BANC CEANNAIS AGUS ÚDARÁS
SEIRBHÍSÍ AIRGEADAIS NA hÉIREANN

CENTRAL BANK &
FINANCIAL SERVICES
AUTHORITY OF IRELAND

SECTORAL DEVELOPMENTS IN PRIVATE-SECTOR CREDIT
JUNE 2008

Summary

- Just three out of fifteen economic sectors experienced annual increases in credit of 20 per cent or more in Q2 2008, compared with five sectors a year earlier.
- The annual increase in lending for real estate activities reached its lowest rate since 1997 in Q2 2008, at 20.7 per cent. The annual growth rate in lending to construction declined to 4.6 per cent, from 35.6 per cent in Q2 2007.
- Property-related lending accounted for just half of the increase in credit in the twelve months to Q2 2008, down from four-fifths twelve months earlier.

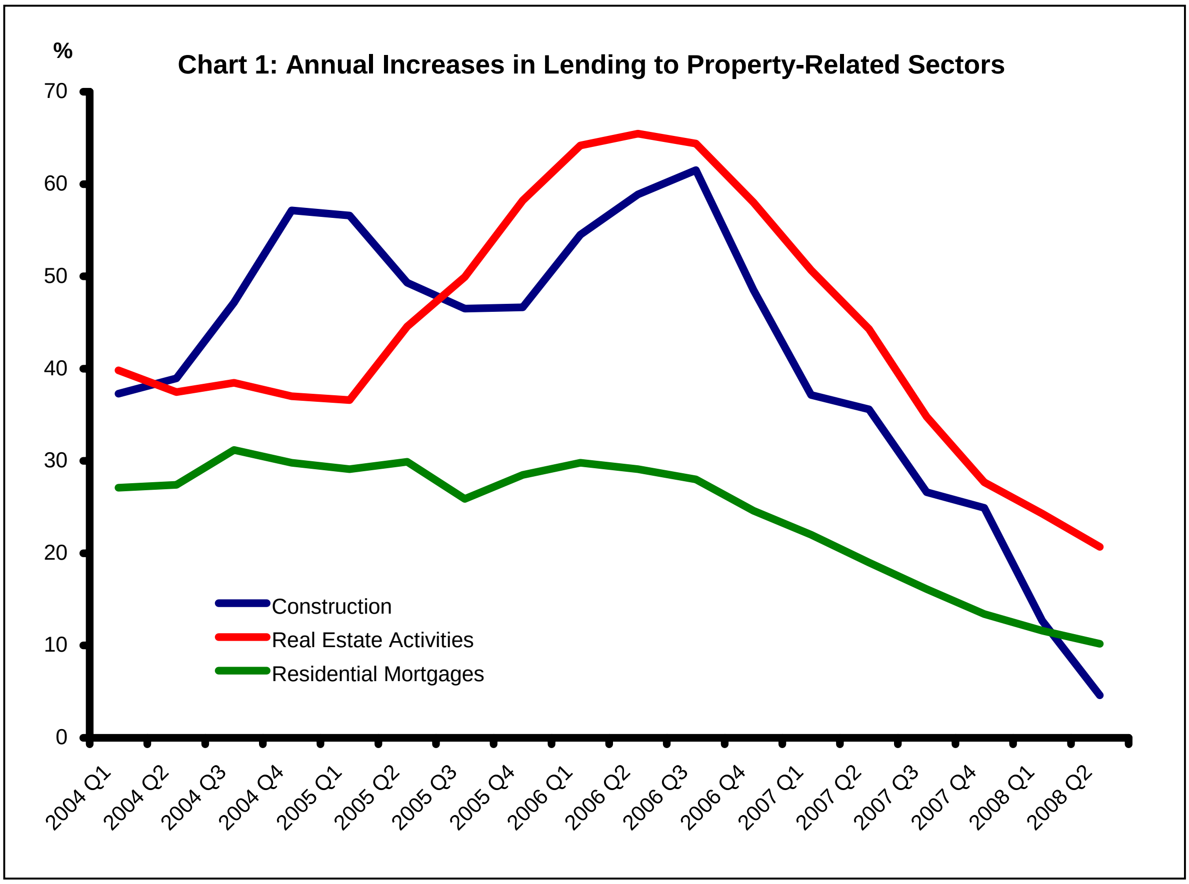
Lending to the Sectors – Annual Change to June 2008

