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1. The U.S. Housing Crisis: Analyzing the Differing Arguments of John Taylor and Alan Greenspan............. 1

The U.S. Housing Crisis: Analyzing the Differing Arguments of John Taylor and Alan Greenspan

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Abstract: Many agree that the recent U.S. Housing Crisis was the worst economic crisis since the Great Depression. After every crises economists look back and try to identify the main trigger. For this particular crisis, the underlying causes are highly debated. The first part of this dissertation focuses specifically on the recent U.S. Housing Crisis and analyzes the differing arguments made by John Taylor and Alan Greenspan. Taylor accuses the Federal Reserve of keeping interest rates too low for too long while Greenspan counters that the federal overnight rate had become useless in affecting housing prices and that the main cause of the crisis was due to the extremely high global saving rate. To evaluate this argument the effect of overnight interest rates on housing prices is tested from 1980-2010. The model analyzes the effects of interest rates during the pre-bubble period as well as the post-bubble period.
The same model was tested substituting for the actual interest rates the interest rates that followed the Taylor rule. The results indicate that while the actual interest rates the Federal Reserve set did not significantly affect U.S. housing prices, following Taylor's interest rates could have ameliorated the extent of the crisis. While this may seem somewhat contradictory, Taylor has repeatedly stated that there were various factors that led up to the housing bubble and triggered its burst. Perhaps, the interest rates set by the Federal Reserve proved to be insignificant in affecting housing prices (and the corresponding monetary policy at the time was not very effective), but if the Taylor Rule was followed, monetary policy could have been more effective and interest rates would have had a greater explanatory role in determining housing prices.
The empirical results are mixed, finding some support for each position and suggesting that this is an important subject for further research using more detailed models of the housing market and of the effects of international capital flows on U.S. interest rates and credit growth.

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