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Real estate valuation, current account and credit growth patterns, before and after the 2008–9 crisis[☆]



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ABSTRACT

We explore the stability of the conditioning variables accounting for the real estate valuation before and after the crisis of 2008–9, in a panel of 36 countries, recognizing the crisis break. We validate the robustness of the association between the real estate valuation and lagged current account patterns, both before and after the crisis. The most economically significant variable in accounting for real estate valuation changes turned out to be the lagged real estate valuation appreciation (real estate inflation minus CPI inflation), followed by lagged declines of the current account/GDP, lagged domestic credit/GDP growth, and lagged equity market valuation appreciation (equity market appreciation minus CPI inflation). A one standard deviation increase in lagged real estate appreciation is associated with a 10% increase in the present real estate appreciation, larger than the impact of a one standard deviation deterioration in the lagged current account/GDP (5%) and of the lagged domestic credit/GDP growth (3%). The results are supportive of both current account and credit growth channels, with the momentum channels playing the most important role.

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Smaller current account/GDP surpluses or larger deficits may serve as warning signals, especially when coinciding with credit expansion and real estate appreciation during the past several quarters.

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1. Introduction and overview

The global crisis of 2008–9 sparked a vibrant debate on the factors contributing to the crisis. Were global imbalances or excessive credit growth the key suspects? Contributors to the debate include [Borio and Disyatat \(2011\)](#), conjecturing that the main causing factor to the financial crisis was not “excess saving” but the “excess elasticity” of the international monetary and financial system; and [Obstfeld \(2012:20\)](#), noting that “The balance sheet mismatches of leveraged entities provide the most direct indicators of potential instability, much more so than do global imbalances, though the imbalances may well be a symptom that deeper financial threats are gathering.” Against this background, we revisit these questions in the context of the real estate market. The macro importance of the real estate market is well appreciated by now. A prime example of it has been the U.S., where [Leamer's \(2007\)](#) title succinctly summarized it: “*Housing is the business cycle.*”

A priori, one expects that both the current account and credit growth trends would impact the valuation of national real estates. A primary link between real estate valuation and the current account deficit follows from national accounting and the absorption approach. Growing current account deficits is a signal of a growing gap between the spending of domestic residents [absorption] and their output. As long as the demand for key non-traded durable assets, like real estate, is positively correlated with absorption, one expects higher current account deficits to be associated with higher real estate valuation. Yet, as most households co-finance the purchase of their dwelling through the banking system, greater financial depth and accelerated growth rate of credit tend to increase the demand for houses, probably increasing the real estate valuation.

Thus, one expects that both current account and credit trends matter for the valuation of real estate, and a priori there is no obvious reason to surmise which of the two should dominate. In [Aizenman and Jinjarak \(2009\)](#) we looked empirically at these issues in 41 countries, for the years 1990–2005, investigating the association between lagged current account deteriorations and the appreciation of the real estate prices/GDP deflator, controlling for macro factors associated with real estate valuation [lagged GDP/capita growth, inflation, financial depth, institution, urban population growth and the real interest rate]. We found a strong positive association between lagged current account deteriorations and an appreciation of the real estate, where the real appreciation is magnified by financial depth, and mitigated by the quality of institutions. Intriguingly, the economic importance of current account variations, in accounting for the real estate valuation, exceeds that of the other variables, including the real interest rate and inflation.

A growing literature identified several related channels contributing to the positive association of the current account and credit growth patterns with real estate valuation. [Tomura \(2010\)](#) analyzed the roles of credit market conditions in the endogenous formation of housing-market boom–bust cycles, in a business cycle model. When households are uncertain about the duration of a temporary high income growth period, expected future house prices rise during a high growth period and fall at the end of the period. These developments induce in his model expectation-driven boom–bust cycles in house prices, only if the economy is open to international capital flows. Furthermore, high maximum loan-to-value ratios for residential mortgages per se do not cause boom–bust cycles without international capital flows. [Laibson and Mollerstrom \(2010\)](#) noted that national asset bubbles may explain the international imbalances – the bubbles raised consumption, resulting in large trade deficits. In their sample of 18 OECD countries plus China, movements in home prices alone explain half of the variation in trade deficits. [Gete's \(2010\)](#) model showed that an increased demand for housing may generate trade deficits without the need for wealth effects or trade in capital goods, and that housing booms are larger if the

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