Discussion: Limiting Mortgage Debt: Aggregate demand externalities and housing market distortions

by Martina Fazio, Andrew Gimber and David Miles

Sevim Kösem

LSE, BoE, SRC, CfM

21 June 2019

This paper

- Studies general equilibrium effects of mortgage debt limits for housing and mortgage markets
- General equilibrium effects are heterogeneous across borrowers and lenders

Why focus on mortgage debt limits?

- Mortgage booms $\Longrightarrow$ severe recessions
  (Jorda, Schularick and Taylor, 2016)
- Policy implication: limit mortgage debt growth

This paper: Model summary

- Two-period two-agent model with
  - heterogeneous initial housing wealth ($h_0^P < h_0^R$)
  - homogeneous endowment income y_1, y_2
  - rich downsize housing and lend to poor
    - Aggregate demand externality:
      too much aggregate debt $\Longrightarrow$ lower aggregate future income
- Housing market with distortions
  - Shelter $\neq$ housing owned $\longrightarrow$ dead-weight loss
- Regulation: limit on debt level

This paper: Findings

Unregulated/laissez-faire equilibrium

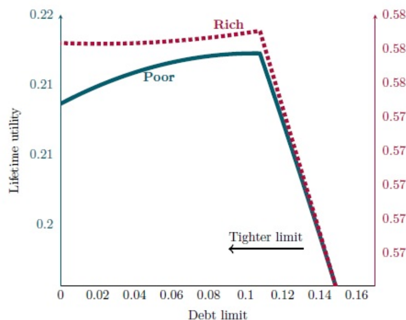
- Aggregate demand externality $\rightarrow$ room for prudential policy
- Shelter equals housing owned

- Debt limit $\uparrow$
  - Rent $\uparrow$
  - House prices $\uparrow\downarrow$
  - Interest rate $\uparrow\downarrow$

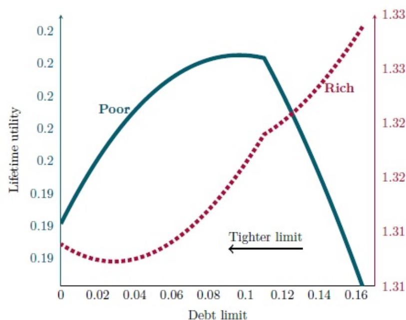
- Heterogeneous effects for borrowers and lenders

This paper: Findings

Calibration matters for utility implications



(a) Calibration with $\pi = 0.52$.



(b) Calibration with $\pi = 0.86$.

Comment 1: Is there room for prudential policy?

	Laissez-faire equilbrium	Regulated equilibrium
Aggregate demand externality	✓	✗
Housing market distortion	✗	✓

- (How much) does policy improve over unregulated equilibrium?

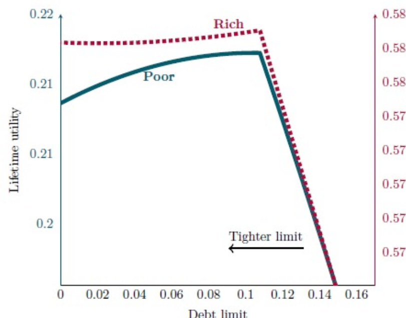
Comment 1: Is there room for prudential policy?

	Laissez-faire equilbrium	Regulated equilibrium
Aggregate demand externality	✓	✗
Housing market distortion	✗	✓

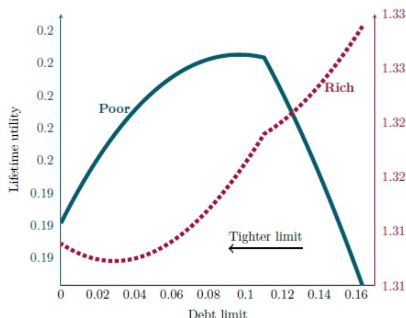
- (How much) does policy improve over unregulated equilibrium?

Comment 2: Significant effects?

How much better/worse is a tighter debt limit



(a) Calibration with $\pi = 0.52$.



(b) Calibration with $\pi = 0.86$.

What is the intuition for the kink?

Why only those values of debt limit are considered?

Comment 3: More results

Would be nice to include in the paper

How does

- Equilibrium rent, house price and interest rate
- Wealth (levels & inequality)
- Consumption (levels & inequality)

vary with the debt limit? Monotonic relationship?

- Any analytical insights?

Comment 4: Why a quantity limit for mortgage debt?

Theory vs practice

Mortgage market regulation in practice

- Loan-to-value ratio ($\rightarrow$ additional pecuniary externality)
- Loan-to-income ratio
- Quantity limit 4.5 $\times$ annual gross income

Mortgage debt is secured

Comment 5: Information structure

Who knows what?

- Is aggregate lending D_2 common knowledge/observable?
- How do beliefs about y_2 are formed?
- What ensures that the beliefs are homogeneous?

Implications:

- Debt market clears?
- Multiple equilibria?

Comment 6: Modeling Assumptions

- Reduced form housing market distortions
  - search and matching frictions?
  - debt limit $\uparrow \rightarrow$ liquidity in the housing market $\downarrow$
- Reduced form aggregate demand externality
  - How big it is might depend on equilibrium prices
  - Debt limit $\uparrow \rightarrow$ interest rate $\downarrow \rightarrow$ aggregate demand externality
- Strictly speaking everyone is a homeowner
- Rental market might not always exist