



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem



**Box E:**

**QB 1 – February 2020**

This Box content is extracted from the Quarterly Bulletin – Q1 2020

## Financing Developments in the Irish Economy

By Statistics Division

Credit developments remain largely modest while deposits from both households and non-financial corporations (NFCs) are picking up strongly. The growth in credit to the NFCs has slowed in the later part of 2019, accompanied by very strong growth in deposits from non-financial companies. This is showing some potential precautionary behaviour of NFCs but business sentiment indicators suggest a modest rebound in December may result in a change in the coming months.

Outstanding loans for house purchase increased at a modest and relatively stable rate during last year. Loans for consumption purposes are growing at a faster rate but the pace of growth has also stabilised or slightly declined in recent months. Deposits from both households and businesses continue to increase despite low or negative rates on certain products. The growth is concentrated in overnight deposit categories reflecting the large decline in the additional interest rate premium for term and notice deposit accounts.

While consumer sentiment has improved, most likely due to the decreased levels of uncertainty regarding the United Kingdom's withdrawal from the European Union, downside risks remain. Should these risks reduce further, and confidence improves among households and businesses, a less defensive stance may result in lower savings and result in additional spending and investment at a time when risks of overheating in the Irish economy may already be increasing.

### Household Credit and Deposits

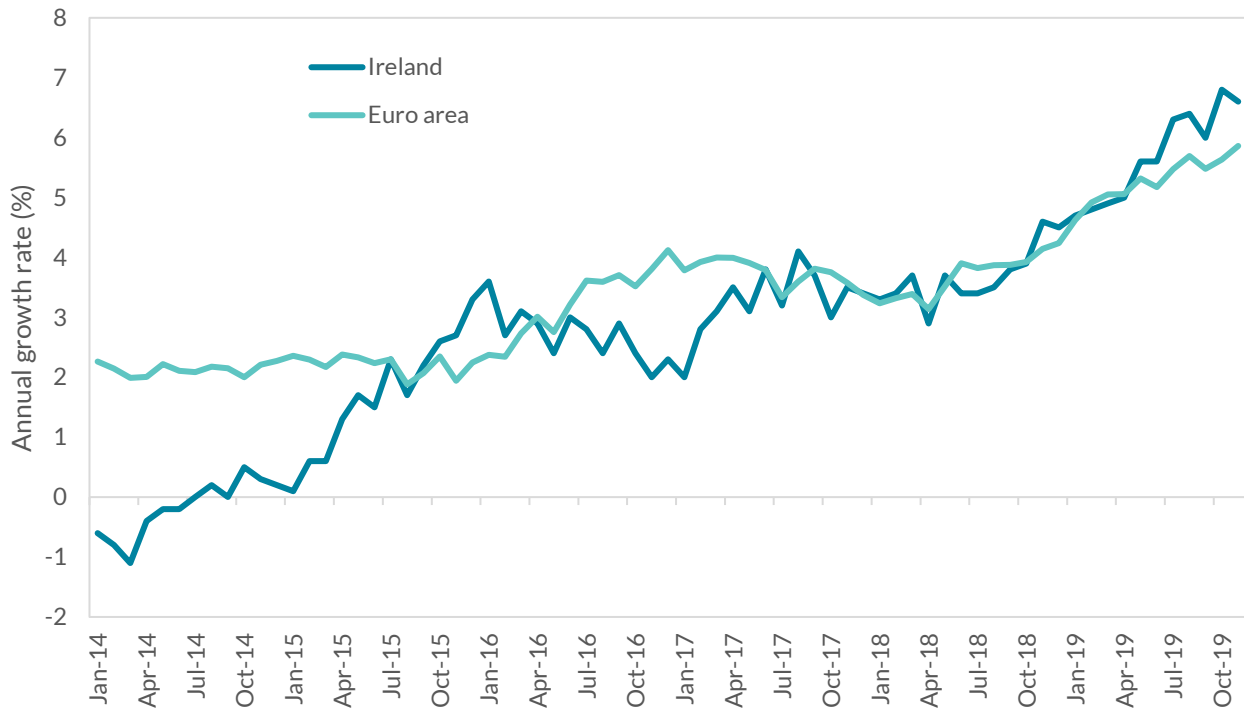
#### Household deposits

While households are continuing to deleverage and pay off their debts, they are simultaneously increasing their savings with the growth rate in household deposits increasing. The growth in household deposits has closely tracked that seen across the euro area since 2017 but there are now



tentative signs in recent months that the deposits of Irish household are now increasing beyond those of the euro area as a whole.

