Countercyclical capital buffer rate announcement

01 October 2019

The Central Bank has today announced that the countercyclical capital buffer (CCyB) rate on Irish exposures is to be maintained at 1 per cent. The Central Bank considers a 1 per cent rate to be consistent with its objective for the CCyB of promoting resilience in the banking sector in order to mitigate the risk of a pro-cyclical reaction of bank lending to the real economy in any future downturn or period of systemic stress .[1,2] The current calibration reflects a number of factors: the gradual build-up of cyclical systemic risk in Ireland; the fact that evidence of broad-based imbalances is yet to emerge; the exposure of Ireland to the global financial cycle.

Notwithstanding the continued, gradual build-up in cyclical risk, the outlook for the macro-financial environment in Ireland is subject to significant uncertainty at this time with a disruptive no deal Brexit one source of material downside risk. The CCyB rate is a cyclical macroprudential instrument which can be increased or decreased in line with macro-financial conditions. Accordingly, the Central Bank remains ready to adjust the CCyB rate in a manner consistent with the objective of mitigating pro-cyclicality and supporting a sustainable supply of credit to the economy. In contrast to announced increases in the buffer rate, which by default have a 12-month implementation phase, any reduction in the CCyB would take effect immediately. In maintaining the rate at 1 per cent, the following were taken into account:

- Overall, credit dynamics continue to strengthen, although in aggregate private non-financial sector credit growth remains modest. Underlying the aggregate data, divergent trends emerge across different segments.
    - PDH mortgage lending grew by more than 4 per cent y-o-y as of 2019Q2. Together with credit to large enterprises, it has consistently been the main driver of credit growth in recent quarters.
    - Lending to large enterprises picked-up further in 2019Q2 and grew by more than 15 per cent y-o-y (from 12 per cent in 2018Q4 and 9 per cent in Q3). It now represents the second largest contributor to overall credit growth.
    - In contrast, the contribution of lending to small and medium enterprises (SMEs) and for buy-to-let (BTL) mortgages remain consistently negative; the latter registered a rate of change of -13 per cent y-o-y as of June 2019.
    - Consumer credit growth (y-o-y) has contributed marginally to overall credit growth, reflecting an increase in the rate of y-o-y growth equal to 5 per cent in 2019Q2, up from 0.2 per cent in the previous year.
    - The upward trend in the volume of new mortgage lending continued into 2019Q2; €8.6 billion of new mortgages were drawn down in the year ending in the second quarter of 2019, mainly driven by lending at fixed interest rates.
    - The standard and national specific gaps, calculated according to ESRB Recommendation 2014/1, have continued to narrow in the first quarter of 2019, but remain in the negative territory (86 and 66 percentage points below zero). The alternative credit gap is in positive territory but does not signal the presence of material imbalances, being just above zero as of 2018Q4.

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[1] See Measuring and mitigating cyclical systemic risk in Ireland: The application of the countercyclical capital buffer, Financial Stability Notes, 2018, No.4 for an overview of the Central Banks high-level approach to the CCyB.

[2] MiFID investment firms that are subject to the Capital Requirements Regulation and Capital Requirements Directive IV will also be required to hold capital equivalent to one percent of their Irish risk-weighted exposures.

- Labour market conditions are now consistent with full employment. The unemployment rate as of 2019Q2 stood at 5.2 per cent with the number of people employed now above its pre-crisis peak. Central Bank estimates forecast the unemployment rate to average 4.7 per cent this year and to decrease further to 4.5 per cent in 2020.
- Projections by the Central Bank point to positive but moderating economic growth for the reminder of the year, reflecting both a slowdown in global economic activity and emerging capacity constraints in the domestic economy. Nonetheless, projected economic performance remains highly uncertain due to the heightened levels of risk posed by Brexit.
- Residential property growth continues to slow and has moderated significantly over the past 15 months. Nontheless, statistical indicators point to prices being above historical averages, relative to incomes and, to a lesser extent, rents. Model based measures of price misalignment suggest that prices are more in line with economic fundamentals.
- Commercial real estate prices moderated in the second quarter of 2019, recording y-o-y growth of just above 2 per cent, down from 3 per cent in Q1. CRE yields stayed broadly constant around 5 per cent.
- Market indicators, which may form part of any consideration regarding the need to release the CCyB rate, are not, at this time, suggestive of a materialisation of significant financial stress in Ireland.
- At a global level, a number of vulnerabilities exist in a mature global financial cycle. Overall, global macro-financial conditions deserve close monitoring but, for the time being, transmission of distress to the Irish economy is not evident.

