

House prices, financial stability and monetary policy

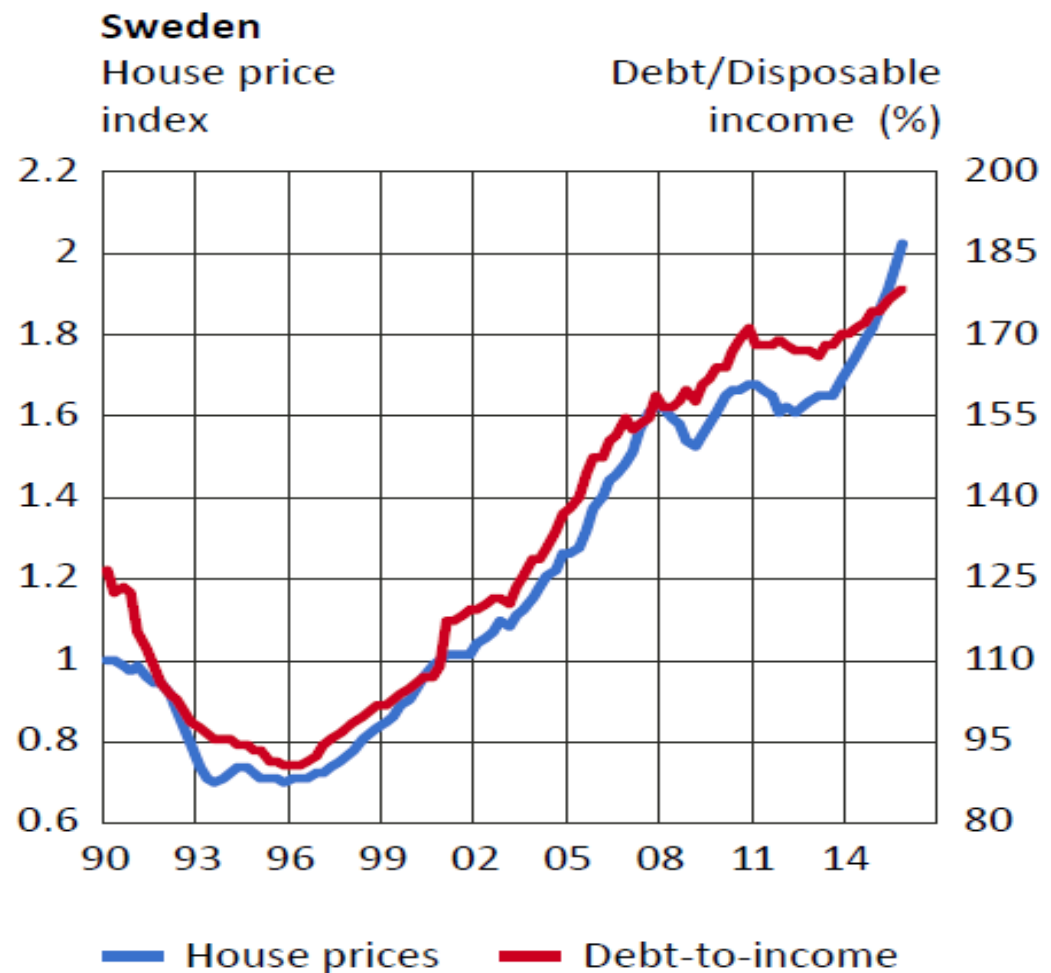
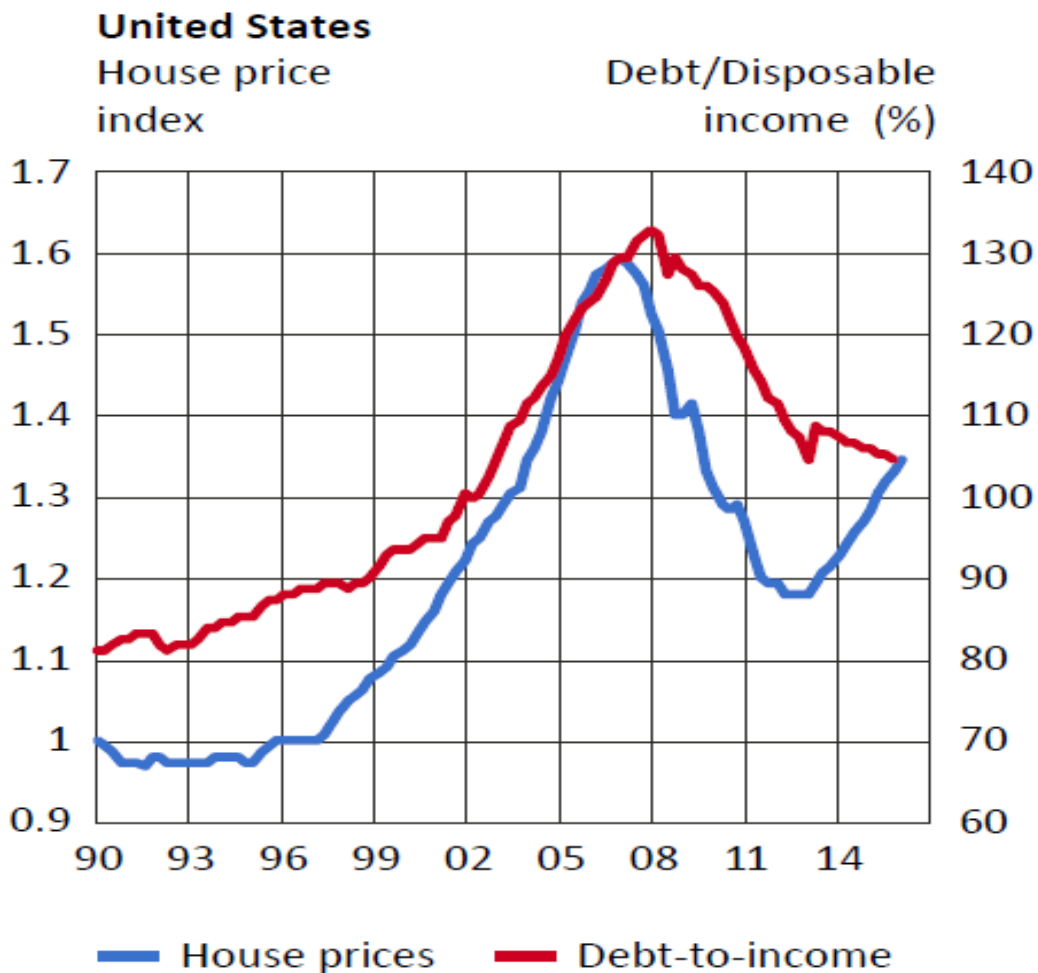
Jesper Linde

