Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box F: QB 4 – October 2019

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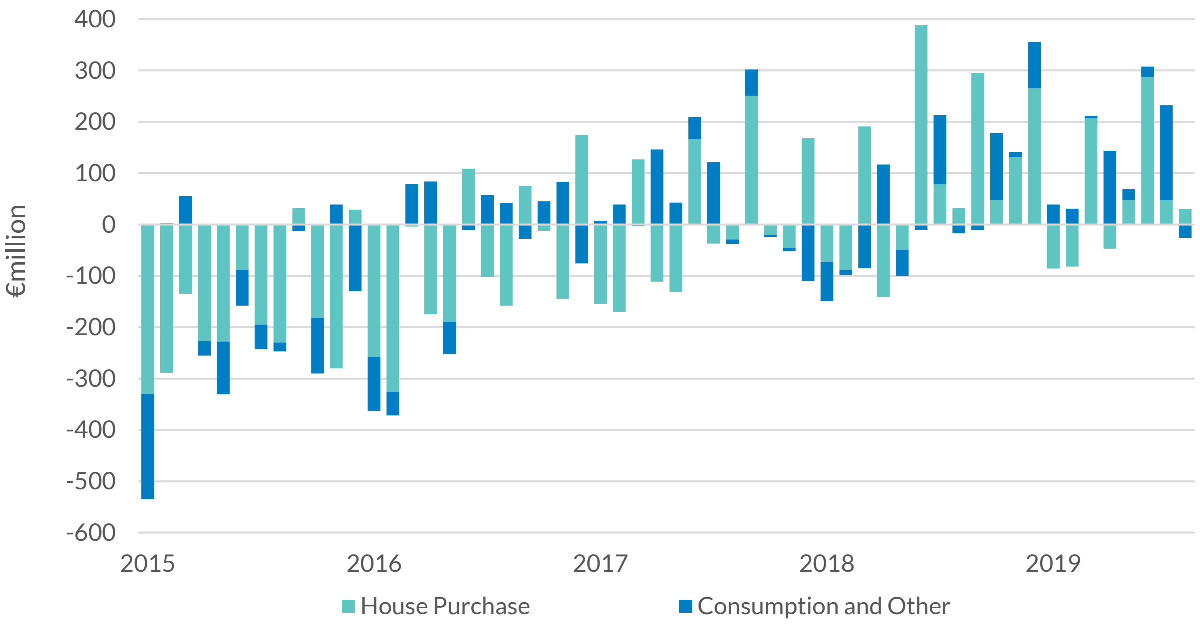
Credit Developments in the Irish Economy

By Statistics Division[1]

The latest macroeconomic data suggest that the Irish economy continues to perform favourably but downside risks have increased largely due to external factors. Coinciding with higher uncertainty around the eventual terms of the United Kingdom's withdrawal from the European Union, Irish consumer and business sentiment indicators have deteriorated recently. While new bank lending to certain sectors continues to grow, credit developments remain modest. Households continue to increase deposits, suggesting the increase in uncertainty could be leading to precautionary savings alongside rising incomes. The deposit growth, however, is in line with the broader euro area trend.

