Financing Developments in the Irish Economy

Overview

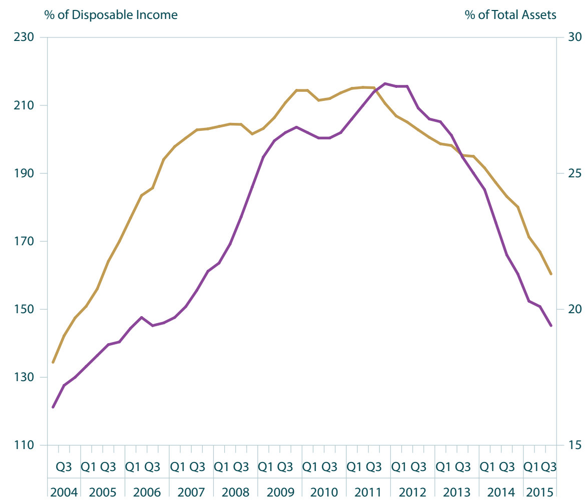
Recent months have seen a continued improvement in financing conditions in the Irish economy. The ongoing economic recovery, coupled with the current accommodative monetary policy stance, has strengthened the funding position of the financial and non-financial sectors. Irish resident credit institutions have experienced further growth in deposits from the private sector, and have reduced their reliance on Eurosystem refinancing operations to just over one quarter of their total funding profile. They have also benefitted from increasing interest margins, as the spread between loan and deposit rates widened to 369 basis points in January 2016. Volatility in global equity markets in early 2016 brought renewed downward pressure on euro area sovereign bond yields. Combined with the robust performance of the Irish economy in recent quarters, this has resulted in a steady decline in borrowing costs for the Government. Borrowing costs faced by Irish households and non-financial corporations (NFCs) have also fallen in recent months, with a particularly pronounced decline in the rate of interest on new loans to small- and medium-sized enterprises (SMEs).

The ongoing decline in net lending to the private sector might suggest that the economic recovery has, to date, been somewhat creditless. The data on credit flows confirm a significant degree of deleveraging is still underway among Irish households and NFCs, as they continue to reduce their overall debt levels. Nonetheless, gross new lending increased in 2015 with households drawing down €4.4 billion in new mortgage loans. Non-financial SMEs recorded drawdowns of €3.4 billion over the same period – the highest volume of new lending to such entities in a twelve month period since the series began in 2010. Notwithstanding these increases in new loans, overall developments in credit to the real economy indicate that repayments continue to outstrip new lending, reflecting the continued adjustment of financial and non-financial sector balance sheets, as well as ongoing concerns regarding credit risk. Although the decline in mortgage arrears has slowly spread to cases of longer-term arrears, the persistent and elevated nature of arrears over 720 days remains a cause for concern.

Household Sector

Against the backdrop of an improving economic environment, debt levels among Irish households have fallen further. Household debt amounted to €151 billion at end-September 2015, or €32,614 per capita, representing its lowest level in almost ten years. Overall, household debt has fallen by 26 per cent since its peak in the third quarter of 2008. Debt sustainability also continued to improve in 2015, as shown in Chart 1. Debt as a proportion of total assets has been declining since the second quarter of 2012 and stood at 19.4 per cent at end-September 2015. Furthermore, over the past year, Irish households have reduced debt as a proportion of disposable income by 24 percentage

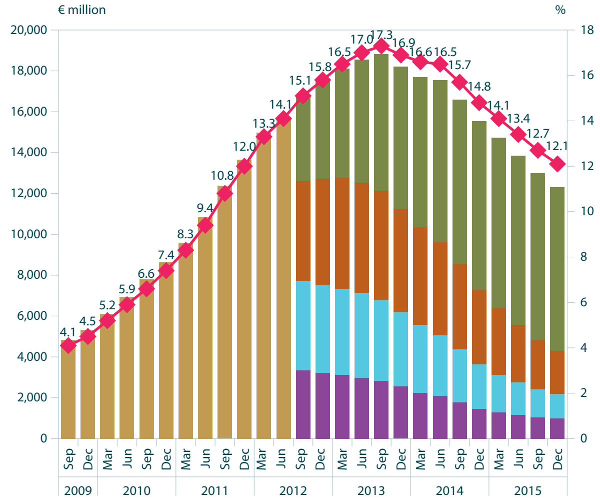
Chart 1: Household Debt Sustainability



— Debt to Disposable Income (LHS)
— Debt to Total Assets (RHS)

Source: Quarterly Financial Accounts, Central Bank of Ireland; Quarterly National Accounts, CSO.

Chart 2: PDH Accounts in Arrears over 90 Days



Outstanding balance on accounts in arrears >90 days
Outstanding balance on accounts in arrears 91-180 days
Outstanding balance on accounts in arrears 181-360 days
Outstanding balance on accounts in arrears 361- 720 days
Outstanding balance on accounts in arrears >720 days
— Value of accounts in arrears >90 days as a % of total (RHS)

Source: Residential Mortgage Arrears and Repossessions Statistics, Central Bank of Ireland.

