

Distributional effects of borrower-based tools

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Insights from a literature review

Bank of England

Distributional consequences of borrower-based macroprudential tools

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Interpretation should consider that the evidence spans cross-country studies, country-specific analyses, and theoretical models, with differences in institutional settings and policy implementation.

Proven effectiveness

Tools effectively dampen credit-house price feedback loops

Credit growth:

- Substantial reduction in mortgage volume
- Particularly effective for high-risk loans

House prices:

- Moderate price growth during booms
- Smaller corrections during busts

Timing matters:

- Most effective when tightened during expansions
- Less effective when loosened in crisis

Tools effectively reduce default risk

Cross-country evidence:

- Brazil, Netherlands: Lower arrears among affected borrowers
- Lithuania: DSTI limits effective in mitigating defaults
- Portugal: Reduced probability of default and loss-given-default during COVID

UK Brexit case study:

Following referendum (negative shock), low-income borrowers in areas more affected by LTI regulation were less likely to default

Distributional impact

By their very nature of limiting household leverage, borrower-based tools are distributional

FIRST-TIME BUYERS

- Highest leverage needs
- Limited savings for deposits
- Delayed homeownership
- Switch to rental market

YOUNGER HOUSEHOLDS

- Earlier career stage
- Lower wealth accumulation
- Higher LTV & LTI ratios

LOWER-INCOME

- Lower liquid assets
- Limited savings for deposits
- Stronger reduction in lending

Household responses & downstream effects

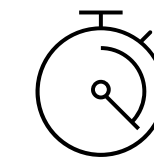
How constrained borrowers adjust their choices



LOCATION CHOICES

Israel: Move further from city centers, cheaper areas, worse socio-economic neighborhoods

Taiwan: Shift purchases to non-restricted areas



TIMING & LIQUIDITY

Norway: Delay purchase, save larger deposits, trade liquidity for lower leverage

Finland & Switzerland: Reduced transition to homeownership

Ireland: Increase in rents negatively effect their ability to save



VULNERABILITY TO SHOCKS

Liquidity-leverage trade-off: Norway suggests higher deposits = less liquid assets → worse outcomes conditional on unemployment

Counter-evidence: Netherlands shows better liquidity management and less volatile consumption post income loss

Lender behavior

Regulatory arbitrage and portfolio adjustments

ADJUSTMENT MECHANISMS

Quantity adjustments (primary):

US: Lenders exit high-leverage market rather than raise rates

UK: Constrained lenders steer high-LTI loans to high-income borrowers

Price adjustments (secondary):

UK: Unconstrained lenders raise rates for low-income/high-LTI in competitive markets (adverse selection concerns)

REGULATORY ARBITRAGE

Singapore: Lenders extend conforming loans to lower-quality borrowers (lower credit scores, higher card penalties)

→ Suggests need for balance-sheet-based affordability tests

PORTFOLIO REBALANCING

Ireland: Affected banks increase risk-taking in non-targeted assets

- More high-yield securities
- Riskier corporate borrowers at lower rates

⚠ Monitor for waterbed effects

Further research

What policymakers need to know

1. FULL CYCLE ANALYSIS

Need to observe effectiveness across entire financial cycles

2. COST-BENEFIT FRAMEWORK

Need for a holistic framework that integrates these diverse strands of evidence into a coherent cost-benefit analysis

3. TOOL SELECTION

LTV vs LTI vs DSTI vs affordability tests: Which tool for which objective? When to implement/withdraw? How do they interact?