Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Macroprudential policy in practice
The case of Ireland

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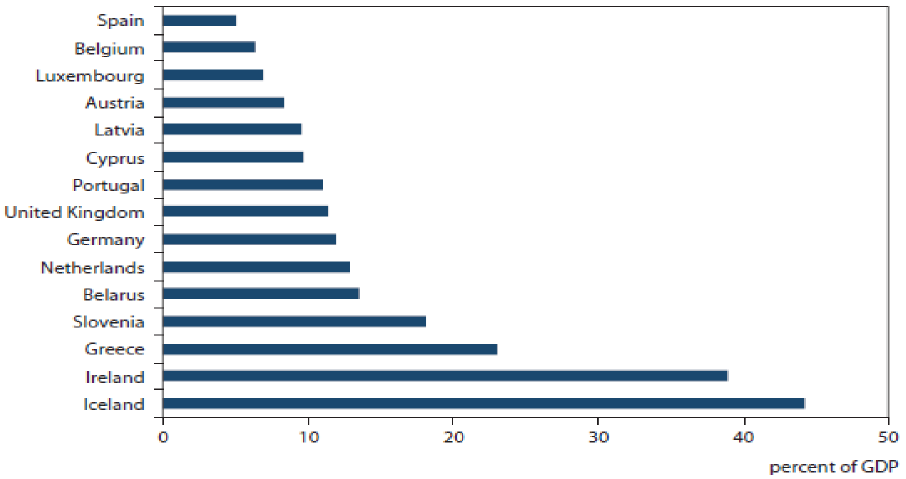
Overview

- 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

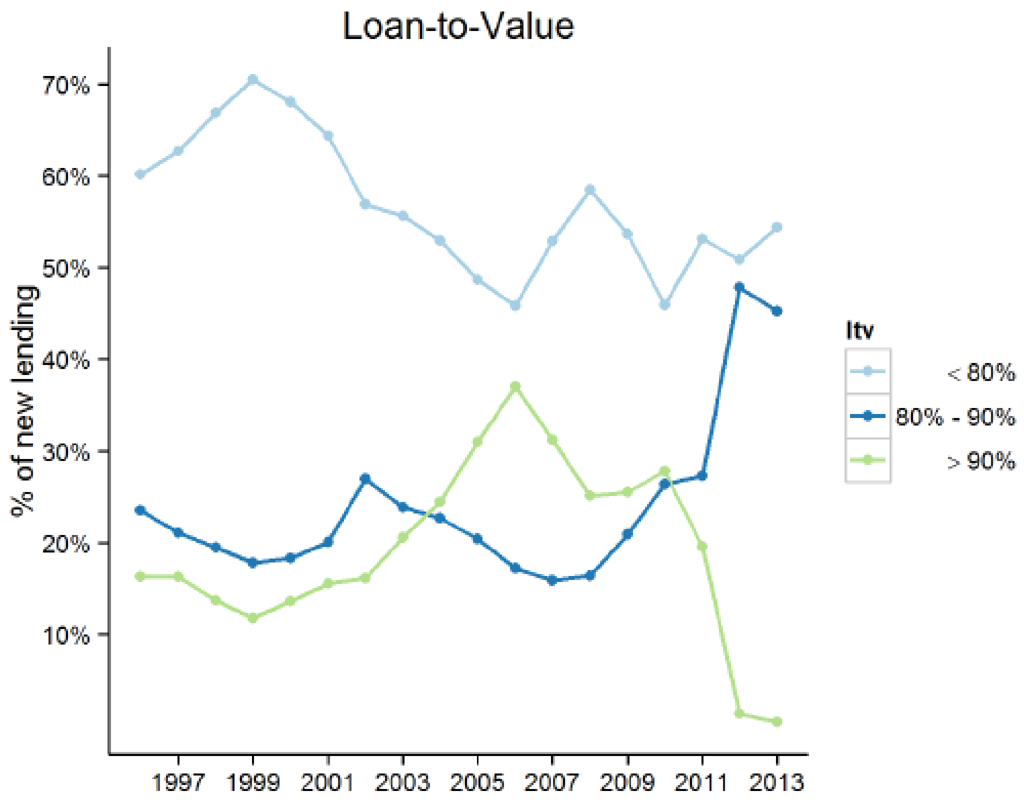
- LTV / LTI caps introduced from February 2015.
- Growing international evidence of effectiveness of such measures.
- Timing of introduction – early in cycle, less binding in aggregate, less distortionary, crisis not a distant memory.
- Specific features
  - Proportionate caps
  - Combined LTV/LTI measures
  - Differentiated treatment for first-time buyers/second and subsequent borrowers and buy-to-let investment properties