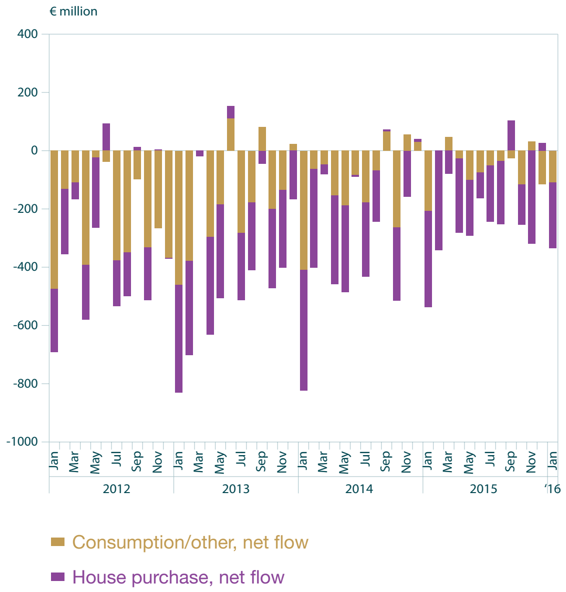
points, to 160 per cent. The decline in these indicators reflects falling debt levels, as well as the increase in household total assets and disposable income. Meanwhile, the cost of servicing outstanding household debt remained broadly stable throughout 2015, as the interest rate on total outstanding loans to households averaged 3.33 per cent over the year. The equivalent rate for the euro area as a whole was 3.54 per cent over the same period.

Household net worth, calculated as the sum of housing and financial assets minus liabilities, rose to €618 billion, or €133,225 per capita at end-September 2015. The largest contributor to this increase was a rise in the value of housing assets of €18 billion during the third quarter of the year, while household liabilities also decreased by almost €3 billion. Overall, household financial assets decreased by almost €4 billion due to a decline in the value of equity and insurance technical reserves, which include life assurance policies and pension funds. This marked the second successive fall in financial assets and the first time since the third quarter of 2011 that financial assets have declined for consecutive quarters.

Falling debt levels among Irish households are also reflected in the continuing decline in mortgage arrears. The final quarter of 2015 marked the tenth consecutive quarterly decline in the number of mortgages on principal dwelling houses (PDH) in arrears. This recovery has now spread to longer-term arrears cases, as the number of loans in arrears of more than 720 days has declined for two consecutive quarters. Nonetheless, the level of long-term arrears remains a cause for concern from a policy perspective. At end-2015 the outstanding value of PDH mortgage accounts in arrears of more than 720 days was just over €8 billion, equivalent to 8 per cent of the total value of PDH mortgage loans.

Despite the upturn in the economy and the decline in non-performing housing loans, total loans to households by Irish resident credit institutions declined by 2.6 per cent in the year ending January 2016. Net transactions

Chart 3: Loans to Households – Developments in Net Flows



Source: Money and Banking Statistics, Central Bank of Ireland.

of minus €2.5 billion over that period predominantly reflected net repayments of mortgage loans. In the year to end-January, mortgage loans declined at a rate of 2.5 per cent, with households repaying €1.9 billion more than was advanced in new loans (Chart 3). Over the same period, the cost of borrowing for households fell, particularly for new drawdowns of mortgage loans. The average interest rate on a new standard variable rate (SVR) mortgage fell by 44 basis points to 3.76 per cent over the year to end-December 2015. The equivalent decline on new mortgages with a fixed interest rate for a period of between one and three years was 58 basis points, giving an average rate of 3.67 per cent at end-December 2015.

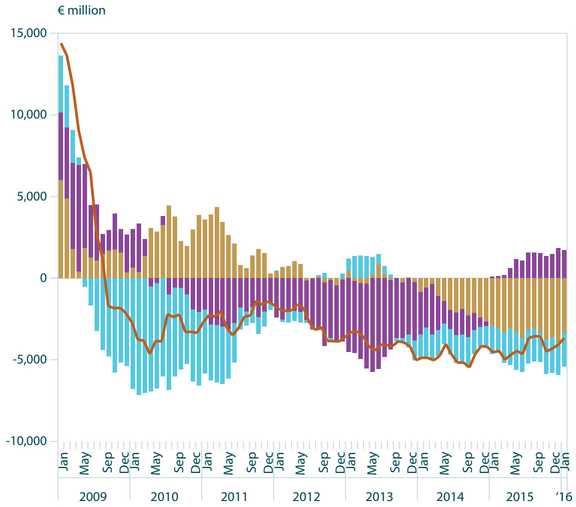
Non-Financial Corporate Sector

Following a period of strong expansion, non-financial corporations' (NFCs) balance sheets contracted somewhat in the third quarter of 2015, with financial assets falling by 2.6 per cent and financial liabilities decreasing by 3.1 per cent. On both sides of the balance sheet, the contraction was driven by negative movements in the valuation of equities reflecting the unsettled global economic conditions that emerged during the second half of 2015. The value of equity assets fell by €55 billion, while equity liabilities had a similar decline falling by €53 billion.

