An Overview of the Enhanced Interest Rate Statistics for Ireland

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Abstract

Accurate, detailed and timely interest rate statistics are an important input into both monetary policy decision-making and domestic policy initiatives. An enhanced interest rate statistics framework was implemented in Ireland and across the eurozone at the beginning of 2015, facilitating a more precise assessment of household and NFC developments. These showed that new business mortgage rates for Ireland were significantly impacted by renegotiations. Similar trends were not evident across the euro area, reflecting the structural differences in euro area mortgage markets. In terms of new business NFC loans, the impact of renegotiations on the corresponding Irish interest rates series was negligible. Furthermore, the latest data for Ireland highlight a shift from floating rate to fixed rate mortgages, which have recently begun to offer lower rates. New data for SMEs show significant differences in rates applied to different types of economic activity. In general, new business rates to SMEs are elevated when compared to rates on existing loans. The new series indicate that rates in Ireland are generally higher than euro area equivalents for both household and SME loans.

1 The authors are an Economist and a MIR compilation expert in the Statistics Division of the Central Bank of Ireland. The views expressed are solely those of the authors and are not necessarily those held by the Central Bank of Ireland or the European System of Central Banks. The authors would like to thank their colleagues in the Central Bank for their respective contributions to this paper.

Introduction

The Monetary Financial Institution Interest Rate (MIR) statistics represent a harmonised framework for collecting data on the interest rates applied to loans and deposits vis-à-vis households and non-financial corporations (NFCs) across the euro area. This harmonised dataset has been compiled by national central banks (NCBs) across the eurozone since 2003. Timely and accurate MIR statistics facilitate both a more complete assessment of the impact of monetary policy on the overall macroeconomy and the analysis of the monetary transmission mechanism. MIR statistics can also be utilised to facilitate comparisons across countries and to support analysis of the domestic financial system.

In January 2015, a revised ECB MIR regulation[2] came into effect, encompassing a number of enhancements to the existing MIR framework. The changes to the MIR framework enshrined within the revised regulation include the identification of residual loan maturities and the proportion of renegotiations present in 'new business' MIR loan cohorts. In addition, the representativeness of the sample of entities reporting Irish MIR data has been improved. Along with the implementation of these mandatory ECB requirements in January 2015, the Central Bank of Ireland introduced a number of domestically orientated improvements. For the first time, interest rates relating to new mortgages drawdown and sectoral SME lending rates have been compiled with reference to the Irish market.

This article outlines the key enhancements to the MIR framework and highlights the additional information and insight provided by the new framework. The primary enhancements and the corresponding new data are presented for both households and NFCs over the period December 2014 – December 2015. This paper is organised as follows. Section 1, focuses on the new additions to the MIR framework, providing a description of the ECB-led improvements. In Section 2, the range of domestically orientated statistical enhancements, outside the MIR framework, are presented. Section 3 discusses the new insights provided on interest rates margin developments for both households and NFCs. Lastly, a number of conclusions are drawn.

1. Enhancements to the MIR Framework

This section describes the new items developed by the ECB in order to enhance the overall MIR framework. The introduction of the revised MIR regulation (EU) No 1072/2013 provided the platform for a number of improvements to the interest rate statistics already disseminated by the Central Bank. Broadly speaking, the ECB-led improvements enshrined in the revised regulation sought to identify the volume of outstanding loans that are due for an interest rate reset (within a predefined period going forward), and the proportion of new business that is accounted for by 'renegotiations'.

Residual Maturity

The residual maturity of both the outstanding stock of term loans and current interest rate fixation agreements are important metrics to consider when assessing the potential impact of a change in monetary policy. These new data allow users to estimate the impact of a change in the benchmark interest rate (i.e. the Main Refinancing Operations rate) on interest repayments. All loans subject to a floating or short-term fixation agreement, as well as loans approaching the end of a longer-term fixation agreement are impacted by changes in the benchmark rate. The new series provides information on the quantum of loans impacted by a change in benchmark rates over the next 12 months. For Ireland, this applies to over 90 per cent of outstanding mortgages, given the historic dominance of floating rate products in the domestic market. The situation is much different across some other euro area countries (Box B, Chart 2) where fixed rates are more prevalent. As part of the enhanced

2 (EU) No 1072/2013 - www.ecb.europa.eu/ecb/legal/pdf/en_l_29720131107en00510072.pdf

Box A: The Composition of 'New Business' MIR Data

MIR statistics are collected on the volumes and corresponding interest rates for both outstanding amounts and new business with respect to loans and deposits vis-à-vis households and NFCs. For retail interest rate statistics purposes, 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 deposit or loan, including any renegotiation of existing deposits and loans. Automatic renewals of existing contracts, which occur without any involvement by the customer, are not included in new business. The rationale for the MIR new business series is, therefore, to capture interest rate changes for all transactions within each instrument category. This approach is adopted by the ECB in order to optimise MIR data for the purpose of monitoring the impact of monetary policy in the euro area.

