

# HIGHLIGHTS

## Highlight 1. Trends on the Market of Residential Real Estate in Serbia and the World

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### Introduction

The prices of residential real estate in Serbia have been on the rise since 2013, when their decline was last recorded. The situation in two large markets, the European Union and the United States of America, largely corresponds to the situation in Serbia. Significant growth in all three mentioned markets was achieved in the last two years. Since the second half of 2020, growth rates have recorded record levels.

Favorable economic trends and low interest rates certainly contributed to the growth of demand, supply and prices. After a few years of low interest rates on housing loans, low inflation, economic growth, employment growth, and other favorable economic indicators, there is a change in economic reality that could be transferred to the real estate market. According to the first available data for the second half of 2022, the changes are obvious. The extent to which there will be a reduction in the growth or fall of real estate prices in Serbia and other markets will depend to a large extent on the general economic trends until the end of this year and during the beginning of 2023.

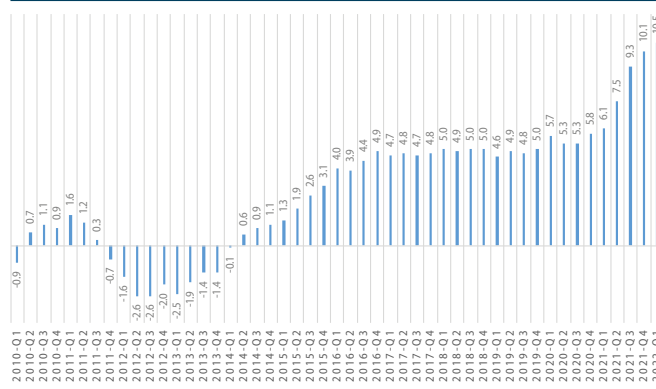
### Trends in the residential real estate market in the European Union

Prices of residential real estate<sup>2</sup> at the level of the European Union in Q1 2022 continued to record historically record growth rates (Graph 1). The price of residential real estate in Q1 2022 was 10.5% higher than the price recorded in the same quarter of the previous year (Q1 2021). This is also the highest growth rate in one quarter on an annual basis in the last more than 10 years.

Favorable conditions on the housing loan market are certainly one of the reasons behind the record growth rates of real estate prices in the EU. As a consequence of

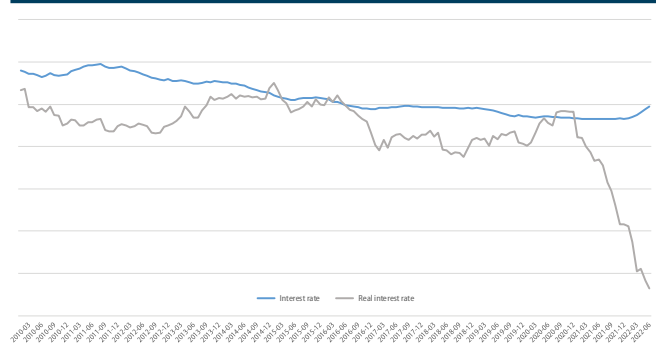
the monetary relaxation aimed at stimulating economic growth during and after the pandemic, the real interest rate, starting from Q2 2021 until today, records negative rates (Graph 2). At the end of the first half of 2022, the average interest rate on housing loans in the Eurozone was 1.9%, while in the same month inflation in the EU was 8.6%, and the real interest rate on housing loans was -6.7%.

**Graph 1. Growth of residential real estate prices in the EU, Q1 2010-Q1 2022, year-on-year growth rate**



Source: Eurostat - House price index

**Graph 2. Movement of nominal and real interest rates on housing loans in the eurozone**



Source: ECB, Euro Area Statistics, Loan for house purchase

The real interest rate is defined by two factors, the interest rate and the inflation rate. And although during most of 2021 the negative real interest rate was a consequence of low interest rates and relatively low inflation, in 2022 the real interest rate is a consequence of rising interest rates on housing loans and high inflation rates.

