FitchRatings

Global Housing and Mortgage Outlook – 2019

Home Price Growth Under Pressure

FitchRatings

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Full contact list is on **page 36** and **page 37**.

Global Highlights

Regulatory Measures Cool City Hotspots

Overheated home prices in several major cities have been a key theme in this report in recent years. But prices fell or stalled in 2018 in Melbourne, Stockholm, Sydney, Toronto and Vancouver due to government actions to reduce foreign purchases, macro-prudential measures and/or stretched affordability. Fitch Ratings forecasts home prices to fall in Australia and Sweden in 2019 before stabilising in 2020, modest corrections in China and South Korea, and stalled growth in Canada. We have also seen regulators actively managing markets through the tightening and loosening of lending rules.

High Household Debt Amplifies Risks

Household debt-to-GDP ratios are at or over 100% in Australia, Canada, Denmark, the Netherlands and Norway, and over 85% in New Zealand, South Korea, Sweden and the UK. High household debt makes the wider economies more vulnerable to shocks in the financial sector and borrowers more exposed to downturns. Household debt growth has stalled in Denmark and the Netherlands due to affordability constraints and regulatory intervention. The household debt-to-GDP ratios in Australia, Canada and Norway have stabilised after sharp growth while they have continued to grow in China and South Korea, albeit at a slower pace.

Political Uncertainty Affects Housing

Fitch highlights several cases of political risks in the report, including Brexit, a political appointment to oversee Fannie Mae and Freddie Mac, and new governments in Latin America. Their impact varies: our no-deal Brexit scenario analysis suggests price drops in the UK and much slower price growth in Ireland while uncertainty is already contributing to price falls in London; less government participation in the US mortgage market could increase mortgage pricing and lead some lenders to reduce product offerings; in Brazil, there is uncertainty regarding the new government's ability to enact market-friendly policies that would support home price growth.

Cracks Appear in Economic Growth Outlook

Fitch notes in its **Global Economic Outlook** that cracks are starting to appear in the global growth picture, with China and the eurozone slowing, further rate increases expected in the US, stubbornly low core inflation in the eurozone and Japan, and the dollar's strength putting pressure on emerging markets. These factors contribute to Fitch's view that economic growth is slowing, albeit to a moderate degree and in many cases from a position of strength. However, our **macroeconomic outlooks** to 2020 for the 24 countries in this report are still mainly stable or improving, which supports our mostly stable **housing and mortgage market evaluations**.

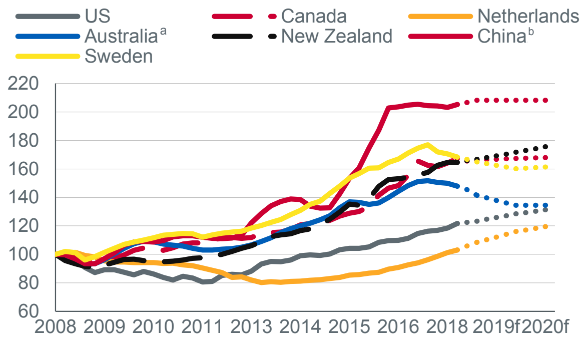
Arrears Concerns Beyond 2020

Fitch does not forecast material increases in arrears in 2019 and 2020 for any country in the report. We expect the impact from weaker growth and generally slow mortgage rate rises to be relatively benign. But there is downside pressure in the medium term from rising rates, fading fiscal stimulus in the US and weaker growth in China, in the context of still high global debt. A faster-than-expected tightening in global financial conditions could worsen mortgage performance.

Mixed Impact from Rising Rates

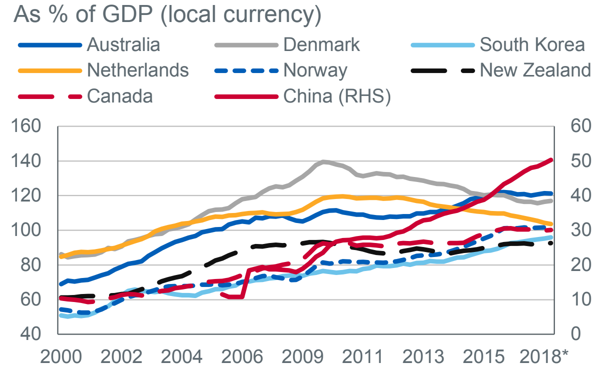
The speed of mortgage rate rises will vary with North America expected to post the fastest increases and Japan and the eurozone the slowest. The impact will depend on whether mortgages have long-term fixed rates and the macroeconomic backdrop. Highly leveraged markets with large numbers of variable-rate loans, such as Australia, Norway, Sweden and the UK, could see marked deterioration in loan performance should rates rise quickly. Markets with long-term fixed-rate loans, such as Belgium, France, Latin America, the Netherlands and the US, may see lenders gradually increase their appetite for higher-risk borrower and loan characteristics as their profitability suffers and competition intensifies.

Nominal Home Price Indices



[a] Eight capital cities in Australia
[b] Tier 1 cities in China: Beijing, Shanghai, Guangzhou and Shenzhen
Note: Forecasts of 4Q18 and later included for all countries.
Source: S&P/Case-Shiller, BIS, CBS, CoreLogic, RBNZ, NBS China

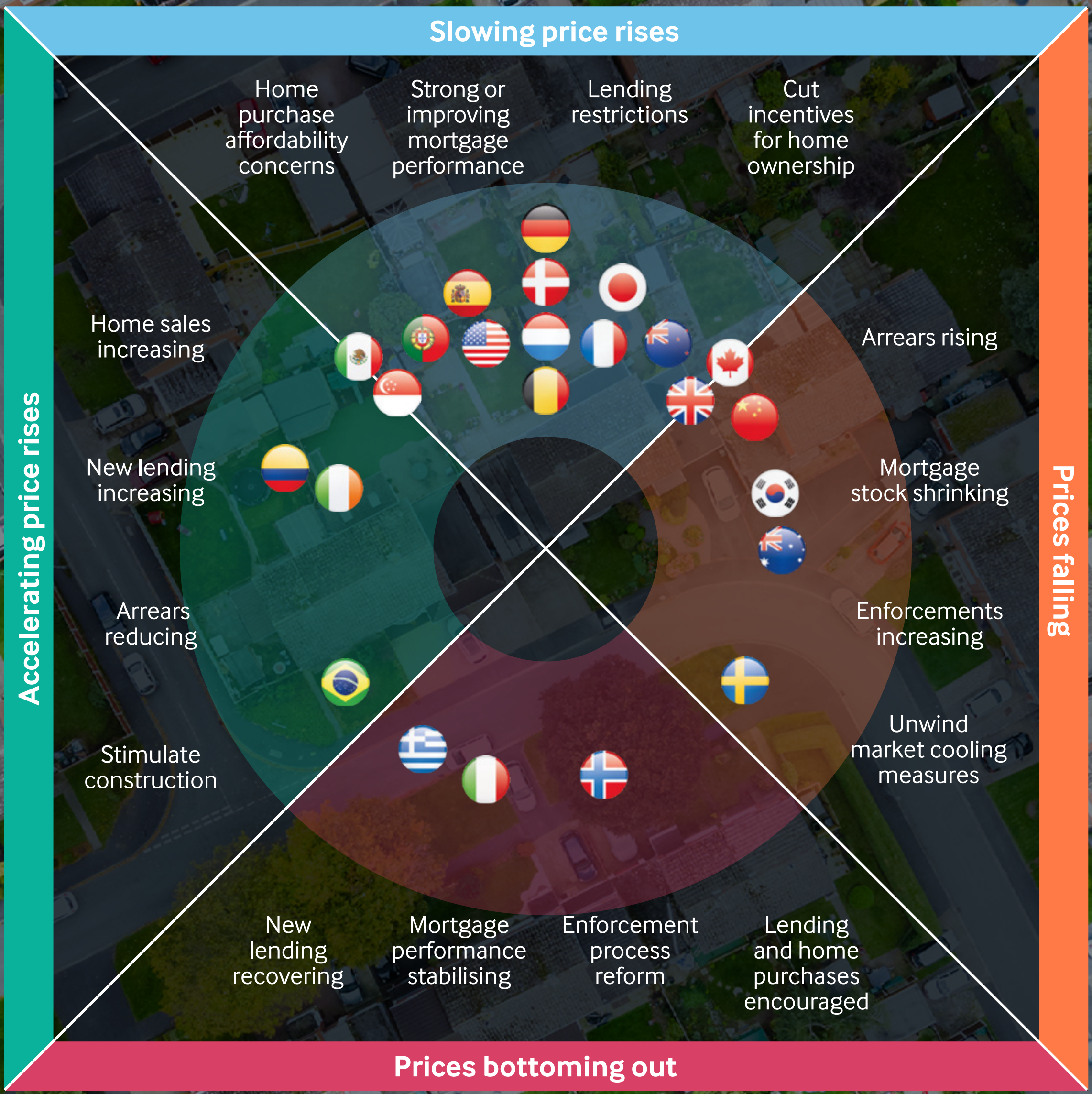
Household Debt-to-GDP Ratio
As % of GDP (local currency)



Note: 2018 data up to 2Q.
Source: BIS

Global Housing and Mortgage Outlook – 2019

Position in Home Price Cycle and Typical Market Characteristics



Market Forecasts

Region	Country	Page	Nominal Home Prices (% Change Yoy)			Arrears (%)			Gross New Mortgage Lending (% Change Yoy)			Overall Market Evaluation	
			2018 estimate	2019 forecast	2020[e] forecast	2018 estimate	2019 forecast	2020[e] forecast	2018 estimate	2019 forecast	2020[e] forecast	Outlook[f]	Change vs 2018[g]
North America	USA	11	5.6	4.1	▲	1.8[c]	1.8[c]	▶	-9.0	0.0	▲	Stable	▶
North America	CAN	12	3.0	0.5	▲	0.3[c]	0.3[c]	▲	2.9[d]	1.5[d]	▲	Stable/ Negative	▶
Europe	UK	13	2.5	2.0	▲	0.9[c]	1.1[c]	▲	0.0	-12.5	▲	Stable/ Negative	▶
Europe	GER	14	8.9	3.5	▲	0.1[c]	0.1[c]	▶	2.5	2.0	▲	Stable	▼
Europe	NLD	15	10.0	7.0	▲	0.2[h]	0.2[h]	▲	1.0	1.0	▲	Stable	▶
Europe	FRA	16	2.8	1.5	▶	1.2[b]	1.2[b]	▶	-35.0	-15.0	▼	Stable	▼
Europe	BEL	17	2.0	2.0	▲	1.1[c]	1.1[c]	▶	-10.0	-10.0	▼	Stable	▶
Europe	DEN	18	3.5	3.0	▲	0.2[c]	0.2[c]	▲	2.0	1.4	▲	Stable	▶
Europe	SWE	19	-4.0	-3.0	▲	n.a.	n.a.	n.a.	5.8[d]	2.4[d]	▲	Stable/ Negative	n.a.
Europe	NOR	20	1.5	1.0	▲	0.2[c]	0.2[c]	▲	6.1[d]	4.9[d]	▲	Stable	▲
Europe	IRL	21	8.0	9.0	▲	9.5[b]	8.8[b]	▼	24.0	18.1	▲	Stable/ Positive	▼
Europe	ESP	22	6.0	5.0	▲	6.4[b]	6.0[b]	▶	10.0	7.5	▲	Stable/ Positive	▶
Europe	ITA	23	-0.1	0.0	▶	8.0[b]	7.7[b]	▶	3.0	3.0	▲	Stable	▼
Europe	PRT	24	6.5	6.0	▲	5.2[b]	5.0[b]	▶	20.0	15.0	▲	Stable/ Positive	▶
Europe	GRC	25	0.5	1.0	▲	33.2[c]	33.2[c]	▶	-5.0	0.0	▶	Stable	▼
Asia-Pacific	AUS	26	-6.1[a]	-5.0	▶	0.6[b]	0.6[b]	▲	5.0[d]	3.5[d]	▲	Stable/ Negative	▼
Asia-Pacific	CHN	27	2.0[a]	0.0[a]	▶	0.3[c]	0.3[c]	▶	17.0[d]	15.0[d]	▲	Stable	▶
Asia-Pacific	JPN	28	2.0	3.0	▼	0.2[c]	0.2[c]	▲	-2.5	2.0	▼	Stable	▶
Asia-Pacific	KOR	29	-0.5	-0.5	▼	0.3[c]	0.3[c]	▶	3.0[d]	2.0[d]	▲	Stable	▶
Asia-Pacific	NZL	30	2.5	3.0	▲	0.5[c]	0.5[c]	▲	5.9	6.0	▲	Stable	▶
Asia-Pacific	SG	31	5.0	2.0	▲	0.4[c]	0.6[c]	▲	4.0[d]	3.0[d]	▶	Stable/ Positive	▶
Latin America	BRA	32	0.5	4.0	▲	1.7[c]	1.6[c]	▶	0.8	2.1	▲	Stable	▶
Latin America	MEX	33	4.0	4.0	▲	2.5c	2.5[c]	▶	4.0	4.0	▲	Stable	▶
Latin America	COL	34	5.8	4.3	▲	3.2[c]	3.3[c]	▲	10.0	10.0	▲	Stable	n.a.

Legend

[a] Index of eight capital cities Australia and Index of Tier 1 cities (Beijing, Shanghai, Guangzhou and Shenzhen) in China.
[b] Fitch-rated RMBS three-months-plus arrears including defaults.
[c] Market-wide or largest lender arrears/impaired loan ratio (definitions vary).
[d] Measures vary – Canada, South Korea, China, Singapore: outstanding mortgage balance; Sweden, Norway: gross household debt; Australia: housing credit.
[e] Forecasts are ▲ (positive), ▶ (0.0), or ▼ (negative) figures for Nominal Home Prices and Gross Mortgage Lending and ▼ (lower), ▶ (stable), or ▲ (higher) versus 2019 forecasts for Arrears.
[f] Outlook on a five-notch scale (Positive, Stable/Positive, Stable, Stable/Negative, Negative).
[g] Change of outlook evaluation is compared with outlook from a year ago. Sweden and Colombia were not included in the GHMO 2018 report.
[h] Fitch-rated RMBS three-months-plus arrears excluding defaults, since default definition varies across Dutch banks.

Source: Fitch Ratings

North America

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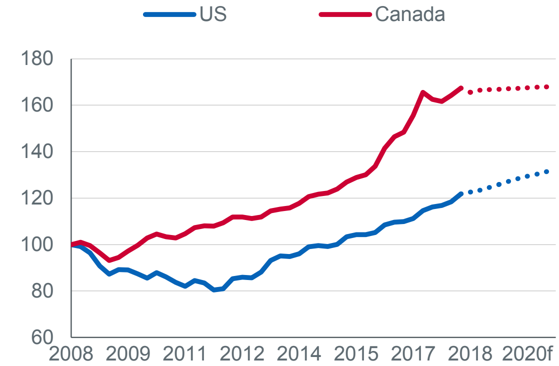
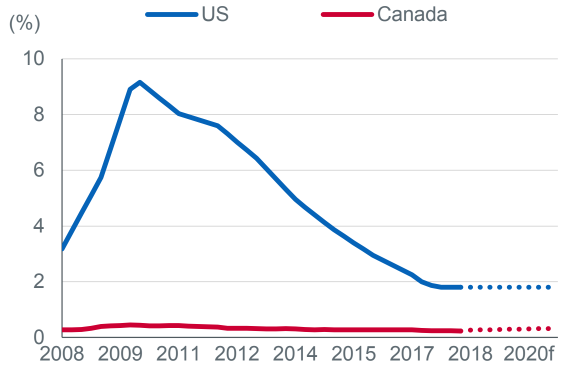
The US faces a potential change in the government's role in mortgages in 2019 while Canada confronts a sharp property price slowdown.

Nominal Home Price Indices



Source: Fitch Ratings, S&P/Case-Shiller, BIS

Mortgage Loans in Late-Stage Arrears or Default



Note: Based on the the market rate for arrears
Source: Fitch Ratings, BKFS, CBA

Increased US Policy Uncertainty

In early 2019, the Trump administration will replace the director overseeing the main government-sponsored enterprises (GSEs), which have bought or insured the majority of US mortgages since 2009. Fitch expects the replacement to reflect a smaller government role in the mortgage market by possibly increasing fees or changing limits to the maximum loan size or product eligibility. We believe underwriting standards and controls between non-bank and bank lenders have been similar due to their selling of originations to GSEs, and that a reduced role for GSEs could lead to more diverse origination practices and a greater role for private capital.

Brake on Home Price Growth

In both Canada and the US, mounting affordability pressures from rising mortgage rates are bringing the unusually strong price gains since 2012 to an end. Fitch expects home price growth in Canada to have slowed sharply to 3.0% in 2018 and prices to grow by only 0.5% in both 2019 and 2020. US home price growth will slow more modestly to 3%-4% over the next two years. Insufficient home-building, falling or stable unemployment and at or above-trend, albeit slowing, economic growth should prevent national price drops in either country. Fitch views Dallas, Las Vegas, Phoenix, Portland, Seattle, Toronto and Vancouver as the most overvalued cities with home prices that are vulnerable to shocks.

Subdued Mortgage Credit Growth

We expect gross new mortgage lending in the US to have fallen by 9% in 2018 and to be stable in 2019-2020. A further fall in refinancing activity and dampened demand in higher-priced markets on the back of reduced tax deductibility of state and local taxes will outweigh the positive impact of a generally strong economy. US non-prime lending continues to grow but volumes remain well below 1% of pre-crisis levels. In Canada, new mortgage lending should post only minimal growth due to affordability constraints and tight qualification standards.

Low Arrears Dependent on Strong Labour Markets

We expect standard mortgage rates in both countries to go above 5% in 2019, but we forecast US arrears levels to be stable because of the very low level of unemployment and the dominance of fixed-for-life mortgages. We forecast a slight increase of arrears for Canadian mortgages, which typically adjust rates every five years and are therefore more vulnerable to rising rates. However, strong underwriting requirements are expected to support loan performance. Fitch sees some vulnerability in the Canadian economy from stalled property prices and high household debt levels.

