



Housing, Stability and the Macroeconomy: International Perspectives

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Housing, Stability and the Macroeconomy: International Perspectives



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Outline

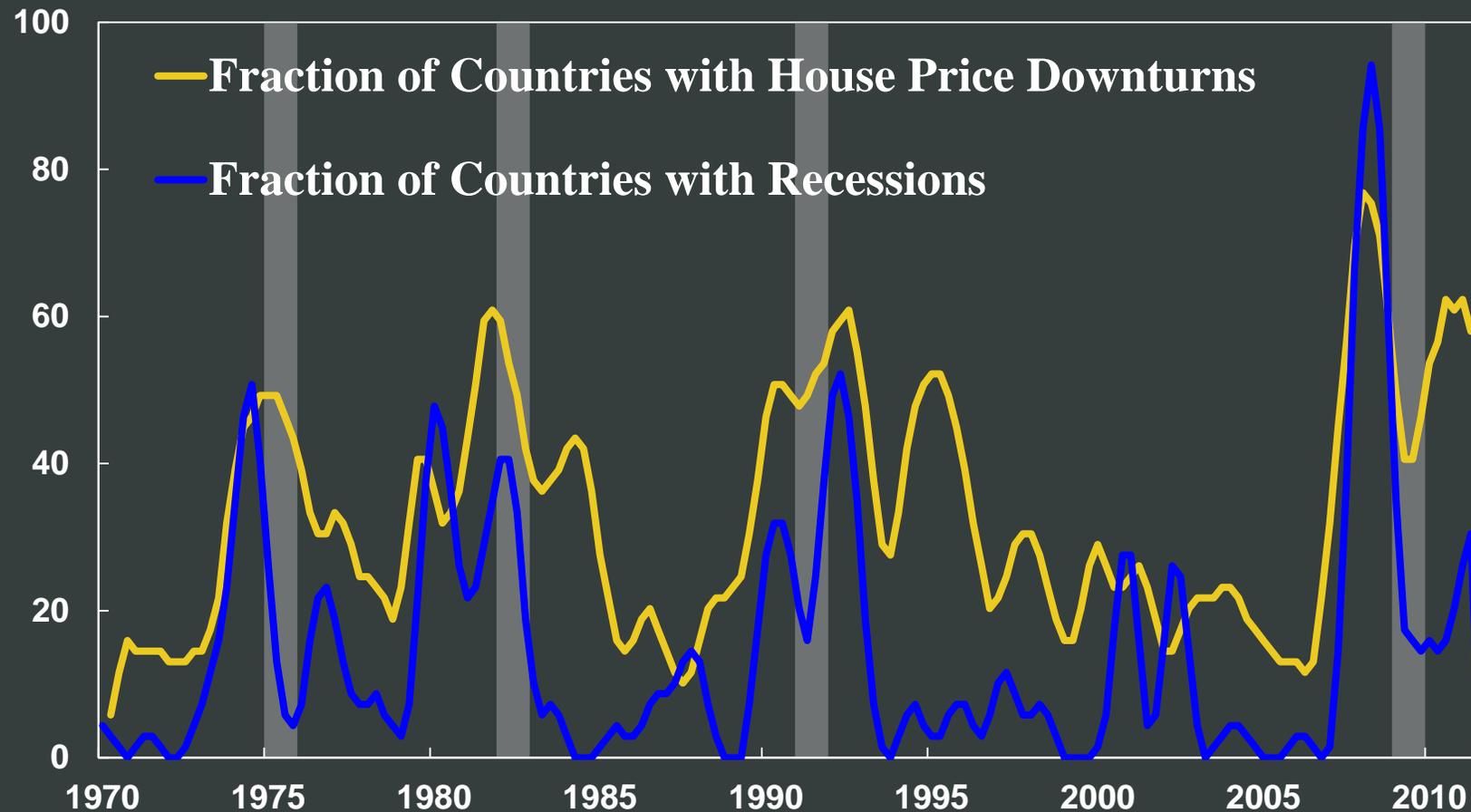
- I. Real estate cycles and macroeconomy
- II. Current state of housing
- III. What to do?
- IV. Questions for discussions

