

Herrero, P., Mendicino, C., & Schang, C. (2025). The Aggregate Demand Channel of Loan-to-Value Shocks

Marcos Gaspar Montenegro Calvimonte

Bank of England

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The views expressed here are my own and do not necessarily reflect those of the Bank of England

Central Question

How do direct and indirect (general equilibrium) transmission channels of LTV restrictions interact?

- The paper studies aggregate and distributional effects using a HANK model + home-ownership decision
- Rich distributional analysis and policy relevance
- Focus on the role of monetary policy in shaping these effects
- Understand the implications of household leverage

- HANK with:
 - Idiosyncratic income risk, liquid assets, mortgages
 - Housing choice (rent vs own), segmented market
 - Long-term nominal mortgages with amortisation and variable interest rate
- Nominal rigidities: sticky wages, flexible prices
- Monetary policy: Taylor rule
- Fiscal policy: neutral
- Calibration to Spain

Transmission Mechanism

- LTV tightening reduces households' borrowing capacity (direct impact)
- House prices fall \Rightarrow affects both buyers and leveraged owners (indirect impact)
- Labor income falls due to lower aggregate demand
- Consumption drops; GE channels amplify the decline
- Counterfactual decomposition of GE responses
- Welfare losses are mainly due to GE effects

Heterogeneity

- LTV tightening displays heterogeneous effects on households
- GE effects amplify distributional asymmetry ($\downarrow HP$ on High-LTV)
- Aggregate demand effects shaped by the share of renters in the economy
- Endogenous response of the economy amplifies the negative effects of LTV changes on homeowners
- More than offsets the increase in consumption by renters
- Real interest rate channel redistributes resources from borrowers to savers

Strength of transmission

- Nominal rigidities
 - Aggregate dynamics substantially affected
 - Distributional effects are qualitatively unchanged
- Monetary policy
 - Accommodation degree is a key factor
 - Mitigates the aggregate effects of $\uparrow LTV$ via the real interest rate channel
 - Impacts the aggregate dynamics, as well as the redistributive effects
 - Reduces the distributional imbalance across households

Policy advice

Take the interaction between macroprudential and monetary policy into account when making policy decisions as it is central.

Comment 1: Strength of the Contribution

- Decomposition into GE channels is a major strength
- Very transparent breakdown of contributions of income vs house price vs real rate
- Suggest highlighting more explicitly what is new relative to existing HANK-macroprudential models

Comment 2: Mortgage Contract Structure

- Model uses long-term, variable-rate mortgages with amortisation
- Given the evolution in the type of mortgages in the Spanish housing market, how robust are results to:
 - Fixed-rate contracts?
 - A mix of them? (Garriga, Kydland & Šustek (2021) MoNK)
 - Does the steady state value of the LTV matter? What if it takes a lower value, closer to the Spanish average?

Comment 3: Policy Coordination

- Strong justification for joint macroprudential-monetary design
- Connect results to policy debates in Euro area and Spain
- What does optimal LTV policy look like under constrained monetary policy?

Comment 4: Expectations

- Role of expectations in the housing market (Adam, Pfäuti & Reinelt, 2024; De Stefani, 2021)
- What if renters and homeowners (HLTV and LLTV) in this economy form expectations not rationally and to different degrees?

Conclusion

- Paper offers a clear and rigorous analysis of LTV tightening
- Focus on the aggregate and distributional effects in the economy
- GE amplification is crucial and well demonstrated
- Distributional focus is valuable for policy design
- Aggregate and redistributive effects of stricter LTV policies depend on the stance of monetary policy

Thank you!