

On the effectiveness of loan-to-value regulation in a multiconstraint framework

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The views expressed do not necessarily reflect those of the Bank of Italy or of the Eurosystem.

THE PAPER IN A NUTSHELL

- ▶ Provides **micro-data evidence from Sweden** of:
 - ▶ slackness (or lack thereof) of LTV and DSTI constraints,
 - ▶ partition of constrained borrowers between classes: LTV-only, DSTI-only, LTV & DSTI.

- ▶ **Crucial claim:**

with DSTI constraints, lower LTV limit may not imply lower debt-to-GDP ratio (and may even increase house prices).

- ▶ **Model-based assessment:**

- ▶ simple and full model with long-term debt (calibrated to Sweden);
- ▶ steady-state comparison with different levels of constraints;
- ▶ deterministic simulations with occasionally binding constraints.

THE PAPER IN A NUTSHELL

- ▶ Interesting topic.
- ▶ Intriguing micro evidence.
- ▶ A step in the right direction in terms of assessment method.

FOUR COMMENTS

1. Effectiveness, global solutions, and policy objectives.
2. Empirics and inframarginal effects of changes in DSTI.
3. Modelling endogenous heterogeneity.
4. Quantitative discipline with the Swedish case.

SIMULATIONS: GAUGING POLICY EFFECTIVENESS

- ▶ How to compare relative size of different shocks?
Is 5% change in max LTV the same as 5% change in DSTI?
- ▶ Given asymmetric responses to shocks, key aspect is to assess macroprud **policy effectiveness in response to different shocks**.

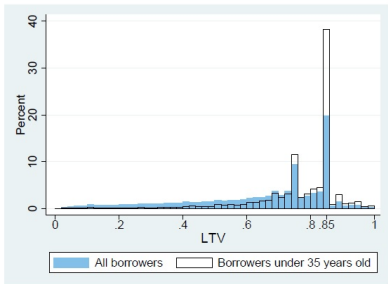
→ Do conclusions follow through if macroprud instruments are activated in response to shocks and not from SS?
- ▶ Effectiveness of **macroprud rules** (and related indeterminacies) rather than discretionary policies.

GLOBAL SOLUTIONS AND POLICY OBJECTIVES

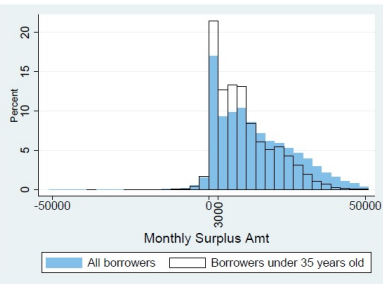
- ▶ To really assess macroprud effectiveness, need for occasionally binding constraints globally (and not just locally).
- ▶ Global solution may inform better about state-dependence (asymmetry) of responses to policy.
- ▶ Plus (and especially): Treat effects of uncertainty properly, with **precautionary motives**.
- ▶ Characterize key **tension between macroprud objectives**:
 - ▶ active dynamic stabilization or
 - ▶ creation of buffers to reduce financial vulnerability.

TAKING EMPIRICS ONE STEP FURTHER

- ▶ Shape of the histograms and degree of bindingness of constraints (and of **precautionary behavior?**).
- ▶ Key empirical challenge: How much of the higher effectiveness of the DSTI limit (found in other studies, too) happens at the limit and how much is inframarginal?
- ▶ (Distribution of LTVs: heads vs. amounts.)
- ▶ (KALP vs. DSTI and transfers, interaction with fiscal policy.)
- ▶ (LTVs with only collateralized debt in model.)



(a) The distribution of LTV 2011-2015



(b) The distribution of KALP 2011-2015

Figure 1: Distributions of constraints for new borrowers in Sweden, 2011-2015

MODELLING ENDOGENOUS HETEROGENEITY

- ▶ Data: Household heterogeneity in debt, wealth, income.
- ▶ Partition of households in four classes is reminiscent of:
 - ▶ savers,
 - ▶ standard borrowers (LTV-only),
 - ▶ poor hand-to-month (LTV & DSTI),
 - ▶ **wealthy hand-to-mouth** (DSTI-only).

—→ HANK-style implications with heterogeneity in MPCs dominating intertemporal substitution effects?

- ▶ **Endogenous distribution responds to policy** (and history).

MODELLING CHOICES FOR SWEDEN

- ▶ Small open economies and international capital flows:
—→ stricter LTV ratios may have sudden stop-like implications (especially with proper fire-sale externality induced by *expected* house prices).
- ▶ LTV-dependent amortization requirement for mortgages (1% for LTV between 50% and 70%, 2% for $LTV > 70\%$); perhaps even DTI-dependent (another 1% if debt > 4.5 I).
- ▶ (Role for FRMs vs ARMs, vintage structure of LT debt.)
- ▶ (Heterogeneous housing preferences quite consequential.)
- ▶ (In the 'Swedish economy,' LTV changes seem a good option: reduce indebtedness, contain house prices better, and even increase output.)