Reflecting the general slowdown in credit growth and an environment of tighter lending standards, eight out of fifteen economic sectors had lower annual rates of increase during the second quarter of 2008 than the same quarter in 2007. Significant sectors such as real estate, construction, and the personal sector are included in this group. The annual rate of increase in lending to construction and the real estate activities sub-sector has now declined for seven and eight consecutive quarters, respectively. As a result, property-related lending, which accounted for nearly four-fifths of the total change in private-sector credit (PSC) during Q2 2007, accounted for half of the increase in Q2 2008.

The annual growth rate of PSC in Table 1 declined to 16.5 per cent in Q2 2008, from 17.2 per cent in Q1 2008, with an increase of €15.3 billion recorded during the quarter. In order to capture personal-sector borrowing, the sectoral breakdown of PSC in Table 1 includes securitised residential mortgages, i.e. they are added back into personal-sector credit, and the residential mortgages sub-sector. (This may result in the aggregate PSC figure in Table 1 entailing a degree of double counting. PSC also includes securities held by Irish credit institutions, which could take the form of securitised residential mortgages. This, and the fact that non-MFI IFSC lending is also included, accounts for the difference in the Table 1 PSC growth rate compared with Table A2.2.[1])

- In Q2 2008, only three sectors experienced annual increases in excess of 20 per cent.

- Up to the first quarter of this year, lending to the health and social work sector had been the fastest growing sector since Q2 2007. However, mining and quarrying sector credit became the fastest growing sector in Q2 2008, with an annual rate of increase of 47.9 per cent. Both of these sectors are very small, with the two sectors, in aggregate, only accounted for 0.8 per cent of total credit.



Source: CFBSAI.

[1] PSC in Table 1 in this note differs from PSC in Table A2.2 in the CBFSAI *Monthly Statistics*, as securitised residential mortgages are included in Table 1, but are not included in PSC in Table A2.2. The year-on-year PSC growth rate, including accrued interest and adjusted for both lending to non-MFI IFSC companies and valuation effects arising from exchange-rate movements, was 14.3 per cent in June 2008.

- Lending to the real estate activities sub-sector, for example, development of real estate projects, or buying and selling of self-owned real estate, etc, increased by €3.7 billion during the second quarter of 2008, down from €5.1 billion a year earlier. The annual rate of increase of just 20.7 per cent was the lowest for this sub-sector since 1997. Lending for real estate activities accounted for a fifth of total credit in Q2 2008.

Table 1: Sectoral Developments in Private-Sector Credit

	Total Stock at End-Jun 2008		Change in Credit End-Jun 2007 / End-Jun 2008		
	€ million	% Share	€ million	% Change[a]	% Share
Agriculture & Forestry	5,221	1.3	519	11.0	0.9
Fishing	400	0.1	-6	-1.5	0.0
Mining & Quarrying	661	0.2	214	47.9	0.4
Manufacturing	9,170	2.2	1,075	13.3	1.8
Electricity, Gas & Water Supply	1,138	0.3	11	1.0	0.0
Construction	25,460	6.1	1,109	4.6	1.9
Wholesale/Retail Trade & Repairs	13,854	3.3	1,751	14.5	3.0
Hotels & Restaurants	12,447	3.0	1,910	18.1	3.2
Transport, Storage & Communications	3,336	0.8	397	13.5	0.7
Financial Intermediation	73,465	17.6	20,699	39.2	35.1
- Lending to Non-MFI IFSC Companies	33,661	8.0	8,186	32.1	13.9
Real Estate & Business Activities	93,913	22.6	15,643	20.0	26.5
- Real Estate Activities	86,733	20.8	14,899	20.7	25.3
Education	691	0.2	13	1.9	0.0
Health & Social Work	2,597	0.6	280	12.1	0.5
Other Community, Social & Personal Services	3,183	0.8	497	18.5	0.8
Personal	170,865	41.0	14,821	9.5	25.2
- Residential Mortgages	145,341	34.9	13,496	10.2	22.9
- Principal Dwelling Houses	110,871	26.6	10,622	10.6	18.0
- Buy-to-Lets	32,968	7.9	2,729	9.0	4.6
- Holiday Homes/Second Houses	1,502	0.4	144	10.6	0.2
- Other Housing Finance	1,153	0.3	-40	-3.4	-0.1
- Other	24,372	5.9	1,366	5.9	2.3
Total	**416,401**	**100**	**58,933**	**16.5**	**100**

