

Housing and Consumption Volatility

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Draft is coming soon

Abstract

Business cycles in emerging economies exhibit both greater volatility of housing prices and relative consumption compared to business cycles in rich countries. This paper provides evidence of a positive relationship between housing price and relative consumption volatility across countries, and explores that linkage by building a real business cycle model of a small open economy with both housing and rental markets. While housing consumption, as measured through rental prices, is a non-negligible portion of total consumption, the role of the rental market has largely been overlooked in studies of consumption volatility. By explicitly modeling separate housing and rental sectors, this paper is able to explain some new stylized facts that emerge when housing and non-housing consumption are disaggregated: first, housing consumption is more volatile than non-housing consumption in emerging countries; and, second, even after controlling for housing consumption volatility, non-housing consumption in emerging economies is still more volatile than that in rich countries. Simulation results suggest that cross-country variation in the volatility of shocks to credit prices and availability is a driving force in generating the observed relationship between house price and relative consumption volatility. The model also suggests that a financial friction stemming from constraints in housing-collateralized credit can explain excess non-housing consumption volatility in emerging countries, while rental market frictions may account for the greater housing consumption volatility observed.

Keywords: Consumption Volatility, Housing Consumption, House Prices, Housing Rental Market, Emerging Countries

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