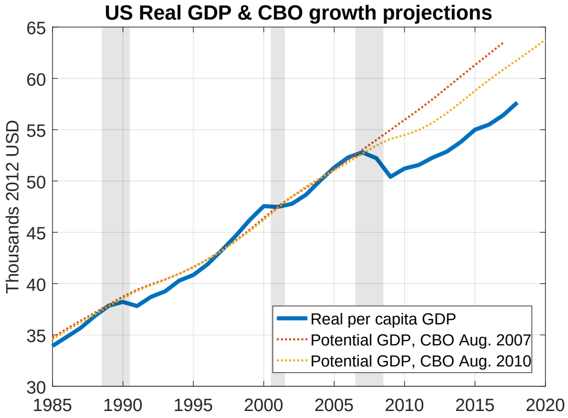
HOUSING MARKET CYCLES, PRODUCTIVITY GROWTH, AND HOUSEHOLD DEBT

Dmitry Brizhatyuk

May 6, 2021

Slow recoveries from financial crises



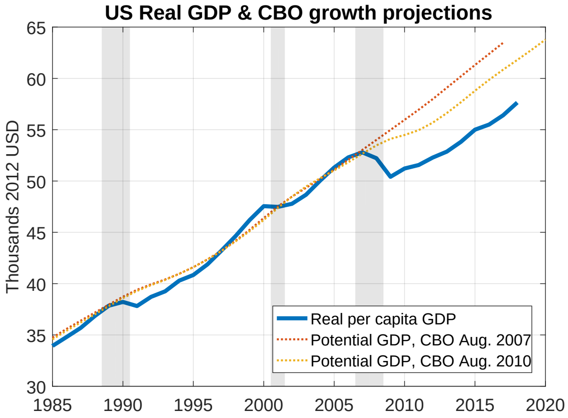
Recoveries from financial crises tend to be slow and incomplete

(e.g. Cerra and Saxena 2008; Reinhart and Rogoff 2009; Romer and Romer 2017)

A growing literature on **hysteresis**

(e.g. Benigno and Fornaro 2018; Comin and Gertler 2006; Queralto 2019)

Slow recoveries from financial crises



Big question: under what conditions hysteresis effects are most prominent?

Focus of this paper: the role of housing market and household debt cycles

Empirical evidence and a dynamic general equilibrium model

Empirical evidence

Housing market boom-and-bust cycles predict lower future TFP growth

(A) Unbalanced panel of 50 countries, 1950 - 2018:

- House price indexes
- Household debt
- Real economy indicators
- Utilization-adjusted TFP (constructed by the author Imbs (1999) correction)

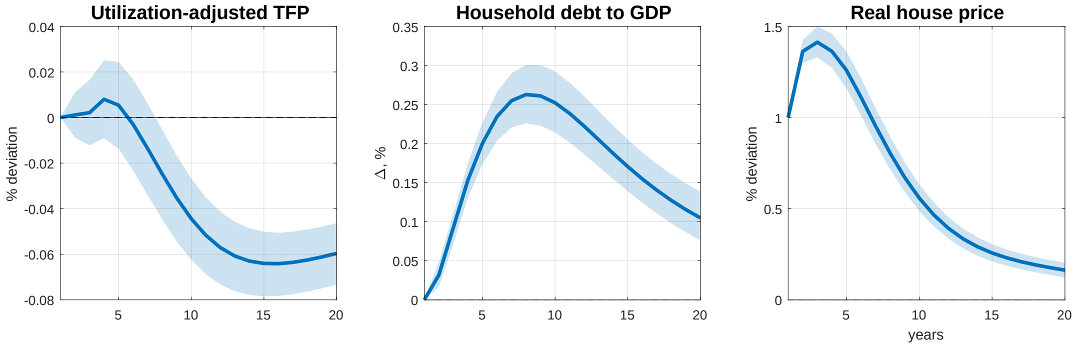
Two experiments:

- House price shock in a panel VAR
- Event study of housing market crashes by local projections

(B) Cross-section of US MSA post Great Recession

House price shock in a panel VAR

Panel VAR in levels, Cholesky identification, house price ordered last:



A rise in house prices and household debt predicts lower TFP growth in the medium run

Event study of housing market crashes

63 housing market boom-and-bust events List

Elasticities of macroeconomic variables to the house price decline during the crash:

$$\Delta_h y_{i,t+h} = \alpha_i^h + \alpha_t^h + \boldsymbol{\beta}^h \Delta p_{i,t}^{\text{crash}} + X_{i,t}' \Gamma^h + \varepsilon_{it}^h$$

$\Delta_h y_{i,t+h} = \log(Y_{i,t+h}) - \log(Y_{i,t})$, country i

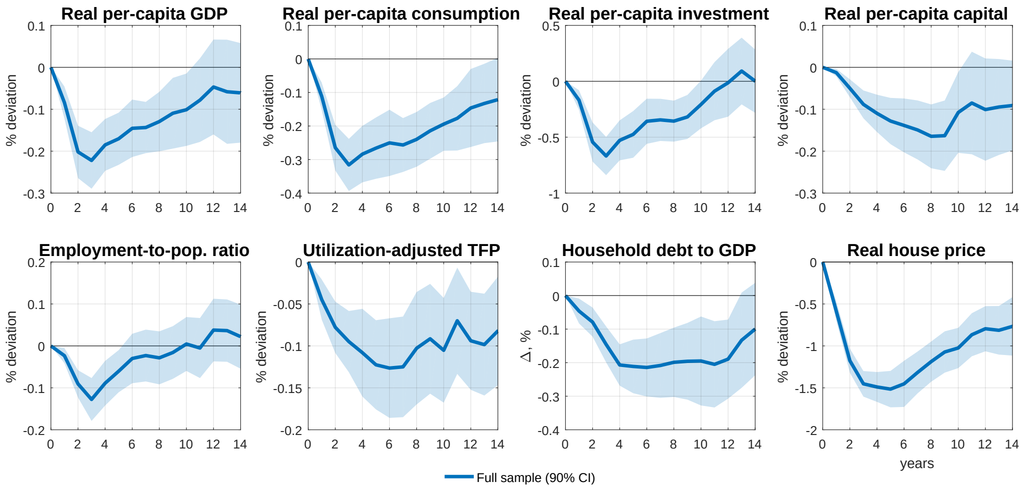
$\Delta p_{i,t}^{\text{crash}}$ – housing crash measure (3-year price decline from the peak)

