Securitization, housing market and banking sector behavior in a stock-flow consistent model

This paper is a contribution to the post-Keynesian stock-flow consistent (SFC) literature. It makes two contributions, first by integrating the housing market into the analysis of the macro economy (although it is inspired by previous work, that of Zezza), and second by integrating the role played by investment banks and mortgage-based securities in the financial sector. Some suggestions had been made about how this could be done within such a framework, but this is the first time that the suggestions are being implemented and the authors provide some original and astute ways to model the behaviour of investment banks. The authors also manage to take into account some of the observations and stylized facts that have been made by Adrian and Shin over the last few years. The consumption function, which depends on relative income, also has interesting properties.

Those who have built SFC models know that it is not an easy task, and that the task gets harder the more complex the model. In particular, the real estate market (with housing prices, rents, mortgages, unsold houses, etc.), is quite difficult to model in general. The model built by the authors is thus a true tour-de-force.

My understanding of the model is that there are two forces at work in the housing market: on the one hand, the worker households react negatively to an increase in housing prices, as houses become more costly; on the other hand capitalist households react positively to an increase in housing prices, as housing is a speculative asset for them. One may wonder however where capitalists sleep at night!

The weakness of the paper is that the results by the authors are not so clear. In other words, relative to the size and complexity of the model, the achieved results are rather disappointing. Here we have a big model with small results. The key achievement is probably that the authors manage to reproduce the main stylized fact described by Adrian and Shin, that is, the leverage of households is counter-cyclical, while that of investment banks is pro-cyclical.

Another more specific weakness is that the number of rented houses is determined by the portfolio decisions of capitalist households, while the paid rent is assumed to be exogenous. One would have thought that with a given supply of rental houses, the rent would need to adjust to the demand by working households. In other words, it is not clear how workers decide between buying a house or renting one.

A few more incidental remarks: On page 2, in the footnote, it is said that private banking is a black box in the work of Kaldorian post-Keynesians: I don't agree: Moore (1988) has explicit bank behaviour, and so does Godley (1999) in his CJE paper, and of course so do Godley and Lavoie (2007) in their book.

Still on page 2, there is a reference to Minsky (1975) and his discussion about securitization; but of course that discussion did not occur in 1975, but either in 1987 or 1996.

On page 10, the discussion of the housing market is rather confusing, with references to points (a) to (d); the text needs to be rewritten. Also the dividends to capitalists seem to have been omitted from equation (23) and equation (iii).

Finally, on page 13, it is not clear to me how the credit obtained by investment banks from commercial banks can help the former to “respect leverage regulations like the ones imposed by Basel III”.