The Effect of Monetary Policy on House Prices (Discussion)

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This paper

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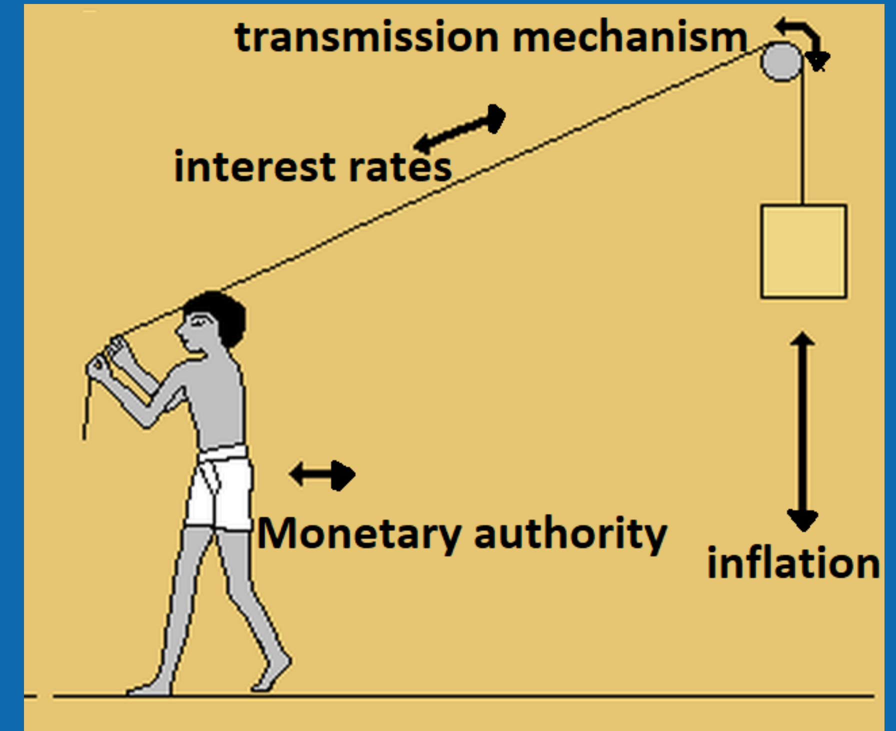
- Explores 31 papers, which use the VAR models to estimate the relationship between interest rates and house prices
- All examined papers find a relationship between the two variables but they differ greatly in terms of the estimated size of effect
- Tests (using SOA meta analysis methods) - and confirms - the presence of “publication bias”. However, even when the bias is controlled for, the relationship is still present
- Discusses the sources of heterogeneity (eg. sign restrictions, inclusion of additional variables, differences between countries)
- The paper is very-well done, but its findings can be interpreted in a more complex way

Some trivial political economy of central banking

- Since the Great Recession the inflation was low for a long time
- So all around the world the CBs kept IR low for a long time (and sometimes went further – QE)
- Now we see signs inflation is picking up so **IR should rise**
- **But** any rise of IR will have an effect on financial stability through the housing market.
- The key question - What should we fear more? Inflation or foreclosures?



The ultimate answer

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- The answer to the Ultimate Question of Life, the Universe, and Everything = 42 (if we trust Douglas Adams)

- "On average, an increase in the interest rate by one percentage point causes a median decrease in house prices of 0.7 percent for the one-year horizon and 0.9 percent for the two-year horizon" (this paper, abstract)

- The price of housing has been growing by 10% of more recently, so can we rest easily an IR increase will result only in a minor correction to housing prices? Maybe, maybe not.

The quest for the true number

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- “The maximum effect, attained at the end of the medium horizon, **varies from –0.9% to –2.7%** in response to a monetary policy shock of a one percentage point increase in the interest rate.” (this paper, p.27)

- The actual finding of this paper is – in my opinion – the **great heterogeneity of possible** (credible) **answers**, rather than the average.

Bias? What bias?

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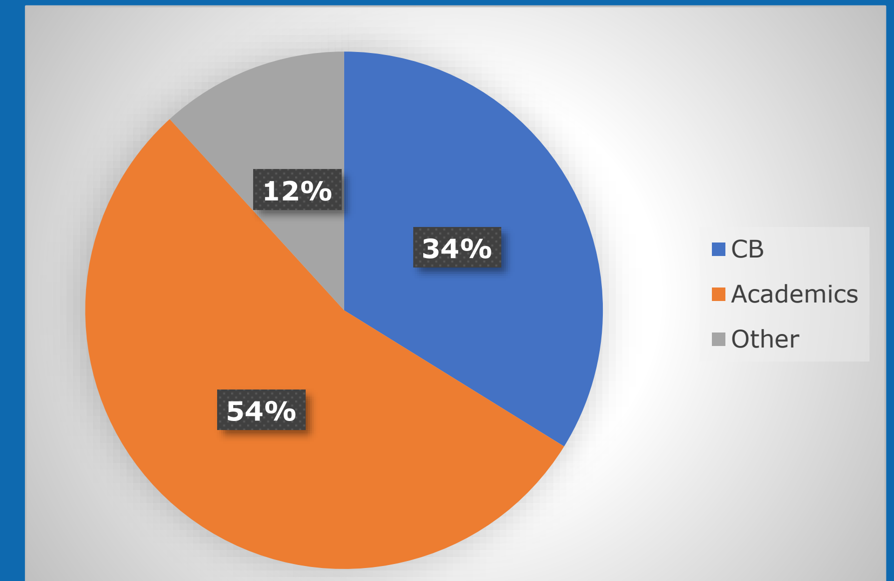
- The paper identifies the „true effect“ on the basis of the well-known publication bias. The idea is simple = an academic wants to publish (not perish), a study which does not find a significant relationship between IR and housing prices is not credible, ergo hard to publish. So we need to correct this bias using econometrics
- But I looked at the affiliations of the authors of included papers and only a **half of them are academics**
- There are 13 authors from the ECB alone, more than any other institutions
- Of course we, the Central Bankers, want to publish well. But we self-selects to CBs for a reason and we tend to share a certain approach to economic thinking. We might have our own biases.
- And what about the business and government people?



Distribution of affiliations of the authors of included papers. Own elaboration

To conclude

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- The discussed paper contains important knowledge for a policy maker burdened by a question that will shape how our society will look like in the years to come

- A wise policy maker will look **beyond** the 0.7 number. The key finding is actually there is **great heterogeneity of credible estimates**

- To the authors - this paper is well done, but when moving on with this research agenda, please consider focusing on the heterogeneity of the results – not just technically, but what are the “priors” that motivate the technical choices producing such a diverse results. How plausible are they?

- To policy makers, a humble idea: Consider imitating what has been suggested recently by John Cochrane: “Applied Critical Thinking project at the New York Fed… Black Swan Hunter with a mandate to "poke holes in the most basic assumptions that central bankers make -- which can lead to big policy mistakes when they're wrong."