Housing Market Challenges in Europe and the United States – Any Solutions Available?

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On September 29, 2008, the Oesterreichische Nationalbank (OeNB) hosted a workshop entitled "Housing Market Challenges in Europe and the United States - any solutions available?" The workshop's objective was to discuss the most recent developments in housing markets and housing finance. Housing prices have developed quite differently in Europe in the last decade. Austria, for example, has faced very moderate price increases compared with, for example, Spain, the U.K. or Central, Eastern and Southeastern Europe. Most economic studies claim that monetary policies exert a major influence on housing price developments, and thus transmission mechanisms are a focus of research. But additionally, different institutional features of housing finance as well as regulatory/fiscal arrangements play an important role in any explanation of house price developments.

The first session addressed the recent crisis in the U.S. housing market and considered possible solutions. Session 2 offered an overview of developments in European housing markets and their macroeconomic implications, while session 3 dealt with micro data on housing wealth. Session 4 highlighted regulation and fiscal aspects. The last session was about statistics on housing markets. A panel discussion concluded the workshop.

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The main shock to the financial markets was triggered by problems in the subprime mortgage market. It spread to securitization instruments and more generally to credit and capital markets. That a crisis within the U.S. national housing market would end up as a worldwide financial crisis was and is surprising not only for "ordinary" private households but also for analysts around the world.

The starting point of the workshop was the question: what are the factors that drive housing markets? As housing prices in European countries have developed quite differently over the years, the workshop's objective was to discuss the factors behind these developments, to analyze how the country-specific house finance markets are linked together, whether spillover effects exist and how they work. Against the background of the current crisis it has become very clear just how important housing markets are. Therefore, the reasons why housing markets and housing finance structures play such an important role and why housing markets can give rise to fluctuations in macroeconomic and financial developments need to be analyzed in detail.

First, the housing sector and housing finance affect the macro-economy because the housing sector plays an important role in a country's development and accounts for a considerable part of a country's welfare and GDP. There exist country-specific differences in demographics and institutional regulations, however. Furthermore, international trends – globalization and liberalization – play a prominent role in housing finance. Liberalization and globalization in housing finance systems and easier access to credit for households have caused this situation because although housing is a sector whose GDP share is too small to cause a recession by itself, spillover effects have caused severe macroeconomic problems. Second,

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fiscal and regulatory aspects of housing markets vary considerably from country to country and have direct implications for households' housing affordability; in any case, housing should be one of the main targets for policymakers. Third, in house financing systems there has been a trend away from more traditional methods relying on specialized intermediaries or government programs towards more market-based systems of housing finance. There has also been the phenomenon of securitization, whereby individual mortgage loans are pooled and used as collateral and sold to investors. Instruments like mortgage-backed securities or special purpose entities have been created. Within this process of securitization, mortgages are financed by institutional investors as pension and mutual funds. Home financing, and especially mortgage financing, has become international and integrated in capital markets. Finally, the role of monetary policy, which influences housing markets by raising or lowering short-term interest rates, needs to be mentioned. During the current crisis, banks have become more restrictive in providing liquidity. This fact, together with banks' subprime market exposure, has had tremendous effects on some investment and commercial banks. The current turmoil has made clear that capital market requirements and regulations have to be completely rewritten. Regulatory policy changes are necessary, as it has become obvious how enormous the spillover effects from the housing markets on the macro-economy and on capital markets can be.

