Allan Davids and Co-Pierre Georg
The Cape of Good Homes: Exchange rate depriciations, foreign demand and house prices

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This paper: assessing the role of demand shocks in segmented asset markets markets

- A case study on the impact of demand shocks in segmented housing market of Cape Town, South Africa.
- Unique data on home ownership by location, residency of buyers and transaction prices in housing markets
- allows to identify and quantify the impact of demand shocks on house prices, holding returns and market spillovers (integration).

This paper: assessing the role of demand shocks in segmented markets

- Main findings
  - Foreign non-resident buyers sort into the highest price segment.
  - Initially, they do not overpay in terms of a hedonic pricing benchmark
  - Over time, they realize lower capital gains than local buyers.
  - Diff-in-Diff of high/low share of foreign-borne homeowners and before/after extreme exchange rate movements. Find large movements of the exchange rate (depreciation) increases the prices of high price houses, but finds no spillover to other market segments.
- Why in a session on QE?
  - Resembles purchase of government bonds by central banks.
  - What is effect on funding costs of other financial and non-financial institutions?

Comment 1: Foreigners do not pay higher prices, c.p., but realize lower capital gains

- FNR realize a holding return of -10.5%: explore the puzzle-
  - Return measurement: calculated in Rand, or in investor's local currency? The latter may be the relevant metric – if investor bets on subsequent exchange rate appreciation (i.e. if rate volatility is high, while mean is constant)
  - To whom do FNR sell – locals or other FNR?
  - Mean reversion? if you target highest price segment today, there may be volatility across house price strata (--> parallel trend assumption?)

Comment 2: Price impact of foreign demand is restricted to high price segment in high price neighborhood. Why?

- Explore possible arbitrage channels
  - Price spillover may take time – but will eventually happen, or not?
  - Cf. Greenwood/Hanson/Liao: Asset price dynamics in partially segmented markets. Establish conditions under which capital moves slowly across asset classes and therefore prices do not converge immediately.
  - Estimate speed and sources of price adjustments: e.g., resident buyers of high price houses are shifting to other segments, thereby raising prices in these "second best" markets.
  - Also, without longer-term adjustments, the low-return finding on asset holdings by FNR is difficult to explain.

Comment 3: role of quality in a volatile environment

- Alternative explanation: Flight to quality
  - Large exchange rate depreciations are also a sign of high uncertainty in the economy at large, when investors search the relatively safest assets (A-locations may offer more stable price paths in volatile periods – do they?).
  - Hypothesis: the spread between housing segments is a function of volatility.
  - Extreme exchange rate moves may signal volatility, and hence FNR and resident-investors increase competition for the same investment assets.

Overall

- Excellent case study, carefully conducted.
- Discussion may connect to neighboring fields: asset pricing dynamics
- Similarly, the reference to QE effects on bond market segments (cost of capital of firms) may also be given.

Thank you for your attention