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FILING FOR BANKRUPTCY: HOW DO HOMEOWNERS FARE?

This paper provides the first in-depth analysis of the homeownership experience of households in bankruptcy. The authors consider households who are homeowners at the time of filing. These households are typically seriously delinquent on their mortgages at the time of filing. The authors measure how often they end up losing their houses in foreclosure, the time between bankruptcy filing and foreclosure sale, and the foreclosure sale price. In particular, they follow homeowners who filed for Chapter 13 bankruptcy between 2001 and 2002 in New Castle County, Delaware, through October 2007. They present three main findings. First, close to 30 percent of the filers lost their houses in foreclosure despite filing for bankruptcy. The rate rose to over 40 percent for those who were 12 months or more behind on their mortgage payment, about the same fraction as among those who entered into foreclosure directly. Second, filing for bankruptcy allowed those who eventually lost their houses to foreclosure to remain in their houses for, on average, an additional year. Third, although the average final sale price exceeded borrowers' own estimates at the time of filing, the majority of the lenders suffered losses. These findings are pertinent to the recent debate over the bankruptcy code on mortgage modification. Finally, the paper also reports circumstances related to

the loan, borrower, and lender that make it more or less likely that a certain result will take place.

Working Paper 08-14, "The Homeownership Experience of Households in Bankruptcy," Sarah W. Carroll, formerly Federal Reserve Bank of Philadelphia, and Wenli Li, Federal Reserve Bank of Philadelphia

UNEMPLOYMENT: A RIGHT-TO-MANAGE BARGAINING SCHEME

If the Mortensen and Pissarides model with efficient bargaining is calibrated to replicate the fluctuations of unemployment over the business cycle, it implies a far too strong rise of the unemployment rate when unemployment benefits rise. This paper explores an alternative right-to-manage bargaining scheme. This also generates the right degree of fluctuations of unemployment but at the same time implies a reasonable elasticity of unemployment with respect to benefits.

Working Paper 08-15, "The Elasticity of the Unemployment Rate with Respect to Benefits," Kai Christoffel, European Central Bank, Frankfurt, and Keith Kuester, Federal Reserve Bank of Philadelphia

EVIDENCE OF DIVERGENT BEHAVIOR IN RETURN AND VOLATILITY SPILLOVERS

The authors provide a simple and intuitive measure of interdependence of asset returns and/or volatilities. In

particular, they formulate and examine precise and separate measures of return spillovers and volatility spillovers. The authors' framework facilitates study of both noncrisis and crisis episodes, including trends and bursts in spillovers, and both turn out to be empirically important. In particular, in an analysis of 19 global equity markets from the early 1990s to the present, they find striking evidence of divergent behavior in the dynamics of return spillovers vs. volatility spillovers: Return spillovers display a gently increasing trend but no bursts, whereas volatility spillovers display no trend but clear bursts.

Working Paper 08-16, "Measuring Financial Asset Return and Volatility Spillovers, with Application to Global Equity Markets," Francis X. Diebold, University of Pennsylvania, and Visiting Scholar, Federal Reserve Bank of Philadelphia, and Kamil Yilmaz, Koc University, Istanbul

GENERATING FORECASTS FOR NONCORE VARIABLES

This paper develops and illustrates a simple method to generate a DSGE model-based forecast for variables that do not explicitly appear in the model (noncore variables). The authors use auxiliary regressions that resemble measurement equations in a dynamic factor model to link the noncore variables to the state variables of the DSGE model. Predictions for the noncore variables are obtained by applying their measurement equations to DSGE model-generated forecasts of the state variables. Using a medium-scale New Keynesian DSGE model, the authors apply their approach to generate and evaluate recursive forecasts for PCE inflation, core PCE inflation, and the unemployment rate along with predictions for the seven variables that have been used to estimate the DSGE model.

