Housing Prices, Inflation, and Unconventional Monetary Policy

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Abstract

The role of housing prices in the mechanism of monetary policy transmission has been a live topic that attracts considerable attention among policy makers and academic researchers in recent years. In this paper, I examine the role of house prices in the unconventional monetary policy transmission mechanism of Japan both theoretically and empirically. I first build a basic New Keynesian model with collateral constraints while using monetary transfers as the unconventional monetary policy instrument under an assumption of the short-term interest rate reaching zero lower bound (ZLB). I find that when given a rise in loan-to-value ratio or house prices, output, and inflation increases, and the effect of an expansionary monetary transfer shock to the economy is amplified by causing a rise in house prices. To examine the theoretical findings empirically, I propose a structural vector autoregression (VAR) model using monthly aggregate data series of Japanese macroeconomy from 2001 to 2015. And I observe that expansionary monetary base shocks generate a persistent rise in real output, inflation, and real house prices while a positive housing price shock also leads to a short-term rise in real output and inflation, which match the simulation results in my theoretical model. Hence, I have examined the important role of housing prices in the unconventional monetary policy transmission, which may have meaningful implications for monetary policy decision making.

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