Discussion of Consumption and House Prices in the Great Recession

by Kaplan, Mitman and Violante

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Source: Cagle Cartoons, www.politicalcartoons.com

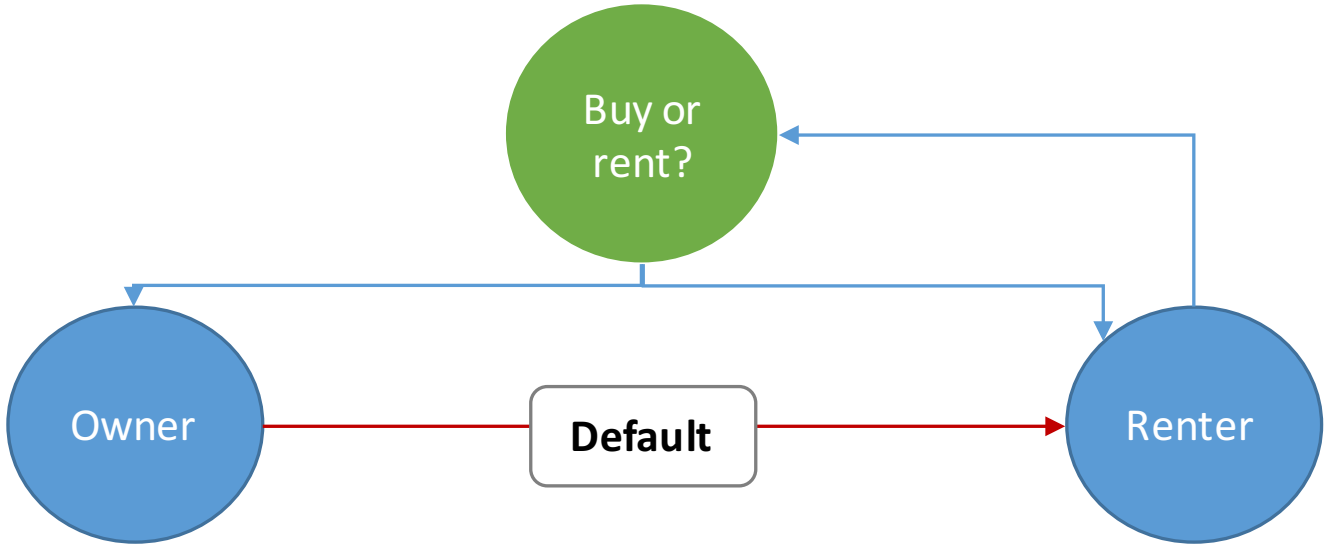
Key questions

1. What explains the house price boom and bust?

2. What's the relationship between house prices and consumption? What's the mechanism?

3. Would a debt-forgiveness program have cushioned the crash?

Approach: the model's housing market



Key ingredients:

- Rental market. Default.
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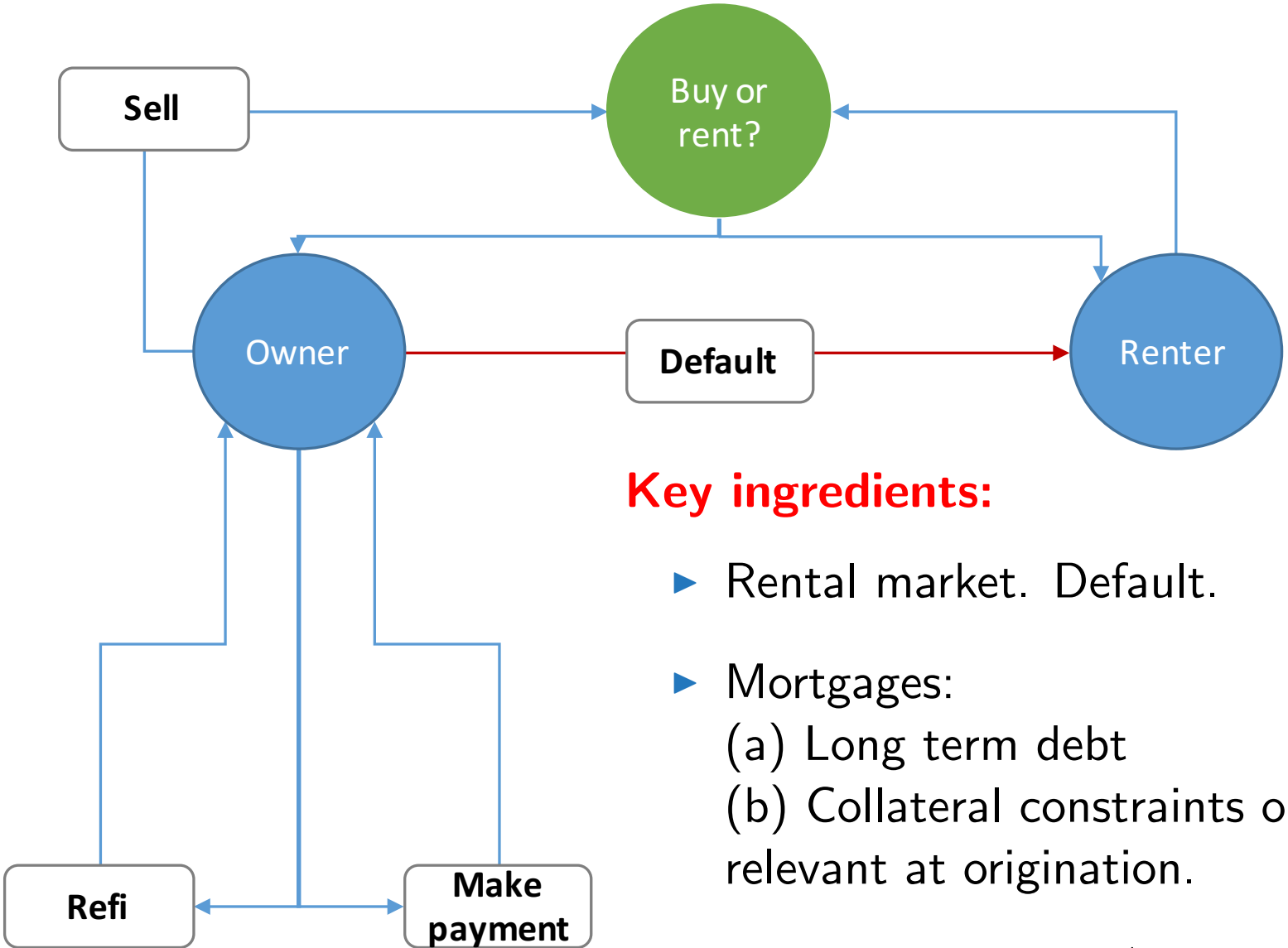


Key ingredients:

- Rental market. Default.
- Mortgages:
  (a) Long term debt
  (b) Collateral constraints only relevant at origination.
- Moments matched/calibrated.

