The Icelandic Housing Market: Finally levelling off

- Increasing supply, slower population growth and tighter credit

Arion Research
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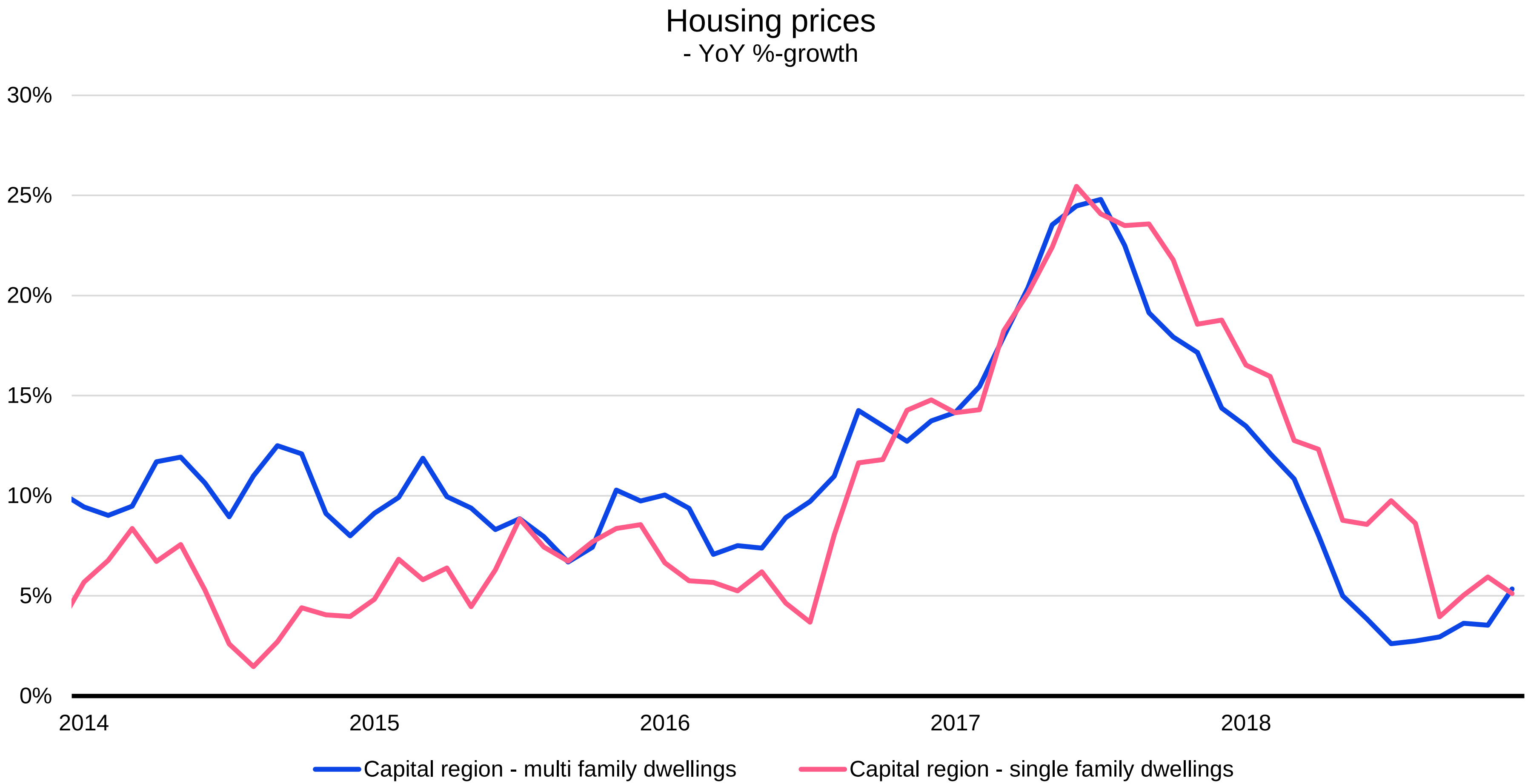
Summary

- Completed residential buildings and the number of residential buildings under construction in the capital area has increased rapidly in the last year. At the same time housing price increases have slowed down. **Expectations of increased supply have undoubtedly contributed to moderate price increases.**
- Recent economic developments, with the troubled airline industry at forefront, all point to slower growth ahead, giving reason to slower population growth than in previous years. **Slower population growth and increased housing supply means that the housing shortage will decrease throughout the forecast period.** This development should subdue housing prices.
- **Credit growth has rapidly increased in recent years**, as mortgage rates have come down to their lowest level in documented history. Only last year net bank lending to households and businesses amounted to around 350 bn.ISK. However, a turning point has been reached as it looks like the **banks' credit growth this year will be considerably lower along with tighter credit terms**. Signs of this can already be seen in lower LTV ratios and deteriorating terms of additional loans.
- **We forecast minor nominal housing price increases throughout the forecast period**, but the rate of increase will slow down as time goes on. Real prices will fall as soon as this year as inflation continues to climb. **According to our forecast, the imbalance between housing prices and wages will slowly correct itself.**

The rollercoaster ride coming to an end

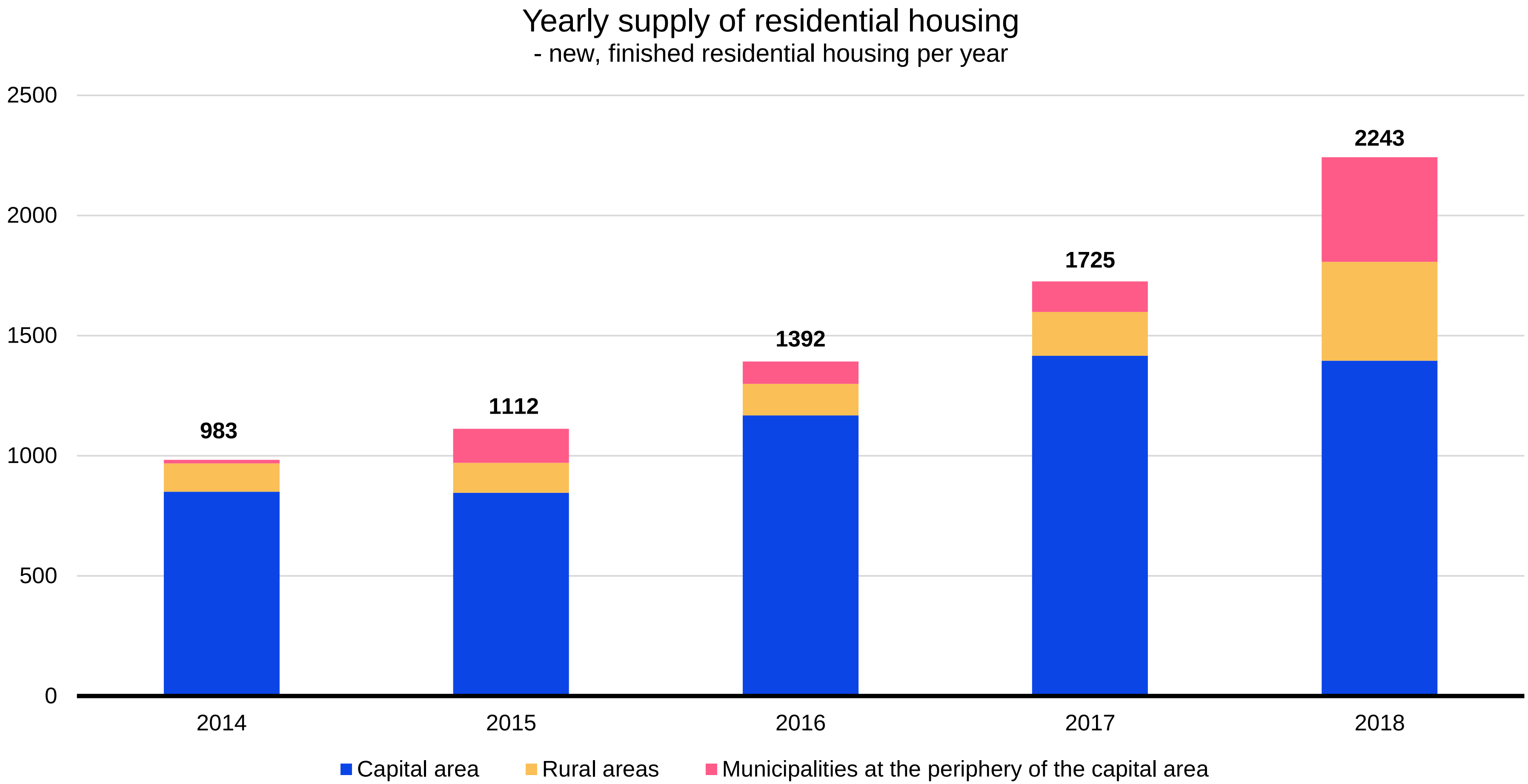
Housing price increases have slowed down in the past 18 months. Housing prices in the capital area increased by 6.2% in 2018, compared to 18.9% increase in 2017.



