Analysis

Wide regional disparities in Finnish house prices and household indebtedness

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Finland's house prices have diverged regionally over the past decade, particularly between the Helsinki metropolitan area and the rest of the country. Regional disparities on the housing market are also reflected in the amount of housing debt held by households. Housing loans are large and have grown in absolute terms as well as relative to income, especially in growth centres, where housing is more expensive and subject to greater pressures from demand. Simultaneous growth in house prices and housing debt, if excessive, can pose a threat to the stability of the financial system.



What does the regional diversity in prices tell us?

Widening regional divergence in house prices and household indebtedness has been a major trend on Finland's housing and credit markets since 2010. Housing market divergence is largely a consequence of urbanisation[1], a global megatrend which often goes hand-in-hand with economic growth. The housing and credit market cycles can prove detrimental to financial stability, particularly if the markets begin to strengthen or weaken one another excessively.

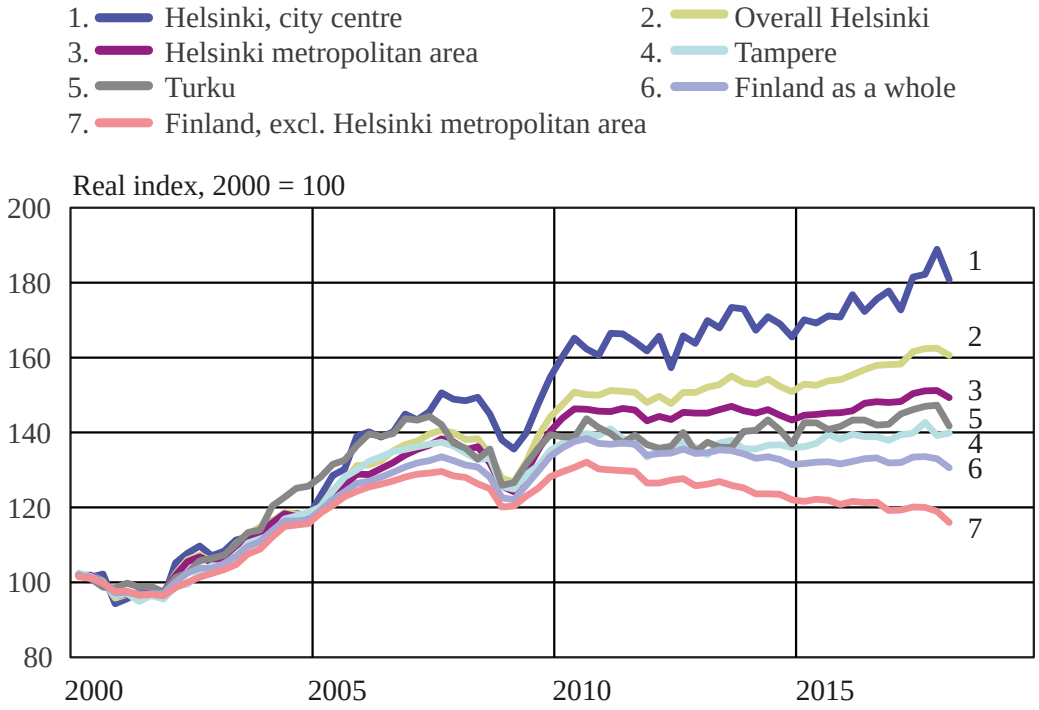
In the article One country, many housing markets (2015), it was established that households with housing debt who resided in growth centres held, on average, more debt than those living elsewhere in Finland. The strong relationship between house prices and housing indebtedness was also illustrated in that households with housing debt were, on average, found to hold larger loans in municipalities where house prices per square metre were higher. This article continues these themes, making use of the latest data to re-examine the regional divergence on the housing market since the turn of the millennium.

Overall growth in house prices has remained relatively modest in Finland since the severe economic downturn of 2009 and the subsequent period of subdued economic growth. At the same time, however, house prices in urban growth centres have significantly diverged from those in the rest of the country. Real house prices have increased most rapidly in Helsinki and in the surrounding metropolitan area (Chart 1). This is in stark contrast to the decrease in the

nationwide average, and especially so when exempting the Helsinki metropolitan area from the index. By early 2018, average real house prices were below their autumn-2010 peak.

Chart 1.

House prices up in growth centres, lower elsewhere



Source: Statistics Finland.

