Banc Ceannais na hÉireann
Central Bank of Ireland
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# Opening remarks by Sharon Donnery, Deputy Governor of the Central Bank of Ireland

## at the launch of the Macro Financial Review

## 15 December 2016

Good morning,

Today, the Central Bank of Ireland is publishing the second edition of the 2016 Macro Financial Review (MFR), which provides an overview of the current state of the macro-financial environment in Ireland.

**The Macro Financial Review aims at supporting the Central Bank's stakeholders – including the public, national and international authorities, and financial market participants - in their assessment of financial risks.** It also provides an opportunity to promote an informed dialogue on the macro-financial environment in Ireland and beyond. It thereby contributes to the Central Bank's mission of *safeguarding stability and protecting consumers.*

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**The immediate impact of Brexit on the euro area has been relatively muted.** Nevertheless, the considerable uncertainty on the outcome of the negotiations between the UK and the EU constitutes a large downside risk to the euro area economy. While it is too early to assess fully its impact on the Irish economy, downside risks to the domestic economy prevail over the medium term, given the extensive linkages between Ireland and the UK.

**A number of further risks to European financial stability arise**. The threat of simultaneous corrections across asset classes persists, given compressed global risk premia in financial markets and macroeconomic uncertainty. Furthermore, the persistent low interest rates pose a challenge to the profitability of both the banking and the insurance sectors. In the financial sector, the high stock of non-performing loans continues to constrain the lending activity of

European banks. Finally, public and private debt in some Member States remains high, thereby increasing their vulnerability to both economic downturns and tensions in financial markets.

**In this context, as per the last Quarterly Bulletin, Irish GDP is projected to grow by 4.5 per cent in 2016 and by 3.6 per cent in 2017**. Domestic demand is expected to be the main driver of growth over the forecast horizon, reflecting, in part, a positive outlook for the labour market and expected investment in infrastructure. The balance of risks to the Irish economy, however, is tilted to the downside owing to Brexit and uncertainty surrounding international trade, high public and private debt, and the susceptibility of the economy to external shocks.

**Overall credit conditions remain subdued, although a rise in new lending is now evident.** Against this background, the Central Bank has decided to maintain the countercyclical capital buffer rate on Irish exposures at 0 per cent in 2017Q1.

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**Turning to specific sectors, today's publication shows a less positive outlook for the non-financial corporate sector compared with the Review published last June, with the decision of the UK to leave the EU posing a substantial downside risk to it**. The sector is expected to see a direct impact of Brexit on trade due to weaker foreign demand and the strengthening of the euro against sterling. In addition, the ongoing uncertainty could act as a drag on investor confidence. In the longer term, greater barriers to trade could materialise.

**Financing conditions for non-financial corporations remain restrained.** The overall stock of credit declined, with an annual rate of growth of -5 per cent in October 2016. Such a trend reflects loan repayments, driven by SMEs, continuing to outpace new lending. Nevertheless, gross new lending to SMEs reached its highest level in Q2 2016, since 2010.

**In the household sector**, **despite the deleveraging that has been occurring in recent years, debt remains high**. Its distribution varies by household age cohort, with the 35-44 age cohort being relatively highly indebted. There is continued momentum in mortgage arrears - mortgage accounts for principal dwelling houses in arrears fell in 2016Q3 for the thirteenth consecutive quarter.

**Turning to the housing market, residential property price growth has declined from recent peaks.** Disparities arise between Dublin - where prices have increased 5.4 per cent in August 2016 year-on-year - and outside Dublin, where prices rose 11.4 per cent over the same period. Rental growth remains strong with regional variability also arising. While residential construction activity is increasing, annual new supply does not meet projected long-term demand.

**At the end-November, the Central Bank announced the findings of its review of the macroprudential mortgage lending requirements.** The review has confirmed that the overall framework is appropriate and that the mortgage measures have been implemented successfully. Nevertheless, a few changes were implemented to improve the effectiveness and the sustainability of the framework. Among those, the €220,000 threshold has been removed for first time buyers, meaning that first time buyers can borrow up to 90 per cent of the value of a home, with a requirement for a 10 per cent deposit. The 3.5 loan to income limit remains unchanged. This anchor remains firmly in place and is key to ensuring that mortgage commitments are not too high relative to income levels.

**Returns on Irish commercial property continued to decline in the first half of 2016, but remain higher than those in other countries.** Rental values are rising as a shortage of supply – especially in Dublin – is becoming evident. Investment by non-resident investors is vulnerable to global economic and financial uncertainty as well as to alternative investment opportunities elsewhere.

**Turning to the banking sector, net-interest income of Irish retail banks declined marginally in the first half of 2016.** Credit quality is improving and the stock of non-performing loans (NPLs) held by Irish retail banks declined by €15.6 billion over the past year to €37 billion in 2016Q3. The reduction of NPLs has occurred across all major loan categories, with commercial property portfolios experiencing the strongest decline. Nevertheless, there is still a lot to be done to reduce the high stock of non-performing loans, which is constraining the activities of Irish banks. While the low interest rate environment has contributed to a reduction in banks' funding costs, it also poses a challenge to the profitability of Irish banks with interest income falling, given shrinking loan books.

**Given the international nature of its business, the non-bank financial sector is exposed to adverse developments in the global economy and international financial system.** Although the Irish domestic economy has limited direct exposure to this sector, any adverse development to the activities of funds based in Ireland could cause reputational damage.

**Looking at the insurance sector, the domestic non-life insurance industry continues to experience operating challenges**. All the domestically-focused high-impact non-life firms reported underwriting losses in the first half of 2016, albeit at lower levels than in the same period of 2015. Those losses are mainly concentrated in the motor insurance market. Moreover, the sector has also been affected by the low-interest rate environment, with interest income falling over time. Nevertheless, the overall solvency position of the non-life sector remains high.

**Domestic life insurers are also well-capitalised and are benefitting from improving economic conditions.** The domestic life firms have little direct exposure to the UK in terms of business written and investment holdings but may be affected by any adverse effects on the Irish economy from Brexit.

We are now at your disposal for questions.