

## “Hot Property: the housing market in major cities”

Introduction speech by Klaas Knot at the DNB High-Level Seminar

Amsterdam, 24 May

In his opening speech at the DNB housing market seminar, Klaas Knot shares his view on how housing prices can become a problem for broader economic wellbeing, and thus form an area of interest to central bankers. A more balanced and suitable supply of housing is needed. The new Dutch housing agenda is a promising example of the leading role our government should play on the Dutch housing market.

Distinguished guests,

Welcome to Amsterdam!

The city with the highest house price rises in the Netherlands and, last year, also in the Eurozone. I live here, so I have witnessed the soaring prices at first hand. Amsterdam, like many capital cities, has led the rebound in the Dutch housing market, which started in 2013. Prices here began to take off, and within a few years were growing at annual rates of over 15%. It is the same story in other large cities in the Netherlands. And more recently, the rest of the country has followed this trend, so house prices are rising everywhere.

My work takes me all over the globe, to the world’s major cities. Many of you come from these cities, in Europe: London, Paris and Stockholm, but also Washington, Seoul and Sydney.

And similarly, I have seen with my own eyes similar housing market dynamics in these locations, as they are becoming increasingly popular. This is why we invited you all here, to discuss some serious questions. Do we agree on the analysis of the problems in this field? Could we learn from each other’s best practices? Is there one solution?

### **My view**

But first, please allow me to share my view. As a resident, as the president and of course as an economist. While the increased popularity of cities worldwide may be good news for these places, and for homeowners, it also poses challenges. Demand for urban housing is strongly outstripping supply. This leads to the surge in housing prices that we are seeing. At the same time, it also puts pressure on rental markets.

And although supervisors, central banks and governments have strengthened mortgage regulation since the crisis, the risk of a credit-driven boom always looms. After all, homeowners are often willing to take on more debt to be able to live in the city. We haven’t yet seen a credit boom in the Netherlands, but in some other countries house price growth is coupled with strong mortgage growth.

Indeed, the strong price increases are making urban housing affordability a pressing issue everywhere in the world. For central bankers, responsible for financial stability, affordability may not always be their most important concern. However, extreme examples such as the San Francisco Bay Area, Silicon Valley, where the average house costs €1.5 million, show this can become a problem for broader economic wellbeing. As these areas are booming, many workers cannot afford to live there anymore. Recently, we see books, research papers and newspaper articles documenting these consequences of decreasing affordability, social as well as economic.

Urban demographics are changing as a result. Young, well-educated people are drawn to cities, often chasing a limited supply of housing. Due to the housing shortage, middle-income households are at a disadvantage: too rich to qualify for social housing, not rich enough to buy a house. They need to rely on the rental market.

However, if this market does not function well, as is the case in many cities, middle income families are forced to move away. Moreover, the rise of major cities also leads to increasing divergence between these cities and more peripheral regions. At the same time, spillover effects cause prices to rise in areas directly bordering major cities. This ultimately affects the structure of economic development, which increasingly shifts to urban areas and away from the periphery.

### **Housing supply**

The lack of suitable housing plays a major role here. Supply shortages in cities, and to a lesser extent in other parts of the country, are a main driver of current price rises. And as we know from past experience, strong house price rises can lead to overshooting. Which is often followed by a correction.

This price volatility does not remain confined to the housing market. In countries like the Netherlands, with a high rate of home ownership and dependence on mortgage lending, house price volatility feeds into the real economy. The link between house prices and private consumption is very strong here. This symbiotic relationship causes booms to grow larger and busts to be deeper.

A more balanced and suitable supply of housing is thus needed. This does not only mean owner-occupied housing, but also private rental, especially for middle-income households. As a DNB study pinpointed last year, they are put in a tight spot on the housing market. In our view, a larger mid-market private rental segment is the key to creating a housing market that is free of such imbalances, especially in cities.

On top of that, it will make the housing market better aligned to the needs of the increasingly flexible and globalized labour market.

However, since last year, the necessary progress on enlarging housing supply is still limited. A lack of planning and building capacity, as well as zoning restrictions, are impeding new-build developments in and around cities. Moreover, lower-tier governments like municipalities lack effective incentives to develop the private rental sector.

So it is up to the Dutch government to take a more pro-active, leading role in ensuring an appropriate supply of new houses. They have the means to encourage municipalities to provide more private rental housing, for instance by setting minimum targets.

In practice, this would mean that the government makes arrangements with municipalities about including a minimum percentage of mid-market rental housing in zoning plans. Moreover, as a higher-level body, the national government can coordinate between localities and is less affected by local pressures, such as NIMBY (Not-In-My-Backyard) protests.