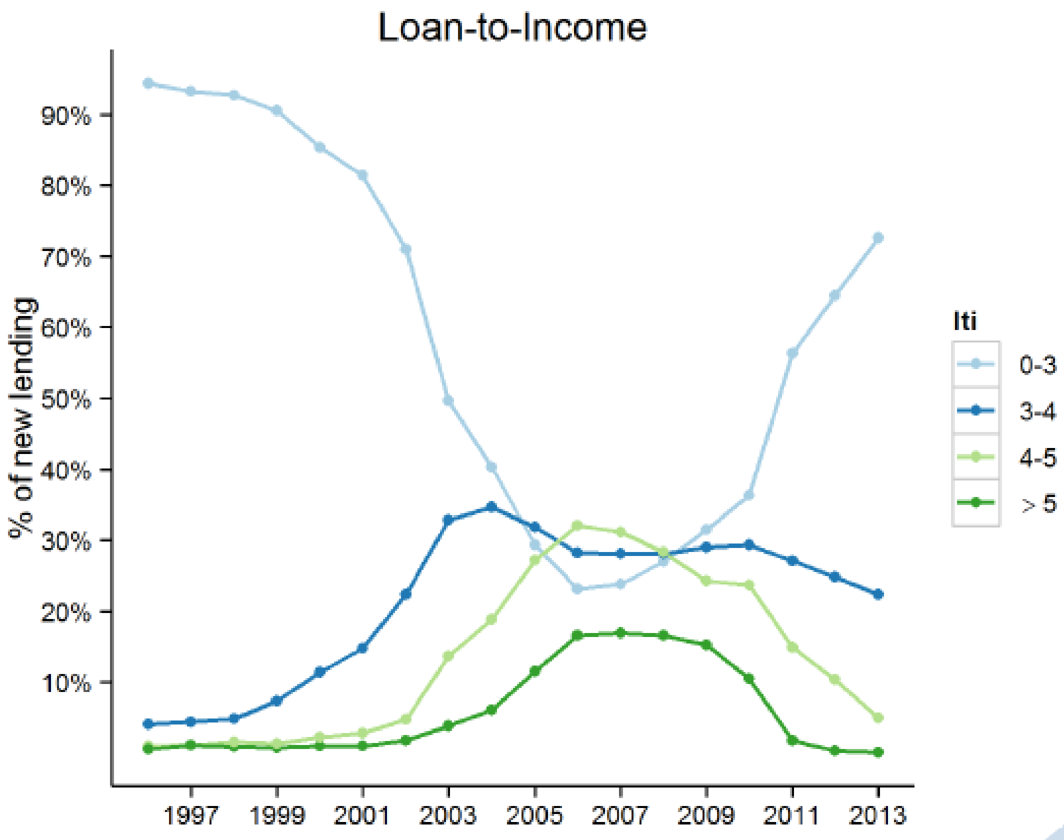
Figure 1 **Estimate of gross fiscal cost of banking crises in 2007–13 in selected European countries**



Source: Bova, Elva, Marta Ruiz-Arranz, Frederik Toscani, and H. Elif Ture. 2016. The Fiscal Costs of Contingent Liabilities: A New Dataset. IMF Working Paper WP/16/14. Washington: International Monetary Fund

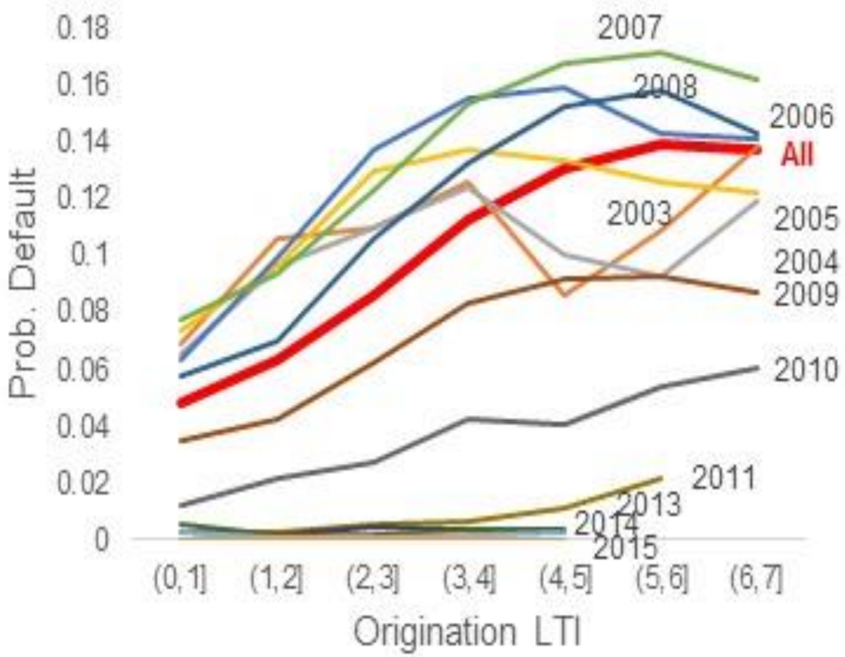
Credit Conditions over the Cycle

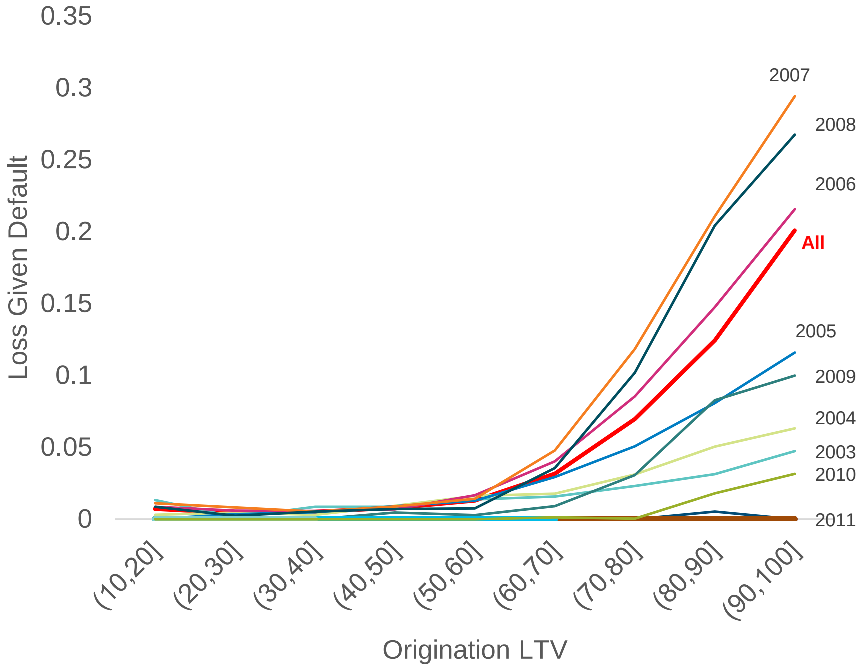




Primary Objective: Enhance bank and borrower resilience

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





See Central Bank or Ireland (2016) “Review of residential mortgage lending requirements”, page 28

