Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Central Bank of Ireland
Financial Stability Review 2023:II

November 2023

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Notes

1. Unless otherwise stated, this document refers to data available on November 3rd 2023.

2. Unless otherwise stated, the aggregate banking data refer to all credit institutions operating in the Republic of Ireland.

   Domestic banks refer to the three banks offering retail-banking services within the Irish State: Allied Irish Banks plc, The Governor and Company of the Bank of Ireland and Permanent TSB, unless stated otherwise.

3. The following symbols are used:

e	estimate	H	half-year
f	forecast	rhs	right-hand scale
Q	quarter	lhs	left-hand scale

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Preface

The Central Bank is responsible for maintaining monetary and financial stability and ensuring the financial system works in the interests of the community.

The *Financial Stability Review* evaluates the main risks facing the financial system and assesses the resilience of the financial system to those risks. A resilient financial system is one that is able to provide services to Irish households and businesses, both in good times and in bad. The Central Bank's policy actions seek to ensure that the financial system functions in this manner.

The structure of this publication mirrors the overall approach the Central Bank takes in reaching a judgement around its macroprudential policy stance.

- The first section outlines the Central Bank's assessment of the main risks facing the Irish financial system over the short to medium term.
- The second section outlines the Central Bank's assessment of the resilience of the domestic-facing financial system to adverse shocks and its ability to absorb, rather than amplify, shocks of this nature.
- The third section explains the Central Bank's policy actions to safeguard financial stability and ensure that the resilience of the financial system is proportionate to the risks it faces.

Ireland is host to a large and diverse financial sector. A growing part of that financial sector serves international clients, with limited direct implications for the domestic economy. This publication focuses on the segments of the financial sector that provide services to Irish households and businesses.

The *Review* reflects, and is informed by, the deliberations of the Central Bank's Financial Stability Committee. The aim of the *Review* is not to provide an economic forecast, but instead focuses on adverse outcomes that may materialise, and their potential implications for domestic financial stability in the event of materialisation. The Central Bank is committed to transparency over its judgements around financial stability and uses this publication as a key vehicle to explain the policy actions taken, within its mandate, to safeguard financial stability.

Réamhrá

Tá an Banc Ceannais freagrach as cobhsaíocht airgeadaíochta agus airgeadais a choimeád ar bun agus as a chinntiú go bhfeidhmeoidh an córas airgeadais ar mhaithe le leas an phobail.

San *Athbhreithniú ar Chobhsaíocht Airgeadais*, déanaimid measúnú ar na príomhrioscaí atá ann don chóras airgeadais agus ar athléimneacht an chórais airgeadais i leith na rioscaí sin. Is ionann córas airgeadais athléimneach agus córas atá in ann seirbhísí a chur ar fáil do theaghlaigh agus do ghnóthaí Éireannacha le linn tréimhsí maithe agus drochthréimhsí araon. Le gníomhaíochtaí beartais an Bhainc Ceannais, féachtar lena chinntiú go bhfuil an córas airgeadais in ann turraingí dochracha a iompar seachas a mhéadú.

Tá struchtúr an fhoilseacháin seo ag teacht leis an gcur chuige foriomlán atá ag an mBanc Ceannais chun teacht ar bhreithniú maidir lena sheasamh beartais macrastuamachta.

- Sa chéad mhír, déantar cur síos ar mheasúnú an Bhainc Ceannais ar na príomhrioscaí atá roimh chóras airgeadais na hÉireann sa ghearrthéarma agus sa mheántéarma.
- Sa dara mír, leagtar amach measúnú an Bhainc Ceannais ar athléimneacht an chórais airgeadais intíre i leith turraingí dochracha agus ar a chumas rioscaí den sórt sin a iompar seachas a mhéadú.
- Sa tríú mír, déantar cur síos ar ghníomhaíochtaí beartais an Bhainc Ceannais chun cobhsaíocht airgeadais a chosaint agus chun a chinntiú go bhfuil athléimneacht an chórais airgeadais comhréireach leis na rioscaí atá roimhe.

Tá earnáil mhór ilchineálach airgeadais in Éirinn. Tá fás ag teacht ar an gcuid sin de sheirbhísí earnála airgeadais a fhreastalaíonn ar chliaint idirnáisiúnta, agus tá impleachtaí díreacha teoranta ann don gheilleagar intíre. Dírítear san fhoilseachán seo ar na codanna sin den earnáil airgeadais a chuireann seirbhísí ar fáil do theaghlaigh agus do ghnóthaí Éireannacha.

San *Athbhreithniú*, léirítear breithnithe ón gCoiste um Chobhsaíocht Airgeadais de chuid an Bhainc Ceannais agus tá na breithnithe sin mar bhonn eolais don *Athbhreithniú*. Ní hé is aidhm don *Athbhreithniú* réamhaisnéis eacnamaíoch a chur ar fáil, ina ionad sin díríonn sé ar thorthaí díobhálacha a d'fhéadfadh teacht chun cinn agus ar na himpleachtaí a d'fhéadfadh a bheith acu don chobhsaíocht airgeadais intíre. Tá an Banc Ceannais tiomanta do thrédhearcacht a chuid breithnithe maidir le cobhsaíocht airgeadais agus tá sé beartaithe aige an foilseachán seo a úsáid mar bhealach tábhachtach chun míniú a thabhairt ar na gníomhaíochtaí beartais a ghlactar laistigh dá shainordú chun cobhsaíocht airgeadais a chosaint.

Overview

The financial stability outlook continues to be shaped by the adjustment of the global economy to higher interest rates. Global inflation has proven persistent, and policy interest rates remain restrictive. Higher long-term interest rates and tighter financial conditions leave financial markets vulnerable to disorderly corrections. Despite ongoing strength in the US economy, there is heightened uncertainty around the ultimate strength of transmission of higher interest rates to the global real economy. The global economy is subject to the risk of further inflationary shocks, for example from conflict in the Middle East, geopolitical tensions, further geo-economic fragmentation, or acute impacts of climate change.

Despite this global backdrop, the domestic economy has continued to expand, albeit at a slower rate. Downside risks are more immediately visible now relative to the last *Review*, for example through continued falling commercial real estate (CRE) prices and early evidence of a slight slowing of export flows and corporation tax receipts following years of exceptional growth. The resilience of the household and corporate sectors continues to benefit from the strength of the labour market and low indebtedness, although there are emerging tentative signs of repayment difficulties for some vulnerable borrowers. Medium-term overheating risks could also increase in the absence of a downturn, owing to ongoing strength in the labour market, capacity constraints, fiscal expansion and weak monetary policy pass-through.

Bank profitability has continued to increase since the last *Review*, strengthening banks' capacity to invest for the future and bolstering resilience to shocks. The Central Bank's macroprudential policy stance aims to maintain resilience at a time when broad, systemic risks have not crystallised. Reflective of this position, the Central Bank is maintaining the CCyB at 1.5 per cent.

Global inflation has proven persistent. While inflation is now falling in most advanced economies, the return to central bank inflation target levels is progressing only gradually, and is subject to upside risks. Demand is being supported, for now, by tightness in labour markets, lagged effects of wage negotiations, and the availability of savings. Supply-side inflationary pressures may include the long-term effects of the pandemic on labour supply, instability in energy markets and supply chains from conflict and geopolitical tension, geo-economic fragmentation, and climate shocks.

Long-term interest rates have been rising, owing both to changed monetary policy expectations and an increase in risk compensation over longer horizons. Since the last *Review*, yields on longer-dated bonds, most prominently in US Treasuries markets, have risen sharply, despite moderation in recent weeks. There has been some increase in short-term interest rate expectations, reflecting the persistence of inflation. However, investors are now also demanding greater compensation over longer durations. This increased "term premium" reflects ongoing uncertainty and may also be owing to factors such as central bank balance sheet reduction through quantitative tightening, weaker demand from key global purchasers, and concerns about fiscal positions.

Uncertainty around interest rates, if combined with weak market liquidity, could increase the risk of further volatility. Uncertainty around key interest rates, both short and long term, remains high, with mixed signals from key US economic data around the lagged effects of monetary policy and the likely path for inflation and economic growth, while risks of an economic downturn appear more pronounced in Europe. Estimates of compressed risk premia suggest that further corrections are possible, notably in equity markets. While future triggers of financial market turbulence are difficult to pinpoint ex-ante, potential key vulnerabilities include weak market liquidity, excessive leverage, previous overvaluation or compression of risk premia.

The domestic economy has continued to expand since the last *Review*, although risks to Ireland's globalised economy are rising. Notwithstanding some recent signs of softening, the Irish labour market remains tight, supporting wage growth and real incomes. Domestic demand is forecast to grow, albeit at a gradually slowing pace owing to capacity constraints and the transmission of higher interest rates to the economy. After years of exceptionally strong growth, Ireland's export flows and corporation tax receipts have fallen somewhat in recent months, the first visible signs of the potential effect of a weakening global economy through trade and FDI channels.

In the absence of a downturn, labour market strength and related capacity constraints pose the risk of elevated medium term inflation and overheating. While short-term downside risks have increased, if they do not crystallise, capacity constraints in labour and other input markets could become increasingly binding. Over the medium term, the Irish economy's competitiveness would be harmed in such a scenario.

Downside risks are most immediately visible in the CRE market. CRE prices have now fallen over 20 per cent in Ireland since the pandemic. While cyclical forces are contributing to price falls across the real estate market, pandemic-related structural changes to the use of office and retail space are playing an outsized role in these two market segments. Heightened uncertainty remains, with the possibility of a continuation of recent price decreases.

The transmission of the CRE price shock to the domestic financial system has been orderly up to now. Over the last decade, CRE lending by Irish banks has been relatively prudent, and a smaller share of overall lending. Property funds now hold more than one third of domestic investible CRE. The presence of international investors increases the risk that global shocks can transmit to the domestic market, however, there are also benefits relating to losses being borne outside of the core domestic financial system, which reduces the risk of amplification in the local economy.

Mortgage lending and house prices appear less affected by higher interest rates so far. Interest rates on new mortgage loans have increased gradually since mid-2022. Despite this, house prices in Ireland have been broadly stable over the last year, supported by the strength of household incomes and the continued imbalance of demand over supply. New mortgage lending for house purchase, particularly for First-Time Buyers (FTBs), has increased in the year to mid-2023.

Irish households continue to appear resilient due to labour market strength and healthy balance sheets. Over half of all mortgages are on a fixed interest rate, which has cushioned the effect of monetary policy so far, although up to a fifth of the market may have rolled onto higher variable rates by the end of next year. Nonetheless, the strength of the labour market is driving robust growth in nominal incomes, and after a decade of falling household leverage, the household sector in aggregate continues to appear resilient. Early tentative signs of the impact of higher interest rates on borrowers' repayment capacity are visible in small pockets of lending markets, particularly among those with previous repayment challenges.

Growth in revenues has supported most domestic businesses to weather the inflationary shock so far. Domestic businesses are in a similar position to households, with low debt levels and strong revenue growth supporting financial resilience. Pockets of vulnerability are visible, particularly relating to businesses that have struggled since the pandemic, with a moderate increase in the insolvency rate and early arrears on business loans now emerging. A slowdown in demand could expose business borrowers, particularly those experiencing sharp increases in costs since 2022.

Responses to higher interest rates have varied widely across segments of the non-bank sector. Mortgage lending by non-bank lenders has fallen sharply in response to higher interest rates. By contrast, lending to small businesses appears to be evolving at a similar rate among non-banks and banks. Property funds have not shown signs of exacerbating the negative CRE price shock thus far, although a pocket of funds could contribute to amplified price declines in the event that asset disposals were required due to high leverage or liquidity mismatch.

Domestic bank profits have risen sharply, driven by increases in interest margins. Banks typically earn a higher loan-deposit spread when interest rates are higher, particularly in more concentrated markets. The Irish domestic banking sector Return on Equity has risen from 7 to above 12 per cent in the last year. Risks to the profitability outlook come from the effect of higher interest rates on loan demand and credit risk, as well as shifts in depositor behaviour and increased funding costs. Combined with robust capital ratios, current profit levels provide additional capacity to absorb shocks and invest for the future.

The Central Bank is maintaining the CCyB at 1.5 per cent. Between June 2022 and June 2023, the Central Bank gradually built the CCyB rate to 1.5 per cent, with the aim of ensuring sufficient resilience to macro-financial risks when cyclical risks are deemed neither elevated nor subdued. Following its latest review, the Central Bank is maintaining the 1.5 per cent rate, supporting banking sector resilience at a time when broad, systemic risks have not yet crystallised.

The refreshed mortgage measures framework continues to ensure sustainable lending standards. As of 2023, a refreshed framework for the macroprudential mortgage measures is in place. Average LTI and LTV ratios are broadly stable in the first half of this year, with a group of FTBs taking out loans between the previous LTI limit of 3.5 and the new limit of 4, consistent with the Central Bank's aim of mitigating the costs imposed by the measures, without unduly compromising their resilience benefits.

Bank capital buffers to address systemic importance are being adjusted, reflecting structural changes in the sector. The O-SII buffer requires bank capital commensurate to the risks posed to the wider system through banks' size, complexity, and interconnectedness. Arising from this year's assessment, PTSB is designated as an O-SII, reflecting its increased importance in the domestic banking sector, while UBIDAC's O-SII designation has been removed. No policy change has been made for the other five existing O-SIIs.

The Central Bank continues to develop the macroprudential framework for non-bank financial intermediation, particularly investment funds. Beyond the phased implementation of the macroprudential measures for Irish domiciled property funds announced last November, the Central Bank is also evaluating measures to safeguard the steady-state resilience of GBP denominated LDI funds authorised in Ireland. As part of this work, the Central Bank has today launched a public consultation paper on the proposed codification of the existing yield buffer for Irish authorised GBP denominated LDI funds which will close on 18 January 2024. The Central Bank is currently considering feedback received to the broader Discussion Paper on an approach to macroprudential policy for investment funds and will publish a feedback statement next year.

Forbhreathnú

Tá an t-ionchas don chobhsaíocht airgeadais á mhúnlú i gcónaí ag an gcaoi a dtéann an geilleagar domhanda in oiriúint do rátaí úis níos airde. Tá boilsciú domhanda dianseasmhach agus tá rátaí úis beartais sriantach i gcónaí. Fágann rátaí úis fadtéarmacha níos airde agus dálaí airgeadais níos géire go bhfuil margaí airgeadais leochaileach do cheartuithe mí-ordúla. D'ainneoin neart leanúnach an gheilleagair sna Stáit Aontaithe, tá éiginnteacht mhéadaithe ann maidir le neart iarbhír tharchur rátaí úis chuig an bhfíorgheilleagar domhanda. Tá an geilleagar domhanda faoi réir riosca maidir le turraingí boilscitheacha breise, mar shampla de bharr na coinbhleachta sa Mheánoirthear, teannas geopholaitiúil, ilroinnt gheo-eacnamaíoch bhreise, nó iarmhairtí géara an athraithe aeráide.

D'ainneoin an chúlra dhomhanda seo, bhí an geilleagar intíre ag leathnú i gcónaí, ach ba mhoille luas an leathnaithe sin. Tá na rioscaí ar an taobh thíos níos feiceálaí anois ná mar a bhí nuair a foilsíodh an *tAthbhreithniú* deireanach, mar shampla trí phraghsanna laghdaitheacha réadmhaoine tráchtála (CRE) agus trí luathfhianaise ar mhoilliú ar shreafaí onnmhairí agus ar fháltais ó cháin chorparáide, tar éis tréimhse fhada d'fhás fíorláidir. Leanann athléimneacht earnáil na dteaghlach agus na hearnála corparáidí de bheith ag tairbhiú de neart an mhargaidh saothair agus d'fhéichiúnas íseal, cé go bhfuil comharthai tosaigh ann go bhfuil deacrachtaí aisíocaíochta ag roinnt iasachtaithe leochaileacha. D'fhéadfaí go méadófaí rioscaí maidir le róthéamh sa mheántéarma freisin d'uireasa cúlú eacnamaíochta, de bharr neart leanúnach an mhargaidh saothair, srianta acmhainneachta, leathnú fioscach agus tarchur lag an bheartais airgeadaíochta.

Leanann brabúsacht mhéadaithe na mbanc ó foilsíodh an *tAthbhreithniu* deireanach, rud a neartaíonn cumas na mbanc infheistíocht a dhéanamh don todhchaí agus athléimneacht i leith turraingí a neartú. Is é is aidhm do sheasamh beartais airgeadaíochta an Bhainc Ceannais athléimneacht a choimeád ar bun nuair nach mbíonn rioscaí leathana, sistéamacha ann. I gcomhréir leis an seasamh sin, tá ráta CCyB á choinneáil ag 1.5 faoin gcéad ag an mBanc Ceannais.

Tá boilsciú domhanda dianseasmhach. Cé go bhfuil boilsciú ag laghdú anois i bhformhór na ngeilleagar forbartha, tá an filleadh ar spriocleibhéil bhoilscithe banc ceannais ag tarlú diaidh ar ndiaidh, agus tá sé faoi réir rioscaí ar an taobh thuas. Tá fáscadh sna margaí saothair, éifeachtaí moillithe comhchainteanna pá, agus fáil ar choigilteas, ag cur leis an éileamh. Ar na brúnna boilscitheacha atá ann ó thaobh an tsoláthair de, áirítear éifeachtai fadtéarmacha na paindéime ar sholáthar lucht saothair, éiginnteacht i margaí fuinnimh agus slabhraí soláthair a eascraíonn as coinbhleacht agus teannas geopholaitiúil, ilroinnt gheo-eacnamaíoch, agus turraingí aeráide.

Tá rátaí úis fadtéarmacha ag méadú, rud atá inchurtha d'ionchais athraithe beartais airgeadaíochta agus do mhéadú ar chúiteamh riosca thar thréimhsí níos faide. Ó foilsíodh an *tAthbhreithniú* deireanach, tá méadú mór tagtha ar thorthaí ar bhannaí fadtéarmacha, go háirithe i margaí Státchistí na Stát Aontaithe, d'ainneoin an mhaolaithe le seachtainí beaga anuas. Tá méadú éigin ar na hionchais maidir le rátaí úis gearrthéarmacha, rud a léiríonn dianseasmhacht an bhoilscithe. Mar sin féin, tá cúiteamh níos airde á éileamh ag infheisteoirí anois de rogha ar thréimhsí níos faide. Léiríonn an "biseach téarma" méadaithe seo éiginnteacht leanúnach agus b'fhéidir go bhfuil sé inchurtha freisin do thosca amhail laghdú ar chlár comhardaithe banc ceannais trí dhaingniú cainníochtúil, éileamh níos laige ó phríomhcheannaitheoirí domhanda, agus ábhair imní maidir le staid fhioscach.

Leis an éiginnteacht faoi rátaí úis, tá seans ann go méadófaí an riosca maidir le luaineacht bhreise i gcás ina mbeadh leachtacht lag mhargaidh ann freisin. Tá móréiginnteacht ann i gcónaí faoi phríomhrátaí úis, sa ghearrthéarma agus san fhadtéarma araon, agus tá comharthaí measctha ag teacht ó phríomhshonraí eacnamaíocha SA maidir le héifeachtaí moillithe an bheartais airgeadaíochta agus maidir leis an gconair a leanfaidh boilsciú agus fás eacnamaíoch, fad atá cuma níos measa ar na rioscaí a bhaineann le cúlú eacnamaíoch san Eoraip. Tugann meastacháin ar phréimheanna riosca comhbhrúite le tuiscint go bhfuil ceartuithe breise indéanta, go háirithe i margaí cothromais. Cé gur deacair spreagthaí suaiteachta i margaí airgeadais amach anseo a shainaithint ex-ante, folaíonn na príomhleochaileachtaí féideartha leachtacht lag mhargaidh, giaráil iomarcach, róluacháil roimhe seo nó comhbhrú préimheanna riosca.

Lean an leathnú ar an ngeilleagar intíre ó foilsíodh an *tAthbhreithniú* deireanach, ach tá na rioscaí do gheilleagar domhandaithe na hÉireann ag méadú. D'ainneoin roinnt comharthaí le déanaí maidir le maolú, tá margadh saothair na hÉireann teann i gcónaí, rud a chuireann le fás ar phánna agus ar fhíorioncaim. Tuartar go méadóidh an t-éileamh intíre, cé go moilleoidh luas an mhéadaithe sin de réir a chéile de bharr srianta acmhainneachta agus tarchur rátaí úis níos airde chuig an ngeilleagar. Tar éis tréimhse fhada d'fhás fíorláidir, tá laghdú éigin tagtha ar shreafaí onnmhairí na hÉireann agus ar fháltais ó cháin chorparáide le míonna beaga anuas, na chéad chomharthaí soiléire d'éifeacht ionchasach lagú an gheilleagair dhomhanda trí thrádáil agus trí chainéil IDC.

In éagmais cúlú eacnamaíochta, tá baol ann go mbeidh boilsciú ardaithe agus rótheamh ann sa mheántéarma de bharr neart an mhargaidh saothair agus srianta acmhainneachta gaolmhara. Cé go bhfuil méadú tagtha ar rioscaí ar an taobh thíos sa ghearrthéarma, mura dtagann siad chun cinn, tá seans ann go n-éireoidh srianta acmhainneachta sa mhargadh saothair agus i margaí ionchuir eile níos daingne. Thar an meántéarma, dhéanfadh sé seo dochar d'iomaíochas gheilleagar na hÉireann.

Is soiléire na rioscaí ar an taobh thíos sa mhargadh Réadmhaoine Tráchtála (CRE). Tá laghdú breis agus 20% tagtha ar phraghsanna CRE in Éirinn ó aimsir na paindéime i leith. Cé go bhfuil tosca timthriallacha ag cur le laghduithe ar phraghsanna sa mhargadh réadmhaoine, tá ról rómhór sa dhá dheighleog seo den mhargadh ag athruithe struchtúracha ar úsáid spáis oifige agus spáis mhiondíola de bharr na paindéime. Tá móréiginnteacht ann i gcónaí agus tá an fhéidearthacht ann go leanfaidh na laghduithe atá feicthe le déanaí ar phraghsanna.

Go dtí seo, tá suaitheadh phraghsanna CRE á tharchur chuig an gcóras airgeadais intíre ar bhonn ordúil. Le deich mbliana anuas, tá iasachtú CRE ag na bainc Éireannacha sách stuama, agus is cion níos lú den iasachtú iomlán é. Tá breis agus aon trian de CRE so-infheistithe intíre á sealbhú anois i gcistí réadmhaoine. Le hinfheisteoirí idirnáisiúnta, méadaítear an riosca go bhféadfar turraingí domhanda a chur ar aghaidh chuig an margadh intíre; ach bíonn buntáistí ag baint freisin le caillteanais a eascraíonn lasmuigh den lárchóras airgeadais intíre, sa mhéid go laghdaítear riosca géaraithe sa gheilleagar áitiúil.

Go dtí seo, is cosúil nach raibh tionchar chomh mór sin ag rátaí úis níos airde ar iasachtú morgáiste nó ar phraghsanna tithe. Tá méadú tagtha de réir a chéile ar rátaí úis ar iasachtaí morgáiste nua ó lár na bliana 2022. Dá ainneoin sin, tá praghsanna tithe in Éirinn sách cobhsaí le bliain anuas, agus tá neart na n-ioncam teaghlaigh agus an éagothroime leanúnach idir éileamh agus soláthar mar thaca leis an gcobhsaíocht sin. Tháinig méadú sa chéad leath de 2023 ar iasachtú morgáiste nua, go háirithe le Ceannaitheoirí Céaduaire.

Is cosúil go bhfuil teaghlaigh na hÉireann athléimneach i gcónaí de bharr neart an mhargaidh saothair agus cláir chomhardaithe fholláine. Tá os cionn leath de na morgáistí go léir ar ráta úis seasta, rud a mhaolaigh éifeacht an bheartais airgeadaíochta go dtí seo, ach féadfaidh go mbeidh suas le haon chúigiú den mhargadh ag filleadh ar rátaí athraitheacha níos airde faoi dheireadh na bliana seo chugainn. Dá ainneoin sin, tá fás láidir ar ioncaim ainmniúla á spreagadh ag neart an mhargaidh saothair, agus tar éis tréimhse deich mbliana ina raibh giaráil na dteaghlach ag titim, is cosúil go bhfuil earnáil na dteaghlach athléimneach ar an iomlán. Tá luathfhianaise i bpócaí beaga de na margaí iasachtaithe ar an iarmhairt atá ag rátaí níos airde úis ar chumas aisíocaíochta na n-iasachtaithe, go háirithe i measc na ndaoine sin a raibh deacrachtaí acu roimhe sin.

Tá fás ar ioncaim ag tacú le formhór na ngnóthaí intíre chun an turraing bhoilscitheach a iompar. Tá gnóthaí intíre sa staid chéanna le teaghlaigh sa mhéid go bhfuil leibhéil ísle fiachais agus fás láidir ioncaim acu, rud a thacaíonn le hathléimneacht airgeadais. Tá leochaileachtaí le feiceáil, go háirithe maidir le gnóthaí atá ag streachailt ó aimsir na paindéime i leith, agus tá méadú measartha ar an ráta dócmhainneachta agus riaráistí luatha ar iasachtaí gnó ag teacht chun cinn anois. Dá mbeadh moilliú ar éileamh, d'fhéadfaí go gcuirfí iasachtaithe gnó i mbaol, go háirithe na gnóthaí sin atá ag streachailt le méaduithe géara ar chostais ó 2022 i leith.

