

# **State Dependent Effects of Monetary Policy: the Refinancing Channel**

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# Summary

- Recent lit documents heterogeneity in monetary policy pass-through to learn about aggregate transmission
    - House prices (Beraja et al., 2018)
    - Unemployment (De Fusco and Mondragon, 2018)
    - Mortgage segment (Di Maggio et al., 2018)
  - This paper: a given rate cut only valuable for borrowers with in-the-money prepayment options
- =>  $r$  path matters for refinancing channel of MP
- Life-cycle model to study secular changes in fixed costs of refinancing
    - Refi costs down => more effective pass through

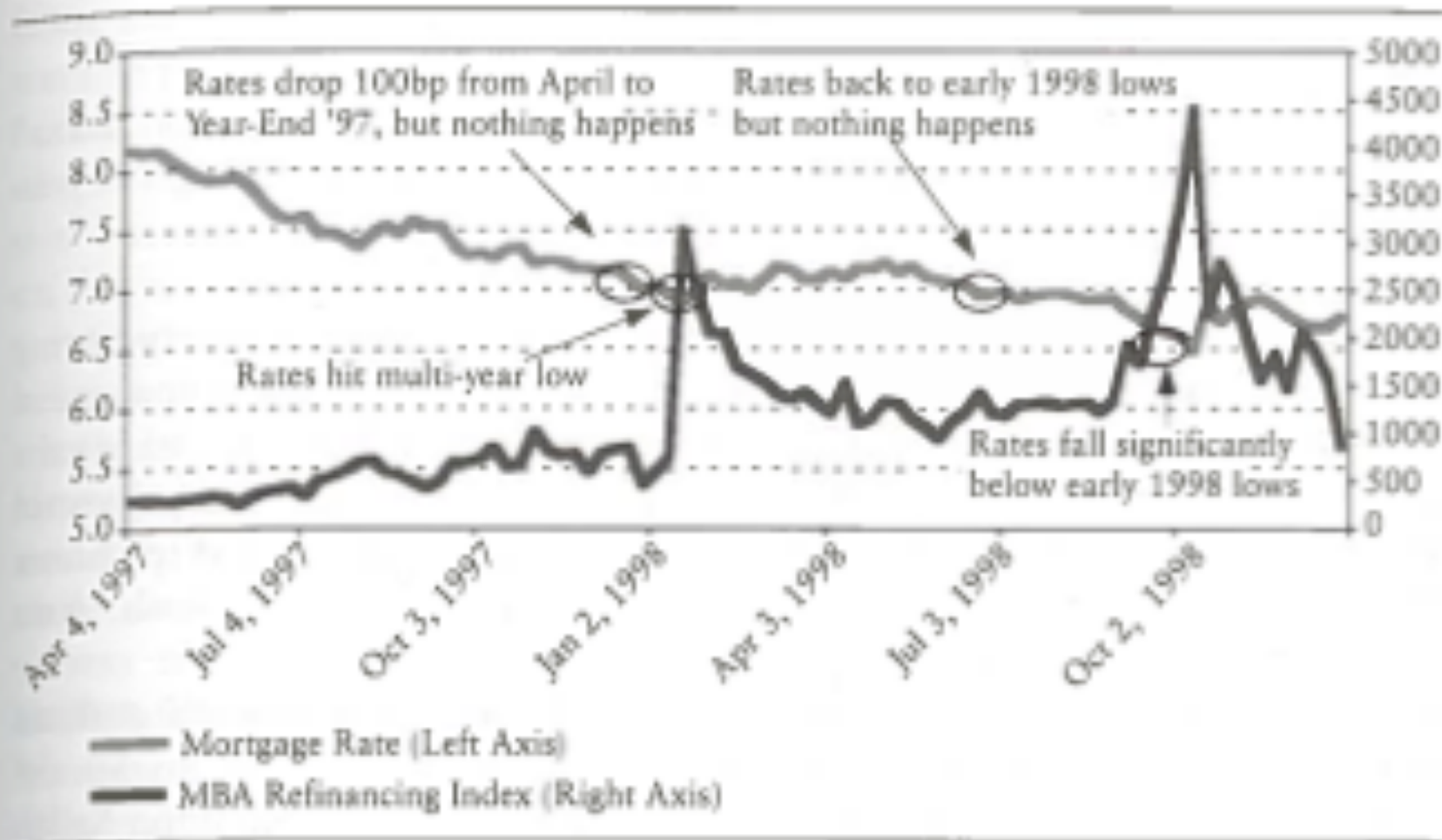
# MBS industry all over this

- “Coupon gap” as measure of prepayment option incentive features prominently in every academic and industry model of mortgage valuation
- Prepayment function nonlinear  $f(\text{coupon gap}) \Rightarrow$  prevailing level of coupon gap matters
- Related to dynamic selection concepts of burnout, seasoning, vintage effects of MBS pools
- Hayre (1999) talks about 1990s changes in coupon-gap sensitivity due to lower fixed costs of origination

# Classic path/state dependence

Hayre (1999)

**EXHIBIT 4.15** Mortgage Rates and the MBA Refinance Index, April 1997–December 1998



Sources: Mortgage Bankers Association, Freddie Mac, and Salomon Smith Barney.

