**The macrofinancial outlook - 2021**

**Opening statement by Gabriel Makhlouf**

**Governor, Central Bank of Ireland**

**At the launch of the Central Bank of Ireland's Financial Stability Review for H1 2021**

Good morning

Thank you for joining us for the publication of our latest Financial Stability Review. As you know, this publication sets out our judgements on the main risks facing the economy and financial system. It also outlines our assessment of the capacity of the financial system to withstand those risks, and the macroprudential policy actions we are taking to safeguard financial stability.

A lot has changed over the last six months.

The country has experienced an extremely challenging period of public health restrictions. At the same time, there has been widespread progress in vaccinating the population, both in Ireland as well as in many partner countries. This progress in one of the most challenging logistical operations ever carried out in the State has meant that social and economic reopening is now a welcome reality. Nonetheless, the understandable caution on the pace of reopening will have implications for the degree of economic activity that will be possible in some sectors for much of the rest of the year.

Overall, economic and financial conditions in Ireland have improved over the last six months. Job losses reached record highs during the pandemic, but government supports played an important role in absorbing the shock to people's livelihoods and incomes. Despite restrictions in place for much of the year so far, downside risks and the sheer level of uncertainty facing us at the time of our last publication has reduced, given the rollout of the vaccination program and the continued effectiveness of public policy support to the real economy.

Firms and households in the community have adjusted to life with the virus, which has meant that the economic effects of the public health restrictions this year have not been as dramatic as those last year. Recent provisional national accounts data which show a 5 per cent fall in modified domestic demand in the first quarter of this year (when compared to the first quarter of last year) are testament to the resilience of aggregate economic activity to the pandemic.

Nonetheless we must be vigilant and act to mitigate the effects of any further adverse events related to the virus. The recovery may be bumpy and uneven, as some sectors in Ireland thrive while others continue to struggle with the effects of the restrictions. The viability of some businesses will be tested by the necessary tapering of government supports. There is of course the potential for a more widespread setback to the recovery, from challenges related to the vaccine rollout, or the virulence of new variants which require a tightening of public health measures. On top of this, the accumulated effect of the shock so far means that, in a range of sectors, the financial resilience of many businesses and households is weak, and their survival is highly

dependent on the intersection of the nature of the economic recovery and the path for policy supports.

A number of global headwinds also give us pause for thought. Global financial conditions remain extremely accommodative, which has meant that risks have been building in many key global financial markets. A range of factors could lead to a sharp repricing of global risk premia, something which would lead to much disruption globally given the level of risk-taking both preceding and during the pandemic.

On top of this, the Irish economy is subject to risks from longer-running structural changes. Among these, changes to global corporation tax arrangements have the potential to lower tax revenues and hamper the Government's capacity to invest and support the economy. On actual FDI activity and employment levels, the risks are perhaps more muted due to the extent that employment-intensive investment is already embedded in Ireland, as a result of strong workforce skills and the operating environment. There is clearly substantial uncertainty around how current tax proposals would translate into a new operating environment for multinational firms. But it seems prudent for the government to begin planning for a world in which corporation tax revenues are lower in the future.

Turning to the resilience of the domestic financial system, for many borrowers the unprecedented level of policy support from government, and flexibility from creditors, has meant that financial distress has yet to crystallise through defaults or insolvencies. It is likely, particularly for business borrowers, that any latent distress will become more visible in some sectors over the coming months as the economy reopens and supports taper off. Our assessment up to now has been that policy supports, both in terms of direct financial assistance to businesses and in loan payment breaks and flexibility from all creditors, have been a critical element in either delaying or outright avoiding financial distress.

It remains a priority for us that lenders continue to play their part in the management of the fallout from the pandemic. This means arriving at restructuring and forbearance arrangements that ensure that viable businesses survive, and that they do not begin to accumulate arrears in ways that caused such damaging long-term issues after the last crisis. Complementing this is the importance of a steady and sustainable flow of new lending to the economy to support the recovery, something that our policy actions since March 2020 have acted to facilitate.

There will come a point when it will become clear that some enterprises will not have a viable future, due to a combination of the effects of the pandemic, and the strength of the business proposition. It is in the best interests of the economy as a whole that, for this subset of businesses, an orderly liquidation process exists that can allow capital, labour and entrepreneurial talent to be reallocated.