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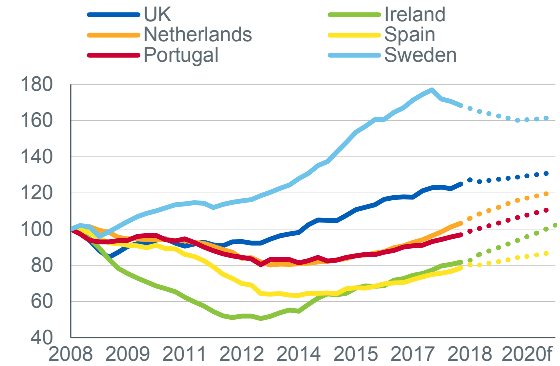
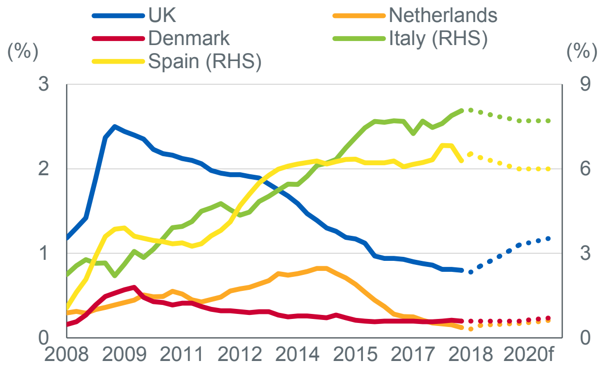
> We expect home price growth to slow in most European countries as affordability tightens and economic growth slows. Improving or tight job markets will support borrower performance.

Nominal Home Price Indices



Source: Fitch Ratings, HM Land Registry, CSO, CBS, INE, BIS

Mortgage Loans in Late-Stage Arrears or Default



Note: Fitch 3m+ arrears index except for the market rate for arrears for the UK and Denmark Source: Fitch Ratings, CML, Finance Denmark

More Challenges to Home Price Growth

Fitch expects home price growth to slow in most European countries in both 2019 and 2020 as the ECB's quantitative easing ends, GDP growth slows towards trend and affordability constraints from the high cost of property limit demand. However, we forecast slowing but still strong price growth of at least 5% in 2019 in Ireland, the Netherlands, Portugal and Spain, which are still recovering from large price falls. Sweden is the only European country in this report where we forecast a nominal price decline in 2019 (of 3% after a projected fall of 4% in 2018) before stabilising in 2020. Price growth in the Nordics will be limited by high household debt levels, which have prompted macro-prudential measures to cool mortgage lending, and the exposure to rising rates in the mainly variable-rate markets of Sweden and Norway.

Heightened Risks from Political Uncertainty

A no-deal Brexit would be a significant risk for both the UK and Ireland; we forecast price falls in the UK and substantially slower price growth in Ireland in this scenario. Fitch does not forecast price falls in Italy, but any home price rebound is unlikely in 2019-2020 in light of increased funding costs for banks and lower demand. Political risks could spread outside of the UK and Italy if there is higher-than-expected support for anti-EU political movements in the next election cycle.

Reliance on Labour Markets and Low or Fixed Rates

Mortgage rates will continue to be low in Europe over the next couple of years with rates in the eurozone likely to rise the slowest while rates in the UK (if a no-deal Brexit is avoided), Norway and Sweden are likely to increase more quickly. Even when rates rise, high levels of long-term, fixed-rate loans in Belgium, France, Germany and the Netherlands, and growing proportions in Italy and Spain will protect borrowers' payment ability. Fitch forecasts most European countries to face slower economic growth rates converging to trend in 2019-2020, but we also forecast low or falling unemployment rates, which support our expectation of stable arrears levels in the near term.

Weakening Home Affordability to Limit Loan Growth

Despite strengthening labour markets, wage growth has failed to keep up with home price growth. Low or falling unemployment often hides the low pay or the lack of security in newly created jobs, such as the flexible-working arrangements in Spain and the UK. This has pushed up the average age of borrowers in several markets as potential first-time buyers struggle to meet deposit or affordability requirements for mortgages and in some places face competition from property investors.

Asia-Pacific

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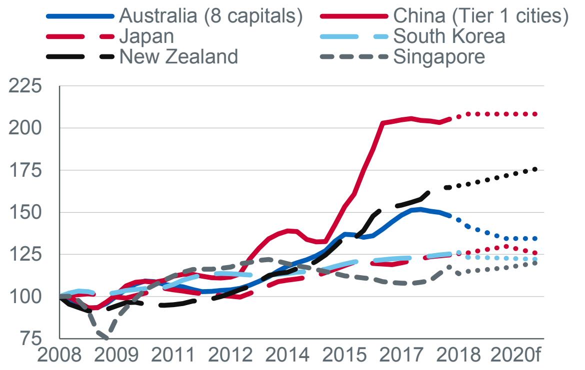
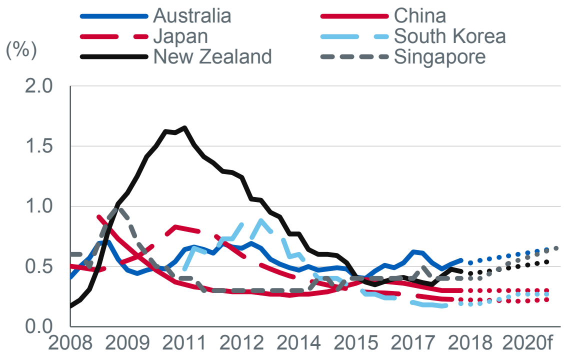
We forecast home price falls or slower price growth throughout the region driven by reduced demand reflecting regulatory interventions and stretched borrower affordability.

Nominal Home Price Indices



Source: Fitch Ratings, CoreLogic, NBS China, Statistics Japan, RBNZ, BIS

Mortgage Loans in Late-Stage Arrears or Default



Note: The market rate for arrears except Fitch 3m+ arrears index for Australia
Source: Fitch Ratings, NBS China, Statistics Japan, FSS, RBNZ, MAS

Price Falls in Australia, South Korea and China

We forecast Australian home prices to fall by a further 5.0% in 2019 before stabilising in 2020 with the fall driven by reduced affordability, restricted access to mortgage finance and higher stamp duty for non-resident buyers. Fitch expects prices to stabilise due to solid, above-trend economic growth and further immigration, despite potential additional immigration restrictions. We forecast annual price declines of about 0.5% in South Korea in 2018-2020 reflecting depressed demand from macro-prudential limits and expectations of rising rates. We also foresee a modest correction in China as home purchase restrictions remain in place. Home price growth rates will be low in New Zealand relative to recent years and will slow in Singapore while a tax change in Japan should lead to prices temporarily increasing in 2019 before reversing in 2020.

Regulatory Restraints Cool Speculative Demand

All countries except Japan have implemented macro-prudential controls designed to cool demand, stabilise home prices and avert systemic risk associated with a build-up of housing debt. Regulations have targeted non-resident demand (Australia, New Zealand and Singapore), domestic investor demand (China, New Zealand and Singapore) and/or improving borrower credit quality (Australia, China, New Zealand, Singapore and South Korea). Fitch has previously highlighted speculative demand as a driver of rapid home price growth in such cities as Sydney, Melbourne and Auckland; the first two posted home price declines in 2018 and falls are likely in all three in 2019.

Affordability to Remain Stretched

Australia, Japan and New Zealand continue to have home price-to-income ratios at or near all-time highs, though South Korea and Singapore have lately seen wages outpacing home price growth. Australian borrowers continue to be vulnerable to financial shocks, despite falling prices, as their very high household debt level (which is the highest in this report relative to GDP at about 120%), is coupled with mostly variable interest rates.

Stable Arrears Despite Slower Price Growth

Fitch continues to expect mostly small increases or stable arrears levels in the near term. Our economic growth forecasts are still at or above trend for most countries and labour markets are expected to remain tight while mortgage rates will stay low (we forecast shallow mortgage rate increases in Australia, New Zealand, South Korea and Singapore in 2019-2020). However, trade threats from the US threaten growth and Fitch forecasts slowing GDP growth in 2019-2020 in several of the countries. In Japan, New Zealand and South Korea, loans mostly pay fixed or hybrid rates. Borrowers who are already struggling will face fewer refinancing options as home price growth slows.

Latin America

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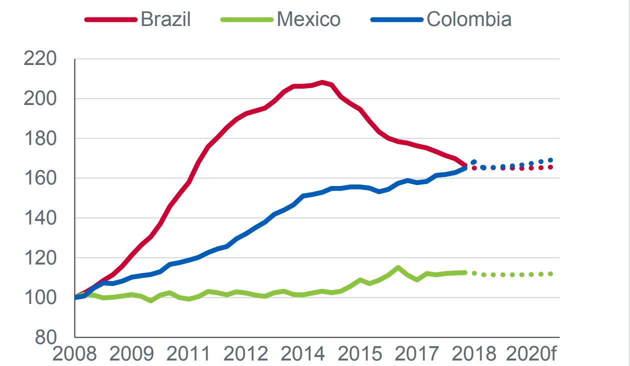
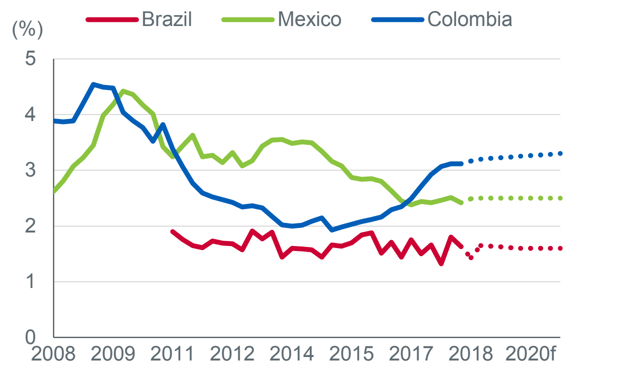
> Downside risks from slowing trade and new governments weigh on our otherwise stable housing and mortgage market outlooks in Brazil, Colombia and Mexico.

Real Home Price Indices



Source: Fitch Ratings, FIPE, SHF, DANE, OECD

Mortgage Loans in Late-Stage Arrears or Default



Note: Based on the the market rate for arrears
Source: BCB, Banxico and Superintendencia Financiera Colombiana

Home Price Growth Matching Inflation

Fitch forecasts nominal home price growth to keep pace with inflation in Brazil and Mexico with some additional real growth expected in Colombia. Brazil's real home prices should finally stabilise after a 21% drop since 2014 as the country's economy continues to improve following the severe 2015-2016 recession. We forecast Colombia's home prices to rise by 1pp-2pp above inflation in 2019-2020 on the back of an improving growth outlook and structural undersupply. Mexico's housing policy will focus even more on lower-income households, keeping average real home prices stable. Risks could stem from a worse than expected slowdown in international trade or a stress on commodity prices.

New Governments Will Affect Housing

Policy uncertainty stems from new presidents taking office in the three countries in the past six months. Fiscal reform and general market-friendly policies are expected to a greater degree in Brazil and to a lesser degree in Colombia but their success will depend on congressional support. In Mexico, Fitch expects a focus on housing access for people on lower incomes, which will weigh on construction for mid-to-high-income segments. Uncertainty around government policy could reduce general demand for purchases. Despite these challenges, Fitch sees the stable to improving macroeconomic environments supporting its overall stable market evaluations for housing and mortgages.

Slight Improvements in Affordability

Fitch forecasts the labour market to strengthen slightly in Brazil, where we expect the unemployment rate to decline to 11.4% in 2020 from a projected 12.2% for 2018, while unemployment rates should remain at about 9% in Colombia and 4% in Mexico. Fitch expects salaries to increase slightly faster than inflation and lending practices to be stable, which should support home purchase affordability. The dominance of fixed-rate mortgages also helps to shield both mortgage affordability and loan performance from increases in interest rates.

Loan Features Support Stable Performance

Strong servicing and small mortgage markets relative to GDP, which allow lenders to target the most creditworthy borrowers, will continue to support stable arrears levels at commercial banks. In Brazil, declining unemployment together with constant amortisation profiles on fixed-rate mortgage loans improve the payment capacity of borrowers over time. Payroll deduction collection mechanisms for Mexican federal government entities (Infonavit and Fovissste), and high initial downpayments and modest home price appreciation in Colombia support stable mortgage performance. The performance of Mexico's non-bank financial institution mortgage portfolios will continue to be weaker than other parts of the market due to higher arrears and low recoveries outside metropolitan areas.

United States

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Fitch sees limited supply fuelling price growth in some cities. Affordability constraints will temper housing demand and help cool overheated markets.

Home Price Growth to Slow

Fitch forecasts annual home price growth to slow to 4% in 2019 and 3% in 2020 from the 5% average of recent years. Stretched affordability from elevated prices and increasing mortgage rates will dampen home price growth with 30-year fixed rates expected to exceed 5% in 2019 for the first time in 10 years.

We view home prices as fairly valued in most areas, but we estimate some areas are overvalued by 10%-20% (see **special report**) due to limited new supply, such as Dallas, Las Vegas, Phoenix, Portland and Seattle. Price growth in high-tax states, such as New York, New Jersey and California, may slow due to the recent cap on state and local tax (SALT) deductions.

Fundamentals Support Performance

With unemployment at a 50-year low and income growth on a positive trajectory, we expect the 60+ day delinquency rate to stay around 1.8% through 2019. Although mortgage rates have risen by more than 1pp and Fitch forecasts a further rise of 30 basis points in 2019, we do not expect bank or non-bank loan arrears to deteriorate.

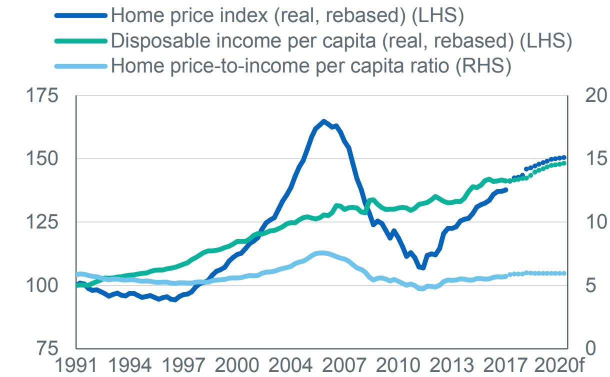
Adjustable-rate mortgages (ARMs) are more exposed to rising rates, but they only form a small part of the current market and borrowers since the crisis have been underwritten considering the maximum instalment over the next five years. Post-crisis ARM delinquencies are forecast to remain below 50bp.

Government Role in Market to Reduce

Less government participation in mortgages is likely under the next director to oversee the GSEs. For example, cash-out refinance and investor loans, which accounted for about 20% and 10%, respectively, of the GSE's 2017 volume, may become ineligible. The most likely impact is that mortgage pricing will increase and lenders will offer a smaller range of products; some expansion to weaker loan and borrowers characteristics is likely at the margins of the market.

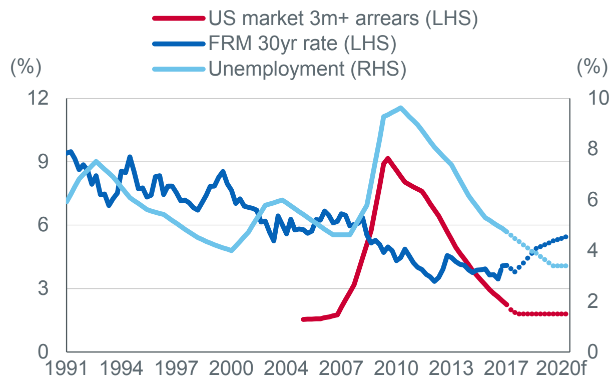
Gross new mortgage lending in 2018 is projected to fall by about 9%. Fitch expects lending to be flat in 2019 considering lower refinancing, tighter affordability and the cap on SALT deductions. There has been some modest relaxation of credit, such as higher debt-to-income ratios and credit scores in the mid to low 700s, but credit quality remains strong. Non-prime lending has grown quickly, but remains below 1% of the pre-crisis volumes.

Home Prices and Affordability



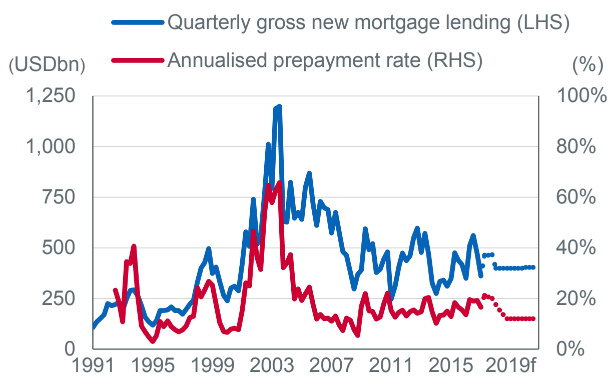
Source: Fitch Ratings, S&P/Case-Shiller, OECD, Ameco

Mortgage Rates and Arrears



Source: Fitch Ratings, BKFS (Black Knight Financial Services), Freddie Mac

Mortgage Lending and Prepayments



Source: Fitch Ratings, MBA (Mortgage Bankers Association)

Canada

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Rising mortgage rates and lending restrictions have cooled the previously hot home price inflation in Canada, but Fitch still views the high prices as vulnerable to an economic stress.

Home Price Growth Cooling

National home price growth is projected to rise by only 3% in 2018 after several years of double-digit growth, and Fitch expects price growth to slow to 0.5% in both of the next two years as tightened lending rules and rising mortgage rates reduce the number of people qualifying for a loan. There have been greater slowdowns in Vancouver and Toronto (annual growth was 4% and 3%, respectively, as of November 2018 compared to 14% and 11% in November 2017), driven also by provincial restrictions on foreign purchases.

The Vancouver and Toronto markets remain vulnerable to a more severe price correction in the event of an economic stress. Cumulative price gains since 2015 of about 50% have far outpaced underlying housing fundamentals.

Stable Economy Supports Low Arrears

Fitch forecasts mortgage arrears of 0.3% by end-2019 from 0.25% at 2Q18, because we expect employment to remain strong. Fitch's 2019 forecast for the policy rate is 2.5% (currently 1.75%) while fixed mortgage rates should rise by less than 50bp as mortgage demand softens. Borrowers paying variable-rates and those resetting fixed-rates have seen rates increase by as much as 1pp since mid-2017, but most mortgages are fixed for five-years, which will support performance in 2019.

