Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Transcript: Media Briefing

Financial Stability Review 2020:I

16 June 2020

Governor Gabriel Makhlouf:

Good afternoon everybody. This slightly surreal virtual world that we live in. As you know, this afternoon we're publishing our latest semi-annual Financial Stability Review.

The FSR is one of the main ways we communicate our thinking on the risks facing the economy and financial system, how well the financial system as a whole can face those risks and the policy actions that we're taking among others to safeguard financial stability and ensure the financial system supports households and businesses in a sustainable way. Our aim remains to have a resilient financial system that can absorb and not amplify adverse shocks, one that performs its essential function to support the real economy through both good times and bad.

Now, I think it's not an overstatement if I say that developments so far in 2020 underline the necessity of that approach.

COVID-19 has been a public health crisis, the likes of which almost none of us have seen in our lifetime. It has also brought in its wake an economic shock unprecedented in scale and speed. And it has been a test of the financial system like no other in the last decade. Unlike the experience of a decade ago, the financial system is not the origin of the current challenges but like the rest of the economy, it is affected by them.

We are perhaps only at the end of the beginning of seeing those challenges emerge.

As we've taken stock of what this means for domestic financial stability in the FSR, I think there are three key messages emerging.

First the speed, size and pervasive nature of the economic shock have presented both immediate challenges and tighter financing conditions as well as a sharp deterioration in the macro financial outlook with further downside risks for households, businesses, the public finances and the financial sector.

Second, households, businesses and the financial system have entered into the current phase in a more resilient position compared to the onset of the crisis a decade ago. Indeed, the domestic banking system has played a role in supporting the liquidity needs of households and businesses so far in this crisis, including through payment breaks. Looking ahead, the banking system will be making losses. The capital buffers we have asked banks to build up in recent years are now there to absorb those losses. But of course, that resilience is not unlimited.

Third, the policy actions taken in the area of fiscal and monetary policy as well as macroprudential and supervisory policy, have been necessary to mitigate the amplification of the immediate shock to enable the financial system to support households and businesses through the crisis and to minimise the extent of longer-term difficulties. As a result of the pandemic, we've seen over one million people in receipt of state income support.

And alongside the domestic economic shock, Ireland remains sensitive to global developments. Both the near-term global downturn and financial market conditions as well as any longer-term structural changes that might be triggered by the experience of the pandemic. And closer to home the outcome of the negotiations on the future EU-UK relationship is also of relevance to the macro financial outlook.

The immediate strain on households and businesses as a result of the economic shock has resulted in a necessary increase in public spending. Fiscal policy is the first line of defence, given the unprecedented collapse in the economic activity. Government support is also necessary to minimise the risk of a long-term fall in the productive capacity of the economy due to COVID-19. The necessary intervention will result in much higher public debt than what would otherwise have been the case and the implications of this will be addressed in the Bank's next Quarterly Bulletin due to be published on 3 July.

The near-term liquidity challenges faced by households and businesses as a result of the COVID-19 shock are significant. And, depending on future developments, could result in solvency issues emerging. In the months ahead, minimising the extent to which these liquidity issues are followed by solvency issues will be important. The banking system has a role to play and it must do so in a suitable way. Temporary payment breaks that have been introduced are partly offsetting the immediate liquidity shock households and businesses are facing. But a portion may ultimately require longer-term solutions.

In such cases, the Central Bank expects lenders to assure appropriate solutions including forbearance are available. We expect lenders to engage with borrowers well in advance of the expiry of the payment break to support customers and our existing arrears handling frameworks, including the statutory code of conduct on mortgage arrears will apply in the normal manner. Those frameworks are designed to protect the interests of borrowers, particularly at times when they experience financial difficulties because of illness or loss of income.

However, policy actions in the years since the last financial crisis have contributed to the financial system being in a much better place to support households and businesses now. Resilience has been built incrementally through the mortgage measures and has been locked in with the activation of the countercyclical capital buffer and other capital buffers. With the release of the CCyB that we announced in mid-March and the availability of the other capital buffers such as the O-SII buffer to absorb losses, banks are in a better position to lend sustainably to the real economy.