Figure 1: Flow of Loans to Households

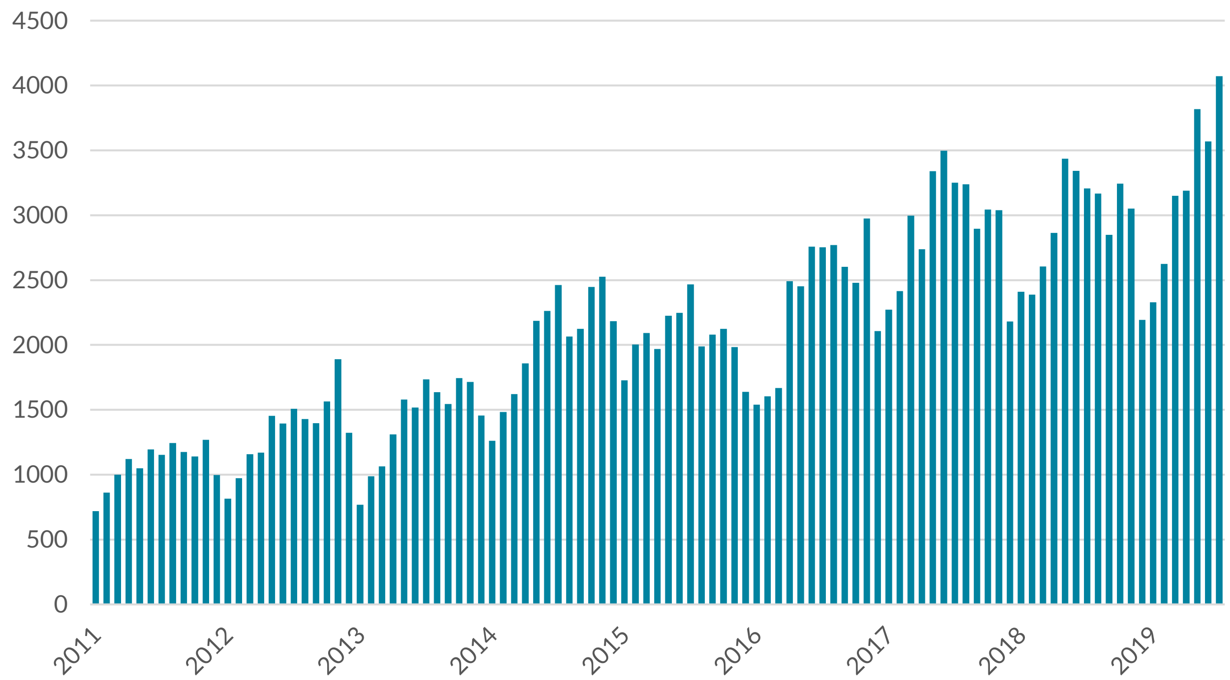


Source: Central Bank of Ireland

[1] Prepared by Brian Kenny

On an annual basis, bank lending to Irish resident non-financial corporations (NFC) and households continued to increase at a relatively modest pace in August 2019 at 2.3 and 2 per cent, respectively. Much of the increase in household lending came from lending for house purchase contributing 64 per cent of the growth. The growth in housing-related lending was driven by principal dwellings with lending for buy-to-let and holiday homes still declining (Figure 1). The pipeline of new lending appears to be strong with mortgage approvals at the highest level since 2011 (see Figure 2). This trend is mirrored in lending for consumption purposes, which in Q2 had the largest annual increase recorded since 2008. New loans for car purchase were also increasing throughout the first half of 2019, marking the largest volume of new lending for car finance recorded since the series began in 2012. Further, the latest results from the Irish Bank Lending Survey show that banks reported a marginal increase in loan demand from households for house purchase and for consumer credit in Q2. As noted earlier however, the materialisation of downside risks to domestic demand could lead to lower consumption with subsequent implications for future credit demand among Irish households.

Figure 2: Developments in Mortgage Approvals[2]



