

# WORKING PAPER SERIES

2020 — 2

## The Housing Phillips Curve

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OSLOMET



HOUSING LAB  
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# The Housing Phillips Curve\*

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August 10, 2020

## Abstract

Using a high-resolution housing transaction data set, we examine the relationship between price changes and the unsold rate in the Norwegian housing market within a Phillips curve framework. Compared to the classical labor market Phillips curve the housing Phillips curve displays a reversed causality, from price changes to the unsold rate. We propose a consistent model based on microfoundations in which households decide on the sequence of buying and selling, i.e. whether to hold two or zero houses in the transition period. Data on individual sellers and buyers support the hypothesis that the propensity to hold two houses is pro-cyclical.

**Keywords:** Buying-before-selling, Granger causality, Hedonic price index, Housing Phillips curve

**JEL Codes:** C20, D44, R21

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\*The authors are grateful to Eiendomsverdi for data.

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# 1 Introduction

The Phillips curve is one of the most studied and well-known relationships in economics. In its simplest form, it refers to a relationship between the level of unemployment and the rate of subsequent wage inflation. That relationship is easy to grasp and useful in practice. After all, it may function as a gauge of how scarcity is priced. Whenever a commodity is scarce, economists believe the price of the commodity tends to increase. Conversely, when the commodity is plentiful, the price increase is modest, absent, or even reversed. While the original Phillips curve was sourced from the labor market, such curves would, could, and should be expected in other markets. This article asks a simple question: Is there a housing Phillips curve?

Yes. This answer is clearly warranted by data for Norway's capital Oslo, and supported by evidence from other large cities. We propose to use the the "unsold rate" as a pressure gauge of the housing market, corresponding to the unemployment rate of the labor market. The unsold rate is the number of unsold units as a share of units for sale in the market. This article documents that there is a clear association between price changes and the unsold rate. However, the direction of causality appears to be reversed: While the causality in the labor market goes from unemployment to wage changes, the housing Phillips curve indicates that in the housing market price changes move before the unsold rate. In fact, we find convincing evidence for the claim that price changes Granger cause unsold rates.

Scarcity may move prices, but it could also be the other way around: Prices are also a signal that people may act on and thus affect scarcity through changes in demand and supply. This article proposes a model based on micro foundations to explain a component of this reversed causality. The core content of this model is this: While the labor market is characterized by a search-and-match activity between employees and employers that leads to one match, the housing market is characterized by a search-and-match activity between buyers and sellers that lead to two matches. After all, an owner-occupier needs to find both a buyer of his old house and a seller of his new house. This dual search-and-match activity

comes with financial implications most easily understood by keeping in mind that a moving owner-occupier needs to choose between owning two houses or no houses in the transition period. If he buys first, he owns two houses and pays two mortgages in the transition period and experiences a capital gain in a rising market or a loss in a falling market. If he sells first, he owns no houses and needs to rent in the transition period. Studying the target value functions, we observe that price developments represent a powerful influence on the relative values of buying first or selling first. When prices rise, owning two houses is more tempting. When prices fall, owning zero houses is more tempting. The implication is that sudden changes in the relative values between buying first and selling first may lead to changes in the unsold rate (Anundsen and Røed Larsen (2014)).

Our contribution lies in bringing novel data to an old idea. The data contain two key dates: the date on which a unit is announced for sale and the date on which the seller accepts the bid from the buyer. These two dates allow us to obtain a complete overview over what is in the market, and distinguish between what is for sale and what has just been sold, at any given point in time. Thus, we are able to construct a temporal grid of price changes and unsold rates with high granularity, which create an opportunity we exploit in the Granger causality regressions and in the documentation of the supporting evidence for our proposed explanation.

There are several reasons why economists should care about these findings. First, houses are assets with an aggregate value that is sufficient to move other markets (Leamer (2015)), and so we seek insights into the mechanisms governing the price formation and the consequences of the price formation. If one can compare price changes with unsold rates and use this to evaluate the overall condition of the housing market, we would like to know.

Second, it is possible that price changes have momentum and lead to feedback loops. A price change may induce a shift in the relative values of the decisions to buy first or sell first, which in turn can re-inforce the very price change that triggered it. Rising house price inflation could initiate a rush among moving owner occupiers to buy first, which increases

relative demand and fuels further inflation. The presence of such dynamics in the housing market bears several policy implications that we would like to inspect more closely. On the one hand, it is useful to know that moderately-behaved house prices may allow heterogeneity in decisions to buy or sell first. On the other hand, if or when a feedback loop is triggered, it may be exacerbated if financial regulation makes it difficult to own two houses for a (short) period of time, i.e. disallows interim access to credit for moving owner-occupiers who want to buy before selling.

This article is organized as follows: In the next section, we describe the literature on Phillips curves and related works on the housing market and our thoughts on taking the Phillips curve framework to the housing market. Section 3 defines the housing Phillips curve. Section 4 describes data and the institutional arrangements of the Norwegian housing market. In section 5, we present our empirical techniques and in section 6 our findings. Section 7 lays out our proposed model based on micro foundations that is consistent with reversed causality. Section 8 summarizes and discusses policy implications.

## **2 Literature and motivation**

### **2.1 The Phillips curve**

It is not within the scope of this article to give a full review of the vast Phillips curve literature that followed Phillips' (1958) seminal article. Instead, we outline a few key features of the early contributions and add some recent perspectives in order to set the stage for introducing the housing Phillips curve (HPC).

The Phillips curve describes an observed empirical relationship between unemployment and wage inflation. Phillips (1958) found this relationship when he studied a long time series for the UK. When unemployment was high, wages increased slowly. When unemployment was low, wages increased more rapidly. Subsequently, economists estimated Phillips curves for several countries and the Phillips curve became part of the toolkit of macroeconomics

(Samuelson and Solow (1960)).