IMF

Disclaimer: Any views expressed in these remarks are solely my own and should not be interpreted as reflecting the views of the IMF or those of any other person associated with the IMF

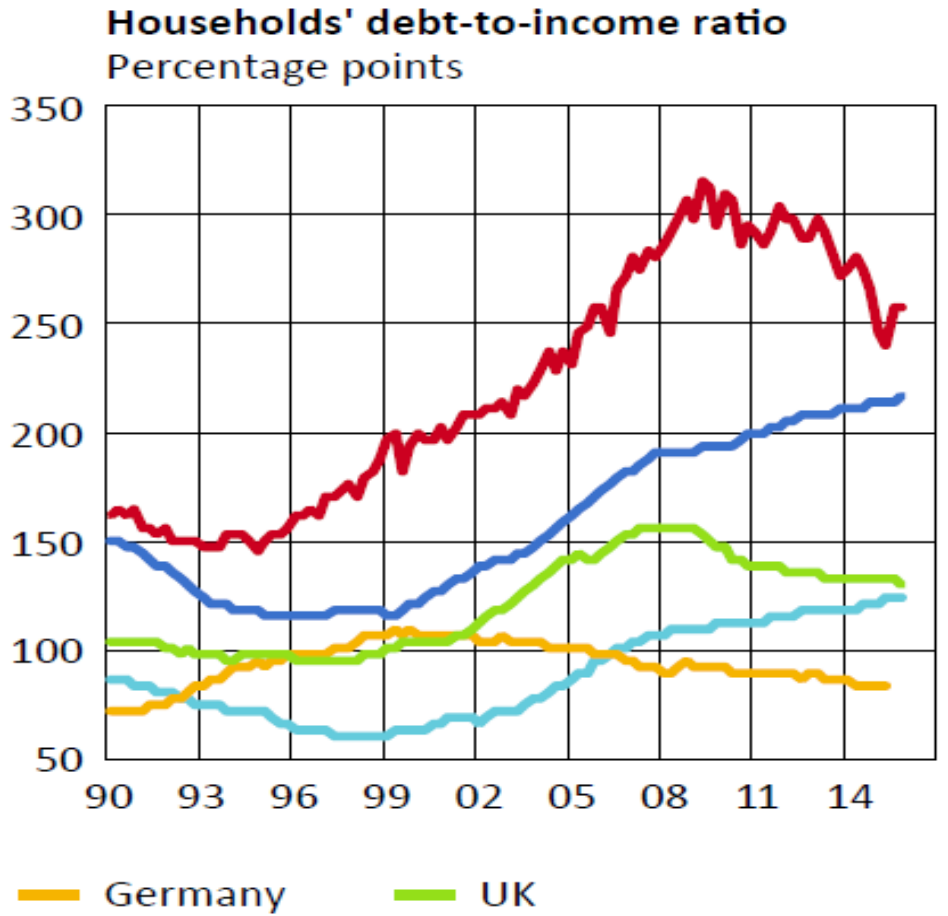
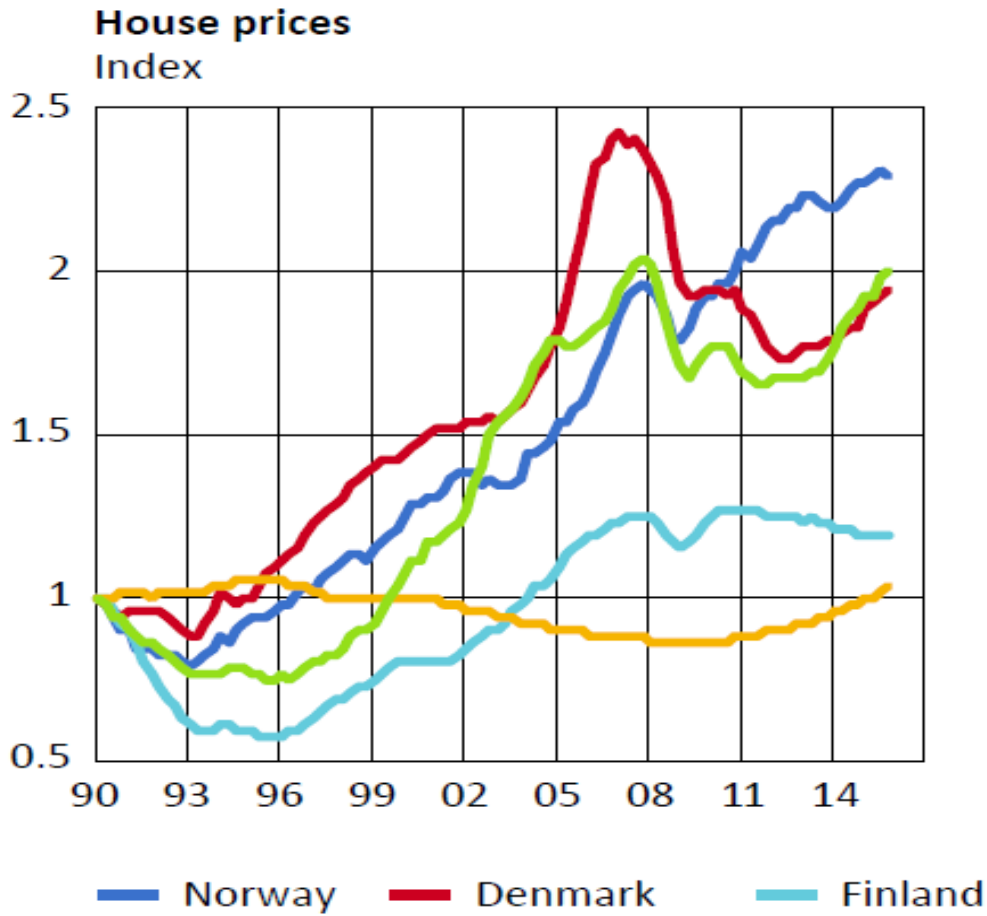
Background – housing boom-bust cycles...

