Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box F: QB 2 – April 2021

This Box content is extracted from the Quarterly Bulletin – Q2 2021

Spending, credit, and deposits: An update on Irish household and business activity

By Statistics Division

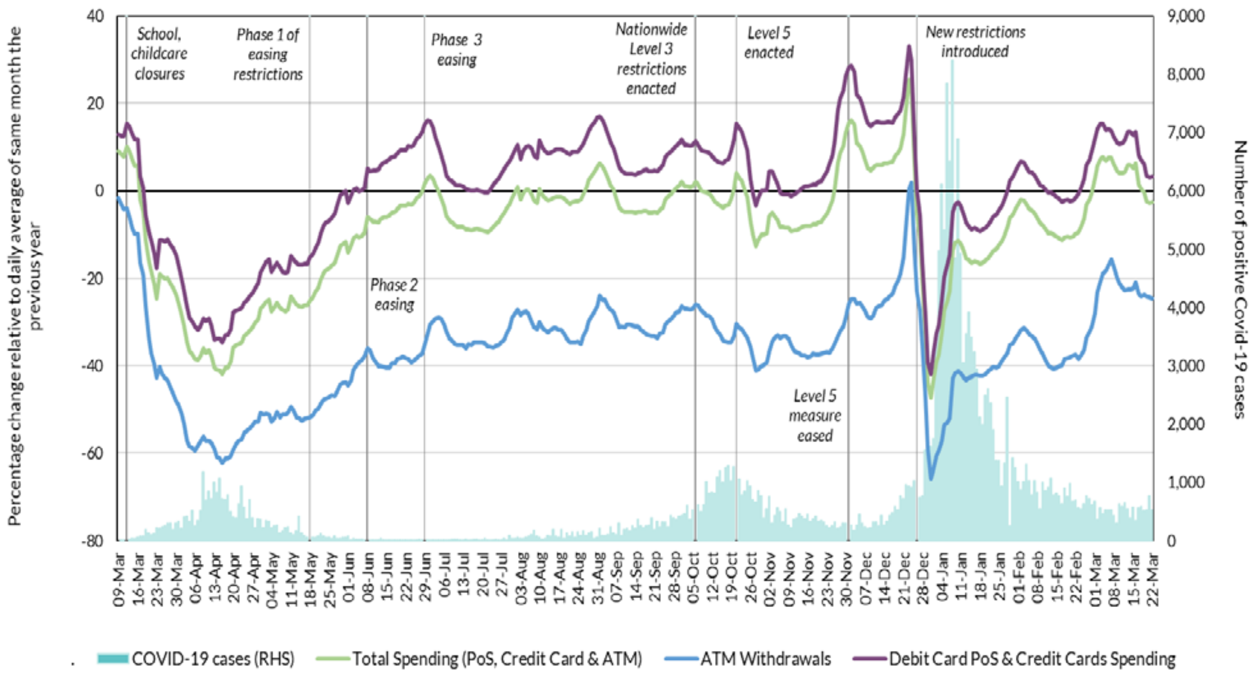
The impact of the COVID-19 and the associated public health measures continue to reverberate throughout all areas of economic activity, including the saving and borrowing decisions of households and businesses. This unprecedented shock brought about a disruption to consumption patterns, a rapid accumulation of savings, and a decrease in demand for external financing. This Box provides an update on the key trends relating to the payments, savings and borrowing activities of Irish households and businesses, relying on the latest available and most timely data.

The move to Level 5 restrictions at end-December coincided with a stark reduction in payment activity, while the growth of household deposits reached rates not seen since before the Global Financial Crisis. Borrowing activity has fallen for both households and businesses. This is particularly the case for short-term consumer lending, while lending for house purchases, continues to grow, but at a slower pace.

Household Spending

Daily card payments data reveal the large impact of the COVID-19 pandemic on the spending patterns of Irish households (Figure 1). Spending, including both payments using cards and ATM withdrawals, decreased during the initial restrictions introduced in March and April. As restrictions were eased during the summer of 2020, spending started to rebound, and by late-June recovered to levels close to what was observed in 2019. Consumer behaviour switched towards greater use of cards to conduct payments rather than cash. ATM withdrawals remained below their 2019 levels for most of the year.

