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Housing Markets Response to Foreign Funds and Monetary Policy in India — An Empirical Study

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Abstract

Globalisation; integration of the financial markets and increased Global Capital Flows (GCF's) towards Emerging Market Economies has impacted the asset prices and often led to its irrational built-up known as "asset bubbles". To ensure financial stability, Central banks manage GCF, which causes misalignments in asset prices-housing and equity.Set in India, the current paper investigates and establishes the causality between GCF's (FDI and FII combined) to India and Housing Price Index (HCPI) with a lag of 8 months by applying a bivariate Granger Causality model. Change in the repo rate impacts the HCPI after a lag of 25 months indicating a sluggish transmission channel and the effectiveness of Central bank to intervene in the market using interest rate as a tool. Study's concludes through the analysis of the housing market-asset price channel that this channel should not be relied upon during a bubble-like episode to control falling housing prices since a Repo rate change has a delayed impact on the Housing index.

I. Introduction

ASSET BUBBLES HAVE been a frequently occurring phenomenon in the current past and there is historical evidence to prove their presence in dated times as well. Most valued commodities in their contemporary era have been a reason for causing bubbles. Instances, of asset bubbles have increased in the last two decades. The last big crash occurred in the real estate markets in The United States (US) during 2007-08. The excess liquidity in the US markets due to the lending boom in the real estate sector had resulted into a continuous built up in prices. The US markets crashed during 2007 and it also pushed the major economies of the world to the brink of recession. Prior to the US real estate bubble, the Asian currency crisis and the Dotcom Crash were reported in 1997 and 2001. 20thcentury experienced the "Florida Real Estate Craze", "The Great Depression" of 1929 and the "Market Crash" of 1987.

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other economies in the housing cycle over all time periods indicating significant spill overs from the US economy to the rest of the world. Therefore, an initial housing market boom in the US resulted into a lagged response in the Indian housing market. The higher FDI inflows to India can be attributed to several *push* and *pull* factors as discussed in literature.

VI. Conclusions

The results and analysis indicates that if RBI decides to use monetary policy for asset price misalignment in the housing market then it needs to be sure of the fact that the transmission mechanism is fast. I conclude through the analysis of the housing market-asset price channel that this channel should not be relied upon during a bubble-like episode to control falling housing prices since a Repo rate change has a delayed impact on the Housing index.

6.1 *Implications of the Study*

The research output of the work carried out has the following implications:

— The housing market findings are important for policy makers since the impact of FII and FDI flows on the Housing index is clearly visible. The possibility of excess liquidity entering into this market and therefore leading to an asset price misalignment or an asset price bubble cannot be ruled out.

— The sluggishness with which the monetary policy affects the Housing Index is also an important finding for the policy makers. Clearly, monetary policy alone will not be sufficient to rectify prices in the Housing sector, especially during an asset bubble burst.

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