Comments on:
Risky Mortgages

By: Chiara Forlati and Luisa Lambertini

Comments by:

Ethan Cohen-Cole
Robert H Smith School of Business
University of Maryland – College Park

September 30-October 1, 2010

General Thoughts

- **Enjoyed the paper**
  - Really, I'm not just saying that.
- **Important Contribution**
  - Few papers that have embedded housing into monetary policy analysis.
  - This is now popularly acknowledged to be important, but still missing from many models.

Summary

- Iacoviello (2005) and Iacoviello and Neri (2010)
  - one borrower, one saver
- Add endogenous borrowing
  - function of economy-wide LTV ratio that emerges as a savers participation constraint.
- Lenders collect collateral on defaulted loans

- Evaluate impact of increased housing prices volatility

What do we learn?

- In a BGG model, more default leads to more output volatility.

- We can interpret this default as being generated by housing price volatility.

Some Comments

- ## What does it mean for one member of the household to experience a housing shock?
  - This is a convenient assumption to ensure that the model fits into Iacoviello and Peri.
  - Hard to rationalize

- ## Housing price volatility generates default
  - What is the relationship between default and volatility implied by the model? How well does it match data?
    - Should be a nonlinear function of volatility
    - Calibration: for a 60% LTV loan, there should be little default. Why does the model generate so much?
    - Core issue: in a housing default model, must find a way to match LTV and delinquency rate.

Comments

- How well does model explain data?
  - In US? Across countries?

- Some figures:
  - Assume correlation between volatility and default is perfect.
  - How does delinquency rate change with various:
- Delinquency v residential lending (no relation)
- Delinquency v 30 year mortgage rate (works)
- Delinquency v Commerical lending (no relation)

- Delinquency v volatility
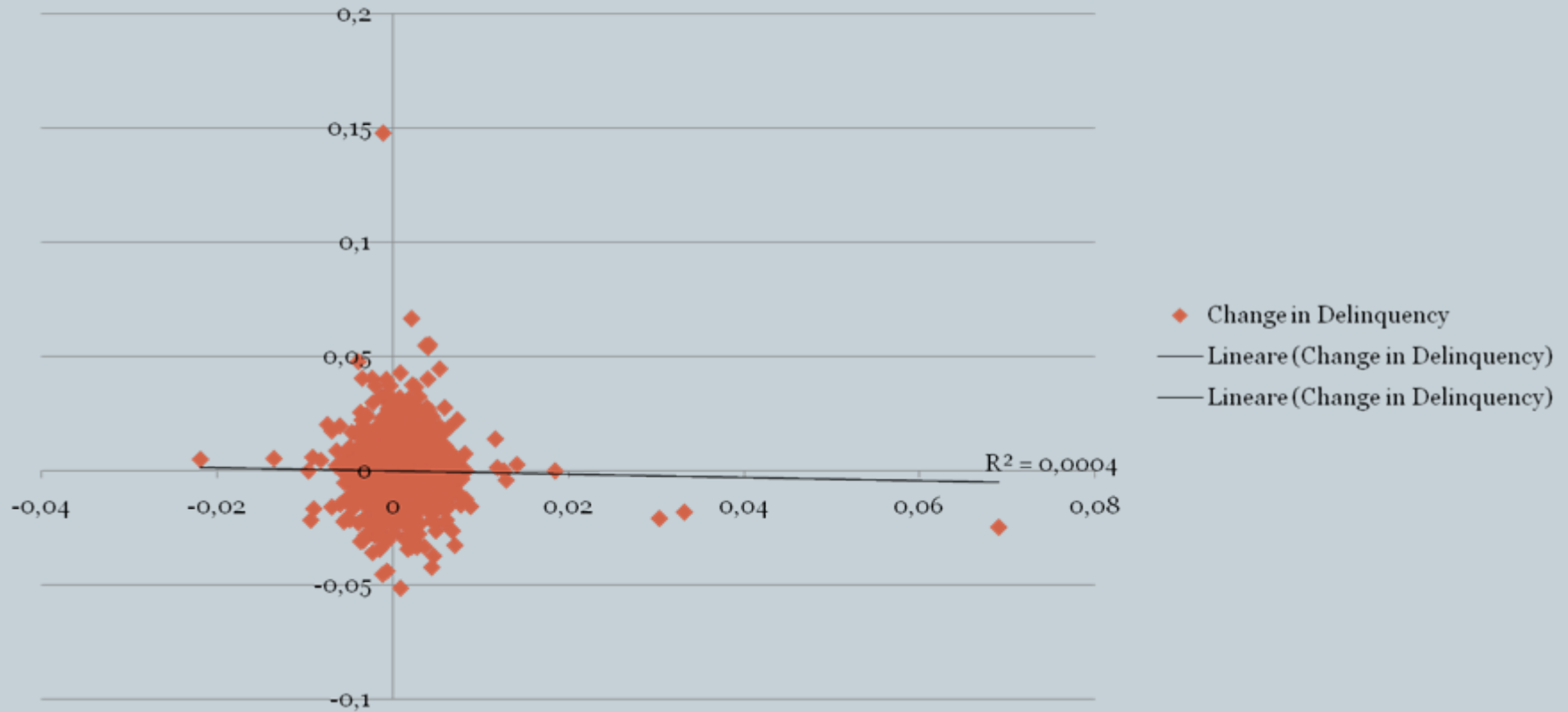
Delinquency and 30 Year Rate