Tá éagsúlacht mhór i gceist ar fud na hearnála neamhbhainc idir na freagairtí do rátaí úis níos airde. Tá laghdú géar tagtha ar iasachtú morgáiste na n-iasachtóirí neamhbhainc mar thoradh ar na rátaí úis níos airde. I gcodarsnacht leis sin, is cosúil go bhfuil iasachtú le gnóthaí beaga ag forbairt ag ráta comhchosúil i measc neamhbhanc agus banc. Níl aon chosúlacht ar an scéal go dtí seo go bhfuil cistí réadmhaoine ag cur le suaitheadh diúltach phraghsanna CRE, ach tá seans ann go gcuirfeadh póca cistí le laghduithe ar phraghsanna i gcás ina mbeadh diúscairtí sócmhainní de dhíth mar gheall ar ardghiaráil nó neamhréireacht leachtachta.

Tá méadú géar tagtha ar bhrabúis na mbanc intíre, rud atá a spreagadh ag méaduithe ar chorrlaigh úis. Go hiondúil, tuilleann na bainc raon difríochta iasachta-taisce níos airde nuair a bhíonn rátaí úis níos airde ann, go háirithe i margaí neamhéagsúlaithe. Mhéadaigh Toradh ar Chothromas de chuid na hearnála baincéireachta intíre ó 7 faoin gcéad go dtí os cionn 12 faoin gcéad le bliain anuas. Eascraíonn rioscaí don ionchas maidir le brabúsacht as an éifeacht a bhíonn ag na rátaí úis níos airde ar éileamh iasachta agus ar riosca creidmheasa, mar aon le haistrithe ar iompar taisceoirí agus ar chostais mhéadaithe maoiniúcháin. I dteannta cóimheasa láidre caipitil, cuireann leibhéil reatha brabúis leis an gcumas chun turraingí a iompar agus infheistíocht a dhéanamh don todhchaí.

Tá ráta CCyB á choinneáil ag 1.5 faoin gcéad ag an mBanc Ceannais. Idir Meitheamh 2022 agus Meitheamh 2023, bhí an Banc Ceannais ag cur le ráta CCyB de réir a chéile go dtí gur baineadh 1.5 faoin gcéad amach, d'fhonn athléimneacht leordhóthanach i leith rioscaí macra-airgeadais a áirithiú nuair nach mbíonn rioscaí timthriallacha ardaithe nó maolaithe. Tar éis dó a athbhreithniú deiridh a chur i gcrích, tá an Banc Ceannais ag cloí le ráta 1.5 faoin gcéad chun tacú le hathléimneacht na hearnála baincéireacht tráth nach bhfuil rioscaí leathana, sistéamacha i gceist.

Leis an gcreat athnuaite le hagaidh bearta morgáiste, leantar de chaighdeáin inbhuanaithe maidir le hiasachtaí a áirithiú. Amhail ó 2023, tá creat athnuaite i bhfeidhm le haghaidh bearta morgáiste macrastuamachta. Bhí cóimheasa iasachta le hioncam (CII) agus iasachta le luach (CIL) ar an meán sách cobhsaí sa chéad leath den bhliain seo, sa mhéid gur thóg grúpa ceannaitheoirí céaduaire iasachtaí amach a bhí idir teorainn CII 3.5 a bhí ann roimhe seo agus teorainn nua 4, i gcomhréir le haidhm an Bhainc Ceannais chun na costais a bhaineann leis na bearta a mhaolú, gan cur isteach go míchuí ar a gcuid buntáistí i ndáil le hathléimneacht.

Tá coigeartú á dhéanamh ar mhaoláin caipitil na mbanc chun tábhacht shistéamach a chur san áireamh, rud a léiríonn athruithe struchtúracha san earnáil. Faoi mhaolán O-SII, ceanglaítear go mbeidh caipiteal na mbanc comhréireach leis na rioscaí a bhaineann leo don chóras níos leithne bunaithe ar mhéid, ar chastacht, agus ar idirnascthacht na mbanc. Mar thoradh ar athbhreithniú na bliana seo, ainmnítear PTSB mar O-SII i gcomhréir leis an tábhacht mhéadaithe a bhaineann leis don earnáil bainéireachta intíre, fad a bhaintear ainmníocht O-SII de UBIDAC. Ní raibh aon athrú beartais i gcás na gcúig O-SII eile.

Leanann an Banc Ceannais d'fhorbairt a dhéanamh ar an gcreat macrastuamachta le haghaidh idirghabháil airgeadais neamhbhainc, go háirithe cistí infheistíochta. Taobh amuigh de chur chun feidhme céimnithe na mbeart macrastuamachta a fógraíodh i mí na Samhna seo caite le haghaidh cistí réadmhaoine a bhfuil sainchónaí orthu in Éirinn, tá measúnú á dhéanamh ag an mBanc Ceannais freisin ar bhearta chun feabhas a chur ar athléimneacht foistine chistí LDI arna n-ainmniú in GBP agus arna n-údarú in Éirinn. Mar chuid den obair seo, tá páipéar comhairliúcháin phoiblí seolta ag an mBanc Ceannais inniu maidir le códú beartaithe an mhaoláin reatha maidir le torthaí ar chistí LDI arna n-ainmniú in GBP agus arna n-údarú in Éirinn agus is é 18 Eanáir 2024 an dáta deiridh don chomhairliúchán sin. Tá breithniú á dhéanamh ag an mBanc Ceannais faoi láthair ar aiseolas a fuarthas ar an bPlépháipéar níos leithne maidir le cur chuige i dtaca le beartas macrastuamachta i leith cistí infheistíochta agus foilseoidh sé ráiteas aiseolais an bhliain seo chugainn.

Risk assessment

Global risk assessment

The risk of persistent inflation, and the associated implications for monetary policy, leave economic growth and financial markets vulnerable to shocks. In the US, real economic activity has been more resilient than expected and market expectations reflect a more prolonged period of elevated interest rates relative to June (despite recent falls in inflation). Term premia on long-dated US Treasury assets have also increased overall, with spillovers to long-term interest rates in other economies, including the euro area. Higher rates raise risks of a reversal in risky asset prices, including equity, corporate bond and international real estate market segments. Key financial markets are exposed to the risk of disorderly repricing amid high volatility and poor liquidity. An intensification of geopolitical tensions may have implications for the demand and supply of commodities with a resultant impact on inflation, while climate related shocks also raise inflationary risks.

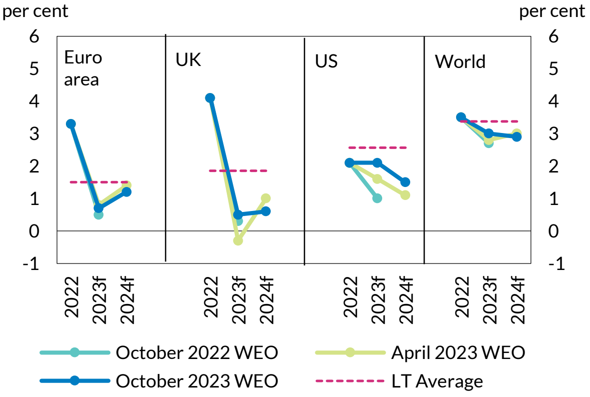
The global economy remains vulnerable to downside risks, amid the ongoing adjustment to higher interest rates. Central banks in many advanced economies have engaged in significant monetary policy tightening since early 2022 in order to achieve price stability. Headline inflation has reduced significantly across many countries, while measures of core or underlying inflation have also reduced, albeit remaining elevated. Global growth is projected to weaken from 3.5 per cent in 2022 to 3 per cent in 2023 and 2.9 per cent in 2024, with Ireland's main trading partners projected to see lower growth in 2023 compared to 2022 (Chart 1). Indicators such as weaker sentiment and declines in consumer and business confidence point to a dampening of economic activity. A further worsening of the growth outlook could arise from a number of adverse shocks, such as spillovers from China's slowing economy; an intensification of conflict in Ukraine or the Middle East; energy and climate related shocks; and greater geopolitical tensions and resultant trade restrictions.[1]

Tighter monetary policy has started to work its way through the financial system, with signs of tighter credit conditions increasingly affecting real economic activity. Lending surveys in the US and euro area suggest that bank lending standards are becoming increasingly restrictive.[2] In both regions, credit growth contracted since the start of the year, reflecting tighter supply as well as lower demand for credit. Market implied policy rates for several advanced economies highlight growing market expectations that interest rates will remain higher, for longer than was expected at the time of the last *Review* in June, potentially exposing vulnerabilities among borrowers (Chart 2). In Europe, for example, the number of businesses filing for bankruptcy has risen to the highest level since 2015, while in the US rating downgrades in the corporate sector have outpaced upgrades for the first time since the pandemic.[3] The speed at which tighter financing conditions feed through to economic activity will vary across different countries due to a number of factors, including the prevalence of variable rate lending among borrowers (see *Domestic risk assessment* for a discussion of the pass-through of tighter monetary policy for Ireland).[4]

[1] Trade activity across the euro area has already showed signs of deterioration, with transaction volumes falling to a two year low. For more see here.
[2] See ECB bank lending survey and Federal Reserve's Senior Loans Officers Opinion Survey.
[3] See European Commission – Quarterly registrations of new business and declarations of bankruptcies for more.
[4] ECB – The inflation outlook and monetary policy in the euro area. Speech by Luis de Guindos, October 2023. See here.

Chart 1: Global growth is forecast to weaken in 2023 and 2024, driven by weaker growth in advanced economies

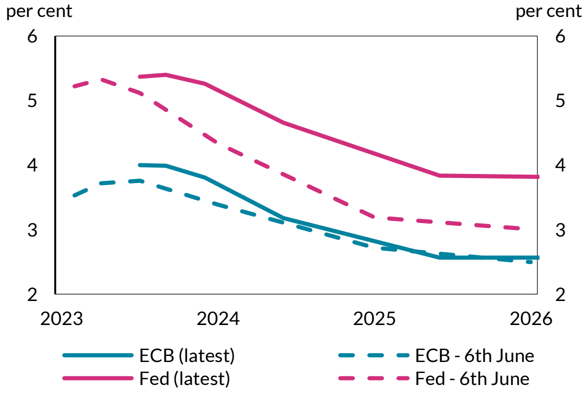
Evolution of global GDP growth forecasts



Source: IMF World Economic Outlook, October 2022, April 2023 and October 2023.
Notes: WEO refers to the IMF's World Economic Outlook. Dashed lines indicate historical average since 1980. Last observation October 2023.

Chart 2: Expected future monetary policy rates are higher than in June, particularly in the US

Market implied policy rates for the ECB and Fed



Source: Bloomberg.
Note: Latest data show market expectations of policy rates as at 3rd November 2023. 6th June refers to market rates on the date of publication of the previous *Review* in June. The ECB rate refers to the deposit facility rate.

While global headline inflation is expected to fall over the course of 2023 and 2024, upside risks to the inflation outlook remain. Global headline inflation is expected to steadily decline from its peak of 8.7 per cent in 2022 (annual average) to 6.8 per cent in 2023 and 5.7 per cent in 2024, with nearly three-quarters of economies expected to see lower inflation in 2023.[5] However, upside risks to the global inflation outlook remain. Intensifying geopolitical fragmentation could constrain the flow of commodities across regions, triggering supply chain disruptions and renewed volatility in food, fuel and other commodity prices. Higher than anticipated increases in wages or profit margins, or an increase in inflation expectations following a persistent period of above-target inflation, could also drive inflation higher, including over the medium term.

Climate related shocks raise inflationary risks, including through food insecurity and food price inflation. A high frequency of intense heatwaves, wildfires and droughts in 2023 has raised concerns globally over both the immediate and long-term impact of climate change, as global temperatures reached record levels this year.[6] The El Niño phenomenon, which is likely to affect food crops around the globe, poses further near-term risks.[7] Climate shocks have the potential to contribute to inflation through supply-side disruptions throughout the economy, while the climate transition is also likely to raise costs for some cohorts of households and businesses. (See Box 1.)

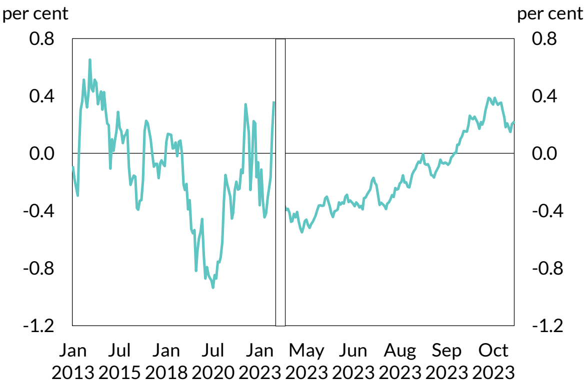
Term premia on US treasury assets have increased, with spillovers to other markets. Despite yield changes in recent weeks, the increase in short-to-medium term interest rate expectations (Chart 2) has been accompanied by a meaningful increase in term premia on US Treasury assets (Chart 3). Long-term yields may be rising not only due to curve steepening as the magnitude of expected interest rate cuts decreased, but also due a number of other factors, such as unwinding of central bank balance sheets through quantitative tightening and key global purchasers, such as banks,

[5] See IMF - World Economic Outlook, October 2023.
[6] For January to September 2023, the global mean temperature for 2023 to date is 1.40°C higher than the pre-industrial average (1850-1900). See here.
[7] ECB – Risks to global food commodity prices from El Niño. Published as part of the ECB Economic Bulletin, Issue 6/2023. For more, see here.

reducing their bond exposures and shortening their maturity profile.[8] Rising yields on 10-year Treasuries have contributed to substantial rises in borrowing costs, with the cost of mortgages, car loans and credit card debt rising in response.[9] In the face of significant movements in long-term sovereign debt yields, market functioning has generally been orderly in recent months. However, volatility is expected to persist in the near future in fixed income markets (particularly US debt markets) as investors continue to adjust portfolios in response to changing inflationary conditions and evolving expectations around monetary policy and its transmission.[10] Measures of fixed income market liquidity have improved in the last couple of months, but are vulnerable due to high warehousing costs of primary dealers in the European government bond market (Chart 4). Ongoing uncertainty and lower liquidity increase the likehood of global asset market overreaction to shocks.

Chart 3: Term premium for US Treasuries has risen in the recent months

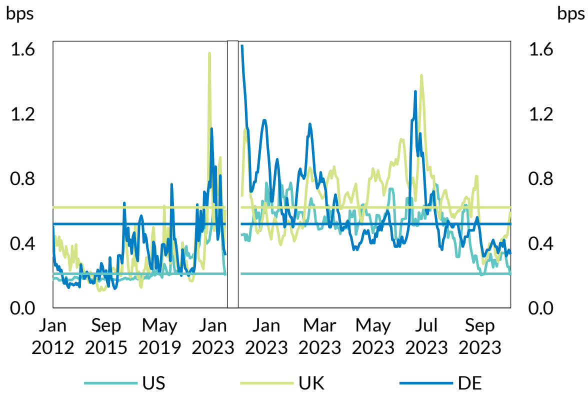
Term premium on a US 10 Year Zero Coupon Bond



Source: Federal Reserve Bank of St. Louis.
Notes: Left panel shows historical monthly data. Right panel shows recent daily data. Term premia are model based estimates, thus are sensitive to the specifications and assumptions used in the model. Last observation for monthly data is October 2023, while daily data is the 10th November 2023.

Chart 4: Market liquidity has improved somewhat in recent months

Bid-ask spreads for 10 year government bonds



Source: Bloomberg.
Notes: Data show the bid-ask spread between US, DE, and UK 10 year government bonds. Left panel shows monthly averages since 2012. Right panel shows 2023 daily data using a five day rolling average. The dashed horizontal lines show respective average values since January of 2000. Last observation 3rd November 2023.

A significant increase in supply of sovereign debt coupled with tight monetary policy conditions could further increase sovereign borrowing costs, putting pressure on public finances. According to S&P Global Ratings, new sovereign debt issuance peaked in 2020 with a record of $14.9 trillion, and is expected to remain relatively high throughout 2023.[11] Higher supply of sovereign bonds can lower their prices and raise their yields, amplifying the increase in interest rates due to monetary policy and making it more costly for governments to roll over their maturing debt. This is particularly a risk for emerging market and low-income developing countries where concerns persist over heightened debt vulnerabilities.[12] The maturity structure of many sovereigns adds to such pressures. For example, around $7.6 trillion in US government bonds (or 31 per cent of all outstanding) will mature over the coming 12 months.[13] If interest rates remain elevated, more

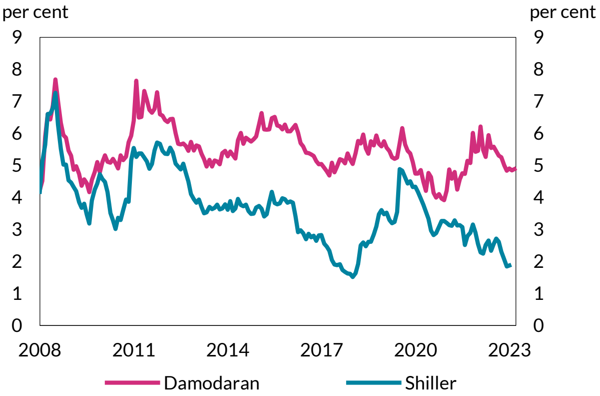
[8] For a detailed discussion on the recent market moves in Treasury yields see here.
[9] The average 30-year fixed rate mortgages is now 7.3 per cent, the highest rate in 23 year. See here.
[10] Raising rates after a period of low values typically increases financial fragility, see Jimenez et al. (2023).
[11] Corporate bond issuance has been high in the first half of 2023 (e.g., issuance by US NFCs totalled $397.71 billion in the first six months of the year, up 36 per cent from $292.94 billion in the first half of 2022. However, the outlook for the issuance in the second half of 2023 for corporates appears less strong, due to higher for longer interest rates and a likely acceleration ahead of the run-up in rates during the first half of this year.
[12] See the IMF Fiscal Monitor, April 2023.
[13] For further details of the maturity profile of US treasuries see here.

fixed-rate debt needs to be refinanced at higher rates, leading to a larger increase in the interest burden of outstanding sovereign debt, and a potential for euro area financial fragmentation.[14] Also, higher sovereign yields reduce the market value of sovereign bonds held by investors, which can erode capital buffers and could potentially trigger margin calls and forced deleveraging.

An unwinding of leveraged bets in US Treasury markets or a sell-off of European debt by Japanese investors could trigger disorderly repricing in these markets. A sell-off of long-term bonds in the US in August has put a spotlight on the growing build-up of leveraged speculative positions by hedge funds in Treasury markets. The scale of the exposure has raised concerns over the potential for non-banks to act as an amplifier of shocks in these markets.[15] Elevated volatility and fragile liquidity conditions in sovereign debt markets heightens the risk that a sharp disorderly repricing could lead to large margin calls and forced deleveraging. Separately, inflation in Japan has increased since early 2022, leading to expectations that the Bank of Japan might start to tighten monetary policy. Japanese investors withdrawing abruptly from foreign debt markets could lead to rapid repricing in more concentrated market segments, including in Europe, where they have a large footprint in many markets, as evidenced by ECB analysis.[16]

Chart 5: Equity risk premium have been falling following tight monetary policy

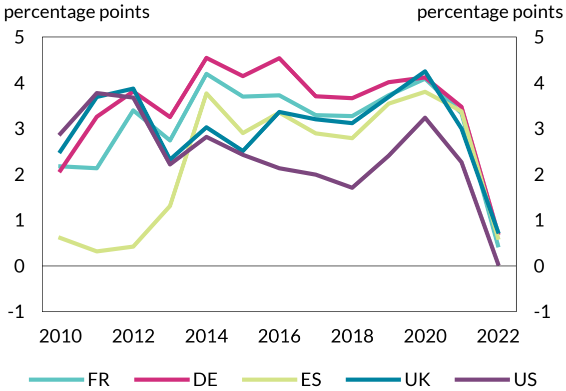
Implied equity risk premium and excess CAPE yield, S&P 500



Source: Aswath Damodaran, NY Stern; Robert Shiller, Yale.
Notes: Damodaran refers to trailing 12 month cash yield implied equity risk premium for S&P 500 estimated by Aswath Damodaran. Shiller refers to excess CAPE yield estimated by Robert Shiller. The excess CAPE yield is a commonly used proxy of the equity risk premium. Equity risk premia are model based estimates, thus are sensitive to the specifications and assumptions used in the model. Last observation: 1st November 2023.

Chart 6: CRE excess yields drop significantly across the globe towards sovereign yields

Global CRE yield less 10-year sovereign yield



Source MSCI, Bloomberg.
Notes: Annual data. Yield refers to net operating income yield. Last observation December 2022.

Market-based risk indicators point to fragilities in the financial system, with potential under-pricing of risk in some market segments. Credit-risk premia have remained largely unchanged in recent months despite recent tightening financing conditions, however equity-risk premia are compressed, likely linked with very low market volatility.[17] The equity-risk premium in US equities has fallen in the recent quarters following tightening monetary policy (Chart 5).[18] In some

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[14] For details on the cost of rolling over US Government debt see here
[15] For details see the BIS Quarterly Review, September 2023 here.
[16] For details see Chart 2.8 of the ECB Financial Stability Review, May 2023 here.
[17] For theoretical discussion of risk premia and volatility see here.
[18] Equity risk premium refers to an excess return that investing in the stock market provides over a risk-free rate. It can serve as a gauge of potential financial stability risks, as compressed values at short horizons tend to be followed by lower GDP growth, lower inflation, and higher unemployment (Duarte & Rosa, 2015). This premium cannot be observed directly and needs to be estimated with a model, thus there are different estimates based on different models.

estimates, it recently went close to its lowest level since at least 2007 on the back of developments in the US Treasury market. This is adding to potential fragilities in the financial system, as the risk premia do not appear to be in line with the less positive macroeconomic outlook and can increase the likelihood of abrupt repricing in the future.[19] The same is the case for high-yield corporate bonds, where their spreads are below historical averages for the US and emerging economies. Price-to-earnings ratios have increased in the healthcare and the technology sectors in the US – notable given the links of the sectors to the Irish economy. Overvaluations in some segments, when compared to long-term averages, may put pressure on these segments and act as potential triggers for wider (disorderly) repricing.

International spillovers from weakness in the Chinese real estate market appear limited to date, although a weaker Chinese economy could result in weaker growth in the euro area. Recent ECB analysis explores the spillovers from further cooling of China's economy.[20] The spillovers are deemed contained, with a disinflationary impact for both domestic and foreign economies leading to lower commodity prices and weighing on external demand. In the euro area, this scenario would result in a slight decrease in euro area real growth, while the impact on oil prices would give rise to a decrease in euro area inflation. Additionally, lower savings in China could potentially mean lower investments in sovereign bonds of advanced economies putting upward pressure on yields.

Amid tight credit conditions, CRE markets are particularly vulnerable. Higher borrowing costs, tighter bank lending standards and weaker demand have seen prices across residential and CRE markets stagnate or decline. In particular, CRE yields are not attractive in comparison with respective sovereign yields (Chart 6). CRE is subject to risks related to structural changes in office and retail usage due to the pandemic and climate-change related changes to building quality.[21] The reliance of CRE investments on debt financing means that a shock to prices can increase risks related to leverage. The sector also has close ties with the construction sector that also heavily relies on debt financing. Global CRE investment volume fell by 57 per cent year-over-year in 2023Q2, partly due to tighter lending conditions.[22] Globally, significant losses on CRE investments have the potential to amplify shocks across sectors through bank loan impairments, credit supply retrenchment, and a broader contagion in risk appetite. Ireland's CRE market is subject to similar dynamics and risks, although the international investor profile may mitigate the potential for domestic amplification of price shocks (see *Domestic risk assessment* and Box 2).

Residential real estate markets are also vulnerable to higher interest rates after a long build-up in price appreciation and household leverage in some economies. The sector could face a correction as higher interest rates hamper affordability and increase default risk for borrowers. Some residential real estate prices have already started falling, although in an orderly manner so far. Large increases in mortgage rates will put strains on the debt servicing capacity of mortgage-holders over time, although this may operate with a lag where fixed-rate loans are more prevalent.

[19] For the above-mentioned low estimate see here.
[20] See ECB Macroeconomic Projections, September 2023.
[21] Market intelligence suggests that lower quality, older and less energy efficient office units in Ireland have experienced larger revaluations in 2022 than newer, more energy efficient stock.
[22] CBRE. For details see here.

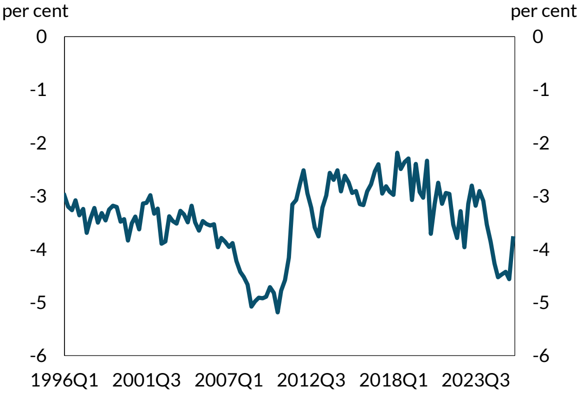
Domestic risk assessment

While continued domestic economic growth is expected, inflation remains high and short-term risks to the economy persist. Global economic weakness poses risks to Ireland through trade and FDI channels. The full effects of monetary policy tightening have yet to be transmitted to the economy, with interest rate pass-through slower in Ireland than elsewhere in Europe but continuing gradually. There is emerging evidence that some borrowers' capacity to service debt is becoming increasingly stretched, and CRE prices have fallen substantially, owing both to tighter financing conditions and structural changes in offices and retail. Capacity constraints within the economy have been growing and may undermine the longer-term competitiveness of the economy if downside risks do not materialise.

