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Article

Selected Macroeconomic and Social Aspects of Housing Affordability

Intereconomics

Suggested Citation: Licchetta, Mirko; Martins, Vitor Dias; Vašíček, Boérek (2025) : Selected Macroeconomic and Social Aspects of Housing Affordability, Intereconomics, ISSN 1613-964X, Sciendo, Warsaw, Vol. 60, Iss. 2, pp. 101-106, <https://doi.org/10.2478/ie-2025-0020>

This Version is available at:

<https://hdl.handle.net/10419/320228>

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Selected Macroeconomic and Social Aspects of Housing Affordability

Over the past decade, the housing market in the EU has been characterised by significant price growth, putting pressure on housing affordability. Despite a price moderation in 2022 and 2023 due to monetary tightening and increased mortgage interest rates, house prices remain historically high in approximately three-quarters of the EU, highlighting an underlying mismatch between demand and supply. On the demand side, urbanisation and demographic changes have driven up housing needs, while on the supply side, constraints in construction have hindered the market's ability to meet demand, leading to reduced affordability. To improve overall housing affordability, there is an urgent need to increase investments in new construction and in the renovation of existing stock as well as to review the role of regulation and to improve administrative capacity, which have been hindering the expansion of the housing supply in the recent decades.

Housing occupies a fundamental position in modern societies and economies. The housing market is economically, socially and politically significant. Housing-related expenses are a substantial share of household spending, and housing is a large share of the total assets in our economies. For many people, rental costs or mortgage repayments are the largest items in their monthly spending, and the purchase of a house is typically the largest purchase in people's lives. Consequently, home mortgages account for most of household indebtedness.

Access to safe and affordable housing is a fundamental human need, essential for individual dignity, health and

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Open Access funding provided by ZBW – Leibniz Information Centre for Economics.

* This article builds on work published in the 2025 Euro Area report and the 2025 Alert Mechanism report. We are grateful to Reinhard Felke, Christine Frayne, Cornelia Lobnig, Joao Nogueira Martins, Geraldine Mahieu, Irene Pappone and Michael Stierle for helpful comments received. The views expressed in this document are solely those of the authors and do not necessarily represent the official views of the European Commission.

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well-being. It is critical for social cohesion, enabling people to build communities and participate in society. Unaffordable or unavailable housing can lead to social exclusion and poverty, and it aggravates the consequences of income inequality, in particular among younger households, undermining the societal fabric. It may hinder regional (and even intra-EU) mobility with damaging implications for economic dynamism and social progress.

Policies affecting house prices

Housing is directly interconnected with the macroeconomy of the EU, both influencing and being influenced by the economic landscape. Residential construction and housing markets are pivotal to the economy, impacting employment, business cycles and overall economic activity.¹ Housing accounts for a sizeable share of output. In 2023, housing construction contributed approximately 6% to GDP, and investment in dwellings accounted for roughly 26% of gross fixed capital formation in the EU. Consequently, fluctuations in housing activities, house prices and rentals have substantial effects on the business cycle and GDP, ultimately affecting well-being. Additionally, housing market cycles have fiscal effects, impacting tax revenues and social expenditure.

Housing shortages can also harm long-term growth and competitiveness. Beyond the immediate social implications, issues of housing availability and affordability can discourage labour and residential mobility. This makes it more difficult to overcome interregional inequalities, improve job matching, and thereby enhance aggregate pro-

1 See also Valderrama et al. (2023) and OECD (2021).

ductivity and social mobility. These issues also raise the cost of land and labour, subsequently increasing the cost of premises and infrastructure for businesses and governments. The result is a mismatch in labour allocation and missed investment opportunities that stymie economic vitality in burgeoning regions, affecting not only national economies but also the euro area and the Union as a whole through diminished overall growth, productivity, and impaired international competitiveness (IMF, 2024).

House prices are driven by various demand and supply factors that interact with diverse policies. Demand for housing is driven by factors that include household income, demographic developments (such as the total population, family structure and urbanisation), mortgage interest rates, the availability of credit, and investor and tourism demand. On the supply side, key factors include the housing stock and the amount of new construction, construction costs and land availability. Policies affect house prices, and consequently housing affordability, via their impact on either demand or supply. These include monetary and macroprudential policies, national and regional rules governing land use, urban planning, building regulations, public infrastructure and rental regulations, such as legal protection for tenants and landowners, rental subsidies and the availability of social housing.² Taxation, including property taxes, registration taxes, capital gains taxes, rental income taxes, inheritance taxes and notarial fees, may also affect house prices. While some policies, such as rent control, homebuyer subsidies or mortgage interest relief, can mitigate the negative consequences of unaffordable housing in the short term, they may have strong adverse effects in the long term because they support demand instead of supply.

