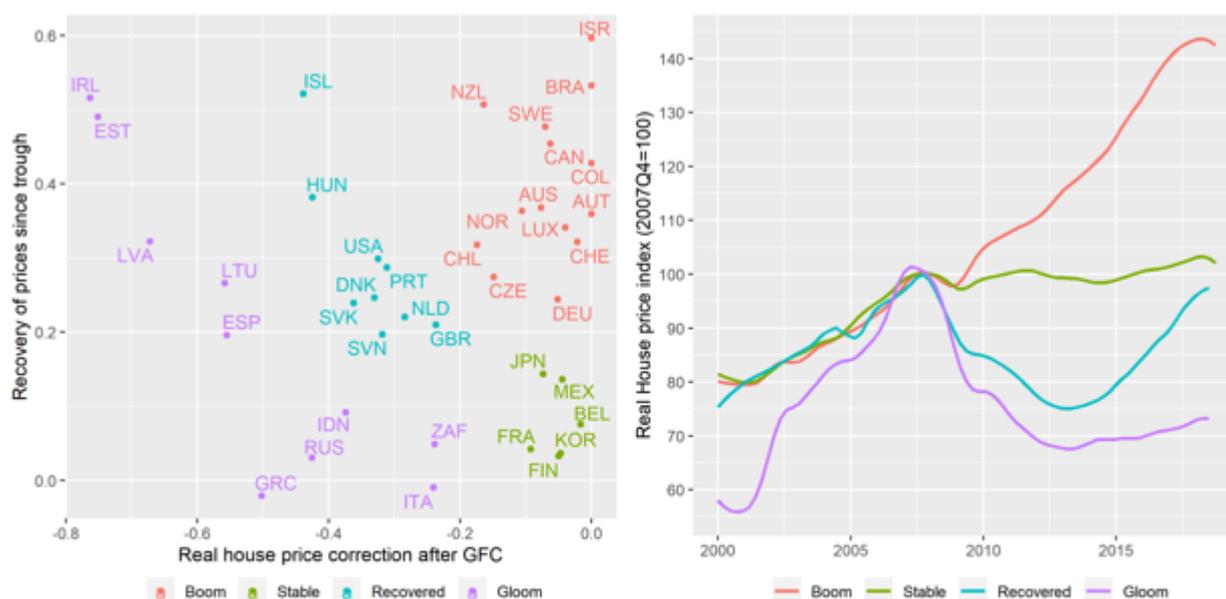


Are there ways to protect economies against potential future housing busts?

by Boris Cournède, Maria Chiara Cavalleri, Volker Ziemann, OECD

Housing, a large and volatile sector, is often at the centre of economic crises, as a trigger or amplifier. The current situation, which is characterised by house prices approaching or exceeding pre-crisis levels in many countries, raises questions as to whether these price levels may be indicative of a possible impending correction and what can be done to reduce housing-related macroeconomic risks.

Figure 1. House price developments since the global financial crisis



Note: The right panel depicts average price movements per country group using local regression techniques. "Boom" and "Stable" countries encountered a limited prices correction (<20%) during the global financial crisis. The former witnessed sharp increases thereafter (>20%) and the latter did not. "Recovered" and "Gloom" countries experienced a major real house price correction during the crisis (>20%). The former benefited from an equally strong rebound while the latter did not.

Source: Cavalleri, M. C., B. Cournède and V. Ziemann (2019), "Housing Markets and Macroeconomic Risks", *OECD Economics Department Working Papers*, No. 1555, OECD Publishing, Paris.