Notwithstanding the precise definitions applicable to the MIR framework, there has been some confusion among users in the interpretation of the data. One example has been a tendency to interpret new business series as actual new business drawn down, instead of all new interest rate agreements in a specific period. In addition, the MIR instrument category pertaining to new household loans for house purchase with 'floating rates and up to 1 year initial rate fixation' is often mistaken to represent new mortgages with a standard variable rate (SVR). Definitional issues of this nature highlight the need to identify why MIR rates may differ from headline mortgage rates and from actual new lending volumes. The reasons for these differences include:

- New household loans for house purchase include 'renegotiated' contracts which increases the volume of new business above the level of actual new mortgages drawn down.
- In the MIR framework, loans to households for house purchase are defined as being '*… for the purpose of investing in housing, including building and home improvements*'. This includes home improvement loans in addition to mortgages issued.
- Interest rates negotiated between customers and issuing institutions may differ from broader rates typically advertised by credit institutions.
- The MIR instrument category combines floating and 1 year fixed rates, in order to facilitate international comparisons. SVR rates, which are predominant in Ireland, are not explicitly identified in the MIR framework.

MIR framework, residual maturity data is now collected in relation to loans for both households and NFCs.

Renegotiations

The MIR framework is designed to capture interest rates applicable to all 'agreed contracts' between banks and borrowers. This definition includes contracts which may not translate into actual new lending, as well as renegotiations of existing contracts. Such an approach allows the ECB to base monetary policy decisions on the widest possible coverage of lending and deposit transactions within euro area retail banks. The composition of MIR 'new business' instrument categories is further elaborated in Box A.

The revised MIR regulation requires that 'new business' volumes and interest rates are reported separately for renegotiated loans. These new data allow for the calculation of gross new lending or actual new drawdowns, exclusive of renegotiations. Gross new lending[3] can, therefore, be derived simply by subtracting renegotiations from the existing MIR new business categories. Renegotiations can occur for a variety of reasons including borrower's renegotiations for a lower rate, or such as mortgage switching from a variable to fixed interest rate contract.

It is also worth noting that 'bad loans' and loans for debt restructuring 'below market conditions' are excluded from MIR data. Bad loans and renegotiations 'below market conditions' do not reflect demand and supply conditions in the market at the time of the agreed contract.[4] However, some renegotiations arise in circumstances where the borrower has repayment difficulties, but the loan is not classified as a 'bad loan'. These are included within MIR renegotiations.

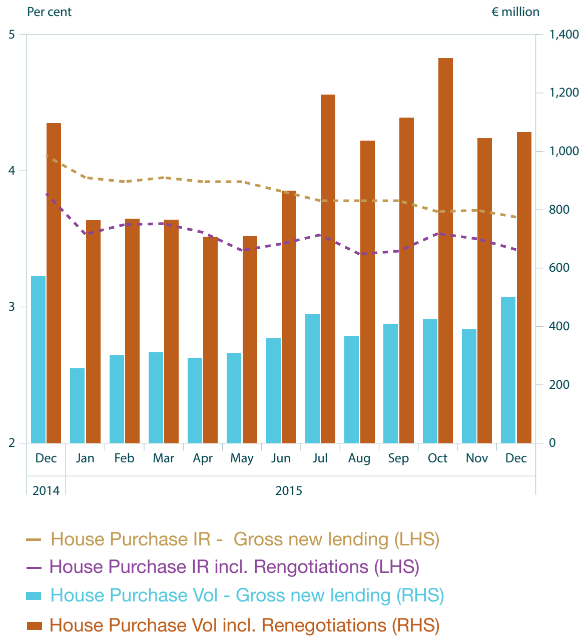
1.1 Households

Gross New Lending

Gross new lending volumes, as defined in the enhanced MIR framework, and their corresponding interest rates provide a more accurate estimate of the actual new credit contracts agreed by the household and NFC sectors in a given period. The separate identification of renegotiated contracts facilitates this breakdown, as well as allowing users to understand the impact of renegotiations on the existing MIR series.