Source: CBFSAI. Data are based on NACE Rev. 1 industrial codes. For earlier data see Table C8 of the CBFSAI *Quarterly Bulletins*.

[a] The growth rates are inclusive of securitised residential mortgages, but are not adjusted for accrued interest, lending to the IFSC or exchange-rate valuation effects. Adjusted growth rates for overall PSC, mortgage credit and non-mortgage credit are available from the CBFSAI *Monthly Statistics*.

- Lending to the construction sector, which recorded the fastest annual growth rate of all sectors during 2006, declined dramatically with an annual growth rate of 4.6 per cent in Q2 2008, from 35.6 per cent a year earlier (see Chart 1). The annual change in construction sector credit was just €1.1 billion over the twelve months to Q2 2008, compared with €6.4 billion twelve months earlier. Reduced activity in the construction sector has been confirmed by other data sources. For example, there were 29 per cent fewer houses completed in H1 2008 than in H1 2007. The Ulster Bank *Construction PMI Index* – a seasonally adjusted index designed to measure the overall performance of the Irish construction economy – posted a survey low in June, and deteriorated for the fourteenth consecutive month in July, with housing remaining the worst performing sector. In addition, the CSO's *Index of Employment in Construction* showed that employment in private firms was 15.2 per cent lower in June 2008 than in June 2007 and this was the 15th consecutive month in which the rate of employment in the industry recorded a negative annual growth rate.

- Property-related lending, in the context of Table 1, is defined as the sum of lending to real estate activities, construction[2] and residential mortgages. The annual growth rate, of 12.9 per cent, in property-related lending in Q2 2008 was less than half that recorded a year earlier. The contribution of property-related lending, inclusive of securitised mortgages, to credit growth in the year to Q2 2008 was just a half, compared with nearly 80 per cent a year earlier. The share of property-related lending in the total outstanding stock of credit declined in Q2 2008 to 61.8 per cent, and was 2 percentage points lower than twelve months earlier.

- Personal-sector credit (inclusive of securitised mortgages) – the largest component of PSC – expanded by just 9.5 per cent over the year to Q2 2008.[3] The annual growth rate in residential mortgages of 10.2 per cent was the lowest recorded since Q4 1991. While house prices have been falling for the last sixteen months

