Prospects

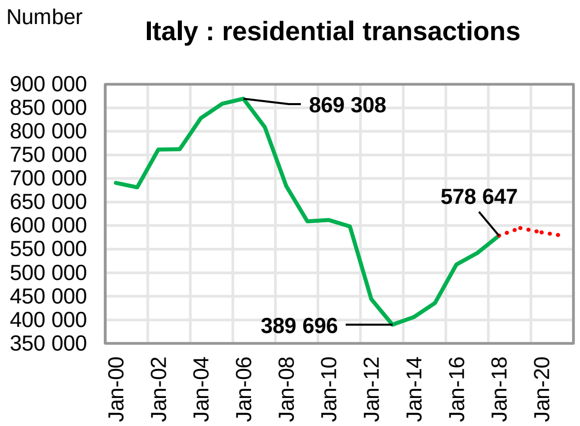
Aperiodic – n°19/186 – November 5, 2019

ITALY – Residential real estate

- **Residential real estate transactions rose sharply over the first half of the year,** confirming the strength of the market, which is being underpinned by households' purchasing power.
- However, **this rise in transactions has not pulled prices along with it.** In the first half of 2019, house prices dropped by 0.2% year-on-year.
- **There is a substantial risk that the market recovery has come too early to generate a genuine real estate cycle. Although the financial cycle may last a while longer, underpinned by accommodative monetary policy, the real economy is approaching a turning point.**
- **In the absence of new factors, the market is expected to ease back. According to Nomisma, prices are expected to drop by 0.4% on average in 2019, before rebounding slightly in 2020 (+0.4%). Transactions are expected to increase by 2.8% in real terms in 2019 before declining by 1.5% in 2020.**
- The **average rate on a newly granted mortgage was low at 1.67% as of the end of August 2019**, which leads us to believe that this could be a factor to support demand. Although this factor is clearly mentioned in the latest Banking Lending Surveys *(BLS)*, deteriorating household confidence seems to have impacted demand.
- After **reaching record levels in 2016, new residential mortgage loan origination continued to decline in the first half of 2019.**
- Outstanding **residential mortgage loans are increasing at a fairly steady pace of around 1.5% per year**, which is a far cry from the levels of 2010. **For individual customers only, the increase was 2.9% year-on-year as of the end of June 2019.**
- In the wake of the decline in loans that are being renegotiated or bought out as a percentage of origination, the current low rates may further increase competition and give customers another opportunity to renegotiate or have their loan bought out.

Residential real estate market

Residential transactions increased by 4% year-on-year in Italy in the second quarter of 2019, which represents a slowdown from the first quarter (+8.8%). The number of transactions in the first half of the year totalled 298,143 units, an increase of 6.1% compared to the same period last year. Although the market has been robust since 2014, it is still a long way from its pre-crisis levels. After a total of 869,308 residential transactions in 2006, this figure fell to just 389,696 in 2013, an almost 55% drop in sales volumes in seven years.



Source : Nomisma, Crédit Agricole SA

Since then, transactions recovered to 578,647 in 2018, reaching only two-thirds of their pre-crisis level.

However, this rise in transactions has not pulled prices along with it. In the first half of 2019, house

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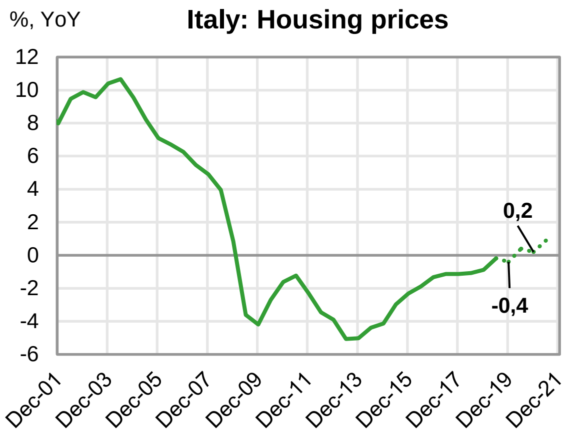
prices dropped by 0.2% year-on-year (after -0.9% in H2 2018). This drop is the continuation of a long period of price decline that began in 2009. After a period of fast growth in real estate prices between 2000 and 2008 (+82%, an annual average of 7%), the 2008 crisis triggered a sharp fall that lasted until 2013 (prices decreased 17% between 2008 and 2013). Since then, the price decline has been less steep. Over the period 2008-2018, prices dropped 25%.

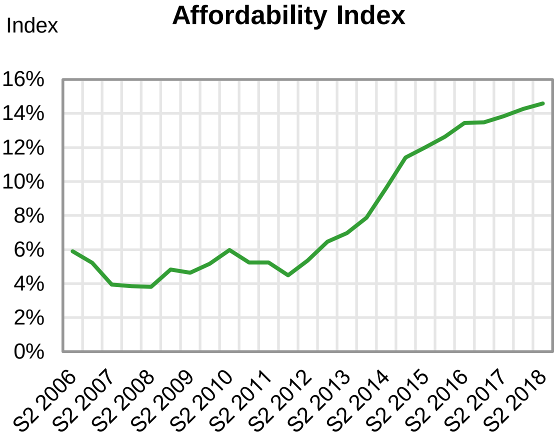
For transactions to recover more quickly than valuations means that there is a large amount of excess supply and too little demand to snap it up.



Source : Nomisma, Crédit Agricole SA

In 2019, the positive trend in the labour market, combined with very low inflation, helped raise purchasing power significantly in the first half. But although it has risen since 2014, household purchasing power has still not regained its pre-crisis level. The erosion in the savings ratio that characterised the post-crisis years resulted in a decline in the investment rate, which did not end until 2017. Since then, the balance between consumption and housing investment has shifted in favour of the latter. The crisis made Italian households poorer. Their net wealth decreased between 2014 and 2016, primarily due to lost real estate asset value since 2012. Beginning in 2017, the increase in their financial wealth has offset both the decline in real estate wealth and the rise of debt. However, debt remains down as a percentage of disposable income (61%). The goal of rebuilding real estate wealth has become a priority again, and the recent rise in the savings ratio confirms it.

Households' ability to afford a residential investment is only increasing. The decline in the price of housing relative to disposable income has reduced the number of years of mortgage payments needed to buy a home. The affordability index[1], which besides these two factors also takes into account interest rate levels, continues to rise, and as of the end of 2018 was 14.6%, or 4.9 points more than its previous peak in 2004.



