

The Treasury

2015 Loan-to-Value Ratios/Macroprudential Policy Information Release

Release Document

June 2015

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Date: 25 May 2015

To: Minister of Finance (Hon Bill English)

Deadline: None

Aide Memoire: RBNZ Consultation on Proposed Macroprudential Policy Settings

You recently asked for advice on the RBNZ consultation document *Consultation paper: adjustments to restrictions on high-LVR residential mortgage lending*. This Aide Memoire provides a Treasury perspective on the consultation document.

The policies the RBNZ recommend in its consultation document are in substance the same as the previous draft that we discussed in our TR (T2015/894). Treasury has provided comments that have been incorporated into this document. These were around sharpening up the description of the factors behind potential instability in the housing market, and the intended influence of the policy. As a result, we think that the consultation document is in a better shape than previously.

Furthermore, work around the definition of investors has been undertaken on the measures to be implemented in the housing market and related areas to ensure coordination as far as practicable between the tax and the RBNZ definitions.

Overall, we do not think that the consultation document makes a compelling case for the proposed use of these macroprudential settings, due to the concerns below. Nevertheless, the RBNZ does have the decision rights, and so our focus will be to work with the RBNZ to make improvements in some key areas. Our main focus will be to encourage:

- **Clarification of the problem identification, evidence and channels.** We accept that house price changes can have macroeconomic implications, but the RBNZ's mandate is to promote financial stability. Therefore, the policy should be reframed to focus more clearly on reducing systemic risk, rather than on prices in a particular market.
- **Additional evidence on the investor segment.** The evidence presented is somewhat mixed on the extent that high-LVR investors underpin systemic fragility, as they are a relatively small part of the market and many may be able to alter their portfolio. Similarly, we will be asking the RBNZ to provide further information on the extent to which the increase in investor activity may have been encouraged by the original LVR policy.
- **Discussion on the risks of relaxation of the speed limit outside of Auckland** should credit growth and prices pick up again. Although we appreciate that the policy was designed to be temporary, and that the RBNZ prefer light touch regulation, there are a number of potential downsides. In this case, the policy rule

is not clear, and the RBNZ policy settings are reactive to recent data. This may lead to an active management of policy settings, which may increase market uncertainty and reduce RBNZ credibility. This is particularly important around LVR limits - Treasury modelling using a DSGE framework suggests that the costs of taking the limits off early may be greater than leaving them in place for longer.

- **Evidence from policy evaluation and additional cost benefit analysis** of this policy to be published, including with respect to the other options available. The consultation paper contains little discussion on some of the possible unintended consequences, such as: increased risk of disintermediation or higher non-bank lending; the possibility of shifting demand towards cashed-up buyers; or risks that investors leverage up property outside of Auckland. We will also be asking the RBNZ for more detailed evaluation on the impact of the existing LVR policy, and of the unintended consequences compared with the impacts anticipated in the Regulatory Impact Statement.

We recommend you note the following points that may impact on Government policies and actions, including the goal to increase housing supply:

- Paragraph 38 of the consultation document notes that house price growth is likely to persist, and points to supply shortages as problematic. This points to a fundamental imbalance in supply and demand that will only be addressed by increasing supply over the longer term.
- The RBNZ notes that LVR restrictions on investors may affect rental inflation should there be a reduction in supply of rental properties. There is also the potential for investors to increase their activity outside of Auckland. The existing exemptions for new build properties continue, and the RBNZ state that they could investigate additional exemptions if this could make a material difference to supply.

Process

A robust process of consultation is a characteristic of good regulatory practice and should occur within government at the options stage well before the policy is made public.

The late notice and lack of consultation complicates the ability of government agencies to coordinate, which could lead to government policy that conflicts or pays inadequate attention to government's wider economic objectives.

We will raise these issues with RBNZ and propose process changes to address these concerns.

Next steps

Treasury will continue working with the RBNZ on the issues raised above, and will provide input on the specific policy settings during the consultation period.

Treasury will work with the RBNZ to discuss:

- The purpose and scope of macroprudential policy
- Risks to financial stability and their implications for government policy

- Process improvements around changes to regulatory settings

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