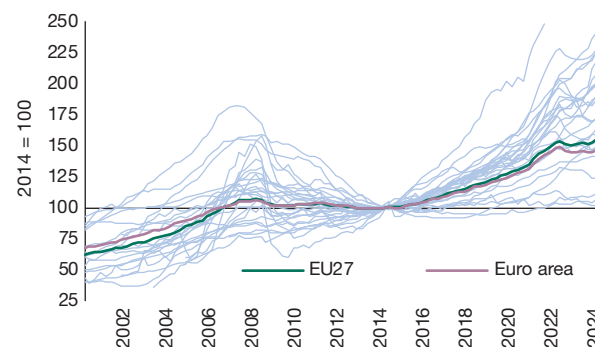
Rising housing costs in the EU

House prices grew significantly across the EU between 2014 and 2022, moderated in 2022 and 2023 following monetary tightening, and started to increase again in 2024. Most EU countries during the pandemic and immediate post-pandemic period experienced strong increases in house prices (Figure 1), building on years of moderate growth. House prices were also increasing steadily in real terms.

Following monetary tightening and a significant increase in mortgage interest rates, house prices began to mod-

² Social and affordable housing both seek to meet the needs of those unable to afford market-rate housing but they do so through distinct methods and target different income levels. Social housing involves government or non-profit rental properties for low to moderate-income individuals and families. Affordable housing includes both rental and purchase options for those earning below the median income, ensuring housing costs do not exceed a set income percentage. Interpretations of these terms vary across EU countries.

Figure 1
Nominal house price evolution in EU countries



Sources: Eurostat and European Commission services.

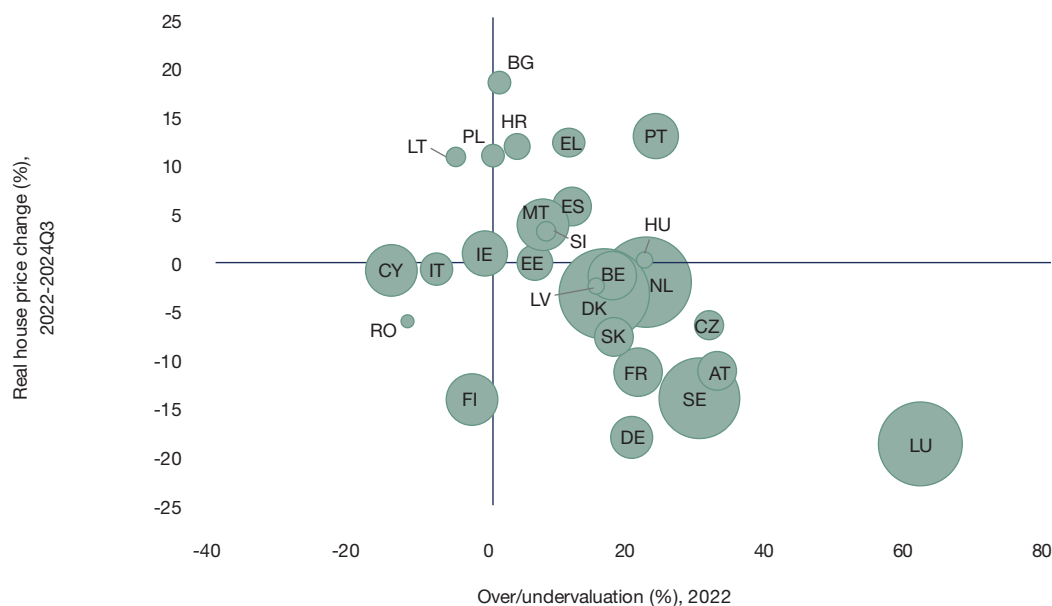
erate in mid-2022, and this trend continued into 2023. In the EU, house prices decreased by 0.3% in 2023. The adjustment was strongest in countries like Luxembourg and Sweden, where prices were estimated to be most overvalued and household debt was and is highest (Figure 2). By the end of 2023, house prices were still estimated to be overvalued in three-quarters of the EU. In 2024, house prices began to recover, and in the third quarter of 2024, nominal house prices in the EU increased by 3.8% on a year-on-year basis.

