Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

# Central Bank of Ireland
# **Financial Stability Review 2023:I**

June 2023

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# Notes

1. Unless otherwise stated, this document refers to data available on 19 May 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 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 and Macroprudential Measures 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 agus ón gCoiste um Bearta Macrastuamachta 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

**Since the last *Review*, global financial risks have increased, as the financial system has continued its sometimes turbulent adjustment to persistently high inflation and the necessary monetary policy response. Vulnerabilities built up in segments of the global financial system during a decade of low interest rates have been exposed, as evidenced most forcefully by the failures in March of a number of US banks and Credit Suisse. Given the uncertainty around the outlook for inflation, further market volatility remains a key risk, which could be amplified by the behaviour of non-bank financial institutions. While the outlook for the global real economy is broadly stable since the last *Review*, significant downside risks remain.**

**Domestically, despite growing international risks, the central outlook for the Irish economy has improved since the last *Review*, owing to the easing of energy price pressures and ongoing strength in the labour market. Nonetheless, the erosion of real incomes and the lagged transmission of higher monetary policy rates continue to pose downside risks to the economy. There remains uncertainty and significant downside risks related to borrowers' repayment capacity amid rising interest rates, particularly in commercial real estate (CRE) markets.**

**Households and businesses are, in aggregate, proving resilient to the inflationary shock so far, owing in part to the significant reduction in private indebtedness over the past decade. Domestic banks currently have headroom above regulatory capital and liquidity requirements which provides capacity to absorb shocks, while profitability is expected to increase through the interest margin channel. In this context, the Central Bank is continuing as indicated in December to increase the CCyB from 1 to 1.5 per cent. This will contribute to the resilience of the banking system to adverse shocks.**

After a decade of low interest rates, global financial markets remain vulnerable to the ongoing adjustment to a higher interest rate environment. Since the last *Review*, vulnerabilities built up in segments of the global banking system over a number of years have been exposed, as evidenced by the failures of a number of regional US banks and Credit Suisse. These events have served as a reminder of the importance of the resilience of the banking system, especially in an environment where interest rates are rising globally to ensure inflation returns back to target. Uncertainty over the path for inflation and, by extension, key central bank policy rates remains elevated.

Globally, pockets of non-bank financial intermediaries remain vulnerable to further disorderly adjustments. While market attention has focussed on banks, and in particular small and mid-sized US banks in recent months, pockets of global non-bank financial intermediaries remain susceptible to further volatility. The 2022 UK gilt market episode was a prominent example of the speed with which risks can crystallise in this sector. Market liquidity in a range of equity and fixed-income markets is low relative to historical norms, posing further risks of volatility and amplification.

The global economy is subject to downside risks, including more persistent inflation or further financial system stresses that could lead to tighter credit supply. Inflation has been more persistent than previously expected, with continued uncertainty about the likely path for a return to target. Stubbornly high inflation, and the prospect of "higher for longer" interest rates in response, are weighing on the global growth outlook, particularly where debt burdens were high entering this shock. Higher bank funding costs and a change in risk appetite present the prospect

of tighter credit supply conditions in many developed economies. Geopolitical risks relating to further fragmentation of the global economy also weigh on the outlook for growth and inflation.

Global real estate markets appear particularly sensitive to the shift to higher interest rates. Real estate markets are at the nexus of risks associated with financial markets and the real economy, and have been particularly responsive to the global monetary policy tightening cycle so far, due to high levels of indebtedness and overvaluations. The real estate sector is unique in its reach into wide swathes of the economy and financial system, for example to bank balance sheets, investment fund portfolios, structured finance products, and collateral values and borrowing capacity for households and businesses.

**Key risks facing the Irish macro-financial system**

- **The global economy is subject to downside risks stemming from high inflation, further tightening of financial conditions and geopolitical fragmentation.**
- **The global financial system remains vulnerable to disorderly market adjustments after a decade of elevated risk-taking, as evidenced by recent turbulence in the banking system.**
- **Domestically, persistent inflation and higher interest rates could lead to slower growth and expose vulnerabilities, particularly in CRE markets.**

The Irish economy's performance has been unexpectedly strong since the last *Review*. The Irish economy is proving resilient. Despite growing international uncertainty, the easing of energy price pressure and strong wage and employment growth have meant that real incomes are being partly restored relative to 2022. Record corporation tax receipts are providing more fiscal space than previously expected. As measured by Modified Domestic Demand, the economy is expected to grow by 3 per cent this year and next, with a further restoration of real incomes expected.

Despite a strong central outlook, persistent inflation and higher interest rates pose risks of an economic slowdown which could expose vulnerabilities. The Irish economy remains vulnerable to the risk of persistently high inflation and the lagged cumulative effect of the accompanying increase in interest rates. Weakness in global trading partners may contribute to a slowdown in growth, while any difficulties among the largest multinational enterprises present in Ireland would have severe implications for the fiscal position. Credit supply tightening also remains a risk, in the event that Irish banks were to experience spillovers from wider global banking challenges, for example through increased funding costs.

Domestic risks relating to higher interest rates have manifested most visibly and immediately in the CRE market. In line with the deteriorating global environment, Irish CRE prices have fallen 9.4 per cent in the year to end-March. While further price falls in CRE markets would pose risks to borrowers, and downside risks cannot be ignored, the knock-on effects for the banking system and wider economy appear at this stage to be relatively contained. In residential markets, where weak supply may somewhat mitigate the magnitude of price falls, increases in mortgage interest rates are starting to slow demand and have contributed to a flattening in house prices in recent months.

In line with the macroeconomic picture, Irish households and businesses have proven resilient to the inflationary shock so far. While real incomes have fallen for many, nominal income growth has been strong and will support debt service capacity of mortgage borrowers. In aggregate, household financial distress is expected to rise modestly based on the current trajectory for the economy, although that aggregate picture masks greater challenges amongst some cohorts of

borrowers. Irish SMEs appear to have been mostly passing on their cost increases to customers, with minimal adverse effects on revenues up to late 2022. Profit margins have held steady or slightly increased, despite the size of the energy price shock. The reduction in household and SME indebtedness over the past decade is supporting resilience to rising interest rates.

The banking system has capacity to absorb potential future shocks, while banking sector profits continue to grow due to higher interest rates. Irish bank profits are growing due to increased net interest income. While costs stemming from increased risks to borrowers could rise, particularly in CRE, the expectation is for continued profitability of the sector in the baseline macro-economic scenario. Capital and liquidity buffers, which are high relative to minimum requirements and strong in a European context, support banks' capacity to absorb adverse shocks. Recent events in the global banking system highlight the speed with which market sentiment can turn, underscoring the unpredictability of sources of risk in the current environment.

Non-bank lenders are showing signs of a more rapid retrenchment in credit supply, most visibly in the mortgage market. Given their reliance on market financing, non-banks have retrenched credit supply rapidly from the mortgage market, while also appearing more responsive to higher interest rates in the market for lending to real estate SMEs. Lending by non-banks to other SME sectors has proven more resilient.

The Irish sovereign is benefiting from strong growth in tax revenue, and a favourable cash position and maturity profile. Despite rising global interest rates, which have raised the cost of sovereign borrowing, debt dynamics are favourable. The headline fiscal position, both in terms of primary budget balances and debt relative to the size of the economy, has improved since the last *Review*. The strength of the economy is supporting this fiscal outlook, however the concentration of corporate tax receipts among a small number of large companies necessitates prudent fiscal planning to ensure the exchequer is resilient to a rapid, unexpected turnaround in these inflows.

The Central Bank is announcing an increase in the CCyB rate from 1 to 1.5 per cent, effective from June 2024. The Central Bank has been gradually building the CCyB rate since June 2022. Capital buffers provide resilience to the potential materialisation of future shocks and provide scope for their release so that banks can maintain the supply of lending when risks materialise. The existing capital headroom of the banking sector and its profitability outlook mean that the CCyB increase is not expected to have a material effect on credit conditions.

Reflecting the scale of the sector in Ireland and the growing connections to the domestic economy, developing macroprudential policy for non-banks is a key priority for the Central Bank. 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. The Central Bank is also working with international partners to develop a macroprudential framework for investment funds. To further advance discussion and progress in this area, a Central Bank Discussion Paper will outline an approach to macroprudential policy for funds in the coming weeks and will be seeking stakeholder feedback in the months ahead.

# Forbhreathnú

**Ó foilsíodh an t*Athbhreithniú* deireanach, tá méadú tagtha ar rioscaí airgeadais domhanda de réir mar atá an córas airgeadais ag dul in oiriúint, ar bhealach suaite in amanna, don bhoilsciú leanúnach ard agus don fhreagairt riachtanach beartais airgeadais. Nochtadh leochaileachtaí a bhí carntha i ndeighleoga den chóras airgeadais domhanda le linn na tréimhse deich mbliana nuair a bhí rátaí ísle úis i réim, rud a chonacthas go soiléir le cliseadh banc éagsúil sna Stáit Aontaithe i mí an Mhárta agus le cliseadh Credit Suisse. I bhfianaise na héiginnteachta a bhaineann leis an ionchas do bhoilsciú, tá luaineacht bhreise margaidh ina príomhriosca i gcónaí, agus d'fhéadfadh iompar institiúidí airgeadais neamhbhainc cur leis an riosca sin. Cé go bhfuil an t-ionchas don fhíorgheilleagar domhanda cobhsaí, tríd is tríd, ó foilsíodh an t*Athbhreithniú* deireanach, tá rioscaí suntasacha ar an taobh thíos ann i gcónaí.**

**D'ainneoin rioscaí méadaitheacha idirnáisiúnta, tá an t-ionchas príomha do gheilleagar na hÉireann feabhsaithe ó foilsíodh an *tAthbhreithniú* deireanach, rud atá inchurtha don laghdú ar an mbrú ar phraghsanna fuinnimh agus do neart leanúnach an mhargaidh saothair. Dá ainneoin sin, is rioscaí ar an taobh thíos don gheilleagar iad an laghdú ar fhíorioncam agus tarchur moillithe rátaí beartais airgeadais níos airde. Tá éiginnteacht agus rioscaí suntasacha ar an taobh thíos ann i gcónaí maidir le cumas aisíocaíochta iasachtaithe i bhfianaise rátaí méadaitheacha úis, go háirithe i margaí réadmhaoine tráchtála.**

**Is cosúil go bhfuil teaghlaigh agus gnóthaí athléimneach, trí chéile, i leith na turrainge boilscithí go dtí seo, rud atá inchurtha go páirteach don laghdú suntasach ar fhéichiúnas príobháideach le deich mbliana anuas. Faoi láthair, tá lamháltas ag na bainc mhiondíola intíre os cionn na gceanglas rialála caipitil agus leachtachta, rud a chuireann ar a gcumas turraingí a sheasamh, fad a mheastar go méadóidh brabúsacht trí chainéal na gcorrlach úis. Sa chomhthéacs seo, tá an Banc Ceannais ag leanúint den Chúlchiste Fritimthriallach a ardú ó 1 go 1.5 faoin gcéad, mar a cuireadh in iúl i mí na Nollag. Cuirfidh sé seo le hathléimneacht an chórais baincéireachta i leith turraingí díobhálacha.**

Tar éis deich mbliana de rátaí úis níos ísle, tá margaí airgeadais domhanda leochaileach i gcónaí don oiriúnú leanúnach do thimpeallacht rátaí úis níos airde. Ó foilsíodh an t*Athbhreithniú* deireanach, nochtadh leochaileachtaí a bhí carntha i ndeighleoga den chóras airgeadais domhanda thar roinnt blianta, rud a chonacthas go soiléir le cliseadh banc réigiúnach éagsúil sna Stáit Aontaithe agus le cliseadh Credit Suisse. Cuireann na himeachtaí seo i gcuimhne dúinn an tábhacht a bhaineann le hathléimneacht an chórais baincéireachta, go háirithe i dtimpeallacht ina bhfuil rátaí úis ag méadú ar fud an domhain, chun a chinntiú go bhfillfidh boilsciú ar an sprioc. Tá an éiginnteacht a bhaineann le conair an bhoilscithe agus, dá réir sin, príomhrátaí bainc ceannais, ardaithe i gcónaí.

Ar fud an domhain, tá idirghabhálaithe airgeadais neamhbhainc anseo is ansiúd leochaileach i gcónaí do choigeartuithe mí-ordúla breise. Cé go raibh aird an mhargaidh dírithe ar bhainc, agus go háirithe ar bhainc bheaga agus mheánmhéide sna Stáit Aontaithe le míonna beaga anuas, tá idirghabhálaithe airgeadais neamhbhainc anseo is ansiúd ar fud an domhain atá soghabhálach go fóill i leith luaineacht bhreise. Ba léiriú maith é an méid a tharla in 2022 le margadh ceannasach na RA ar cé chomh tapa is a thagann rioscaí chun cinn san earnáil seo. Tá leachtacht mhargaidh i raon margaí cothromais agus ioncaim sheasta íseal i gcomparáid le noirm stairiúla, rud a chruthaíonn rioscaí breise maidir le luaineacht agus géarú.

Tá an geilleagar domhanda faoi réir rioscaí ar an taobh thíos, lena n-áirítear boilsciú níos seasmhaí nó strus breise ar an gcóras airgeadais ar dóigh dóibh soláthar creidmheasa a ghéarú. Tá boilsciú níos seasmhaí ná mar a bhíothas ag súil leis agus tá éiginnteacht ann i gcónaí maidir leis an gconair chun filleadh ar an sprioc. Tá boilsciú leanúnach ard, mar aon leis an bhféidearthacht go bhfreagrófar dó le rátaí úis "níos airde ar feadh tréimhse níos faide", ag cur isteach ar an ionchas d'fhás domhanda, go háirithe i gcás ina raibh ualaigh fiachais arda ann sular thosaigh an turraing seo. Le costais maoiniúcháin níos airde do na bainc agus le hathrú ar fhonn riosca, tá an fhéidearthacht ann go mbeidh dálaí soláthair creidmheasa níos déine ann in go leor geilleagar forbartha. Tá rioscaí geopholaitiúla maidir le hilroinnt bhreise an gheilleagair dhomhanda ag cur isteach freisin ar an ionchas d'fhás agus do bhoilsciú.

Is cosúil go gcuireann an t-aistriú chuig rátaí úis níos airde isteach go háirithe ar mhargaí réadmhaoine domhanda Tá margaí réadmhaoine i gcroílár na rioscaí a bhaineann le margaí airgeadais agus leis an bhfíorgheilleagar, agus bhíodar thar a bheith freagrúil don timthriall ghéaraithe ar bheartas airgeadaíochta domhanda go dtí seo, de bharr ardleibhéil féichiúnais agus ró-luachálacha. Tá tionchar uathúil ag an earnáil réadmhaoine ar stráicí leathana den gheilleagar agus den chóras airgeadais, mar shampla ar chláir chomhardaithe na mbanc, ar phunanna cistí infheistíochta, ar tháirgí airgeadais struchtúrtha, agus ar luachanna comhthaobhachta agus ar chumas iasachtaithe teaghlach agus gnóthaí.

**Príomhrioscaí atá ag bagairt ar chóras macra-airgeadais na hÉireann**

- **Tá an geilleagar domhanda faoi réir rioscaí ar an taobh thíos a eascraíonn as boilsciú ard, as géarú breise ar dhálaí airgeadais agus as ilroinnt gheopholaitiúil.**
- **Tá an córas airgeadais domhanda leochaileach i gcónaí do choigeartuithe mí-ordúla margaidh i ndiaidh deich mbliana de ghlacadh ardaithe riosca, mar a léiríodh leis an tsuaiteacht le déanaí sa chóras airgeadais.**
- **Sa chríoch bhaile, d'fhéadfadh go mbeadh fás níos moille ann agus go nochtfaí leochaileachtaí, go háirithe i margaí réadmhaoine tráchtála, mar gheall ar bhoilsciú seasmhach agus rátaí úis níos airde.**

Ó foilsíodh an t*Atbhreithniú* deireanach, tá feidhmíocht gheilleagar na hÉireann níos láidre ná mar a bhíothas ag súil leis. Tá sé cruthaithe ag geilleagar na hÉireann go bhfuil sé athléimneach. D'ainneoin éiginnteacht mhéadaitheach idirnáisiúnta, ciallaíonn an maolú ar bhrúnna ar phraghas an fhuinnimh agus an fás láidir ar phá agus ar fhostaíocht go bhfuil fíorioncam tugtha ar ais go páirteach chuig leibhéal 2022. Tá níos mó solúbthachta fioscaí ann ná mar a bhíothas ag súil leis, rud atá inchurtha d'fháltais ab airde riamh ó cháin chorparáide. Meastar go dtiocfaidh fás 3 faoin gcéad ar an ngeilleagar i mbliana agus an bhliain seo chugainn, arna thomhas le hÉileamh Modhnaithe Intíre, agus meastar go ndéanfar fíorioncam a athbhunú tuilleadh.

D'ainneoin ionchas príomha láidir, tá an baol ann go dtarlóidh moilliú eacnamaíoch, rud a d'fhéadfadh leochaileachtaí a nochtadh, de bharr boilsciú leanúnach agus rátaí úis níos airde. Tá geilleagar na hÉireann leochaileach i gcónaí don riosca maidir le boilsciú leanúnach ard agus d'éifeacht charnach mhoillithe an mhéadaithe tionlacain ar rátaí úis. Féadfaidh go gcuirfidh laigeacht páirtithe trádála domhanda le moilliú ar fhás, fad a bheadh impleachtaí tromchúiseacha ag aon deacrachtaí i measc na bhfiontar ilnáisiúnta is mó in Éirinn don staid fhioscach. Tá géarú soláthair creidmheasa ina riosca i gcónaí, i gcás ina mbeadh iarmhairtí ag dúshláin baincéireachta dhomhanda níos leithne ar na bainc Éireannacha, mar shampla trí chostais mhéadaithe maoiniúcháin.

Na rioscaí intíre a bhaineann le rátaí úis níos airde, tá siad tagtha chun cinn go mór mór sa mhargadh réadmhaoine tráchtála. I gcomhréir leis an timpeallacht dhomhanda atá ag dul in olcas, tá laghdú 9.4 faoin gcéad tagtha ar phraghsanna réadmhaoine tráchtála sa bhliain suas go dtí deireadh Mhárta. Cé go mbeadh laghduithe breise ar phraghsanna i margaí réadmhaoine tráchtála ina riosca d'iasachtaithe, agus cé nach féidir neamhaird a thabhairt ar rioscaí ar an taobh thíos, is cosúil go bhfuil na hiarmhairtí iarmhartacha ar an gcóras baincéireachta agus ar an ngeilleagar níos leithne sách srianta ag an bpointe seo. I margaí cónaithe, áit a bhféadfaidh soláthar lag méid na laghduithe ar phraghsanna a mhaolú go pointe, tá moilliú ag teacht ar éileamh de bharr méaduithe ar rátaí úis morgáiste agus tá na méaduithe sin ag cur le cothromú praghsanna tithe le míonna beaga anuas.

I gcomhréir le cúrsaí maicreacnamaíocha, tá sé cruthaithe ag teaghlaigh agus gnóthaí na hÉireann go bhfuil siad athléimneach i leith na turrainge boilscithí go dtí seo. Cé go bhfuil laghdú tagtha ar fhíorioncam go leor daoine, bhí fás láidir ar ioncam ainmniúil, rud a thacóidh le cumas seirbhísithe na n-iasachtaithe morgáiste. Ar an iomlán, meastar go dtiocfaidh méadú beag ar anás airgeadais na dteaghlach bunaithe ar chonair reatha an gheilleagair ach, leis an bpictiúr sin, ceiltear na dúshláin níos mó atá roimh ghrúpaí iasachtaithe áirithe. Is cosúil go raibh na méaduithe ar chostais FBManna Éireannacha á gcur ar aghaidh acu chuig a gcuid custaiméirí agus ba bheag na héifeachtaí díobhálacha a bhí ar a n-ioncam suas go deireadh 2022. Bhí corrlaigh bhrabúis socair nó tháinig méadú beag orthu fiú, d'ainneoin mhéid na turrainge ar phraghas an fhuinnimh. Tá an laghdú ar fhéichiúnas teaghlach agus FBManna le deich mbliana anuas ag tacú leis an athléimneacht i leith rátaí méadaitheacha úis.

Tá cumas ag an gcóras baincéireachta turraingí ionchasacha amach anseo a sheasamh, fad a leanann an méadú ar bhrabúis na hearnála baincéireachta de bharr rátaí úis níos airde. Tá brabúis na mbanc Éireannach ag méadú de bharr glanioncam úis méadaithe. Cé go bhféadfaidh go dtiocfaidh méadú ar chostais a eascraíonn as rioscaí méadaithe d'iasachtaithe, go háirithe i réadmhaoin tráchtála, meastar sa chás bonnlíne maicreacnamaíoch go leanfaidh brabúsacht na hearnála. Tacaíonn maoláin chaipitil agus leachtachta, atá sách ard i gcoibhneas le ceanglais íosta agus láidir i gcomhthéacs Eorpach, le cumas na mbanc turraingí díobhálacha a sheasamh. Leis na himeachtaí le déanaí sa chóras baincéireachta domhanda, léirítear cé chomh tapa is a bhíonn seintimint an mhargaidh in ann athrú, rud a leagann béim ar neamh-intuarthacht foinsí riosca sa timpeallacht reatha.

Tá comharthaí ann go bhfuil iasachtóirí neamhbhainc ag gearradh siar ar sholáthar creidmheasa ar bhonn níos tapúla, go mór mór sa mhargadh morgáiste. I bhfianaise a spleáchais ar mhaoiniúchán margaidh, tá neamh-bhainc tar éis soláthar creidmheasa a ghearradh siar go tapa ón margadh morgáiste, agus is cosúil go bhfuil siad níos freagrúla do rátaí úis níos airde sa mhargadh le haghaidh iasachtú le FBManna réadmhaoine. Is cosúil go bhfuil iasachtú ag neamh-bhainc le hearnálacha FBM eile níos athléimní.

