

UBS Swiss Real Estate Bubble Index 3Q. 2020

UBS Swiss real estate bubble index

Authors: Matthias Holzhey, Economist, UBS Switzerland AG; Claudio Saputelli, Economist, UBS Switzerland AG; Maciej Skoczek, CFA, CAIA, Economist, UBS Switzerland AG

- The *UBS Swiss Real Estate Bubble Index* measures the risk of a real estate bubble in the Swiss residential housing market.
- The index saw a sharp rise to 2.05 index points in the third quarter of 2020. This was driven by the economic shock of the COVID-19 crisis and should be put into perspective. However, the large jumps in price also contributed to the imbalance.
- The forecast for the Real Estate Bubble Index up to the end of 2021 shows that valuations in the residential housing market will fall again as the economy recovers.

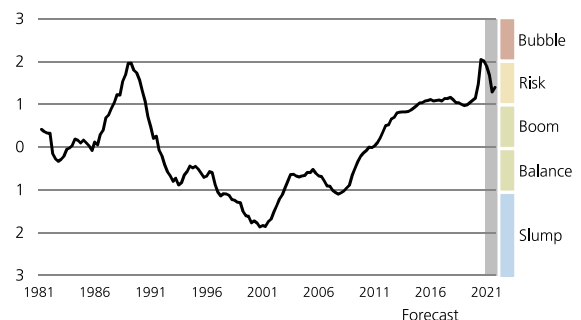


In 2020, Switzerland recorded the sharpest drop of economic output in the last 40 years. We, nevertheless, expect a sustained strong recovery in the coming quarters. This means that our model-based assessment of the real estate bubble risk for the Swiss residential housing market is subject to extreme fluctuations. Due to this volatility, our presentation of the expected trend in the *UBS Swiss Real Estate Bubble Index* for the next few quarters will temporarily be based on our forecasts for the performance of the economy and the real estate market.

Pandemic is exacerbating imbalances

Thanks to COVID-19, the index jumped from 1.5 points in the second quarter of 2020 to more than 2 index points in the third quarter, positioning it in the bubble risk zone. Currently, both the price level and the momentum of mortgage lending in the residential housing market are not sustainable. However, the Real Estate Bubble Index is likely to exit the bubble risk zone to from 2021 onwards, in parallel with the expected economic recovery.

UBS Swiss Real Estate Bubble Index



Source: UBS

Index calculation: The UBS Swiss Real Estate Bubble Index comprises six sub-indices. It is calculated as the weighted average of standardized indicators, using primary component analysis, and shows the deviation in standard deviations from the average, which is standardized to zero. The index uses the following classification: Downward Trend (below -1), Balance (from -1 to less than 0), Boom (from 0

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to less than 1), Risk (from 1 to less than 2) and Bubble (2 and upwards).

As in the previous quarter, however, inflation-adjusted home prices in the third quarter of 2020 posted a high year-on-year increase of almost 4 percent, while rents fell by 2 percent. Buy-to-let demand and mortgage lending have also proved to be largely resistant to the crisis so far. This shows that the imbalances in the residential housing market would have increased even without the extreme economic situation that we are currently seeing.

Updated risk map

The Pays d’Enhaut, Lugano, and Saanen-Obersimmental regions are no longer classified as risk regions. The current risk map shows that the imbalances are now very heavily concentrated in the regions around the city of Zurich and in central Switzerland. In these regions, the ratio of owner-occupied house prices to annual rents and to household incomes is significantly higher than the Swiss average, and price increases have been clearly above average over the past ten years.

UBS Swiss Real Estate Bubble Index

Year	Period	Index	Trend
2016	Quarter 1	1.11	
	Quarter 2	1.08	
	Quarter 3	1.09	
	Quarter 4	1.10	
2017	Quarter 1	1.08	
	Quarter 2	1.14	
	Quarter 3	1.14	
	Quarter 4	1.17	
2018	Quarter 1	1.12	
	Quarter 2	1.04	
	Quarter 3	1.04	
	Quarter 4	1.00	
2019	Quarter 1	0.97	
	Quarter 2	0.99	■
	Quarter 3	1.04	■
	Quarter 4	1.10	■
2020	Quarter 1	1.15	■
	Quarter 2	1.48	■
	Quarter 3	2.05	■
	Quarter 4	2.02	■
2021	Quarter 1	1.90	■
	Quarter 2	1.68	■
	Quarter 3	1.29	■
	Quarter 4	1.40	■

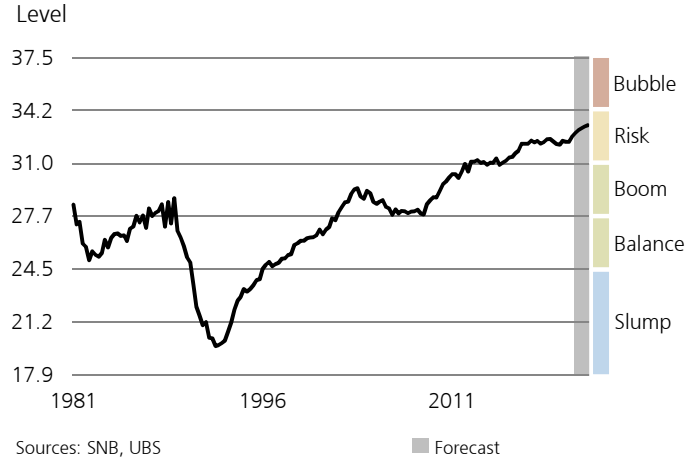
- Increase compared to the previous quarter
- Decrease compared to the previous quarter
- Unchanged
- Forecast

