



FEDERAL RESERVE BANK OF SAN FRANCISCO

Comments on “What’s Driving Deleveraging” by Dynan and Edelberg

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The views expressed here are those of the author and not necessarily those of the Federal Reserve Bank of San Francisco or the Board of Governors of the Federal Reserve System.

Background

- Theory holds that consumption depends on wealth and (permanent) income
 - Estimates of housing wealth effect range from .02 - .09 cents on the dollar (Carroll, Otsuka, Slacalek (2010))
 - Role of expectations and discounting
- No explicit role for debt in the theory
- What happened in the recent downturn?
 - \$6.8 trillion lost homeowners equity
 - Decline of ~\$372 billion in aggregate consumption
 - Decline of \$961 billion in household debt

Why did household debt decline?

- Precautionary savings motive increased
- Asset values declined: households have a target leverage ratio
- Credit constraints
- Dynan and Edelberg can explore these candidate explanations at the household level

Main takeaways

- Nice to have a panel!
 - Control for intervening life events
- Leverage in 2007 strongly related to 2009 attitudes towards spending/consumption
- Changes in net worth are not strongly related to 2009 attitudes towards spending/consumption
- Lingering questions: credit supply or credit demand?

Desire to cut back consumption

- Basic approach is to correlate leverage with household indicators of willingness to cut back
 - Economic significance of leverage coefficient—smaller than job loss coefficient
 - Interactions???
 - Job loss x Debt/Income, do we know duration of unemployment spell?
 - Age x Debt/Income
- Leaves open the question of which shocks are driving attitudes towards consumption
 - Shocks to financial wealth may generate responses that are different than shocks to housing wealth, or shocks to uncertainty
 - Wealth effect estimates differ by asset type
 - Distribution of financial wealth across households may be different from distribution of housing wealth, or exposure to uncertainty
- Do these households know how much housing wealth changed for them?
- Not eliminating/isolating credit constraints as a determinant of a consumption cut back

Extensive vs intensive margin of cutting back

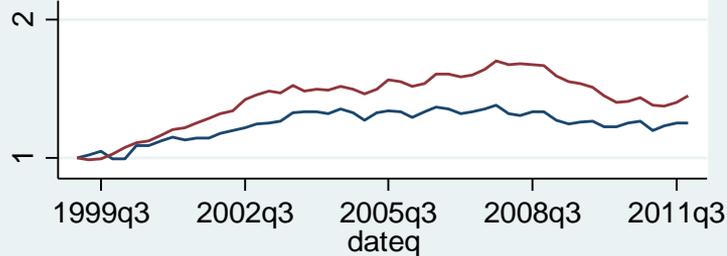
- Any way test directly how material are the cut backs in spending?
- Might help differentiate between household balance sheet-related motives and more general aggregate risk aversion
 - Peer effects
- What about forced deleveraging via foreclosure or bankruptcy?

Intensive margin of deleveraging

Nonmortgage debt profiles

Households never defaulted

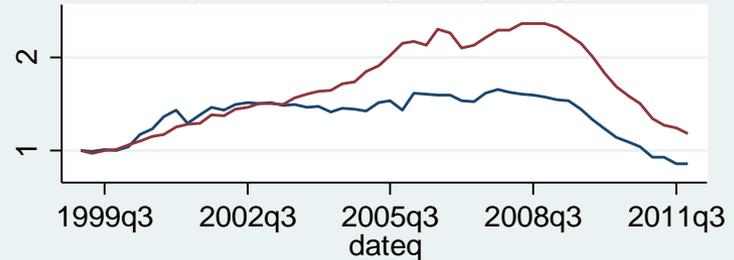
Sorted by 2001-2006 county house price appreciation



— Decile 1, no default — Decile 10, no default

Households defaulted

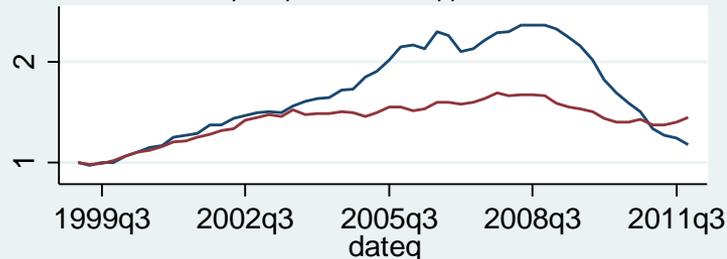
Sorted by 2001-2006 county house price appreciation