Tá bannaí ceannasacha na hÉireann ag tairbhiú d'fhás láidir ar ioncam cánach, agus de staid fhabhrach airgid agus de phróifíl aibíochta. D'ainneoin rátaí méadaitheacha úis domhanda a bhfuil costas na hiasachtaíochta ceannasaí méadaithe acu, tá dinimic fiachais fabhrach. Ó foilsíodh an t*Athbhreithniú* deireanach, tá feabhas tagtha ar an staid fhioscach phríomha, i dtéarmaí príomh-iarmhéideanna buiséid agus fiachais i gcoibhneas le méid an gheilleagair. Tá neart an gheilleagair ag tacú leis an ionchas fioscach seo, ach de bharr comhchruinniú fáltas ó cháin chorparáide i measc

líon beag cuideachtaí móra, tá gá le pleanáil fhioscach stuama chun a chinntiú go mbeidh an státchiste athléimneach i leith athrú gan choinne ar na hinsreafaí seo.

Tá méadú ar ráta CCyB á fhógairt ag an mBanc Ceannais ó 1 go 1.5 faoin gcéad, le héifeacht ó mhí an Mheithimh 2024. Tá méadú de réir a chéile á dhéanamh ag an mBanc Ceannais ar ráta CCyB ó mhí an Mheithimh 2022 i leith. Cuireann maoláin chaipitil athléimneacht ar fáil i leith turraingí a d'fhéadfadh teacht chun cinn amach anseo agus cuireann siad deis ar fáil chun iad a scaoileadh sa chaoi go bhféadfaidh bainc soláthar na hiasachtaíochta a choimeád ar bun nuair a thiocfaidh rioscaí chun cinn. I bhfianaise lamháil chaipitil reatha na hearnála baincéireachta agus an ionchais dá brabúsacht, ní dóigh go mbeidh éifeacht ábhartha ag scaoileadh CCyB ar dhálaí creidmheasa.

I bhfianaise scála na hearnála in Éirinn agus na nasc méadaitheach leis an ngeilleagar intíre, is príomhthosaíocht don Bhanc Ceannais é beartas macrastuamachta a fhorbairt do neamh-bhainc. Is iad na bearta beartais macrastuamachta do chistí réadmhaoine arna bhfógairt i mí na Samhna 2022 na bearta tosaigh faoin tríú colún de chreat macrastuamachta an Bhainc Ceannais, i ndáil le neamh-bhainc. Tá an Banc Ceannais ag obair le páirtithe idirnáisiúnta freisin chun creat macrastuamachta a fhorbairt do chistí infheistíochta. D'fhonn plé agus dul chun cinn sa réimse seo a chur chun cinn, foilseofar Plépháipéar de chuid an Bhainc Ceannais sna seachtainí atá romhain ina leagfar amach cur chuige maidir le beartas stuamachta do chistí agus lorgófar aiseolas ó pháirtithe leasmhara sna míonna atá le teacht.

# Risk Assessment

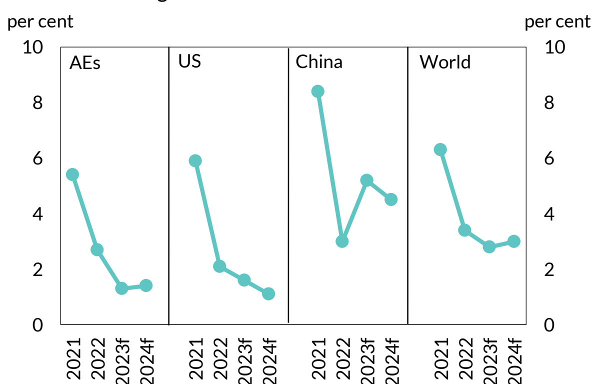
## *Global risk assessment*

*The recent turmoil in the global banking system highlights the risk that pockets of vulnerabilities in the financial system can be exposed as the global economy adjusts to higher inflation and rising interest rates. Uncertainty regarding the future path of inflation and interest rates has contributed to volatility in financial markets, which is likely to continue amid poor market liquidity in many market segments and may be amplified by the activities of non-banks. Headline inflation rates have eased but core inflation remains particularly high. This macro-financial context has led to elevated risks of a slowdown in the economies of many of Ireland's key trading partners. Difficulties in global real estate markets are the most prominent example of the interlocking connections between difficulties in financial markets and the real economy in this environment, with stretched valuations, over-indebtedness and increased interconnectedness exposing global property markets in this high interest-rate environment.*

The recent turmoil in the global banking system highlights the ongoing challenge of adjusting to higher inflation and rising interest rates. The collapse in March of Silicon Valley Bank and Signature Bank of New York was a strong reminder of how the sudden tightening of financial conditions after a decade of low rates can expose underlying vulnerabilities. The forced merger of Credit Suisse – a global systemically important bank in Europe – and UBS led to a period of increased financial market volatility (see Box B for a more detailed analysis of domestic banks in this context). Perceived risks surrounding the health of banks have increased and contributed to elevated levels of uncertainty. Further financial market volatility could undermine an already relatively weak global economic outlook (Chart 1), particularly if recent banking tensions were to re-emerge and/or lead to a significant worsening of credit conditions. The euro area Bank Lending Survey (BLS) had already pointed to a tightening of lending standards for firms and households before the recent tensions began. Despite an improvement in global market sentiment recently, depositors in the US have continued to shift assets from banks into money-market funds, availing of higher returns, adding to the tightening of credit conditions in the US.

**Chart 1: The global economic outlook remains weak for most regions, particularly for advanced economies**

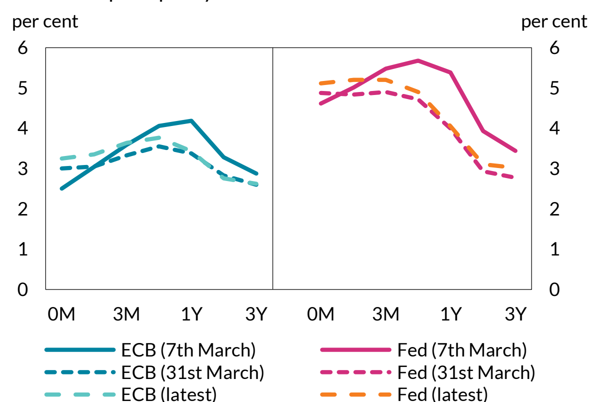
IMF's economic growth forecast




Source: IMF World Economic Outlook, April 2023.
Notes: 'AEs' refers to advanced economies.

**Chart 2: Monetary policy rate expectations shifted downward following the global banking turmoil**

Market implied policy rates for the ECB and Fed



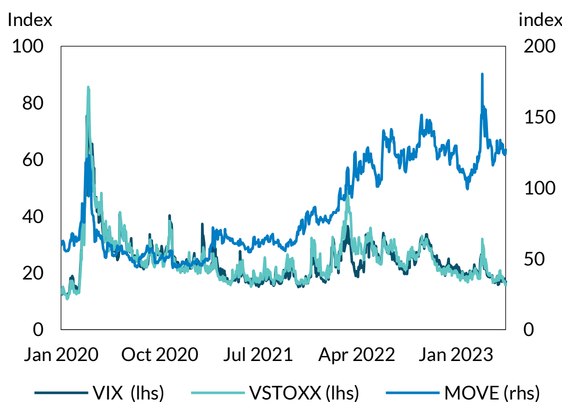

Source: Bloomberg.
Notes: Latest data show market expectations of policy rates as at 19 May 2023. The dates in March capture the fall in market implied interest rate expectations in the immediate aftermath of the banking turmoil. The ECB rate refers to the deposit facility rate.

The path of inflation, and the necessary monetary-policy response, is highly uncertain, increasing the risk of misalignment between market expectations and central bank actions. At the start of March, interest-rate expectations in advanced economies were broadly aligned with central bank communications regarding the need to keep monetary policy sufficiently restrictive to ensure price stability. However, the emergence of stress in financial markets in March led to a significant reassessment of monetary policy rate expectations, particularly in the US (Chart 2). Continued uncertainty over the path of inflation in the euro area, and in particular the persistently high levels of core inflation, have led to recent increases in near-term interest-rate expectations, and the risk of further abrupt shifts in market pricing of future interest rates.

Uncertainty in the path of inflation and interest rates has fuelled volatility in asset markets. Volatility in asset markets is elevated and expected to persist in the near term, particularly in fixed-income markets (Chart 3). This is largely driven by investors continuing to adjust their portfolios in response to changing inflationary conditions and evolving expectations around the path of monetary policy. Despite the fact that, for the most part, markets have adapted to changing conditions in an orderly manner, the recent global banking system turmoil and on-going level of uncertainty increases the susceptibility of global asset markets to shocks. High levels of global indebtedness, both public and private, may also amplify the effects of market stress. Although a wide-spread disorderly market correction leading to contagion across asset classes has not manifested, it still remains a possible source of disruption of financing for the real economy. Furthermore, there has been an unusually strong co-movement in prices across a wide range of asset classes in recent months. This complicates diversification strategies - making it harder to diversify away idiosyncratic or asset class risks - increasing systemic market risk. Entities with higher levels of leverage – built up during times of easier financing conditions – will be more vulnerable to these risks.

**Chart 3: Fixed income market volatility jumped to high levels in March**

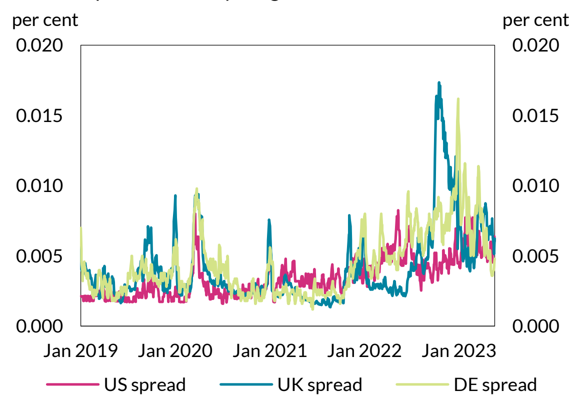
VIX, VSTOXX and MOVE indices




Source: CBOE via Bloomberg and BofA Securities via Eikon Datastream.
Notes: The VIX index measures 30-day expected equity market volatility of the US stock market while the VSTOXX index measures 30-day equity market volatility based on the EuroStoxx 50 index. The MOVE index measures expected bond market volatility by tracking US Treasury options. Last observation 19 May 2023.

**Chart 4: Market liquidity conditions have deteriorated**

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. Data show a five day rolling average for spreads. Last observation 19 May 2023.

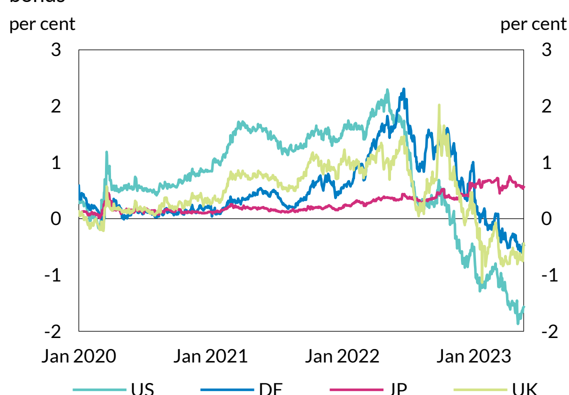
Liquidity has been exceptionally poor in both fixed-income and equity markets, including US treasuries. Heightened fixed-income market uncertainty has made already shallow market depth even shallower across all maturities. Bid-ask spreads in US Treasury, German Bunds, and UK Gilt markets have widened sharply (Chart 4). Additionally, the ongoing process of central bank balance

sheet reduction (quantitative tightening) could also have an impact on market liquidity, and could put strains on sovereign debt markets amid high indebtedness in many countries and low market liquidity. This comes at a time when sovereign yield curves are already inverted in many major economies, which may reflect concerns about a potential deterioration in economic conditions (Chart 5).[1] The lack of liquidity can result in significant price movements, and can cause significant losses and also trigger margin calls leading to further asset sales and potentially creating a self-reinforcing loop.

In pockets of the non-bank financial intermediation sector, existing vulnerabilities could amplify market shocks. Liquidity mismatches, leverage and interconnectedness are key potential sources of vulnerability in non-bank financial intermediaries.[2] Significant price movements could be amplified by these existing vulnerabilities and cause disruptions and spillovers across markets. Such dynamics could potentially lead to broader financial stability concerns, as evidenced by the September 2022 episode in the UK Gilt market, where the Bank of England had to intervene in the face of vulnerabilities in LDI funds (see Box D, *Policy: Non-banks*, for a discussion of recent developments relating to GBP LDI funds).[3]

**Chart 5: Sovereign yield curves are inverted in many major economies**

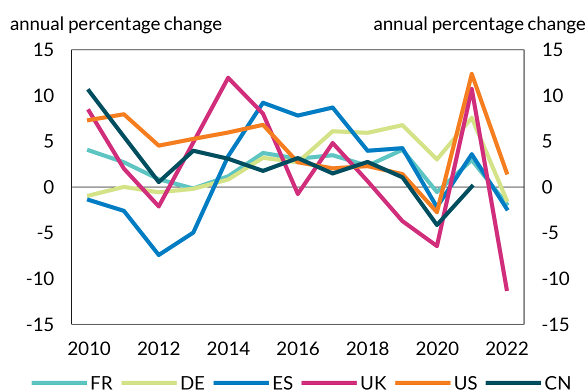
Spread between yield on 10 year and 3 month government bonds




Source: Bloomberg.
Notes: Spread between yield on 10-year and 3-month generic government bonds in selected countries. Last observation 19 May 2023.

**Chart 6: Commercial real estate prices have started falling across the globe**

Global commercial real estate prices (nominal)




Source: MSCI.
Notes: Annual data. Last observation 2022.

Amid the rapid tightening of monetary policy, global commercial real estate (CRE) markets are particularly vulnerable due to concerns over stretched valuations and the increase in non-bank and international financing of the sector. The sustained growth of CRE investment globally in the years up to 2023 has led to concerns about stretched valuations in the sector (see Box A).[4] The sector is facing both cyclical headwinds, due to rising interest rates, as well as structural challenges, including the growth in home working affecting the office segment. Furthermore, increasing synchronisation in global real estate market valuations, partially due to non-bank and international financing of real estate investment, has raised concerns about the vulnerability of

[1] If market participants expect economic conditions to deteriorate, short-term yields will be higher than the long-term due to interest-rates expectations falling. The market expectations of falls in inflation and nominal interest rates could be a contributing factor to the inversion of the yield curve.
[2] Central Bank of Ireland – Securities Markets Risk Outlook Report 2023, March 2023. For more information, see here.
[3] Central Bank of Ireland - Financial Stability Review 2022:II, Box C, pp. 46-47. For more information, see here.
[4] For example, the European Systemic Risk Board (ESRB) published both a report and recommendations into the vulnerabilities in the EEA commercial real estate sector.

these markets to external or regional shocks (Chart 6).[5] A weakening global economic outlook, tighter financing conditions and international developments, such as the ongoing debt crisis in China's property sector, could trigger a further retrenchment of international real estate investment activity.[6] Corrections in CRE markets could be amplified by real estate investment funds via an increase in large redemption requests and/or forced sales due to covenant breaches. This could compound price corrections in CRE markets with potential repercussion for the banking system, e.g. through declining collateral values.

Tighter bank lending standards pose risks to global real estate investment activity. According to recent Bank Lending Survey data from the ECB, the tightening of credit standards and the decline in demand for loans in the second half of 2022 was particularly pronounced in the CRE and construction sectors, and continued declining (albeit at a lower rate) in the first quarter of 2023.[7] The decline in credit comes amid falling real estate market valuations in 2023, with US-listed real estate prices decreasing 14 per cent year-on-year in the first quarter, whereas in Europe prices declined 13 per cent.[8] The recent global banking turmoil has served as a reminder that funding can disappear rapidly amid widespread loss of confidence. A further rise in funding costs for banks could restrict their ability to fund real estate investments in the future. Additionally, risks to bank balance sheets remain elevated in part due to rising insolvencies across Europe, particularly in the real estate sector.

Residential real estate markets are also vulnerable to higher interest rates after a long build-up in price appreciation and household leverage. The sustained growth of house prices in recent years has led to concerns about valuations of residential real estate across many advanced and emerging economies. Coupled with the high level of household indebtedness and the growth of housing credit, this has increased the vulnerability of global real estate markets to the current monetary-tightening cycle. The steep increase in residential-mortgage rates has cooled global housing demand, with quarter-on-quarter residential real estate growth rates turning negative in some advanced economies at the end of 2022 (e.g. Germany, Sweden, and the US). As valuations remain stretched in many countries, there is a risk of a sharp price correction if interest rates rise by more than is currently expected.

Tightening monetary policy is also giving rise to increasing funding costs for European sovereigns, although the risk of a return of "doom loop" dynamics in Europe is mitigated by actions taken by the ECB. Banks are exposed to sovereign risk due to their direct exposures but also indirectly via informational links, i.e. the markets seeing the two sectors as interconnected, for example through implicit government guarantees or sovereign bank ownership.[9] As such, there is a potential for "doom loop" dynamics to occur in a tail scenario, as sovereign debt markets are likely to be particularly fragile amid interest-rate uncertainty and quantitative tightening. However, these risk are mitigated to some extent by heightened banking sector resilience, as well as ECB's policies and programmes which help ensure effective transmission of monetary policy (e.g. the ECB's

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[5] See paper by Committee on the Global Financial System (2020), "Property price dynamics: domestic and international drivers", CGFS Papers No. 64.
[6] Concerns about debt sustainability of local government financial vehicles (with debt estimated at about 50 per cent of China's GDP) have intensified in the last quarters, see IMF Global Financial Stability Report 2023, page xv and chapter 1.
[7] ECB – Bank Lending Survey, April 2023. For more information, see here.
[8] Based on the market prices of listed real estate investment trusts or REITS, IMF Global Financial Stability Report 2023, chapter 1.
[9] With incomplete Banking Union the deposit protection is provided at the national level, reinforcing the bank-sovereign relationship.

Transmission Protection Instrument (TPI) and pandemic emergency purchase programme (PEPP) reinvestment policies).[10,11]

Outside of the direct effects of high inflation and interest rates, heightened geopolitical tensions among major economies have also intensified concerns about global economic and financial fragmentation which could have adverse implications for macro-financial stability. Geopolitical tensions have risen globally amid the ongoing war in Ukraine and deteriorating diplomatic relations between the US and China. This is reflected in the growing incidence of geopolitical threats and conflicts, greater military spending across economies and increased political disagreement by the US and China on foreign policy issues. Increasing financial restrictions, prompted by heightened geopolitical tensions, could exacerbate global financial fragmentation due to a sudden reversal of cross-border capital flows. Additionally heightened geopolitical tensions could impact the real economy through an escalation of the war in Ukraine and greater commodity market volatility, renewing the energy crisis in Europe. A worsening of these tensions or a sudden reallocation of capital could generate liquidity and solvency stress in the financial and nonfinancial sectors by increasing funding costs, exacerbating debt rollover risks and reducing asset values, leading to macro-financial stress.[12] Moreover, increased financial fragmentation could make countries more vulnerable to adverse domestic shocks by reducing international risk diversification, increasing the likelihood of a systemic financial crisis in the longer term.

[10] See remarks by Luis de Guindos, Vice-President of the ECB, on Euro Area banking resilience at the 18th edition of the Banking Sector Industry Meeting. For more information see here.
[11] For more information on the ECB's TPI, see here. For information on the PEPP reinvestment see Box 1 of Böninghausen et al. (2022) "The pandemic emergency purchase programme – an initial review", ECB Economic Bulletin, Issue 8/2022
[12] See IMF Global Financial Stability Report 2023, chapter 3.

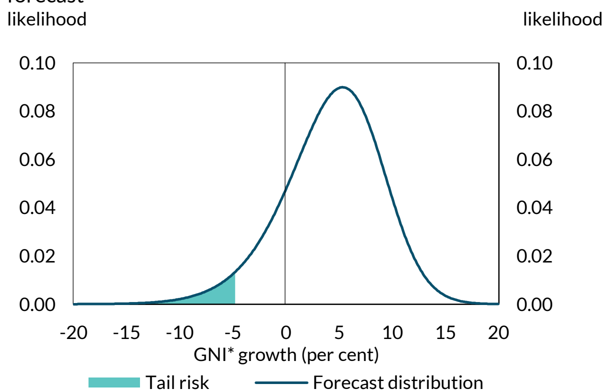
# *Domestic risk assessment*

*While the outlook for the Irish economy has improved in recent months, downside risks, in particular those relating to the lagged effect of high interest rates, the erosion of real incomes, and slowing economic activity, remain elevated. Real estate markets are susceptible to the tightening of financing conditions that is accompanying the monetary-policy response to inflation. While domestic banks are more exposed to residential real estate price falls, it is commercial real estate markets that face a more acute combination of structural and cyclical headwinds, leaving prices particularly vulnerable to further falls. Although domestic banks have not experienced the most adverse market reactions since events in March, volatility in the global banking system has the potential to spill over into the real economy through a reduction in the supply of credit or increases in the cost of borrowing.*

While economic activity has been stronger than had been anticipated at the time of the last *Review*, downside risks remain high. A stabilisation in the international economic environment coupled with a more resilient domestic economy and lower energy prices have contributed to this recent performance. While growth forecasts for the domestic economy are positive the outlook for the Irish economy is subject to a high degree of uncertainty and downside risks relating to the continued erosion of real incomes and the lagged effect of high interest rates in slowing economic activity. Measures such as GNI* at risk, estimate the amount of economic output that could be lost in the event of a negative outcome (Chart 7).

