



Main messages of the Financial Stability Review

Risks facing the financial system

- Amid persistent inflation, the global economy is subject to downside risks related to the erosion of real incomes, financial sector stresses, credit supply tightening, and geopolitical fragmentation.
- The global financial system remains vulnerable to disorderly market adjustments after a decade of elevated risk-taking, as evidenced by recent turbulence in the global banking system.
- Domestically, persistent inflation and higher interest rates could lead to slower growth and expose vulnerabilities, particularly in CRE markets.

Resilience of the financial system

- The balance sheets of household and business borrowers are proving resilient to the inflationary shock, but remain vulnerable to sharp increases in unemployment.
- While credit risk is likely to rise, retail banks are continuing to benefit from rising net interest income and have strong capital and liquidity buffers.
- Some non-bank lenders are retrenching credit supply, reflecting risks associated with their funding models, particularly in the mortgage and real estate markets.

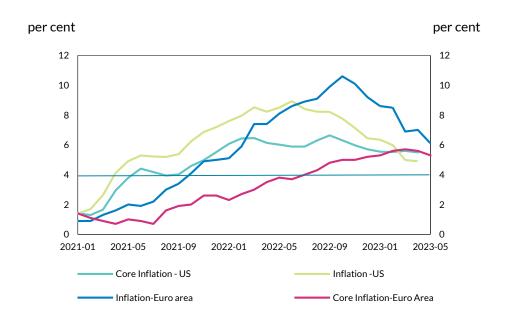
Policies to safeguard financial stability

- CCyB to be increased to 1.5%, in line with gradual build-up announced last year, reflecting the importance of building resilience in the banking sector.
- financial stability · Limited effects on credit supply expected given capital headroom and profitability outlook for the banking sector.



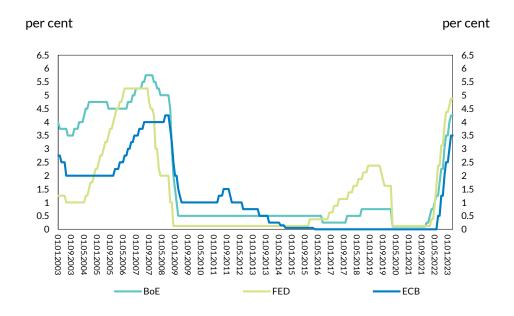
Underlying inflationary pressures are persisting globally, despite significant monetary tightening

Core inflation is proving persistent at levels well above target



Source: Eurostat and FRED

In response, central banks have been raising interest rates, with further increases expected in the near term



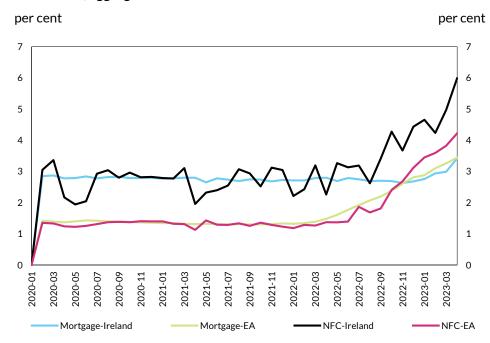
Source: BIS Rates: DFR (ECB), Fed funds rate (FED), Bank of England Base rate (BoE)



Tighter global financial and credit conditions are increasingly impacting firms and households, leading to elevated economic and financial risks

