Gabriel Makhlouf: Introductory statement - Joint Oireachtas Committee on Finance, Public Expenditure and Reform, and Taoiseach

Opening statement by Mr Gabriel Makhlouf, Governor of the Central Bank of Ireland, before the Joint Oireachtas (National Parliament) Committee on Finance, Public Expenditure and Reform, and Taoiseach (Head of Parliament), Dublin, 14 February 2024.

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Good afternoon Chair, Committee members.

Thank you for your invitation to appear before you today. I am joined by Deputy Governors Vasileios Madouros and Derville Rowland.

I will begin by giving a brief overview of the economic outlook and the resilience of household borrowers in the current economic environment and by setting out some of our regulatory priorities for the year ahead.

The economic outlook

Turning to the outlook, the most recent Eurosystem staff projections show economic activity and inflation for the Euro Area weakened in the second half of 2023. The short-term outlook for the Euro Area economy points to stagnation in the face of tighter financing conditions, weak business and consumer confidence and low foreign demand. However, the economy is expected to start gradually improving over the course of the year. A broad-based disinflationary process is unfolding across Europe and is expected to continue during 2024 as the effects of past energy price shocks and other pressures fade. The pace of growth in labour costs will then be the dominant driver of core inflation.

Overall, Euro Area headline Harmonised Index of Consumer Prices (HICP) inflation is expected to decrease from 5.4 per cent in 2023 to an average of 2.7 per cent this year, 2.1 per cent next year and 1.9 per cent in 2026. Although inflation has fallen in many member states, we have not yet seen the full extent of the lagged effect of monetary policy actions on borrower finances or economic demand. At our most recent meeting at the end of January, my colleagues and I at the ECB decided to keep rates unchanged.

With disinflation well underway, we are confident in sustainably reaching our target of 2 per cent. Policy rates are now at levels that, if maintained for a sufficiently long duration, will make a substantial contribution to bringing Euro Area inflation back to target. Although uncertainties remain, it is clear that our monetary policy decisions are working. Finally, and for the avoidance of doubt, I remain open-minded about the path of our policy rates.

The Irish economy

As for Ireland, economic activity at home slowed noticeably in 2023. The Irish economy is still expected to grow over the coming years, albeit at a slower pace. We published our latest Quarterly Bulletin at the end of December, which sets out our latest assessment of the economy. Our forecasts suggest Ireland's domestic economy will grow by 2.5 per cent this year, and by 1.9 and 2 per cent in 2025 and 2026 respectively. Inflation has declined significantly over the course of 2023 and the outlook for inflation is now lower than projections given in our previous forecasts.

However, there are a series of general and sector-specific factors that, to varying degrees, underlie recent developments and could affect those current forecasts. First, base effects and a post pandemic normalisation, which mostly relate to the unwinding of the exceptional level of physical investment in the State by multinational enterprises in 2022, as well as in the normalisation of export activity in the pharmaceutical sector post-Covid. Second, structural factors such as geoeconomic fragmentation in goods and services trade, and capacity constraints in the labour market and in housing, which limit the scope for higher sustainable growth in the domestic economy.

Third, the general slowdown of activity globally and domestically, as demand is dampened by tighter monetary policy necessary to bring inflation back to sustainable levels. This is already affecting both external and domestic demand developments for Ireland, and is contributing to slower growth than would otherwise be the case over the forecast horizon.

The resilience of household borrowers in the current economic environment

Let me turn to the resilience of household borrowers in the current economic environment. There are two key points that I would like to highlight. First, at an aggregate level, the Irish household sector has proved resilient in the face of these challenges, and we expect that to continue if economic conditions evolve in line with our forecast. Second there are, of course, some borrowers that are more vulnerable and we have been working to ensure that the financial system is ready to deal with cases of financial distress in a consumer focused way. Overall, the frameworks we have in place have been working, and we intend to ensure this remains the case.

The impact of inflation and rising interest rates on Irish household borrowers has been cushioned by nominal income growth, fiscal measures, and the relatively slow pass-through of monetary policy by lenders to household borrowing rates. The resilience of households has also been supported by more than a decade of balance sheet repair since the previous crisis, fixed borrowing costs for many, low levels of debt and prudent new lending following the introduction of our mortgage measures. We also have a strong labour market, with over 300,000 jobs created in the past few years.