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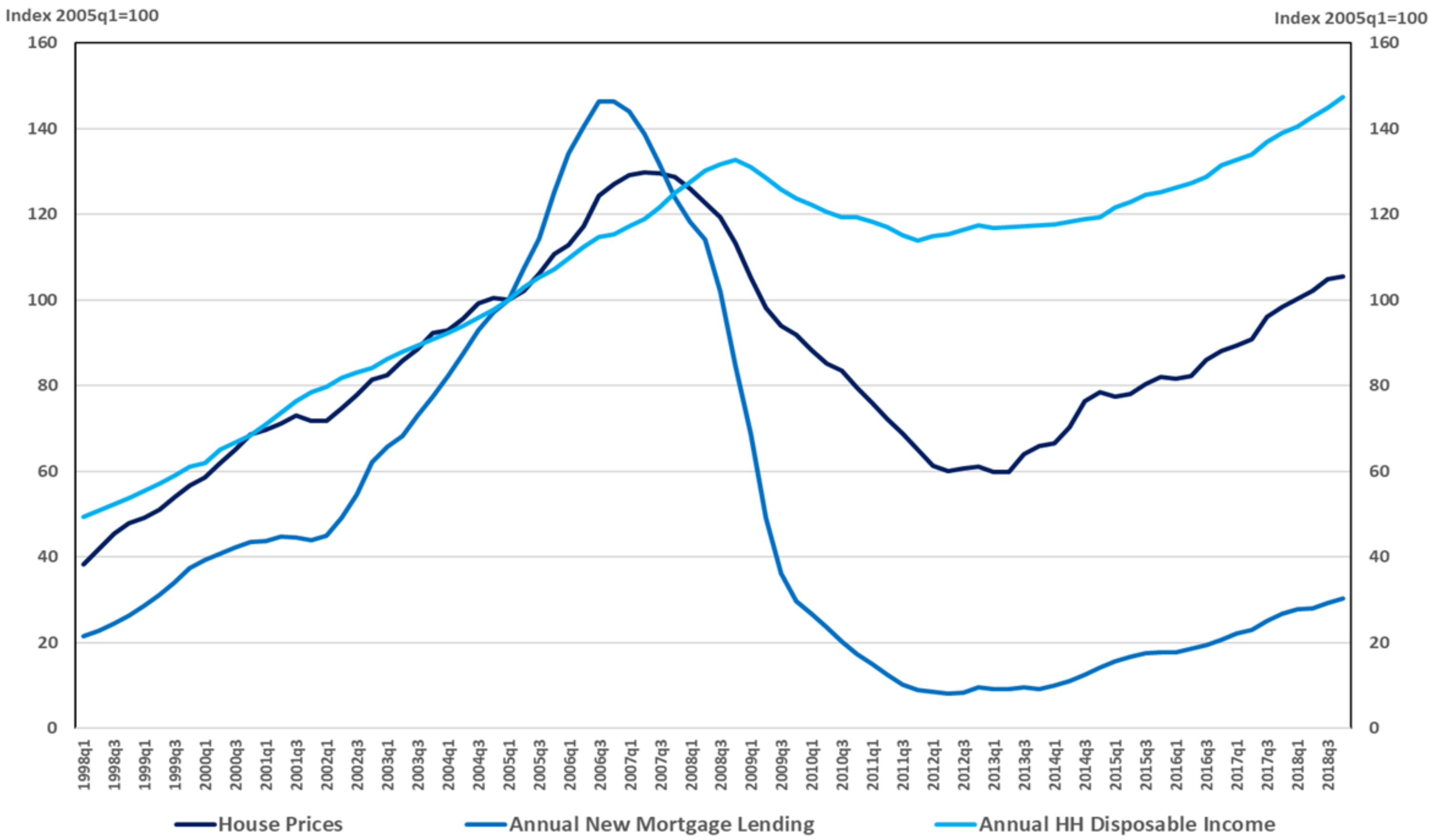
Secondary Objective: Dampen the extent of pro-cyclicality between credit and house prices



Sources: BPFI, DoHPCLG, CSO, ESRI/PTSB and Central Bank of Ireland calculations.

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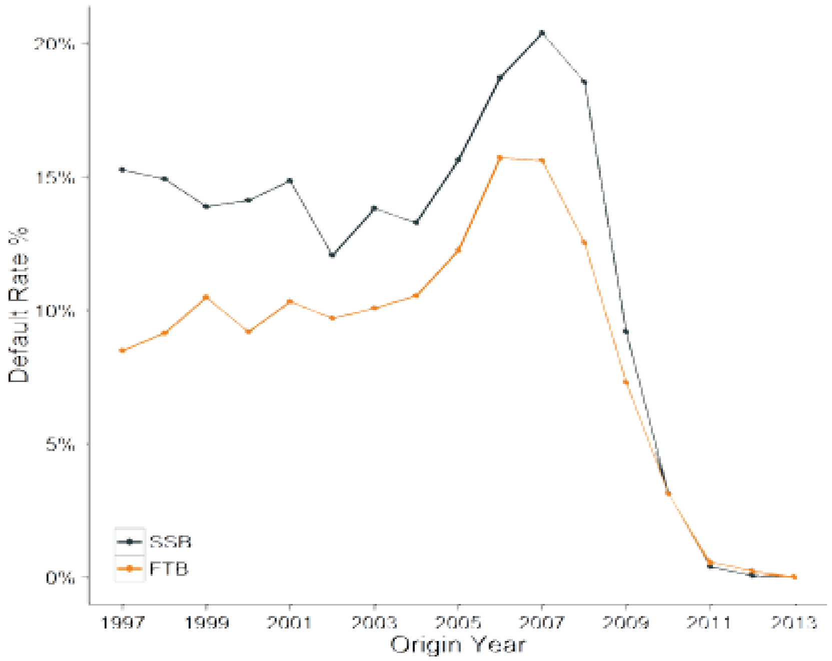
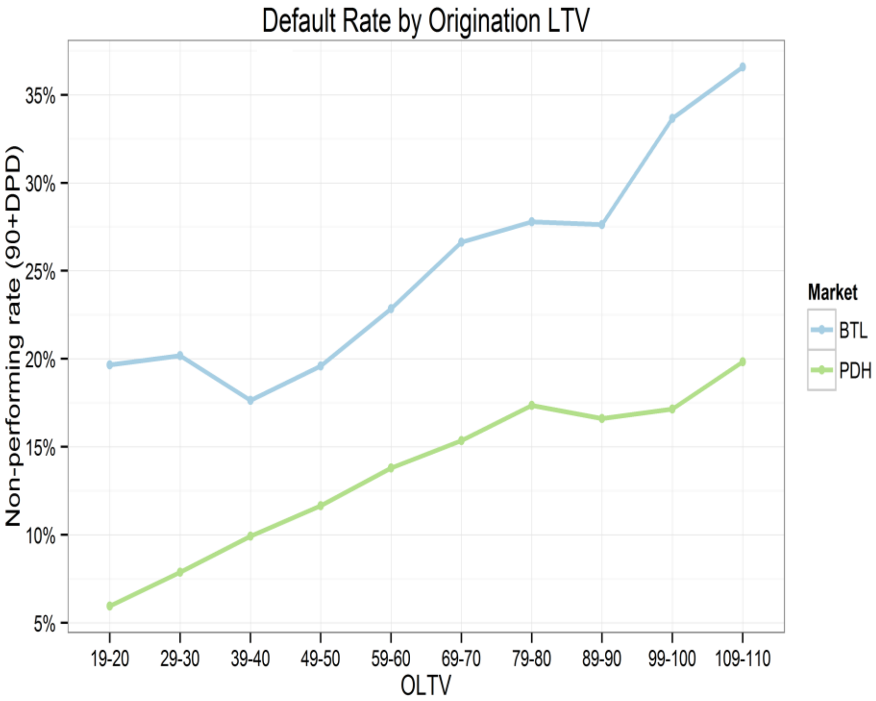
Rationale for aspects of the measures design– Differentiation

