Banc Ceannais na hÉireann
Central Bank of Ireland
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Box F: QB 1 – January 2021

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Household and Business Financing Developments in the Irish Economy

By Statistics Division

COVID-19 represents an unprecedented shock to the Irish and global economy. The virus and the containment measures taken in response to it have had a significant impact on the financial activities of Irish households and non-financial corporations (NFCs). This Box provides an update on the development of Irish households' and firms' financing activities at an aggregate level throughout the pandemic period.

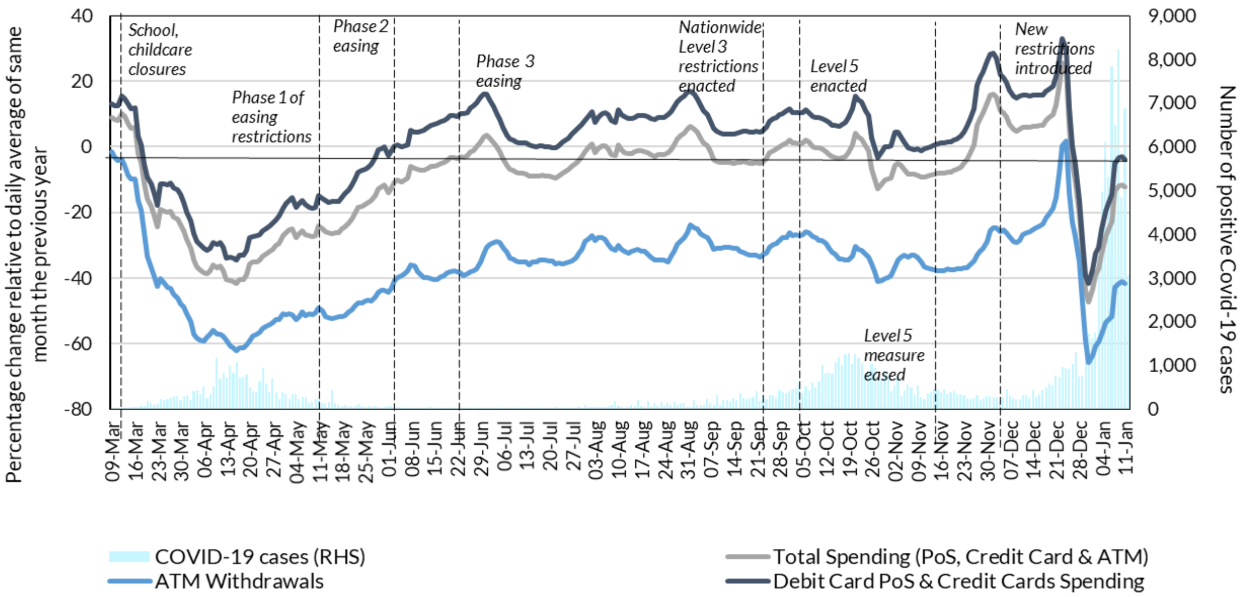
The initial months of the pandemic saw sharp declines in consumer spending, and in household and NFC lending. While spending and lending started to recover during the summer months as the restrictions were eased, the resurgence in COVID-19 cases and reintroduction of restrictions in late-October, again posed challenges for households, NFCs and banks. At the same time, deposits from households and NFCs significantly increased as the pandemic heavily curtailed consumption, and both government supports and payment breaks have helped ease financial pressure.

Households

The COVID-19 pandemic has had a large impact on Irish household spending, as daily card payments data demonstrates (Figure 1). During the initial restrictions introduced in March and April, total spending, which includes card spending and ATM withdrawals, decreased sharply. Over the summer months, following the easing of restrictions, spending recovered significantly to levels close to 2019. Given the impact of COVID-19 on spending behaviour, ATM withdrawals remained well below normal levels, with consumers demonstrating a strong preference for card over cash.

Following the rise in COVID-19 infections and the introduction of Level 5 restrictions in late-October, spending again declined, but not to the same extent as in mid-March. Spending increased as Level 5 measures were eased before Christmas, which combined with positive news on vaccines as well as strong economic and employment data, likely reflected an increase in consumer sentiment[1]. Similar to the initial restrictions earlier in the year, card spending increased substantially in the days prior to the reintroduction of strict restrictions from Christmas Eve, with a fall in card spending observed in the following days, at an even stronger pace than in mid-March. The extent of the decline on this occasion was likely exacerbated by the restrictions coinciding with the holiday period, as the subsequent recovery in the first weeks of January indicates.

