

# **How Monetary Policy Shaped the Housing Boom**

by Drechsler, Savov, and Schnabl

Discussion by Christopher Palmer

MIT Sloan & NBER

Columbia New Topics in Banking

May 3, 2019

# Contributions

- Address debate about monetary policy vs. lending standards and the mortgage boom
- Argue timing doesn't line up for *low* rates to be problem
- Provide explanation for rising rates => PLS growth

Two major contributions:

1. Unifying explanation for boom: combining monetary policy and rise in private-label securitization
2. Cross-sectional exposure for identification

# Summary

DSS (QJE, 2017)

Banks fund portfolio  
lending with deposits

Fed raises  
rates



Banks with  
market  
power  
don't pass  
through 1-1



Deposits  
(relatively)  
decrease



Banks  
(relatively)  
contract  
portfolio  
lending



PLS lending  
increases in  
exposed  
areas

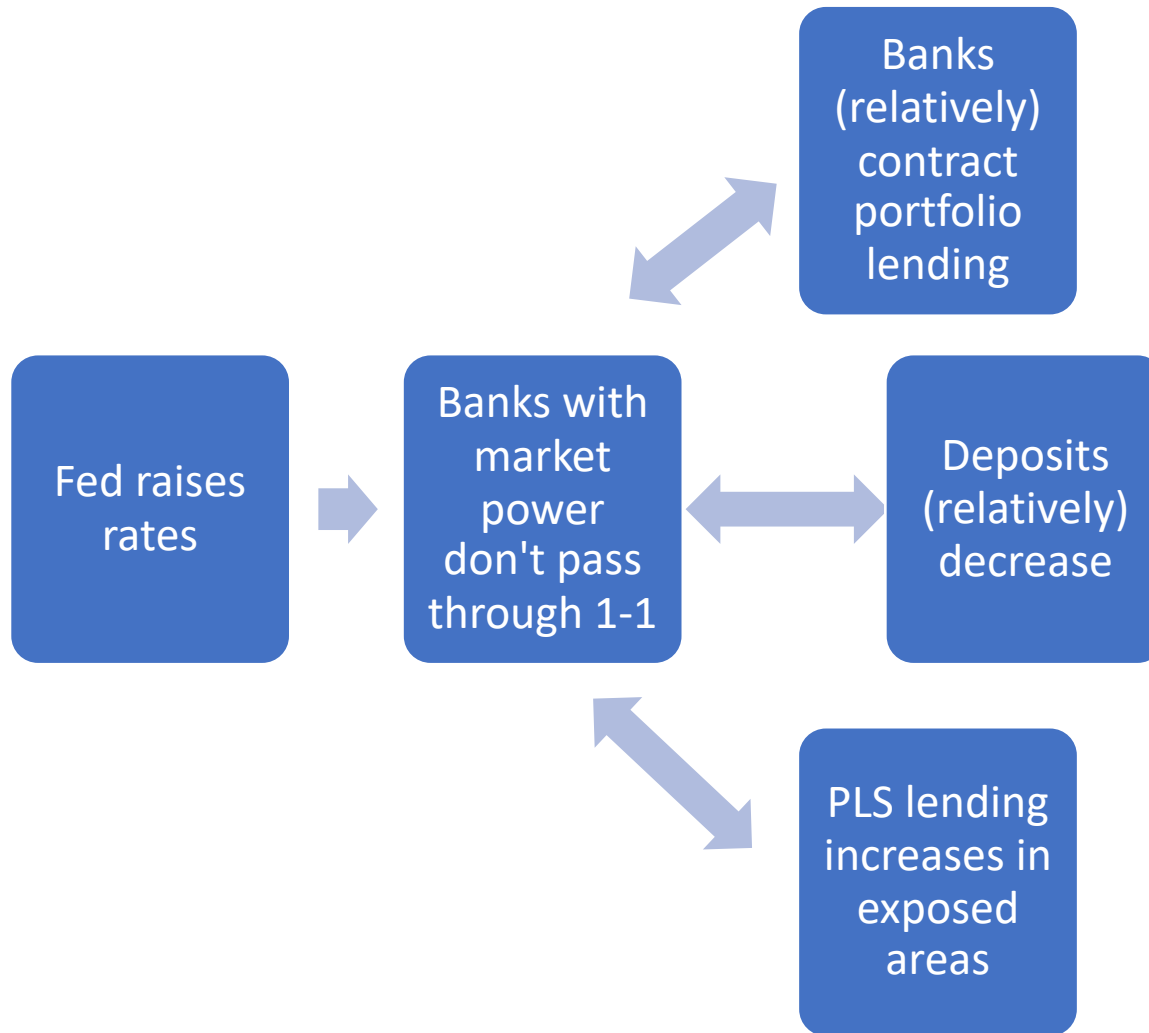
$Q_{\text{monopoly}} < Q^*$

vacuum

# Findings

1. Avg bank passed through only 60% of Fed tightening
2. Banks with most market power passed through least
3. Banks w/ most market power had lower deposit growth
4. Banks w/ most market power increased lending least
5. PLS increased most where bank market power highest
6. Basically all of 2003-2006 increase in PLS share explainable by cross-sectional exposure to deposit channel

# What empirics establish



What's the difference?

