SME Market Report

2015 H2

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

The Central Bank of Ireland's *SME Market Report* is compiled by economists in the Financial Stability Division and aims to collate information from a range of internal and external sources to give an up-to-date picture of developments in the Irish Small and Medium Enterprise (SME) credit market.[1] The report provides information on credit demand, credit access, loan terms and conditions, loan default, interest rates and credit market concentration. The report is released twice yearly. This edition updates previous reports using the latest available data. The data sources are detailed in Appendix 1 and the SME definition adopted in each data source is defined in Appendix 2.

Overview

- Gross new lending to non-financial, non-real-estate SMEs shows positive growth since the start of 2014. For the first three quarters of 2015, year-on-year growth rates in quarterly new lending were 26%, 33% and 4.9%, respectively. Despite this growth, the overall stock of outstanding SME credit continues to decline, implying that the volume of repayments is outstripping new lending in each quarter. Since the last report, outstanding credit has declined by 8%. Compared to other euro area countries, new lending (including renegotiations) relative to domestic demand is currently low.
- While SME perceptions of bank willingness to provide credit have improved, 39% of Irish SMEs still consider access to finance a 'high' concern. This share is similar to EU2 countries (Spain, Portugal, Italy and Greece) but above EU1 countries (Austria, Belgium, Germany, Finland, The Netherlands and France).
- Interest rates on Irish SME loans are high relative to the euro area. Furthermore, SME rates did not decline in line with the euro area from 2014, particularly relative to EU2. The difference between SME and large firm interest rates is also relatively high in Ireland. The latest data show a slight reduction in interest rates for smaller SME loans. In addition, the share of SMEs reporting interest rate increases is declining (survey data).
- Bank finance application rates have been declining since 2012, driven by declines in applications for renewed/restructured products. Loan application rates, which have been steady since 2013, are low by European levels. The majority of finance applications are for working capital purposes, although this rate is declining. Bank rejection rates have declined slightly since the last report (currently 15%, down from 16%), but this rate is above euro area averages (8-9%).
- Firm-level data show that the share of SMEs with no outstanding debt is rising while debt-to-turnover ratios are declining. Furthermore, it is evident that the majority of fixed asset investments are currently financed through internal funds/retained earnings rather than external bank finance.
- SME default rates are declining. Currently, 19% of loans and 31% of total outstanding balance are/is in default (down from 26% and 41% respectively in 2013). Default rates remain highest in the Construction and Hotel/Restaurant sectors.
- Box 1 shows that SME profitability and turnover have improved substantially since 2013. The recovery in activity has been strong by European standards. For example, the net increase in profits (share of SMEs reporting increases minus share reporting decreases) is currently 28% in Ireland, compared to 5% in EU1 and -10% in EU2. Similar trends are observed for turnover changes. However, improvements in business performance are weaker for smaller SMEs, both in Ireland and the euro area.

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1 Central Bank of Ireland *Credit, Money and Banking* Statistics

Figure 1 presents annualised (rolling summation over previous four quarters) gross new lending to non-financial, non-real estate SMEs.[2] New lending has been increasing since the beginning of 2014. For the first three quarters of 2015, year-on-year growth rates in quarterly new lending were 26%, 33% and 4.9%, respectively.

Figure 1. New SME lending (4 quarter rolling summation, by quarter), Q4 2010 - Q3 2015

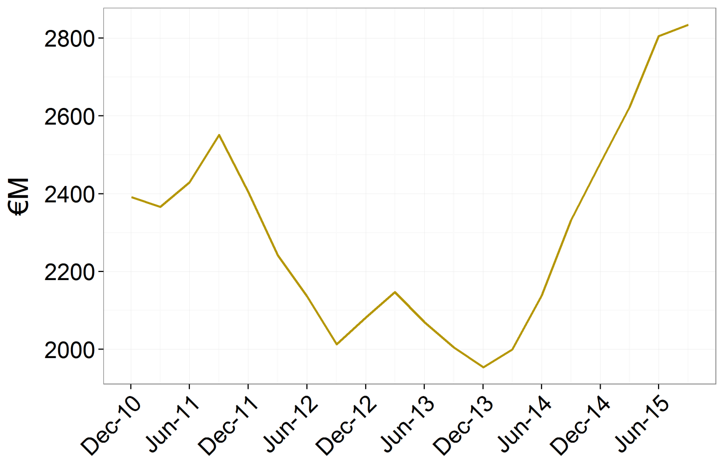
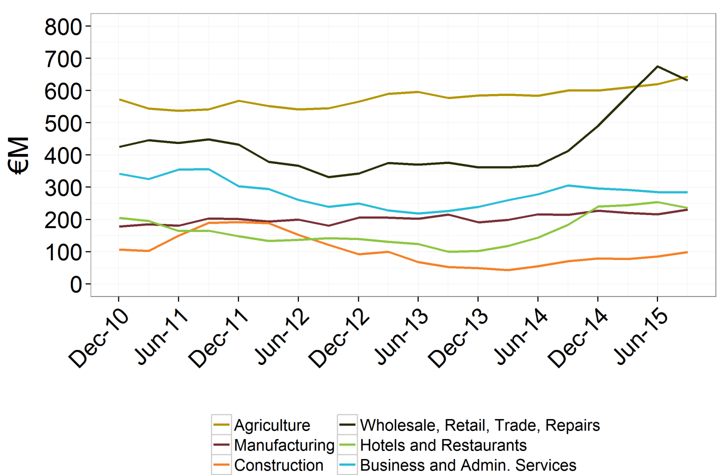


Figure 2 presents annualised gross new lending trends for the main business sectors. The Agriculture and Wholesale/Retail sectors continue to receive the largest amount of new lending. Annualised new lending growth between Q3 2014 and Q3 2015 has been highest in the Wholesale/Retail (53%), Construction (41%) and Hotel/Restaurant (29%) sectors.

Figure 2. New SME lending, by sector (4 quarter rolling summation, by quarter), Q4 2010 - Q3 2015



[2] Gross new lending is defined as the 'amount of new credit facilities drawn-down during the quarter by SME counterparties, i.e. where this credit facility was not part of the outstanding amount of credit advanced at the end of the previous quarter'. These data exclude renegotiations.

Figure 3. Credit outstanding to SMEs, Q1 2010 - Q3 2015

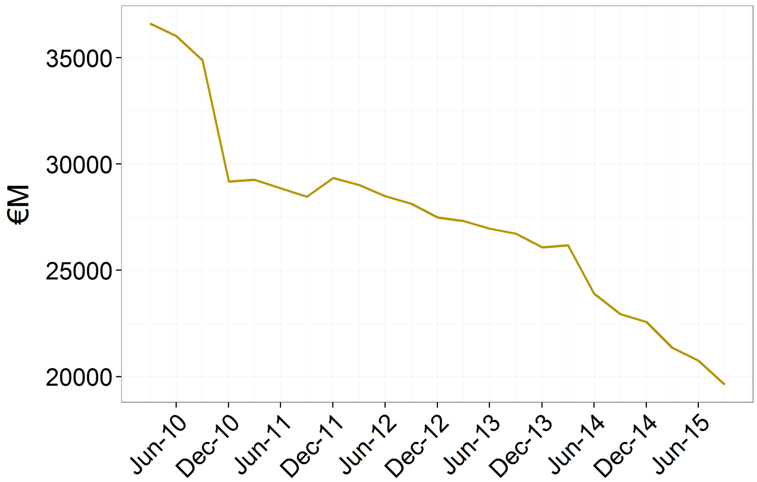


Figure 3 presents the value of outstanding credit to non-financial, non-real-estate SMEs. The stock of credit continues to decline. Between Q1 2010 and Q3 2015 stocks have declined by 46%. Since the last *SME Market Report*, stocks have declined a further 8% (Q3 versus Q1 2015).