In his keynote speech in session 1 entitled "The US housing market – recent crisis and way out", *Elias Karakitsos* (University of Cambridge, U.K.) expanded the overview of the U.S. housing market and focused on the causes of the crisis and some of their implications for theory and policy. He recommended that all institutions confronted with this unforeseen crisis, including central banks, should critically reassess their instruments for detecting an emerging crisis. The origin of the current crisis could only occur through an increase in credit. The excessive liquidity which led to the bubble was mainly driven by financial innovation and loose monetary policy. The financial innovation followed the repeal of the U.S. Glass-Steagall Act in 1999. The new regime allowed financial institutions to separate loan origination from loan portfolio. Banks were no longer obliged to keep their own loan portfolio. This financial innovation encouraged banks to provide risky loans, also to subprime borrowers who were less able to service their mortgage principal and interest. Furthermore, Structured Investment Vehicles (SIVs) with a simple legal structure and a very small capital base were created. SIVs raise money from the short-end capital markets and then use that money to buy the loan portfolio of the parent company. While they do that, they repackage it in a collateralized debt obligation (CDO) and sell it back to the private sector – either to hedge funds or pension funds. So, minimal capital was necessary. This was profitable so long as the yield curve was positive. Karakitsos stated that this form of banking, outside the regulatory framework, was behind the current credit crisis. When the yield curve became inverted, the bubble burst. All these financial innovations, especially CDOs, have injected huge liquidity into the financial system – a kind of liquidity not reflected in monetary aggregates. The sale of CDOs to international investors made the U.S. housing bubble a global problem and influenced the world economy and all European countries. Loose monetary policy was a further driving force: the Federal Reserve System cut interest rates dramatically (from 6.5% to 1%) as a reaction to the Asian-Russian crises in Asia and Russia of 1997 and 1998 and to the dotcom crash, and it injected huge liquidity. Karakitsos argued that this liquidity financed in the first instance the Internet bubble but because there was no deleveraging following the dotcom crash and because of very low rates, the liquidity went on to finance other bubbles, including housing, private equity and commodities. Thus, the housing bubble is a transformation of the previous dotcom bubble. He explained the problems of central banks in first detecting and then in dealing with such phenomena: their major tool of analysis, namely New Consensus Macroeconomics, is not capable of monitoring the kind of liquidity which has been responsible for financing such bubbles. Even if central banks were to include monetary aggregates it would not solve the problem. Financial innovations do not allow a monitoring of a significant proportion of liquidity in the system by way of traditional monetary aggregates. Besides, the models used ignore the role of wealth in affecting households' decisions. Karakitsos then presented a model showing the current credit crisis. He revealed the shortcomings for central banks of only having an inflation target. He stressed the need to monitor and to work out what implications of asset prices for the spending patterns of consumers (by the variable of net wealth) and pointed to the need to target also the output gap in an asset-led business cycle as the volatility in the output gap is greater than the volatility of inflation.

Session 2 examined European housing market developments and their macroeconomic implications.

Elisabeth Springler (University of Economics and Business Administration, Vienna) and *Karin Wagner* (OeNB) presented a paper that seeks to explain differentials in housing finance and especially in home ownership rates across Europe and the U.S.A. Their paper does not solely focus on changes in housing finance. It also deepens the analyses of the implications of the structure of housing finance systems for the level of home ownership rates. To date, the impact of the level of (mortgage) interest rates on ownership rates has been most often analyzed. However, the role of government in national housing markets is widely acknowledged but only rarely integrated into empirical studies (topics such as whether governments foster ownership rates or how to get more demand- or supply-side subsidies into the system or whether governments try to encourage a shift from rental housing to ownership via tax structures, etc.). In their paper, Springler and Wagner tried to broaden this approach by including a measure for the role of the state in housing via its impact on the cost of financing. The included variable of the cost of financing provides for the deductibility of mortgage interest rates and for tax allowances for homeowners. So, the model tests for impacts of house financing systems and of the dynamics of changes in tax structures to home ownership rates by analyzing data from 1996 to 2006 for European countries and for the U.S.A. Results of their model indicate that institutional features are important. Taxation regulations in particular play an important role and have a significant influence on the level of home ownership.

