

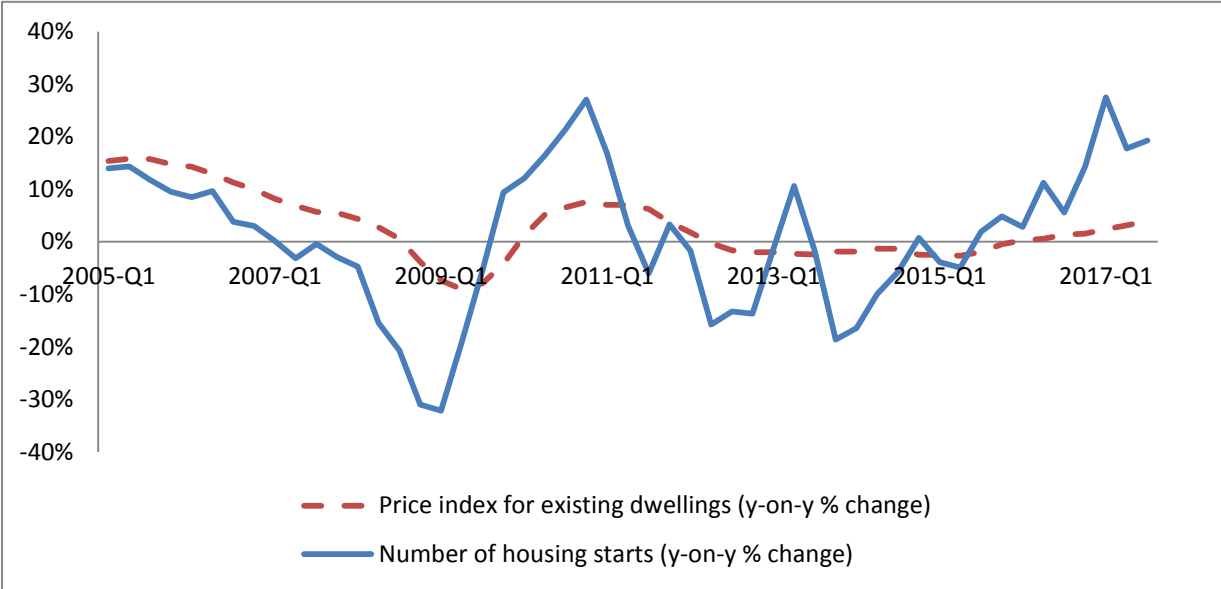
# Stable borrowing capacity and dynamic real estate market in 2017

By Edouard Jousselin with Simon Ray

*In 2017, the French real estate market continued its recovery. It was fueled by households' borrowing capacity: household income increased and lending conditions remained favourable. This situation can be explained by low interest rates and long loan terms. After rising by 20% between 2014 and 2016, households' borrowing capacity stabilised in 2017.*

**Chart 1: the real estate market recovery continued in 2017**

Year-on-year % change



Sources: Insee-Notaires; Ministry of the Environment, Energy and the Sea.

In a previous post, Simon Ray mentioned the upturn in the real estate market, as shown by the increase in housing starts since the end of 2014 (see Chart 1). This growth momentum continued in 2017, albeit at a slower pace (see [the Banque de France's macroeconomic forecasts](#)). At the same time, prices for existing dwellings rose significantly, climbing by almost 4% year-on-year (see Chart 1), and did not experience the same slowdown as construction. However, they did not reach their end-2011 peak, which was followed by fifteen consecutive quarters of decline.

## **Households' borrowing capacity combines lending conditions and income**

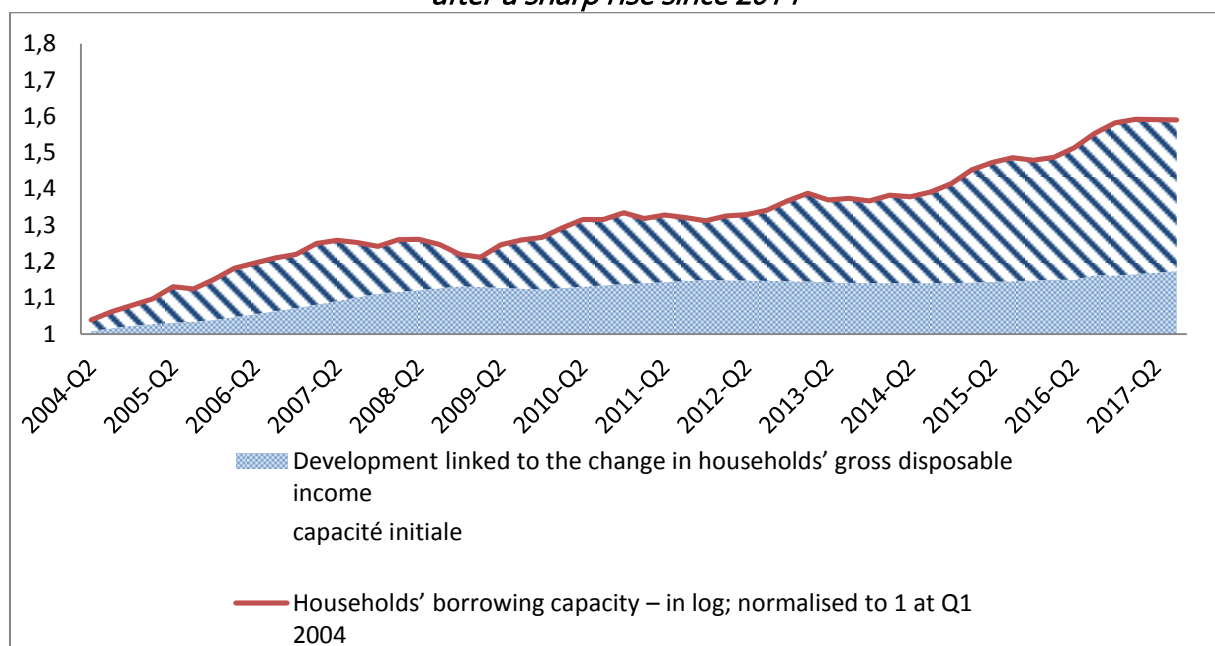
Households' borrowing capacity is the maximum amount a household can borrow to purchase a dwelling under the lending conditions prevailing in the market. It results chiefly from a combination of four factors: the household's level of income at the time the loan is granted, the maximum share of that income that can be used to repay the principal and interest, the interest rate and the initial maturity of the loan. We use an aggregate indicator of households' borrowing capacity based on the average borrowing conditions observed in the credit market ([Avouyi-Dovi et al., 2014](#)). This indicator reflects the changes in the sum - discounted at the market rate - of the maximum monthly repayment capabilities, over the average maturity of a loan.