While NFC debt as a percentage of GDP continued to decline in the third quarter of 2015, falling 2 percentage points to 184 per cent, the pace of decline was more moderate than in the preceding quarters of 2015. This was, in part, due to a slower pace of annualised GDP growth, but more so due to an increase in NFC debt liabilities in nominal terms which rose by €4.7 billion, or 1.3 per cent, in the third quarter of the year. The largest contributor to the rise in NFC debt was an increase in loans held by non-residents of €4.1 billion. When analysing Irish NFC debt trends, it is important to note that Ireland has substantial multinational corporation (MNC) activities, which have little interaction with the domestic financial system. Though NFC debt as a percentage of GDP is currently at its lowest level since Q2 2009, it remains high in an international context. Ireland ranks third highest among European countries in terms of NFC debt to GDP, behind Luxembourg (328 per cent) and Cyprus (231 per cent), both countries that also have relatively large MNC sectors.

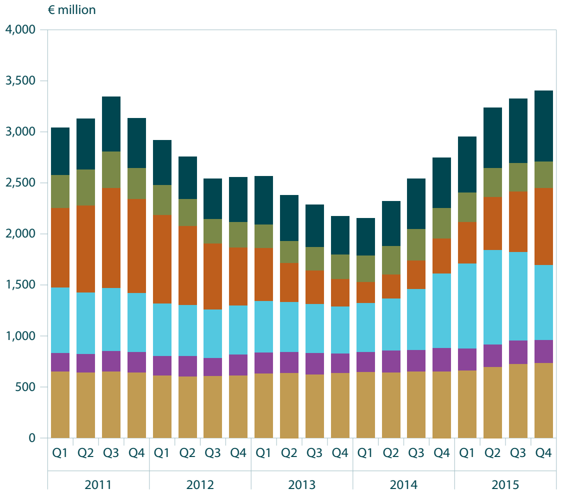
Direct investment by foreign-owned MNCs into their Irish operations increased by a very strong €65.2 billion in the fourth quarter of 2015, reflecting large increases in equity and other capital of €24 billion and €35 billion, respectively. Reinvested earnings increased by €6.5 billion. Over the same period, direct investment income earned abroad by Irish-owned MNCs remained steady at €5.8 billion. Meanwhile, foreign direct investment (FDI) by Irish-owned MNCs abroad eased to €7.2 billion in Q4 2015, following three very strong quarters. FDI abroad by Irish resident companies and associated income flows predominantly reflect the operations of multinational NFCs who have established their corporate headquarters in Ireland.

Chart 4: Loans to NFCs – Net Flows by Category of Original Maturity



Source: Money and Banking Statistics, Central Bank of Ireland.

Chart 5: Gross New Lending to SMEs by Sector (12 Month Moving Average)



Source: Business Credit and Deposits Statistics, Central Bank of Ireland.

Lending by Irish resident credit institutions to Irish resident NFCs continues to decline, falling by 6.8 per cent on an annual basis in January 2016. This deleveraging may indicate a greater reliance on non-bank funding. Box A highlights one example of this, namely the role of Real Estate Investment Trusts (REITs) in funding property transactions. There have been contrasting developments among the various maturity categories, however, suggesting a move away from the use of overdrafts and other shorter-term facilities (Chart 4). In the year ending January 2016, repayments of loans with an original maturity of up to one year by NFCs exceeded new drawdowns by €3.4 billion. Over the same period, the net flow of loans to NFCs with an original maturity of between one and five years increased by €1.7 billion. Notwithstanding the developments at an aggregate NFC level, where repayments continue to outstrip new drawdowns, data relating to small- and medium-sized enterprises (SMEs) show continued growth in gross new lending by Irish resident credit institutions to these entities. New lending drawdowns[1] by non-financial SMEs amounted to €3.4 billion in 2015. This was the highest volume of new drawdowns by SMEs in a twelve month period since these data were first collected in 2010. The recent increase in new lending has been driven by the agriculture sector and real estate activities.

The cost of servicing outstanding debt has increased marginally for Irish NFCs in recent months, though the average interest rate of 3.16 per cent at end-2015 was six basis points lower than at end-2014. The average cost of new NFC loans was 2.84 per cent in December 2015, also slightly lower compared to twelve months previously. Nonetheless, this cost of borrowing is a full percentage point higher than the euro area equivalent. Interest rates on new drawdowns by Irish SMEs have fallen considerably over the past year. The average cost of borrowing for non-financial SMEs was 4.52 per cent in the fourth quarter of 2015 – a decline of 71 basis points compared to the same period in 2014.

1 Gross new lending excludes restructures or renegotiations which do not increase the size of outstanding loans. It does include new funds drawn-down following a restructure or renegotiation of an existing facility that were not included in credit advanced at the end of the previous quarter.