The Phillips curve's lack of theoretical foundation was subject to considerable criticism, notably by Phelps (1967, 1968) and Friedman (1968, 1977, 1995). They argued that the government could not trade higher inflation for lower unemployment permanently. The difference between nominal and real wages was pointed out. Instead, they suggested, the Phillips curve is vertical in the long run. Gordon (2018) present recent perspectives of the Friedman-Phelps approach. Gordon also proposes a framework within which one may explain how adverse supply shocks like the oil crises in the 1970s lead to high unemployment and high inflation. The presence of information asymmetry was debated. Lucas (1972, 1973) and Sargent and Wallace (1975) argued that expectations are rational, so that economic agents will anticipate expansionary economic policies based on a known rule for monetary policy and adapt immediately.

The short-run Phillips curve is also known as the expectations augmented Phillips curve because an increase in expected inflation makes it shift up. Under this name it also appears in a more recent class of macroeconomic models with sticky prices, the New Keynesian dynamic stochastic general equilibrium models. In these models, there is a positive relation between the rate of inflation and the level of demand, and thus a negative relation between the rate of inflation and the rate of unemployment. This is often called the "New Keynesian Phillips curve". The New Keynesian Phillips curve implies that the government can reduce unemployment temporarily by increasing inflation, but not permanently (Clarida et al. (1999) and Blanchard and Galí (2007)).

Several other explanations of a short run trade-off have been suggested: long-term labor contracts (Fischer (1977)), sticky prices (Rotemberg (1982) and Mankiw (1985)), and non-rational expectations (Akerlof and Yellen (1985)). Other contributions reject the idea of the Phillips curve, arguing that wages and prices are determined by the market, and that competitive firms cannot just raise prices to compensate for higher wages, see e.g. Herbener (1992).

There is a more recent branch of more micro-oriented empirical analyses of the Phillips curve, which exploits disaggregated or high-frequency data. Kumar and Orrenius (2016) use state-level data from 1982 to 2013 to study the curvature of a wage-price Phillips curve using spline specifications, in which short-term unemployment is associated with increases in average and median wages while long-term unemployment is associated with the latter. Coibion and Gorodnichenko (2015) study the difference between inflation and expected inflation and the unemployment rate to explain the disinflation during the Great Recession. Antoine and Boldea (2018) study a Phillips curve at a monthly frequency and argue that this is more appropriate given the twice-quarterly monetary policy meetings. Galbács (2015) and Gordon (2018) present recent overviews of the Phillips curve literature and Bhattarai (2016) offers empirical evidence for the presence of Phillip’s curves in 28 out of 35 OECD countries in the period from 1990 to 2014.

## **2.2 Phillips curves in other markets**

The standard Phillips curve emerges from studies of the labor market and reflects the changes in the price of labor when the scarcity of labor changes. A low unemployment rate mirrors a tight labor market, in which firms compete with other firms over labor. Wages increase faster when unemployment is reduced and vice versa. Since prices reflect scarcity in every market, it is reasonable to expect Phillips curve-type relationships in other markets as well. In this article, we study the housing market through a Phillips curve framework.

An early contribution can be found in Rosen and Smith (1983) who study the U.S. rental market. They find that rents are connected to excess supply or demand and estimate a natural vacancy rate for U.S. cities. They found that the natural vacancy rate ranged over a considerable spectrum, and was estimated at 6 percent for New York and 14.6 for Denver.

Gabriel and Nothaft (2001) study U.S. rents and vacancies and obtain evidence that supports the idea that the rent changes reflect equilibrium deviations of the probability that a unit becomes vacant and the length of the vacancy. Lerbs and Teske (2016) find that, in

Germany, a doubling of the vacancy rate at the municipality level is associated with a 5-8 percent discount in quality-controlled house prices. Zabel (2016) uses MSA level data for 1990–2011 to develop a dynamic model of the housing market. He finds that when there is excess demand, prices rise as vacancies are reduced. However, he finds an asymmetry since prices do not decline when there is excess supply and vacancies increase.

This study contributes to this literature by combining data on dates of announcements for sale and dates of acceptances of highest bid. This combination allows us to measure the number of units for sale and the number of units sold within a given period. Using transaction data, we construct a price index that allows us to study quality-controlled price changes before, within, and after the same period. This enables us to test whether a housing Phillips curve exists.

### 3 The Housing Phillips curve

We start out by defining the housing market equivalents to the components in the standard Phillips curve, i.e. wage inflation and the unemployment rate. The equivalent to the price for labor, the wage level, is a quality-controlled house price level. The equivalent to the unemployment rate is the ratio of available housing units to the total number of units in the housing market. The "housing market" could be defined as the housing stock. We dismiss this definition because it would not keep the analogy to the original Phillips curve intact, as the housing stock is the population of housing units and is similar to the population in an economy, not the labor force. In the labor market, the unemployment rate is the ratio of the for-hire workers to the sum of for-hire and hired workers. We let the housing market component be the ratio of for-sale houses to the sum of for-sale houses and sold houses.

More precisely, the unemployment rate in period  $t$ ,  $UR_t$ , is defined as the number of unemployed workers,  $U_t$ , as a share of the labor force,  $LF_t$ :

$$UR_t = U_t/LF_t. \tag{1}$$

Similarly, the unsold rate of housing units in period  $t$ ,  $UR_{H,t}$ , is the number of unsold units as a share of units for sale in the housing market  $H$ , which is the sum of unsold units,  $U_{H,t}$ , and sold units in the same period,  $(S_{H,t})$ :

$$UR_{H,t} = U_{H,t}/(U_{H,t} + S_{H,t}). \tag{2}$$

In its simplest form, the housing Phillips curve represents the empirical trace of an association between the unsold rate at time  $t$ ,  $UR_{H,t}$ , and the rate of house price change at time  $t$ ,  $\Delta P_t = (P_t - P_{t-1})/P_t$ :

$$UR_{H,t} = \alpha + \beta \Delta P_{t+s} + u_t, \tag{3}$$

in which the subscript  $s$  represents a difference in timing. It is an empirical question whether  $\beta$  is positive, zero, or negative. The coefficient  $\beta$  represents the relationship between house price changes and the levels of the unsold rate and is expected to be negative: a low unsold rate goes hand in hand with high house price inflation and vice versa. The error term  $u$  represents classical noise.