**Chart 7: Downside risks to the domestic economy remain high**

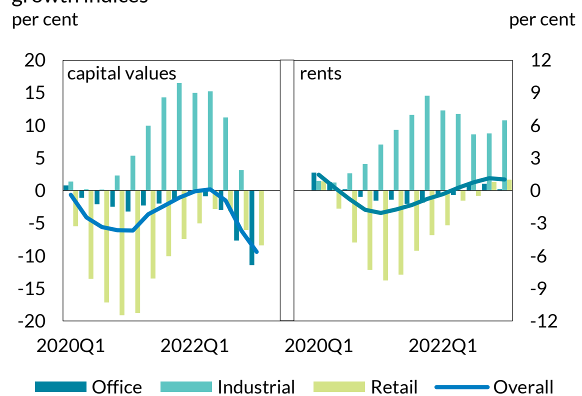
Output growth tail risk and uncertainty – three year ahead forecast




Source: Central Bank of Ireland.
Notes: The T+12Q ahead output (GNI*) at risk). Latest forecast for 2025Q4. Tail risk is defined as the fifth percentile of the forecast distribution. The estimated tail risk remains affected by the large increase in investment which impacted modified domestic demand and GNI* in 2022Q2 (Quarterly Bulletin 2022Q4, p.12). The model utilises the new alternative credit gap series, see *Policy: Macroprudential capital buffers*, for details.

**Chart 8: Irish commercial property values recorded notable declines in 2022 and into 2023**

Annual change in CRE sectoral capital value and rental growth indices




Source: MSCI.
Notes: Observations in left pane denote annual changes in CRE capital values, while those in right pane denote annual changes in CRE rents. Last observation 2023Q1.

Persistently high inflation would have adverse consequences for the Irish economy. Both headline and, in particular, core inflation remain well in excess of the rates experienced over the last two decades and are expected to remain so over the course of this year and into 2024. A longer than anticipated period of persistently high inflation levels has led to an erosion of real incomes and is expected to contribute to wage and other price demands. The outlook for inflation remains heavily dependent on energy prices and any additional negative shock to these could lead to a further decline in real incomes and increase the pressure on the debt servicing capacity of households and

firms. On the other hand, in the event that the current robust performance of the Irish economy continues, further price pressures and capacity constraints could materialise across the economy. If these were to arise they could pose medium-term financial stability risks for the Irish economy and potentially undermine competitiveness.

Risks relating to tighter financing conditions are evident in many parts of the economy but are most acute in real estate markets. The commercial real estate (CRE) sector, in particular, appears sensitive to changes in interest-rates. Recent developments with regard to asset valuations may reflect increasing borrowing costs associated with real estate transactions as well as other cyclical and structural factors within the sector.

CRE prices have fallen considerably already. Adjustments in CRE markets can transmit through the financial system either directly via a fall in collateral values or indirectly through increased loan impairments, wealth effects and a loss of confidence in both markets and financial institutions (see Box A). There were notable CRE price declines over the past year, with overall annual capital values down by 9.4 per cent in 2023Q1, while rents posted a modest increase (Chart 8). Aggregate figures mask divergence at the sectoral level. Lower quality office units fared particularly badly, in the face of significant challenges, such as increased levels of remote working and the increasing focus on energy efficiency. Survey data indicates that market participants expect further declines in capital values and rents over the near-term, and believe that the domestic CRE market is currently experiencing a downturn.[13]

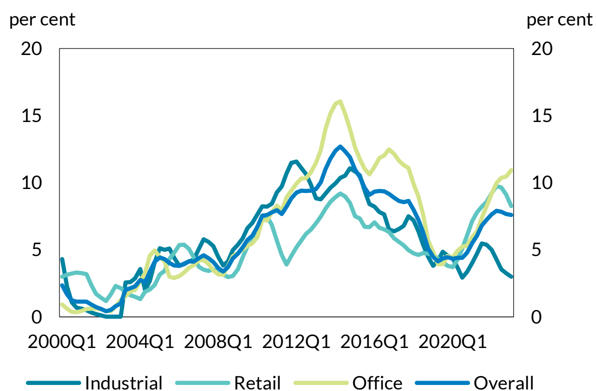
Elevated vacancy rates and supply-side factors may also aggravate ongoing price adjustment in the CRE market. In the Dublin office market, take-up increased in 2022 following the removal of COVID-19 related restrictions earlier last year, but has fallen back in the opening quarter of 2023, with volumes still well down on pre-2020 levels.[14] Office and retail vacancy rates remain above pre-pandemic levels at 10.9 per cent and 8.2 per cent, respectively (Chart 9). The supply of Dublin office space scheduled for delivery over the next few years is still significant and, given recent structural changes in working practices, there is a degree of uncertainty around the capacity of the market to absorb this level of additional space over a relatively short period.[15] A failure to do so could lead to oversupply, which would exacerbate the downturn, place further downward pressure on both capital and rental values, and give rise to losses for financial institutions and investors.

The domestic economic impact will be mitigated by the fact that banking sector CRE exposures are smaller and less risky than in the past. Increased foreign investment in recent years means that the funding profile of the sector is more diversified, with less concentrated systemic risks in the domestic banking system when compared to the pre-2008 period (see *Resilience: Domestic Banks*). Other local spillover channels may include a reduction in the value of pension or investment funds,

[13] According to the latest RICS Global Commercial Property Market survey (2023Q1), average CRE capital values and rents are forecast to decrease by 1.9 and 0.5 per cent, respectively over the next 12 months. Moreover, approximately two thirds of survey respondents described the current phase of the CRE property cycle as either “early downturn” (38 per cent) or “mid-downturn” (27 per cent).
[14] According to CBRE, take-up in the Dublin office market reached approximately 26,000 square metres in 2023Q1, which was 42 per cent lower than the figure for the equivalent quarter in 2022.
[15] Data from CBRE also show how the volume of Dublin office space currently under construction and due for delivery across the next three years has declined from about 500,000 square metres a year ago to less than 300,000 square metres at the beginning of 2023 – about 30 per cent of which is pre-let.

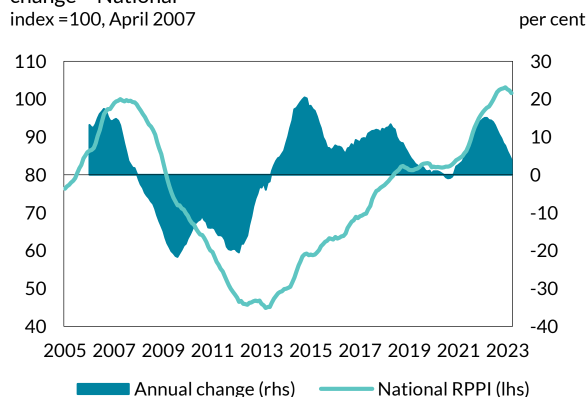
reductions in collateral available for local businesses, and a downturn in real estate construction activity and employment.

**Chart 9: CRE vacancy rates remain elevated as certain sectors are still coming to terms with on-going structural issues**
Irish CRE vacancy rates – overall and by sector




Source: MSCI.
Note: Chart is based on a 4-quarter rolling average of the observations. Last observation 2023Q1.

**Chart 10: The growth rate of residential property prices has slowed significantly from the elevated levels of early-2022**
CSO Residential Property Price Index and annual percentage change – National




Source: CSO.
Note: Last observation March 2023.

Vulnerabilities in CRE financing may amplify the ongoing price correction. A high share of expenditure in the Irish CRE market originates from abroad, raising concerns about its sensitivity to external shocks, such as global CRE market synchronisation, the weakening global economic outlook or the further tightening of financing conditions. There has been some slowing of investment activity in recent months. Yields across all Irish CRE sectors are likely to come under further pressure in 2023 while the attractiveness of alternative investments has increased with the normalising monetary-policy environment. A sudden stop or reversal in foreign investor demand would increase the probability of further declines in CRE prices.

As in many countries, residential property price growth has been decelerating for much of the past year in Ireland, after sharp increases during the pandemic (Chart 10). Survey evidence, as well as forecasts from a number of private-sector institutions, suggest that market participants expect the pace of residential real estate (RRE) price growth to ease further throughout 2023, as interest rates increase.[16]

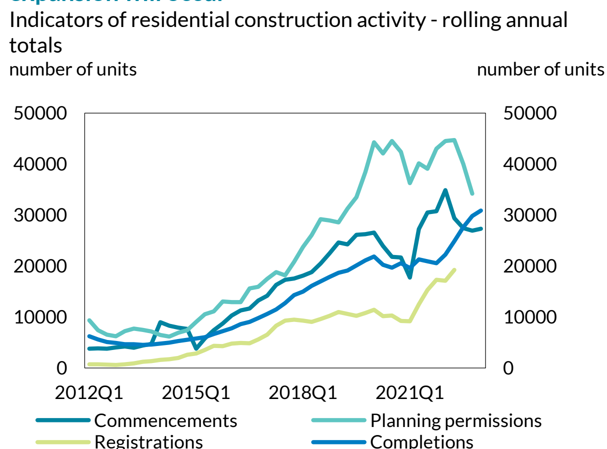
House price dynamics have important financial stability implications, but a number of factors may offset downward pressure from higher interest rates. The mismatch between housing supply and demand, should support house prices, all else equal. While annual housing completions did increase markedly last year, forward-looking indicators of residential construction activity point to a slowdown in the volume of output this year, to approximately 27,000 units (Chart 11). Some recovery in the number of residential completions is expected beyond this, with the Central Bank forecasting the delivery of 29,500 housing units in 2024, rising to 32,500 in 2025. Increases in the

[16] For instance participants in both the Central Bank of Ireland/Society of Chartered Surveyors property survey (2022Q4) and the Daft.ie Market Survey (2023Q1) expect house price inflation to be in low single figures, 1 and 2 per cent respectively, over the coming 12 months. Elsewhere, Sherry FitzGerald (Irish Residential Market Review (2022Q4 / Outlook 2023) Report) anticipates house price growth of less than 3 per cent in 2023, while in its recent 2023Q1 Property Report, MyHome.ie revised down their annual asking price inflation forecast to 1.5 per cent from 4 per cent.

cost of funding, as well as construction and building materials,[17] coupled with shortages of skilled labour, may call into question the viability of some planned RRE developments, leaving the volume of new housing supply constrained and well below the level required to meet current estimates of housing demand.[18, 19]

**Chart 11: Forward-looking indicators of residential construction activity suggest a slowdown in the pace of expansion will occur**

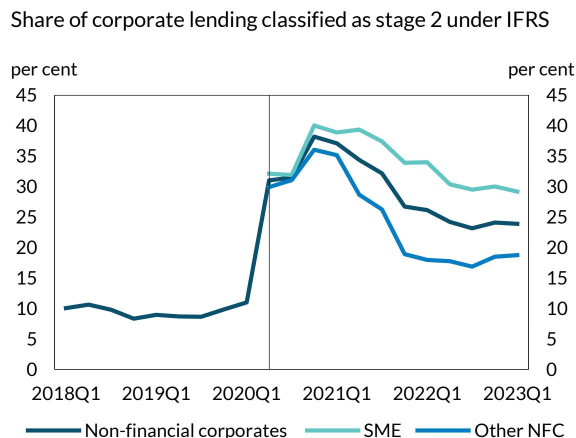
Indicators of residential construction activity - rolling annual totals




Source: CSO, Homebond and Department of Housing, Local Government and Heritage.
Notes: Latest commencements and completions data 2023Q1. Latest planning permissions data 2022Q4. Latest registrations data 2022Q2.

**Chart 12: Asset quality remains a concern in some corporate lending categories**

Share of corporate lending classified as stage 2 under IFRS




Source: Central Bank of Ireland.
Notes: 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 non-financial corporates available from 2020Q2. Last observation 2023Q1.

Tighter financial conditions will impact all sectors of the economy, to differing degrees. For households, while the increasing prevalence of fixed-rate mortgage products mean around one half of mortgagors are insulated from the immediate effects of increases in interest rates, pockets of vulnerabilities remain. Over the medium term, many mortgaged households will be exposed to higher rates when their current fixed-rate contracts expire. Despite prudent lending standards, higher interest rates coupled with the rising cost of living will stretch some household's ability to service debt (see *Resilience: Households)*, with knock-on implications for consumption and potentially loan defaults in an adverse scenario.

An uncertain operating environment presents a range of challenges for indigenous firms. While domestic businesses appear to be weathering the inflation shock to their cost base so far (see *Resilience: Non-Financial Corporations)*, the potential for lower turnover in the event of weaker than expected domestic growth, coupled with a challenging international trading environment, may act as a drag on revenue growth. At the same time, firms in some sectors continue to face capacity constraints and elevated operating costs. Energy prices remain significantly above pre-war levels

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[17] In March 2023, the annual wholesale prices for construction products rose by 13.5 per cent, with structural steel (58.4 per cent), plaster (34.7 per cent) and cement (24.1 per cent) recording some of the largest increases - see the CSO's Wholesale Price Index,

[18] Recently announced policy initiatives, which will see the removal of certain development levies and an increase in the value of grants available for the restoration of vacant properties, may help to support the viability of some projects.

[19] Estimates of housing demand are sensitive to the underlying assumptions made about population growth and average household size. Conefrey and Staunton (2019) estimate that annual housing demand could range from 34,000 to 47,000 units per year. In addition, acute shortages of second hand units for sale (and rent), which have reached historical lows, are exacerbating the housing supply issue. The exit of many small-scale landlords from the market, the resumption of significant levels of net inward migration, as well as efforts to house refugees fleeing the war in Ukraine and others seeking international protection have been put forward as the main drivers of dwindling supply.

and have exhibited a high degree of volatility in recent months. The tight labour market continues to put upward pressure on the cost of labour and financial conditions are expected to continue tightening. An uncertain outlook in the context of tightening financial conditions may impact firms' investment decisions and could ultimately impact Ireland's growth outlook and competitiveness.[20]

There are some emerging signals of increased financial vulnerability and credit risk across Irish businesses. Corporate insolvencies have increased in recent months, likely reflecting the delayed effect of pandemic-related lockdowns and a materialisation of some of the challenges outlined above (see *Resilience: Non-Financial Corporations*). In addition, domestic banks continue since the pandemic to classify high shares of their corporate loan book as exhibiting an elevated level of credit risk (Stage 2 IFRS 9 classification) (Chart 12).

The recent global banking turmoil highlights the uncertainty inherent in the ongoing global adjustment to rapidly rising interest rates. The turmoil that led to failures of a number of US banks highlighted the sensitivity of some business models to the ongoing normalisation in interest rates. The heavily interconnected nature of the Irish financial system means that global spillovers from future stress events have the potential to also impact banks and other financial institutions operating in Ireland.

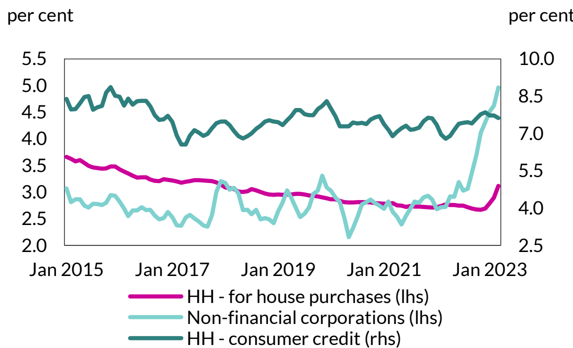
While domestic banks do not exhibit the features that have caused difficulties in the global banking system, all banks are now more susceptible to a repricing of funding costs, with the potential to spill over into the real economy through a tightening of credit standards. In contrast to some US banks, debt securities account for a relatively small share of domestic banks' assets (Box B provides further elaboration on domestic banks' exposure and the Central Bank's assessment of recent events). Irish credit institutions' primary source of funding is customer deposits. A plentiful supply of deposits combined with a reduction in the number of active deposit-taking institutions within the State has contributed to Irish banks having among the lowest deposit rates in the euro area, supporting profitability through interest margins (see *Resilience: Domestic banks*). An increase in funding costs which in turn would lower banks' income generating ability and undermine profitability.[21] Such dynamics, if they materialised, could impact the availability and price of credit supplied to the real economy.

Even before the onset of the recent banking turmoil, domestic credit supply had tightened and was expected to tighten further in the short-term. The latest domestic BLS results, published in April 2023, points to tightening in credit standards in 2023Q1.[22] Tighter lending standards are most evident in the interest rates charged on new NFC lending where rates have increased from 4.1 per cent in November to just under 5 per cent in March (Chart 13). In contrast, the pass-through of rates to households has been much more muted. The results of the April BLS also indicate that that a further marginal tightening of credit standards is expected in the second quarter of the year.

[20] The acute supply of available housing has also been identified as challenge for Irish businesses For example, see IBEC (2023) "Better Housing Better Business", January.
[21] Deposits are not the exclusively avenue of risk, Irish banks also active in debt markets. Concerns surrounding pricing/market appetite for Irish bank debt could impact the future issuance and in turn business decisions.
[22] Banks cited a range of factors for the tightening of credit standards. These included the general economic outlook as well as firm and industry specific risks and concerns about housing market prospects and borrower credit worthiness. For more see April 2023 Survey Results.

### Chart 13: Interest rates on new lending have risen since the last Review

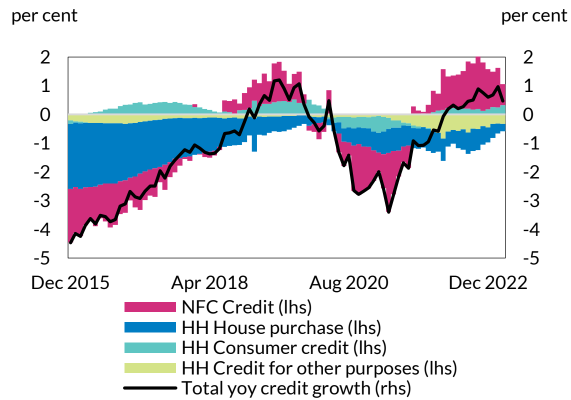
Interest rates on new lending by loan type




Source: Central Bank of Ireland Money and Banking statistics.
Note: The chart shows 3-month rolling averages. Last observation March 2023.

### Chart 14: An easing in credit to NFCs growth explains most of the slowdown of annual bank credit growth

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

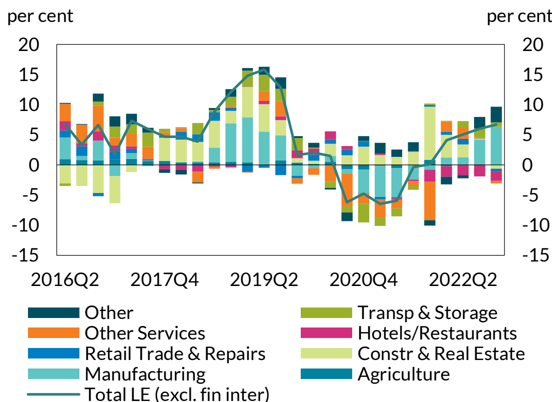



Source: Central Bank of Ireland Money and Banking statistics.
Notes: Calculations based on data from Tables A.1 and A.6. As of January 2022 Table A.6 has been discontinued following an updated ECB regulation on the treatment of securitised loans. Credit considers only loans from banks to Irish residents.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

There are signs that higher interest rates are starting to impact credit growth. Although credit growth remains positive, the rate of increase has eased in recent months (Chart 14). The impact of higher interest rates has begun to affect lending. Although lending to NFCs remains the largest contributor to (positive) credit growth, a slowdown in lending to NFCs is one of the drivers of the decline of overall credit growth. Within NFC lending, growth remains concentrated among larger firms.[23] The composition of credit growth across large enterprises has evolved since the last Review. The share of lending accounted for by manufacturing has increased while the contribution of construction and real estate has reduced (Chart 15).

### Chart 15: The composition of credit growth for large enterprises across economic sectors has significantly changed since the last *Review*

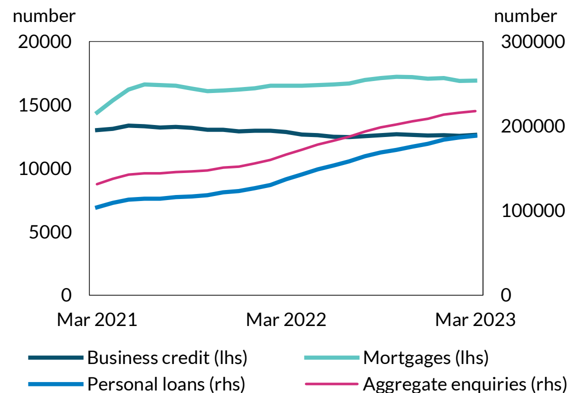
Credit growth to large enterprises




Source: Central Bank of Ireland Money and Banking Statistics.
Note: "Other" includes Electricity, Gas, Steam and Air Conditioning Supply, Water Supply, Sewerage, Waste Management and Remediation Activities, Hotels and Restaurant, Transportation and Storage, Community, Social and Personal services, Education, Human health and social work. The chart excludes financial intermediation services. Last observation 2022Q4.

### Chart 16: Forward-looking credit demand indicators are stabilising in recent months

Average annual number of enquiries




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

[23] The annual growth rate in SME lending was 0 per cent in 2022Q4 while lending to large enterprises grew by 3.5 per cent over the same timeframe.