Box A: Real Estate Investment Trusts and the Property Sector in Ireland
By Dermot Coates and Aoife Moloney[2]

Real Estate Investment Trusts (REITs) are listed companies that undertake a property rental business. These companies – as publicly listed entities – are not strictly trusts but the term has found common usage[3]. The specific tax treatment applicable to these companies means that they are not subject to tax on rental income or on capital gains[4] arising from the disposal of assets of the property rental business. However, these entities are not wholly tax exempt[5]. This treatment avoids the imposition of an additional layer of taxation, albeit that the REITs are required to distribute much of their rental income. REIT regimes have been in operation in North America for a number of decades and a UK REIT regime came into operation in 2007 with a number of large property companies converting to REIT status at that time. Pursuant to Budget 2013, legislative changes introduced under the subsequent Finance Act[6] provided for REITs to operate in Ireland. At present, there are three principal Irish-listed REITs operating here: Green REIT, Hibernia REIT and I-RES REIT[7]. Furthermore, Starwood Property Trust – a US-listed REIT – is active in the Irish market having acquired a portfolio of commercial and residential properties in 2015. The objective of this Box is to outline some characteristics of the development of the REIT sector in Ireland over recent years.

There are a number of qualification criteria that a company must meet in order to operate as a REIT under the Irish tax code. These include, but are not limited to, the following: (i) Irish-resident and not resident elsewhere; (ii) a company incorporated under the Irish Companies Acts; (iii) a quoted company on a main EU stock exchange; and (iv) the distribution of at least 85 per cent of income by way of a dividend to shareholders. In addition, there are restrictions on gearing, the ratio of income to financing costs and on the percentage of the total shareholding that an individual shareholder can control in a REIT.

In the aftermath of the Finance Act 2013, the aforementioned three incumbents raised equity finance through a series of IPOs, with Green REIT and Hibernia REIT listing on the Irish Stock Exchange in 2013 followed by I-RES REIT in 2014. Furthermore, both Green REIT and Hibernia REIT issued new shares in a secondary offering in 2014 (Chart 1). The cumulative market capitalisation of these three REITs has increased significantly since 2013 (Chart 2), reflecting both the aforementioned share issuance alongside share price movements over time. By late 2013, this stood at €874 million, but by Q4 2015 this had increased by 190 per cent to over €2.5 billion. Over the same time period, the market capitalisation of the overall non-financial corporation (NFC) sector also grew substantially, increasing by over 100 per cent to €524.5 billion by Q4 2015. However, the redomiciling of NFCs into Ireland has contributed to a large portion of the increase for the total NFC sector[8].

2 Statistics Division, Central Bank of Ireland.

3 REITs Forum (http://www.irishreits.ie/).

4 PwC (2013): *'Investing in property: Irish Real Estate Investment Trust'*.

5 A tax charge arises where a dividend is paid to shareholders with 10 per cent or more of the share capital and where a property asset is developed at a cost exceeding 30 per cent of its market value (and disposed of within three years).

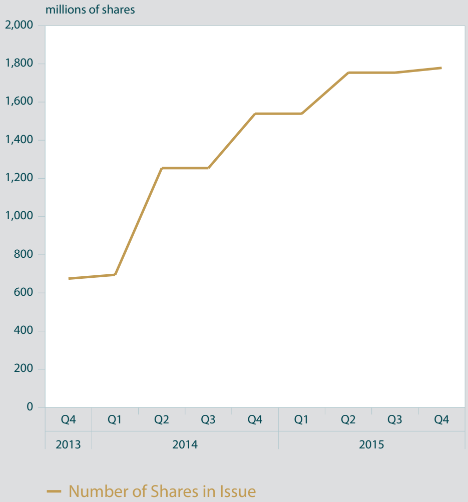
6 Finance Act 2013 (Section 41).

7 Irish Residential Properties (I-RES) REIT is a related party to Canadian Apartment Properties (CAP-REIT).

8 Coates, D. and A. McHugh, (2014) 'Box A: The Impact of Redomiciled NFCs on Irish Securities Issues Statistics', Central Bank of Ireland Quarterly Bulletin, No.3.

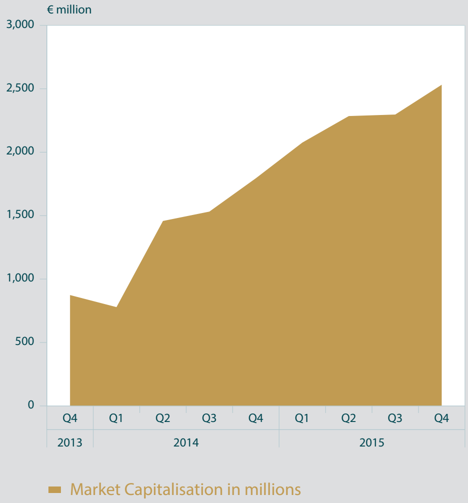
Box A: Real Estate Investment Trusts and the Property Sector in Ireland
By Dermot Coates and Aoife Moloney

Box A Chart 1: Number of Shares in Issue for the Irish-Listed REIT Sector, Q4 2013 - Q4 2015



Source: Central Bank of Ireland Securities Issues Statistics database.

