Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

FAQ Special Portfolio

Background

The Central Bank acquired a range of assets following the liquidation of IBRC in February 2013. These included Promissory Notes, a standard fixed rate Irish 2025 Government Bond, special NAMA bonds specifically related to the assets of IBRC itself and some standard NAMA bonds as well as a small amount of other assets. The Promissory Notes, which were non-standard instruments, were exchanged for a portfolio of floating rate notes (FRNs) which are standard long-dated government bonds with a floating rate coupon (i.e. a regular interest payment which varies with market rates).

The Central Bank stated that it would dispose of the government bonds as soon as possible, provided conditions of financial stability permit. It also indicated a minimum schedule of €0.5 billion up to the end of 2014, €0.5 billion per annum up to 2018, €1 billion per annum for each of the next five years and €2 billion per annum after that. This position remains unchanged.

The following are some questions and answers which provide more information on this topic.

What has happened to the assets acquired by the Central Bank since the liquidation?

All of the IBRC-related NAMA bonds have been redeemed by NAMA, following the successful sale of the assets it acquired as part of the liquidation process. Some of the standard NAMA bonds have also been redeemed as part of NAMA's regular redemption activity. In addition, the Central Bank has sold its €3.46 billion holding of the 2025 fixed rate government bond, €350 million in 2013, followed by another €2.3 billion in 2014 and the remainder in early 2015. The Central Bank has also sold €500 million of the 2038 FRN to the NTMA in December 2014. The remaining assets now consist solely of €395 million of standard NAMA bonds and approximately €24.5 billion of FRNs. The amounts quoted above are all nominal amounts, i.e. the value of the debt in nominal terms, not the market value of the bonds which varies over time.

Did the Central Bank make any profits on its sales of these government bonds?

Irish government bonds have been consistently attracting higher prices in the bond market over time and, as a result, the value of the government bonds on the Central Bank's balance sheet has also risen. These gains are recorded as unrealised gains and contribute to the Central Bank's accounting reserves but not to its profits, unless or until they are sold. When the Central Bank sells one of these bonds, however, it realises a gain which is then recorded as part of its profit. The total realised gains on sales of the fixed and floating rate government bonds to date are approximately €1,057 million. Of this figure, about €877 million relate to gains on the sales of fixed rate bonds and about €180 million to the sales of the 2038 FRN in December 2014.

While such bonds are held by the Central Bank, interest paid on them contributes to the Central Bank's profits, partly offset by the effective cost of funds to the Central Bank (though this, at present, is only 0.05 per cent). The FRNs pay interest at a rate equal to the 6-month euribor rate plus a fixed spread which differs between the bonds of different maturities but has a weighted average of 2.62%.

What happens to the Central Bank's profits?

By law, the Central Bank can retain up to 20 per cent of its profits for the purpose of adding to its accounting reserves; any amount not retained is distributed to the Exchequer. According to Government accounting principles defined by Eurostat the surplus income paid to the Exchequer is partly treated as a capital receipt and partly as a current receipt. Only the current part serves to reduce the General Government deficit; the remainder does not impact on the deficit but does reduce Government net debt.

What implications do such sales have for the overall position of State's finances?

One way of thinking about the Exchequer's position in this regard is to consider the disposal by the Central Bank of FRNs to the NTMA. For example, in December 2014, the NTMA bought €500m (nominal) of the 2038 FRN from the Central Bank for a cash price of €680m. The €680m was, of course, funded by the NTMA in the market, at the current low interest rates, but the additional €180m has augmented the 2014 profit of the Central Bank, the bulk of which will be distributed back to the Exchequer as surplus income. So the Exchequer is now servicing the €500m at current market yields with the bulk of the €180m being returned to it in cash. Thus, from the point of view of the Government's budget, the disposal can be seen as a refinancing of part of Government debt at current market rates, which are much lower than the rates which prevailed when the FRNs were issued.

As long as the Central Bank is the holder of the FRNs, and as long as the effective cost of funds to the Central Bank (in practice, the ECB Main Refinancing Rate or 'MRO' rate, currently 0.05 per cent.) is below the coupon on the bonds, there will be some net interest contribution to the Central Bank's profits. Since most of the Central Bank's profits are remitted as surplus income to the Exchequer, it might appear that a relatively slow pace of disposal would benefit the Exchequer. The eventual impact will, of course, depend on a range of factors, including future interest rates, which cannot be predicted with accuracy. Nevertheless, when interest rates on new issues of Government debt were much higher than they are today, refinancing would have seemed relatively expensive and this would have supported the idea that slower sales might be beneficial to the Exchequer. However, the current low cost of refinancing by the NTMA, though still somewhat above the Central Bank's effective cost of funds, reflects the exceptionally low level of interest rates and it could, therefore, be below the cost of the same refinancing at some point in the future. As a result, any small short term gain to the Exchequer resulting from slower refinancing could be more than offset by a higher cost of refinancing in the future.

An additional consideration is that future and, therefore, more uncertain profit flows should be discounted relative to early profit flows.

Is there a danger that sales could disturb the market?

As already noted, the Central Bank will continue to take account of financial stability considerations in its disposals. There have been no indications of a disturbance to the market arising from any sales to date.