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



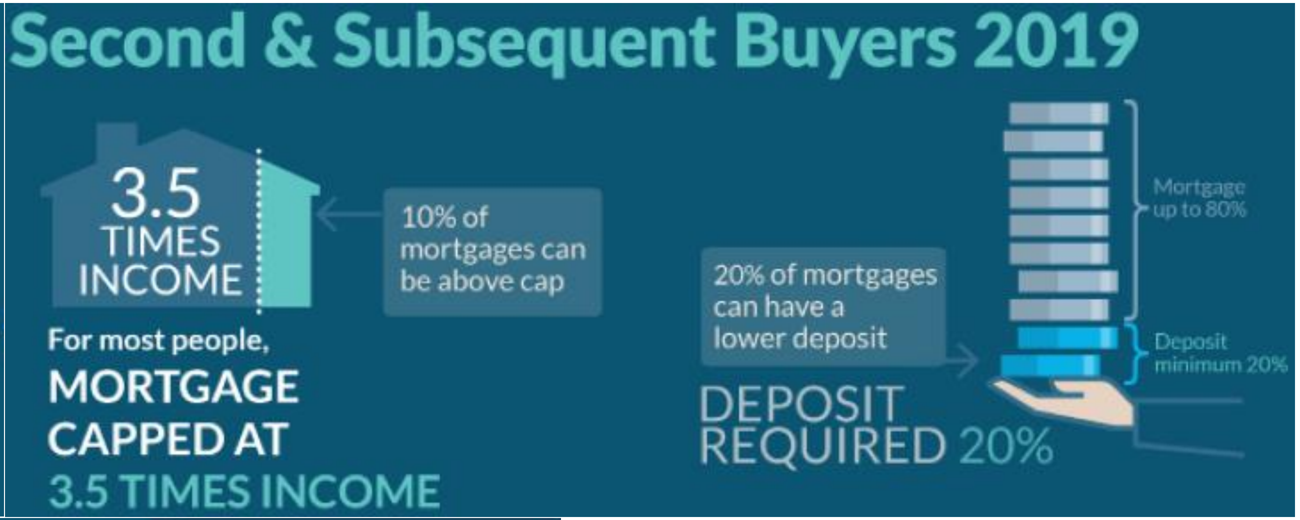
Source: Central Bank of Ireland: *[Designing Macro-prudential Policy in Mortgage Lending: Do First Time Buyers Default Less?]*

