

The Influence of the Exchange Rate on the Real Estate Market

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Abstract

Globally, we are dealing with markets influenced by various "strong currencies", dominated by the US dollar and newer, especially on the European market, the Euro. These currencies influence prices through the exchange rate with the national currency of countries that are not affiliated to them but have their own currency. The aim is to present the margin of evolution of the real estate market, depending on the evolution of the exchange rate.

Key words: influence, exchange, real estate

J.E.L. classification: M31

1. Introduction

In the exchange rate of a country we will always find one or two top currencies, i.e. currencies around which economic transactions are made. At these currencies, through their exchange rate, directly affect the price of products on the markets of that country, bank rates and in general all types of transactions. So valid for the real estate market, these currencies have taken over the way of expressing the prices of real estate assets, we find ourselves in the situation where in many countries we will find the price of real estate expressed in the currency predominant in the area. In order to better see the influence of the exchange rate on the actual price of a building, we will summarize, for the most part, to treat the situation on the Romanian market.

2. Theoretical background

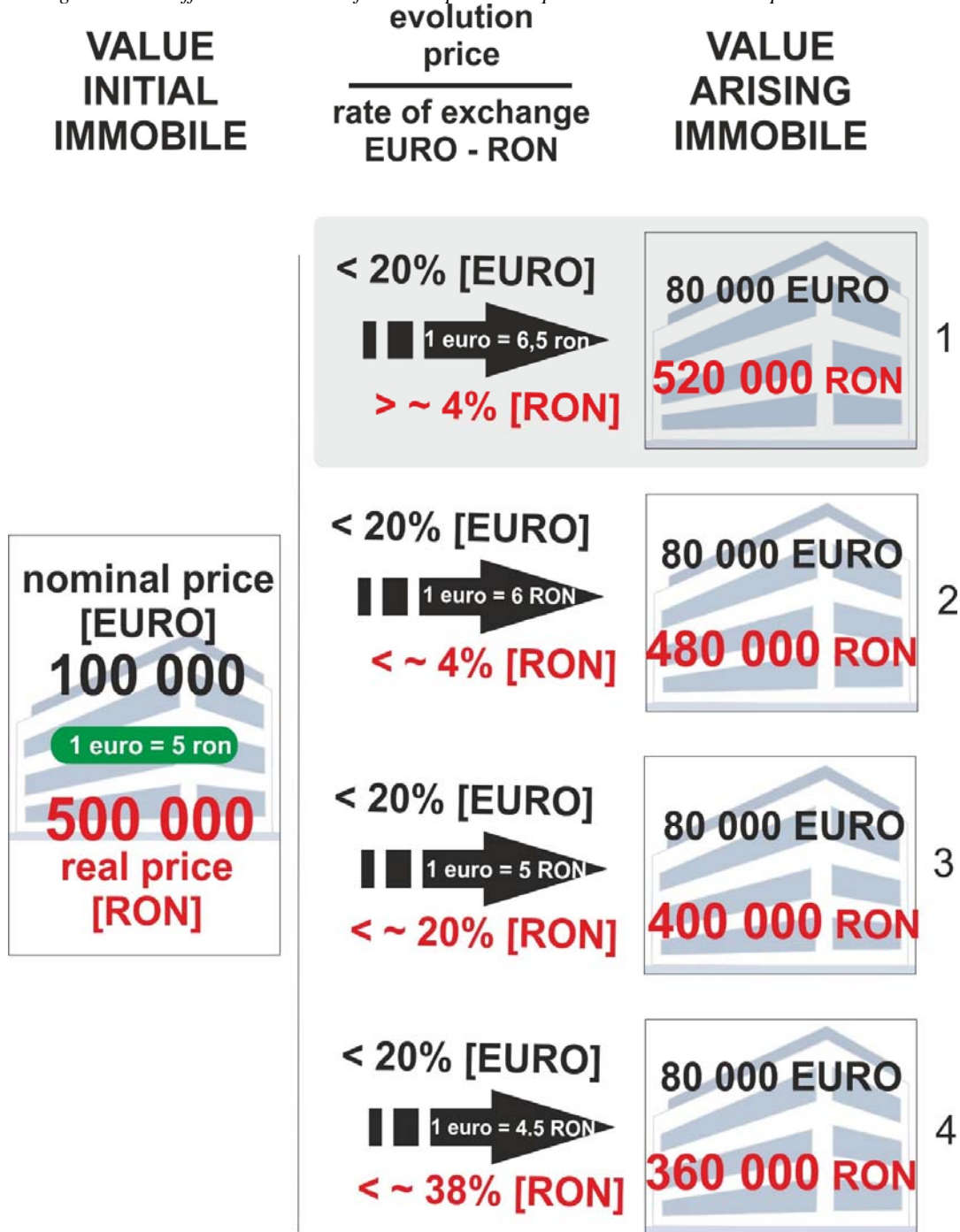
Regardless of the type of market, we must take into account the fluctuations of the transaction currency and at the same time the evolution of the exchange rate. Real estate market experts say that the evolution of the euro has an overwhelming influence on the real estate market. The price regardless of the market, bears the influence of the exchange rate.

