Countercyclical capital buffer rate announcement

27/09/2018

Announcement of rate

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 1 per cent rate was originally announced by the Central Bank in July and comes into effect in July 2019.

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] Setting a 1 per cent buffer at this stage follows the sustained trajectory in a number of indicators consistent with the gradual build-up of cyclical systemic risk. In activating the CCyB, the Central Bank also acknowledges the relative exposure and susceptibility of the Irish economy to a cyclical downturn or the materialisation of systemic risk, whereby resilience is most effectively maintained by moving early in the cycle. However, as there is no indication at present of wider imbalances in the macro-financial environment, the current buffer rate of 1 per cent can be maintained alongside a continued prudent strengthening of the aggregate credit environment (see build-up phase dashboard below).

- Overall non-financial private sector credit has maintained its trajectory towards positive growth, with year-on-year rates of change being close to 0 per cent. However large differences are seen across sub-categories, with the strengthening of credit growth evident in a number of sectors. Credit for principal dwelling home (PDH) mortgages, for instance, has now seen 9 consecutive quarters of positive and strengthening year-on-year growth. On the other hand, credit growth for buy-to-let (BTL) mortgages remains strongly negative, as would be expected given the impact of the last crisis on this sector, and provides the main drag on overall household credit growth. Growth in lending to large enterprises continues. SME credit is strengthening as the deleveraging concentrated in property related activities is increasingly offset by developments in non-property sectors.
- The national specific measure of the credit gap has been on an upward trajectory for over a year now, although in level terms remains substantially below zero. Updated estimates of an alternative credit gap estimated by the Central Bank[3] point to the gap being closed at a quicker pace. This alternative gap measure is estimated to have been just below zero in 2018Q1 (the latest available data point) and is expected to become positive during the course of 2018.

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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.

[3] See Measuring and mitigating cyclical systemic risk in Ireland: The application of the countercyclical capital buffer, Financial Stability Notes, 2018, No.4 for a discussion on estimating the various credit gap measures in Ireland and further information on the estimation of this alternative measure of the credit gap.

- New lending, and in particular mortgage lending, has been increasing rapidly for a period of time now, recovering strongly from initial subdued levels. While there remains scope for some further sustainable increases in new lending, it will be important that lending remains prudent.
- Growth in residential property prices has moderated in recent months, albeit year-on-year growth rates remain in double digits. The most recent valuation model estimates (2018Q1) point to house prices being (marginally) above what might be expected given underlying macroeconomic developments for the first time since the beginning of the recovery.
- The high level of household indebtedness as well as the large stock of NPLs that still exist are sources of vulnerability within the domestic macro-financial environment. This at a time when robust growth in the domestic economy and a tightening labour market raise the potential for overheating dynamics to emerge.
- Moreover, the small open nature of the Irish economy makes it particularly susceptible to external events where plausible tail risk events are present (e.g. hard Brexit scenarios, protectionist trade policies).

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.[4] Based on these credit gap indicators the benchmark CCyB rate is zero per cent.[5] 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.

Table 1: Credit Gap and benchmark CCyB rate (based on data referring to 2018Q1)

		Standardised Approach	**National-Specific Approach**	**Alternative (model-based) National Approach**
A	Ratio	241 per cent	97 per cent	97 per cent
B	Trend	334 per cent	173 per cent	101 per cent
C	**Credit Gap** *(=A-B)*	-93 per cent	-76 per cent	-4 per cent
	Benchmark CCyB rate	0 per cent	0 per cent	
	Δ credit gap since trough	NA	13pps	36pps

[4] 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*.

