

UBS Swiss Real Estate Bubble Index 2Q. 2020

UBS Swiss real estate bubble index

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- The *UBS Swiss Real Estate Bubble Index* measures the risk of a real estate bubble in the Swiss market for owner-occupied homes.
- The index recorded a sharp increase to 1.52 index points in the second quarter of 2020. The increase was driven by the short-term corona crisis shock and should thus be put into perspective.
- The forecast of the *UBS Swiss Real Estate Bubble Index* until the end of 2021 shows that valuations in the owner-occupied home market will be reduced during the economic recovery.



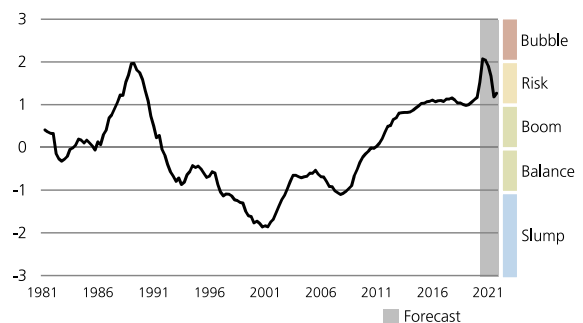
Sources: Mauro Mellone, UBS

In the first six months of 2020, Switzerland recorded its most severe economic performance collapse in the last 40 years. However, we are expecting a powerful recovery in the second half of the year. This leads to extreme fluctuations in the model-based estimations of the risk of a real estate bubble in the Swiss owner-occupied housing market.

Prices are increasing too quickly

The *UBS Swiss Real Estate Bubble Index* soared from 1.30 points in the first quarter to 1.52 index points in the second quarter of 2020. In the following quarter, the index will even jump marginally into the bubble zone according to our forecast. In addition to falling incomes in the severe recession, higher owner-occupied home prices are contributing to the significant increase. Owner-occupied home prices recorded an inflation-adjusted plus of almost 4 percent in the second quarter of 2020 compared to the previous year, which is the strongest increase since 2013.

UBS Swiss Real Estate Bubble Index



Source: UBS

Index calculation: The UBS Swiss Real Estate Bubble Index comprises six sub-indexes. It is calculated as the average of trend-adjusted and standardized indicators, weighted using a principal component analysis. The index level shows the deviation in standard deviations from the average, normalized to zero. The index value is categorized into one of five levels based on the current value: slump (below -1), balance (between -1 and 0), boom (between 0 and 1), risk (between 1 and 2) and bubble (above 2).

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Because of this volatility, we are also temporarily showing the development of the *UBS Swiss Real Estate Bubble Index* for the next quarters according to our forecasts for economic and real estate market performance. By the end of 2021, the index value will come back to its pre-corona level even without a price correction. This, however, applies particularly when the following three assumptions materialize: income per household at the end of 2021 will be almost equal to its value at the end of 2019. The rate of increase for owner-occupied home prices will lessen and rents will continue to fall slightly. The growth of mortgage volumes will slightly lessen compared to 2019.

With this in mind, the coronavirus crisis will probably only temporarily drive up the imbalances in the owner-occupied home market. However, there is reason for caution. The high prices in the Swiss owner-occupied home market are not compatible with an economy that remains in crisis mode for a longer period of time. Continual price increases at current levels are not sustainable either in the face of falling incomes.

UBS Swiss Real Estate Bubble Index

Year	Period	Index	Trend
2016	Quarter 1	1.25	■
	Quarter 2	1.21	■
	Quarter 3	1.22	■
	Quarter 4	1.23	■
2017	Quarter 1	1.21	■
	Quarter 2	1.27	■
	Quarter 3	1.27	■
	Quarter 4	1.30	■
2018	Quarter 1	1.24	■
	Quarter 2	1.16	■
	Quarter 3	1.15	■
	Quarter 4	1.11	■
2019	Quarter 1	1.10	■
	Quarter 2	1.11	■
	Quarter 3	1.20	■
	Quarter 4	1.26	■
2020	Quarter 1	1.30	■
	Quarter 2	1.52	■
	Quarter 3	2.08	■
	Quarter 4	2.04	■
2021	Quarter 1	1.90	■
	Quarter 2	1.67	■
	Quarter 3	1.18	■
	Quarter 4	1.27	■

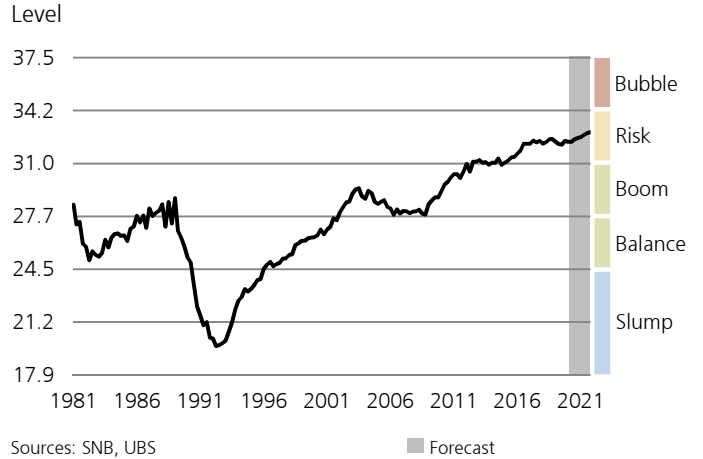
- Increase compared to the previous quarter
- Decrease compared to the previous quarter
- Unchanged
- Forecast

