



ESRB

European Systemic Risk Board

European System of Financial Supervision

ESRB assessment of vulnerabilities in the residential real estate sector and the role of prices

Should macroprudential policy target real estate prices?

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Presentation outline

1. Introduction
2. Setting the scene
3. Vulnerabilities in the EU residential real estate sector: the assessment framework
 - How were prices considered and how were they seen together with other factors
4. Results of the analysis: 8 warnings issued
5. Recent activity: examples on the role of prices in recent macroprudential actions



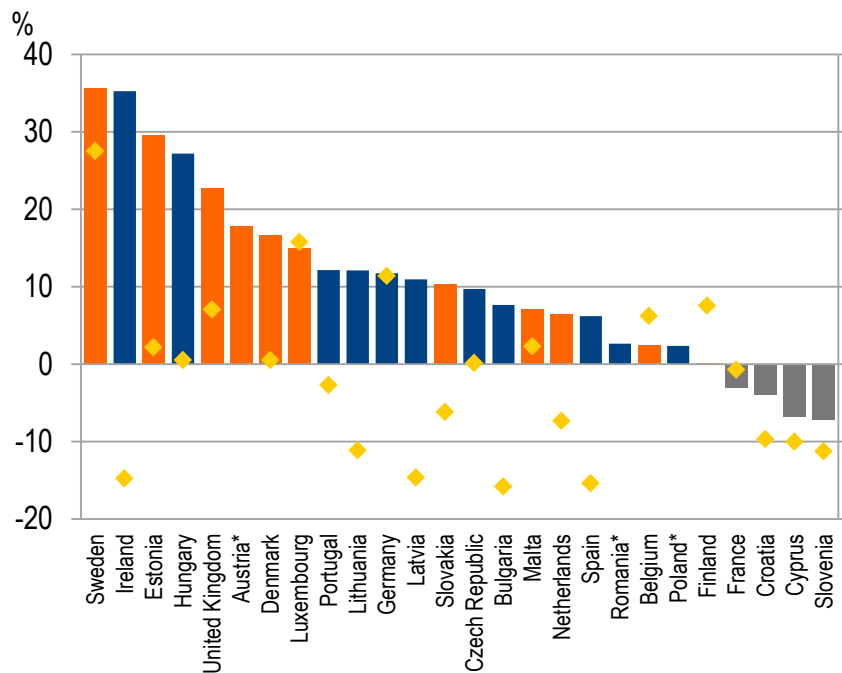
1. Introduction

- Policy discussion: Macroprudential policy reacts to changes in housing prices and also affects them, so why not make housing price growth rates a macroprudential policy target?
- Prices are important as they are a driver of indebtedness . . . but for financial stability they are not the only thing to consider:
 - Spill-overs to the financial sector comes from exposures (direct and in-direct)
 - Prices are difficult to target directly with measures
- Therefore the ESRB has taken a holistic view in our assessment of vulnerabilities in the EU residential real estate markets:
 - Prices matters
 - But so does banks' exposures and households' indebtedness



2. In past three years, residential real estate prices have increased in the majority of EU countries. In many countries, price growth has exceeded income and rent growth...

Changes of house price index (HPI),
Q1 2013 – Q1 2016



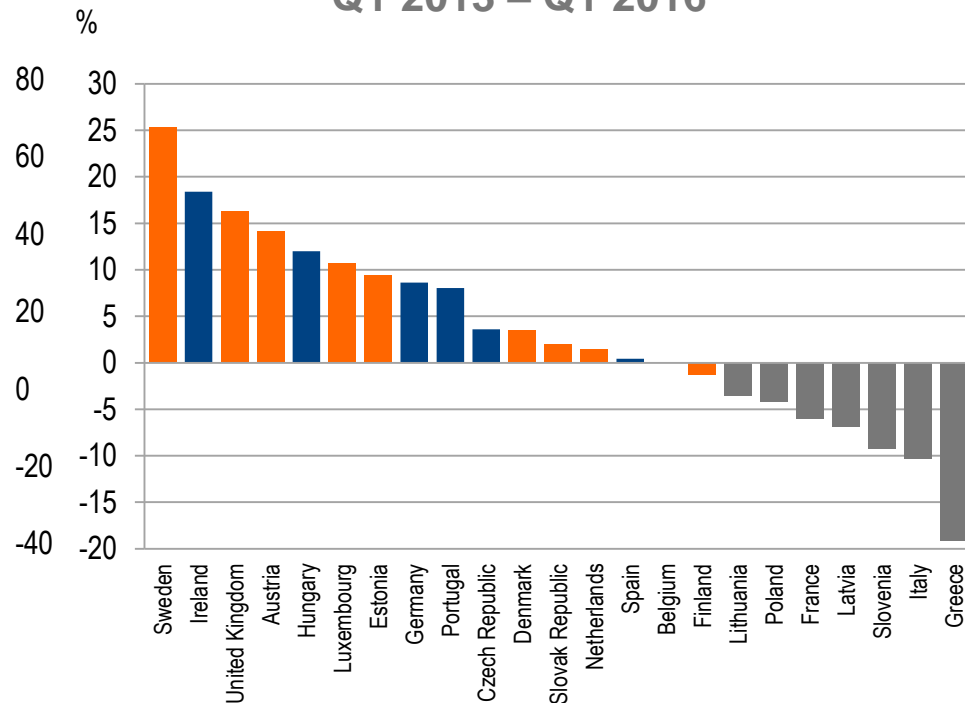
■ Change of HPI from Q1, 2013 till Q1, 2016

