Quantitative Impacts of the Asset Price Channel in the Credit-Constrained Economy

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Abstract

We investigate under what conditions quantitative impacts of the asset price channel are *strong* by using a credit-constrained model in which land is used for production and serves as collateral. The technological substitutability between capital and land and adjustment costs of investment play important roles in amplifying and propagating shocks to the economy by the impacts through accumulating collateralizable assets. As the elasticity of substitution becomes smaller, the financial acceleration is at work strongly because firms accumulate greater amounts of land in early periods to finance investment in later periods. The adjustment cost of investment strengthens the asset price effect. By contrast, the adjustment cost of land weakens the asset price effect.