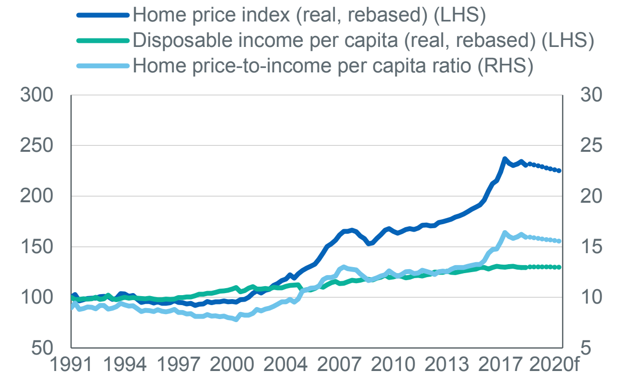
It is possible that policy rate increases may not materialise given the stated concern of the Bank of Canada governor about the impact that higher rates may have on affordability for already indebted borrowers. Canada's household debt level is 100% of GDP.

Credit Growth Slowing

We forecast mortgage growth to drop to 1%-2% in 2019-2020 from about 5%-6% in recent years due to stretched affordability and tighter qualification standards imposed by the Canadian Housing and Mortgage Corp. and the Office of the Superintendent of Financial Institutions.

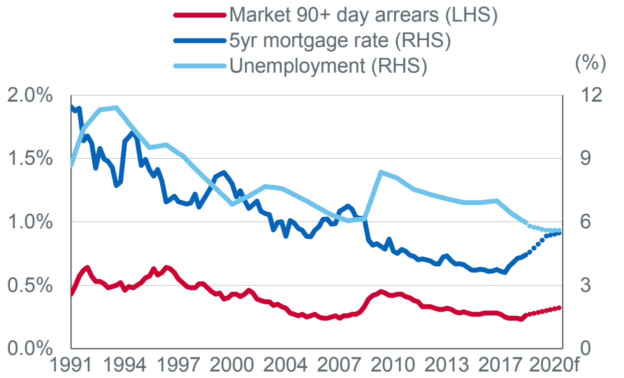
The stricter standards aim to address the high household debt-to-income ratio, which Fitch forecasts to be 170% by 2019. Lenders are required to qualify borrowers at the higher of the contractual rate plus 2pp or the five-year Bank of Canada benchmark rate. Because fewer people now qualify for mortgages, rental demand has risen and rents in Toronto and Vancouver, in particular, have surged over the past year. Higher rents may increase demand for home purchases, but Fitch expects fewer renters to qualify for mortgages.

Home Prices and Affordability



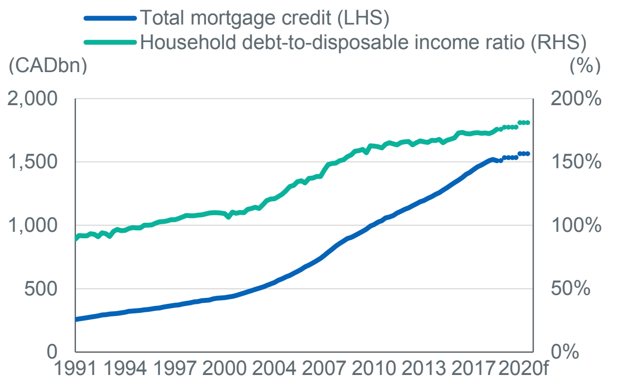
Source: Fitch Ratings, OECD, BIS, Chamber of Commerce of Metropolitan Montreal

Mortgage Rates and Arrears



Source: Fitch Ratings, Statistics Canada, CBA (Canadian Bankers Association)

Mortgage Credit



Source: Statistics Canada

United Kingdom

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Our home price forecasts in the UK depend on Brexit outcomes: if a no-deal exit is avoided, we expect small national increases with London flat to falling, but larger drops under a no-deal exit.

Home Prices Stable but with Risks

Fitch forecasts home price growth to slow to 2.0% in both 2019 and 2020 from about 2.5% in 2018, if the UK avoids a no-deal Brexit. This would be a small deflation in real terms. The national trend masks regional divergences, with prices stagnant to falling in London, and the south east and east of England, due to the impact of Brexit uncertainty on foreign investment and the financial services sector. We believe that affordability in these regions is approaching its limit and that home prices will only rise in line with disposable income.

We consider illustrative scenarios for a disorderly Brexit in our report, **"No-Deal" Brexit Rating Impact**. Under these scenarios, average home prices are not expected to fall below the trough observed in 2009 (i.e. 30% from current), though outcomes would heavily depend on subsequent UK/EU agreements.

Arrears, Interest Rates to Rise

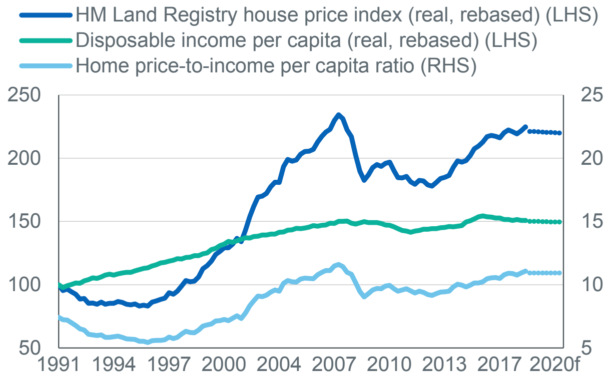
We forecast arrears to rise, but to remain low in a historical context, as long as a no-deal Brexit is avoided, underpinned by our expectation of rising interest rates and declining real disposable income. We believe the increase in mortgage arrears will be limited unless there is a material rise in unemployment. Increases in policy rates will fully be reflected in lenders' standard variable rates while competitive pressures will reduce margins on new loans during their initial period.

Credit Growth and Prepayment Rates to Slow

Fitch forecasts new mortgage lending in both the owner-occupied and buy-to-let markets to contract in 2019 as the uncertain economic outlook hits confidence. As long as a no-deal Brexit is avoided, we anticipate a reduction in gross new mortgage lending to the level seen in 2015 – a reduction of some 12.5% – but expect this to partially reverse in 2020 as uncertainty subsides and market confidence returns.

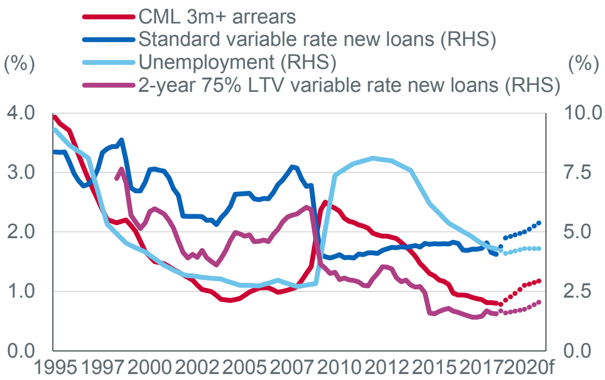
Our view is that, if a no-deal Brexit is avoided, rising interest rates should reduce prepayment rates to about 12.5%, which is close to the average observed over the past five years, from 15.5% projected for 2018. Under a no-deal scenario, there remains a risk that contracting home prices will result in borrowers being unable to refinance at the end of their teaser-rate period leading to a larger reduction in prepayment rates.

Home Prices and Affordability



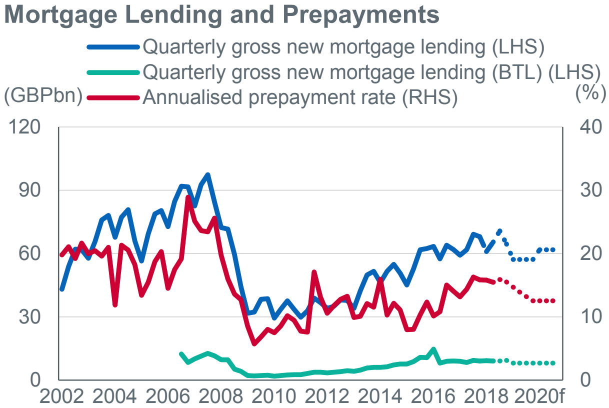
Source: Fitch Ratings, HM Land Registry, OECD, Ameco

Mortgage Rates and Arrears



Source: Fitch Ratings, CML, BoE (Bank of England)

Mortgage Lending and Prepayments



Source: Fitch Ratings, CML (Council of Mortgage Lenders)

Germany

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We expect home price growth in Germany to wane in large cities and continue in medium-sized cities.

Price Growth Highest Outside Large Cities

We expect home price growth in Germany to slow to about 3% in both 2019 and 2020 from 8% yoy to 3Q18 based on our forecasts for increasing mortgage rates and slower GDP growth. Affordability is becoming a limiting factor for the population in large cities, but strong demand and limited new supply continue to support prices. We expect faster price increases in suburbs and medium-sized cities.

We can also foresee a scenario in which home prices could continue a high level of growth in 2019-2020 given our forecasts for falling unemployment (to 3.4% in 2020), the inflation rate increasing to 2.1% by 2020 (from an average of 0.9% in 2013-2017) and a new subsidy for buyers with children. However, the bank regulator could also use its macro-prudential toolkit to limit mortgage lending and contain price growth, although there are no signs of such measures being activated.

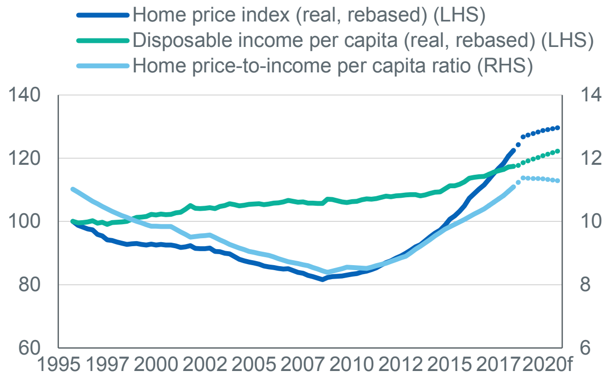
Low Unemployment Limits Arrears

Even though we expect mortgage rates to gradually increase, Fitch believes 3m+ arrears will remain very low at 0.1% in 2019 and 2020 because home buyers and borrowers who have reached their reset dates over the past three years have fixed at very low rates, often for a period of more than 10 years. Banks also test affordability at higher rates when underwriting loans. The macroeconomic environment continues to be supportive with Fitch forecasting GDP growth to slow but still be above trend in 2019-2020. Record-low unemployment, increasing wages (by 2.7% in 2018) and government surpluses may tempt politicians to expand public spending.

Mortgage Lending to Increase Further

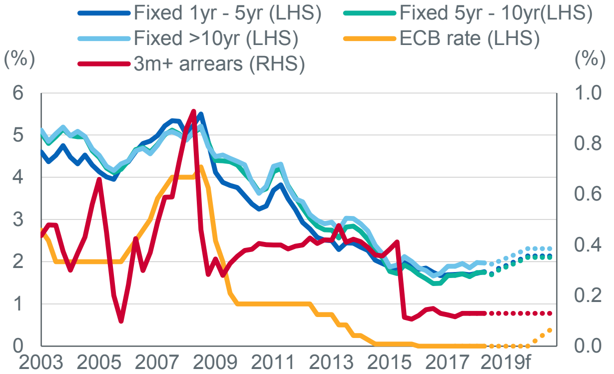
The volume of new mortgages is expected to rise by 2% a year in 2019-2020 primarily due to continued favourable financing conditions. Mortgage demand should increase on the back of growing incomes and higher prices. This should translate into more volume, especially outside the large cities that are constrained by limited property supply and a high cost of living. Limited construction capacity and a 5% increase in construction prices since 2017 will dampen new supply. Banks are likely to continue to accept lower margins on new lending to maintain or increase their volumes. Refinancing activity should continue for borrowers reaching their reset dates.

Home Prices and Affordability



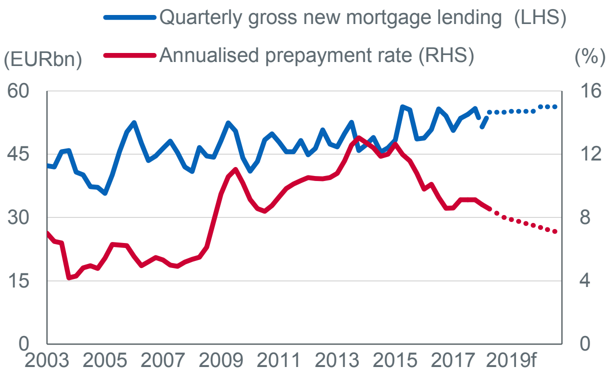
Source: Fitch Ratings, BulweinGesa, OECD, Ameco, Verband der Sparda-Banken

Mortgage Rates



Source: Fitch Ratings, Deutsche Bundesbank, ECB

Mortgage Lending and Prepayments



Source: Fitch Ratings, European Mortgage Federation

The Netherlands

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Fitch forecasts home price growth in the Netherlands to slow over the next two years driven by stretched affordability and more difficult lending conditions.

Home Price Growth Slowing after a Surge

Fitch expects tighter affordability, especially for first-time buyers, to cause home price growth to moderate to 7% in 2019 and 4% in 2020 (from 10% projected for 2018). Housing construction should pick up and lending conditions should gradually tighten, reflecting monetary policy normalisation. Home prices rose sharply over the past year while the number of sales fell by 15% yoy in 1H18. The low supply and competition from buy-to-let investors (who are both consumers and institutional investors) is limiting options for home buyers.

Absent a material economic shock, Fitch expects areas near the fast-growing Noord-Holland and Zuid Holland regions (which include Amsterdam, the Hague and Rotterdam) to record higher growth than in the recent past, as buyers look for more affordable housing. Home prices in Amsterdam grew by about 40% over the past three years, which is double the national average.

Arrears to Rise but Remain Low

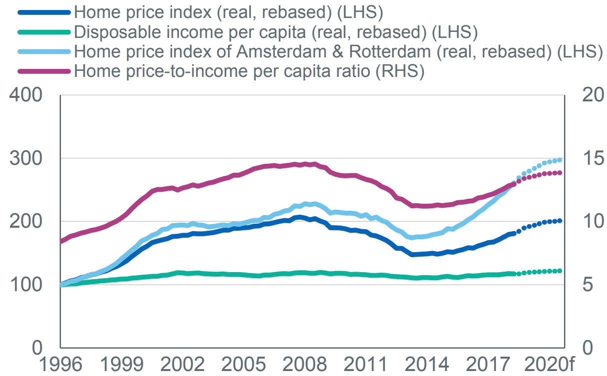
Fitch forecasts arrears to rise gradually to a still low 0.22% by 2020, from a projected 0.15% at end-2018. The increase is likely to be driven by the slightly higher mortgage rates on new mortgages available to first-time buyers, home movers and refinancing borrowers.

Most existing borrowers will be shielded form near-term rate increases as they have typically opted for fixed-rate periods of at least 10 years. Moreover, tax relief on new mortgage loans favours less-risky products, such as annuity loans.

Mild Reduction in Prepayments Expected

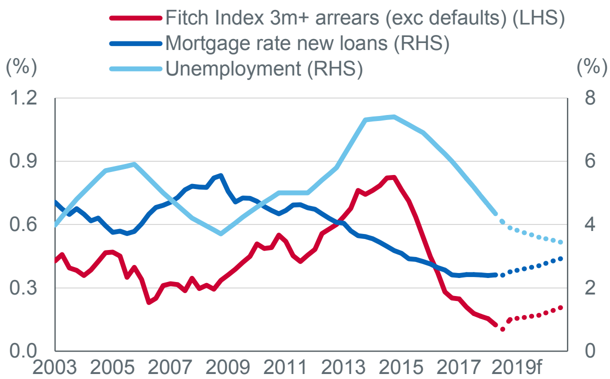
Fitch expects prepayments to decrease slightly to 7% in 2020 from the 9% projected for 2018 as refinancing activity loses traction and mortgage rates increase. Reduced affordability for first-time buyers puts a natural cap on future purchase activity, another driver of prepayments. Tax exemptions on gifts used for housing costs (from parents to children under 40, re-introduced in 2017 at a higher cap) are partly behind the increase in partial repayments over the past two years. The tax deductibility of mortgage payments has been reduced further.

Home Prices and Affordability



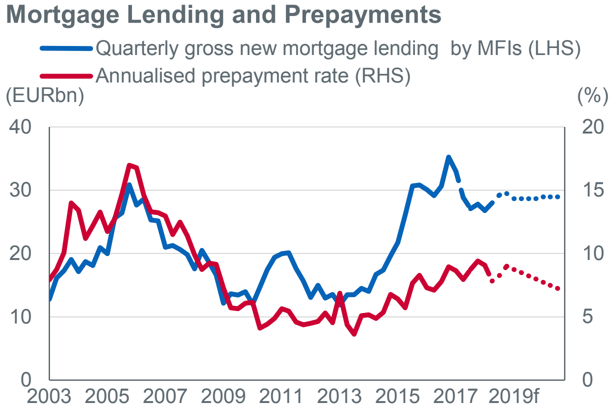
Source: Fitch Ratings, BIS, CBS (Statistics Netherlands), OECD, Ameco

Mortgage Rates and Arrears



Source: Fitch Ratings, DNB (De Nederlandsche Bank)

Mortgage Lending and Prepayments



Source: Fitch Ratings, DNB (De Nederlandsche Bank)

France

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Fitch expects flat home prices in France as affordability continues to deteriorate, but performance will remain sound.

Lower Affordability Tempers Price Growth

Fitch estimates home price growth to have slowed in 2018 and to be flat in 2019 and 2020 due to stretched affordability in locations that have experienced higher home price inflation. Fitch believes the two-speed housing market will continue with home price growth in dynamic cities (Paris up 7.1% yoy in 2Q18) and attractive coastal areas, and further home price declines in weaker economic areas.

The stretched affordability for some borrowers is reflected in average LTVs for new loans being at a historical high of 87%. Lending rates have reached a floor (1.53% in 3Q18) and no longer help maintain purchasing power, so signs of banks easing underwriting standards to preserve borrower affordability have appeared. We expect a minor deterioration in standards to continue following the average residential loan duration increasing by six months in 3Q18 and the debt-to-income ratio increasing by 45bp in January-April 2018.