◆ Difference of HPI from 2008 (rhs)

Sources: Eurostat and ESRB calculations.

* no data available for HPI in 2008.

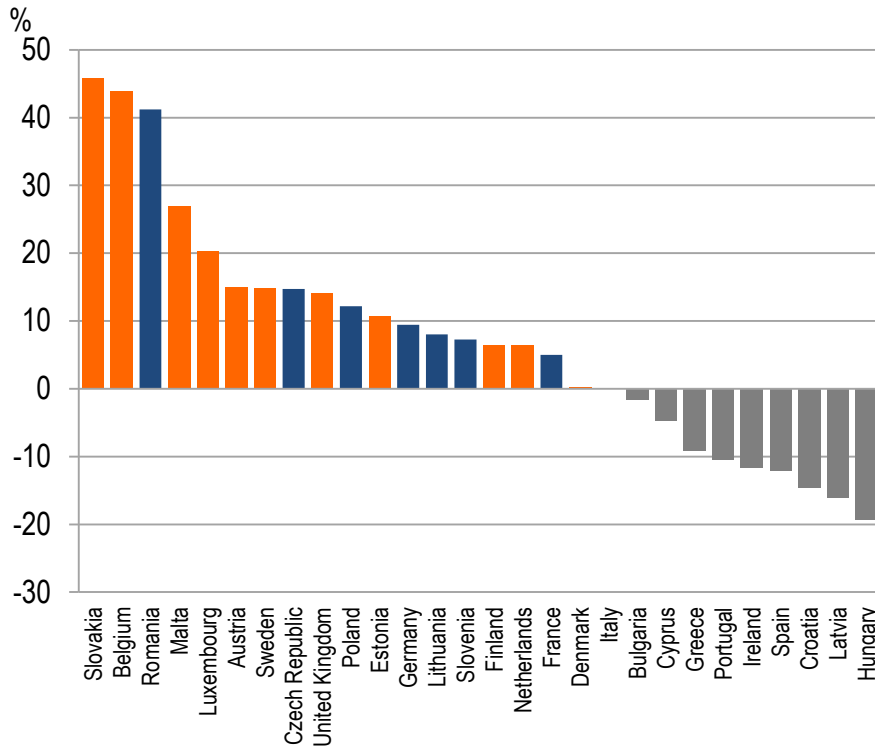
Changes of house price to income ratio,
Q1 2013 – Q1 2016