Source : ABI, Crédit Agricole S.A.

Despite these more positive changes, household investment dropped 1.2% in Q2 2019 after very strong growth in Q1 (+3.4%, a quarterly change that had not been observed since 2010). Household surveys conducted by the National Institute of Statistics (ISTAT) regarding intentions to purchase a home show few signs of improvement since late 2017. Households' perception of their financial situation, which has worsened since late 2018, improved during the summer, while opinions about the country's economic situation have been getting worse since spring 2018. The decline in household confidence and purchase intentions (in the third quarter) is in line with the most recent survey on the residential market conducted by the Bank of Italy, which signals more unfavourable expectations about how the market will develop. Demand conditions during Q2, on the other hand, are indicated as having improved, with an increase in the share of agencies that carried out at least one transaction and faster sales turnaround. Note that a significant gap between price offers and asking price is the main reason for ending brokerage agreements. The price adjustments therefore do not seem to be over, although agencies are expecting prices to stabilise. The Italian real estate market is characterised by a very high ownership rate (70%, per Nomisma), which makes it easier to sit and wait during an economic slowdown or uncertain period (being a homeowner, and therefore benefiting from a more solid and stable personal housing situation, makes it possible to delay investment decisions).

[1] The affordability index, produced by the Italian Banking Association (ABI) using the method of the National Association of Realtors (NAR) in the United States, employs the concept of financial cost combined with the repayment of a loan (based on its term and loan-to-value) needed to cover the purchase cost. The idea is that the home is affordable if the financial cost plus the payment of principal does not exceed 30% of gross disposable income.

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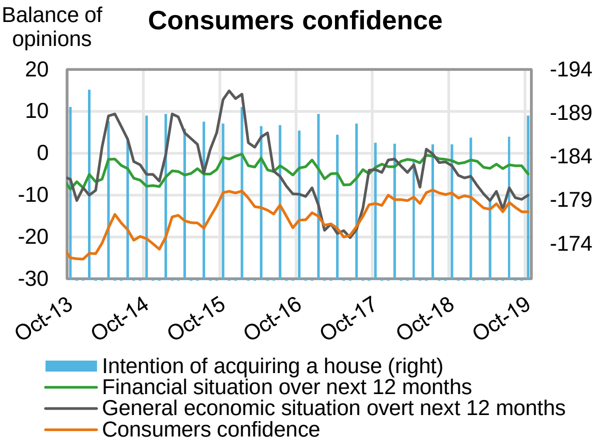
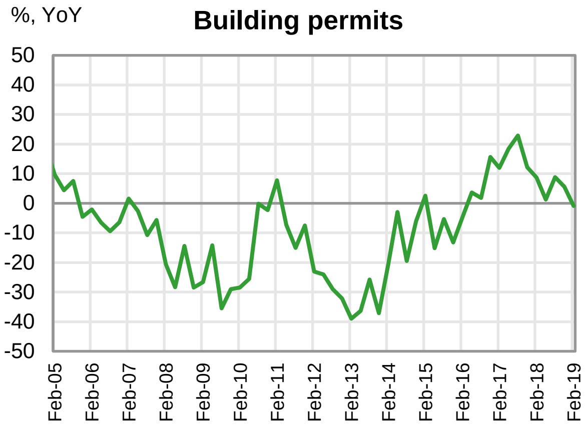
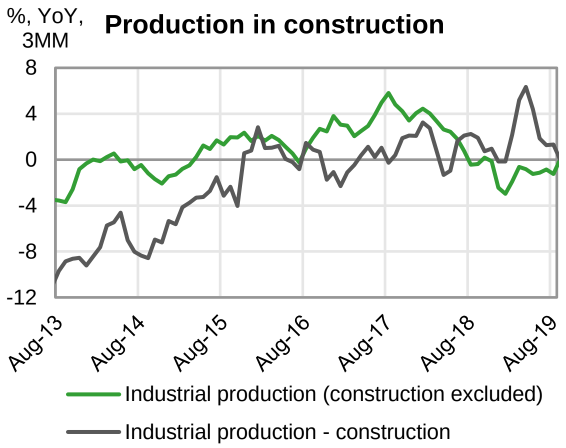


Source : ESI, Crédit Agricole S.A.



Source : Istat, Crédit Agricole S.A.

When it comes to supply, production in construction is at historically very low levels, far from where it was pre-crisis. The trend over the current year is stable: the production in construction index in July is at the same level it was in January. Average construction growth between 2016 (its lowest point since the crisis) and 2019 was 1.2% per year. This growth is still very low compared to the 42% drop observed between 2007 and 2015. The number of building permits, which was slightly up from 2017, has dipped again since late 2018. It is still only one-fifth of where it was in 2004, its pre-crisis peak.



Source : Istat, Crédit Agricole S.A.

Construction purchasing manager surveys show a drop in confidence since summer 2018; however, in the month of September 2019, confidence grew to just above the threshold of 50 (which indicates an expansion of activity). Expectations of future activity, hiring, subcontractor availability, and comercial activity have also improved. As for the European Commission's surveys, they are even more encouraging: Construction business confidence quickly recovered after its 2018 fall, and has now reached levels close to 2007. Expectations about future orders, employment, and prices have also improved.

The residential market is still very far from pre-crisis levels, and the new normality will be a much less dynamic market than the one from the last cycle. Just as the Italian real estate market had nearly succeeded at reversing the price trend, uncertainties about the economy have made prospects for stabilisation hazier. All indicators seem to have slowed somewhat since mid-2018. However, advanced indicators improved in recent months, and transactions in 2019 have proven very active. Production in construction is still seeing very small growth, but it has picked up since 2015. On the other hand, demand does not yet seem to be powerful enough to reinvigorate prices.

Potential market and structural supports

With a very high ownership rate (in 2019, 70% of families were homeowners), the potential for expansion is limited (especially in a country where the population's natural growth rate has been declining for four years). However, it should be noted that households in Italy are made up of two or three different generations living in the same home, which may cause potential demand to be misread. According to Nomisma's household survey, the percentage of families that intend to buy a home in the next twelve months dropped from 10.2% in 2018 to 9.6% in 2019, due to the wait-and-see attitude triggered by the economic slowdown and declining consumer confidence. This represents a potential market of 2.4 million families. 75% of purchase demand focuses on buying a first home or replacing the current home, which is more solid and less volatile than investment-oriented demand (which accounts for just 14% of purchase demand).

