The Effects of Discretionary Housing Policies on Asset Returns

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Abstract

This paper examines the extent to which the equity premium puzzle and the riskfree rate puzzle can be resolved by a decomposition of aggregate consumption risk into housing and non-housing components in the context of Singapore asset markets. Singapore offers a unique testing ground since large-scale state intervention in the housing market presents an interesting source of macro-economic risk. In addition, the Singapore stock returns are substantially more volatile than the U.S. stock returns. The Housing Consumption Capital Asset Pricing Model (HCCAPM), a two factor extension of the traditional consumption-based capital asset pricing model, first proposed by Piazzesi et al (2003), replicates observed realities of Singapore equity and housing markets quite well, showing that consumption risks and housing risks are properly priced in the Singapore asset markets. We also present an estimate of the equity risk premium due to land policy by the government.