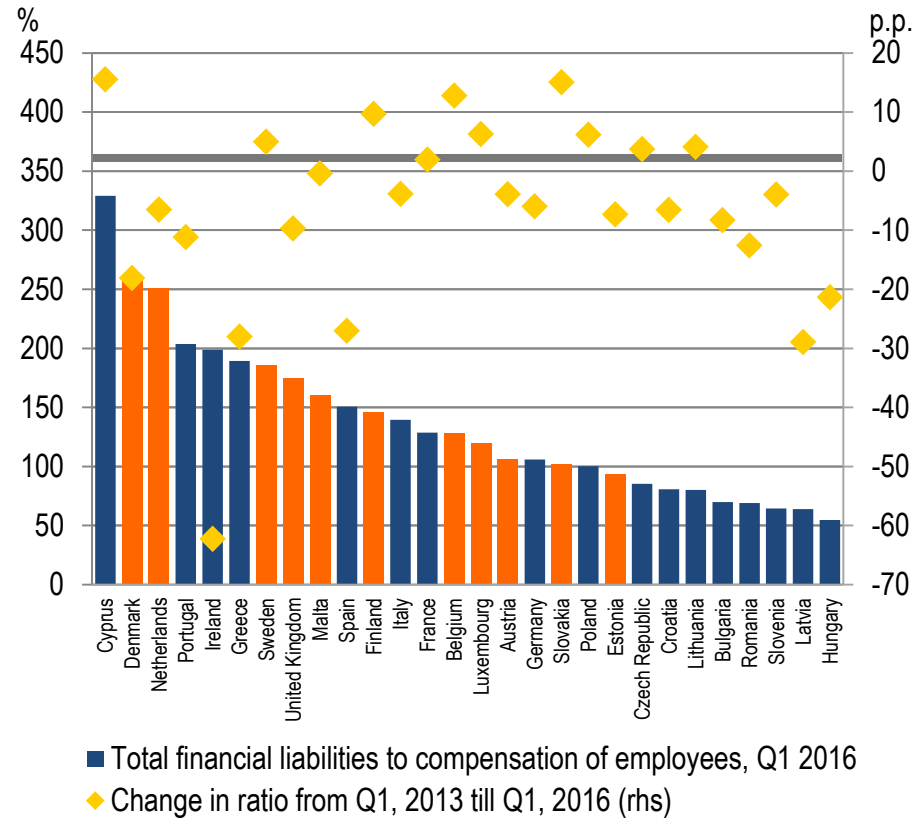
Sources: OECD and ESRB calculations.

...in some cases, these developments have been accompanied by strong mortgage credit growth and an increase in household indebtedness

Changes in stock of loans to house purchase, Q2 2013 – Q2 2016



Total financial liabilities to compensation of employees



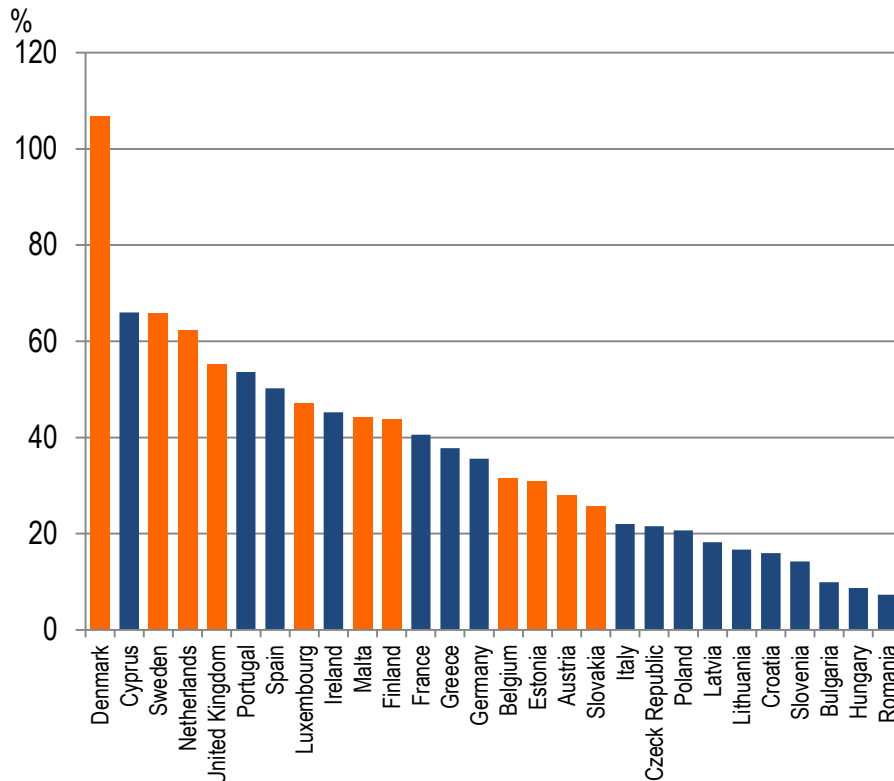
Sources: ECB SDW and ESRB calculations.

Sources: Eurostat and ESRB calculations.