We continue to assess the domestic banking sector to be resilient to absorb losses and support the economy, even in scenarios that are considerably worse than current baseline projections. The current situation is that the banking sector actually has a stronger capital position than we expected towards the end of last year. This reflects both the evolution of the macro-financial environment relative to what we were expecting, but also the impact on bank balance sheets. In addition, a wide range of policy choices have either supported borrowers in avoiding default or have temporarily mitigated or delayed certain effects on capital positions. Collectively, these

policy choices have ensured that, unlike the global financial crisis, the financial sector in Ireland has acted to absorb this shock.

I will now turn to our policy actions.

We have maintained our macroprudential stance on bank capital with today's announcement that the CCyB will remain at 0%. This decision reaffirms our commitment to ensuring that banks have capacity to absorb, rather than amplify, the negative effects of the pandemic, and to support the recovery. A primary overarching aim of our macroprudential framework is that banks' credit supply decisions do not act to amplify the economic cycle, whether in periods of growth or during crises such as the pandemic. The evidence we have to date is that, through both our actions and a wide range of other supportive policy decisions, a lack of credit has not contributed to the economic challenges facing our country. This is a big contrast to where we found ourselves a decade ago, and reflects all the efforts to build resilience over the past decade.

Before I talk about our plans for the mortgage measures, let me start with the housing and mortgage market. Our assessment of conditions in the housing market can be thought of in two phases. First, one must highlight that recent challenges in delivering the supply of housing are part of a decade-long trend of under-supply relative to levels required. The pandemic has exacerbated this trend which stems from the damage to the construction sector as a result of the last crisis, as well as a complex set of policy factors.

Second, the period of the pandemic itself, while exacerbating supply issues due to closures of construction sites, has at the same time seen a number of forces potentially stimulating demand levels. One paradox of the pandemic is that, while job losses are at a scale never seen before, the strength of economic activity in unaffected sectors combined with the level of additional savings owing to a lack of spending opportunities, precautionary behaviour and direct fiscal support, mean that there is ample scope for a liquidity-driven growth in house prices coinciding with never-seen-before economic disruption in some sectors.

On the mortgage market, we have seen a continued recovery in approvals levels since the initial phase of the pandemic, suggesting that households do indeed stand ready to transact. Our mortgage measures have acted to ensure that, while price pressures mount, and while demand increases, the role that credit can play in driving unsustainable house price rises is limited.

On the topic of the mortgage measures, today I am also announcing an important milestone in our review of the framework. The role of the mortgage measures in guarding against the over indebtedness of households and protecting financial stability is clear. However, as a permanent feature, it is important that we not only maintain the good practice of regularly reviewing the calibration of policy but also consider the overarching framework. It is now approaching seven years since the introduction of the measures and a review of the framework will allow us to consider the overarching approach, our toolkit and strategy to ensure they continue to remain fit for purpose in view of the evolution of our financial system and economy. The framework review accompanies a review of the bank capital framework and the development of the Central Bank's framework for macroprudential policy in the area of market-based finance as part of a current three-pronged review of our macroprudential framework at the Central Bank of Ireland.

Much has changed since the measures were introduced. We now have access to better information thanks to the Central Credit Register. Globally, interest rates have been on a downward path since 2015. The role of non-bank financial institutions in the housing market has expanded considerably, while housing supply overall has recovered more slowly than perhaps many people expected back in 2015.

As part of this review, we will assess the objectives of the measures themselves, and ask whether they remain appropriate. We will review the tools that we use, and the factors that we take into account when setting their levels. Most importantly, we will listen to the Irish public, and let them have their say. Today, I am announcing a digital tool, which will remain open from late June through July and will allow all members of the Irish public to participate in a survey and give their views on the functioning and appropriateness of the measures. I encourage you all to engage with this tool, and to inform friends and colleagues. The more information we gather from the community, the stronger will be our overarching review. To complement this, we will host *Central Bank Listens* events during July, where we will allow stakeholders from Irish civil society and business to give their views.

We will publish our own assessment of what we have learned from both the Listening events and the digital tool throughout the second half of this year. We will complement this with emerging research from our own teams which forms part of this review. I look forward to providing you with an update on what we have learned, and how it is shaping our thinking, at the launch of the second *Review* of this year in the weeks before Christmas.

Thank you and we are available to take your questions.