CONTRASTS IN EUROPE'S RECENT HOUSE PRICE CYCLES

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Introduction

An examination of recent house price behaviour in Europe illustrates the problems of housing market generalisations:

1. Several European countries have seen very high real house price rises over the past two decades, notably in order of scale of increase: Spain, Ireland, the Netherlands, the United Kingdom and Belgium. They have all significantly surpassed the leading non-European highest price rise contender: Australia (see Table 1).

2. Many other European countries have experienced significant real rises in house prices over the same time period.

3. In contrast to the booming countries, others have had declining or stagnant house prices over the past decade: notably, Austria, Germany and Switzerland.

4. Housing market cycles, their scale and associated volatility vary significantly across Europe. This is true for countries within the Euro-zone as outside of it, so uniform short-term interest rate setting is not leading to uniform housing market behaviour.

European countries contain housing markets with a myriad of relevant policies, institutions, tenure shares and market performances. Trying to capture those

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differences into a few features is a hard task. Even so, considering what has happened to house prices across Europe in recent decades enables insights into some key housing market differences to be discerned. An advantage of such variation is that it provides some useful empirical evidence on how housing markets work.

Three specific questions are addressed here:

- To what extent do European countries' housing markets exhibit the similar price performance over time in terms of trend growth and fluctuations around those trends?
- Apart from the scale of price changes, what are the comparative temporal patterns? That is, do European countries' house prices cycles approximately follow each other over time?
- What can explain any discovered differences in European countries' house price behaviour? In particular, to what extent are those differences systematic and caused by stable institutional factors or how much are they a result unpredictable variations in historical events?

Attention will be paid to the old EU15 countries plus Norway and Switzerland, because these are the ones with mature developed housing markets, so that they can be examined over a long period of time. In contrast, the new EU accession countries have distinctive and relatively new markets, particularly those in central and eastern Europe, which require a separate analysis.[2]

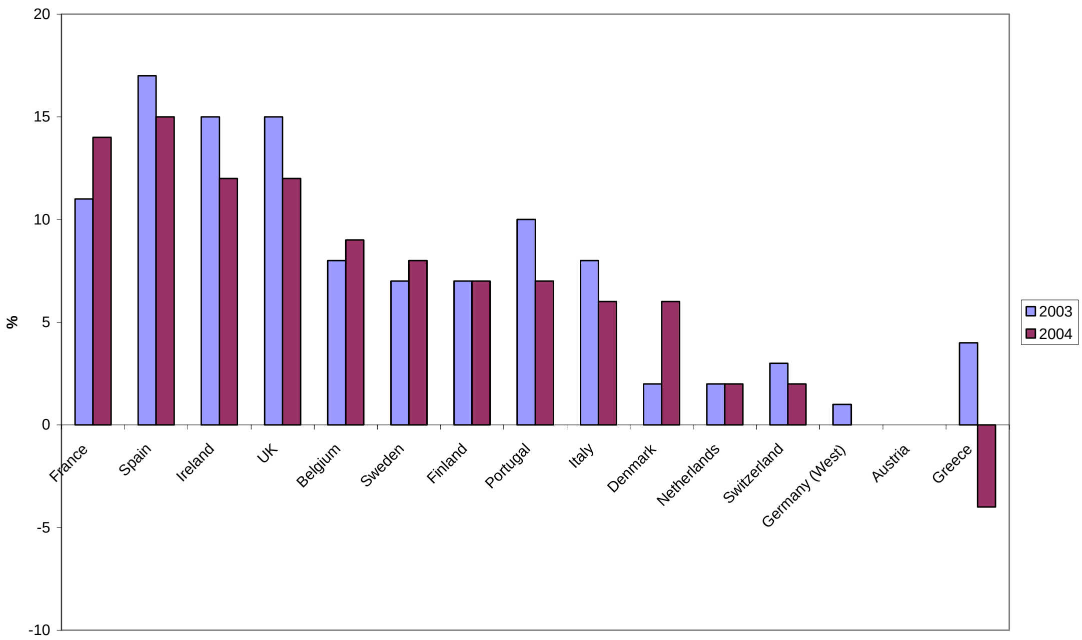
[2] An overview of these housing markets in provided in M. Ball *RICS European Housing Review 2005*, Ch 3, www.rics.org .

