Industry Briefing Summary Transcript

Review of Mortgage Measures, 28 November 2018

Sharon Donnery, Deputy Governor, Central Banking: Maybe let me just make a few general comments about the outcome of the review first, echoing some of the remarks the Governor has just made at the press conference, then Rob [Robert Kelly], the plan was Rob was going to take you through a short presentation that we have which we're distributing now and which we'll also publish after this, so that you can have access to it if you want or if any of your colleagues want to look at it either. So, as you've probably heard or read in the material, if you've read it already by now, the outcome of the review this year has been no change at all in the measures themselves or in the utilisation of the exemptions or anything, so simply no change at all. I think there's a couple of reasons for that which you'll see, I think particularly in the data when Rob goes through that at the moment. But you'll know, I think, that we've been very clear about the objective of these measures; to enhance the resilience both of borrowers and banks and also to mitigate against future risk of the credit-house-price spiral emerging again into the future. And I think taking into account those objectives, so looking at kind of overall financial stability and also protecting individual borrowers, we're satisfied that the measures are working well in trying to achieve those objectives. So the work that we do each year as part of the review is really to look at the calibration of the measures. We do that by looking in a lot of detail of what's going on in the mortgage market itself. And as you know now, because I'm sure many of you are using it, we have a lot of loan by loan data on what's going on in the mortgage market and we'll talk a bit more about that in a moment and we tried to publish a wide range of that data as well so that you can look at it. We also look in quite a lot of detail at what's going on in the wider property market, wider housing market and so on and how those things are interacting. We'll talk a bit more in a few minutes about the pace of new mortgage lending, which I think while we accept is now kind of picking up and is more significant, is not kind of out of line with what you expect for how things are in the current state of the market. And we've done some work as well around modelling house prices, which shows they're broadly in line with developments in income, rents, interest rates, housing supply and so on. And as I said, these kind of destabilising credit prices feedback dynamics are not happening at this stage. I think the other thing that we've talked a little bit about today, is maybe one thing that has changed since last year, is that we made the decision during the summer also to activate the Countercyclical Capital Buffer. Again we've published a wide range of analytical work in relation to that. So, it means that in the context of the kind of overall macro-prudential framework and the tools that we have at our disposal, these LTV [loan-to-value], LTI [loan-to-income] tools, the Countercyclical Capital Buffer and also the O-SII buffer - the Other Systemically Important Institutions buffer - that the Bank has now taken action to activate all of those buffers and the Countercyclical Capital Buffer will come into effect in the summer of next year. So, I suppose in terms of the future evolution of the framework, a lot of the work that we're beginning to look at now also is how these tools kind of interact with each other. So, for example, the LTV, LTI measures are obviously targeted at new lending, so new mortgage draw downs and so on. The Countercyclical Capital Buffer is more effective in capturing risk, I suppose, in the wider stock of credit across the system, so not just targeted at new lending or particularly at residential mortgage lending. And I think a lot of our, you'll see kind of evolution of our analytical work over the last few months and into the future, will be looking at some of these particular factors.

There's a lot of material that has been published today, so I'm sure even after today maybe people will have questions or things they want to come back on too but anyway, if anybody has questions or comments or things that they want explained in a little bit more detail, please feel free to ask us now.

Briefing participant: Was there any consideration to moving to a rolling average or a quarterly compliance, versus the calendar period? If I look at the measures across Europe, a lot of them appear to have a more quarterly or rolling average in other countries in Europe.

Sharon Donnery: So, I think there's been a couple of factors in our thinking about the exemptions. The first thing is, I mean the reason why we can have some of the analysis that we have here is we have all of these data on the exemptions and we can look at exactly how the exemptions are being used, by which banks, to which category of borrowers and so on. So we have a lot of information we can use for understanding it all. Because we're also the supervisory authority as well as the macro-prudential authority, we're obviously engaging with the banks all the time about how they're getting on with the use of exemptions, how close they are to the limits and so on and that's part of Triona's [Triona Forde] work in banking supervision. So, I suppose I would say we're well aware of the issues about the exemptions and we're in dialogue with the banks about them. I think in terms of whether we would change them or not, we felt that the exemptions, I mean they're pretty generous in terms of what's there for the banks to use, and we feel that because of that, they give enough flexibility for the banks to be kind of able to plan prudently. We also think, I think, that a factor this year in the utilisation of the exemptions was the change that we made last year and maybe some, not necessarily all, but some of the banks maybe hadn't kind of carried over in terms of planning that as best they could into this year. So, we're hoping, I suppose, that the stability particularly that 'no changes' brings this year, including no changes to the exemptions or anything like that, will allow the banks the space to kind of manage the exemptions in the best way possible. I don't know if you want to add anything, Triona.