Causality may go from scarcity to prices, but it could also be the other way around. To see this, keep in mind that even though scarcity may push prices up, prices are also a signal that people may act on and thus affect scarcity through changes in demand and supply. In the original Phillips curve for the labor market, causality is normally found to go

from scarcity to prices, i.e. from unemployment to wages. Here we investigate the direction of causality between housing prices and the unsold rate, and a negative  $s$  in equation (3) would represent reverse causality, i.e. that house price changes are leading the levels of the unsold rate. The relationship between the unsold rate and price change and the direction of causality are empirical questions, to which we will return in section 6.

## 4 Data and institutional arrangements

We use data from Eiendomsverdi, a firm that specializes in acquiring housing market data and collaborates with Real Estate Norway (the association of real estate brokerages), Finn.no (an online advertising platform), and other firms that source housing information, and combines these data with public records. About 70 percent of all transactions pass through Finn.no and real estate agents. Examples of transactions that do not pass through such market places are within-family transactions and other non-arms-length transactions.

### 4.1 Transaction data

Our transaction data set comprises sell price, ask price, date on which the highest bid was accepted by seller, attributes of the unit, date of advertisement registration on the online platform Finn.no, and appraisal value. The original data file consists of 445,810 observations and 41 variables. We study owner-occupied units, and exclude co-ops.

We trim on sell price, size, and the ratio of sell price on size, using 1 and 99 percentiles. We also trim after having estimated our hedonic model and we trim on missing data. After trimming, we are left with 378,294 observations covering January 2010 - October 2017.

While the public registration date and unit attributes are sourced from official registers, we obtain three additional unique variables: the ask price, the date on which the unit was registered online, and the date on which the highest bid is accepted. The ask price is the last ask price a seller sets, and it is entered into an electronic registering system by a realtor.

Typically, an ask price is not revised during the first three weeks of the sales process and only a fraction of sales involve revised ask prices. In the period before 2014, reports indicate that less than 10 percent were revised. In the period after 2014, the practice may have increased somewhat in frequency.

## 4.2 Data on unsold units

Eiendomsverdi registers advertisements on Finn.no. It compares every registered advertisement with the next nine months of transactions. As long as there is no match, the advertised unit is classified as "for sale" and is counted in the stock of unsold units. If it has not been registered as sold after nine months, it is removed from the for-sale stock.

## 4.3 Data on the buy first rate

To test for a presence of a link between observed prices and households' decisions about selling or buying first, we employ survey data for the proportion of households who reports that if they were to move, they would buy a new dwelling before selling their existing one. The survey data is collected by the analysis company Prognosesenteret on behalf of the real estate company Eiendomsmegler 1. The survey is based on a sample of approximately 1400 households all over the country from a population of just above one million. The survey has been done at varying intervals over the years, from four to twelve times each year. We construct a quarterly time series based on monthly averages when available, otherwise a quarter is represented by a corresponding monthly observation<sup>1</sup>.

## 4.4 Institutional arrangements

The home is the most important asset of most Norwegian households. Almost 80 percent of Norwegians are owner-occupiers at any given time (Røed Larsen and Sommervoll (2009))

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<sup>1</sup>Only data on a national level have been available to us. However, the national housing market is highly correlated with the Oslo market, with an  $R^2$  of 0.97

and more than 90 percent own during their lifetime. The high proportion of owner-occupiers separates Norway from many countries, including its neighbors Sweden and Denmark. As early as 1920, more than 50 percent of Norwegian households were homeowners (see e.g. Benedictow et al. (2020)). The share was boosted after World War II, in part due to tax incentives. The incentives have been eased in latter years, but the aim of a high share of homeowners still has broad political support.

The Norwegian housing market is liquid and transparent. It is arranged as electronic auctions of houses. A brief description of the sales process would start with a seller contacting a realtor. The realtor and the seller discuss when to put the unit on the market and at what ask price. Then, the unit is announced for sale on the online platform Finn.no and sometimes, but increasingly rarely, also in national and local newspapers. There is some geographical variation in the process, although the basic "rules of the game" are the same. In Oslo, the public posting of advertisement on Finn.no typically occurs on a Friday, with an announced public showing nine or ten days later, i.e. on a Sunday and a Monday. Included in the ad is an ask price, which is called a "price suggestion" rather than a reservation price, pictures, and a detailed description of the unit. Historically, advertisements would also include an appraisal value, but recently this practice has waned. Even if sellers often hire an appraiser, the role of the appraiser is to deliver a technical report. The assessment of the market value is left to the realtor.

During the public showings, interested parties inspect the unit while the realtor is present. The seller may or may not be present. The day after the last showing, the auction commences. The auction is arranged as an ascending bid (English) auction. Bids are delivered digitally, and the first bid is usually accompanied by a proof of financing issued by a bank. The proof of financing is done in a way that masks what the maximum bid potential is. Bids may or may not include an expiration time or date. The realtor continuously informs the participants of developments in the auction. All bids are legally binding. A seller accepts the bid by making a formal acceptance through informing the realtor. This acceptance is

legally binding, i.e. after acceptance the seller has essentially granted transfer of ownership. The signature meeting is often a few weeks later and the registration into public registers is done after an additional few more weeks.

