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Box F:

QB2 – April 2019

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Credit Developments in the Irish Economy

By Statistics Division

There are signs that wider economic developments are leading to a recovery in credit flows and a slowdown in the deleveraging seen in recent years. Credit from the Irish banking sector has become broadly positive for both mortgage and consumer lending. New lending to SMEs continues to grow primarily due to increased lending for real estate activities, which now account for one-third of all new SME lending.

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Developments in household consumption and investment activity continue to strengthen, notwithstanding the slower pace of recovery in credit to the household sector. The Quarterly Financial Accounts gives a comprehensive overview of credit to the household sector, and shows that households are still, on aggregate, paying down debt. However, the rate at which this is occurring has declined significantly, as bank credit begins to grow, while loans held by non-banks are repaid. Declining household debt combined with rising household incomes has led to substantial deleveraging. The ratio of household debt to income fell to 125.8 per cent in Q3 2018. Irish households are relatively highly indebted, ranking fourth highest amongst European countries in terms of debt to income.

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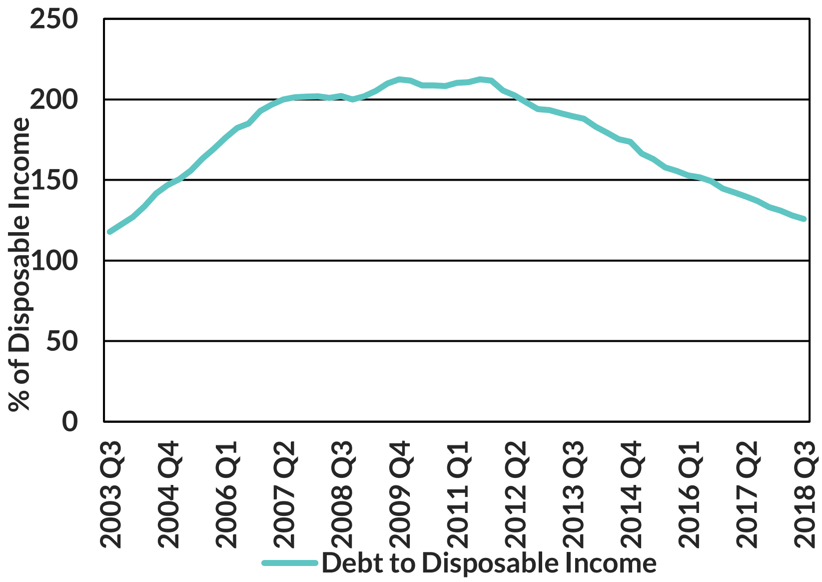
Box F Figure 1: Household Debt as a Percentage of Disposable Income



Source: Central Bank of Ireland

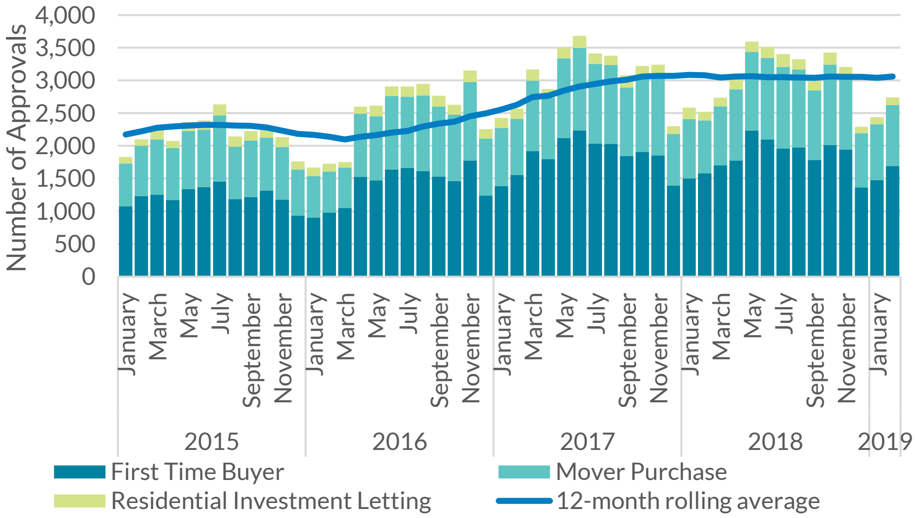
Loans to Households

While overall credit of households continues to decline, new mortgage agreements increased 18.3 per cent in the year to end-January 2019. In net terms, new mortgage lending was consistently higher than repayments by households throughout the second half of 2018, and while net lending for the beginning of 2019 has turned negative, it is reflective of seasonal effects. The return to broadly positive net mortgage lending reverses a trend of prolonged deleveraging which had taken place since the onset of the financial crisis.