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

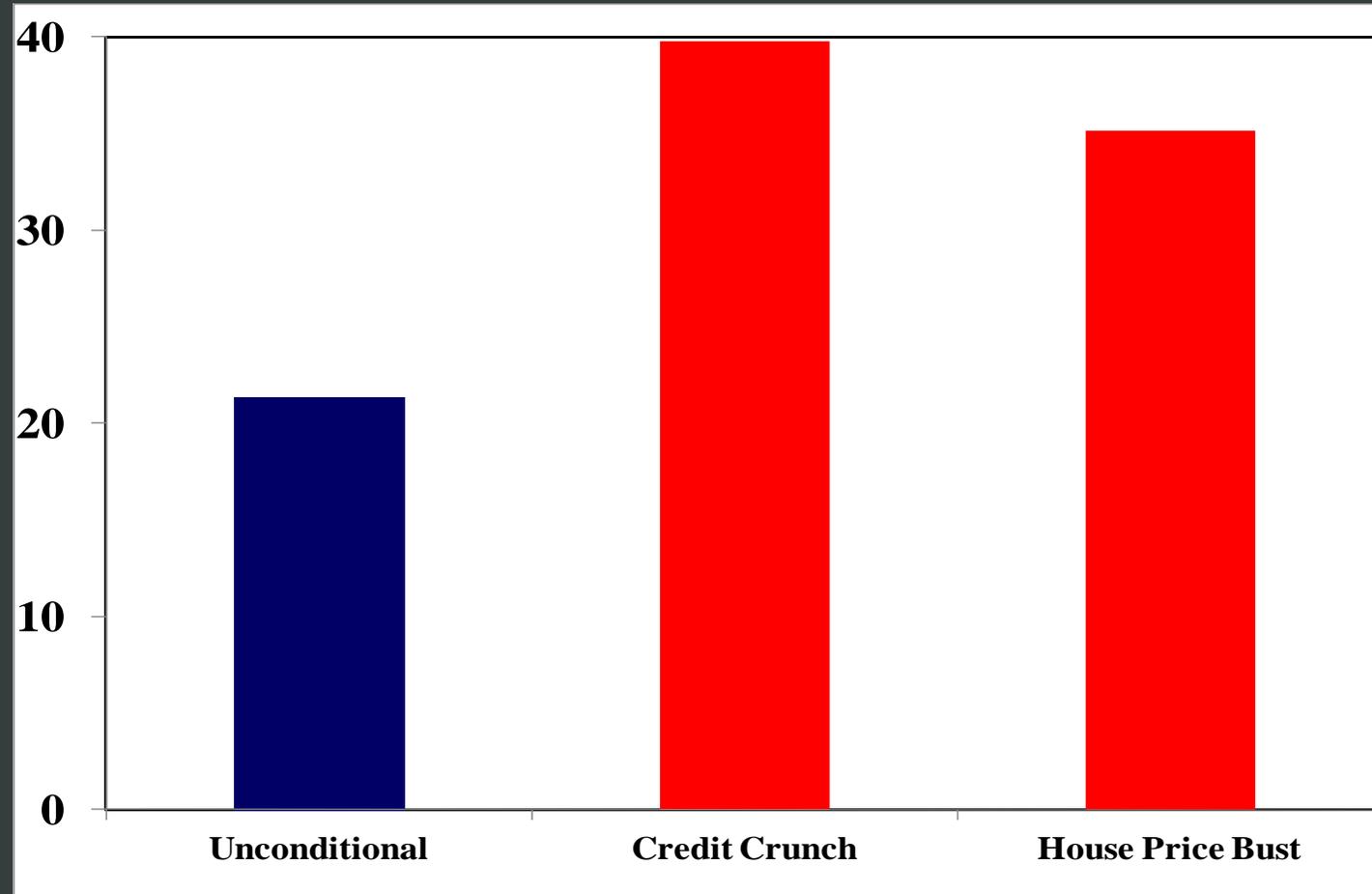


Consequences of busts can be severe

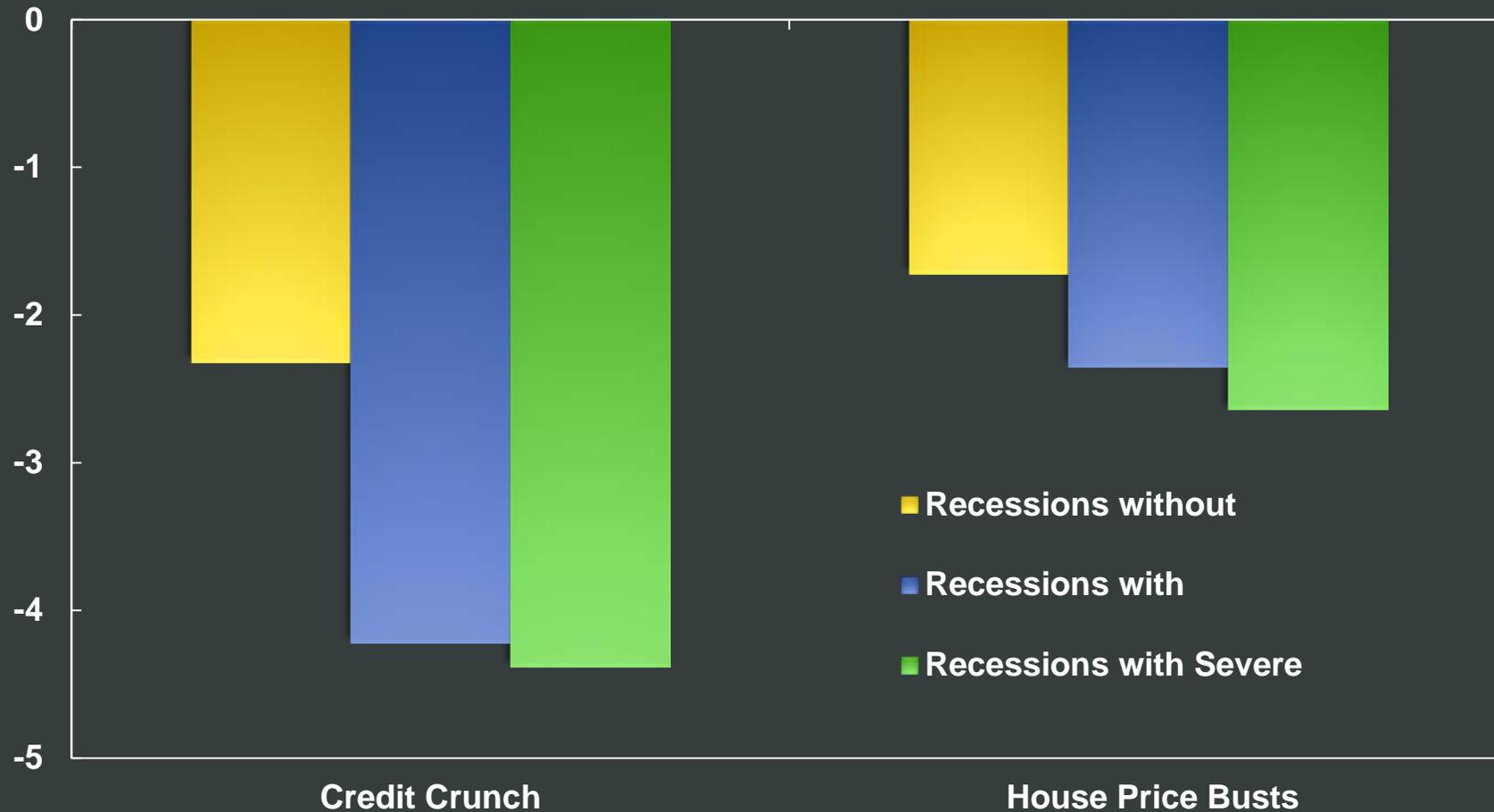


Recession more likely given a financial disruption