Figure 1: Change in card spending and cash withdrawals compared to the daily average in the same month the previous year



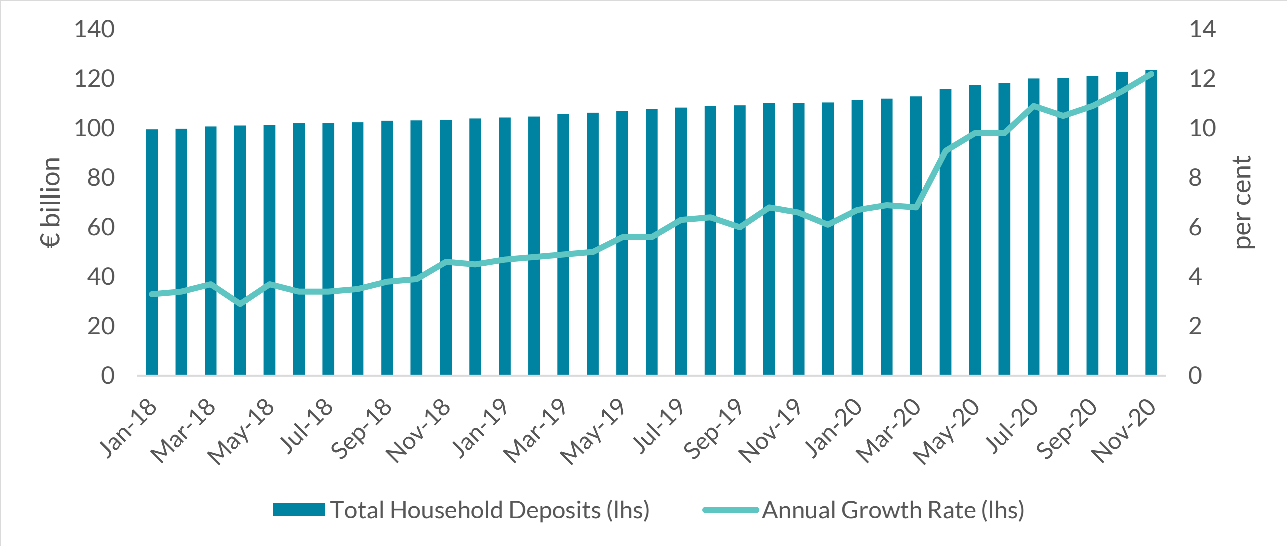
Source: Central Bank of Ireland

Household deposits have seen a significant increase since the start of the pandemic, with outstanding amounts increasing by €10.6 billion from March to end-November, to stand at €123.6 billion (Figure 2). This growth likely reflects an increase in forced savings due to heavily curtailed consumption opportunities, while income support and payment breaks mitigated income shocks to some extent. There may also have been an increase in precautionary savings, driven by expectations of future unemployment and economic uncertainty[2].

[1] See: https://www.kbc.ie/blog/consumer-sentiment-surveys/sentiment-survey-suggests-irish-consumers-still-ca

[2] For more information on savings and consumer spending see: https://www.centralbank.ie/docs/default-source/publications/economic-letters/the-impact-of-covid-19-on-consumer-spending.pdf?sfvrsn=7