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

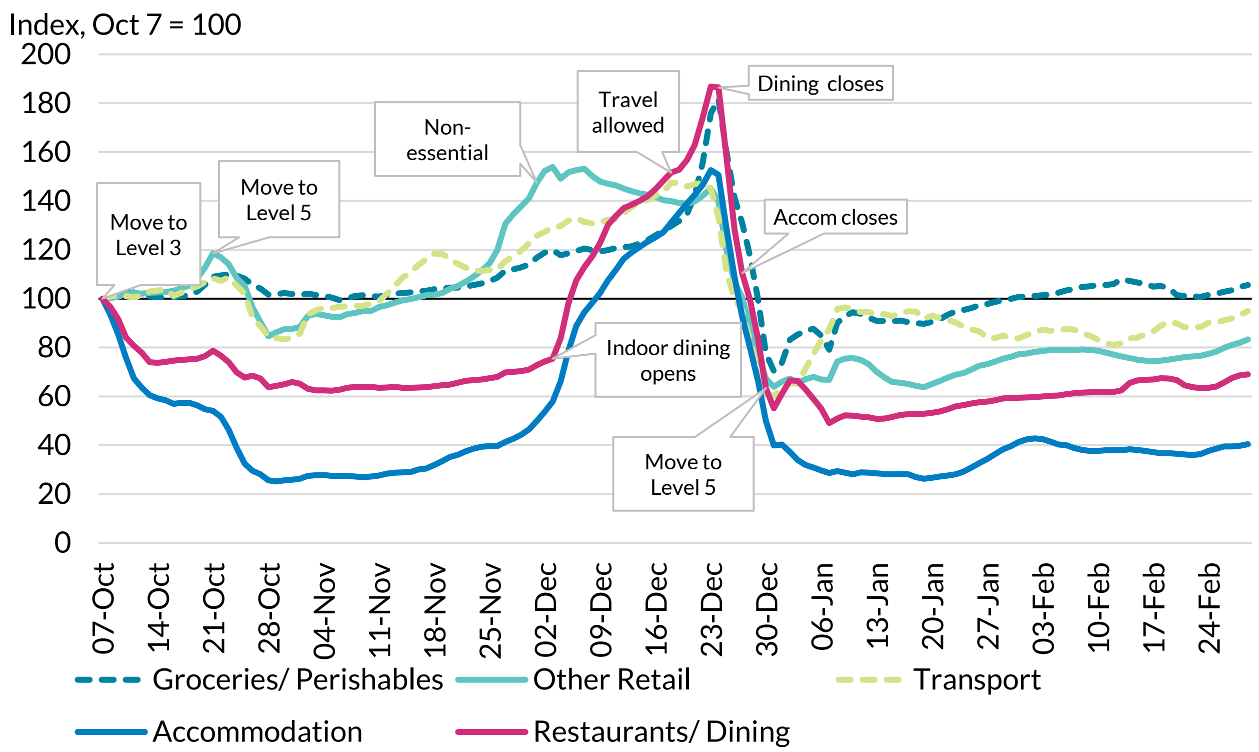
In late December, spending and payment activity again fell sharply. This coincided with the introduction of national Level 5 restrictions from Christmas Eve, initiated in response to the rapidly deteriorating situation regarding COVID-19 infections. It is worth noting that there were significant seasonal and other factors at play on this occasion, which contributed to the steep decline in payment activity, relative to the response during the March restrictions. Contributing factors such as the impact of public holidays, the impact of the weekend, and the relatively higher rate of infections, all likely exacerbated the decline relative to the previous imposition of restrictions. Both cash and card payments sharply declined, with the fall in card payments driven primarily by the reduction in the use of cards for in-store payments.

While the extent and pace of the initial decline in activity was even greater than that which was seen during the March 2020 restrictions, the subsequent recovery in payment activity has also been swifter. By late-January, card payment activity had recovered to 2020 levels, while total payment activity would recover by early March, reflecting both the seasonal post-Christmas recovery and an improvement in consumer sentiment that accompanied the beginning of the vaccination programme[1].

[1] See https://www.kbc.ie/w/confidence-recovers-in-march-as-irish-consumers-focus-on-post-pandemic-improvement-in-economy-and-jobs-but-household-savings-likely-to-remain-higher-in-future-1?redirect=%2Fblog%2Fconsumer-sentiment-surveys

Using the card data to monitor shifts in sectoral spending, payments for accommodation and restaurants/dining, which had surged during the December opening, have reverted to levels seen during the previous Level 5 period from late-October to early-December (Figure 2). Meanwhile, spending on groceries, has proven largely resilient to the recent changes regarding public health measures, and remains significantly higher than pre-pandemic levels[2].