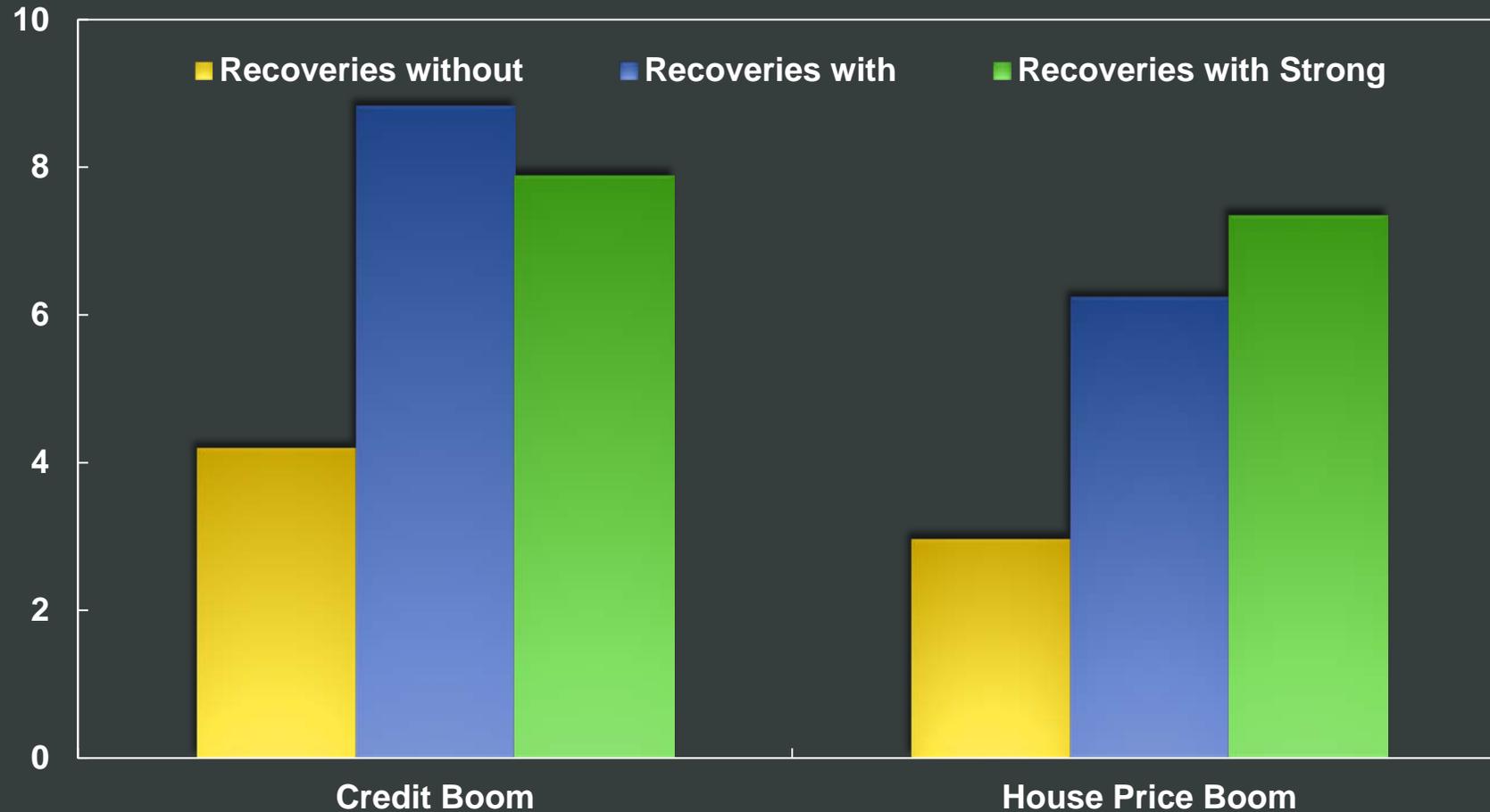
(fraction of time in recession given a disruption)



Recessions associated with crunches and house price busts are deeper (percent)



Strength of recoveries are greater with credit and house price booms (percent)

