Demographic Cycle, Migration and Housing Investment: a Causal Examination

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Abstract

This paper argues that residential investment is much more volatile than GDP because the demographic variable that determines specifically housing demand (growth of population aged 20-49) is itself highly volatile. First, we depart from the literature on housing cycles which has mainly focused on explaining the cycle of housing prices by changes in financial conditions. Instead, we study the cycle of real residential investment as a share of real GDP in 20 OECD countries since 1980, and show that it is closely associated with the growth dynamics of population aged 20-49. Second, the paper develops a new method to uncover the causal effect of the growth of population aged 20-49 on housing construction. We use past demographic data as an instrument to avoid the potential endogeneity bias between migrations and the housing cycle. The instrument is strong in countries where net migration is low. Overall, we find that a 1% increase in the population aged 20-49 increases the ratio of residential investment to GDP by 1.3 pp. Demographic changes appear to be a better predictor of the cycle of the residential investment rate than any other macroeconomic variable we control for. (JEL E32, J11, R21)

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