The outlook for the Irish economy is for continued expansion albeit at slower rates of growth than experienced during the post-pandemic period. Economic activity has remained relatively resilient throughout 2023, however, there has been a clear slowdown in key export-oriented sectors, visible both in export flows and corporation tax receipts after years of exceptionally strong growth. As a small open economy, Ireland is especially sensitive to developments in the global economy. The concentrated nature of Ireland's exports in both a small number of sectors and firms represents a risk to future growth.[23] Overall, the pace of growth is expected to moderate over the next two years, all while remaining robust and positive.[24] Slower growth reflects a combination of domestically binding capacity constraints as well as the impact of monetary policy tightening on demand, both in Ireland and globally (see *Global risk assessment*).

Chart 7: Downside risk to the domestic economy's growth rate has eased yet remains relatively high

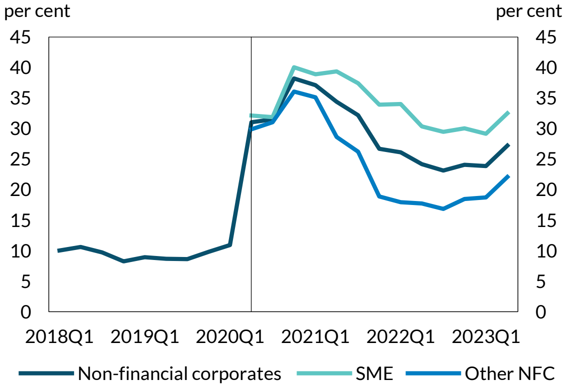
GNI* at risk



Source: Central Bank of Ireland.
Notes: The chart shows forecast tail risk of GNI* for the period three years ahead. It is an estimate of the amount by which growth could fall given current economic activity and various systemic risk indicators. For the purposes of the chart, tail risk is defined as the fifth percentile of forecast distribution of GNI* growth. Last forecast observation 2026Q1. For more on Growth at Risk see Box 3 from FSR 2020: 1

Chart 8: Forward looking indicators of credit risk are rising

Share of corporate lending classified as stage 2 under IFRS



Source: Central Bank of Ireland.
Note: Based on data submitted by the three domestic banks. Stage 2 assets refer to assets where there has been a significant increase in credit risk since the time they were originally recognised. SME and Other NFC are subsets of NFC available from 2020Q2. Last observation 2023Q2.

Uncertainty remains high and short-term risks to the economy persist. Measures such as GNI*-at-risk estimate the potential loss of economic output in the event of a negative outcome. Current

[23] For more on recent trends in Irish exports see Box D in the Central Bank Quarterly Bulletin QB3 / September 2023.
[24] For more on the outlook for domestic economic growth see the Central Bank Quarterly Bulletin QB3 / September 2023.

estimates indicate that such a downturn could be severe, with the magnitude of tail risks having gradually increased since 2018, despite a slight moderation recently (Chart 7). Elevated risks are not currently driven by strained financial conditions or excessive credit growth, as was more likely to be the case in the past.[25] Regardless of the underlying drivers, a severe shock to the economy could have far reaching consequences for financial stability including negatively impacting the debt servicing capacity of borrowers, reducing asset values as well as undermining the smooth functioning of the financial system. In comparison to other countries, the small and open nature of the Irish economy contributes to greater tail risk.

Cost of living pressures remain acute for some households and business. A combination of high and rising prices has led to an erosion of households' real incomes. Inflation, particularly core inflation, continues to be persistent. Households – particularly those on lower incomes –and firms in energy intensive sectors are exposed to elevated energy prices. While the central outlook is for a gradual easing in energy prices and a restoration of real incomes to pre-2022 levels, retail energy prices are likely to remain at elevated levels for some time, and many will remain vulnerable to further energy volatility. Despite ongoing government support, arrears rates in retail energy markets indicate that a cohort of consumers are facing difficulties meeting higher costs.[26]

The pass-through of tightening monetary policy is continuing**.** The pass-through of policy rates by Irish banks has lagged behind other euro area banking systems and has been relatively slow when compared to past periods of monetary policy tightening.[27] A small increase in short-term mortgage arrears among some vulnerable customers is pointing to the emerging risk of repayment difficulties for some parts of the household sector (see *Resilience: Households)*. The prevalence of fixed-rate mortgages means approximately half of mortgage holders are insulated from the immediate impact of rising interest rates. However, the relatively short term of some of these fixed-rate contracts means many mortgaged households will likely face higher repayment burdens in the medium term. There has been a small increase in the cohort of business borrowers that banks classify as higher-risk (Chart 8). Other indicators such as moderately rising corporate insolvencies point to potential weaknesses among some firms (see *Resilience: Non-financial corporations).*

Medium-term risks are building as capacity constraints within the economy have become more evident. In the absence of a materialisation of the downside risks outlined above, projections for the economy remain favourable, raising the risk that cyclical conditions could give rise to overheating dynamics over the medium term. Such dynamics may ultimately undermine the competitiveness of the Irish economy increasing the risk of an abrupt and destabilising correction. Signs of capacity constraints are particularly evident in labour markets, where – despite some recent softening of indicators – employment rates remain at historical highs, vacancy rates are rising and the unemployment rate is close to levels associated with full employment (Chart 9).

With monetary policy set at the euro area level, fiscal policy is particularly important for economic and price stability domestically. There are a number of future issues facing the Irish economy that warrant greater investment, including demographic changes, climate transition and greater

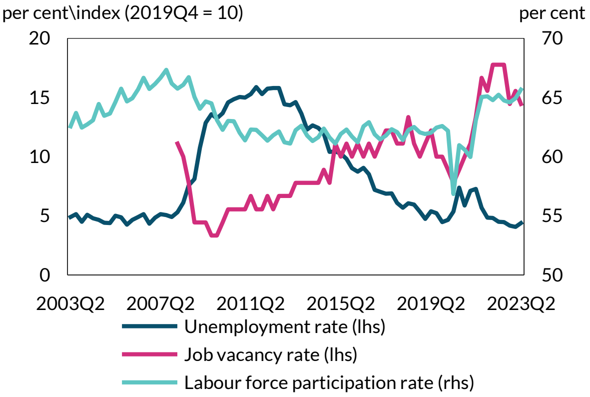
[25] Post-pandemic growth dynamics are an important feature of the underlying modelling dynamics. For more on the implications of COVID-19 on growth at risk see Box 3 in FSR 2020:I
[26] Commission for Regulation of Utilities (2023), "CRU Report on Retail Energy Markets September 2023".
[27] See Byrne and Foster (2023), "Transmission of monetary policy: Bank interest rate pass-through in Ireland and the euro area", Economic Letter, Vol. 2023, No 3.

digitalisation of the economy. However, given the economy is now operating at full capacity, expansionary fiscal expenditure risks triggering potentially damaging overheating dynamics.[28] Measures such as the recently introduced mortgage interest tax relief have the potential to weaken monetary policy transmission both directly – by adding to aggregate demand – but also indirectly by influencing households' expectations of future government supports.

Tighter credit conditions are adding to the significant headwinds facing the Irish CRE market. Amid rising funding costs and a deterioration in sentiment amongst market participants, investment activity in the CRE sector was down over 70 per cent during the first three quarters of 2023 compared to the same period in 2022 (Chart 10). This fall-off in transactional activity has been accompanied by a sharp decline in property values (Chart 11). Overall annual capital values were down 14 per cent year-on-year according to 2023Q3 data, bringing the cumulative fall to over 20 per cent since late 2019. The magnitude of the decline, while large, remains substantially smaller than that experienced in the GFC period.[29] The office sector is currently the weakest sector, with the largest price declines for lower quality, older and less energy efficient units.

Chart 9: The economy is operating at close to capacity with little labour slack remaining

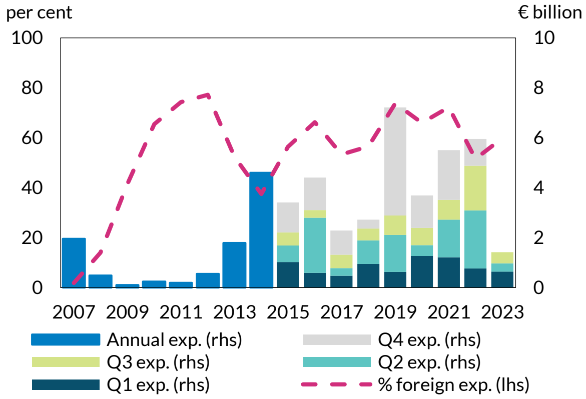
Unemployment rate, vacancy rates and labour force participation rate



Source: CSO.
Notes: Job vacancy rate is shown as an index with 2019Q4 values indexed to 10. Last observation 2023Q2

Chart 10: CRE investment activity has dropped sharply during 2023

Investment expenditure on Irish CRE



Source: JLL and CBRE Research.
Note: Share of foreign expenditure excludes investment where origin is unknown. Last observation 2023Q3.

Shocks to the Irish CRE market might be amplified by vulnerabilities in financing. The investor base in the domestic commercial property market is much more international than in the past (Chart 10). While a broadening of the investor base may help to reduce concentration risk, it does increase the sensitivity of the sector to external shocks, such as global CRE market synchronisation, the weakening global economic outlook or the further tightening of global financing conditions (see *Global risk assessment*). These effects can be amplified when leverage is high or liquidity profiles are weak at property funds. Other financial institutions – such as banks with similar exposures through the use of real estate as collateral for lending – may be impacted by the resultant declines in CRE values, with long-run implications for the market.

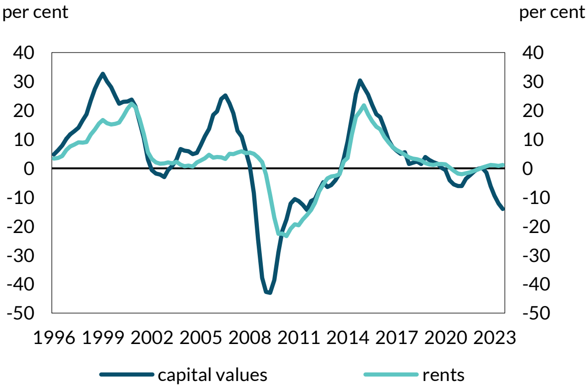
[28] The sovereign financing position is currently favourable (see *Resilience: Sovereign*) and recently announced measures to divert current "excessive" corporation tax receipts for longer-term needs may help to limit some of the short-run inflationary pressures from fiscal policy.
[29] At a similar stage in the 2007 property crash, (i.e., 16 quarters post-peak value – 2011Q4), CRE values had fallen by 65 per cent, and reached a trough of 68 per cent below peak values 6 quarters later in 2013Q2.

A significant volume of outstanding CRE lending in banks is due to mature in the short term. The majority of CRE bank loans are expected to mature by the end of 2027 (see *Resilience: Domestic banks*). In cases where borrowers are unable to meet increased financing costs or additional equity injections are not forthcoming, asset sales may be required, which could depress prices further. The attractiveness of CRE assets relative to safer assets such as bonds has also waned due to higher interest rates, which increases the risk of further declines in CRE prices.

Outside of funding conditions, weaker occupier demand may place additional downward pressure on CRE prices. In some markets, there are indications that the demand for space may be structurally lower as a result of pandemic-related shifts in work practices.[30] The weakening in letting activity occurs against the backdrop of a steadily increasing Dublin office vacancy rate which has now moved above the average rate for the previous 20 years (Chart 12). In recent quarters, growth in Dublin office rents has been broadly flat.[31] A significant fall in rents would have a negative impact on future capital values and may hamper the ability of CRE borrowers and investors to meet loan repayments or service an increase in funding costs arising from a refinancing event.

Chart 11: CRE prices have now fallen more than 20 per cent since the fallout from the pandemic began

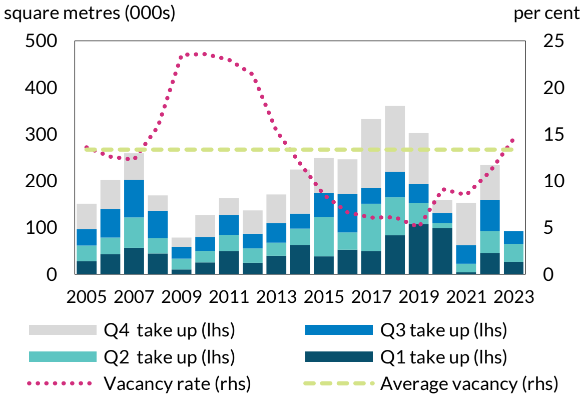
Annual change in CRE capital value and rent indices



Source: MSCI.
Notes: Last observation 2023Q3.

Chart 12: Take-up is well down and the vacancy rate well up, in the Dublin office market

Dublin office stock take-up and vacancy rate



Source: CBRE Research.
Note: Last observation 2023Q3

The delivery of a significant volume of new/and or refurbished office space into the market could further aggravate price declines. A failure in the ability of the office sector to absorb this additional space in the coming years gives rise to the risk of an oversupply in the market, a development which would place further downward pressure on both capital and rental values. There is some evidence of a supply response; CBRE data on the Dublin office supply pipeline show how projections of the volume of office space, which has planning granted or is currently under construction and due for delivery before the end of 2025, has declined from about 680,000 square metres at the end of 2022, to approximately 255,000 square metres at 2023Q3 – about 30 per

[30] For example, in the Dublin office market, the volume of space let in the first 9 months of 2023, was over 40 per cent lower than the corresponding figure from a year earlier and more than 30 per cent below the equivalent average figure across the last two decades.

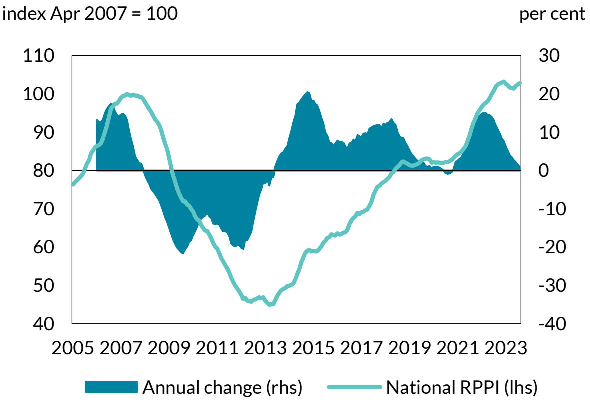
[31] According to Catella, in early-2023 prime rents in Dublin were the 5th highest across a selection of 40 European locations. MSCI data indicate that Dublin office rents were 0.4 per cent lower year-on-year in 2023Q3, with the annual change in the series staying within a range of plus or minus 1 per cent throughout the past 7 quarters.

cent of which is pre-let.[32] Nevertheless, even this lower quantity of additional space may depress prices further.[33] Changes to office demand due to increased levels of remote working, as current leases expire and come up for renewal has the potential to exacerbate the situation.

House price growth has moderated rapidly. Housing accounts for almost 70 per cent of households' net wealth, while mortgage-related lending accounts for 63 per cent of credit institutions' exposures to the private non-financial sector. Ireland is one of a number of countries that have experienced a similar pattern in the path of residential property prices in recent years, that is, a rapid rise in growth rates following the outbreak of COVID-19 which have been slowing steadily for much of the past 18 months (Chart 13).

Chart 13: RRE price growth has slowed significantly in recent months

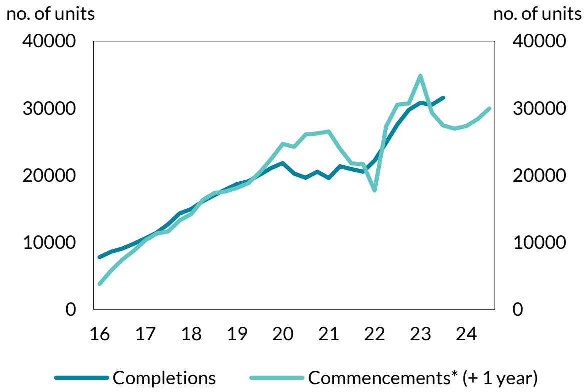
CSO residential property price index and annual percentage change: national



Source: CSO.
Notes: Last observation August 2023

Chart 14: Forward-looking indicators suggest further increases in the level of housing supply

Housing completions vs. (+ 1 year) commencements



Source: CSO and Department of Housing.
Note: Last observations 2023Q3

The full impact of higher interest rates on house prices may occur with a lag. All else equal, higher interest rates should weaken mortgage demand with negative implications for house prices. However, there are a number of factors that may support current house prices, notably the long standing imbalance between housing supply and demand. After a marked increase in the completion of housing units in 2022, forward-looking indicators point to further growth in the level of delivery in 2023 (Chart 14).[34] However, tightening funding conditions for developers and viability challenges due to higher construction costs, may slow further growth in supply.[35] The situation is further exacerbated by an acute shortage of second hand units, with listings close to

[32] Prior to an uptick in commercial construction activity during October 2023, recent editions of the BNP Paribas PMI (for July, August and September 2023) as well as the RICS Global Commercial Property Monitor (2023Q3) had all pointed to a pronounced reduction in commercial building activity in Ireland of late. The increase in construction activity seen in the BNP Paribas PMI for October, is explained by a delay in the delivery of a sizeable volume of new office space from Q3 to Q4, and a push to get other projects completed before year's end. Due to a notable drop in the number of recent speculative office commencements the supply pipeline is expected to fall away sharply from next year.

[33] The difference in the volume of additional office space projected for delivery by end-2025, is largely explained it appears by a postponement in developers' planned completion dates. For instance, approximately 725,000 square metres of office space currently under construction or with planning granted is due for delivery from 2026 onwards, up from estimates of about 320,000 square metres, at the end of last year.

[34] The current rolling annual total of housing completions surpassed 31,500 in 2023Q3, an increase of 6 per cent from the end 2022 figure. Similarly, there was a notable increase in the number of residential commencements in 2023Q3 (8,350), an increase of about 25 per cent over 2022Q3, taking the rolling annual commencement figures above 29,950, up from 27,400 a year earlier.

[35] While falls in the prices of some building materials have occurred in recent months, the cumulative increase in construction and building materials since December 2019 is approximately 36 per cent as of September 2023.

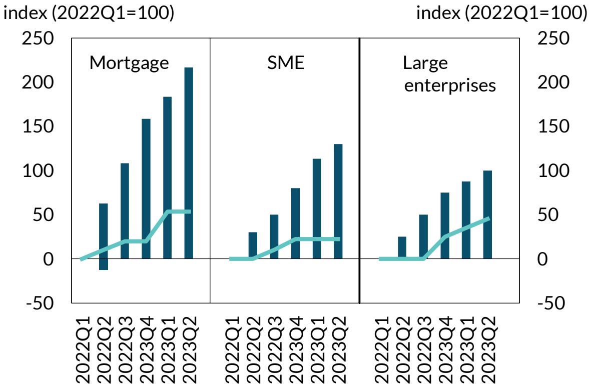
historical lows. Other factors supporting house prices include the tightness in the labour market, the favourable outlook for household disposable incomes, government initiatives and demographic trends that appear likely to sustain a structurally high level of housing demand.

Market participants do not envisage house price falls materialising. Survey evidence and forecasts from a number of private-sector institutions, suggest market participants expect the pace of residential real estate (RRE) price growth to stabilise in the low single digits for the remainder of 2023 and into 2024, as the lack of supply within the housing market remains a key issue, and higher interest rates increasingly weigh on affordability.

Domestic credit supply has tightened and is expected to tighten further in the short-term. In line with other euro area banking systems Irish banks have tightened lending standards across various categories of lending (Chart 15). However, the degree of tightening has been lower and occurred at a slower pace than international peers. Tighter lending standards are most evident in the interest rates charged on new NFC lending (Chart 16). However, since the publication of the last *Review*, mortgage interest rates have also increased. The latest round of the Bank Lending Survey indicates that further tightening of credit standards are expected in the near term.

Chart 15: Irish banks have not tightened credit standards by as much as European peers

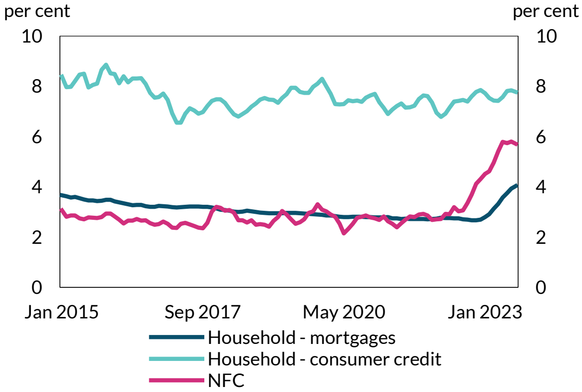
Evolution of diffusion index of credit standards as reported in the Bank Lending Survey



Source: ECB and Central Bank of Ireland calculations.
Notes: Positive (negative) values indicate a tightening (loosening) of credit standards. Dark teal bars denote the rate of credit tightening across euro area banking systems. Teal lines show the corresponding level of tightening for Irish banks.

Chart 16: Interest rates for new borrowing are much higher than a year ago

Interest rates on new lending by loan type



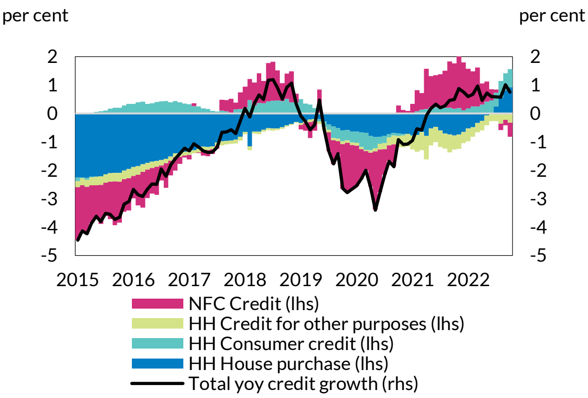
Source: Central Bank of Ireland Money and Banking statistics.
Notes: Data are 3-month rolling averages. Last observation August 2023.

Credit growth remains relatively subdued with divergent trends across segments. Annual credit growth to the non-financial private sector was 0.8 per cent in September (Chart 17). NFC credit – which had positively contributed to overall credit growth at the time of the last *Review* – has since started to decline. The fall in lending is evident across sectors and is reflected in both large enterprises as well as SMEs. Lending for house purchases and other household credit have gathered pace in recent months and is driving overall credit growth.

Against a backdrop of credit tightening, credit demand has shown signs of softening in some segments. Personal loan enquiries – which account for the majority of all enquiries made by Irish residents – continue to increase albeit at a slower pace than previously reported (Chart 18). Residential mortgages have also exhibited a modest decline. The expectation is for mortgage credit demand to ease, with future demand more closely aligned with first time buyer and mover purchasers' activity.[36] The number of business enquiries continues to moderate.

Chart 17: Household credit developments have more than offset declines seen in the NFC sector

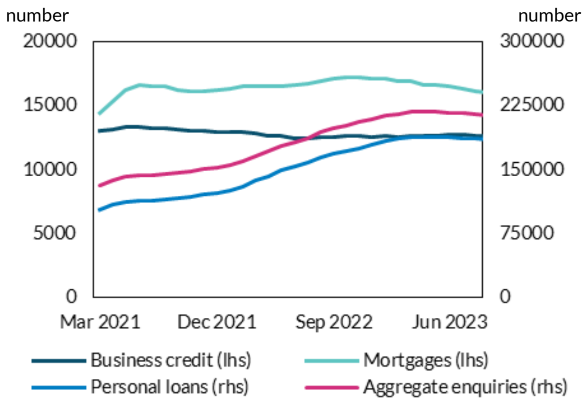
Contribution by type of loan to the annual growth rate of total credit



Source: Central Bank of Ireland Money and Banking statistics.
Notes: Calculations based on data from Tables A.1 and A.6. As of January 2022 Table A.6 has been discontinued following an updated ECB regulation on the treatment of securitised loans. Credit considers only loans from banks to Irish residents. HH – households. Last observation September 2023.

Chart 18: Forward-looking credit demand indicators have eased in recent months

Average annual number of enquiries



Source: Central Credit Register.
Notes: Data are the monthly average spanning a twelve month period. Last observation October 2023.

Intra-financial system interconnectedness is a channel for amplifying external shocks and transmitting shocks into the domestic economy. The Irish banking system remains highly interconnected, though the results differ by banking category.[37] Domestic banks tend to have limited interconnections, with small exposures to the global financial system, while international banks account for the majority of banking interconnectedness (Chart 19).[38]

The domestic banking system remains highly concentrated. Over the past decade a combination of banking withdrawals and consolidation has seen the importance of a small number of providers increase. This is evident across a range of banking services (Chart 20). The failure or distress of some of these providers may have negative externalities to the economy. The risks of a concentrated banking sector may be aggravated further by commonalities between those institutions. The domestic banking sector's main exposures relate to counterparties located within Ireland. Across all exposures, real estate related lending, in particular residential mortgage lending, accounts for a large share of lending, increasing concentration risk.

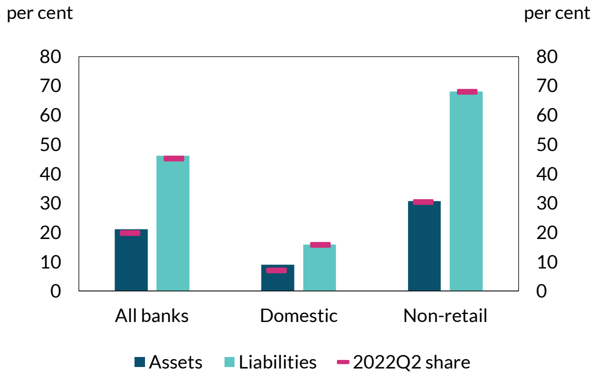
Operational and cyber risk remains an area of potential weakness for parts of the domestic financial system.[39] Providers of financial services are becoming increasingly reliant on new technologies to both improve operational efficiencies and expand the range of products available.