Loan rates have risen in the euro area and Ireland

Interest rates, aggregate for the euro area and Ireland

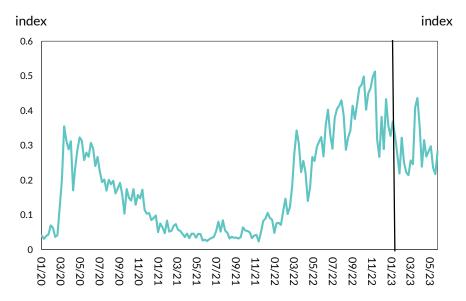


Source: SDW, Central Bank of Ireland Money and Banking statistics



Systemic risks have increased in line with tightening financial conditions

Euro area composite indicator of systemic stress



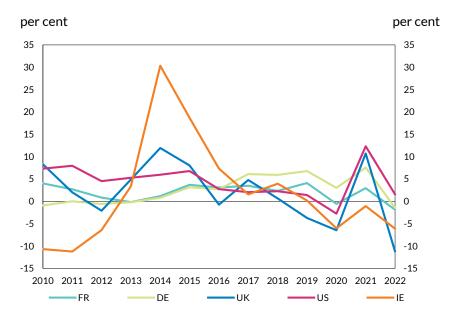
Source: SDM

Notes: Date of SVB collapse noted in black line. The CISS is a composite indicator for systemic stress and includes 15 raw, mainly market-based financial stress measures that are split equally into five categories, namely the financial intermediaries sector, money markets, equity markets, bond markets and foreign exchange markets. For further details, see Holló, D., Kremer, M. and Lo Duca, M. (2012)

The correction in some global property markets could turn disorderly in the event of further negative shocks or amplification through balance sheets

CRE prices have started to fall across the globe, particularly in the office segment

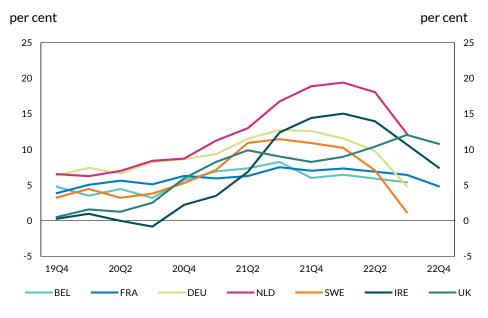
Change in global commercial real estate prices (nominal)



Source: MSCI

House prices are cooling in many advanced economies

Change in national house price indices



Source: OECD



Domestically, economic activity is showing signs of resilience and labour markets remain tight

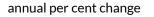
Unemployment at multi-decade lows, increasing signs that capacity constraints are more binding

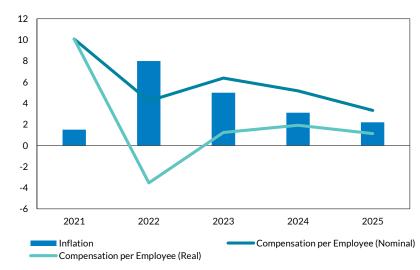


Source: Central Statistics Office

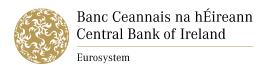
Note: Vacancy rate is calculated as the number of job vacancies divided by the sum of the number of job vacancies and occupied posts.

Domestic demand growth will be supported by expected recovery in real disposable incomes





Source: CSO and Quarterly Bulletin Q1 2023



Irish households have proven resilient to the inflationary shock so far, although increased financial stresses will emerge among some cohorts

Irish households have deleveraged substantially through the last decade

Households debt service burden



 $Source: Central\ Bank\ of\ Ireland,\ Eurostat$

Notes: Household mortgage interest payment to disposable income ratio. Solid pink line after 2023 provides baseline forecast. Dotted line provides a hypothetical adverse scenario where the MRO increases to 7%.

- <u>Build-up:</u> decade of deleveraging, nominal income growth, strong housing equity, prudent new lending, substantial aggregate savings.
- <u>Central outlook:</u> nominal income growth supports debt repayments; some increase in credit risk and arrears.
- <u>Survey:</u> 2/5 of mortgagors have thin liquidity buffers to cover repayments, if income shocks do arise.
- <u>Simulation</u>: modest increases in financial stress (8 to 9%) in baseline; increase of one half (8 to 12 %) in severe adverse.

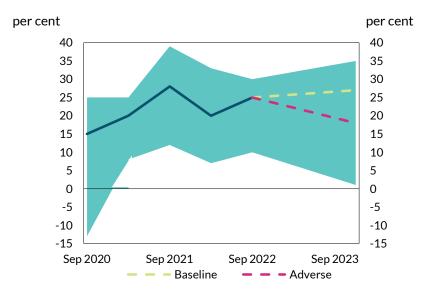


SME profits steady in face of input cost shock, owing to strength of domestic economy. Many businesses vulnerable to demand slowdown.

