Housing, Stability and the Macroeconomy: International Perspectives

Federal Reserve Bank of Dallas
Journal of Money, Credit and Banking
International Monetary Fund

Financial Stability and the Mortgage Market:

Canada’s Policy Framework

Allan Crawford, Bank of Canada

This paper was presented at **Housing, Stability and the Macroeconomy: International Perspectives** conference, November 14-15 2013. The conference was sponsored by the Federal Reserve Bank of Dallas, the International Monetary Fund, and the *Journal of Money, Credit and Banking*. The conference was held at Federal Reserve Bank of Dallas (http://dallasfed.org).

BANK OF CANADA
BANQUE DU CANADA

Financial Stability and the Mortgage Market: Canada's Policy Framework

Housing, Stability and the Macroeconomy: International Perspectives Conference
Dallas, Texas
14 November 2013

A. Crawford
Bank of Canada

Outline

- Canada's experience during the financial crisis
- Canada's housing finance system
  - Factors contributing to resilience
- Policy responses (2008-2013)
  - Lessons learned

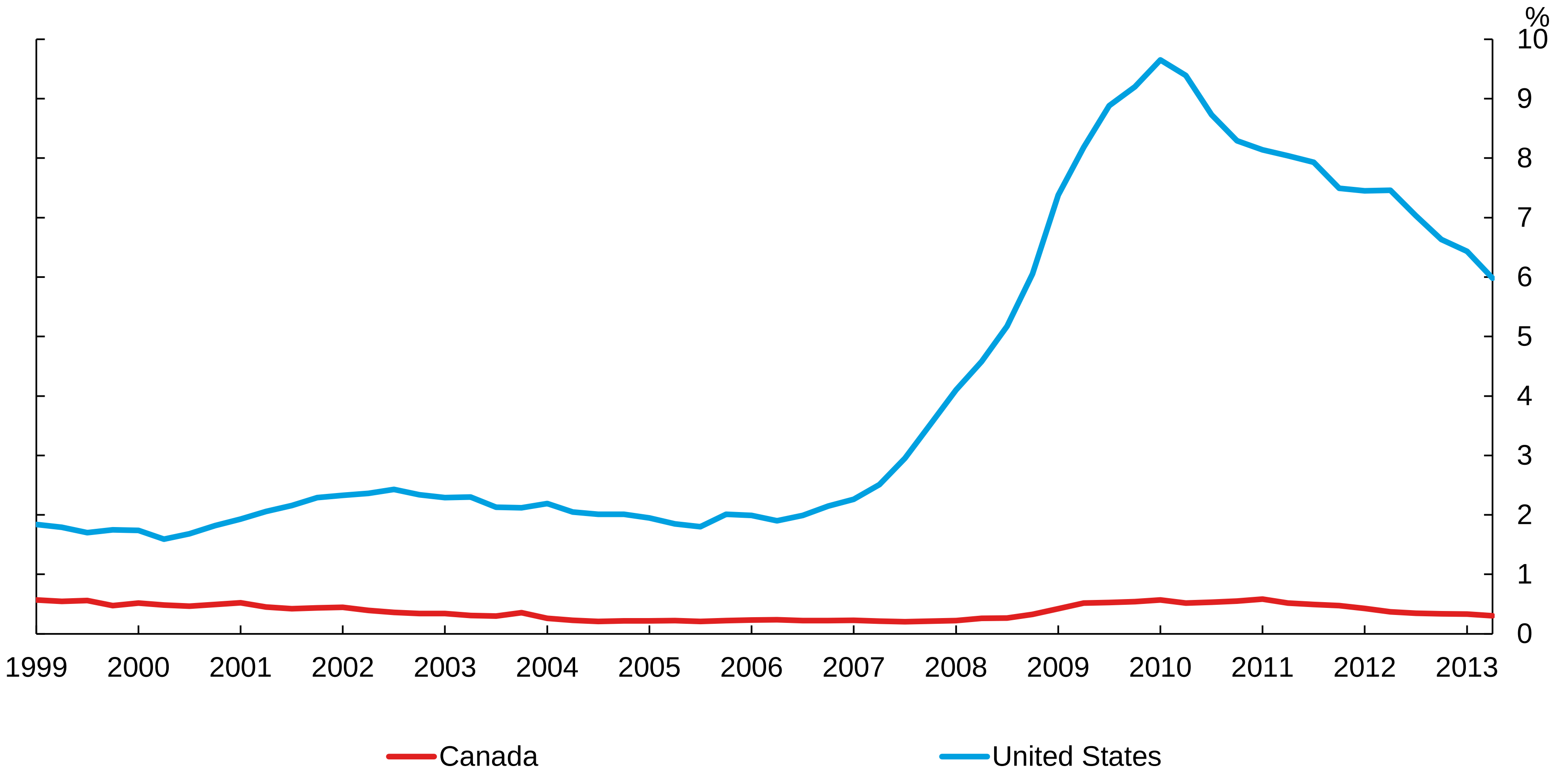
BANK OF CANADA
BANQUE DU CANADA

Canada's experience during the financial crisis

BANK OF CANADA
BANQUE DU CANADA

Mortgage delinquencies lower than in the U.S. over history and rose much less in 2008-09