Chart 1. House prices and household indebtedness in the United States and Sweden

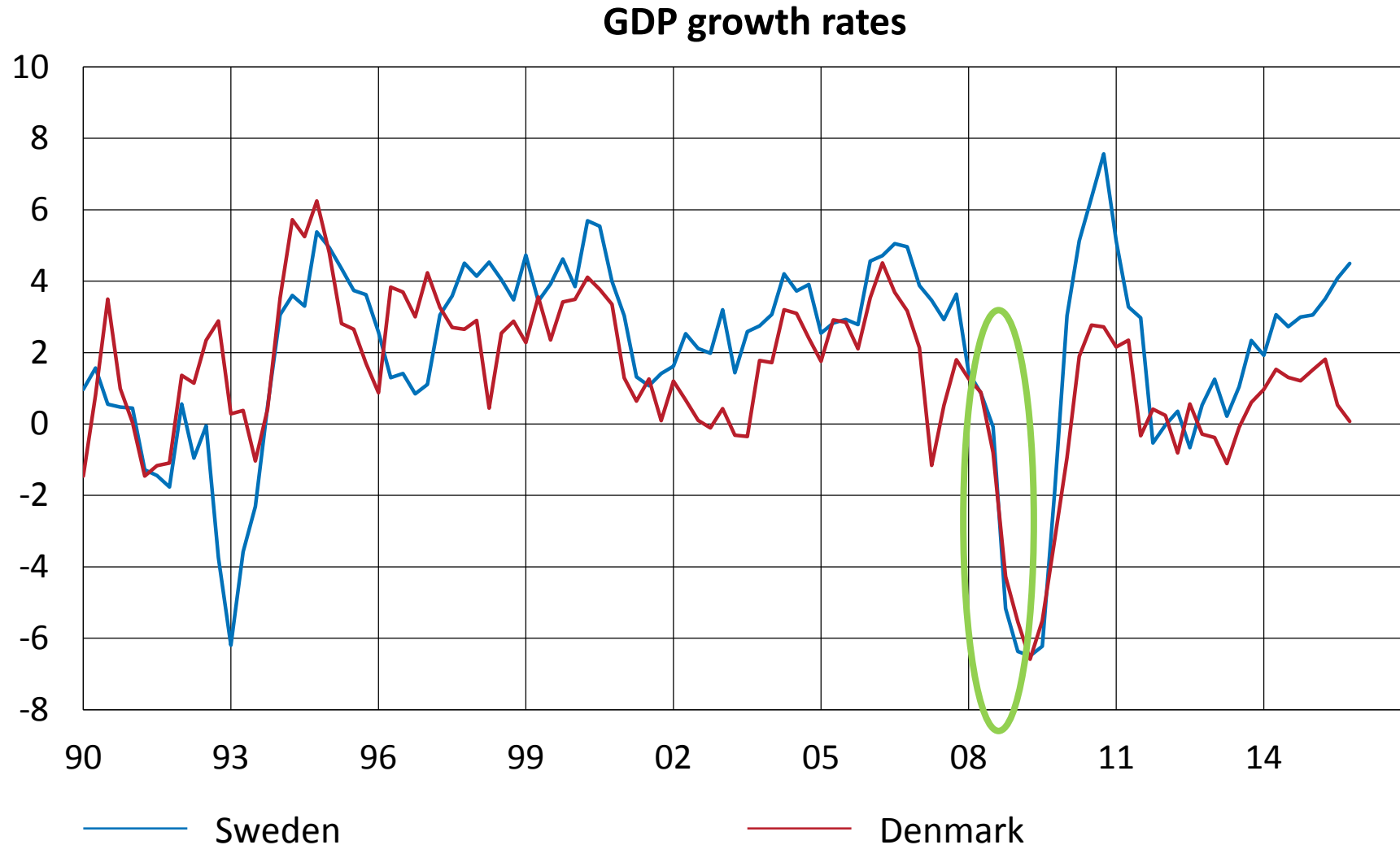


Background – housing boom-bust cycles...

Chart 3. House prices and household indebtedness in a selection of European countries

