Rigid Mortgage Rates and Monetary Policy Transmission

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Quick Summary

- Key questions:
  - How would the rigidity of mortgage rates in China affect the effectiveness of monetary policies?
  - How would the gap between mortgage rates and saving returns affect households' mortgage prepayment, saving, and consumption behaviors?
  - What is the implication of the effect from the monetary policy perspective?
- Research strategy:
  - Micro-level: unique loan-level data from a major bank; OLS and DID analyses
  - Macro-level: unique city-level data from both the bank and UnionPay; IV analyses
  - Embedded exogeneity of the mortgage rate gap

Quick Summary

- Major findings:
  - Unique institutional arrangements led to mortgage rate rigidity in China during the downward trend of interest rates.
  - Larger positive gaps between mortgage rates and saving returns led to greater prepayments and lower consumption.
  - Mortgage rate rigidity could make monetary easing counterproductive!
- Convincing results on an important and timely policy issue in China!
- New perspective to understand households' mortgage prepayment behaviors
- Very mature paper

Comment 1 – Reasons of Rigidity

- The dilemma for the policymakers…
- They had well realized the potential cost of mortgage rate rigidity during monetary easing (although not necessarily quantitatively)
- The other side of the story:
  - The mortgage rate adjustment would cost the commercial banks 150 billion RMB annually
  - With a strict restriction on issuing additional shares for commercial banks, accumulating profits is practically their only way to raise capital
  - With a strict regulation on the Capital Adequacy Ratio, the commercial banks are unable to issue more new loans if they cannot continue to raise capital

Comment 1 – Reasons of Rigidity

- The dilemma for the policymakers:
  - Can the benefits (continuing to leverage the firm, local government, or even the new household borrower sectors) outweigh the costs (deleveraging the existing mortgage borrowers)?
  - The key to the answer lies in comparing the elasticities
- The negative effect on existing mortgage borrowers' consumption seems relatively low (and acceptable)?

- What is the real policy implication of the empirical findings (from both the short- and long-term perspectives)?

Comment 2 – Another Cost of Rigidity

- Negative effect on potential home buyers' expectations and willingness-to-buy
  - "I would suffer from a substantial loss if the mortgage rate continues to drop after I purchase a dwelling unit, borrow a mortgage loan, and, thus, partially fix the mortgage rate for 30 years"
  - Low housing transaction volume under continuous mortgage rate decreases
  - The primary reason that finally pushed the policymakers to release mortgage rate rigidity in 2024Q4

- Maybe the topic of another paper, but it might affect the interpretation of the city-level results

Comment 3 – Potential Endogeneity

- Which households are more likely to have higher mortgage rates?
  - Second (or even multiple) home buyers
  - Households who purchased the units during the housing market peak
  - More likely to be investors/speculators?
  - Overestimating the effect on prepayment?

- Potential strategy:
  - Using the first-home buyers and controlling for the time fixed effect of home purchase
  - Mainly taking advantage of the city-level variations

Comment 4 – Potential Overestimate

- The micro-level data comes from a single bank, which may overestimate the negative effect of prepayment on savings and consumption
  - Borrowers' common practices: using savings in the same bank to (automatically) repay the monthly mortgage services
  - Households may be more likely to transfer savings from other banks to this bank before prepayment, and…
  - …less likely to use savings accounts in this bank after they have (fully prepaid) their mortgage loans

- Using the period several months before prepayment as the benchmark
- Estimates based on partial prepayment

Summary

- A very important topic, valuable unique datasets, rich empirical analyses, and convincing results
- New insights on the micro-level mechanism of monetary easing policies
- More discussions of the whole picture of policymakers' dilemma would be valuable
- More clarifications and robustness checks on the prepayment/saving/consumption estimates are also helpful