Mortgage balances in arrears 90 days or more as a per cent of total mortgage balances outstanding



Sources: U.S Mortgage Bankers Association, regulatory filings of Canadian banks and Bank of Canada

Last observation: 2013Q2

Canada’s housing finance system

Regulatory framework

- About 80% of mortgages are originated by federally-regulated lenders
  - Most other lenders are provincially regulated
- Risk-weighted capital requirements are supplemented by an unweighted leverage ratio
- System of early intervention

Government guaranteed mortgage insurance

- Lenders must have insurance for mortgages with LTV ratio > 80%
  - Premium depends on the LTV ratio

- Three mortgage insurers
  - Two private (about 25% market share)
  - One publicly owned: Canada Mortgage and Housing Corporation (CMHC)

- Provides an important policy lever for controlling risk
  - Qualifying rules set minimum underwriting standards

BANK OF CANADA
BANQUE DU CANADA

Other institutional features

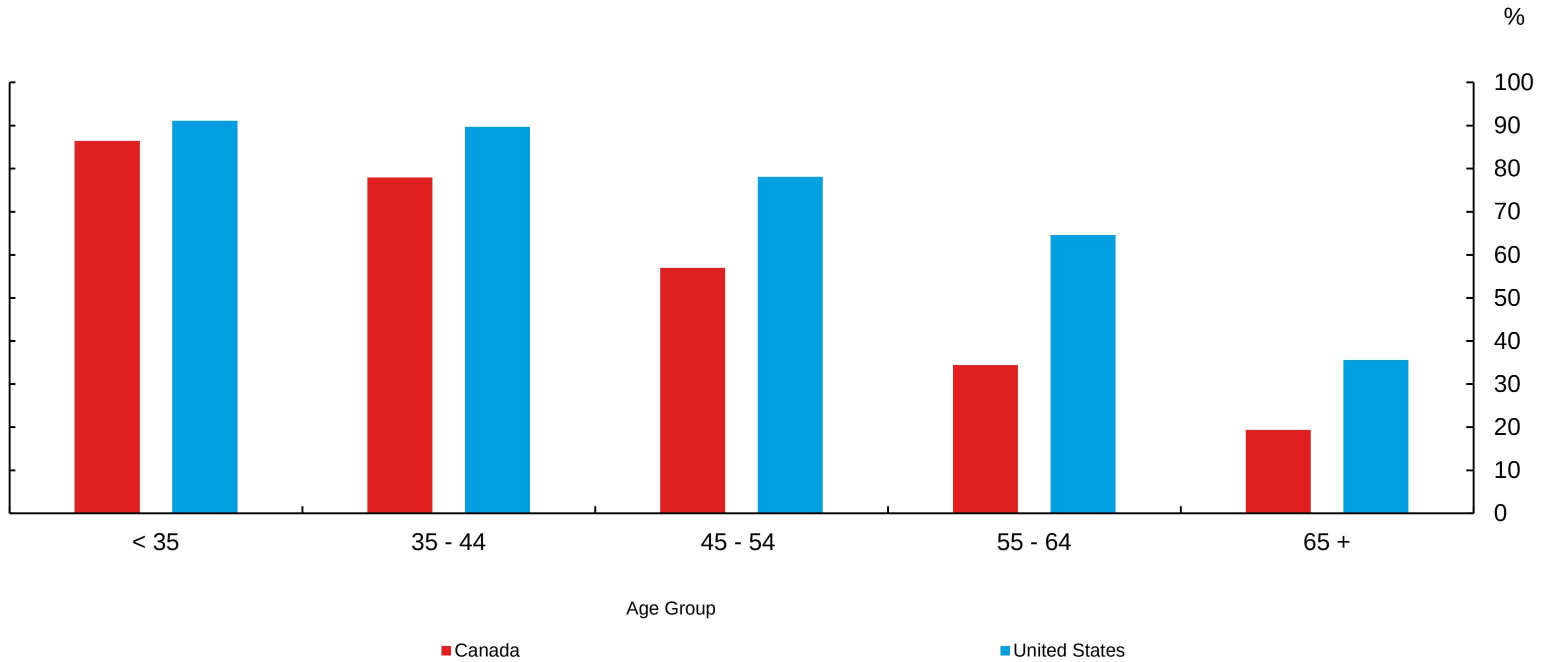
- Mortgage lending is dominated by large nation-wide banks
- Funding
  - Less reliance on securitization
  - Securitization dominated by insured mortgages (which are subject to qualifying rules)
- Non-prime mortgages (Alt-A, near-prime and sub-prime) about 7% of outstanding mortgages in 2012