Figure 1: Annual Growth in Household deposits

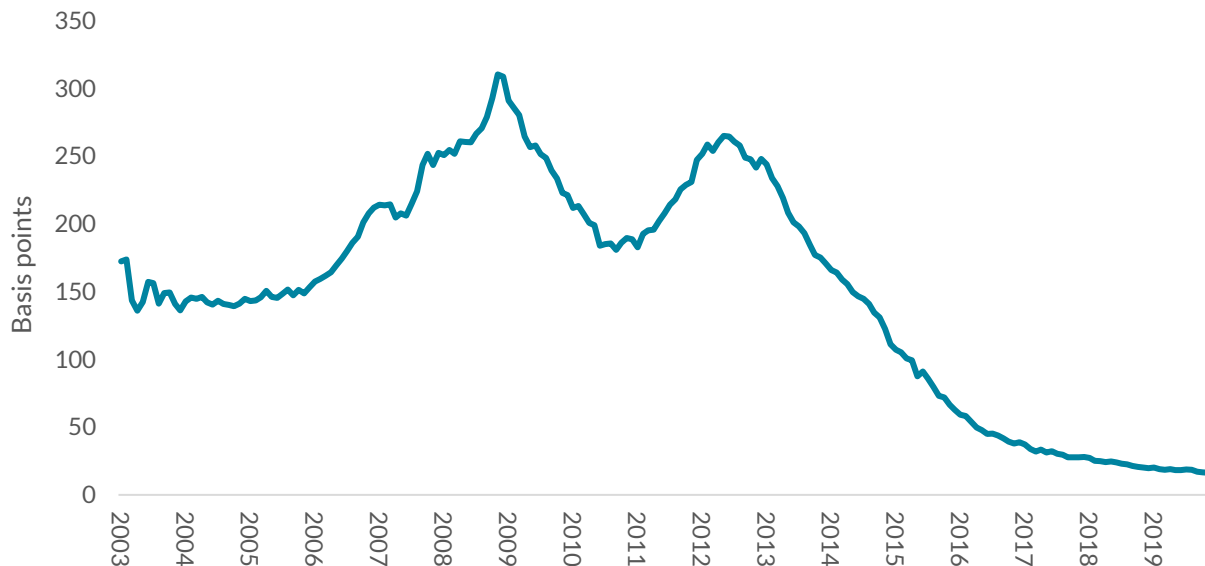


Source: Central Bank of Ireland

A preference for short dated products remains strong. The trend observed over the last number of years of households preferring overnight accounts as opposed to longer-term savings continued in 2019. In the year to end November, the entire growth in household deposits was in the overnight category with term and notice accounts seeing minor declines. The trend of consumer preferences for short-term deposits began in February 2013 and has been consistently observed since. Historically, households received an interest rate premium of at least 140 basis points on term and notice accounts reflecting the lower levels of liquidity in these products. In recent years, the premium has declined steeply and households are now only receiving a 16 basis points premium. Such pricing behaviour in the market reflects flattening yields curves in financial markets and is likely to be driving the current preference of households for overnight products.



