

## Summary

**L**arge house price declines can adversely affect macroeconomic performance and financial stability, as seen during the global financial crisis of 2008 and other historical episodes. These macro-financial links arise from the many roles housing plays for households, small firms, and financial intermediaries, as a consumption good, long-term investment, store of wealth, and collateral for lending, among others. In this context, the rapid increase in house prices in many countries in recent years has raised some concerns about the possibility of a decline and its potential consequences.

Against this backdrop, this chapter studies and quantifies house prices at risk—a measure of downside risks to future house price growth—in a sample of 32 advanced and emerging market economies and major cities. The chapter finds that lower house price momentum, overvaluation, excessive credit growth, and tighter financial conditions predict heightened downside risks to house prices up to three years ahead. The measure of house prices at risk helps forecast downside risks to GDP growth over and above other simpler measures of house price imbalances, and thereby adds to early-warning models for financial crises. Estimates show that downside risks to house prices have rotated since the global financial crisis, with most countries at higher risk at the end of 2007 facing lower risks today, but in many advanced and emerging market economies house prices remain at risk.

This chapter also explores the relationship between policies and house prices at risk. While house price levels should not be considered a direct target for monetary or macroprudential policies or for capital flow management measures, the link between policy actions and downside risks to house prices can shed light on how these actions map into housing sector vulnerabilities and financial stability. The results indicate that a tightening of macroprudential policies is associated with a reduction of downside risks to house prices. This is especially the case for policies aimed at strengthening the resilience of borrowers, such as limits to the maximum loan-to-value or debt-service-to-income ratios. Monetary policy can also influence downside risks through its relationship with financial conditions, but on top of that, the chapter finds that an unexpected easing of the monetary policy rate is associated with lower downside risks to house prices, but only in the short term in advanced economies. Thus, the overall results point to a higher effectiveness of targeted and timely macroprudential policies than monetary policy in reducing downside risks. The relationship with capital flow management measures is more nuanced, with some results suggesting a temporary association between a tightening of those measures and lower downside risks in advanced economies.

What can policymakers do with this knowledge? In addition to building buffers for banks and ensuring households do not overborrow, policymakers in charge of financial stability can use estimates of house prices at risk to complement other surveillance indicators of housing market vulnerabilities and guide macroprudential policy actions aimed at building buffers and reducing vulnerabilities. Downside risks to house prices could also provide relevant information for monetary policymakers when forming their views on the downside risks to the economic and inflation outlook.