Triona Forde, Risk Analysis, Banking Supervision, Central Bank: I think maybe it's important to say that the exemptions or the allowance shouldn't be seen by the banks as a target. So, it is leeway, so they don't have to be aiming for the 20%, 10%, that they can freely work at 1, 2 or 5%. So, we don't see it as something that they're aiming to get close to. They can manage their book within that framework as well.

Sharon Donnery: Yes, thanks.

Briefing participant: And just on your last point, just to follow up, the month's notice last year, I mean if you get the circumstance where you're making change again, do you think a month is sufficient time, given that the mortgage market in particular has a very long tail, when somebody gets approval to actually draw down. Is a month long enough in that?

Sharon Donnery: So, I think this issue to be honest is a little bit challenging for us in the sense that we also need enough data on what's been happening so far this year to really be able to inform the decision. And, you know, we have to make that judgement call at a point in time and that means there's a lead in time for the banks. I mean we could think about changing the lead in time. I think that also raises questions about things like the mechanics of the reporting framework and when banks report to us. Also the kind of ebb and flow of the market, which as everybody knows, transactions have a certain kind of rhythm to when transactions happen in the market. So, to be honest, I think it's a bit of a balancing act and I think we feel on balance, taking into account all those factors, but particularly so that we have enough information to kind of make an informed decision, that we have it about right. I don't know if you want to add anything?

Robert Kelly, Head of Macro Financial Division, Central Bank: I think that's the main point and the other thing to note is there's a lot of focus on 2018 because of the change with the first-time borrower. But if you look at 2017, it was almost 25% in each quarter. So, there wasn't really an operational difficulty and I would be slow to say, if you move to a quarterly one, we're then kind of trying to manage the demand for mortgages. Maybe the demand isn't uniform across the year and there is a role here for banks to manage their own book. We have to be careful to get that balance between, operationalise as best we can, with allowing the banks to manage their own book. This is a well thought out process within banks, how they manage this flow. And if we go to a rolling window, banks can implement that currently if they wish, we don't say, it's just you have to be compliant at one point in the year.

Briefing participant: Have you any evidence where borrowers are applying to multiple banks for exceptions and its impact on trying to manage exceptions?

Sharon Donnery: In terms of actually making mortgage applications as opposed to actual draw downs?

Briefing participant: Like a borrower who goes direct typically, will go to several banks to try and get exemptions. They get two or three, they hold onto them, don't tell the bank and others could lose out. Is there any evidence of….

Sharon Donnery: I don't know if Triona wants to say something about that. So, we do talk to the banks, I suppose, about that although we're not formally collecting through the CCR [Central Credit Register] or anything.

Briefing participant: Bank of Ireland wouldn't know that the AIB have an exemption for….

Triona Forde: But they will know from the last three years that, you know, what their conversion rate is, so what the conversion rate is of someone who gets an exception versus someone who doesn't. So, we are expecting them to have that built into their operational processes.

Sharon Donnery: So, they have the data, I mean we're not collecting data on that particular aspect, but they have the data, yeah. Thanks.

Briefing participant: I work in a residential agency, and I think a number of the people here today do, and certainly this year we noticed much more acutely than say last year that all our activities seem to be frontloaded to the first six months, which would mean the first six months, apart from March which weather-wise was a disaster. We came back after summer break, expecting business as usual and it was almost like somebody had turned off the lights, because it seemed to us, correctly or not, that all the banks had front loaded the issuing of these exemption loans and then when people were looking to get the mortgages and avail of those in the autumn, they just weren't there. And so the change in transaction levels, and certainly among the big firms, was dramatic I'd say.

Sharon Donnery: The first thing I would say is that part of it is about exemptions, of course, but there's lots of other activity that's happening in the market that is not dependent on exemptions. So there are other transactions going through that don't necessarily require an exemption. The other thing is, I think, I mean we can't talk about individual institutions, but I think I can say that what we see is different across individual institutions. So I don't think it's fair to interpret either that all the institutions are having the same, the exact same challenges in terms of dealing with the exemptions. I mean there's been media commentary I think about some particular institutions, but it's not the case that it's universal across the entire system, that they're all having the same types of problems in terms of how they manage them. So for me I think there are differences in how that's playing out across the individual banks and as I said that's only in relation to the exemptions. It doesn't affect the kind of wider bulk of mortgages which happens without the exemption. Do you want to say something?

Triona Forde: I suppose we would see a trend that would suggest otherwise in previous years. While we don't have the full granular level detail for the rest of this year, I would be very surprised if that was the case. It goes back to Sharon's point that a lot of transactions are below the regulations. And we don't see any evidence to maybe … I agree with what you're saying, there but then we don't have the full data set yet.