Figure 2. Additional Return on Term and Notice Deposits over Overnight Deposits



Source: Central Bank of Ireland

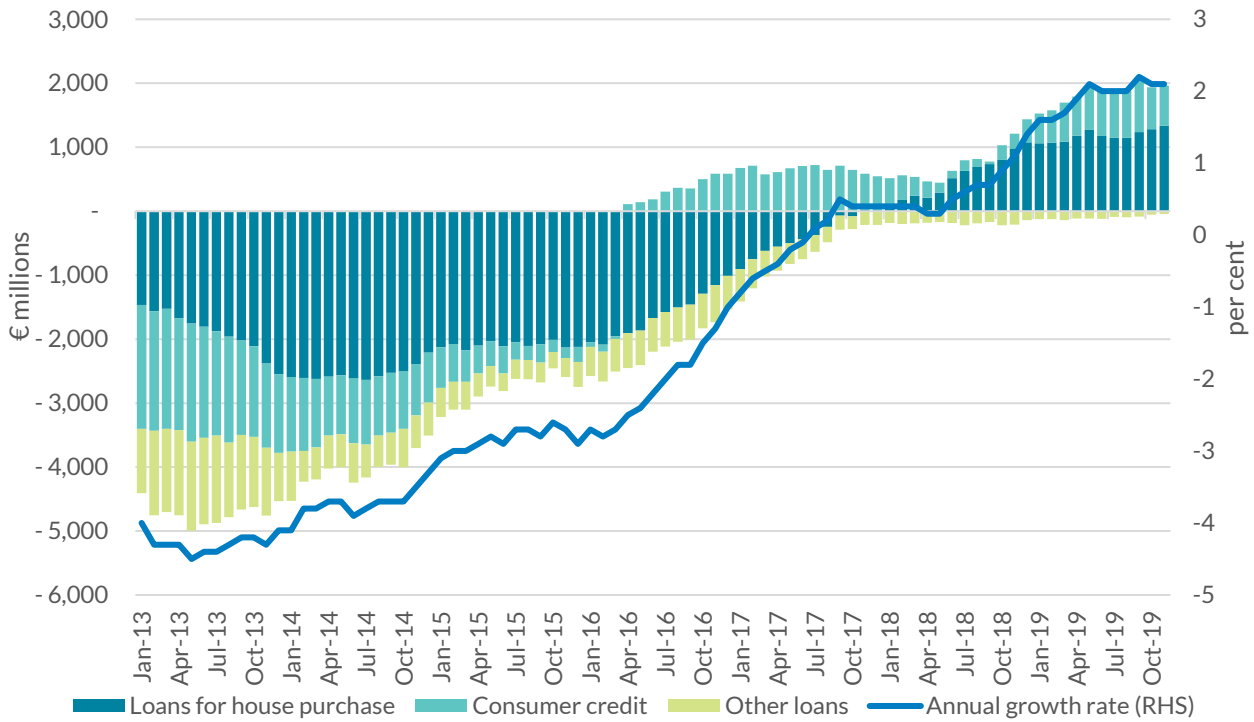
Note: Calculated as the weighted average interest rate on term and notice deposits minus the weighted average interest rate on overnight deposits

## Household borrowing

Loans for house purchase comprise the largest component of overall household borrowing at 83 per cent followed by lending for consumption and other loans at 17 per cent. New borrowing by households increased by 2.1 per cent and exceeded loan repayments by €1.9 billion in the year to end-November 2019. This was driven by longer-term loans, and particularly increases in mortgage lending. Loans for house purchase recorded 1.8 per cent growth in the year to end-November. Although this is the highest annual growth rate since October 2009, the rate of growth is still modest and has stabilised at between 1.4 and 1.9 per cent throughout 2019. According to recent data from the Banking Payments Federation of Ireland, the number of mortgage approvals in annual terms at the end of November 2019 continued their upward trend, suggesting further increases in loans for house purchases if these approvals translate into drawdowns in the future.