- Interlocking shocks: Domestic businesses have experienced a severe input cost shock, following on from pandemic challenges.
- Central Outlook: Owing to strong demand growth, SME profit margins steady or slightly increased in 2022/2023.
- <u>Pockets of risk:</u> ~1/5 SMEs had declining margins in 2022, despite average strength.
- <u>Financial distress:</u> Increase in insolvencies from pandemic lows, modest in historical context. Slowdown in demand will expose further vulnerabilities, particularly if costs remain elevated.

SME profits are stable but remain vulnerable to a slump in consumer demand

Observed and simulated profit margins under baseline and adverse scenarios



Source: Adhikari and McGeever (2023)

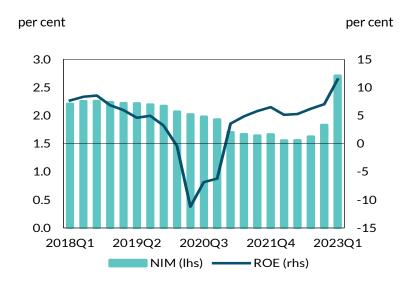
Notes: Average observed profit margin up to September 2022 and simulated margins under Baseline and Adverse scenarios consistent with the Central Bank of Ireland's Quarterly Bulletin and EBA stress test adverse scenario, respectively. The shaded range shows the minimum and maximum outcome by sector observed to September 2022 and under the baseline scenario.



The banking sector continues to benefit from higher interest rates, despite recent global banking difficulties and potential increases in credit risk

Profitability is improving in a rising rate environment

Net Interest Margin (NIM) and Return on Equity (ROE)

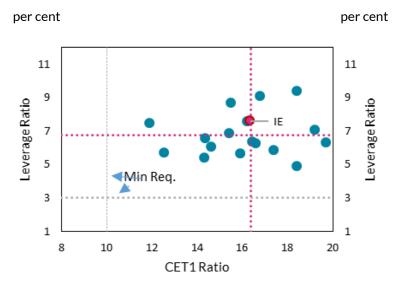


Source: Central Bank of Ireland, FINREP. Notes: ROE calculated as profit (annualised) divided by total equity. NIM calculated as net-Interest income (annualised based on year to date) divided by interest-earning assets.

Banc Ceannais na hÉireann Central Bank of Ireland Eurosystem

Regulatory capital and leverage ratios have substantial headroom above minimum requirements

Capital ratio (FL) along with Leverage ratio for Ireland and EU peers



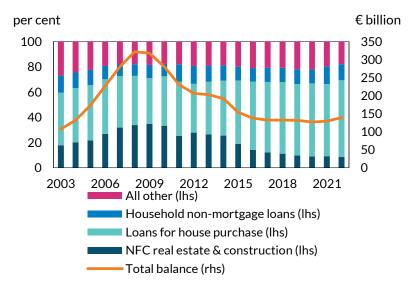
Source: EBA Transparency Exercise 2022 and Central Bank of Ireland.

Notes: Each dot represents the aggregate CET1 ratio and aggregate leverage ratio of all banks in that country that were included in the EBA transparency exercise in 2022. We exclude banks that have minimal lending to households and firms. The minimum leverage ratio is the Basel III requirements of 3 per cent while the minimum CET1 ratio shown is the aggregate 2022 FL requirements of the three banks (ex P2G, which is not reported publicly as per supervisory preferences).

Exposure of Irish banks to CRE and "SVB-type risks" is low by international standards

Commercial real estate represents a lower share of lending than in the past

Irish resident bank lending by sector (shares) and total lending euro balance

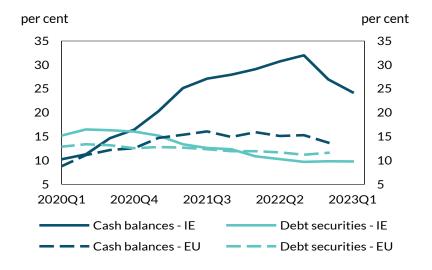


Source: Central Bank of Ireland credit and banking statistics.