[36] This follows a surge in mortgage refinancing in 2022 related to borrowers' attempts to fix interest rates at the bottom of the interest rate cycle.
[37] The banking system in Ireland consists of two distinct groups. First, those banks located in Ireland that predominantly provide financial services to the domestic economy. The second cohort are international banks that while located in Ireland, have limited interaction with the domestic economy. They have a diverse range of exposures across the EU, UK and other regions.
[38] International banks' intra-financial liabilities primarily relate to interbank deposits and deposits from other financial institutions.
[39] To help mitigate these risks the EU has implemented the [Digital Operations Resilience Act (DORA)](#).

Increased competition from fintech companies mean many existing financial services providers may need additional investment in their digital and operational resilience infrastructure to safeguard the sustainability of their business models. However, the adoption of new technologies presents firms with execution risk which has the potential to interrupt the smooth operation of key elements of the financial system. This is particularly relevant where these new technologies are built upon or have to integrate with older systems. Globally, cyber-attacks have increased in recent years.[40] Outside of a deliberate attack on elements of the financial system a growing area of vulnerability is the increasing reliance on outsourcing of data management and services to a small number of third party providers. Should one or more of these providers' services become compromised it could have broader consequences for the financial system.

Chart 19: Non-retail banks are more interconnected than domestic banks

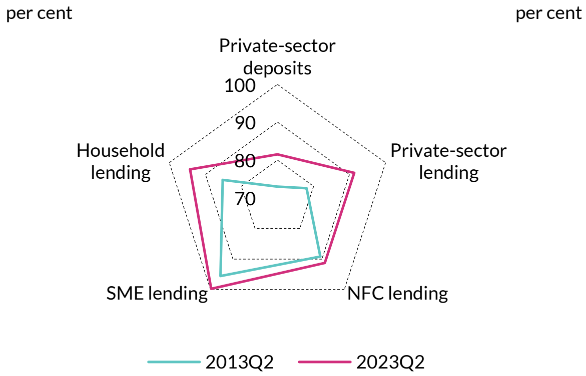
Interconnectedness of the Irish banking system across banking assets and liabilities



Source: Central Bank of Ireland.
Notes: Financial interconnectedness relates to on-balance sheet exposures of banks to 1) each other and 2) other parts of the financial system. Data are for a sample of banks that submit a breakdown of exposure data. Non-retail refers to international banks located in Ireland. Data as at 2023Q2.

Chart 20: Domestic banking services are heavily concentrated into a small number of banking groups

Market share of the top five banking groups



Source: Central Bank of Ireland.
Note: Data are collected on a residency basis and for the purposes of analysis are adjusted for group structure. Five largest banking groups are calculated per category and may not be the same across markets or points in time.

Risks related to climate change are coming into shorter-term focus. Broadly, risks from climate change fall under two categories (see Box 1). First, so-called 'physical risks' which result from the increased incidence or severity of extreme weather events as well as gradual and structural shifts in the environment. Financially, physical risks are particularly relevant for insurance claims and their negative impact on underlying collateral values, for example in property-related lending. However, over time, the increasing frequency and intensity of climate shocks means that wider implications may arise from unexpected climate events in the near term. Shocks to borrowers' repayment capacity from severe weather are difficult to foresee, and could materialise rapidly and without warning. Second, 'transition risks' are also relevant for financial stability, due to changes in the relative price of carbon-intensive assets, which may hamper employment and growth prospects in some sectors of the economy that are more reliant on carbon-intensive activity, increasing the risk that borrowers in these sectors will become financially unviable over the medium term.

[40] Arguably the most high profile case of a cyber-attack in Ireland was the ransomware attack on the HSE.

Box 1: Financial stability risks from climate change

This box highlights the main drivers of financial stability risks relating to climate change. Broadly, risks from climate change fall under two categories. Physical risks are losses from climate related events, or shifts in climate patterns. Real economy costs can include a reduction in food supply, supply chain needs, employee safety etc. Transition risks are costs to society from evolving to a low-carbon economy, these include for example higher compliance costs, changing demand patterns, erosion of existing carbon-intensive markets and unexpected energy and/or insurance costs.

Both physical and transition risks can increase global inflation and interrupt supply chains. In 2023, there has been an increase in intense heatwaves, wildfires and droughts. Losses linked to droughts account for around €5 billion annually for the agricultural sector in Europe, with losses projected to increase in the future. The El Niño phenomenon raised global food prices by more than 6 per cent in a year. Similar events in the future, including supply-side disruptions, could pose further risks to inflation. In certain carbon-intensive sectors, the climate transition is likely to raise costs for households and businesses impacting regional/sectoral profitability and growth *(see Global risk assessment).*

Vulnerabilities in domestic government finances can impact domestic climate change policy. Expansionary fiscal expenditure to improve the long term energy efficiency of domestic real estate could be inflationary in the short term and contribute to potentially damaging overheating dynamics for the economy *(see Domestic risk assessment*). Also, should the recent 'excessive' corporation tax receipts in Ireland not materialise in the future, the sovereign financing position will be less favourable to meet future climate change costs. These could be costs relating to investment for climate adaptation, as well as to meet expanding demands for compensation against uninsurable risks related to extreme weather events *(see Resilience: Sovereign)*,

Climate risks may reduce collateral values and borrowers' repayment capacity, with implications for banks. Older office units in Ireland have experienced larger revaluations in 2022 than newer, more energy efficient stock (*see Domestic risk assessment*).[1] Similarly, other sectoral valuations such as agricultural and other business assets may be affected. Banks may also be exposed to borrowers' repayment difficulties following more frequent and more damaging physical risk events *(see Resilience: Domestic banks).*

Rising Insurance claims have the potential to increase premia. The increase in severe weather events will lead to increased and more frequent property damage claims as well as reducing asset values and increasing claims volatility. Climate-related liability claims may also increase, that is claims for failing to manage climate risks, greenwashing etc. (*Resilience: Insurance).* The increase in claims has the potential to increase insurance premia, impacting households and businesses alike.

While climate change has typically been considered a medium-to-long term risk to financial stability, the frequency and severity of weather events is bringing it into more immediate focus. Financial stability policies must become increasingly alert to the frequency and severity of weather events, such as the multitude of extreme events globally in 2023. The unpredictable nature of climate shocks, combined with the potential that more extreme outcomes are now becoming more likely, increases the need for resilience across all sectors of the macro-financial system.

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[1] This could impact Irish property fund valuations, depending on the magnitude of their exposures to these particular CRE assets.

Resilience

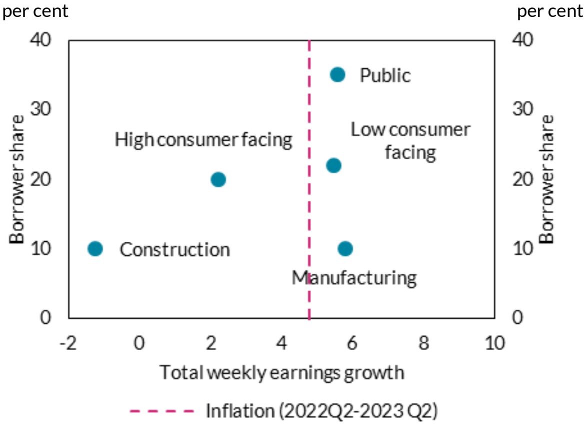
Households

The real incomes of households are expected to further recover over the short to medium term, as inflation declines and a tight labour market supports wage growth. However, the effects of rising interest rates on borrowers' repayment capacity are now visible in some vulnerable segments. Despite this, there are few signs of a system-wide deterioration in borrowers' repayment capacity, based on a range of indicators. New survey evidence points to risks to the current outlook for households: nearly half of borrowers report that their ability to continue servicing debt repayments would be put at risk if debt payments increased by a further fifth, while a quarter of mortgage borrowers report that they do not have liquidity buffers that they would deploy to repay debt if they were to became unemployed.

Real incomes are improving, as inflation declines and nominal wage growth rises. Most broad borrower-concentrated sectors have seen their nominal income growth outpace inflation in the last year (Chart 21). Labour market conditions remain relatively tight, which could further support wage growth out to 2025.[41] These labour market fundamentals have been supporting household resilience despite rising debt payment pressures from tightening monetary policy. In addition, many households have built up a stock of financial buffers during the pandemic, which could provide further resilience against cost of living shocks (Lydon and McIndoe-Calder (2022)).

Chart 21: Real income growth is improving as inflation subsides

Mortgage book exposure and accumulative total weekly earnings growth between 2022Q2 and 2023Q2



Source: CSO, Earnings and Labour Costs and Central Bank of Ireland.
Notes: Low consumer facing sectors are: ICT, finance and professional. Public sectors include: health, education and public admin. High consumer facing sectors include retail, accommodation, arts, transport and admin. Pink dash line at 4.8 per cent represents the cumulative HICP inflation rate between 2022Q2 and 2023Q2.

Chart 22: Borrowers with higher debt service burdens have been more likely to miss debt or utility payments

Share of borrowers by debt service to income ratio (LHS) and missed payment status (RHS)

Source: Central Bank of Ireland Expectations Survey.
Notes: The share of Irish household borrowers by debt service to income (DSTI) cohort (LHS) and the rate of missed payments on debt and/or utility payments in the period October 2022 and September 2023 (RHS).

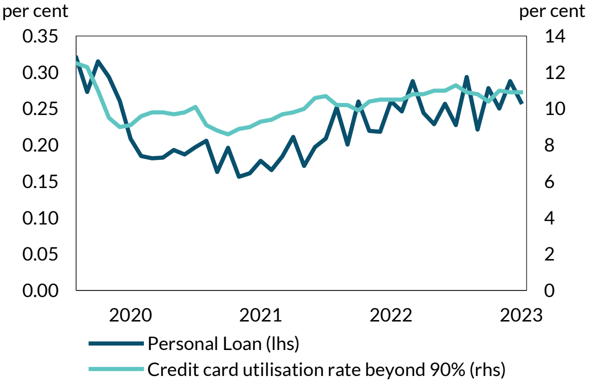
Borrowers with higher debt service ratios have been more likely to miss payments on debt or utility payments (Chart 22). In a survey of households conducted by the Central Bank of Ireland, approximately 20 per cent of indebted households report missing a debt and/or utility payment in this period (Singh and Yao (2023)). This is most pronounced among borrowers with higher debt

[41] See Central Bank Quarterly Bulletin QB3 / September 2023.

burdens, measured by the ratio of debt instalments to net income – their 'debt service to income' (DSTI) ratio. One in six borrowers report having a DSTI ratio of over 40 per cent and the rate of missed payments among this cohort is almost double that of the lower DSTI cohorts.

Chart 23: Arrears on personal loans are rising from a low base

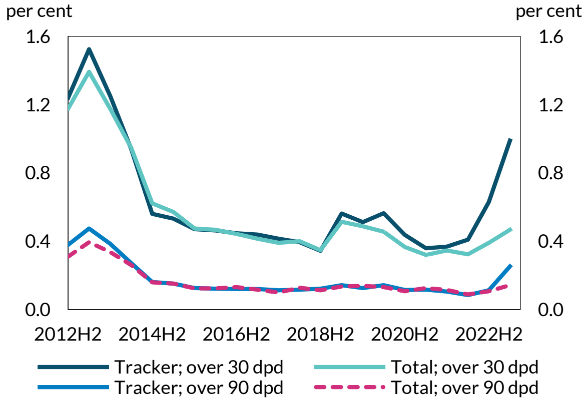
Monthly share of early arrears in personal loans and share of credit card utilization beyond 90 per cent



Source: Central Bank of Ireland; Central Credit Register.
Notes: Loan arrears are calculated using domestic bank data. Credit card utilisation is the ratio of outstanding balance to credit limit, adjusting for the impact of annual stamp duty charges. The teal line reports the share of borrowers with utilization above 90 per cent.

Chart 24: Early arrears flows are rising among tracker mortgages, but remain low across all mortgage types

Share of retail bank mortgage loans entering arrears



Source: Central Bank of Ireland.
Notes: The share of domestic bank Irish primary dwelling house mortgage loans moving from zero days past due to 31-180 days past due and zero days past due to 91-180 days past due in the following six months, by interest rate type. Last observation: 2023H1

Arrears on personal loans are rising from a low base, reaching pre-pandemic levels (Chart 23). The share of personal loans entering arrears has risen from 0.17 per cent per month in early 2021 to approximately 0.27 per cent per month in early 2023. This is a return to the average new arrears flow rate immediately prior to the pandemic. The share of credit card with utilisation rates above 90 per cent has also ticked back up to its pre-pandemic level of approximately one-in-ten.

Early arrears are rising among tracker mortgages (Chart 24). At domestic banks, non-performing loan ratio for lending to households for mortgage lending and consumer lending has been steadily declining since 2014, and mortgage arrears have not increased significantly in recent months.[42] Flows into arrears reached their lowest recent level in 2021-22. Since then, the share of tracker mortgages beginning to miss more than one payment over a six-month period has increased from 0.4 per cent to 1.0 per cent, amid rapid increases in interest rates, while remaining around the recent average across banks' all mortgage types. The trend is particularly strong for borrowers with a history of repayment difficulties (Shaikh, Kilgariff and Gaffney (2023)). The share of borrowers entering arrears of more than 90 days past due is much smaller, signalling no significant recent increase in persistent loan problems.

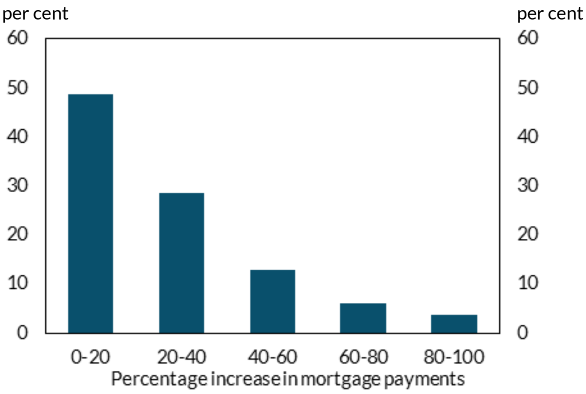
The impact of monetary policy tightening on mortgage borrowers has been mitigated by a number of important factors. The large scale take-up of fixed interest mortgages in recent years, the moderate pass-through of monetary policy rate decisions thus far to SVR loans, and anticipatory behaviour on the part of households to pay down debt or refinance prior to retail interest rate

[42] In both cases, non-performing loans have dropped considerably with the mortgage non-performing loan rate reducing from 18 per cent in 2014 to a low of 1.98 per cent in Dec 2022 before experiencing a slight pick up to 2.22 per cent as at June 2023. Likewise, non-performing consumer loans have fallen from 25 per cent of total outstanding balance in 2014 to a recent historical low of 3.81 per cent. Data sourced from FINREP for three remaining domestic banks.

increases have all contributed to dulling the short-term impact of policy tightening. As a consequence, the average mortgage instalment increase between June 2022 and June 2023 was only 7 per cent.[43] A steady flow of borrowers will see their fixed rate periods expire over the next 3 to 5 years and be exposed again to elevated interest rates.

Chart 25: Many borrowers report that higher debt instalments would stretch their finances

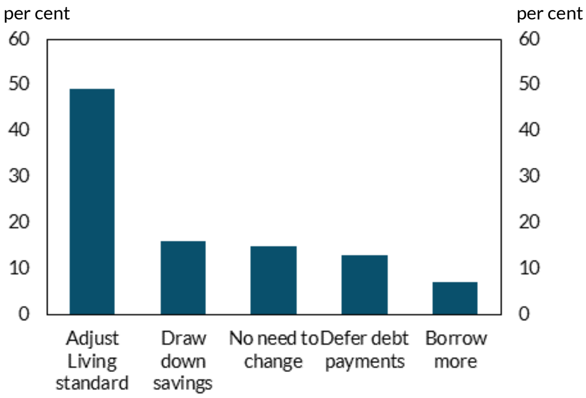
Distribution of self-reported instalment increases that would make debt payments unaffordable



Source: Central Bank of Ireland Expectations Survey.
Notes: The share of household borrowers by their maximum affordable percentage increase in their mortgage payment in the next 12 months. The survey was conducted in September 2023.

Chart 26: Most borrowers would cut consumption and deplete savings before missing a debt repayment

Households' responses to further costs of living pressure



Source: Central Bank of Ireland Expectations Survey.
Notes: The share of households reporting that they adopt each strategy in the event that cost-of-living pressures do not improve in the next 12 months.

Many borrowers report that further increases in debt instalments would be stretch their finances (Chart 25). In a self-reported survey in September 2023, household borrowers were asked to report the level of instalment increase that would place their ability to continue making repayments at risk. Approximately half of borrowers say that an increase of up to 20 per cent would make their loans unaffordable. Another 28 per cent of borrowers in the survey said that they can afford up to 40 per cent increase in their loan payments. These figures are the result of households' own assessments of their financial position, and are not corroborated with income or credit data, as might be the case in a more formal household finance survey. Nonetheless, the evidence suggests that borrowers themselves see minimal capacity to deal with further increases in interest rates.

Most borrowers say that they would cut consumption and deplete savings before missing a debt payment (Chart 26). The recent survey also sheds lights on different measures taken by households to deal with continuing increases in the costs of living. Around 50 per cent of respondents in the survey choose adjustment of living standard as their primary response if high inflation persists for the next 12 months. 16 per cent of respondents suggest that they would use their savings to damp the real income shock, while only 13 per cent believe that they would have to defer payments on loans or bills.

[43] For estimates of likely increases in repayments during the tightening cycle, as well as information on the end date of interest rate fixation periods, see Byrne, Gaffney and McCann (2023).

Non-financial corporations

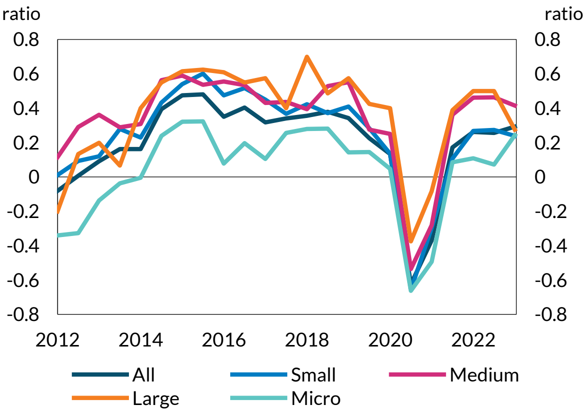
The trading performance of Irish businesses has remained buoyant in 2023. Turnover and profitability indicators remain strong, though moderating aggregate demand and wage growth pressures have the potential to compress profit margins. Monetary policy pass-through has been more complete for business lending than household lending and is placing downward pressure on investment and employment growth. CRE firms remain exposed both to a higher interest rate environment and a structural slump in demand for assets such as offices. Loan delinquencies have yet to rise significantly. Corporate insolvencies continue to rise from historic lows, though the majority of recent cases relate to firms that struggled during the pandemic.

The trading conditions of Irish businesses remained buoyant in 2023. Retail sales volumes continue to hold up, despite the large cumulative rise in the cost of living since 2021.[44] Other measures of household consumption remain strong.[45] Labour market indicators are starting to show early signs of moderating, but business hiring is still at elevated levels.[46]

Turnover indicators show continued evidence of strong trade into 2023 (Chart 27). Survey data up to March 2023 show that the net share of Irish firms reporting increased turnover over the prior six months was 29 per cent. This compares with 26 per cent in September 2022 and approximately 30 per cent per cent in the pre-pandemic period. It is also significantly above the euro area median level of 21 per cent. While micro enterprises typically report the weakest turnover performance of any size category, the reading at March 2023 for this group is relatively strong at 24 per cent. This is consistent with a broad-based improvement in turnover across the full size distribution of firms.

Chart 27: Turnover growth indicators have remained positive into 2023

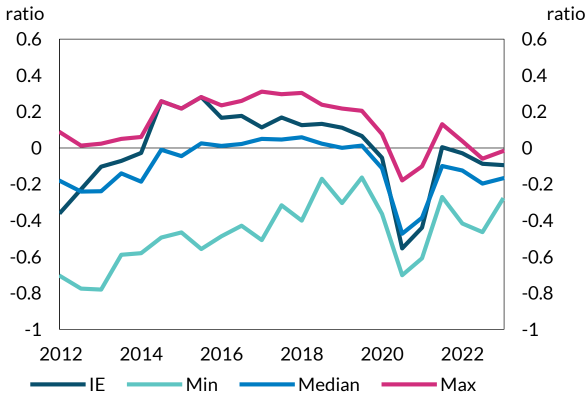
Net share of firms reporting increased turnover



Source: ECB SAFE.
Notes: The net share of Irish businesses reporting increased turnover in the preceding six months by firm size.

Chart 28: Profitability measures provide suggestive evidence of margin compression

Net share of firms reporting increased profitability



Source: ECB SAFE.
Notes: The net share of Irish (IE) businesses reporting increased profitability in the preceding six months, along with the euro area minimum, median, and maximum.

Profitability measures provide suggestive evidence of margin compression (Chart 28). Despite rapid increases in energy and other input costs, average profit margins grew in 2022 due to a

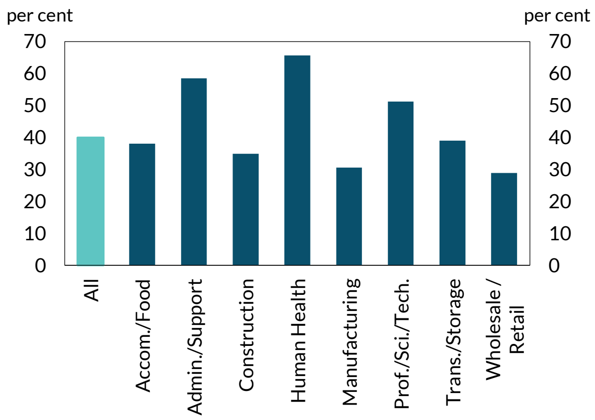
[44] See the CSO Retail Sales Index.
[45] See the Central Bank's Card Payment Statistics.
[46] See the Central Bank Quarterly Bulletin QB3 / September 2023.

combination of cost pass-through to unit pricing and exceptionally strong consumer demand.[47] Survey data up to March 2023 provides some signs of these strong profits moderating. A net share of 9 per cent of Irish firms report that their profitability declined in the six months to March 2023, falling from a net share of zero in the September 2022 survey.

Wage growth is likely to be a key factor influencing firm profitability in the short-term (Chart 29). Pressure from wage increases and moderation of aggregate demand in the economy have the potential to reduce firm profitability. Approximately 40 per cent of SME operating costs in Ireland are made up of wages. The share is even higher at between 50 and 65 per cent for service-orientated firms in the Professional, Administrative & Support, and Human Health sectors. Increases in wage costs have the potential to reduce firm profits significantly.

Chart 29: Wage growth is likely to be a key factor influencing firm profitability in the short term

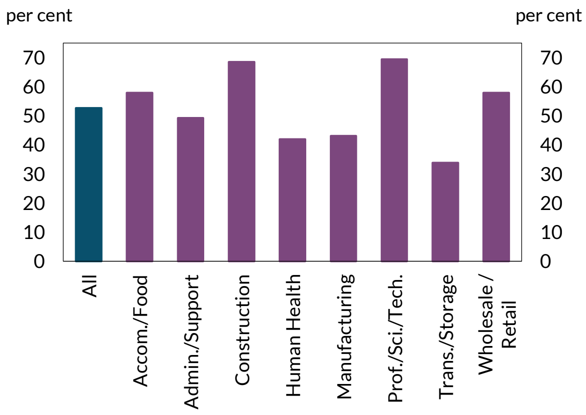
Wage share of SME operating costs by sector



Source: Credit Demand Survey.
Notes: The wage share of SME operating costs in the period March to September 2022 by sector.

Chart 30: Half of SME bank loan balances have variable interest rates

Share of outstanding SME balances to domestic banks with variable rates by sector



Source: Central Bank of Ireland.
Note: The share of Irish SME outstanding loan balances owed to domestic banks that have variable interest rates by sector.

The resilience of Irish firms to a debt servicing cost shock is supported by a long cycle of deleveraging since the Global Financial Crisis. The amount of debt owed by non-financial firms in Ireland to domestic banks declined by approximately two thirds between 2012 and 2023. Credit demand has been relatively muted in recent years, with firms broadly preferring to finance investment using internal funds. The result of this deleveraging cycle is that approximately half of SMEs have no financial debts and are thus not directly subject to any debt service shock. Microsimulation evidence also suggests that interest expenses are not a key determinant of profitability for most indebted firms.

Half of SME loan balances owed to the domestic banks have variable interest rates (Chart 30). This suggests a nuanced picture of how the recent increase in interest rates is impacting small firm debt service burdens. While monetary policy pass-through has been more complete for business loans than for household loans, many business borrowers have yet to see any increase in their instalments. This overall picture varies somewhat across sectors. Variable rate loans are most prominent in the Professional Services, Construction, and Wholesale & Retail sectors. Transport & Storage, Manufacturing, and Human Health have the lowest variable rate shares.

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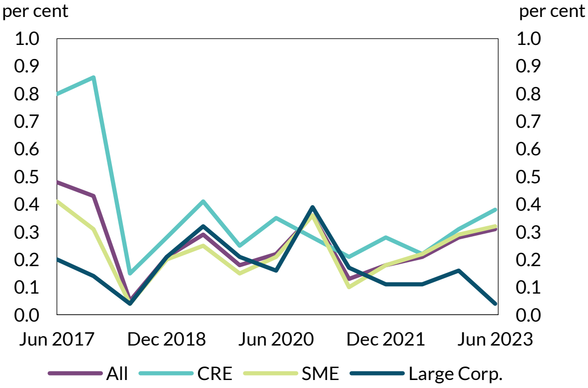
[47] See Adhikari and McGeever (2023) and the Central Bank Quarterly Bulletin QB2 / June 2023.

