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Mortgage measures framework review: Focus on the calibration decision

October 2022

Objectives of the measures

The measures aim to ensure sustainable lending standards in the mortgage market.

In doing so, the measures:

- Prevent the emergence of an unsustainable relationship between credit and house prices;
- Support the resilience of borrowers, lenders and the broader economy.

Like all policy interventions, the measures entail both benefits and costs for society.

- The Central Bank seeks to balance these carefully. We do not aim for resilience at any cost.

The mortgage measures:

- Do not aim to replace lenders' own prudent underwriting criteria.
- Do not – and cannot – aim to target house prices.

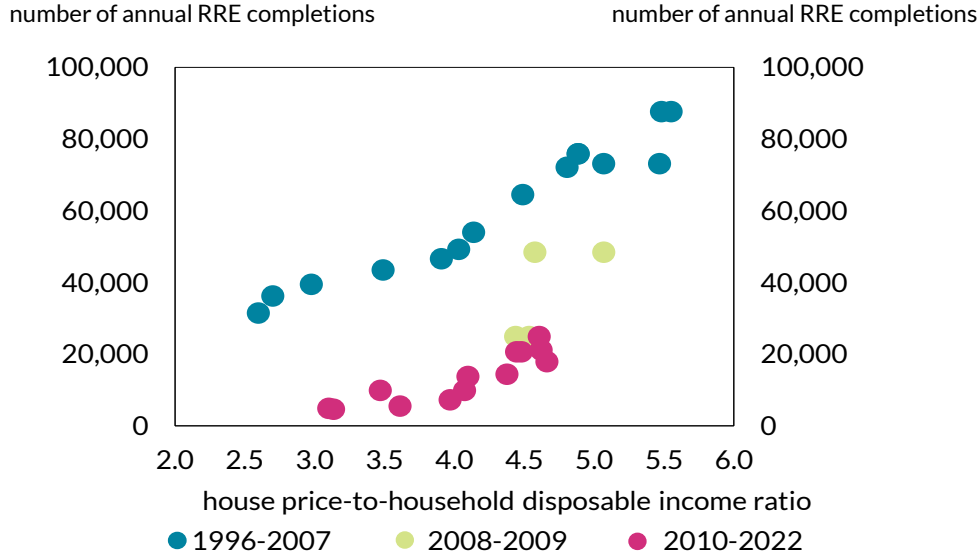


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The housing market context has been one of structural weakness in housing supply, relative to the growth in demand...

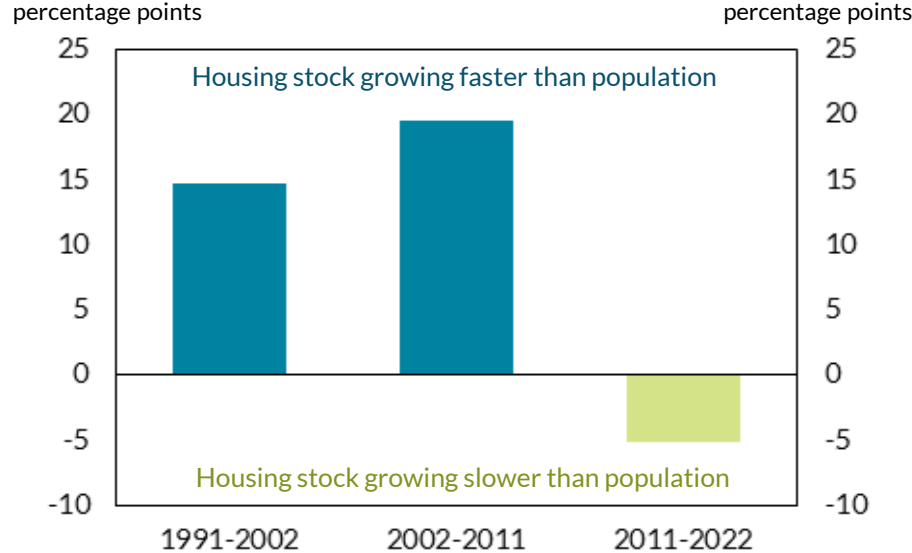
Fewer houses are being built, for a given level of house prices relative to incomes, than in the past



Source: Kennedy and Myers (2019).
 Notes: Horizontal axis: Estimated ratio of house prices to household disposable income. Vertical axis: housing units completed per year. Estimates of completions have been obtained by taking total estimates of electricity connections and removing average number of connections in each year that are unrelated to dwelling completions. Findings are robust to use of raw electricity connections data, or to using proportional estimates of completions. Last observation 2022.



