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Can we prevent House Price Bubbles?

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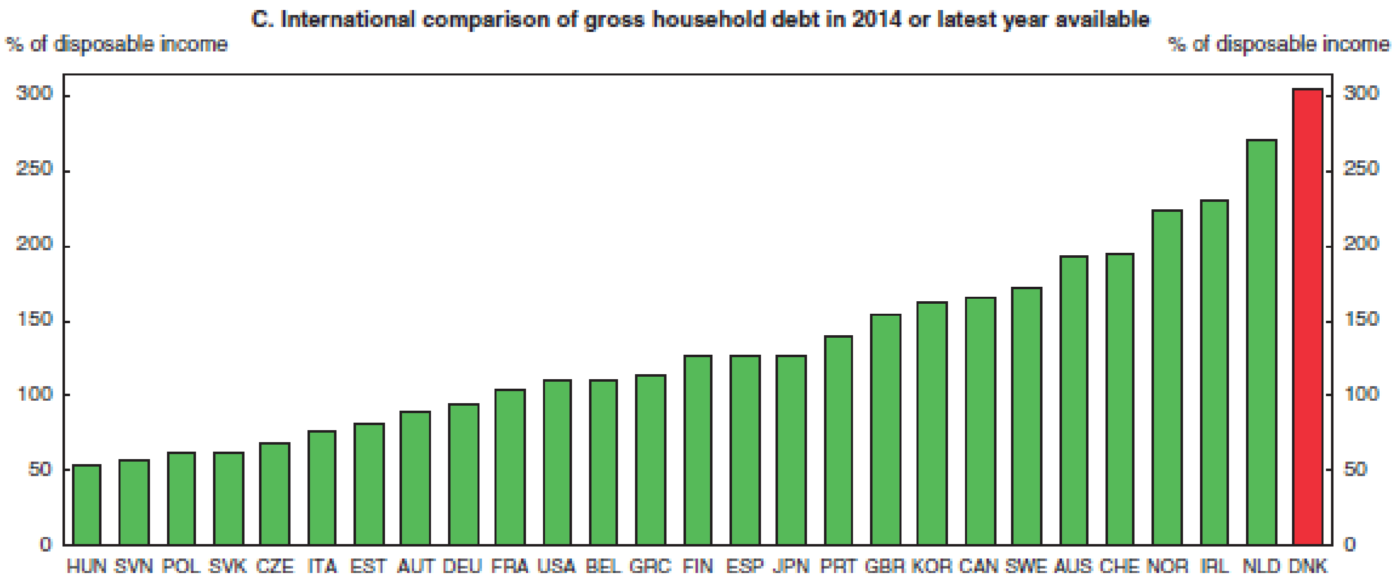
Danish economy sensitive to house price changes



Source: Danmarks Nationalbank; OECD Analytical database.

- High household debt (OECD 2016)
- High LTV's (ESRB 2015)