Rental demand has proven to be another supporting factor, because it encourages buying for investment, although this demand is more unstable. Since 2007, we have seen a rise in the share of families that rent, peaking in 2013, owing to the worsening economic situation of household and the

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tougher conditions that banks have imposed for real estate lending. Nomisma's household survey is now reporting that demand for home purchases and rentals have reached parity, indicating heightened interest in ownership. However, it must be noted that among aspiring tenants in 2019, 60% say that they don't have the economic resources to buy a home, 18% say that their situation is temporary (they plan to buy in the future), and 15% believe that ownership is undesirable due to its costs (young people, who prefer flexibility and mobility, may form the core of this cohort, which accounted for just 8% in 2018). The vast majority of aspiring tenants are actually potential homebuyers waiting for financial conditions to improve, which strengthens the income-related restrictions mentioned above.

Finally, Italian housing inventory remains old (50% of construction is from before the 1970s), which constitutes great potential for investment on housing renovations. Renovation investments recovered in 2018. €16.8 billion were invested in energy optimisation over the past five years to benefit from tax abatements under Ecobonus programmes[2]. Investment volumes are high, but are still far from a process that would bring about widespread efficiency restructuring and energy adaptation of the Italian housing inventory.

Forecasts

The Italian residential market accounted for 84% of total transactions in 2018, 15% of which were for new housing (still far from 25% as seen in 2005-2006), and 18% of which were purchases for full renovations (which increases the supply of housing in optimal condition). We have identified a few facts that reveal the potential of this market. However, the economic backdrop is less encouraging. There are numerous risks: weak economic growth, lack of inflation and property valuation, household confidence, and depressed businesses generating a wait-and-see attitude.

There is a substantial risk that the market recovery has come too early to generate a genuine real estate cycle. Although the financial cycle may last a while longer, underpinned by accommodative monetary policy, the real economy is approaching a turning point. Absent any new evidence, the market is expected to decline: according to Nomisma, prices are expected to fall 0.4% on average in 2019, then slightly rebound in 2020 (+0.4% on average). Transactions are expected to increase by 2.8% in real terms in 2019 before declining by -1.5% in 2020.

[2] Tax break for people who install energy improvements: adding solar panels, making renovations to eliminate heat waste, installing systems to control heating and lighting, etc.

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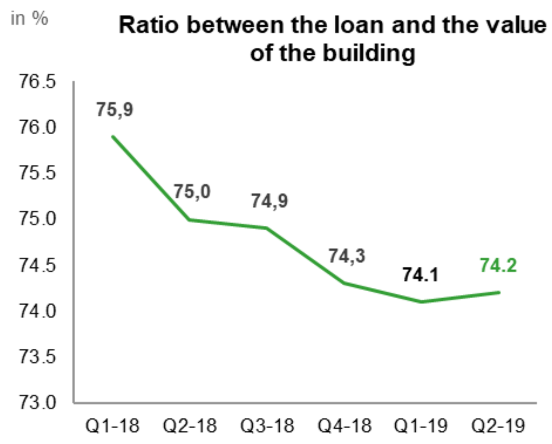
Access to real estate lending in Italy

As mentioned earlier, Italy is a country of homeowners (over 70%), with multiple generations under the same roof, which could explain why households take out home loans relatively rarely. Italian households, however, remain a preferred target for banks making home loans, due to several factors: **the low debt ratio** compared to other European countries (61% of gross disposable income as of late 2017, compared to 93% in France and 95% in the eurozone) and **lower risk than for non-financial corporations** (NFCs).

Lending criteria similar to France

Real estate loan access conditions are fairly similar to those found in France, because the value of the loan generally may not exceed 80% of the property's worth. According to the latest survey by the Bank of Italy[3], this ratio was **74.4% in Q2 2019**. The maximum monthly mortgage payment accepted by banks is about one-third of household income. Naturally, exceptions may be made to these criteria depending on the collateral provided. Furthermore, quarterly surveys from the Bank of Italy show that **80% of real estate purchases involve a loan.**



Support for first-time homebuyers

In a country where the population is ageing and youth unemployment still remains very high (28.4% for ages 15-24 and 15% for ages 25-35 in Q2-2019), support measures for first-time homebuyers are essential.

In 2014, the stability law had introduced a **guarantee fund for loans to purchase a first home** (*Fondo garanzia per i mutui per la prima casa*) in order to facilitate household access to credit and assist in home renovations and energy efficiency improvements. After being completely used up, **it was given an additional €100m, as part of the Growth Decree (law decree no. 34 of 30 April 2019),** published in the official journal on 30 April 2019, which is expected to expand its reach. Managed by Consap (under the oversight of the Treasury), it is accessible to about 180 banking institutions in Italy (more than one-third of the country's banks). The guarantee covers 50% of the value of the loan taken out, up to a limit of €250,000. No income conditions are applied, but "luxury" properties are excluded. It is reserved for young couples (at least one of whom is under 35 years old), single-parent households with a minor child, and young people under 35 in unstable employment.

Another support measure is the one which allows first-time homebuyers to deduct from their income tax (*Imposta sul reddito*, IRPEF) a share of the interest paid to buy their primary residence using a mortgage. The previous government had considered ending it in order to save money to fund the citizens' income and enact a flat tax, but this ended up not happening. Under certain conditions, the law allows 19% of interest to be deducted for a mortgage to buy a primary home, up to €4000. Real estate brokerage fees are also subject to the same deduction, up to a maximum of €1000.

An economic environment that hampers lending

Although it is difficult to evaluate the impact of real estate support measures, they nonetheless reflect the concern of successive governments for making ownership more affordable.

Lending continues to climb

Beginning in 2016, following a downturn from November 2012 to May 2015, **total home loans to households regularly accelerated until 2018, then slowed down. They are now increasing at around 1.5% per year.** At the same time, this rate of growth in home loans is much smaller than that of consumer credit, despite the support measures for remedying the structural weaknesses mentioned earlier.

[3] Sondaggio congiunturale sul mercato delle abitazioni in Italia, Banca d'Italia, 9 August 2019.

