SECTORAL DEVELOPMENTS IN PRIVATE-SECTOR CREDIT
MARCH 2008

Summary

- Just five out of fifteen economic sectors experienced annual increases in credit of 20 per cent or more in Q1 2008.
- Annual growth rates in lending for real estate activities and construction reached their lowest rates since the end of 2002, at 24.3 per cent and 12.7 per cent, respectively. This was a sharp decline in the annual rate of increase in lending to the construction sector, from 24.9 per cent in Q4 2007.
- Property-related lending, broadly defined, accounted for 58 per cent of the increase in credit in the year to Q1 2008, down from 77 per cent twelve months earlier.

Lending to the Sectors – Annual Change to March 2008

Reflecting the general slowdown in credit growth and an environment of tighter credit standards, eleven out of fifteen economic sectors had lower annual rates of increase in the first quarter of 2008 than in the first quarter of 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 declined in each of the last six and seven consecutive quarters, respectively. As a result, property-related lending, which accounted for over three-quarters of the total change in private-sector credit (PSC) during Q1 2007, accounted for less than three-fifths in Q1 2008.

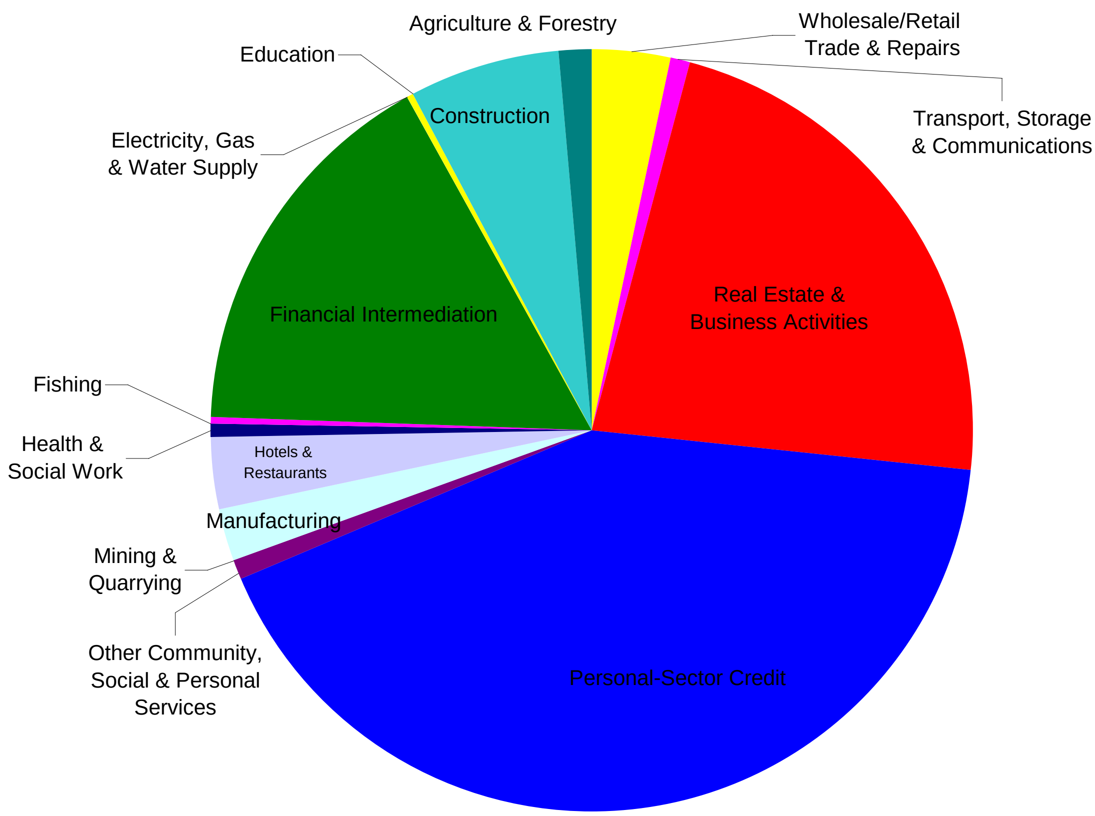
The annual growth rate of PSC in Table 1 declined by 2 percentage points between Q4 2007 and Q1 2008, to 17.2 per cent. PSC increased by €8.8 billion over the quarter, which was less than half of the increase recorded in the previous quarter earlier. The sectoral breakdown of PSC in Table 1 includes securitised residential mortgages, i.e. they are added back into personal-sector credit, and the residential mortgages sub-sector. This, 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] The sectoral breakdown of total PSC at end-March 2008 is shown in Chart 1 and Table 1, which also includes the annual changes in lending to these sectors.