As I said, households have been broadly resilient in this environment but there are pockets of vulnerability and, for some, mortgage repayments have increased significantly, particularly for those on tracker rates but also some borrowers on variable rates and those newly applying for credit.

Mortgage switching has played a role in ensuring consumers access what they consider to be the best option for their circumstances. Switching volumes have increased from

€1.3bn in 2019 to €3.7bn in 2022, with borrowers continuing to benefit from switching even after the ECB tightening cycle began. Moreover, the switching rate of mortgage holders at non-bank lenders increased during 2023, and our estimates suggest that it now stands at around the same level as the switching rate for mortgage holders at retail banks, having been substantially below that for many years. We also saw credit unions beginning to play a growing role in switching last year.

Nevertheless, we continue to remain focused on how lenders deal with borrowers in financial distress. As I indicated, over the past year we have been particularly focused on ensuring that the financial sector is ready to respond to borrowers who find themselves in a difficult financial position.

The most important thing for people who find themselves in difficulty is to contact their financial services provider without delay. We know that early engagement leads to better outcomes.

Through our work we have seen firms enhance their early warning indicators and customer engagement, widen the suite of alternative repayment arrangements they offer (including certain limited fixed-rate options) and the introduction of new support measures for borrowers through the BPFI's "Dealing with Debt" campaign.

The broadly stable arrears trend in 2023 masks some movement in the depth of distress: long-term arrears cases, a scarring legacy of the previous crisis, continue their long-term decline, while early arrears cases and those missing three payments (but not yet in long-term arrears) both increased by an offsetting amount.

Though every case represents a person or household in distress, when compared to historical levels, the household sector continues to appear resilient at an aggregate level. Tracker rate borrowers, and in particular those with a history of previous repayment challenges dating back to the global financial crisis, appear to explain the modest rise in early arrears cases seen up to the middle of last year.

However, challenges remain. We recognise that there is a proportion of mortgages in long-term arrears where resolution of these arrears will require system-wide initiatives and we will continue to work with firms and with the broader system on this. We cannot be complacent, notwithstanding the robustness of our framework and our work to enhance consumer protections and supports for those in difficulty.

Finally, I should add that we continue to look to mitigate the risks to consumers of financial services from increased costs beyond the mortgage market. This has included work to enhance the transparency in the investment market around fees and the risks of complex products. And we have also implemented new regulatory regimes for short term and high cost credit, as well as running high impact consumer awareness campaigns on frauds and scams, including scams relating to advance fee fraud.

Regulatory priorities

Let me turn to our plans for 2024. Every year we set our priorities for financial regulation and supervision in the context of our domestic and international responsibilities and current and emerging issues in the large and increasingly complex financial sector that

we regulate. Overall, the financial system in Ireland – and across Europe – has proved to be financially and operationally resilient in the face of the turmoil of recent years. However, as the sector continues to grow in size, complexity and connectivity, we need to continue to deal with the medium-term implications of the evolving system and ensure that our policy frameworks remain fit for purpose for the future.

Our overarching objective remains ensuring we have a stable, resilient and trustworthy financial sector, operating sustainably in the best interests of the public and consumers. Particular milestones in our work programme this year include putting in place a revised and modernised Consumer Protection Code, continuing to progress work both internationally and domestically to address systemic risks from the non-bank sector, and implementing both the Individual Accountability Framework and the new Credit Unions (Amendment) Act.

We will in particular work with the Department of Finance on implementing recommendations from the Retail Banking Review, in developing a framework to protect access to cash services and the resilience of the cash system. We welcome the draft legislation on maintaining access to cash which we believe is an important public policy intervention. It is clear that there is a societal demand and need for cash, and the Central Bank – along with the rest of the Eurosystem – remains committed to the provision of cash.

Conclusion

In conclusion, the Central Bank will continue to focus on maintaining monetary and financial stability and ensuring the financial system works for consumers and the wider economy in 2024.

We are happy to take your questions.