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ABSTRACT

This paper investigates how monetary policy stance and mortgage market structure affect non-fundamental house price movements in eleven Euro area countries. Based on a three-stage approach, our empirical evidence suggests that a one-time monetary-easing shock can significantly trigger house price booms in Euro area countries with liberal mortgage markets. Such shocks can explain over 20% of the forecasting error variance of non-fundamental house price runups in Ireland and Spain. We find that, in countries with more regulated mortgage markets, monetary policy stance does not significantly affect non-fundamental house prices. Policymakers may wish to focus on limiting mortgage equity withdrawals and on monitoring loan-to-value ratios and tax policies in order to minimize the side effects of accommodative monetary policies on housing market stability for Euro area countries. We posit that this is especially true for peripheral countries, which are more likely to be subjected to overly loose monetary policy stances.

Keywords: House prices, Taylor rate, non-fundamental house price, mortgage market structure.

JEL classification: E4, R3.

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