Sharon Donnery: And as always with the data, we will in due course publish all the data as well so that everybody … I mean these charts that Rob has shown here today, the ones with the distributions and so on, we publish them periodically in Financial Stability Notes, so everybody would be able to see the kind of exemptions that were granted and so on in the end. Yes?

Briefing participant: Could I perhaps just make a comment rather than a question. I think what was alluded to is very evident in Dublin and maybe if you look at the data, separate Dublin from the rest of the country, there's two very, very different trends. We have … we have data coming from all over the country. Outside of Dublin the market is functioning relatively normally. Within Dublin, where I think the exceptions were required because of the value of properties, there is a distinct slow down and this year. It wouldn't have been evident last year because the market was more sustained, but it was really felt this year, so that point that was raised earlier about the rolling annual would be impactful perhaps.

Sharon Donnery: Okay, well we'll certainly look at the exemptions and how they turn out Dublin when, as Triona says, we have the full data set. Thanks.

Briefing participant: Can I ask on the new mortgage lending to disposable income, it's easier to say that than the acronym. How does the level of interest rates calibrated on your dotted line there, because obviously we're at a low point in the ECB [European Central bank] cycle. So if that begins to move up one would have to assume that it puts pressure on the moving bar, if you like, the moving line?

Martin O'Brien, Head of Macro-Prudential Policy, Central Bank: The interest rate though that's included in that model is basically a very, very long-term average of long-term interest rates. So, there is certainly scope for interest rates to increase beyond and above. So, it's basically above the very current level of low interest rates.

Briefing participant: Can I ask about this chart as well? When we were here last time, it was mentioned that the number mortgage loans last year was the lowest number since 1987, so it seemed a little bit strange that the original working paper concluded that new mortgage lending was actually at its structural economic value. So that message has changed slightly today, and it looks like about 20% below. But even if you took that 20%, it would still suggest, if all of that went on volume, it would still be the lowest level of mortgage lending since the early 1990s. So, you know, I think investors looking at that kind of conclusion would say, you know, maybe the scope for the mortgage market to grow is limited. And I think we need to remember the original paper, the actual structural economic value itself showed extraordinary volatility. You might even say it's quite cyclical. So, the point you made about kind of being in general equilibrium framework where things like demography and so forth, kind of affect the structural economic value, needs to be kind of underlined.

Robert Kelly: I completely agree. It's baked into that actual ratio though, right? The long-term value, the dotted line is independent of that point. If both disposable income and mortgages grow at the same pace, that ratio won't move.

Briefing participant: Yeah, but I don't think that's the point. So, if you take, I suppose the point I've made here that people say, sort of, the rate of the turnover rates here of 5%, is well below that. So that conceivably the number of mortgages in the economy could kind of double over the next five, six years to get back to that kind of equilibrium and, you know, obviously this ratio conflates valuation and transaction volumes. So, you know, I think there was quite a mixed message at this meeting last time round. We currently have just around 31,000 mortgages. If that went to 36, 37,000, which would be equivalent to 8%, I think that would still be quite a low turnover rate compared to the past, compared to the UK and, you know…you can make these comparisons versus Europe but, you know, there's very different structural housing market there and where obviously home ownership is lower and it is hard compare…the demographics in Europe are also very different for a lot of countries. So, I think of the kind of population growth figures, and the household information figures, what kind of liquidity amongst existing stock of mortgage holders you'd normally expect, you know, I just think are we tying ourselves up in knots slightly here with this ratio which we know in the original paper moves around enormously itself over time. Or if that's at least how I can interpret it?

Martin O'Brien: Well I think the structural estimate as is represented there in the line is … did move around quite a bit, it does move around quite a bit, but that's what the long-term average of it is there. I think the factors around Europe, you're quite right, and there's nothing in the paper and there's nothing in what we've discussed here today that says anything about the number of mortgages. And there is certainly scope for the number of mortgages to increase and one would expect it to increase as turnover rates increase, as housing supply increases. But what this actually reflects is the total value of mortgage lending in the economy. So, I don't think that there's necessarily any differences in terms of what the perspective is here. There is certainly scope for further increases in both the volume and in the value of mortgage lending and in a general equilibrium perspective as Rob has mentioned. The key thing here is increase in housing supply and as increase housing supply, it has a moderating impact in terms of house price growth, it has a supportive impact in terms of disposable income growth and so that should feed through in terms of mortgage demand and average value of mortgage demand as well. So, putting all these things in together, there is certainly, from this perspective looking at the developments in the market, looking at what would be the long-term structural features, given things like demographics, given things like long-term interest rates, what we would consider as being a structural determinant of the level of activity in terms of the value of mortgage lending in the economy.