Christophe André (OECD) took a closer look at housing markets, business cycles and economic policies in OECD countries. In the vast majority of OECD countries, house prices and housing wealth have risen sharply from the mid-1990s to 2006 and 2007. At the same time, household debt has reached record levels in many countries, largely as a result of the decrease in real and nominal interest rates and a wide range of financial innovations in mortgage markets. He argued that the current house price cycle differed from past experiences in three respects: In most OECD countries, the increases in recent years have pushed house prices above previous peaks. Second, the duration of the run-up has been longer than in past episodes of large price increases. And third, this house price cycle has been disconnected from the business cycle. He then focused on interest rate developments – the envisaged reduction in nominal and real interest rates over time and the reduction of spreads on mortgages in some countries. He mentioned furthermore the increase in the proportion of adjustable rate loans in some countries. André said that innovations in mortgage markets and the considerable increase of household wealth in the economy implied a high impact on asset price changes in the monetary policy transmission mechanism, in particular through their influence on private consumption. Subsequently, he examined the impact of interest rates on households' consumption, particularly on the consumption of durable goods, on income, wealth and liquidity. He concluded that the mentioned developments in mortgage finance had also created new challenges for central banks and financial regulators and that financial system regulation and supervision had a crucial role to play in avoiding crises.

Dieter Gstach (University of Economics and Business Administration, Vienna) discussed both papers. In his opinion, analyses of wealth effects, such as the one presented by André, should be adjusted to take account of a variable for rental rates. If, in the long run, rental rates follow house prices, we should see a much greater impact of higher house prices than we observe today simply based on consumption function. He suggested expanding Springler and Wagner's model by including rental price measures. Furthermore, he stressed the need for indicators to measure the financing cost of housing as presented in the paper. As data availability on housing is poor in European countries he pointed out the need for housing data.

The main topic in session 3 was the measurement of households' wealth position and the question whether micro data could provide a better understanding of housing markets.

Karin Wagner (OeNB) considered why it was interesting to measure housing wealth. She pointed out that housing assets were the most important form of collateral. The value of housing property can affect households' expenditure by improving access to credit for liquidity-constrained households. Furthermore, micro data give more disaggregated information on the mortgage situation and vulnerability of the various subgroups of households as the sociodemographic information behind is available. Additionally, such data may be interesting when comparing financial wealth effects with housing wealth effects. She presented some results on the OeNB Household Survey on Housing Wealth 2008 and talked about its sample and implementation. The focus of the survey is the analysis of housing wealth and housing debt of households. The objective was to learn more about how households finance their homes. Furthermore, the survey contains information on intergenerational transfers and gifts – when, how much, from whom households receive something. It included questions on whether they expect an inheritance. Wagner stressed that it is the first time that micro data on housing wealth had been available in Austria. She subsequently stated that the survey results would be published in early 2009 in the OeNB publication "Monetary Policy & the Economy".

Thereafter, *Michael Wagner-Pinter* (Synthesis Forschung) discussed Wagner's presentation. He raised two issues. First, he discussed how to optimize the informational value added of the OeNB Household Survey on Housing Wealth 2008. He regards the survey as a unique source of micro data in Austria but also as part of an information string, and it does not stand alone. He recommended using the survey data with other register statistics with a much larger sampling size to recalibrate the weights derived from sampling procedures. The survey, which in his opinion is rich in variables but rather limited on sample size, should not primarily be used to draw inferences about the distribution of variables among the total population of Austrian households. The survey should be used to concentrate the analysis on co-variances between variables to derive estimated statistical models, the results of which could be applied to micro data sets much larger than the survey.

Second, he asked how micro data could help us to understand housing markets better. In his opinion, such surveys would not help. Instead, other housing market data sources (on transaction values, household mobility, etc.) would be useful. The survey reports on the risk positions households take to acquire property. It is not a survey on markets where the transaction is at the center of interest but rather the risk issue that is of interest. He thinks that equating the housing market with the financing of housing can be misleading. Different questions have to be answered on housing market dynamics and on the dynamics of financing housing.

Session 4 offered some specific insights into European housing policies. *Montserrat Pareja Eastaway* (University of Barcelona, Spain) focused on European rental markets and asked whether regulation or liberalization was on the increase. She subsequently focused on Spain.