Lending for investment properties riskier at each LTV level



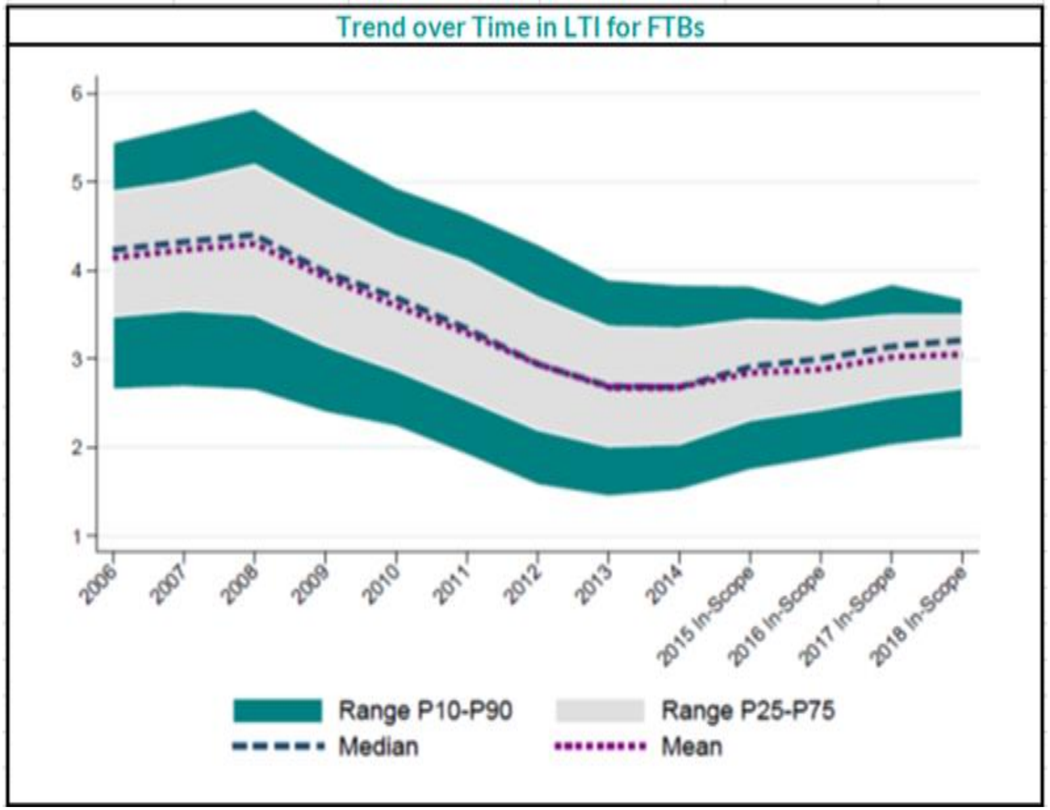
Source: Central Bank of Ireland

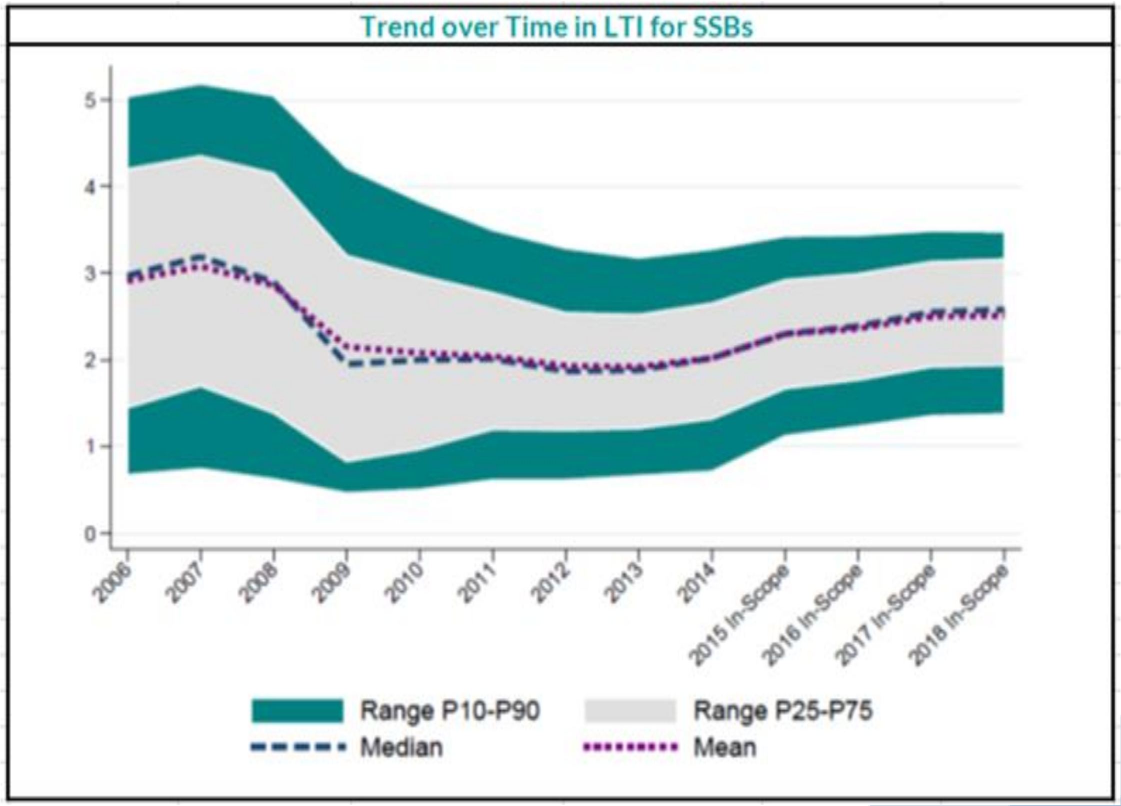
Current calibration of the measures



Are the measures meeting their objectives? - Resilience

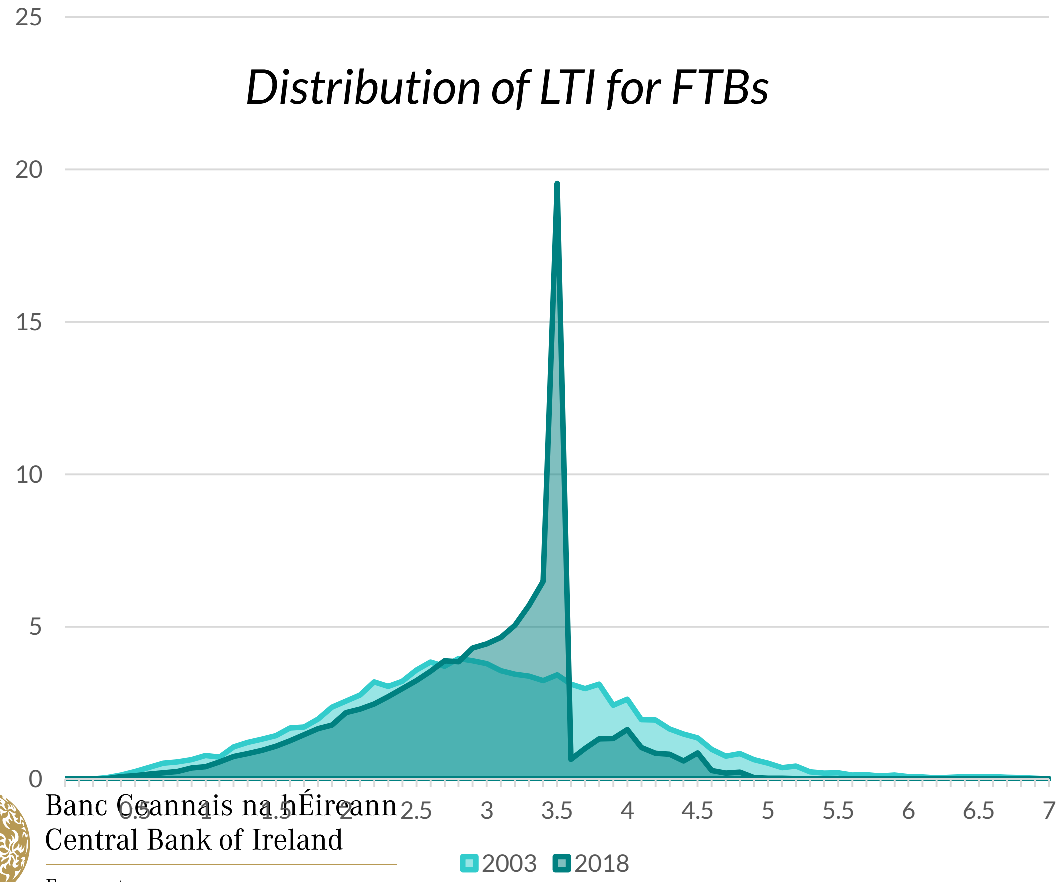
Upper tail of LTI distribution brought in