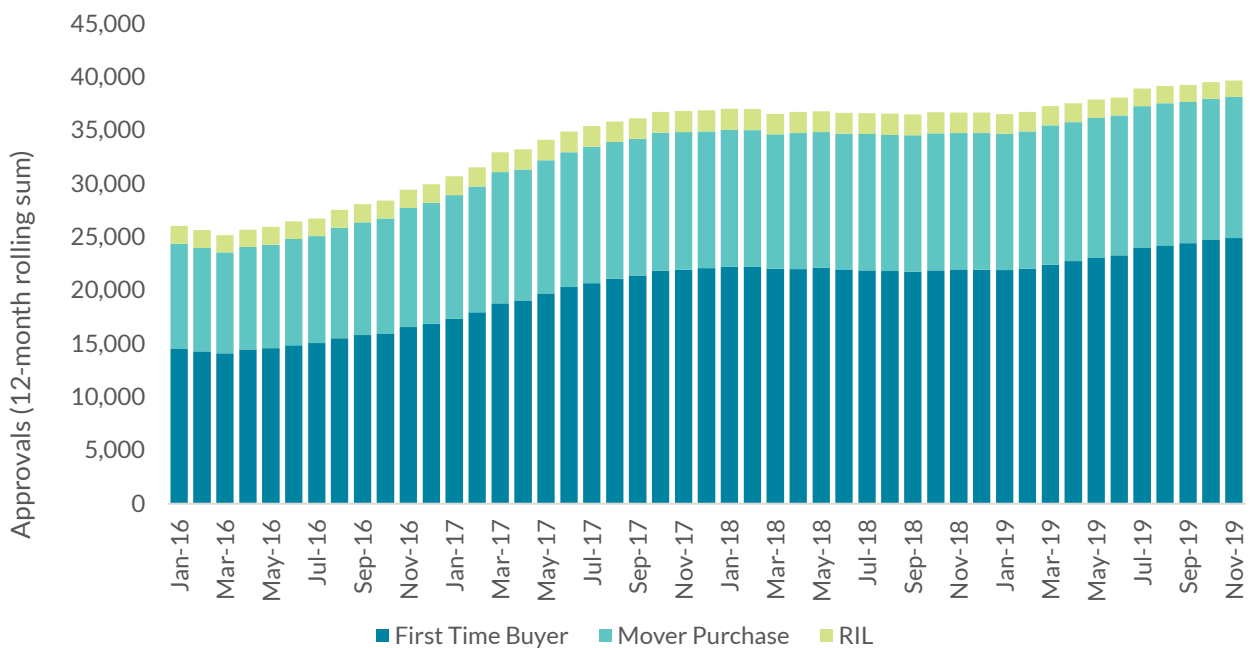


Figure 3: Loans to Irish households, net flows 12-month sum and annual growth rate



Source: Central Bank of Ireland

Figure 4: Total Mortgage approvals (excluding refinancing), 12-month sum



Source: Banking and Payments Federation of Ireland

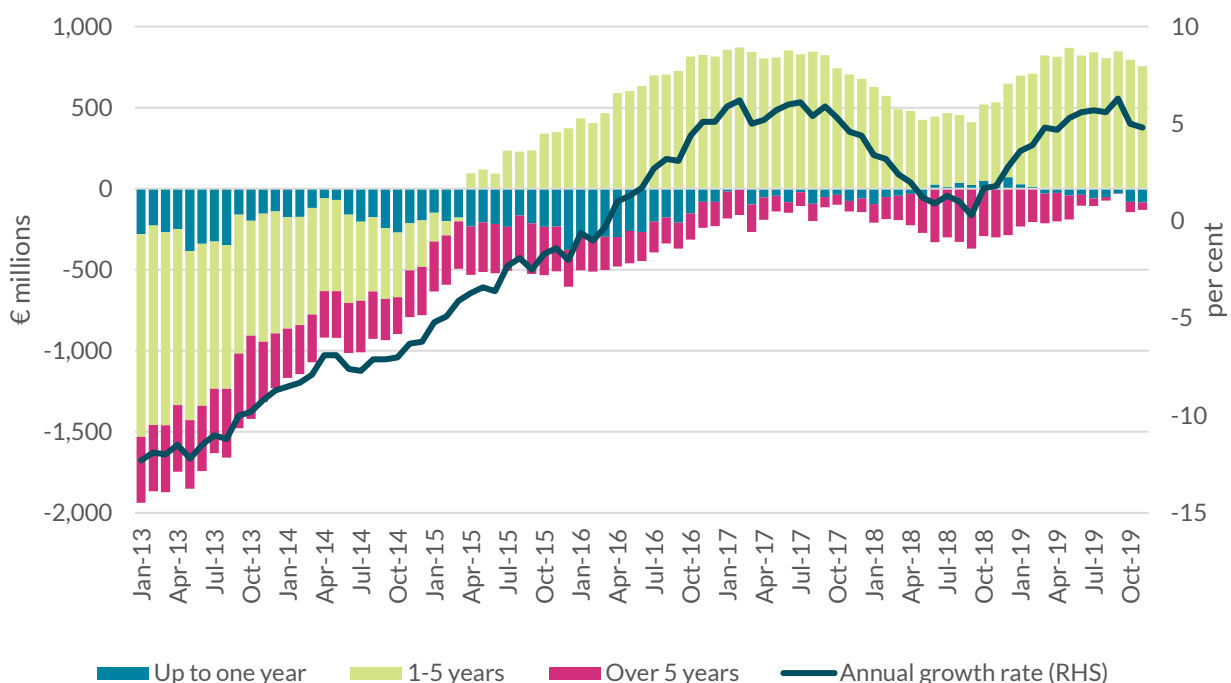


Borrowers continue to favour fixed rate mortgages at levels not seen in the past, with fixation periods of three to five years being the most popular amongst borrowers. The cost of credit facing new Irish resident mortgage borrowers remains high relative to their European peers. The average rate recorded for new mortgage lending in October 2019 was the second highest in the euro area at 2.93 per cent. The average rate for the euro area stood at 1.37 per cent, although the rate varied considerably across countries. Fixed rate mortgages comprised 75 per cent of all new agreements by loan amount on a three-month rolling basis to October.