α_i^h, α_t^h – country and year fixed effects

$X_{i,t}$ – vector of controls List

H-period response: $\{\boldsymbol{\beta}^h\}_{h=1:H}$

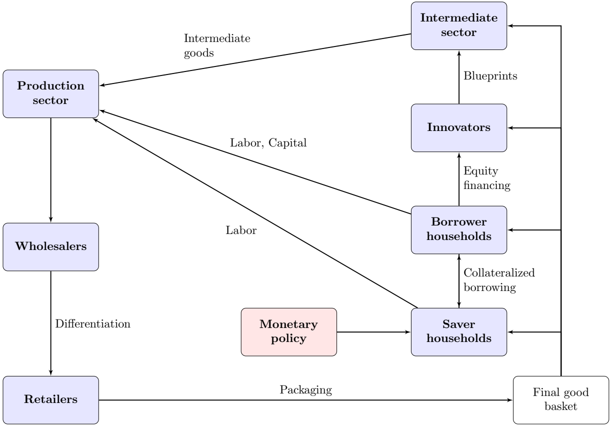
Event study of housing market crashes



Deleveraging → persistent decrease in TFP and capital driving persistence

Pre-2007 sample

General equilibrium model



- Borrower-saver NK model
- Housing as collateral (Iacoviello 2005)
- Borrowing subject to an occasionally binding constraint
- Endogenous growth through product creation (Romer 1990)
- **Experiment:** a housing market crash triggered by negative housing demand shocks (Liu et. al. 2013)

Endogenous growth through innovation

Aggregate production function: $$Y_t = F\Big(\underbrace{K_t,\ L_t}_{\text{Rival factors}},\ \underbrace{\int_0^{N_t} x_t(\omega)d\omega}_{\text{Non-rival "ideas"}}\Big)$$

New "ideas" through innovation (S): $$\dot{N}_t = \phi_t S_t^{\rho}$$

Positive externality in innovation: $\phi_t = \phi N_t$ (generates growth)

Monopolistic competition: $x_t(\omega)$ are imperfectly substitutable $\rightarrow$ positive profit $\rightarrow$ entry subject to a sunk cost

Connection to business cycles: Entry incentives depend on cyclical conditions

Housing as collateral

$$\max \quad \mathbb{E}_t \sum_{j=t}^{\infty} \beta^{j-t} [u(C_j, L_j) + \underbrace{\eta_j g(h_j^B)}_{\text{Utility from housing}}]$$

Budget constraint: $\quad C_t + P_t^h (h_t - h_{t-1}) + (1 + r_{t-1}) \frac{B_{t-1}}{P_t} = \frac{B_t}{P_t}$ + other terms

Occasionally binding collateral constraint: $\quad B_t \leq \underbrace{m P_t^h h_t}_{\text{Fraction of housing value}}$

$$\mathbb{E}_t \left(\beta \frac{u'_{c_{t+1}}}{u'_t} \frac{1+r_t}{\Pi_{t+1}} \right) = \underbrace{1 - \chi_t}_{\text{Intertemporal distortion}}$$

$\chi_t \geq 0 \equiv$ Lagrange multiplier w.r.t. the collateral constraint

---

The rest of the model includes standard quantitative NK features: nominal rigidities, capital accumulation subject to adjustment costs, varying capital utilization, etc.

IRF matching

Crisis experiment: a sequence of negative housing preference shocks to mimic the empirical housing price decline

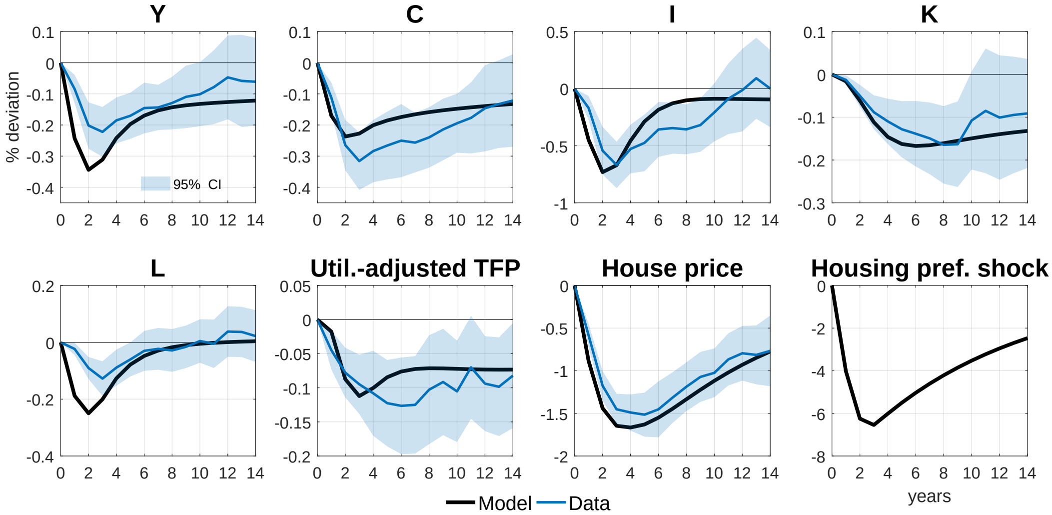
The resulting theoretical IRFs are used to estimate a set of quantitative parameters P