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

Table: Selected CCyB indicator dashboard – build-up phase

		Trajectory		Indicator	Data as of	Threshold	Qualitative assessment
		Persistance	*12-month change in indicator*	Latest observation			
Credit growth	Household credit		0.4pps	-1.4%	Jul-18	Historical average (1972Q2-2018Q2)	
	NFC credit		4.8pps	1.5%	Jul-18	Historical average (1972Q2-2018Q2)	
	Private Household: PDH mortgage		2pps	3.4%	Jun-18		Aggregate credit environment remains contained, but large differences in the dynamics across categories is evident.
	Private Household: BTL mortgage		-3.7pps	-12.5%	Jun-18		
	Private Household: Non-mortgage		-6.2pps	0.2%	Jun-18		
	Irish private sector enterprises: Large enterprises		3.5pps	5.2%	Mar-18		
	Irish private sector enterprises: SMEs		2.5pps	-4.5%	Mar-18		
Credit gap	National Specific		7.6pps	-76pps	Mar-18	Basel CCyB guide	Currently do not point to unsustainable imbalances in credit. Alternative measure expected to turn positive in coming quarters.
	Standardised		-37pps	-93pps	Mar-18	Basel CCyB guide	
	Alternative National Specific		17pps	-4 pps	Mar-18	Basel CCyB guide	
New lending	Mortgage lending - growth rate in 4-quarter volume		-2.5pps	24.20%	Jun-18		Mortgage lending recovering strongly from subdued levels. Scope for some further sustainable increases in the near term, but current rates of increase would be unsustainable in the medium term.
	Mortgage lending - 4-quarter volume		2.2 euro bn	7.8 euro bn	Jun-18		
	Mortgage Lending to Disposible Income Ratio		0.8pps	6.7%	Mar-18	Model benchmark (2003Q1-2018Q1)	
	Lending to SMEs - 4-quarter volume		0.4 euro bn	5.2 euro bn	Mar-18		
	Lending to SMEs - growth rate in 4-quarter volume		-24.7pps	8.24%	Mar-18		
Real estate	Residential real estate price growth		-1.2pps	10.4%	Jul-18	MIP threshold	Rate of house price growth showing signs of moderation but remains strong. House prices are now at or above levels consistent with broader economic developments.
	Residential real estate price-to-income ratio		0.3	4.2	Jun-18	Historical average (1980Q1-2018Q1)	
	Residential real estate price misalignment (model-based)		7.3pps	0.4%	Mar-18	Zero	
	Commercial real estate: price growth		-2.9pps	2.2%	Jun-18	Historical average (1996Q1-2018Q2)	
Indebtedness	Total credit-to-GDP ratio		-49pps	241.0%	Q1 2018	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 high levels of indebtedness.
	National credit-to-GNI* ratio		-9pps	97.0%	Q1 2018	Euro area aggregate (bank credit-to-GDP)	
	Household debt-to-disposable income ratio		-10pps	133%	Q1 2018	Euro area aggregate	
Macro-economy	Employment rate		1.1pps	69%	Jun-18	Historical average (1960-2017)	Approaching full employment/capacity constraints.
	Unemployment rate		-1pps	5.6%	Aug-18	Historical average (1960-2017)	
Bank balance sheets	CET1		-0.1pps	16.7%	Jun-18	CRD IV minimum requirement	Well above minimum requirements/benchmarks.
	Leverage ratio		-0.7pps	8.7%	Jun-18	CRD IV monitoring level	
Market conditions	Commercial real estate spreads		-0.1pps	4pps	Jun-18	Historical average (1994Q4-2018Q2)	Spreads are narrow but relatively unchanged.
	Irish Government bond spreads		0.1pps	0.6%	Aug-18	Historical average (Jan1998-Aug2018)	

Notes: The table provides a visual representation of the Central Bank's high level approach that informs the setting the CCyB rate. 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 moving in a direction that is indicative of a rise in cyclical systemc risk (Green represents no sustained rise in systemic risk, Amber reflects a trend of rising systemic risk for a period of 1 to 3 years, Red indicates where this trend exists for over 3 years). 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. 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[6]

A number of European authorities have announced positive CCyB rates (Table 2) which will impact on 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
UK	0.50%	27 June 2017	1.00%	28 November 2018
Slovakia	1.25%	01 August 2017	1.50%	1 August 2019
Lithuania	0.00%	30 June 2015	1.00%	30 June 2019
Czech Republic	1.00%	01 July 2018	1.50%	01 July 2019
Iceland	1.25%	01 November 2017	1.75%	15 May 2019
Norway	2.00%	31 December 2017		
Sweden	2.00%	19 March 2017		
France	0.00%	30 December 2015	0.25%	1 July 2019
Denmark	0.00%	1 January 2016	0.50%	31 March 2019

Note: *Table is provided for information only. Information as of 14 September 2018. Pending rate refers to the most recently announced rate. In some cases lower rates may come into effect in at an earlier date.*

In the case of third countries which 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.

[6] Further information can be found the ESRB website.