- In Q1 2008, only five sectors experienced annual increases in excess of 20 per cent.

- Health and social work sector credit, with a 34.8 per cent annual increase, has been the fastest growing sector for the last four quarters. While growth rates in lending to this sector have remained quite high since end-2004, it accounted for only 0.6 per cent of the total stock of outstanding PSC in Q1 2008 (see Chart 1).

Chart 1: Sectoral Composition of Private-Sector Credit, Q1 2008

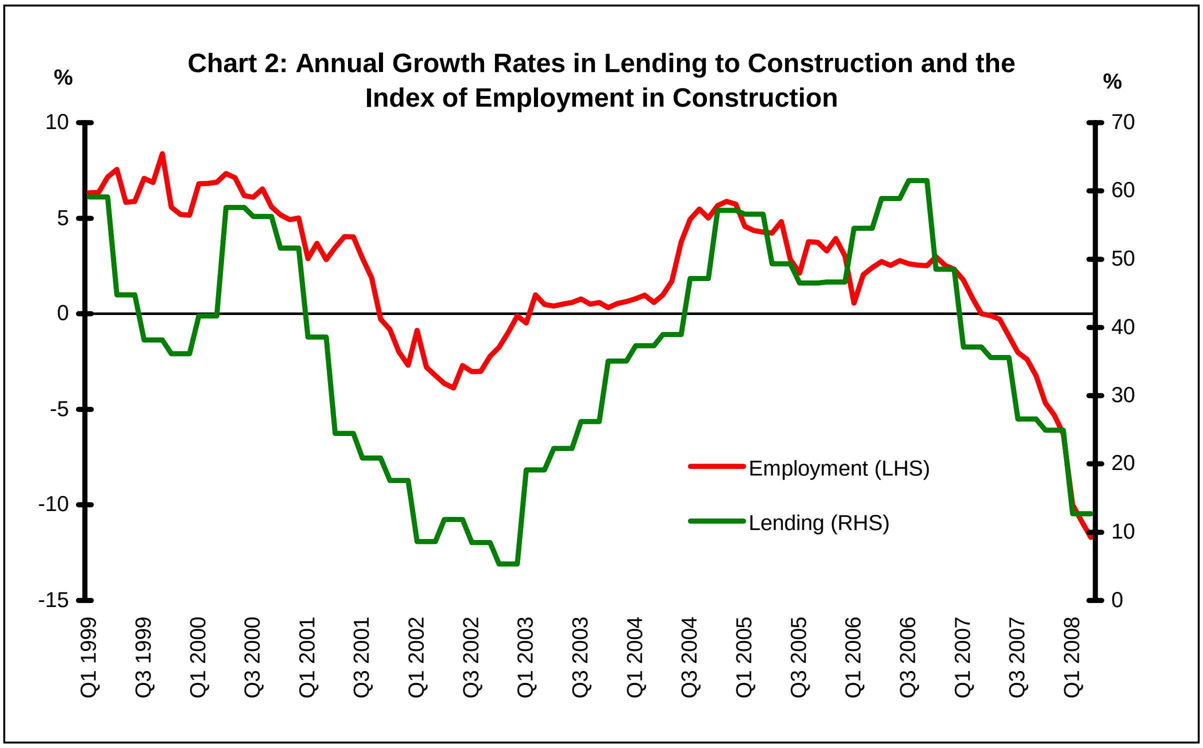


Source: CBFSAI.