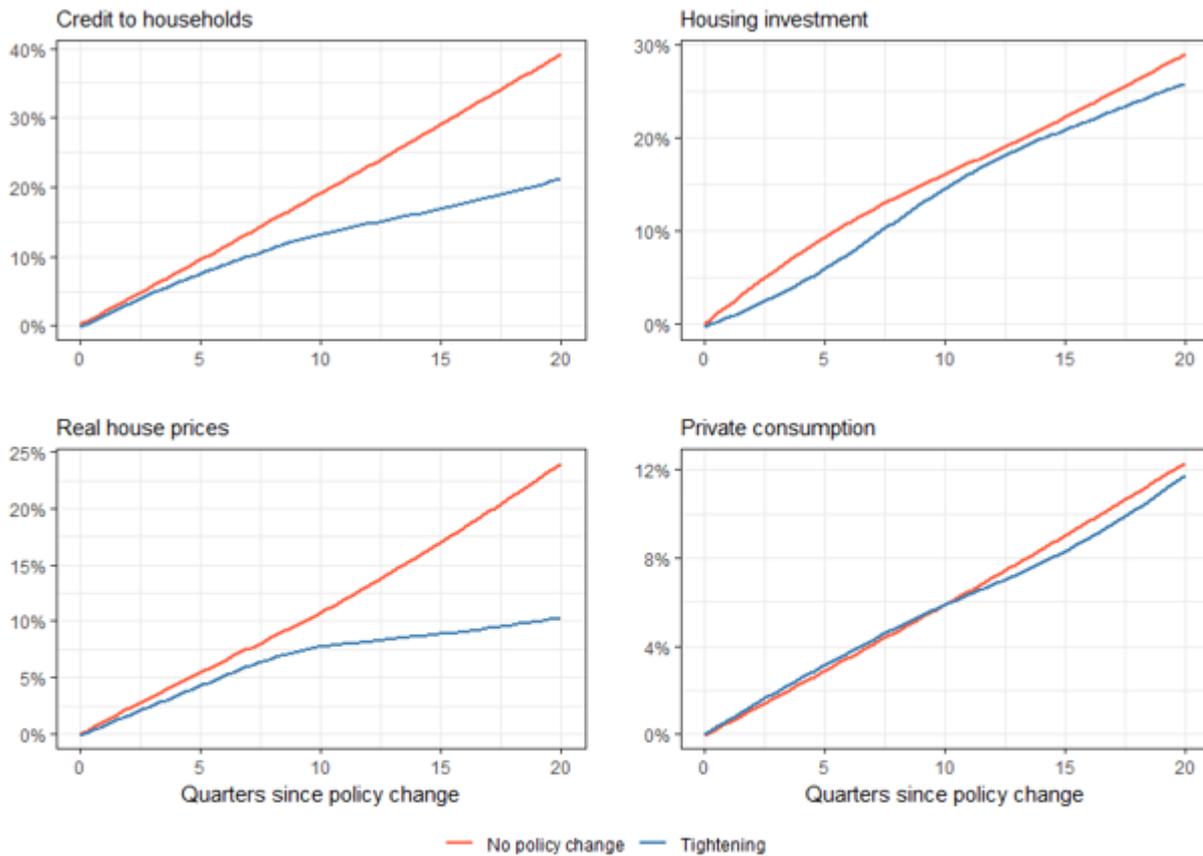
The OECD has been developing models that allow assessing to

which extent economic trends associated with housing booms, such as steep house price increases or strong debt expansion, can fuel the risk of a severe economic downturn (Turner, Chalaux and Morgavi, 2018). About half of the countries covered by the models are estimated to face real yet limited risks (above 20% but below 30%) of experiencing a severe downturn over the medium term, with housing trends playing a significant role." Model results suggest that housing booms can fuel crisis risk domestically but also across borders as a consequence of international financial links (Cavalleri, Cournède and Ziemann, 2019).

Countries can reduce housing-related risks in particular by:

- Capping the size of loans relative to house prices. New evidence suggests that such caps are capable of containing house prices and mortgage lending incurring limited economic cost (Figure 2): housing investment is only marginally reduced and there is very little effect on consumption. Tighter loan-to-value ratios are also linked with a lower risk of severe downturns.
- Limiting the size of loans relative to income. This measure holds promising potential but has been seldom used so far, which means there is little scope yet to evaluate it ex post.
- Tightening bank capital requirements for riskier housing loans. Measures of this nature are linked to more moderate output fluctuations and stronger recoveries after downturns.
- Reducing the tax advantages given to housing assets. Higher effective taxation of housing assets (which can come from higher property taxes or lower income tax breaks for housing) favours smoother housing cycles.

Figure 2. Effect of tightening LTV caps



Note: The treatment group consists of episodes where countries tightened their LTV caps at time=0. The control group comprises episodes where countries did not implement such a policy change although their conditions were otherwise similar. This treatment group has been determined by propensity matching techniques using a probit model with real and financial variables as covariates. The lines show averages for each group.

Source: Cournède, B., S. Sakha and V. Ziemann (2019), "Housing Markets and Economic Resilience," *OECD Economics Department Working Papers*, forthcoming, OECD Publishing, Paris.

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Cavalleri, M. C., B. Cournède and V. Ziemann (2019), "Housing Markets and Macroeconomic Risks", OECD Economics Department Working Papers, No. 1555, OECD Publishing, Paris.

Turner, D., T. Chalaux and H. Morgavi (2018), "Fan Charts around GDP Projections Based on Probit Models of Downturn Risk", OECD Economics Department Working Papers, No. 1521, OECD Publishing, Paris.