House price rises

The current situation

2004 was another strong year for most EU housing markets, more so than 2003, particularly when account is taken of a mixture of indicators – prices, transactions, housebuilding and mortgages. Figure 1 shows forecast 2004 out-turn rates of house price inflation across Europe.

Figure 1: House prices rises in 2003 and 2004



Source: M. Ball *RICS European Housing Review 2005*

Several countries show slight declines in their rates of inflation but such changes matter little as they are probably within the bounds of accuracy of the house price data. Many countries, in other words, saw similar house price rises in 2004 to those in 2003. However, two countries experienced marked increases in house price inflation. For Denmark, the increase was from a period of stagnation to renewed, but relatively moderate, real price growth. For France, in contrast, greater force was applied to the price accelerator. Price rises had already reached double figures in 2003, but in 2004 they raced ahead of the rest of Europe, with strong rises in the Paris area as well as in the Mediterranean regions - the areas with the most inflation a year before.

Only Germany of the larger countries had a stagnant housing market throughout the year, a market situation that has existed for some time now. Even there, signs of increased mortgage demand by owner occupiers in the second half of the year suggested that the long downswing in its housing market cycle may finally be over. Elsewhere, Austria also had a stagnant housing market year and Greek house price fell slightly, though transactions, as indicated by mortgage demand, were high.[3]

The main drivers of this housing market strength were financial and economic. Continued low interest rates in the Euro area - and cuts in some other countries, notably Sweden – kept down the cost of mortgage borrowing. Economic growth was also better than in 2003, even if in Germany and a few other countries it was still below par. This helped to boost consumer confidence. The worst performing housing markets still tended to be those with the weakest economies as in previous years.

By the second half of 2004, only one country seemed clearly to be heading in a different direction, the UK. Its long boom grounded to a halt in the summer of 2004 after a series of interest rate rises by the Bank of England. Central bank interest rate changes directly affect mortgage costs because the UK has a predominantly variable rate mortgage system. Nevertheless, the full impact of the interest rate rises does not seem to have yet been felt by new borrowers, with lenders absorbing some of the impact in reduced interest rate spreads in response to marker falls in mortgage demand.

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[3] Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Netherlands, Poland, Portugal, Spain, Sweden, Switzerland and the UK.

From rising at double digit levels in the first half of the year, UK house prices stopped growing and fell slightly the second half of 2004, while unsold houses hung on the market. Even so, year end prices were still significantly up on 2003, because of the strong increase in the earlier part of the year.

European house prices – The booming, the strong and the flat

There are now three categories of country with respect to house price inflation in Europe:

Very high, double-digit inflation countries

This group includes *France, Spain, Ireland and the UK*. However, the UK may have now spun out of the inflationary race, as mentioned earlier. Each year for the past three or four years, pundits have predicted that the following year would herald a market slowdown in the booming residential markets of Europe. Yet, UK apart, the slowdowns have failed to materialise. Low interest rates, instead, have continued to feed beliefs that capital gains can still be made out of housing and, to an extent, they have become self-reinforcing.

Strong inflation countries

They are *Belgium, Denmark, Finland, Italy, Portugal and Sweden*, all of which in 2004 had annual prices rises hovering around the 5% mark in real terms. 5% may not seem so large compared to the very high inflation countries, but that rate of increase highlights that their housing markets are still in the upswing phase of the housing market cycle and most of them, with hiccups, have been in that phase for well over five years now, sometimes much longer. Such price rises are unsustainable over the long-run. For example, they would imply that real house prices would rise by 55%

every 10 years or double in real terms every 15 years, requiring the transfer of national wealth to house owners from non-owners on a substantial and unlikely scale.

Flat (low or zero rate) inflation countries

They are the *Austria, Netherlands, Greece, Germany and Switzerland*. The reasons why their markets are in such situations varies:

1. *Austria, Germany and Switzerland* all have had recent chronic excess supply overhangs arising from building booms the 1990s plus below trend rate economic growth. Switzerland recovered from its late 1990s housing market downturn a few years ago, but the experience has made housing market investors cautious in this predominantly rental country. Therefore, they - and owner occupiers - are still reluctant to bid up prices, despite favourable interest rates. Austria and Germany, apart from in East Germany, have also mainly recovered from early housing market downturns and may experience stronger demand in the coming years. Much of this potential expansion is likely to come through a growth in owner occupation, especially in Germany, where policy is now directed towards encouraging it after decades of renter biases.