Over the last decade, house prices grew faster than incomes, putting pressure on housing affordability. Price-to-income ratios³ increased by over 10% in the EU between 2014 and 2022 (Figure 3). Since 2022, most of this increase has been undone, but there are significant differences between member states (Figure 4), and within these, among regions and cities (Frayne et al., 2022). Moreover, the situation varies among income groups and age cohorts, with lower-income and younger groups being the most affected (Kouvavas & Rusinova, 2024).

Higher interest rates have decreased the borrowing capacity of households in recent years. The borrowing capacity of households is affected by incomes and mortgage interest rates, along with country-specific rules about how much of a home's value can be borrowed (see also Andrlé and Plašil, 2019). While the decline in housing prices has improved price-to-income ratios, particularly given rising incomes, the increase in interest rates has raised monthly payments for loans of the same size. This reduces the bor-

³ The price-to-income ratio is the house price divided by gross disposable household income. However, price-to-income ratios do not consider the funding costs and therefore it reflects the affordability from a cash buyer perspective.

Figure 2
Real house price change vs over/undervaluation in EU countries



Notes: The size of the bubbles represents household debt in percentage of disposable income. Over/undervaluation is the difference in percentage points between observed house prices and house prices justified by fundamentals and is computed as an average of three metrics (model based, price-to-income ratio and price-to-rent ratio). See Philipponnet and Turrini (2017).

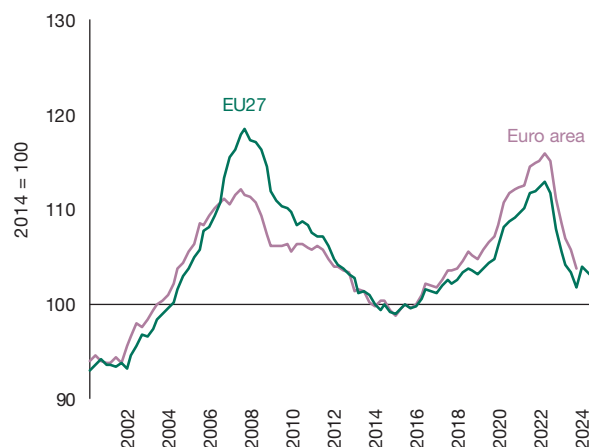
Sources: Eurostat and European Commission services.

rowing capacity of households as households can only afford the monthly payments associated with smaller loans.

Figure 5 presents the first-year mortgage debt service cost (payment of interest and repayment of principal) as a percentage of median household income. First, it highlights significant differences in the borrowing capacity of

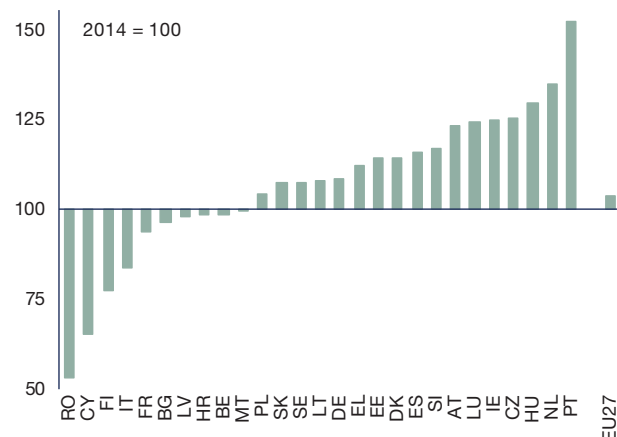
a representative household across EU countries, with no distinct geographical pattern. Second, in most countries, the borrowing capacity of a representative household in 2024 was lower than a decade ago, as mortgage service represented a higher share of income. This is mainly due to house prices increasing more than median incomes, despite favourable financing conditions until 2022. In

