The effects of government spending on residential investment

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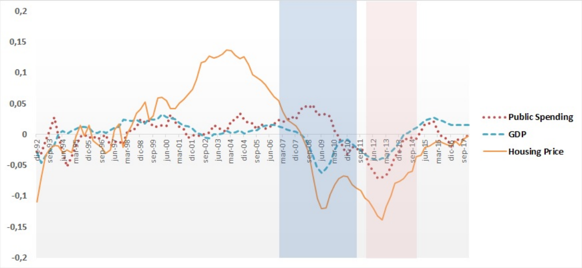
The burst of the Spanish housing bubble

Rate of growth of GDP, Public Spending and Housing Prices in Spain



Year-on-year variation rates of the variables (relative to working-age population in the case of GDP and government spending) and detrended according to the mean of each variable along the period 1992:4 - 2017:4. *Source of data: BDREMS.*

Did fiscal policy really help to overcome the housing shock? Was it at expense of a further penalty on the housing sector?

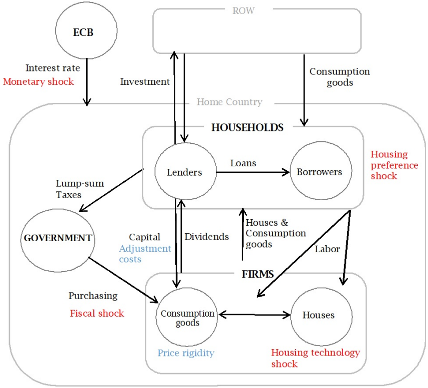
Effect of government spending policy on housing sector

Article	**Residential investment**	**Housing price**
Ramey and Saphiro's (1998)	$\downarrow$	
Edelberg, Eichenbaum and Fisher (1999)	$\downarrow$	
Fatas and Mihov (2001)	$\uparrow$	
Mountford and Uhlig (2005)	$\downarrow$	
Alfonso and Sousa (2012)		$\uparrow$
Agnello and Sousa (2013)		$\downarrow$
Andres, Bosca and Ferri (2015)		$\downarrow$

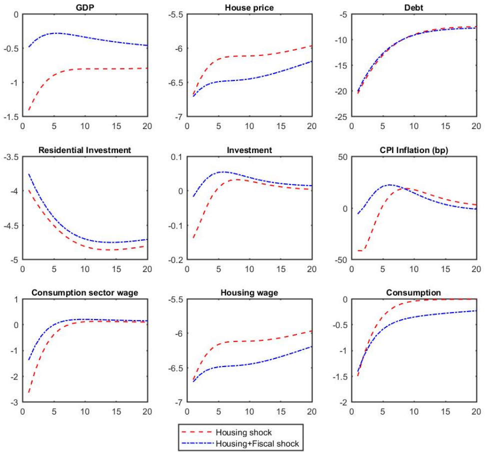
Lack of consensus in empirical literature about the effect of increasing government spending policies on residential investment and housing prices

Model calibrated so that steady state ratios of main economic aggregates to GDP match average historical ratios for Spain.

Landscape of the model



Housing and fiscal policy shocks



Impulse Response to a housing shock that reduces house price 6.6% and countercyclical fiscal policy. Public spending shock increases g in 4.8%. Y-axis represent percent deviation of the variable from its steady state.

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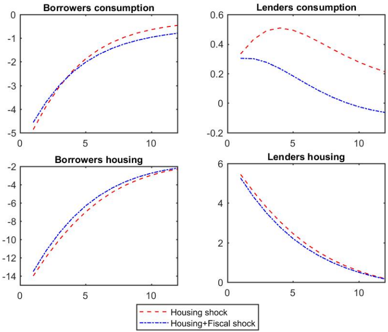

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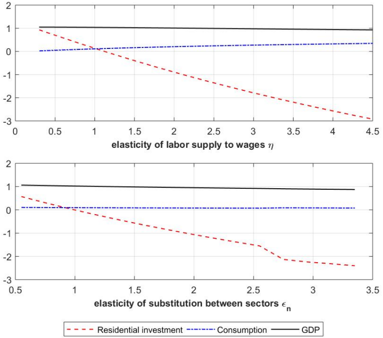
Borrowers increase consumption and home buying and compensate the fall in consumption and housing of lenders.

Impact responses to government spending shock



- Increase in public spending can play a positive or negative role in recovery of residential investment sector, depending on some features of the labor market.
- Fiscal policy may worsen residential investment the greater the mobility of labor between sectors and the lower the reaction of hours worked to wages.

Main results

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- Unlike for the rest of macro-variables, the response of residential investment to fiscal shocks may be significantly affected depending on the characteristics of the labor market .
- Despite the positive effect of the increase in government spending on GDP and consumption goods sector, fiscal policy may damage housing sector (decoupling effect).
- This decoupling effect of the fiscal shock strengthens the easier it is to reallocate employment between sectors and the lower is the response of hours worked to wages.