Source: UBS

Sub-indexes of the UBS Swiss Real Estate Bubble Index

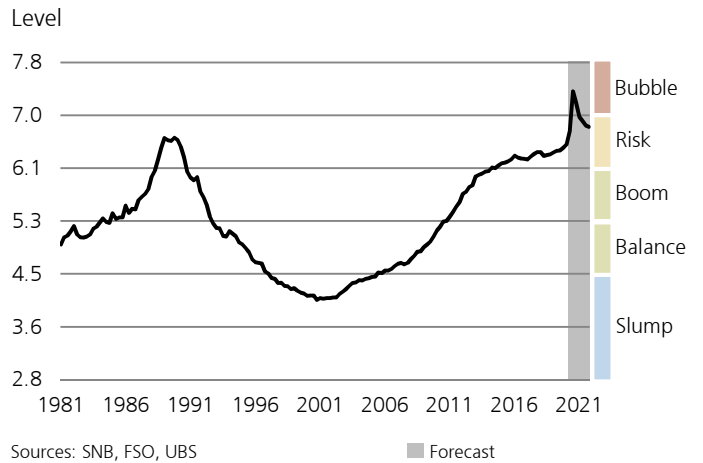
Home prices to annual rents

An above-average price-to-rent ratio indicates a high dependency on sustained low interest rates or implies expectations of price increases.



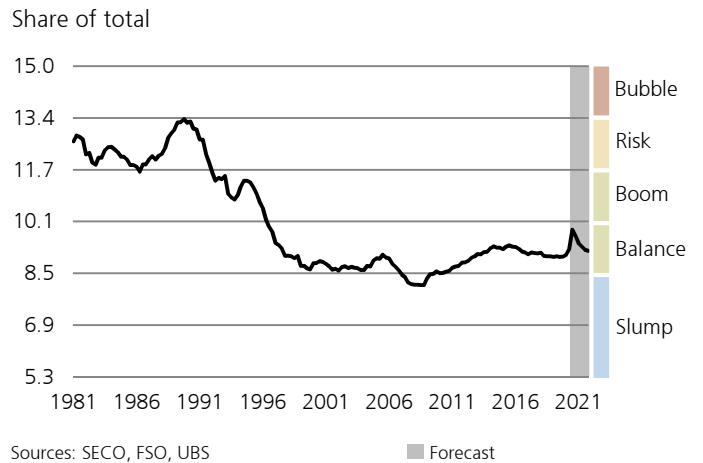
Home prices to household income

The indicator shows whether the price behavior of the owner-occupied housing market is supported by a change in household income. A decoupling of prices from average household income can be interpreted as a sign of interest rate risks.



Construction relative to gross domestic product (GDP)

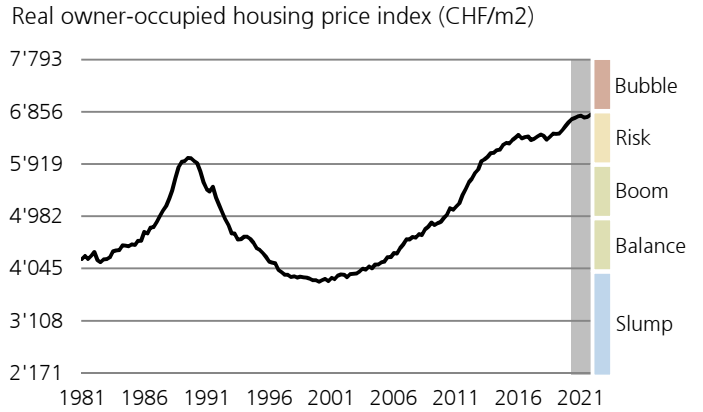
The construction sector gaining weighting within the national economy can signal an overheating of the real estate market.



Sub-indexes of the UBS Swiss Real Estate Bubble Index

Home prices relative to consumer prices

Over the long term, owner-occupied housing prices are likely to relate to construction costs and general inflation. A sharp and lasting increase in inflation-adjusted owner-occupied housing prices is thus a warning signal for a possible correction.