Key possibility raised:  
Reverse causality

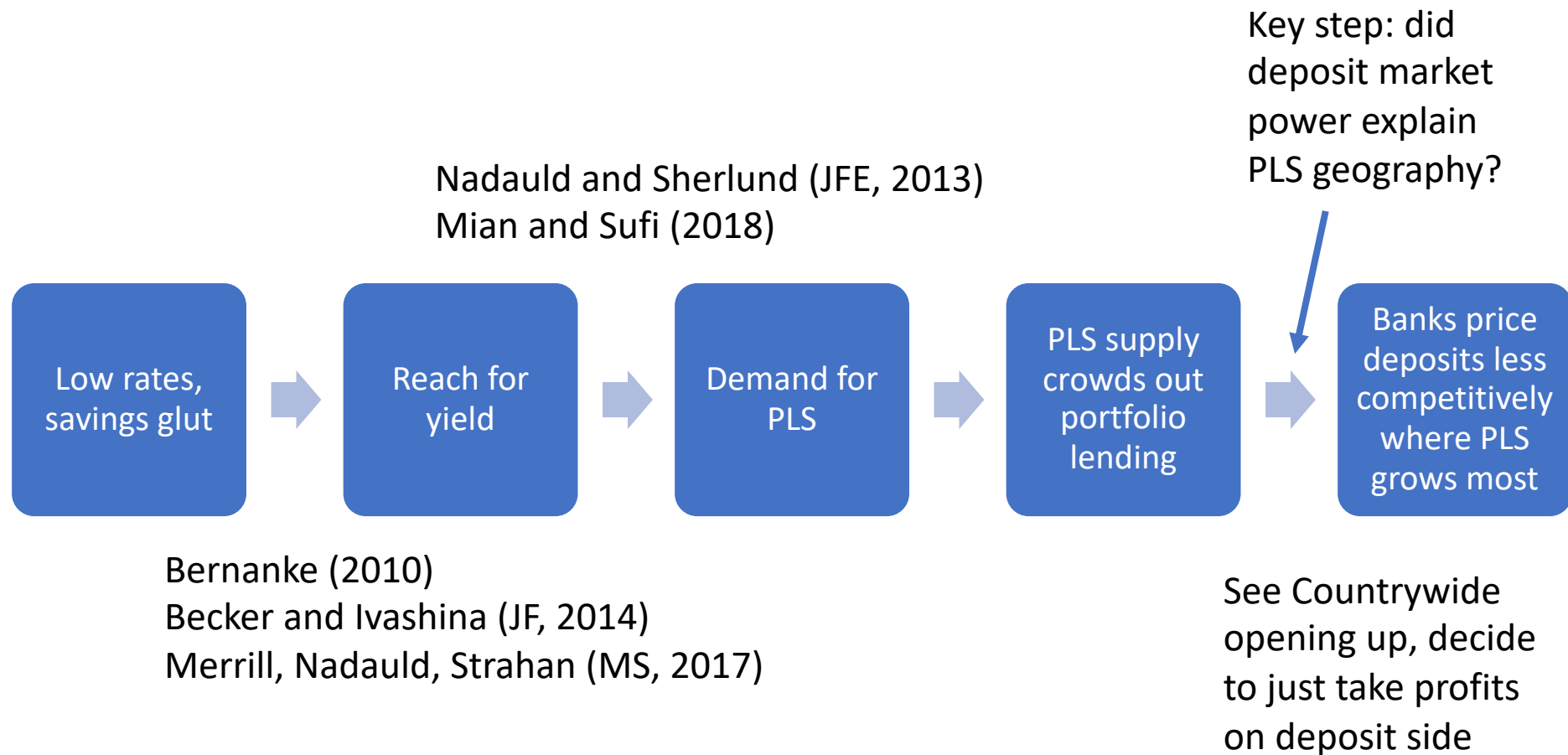
Banks **choose** to not pass through 100% of FFR hike when return to portfolio lending goes down