Over the short-term, forward-looking indicators for credit demand appear strong but the outlook is less certain as credit conditions tighten. Personal loan enquiries account for the majority of all enquiries made by Irish residents. This category has steadily increased over the course of the past two years (Chart 16). In contrast, credit enquires relating to residential mortgages and businesses have been much more stable. While credit enquiries may be influenced by a range of factors, including the prevailing economic conditions, the withdrawal of two retail banks will have contributed to the volume of recent enquires.[24] While the number of mortgage approvals remained strong in recent months, a large proportion of activity stemmed from existing mortgage holders switching provider. In addition to the bank withdrawals, expectations of increases in mortgage interest rates may have contributed to the large increase in switcher activity. However, as these factors wash through the data, mortgage demand is likely to track activity in the FTB and mover purchaser segments of the market over the coming months. The number of approvals across these markets has fallen in recent months.[25]

In addition to the cyclical risks facing the Irish economy, the performance of the economy has become increasingly concentrated in a small number of sectors and firms, leaving it vulnerable to idiosyncratic shocks. This is evident in the contributions of ICT and the pharmaceutical sector to the share of Irish exports as well as the increasingly concentrated nature of corporation tax receipts. Estimates suggest more than half of the 2021 corporate tax receipts may not be explained by developments in the domestic economy, which points to risks as to the sustainability of some of these revenues in future periods.[26] In addition to the volume of tax receipts, the latest corporate tax returns indicate that ten companies now account for 57 per cent of total net receipts.[27] Such a large concentration in a small number of firms exposes Ireland's fiscal position to the performance of specific sectors and the financial position of a small number of individual companies. Of particular note is the exposure to the ICT sector, which is estimated to account for over 20 per cent of corporate tax receipts.[28] A sector specific shock, such as a prolonged global ICT slowdown, or unexpected developments arising from ongoing international corporation tax reforms may impede domestic growth and also reduce the future capacity of the State to help mitigate future economic shocks. While the sovereign's funding profile is currently strong and debt dynamics favourable (see *Resilience: Sovereign*), this concern has the potential to become particularly acute were Ireland's debt burden to rise relative to a weakening economy, at a time of rising yields in sovereign bond markets.

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[24] For more on credit enquiries see Sherman and Woods (2023), "Credit demand and lender activity to February 2023: What can high-frequency lender credit enquiries tell us?", Central Bank of Ireland, Behind the Data series, April.
[25] BPFI mortgage approval data show the annual growth rate in all mortgage lending was 7.4 per cent in the year to February 2023. However, the corresponding growth rate for FTB's and mover purchasers was a decline of 5.1 per cent.
[26] For an estimate of the potential corporate tax at risk Conefrey et al (2022) "Managing the Public Finances in Uncertain Times", Central Bank of Ireland, Quarterly Bulletin 02, July, and Box G in Irish Fiscal Advisory Council (2022), "Fiscal Assessment Report", May
[27] This compares with 32 per cent in 2010 - see Revenue (2023) "Corporation Tax – 2022 Payments and 2021 Returns".
[28] For more see Conefrey et al (2023) "The Role of the ICT Services Sector in the Irish", Central Bank of Ireland Quarterly Bulletin 01, March 2023.

## Box A: Financial stability risks emanating from commercial real estate markets

**This box highlights the main financial stability risks associated with the CRE market.** Amid high inflation and interest rates globally, CRE markets are coming under increasing pressure. Rising funding costs and uncertainty, tightening credit standards, increased interconnectedness due to the rise of international institutional investors, and weaker growth prospects are all putting downward pressure on global CRE market prices *(see Global Risks).* In addition, segments of the CRE market are affected by structural factors, such as pandemic-related changes in working patterns (with implications for the office segment in particular) and consumption habits (with implications for the retail segment).

**While shocks to the domestic CRE market will have implications for domestic banks, the banking system is now better able to absorb a CRE shock**. Banks' CRE exposures are a smaller portion of total lending than in the past, having declined significantly since 2008 from just over one third to under 10 per cent (Chart 24).[1] In addition, the composition of lending has shifted, with CRE lending now less concentrated in riskier development exposures than in the past. CRE borrowers typically have LTV ratios that will allow for substantial price declines before losses are experienced, with the estimated weighted average current LTV of banks' CRE investment exposures currently around 50 per cent. However, these LTV positions are subject to elevated risks relating to market liquidity when trying to realise collateral values in a stressed market. Floating-rate loans and the need to refinance positions amid higher interest rates in the coming years add to the underlying vulnerabilities of banks' CRE exposures. Nevertheless, with loss-absorbing capital ratios well above minimum requirements, banks are now less likely than in the past to amplify rather than absorb shocks to domestic CRE borrowers *(see Resilience: Domestic Banks).*

**However, vulnerabilities are apparent in the non-bank sector, which could amplify the effects of a fall in CRE prices**. In the insurance sector, signs of large but contained withdrawals are apparent as a number of unit-linked property entities temporarily suspend withdrawals to allow time to sell assets. Irish property funds own approximately 34 per cent of estimated investable CRE in Ireland. Within this sector, a cohort of funds is currently vulnerable to CRE price falls due to high leverage (*see Policy: Non-banks*). There has also been a notable reduction in new lending advanced to SMEs for real estate activities from non-banks. Lending volumes declined by 41 per cent on an annual basis in 2022. Funding models of non-bank lenders appear to be more sensitive to current financial conditions than that of banks. Borrowers from non-banks are also more vulnerable than bank borrowers (Gaffney & McGeever, 2022). Taking together the importance of property funds as investors in Irish CRE along with the role of non-bank lenders in funding lending for real estate, the actions of non-banks in response to falling CRE prices will be an important channel to monitor for domestic financial stability in this tightening cycle.

[1] See Lyons, P., Nevin, C. and Shaw, F. (2019), "Real-estate concentrations in the Irish banking system", Central Bank of Ireland Financial Stability Note, Vol. 2019, No. 4.

## Box B: The global banking turmoil through an Irish lens

Since the last *Review*, developments in the global banking sector have been at the forefront of financial stability considerations. In the United States, a number of banks have failed as underlying vulnerabilities were exposed by the rapid transition to higher interest rates in response to persistently high inflation. In Switzerland, Credit Suisse (CS), a globally systemically important bank (G-SIB), was acquired, following long-standing governance and risk management issues, which were amplified by a loss of confidence of investors and depositors.

The Central Bank has been evaluating the impact of these global developments on the Irish financial system, including through close engagement with European counterparts and, domestically, under the auspices of the Financial Stability Group. It has also been engaging very closely with regulated financial institutions from a supervisory perspective, including to ensure that those institutions themselves are assessing the impact of global market developments and managing any emerging risks.

The direct connections between Irish retail banks and those international banks most affected by the global turmoil have been very limited. The Central Bank has also considered potential commonalities in risk exposures, and judges that the mix of underlying vulnerabilities of those US regional banks that failed is not evident in Irish retail banks.

While each of the US bank failures has entailed idiosyncratic features, there were certain balance sheet vulnerabilities related to interest rate and liquidity risk that left them particularly exposed to the changing macro-financial environment. For example, some or all of the following were features of the banks that failed in the US: significant exposures to long-duration debt securities, which were particularly sensitive to interest rate moves, often not marked-to-market and/or not hedged; a high share of uninsured depositors; and a concentration of depositors in a single sector of the US economy.

The Central Bank's analysis is that, on all these dimensions, Irish banks do not share the same mix of vulnerabilities (see *Resilience: Domestic banks*). For example:

- Debt securities represent only 10 per cent of total assets at Irish domestic retail banks, and among these, around half are marked-to-market, impacting on other comprehensive income. In those cases, changes in valuation are passed directly to bank balance sheets and capital, rather than accumulating as "unrealised losses" that only become realised when liquidated, as would be the case when held to maturity. The impact of such valuation changes will depend on banks' interest rate hedging strategies. Where banks have hedged themselves against changes in interest rates (through use of derivatives) the impact on the marked to market assets and the "unrealised losses" on amortised costs assets will be more muted.

- Insured deposits represent 56 per cent of total deposits of the three Irish domestic retail banks, and among the uninsured component, deposits are spread across a wide cross-section of the Irish economy, rather than being concentrated within a single sector as was the case with SVB (venture capital deposit concentration) or Signature Bank (crypto deposits concentration).

- Among their substantial liquid asset holdings, those of Irish banks are particularly concentrated in central bank reserves (24 per cent of total assets), rather than other liquid securities such as government bonds, whose value is particularly sensitive to interest rates. Central Bank reserves

are the most resiliently liquid asset and do not expose banks to mark-to-market losses if liquidity needs to be used.

More broadly, the quality and quantity of loss-absorbing capital has improved markedly in the Irish banking system, owing to a range of post-2008 reforms. Banks have ample headroom above minimum capital requirements that provides for substantial capacity to absorb shocks. This loss-absorbing capacity, as well as prudent supervisory oversight and a strong focus on risk management, all strengthen the resilience of the Irish banking system and its ability to absorb adverse shocks.

Nevertheless, any deterioration in the global banking environment would have the potential to transmit to Ireland through different channels. For example, a continued shift of deposits from regional US banks towards money market funds (MMFs) or larger US banks could lead to a deterioration in overall credit conditions in the US, given the meaningful share of lending by regional banks, including in the US CRE market. This could have broader macro-financial implications for the US, and by extension for global growth. More broadly, any reappraisal of bank soundness globally could lead to an increase in banks' funding costs, which would reverse some of the banks' recent profitability gains. For example, pricing of Additional Tier 1 (AT1) debt securities in response to the failure of CS highlights the risk that market perceptions can move quickly in response to uncertainty, even if policymaker actions in March ultimately led to a normalisation of AT1 yields within the EU (see *Resilience: Domestic Banks*).

The recent turmoil in the US and Swiss banking sectors highlights the importance of robust global regulatory standards and effective supervisory frameworks to safeguard the resilience of the banking system. These episodes also offer lessons that will need to be considered over time. For example, the growth in digital banking and the availability and spread of information through technology has the potential to increase the speed at which deposits can flow, with implications for liquidity management. Recent events also emphasise the importance of a robust and predictable resolution framework within which banks can fail, without wider consequences for the financial system and economy. It is therefore welcome that the Financial Stability Board has agreed to review the lessons learned from the recent measures taken by the authorities to resolve financial institutions for the operation of the international resolution framework. Finally, recent events serve as a reminder of the importance of completing the Banking Union in the European Union, including through making progress on a European Deposit Insurance Scheme, which remains a gap in the European framework.

# Resilience

## Domestic banks

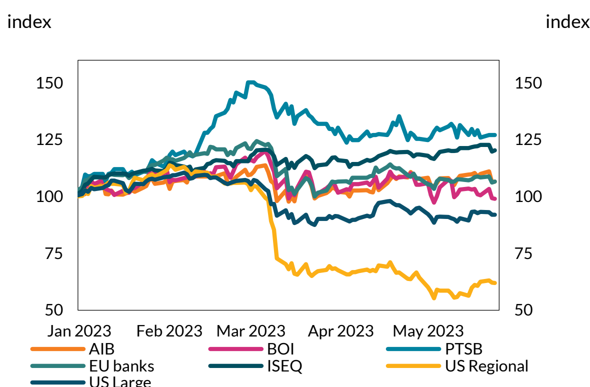
*A core business model of deposit-taking and lending leaves Irish domestic banks in a stronger position than many European peers to maintain high profitability levels amid rising interest rates. The risk factors that posed challenges globally in March do not appear prominently on balance sheets here. Securities holdings are modest relative to total assets and are largely hedged against interest rate risk. Substantial liquid asset holdings, mainly in the form of central bank reserves, and a high share of insured deposits reduce the risks associated with deposit outflows. Capital levels remain relatively high and provide ample loss-absorbing capacity, although these would be tested by a downturn in which borrowers experience significant repayment shocks, or if interest rates paid on deposits were to rise more than expected. In addition, higher rates may hit property valuations and potentially weaken loan performance in the CRE sector in particular.*

Domestic banks have been relatively unaffected by the recent stress in the global banking market. While all banks globally experienced some adverse effects from the failures of SVB, other small-to-mid-sized US banks and Credit Suisse since March, the equity market performance of Irish domestic banks has been favourable relative to US or European peers (Chart 17). This is consistent with market perceptions of balance sheet strength, as well as positive exposure to a rising interest rate environment. Securities holdings are also small relative to total assets and are largely hedged against interest rate risk, reducing risks relating to the specific vulnerabilities of SVB (see Box B).

Domestic banks' loan-deposit franchise leaves them well positioned to benefit from rising interest rates. The core business model of the domestic banks is orientated towards deposit-taking and lending, with net-interest income (NII), which grew 75 per cent in the year to March 2023, making up a relatively large share of operating income (Chart 18).[29] The benefits of rising interest margins must always be viewed in the context of challenges that higher rates will pose to credit risk among some borrowers.

**Chart 17: Market perceptions of Irish domestic banks have been relatively favourable in recent months**

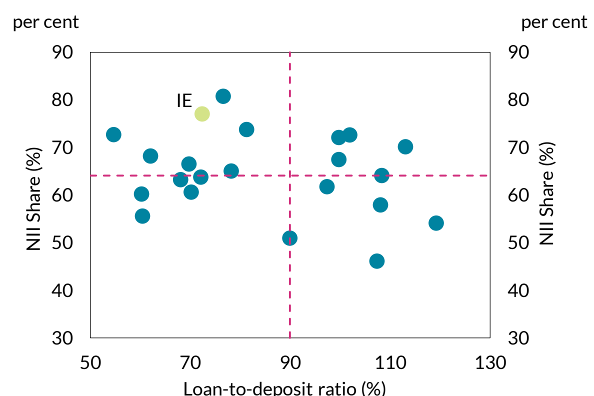
Equity prices for Irish, EU and US Regional and Large banks




Source: Bloomberg.
Note: Equity prices for the Irish domestic banks, ISEQ overall, EU Banks (EURO STOXX Banks (Price) Index); US Regional Banks (S&P 500 Regional Banks Index) and US Large Banks (Dow Jones US Large Cap Banks Index). Index 100 = 31/12/2022. Last observation 25 May 2023.

**Chart 18: Irish domestic banks rely more on net interest income and have lower loan-to-deposit ratios**

Net interest income (NII) shares and loan-to-deposit ratios for banks in Ireland and in EU countries




Source: Central Bank of Ireland; EBA; FINREP.
Note: NII refers to net interest income over total operating income. Loan-to-deposit ratios refer to loans over deposits for households and NFCs. Data as of 2022Q4. IE refers to domestic banks. Dashed lines reflect the median values across all countries in sample.

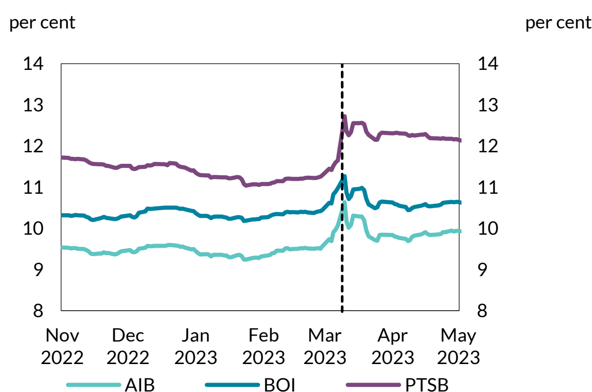
[29] Growth in system-wide NII of the three banks reflects both the benefits accruing from higher spreads on loan versus deposit rates, but also the growth in assets due to the transfer of portfolios from exiting banks.

Domestic banks' Additional Tier 1 (AT1) yields rose during the period of acute market stress, but have since stabilised, albeit at higher levels. Yields peaked during the distressed sale of Credit Suisse to UBS in late March, which was accompanied by a full writedown of AT1 instruments to zero by the Swiss regulator. However, following the swift clarification by the EU authorities that creditor ranking, as established by the Banking Recovery and Resolution Directive (BRRD),[30] would apply in the event of a bank failure in the EU, yields on these loss-absorbing instruments have reversed somewhat, but remain above levels earlier in the year (Chart 19).

High-quality liquid assets are available to domestic Irish banks, providing resilience against any liquidity shocks. Domestic banks currently have a weighted average Liquidity Coverage Ratio (LCR) of 192 per cent. Importantly, relative to SVB where long-dated bonds formed an important share of the stock of liquid assets, domestic banks rely more on central bank reserves, the most risk-free form of liquid asset available (Chart 20). Finally, 56 per cent of deposits fall within the €100,000 limit for coverage under the Irish Deposit Guarantee scheme. This level of deposit insurance coverage reduces risks related to liquidity and run dynamics, although recent events in the global banking system highlight the rapid pace at which events can unfold (see Box B).

**Chart 19: Domestic bank AT1 yields rose during the period of acute market stress, but have stabilised since**

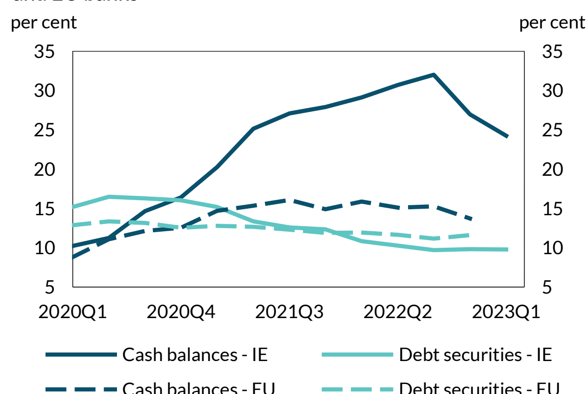
Yields on selected AT1 debt of domestic banks




Source: Bloomberg.
Note: Selected 'MREL' Bonds of the three domestic banks. Mid Yield to Maturity. Vertical dashed line represents the events of the weekend of 19 March 2023 when the Swiss Authorities agreed the takeover of Credit Suisse by UBS. Last observation 25 May 2023.

**Chart 20: Cash balances at Irish banks remain well above the EU level, while debt securities are around the European average**

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




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

Bank profitability is improving in the high interest rate environment. During the pandemic, large swings in impairments resulted in losses, but banks have since returned to profitability, with a return on equity (RoE) of 7 per cent at year end 2022 (and rising to an annualised 11.4 per cent in the first quarter of 2023) (Chart 21). The sector is now close to the median European RoE, having previously been in the bottom quartile, due to rising margins in the interest-rate environment. Net-interest margin (NIM) grew 115 bps on a year-on-year basis to 2.7 per cent in the first quarter of this year (Chart 21). The favourable outlook on profitability is subject to uncertainty relating to the overall effects of higher interest rates on borrower credit risk, particularly in CRE; a

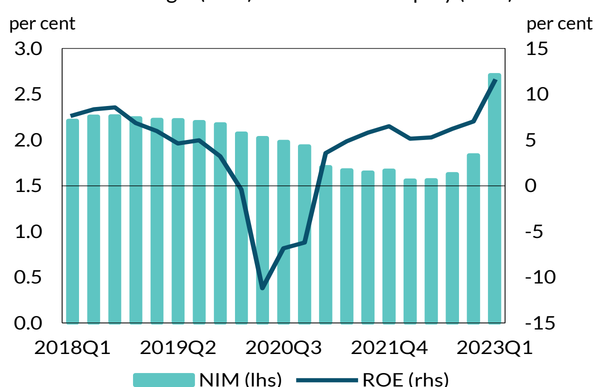
[30] See SRB, EBA and ECB Banking Supervision statement on the announcement on 19 March 2023 by Swiss authorities.

macroeconomic downturn eventually causing significant increases in loan losses; or a sharp increase in the pass-through of higher interest rates to depositors.

The pass-through of monetary policy by domestic banks has been slow thus far. Average interest rates on new mortgages for house purchases in Ireland increased by 86 basis points between June 2022 and March 2023 and are now among the lowest in the EU (Chart 22). Smaller increases in the interest rate offered to depositors may be supporting banks to only slowly increase lending rates. Slow deposit pass-through has a particularly strong effect on profits given domestic banks' funding reliance on deposits (76 per cent of total liabilities v European average of 64 per cent). If lending rates were to continue to increase more than deposits, as is suggested by offered rates currently on the market, NIM would rise further. This is subject to the risk of any sharp increase in deposit rate pass-through such as that experienced by smaller US banks in recent months.

**Chart 21: Profitability is improving in a rising rate environment**

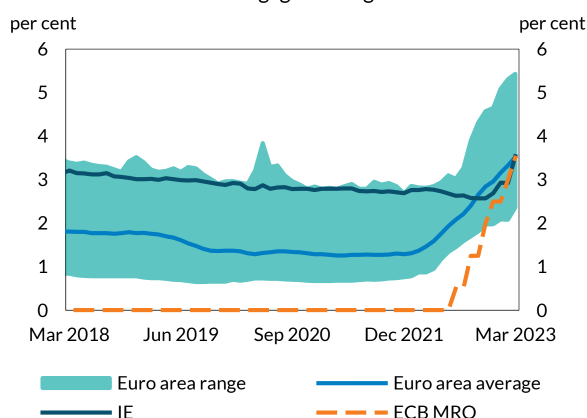
Net Interest Margin (NIM) and Return on Equity (ROE)




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

**Chart 22: Interest rates on new mortgage lending have risen more slowly than elsewhere in Europe**

Interest rates on new mortgage lending




Source: ECB and Central Bank of Ireland calculations.
Notes: MRO refers to Main Refinancing Operation rate. Euro area range represents the difference between the maximum and minimum level of interest rates on new mortgage lending. Last observation March 2023.

Non-performing loans remain at decade-long lows (Chart 23). Non-performing loan (NPL) ratios are decreasing for households and for non-financial corporates (NFCs), and are at very low levels when compared to the previous decade in Ireland. NPLs have been on a long-run downward trajectory since 2014, owing to improved borrower finances amid a strong economic recovery, loan restructuring, and portfolio transfers and sales.

