Housing, Stability and the Macroeconomy: International Perspectives

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Housing, Stability and the Macroeconomy: International Perspectives

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Outline

I. Real estate cycles and macroeconomy
II. Current state of housing
III. What to do?
IV. Questions for discussions
Part I: Real estate cycles and the macroeconomy

Business cycles associated with financial cycles are different

- Recessions often coincide with adverse financial events
  - Especially housing busts and credit crunches
- Recessions (recoveries) coinciding with financial disruptions (booms) differ from other recessions (recoveries)
  - Recessions (recoveries) become deeper (stronger)
  - Especially for housing busts and booms
Recessions and house downturns often overlap

Part I: Real estate cycles and macroeconomy
Consequences of busts can be severe
Recession more likely given a financial disruption

(fraction of time in recession given a disruption)
Recessions associated with crunches and house price busts are deeper (percent)
Strength of recoveries are greater with credit and house price booms (percent)

![Bar chart showing recoveries without, with, and with strong recoveries during credit and house price booms.]

**Part I: Real estate cycles and macroeconomy**
Part II. Current state of housing

Where are housing markets today?

- Much variation in housing markets today
- Recoveries in some markets
  - Which is good news, but new bubbles?
- In other markets, busts continue
  - Restructuring needs not yet fully addressed
  - With impact on the real side, housing investment
While house prices globally are rising again

Global House Price Index Weighted (2000=100)
(real house prices, seasonally-adjusted quarterly series, average for 51 countries)

Source: OECD, Global Property Guide, Haver, Analytics and authors’ calculations
in 30 countries (out of 51 included); but among OECD countries, increases and declines are evenly balanced.
….with house prices in Germany, US, Spain, Ireland showing the difference in developments

Real House Prices, index

Source: OECD

Part II: Current state of housing
Are these house price developments a cause for cheer or concern?

- Evidence from house price valuation measures — price-to-rent and price-to-income ratios — is mixed
  - Price-to-rent ratio: compares total costs of homeownership to cost of renting similar property
  - Price-to-income ratio: basic affordability measure for housing in a given area
In most OECD countries house price-to-rent ratio remains above historical averages …
... as do many price-to-income ratios

Magnitude of overvaluation or undervaluation in house price-to-income ratio

Source: OECD and authors calculations

Part II: Current state of housing
Although housing investment and house prices only relate to some degree...

Part II: Current state of housing
...housing investment has generally still some way to recover

Part II: Current state of housing
Part III. What to do?

Ignoring real estate markets comes at a high cost, but what to do? General issues with bubbles

- Should one stop? Clarify objectives first
  - Prevent unsustainable booms and leverage buildup
  - Increase resilience to busts

- When to take action? Bubbles difficult to spot
  - But many policy decisions are taken under such uncertainty
  - Deviation from yardsticks (price-income, price-rent, or leverage, credit growth), but imperfect

- How? No silver bullet
  - Broader measures: hard to circumvent but more costly
  - Targeted tools: more limited costs, but loopholes
Does one prick a housing bubble? And if so, when? And how?
A short-term view suggest, prices go up for ever...

Part III: What to do?
A very long view suggest, however, prices do not go up forever....
Can we predict house prices? Only poorly…

i.e., hard to pick (and prick) bubbles

Actual (2006-13) and Predicted House Prices Change
Model with Price-to-Income Ratio

Part III: What to do?
Policy options to deal with real estate booms and busts

1. Monetary policy
2. Fiscal tools
3. Macroprudential regulation
   a. Supply-side
   b. Demand-side

Part III: What to do?
Policy options

1. Monetary Policy: (sometimes) effective at a (large) cost

- Make borrowing more expensive while limiting risk taking, leverage in financial institutions
- But:
  - Effect on speculative component is limited
  - Too blunt: costly for the *entire* economy
  - E.g.: Panel VAR suggests 100 basis points increase reduces house price appreciation by 1 pp. but also lead to a decline of 0.3 pp. in GDP growth
Policy options
2. Fiscal Tools: distortionary and limited cyclical use