Figure 3
House price-to-income ratio in the EU and the euro area



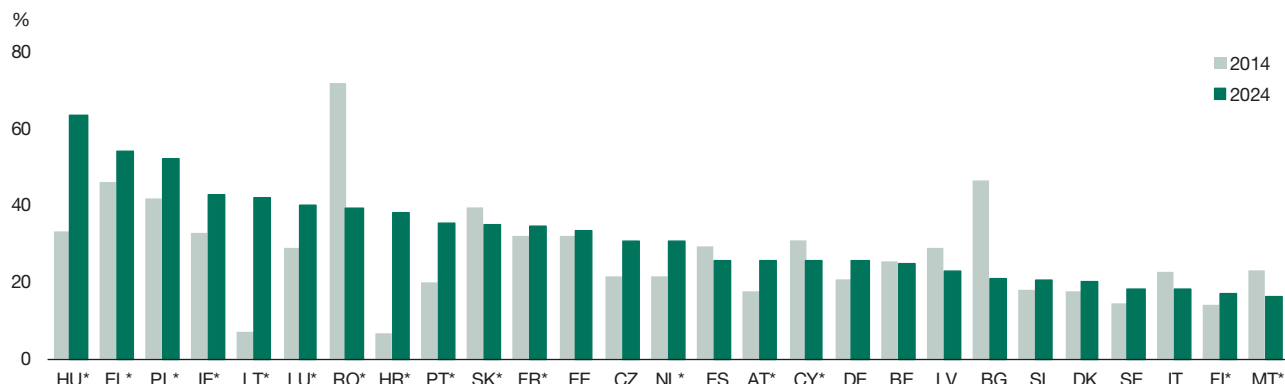
Sources: Eurostat and European Commission services.

Figure 4
House price-to-income ratio in EU countries, 2024Q3 vs 2014



Sources: Eurostat and European Commission services.

Figure 5
Mortgage service as percentage of income in EU countries



Notes: *As 2024 data is unavailable, 2023 data is used instead. The mortgage service as a percentage of income is calculated by dividing the annual cost of a mortgage (interest and principal amortisation) required to buy a 100 m² apartment by a family median income. The family median income is defined as two times the median equivalised income. The maximum maturity is used for the loan maturity, available in Grünberger et al. (2023). The loan-to-value ratio considered is 100%, and other variables, such as taxation, tax relief and transaction costs, were fixed to zero to capture only the impact of income and interest rates on borrowing capacity. The type of mortgage considered is full amortisation mortgages with constant payments.

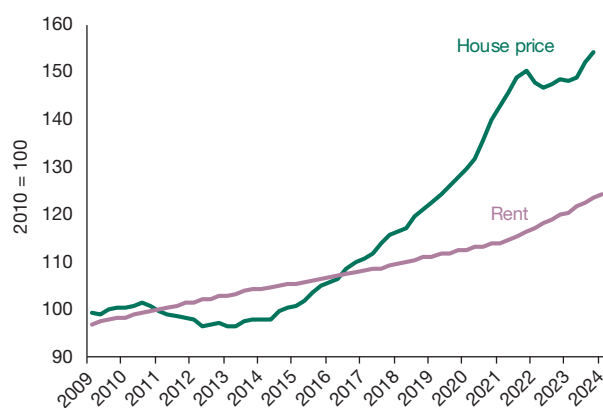
Sources: Eurostat, JRC, ECB and European Commission services.

2024, the median-income family in many EU countries needed a significant share of its annual income to service mortgage debt, more than a decade ago. This makes home purchases unviable for many households, forcing them to seek alternatives.

While overall rents have grown at a significantly lower pace than house prices, rent levels in most capital cities are very high compared to incomes. At first glance, it appears that nominal rents have increased significantly less than house prices over the past decade, suggesting that rentals have become relatively less expensive and more affordable (Figure 6). However, the standard

rent index, which is part of the harmonised index of consumer prices (HICP), considers existing rents (excluding new rents), which are adjusted at a significantly slower pace than rents faced by newcomers to the rental market, such as younger cohorts. Moreover, a more nuanced picture emerges when rents are adjusted for inflation or compared to income. In most countries, new rent levels in the cities are rather high compared to median incomes, namely a household of two people of median income spends more than 40% on rent (Figure 7). Additionally, the rental market's development in certain areas may be influenced by its relatively small size and regulatory framework, which can pose challenges in terms of responsiveness to evolving housing needs and affordability.