Box A Chart 2: Cumulative Market Capitalisation of the Irish-Listed REIT Sector, 2013-2015



Source: Central Bank of Ireland Securities Issues Statistics database.

By early 2015, the three Irish-listed companies were primarily financed via equity liabilities[9] rather than borrowings from credit institutions. At their respective Balance Sheet dates, the cumulative shareholder equity stood at some €1.9 billion (or 89 per cent of total liabilities[10]) with the balance consisting of bank indebtedness and other current liabilities (i.e. accounts payable, security deposits, etc.) (Chart 3). The published financial statements for this sector provide some interesting information with regard to substantial shareholdings. This indicates that non-resident institutional investors held significant stakes in each entity, with US, Canadian and UK investors featuring prominently. The REIT sector in Ireland also recently put in place a series of revolving credit and bridge facilities with both resident and non-resident banks but much of this finance had not yet been drawndown. The authors calculate that debt facilities of up to approximately €520 million had been put in place but less than 28 per cent (or €144 million) of these had been drawndown as at respective balance sheet dates. In addition, I-RES REIT entered into a *'pipeline agreement'* with a non-resident, related entity[11] in 2014. This €150 million facility terminated with the completion of the latter's Irish Stock Exchange floatation, however, it can potentially be reauthorised.

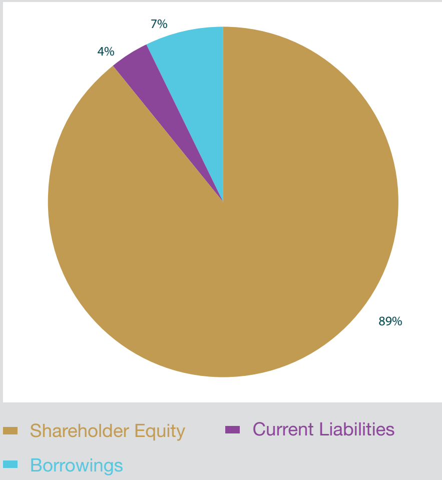
9 Shareholder equity consisting of share capital and premium, reserves and retained earnings

10 Total shareholder equity plus liabilities which includes current liabilities and borrowings

11 CAP-REIT limited partnership (CAP-REIT LP), a wholly owned subsidiary of CAP-REIT. Under the terms of this agreement, CAP-REIT LP made available up to €150 million to I-RES REIT which was used to acquire and hold properties on behalf of I-RES REIT until such time as the latter raised sufficient equity or debt capital to purchase these properties.

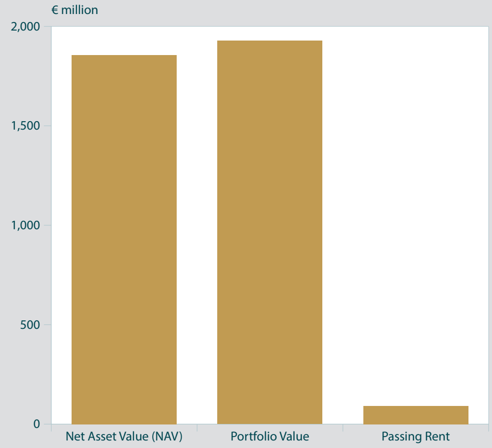
Box A: Real Estate Investment Trusts and the Property Sector in Ireland
By Dermot Coates and Aoife Moloney

Box A Chart 3: Decomposition of Cumulative Liabilities of the Irish-Listed REIT Sector, 2014/15



Source: Green REIT Annual Report 2015 (Balance Sheet date: 30/6/2015); Hibernia REIT Annual Report 2015 (Balance Sheet date: 31/3/2015); I-RES REIT Annual Report (July 2013-December 2014) (Balance Sheet date: 31/12/2014).

Box A Chart 4: Sample of Balance Sheet Metrics



Source: Green REIT Annual Report 2015 (Balance Sheet date: 30/6/2015); Hibernia REIT Annual Report 2015 (Balance Sheet date: 31/3/2015); I-RES REIT Annual Report (July 2013-December 2014) (Balance Sheet date: 31/12/2014).

Over the past two years, the REIT sector has established a significant property portfolio including some 1,500 apartments in addition to more than 40 investment assets spanning the office, retail and industrial sectors. These are primarily focussed on the Dublin region at this point. The cumulative Net Asset Value (NAV) – those assets attributable to shareholders – of these entities stood at €1.9 billion in 2014/15 while passing rent[12] for the Irish REIT entities totalled €92 million at their respective balance sheet dates (Chart 4). Finally, the REIT sector in Ireland posits the view that such entities can provide a route to market and an element of the deleveraging strategies for those banks – and NAMA – taking control of assets underlying non-performing loan portfolios. For instance, the Sapphire and Rockbrook portfolios were acquired by these entities between late 2014 and early 2015 at a total cost of approximately €465 million.