## 5 Empirical techniques

To construct the house price index, we employ our own version of the Sale Price Appraisal Ratio (SPAR) method (Bourassa et al. (2006), de Haan et al. (2009)), in which we use a predicted price from a hedonic model in stead of the appraisal value. The SPAR-approach involves first estimating a hedonic model for a base year, then predicting each house price based on the hedonic model. Then, we compute the ratio of the sell price on the predicted price and use the median ratio for each month. This set-up has the advantage that all observations includes the sell price (the numerator), controls for type and attributes by dividing by the hedonic price (the denominator), and handles outliers by using the median, not the mean, ratio each month.

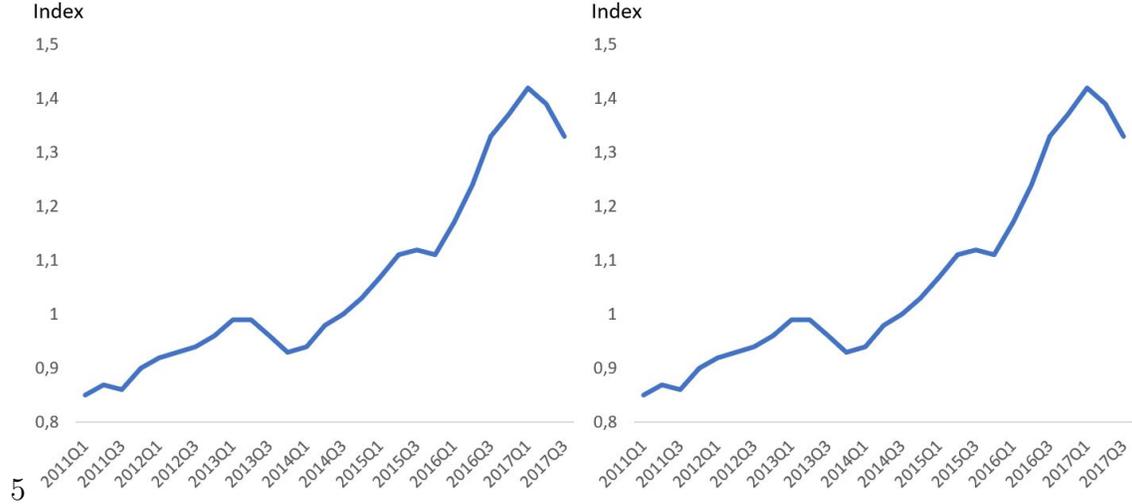
### 5.1 The hedonic model

The hedonic model is a regression of observed sell price onto a space consisting of a second order polynomial of the logarithm of size, dummy variables for type, interaction variables between apartment and the second order polynomial of size and dummy variables for plots above 1000 square meters.

### 5.2 The SPAR-index

We compute the ratio of sell price to predicted price, the SPAR, and extract the median SPAR for each month. Figure 1 show the smoother quarterly version, calculated by the average of monthly observations.

**Figure 1: Hedonic house price index. Oslo, 2011(1) - 2017(3)**



Notes: The index is constructed using a SPAR-approach (Sell Price on Appraisal Ratio) while using a hedonic model in stead of the appraisal value. The index level is relative to the index base of 2014(3), which is set equal to unity.

### 5.3 Granger causality

As outlined in Section 3, economic theory does not give firm guidance on the direction of causality between a house price index and the unsold rate. Granger (1969) provides a commonly used approach for constructing an apparatus for empirical testing, in which a time series  $X$  is said to Granger-cause another time series  $Y$  if it can be shown that  $X$  provide statistically significant information about future values of  $Y$ . More specifically, we say that  $Y$  is Granger-caused by  $X$  if the coefficients on the lagged  $X$ 's are statistically significant in a specification in which lagged values of  $Y$  are also included. Thus, Granger causality measures precedence, a necessary condition for causation. We also note that two-way causation is frequently found, i.e. that  $X$  Granger causes  $Y$  and  $Y$  Granger causes  $X$ . Therefore, we test both directions.<sup>2</sup> We run bivariate regressions for  $UR^3$  and  $\Delta P$ :

<sup>2</sup>We also test for different leads and lags of  $\Delta p$  when estimating the Housing Phillips curve in Section 6

<sup>3</sup>For the sake of simplicity we skip the subscript  $H$  on the unsold rate,  $UR$ , from here on

$$UR_t = \alpha_{0,1} + \sum_{n=1}^N \alpha_{n,1} UR_{t-n} + \sum_{n=1}^N \beta_{n,1} \Delta P_{t-n} + u_t, \quad (4)$$

$$\Delta P_t = \alpha_{0,2} + \sum_{n=1}^N \alpha_{n,2} \Delta P_{t-n} + \sum_{n=1}^N \beta_{n,2} UR_{t-n} + w_t, \quad (5)$$

in which  $u$  and  $w$  are error terms. We test the null hypothesis that  $\beta_{1,k} = \beta_{2,k} \dots = \beta_{N,k} = 0$  for  $k = 1, 2$ .

We say that price changes,  $\Delta P$ , Granger cause levels of the unsold rate, UR, if there are  $\beta$ s significantly different from zero in the first equation. This means that we reject a null hypothesis of all  $\beta$ s equal to zero. Likewise, we say that levels of the unsold rate, UR, granger cause price changes if any  $\beta$ s in the second equation are significantly different from zero.