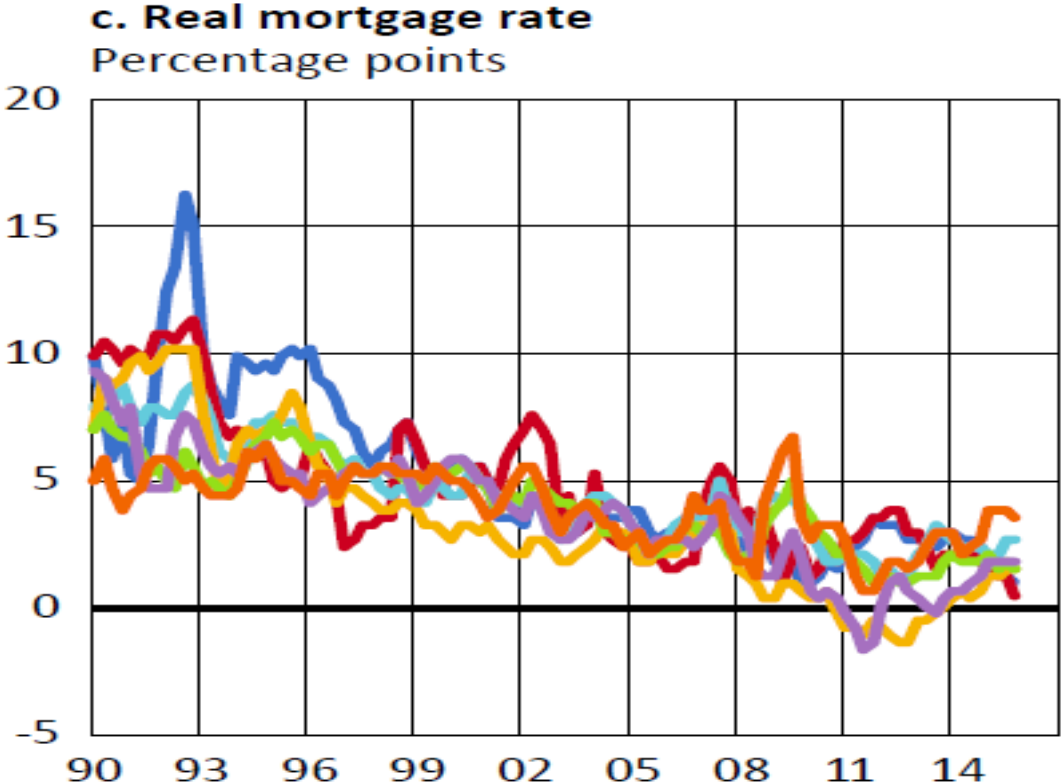
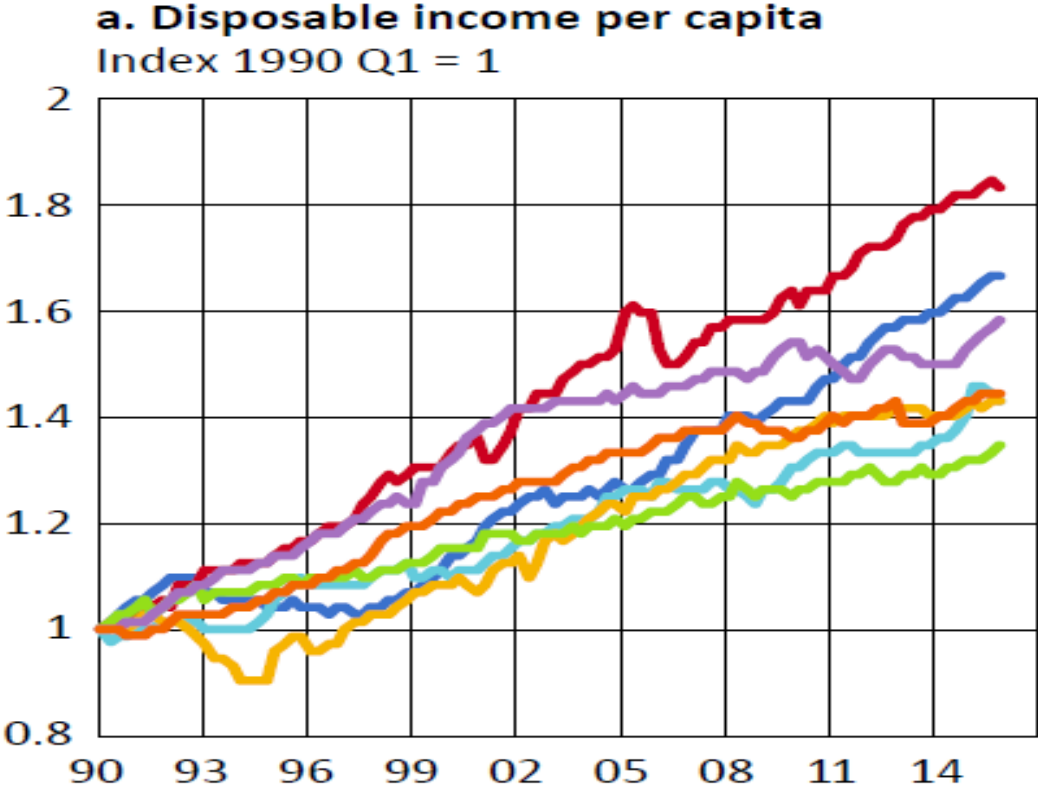


