitals.
- Household income: 1.5 of average monthly net wages in Baltic capitals.
- Mortgage interest rate: three-month average annual percentage rate of charge (including interest rate and other related charges) for new housing loans to households, issued in euros, in the Baltics.

## Other assumptions

- Average apartment size: 55 m<sup>2</sup>.
- Down payment: 15% of total apartment price.
- Term: 30 years.
- Saving rate for down payment: 30% of household income.

## Calculation of HAI

The HAI shows actual household income in relation to the income that meets the norm. Thus, if the HAI equals 100, a household uses 30% of its income to service mortgage payments. If the HAI exceeds 100, the household has higher income than required to satisfy the norm. And if the HAI is below 100, the household does not have sufficient income to fulfil the norm.

$$\text{HAI} = \frac{\text{AverageINC}}{\text{NINC}} \times 100, \text{ where } \text{NINC} = \frac{\text{PMT}}{30\%}$$

where  
 AverageINC – household income,  
 NINC – household income that satisfies the norm,  
 PMT – monthly mortgage payment.

## HAI of apartments built/renovated after 2000 in the suburbs

The calculation of the HAI of apartments built/renovated after 2000 in the suburbs (i.e., outside the city centre) for Riga is intended to improve the comparability of affordability levels across the three capitals. This is because it considers types of apartments more commonly purchased in Tallinn and Vilnius.

All variables and assumptions, except for the average apartment transaction price, remain the same.

The new index and associated apartment price variable are represented by a yellow dashed line in the graphs of the report.

## Limitations

The HAI provides an indication of the average household situation, not that of a particular household. Household income and mortgage interest rates faced by a particular household may differ from those presented in the report. The HAI accounts for mortgage costs but excludes taxes and subsidies, including property tax and interest deductions. It also does not consider other household expenses that could affect the household's ability to service mortgage payments, such as rent, lifestyle, or existing liabilities. The HAI does not provide any direct guidance for business decisions, including lending and interest rate decisions.

The average apartment price per m<sup>2</sup> reflects past transactions and does not necessarily indicate the potential affordability or price of apartments in the future. Differences in apartment segment structure and the physical condition of newly built apartments at the time of purchase might affect the comparability of the average apartment price per m<sup>2</sup> across the Baltic capitals.

The HAI is of an informative nature and reflects macroeconomic developments, rather than banks' decisions and lending policies or the potential behaviour of individual households.

## Change of data

A data revision was made in the fourth quarter of 2019 for Riga. The history of wages, prices, and transaction counts was changed in 2011.

## Frequency

Quarterly.

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