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Productivity Shocks and Housing Market Inflations in New Keynesian Models

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Abstract

Econometric evidence suggests the existence of two dynamics in the postwar U.S. housing market: (i) housing rental and purchase prices co-move positively in response to productivity shocks, and (ii) the purchase price exhibits much larger volatile movements than the rental price in response to the shocks. A standard New Keynesian model with nominal rigidity in the production sector is inconsistent with these facts. We incorporate a rental market into an otherwise standard New Keynesian model with durables and show that nominal rigidity in the rental market contributes to our empirical findings.

Keywords: Housing market; Price-rent ratio; Productivity shocks; New Keynesian model

JEL classification: E31; E32; E37; R21; R31