— Decile 1, default — Decile 10, default

High appreciation counties

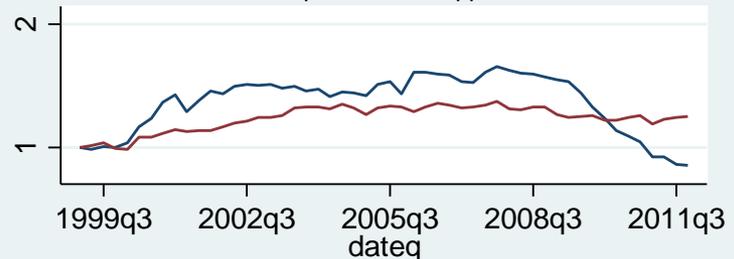
top 10 percentile of appreciation



— Decile 10, default — Decile 10, no default

Low appreciation counties

bottom 10 percentile of appreciation



— Decile 1, default — Decile 1, no default

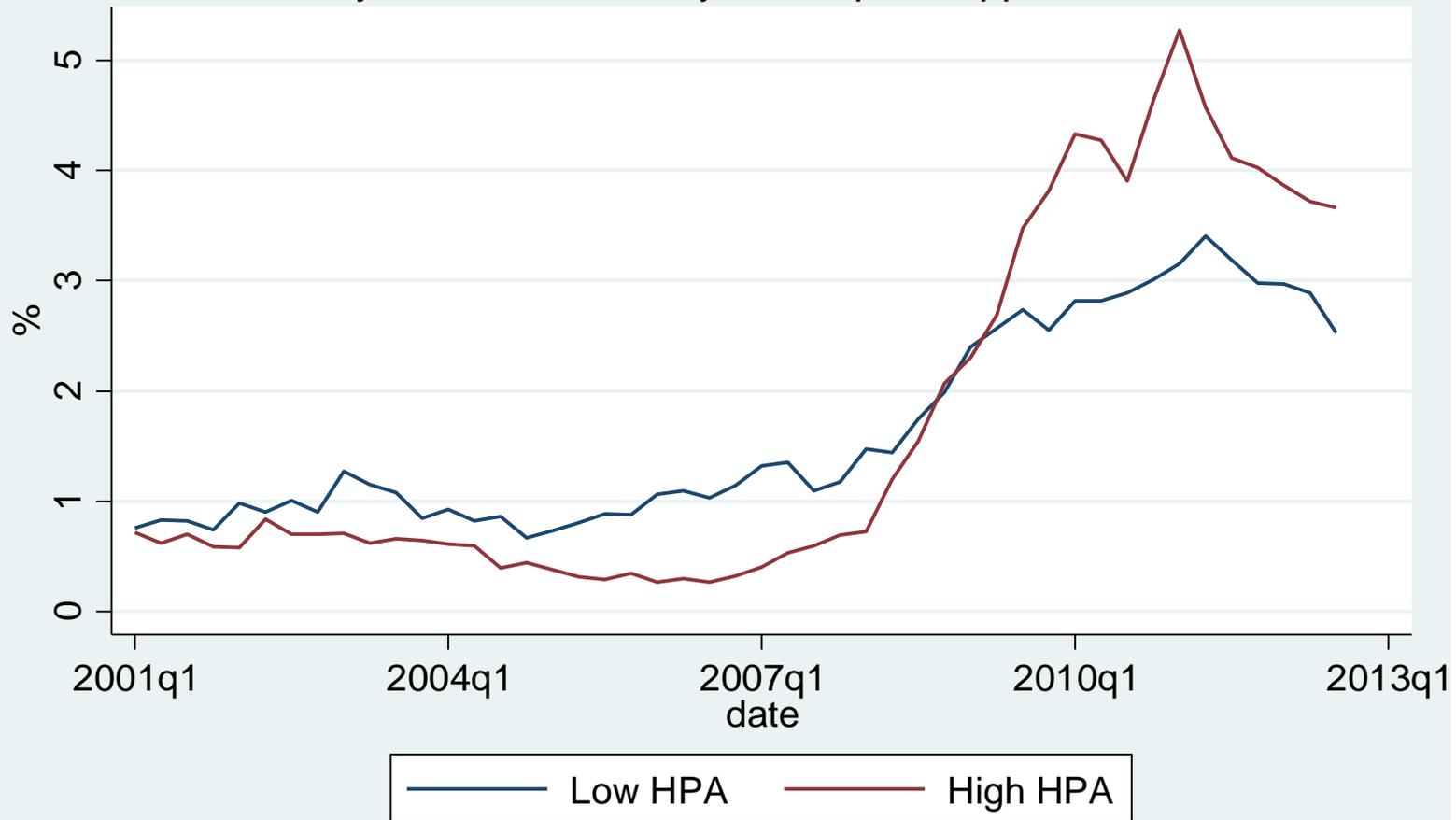
Source: Equifax. All series indexed to 1999Q1=1.

