

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

	(1)	(2)	(3)	(4)
Δ MBS Yield _t	-0.091*** (-3.412)		-0.023 (-0.807)	
Δ MBS Yield _t × Top 4 _{i,t-1}	0.038 (1.260)	0.091** (2.621)	0.038* (1.873)	0.083** (2.583)
Top 4 _{i,t-1}	-0.038 (-1.681)	0.023 (0.825)	-0.033 (-1.607)	0.018 (0.668)
Propensity _{i,t-1}			-0.090 (-1.215)	-0.019 (-0.687)
Δ MBS Yield _t × Propensity _{i,t-1}			-0.193* (-2.098)	-0.100* (-2.193)
R-squared	0.434	0.669	0.469	0.680
N	26634	26634	26624	26624
County and Year FE	N	Y	N	Y

Evidence on Securitization Channel from QE1 Period

Hazard Model Estimates of QE1 Effect on Refinancing

	(1)	(2)	(3)	(4)
QE1 Indicator	1.229*** (0.013)	0.462*** (0.013)	0.054** (0.025)	-0.026 (0.039)
QE1 Indicator x High-LTV	-0.700*** (0.081)	-0.781*** (0.081)	-0.643*** (0.081)	
QE1 Indicator x GSE Owned			0.500*** (0.028)	0.541*** (0.044)
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

Deposit Channel vs Lending Channel

- 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 \Rightarrow 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?