Figure 6
House and rental prices in the EU



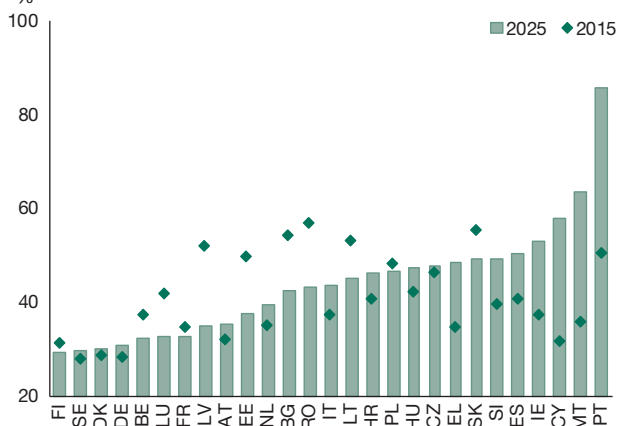
Sources: Eurostat.

Challenges in housing supply

Housing supply has been insufficient over the past decade in many member states, with numerous factors contributing to an increasing cost of new construction and renovations. Housing availability has often responded slowly and in an incomplete way to changes in demand because the processes of planning and building are time-consuming and subject to significant regulatory barriers and capacity constraints. This stickiness in supply leads to price pressures accumulating whenever there are increases in demand, such as when regional economies and populations grow.

In recent years, rising construction and refurbishment costs (Figure 8) – partly driven by stricter (sustainability) requirements and frequent disruptions in the supply of building materials – have increased the cost of new con-

Figure 7
New rent in prime locations as percentage of income



Notes: Annual rent of a two-bedroom apartment in prime locations of EU capitals (Eurostat file *prc_colc_rents*) divided by the median family income. The family median income is defined as two times the median household equivalised income.

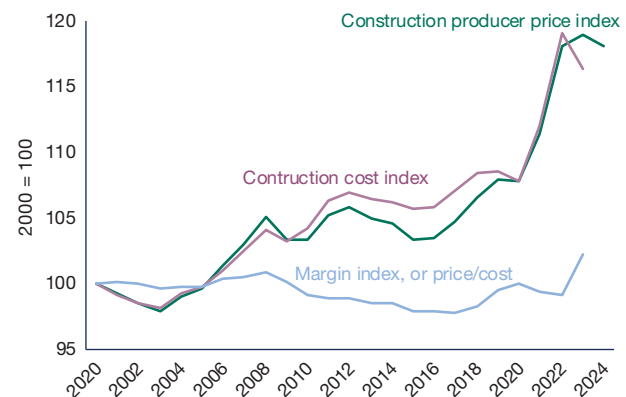
Sources: Eurostat and European Commission services.

struction. In most member states, high property prices and regulatory uncertainty have not provided sufficient incentive to invest in build-to-rent projects, exacerbating the supply shortage. Underlying factors include regulatory restrictions such as insufficient areas designated for brownfield investment and densification.

Additionally, the existing building stock has increasingly been purchased by institutional investors, which might contribute to rising rental prices and reduced housing affordability, as profit-driven strategies may prioritise high-income tenants (Banti & Phylaktis, 2024; Bandoni et al., 2025). Moreover, in some touristic areas long-term rents have been replaced by short-term tourist rentals (Cró & Martins, 2023). This has led to a potential supply contraction in the long-term rental market, resulting in higher rents. As shown in Figure 9, the number of houses completed in the EU (by thousand persons per year) significantly declined after the global financial crisis and has not yet recovered. In fact, housing completions in recent years have hit historical lows, partly due to rising funding costs for construction firms.

The situation is not expected to improve in the medium term, as building permits – typically a leading indicator of residential construction – are also at historical lows. Given this shortage, many policy interventions may have unintended consequences. For instance, rental subsidisation, while intended to support low-income households, may increase demand for rent, ultimately raising rents, effectively transferring resources to homeowners and further hampering housing affordability. In some countries, rental

Figure 8
Construction cost and construction producer price, adjusted for inflation, EU27 aggregate