Chart 1 illustrates the impact of renegotiations on the weighted average of all new business household loans for house purchase in Ireland. The volume of renegotiations present in the aggregated MIR series is pronounced. For instance, at end-December 2015, gross new lending volumes were circa €565 million lower than the existing new business MIR series once renegotiations were excluded. Furthermore, as previously described, the presence of renegotiated loans in Ireland's data has the effect of lowering the corresponding weighted average interest rate. In the example in Chart 1, the weighted average interest rate on loans to households for house purchase falls by 33 basis points on average when renegotiations were included.

Chart 1: Ireland: Household Loans for House Purchase - Gross New Lending



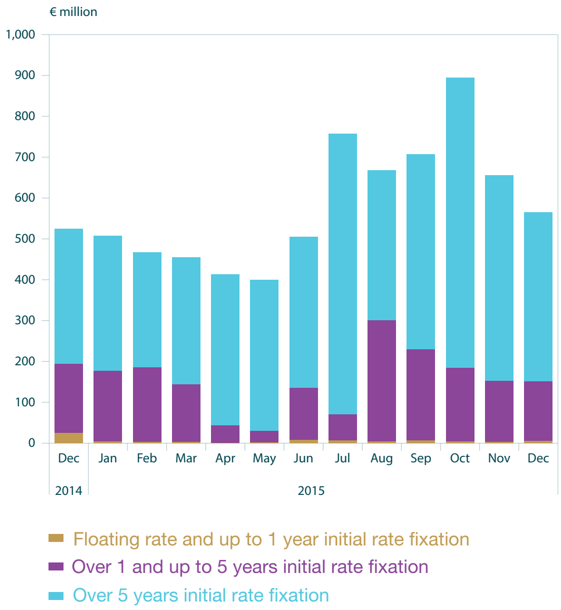
Source: MIR Statisics, Central Bank of Ireland.

The high volume of renegotiated new business loans to households may reflect a combination of both normal market activity and financial fragility in the sector. The new data series show high levels of renegotiations for Ireland during 2015. A high volume of renegotiations has the effect of lowering the overall interest rate for a given MIR instrument category as they indicate a movement to more favourable terms. While some renegotiations, particularly in earlier years, may reflect repayment difficulties on behalf of the borrower, this does not appear to be true for the period December 2014 – December 2015. Over this period, renegotiations appear to largely reflect normal market activity, such as mortgage switching or moving from a variable to fixed interest rate contract. The data does not allow us, however, to distinguish between renegotiations that

3 This paper uses the term 'Gross New Lending' to denote the difference between existing new business MIR categories and the corresponding 'renegotiations'.

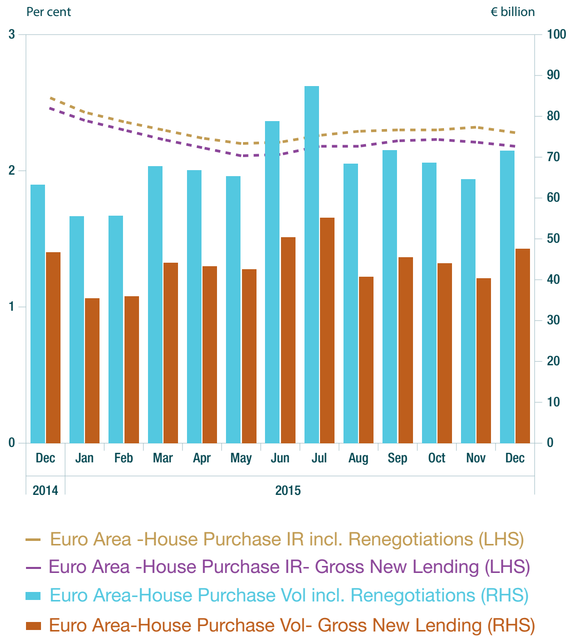
4 'Bad loans' are defined in accordance with Annex II to Regulation (EU) No 1071/2013 (ECB/2013/33). A loan below market conditions reflects interest rates that would not be offered to a similar customer seeking a new loan.

Chart 2: Ireland: Volume of Renegotiations - Household Loans for House Purchase



Source: MIR Statisics, Central Bank of Ireland.

