

John Hurley: Protecting the stability of the Irish financial system

Statement by Mr John Hurley, Governor of the Central Bank & Financial Services Authority of Ireland, Dublin, 3 October 2008.

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The Government decision to guarantee depositors in and lenders to Irish financial institutions was taken to protect the stability of the domestic financial system. It does this by supporting the Irish banking system's ability to secure access to funds both domestically and internationally. The Government's decision was taken after close consultation with the Central Bank and Financial Regulator.

For over a year now, the Central Bank has been monitoring the disruption in international financial markets. This was triggered by difficulties in the US subprime mortgage market and resulted in a protracted drying up of liquidity in a range of markets. Despite central bank actions, both at Eurosystem and global levels, to inject liquidity to improve the functioning of money markets, these markets have become increasingly impaired. The net effect was that banks internationally found it difficult, and expensive, to obtain term funding.

The access of the Irish banking system to term funding was affected in a similar way to their international peers. The pressures became particularly acute during recent weeks following difficulties in state-sponsored financial institutions, investment and high-street banks both in the US and then Europe, and over the last weekend the failure to pass the US legislation.

These events came to a head last Monday evening when the supply of funding to the Irish banking system was seriously threatened. At that time, I had to inform the Minister that the risks to financial stability were becoming unacceptably high with knock-on effects for the wider economy. A major consideration was that the highly concentrated nature of the Irish banking system created a high risk of contagion. Decisive action to protect the stability of the economy and its financial system was needed.

While the decision was difficult, it was aimed at ensuring renewed access to funding for Irish financial institutions. The Irish banking system, unlike many of its international peers, has not to date had to write-off significant losses on loans and investments so that bad debts and loan losses were not the key issues for our financial system last Monday evening. The issue then was the unprecedented shortage of liquidity in financial markets and the urgent need to implement a solution that targeted that issue directly.

The legislation giving effect to the Government's decision was signed into law yesterday. Over the coming days, the Central Bank together with our colleagues in the Financial Regulator will be advising Government on how the scheme should now operate in practice.

The guarantee will be provided for two years on commercial terms. The pricing of the guarantee and the terms and conditions are critical. The primary consideration underlying this decision is to ensure financial stability at minimum cost to the taxpayer. For instance, the price should reflect a market-based assessment of the benefits to the banks covered by the guarantee and thereby minimise any impact on banks not covered by the guarantee; it should minimise moral hazard implications such that the banking system will not take on additional risks on the back of this guarantee. Designing such a scheme that takes account of these various principles is a complex task and work is at an advanced stage and will be completed over the weekend.

The Central Bank, as part of the Eurosystem, is actively involved in the provision of significant liquidity to credit institutions. We are also actively involved in international fora that are discussing solutions to the global crisis.

Internationally, liquidity conditions remain difficult and the likely duration of the crisis in international markets remains uncertain. Accordingly, the outlook for the global economy

remains uncertain. Against this international background, and alongside a necessary rebalancing of our economy after more than a decade of very strong growth, the Irish economy is entering a difficult period. We have shown in the past as a country that we can face up to difficult challenges and I suggest it will be no less on this occasion. If we adopt the correct decisions now, the medium term outlook for the economy is good.