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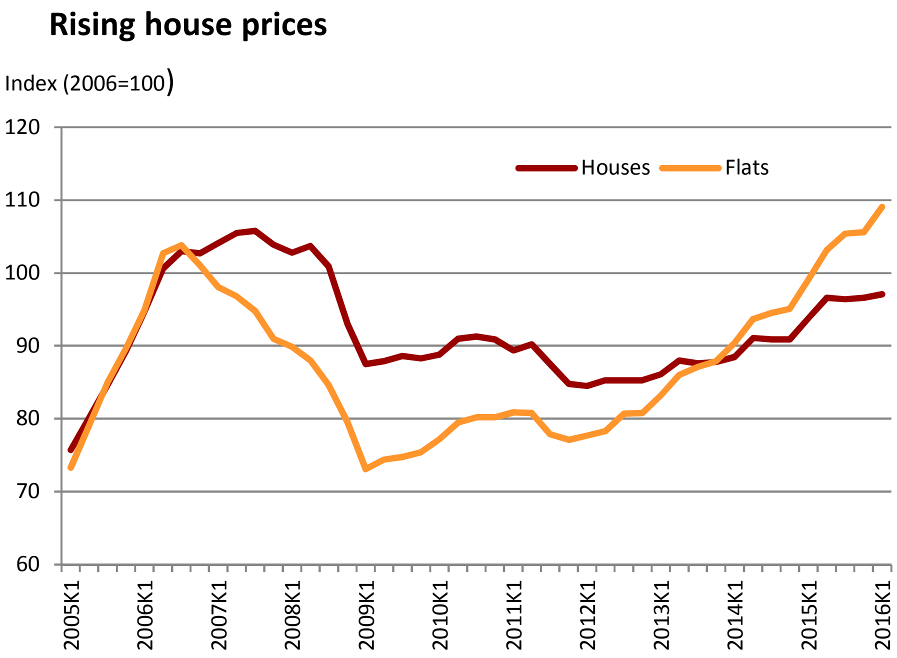
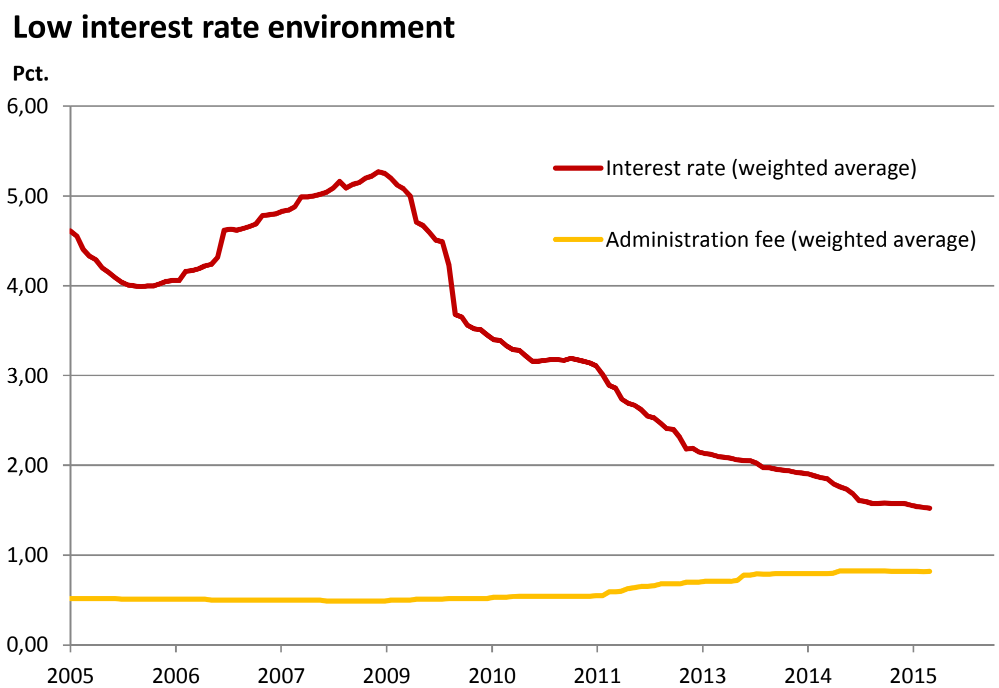
Evaluate risks rather than bubbles



Source: Statistics Denmark



Source: Statistics Denmark

- Increasing house prices fueled by low interest rates
- Rising interest rates can lead to falling house prices even if there is no bubble