Credit constraints

- Changes in relative prices generate both winners and losers in housing markets
 - Don't credit constraints need to be present to generate wealth effects at some level of aggregation?
- Did credit become more expensive because collateral values changed?
 - Moving along the credit supply curve
- Did credit become more expensive because standards changed?
 - Shift in the credit supply curve
 - Gropp, Krainer, and Laderman (2012) find that deleveraging is more severe for consumers without mortgages

Possible origins of shift in credit supply

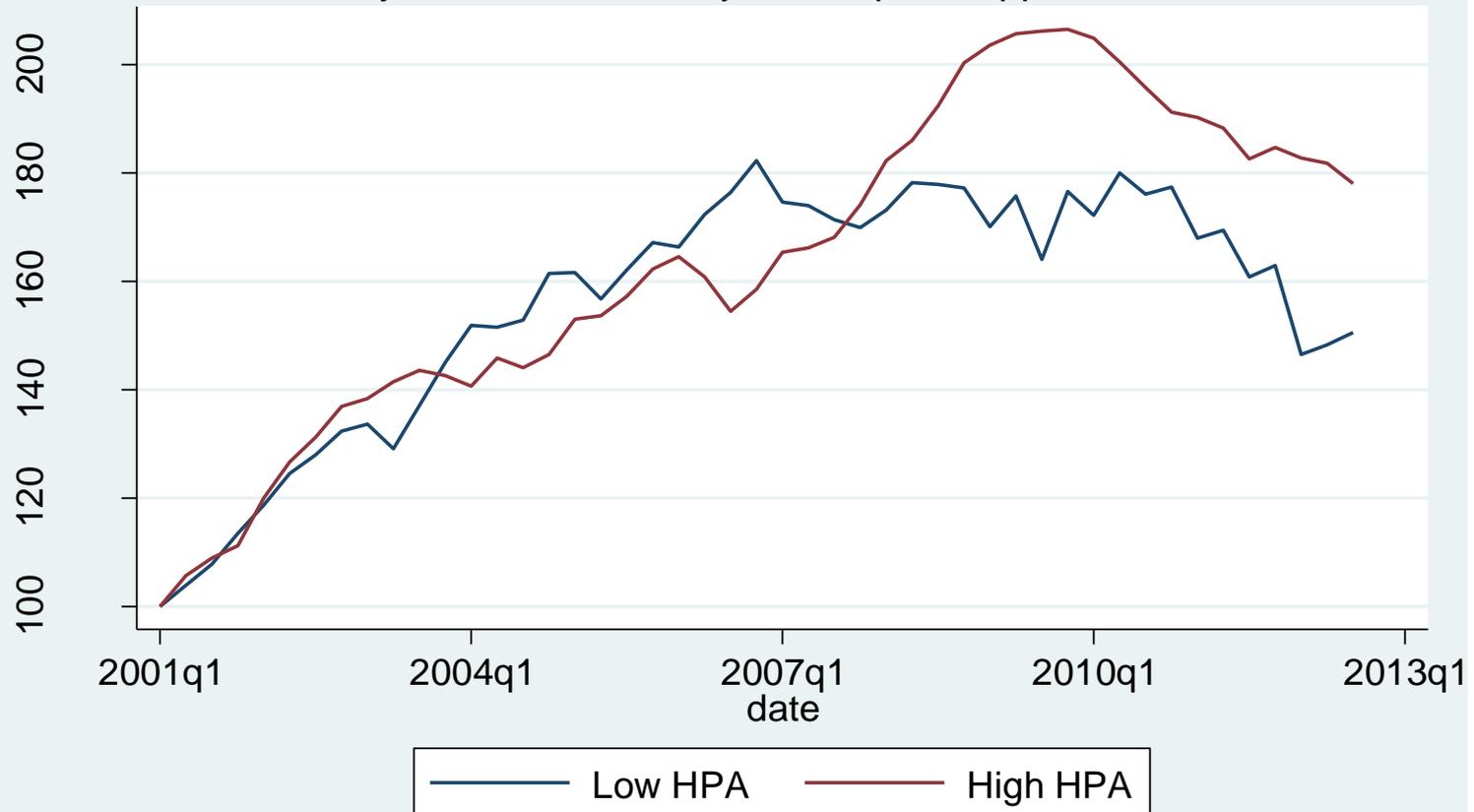
Commercial Real Estate Nonperforming Loan Ratios
by 2002-2006 county house price appreciation



Source: FRB Call Report Banks with < \$1 billion in assets

Relative importance of aggregate vs. local shocks

Commercial Real Estate Loans (Stock)
by 2002-2006 county house price appreciation



Source: FRB Call Report banks with < \$1 Billion in assets; indexed to 2001q1