Figure 4. Credit outstanding to SMEs, by sector, Q1 2010 - Q3 2015

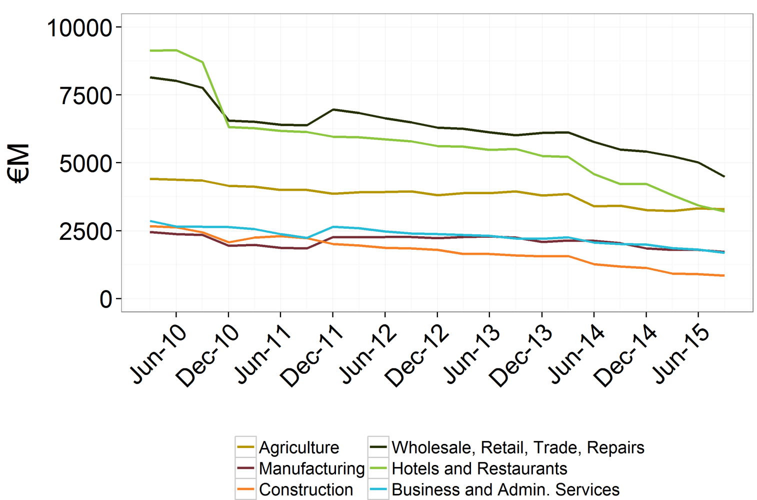
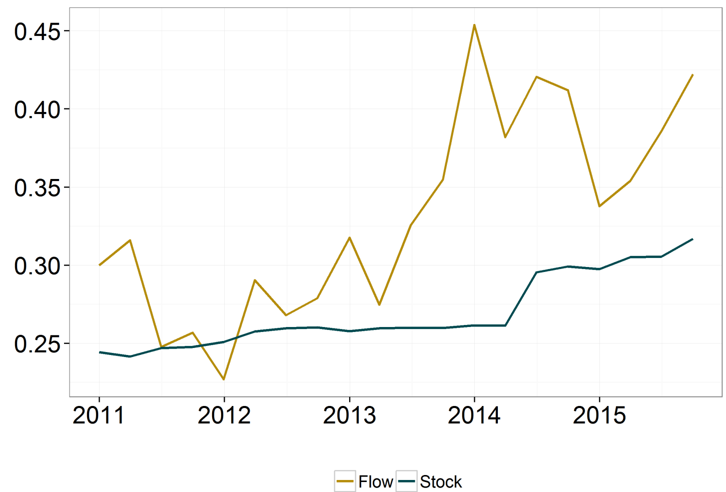


Figure 4 presents outstanding SME credit for the six largest non-financial, non-real estate sectors. All sectors show overall declines since 2010. Since the last report (Q1 2015), the majority of sectors show declines, particular the Hotel/Restaurant (-16%), Wholesale/Retail (-14%) and Services (-9.3%) sectors. Only the Agriculture sector shows a slight increase (2%).

Figure 5 reports the movement in the Herfindahl-Hirschman index, which measures the concentration of lending 'stocks' (outstanding balance) and 'flows' (gross new lending) for non-financial, non-property-related lending.[3] Flow concentration has increased since the last report (Q1 2015). Stock concentration has increased since Q1 2014. In the latest quarter, the combined market share (stock) of the three main lenders is 92%.

Figure 5. Herfindahl-Hirschman index for non-financial, non-real estate SME lending, Q4 2010 - Q3 2015



[3]The Herfindahl-Hirschman index is calculated as the sum of the squared market shares. Higher values indicate higher market concentration or lower levels of competition.

2 Red C SME Credit Demand Survey

Figure 6. Application rate for bank finance, October 2012 - September 2015

Figure 6 displays the percentage of SMEs that applied for bank finance. The latest survey (September 2015) shows that application rates are identical for Small and Medium firms (34%) but lower for Micro firms (24%). There has been a general decline in application rates since 2012. Since the last survey, further declines are observed in all SME size categories.

Figure 7. Application rate by product, October 2012 - September 2015

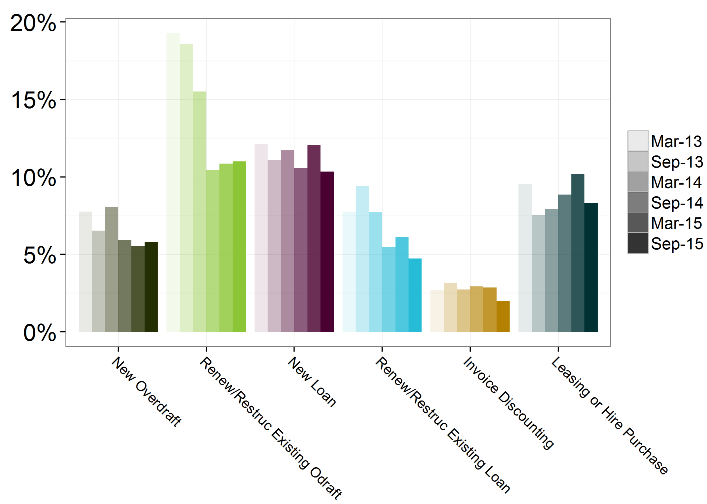


Figure 7 presents application rates for each bank finance product (all SME size categories combined). The general decline in the overall application rate (Figure 6) is primarily driven by declining applications for renewed/restructured products, with application rates relatively more stable for the remaining products. In the latest survey, new loans and renewed/restructured overdrafts are the most common bank finance products requested (10-11% of SMEs applied).

Figure 8 shows that the majority of credit applications in the latest survey are for working capital purposes (48% of all applications across all SME size categories), and this rate decreases for larger firms.[4] Applications are also high for new vehicles/equipment (28% across all SMEs) and growth/expansion (25%), with rates increasing with firm size.

Figure 8. Reasons declared for credit application, April - September 2015

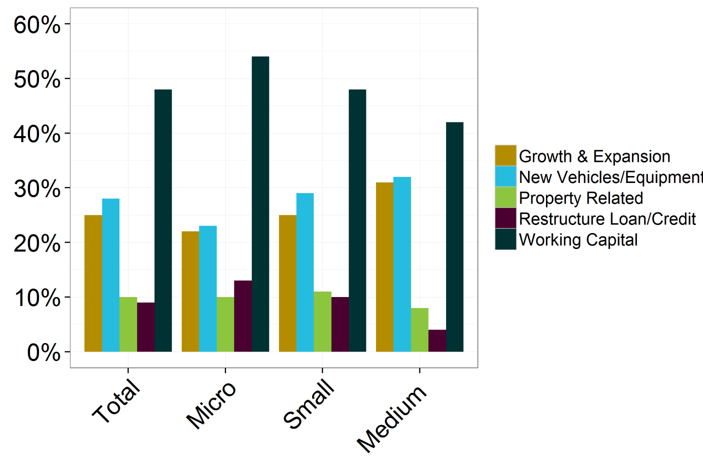
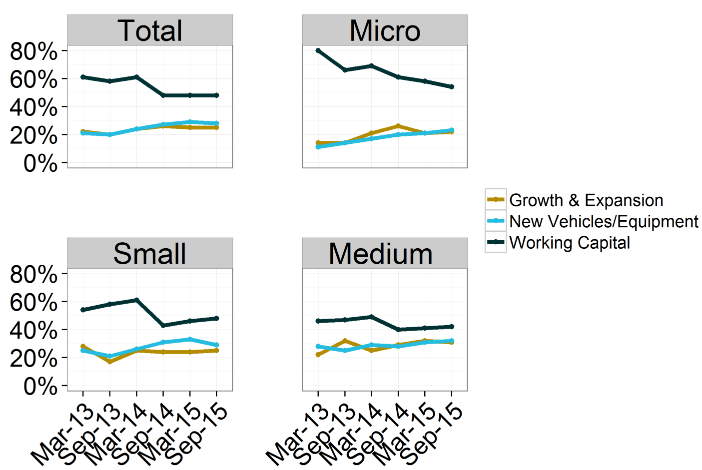


Figure 9 shows how the three main reasons given for credit applications have changed over time. Borrowing for working capital has generally decreased since 2013, while borrowing for growth/expansion and vehicles/equipment have increased (all SME size categories). These trends are generally observed across all SME size categories, although Micro firms show larger reductions in borrowing for working capital. Across all SME size categories, there is no significant change since the last report.