Change in Delinquency vs Change in 30 year Fixed Rate
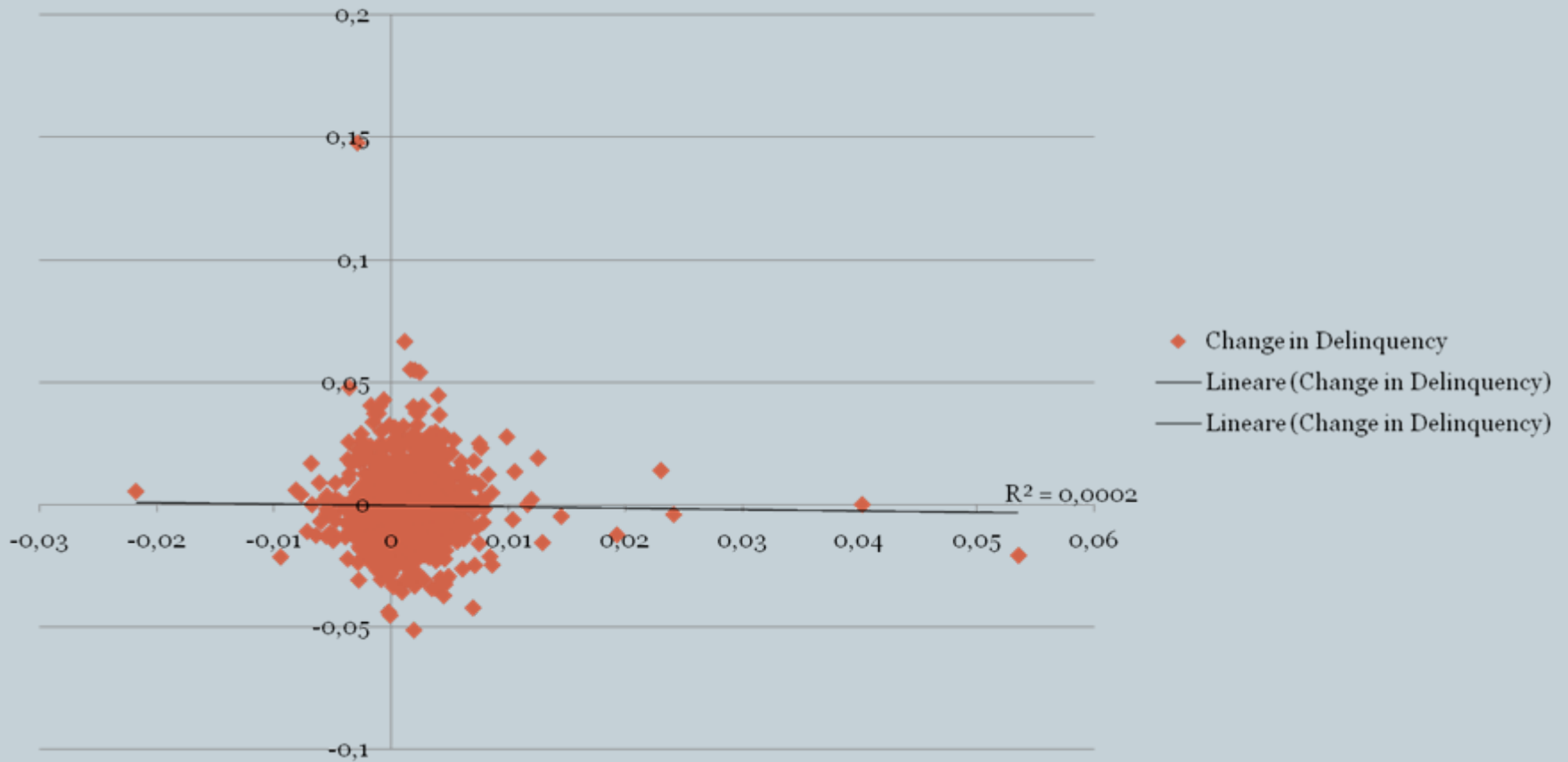
Delinquency and Commercial Loan Volume

