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Borrowing constraints and housing market liquidity

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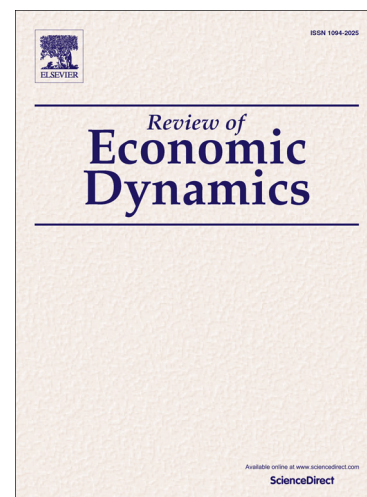
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Borrowing constraints and housing market liquidity<sup>☆</sup>Essi Eerola<sup>a</sup>, Niku Määttänen<sup>b</sup><sup>a</sup>VATT Institute for Economic Research and CESifo<sup>b</sup>The Research Institute of the Finnish Economy and Aalto University

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**Abstract**

We study how changes in household borrowing constraints influence housing market liquidity. To this end, we develop a housing market model with both matching and credit frictions. In the model, risk-averse households may save or borrow in order to smooth consumption over time and finance owner housing. Prospective sellers and buyers meet randomly and bargain over the price. In the model, housing market liquidity is very sensitive to changes in household credit conditions. In particular, a moderate tightening of household borrowing constraints increases the average time-on-the-market and idiosyncratic price dispersion substantially. *Keywords:* Housing, Borrowing constraint, Matching. *JEL:* E21, R21, C78.

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**1. Introduction**

Housing market liquidity varies a lot over time, at least if liquidity is measured by the average time it takes to sell a house. Díaz and Jerez (2013) and Ngai et al. (2017) demonstrate this for the US and UK housing markets. We provide similar evidence for the Finnish housing market. While Finland has experienced very large house price fluctuations, the average time-on-the-market (TOM) has been even more volatile. Given that the primary residence typically represents a very large share of a home owner's total assets, large changes in housing market liquidity are bound to affect household welfare.

In this paper, we analyze the determinants of housing market liquidity. Specifically, we consider the possibility that the observed changes in the average TOM are driven by changes in household credit conditions. Intuitively, a tighter borrowing constraint may imply that some potential buyers are willing to buy only if the seller accepts a relatively low price. The evidence from the Finnish housing market is also consistent with this conjecture. The average TOM has increased drastically during periods when household credit conditions have tightened, and vice versa.

The relation between credit conditions and housing market liquidity is also relevant for the current debate on 'macroprudential' policies. Many countries have recently implemented loan-to-value restrictions on household borrowing. The aim of such policies is to make households and banks less vulnerable to housing market fluctuations

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