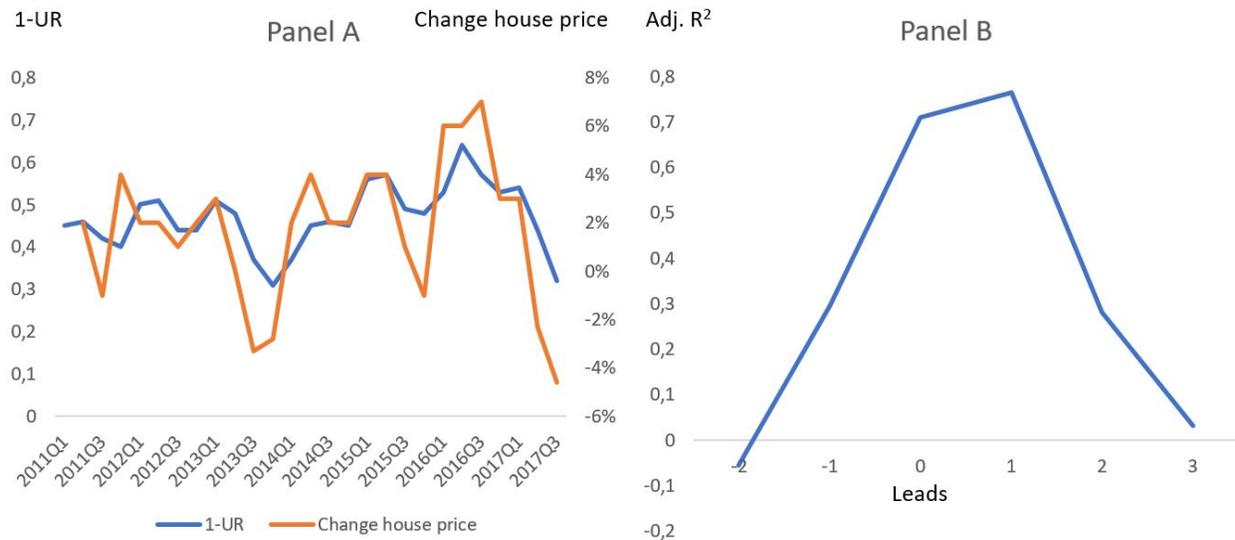
## 6 Empirical results

### 6.1 Causality

Panel A of Figure 2 plots  $UR$  (inverted) and quarterly changes in the house price,  $\Delta P$ , from 2011 to 2017. By visual inspection, we see that they are highly correlated. High house price inflation is accompanied by low unsold rates and vice versa. Panel B displays the Adjusted  $R^2$  of regressions of the two variables for different lags of UR on  $\Delta P$ . The horizontal axis indicates the number of quarters  $\Delta P$  is leading on UR, and the vertical axis indicates the corresponding Adjusted  $R^2$ . We observe that the highest Adjusted  $R^2$  of 0.76 is achieved when house price changes lead UR by one quarter.

As described in subsection 5.3, we perform a two-directional test of Granger causality for the unsold rate and changes in the price index. We estimate both equations 4 and 5 with 1-5 lags, e. g. we test the respective null hypotheses, see Table 1. The F-statistics reported

**Figure 2: House price changes and unsold rates. Oslo, 2011-2017. Panel A: Quarterly house price changes and  $UR$  (inverted). Panel B: Correlation of house price changes and  $UR$  (inverted) at different lags of  $UR$ . A positive figure indicates house price changes lead on  $UR$**



Notes: The house price index is constructed using a SPAR-approach (Sell Price on Appraisal Ratio) while using a hedonic model in stead of the appraisal value. The unsold rate ( $UR$ ) is the number of unsold units as a share of units for sale in the housing market, which is the sum of unsold and sold units in the same period.

in brackets are the Wald statistics for the joint hypothesis  $\beta_1 = \beta_2 \dots = \beta_N = 0$  for equation 4 and 5, respectively.

For 1-3 lags we cannot reject the hypothesis that  $UR$  does not Granger cause  $\Delta P$ , but we do reject the hypothesis that  $\Delta P$  does not Granger cause  $UR$ . Thus, our evidence suggest that Granger causality runs one way from  $\Delta P$  to  $UR$  and not the other way around. The estimate with one lag provides the best fit.

## 6.2 The housing Phillips curve

Based on the results above, we estimate the Phillips curve by regressing  $UR_t$  on  $\Delta P_{t-1}$  and an intercept. The highly significant estimates of the regression line is presented in Table 2. Figure 3 displays the housing Phillips curve by plotting the lagged quarterly change in the price index versus the level of  $UR$  and the regression line, i. e. the price changes for quarter

**Table 1: Granger causality. Price change and unsold rate. Oslo, 2011(1)-2017(3)**

$H_0: \beta_1 = \beta_2 \dots = \beta_N = 0$	P-value (F-statistic)				
	No. of lags. N=5				
	1	2	3	4	5
$H_0 : \Delta P$ does not Granger cause $UR$	0.0010*** ( 14.42)	0.0112* (5.74)	0.0112* (5.13)	0.0059** (5.98)	0.0378* (3.68)
$H_0 : UR$ does not Granger cause $\Delta P$	0.5940 (0.29)	0.5108 (0.69)	0.3300 (1.23)	0.0245* (4.02)	0.1074 (2.44)

Notes: We use the software package EViews to test for Granger causality. \*\*\* Indicates significance level 0.001, \*\* = 0.01 and \* = 0.05.

q-1 are plotted against the UR for quarter q. Large price increases are followed by low levels of UR and vice versa. We also estimate the Phillips curve with up to 3 lags and 3 leads. In line with the Granger test, the best fit is achieved with one lag.

