Imbalance on the Croatian Housing Market in the Aftermath of an Economic Crisis

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Abstract : This manuscript examines factors that affect demand and supply of the housing market in Croatia. The period from the beginning of this century, until 2008, was characterized by a strong expansion of construction, housing and real estate market in general. Demand for residential units was expanding, and this was supported by favorable lending conditions of banks. Indicators on the supply side, such as the number of newly built houses and the construction volume index were also increasing. Rapid growth of demand, along with the somewhat slower supply growth, led to the situation in which new apartments were sold before the completion of residential buildings. This resulted in a rise of housing price which was indication of a clear link between the housing prices with the supply and demand in the housing market. However, after 2008 general economic conditions in Croatia worsened and demand for housing has fallen dramatically, while supply descended at much slower pace. Given that there is a gap between supply and demand, it can be concluded that the housing market in Croatia is in imbalance. Such trend is accompanied by a relatively small decrease in housing price. The final result of such movements is the large number of unsold housing units at relatively high price levels. For this reason, it can be argued that housing prices are sticky and that, consequently, the price level in the aftermath of a crisis does not correspond to the discrepancy between supply and demand on the Croatian housing market. The degree of rigidity of the housing price can be determined by inclusion of the housing price as the explanatory variable in the housing demand function. Other independent variables are demographic variable (e.g. the number of households), the interest rate on housing loans, households' disposable income and rent. The equilibrium price is reached when the demand for housing equals its supply, and the speed of adjustment of actual prices to equilibrium prices reveals the extent to which the prices are rigid. The latter requires inclusion of the housing prices with time lag as an independent variable in estimating demand function. We also observe the supply side of the housing market, in order to explain to what extent housing prices explain the movement of new construction activity, and other variables that describe the supply. In this context, we test whether new construction on the Croatian market is dependent on current prices or prices with a time lag. Number of dwellings is used to approximate new construction (flow variable), while the housing prices (current or lagged), quantity of dwellings in the previous period (stock variable) and a series of costs related to new construction are independent variables. We conclude that the key reason for the imbalance in the Croatian housing market should be sought in the relative relationship of price elasticities of supply and demand.

Keywords : Croatian housing market, economic crisis, housing prices, supply imbalance, demand imbalance