Econometric Regime Shifts and the U.S. Subprime Bubble.

Abstract:
Using aggregate quarterly data for the period 1975:Q1–2010:Q4, I find that the US housing market changed from a stable regime with prices determined by fundamentals, to a highly unstable regime at the beginning of the previous decade. My results indicate that these imbalances could have been detected with the aid of real-time econometric modeling. With reference to Stiglitz’s general conception of a bubble, I use the econometric results to construct two bubble indicators, which clearly demonstrate the transition to an unstable regime in the early 2000s. The indicators are shown to Granger cause a set of coincident indicators and financial (in)stability measures. Finally, it is shown that the increased subprime exposure during the 2000s can explain the econometric breakdown, i.e. the housing bubble may be attributed to the increased borrowing to a more risky segment of the market.