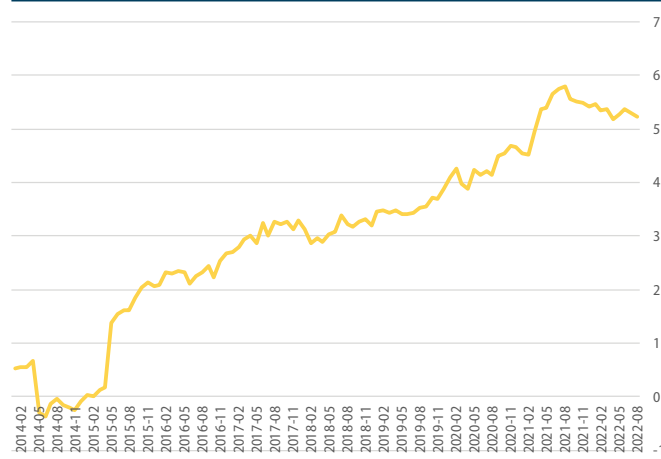
The negative real interest rate in conditions of low inflation led to an accelerated growth of the mass of housing loans in the eurozone at the beginning of 2021. The highest growth rate was recorded precisely at the end of 2021, when the growth rates of the mass of housing loans also recorded a record. However, the growth rates of the mass of housing loans slowed down at the beginning of 2022, in conditions when the real interest rate is significantly lower than during 2021 (Graph 3). The main reason behind such trends

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<sup>2</sup> The House price index (HPI) measures inflation in the residential real estate market. HPI records price changes of all types of residential real estate purchased by households (apartments, houses, etc.), both new and existing. Only market prices are taken into account.

is precisely the fact that such low real interest rates are the result of high inflation, which reduces disposable income, and thus the risk of borrowing for housing loans even in conditions of very low real interest rates.

**Graph 3. Growth in the mass of housing loans, eurozone, year-on-year growth rate**



Source: ECB, Euro Area Statistics, Banks balance sheet, house loans

The European Central Bank (ECB) warned as early as May 2022, in the Financial Stability Review publication, that the moment when interest rates rise faster than inflation will probably be a turning point in the real estate market. It is very likely that such conditions will be realized during 2023, when inflation growth rates slow down and interest rates continue to rise. The growth rates of the mass of housing loans shown in Graph 3 also indicate a significant increase in the indebtedness of the EU population, which certainly, in addition to high inflation, reduces their disposable income, which will especially come to the fore in the coming period under the influence of rising interest rates.

Although prices continue to rise, there is a noticeable drop in the number of properties sold. Already in Q1 2022, out of 12 observed EU countries, for which there are official data, as many as 8 countries recorded a decrease in the number of sold real estate on an annual level compared to Q1 2021. As many as 9 out of 12 observed countries recorded a decrease in the number of sold real estate compared to the previous quarter (Q4 2021).

Available data in Q2 2022 indicate an even stronger deterioration in the real estate market in the EU. According to the research of the European Central Bank, which includes 153 banks, as many as 62% of banks reported a strong tightening of credit conditions for obtaining housing loans. According to the same research, further tightening of credit conditions for obtaining housing loans is expected in Q3 2022.

It should be noted that only 55% of banks reported only a moderate worsening of conditions for consumer loans and other loans aimed at citizens, which clearly indicates that the strong deterioration of conditions for housing loans is primarily related to the perception of risk on the real estate market, considering the characteristics of this type of loan (long repayment term, high loan value, uncertain real estate price movements, etc.).

Of the 153 banks surveyed, in the previous four quarters, an increase in rejected applications for housing loans was reported by 74 banks in Q3 2021, 75 in Q4 2021, 76 in Q1 2022 and as many as 98 in Q2 2022.

In addition to the increase in banks reporting an increase in rejected requests for housing loans, for the first time in the last year, a larger number of surveyed banks reported a decrease in requests for credit funds for the purchase of real estate. In the predictions for Q3 2022, as many as 74 percent of surveyed banks expect a strong reduction in the demand for housing loans.