Output Costs of Housing Boom-Bust Cycles



Drivers of the housing-debt cycle

Chart 4. Data for the explanatory variables: 1990 Q1 – 2015 Q4



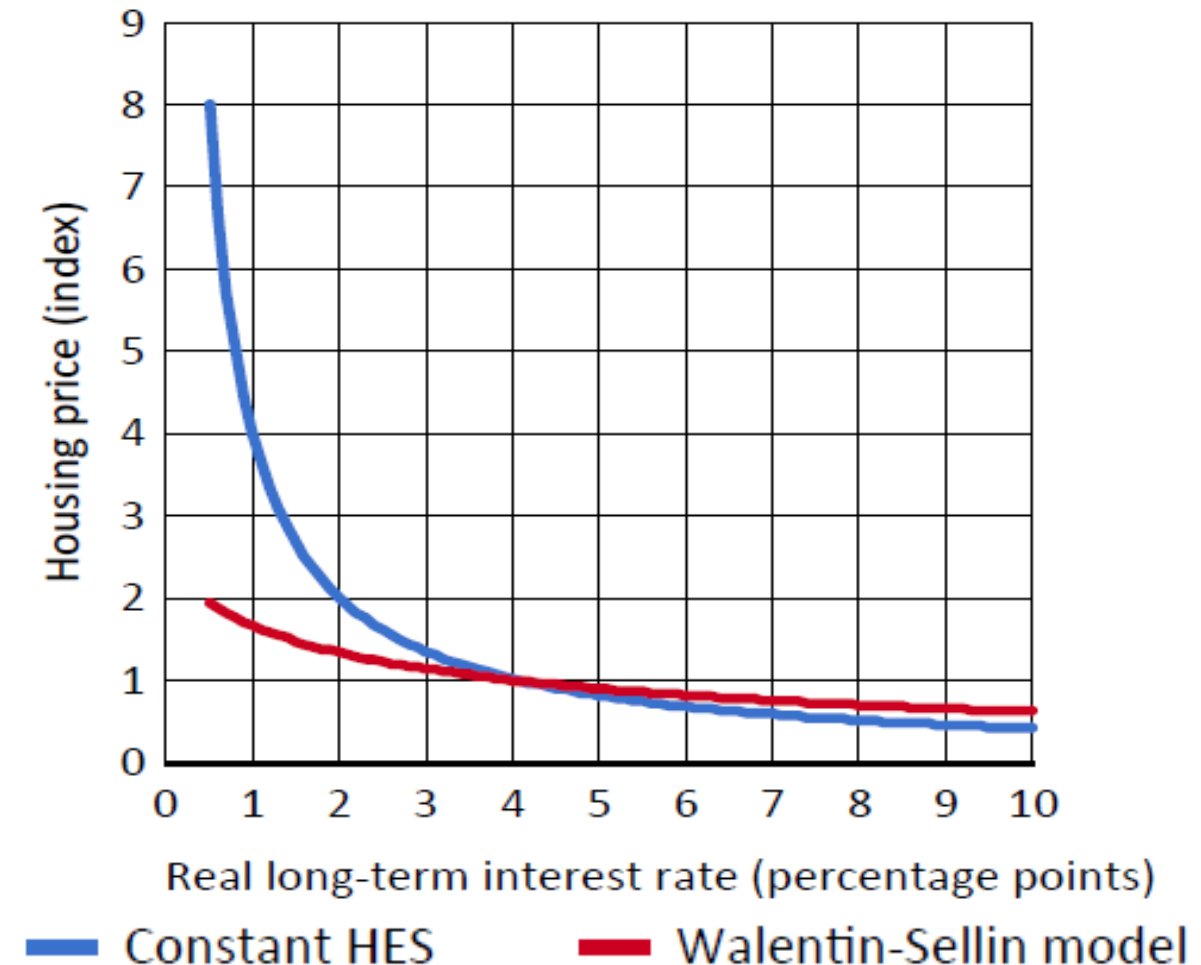
Sweden Norway Denmark Finland Germany
UK USA

Driver of the housing-debt cycle Cont.