The *Netherlands and Greece* have come out of a different phase of the housing market cycle to the previous stagnant three countries. In both of them, house prices boomed until either 2002 or 2003, then suddenly stopped growing. (The fall in Greece should be treated cautiously as the data are not quality-adjusted and refer to Athens only – zero is probably a better guess than falling prices.) Earlier, the Netherlands had one of the highest increases in real house prices of all European countries between 1995 and 2001.

Apart from slightly falling real prices, neither of these two countries' housing markets shows much other evidence of market stagnation. Mortgage demand in Greece in 2004, for example, continued its large-scale expansion, growing at 25% a year in late 2004 and new housing investment also remained strong. In the Netherlands, transaction levels have stayed at record highs in recent years and have even increased in some of the major cities. Greece and the Netherlands may indicate that a soft landing when interest rates and economic variables are relatively benign is currently possible in other European countries.

None of low house price rise countries show indications of an imminent crash. Instead, it may be the countries with currently the highest price rises that face the greatest risk of future market adjustments. There is now a strong supply response in the remaining three boom countries, for example; in addition, the European economy seems to be slowing again; and there is a possibility that the Euro-zone interest rate cycle will start to move up later in the year in response to cost-driven inflation. So, 2005 or, possibly 2006, might see the end of the long house price upswing in Europe and the start of a new, uncertain era.

The current housing price cycle in context

The house price boom affecting many countries has been quite a long one, see Table 1. Other advanced economies have also long periods of rising real prices, such as the USA from 1995 and Australia from 1996.[4] In contrast, Japan has experienced falling prices since the early 1990s.[5]

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[4] Accoridng to BIS data.
[5] Japan has much own building, so that land prices proxy house prices. This makes for poor comparisons across time as the quality and size of dwellings built on land plots are likely to improve significantly over time, especially in Japan where land plots often arise from existing dwelling demolitions. Japanese 'house' price fluctuations, therefore, are likely to be substantially exaggerated relative to other countries' house price indices. This index number problem arises for several European

Belgium's upswing is the longest. It seems to have been going on for almost two decades. Yet, others have experienced prolonged growth: Denmark for 11 years and others for 6 years or more. Prior to that homeowners in many countries saw house prices fall in real terms for several years in the early 1990s after an earlier 1980s boom. In summary, a common historical experience of fluctuating house prices exists across Europe, though there has not been a particularly close correspondence in the timing of the price cycles of each country, as Table 1 shows.

Table 1: Characteristics of the most recent house price upswings[+] in Europe

Country	Approx. 2003 real house price (1985=100)	Approx. real house price rise in latest upswing (to 2003 %)	Start date of most recent real house price upswing	Current length of upswing (years to end 2004)
Austria	100	6*	1986 (to 1991, then declined, flat post-2000)	0 (5)
Belgium	210	110	1986	18
Denmark	120	65	1993	11
Finland	120	55	2002 (1 yr dip, otherwise 1996)	2 (8)
France	160	45	1996	8
Germany	95	15*	1985 (peaked 1995)	0 (10)
Ireland	260	160	1995	9
Italy	150	40	1998	6
Netherlands	255	160	1991(zero real price change since 2002)	0 (10)
Spain	315	75	1998	6
Sweden	150	50	1997	7
Switzerland	95	4	2000 (1-2% annual price growth only)	4
UK	240	100	1996	8

[+] Upswing is defined as a period of continuous positive real price growth * Upswings in Austria: 1990-94; Germany, 1988-1996.
Sources: Own calculations based on Ball, 2003, 2005 and BIS data.

The past two decades for many countries, furthermore, stand in stark contrast to the previous era from the early 1970s to the mid-1980s, when house price growth rates were generally far less. Denmark, Italy and the UK are the only European countries to

countries where owner organised building is prevalent, such as Belgium, Germany, France and Italy – see later - though the result might be to smooth price indices in some countries, such as Germany.

witness substantial trend price growth in both eras (Table 2). In fact, there is a generally negative correlation between the ranks of house price growth in the first period and the second one. This suggests that countries cannot be divided broadly into low and high house price inflation ones beyond fairly narrow time frames, with the possible exception of the UK.