Credit Gap indicators

The credit gap refers to the deviation in the credit-to-GDP ratio from its estimated trend level. The credit gap is a required reference indicator for macroprudential authorities in Europe when setting the CCyB rate. Given the specificities of the Irish economy, a number of credit gap indicators are analysed.[3] Based on these credit gap indicators the benchmark CCyB rate is zero per cent.[4] The standard credit gap concept is of limited value in the Irish context, since measures of trend credit are severely distorted by the unsustainable credit boom in the mid-2000s. These shortcomings are in part addressed in the Alternative (model-based) National Approach, as well as considering the pace of change in the credit gap and not just the level of the credit gap.

[3] The standardised credit gap is calculated in line with ESRB Recommendation 2014/1 and is based on a broad measure of credit. In Ireland, issues related to the presence of multi-national enterprises, as discussed in the Report of the Economic Statistics Review Group, impacts heavily on these data. The national specific approach looks to adjust for this by using data more reflective of the domestic economic environment, using a narrower more domestically focused measure of credit and GNI*.

[4] ESRB Recommendation 2014/1 sets out a benchmark buffer guide linking the level of the credit-to-GDP gap to potential CCyB rates.

Table 1: Credit Gap and benchmark CCyB rate

		Standardised Approach (as of 2019Q1)	National-Specific Approach (as of 2019Q1)	Alternative (model-based) National Approach (as of 2018Q4)
A	Ratio	237.5 per cent	89.8 per cent	89.8 per cent
B	Trend	324.1 per cent	156 per cent	89.3 per cent
C	Credit Gap (=A-B)	-86.6 per cent	-66.2 per cent	0.5 per cent
	Benchmark CCyB rate	0 per cent	0 per cent	
	Δ credit gap since trough	NA	23.8pps (2016Q1-2019Q1)	43.5pps (2015Q3-2018Q4)

Table: Selected CCyB indicator dashboard – build-up phase

CCyB indicator dashboard related to the build-up of systemic risk		Trajectory		Indicator		Latest obs date	Threshold	Qualitative assessment
		Persistance	*12-month change in indicator*	*Latest observation*	*Risk level*			
Credit growth	Household credit growth		1.2 pps	-0.2%		Jul-19	Historical average	Aggregate credit environment while strengthening remains relatively contained. Large differences in the dynamics across categories are evident.
	Domestic NFC credit growth		2.9 pps	4.4%		Jul-19	Historical average	
	Private Household: PDH Mortgage		0.7 pps	4.1%		Jun-19	No threshold established	
	Private Household: BTL Mortgage		-0.5 pps	-13.0%		Jun-19	No threshold established	
	Private Household: Non-mortgage		5.2 pps	5.4%		Jun-19	No threshold established	
	Irish Private Sector Enterprises: Large Enterprises		11.9 pps	15.8%		Jun-19	No threshold established	
	Irish Private Sector Enterprises: SMEs		0.5 pps	-3.0%		Jun-19	No threshold established	
Credit gaps	Standardised credit gap		8.1 pps	-86.6pps		Mar-19	Lower threshold for CCyB setting (BCBS 2010)	The alternative gap measure is now positive. Nonetheless, the gap measures do not currently point to unsustainable imbalances in credit.
	National credit-to-GNI* gap		12.8 pps	-66.2pps		Mar-19	Lower threshold for CCyB setting (BCBS 2010)	
	Alternative National Specific gap		8.0 pps	0.5pps		Dec-18	Lower threshold for CCyB setting (BCBS 2010)	
New lending	Mortgage Lending: 4-quarter volume		€1.0 bn	€8.6 bn		Jun-19	No threshold established	Mortgage lending has recovered strongly from subdued levels. Scope for some further sustainable increases in the near term.
	Mortgage Lending-to-Disposable Income ratio		-0.2 pps	6.4%		Mar-19	Model Benchmark (2003Q1-2018Q1)	
	Lending to SMEs: 4-quarter volume		€0.0 bn	€5.3 bn		Jun-19	No threshold established	
Real estate	Residential property price growth (m)		-7.7 pps	2.3%		Jul-19	MIP threshold	Rate of house price growth has moderated substantially. House prices are close to fundmental levels, albeit high relative to incomes.
	Residential property price-to-income ratio		1.3%	4.4		Mar-19	Historical average	
	Res. real estate misalignment measure		-4.9 pps	-6.9%		Mar-19	Zero	
	Commercial real estate price growth		-0.2 pps	2.2%		Jun-19	Historical average	
Indebtedness	Total credit-to-GDP ratio		-3.9 pps	237.5%		Mar-19	MIP threshold	Total credit in Ireland is substantially impacted by the presence of foreign owned MNCs. More domesticaly relevant measures have been on a downward trajectory for some time, although still indicate relatively high levels of indebtedness.
	National credit-to-GNI* ratio		-5.9 pps	89.8%		Mar-19	Euro area aggregate (bank credit-to-GDP)	
	Household debt-to-income ratio		-9.0 pps	119.8%		Mar-19	Euro area average	
Macro-economy	Employment rate		0.6 pps	69.1%		Jun-19	Historical average	At or approaching full employment/capacity constraints.
	Unemploment rate		-0.7 pps	5.2%		Jun-19	Historical average	
Bank balance sheets	CET1 Ratio - retail banks		0.3 pps	17.0%		Jun-19	CRD IV minimum requirement	Well above minimum requirements/benchmarks.
	Leverage ratio - retail banks		0.1 pps	8.8%		Jun-19	European average	
Market conditions	Commercial real estate spreads (bps)		77.5 bps	514 bps		Jun-19	Historical average	Against a background of accommodative global financing conditions, Irish government bonds spreads are low by historical comparison.
	Irish gov bond spreads - monthly avg (bps)		1 bps	55 bps		Jun-19	Historical average	

