Monetary and Financial Market Developments

Overview

In the final quarter of 2009, financial markets globally continued to recover as a number of positive macroeconomic developments led to more confidence that the economic recovery would be sustained. While recovery was the benchmark scenario, risks to this scenario were still considered significant. This was particularly the case as investors reacted nervously to developments in Dubai and in the sovereign debt market in the euro area from mid-November 2009. These events highlighted more fundamental concerns about the pace and distribution of the economic recovery in the near future, as both monetary and fiscal support measures cannot be sustained at their current levels indefinitely.

The equity market rally that started in March 2009 slowed over the final quarter of the year, as investors sold off more risky asset classes from mid-November. This particularly impacted on equities in the financial sector. Debt market funding has, however, improved for financial institutions, including those resident in Ireland. Meanwhile government bond yields began to rise marginally towards the end of 2009. This was more in response to the expected increase in supply of sovereign debt in the market in 2010, as many governments will run significant fiscal deficits, than more confidence in a robust economic recovery or expected inflationary pressures. Yields on virtually all euro-area sovereign bonds, including the German Bund, increased over the quarter, while spreads over the Bund increased for some member states, issuance over the period. During the final quarter of 2009, the euro area sovereign bond market was driven by concerns over the fiscal position in Greece.

The major central banks, including the ECB, have continued to maintain a very accommodative monetary policy stance. This has contributed to an improved environment in money markets, which, in general, remained stable over the final quarter of 2009. In the euro area, risk spreads in the inter-bank market are now back to levels last seen in early 2008. The level of inter-bank borrowing rates remain at historic lows, with both the Eonia and the 3-month Euribor remaining consistently below the ECB main refinancing rate over the period. This sustained normalisation in the money markets has led the Governing Council to outline a gradual exit strategy from the non-standard support measures introduced during the crisis. Meanwhile market participants expect inter-bank lending rates to increase marginally through 2010.

While the reductions in wholesale money market rates since autumn 2008 were, in general, passed through to high street lending rates, this pattern has now begun to reverse. High street lending rates appear to have passed the bottom of the current cycle, as indications that they are increasing have become more evident. This is particularly so when the expected increase in inter-bank lending rates and the impact of potential losses as a result of bad debts are considered.

The volume of credit being advanced in the Irish economy has declined also. Headline private-sector credit (PSC) fell by 5.3 per cent in the year ending November 2009. Valuation effects, such as increased write-downs and provisions for bad and doubtful debts account for most of the recent fall in headline credit, and when these are accounted for the decline in the net flow of credit over the period was 1.7 per cent. Similarly, excluding valuation effects, loans to the private sector in the euro area as a whole declined by 0.7 per cent.

In November 2009 the National Asset Management Agency (NAMA) Bill was passed by the Oireachtas. NAMA will, via a special purpose vehicle (SPV), purchase land and development loans from participating banks by issuing them with government backed bonds[1] from February 2010. This process should remove uncertainty surrounding the participating banks' balance sheets and further enhance their funding position. It also front-loads the losses participating banks face on these land and development loans and will allow for more immediate transparency on their capital requirements. Subsequent

[1] NAMA will have a significant impact on the statistics published by the Central Bank. The affected series, particularly relating to PSC, will be made available both including and excluding the impact of NAMA.

recapitalisation should then increase these banks' capacity to lend to the real economy.

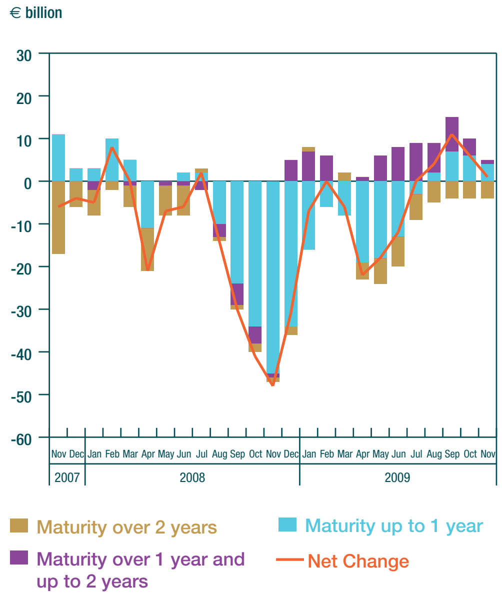
A: Financial Markets

Bank Funding and Money Market Developments

The wholesale bank funding markets continued to normalise during Q4 2009 as supporting measures provided by monetary authorities and governments remained in place. Access to debt and equity markets by financial institutions has, in general, improved with the aid of various guarantee schemes currently being offered by some governments. Government backed support schemes are also helping to remove uncertainty around bank balance sheets and, in turn, promote confidence for potential investors. Debt securities issuance by monetary financial institutions (MFIs) has begun to rise across the euro area and a number of institutions have announced plans for new equity offerings.

The situation has also improved for Irish resident MFIs, with outstanding debt securities issued increasing on a quarterly basis since mid-2009. This follows a sharp contraction in the amount of outstanding debt securities issued by these institutions from mid-2008 through to early 2009. The improvement up to November 2009 was driven by increases in debt securities issued with a maturity of less than two years, with domestic banks being particularly active in this market given the scope of the original Government guarantee from autumn 2008. The contraction in debt securities seen at that time was in the short-term (i.e. less than one year maturity) notes. The issuance of these securities has, however improved significantly, and has been increasing on a rolling 3-month basis since August 2009. This is consistent with the Irish results of the Q4 2009 Bank Lending Survey (BLS), which included questions on access to wholesale funding. Irish respondents to the BLS noted that access to wholesale unsecured money markets as well as the market for debt securities improved in the final quarter of

Chart 1: Net Issuance of MFI Debt Securities
(Rolling 3-month change)