Table 2: Real house price growth 1970s-80s & 1980s to 2000s compared

RANKINGS growth % pa average	1971-1985	1986-2003
EUROPE		
Spain	-0.2	6.8
Ireland	0.4	5.9
Netherlands	0.0	5.3
United Kingdom	2.3	4.7
Belgium	-0.3	4.1
France	0.7	2.6
Sweden	-1.5	2.6
Italy	1.9	2.6
Norway	0.8	1.9
Finland	0.4	1.6
Denmark	1.9	1.2
Germany	0.2	0.0
Switzerland	1.2	-0.6
OTHER COUNTRIES		
Australia	1.6	3.7
Canada	0.8	2.5
United States	0.7	1.7
New Zealand	0.0	0.9
Japan	2.1	-0.6
'Europe' average	0.6	3.0
'World' average	0.7	2.6

Source: based on IMF data

The temporal changes in Europe, in addition, map those occurring elsewhere in advanced economies. The average rate of real house price inflation grew in Europe from a modest level in the 1970s and first half of the 1980s to far more substantial levels in the second half other 1980s through to the mid-2000s. The ‘English-speaking’ world in general, as well as Europe, experienced such an event, while Japan did not.

The length of the most recent house price upswings in European countries is by no means historically unique. House prices in France, for example, rose for two decades in real terms up to the late 1970s, pushing prices up almost threefold. Other countries have had similar long upswings in the past.[6] This suggests that house price fluctuations and relatively long cycles in them are fact of economic life. Tantalisingly, such price cycles do not come in neat regular cycles; instead both the length and amplitudes of upswings and downturns are highly irregular.[7]

House price volatility

The irregularity of house price cycles shows through in house price volatility. Table 3 shows price volatility for the same sample of countries as listed in Table 2. It can be seen that volatility varies considerably over time, between countries and within each one. This suggests that it is going to be difficult to identify countries with housing market regimes that induce greater price stability than others.

The reduction in volatility overall from the first high inflation period to the second lower inflation one is similar in Europe to elsewhere. However, the reduction is quite small. Furthermore, there are only a limited number of countries that are either high or low volatility countries over both periods. In Europe, Spain and the UK are towards the more volatile end of the spectrum in both rankings; whereas France and Germany are towards the lower ends and Ireland and Switzerland somewhat below average. Elsewhere, the USA consistently ranks as the least volatile country – though it has greater price fluctuations than Belgium and Germany in the second period.

[6] *Housing Markets and Economic Convergence in the European Union*, Ball, M. and Grilli, M. Royal Institution of Chartered Surveyors, London, 1997. The average housing market cycle, from trough to trough, in Europe was estimated there to be around 12 years.
[7] The same is true of housebuilding, over which there is a much larger historical literature than for house prices, see Ball et al, 1996.

The historical specificity of these volatility data is highlighted by the current behaviour of house prices in France. Although it has traditionally been a low price volatility country, French house prices are now surging dramatically and, so, its erstwhile price stability is rapidly disappearing.

Table 3: Real house price volatility 1970s-1980s & 1980s-2000s compared

	1971-1985	1986-2003	Difference	Rank 71-85	Rank 86-03
EUROPE					
Finland	6.9	11.8	4.9	7	1
Spain	8.6	9.4	0.8	5	2
Norway	4.5	8.5	4.0	11	3
United Kingdom	11.1	8.4	-2.7	3	4
Sweden	5.9	7.6	1.7	10	5
Italy	12.3	7.5	-4.8	1	6
Denmark	10.1	6.4	-3.7	4	7
Ireland	6.6	6	-0.6	8	8
Switzerland	6.5	5.9	-0.6	9	9
France	4.3	4.7	0.4	12	10
Netherlands	11.7	4.1	-7.6	2	11
Germany	3.3	2.6	-0.7	13	12
Belgium	7.9	1.7	-6.2	6	13
OTHER COUNTRIES					
Australia	5	6.6	1.6	4	1
Canada	6.8	5.6	-1.2	3	2
Japan	8	4.6	-3.4	1	3
New Zealand	8	4.4	-3.6	1	4
United States	3.4	2.7	-0.7	5	5
'Europe' average	7.7	6.5	-1.2		
'Other' average	7.3	6	-1.3		