Sources: Registers Iceland, Arion research

Moving to the country, going to pay a lower price

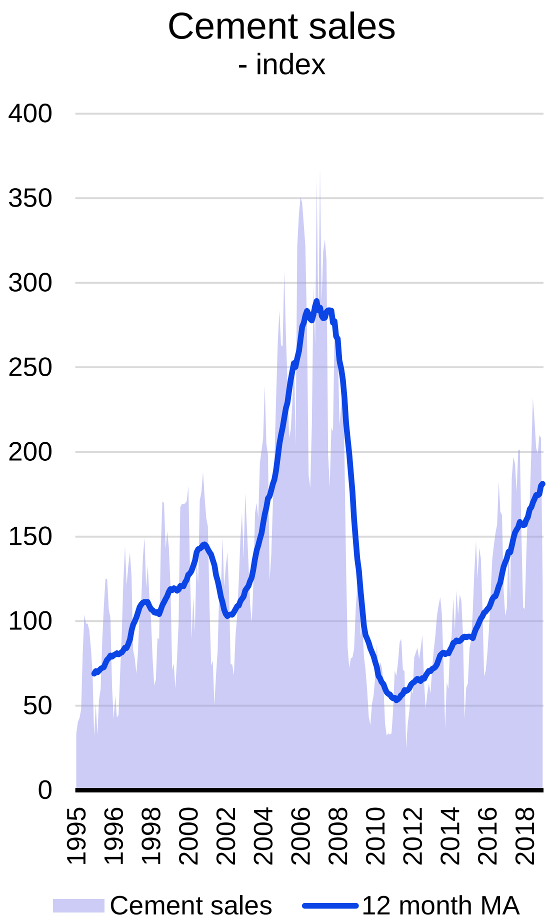
Relatively speaking, municipalities close to the capital area, i.e. in 45 minutes drive or less, are the main driving force behind supply increases in 2018. More and more people are choosing to live close to the city, not in the city itself, both due to high housing prices and tourism related job opportunities.

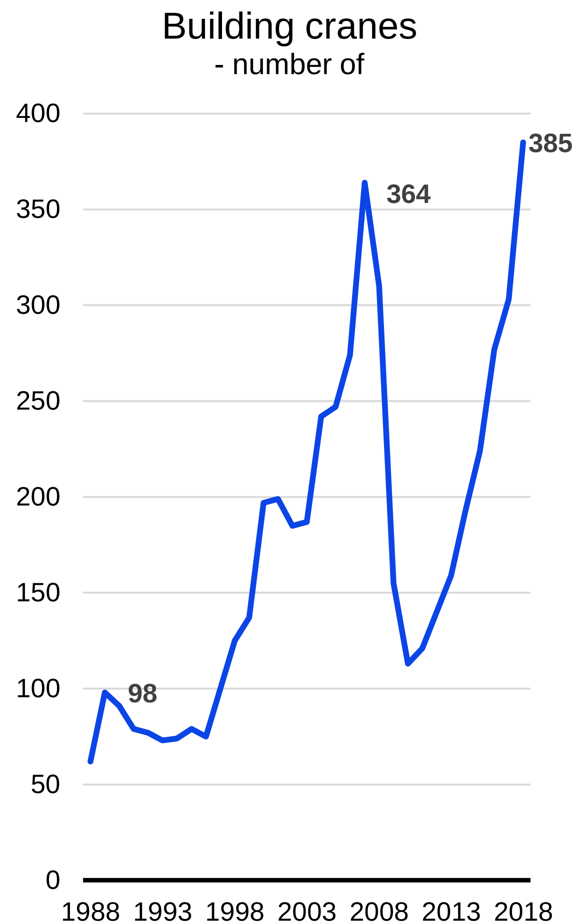


Sources: Register Iceland, Arion research

The real economy indicates that further construction is underway

The building crane index has never been higher, cement sales have increased and more and more are working in construction

