Countercyclical capital buffer rate announcement

18 April 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 1 per cent rate was originally announced by the Central Bank in July 2018 and comes into effect in July of this year. 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 is informed by the trajectory in a number of key indicators, pointing to a gradual build-up of cyclical systemic risk, while also acknowledging that material evidence of imbalances in credit, new lending, real estate prices and the wider economy is yet to emerge.

The decision to maintain the CCyB rate at 1 per cent is taken under the assumption of no disorderly Brexit scenario occurring over the relevant time horizon. Such a scenario however remains a possibility and the Central Bank stands 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:

- Credit dynamics continue to strengthen with aggregate (on-balance sheet) non-financial private sector credit growth now approximately 2 per cent, on a year-on-year basis.[3] Underlying the aggregate figure, divergent trends emerge across different segments:
    - Mortgage lending for primary dwelling homes (driven by lending at short to medium-term fixed interest rates) is seeing increasingly robust growth and is the main driver of growth in aggregate credit.
    - Lending to large enterprises is also seeing strong rates of growth, having picked up somewhat over the later part of 2018.
    - In contrast, rates of change in lending to small & medium entrerprises (SMEs) and for buy-to-let (BTL) mortgages remain consistently negative.
    - New lending continues to see rapid rates of growth, particularly in relation to mortgage lending, although new lending to SMEs is also on a general upward trend.
    - The upward trajectory of the national specific and alternative credit gaps continued in 2018Q3. The alternative measure is now in positive territory although, at a level of 1 per cent, does not yet indicate significant imbalances.

[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] Taking account of mortgages which have been transferred off-balance sheet but continue to be serviced by the credit institution the corresponding rate of growth is 0.4 per cent.

- The Irish domestic economy continues to perform strongly. Benchmarked against their long-run averages, both employment and unemployment rates reflect relatively tight labour market conditions. As of March, the monthly unemployment rate had declined to 5.4 per cent.
- While acknowledging the uncertainty around the outlook for the Irish economy, the central forecast as set out in the Central Bank's latest Quarterly Bulletin is for a still solid, albeit moderating, pace of expansion.
- As of February, the annual rate of house price growth stood at 4.3 per cent. The annual rate of house price growth has consistently moderated since April 2018. On the other hand, the sustained price increases that have occurred in recent years have eroded any undervaluation present in the aftermath of the crisis, to the extent price levels are now at or above those consistent with broader economic developments.
- Although reducing over time, the long-standing and slow moving vulnerabilities of high private sector indebtedness and non-performing loans (NPLs) remain features of the macro-financial environment in Ireland.
- While showing some signs of volatility over recent months, market-based indicators do not appear, overall, to be reflective of significant financial stress or a material change in the perception of risk in the Irish macro-financial environment at present.

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, 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 2018Q3)

		Standardised Approach	**National-Specific Approach**	**Alternative (model-based) National Approach**
A	Ratio	239 per cent	94 per cent	94 per cent
B	Trend	330 per cent	164 per cent	93 per cent
C	**Credit Gap** *(=A-B)*	-91 per cent	-70 per cent	1.1 per cent
	Benchmark CCyB rate	0 per cent	0 per cent	
	Δ credit gap since trough	NA	19.3pps (2014Q3-2018Q3)	43pps (2013Q1-2018Q3)

[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

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		0.8 pps	-0.7%		Feb-19	Historical average	Aggregate credit environment while strengthening remains contained. Large differences in the dynamics across categories are evident.
	Domestic NFC credit growth		3.5 pps	3.4%		Feb-19	Historical average	
	Private Household: PDH Mortgage		2.7 pps	4.7%		Dec-18	No threshold established	
	Private Household: BTL Mortgage		-7.2 pps	-15.9%		Dec-18	No threshold established	
	Private Household: Non-mortgage		-1.0 pps	2.7%		Dec-18	No threshold established	
	Irish Private Sector Enterprises: Large Enterprises		7.5 pps	12.1%		Dec-18	No threshold established	
	Irish Private Sector Enterprises: SMEs		-2.3 pps	-3.2%		Dec-18	No threshold established	
Credit gaps	Standardised credit gap		-17.2 pps	-91.5pps		Sep-18	Lower threshold for CCyB setting (BCBS 2010)	Currently do not point to unsustainable imbalances in credit. The alternative gap measure is however now positive.
	National credit-to-GNI* gap		10.3 pps	-70.3pps		Sep-18	Lower threshold for CCyB setting (BCBS 2010)	
	Alternative National Specific gap		13.2 pps	1.1pps		Sep-18	Lower threshold for CCyB setting (BCBS 2010)	
New lending	Mortgage Lending: 4-quarter volume		€1.6 bn	€8.3 bn		Dec-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		0.4 pps	6.5%		Sep-18	Model Benchmark (2003Q1-2018Q1)	
	Lending to SMEs: 4-quarter volume		€0.4 bn	€5.3 bn		Dec-18	No threshold established	
Real estate	Residential property price growth (m)		-8.1 pps	4.3%		Feb-19	MIP threshold	Rate of house price growth has moderated substantially in recent months. House prices are now at or above levels consistent with broader economic developments.
	Residential property price-to-income ratio		16.6%	4.2		Sep-18	Historical average	
	Res. real estate misalignment measure		1.8 pps	-0.5%		Sep-18	Zero	
	Commercial real estate price growth		1.8 pps	5.3%		Dec-18	Historical average	
Indebtedness	Total credit-to-GDP ratio		-27.3 pps	239.1%		Sep-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		-6.6 pps	94.2%		Sep-18	Euro area aggregate (bank credit-to-GDP)	
	Household debt-to-income ratio		-12.4 pps	125.8%		Sep-18	Euro area average	
Macro- economy	Employment rate		0.8 pps	69.1%		Dec-18	Historical average	Approaching full employment/capacity constraints.
	Unemplopment rate		-0.4 pps	5.4%		Mar-19	Historical average	
Bank balance sheets	CET1 Ratio - retail banks		-1.2 pps	16.6%		Dec-18	CRD IV minimum requirement	Well above minimum requirements/benchmarks.
	Leverage ratio - retail banks		-0.5 pps	8.7%		Dec-18	European average	
Market conditions	Commercial real estate spreads (bps)		-23.3 bps	396 bps		Dec-18	Historical average	
	Irish gov bond spreads - monthly avg (bps)		20 bps	63 bps		Mar-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[6]

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
UK	1.00%	28 Nov 2018		
Slovakia	1.25%	1 Aug 2018	1.50%	1 Aug 2019
Lithuania	0.50%	31 Dec 2018	1.00%	30 June 2019
Czech Republic	1.25%	1 Jan 2019	1.75%	1 Jan 2020
Iceland	1.25%	1 Nov 2017	2.00%	1 Feb 2020
Norway	2.00%	31 Dec 2017	2.5%	31 Dec 2019
Sweden	2.00%	19 Mar 2017	2.5%	19 Sept 2019
France	0.00%	30 Dec 2015	0.25%	1 July 2019
Denmark	0.50%	31 Mar 2019	1.00%	30 Sept 2019
Bulgaria	0.00%	1 Jan 2016	0.50%	1 Oct 2019
Luxembourg	0.00%	1 Jan 2016	0.25%	1 Jan 2020

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.

[6] Information as of 10 April 2019. Further information on the CCyB in Europe can be found on the ESRB website.