Source: Own calculations and IMF

Causes of house price changes

Table 4 identifies several factors that are generally regarded as influential on house price change:

- economic growth
- increases in housing supply
- share of owner occupation

- mortgage debt to income ratio
- increase in mortgage indebtedness
- extent of use of fixed and variable rate mortgages
- existence of mortgage interest tax relief

There is not a simple systematic relationship across countries between house prices and economic growth, housing supply, existing degree of mortgage indebtedness nor whether mortgages are fixed or variable interest rate based. Therefore, singular institutional or economic performance factors are unlikely to be straightforward explanations of contrasting housing market performance.

Perhaps, the one factor that stands out most strongly in Table 4 is the scale of mortgage interest tax relief (MITR). The most generous countries tending to have had the highest recent increases in house prices, namely Ireland, the Netherlands, Belgium and Spain. (Italy has traditionally had poor mortgage availability and, so, is not directly comparable with the other MITR countries and Switzerland's tax system is tenure neutral with respect to MITR and generally more favourable to renting). However, the UK provides illustration that abolishing MITR is no guarantee of slow rises in house prices.

Higher house price inflation countries also tend to have high ratios of owner occupation, with the exception of the Netherlands; whereas lower house price inflation countries tend to have 40% or more renting. This may suggest that higher entry costs to owner occupation discourage tenure transfer to home ownership and the resultant lack of first time buyer demand stops prices from escalating too fast.

However, this argument is one-sided as it only looks at the consumption of rental housing. In order to absorb the increases in housing demand that are the potential

Table 4: Potential causes of house price inflation

	Approx. real house price rise in latest upswing to 2003 %	Average annual growth 1995-2003 in: GDP	Res. Invest	Owner occupation % 2001-3	Mortgage debt to GDP ratio % 2002	% change in M/GDP ratio 1996-2002	% variable rate mortgages 2002	Mortgage interest tax relief
Ireland	160	8.2	11.6	77	37	32	70	Y
Netherlands	160	2.5	1.2	54	88	40	26	Y
Belgium	110	2.0	1.4	68	28	21	25	Y
UK	100	2.7	2.6	69	62	2	72	N
Spain	75	3.2	6.3	81	38	61	75	Y
Denmark	65	2.1	5.0	51	82	22	25	Y^+
Finland	55	3.6	4.9	58	32	3	97	Y^+
Sweden	50	2.8	0.9	60	48	-17	62	Y^+
France	45	2.2	2.2	56	19	5	20	N*
Italy	40	1.7	1.2	80	11	36	56	Y
Austria	0	2.0	-1.3	56	27	22	30	Y^+
Germany	0	1.3	-1.6	43	51	4	30	N
Switzerland	4	1.3	-2.1	31	-	-	-	Y

* France has many subsidised mortgage schemes $^+$ MITR is limited.

Sources: Based on Ball, 2003, 2005, BIS, OECD, *Housing Statistics in the EU, 2003*.

stimulus to house price rises in the first place, vacancies or additional supply have to exist in rental housing. Where do they come from? Does not that demand raise house prices itself? In other words, investment behaviour by landlords has to be incorporated into the picture. The very price rises that deter first-time buyers from owner occupation may encourage investors into rental housing. Moreover, they might have higher expectations of future house price rises than first-time buyers and are prepared to put up with low yields from rental income on the expectation of future capital gains. Hence, they can have higher housing demand than the potential first-time buyers they displace from purchase and accommodate in their rental homes during price booms. A rush of investors into rental housing has occurred in Australia, Ireland and the UK, for example, over the past decade. It is debatable consequently whether a higher share of rental housing actually stabilises housing demand.

An alternative interpretation of the impact of higher shares of renting may be that it is acting as a surrogate indicator of somewhat different processes associated with the process of buying and selling dwellings. For example, it may be highlighting a transactions effect in that high homeownership countries have more liquid housing markets where buying and selling is easier and, so, price changes are more rapidly transmitted through the housing stock as a whole than in other higher renter share countries.