- Lending to the real estate activities sub-sector increased by €3.2 billion during the first quarter of 2008, down from €5.3 billion over the previous quarter. The

[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 17.1 per cent in March 2008.

average quarterly growth rate for the real estate activities sub-sector of 6.3 per cent in 2007 was just over half of the average quarterly growth rate in 2006. This sub-sector had the fastest annual growth rate in Table 1 in Q1 2007, but fell to fourth place in Q1 2008, at 24.3 per cent; this was the lowest annual growth rate for this sub-sector since the third quarter of 2002.



Sources: CBFSAI and CSO.

- The construction sector, which recorded the fastest annual growth rate of all sectors in Q3 2006, had one of the lower growth rates in Q1 2008, of 12.7 per cent. Reduced activity in the construction sector has been confirmed by other data sources. For example, there were nearly a third fewer houses completed in Q1 2008 than in Q1 2007. The Ulster Bank *Construction PMI Index* – a seasonally adjusted index designed to measure the overall performance of the Irish construction economy – posted its lowest reading in April 2008 since the survey began, with activity affected by, in particular, lower new-order volumes. In addition, the CSO's *Index of Employment in Construction* showed that employment in private firms was 11.7 per cent lower in March 2008 than in March 2007 and this was the 12th consecutive month in which the rate of employment in the industry recorded a negative annual growth rate (see Chart 2).

Table 1: Sectoral Developments in Private-Sector Credit

	Total Stock at End-Mar 2008		Change in Credit End-Mar 2007 / End-Mar 2008		
	€ million	% Share	€ million	% Change[a]	% Share
Agriculture & Forestry	5,088	1.3	512	11.2	0.9
Fishing	484	0.1	80	19.7	0.1
Mining & Quarrying	500	0.1	85	20.6	0.1
Manufacturing	8,447	2.1	1,407	20.0	2.4
Electricity, Gas & Water Supply	1,105	0.3	-158	-12.5	-0.3
Construction	25,598	6.4	2,884	12.7	4.9
Wholesale/Retail Trade & Repairs	13,671	3.4	2,218	19.4	3.8
Hotels & Restaurants	12,350	3.1	1,099	9.8	1.9
Transport, Storage & Communications	3,326	0.8	523	18.7	0.9
Financial Intermediation	66,071	16.5	15,185	29.8	25.8
- Lending to Non-MFI IFSC Companies	32,343	8.1	7,563	30.5	12.8
Real Estate & Business Activities	90,211	22.5	17,119	23.4	29.1
- Real Estate Activities	83,009	20.7	16,225	24.3	27.6
Education	661	0.2	6	0.9	0.0
Health & Social Work	2,580	0.6	666	34.8	1.1
Other Community, Social & Personal Services	2,915	0.7	296	11.3	0.5
Personal	168,141	41.9	16,958	11.2	28.8
- Residential Mortgages	142,403	35.5	14,848	11.6	25.2
- Principal Dwelling Houses	107,680	26.8	10,632	11.0	18.1
- Buy-to-Lets	33,347	8.3	4,184	14.3	7.1
- Holiday Homes/Second Houses	1,375	0.3	32	2.4	0.1
- Other Housing Finance	1,159	0.3	5	0.4	0.0
- Other	24,579	6.1	2,105	9.4	3.6
Total	**401,150**	**100**	**58,882**	**17.2**	**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*.

- Personal-sector credit (inclusive of securitised mortgages) – the largest component of PSC – expanded by just 11.2 per cent over the year to Q1 2008.[2] One interesting sub-sector is ‘other personal’, which is mainly composed of consumer credit loans. The annual growth rate of this sub-category was distorted by a reclassification in June 2007. However, over the nine months since then, the value of consumer credit loans have increased by nearly 9 per cent. In view of

[2] 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.

reports of slowing consumer spending − for example the annual increase in the value of the CSO's *Retail Sales* index in March 2008 was the lowest since early-2004 − demand for consumer credit loans may remain moderate. At 11.6 per cent, this was the lowest annual growth rate in residential mortgages recorded since May 1992. While house prices have been falling for the last thirteen months and official interest rates have been unchanged since June 2007, mortgage demand has been quite weak with an increase of just €2.6 billion in mortgages in Q1 2008, compared with €5.6 billion in Q1 2006. The slowdown in demand for housing loans by households is consistent with Irish Banking Federation (IBF) data, which found that the value of *new* mortgage drawdowns (excluding 'switcher' mortgages) during Q1 2008 were over a quarter lower than during Q4 2007.[3]