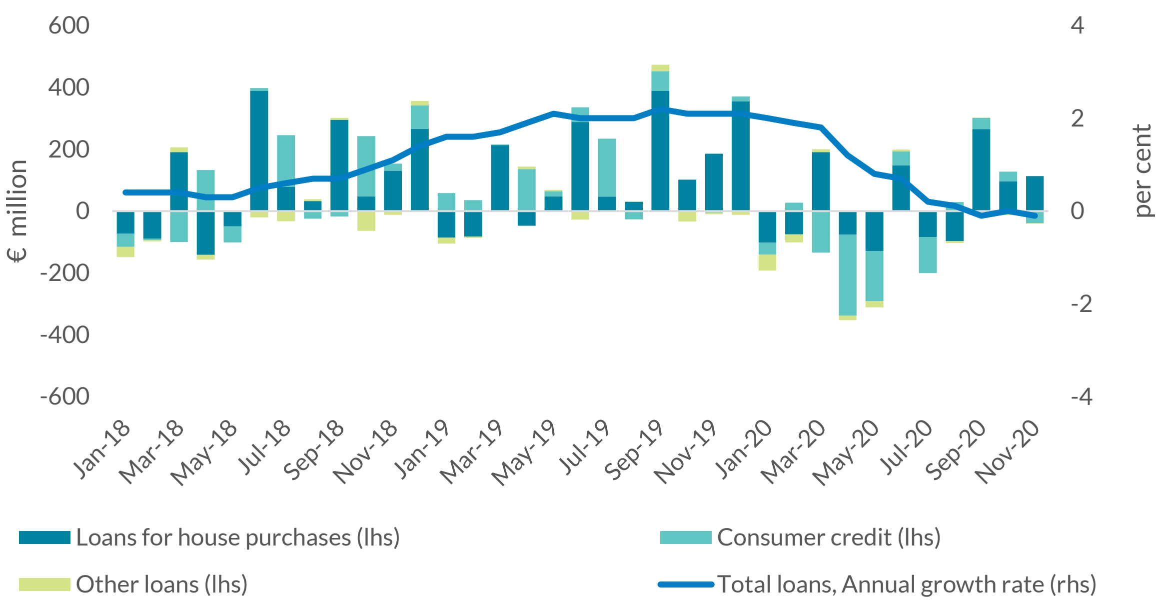
Figure 2: Household Deposits Outstanding Amounts and Annual Rate of Change



Source: Central Bank of Ireland

The growth in household debt observed in recent years stalled in 2020. Since August, the annual growth rate has fluctuated between plus and minus 0.1 per cent (Figure 3), reflecting subdued levels of both new lending and repayments during the pandemic. In monthly terms, net lending saw moderate increases since September, mainly driven by loans for house purchases.

Figure 3: Monthly Net Flow of Loans to Households by Purpose of Loan, and Annual Growth Rate



Source: Central Bank of Ireland

New mortgage lending dropped substantially in the initial phase of the pandemic, before recovering in the second half of the year. In September, new mortgage agreements were back on par with March 2020, but 13.8 per cent below 2019 levels. By end-November, mortgage agreements had further increased, rising by 22.3 per cent from September's level, and were marginally higher than in November 2019. Forward looking indicators also point to a solid recovery in mortgage market activity, with approvals 24.3 per cent higher on an annual basis in November[3]. The higher approval numbers may be inflated by re-approvals of applications that expired during the earlier lockdown-periods in 2020. Banks are also reporting an increase in demand and this is reflective of a less adverse impact of the COVID-19 shock on the demand for housing than was originally expected at the onset of the pandemic[4].

In contrast, new agreements for consumer credit and other household lending, which had started to recover over the summer months, ultimately declined over the second half of the year. At end-November, there was a 34.6 per cent year-on-year reduction in new consumer credit lending agreements, compared with minus 14.2 per cent at end-June. At an aggregate level, Irish households did not increase their use of short-term credit such as overdrafts and credit cards during the pandemic. For consumer credit, repayments exceeded new lending by €567 million over the 12 months to end-November, representing an annual growth rate of minus 4.4 per cent in outstanding consumer debt, down from plus 4.5 per cent growth a year earlier.

The prevalence of payment breaks has helped to relieve pressure for existing borrowers by providing an opportunity to postpone or substantially reduce their repayments at a time of severe financial stress. Lenders have offered a wide range of loan payment breaks since late March, typically granted on a three-month basis, with the option to extend for a further three months[5]. Since their peak of 11.1 per cent for mortgages and 6.5 per cent for consumer loans, the ratio of payment breaks[6] has already halved in September and continuously fallen since, with the decline partly due to the expired payment breaks[7]. Nevertheless, payment breaks continue to provide necessary relief for many households.

