

Household savings and mortgage decisions: the role of the "down-payment channel" in the euro area

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The present paper analyses the link between savings and mortgage decisions in the euro area and identifies empirically an important "down-payment channel". The channel captures the fact that, when house prices increase, credit-constrained households who wish to buy a property need to accumulate more savings because the down payment required by banks (i.e. the share of the acquisition price that is not covered by a mortgage) also increases. This down-payment requirement may affect both first time buyers and existing owners who wish to move up into a more expensive property. The main contribution of the present paper is to offer an estimate of the magnitude of the down-payment channel in the euro area.

The down-payment channel appears to be quite sizeable in the euro area and, in the medium-term, dominates the traditional housing wealth effects channel, translating into a positive impact of a rise in house prices on savings. The existence of these two offsetting channels explains why housing wealth effects have been notoriously difficult to identify empirically in the euro area, with housing wealth variables generally coming out as statistically insignificant in consumption equations. The identified "down-payment channel" sheds some light on the root causes of the sluggish developments of consumption in the euro area in the last decade. The significant increase in net housing wealth in the period 2000-2007 did not fuel a consumption boom. This can be explained by the small size of housing wealth effects in the euro area but also by the interaction between credit constraints and house prices. Over 2000-2007 the ratio of mortgages to housing wealth did not increase significantly as the relaxation of loan-to-value constraints by banks was largely offset by the rapid rise in house prices leading to higher down-payment requirements.