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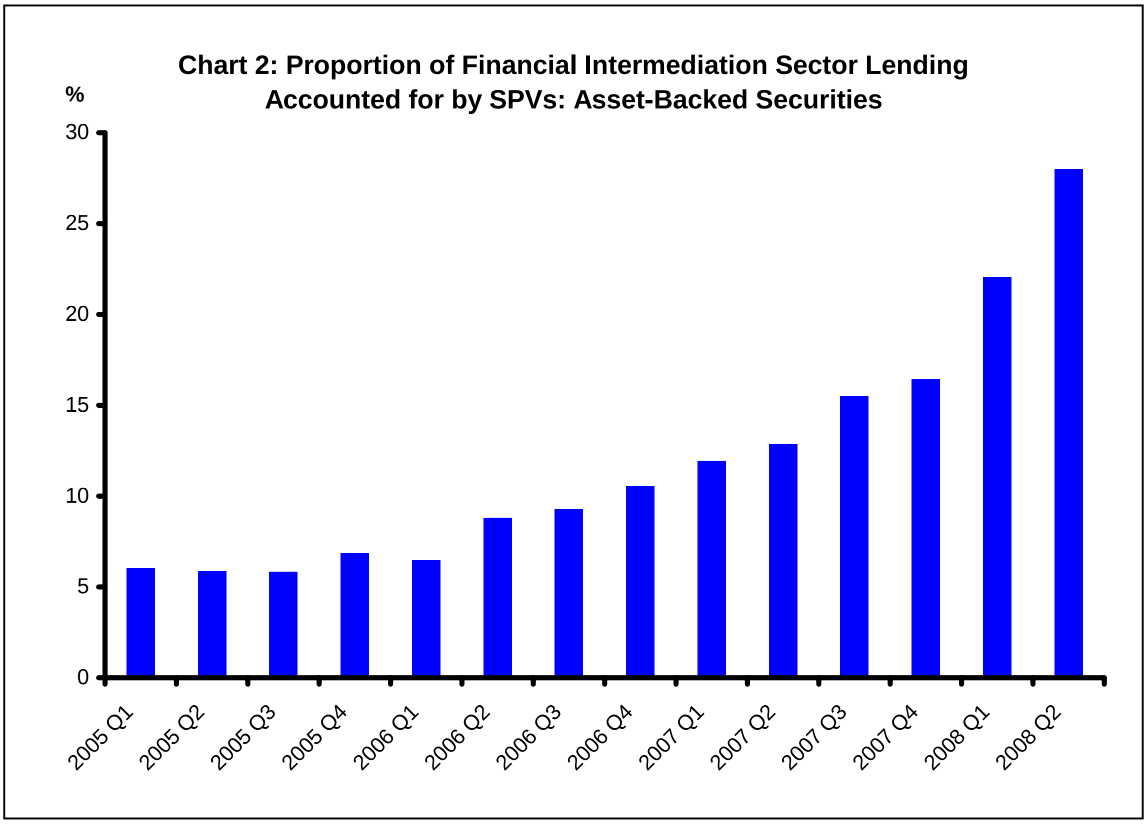
[2] While it is acknowledged that a significant but unquantified portion of lending to the construction sector is not property related (for example, construction work on infrastructural projects), it is usual to include this sector in property-related lending.

[3] For a discussion on how securitisations and reclassifications affect credit and mortgage lending, see Kelly, J. and A. Menton 'Residential Mortgages: Borrowing for Investment', CBFSAI *Quarterly Bulletin* No. 2 2007.

and official interest rates were unchanged for the year to June 2008, mortgage demand has been quite weak with an increase of just €5.5 billion in H1 2008, compared with €11.4 billion in H1 2006.

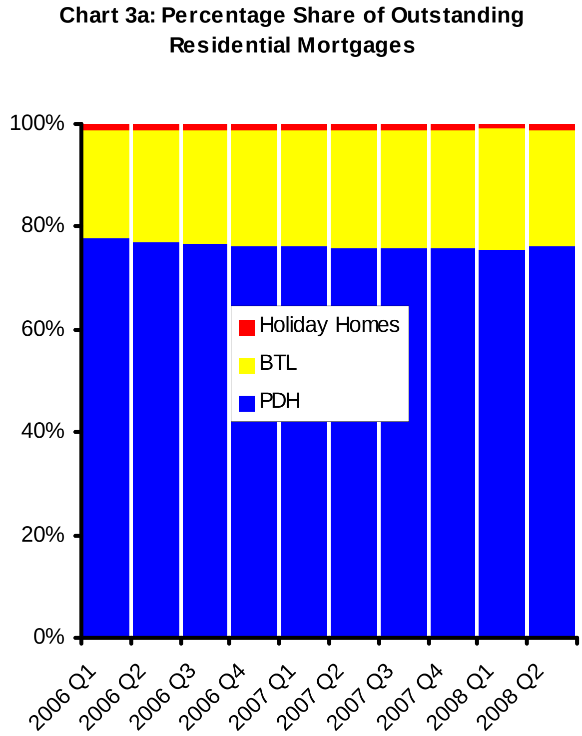
- One component of PSC that has become more prominent in recent times is a sub-sector of financial intermediation – the holdings by Irish credit institutions of asset-backed securities issued by SPVs (see Chart 2). The value of credit in this form rose from €6.8 billion in Q2 2007 to €20.6 billion in Q2 2008. Similarly, on the issuance side, residential mortgage-backed securitisations issued by Irish credit institutions became increasingly popular since mid-2006 with the outstanding value of securitised residential mortgages increasing by €18.3 billion since then. These developments reflect the strategies and preferences of Irish credit institutions.