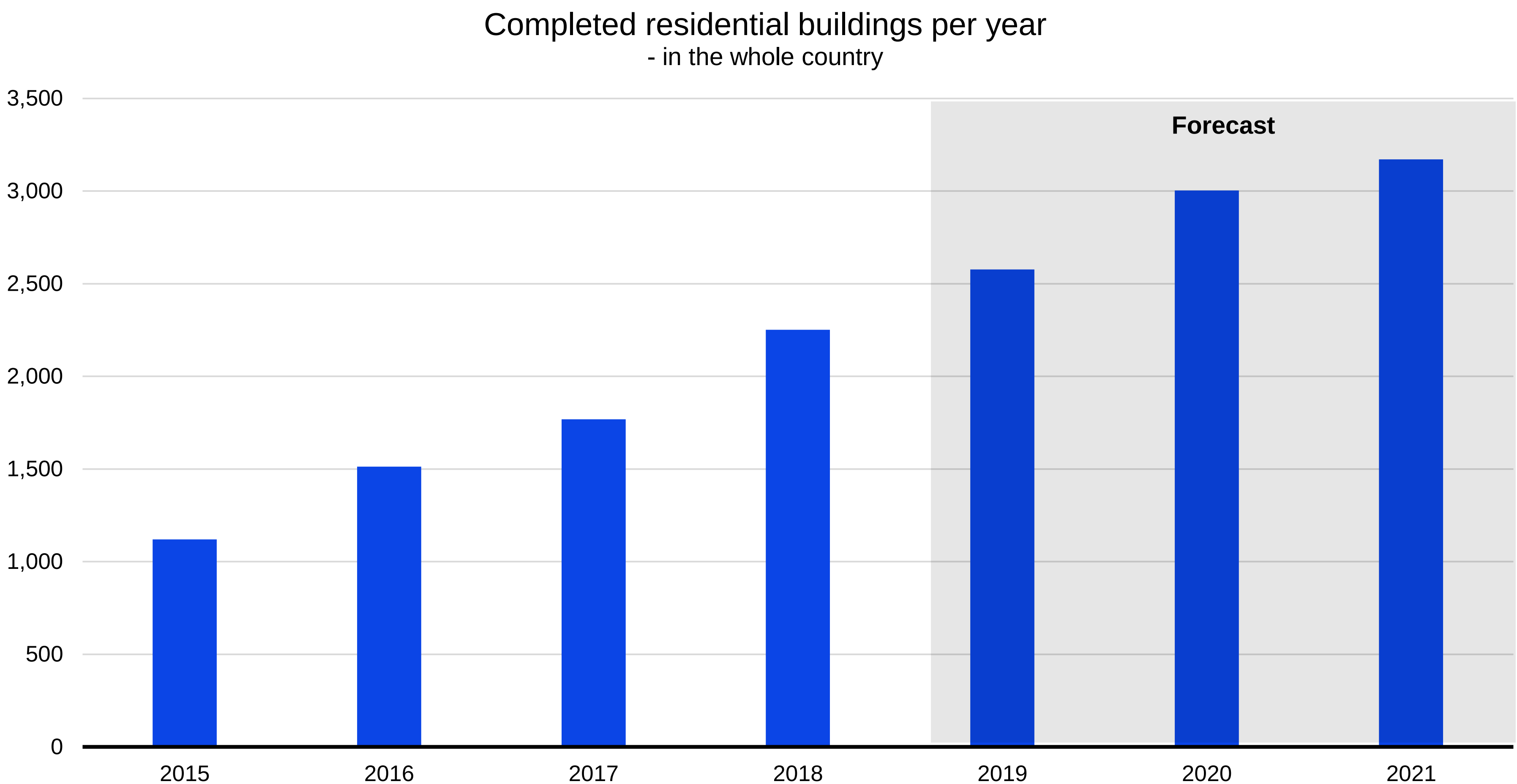




Sources: Statistics Iceland, CBI, Arion Research

Nearly 9,000 new homes in three years

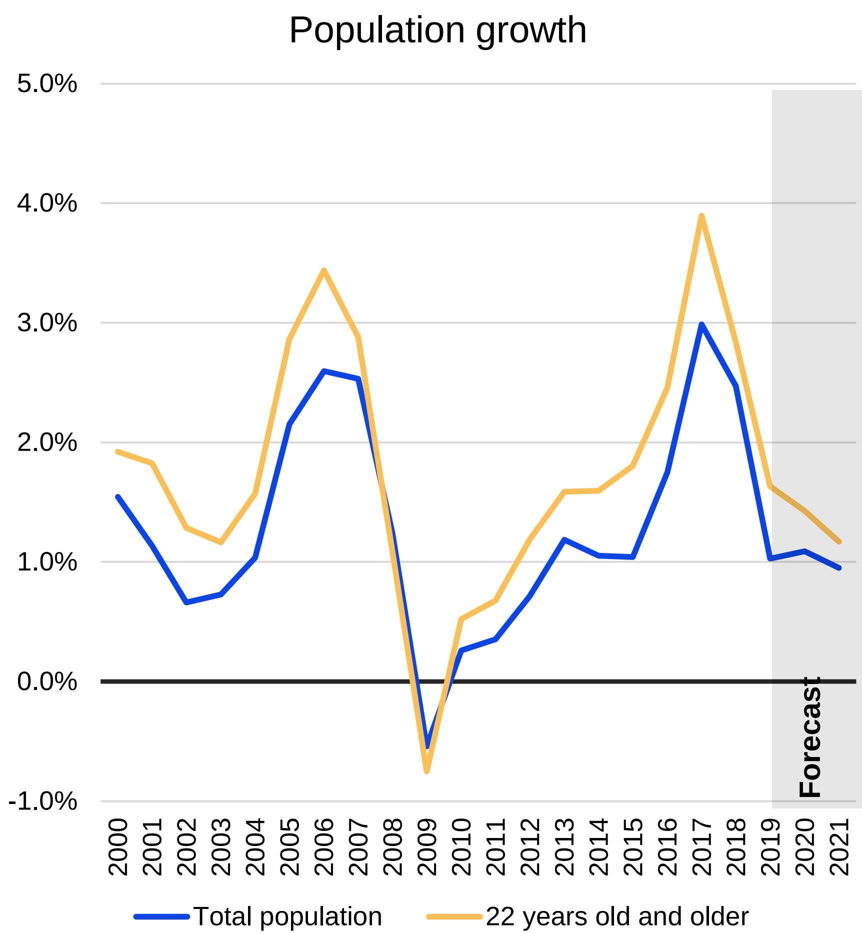
According to our residential housing investment forecast, nearly 2,600 residential buildings will be completed this year. This is the highest number since before the financial crisis. Furthermore, the number of projects that began last year has probably never been higher.

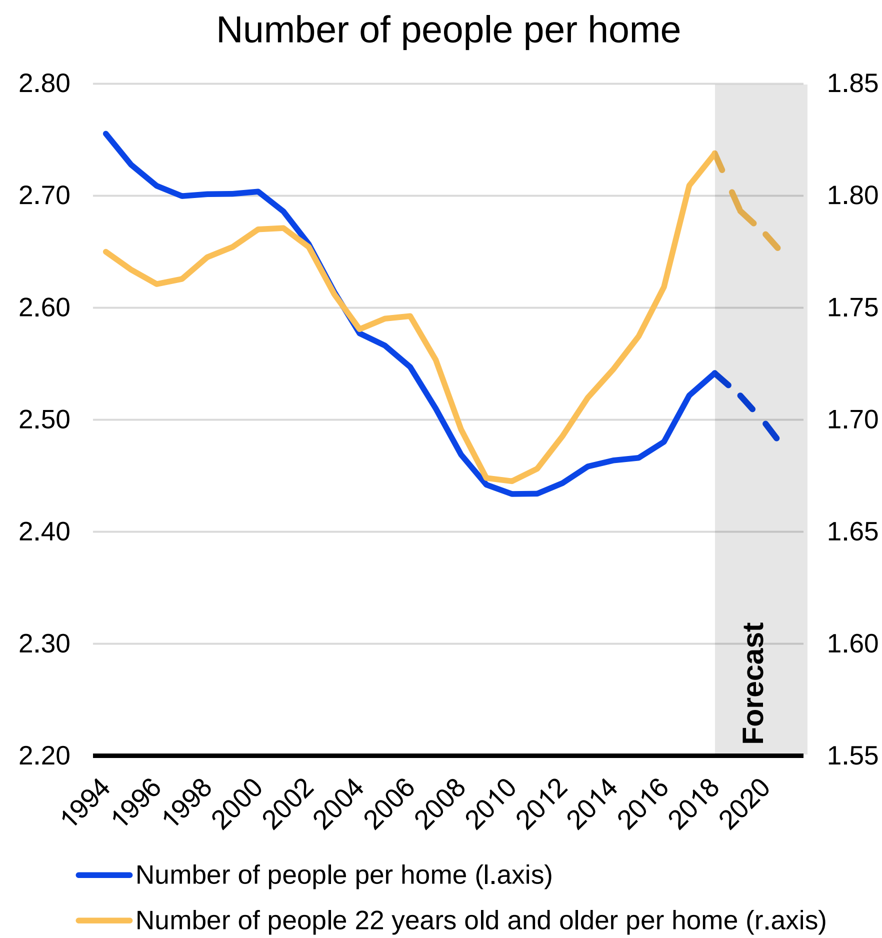


Sources: Statistics Iceland, Arion Research

Slower population growth + increased supply = the housing shortage decreases

If our forecasts of increased residential housing supply and slower population growth are combined, one can see that the number of people per home starts to decline, for the first time since 2010. This of course implies that a certain group is waiting on the sidelines for the opportunity to enter the market when circumstances allow.