# “Dry powder” application

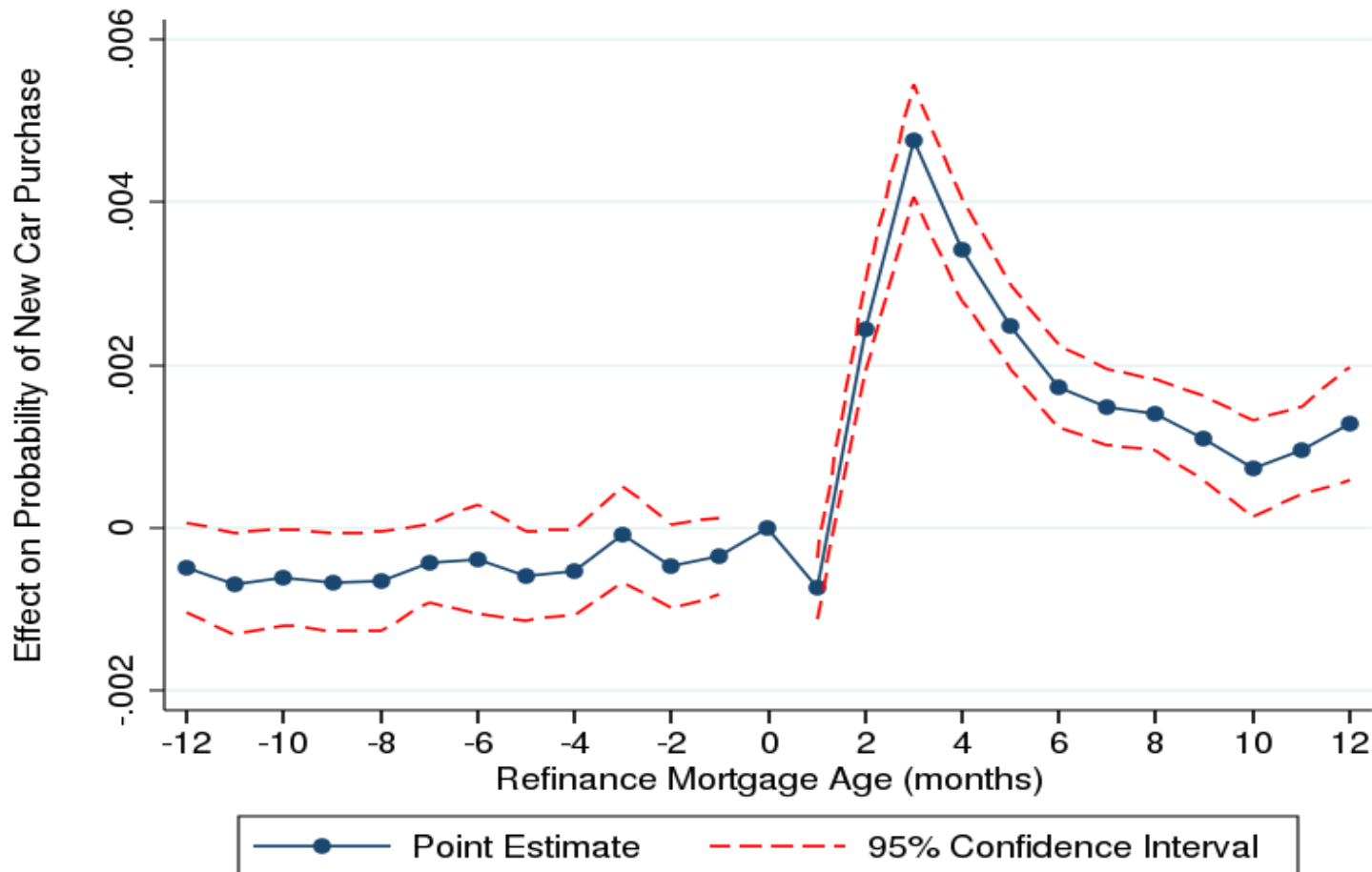
“We want to ensure that we have the ability to respond to adverse shocks by easing monetary policy by lowering the policy rate. Having more “**dry powder**” in the form of higher short-term interest rates seems more desirable than less dry powder and a smaller balance sheet.”  
– then-NY Fed President Bill Dudley, 2016