Sharon Donnery: I think as well in general terms we would say, I mean, I think everybody, particularly at this table, knows there's a huge amount of complexity going on, both in the housing market itself, what's determining prices, what's going on from a credit point of view as well. And so we do all this range of analysis, you know, there are pros and cons with different approaches and different aspects of that analysis. No one particular thing that has been said here today is the key thing that's used to determine this. It's really about looking in the round at all these range of factors and trying to understand how they interact together overall and also, I think going back to Martin's last chart, in terms of the tools that we have to interact with all of what's going on, what are the objectives of those tools and how do they work and how are they best calibrated, taking into account all of the things that we look at.

Briefing participant: There is maybe a point though, to generalise, that the measures in terms of the objectives, the objectives are very general. And then there is a risk when something like the mortgage ratio is introduced, that people focus in on it as the measure and 8% becomes the goal. In much the same way as, you know, Central Bank will talk about price stability and then will operationalise that in some way, there isn't that operationalised sort of element in this and it's just a risk that over time, as these things shift, because of the nature of the economy, that people will get hung up on one other element of it. For example, you know, if the LTIs, you know, how much of the distribution moves, you know, where does that become a risk of … because most of these are sort of very much ex-post sort of elements rather than ex-ant,e so I think maybe it's a case of we're at the early stages of a learning path, you know, with these elements of it, but it would be helpful to have a little more understanding of maybe what might be a concern ratio on that or where might that …

Martin O'Brien: So, I think this is a general point with macro-prudential policy everywhere. That we don't have a single, unitary objective of inflation of close to but below 2%. It's a much more of a multilateral, sort of, multifaceted perspective. So, as Sharon has mentioned, no decision is ever hooked on one particular indicator. What we attempt to do in terms of our wider communications is to think about - and we've done this in terms of presenting different heat maps of indicators - looking at how things sort of look at in a holistic perspective and that is really the kind of thing that will inform decision making as it gets … And obviously judgement, in terms of, will feature heavily there too. So, there is no one single indicator anybody, anywhere can think about with respect to the overall financial stability objective, because it's multifaceted and this is a feature not just here but also across Europe as well as well our European framework has been evolving too.

Sharon Donnery: I think as well, I mean part of the reason for having sessions like this, for publishing as much work as we do and for having the other engagements that we have is also to hear other perspectives like this, to factor those into our thinking in terms of how we do further work on this particular indicator or any other as well. So I mean from that point of view I think raising those issues with us, we also appreciate from that perspective.

Any other comments or questions? I'm conscious it's a lot to digest as well so people might prefer to take it away and maybe come back to us and that's possible too.

Briefing participant: Rob, would you mind taking us through the graph 'drivers of house price growth' again please?

Robert Kelly: So, essentially what happened here, we're trying to get a feel for, you know, this is incredibly difficult to do, but get a feel for if credit is a driving factor for unexplained house price movement. So, one way of going about this, and it is just one way, is to say well if you estimate a model up to the end of 2016 and you ask that model to forecast, the forecast would inevitably be wrong, but what you can use the model to do is then try to work out what were the contributing factors for that forecast error. And that's exactly what this is through time, so the blue line here is the error, so the model would have predicted, from a distance about 2% lower house prices, let's say, and in 2017 Q3 relative to its forecast. And what we work out is, from the model, what are the contributing factors there. The red bar is new lending, the yellow bar is the cost of lending if you like and the blue bar here is changes in disposable income. The dark navy bar is the, if you like, the lag structure of house prices, so what's happening in momentum in the house-price market and the green is supply. Now, I will strictly say this is one model, these co-efficients vary, but it's like this idea of a toolbox. We're trying to get ways of thinking about - and when we travel to the ECB and you hear what other countries discuss, they're doing the very same type of thing - try to understand can we decompose, are the errors being driven by credit. We're looking for evidence that credit may be conflating the house price dynamics. And that feedback then ultimately from credit to house prices which is the other half of this which is in the paper, as far as I know.

Briefing participant: So, does that suggest then that new lending has contributed more than might have been expected, am I reading it right?

Robert Kelly: Than the model would have suggested. Lending contributes … if we take the last bar, lending is contributing, of the error it's 2%, disposable income eyeballing it, is about 2% plus, mortgage lending rates is maybe point 1 or 2 of a per cent. New lending is maybe 1.5% of that and supply is driving it down.

Briefing participant: And house price … you know, the … what it seems to be suggesting is that high house prices have led prices, sorry, that we are …

Robert Kelly: So, like momentum.

Briefing participant: The momentum seems to be negative there, it should be pulling back house price growth.

Robert Kelly: Relative to its lag structure yes, that's what that says.

Briefing participant: It just looks a little strange.

Sharon Donnery: Okay. Any final comments or questions? Okay, so I hope you enjoy reading all the materials over the next few days and as I said, if people have comments or questions on the various papers and so on, the research notes and stuff, all have corresponding author names on them, isn't that right? So, you can come back if you have anything else that you need. Okay. Thanks a lot for coming in.