Chart 3: Euro Area: Household Loans for House Purchase - Gross New Lending



Source: MIR Statistics, European Central Bank & Central Bank of Ireland.

reflect financial fragility of the borrower and normal market activity.

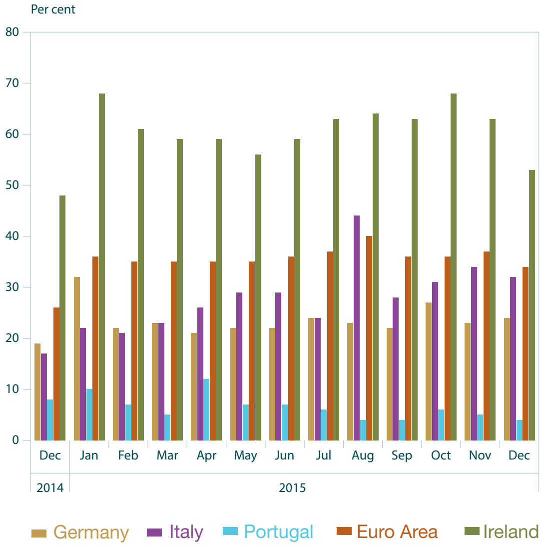
New product offerings from domestic banks may also entice existing SVR holders to switch to more favourable fixed rates. These interest rate offers may result in an increase in the volume of normal market activity renegotiations,[5] which feed directly into the MIR series. Switching is becoming increasingly common in the Irish market, as the pricing of fixed rate mortgages has fallen relative to the equivalent SVR products during 2015 (see Table 1). While it is reasonable to conclude that some portion of the heightened volume of Irish household loan renegotiations may be attributable to the financial fragility of the sector, the available evidence suggests that a large proportion of these renegotiated contracts may be reflective of normal market activity.

Chart 2 provides a breakdown of new business household renegotiations by the initial type of interest rate fixation. Renegotiated loans to Irish households are predominately fixed rate mortgage products, comprising both 1-5 years fixed and over 5 years fixed contracts. This would confirm that renegotiations in Ireland appear to be driven by households' shifting preference for fixed rate mortgage products throughout 2015.

In contrast, for the euro area as a whole, the proportion of household loans for house purchase accounted for by renegotiations is less pronounced (Chart 3). Accordingly, the impact of lower levels of renegotiated contracts on the related weighted average interest rate series is significantly less. At end-December 2015, the gross new lending interest rate for household loans is just nine basis points lower than the equivalent MIR rate, emphasising the heightened impact of renegotiations in Ireland.

5 Examples of new product offers include (1) Bank of Ireland cuts to fixed mortgage rates to new and existing customers (Link to press release). (2) Permanent TSB offer to existing SVR holders to switch (Link to press release).

Chart 4: Renegotiations as a Percentage of Total Household Loans for House Purchase - Euro Area Comparison[6]



Source: MIR Statistics, European Central Bank & Central Bank of Ireland.

The high volume of renegotiated contracts in the Irish market potentially increases the degree to which weighted average interest rates in the MIR framework may be lower than actual rates available from high street banks. Chart 4 compares the level of renegotiated household loan contracts in both Ireland and a number of other euro area countries. Over the twelve months to December 2015, renegotiations averaged 61 per cent of all new loans to households for house purchase in Ireland. In contrast, the proportion of renegotiated loans in the euro area averaged just 36 per cent, over the same period. During 2015, the ratio of renegotiations in euro area countries such as Germany and Italy averaged 24 and 29 per cent, respectively. Portugal, however, recorded a much lower proportion of renegotiations, averaging approximately 12 per cent over the course of 2015. Some of the differences between countries may be explained by different national market structures – this is further explored in Box B.

Box B: Ireland and the Euro Area - Comparing MIR Statistics

One of the primary benefits of a harmonised statistical framework in the euro area is the ability to conduct cross-country comparisons vis-à-vis interest rate developments. However, it is evident that a range of structural differences across the euro area has led to national differences in the MIR framework. This Box elaborates on some of these national structural differences.

