The Myth of the Lock-in Effect

One story that made the media rounds during the recession and early recovery claimed that underwater homes—when people owe more than the property's value—were deterring unemployed people from moving to get new jobs. People with negative equity could sell only at a loss, an option so unattractive that they refused to pull up stakes in search of work.

It was a good story with a catchy name, “the lock-in effect.” It seemed to help explain why joblessness persisted so stubbornly during the recovery’s first fitful years. And it seemed to support data showing that mobility was declining in the states with the most underwater homes.

But now a team of researchers is spoiling that story, perhaps once and for all. These economists, including the Cleveland Fed’s Yuliya Demyanyk, found conclusive evidence that negative home equity is not an important barrier to labor mobility. In fact, underwater homeowners are probably more likely to move than borrowers with equity in their homes.

“Underwater homeowners aren’t reluctant to move,” Demyanyk said. “If a hypothetical unemployed, underwater homeowner gets a job offer, he is going to take it.”

The study was twofold. First, the researchers looked at credit-report data. The reports gave them enough longitudinal information about borrowers to infer whether they moved to new regions and whether falling home prices limited mobility—particularly for people with negative home equity.

Next, the researchers designed a theoretical model to replicate the experience of real-world homeowners. It churned out results suggesting that the findings—that underwater homeowners weren’t reluctant to move—were plausible. Key to the model is the idea that people would rather move to get a steady paycheck than stay in an underwater home in a place with no job prospects.

This paper is not the first to debunk the lock-in-effect story. Others, including work by the San Francisco Fed, have likewise found little evidence that people didn’t move during the recession because of the condition of their mortgages.

The Problem of Underwater Homes Increased During the Recession

2007

2008

2009

Percent with negative equity

0.0 – 1.0
1.0 – 2.0
2.0 – 5.0
5.0 – 20.0
20.0 – 40.0
40.0 – 100.0

Note: Maps show only subprime mortgages, which are more likely to be underwater.
Source: TransUnion.

Read more

Yuliya Demyanyk, Dmytro Hryshko, María José Luengo-Prado, and Bent E. Sørensen. 2013. “Keeping the House or Moving for a Job.” Federal Reserve Bank of Cleveland, Economic Commentary.
www.clevelandfed.org/research/commentary/2013/2013-09.cfm
More plausible is that Americans faced almost uniformly dismal employment options across the country—opportunities to move for good jobs were few and far between.

An implication for national policymakers is that job creation efforts need not focus on the regions hit hardest by the housing bust. Consider that at the end of 2009, the underwater problem was concentrated in four “sand” states—Arizona, Florida, California, and Nevada—and in Michigan, all with negative equity rates topping 35 percent of total mortgages. If national policymakers thought about creating jobs only in those states out of fear that negative-equity borrowers wouldn’t move to other states for employment, they might be missing an opportunity to lift employment more broadly.

—Forefront Staff

Since the end of the financial crisis, bank supervisors and regulators have been working furiously to develop new tools that will avert the next one. One of the most promising innovations is a “financial stress index.” The index tracks an array of data collected from public markets to help analysts pinpoint periods when financial market strains are growing acute. When the index gets too elevated, it may be time for supervisors to look more closely at specific companies and markets.

More than a dozen public indexes, produced around the globe, are now up and running. We introduced the Cleveland Financial Stress Index, or CFSI, in Forefront in 2011. It monitors stress in the financial system by tracking conditions in several different financial markets.

Cleveland Fed researchers have recently enhanced the CFSI with the addition of two new markets: real estate and securitization. These markets were, of course, key contributors to the depth and duration of the 2008 financial crisis, and incorporating them into the stress index improves the CFSI’s ability to detect emerging instability. (The CFSI already tracks the funding, credit, equity, and foreign exchange markets.)

A useful feature of the CFSI is its ability to show how much each market is contributing to overall stress. So far in 2013, for example, securitization markets are the leading culprit, while foreign exchange markets have been relatively benign.

And now, the CFSI is updated daily on our website. We encourage you to check it out, along with others available on the internet. (Google “financial stress index” to find them.) A quick scan of public indexes shows that financial stress is at fairly low levels in spring 2013, a welcome return to stability after the very high stress seen during the financial crisis.

—Doug Campbell

Use the index
www.clevelandfed.org/research/data/financial_stress_index