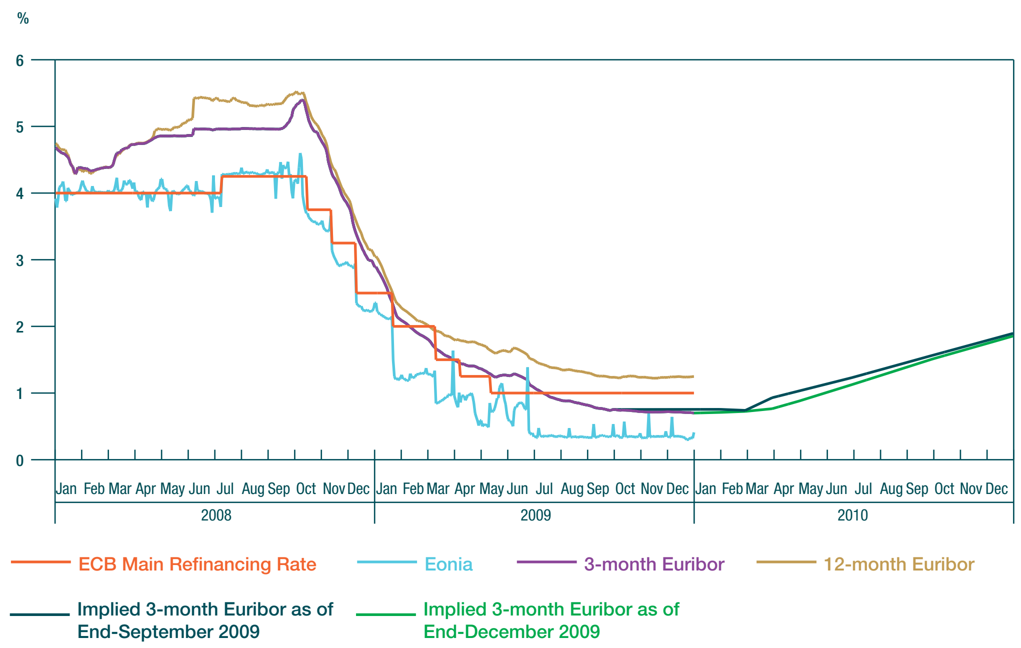


Source: CBFSAI.

2009 and that conditions are expected to improve further during the first quarter of 2010 across the maturity spectrum.

The non-standard measures adopted by the Eurosystem since the onset of the financial crisis continued to contribute to the improvement in money market conditions during Q4 2009. In refinancing operations the Eurosystem continued to supply counterparties with ample liquidity, through its full allotment policy for its main refinancing (MRO) and enhanced longer-term refinancing operations (LTRO). Amounts allotted at the refinancing operations have, in general, declined following the first 12-month LTRO in June 2009 and the subsequent improvement in inter-bank markets. Demand did, however, increase at end-December, as would be expected at year end. The last 12-month LTRO was also offered during December, with €96.9 billion allotted following €442 billion and €75.2 billion of liquidity provided at this maturity in June and October 2009 respectively. Lending to credit institutions by the Irish Central Bank as part of the Eurosystem's monetary policy operations increased during December to

Chart 2: Main ECB and Money Market Interest Rates



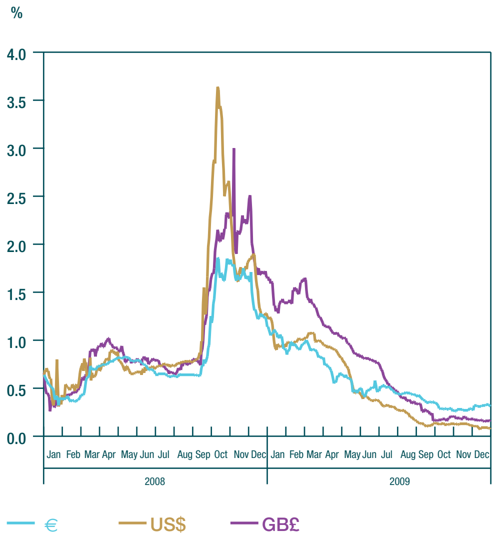
Source: CBFSAI and Thomson Reuters Datastream.

€92 billion following consecutive monthly declines since June. The composition of the lending has shifted since June, with on average 90 per cent of the funds being provided in LTROs, compared with approximately 60 per cent on average before June. Within the LTROs, demand has tended to be higher for the 12-month operations. Meanwhile, the covered bond purchase scheme provided assistance to a key segment of the credit markets, with approximately €28 billion of the planned €60 billion outlay completed by the end of 2009.

The ECB MRO rate remains unchanged at 1 per cent. Unsecured inter-bank lending rates across all maturities were relatively stable through Q4 2009 at historic lows. The overnight Eonia rate and the 3-month Euribor rate were consistently below the ECB MRO during the period as conditions in the money market remained calm. According to the implied path derived from 3-month Euribor futures, market participants expect interest rates to rise over the coming year from their current low base. The expected trajectory of the 3-month Euribor did not, however, change materially from end-September to end-December 2009, reflecting more stable expectations of market participants. Consistent with this outlook, unsecured euro-area money market rates also remained stable during Q4 2009, following their decline through most of 2009. Spreads between unsecured and secured rates, as represented by Euribor-OIS spreads, declined early in the quarter and are now at levels last seen before the bankruptcy of US investment bank Lehman Brothers. The Euribor-OIS spread peaked at just under 200 basis points in October 2008 and by end-December 2009 stood at less than 35 basis points, a level last seen in January 2008.

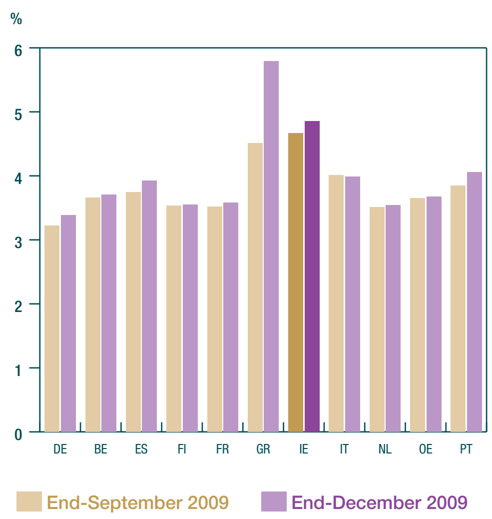
The Governing Council has contributed to the increased level of certainty in euro-area money markets by outlining the gradual exit strategy from the non-standard measures introduced during the financial crisis. This strategy includes the winding down of the LTROs at the 12-month and 6-month horizon, with the final 12-month LTRO offered in December 2009 and the final 6-month LTRO due to be offered in March 2010. The full allotment policy with the fixed rate tender process will also be maintained during the first quarter of 2010. The gradual removal of the non-standard support measures, which alongside the reduction in key ECB interest rates have assisted in reducing money market rates, risk spreads and retail lending rates, should ensure that the effect of the support measures will continue to feed through to credit provision to the euro area economy, further promoting recovery.

Chart 3: 3-Month Euribor (€) and Libor (GB£, US$) Spreads versus Overnight Index Swaps



Source: Thomson Reuters Datastream.

Chart 4: Euro Area Ten-Year Government Bond Yields



Source: Thomson Reuters Datastream.