Stable Arrears despite Economic Recovery

Fitch expects 3m+ arrears to remain broadly unchanged through 2020. The level of impaired residential loans had been declining since the unemployment rate started to fall in 2015. Despite our forecast of lower unemployment and GDP growth that is slowing but should remain above trend in 2019-2020, the potential moderate loosening in banks' underwriting criteria to support their market shares may negatively impact performance in the long run.

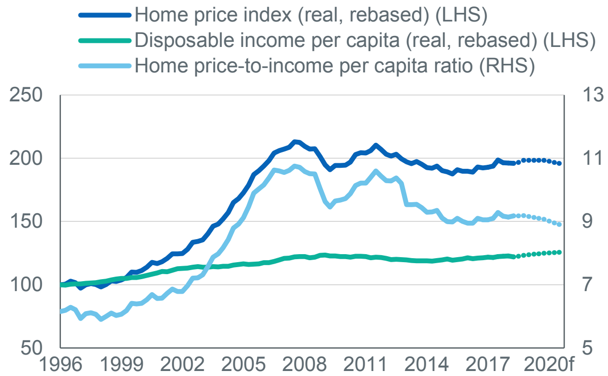
Residential loan interest rates will remain low as intense bank competition should delay the transmission of monetary policy tightening. An eventual pick-up in lending rates is not expected to affect performance as the vast majority of French home loans are fixed-rate for life.

Lending Down from Stretched Affordability

Refinancing activity is expected to decrease as borrowers can no longer find lower rates with different banks. Refinancing has already dropped to 10% (as a percentage of new lending) at end-1Q18 from its peak of about 35% a year before.

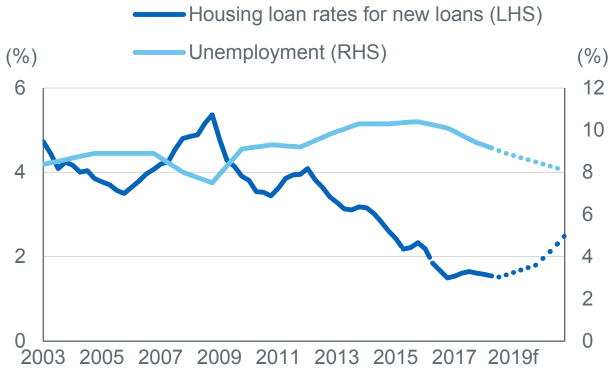
Fitch forecasts residential lending to decline by about 15% in each of the next two years in line with worsening affordability and demand. As home prices stabilise, potential buyers are likely to adopt a "wait-and-see" approach while the government's building incentives are not expected to yield significant results, because developers are holding back in anticipation of reduced demand. New building permits (12-month cumulative figures) fell by 4.4% between January and August 2018.

Home Prices and Affordability



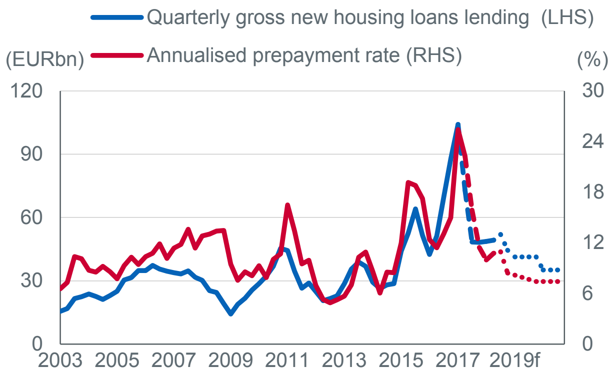
Source: Fitch Ratings, BIS, OECD, Ameco

Housing Loan Rates



Source: Fitch Ratings, Banque de France

Housing Loans Lending and Prepayments



Source: Fitch Ratings, Banque de France

Belgium

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In spite of stretched affordability, we expect stable home prices in Belgium in the medium term. Mortgage performance will remain resilient despite higher LTVs.

Home Prices Reaching Peak

We expect annual home price growth of about 2% to continue over the next two years, followed by a potential moderate price decline once mortgage rates gradually increase. Prices are supported by falling volumes of new dwellings with a yoy drop of 7.5% in 2017, as well as positive net population growth expected in 2019 and 2020.

Recent signs of stretched borrower affordability, including higher LTVs and longer loan maturities beyond the typical 20-year term, are likely to limit further home price growth. The volume of new loans with a 20- to 25-year maturity increased by 6% between 2016 and 2017. Expected increases in mortgage rates should dampen prices in the longer term.

Mortgage Performance to Remain Resilient

Gross default levels on the stock of Belgian residential loans – which have historically remained low (1% in 1Q18) – are likely to show a moderate increase as a result of higher debt burdens where there are high LTV or debt-to-income ratios and/or long maturities. Overall asset performance will remain strong, however, supported by forecasts for stable GDP growth at trend, lower unemployment and the long-term fixing at very low rates for most loans in recent years.

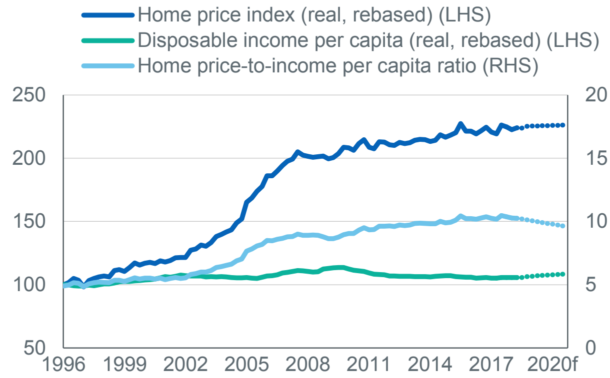
We expect a minor easing of banks' underwriting standards, within regulatory limits, with higher LTVs offered to first-time buyers. This will be accompanied by a continuing shift towards longer maturity loans, as already seen in 2017, mitigating a potential higher repayment burden for borrowers as banks aim to maintain debt service levels.

Declining Mortgage Lending Volumes

Fitch forecasts new mortgage lending volumes to fall by about 10% in 2019, before stabilising in 2020 as the low-rate refinancing boom of recent years is unlikely to be repeated.

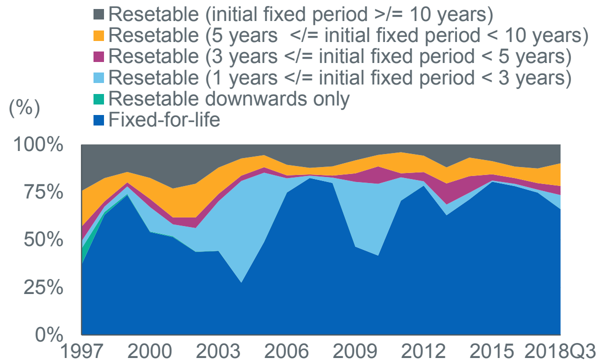
Macro-prudential measures implemented in 2018 targeting the risk weight of mortgage loans perceived as high-risk (ie. high LTV and debt-to-income segments) are likely to reduce banks' appetite for lending to this sub-segment of the market, which could affect first-time buyers. Higher household debt levels and potential interest-rate rises will further limit borrowers' capacity to service additional debt burdens, which could lead to smaller average loans.

Home Prices and Affordability



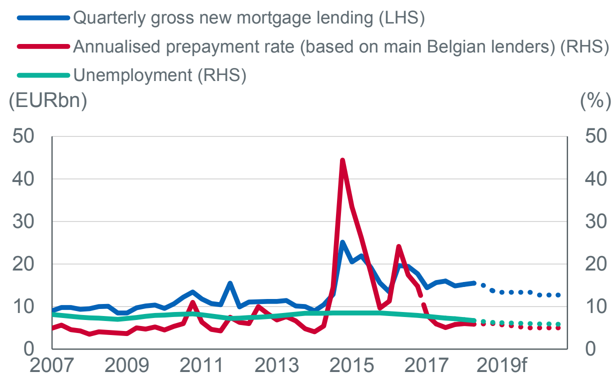
Source: Fitch Ratings, Stadim, StatBel, OECD, Ameco

Residential Loan Distribution
By interest-rate type



Source: UPV-BVK (Union Professionelle du Credit)

Mortgage Lending and Prepayments



Source: Fitch Ratings, NBK, Belfius, ING Belgium, Axis, Fortis, KBC

Denmark

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We expect home prices in Denmark to converge towards a sustainable growth rate in line with wage inflation.

Home Prices to Rise Moderately

Fitch forecasts home prices throughout Denmark to continue increasing moderately in 2019, but with the growth rate limited by tighter lending practices enforced by the Danish Financial Stability Authority (FSA) since 2016. We forecast home prices to grow in line with household income at 2.5%-3.5% a year over the next two years as the employment rate continues to rise.

The agency expects affordability to remain strong as home price-to-income ratios stabilise. Unemployment has consistently fallen since 2012. We expect a further decline in unemployment in 2019, which should translate into upward pressure on wages.

Borrowers Less Sensitive to Rate Increases

Fitch expects mortgage arrears to be broadly stable over the next two years and in line with observed levels since 2015.

Arrears have remained low in 1H18 with 0.2% of loans classified as 3.5 months delinquent. Mortgage performance and affordability continues to rely on falling unemployment and Denmark's supportive social security system. A growing number of borrowers have moved to mortgages with longer fixed-rate periods of five years or more, while those exposed to shorter-term interest fixings have benefited from lenders not increasing the administrative margins. Fitch does not believe that an increase in interest rates will translate into a severe mortgage performance deterioration.

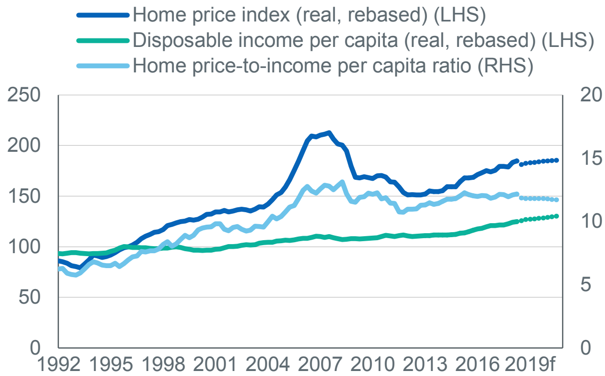
Moderate Mortgage Lending Growth

Fitch forecasts lending volumes to increase by only about 1% in both 2019 and 2020, as the FSA continues to focus on adherence to prudent lending standards in growth areas, such as Aarhus and Copenhagen. The gross debt-to-income ratio for households should continue its steady decline (from a high of 270% in 2009 to 241% in 2017).

The stock of interest-only loans has gradually reduced to 47% in 2018 from 56% in 2013 in line with guidance from the Danish supervisory authority as well as guidelines implemented in 2018 from the FSA. Under the FSA guidelines, interest-only loans should not be offered to individuals with both high LTVs and loan-to-income ratios over 4x.

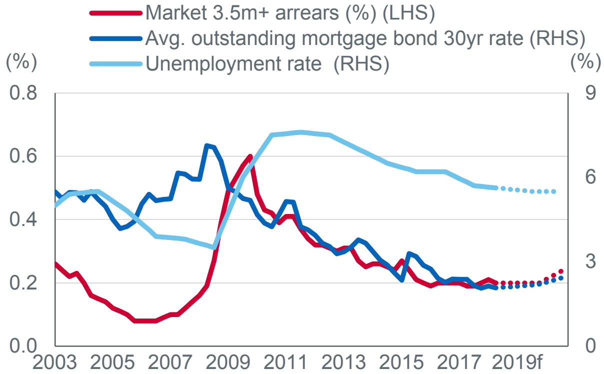
The reduction in the popularity of interest-only loans could be reversed by the introduction of new loan products allowing deferred amortisation for up to 30 years when the LTV ratio is lower than 60%. However, these loans currently constitute a small part of the market.

Home Prices and Affordability



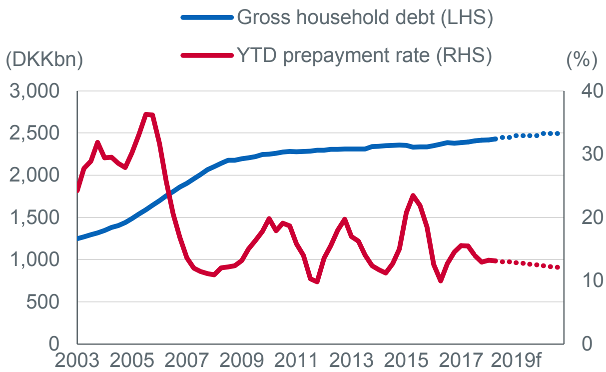
Source: Fitch Ratings, OECD, Ameco, BIS

Mortgage Rates and Arrears



Source: Fitch Ratings, Realkreditradet

Gross Household Debt and Prepayments



Source: Fitch Ratings, Realkreditradet

Sweden

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Fitch expects further home price declines in Sweden to be modest before prices start to rebound because of the longstanding national housing shortage.

Home Price Correction to Continue

Monthly home price data from Valueguard show a marked 9.2% drop in dwelling prices between October 2017 and January 2018, after which prices recovered marginally in 2Q18 and have since stabilised. Fitch expects a further decline in 2019 of 3% driven by an increasing supply of dwellings from completions expected in 2019 and affordability constraints from tighter credit standards and moderate interest rate increases.

We expect the correction to be temporary. Sweden, and particularly Stockholm, has experienced persistent housing shortages, which Fitch views as a key driver of Sweden's long-term home price growth. Although construction of new buildings has increased significantly since 2014, we do not think this will reverse the shortage as recent constructions have only matched the increase in households. However, local oversupply, especially in luxury apartments in Stockholm, is likely to dampen prices for some property types.

Strong Performance Despite Rate Rises

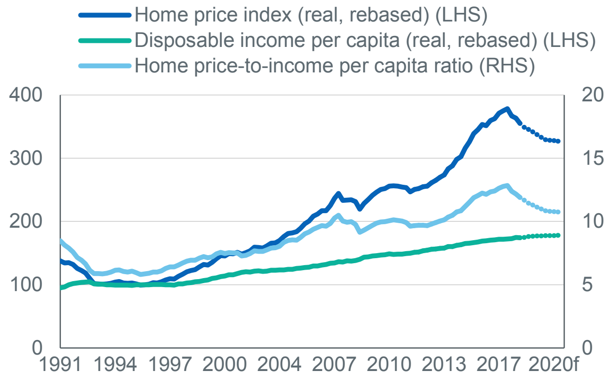
Fitch expects arrears on mortgages to remain stable in 2019 at close to 0.2% (as per SEB data) notwithstanding home price declines. While we expect the policy rate to increase to 0.0% towards the end of 2019, we believe competition may lead to lenders not passing on the full increase to borrowers as current margins are high.

Continued low mortgage rates, high net household wealth and a stable labour market should continue to support mortgage performance, which has been very strong since the mid-1990s by international standards.

Tighter Standards Limit Lending Growth

Fitch expects private credit growth to more than halve in 2019 to 2.4% from 5.8% in 2018. The Swedish FSA has taken several measures to manage the risks associated with increasing household debt, such as introducing an LTV cap in 2011, raising the risk-weights on mortgages in 2014, increasing amortisation requirements twice in 2014 and 2016 and introducing debt-to-income-dependent amortisation requirements in March 2018. The latest, which targets borrowers with debt-to-income ratios above 4.5x, is expected to affect borrowers in Stockholm most due to their stretched affordability. Fitch believes this will continue to translate into tight credit conditions that will offset any increase in affordability resulting from falling property prices.

Home Prices and Affordability

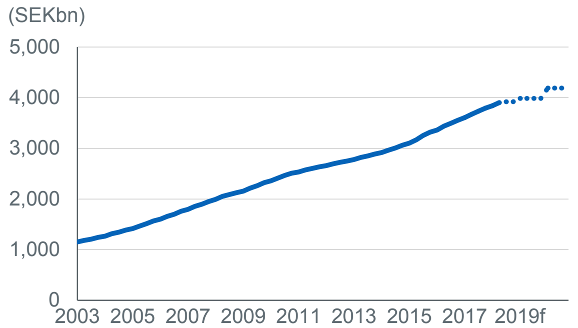


Source: Fitch Ratings, OECD, Ameco, BiS

Lending Rate to Households and Unemployment

Source: Fitch Ratings, SCB (Statistics Sweden)

Gross Household Debt



Source: SCB (Statistics Sweden)

Norway

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Fitch forecasts home prices to stabilise following the price falls since 2017. The negative impact of mortgage rate increases will be offset by wage growth leading to flat prices.

Muted Home Price Growth

Fitch expects price growth of 1% in both 2019 and 2020 as prices start to rebound from the home price declines in 2017 and 1Q18. Higher incomes are likely to be offset by lower population growth and higher mortgage rates. The supply-demand imbalance in the largest cities (Bergen, Oslo and Trondheim) will continue to put downward pressure on prices in the first half of 2019, driven by completions of property constructions coinciding with lower immigration. Immigration began falling in 2016 while construction peaked in 2018.

Higher Rates Offset by Wage Growth

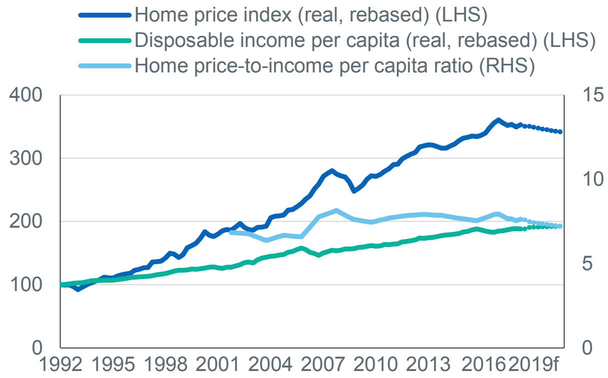
We expect arrears levels for prime mortgages to remain low at about 0.2% over the next two years, supported by wage growth and falling unemployment. Mortgage performance nationally has been supported by low interest rates, a sustained reduction in unemployment, favourable tax treatment of household debt and Norway's protective social security system. The implementation of stricter underwriting requirements in 2017, together with less aggressive origination from branches of foreign banks, has eased competition for mortgages.