- Dry powder argument: need big  $\Delta r$
- This paper: Stockpiling dry powder may shut down refinancing channel
- So does Dudley not talk to MBS people? incl. Haas MFEs?
- More likely: thinking about firms, first-time homebuyers, discount rates, other durables... and *not* refinancers

# Claim: MP more effective with more responsive refinancing

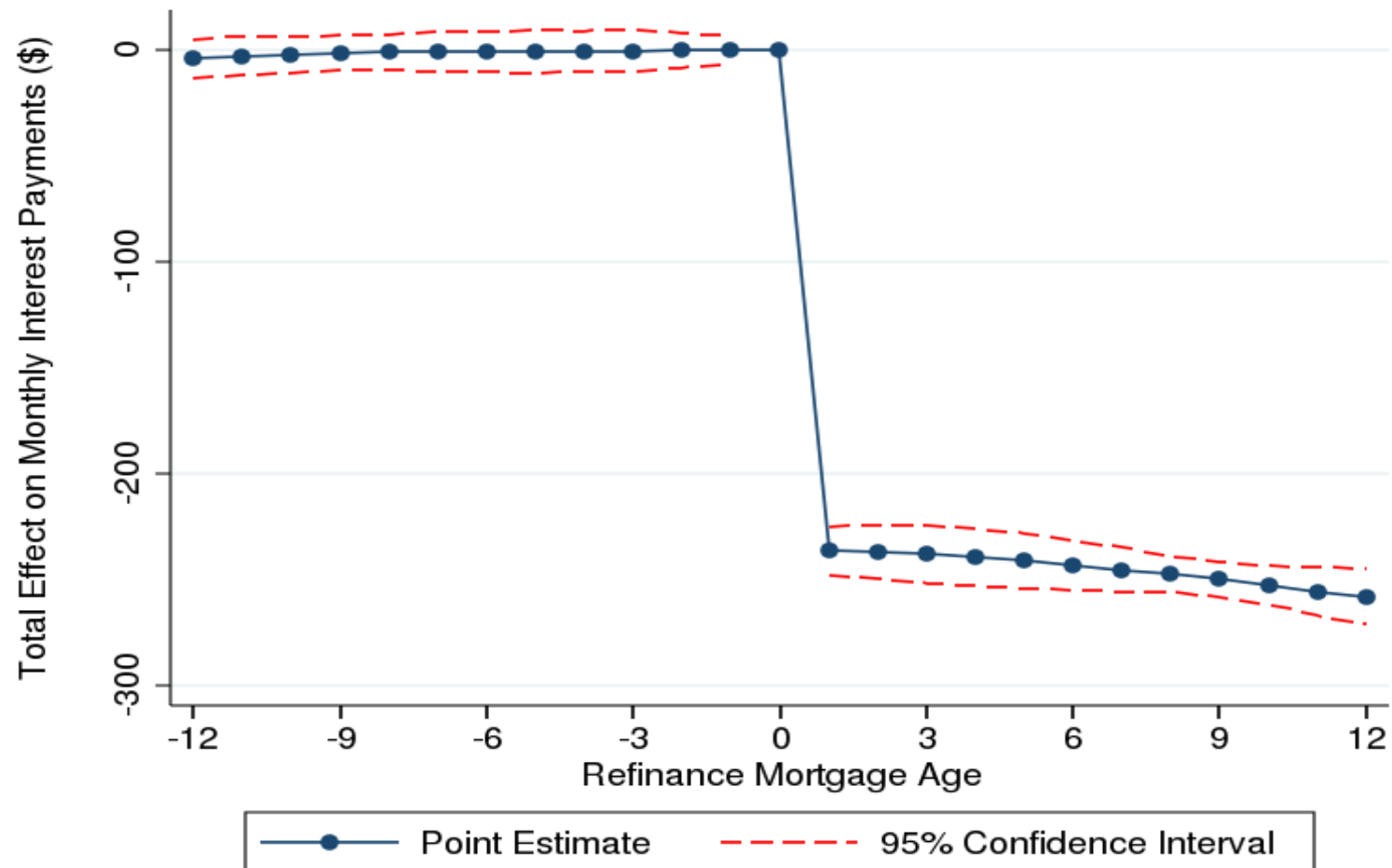
*Panel II. Effect of Refinancing on Car Purchases*

Di Maggio Kermani Palmer (2018)



# But $\Delta\text{Consumption} = f(\text{refi savings})$

*Panel I. Effect of Refinancing on Mortgage Interest Payments*



# Conclusion

1. Simple point with significant backup in MBS industry
2. Important implications for monetary policy  
passthrough: semi-elasticity of +/- 25bp is not some constant deep parameter
3. Blunts dry-powder argument, although maybe not about refi channel anyway
4. Key concern with partial equilibrium counterfactual:  
if state dependency less acute, MP would more consistently stimulate *refinancing* but with smaller consumption effects