- The quarterly growth rate for manufacturing credit increased to 4.5 per cent in Q1 2008, from 2.5 per cent in Q4 2007, while the annual growth rate edged back up, to 20 per cent in Q1 2008. The annual growth rate in lending to the manufacturing sector had jumped to nearly 30 per cent during 2007, compared with 13.5 per cent at end-2006. In line with these developments, the CSO's *Industrial Production* index was, year-on-year, 7 per cent higher in March 2008, up from 4.1 per cent in December 2007. However, in March 2008 the *NCB Purchasing Managers' Index (PMI)* – an indicator designed to provide a single-figure measure of the economic health of the manufacturing industry – declined sharply, and activity in the manufacturing sector in 2008 is expected to moderate from 2007 levels.

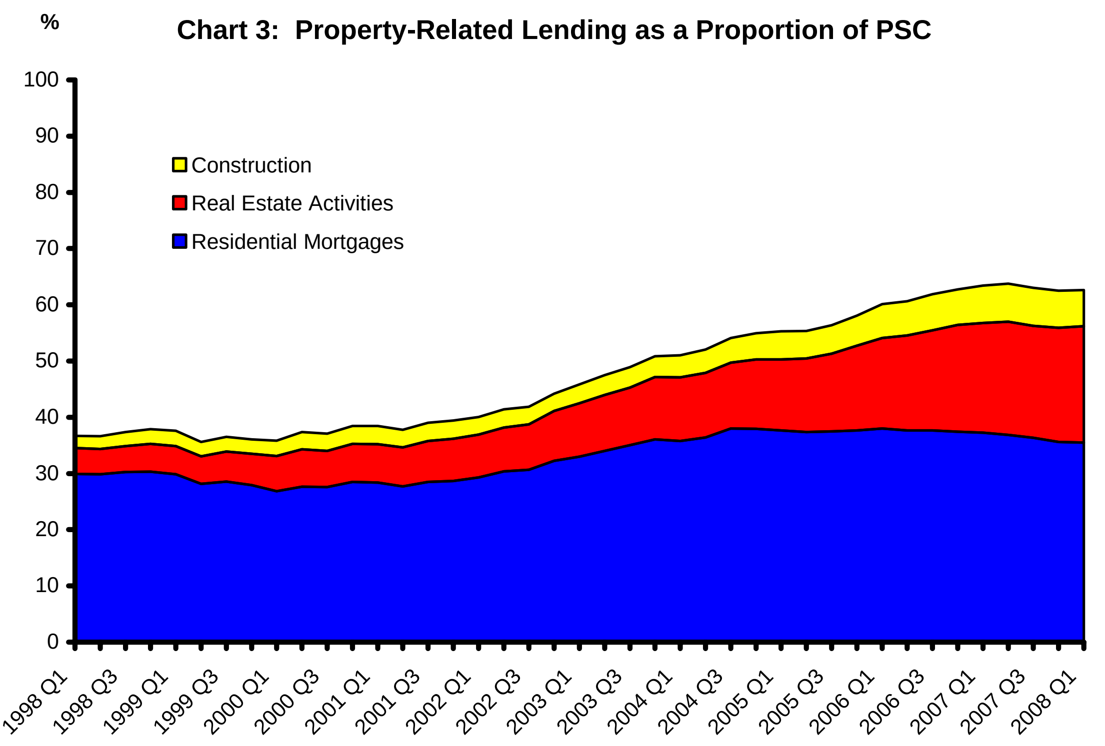
- A number of transactions in Q1 2008 brought the quarterly change in financial intermediation credit down from record highs recorded in H2 2007. The early repayment of a large loan caused a drop in the 'other financial intermediation' sub-sector, but this was offset by a large increase in the holdings of securities in March. Overall the quarterly increase of €1.6 billion was normal for the financial intermediation sector, compared with the increase of €5.5 billion in Q4 2007,

[3] Source: IBF data series on New Lending (excluding 'switcher' mortgages), May 2008.

which was the result of substantial increases in lending to non-MFI IFSC companies.

