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Macroprudential policies to mitigate housing market risks

CGFS Study Group report, Ryan Banerjee (Secretary)

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Study Group mandate and organisation of the report

- Take stock of recent experience with macroprudential measures

- Report
  - Country case studies (14 members – total 168 years of operational experience)
  - Overview chapter → Distil the essence from country experiences
  - https://www.bis.org/publ/cgfs69.htm

Overview chapter - Practical handbook

- Guidance on how to implement macroprudential policies based on 6 questions
  1. Why are housing markets a source of risk?
  2. What to monitor?
  3. **How to set policy?**
  4. **What tools to use ?**
  5. **How to calibrate tools?**
  6. **What influences policy effectiveness?**

How to set policy?

How to structure governance?

Models of macroprudential governance	Table 2
Central bank has main powers of direction	IE, IL, IN, HK, NZ, SG,[1] SA, UK
Supervisor (separate from the central bank) has main powers of direction	AU
Inter-agency macroprudential authority with powers of direction (joint decision of represented agencies)	FR,[2] LU
Macroprudential powers of direction split between various authorities	BE, CA, NL

[1] The Monetary Authority of Singapore (MAS) is the only macroprudential authority; however, for the property market an interagency taskforce (MAS, the ministry of finance and the ministry of national development) coordinates measures under the overarching goal of promoting a sustainable property market. [2] Central bank has exclusive powers to propose measures to be considered by the interagency authority.

- Challenges
  - Who is accountable for outcome, do they have powers of direction over tools?
  - Operational independence, how well aligned are principal objectives with macropru objectives?

What intermediate macroprudential objectives to set?

Ranking of intermediate policy objectives to mitigate housing market risks

1 = more important objective, 2 = less important objective[1] Table 3

	AU	BE	CA	FR	HK	IE	IL	IN	LU	NL	NZ	SA	SG	UK
Maintain lender resilience	1	1	1	1	1	2	1	1	1	1	1	1	1	1
Maintain borrower resilience	1	2	2	1		1				1		1	1	1
Dampen housing credit cycles						1		1	1		2			
Promote the evolution of house prices in line with fundamentals											2		1	

[1] An empty cell indicates that it is not an intermediate objective.

- Lender (bank) resilience is the most important intermediate objective
- Different views on borrower resilience → Defaults vs demand externalities
- Few actively lean
  - Due to mandates, governance frictions and doubts about effectiveness of tools to lean

What tools to use?

Which tools are most effective?

Which tools for which objectives? Table 5

Tools	Resilience objectives	Other objectives
Supervisory expectations	• Supervisory expectations on loss-absorbing buffers, for example through stress tests, boosts lender resilience. • Supervisory expectations on target. variables and peer benchmarking of lending standards boosts borrower resilience by raising lending standards but can still require follow up with more quantitative measures to achieve objectives.	• Supervisory expectations can be flexibly dialled up or down to smooth credit cycles.
LTV limits	• Boosts lender resilience to shocks by improving loss-given-default rates. • Less effective in raising borrower resilience as less effective in holding down debt service-to-income. But larger equity buffers provide more options in meeting serviceability challenges.	• Active adjustment dampens credit cycles. • Reduces house price growth and deviations from fundamentals, but the effect is relatively modest.
Borrower income-based limits (DTI, DSTI)	• Boosts borrower resilience to shocks, as debt service-to-income is closely associated with default probabilities and weaker consumer demand. • Can boost lender resilience by reducing LTVs in certain cases.	• Can help smooth credit cycles by dampening credit growth.
Capital-based risk-weight floors, add-ons and multipliers; sectoral systemic risk buffers	• Boosts lender resilience by adding a macroprudential capital buffer to cover systemic risks not reflected in microprudential capital requirements. • Limited effects on borrower resilience.	• Limited effects on credit cycles and house prices.
Risk weights linked to LTV or DSTI	• Boosts lender resilience to shocks.	• Active adjustment dampens credit cycles but more effective when tightening compared with loosening.
Investor targeted measures	• Raises borrower resilience.	• Mixed evidence about influence in dampening housing credit cycles.

- First tool often
  - Supervisory expectations
- Match tools to intermediate objective
  - Policy is most effective when best tools used to meet specific intermediate objective
- Combinations of tools?
  - Multiple tools for multiple objectives
  - Path dependence
  - Experimentation followed by streamlining
  - Mitigating leakages and costs

How to calibrate tools?

How to calibrate tools?

