Unintended Consequences of QE: Real Estate Prices and Financial Stability

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The views expressed in this paper are those of the authors and do not necessarily reflect the views of Deutsche Bundesbank or its staff.

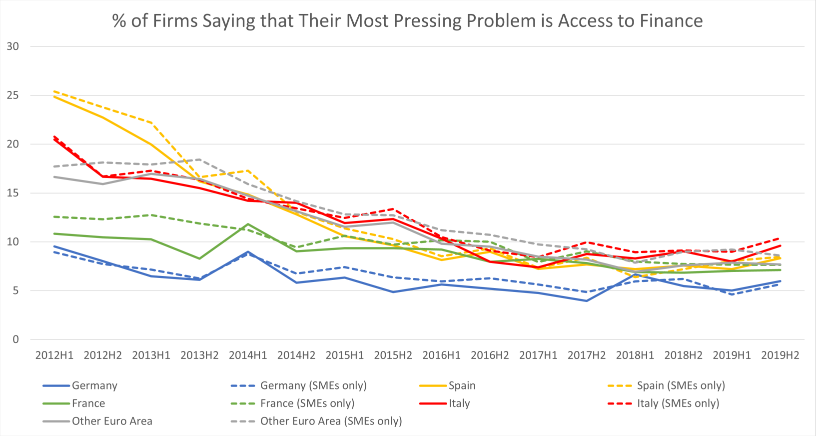
Motivation: The Corporate Sector Purchase Programme

- Announcement in March 2016, start of purchases in June 2016. Complemented by PEPP since March 2020.
- Eurozone IG-rated non-financial corporate bonds are eligible
- Rationale: Overcome credit supply frictions by providing credit directly to the real sector
- Holdings amount to €350bn at peek in 2022
  $\Longrightarrow$ 31% of the eligible universe
  $\Longrightarrow$ 7% of Eurozone bank lending to non-financial corp.
- Similar programs: Japan (2011), UK (2016), and U.S. (2020)

Credit saturated economies

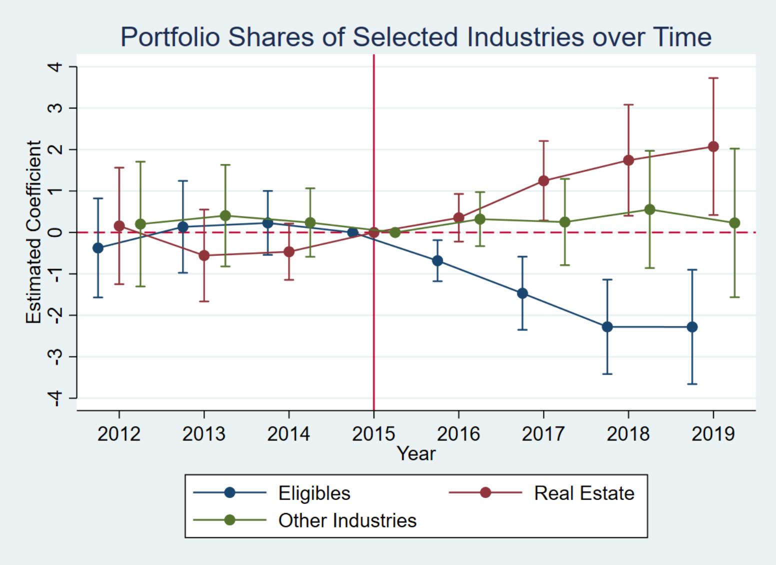
- What if the banking sector frictions these programs are supposed to address do not exist?
- Why important?
  $\Longrightarrow$ Heterogeneity within currency area
  $\Longrightarrow$ Unwinding of CSPP
- Our setting: Germany, 2012-2019
  $\Longrightarrow$ Pre-CSPP (i.e. in 2015), only 5% of German firms considered access to finance a problem
  $\Longrightarrow$ Unemployment rate low
- Method: Difference-in-difference, including Khwaja-Mian and Amiti-Weinstein estimators to isolate supply

