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News release

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Finding the Right Tool for Dealing with Asset Price Booms - Speech by Adam Posen

In a speech at the MPR Monetary Policy and Markets Conference in London today, Adam Posen - an external member of the Bank's Monetary Policy Committee - discusses how asset price booms might be addressed in the future. He rejects the notion that monetary policy should be used to tackle asset prices, and believes other tools are needed and better suited for the task. In addition to macroprudential policies - such as those outlined in a recent Bank of England discussion paper - Adam Posen suggests there is merit in considering tools that tackle asset prices directly. In particular, he discusses the idea of an automatic stabiliser for housing prices.

Adam Posen argues that even if central banks could identify asset booms or bubbles far enough ahead of time and could assess whether the benefits of pre-empting bubbles outweighed the cost of deviating from price and output stabilisation, there is no dependable relationship between interest rates and either housing price growth or equity price rises. He argues that the concept of 'leaning against the wind' omits the scale of policy tightening required. It implies a subtle adjustment but, he says: ".all indications are that it would take extremely aggressive policy action to counteract boom dynamics." He adds: "These calls for leaning against the wind also run into the face of logic and experience for all but perhaps the largest or most closed economies."

Adam Posen supports the proposals for dynamic provisioning by banks and variable capital surcharges to address the build-up of systemic risk in the banking system across the credit cycle. But, in addition, he thinks some asset prices can be addressed directly with other tools. His focus on housing reflects his view that bubbles in real estate are often more destructive than in other assets. He says: "Real estate bubbles tend to have much higher real economic costs than equity bubbles, perhaps because they involve illiquid collateral and local spillover effects."

So what could be done to limit or pre-empt real estate price booms? He suggests as a complementary policy, changes to real estate taxes and regulation, to provide a counter-cyclical element - automatic stabilisers - to structures already in place in many countries' housing markets.

Adam Posen stresses that the proposal is ".something modest, without any large implications for tax revenue over the cycle.". He says: ".it would mean having already existing title fees, capital gains taxes, stamp and transfer taxes, varying over time in line with price developments in the housing market more broadly. ...a simple blunt instrument targeted to lean against the wind in real estate prices in an automatic fashion."

In conclusion, Adam Posen argues: "The bottom-line for monetary policy coming out of the crisis is, if you have a financial problem, use financial policy tools to fix it. That applies to bubbles, which means monetary policy should not be targeting asset prices as well as inflation." He says: ".the direct role of monetary conditions (and tightening thereof) in the creation of asset price booms is minimal. Financial problems come from something else. Where else? Changes in technology (for equity bubbles) and in financial regulation and supervision (for both equity bubbles and real estate bubbles) are the key drivers. That is the reason for my suggesting a new line of discussion for stabilization policy in addition to the necessary macroprudential proposals for the financial system."

Key Resources

Finding the Right Tool for Dealing with Asset Price Booms - Full speech
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech415.pdf