Notes: NFC real estate & construction is the sum of "Construction" and "Real Estate, Land & Development Activities" Includes all banks resident in Ireland and Irish exposures only.

Cash balances at Irish banks remain well above the EU level, while debt securities are around the average

Cash balances and debt security shares of total assets for Irish and EU banks



Source: EBA and FINREP.

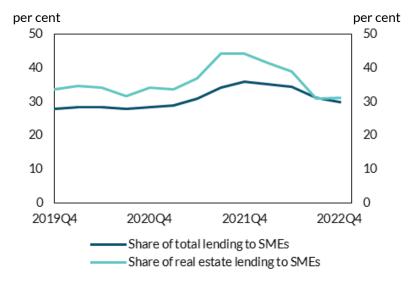
Note: Expressed as shares of total assets. Irish data refer to the domestic banks. Last observation is March 2023 for Ireland and December 2022 for EU.



Non-bank lenders have retrenched from mortgage and real estate lending

The share of SME lending provided by non-banks contracted through 2022

Share of lending to SMEs by non-banks

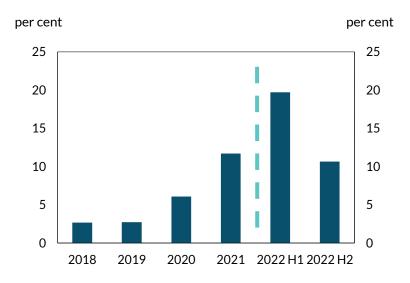


Source: CCR, Credit and Banking Statistics

Notes: Share of total (real estate) lending to SMEs is a four quarter moving average of the share of new lending (new lending to real estate SMEs) from nonbank lenders relative to the sum of NBL and bank new lending (NBL and bank new lending to real estate SMEs). Real estate-SMEs include SMEs in real estate activities and construction. Last observation 2022Q4.

The role of non-banks in new mortgage lending peaked in H1 2022

Percentage of new mortgage lending by non-banks, 2018-2022



Source: Central Bank of Ireland Monitoring Templates data. Notes: In-scope lending only. Last observation H2 2022.



The Central Bank is progressing with the increase in the CCyB to 1.5%, supporting resilience to future adverse shocks.

- In line with its strategy for the CCyB, the Central Bank has been gradually building towards a 1.5 per cent rate since June 2022.
- The buffer provides resilience to the (potential)

 materialisation of risks facing the financial system.
- The capital position and profitability outlook for the banking sector (in the central scenario) limit the potential for adverse impacts.
- The 1.5 per cent rate will come into effect from June 2024.

- The Central Bank would expect to
 - maintain the 1.5 per cent rate when (cyclical) risks are neither elevated nor subdued;
 - **release the CCyB** if **risks were to materialise**; and
 - increase the CCyB if cyclical risks were becoming elevated.
- An addendum to the Central Bank's capital framework document is published today, providing further clarity on the CCyB framework and in particular how the Central Bank determines the risk environment.

Risk, Resilience, Policy

Global risks have increased & Irish economy faces downside risks. However, central outlook for domestic economy has improved.



Inflationary & geopolitical risks weigh on the global economy



Increased turbulence in global financial markets



Domestically, persistent inflation & higher interest rates could lead to challenges



Risk, **Resilience**, Policy

Pockets of vulnerability but households & businesses resilient thus far to inflationary shock. Domestic bank outlook is for continued resilience.



Many households stretched by cost of living, but risks contained



Businesses absorbing cost shock, but commercial real estate vulnerable



Domestic banking system has capacity to absorb potential future shocks



Risk, Resilience, Policy

Macroprudential policy supports resilience to adverse shocks.



Increasing the CCyB to 1.5% supports resilience to adverse shocks



Refreshed mortgage measures framework in place since January 2023



Property fund measures announced November 2022