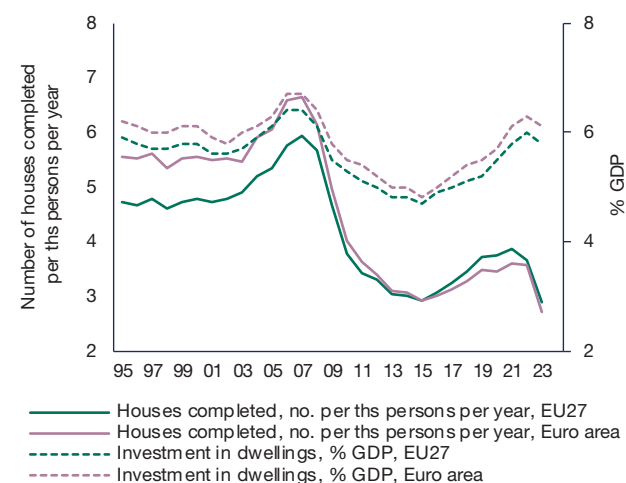
Sources: Eurostat and European Commission services.

regulation may have reduced the incentive to build to rent, thus shrinking the size of the rental market. Additionally, generous mortgage interest rate relief in some countries not only drives up demand for home purchases in the face of staggered new construction but also favours home-ownership over renting, essentially providing a subsidy targeted at higher income groups.

Policies supporting affordable housing

The housing market is shaped by national and regional policies and regulations. National governments typically manage social housing strategies, rental regulations

Figure 9
Completion of houses and investment in dwellings, EU27 aggregate



Sources: Eurostat, ECB and European Commission services.

and the tax treatment of mortgages, while regional and local authorities control land use, zoning, and building permits and licensing, which affect urban development. The primary responsibility for housing policies, including investing in social housing, ultimately lies with the member states, which have adopted diverse approaches to meet their specific needs and preferences. EU-derived regulations, and the way they are implemented in member states, have an indirect impact on how complex, costly or time-consuming it is to deliver housing.

Policies supporting the supply of social and affordable housing are needed. Investment in social and affordable housing, including new construction, maintenance and refurbishment, should be part of the policy strategy. The supply of social housing has been very muted in most member states over the last decade. Investments in social and affordable housing initiatives can alleviate overall supply constraints while enhancing affordability, particularly for low-income and younger families. These programmes typically offer rental units at regulated prices or sell properties below market rates under specific conditions. Unlike housing allowances, which may increase demand and risk becoming counterproductive and costly for the public purse, the construction of social housing expands supply.

Policies aimed at reducing urban congestion can also help alleviate pressure on the housing market. By incentivising firms to relocate staff or move services away from congested areas, these policies can redistribute housing demand and ease supply constraints. This redistribution can enhance the effectiveness of policies supporting housing supply, such as social housing initiatives, allowing them to have a more significant impact. Investment in urban and suburban transport also plays an important role in this process.

At the European level, a supportive environment can be fostered through complementary funding mechanisms and strategic initiatives to promote affordable housing. Recognising the importance of affordable housing for social cohesion and economic stability, the European Commission is introducing a European Affordable Housing Plan, making this a key priority for the current term.⁴ The plan will make proposals on how to offer technical assistance to cities and member states, and focus on investment and skills needed. A key component will be a European Strategy for Housing Construction to support housing supply, including measures to reduce building costs, increase the skills of the labour force, raise productivity and enhance the environmental performance of construc-

tion. Together with the European Investment Bank and other financial institutions, the aim is to attract more private and public investment for affordable and sustainable housing. Part of this will be allowing member states to inject liquidity into the housing market, including by reviewing state aid rules, and doubling the planned cohesion policy investments in affordable housing. It will also contain proposals on short-term accommodation rentals and how to tackle the inefficient use of the current housing stock.

By promoting deeper financial integration and attracting private investment, EU initiatives can improve financing conditions, including those for housing. As private financing remains dominant in real estate investment, integrated capital markets can attract private investment into long-term housing projects, thereby increasing liquidity and diversifying funding, particularly in underserved sectors like social housing.⁵ The Banking Union reduces risks across the banking sector and better integrates financial institutions, enabling them to offer new and affordable mortgages. Future Union initiatives on banking and capital markets, under the Savings and Investments Union, could contribute to improving housing finance and boosting economic growth, providing a strong foundation for the targeted policies essential in tackling housing affordability.

5 Fransen et al. (2018) identified a minimum annual investment gap of €57 billion.

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4 Under this plan, member states will be allowed to double cohesion policy investments in affordable housing as an immediate first step. See political guidelines for the next European Commission (von der Leyen, 2024).