With more than 90% of loans carrying variable interest rates, households are particularly vulnerable to further policy rate rises. All major Norwegian banks passed September's 0.25pp increase to the policy rate on to borrowers. The impact of rate rises is magnified by the high and growing household debt ratio (229% of disposable income as of end-2Q18).

Mortgage Lending Reined In by Regulation

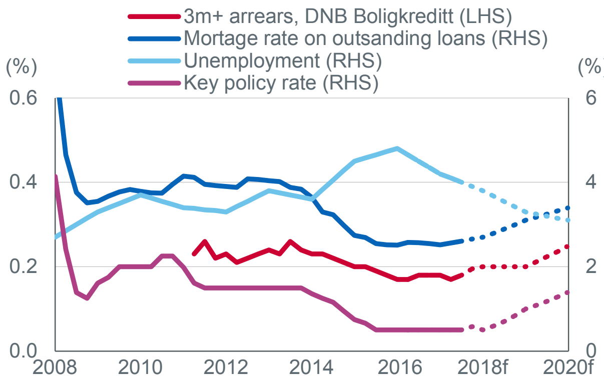
Fitch expects mortgage lending to grow only moderately in 2019 and 2020, driven by continued application of the stricter mortgage regulation that was introduced in 2017 and an unsecured debt register, expected to be operational in 2019-1Q20. The agency believes the debt register, along with key measures from the mortgage lending regulation (such as a loan-to-income cap of 500%), will help contain the growth of mortgage debt among highly indebted households. We expect more prudent mortgage lending as lenders will have access to more accurate and up-to-date information on the financial condition of applicants.

Home Prices and Affordability



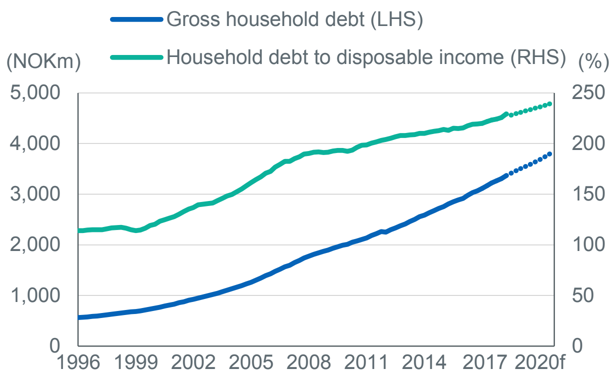
Source: Fitch Ratings, OECD, Ameco, BIS

Mortgage Rates and Arrears



Source: Fitch Ratings, SSB (Statistics Norway), DNB Boligkreditt, Norges Bank

Mortgage Debt and Debt-to-Income Ratio



Source: SSB (Statistics Norway), Norges Bank

Ireland

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> We forecast annual home price growth close to 9% to continue in Ireland as supply constraints put upward pressure on home prices and as long as a no-deal Brexit is avoided.

Home Price Inflation to Stay High

We forecast home prices to grow by 9% in both 2019 and 2020 if the UK avoids a no-deal Brexit, because new supply would be constrained, employment prospects would continue to improve, and both first-time buyers and home movers should remain active (in particular outside Dublin for first-time buyers). We forecast the supply of housing to increase in this scenario driven by government initiatives and higher volumes of residential property development lending by banks, but new supply would fail to meet demand when coupled with the favourable economic environment. Existing homeowners would benefit from increasing levels of equity allowing for home moves that were previously not possible when equity levels were negative or low.

Downside risks would increase in case of a disorderly Brexit. Our report, **"No-Deal" Brexit Rating Impact**, sets out two illustrative scenarios. If either of these were to transpire, we forecast the rate of home price growth to decrease but remain positive as the imbalance between demand and supply would remain.

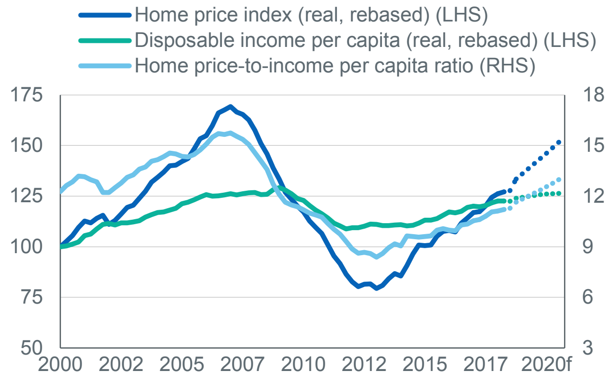
Arrears to Reduce Slowly

We forecast Fitch-rated RMBS' 90 days+ arrears to decrease to 8.3% by 2020 from the 9.5% expected in 2018 if a no-deal Brexit is avoided, but to still remain high as forbearance measures continue to apply to many delinquent legacy borrowers. Fitch also forecasts more borrowers to reduce mortgage arrears under loan restructurings that have been initiated since the housing market crash. Mortgage performance in this mostly floating-rate market (with initial fixed-rate periods) would continue to be supported by low mortgage rates and other initiatives, such as the Tax Relief at Source scheme, which is set to run up until 2021.

Significant Mortgage Growth

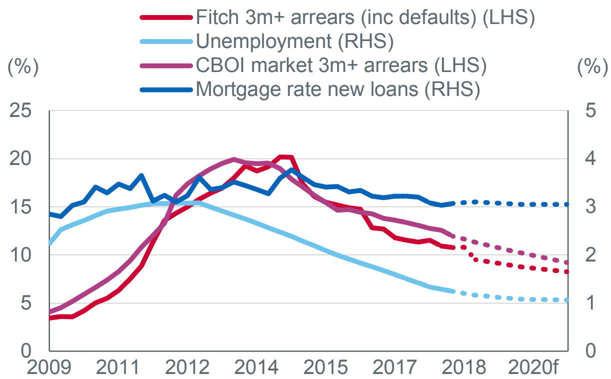
Fitch anticipates annual mortgage credit growth of 18% in 2019 and 15% in 2020 if the UK avoids a no-deal Brexit. From 2019, the Central Bank of Ireland will require lenders to provide additional transparency and better facilitate mortgage switching. Some lenders will therefore aim to improve their market shares by increasing re-mortgage activity. Mortgage rates could come under pressure and longer initial fixed-rate periods, of up to 10 years, are likely to be offered in this scenario. However, mortgage rates would remain at about 3%, above the eurozone average of closer to 2% reflecting the concentrated Irish banking system and the need for banks to compensate for large stocks of low-yielding legacy tracker mortgages.

Home Prices and Affordability



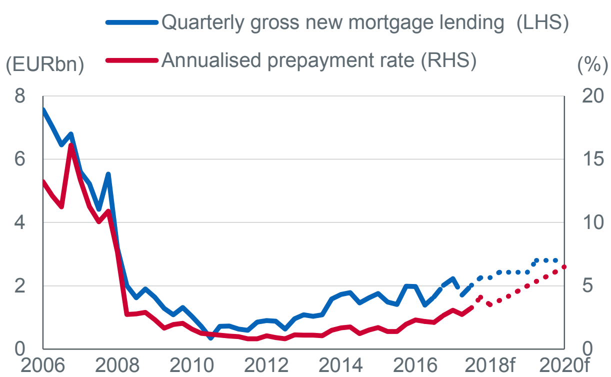
Source: Fitch Ratings, CSO (Central Statistics Office), Ameco, OECD

Mortgage Rates and Arrears



Source: Fitch Ratings, CBOI (Central Bank of Ireland)

Mortgage Lending and Prepayments



Source: Fitch Ratings, BPFI (Banking & Payments Federation Ireland)

Spain

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> Fitch expects more high LTV mortgages to be offered in Spain at a premium cost. Affordability is set to weaken as wage inflation lags property price growth, especially in the main cities.

Wages and Insecure Jobs Limit Affordability

Fitch forecasts Spanish home prices to grow by 5% in 2019 and 4% in 2020, influenced by labour market dynamics. Even though we forecast unemployment to fall to 13% by 2020 from the 2013 peak of 26%, wage growth is expected to remain subdued due to the still large count of unemployed people and the large share of temporary jobs, which account for about half of new employment.

Housing affordability will continue its gradual deterioration in 2019 as wages increase more slowly than home prices. This is most pronounced in large cities where cash and corporate buyers have driven up prices. Madrid city home prices reported a 19% yoy increase for 2Q18 against the national average of 7%.

Fixed Interest Rates Support Performance

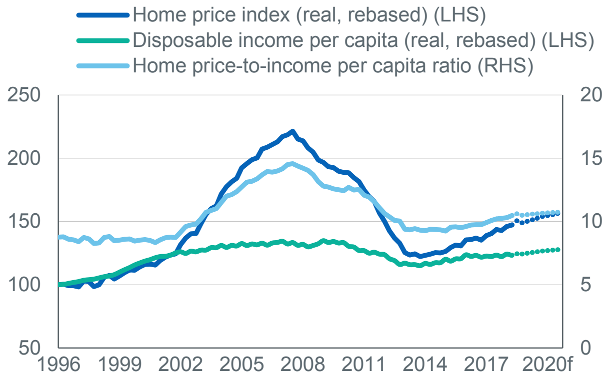
Fitch expects at least half of the new mortgages in 2019 to pay fixed interest rates, which should lead to better performance relative to floating-rate loans when interest rates rise in the medium term. This marks a contrast from a market of nearly all floating-rate loans in the past. However, the overall volume of fixed-rate mortgages remains small on banks' loan books at about 8%.

Fitch expects new residential mortgage lending growth to slow to 7.5% in 2019 and 5.0% in 2020 from the 10.0% projected for 2018. Some easing of underwriting is expected, such as the offering of high LTV mortgages to permanently employed first-time buyers at a higher price, but not to borrowers working under temporary contracts, as the default probability of these borrowers is considered materially higher than for permanently employed borrowers. Therefore, Fitch does not expect the criteria loosening to feed into worse arrears performance, which we forecast to stay about 6%.

Higher Mortgage Pricing from Legislation

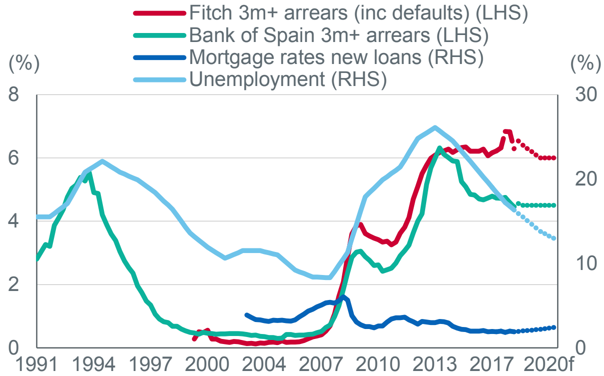
We foresee residential mortgage credit becoming more expensive in Spain following the Royal Decree enacted in November 2018, which resulted in a new split of mortgage costs between lenders and borrowers that is less favourable to lenders. We also expect mortgage pricing to increase due to a longer waiting period of nine months, from three months, before the judicial recovery process can be started on defaulted loans under upcoming changes to the mortgage law. The longer period reflects the view that evictions were activated too quickly during the recent housing crisis. A long-awaited update to Spain's mortgage law should be enacted following parliamentary debate.

Home Prices and Affordability



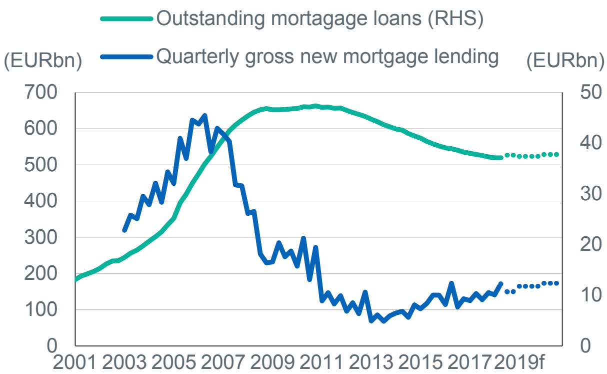
Source: Fitch Ratings, OECD, Ameco, INE (Instituto de Estadistica)

Unemployment, Mortgage Rates and Arrears



Source: Fitch Ratings, Bank of Spain

Mortgage Lending



Source: Fitch Ratings, Bank of Spain, ECB

Italy

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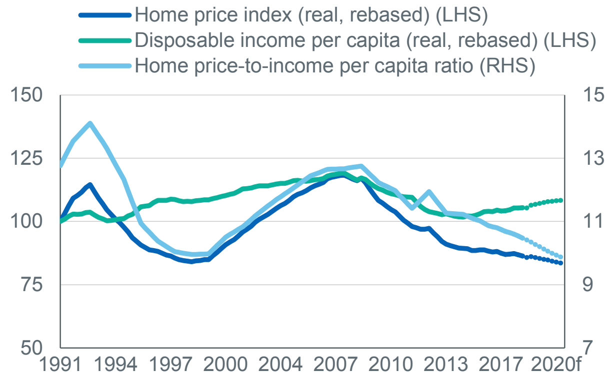
We expect home prices and mortgage rates to remain exceptionally affordable in Italy in 2019, despite moderate rate increases. However, higher country risk may dampen demand.

Home Prices to Remain Flat

Fitch expects national home prices to remain broadly unchanged next year, leading to no rebound in prices since the trough first reached in 2Q16. Prices are still 17% below their 2008 peak. Average prices have not been lifted by the increasing number of sales due to the limited supply of newly constructed or recently refurbished buildings, which are selling at a premium. Except in large cities, such as Milan, most properties on offer are now dated, capping prices for these properties.

Flat home prices, still attractive mortgage rates and growing disposable income will preserve borrowers' affordability through 2019. However, tensions within the coalition government, recently highlighted by the budget process, may threaten consumer confidence, making potential buyers postpone property purchases and further delaying any price rebound.

Home Prices and Affordability



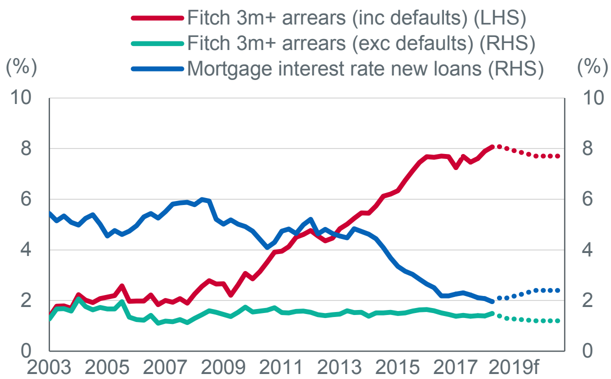
Source: Fitch Ratings, Scenari Immobiliari, Ameco, OECD

Unlikely-to-Pay Up for Sale

Mortgage arrears (3m+, including defaults) will decrease at banks as they continue to dispose of their non-performing loans (NPLs) to improve the credit quality of their books (see our report **Non-Performing Loans: Structured Finance Implications**). Fitch expects offloading of NPLs to continue with sales also increasingly involving unlikely-to-pay (UTP) loans, driving bank arrears (excluding defaults) down by 10bp in 2019 (30bp including defaults). Headwinds from the economy could undermine planned NPL and UTP sales. If so, the level of arrears (including defaults) on bank balance sheets would remain high for longer.

We expect new mortgage rates to remain attractive and to increase only slowly by about 40bp next year. This will support borrower affordability and stable loan performance, with the flow of new defaults not changing from 1% a year.

Mortgage Rates and Arrears



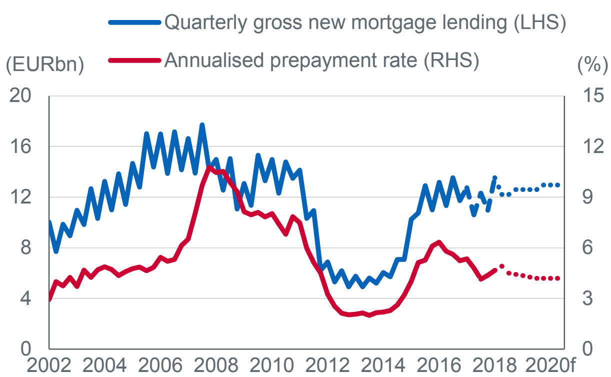
Source: Fitch Ratings, Bank of Italy

Origination Driven by Home Acquisition

Fitch expects gross mortgage lending to increase by 3% in 2019 driven more by demand from buyers than from refinancing. Offloading distressed assets would help banks free up capital. However, increasing mortgage rates from higher funding costs of banks may weaken demand for purchases.

Refinancing is losing momentum with many borrowers already locking in low interest rates for 20 to 25 years. As a result, prepayments are expected to fall to 4% by 2019. We also expect price competition in the market to soften as quantitative easing and access to very cheap bank funding wanes.

Mortgage Lending and Prepayments



Source: Fitch Ratings, Bank of Italy

Portugal

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“ We expect housing affordability to be a challenge for borrowers in Lisbon and Porto, where home prices are growing quickly. Mortgage credit will expand.

Housing Affordability Hinges on Wage Inflation

We expect national housing affordability to worsen only moderately over the next two years. However, affordability in large cities will weaken to a greater extent as wages grow more slowly than home prices with non-resident cash buyers and limited new housing supply forcing up prices. Latest home price sales data from Lisbon and Porto show a 20%-22% yoy increase at end-2Q18, which is more than twice the national home price increase of 9% over this period.

Fitch forecasts the unemployment rate to decrease to 7% in 2019 from its peak of 16% in 2013, so household disposable income should remain strong.

Tolerable Rate Increases

Fitch expects the NPL ratio (as per the EBA definition) for housing loans at banks to stabilise at about 5% from a peak of 7% in 2014. The reduction is linked to a combination of portfolio sales, write-offs, cures and fewer loans falling into arrears.