Change in Delinquency vs Change in Commercial Lending
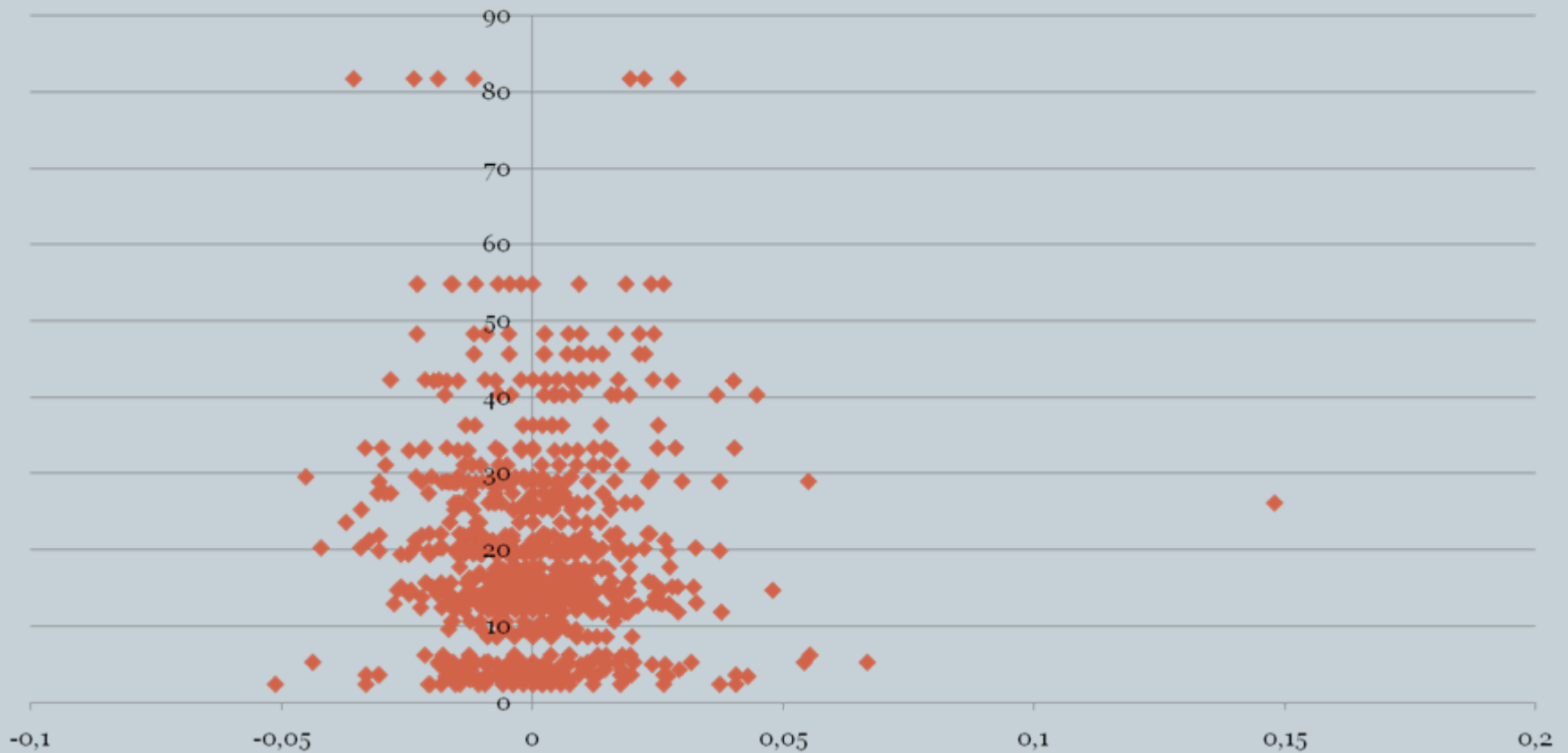
Delinquency and Real Estate Volume