To sum up, the COVID-19 crisis is not over. And the scale of its economic impact is uncertain. The initial shock is behind us but the macro-financial outlook will depend on a number of factors. Fundamentally it boils down to the uncertainty over how the pandemic itself will play out, the success of the public health measures and medical advances to tackle it, the capacity and actions of the financial system, households, and businesses to absorb and not amplify the shock, and the success of economic and financial stability policies to mitigate its impact. We are, as I said, at the end of the beginning.

And finally, when we published our previous FSR in early December last year, I spoke about our key areas of focus going into 2020 from a macroprudential perspective and how we were developing our approach to building additional resilience covering banks, borrowers and non-banks. That agenda remains but events over the last few months have led us to focus our work programme to devote more resources to ensuring that the resilience built in recent years can be drawn upon as appropriate to support the economy through the crisis. It is in the wider interests of the Irish financial system that it continues to provide credit to households and businesses in a sustainable way, minimising the extent of the downturn and maximising its contribution to the recovery.

Journalist 1:

I have two questions. You mentioned that you expect the banks to incur losses this year. Just wondering if you've done any scenario planning onto this. Is there a range of losses, it obviously depends on a wide number of variables, but have you done any range of what these losses might be or how large they might be? And my second question is on the insurance industry. I know you've engaged with the insurance industry on this issue of business interruption cover and the bank has asked the industry for estimates of their exposure. But just wondering if you could share any information with us on that. What might be the potential exposure of the insurance industry to business interruption claims?

Governor Makhlouf:

I'll take the insurance one first. I can't actually give you a scale of the numbers. What I can tell is what the industry has told us; which is that there's probably around 90,000 policies which are relevant here. That's not to say there are 90,000 where they agree they'll pay out, but there are 90,000 policies that are under consideration. Obviously one thing to bear in mind. I can't give you a number in terms of the number of euro that might be at stake. One thing that is worth just pointing out is even where a policy is going to pay out, it's not immediately clear what it will pay out so I think it's actually quite an uncertain area. But the only number I can give you is the one they've given us which is 90,000.

On your first question absolutely, we're absolutely focused, it's core, at the centre of our work programme what the shock means for the financial position of the banking system. But you're right. There's a huge degree of uncertainty right now. Partly because the macro-financial outlook remains highly uncertain and you'll have seen the recent ECB staff projections which we've published last … ten days ago.

Secondly the impact of any of those scenarios on banks' balance sheets will depend on the effectiveness and length of the supports that are out there provided by the state and others. So, the uncertainty around the outlook and the impact of that on the financial position of the system is very significant. And any kind of analysis will have very, very large ranges around it to reflect the reality of where we are. But we have and we continue to conduct sensitivity analysis and scenario analysis. And the one thing I can tell you in addition to my point about the resilience of the system being the core of the agenda is that the banks are starting from a strong position and certainly starting from a stronger position. In fact, everybody in the community is starting from a stronger position than when we were at the last financial crisis. And that's partly thanks to the stronger capital buffers that have been put in place to the more effective supervision that we've been doing. The introduction of macroprudential policies since the last crisis.

Journalist 2:

Just to follow up on the banks there, Governor, there has been some expression of frustration from both businesses and consumers that there doesn't seem to be the transmission of very low rates available for banks, from the ECB and that being translated into the rates being offered to businesses and to consumers. I'm just wondering could you comment on that. And then the general acceptance that there'll be a significant increase in the level of borrowing being undertaken by Ireland and other states within the Eurozone. Is there a level at which you would become concerned in terms of the overall debt level carried by the Irish state?