Other institutional features

- Legal framework
  - Recourse for almost all mortgages
  - Non-deductibility of mortgage interest payments

Mortgage debt decreases more rapidly with age in Canada

Per cent of homeowners with mortgage (2010)



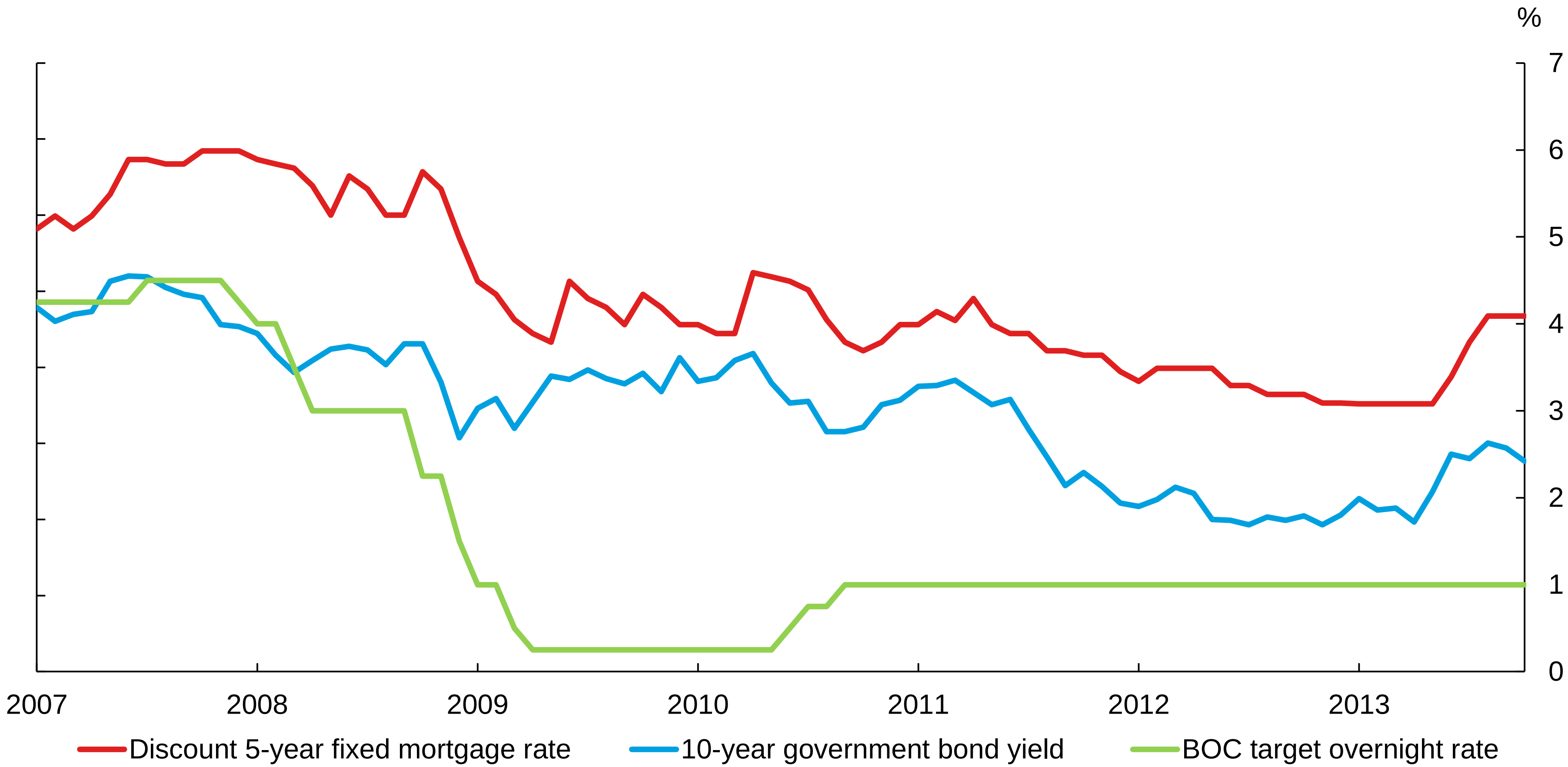
Sources: Survey of Consumer Finances and Canadian Financial Monitor

