

# Credit Conditions and Consumption, House Prices and Debt: What Makes Canada Different ?

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## Motivation

The paper investigates the determinants and the dynamic relationship between three key variables to understand the Great Recession:

- ▶ **Consumption**
- ▶ **House price**
- ▶ **Credit**

## Balance sheet recession

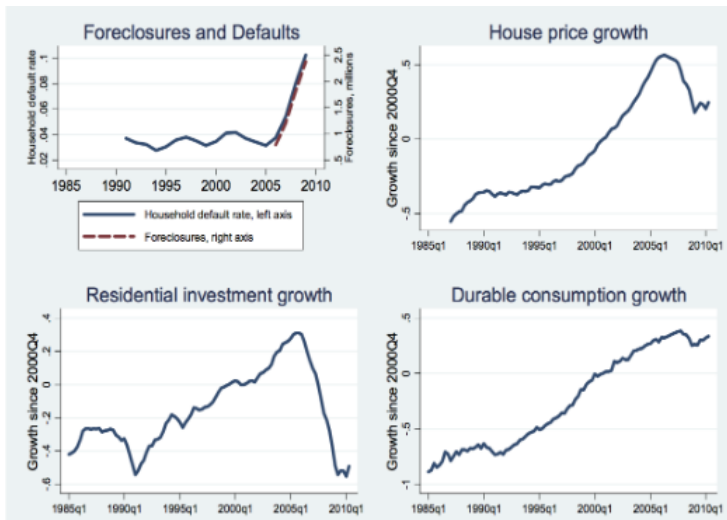
Mian and Sufi (AER, 2011; QJE, 2013) provide empirical evidence the transmission channel of the crisis in US was principally the **households balance sheet channel** rather than the **bank lending channel**

- ▶ Consumption started to fall before the failure of Lehman Brothers
- ▶ In 2009 reduction in consumption larger than reduction in investment

Financial liberalization in 1990s  $\Rightarrow$  overborrowing

Negative shock on housing  $\Rightarrow$   $\downarrow$  households' home equity  $\Rightarrow$  deleveraging  $\Rightarrow$   $\downarrow$  consumption

# Consumption, house price and residential investment



Source: Mian and Sufi (2011)

## Canada: a long-run relationship

Incorporate financial variables as determinants of consumption

A long-run relationship between consumption, house price and credit arising endogenously in the business cycle

Consumption is positively affected by easier credit condition but negatively affected by higher house prices relative to incomes

# Macroprudential policy

Latent variable as credit condition index

Consider macroprudential measures in the system of equations as observed variable

- ▶ demand side of credit: limits on loan-to-value and on debt-to-income
- ▶ supply side of credit: countercyclical capital buffer and dynamic provisioning

The impact of macro-prudential policy on the real economy

## Econometric model

- ▶ Johansen cointegration test
- ▶ Structural analysis: impulse response function and forecast error variance decomposition
- ▶ Consumption in level  $I(0)$  instead of rate of growth  $I(1)$

## Conclusion

- ▶ Very interesting paper



## Conclusion

- ▶ Very interesting paper
- ▶ Why is Canada different ?