

# The impact of Financial Stability Report's warnings on the loan to value ratio

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## What the paper does

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- Tests for the effectiveness of warnings in Central Bank of Chile's Financial Stability Report (June and December 2012)
- No effect on aggregate house prices or on total volume of mortgage loans granted...
- ... but reduction in LTV ratios
- Taken as evidence that warnings were effective
- Impressive database
  - Administrative data on every housing transaction
  - Price, location, size, house type, loan conditions, maturity, bank,...
  - 2011Q1-2014Q2

# My comments

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- Can we be sure this was triggered by the FSR warnings?
  - How does communication affect behaviour?
  - The econometric identification
- The role of BancoEstado

# The transmission mechanism of communication

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# The transmission mechanism of communication

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- Message released by central bank – salience?
- Message picked up by media?
- Message received by intended recipient?
- Message understood by recipient?
- Effect on behaviour?

## Salience of the information

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- FSRs are lengthy documents (70 pages)
- Messages were part of the 2 (3)-page summary
- Bold sentences:
  - Aggregate housing prices move in tandem with the economy's level of interest rates and income
  - There are, however, developments in the local market that require close attention. A first development is the evolution of the real estate sector.
- What happened afterwards (sample runs until 2014), was the message reiterated elsewhere (e.g. in speeches)?

## Did the warnings make it to the news?

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- A search for "central bank of chile" or "banco central de chile" in all sources within Factiva (but only in English) yields
  - June 2012
    - Chile Central Bank Only Considered Standing Pat In June -Minutes
    - Chile Traders See No Change in CPI in June - Central Bank Poll
    - Central Bank of Chile Maintains Policy Rate at 5.0% in June
  - December 2012
    - Central Bank keeps the policy rate unchanged at 5%
    - Chile's Central Bank Holds Benchmark Rate at 5%, as Expected
    - Financial Stability Board Regional Consultative Group for the Americas meeting

### **BoC warns of growing mortgage risks**

 The Globe and Mail - 06/10/2016 - 1184 words

By TAMSIN McMAHON, DAVID BERMAN - payment level and people are trying to find a break through the mortgage debt, pointing out that just 0 [...]

### **Housing boom can't last, bank says; Consumers warned to avoid getting caught up in the frenzy**

 The Toronto Star - 06/10/2016 - 720 words

Tess Kalinowski Toronto Star - pace and blistering prices of the housing market to continue, warns the heat recent real estate performance into the [...]

### **L'endettement des ménages fragilise l'économie**

 La Presse+ - 06/10/2016 - 707 words


Rudy Le Cours - Deux fois l'an, la Banque du Canada nous gratifie de sa Revue du système financier. À l

### **Hot housing won't last forever: Poloz**

 National Post - 06/10/2016 - 742 words


Gordon Isfeld - in Toronto, and especially Vancouver, is unlikely to be sustained, given the underlying fundamentals; homebuyers and their lenders should not extrapolate recent real [...]

### **Bank tries to cool housing market with a warning**

 The Vancouver Sun - 06/10/2016 - 794 words

Peter O'Neil - skyrocketing housing market will likely fail, B.C. economists say. In an unusual move, government Vancouver are unsustainable [...]

### **Soaring house prices in Vancouver and Toronto unsustainable: Bank of Canada**

 The Canadian Press - 06/09/2016 - 805 words

Andy Blatchford - in the hot markets of Vancouver and Toronto are rising at an unsustainable clip. Government economic fundamentals like job creation [...]



# Would the message be understood?

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- Flesch-Kincaid grade level statistic: how many years of education are required to understand a text?

$$0.39 * \left( \frac{\text{total words}}{\text{total sentences}} \right) + 11.8 * \left( \frac{\text{total syllables}}{\text{total words}} \right) - 15.59$$

- June 2012: 15 years
- December 2012: 13 years
- But... FSR is in good company
  - Humphrey–Hawkins hearings 1979-2009: 14-16 years (Jansen, 2010, Contemporary Economic Policy)
  - Haldane (2016), The Great Divide: impenetrable CB communication

