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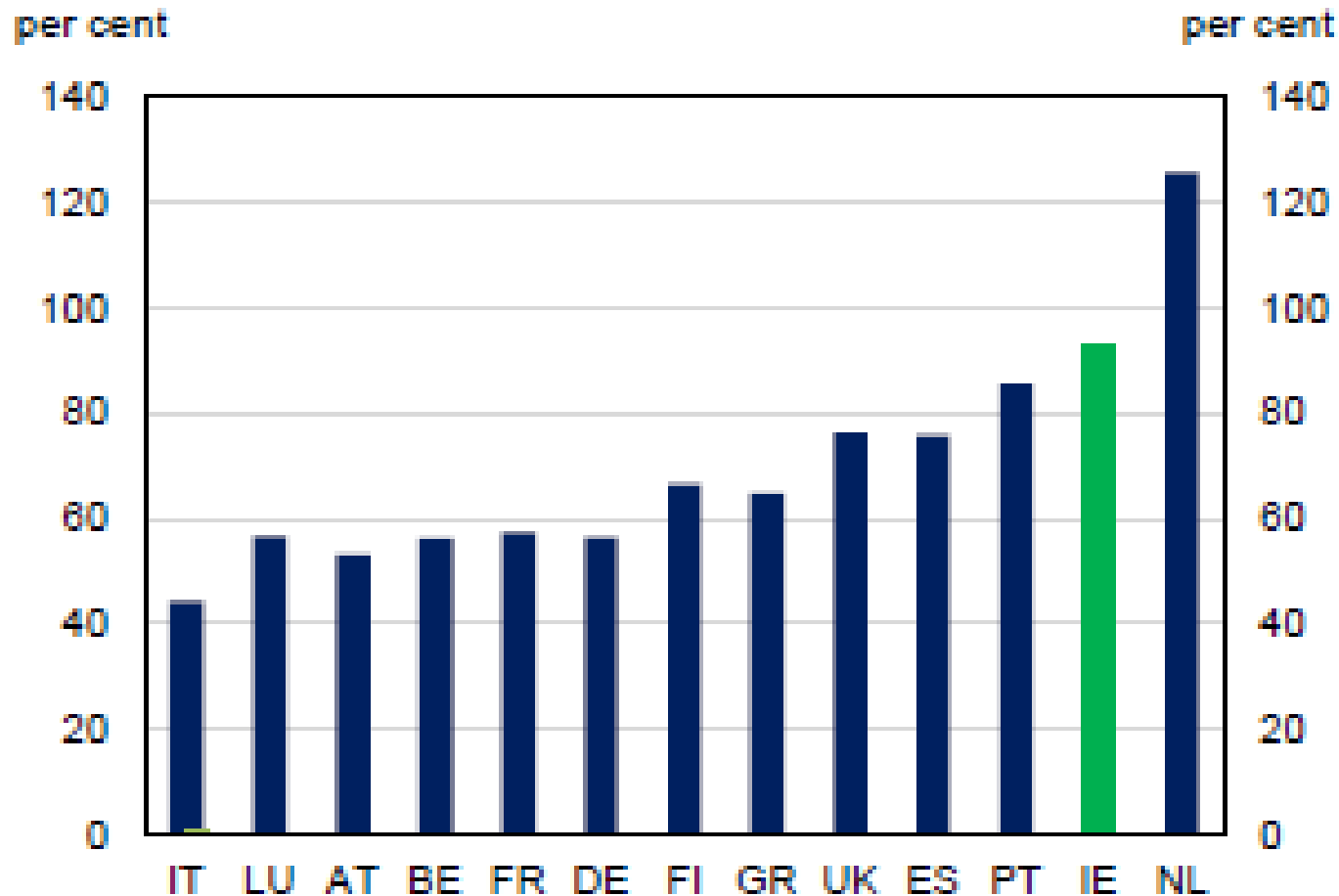


Stabilising and Healing the Irish Banking System: Policy Lessons

Dirk Schoenmaker
Duisenberg School of Finance

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Household debt-to-GDP



Irish Banking Crisis

- Macro-finance approach
- Classical drama in three acts
 1. Run-up to the banking crisis
 2. Confrontation: stabilisation of the banks
 3. Resolution: healing of the banks - climax already reached?
- Policy lessons
 1. Macroprudential policy
 2. Crisis-management: stabilising
 3. Crisis-management: restructuring