Over the past decade, growth in the housing stock has fallen short of growth in population growth

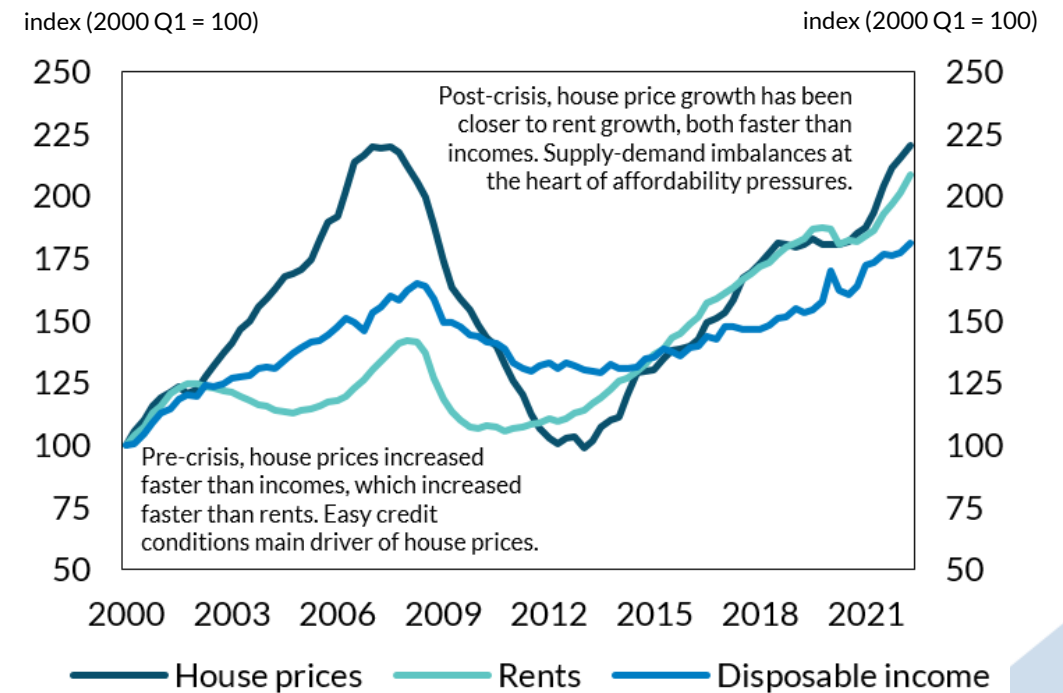


Source: CSO and Central Bank of Ireland calculations.
 Notes: Percentage point difference between growth in stock of housing and growth in population. The past decade has seen growth in the housing stock falling short of population growth, with associated slowdown in structural trend of falling average household size. Last observation 2022.

...leading to persistent upward pressures on house prices and rents, relative to household income.

- Persistent housing supply-demand imbalance has been a key driver of affordability pressures in recent years, with both house prices and rents rising faster than incomes.
- This contrasts with the period before the financial crisis, when unsustainable mortgage lending standards were driving increases in house prices relative to incomes.

With housing supply failing to meet demand, both house prices and rents have risen faster than incomes



Source: CSO and Central Bank of Ireland calculations.

Notes: Last observation house prices and rents, and household disposable income 2022Q2.