Figure 9. Reasons declared for credit application, October 2012 - September 2015



[4] 'Working capital' refers to requests for the purposes of cash flow management, decline in business revenues, delayed customer payments, increased supplier costs and increased bad debts. Totals sum to greater than 100% as firms may respond with multiple reasons for requesting bank finance

Figure 10. Bank finance rejection rates, October 2012 - September 2015

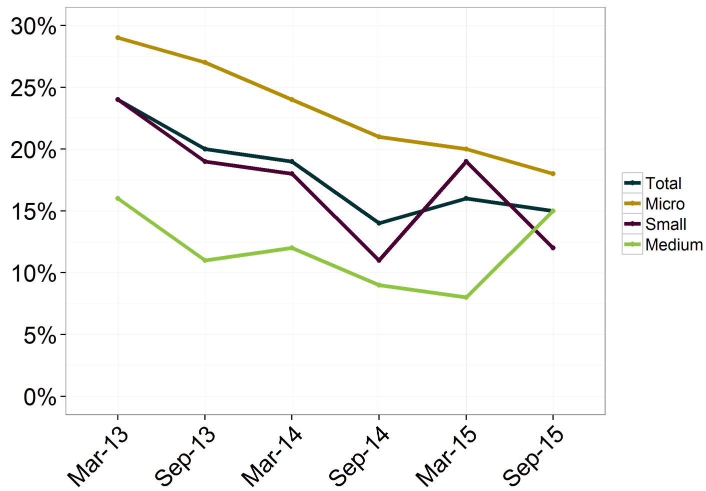


Figure 10 displays rejection rates on SME finance applications.[5] While rejection rates decreased between March 2013 and September 2014, trends have been more stable since. The current rejection rate across all SME sizes is 15%, down slightly on the previous survey (16% in March 2015). By SME size, rejection rates have declined for Micro and Small SMEs, but increased for Medium SMEs (compared to the previous survey).

Figure 11. Collateral and personal guarantee rates, October 2012 - September 2015

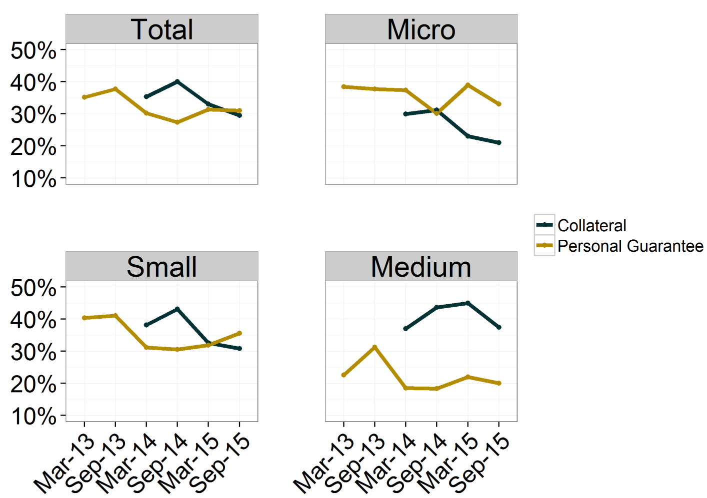
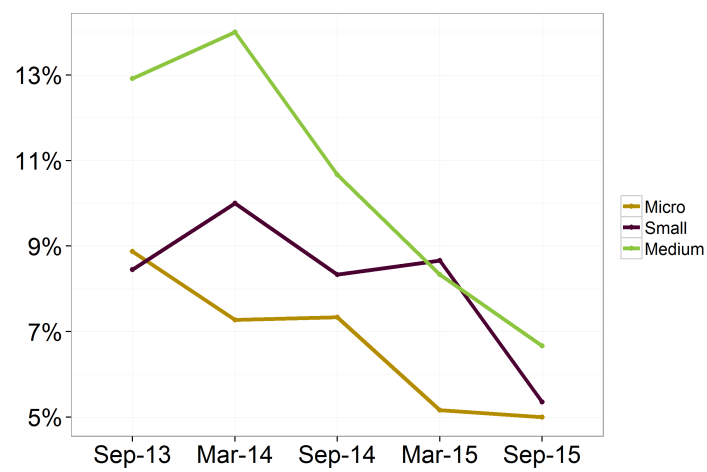


Figure 11 displays collateral and personal guarantee rates for successful and partially successful finance applications. Overall (all SMEs), collateral and the personal guarantee rates are declining, and both are currently around 30%. In the latest survey, collateral rates are highest for Medium firms (38%), followed by Small (31%) and Micro (21%). For personal guarantees, rates are highest for Small firms (35%), followed by Micro (33%) and Medium (20%).

[5]Rejection rates are for those SMEs applying for credit and having received a decision in the last six months. These rates are for all finance types described in Figure 7.

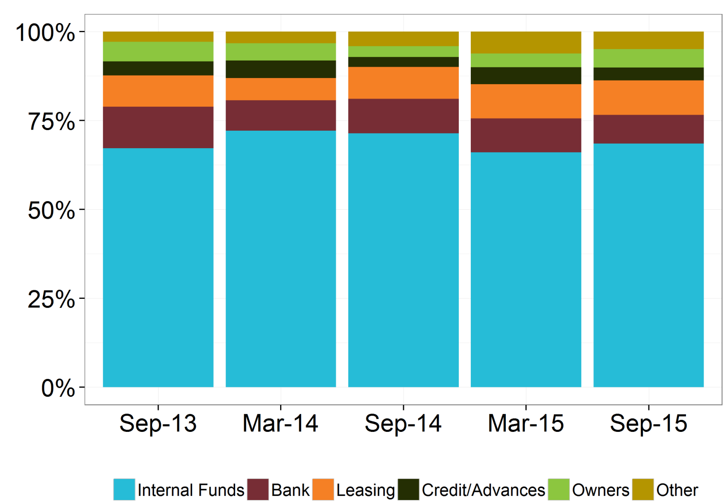
Similar to Figure 3, Figure 12 shows that SME debt levels are declining.[6] Across all SME sizes, the median debt-to-turnover ratio has declined from a peak of 10% in March 2014 to 5.5% in September 2015. While Medium firms had a significantly higher ratio in earlier survey waves, all firm sizes are now between 5% and 7%. The share of firms with no debt has increased from 23% in September 2013 to 35% in September 2015, while the median level of debt has declined from €75,000 to €30,000.

Figure 12. Median debt-to-turnover ratio, April 2013 - September 2015



For firms that acquired fixed assets in each survey wave, Figure 13 presents the share of financing sources (all firm sizes).[7] It is apparent that the majority of SME investment is financed through internal funds/retained earnings – 69% across all survey waves – and this share has been stable through time. The share of bank financing is considerably lower (average of 9.5% across all survey waves). By firm size, the average bank financing share (all survey waves) is highest for Small firms (11%), followed by Micro (8.7%) and Medium (8.4%).

Figure 13. Average share of financing source in fixed asset investments, April 2013 - September 2015



[6] The debt-to-turnover ratio is calculated using a reduced sample. This is the result of missing debt and turnover information (18% and 33% of firms respectively), leading to a missing debt-to-turnover ratio for 40% of firms.

[7] 'Other' includes the issue of equity shares, the issue of debt (including commercial paper and debentures), loans from friends and family, informal loans, and borrowing from non-bank financial institutions. 'Owners' refers to contributions from the owners of the firm.

Box 1: Performance of SMEs – Ireland and the Euro Area

After several years of challenging economic conditions for SMEs, a tangible recovery is now apparent. Real GNP grew by 4.6% in 2013 and 6.9% in 2014, and forecasts for 2015 are equally strong.[8] Unemployment, which was over 14% in December 2012, has reduced to 8.9% (November 2015).[9]

SME survey data for this period demonstrates that this turnaround is being felt by Irish SMEs. Results from the Department of Finance *Red-C SME Credit Demand Survey* shows that the share of SMEs reporting increased turnover has risen from 35% in March 2013 to 52% in September 2015, while the share reporting decreased turnover has declined from 30% to 14%. Analysis of SME profitability is equally favourable. For example, the share of SMEs making a profit has increased from 40% to 60%.

