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Out of Sight, Out of Mind: Financial Illiteracy, Inattention, and Sluggish Mortgage Refinancing

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Abstract

We analyze the effect of an exogenous shock to the Italian mortgage market. A new reform passed in 2007 has abolished prepayment fees and simplified mortgage refinancing, making it akin to a cost-free decision to households. This law — along with the almost simultaneous drop in market interest rates — has generated important gains for fixed rate borrowers, which we quantify at up to 8 percent of the principal balance. Nevertheless, only 4.2 percent of borrowers have locked in this opportunity. We establish a causal relationship between this sluggish behavior, investors' inattention, and their level of financial illiteracy.

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