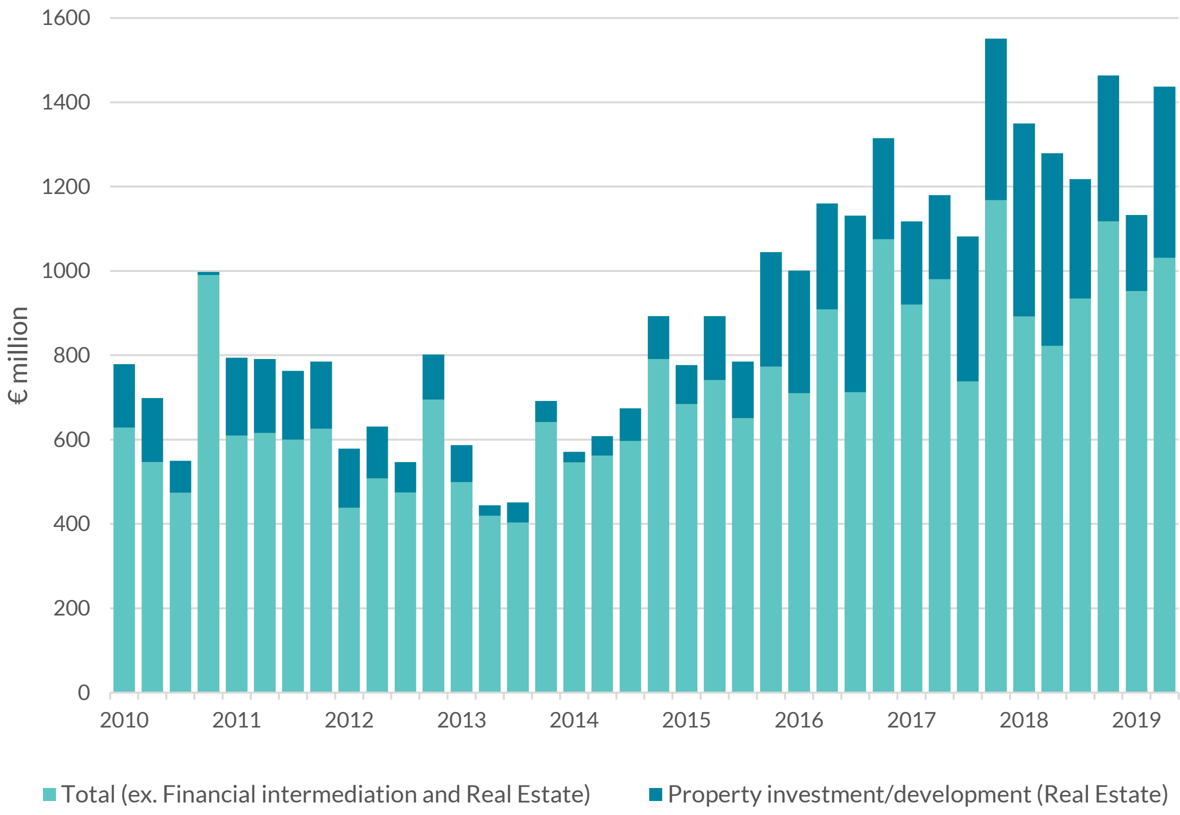
Source: BPFI

While annual growth in SME credit continued to remain negative, a strong flow of new lending is also evident for this sector. Gross new lending to SMEs continued to increase in the second quarter of 2019, up 11 per cent on the same period in 2018. SMEs in the property sector accounted for the

[2] Source: Banking and Payments Federation of Ireland Mortgage Approvals Report

majority of new drawdowns with increases also observed in the primary industries, retail and manufacturing sectors. The latest euro area SAFE data[3] notes that SME demand for bank loans, along with the reported availability of external sources of finance, increased in the six-month period to end March 2019. Moreover, it shows that the countries in which SMEs reported the most improvement in the availability of bank loans were Spain, Ireland and Portugal. While growth in SME lending remains robust despite Brexit related uncertainty facing the economy, the latest Department of Finance Credit Demand Survey[4] shows that although credit demand increased relative to the previous survey, it declined marginally in annual terms. A lack of credit requirements and availability of internal funding[5] may explain the decline. The survey also highlighted the deterioration in business sentiment among SMEs due to Brexit.