Motivation: Germany as Credit-Saturated Market

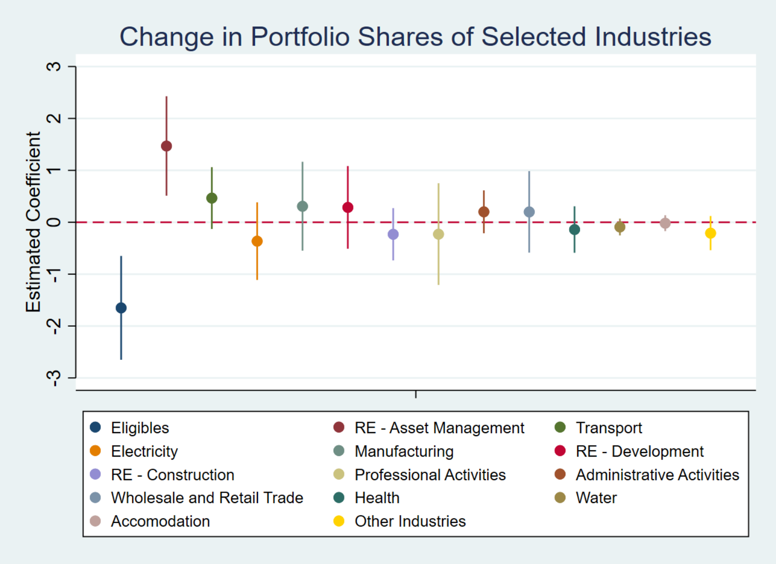


Source: ECB SAFE survey

Lending share of eligibles is entirely shifted to real estate

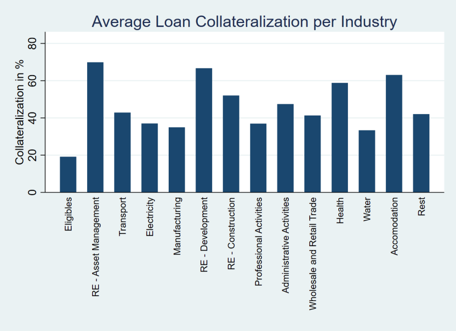


Within real estate sector funds go to RE asset managers



Discussion: Why Real Estate Asset Managers?

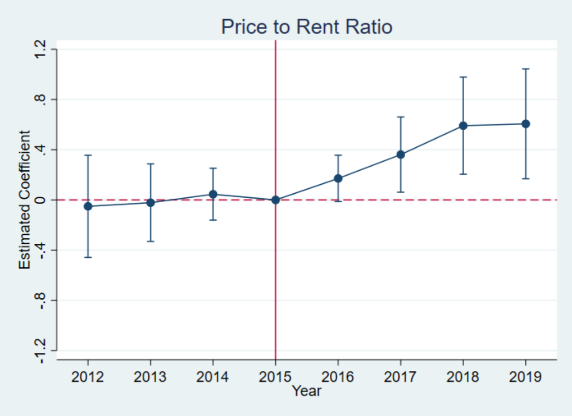
- Supply based argument: Attractive for banks to lend to due to high collateralization, i.e. low risk weight:



- Demand based argument: Real Estate asset managers can scale up their business easily (as opposed to e.g. project developers who depend on the construction industry)

- Other industries (i.e. construction industry) in Germany were operating at full capacity already prior to the CSPP

Real Estate Prices and (Over-)Valuation



- Approximately 1/5 of price increases explained by CSPP over our sample period (until 2019)
- High elasticity of housing prices to credit supply (Credit supply $\uparrow$ 1% $\Rightarrow$ Price $\uparrow$ 0.67%)

Results: Why Care?

- Same issues in multiple credit-saturated Eurozone economies:

23 September 2019

The European Systemic Risk Board (ESRB) has today published a set of country-specific warnings and recommendations on medium-term vulnerabilities in the residential real estate sector. The ESRB has a mandate to issue warnings when significant systemic risks are identified and to provide recommendations for remedial action to address such risks. The warnings were sent to the competent ministers of the following five countries: the Czech Republic, Germany, France, Iceland and Norway[1]. Similarly, the recommendations were sent to the competent ministers of the following six countries: Belgium, Denmark, Luxembourg, the Netherlands, Finland and Sweden[2].

- ECB very concerned about real estate prices (e.g. TLTRO series did not allow for lending to real estate sector)

Banking Sector Stability Impaired

- Riskiness of banks' loan portfolios increases
  (because ECB buys IG-rated bonds)
- Bank profitability decreases
  (increase in competition for remaining business)
- Reliance on real estate collateral increases
- Not (fully) cushioned by regulatory actions

Conclusion

Unintended side effects of ECB's Corporate Sector Purchase Program (CSPP) in credit-saturated economies

(1) Reallocation of lending entirely to real estate sector

(2) Fuels overvaluation
$\Longrightarrow$ high elasticities in saturated economies

(3) Impairs financial stability

Particular relevant in heterogeneous currency areas and when unwinding QE programs