Underlying Reasons for National Differences in MIR Series

Following the creation of a harmonised MIR statistical framework, one might have expected credit institutions with the same monetary environment and broadly similar wholesale funding market conditions to converge in their pricing of retail banking products. However, as Chart 1 shows, retail interest rates have continued to diverge across countries in recent years. A number of factors can contribute to differences in interest rates charged to households and NFCs:

- Credit Risk – The perceived risk of credit default has an obvious link with the pricing of retail banking products. In countries with a higher perceived risk of default, higher retail interest rates may be offered. The perceived risk of default can be influenced by developments in house prices, weakening household/NFC financial strength and the growth prospects of the wider macroeconomy.

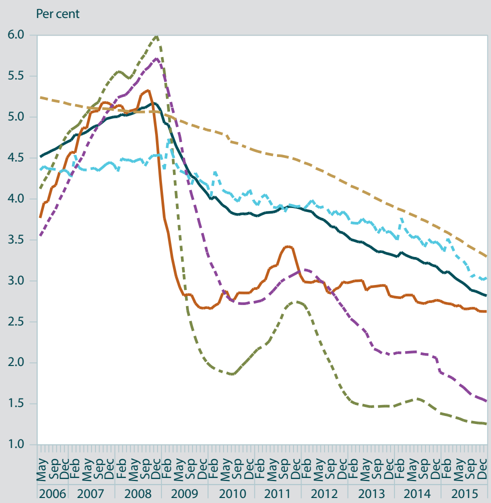
6 Confidentiality restrictions prohibit the inclusion of other euro area countries. These restrictions reflect confidentiality flags implemented by the respective national central bank.

Box B: Ireland and the Euro Area - Comparing MIR Statistics

- Market Structure – Structural differences in retail financial markets can lead to divergent interest rates. For example, some markets tend to have higher levels of loan collateralisation. The level of collateralisation can impact on the prevailing interest rate offered. In addition, different levels of competition can lead to interest rate variations across markets and affect the pass through mechanism.

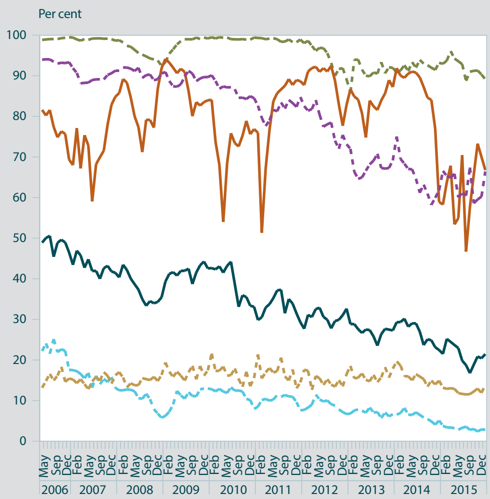
- Regulatory Framework – While great strides have been made in recent years to harmonise regulatory structures across Europe, legislation at national level can still impact retail interest rates differently. National regulations may restrict the number of times a variable interest rate can be changed annually or control the maximum rate than can be applied to customers.

Box B Chart 1: Outstanding Loans to Households for House Purchase



Source: MIR Statistics, Central Bank of Ireland.

Box B Chart 2: New Business Loans for House Purchase



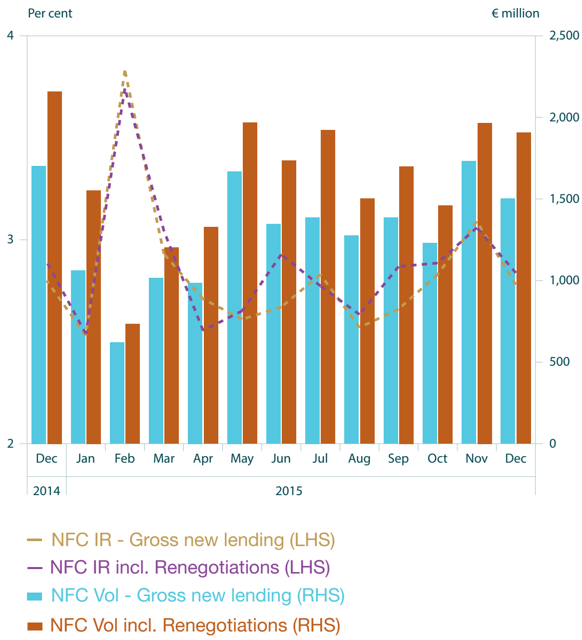
Source: MIR Statistics, Central Bank of Ireland.