IRF matching estimator: choose P to minimize the weighted distance between empirical (Σ^{LP}) and theoretical (Σ^{DSGE}) impulse responses:

$$\min_{P} \;(\Sigma^{DSGE}(P) - \Sigma^{LP})\; \Omega^{-1}\; (\Sigma^{DSGE}(P) - \Sigma^{LP})'$$

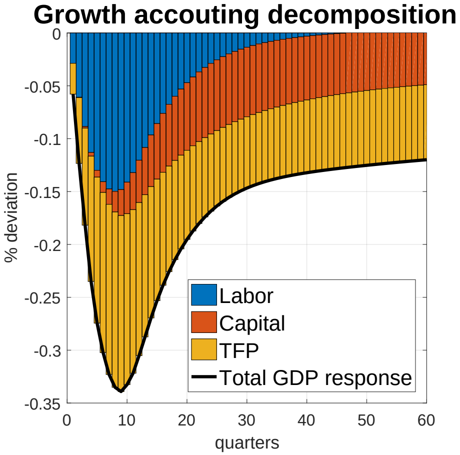
Quantitative parameters: Capital adjustment costs (ψ_K); R&D adjustment costs (ψ_N); Borrowing limit inertia (ρ_b); Labor disutility inertia (γ), Capital utilization parameter (c_2)

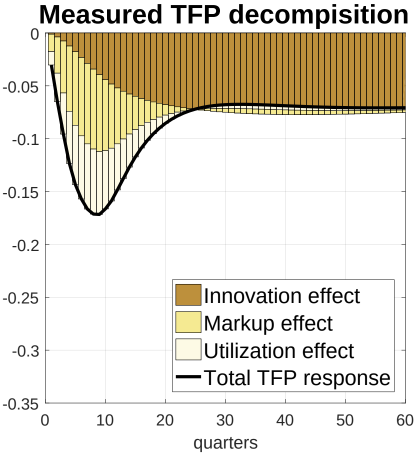
Housing market crash: model vs evidence



More IRFs

Model-based decomposition of output and TFP dynamics



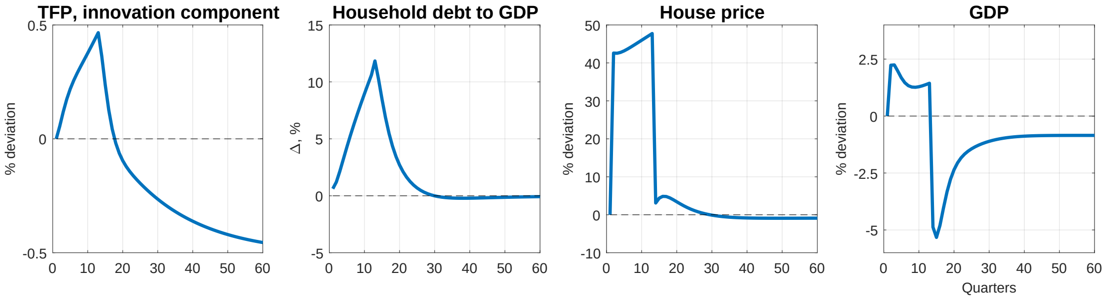


$$\Delta \mathrm{GDP}_t = \Delta \mathrm{TFP}_t + \underbrace{\alpha \Delta K_t}_{\text{Capital}} + \underbrace{(1-\alpha)\Delta L_t}_{\text{Labor}}$$

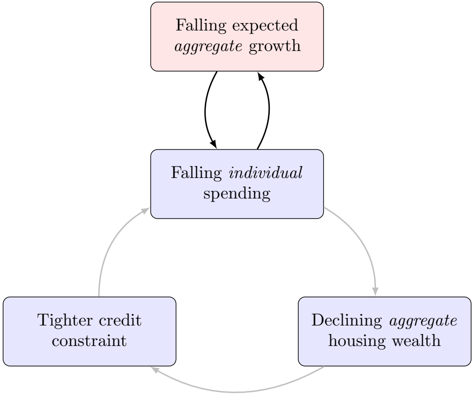
$$\Delta \mathrm{TFP}_t = \underbrace{\Delta \Omega_t}_{\text{Markup}} + \underbrace{\alpha \Delta u_t}_{\text{Utilization}} + \underbrace{(1-\alpha)\Delta N_t}_{\text{Innovation}}$$

Asymmetric belief-driven boom and bust cycle

- Housing cycles driven by beliefs about future demand (Kaplan, Mitman, Violante 2020)
- Asymmetry is driven by occasionally binding collateral constants that amplify negative but not positive shocks
- **Example:** unrealized positive housing demand news shock about t=12:



Housing market crash: main channels



(1) **AD channel** Flex price IRFs Binding ZLB IRFs

Demand effects of deleveraging

(2) **Productivity growth channel** No growth IRFs

Endogenous slowdown in TFP growth prolonging the crisis

(3) **Fisherian debt deflation channel** Housing IRFs

Negative feedback loop between deleveraging and the collateral price

(4) **Expected income growth channel**

Negative feedback loop between expected growth and consumption

Housing market crash: lessons for monetary policy

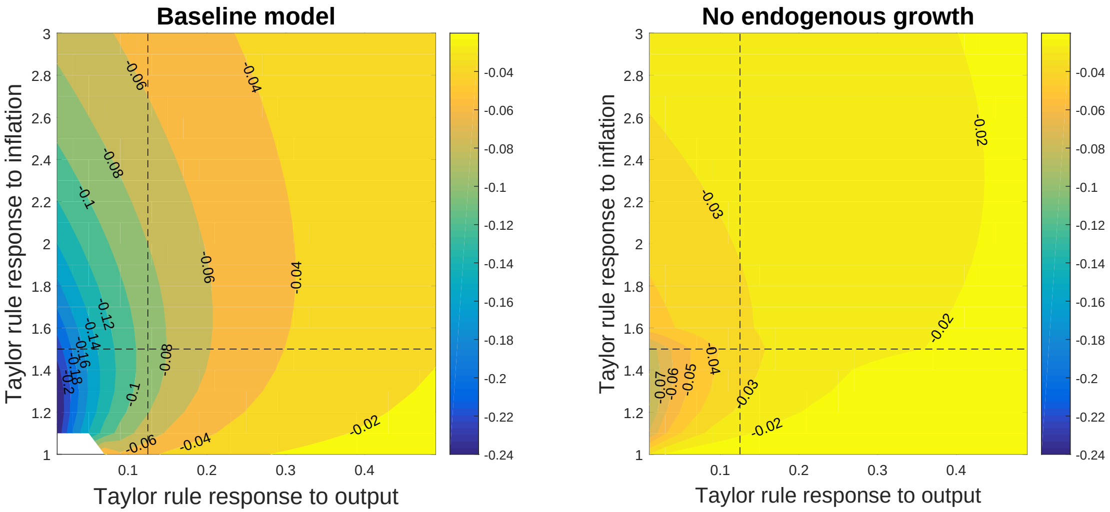
Counterfactual simulations under various parameters of the Taylor rule (ϕ_y, ϕ_π):

$$\frac{1+r_t}{1+r} = \left(\frac{1+r_{t-1}}{1+r}\right)^{\rho_r} \left(\left(\frac{Y_t}{Y_t^{BGP}}\right)^{\phi_y} \left(\frac{\Pi_t}{\Pi}\right)^{\phi_\pi}\right)^{1-\rho_r}$$

Criterion: welfare cost of the scenario in % of the steady-state consumption

- The welfare cost is more sensitive to the policy response to output...
- ...especially in the presence of endogenous growth mechanism

Monetary policy and the the welfare cost of the crisis



Conclusion

Housing market crashes are transitory events but they can leave long-lasting scars on economic activity...

- ...especially in the economy with a high household debt burden
- ...especially when monetary policy focuses on inflation stabilization relative to output stabilization and/or is constrained by the zero lower bound
- occasionally binding collateral constants make these effects asymmetric: housing market booms do not induce comparable increases in productivity growth

APPENDIX

Utilization-adjusted TFP

Utilization adjustment approach of Imbs (1999) based on a partial-equilibrium version of a model from Burnside and Eichenbaum (1996)

Firms problem:

$$\max_{K_t, u_t, e_t} \left[Z_t (u_t K_t)^{\alpha} (e_t L_t)^{1-\alpha} - w(e_t) L_t - (r_t + \delta u_t^{\phi}) K_t \right]$$

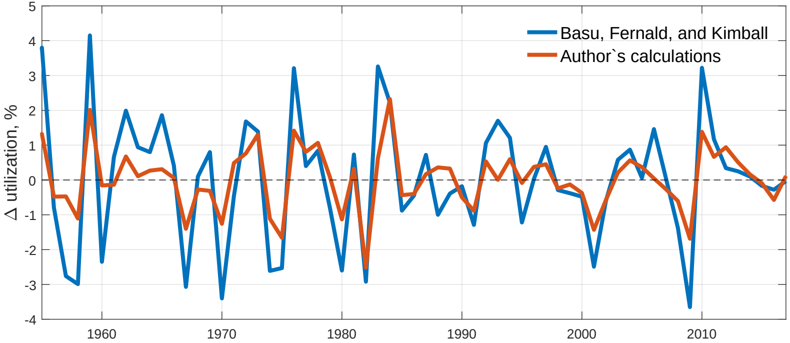
Households problem:

$$\max_{\{C_{t+j}, L_{t+j}, e_{t+j}\}_{j=0}^{\infty}} \mathbb{E}_t \sum_{j=0}^{\infty} \beta^j \left(\ln(C_t) - \frac{L_t^{1+\epsilon}}{1+\epsilon} - \frac{e_t^{1+\psi}}{1+\psi} \right) \quad \text{s.t. } C_t \leq w(e_t) L_t$$

Capital utilization: $u_t = \left(\frac{Y_t/K_t}{Y/K} \right)^{\frac{\delta}{r+\delta}}$ **Labor effort:** $e_t = \left(\frac{Y_t/C_t}{Y/C} \right)^{\frac{1}{1+\psi}}$