**Table 2: The housing Phillips curve. UR on lagged  $\Delta P$ . Oslo, 2011(1)-2017(3)**

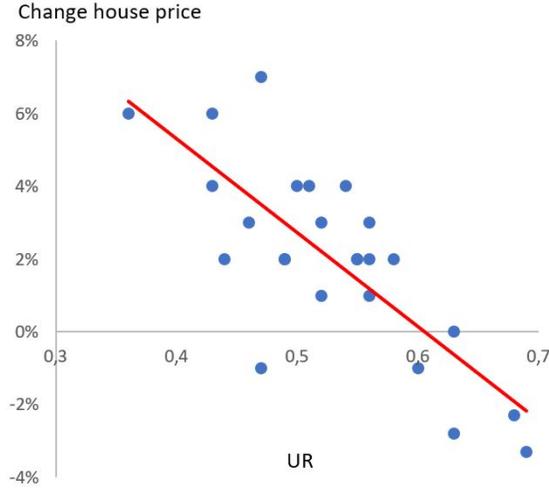
<i>Dependent variable UR (st.err.)</i>	
Oslo	
$\Delta P_{t-1}$	-2.322** (0.389)
Intercept	0.575*** (0.013)
Adj. R <sup>2</sup>	0.591
<i>Note:</i>	*p<0.1; **p<0.05; ***p<0.01

### 6.3 Other cities

In subsections 6.1 and 6.2, we find clear evidence of a housing Phillips curve in Oslo, and that  $\Delta P$  Granger causes  $UR$ .

However, there is not one single, homogeneous housing market in Norway, but rather many local markets. Norway is a geographically large and sparsely populated country, with a population about 5.5 million people. The distance from Hammerfest in the far north to Oslo in the south equals the distance from Oslo to Rome. Sub-markets emerge from geographical heterogeneity in regulations and other institutional conditions and the size of

**Figure 3: The Phillips curve. Oslo, 2011(1)-2017(3)**



Notes: The house price index is constructed using a SPAR-approach (Sell Price on Appraisal Ratio) while using a hedonic model in stead of the appraisal value. The unsold rate ( $UR$ ) is the number of unsold units as a share of units for sale in the housing market, which is the sum of unsold and sold units in the same period. The Phillips curve is estimated by regressing  $UR_t$  on  $\Delta P_{t-1}$  and an intercept

and developments in local labor markets. Oslo with its 680,000 inhabitants is the only truly large housing market in Norway, interacting with a large and diverse labor market. Therefore, the main focus is on Oslo in this paper. For the sake of comparison, we repeat the same exercise for three other Norwegian cities, Trondheim (180,000 inhabitants), Bergen (270 000) and Stavanger (130,000).

**Table 3: The housing Phillips curve. Trondheim, Bergen, and Stavanger, 2011(1)-2017(3)**

	Dependent variable (st. err.) = $UR$		
	Trondheim	Bergen	Stavanger
$\Delta P_{t-n}$	-1.53** (0.47)	-1.44** (0.36)	-2.22** (0.75)
Intercept	0.57*** (0.013)	0.58*** (0.01)	0.68*** (0.02)
Adj. $R^2$	0.28	0.37	0.24

Note: \* $p < 0.1$ ; \*\* $p < 0.05$ ; \*\*\* $p < 0.01$ .  $n=1$  for Trondheim and 0 for Bergen and Stavanger

We find clear evidence for housing Phillips curves in all three cities, as shown in Table 3. Like the case of Oslo, data for Trondheim also show clear evidence of reverse causality,

**Table 4: Granger causality. Price change and unsold rate. Trondheim, Bergen, Stavanger, 2011(1)-2017(3)**

$H_0: \beta_1 = \beta_2 \dots = \beta_N = 0$	P-value (F-statistic)				
	No. of lags. N=5				
	1	2	3	4	5
Trondheim					
$H_0 : \Delta P$ does not Granger cause $UR$	0.0053**	0.0016**	0.0009***	0.0014**	0.0046**
$H_0 : UR$ does not Granger cause $\Delta P$	0.0415*	0.1188	0.2007	0.0773	0.0491*
Bergen					
$H_0 : \Delta P$ does not Granger cause $UR$	0.3315	0.2131	0.6574	0.8483	0.0378*
$H_0 : UR$ does not Granger cause $\Delta P$	0.7099	0.0999	0.3434	0.5065	0.2179
Stavanger					
$H_0 : \Delta P$ does not Granger cause $UR$	0.1975	0.6426	2566	0.9721	0.1922
$H_0 : UR$ does not Granger cause $\Delta P$	0.2282	0.7713	0.1352	0.2130	1732

Notes: We use the software package EViews to test for Granger causality. \*\*\* indicates significance level 0.001, \*\* = 0.01 and \* = 0.05.

see Table 4. However, that is not the case for Stavanger and Bergen, where we find no clear indication of the direction of causality. The differing results may be attributable to several factors affecting market dynamics. Stavanger and Bergen are smaller cities with less diverse labor markets. The Stavanger market in particular, is unique and behaves differently than other Norwegian markets. Stavanger is located on the west coast and is the petroleum capital of Norway. It serves as host for oil companies and off shore activities and is home to a visiting international audience. Stavanger is also a twin city with neighbouring Sandnes, and both markets are sensitive to the cycle in the oil market. Bergen is also located on the west coast and sensitive to the petroleum sector, although at a smaller scale than Stavanger. Hosting two large universities brings a significant population of students to Bergen with a large share on short term rental contracts and large fluctuations in supply and demand in the periods between university semesters.

## 7 Micro foundations: Reversed causality explained by searching and matching in the housing market

Our prior is that causality goes from scarcity to price, as in the standard Phillips curve literature. However, in the housing market causality appears to be reversed since our empirical evidence clearly indicates that price changes Granger cause unsold rates in Oslo. In this section we present a skeleton model consistent with such reversed causality.<sup>4</sup>

The housing market is characterized by a simultaneous search-and-match activity in which a moving owner-occupier attempts to locate two matches: a buyer of his old house and a seller of his new house. This dual search-and-match activity comes with financial implications most easily understood by keeping in mind that a moving owner-occupier needs to choose between owning two houses or no houses in the transition period.