Figure 2: Changes in Sectoral Spending



Source: Central Bank of Ireland Table A.13.2, 7-day moving average, author's calculations

Household Credit & Deposits

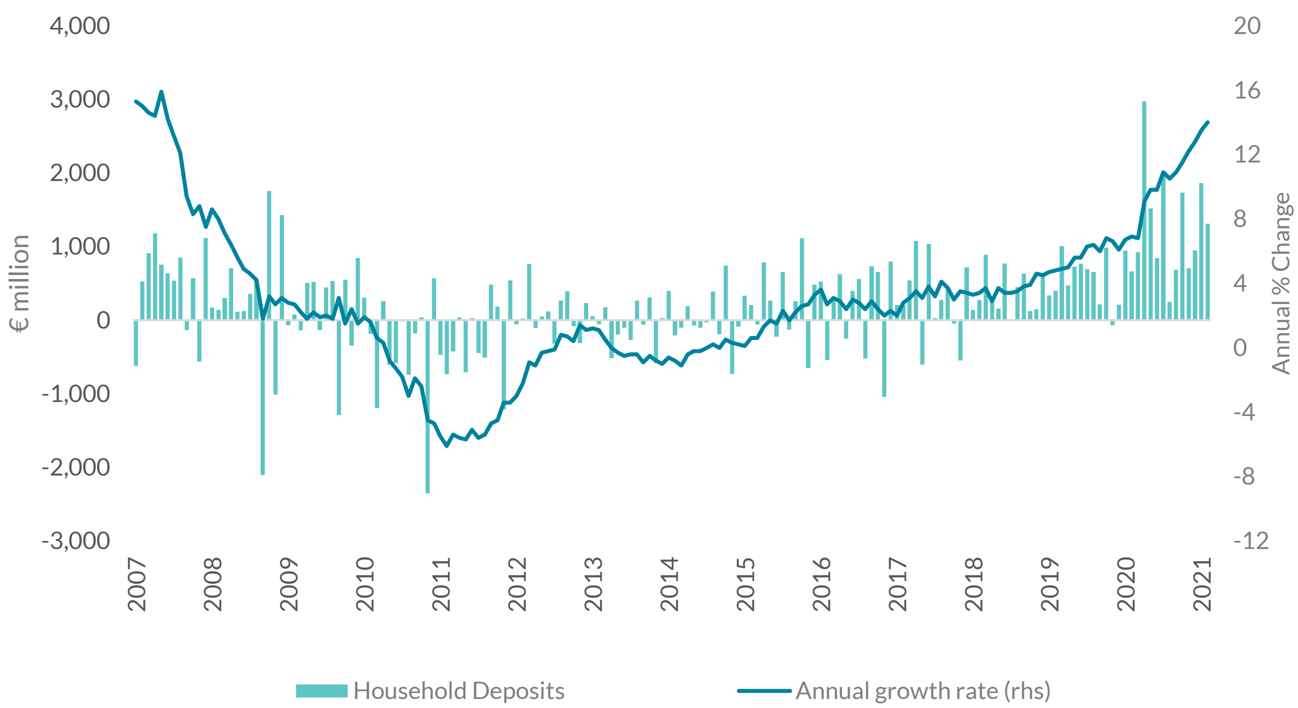
Household savings have increased sharply since the outbreak of the pandemic and the introduction of public health measures. These measures have reduced the opportunities for households to spend, while government interventions have helped mitigate shocks to household income, resulting in a higher level of saving at an aggregate level. Additionally, precautionary motives may also be driving households to save more in response to uncertainty over future economic conditions.[3]

[2] For more information on changing consumer spending patterns, see Hopkins, A. and Sherman, M. Shining a light on sectoral spending behaviours through the most recent phases of the pandemic, Central Bank of Ireland, Behind the Data

[3] For a discussion on who is saving and why, see Lydon, R. and McIndoe-Calder, T. Saving during the pandemic: Waiting out the storm? Central Bank of Ireland Economic Letters Vol. 2021 No. 4

The broadest view of what is occurring regarding household savings comes from the Quarterly Financial Accounts. Although only available with a lag, these data clearly show the increase in saving activity during the first three quarters of 2020 was driven primarily by the accumulation of currency and deposits, rather than investing in housing or other financial assets such as stocks or bonds. The more timely Credit and Banking Statistics show that, in the period from March 2020 to February 2021, net inflows of deposits amounted to €15.7 billion. This compares to net inflows of €7.3 billion for the same period in the preceding 12 months. In February 2021, the annual growth rate of household deposits reached 14 per cent, the highest rate of growth since June 2007 (Figure 3).