Back

US factor utilization



Back

Event study: sample of housing market crashes

	Peak	Trough	3 years	Total		Peak	Trough	3 years	Total		Peak	Trough	3 years	Total
BEL	1979	1985	-26%	-38%	GBR	1973	1977	-24%	-29%	NLD	1978	1985	-34%	-48%
BGR	1996	2002	-40%	-52%	GBR	1989	1996	-22%	-30%	NLD	2008	2013	-11%	-26%
BGR	2008	2013	-39%	-44%	GBR	2007	2012	-16%	-23%	NOR	1987	1992	-29%	-43%
BRA	2014	2017	-16%	-16%	GRC	2007	2017	-15%	-45%	NZL	1974	1980	-18%	-36%
CAN	1981	1985	-26%	-30%	HKG	1981	1984	-47%	-47%	NZL	2007	2009	-11%	-11%
CHE	1973	1976	-20%	-20%	HKG	1997	2003	-42%	-57%	PER	1999	2003	-15%	-29%
CHE	1990	2000	-20%	-33%	HRV	1999	2002	-14%	-14%	PHL	1996	2004	-36%	-53%
CHE	1959	1961	-12%	-12%	HRV	2009	2015	-19%	-24%	POL	2010	2013	-16%	-16%
COL	1989	1992	-13%	-13%	HUN	2006	2013	-17%	-37%	PRT	1992	1996	-11%	-12%
COL	1995	2003	-14%	-35%	IRL	2006	2012	-30%	-46%	RUS	2008	2011	-33%	-33%
CZE	2008	2013	-15%	-19%	ISL	2007	2010	-32%	-32%	SGP	1983	1986	-31%	-31%
DEU	1981	1987	-11%	-14%	ITA	1981	1986	-21%	-31%	SGP	1996	1998	-32%	-34%
DNK	1979	1982	-34%	-34%	ITA	1992	1997	-14%	-26%	SRB	2010	2013	-29%	-29%
DNK	1986	1993	-18%	-31%	JPN	1974	1977	-23%	-23%	SVK	2008	2012	-21%	-26%
DNK	2007	2012	-19%	-28%	JPN	1991	2012	-13%	-51%	SVN	2011	2014	-21%	-21%
ESP	1991	1996	-13%	-15%	KOR	1991	1998	-25%	-43%	SWE	1979	1985	-26%	-35%
ESP	2007	2014	-15%	-36%	LTU	2007	2010	-43%	-43%	SWE	1990	1993	-30%	-30%
EST	2007	2009	-51%	-52%	LUX	1980	1984	-22%	-23%	THA	2006	2009	-30%	-30%
FIN	1974	1979	-25%	-31%	LVA	2007	2010	-47%	-47%	USA	2006	2012	-14%	-26%
FIN	1989	1993	-42%	-47%	MYS	1997	1999	-15%	-18%	ZAF	1984	1987	-39%	-39%
FRA	1980	1985	-11%	-16%	NLD	1964	1966	-27%	-29%	ZAF	2007	2012	-16%	-19%

- 63 events in total, 39 before 2006,
- Median duration: 5 years peak to though, -30.6% price decline

Back

Local projections, control variables

Value at the peak and one lag:

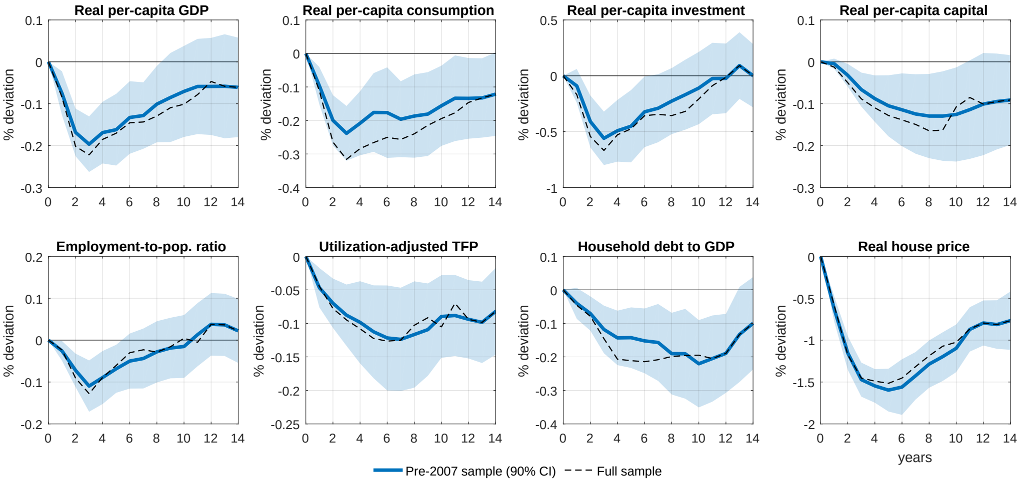
- Growth rate of the response variable
- Real per-capita investment growth
- GDP-deflator inflation rate
- Real house price growth rate
- Net exports to GDP

Value at the peak:

- Investment to GDP
- Exchange rate regime indicator (Ilzetzki et al. 2019)
- Systematic banking & currency crises indicator (Laeven and Valencia 2012)

Back

Event study of housing market crashes, pre-2007 sample



Baseline results are not driven by the GFC

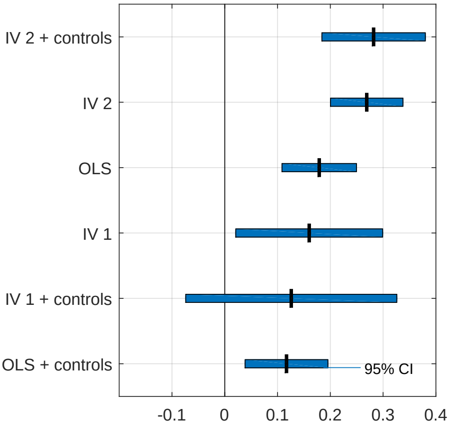
Back

Housing market crash and productivity growth across US MSAs

Higher exposure to the crash, slower post-crisis labor productivity growth

Housing market crash and productivity growth across US MSAs

$$\Delta^{2007}_{2017} \log (Y/L)_i = \alpha + \eta \widehat{\Delta^{2007}_{2010} \log P^H_i} + X_i'\Gamma + \varepsilon_i$$



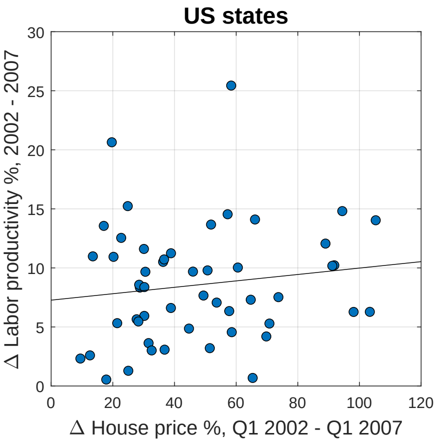
Higher exposure to the crash, slower labor productivity growth

