

The welfare effect of real estate prices fluctuations

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Abstract ID: 75

Inviato: 10/05/2021

Evento: XIX Workshop Annuale SIEPI

Argomento: XIX Workshop Annuale SIEPI

Parole chiave: Real estate prices, collateral, financial constraints, pecuniary externality, welfare

The price of a collateral asset can affect agents' financial constraints and, since agents do not internalize the effects of their choices on asset prices, this induces a so-called pecuniary externality. When it is positive and sizeable, higher asset prices stimulate economic activity, which causes increases in households' consumption expenditures large enough to improve aggregate welfare despite the higher user cost of assets. This insight yields a sufficient statistic to evaluate the importance of pecuniary externalities related to specific collateral assets. We use Italian data in the late 90's and early 00's to estimate the value of our statistic for the price of land|a collateral asset typically used by Italian households and firms to obtain external financing. We rely on exogenous shocks to the foreign demand for Italian land to obtain variation in its price. The data indicate that the Italian economy is subject to sizeable pecuniary externalities with a higher value of land leading to welfare gains, suggesting that the Italian economy is heavily financially constrained.