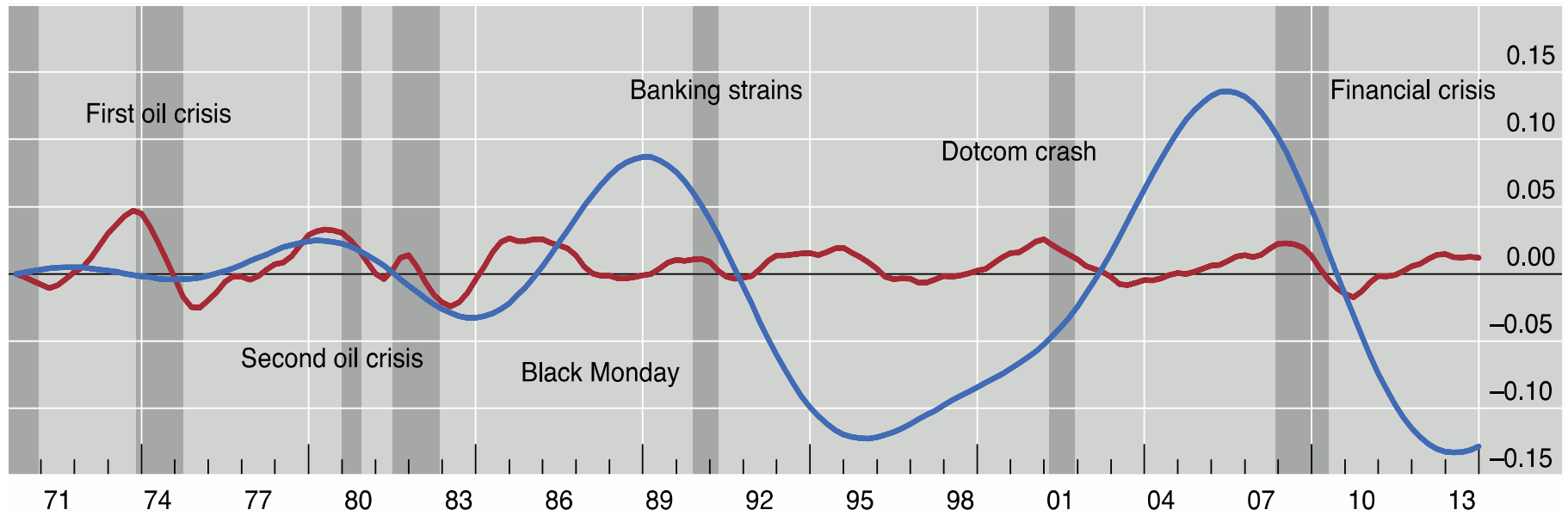
Act 1: Run-up

- ❑ Minsky model of boom-bust:
 1. credit expansion, characterised by rising assets prices;
 2. euphoria, characterised by overtrading;
 3. distress, characterised by unexpected failures;
 4. discredit, characterised by liquidation; and
 5. panic, characterised by the desire for cash.

- ❑ Borio (2014) / Claessens, Kose and Terrones (2014):
 - Not only credit,
 - But also housing

