

The thesis tries to explain different nature of the dynamics during the upward and downward part of the last house price cycle in Spain, characterized by important rigidities. Covered bonds are introduced as an instrument which may accelerate a house price boom, while it may also serve as a source of correction to overvalued house prices in downturn. In a serious economic stress, lack of investment opportunities motivates investors to buy the covered bonds due to the strong guarantees provided, which may in turn help to revitalize the credit and housing markets. To address such regime shift, house price dynamics is modelled within a framework of mutually related house price, credit and business cycles using smooth transition vector autoregressive model. Linear behaviour of such system is rejected, indicating the need to model house prices in a nonlinear framework. Also, importance of modelling house prices in the context of credit and business cycles is confirmed. Possible causality from issuance of covered bonds to house price dynamics was identified in this nonlinear structure. Finally, threat to financial stability resulting from rising asset encumbrance both in the upward and downward part of the house price cycle was identified, stressing the need to model impact of the covered bonds on house prices in a situation when Basel III liquidity requirements motivate towards use of this instrument.