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[3] Banking and Payment Federation Ireland, https://bpfi.ie/publications/bpfi-mortgage-approvals-report-november-2020/

[4] See https://www.centralbank.ie/docs/default-source/publications/financial-stability-review/financial-stability/financial-stability-review-2020-ii.pdf?sfvrsn=9

[5] For more on payment breaks see: https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/covid-19-payment-breaks-who-continues-to-avail-of-them and https://www.centralbank.ie/docs/default-source/publications/financial-stability-notes/no-6-which-firms-took-covid-19-payment-breaks-(duignan-and-mcgeever).pdf?sfvrsn=6

[6] Calculated as the outstanding value of accounts with active breaks as a proportion of the total outstanding loans. See: https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/covid-19-payment-breaks-who-continues-to-avail-of-them

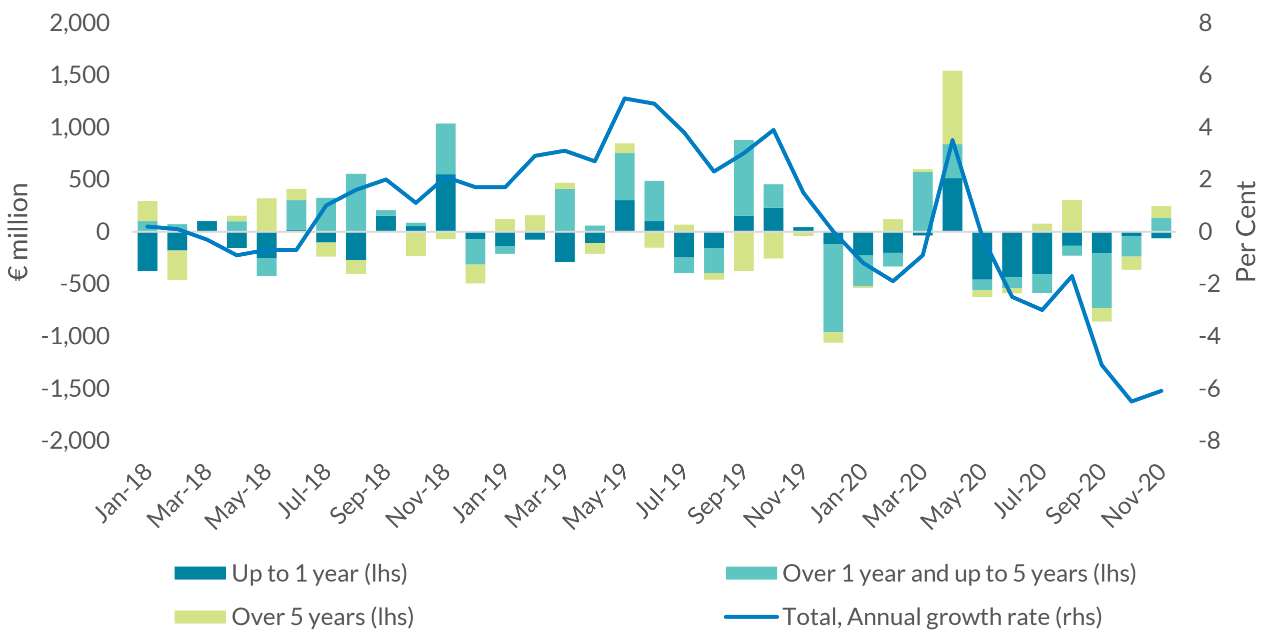
[7] See: https://www.centralbank.ie/docs/default-source/publications/financial-stability-review/financial-stability/financial-stability-review-2020-ii.pdf?sfvrsn=9

Business

Overall, lending to non-financial corporations (NFCs) contracted during 2020. From January to November, repayments exceeded new drawdowns by €1.3 billion. An initial spike in net lending to NFCs at the onset of the pandemic was followed by three months of negative net flows (Figure 4). The modest increase in net lending in August was driven by the loans with a maturity over 5 years maturity, while the following two months recorded decreasing net lending in all maturity categories. In October, total NFC lending recorded the most negative annual growth rate since November 2015, at minus 6.5 per cent.

The uptick in November may reflect a tentative increase in demand for loans from enterprises that the banks had expected for the fourth quarter according to the October Bank Lending Survey. In addition, indicators such as firm credit enquiries on the Central Credit Register point to a recovery in credit applications. The introduction of the Credit Guarantee Scheme and other support schemes should support the provision of credit at favourable rates to firms, although some firms may be reluctant to borrow given the highly uncertain economic outlook[8].

