Real Estate Markets and Macroprudential Policy in Europe

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Dallas, Texas
14 November 2013

Panel on “Lessons Learnt and Implications for Policy” at the Fed Dallas/IMF/Journal of Money, Credit and Banking conference on “Housing, Stability and the Macroeconomy”

Disclaimer: Any views expressed are only the speaker’s own and should not necessarily be regarded as views of the ECB or the Eurosystem.
Introduction

• Lesson from economic history (current crisis “refresher”)
• Housing bubbles or imbalances in real estate markets often preceded systemic financial crises (overview Crowe et al. 2013)
• Potential reasons (not so well researched!?)
  • Asset that many agents in the economy possess → systemic, potentially large real effects
  • Credit financed through leveraged lenders → worse crises and downturns
  • Sluggish supply, slow price discovery and high transaction costs lead to long large swings in property prices (“illusions” in upturns)
  • Indivisibility weighs further on prices in downturns
• Area of primary attention for macroprudential policy
• Additional challenge: Social and tax policies fostering home ownership and debt/credit may go in the opposite direction
Outline

• Real estate price developments before and during the crisis
• Macroprudential regulatory instruments against real estate bubbles
• Concluding remarks
• Annex
**EU residential property price developments: “Boom-bust” countries (7)**

Levels normalised to 100 for Q1 2002

Source: ECB calculations and DataStream
EU residential property price developments: Other countries (8)

Levels normalised to 100 for Q1 2002

Source: ECB calculations and DataStream
Comparison of EU and US residential property price developments: Selected countries and states

Normalised to 100 for December 1996

Source: ECB calculations and DataStream
Share of European countries in a high- or low-growth residential property price regime

Percentage of total number of countries (13)

Source: ECB calculations, based on Corradin and Fontana (2013)
Macroprudential regulatory instruments for addressing problems in real-estate markets

• **Systemic Risk (ECB 2009)**
  • Risk that financial instability becomes so widespread that it impairs the functioning of a financial system to the point where growth and welfare suffer materially

• **Macroprudential policy**
  • Supervision: Public oversight that aims at identifying and containing systemic risks
  • Regulation: Public regulations that aim at maintaining systemic stability

• **Instruments against widespread imbalances in real-estate markets**
  • Targeting **banks**: **Sectoral capital requirements**
    • Direct: Pillar 1 – Systemic risk buffer, subsidiarity case for own funds; Pillar 2
    • Indirect: Pillar 1 or 2 – higher risk weights (RWs) or higher loss given default (LGDs)
Macroprudential regulatory instruments for addressing problems in real-estate markets (cont.)

• Instruments against widespread imbalances in real-estate markets (cont.)
  • Targeting borrowers:
    • Loan-to-value limits (LTVs)
    • Loan-to-income (LTIs), debt-to-income limits (DTIs) or debt-service-to-income limits (DTSIs)

• Memorandum item: Broader instruments against the build-up of widespread financial imbalances
  • Countercyclical capital buffer
  • Dynamic provisioning
  • Leverage ratio
  • Sectoral concentration limits
  • Balanced accounting approaches
  • Influence compensation practices
  • Maximum loan amortisation period (sectoral) risk weights
Allocation of policy competencies for macroprudential real-estate instruments in Europe

- **EU legislation (all countries)**
  - Capital Requirements Directive (CRDIV) and Capital Requirements Regulation (CRR)
  - Sectoral capital requirements, RWs, LGDs
  - Applied by the **competent or designated national supervisory authority**
  - **Single Supervisory Mechanism (SSM)**; first leg of Banking Union. At the ECB, measures can be made more restrictive (but not relaxed)

- **National legislation (countries that have it; highly “distributive”)**
  - LTVs (16 countries)
  - DTIs (6 countries), LTIs (2 countries) or payment to income limits (PTIs, 3 countries)
  - Primary purpose can also be consumer protection (3 countries), bank solvency requirements (4 countries) or link between loan and funding instrument (2 countries) → not actively changeable by macropru authority

- **Policy issues**: Active time variation (Mendicino 2012) and cross-country coordination (see common component before)
Policy effectiveness of macroprudential real-estate instruments