# Stupidity or Endogeneity?

Implication of paper: Banks either

- a) failed to anticipate PLS market coming and thought could retain more lending market share than did
  - Why don't banks compete more?
  - "Shucks, guess we've been disrupted."
  - Could have replicated non-bank securitized lending more.
- b) made a calculation that increasing spread **was worth losing lending market share**
  - Could have held spreads and kept up portfolio lending

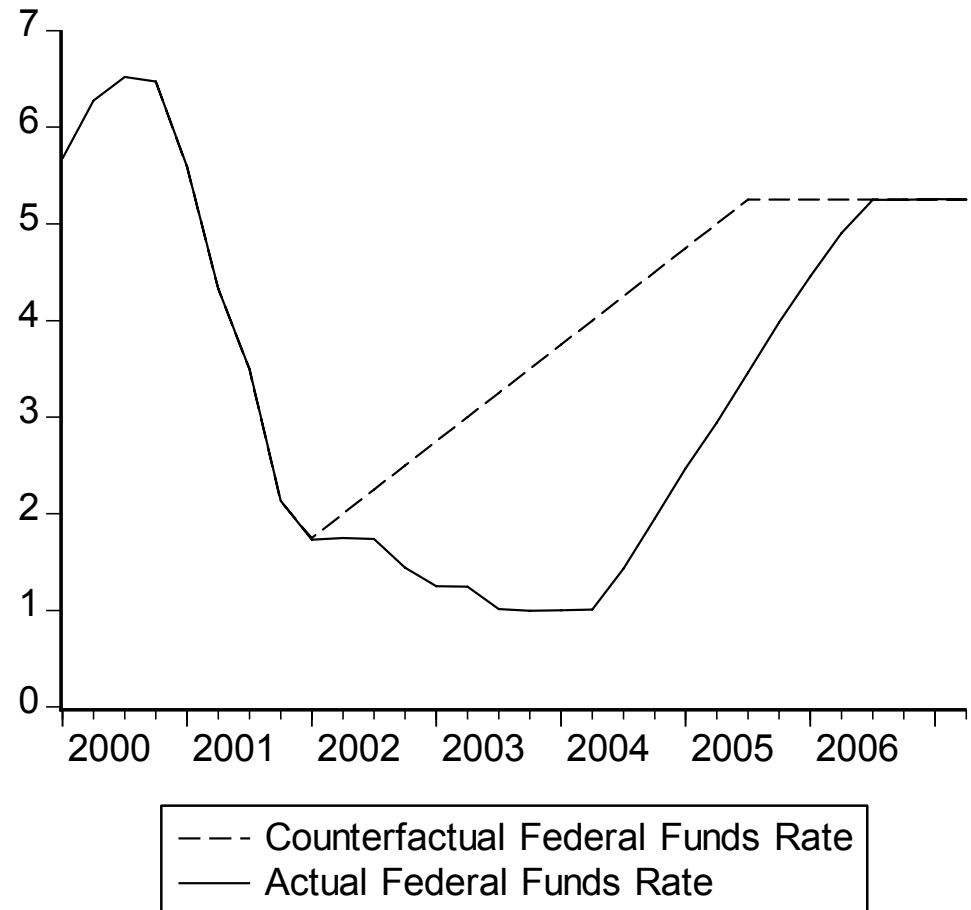
# Alternative, also-consistent story



Key question: did deposit channel drive increase in PLS share? Or vice-versa?

# Consistent with Taylor (2007) ?

- Authors point out time inconsistency of Taylor's claim that too-low rates caused lending standards decline
- But Taylor's point isn't about nominal changes
- All about levels relative to Taylor rule