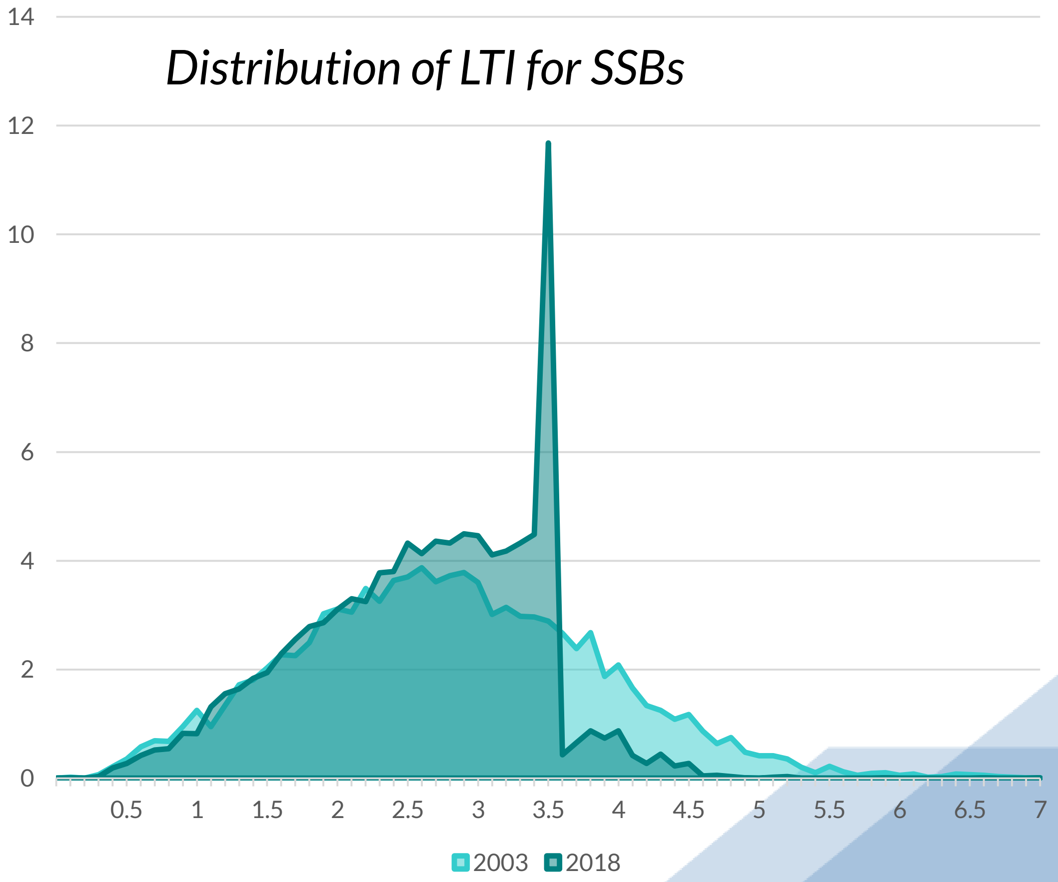




Are the measures meeting their objectives? - Resilience

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)

