The Toolkit of Policies in the Brave New World of Debt

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DeNederlandscheBank

EUROSYSTEEM

Agenda

1. What drives leverage?

2. What makes leverage a concern?

3. What policies can be used to mitigate the risks of leverage?

What drives leverage?

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Leverage is driven by various factors

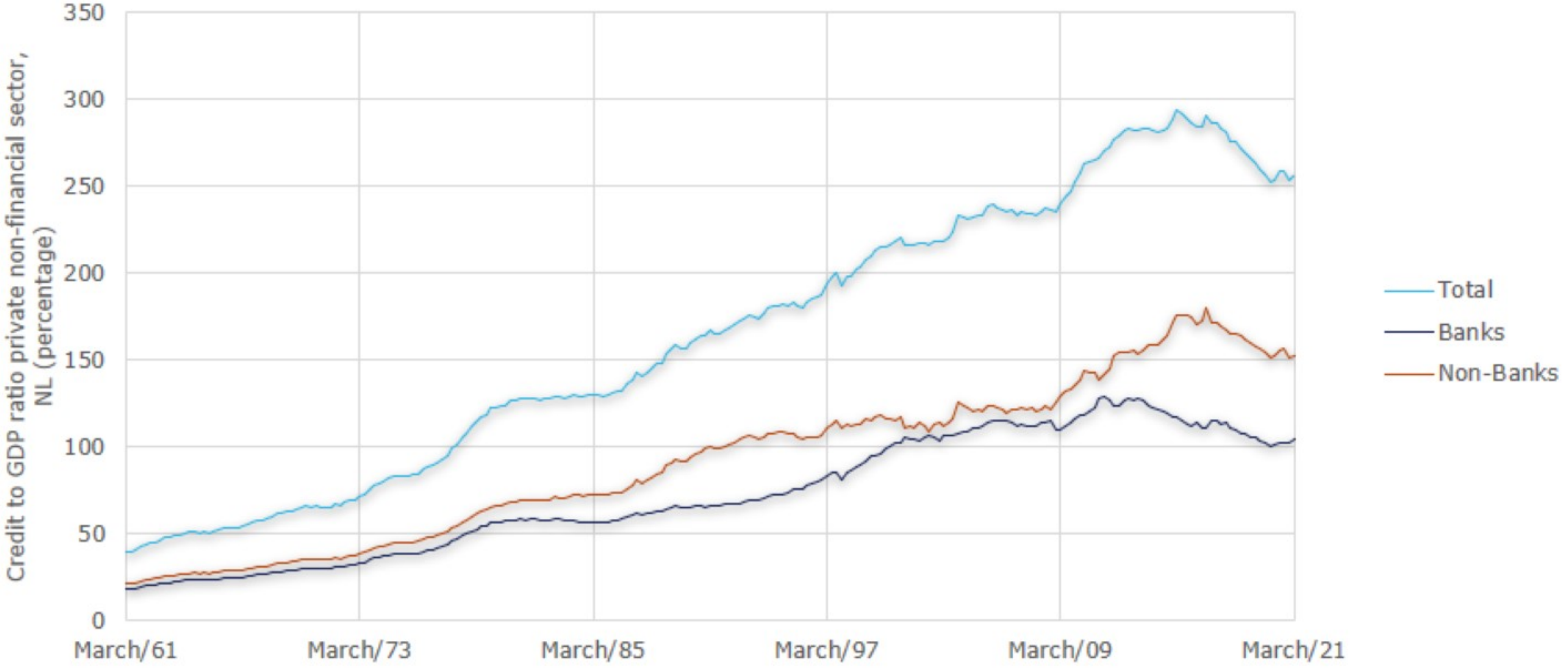
Corporates (financial)

- Tax shield – leverage can act as a gain (or loss) amplifier
- Easier to raise than external equity (i.e. barriers to equity financing)
- Protection of existing shareholders
- Cheaper than equity

Households

- Interest tax deductibility (promotes home ownership)
- For wealthier households, borrowing will be driven by the expectation of higher future income
- For the typical household, borrowing will be determined by the increase in asset values and the down-payment required by the lender

Debt levels are steadily increasing



Source: BIS credit statistics

Supported by record low borrowing costs…

Source: MFI Interest Rate Statistics, DNB

What makes leverage a concern?