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House prices are influenced by a variety of cyclical and structural factors whose effects can vary from region to region. For example, the effects of low interest rates and improved employment conditions are particularly evident in areas where demand for housing outpaces supply. In Finland, growth centres such as the Helsinki metropolitan area have become increasingly attractive compared with the rest of the country, resulting in growing urbanisation and divergence in regional house prices.

Migration among Finland's working-age population has increased. The majority of households (approximately 64%) are home owners, but the availability of rental housing also remains good. The lack of affordable housing in growth centres is, however, widely considered to be a bottleneck

for employment and economic growth. Other structural factors, such as the impact of transfer tax on moving costs, might also restrict migration and reduce household mobility within the labour market.[2] Moreover, the labour market mismatch between vacancies and skills of jobseekers has, for various reasons, worsened particularly in the Helsinki sub-region and the labour markets in other growth centres.[3]

Housing debt increased particularly in growth centres

The growth of housing debt and its regional divergence can be examined by comparing the average amount of housing debt per household with housing debt across Finland's municipalities. The increase in the average size of housing loans and the lengthening of average repayment periods is well-characterised by the fact that, in 2002, the average household with housing debt in a typical municipality held approximately EUR 43,000 of housing debt. In 2009 and 2016, these figures reached EUR 69,000 and EUR 72,000, respectively. In each year, the average household with housing debt held more housing debt than this median amount in half of all municipalities, while corresponding households in the remaining half held an amount below the median. These figures exclude the household share of housing company loans as well as loans related to investment properties.

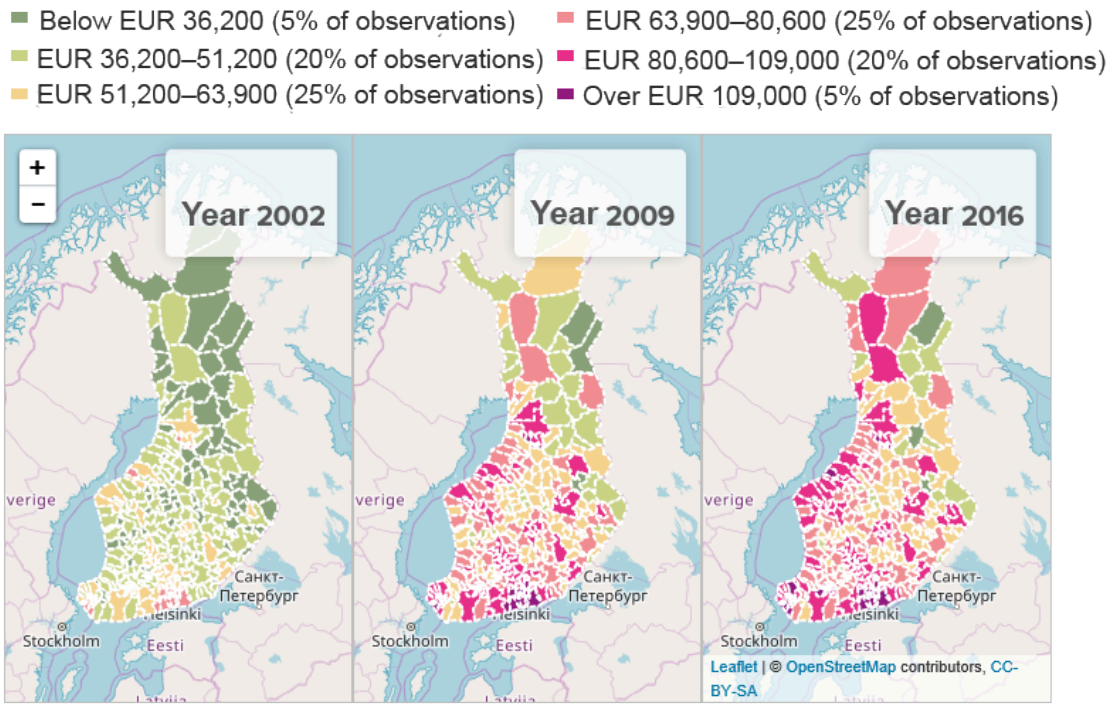
In Chart 2, municipalities have been divided into six categories based on the median amount of housing debt over the years 2002–2016 (approximately EUR 63,900) and other key values (i.e. percentiles) pertaining to the distribution. In 2016, the largest housing loans (averaging over EUR 80,600) were concentrated around Helsinki and Finland's other major urban areas (purple and pink in Chart 2). In 2002, only a few municipalities, generally restricted to the Helsinki sub-region, saw average housing loans this large. The shift from 2009 to 2016 was much smaller.