- Debt-financed ownership favored: allow deductibility of mortgage interest (DMI), do not tax imputed rents and capital gains fully

- But:
  - No link between favorable treatment and crisis; and Cyclical use difficult and violates tax smoothing

- Evidence:
  - Structurally, removal of DMI may help reduce leverage; and Cyclically, transaction taxes may help
    - During busts to support prices, but less so during booms (transaction volumes rather than prices)
Policy options
3. Macroprudential Tools: promising but early evidence

- Most ‘experiments’ in emerging markets, Asia, Latin America
- Common tools:
  - Dynamic provisioning on supply
  - Differentiated risk weights on high-LTV loans
  - Maximum LTV/DTI limits
- Discretion rather than rule-based so far
- Mixed evidence on effectiveness, some cooling off
Overall: what is the best tool?

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<tr>
<th>Impact:</th>
<th>1. Monetary measures</th>
<th>2. Fiscal measures</th>
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<tbody>
<tr>
<td></td>
<td>Potential to prevent booms, less so to stop one already in progress</td>
<td>Automatic stabilizer; reduce incentive for leverage</td>
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<tr>
<th>Side effects:</th>
<th>Inflict damage to activity and welfare</th>
<th>Impair already-slow price discovery process</th>
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<th>Practical issues:</th>
<th>Identifying and reacting in time a challenge</th>
<th>Little room for cyclicality; incentive to avoid by misreporting</th>
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## Part III: What to do?

### 3b. Macroprudential: Supply Side

**Impact:**
Increase cost of borrowing while building buffer for downturn

**Side effects:**
Potential credit rationing; earnings management

**Practical issues:**
Data requirements and calibration

### 3b. Macroprudential: Demand (LTV/DTI limits)

**Impact:**
Potentially limit leverage and price appreciation; decrease default probability

**Side effects:**
Potential credit rationing (first time buyers); can worsen bust

**Practical issues:**
Calibration difficult, circumvention easy
Part IV. Questions for discussion at conference

1. What is the extent of recovery in housing markets?
   - Are some markets looking stretched (again)? To what extent is this driven by unconventional monetary policies?

2. Should we be cheering (any) recovery?
   - Where corrections took place, should we want prices and investment to go back up to 'unsustainable' pre-crisis levels? Where little correction, is there (still) a 'bubble'?

3. When should policymakers act? How?
   - Do we know more about how to detect bubbles? Given unresolved uncertainties on how to detect bubbles, when and how to prick them? Are we "navigating by sight"?
4. How to make macroprudential policies more effective?
   ▪ Some countries, Hong Kong, Korea and Israel, were active in macropru policies. What are lessons for others?
   ▪ Demand vs. supply/financing limits. What are most effective?
   ▪ Capital flows/international integration/arbitrage etc.
     ▪ Should/can one we limit foreign exchange for housing finance?

5. What roles for structural supply, finance and real, in bubbles (and busts)?
   ▪ Are some forms of housing finance less prone to bubbles?
     ▪ Bank vs. market financing. Fixed vs. floating. Degree of competition.
   ▪ What is a role for supply measures (e.g., limits on permits)?
     ▪ Support prices, but distortions, inequality and political economy risks?
...Other, current policy issues in housing

1. Ability and speed of restructuring
   - Problems with large scale underwater borrowers, speed of bankruptcy/restructuring (e.g., Ireland, Spain, U.S.)
     - What are lessons from experiences? Any analyses, e.g., on differences within the US, useful for others?
   - How to adapt micro-/macro-prudential (e.g., LTV) in busts?
     - Any scope to manage speed of decline? How to avoid perverse effects?

2. Role of the state in housing finance
   - Do we need greater or less role for the state, short-term and long-term?
     - Short-Term: “Help to Buy.” Insurance.. Other. Risks?
     - Long-Term: Role of tax deductibility, phasing out. Securitization, “GSE” models
Thank you