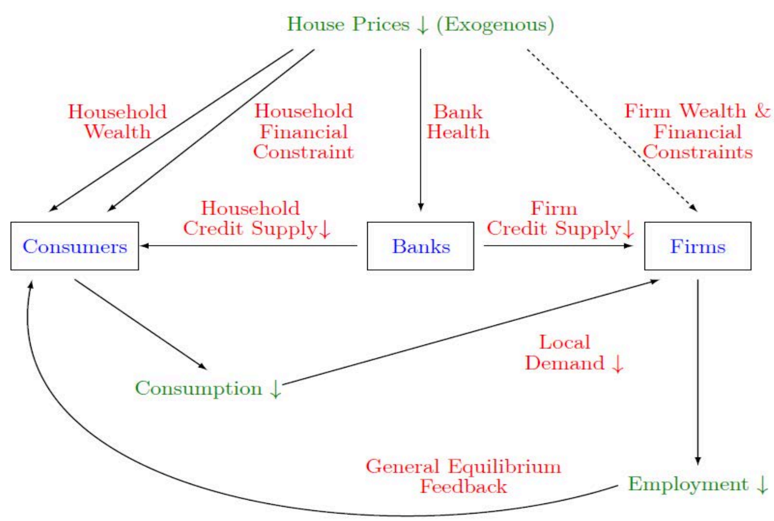
Housing Wealth, Credit Constraints and Consumption

(with Ronel Elul and Şebnem Kalemli-Özcan)

Figure 1: House Prices and Consumption: Channels



We investigate the effect of declining house prices on household consumption behavior during 2006–2009. We use an individual-level data set that has detailed information on borrower characteristics, mortgages, and credit risk. Proxying consumption by individual-level auto loan originations, we decompose the effect of declining house prices on consumption into three main channels: wealth effect, household financial constraints, and bank health. We find a negligible wealth effect. Tightening household-level financial constraints can explain 40-45 percent of the response of consumption to declining house prices. Deteriorating bank health leads to reduced credit supply both to households and firms. Our dataset allows us to estimate the effect of this on households as 20-25 percent of the consumption response. The remaining 35 percent is a general equilibrium effect that works via a decline in employment as a result of either lower credit supply to firms or the feedback from lower consumer demand. Our estimate of a negligible wealth effect is robust to accounting for the endogeneity of house prices and unemployment. The contribution of tightening household financial constraints goes down to 35 percent, whereas declining bank credit supply to households captures about half of the overall consumption response, once we account for endogeneity.

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Paper

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