The ECB/EC *Survey on the Access to Finance of Enterprises* (SAFE) is employed to compare turnover and profit growth in Ireland to the euro area (see appendices for background information on this data). Figure 14 and 15 present the net increase (share reporting increases minus share reporting decreases) for profit and turnover across the three SME size categories in the latest six survey waves (March 2013 through September 2015). Ireland is compared to two groups of euro area countries: EU1 which comprises of Austria, Belgium, Germany, Finland, The Netherlands and France; and EU2 which comprises of Portugal, Italy, Spain and Greece.

Figure 14. Net increase in profit by SME size, October 2013 - September 2015

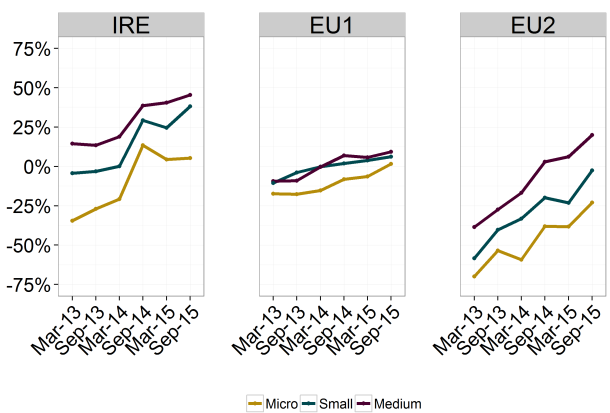
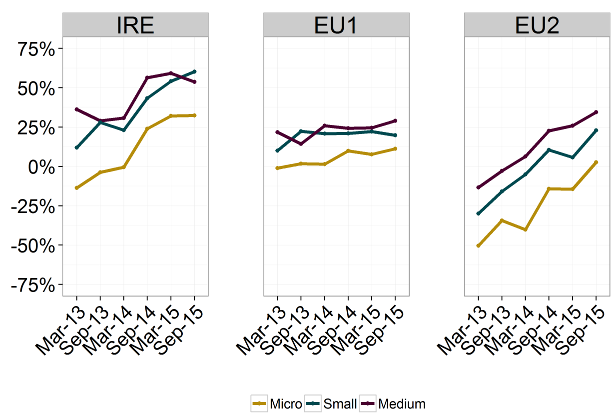


Figure 15. Net increase in turnover by SME size, October 2013 - September 2015



Across all SME size categories in Ireland, the profit net increase (NI) has risen substantially, from -10% in March 2013 to 28% in September 2015. The current NI is high relative to euro area averages. For example, the NI from the latest survey is -10% in EU2 and 5% in EU1, with the former also showing large improvements since 2013, albeit from a lower base. Improvements are highest for Medium firms, followed by Small and Micro (generally observed in all regions). Irish SME turnover improvements are equally high. Across all SME size categories, the turnover NI has increased considerably, from 9% in March 2013 to 48% in September 2015, with improvements again higher for Small and Medium firms. Similar to profit NI, the current turnover NI in Ireland (all size categories) is higher than both EU2 (13%) and EU1 (19%).

[8] National accounts information for 2013 and 2014 available from Central Statistics Office. The Central Bank's latest forecast for GDP growth in 2015 is 5.8% (see Macro-Financial Review 2015:II)

[9] Unemployment statistics (Live Register) available from Central Statistics Office

3 Central Bank of Ireland Loan-Level Data

Loan-level data on the population of SME loans in Ireland are employed to describe lending trends and loan performance.[10] Figure 16 presents trends in SME default rates, by loan count (the share of loans in default) and by balance (the share of outstanding stock in default). The default rate by count has declined over the past two years, from 26% in 2013 to 19% in 2015. Similar improvements are observed by balance, with the rate reducing from 41% to 31%.

Figure 16. SME default rates, December 2013 - June 2015

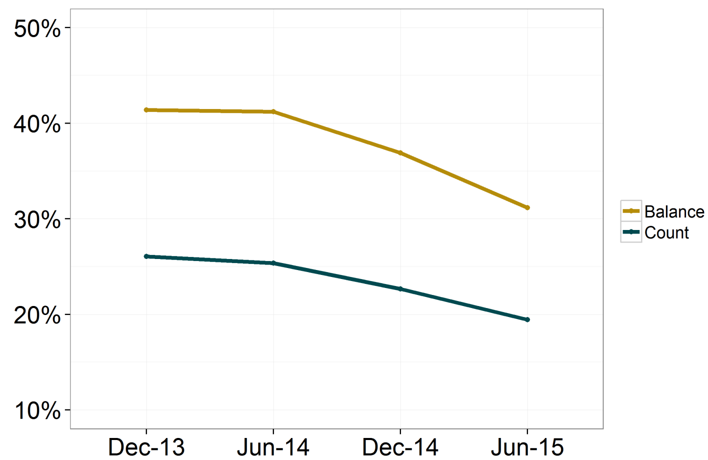


Figure 17 presents the share of SME loans that switched performance status between December 2014 and June 2015 (latest two datasets). 2% of loans that were performing in December 2014 are now in default (5,510 loans). The data also show that 4% of defaulted loans have returned to performing (2,396 loans). While these figures are similar to the last report, the share of performing stock (balance) switching to default shows some improvement, reducing from from 3.5% to 2.4%. However, the share of the defaulted stock switching to performing is lower than the previous report (4.6% previously).

Figure 17. Transition between performing and default, December 2014 - June 2015

	Performing Jun-15	Default Jun-15	Total
By Count	%	%	Number
Performing Dec-14	97.95	2.05	268,759
Default Dec-14	3.98	96.02	60,202
By Balance	%	%	€M
Performing Dec-14	97.60	2.40	11,042
Default Dec-14	3.47	96.53	6,018

[10] These data are collected every six months with the latest data from June 2015. The finance types are predominantly comprised of loans, overdrafts, hire-purchasing and leasing.

Figure 18. SME default rates by sector, June 2015

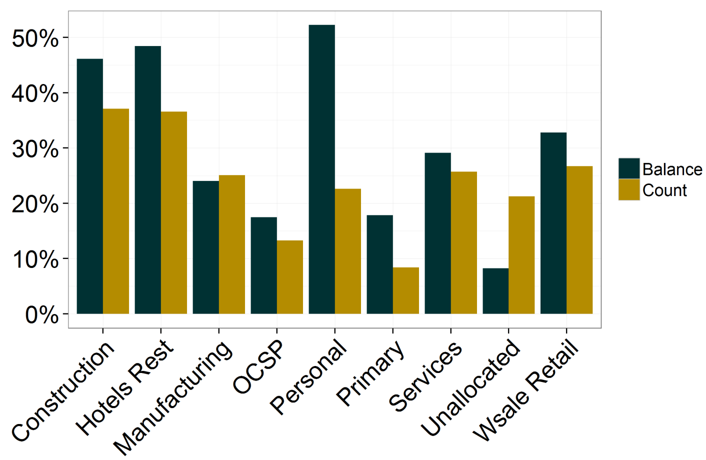
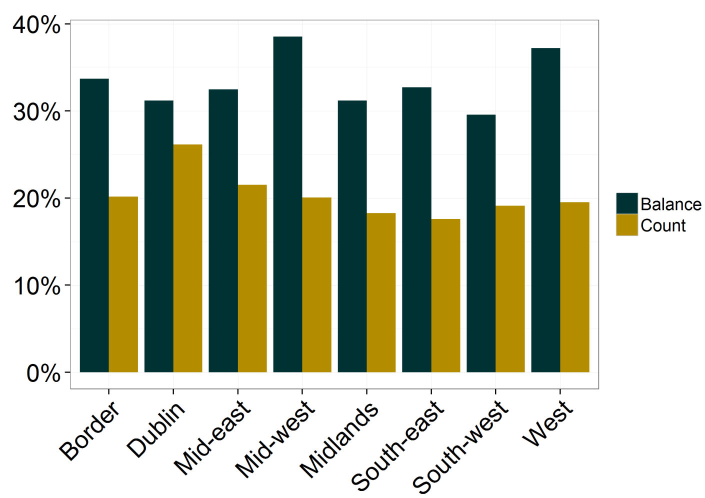


Figure 18 presents default rates across the main economic sectors.[11] Similar to the last report, default rates (by outstanding balance) are highest in the Construction, Hotels/Restaurants and Personal sectors and lowest in the Manufacturing, Primary, and Other Community, Social and Personal Services (OCSP) sectors. All sectors show a reduction in default rates relative to the last report (not shown).