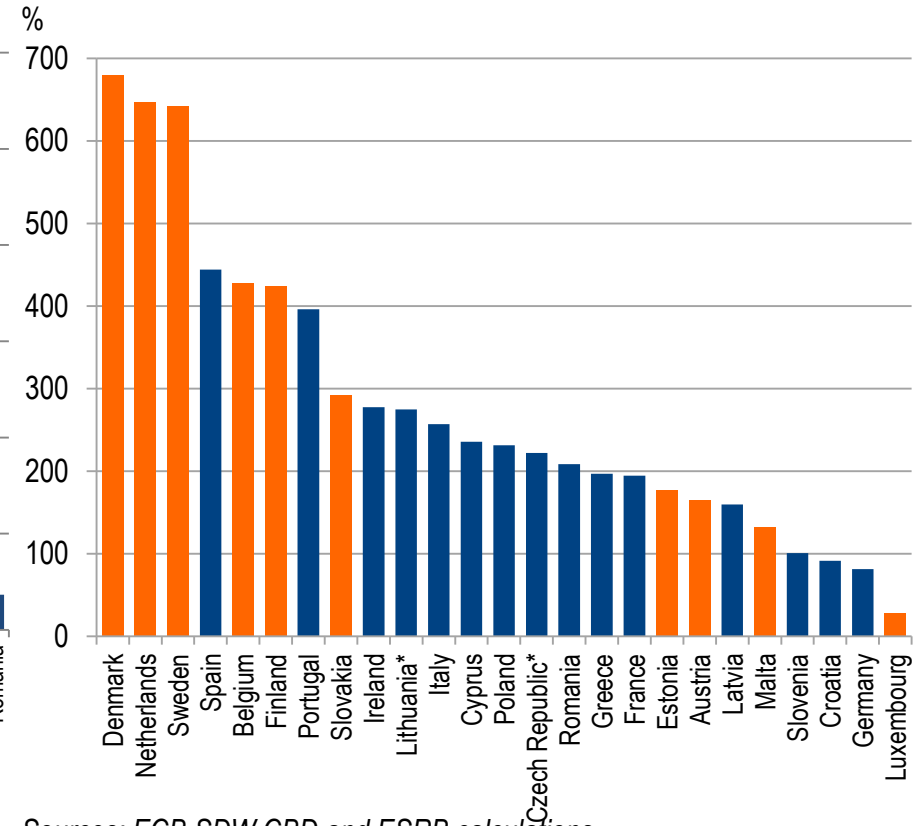


The RRE sector is highly significant for banks and the real economy in many EU countries

Credit to House Purchase (% of annual nominal GDP) – Q1, 2016



Credit for House Purchase (% of Tier1 Capital of all banks) – Q1, 2016



Sources: ECB SDW and ESRB calculations.

Sources: ECB SDW CBD and ESRB calculations.
* Q4, 2015



3. Process for identifying significant residential real estate vulnerabilities

- **Aim:** To identify RRE-related vulnerabilities across all EU countries and identify countries for further in-depth analysis
 - From a countercyclical macroprudential perspective, not focussing on risks that have already materialised (legacy issues)
 - Joint project with the ECB
- The assessment of vulnerabilities followed a two step procedure:
 1. Common risk indicators for the whole of the EU were used to short list countries for further analysis
 2. 11 countries were selected for an in-depth analysis
- The analysis takes account of developments until mid-September 2016



3. Vertical methodology – a vulnerability assessment

- Inspired by the ESRB Expert Group on RRE report (December 2015), a **three stretch approach** were applied to analyse vulnerabilities and for categorising policy measures:
 - **Household stretch**
 - **Collateral stretch (prices)**
 - **Banking stretch** } **Overall assessment**
- An organising framework to guide expert judgement. Structures help ensure consistency. Allowed for identifying ‘gaps’ between vulnerabilities and policy measures

4. Results of the assessment: the ESRB General Board decided to issue 8 warnings

- The ESRB General Board **decided** by voting in its meeting on 22 September to issue warnings on **medium-term vulnerabilities in the residential real estate sector** to the relevant ministers in the following 8 countries:
 - Austria
 - Belgium
 - Denmark
 - Finland
 - Luxembourg
 - the Netherlands
 - Sweden
 - the United Kingdom
- Further, the GB decided to make the Warnings and background analysis **public on the 28th of November**



5. Recent activity: examples on the role of prices in recent macroprudential actions

Slovakia

- The central bank of Slovakia has adopted a decree limiting the DSTI, the LTV and the maturity for housing loans (tightening of measures and transfer from recommendation into binding decree)
- The measures are motivated by the vulnerabilities related to households' abilities to repay their debt as well as rapid credit growth. Prices are not the main concern (they have been picking up since late 2014) but are one of the indicators on the basis of which the measure was activated
- The target of the decree is lending standards