She said that the recent change in the economic scenario directly affected the approach taken towards the mechanisms used by housing policies in order to achieve their goals. Housing markets are currently unstable and uncertainty characterizes expectations for the final market equilibrium. The characteristics of rental markets and their regulations vary across Europe. However, in terms of tenure, there are some general trends in Europe: a general increase in home ownership and a fall in the share and quality of rented dwellings. In some cases, the percentage of dwellings in this segment has been stable (e.g. Germany); in others, it has fallen dramatically (i.e. Spain). Concerning the trend in rents, real rents have increased in the long run (except in Portugal and Denmark) because of the cost of construction land, the cost of housing services and the need for quality improvements. Real rents are less cyclical than house prices and fluctuations are usually linked to regulatory reforms. There is a sort of relationship between the private rental regime in Europe and the trend towards private rented houses. There are two reasons why the share of rented dwellings has decreased since 1980 in Europe: The strictness of rent controls may have reduced the amount of rental accommodation, and ownership has become more attractive given the lower cost of mortgage credit, favorable tax/subsidy policies for owner-occupation and expectations of capital gains from rising housing prices. Fundamental aspects in rent control systems are how the initial rent will be raised over time, how the control on the initial rent will be negotiated in a new contract and how to regulate contract termination. Concerning the situation of the rental market regulations in Europe, most EU countries allow annual rent indexation in a simple way. There are provisions on renewing contracts (which limit the landlord's negotiating power). Most countries have moved towards a process of decontrolling rents in new contracts and have a tendency to allow the duration and contract termination rules to be freely negotiated. In Spain with highly negative rates of building permissions and the highest house price increases in Europe a quite high proportion of immigrants worked in the real estate sector. These people are unemployed now. Social renting is very small (1% of housing stock) – tenants account for 10%, owner-occupiers for 89%. By contrast, the rented sector in 1950 was 54%. The share varies greatly across the country. Over the years there have been three stages of regulation (or deregulation) in Spain: Till the 1980s there was a rent freeze as well as indefinite contracts. During the 1950s owners preferred their flats to stay empty. Between 1985 and 1994 there was a complete liberalization of rents and length of contracts. After 1994, rents were freely negotiable and rental contracts lasted a minimum of five years. Until the late 1990s there were better returns from public debt bonds than from rented housing (which, among other things, explains the high share of owner-occupied housing in Spain). Pareja Eastaway concluded that Spanish housing policy was currently completely focused on the rental sector. The public sector/government is the guarantor for all new contracts. There are favorable financial conditions for the landlord (in case of repairs and improvements) and fiscal advantages for landlords.

Guido Wolswijk (European Central Bank) presented some fiscal aspects of housing in Europe. He discussed the role of fiscal instruments in the housing and mortgage markets. He stressed that almost any fiscal measure mattered for the housing markets. Government intervention aims to extend home ownership as it results in positive external factors (home owners are more active in local communities, they are more healthy, etc.). Related to that is the argument that households underestimate the importance of housing for themselves and that they cannot make a proper assessment of how much to spend on housing. Furthermore, governments try to increase the affordability of housing for the entire population, and especially for low-income households, who are more credit-constrained. Housing is an investment and consumption good. So whether governments favor ownership or not can be seen by the benchmark of tax neutrality. Tax neutrality is defined as treating owner-occupied housing like other assets (e.g. bonds) or – as it is also consumption good – as the purchase of other durables (e.g. cars). Treating it as e.g. bonds means that any costs involved in such investments are usually tax-deductible and the annual returns are taxed. There is some degree of diversity in Europe concerning fiscal treatment. In Germany, where the share of the rented sector in the entire housing market is the largest in Europe, households often take out a mortgage with buy-to-rent in mind. So even if there is quite a big rental market it is heavily affected by interest rates and fiscal regulations. But, in general, in most European countries the fiscal systems financially favor owner-occupied housing. Wolswijk then elaborated on the effects and risks of the fiscal subsidization of housing. It is said to have a positive effect on housing consumption. It can be questioned whether fiscal subsidization is needed for that. Furthermore, other taxes need to be raised if there are subsidies for housing. Capitalization of subsidies should be also mentioned (i.e., if there is low housing supply elasticity, then higher subsidization causes redistribution from new to current owners). There is also a regressive income distribution effect (higher income classes profit more than lower income classes, basically because of the deductibility of mortgage interest payments at the highest marginal interest rate). Wolswijk questioned what fiscal measures could do if there are housing market imbalances or if imbalances are just coming up. Although there is a single euro area monetary policy, housing markets remain national. The literature also discusses if and when there is a right time to intervene. Structural and fine-tuning measures are to be distinguished. "Structural" means that a measure is implemented to reduce the variability of house prices, while "fine-tuning" is more on an ad hoc basis. All the instruments to be used are country-specific. He concluded that there was an overall favorable fiscal treatment of housing, with country variation, and that the single monetary policy potentially played a relatively big role in housing markets.