Working Paper 08-17, "DSGE Model-Based Forecasting of Non-Modelled Variables," Frank Schorfheide, University of Pennsylvania, and Visiting Scholar, Federal Reserve Bank of Philadelphia; Keith Sill, Federal Reserve Bank of Philadelphia; and Maxym Kryshko, University of Pennsylvania

PAYDAY LENDING AND PERSONNEL PERFORMANCE

Does borrowing at 400 percent APR do more harm than good? The Pentagon asserts that payday loans harm military readiness and successfully lobbied

for a binding 36 percent APR cap on loans to military members and their families (effective October 1, 2007). But existing evidence on how access to high-interest debt affects borrower behavior is inconclusive. The authors use within-state variation in state lending laws and exogenous variation in the assignment of Air Force personnel to bases in different states to estimate the effect of payday loan access on personnel outcomes. They find significant average declines in overall job performance and retention and significant increases in severely poor readiness. These results provide some ammunition for the private optimality of the Pentagon's position. The welfare implications for military members are less clear-cut, but the authors' results are consistent with the interpretation that payday loan access causes financial distress and severe misbehavior for relatively young, inexperienced, and financially unsophisticated airmen. Overall job performance declines are also concentrated in these groups, and several pieces of evidence suggest that these declines are welfare-reducing (and not the result of airmen optimally reducing effort given an expanded opportunity set); for example, performance declines are larger in high unemployment areas with payday lending.

Working Paper 08-18, "In Harm's Way? Payday Loan Access and Military Personnel Performance," Scott Carrell, University of California, Davis; and Jonathan Zinman, Dartmouth College, and Visiting Scholar, Federal Reserve Bank of Philadelphia

MEASURING BUSINESS CONDITIONS: ESTIMATING THE STATE OF REAL ACTIVITY

The authors construct a framework for measuring economic activity at high frequency, potentially in real time. They use a variety of stock and flow data observed at mixed frequencies (including very high frequencies), and they use a dynamic factor model that permits exact filtering. They illustrate the framework in a prototype empirical example and a simulation study calibrated to the example.

Working Paper 08-19, "Real-Time Measurement of Business Conditions," S. Boragan Aruoba, University of Maryland, and Visiting Scholar, Federal Reserve Bank of Philadelphia; Francis X. Diebold, University of Pennsylvania, and Visiting Scholar, Federal Reserve Bank of Philadelphia; and Chiara Scotti, Federal Reserve Board

TRANSMITTING MONETARY POLICY THROUGH THE BANK LENDING CHANNEL

This study shows that during Paul Volcker's drastic monetary tightening in the early 1980s, local banks operating in only one county reduced loan supply much more sharply than local subsidiaries of multi-county bank holding companies in similar markets, after controlling for bank (and holding company) size, liquidity, capital conditions, and, most important, local credit demand. The study allows cleaner identification by examining 18 U.S. "county-banking states" where a bank's local lending volume at the county level was observable because no one was allowed to branch across county borders. The local nature of lending allows us to approximate and control for the exogenous component of local loan demand using the prediction that counties with a higher share of manufacturing employment exhibit weaker loan demand during tightening (which is consistent with the interest rate channel and the balance-sheet channel of monetary policy transmission). The study sheds light on the working of the bank lending channel of monetary policy transmission.

Working Paper 08-20, "The Effect of Monetary Tightening on Local Banks," Rocco Huang, Federal Reserve Bank of Philadelphia

MACROECONOMIC FLUCTUATIONS AND CORPORATE DEFAULT

This paper studies the relation between macroeconomic fluctuations and corporate defaults while conditioning on industry affiliation and an extensive set of firm-specific factors. Using a logit approach on a panel data set for all incorporated Swedish businesses over 1990-2002, the authors find strong evidence for a substantial and stable impact of aggregate fluctuations. Macro-effects differ across industries in an economically intuitive way. Out-of-sample evaluations show their approach is superior to both models that exclude macro information and best fitting naive forecasting models. While firm-specific factors are useful in ranking firms' relative riskiness, macroeconomic factors capture fluctuations in the absolute risk level.