Denmark

- The systemic risk council has recommended that the government restricts the flow of new 'risky' loans to borrowers in Copenhagen and Aarhus (risky loans are interest only loans and loans with variable rates where the DTI is above 400%)
- This is motivated by the continued price growth in the major cities and the following growth of indebtedness and interest rate sensitivity
- The target of the recommendation is the risky loans



5. Recent activity: examples on the role of prices in recent macroprudential actions

Norway

- The ministry of Finance adopted a new regulation on requirements for new residential mortgage loans. Covering both LTV limits, amortization requirements, and a sensitivity test (replacement and tightening of existing measures)
- The main risk to be addressed is related to credit growth and leverage of households. The measure is introduced on the basis household debt, house price inflation and Finanstilsynet's lending survey





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Background slides

6. General observations (1)

- **The ESRB assessed all Member States** and concluded that residential real estate **vulnerabilities prevail in eight Member States**. These vulnerabilities may be a source of systemic risk to financial stability in the medium-term and could potentially spill over to other Member States
- The specific nature of the vulnerabilities varies across the eight Member States. Generally, they relate to **the capacity of borrowers to repay their mortgage debt** and to the **valuation or price dynamics in residential real estate markets**
- Regarding households, vulnerabilities are related to the level of indebtedness or the growth of mortgage credit. Regarding valuation, vulnerabilities are generally related to the overvaluation of residential real estate and the rate of price growth



General observations (2)

- The ESRB has **not identified direct near-term risks arising from residential real estate exposures in the banking systems** of the warned countries, although **second-round effects are not excluded in the medium term**. Moreover, Member States have taken steps to ensure the resilience of their banking sectors, for example through the increase in bank capital requirements in recent years.
- In most of the warned countries, however, **medium-term vulnerabilities are generated by a combination of household indebtedness and price dynamics**.
- **In the remaining Member States**, a build-up of any material residential real estate **vulnerabilities has either not been identified**, or such vulnerabilities have been identified but **the current policy stance is sufficient in addressing them**



Country specific observations

Country	Key messages in warnings
Austria	The main vulnerabilities are the robust growth , particularly recently, in residential real estate prices and mortgage credit and the risk of a further loosening in lending standards .
Belgium	The main vulnerabilities are the fast increase in overall household indebtedness combined with significant groups of already highly indebted households, against the background of a significant increase in residential real estate prices over the past few years.
Denmark	the main vulnerabilities are the robustly increasing residential real estate prices – in particular in the major cities – in combination with highly indebted households . In addition, if risks were to materialise, there could be potential spill-over effects to other countries in the Nordic-Baltic region.
Finland	The main vulnerabilities are the high and increasing household indebtedness , especially among some groups of households. In addition, if risks were to materialise, there could be potential spill-over effects to other countries in the Nordic-Baltic region.



Country specific observations

Country	Key messages in warnings
Luxembourg	The main vulnerabilities are the combination of high residential real estate prices and increasing household indebtedness .
Netherlands	The main vulnerabilities are the persistently high household debt levels combined with low mortgage collateralisation . In particular, there is a large group of households , especially younger mortgagors, which have debt levels that exceed the value of their home .
Sweden	The main vulnerabilities are the rapidly growing residential real estate prices that appear to be overvalued , and high and increasing indebtedness especially among some groups of households. In addition, if risks were to materialise, there could be potential spill-over effects to other countries in the Nordic-Baltic region.
UK	There are risks under different housing market scenarios – either through the crystallisation of accumulated vulnerabilities , particularly related to household indebtedness and the interaction with elevated residential real estate prices , or through the further build-up of vulnerabilities . The appropriate policy response is likely to differ between these two scenarios. Therefore, it will be important for the UK authorities to monitor developments closely and adjust macroprudential policy as necessary in light of them.



ECB/ESRB framework for identifying vulnerabilities in RRE (joint method with the ECB) – 11 focus countries

