Home Equity, Mobility, and Macroeconomic Fluctuations

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Abstract

How does a fall in house prices affect real activity? This paper presents a tractable business cycle model in which a decline in house prices reduces geographical mobility, creating distortions in the labor market. This happens because homeowners face declines in their home equity levels, which makes it more difficult to provide the downpayment required for a new mortgage loan. Therefore, unemployed homeowners more often turn down job offers that would require them to move. The model can account for joint cyclical patterns in housing and labor market aggregates, and predicts a breakdown of the Beveridge curve in 2009. Counterfactual experiments are used to quantify the macroeconomic importance of the mobility channel during the Great Recession.

Key Words: Housing Markets, Labor Markets, Refinancing Constraints, DSGE

JEL Classification: E24, E44, R21

1. Introduction

During the "Great Recession" of 2008, the U.S. economy experienced unusual disruptions in both housing and labor markets. Housing markets were hit by sharp declines in both prices and the number of transactions. Labor markets witnessed an increase in aggregate unemployment that was surprisingly large, even given the strong decline in job vacancies (Elsby, Hobijn, and Şahin (2010)). The upper panel of Figure 1 plots vacancies versus the unemployment rate. The figure shows that the historically strong and negative correlation between these two variables, known as the Beveridge Curve, broke down during 2009. A common interpretation of this phenomenon is that frictions in the labor market had become

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