Credit expansion and boom-bust cycle of housing prices

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Abstract

This paper empirically tests for the channel through which credit supply expansion affects housing prices, using a dataset of an unbalanced panel of 20 OECD countries that covers the period from 1980 to 2019. We use Jordà' s (2005) local projection method to estimate impulse response functions of housing prices to the credit shock. An exogeneous expansion of credit growth leads to the boom in housing price growth in the short run and leads to the bust of housing price growth in the medium run. The cycle from boom to bust takes four or five years. This finding is established using Bartik-like instrument that is constructed by combining a country's measure of banking deregulation and conditions of global credit growth. Our result for the boom and bust suggests that the credit was excessively supplied, and contradicts with the rational expectation models. Impulse responses of interest rates also support that our identified shock is the credit supply shock rather than the demand shock. The estimated LP-IV shows deeper cycle of boom and bust than the estimators of SVAR.