3. Research methodology

The limitation to working with levels models in valuation analyses according to the study conducted from external sources.

On the Romanian market, in most cases, the real estate trading currency is Euro, and the income of market participants is of course in Lei. We will see that we are dealing here with a phenomenon, which may seem strange at first sight, namely the nominal level of prices has in some situations, an opposite evolution to the real level of prices and in other situations their value behaviour differs. - see figure no. 1.

Figure no. 1. Different evolutions of nominal prices compared to real ones - example



Source: Author's own contribution

4. Findings

We see a decrease in the price of a building from 100,000 Euros, - called nominal price (equivalent to 500,000 Ron - called real price, expresses the price in the currency in which the gains are made), to 80,000 Euros which is actually a reduction *nominal* by 20% of the prices, which, however, in *reality* puts us in one of the following situations:

1. an increase of the price by about 4 percent, given by the devaluation by over 25% of the national currency (in our case the Leu) in relation to the Euro;
2. a 4% decrease in the price, in the conditions of the devaluation of the national currency by only 20% in relation to the Euro;
3. a decrease of about 20 percent in the price, provided that the same exchange rate between the Euro and the Leu is maintained;
4. a decrease of more than 20% in the price, if the national currency (Leu) suffers an appreciation in the exchange rate with the Euro.

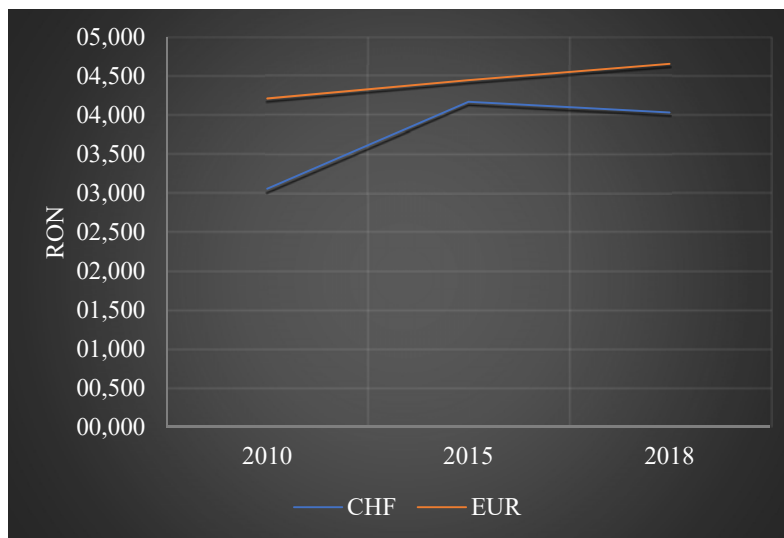
As can be seen, real prices depend on the exchange rate (in our case Euro / Leu), a rate that also has an effect of accentuating the impact of macroeconomic indicators on prices. However, in reality, the exchange rate has a balanced role in the steep changes in nominal prices:

* during the period of sustained economic growth, the nominal prices of real estate assets have an accentuated upward trend, partially offset, however, by an appreciation of the national currency against the Euro;

* during the period of economic adjustment, the phenomenon was reversed, the decrease in real estate prices being partially offset by the depreciation of the national currency.

Basically, due to the effect generated by the exchange rate, real prices (in Lei) had a much lower margin of volatility than nominal prices (in Euro). This, however, is not a market rule, as all the variants presented in the example above are possible on the market.

