Abstract

When minimum equity stakes in durable goods constrain a household's debt, a persistent wage increase generates a liquidity shortage. This temporarily limits the income effect, so hours worked grow. This is the financial labor supply accelerator, which links labor supply decision to limits on household borrowing. This paper examines its implications for the comovement of hours worked and household debt by comparing model-generated data with evidence from the PSID. The drastic deregulation of household debt markets in the early 1980s effectively reduced required equity stakes in durable goods. Since then, the estimated regression effect of mortgage debt on hours worked, interpreted as comovement rather than causality, has dropped dramatically. Analogous estimates from model-generated data display a quantitatively comparable fall after a calibrated reduction in equity requirements.