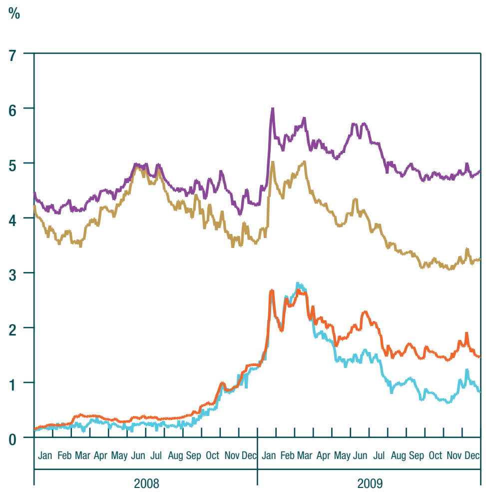
Sovereign Debt Market

During Q4 2009 euro area ten-year government bond yields increased marginally in the main, including that of the German Bund, while spreads over the Bund rose for some member states. Much of this increase happened during December, as yields on euro area government bonds either continued on their downward trajectory or remained relatively stable during October and most of November. This downward trend had persisted through the summer and autumn of 2008 despite more confidence about the overall economic outlook and positive data showing the euro area as a whole exiting recession in Q3. Demand for government debt had, however, been strong through 2009, which led to the lower yields. The high demand for government debt reflected the relatively steep yield curve as short-term interest rates remained at historical lows and the search for higher returns at longer maturities began to limit the scope for increased long-term yields. There was also high demand for government bonds by MFIs as they deleveraged their balance sheets and moved into less risky and more liquid assets.

Euro area sovereign bond developments from mid-November 2009 onwards, however, changed direction, with yields and CDS spreads beginning to move upwards. This has been particularly related to the increased concern over the fiscal position in Greece, which has led to a general rise in yields in recent weeks. The markets are also taking into account the fact that the supply of government debt will increase substantially next year, and may exceed demand, as most euro area member states will be running significant fiscal deficits. This concern is even more relevant for the UK and the United States, whose monetary authorities have announced plans to scale down their current programmes of direct gilt and Treasury bond purchases.

In this uncertain environment, Irish government bond yields and spreads over their German equivalents remained relatively stable over Q4 2009. The ten-year yield averaged 4.8 per cent over the period, while the five-year yield averaged 3.2 per cent, and the slope of the yield curve was relatively unchanged on Q3. Irish government bond spreads over comparable German Bunds increased towards the end of Q4, in line with the general trend of many euro area sovereigns. Irish spreads over German Bunds remain among the highest in the euro area, but have declined significantly

Chart 5: Irish Government Bond Yields and Spreads over German Equivalents



Source: Thomson Reuters Datastream.

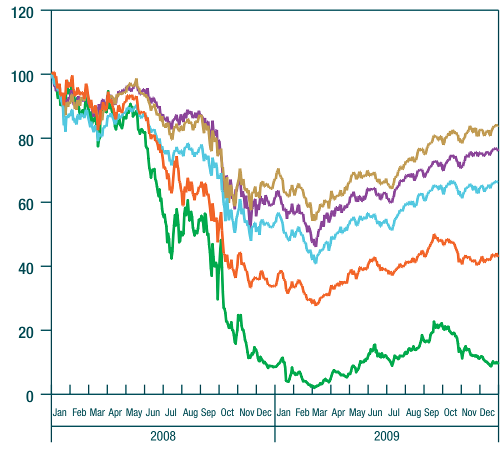
since their post-1999 peak of 270 basis points in March 2009.

Equity Markets

International equity markets continued their upward trend in Q4 2009, although the pace of recovery was more moderate than in Q2 and Q3. The gains that were recorded in the major markets in Europe and the United States were driven by more positive than expected economic data and continued positive earnings expectations for major listed companies. During November and into December 2009, however, equity markets were less buoyant as concerns over the robustness of the global recovery, and in particular the likely trajectory of returns in the financial sector, led to a sell-off of more risky asset classes. The announcement of the proposed moratorium on debt repayments by Dubai World, a holding company backed by the Dubai Government, reinforced and exacerbated this view. As a result stock market volatility increased somewhat in the second half of Q4 2009, but remains much lower than at the height of the crisis in 2008 and is now generally back to long-run averages.

Unlike the major equity market indices, the ISEQ fell by approximately 10 per cent in Q4 2009 compared with Q3 2009. On an annual

Chart 6: Irish and International Share Price Indices (December 2007 = 100)



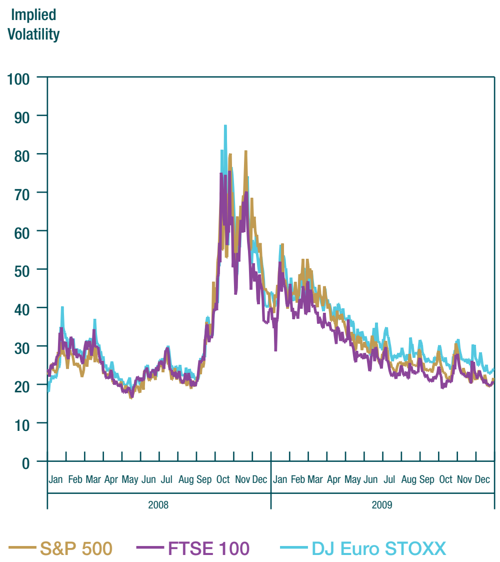
Source: Thomson Reuters Datastream.

basis, however, the ISEQ increased by 27 per cent in 2009, mirroring the trend in the major indices. The performance of the ISEQ during Q4 mostly related to the reduction in the value of financial sector stocks, which reflected both domestic and international developments. Domestically, the announcement that the purchase of loans from participating banks by NAMA was being delayed until early 2010, as well as more transparency on the expected losses to be realised by participating banks, weighed somewhat on Irish financial share prices. Financials were, however, lower globally as investors re-evaluated the sustainability of the significant earnings posted by the financial sector during 2009, given the potential reduction of monetary and fiscal support and the credit losses expected to be realised in 2010. The impact of the restructuring within the industry in the EU to comply with competition and state aid regulations and the need for future rights issues to meet capital requirements also affected financial sector equities in Europe during Q4 2009.

Foreign Exchange Developments

On a quarterly average basis the euro strengthened against the US dollar and sterling during Q4 2009 compared with Q3 2009, by 3.3 per cent and 3.8 per cent respectively. For the dollar rate, this continued the trend of appreciation of the euro evident through most of 2009. On an annual average basis, however, the euro traded at 5.2 per cent below its 2008 level vis-à-vis the dollar during 2009, as it was still regaining ground from the significant depreciation in late 2008 when investors bought into the dollar as a safe haven currency during the height of the crisis. However some of the euro's appreciation was reversed in the last weeks of 2009, which saw a similar trend to that of the previous year as investors became more confident of a sustained economic recovery in the US. During Q4 2009 the euro/US dollar exchange rate was less volatile than the preceding quarters, as was the euro/sterling exchange rate. The euro appreciation against sterling during Q4 on a quarterly average basis reversed sterling gains seen in Q2 and Q3. On an annual average basis, the euro appreciated by 12 per cent against sterling in 2009, as the UK continues to face more challenging fiscal and general economic conditions than the euro area as a whole. Meanwhile the euro depreciated slightly against the Japanese yen on a quarterly average basis in Q4 2009, but fell by 14.5 per cent on an annual average basis for 2009 as a whole, as the strong move into the yen that took place during Q4 2008 was not reversed.