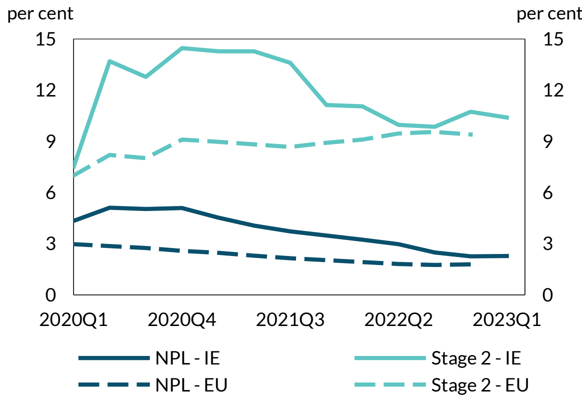
Despite improved headline asset quality, banks' borrowers will not be fully insulated from rising interest rates, particularly in CRE. Commercial borrowers continue to exhibit elevated risk, with banks reporting 23.9 per cent of performing borrowers as being of increased risk in 2023Q1 versus 11.8 in 2020Q1. While the share of commercial loans in Stage 2 decreased over 2022 and into 2023 to date, higher interest rates will impact negatively on credit quality, particularly for CRE where a synchronised global downturn is already under way (see *Risks: Global*). In addition, a tightening of financial conditions limits the scope to refinance existing debt, particularly relevant for CRE where loans are more likely to require rollovers at maturity.

While risks are likely to materialise, CRE exposures are less likely to pose systemic risks than in the past (Chart 24). The CRE sector is currently vulnerable to cyclical and structural risks (*Risks: Domestic*). Refinancing in the coming years at higher interest rates may be particularly challenging for many borrowers. However, the risks must be placed in the context that banks' CRE exposures

are small relative to the past (approximately 34 per cent of total lending in 2008 versus just under 10 per cent currently), less likely to be for riskier development projects, and have been subject to tighter underwriting criteria in response to changed risk appetite after the 2008 crisis.

### Chart 23: Loan impairments have yet to materialise

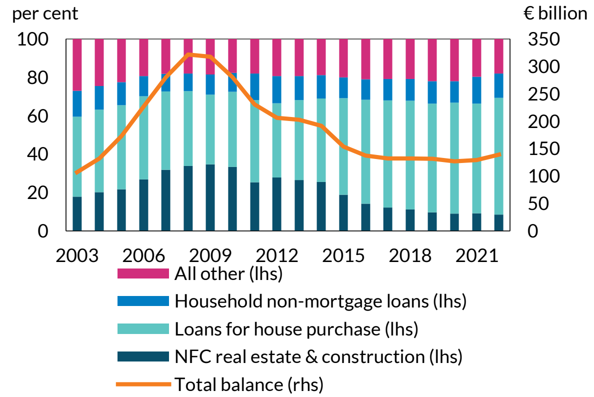
IFRS 9 Stage 2 and NPL ratios by jurisdiction




Source: Central Bank of Ireland; EBA; FINREP.
Notes: NPL - IE and NPL – EU: Irish and EU Non Performing Loans ratios, Stage 2 - IE and Stage 2 - EU represents the ratio of IFRS9 Stage 2 loans to total loans for Ireland and EU, respectively. Last observation is 2023Q1 for Ireland and 2022Q4 for European data.

### Chart 24: Commercial real estate represents a lower share of lending than in the past

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

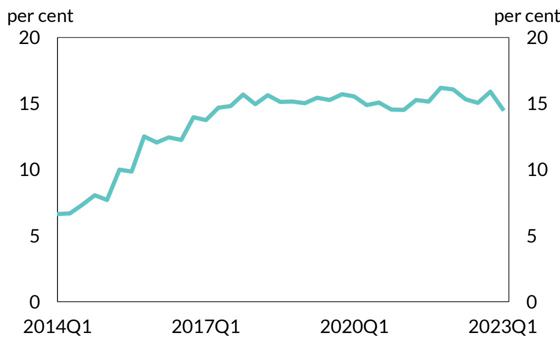



Source: Central Bank of Ireland Credit and Banking statistics.
Notes: NFC real estate & construction is the sum of "Construction" and "Real Estate, Land & Development Activities" Includes all banks resident in Ireland and Irish exposures only.

Loss-absorbing capital ratios remain well above minimum regulatory requirements, providing ample scope to absorb potential future losses. The capital position of the domestic banks has been stable in recent years (Chart 25) despite absorbing portfolios from the two exiting foreign-owned banks. Capital ratios are at or above European averages, with ample buffers above regulatory requirements (Chart 26). In addition to strong CET1 ratios, the leverage ratio, at close to 7 per cent, is well above regulatory minimum levels.

### Chart 25: Regulatory Capital Ratios have increased substantially over the last number of years

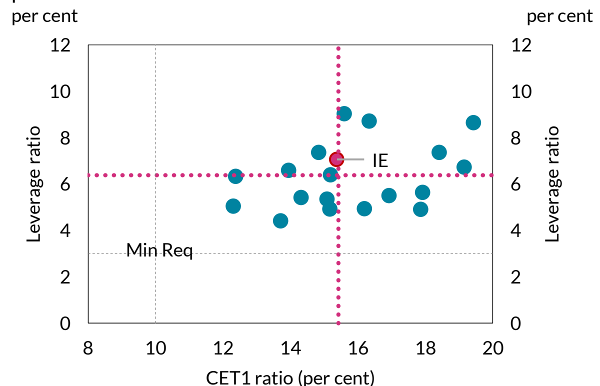
Capital Ratio – Fully Loaded (FL)




Source: Central Bank of Ireland, COREP
Note: Aggregate fully loaded capital ratios for domestic banks. Last observation 2023Q1.

### Chart 26: Regulatory capital and leverage ratios have substantial headroom above minimum requirements

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




Source: EBA Transparency Exercise 2022 and Central Bank of Ireland.
Notes: Each dot represents all banks in a country reporting to the EBA transparency exercise in 2022. Banks that have low (<7 per cent) lending shares to mortgage/SME borrowers are excluded. The grey dashed lines report the minimum leverage ratio of 3 per cent and the minimum CET1 ratio shown is the aggregate 2022 FL requirements of the three domestic banks (ex P2G, which is not reported publicly).

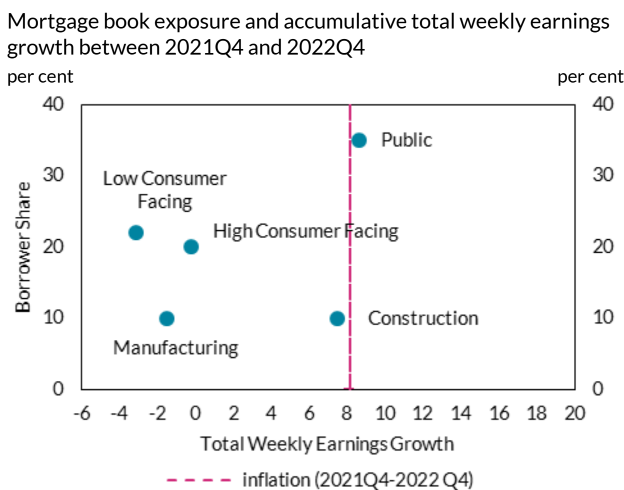
## Households

*Inflation has reduced the real incomes of households and interest rate increases have raised debt service burdens for some borrower cohorts. However, a number of factors are supporting household resilience, including nominal income growth, substantial deleveraging and prudent mortgage lending over recent years, and strong aggregate levels of savings. Taking the full balance sheet profile of households into account, simulation evidence suggests that the share of household borrowers experiencing financial stress would rise modestly under baseline projections. The main risk to household resilience would be an abrupt increase in unemployment. A new Central Bank survey evidence provides a note of caution, with up to two-fifths of mortgage borrowers reporting thin liquidity buffers to continue repayments in the event that widespread income and employment shocks were to materialise.*

Inflation is eroding real incomes, with survey data showing that it is the predominant source of financial difficulties in early 2023. In sectors with a high number of mortgage borrowers, the majority of employees have experienced declines in real income since the start of the pandemic (Chart 27). In a recent survey, Irish borrowers cited inflation as the largest single reason for missing payments on loans and utilities (Yao, 2023). However, the outlook for the labour market remains positive out to 2024. The unemployment rate is expected to drop to 4.4 per cent and compensation per employee is expected to increase 5.2 per cent by 2024 (Quarterly Bulletin 2023Q1). Nominal income growth will erode the real value of households' debt balances.

**Chart 27: Real income growth deteriorated in 2022**

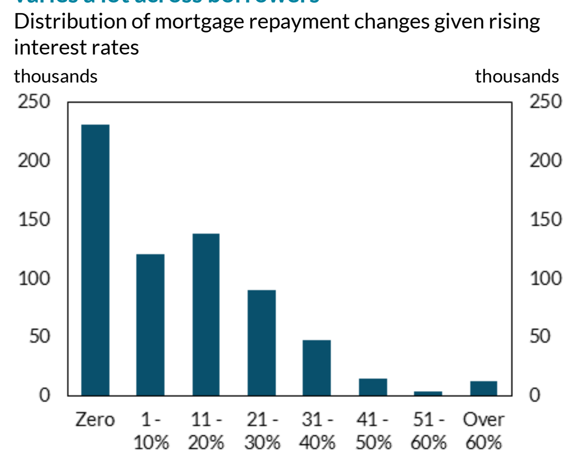
Mortgage book exposure and accumulative total weekly earnings growth between 2021Q4 and 2022Q4




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 8.2 per cent represents the cumulative HICP inflation rate between 2021Q4 and 2022Q4.

**Chart 28: The impact of monetary policy tightening varies a lot across borrowers**

Distribution of mortgage repayment changes given rising interest rates

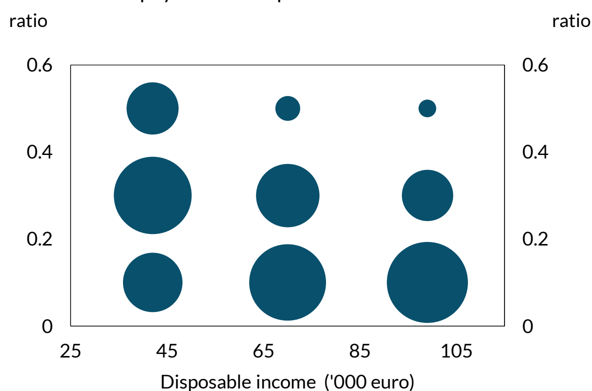



Source: Byrne, Gaffney and McCann (2023).
Notes: The bars indicate the number of household borrowers in thousands. The distribution of repayment changes given a 350bps increase in ECB interest rates.

The monetary policy response to inflation is leading to sharp increases in debt service burdens for some households, but most fixed rate borrowers have been unaffected up to now. Since July 2022, the European Central Bank (ECB) has lifted policy rates by 375 basis points. However, the Irish mortgage market has been moving towards more fixation in recent years as 80-90 per cent of new loans have been issued on fixed rates in 2020-2022. The median household has experienced only a modest increase in payments so far, while the top fifth of borrowers are seeing increases of 40 to 50 per cent on average (Chart 28).

**Chart 29: Most households entered the inflationary shock with relatively small debt service burdens**

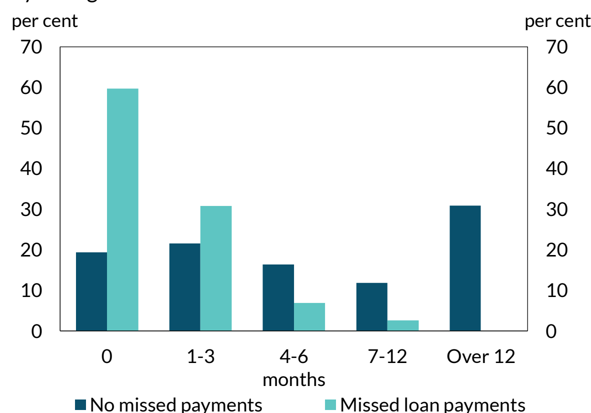
Distribution of household borrowers by disposable income and the total debt payment to disposable income ratio in 2020




Source: Household Finance Consumption Survey.
Notes: The size of the bubbles in the chart represents the weighted proportion of households in the survey.

**Chart 30: Despite strong aggregate savings, many households report thin liquidity buffers available if income shocks do arise**

Number of months in which debt repayments can be covered by savings



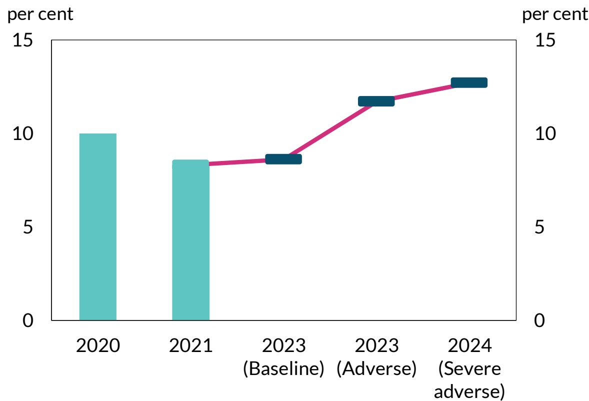

Source: Central Bank of Ireland Expectations Survey (Yao, 2023).
Notes: Sampling period: February 2023. 73 per cent of all households are in the "No missed payments" category, while 10.2 per cent are in the "Missed loan payments" category. Data source is a telephone survey, rather than official financial statistic.

Households in aggregate entered the inflationary shock with healthy balance sheets. Robust income and house price growth in recent years and more prudent lending standards since the GFC mean that households are in a better position to absorb adverse shocks than they were in the past (see Box C). Aggregate net wealth has grown substantially since 2013, with the household sector's wealth as a whole valued at over €1 trillion in 2022Q4. Mortgaged households have relatively high incomes and their repayments are generally less than 20 per cent of disposable income in 2020 (Chart 29), providing capacity to absorb increases in repayments or falls in income.

Strong aggregate savings growth may mask weaker liquidity buffers for some mortgage borrowers. According to a recent survey conducted by the Central Bank (Yao, 2023), about 40 per cent of households who are currently making loan repayments report having less than three monthly payments' worth of savings available in the event of income loss (Chart 30). The underlying variation across the population suggests that pockets of vulnerability could be exposed in the event of widespread falls in income under a macroeconomic downturn.

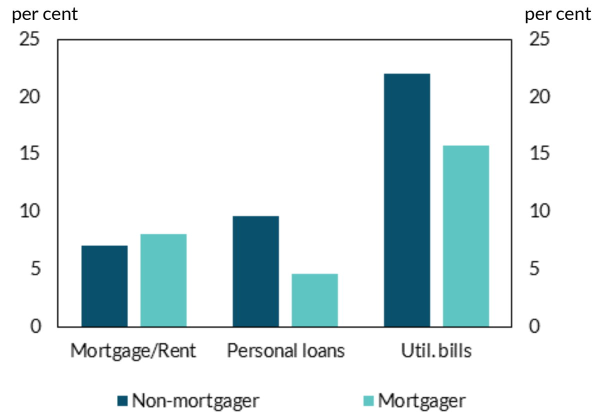
Taking households' full balance sheet position into account, Central Bank projections suggest growth in financial stresses is likely to be contained, even under an adverse scenario. Taking account of nominal income growth, shocks to repayments and spending, the distribution of fixed and floating loans, and the availability of savings buffers, Adhikari and Yao (2023) show that under baseline projections for the economy, only modest increases in households experiencing financial stress are likely over 2022 and 2023. The majority of mortgage borrowers appear capable of absorbing the shock from rising inflation and higher interest rates, with pockets of vulnerability among lower-income borrowers. Under a very severe adverse scenario with unemployment rising to 9 per cent, the share of financially stressed households could grow by one half relative to the 2021 level, from 8 to 12 per cent (Chart 31). The main driver of distress in this scenario would be loss of income due to rising unemployment.

**Chart 31: Growth in financial stress is projected to be modest in the baseline scenario**
Share of mortgage borrowers experiencing financial stress




Source: Adhikari and Yao (2023).
Notes: Households are classified as financially stressed in this modelling approach when income and liquid assets cannot cover essential expenditure, rent and debt payments. Baseline and adverse scenarios correspond to the EBA 2023 stress test scenarios.

**Chart 32: Non-mortgagors are more likely to be missing personal loan and utility payments**
Share of mortgagors versus non-mortgagors who missed payments in 2022




Source: Central Bank of Ireland Expectations Survey.
Notes: Share of respondents reporting a missed payment in the last 12 months by household type and repayment type.

Survey evidence suggests that mortgaged household balance sheets are broadly resilient for now, but missed payments on personal loans and utilities suggest that inflation has contributed to financial distress. 8 per cent of mortgage borrowers sampled in a recent survey report missing a mortgage payment in the year to February 2023, slightly above the 6 per cent of mortgages in arrears as per aggregate Central Bank mortgage arrears statistics (Chart 32). 5 percent of mortgage borrowers also missed other personal loan payments and 16 per cent missed a utility payment (of whom 8 per cent missed utility payments only, while the other 8 missed utility and loan payments, Yao (2023)). Inflation has been the primary reason cited by people that missed utility payments. For those who missed mortgage repayments, inflation is still the largest single response, but other economic factors, such as losses of income and debt servicing are also important for explaining missed repayments. These distress rates would therefore be at risk of rising if banks significantly increase the pass-through of monetary policy rates to variable-rate customers, or if increases in unemployment arise.

## Box C: Private sector deleveraging and resilience to rising interest rates

High indebtedness at the onset of any adverse shock leaves economies more vulnerable to weak consumption and investment, borrower defaults and knock-on implications for bank balance sheets and credit supply. All else equal, rising interest rates will have a larger impact on economic activity and asset prices in more indebted economies, as is currently evidenced in global housing markets, where house prices falls are more pronounced in countries with higher levels of household debt (see *Risks: Global*).

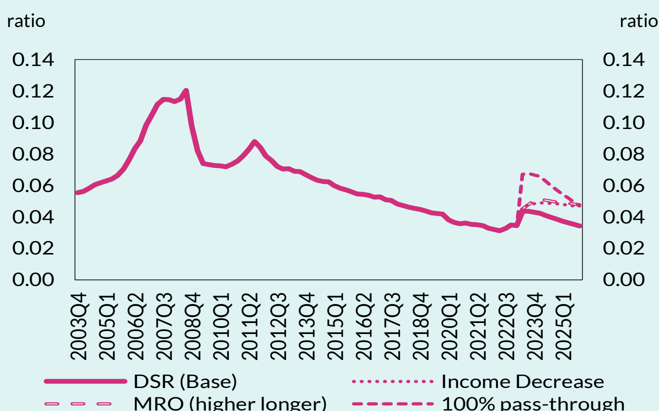
Both public and private debt rose in the run up to, but particularly during the Covid-19 pandemic (see for example IMF Debt Monitor, 2022). The analysis in this box places the evolution of private debt in the Irish economy in a historical context. Ireland is among a small group of countries in which the above debt dynamics have not played out since 2008. On the contrary, Irish households and Small and Medium Enterprises (SMEs) have been in a long-running deleveraging cycle which owes both to credit supply and demand factors following the experience of the GFC.

Chart A shows that the ratio of Irish households' mortgage interest payments to disposable income rose sharply after 2003, hitting a peak of 12 per cent in 2008, before trending down to 3 per cent in 2022. The stock of debt relative to income has fallen more in Ireland than most European countries during this period. Even under a number of scenarios for increases in interest rates to 2025, the interest service ratio is expected to remain well below 2008 levels. Debt-to-disposable income ratio of the Irish household sector also fell from 200 per cent in 2011 to 90 per cent in 2022, in contrast to steady or rising indebtedness among many European peers.

Chart B focusses on the deleveraging of SME debt in Ireland since 2011. The stock of SME debt at Irish banks fell by 70 per cent between 2012 and 2022. The largest declines were in the Real Estate (-85 per cent) and Accommodation & Food (-72 per cent) sectors. Survey results have consistently shown that Irish SMEs use external financing less frequently than European peers, and are more likely to use internal financing to fund investment, suggest a role for demand-side factors. All else equal, lower indebtedness will provide support in the face of rising interest rates, relative to other economies.

### Chart A: Household deleveraging since 2008 has increased resilience to rising interest rates

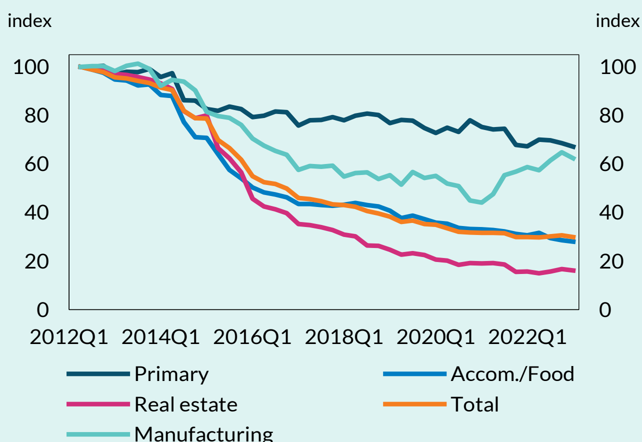
Household interest service to income ratios




Source: Central Bank of Ireland; Eurostat.
Notes: Household mortgage interest payment to disposable income ratio. Solid pink line after 2023 provides baseline forecast. Dotted and dashed lines provide scenarios for varying income growth, ECB interest rates and pass through assumptions. The highest DSR occurs in an extreme scenario where all loans receive 100% pass-through.

### Chart B: Irish SME bank debt also fell by more than two thirds in the same period

Growth in SME loan balances across sectors in Ireland relative to 2012




Source: Central Bank of Ireland.
Notes: Outstanding debt owed by Irish SMEs to Irish banks by sector, indexed to March 2012.