1. Early in the cycle
2. Benchmark to historical period / norms
3. Guard rails
4. Gradual approach
5. International benchmarking
6. Stress tests and model simulations

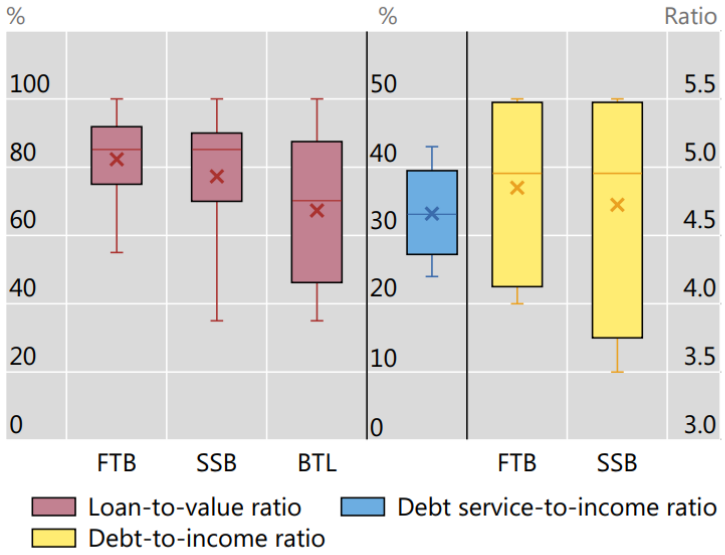
Calibration methods — Table 6

Method	Description	Advantages	Disadvantages	Examples
Early in the cycle	Calibrate measures using early in the cycle lending standards / capital buffers	Avoids a sudden tightening in lending standards / capital buffers. Based on lender' standards / capital buffers when they are prudent	Requires consensus to act early in the cycle before risks have become excessive	IE: 2015 LTV and LTI limits
Benchmark to historical period / norms	Calibration is determined by a historical period when lending standards were considered prudent / when lenders' buffers were conservative	Lenders already familiar with benchmark	Historical norms may not be appropriate after structural changes	FR: 2019 DSTI limit; NL: 2022 average risk-weight floor
Guardrails	Measures calibrated to only bind in scenarios of housing market exuberance	Avoids a sudden tightening in lending standards / capital buffers	Requires modelling scenarios and assumptions	UK: 2014 LTI flow limit
Gradual approach	Gradually adjust tools if uncertain about the calibration	Avoids a sudden tightening in lending standards / capital buffers and risk of overshooting objective	Requires multiple inputs and reliant on expert judgment	HK: 2009-17 LTV caps
International benchmarking	Calibrate measures based on calibrations used in other economies	Leverages practical experiences from other economies	Might not be appropriate due to differing structure of housing markets across countries	LU: 2016 average risk-weight floor
Stress tests and model simulations	Stress tests / model simulations to assess impact on banks, lenders and house prices	Potential to calibrate with respect to resilience objectives and economic impact. Can guide re-calibration with evolving macroeconomic and financial conditions	Data-intensive, requires modelling assumptions	FR: 2019 DSTI limit LU: 2021 LTV limit

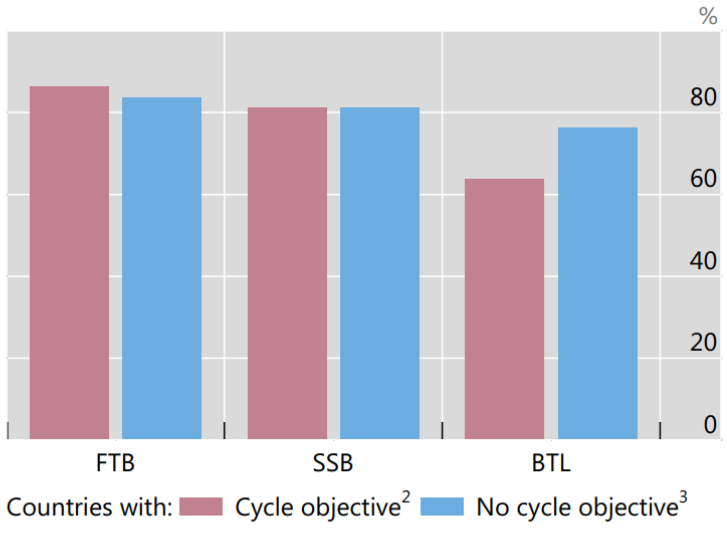
International benchmarking of borrower-based measures

Greater dispersion of borrower-based limits for buy-to-let investors — Graph 3

A. Cross-country heterogeneity of limits[1]



B. Average LTV limits by borrower type



BTL = buy-to-let; FTB = first-time buyers; SSB = second-time or subsequent buyers.