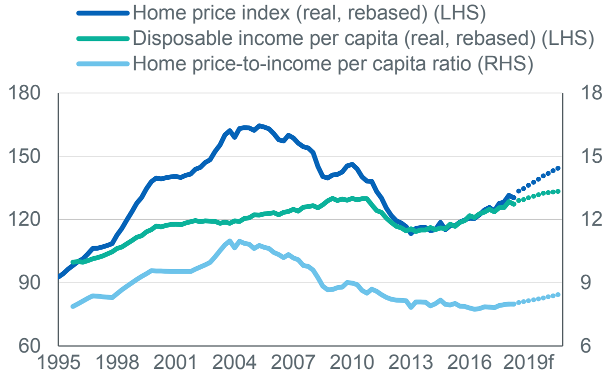
As bank funding costs increase in line with the ECB policy rate, which Fitch forecasts to first increase in 2020, mortgage coupon rates charged to borrowers should also rise, considering the prevailing tight spreads of about 100bp charged by lenders which are not expected to tighten much further. However, we anticipate only a limited effect on the NPL ratio from increases to the ECB's base rate, which is projected to reach 0.50% in 2020, as the effect on debt service would be small.

Deleveraging Comes to an End

Fitch expects the balance of outstanding housing loans to stabilise in 2018 before growing in the next two to three years, reversing the seven-year contraction since 2011. Growth in new mortgage lending should soften to 15% in 2019 from 25% in 1H18. New loans will continue to mainly pay a floating-rate referencing Euribor unless a successor reference is established.

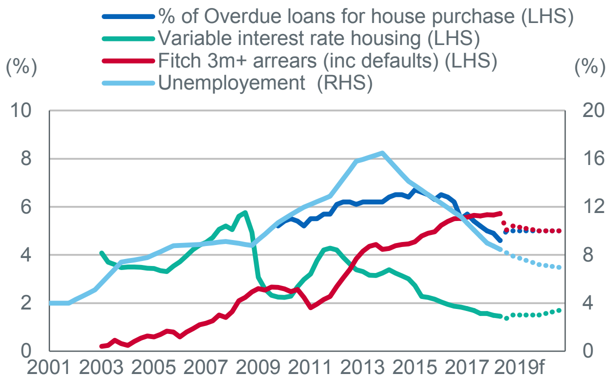
Underwriting standards may ease slightly in light of our forecast of decelerating GDP growth that is above trend in 2019-2020 and fierce competition among banks. However, lending standards should remain adequate following the macro-prudential rules defined by the Bank of Portugal last year that relate to maximum LTV, debt-to-income and tenor limits (see **New Portugal Mortgage Rules in Line with Market**).

Home Prices and Affordability



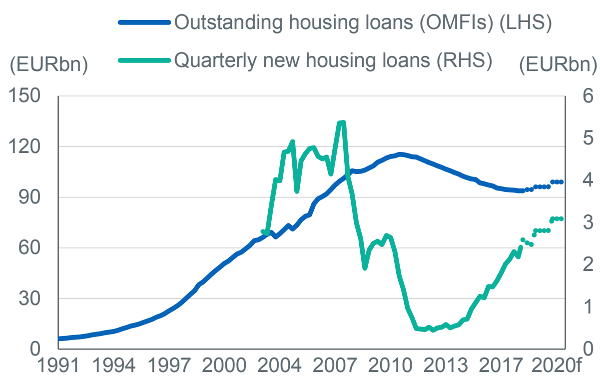
Source: Fitch Ratings, INE, Ameco, OECD

Unemployment, Mortgage Rates and Arrears



Source: Fitch Ratings, Bank of Portugal

Mortgage Lending



Source: Fitch Ratings, Bank of Portugal, ECB

Greece

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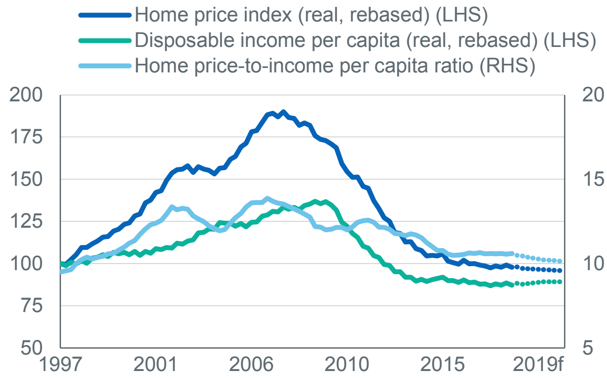
While economic activity recovers in Greece, Fitch expects home prices, mortgage originations and loan performance to all lag behind.

Home Prices to Remain Almost Flat

Fitch expects home prices to remain flat or marginally increase over the next two years, despite a mild improvement in the economy's fundamentals, due to Greek banks' limited lending capacity and high property taxes on new buildings. In 3Q17, home prices reached a trough and showed marginal growth in the following three quarters. Positively, real annual GDP growth reached 2.2% in 1H18 and we forecast the economy to grow by 2.3% in 2019 and 2.2% in 2020.

Home prices in Athens saw the largest increases (1.2% yoy as of end-1H18), with overseas buyers attracted by very low prices and the Golden Visa scheme, which offers a residency visa or citizenship if a minimum investment is made. Foreign investment is driving up rents to levels that are unaffordable for the local population in some parts of the capital.

Home Prices and Affordability

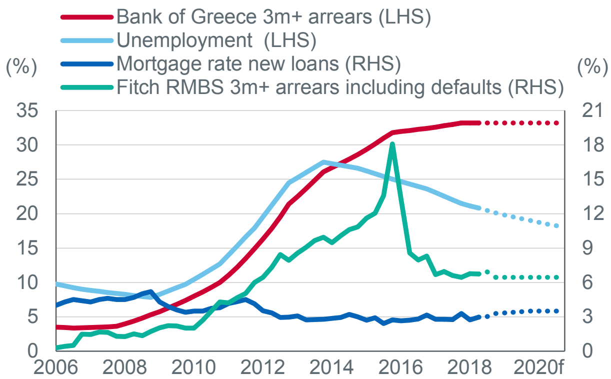


Source: Fitch Ratings, Bank of Greece, Ameco, OECD

Performance Lags Economic Recovery

We expect the stock of non-performing exposures (NPEs) – according to both the EBA definition and the level of 3m+ arrears – to decrease further in the medium term supported by policy measures and banks' efforts to meet their Single Supervisory Mechanism targets, although it is unclear whether these efforts will be effective. Since February 2018, property liquidations only have to be performed electronically and according to a Bank of Greece report, the first such liquidations have occurred, but NPE sales and write-offs were the main contributor to the NPE stock reduction in 1H18. The Greek government is reported to be considering additional actions aimed at accelerating resolution of NPEs. The economic recovery has not yet fully fed through to residential mortgage loan performance as NPE inflows continued to exceed outflows for some banks in 1H18.

Mortgage Rates and Arrears

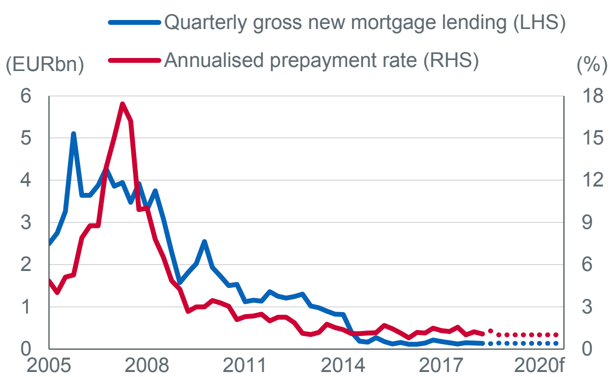


Source: Fitch Ratings, Bank of Greece

Mortgage Origination Subdued

Fitch forecasts that growth in mortgage lending will continue to lag behind the slowly improving macroeconomic environment despite the enhanced liquidity positions of banks, with the four largest Greek banks having repaid or significantly reduced the Emergency Liquidity Assistance with the Central Bank of Greece. Domestic demand will be depressed as long as wages continue to fall. Since the sovereign crisis in 2011, reductions to pensions and the income tax reform have reduced private-sector spending, credit demand and economic growth. These led to almost a standstill of mortgage originations (gross new mortgage lending was only EUR280 million in 1H18), which we expect to continue over the next two years.

Mortgage Lending and Prepayments



Source: Fitch Ratings, Bank of Greece

Australia

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We expect a national peak-to-trough home price drop of 12% in Australia with Sydney and Melbourne posting larger declines in 2019.

Home Price Declines Set to Continue

Fitch forecasts a national home price decline of an additional 5% in 2019 before above-trend GDP growth and strong net migration should stabilise prices in 2020. The peak-to-trough decline of 6.7% as of December 2018 has been driven by lower investor demand reflecting macro-prudential limits on interest-only and investment lending, and tighter enforcement of lending standards.

We expect price declines to continue at a similar pace in 2019 in Sydney and Melbourne, where larger falls have occurred (peak-to-trough declines of 11.1% and 7.2%, respectively, as of December 2018). The most expensive quartile of properties has experienced the largest declines with falls of 9.5%.

GDP Growth Supports Performance

We forecast loans in arrears over 90 days to increase slightly to 70bp by 2020. Properties in possession will take longer to sell as home prices fall, so loans will remain delinquent for longer. Early-stage mortgage arrears (30 to 90 days in arrears) will be broadly stable in 2019 at 60bp even though lenders have modestly raised mortgage rates for investment and interest-only loans despite no policy rate increases.

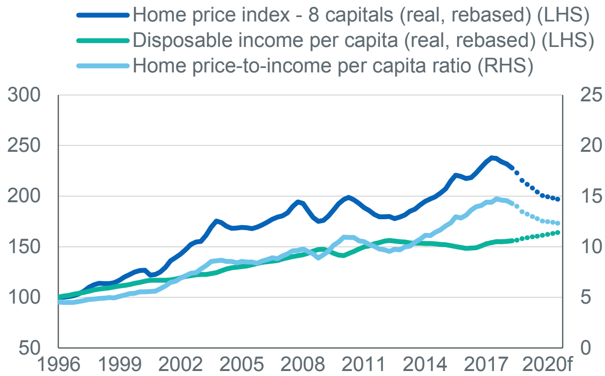
Mortgage performance will be supported by slowing but still solid economic growth, decreasing unemployment and only gradually rising policy and mortgage rates. Risks remain, stemming from the highest household-debt-to-GDP ratio in this report at 121% as of 2Q 2018.

Credit Growth to Remain Low

Housing credit growth is projected to ease further in 2019 to 3.5% from 5.1% yoy growth in October 2018. This is due to tightened macro-prudential limits and a more conservative interpretation of regulatory guidelines for mortgage servicing in light of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Fitch believes the commission's final recommendations, due in February, may further reduce credit availability.

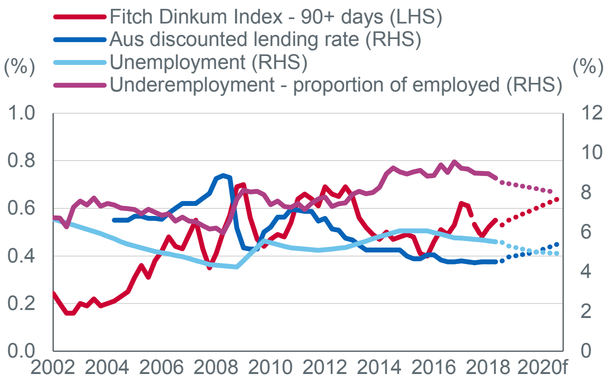
Investment loan origination has been hit by a limit to investment loan growth of 10% (introduced in 2014 and removed in July 2018 for lenders that can prove they have met regulatory requirements for the past six months) and a limit of interest-only origination to 30% of new lending (introduced in 2017 and removed from January 2019 for lenders that have met regulatory requirements for the past six months) along with foreign investor levies and taxes from state governments.

Home Prices and Affordability



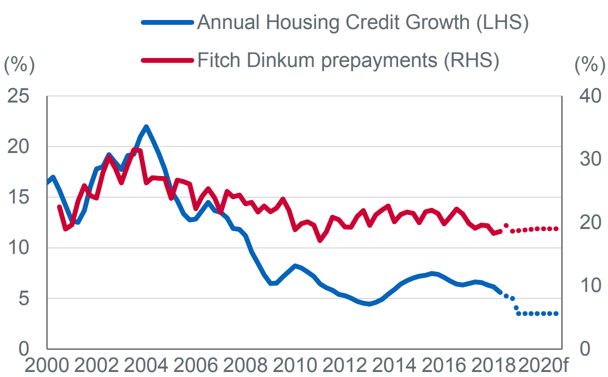
Source: Fitch Ratings, CoreLogic, ABS, OECD

Mortgage Rates and Arrears



Source: Fitch Ratings, RBA (Reserve Bank of Australia)

Mortgage Lending and Prepayments



Source: Fitch Ratings, RBA (Reserve Bank of Australia)

China

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We expect a modest correction in home prices in China as the government enforces purchase restrictions. We also expect stable mortgage performance and slower growth in mortgage lending.

Slight Decline for National Home Prices

We expect home prices in tier one and two cities to be flat over the next two years while tier three cities will experience a moderate decline of 5% a year as home purchase and reselling constraints remain in place under the national policy that "houses are for living in, not for speculation". The government's measures to meet pent-up demand by constructing properties for joint ownership and long-term leasing are only likely to have a longer-term effect on a small part of the market. Affordability is expected to mildly improve in 2019 as disposable income continues its annual growth of about 5.5% while home prices are stable.

Stable Mortgage Performance

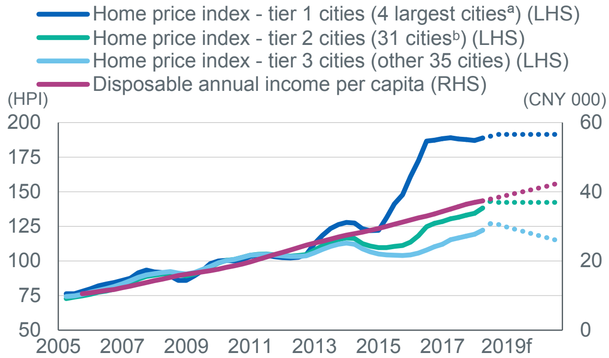
Fitch forecasts mortgage performance to remain stable as key underwriting standards remain prudent and tight regulatory restrictions (e.g. minimum downpayments and a higher interest rate for non-first-time buyers) continue to be enforced. The weighted average original LTV of RMBS issuance in 2017 and 2018 was just over 50%. NPLs are likely to remain low despite the increase in household leverage given low LTVs and stable employment conditions.

Fitch believes that mortgage rates will remain close to current levels. Despite banks pushing to increase their retail lending, Fitch does not expect large discounts in mortgage rates to be offered given banks' funding costs.

Credit Growth to Slow

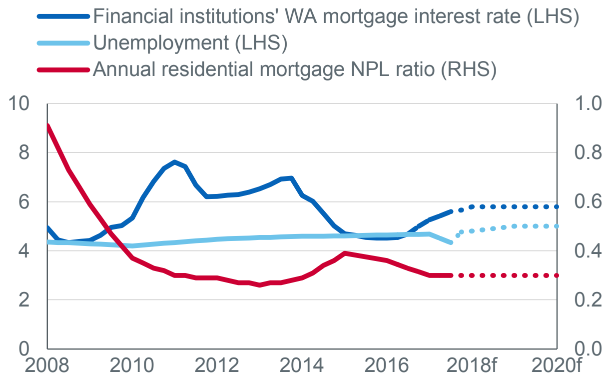
Urbanisation and economic and wage growth will continue to support the high, although moderating, growth rate. Fitch expects mortgage lending growth to slow with the balance of outstanding mortgages forecast to grow by 15% in 2019 and 12% in 2020 from 17% projected for 2018. Although banks are keen to provide mortgage loans given their perceived lower credit risk and risk-weight relative to corporate lending, mortgage demand from speculators is likely to drop as price growth expectations are much lower than in previous years. Home purchase restrictions and other housing policies also play a role in dampening housing demand which also continues to be supported by population moves to urban centres and households' upgrade needs.

Home Prices and Affordability



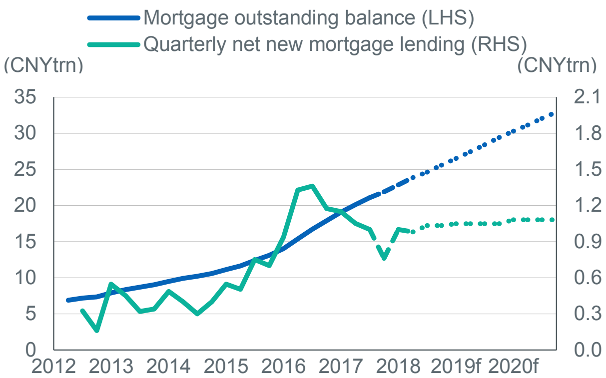
[a] (Beijing, Shanghai, Shenzhen & Guangzhou)
[b] (Capitals of provinces and autonomous regions), Rebased 2010
Source: Fitch Ratings, NBS China (National Bureau of Satistics), OECD

Mortgage Rates and Arrears



Source: Fitch Ratings, NBS China (National Bureau of Statistics)

Mortgage Lending and Prepayments



Source: Fitch Ratings, NBS China (National Bureau of Statistics)

Japan

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Fitch forecasts home prices to grow in 2019 supported by the low-interest environment and demand for property before the consumption tax rises. Loan performance will be stable.

Growth in Home Prices in 2019 Before Drop in 2020

Fitch forecasts price growth of 3% in 2019 for newly built condos, up from a projected 2% in 2018, due to both natural demand under the low-interest-rate environment and a likely rush to purchase residential properties before the consumption tax rate is raised to 10% in October 2019. We expect the price growth to reverse in 2020 with a decline of 4%, in reaction to the price rise in the preceding year and due to declining demand, especially from non-residents after the Tokyo Olympics in 2020. In the longer term, declines in both the population and number of households will put downward pressure on prices, especially outside the larger cities.

Fitch expects affordability for new home purchasers to remain weak in 2019 with a very high home price-to-income per capita ratio of 28x for new condos as prices rise but disposable income is stable.

