"House of Debt. How They (and You) Caused the Great Recession, and How We Can Prevent It from Happening Again", by A. Mian and A. Sufi

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Macro Reading Group
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The Book

ATIF MIAN and AMIR SUFI

HOUSE OF DEBT

How They (and You) Caused the Great Recession, and How We Can Prevent It from Happening Again
The Papers


2. Foreclosures, House Prices, and the Real Economy (with F. Trebbi - JoF, forthcoming)


5. House Prices, Home Equity-Based Borrowing, and the U.S. Household Leverage Crisis (AER, 2011)


7. The Consequences of Mortgage Credit Expansion: Evidence from the U.S. Mortgage Default Crisis (QJE, 2009)
Question

What is the cause of the recent Great Recession?

Answer

- Financial liberalization from late 90’s on → households overborrowed, especially those with poor credit records
- A negative shock to house price has lead to:
  - a collapse in households’ home equity;
  - deleveraging process by households → reduction of consumption;
  - lack of aggregate demand pushed up unemployment

Methodology

- Use of micro data which let the authors discard potential alternative stories

Policy Implications

- US Government should have bailed out the households and not the banks
- Rethinking of the mortgage markets
The Rise in Households’ Leverage
Household Mortgage-to-Income Ratio
Rise in Leverage: Strong Economic Fundamentals?

- Extra $7 trillion of debt during the housing boom

- Who was the **marginal borrower**?
  - Credit into low credit-score zip codes experiencing declining income growth
  - Mortgage-credit growth and income growth became negatively correlated
  - **Low credit-score zip codes** experienced 80% increase in house price
  - **High credit-score zip codes** experienced 40% increase in house price

- Evidence suggests that rise in credit was NOT driven by fundamentals

- Did the rise in credit cause an expansion in house prices?
Credit and House Prices

- Saiz (2010, QJE): degree of elasticity housing supply
  - Elastic cities able to build new houses → house price cannot increase so much
  - Inelastic cities are restricted → house price responds a lot
  - House price rose by 100% in inelastic cities & 40% in elastic cities

- In elastic cities there was a huge credit expansion by low credit score borrowers
  - No difference in house price growth between low & high credit score zip codes

- Lending boom fuelled house price growth, not vice versa
A Negative Shock Hits the Economy
Foreclosures and House Prices

Foreclosures and Defaults

House price growth

Residential investment growth

Durable consumption growth
Foreclosures and House Prices

[Graphs showing the relationship between miles from the border and foreclosures per delinquency for different years (2006, 2007, 2008, 2009).]
Foreclosures and House Prices
Foreclosures and House Prices
The Consequences of Households’ Deleveraging
Household Deleveraging and the Great Recession

![Graph showing the change in default rate and house price growth](image)
Household Deleveraging and the Great Recession
Household Deleveraging and the Great Recession
Leverage Matters

[Bar chart showing marginal propensity to spend on autos out of housing wealth for different income brackets: AGI <= 35K, 35K < AGI <= 50K, 50K < AGI <= 100K, 100K < AGI <= 200K, 200K < AGI]
Leverage Matters

The bar chart shows the marginal propensity to spend on autos out of housing wealth across different ranges of housing wealth.

- UW <= 15%
- 5% < UW <= 25%
- 15% < UW <= 40%
- 40% < UW <= 50%
- 50% < UW

The marginal propensity increases as the housing wealth increases.
House Prices and Tradable Employment
House Prices and Not-Tradable Employment
Summing Up
The Anatomy of the Great Recession

- Excessive lending from the financial intermediaries during the late 90’s
- Credit boom fueled a boom in house prices
- Out of a sudden, a large negative shock hit house price
- Households leverage acted as a multiplier
- Household deleverage cutting their consumption
- Regions hit harsher by the fall in house prices experienced a larger increase in unemployment in the non-tradable sector
- The tradable sector could survive because of demand of other regions
- Importance of frictions that do not allow employment to move across regions or prices to equalize
- The recession is mainly driven by a lack of demand
Macroprudential Policy

- Great Recession caused by deleveraging of households who overborrowed due to lax credit conditions from banks
- Bailing out the households yields larger gains than any moral hazard fear
- Yet,
  - Macroprudential policy tackles the origin of the rise in systemic risk
  - Optimal policy should mostly avoid excessive credit supply
  - Focus should be on capital controls on the financial intermediaries
  - Ex-post subsidies to households only contingent to realization of financial crises
Conclusion

- Fantastic papers,

- ...and even a better book!

- Smoking gun on the origins of the last crisis

- Excessive credit supply & households deleveraging

- Ex-post emphasis on financial sector was not the right answer