# Inequality and House Prices

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**Abstract**

This paper studies the interaction between inequality and house prices using an incomplete market model with heterogeneous households. The model links cross-sectional household portfolio saving decisions to housing market outcomes, and it can account for the positive empirical relationship between growth in income inequality and changes in house prices. It also illustrates a new house price formation mechanism in which an investment motive among the wealthy plays a key role. A quantitative application of the theory rationalizes the recent substantial housing boom accompanied by rising household saving rates in China. The theory in this paper shows that market frictions can have a differential impact cross-sectionally, increasing inequality. Inequality can, in turn, amplify frictions in the market.

**JEL Codes:** E21, G11, P22, R20.
**Keywords:** housing, inequality, Chinese economy.