

March 2023 Briefing on European Construction

# THE CZECH HOUSING MARKET STUCK

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**High inflation brings something that has not been seen in Czechia for a long time – a halt to the growth of residential property prices, especially flats. Prices of older flats are even falling. Frozen demand will soon hit construction companies. The housing market has slowed down considerably and players are waiting for further economic development. Will this situation bring about a long-term change, or is the market just taking a break before returning to its old ways?**

As in the CEE region as a whole, home ownership is very widespread in Czechia. According to the latest Eurostat data, 78.3% of the population own their homes. Demand for owner-occupied housing has been high for a long time, and the housing market has benefited from this for many years. Thanks to high demand and its significant excess over supply, the residential sector has been the long-term engine of Czech construction.



In this situation, property prices have risen sharply. According to the Czech Statistical Office, property prices increased by around 130% between 2015 and 2022. One of the fastest price growth rates in the EU made residential property in Czechia a lucrative market for investors, and in Prague, where the growth rate was highest, the residential market resembled a kind of risk-free stock market rather than a housing market.

## Reaction trigger: Inflation

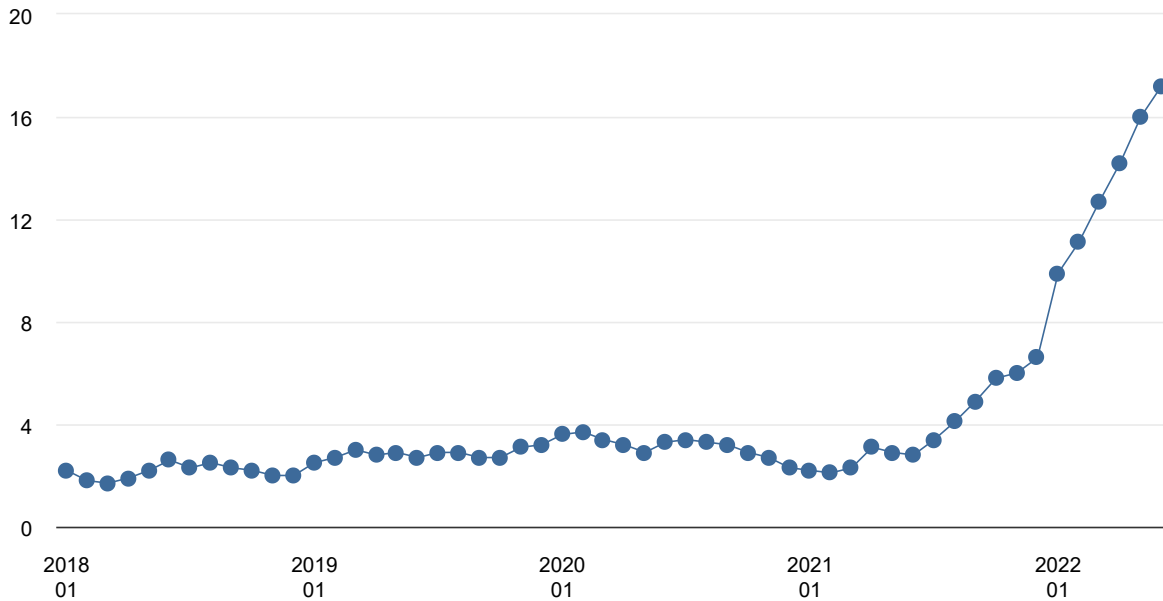
Consumer price growth accelerated in the second half of 2021, when it finally left the tolerance range of the Czech National Bank and reached an average of 5.1%. One of the hardest hit sectors was construction, which has been plagued by a shortage of materials since the pandemic.

The war in Ukraine has pushed inflation into double digits. The average inflation rate for the year reached 15.1%, clearly the highest level since 1993, when the independent Czechia was founded and its economy was in the process of being transformed into a market economy. Czechia was among the five EU countries with the highest inflation rates from 2022 onwards (together with Hungary and the Baltic countries). Double-digit inflation is expected to continue in the coming months.