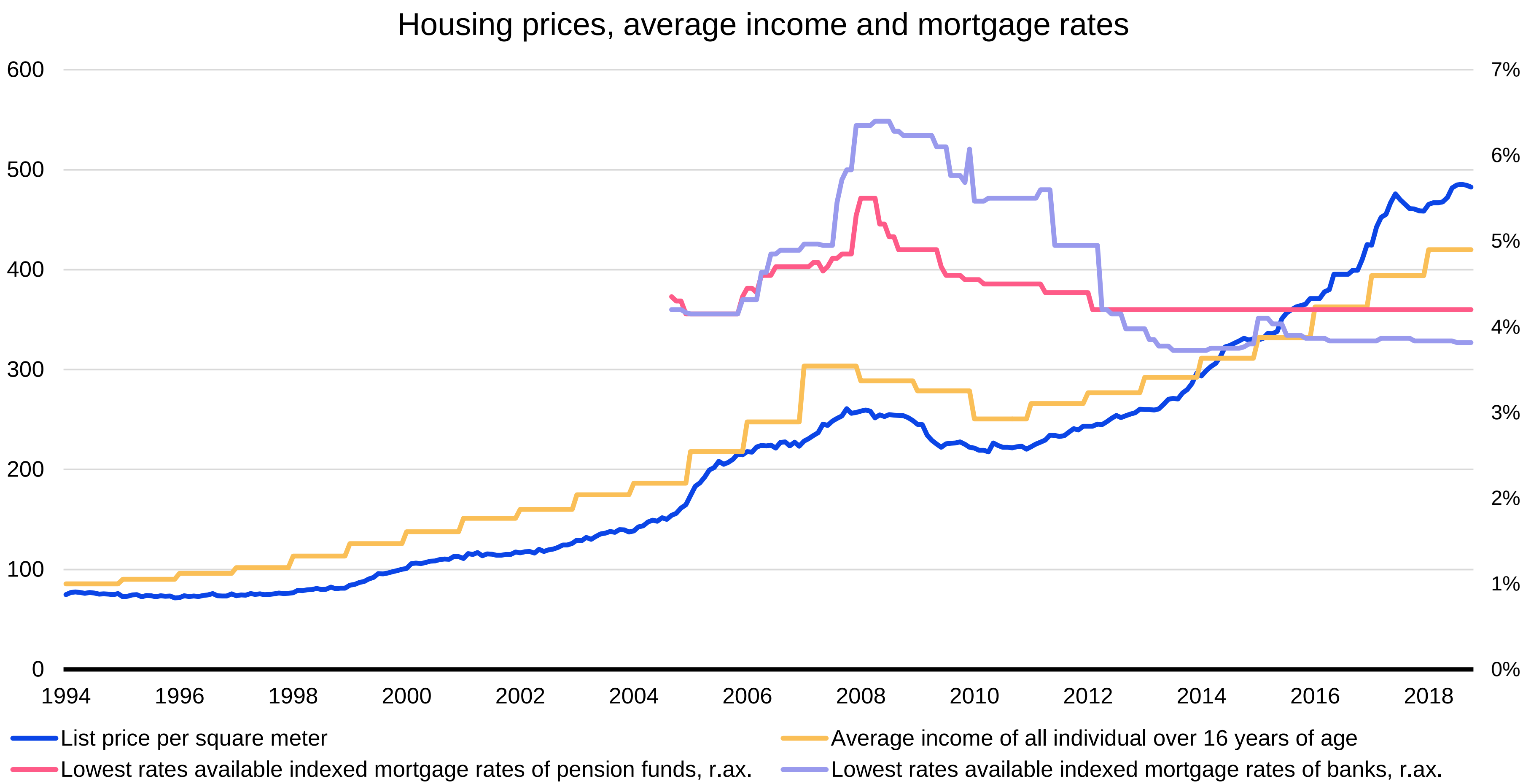




Sources: Statistics Iceland, Arion Research

Price of residential housing has increased more than average income…

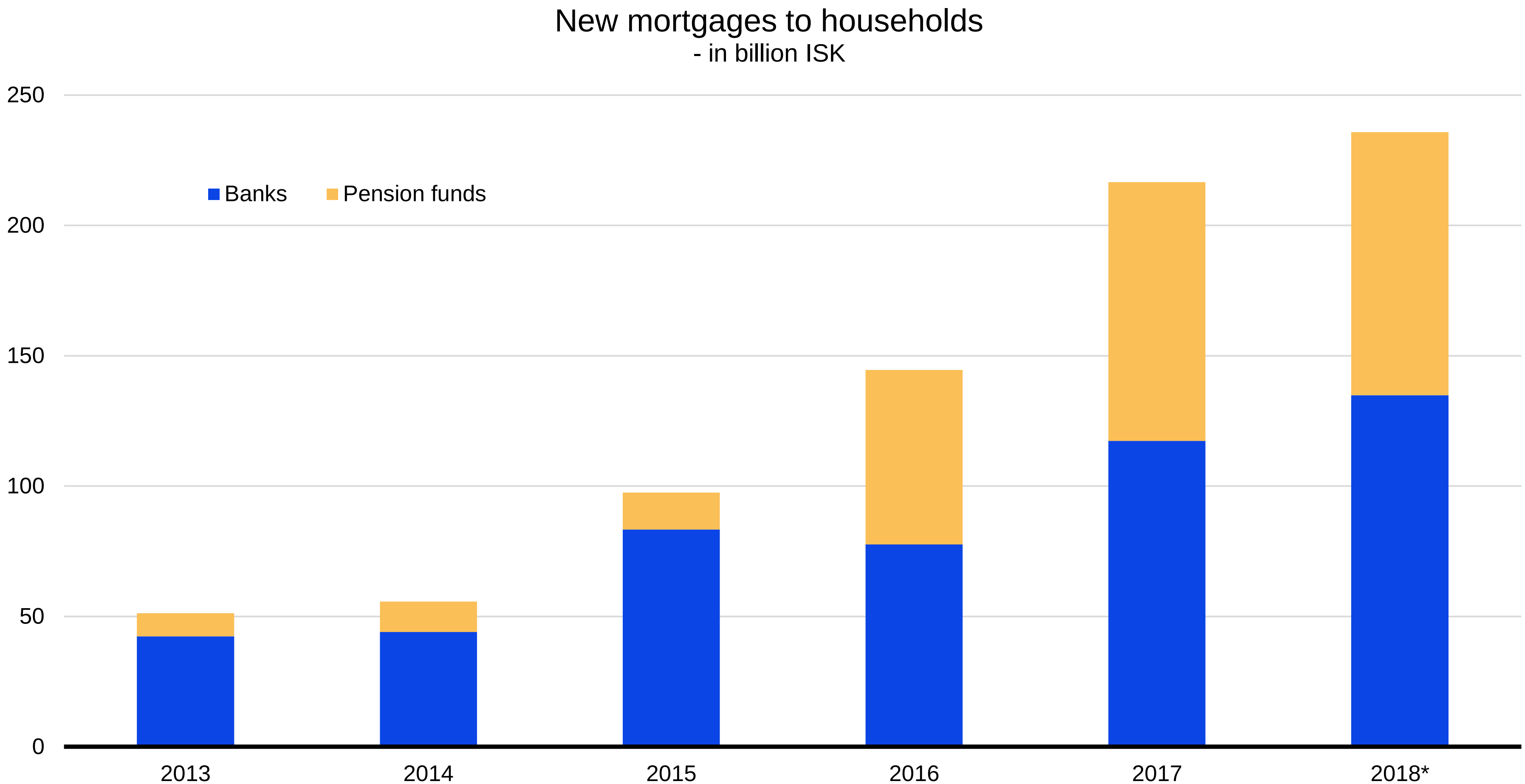
...while mortgage rates have decreased. Because of lower interest rates, monthly mortgage payments have not increased as much as housing prices



Sources: Register Iceland, Statistic Iceland, Central Bank of Iceland, fasteignir.is, Arion research

Who is lending households?