- Standard assumption: Constant housing expenditure share (HES) in the long-term, i.e.

$$(3) \quad HES = \frac{r^* p^h \bar{h}}{y}$$

- Strong upward pull on housing price (p^h) when long-term real rate (r^*) falls and housing supply (\bar{h}) is unaffected (Constant HES)
- Effect notably smaller when supply h increases (Walentin-Sellin model)



The 2010-2014 Swedish Experience

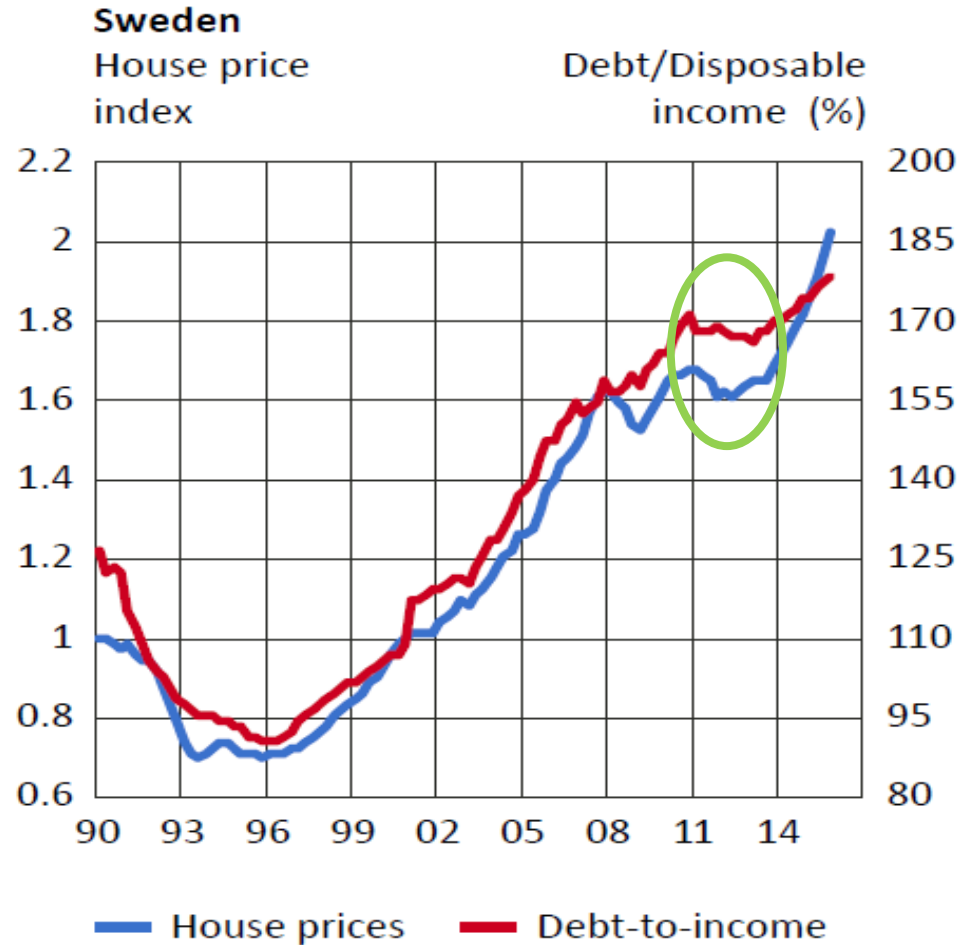
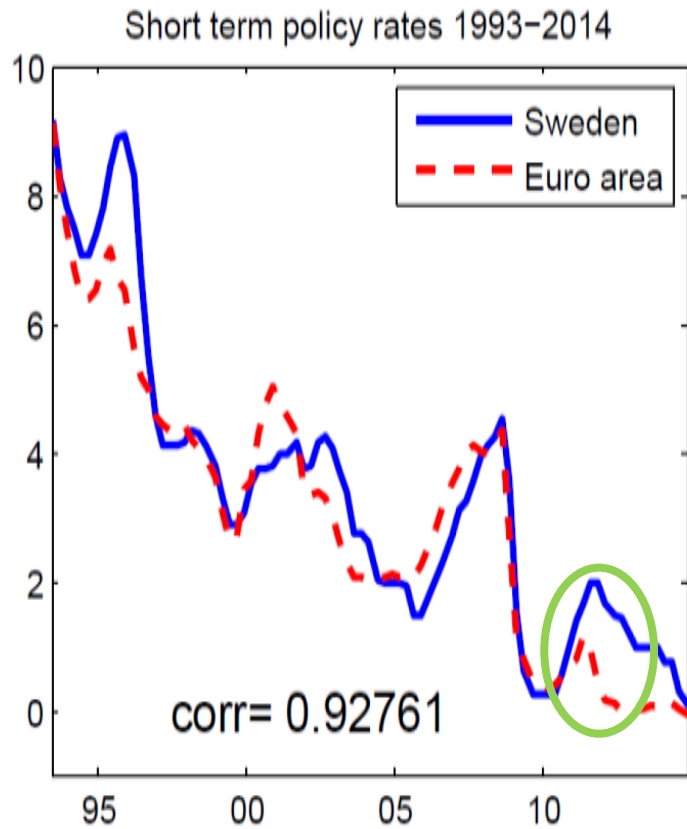
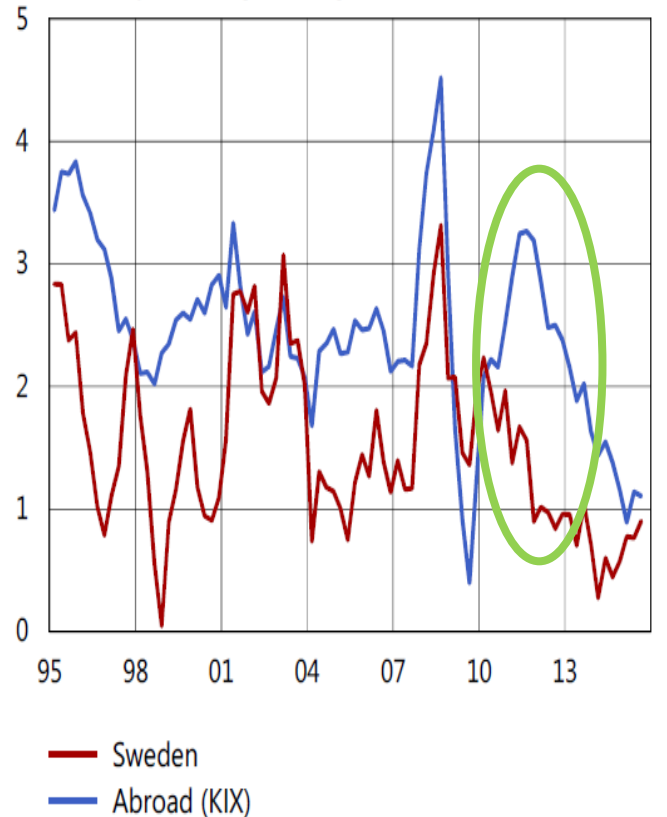