Volatility v Delinquency

Housing Price Variance v Delinquency Rate

Other questions likely outside the scope of paper:

- Should we promote a rental market?
- Other policy implications
- Distribution of 'constrained' households?
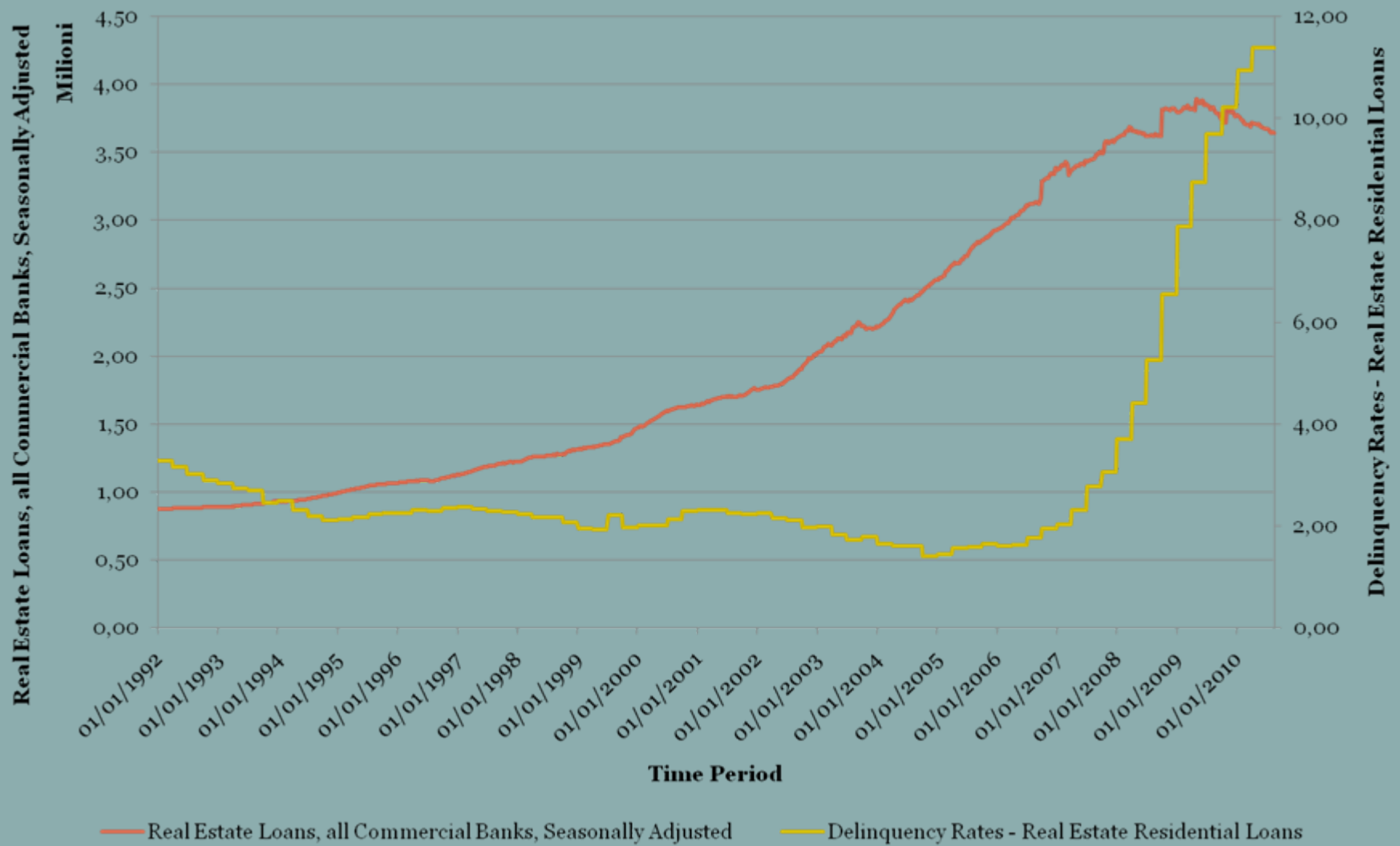 - Who defaults? How often?

Suggestions and Take-Home Message?