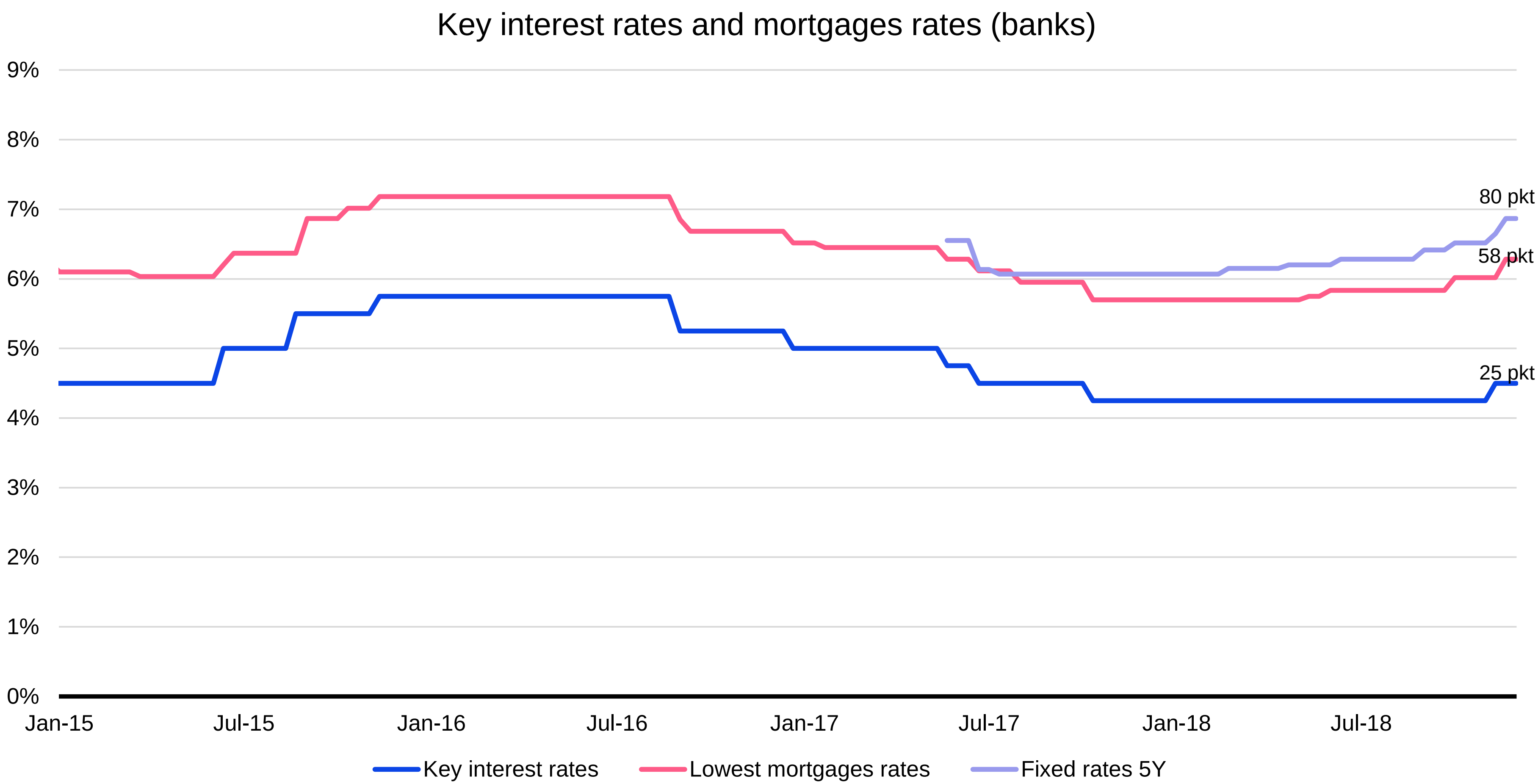
Banks and pension funds are the main lenders



Sources: Central Bank of Iceland, Arion research. * Desember figures for pension funds haven´t been published

Since 2018 key interest rates have increased by 25 bps

However, mortgage rates (banks) have risen more sharply and started rising long before the CBI hiked rates