Figure 19. SME default rates by region, June 2015



Default rates are more evenly spread across regions.[12] By balance, default rates are highest in the Mid-West (39%) and West (37%) and lowest in the South-West (30%) and Midlands (31%). By count, default rates are highest in Dublin (26%) and the Mid-East (22%) and lowest in the South-East and Midlands (18%). While differences between regions are similar to the last report, all regions show an improvement (not shown).

[11] Sectors with small exposures are subsumed into larger sectors for exposition purposes. The Electricity, Gas, Steam and Air Conditioning Supply, and Water Supply, Sewerage, Waste Management and Remediation Activities sectors are included with the Manufacturing sector; the Transportation and Storage sector is included with Wholesale and Retail; the Human Health and Social Work, and Education sectors are included with the Other Community, Social and Personal sector; the Information and Communication sector is included in Services. The Personal sector involves lending for the purposes of house purchase, property investment and consumer lending that is managed in the business banking units of the subject banks.

[12] Nomenclature of Territorial Units for Statistics (NUTS) regions - 'Border': Cavan, Donegal, Leitrim, Louth, Monaghan, Sligo; 'Mid-East': Kildare, Meath, Wicklow; 'Mid-West': Clare, Limerick,; 'Midlands': Laois, Longford, Offaly, Westmeath; 'South-East': Carlow, Kilkenny, Tipperary, Waterford, Wexford; 'South-West': Cork, Kerry, 'West': Galway, Mayo, Roscommon.

In Figure 20, the SME loan book is divided into one hundred percentiles of outstanding balance and the default rate (by count) is plotted for each percentile. In the latest data, defaults rates are in the region of 10% between the 35th and 75th percentiles, but increase for higher and lower amounts. Compared to June 2014, June 2015 shows lower default rates on the majority of balances.

Figure 20. SME default by loan balance percentile, June 2014 - June 2015

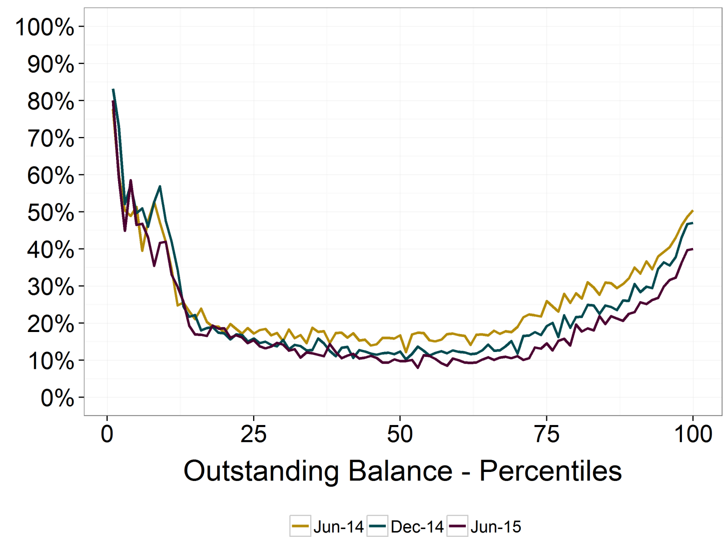


Figure 21 describes new lending in the three latest datasets.[13] New lending is defined as that which originated in the six months prior to each respective dataset date. The average amortising loan balance, which increased between June and December 2014, has declined again. The median balance, which is considerably below the mean, is more stable through time. Slight decreases are also observed for overdrafts between December 2014 and June 2015, although relatively smaller in magnitude. Interest rates (weighted by outstanding balance) show slight declines since June 2014.[15]

Figure 21. Description of new amortising loans and overdrafts, June 2014 - June 2015

	Jun-14	Dec-14	Jun-15
Amortising:			
Average Balance (€)	39,640	58,962	45,014
Median balance (€)	15,402	16,653	16,081
Average interest rate (%)[14]	5.50	4.88	5.09
Overdrafts:			
Average balance (€)	12,514	14,582	13,627
Median balance (€)	6,000	6,500	6,093
Average interest rate (%)[14]	7.15	7.00	6.78

[13]The balance in Figure 22, for both amortising loans and overdrafts, is the summation of current outstanding and undrawn balances (for overdrafts, this summation equates to the total credit limit). Amortising finance products are comprised of loans, hire-purchasing and leasing. Renegotiations or restructuring of existing loans are included in these data.

[14]Average interest rates are weighted by outstanding balance

[15]For amortising loans, the unweighted averages are 7.23% (June 2014), 7.03% (December 2014) and 6.64% (June 2015). For overdrafts, the unweighted averages are 7.74%, 7.68% and 7.62%

Figure 22. Mean interest rate on new lending by loan balance quintile, December 2014 and June 2015

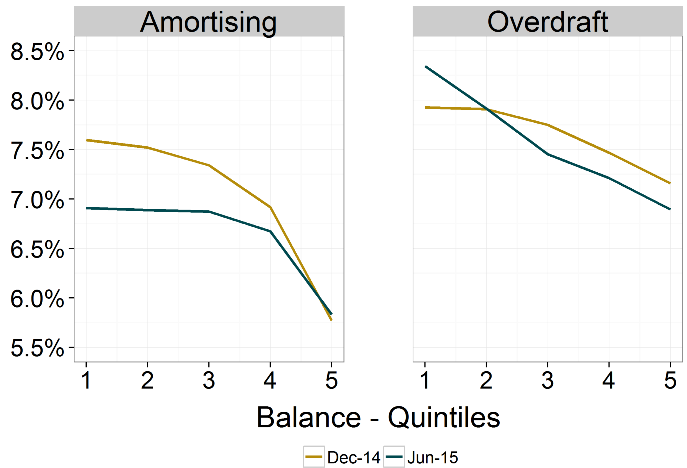


Figure 22 displays the mean interest rate by loan balance quintile on new amortising loans and overdrafts for the two latest datasets.[16] Interest rates decline for higher loan balances. For example, the average overdraft rate declines from 8.3% to 6.9% between the bottom and top quintiles. For amortising loans, the rate drops from 6.9% to 5.8%. Between datasets, overdraft rates in June 2015 are similar to December 2014, although slightly reduced for balances above the second quintile. For amortising loans, rates on loans up to the fourth quintile have declined by about half a percentage point.

Figure 23. New amortising loan distribution, June 2015

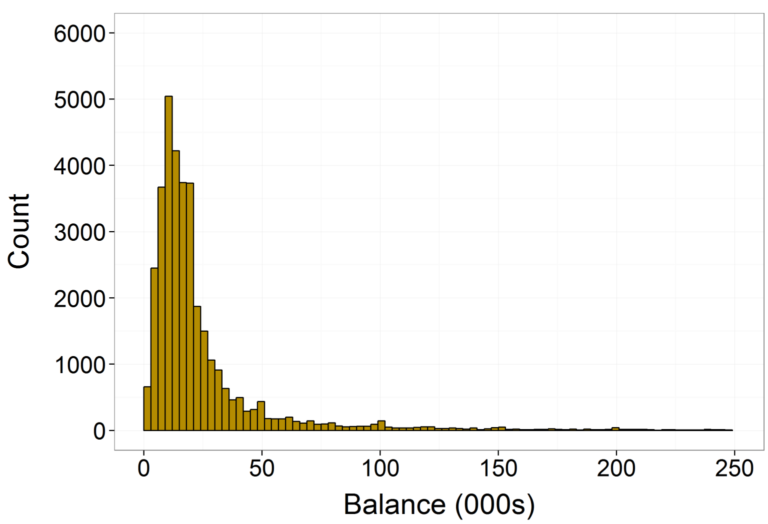


Figure 23 displays the distribution of new amortising loans.[16] Loans with balances above €0.25M (2.2% of the sample) are excluded for exposition purposes. 88% of new SME loans have balances of less than €50,000. The median balance has decreased slightly, from €16,653 in December 2014 to €16,081 in June 2015.

[16]As with Figure 21, new lending is defined as that which originated in the six months prior to each respective dataset date and the loan balance is the summation of current outstanding and undrawn balances. Amortising finance products are comprised of loans, hire-purchasing and leasing.