Margarete Czerny (Austrian Institute of Economic Research) discussed both papers (Pareja Eastaway's and Wolswijk's). She observed that while there was a big increase in home ownership in Europe, there was a substantial decrease in the subsidization of all housing allowances, both for rental homes and for tax allowances. Housing investment has had a big impact on growth in Spain and other countries. Persons with higher incomes benefit from fiscal instruments more. Low interest rates favor ownership. However, only half of the population lives in owner-occupied homes. The influence of fiscal instruments on home ownership is hard to evaluate. In her opinion, fiscal measures on home ownership cannot be said to have a strong influence in Europe. For example, in Germany and Austria fiscal instruments do not play an important role. In Spain, the U.K. and Ireland house prices have increased by 10% to 20% in some years. In neoclassical theory, housing transactions should decrease, but the opposite has happened: Dwellings became more and more expensive and housing purchases went up. As speculative aspects increased there should have been policy interventions, but there were none. Spain is a special case in Europe as there was additionally overinvestment in housing in the past few years, because of high revenues in tourism and many rental apartments for tourism (second homes) were constructed for tourism. A shift from home ownership-oriented fiscal policy towards rental housing is necessary. Then Czerny gave some reasons why house prices have become an object of speculation and recommended a new orientation in housing policy in Europe.

A further topic to be discussed in the workshop was housing finance in Central, Eastern and Southeastern Europe – trends and challenges.

Wolfgang Amann (Institute for Real Estate, Construction and Housing, IIBW) gave a presentation on new policies to facilitate affordable housing in Central and Eastern Europe (CEE). He said that, first, it was necessary to describe the present housing provision, housing construction and housing markets in the CEE countries to understand the housing policy challenges in CEE properly. Most CEE countries have a small share of rental housing due to major privatizations in the early 1990s. Major challenges include: housing market prices being at western levels while household incomes being far below, deteriorating housing stocks, insufficient housing construction for lower- and middle-income groups as well as in regions with low economic dynamism, small and even diminishing rental markets and inadequate legal frameworks. Amann then presented projects which have been developed by IIBW. The focus of the institute is the development of sound legal regulations and, linked to this, the establishment of business structures for PPP (public-private partnerships) housing. He highlighted the recently passed housing law for Romania (it was drawn up by IIBW). The second main project is the design of structured financing for affordable rental housing to make it economically attractive for tenants to go into rental markets instead of living in owner-occupied apartments. Respective projects are currently being prepared for Montenegro and Albania.

József Hegedüs (Metropolitan Research Institute) commented on Amann's paper and discussed whether there was divergence or convergence of housing policies in CEE. After the political changeover, governments in the region worked under constant fiscal pressure caused by the social and economic costs of bankrupt socialist economies. Housing policies responded differently in CEE countries. In the process of transition, the negative consequences of economic restructuring (regional and social inequality, declining living standards, affordability problems, etc.) raised the need for a new housing policy that first had to build up a new market-based housing finance system (legal framework and subsidies) and then to develop a sustainable social housing policy. These processes have been carried out at different speeds and in different ways across CEE countries.

Session 5 dealt with statistics and the question of how to measure house prices properly.

Anthony Murphy (University of Oxford) considered the need for a strategic approach to the development of statistics to meet user requirements. Good-quality house price data are essential (especially data over a longer period, at least 20 years). He explored the advantages and disadvantages of various house price data in the U.K., the U.S.A. and Ireland at annual or quarterly frequency.