Country	Indicators										Summary measures	
	Price Indicators				Lending Indicators			Household Balance Sheet			Average rating across indicators	Composite indicator
	Residential real estate price index, 12m growth, %	Residential price index relative to peak prior to 2014	RRE valuation measure, house price to income	RRE valuation measure, econometric model	Loans to HH for house purchases, 12m growth, %	Loans to HH for HP relative to peak prior to 2014	HH Loan spread	HH debt, % of GDP	HH financial assets to debt, %	Debt service to income ratio for HH, %		
AT	8.1	1.1	26.0	14.0	4.9	1.1	2.1	51.2	350.8	10.2	1.4	0.3
BE	6.5	1.0	26.0	4.0	8.1	1.2	1.8	59.6	500.2	10.7	1.5	0.2
BG		0.8	-9.0	-11.0	0.6	1.0	5.6	23.8	552.6	8.1	0.0	-0.9
CY	-1.6	0.7	-16.0	-3.0	-1.8	0.9	3.2	127.3	206.0	28.8	0.9	0.3
CZ		1.0	8.0	2.0	8.7	1.1		30.3	360.4	8.2	0.9	-0.1
DE	4.7	1.1	5.0	-2.0	3.7	1.1	1.9	53.4	338.1	9.4	0.8	0.1
DK	3.5	0.9	19.0	4.0	1.2	1.0	1.4	122.8	248.5	20.4	1.5	0.6
EE	0.8	0.9	8.0	-7.0	4.6	1.0	2.3	40.6	270.4	7.6	0.4	-0.2
ES	6.3	0.7	-6.0	5.0	-3.5	0.8	1.9	66.4	275.8	12.9	0.5	-0.1
FI	-0.1	1.0	10.0	3.0	2.6	1.0	1.4	66.7	210.9	11.4	1.4	0.2
FR	0.3	0.9	14.0	4.0	3.2	1.0	1.7	56.5	394.1	10.0	1.0	0.0
GB	8.7	1.0	30.0	11.0	4.6	1.1		87.0	372.9	18.4	1.7	0.6
GR	-5.0	0.6	-25.0	-5.0	-3.6	0.8	2.7	61.8	218.3	21.8	0.7	-0.2
HR	-2.1	0.8	-11.0	-16.0	-4.8	0.8	4.4	36.9	302.7	8.8	0.0	-0.6
HU	4.3	0.9	-7.0	-15.0	-3.3	0.6	4.6	21.2	563.5	7.6	0.1	-0.9
IE	7.4	0.7	-3.0	-23.0	-4.2	0.6	3.4	57.8	237.3	19.9	0.7	-0.4
IT	-1.2	0.8		-5.0	0.9	1.0	1.6	42.1	581.5	11.8	0.3	-0.3
LT	10.5	0.7	-3.0	0.0	6.6	1.0	1.9	22.3	414.2	5.1	0.6	-0.4
LU	4.5	1.1	18.0	9.0	7.0	1.2	1.7	57.4	242.1	10.8	1.7	0.4
LV	7.4	0.7	-6.0	-19.0	-2.2	0.7	3.3	24.3	430.8	5.7	0.2	-0.8
MT	10.0	1.1	10.0	-9.0	7.9	1.2	2.3	57.8	462.8	12.8	1.6	0.1
NL	4.4	0.9	-4.0	2.0	6.2	1.1	2.8	111.4	296.7	21.5	0.9	0.3
PL	1.8	0.9	-9.0	-17.0	0.7	1.1	1.4	36.2	268.6	13.4	0.5	-0.2
PT	5.0	0.9	-9.0	-3.0	-3.5	0.8	2.0	76.3	269.5	16.4	0.6	0.0
RO	3.6	0.7	-20.0	-29.0	16.5	1.3	2.8	17.2	414.6	6.5	0.6	-0.6
SE	12.9	1.3	69.0	47.0	8.7	1.1		84.7	333.4	16.0	2.2	1.2
SI	0.8	0.8	-10.0	-8.0	3.2	1.0	2.0	27.5	367.4	5.8	0.1	-0.4
SK	1.0	0.8	-6.0	-15.0	13.8	1.3	2.3	35.8	213.9	10.0	1.0	-0.1
EAA	2.4	1.0	5.0	-1.0	2.1	1.0		59.3	356.1		0.5	0.0
EAM	4.5	0.9	-3.0	-3.0	3.2	1.0	2.0	57.4	296.7	10.8	0.8	0.0
EUA		1.0									1.0	0.4
EUM	4.4	0.9	-3.0	-3.0	3.2	1.0	2.1	54.9	335.8	10.8	0.8	-0.1
T1	4.0	0.9	2.5	2.5	5.0	1.0	1.5	50.0	220.0	10.0	1.0	0.0
T2	6.5	1.0	5.0	5.0	7.5	1.1	1.8	70.0	240.0	15.0	1.2	0.2
T3	9.0	1.1	7.5	7.5	10.0	1.2	2.0	90.0	260.0	20.0	1.7	0.5
TR	4.0	0.9	2.5	2.5	5.0	1.0	2.0	50.0	260.0	10.0		

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