12 Annualised rental income being received on a cash basis as at a certain date. The figure for 'passing rent' shown in Chart 4 is the aggregate of the figures quoted in the respective Annual Reports.

Government

Financing conditions for the Irish Government continued to improve in recent months, as bond yields broadly remained on a downward trajectory. This has reflected the ongoing economic recovery in Ireland, as well as the continuation of the ECB's expansionary monetary policy, that has depressed euro area sovereign bond yields generally. Increased uncertainty related to developments in China as well as falling oil prices have contributed to a decline in global equity prices in early 2016. This, in turn, has caused further downward pressure on sovereign bond yields since the beginning of 2016. Chart 6 highlights how international developments have impacted Irish sovereign bond yields, and how the National Treasury Management Agency has raised funding during this recent period of low interest rates.

Chart 6: Irish Government Ten-Year Bond Yields

Source: Thomson Reuters.

Financial Sector

The funding position of Irish resident credit institutions improved throughout 2015, as evidenced by growth of 3.2 per cent in deposits from the resident private sector in the year ending January 2016. The net flow of private-sector deposits into resident credit institutions over this period was €5.5 billion, with the household sector accounting for 60 per cent of this. Reliance on funding from the Eurosystem almost halved over the same period, and amounted to just over €10 billion at end-January 2016. Interbank borrowing has also declined in both absolute and relative terms. Borrowing from other monetary financial institutions now accounts for just over a quarter of Irish resident credit institutions' funding profile, having fallen from around 40 per cent at the onset of the financial crisis. The role of interbank borrowing and lending is further explored in Box B.

The net asset value of money market funds (MMFs) resident in Ireland at end-December 2015 was €467 billion, an increase of 10 per cent since September 2015. This increase was driven by large investor inflows of €37 billion over the quarter, with €23 billion of this occurring in November 2015. This appears to have been in anticipation of the US interest rate move which occurred in December. Total debt securities held by MMFs increased to €371 billion in December. The increase was largely driven by €22 billion inflows into US debt securities, of which €17 billion were issued by the US government. In contrast, euro area debt securities holdings remained largely flat, with significant outflows from German and Dutch debt securities. These occurred during a period in which the ECB signalled its decision to leave interest rates unchanged as well as decreasing the deposit facility rate by 10 basis points to -0.3 per cent in December and extending the period of the asset purchase programme. All of these actions point to downward pressure on euro area yields that may persist for longer than previously thought.

The net asset value of investment funds (IFs) resident in Ireland increased by 6 per cent (€76 billion) in the final quarter of 2015, to €1,431 billion from €1,355 billion in Q3 2015. This was due to a mix of strong net inflows and a recovery in equity markets from their end-September lows. Investor inflows over Q4 2015 stood at €37 billion with equity funds accounting for €13 billion of this. Valuation changes arising from the recovery in equity prices contributed €49 billion to the increase in net asset values. Holdings of government debt stood at €298 billion in Q4 2015, with €13 billion in transaction inflows. There were strong inflows (€10 billion) into higher yielding UK government debt, relative to similarly rated other European sovereign debt. Prime euro area debt from Germany, France and the Netherlands recorded outflows of €864 million, amid expectations of low to negative yields persisting for a longer time frame. In terms of United States government debt, transactions and revaluations remained relatively flat despite an uptick in US yields after the Federal Reserve decision in December.

Box B: Banks and their Affiliates - Insights from Money and Banking Data

By Martina Sherman and Jennifer Dooley[13]

Banking groups undertake significant volumes of intergroup borrowing and lending with the aim of managing overall funding within the group. Individual units within a group can range from full service banking operations which primarily manage their own funding and assets, to specialised operations, which may solely raise money or manage assets for the broader group. Unlike group consolidated financial accounts, international statistical standards do not net out, or consolidate, these intergroup lending and borrowing activities. Given the scale of these intergroup borrowings, they have the potential to distort or cause confusion among users about the underlying dynamics in various funding markets (e.g. interbank lending). These can be particularly true in a banking system such as Ireland with a very large international banking community, and where the majority of banks are part of larger foreign banking groups.

The Central Bank of Ireland has recently begun to publish data on interbank affiliated lending and borrowing in the *Money and Banking Statistics*. These data series are available from the late 1990's so provide a useful insight into interbank and intergroup behaviour leading up to and during the financial crisis. The dataset also allows us to disaggregate by balance sheet instrument, counterpart residency, and examine the role of domestic banks within intergroup activities. This Box, therefore, aims to provide further detail on the Irish banking sectors' interaction with their group affiliates.