Chart 7: Implied Equity Market Volatility



Source: Thomson Reuters Datastream.
Note: S&P 500 is the implied volatility of S&P 500 options taken from the VIX index. FTSE 100 is the implied volatility of FTSE 100 options taken from the FTSEIX index. DJ Euro STOXX is the implied volatility of DJ Euro STOXX 50 options taken from the VSTOXX index.

B: Money and Credit

Monetary Aggregates

The euro area broad money supply (M3) contracted by 0.2 per cent on an annual basis in November 2009, continuing a downward trend in M3 rates of change for the euro area evident since October 2007. In contrast, the Irish contribution to euro-area M3 has begun to increase on an annual basis in recent months, with annual growth averaging 3.1 per cent in the three months ending November 2009. This reverses a trend of decline in the Irish contribution to euro-area M3 which began in mid-2008.

A significant factor in the growth of the Irish M3 contribution is the developments in M1 here in recent months, which recorded an annual growth averaging 8.2 per cent in the three months ending November 2009. Currency in circulation has grown by almost 40 per cent on average through 2009, mostly due to the large increase in currency holdings in the face of uncertainty following the Lehman Brothers collapse in September 2008. The annual rate of change in currency in circulation has declined in recent months as the base effect of this event passes, but still remains in excess of 30 per cent. There has also been a significant reversal in the rate of change in overnight deposits which has contributed strongly to M1 growth. After declining consistently on an annual basis since April 2008, overnight deposits increased on an annual basis again in September 2009, and annual growth averaged 6.4 per cent in the three months ending November. This increase in overnight deposits is mirrored at a euro area level and is partly explained due to the reduced opportunity cost of holding overnight deposits vis-à-vis short-term time deposits (i.e. with agreed maturity up to 2 years). The fall in retail interest rates for term deposits since September 2008 has now made it less costly for the money-holding sectors to keep their assets in the more liquid form. This can also partially explain the continued decline in M2-M1, which has been evident both in Ireland and at a euro area level since Q3 2009. The decline in short-term time deposits, which are included in M2, has been only partially offset by an increase in short-term savings deposits (i.e. redeemable at notice up to 3 months). The increase in short-term savings deposits may also reflect the interest rate dynamics between these accounts and short-term time deposits, as the remuneration on savings deposits has exceeded that on time deposits since January 2009.

Another trend underlying monetary dynamics at the euro area level and to some extent domestically, is an increased risk appetite given the steepening yield curve and more certainty about a global economic recovery. This has led to more funds being transferred out of the M3 measure and into other asset categories such as equities, commodities and longer-term debt securities, particularly at the expense of short-term time deposits. The decline in the level of short-term time deposits held at Irish resident credit institutions has driven a decline in total M3 deposits, which averaged an annual rate of change of approximately minus 5 per cent in the three months ending November 2009. The pace of this contraction in M3 deposits has, however, begun to slow since August 2009. Underlying this is a more muted contraction in M3 deposits from non-financial corporations. Meanwhile M3 deposits from households continued to grow at approximately 2.5 per cent on an annual basis on average in the three months ending November, as they had done through the earlier months of 2009.

Developments in Private-Sector Credit Advanced by Irish Resident MFIs

The annual rate of change in private-sector credit (PSC) continued to decline in recent months, reaching minus 5.3 per cent in November 2009. In the three months ending November 2009, headline PSC declined by 1.8 per cent. Underlying this fall in PSC is continued weak demand for credit and muted supply due to the ongoing balance sheet constraints of lenders (see Box B: Irish Results of the Euro Area Bank Lending Survey).

Statistically, the biggest component of year-on-year changes in credit outstanding to the private sector as currently published, has been due to revaluation effects, such as increased write-downs and provisions for bad debts. Other technical factors (reclassifications) have contributed to a lesser extent. While revaluations have impacted mostly on the NFC sector, they have also been important in the household sector. As part of the update of money and banking statistics the Bank will separately identify households and NFCs within PSC from July 2010, and examine the components underlying changes in credit outstanding for these sectors. Credit growth rates which are based on the underlying flows of credit (i.e. new lending less repayment of existing facilities) and which exclude revaluations and reclassifications will also be published. Box A provides an overview of the new methodology and explains its relevance in the current analysis of credit developments.

The outstanding stock of residential mortgage lending (inclusive of securitisations) declined by €134 million during the month of November 2009 to €147.7 billion. This followed declines of €15 million and €161 million in September and October respectively. The reduction in mortgage lending in November 2009 was the eighth consecutive month-on-month decline, as the level of outstanding mortgages peaked at €148.5 billion in March 2009. Mortgage debt outstanding fell on a year-to-year basis by €207 million in November, or 0.1 per cent. This was the first annual decline in mortgage lending on record since the current mortgage series began in the early 1990s, and is in contrast to annual growth of 6.8 per cent in residential mortgage lending in November 2008.

The latest data on the breakdown of residential mortgages relating to Q3 2009 show that the decline in residential mortgage lending has mostly been concentrated in buy-to-let (BTL) mortgages and lending for the purchasing of holiday homes. These categories declined by €1.4 billion (4 per cent) and €328 million (11.7 per cent) respectively, in the year ending Q3 2009. Meanwhile mortgages on principal dwelling houses (PDH) continued to increase on an annual basis during Q3 2009, albeit at a much slower pace of 1.9 per cent (€2.1 billion).

Box A: Measuring Credit Growth — A New Approach

From July 2010, the CBFSAI will introduce a new methodology and a new presentation of money and banking statistics. In advance of this new publication, this Box provides some background information on the new methodology, and how it differs from current practices. The new tables will provide a breakdown of credit outstanding for the key sectors within PSC, particularly for households and NFCs. As well as stocks of credit outstanding, growth rates will be calculated based on the underlying transactions in lending. This method is similar to that used by the ECB to calculate growth rates for the euro-area aggregates including money and the counterparts to money (e.g. loans), and is also used by a number of other monetary authorities. The methodology adjusts stocks from period to period to exclude revaluations and reclassifications in addition to the current practice of excluding exchange-rate effects and lending to non-bank IFSC companies. The primary focus of the new methodology will be on the household and NFC sectors — growth rates for both these sectors based on underlying credit flows are provided below.