### Consumer credit

Loans to households for the purpose of consumption also recorded annual increases, amounting to €631 million of new drawdowns exceeding repayments by end November, representing growth of 4.8 per cent. This growth was driven by medium term loans (€760 million). The KBC Irish consumer sentiment index notes that the first back-to-back monthly gains in four years in consumer sentiment were recorded in December 2019. The concerns of consumers have eased due to a more favourable outlook on the departure of the United Kingdom from the European Union, with one in three respondents expecting circumstances to improve in 2020 when compared with 2019.

Figure 5: Consumer Credit, 12-month sum net flows and annual growth rate



Source: Central Bank of Ireland

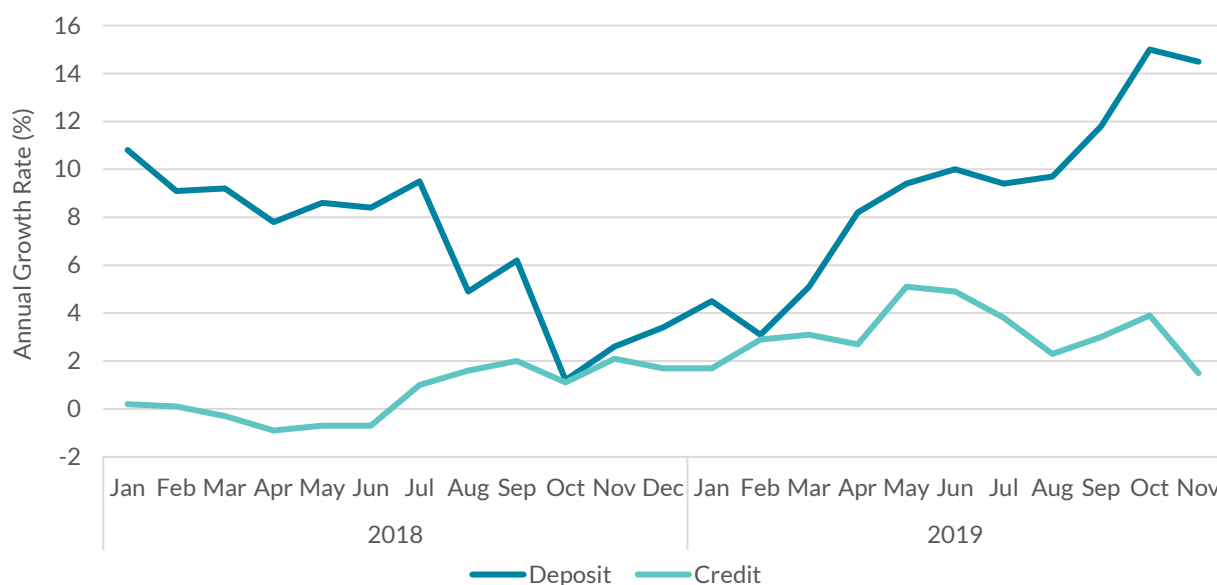




## Irish Private Sector Enterprises Credit and Deposits

The behaviour of Irish non-financial corporations (NFCs) exhibited potential defensive traits in the second half of 2019. Overall, credit growth to NFCs increased by 1.3 per cent in the year to November 2019, down from 5.4 per cent in the middle of the year. Many Irish NFCs have been able to self-fund investment and working capital requirements in recent years without recourse to bank funding and it may be the case that this is increasingly occurring<sup>1</sup>. However, we are now seeing the decline in lending being accompanied by very strong increases of 14.5 per cent in deposits from NFCs.