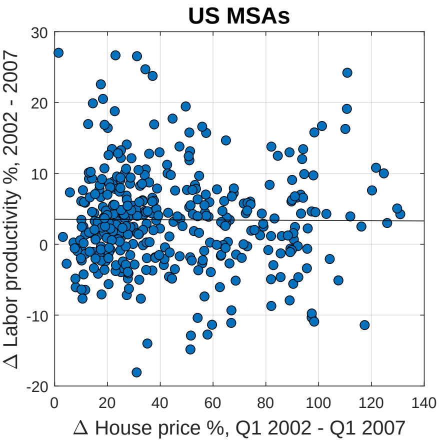
Can explain >40% of the US GDP gap relative to the pre-GFC trend

Identification

- IV 1: housing supply elasticity
- IV 2: regional sensitivity

Housing market boom and productivity growth across US MSAs





No relation between the house price growth and productivity growth during the boom

Production sector, full problem

Production function: $F_t = Z_t \left(\tilde{K}_t^{\alpha} L_t^{1-\alpha}\right)^{1-\xi} \left(\int_0^{N_t} x_t(\omega)^{\frac{1}{\nu}} d\omega\right)^{\nu\xi}$

$$\max_{\{x_{t+j}(\omega), L_{t+j}, K_{t+j}\}_{j=0}^{\infty}} \mathbb{E}_t \sum_{j=0}^{\infty} \Lambda_{t,t+j}^{B} \left[p_t^F F_{t+j} - R_{t+j}^K \tilde{K}_{t+j} - W_{t+j} L_{t+j} - \int_0^{N_t} p_{t+j}^x(\omega) x_{t+j}(\omega) d\omega\right]$$

Labor demand: $W_t = p_t^F (1-\alpha)(1-\xi) \frac{F_t}{L_t}$

Capital demand: $R_t^K = p_t^F \alpha (1-\xi) \frac{F_t}{\tilde{K}_t}$

Intermediate-good demand: $p_t^x(\omega) = p_t^F \xi \frac{F_t}{X_t} x_t(\omega)^{\frac{1-\nu}{\nu}}$

Intermediate sector, full problem

$$\max_{p_t^x(\omega)} \quad \left[(p_t^x(\omega) - A^{-1})x_t(\omega)\right] \text{ s.t.} \qquad p_t^x(\omega) = p_t^F \xi \frac{F_t}{X_t} x_t(\omega)^{\frac{1-\nu}{\nu}}$$

Optimal relative price: $\quad p_t^x = \nu \; A^{-1}$

Optimal quantity: $\quad x_t = \left(\frac{A\xi}{\nu}\right)^{\frac{1}{1-\xi}} (p_t^F Z_t)^{\frac{1}{1-\xi}} N_t^{\frac{\nu\xi-1}{1-\xi}} \tilde{K}_t^{\alpha} L_t^{1-\alpha}$

Real profit: $\quad d_t = \frac{\nu-1}{\nu} p_t^x x_t = \frac{\nu-1}{A} x_t$

Innovators, full problem

Individual production function: $N^i_{et} = \phi^i_t S^i_t$ Aggregate productivity: $\phi_t = \phi \frac{N_t}{N_t^\rho S_t^{1-\rho}}$

$$\max_{\{S^i_{t+j}\}_{j=0}^\infty} \quad \mathbb{E}_t \sum_{j=0}^{\infty} \Lambda^B_{t,t+j} \left(p^{i,b}_{t+j} \phi^i_{t+j} S^i_{t+j} - (1 + AC_{S,t+j}) S^i_{t+j} \right)$$

Optimal blueprint price: $$p^{i,b}_t = \frac{1}{\phi^i_t} \left(1 + AC_{S,t} + AC'_{S,t} S^i_t - \mathbb{E}_t \left(\Lambda^B_{t,t+1} AC'_{S,t+1} S^i_{t+1} \right) \right)$$

Downstream sectors: retailers and wholesalers, full problem

$$\max_{\{P(j)_{t+k}\}_{k=0}^{\infty}} \quad \mathbb{E}_t \sum_{k=0}^{\infty} \Lambda_{t,t+k} \left[\frac{P_{t+k}(j)}{P_t} Y_{t+k}(j) - \frac{P^F_{t+k}}{P_t} F_{t+k}(j) - AC_{p,k}(j) - \Gamma \right], \qquad \text{s.t}$$

$$\text{Production fucntion:} \qquad Y_t(j) = F_t(j)$$

$$\text{Retailers demand:} \qquad Y_t(j) = \left(\frac{P_t(j)}{P_t} \right)^{-\eta} Y_t$$

$$\text{Price adjustment cost:} \qquad AC_{p,t}(j) = \frac{\psi_p}{2} \left(\frac{P_t(j)}{P_{t-1}(j)\Pi} - 1 \right)^2 Y_t$$

$$P_t(j) = \mu_t P^F_t \qquad \mu_t = \frac{\eta}{(\eta - 1) + \psi_p \frac{\Pi_t}{\Pi} \left(\frac{\Pi_t}{\Pi} - 1 \right) - \psi_p \mathbb{E}_t \Lambda_{t,t+1} \left(\frac{\Pi_{t+1}}{\Pi} - 1 \right) \frac{\Pi_{t+1}}{\Pi} \frac{Y_{t+1}}{Y_t}}$$