Weight is given to the transaction argument when it is recognised that some high renter countries housing markets are more segmented than others and such segmentation limits price transmission effects and/or influences the rate of change of measured housing prices. In a country like Germany, for example, many new owner occupier dwellings do not appear in the house purchase statistics because they are individually built on purchased land sites. Increased demand for such properties, therefore, will transmit potential price effects through the land and construction markets not the housing market.[8] The same is true in France, where around 40% of new dwellings are built in such a way, plus in Belgium, Greece, Italy and several other countries. Such ‘self-organised’ building may also be a way of avoiding paying tax and, so, not be associated with large increases in mortgage finance either.

A reduction in new building or a greater capture of such housebuilding in the statistical net may also explain some house price changes. In Belgium and Italy, for example, land shortages have encouraged a significant switch from new housebuilding to improvement of the existing stock. The price of existing dwellings has consequently risen relative to new ones. As house price indices in those countries are predominantly based on estate agent sales of existing dwellings, as a result, they may be exaggerating the true extent of house price inflation. In more integrated house markets, especially those that rely most strongly on second-hand sales, demand transmission is more likely to occur through a succession of well-recorded purchases and sales by different households in transaction chains (and be clearly measured as housing market activity).

One factor missing from Table 4 is information on mortgage credit availability. This is some of the most difficult information to come by systematically but, obviously, most households in situations of rising house prices are going to have to borrow ever larger sums to fund home purchases. Mortgage availability, therefore, may be a crucial variable in understanding whether a country’s financial system is accommodating to significant house price increases or not. A number of countries do seem to have had noticeable increases in mortgage credit availability over the past

[8] German average house price indices are dominated by purchases and sales of flats, where owner occupiers are competing with landlords. This may have an influential effect on the smoothness of German house price indices.

decade, for one reason or another, including most of the higher house price inflation countries. France and Italy have also over the past five years seen relaxations in mortgage lending criteria and those two countries have experienced somewhat later house price accelerations in recent years.

Even so, a simple correlation between the most relaxed mortgage lenders and the rate of change of house prices is unlikely. Moreover, it is debateable whether severe credit rationing is actually a good way to regulate a housing market and whether mortgage growth is a consequence or cause of rising housing demand. Restrictive mortgage rationing inefficiently stifles housing demand, diminishes competition amongst financial institutions and creates distributional and social mobility problems through, often arbitrary, creditworthiness criteria.

Another absent element is the degree to which rising price expectations have become ingrained in popular perceptions of housing markets. With substantial price increases lasting for 6 to 18 years across many of Europe’s housing markets, many consumers have ingrained expectations of future rises, especially as pundits’ forecasts of stagnation or falling house prices fail to materialise. Obviously, prices cannot rise forever, so that each year the major price rises continue the more likely they are to be driven by unrealistic investment expectations and the greater is the probability of a period of falling real prices in the future.

Housing regions?

The ranking in Table 4 does suggest that there might be some regional similarities across Europe in house price behaviour, although the correlations may be chance events. Adjacent countries seem to be behaving in broadly similar ways, enabling 4 house price regions to be loosely identified.

- *Nordic countries:* Denmark, Finland, Norway and Sweden. They have experienced broadly similar 'mid-range' house price inflation for many years. They also all suffered from housing market 'bubble' shocks in late 1980s/early 1990s, which has left them with relatively high measured price volatility. They have high shares of rental housing, which itself is subject to strict controls with the partial exception of Finland. They have comparatively high levels of housing output with the exception of Sweden. Economic growth has been strong and geographically focused in recent years. Mortgage markets are highly concentrated.
- *Central European countries:* Austria, Germany and Switzerland. They have had stagnant housing markets for many years. Economic growth has been poor. Housing supply is relatively elastic by European standards. Rental sectors are large and strongly regulated. Housing markets are weakly integrated. Mortgage finance is strongly regulated as well.
- *Northern Atlantic countries:* Belgium, Ireland, the Netherlands and the UK. They have experienced the greatest recent house price rises. Economic growth has been strong, particularly in Ireland, and geographically focused. Mortgage markets are moderately concentrated. Housing supply has been poor, with partial exception of Ireland (though there much new housing is in the wrong places). Two of the countries in this group have recently experienced stagnation in their house prices: the Netherlands and the UK.
- *Mediterranean countries* France, Italy and Spain. Experience here has been more mixed, but all three have had substantial house price inflation, which has been accelerating in recent years. They share different institutional traditions

from countries in the other groupings, though they are generally unique ones rather than reflect the common features of the first two groupings.