The financial crisis highlighted the importance of monitoring and examining banks' interaction with other sectors of the financial system, both domestically and internationally, given its implications for the real economy. We are now acutely aware that adverse developments or shocks in other financial sector jurisdictions can have negative consequences for our banking sector, which is exacerbated by inter-linkages between institutions. Research such as Liu and Quiet (2015)[14] notes that this interconnectedness is not necessarily always negative as it enables banks to transfer risk and raise funds, while Hallissey (2016)[15] notes that these inter-linkages can act as both a shock-absorber and shock-amplifier, depending on the level of interconnectedness.

Total interbank borrowing currently accounts for 26 per cent of all Irish resident credit institutions' funding profile (Chart 1). From the early 2000's, interbank lending fell considerably from in excess of 40 per cent of all liabilities, as new forms of non-bank wholesale funding became more widespread (i.e. securitisation). The level of interbank funding again increased rapidly as the crisis hit. Such developments are somewhat surprising, as during this period financial markets were very volatile and the interbank market was becoming increasingly aware of counterparty risk. Deeper analysis of the data to better understand the underlying dynamics, shows that the majority of this increase relates to interbank developments vis-à-vis overseas affiliates. On the assets side, despite a significant fall in outstanding stock from its peak in 2009, interbank lending relative to total assets, has remained close to 30 per cent since the crisis despite balance sheet contraction (Chart 1). The Irish resident banking sector includes a significant number of foreign-owned banks which rely more on interbank funding than traditional sources such as customer deposits.

13 Statistics Division, Central Bank of Ireland.

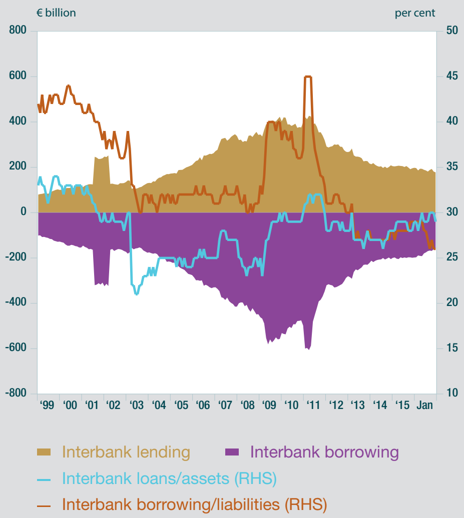
14 Liu, Z. and S. Quiet, (2015), 'Banking sector interconnectedness: what is it, how can we measure it and why does it matter?', Bank of England Quarterly Bulletin, Q2 2015.

15 Hallissey, N. (2016), 'Interconnectedness of the Irish banking sector with the global financial system', Central Bank of Ireland Quarterly Bulletin, Q1 2016.

Box B: Banks and their Affiliates - Insights from Money and Banking Data

By Martina Sherman and Jennifer Dooley

Box B Chart 1: Outstanding Stock of Irish Banks' Interbank Lending and Borrowing, and Stock Relative to Total Balance Sheet



Source: Money and Banking Statistics, Central Bank of Ireland.

Note: Data are reported on a gross basis and are not consolidated.

A high proportion of interbank funding relates to transactions between affiliated banks, with the most recent data showing that 78 per cent, or €123 billion, of outstanding interbank deposits are intergroup positions. Furthermore, almost two-thirds of this intergroup funding comes from non-Irish affiliated credit institutions. The share has varied between 55 and 70 per cent since the crisis. As highlighted previously, this is reflective of the high number of foreign-owned banks in Ireland. Interestingly, there has been a steady increase in the share of domestically sourced intergroup funding from 10 per cent in 2002, to over a third by 2007. As the data are not consolidated, this possibly reflects market competition developments during this period of economic expansion.

In addition to interbank-intergroup information, the *Money and Banking Statistics* include data on non-bank affiliates; i.e. where the parent or subsidiary of the group is not a credit institution but a private-sector entity. At end-January 2016, €25 billion was outstanding in intergroup deposits with non-banks. This translates into a quarter of total liabilities, or almost 40 per cent of total Irish banking sector deposits relating to intergroup positions. The counterpart split for inter-group deposits is currently 83 per cent with affiliated banks, and 17 per cent with affiliated private-sector entities. Most of these private-sector entities are other financial intermediaries (OFIs).

In terms of developments over time, we can see from Chart 2, which shows the 12-month net flow of funds, that total intergroup activities accounted for the majority of net outflows in total deposits between 2009 and 2013 – as repayments of borrowings outstripped funding. This follows strong intergroup funding between 2007 and 2008, which was required in the absence of net private-sector deposit inflows.