Chart 2.

Regional divergence in housing debt remains evident even when regional differences in average household income are taken into account. It would then appear that the regional divergence in house prices is generally stronger than the divergence in incomes. Housing debt relative to income *of households with housing debt* is largest in Åland (212% in 2016), the Helsinki metropolitan area (205%) and elsewhere in the province of Uusimaa (198%) (Chart 3). In contrast, debt ratios actually remain below the national average (182%) throughout the rest of the country. Growth in housing debt relative to income remained brisk across all regions, particularly in the early 2000s, when both the average loan size as well as the average repayment period increased considerably.

Chart 2.

Average housing debt (per household with housing debt) greatest in growth centres



Housing debt categories are composed on the basis of the 5th percentile (approx. EUR 36,200), lower quartile, median, upper quartile and 95th percentile (approx. EUR 109,000) of all data points. The annual data refer to the amount of housing debt per household with housing debt (in 2016 prices) in each municipality over 2002–2016.

Sources: Statistics Finland and calculations by the Bank of Finland.
The map contains data from the National Land Survey of Finland Topographic Database 03/2018.

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Housing debt accumulation moderated by macroprudential policy

Housing and credit markets are notoriously prone towards mutually reinforcing cycles during economic upswings. Rapidly growing indebtedness and soaring house prices are consistently found to be key factors in determining the probability and severity of financial crises. Macroprudential policy is conducted with the goal of maintaining financial stability, both by moderating dangerous financial cycles as well as by strengthening the ability of households and credit institutions to withstand the realisation of systemic risk.

One intermediate goal of macroprudential policy is to mitigate and prevent excessive credit growth and leverage, e.g. by setting restrictions on lending for house purchase. It is widely

accepted that macroprudential policy should not be conducted with the explicit goal of maintaining price stability on the housing market.[4] Nevertheless, house prices, e.g. relative to disposable income, are an important economic indicator and often serve to warn of growing vulnerability and systemic risk in the financial system.[5]

While restrictions on lending tend to vary from one country to another, macroprudential policy is generally applied consistently across all regions. Despite this, regional factors, such as local housing market conditions, can prove to be significant. When the economy is in a period of cyclical expansion, it is possible for a rise in house prices to feed households' borrowing capacity and accelerate debt accumulation, especially in areas where the housing prices are already above average. Conditions such as low interest rates and long repayment periods only add to this risk.

Some countries have adopted a strategy where macroprudential policy is targeted to address specific regional vulnerabilities on the housing market. In Norway, for example, the maximum LTV ratio on new housing loans is enforced more stringently in Oslo than elsewhere in the country. In addition, loan cap limits on second home purchases remain tighter in Oslo.

In Finland, the maximum LTV ratio is the same for home-buyers everywhere: 95% for first-time buyers and 90% for other buyers (85% from July 2018 onwards). Certain countries have started to adopt loan caps based on loan-to-income (LTI) and debt service-to-income ratios (DSTI). Policies such as these could prove to be effective for containing household indebtedness, especially in the face of rising house prices.

Notes

1. Urbanisation is the increase in the proportion of people living in towns and cities relative to the entire population. According to Statistics Finland's most recent data (2016), approximately 70% of Finland's population reside within an urban area, whereas the corresponding figures for 2000 and 1990 were approximately 65% and 62%, respectively. ↑
2. Eerola, E. – Harjunen, O. – Lyytikäinen, T. – Saarimaa, T. (2018) Effects of Real Estate Transfer Taxes: Evidence from a Natural Experiment. Publication series of the Government's analysis, assessment and research activities 17/2018. ↑
3. According to a study, this is partially explained by structural changes within the labour market, both on the supply-side (e.g. age and education) as well as the demand-side (e.g. sectoral composition and fixed-term and part-time contracts). See Pehkonen, J. – Huuskonen, J. – Tornberg, K. (2018) Matching efficiency in the labour market – observations and policy suggestions. Publication series of the Government´s analysis, assessment and research activities 15/2018. ↑
4. For further discussion, see Stefan Ingves' "Avoiding collective amnesia", keynote speech at the conference "Should macroprudential policy target real estate prices?" 11-12 May 2017. ↑

5. For research, see e.g. Tölö, E. – Laakkonen, H. – Kalatie, S. (2018) Evaluating indicators for use in setting the countercyclical capital buffer. International Journal of Central Banking, 14, 2, p. 51–112. ↑

Keywords

financial stability, households, housing markets, indebtedness