The Fed - Beliefs, Aggregate Risk, and the U.S. Housing Boom

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Abstract:

Endogenously optimistic beliefs about future house prices can account for the path and standard deviation of house prices in the U.S. housing boom of the 2000s. In a general equilibrium model with incomplete markets and aggregate risk, agents form beliefs about future house prices in response to shocks to fundamentals. In an income expansion with looser credit conditions, agents are more likely to underpredict house prices and revise up their beliefs. Matching the standard deviation and steady rise in house prices results in homeownership becoming less affordable later in the boom as well as consumption dynamics that match the data.

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PDF:  
Full Paper

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