• General problem: Limited experience about macroprudential effectiveness or unintended side effects

• Sectoral capital requirements
  • More bank resilience, less “leaning”
  • Circumvention possible through unregulated or foreign institutions, reduction of other activities and off-balance sheet activities etc.
  • Less effective when capital in excess of regulatory minimum
  • Experience: Mixed – some effective, some ineffective cases

• LTVs, LTIs, DTIs, DSTIs
  • Direct limits to real-estate lending demand, household leverage and bank risks
  • Circumvention possible through splitting of loans or under-reporting etc.
  • Socially charged (noticeable effect on less wealthy, no borrower differentiation), sometimes governments in charge not supervisors
  • Experience: A number of effective cases, but effects can vanish over time
Concluding remarks

- Historical importance of real-estate markets for systemic crises
- Surveillance systems in place at the ECB (see e.g. FSR)
- New institutional framework for macroprudential policy in Europe is also taking shape
- Substantial work by the European Systemic Risk Board about policy instruments
- Some evidence of effectiveness, but experiences still limited
  - Are instruments strong enough? How bad are negative side effects?
  - Will they be used to “lean” (“distributive” effects, role of governments)?
  - Can/should LTVs/DTIs be made dynamic and coordinated across Europe?
- Role of monetary policy? Other policies?
- At present the priority in the (whole) EU is to recover from the crisis
- But a few countries already have high or rising property prices
References 1

- Campbell, Ramadorai and Ranish (2012), How do regulators influence mortgage risk? Evidence from an emerging market, mimeo., Harvard University
- Duca, Muellbauer and Murphy (2011), House prices and credit constraints: Making sense of the U.S. experience, Economic Journal
- European Central Bank (2009), The concept of systemic risk, Financial Stability Review, December
- Hall, Psadarakis and Sola (1997), Switching error-correction models for house prices in the United Kingdom, Economic Modelling
References 2

- Mendicino (2012), Collateral requirements: Macroeconomic fluctuations and macroprudential policy, Banco de Portugal Working paper, no. 1211
- Oxford Economics (2009), Developing analytical methods for the identification of imbalances and risks in the EU housing markets, Final Report, September
Annex
EU residential property price developments: All countries in the sample (15)
Levels rates normalised to 100 for Q1 2002

Source: ECB calculations and DataStream
Share of European countries with house prices persistently above fundamental-based values

Percentage of total number of countries (13)

Source: ECB calculations, based on Corradin and Fontana (2013)
European countries in a high- or low-growth residential property price regime

High-growth red and low-growth blue

Source: ECB calculations, based on Corradin and Fontana (2013)
EU commercial property price developments: 14 countries

Levels rates normalised to 100 for Q1 2002

Source: Jones Lang LaSalle
EU commercial property price developments: “Boom-bust” countries (12)

Levels rates normalised to 100 for Q1 2002

Source: Jones Lang LaSalle
EU commercial property price developments: Other countries (6)

Levels rates normalised to 100 for Q1 2002

Source: Jones Lang LaSalle
# Likely designated macroprudential authorities in EU countries and their real-estate instruments

<table>
<thead>
<tr>
<th>(Likely) Designated authority (main one)</th>
<th>Austria</th>
<th>Belgium</th>
<th>Bulgaria</th>
<th>Croatia</th>
<th>Cyprus</th>
<th>Czec Republic</th>
<th>Denmark</th>
<th>Estonia</th>
<th>Finland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Market Authority</td>
<td>National Bank of Belgium</td>
<td>Bulgarian National Bank</td>
<td>New macroprudential body</td>
<td>N.A.</td>
<td>Czech National Bank</td>
<td>The Minister of Business and Growth</td>
<td>Eesti Pank</td>
<td>Financial Supervisory Authority</td>
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</tr>
</tbody>
</table>

## Instruments

<table>
<thead>
<tr>
<th>European legislation</th>
<th>Sectoral capital requirements, risk weights, losses given default</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>National legislation</th>
<th>None</th>
<th>Government responsible for LTV, DTI</th>
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<th>To be defined</th>
<th>N.A.</th>
<th>Any useful instrument</th>
<th>None</th>
<th>To be defined (maybe LTV)</th>
</tr>
</thead>
</table>