Turning to mortgage refinancing, the value of mortgages renegotiated with an existing bank amounted to €5,090 million in the twelve-months to end-January; a 7 per cent decline on the previous twelve-months. The majority of these mortgages were renegotiated with an over 1 year fixation term. In contrast, mortgage switching between banks increased by 75 per cent in annual terms over 2018, albeit involving lower volumes with €1,242 million re-mortgaged during 2018. [1] Central Bank data from the first half of 2018 indicate that the average LTV of re-mortgage loans was 58 per cent, in contrast to new mortgage LTVs of 75 per cent.[2]

[1] Source: Banking and Payments Federation of Ireland Mortgage Drawdowns Report Q4 2018
[2] Source: Central Bank of Ireland Household Credit Market Report 2018

Box F Figure 2: Monthly Mortgage Approvals for House Purchase

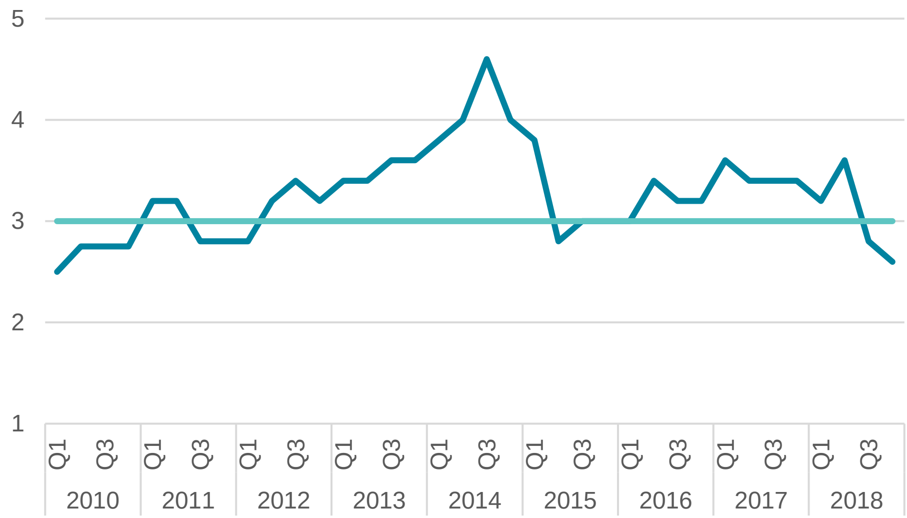


Source: Banking and Payment Federation of Ireland

There are signals that mortgage credit growth may be easing. Recent data indicate a stabilisation of the annual growth rate in mortgage lending at around 1.4 per cent per month. One potential forward-looking indicator for mortgage credit is the number of mortgage approvals for house purchase, which declined by 0.7 per cent in the year to February 2019 (Figure 2).[3] Additionally, demand for credit for house purchase, as measured in the Central Bank of Ireland Bank Lending Survey, decreased slightly in Q4 2018[4]. The BLS respondent indicated that the decline in demand is due to the perceived impact of the regulatory and fiscal regime governing the housing market.

[3] Source: Banking and Payments Federation of Ireland Mortgage Approvals Report February 2019
[4] Source: Central Bank of Ireland Bank Lending Survey