Loan delinquencies have yet to rise significantly (Chart 31). This is consistent with strong trading conditions and high levels of profitability in recent periods. Loan-level data up to June 2023 show no significant increase in early arrears for NFC borrowers of domestic banks. The rate of early arrears has ticked up in recent periods, but only to levels seen immediately prior to the pandemic. The rate of early arrears for Large Corporate borrowers is low and balance-weighted transition measures similarly show no upward trend for the aggregate portfolio. These findings are consistent with portfolio-level measures of IFRS9 stage classifications and NPL ratios (see *Domestic risk assessment*).

Chart 31: Loan delinquencies have yet to rise significantly

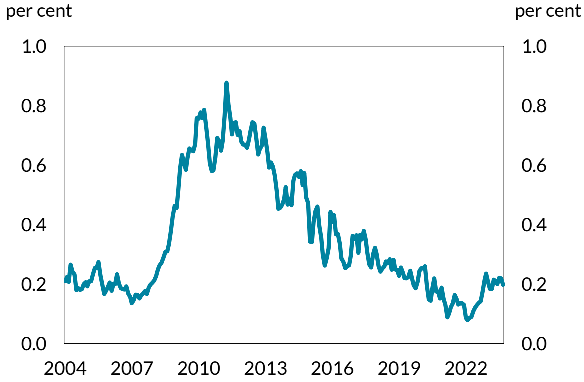
Share of NFC loans transitioning from no arrears to greater than 30 days of arrears by borrower cohort



Source: Central Bank of Ireland.
Notes: Share of performing Irish NFC loans by count transitioning from no arrears to greater than 30 days of arrears by borrower cohort. The CRE cohort refers to borrowers in the construction or real estate sectors. The SME and Large Corporate cohorts exclude CRE borrowers.

Chart 32: Insolvencies continue to rise

Annualised insolvent liquidation rate



Source: CRO and CRIF Vision-Net.
Note: Three-month average annualised insolvent liquidation rate.

Insolvencies continue to rise from historically low levels (Chart 32). To date, this trend appears to relate primarily to firms that exited the pandemic in a weak financial condition. A majority of companies entering insolvent liquidation in 2023 claimed wage subsidies during the pandemic. This fact, alongside the buoyant trading and profitability conditions in sectors badly hit by the pandemic (e.g., Accommodation & Food) and the relatively weak pre-pandemic financial characteristics of subsidy claimants (Lambert et al. (2022)), suggests that the recent uptick in insolvency cases has more to do pre-pandemic or pandemic-related difficulties than a new wave of distress caused by input-cost pressures. The resolution of pandemic era difficulties is still in progress, with a significant number of firms still owing large deferred tax liabilities. Profit margin compression or a broader macroeconomic slowdown also has the potential to put further upward pressure on the insolvency rate.

Box 2: The exposure of CRE borrowers to a higher interest rate environment

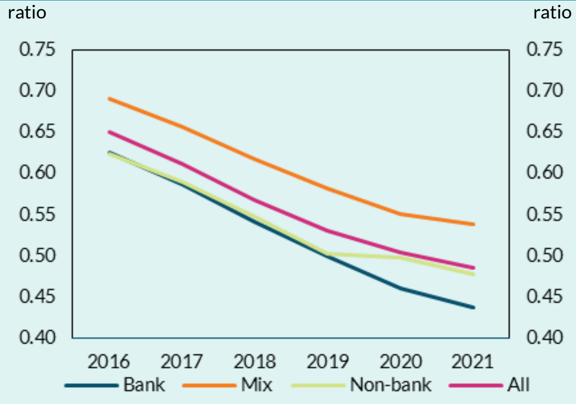
By Derek Lambert & Niall McGeever (Macro-Financial Division)

Commercial real estate (CRE) firms face strong cyclical headwinds in the form of higher interest rates, as well as a structural slump in demand for certain types of assets such as offices. This box examines the leverage of Irish CRE borrowers and characterises their exposure to the domestic financial sector. We do this using a sample of matched firm-loan data from the Central Credit Register and a range of other corporate databases. Our sample includes corporations whose principal economic activity is construction or real estate investment and development.[1]

The book leverage of CRE borrowers was declining in recent years (Chart A). The median ratio of total liabilities to total assets for these firms fell from approximately 0.65 in 2016 to 0.5 in 2021.[2] This pattern is observable across lender types, with bank borrowers having the lowest median leverage in 2021. The decline is also seen across borrower size quintiles (based on 2021 total assets), with larger firms seeing more of a leverage decline than smaller firms.

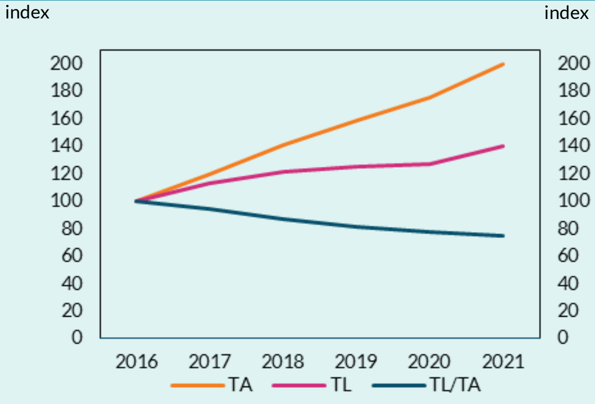
Asset values rose faster than liabilities up to 2021, explaining the decline in book leverage (Chart B). Firms with debts in 2023 saw their asset values approximately double in the period 2016 to 2021. While their total liabilities also rose in the same time period, they did so by approximately 40 per cent. This has resulted in book leverage trending steadily downwards over time.[3]

Chart A: The book leverage of Irish CRE firms was trending down until 2021



Source: Central Credit Register, CRO and Dun & Bradstreet.
Notes: Median book leverage – total liabilities / total assets – of Irish CRE borrowers by whether they borrow only from banks, a mix of banks and non-banks, or only non-banks.

Chart B: Asset values grew faster than liabilities



Source: Central Credit Register, CRO and Dun & Bradstreet.
Notes: Total assets (TA), total liabilities (TL), and book leverage (TL/TA) of Irish CRE borrowers, indexed to 2016 levels.

Asset growth is a function of several factors including credit availability, expectations of rental income, and discount rates. So, care should be taken when interpreting a downward trend in book leverage. Shocks to discount rates (e.g., due to a sharp tightening in monetary policy) or expected rental income (e.g., due to changing work patterns) have the potential to significantly impact asset values. The sensitivity of asset values to such shock is also likely higher when exiting a low interest rate, reach-for-yield environment. Book leverage is thus useful primarily as a gauge of how close firms are to balance sheet insolvency, rather than as a directional signal of increasing or decreasing resilience.

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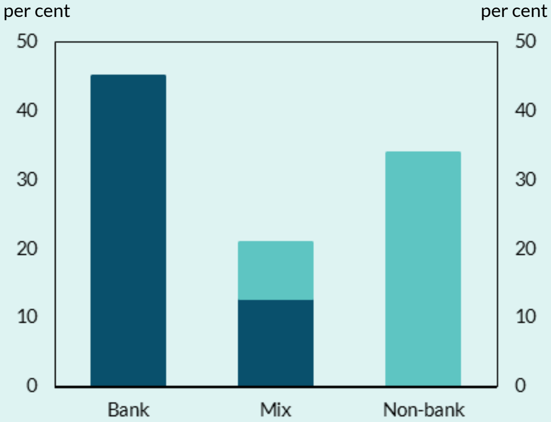
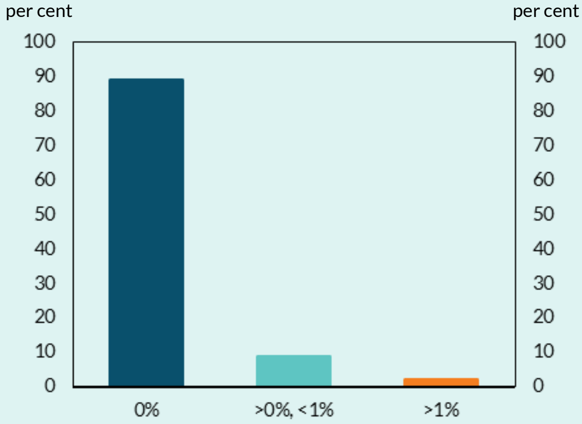
[1] Financial account data for the balance sheet year 2022 are not yet available for all firms, but the available data show similar levels of leverage to 2021.
[2] Beck et al. (2023) find a similar pattern of declining book leverage among European NFCs in recent years.
[3] Companies with NACE sector classifications of F and L are included, as are other corporations that can be readily identified as being involved in real estate investment and development. For example, we include some holding companies (technically in NACE sector K) that can be clearly identified as CRE enterprises. The vast majority of counterparties are ordinary registered companies, with investment funds outside the scope of this exercise.

Chart C: Non-bank lenders have played an important role in financing Irish CRE firms in recent years



Source: Central Credit Register and CRO.
Notes: The share of outstanding balances owed by Irish CRE enterprises by lender relationship type (bank only, mix of bank and non-bank, or non-bank only).

Chart D: Borrowers with large loans from banks generally owe very little to non-banks



Source: Central Credit Register and CRO.
Notes: The share of non-bank liabilities as a share of total outstanding balances among the borrowers with the largest 100 outstanding balance totals owed to banks.

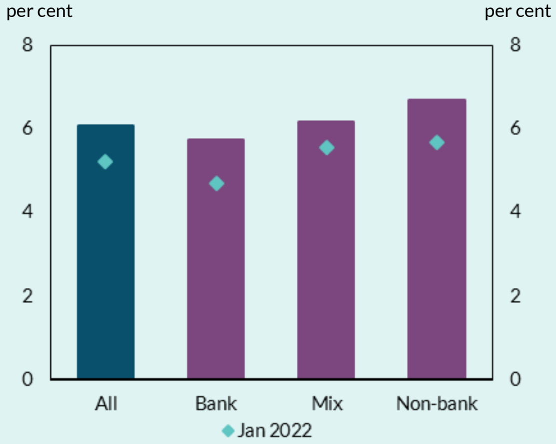
A minority of borrowers have quite high levels of book leverage. 16 per cent of firms in 2021 had book leverage ratios in excess of 1, suggesting that they are dependent on the support of investors or the forbearance of third party creditors to remain a going concern. Large capital value declines for borrowers most exposed to the real estate downturn, such as those involved in office development and investment, have the potential to test the resilience of borrower balance sheets.

In our sample of exposures, banks are owed approximately 60 per cent of outstanding debt balances, with non-banks owed the remaining 40 per cent (Chart C). CRE firms that borrow solely from banks owe 45 per cent of outstanding balances, firms with some bank and non-bank borrowers owe 21 per cent, and non-bank only borrowers owe 34 per cent. These shares are broadly consistent with prior observations of new lending flows (see *Resilience: Non-bank financial sector*) and non-bank lending relationship shares among small real estate firms (Gaffney and McGeever (2022)). These figures reflect the important role non-bank lenders have played in financing Irish CRE firms over recent years, while also highlighting the diversified financing base of the sector.

A potential financial stability risk could materialise for banks in the event that their borrowers had taken on large additional debts from non-bank lenders in recent years. Interestingly, our CCR data suggests borrowers with large bank loans appear to have limited additional borrowings from non-bank lenders (Chart D). Eighty nine of the top 100 largest bank CRE exposures are owed by corporations with no additional observed non-bank borrowings. Nine counterparties have incidental non-bank exposures comprising less than 1 per cent of their total borrowings. Only two of the top 100 corporations have a non-bank share of their borrowings in excess of 1 per cent. The bank loan exposures of these top 100 counterparties are also generally large relative to stale estimates of the book value of their total liabilities. While it is possible that some of these large borrowers are also sourcing finance from capital markets or through other group companies, our findings are consistent with bank debt being their main source of finance.

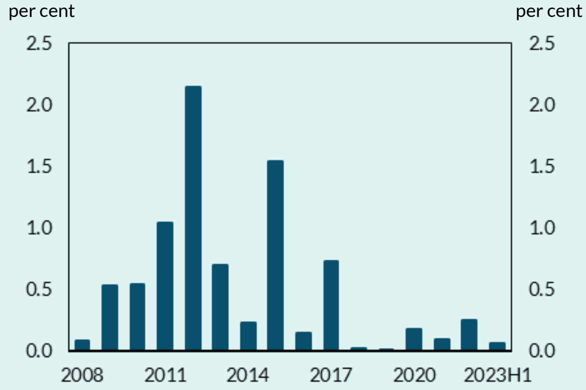
Interest rates have increased somewhat for CRE borrowers since early 2022 (Chart E). The median balance-weighted interest rate paid by these borrowers rose from 5.2 per cent in January 2022 to 6.1 per cent in June 2023. Firms that borrow only from banks paid rates that were modestly lower (5.7 per cent) than those with a mixed set of lenders (6.2 per cent) or those reliant purely on non-bank lenders (6.7 per cent). The scale of the borrowing cost increase was quite similar for bank only and non-bank only borrowers, with median rates increasing by approximately 1 percentage point.

Chart E: Interest rates have risen for CRE borrowers



Source: Central Credit Register and CRO.
Notes: The median balance-weighted interest rate on Irish CRE exposures by lender type in January 2022 and June 2023.

Chart F: Receivership numbers remain low



Source: Central Credit Register, CRO and CRIF Vision-Net.
Notes: The share of June 2023 outstanding CRE balances by year of receivership initiation.

Receivership is an important tool for lenders in the event that a borrower enters repayment difficulty. A secured lender can appoint a receiver to take possession of a specific collateral asset (often a piece of real estate) or a pool of assets owned by a corporate borrower. Monitoring this insolvency channel is of specific interest when considering the adverse outcomes for CRE borrowers. The repossession and potential sale of CRE assets by lenders also has the potential to amplify price declines.

Receivership numbers remain low (Chart F). Looking at the stock of outstanding balances owed by Irish CRE borrowers in June 2023, just 0.1 per cent of these balances are associated with a receivership initiation in 2023. This is broadly in line with an average of 0.2 per cent for the years 2020 to 2022. In contrast, over 2 per cent of the outstanding stock of balances still owed in 2023 first had a receiver appointed in 2012. This reflects the scale of the post-GFC crisis and the long resolution path for loans of that era. The figures show clearly that there has yet to be any significant uptick in repossession activity relating to Irish CRE borrower assets.

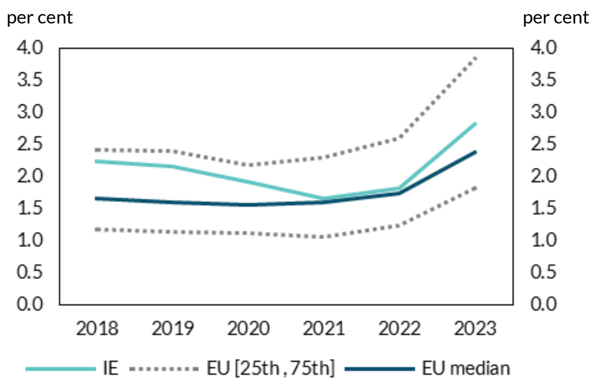
Domestic banks

Domestic bank profitability has increased significantly over the past year. The sustainability of this level of profitability is uncertain though, given the potential for monetary policy transmission to further slow the economy and loan growth, for deposit competition to raise bank funding costs, and for increases in loan impairment. While measures of loan default have yet to rise significantly, pockets of vulnerabilities exist including CRE exposures, leveraged finance exposures and pockets of the mortgage market with previous repayment difficulty. Liquidity risks appear muted given the scale of liquid asset holdings and a large and stable deposit base. While cost-to-income ratios have declined, costs are still rising and remain a structural challenge. Capital levels remain above regulatory requirements and provide a degree of loss-absorbing capacity in the event of adverse shocks.

Domestic bank profitability has increased significantly in Ireland and across Europe, driven by a substantial rise in net interest income (Chart 33). The annualised net interest margin of Irish domestic banks rose from 1.8 per cent in 2022Q4 to 2.8 per cent in 2023Q2. Return on equity similarly rose strongly in the same period from 7 per cent to 12.6 per cent. This increase in Ireland is explained principally by weak pass-through of recent monetary policy decisions to certain deposit interest rates and moderate pass-through to lending rates. A similar dynamic is observable across Europe, with the median NIM at 2.4 per cent and RoE at 13 per cent as of 2023Q2.

Chart 33: Banks' net interest margins have increased in Ireland and across Europe

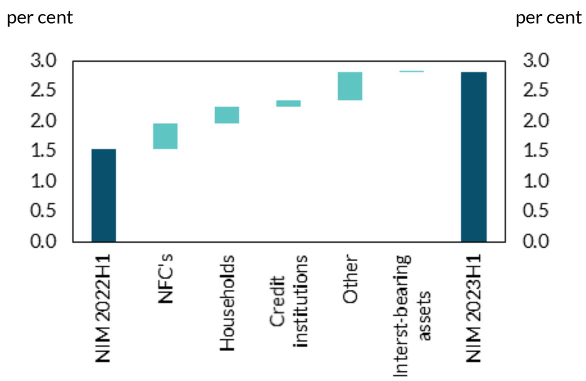
Net interest margins of domestic Irish banks and EU peers



Source: BankFocus and Central Bank of Ireland.
Notes: Annualised net interest margin for domestic banks and EU banks. Last observation June 2023.

Chart 34: Interest income has risen strongly

Contribution of interest income to net interest margin change between 2022Q2 and 2023Q2 by counterparty



Source: Central Bank of Ireland.
Note: Other represents Other Liabilities, Central Bank liabilities, Derivatives-Trading, Debt securities issued, Derivatives-Hedge accounting, interest rate risk and Interest earning assets.

The sustainability of current bank profitability is subject to downside risks. The rise of net interest margins is explained by higher interest income, particularly from non-household borrowers (Chart 34). However, there are three key factors that could weigh on profitability in the short term. First, the ongoing tightening of monetary policy may further slow the macroeconomy, potentially reducing credit demand and bank lending volumes.[48] Second, heightened competition for deposits and greater switching levels by consumers could raise bank funding costs. Third, higher interest rates are pushing up debt repayment burdens for borrowers and have the potential to generate

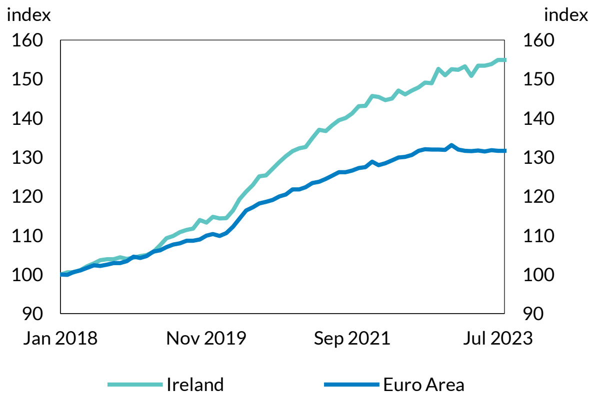
[48] See the Bank Lending Survey of July 2023.

greater levels of loan default and associated bank provisioning. These adverse outcomes, were they to materialise, should be expected to come at a lag to the initial rise in interest income (see Box 3 for a more detailed analysis of the evolution of bank profitability).

Domestic banks have access to a large and stable stock of deposits (Chart 35). Household and NFC deposits made up 89 per cent of total domestic bank funding as of June 2023. Deposit levels continue to rise, albeit at a slower pace, increasing at an annualised rate of 5 per cent between January and June 2023. While interest rates on fixed term deposits and new lending have risen, approximately 90 per cent of bank deposits are held in overnight deposit accounts for NFCs and HHs with minimal interest remuneration. This has contributed to the higher net interest margins being generated by the domestic banks. The aggregate liquidity coverage ratio declined from 204 per cent in December 2022 to 177 per cent in June 2023 due principally to how loan portfolio acquisitions were financed and TLTRO repayments. These levels are well above minimum regulatory requirements and provide a buffer to meet withdrawal requests.

Chart 35: Domestic banks have access to a large and stable stock of deposits

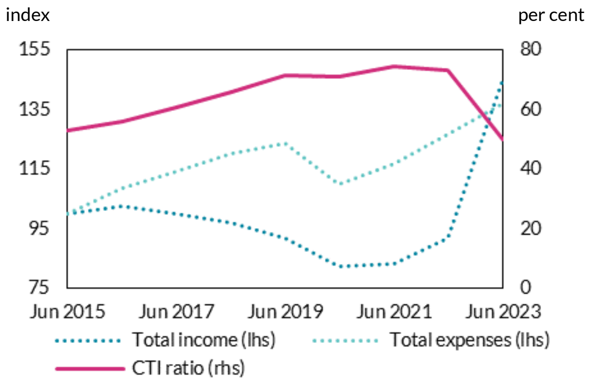
Household and NFC deposit levels, indexed to 2018



Source: European Central Bank.
Notes: Base 100 in January 2018. Monthly data. Outstanding amounts of domestic deposits in all currencies for each jurisdiction. Last observation in July 2023.

Chart 36: Costs remain a structural challenge, even as cost-to-income ratios fall

Income, expenses indexed at 2015, and cost-to-income ratios of domestic banks



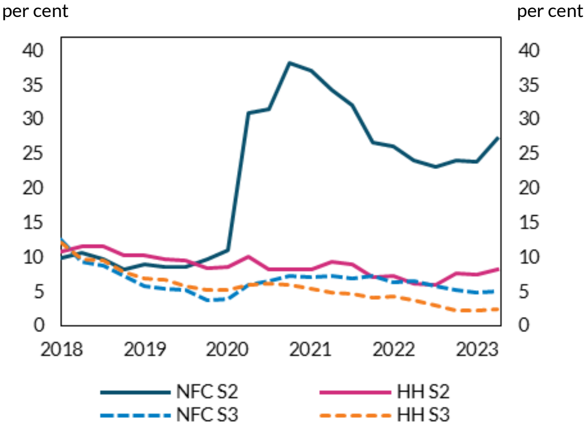
Source: Central Bank of Ireland.
Notes: Cost-to-income (CTI) ratio of domestic banks on the right-hand side. Total income and expenses are indexed to June 2015 value, represented on the left-hand side of the chart. Last observation June 2023.

Costs remain a structural challenge, even as cost-to-income ratios fall (Chart 36). The growth rate of interest income in the year to June 2023 was substantially higher than that of costs, resulting in a sharp decline in the aggregate cost-to-income ratio. Nonetheless, costs still rose by 8 per cent over this period. Domestic banks have in recent years had relatively high cost-to-income ratios both compared with European peers and historical context. High costs remain a structural challenge and any increases in regular expenditures will pose particular risk if net interest income levels revert from current highs. Investment in increased digitalisation and operational resilience, along greater scale economies in a consolidated sector, provides an opportunity to lower costs.

Loan default rates have yet to rise significantly (Chart 37). NPL ratios, a lagging indicator of borrower financial distress, declined again to 2.3 per cent between January and June 2023 despite the very sizeable debt service shock being experienced by household and NFC borrowers with tracker or variable interest rate loans. One potential earlier signal of deteriorating credit risk is a rise in IFRS9 stage 2 loan shares, which reflect banks' judgments around the risk profile of performing loans, in both residential mortgage and NFC loan portfolios, which remain far in excess of pre-pandemic levels despite falling in 2021 and 2022.

Chart 37: Loan delinquency rates are stable, but elevated risks are flagged for business lending

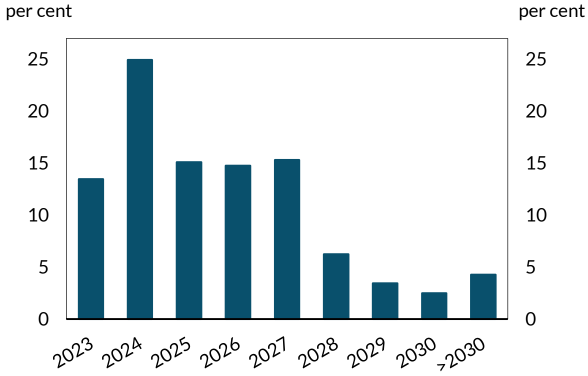
Share of domestic bank NFC and household loan exposures that are classified as IFRS9 stage 2 or stage 3



Source: Central Bank of Ireland.
Notes: Share of domestic bank non-financial corporate (NFC) and household (HH) outstanding balances classified as IFRS9 stage 2 and stage 3 by period. Last observation June 2023.

Chart 38: CRE loans generally need to be repaid or refinanced by 2027

Maturity schedule of domestic bank CRE exposures



Source: Central Bank of Ireland.
Notes: The share of construction and real estate NFC exposures of Irish domestic banks at end-June 2023 by year of loan maturity. Data as of June 2023.

Pockets of vulnerability in domestic bank loan portfolios include CRE exposures, leveraged finance exposures to large corporates, and lending to vulnerable residential mortgage borrowers. CRE markets are coming under increasing pressure due to a range of cyclical and structural factors (see *Domestic risk assessment*). Despite these growing risks to borrowers, the systemic impact is likely to be mitigated due to a decline since 2008 in the share of CRE in total loans from just over one third to under ten per cent. Beyond the real estate sector, highly leveraged corporates may similarly find refinancing more challenging compared with conditions in debt and private equity markets over recent years. Mortgage borrowers with tracker rates or a history of past repayment difficulties may be less resilient than other borrowers, given the speed of interest rate pass-through for tracker borrowers and the observed levels of distress observed among borrowers with loans originated in the period 2003 to 2008.[49]

Most CRE loans owed to domestic banks need to be repaid or refinanced by 2027, with a quarter due by the end of next year (Chart 38). The relatively short maturities on CRE loans will test the resilience of real estate borrowers' business models and their capacity to service potentially higher interest costs. Falling capital values will also raise loan-to-value ratios, increasing the credit risk profile of CRE loans and potentially making it more difficult for borrowers to refinance.

