

Discussion of “The role of housing collateral in an estimated two-sector model of the U.S. economy” by M. Iacoviello and S. Neri

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Outline

1. Main theoretical contributions of the paper
2. Empirical issues / Questions
3. Possible extensions
4. What do we learn from the exercise?

Taking Iacoviello (AER, 2005) as the starting point

- Same basic structure with patient / impatient consumers
- Housing as collateral for credit constrained households
- Sticky prices
- Studying impact of housing preference shock
- Focus on the question: “Should monetary policy respond to house prices?”

Recalling the main conclusions of Iacoviello (2005)

- There are feedback effects from housing preference shocks to non-housing consumption
- The effect is positive only due to the collateral constraint; it would be negative otherwise
- Optimal policy requires to respond very little to house price fluctuations (independently of output gap and inflation)

Main innovations / differences compared with Iacoviello (2005)

- Modelling the supply side of housing → two-sector model
- Allows to derive the long-run trend in house prices (heterogeneous trends in productivity in construction and non-construction production; fixed supply of land)
- Very important contribution to the literature!
- Absence of entrepreneurs (credit to firms) in the model
- Focus on counterfactual simulations rather than on optimal policy

Main results of the paper, in a nutshell

- House prices are mainly explained by housing preference shocks (“own shocks”)
- There are small, but non negligible feedback effects from housing shocks to overall consumption and GDP
- Had housing preference shocks been shutted down from 2002 onwards, consumption growth would have been lower by about 0.1% per annum, and residential investment growth by 1% per annum
- Stabilising housing prices in this period would have led to a disaster
- Overall, not very different from Iacoviello (2005), but nonetheless interesting due to the different focus of the paper

Some questions on the set-up of the model

- Not completely clear why adjustment costs on housing are ruled out
- Can one hold (and consume) housing services without owning land? Why are borrowers excluded from owning land?
- Weight of land in the housing production seems too low (compare house prices in Manhattan and in Nebraska ...)
- Why not integrate wage stickiness in the baseline model?

Empirical issues

- As in all estimated SDGE models, identification is an issue (Canova and Sala 2006)
- Why is the posterior densities not reported in the paper? How “flat” are they?
- I see a possible problematic issue in the Phillips curve estimation, since the authors do not control for shifts in the inflation target (and the inflation are apparently not detrended)
- Could be one reason for the unusual estimate of price stickiness?

Possible extensions

- One of the most interesting features of the model is the role of a fixed supply production factor, i.e. land
- The authors could make more from this, in particular study the role of the fixed supply factor in periods of extreme high monetary accommodation (say the US in the 2000s)
- Connection to the “story” of assets in fixed supply (say land, oil) reacting to the monetary expansion differently from productions where factors are unlimited (say, manufacturing products from China)?
- Is there any interesting non-linearity stemming from the fixed supply?

What do we learn from the exercise?

- In my view (but issue for discussion) feedback effects identified in this paper are smaller than what most observers may have in mind (see in particular variance decomposition: less than 1% of consumption variability is explained by housing shocks)
- In this sense, this seems an innovation compared with Iacoviello (2005) (again, issue for discussion)
- Our preliminary work on other countries (e.g. euro area) also indicates that feedback effects are small
- Certainly not a reason to discard housing, however
- For it could play an important role in the transmission of monetary policy in these models (and in reality)