Governor Makhlouf:

Well, I really want to answer that question in the light of the quarterly bulletin work that we're doing now and our updated forecasts. Your second question about the Irish state, two particular things which are flagged now, which is as I said in response to [journalist 1's] question a minute ago, like the banking system, the state is going into this crisis in a much better position than it did last time. Government debt is a lower proportion of national income on any measure than it was back in 2007.

Secondly, there are two things in particular that matter in terms of the amount of debt we carry as a country. One is the total volume and secondly is the actual cost of financing that debt. And clearly the cost of financing that debt is right now at exceptionally low levels. I also think that what matters to the markets in terms of being prepared to continue to lend to the government is a credible plan. Ireland went into this particular crisis with an economy that was in a good position. I'll stop there because I do and I will address this much more thoroughly as an issue in a few weeks' time.

In terms of why are the banks not passing on … I'll invite Ed in to comment on this, why are banks not passing on lower interest rates to consumers? I suspect it's a combination of things. Partly, I suspect, it's the legacy of the crisis which a number of these banks will carry. It's the effectiveness and their cost structure. And thirdly it may be that they just haven't got round to taking advantage of some of the offerings that the ECB has put on the table. But Ed, would you like to comment on that.

Deputy Governor Ed Sibley:

Thank you, Governor. This isn't a new issue so there's been a lot of discussion about interest rates in Ireland, both business and personal customers over many years. There are a number of reasons behind interest rates being higher in Ireland than the Eurozone average that, as the Governor refers to relates to legacy issues, cost of credit here all the way through to probably some competition factors to … It's fair to say that the Irish banks haven't to date taken up much of the specific ECB funding that's being made available as a result of the COVID-19 pandemic. That may change over time. But it is also a factor of how the domestic banking system here is funded which is mainly deposit-based and they're at the moment highly liquid so they've got a necessity for them to draw down but funding is relatively low. But this is not a new issue and I'm sure it'll continue to be a subject of scrutiny.

Director of Financial Stability, Vasileios Madouros:

Just to add one point … some of the analysis we have on the report is talking about the tightening financing conditions. And how that has come down because of Central Bank interventions and it's also referring to the impact of this kind of calming down of tightening conditions on potential outcomes for growth but also in some of the analysis we have on what this might mean for credit. There is already some analysis in the report that outlines how some of the actions taken which have guarded against this potential procyclical tightening in financing conditions are directly affecting Ireland.

Deputy Governor Sharon Donnery:

Just to clarify there the point [journalist 2] had made about the kind of government going into the situation now versus the previous crisis. Obviously, debt to GDP and so on was of a different order before the crisis last time. I think the point is more about households, businesses, financial system, and so on entering the current phase in a better position than the previous crisis. Of course, in terms of kind of debt to GDP during the crisis and how that developed we're in a different situation also in the context I think of the low interest rate environment that we're in now.

Journalist 3:

Just a few questions. Just following on from [journalist 1]'s question on bank capital levels, in any of the scenarios that you are looking at, do you see any case of banks falling below minimum regulatory capital levels? Secondly, I'm sure you've had a look at the programme of government and just looking for maybe, Governor, your initial impressions of that and also maybe particularly a review on the lack of costings surrounding some of the policies that have been announced. Also, in terms of loan guarantees that was announced early last month, we're still waiting for a government to be formed to bring forward and enact legislation to bring that into being. I'm just wondering is there a big risk of companies stating in the meantime – I think your own report, your own analysis a few months ago kind of pointed to up to 5.7 billion of three-month money being needed by firms and just wondering about your views on that and just one slight question in terms of house prices. The survey in the Q1 survey, when did that take place? Was that prior to the whole COVID-19 situation or was it post that?

Governor Makhlouf:

Let me take your questions in order. I did say in my opening remarks that the resilience of the financial system is not infinite, so a big question back to you, [journalist 3], is how long do you think it will take for the vaccine to be invented and for everything in the current crisis to disappear, but banks are in a much better position, as I said, than they were at the last crisis. At the moment their CT1 ratios are twice if not three times what they were in 2007. As I said in response to the other question, we are working on a range of scenarios to test the resilience of the overall system.

