

Monetary policy and regional price boom in Sweden

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Abstract

This study measures the heterogeneous effects of monetary policy on regional house prices in Sweden 1991–2002. We use a multivariate persistent shock metric to examine the impact of short-term interest rate on the property market. We also segregate the influence of interest rate shocks and influence of local shocks to capture their respective effects on regional price boom. We find significant regional effect of monetary policy on housing markets. Interest rate effects dominate the influence of local price innovations in the core economic regions in Sweden. We further discuss the monetary transmission channels and highlight political implications.

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1. Introduction

Over the last decade, the rapid and sustained escalation of home prices in Sweden has attracted a great deal of attention. From year 1991 through year 2002, house prices in Sweden increased by 1.5% per year in real level and 3.3% per year nominally. This large increase in house price has been associated with increases in household disposable income and with declining interest rates.³ According to the central bank of Sweden (Riksbank), from the beginning of 1990s, both

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³ See “Financial Stability Report”, 2005:1, Swedish Riksbank.

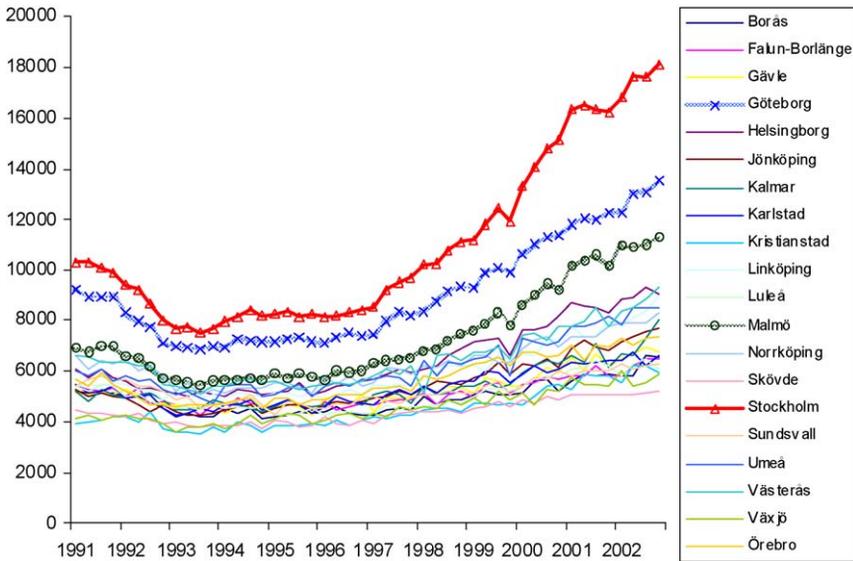


Fig. 1. Transaction house prices for 20 Local Labor Markets (LLMs) 1991–1992, by fiscal quarter. *Note:* more information on the LLMs can be found in Section 3.2.

short-term interest rate (6 months treasury bills) and long-term interest rate (5-year government bond) decreased dramatically in Sweden. During 1991–2002, nominal treasury bills decreased from 12.65% to 3.89%; while nominal 5-year government bond decreased from 10.52% to 4% over the same period. This stimulated household debt growing at a considerable high rate. The loans have been obtained largely to finance house purchase, in which more than 85% are secured with real estate. Consequently, the amount of debt has grown relative to disposable income significantly, the debt ratio to disposable income in year 2002 is around 100%, and it arrived at 145% by the end of year 2006.

However, at the regional level, the rise in house prices has been very uneven across the nation. Regional prices roughly follow national cyclical trends, but with large differences in amplitude and some differences in timing (Fig. 1). The same price level applies to many regions in northern and southern Sweden, with the largest city in each metropolitan region tending towards a higher price level. The price of housing in Stockholm is three times higher than the national average. In regions of small population like Norrbotten (in far north Sweden), house prices are only one-fifth of the average national level (Yang & Turner, 2004a).

Against this background, we consider two related research questions in this paper: (1) Should we expect monetary policy to have a homogeneous effect on housing prices across regions? (2) To what extent are recent regional prices boom related to changes in the level of interest rates? These two questions are critical to our understanding of the sources of risk for regional price volatility, and they have important implications for monetary policy.

Monetary policy is focused in this study also because policy makers have paid increasing attention to the housing sector. Swedish central bank in early 2006 decided to increase rate despite justified with an explicit reference to rising household debt and housing prices.⁴ House

⁴ See more information from Sveriges Riksbank (2006). “Repo rate raised by 0.25 percentage points,” press release, February 23.

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