Notes: The table provides a visual representation of the Central Bank's high level approach that informs the setting the CCyB rate during the build-up phase. As such indicators and shading are presented from the point of view of monitoring a build-up in cyclical systemic risk. Indicators can be interpreted differently from other perspectives. The indicator trajetory relates to the degree of persistance in each indicator and the change in the indicator over the previous 12 months. The coloring of the trajectory is based on the length of time an indicator has been trending in a direction that is indicative of a rise in cyclical systemc risk (Green: no sustained rise in systemic risk, Amber: sustained trajectory indicating build-up of systemic risk, Red: more persistent trend of increasing systemic risk). The shading of the latest indicator value represents the level of risk associated with the current level of each indicator relative to its threshold value (Green: low risk - red: high risk). Grey shading is used where no threshold value is available. For further details on the indicators and thresholds see the Central Bank of Ireland bi-annual Systemic Risk Pack. CCyB rate decisions are made on the basis of guided discretion.

Reciprocity[5]

A number of European authorities have announced positive CCyB rates (Table 2) which will affect the individual buffer requirements of institutions in line with their exposures in these jurisdictions.

Table 2: Positive CCyB rate setting in Europe

Country	Current applicable rate	Implementation date	Pending CCyB rate	Pending implementation date
Belgium	0.00%	1 Jan 2016	0.50%	1 Jul 2020
Bulgaria	0.50%	1 Oct 2019	1.00%	1 Apr 2020
Czech Republic	1.50%	1 Jul 2019	1.75%	1 Jan 2020
Denmark	0.50%	31 Mar 2019	1.00%	30 Sep 2019
France	0.25%	1 Jul 2019	0.50%	2 Apr 2020
Germany	0.00%	1 Jan 2016	0.25%	1 Jul 2020
Iceland	1.75%	15 May 2019	2.00%	1 Feb 2020
Lithuania	1.00%	30 Jun 2019		
Luxembourg	0.00%	1 Jan 2016	0.25%	1 Jan 2020
Norway	2.00%	31 Dec 2017	2.5%	31 Dec 2019
Slovakia	1.50%	1 Aug 2019	2.00%	1 Aug 2020
Sweden	2.00%	19 Mar 2017	2.5%	19 Sep 2019
UK	1.00%	28 Nov 2018		

Note: *Table is provided for information only. Pending rate refers to the most recently announced rate. In some cases lower intermediate rates may come into effect in at an earlier date.*

In the case of third countries that are material from an Irish perspective, the CCyB rate in the US is currently zero per cent.

Further information

For further information, see the Macroprudential Policy section of the Central Bank website here.

[5] Information as of 26 September2019. Further information on the CCyB in Europe can be found on the ESRB website.