

Non-technical summary for 'The Effect of Credit Constraints on Housing Prices: (Further) Evidence from a Survey Experiment'

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Understanding the effect of credit constraints on housing prices is important for analysing the economy, as well as for setting monetary policy and mortgage lending rules. The focus of this paper is the required down payment on a mortgage, which is usually referred to as a deposit in Australia. One difficulty facing researchers on this topic is that credit conditions can change for a variety of reasons and tend to change at the same time as other factors that affect the housing market. To get around this difficulty, some researchers conduct controlled survey experiments that ask people how much they would be willing to pay for a home under different conditions.

In one such survey conducted in the United States, people were asked to imagine they are planning to move and have found a home they would like to live in. They were then asked how much they would be willing to pay for the home under different credit conditions. By varying the required down payment and mortgage rate, their responses showed the effects of changes in these conditions. In response to lowering the required down payment on a mortgage from 20 per cent to 5 per cent, people raised their willingness to pay for a particular home by around 16 per cent on average. However, there were large differences in the effects across different demographics. In particular, wealthier people tended to increase their willingness to pay by less in response to a lower required down payment and less wealthy people increased by more.

This paper further analyses the results of the survey experiment.

How is the survey data used?

In any market, the price is not determined by the average change in willingness to pay, but by the change in the willingness to pay of the 'marginal buyer'. The marginal buyer is the person who would no longer buy if the price was just a little bit higher. The marginal buyer's willingness to pay coincides with, and sets, the price.

This paper uses the experimental data to build housing demand curves for the different down payment scenarios. Along with an inference about supply, these demand curves allow the marginal buyer to be identified, which gives the effect on price. Overall, I find that the response of the marginal buyer (and thus the price) to a reduction in the required down payment is much smaller than the average response. The large increases that push up the average tend to come from households that are not willing to pay close to the market price because they are the most constrained by the required down payment.

What have we learned?

The overall message is that housing prices respond a little to lower down payment requirements, but probably not enough to drive housing price booms.

Previous research on this topic has been split. Quite a bit of research, including the paper by the economists who ran the survey experiment, argues that the response of prices to lower down payment restrictions is large and can drive the housing market. Another body of research argues the opposite on the basis that down payment restrictions are not binding for the wealthier households that determine prices. I find that somewhere in between these two views is likely to be right; the marginal buyer that sets prices does respond to changes in down payment requirements, but not as much as the average household.