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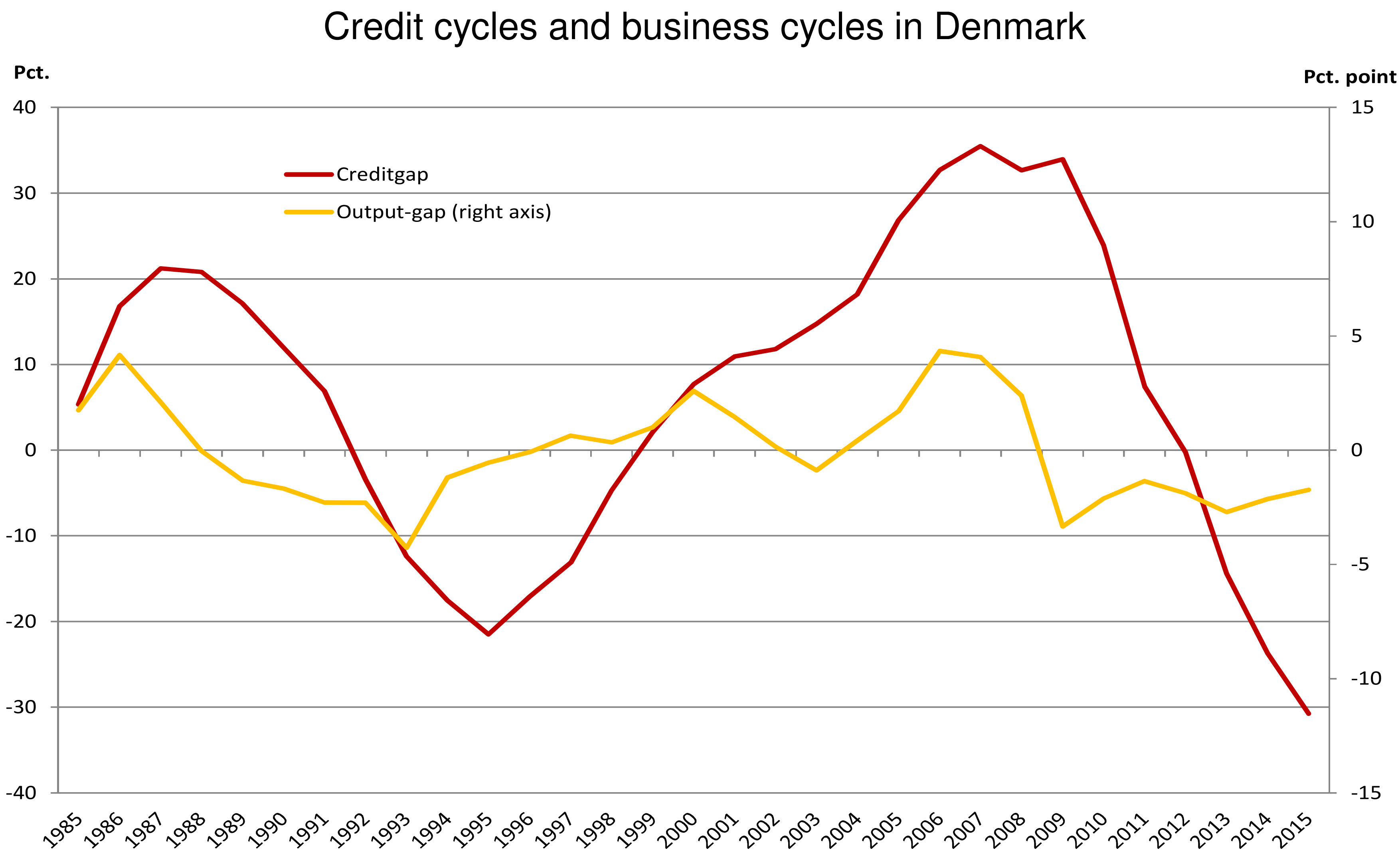
Financial cycles are longer than business cycles



We cannot prevent business cycles – only reduce the severity

Instruments

- Structural (or microprudential) initiatives:
  - 5 percent down payment requirement (corresponding to 95 pct. LTV)
  - Mortgage diamond (supervisory tool)
    - 15 pct. cap on loan growth
    - 25 pct. cap on high LTV variable rate loans
    - 10 pct. cap on high LTV interest only loans
  - Requirement of positive liquidity in commercial real estate

- Leaning against the wind
  - 7 best practices
    - Interest rate stress
    - Amortization requirement for negative net value customers
    - High net value requirement for customers with high LTI
    - Etc.

- Real macro prudential initiatives
  - As an example the countercyclical capital buffer
  - We have not been there yet

Conclusions

- History and the actual structures tell us to keep a sharp watch on the real estate market in Denmark. We have to be prudent.

- Macroprudential instruments cannot prevent business cycles and probably not even price bubbles, but we should:
  - Reduce the banking sector's contribution to the build-up
  - Increase resilience in the banking sector in order to stop a macroeconomic crisis turning into a financial crisis

- Macroprudential regulation is not (only) a question of whether to react or not, it's (mainly) a question of taking the appropriate initiatives in the given situation:
  - Follow "leaning against the wind strategy" if you gradually need to implement/tighten instruments
  - Standard macroprudential tools as the Countercyclical Capital Buffer to strengthen robustness of the sector
  - Hard and very prudent rules to influence economy in a broader sence?