4 ECB/EC SAFE Survey

The ECB/EC *Survey on the Access to Finance of Enterprises* (SAFE) is used to compare credit conditions in Ireland to that of the euro area.[17] Figure 24 describes how 'pressing' a problem access to finance is for SMEs in the last six surveys.[18] Since the last report, there is a slight increase in the share of Irish SMEs stating a 'high' concern, from 37% to 39%. The current rate is similar to EU2 (40%) but above EU1 (29%).

Figure 24. Concerns on access to finance, October 2012 - September 2015

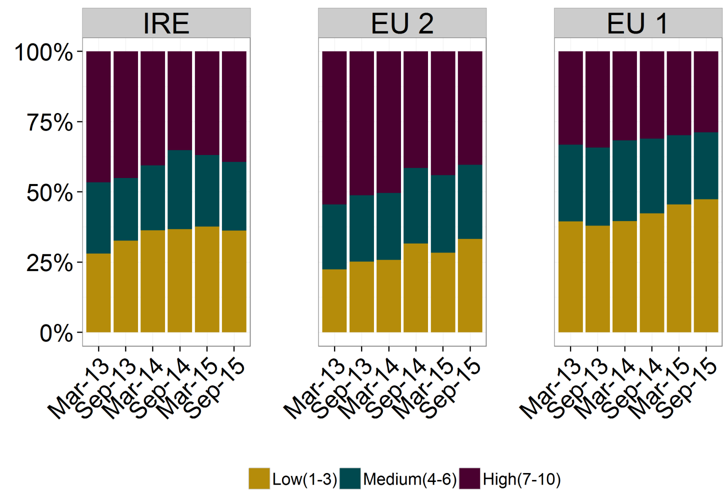
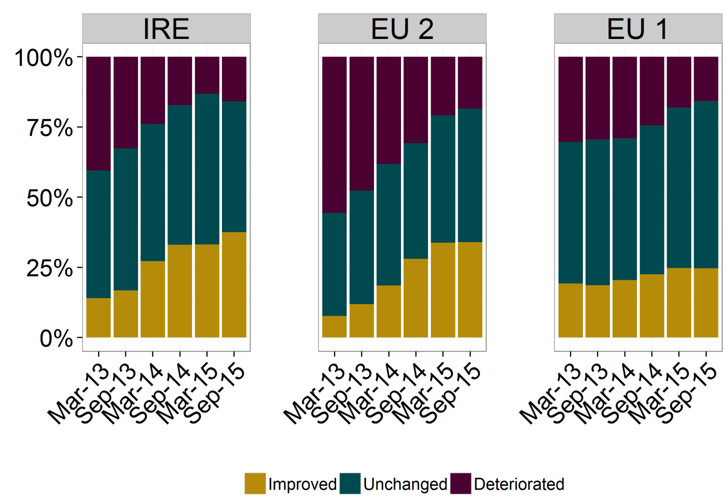


Figure 25 describes SME perceptions on bank willingness to provide credit. And improving situation is evident in Ireland and the euro area (particularly EU2). While most Irish firms report an unchanged situation in the latest survey (47%), the share of improvements (38%) is over twice as high as the share of deteriorations (16%).

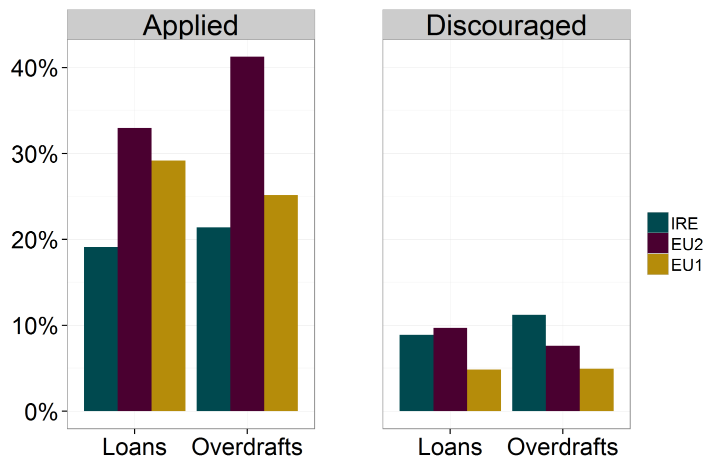
Figure 25. SME perceptions of bank willingness to provide credit, October 2012 - September 2015



[17] The survey is conducted twice-yearly with the most recent survey covering the period from April to September 2015. Ireland is compared to two groups of countries: EU1 which comprises of Austria, Belgium, Germany, Finland, The Netherlands and France, and EU2 which comprises of Portugal, Italy, Spain and Greece.

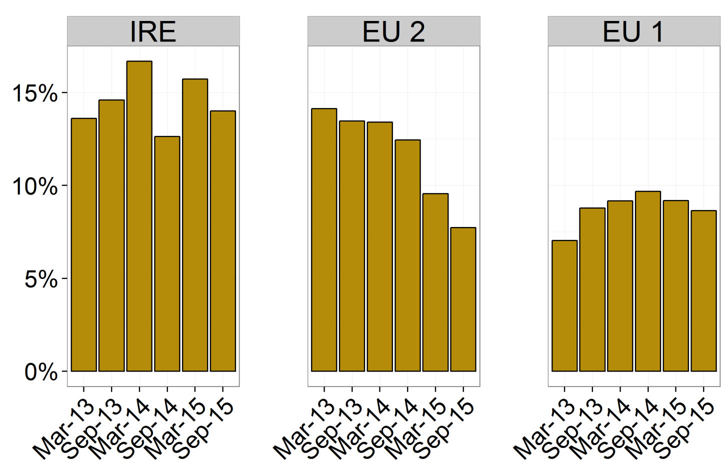
[18] Responses range from 10 ('extremely pressing') to 1 ('not at all pressing')

Figure 26. Application and discouraged borrower rates for loans and overdrafts, April - September 2015



Loan and overdraft application rates are currently below euro area averages. For loans, the current rate in Ireland is 19%, compared to 29% in EU1 and 33% in EU2.[19] For overdrafts, application rates are slightly behind EU1 but considerably behind EU2. The share of discouraged borrowers (SMEs that did not apply because of fear of rejection) in Ireland and EU2 is higher than EU1.

Figure 27. Rejection rates for loan and/or overdraft applications, October 2012 - September 2015



Similar to Section 3, rejection rates on loan/overdraft applications in Ireland show a slight decrease relative to the previous report (from 15.7% to 14%).[20] The current rate is higher than both EU1 (8.6%) and EU2 (7.7%).

[19]Following the SAFE reports, Figure 26 only include SMEs for which bank loans and overdrafts are relevant.
[20]SMEs that applied for both a loan and an overdraft but received a rejection for either are treated as rejected for Figure 27

For SMEs that used financing in the previous six months, Figure 28 describes the purpose of these funds.[21] Since the last report, there has been a rise in the share of Irish SMEs reporting ‘fixed investment’ (38%, up from 23%), and shares are now similar to EU2 but behind EU1 (54%). The share reporting ‘working capital’ has declined (54%, down from 59%), and shares are now similar to EU2 but above EU1. The remaining categories show similar shares across areas.

