

Take It to the Limit? The Effects of Household Leverage Caps

Sjoerd van Bakkum, **Marc Gabarro**, Rustom Irani, José-Luis Peydró

Discussant: Jason Allen (Bank of Canada)

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The views in this paper do not reflect those of the Bank of Canada.

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 - Renting-to-owning transition;
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- Methodology: Event study
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 - Matched samples of FTHBs pre-constraint vs. post-constraint.
- **Policy take-away:** LTV limits are an effective tool for decreasing FTHBs' exposure to the housing market

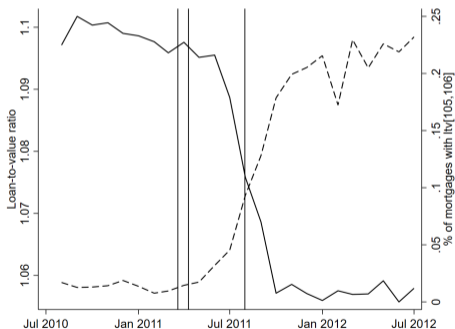
Relevant to the Dutch, Canada and beyond...

Eagles (extended title): **Take it to the Limit, One More Time.**

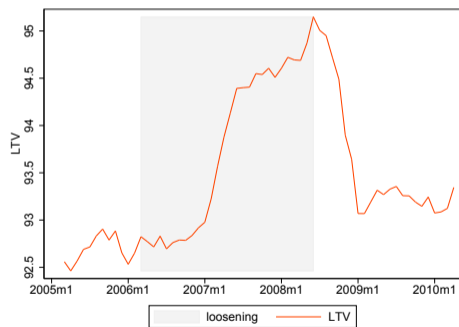
- Canada and the Netherlands have actively used macroprudential policies to dampen demand/supply of credit
 - Netherlands: LTV, DTI, amortization, interest deductability, risk weights
 - Canada: LTV, GDS, TDS, amortization, insurance, securitization
 - EU database on macroP policies: <https://www.ecb.europa.eu/pub/research/working-papers/html/mapped.en.html>
 - 2020 special issue of the JFI: Macroprudential policies in the Americas

Relevant to the Dutch, Canada and beyond...

Impact on average LTV ratios of FTHBs: Tightening in the Netherlands and Loosening in Canada



(a) Netherlands



(b) Canada

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- **Praise:** Important to conduct retrospective analysis of the efficacy of macroprudential policies
- **Ask:** Crucial to have models (framework) that allow policy-makers to 'test out' different policies in the controlled environment of our computers
 - IMF FSAP (2017) has a long list of recommendations for the Netherlands ...coming from where???
<https://www.imf.org/-/media/Files/Publications/CR/2017/cr1793.ashx>
 - Greenwald (2018), Garriga and Hedlund (2018), Johnson (2018), Grodecka (2019), Justiniano, Primiceri, and Tambalotti (2019).

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- Extensive margin
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- Intensive margin
 - FTHBs reduce borrowing (9.4%)
 - FTHBs buy less expensive homes (5.5%)
 - Implies an increase in down-payment
 - Mortgage payment falls (8.9%)

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- Households draw down savings (increase in liquidity risk)... but fully recovered in 2 years!
- Mortgage arrears fall: 25% (from a very low base and using ‘outside’ data)

Comments

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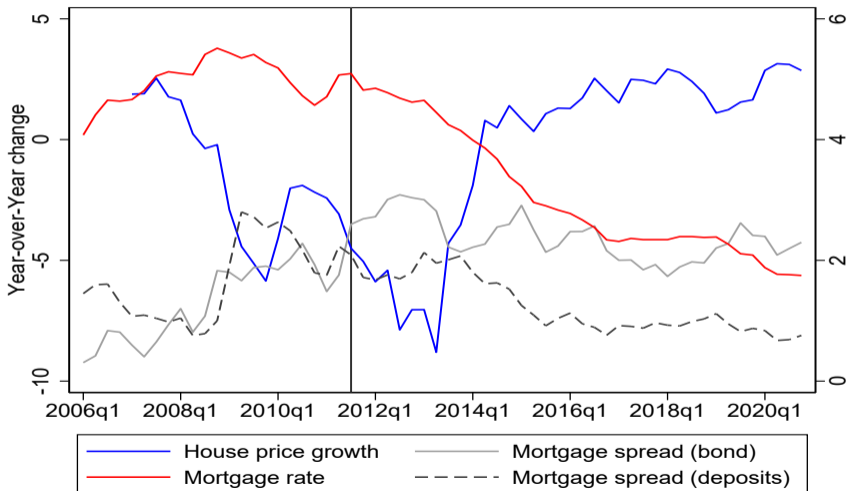
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- Fantastic! More than just looking at credit outcomes. **Data on savings paints a more complete picture**
- How should we think about households?
 - **Tax-free parental gift**
 - Size of the tax-free gift from parents to kids to purchase a house **appears** to be part of the macroP tool-kit.
 - Benetton, Kudlyak, Mondragon (2022): Parents extract equity from their house to gift to kids—family wealth \Rightarrow household wealth accumulation
 - Allen, Clark, Li, Vincent (202?): In addition to gifts for large down-payments, parents are also taking on income risk by cosigning

#2: What's missing?

- Interest rates
 - Mortgage terms 5-10 years + FT HB/Renewer price discrimination
 - Rates falling over time
- House prices
 - MacroP to reduce household exposure to housing or dampen house prices?
 - Greenwald (2018): Tightening LTV can be counterproductive (when there are also PTI constraints)—collateral value of housing increases and so demand for housing goes up.

Confounding policy change: Interest-only mortgages for the entire purchase changed to max 50% of the market value of the house (increase in mortgage payments).

House prices and Interest Rates



#3: Begging for a model... supply

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What happens to mortgage spreads? Given lower credit risk, spreads should fall but unsure if this is the case

- What do spreads look like across the income distribution? House price distribution (given rules about who pays in case of default is tied to house price)?
- Any concerns about competition (Dijkstra et al. (2014))?

#3: Begging for a model... demand?

- Retrospectively we observe that households in the Netherlands responded to a tighter LTV by either renting or buying smaller homes
- MacroP policy in the Netherlands continued lowering the maximum allowable LTV by 1 p.p per year. It is now 100%. IMF recommends 80%
- What would going to 80% mean for the Dutch housing and rental markets?
- **Household static vs. dynamic problem:** with rules changing every year, **expectations** matter a lot.

Random questions

- Porting
 - Movers can port their high LTV (negative equity) mortgage.
 - Annual fraction of renting-to-FTHB is about 4%.
 - What is fraction of movers?
- Matching of FTHBs is at the 2-digit postal code.
 - This is meant to capture variation across markets in house prices?
 - How much variation is therefore within these markets?
 - Do you not observe house prices on the land registry?