Figure 3: Household Deposits Net Transactions and Annual Rate of Change



Source: Central Bank of Ireland

Annual growth in household debt, which has been positive since mid-2017, turned negative in the final months of 2020. The most recent data for February shows a small annual decline of 0.3 per cent, as dampened levels of new lending have been counterbalanced by decreased repayment activity since the onset of the pandemic.

Looking further into household debt by purpose of lending reveals different trends in lending for house purchases and shorter-term lending for consumption and other purposes. New mortgage lending, which had slumped during the initial phase of the pandemic, witnessed a recovery in activity late last year, as new mortgage agreements reached a multi-year peak in December (Figure 4). New

mortgage lending has been somewhat slower so far in 2021, down to €500 million in January, compared to €535 million in January 2020. Forward-looking indicators such as approvals and Central Credit Register enquiries remain buoyant in recent weeks. New mortgage approvals, for example, were up 3.9 per cent annually in volume terms in February[4]. According to the latest Bank Lending Survey[5], demand for household loans has continued to recover from the steep decline seen in Q2 2020, and lenders expected that demand for loans for house purchase would continue to rise in Q1 2021.

The average interest rate recorded for new mortgage lending in January was 2.79 per cent. While 13 basis points lower than the average rate in January 2020, the cost of mortgage credit in Ireland is higher than the average for any other euro area country[6]. In addition to the reduction in interest rates, credit standards on loans for house purchases loosened somewhat in the final quarter of 2020, as reported in the Bank Lending Survey. This follows the significant tightening of standards seen in the second quarter of last year.

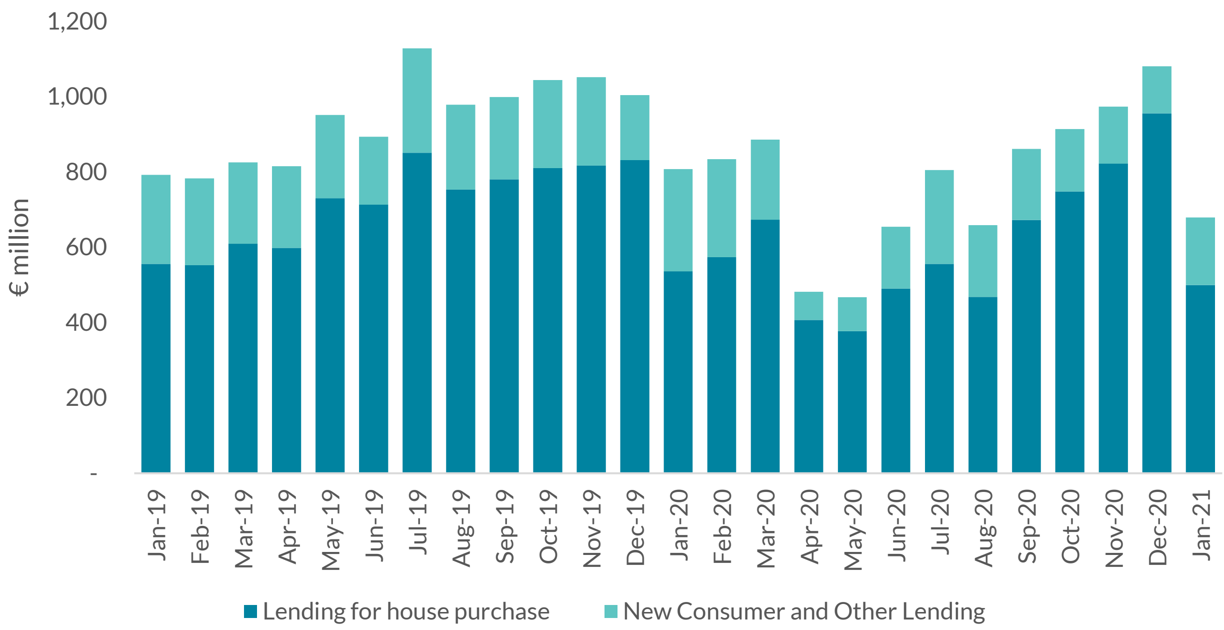
New lending for consumption purposes is expected to remain subdued until consumer confidence and activity returns. New agreements for consumer credit and other household lending were down 33.9 per cent year-on-year in January. For consumer credit, repayments exceeded new lending by €817 million over the 12 months to end-February, reflecting the weakening of household consumption and increased deleveraging over the period. This represents an annual growth rate of minus 6.7 per cent in outstanding consumer debt, down from plus 3.2 per cent growth a year earlier. This is the strongest pace of decline in consumer debt since October 2014. Consumer credit is largely driven by car purchases, holidays and credit cards, on which the opportunity to spend has been substantially curtailed due to the public health restrictions. The quick rebound in consumer lending seen in summer 2020 highlights that the flow of consumer credit can pick up quickly and sharply to support the recovery when health restrictions ease.