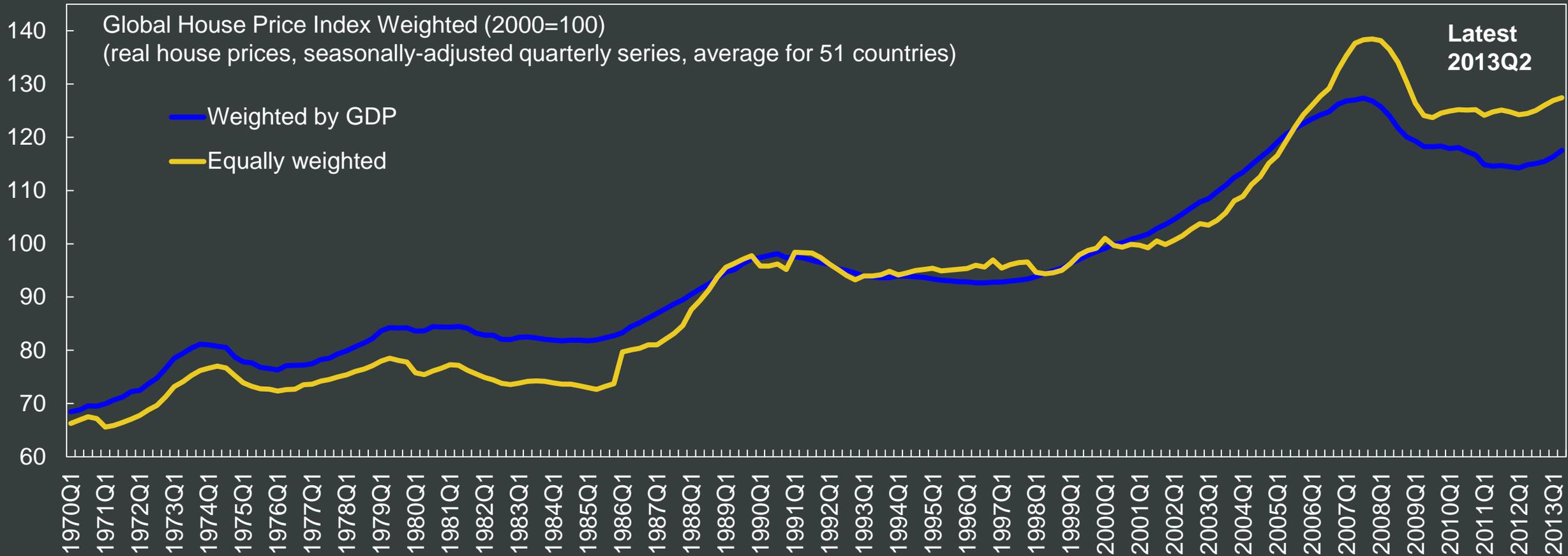


Part II. Current state of housing

Where are housing markets today?

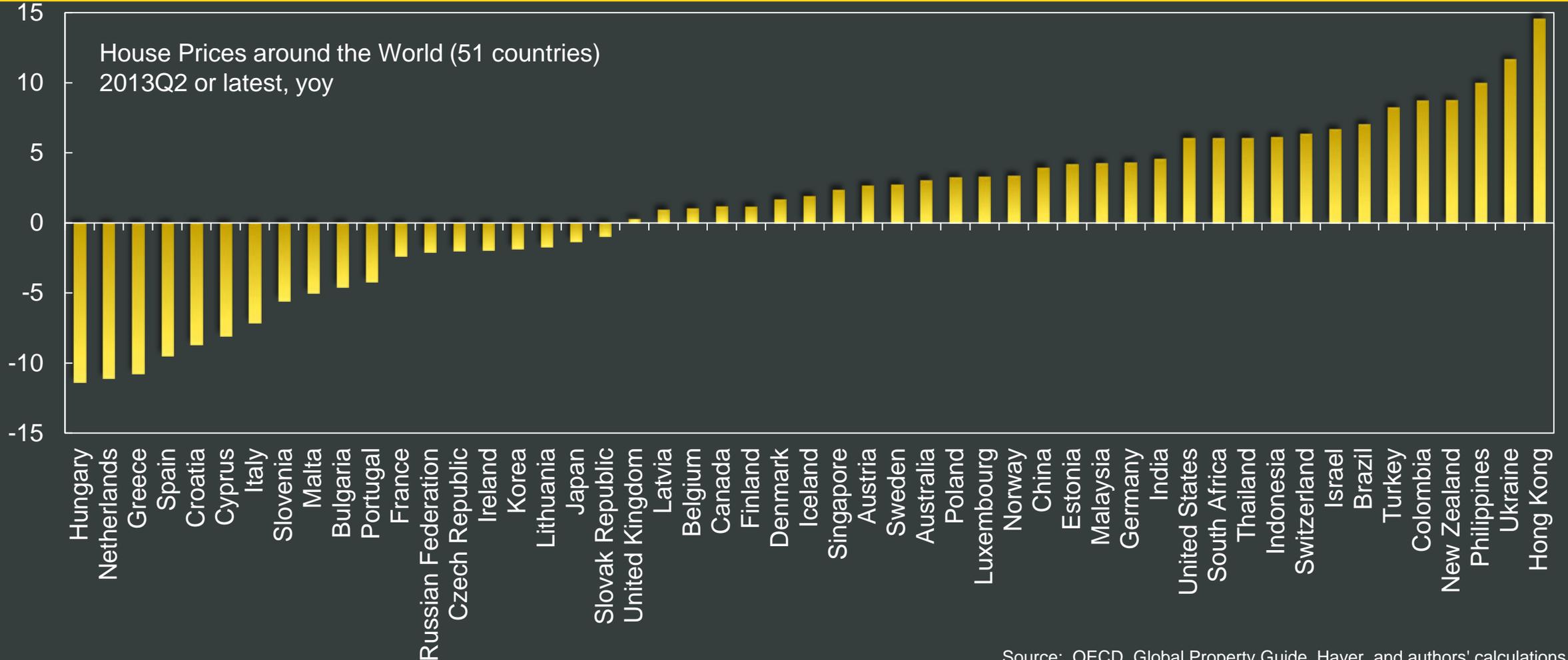
- Much variation in housing markets today
- Recoveries in some markets
 - Which is good news, but new bubbles?
- In other markets, busts continue
 - Restructuring needs not yet fully addressed
 - With impact on the real side, housing investment