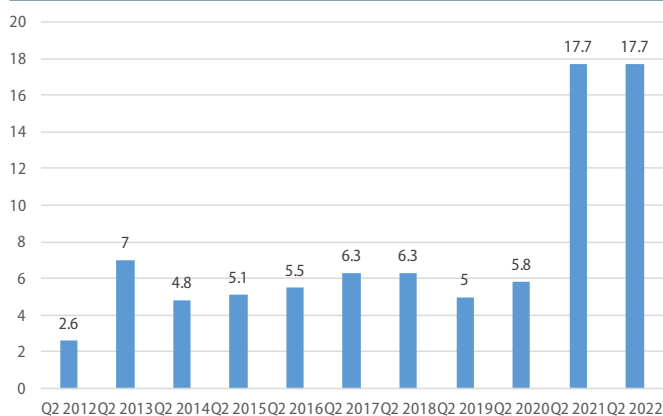
If the banks' estimates for Q3 2022 come true, it would represent the biggest drop in demand for housing loans since the last quarter of 2008, if we exclude the period of the covid pandemic in which the movement of citizens was also limited. Also, if we exclude the pandemic period, this is the first time since 2013 that, according to banks' perceptions, the conditions on the real estate market do not have a positive effect on the demand for loans.

The observed decline in sales in a large number of EU countries, for which there are available data, followed by the decline in demand for housing loans, represent a clear signal that changes are coming to the residential real estate market in the European Union. A slowdown in real estate price growth in EU countries is almost certain in the coming period. Whether their decline will occur will depend on a number of factors, and the data for the next quarter (when available) will provide us with a clearer picture of the possible decline in residential real estate prices in the EU.

### Trends in the residential real estate market in the United States of America

The y-o-y growth rate of real estate prices in the USA in Q2 was 17.7%, the same as in Q2 2021 (Graph 4). Such high growth rates in the previous two years are consistent with the high growth rates of real estate prices in the US on a monthly basis in the previous two years.

**Graph 4. Growth of residential real estate prices, seasonally adjusted quarterly data**

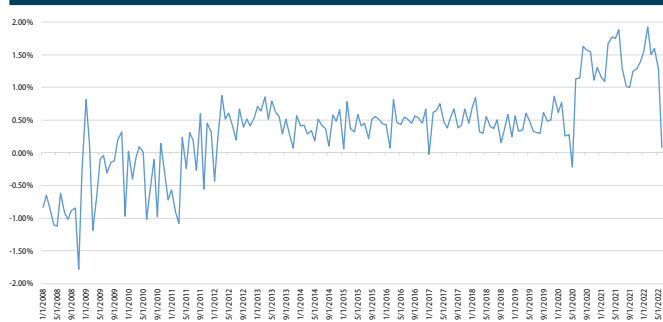


Source: FHFA House Price Index (HPI) Quarterly Report

The growth rates of real estate prices in the United States of America on a monthly basis from June 2020 until May 2022 exceeded 1% (24 months in a row), and in total the growth rate in that period was 38%, and since 2012 cumulatively 117%. Growth rates of over 1% on a monthly basis were recorded in only 4 months in the 30 years (or 360 months) preceding this period.

But, as in the EU market, global economic uncertainty, along with high real estate prices, rising interest rates and high inflation rates lead to a slowdown in the real estate market. In June 2022, the monthly growth rate of real estate prices in the USA was only 0.08% (Graph 5).

**Graph 5. Monthly growth rates of real estate prices in the USA**



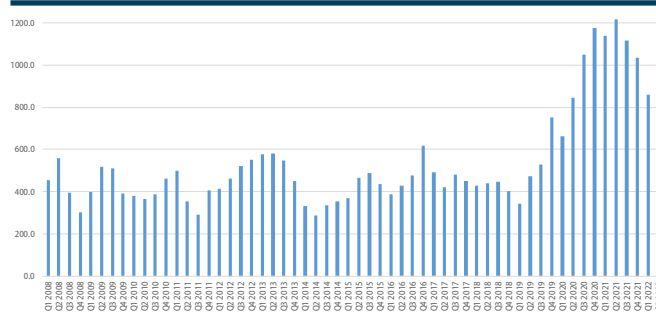
Source: Federal Housing Agency of the United States Government, Monthly FHFA House Price Index

In addition, data on the number of residential units sold indicate a slowdown in the residential real estate market. According to data from the Department of Housing and Urban Development of the United States Government<sup>3</sup>, the number of newly built residential units sold in July 2022 was 12.6% lower than the previous month, and even 29.6% lower than the same month of 2021. The number of existing residential units sold is 5.9% lower in July compared to June 2022, and 20.2% lower compared to July 2021.

