28 September 2020

The Central Bank ("the Bank") has today announced that the countercyclical capital buffer (CCyB) rate on Irish exposures is to be maintained at 0 per cent. Maintaining the rate at 0 per cent is deemed appropriate in the current economic conditions and consistent with the Central Bank framework in setting the CCyB.

The CCyB is the Bank's primary macroprudential tool to address cyclical systemic risks. In setting the CCyB the Bank aims to promote a sustainable provision of credit to the economy by making the banking system more resilient and less pro-cyclical. It does so by increasing regulatory capital requirements early in the upward phase of the cycle and decreasing them during a downturn.

The COVID-19 outbreak has represented an exceptional negative shock for the Irish economy, triggering the materialisation of potential challenges for financial stability. In response to this shock, the Bank has fully released the CCyB with the aim to help the banking system to absorb its impact and continue to support the economy through the sustainable provision of credit. In doing so, the Bank limits the scope for regulatory capital requirements to act as an impediment to the supply of credit. It remains in the wider interests of the Irish financial system that it continues to lend sustainably to households and businesses – minimising the extent of the downturn and maximising the contribution to the recovery.

Assessment of current macro-financial conditions in Ireland

Current conditions suggest that the Irish as well as the global economy are yet to recover to pre-COVID-19 levels.

- Domestic credit to private sector has weakened as a result of COVID-19 shock. Year-on-year non-financial private sector credit growth was -1.4 per cent as of June 2020, compared with +1.2 per cent in the same period in 2019. These numbers should however be treated with a certain degree of caution as they are being influenced by the provision of payment breaks set in place in response to the pandemic crisis. Data on the flow of lending, which are not affected by this issue, show that new lending to households and NFCs was substantially down over the course of 2020Q2.
- Data from the Banking and Payment Federation Ireland (BPFI) show that over the course of 2020Q2 mortgage drawdown activity was over a third below that of the same period in 2019. Mortgage approvals data from the same source show approximately a 50 per cent decline

relative to Q2 last year, which could result in some further weakness in credit drawdowns in the coming quarters.

- Data on Central Credit Register enquiries from the Central Bank show that enquiries on new loan applications by individuals reached a trough in April and have been steadily increasing since. July saw a 15 per cent increase on June and was just 2 per cent lower than the number of enquires seen in February. The trends on enquiries on companies are somewhat different with the trough being seen in May and as of July the number of enquiries remained 13 per cent below that seen in February.
- Notwithstanding its limitations during periods where cyclical risks have materialised such as the present time, the credit-to-GDP gap is a required reference indicator under CRD IV. Latest data on the standard and national specific credit gaps (2020Q1) [1] indicate they remain negative. The alternative gap measure is close to but below zero at -1.5. Due to the lag in the publication of the underlying data, these measures only marginally reflect the impact of the economic crisis triggered by the COVID-19 outbreak.
- High frequency data suggest that real economic activity has rebounded after reaching its trough in April, however it remains well below pre-COVID levels. The Covid-Adjusted measure of the unemployment rate[2] stood at 17 per cent in July 2020. Under the Bank's current baseline forecast scenario, the adjusted unemployment rate is set to decline from its second quarter peak of about 25 per cent as the year progresses before averaging just over 9 per cent next year and 7 per cent in 2022[3].
- The Irish PMI and KBC's monthly index of Irish consumer confidence rebounded in July as restrictions eased and some businesses re-opened. Looking forward, the outlook for economic activity is surrounded by considerable uncertainty given by both future developments of the pandemic as well as the potential impact of a new EU-UK trading relationship. Under the Bank's baseline scenario, underlying domestic demand is expected to contract by 9.5 per cent this year, while GDP is estimated to fall by 9 per cent.

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[1] 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*.

[2] In March, the CSO has introduced an alternative COVID-19 Adjusted Measure of Unemployment to estimate the share of the labour force that are not working due to unemployment, or due to COVID-19 related absences. The number to be considered as unemployed for this measure is calculated by adding persons in receipt of the Pandemic Unemployment Payment to the non-seasonally adjusted volume of unemployed persons. For more information see the CSO Technical Note.

[3] Quarterly bulletin, July 2020, Central Bank of Ireland.

- On the global financial markets side, policy interventions worldwide helped ease financial conditions. Central Banks across the globe took unprecedented measures against the financial turmoil and contributed to declining benchmark interest rates and rebounding assets prices, leading to an overall easing in financing conditions.

In terms of the outlook, the Central Bank has made it clear that no increase in the CCyB rate will be announced prior to 2021Q1 at the earliest, with subsequent decisions being made in line with the Bank's CCyB framework and based on the prevailing macroeconomic and financial conditions. The regular assessment of macro-financial conditions published in the semi-annual Financial Stability Review provides the next opportunity to review the CCyB outlook. In this regard, the Bank will also take into account that the ECB has recently clarified that it will not require banks to comply with P2G and the combined buffer requirement any earlier than end-2022.