



# Macro-prudential policy

Slides to accompany aide memoire for Minister of Finance on Macro-Prudential Policy and Consultation Results





# Outline

1. **Macro-Prudential Policy**
  - Macro-prudential policy objectives
  - Policy instruments
  - Implementation
  - Governance and accountability
  - Points raised in the submission process
  
2. **RBNZ perspective on housing**



# Objectives

- Macro-prudential policy aims to promote financial stability by:
  - *building additional resilience in the financial system during periods of rapid credit growth and rising leverage or abundant liquidity; and*
  - *dampening excessive growth in credit and asset prices.*



# Policy instruments

|                          |                                                                                                                                                      |                                                                                                                                                                                                                                                                                           |
|--------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>System-wide tools</b> | <b>Core funding ratio</b><br><br>Greater use of stable funding e.g. deposits, long-term wholesale funding                                            | <b>Counter-cyclical capital buffer</b><br><br>Extra capital required against total lending book                                                                                                                                                                                           |
| <b>Targeted tools</b>    | <b>Sectoral capital requirements</b><br><br>Extra capital required against lending to risky sector(s) e.g. housing, commercial property, agriculture | <b>Housing loan-to-value restrictions</b><br><br>Option 1<br>- outright caps <br><br>Option 2<br>- speed limits  |



# Implementation

- Tools used temporarily to manage extremes of credit cycle
- Tools need to be used early enough to build buffers/lean against cycle
- Could be a single tool or a mix of tools
- Instruments are not monetary policy tools
  - But likely to support the Official Cash Rate
- All tools have costs and risks as well as benefits
  - efficiency, disintermediation and avoidance



# Governance and accountability

- Memorandum of Understanding between Governor and Minister of Finance
- Consultation with Minister ahead of decision
- Final decisions would rest with Reserve Bank
- Financial Stability Report – will be key accountability document



# Memorandum of Understanding

- Defines the objectives of macro-prudential policy
- Lists the agreed macro-prudential instruments
- Sets out the Reserve Bank's powers and governance/accountability mechanisms (as per the Reserve Bank Act)



# Submissions (1)

- Submissions generally supportive of proposed objectives but a few asked ...
  - Could the tools be used more actively to assist other policy goals e.g. monetary policy, exchange rate management, housing affordability?
  - Is existing prudential regulation not sufficient?
- RBNZ Response:
  - Macro-prudential tools may assist monetary policy but not as powerful as OCR
  - Tools intended to bolster existing prudential regulation during extremes in credit and asset price cycles



# Submissions (2)

- Much of the focus was on LVR restrictions:
  - Concern about 1<sup>st</sup> home buyers, SMEs, Christchurch rebuild, Welcome Home Loans
  - Could LVRs be applied with exemptions?
  - Could LVRs be applied regionally?
  - Risks of disintermediation were noted
- RBNZ response:
  - Policy focus is on high-risk borrowing – 1<sup>st</sup> home buyers are a big driver of Auckland market
  - Exemptions or regional use would be practically difficult and would increase risk of avoidance
    - But there is a government policy case for exempting Welcome Home Loans
  - Disintermediation risk can be mitigated by temporary use of LVRs
    - Might still need to contemplate extension beyond the banks



# Submissions (3)

- Feedback on effectiveness of tools
  - LVRs likely to be better for dampening credit cycle but costly (eg in terms of fairness, disintermediation)
    - Costs would be mitigated under “speed limit” approach
  - Other macro-prudential tools:
    - some banks might opt to run down existing funding or capital buffers if these exceed the requirement
    - impact on lending/pricing will depend on a range of levers, including competition considerations, state of funding and capital markets, banks’ internal policies and targets
- RBNZ response:
  - Instrument choice/calibration will need to consider many factors, including banks’ balance sheets and market conditions
  - Capital and funding tools may be more effective in building resilience than dampening credit cycle
  - Instrument choice will balance effectiveness and cost/risk considerations



# Submissions (4)

- Clarity sought on the risk indicators used to guide macro-prudential policy
- Mixed views on proposed notice periods
- A few submitters proposed other tools
  - *Debt service ratios, mortgage interest levies*
- RBNZ response:
  - We will continue to publish guidance on our macro-prudential indicators
  - Notice periods balance need to be timely and avoid pre-emptive borrowing behaviour
  - Other instruments may be considered in future