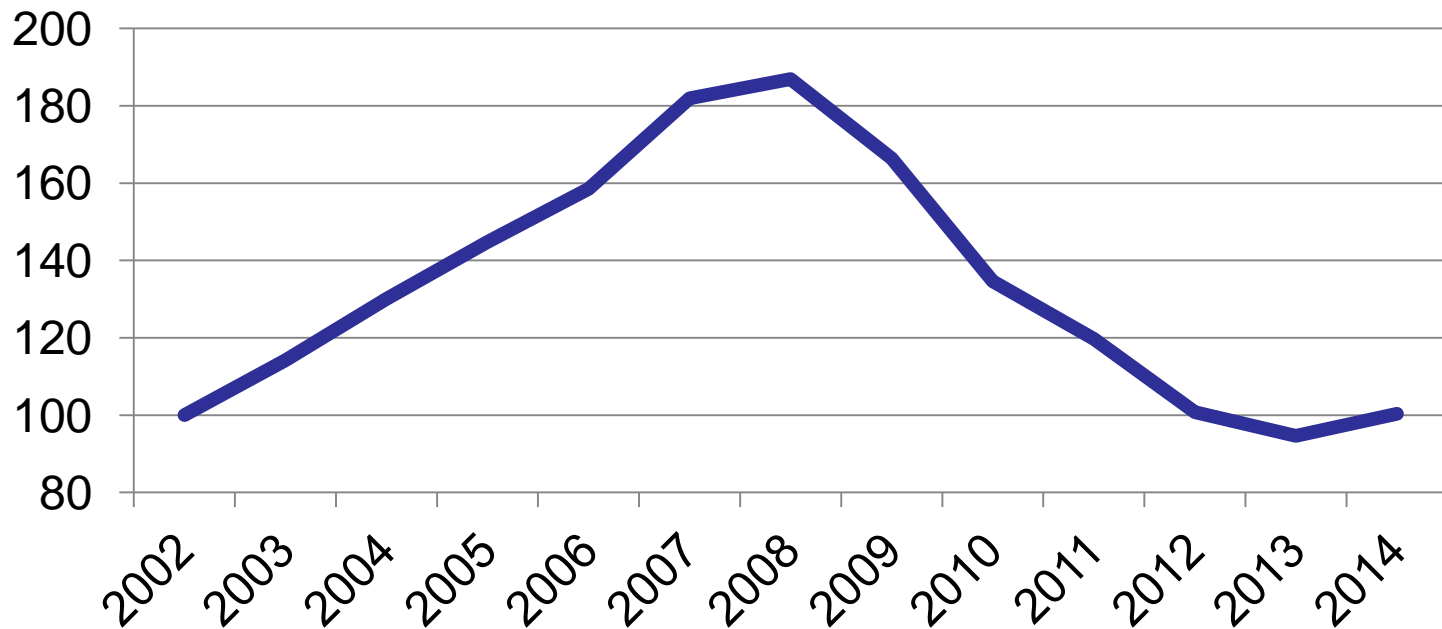
Financial cycle

Figure 1. The Financial and Business Cycles in the US



Property: housing + CRE

House Prices Ireland (2002=100)

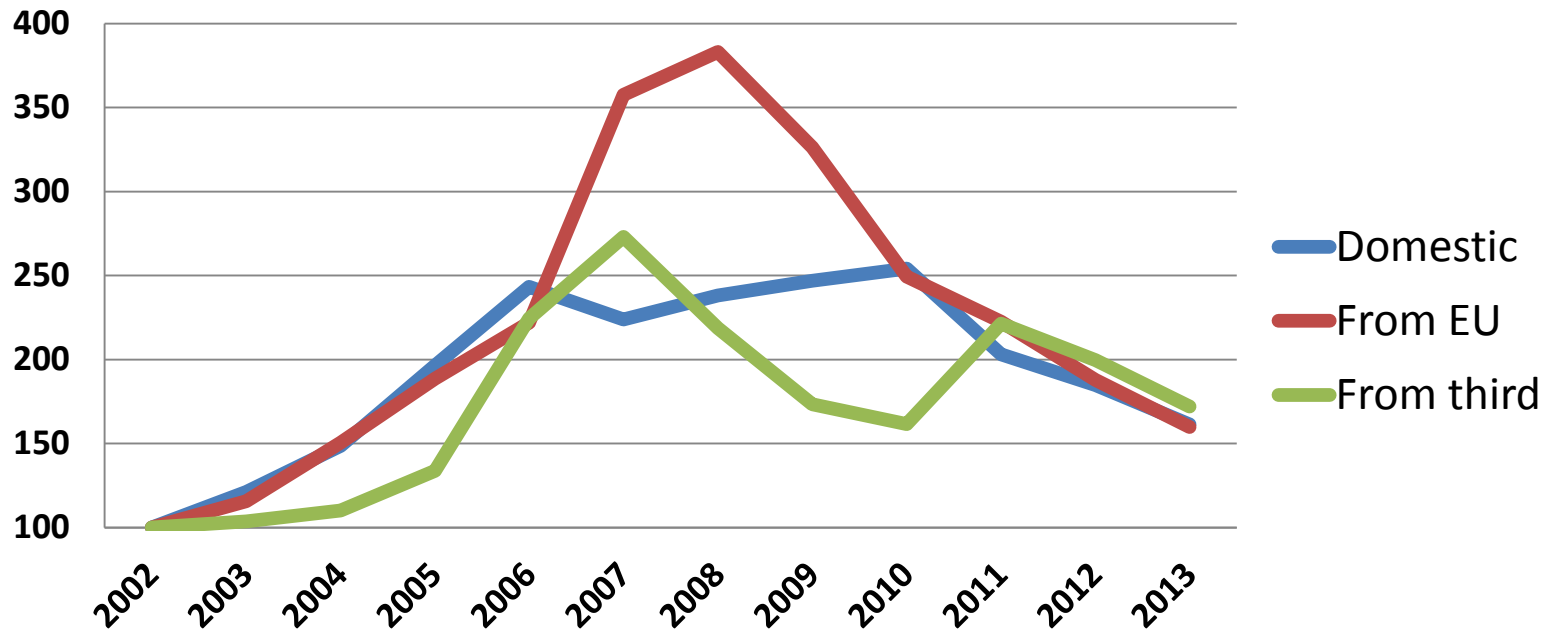


Property: housing + CRE

- Run-up: credit-fuelled property bubble (like US and Spain)
- Three features stand out
 1. Groupthink among policy makers and bankers
 2. Loosening of credit standards -> high LTVs well above 90%
 3. Role of cross-bank credit