Households: savers

$$\max_{\{C_j^S, L_j^S, h_j^S, B_{j+1}^S\}_{j=t}^{\infty}} \quad \mathbb{E}_t \sum_{j=t}^{\infty} \beta_S^{j-t} \left(u(C_j^S, L_j^S) + g(h_j^S) \right) \quad \text{s. t.}$$

Budget constraint: $$C_t^S + P_t^h \Delta h_t^S + (1 + r_{t-1}) \frac{B_t^S}{P_t} = W_t L_t^S + \frac{B_{t+1}^S}{P_t}$$

Households: borrowers

$$\max_{\{C_j^B, L_j^B, h_j^B, B_{j+1}^B, I_j, K_{j+1}, \iota_{j+1}, u_j\}_{j=t}^{\infty}} \mathbb{E}_t \sum_{j=t}^{\infty} \beta_B^{j-t} \left(u(C_j^B, L_j^B) + g(h_j^B) \right) \quad \text{s. t.}$$

Budget constraint:
$$C_t^B + I_t + P_t^h \Delta h_t^B + (1 + r_{t-1}) \frac{B_t^B}{P_t} + \iota_{t+1} v_t (N_t + N_{et}) =$$
$$= \iota_t (v_t + d_t) N_t + W_t L_t^B + R_t^K K_t + \frac{B_{t+1}^B}{P_t}$$

Capital accumulation:
$$K_{t+1} = (I_t - AC_{I,t}) + (1 - \delta_K(u_t)) K_t$$

Collateral constraint:
$$B_t^B \leq \rho_B \frac{B_{t-1}^B}{\Pi_t} + (1 - \rho_B) m P_t^h h_t^B$$

Capital utilization:
$$\delta_K(u_t) = \delta_K + c_1 (u_t - 1) + (c_2/2)(u_t - 1)^2$$

Calibration summary

	Calibrated parameters	Value	Source / target
β_S	Savers discount factor	0.9968	4% annual real interest rate
β_B	Borrowers discount factor	0.9918	$\beta_B = \beta_S - 0.005$
σ	Relative risk aversion	2	Conventional
$1/\epsilon_L$	Elasticity of labor supply	1	Conventional
$\nu/(\nu-1)$	Intermediate-good elasticity of subst.	1.6	BGP requirement $\xi(\nu-1)/(1-\xi) = 1-\alpha$
η	Retail-good elasticity of subst.	11	10% steady-state markup
$1/A$	Intermediate sector marginal cost	1	Normalization
ρ	R&D output elasticity	0.8	Comin and Gerlter (2006)
δ_N	Intermediate sector exit rate	0.025	Bilbiie et al. (2012)
ϕ_y ; ϕ_π ; ρ_r	Taylor rule: output; inflation: inertia	0.5/4; 1.5; 0.7	Conventional
$\bar{Z}$	Final sector productivity	1.74	Normalization, $Y^{GDP} = 1$
ψ_p	Price adjustment cost	120	4-quarter average Calvo price ridigity equivalent
$-1/\epsilon_h$	Elasticity of housing demand	-0.2	Hanushek and Quigley (1980)
m	Max leverage	0.75	Warnock and Warnock (2008)
α	Capital share	0.4	Data median, PWT 9.1
δ_K	Steady state capital depreciation	0.025	Conventional
ϕ	R&D productivity	0.11	Annual per-capita TFP growth = 0.8% (data median, PWT 9.1)
κ	Share of housing in utility	0.03	Mortgage debt to GDP = 0.55
ξ	Intermediate good share	0.5	Comin and Gertler (2006)

Utility function

GHH preference: $u(C_t^H, L_t^H) = \left(\left(C_t^H - \Upsilon_t (L_t^H)^{1+\epsilon_L}/(1+\epsilon_L) \right)^{1-\sigma} - 1 \right) / (1-\sigma)$

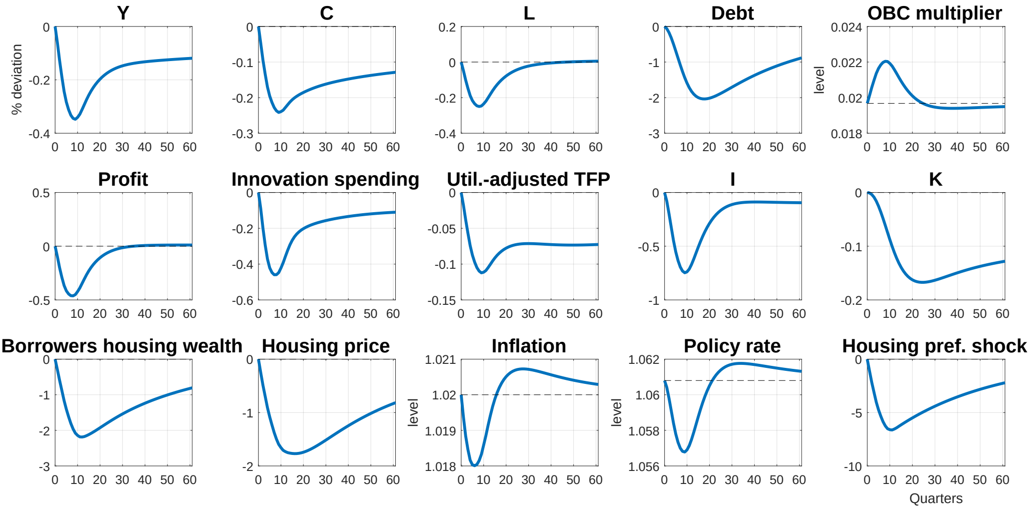
Housing utility: $g(h_t^H) = (h_t^H)^{1-\epsilon_h}/(1-\epsilon_h)$