3 <https://www.hud.gov/>

Along with the slowing growth of real estate prices and the decline in the number of newly built units in the US, there was a decline in new real estate loans in 2022. The total amount of newly approved loans for the purchase of real estate in Q2 amounted to 758 billion dollars, which is 38% less compared to the same period of the previous year (Graph 6). After the record quarterly amounts achieved in 2021, in 2022 it is expected that the value of newly approved loans for the purchase of real estate will decrease further, and the total annual value will decrease from 4,505 billion dollars to 2,700 billion dollars (a drop of 40%).

**Graph 6. Value of newly approved loans for real estate in the USA, by quarter**



Source: Federal Reserve Bank of New York Household Debt and Credit Developments in 2022Q2

The Federal Mortgage Corporation for housing loans of the USA, Freddie Mac, in the latest market research indicates that citizens' confidence in the residential real estate market is below 50% for the first time since March 2020, i.e. the beginning of the COVID19 pandemic. Confidence has been declining since the beginning of 2022 and in September 2022 it is at the level of 46%.

According to the forecasts of financial institutions, private and public, the growth rate of real estate prices in the USA in 2022 should be between 10-12%, while growth forecasts for 2023 are 0-4%.

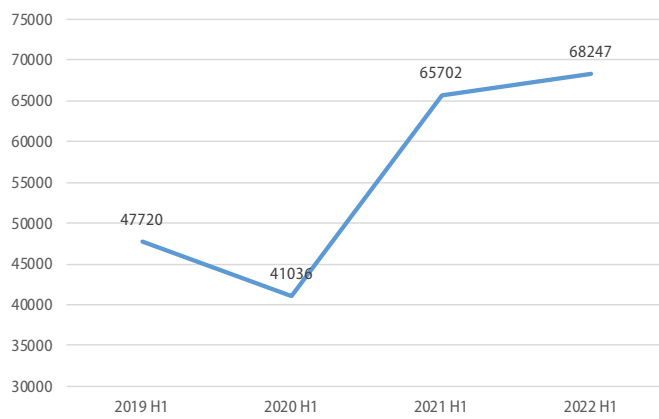
### Trends in the residential real estate market in Serbia

The volume of funds on the real estate market in Serbia in the first half of 2022 amounted to 3.6 billion euros, 25% more than in the first half of 2021. This result is primarily a consequence of the increase in real estate prices, as the recorded increase in the number of real estate sold in the same period was only 4%.

The fact that the growth in the number of sold real estate between the first half of 2021 and 2020 was as much as 60% shows that the real estate market is slowing down. Considering that 2020 was a pandemic year, this data does not show a realistic picture because in 2020 there was a decrease compared to 2019. If we take 2019 as a

comparable year, we will see that the number of real estate sales contracts in the first half of 2021 was 37% higher than in the first half of 2019.

**Graph 7. Number of sales contracts in the Republic of Serbia, H1 2019 – H1 2022**



Source: Republic Geodetic Institute

Another indicator that the real estate market in Serbia is in a slowdown, which is evident at the level of the European Union and the USA, is the decrease in the share of credit funds in the total purchases of real estates in Serbia.

**Table 1. Share of credit funds in the total purchase of real estates in Serbia, I 2017 – I 2022**

Year	2017 H1	2018 H1	2019 H1	2020 H1	2021 H1	2022 H1
Real estate	11%	12%	13%	15%	16%	12%
Appartments	/	/	28%	33%	36%	28%

Source: Republic Geodetic Institute

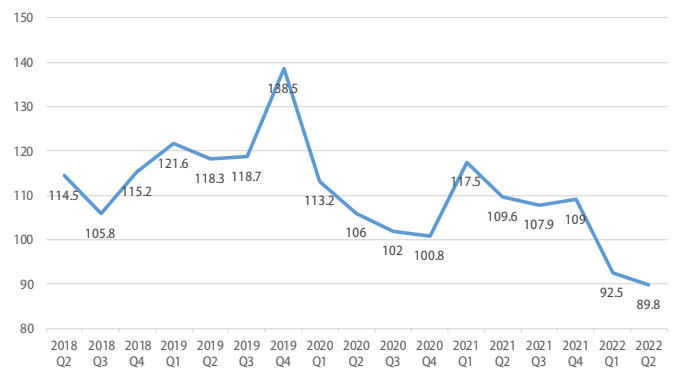
Stable growth in the share of credit funds in the total purchase of real estates, stimulated by favorable borrowing conditions and the growth of average wages in euros, contributed to faster growth in demand and pressure on real estate prices in Serbia. In addition to the limited scope of supply, despite intensive construction, the growth in demand also affected the rise in real estate prices. The decrease in the share of credit funds in the total purchase of real estates in the first half of the year, along with the expected further decrease in the second half of 2022 and throughout 2023, will definitely have an impact on reducing the demand for real estate in Serbia.