A. I would have liked to see an explicit implication for monetary policy:

   A. Central bank should target prices?
   B. Central bank should use price/output targeting optimally given housing prices?
   C. Can monetary policy have been different given this model?
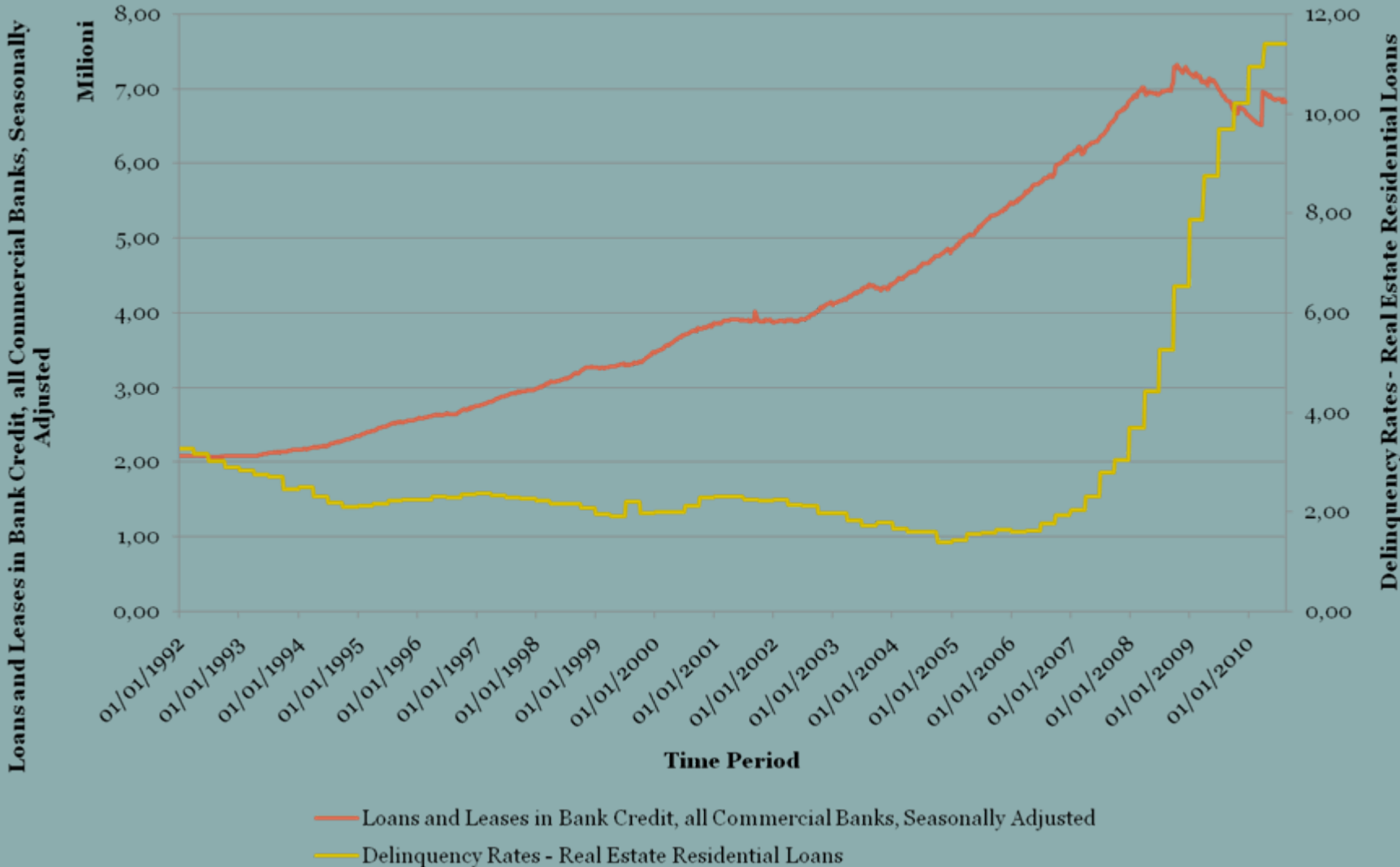
B. Calibrate to elasticities, rather than means.

end

Residential Real Estate Loans Vs. Deliquency Rate in Residential Loans

Commercial Bank Lending Vs. Deliquency Rate in Residential Loans

Loans and Leases in Bank Credit, all Commercial Banks, Seasonally Adjusted

Delinquency Rates - Real Estate Residential Loans

Time Period

Mortgage 30 yr Fixed rate Vs. Deliquency Rate