For the U.K. various mix-adjusted house price indices are available. According to Murphy, there is no single ideal index. However, all the indices are co-integrated with each other (since real house prices are I(1) and composition or mix bias is I(0) or trend stationary) and display the same medium- and long-run trends. So, for forecasting purposes, the choice of index is not that important. However, when modeling European housing markets, there appears to be a shortage of long-run, disaggregated average and mix-adjusted house price data, as well as other housing-related data, which hinders research. At the end of his presentation Murphy showed a wish list. At the macro level, he would like consistent, medium-run time series data on the housing stock (including vacancy rates) and the main components of household wealth. In addition, the distribution of LTV (loan-to-value ratio) and LTI (loan-to-income ratio) data for first time buyers and other borrowers would be very useful for tracking changes in credit conditions. At the micro level, he would like survey measures of house price expectations and lending, as well as more information on housing finance and wealth in household and panel surveys.

The second speaker of this session, *Adrian Page* (European Central Bank) gave an overview of residential property price statistics for the euro area and selected EU countries. Since 2001, the ECB, in cooperation with the EU national central banks, has gradually expanded the collection of residential property price statistics. The data are used both for country analyses and the monitoring of euro area-wide developments.

He concluded that considerable data were available but significant work was needed to achieve the urgently required improvements in EU residential property price statistics in terms of representativity, comparability, timeliness and frequency. Such work is underway, notably being done by EU national statistical institutes in the context of the Eurostat pilot project on price indices for owner-occupied housing.

The workshop was concluded by a panel discussion entitled "What lessons have we learned from the Spanish/Italian/British/U.S. case? What can be done in Europe to make housing markets more stable?" *Elias Karakitsos* (University of Cambridge), *Montserrat Pareja Eastaway* (University of Barcelona) and *Leonardo Gambacorta* (Banca d'Italia) discussed ways out of and the perspectives for the U.S./Spain/Italian (respectively) house price crisis/bubble.

Montserrat Pareja Eastaway observed that housing markets were not competitive. She pointed out the vulnerability of households and said that intervention was needed. Regulation can be a source of distortion. Although regulation measures seem to enforce stability, sometimes the opposite is the result. Against a background of a 90% ownership rate in Spain, it can be seen that housing policy has not at all been neutral in the current situation. Under the Franco regime the main issue in housing policy was to give shelter to people. Direct construction was the main issue in housing policy until the end of the dictatorship. After it, housing policy strategy was transformed into subsidies directly given to people. In this period, officially protected housing (these are privately owned flats, a characteristic specific to Spain) were invented. After a period of 15 years, the flats/houses could be sold on the free market. So, housing policy was subsidizing protected housing, privately owned, which allowed the owners to profit from it. One of the consequences of the possibility to sell these flats was that the effect of "protected housing strategy," which was originally trying to stimulate ownership, in fact discouraged ownership. But also public housing is diminishing. Decentralization of housing policies made the autonomous communities responsible for housing. According to Pareja Eastaway, the private rented sector should be stimulated in the Spanish market. Furthermore, it was decided to deregulate completely the land market. But the land market and housing markets are interdependent. In reply to the question "What have we learned?" she said that the Spanish example showed that it was not healthy to keep the housing price bubble continuing for a period of six years and it should be discussed whether it was wise to keep such a small share of housing stock as public housing. Furthermore, it should be discussed whether the tenure imbalance should be counteracted by the public sector. As a strategy for the future she recommended that changing economic conditions be taken into consideration in order to have adequate housing policy instruments. Furthermore, social housing is a determinant in dampening overheated markets. Land markets play a crucial role in guaranteeing a certain percentage of social housing. (Nowadays in Spain, it varies between 20% and 50% of new dwellings built – depending on the autonomous community).

