Comments on
Real Estate Markets:
Recent developments, outlook, financial stability risks

Prakash Loungani
Johns Hopkins University
Comments

• Excellent work by ECB authors
  • Highlights clear risks in commercial real estate (CRE)
  • More sanguine about risks in residential real estate (RRE)

• My comments pertain to RRE

  1) Analytic toolkit to assess vulnerabilities is improving but challenges remain

  2) Effectiveness of macroprudential tools needs to be kept in constant review
     • Should monetary policy help in the boom phase?

  3) More attention needed to housing supply and distributional issues ("affordability")
Analytic toolkit to assess vulnerabilities

- Typical ‘macro’ approach
  - model house price growth in terms of fundamentals
  - residual growth can be a sign of “overheating”

- Difficult to establish relationships between house price growth and fundamentals
  - Panel results often ‘look good’ but country-by-country estimation challenging (Igan and Loungani, 2012)
  - Shifts in relationships and nonlinearities
    - e.g. non-linearities in relationships between interest rates and house prices highlighted by ECB authors
  - Difficult to measure supply factors driving house prices
  - Duca, Muellbauer and Murphy (JEL 2021) pointed out limited success of this approach in pinpointing vulnerabilities

- Useful that ECB supplements ‘macro’ approach with ‘micro’ data
  - Using loan-level data to conduct sensitivity analysis of household resilience
  - Monitoring lending standards in new loans
Effectiveness of macroprudential tools

- Macroprudential tools have become the ‘first line of defense’ against “overheating” RRE markets

- Assessment of effectiveness of these tools has been growing

- But still: tools seem to take ‘some of the froth off for a bit of time’
  - “significant challenges of limiting the pace of accumulation of imbalances” (ECB)

- Should monetary policy be helping out during the boom phase?
  - “there are strong complementarities between monetary and macroprudential policies, such that where both monetary and macroprudential policies are used actively, overall policy effectiveness is enhanced relative to a world in which any one policy acts without the support of the other” (Nier and Kang, BIS Paper No. 86, 2016).
Housing Supply and Distributional Issues

• Are we trying to fix a supply issue with demand management tools?

• Several studies point to importance of supply constraints in driving house price appreciation
  • e.g. IMF report on Canada, 2019 (“To Tackle Housing Affordability in Canada, Build More Houses”)

• Expanding supply can help with distributional issues
  • “their beneficial impact on financial stability apart, borrower-based [macroprudential] measures may also have ‘undesirable’ distributional effects given that they may limit access by younger or poorer households” (ECB authors)
Housing affordability in US, by income level
(Source: Aziz Sunderji, Home Economics)

An increasing fraction of households at each income level are housing-burdened
Percentage of households within each income band who are spending more than 30% of their gross income on housing

**OWNERS**

- < $20k: [Graph showing percentage]
- $20-34k: [Graph showing percentage]
- $35-49k: [Graph showing percentage]
- $50-74k: [Graph showing percentage]
- $75k+: [Graph showing percentage]

**RENTERS**

- < $20k: [Graph showing percentage]
- $20-34k: [Graph showing percentage]
- $35-49k: [Graph showing percentage]
- $50-74k: [Graph showing percentage]
- $75k+: [Graph showing percentage]

38% of renting households earning $50-74k are housing-burdened

Source: Census Bureau, American Community Surveys, 2006-10 through 2018-22, via NHGIS
Housing affordability in US, by county
(Source: Aziz Sunderji, Home Economics)