Introduction of the CCB in Ireland and announcement of buffer rate

8th December 2015

Announcement of rate

The Central Bank today announces the introduction of the countercyclical capital buffer (CCB) in relation to Irish exposures, pursuant to the European Union (Capital Requirements) Regulations 2014.[1] The CCB will come into effect as of January 1 2016 at a rate of 0 per cent.

CCB Framework

The CCB is a macro-prudential tool introduced by S.I. 158 of 2014. It is a time-varying capital requirement for banks (and investment firms) which aims to protect the banking sector from potential losses that can arise when excessive credit growth is associated with a build-up of systemic risk.

S.I.158 of 2014 designates the Central Bank as the national authority responsible for setting CCB rates for the State. The CCB rate for the State will be set on a quarterly basis henceforth.

Rationale

In setting the rate at 0 per cent, the Central Bank took into account the following:

- Credit developments in the economy remain subdued as the non-financial private sector continues to deleverage.
    - Credit growth is weak across both the household and non-financial corporate (NFC) sectors and has been lagging behind GDP growth.
    - The outstanding stock of credit, as measured by both the standardised credit-to-GDP ratio and an adjusted measure of the same that adjusts for the contribution of multinational non-financial corporations, is below trend.
    - The level of household indebtedness, in particular, has fallen considerably in the past number of years and this pattern is on-going.
- In the residential property sector, prices are growing, in real terms, at about 8 per cent year-on-year. This represents a moderation relative to growth rates recorded at end-2014, however. Future house price expectations have also moderated.[2]
- While commercial property prices continue to increase rapidly, this is driven by a combination of supply shortages and strong international investment demand. Credit developments and bank lending to the commercial property sector remain muted.

[1] S.I. 158 of 2014 transposes Directive 2013/36/EU ('the EU Capital Requirements Directive') in Ireland.

[2] The CBI has taken targeted action in placing limits on residential mortgage lending early in 2015 in order to ensure households and banks maintain resilience against declines in residential property prices and to limit pro-cyclical developments in the market.

- Additional indicators relating to external imbalances, the private-sector debt burden and the strength of bank balance sheets, do not currently point to emerging imbalances or vulnerabilities.

Required indicators

The Central Bank is required to take account of the credit-to-GDP gap, calculated in a standardised manner, when setting the CCB rate. Following the prescribed approach, the credit-to-GDP gap is -60 percentage points, based on a credit-to-GDP ratio of 262 per cent and an estimated trend[3] of 321 per cent. The corresponding benchmark buffer rate is 0 per cent.

In addition to the standardised approach, a national specific credit gap has been calculated. Large multinational companies play a substantial role in the NFC sector in Ireland. Such companies often source credit from abroad, through for example, non-Irish parent companies, international banks or capital markets. As such, total credit to the NFC sector may not reflect the underlying performance of the domestic economy. A national specific credit gap, where credit is equal to household credit plus NFC credit from resident banks to resident NFCs, may better reflect domestic developments. The credit-to-GDP ratio in this case, at 105 per cent, is significantly lower than that under the standardised approach. However, the associated credit gap is also negative (-67 percentage points), once again resulting in a benchmark buffer rate of 0 per cent.

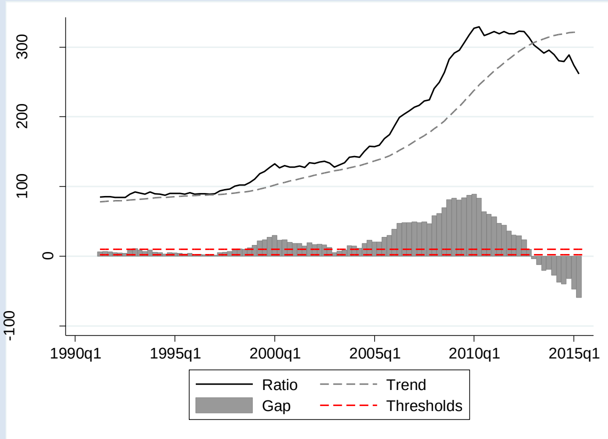
Further information

Further information, including the credit-to-GDP gaps referred to above and other quantitative indicators can be found on www.centralbank.ie. A selection of relevant indicators is shown in the Annex.

[3] The trend credit-to-GDP ratio is calculated in line with ESRB Recommendation 2014/1 using a recursive Hodrick-Prescott filter with a lambda value of 400,000.

