Financial Stability and Mortgage Markets

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Household debt and Macro-prudential policies

- **Traditional focus**
  - Bank lending channel impacts the business cycle through firm investment / aggregate supply side.

- **More recent focus**
  - Household credit impacts the business cycle through aggregate demand side
  - Theory embeds aggregate demand externality or behavioral biases with macro-frictions.

- New evidence from Mian, Sufi and Verner (forthcoming)
Increase in Household Debt Predicts Lower Growth
How do credit shocks feed into GDP?
Household Debt Expansion and Forecast Errors

**Year t GDP Forecast**

**Year t GDP Forecast Error**

- **Year t forecast of growth from t to t+1,..., t+5**
- **Year t forecast error of growth from t to t+1,..., t+5**

- **Household**
- **NF Firm**
Heterogeneity across Exchange Rate Regimes

- Result strongest among fixed exchange rate regimes

Graphs showing the coefficient on HHD/GDP expansion and FD/GDP expansion for different horizons and exchange rate regimes.
Rise in Global Household Debt $\Rightarrow$ Lower Global Growth
Global Non-Fin. Debt Does Not Predict Global Growth
Summary

- Household credit shocks and GDP growth
  - 6 percentage point increase in HHD/GDP over 3 years predicts 2 percentage point lower GDP 3 years out.
  - Asymmetry between household and non-financial firm debt
  - HH credit shocks negatively predict GDP forecasting errors

- Support for macro-frictions The effect is stronger in fixed ER regimes, ZLB and external borrowing.
  - There is a global household credit cycle that strongly predicts lower global GDP growth
    - HH credit to GDP predictability stronger for countries with higher global cycle beta
    - predicts slower out-of-sample global growth post-2007