Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Announcement

Countercyclical capital buffer rate announcement

18 December 2018

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] The current calibration reflects the sustained trajectory in a number of key indictors related to the gradual build-up of cyclical systemic risk, while also acknowledging the scope for further sustainable increases in aggregate credit. As imbalances in credit, new lending, real estate prices and the wider economy are yet to emerge, a buffer rate above 1 per cent is not considered appropriate at this time.

In maintaining the rate at 1 per cent the following were taken into account:

- Credit dynamics continue to strengthen albeit that in aggregate non-financial private sector credit growth remains relatively contained. Underlying the aggregate figures a number of consistent trends are evident:
    - PDH mortgage lending (driven by lending at fixed interest rates in particular) is seeing more robust increases.
    - New mortgage lending continues to see strong increases on an annual basis although there appears scope for some further sustainable increases. The ratio of new mortgage lending to household disposable income (6.7 per cent) is below its threshold (8 per cent), although this gap is narrowing.
    - New lending to SMEs continues to see modest increases although overall it continues to be offset by repayments with overall SME credit continuing to decline. This is especially the case in relation to lending for property related activities.
- Robust cyclical dynamics continue to be observed in the domestic economy. Persistent declines in the unemployment rate have brought it to ten year lows, alongside continuing growth in employment and indications of a tighter labour market. Moreover, forecasts for the domestic economy are for a continuation of robust growth into 2019 and further reductions of the unemployment rate which is expected to fall to 4.9 per cent on average in 2019.
- In terms of asset prices, recent months have seen a moderation in the rate of house price growth. However, valuation metrics would indicate that house prices are now in line with or above values justified by economic fundamentals.
- Market based indicators, which may be useful in the context of releasing the CCyB rate, do not point to the materialisation of financial stress at present.

In addition, given the relative exposure and susceptibility of the Irish economy to a cyclical downturn or the materialisation of systemic risk the calibration of the CCyB rate takes account of the substantial downside risks which are prevalent both domestically and internationally and the

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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.

vulnerabilities within the Irish macro-financial environment (e.g. high NPLs, household indebtedness).

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.

Table 1: Credit Gap and benchmark CCyB rate (based on data referring to 2018Q2)

		Standardised Approach	**National-Specific Approach**	**Alternative (model-based) National Approach**
A	Ratio	240 per cent	94 per cent	94 per cent
B	Trend	330 per cent	169 per cent	93 per cent
C	**Credit Gap** *(=A-B)*	-93 per cent	-75 per cent	0 per cent
	Benchmark CCyB rate	0 per cent	0 per cent	
	Δ credit gap since trough	NA	15pps	43pps

[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: Selected CCyB indicator dashboard – build-up phase

CCyB Indicator Dashboard								
		Trajectory		Indicator		Latest obs date	Threshold	Qualitative assessment
		Persistance	*12-month change in indicator*	*Latest observation*	*Risk level*			
Credit growth	Household credit growth		0.3 pps	-1.2%		Oct-18	Historical average	Aggregate credit environment remains contained, but large differences in the dynamics across categories is evident.
	Domestic NFC credit growth		1.9 pps	0.9%		Oct-18	Historical average	
	Private Household: PDH Mortgage		2.1 pps	3.9%		Sep-18	No threshold established	
	Private Household: BTL Mortgage		-5.3 pps	-13.5%		Sep-18	No threshold established	
	Private Household: Non-mortgage		-5.3 pps	0.2%		Sep-18	No threshold established	
	Irish Private Sector Enterprises: Large Enterprises		-3.3 pps	4.2%		Jun-18	No threshold established	
	Irish Private Sector Enterprises: SMEs		3.0 pps	-6.3%		Jun-18	No threshold established	
Credit gaps	Standardised credit gap		-28.9 pps	-93.0pps		Jun-18	Lower threshold for CCyB setting (BCBS 2010)	Currently do not point to unsustainable imbalances in credit. Alternative measure now marginally positive however.
	National credit-to-GNI* gap		7.0 pps	-74.9pps		Jun-18	Lower threshold for CCyB setting (BCBS 2010)	
	Alternative National Specific gap		18.0 pps	0.3pps		Jun-18	Lower threshold for CCyB setting (BCBS 2010)	
New lending	Mortgage Lending: 4-quarter volume		€1.8 bn	€8.0 bn		Sep-18	No threshold established	Mortgage lending recovering strongly from subdued levels. Scope for some further sustainable increases in the near term.
	Mortgage Lending-to-Disposable Income ratio		0.5 pps	6.6%		Jun-18	Model Benchmark (2003Q1-2018Q1)	
	Lending to SMEs: 4-quarter volume		€0.4 bn	€5.3 bn		Jun-18	No threshold established	
Real estate	Residential property price growth (m)		-3.2 pps	8.4%		Oct-18	MIP threshold	Rate of house price growth has moderated in recent months but remains strong. House prices are now at or above levels consistent with broader economic developments.
	Residential property price-to-income ratio		6.6%	4.2		Jun-18	Historical average	
	Res. real estate misalignment measure		5.4 pps	0.8%		Jun-18	Zero	
	Commercial real estate price growth		-4.2 pps	1.4%		Sep-18	Historical average	
Indebtedness	Total credit-to-GDP ratio		-37.5 pps	240.4%		Jun-18	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		-10.0 pps	93.6%		Jun-18	Euro area aggregate (bank credit-to-GDP)	
	Household debt-to-income ratio		-12.4 pps	128.5%		Jun-18	Euro area aggregate	
Macro- economy	Employment rate		1.1 pps	69.1%		Sep-18	Historical average	Approaching full employment/capacity constraints.
	Unemployment rate		-1.1 pps	5.3%		Nov-18	Historical average	
Bank balance sheets	CET1 Ratio - retail banks		-0.6 pps	16.4%		Sep-18	CRD IV minimum requirement	Well above minimum requirements/benchmarks.
	Leverage ratio - retail banks		-0.5 pps	8.6		Sep-18	Historical average	
Market conditions	Commercial real estate spreads (bps)		-14.1 bps	397 bps		Sep-18	Historical average	
	Irish gov bond spreads - monthly avg (bps)		7 bps	30 bps		Nov-18	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 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	1.00%	28 November 2018		
Slovakia	1.25%	01 August 2018	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	2.5%	19 September 2019
France	0.00%	30 December 2015	0.25%	1 July 2019
Denmark	0.00%	1 January 2016	1.00%	30 September 2019
Bulgaria	0.00%	1 January 2016	0.50%	1 October 2019

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 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.

[5] Information as of 12 December 2018. Further information on the CCyB in Europe can be found on the ESRB website.