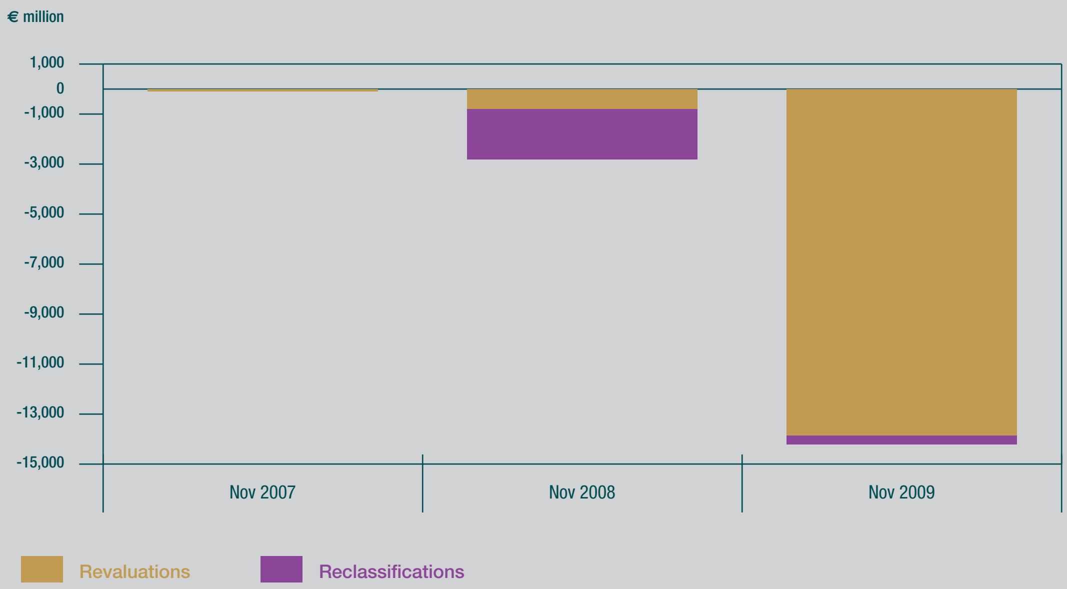
Private-sector credit (PSC) growth rates are compiled from the balance sheet returns submitted monthly by the Irish resident offices of credit institutions. The current method for analysing changes in credit adjusts the changes in the stock of loans and other credit instruments, by removing the effects of exchange-rate movements and lending to non-bank IFSC companies, which have little impact on the domestic real economy. These growth rates are published in Table A2.2 of the CBFSAI *Monthly Statistics* and in the *Statistical Appendix* of the *Bulletin*.

These adjustments alone, however, do not give a full picture of changes in the net flow of credit (i.e. new lending less repayments of existing credit), which are most relevant from an economic perspective. Other factors, such as revaluation effects and reclassifications can influence the changes in the stock of credit and consequently, the credit growth rate as currently published[2]. Revaluation effects capture the impact of write-offs or write-downs of loans as well as changes in the level of bad debt provisions. Reclassifications are changes in the balance sheet stocks due, for example, to changes in the reporting population, changes in the classification of instruments, counterparties or residency of assets, or changes due to the correction of reporting errors. These non-transaction related factors need to be excluded in order to get a more accurate picture of the underlying flows of credit.

The vast majority of the contraction in the currently published measures of PSC is due to revaluation effects, i.e. changes in the level of write-downs and bad debt provisions. Prior to 2008, these effects were not very significant and the net flow of credit was, therefore, closely approximated by changes in stocks of credit from the published statistics. Chart A1 illustrates this point in particular, and shows how the treatment of revaluations and reclassifications causes divergences in the net flow of credit on an annual basis once these effects became significant in 2008. As economic conditions worsened and banks began to re-examine their loan books in more detail, these revaluation effects increased strongly. Revaluations are predominantly within the NFC sector, but also apply to households. While reclassifications have had a smaller impact, they can also be important at the disaggregated sectoral level. The difference in the change in PSC between the two methods for the year-end November 2009 is approximately €14.2 billion. The growth rate compiled under the new methodology is minus 1.7 per cent compared to minus 5.3 per cent under the current methodology (Table A1).

[2] The detail behind accounting for the exchange-rate effect is not discussed here, as it is broadly similar to the method being currently used to produce the adjusted annual rate of change in private-sector credit and non-mortgage credit published in Table A2.2 of the *Monthly Statistics* and the *Statistical Appendix* of the *Bulletin*.

Chart A1: Difference in Year-on-Year Change in PSC between Old and New Method



Source: CBFSAI.

Table A1: Private-Sector Credit (adjusted) using the Current and New Methodology

	PSC less non-bank IFSC	Annual Change in PSC less non-bank IFSC	Exchange Rate Effects	Annual Rate of Change in PSC (Current Method)	Revaluations	Reclassifications	Annual Rate of Change in PSC (New Method)
	€m	€m	€m	%	€m	€m	%
	A	B	C	$(B–C)/(A_{T–12})$*100	D	E	$(B–C–D–E)/(A_{T–12})$*100
Jan 09	365,380	22,290	5	6.6	–2,479	–2,052	7.8
Feb 09	365,279	19,639	709	5.6	–2,839	–2,052	6.9
Mar 09	360,645	8,648	687	2.4	–5,386	–1,668	4.3
Apr 09	358,829	5,861	861	1.6	–6,453	–1,397	3.6
May 09	358,192	1,919	346	0.6	–7,002	–1,397	2.8
June 09	356,879	–2,398	833	–0.8	–7,987	–1,397	1.7
July 09	353,947	–7,973	650	–2.2	–9,852	–1,813	0.8
Aug 09	353,019	–11,807	–88	–3.0	–10,469	–1,397	0.0
Sep 09	349,458	–14,245	–1,181	–3.4	–11,425	–980	–0.2
Oct 09	347,614	–16,616	–2,552	–3.7	–13,041	–367	–0.2
Nov 09	345,850	–22,532	–2,250	–5.3	–13,839	–367	–1.7

Source: CBFSAI.

Note: Formulae shown above are for illustrative purposes. Minor differences may exist between the growth rates above and their underlying components, as the exact formula for calculating growth rates is based on the aggregation of twelve monthly changes, as opposed to annual changes. See the credit growth data referenced in footnote 3 for more details.