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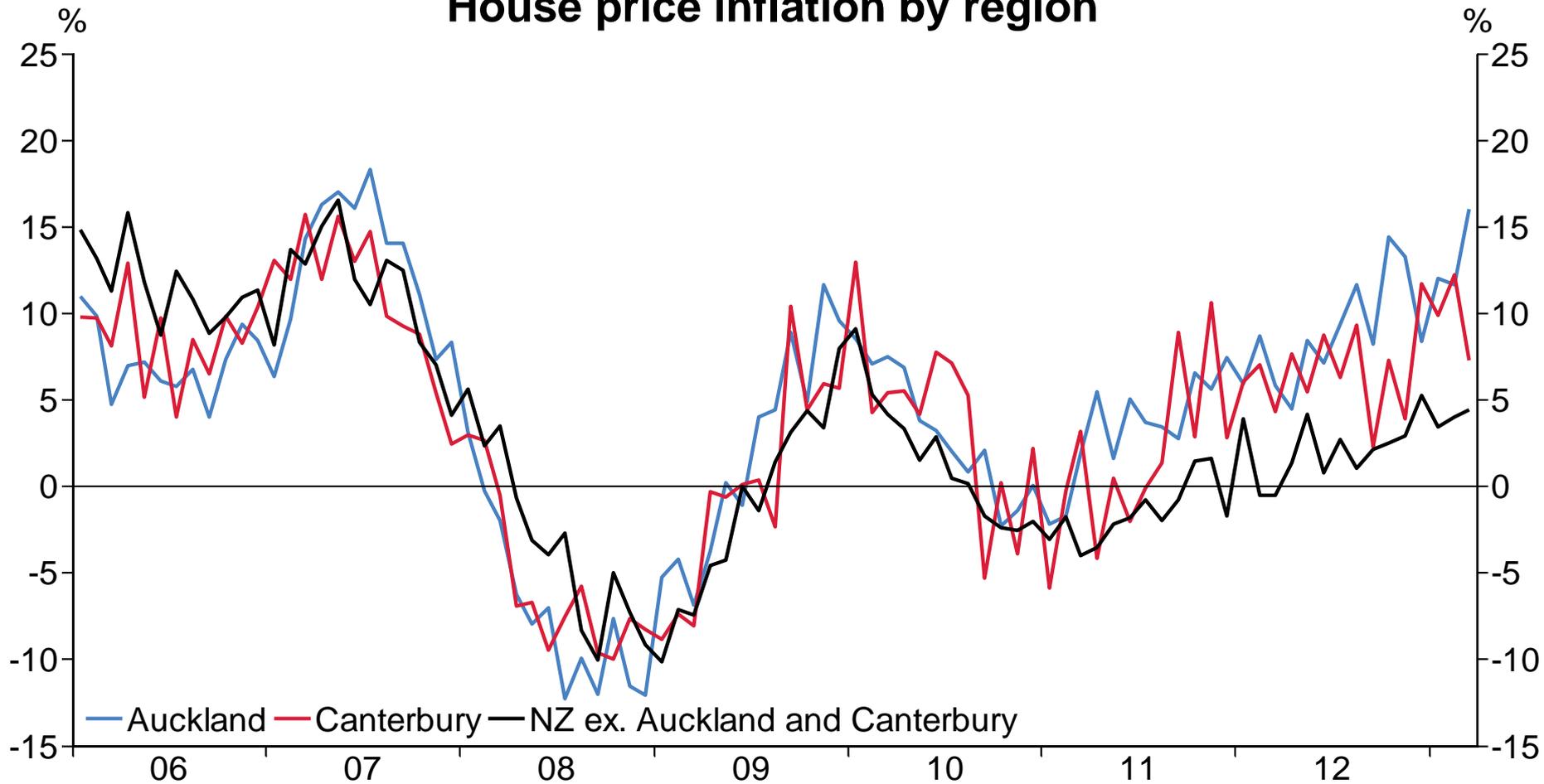
# RBNZ perspective on housing

- Significant risks are building in the housing market
- Household leverage remains near historic highs
- Supply will be key to long-term solution
- But near-term risks cannot be ignored

