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

Discussion, BIS CCA CGDFS conference, June 2016

The views expressed here are our own and do not necessarily reflect those of the Bank of Canada or the Bank’s Governing Council

www.bank-banque-canada.ca
What the paper does

- 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

- 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
The transmission mechanism of communication

- 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

- 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?

- 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 BERMANN - payment level and people are trying to find a break through t 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 hea-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**  
The National Post - 06/10/2016 - 742 words  
Gordon Isfeld - in Toronto, and especially Vancouver, is unlikely to be sustained, given the underlying fund-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, goven-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. Gover-economic fundamentals like job creation […]
Would the message be understood?

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

\[
0.39 \times \left( \frac{\text{total words}}{\text{total sentences}} \right) + 11.8 \times \left( \frac{\text{total syllables}}{\text{total words}} \right) - 15.59
\]

- June 2012: 15 years
- December 2012: 13 years

- But… FSR is in good company
  - Haldane (2016), The Great Divide: impenetrable CB communication
The econometric identification

- 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

- 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

- 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

- 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!