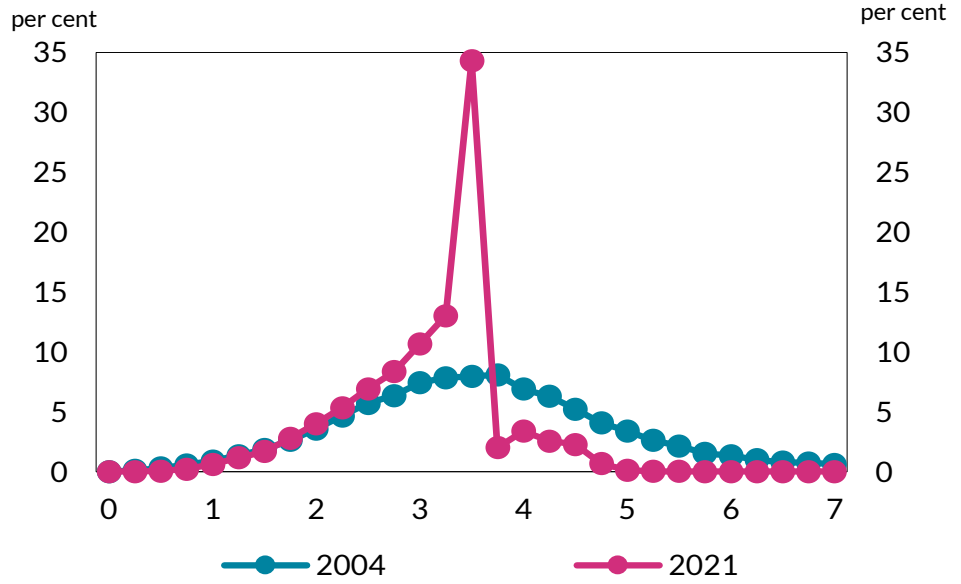


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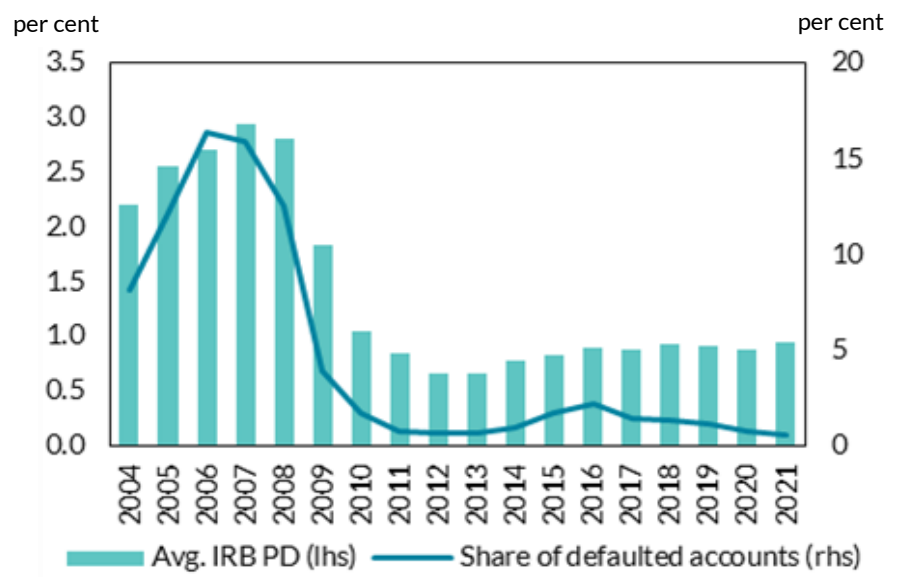
In this context, the measures have delivered substantial economic benefits by guarding against weak lending standards...

Compared to a period with similar aggregate HPI ratios, the LTI distribution now contains fewer high-debt loans



Source: Central Bank of Ireland. Notes: Percentage of loans at each point on LTI distribution, new lending in each of 2004 and 2021.

Lending under the mortgage measures has been much less risky, than loans issued before the financial crisis



Source: Lyons and Rice (2022). Notes: Defaults (observed from 2018 to 2021, and modelled in banks' internal models in 2021) by origination year. IRB: Internal models of Irish retail banks used for risk weight purposes. PD: probability of default.

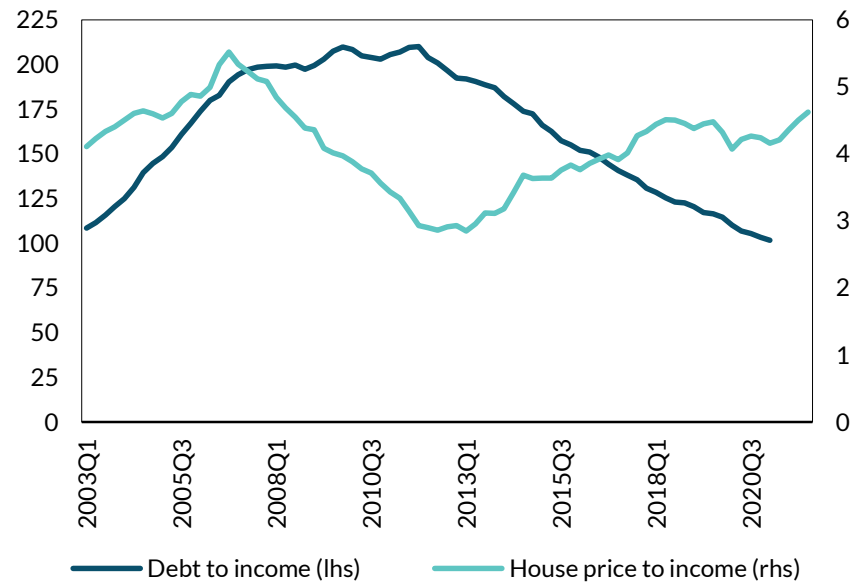
...but the economic costs of the measures have also gradually grown as housing market access has become more challenging.

- Part of the increase in the house price to income ratio has been driven by structural factors, notably the continued imbalance between demand for, and supply of, housing.
- Mortgage measures cannot address underlying housing supply challenges. But these structural trends have implications for evolution of benefits and costs.
- The LTI limit has become increasingly 'binding', especially for FTBs, due to factors related to the underlying evolution of the housing market.
- Persistent increases in house prices relative to incomes – where these are not due to unsustainable mortgage lending standards – can increase the economic costs of a given calibration.
- Flexibility embedded in the measures through the allowances has meant that the framework has been able to accommodate these slow-moving changes over time.



In parallel, strengthening bank resilience and lower household indebtedness have provided some degree of ‘policy space’...

Aggregate household indebtedness has continued to fall, despite growing house prices relative to incomes



Source: CSO, PTSB House Price Index, Central Bank of Ireland calculations.
 Note: House prices are compared to disposable income, rather than gross income, per household, based on Central Bank calculations using CSO data. See [Kelly, Kennedy, Lambert \(2021\)](#) for further details.

Measures of banking system resilience, in 2015 (introduction of the measures) and now

	2015	2022
CET1 capital ratio, fully-loaded (%)	12.5%	15.3%
Non-performing loans (%)	18.7%	3.5%
Liquidity Coverage Ratio (%)	115%	222%
Share of mortgage book issued under measures	N/A	49%



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...leading to a judgement that a targeted recalibration of the measures is appropriate.

- Targeted recalibration can relieve some of the costs of the measures, without unduly reducing their benefits.