Figure 4: Monthly Net Flow of Loans to NFCs by Maturity, and Annual Growth Rate

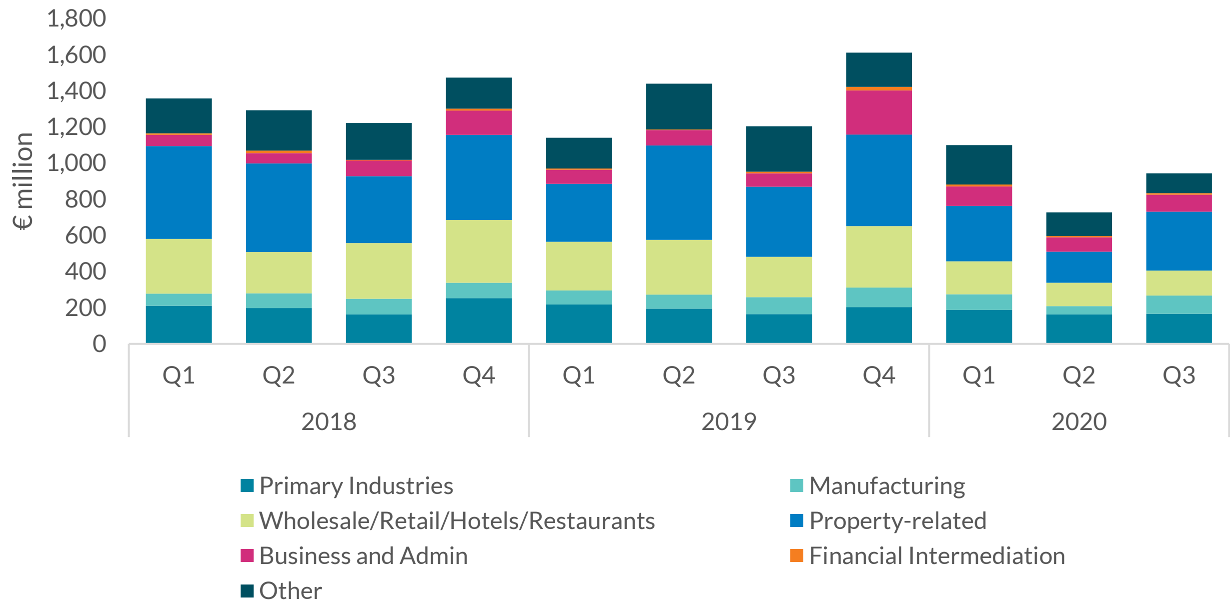


Source: Central Bank of Ireland

[8] See: https://www.centralbank.ie/docs/default-source/publications/financial-stability-notes/no-8-sme-finances-the-pandemic-and-the-design-of-enterprise-support-policies-(lambert-mccann-mcquinn-myers-and-yao).pdf?sfvrsn=6

Gross new lending to SMEs decreased significantly during the year. In Q3 2020, total gross new lending to SMEs increased on a quarterly basis, albeit was down by 21.7 per cent when compared with the same period the previous year (Figure 5). At sector level, real estate activities, and the wholesale, retail and hotels and restaurants sectors were particularly impacted. During the third quarter, gross new lending to these sectors moderately recovered from the substantial drop seen in Q2. However, gross new lending was still 38.6 per cent and 16.0 per cent below the Q3 2019 levels for the wholesale, retail, hotels and restaurant sectors, and for the property-related sectors, respectively. Repayments by all SMEs in Q3 2020 recorded the lowest quarterly level of repayments since Q3 2013. Similar to the situation with households, the payment break ratio was at its peak in June, at 22.9 per cent for SMEs, and since then continuously fell, albeit at a slower pace than for households[9]. However, by end-October almost all payment breaks were expired, with a payment break ratio of 3.3 per cent for all outstanding loan balances, including SME, household and corporate loans[10].