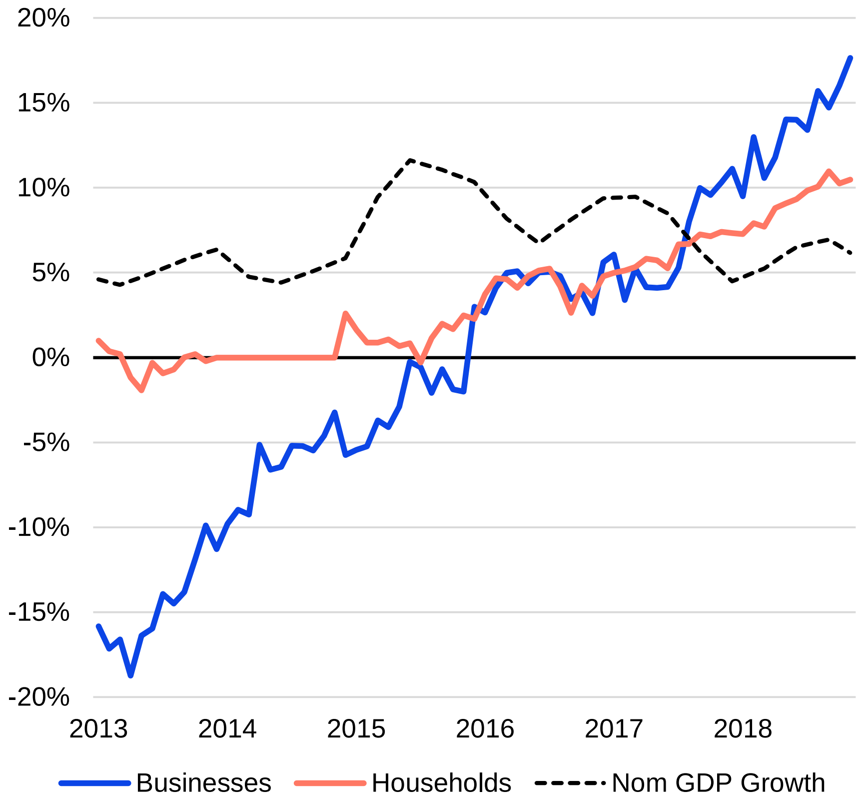


Sources: Central Bank of Iceland, Arion research

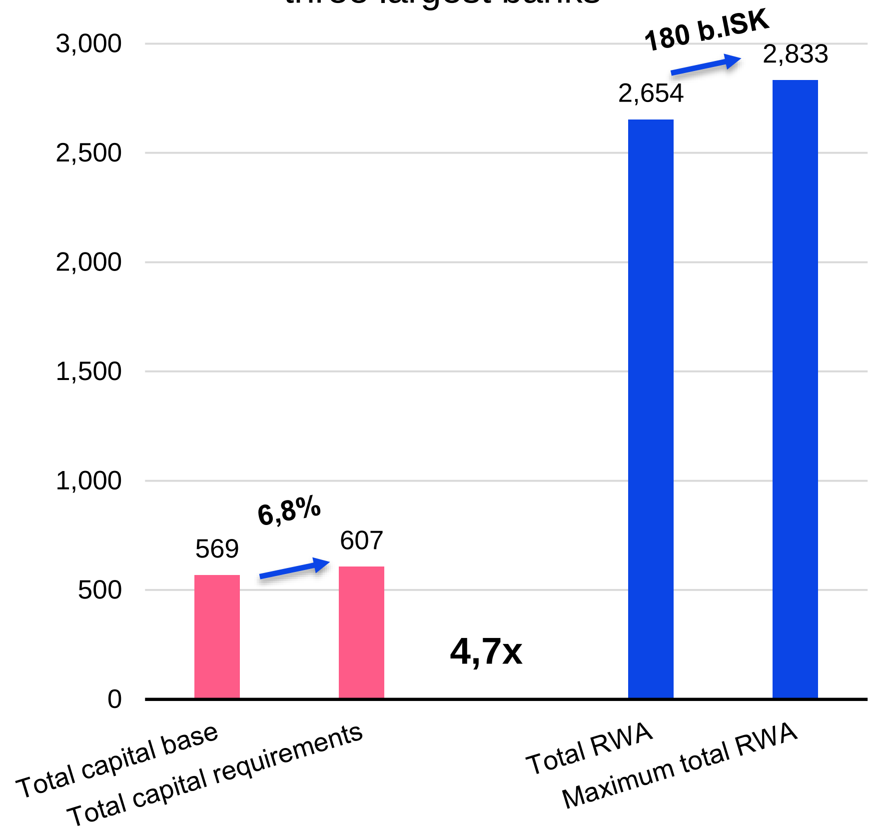
Limited scope for loan growth

Since 2017 loan growth in the Icelandic banking sector has exceeded GDP growth following period of negligible real growth. In 2018 net domestic bank lending to households and businesses amounted to 350 bn.ISK. Strong balance sheet growth coupled with sizeable dividend payments and tighter capital buffers lead us to the conclusion that the current leeway for loan growth now amounts to 150-200 bn.ISK (in picture below estimated at 180 bn.ISK).

Domestic bank´s outstanding loans
- trailing 12m change by type of lending



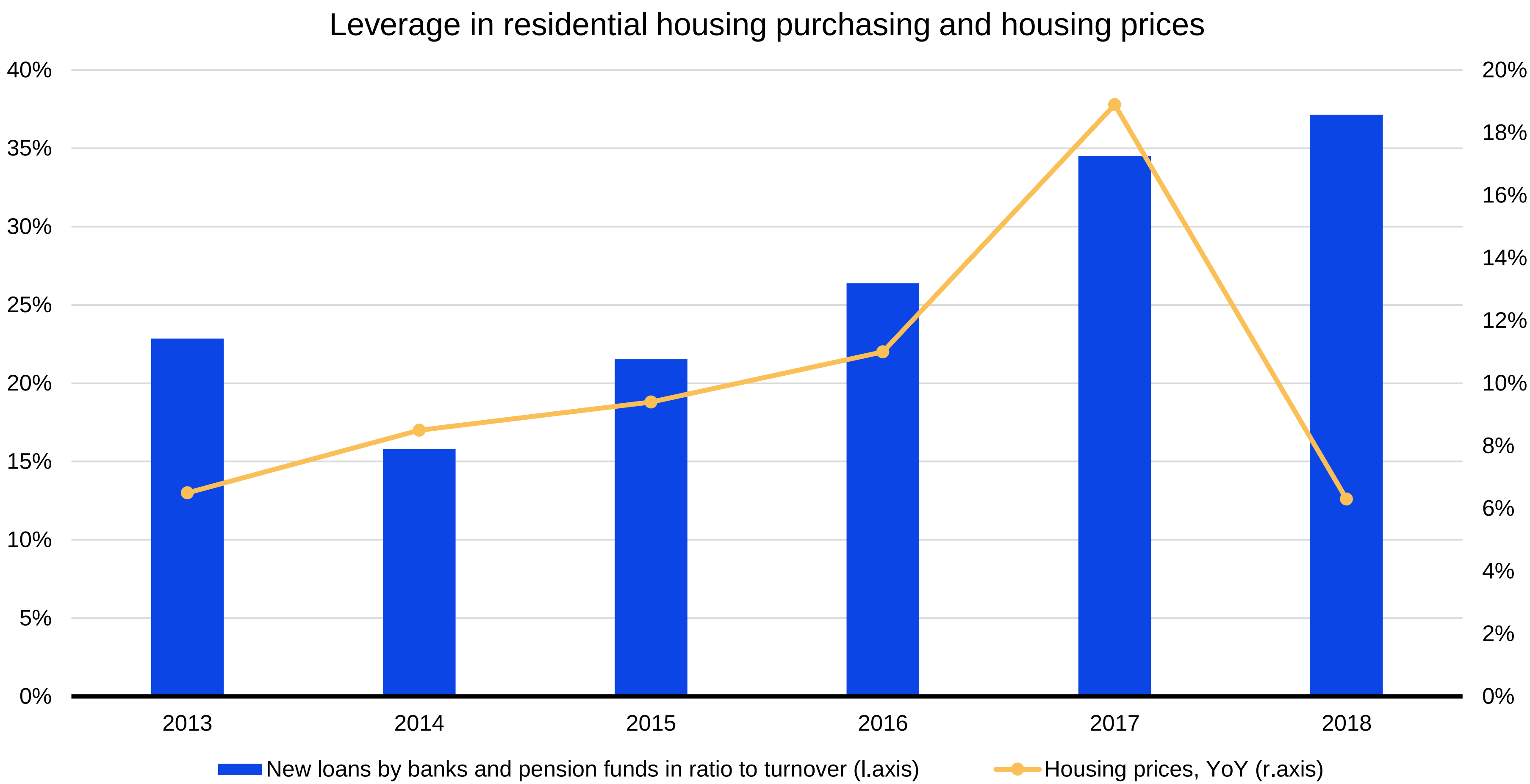
RWA and capital requirements of the three largest banks*



Sources: Central Bank of Iceland, Statistics Iceland, Arion Bank, Islandsbanki and Landsbanki Q3 reports, Arion Research. * Maximum loan growth given full utilization of capital base based on capital requirements as decided by legislation, FME and the bank´s themselves.