[1] AU, BE, CA, FR, HK, IE, IL, IN, KR, LU, NL, NZ, SA, SG and UK, depending on implementation. The crosses, lines, boxes and whiskers respectively show the means, medians, interquartile range and min–max range. LTV coefficient of variation for FTBs: 0.17; SSBs: 0.26; BTL: 0.33. DSTI coefficient of variation: 0.20. DTI coefficient of variation for FTB: 0.15; SSBs: 0.20. [2] IE, IN, LU, NZ and SG. [3] BE, CA, HK, IL, NL and SA.

Sources: CGFS study group.

- Limits less tight for FTB
- Less dispersion in FTB limits
- More dispersion for SSB and BTL
  - Dispersion partially reflects intermediate objectives to dampen cycles

What influences policy effectiveness?

What influences policy effectiveness?

1. Availability of the best tool to meet the objective
2. Leakages
3. Lags
4. Automatic stabiliser properties of tools

- *Governance frictions are a common thread that influences effectiveness*

Leakages Table 7

Leakage	Problem	Mitigation strategies
Extending loan maturities to loosen DSTI limits	• Spreads amortisation over a longer period, which slows rate of housing equity accumulation, undermining borrower resilience	• Limits on loan maturities • Lower LTV limits on long-maturity loans
Lenders out of scope	• Financial system vulnerabilities migrate to non-bank lenders • Cross-border leakages • Undermines lending standards	• Legal basis of regulation in law covering all lenders (not only supervised ones) with anti-avoidance clauses • Apply higher risk weights for supervised lenders' credit exposures to non-compliant lenders who fall outside the authority's supervisory remit • Request that supervised financial intermediaries terminate credit relationships with non-compliant lenders • Cross-border reciprocity agreements
Borrowers out of scope	• Households set up legal entities to avoid macroprudential policies targeting households	• Apply policies to all mortgage borrowers
Income definition	• Unstable incomes • Inflated incomes • Multiple names on mortgages	• Haircuts on less-stable income sources • Income verification based on taxable income • Supervisory oversight of banks' credit policies • Weighted limits based on full portfolio of borrowers' loans
Use of non-mortgage loans	• Lower lender resilience as actual debt higher than captured by LTV ratio • Lower borrower resilience than captured by loan-to-income or loan service-to-income ratios	• Use credit bureaus or credit registries to enable lenders to assess total debt • Use total debt/debt service to compute income-based limits • Anti-avoidance clauses

Governance: smooth the rough edges

- Provide key "principles" of governance
- When ideals not met
  - Practical tips to facilitate policy setting within existing governance frameworks

Governance: practical remedies that facilitate policy-setting — Table 10

Issue	Consequences	Remedies	Examples of remedies from case studies
Political considerations influencing policy	• Constrains operational independence • Inaction bias	• Write political considerations explicitly into objectives with a hierarchy (eg similar to price stability and secondary objective of full employment). • Include external academics on panel to bring an outside perspective	• New Zealand – political considerations explicitly written into the memorandum of understanding
Inter-agency macroprudential governance structures	• Challenge to assign responsibilities and hence ensure accountability • Inaction bias / easing bias	• Only the institution with the macroprudential objective has power to initiate relevant measures • Qualified majority voting	• France – only central bank has powers to initiate measures among High Council of Financial Stability (HCSF) members • France – HCSF includes outside academics as members
Measures delayed due to need for consensus	• Delays build-up of resilience • Weakens ability to implement cyclical policy • Reduces predictability of policy • Can distort incentives to loosen policy	• Initial and early implementation of measures though non-binding recommendations • Use of tools with automatic stabiliser properties	• France – implementation of DSTI requirement initially via guidance
Desired tool is outside the remit of the macroprudential authority or has not been granted legal backing	• Constrains ability of authorities to mitigate housing risks • Use of second- or third-best tools to mitigate risks	• Implement macroprudential measures though banking supervision mandates • Peer benchmarking to inform lenders of externalities • Robust supervisory expectations to counteract extrapolative expectations of lenders • Introduce macroprudential measures on a "comply or explain" basis	• Israel – implement macroprudential policies targeting housing risks through banking supervision mandates • Belgium – supervisory expectations with a formal "comply or explain" mechanism

Lessons for macroprudential policy

- Macroprudential policies complement other housing-related policies
- Governance frameworks influence policy effectiveness
- Tools that meet objectives without active adjustment are especially effective
- Openness about cost-benefit trade-offs foster support

Link to the CGFS report: https://www.bis.org/publ/cgfs69.htm