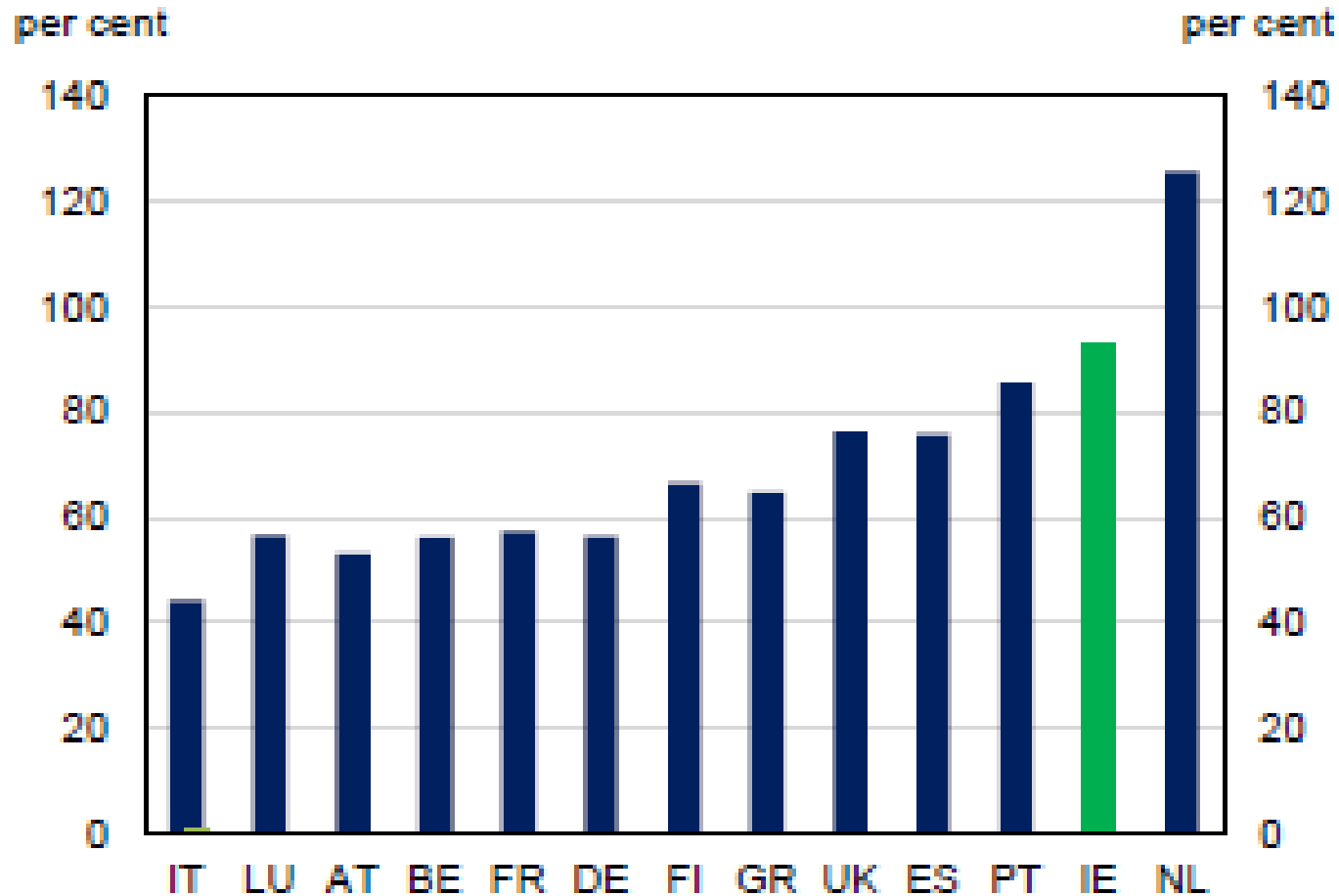
Credit: sources

Bank assets growth (2002 = 100)



- Ireland: from EU; Spain + Portugal: also domestic

Household debt-to-GDP



Policy lessons

1. CBI should stabilise credit and housing cycle -> time-varying LTVs, which should not exceed 80 / 90% (LTVs and countercyclical capital buffer are residence based)
2. CBI may consider Financial Stability Committee with external members + published minutes

Assessment framework

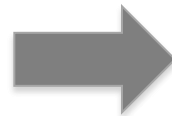
Public policies

**Intermediate objective:
Stable banking system**

**Ultimate objective:
Economic growth**

Public authorities:

- **Government**
- **Central Bank**
- **Financial Regulator**



1

Banking system:

- **Irish banks**
- **Foreign banks**



2

Economy:

- **Firms**
- **Households**

Act 2: Stabilisation

- Blanket guarantee for 2 years
 - Expiration was tipping point
- 4 rounds of recapitalisation
 - Need to do comprehensive + bottom up with externals
- NAMA
 - Bad asset management company worked very well
 - Could also have been used for smaller (below € 20 mn) loans

2. Stabilisation - 2

- Senior debt holders: write down or rescue
 - Irish authorities / IMF: write down
 - ECB (and US): rescue because of contagion
 - Then also burden sharing (direct recap from EFSF)
 - But it was given to Irish government -> policy mistake

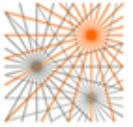
- Mergers and nationalisations
 - Tough measures -> closures
 - 2 broad banks + 1 small bank (loss of competition)
 - Alternative: 2 broad banks + 1 medium-sized banks

Policy lessons

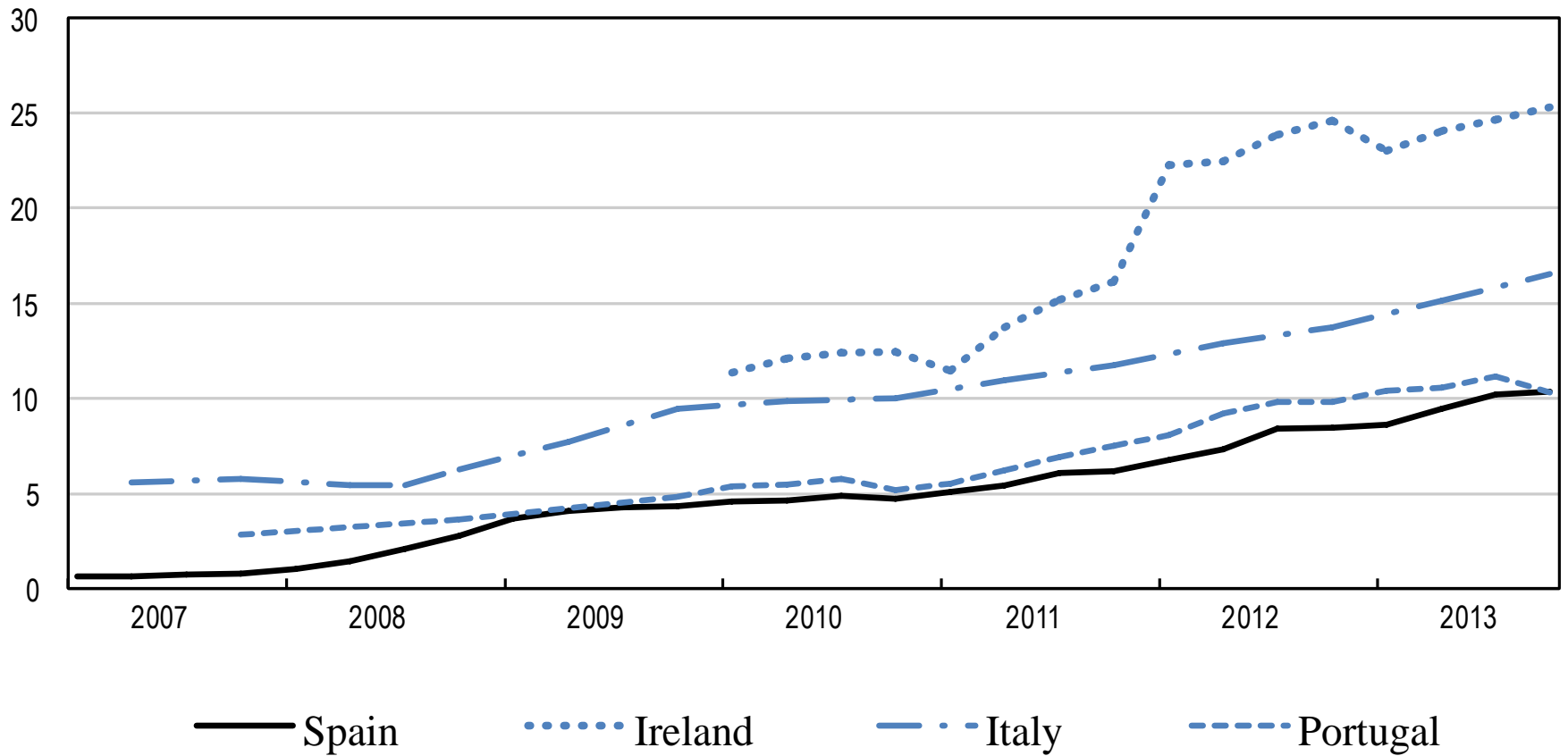
3. In Banking Union with ECB supervision of large banks, ECB and ESM should provide direct liquidity and capital support to large banks (= burden sharing)
4. Ireland followed best practice with NAMA to run down bad assets
5. Assessment of capital needs of banks should be comprehensive with external consultants and bottom-up