Source: Unpublished results of ESRB survey on macroprudential instruments (August 2013)
## Likely designated macroprudential authorities in EU countries and their real-estate instruments

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<th>European legislation</th>
<th>Instruments</th>
<th>National legislation</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>Haut Conseil de Stabilite Financiere</td>
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<td>LTV, LTI/DTI, loan rates and maturity</td>
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<tr>
<td>Germany</td>
<td>Federal Financial Supervisory Authority</td>
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<td>LTV, PTI, deposit coverage ratio, balance-sheet coverage ratio, FX funding adequacy ratio</td>
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<td>Greece</td>
<td>Bank of Greece</td>
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<td>Hungary</td>
<td>Magyar Nemzeti Bank</td>
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<td></td>
<td>To be defined</td>
</tr>
<tr>
<td>Ireland</td>
<td>Central Bank of Ireland</td>
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<td>To be defined</td>
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<tr>
<td>Italy</td>
<td>Banca di Italia</td>
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<tr>
<td>Latvia</td>
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<td>To be defined</td>
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<tr>
<td>Lithuania</td>
<td>Bank of Lithuania Systemic Risk Council*</td>
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<td>Luxembourg</td>
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<td>Malta</td>
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<td></td>
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* composed of the Ministry of Finance, BCL, CSSF and the Commissariat aux Assurances

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<tr>
<td>Netherlands</td>
<td>De Nederlandsche Bank</td>
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<tr>
<td>Poland</td>
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<td>Portugal</td>
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<td>Romania</td>
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<tr>
<td>Slovakia</td>
<td>National Bank of Slovakia</td>
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<td>Any useful instrument</td>
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<td>Slovenia</td>
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<tr>
<td>Spain</td>
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<td>Sweden</td>
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<tr>
<td>United Kingdom</td>
<td>Bank of England Financial Policy Committee</td>
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<td>To be defined</td>
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</tbody>
</table>

Instruments:
- **European legislation**
  - Sectoral capital requirements, risk weights, losses given default
- **National legislation**
  - None
  - None
  - Any useful instrument
  - To be defined
  - Any useful instrument
  - To be defined
  - To be defined

Source: *Unpublished results of ESRB survey on macroprudential instruments (August 2013)*

* composed of NBP, Minister of Finance, FSA, Bank Guarantee Fund, the Prime Minister and the Central Statistic Office

** composed of Bank of Spain, CNMV, General Directorate for Insurance and Pension Funds, the Government
# National macroprudential real-estate instruments in the European Union 1

<table>
<thead>
<tr>
<th>Instruments</th>
<th>Austria</th>
<th>Belgium</th>
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<th>Finland</th>
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</thead>
<tbody>
<tr>
<td>Available</td>
<td>None</td>
<td>LTV, DTI</td>
<td>LTV, DTI</td>
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*Source: Unpublished results of ESRB survey on macroprudential instruments (August 2013)*
# National macroprudential real-estate instruments in the European Union 2

<table>
<thead>
<tr>
<th>Instruments</th>
<th>France</th>
<th>Germany</th>
<th>Greece</th>
<th>Hungary</th>
<th>Ireland</th>
<th>Italy</th>
<th>Latvia</th>
<th>Lithuania</th>
<th>Lux.</th>
<th>Malta</th>
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</thead>
<tbody>
<tr>
<td>Available</td>
<td>LTV, LTI, DTI, controls on loan rates and maturities (presently non-binding)</td>
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<td>Payment-to-income ratio (PTI, guideline)</td>
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Source: Unpublished results of ESRB survey on macroprudential instruments (August 2013)
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<th>Slovenia</th>
<th>Spain</th>
<th>Sweden</th>
<th>United Kingdom</th>
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</thead>
<tbody>
<tr>
<td>Available</td>
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<td>LTV, risk weight floor under pillar 2</td>
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<td>LTV</td>
<td>None</td>
<td>Dynamic provisioning</td>
<td>LTV, risk weight floor (see above)</td>
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