But that's not an issue right now that's sort of top of our minds because of the position that they've gone into this crisis but we need to be absolutely clear that the resilience that does exist is not infinite. Are we worried about how long it'll take to get the legislation guarantees? Hopefully the legislation will help, will happen sooner rather than later. But again, I'm pretty sure that these are issues which the new government will have at the forefront of its mind. You will be amazed that I haven't studied the programme for government. I've read other people's reports on it. And I've heard the various comments about lack of costings. I don't find it particularly surprising, but I really can't comment because I haven't read it. And as for the answer on the house price point, Vas, what's the answer to that?

Director of Financial Stability, Vasileios Madouros:

It was post-COVID, so it was done in April, between April 8th and 24th. So, it would be incorporating expectations of that. As you can see also around the ranges of these expectations, they are very high which is kind of reflective of the overall pervasive uncertainty of the macro picture but also including on property valuation.

Deputy Governor Ed Sibley:

Could I supplement on the main point, just a couple of comments. Obviously I agree with what the Governor's outlined in terms of the banks going into this and the pandemic in a much stronger position, that resilience had been built up over many years across the system and individual banks, that being the case, I think it's evident from what we've seen over the initial phases of the crisis that they've continued to work to support the wider economy and their customers effectively.

I think it's important also to think about this not only from a financial resilience perspective but also an operational resilience perspective and if you think about the operational and organisational stresses the financial system has been under, that is something that's also been built up over many years as well. And it's obviously really important that that has worked effectively to date. Clearly there's a lot of work that we are doing in terms of thinking about the range of possible outcomes considering how they will play out or possibly play out and connect that with kind of the stresses we've experienced in the past including the financial crisis in 2008 and on. And clearly that additional resilience and further resilience that the banking system has today will take us further into the tail in terms of risks that might crystallise in relation to COVID.

But clearly that resilience is not infinite as the Governor has outlined. We will continue to focus on that but continue to kind of engage with the individual banks and make sure that they're considering all scenarios and not being overly optimistic which can be their tendency and to make sure that they're as prepared as they can be and to ensure that they can continue to operate and support the economy and support their customers.

Journalist 4:

An ECB question for the Governor, I think. I'm a little bit confused between the differences between the PEPP and the PSPP. If the PEPP is your preferred policy tool that eases monetary policy and smooths its transition, why is the ECB trying to use the PSPP to achieve the deviation from the capital key and when will that, the PSPP, be used in *the PEPP? Why do you have these two instruments whereas the PEPP is clearly the preferred policy tool, so that is the role of the PSPP now?*

Governor Makhlouf:

Well, the PSPP's role hasn't changed. The PEPP is, the clue is in the word P, it's confusing that they both start with the word P because the second P is pandemic. The PEPP's focus is on dealing with the impact of the pandemic. I have to say my own view – so this is not the ECB's view – my own view is that when you start looking at the forecasts that show the impact of the crisis on our main price stability objective, I personally find it very hard to sort of become too sophisticated in separating out what the PSPP is doing from what the PEPP is also doing. Both of them – and other instruments that we've got in play – are all ultimately supporting the achievement of our price stability objective. But the PEPP was introduced specifically in response to the pandemic and is a temporary programme that will end all things going well, next year.

Journalist 6:

Two questions for the Governor, please. You note in the report that a number of European countries have responded to the crisis by adjusting structural buffers such as the O-SII. Will similar adjustments be under consideration by the Central Bank when it reviews the O-SII later this year? And just on the ECB which is also highlighted in the report, the action it's taken. Are you satisfied with the market reaction to the ECB's June measures? Just note that the Italian ten-year spreads are back where they were before the June meeting and I'm wondering why that is in your view. Thank you.

