

Mortgage market design and wealth inequality: Evidence from interest-only mortgages in Denmark*

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Abstract

We study how mortgage market design affect wealth inequality. Mortgage amortization require household to save and build up wealth in the form of home equity, but also restricts portfolio choice. Using a mortgage market reform in Denmark, we show that many households chose to save less after being able to chose interest-only mortgages, and that interest-only mortgages are U-shaped across the wealth distribution. We build a model of heterogeneous households for an endowment economy with risky and non-risky assets to evaluate the impact of this structural change on households' portfolio composition and wealth inequality in the economy. Since amortization requirements act as both a portfolio restriction and a saving requirement, we disentangle and quantify the channels through which this reform exercises its impact.

JEL Classification: D31, E21, G51.

Keywords: Mortgages, interest-only, savings choice, wealth inequality, heterogeneous agent model.

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