Tax incentives determine the leverage of households, portfolio diversification and thus matter for economic stability. We demonstrate this point in a dynamic portfolio-choice model of homeowners, focusing on the tax incentives for mortgage amortization and pension savings that determine household leverage. We show how tax incentives may explain observed cross-country differences in household leverage. Higher leverage is associated with stronger portfolio diversification if it shifts wealth accumulation from home equity to tax-incentivized pension savings. We argue that the stronger diversification stabilizes homeowners’ consumption in housing busts at intermediate levels of leverage.

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