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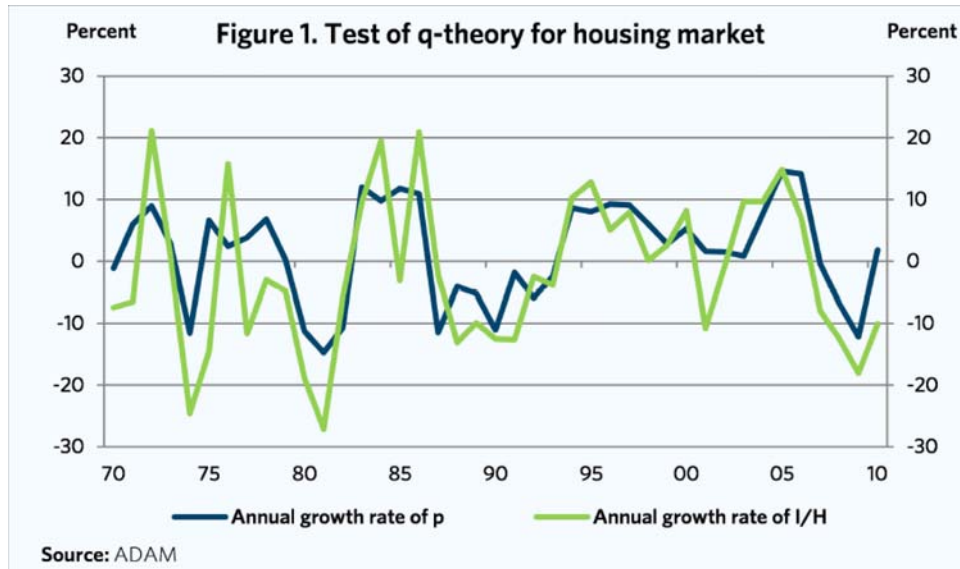


Figure 7.1

VII.7 *The housing sector.* We consider the housing sector in a small open economy facing a constant real risk-free interest rate, $r > 0$, given from the world financial market. Time is continuous. Let:

H_t = aggregate stock of houses,

S_t = aggregate housing services,

p_t = (real) price of houses,

R_t = (real) price of housing services,

\dot{p}_t^e = expected increase per time unit in p_t ,

I_t^H = aggregate gross housing investment (residential construction),

δ = rate of physical depreciation on houses,

τ_R = tax on (imputed) rental income after allowance for depreciation,

τ_p = tax on housing property,

$\tau_r \equiv$ tax on interest income.

We assume that S_t is proportional to H_t , and we normalize the factor of proportionality to be one:

$$S_t = H_t, \quad (1)$$

$$R_t = R(H_t), \quad R' < 0. \quad (2)$$