Source: UBS

Sub-indexes of the UBS Swiss Real Estate Bubble Index

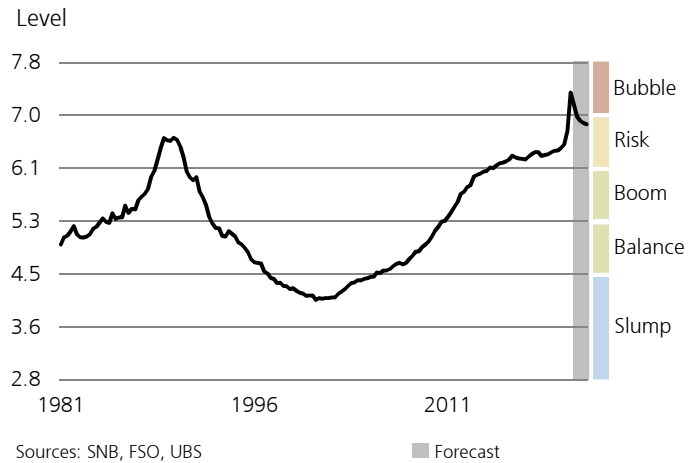
Home prices to annual rents

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



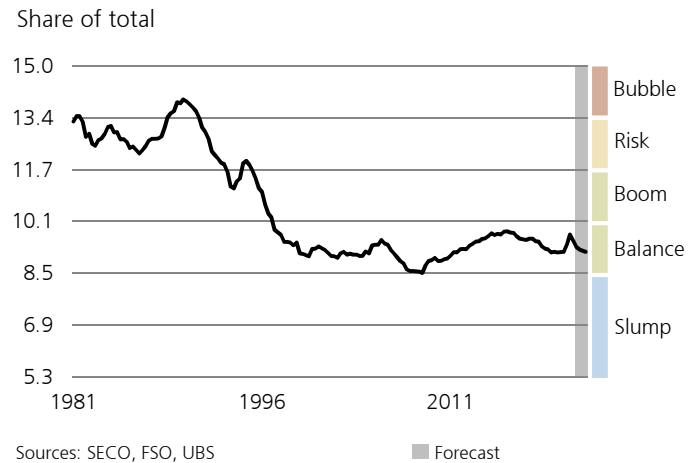
Home prices to household income

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)

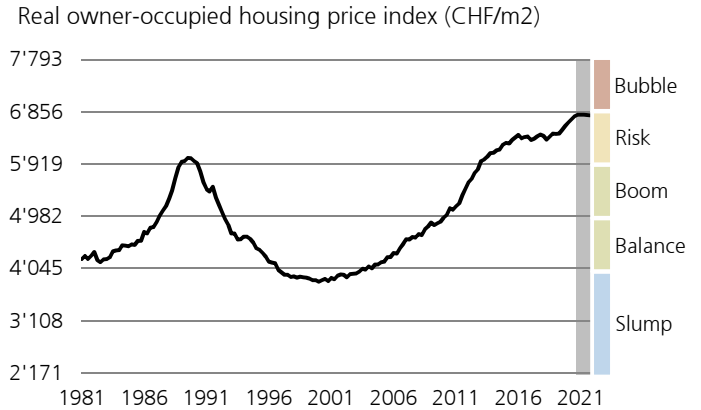
The construction sector gaining weighting within the national economy can signal an overheating of the real estate market.



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.

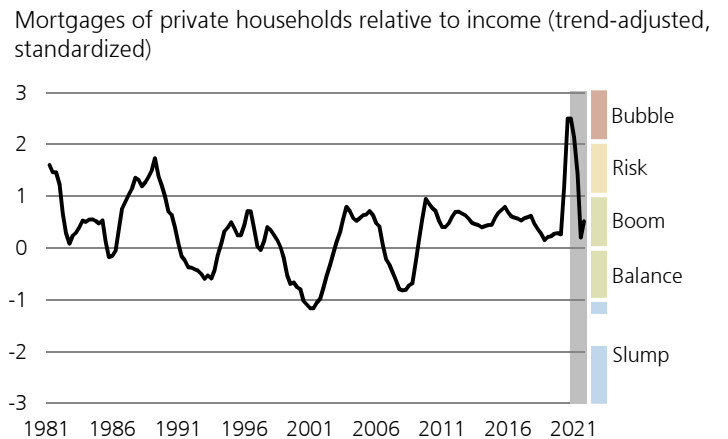


Sources: SNB, FSO, UBS

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.

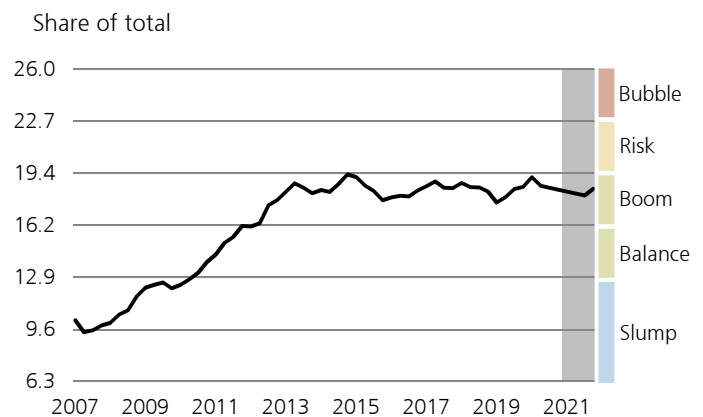


Sources: SNB, FSO, UBS

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.

Risk regions in the Swiss residential real estate market



Exposed regions

Source: UBS

Appendix

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