

# Accepted Manuscript

International House Price Cycles, Monetary Policy and Credit

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PII: S0261-5606(17)30053-0

DOI: <http://dx.doi.org/10.1016/j.jimonfin.2017.03.003>

Reference: JIMF 1777

To appear in: *Journal of International Money and Finance*



Please cite this article as: G.H. Bauer, International House Price Cycles, Monetary Policy and Credit, *Journal of International Money and Finance* (2017), doi: <http://dx.doi.org/10.1016/j.jimonfin.2017.03.003>

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International House Price Cycles, Monetary Policy and Credit<sup>☆</sup>

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**Abstract**

We evaluate three alternative predictors of house price corrections: anticipated tightenings of monetary policy, deviations of house prices from fundamentals, and rapid credit growth. A new cross-country measure of monetary policy expectations based on an international term structure model with time-varying risk premiums is constructed. House price overvaluation is estimated via an asset pricing model. The variables are incorporated into a panel logit regression model that estimates the likelihood of a large house price correction in 18 OECD countries. The results show that corrections are predicted by increases in the market's forecast of higher policy rates. The estimated degree of house price overvaluation also contains significant information about subsequent price reversals. In contrast to the financial crisis literature, credit growth is less important. All of these variables help forecast recessions.

**Keywords:** House prices; monetary policy; term structure of interest rates; term premium; credit; recession.

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**1. Introduction**

The recent financial crisis has highlighted the importance of housing markets as both a source and a transmission channel of financial instability. Policy-makers have responded to the crisis with a number of innovative measures and a desire for better analytic tools

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<sup>☆</sup>I would like to thank Antonio Diez de los Rios, Eleonora Granziera, Sermin Gungor, Soojin Jo, Anthony Landry, Teodora Paligorova, Rodrigo Sekkel, Alexander Ueberfeldt, Jonathan Witmer and participants at the Bank of Canada seminar, the Computational and Financial Econometrics conference, the International Association of Applied Econometrics conference, and the INFINITI Conference on International Finance for their comments. I would also like to thank the editor and two referees for many excellent suggestions. Many thanks to Monica Mow and Graeme Westwood for excellent research assistance. Any errors are those of the author. The views expressed in this paper represent those of the author and do not necessarily reflect those of the Bank of Canada.

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