Property-related lending, in the context of Table 1, is defined as the sum of lending to real estate activities, construction[4] and residential mortgages. The annual growth rate of property-related lending in Q1 2008, of 15.6 per cent, was half that recorded a year earlier. The contribution of property-related lending, inclusive of securitised mortgages, to credit growth in the year to Q1 2008 was less than three-fifths, compared with over three-quarters a year earlier. However, the share of property-related lending in the total outstanding stock of credit stabilised in Q1 2008, after it fell in Q3 2007 and Q4 2007 for the first time since 2001.

Chart 3: Property-Related Lending as a Proportion of PSC



Source: CBFSAI.

[4] 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.

Breakdown of Residential Mortgages

One feature of residential mortgage lending in Q1 2008 was the resilience of demand for mortgages from investors. While annual growth rates declined across all three categories of mortgage lending, the quarterly growth rate for the buy-to-let (BTL) category increased, with the net change in BTL mortgages of €1.1 billion in Q1 2008 up from just €828 million in Q4 2007. The proportion of outstanding residential mortgages (inclusive of securitised mortgages)[5] that are classified as BTLs increased in Q1 2008 to 23.4 per cent from 23.1 per cent, while principal-dwelling houses' (PDHs) proportion fell to 75.6 per cent.[6] IBF data also showed that, while the overall value of *new* mortgage drawdowns (excluding switcher mortgages) were down 30 per cent year-on-year in Q1 2008, BTL mortgages increased their market share. Lower immigration and falling employment in the construction sector may have contributed to a softening in rents but investors appear to be taking a longer-term perspective.

Chart 4a: Percentage Share of Outstanding Residential Mortgages

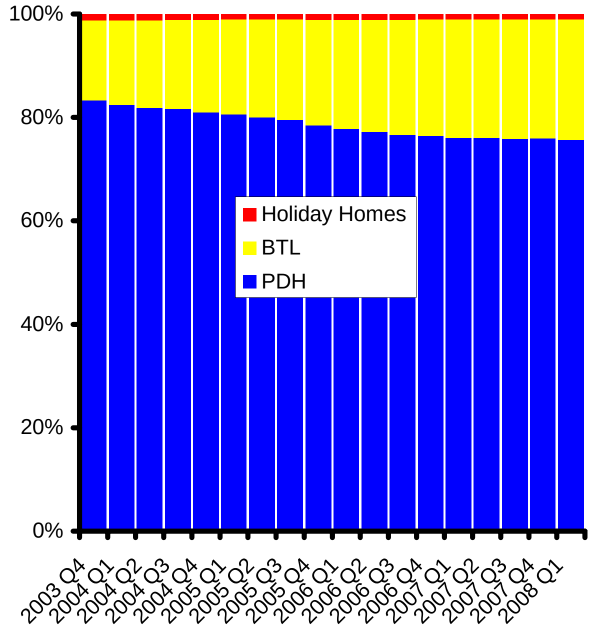
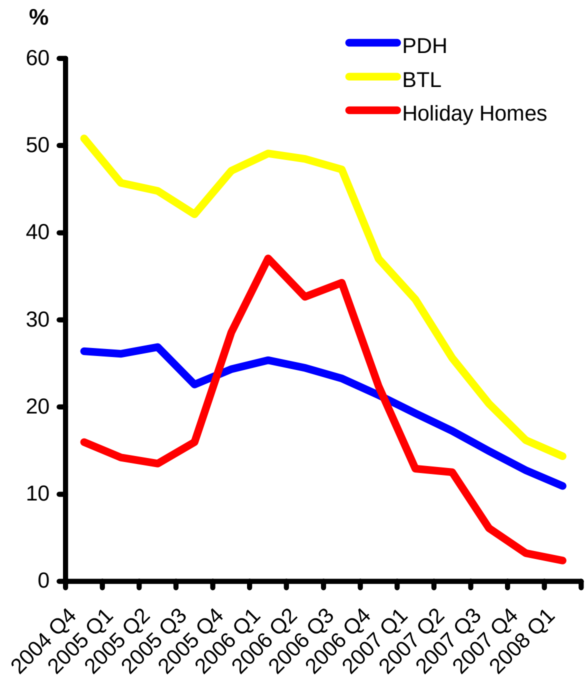