The importance of supply

As with all other goods, the long-run price of housing is determined by the costs of its supply. Supply is slow to come on stream in housing markets, so that short run house prices tend to overshoot longer term ones. Two supply-side factors have had a long-term influence on European house price growth.

- A greater concentration of economic activity in a number of countries in a narrow range of growth regions. The more geographically concentrated economic activity is the less is the available existing housing stock and residential land supply likely to be to satisfy increases in housing demand.
- One of the major problems of housing markets in Europe is that an already low supply responsiveness to housing market upturns is becoming worse. Some countries, such as Denmark, the Netherlands and Sweden, for a variety of reasons have relatively high construction costs. Most, to varying degrees, have tightening land-use policies that limit the supply of building land, particularly in the regions where it is in greatest demand.

The UK is renowned for the cap on suburban housing growth in Southern England imposed by its planning system and recent central and local government announcements about land supply indicate that the problem will grow. Attempts to deal with the Irish housing boom have also focused on tardy land supply and the need for more infrastructure facilities to open up additional development sites. Municipalities in Spain were blamed for delaying land release for several years, although housebuilding picked up strongly in recent years – though less so in the major cities. In the Netherlands, in the second half of the 1990s, a stricter land development policy was introduced at a time when housing demand was extremely strong. Belgium is also experiencing severe land shortages. Even Sweden, which once could claim to have low land costs, now faces problems of growing development land shortages.

Some element of current house price surges, therefore, may be that market actors are anticipating the implications of a more restricted European housing supply.

Shifts in real wealth and impacts on labour mobility and general inflation

The real price of housing has risen by substantial amounts in a number of European countries. This can be seen in Table 1, where by 2003 house prices have risen since the mid-1980s by over threefold in Spain; over twofold in Belgium, Ireland, the Netherlands and the UK; and by 20 to 60% in France, Italy and the Nordic countries.

Not only does this substantial wealth increase create 'affordability' problems for new entrants to housing markets who are hit by high entry costs.[9] It also generates substantial shifts in wealth within societies between property owners (landlords as well as owner occupiers) and non-property owners. Such substantial distributional changes run counter frequent claims within Europe of a greater concern with distributional issues than exists less 'socially concerned' countries elsewhere in the world.

Furthermore, high housing entry costs restrict labour mobility identified by many as so important to European countries growth prospects. It is paradoxical that a country like the UK can be proud of its labour market flexibility, contrasting its characteristics

[9] This does not mean that house price rises are necessarily bad news for new owner occupiers because, as long as prices continue to rise, they receive large capital gains on their own highly geared capital.

in that respect to countries such as Germany,[10] while at the same time negating the possibility of mobility for many by the existence of barriers in the housing market, which contemporarily exist far less in a ‘rigid labour market’ country like Germany.

It is interesting to noted that many of the highest house inflation countries in the Europe have also been the most general price inflation prone ones over the past five years, including Ireland, the Netherlands and Spain. In part, this has been due to the stimulus to consumer demand of house wealth and equity withdrawal, but there has been a labour market route for housing-related influences as well, particularly when collective bargaining is an important element of wage setting as it is in a number of European countries, such as Ireland, the Netherlands and Spain.

Are there world residential price cycles?

With many advanced economies and some lesser developed ones experiencing marked increases in real house prices over the past decade, many observers argue that there has been a world house price upswing over the period that, writing early in 2005, has yet to end.[11] Much debate focuses on whether these rises represent ‘price bubble’ features and what consequences are likely to arise. Within that debate, commentators and experts are divided on the lines of a two-by-two matrix; the rows of which separate those with a ‘hard’ view of a severe price crash or a ‘soft’ view of price stagnation after the boom and the columns divide those that think the impact of the end of the housing boom for individual countries’ economies or the world economy will be substantial or limited.