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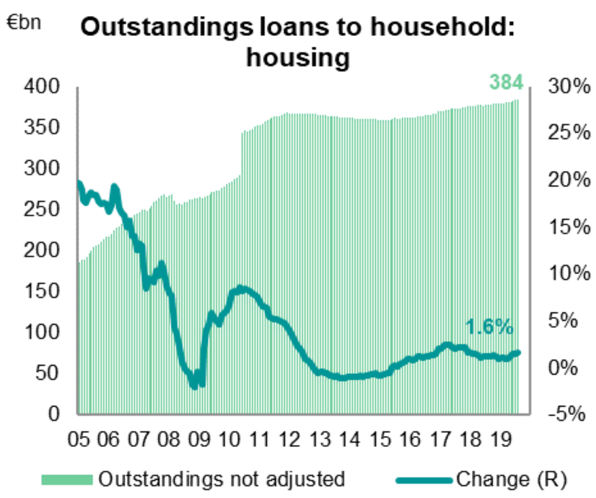
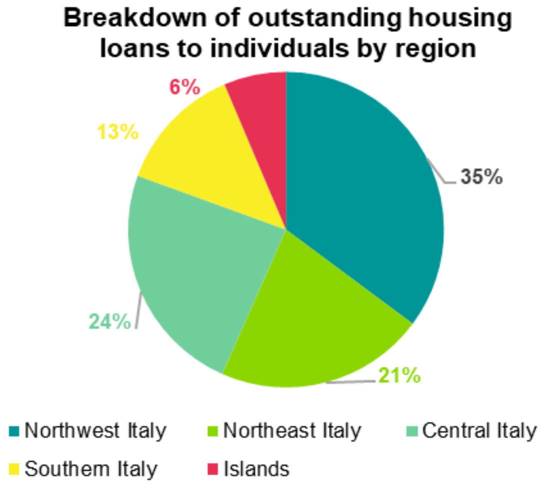


Sources: Bank of Italy, Crédit Agricole S.A. / ECO

Looking solely **at individual customers** (excluding individual entrepreneurs and non-profits that serve households), **home lending is growing by about 2.9% year-on-year.** compared to the 1.5% stated earlier for households. North-western Italy, the site of 35% of home loans in Italy, is slightly below that level, with 2.4% growth in the individual market.

The **non-refinanced loan stock grew 3.8% year-on-year**, and 0.8% Q2/Q1.



Sources: Bank of Italy, Crédit Agricole S.A. / ECO

Change in outstanding housing loans to customer households by region

Jun-19	**QoQ change by type of contract**			**YoY change by type of contract**		
In %	**Total**	Non renegotiated	Renegotiated	Total	Non renegotiated	Renegotiated
ITALY	**0.8%**	**0.8%**	**-0.1%**	**2.9%**	**3.8%**	**-1.5%**
Northwest Italy	0.4%	0.7%	-1.0%	2.4%	4.0%	-4.5%
Northeast Italy	0.9%	1.1%	-0.3%	3.1%	4.1%	-2.4%
Central Italy	1.0%	1.0%	0.9%	3.0%	3.1%	2.2%
Southern Italy	1.0%	1.2%	0.1%	3.6%	4.7%	-1.5%
Islands	1.0%	1.0%	0.0%	3.5%	3.1%	3.7%

Northwest: Piedmont, Valle d'Aosta, Liguria and Lombardy. Northeast: Trentino Alto Adige, Veneto, Friuli Veneto g and Emilia Romagna. Centre: Tuscany, Marche, Umbria and Lazio. South: Abruzzo, Campania, Puglia, Basilicata and Calabria. Islands: Sicily and Sardinia.

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Origination drops in early 2019

The origination of real estate loans seems to have started to decline in the first half of 2019, which could be because of the wait-and-see attitude of households in a less favourable environment. **The decline in new loan origination, excluding refinancing, was 9.1% year-on-year as of Q2 2019.**

2016 saw record origination of €79bn, divided between pure originations and refinancing. Although origination has declined since then, its level is still well above that of 2008-2010. You would have to go back to 2006 and 2007 to see 2018's level.

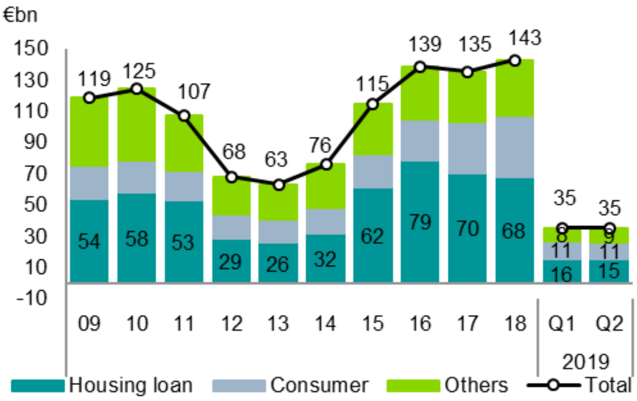
At the same time, the recent fragility of the Italian economy suggests that banking institutions have all adopted a cautious attitude toward approving loans.

This is despite the fact that NFCs represent the category most affected by defaults, with 9.1% of gross bad loans as of late June 2019, after peaking at 18.8% in April 2017. For households, 4.4% of loans were gross bad loans over the same period, falling to 3.7% when individual entrepreneurs are excluded.

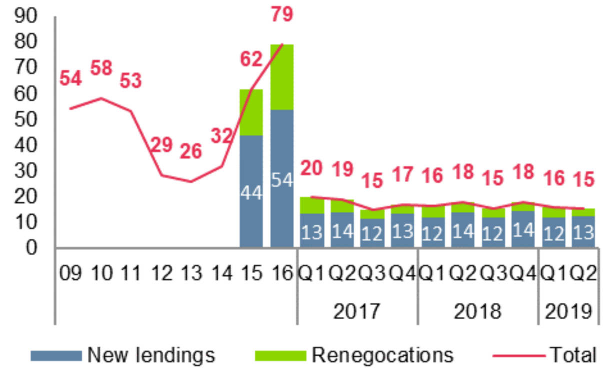
This is what is shown by the results of the latest BLS survey (July 2019): Since the fourth quarter of 2018, we have witnessed a **tightening of home loan approval criteria, related to the perception of risk.** As for demand, the favourable growth has been supported by **low interest rates and the positive outlook for the housing market**.

No major changes seem to be in store for the months ahead, whether in terms of approvals (toughening) or demand (expanding).