Figure no. 2. Trends of some euro currencies in the exchange rate with the RON



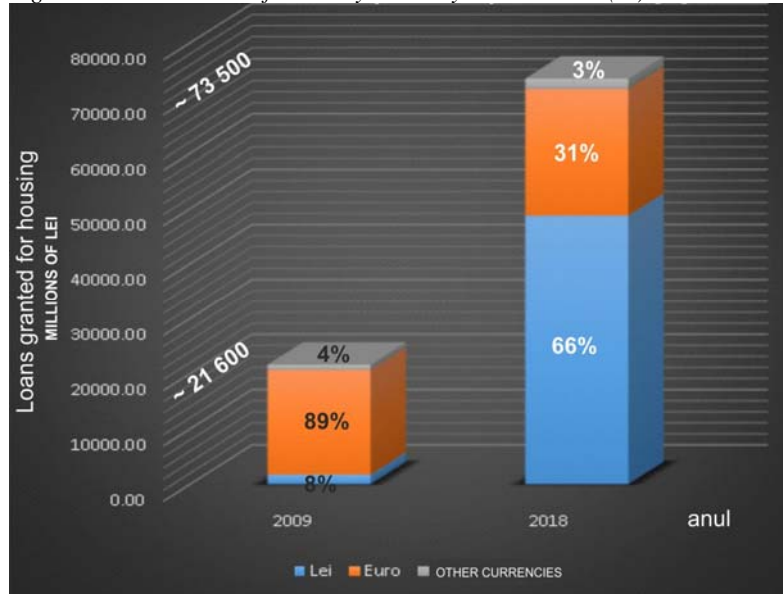
Source: National Bank of Romania

If we analyse a little the last 10-15 years, we will notice interesting periods in the currency behaviour, especially for certain so-called exotic currencies, in this case the Swiss Franc (CHF) - see figure no. 2 (the data source is the NBR statistics^[1]), which decisively influenced the real price of real estate credited by this currency and in time the consumer's opening on the credit currency, see figure no. 3 (the data source is the NBR statistics^[2]), although quotations remained in Euro.

Thus, on the credit market during the economic crisis, the Swiss franc appears with very attractive interest rates for the population, first of all, making it to focus on loans in this currency. On the other hand, at the first opportunity, with the recovery of the economy, the parity with the leu has a sudden rise for quite a short time, which determines a real increase in the rates paid by the creditor with his income in lei, so a citizen who at the beginning of the loan had a rate of about 700 lei wakes up in a period of about 2 years with a rate exceeding 1000 lei, in some months, but without benefiting from proportional salary increases (incomes). At some point the situation becomes so stressful that even state intervention is needed to balance the situation. This situation is a good example to show the difference between the real cost and the nominal cost of a building.

Analysing the graphs in Figure no. 3 we can say that along with the behaviour of the dominant currency on the market, this situation (the risk generated by exotic currencies), influences the buyer's behaviour towards lending, especially in real estate, because if we take consumer loans we will see that they are divided almost equally between local currency and currencies.

Figure no. 3. The share of currency/currency in total loans (%)



Source: National Bank of Romania

From the NBR statistics, we find out that at the end of 2018, the loans for housing of the population reached around the amount of 73.5 billion lei (approximately 15, billion euros). Of which more than half, about 66% loans in Lei, followed by those in Euro with about 31% and other currencies with only 3%. If we compare these with the situation in 2009, we will find a reversal of the ratio between types of loans, with a significant increase in loans in lei to the detriment of those in euros and a significant decrease in those in other currencies - due to the confidence of the beneficiary their behaviour in the exchange rate.

Also statistically, we see a tripling of the value of lending, a fact highlighted by the recovery from the economic crisis, the improvement of living standards and last but not least the increase of investors' interest in this market.

Another indication of the impact of the trading currency on the share of the domestic currency in total housing loans is related to the discrepancy between certain regions. Thus, in addition to the dominant market of Bucharest, significant markets also appeared in the province, highlighting Cluj Napoca, Timișoara, Constanța, Iași etc., although there are still areas with relatively low potential. Although the national currency has taken the place of currencies in lending, prices remain in Euro.

5. Conclusions

We could say that the quotations in euro on the domestic real estate market have a double effect: it gives stability to real prices, but it is also an additional source of inefficiency. This last fact is due to the impact that foreign currency trading has on the increase of transaction costs and on its total risk. But as we have shown, the reversal of the share of the national currency in relation to the currency, in the value of lending, could translate into several aspects:

- the buyer's awareness that his income is in lei;
- the impression that risks are controlled, the exchange rate difference is expressed at the beginning of the transaction and in principle no longer affects rates;
- balancing the level of interest rates on loans in Lei with those in Euro;

- the buyer's awareness that loans in exotic currencies, so-called advantageous, generate much higher risks than those in the national currency or the euro.

And yet the tradition and the impression of the stability or growth of the Euro, as well as the fact that the future is defined by the changeover to the Euro currency, makes the price of real estate remain expressed in Euro. Even the buyer who took a property in lei, in the capacity of seller will ask for the price in Euro.

6. References

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