# The econometric identification

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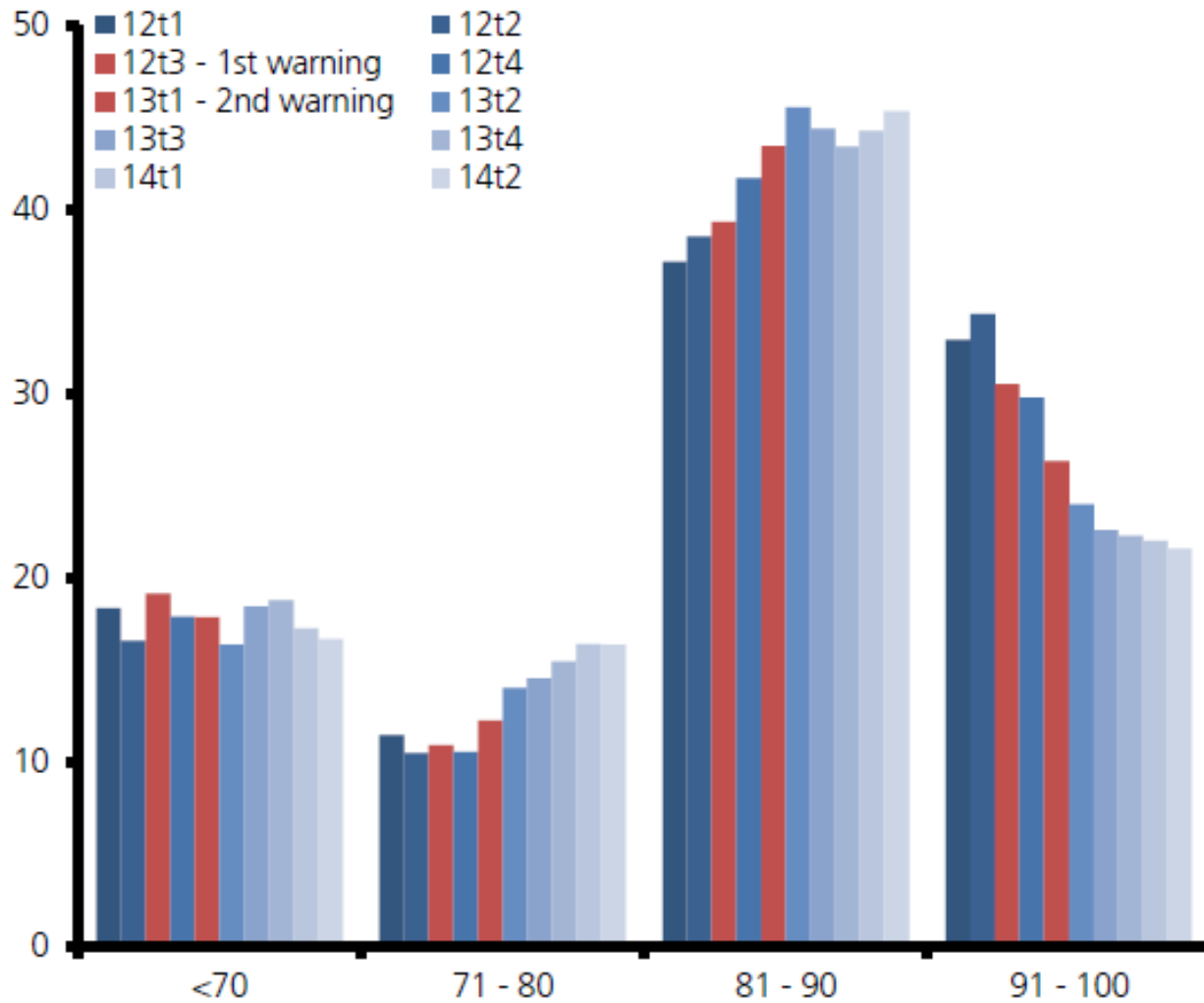
- Causality versus correlation
- Identification assumption: announcement dominates other news
  - More plausible, the smaller the time window
- Compare outcome to counterfactual
  - Without announcement, what would have happened?
  - Implicit assumption is  $\Delta LTV = \mu$

# The econometric identification

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- 2011Q1-2014Q2
- Effect of warnings is estimated using step dummies – implies permanent effects
- No other controls (size, type, maturity, ...)

# The econometric identification – LTV ratios



# The role of BancoEstado

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- 14% of total loans, 24% of mortgage loans
- Second largest player after Santander
- Loans are relatively small
- Probit LTV90 model: BE has increased lending in the high LTV brackets after the first warnings— why?
- Has BE lending been the cause of concern?

# Summary

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- Interesting question, impressive data
- Not yet convinced about causality
- Would suggest
  - More discussion on
    - Salience of information, pickup by media
    - The role of BE (mandate, etc.)
  - Extending the econometric model
    - More controls
    - Counterfactual à la event studies

# Thank you!