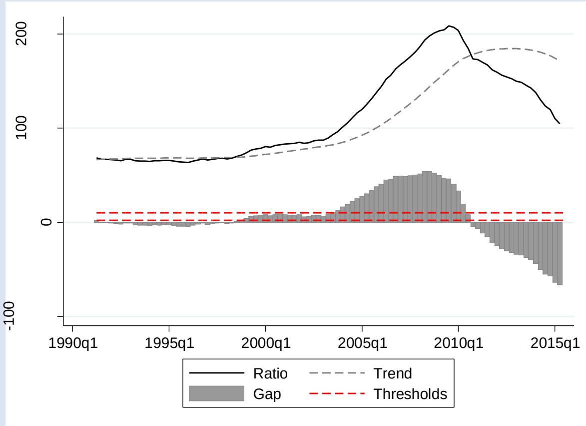
Annex: Quantitative indicators

Credit-to-GDP ratio and gap: Standardised Methodology



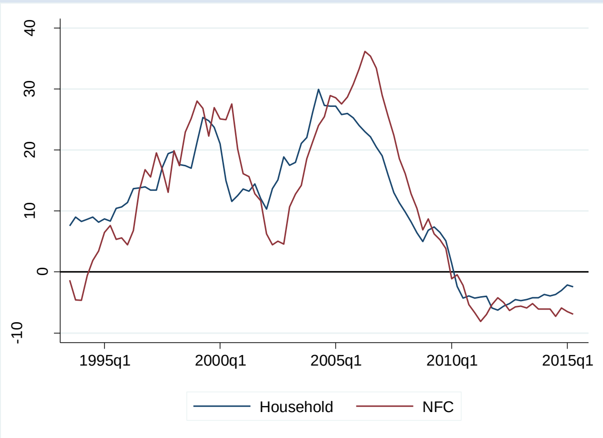
Source: CBI calculations

Credit-to-GDP ratio and gap: National specific approach



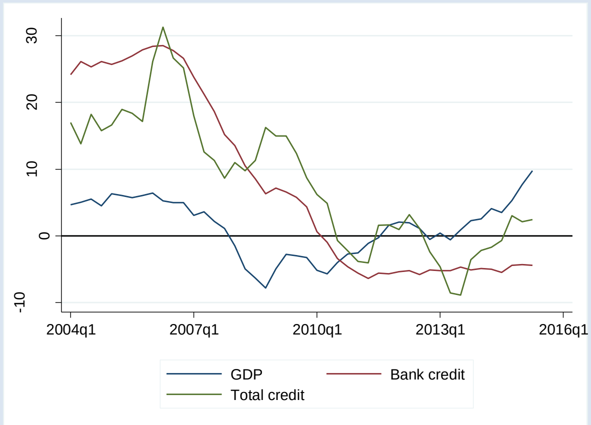
Source: CBI calculations

Year-on-year credit growth in bank lending to household and non-financial corporate sectors (Real)



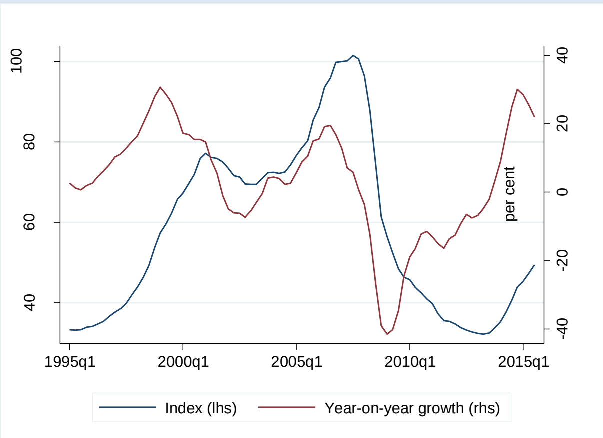
Source: CBI

Year-on-year growth in credit to non-financial private sector and real GDP (Real)



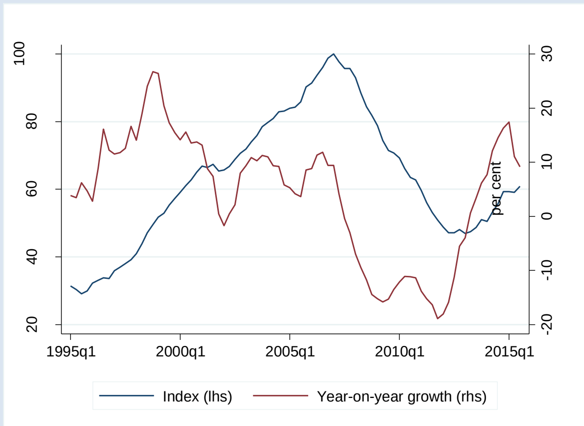
Source: CSO & CBI

Commercial property price index and year-on-year growth rate (Real)



Source: IPD and CBI calculations

Residential property price index and year-on-year growth rate (Real)



Source: CSO, ESRI and CBI calculations