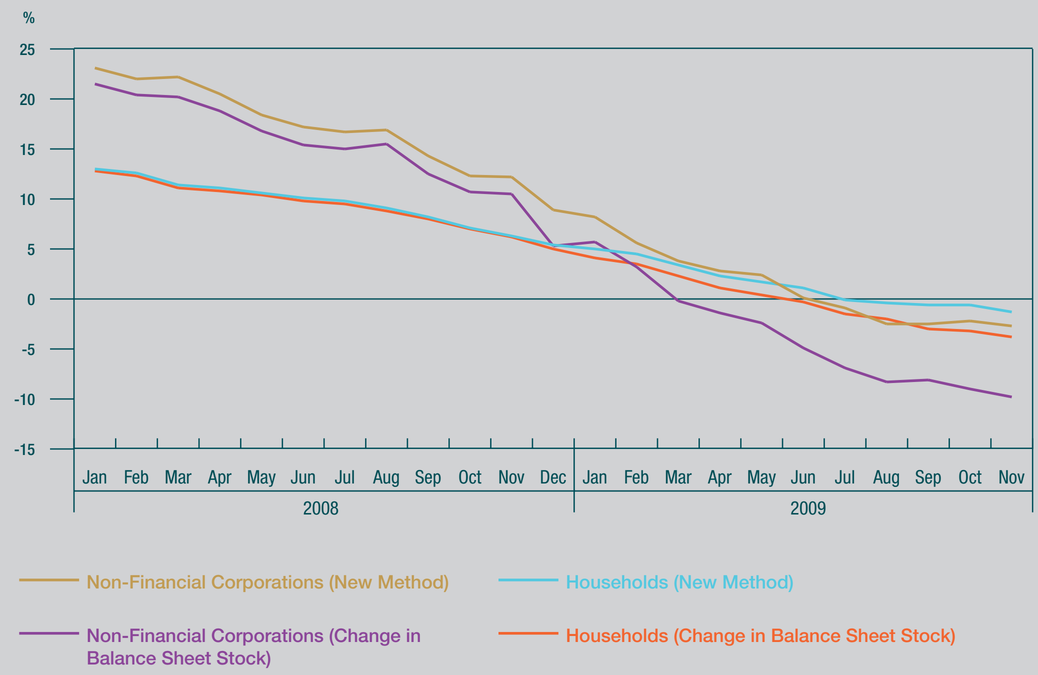
This new method of calculating credit growth relating to households and NFCs will be published domestically from July 2010 in the new monthly money and banking statistics release[3]. Chart A2 shows how the annual rate of change in credit to NFCs and households (including securitised mortgages) has evolved in recent months using the new method and a simple comparison of balance sheet stocks without adjusting for revaluations, reclassifications and exchange-rate effects.

The impact of revaluations on lending to NFCs has depressed the reported stocks of NFC credit on credit institutions' balance sheets. Exchange-rate developments have also contributed to the divergence in growth rates using the two methods, as the reported book value of non-euro denominated NFC loans have fallen in line with the strengthening of the euro against other major currencies over the year. Using the new method, the trend for both household and NFC lending has shown a long period of slowing growth rates up to mid-2009 when credit extended to these sectors began to contract on an annual basis. The deceleration has been particularly rapid for NFC lending, having gone from an annual increase of 23.1 per cent in January 2008, to an increase of 8.2 per cent in January 2009, with the latest data showing an annual rate of contraction of minus 2.7 per cent. In contrast to early and mid-2009, however, the annual rate of change for NFCs has not declined significantly since August 2009, being approximately minus 2.5 per cent in most recent months.

The decline in the pace of growth in household credit has been less pronounced than that of NFCs. Household credit increased by 13 per cent in the year ending January 2008, with this pace of increase slowing to 5 per cent at year ending January 2009. The latest data for November 2009 shows a decline of 1.1 per cent in household credit in the year ending November 2009. Much of the decline is due to falling non-mortgage household credit, which has been declining consistently through 2009. Since April 2009, however, residential mortgages have also been declining on a month-to-month basis, and were virtually unchanged on an annual basis in November 2009.

[3] Back-data of these series to 2004 are available at http://www.centralbank.ie/frame_main.asp?pg=sta_late.asp&nv=sta_nav.asp.

Chart A2: NFC and Household Credit (incl. securitisations), Annual Rates of Change

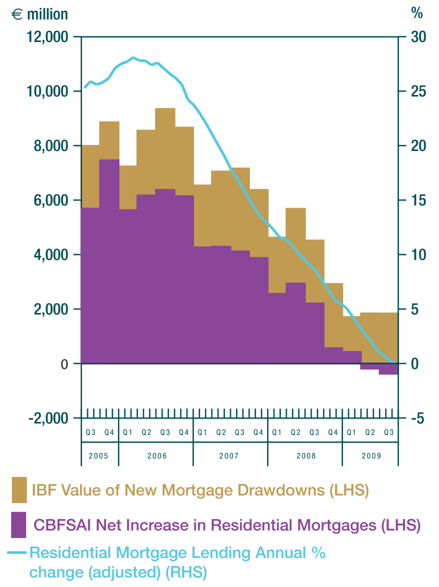


Source: CBFSAI.

On a quarter-on-quarter basis PDH mortgages increased by €243 million in Q3 to €113.5 billion[4], whereas BTL and holiday home mortgages declined by €473 million to €33.4 billion and €149 million to €1.1 billion respectively. The annual rate of decline in the value of new mortgage business[5] in Q3 2009, as reported by the Irish Banking Federation/PricewaterhouseCoopers Mortgage Market Profile, slowed to minus 58 per cent from minus 67 per cent in Q2 2009. The developments in new mortgage business over the past year have been dominated by the reduction in the volume of activity. The average loan size for new mortgages has not declined to the same extent as the value of new mortgage business. The rate of decline in the volume of new activity in the mortgage market also slowed, however, over Q3 2009, particularly for first-time buyers and mover-purchasers. This has contributed to the less severe slowdown in PDH mortgages relative to BTL and holiday home mortgages witnessed in recent months.

Sectoral data for Q3 2009 show that lending to the financial intermediation sector was again

Chart 8: Quarterly Increase in Residential Mortgages — New Lending and Outstanding Amounts



Source: CBFSAI and the Irish Banking Federation.

[4] The Financial Regulator is now publishing a series on principal dwelling mortgages with a particular emphasis on mortgage arrears. This series shows PDH mortgages outstanding at end-Q3 2009 as €118.6 billion. Some differences exist between the two series, particularly due to the inclusion of sub-prime mortgage providers in the Financial Regulator data.

[5] Excluding top-up and re-mortgaging activity.

Table 1: Sectoral Breakdown of Private-Sector Credit[a]

	Total stock at end-Sep. 2009		Change in credit			
			Q-on-Q		Y-on-Y	
	€ million	% share	€ million	% change	€ million	% change
Primary industries[b]	6,039	1.5	–124	–2.0	–376	–5.9
Manufacturing	7,550	1.8	–271	–3.5	–1,612	–17.6
Electricity, gas and water supply	1,100	0.3	85	8.4	–134	–10.8
Construction	16,603	4.0	–2,398	–12.6	–6,341	–27.6
Wholesale/retail trade and repairs	12,965	3.1	–271	–2.0	–1,345	–9.4
Hotels and restaurants	11,214	2.7	–81	–0.7	–593	–5.0
Transport, storage and communications	3,225	0.8	–58	–1.8	–370	–10.3
Financial intermediation	86,206	20.7	25	0.0	11,336	15.1
Real estate activities	88,050	21.2	–1,352	–1.5	–4,065	–4.4
Business activities	7,096	1.7	935	15.2	293	4.3
Services to households	6,358	1.5	–28	–0.4	266	4.4
Personal	169,047	40.7	–1,888	–1.1	–3,803	–2.2
of which:						
– Residential mortgages	147,969	35.6	–380	–0.3	419	0.3
– Other housing finance	644	0.2	–74	–10.3	–467	–42.0
– Other	20,434	4.9	–1,434	–6.6	–3,756	–15.5
Total	**415,453**	**100.0**	**–5,426**	**–1.3**	**–6,744**	**–1.6**
Total PSC (Table A2.2, Statistical Appendix)	*378,086*		*–9,264*	*–2.4*	*–21,057*	*–5.3*

