

Preference for Housing Services and Rational House Price Bubbles

Authors : Stefanie Jeanette Huber

Abstract : This paper explores the relevance and implications of preferences for housing services on house price fluctuations through the lens of an overlapping generation's model. The model implies that an economy whose agents have lower preferences for housing services is characterized with lower expenditure shares on housing services and will tend to experience more frequent and more volatile housing bubbles. These model predictions are tested empirically in the companion paper Housing Booms and Busts - Convergences and Divergences across OECD countries. Between 1970 - 2013, countries who spend less on housing services as a share of total income experienced significantly more housing cycles and the associated housing boom-bust cycles were more violent. Finally, the model is used to study the impact of rental subsidies and help-to-buy schemes on rational housing bubbles. Rental subsidies are found to contribute to the control of housing bubbles, whereas help-to-buy scheme makes the economy more bubble-prone.

Keywords : housing bubbles, housing booms and busts, preference for housing services, expenditure shares for housing services, rental and purchase subsidies

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