## Non-financial corporations

*The trading performance of Irish businesses has been remarkably strong during the current inflationary episode. While input costs have risen, firms have largely passed on these cost rises to customers and maintained or increased their profit margins. This cost pass-through dynamic has been facilitated by robust demand, even as real household incomes fell. SMEs in aggregate appear resilient under baseline projections, but profit margins would be vulnerable to a decline in aggregate demand. Debt service costs are rising for indebted firms and small firms in particular are sensitive to a deterioration in credit conditions. Loan performance indicators have yet to show a substantial deterioration in the repayment capacity of indebted firms. The pandemic fallout continues, with insolvency rates climbing and a considerable level of accrued liabilities still outstanding.*

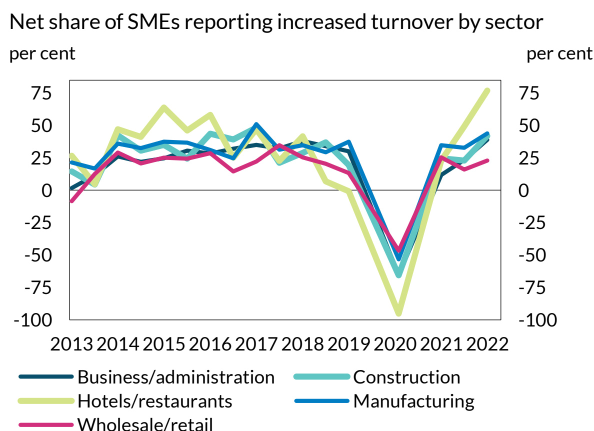
The trading performance of Irish businesses has been remarkably strong during the current inflationary episode. Despite the significant pressures facing households and firms, aggregate indicators of economic activity have been robust. Retail sales volumes remained strong throughout 2022 and into early 2023.[31] Similarly, labour market data continue to show unemployment at low levels.[32]

SME turnover increased strongly in 2022 (Chart 33). The net share of firms reporting an increase in turnover has reverted to pre-pandemic levels for most sectors. The pandemic-hit Accommodation & Food sector rebounded very strongly, with a net share of 77 per cent of firms reporting increased turnover. This shows the strength of the pandemic economic recovery, even in the context of rising costs.

Firms have raised prices significantly (Chart 34). Survey evidence shows that 61 per cent of SMEs raised their prices in the period March to September 2022. The average increase was 7 per cent. There is some variation across sectors, with firms in Accommodation & Food and Construction raising prices the most at 9 and 11 per cent, respectively. Human Health and Professional, Scientific & Technical businesses report more modest price rises of 1 and 3 per cent, respectively.

**Chart 33: SME turnover increased strongly in 2022**

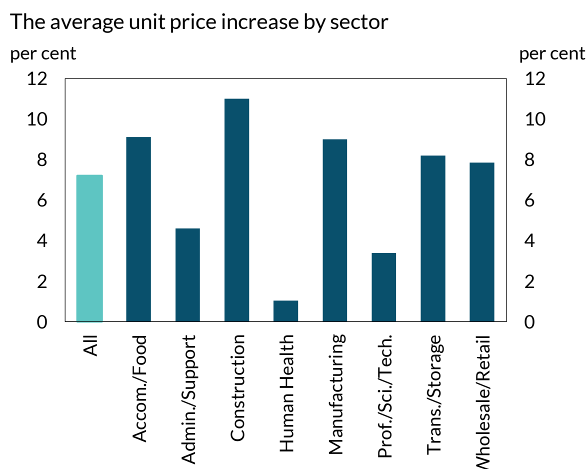
Net share of SMEs reporting increased turnover by sector




Source: Department of Finance, SME Credit Demand Survey.
Notes: The share of SMEs reporting a rise in turnover in the previous six months minus the share of SMEs reporting a decline by sector.

**Chart 34: Firms have raised prices significantly**

The average unit price increase by sector




Source: Department of Finance, SME Credit Demand Survey.
Note: The average unit price increase by sector.

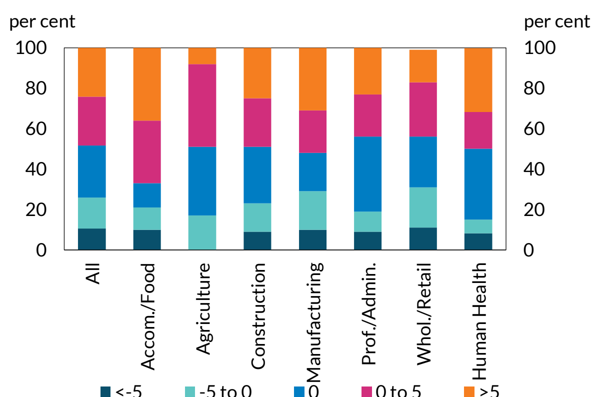
[31] See the February 2023 CSO Retail Sales release.
[32] See the April 2023 CSO Monthly Unemployment release.

Higher prices and robust consumer demand have broadly allowed profit margins to hold steady or increase (Chart 35). Firms have largely been able to pass on cost increases to consumers and thus maintain or increase their profit margins. Consumer demand has been more robust than expected in the face of very large price rises.

Profit margins are expected to be resilient under baseline projections, but they remain sensitive to a slump in consumer demand (Chart 36). Despite strong recent performance, simulation evidence shows that profit margins remain sensitive to a decline in demand and continued cost pressures. Under conditions consistent with the EBA stress test adverse scenario, average gross profit margins would fall from 25 per cent to 18 per cent in 2023. The share of firms making material losses would also rise from 9 per cent to 16 per cent.[33]

**Chart 35: Profit margins have broadly held steady or increased**

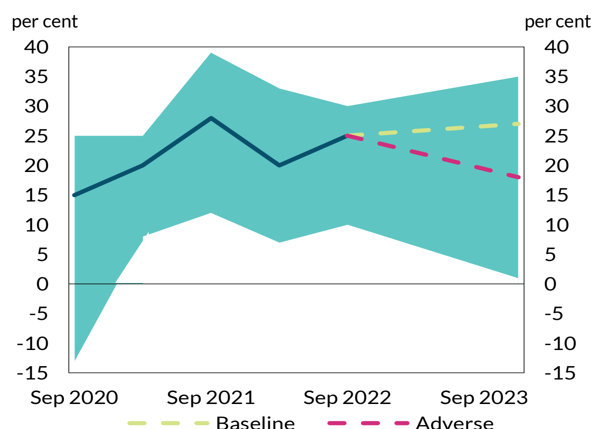
Share of SMEs by profit change and sector




Source: Department of Finance, SME Credit Demand Survey.
Notes: The share of firms reporting various profit outcomes by sector.

**Chart 36: Profit margins are resilient in the baseline, but are vulnerable to a slump in consumer demand**

Observed and simulated profit margins under baseline and adverse scenarios




Source: Adhikari and McGeever (2023).
Notes: Average observed profit margin up to September 2022 and simulated margins under Baseline and Adverse scenarios consistent with the Central Bank of Ireland's Quarterly Bulletin and EBA stress test adverse scenario, respectively. The shaded range shows the minimum and maximum outcome by sector observed to September 2022 and under the baseline scenario.

Debt service costs for firms are rising. Data to March 2023 show that the three-month moving average interest rate on new NFC lending was 5 per cent, up from 4.1 per cent in November 2022.[34] Higher interest rates are likely to reduce credit demand and business investment, while also raising debt service costs for existing borrowers.

The capacity of Irish businesses to absorb adverse shocks is supported by a long period of deleveraging since the Global Financial Crisis. Approximately half of SMEs have no financial debts, while the SME sector in aggregate has deleveraged substantially over the last decade (see Box C). Among the indebted half of businesses, fixed rate loans are common and provide short-term insulation from rising interest rates. These factors mean that the potential role played by small businesses in a debt-deleveraging spiral is substantially diminished relative to post-2008 crisis.

Businesses would still be sensitive to a sharp deterioration in credit conditions. The ongoing tightening of financial conditions may result in higher lending rates and a tightening of non-price

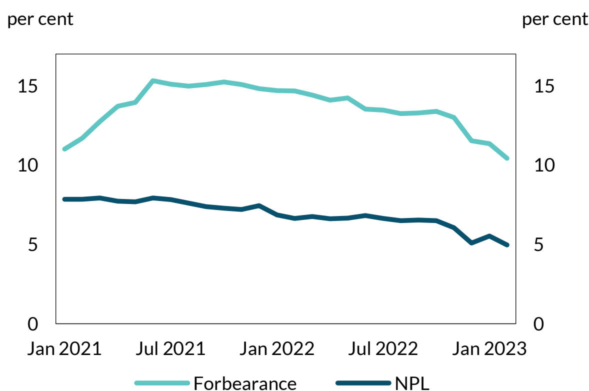
[33] Material losses are defined as a gross profit margin of -5 per cent or less. See Adhikari and McGeever (2023) for more methodological detail.
[34] See the March 2023 release of the Central Bank of Ireland's Money and Banking statistics.

credit standards. This would particularly impact smaller businesses that generally have only one lending relationship (Gaffney and McGeever, 2022) and fewer financing options than large corporates.

Large corporate leverage is stable, but a subset of firms are sensitive to rising finance costs. The average liabilities-to-assets ratio is approximately 0.57, with ten per cent of firms having ratios in excess of 0.8. Simulation evidence in FSR 2022:II shows that a doubling or tripling of finance costs would reduce operating profitability significantly for firms with weaker *ex ante* profit margins.

**Chart 37: Forbearance and NPL ratios of Irish business borrowers have fallen modestly in recent months**

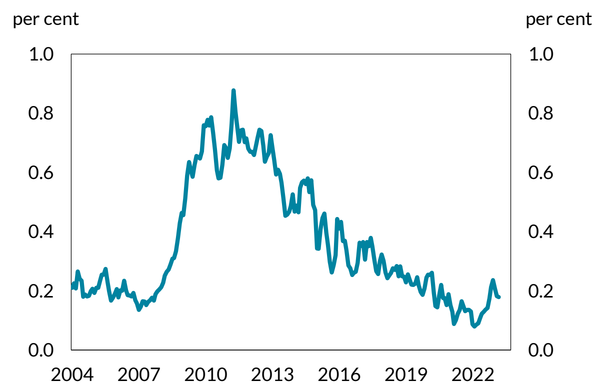
Forborne and NPL ratios of Irish NFC borrowers




Source: Central Bank of Ireland.
Notes: The forborne and non-performing loan (NPL) share of Irish non-financial corporate exposures at the domestic retail banks.

**Chart 38: Insolvencies have risen from pandemic lows**

Annualised three-month moving average insolvent liquidation rate




Source: Companies Registration Office; CRIF Vision-Net.
Notes: The annualised three-month moving average insolvent liquidation rate.

Loan performance indicators have yet to show a substantial deterioration in the repayment capacity of indebted businesses (Chart 37). The share of loan balances owed by Irish non-financial corporations to domestic banks that are forborne or non-performing has trended downwards over the last two years. The forborne share was 10 per cent in February 2023, while the NPL ratio was 5 per cent.

Insolvencies have risen from pandemic lows (Chart 38). Following a period of exceptionally low levels of company failure, the rate of insolvent liquidation ticked up during the second half of 2022. 58 per cent of companies that entered insolvent liquidation so far in 2023 were wage subsidy claimants during the pandemic, suggesting that the fallout from the pandemic period is still playing out. Deferred liabilities built up during the pandemic also remain substantial, with over €2 billon of deferred ('warehoused') tax liabilities still to be repaid and repayment plans outstanding still to be agreed with 60,000 businesses.

## Sovereign

*The headline fiscal position has improved since the last* Review, *both in terms of the budget balance and the debt ratio. This is due to strong revenue growth across all major tax heads – but especially corporate tax receipts, which remain very uncertain. Debt dynamics remain favourable, even in the context of rising interest rates. Sovereign resilience can be supported by ensuring that temporary spending measures expire as planned and by contributing windfall gains from corporation tax receipts into the National Reserve Fund.*

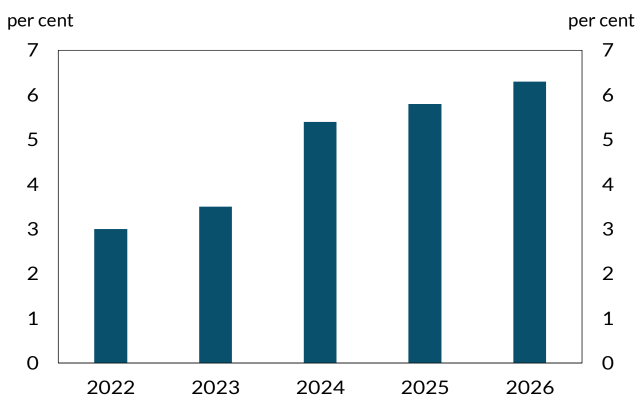
Tax revenue growth is driving a continued improvement in the public finances, but rising interest rates or a substantial decline in corporate tax receipts could test sovereign resilience. The Department of Finance's 2023 Stability Programme update forecast a surplus of 3.5 per cent of GNI* for 2023, up from the 2.2 per cent forecast in autumn 2022. Exchequer returns data show that income tax, VAT and corporation tax receipts have all grown strongly in 2023Q1. Corporation tax is again the primary source of growth, up 71 per cent on 2022Q1.

The General Government Balance (GGB) is forecast by the Department of Finance to rise strongly over the coming years (Chart 39). However, a range of spending pressures mean there is a higher degree of uncertainty around the forecast. For example, the favourable outlook for the GGB depends on temporary spending being wound down as planned and not becoming part of the permanent expenditure base. In addition, inflation could lead to higher core spending, while ageing and climate action measures will need to be funded over the medium to long term.

Ireland is expected to benefit from positive debt dynamics over the coming years. However, sovereign financing conditions have tightened considerably and the stock of debt remains elevated at 86 per cent of GNI*. Since the last *Review*, the yield on 10-year Irish Government bonds has continued to rise and now stands at 2.7 per cent. The NTMA retains significant cash balances of nearly €25 billion (8 per cent of GNI*) as of March 2023. While this provides funding flexibility, the value of sovereign debt maturing increases notably in 2025 and 2026 (Chart 40).

**Chart 39: The General Government Balance is forecast to improve**

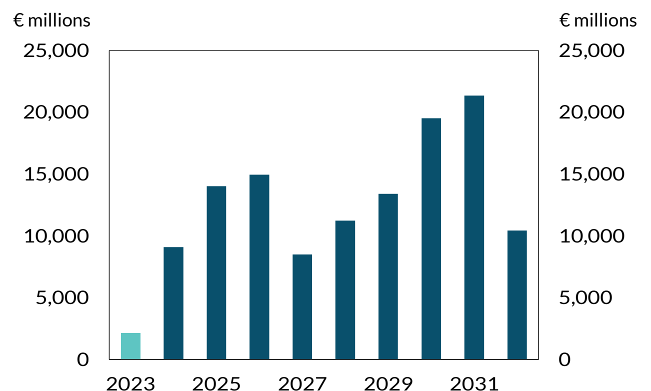
GGB as per cent of GNI*




Source: Department of Finance.

**Chart 40: The debt maturity schedule is favourable**

Debt balances by maturity year




Source: National Treasury Management Agency.

# *Non-bank financial sector*

## Investment funds and non-bank lenders

*In recent years, investment funds and non-bank lenders have become increasingly important for the Irish property market. Adverse price movements in property markets – reducing the value of property assets – could increase the de facto leverage of Irish property funds. Should this lead to forced sales, it may amplify any downward movement in property prices, with broader macro-financial implications. The amount of credit provided by non-bank lenders to Irish SMEs has decreased significantly throughout 2022. This reduction in credit supply is particularly noticeable for the real estate sector (which includes development projects), where new lending has fallen by 41 per cent annually.*

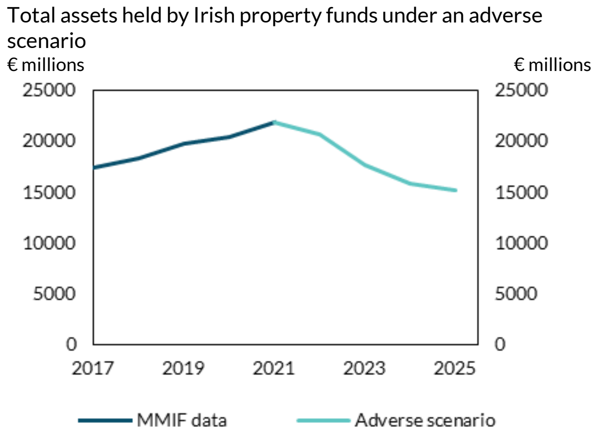
Irish property funds hold a significant share of the Irish CRE market, with the share held by highly leveraged funds decreasing in recent quarters. The outlook for the Irish CRE market has deteriorated sharply in recent months (see *Domestic Risk Assessment*). As of 2022Q3, Irish property funds held €22.3 billion in total assets, including €21.0 billion directly in Irish property assets, equivalent to approximately 34 per cent of the estimated 'investable' Irish CRE market.[35] The property fund sector has aggregate leverage of 47 per cent, calculated as the ratio of total non-equity liabilities to total assets. The share of highly leveraged firms – those with leverage greater than 60 per cent – has been in decline, with 31 per cent of assets in the sector held by these funds in 2022Q3 compared to 38 per cent in 2021Q3.[36] The last *Review* (FSR 2022:II) shows that part of the reduction in high leverage relates to active deleveraging through additional subscriptions from fund investors. This is in the context of the phased introduction of macroprudential policy measures to address the vulnerabilities arising from excessive leverage and liquidity mismatch in segments of the Irish property fund sector, limiting property funds to 60 per cent leverage.[37]

In adverse market conditions, leverage in the Irish property fund sector would rise as asset prices fall, increasing risks stemming from the sector. Under the EBA adverse scenario, where CRE prices decrease by 32.6 per cent on a cumulative basis from 2022-2025 (Chart 41), the share of total assets in highly leveraged funds would increase to 57 per cent (Chart 41, Chart 42).[38] In this scenario, 22 per cent of total assets in the sector would be held by Irish property funds in negative equity, which would represent an increase from 6 per cent in 2021Q4. The results highlight the vulnerability of a segment of the Irish property fund sector to falling real estate values due to pockets of high leverage. If the adverse scenario were to occur, this would increase the likelihood that property funds would amplify the shock, for example by being forced (by their creditors) to sell CRE assets in a situation of decreasing prices. As Irish property funds hold about a third of all investable CRE, these fire sales could contribute to further downwards pressure in prices, with adverse macro-financial implications. This underlines the need for a gradual adjustment to reduce leverage by a cohort of the property fund sector, consistent with the Central Bank's measures.

[35] Irish property funds are Alternative Investment Fund Managers (AIFMs) of Alternative Investment Funds (AIFs) that are domiciled in Ireland, authorised under domestic legislation, and investing 50 per cent or more directly or indirectly in Irish property assets.
[36] As most Irish property funds value their property assets annually, the impact of changes to CRE values over 2022 will not be fully reflected in leverage ratios of the funds until 2022 valuations are finalised at end 2023Q2.
[37] Daly, P., Moloney, K. and Myers, S. (2021) "Property funds and the Irish commercial real estate market" Vol. 2021, No. 1.
[38] The scenario analysis is based on the -6 per cent outturn for CRE asset valuations in 2022, based on the MSCI index, and a further 28.3 per cent decline as per the EBA 2023 EU-wide banking sector stress test for 2023-2025.

### Chart 41: In adverse conditions, falling CRE prices will reduce the value of assets held by Irish property funds

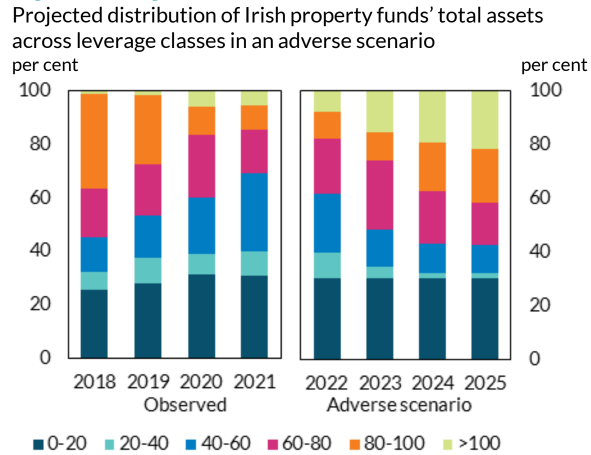
Total assets held by Irish property funds under an adverse scenario




Source: MMIF, MSCI, EBA Stress Test and Central Bank calculations.
Notes: MMIF data are used up to 2021Q4 due to unavailability of final 2022Q4 valuations. 2022 scenario is calculated using the MSCI index growth rate for Ireland. The MSCI index does not include residential investment assets and decreases in the asset values for funds holding these assets may be overstated. Scenarios are initiated at year end 2021. The CRE scenario after 2022 is based on the EBA 2023 EU-wide banking sector stress test, which includes all CRE cohorts.

### Chart 42: In adverse conditions, the proportion of highly leveraged Irish property funds will rise

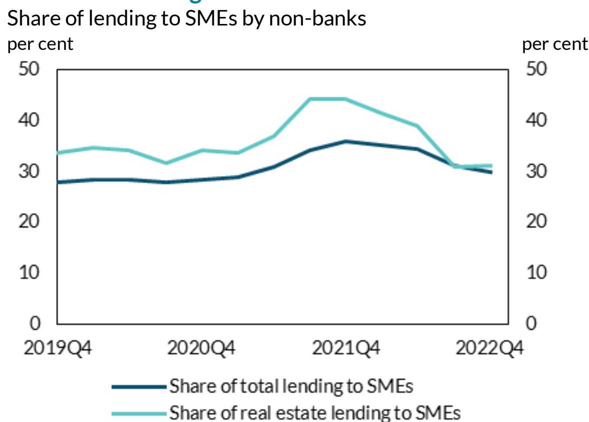
Projected distribution of Irish property funds' total assets across leverage classes in an adverse scenario




Source: MMIF, EBA Stress Test and Central Bank calculations.
Note: The chart 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 2021Q4 due to unavailability of final 2022Q4 valuations. 2022 scenario is calculated using MSCI index growth rate for Ireland. Scenarios are initiated at year end 2021.