According to SORS data, the value of construction works performed in Serbia in constant prices in Q2 2022 was lower by 8.8% compared to Q2 2021. The value of construction works performed on buildings was lower by as much as 10.2%. In the previous quarter, Q1 2022, the value of construction works performed in Serbia at constant prices compared to the same quarter of the previous year (Q1 2021) was lower by 5.9% for all activities, while for buildings it was lower by 7.5%.

The decrease in the value of the works performed, along with the increase in prices, implies that the decrease in the quantity of the works performed is even greater.

These are also the only two quarters in the last 4 years in which a decline in the value of works performed on buildings in Serbia was recorded, even including the pandemic year 2020 in the analysis.

**Graph 8. Indices of the value of construction works performed in constant prices on buildings in the Republic of Serbia, y-o-y indices**



Source: SORS

## Expectations on the residential real estate market in Serbia

A stronger economic slowdown in Serbia is expected in the second half of the year. Estimates of the relevant institutions' of GDP growth in Serbia at the level of the whole year 2022 are lower compared to the achieved growth in the first half of the year, so the slowdown of the economy in the second half of the year is almost certain. In addition to the existing high inflation, which is expected in the coming period as well, and which reduces the disposable income of households and individuals, the slowdown in GDP will certainly affect the decrease in demand for real estate.

Also, interest rates in the European Union have been significantly increased during the last few months, and their further growth is expected until the end of this year, as well as during the first half of the next year. For example, the six-month Euribor in January 2022 was -0.535%, while on September 26 it was 1.803%. It should also be noted that the highest Euribor rate in the last 10 years was 0.472% in September 2012. Such a change, and further growth, will certainly affect interest rates on housing loans in Serbia which are linked to Euribor.

The slowdown in economic growth, the rise in interest rates and high inflation rates will certainly have a certain effect on reducing the demand for apartments in Serbia. However, the slowdown in demand on the real

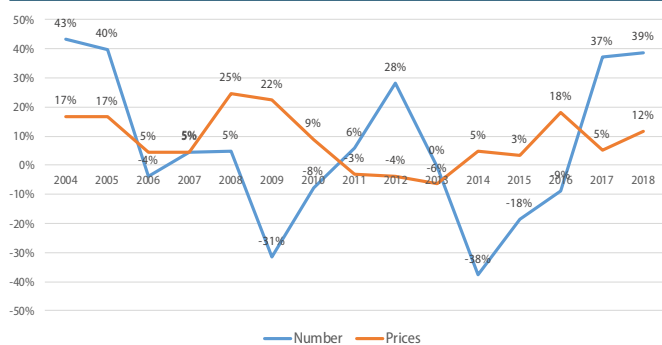


estate market will probably not result in a significant reduction in prices, i.e. we should not expect them to return to the pre-crisis level. In addition to the fact that the costs of labor and materials needed in construction have significantly increased compared to the pre-crisis level, as a rule, the real estate market adjusts its activity to price movements, so in the immediate future, above all, a decrease in the number of built properties can be expected, rather than a significant drop in prices.

The period of the world economic crisis of 2008-2009, which was activated by the bursting of the bubble on the real estate market in the USA, had significant consequences on the decline of economic activity at the level of the whole world, including Serbia. Real estate prices in Serbia recorded a drop of only -3% in 2011, -2% in 2012, and -5% in 2013, that is, cumulatively only 9.4%.