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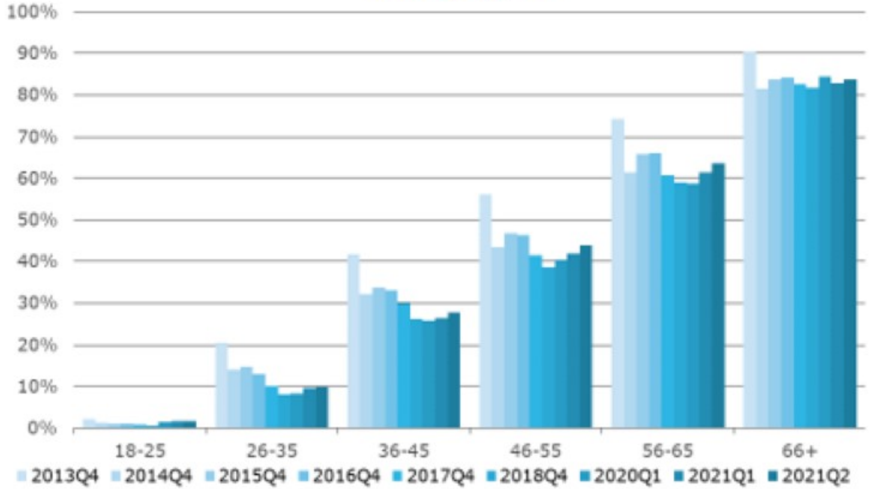
Home-buyers are borrowing more… and more risky

Share of new loans with very high LTI, NL

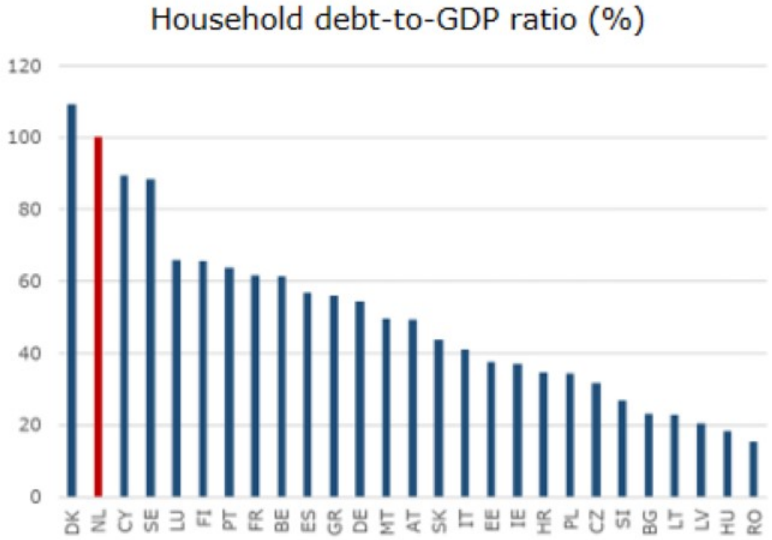
Share interest-only in loan production per age category, NL



Source: DNB LLD & RRE

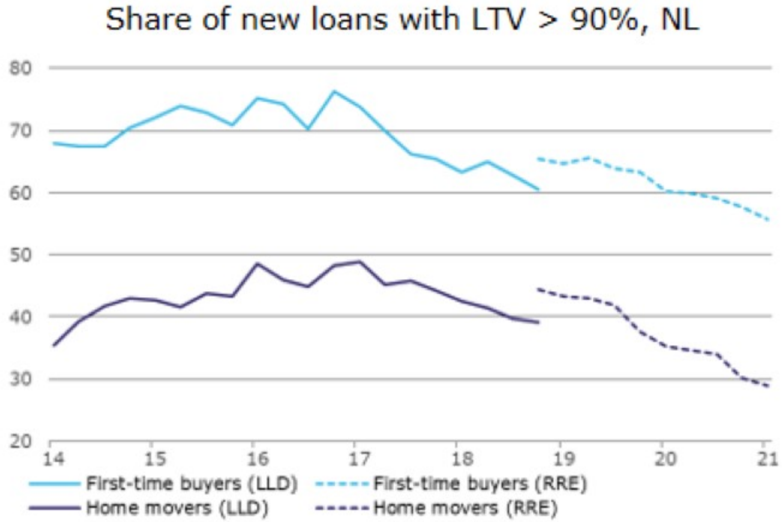
And structural vulnerabilities remain high

