Vijit Supinit
June 8, 2017

Abstract

As history has shown, bubbles in the real estate market can have a devastating impact, not only on the domestic economy but on the whole world. The current events and developments on the German housing market have shown strong, yet excessive growth in both purchase prices and rent rates and brought it to the attention of public debate. However, the indicators of speculation driven price bubbles are very individual, vary from market to market and are difficult to identify at a national level, since the aggregation of data is covering diverging developments on submarkets.

This independent study deals with the question whether there is a bubble in the German residential real estate market by application of different ratio analysis (Price-to-Rent ratio, Price-to-Income ratio, Debt ratio) and economic indicators. Firstly, these different key ratios will be applied on past bubbles as a back-test to verify its effectiveness. The property market bubbles of the USA in 2008/09 and of Spain in 1997 and 2008 will be analyzed. After verification of the key ratios they will be applied on the German real estate market.

It turns out that, by applying the presented ratios and including economic indicators and the gained insights from the American and Spanish markets, there is no clear answer to the question. Prices have grown drastically in many major cities, often much stronger than the rent rates have increased. But unlike the back-tested bubbles in the USA and Spain, private debt has not increased but even decreased and various economic indicators provided suitable explanations for fundamental changes in the market. But nonetheless, the emergence of a bubble could not be fully ruled out.