Leonardo Gambacorta first explained some characteristics of the Italian household loan market, with its fast growth (even faster than in the euro area) but relatively small size compared with other countries (e.g. Spain). Then he pointed out some of the effects of the financial turmoil, especially securitization, on the quality of loans. He showed that half of the observed slowdown in lending to households in Italy was due to the statistical effect of securitization. Even in a phase of financial turmoil, securitization in Italy went up. After the introduction of the law on securitization in Italy, the annual flow of securitized lending as a percentage of the stock increased as from December 2007 due to self-retained securitization. It means that banks sold mortgages via SPVs but they bought them back in order to obtain asset-backed securities that could be used as collateral in a Eurosystem refinancing operation. So, securitization had a direct role in the market, spreading credit risk among financial intermediaries. He questioned whether this fact was good or bad. As this is difficult to answer it is very important to understand what the effects of securitization are on bank lending. They are not trivial at all. There are negative ones – e.g., as banks sell loans to the private and institutional markets they lose the incentive to monitor them and thus there is deterioration in the quality of credit. But there are also positive aspects of securitization cited in the literature and generally securitization is seen as positive; problems of asymmetric information can be mitigated. It is an empirical issue. Some preliminary estimates for Italy show that securitized lending is, other things being equal, less risky. The quality of credit in Italy remains high, but the number of clients in difficulties has increased. Institutional factors that may have limited the financial tensions in Italy include the increase of the loan-to-value ratios by law (from 50% to 80%) and the usury law, which imposes a ceiling on interest rates. Both factors have contributed to a reduction in the subprime market. The strength of retail funding is a further interesting institutional characteristic. During the current crises many banks are facing a shortage of deposits. So banks should look more closely at their liabilities. Italy – unlike the rest of the euro area – has faced an increase in borrowing from banks since the beginning of the financial crisis. Gambocorta concluded that we had to rethink regulation for the financial economies, having in mind that they are subject to "booms and busts." There have to be new rules but regulation should not inhibit financial innovation. In his opinion, some rules are necessary in order to have a continuous chain that goes from "financial deepening" to economic growth. The Italian experience shows that some rules (limits on LTV, usury law) have reduced at least so far the effects of the financial turmoil. Overall, he claimed that we had to think up new rules that do not affect negatively loan supply and ended his comments with the sentence: "A bank has to be a bank!"

Elias Karakitsos started his contribution by stating that the housing market is just a market where liquidity has been channeled effectively and therefore he did not consider regulation in housing markets as really important. For financial institutions and the question of what has to be changed, he said that things were changing fast. He stressed that we were lagging behind. The problem has been liquidity and liquidity is draining out very fast. The U.S. housing market was not the cause of the credit crisis and the current turbulence in the global economy. Rather, the crisis is a symptom of the huge liquidity that was put in place by "financial engineering" and some mistakes in the conduct of monetary policy, especially in the U.S.A. This liquidity has financed a number of major bubbles in the last ten years (Internet, housing, and commodities) and a few minor ones (shipping and private equity). Nowadays, the financial system is deleveraging. To stop this is the challenge before it becomes systemic. The question is how to do this and to prevent it deteriorating rapidly into a crisis. The system that we have seen, namely borrowing from the short end of the market and using it at the long end (which was done e.g. by the investment banks) is going to collapse. Karakitsos commented that private equity and hedge funds would not take over the role of those banks. So, this kind of model will not work any longer. As the U.S. administration is taking over more companies, much more regulation will be coming. The real risk is the proper asset in that deflation process that may take about ten years. He would have preferred to see some recapitalization of the U.S. banking sector rather than injecting money into the markets. But from a policy perspective it should be recognized that regulation is backward- rather than forward-looking. Smart people will always find loopholes in any given legislation and take advantage. Regulators will always react with a long lag to close the loopholes and on some occasions, like the current crisis, will react too late to prevent a calamity. A better approach than over-regulation is for the central bank to have an asset price target that does not impede the functioning of free markets and does not prevent financial innovation. Since securitization implies the transfer of assets and risks to the private sector he considers the ideal target variable for a central bank to be the net wealth of the personal sector as a percentage of disposable income.

The workshop program and the papers/presentation slides can be found at
http://www.oenb.at/en/geldp_volksw/Volkswirtschaftliche_Veranstaltungen/workshop__housing_market_challenges_in_europe_and_the_united_states__any_solutions_available_.jsp
on the OeNB website.

Furthermore, there is a publication planned with Palgrave Macmillan.