Figure 28. Purpose of financing, April - September 2015

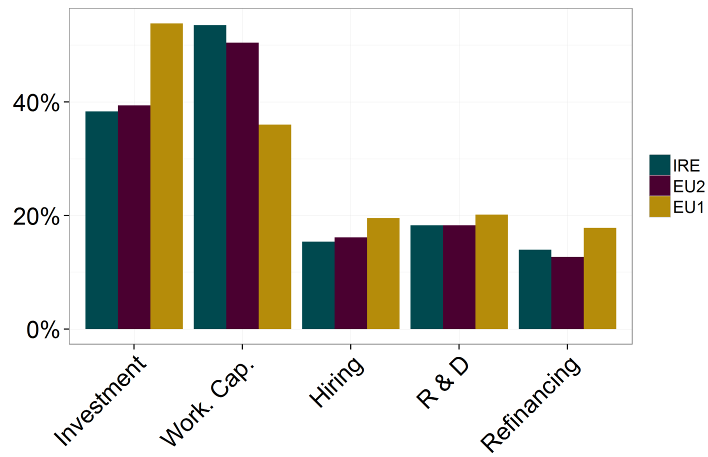
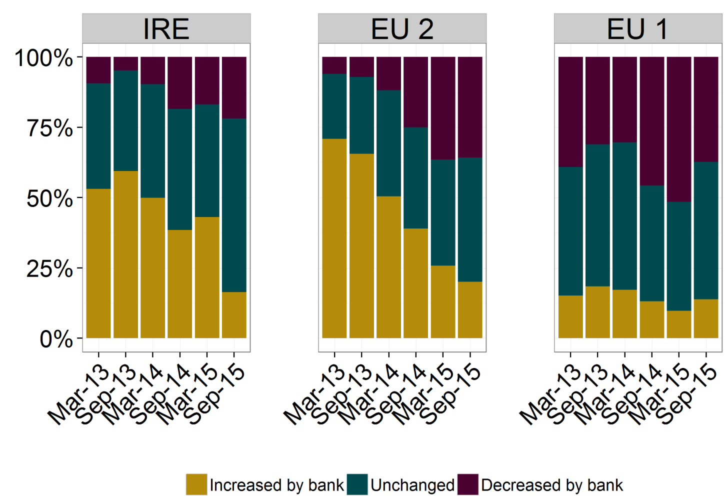


Figure 29 describes changes in interest rates, as reported by SMEs that applied for a loan and/or overdraft. The upward trend in interest rates in Ireland up until the last report appears to have slowed, with the latest survey showing a higher share of decreases than increases (22% versus 16%), although the majority of SMEs report an unchanged situation. The share of SMEs reporting decreases in the latest report is below EU1 and EU2.

Figure 29. Change in credit conditions: interest rates, October 2012 - September 2015



[21] In SAFE, financing refers to ‘external sources or from funds generated by your enterprise’. In Figure 28, ‘Investment’ refers to investment in property, plant, machinery or equipment, ‘Work. Cap.’ refers to inventory or working capital, ‘Hiring’ refers to hiring and training of employees, ‘R & D’ refers to developing and launching new products or services and ‘Refinancing’ refers to refinancing or paying off obligations. The shares presented exclude SMEs who responded with ‘don’t know’ or ‘not applicable’.

Figure 30. Change in credit conditions: loan size, October 2012 - September 2015

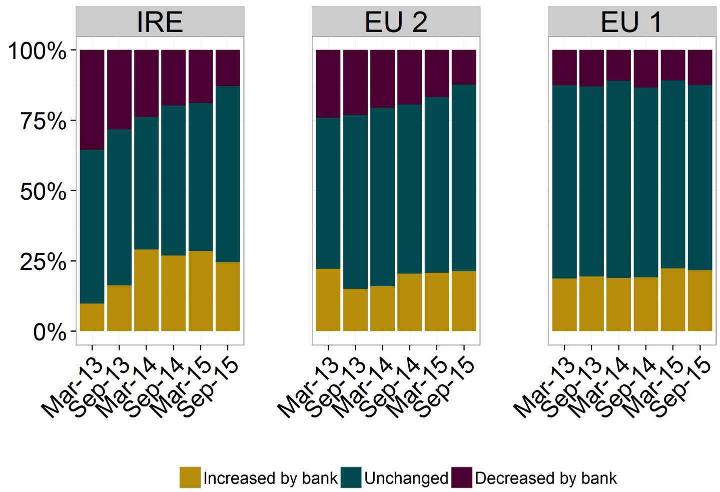


Figure 30 presents changes in loan size availability, as reported by SMEs. While the majority of SMEs report an unchanged situation in each survey, the net increase (share of increases minus share of decreases) has generally risen. Since the last survey, the net increase has improved in Ireland (from 9.6 to 11.8 percentage points) and EU2 (from 4.1 to 9 percentage points).

Figure 31. Change in credit conditions: collateral, October 2012 - September 2015

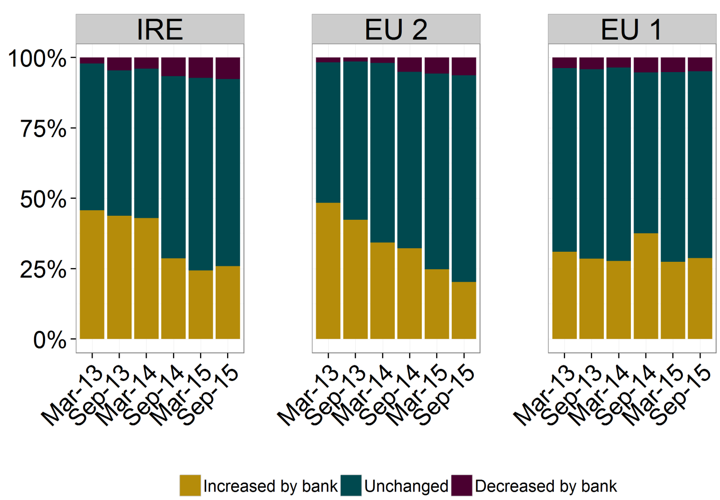


Figure 31 presents changes in collateral requirements, as reported by SMEs. In all survey and regions, more SMEs report increased collateral requirements than decreased, implying that collateral requirements are generally tightening. The share of SMEs reporting collateral increases has declined in Ireland and EU2. The latest survey shows little change to the previous report.

5 ECB Monetary and Financial Statistics

Figure 32 presents interest rates on loans to Irish non-financial corporations (NFCs) for various originating values.[22] Given the mean loan balance of €58,319 in the Loan-Level data, we use rates on loans under €0.25 million as a proxy for SME cost of credit. SME interest rates are higher than that for larger firms. For example, the average interest rate for SMEs for the last 6 months of data (April to September) is 5.7%, which is 3.4 percentage points higher than that for loans above €1 million and 1.8 percentage points higher than that for loans between €0.25 million and €1 million.

Figure 32. Interest rates on NFC loans (3-month moving average), Ireland, January 2006 - September 2015

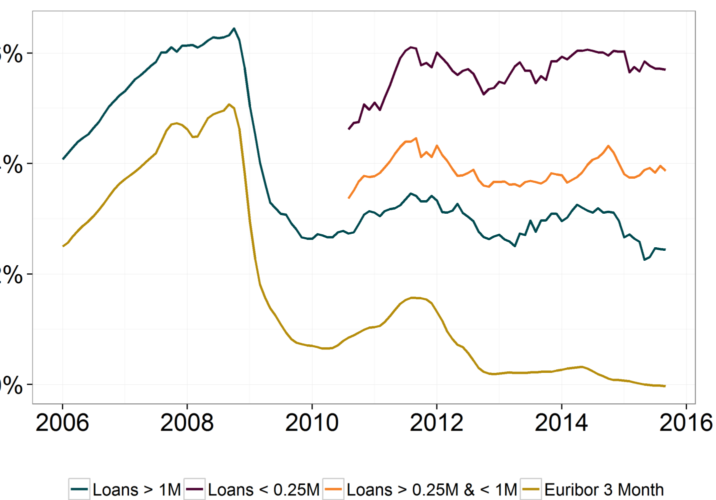
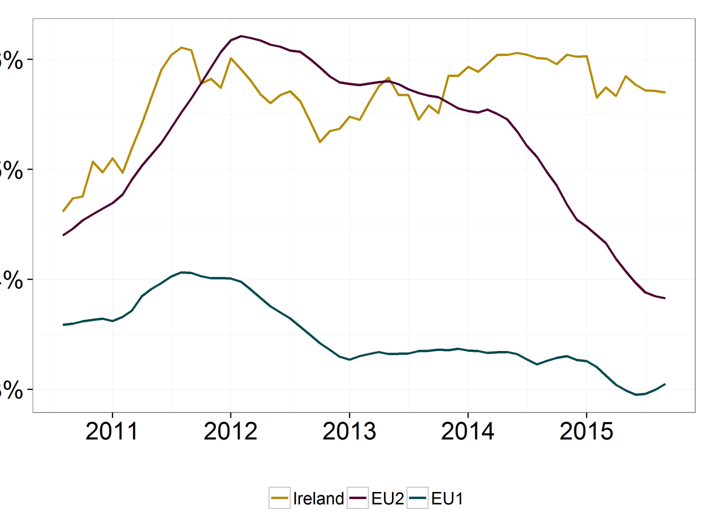


Figure 33 presents the trend in interest rates on NFC loans below €0.25 million (our proxy for SME lending).[23] These data are presented for Ireland and, for consistency with Section 4, two sets of euro area countries – EU1 and EU2 (see Appendix 2 for country groupings). Prior to 2014, rates in Ireland and EU2 were similar, but above EU1. Since the start of 2014, rates in EU2 have declined while they have remained at close to 6% in Ireland. A slight decrease in interest rates is observed in Ireland since the start of 2015.

