Consumption Volatility and Housing

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Draft is coming soon

Abstract

This paper links the two stylized facts of business cycle observed in emerging countries — higher house price volatility and relative consumption volatility — by providing an evidence of a positive relationship between two volatilities across countries. I build up a real business cycle model with housing for small open economy by incorporating new features into the existing theoretical framework to explain it. Specifically, the model explicitly accommodates a housing rental market and its price whose role has been overlooked in explaining consumption volatility though housing consumption whose corresponding price measure is the rent accounts for non-negligible portion of total consumption. Moreover, the disaggregation of housing and non-housing consumption brings new stylized facts for emerging countries: first, housing consumption is more volatile than non-housing consumption in emerging countries; second, non-housing consumption still shows excessiveness in emerging countries. The result of the model suggests that the variation of credit shock volatility is a driving force in generating the relationship between house price volatility and relative consumption volatility, and this paper provides qualitative evidences for cross-country discussion. The mechanism relies on a financial friction of housing collateral constraint, the degree of which gives an account of excess non-housing consumption volatility in emerging countries. I also discuss another key friction, a rental market friction, which explains the higher housing consumption volatility for emerging countries.

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

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