Therefore, I was very happy to hear, yesterday, the Minister of the Interior presenting a new housing agenda. This agenda is meant as an accelerator to ensure the construction of 75,000 new houses each year until 2025. I think this is good initiative, all the more because a broad spectrum of housing market stakeholders is involved: builders, housing associations, home-owners, institutional investors and local governments. To me, this is a promising example of the leading role our government should play on the Dutch housing market.

Our next speaker, whom I will introduce shortly, will speak more about the Dutch government's efforts in this field.

As a central banker with a financial stability mandate, these housing market developments pose new challenges for risk analysis and possible policy responses. And I am sure you are all struggling with these challenges too.

### **Today's and tomorrow's seminar**

You are now all here in this room to discuss these issues under the watchful eye of our past presidents. And as you might have noticed from the programme, not only do you come from different countries, but also from divergent backgrounds. When organising this seminar, we wanted to avoid groupthink and promote a healthy exchange of views from different perspectives. So some speakers come from central banks and public bodies, others from academia or the private sector. And of course a seminar about major cities would not be complete without representatives from cities themselves.

We hope your different backgrounds help us tackle the questions that are facing us. Today and tomorrow, we would like to address four of these questions.

We start with the question of why big cities are so popular, and whether this popularity is here to stay. The first session will be devoted to this question. But I am also sure our keynote speaker professor Edward Glaeser will shine more light on this issue. After all, he has been conducting research on urban development for over 25 years.

Being at a central bank, we will also broach the bubble question: is there a housing bubble in the big cities and how do you measure this? If there is anything the financial crisis has taught us, it is that there is most cause for concern when this bubble is fuelled by excessive credit provision. Credit-driven bubbles are most detrimental to financial stability. Curiously, in the Netherlands, the housing market recovery does not seem to be credit-driven: house prices seem to be exploding, but mortgage growth is near zero. I cannot help but notice that this uncommon development is driven by today's low interest rates. As private investors do not find sufficient return in savings accounts or other safe investments, they turn to the housing market which drives up prices.

Tomorrow, we will then look at the third question, on the supply side of the housing market: what role do supply frictions play in the current environment? Cities are notoriously dense, and expanding supply is thus difficult in urban areas. So more than in peripheral areas, supply issues and policy options should be studied in detail.

This brings us to the last topic, our fourth question: which policy actions are needed to effectively address these issues? Until recently, policymakers, at least at central banks, focused mainly on restricting demand. Measures like LTV limits, LTI restrictions and capital requirements should keep mortgage growth, and thus price growth, in check. However, current developments seem less driven by credit, at least in the Netherlands, and more by fundamentals like population growth and supply shortages. It's thus likely we need to look further than our standard housing market toolkit.

### **The seminar: proceedings & logistics**

To ensure the lessons learned today and tomorrow are available for the future, we will publish a conference proceedings after the summer. From the contributions we have already received, I can tell that this will be a rich collection of papers that will surely add to collective knowledge on urban housing markets. Before I introduce the next speaker, I would like to give you a few details on the logistics of the seminar. To begin with, each session has a different moderator. They have an important role today: to make sure presentations are kept brief and to-the-point, and to stimulate debate.

Second, we are fortunate to have an impressive turnout of high-level policy makers, leading academics and financial sector representatives from various countries. Given the seating constraints, a number have to sit in the second row. At the same time, let me stress that everyone in the second row is just as welcome to participate in the discussion as those seated at the front.

Finally, please note that we've invited a couple of our trusted friends from the Dutch press to attend this seminar. But, obviously, the Chatham House Rule applies, starting right after this introduction and the key note speech. So, nothing stands in the way of an open, thought-provoking and stimulating discussion!

I sincerely hope that today's seminar will bring our collective understanding of urban housing markets a bit further, and help us tackle the challenges ahead.

And let me now turn to our next speaker. We had invited our Deputy Prime Minister, and Minister of the Interior and Kingdom Relations, Kaja Ollongren. She is responsible for housing policy in the Netherlands. Unfortunately, and perhaps ironically, she has been called to The Hague for a parliamentary debate on the affordability of Dutch housing. In her stead, Erik-Jan van Kempen will deliver the opening remarks. Erik-Jan is Program Director General at the Ministry, responsible for implementing the Environmental and Planning Act. Moreover, as an inhabitant of Amsterdam, he is very familiar with the situation in the capital.

He will now enlighten us with his view on these matters. Erik-Jan, the floor is yours.