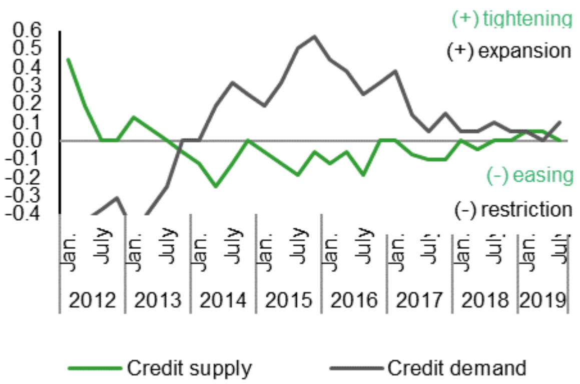
New loan production to households



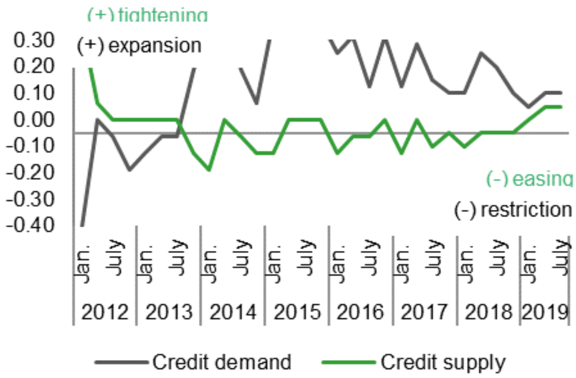
Housing loan production to Italian households



BLS - Supply conditions and trends in credit demand (last 3 months)



BLS - Supply conditions and trends in credit demand (next 3 months)



Sources: Bank of Italy, Crédit Agricole S.A./ECO

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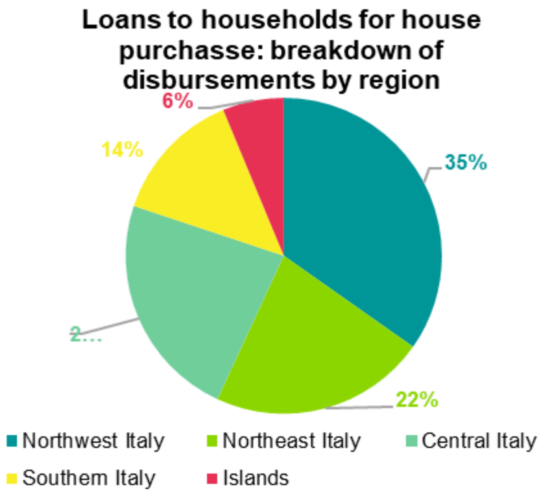

Long-term loans to consumer households for house purchasse: quarterly disbursements

Jun-19		Type of contrat		
In €Bn	**Total**	New contracts	Subrogations	Substitutions
ITALY	11.8	10.76	0.84	0.16
Northwest Italy	4.1	3.77	0.29	0.03
Northeast Italy	2.6	2.42	0.16	0.02
Central Italy	2.7	2.47	0.22	0.04
Southern Italy	1.6	1.43	0.13	0.04
Islands	0.7	0.67	0.01	0.00

Northwest: Piedmont, Valle d'Aosta, Liguria and Lombardy. Northeast: Trentino Alto Adige, Veneto, Friuli Veneto g and Emilia Romagna. Centre: Tuscany, Marche, Umbria and Lazio. South: Abruzzo, Campania, Puglia, Basilicata and Calabria. Islands: Sicily and Sardinia.

Sources: Bank of Italy, Crédit Agricole S.A./ECO
Banks and CDP perimeter.

Focusing on individual customers, home loan originations have declined by 14.4% year-on-year, compared to 15.6% for households in Q2 2019. The year-on-year decline in originations, excluding refinancing, is even stronger for individuals than for households, because it has reached -11% year-on-year (compared to 9.1%).

It is no surprise that with 57%, the northern regions of Italy are the ones where loan origination is most concentrated. Nonetheless, Southern Italy is showing a good trend, with a 9.8% increase in loan originations over the quarter.

Finally, refinancing declined heavily in all regions, both year-on-year and quarter-on-quarter. ■

Change in long-term loans to consumer households for house purchasse: quarterly disbursements

Jun-19	QoQ change by type of contract				YoY change by type of contract			
In %	**Total**	New contracts	Subrogations	Substitutions	Total	New contracts	Subrogations	Substitutions
ITALY	4.8%	7.8%	-18.7%	-23.2%	-14.4%	-11.0%	-40.5%	-33.0%
Northwest Italy	4.8%	7.4%	-17.7%	-27.6%	-14.0%	-10.7%	-41.3%	-31.8%
Northeast Italy	6.0%	7.6%	-11.0%	-8.6%	-12.9%	-10.5%	-37.0%	-17.3%
Central Italy	3.4%	7.7%	-25.9%	-23.2%	-17.5%	-13.9%	-41.8%	-34.3%
Southern Italy	4.8%	8.5%	-16.2%	-26.4%	-14.5%	-9.3%	-43.9%	-38.0%
Islands	6.0%	9.8%	-27.8%	-11.3%	-9.1%	-6.0%	-31.0%	-34.9%

Northwest: Piedmont, Valle d'Aosta, Liguria and Lombardy. Northeast: Trentino Alto Adige, Veneto, Friuli Veneto g and Emilia Romagna. Centre: Tuscany, Marche, Umbria and Lazio. South: Abruzzo, Campania, Puglia, Basilicata and Calabria. Islands: Sicily and Sardinia.

Sources: Bank of Italy, Crédit Agricole S.A./ECO
Banks and CDP perimeter.

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Mortgage rates hit a new low

The liquidity of the Italian banking system, as well as the TLTRO programmes, have helped contain the cost of financing, despite a long-standing BTP-Bund spread that has remained relatively high in recent months. The recent decline in the spread following the arrival of the new Conte government to power, as with the ECB's latest announcements, imply that rates are not expected to rise, giving households the chance to benefit.

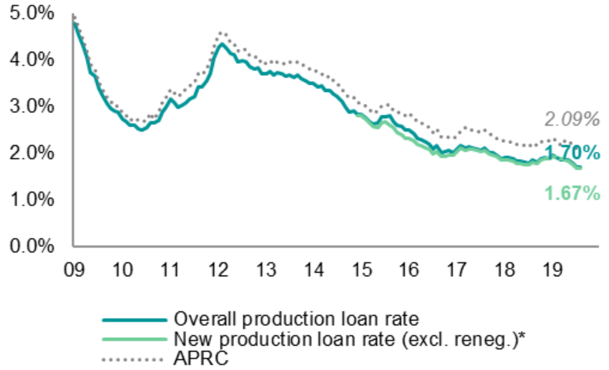
After going through an upward trend in 2018, primarily due to increased financing costs for banking institutions, real estate lending interest rates have dropped to a low of 1.67% for new loans in late August 2019 (compared to 1.98% for existing loans), far below the levels reached in 2012 at the peak of the crisis. Starting in 2015, Italian banks have preferred fixed-rate mortgages as rates have begun to decline. The share of fixed-rate loans accounted for 65% of origination in late August 2019, compared to 20% in 2014[4].