### Chart 43: The share of lending provided by non-banks contracted through 2022

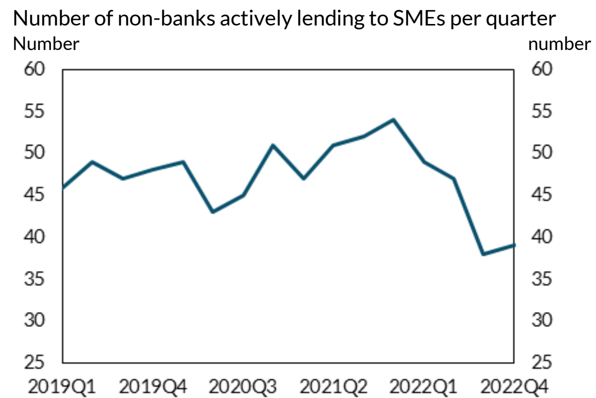
Share of lending to SMEs by non-banks




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

### Chart 44: The number of non-banks actively lending to SMEs has fallen

Number of non-banks actively lending to SMEs per quarter




Source: Central Bank of Ireland, Central Credit Register.
Notes: Last observation 2022Q4.

**Non-bank lender activity declined in 2022, both in terms of new lending volumes and numbers of active lenders.** Non-bank lenders are financial entities extending credit to domestic borrowers. Unlike banks, they do not accept deposits but are financed from other sources. Data for 2022Q4 show that Irish SMEs owed non-bank lenders €4.5 billion in comparison to €18.4 billion owed to banks.[39] This represents 20 per cent of the total outstanding stock of lending to SMEs. The share of new lending provided by non-banks in comparison to banks decreased from a peak of 39 per cent in 2021Q3 to 32 per cent in 2022Q4. The volume of new lending provided by non-banks to SMEs has decreased by 20 per cent annually. The decline in the share of new lending was strong for lending related to real estate activities (Chart 43). In line with the decrease in new lending

[39] The data source for non-bank lending is the Central Credit Register. The data source for bank lending is the SME and Large Enterprise Credit and Deposits.

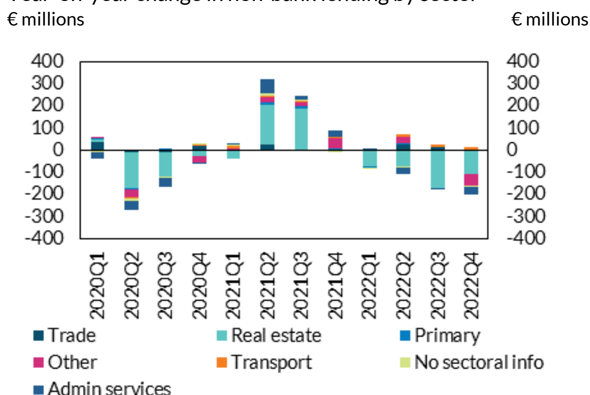
provided to SMEs, the number of non-banks actively lending also decreased in 2022 (Chart 44). Nine of the lenders that stopped lending in 2022 specialise in real estate lending to SMEs. In the mortgage market, similar dynamics are playing out, with non-bank lending shares falling sharply during the second half of the year (*Policy: Mortgage measures*, Chart 53).

There has been a strong decrease in non-bank lending to the real estate sector. Relative to other sectors, the real estate sector, including property development, has received the most funding from non-banks in recent years but has also been the most volatile in terms of changes over time (Chart 45). In comparison to 2021, lending to SMEs in the real estate sector has decreased dramatically in 2022, by 41 per cent.[40] This is in contrast to other sectors that are less reliant on non-bank funding, where the picture has been more mixed.[41] A significant portion of the decline in the number of active non-bank lenders can be linked to Special Purpose Entities (SPEs), which mainly provide credit to real estate SMEs.[42]

Non-bank lenders have less stable funding sources than banks, with implications for the supply of credit to Irish SMEs. In contrast to Irish banks, which tend to be funded through deposits, non-banks use other sources of funding. For example, SPEs lending to SMEs in Ireland have significant interconnections with the European banking sector and other non-bank financial entities based in Europe (Chart 46).[43] Financial statements also suggest that interest on loans received by SPEs from the European banking sector is paid on a floating rate basis, often tied to Euribor. Some of the other financing to non-banks may be less sensitive as it is at a fixed rate and/or based on other criteria e.g. the profits of the lender. The tightening in financial conditions in Europe, and globally, is likely a driver of the reduction in credit supply and in the number of active non-bank lenders in Ireland (Chart 43 and Chart 44). This reduction in credit may have knock-on implications for activity in the near term, particularly in the real estate sector.

**Chart 45: Non-bank lending flows are driven by changes in lending to real estate businesses**

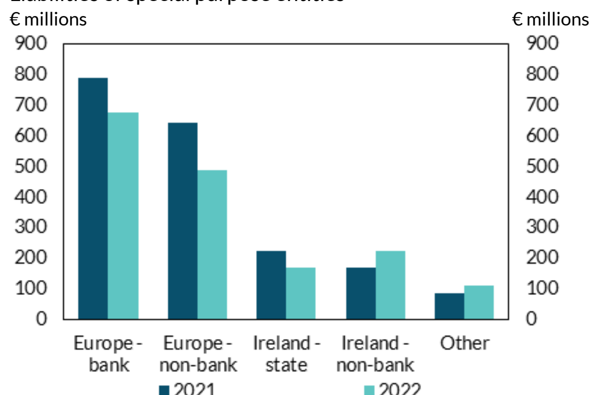
Year-on-year change in non-bank lending by sector




Source: Central Credit Register.
Notes: Real estate includes SMEs in real estate activities and construction, trade refers to wholesale/retail trade & repairs SMEs, primary refers to primary industries SMEs, admin services refers to business and administrative services SMEs, and transport refers to transportation and storage SMEs. Further details on the sectoral composition can be found in the explanatory notes for the Central Bank of Ireland SME and Large Enterprise Credit and Deposits statistics.

**Chart 46: Special purpose entities lending to SMEs receive funding from the European banking system**

Liabilities of special purpose entities




Source: Quarterly SPE Returns, CRO.
Notes: Non-bank entities include other financial intermediaries, financial auxiliaries and pension funds. Ireland – state refers to funding from the Ireland Strategic Investment Fund (ISIF). The ISIF, managed and controlled by the NTMA, is a sovereign development fund with a mandate to invest on a commercial basis to support economic activity and employment in Ireland.

[40] Bank lending to real estate SMEs also declined in 2022Q4, but is not significantly down in 2022 compared to 2021.
[41] The real estate sector is particularly reliant on non-bank lenders, with 37 per cent of borrowers in this sector borrowing exclusively from non-banks. See Gaffney, E. and McGeever, N. (2022), "The SME-lender relationship network in Ireland", Central Bank of Ireland, Financial Stability Notes, Vol. 2022, No. 14.
[42] Special Purpose Entities are legal entities established under Section 110 Legislation.
[43] The Central Bank of Ireland collects balance sheet data for the cohort of non-bank lenders categorised as SPEs.

## Insurance firms

*The resilience of the insurance sector is determined by a combination of the capital buffers held, the strength of reserves, and the exposure to underwriting losses as well as broader macroeconomic and financial market events. The capital buffers held by (re)insurers based in Ireland remained stable and well above regulatory requirements throughout 2022, despite the challenging macroeconomic environment and at times volatile financial market conditions. The solvency position of the sector has been resilient to the rises in interest rates and inflation. However, inflation remains a key concern (particularly for non-life insurance) as the reserves held to meet future claim costs may need to be increased further if inflation remains elevated for a prolonged period. The direct exposure of the Irish insurance sector to recent issues in the global banking sector was very limited, however it highlighted the potential risk of concentrated exposures to specific counterparties or sectors.*

With capital buffers significantly above minimum requirements, (re)insurers in general are well placed to withstand significant stress. Despite a year of financial and economic headwinds, (re)insurers' aggregate solvency decreased only marginally to stand at 186 per cent of regulatory requirements by 2022Q4. Individually, 99 per cent of firms had solvency coverage ratios above 121 per cent (unchanged from 2021Q4), with the median standing at 199 per cent (up from 189 per cent).[44] Solvency movements continue to be widely dispersed, reflecting the diverse nature of the firms comprising the industry - their business models, balance sheets, and risk management strategies in particular. Solvency coverage increased for 60 per cent of firms and decreased for the remainder (Chart 47).

Insurers and reinsurers are substantial investors in financial markets. Each firm's exposure to market risk varies according to its risk appetite. The extent to which a firm's assets match the nature of its liabilities and its strategy for investing excess assets are important choices. Fixed interest securities comprise the majority of (re)insurers' investments, accounting for 51 per cent of non-linked investments at 2022Q4. The average credit quality of (re)insurers' bonds decreased slightly during 2022, but broadly equates to a Standard & Poor's AA-/A+ rating. Although bond valuations generally declined in 2022 due to rising interest rates resulting in significant investment losses for some (re)insurers, the sector's robust aggregate solvency indicates that bond assets were well matched to interest rate sensitive liabilities. (Re)insurers invest relatively lightly in traditionally more risky assets. Allocations of the industry's non-linked assets to equities[45], property, and collateralised securities were all between 1 per cent and 3 per cent at 2022Q4 (with a further 10 per cent allocated to collective investment undertakings which are partially invested in these asset classes). A significant 22 per cent of non-linked assets were held as cash or deposits. In 2023H1 Irish life insurers implemented deferral periods on withdrawals from several property-related unit-linked funds. This was due to an increase in redemption requests which impacted the liquidity position of the funds. These actions allow for the orderly disposal of property investments which protects the interests of all policyholders. Importantly, however, the value of direct investments in Irish property by unit-linked funds is small in comparison to Irish investment funds, with the investment by unit-linked funds equally to approximately 15 per cent of the total value of Irish property held by Irish investment funds.

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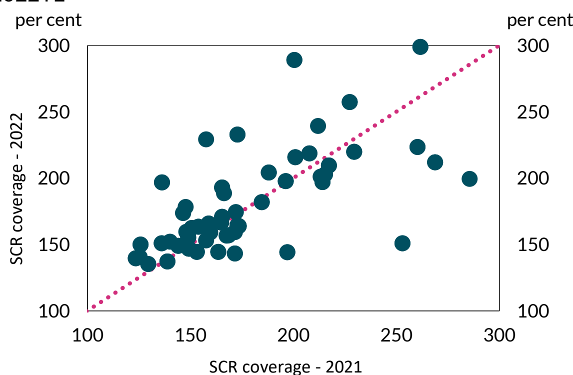
[44] Solvency coverage is measured as a firm's available capital (known as "own funds" under Solvency II) as a percentage of its Solvency Capital Requirement (SCR).
[45] Excluding holdings in related undertakings and participations.

High inflation affects (re)insurer's loss reserving and profitability, as well as premium rates in the market. Inflation impacts the cost of settling many types of insurance claims for which policyholders must be compensated in real terms (e.g. motor repairs or medical care). Non-life insurers are more exposed than life insurers (where claim payments are more likely to be fixed monetary amounts), though both are affected by higher operating expenses. For (re)insurers, setting inflation assumptions is complicated by the number of influencing factors – non-life claims inflation is impacted by general economic inflation, legislative changes, new court precedents, and changing societal behaviours such as private car usage and propensity to claim for minor injuries. An upward revision in the assumed level of future inflation can require insurers to increase their claims reserves for written business without receiving any additional premium, negatively impacting their profitability and balance sheet. Insurers' ability to recover the increased cost of future claims by increasing premium rates may be limited by competitive pressures. However, once most insurers recognise the need to increase premium rates, there can be a rapid, market-wide increase, adding to inflationary pressures in the economy and affecting the affordability of insurance. In the Irish home insurance market, average premiums initially did not respond to rising building repair costs in 2021 but have risen rapidly in latter half of 2022 due to a combination of increased premium rates and increased sums insured (Chart 48).

**Chart 47: Solvency coverage movements over 2022 were widely dispersed**

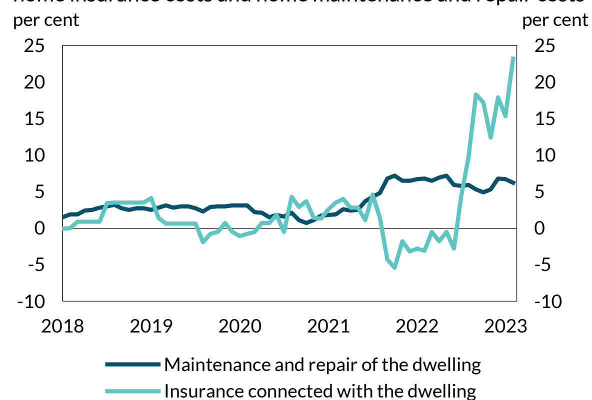
Solvency coverage of insurers and reinsurers 2021YE and 2022YE




Source: Central Bank of Ireland.
Notes: The scatter chart shows the solvency coverage of individual firms at 2021YE (x-axis) versus their coverage at 2022YE (y-axis). A position below the diagonal line means a fall in coverage over the period. Only firms with PRISM impact rating[46] of Medium Low and above are shown. Firms with solvency coverage of greater than 300 per cent are not shown.

**Chart 48: Cost of home insurance increased rapidly in 2022 having initially not responded to increased home repair costs**

Annual percentage change in consumer price sub-indices for home insurance costs and home maintenance and repair costs




Source: CSO
Note: The chart shows monthly data for the percentage change over the previous 12 months for selected CPI sub-indices. Last observation April 2023.

The Irish insurance sector had a very low level of exposure to the recent issues in the global banking sector. Irish (re)insurers had no material exposure to SVB or Signature Bank and held €135 million of their non-linked investments in equities or bonds issued by Credit Suisse at 2022Q4 (representing less than 0.2 per cent of their total non-linked investments). However, Irish insurers hold significant levels of investments in securities issued by banks and in funds managed by banks, while a number of Irish regulated insurers are owned by banks.

[46] Further information on PRISM can be found on the Central Bank of Ireland website here.

# Macroprudential policy

The domestic financial system has, to date, remained resilient to recent developments in the global and domestic economies. 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 strengthening of the international regulatory framework, including the active use of macroprudential policies, since the global financial crisis have put the financial system, and in particular the banking sector, in a better position to withstand adverse shocks. The benefits of this resilience has been evident in recent years, as the financial system has encountered a series of adverse shocks.

The Central Bank's macroprudential policies look to promote resilience, proportionate to the risks faced by the financial system. 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 focusing on the CCyB, the mortgage measures and policies relating to non-banks, in particular investment funds.

It is important that the macroprudential policy framework continues to develop and adapt to the evolving financial system. In this regard, developing macroprudential policy for non-banks is a key priority for the Central Bank. The Central Bank is actively working with peer institutions in the EU and internationally to advance this work in the area of investment funds.

**Table 1 | Summary of macroprudential policies**

| | O-SII | CCyB | Mortgage Measures | Property funds |
|---|---|---|---|---|
| **Objective** | Safeguard resilience of systemically important banks, defined as those institutions whose failure would have a large impact on the financial system. | Promote banking sector resilience to future adverse shock – proportionate to the risk environment – with a view to facilitating a sustainable flow of credit to the economy through the financial cycle. | Ensure sustainable lending standards in the mortgage market. | Increase the resilience of this growing form of financial intermediation, reducing the risk that financial vulnerabilities might amplify adverse shocks in future periods of stress. |
| **Rate** | 0.5% - 1.5% depending on the institution | 1.5% | LTV: 70% - 90% depending on borrower type<br>LTI: 3.5 - 4 times depending on borrower type<br>A proportion of new lending above the limits is allowed<br>*See Table 2 for details* | Leverage limit - sixty per cent (total debt to total assets) and Central Bank Guidance that generally property funds should provide for a liquidity timeframe of at least 12 months, taking into account the nature of the assets held. |
| **Exposures in scope** | All exposures | Irish exposures | Proportion of newly originated mortgage exposures | Funds domiciled in Ireland, authorised under domestic legislation, and investing over 50 per cent of their |

| | O-SII | CCyB | Mortgage Measures | Property funds |
|---|---|---|---|---|
| | | | | portfolio in either directly or indirectly held Irish property assets. |
| **Effective from** | July 2019 on a phased basis. All buffers have been fully-phased in since January 2022. | 0.5% from June 2023<br>1% from November 2023<br>1.5% from June 2024. | Measures initially introduced in February 2015.<br>Targeted changes to the framework came into effect in January 2023. | 24 November 2022 for any newly authorised property funds. November 2027 for the leverage limits and May 2024 for the Guidance on liquidity timeframes. |

## *Macroprudential capital buffers*

### Countercyclical capital buffer

*The Central Bank is increasing the CCyB rate from 1 per cent to 1.5 per cent, effective from June 2024. In line with its strategy for the CCyB, the Central Bank has been gradually building the CCyB towards 1.5 per cent, the rate that will be set when risks are neither elevated nor subdued, since June 2022. This is consistent with the objective of the CCyB, to provide resilience to the potential materialisation of future shocks and, in such circumstances, better enable the banking system to absorb losses and facilitate a sustainable flow of credit to the economy. The capital position of the domestic banking sector and the strong profitability outlook for the sector mean that the increase in the CCyB is not expected to have a material effect on credit supply or on the real economy in the central scenario. 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's 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. The CCyB achieves this objective by building loss-absorbing capacity as the risks facing the banking system grow, and reducing or releasing the CCyB as risks materialise or imbalances unwind (Chart 49). In that way, the banking system is better able to withstand adverse shocks, without restricting the supply of credit to the economy.

The Central Bank sees the increase of the CCyB rate from 1 per cent to 1.5 per cent (effective from June 2024) as appropriate given current macro-financial conditions, and should support the resilience of the banking sector to the potential future materialisation of risks. Downside risks to global growth are significant due to the continued erosion of real incomes and tightening financing conditions (*see Risks: Global)*. Domestically, the economy has remained resilient and the central outlook is for solid growth and ongoing strength in the labour market. Nonetheless, the erosion of real incomes continues to pose downside risks, while the impact of higher interest rates has manifested most visibly and immediately in the CRE market (*see Risks: Domestic)*.

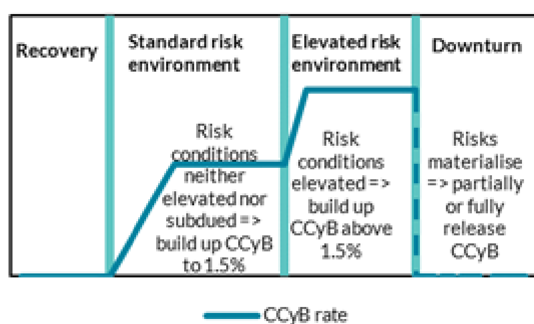
Credit developments have been heterogeneous across the market. While a retrenchment in non-bank lending has been evident, in aggregate, bank credit has continued to see modest rates of growth even as credit conditions have tightened. Into the early months of 2023, new mortgage lending in particular has remained robust overall. The impact of tightening financing conditions has been more evident in a slowdown in lending to the NFC sector. Given lags in the credit data,

further tightening of credit conditions is likely to have occurred which would be expected to feed through to credit volumes. As of 2022Q4, the alternative credit gap stood at 6.64 up slightly from 6.37 in 2022Q3 (Chart 50).[47]

The capital position of the banking sector and the profitability outlook in a central scenario mean that the CCyB increase is not expected to have a material impact on credit conditions or the real economy. As discussed in *Resilience: Domestic Banks*, the capital position of the sector has remained resilient and well above regulatory requirements. The banking sector's capital position would also be expected to remain resilient under the central outlook for the economy, supported by a strong labour market position and improving profitability. Such conditions provide scope for the banking sector to absorb the increase in the CCyB rate while minimising the potential for the buffer increase to have negative effects on credit supply and economic activity.

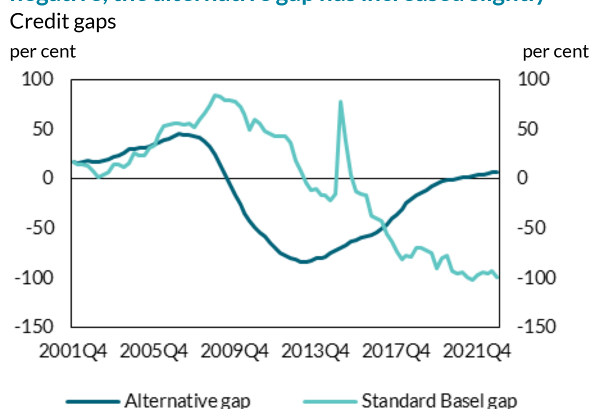
Future CCyB rate decisions will be taken in the context of macro-financial conditions in a manner consistent with the Central Bank's strategy for the buffer. Since June 2022 the Central Bank has been communicating on its expected path for building the CCyB rate to a level of 1.5 per cent – the rate considered appropriate for a standard risk environment. As such, a CCyB rate of 1.5 per cent would be maintained when cyclical risks are neither elevated nor subdued. Having the buffer in place provides scope for its release, partially or fully, should it be required in response to a materialisation of risks. On the other hand, the CCyB could be increased above 1.5 per cent if cyclical risks were becoming elevated (Chart 49). An addendum[48] to the Central Bank's Framework for Macroprudential Capital has been published which aims to provide further detail as to the implementation of the Central Bank's strategy for the CCyB.

**Chart 49: Stylised representation of the Central Bank's strategy for the CCyB**
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 50: 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 December 2022.