Leverage ratio of home buyers has been rising since 2014

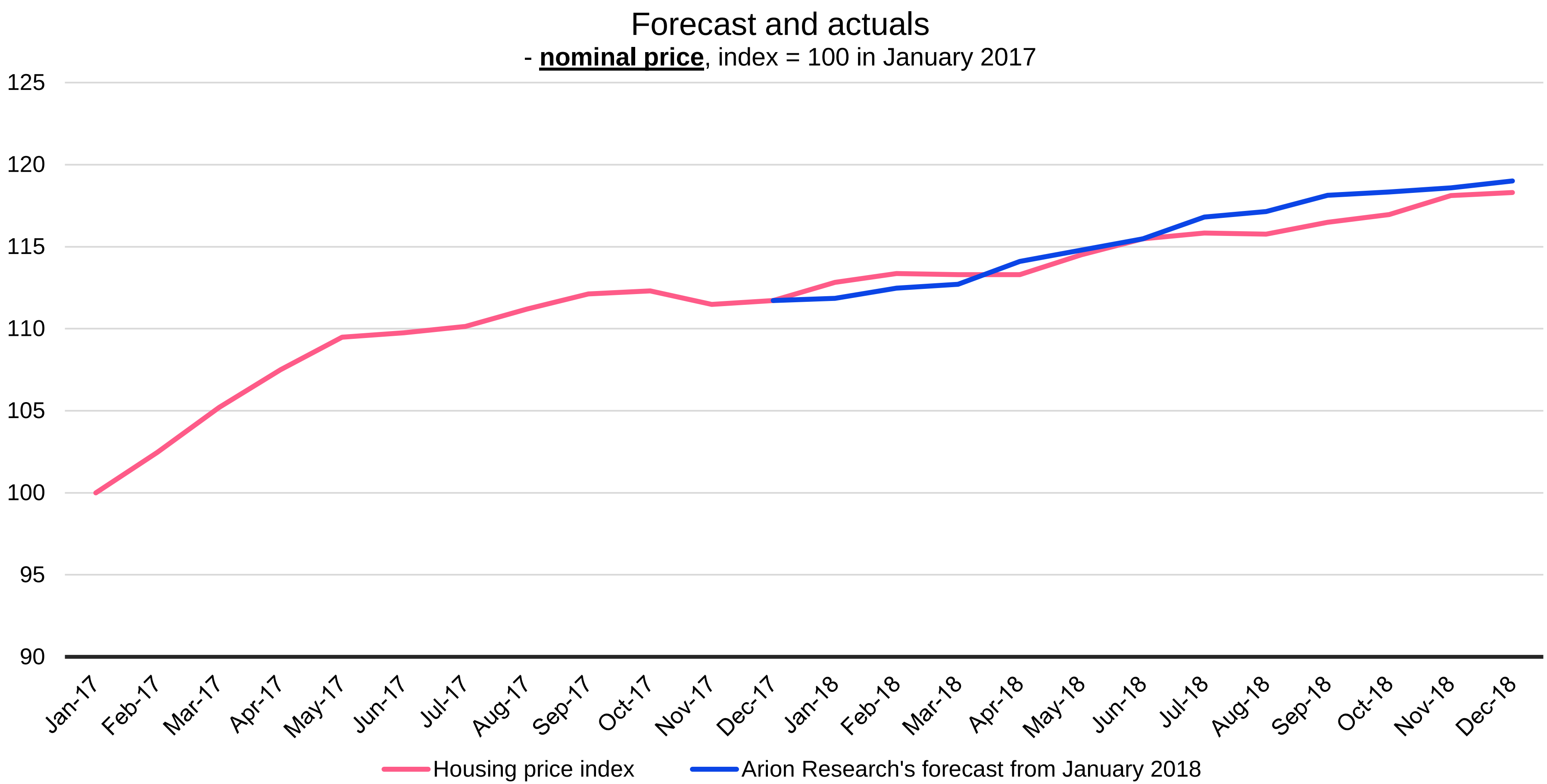
Although leverage ratio was at its highest last year the price increases are getting more marginal



Sources: CBI, Registers Iceland, Arion Research

(Almost) spot on!

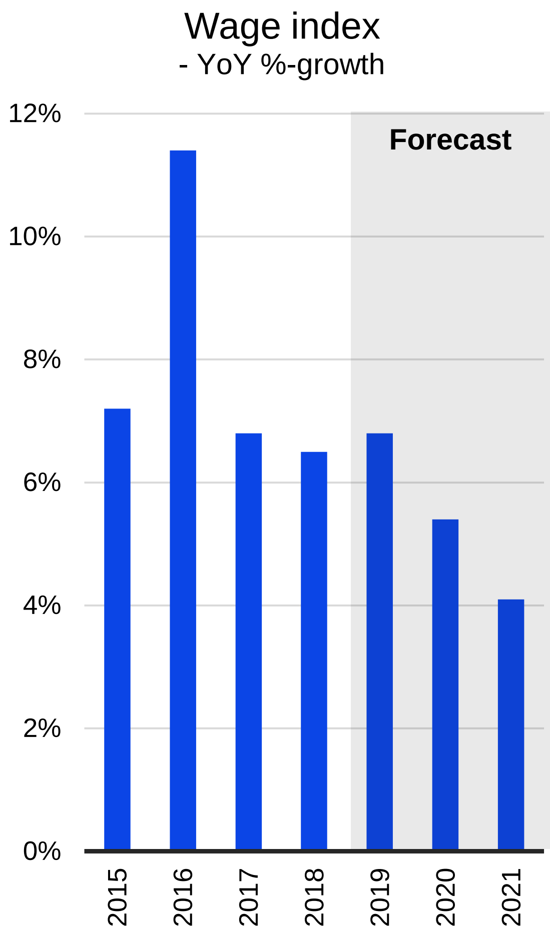
Housing price has developed in line with our expectations. In our previous report on the housing market* we forecast 6.6% price increases in 2018. According to the actual figures housing price increased by 6.2%, when comparing annual averages.