While house prices globally are rising again



Source: OECD, Global Property Guide, Haver, Analytics and authors' calculations

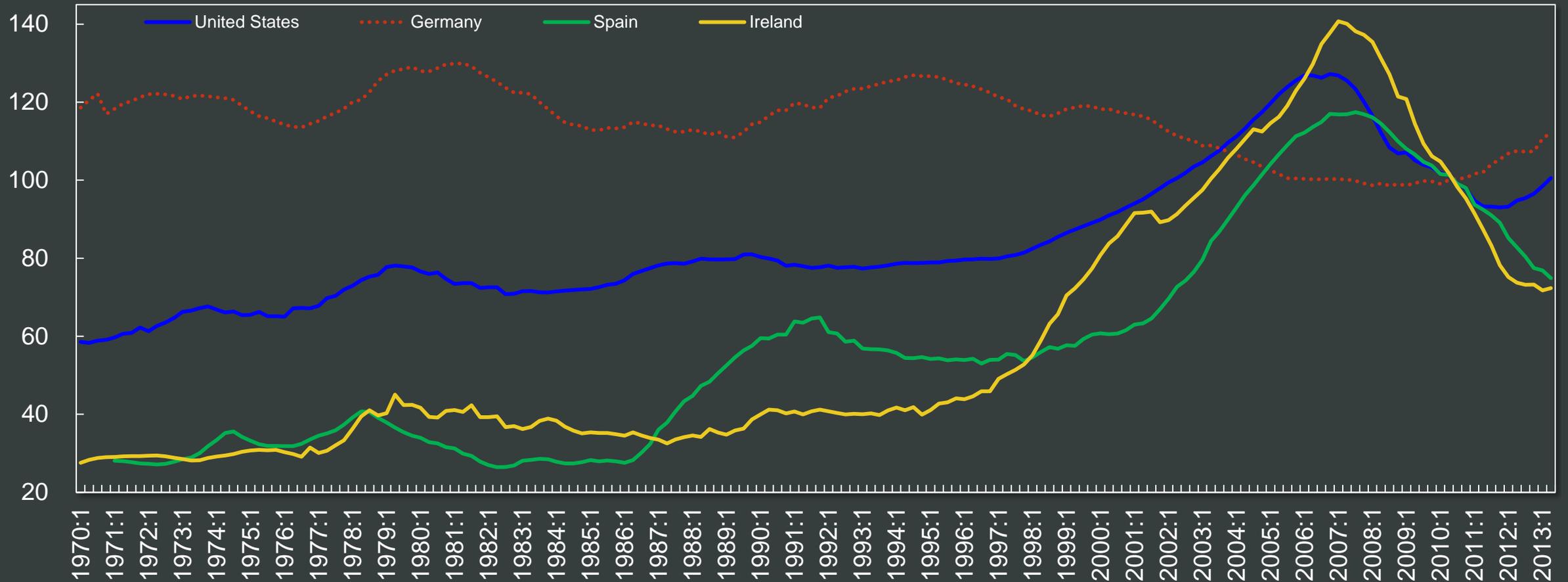
in 30 countries (out of 51 included); but among OECD countries, increases and declines are evenly balanced



Source: OECD, Global Property Guide, Haver, and authors' calculations

....with house prices in Germany, US, Spain, Ireland showing the difference in developments

Real House Prices, index



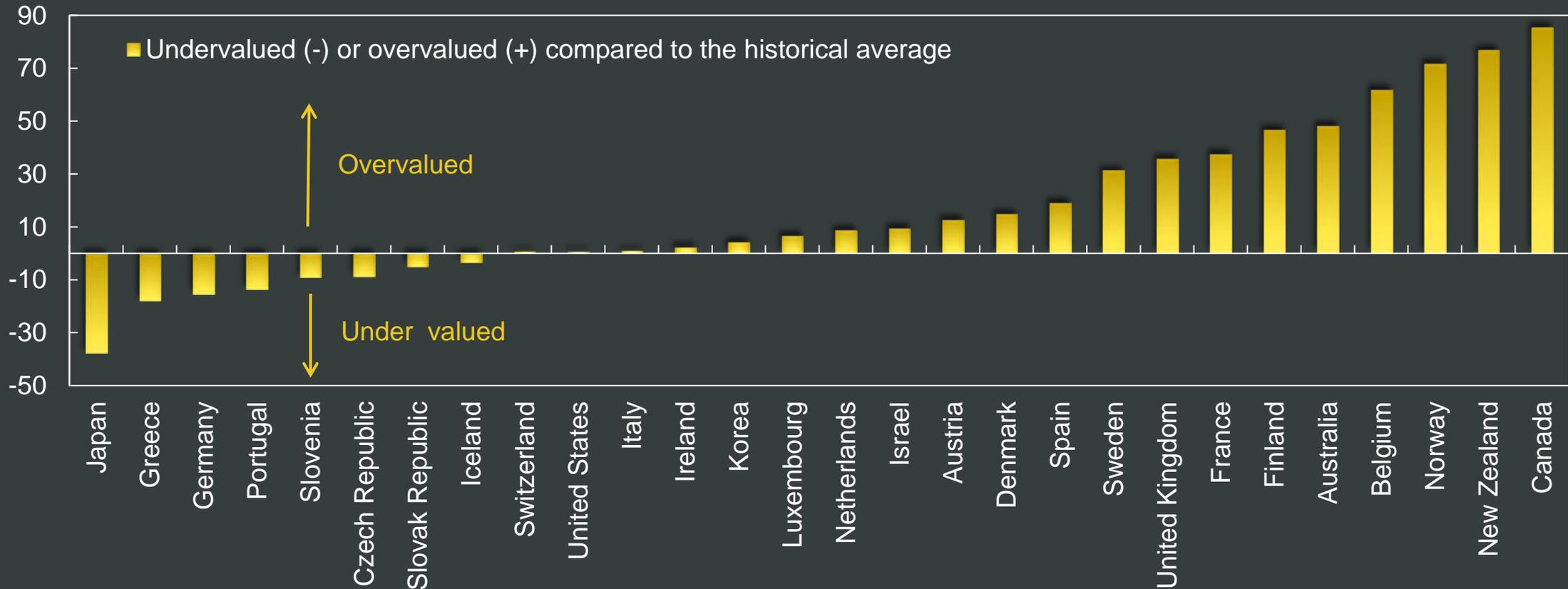
Source: OECD

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 ...