Figure 4:14. Inflation in Sweden and abroad
Annual percentage change



What Can be Done to Mitigate the Debt Cycle?

- This leads me to believe that the scope of monetary policy alone to stem the boom is limited in the current low inflation (and persistently low global real rate) environment
- Macroprudential (and fiscal) tools should instead be used to reduce the incentives and capacity for loan creation by households (to take up loans) and banks (to extend new loans)
- In the remaining, I want to discuss possible state-dependent effects of such policies.
- I also want to offer some thoughts on the merits of increasing the effective supply of housing.

Macroprudential actions

- Can in principle be implemented swiftly (given political support) – and some of them may potentially have strong near-term effects.
- However, if actions too large, and come online when households are already highly leveraged, they can force a deleverage cycle among indebted households with potentially large adverse effects on the economy.
 - Many households near their borrowing capacity, ZLB/CU-membership and limited fiscal space serve as channels to magnify negative spillovers.
- Importantly, papers assessing the impact of macropru tools have generally not taken these non-linearities into account.
 - As a consequence, the effects of large actions on housing prices and household indebtedness may be underestimated in current work.
- In sum, important to size Macropru properly (and act!).

Supply side actions

- While various macroprudential policies should be pursued in the near-term, they should be complemented by attempts to increase the effective housing stock. This includes
 - Policies that increase incentives to use existing housing stock more efficiently.
 - Policies that increase the size of the housing stock itself.
- In some countries, like Sweden, this goes together with large public infrastructure investments.
 - OK from fiscal perspective as long-term interest rates are record low (cheap for the government to borrow), and by increasing potential output they should not cause elevated output gaps.
- Also, with forward-looking households, credible supply reforms should have some notable near-term effects on prices, and create some policy space to implement macroprudential changes more gradually.