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[10] This theme has be a frequent one of recent EU related speeches by the current UK Chancellor of the Exchequer, Gordon Brown.

[11] This view has been expressed most succinctly by researchers at the IMF, though other leading international banking organisations and many national central banks have also followed suit. More journalistic international publications, such as *The Economist,* have also promoted the world property boom view and issued dire warnings of the disastrous impacts of its aftermath.

One major problem with the notion of a world residential price cycle is that it relies on a one-sided interpretation of the available empirical evidence. The most notable counter-evidence is that the world's second and third largest economies – Japan and Germany, plus some of its richest – like Austria and Switzerland, rather than seeing rapid house price rises over the past decade, have experienced long periods of stagnant or falling house prices. Moreover, even for the countries with rises in prices, neither the timing of recent house price upswings nor their scale are actually that well correlated. Empirical generalisations about world property markets, thus, fall foul of widespread real diversity in housing market behaviour.

In addition, there are theoretical problems with the world housing market view. The question has to be asked of what transmission mechanisms generate world, rather than country or region specific, residential price booms. People tend to live and move only within one country or even regions and cities within them. International migration is relatively small in housing market terms and, even though it may stimulate housing demand in the recipient nation, it is simultaneously depressed in the country of origin. In any case, the majority of migrants tend not to have incomes as high as incumbent households. The same conundrum is true of economic growth as a housing demand stimulus – booming national or regional economies may be offset by declining or stagnant ones elsewhere.

Real economic variables, however, rarely appear in generalisations about world house prices. The suggested causes focus overwhelmingly on monetary and financial factors. The three most cited concern the behaviour of the price level (inflation has fallen markedly over the past decade), interest rates (they are at historic lows) and asset allocation strategies (investors in an era of easy credit are frustrated in the aftermath of post-dotcom and bond price booms and have diverted funds into housing). Such monetary factors obviously affect housing markets but so do many other variables. No credible housing market model, in fact, is a purely monetary one; instead they identify arrays of real and monetary factors influencing demand and supply.

The timing of housing market cycles, moreover, depends on local demand and supply circumstances. Demand is determined by local demographics, migration, taxation and subsidy policies plus institutional and structural economic change, as well as the general pattern of income, interest rate and other macroeconomic change. Supply responsiveness varies considerably as well, so that regional housing market behaviour in any individual country varies in the timing of their cycles. The same lack of synchronisation holds when comparing countries as well.

Conclusions and policy implications

A diversity of housing market experiences has been identified across Europe and across time. The length and irregularity of housing market cycles has important policy implications.

First, changes in the phases of cycles are extremely hard to identify when they are occurring. Measures to moderate fluctuations, such as interest rate adjustments or demand stimulation measures, consequently face severe problems of identifying when to intervene. France shows this problem starkly. In the late 1990s and early 2000s, a series of housing market demand stimuli were introduced in the, what turned out to be false, belief that demand needed boosting – whereas, in fact, it needed to be dampened.

The second major problem facing attempts to intervene in housing markets is that general economic activity and housing market demand do not necessarily correlate well. It is easy to identify, after the event, situations when both move strongly in parallel. Yet there are probably more cases when they do not. Demand management clearly should be focused on performance in the macro-economy, rather than on the housing market. Dragging the housing market into such an arena, therefore, is often not helpful, especially as the relationship between house price and aggregate demand changes does not seem to be that stable.

It may be wisest to conclude that housing market fluctuations are an inevitable part of economic life. With that in mind, it is unadvisable to intervene and to regulate housing market too strongly, because to do so loses substantial efficiency gains from market activity and builds up entrenched economic interest groups, whose rationale for state largesse becomes progressively diminished over time. Housing is a classic pressure group interest. Taxes breaks and subsidies about and, perhaps most importantly, special interest groups now have strongly influences in restricting the supply of housing land in many European countries. Rather that over-reacting to housing market cycles, governments would be better advised to deal with the structural issues in housing of excessive tax breaks and subsidies, too much regulation (particularly in rental markets) and insufficient land supply. Housing booms go away, these politically tricky structural issues do not.