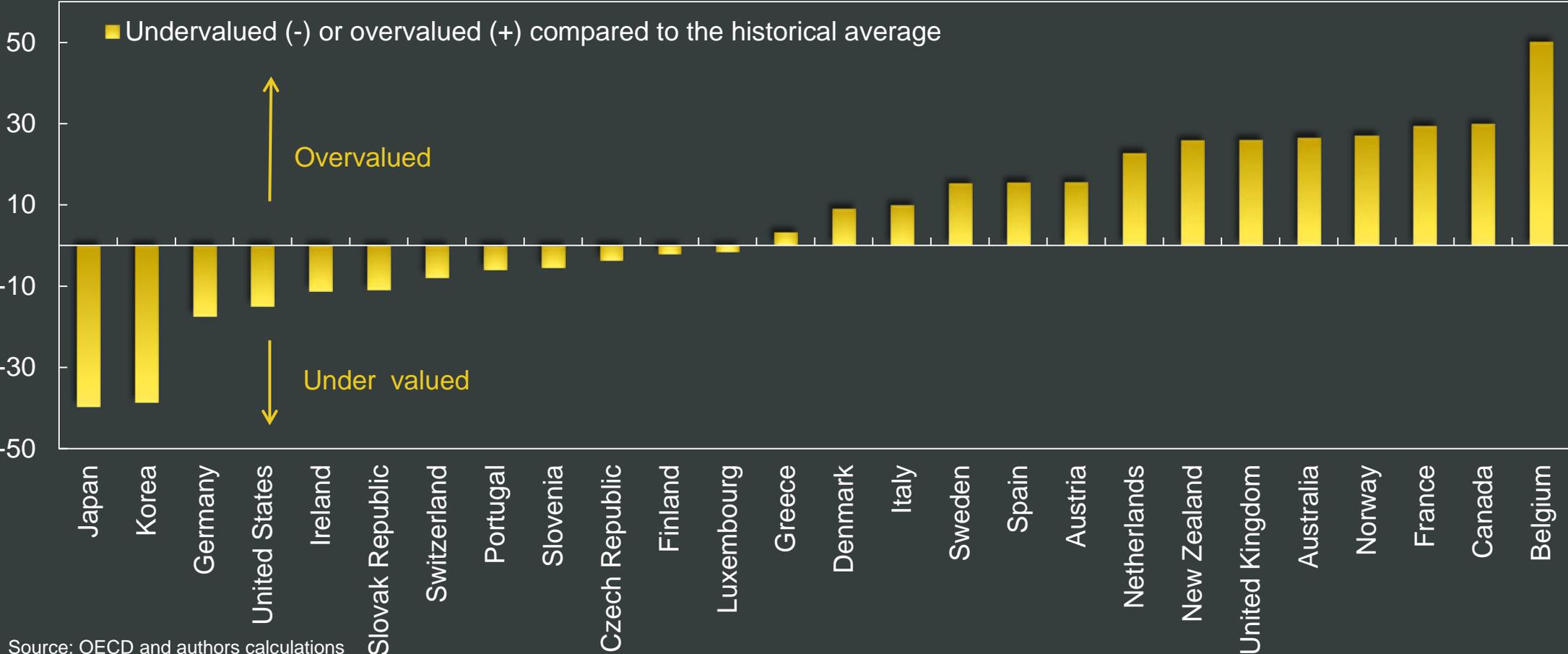
Magnitude of overvaluation or undervaluation in house price-to-rent ratio



Source: OECD and authors calculations

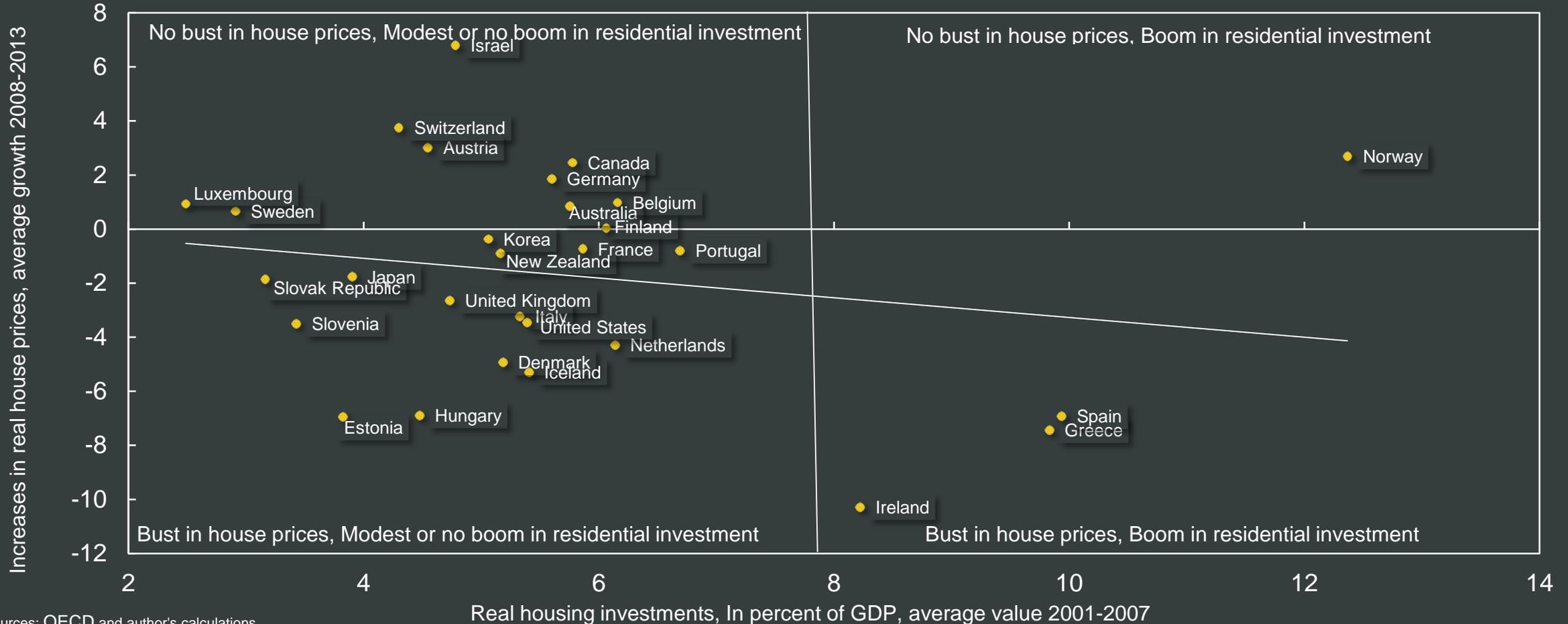
... as do many price-to-income ratios

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



Although housing investment and house prices only relate to some degree...