Climate transition risk presents challenges for the domestic banking sector. Internalising the costs of carbon and other emissions into market pricing through taxation and regulation has the potential to raise energy and other costs for households and businesses, placing upward pressure on debt service burdens. Climate transition also has the potential to hit housing values, as well as agricultural and business assets that may become stranded following climate-informed policy

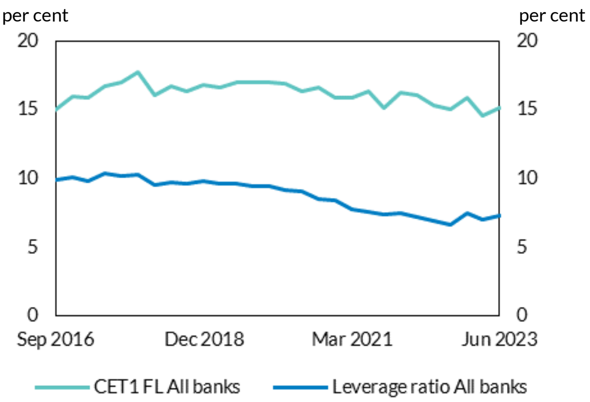
[49] See Shaikh, Kilgariff and Gaffney (2023) on recent flows into mortgage arrears, Gaffney and Greaney (2020) on Covid-19 payment breaks, and Gaffney and McCann (2018) on credit risk and re-default.

changes.[50] Banks may also be exposed to borrowers' repayment difficulties that arise due to more frequent and more damaging physical risk events, such as floods, fires and storms.

Domestic bank capital levels are on aggregate well above minimum regulatory requirements and provide loss-absorbing capacity (Chart 39). The aggregate domestic bank CET1 ratio stood at 15.2 per cent in June 2023. This is down modestly from 15.9 per cent in 2022Q4 and explained by consolidation in the sector.[51] Increased profitability in 2023 has partially offset this effect. The aggregate leverage ratio has also fallen from 9.2 per cent in March 2020 to 7.3 per cent in June 2023, but remains significantly above the minimum requirement of 3 per cent and above the weighted average of 5.7 per cent at the EU-27 level. This decline is partly explained by a very substantial rise in deposits and excess reserves during the pandemic.

Chart 39: Bank capital ratios continue to provide capacity to absorb shocks

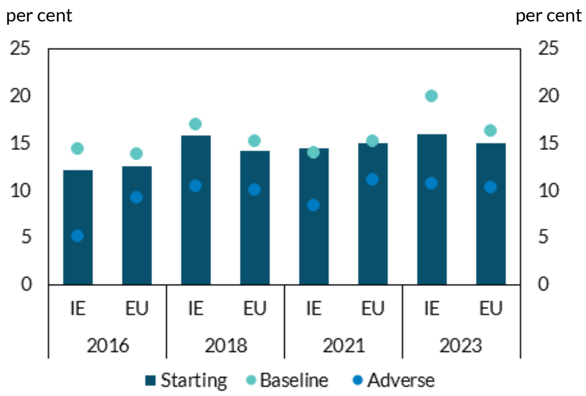
Aggregate domestic bank CET1 and leverage ratios



Source: Central Bank of Ireland.
Notes: Aggregate domestic bank fully-loaded (FL) CET1 ratio and leverage ratio.

Chart 40: EBA stress test results suggest that domestic banks are resilient to adverse shocks

CET1 ratio of Irish domestic and EU banks by stress test year and scenario



Source: European Banking Authority.
Note: CET1 ratio of Irish domestic significant institutions and EU banks in the baseline and adverse scenario within each stress test.

Stress test results from the EBA's 2023 exercise suggest that the Irish domestic banks can withstand large adverse shocks (Chart 40). The exercise considered the impact of a hypothetical macroeconomic scenario on bank capital over the period 2023 to 2025.[52] Under this adverse scenario, the aggregate CET1 ratio for domestic Irish banks declined from 16 per cent in 2022 to 10.8 per cent in 2025. Impairments and market risk losses drive the decline in the CET1 ratio (reducing it by 7 percentage points and 2 percentage points, respectively), but higher interest income boosts the CET1 ratio by more than 4 percentage points. These findings suggest that Irish domestic banks have substantial loss-absorbing capital buffers to weather plausible yet severe adverse macroeconomic outcomes.

[50] See Adhikari et al. (2023).
[51] The remaining domestic banks acquired the bulk of the residential mortgage and NFC loan portfolios of KBC Ireland and UBIDAC.
[52] The adverse scenario is consistent with persistent high inflation in the EU, higher interest rates and credit spreads, higher unemployment rates, and a decline in asset prices. Real GDP in the EU declines by 6 percent cumulatively over the three year horizon.

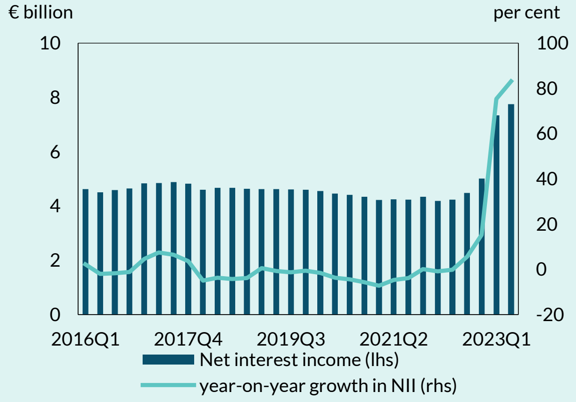
Box 3: Irish domestic bank profitability

By Paul Lyons & Quentin Bro de Comères (Macro-Financial Division)

The changing interest rate environment and evolving structure of the domestic banking sector have led to a substantial increase in bank profitability over the past year. This box places current domestic bank profitability in an international and historical context.

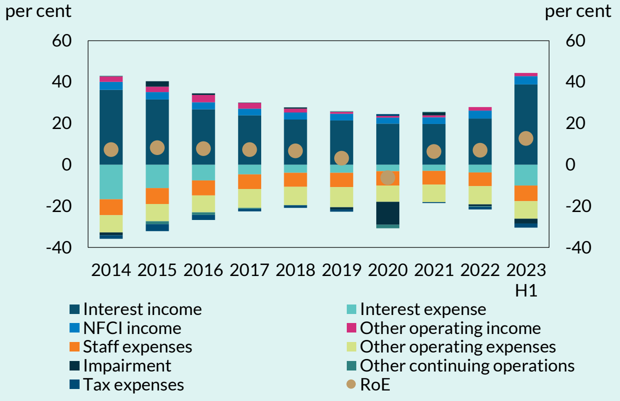
Net interest income (NII) increased by 83 per cent at the domestic banks between 2022Q2 and 2023Q2 (Chart A), and has been the main factor behind the strong increase in profitability (Chart B).[1] Amid tightening monetary policy, interest rates on the stock of domestic banks' loans have increased by more than interest rates on the stock of their deposits to date. In part, this is due to compositional factors. For example, domestic banks have seen a very small increase in the share of higher-yielding household time deposits, compared to euro area banks. Domestic banks' tracker mortgages also mean these loans have experienced full pass-through of ECB interest rate increases. NII at domestic banks has also been supported by the high share of reserves held with the Central Bank, most of which are remunerated at the Deposit Facility Rate.

Chart A: NII for the domestic banks has grown substantially



Source: Central Bank of Ireland.
Notes: NII annualised for comparison purposes. Year-on-year growth rate reflects the growth rate between a given quarter and the same quarter a year early. Last observation 2023Q2.

Chart B: Interest income has been the predominant source of domestic banks' profits

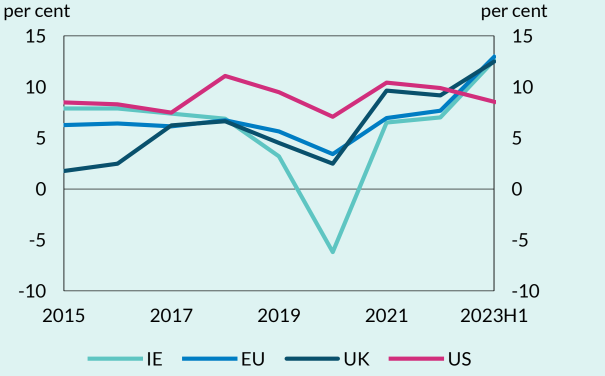


Source: Central Bank of Ireland.
Notes: Percentage contribution of components to banks' Return on Equity (RoE). NFCI stands for Net Fee & Commission Income while Other operating income is income that is not from NII or NFCI sources. Data for the three domestic banks.

Driven by rising interest income, Irish domestic bank profitability has increased by more than that of international peers since 2020. Return on equity (RoE)[2] increased from the low point of -6.2 per cent in 2020 (at the height of the pandemic) to 6.5 per cent in 2022Q4 and 12.6 per cent in 2023H1. The absolute level of RoE in 2023H1 was close to EU and UK banks and somewhat above US banks (Chart C). Similarly, the aggregate Return on Assets (RoA)[3] for the domestic banks also rose significantly in 2023H1, and is now above EU, UK and US peers (Chart D). These relative outcomes are reflected in positive investor sentiment towards the Irish banking sector (FSR 2023:I).

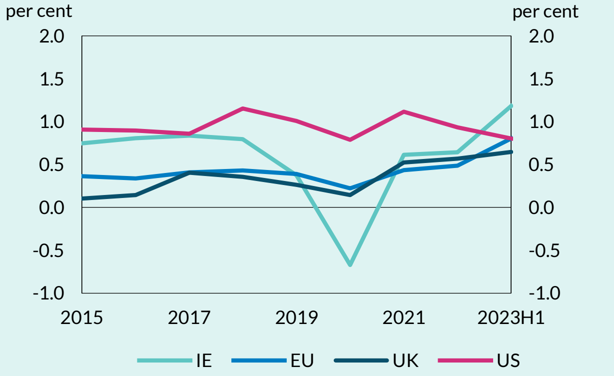
1. Net interest income is the difference in what a bank earns from loans and other assets and what banks pay on deposits and other funding.
2. RoE is measured as the annualised profit or loss for the year divided by average total equity.
3. RoA is defined as the annualised profit or loss for the year divided by average total assets.

Chart C: RoE for domestic banks



Source: BankFocus and Central Bank of Ireland.
Notes: IE" reflects the average RoE for the domestic banks and median RoE for a selection of EU/US/UK banks respectively (changing composition). Half year data are annualised.

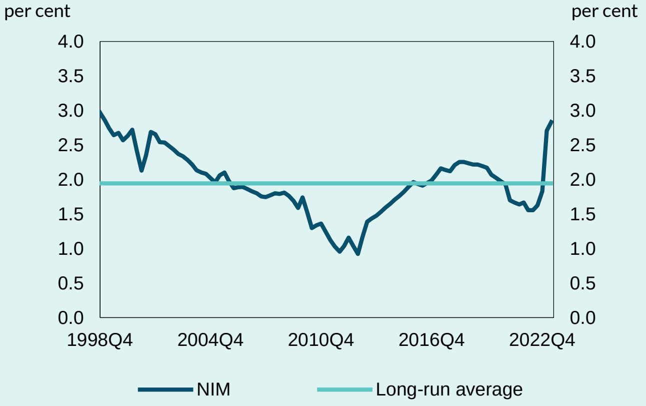
Chart D: RoA for domestic banks



Source: BankFocus and Central Bank of Ireland.
Notes: "IE" reflects the average RoA for the domestic banks, "EU" denotes the median for a sample of representative European banks. "UK" and "US" represent the median for a sample of UK and US banks, namely, those that took part in the stress tests of the Bank of England and US Federal Reserve in 2023 respectively. Half year data are annualised.

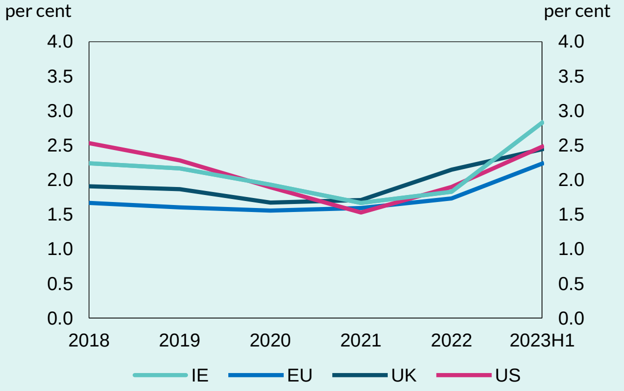
Net interest margin (NIM), defined as the ratio of net interest income to average interest earning assets, shows the profitability of a bank's core credit intermediation activities. In a historical context, NIM in the domestic banking sector is now at a near 20-year high (Chart E) after a significant drop during the Global Financial Crisis and a slow recovery under the "low-for-long" interest rate regime. Furthermore, the NIM for the domestic banking sector is now somewhat higher than that of EU, UK or US peers (Chart F).

Chart E: NIM for domestic banks



Source: Annual reports, Bloomberg and Central Bank of Ireland.
Notes: Data are for the domestic banks. For years prior to 2012, the NIM of Irish Life & Permanent is used for PTSB. The long-run average is the average of the NIMs over this period. Last observation 2023Q2.

Chart F: NIM for domestic banks v EU, UK & US



Source: BankFocus and Central Bank of Ireland.
Notes: "IE" reflects the NIM for the 3 domestic banks, while "EU" denotes the median NIM for a sample of representative European banks. "UK" and "US" represent the median NIM for a sample of UK and US banks respectively, namely, those that took part in the stress tests of the Bank of England and US Federal Reserve in 2023 respectively. Last observation 2023H1.

Looking ahead, there a number of channels through which the evolving macro-financial environment could moderate some of the strong increases in profitability seen to date (see for example Morell et al. (2022) and Lane (2023)).

Credit impairments may rise through direct debt servicing channels, particularly for floating rate lending. More broadly, the impact of higher inflation and interest rates on the economy is also likely to increase impairments and slow loan growth. Any adverse effect of rising interest rates on nominal asset values, particularly real estate, would reduce collateral values on bank and borrower balance sheets, potentially increasing both the probability of, and loss-given, default. Evidence from the recent European Banking Authority stress tests points to a negative correlation between NII and impairment losses, illustrating a trade-off whereby banks with more rapid gains through the loan-deposit spread (those with greater reliance on lending over other investments, and more variable rate than fixed rate loans) carry a greater risk associated with loan losses in a rising interest rate environment.

Finally, if the higher interest rate environment stimulates competition for bank deposits, or a shift in customer behaviour initiates a more rapid switch to higher-yielding term deposits, bank funding costs will rise, adding a further drag on profitability.

To date, Irish domestic banks have seen the benefits of the higher interest rate environment, but the offsetting effect of the above headwinds has not affected profitability dynamics. This is partly due to the underlying strength of the economy and the fact that monetary policy affects economic activity with a lag. These current elevated profitability levels at Irish banks are producing gains which provide opportunities for banks to improve their long-term financial and operational resilience. Medium-to-long term resilience is particularly important at the current juncture, given that the above risk factors may come into sharper focus if recent deteriorations in the global and local economic outlook become more pronounced.

Non-bank financial sector

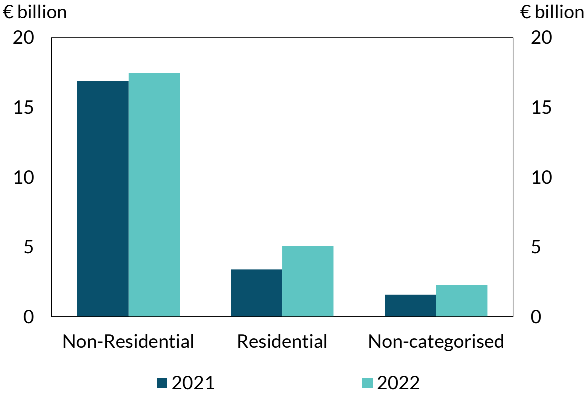
Investment funds and non-bank lenders

Recent data suggest that Irish property funds' holdings in the Irish CRE market increased in 2022 despite falling CRE market prices. Funds continued to invest in the market, with net transactions in the residential segment of the Irish CRE market notably higher. The value of Irish property funds' existing property assets decreased given weakness in the wider CRE market, although decreases did not fully match those in underlying market indices. High leverage, which could be exacerbated by decreasing asset values, remains a vulnerability in segments of the sector. Non-bank lending to SMEs in the Irish economy stabilised in early 2023, after notable declines in 2022. However, lending from non-banks has not recovered to previously higher levels of 2021.

Despite an overall fall in the value of CRE assets, the Irish property funds sector continued to grow to end-2022. As of 2022Q4, Irish property funds held €24.7 billion in total assets, including €23.2 billion in Irish property holdings – equivalent to approximately 40 per cent of the estimated 'investable' Irish CRE market.[53] Despite falling asset prices, the size of the sector increased 13 per cent, or €2.9 billion, in the year up to 2022Q4 as Irish property funds continue to invest in the Irish CRE market, reporting €1.4 billion in net inflows and €3.1 billion in net property acquisitions in the year 2022. Funds whose 'Principal Strategy' is to invest in 'Residential' assets increased from 15 per of total sector assets in 2021 to 20 per cent in 2022, driven by purchases of Irish property used for residential purposes (Chart 41).

Chart 41: 'Residential' funds' assets have increased more than 'Non-Residential'

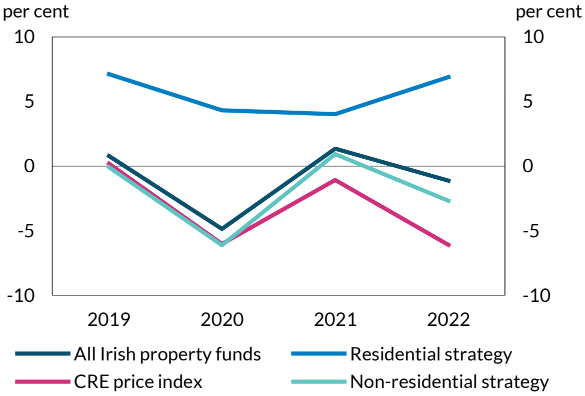
Total assets of Irish property funds across three types of principal strategies.



Source: Central Bank MMIF return and Alternative Investment Fund Managers Directive (AIFMD) data.
Notes: The vertical axis describes the AUM of each fund category. The horizontal axis identifies three categories of funds based on AIFMD's 'Principal Strategy'. Last observation 2022Q4.

Chart 42: As overall sector valuations fall, 'Residential' strategy funds report growth

Estimated revaluation rate of Irish property held by Irish property funds



Source: MMIF returns, MSCI and Central Bank calculations.
Notes: The vertical axis describes the estimated percentage revaluation of Irish property assets. The classification into 'Residential' and 'Non-residential' is based on AIFMD's 'Principal Strategy'. The CRE price index is calculated using the MSCI index on capital growth in the Irish property market. Last observation: 2022Q4.

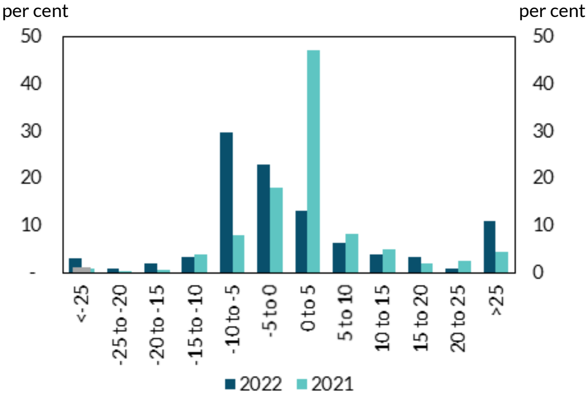
Property assets held by Irish Property Funds have been valued downwards, though revaluations are less than the overall decline in market prices. Irish property funds overall reported a 1.1 per

[53] This refers to direct Irish property holdings. Funds may also have indirect exposures to the Irish CRE market.

cent decline in the value of their property assets in the year up to 2022Q4 (Chart 42).[54] Funds with a 'Non-Residential' primary strategy reported larger negative revaluations, with property assets falling 3 per cent. The fall in value is less than the market CRE price index would suggest, though this may be explained by the particular sectoral and geographical makeup of the funds' property portfolios, as well as the presence of funds involved in property development. In contrast, funds with a 'Residential' primary strategy reported strong positive revaluations, with property assets increasing in value by 7 per cent. While the aggregate decline in asset values in the sector is quite limited, more than a third of funds by AuM reported negative revaluations of 5 per cent or more (Chart 43). Furthermore, 62 per cent of funds (by AuM) in the sector reported negative revaluations in 2022, compared to 31 per cent in 2021. Low CRE market transaction volumes can make valuation more difficult and current valuations may not be realised in illiquid market conditions. Concerns around comparatively larger declines in valuations for lower quality and less energy efficient office buildings could also be relevant for Irish property funds, depending on the magnitude of their exposures to these particular CRE assets (see *Domestic risk assessment*).

Chart 43: CRE assets are being revalued downwards, though there is a wide variation across funds

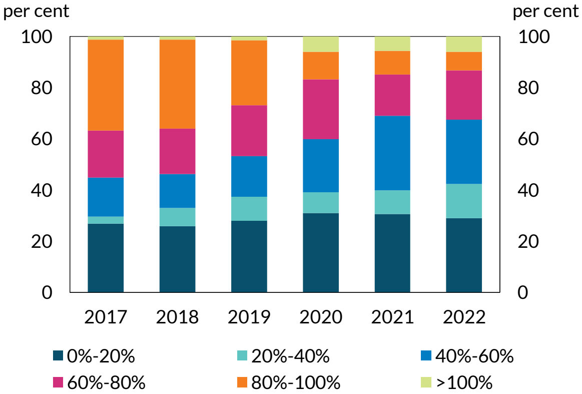
Distribution of how funds are revaluing Irish property assets by AuM.



Source: MMIF returns and Central Bank calculations.
Notes: The vertical axis describes the share of total assets across property funds grouped in terms of how they revalued their property assets. MMIF data is used to estimate the revaluation of assets. Last observation: 2022Q4.

Chart 44: The proportion of highly leveraged funds increased marginally in 2022

Distribution of Irish property funds total assets across leverage classes.



Source: MMIF returns and Central Bank calculations.
Note: The vertical axis describes the share of six classes of property funds grouped in terms of their financial leverage. The share is the ratio between the AUM of each class and the total property fund AUM, in each single year. Last observation 2022Q4.

Leverage could increase through falling property values, increasing risks of amplification. Funds posting negative revaluations will experience an increase in leverage (unless they take active actions to reduce outstanding debt via share issuance or other means). Thus, leverage-related risks to the sector remain for some cohorts of funds amid continuing falls in Irish CRE values in 2023 and the risk that the full impact of pandemic-related structural change is yet to play out.

High leverage amongst a cohort of property funds remains a vulnerability in the event of disorderly asset prices decreases. Leverage remains a key vulnerability in the sector. Aggregate leverage in the property fund sector as a whole remains unchanged year on year at 46 per cent in 2022Q4.[55] The proportion of assets held by highly leveraged funds (i.e., leverage above 60 per

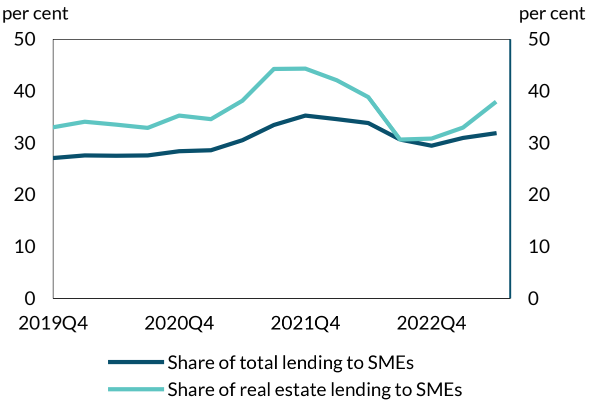
[54] As most Irish property funds value their property assets annually, the impact of changes to CRE values in 2023 will not be fully reflected until 2023 valuations are finalised. Thus, revaluations are estimated over the period 2021Q4 to 2022Q4. Furthermore, the valuation date for some funds is prior to year-end, thus falls in market valuations for the entire year 2022 may not be fully reflected for such funds in our analysis.
[55] Leverage is calculated as the ratio of total non-equity liabilities to total assets.

cent) was stable at 32 per cent in 2022Q4 (Chart 44). The downward trend in the proportion of assets in highly leveraged funds has stalled in light of falling CRE prices. Should these price falls continue, the risk of property funds amplifying this shock would increase. In 2022, the Central Bank announced the phased implementation of a 60 per cent leverage limit for Irish property funds, with the expectation that existing funds make gradual and orderly progress towards lower leverage levels over the 5 year implementation period.[56] Any new property funds seeking authorisation and that fall within the scope of the leverage limit would need to meet the 60 per cent limit at the outset. To address the liquidity mismatch observed in property funds, the Central Bank also set out guidance for funds to provide for a liquidity timeframe of at least 12 months, taking into account the nature of the assets held.

Non-bank lenders (NBLs) continue to provide a significant share of credit to SMEs in Ireland. Non-bank lenders are loan-originating entities that are not banks, credit unions or government-sponsored entities. Data for 2023Q2 show that Irish SMEs owed non-bank lenders €4.5bn in comparison to €18.2bn owed to banks. The share of new lending provided by NBLs (in comparison to banks) decreased throughout 2022 but has stabilised in the first two quarters of 2023 (Chart 45), at 34 per cent in 2023Q2. The volume of credit provided by NBLs to SMEs is 6 per cent higher in the first half of 2023, in comparison to the first half of 2022. SMEs in the real estate sector continue to receive the largest volume of credit from non-banks (Chart 46). Lending to this sector declined in 2022 but has stabilised and recovered to some extent in the first half of 2023. Non-bank lending to SMEs relies on a variety of funding sources, which are less stable in comparison to those for banks (such as deposits).[57] This difference in funding sources has implications for non-banks, particularly in an environment of higher interest rates, and has potential implications for the resilience of non-bank lending to SMEs in Ireland.

