

## **Macroprudential Measures Committee**

### **Account of meeting no. 2 of 2017 held on 3 March**

**In attendance:** Governor Philip Lane (Chair); Sharon Donnery (Deputy Governor, Central Banking); Gabriel Fagan (Chief Economist); and Mark Cassidy (Head of Financial Stability Division and Secretary to the Committee).

**Also present:** Martin O'Brien (Macroprudential Manager, Financial Stability Division); Eoin O'Brien (Economist, Financial Stability Division); and Breda Cassidy (Advisor, Financial Stability Division).

**Apologies:** Cyril Roux (Deputy Governor, Financial Regulation); Ed Sibley (Director of Credit Institutions Supervision); and Maurice McGuire (incoming Director of Financial Stability and Resolution).

1. The draft agenda was adopted and the account of the previous meeting was approved for publication. Follow-up actions arising from the discussion at the previous meeting were noted to include: a policy note on potential interactions between the countercyclical capital buffer (CCyB) and the macroprudential mortgage market measures tabled for the meeting on 2 June; and a note on debt-to-income and debt-servicing limits tabled for the meeting on 3 October.

#### **2. (a) Quarterly review of CCyB rate on Irish exposures**

The CCyB is aimed at reducing the pro-cyclicality of the financial system and, more specifically, at protecting the banking sector from periods of excess aggregate credit growth that can be associated with the build-up of system-wide risk. The CCyB requires banks to set aside additional common equity tier one capital during periods of strong credit growth and growing systemic risk.<sup>1</sup> The buffer can be released during economic downturns to prevent undue restrictions in the supply of credit to the private sector. The Central Bank (the Bank) is designated as the national authority responsible for setting the CCyB rate in Ireland<sup>2</sup> and as such is required to set a rate, having consulted with the ECB, on a quarterly basis.

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<sup>1</sup> The CCyB is also applicable to in-scope investment firms of which there are currently none identified in Ireland.

<sup>2</sup> Statutory Instrument 158 of 2014 gave effect to this mandate. There is a strong European element to the framework, with the European Systemic Risk Board (ESRB) having the power to issue guidance to national authorities on the implementation of the CCyB framework, as well as the powers of the ECB to top-up CCyB rates set by national authorities within the macroprudential mandate given to it by the Single Supervisory Mechanism.

To facilitate a comprehensive review of the CCyB rate on Irish exposures, currently at 0 per cent, the Financial Stability Division prepared a chartpack which provided latest developments for a range of mandated and other policy-relevant indicators such as broad credit developments and credit-to-GDP gap indicators. In addition, indicators relating to other potential sources of cyclical systemic risk were included, for example, pertaining to property prices, external imbalances and the debt-service ratio.

To a large extent, prevailing conditions relevant for the setting of the CCyB rate were considered to be similar to the last quarter. It was highlighted that at an aggregate level the credit environment remains relatively subdued, however a relative strengthening is occurring with certain areas now seeing positive credit growth. The following indicators were discussed:

- Private non-financial sector credit continues to decline, albeit the rate of decline is slowing;
- Underlying the aggregate figures, certain pockets of positive credit growth have emerged. Consumer credit, fixed-rate mortgage lending and credit to large enterprises are all now seeing consistently positive rates of credit growth;
- New lending continues to increase with the construction and real estate sector accounting for a sizable portion;
- Notwithstanding the caveats relating to the credit gap indicators at this time, they are currently suggestive of a weak credit environment in Ireland. The associated benchmark buffer rate is currently 0 per cent;
- In terms of property prices, the rate of increase in commercial real estate prices continues to moderate and is currently in single digits. On the residential side, looking beyond some monthly volatility, the year-on-year rate of increase in prices picked-up somewhat during 2016; and
- External imbalance indicators and aggregate bank balance sheet ratios do not point to growing vulnerabilities at this time.

The CCyB Indicator Dashboard and Heatmap were noted. Following discussion of the CCyB rate on Irish exposures, the Committee agreed on no change at this juncture. For future reviews, it was recommended that consideration be given to possible turning points in the cycle from an analytical perspective along with a review of the literature and experience on double-credit booms. Further analysis focussing on gross versus net lending at this stage of the credit cycle was also recommended as well as analysis of the distribution of credit for different cohorts (e.g. 25-35 year olds). From discussions with other central banks in the EU, it was noted that there has been little experience to

date with the setting of positive buffers in the context of banks holding capital in excess of the regulatory minima.

#### **(b) Annual review of material third countries**

Recommendation B of ESRB/2015/1<sup>3</sup> states that designated authorities are to identify and, where relevant, monitor third countries<sup>4</sup> which are material to them in the context of the CCyB on an annual basis. The issue was initially discussed by the Bank at its Financial Stability Committee in March 2016 – where the US was identified as the sole third country to which Ireland had a material exposure at that time. Furthermore, as the US was deemed material from a European perspective and is therefore subject to monitoring by the ESRB, it was decided that the Bank would not monitor the risks arising from excessive credit growth in the US.

It was noted that a country is to be deemed material from an Irish perspective if:

- Two of the three quantitative measures used indicates an exposure above the given threshold on the basis of: the current level of exposure; and the average level of exposure over the most recent four quarters;
- A threshold of 1 per cent to be applied; and
- In borderline cases, judgement based on the nature of the exposures should be applied.

The three quantitative measures used, in line with those applied by the ESRB as outlined in Decision ESRB/2015/3<sup>5</sup>, are:

- risk weighted exposure amounts;
- original exposures; and
- defaulted exposures.

Based on the review carried out by the Financial Stability Division, it was agreed that the third country identified as material from an Irish perspective is the US. It was recommended that the Bank maintain its stance not to monitor the cyclical systemic risks associated with excess credit growth in third countries identified as material where the country in question is already subject to monitoring by the ESRB.

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<sup>3</sup> [Recommendation of the ESRB on recognising and setting countercyclical buffer rates for exposures to third countries.](#)

<sup>4</sup> Third country refers to any jurisdiction outside the European Economic Area.

<sup>5</sup> [Decision of the ESRB on the assessment of materiality of third countries for the Union's banking system in relation to the recognition and setting of countercyclical buffer rates.](#)

### 3. Recommendations

- Following agreement on no change to the CCyB rate of zero, it was recommended to proceed with notifying the ECB of the proposal in line with the required notification process. A public statement will issue following the notification process;
- For future reviews of the CCyB rate on Irish exposures, it was recommended that consideration be given to possible turning points in the cycle from an analytical perspective along with a review of the literature and experience on double-credit booms. Further analysis focussing on gross versus net lending at this stage of the credit cycle was also recommended as well as an analysis of the distribution of credit for different cohorts (e.g. 25-35 year olds); and
- Following agreement on no change to the existing position of the Bank with regard to the review of material third countries, for the purpose of the CCyB, it was recommended that the ESRB be notified as required under ESRB/2015/1.