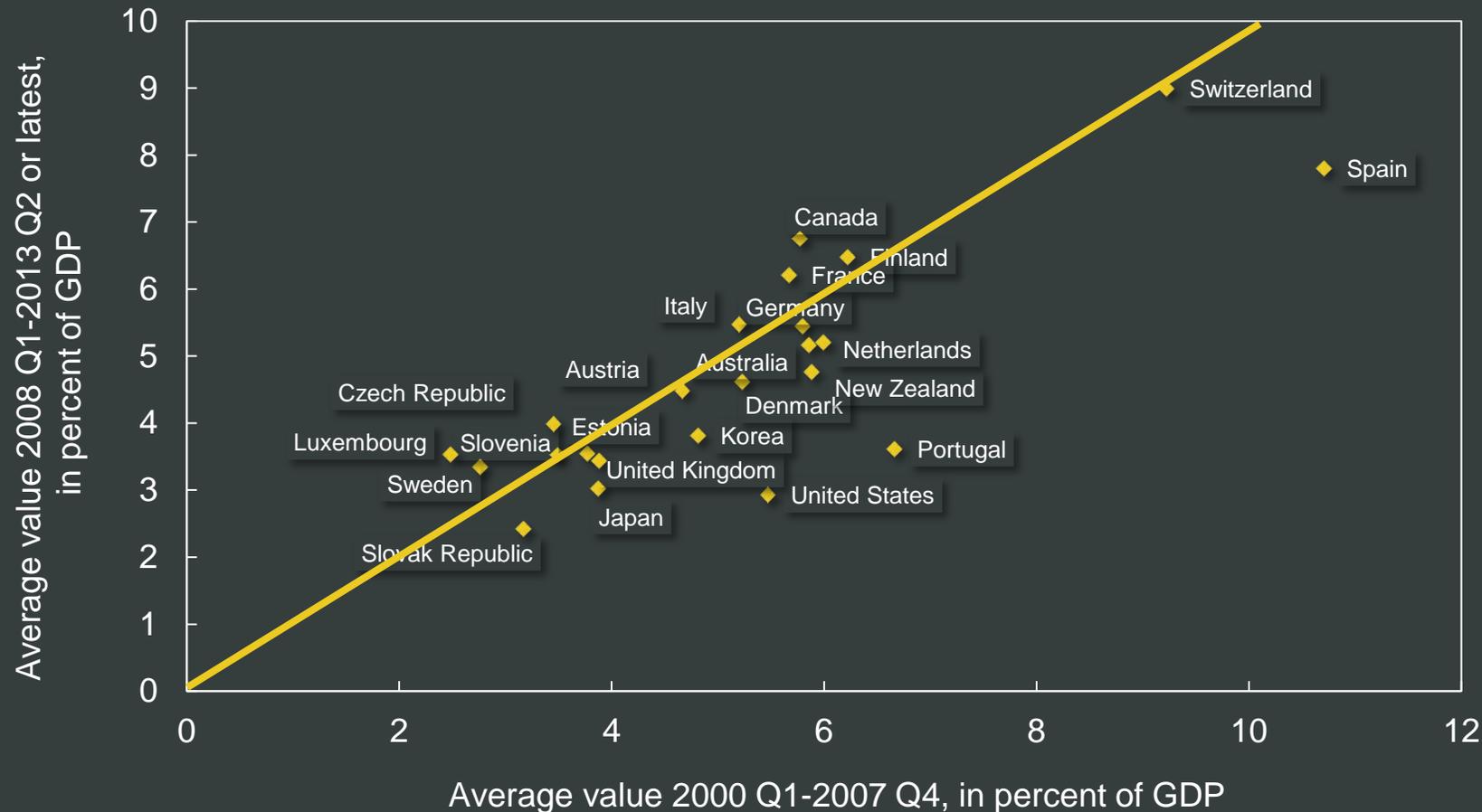
Housing investment and house price growth



Sources: OECD and author's calculations

...housing investment has generally still some way to recover

Housing Investment



Source: OECD and author's calculations

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?



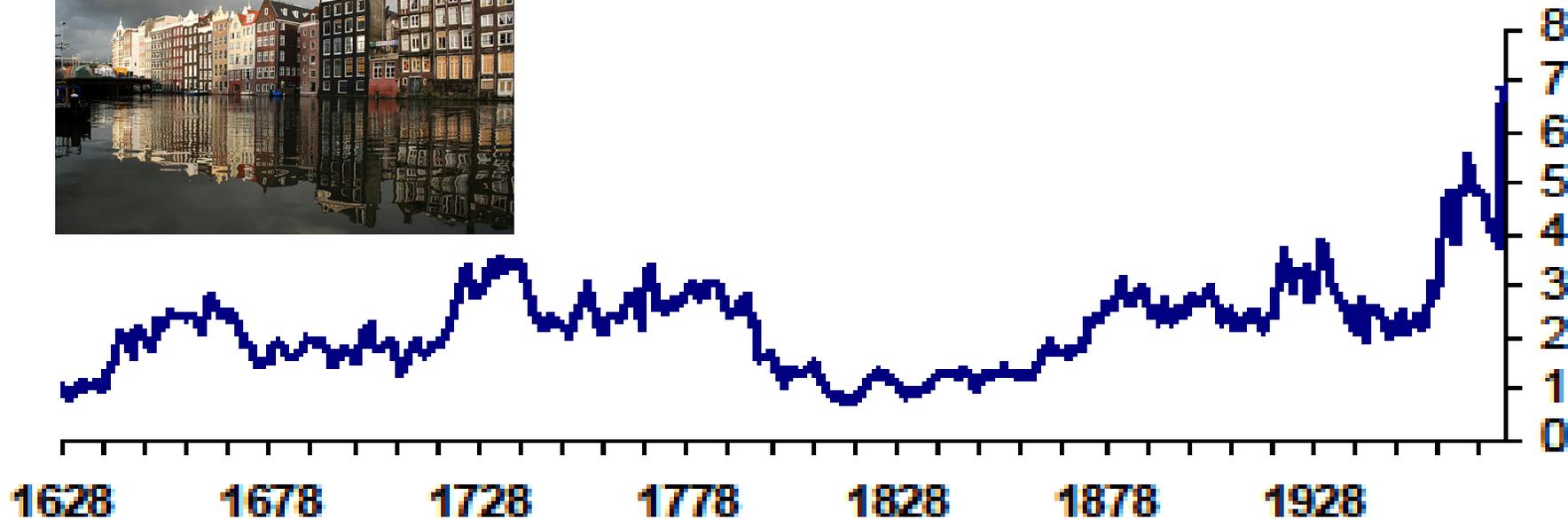
A short-term view suggest, prices go up for ever...