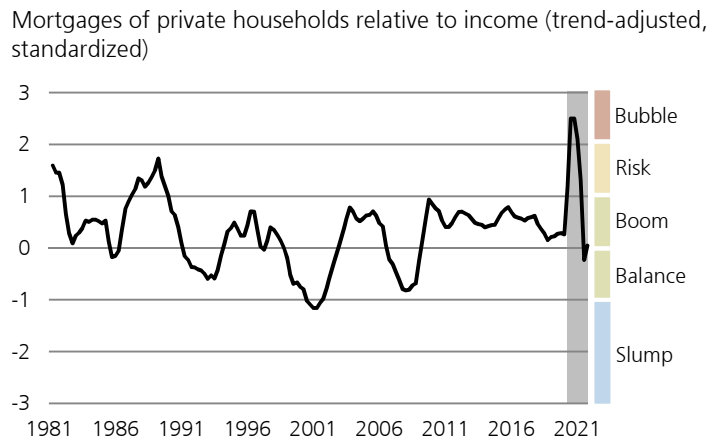


Sources: SNB, FSO, UBS

Forecast

Mortgage volume relative to disposable income of private households

Any sharp growth in mortgage debt is a clear indication of the owner-occupied housing market overheating. If interest rates rise or owner-occupied housing prices correct, high household debt increases the negative consequences for the national economy.

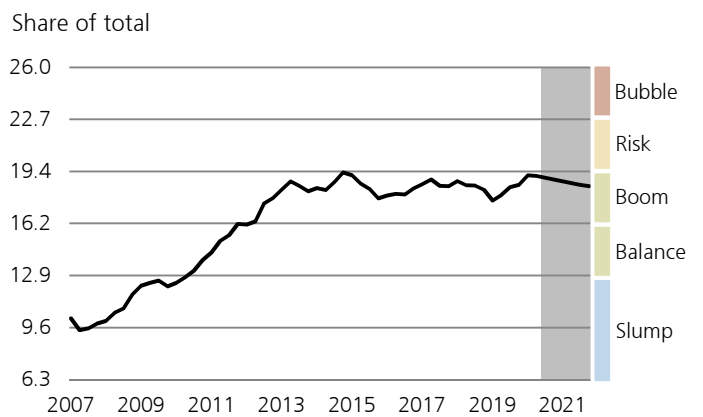


Sources: SNB, FSO, UBS

Forecast

Credit applications for residential real estate not intended for self-occupancy (UBS clients)

High demand for residential property for the purpose of leasing (buy-to-let) indicates greater speculative demand.



Source: UBS

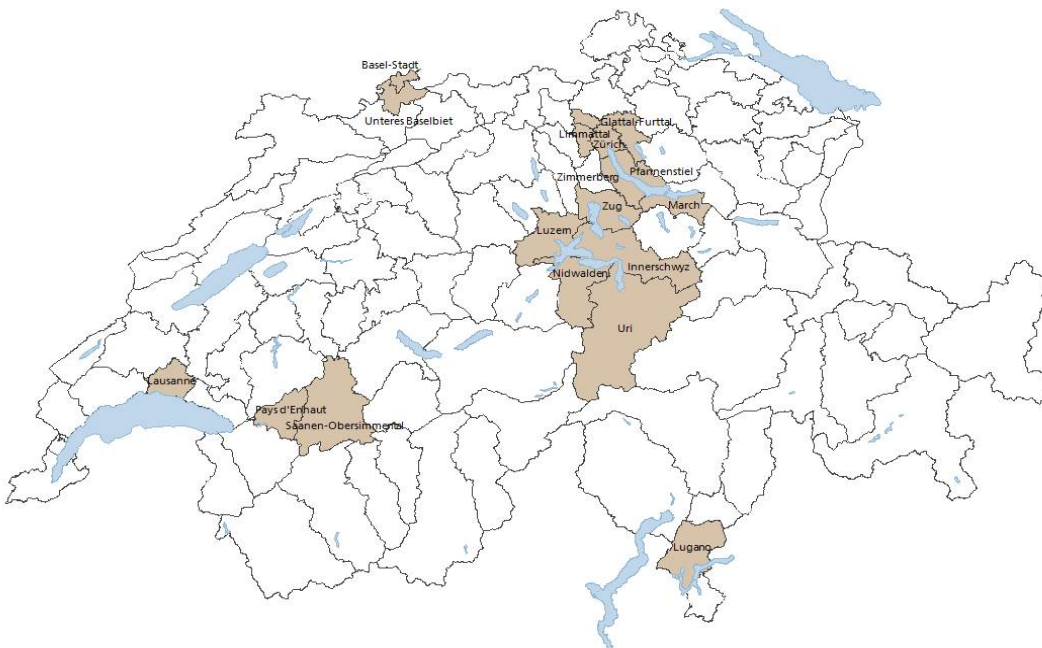
Forecast

Regional risk map

The regional risk map shows the regions with the most pronounced imbalances. The analysis is based on the local price/income ratio, the local price/rent ratio and the long-term price behavior for owner-occupied homes. The selection of risk regions is linked to the UBS Swiss Real Estate Bubble Index and takes into account the size of the local second-homes market. Strong index variations over the next few quarters would also cause the number of risk regions to fluctuate. To prevent this, we are linking the selection of risk regions with the forecasted index value in 2021.

The number and composition of the risk regions will, thus, remain unchanged. The analysis continues to show that the relatively largest imbalances are at Lake Zurich, Lausanne and Basel City.

Risk regions in the Swiss residential real estate market



Exposed regions

Source: UBS

Appendix

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