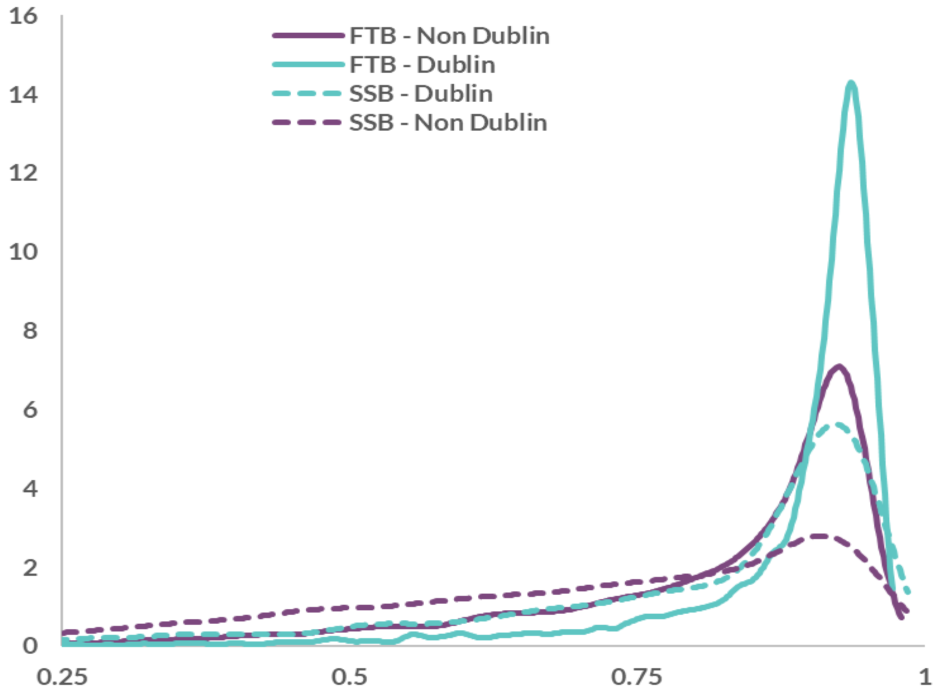




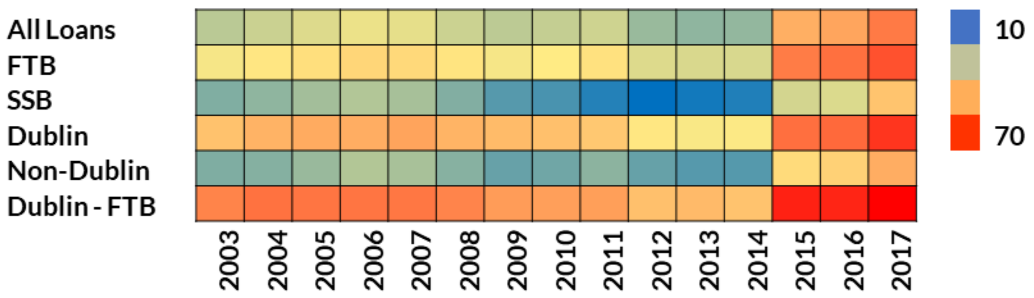
Are the measures meeting their objectives? - Resilience

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

Cross-sectional variation of utilisation for loans originated in 2017



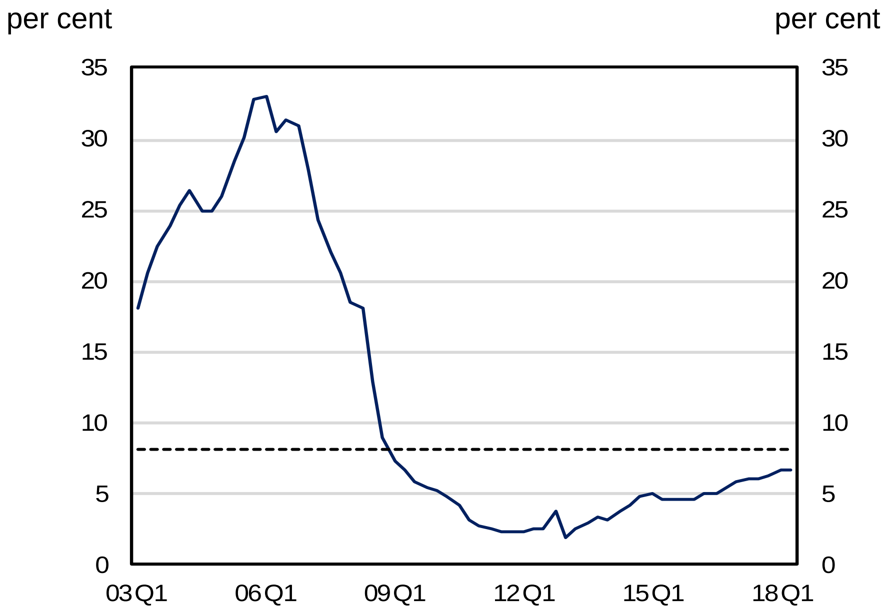
Heatmap on Binding Indicator (Tail Measure)
(Tail measure is the proportion of loan with utilisation > 90%))



Are the measures meeting their objectives? - Procyclicality

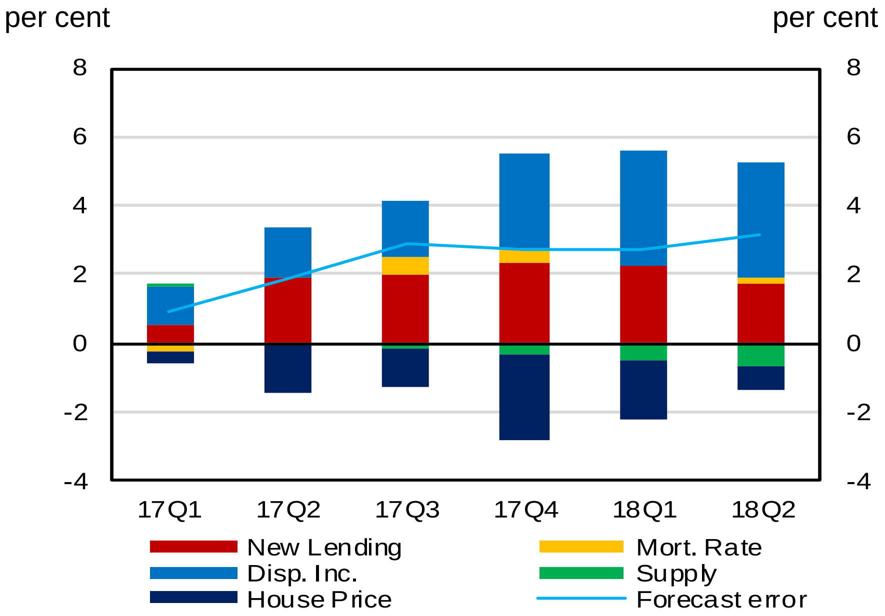
Mortgage lending activity in aggregate remains in-line with structural determinants and has not driven unexpected price dynamics

New mortgage lending to disposable income (NMDI) ratio



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

Drivers of house price growth

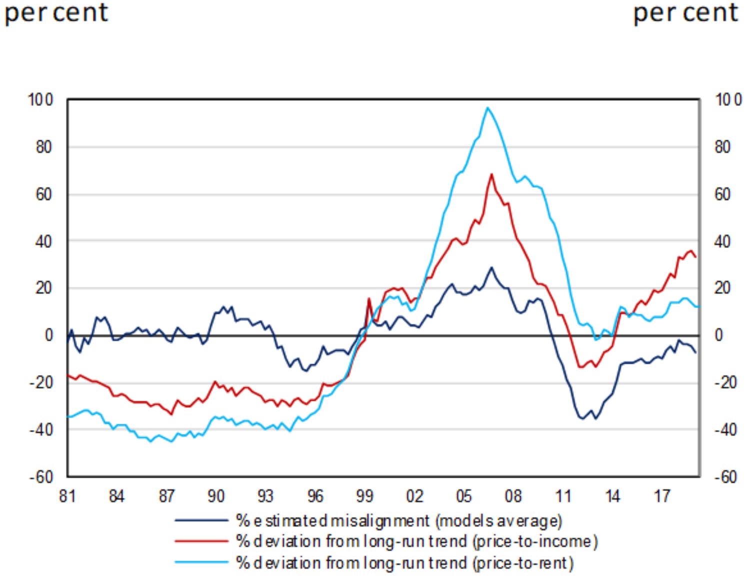


Source: CSO, BPFI and Central Bank of Ireland calculations.
Notes: Forecast error is the difference between the forecast price growth from an empirical model and actual house price growth. A positive forecast error implies actual house prices growth was higher than the model forecast. The bars represent 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