Stable Performance Expected

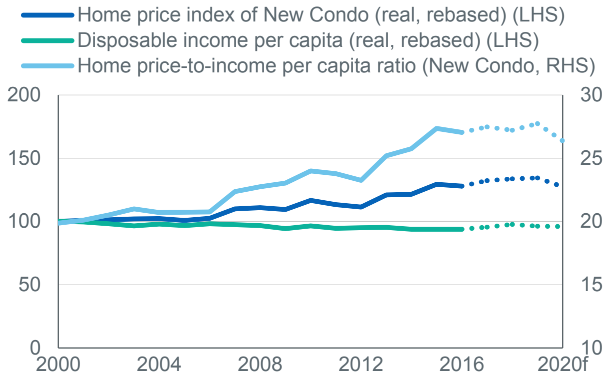
Fitch expects mortgage arrears to remain low over the next couple of years supported by GDP growth above or close to trend, low unemployment and interest rates, and a gradual improvement in household income. The three-month plus arrears rate was 0.22% at end-June 2018 and we expect a similar performance in 2019 and 2020.

With mortgage rates bottoming out, prepayment rates declined to 5% in August 2018 from 8% in August 2017. We expect the prepayment rate to remain low in 2019 and 2020.

Credit Growth to Increase, then Contract

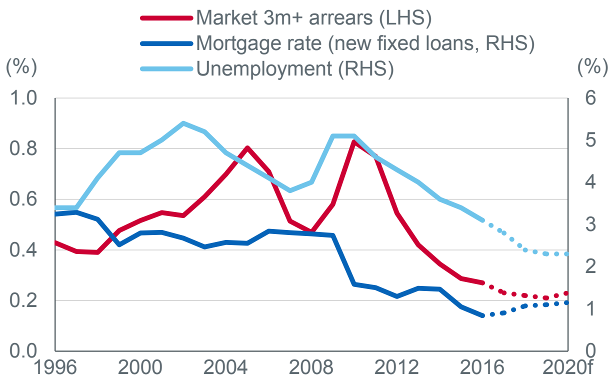
Fitch forecasts new mortgage lending growth rates in 2019 and 2020 to be 2% and -8%, respectively, following a decline in 2018, partly due to a slowdown in refinancing activity. We expect a slight increase in new residential mortgage lending in 2019 supported by a rush of demand for purchasing properties before the consumption tax rise. New mortgage lending is expected to decline thereafter.

Home Prices and Affordability



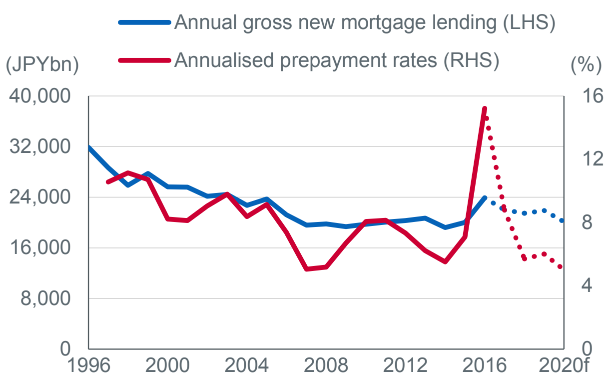
Source: Fitch Ratings, STAT.GO (Statistics of Japan), Ameco, OECD

Mortgage Rates and Arrears



Source: Fitch Ratings, STAT.GO (Statsitics Japan), Japan Housing Finance Agency

Mortgage Lending and Prepayments



Source: Fitch Ratings, STAT.GO (Statistics Japan), Japan Housing Finance Agency

South Korea

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> We expect minor home price drops in South Korea to continue. Tight lending restrictions will enhance new borrowers' credit quality, which will help sustain low mortgage arrears rates.

Home Prices to Continue to Post Small Declines

We expect national home prices to fall at an annual rate of 0.5% in 2018, 2019 and 2020 from growth of 2% yoy in 2Q18. The main drivers for the negative price momentum are borrowers' expectation of rising mortgage rates and continuing regulatory restrictions, including an LTV cap of 40% in Seoul and other areas that have attracted speculation, which will cause both transaction volumes and investment levels to slow. We expect Seoul to experience a gradual price softening and home prices may even be flat while prices will decline elsewhere.

Fitch expects the Bank of Korea to raise its base rate by 25bp in both 2019 and in 2020, and for mortgage rate increases to be modest by around a minimum of 30bp in 2019 and 2020. As a result, we believe that affordability will continue improving as household income is expected to rise by about 3% while home price values soften.

Strong Lending Rules Support Low Arrears

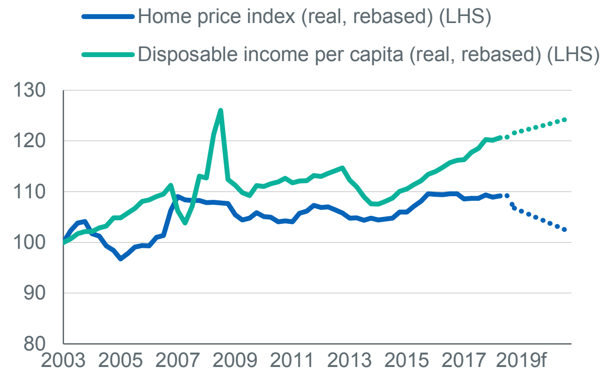
Fitch believes that banks' mortgage arrears will increase marginally over the coming years due to rising mortgage rates.

We expect the following factors to support the outlook for low arrears despite South Korea's significant trade links with both China and the US: stable labour market conditions with unemployment forecast at 3.8% in 2019, a high equity-to-mortgage debts ratio for borrowers, the large proportion of owner-occupiers (over 90% of the pools that Fitch monitors) and the strong credit profile of banks' new borrowers in particular due to the more stringent LTV rule applied since August 2017.

Credit Growth to Slow

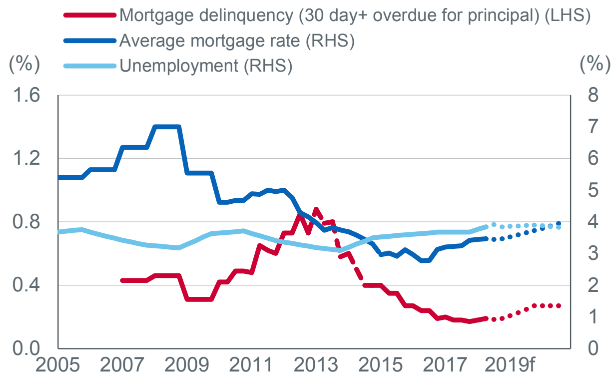
Fitch expects credit growth to fall to about 2% in both 2019 and 2020 from 5.7% yoy in 2Q18. Countercyclical buffer requirements for banks, which add capital in benign times – will partly contribute to lower credit growth over the next years. In addition, a debt-service coverage ratio cap of 70% of pre-tax income enacted in October 2018 for new loans is likely to slow mortgage credit expansion. Since August 2017, first-time buyers with mortgages in Seoul, Sejong and Gwacheon are limited to an LTV ratio of 40%.

Home Prices and Disposable Income Trend



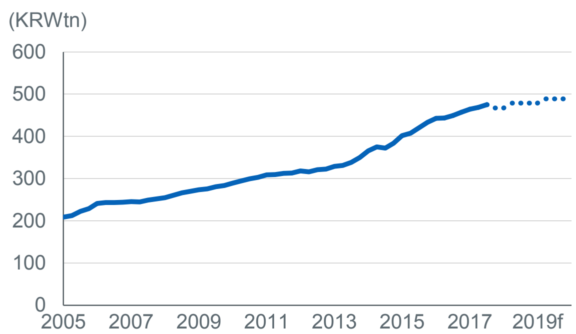
Source: Fitch Ratings, BIS, OECD

Mortgage Rates, Arrears and Unemployment



Source: Fitch Ratings, FSS (Finanical Supervisory Service), KHFC, OECD

Mortgage Lending
Outstanding bank mortgage lending (Nationwide)



Source: Korea Housing Finance Corporation (KHFC)

New Zealand

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We expect lower home price growth in New Zealand driven by restrictions on loan-to-value ratios.

Home Prices Cooling as Government Restrictions Temper Demand

Fitch expects annual home price growth of 3% over the next two years down from 14% in 2016. Demand for housing in New Zealand is expected to weaken as credit lending restrictions will continue to keep the number of first-time buyers and investors low. Although New Zealand's high household debt levels (at 93% of GDP as of 2Q18) place downward pressure on prices, supply remains constrained, which along with strong, above-trend economic growth and stable mortgage rates, will keep home price growth positive.

In October 2018, the government banned non-residents from buying existing homes with the aim of improving affordability, although Australians and Singaporeans are exempt due to free-trade deals. Fitch believes this will have a limited impact on national prices as it is estimated that fewer than 3% of homes are sold to foreign buyers. However, we expect Auckland to be affected, as the percentage of sales to foreign buyers is about 20%. Fitch expects Auckland to continue to post lower growth than other regions in 2019 with price falls likely.

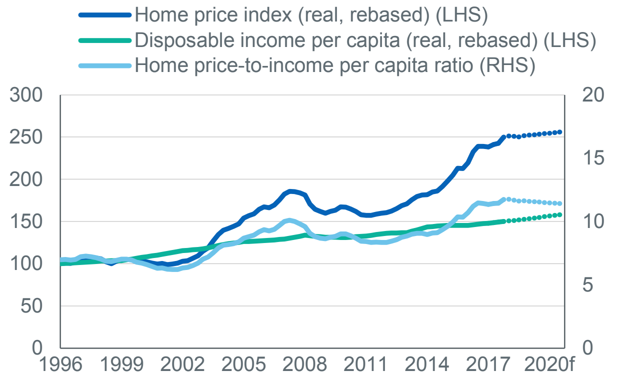
Benign Economy Supports Low Arrears

We expect mortgage performance to remain stable with 90+ days arrears of about 0.5% in 2019 reflecting Fitch's forecast of stable employment and wage growth. Mortgage rates will remain at low levels with Fitch forecasting a 0.25% increase in 2019 and a further 0.25% increase in 2020.

Stable Mortgage Lending Growth

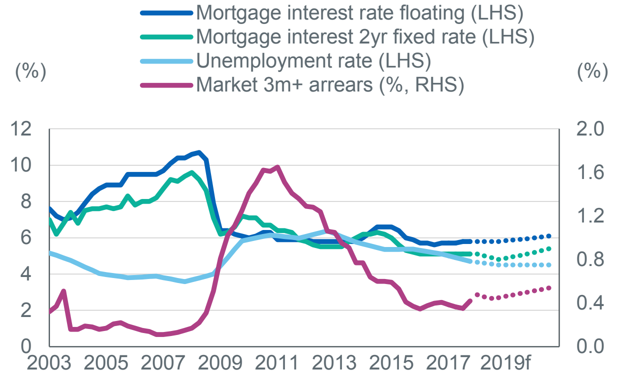
Fitch expects mortgage credit growth to remain stable at 6% as the RBNZ is likely to continue to relax LTV restrictions that were introduced in 2013. From 1 January 2019, banks cannot underwrite more than 20% of new mortgage lending to owner-occupied borrowers with LTVs of over 80% (with the former limits 15% in January 2018 and 10% in October 2016) nor can they disburse more than 5% of new loans to investors where LTVs are over 70% (increased from a limit of 65% in January 2018 and 60% in October 2016). The previous limits have resulted in the share of mortgages with an LTV greater than 80% falling by half in three years to less than 7% in September 2018.

Home Prices and Affordability



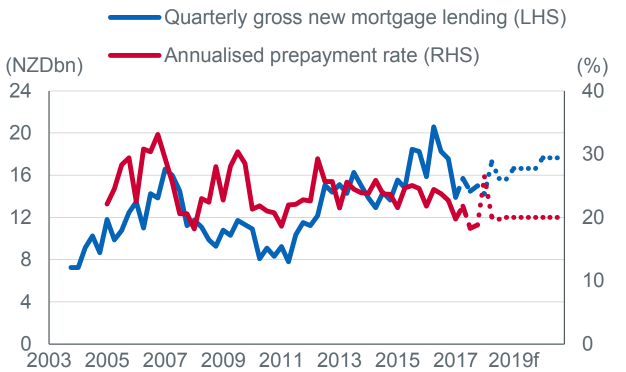
Source: Fitch Ratings, Statistics New Zealand, RBNZ, OECD

Mortgage Rates and Arrears



Source: Fitch Ratings, RBNZ (Reserve Bank of New Zealand)

Mortgage Lending and Prepayments



Source: RBNZ (Reserve Bank of New Zealand)

Singapore

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Fitch expects the rebound in home prices in Singapore to slow amid regulatory tightening. Higher interest rates may weaken loan performance modestly but household finances will remain strong.

Home Price Growth Kept Low by the Regulator

Fitch expects home price growth to be moderate at 2% in 2019 and 3% in 2020, as a fresh round of regulatory tightening from 2018 and rising interest rates are likely to weigh on buyer sentiment. The authorities raised the additional buyer's stamp duty on purchases other than first homes for Singapore residents by an additional 5-10pp in July 2018, and tightened various LTV limits each by 5pp, including to 75% for first homes and 45% for second homes. These moves were aimed at cooling the property market as home price growth had begun to accelerate again.

Rising mortgage rates should further temper property price inflation but there will still be upward price pressure as household income is expected to continue to grow faster than home prices, which will improve affordability.

Delinquencies to Rise

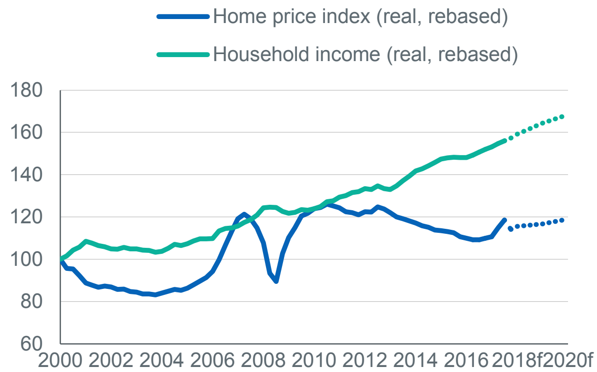
Fitch expects the housing NPL ratio to rise to 0.7% in 2020 from the 0.4% projected for 2018 as Singapore mortgage rates continue to climb. Mortgage rates in this primarily floating-rate market are expected to follow the policy rate, which should be influenced by further US rate rises, as short-term rates in Singapore and the US have historically shown a fairly strong correlation.

However, we expect any increase in delinquencies to be limited due to support from rising household incomes, a tight labour market and strong household balance sheets. Fitch forecasts the unemployment rate to remain low at 2% in 2019 and 2020. The housing NPL ratio was 0.4% in 2Q18 and we expect it to rise only slightly to 0.55% in 2019 and 0.65% in 2020.

Moderate Lending Growth

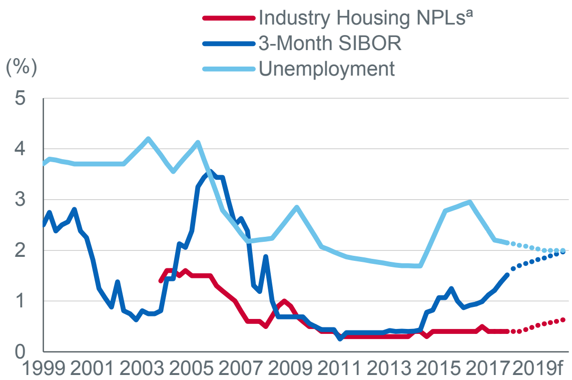
Fitch forecasts moderate growth in mortgage lending of 3% in both 2019 and 2020. The agency expects owner-occupied home purchases to remain the main driver of mortgage loan growth, though momentum is likely to be weak in 2019-2020 due to slowing home prices, rising interest rates, low population growth and the regulator's cooling measures.

Home Prices and Affordability



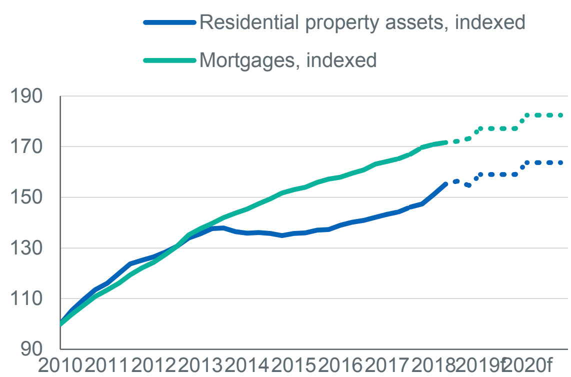
Source: Fitch Ratings, BIS, Singapore Dept of Statistics

SIBOR & Unemployment



[a] Non-performing Loans
Source: Fitch Ratings, MAS (Monetary Authority of Singapore)

Mortgage Lending



Source: Fitch Ratings, Singapore Dept of Statistics

Brazil

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We expect a gradual recovery in housing market activity in Brazil amid continued economic growth and supportive new home financing rules.

Real Home Prices to Stabilise

We forecast home prices to gradually recover after two years of flat nominal and declining real prices. The São Paulo region, which saw a nominal prices increase of 1.5% in 2018, is likely to lead the trend for the wider housing market. We expect real prices to stabilise nationally in 2019 on the back of macroeconomic improvements since the 2015-2016 recession, so nominal prices should increase by 8.8% by end-2020.

Affordability is expected to stay favourable as we forecast nominal home prices to increase slightly below working income growth of about 10% by end-2020. Per capita real disposable income should increase by 1.5% by end-2020 reflecting the expected progression of fiscal reforms and effects from the market-friendly policies of new President Bolsonaro. However, this would be at risk if reform progress is slow or there are challenges from international financial markets.

Arrears to Remain Low

Fitch expects mortgage performance to be stable in 2019 as the economy improves and the unemployment rate declines (from 12.8% at end-2017 to 12.2% forecast for 2018 and 11.8% for 2019).

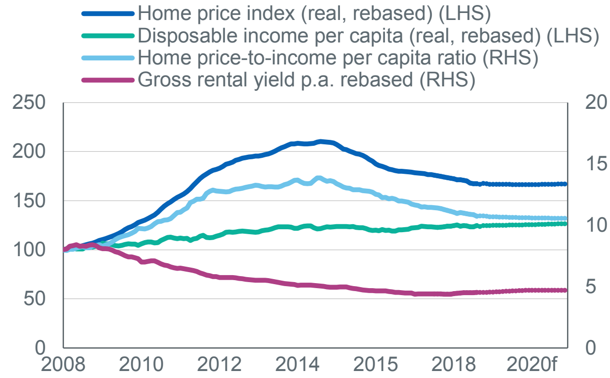
Average mortgage rates are expected to rise back to about 9% in 2019, tracking an increase of the basic interest rate, known as Selic, which should increase to about 8%. However, this should not lead to any material rise in arrears. Most Brazilian mortgages have fixed rates with constant amortisation, which preserves the payment capacity of borrowers while allowing for rapid deleveraging. We see these characteristics as key to the resilient performance during the 2015-2016 recession.