Chart 4b: Breakdown of Residential Mortgages - Annual Growth Rates

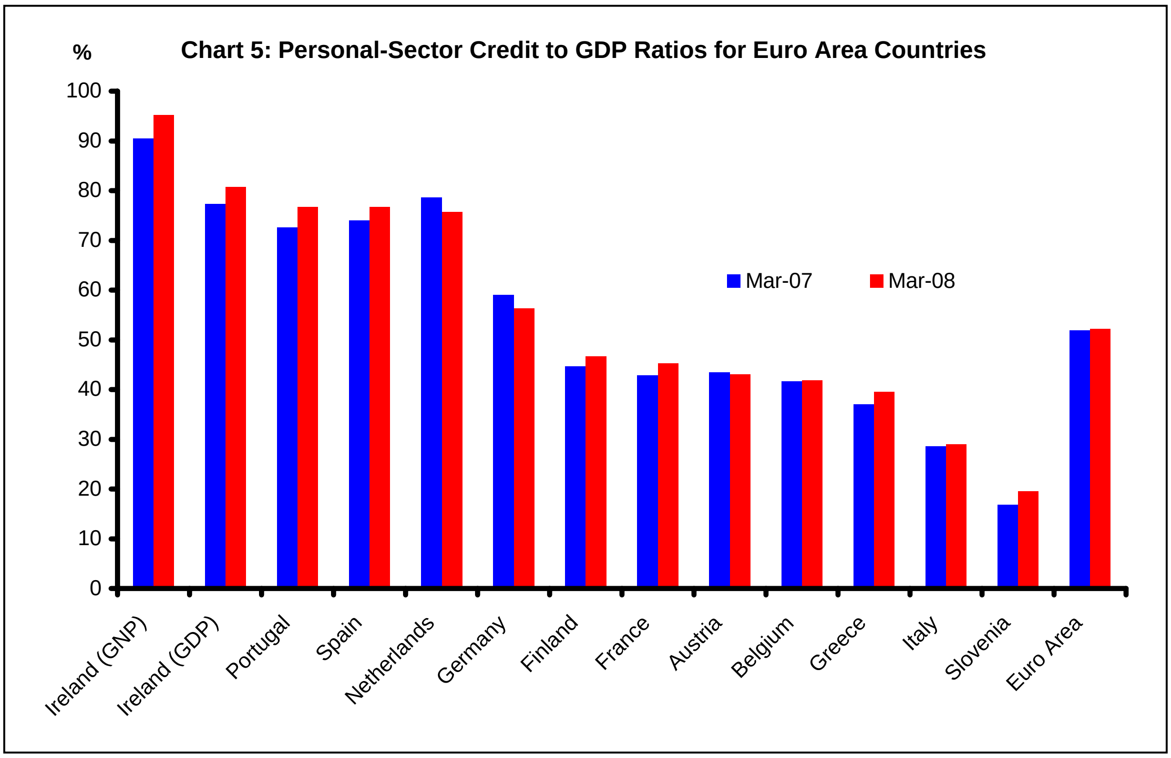


Source: CBFSAI

[5] All securitised residential mortgages, which are removed from credit institutions' books, are added back into the principal-dwelling houses (PDHs) category, although this may slightly overstate the proportion of outstanding residential mortgages that are classified as PDHs.

[6] 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.

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. 2 2008. Personal-sector credit data are not adjusted for mortgage-backed securities. March 2007 lending data are expressed over 2007 GDP data while March 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.[7] Between March 2007 and March 2008 ratios increased in most countries. However, the ratio of indebtedness in the Netherlands, which had the highest ratio since 2002, has been falling in position since mid-2007 and dropped to fourth place in Q1 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.

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