



## Housing, consumption and monetary policy: How different are the US and the euro area? <sup>☆</sup>

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### ABSTRACT

This paper provides a systematic empirical analysis of the role of the housing market in the macroeconomy in the US and the euro area. First, it establishes some stylised facts concerning key variables in the housing market on the two sides of the Atlantic, such as real house prices, residential investment and mortgage debt. It then presents evidence from Structural Vector Autoregressions (SVAR) by focusing on the effects of monetary policy, credit supply and housing demand shocks on the housing market and the broader economy. The analysis shows that similarities outweigh differences as far as the housing market is concerned. The empirical evidence suggests a stronger role for housing in the transmission of monetary policy shocks in the US. The evidence is less clear-cut for housing demand shocks. Finally, credit supply shocks seem to matter more in the euro area.

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## 1. Introduction

The role of the housing market in the business cycle, especially in the US, has been the subject of considerable interest among academics even before, but especially in the wake of, the 2007–2009 financial crisis; for example, the topic of the 2007 Jackson Hole symposium held by the Federal Reserve Bank of Kansas City was the role of the housing market in modern economies (see in particular Mishkin, 2007 and Taylor, 2007). There are several questions that are of much interest for academics and policy-makers, among which three tend to stand out in the debate. First, the role of mon-

etary policy in affecting the behaviour of residential investment and house prices, as opposed to other, possibly non-fundamental, factors that drive house prices up and down, such as bubbles. This role is particularly relevant in the present circumstances as very low nominal and real interest rates in the first half of the decade may have been an important determinant of soaring house prices in the US and elsewhere. Second, the role of the mortgage market in affecting and possibly amplifying the effect of changes in house prices (in turn due to both monetary and non-monetary factors) on consumption, residential investment and overall economic activity through some sort of financial accelerator mechanism. Third, the impact of housing market corrections on financial stability.

The role of the housing market in the macroeconomy was particularly prominent in the 2007–2009 financial crisis. Fig. 1 shows that the drop in activity, much more so in the US than in the euro area, was concentrated in residential investment, while consumption slowed down to a much lesser extent both in the US and the euro area. Although there is still controversy about the precise mechanism through which the correction of US housing prices triggered the crisis and the recession, it is clear that the housing market was, this time, the epicentre of the crisis.

Shocks that affect house prices and the conditions at which mortgage credit is extended are therefore at the heart of the current policy discussion. Our paper aims to shed some light on the

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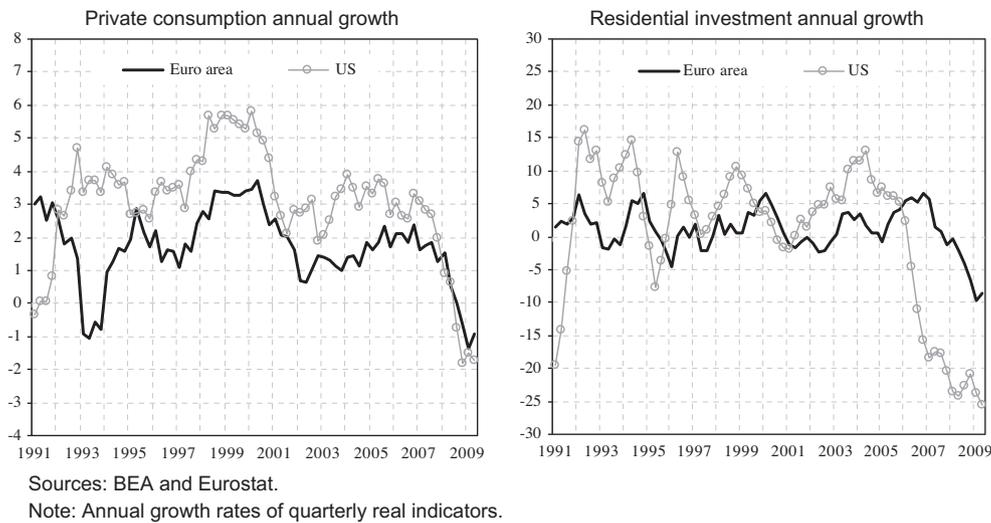


Fig. 1. Private consumption and residential investment growth in the euro area and the US.

