Balancing Act: the Link between Monetary Policy and Financial Stability

CMHC National Housing Conference
22 November 2018
Monetary and macro-prudential policies work best when they work together.

Monetary Policy

- Inflation control

Mortgage Finance and Housing Policies

- Prudential, social and other objectives

Support stability of the financial system
Loan-to-income ratios in Greater Toronto Area 2013

Average loan-to-income ratio of new high-ratio mortgages, by Forward Sortation Area (FSA)
Loan-to-income ratios in Greater Toronto Area 2014
Loan-to-income ratios in Greater Toronto Area 2015

Average loan-to-income ratio of new high-ratio mortgages, by Forward Sortation Area (FSA)
Loan-to-income ratios in Greater Toronto Area 2016

Average loan-to-income ratio of new high-ratio mortgages, by Forward Sortation Area (FSA)

- N/A
- <350
- 350-400
- 400-450
- >450
Loan-to-income ratios in Greater Toronto Area 2017

Average loan-to-income ratio of new high-ratio mortgages, by Forward Sortation Area (FSA)
Policy measures have improved the quality of new mortgages...

Share of new mortgages with a loan-to-income ratio over 450 per cent;
5-year mortgage rate

- **Rules tightened for insured mortgages**
- **Rules tightened for uninsured mortgages (Guideline B-20 revised)**

5-yr mortgage rate (right scale)
Insured mortgages
Uninsured mortgages (left scale)
...and have slowed the housing market to a more sustainable pace.
Housing affordability is on a better track than it might have been.

Average cost of servicing a new mortgage, as a share of disposable income

Counterfactual if house price growth had remained at its peak (all else equal)

1. https://credit.bankofcanada.ca/financialindicators/hai
Example of how Bank assesses micro effects of interest rate increases

Annual mortgage payments as a percentage of annual income for 5-year fixed-rate mortgages, at different household indebtedness levels at origination

From origination in 2015 to renewal in 2020

- **22%**: Loan-to-income ratio below 250%
- **18%**: Loan-to-income ratio between 250% and 350%
- **22%**: Loan-to-income ratio between 350% and 450%
- **38%**: Loan-to-income ratio above 450%

Annual mortgage payments as a percentage of annual income for 5-year fixed-rate mortgages, at different household indebtedness levels at origination.
Research to inform macro-prudential policy framework

• Work with partners to strengthen operations
  • On setting clear objectives, anything to learn from inflation-targeting framework?
  • How well do macro-prudential tools work at achieving the desired effects, and for how long?

• Design questions for macro-prudential policies
  • Structural or countercyclical? Rules-based or discretionary?
  • Can macro-prudential policies address time-inconsistency? Governance?

• Optimal policy mix
  • Best modeling strategy to map policy interactions?
  • How can authorities with clear and independent mandates coordinate effectively?