[a] The Total figure in Table 1 includes securitised residential mortgages which have been added back into lending to the Personal sector to give a more accurate figure for personal borrowing. Some of the mortgage-backed securities created with these loans have been purchased by Irish credit institutions and would also be included under Financial Intermediation above. As such there is an element of double-counting in the Total figure. The official level of PSC outstanding (inclusive of accrued interest) is reported in Table A2.2 of the Statistical Appendix and is shown in the last row of Table 1 above, along with the unadjusted quarterly and annual changes in PSC. The adjusted growth rates for total PSC (which account for exchange-rate valuation effects and lending to non-bank IFSC companies), mortgage and non-mortgage credit are available from Table A2.2 of the Statistical Appendix.

[b] Primary industries refer to agriculture, forestry, fishing, and mining and quarrying.

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

Box B: Irish Results of the Euro Area Bank Lending Survey

The latest Bank Lending Survey, which examined credit conditions during Q4 2009 and expected credit conditions for Q1 2010, showed a further tightening of credit standards on loans to enterprises for the final quarter of 2009 (Table B1). A further rise in their cost of funds and balance sheet constraints contributed to the tightening of credit standards by banks. Allied to this was uncertainty surrounding both the general economic outlook and that for specific industries and firms. The tightening of credit standards was reflected in both price and non-price terms and conditions: higher loan margins, more restrictive collateral requirements, and reduced loan covenants.

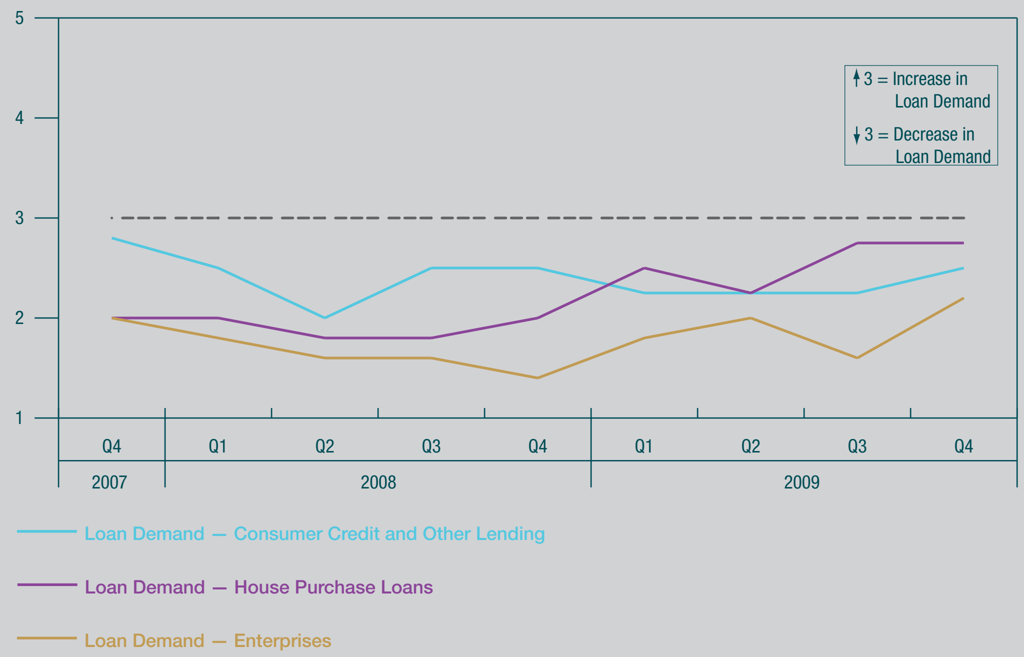
Credit standards on loans to households for house purchase were unchanged during Q4 2009 for the first time since Q4 2007. Credit standards were also unchanged regarding consumer credit and other lending to households.

Table B1: Change in Credit Standards

		Q3 2009	Q4 2009
Enterprises:	Overall	2.60	2.40
	Small/medium enterprises	3.00	2.75
	Large enterprises	2.50	2.25
	Short-term loans	2.60	2.40
	Long-term loans	2.60	2.40
Households:	House purchase	2.75	3.00
	Consumer credit and other lending	3.00	3.00

Key: 1 = tightened considerably; 2 = tightened somewhat; 3 = basically unchanged; 4 = eased somewhat; 5 = eased considerably.

Chart B1: Change in Loan Demand: Enterprises and Households



During Q1 2010 credit standards are expected to remain unchanged on loans to enterprises and households across all categories examined.

Meanwhile the demand for loans from enterprises decreased during Q4 2009, for the 12th successive quarter and this was independent of loan maturity or firm size. Lower levels of fixed investment and declining volumes of mergers and acquisitions (M&A) activity were the main factors attributed by banks to this decline.

Similar to enterprises, the demand for loans from households for house purchase as well as consumer credit and other lending also decreased during Q4 2009 continuing a trend of recent quarters. Less favourable housing market prospects, declining levels of consumer confidence, and reduced spending on durable consumer goods are some of the factors cited by the participating institutions as being responsible for the decline in household loan demand.

During the first quarter of 2010 loan demand from enterprises is expected to decrease and is expected to remain unchanged regarding loans to households.

For the first time since the BLS commenced, participating institutions were asked about expected changes in credit standards on loans to enterprises and households as well as the expected impact of various factors on credit standards during the whole of 2010. All participating institutions reported that credit standards are expected to remain unchanged for the next twelve months. However, given the increased horizon to which these responses relate, greater uncertainty has to be attached to these expectations.

significant, with growth of 15.1 per cent on an annual basis. This is, however, stabilising following growth in excess of 20 per cent for all quarters from mid-2007 to early 2009. This strong growth in lending largely reflects a technical issue relating to the purchase of mortgage-backed securities by credit institutions from special-purpose vehicles (SPVs). In many cases, the credit institutions themselves are the originators of the loans underlying the securities issued by the SPVs. In addition, a significant part of lending to the financial intermediation sector is to non-bank IFSC companies, although this has declined over Q3 2009 by 6 per cent. The increase in financial intermediation lending in recent quarters relates to non-IFSC business.

