Potential criticisms of Duca-Muellbauer paper

Points often raised

- Latent variable could be measuring non credit-supply related things: 1.exuberant income expectations, 2. demography, 3. technological progress in producing consumption goods or housing investment goods, 4.loose monetary policy, or 5. changes in consumer preferences.
- Reply: 1. we control for survey based income expectations and between 1990 and 2011 HLI matches well SLO-mortgage conditions survey
- 2. what demog. indicator collapses in 1990-1 and then recovers and collapses from 2007?
- 3. and 5. ditto
- 4. loose monetary policy is reflected in controls for interest rates, as well as in asset prices

Reduced form 'kitchen-sink regressions'

- What does 'explain' mean? the model is just reduced form and not 'structural'. We are just 'describing' the data.

- Reply: 'explain' can have multiple meanings:
- 1. Finding a well-fitting, statistically well-behaved – including incorporating co-integration properties-, set of equations with stable parameters, hence 'structural' equations.
- 2. Finding economically interpretable estimated parameters (e.g. marginal propensities and elasticities) which permit comparisons to be made across countries and across time.

Explain…

- 3. Providing interpretations, relevant for short to medium term forecasting and policy, of the effects for consumption, house prices, mortgage debt etc. of shocks to credit availability, shocks to income, shocks to interest rates etc.

- Not complete system, but because we endogenise house prices, mortgage debt, and income expectations, we can trace the effect of credit shocks on consumption via house prices (a positive indirect effect) and via income expectations (again positive indirect) and via mortgage debt (a negative indirect effect) and so can split their separate effects via these main indirect channels from their direct effect on consumption.

- Most empirical papers attempting to estimate so-called 'housing wealth effects' on consumption confuse these with effects of credit shocks and other controls. This is why many current papers have far higher estimates of the mpc out of housing wealth.

Lesser points

- Over-fitting spline function?
- Just upward trend in data – linear trend just as good?
- If latent variable is particularly important for explaining one dependent variable, it may just be a shadow of that variable, rather than of credit conditions?
- Why not make *all* the parameters vary with the latent variable?

The credit channel features through -

- the **different mpcs** for net liquid assets, illiquid financial assets (larger for net liquid, Otsuka, 2006) and for housing;
- through possible short-term cash flow effects for borrowers;
- by the possibility of parameter shifts with credit market liberalisation:

- index **CCI** from SLO survey for unsecured credit
- housing liquidity index, **HLI**, latent variable defining access to home equity credit.

- For US, we also have data from 1980-2009 on **loan-to-value ratio for first time buyers**, measuring shifts in the down-payment constraint, and relevant for the house price equation.