Towards a refinancing movement?

If both fixed-rate and variable-rate loans continue to see rates drop, this could lead to a new wave of refinancing. Both the Italian media and online brokers are touting the benefits of doing so, although the gap only allows customers to save 50 to 100 basis points.

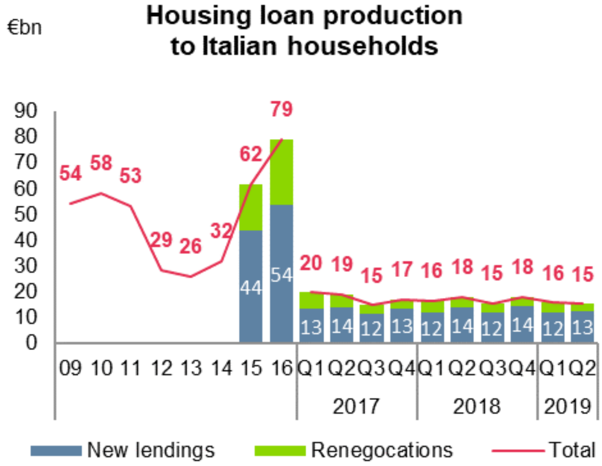
Although home loan origination recovered strongly in 2016, driven by refinancing and loan repurchases, the loss of momentum over the past six months implies that interest rates might not be enough for the trend to pick back up.

Production: monthly housing loan rates to Italian households



Interest rate on the housing credit stock by region *(sample of banks**)*		
Jun-19	**Rate**	
	variable	fixed
Italy	**1,63%**	**2.24%**
Northwest Italy	1.53%	2.17%
Northeast Italy	1.63%	2.17%
Central Italy	1.67%	2.29%
Southern Italy	1.76%	2.30%
Islands	1.81%	2.45%

Housing loan production to Italian households



*Data available from Dec. 2014

**The Bank of Italy publishes data that cover a wide range of sample of banks that is not known.

Sources: Bank of Italy, Crédit Agricole S.A./ECO

[4] Rate fixation period: Up to 1 year for data published by the Bank of Italy. Rates published by Nomisma differ slightly. Fixed-rate loans account for 72.6% of all loans granted.

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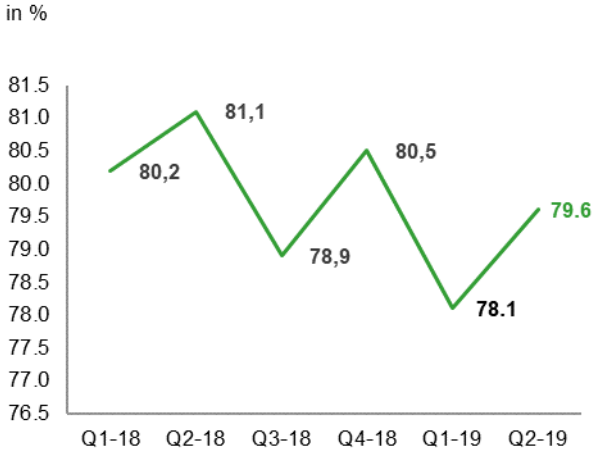
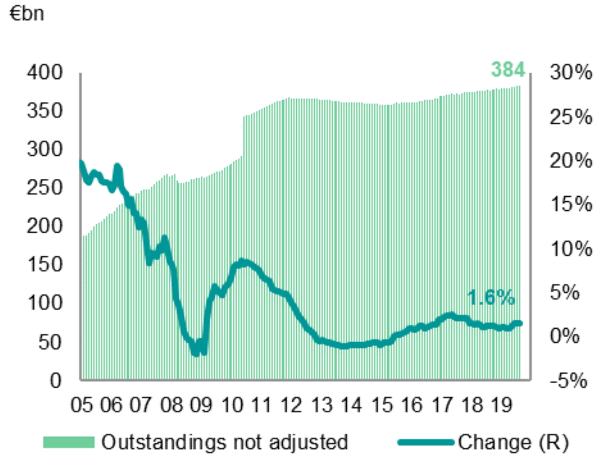
Home loans: outstandings

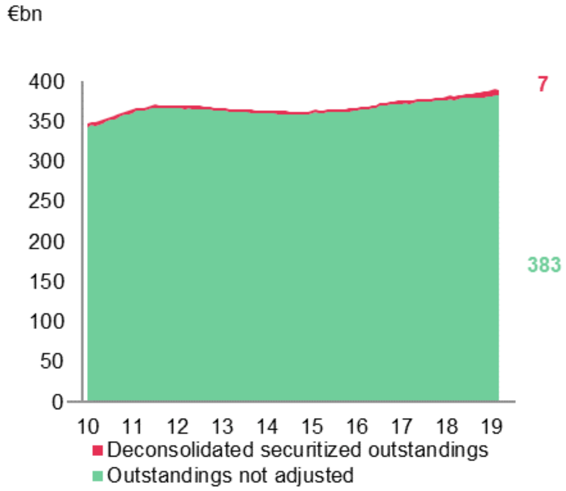
Proportion of real estate purchases financed by loan



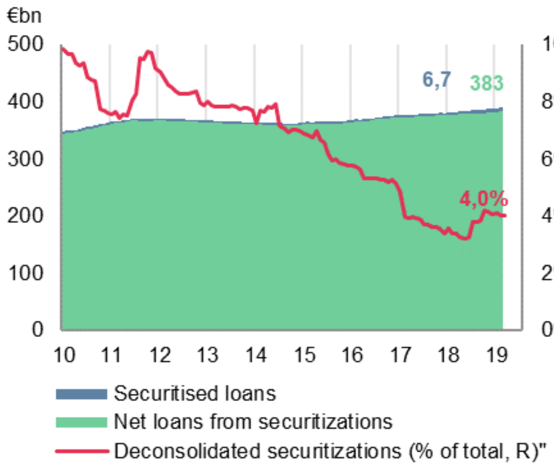
Outstandings loans to household: housing
(until August 2019)