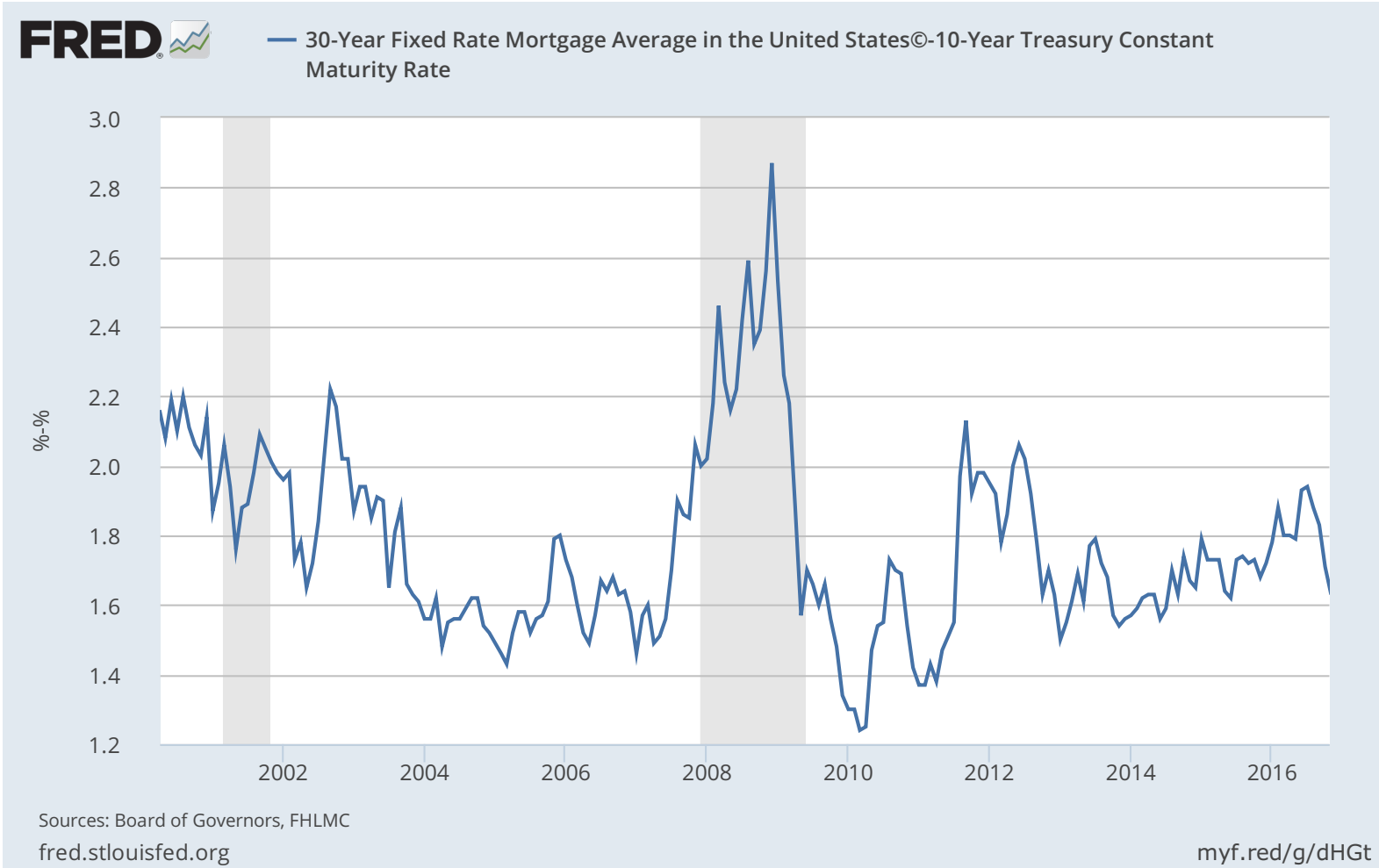
Results: What explains the boom and the bust?

- Aggregate productivity: mostly relevant for consumption.
- Changes in credit constraints: important for ownership, refinancing, leverage and foreclosures.
- Beliefs about future housing demand: key driver of house prices and about half of consumption. Channel: wealth effects.

Comments/questions

- Really great paper; significant contribution to modeling the housing market.
- Goes beyond binding constraints (Iacoviello-Guerrieri (2016) one exception), or exogenous house prices (Berger et al. 2015).
- Detailed, careful analysis. Really helps us understand what can and can't explain the boom/bust.
- Three questions for discussion

Question 1: could there be additional financial frictions?



- Could other financial frictions have a more widespread effect?

Question 2: Is the house price elasticity still useful?

- Result: Aggregate elasticity depends on source of the shock.

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(a) *Can we identify β?*
(b) *Is β interesting?*

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- Cloyne, Huber, Ilzetzki and Kleven (2017) equity extraction-price elasticity: 0.21, similar to the belief shock.

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- Another example:

$$\Delta c_{t+1} = \frac{1}{\sigma} i_t - \frac{1}{\sigma} \pi_{t+1} + u_t$$

- New Keynesian reduced form elasticity ($\sigma = 2$):
  Demand shock: 2.0
  i_t shock: -0.5.

- Is this like the house price elasticity?

Question 3. What are the key channels?

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- Key result: wealth effects, not forced deleveraging
- The source of the real wealth effect in the model. Is there a way to vary it?
- Exploit the life cycle predictions of the model?
- In general, interesting to discuss which frictions are the most important for driving the main results.

Summary

- Really great paper. Rich, detailed model of a complex market.
- Housing tenure choices, rental markets and long term debt are very important for understanding the boom/bust
- Learn a lot about what can and can't explain house prices and consumption in the boom/bust.
- Could there be other credit shocks? Is there a way to measure the wealth effect using the model? Perhaps the house price elasticity still has some life left.