Discussion

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AEA Session on Housing, Unemployment, and Monetary Policy
Discussion of "On the Dynamics of Unemployment, Sectoral Reallocation, and Housing Prices under Financial Frictions"
by William Branch, Nicolas Petrosky-Nadeau, and Guillaume Rocheteau
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Two big challenges in fluctuations modeling after the Great Recession

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1. Generating unemployment variation in the DMP model
    A. Determining appropriate driving force, not productivity
    B. Solving the Shimer puzzle for that driving force
2. Generating big changes in house prices

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1.A. DMP driving force in the paper

Equations (19) and (20) give the employer's revenue from a hire

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Equations (19) and (20) give the employer's revenue from a hire

Higher revenue from selling with market power in the decentralized frictional market; lower revenue from fallback to the centralized market

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This connects the labor market to the housing market

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Strength of this source of variation in the payoff to a new hire

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It would be desirable to reveal the size of the variations in z^g and z^h directly

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1.B. The Shimer Puzzle

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Example: Walsh (2003) invoked shifts in market power known to occur in the New Keynesian model as a driving force in the DMP model, but the resulting movements in the marginal revenue product of labor are not nearly big enough to explain unemployment movements with the Shimer calibration

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DMP in this paper

Two separate labor markets with migration cost

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Wage determination expressed in equation (21), following Pissarides (2000), equation 1.23, dropping a forest of sub- and superscripts, as :

$$w = \lambda z + (1 - \lambda)w_0 + \lambda\theta k + (1 - \lambda)\Omega(i),$$

where z the a new worker's contribution to revenue, w_0 is the flow value of unemployment, θ is tightness, the ratio of vacancies to unemployment, k is the cost of maintaining a vacancy, and Ω is the cost of moving to the other sector

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The issue

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It arises because the threat point in the Nash bargain is to return to search, and that threat is more valuable if another job opportunity is easy to find

The calibration departs from Shimer's. Bargaining is biased toward the jobseeker and the flow value of unemployment is higher relative to productivity. Neither would explain how the paper overcomes the Shimer puzzle

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Flow value of unemployment

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Chodorow-Reich and Karabarbounis have made a careful empirical study using microdata on benefit recipients to show that unemployment-conditioned benefits are very small–about 4 percent of productivity, contrary to the impression from Mulligan, who has not made a similar empirical analysis

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Hornstein-Krusell-Violante (2007) with support from Hall-Mueller (2014), using microdata on acceptance decisions of jobseekers, find very low flow values, even negative

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Conclusion on the labor market

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But the paper needs to take the reader through the numbers to see how it overcomes the Shimer puzzle so decisively

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2. Housing and unemployment

A standard view—one that I buy into—is that the collapse of housing prices squeezed household budgets by cutting off borrowing opportunities, and that the Fed could not offset the decline in demand fully because of the zero lower bound

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Modeling this with endogenous house prices has been a challenge. Burnside, Eichenbaum, and Rebelo, "Understanding Booms and Busts in Housing Markets" is one effort that deserves discussion and Justiniano, Primiceri, and Tambalotti, "Credit Supply and The Housing Boom" is another

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The successful version of the model has extrapolative house-price expectations, explained in equation (52).

The run-up in house prices becomes self-sustaining, as rising prices free up borrowing power and generate a consumption-housing boom

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House-price explosion

I calculated the response of house prices under the following conditions. From quiescent origins, an outside force causes a one-percent increase in house prices. From that point on, the prices follow the trajectory of the expectation-formation equation.

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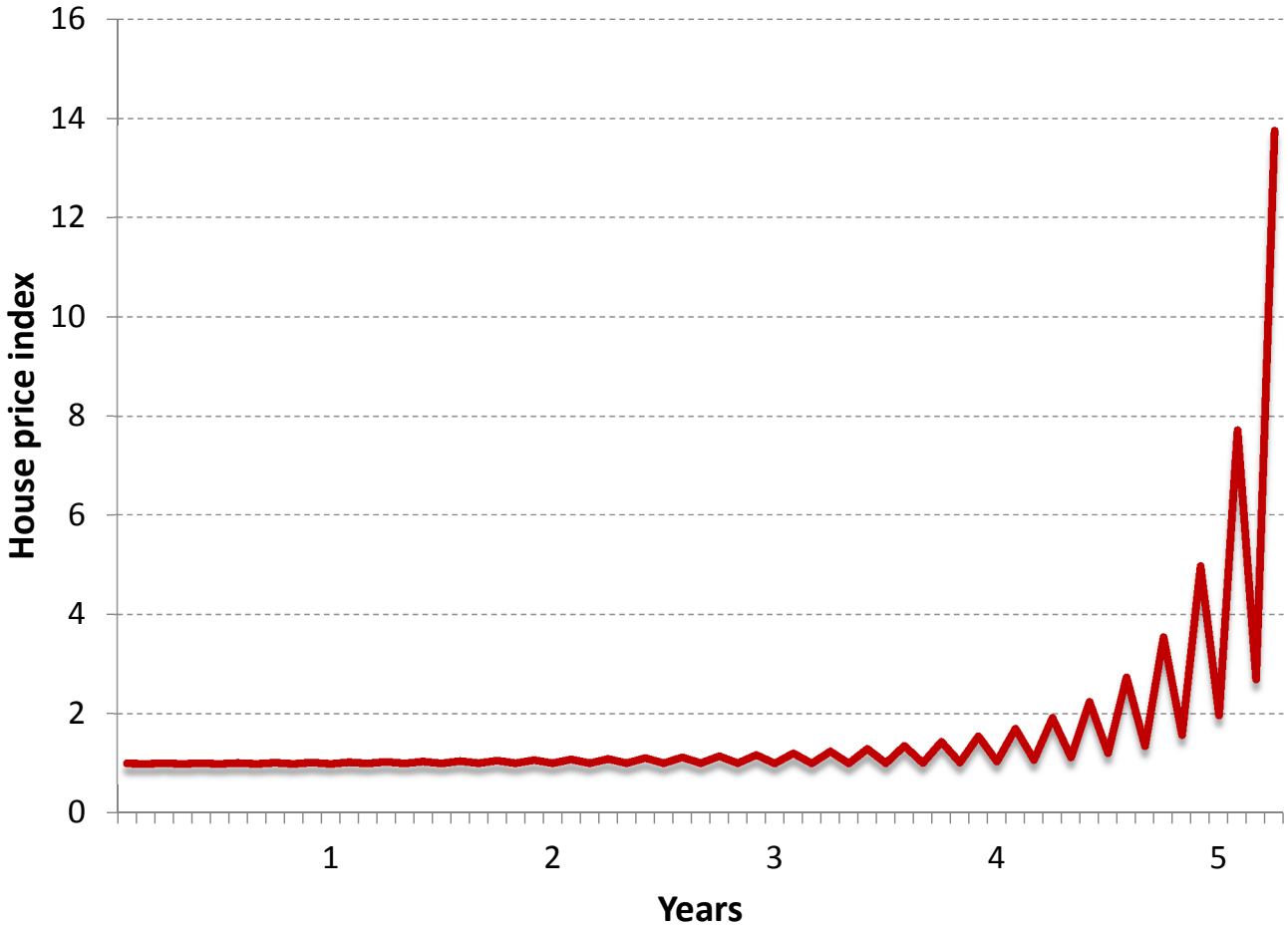
Impulse response of house prices



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The leap from rational expectations to extrapolation is a big one—some of us need more convincing even though we know that rational expectations seems to fail in the housing market

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