[4] Banking and Payment Federation Ireland Mortgage Approvals Report, February 2021 https://bpfi.ie/publications/bpfi-mortgage-approvals-report-february-2021/

[5] See: https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-lending-survey

[6] See Governor's Blog, 'Monetary policy and interest rates in Ireland' for a discussion on the factors effecting interest rates in Ireland https://www.centralbank.ie/news/article/blog-monetary-policy-and-interest-rates-in-ireland

Figure 4: Volume of New Household Loan Agreements by Purpose of Loan



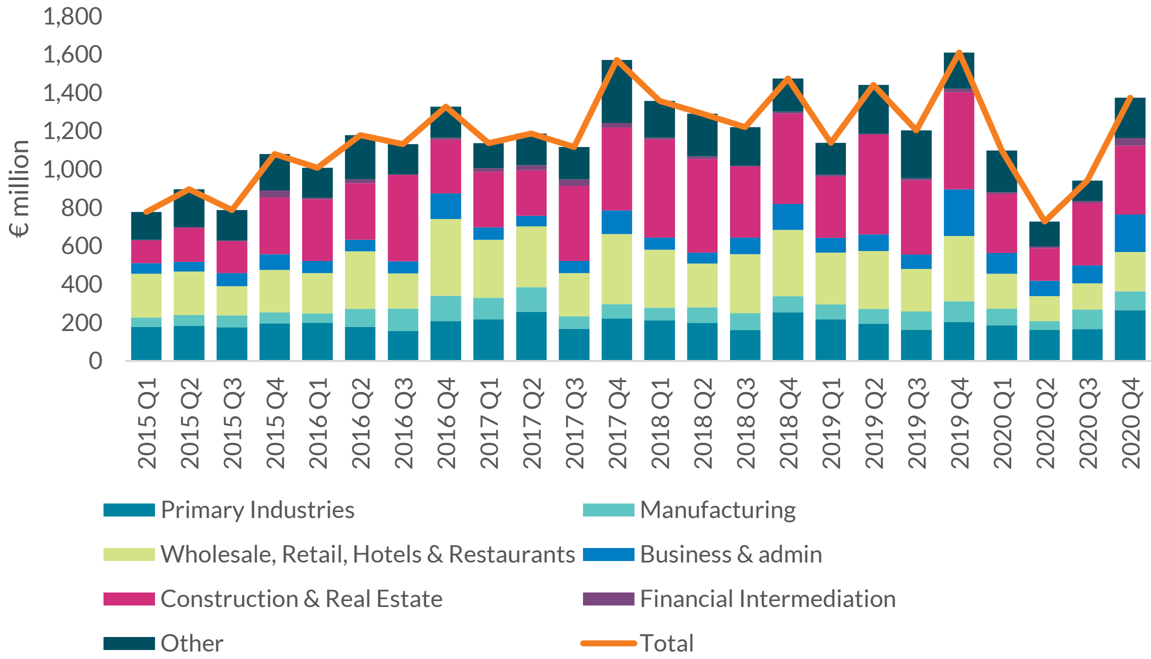
Source: Central Bank of Ireland

Business Credit & Deposits

Following a three-year period of relative stability, lending to non-financial corporations (NFCs) contracted over the course of 2020, with repayments exceeding drawdowns by €2.1 billion on a whole-year basis. This pattern has continued into 2021, with NFC loans contracting by 2.5 per cent year-on-year in February. The decrease in February mostly reflects strongly negative movements in short-term lending with maturity of one year or less, which was down 21 per cent compared to the previous year. Lending between one and five year's maturity was relatively stable, at minus 1.1 per cent, while longer-term lending with maturity of over five years increased by 4.8 per cent year-on-year.