Act 3: Restructuring – healing banks

- NAMA instrumental in writing down bad loans
- But small loans (below € 20 mn) kept at banks
 - Almost no write-offs
 - 25% NPLs (impaired loans) with high provisions (53%)
- Debt overhang
 - SMEs: 34% no debt; 66% has debt
 - So, 66% (debt) * 25% (NPLs) = **16.5%** of SMEs with payment arrears

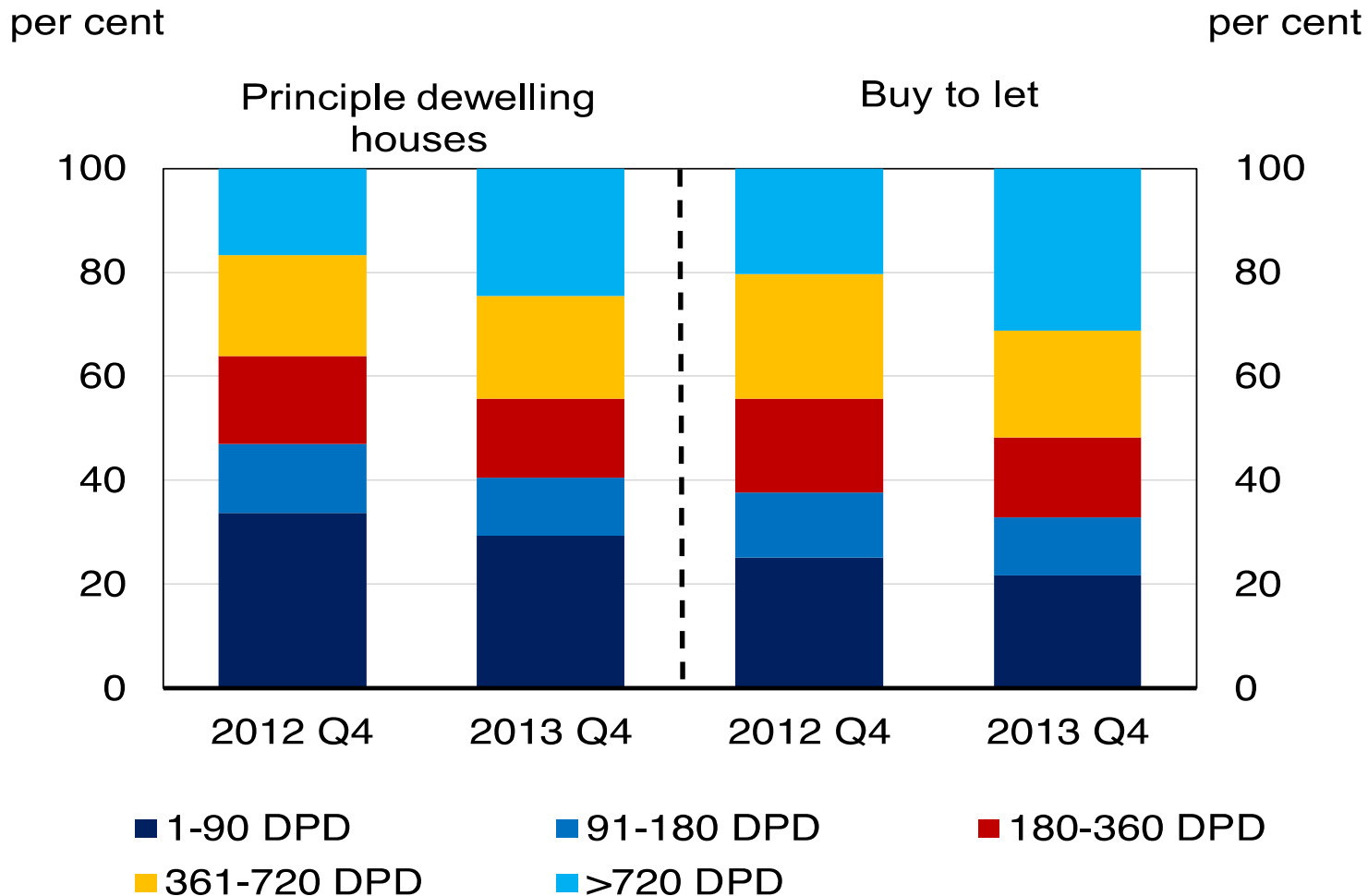


Non-performing loans



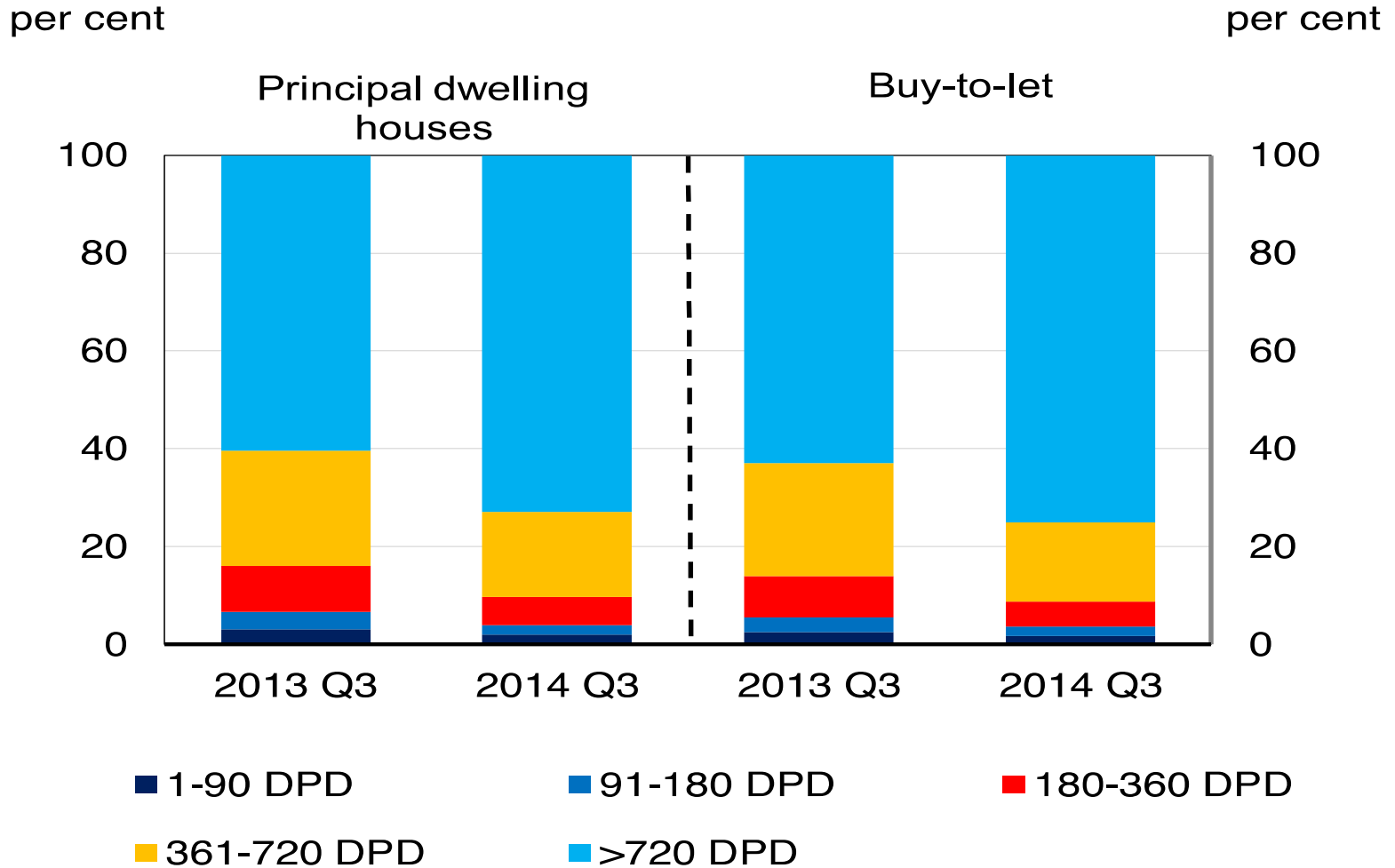
Mortgage arrears (number)

Panel A: Mortgages in arrears as a percentage of total mortgages in arrears



Mortgage arrears (value)

Panel B: Mortgages in arrears as a percentage of total arrears (value)

