Discussion of

A Quantitative Model of Too Big to Fail, House Prices, and the Financial Crisis?

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Big Picture

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- This paper: increase in the availability of government subsidies

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- Keep CLL elevated until "crisis" occurs, lower back to 80% after
- **Result: House prices, mortgage debt, leverage, defaults, and foreclosure costs all go up**
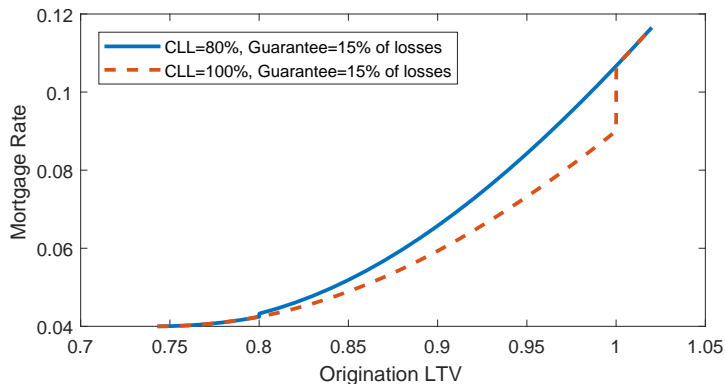
Steady-State Mortgage Menu: Baseline

Mortgage Rate = Risk-Free Rate + (1 − Subsidy) × Expected Loss
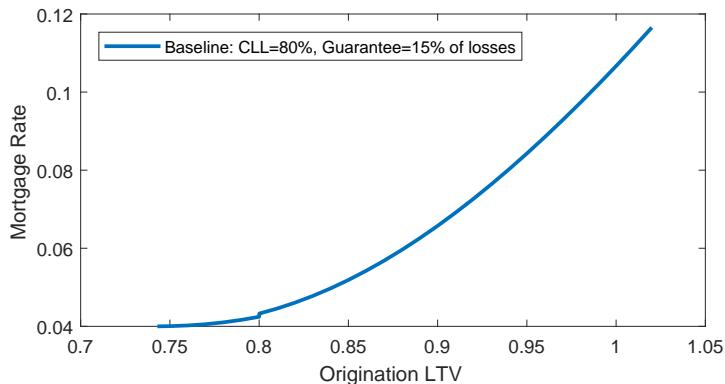
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Steady-State Mortgage Menu: Boom (w/ Exp Bailout)

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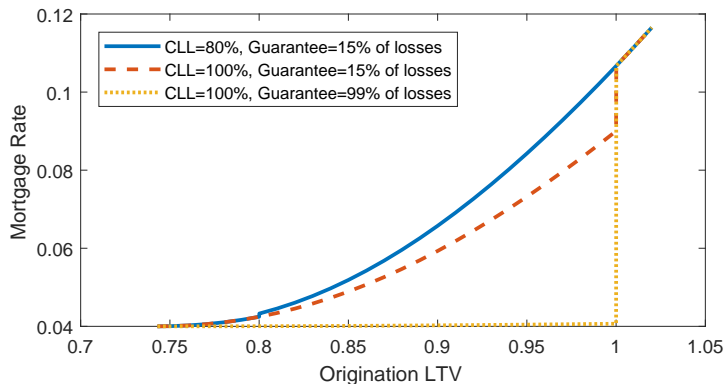
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- Frictionless moving
  - High CLL $\implies$ immediate jump in house prices, aggregate defaults
  - Losses cross bailout threshold, guarantee jumps to 99% (as banks expected)
  - Future house prices back to baseline steady-state level

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- Frictionless moving
- Calvo moving friction
  - ▶ Movers take out high-LTV loans, drive up value of housing collateral for everyone, so everyone borrows more
  - ▶ When enough have moved, LTVs become high enough to trigger bailout threshold, denouement same as above

Major Comments

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  - Elenev, Landvoigt, and Van Nieuwerburgh (JME 2016): underpriced mortgage guarantees $+$ commitment to bail out financial sector debt-holders increase house prices, defaults
    - ★ Model with both aggregate and idiosyncratic risk, long-term mortgages, levered and risk-averse financial intermediaries w/ bankruptcy option, government fiscal policy
    - ★ Also find: increase financial sector leverage, fiscal uncertainty, disrupt allocation of aggregate risk, and reduce welfare

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  - ▶ Elenev, Landvoigt, and Van Nieuwerburgh (JME 2016): underpriced mortgage guarantees + commitment to bail out financial sector debt-holders increase house prices, defaults
- Main novel feature: role of moving frictions in propagating debt build-up, gradual ramp-up in prices and crisis risk
  - ▶ If microfounded, would these frictions vary with aggregate losses, price dynamics?

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  - With CRRA, simultaneous taxation reduces potential consumption smoothing benefit of bailouts
- Condition for households to choose $z = \zeta$ (leverage = CLL) $(1 - \eta)m\gamma zg(z) < \eta G(z)$ is sensitive to parameters and distribution.
  - E.g. sign flips from baseline calibration if moving probability $m = 1$
  - Intuition: foreclosure inevitable with default, expected DWL much higher, subsidy no longer wins out

Conclusion

- Important question: were government macro-prudential policies partly responsible for the housing boom/bust? Which policies and what are the channels?

- Model produces many analytical results, could be used for interesting comparative statics

- Encourage authors to think more about the contribution – focus on the model's ability to generate persistence (a struggle for many others)