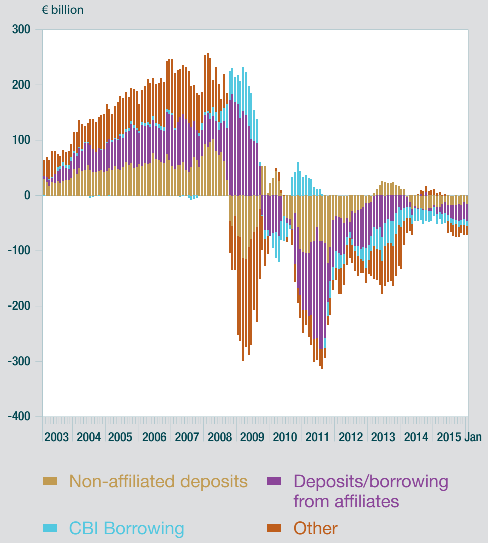
We can also look at developments between both Irish-owned and foreign-owned Irish resident banks. Foreign-owned Irish resident banks source almost a third of their funding (total balance sheet) from intergroup entities, with the majority coming from non-Irish euro area banks and corporations. It can be seen from Chart 3 that this trend was evident throughout the crisis where foreign-owned banks based here had access to large amounts of funding in the build-up and initial onset of the crisis. Intergroup support peaked during 2008 and 2009, at a time when euro area interbank market conditions were difficult. As regards the Irish-owned banks', some of the increase in intergroup activity is reflective of mergers in the Irish banking sector. As the data are not consolidated, group positions are not netted out; for example, when AIB acquired EBS, any positions between the two entities would show up as intergroup loans and deposits with an Irish banking affiliate.

While domestic-owned banks source almost half of their funding from unaffiliated deposits, the Irish banking sector as a whole could be exposed to certain risks, given foreign-owned banks interaction with non-Irish affiliates. Lane (2015)[16] found that the dependence of foreign-owned banks on net foreign deposit funding, which is mainly short-term, increased from 2007 onwards at the expense of longer-term net foreign securities (bonds) funding.

Box B: Banks and their Affiliates - Insights from Money and Banking Data

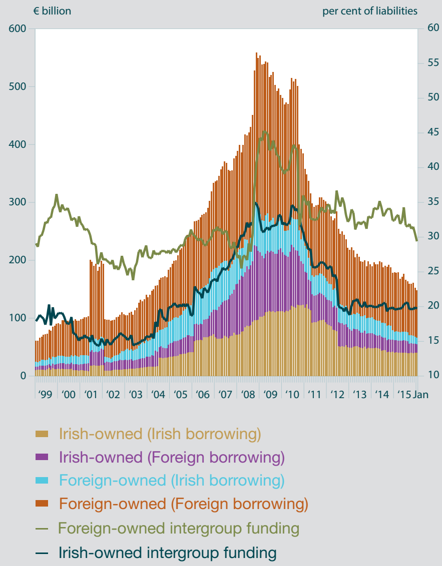
By Martina Sherman and Jennifer Dooley

Box B Chart 2: Funding Developments, Net Flows (12-Month Sum)



Source: Money and Banking Statistics, Central Bank of Ireland.

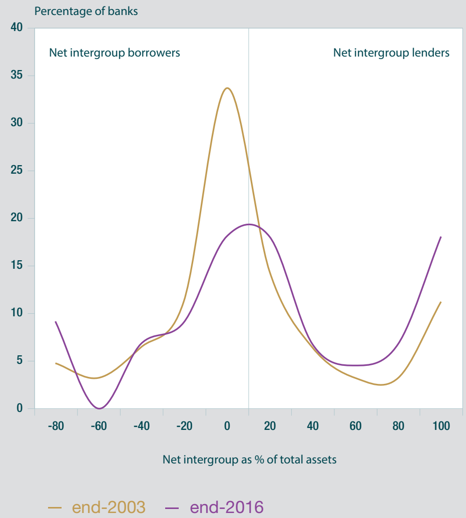
Box B Chart 3: Total Intergroup Borrowing of Irish Banks, by Residency of Counterpart



Source: Money and Banking Statistics, Central Bank of Ireland.

Understanding the aggregate developments is assisted by understanding the funding profile of the various individual banks in Ireland and the changing nature of these activities over time. Given the large international banking sector in Ireland, there are a number of banks that undertake specialised functions on behalf of their parent groups. For example, a bank in Ireland may solely manage liability or funding operations and subsequently lend the funds to other parts of the banking group for onward lending. In the early 2000's, just under two-thirds of foreign-owned Irish resident banks' had larger net intergroup liabilities than net asset positions (relative to total assets), i.e. they were net borrowers from their group. By early 2016 this position had partially reversed, with over half of Irish resident foreign-owned banks now net lenders to their group (Chart 4). The most recent data also show an increase in the percentage of banks whose net intergroup lending is between 80 and 100 per cent of their total assets, indicating their sole purpose is the funding of their group. Many of these banks are internationally-focused IFSC resident banks who do not engage in lending to the Irish real economy, and whose main funding is from non-Irish residents.

Box B Chart 4: Net Intergroup Position of Foreign-Owned Banks, Percentage of Banks



Source: Money and Banking Statistics, Central Bank of Ireland.

Note: The net intergroup position is calculated as affiliated loan assets minus affiliated deposit liabilities.

16 Lane, P. (2015), 'The funding of the Irish Domestic Banking System during the Boom', Journal of the Statistical and Social Inquiry Society of Ireland, Vol. XLIV.