BANK OF CANADA
BANQUE DU CANADA

Policy responses (2008-2013)

BANK OF CANADA
BANQUE DU CANADA

Response to crisis: Bank of Canada lowered policy rate to "effective" lower bound



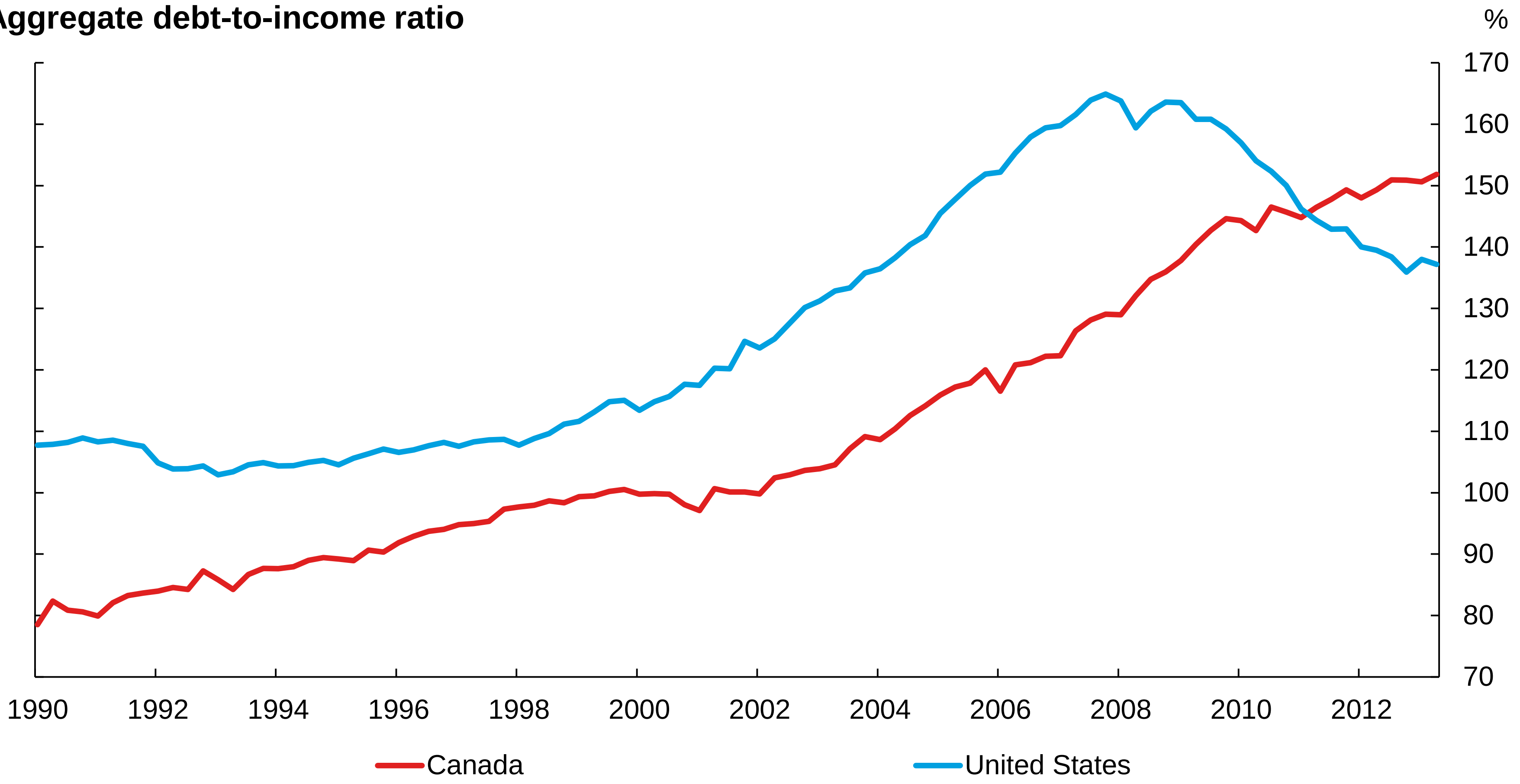
Source: Bank of Canada and ING Direct

Last observation: October 2013

BANK OF CANADA
BANQUE DU CANADA

Low interest rates stimulated domestic demand and led to higher household debt

Aggregate debt-to-income ratio



Sources: Statistics Canada (Canadian household credit market debt to disposable income ratio adjusted for U.S. concepts and definitions) and U.S. Federal Reserve