Chart 45: The non-bank share of new SME lending has stabilised in 2023

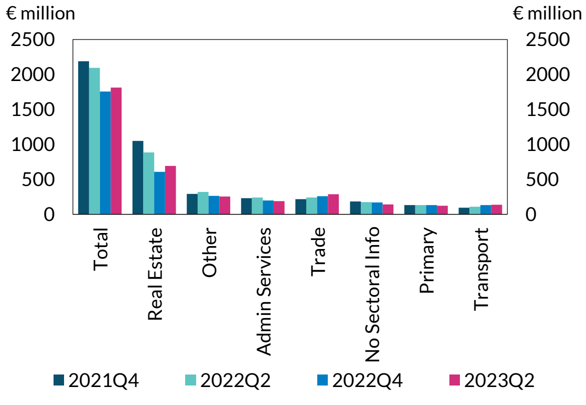
Share of lending to SMEs by non-banks



Source: CCR, Credit and Banking Statistics.
Notes: Share of total lending to SMEs is a four quarter moving average of the share of new lending from nonbank lenders relative to the sum of NBL and bank new lending. Real estate SMEs include SMEs in real estate activities and construction. Last observation 2023Q2.

Chart 46: The real estate sector remains the largest recipient of funding from NBLs

Volume of new lending to SMEs by non-banks



Source: CCR.
Note: Non-Bank lending for each period outlined shows lending for the previous 4 quarters up to the date mentioned, e.g., 2021Q4 shows the amount of new credit provided for the 2021Q1-2021Q4 period. The real estate sector includes SMEs in real estate activities and construction. Last observation 2023Q2.

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[56] See FSR 2022-II: Macroprudential policy for Non-Banks.
[57] See Moloney. K., O'Gorman. P., O'Sullivan. M. & Reddan, P. (forthcoming) "Non-bank lenders to SMEs as a source of financial stability risk – a balance sheet assessment.

Insurance firms

The aggregate solvency position of the Irish insurance sector remains stable, with capital buffers well in excess of regulatory requirements. While the sector has been resilient to the initial impact of rising interest rates and high inflation, the sector could be negatively impacted by potential secondary impacts of higher interest rates on the real economy. A decrease in economic activity may reduce demand for insurance and tighter credit conditions could impact the value of bond investments. Inflation remains a concern with the risk that current premium and reserve levels may be inadequate if inflation remains above target for longer than currently expected. The sector allocates a high proportion of its assets to investment grade bonds whose value has been negatively impacted by rising yields, however this has been offset by a reduction in the value of interest rate sensitive liabilities. The introduction of the Personal Injury Guidelines has reduced the level of awards for personal injuries, however their final impact remains uncertain.

The aggregate solvency of (re)insurers was broadly stable in the first half of the year, despite the challenging macroeconomic environment and at times volatile financial market conditions. The sector has proven resilient to the initial impact of high inflation and rising interest rates. With capital buffers significantly above regulatory requirements, (re)insurers in general are well placed to withstand significant stress. While solvency coverage ratios (SCR)[58] vary between individual firms reflecting the diverse nature of the firms comprising the industry, over 99 per cent of the sector's liabilities are held by (re)insurers with solvency coverage ratios of 130 per cent or more. The median SCR coverage ratio of the subset of insurers that are active in the Irish domestic market increased in 2023H1 for non-life insurers while it reduced for life insurers, with capital continuing to exceed firms' SCRs (Chart 47).

The potential secondary effects of higher interest rates on the real economy could adversely impact the sector. Reduced economic activity could reduce the demand for insurance policies, and potentially lead to increased lapses of existing life insurance policies. No material increase in the lapse rate has been observed in the Irish life insurance sector to date. Deteriorating credit conditions could cause bond credit spreads to widen reducing the value of bonds held by (re)insurers without any offsetting reduction in liabilities.

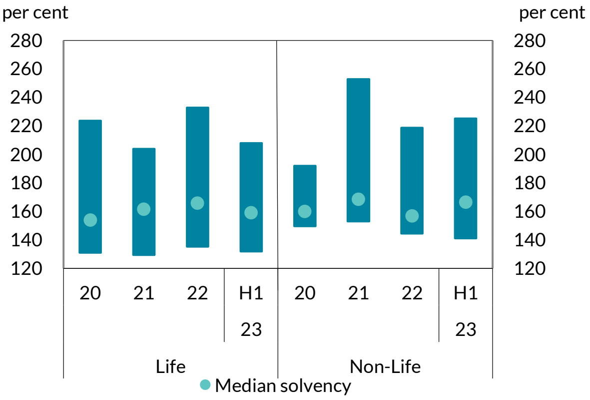
Current premium rates and reserve levels may prove inadequate if inflation remains elevated for a prolonged period. Inflation impacts the cost of settling claims for which policyholders must be compensated in real terms (e.g. property repairs or future medical care) while all (re)insurers are exposed to operating expense inflation. Insurers have to make assumptions regarding the future level of claims and expense inflation when setting their premiums and reserves. In the event that inflation takes longer than previously expected to revert to long-term target levels, insurers may need to revise upwards their claims reserves for business already written without receiving any additional premium, negatively impacting their profitability and balance sheet.

Exposure to market risk varies across the sector and depends on an individual firm's asset mix, which will reflect the duration, nature and currency profile of their liabilities plus their risk appetite. Fixed interest securities comprise the majority of (re)insurers' investments, accounting for 51 per cent of non-linked investments at 2023Q2. The average credit quality of (re)insurers' bonds increased slightly during 2023H1, and broadly equates to a Standard & Poor's AA-/A+

[58] Solvency coverage is measured as a firm's available capital (known as "own funds" under Solvency II) as a percentage of its Solvency Capital Requirement (SCR).

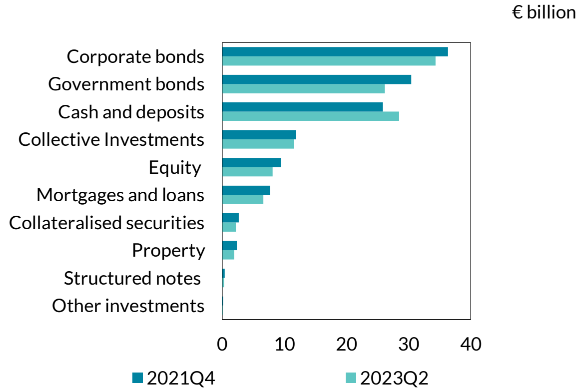
rating. The increase in bond yields over the last 18 months has negatively impacted the value of bond investments (Chart 48), however the robust aggregate solvency indicates that bond assets were well matched to interest rate sensitive liabilities. A number of Irish life insurers implemented deferral periods on withdrawals from property-related unit-linked funds in 2023.[59] These restrictions allow for the orderly disposal of property investments to meet redemption requests. At the end of 2023Q3 the deferral periods remain in place for a number of funds as the liquidity levels remain low.

Chart 47: Domestic insurers' solvency positions remain robust and are above regulatory requirements
Solvency coverage of domestic life and non-life insurers



Source: Central Bank of Ireland.
Notes: The box at each point shows the maximum and minimum range. Sample is time varying comprising the largest domestic life and non-life insurance firms. Last observation 2023H1.

Chart 48: The aggregate value of bond investments has decreased as yields have risen
Aggregate value of (re)insurers' non-linked investments



Source: Central Bank of Ireland.
Note: Non-linked investments exclude those which life insurers hold to back their unit-linked policies.

The introduction of the Personal Injury Guidelines has reduced the value of personal injury claim awards in Ireland, however the final impact of the new guidelines remains uncertain. The guidelines came into effect in April 2021, setting lower benchmarks for the level of compensation for personal injuries. The latest data published by the Personal Injuries Assessment Board[60] shows a reduction in the average award by 38 per cent between 2020 and 2022H1. Due to the long delays in settling claims through the courts the full impact of the new guidelines on awards for litigated claims remains to be seen. There is an outstanding legal challenge to the constitutionality of the guidelines in the Supreme Court. For motor insurance the reduction in the level of personal injury awards has been partially offset by an increase in the value of vehicle damage claims.[61]

Climate change represents a significant risk for the insurance sector. The increase in severe weather events will lead to increased property damage claims and the possible emergence of protection gaps where certain regions or events are no longer insurable. The transition of society to a low carbon economy will trigger revaluations of specific investments, a step change in demand for certain insurance products, and increased claims volatility. The sector is also potentially exposed to an increase in climate-related liability claims for failing to manage climate risks, greenwashing, and enabling carbon intensive industries.

[59] As at 2022Q4 the value of direct investments in Irish property by unit-linked funds was approximately €3 billion which was small in comparison to Irish investment funds, with the investment by unit-linked funds equal to approximately 13 per cent of the total value of Irish property held by Irish investment funds.
[60] PIAB Personal Injuries Award Values, January to June 2022 published 29 June 2023.
[61] National Claims Information Database:Private Motor Insurance Mid-Year Report 1 published 25 April 2023.

Sovereign

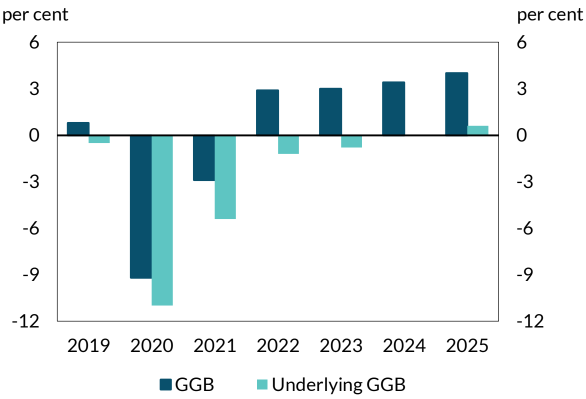
The baseline fiscal outlook remains favourable, both in terms of the budget balance and the debt ratio. This outlook, and fiscal policy more generally, faces a number of challenges and risks over the medium term, however. Excluding receipts of corporation tax that cannot be explained by developments in the underlying economy, projected budget surpluses would be much lower, reducing resources available for future ageing and climate transition costs, and to deal with any other unexpected shocks.

The general government balance is expected to show large surpluses in the coming years, while the government debt ratio is forecast to continue its downward trajectory. The Central Bank's latest outlook forecasts a budget surplus of 3 per cent of GNI* for 2023, increasing to 4 per cent by 2025.[62] Following a very sharp decline last year, meanwhile, the general government debt ratio is projected to fall to 70 per cent of GNI* by 2025. The ratio was over 100 per cent as recently as 2021.

The outlook for the public finances faces a number of challenges and risks over the medium term. Highlighting its unreliability as a revenue source, corporation tax receipts in the year to October 2023 are 2.7 per cent lower than the same period last year. Excluding 'excessive' corporation tax receipts, budget surpluses would be significantly weaker in 2024 and 2025 (Chart 49). This would not only leave less resources available to meet known future ageing and climate transition costs, but would reduce buffers to deal with other shocks. Additional challenges for fiscal policy include necessary public capital expenditure, maintaining an appropriate fiscal stance when the economy is already growing at full capacity, and ensuring that non-core spending measures are withdrawn.

Chart 49: Excluding 'excessive' CT receipts the budget balance would remain in deficit this year

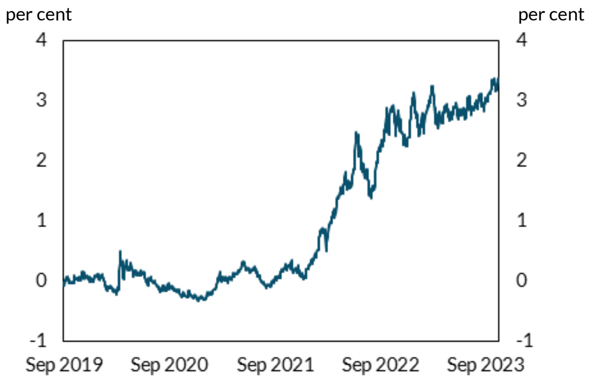
General Government Balance (% GNI*)



Source: Department of Finance.
Notes: GGB denotes General Government Balance as a share of GNI*.

Chart 50: Irish marginal borrowing costs have continued to increase

Irish 10-year sovereign bond yield



Source: NTMA.
Notes: Irish 10-year sovereign bond yield.

While Ireland is expected to benefit from positive debt dynamics over the coming years, sovereign financing conditions have tightened considerably. Since the last *Review*, the yield on 10-year Irish Government has continued to trend upwards, moving above 3 per cent (Chart 50). The NTMA retains significant cash balances of nearly €28bn (10.3 per cent of GNI*) at end September 2023. This provides some funding flexibility over the near term, especially given just one bond (€8bn) matures in 2024.

[62] As published in the Central Bank Quarterly Bulletin QB3 / September 2023.

Macroprudential policy

The Central Bank's macroprudential policies aim to promote resilience, proportionate to the risks faced by the financial system. The Central Bank undertakes regular monitoring and assessment of each of its macroprudential policies to ensure its policy stance remains appropriate for the prevailing systemic risk environment. This chapter presents an update on the Central Bank's current macroprudential policies (summarised in Table 1) across the three broad pillars of its macroprudential policy framework: macroprudential capital buffers for banks, the mortgage measures, and policies relating to non-banks, in particular investment funds.

Table 1 | Summary of macroprudential policies

	Instrument	Policy stance	Additional information
Macroprudential capital buffers for banks	• **O-SII buffer** – acts to safeguard resilience of systemically important institutions.	• 6 O-SIIs identified • Institution specific buffer rates range between 0.5% - 1.5%	• 5 O-SIIs have buffer rate already in place • 2023 review identified 1 new O-SII where buffer rate will apply from Jan 2025
	• **CCyB** – looks to promote resilience in the banking sector with a view to facilitating a sustainable flow of credit to the economy through the financial cycle.	• 1.5%	• 1 per cent rate applicable from November 2023. • 1.5 per cent rate comes into effect in June 2024.
Mortgage measures	Aim to ensure sustainable lending standards in the mortgage market. • **LTV** - provides a buffer against the risk of house price falls, which could leave borrowers in negative equity. **LTI** – provides a long-term link between developments in the housing market and the real economy.	• LTV: 90% for PDH loans, 70% for BTL loans • LTI: 3.5 times for SSB loans; 4 times for FTB lending • 15 per cent of new lending to each borrower segment is allowed above the limits.	•
Policies relating to non-banks	Measures relating to Irish property funds aim to increase resilience of the sector, reducing the risk that financial vulnerabilities might amplify adverse shocks in future periods of stress. • Leverage limit on Irish property funds • Liquidity guidance for Irish property funds	• 60% total debt to total assets ratio • Generally, property funds should provide for a liquidity timeframe of at least 12 months	• Applies to funds domiciled in Ireland, authorised under domestic legislation, and investing over 50 per cent of their portfolio in either directly or indirectly held Irish property assets. • Measures have applied to newly authorised funds since Nov 2022. A phase-in period is provided for funds authorisied prior to this date whereby leverage limits become effective from November 2027 and liquidity guidance from May 2024.

To enhance the effectiveness and consistency of macroprudential policy in the EU, the ESRB has in place a framework of voluntary reciprocity for macroprudential policy measures. Reciprocation is the process whereby a Member State applies the same or equivalent macroprudential measure that is activated in another Member State in order to address a risk related to a specific exposure. In July of this year, following an ESRB Recommendation (ESRB/2023/1), the Central Bank decided to reciprocate a Norwegian systemic risk buffer (SyRB).[63] Reciprocation of the measure will apply from 1 January 2024. In 2019, the Central Bank began reciprocating a French measure that tightened the limits for large exposures of French systemically important institutions to highly indebted large non-financial corporations (NFCs). This measure expired on 30 June 2023.

Macroprudential capital buffers

Countercyclical capital buffer

The Central Bank is maintaining the CCyB rate at 1.5 per cent. This rate will be effective from June 2024. Maintaining the CCyB rate at 1.5 per cent is deemed appropriate in the context of the current macro-financial environment – where the domestic economy has proven resilient to date, with signs of capacity constraints in certain areas, but the impact of monetary policy tightening becoming increasingly evident. Globally the economy remains vulnerable to downside risks.

The buffer provides resilience to the potential materialisation of risk, and if a shock were to hit the banking system, its release would better enable banks to absorb losses and facilitate a sustainable flow of credit to the economy. Future CCyB rate decisions will be based on macro-financial conditions in a manner consistent with the Central Bank's strategy for the CCyB.

The Central Bank is maintaining the CCyB rate at 1.5 per cent. Following a gradual build-up, the 1.5 per cent rate was announced in June 2023 and has been maintained since. The 1.5 per cent rate will become effective in June 2024.

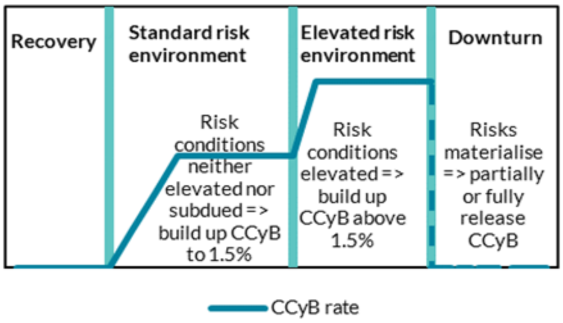
Given the prevailing risk environment alongside emerging effects of monetary policy tightening, maintaining the CCyB rate is considered appropriate. Domestically, economic activity has remained relatively resilient with signs of capacity constraints particularly evident in the labour market. Nonetheless, the impact of monetary policy tightening is also becoming increasingly evident with further adjustments expected. Initially domestic risks manifested most prominently in real estate markets, in particular the CRE market, but early signals of the impact of inflation and monetary policy tightening are now becoming visible in other pockets of the economy (see *Resilience and Domestic risk assessment*). Globally, the economy remains vulnerable to downside risks, amid the ongoing adjustment to higher interest rates. A broad range of supply and demand-side forces pose the risk of persistent inflation, including through the escalation of geopolitical tensions (*see Global risk assessment*).

In aggregate, bank credit has continued to see modest rates of growth even as credit conditions have tightened and interest rates increase. The impact of tightening financing conditions has been most evident in lending to the NFC sector (see *Domestic risk assessment*). Household lending has not yet seen the same rate of monetary policy transmission, although interest rates have now

[63] Announcement of decision by the Central Bank of Ireland to reciprocate a Norwegian Systemic Risk Buffer (SyRB) rate.

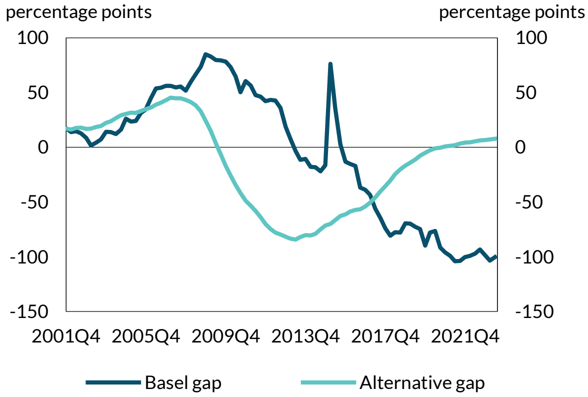
begun to increase. As of 2023Q2, the alternative credit gap stood at 7.90 up slightly from 7.24 in 2023Q1 (Chart 52). Insights from the Bank Lending Survey do not indicate banks' capital position having been a source of tightening credit conditions. Indeed as discussed in *Resilience: Domestic banks*, the domestic banking sector in aggregate has maintained a resilient capital position, with loan defaults yet to rise significantly, and strong profitability evident in recent months.

Chart 51: The CCyB calibration reflects the Central Bank's strategy for the buffer
The Central Bank's high-level strategy for the CCyB



Source: A framework for macroprudential capital.
Notes: Stylised representation, does not refer to specific figures.

Chart 52: While the standardised credit gap remains negative, the alternative gap has increased slightly
Credit gaps



Source: Central Bank of Ireland calculations.
Notes: The standardised gap measure is based on the HP-filter methodology applied by the BIS and shows the deviation of the total credit-to-GDP ratio from its long-term trend. The alternative credit gap is based on a revision of O'Brien and Velasco (2020). Last observation June 2023.

Against this backdrop, the CCyB supports the resilience of the banking sector to possible adverse shocks ahead, in line with the Central Bank's CCyB strategy (Chart 51). Under its strategy for macroprudential capital buffers, the Central Bank uses the CCyB to safeguard resilience against macro-financial risks, including those stemming from the small and globalised nature of the Irish economy. The primary objective for the CCyB is to promote resilience in the banking sector – proportionate to the risk environment – with a view to facilitating a sustainable flow of credit to the economy through the macro-financial cycle. Maintaining the buffer at the current level, supports the resilience of the banking sector to the potential future materialisation of risks and provides scope for the release of the CCyB in such circumstances. A release of the CCyB would allow the banking system to better withstand adverse shocks, without restricting the supply of credit to the economy. On the other hand, the CCyB could be increased above 1.5 per cent if cyclical risks were deemed to have become, or risk becoming, elevated. The Central Bank reviews the CCyB rate on a regular basis and will take future decisions in a manner consistent with its strategy for the buffer.[64]

[64] See the Central Bank's Framework for Macroprudential Capital and The Central Bank's framework for macroprudential capital: CCyB addendum

Buffers for systemically important institutions

Arising from the Central Bank's 2023 Other Systemically Important Institution (O-SII) review, six institutions are identified as systemically important and are required to maintain an associated supplementary capital buffer. This outcome incorporates a number of policy changes which are reflective of the evolution of the Irish retail banking sector. UBIDAC is no longer being designated as an O-SII as its systemic footprint has materially reduced with its phased withdrawal from the market. On the other hand, reflecting its growth and increased importance in the domestic retail banking sector, PTSB is identified as an O-SII and has been assigned a corresponding buffer rate. No policy change has been made for the other five existing O-SIIs (AIB, BofAE, BOI, BBI, and CEP).

The objective of the O-SII buffer is to reduce the probability of failure of a systemically important institution, given the potentially greater impact of failure of those institutions. Institutions that are systemically important to the domestic economy or to the economy of the EU are referred to as O-SIIs.[65] The failure of one of these systemically important institutions would have a greater impact on the financial system and economy than the failure of a non-O-SII. Higher capital requirements for these institutions, in the form of O-SII buffers, aim to reduce the probability of their potential failure.

The Central Bank's approach to the application of the O-SII buffer acknowledges the distinct features of the Irish banking system.[66] The Irish banking system is composed of two distinct groups, one serving the domestic economy and the other serving mainly European or global economies. This heterogeneous make-up of the banking sector has implications for the distribution of risk across the banking system as the channels through which these different types of institutions can affect systemic risk vary. Some institutions are more relevant from the perspective of the domestic economy, while others are more relevant from the perspective of their interconnectedness with the broader financial system and/or the overall European economy. As such, the Central Bank considers measures of systemic importance relating to institutions' linkages with the domestic economy as well as broader measures that would be relevant from the perspective of European financial stability.

Arising from its 2023 review, the Central Bank has identified six institutions as O-SIIs. Five institutions – AIB, BofAE, BOI, BBI and CEP – met the threshold for identification under the mandatory EBA scoring methodology.[67] Under this approach – which provides for a level of consistency within the EU – quantitative indicators relating to an institution's size, importance, complexity and interconnectedness are used to calculate a composite score. One additional institution, PTSB, is designated as an O-SII on the basis of supervisory overlay. Supervisory overlay allows authorities to account for national specificities within the process and is important in the Irish case given the heterogeneous make-up of the banking sector. UBIDAC which had been identified using supervisory overlay last year, and has been an O-SII since 2016, is not being

[65] Differentiating these institutions from institutions that are systemically important at a global level, referred to as G-SIIs.
[66] Further detail on the approach is set out in The Central Bank's framework for macroprudential capital.
[67] For more on the EBA scoring methodology see the EBA O-SII guidelines. For the 2023 assessment, scores were calculated based on end-2022 data, with the standard 350 basis point threshold applied.

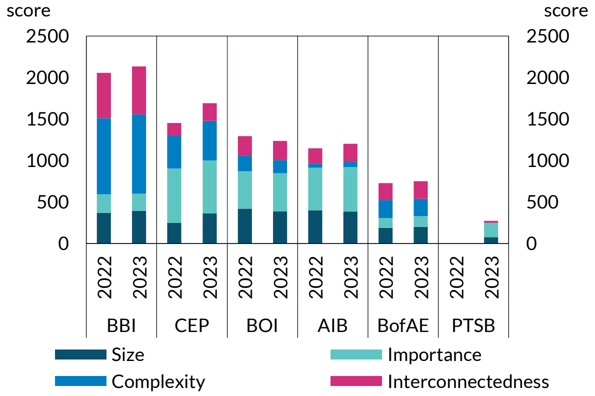
designated as an O-SII. The list of O-SIIs and their associated scores arising from the mandatory EBA methodology are laid out in Chart 53.

