Bank Lending and Property Prices: Some International Evidence

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Summary

Over the last couple of years, the coincidence of cycles in credit and property markets has been widely documented and discussed in the policy oriented literature. In this paper I analyse the causes of this coincidence. From a theoretical point of view, the relationship between bank lending and property prices is multifaceted. Property prices may affect credit via various wealth effects, while credit may affect property prices via various liquidity effects. Previous empirical studies were not able to disentangle the direction of causality, since the focus was usually on one of these effects, but not on both. This paper analyses the patterns of dynamic interaction between bank lending and property prices based on a sample of 20 industrialised countries using both time series and panel data techniques. Long-run causality appears to go from property prices to bank lending, rather than conversely. This finding suggests that property price cycles, reflecting changing beliefs about future economic prospects, drive credit cycles, rather than excessive bank lending, in the wake of financial liberalization or overly loose monetary policy, being the cause of property price bubbles. However, there is also evidence of short-run causality going in both directions, implying that a mutually reinforcing element in past boom bust cycles in credit and property markets cannot be ruled out.