Governor Makhlouf:

I'm always very cautious about commenting on the market's reactions or otherwise. I certainly think that the decisions that we made in June were the right decisions and at the right time. We had a good discussion, the Governing Council, on this. But I think in the end it was right to make the decisions. I think the market, I suspect, is like so many of us, wants to have more information, more data to be able to sort of calibrate the decisions that we made. But we're all living with greater degrees of uncertainty than we're used to. But I think in the end I think we made the right call. The … sorry, what was the first question?

Journalist 6:

The first question was on the O-SII.

Governor Makhlouf:

Oh, the O-SII, we are going to be doing our usual exercise and looking at the O-SII this year and we'll make a call as to what if any changes need to be made. The fact that we have released the CCyB back in March shouldn't be taken as any guidance at all for where the O-SII may end up.

Journalist 7:

Question for the Governor and I may have misheard him but in relation to the government supports, they seemed to say the bank balance sheets were essentially insulated to a certain extent by the government supports and their future health depends on the length of those supports. If that is the case, what does he feel the most important aspect of those government supports were and how long should they pertain? And secondly, he spoke also about the need for a credible plan to ensure that we keep interest rates under control and that investors are confident to loan us money. What sort of credible plan would he envisage?

Governor Makhlouf:

Well the answer to the first question, what I said is government is supporting households and businesses, firms, which obviously has an impact in terms of banks' balance sheets. Without that support, banks' balance sheets would be in a worse position but so would households' and businesses'. I made the point earlier, the financial system is resilient but its resilience is not infinite. And it does all depend on the path of the virus, the speed at which a vaccine arrives, the actions not just of the government in Ireland but the action of governments throughout the EU, the extent to which the recovery can take hold not just in the EU but across the world. It's all those sorts of factors that are relevant here.

We are dealing with fantastic levels of uncertainty.

What's a credible plan? I'd argue that the government had a credible plan back in March, the beginning of March because clearly markets were prepared to lend. There was a path to a reduced debt that was a path to the creation of a rainy-day fund. We had a surplus so a path that takes us back to those sorts of conditions which ultimately give confidence to markets that the government … it's a very simple proposition at the end of the day. Markets were asking themselves if we lend to the State will we get our money back. And I think a plan that achieves that is what markets want to see.

Journalist 8:

Governor, just a quick question. I suppose it's fair to say that even if in Ireland we are able to prevent or suppress a second wave of the virus, the economy is still very vulnerable?

Governor Makhlouf:

We're exposed to geopolitical shocks and that is a point that we've flagged in the past. I think this is one of the speeches that I'm not going to forget very quickly. I gave a speech in the middle of February which said that two of the risks facing the Irish economy were, one was the UK's departure from the EU and the other one was the coronavirus and the reason I mentioned the coronavirus was because it was impacting China. And within a fortnight, I think, obviously events had moved on.

I think we're exposed to the world, so we are exposed to the impact of not just of the second wave which to be honest, we're exposed to the pace at which other countries recover from the first wave and the many risks actually that were in, that we were facing before the crisis haven't gone away. The UK-EU one I mentioned earlier. The geopolitical tensions are still out there. The impact of the risk and in fact of greater protectionism on global trade is an issue. Climate change and its longer-term implications for us, all these risks that we talked about in the past still exist.

We are dependent on the actions and decisions made elsewhere. We can influence them, some of those issues directly, but of course the most important thing we can do is to build up our own resilience, the resilience of our financial system and the resilience overall of our economy. Specifically, around a second wave, I mean what's been clear, [Journalist 8], is that other countries experienced the first wave and we couldn't isolate ourselves from the first wave. The scenario that we would somehow isolate ourselves from a second wave if it occurred is one that I hope is true. But I wouldn't plan that way, that's for sure.

Journalist 5:

Governor, a question, there has been some speculation that, you know, the ECB, to add to its asset purchase programme maybe as soon as September, there's a possibility that the ECB may add to the asset purchase programme.

Governor Makhlouf:

I guess that I'm not going to say very much. I think what was always said before our last meeting is that we're ready to take whatever action's needed to deliver our mandate.