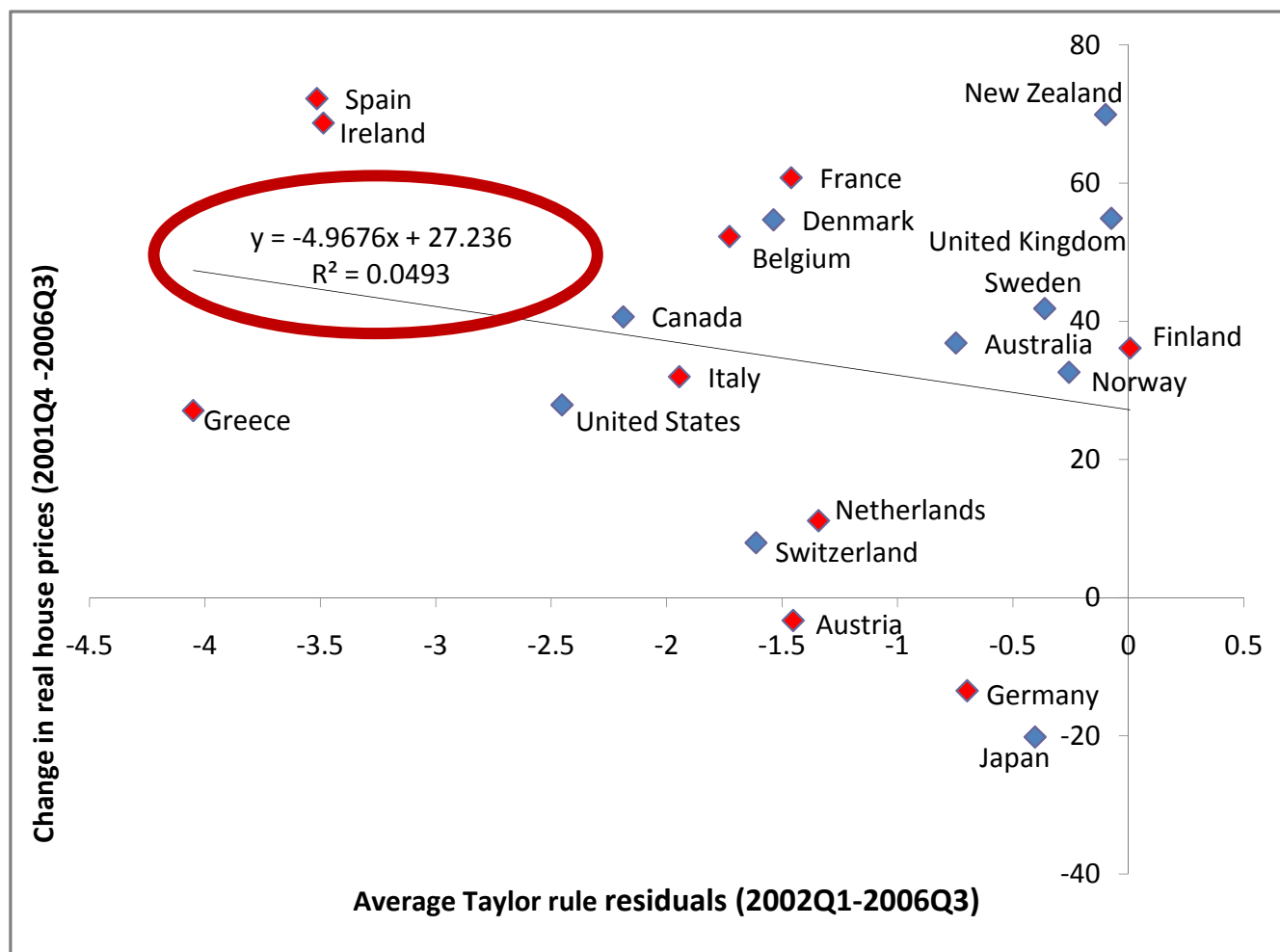


**Figure 1**



# Counter: Bernanke (2010)

Figure 12: Monetary Policy and House Prices in the Advanced Economies



...but we're generally skeptical of cross-country growth regressions.

Should deposits channel -> PLS be operant everywhere? Or only where PLS in play?

# What could rule this out?

- Estimate deposit effects within-bank since lending and deposits needn't be co-located?
  - No, since lending effects are at the bank/county level, doesn't rule out reverse causality
- Controls for future return on lending?
  - No, low  $R^2$ . Still lots of scope for omitted variables.
- Measuring beta in pre-period?
  - Helps rule out contemporaneous shocks to local PLS supply, but measure conflates deposit market power with lower return on activities funded by deposits

# What could rule this out? (2)

- Show effects on house prices?
  - No, doesn't rule out reverse causality
- 2SLS of lending on deposit changes with mkt power IV?
  - No, first-stage correlated with lending demand shocks
- Placebo tests? 2000-2002 reverse causality story: exposed banks slow lending growth even when MP loose
- Identifying cross-sectional magnitude of other local supply shock channels (e.g., final demand) and show they are identified but near zero effect on PLS share

# Conclusion

- Banks with market power find it profitable to not pass through 100% of rate hikes even though lose non-GSE lending market share
- Creates local vacuums for PLS market, shown to contribute to housing boom
- Find this explains *all* of PLS growth from 2003-2006
- No room for other cross-sectional reasons for some areas to increase PLS share more than others
- Important to better address that deposit spreads are a choice influenced by anticipated local PLS boom