Box F Figure 3: Change in Demand for Loans for House Purchase



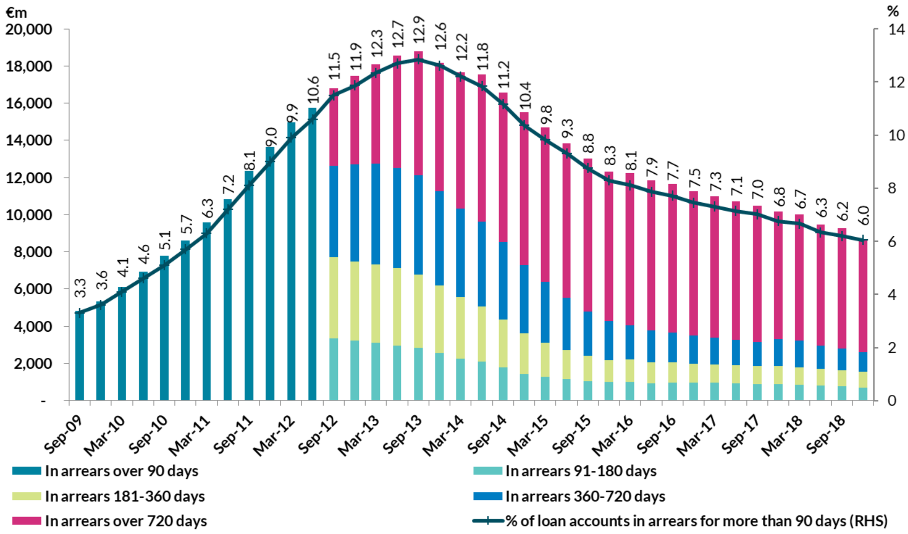
Source: Central Bank of Ireland

Key: 1 = decreased considerably,
2 = decreased somewhat,
3 = remained basically unchanged,
4 = increased somewhat,
5 = increased considerably.

Levels of mortgage arrears continue to fall. Having peaked at 12.9 per cent in 2013, the percentage of principal dwelling home (PDH) mortgage accounts in arrears of over 90 days has more than halved to 6 per cent (Figure 2). The figure has now fallen for 21 consecutive quarters. A large arrears reduction has also been seen in the buy-to-let (BTL) market segment, though the over 90 days in arrears levels remain elevated at 14 per cent. The majority of the remaining arrears in both market segments are now concentrated in the greater than 720 days category, suggesting that the remaining arrears cases may be more difficult to resolve than was previously the case. A large number of these cases have also been shown to be in arrears of significantly more than the 720 days threshold.[5]

[5] Source: Central Bank of Ireland: https://www.centralbank.ie/docs/default-source/publications/research-technical-papers/10rt17---resolving-a-non-performing-loan-crisis-the-ongoing-case-of-the-irish-mortgage-market.pdf

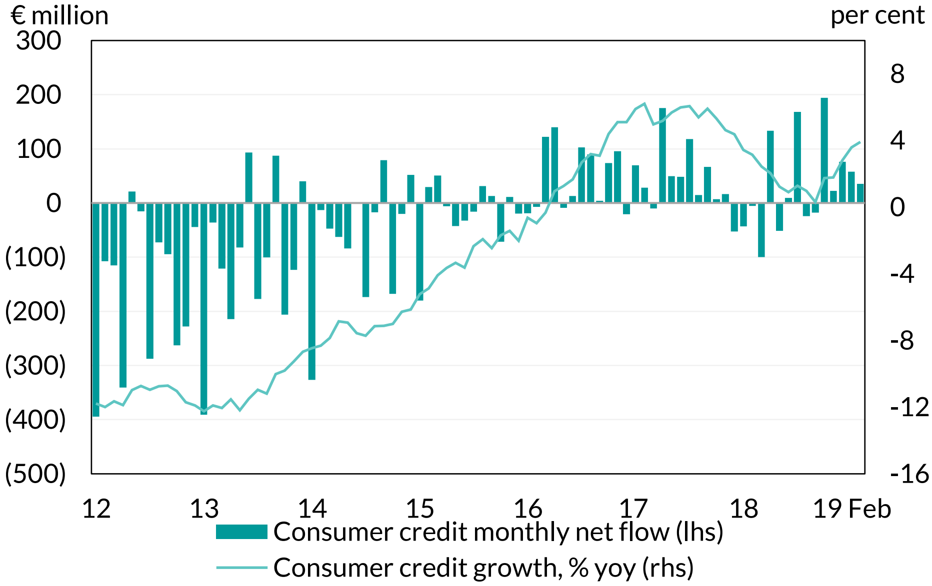
Box F Figure 4: PDH Mortgage Accounts in Arrears over 90 Days



Source: Central Bank of Ireland

Levels of consumer credit advanced by Irish banks continued to increase. The rate of growth has picked up in recent months following declines in mid-2018; however, it is still below the high growth rates experienced in 2017. Car finance loans account for a sizeable proportion of consumer credit and seasonality in the purchase of vehicles likely drove the increases in net lending in early-2019. The Q4 2018 Bank Lending Survey indicates that demand for consumer credit remained unchanged on earlier quarters, reflecting solid consumer confidence and spending on durable goods.

Box F Figure 5: Bank Lending to Households for Consumption; Developments in Net Flows, Annual Rate of Change



Source: Central Bank of Ireland

Lending to SMEs

New bank lending to Irish SMEs continues to grow, with loan drawdowns in 2018 at the highest level since the start of the data series in 2010. The 6.2 per cent increase in new lending in 2018 is primarily due to increased lending for real estate activities, which now account for one-third of all new SME lending. Although the level of loan repayments by SMEs has held broadly steady when compared to the previous year, the increase in gross new lending is not yet sufficient to halt the overall decline in outstanding SME loans. However, the rate of decrease has slowed significantly in recent quarters when compared to earlier years.