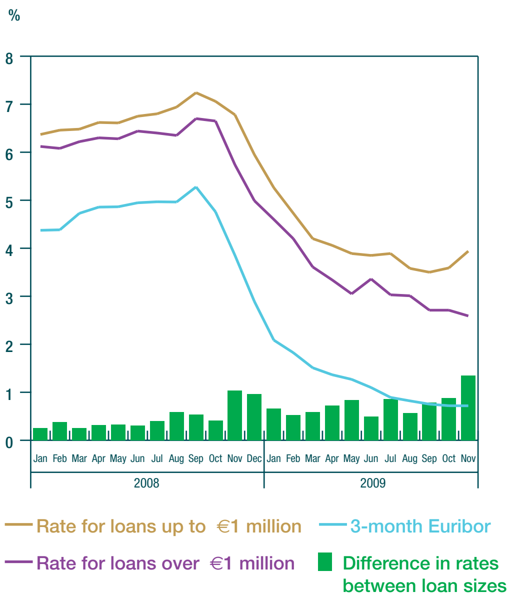
Lending to the non-property business sectors[6] increased over Q3 2009 by €215 million, or 0.4 per cent, mostly related to an increase in credit to firms in the non-real estate services sectors. However on an annual basis, credit to non-property business sectors was 7.8 per cent lower than in Q3 2008. There are significant differences across the sectors in the rate of decline seen since lending to most of these sectors peaked between Q2 and Q3 2008. Credit to the manufacturing sector, for example, had fallen by 17.8 per cent from its peak in Q2 2008 to Q3 2009, whereas wholesale/retail trade and repairs and the hotel and restaurant sectors have seen declines of 9.4 per cent and 8.4 per cent respectively from their peaks in Q3 and Q2 2008. These latter two sectors combined account for almost 50 per cent of all non-property related business credit outstanding, and had witnessed the most significant growth rates in credit to non-property sectors prior to mid-2008. Meanwhile lending to property-related business sectors fell by €3.8 billion during Q3 2009. On an annual basis, credit to the construction and real estate sectors fell by 9 per cent in the year to the end of the third quarter. Write-downs and rising bad debt provisions have been significant factors in the quarterly and annual developments in credit to these combined sectors.

[6] The non-property business sectors are defined as business sectors excluding construction, real estate activities and the financial intermediation sector. Social and personal sectors are also excluded in this categorisation.

Domestic Lending and Deposit Rates

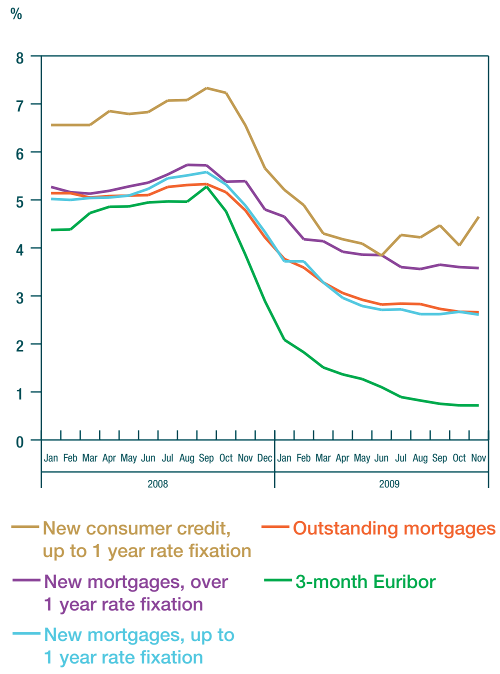
Interest rates on lending for households and NFCs have been relatively stable in recent months following the falls seen across most

Chart 9: New NFC Loans with Floating Rate and up to One-Year Initial Rate Fixation



Source: CBFSAI.

Chart 10: Lending Rates to Households



Source: CBFSAI.

categories from autumn 2008. Lending rates appear to have reached the bottom of their cycle, however, and for some lending categories the margins between retail and inter-bank lending rates (e.g. Euribor) have widened. This is the case for new short-term or variable rate NFC loans of less than €1 million, the rates for which increased by 36 basis points between August and November 2009. Lending rates in this category still remain significantly lower than in 2008, however, as they were 284 basis points lower in November 2009 compared with November 2008. NFC loans under €1 million can be used as a proxy for lending to smaller companies. Meanwhile rates on new short-term or variable rate NFC loans of more than €1 million declined by 42 basis points from August to November 2009. This brought the gap between rates for smaller and larger NFC loans to 135 basis points in November, the highest for 2009. Overall, rates for loans under €1 million are 3.1 percentage points lower, while rates for loans over €1 million are 4.1 percentage points lower than before the beginning of the rate-cutting cycle in October 2008. This compares to cuts totalling 3.25 percentage points in the ECB main refinancing rate.

Average rates for new variable-rate mortgage customers remained relatively unchanged between August and November 2009, while rates for existing mortgage holders fell by almost 20 basis points. Rates for new mortgages with over 1 year rate fixation have also remained relatively unchanged in recent months, but these have not declined to the same extent as variable rate mortgages since the beginning of the rate cutting cycle in 2008. New variable-rate mortgages have declined by 270 basis points from October 2008 to November 2009 whereas new mortgages with over 1 year initial rate fixation have only fallen by 180 basis points. The margins above the ECB main refinancing rate for new variable-rate mortgages and for existing mortgages remained relatively constant through 2009 at approximately 1.7 per cent. Irish mortgage rates remain among the lowest in the euro area for both new business and outstanding amounts.

Overnight deposit rates for both households and NFCs remained relatively stable during the three months ending November 2009, having declined by 64 and 67 basis points respectively, over the year since November

2008. Rates offered on deposits with agreed maturity have seen the sharpest decline since the autumn of 2008, with rates for NFC deposits in this category continuing to fall during the three months ending November 2009 to 0.94 per cent. These rates were as high as 4.4 per cent in September 2008. However rates on deposits with agreed maturity from households, which had fallen consistently from their peak of 4.4 per cent since September 2008, increased during October 2009 by 10 basis points, with a further rise of 16 basis points in November. This trend was mirrored in the euro area as a whole. Meanwhile household deposits which are redeemable at notice remained relatively unchanged since May 2009, averaging 2.3 per cent since then. This is in contrast to the euro area as a whole, where rates on household redeemable at notice deposits are continuing to decline.

Table 2: Deposit Rates to Households and Non-Financial Corporations[a]

%	2009					
	June	**July**	**Aug.**	**Sep.**	**Oct.**	**Nov.**
DEPOSITS						
Households						
— Overnight[b]	0.56	0.59	0.60	0.63	0.63	0.64
— With agreed maturity	1.61	1.48	1.40	1.23	1.33	1.49
— Redeemable at notice[b]	2.32	2.29	2.29	2.21	2.22	2.24
Non-financial corporations						
— Overnight[b]	0.30	0.36	0.29	0.30	0.30	0.30
— With agreed maturity	1.38	1.22	1.02	1.00	0.96	0.94

[a] Rates are for new business.
[b] For these categories, new business is defined as outstanding amounts.
Source: CBFSAI.