Labor supply: $W_t = \Upsilon_t (L_t^H)^{\epsilon_L} \qquad \Upsilon_t = \Upsilon_{t-1}^{\gamma} N_t^{1-\gamma}$

Time-varying disutility of labor (Queralto 2019; Jaimovich and Rebelo 2009)

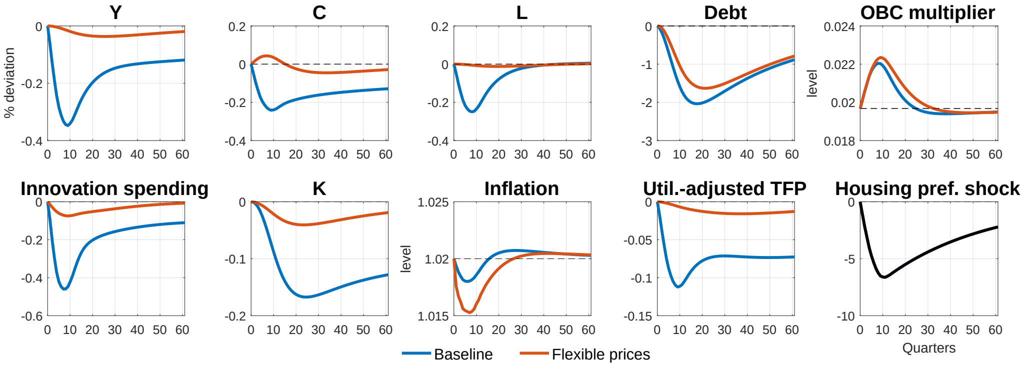
BGP with constant hours exists but the short-run effect of growth on labor supply is limited

Baseline simulation, extended set of impulse responses



Back

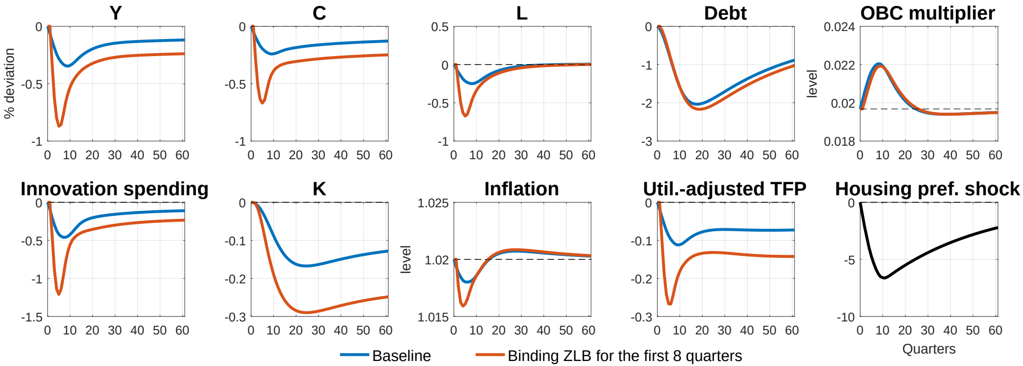
Aggregate demand channel: baseline vs flexible price economy



Nominal frictions matter

Back

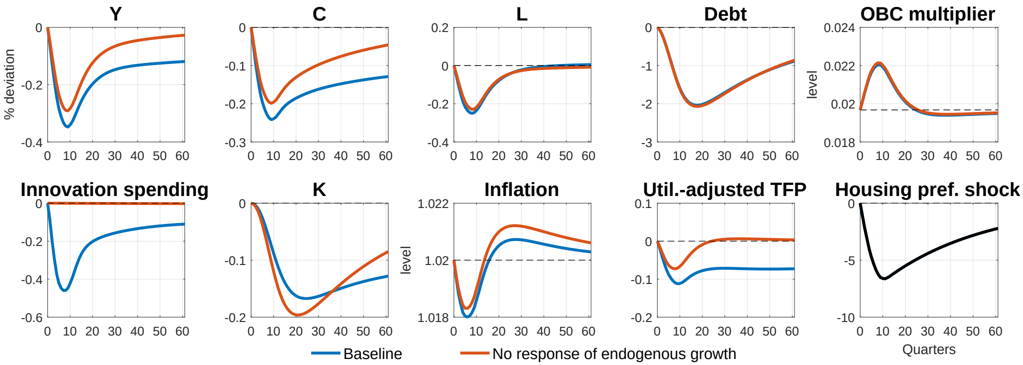
Aggregate demand channel: baseline vs binding ZLB



The amplification role of the binding zero lower bound constraint

Back

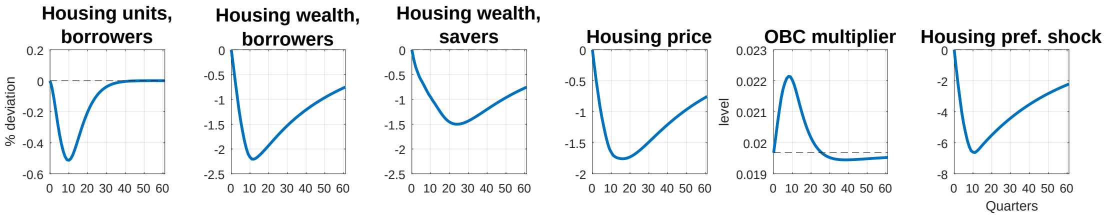
Productivity growth channel: baseline vs no growth response



Endogenous productivity growth is key for generating the empirically-relevant persistent response of TFP, consumption, and output

Back

Fisherian debt deflation: details of the housing mrkt dynamics



- The aggregate shock has an asymmetric effect across borrowers and savers
- Credit-contained borrowers reduce their housing demand by more than savers
- GE effects amplify the fall in borrowers housing wealth and exacerbate deleveraging

Back