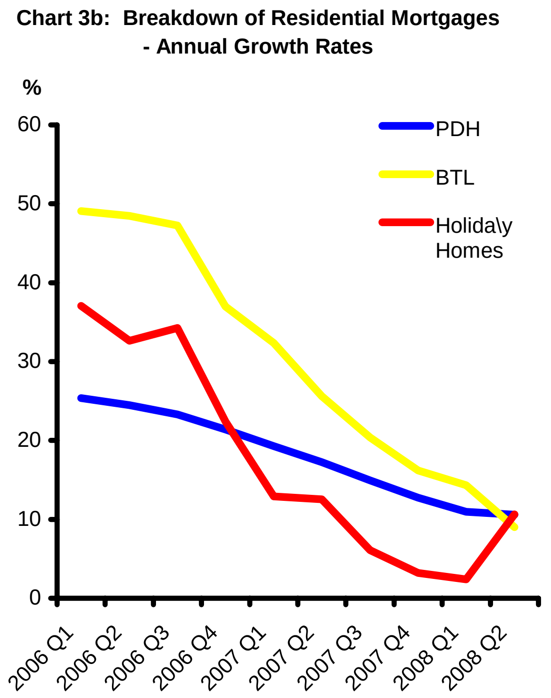


Source: CBFSAI.

Breakdown of Residential Mortgages[4]

After maintaining its market share in the last quarter, demand for mortgages from investors declined in Q2 2008. The annual growth rate of principal dwelling house (PDH) and buy-to-let (BTL) mortgages fell in Q2 2008. The proportion of outstanding residential mortgages (inclusive of securitised mortgages)[5] that are classified as PDHs increased in Q2 2008 to 76.3 per cent from 75.6 per cent in Q1 2008. However, there were net repayments in the BTL category for the first time since the series began. The CSO's private rental index in June showed that, quarter-on-quarter, rents declined for the first time since 2004. With the prospect of capital gains lowered, and a report from *Daft.ie* stating that the doubling of supply of rental properties has resulted in a fall in average rents, this may indicate that investors may not be as resilient to market conditions as last quarter's figures suggested.