Broad Support for Loan Growth

Relatively low mortgage rates, GDP growth expectations of 2.2% in 2019 and 2.7% in 2020, inflows from saving deposits and the new financing rules planned by the central bank all contribute to our expectation of 12% growth in outstanding mortgage loans over the next two years.

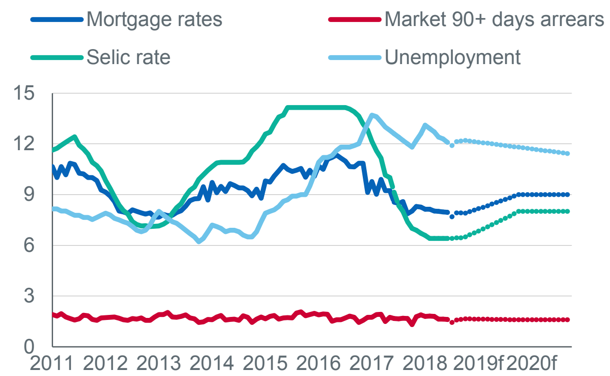
The new rules will come into effect in 2019 bringing more flexibility to lenders as the allocation of saving deposits, which must be used for housing finance, can be freely distributed by banks between regulated and unregulated mortgage loans. The property price cap for regulated loans has also been raised to USD400,000 from USD250,000, giving lenders and borrowers a wider choice.

Home Prices and Affordability



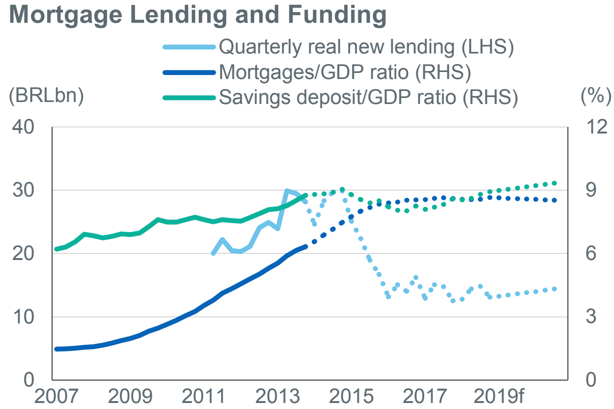
Sources: Fitch Ratings, FIPE (Fundacao Instituto de Pesquias Economicas), IBGE (Instituto Brasileiro de Geografia e Estatistica)

Mortgage Rates and Arrears



Source: Fitch Ratings, BCB (Banco Central do Brasil)

Mortgage Lending and Funding



Source: Fitch Ratings, BCB (Banco Central Do Brasil), ABECIP (Association of Brazilian Real Estate Loans and Savings Companies)

Mexico

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We expect home prices In Mexico to increase in line with inflation while new construction is likely to slow.

Flat Real Prices, Affordability Improving

We expect home prices to grow in line with inflation at about 4% over the next two years supported by our forecasts for stable and then growing, but below-trend, GDP growth of 2.1% in 2019 and 2.4% in 2020, and a benign labour market with unemployment below 4%. We expect strong credibility of monetary policy to reduce the inflation rate, which, together with growing wages, should moderately improve affordability. Scope for large interest rate cuts in 2019 is limited.

Most properties should see their values increase, but the average sale price should fall as a consequence of the new administration's continuation of expansive supply-side policies in city centres likely increasing housing access to lower-income sections of the population and driving out construction for mid-to-high-income segments. Policy uncertainty under the new administration may also reduce housing demand.

Stable Loan Performance Except for NBFIs

We do not expect the new administration to make significant changes in 2019 to the operations of Infonavit and Fovissste, the main mortgage providers in the low-income segment. Strong performance is expected from commercial banks' loans, primarily targeted to middle- and high-income borrowers.

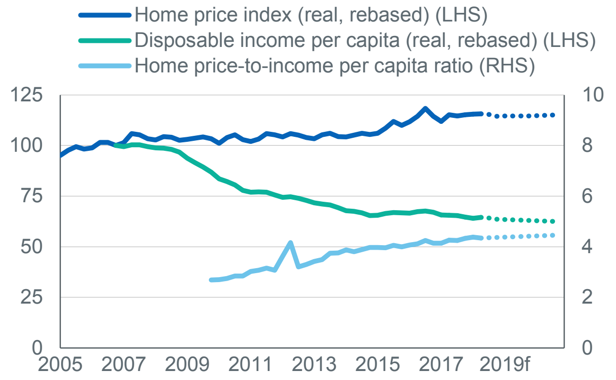
Mortgage loan portfolios sponsored by non-bank lenders are still struggling with recoveries. Fitch expects this to continue for borrowers residing outside metropolitan areas who will have an incentive to relocate under the government's city-focused housing policy as investment in infrastructure outside cities will be pared back.

Steady Loan Growth

Fitch believes the availability of mortgage credit will remain strong, although loan growth should decelerate and stabilise around 4% due to increased policy uncertainty under the new administration. Mexican mortgages are characterised by fixed rates and terms of 20-25 years, partly explained by commercial banks' cheap deposit funding and government agencies' policy-driven interest rates, which are insensitive to monetary policy decisions.

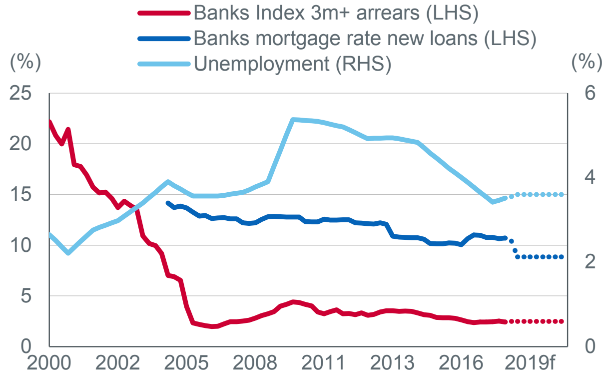
The continued prevalence of relationship lending by commercial banks should largely insulate mortgage rates from base-rate volatility. Higher vacancy rates and increased cost of raw materials point towards a likely slowing in overall urban construction activity while demand for housing finance from the middle-income population appears to be waning.

Home Prices and Affordability



Source: Fitch Ratings, BIS, OECD, INEGI

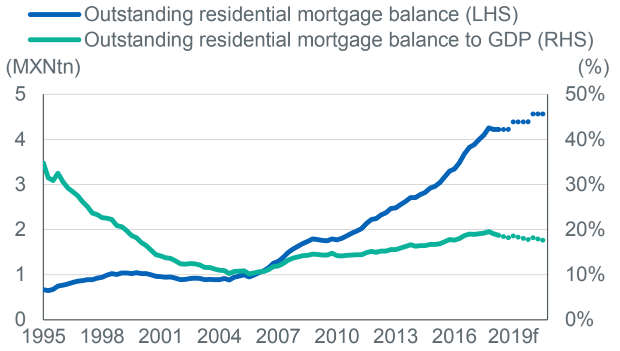
Mortgage Rates and Arrears



Source: Fitch Ratings, Banxico, INEGI

Mortgage Lending and Prepayments

Commercial banks



Source: Fitch Ratings, Banxico, INEGI

Colombia

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“ We expect a slight increase in real home prices as the mortgage market gathers pace. Lending should grow moderately due to improving loan affordability and tight regulation.

Home Prices Pick Up

We expect a slight growth in home prices in real terms in the coming years in line with the economic recovery. A persistent undersupply of housing balances a weakened demand for home purchases, driven by stagnant disposable income that limits market speculation as affordability has not increased significantly.

Governmental initiatives to shift construction towards homes for the low- and middle-income segments were reflected in the price-to-income ratio, which dipped in 2016 when lower-value properties increased their share of the total. As construction will be more balanced between different value segments and policies will support both buyers and home builders, Fitch expects the price-to-income ratio to increase.

Strong Loan Performance

Mortgage arrears are likely to remain low. Inflationary pressures on household income in 2016 and a slight increase in unemployment led to an increase of arrears levels to 3.1% in 2Q18 from 2.1% in 1Q16. Fitch expects that arrears will remain largely flat as the labour market is expected to be stable and the unemployment rate to remain in single digits. Average initial downpayments of 50% on mortgage loans as well as a modest home price appreciation are also expected to keep arrears low.

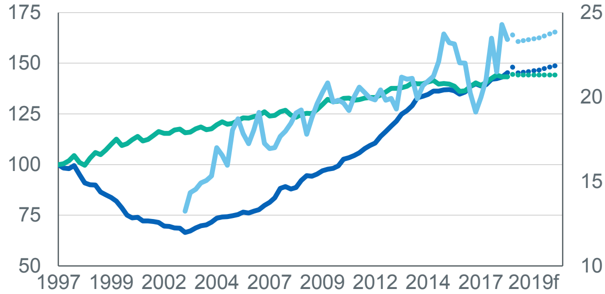
Mortgage interest rates are expected to increase slightly by 2019, mirroring movements of the policy interest rate. The impact on loan performance is expected to be limited as the Colombian mortgage market is dominated by long-term fixed-rate loans.

Modest Real Credit Growth

Fitch expects mortgage credit to maintain growth of about 10% a year over the next two years supported by moderately stronger market dynamics. In addition, changes in bank capital regulation are likely to increase originators' risk appetite for mortgage loans. Tight mortgage regulation and increasingly leveraged households will limit the degree of credit growth. Fitch expects the total mortgage balance to remain below 6% of GDP in 2019 due to conservative underwriting criteria.

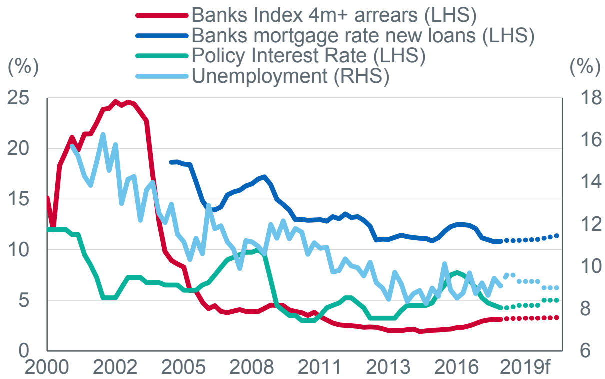
Fitch expects prepayment levels to remain well below 15% as market interest rates are not anticipated to decline in a way that could lead to a recurrence of the refinancing frenzies seen in 2009 and 2013. Prepayment expectations are based on policy rate stability and a controlled inflation environment.

Home Prices and Affordability



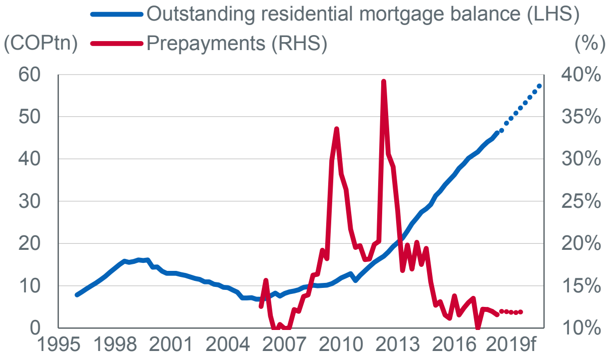
Source: Fitch Ratings, Banrep, DANE, Asobancaria

Mortgage Rates and Arrears



Source: Fitch Ratings, Banrep, Superintendencia Financiera, DANE

Mortgage Lending and Prepayments
Commercial banks



Source: Fitch Ratings, Superintendencia Financiera, Titularizadora Colombiana

Macro Indicators

Region	Country	Sovereign Environment			Unemployment (%)			Real GDP Growth (%)			Short-term Rates (%)			Overall Macro Evaluation	
		IDR[a]	BSI[b]	MPI[c] (last year)	2018f	2019f	2020f	2018f	2019f	2020f	2018f	2019f	2020f	Outlook[d]	Change vs 2018[e]
North America	USA	AAA	a	1 (1)	3.9	3.4	3.4	2.9	2.6	2.0	2.5	3.3	3.5	Stable/ Positive	▶
North America	CAN	AAA	aa	1 (1)	5.8	5.6	5.6	2.1	1.9	1.7	1.8	2.5	2.8	Stable/ Positive	▼
Europe	UK	AA	a	1 (1)	4.1	4.3	4.3	1.3	1.6	1.8	0.8	1.0	1.5	Stable/ Negative	▲
Europe	GER	AAA	a	1 (1)	3.5	3.5	3.4	1.6	1.6	1.4	0.0	0.0	0.5	Stable/ Positive	▼
Europe	NLD	AAA	a	1 (1)	3.9	3.6	3.4	2.9	2.5	2.0	0.0	0.0	0.5	Stable/ Positive	▶
Europe	FRA	AA	a	1 (1)	8.9	8.5	8.1	1.6	1.7	1.6	0.0	0.0	0.5	Stable	▼
Europe	BEL	AA-	a	2 (2)	6.3	6.0	5.8	1.5	1.4	1.4	0.0	0.0	0.5	Stable	▼
Europe	DEN	AAA	a	1 (1)	5.6	5.5	5.5	1.8	1.9	1.8	0.0	0.0	1.0	Stable/ Positive	▶
Europe	SWE	AAA	aa	1 (1)	6.3	6.1	5.9	2.6	2.2	2.1	-0.3	0.0	0.5	Stable/ Positive	▶
Europe	NOR	AAA	a	2 (2)	3.8	3.3	3.1	2.6	2.3	1.8	0.5	1.0	1.4	Stable	▶
Europe	IRL	A+	bbb	1 (1)	5.8	5.4	5.3	4.8	3.5	3.0	0.0	0.0	0.5	Stable	▶
Europe	ESP	A-	bbb	1 (1)	15.5	13.8	12.7	2.6	2.3	1.9	0.0	0.0	0.5	Stable/ Positive	▶
Europe	ITA	BBB	bbb	1 (1)	10.9	10.5	10.2	1.0	1.1	1.0	0.0	0.0	0.5	Stable/ Negative	▼
Europe	PRT	BBB	bb	1 (1)	7.9	7.2	6.9	2.2	1.8	1.5	0.0	0.0	0.5	Stable	▼
Europe	GRC	BB-	ccc	1 (1)	20.1	19.0	18.0	2.0	2.3	2.2	0.0	0.0	0.5	Stable/ Positive	▶
Asia Pacific	AUS	AAA	aa	1 (1)	5.3	5.0	4.9	3.3	2.7	2.7	1.5	1.8	2.3	Stable	▶
Asia Pacific	CHN	A+	bb	1 (1)	4.8	5.0	5.0	6.6	6.1	6.1	4.4	4.4	4.4	Stable	▶
Asia Pacific	JPN	A	a	2 (1)	2.4	2.3	2.3	0.9	0.9	0.6	-0.1	-0.1	-0.1	Stable	▼
Asia Pacific	KOR	AA-	a	1 (1)	3.9	3.8	3.8	2.6	2.5	2.5	1.8	2.0	2.3	Stable	▶
Asia Pacific	NZL	AA	a	1 (1)	4.5	4.5	4.5	2.8	3.0	2.7	1.8	1.9	2.3	Stable	▶
Asia Pacific	SG	AAA	aa	2 (2)	2.1	2.0	2.0	3.4	3.2	3.2	2.6	3.1	3.3	Stable	▶
Latin America	BRA	BB-	bb	1 (1)	12.2	11.8	11.4	1.3	2.2	2.7	6.5	8.0	8.0	Stable	▼
Latin America	MEX	BBB+	bbb	1 (1)	3.6	3.6	3.6	2.2	2.1	2.4	8.0	7.8	6.8	Stable	▶
Latin America	COL	BBB	bbb	1 (1)	9.6	9.3	9.0	2.6	3.3	3.5	4.4	4.5	5.0	Stable/ Positive	▲

Legend

[a] IDR: Issuer Default Rating
[b] As of Septembers 2018; the Bank System Indicator (BSI) is a system weighted average of bank standalone strength as measured by banks' Viability Ratings.
[c] As of September 2018; with the Macro-Prudential Indicator (MPI) Fitch systematically monitors macro-prudential risks on a scale from '1' (low) to '3' (high).
[d] Short-term rates shown are end-of-period policy rates in the US, Canada, the eurozone, Australia, Japan, South Korea, Brazil and Mexico, the one-year policy lending rate in China and annual average policy rates for the others.
[e] Outlook on a five-notch scale (Positive, Stable/Positive, Stable, Stable/Negative, Negative).
[f] Change of Outlook evaluation compared with evaluation a year ago.
Source: Fitch Ratings

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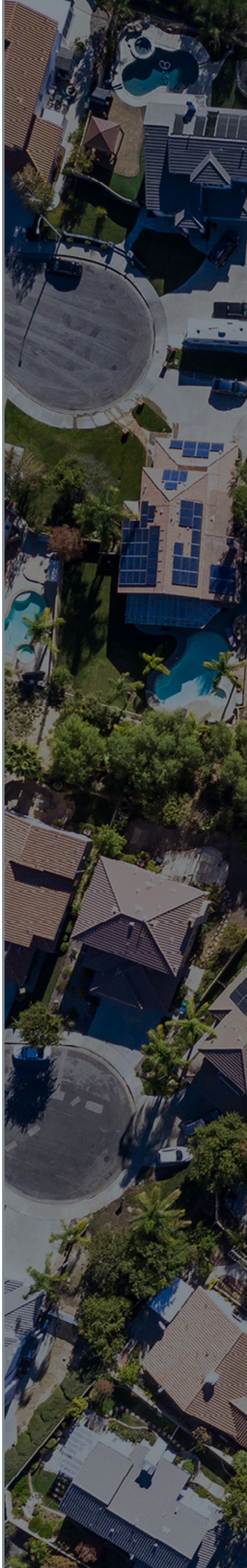
FitchRatings



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