Bank Lending and Property Prices in Hong Kong

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Summary

In many countries, property prices have displayed pronounced cycles that have coincided with large fluctuations in the rate of credit expansion. This raises the question what the sources of these fluctuations are. In particular, should the strong co-movements be interpreted as bank lending in some sense triggering property price cycles, or as movements in market sentiment impacting on both prices and the demand for loans?

In this paper we look at the evidence for Hong Kong. There are three reasons for why this is a particularly interesting case study. First, while in most economies swings in bank lending and property prices are best seen as a single episode, perhaps associated with financial deregulation, Hong Kong has experienced a number cycles of extraordinarily large amplitude. Second, since the Hong Kong Dollar is tied to the US Dollar through a currency board, monetary policy cannot be used to guard against asset price cycles. Instead, regulatory policy has been used in Hong Kong to limit the impact of property price booms on the banking sector. Third, despite the very pronounced decline in property prices since the Asian financial crises, the banking sector remains sound.

The main conclusions we draw are as follows. First, the empirical evidence suggests that the correlation between property prices and bank lending reflects mainly causal influences of property price movements on the demand for credit. The alternative hypothesis that excessive lending has triggered asset price movements is not supported by the data. Second, regulatory policy has reduced the impact of property price movements on the rate of credit expansion. This, together with good banking practices, appear to be the reasons why the banking sector has withstood the recent collapse in property prices so comparatively well.