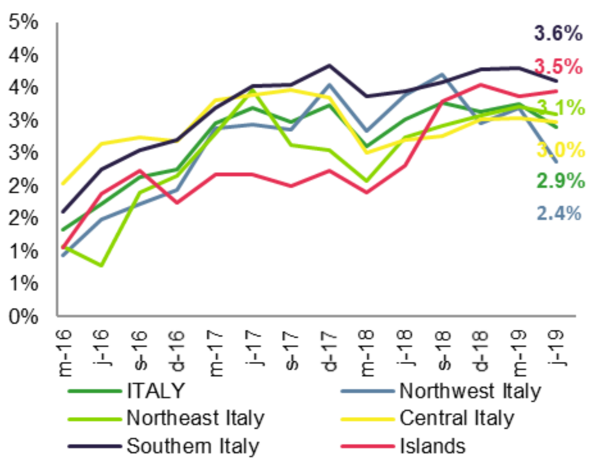
Outstandings loans to household: housing
(until August 2019)



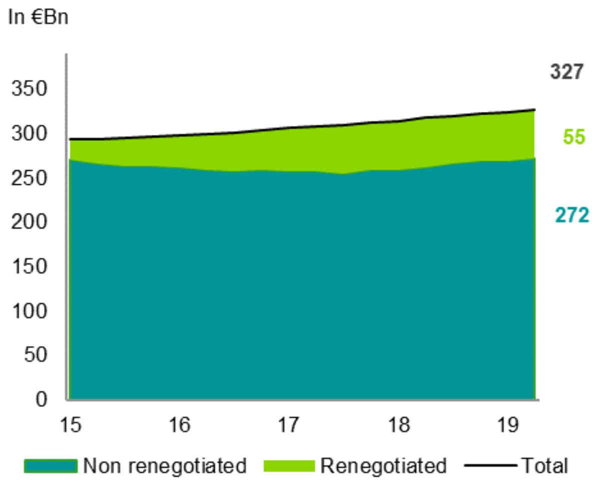
Home loans: securization
(until August 2019)



Annual change in outstanding loans to individual by region
(until June 2019)



Households - Breakdown of outstanding housing loans
(until June 2019)



Sources: Bank of Italy, Crédit Agricole S.A./ECO

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Home loans: outstandings

Twelve-month percentage change in loans by customer region and sector

Jun-19	by customer			
in %	Total resident sectors (excluded MFI)	Consumer households	Non-financial companies	o/w Small firms
ITALY	0.4	3.1	-0.7	-2.7
Northwest Italy	-0.7	3.1	-1.3	-3.3
Piedmont	1.3	2.9	-0.1	-2.6
Valle d'Aosta	-1.1	3.4	-5.6	-4.3
Lombardy	-1	3.1	-1.3	-3.5
Liguria	-3.4	3	-4.8	-3.5
Northeast Italie	0.1	3.2	-1	-3.6
Trentino-Alto Adige	0	0	0	0
Veneto	-0.7	3.1	-2	-4.2
Friuli-Venezia Giulia	2.8	3.5	3.1	-4.9
Emilia Romagna	0.1	3	-0.9	-3.6
Central Italy	1.6	3	0.6	-2.6
Toscany	0.3	3.5	-1.6	-3.3
Umbria	-1.3	2.7	-3.1	-3.9
Marche	-0.8	1.3	-2.1	-3.8
Lazio	2.4	3.1	3.3	-0.4
Southern Italy	0.9	3.4	-0.9	-1
Abruzzo	0.5	2.5	-0.3	-3.2
Molise	-1.4	1.8	-2	-1.3
Campania	1.2	4.1	-1.2	-0.6
Apulia	0.9	3.6	-0.6	-1
Basilicata	0.7	3.4	0.8	-0.7
Calabria	0.4	2.1	-1.9	-0.5
Islands	0.6	3.1	-0.6	-0.5
Sicily	0.2	3	-0.8	-1.5
Sardegna	1.6	4	-1	-0.5

Fixed (or not) securitisations and other effects: ie deconsolidated securitized loans are reintegrated into outstanding amounts; the 12-month rate of change, given by the Bank of Italy, is calculated from the monthly flows

Sources: Bank of Italy, Crédit Agricole S.A./ECO

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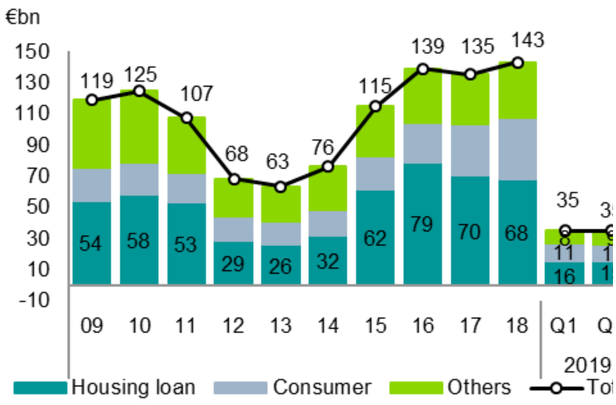
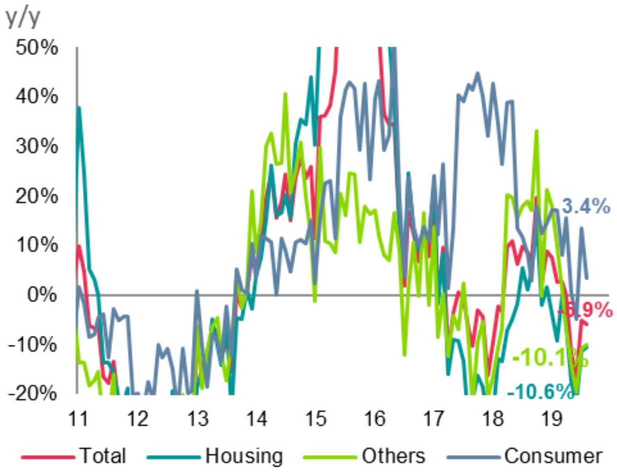
Home loans: production

