Macroprudential policy in practice
The case of Ireland

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Any views expressed are my own and do not necessarily represent the views of the Central Bank of Ireland.
Overview

- Irish LTV/LTI measures: rationale, objectives, design.
- Are the measures meeting their objectives?
- Where do they sit in the context of wider housing market?
- Where they sit in the context of the macroprudential toolkit?
LTV/LTI Caps in Ireland

- LTV / LTI caps introduced from February 2015.
- Growing international evidence of effectiveness of such measures.
- Timing of introduction – early in cycle, less binding in aggregate, less distortionary, crisis not a distant memory.

Specific features
- Proportionate caps
- Combined LTV/LTI measures
- Differentiated treatment for first-time buyers/second and subsequent borrowers and buy-to-let investment properties
Credit Conditions over the Cycle

Loan-to-Value

Loan-to-Income

% of new lending

< 80%

80% - 90%

> 90%

% of new lending

0-3

3-4

4-5

> 5
Primary Objective: Enhance bank and borrower resilience

Higher LTV and LTI ratios at origination are associated with an increased likelihood of subsequent default and higher loss given default

Secondary Objective: Dampen the extent of pro-cyclicality between credit and house prices
Rationale for aspects of the measures design—Differentiation

Default rate for first-time buyers (FTBs) and second and subsequent buyers (SSBs)

Lending for investment properties riskier at each LTV level

Source: Central Bank of Ireland: Designing Macro-prudential Policy in Mortgage Lending: Do First Time Buyers Default Less?

Source: Central Bank of Ireland
Current calibration of the measures

First Time Buyers 2019

- 3.5 TIMES INCOME
- For most people, MORTGAGE CAPPED AT 3.5 TIMES INCOME
- 20% of mortgages can be above cap
- 5% of mortgages can have a lower deposit
- DEPOSIT REQUIRED 10%

Second & Subsequent Buyers 2019

- 3.5 TIMES INCOME
- For most people, MORTGAGE CAPPED AT 3.5 TIMES INCOME
- Mortgage up to 90%
- 10% of mortgages can be above cap
- 5% of mortgages can have a lower deposit
- DEPOSIT REQUIRED 20%

Buy-to-Let 2019

- DEPOSIT REQUIRED 30%
- 10% of mortgages can have a lower deposit
- Mortgage up to 70%
- Deposit minimum 30%

Other Exemptions

- Negative equity mortgages exempt from Loan-to-Value (LTV) limit
- Buy-to-Let mortgages exempt from Loan-to-Income (LTI) limit
- Switcher mortgages exempt from LTI and LTV limits
Are the measures meeting their objectives? - Resilience

Upper tail of LTI distribution brought in
Are the measures meeting their objectives? - Resilience

Distribution of new lending much safer than it was when the price to income ratio was at 4.4 times during the last upswing (Q4 2003)

Distribution of LTI for FTBs

Distribution of LTI for SSBs
Are the measures meeting their objectives? - Resilience

Measures becoming increasingly binding, as house price growth has outstripped income growth

Cross-sectional variation of utilisation for loans originated in 2017

Heatmap on Binding Indicator (Tail Measure)
(Tail measure is the proportion of loan with utilisation > 90%)
Are the measures meeting their objectives? - Procyclicality

Mortgage lending activity in aggregate remains in-line with structural determinants and has not driven unexpected price dynamics

New mortgage lending to disposable income (NMDI) ratio

Drivers of house price growth

Source: Central Bank of Ireland calculations
Notes: The black dotted line denotes a NMDI ratio threshold derived based on long-run structural determinants. Last observation 2018Q2. See Central Bank of Ireland Economic Letter (Vol 2018, No.5) by E. Keenan & M. O’Brien

Source: CSO, BPFI and Central Bank of Ireland calculations. Notes: Forecast error is the difference between the forecast price growth from an empirical model and actual house price growth. A positive forecast error implies actual house prices growth was higher than the model forecast. The bars represent the contribution of shocks to the other variables in the model to the forecast error. See 2018 Review of Mortgage Market Measures.
Context of the wider housing market

Despite recent moderation, years of strong price growth and rental growth has stretched valuations and affordability – symptomatic of wider market dysfunction – but challenging for communication.
Resilience to cyclical vulnerability of stretched housing market may not be tackled in isolation by measures targeting the flow of bank lending => reinforced by CCyB.

Source: Central Bank of Ireland. The chart presents the various macroprudential policy instruments based on the nature of systemic risk they are designed to mitigate (structural to cyclical), the relevant exposures through which the policies becomes effective (stock to flow) and the objective or impact of the measures ("Building resilience" to "Leaning against the wind"). All three dimensions are, to an extent, not mutually exclusive. This is especially the case for the latter dimension where there is significant overlap and complementarily.
Summary

Are the measures meeting their objectives?
- Yes, so far – but we check on an annual basis!

Where do they sit in the context of wider housing market?
- Important to be understood as a permanent feature – challenging in market with wider dysfunction

Where they sit in the context of the macroprudential toolkit?
- Necessary, but not necessarily sufficient, to address systemic risk related to housing market and mortgage market vulnerability