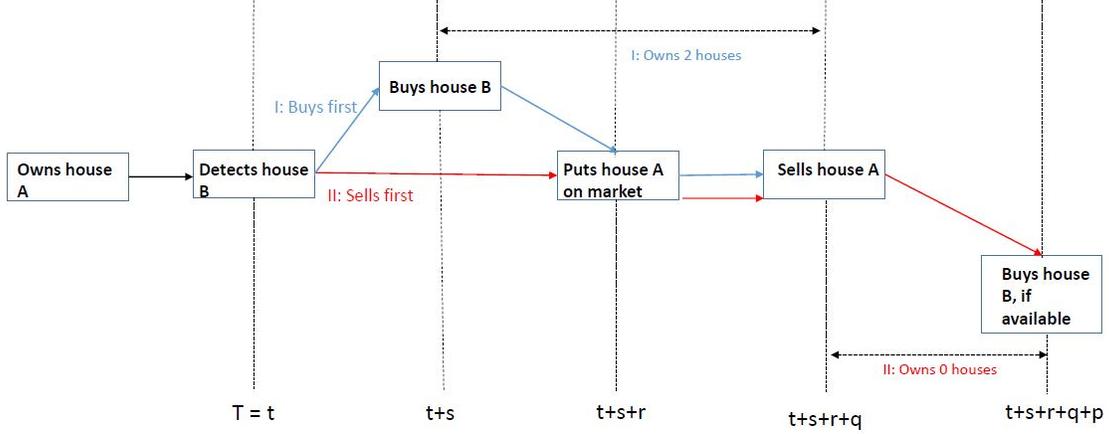
Consider first a simple timeline of a moving owner-occupier, as illustrated in Figure 4. While moving and transfer of ownership might occur on different dates, we simplify here in order to illustrate the main point of holding zero or two units. We let a sell date imply that the seller transfers ownership and moves out of his old house.

If a moving owner-occupier of house A first buys (subscripted b) a house B, this household will hold two houses, A and B, in a transition period. In Figure 4, the path of a buy-first household is illustrated by the blue line and that of a sell-first household by the red line. If house prices increase by the rate  $\pi$  per month  $m$  in that period, the buy-first household enjoys price appreciation of two assets during the holding time. The capital gains of this appreciation is approximately the duration times the appreciation rate per month times the initial price for both houses,  $m_b(\pi(P_A + P_B))$ . At the same time, the buy-first household services two mortgages ( $M_A$  and  $M_B$ ) at an interest rate  $i$ , some of which is tax deductible at rate  $\tau$ . Finally, by buying the house B when the household detects it, the household locks

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<sup>4</sup>A related approach is found in Moen et al. (2019). They argue that moving home-owners prefer to buy first whenever there are more buyers than sellers in the market, and that this leads to multiple steady state equilibria and large fluctuations.

Figure 4: Timeline buy-first vs sell-first



in a utility gain since it obtains a good match between household preferences  $f$  and the house attributes  $a$  of house B. Assuming a monetary conversion of match-utility  $U$  we may write his value function as:

$$VA_b = m_b(\pi(P_1 + P_2) - i(1 - \tau)(M_1 + M_2)) + U(f, a_B). \quad (6)$$

If the household sells first (subscripted  $s$ ), the household foregoes the appreciation of two houses, but also avoids interest on two mortgages. Moreover, the household locks in utility from equity certainty (UEC), which means that the household avoids risking buying a more expensive house than they would have had they known the magnitude of the realized home equity. However, the sell-first household must rent a house at a rental price of  $R$  per month  $m_s$  of renting. Additionally, there is a probability  $\rho(s)$  that some other buyer buys house B and the household must settle for another, potentially suboptimal, house C. The probability of losing out on house B increases as the number of months in transition increases. This may imply a loss of match-utility since house C may yield less utility than house B. We may write the value function of selling first as:

$$VA_s = UEC_s - m_s R - \rho(s)((U(f, a_B) - U(f, a_c)), \quad (7)$$

in which we use general, unspecified functions  $UEC$  and  $U$  simply to point out the components.

The value functions  $VA_b$  and  $VA_s$  are affected by the price development in the transition period if the moving owner-occupier has extrapolative expectations. Thus, we sketch an idea about a link from observed prices to households' decisions about selling or buying first that contains the following elements:

- A change in prices leads to a change in expected prices and thus the expected value of holding two houses,
- which leads to a change in the relative values of  $VA_b$  vs  $VA_s$ ,
- which with preference heterogeneity implies that some, but not all, moving owner-occupiers change their decisions from sell-first to buy-first or vice versa,
- which leads to an observable change in the frequency of moving occupiers buying first,
- which leads to a temporary change in the number of unsold units as a share of the sum of unsold units and sold units, i.e. a temporary change in the unsold rate.