Figure 5: Gross New Lending to SMEs (quarterly basis)



Source: Central Bank of Ireland

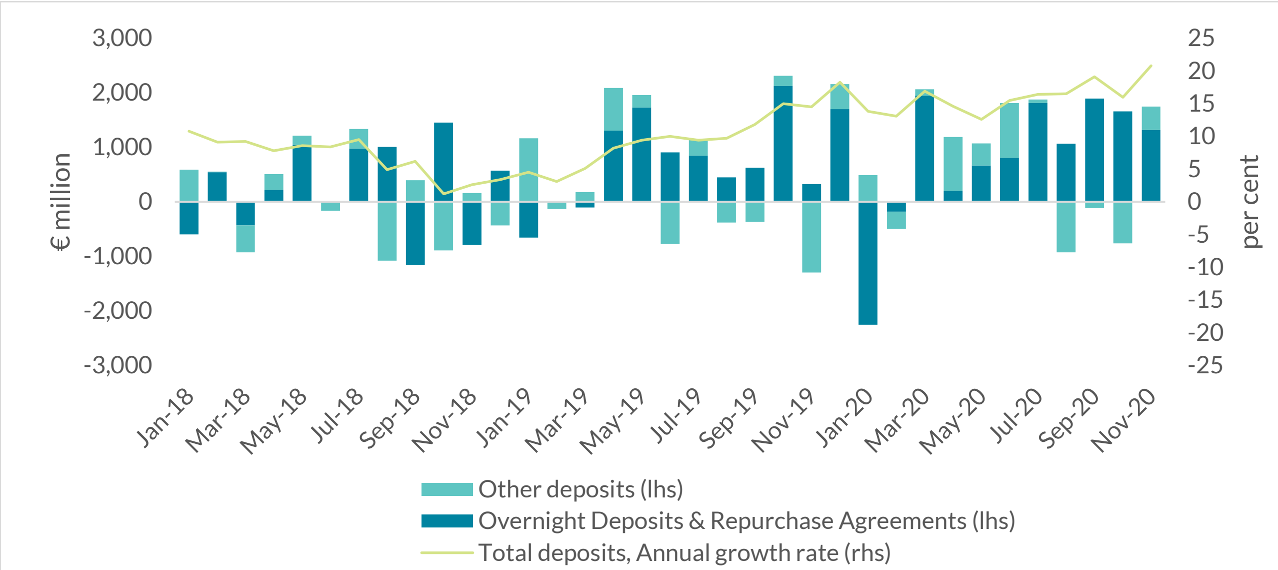
The general upward trend in NFC deposits continued during the pandemic, despite the low or negative deposit interest rates (Figure 6). Since April, deposits from NFCs recorded a net inflow of €10.5 billion. At the same time, the strong annual growth was mainly attributable to overnight deposits and repurchase agreements, reflecting the firms' strong preference for liquidity in light of the high level of

[9] See: https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/covid-19-payment-breaks-who-continues-to-avail-of-them

[10] https://www.centralbank.ie/docs/default-source/publications/financial-stability-review/financial-stability/financial-stability-review-2020-ii.pdf?sfvrsn=9

uncertainty about the future of the pandemic and about the trading arrangements between the UK and the EU at the end of the Brexit transition period.

Figure 6: NFC Deposits Net Flows by Maturity, and Annual Rate of Change



Source: Central Bank of Ireland

Summary

The economic shock from the initial restrictions related to the COVID-19 pandemic led to a notable change in behaviour from households and firms. Household spending fell as restrictions were introduced and reintroduced during the pandemic, and gradually increased during times when restrictions were lifted. Card spending was strong during much of December, but dropped steeply after Christmas Eve, likely to be due to a combination of the holidays and the reintroduction of strict restrictions. To end-November 2020, the curtailment in household spending coincided with a substantial growth in household deposits at aggregate level. New lending to households declined markedly to end-November, and remains below 2019 levels despite recent monthly gains, particularly in mortgage lending. As with households, NFCs' deposits increased significantly, while NFC lending declined, with the impact of the pandemic varying across sectors and for individual firms given the nature of the restrictions. The most up-to-date data on household and NFC deposits and credit do not cover the latest tightening of restrictions. The impact of this on the financial activities of Irish households and firms is yet uncertain, as it will also depend on the further evolving nature of the pandemic and related restrictions.