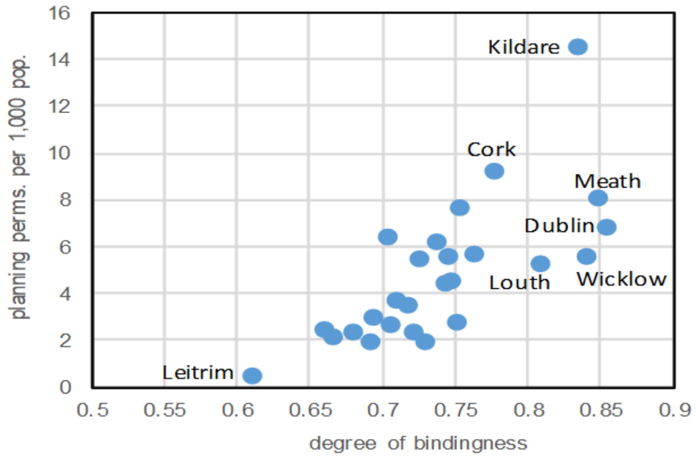
Estimated house price misalignment and deviation of statistical house price indicators from long-run average values



Source: Central Bank of Ireland calculations

Note: "Models" series is calculated as the average of 2 simple reduced form house price models, outlined in Kennedy, O'Brien and Woods (2016).

Bindingness of mortgage measures and planned residential units per county - 2018



Source: CSO and Central Bank of Ireland

Note: Planning perms. indicator = units with planning perm. per 1,000 of county population based on Census 2016 figures

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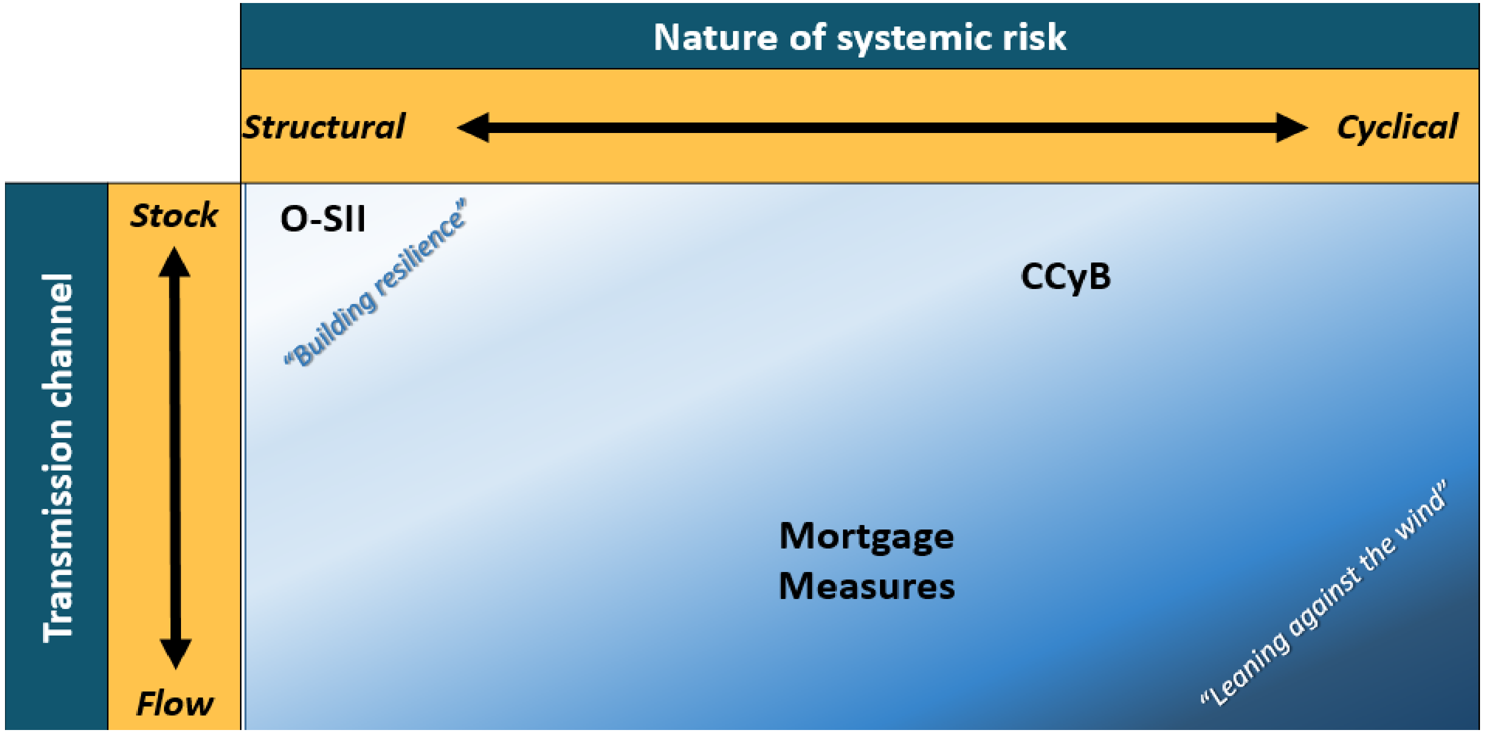
Context of the macroprudential policy mix



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 complementarity.

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.

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*