Discussion of "Phasing out the GSEs" by Vadim Elenev, Tim Landvoigt & Stijn Van Nieuwerburgh

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What they do

- Ambitious project to investigate the welfare and financial effects of government guarantees in the mortgage market
- Key ingredients:
  - Three types of agents: borrowers, savers, risk-takers
  - Idiosyncratic housing depreciation risk
  - Borrowers cannot commit to long-term contracts
  - Limited liability of risk-takers, private utility cost of bankruptcy
  - Risk-takers intermediate between borrowers and savers
- Model GSEs as tax and debt financed mortgage insurance:
  - Baseline: insurance is underpriced
  - Consider alternate insurance pricing
- Finds significant (and pareto) welfare gains from raising price of insurance

Big Picture Thoughts

- GSEs huge players in mortgage market
- Cost of bailout sizable ($\sim$ \$180 billion)
- First-order Housing-Urban-Finance-Macro policy question (mostly neglected so far):
  - Home-ownership and house prices
  - Mortgage leverage and foreclosures
  - Misallocation between housing and productive capital
  - Financial distortions and fragility
- Focus on financial sector...

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- ...very nice paper and complements household focus of Gete and Zecchetto (2015) and Jeske, Krueger & Mitman (2013)

Risk-taker Default

- Risk-takers face stochastic utility penalty of default ρ
- If net-worth goes negative, default rule as a function of ρ
- Bankruptcy is very orderly:
  - Risk-taker equity is wiped out
  - Assets and liabilities liquidated competitively
  - Government bails out negative equity
- No deadweight loss from bankruptcy
- No scope for bailouts to mitigate/impact that
- Can the government commit not to bailout banks ex-post?

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- Mortgage "crisis" in the model driven by increase in variance of housing depreciation shock, ω. State of the world where it's more likely the roof falls in.
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- How much of default is driven by price drop vs realized depreciation?
- Is this the right way to think about what drives a crisis?

Government Debt and Savings

- Debt is high and volatile in the GSE economy
  - Lowers the risk-free rate
  - Hurts welfare of depositors
- No foreign ownership of government debt
- No capital in the economy
  - Does this make savers consumption too sensitive to government debt?
  - Does it make risk-fee rate too sensitive to mortgage debt?

Transition Dynamics

- Title: "Phasing Out the GSEs", yet focus is mostly on comparison of different economies
- Transition dynamics see important here:
  - In benchmark government debt is high
  - LTV and house prices are high
  - Transition induces borrower deleveraging (perhaps exacerbated by drop in house prices induced by reform).
- May reverse welfare gains by borrowers?

Distributional Implications

- Limited heterogeneity in the model
  - Everyone is a homeowner
  - Borrowers have perfect consumption insurance against idiosyncratic risk
  - Foreclosure not really adverse event to household
  - No tension between young renters and homeowners with big mortgages