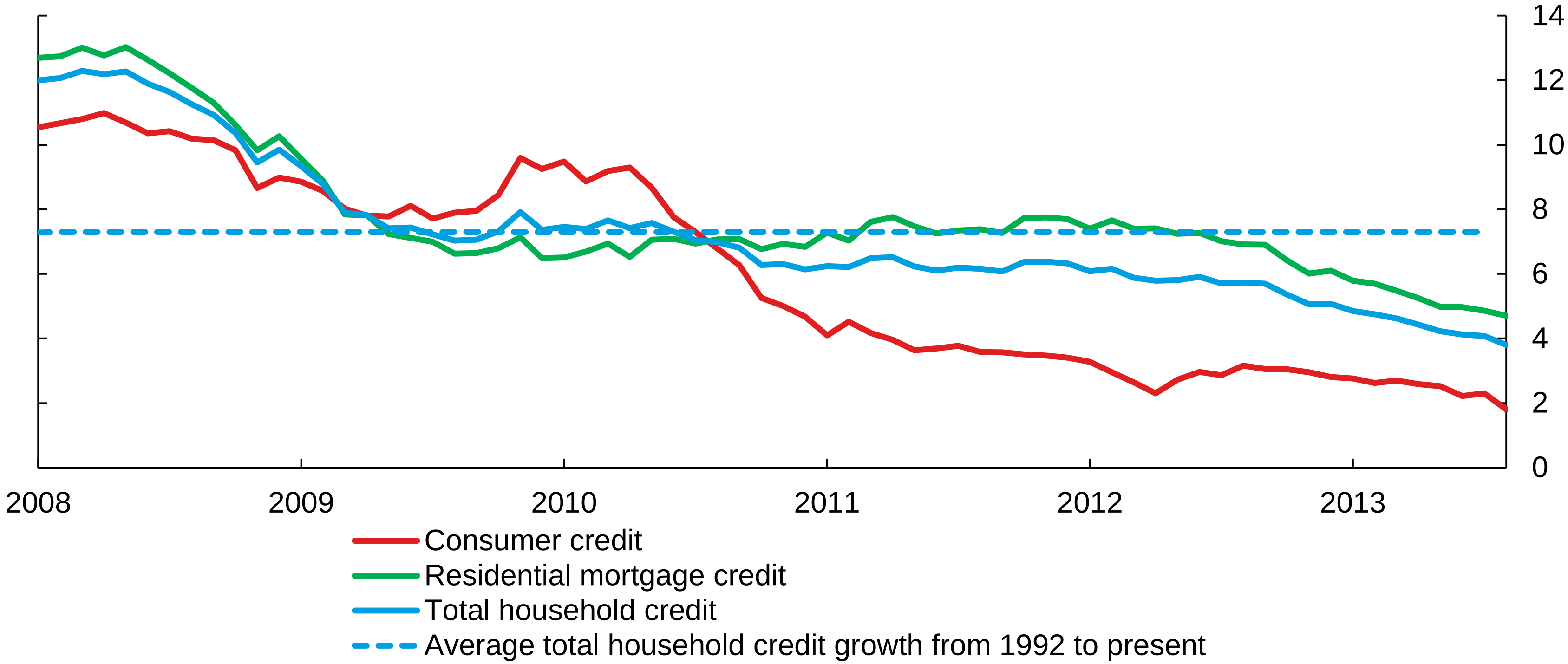
Last observation: 2013Q2

Policy actions

1. Tightened qualifying rules for mortgage insurance (2008-2012) to promote long-run stability of housing and mortgage markets
   - Maximum amortization of 25 years, and maximum LTV ratio of 95% for new purchases (reversed changes in 2006)
   - Maximum LTV ratios of 80% for mortgage refinancing and investor purchases
   - Limits on debt-service ratios
   - Minimum credit score

New mortgage rules contribute to trend decline of household credit growth

Year-over-year percentage change, monthly data



Source: Bank of Canada

Last observation: August 2013

Policy actions (Cont'd)

2. Tightened supervisory guidelines for mortgage underwriting

3. Strengthened oversight of public mortgage insurer (CMHC)

4. Public communication of risks related to household debt and the housing market