**Figure 1: Development of consumer prices in Czechia**

Year to year change, in %

S: CZSO (2023).



*“One of the highest rates of consumer prices growth among EU members has led to a chain of events, the end of which includes the freezing of the housing market.”*



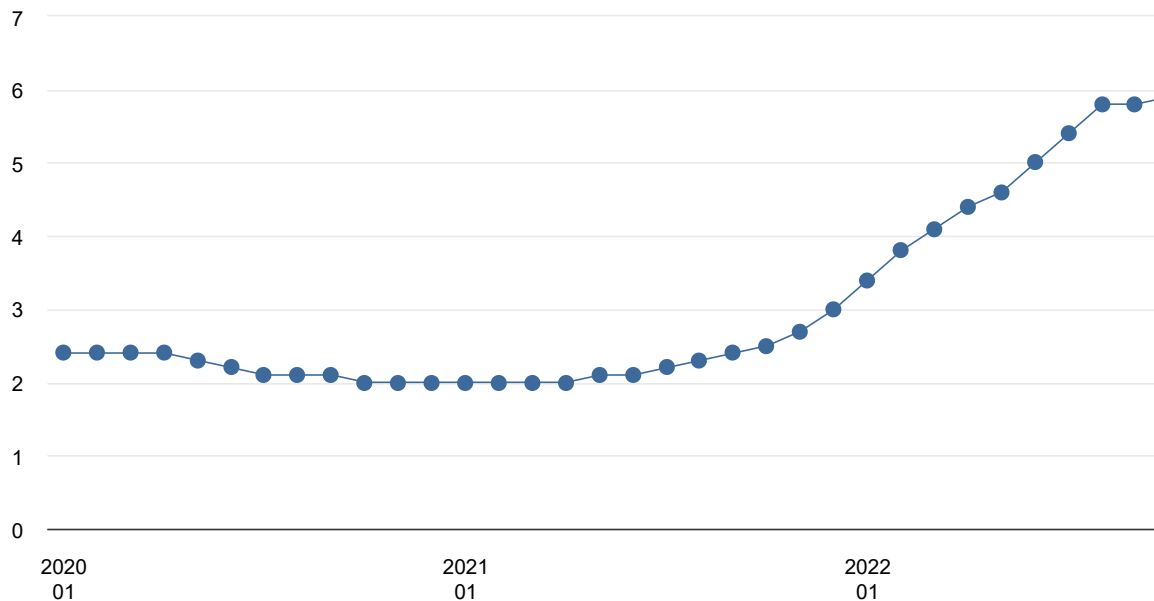
The Czech National Bank responded by sharply raising the two-week base rate. It rose from 0.25% in mid-2021 to 7.0% in about a year. This made loans, including mortgages, more expensive. The current mortgage rate is around 6%.



## Figure 2: Development of overall mortgage rates

Monthly averages, in %

S: CBA (cbaonline.cz).



*“The volume of newly granted mortgages fell by 60% due to high interest rates.”*



### A drop in demand for dwellings

In a relatively short space of time, the housing market has found itself in a situation where high house prices have been accompanied by high mortgage rates, leading to a cooling in demand for owner-occupied housing. The volume of newly granted mortgages fell by 60% last year. Interest in new apartments in Prague also fell by roughly the same proportion. Nationally, interest fell by a third.

It's not worthwhile for developers to build new apartments now. Entry costs have risen sharply – the prices of construction work, building materials and energy are so high, but it's difficult to find buyers for new flats. As a result, prices for new homes are stagnating, while prices for older homes have actually started to fall for the first time in almost a decade. In some regions, house prices are falling by more than 10% compared with the previous quarter. Growth in prices for single-family homes has slowed. Both prices and demand for second homes are falling. The situation is similar in a number of EU countries, and in some, such as Sweden and Germany, house prices have already fallen significantly.