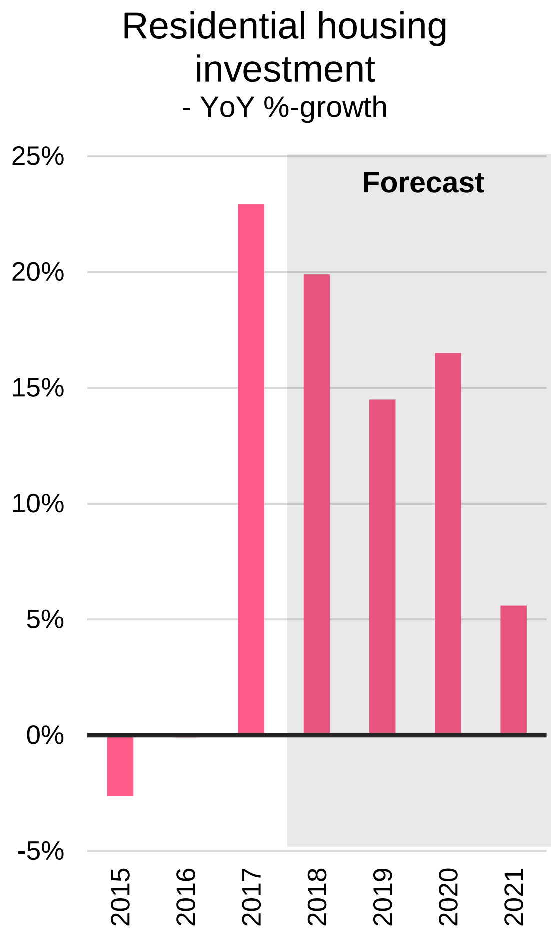


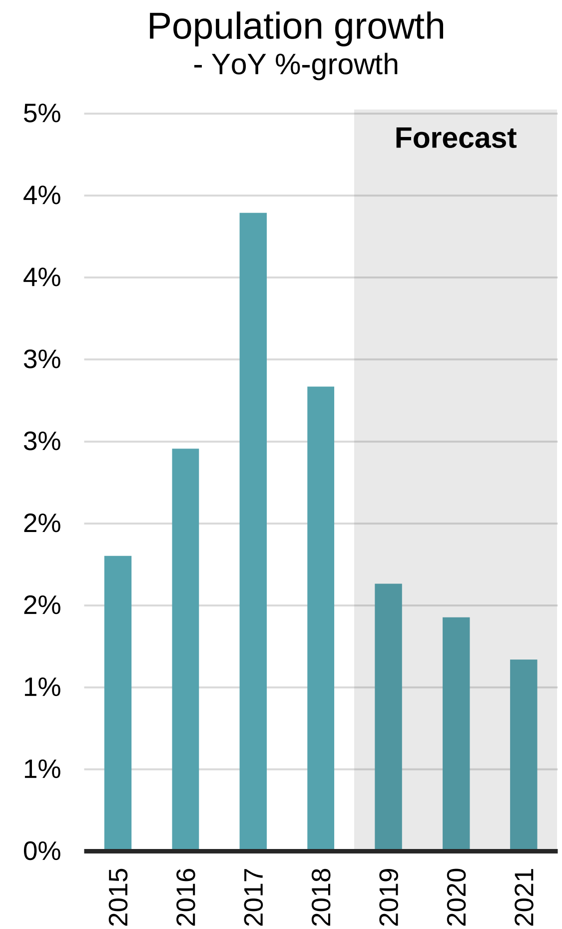
Sources: Registers Iceland, Arion Research. * The report was published in January 2018.

A forecast is only as strong as its weakest link - assumptions

If the assumptions that the forecast is built on are incorrect, the forecast is likely to be incorrect. The main variables in our housing price model are listed below. The forecasts for these variables are mainly based on our Economic outlook from the end of October.



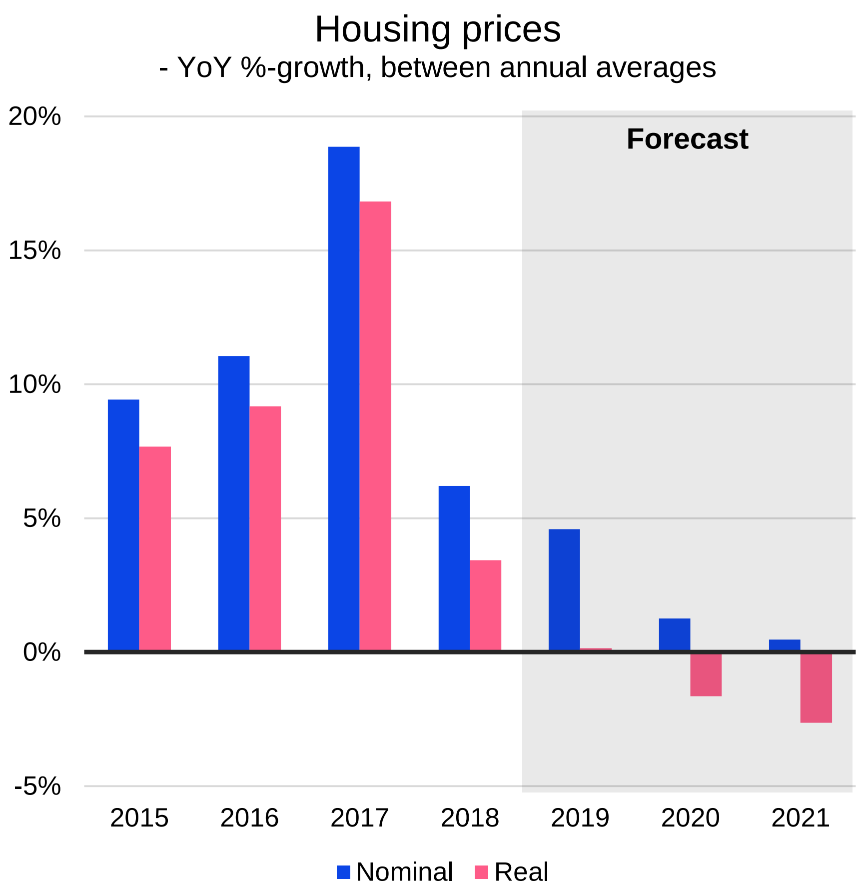


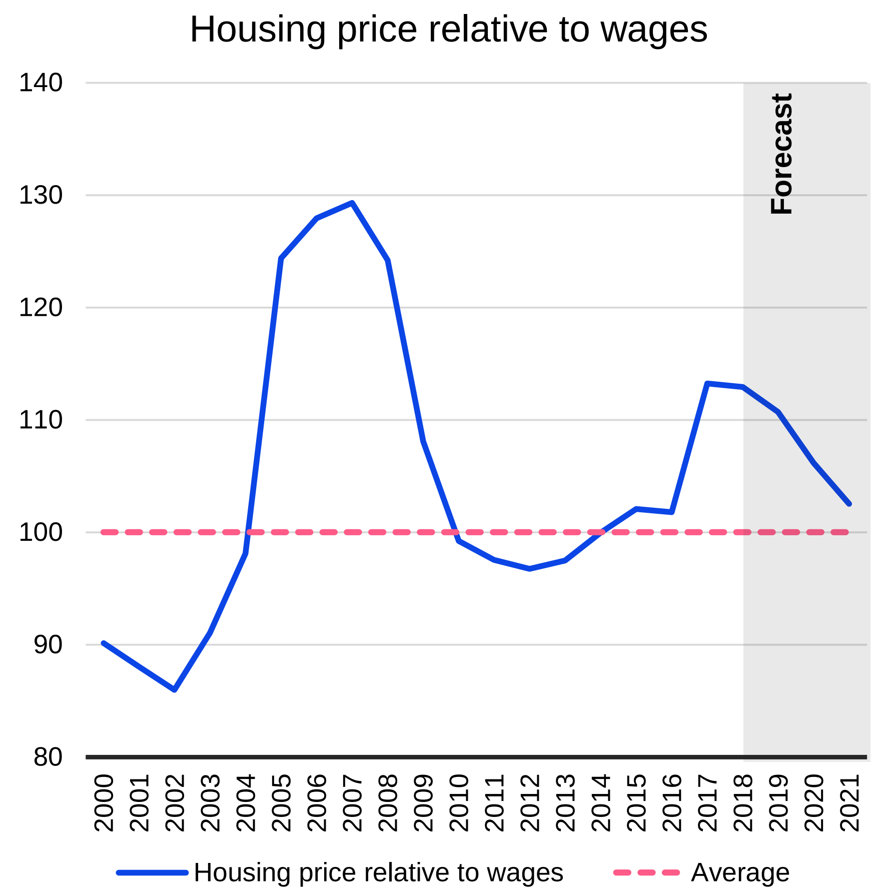


Sources: Statistics Iceland, Arion Research

We expect minor nominal price increases

The rate of increase will slow down as time goes on. Real price* will fall as soon as this year as inflation continues to climb. According to our forecast, the imbalance between housing price and wages will slowly correct itself. Equilibrium on the horizon?





Sources: Registers Iceland, Arion Research.* Real prices are calculated using CPI.

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