In the Netherlands, household debt is high...

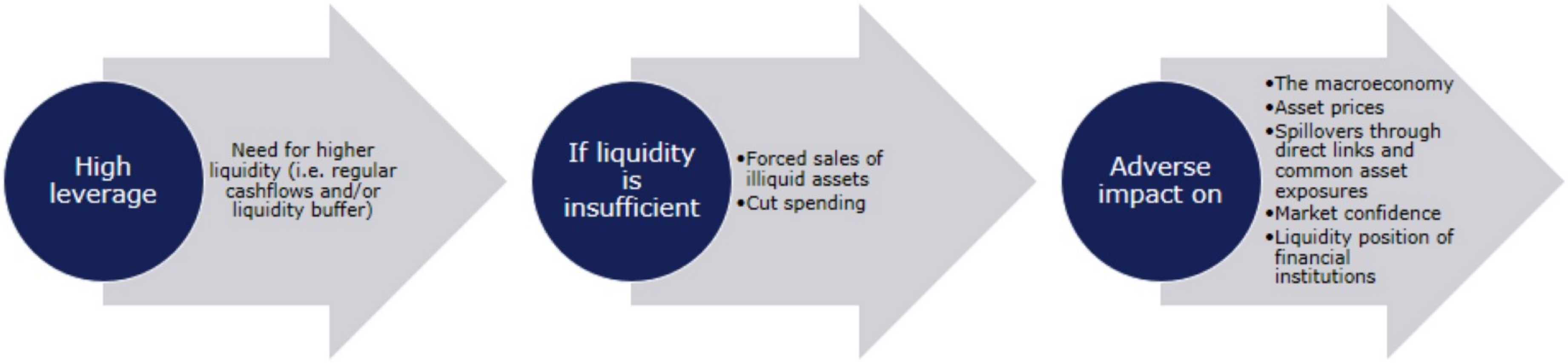


Source: Eurostat

... and home buyers are highly leveraged



Source: DNB LLD & RRE


High leverage
Need for higher liquidity (i.e. regular cashflows and/or liquidity buffer)
If liquidity is insufficient
•Forced sales of illiquid assets
•Cut spending
Adverse impact on
•The macroeconomy
•Asset prices
•Spillovers through direct links and common asset exposures
•Market confidence
•Liquidity position of financial institutions

What policies can be used to mitigate the risks of leverage?

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	Banks	Non-banks	Households/ corporates
credit growth	• CCyB • Leverage ratio	• Leverage ratio (AIFMD)	• Tax regime
public / private debt	• Sectoral risk-weights • Sovereign risk-weights/ concentration limits	-	-
real estate markets	• Discretionary measures • Sectoral risk weights	-	• LTV/LTI/DSTI • Supply measures • Subsidies / tax regime
liquidity risk	• LCR and NSFR (only micro) • Stricter national measures	• Liquidity risk management rules • Suspension of redemptions (AIFMD/UCITS)	-
systemic relevance / concentration	• O-SII/G-SII-buffer • SRB	- • SII-framework	-

available | limited effective | not available | - non-existent

Recent measures in the Netherlands

1. Increasing risk weights for mortgages
   - Motivation: risk weights do not currently reflect the level of systemic risk in the housing market.
   - Main goal: improve the resilience of banks against a significant drop in house prices.

2. Introducing a new CCyB framework
   - Motivation: there is limited room to release capital in response to cyclical shocks.
   - Main goal: facilitate a more active use of the buffer to respond to cyclical risks.