How the market reacts is best shown by the example of new construction in the City of Belgrade during the crisis period (Graph 9). Immediately after the beginning of the world economic crisis and despite the expected slowdown in economic growth, problems in the financial system, and other problems that were evidently going to occur, the real estate market managed to maintain a growth rate of 22% in 2009, precisely by reducing the supply of newly built apartments by as much as 31%. A slight drop in the prices of newly built apartments was recorded in 2011, 2012, and 2013, by only -3%, -4% and -6%, respectively. Cumulatively, in the three-year period, prices fell by 13%. The market reacted again by reducing the supply of newly built apartments by as much as -38% in 2013, after which prices recorded positive growth rates.

**Graph 9. Price movements and quantities of newly built apartments in Belgrade, 2004-2018**



Source: SORS

The slowdown in activity on the real estate market represents a good opportunity for decision makers in Serbia to actively respond to increasing the availability of apartments for Serbian citizens, as well as the quality of housing conditions. The first step towards solving the housing problem in a country is the successful adoption and implementation of the National Housing Strategy.

## Conclusion

Data from the residential real estate market in Serbia, as well as in the European Union and the United States of America, indicate the beginning of a change in the growth trend that has been especially present in the last two years.

Residential real estate prices in the European Union in Q1 2022 recorded a record year-on-year growth rate of 10.5% compared to the same quarter of the previous year (Q1 2021), thus continuing the trend of extremely high growth rates that began in the second half of 2020. However, in Q2 2022, there was a gradual change in the residential real estate market. There is a noticeable decrease in the number of real estates sold, while most banks report a strong tightening of credit conditions for obtaining housing loans, a decrease in requests for credit funds for the purchase of real estate, and an increase in rejected requests for housing loans. The observed changes, accompanied by the growth of interest rates on housing loans, represent a clear signal that there are changes in the residential real estate market in the European Union.

Similar trends are also present in the USA. The y-o-y growth rate of real estate prices in the USA in Q2 was 17.7%, the same as in Q2 2021. On a monthly basis, from June 2020 until May 2022, growth rates exceeded 1% (24 months in a row). However, in June 2022, the monthly growth rate of real estate prices in the USA was only 0.08%. The number of newly built and existing residential units sold in July 2022 is lower by 29.6% and 20.2%, respectively, compared to the same month in 2021. The total amount of newly approved loans for the purchase of real estate in Q2 was 38% less compared to the level from the same period of the previous year, while citizens' confidence in the stability of the real estate market is below 50% for the first time since the beginning of the pandemic.

In Serbia, the volume of funds on the real estate market in the first half of 2022 amounted to 3.6 billion euros, 25% more than in the first half of 2021. The y-o-y growth rates of real estate prices in the first half of 2022 are still very high. In line with global economic trends, signs of a slowdown in the real estate market are also present in Serbia. The recorded growth in the number of sold real estate in the first half of 2022, compared to the previous year, increased by only 4% (compared to rates from previous years that exceeded 35%). The value of construction works performed in Serbia in Q2 2022 was lower by 8.8% compared to Q2 2021, while the value construction works performed on buildings is lower by as much as 10.2%. The share of credit funds in the purchase of apartments in Serbia decreased to

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28% in the first half of 2022, compared to 36% from the first half of 2021. The slowdown in economic growth, the rise in interest rates and high inflation rates will certainly have a certain effect on reducing the demand for apartments in Serbia.

The main problem in Serbia is not the price of residential real estate and its movement, but the relationship between residential real estate prices and wages, which limits access to the real estate market to a small segment of society. The expansion of the number of people able to participate in the real estate market in the last few years is also a consequence of exceptionally low interest rates, but the influence of this instrument is gradually decreasing, while in the coming period its influence in the opposite direction can be expected.

Unlike the EU countries, the Republic of Serbia does not have instruments that would ensure the availability of housing to a wider segment of society, so significant developments in the real estate market in terms of availability to citizens should not be expected in the near future. Even the basic instrument of the state's action, the current National Social Housing Strategy, which to a certain extent was supposed to contribute to the improvement of housing conditions and the availability of housing for the wider population, in almost 10 years has realized only about 10% of the planned 400 million euros of investment.

The National Housing Strategy for the period from 2022 to 2032, which is in the process of being adopted,

should continue the activities of the previous National Social Housing Strategy. However, even if the new strategy is fully implemented, the way it is defined at this moment it is questionable to what extent it can have an impact on improving the living conditions of Serbian citizens.

### Literature

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