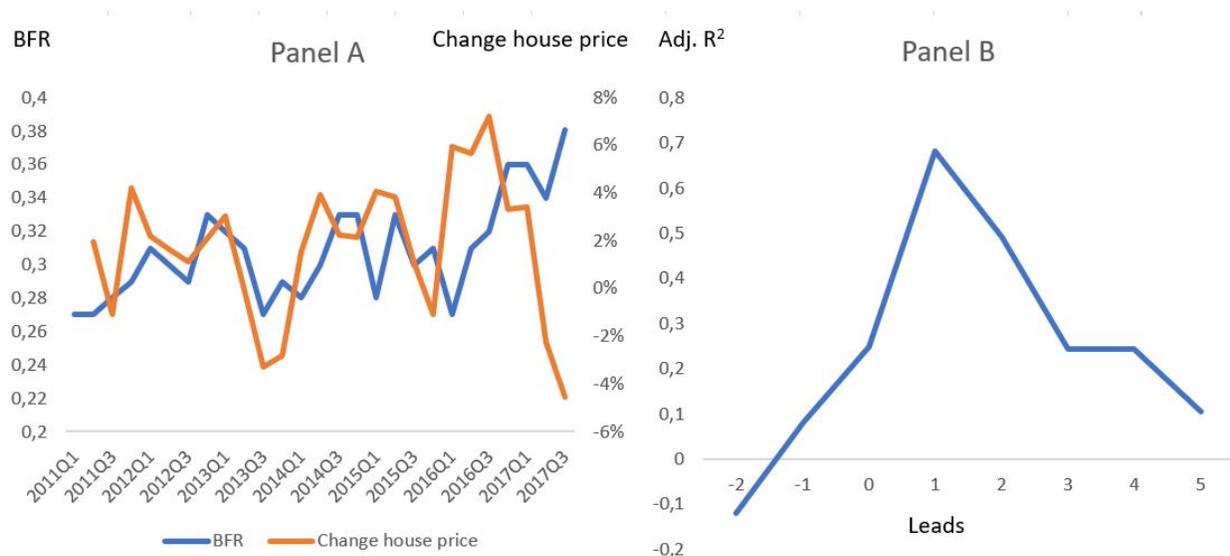
In line with this reasoning, Panel A in Figure 5 indicates a close relationship between the buy-first rate,  $BFR$ , i.e. the share of households that want to buy before selling, which implies that they hold two dwellings in the transition period, and changes in the house price index.<sup>5</sup> Periods of moderate house price increases are associated with around-average values of the buy-first rate. Rapidly increasing house prices are associated with a larger share of moving owner-occupiers who buy first, and vice versa.<sup>6</sup> Panel B shows that the highest correlation between house price changes,  $\Delta P$ , and the buy-first rate,  $BFR$ , occurs when  $\Delta P$  leads on  $BFR$  by one period, with an estimated Adjusted  $R^2$  of 0.68.

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<sup>5</sup>Extremely high house price growth in Oslo in 2016 (24 per cent from 2015 Q4 to 2016 Q4) was followed by a sharp downturn in 2017. These extreme amplitudes may explain the seemingly weakened relationship between the  $\Delta P$  in Oslo and  $BFR$  for Norway in this period.

<sup>6</sup>Anenberg and Bayer (2020) find empirical evidence that the dual search and match problem is a substantial driver of fluctuations in transaction volumes and price volatility in the housing market.

**Figure 5: House price changes and buy first rates (*BFR*). Oslo, 2011(1) - 2017(3). Panel A: Quarterly house price changes and *BFR*. Panel B: Correlation of house price changes and *BFR* at different lags of *BFR*. A positive figure indicates house price changes lead on *BFR***



Notes: The house price index is constructed using a SPAR-approach (Sell Price on Appraisal Ratio) while using a hedonic model in stead of the appraisal value. The *BFR* reflects the proportion of households who reports that if they were to move, they would buy a new dwelling before selling their existing one.

As described in subsection 6.1, we perform a two-directional test of Granger causality for the buy first rate and changes in the price index. Our results are tabulated in Table 5. For 1-3 lags we cannot reject the hypothesis that *BFR* does not Granger cause  $\Delta P$  but we do reject the hypothesis that  $\Delta P$  does not Granger cause *BFR*. Thus, Granger causality appears to run one way from  $\Delta P$  to *BFR* and not the other way around. Again, the estimate with one lag provides the best fit.

Thus, it is possible that price changes have momentum and lead to feedback loops, and that such feedback loops initially are triggered by price changes. If a price change induces a shift in the relative values of the decisions to buy or sell first, this could in turn reinforce the price change that triggered it: Rising house price inflation could initiate a rush among moving owner occupiers to buy first, increasing relative demand and fuelling further inflation etc.

**Table 5: Granger causality. Price change and buy first rate. Oslo, 2011(1)-2017(3)**

$H_0: \beta_1 = \beta_2 \dots = \beta_N = 0$	P-value (F-statistic)				
	No. of lags. N=5				
	1	2	3	4	5
$H_0 : \Delta P$ does not Granger cause $BFR$	0.0009*** (15.35)	0.0032** (8.43)	0.0355* (3.86)	0.1111 (2.48)	0.1755 (2.13)
$H_0 : BFR$ does not Granger cause $\Delta P$	0.91 (0.013)	0.2678 (1.43)	0.5706 (0.70)	0.1849 (1.91)	0.2459 (1.73)

Notes: We use the software package EViews to test for Granger causality. \*\*\* indicates significance level 0.001, \*\* = 0.01 and \* = 0.05.

## 8 Concluding remarks

We find clear evidence of a Phillips curve relationship in the Oslo housing market. While the classical Phillips curve in the labor market represented a scarcity impulse that yielded a price response, the housing Phillips curve appears to involve a reverse causality. We propose a simple model that is consistent with reverse causality. It involves sketching the costs and benefits of holding 0 (sell-first) or 2 (buy-first) units in the transition period and explaining how price changes affect the relative values of holding 0 or 2.

This paper makes several contributions to the literature on the functioning of the housing market. First, although there exist several studies of the link between scarcity and prices in the housing market, we have not found an explicit estimation of a housing Phillips curve. To the best of our knowledge, we are the first to estimate a housing Phillips curve. Second, we propose using the unsold rate as a pressure gauge of the housing market, corresponding to the unemployment rate of the labor market. We also acquire data that allow us to estimate this rate. Third, we find empirical evidence of reversed causality in the housing Phillips curve. The Granger causality goes from price changes to the unsold rate, and not the other way around. Fourth, the reversed causality is explained within the proposed model, which incorporates the specific characteristic of the housing market of a dual search and match problem, in which moving owner-occupiers are sellers and buyers in the same market. Fifth,

we bring empirical evidence on a new indicator, the buy-first rate, and study how this variable co-varies with price changes.

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### **Acknowledgements:**

Housing Lab is partly funded by the Norwegian Ministry of Finance and the Norwegian Ministry of Modernisation and Municipalities. Housing Lab also receives financial support from Krogsveen and Sparebank1-Gruppen. We are grateful for the financial support. All views expressed in our papers are the sole responsibility of Housing Lab, and does not necessarily represent the views of our sponsors.

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