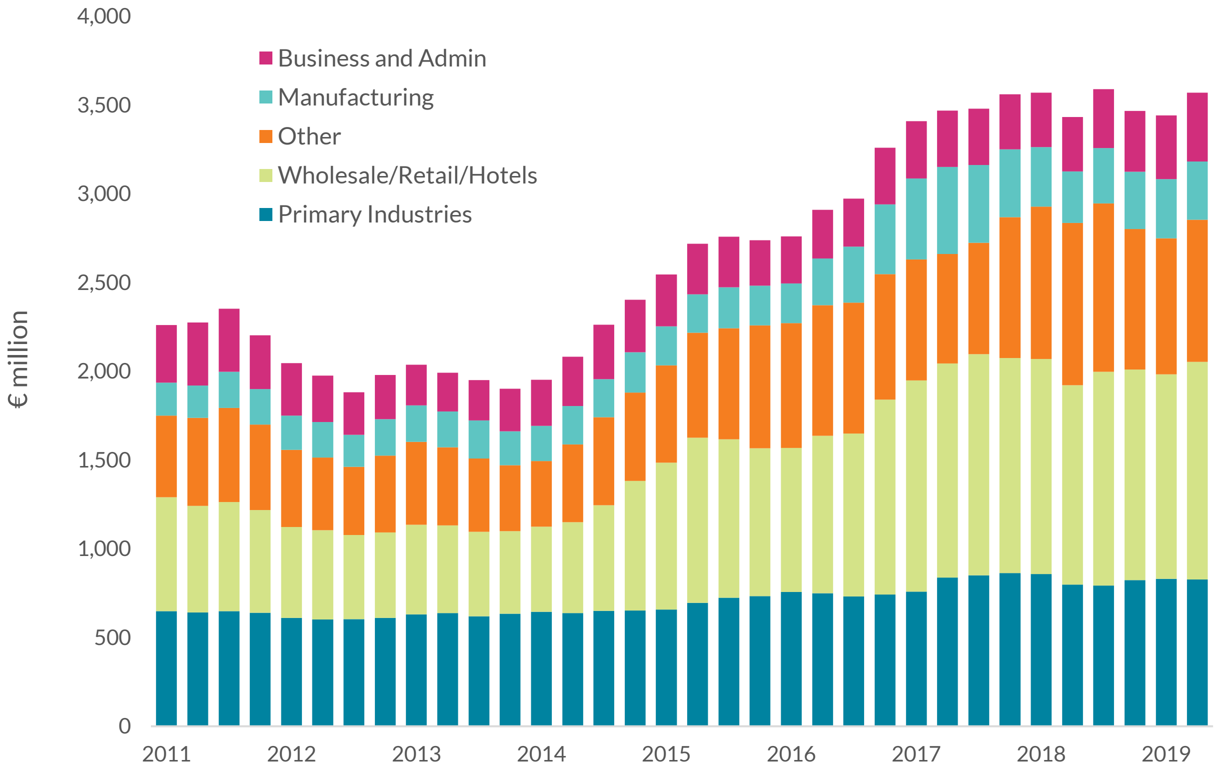
Figure 3: Developments in New Lending to SMEs



Source: Central Bank of Ireland

[3] https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/ecb.safe201905~082335a4d1.en.html#toc2
[4] The Department of Finance SME Credit Demand Survey released in September 2019 covers the six-month period October 2018 – March 2019.
[5] See the Central Bank's Financial Stability Review and the SME Market Report for further information and analysis of the Irish SME sector.