Exhibit 3: Annual Herengracht Location Value Index in Real Terms (1628 = 1)

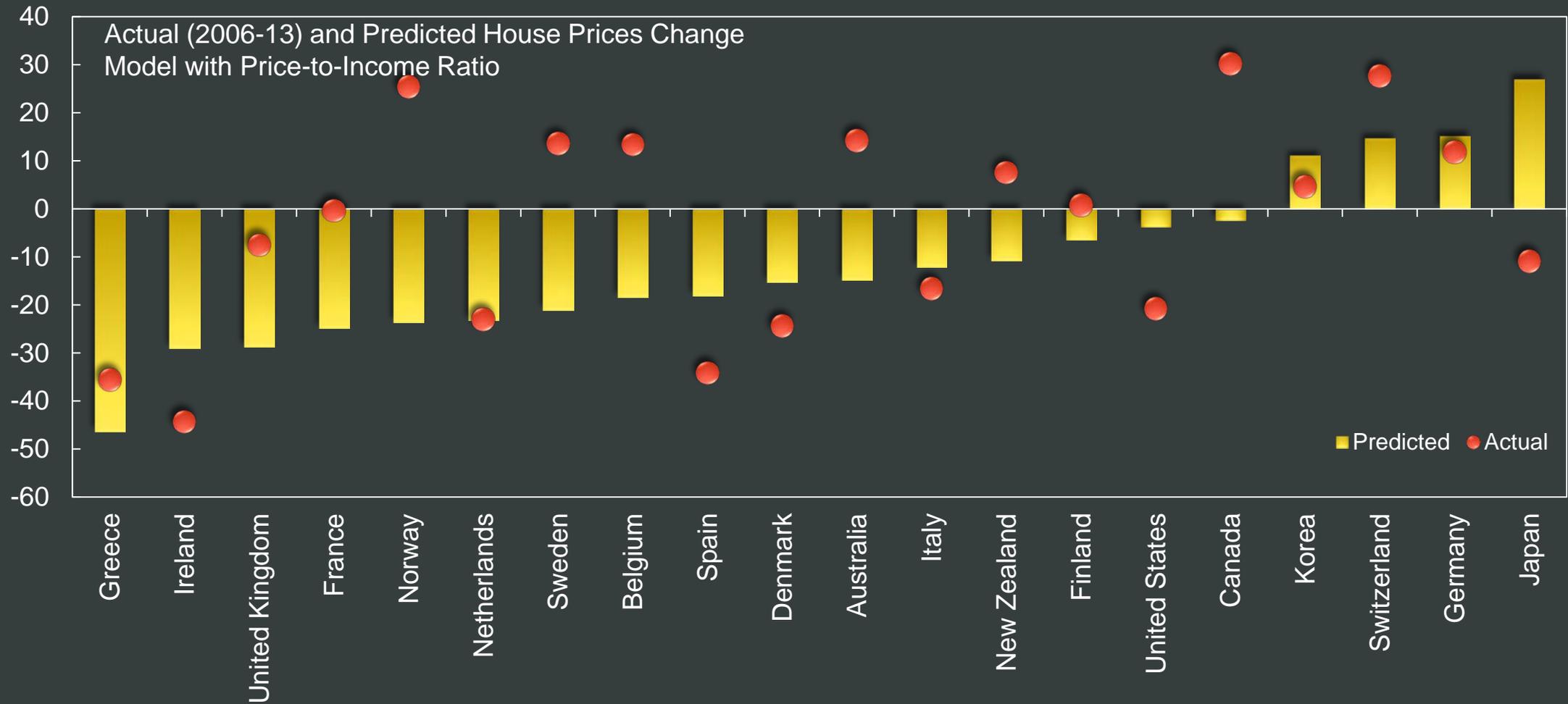


A very long view suggest, however, prices do not go up forever....

Exhibit 3: Annual Herengracht Location Value Index in Real Terms (1628 = 1)



Can we predict house prices? Only poorly... i.e., hard to pick (and prick) bubbles



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

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?

1. Monetary measures

2. Fiscal measures

Impact:

Potential to prevent booms, less so to stop one already in progress

Automatic stabilizer; reduce incentive for leverage

Side effects:

Inflict damage to activity and welfare

Impair already-slow price discovery process

Practical issues:

Identifying and reacting in time a challenge

Little room for cyclical; incentive to avoid by misreporting

Overall: what is the best tool?

3b. Macroprudential: Supply Side

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

Impact:

Increase cost of borrowing while building buffer for downturn

Potentially limit leverage and price appreciation; decrease default probability

Side effects:

Potential credit rationing; earnings management

Potential credit rationing (first time buyers); can worsen bust

Practical issues:

Data requirements and calibration

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"?

...more questions

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