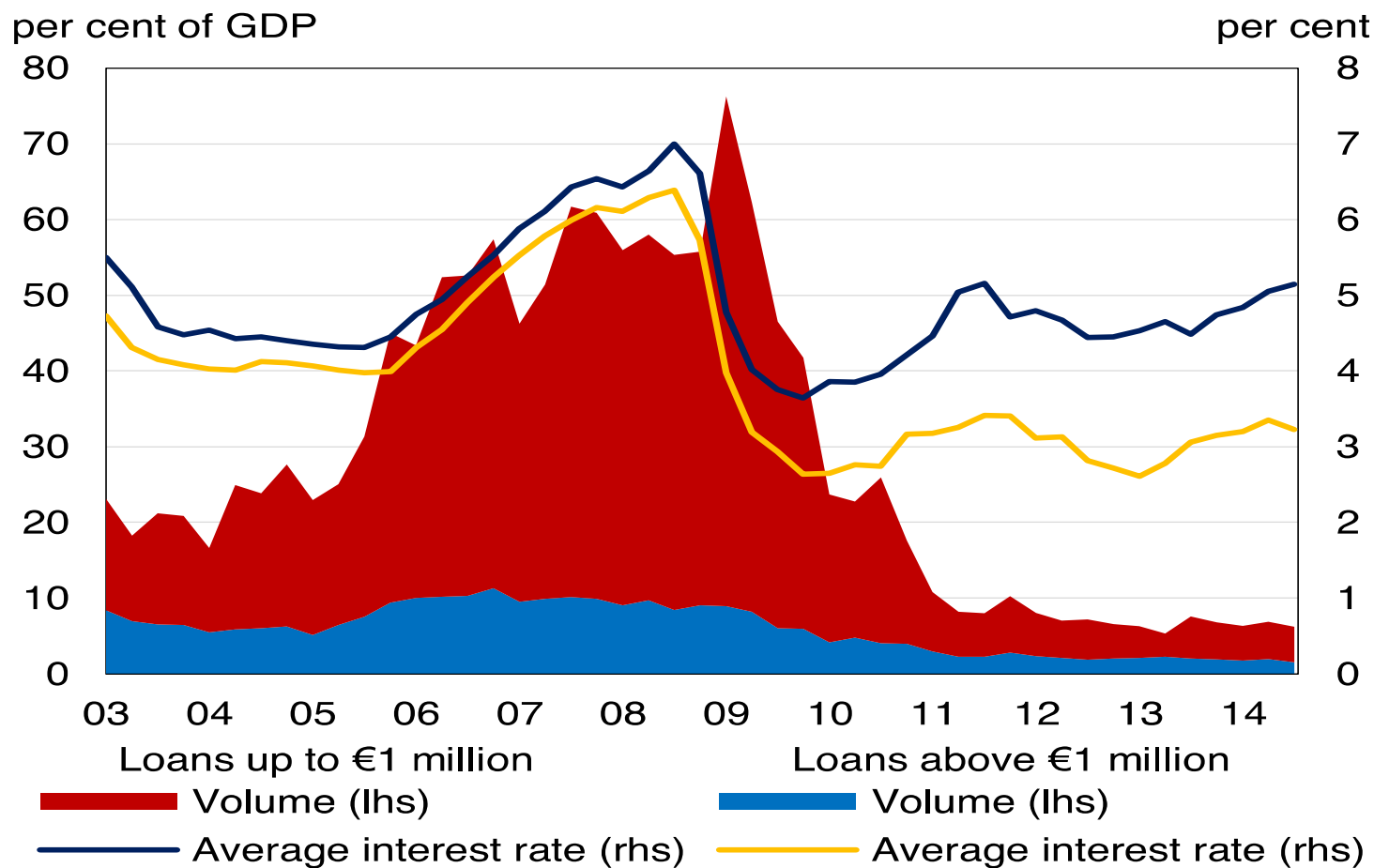


3. Healing - 2

- Targets for restructuring mortgages
 - But largest component is capitalising arrears
 - Does not help to solve problem
- Debt overhang
 - 1.650.000 private households in Ireland
 - 760.000 PDH mortgages, 118.000 in arrears
 - So, $118\text{k}/1.650\text{k} = 7.2\%$ of households in arrears

Limited new lending

Figure 13. New lending by banks to NFCs



Policy lessons

6. Irish took some bold restructuring decisions with closures, but be mindful that banking system remains competitive post-crisis
7. Taking NPLs is first step in healing banks (Ireland pro-active); necessary second step is to write-off loans (very slow)
8. Recapitalisation of ailing banks may be needed for economic growth. When providing bank support, government should set targets for partial write-off of bad loans to corporates and households

Conclusions

- ❑ After bursting of property bubble, successful management of banking crisis by Irish authorities

- ❑ On balance:
 - Strong focus on stabilisation of banks
 - Less emphasis on restructuring loans (25% NPLs)
 - Still SMEs and households with debt overhang

- ❑ In Banking Union, burden sharing needed
 - ECB as Lender of Last Resort
 - ESM for direct recapitalisations