Figure 4: New lending to core SMEs - 12 month sum

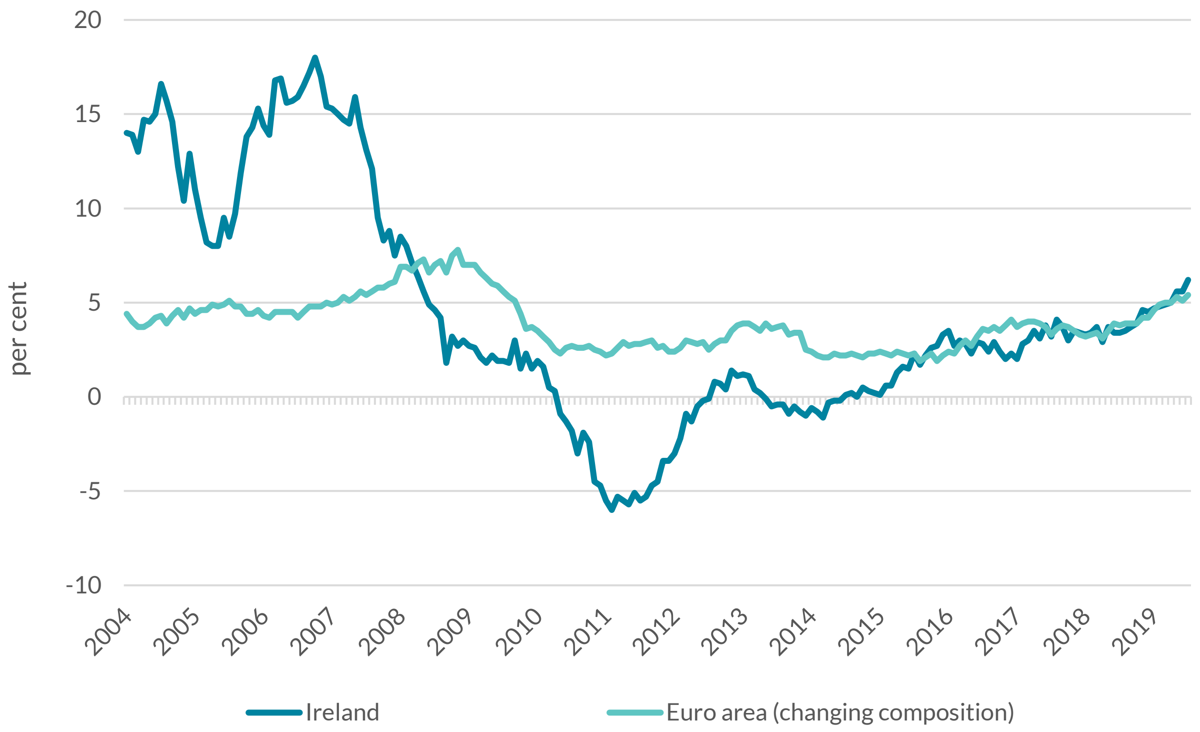


Source: Central Bank of Ireland

Household deposits have been increasing strongly and were up by 6.4 per cent on an annual basis in August, reaching a series high of over €109 billion. This could be due to overall economic uncertainty, with Irish annual growth rates in deposits converging with EU levels in recent times, or potentially an increased desire for precautionary savings as mentioned in previous Central Bank Quarterly Bulletins[6]. The savings behaviour of households is also changing in terms of the maturity within the deposits. Previously, Irish households held roughly equal shares of term and overnight deposits. The recent trend of has seen a strong rebalancing towards overnight deposits. This shift in preference could be due to the fact that the interest rate premium on term deposits have fallen significantly due to a flattening of the yield curve. Since late 2012, the premium on term deposits has steadily declined from 304 basis points to just 27 basis points in July 2019.

[6] See Central Bank of Ireland Quarterly Bulletin No.3 2019

Figure 5: Annual growth in Household deposits[7]



Source: ECB Statistical Data Warehouse

Although indicators suggest consumer sentiment is slowing, credit continues to increase in certain sectors. There is uncertainty about the future path of consumption and in turn credit and deposit developments. In the event of a disorderly withdrawal of the United Kingdom from the European Union and a corresponding income shock, personal consumption could moderate with a reduction in credit demand and a decline in savings. If household income does not decrease significantly, there could be an uptake in precautionary deposits. However, given the scenario of an orderly withdrawal, the opposite effect may emerge with continued growth in credit and drawdowns in deposits as consumer sentiment recovers.

[7] Source: Central Bank of Ireland and the European Central Bank Statistical Data Warehouse