We assume that the maximum share of income that a household is able to devote to the repayment of the loan is a structural component which does not vary over time. While it can theoretically influence the risk premium and thus the observed average rates, it has not affected the results concerning the dynamics of the borrowing capacity over the period under review. French banks usually set it at one-third of current income, subject to a sufficient "living allowance" (fixed according to the size of the household).

**After rising by 20% between 2014 and 2016, households' borrowing capacity stabilised in 2017.**

Chart 2 shows the changes in the indicator of households' borrowing capacity as well as the contributions of lending conditions (interest rate and loan maturity) and gross disposable income per household to the changes in this indicator. After rising sharply by 20% between 2014 and 2016 due to improved lending conditions (hatched area), households' borrowing capacity stabilised at a high level in 2017.

**Chart 2: the indicator of households' borrowing capacity stabilised in 2017, after a sharp rise since 2014**



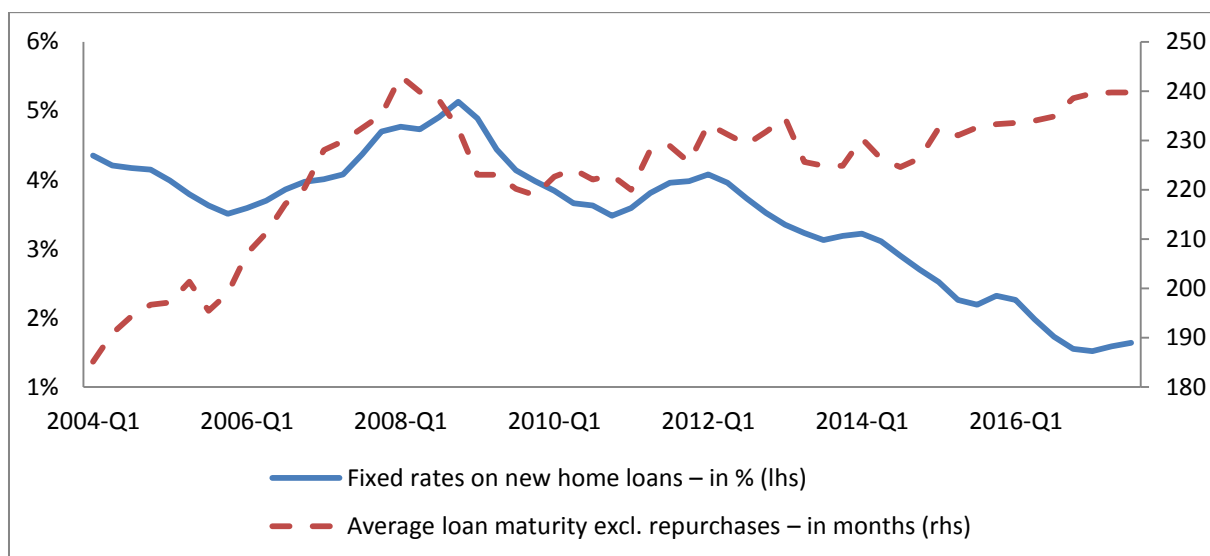
*Sources: Banque de France, INSEE and authors' calculations*

The upturn in the real estate market observed since 2015 has been fueled by the favourable growth momentum of households' borrowing capacity. The acceleration in the production of new loans, which was pronounced in 2016, with a record high in early 2017, ran slightly out of steam in 2017 due to the drop in repurchases and renegotiations (which slid from 62% to 15.8% of new loan flows between January and December 2017 - see [Stat info, loans to households, France 2017](#)). However, loan production, excluding repurchases and negotiations, remained strong, contributing to the sustained growth in outstanding loans (up 6.2% year-on-year) in December 2017.

### **Interest rates and loan maturities, the drivers of the increase in households' borrowing capacity, stabilised in 2017**

After reaching 1.5% in Q1 2017, interest rates stabilised at 1.6% at the end of the year (see Chart 3). Similarly, loan maturities levelled off in 2017, slightly below 240 months (see Chart 3).

*Chart 3: the growth momentum of households' borrowing capacity slowed in 2017*



*Source: Banque de France*

Thus, after reaching record highs, the two drivers of lending conditions - low rates and long loan maturities - levelled off in 2017. The growth rates of the gross real disposable income of households estimated by the Banque de France ([December 2017](#)) at 1.7% in 2018 and 2.5% in 2019 could nevertheless help boost households' borrowing capacity.

In December 2017, le Haut Conseil de stabilité financière (High Council for Financial Stability) called for particular vigilance regarding pricing conditions, the profitability of the production of new real estate loans, and their effect on the structure of banks' balance sheets. It continues to closely monitor these developments and the risk that they may trigger speculative dynamics.