Each identified O-SII has been assigned a corresponding institution specific buffer reflective of their importance to domestic and European financial stability. For the five banks identified previously there has been no change to their O-SII capital requirements (Chart 54) – all of which are already fully phased in. A buffer rate of 0.5 per cent is being applied to PTSB – which will come into effect from 1 January 2025. All buffer rates comply with the buffer floor methodology developed by the ECB.[68]

The O-SII policy changes arising from the 2023 assessment reflect the underlying evolution of the domestic retail banking sector. UBIDAC is now at an advanced stage of withdrawing from the Irish retail banking market. This has seen UBIDAC significantly reduce in size alongside a reduction in its financial intermediation role with the domestic economy. Given this reduction in its systemic footprint UBIDAC is no longer designated as an O-SII.[69] At the same time, and indeed relatedly including through portfolio acquisitions from UBIDAC,[70] PTSB's systemic footprint has grown. Proportionate with these changes, PTSB – which in terms of size and scale is now broadly similar to that of UBIDAC previously – has been designated as an O-SII with an associated buffer rate of 0.5 per cent.[71]

Chart 53: Channels of systemic importance differ across institutions

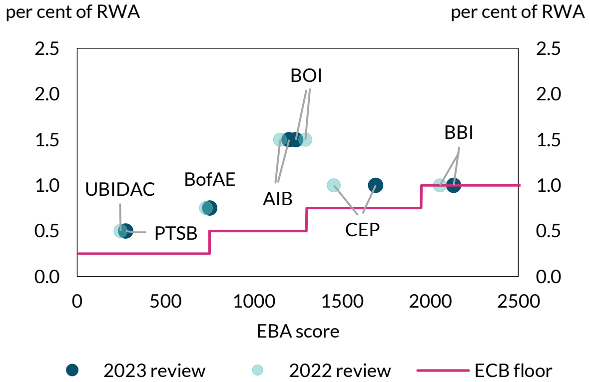
EBA O-SII score and category contributions



Source: Central Bank of Ireland.
Notes: Data are contributions to overall EBA score. For each year only data for identified O-SII's are shown.

Chart 54: O-SII buffers have remained the same for five of the six identified institutions

O-SII buffer rates and ECB floor



Source: Central Bank of Ireland and ECB.
Notes: For each year only data for identified O-SII's are shown.

[68] The floor methodology was designed to ensure a minimum level of harmonisation in O-SII buffer setting within the SSM. Under the methodology, minimum buffers rates are based directly on their EBA score. See ECB Macroprudential Bulletin, June 2017 for details of the initial approach and the Governing Council statement on macroprudential policies for the most recent amendments to the floor methodology.
[69] The role UBIDAC has played in financial intermediation with the domestic economy has declined substantially and overall total assets have fallen from €28 billion in 2021 to just over €7 billion in June of this year.
[70] See for example PTSB press releases of July 24 2023 and 13 February 2023.
[71] PTSB was previously identified as an OSII in 2016 but reflecting a reduction in its total assets was removed as an OSII a year later. For more on the outcome of previous OSII assessments see centralbank.ie.

Macroprudential mortgage measures

Mortgage measures

The mortgage measures aim to ensure sustainable lending standards in the mortgage market. The refreshed mortgage measures framework, which came into effect on 1 January 2023, has been operating against the wider backdrop of an evolving market and tightening financing conditions. Overall, the observed changes in the distribution of new lending have been in line with what has been expected by the Central Bank during the framework review.

The Central Bank views the measures as a permanent feature of the housing and mortgage market and does not foresee regular changes to the calibration of the measures, which are expected to be driven mainly by structural forces.

The refreshed mortgage measures framework, which came into effect on 1 January 2023, has been operating against the wider backdrop of an evolving market and tightening financing conditions. The targeted changes to the mortgage measures were the outcome of the Central Bank's comprehensive framework review announced in late 2022. The changes included a recalibrated first-time-buyer (FTB) LTI and second-and-subsequent buyer (SSB) LTV limit (Table 2). The outcome of the framework review was based on the Central Bank's judgement that the targeted recalibration could relieve some of the costs of the measures, which had increased since introduction, without unduly reducing their benefits.

A number of factors have been shaping the evolution of the mortgage market over the past two years. Persistent inflationary pressures as well as the pass-through of policy rate increases to mortgage interest rates, have been impacting the mortgage decisions of both borrowers and lenders. In addition, the new mortgage lending market has become more concentrated relative to recent years following the phased-exit of two retail banks as well as a decline in the level of new lending provided by non-bank lenders.

Table 2| Details of the LTV and LTI Regulations

Borrower type	FTBs	SSBs	BTL
Limits under the mortgage measures	LTI: 4x LTV: 90%	LTI: 3.5x LTV: 90%	LTV: 70%
Allowance share above the limits	15%	15%	10%
Exemptions	Refinance loans without an increase in capital are exempt from the mortgage measures. The LTI limit does not apply to lifetime mortgages. The LTV limit does not apply to negative equity mortgages.		

The Central Bank considers the mortgage measures to be permanent in nature and their calibration to be largely driven by slower-moving forces. The Central Bank is committed to undertaking periodic reviews of the strategy around the measures. These periodic reviews are complemented by continuous monitoring, analysis, engagement and communications around the measures.

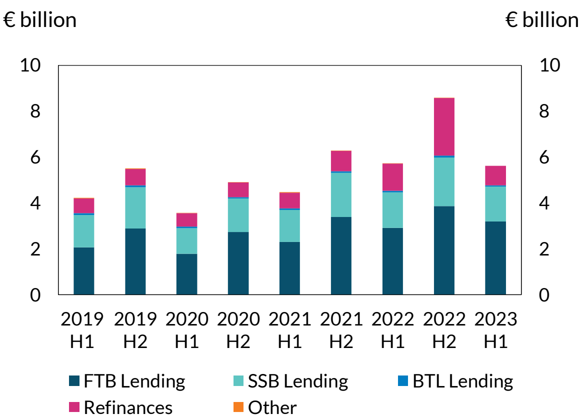
Insights on new mortgage lending in 2023H1

A total of 20,153 loans, with a value of €5.6 billion, were originated in the first half of 2023. These loans were originated by the five institutions that submitted mortgage measures monitoring template data to the Central Bank for 2023H1.[72, 73] Although total new mortgage lending value decreased by 1.8 per cent with respect to the same period in 2022, this was driven by changing dynamics in the refinancing segment. New lending for property purchase remained strong and indeed increased relative to 2022H1. In particular, new FTB lending grew robustly, increasing by more than 9 per cent from €2.9 billion in 2022H1, to €3.2 billion in 2023H1 (Chart 55). More recent data from the BPFI points to a continuation of this trend into 2023H2.[74]

Refinance and non-bank mortgage lending declined significantly in 2023H1. Refinances[75] accounted for between 13 – 16 per cent of total lending from 2019H1 – 2021H1 before increasing to highs of 20 – 30 per cent of total lending in 2022. Refinanced lending then decreased to 14 per cent in 2023H1, consistent with pre-2022 time periods. The high shares of refinanced loans evident in 2022 can be attributed in part to the exit of two retail banks from the mortgage market and the changing interest rate environment. Non-bank lending increased steadily between 2019 and early 2022, as both the share of lending and number of non-bank lenders increased. Evidence of decreasing shares of non-bank lending emerged in 2022H2, with non-bank lenders impacted by the rapid monetary policy tightening that occurred during this time. Non-bank lending accounted for less than 5 per cent of total lending under the mortgage measures in 2023H1.

Chart 55: First-time buyer lending represents the largest share of new lending in 2023H1

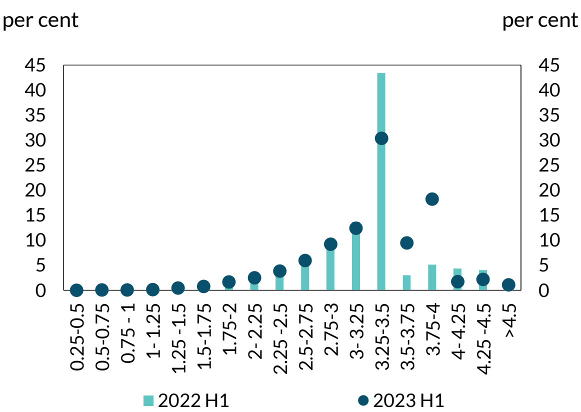
Breakdown of new lending volumes by type



Source: Monitoring Templates Data.
Note: Includes all new loans. Refinances category includes loans both in and out-scope of the mortgage measures. 'Other' refers to out-scope negative equity, title transfer and restructured loans.

Chart 56: Many loans that would have clustered at the 3.5 LTI limit in previous years have originated between 3.5 and the new limit of 4 this year

LTI distribution for FTBs in 2023H1 vs 2022H1



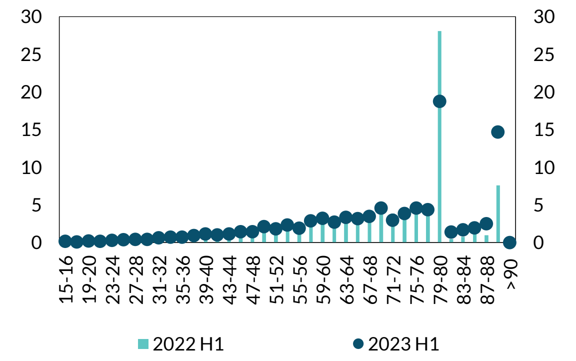
Source: Monitoring Templates Data.
Note: Share of value. FTB in-scope new property purchase and self-build loans only.

[72] For the purposes of monitoring the mortgage measures, any lender that originates €50 million or more in new lending in a given 6 month period (Jan-June; July-Dec) is required to submit corresponding loan level data to the Central Bank.
[73] A detailed overview of new lending under the mortgage measures is published twice yearly by the Central Bank on its website – See New Mortgage Lending Data.
[74] These patterns are consistent with those outlined by the BPFI, whose data show that primary dwelling mortgage lending continues to be robust, but growth rates are at a slower pace than one year ago, at 7 per cent in the year to September 2023 compared to 17 per cent one year ago. BPFI mortgage approvals data show a similar trend.
[75] Refinances category includes loans both in and out-scope of the mortgage measures (i.e. switcher activity).

The evolution of the distribution of new lending so far has been broadly in line with the Central Bank's assessment as part of the framework review. Many FTB loans that would have clustered at the 3.5 LTI limit in previous years have originated in the range between 3.5 and the new limit of 4 in 2023H1 (Chart 56). These changes are broadly in line with patterns modelled during the framework review prior to the introduction of the refreshed framework (Gaffney (2022)). The share of SSB lending originated at LTV above 80 per cent doubled to 22 per cent, compared to 2022H1 (Chart 57). These shifts in the distribution have seen a small increase in the 90th borrower percentile in each category but have not resulted in any material change to the median (or average LTI and LTV) (Chart 58).

Chart 57: Higher shares of SSB lending originated at LTVs above 80 per cent in 2023H1, compared to 2022H1

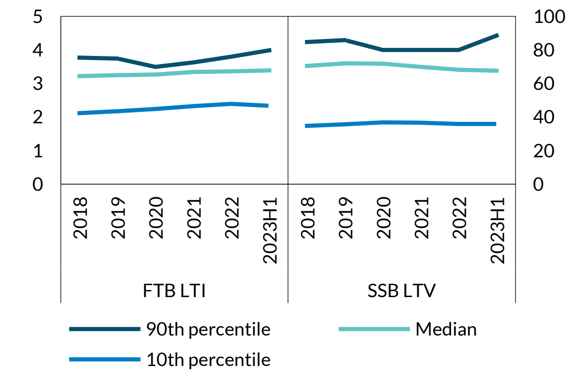
LTV distribution for SSBs in 2023H1 vs 2022H1



Source: Monitoring Templates data.
Note: Share of value. SSB in-scope new property purchase and self-build loans only.

Chart 58: Both the 90th percentile LTI of FTBs and LTV of SSBs increased, while medians remained stable

FTB LTI and SSB LTV percentiles over time

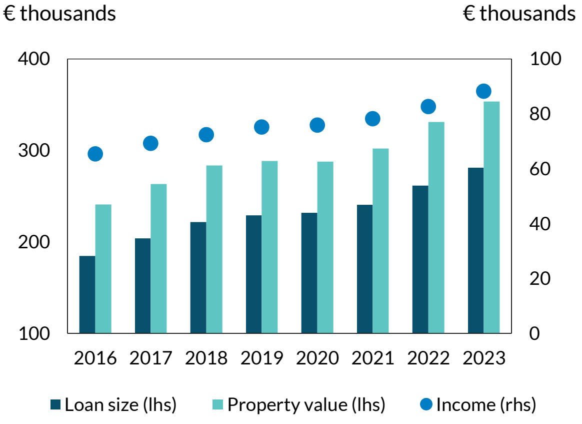


Source: Monitoring Templates data.
Note: In-scope lending. Percentiles are based on the number of loans.

The share of lending at very high LTI multiples has reduced relative to 2022H1. The share of FTB lending at the upper end of the distribution, i.e. above the new limit of 4, declined from 10 per cent in 2022H1 to 5 per cent in 2023H1. In recent years, lending at LTVs above 90 has been limited but in the first half of 2023 essentially no lending took place at an LTV above the 90 per cent limit. This reduction in the upper end of the distribution is likely to reflect institutions' own lending practices. While compliance with the mortgage measures applies only on a calendar year basis, the level of lending above the limits in H1 was nonetheless well below the 15 per cent allowed (for FTB and SSB lending) under the refreshed framework. Overall, the percentage of primary-dwelling lending above the limits was approximately 5 per cent in 2023H1. As might have been expected, given the changes to the headline limits, lenders' utilisation of the carry-over mechanism was limited in 2023H1.

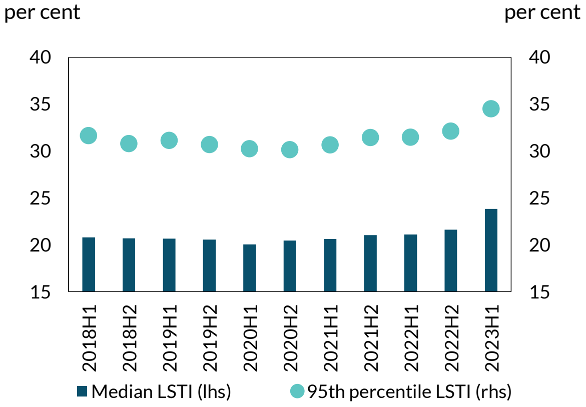
Growth in borrowers' incomes, loan sizes and purchase prices has followed trends observed in previous years. FTB loan sizes, property values and incomes increased at broadly similar rates, in a continuation of the trend observed over the last number of years, with each rising by approximately 7-8 per cent compared with 2022H1 (Chart 59). The average interest rate increased by approximately 1 percentage point, for both FTB and SSB lending, compared to 2022H1 with further increases likely to be evident in 2023H2 data given the on-going pass through from policy rates that has occurred in recent months. Higher interest rates are likely to put upward pressure on the mortgage service burden faced by new borrowers. Indeed, loan-service-to-income ratios (LSTI), computed as the ratio of the annual loan servicing costs and borrower after-tax income,[76] have seen an uptick in 2023H1(Chart 60). In 2023H1 the median LSTI was approximately 24 per cent with the 95th percentile LSTI at 34.5 per cent, up from approximately 22 per cent and 32 per cent, respectively, in 2022H2.

Chart 59: Average FTB loan size, property value and income have continued to grow in line with trends
Average characteristics of FTB lending



Source: Monitoring Templates Data.
Note: FTB in-scope new property purchase and self-build loans only. Income refers to total gross income of all borrowers in each year. All figures are nominal and refer to H1 data.

Chart 60: Amid higher interest rates, repayments on new loans have increased relative to net incomes
New mortgage LSTI 2018H1 – 2023H1



Source: Monitoring Templates Data and Central Bank calculations.
Note: LSTI figures are calculated using a proxy of net income. Sample restricted to fully amortising loans (with a monthly repayment schedule) for new property purchase and self-build. Percentiles are based on the number of loans.

[76] For the purposes of this analysis, the LSTI is calculated using a proxy of net income. After-tax income is estimated by deducting an approximation of income taxes, social security contributions and tax credits from the gross income figures reported by lending institutions in the context of the mortgage measures monitoring templates. LSTI figures refer to fully amortising loans (with a monthly repayment schedule) for new property purchase and self-build only.

Macroprudential policy for non-banks

Reflecting the scale of the sector in Ireland and the growing connections to the domestic economy, developing a macroprudential framework for non-banks is a key priority for the Central Bank. The focus for the Central Bank in recent years when developing macroprudential policy for non-banks has been on the investment fund sector. This reflects the size of the investment fund sector resident in Ireland, its significant growth over the last decade and its interconnectedness to the wider financial system and in some cases the real economy.

The macroprudential policy measures for property funds announced in November 2022 are the first measures under the third pillar of the Central Bank's macroprudential framework in relation to non-banks with further work ongoing on liability driven investment (LDI) funds. The phased implementation of the macroprudential measures for property funds is continuing, including engagement with the relevant property funds in scope of the measures. Furthermore, the role of LDI funds in the 2022 gilt market crisis led the Central Bank to outline supervisory expectations for GBP denominated LDI funds to maintain an enhanced level of resilience, via an industry letter in November 2022. Work has been ongoing to ensure the steady state resilience of Irish-resident GBP denominated LDI funds in recent months, working with European partners given the cross-border nature of GBP LDI funds. As part of that effort, the Central Bank is today publishing a consultation paper on measures to codify, and in certain cases augment, the yield buffer for GBP denominated LDI funds authorised in Ireland. In parallel, the Commission de Surveillance du Secteur Financier (CSSF) is also publishing a consultation paper on GBP LDI funds authorised in Luxembourg.

Beyond the phased implementation of macroprudential measures for property funds and work to ensure the resilience of GBP denominated LDI funds, the Central Bank published a Discussion Paper on an approach to macroprudential policy for investment funds in July 2023. The Discussion Paper takes a holistic perspective and sets out what the Central Bank considers to be important elements in the development of a comprehensive macroprudential framework for the wider funds sector. It does not propose specific policy measures at this time, rather is designed to engage stakeholders, domestically and internationally, in order to further advance discussion and progress on an approach to macroprudential policy for investment funds. A macroprudential framework for investment funds should target the collective action of fund cohorts and given the global nature of the funds industry would ideally would have a high degree of consistency internationally. While international efforts are underway in this area, the lack of a complete and operational macroprudential framework for investment funds remains a key gap. The Central Bank is actively working with peer institutions in the EU and internationally to advance work in this area.

The Central Bank's Discussion Paper sought views across a number of areas relevant for the development of a macroprudential framework for funds. These included the nature of the systemic risk in the funds sector. The Discussion Paper highlighted the underlying systemic risk posed by the investment fund sector is its ability to spread or amplify shocks to other parts of the financial system and/or the real economy. The materialisation of systemic risk arises from a shock and the interplay between leverage and liquidity mismatch, and interconnectedness of the fund cohorts. The Discussion Paper noted that while the current investor protection-focused regulatory framework for the funds sector can help to address some funds-specific elements of systemic risk, it does not fully address them all. A macroprudential perspective is therefore needed to complement the current investor protection focus. The Discussion Paper described the objectives and principles of macroprudential policy; the design of macroprudential tools; and considerations for operationalising the macroprudential framework for the funds sector. The Central Bank welcomes the feedback received to the Discussion Paper. The Central Bank will publish a feedback statement, covering some or all of the topics raised, in 2024.

Macroprudential measures for Irish property funds

In November 2022, the Central Bank announced the phased implementation of new macroprudential leverage limits and Central Bank Guidance on liquidity timeframes for Irish property funds. The measures reflect the growing importance of these funds in the Irish CRE market – a systemically important market for the Irish financial system and real economy.

The Central Bank is currently focused on the implementation of the measures. Property funds have until 24 November 2027 to comply with the leverage limits and until 24 May 2024 to take appropriate action in response to the Guidance. The measures apply immediately for any property funds authorised on or after 24 November 2022.

Property funds have become a key participant in the Irish CRE market, holding approximately 40 per cent of the estimated investible Irish CRE market. Central Bank analysis has highlighted that there is a cohort of property funds with high levels of leverage, and, to a lesser extent, liquidity mismatches.[77] In the event of an exogenous shock, the presence of these vulnerabilities could lead to widespread forced sales in the CRE market, amplifying the impact of the shock on the CRE market and the economy more broadly. To guard against excessive levels of leverage in property funds the Central Bank announced a 60 per cent leverage limit. The leverage limit is calculated as total debt (i.e. total non-equity liabilities) to total assets. To address the liquidity mismatch observed in property funds, the Central Bank announced new Guidance on redemption terms for property funds. The Guidance outlines the Central Bank's expectation that property funds should generally provide for a liquidity timeframe of 12 months.

In line with the Central Bank's approach to macroprudential policy, the phased implementation of the property fund measures is being closely monitored. A new annual data collection has been introduced to assist with the ongoing phased implementation of the measures. Relevant property funds are expected to submit plans to the Central Bank on how they intend to reduce or maintain leverage below the 60 per cent limit. The Central Bank is actively engaging with those funds.

The Central Bank does not intend to recalibrate the leverage limit regularly. These measures are intended to deliver a structural level of resilience for the property fund sector to adverse shocks. Nevertheless, to achieve its macroprudential objective, there will be flexibility to respond to material changes in the macro-financial environment. See the Macroprudential policy framework for Irish property funds for further details.

[77] Central Bank analysis for Irish property funds is largely based on a bespoke survey of Irish property funds carried out in 2020 referring to data as of 2019Q4 (i.e. the Deep Dive Survey) together with regulatory and statistical data collected regularly by the Central Bank. The results of the Deep Dive Survey are outlined in Daly. P, Moloney. K., & Myers, S. (2021) "Property funds and the Irish commercial real estate market", Central Bank of Ireland Financial Stability Note Vol 2021, No. 1.

Macroprudential measures for Irish GBP liability driven investment funds

The 2022 gilt market crisis highlighted vulnerabilities amongst GBP denominated LDI strategies that pose a risk to financial stability. Given the significance of Irish-resident LDI funds in the GBP LDI sector, in November 2022 the Central Bank outlined supervisory expectations for GBP LDI funds to maintain an improved level of resilience, via an industry letter.

Building on the November 2022 letter, the Central Bank committed to arrive at a more steady state assessment of the level of resilience required across the sector and worked closely with regulators across Europe and the UK. The Central Bank is today publishing a consultation paper on the proposals to codify, and in certain cases augment, the yield buffer measure. The full proposal is outlined in the Consultation Paper "Macroprudential measures for GBP Liability Driven Investment funds", and feedback on these proposals is invited until 18 January 2024.

Irish-authorised GBP denominated LDI funds played a significant role in the gilt market crisis in 2022, accounting for approximately 30 per cent (£11 billion) of total net gilt sales. The 2022 gilt market shock resulted in a sudden and sharp increase in yields. This in turn, led to LDI funds, particularly those employing high leverage, to sell gilts into a market with low liquidity, causing yields to rise further. Gilt sales by Irish-authorised GBP LDI funds were notably concentrated amongst less resilient LDI funds, i.e. those with a lower yield buffer.[78]

In November 2022, the Central Bank outlined supervisory expectations via an industry letter, in cooperation with international peers, for GBP LDI funds to maintain an enhanced level of resilience. The Central Bank set out an expectation of a 300-400 basis points (bps) yield buffer as a minimum safeguard to maintain the operational and financial resilience of GBP denominated LDI funds domiciled in Ireland. The yield buffer requires that the value of a fund's net asset value (NAV) remain positive following a 300-400 bps increase in yields, which takes into account the fund's leverage and the interest rate sensitivity of its portfolio (i.e. its duration).

The Central Bank is today publishing a consultation paper outlining measures to strengthen the steady-state resilience of Irish authorised GBP denominated LDI funds. The consultation paper outlines policy proposals to codify, and in certain cases augment, the supervisory expectations outlined in the industry letter. The proposed codification of the yield buffer will be based on the "other restrictions" under Article 25 of the Alternative Investment Fund Managers Directive (AIFMD). In line with the November 2022 industry letter, the consultation paper on the proposed codification is being undertaken in conjunction with the Commission de Surveillance du Secteur Financier (CSSF). This should ensure alignment across the two principal EU fund domiciles for GBP LDI funds on yield buffer requirements. The consultation paper describes the main features of the codification, including design features to facilitate yield buffer usability, buffer composition requirements and is accompanied by liquidity guidance. Stakeholder feedback is invited until 18 January 2024, after which the Central Bank will analyse the responses and publish a final announcement on the steady state measures.

[78] See Dunne et al. (2023).

Abbreviations

Country and currency abbreviations follow the European Union standards.

AIB	Allied Irish Bank
AUM	Assets under management
BBI	Barclays Bank Ireland
BIS	Bank of International Settlements
BofAE	Bank of America Europe
BOI	Bank of Ireland
BPFI	Banking & Payments Federation Ireland
BTL	But-to-let
CBRE	Coldwell Banker Richard Ellis Group
CCR	Central Credit Register
CCyB	Countercyclical capital buffer
CEP	Citibank Europe
CET1	Common equity tier 1
CRE	Commercial real estate
CRO	Company Registrations Office
CSO	Central Statistics Office
DSTI	Debt service to income
EA	Euro area
EBA	European Banking Authority
ECB	European Central Bank
ESRB	European Systemic Risk Board
EU	European Union
FDI	Foreign direct investment
FINREP	Financial reporting
FSR	Financial Stability Review
FTB	First-Time Buyer
GDP	Gross domestic product
GFC	Global Financial Crisis
GNI	Gross national income
HH	Households
HICP	Harmonised index of consumer prices
IFRS	International financial reporting standard
IMF	International Monetary Fund
JLL	Jones Lang LaSalle
KBC	Kredietbank ABB Insurance CERA Bank
LDI	Liability driven investment
LSTI	Loan service to income
LTI	Loan to income ratio
LTV	Loan to value ratio
MSCI	Morgan Stanley Capital International
NBL	Non-bank lender
NFC	Non-financial corporation
NII	Net interest income
NIM	Net interest margin
NPL	Non-performing loan
NTMA	National Treasury Management Agency
OFI	Other financial institution
O-SII	Other Systemically Important Institutions
PDH	Primary dwelling house
PMI	Purchasing managers' index
PTSB	Permanent TSB
ROA	Return on assets
ROE	Return on equity
RRE	Residential real estate
RWA	Risk-weighted asset
SCR	Solvency capital requirement
SME	Small and medium enterprise
SSB	Second and subsequent buyer
SSM	Single supervisory mechanism
SVR	Standard variable rate
UBIDAC	Ulster Bank Ireland DAC

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