Discussion of “Market Power in Mortgage Lending and the Transmission of Monetary Policy”

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This Paper

- Opens the black box of monetary policy.
- Transmission of monetary policy to households (and to real economy) depends on the market power of lenders.
- Higher market power leads to:
  - Lower pass-through of secondary market rates to households.
  - Lower refinancing activity in response to declining interest rates.
- This result is not driven by spurious correlation between lenders concentration and other unobserved heterogeneities.
  - Matching estimator
  - IV
Inspecting the Mechanism I: “OTD” lending model

- Let assume lenders Originate to Distribute: no balance-sheet exposure to rate-refi.
- As long as loans with higher interest rate are sold at a higher price more concentration is associated with:
  - higher interest rates (static effect)
  - lower pass-through of costs to prices (dynamic effect)
- purchase loans are less price sensitive than refinance loans.
  - Hypothesis: effect of competition on pass-through of secondary rates should be stronger for purchase loans than for refinance loans.
Inspecting the Mechanism II: Balancesheet lending

- If loans remain on banks balancesheet the lender has interest rate exposure to that loan.
- The lender has even less incentive to refinance the mortgage (compared to the usual monopoly pricing).
- Competition has more impact on refinancing volume because bank B has a lot of incentive to refinance bank A loans.
  - Bank B collects origination fees+ no interest rate exposure. (second effect is absent in usual oligopoly competition)
- Hypothesis: Banks refinance off-balancesheet loans more frequently than on-balancesheet loans.
  - The difference in the hazard of refinancing off-balancesheet and on-balancesheet loans is declining in market competition.
- Both Kamdar (2016) and Di Maggio, Kermani and Palmer (2016) find support for this channel.
### Evidence on Securitization Channel from Kamdar (2016)

**Dependent variable:** $\Delta \left( \frac{\text{Refi Balance}}{\text{Outstanding Mortgage Debt}} \right)_{i,t}$

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<tr>
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<th>(1)</th>
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<th>(3)</th>
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<tbody>
<tr>
<td>$\Delta \text{MBS Yield}_t$</td>
<td>-0.091***</td>
<td>-0.023</td>
<td>(-3.412)</td>
<td>(-0.807)</td>
</tr>
<tr>
<td>$\Delta \text{MBS Yield}<em>t \times \text{Top 4}</em>{i,t-1}$</td>
<td>0.038</td>
<td>0.091**</td>
<td>0.038*</td>
<td>0.083**</td>
</tr>
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<td></td>
<td>(1.260)</td>
<td>(2.621)</td>
<td>(1.873)</td>
<td>(2.583)</td>
</tr>
<tr>
<td>Top 4$_{i,t-1}$</td>
<td>-0.038</td>
<td>0.023</td>
<td>-0.033</td>
<td>0.018</td>
</tr>
<tr>
<td></td>
<td>(-1.681)</td>
<td>(0.825)</td>
<td>(-1.607)</td>
<td>(0.668)</td>
</tr>
<tr>
<td>Propensity$_{i,t-1}$</td>
<td>-0.090</td>
<td>-0.019</td>
<td>-1.215</td>
<td>(-0.687)</td>
</tr>
<tr>
<td></td>
<td>(-1.681)</td>
<td>(0.825)</td>
<td>(-1.607)</td>
<td>(0.668)</td>
</tr>
<tr>
<td>$\Delta \text{MBS Yield}<em>t \times \text{Propensity}</em>{i,t-1}$</td>
<td>-0.193*</td>
<td>-0.100*</td>
<td>(-2.098)</td>
<td>(-2.193)</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.434</td>
<td>0.669</td>
<td>0.469</td>
<td>0.680</td>
</tr>
<tr>
<td>N</td>
<td>26634</td>
<td>26634</td>
<td>26624</td>
<td>26624</td>
</tr>
<tr>
<td>County and Year FE</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
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### Evidence on Securitization Channel from QE1 Period

#### Hazard Model Estimates of QE1 Effect on Refinancing

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<tbody>
<tr>
<td>QE1 Indicator</td>
<td>1.229***</td>
<td>0.462***</td>
<td>0.054**</td>
<td>-0.026</td>
</tr>
<tr>
<td></td>
<td>(0.013)</td>
<td>(0.013)</td>
<td>(0.025)</td>
<td>(0.039)</td>
</tr>
<tr>
<td>QE1 Indicator x High-LTV</td>
<td>-0.700***</td>
<td>-0.781***</td>
<td>-0.643***</td>
<td></td>
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<tr>
<td></td>
<td>(0.081)</td>
<td>(0.081)</td>
<td>(0.081)</td>
<td></td>
</tr>
<tr>
<td>QE1 Indicator x GSE Owned</td>
<td></td>
<td></td>
<td>0.500***</td>
<td>0.541***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(0.028)</td>
<td>(0.044)</td>
</tr>
</tbody>
</table>

- **Loan Controls**: Yes, Yes, Yes, Yes
- **Borrower Controls**: Yes, Yes, Yes, Yes
- **Control for Coupon Gap**: No, Yes, Yes, Yes
- **Sample**: Below CLL, Below CLL, Below CLL, Super-conforming
- **Observations**: 2,621,573, 2,621,573, 2,621,573, 987,825
Drechsler, Savov and Schnabl (2016) show that there is more outflow of deposits in more concentrated markets.

- Banks use their market power and do not adjust rates ⇒ Result in outflow of less sticky deposits.
- They also show this outflow of deposits result in less lending.

Even in the absence of any deposit channel there is a “lending market power” channel.

My prior is that because of the FHLB and GSEs deposit channel has less effect on mortgage lending.

It would be great to use the variation in the two measure to disentangle the channel.

- the IV approach moves in the opposite direction. (which could be the reason for larger IV estimates)
Other Comments

- What about the pass-through to interest rates for longer differences.
  - Does the imperfect pass-through accumulate over time or is it only about the sluggish response of more concentrated counties?
  - If it accumulates over time, this means 3% decline in interest rates will result in 75 bps difference in low vs. high concentration counties.
- How much of the quantity result can be explained by the interest rate result?
  - Are there non-pricing factors (eg. marketing effort) that are also affected by competition?
- Would be great to investigate real effects as well.
  - Are car sales more sensitive to MBS yields (or other interest rates) in counties with more concentrated lending?
Policy Implications

- Good securitization or covered bonds can increase the pass-through of monetary policy.
- From the risk point of view:
  - interest rate risk (prepayment risk) is a macro risk. No need for the banks to bear the macro risk. (Farhi and Tirole 2012)
  - credit risk has a lot of idiosyncratic component. Better to use it as skin-in-the-game. (Anderson, Campbell and Ramadorai 2014)
- What if we let GSEs to sell mortgages to households directly and get rid of the middle-man?
  - GSE loans are mainly using AVM for appraisal. FICO for credit score, ...
  - GSE/FHLB provides line of credit for the time lag between origination and securitization.
  - What does exactly BoA do?