Figure 33. Interest rates on NFC loans under €0.25 million (3-month moving average), euro area, August 2010 - September 2015



[22] In this section, interest rates and lending volumes are for 'new business' lending to NFCs. This data excludes revolving loans and overdrafts, convenience and extended credit card debt. 'New business' is defined as any new agreement between the customer and the credit institution. This agreement covers all financial contracts that specify, for the first time, the interest rate of the loan, including any renegotiation of existing loans.

[23] This figure is created by first calculating the three-month moving average in each country. For the comparison country groupings (EU1 and EU2), a direct unweighted average is then used. This figure excludes Belgium and Greece due to missing data.

Figure 34. Difference between interest rates on small and large NFC loans (3-month moving average), August 2010 - September 2015

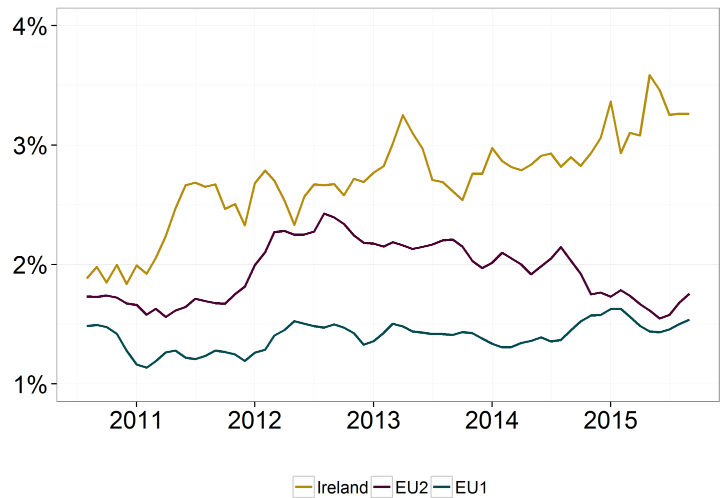


Figure 34 displays the difference in interest rates between small loans (below €0.25 million – proxy for SMEs) and large loans (above €1 million).[24] This interest rate differential is high in Ireland, and above 3% during 2015. The corresponding figure for EU1 and EU2 is around 1.5%.

Figure 35. New lending to NFCs (loans below €1 million) as a proportion of domestic demand, Q1 2003 - Q2 2015

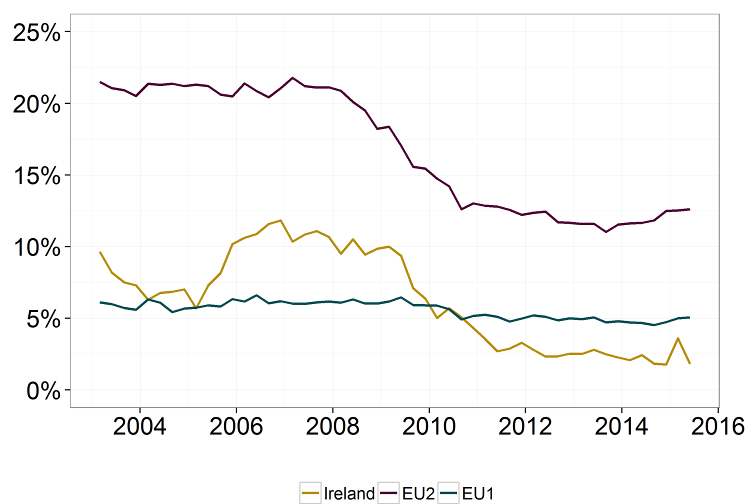


Figure 35 presents NFC lending as a proportion of domestic demand. Lending flow data are for loans on amounts up to and including €1 million.[25] The current ratio in Ireland (2.7% – average over last two quarters) is below EU1 (5%) and EU2 (12.5%). Other Member States with current ratios less than 5% include the Netherlands (3%), France (3.5%), Austria (4.1%) and Germany (4.6%).

[24]This figure is created by first calculating the three-month moving average for the two interest rate series in each country. The data presented is then the difference between these two moving averages, by month. For the comparison country groupings (EU1 and EU2), a direct unweighted average is used. These averages exclude Belgium and Greece due to missing data.

[25]This higher loan threshold is chosen as lending data for loans on amounts up to €0.25 million are not available pre-2010. Quarterly domestic demand data (final consumption expenditure and gross capital formation) are downloaded from *Eurostat* and are at current market prices and non-seasonally adjusted. Monthly new lending data are aggregated to quarterly for comparison. EU2 excludes Greece due to missing data.

Appendix 1: Data Sources

- Central Bank of Ireland *Credit, Money and Banking* statistics, Q1 2010 to Q3 2015. This source contains lending stocks and flows by quarter and sector for all Irish banks.
- Department of Finance *Red-C SME Credit Demand Survey*, October 2012 to September 2015. This nationally representative survey of 1,500 Irish SMEs is carried out on behalf of the Department of Finance on a six-monthly basis, and collects information on a range of economic and financial factors including firms' demand for credit, their success in applying for credit, their trading performance and their views on Government interventions in the SME credit market.
- European Central Bank (ECB) / European Commission (EC) *Survey on the Access to Finance of Enterprises* (SAFE), October 2012 to September 2015. The Irish component of this European survey contains information for 500 SMEs. The cross-country nature of the survey allows credit conditions faced by Irish SMEs to be placed in an international context. In this report, Ireland is compared to two groups of EU countries: EU2 is comprised of Portugal, Spain, Italy and Greece while EU1 is comprised of Austria, Germany, Belgium, Finland, The Netherlands and France.
- Central Bank of Ireland loan-level data, December 2013, June 2014, December 2014 and June 2015. This data set provides information on a wide range of loan characteristics including outstanding balances, sector of activity and loan repayment for the population of enterprise loans outstanding at Allied Irish Banks, Bank of Ireland and Permanent TSB. 'Default' is defined as loans greater than 90 days past due, or deemed unlikely to repay without giving up collateral (Basel II).
- Monthly euro area interest rates and new lending data to non-financial corporations are based on the ECB's *Monetary and Financial Statistics* (MFI interest rates). These data are for loans other than revolving loans and overdrafts, convenience and extended credit card debt (all maturities), and include renegotiations.

Appendix 2: Classification of SMEs

For the purposes of the Central Bank of Ireland aggregate statistical series and the *Red-C SME Credit Demand Survey*, an SME counterparty is defined as any entity engaged in an economic activity, irrespective of legal form (i.e. corporation, partnership, sole-trader, etc.), which employs fewer than 250 persons and whose annual turnover does not exceed €50 million or whose annual balance sheet does not exceed €43 million. This is the standard EU definition of an SME, and is consistent with that applied in the Code of Conduct on SME Lending and by the Credit Review Office.

In the SAFE survey data, SMEs are defined solely by their employment size. Three categories of SME are analysed: Micro firms, with less than 10 employees, Small firms with 10 to 49 employees, while Medium firms are those with 50 to 249 employees. All firms with more than 250 employees are considered to be Large firms and are removed from the analysis.

The Central Bank of Ireland loan-level data do not contain the relevant information on borrowing firms to define SMEs in a similar fashion. Rather, SMEs are separated from Large borrowers in the data in a manner similar to that used by the current EBA/SSM Asset Quality Review. All firms whose exposures are managed in retail and business banking units of the subject banks are modelled as SMEs, while all exposures managed in corporate banking divisions are considered to be Large firms and excluded from the analysis.