Working Paper 08-21, "Firm Default and Aggregate Fluctuations," Tor Jacobson, Sveriges Riksbank; Rikard Kindell, Svenska Handelsbanken; Jesper Linde, Sveriges Riksbank and CEPR; and Kasper Roszbach, Sveriges Riksbank, and Visiting Scholar, Federal Reserve Bank of Philadelphia

LEISURE AMENITIES AND URBAN DEVELOPMENT

The City Beautiful movement, which in the early 20th century advocated city beautification as a way to improve the living conditions and civic virtues of the urban dweller, had languished by the Great Depression. Today, new urban economic theorists and policymakers are coming to see the provision of consumer leisure amenities as a way to attract population, especially the highly skilled and their employers. However, past studies have provided only indirect evidence of the importance of leisure amenities for urban development. In this paper the authors propose and validate the number of leisure trips to metropolitan statistical areas (MSAs) as a measure of consumers' revealed preferences for local leisure-oriented amenities. Population and employment growth in the 1990s was about 2 percent higher in an MSA with twice as many leisure visits: the third most important predictor of recent population growth in standardized terms. Moreover, this variable does a good job of forecasting out-of-sample growth for the period 2000-2006. "Beautiful cities" disproportionately attracted highly educated individuals and experienced faster housing price appreciation, especially in supply-inelastic markets. Investment by local government in new public recreational areas within an MSA was positively associated with higher subsequent city attractiveness. In contrast to the generally declining trends in the American central city, neighborhoods that were close to "central recreational districts" have experienced economic growth, albeit at the cost of minority displacement.

Working Paper 08-22, "City Beautiful," Gerald A. Carlino, Federal Reserve Bank of Philadelphia, and Albert Saiz, The Wharton School, University of Pennsylvania, and Visiting Scholar, Federal Reserve Bank of Philadelphia

MEASURING GROWTH AND INTANGIBLE INVESTMENT IN THE CHANGING U.S. ECONOMY

In this paper the author focuses on three related and difficult areas of the measurement of national income. He argues that the economic theory underlying measurement of these items is currently controversial and incomplete.

Working Paper 08-23, "Intangible Assets and National Income Accounting," Leonard I. Nakamura, Federal Reserve Bank of Philadelphia

MODELING PREDATORY LENDING WITH AND WITHOUT COMPETITION

Regulators express growing concern over predatory loans, which the authors take to mean loans that borrowers should decline. Using a model of consumer credit in which such lending is possible, they identify the circumstances in which it arises both with and without competition. The authors find that predatory lending is associated with highly collateralized loans, inefficient refinancing of subprime loans, lending without due regard to ability to pay, prepayment penalties, balloon payments, and poorly informed borrowers. Under most circumstances competition among lenders attenuates predatory lending. They use their model to analyze the effects of legislative interventions.

Working Paper 08-24, "Predatory Mortgage Lending," Philip Bond, The Wharton School, University of Pennsylvania, and Visiting Scholar, Federal Reserve Bank of Philadelphia; David K. Musto, The Wharton School, University of Pennsylvania; and Bilge Yilmaz, Graduate School of Business Stanford University

SELECTING FACTOR PROXIES

In economics, common factors are often assumed to underlie the co-movements of a set of macroeconomic variables. For this reason, many authors have used estimated factors in the construction of prediction models. In this paper, the authors begin by surveying the extant literature on diffusion indexes. They then outline a number of approaches

to the selection of factor proxies (observed variables that proxy unobserved estimated factors) using the statistics developed in Bai and Ng (2006a,b). The authors' approach to factor proxy selection is examined via a small Monte Carlo experiment, where evidence supporting their proposed methodology is presented, and via a large set of prediction experiments using the panel data set of Stock and Watson (2005). One of their main empirical findings is that their "smoothed" approaches to factor proxy selection appear to yield predictions that are often superior not only to a benchmark factor model, but also to simple linear time series models, which are generally difficult to beat in forecasting competitions. In some sense, by using the authors' approach to predictive factor proxy selection, one is able to open up the "black box" often associated with factor analysis, and to identify actual variables that can serve as primitive building blocks for (prediction) models of a host of macroeconomic variables, and that can also serve as policy instruments, for example. The authors' findings suggest that important observable variables include various S&P500 variables, including stock price indices and dividend series; a one-year Treasury bond rate; various housing activity variables; industrial production; and exchange rates.

Working Paper 08-25, "Seeing Inside the Black Box: Using Diffusion Index Methodology to Construct Factor Proxies in Large Scale Macroeconomic Time Series Environments," Nii Ayi Armah, Rutgers University, and Norman R. Swanson, Rutgers University, and Visiting Scholar, Federal Reserve Bank of Philadelphia.