New lending to SMEs has recovered from the very low levels seen after the initial health restrictions in Q2 2020 (Figure 5). New lending to SMEs in Q4 2020 was 90 per cent above that of Q2, albeit still 15 per cent below Q4 2019. The recovery in lending activity varies dramatically across sectors with very strong levels of lending to construction and primary industry sectors reflecting their continued operational activity in late 2020. The strong rebound in construction lending as construction sites reopened provides some evidence that credit is flowing and available when demand returns. On the other hand, credit drawdowns in heavily impacted service orientated sectors are far below normal levels. This is most acute in the hotel sector where new drawdowns are 85 per cent down on Q4 2019.

Figure 5: Gross New Lending to SMEs by Sector of Activity



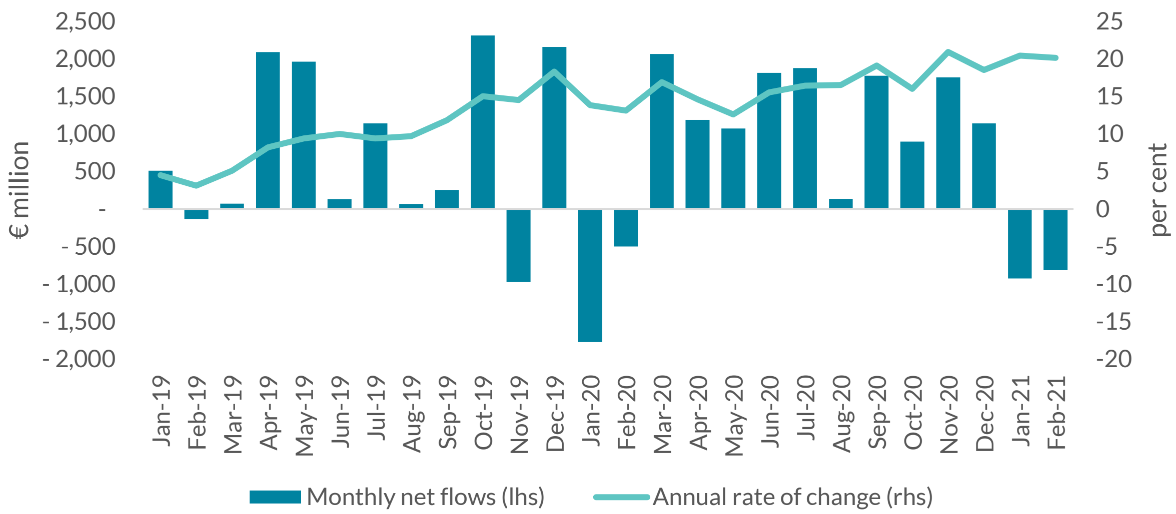
Source: Central Bank of Ireland

The continued weakness in bank lending corresponds with marginal tightening of credit standards reported in the Bank Lending Survey, due to broad economic and firm specific conditions[7]. The tightening in credit supply conditions observed so far does not appear to be driven by factors that relate to bank balance sheet constraints, such as capital, access to funding or liquidity. Lenders reported via the survey that conditions for lending to SMEs tightened in Q4, while they remained unchanged for larger businesses. Lenders also reported an increase in demand from SMEs, particularly for longer-term loans although additional health restrictions introduced in December may delay this demand materialising.

Similarly to households, businesses responded to the pandemic by increasing their aggregate holdings of deposits. Deposits from businesses have been growing since 2013, but the recent figures point to an acceleration of that trend. In the period between March 2020 and February 2021, businesses have accumulated deposits of €12 billion, compared to €6.9 billion in the same period of the previous twelve months (Figure 6).

[7] See: https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-lending-survey

Figure 6: Business Deposits: Net Transactions and Annual Rate of Change



Source: Central Bank of Ireland

Summary

Irish households and businesses continue to adapt their financing activities in response to the evolving nature of the COVID-19 pandemic and the corresponding public health measures. Daily payments data highlight the rapid adjustment of spending activity that was prompted by the re-introduction of Level 5 restrictions late last year, and highlight the differing sectoral impacts of the ongoing restrictions. Household savings, meanwhile, are growing at rates not seen since before the Global Financial Crisis, reflecting the lack of opportunities to spend, the ongoing income supports provided by the government and precautionary motives.

In terms of observed credit outcomes, there was a material contraction in new lending volumes at the onset of the COVID-19 shock across most segments. New lending has started to recover, with trends diverging across segments. In the mortgage market, we have seen a strong recovery in activity but consumer lending remains at low levels, in line with general consumer spending patterns. In the SME segment, there has been a relatively strong headline recovery in bank lending activity, but trends vary widely across sectors, depending on the impact of COVID-19.