



Coping with a housing market slowdown



But what is...?

A bubble is a rise in the price of some asset (e.g. houses, stocks) that is unsustainable. But is it always possible to identify bubbles in advance? Sometimes there can be good reasons for houses or stocks to increase in value.

Low interest rates may contribute to housing bubbles, by making it cheaper to take out a mortgage. The ECB sets the interest rate for the euro area as a whole. Can this interest rate ever be too low for some countries?

The Wealth Effect refers to the fact that people feel richer when their houses rise in value and poorer when their houses fall in value. This can influence spending.

Questions? Use the Euro Challenge Forum!

As in the United States, over the past decade several euro area economies experienced sharp run-ups in housing prices followed by subsequent sharp collapse. When housing bubbles collapse, this can have a detrimental impact on households who may have borrowed too much, and banks and other financial institutions who may have lent too much. Often, governments rely on property taxes to help pay for public services. A collapse in revenues from property taxes can put government finances under strain.

- ① What is a "bubble" (in the economic sense of the term)? Is it always easy to spot bubbles in advance? When are there good reasons for houses to rise in value?
- ② What happens to an economy when a housing bubble bursts or deflates? How does a collapse in house prices affect consumers, banks and government tax revenues? Is it justified for governments to use taxpayers' money to rescue banks?
- ③ In what ways is the housing market downturn in your chosen euro area country similar to the [US housing crisis](#), and in what ways is it different? Were there many subprime borrowers in your chosen country?
- ④ What has been the [impact on economic activity](#) (GDP growth) in your chosen country as a result of the housing market slowdown?
What factors do you think contributed to the housing bubble in your country? Low interest rates? Poor lending decisions by banks? Bad regulation of lenders? Inadequate financial education of households? How can these factors be addressed?
- ⑤ What is the "[wealth effect](#)"? Did this effect cause consumers to spend more when houses were rising in value? Have consumers cut back on spending since house prices collapsed?
- ⑥ What [policies](#) is your chosen country undertaking, or what policies might it undertake, to help its housing market to recover and to help lessen the impact of the housing downturn on the overall economy?