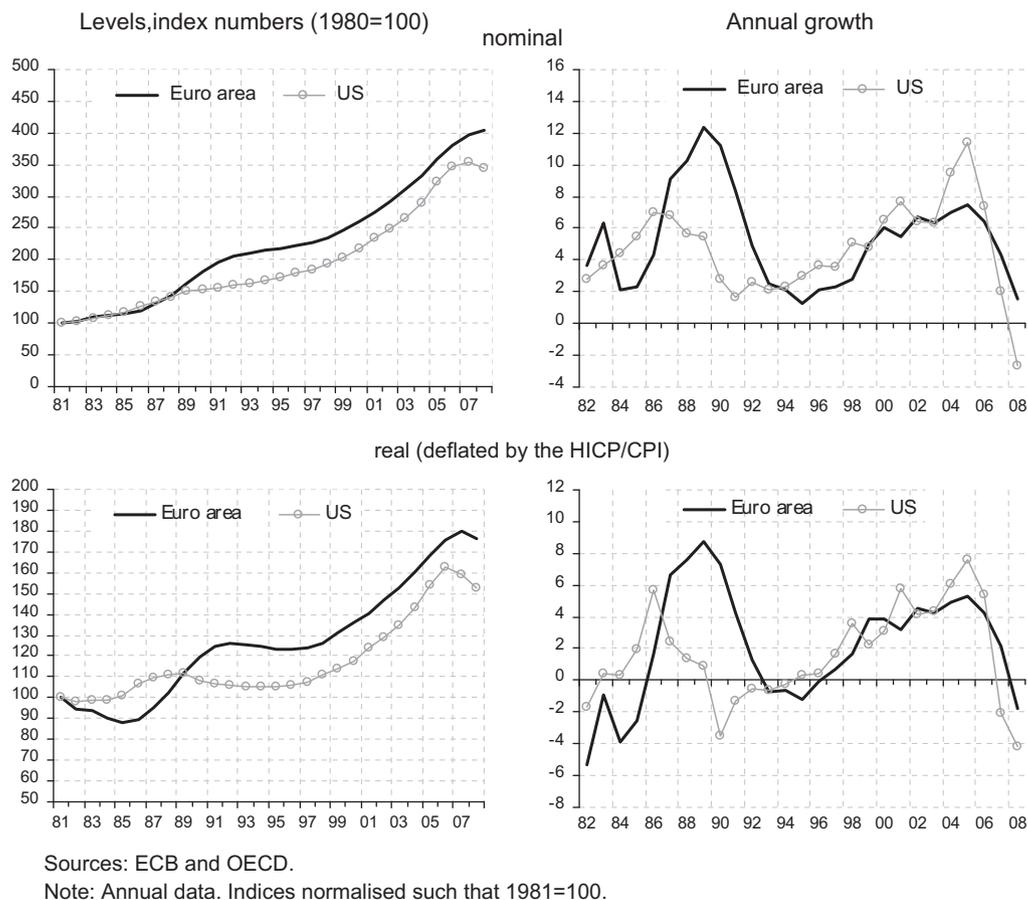


Fig. 2. Residential property prices in the euro area and the US.

transmission mechanism of housing and mortgage market related shocks on the two sides of the Atlantic. Indeed, although much of this debate concerns the US economy, it is notable that housing prices have also displayed rather strong dynamics on the other side of the Atlantic in the run up to the financial crisis. Fig. 2 reports the behaviour of an index of house prices in the US and the euro area up to 2008. While house prices remained stable in Germany over

the last decade, they increased strongly in the rest of the euro area, even more than in the US. In the euro area as a whole, the dynamics of house prices have been similar to the US.

In this respect, there are three notable differences between the euro area and the US as far as the housing market is concerned. First, land availability is more abundant in the US than in the euro area, which means that there should be fewer supply constraints in

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