Figure 6: Non-Financial Corporate Credit and Deposit Trends (annual growth rate)



Source: Central Bank of Ireland

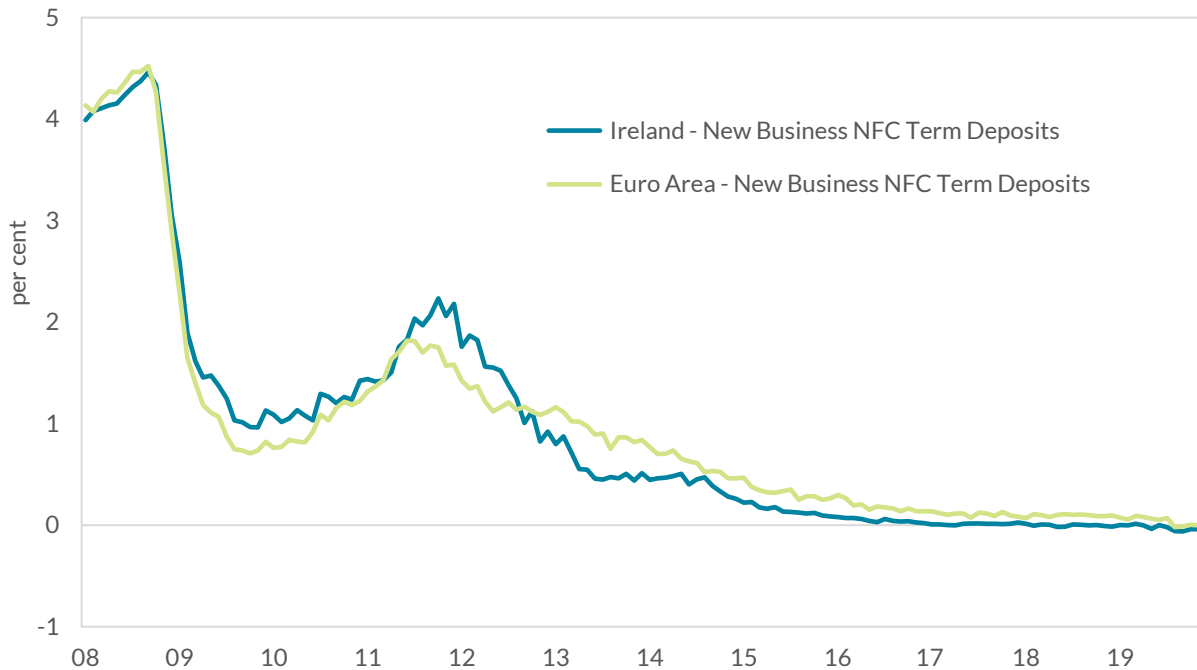
The underlying driver of the high NFC deposit growth was seen in overnight deposits, which recorded annual growth in November of 18.3 per cent. Similar to households, the premium on term deposits has significantly declined in recent years. In addition, some NFC deposits are attracting negative interest rates, in particular in the short-term agreed maturity categories. Despite these low, and occasionally negative, deposit interest rates, the volume of deposits continued to grow strongly. This could be due to overall economic uncertainty over the past year leading up to the Brexit deadlines, rising trade tensions and the potential adverse macroeconomic spillovers in Ireland. There are tentative sentiment indicators showing that businesses outlook improved in December, in particular in the services sectors. Recent data from the CSO Retail Sales Index shows that sales in November slowed slightly when compared with October, however an increase of 1.4 per cent is evident when compared with the same period in 2018. This could represent consumer uncertainty in anticipation of a Brexit

<sup>1</sup> See Financial Stability Review 2019: 1 <https://www.centralbank.ie/docs/default-source/publications/financial-stability-review/financial-stability-review-2019-i/financial-stability-review-2019-i.pdf?sfvrsn=9>



deadline approaching, which may have been alleviated somewhat by the end of 2019. Should this sentiment continue to improve, it may result in a return to lower deposit growth and a pick-up in credit demand as confidence and investment plans grow.

**Figure 7: Interest rates on New Household and Business Term Deposits**



Source: Central Bank of Ireland

Gross new lending to all SMEs increased by €5.3 billion in the year to end-September 2019, with property-related lending accounted for just under one-third of gross new lending at €1.7 billion. Repayments by SMEs were high in the third quarter at €2 billion, surpassing the same periods in 2017 and 2018. The latest [SAFE data](#) show that external funding availability and needs are broadly balanced in Ireland. Overall, SMEs in Ireland were among the most upbeat about their external financing environment. The SAFE data also indicate increases in interest expenses for Irish SMEs, with Ireland reporting the highest net percentage of SMEs reporting an increase in interest expenses, along with increases in labour and other costs. Interest rates on new NFC loans of under €1 million, which typically include SME loans, recorded a weighted average interest rate of 4.51 per cent in October 2019. This is markedly higher than the euro area average of 1.88 per cent.