Data from the Department of Finance SME Credit Demand Survey indicate a slowdown in the number of SMEs applying for bank credit in recent years, with only 20 per cent of firms having applied the six months to September 2018.[6] The survey also indicated the lack of credit requirement as the reason for the low application rate.

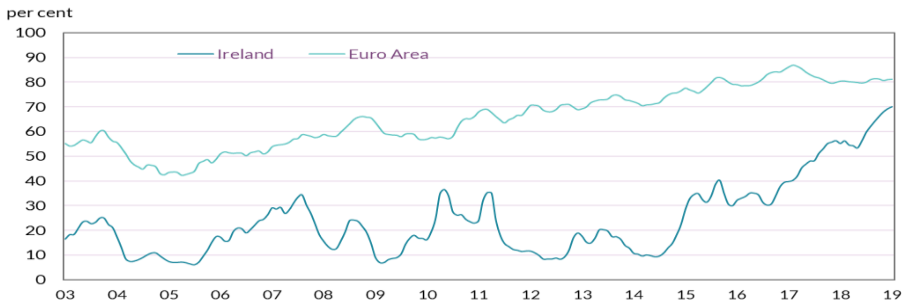
Interest Rates

The cost of new mortgage credit remains high relative to European peers. The average rate recorded for new mortgage lending in January was 3.01 per cent, higher than the average for any other euro

[6] Source: SME Credit Demand Survey – April 2018 – September 2018

area country other than Greece. A significant change is ongoing in the interest rate fixation behaviour of households in recent years. Fixed rate mortgages now comprise 70 per cent of all new agreements[7] . This proportion of fixed rate drawdowns is the highest recorded in the series' history and brings Ireland closer to the high fixation rates seen elsewhere in the euro area. Fixation period can vary significantly however, and the typical historical fixation period in Ireland is less than 3 years. Recent months have seen a shift to longer interest fixation products, with the increase in lending in PDH mortgages in Q4 2018 driven by mortgages with fixed rate of over 3 years. This is reflective of the wider range of 5, 7 and 10 year fixed rates mortgages available on the market.

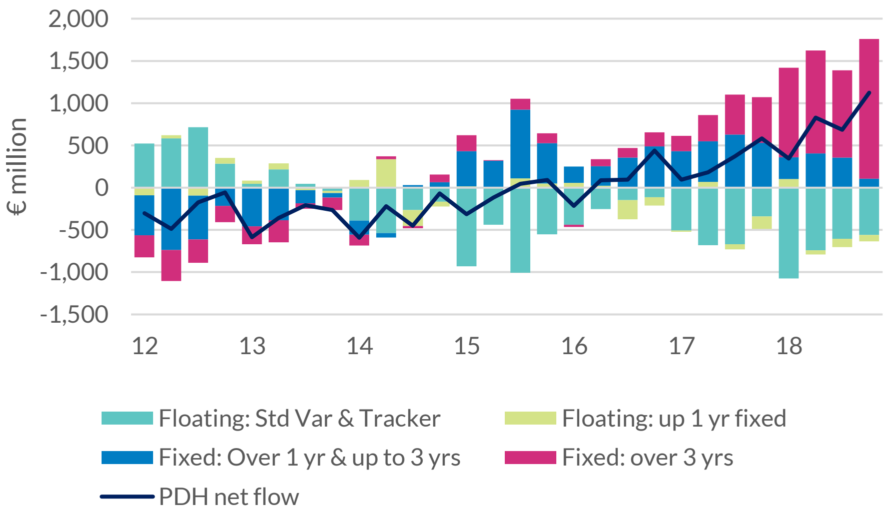
Box F Figure 6: New mortgage agreements: Share of fixed rate mortgages (3-month rolling average)



Source: Central Bank of Ireland

[7] As measured by loan amount on a three-month rolling basis

Box F Figure 7: PDH fixed and floating rate loans (Net Flows)



Source: Central Bank of Ireland

SME interest rates continue to decline, albeit at a slower rate than mortgage rates. The average interest rate on new SME drawdowns at the end of 2018 was 3.97 per cent, a marginal twelve basis lower than end-2017. Interest rates on SME loans vary significantly between sectors, with collateralised real estate lending securing rates of 3.22 per cent, and SMEs engaged in the market driven agriculture sector agreeing rates of 4.64 per cent as the end of 2018.