# House prices rising, led by Auckland and Christchurch



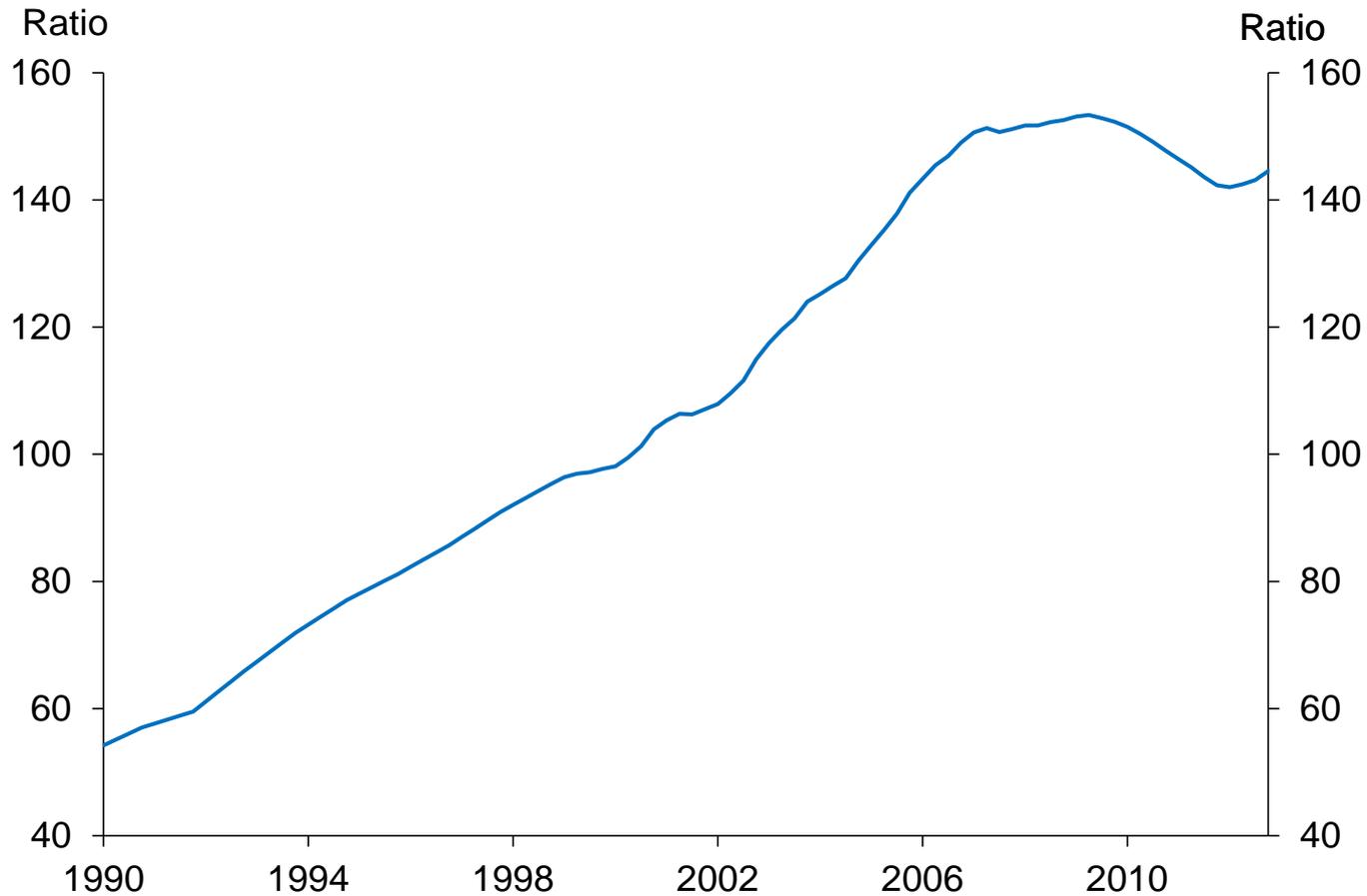
## House price inflation by region





# Households still highly leveraged despite post GFC correction

## Household debt to income





# Supply response key to long-term solution

Supply responses include:

- Freeing up land for subdivision
- Reducing time and cost of development
- Improving productivity of building sector



# But near term risks cannot be ignored

## Potential Reserve Bank policy levers

- Prudential
  - Increase baseline capital requirements for high-LVR housing lending
  - Temporary macro-prudential tightening to moderate credit
- Monetary policy
  - Tightening more likely if housing boosts consumption