Referee Report on "The aggregate and distributional implications of credit shocks on housing and rental markets" -- AER-2024-1025

Summary

The authors want to analyse the aggregate and distributional implications of credit shocks on housing and rental markets, including a welfare analysis.

They build a model of the aggregate housing and rental markets in which house prices and rents are determined endogenously, and use the model to study the impact of changes in credit conditions on house prices, rents and household welfare.

They analyse two forms of credit shocks: the introduction of policies that limited loan-to-value (LTV) and loan-to-income (LTI) ratios of newly originated mortgages (also an unexpected permanent rise in real interest rates).

In their main experiment, they analyze a borrower-based macro-prudential policy intervention that imposes maximum loan-to-value (LTV) and loan-to-income (LTI) ratios to newly originated mortgages, focusing on the introduction in Ireland in 2015 of a minimum 20% downpayment on a house and a maximum 3.5 ratio of mortgage debt to household income. The authors argue that this intervention, which was largely unanticipated and binding for many prospective buyers, is an excellent case study for the credit shocks they model. Acharya, Bergant, Crosignani, Eisert, and McCann (2022) showed empirically that this policy led to a reduction in house price growth in the areas in which the limits were particularly binding. They extend their analysis to rental prices and find that, consistent with they model mechanism, the reform led to a larger acceleration in rental price growth in those areas in which it had stronger effects. They use their model, calibrated to the Irish economy, to quantify the short and long run effects of the reform while keeping all other features of the housing and rental markets fixed.

They find that these credit shocks reduce house prices, but increase rents. Homeownership rates drop, and young and middle-income households are negatively affected.

Comments

This paper deals with an important question and is well executed. To make the paper even more relevant for a top-5 journal, or in general for a top-field macro journal, I provide some suggestions.

1. The objective of this paper is to analyse the distributional implications of credit shocks on housing and rental markets. Policies on maximum loan-to-value (LTV) and loan-to-income (LTI) should affect differentially wealthier households (LTV) or higher income households (LTI), and age correlates with wealth and income. Nevertheless, the empirical part on the Irish data is not

exploiting e.g. the wealth differentials stemming from LTV incidence.
Therefore, the authors should exploit further the data to understand how rental and house prices change depending on e.g. wealth or age (the distance measure used is not related to e.g. wealth or age). In addition, the action of buying a house may imply changing the county where the household lives renting an apartment (and thus buying in a different county), this is not addressed either. Improving this part is essential given the objective of this paper.

2. Less essential, but nevertheless, crucial for household welfare is to understand whether there is any benefit of these policy (credit) changes. That is, these policy changes happen because there are intended positive consequences, which could be higher for households with less income and wealth (younger).
There is an influential literature by e.g. Mian and Sufi that argue that subprime borrowing was crucial for the 2007-09 crisis (externalities here could be fire sales, credit crunches). In Europe (Ireland), effects could be even higher than USA for households welfare given that mortgage loans are with full recourse (externalities here could be not only via fire sales but also massive consumption reduction).
Therefore, the paper could analyse both the benefits and costs of policies on credit, as this will have for sure importante effects for household welfare, especially distributional effects.

3. Much less important, and not essential, but interesting for macro is that once credit is changed and hence house prices are changed, this implies different implications for firms' access to credit. Smaller firms will be differently affected, and lower income households may work substantially more at smaller firms, with important distributional implications.