[47] As discussed in The Central Bank's framework for macroprudential capital: CCyB addendum the calculation of the alternative credit gap was been subject to recent methodological changes.
[48] The Central Bank's framework for macroprudential capital: CCyB addendum

# *Macroprudential mortgage measures*

## Mortgage measures

*The refreshed framework for the mortgage measures, announced in late 2022 following a comprehensive review, came into effect on 1 January 2023. The Central Bank will be monitoring the implementation of the refreshed framework as data become available in the months ahead and will continue to communicate on the measures in the Financial Stability Review. As outlined in its framework for the mortgage measures, the Central Bank does not foresee regular changes to the calibration of the measures. The mortgage measures are viewed as permanent in nature with the calibration mainly driven by structural factors in the economy.*

*Since the last Review, data on new mortgage lending for the full year 2022 point to robust lending activity overall, albeit with underlying trends reflective of the changing nature of wider market conditions, in particular the implications of the higher interest rate environment.*

The Central Bank concluded its comprehensive review of the mortgage measures framework in late 2022 announcing targeted changes to the measures. The refreshed framework (Table 2) came into effect on 1 January 2023. 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 the measures were introduced, without unduly reducing their benefits, as were reaffirmed by the review. The Central Bank will be monitoring the implementation of the refreshed framework as data become available in the months ahead and will continue to communicate on the measures in future Financial Stability Reviews.

The Central Bank considers the mortgage measures to be permanent in nature and their calibration to be largely driven by structural factors, so does not foresee regular changes to calibration. As outlined in the mortgage measures framework, the Central Bank's strategy focuses on the evolution of slower-moving structural forces, such as the magnitude of risks to affordability or the sustainable level of house prices relative to incomes, which may warrant long-term changes to the calibration of the measures. The Central Bank is committed to undertaking periodic reviews of the strategy around the measures. These periodic reviews will complement the regular monitoring, analysis, engagement and communication undertaken on an on-going basis.

**Table 2 | Details of the LTV and LTI Regulations (in force since January 2023)**

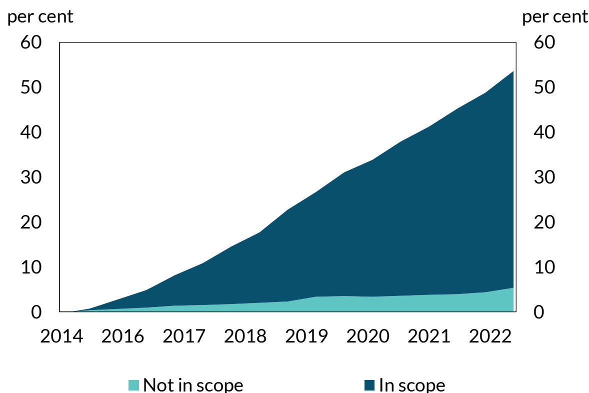
| Borrower type | FTBs | SSBs | BTL |
|---|---|---|---|
| Limits under the mortgage measures | LTI: 4x<br>LTV: 90% | LTI: 3.5x<br>LTV: 90% | LTV: 70% |
| Allowance share above the limits | 15% | 15% | 10% |
| Exemptions | Switcher loans are exempt from the mortgage measures. The LTI limit does not apply to lifetime mortgages. The LTV limit does not apply to negative equity mortgages. | | |

*Overview of new mortgage lending in 2022*

The mortgage measures act incrementally to enhance the resilience and credit quality of the overall stock of mortgage loans. As of end-2022, 53.6 per cent of outstanding mortgage lending had been drawn down since the introduction of the mortgage measures, 48.3 per cent in-scope of the measures and 5.3 per cent not in-scope (Chart 51).

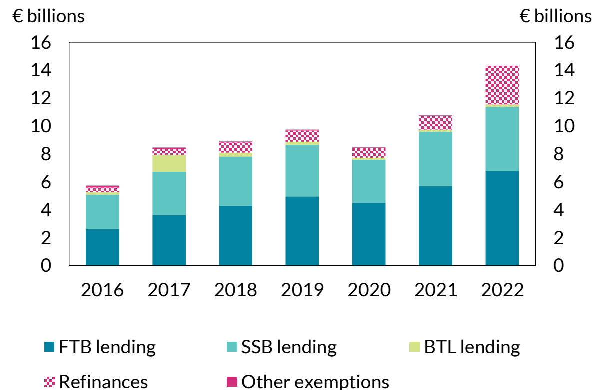
Overall, new mortgage lending was strong in 2022. Under the measures prevailing at the time, i.e. prior to the introduction of the refreshed framework this year, the eight lenders that report regulatory data to the Central Bank originated a total of 52,810 loans worth €14.3 billion in 2022. This represents a substantial increase on the level of lending in 2021 and indeed is the largest annual volume of lending seen since the Central Bank began collecting these data.[49]

**Chart 51: The mortgage measures have been incrementally increasing resilience since their introduction in 2015**
Share of Irish retail bank outstanding mortgage portfolio issued under the mortgage measures framework




Source: Central Bank of Ireland Loan-Level data and Monitoring Templates data.
Notes: Mortgages issued under the mortgage measures framework are those mortgage loans approved and drawn down since 9 February 2015. Data are a join of the loan-level data and monitoring template data. Irish retail banks are defined as the domestic banks plus KBC Bank Ireland plc and Ulster Bank Ireland DAC. Last observation 2022.

**Chart 52: FTB lending continues to represent the largest share of new lending, while refinance activity increased significantly in 2022**
Volume of new lending by borrower type




Source: Central Bank of Ireland Monitoring Templates data.
Notes: Refinances relate to where there is no increase in the mortgage amount outstanding and which are exempt from the mortgage measures. Other exemptions includes negative equity. Last observation 2022.

First-time buyers and refinancing borrowers accounted for the majority of the growth in the mortgage market last year.[50] Lending to FTBs in 2022 amounted to €6.7 billion, the largest share of new lending (Chart 52). Refinancing activity where there was no increase in the mortgage amount outstanding, which are exempt from the mortgage measures, accounted for €2.7 billion in 2022, a large increase from the year before (€0.9 billion in 2021). The increase in refinancing activity is consistent with the market dynamics experienced over the course of the year, i.e. the on-going exit of two retail banks and the changing interest rate environment. Focusing on in-scope loans only, the impact of the changing interest rate environment is also evident in the role of bank and non-bank entities. Overall and consistent with the trends of recent years, non-banks contributed an increased share of new (in-scope) lending in 2022 (14.5 per cent in 2022 compared with 11.7 per cent in 2021) (Chart 53). However, the share of non-bank lending declined in H2 from the highs seen in H1 (Chart 53), reflecting the greater impact that the changing interest rate

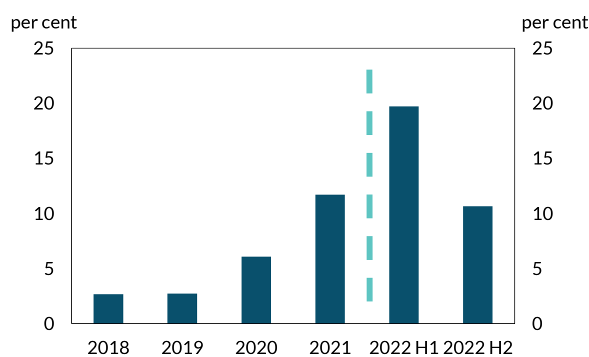
[49] A detailed overview of new lending under the mortgage measures is published twice yearly by the Central Bank on its website – See New Mortgage Lending Data.
[50] In this context, refinancing relates to situations where there is no increase in the mortgage amount outstanding only.

environment had on these lenders relative to banks. Another continuing trend evident in the data is the increasing prevalence of fixed-rate mortgage lending, with the majority of new lending in 2022 taking place at initial fixation periods of 3 years or more.

The incomes of new FTB borrowers have risen by around 20 per cent over the last five years. In terms of the key characteristics of borrowers in the new lending market (Chart 54), data show that the average loan size, property value and total (gross) income of FTBs steadily increased since 2017 but especially in the last year. Indeed, average (total) gross income rose by nearly 7 per cent between 2021 and 2022 and similarly, average loan size and property value increased by roughly 8 per cent.

**Chart 53: The role of non-bank financial intermediaries peaked in the first half of last year**

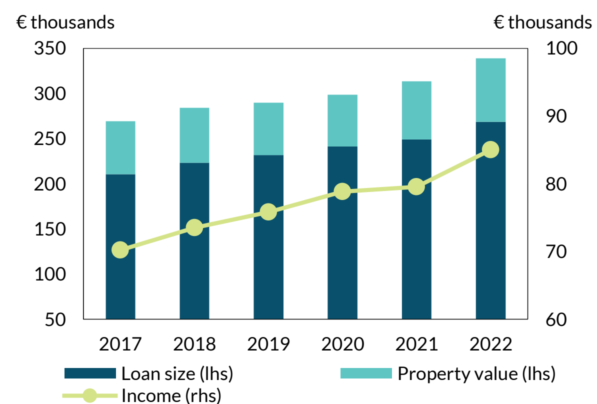
Percentage of new mortgage lending by non-banks 2018-2022.




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

**Chart 54: Average FTB loan size, property and income have increased again in 2022**

Average characteristics of FTB lending (2017 – 2022).




Source: Central Bank of Ireland Monitoring Templates data.
Notes: Average characteristics of in-scope FTB lending. Last observation 2022.

The share of new lending issued with an allowance increased somewhat in 2022, continuing to rise from pandemic lows. Overall, the percentage of PDH lending with an allowance in 2022 continued to rise from the lows of pandemic-years (from around 15 percent in 2020 to 16.5 per cent in 2022). Lending issued with an allowance in 2022 includes lending classified as "carry-over" from 2021. These "carry-over" loans issued in 2022H1 are assessed as part of an institution's 2021 compliance with the mortgage measures. Overall, lenders issued approximately €250 million worth of loans which were allocated as carryover from 2021, €155 million of this related to the FTB LTI category.

## *Macroprudential policy for non-banks*

Reflecting the scale of the sector in Ireland and the growing connections to the domestic economy, developing a macroprudential policy framework for non-banks is a key priority for the Central Bank. The non-bank financial sector in Ireland is large and diverse with heterogeneous business models and activities. As such it is necessary to prioritise those segments of the non-bank financial sector that pose systemic risks. Consistent with this, the Central Bank's initial focus when developing macroprudential policy for non-banks is on investment funds, given the sector's size, significant growth over the past decade and its interconnectedness to the wider financial system. 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.

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. In light of underlying financial vulnerabilities, the collective actions of fund cohorts have the potential to cause material macro-financial impacts. The potential for the collective actions of fund cohorts to have systemic risk implications was evident in the March 2020 "dash for cash" and the more recent UK gilt market stress (see Box D). Assessing systemic risks of investment funds therefore requires a macroprudential perspective that focuses on the vulnerabilities of the investment fund sector such as leverage, liquidity mismatch and interconnectedness and funds' potential to amplify shocks.

A macroprudential framework for investment funds should target the collective action of fund cohorts and requires international and European coordination given the global and cross-border nature of the investment funds sector. While international efforts are underway to develop a common approach in this area, the lack of a complete and operational macroprudential toolkit 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. To further advance discussion and progress in this area, a Central Bank Discussion Paper to be published in the coming weeks will outline an approach to macroprudential policy for funds and will be seeking stakeholder feedback in the months ahead.

### Measures for Irish Property Funds

*Reflective of their growing role in financial intermediation, the Central Bank in November 2022, announced new macroprudential leverage limits and new Guidance to mitigate leverage and liquidity mismatch in Irish property funds. The Central Bank is providing a five year implementation period for existing Irish property funds to comply with the leverage limits and 18 months for existing Irish property funds to take appropriate action in response to the Guidance. The measures have applied immediately for any Irish property fund authorised on or after 24 November 2022.*

*The Central Bank will be closely monitoring the adoption of the measures and their effectiveness and impact, which will include a new data collection and further engagement with Irish property funds where warranted.*

Following extensive analysis and engagement, the Central Bank announced new macroprudential limits on leverage and Guidance on liquidity timeframes for Irish property funds ("property funds") in November 2022.[51] Reflecting the macroprudential objective of the measures, the measures apply to Alternative Investment Fund Managers (AIFMs) of Alternative Investment Funds (AIFs) that are domiciled in Ireland, authorised under domestic legislation, and investing 50 per cent or more of their assets under management directly or indirectly in Irish property assets.

The Central Bank judges that the CRE market is systemically important for the Irish financial system and the wider economy. Property funds have become a key participant in the Irish CRE market, holding a considerable amount of investible Irish CRE. Central Bank analysis illustrates that there is a cohort of property funds that have high levels of leverage and, to a lesser extent,

[51] See Macroprudential policy framework for Irish property funds.

liquidity mismatches.[52] 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 *(see Resilience: Investment funds and non-bank lenders).*

### *Measures to address leverage*

To guard against excessive levels of leverage across the property fund sector, the Central Bank has introduced a 60 per cent leverage limit. The 60 per cent leverage limit is calculated as total debt (i.e. total non-equity liabilities) to total assets. There will be some adjustments to the leverage limit for property funds invested in social housing assets and/or development activities. Further detail on these adjustments are outlined in the Macroprudential policy framework for Irish property funds. The leverage limit is being imposed using Regulation 26 and, as appropriate, Regulation 9 of the Irish AIFM Regulations.

Existing property funds must comply with the 60 per cent leverage limit by 24 November 2027. It is expected that existing funds with leverage above 60 per cent would not increase the quantum of their debt during the implementation period but would make early and steady progress towards lower leverage levels over the implementation period. The Central Bank will only authorise property funds established on or after 24 November 2022 with leverage below the 60 per cent limit.

### *Measures to address liquidity mismatch*

To address the liquidity mismatch observed in property funds, the Central Bank has introduced new Guidance. The Guidance relates to how Regulation 18 of the Irish AIFM Regulations should be applied in the case of property funds. The Guidance states that property funds should generally provide for a liquidity timeframe of at least 12 months, taking into account the nature of the assets held. This timeframe should be appropriately balanced between the notification and settlement period. The Central Bank expects existing property funds to implement liquidity timeframes in-line with the Guidance by 24 May 2024. The Central Bank expects that property funds authorised on or after 24 November 2022 will adhere to the Guidance at inception.

### *Monitoring and review*

Consistent with the Central Bank's macroprudential policy approach for banks and borrowers, the Central Bank will closely monitor the adoption of the measures and their effectiveness and impact. As outlined in the Macroprudential policy framework for Irish property funds, the Central Bank has developed a new data collection, to be filed annually, which will assist in its assessment of the effectiveness of the measures. The property fund measures will also be subject to periodic (less frequent) framework reviews.

The Central Bank expects relevant property funds 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 will engage with these funds as part of the regular supervisory process in the second half of 2023.

[52] 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.

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.

## *Recognition of macroprudential measures taken by other countries*

The reciprocation of macroprudential measures enhances the effectiveness and consistency of macroprudential policy in the EU. Macroprudential policy measures taken in one country are likely to have external effects on financial stability in other countries through cross-border linkages. In order to ensure the effectiveness of macroprudential measures, the ESRB has established the process of reciprocation 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. The Central Bank's reciprocation framework has two distinct processes; responding to ESRB reciprocation recommendations and conducting an annual review of outstanding reciprocation recommendations.[53]

The Central Bank continues to reciprocate a French macroprudential measure under Article 458 of Regulation (EU) No 575/2013 ("CRR").[54] The conditions for ongoing reciprocation of this measure were confirmed as part of the Central Bank's annual review of outstanding reciprocation recommendations in 2022. All other active measures recommended for reciprocation by the ESRB are not currently reciprocated by the Central Bank on the basis that the relevant exposures of the Irish banking system were not deemed to be material, and hence reciprocation of the measures was not warranted.

[53] The Central Bank has laid out a framework in line with ESRB/2015/2 and undertakes an assessment of all ESRB recommendations for reciprocation and where appropriate may comply with the recommendation to reciprocate the measures taken. See Central Bank of Ireland (2016) Macro Financial Review 2016:1, Pg. 50 for details.
[54] See decision by the Central Bank to reciprocate a French measure under Article 458 of Regulation (EU) No 575/2013 ("CRR").

## Box D: Recent developments relating to GBP Liability Driven Investment Funds

**This box discusses recent developments relating to the GBP liability driven investment (LDI) fund sector resident in Ireland**. As outlined in the last *Review*, the UK's *mini-budget* on 23 September led to turmoil in UK gilt markets, exacerbated by the LDI strategies employed by defined benefit UK pension funds that were forced to sell gilts to raise liquidity or reduce leverage.

**Data show that the selling of gilts by Irish-resident GBP LDI funds was most acute for funds with higher leverage through repo, and for funds with more than one investor.** Over 23 September – 14 October, LDI funds' gross sales of gilts were approximately £23 billion. Multi-investor funds accounted for £15 billion, while gilts used as collateral in repo on 22 September accounted for £19 billion. These findings align with analysis conducted by the Bank of England (2023).

**In November 2022, the Central Bank set out a 300-400 basis point (bps) yield buffer as a minimum safeguard to maintain the operational and financial resilience of Irish-resident GBP LDI funds**. The buffer requires the value of investors' equity to be at least as large as the asset valuation decrease that would follow a 300-400 bps increase in yields. This implies a maximum leverage ratio between fund assets and investors' equity, determined by the interest rate sensitivity of a fund's assets. This measure was introduced in coordination with the Commission de Surveillance du Secteur Financer (Luxembourg's competent regulatory authority), after interaction with the European Securities and Markets Authority (ESMA), and UK authorities as outlined in an industry letter.

This has improved fund resilience - the median buffer increased from 170 bps in October 2022 to 444 bps in March 2023. Liquidity and leverage have also improved.[1]

**On 29 March 2023, the Financial Policy Committee (FPC) of the Bank of England published recommendations to improve the resilience of LDI funds.** These recommendations aim to ensure that LDI funds maintain a steady-state minimum level of resilience, determined to be resilient to a minimum 250 bps increase in yields, in addition to a buffer that would allow them to operate under normal conditions. On 24 April, The UK Pension Regulator published guidance for trustees and the UK Financial Conduct Authority published guidance and recommendations on risk management for LDI managers and advisors.

**The Central Bank of Ireland noted the FPC announcement and reaffirmed its expectations that the minimum safeguards highlighted in the November 2022 communication should continue to be observed for GBP LDI funds.** The resilience levels expected by the Central Bank as outlined in the industry letter last November are consistent with those outlined in the FPC announcement. The Central Bank will continue to work closely with regulators in the UK and across Europe as well as international regulatory bodies to ensure that all relevant leverage and liquidity risks are managed effectively across the investment fund sector, including those in LDI funds.

[1] Median on-balance sheet leverage (total assets/net asset value) was 1.9 in March 2023, down from 2.9 in September 2022. Liquid assets (cash + money market fund shares) constituted 28 per cent of LDI funds' balance sheet at December 2022, up from 20 per cent in June 2022.

# Abbreviations

Country and currency abbreviations follow the European Union standards.

| | |
|---|---|
| **AE** | Advanced economies |
| **AIB** | Allied Irish Bank |
| **AT1** | Additional tier 1 |
| **AUM** | Assets under management |
| **BIS** | Bank of International Settlements |
| **BLS** | Bank Lending Survey |
| **BOI** | Bank of Ireland |
| **BTL** | But-to-let |
| **CBOE** | Chicago Board Options Exchange |
| **CBRE** | Coldwell Banker Richard Ellis Group |
| **CCR** | Capital Requirements Regulation |
| **CCR** | Central Credit Register |
| **CCyB** | Countercyclical capital buffer |
| **CET1** | Common equity tier 1 |
| **CPI** | Consumer price index |
| **CRD** | Capital Requirements Directive |
| **CRE** | Commercial real estate |
| **CRO** | Companies Registration Office |
| **CSO** | Central Statistics Office |
| **EA** | Euro area |
| **EBA** | European Banking Authority |
| **ECB** | European Central Bank |
| **EEA** | European Economic Area |
| **EM(E)** | Emerging market (economies) |
| **ESMA** | European Securities and Markets Authority |
| **ESRB** | European Systemic Risk Board |
| **EU** | European Union |
| **FSR** | Financial Stability Review |
| **FTB** | First-Time Buyer |
| **GGB** | General Government Balance |
| **GDP** | Gross domestic product |
| **GFC** | Global Financial Crisis |
| **GNI** | Gross national income |
| **HH** | Households |
| **HICP** | Harmonised index of consumer prices |
| **ICT** | Information and communications technologies |
| **IFRS** | International Financial Reporting Standards |
| **IMF** | International Monetary Fund |
| **KBC** | Kredietbank ABB Insurance CERA Bank |
| **LDI** | Liability driven investment |
| **LTI** | Loan to income ratio |
| **LTV** | Loan to value ratio |
| **MMIF** | Money market and investment funds returns |
| **MSCI** | Morgan Stanley Capital International |
| **NBFI** | Non-bank financial intermediary |
| **NFC** | Non-financial corporation |
| **NII** | Net interest income |
| **NIM** | Net interest margin |
| **NPL** | Non-performing loan |
| **NTMA** | National Treasury Management Agency |
| **OECD** | Organisation for Economic Co-operation and Development |
| **O-SII** | Other Systemically Important Institutions |
| **PDH** | Primary dwelling house |
| **PMI** | Purchasing managers' index |
| **PTSB** | Permanent PTSB |
| **RPPI** | Residential property price index |
| **RRE** | Residential real estate |
| **RWA** | Risk-weighted asset |
| **SCR** | Solvency capital requirement |
| **SME** | Small and medium enterprise |
| **SPE** | Special purpose entity |
| **SSB** | Second and subsequent buyer |
| **SSM** | Single Supervisory Mechanism |
| **SVR** | Standard variable rate |
| **UBI** | Ulster Bank Ireland |
| **VAT** | Value added tax |

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