Journalist 5:

Nothing beyond that, Governor, no?

Governor Makhlouf:

No.

Journalist 6:

Just one for the Governor, just another ECB matter. Just wondering what would happen if the EU failed to agree on a fiscal package, what would be the consequences for the market for monetary policy etc? I think one of your colleagues from Italy was speaking this morning and talking about the risks if the member states can't agree on what was proposed at the start of the month.

Governor Makhlouf:

There's a difference between agreeing to a particular package and agreeing to no package. At the beginning of this crisis, I said that what was needed was a co-ordinated ambitious and urgent response on the part of every government and every EU institution. And while it took a little bit of time for some of that to happen and not all of it has necessarily happened, but we are – and it's very welcome – we are in a position where there is a proposal on the table.

Like every single European proposal in history, it's likely to be subject to negotiation and there's likely to be a debate about the detail about exactly how it's going to work. In the end, I'm hopeful that there will be a package and the fact that it's different to the one that may have been announced I don't think would be particularly material as long as it's of sufficient size, of sufficient ambition to respond to the type of shock that the Euro area has undergone. If there is no agreement to anything, then we're essentially at the beginning back to the beginning when I would have said we need a co-ordinated package. And I think that is a scenario which I don't actually anticipate will emerge.

I don't anticipate that there would be no package. I think there will be a package and there are already packages agreed. I think we should not be surprised if there's a debate, discussion and changes to the package. There will be something. That's my expectation.

Journalist 1:

I was wondering if you could give us any update on the regulatory fines that are being faced by one of the retail banks in relation to tracker mortgages and secondly just to say is it appropriate to levy multi-million euro fines on the bank now given the scenario that they will all potentially be loss-making this year? Is there anything to be achieved by imposing exemplary fines on the banks at this stage?

Governor Makhlouf:

I will answer that now but can I ask you the answer to that second question. What do you think?

Journalist 1:

I would wonder at this stage. I was wondering in the context that a lot of them are State-owned. Are we robbing Peter to pay Paul in some respect?

Governor Makhlouf:

Yes. I understand that. My own view is that our enforcement role is incredibly important. I don't think that we can or should treat it less seriously simply because of particular stresses in the markets going on now.

I don't want to repeat my answers from the very beginning which is to say that the banks are in a stronger position than they were before. I think it's important that the lessons of tracker are understood. And more importantly are learnt and fines, enforcement actions and fines ultimately play a role which I personally think is incredibly important. In terms of where we are precisely on the fines themselves and the amounts, I'm afraid I don't have those to hand. I don't know if anyone on the call has got those.

Deputy Governor Ed Sibley:

I don't think it's something we can specifically, in terms of the level of fines that may or may not be forthcoming. The enforcement investigations are clearly still underway. In some cases they have concluded in others, and will be brought to conclusion as soon as possibly they can be, subject to engagement with the banks and the individuals concerned, so we will continue to pursue the enforcement investigations given the issues and the detriment that people suffered and the weaknesses that were clearly there in terms of how that came about.

But my own perspective on it is that I would entirely separate the two matters. We have a strong credible approach to enforcement. As the Governor has mentioned, it's absolutely critical we continue to deliver on that and we see it as a very important tool to be used when things go wrong but also to make sure that less goes wrong in terms of our ongoing regulation and supervision. I don't think there's anything that I am seeing to date in terms of solvency concerns in relation to an institution that would result in us taking a different view and I would separate the two matters entirely, the enforcement, whatever happens from an enforcement perspective needs to run its course regardless of what happens in the COVID-19 space.

Governor Makhlouf:

We have announced, haven't we, at least the PTSB fine. I just can't remember what else we've announced.

Deputy Governor Ed Sibley:

The PTSB has concluded. The others are still ongoing. I would note that they are incredibly complex in terms of the cases and we are looking both at what happened in terms of the funds and sales but also the individuals.

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