New loan production to households

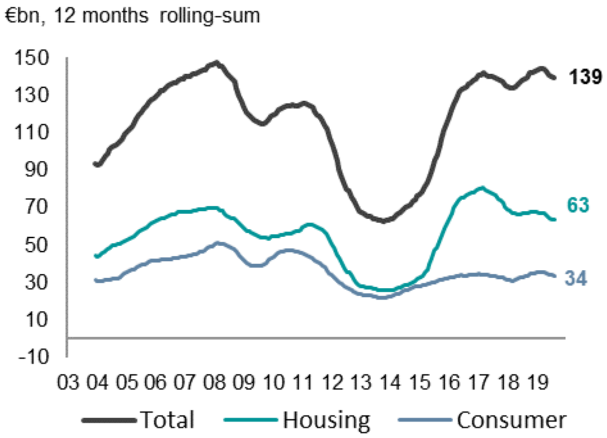


New loan production to households
(until August 2019)

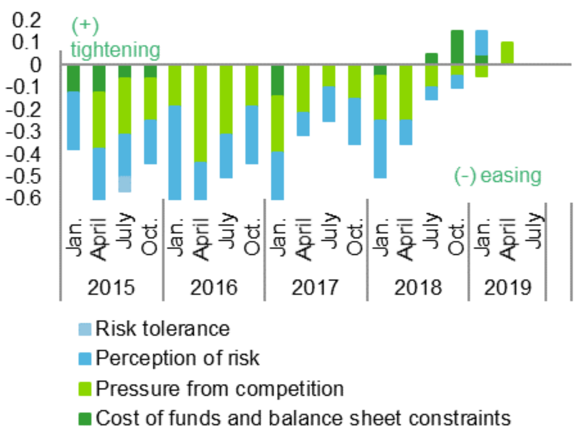


Production of housing loans to households: rate changes *(until August 2019)*

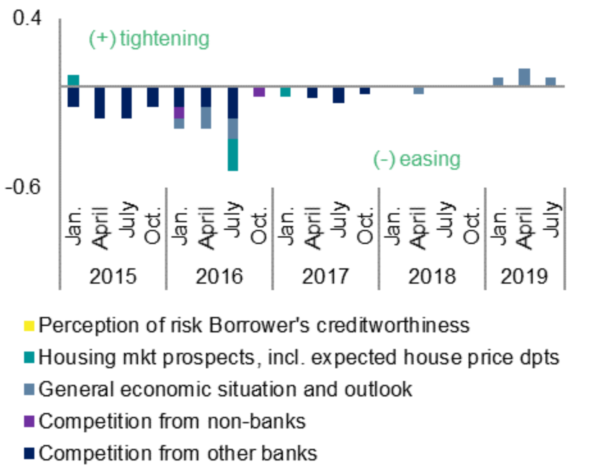
Production of loans to households
(until August 2019)



Credit supply - Change of the contribution of housing credit factors (retail)



Credit supply - Change of the contribution of housing credit factors (retail)



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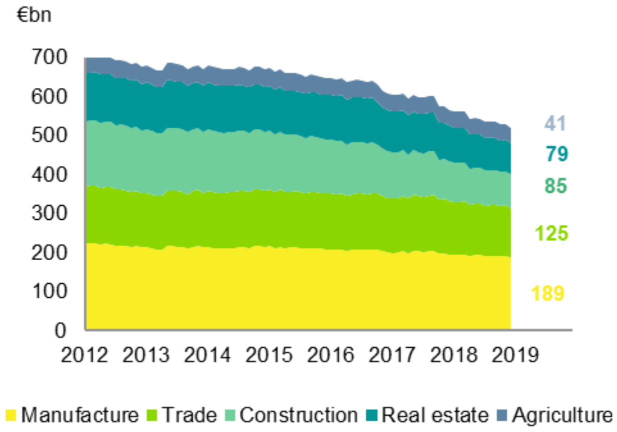
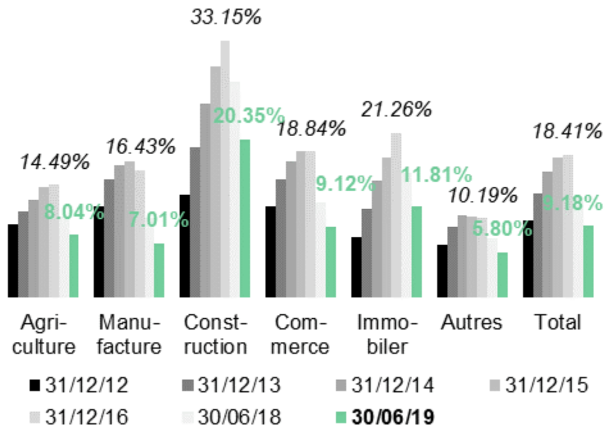
Real estate and construction sectors: production and outstandings

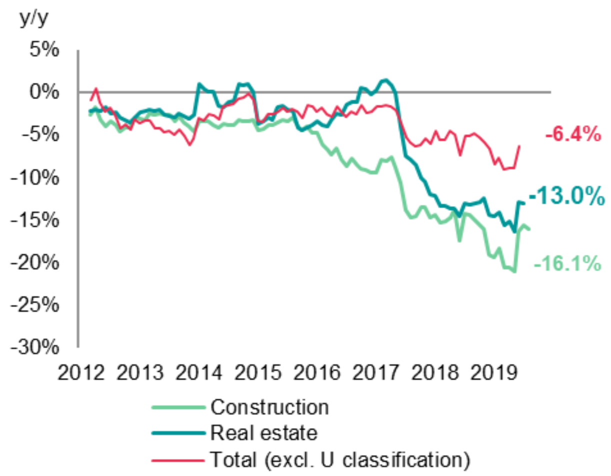
Change in business loans: main sectors



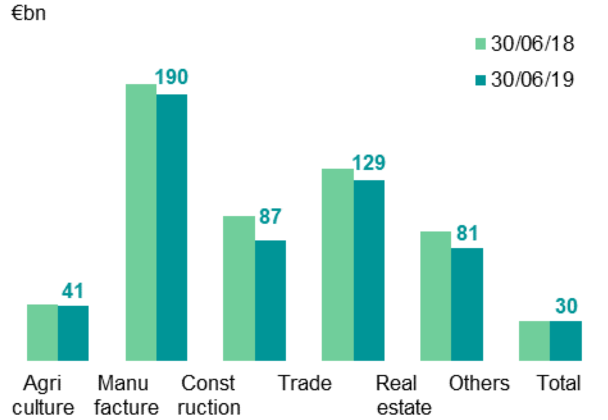
Sofferenze ratio by sector



Change in outstanding loans to the productive sector



Outstanding business loans in the main sectors



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