

Not surprisingly, given the nasty state of affairs in Irish banks, were NPLs to fall to their historical averages from current levels, there will be huge capital relief to the banking sector in Ireland, as chart below illustrates, albeit in Ireland's case, historical levels must be bettered (-5% on historical average) to deliver such relief:

"NPL disposal can free up large volumes of regulatory capital and generate significant capacity for new lending. For a large sample of euro area banks covering almost 90 percent of all institutions under direct ECB supervision, the amount of aggregate capital that would be released if NPLs were reduced to historical average levels (between three and four percent of gross loan books) is calculated. This amounts to between €13–€42 billion for a haircut range of between zero and 5 percent, and assuming that banks meet a target capital adequacy ratio of 13 percent. This in turn could unlock new lending of between €167–€522 billion (1.8–5.6 percent of sample countries' GDP), provided there is corresponding demand for new loans. Due to the uneven distribution of capital and NPLs, capital relief varies significantly across euro area countries, with Portugal, Italy, Spain, and Ireland benefiting the most in this stylized example."

A disappointing feature, from Ireland's perspective, of the above figure is that simply driving down NPLs to historical levels will not be enough to deliver on capital relief in excess of the average (as shown by the red dot, as opposed to red line bands). The reason for this is, most likely, down to the quality of capital held and the impact of tax relief deferrals absorbed in line with NPLs (lowering NPLs via all but write downs = foregoing a share of tax relief).