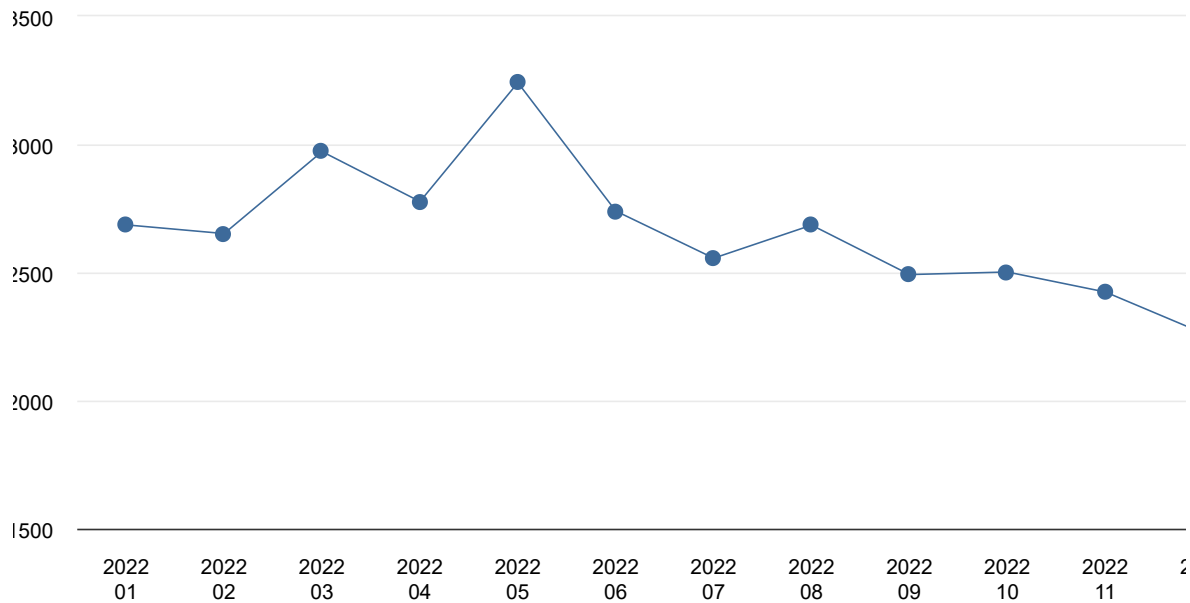
Current housing construction is continuing due to inertia, but the trend in residential building permits is already showing a slowdown. Developers are halting construction in major cities so as not to add to the housing stock while they wait for the situation to improve.



### Figure 3: Residential building permits

Number of units

S: CZSO (2023).



*“As indicated by the development of residential building permits, the decline in the record of the construction industry will be reflected mainly during 2023.”*



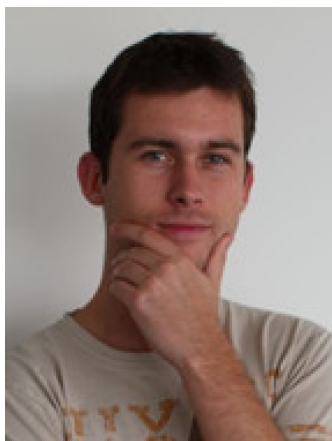
#### The future of the housing market

High mortgage rates are reinforcing the trend towards rental housing, which started earlier in large cities due to high house prices. This is also the reason why more and more property developers are focusing on rental housing projects, which they see as the future.

The Czech National Bank is currently in the spotlight among property developers, those interested in housing and homeowners paying off their mortgages. It continues to hold the two-week base rate at 7.0%, preventing banks from lowering mortgage prices. Forecasts suggest that the Czech National Bank may cut rates at the end of this year. However, it is far from the level that would shake up the mortgage market. A rate of 3% could be reached by the end of next year, according to forecasts. Such a reduction should get the housing market moving again.

However, there are legitimate fears that the spiral of price increases will resume at the high pre-crisis pace and that speculators will be back in full force. Ordinary people interested in buying a home without millions in their bank accounts have no choice but to look for an alternative. At the same time, rental prices in the most desirable locations are rising at a similar pace to property prices, so the question is whether the free hand of the market will aggravate the housing crisis.





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