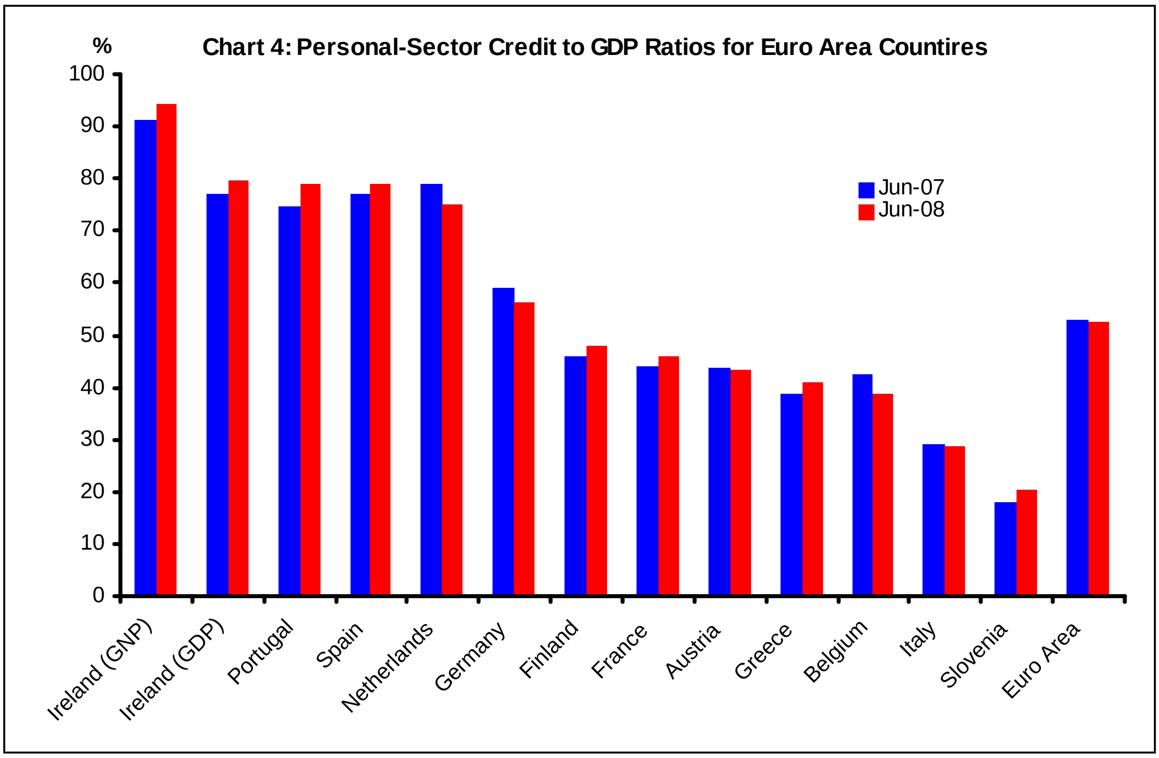


Source: CBFSAI.

[4] A historical breakdown, from December 2003, of outstanding residential mortgages into the three sub-sectors is available on the Bank's website, www.centralbank.ie. This series is not adjusted for securitised residential mortgages.

[5] Where possible, securitised residential mortgages are added back into the relevant sub-category. When no breakdown is available, they are added back into the PDH category, although this may slightly overstate the proportion of outstanding residential mortgages that are classified as PDHs.

Personal Sector: Euro Area Comparison



Source: ECB Statistical Data Warehouse, https://sdw.escb.eu. GDP and GNP data for Ireland are sourced from the CBFSAI *Quarterly Bulletin* No. 3 2008. Personal-sector credit data are not adjusted for mortgage-backed securities. June 2007 lending data are expressed over 2007 GDP data while June 2008 lending data are expressed over estimated 2008 GDP data.

Comparisons of personal-sector credit to GDP for euro area countries can only be made on the basis of credit institutions' on-balance-sheet lending, as comparable figures for securitised mortgages are not available.[6] Between June 2007 and June 2008, debt ratios decreased in just under half of the euro area countries. The ratio of indebtedness in the Netherlands, which had the highest ratio since 2002, has been falling in position since mid-2007 and was ranked fourth in Q2 2008. Portugal moved into second place, and had the fastest rising ratio of indebtedness over the period. Ireland continued to have the highest indebtedness ratio, after it moved into first position in Q3 2007 using both GNP and GDP measures. However, while the use of off-balance sheet securitisation has varied across countries, those countries that are close to Ireland in terms of indebtedness ratios, such as Portugal, Spain and the Netherlands have sizeable amounts of securitised residential mortgages. A more comprehensive measure of personal-sector indebtedness, including securitised mortgages, could give Ireland a lower ranking.

[6] Personal-sector credit data for the euro area countries include cross-border lending within the euro area.