

Press Points for Chapter 3: *The Changing Housing Cycle and Its Implications For Monetary Policy*

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Key Points

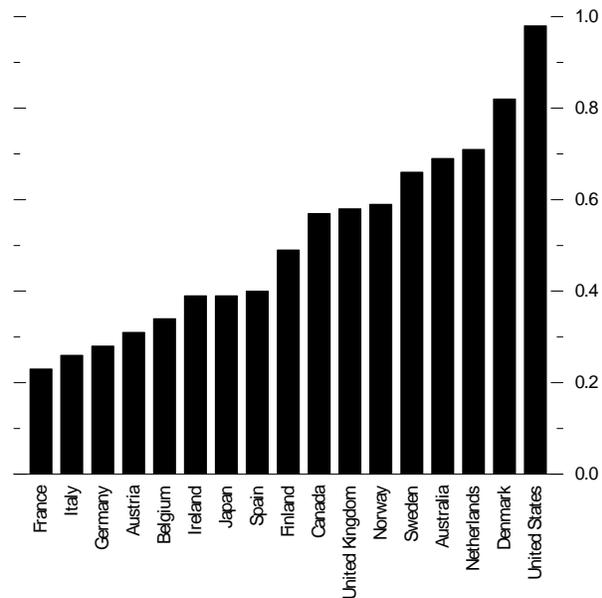
- **Housing finance innovations have made it easier for households to gain access to mortgage credit, and have also increased the exposure of economies in advance countries to developments in the housing markets.**
- **A monetary policy approach that responds to extreme house price movements within a broader risk management framework may help smooth the impact of the housing sector on the economy, especially when the household sector is more leveraged. However, policy should not target specific housing price levels.**

Chapter 3 of the WEO examines how innovations in the systems of housing finance in advanced economies over the past two decades have altered the role of the housing sector in the business cycle and in the monetary policy transmission mechanism.

The chapter shows that there are significant cross-country differences in the institutional characteristics of mortgage markets, which may contribute to explaining the large variation in the stock of household mortgage debt. The United States, Denmark, Australia, Sweden and the Netherlands appear to have the most “developed” mortgage markets, while countries in continental Europe tend to rank at the lower end, suggesting that mortgage markets in these countries provide less easy access to financing (Figure 1).

Figure 1. Mortgage Market Index

(Index values from 0 to 1; higher values indicate easier household access to mortgage credit)



The chapter finds that the spillovers from the housing sector to the rest of the economy are larger in economies where it is easier to access mortgage credit (Figure 2). This is because the larger use of homes as collateral in such economies strengthens the feedback effect of rising house prices on consumption via increased household borrowing.

Recent innovations in housing finance markets have generally increased the impact of monetary policy on house prices.

More flexible and competitive mortgage markets have amplified the impact of monetary policy on house prices and thus, ultimately, on consumer spending and output.

Easy monetary policy at the beginning of the current decade seems to have contributed to the run up of housing prices and residential investment in the U.S., although its effect was probably amplified by the loosening of lending standards and excessive risk taking by lenders.

Chapter 3 suggests that the conduct of monetary policy needs to take into account the level of development of mortgage markets. In particular, the chapter suggests that in economies with higher household mortgage debt, stabilization outcomes could be improved if monetary policy makers respond more aggressively to movements in house prices, particularly when house prices move rapidly or out of line with normal valuation ranges. Such an approach could be pursued in a broader risk management approach to monetary policy, and would need to be applied symmetrically.

These suggestions, however, do not extend to a recommendation that monetary policy should target house prices. Given the uncertainty surrounding both the shocks hitting the economy and the effects of interest rates on asset-price bubbles, house prices should be one of the many elements to be considered in assessing the balance of risks to the outlook, within a risk-management approach to monetary policy. Moreover, monetary policy alone cannot bear the full weight of responding to possible assets price bubbles; regulatory policy has a critical role to play in guarding against an inappropriate loosening of lending standards that may fuel extreme house price movements.

Figure 2. Correlation between the Share of Output Variation Explained by Housing Demand Shocks and the Mortgage Market Index
(Percent, at eight quarters, 1983–2007)

In countries with more developed mortgage markets, housing demand shocks tend to explain a larger share of output fluctuations.