Share of Fixed versus Floating Household Loans

MIR loans are categorised based on the initial period of interest rate fixation, while deposits are classified on their respective maturity length. For loans with an initial fixation period of between 1 and 5 years, some countries may have an average fixation period of just 1 year, while others might average 5 years. This variance will lead to different retail interest rates being reported within the same instrument category across eurozone countries. In Ireland, credit institutions have a large portion of loans for house purchase on variable rates[7]. For illustrative purposes, Chart 2 outlines the volume of new business loans for house purchase with a 'floating or initial fixation period of up to 1 year' as a percentage of total household loans. In Ireland and Portugal, variable or one year fixation contracts constitute a very high percentage of their mortgage market, albeit, with a notable decline in the ratio of variable rate products in Ireland from the beginning of 2015 onwards. This decline reflects the increasingly competitive fixed interest rates being offered by Irish banks in 2015. In contrast, Germany and France have a much lower proportion, as longer-term fixed-rate contracts tend to be much more prevalent. This structural difference means countries are impacted differently by movements in benchmark ECB rates, with fixed rates not affected until the end of the current fixation period.

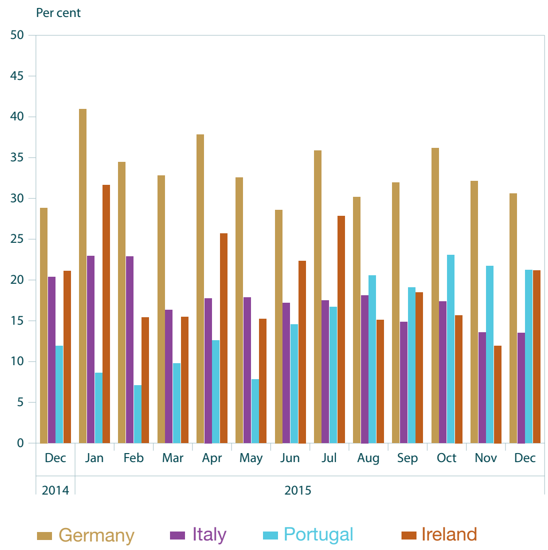
7 Variable rates, which are primarily SVRs in Ireland, are included with rates fixed for up to one year in the MIR framework.

Chart 5: Ireland: Total NFC Loans - Gross New Lending



Source: MIR Statisics, Central Bank of Ireland.

Chart 6: Renegotiations as a Percentage of Total NFC Loans - Euro Area Comparison[8]



Source: MIR Statistics, European Central Bank & the Central Bank of Ireland.

1.2 Non-Financial Corporations

Loans and deposits vis-à-vis non-financial corporations are an important element in monitoring economic activity, given their central role within the real economy. Timely and accurate data pertaining to NFC loans and interest rates, which are collected within the MIR framework, assist in such monitoring. MIR interest rate statistics in relation to NFCs are compiled on the same basis as household loans. As such, 'new business' NFC instrument categories also include renegotiated contracts. Similarly to households, the exclusion of renegotiations from new business NFC loans provides a clearer picture of actual new loan contracts, and allows for the identification of gross new lending. In addition, breakdowns by size of loan agreement to NFCs are provided with loans up to €250k regarded as a proxy for lending to SMEs.

NFC Gross New Lending

Chart 5 outlines the gross new lending (defined in the same fashion as households in Section 1.1) for total NFC loans for Ireland over the 13 months to end-December 2015. Over this period, the volumes of renegotiations (the difference between both volumes series in Chart 5) averaged just over €324 million. Total new NFC loans, including renegotiations, stood at almost €2 billion at end-December 2015. Accordingly, the relative volume of renegotiated NFC loans does not appear to be particularly pronounced, when compared to the corresponding figure for household loans for house purchase.

Renegotiated loans may decrease the weighted average MIR interest rate, as outlined for households in Section 1.1. However, in the case of NFC loans, the gross new lending interest rates are broadly similar to the existing

8 Confidentiality restrictions prohibit the inclusion of other euro area countries. As such, a series for the euro area as a whole is not available for comparison.

Table 1: New Business - Mortgage Rates (as of December 2015)

	SVR	1-3 year fixed	>3 year fixed
Principal Dwelling Houses			
Q4 2014	4.20	4.25	4.07
Q1 2015	4.13	3.93	3.92
Q2 2015	4.13	3.80	3.79
Q3 2015	3.96	3.70	3.80
Q4 2015	3.76	3.67	3.79
Buy-to-Let			
Q4 2014	5.22	5.70	6.24
Q1 2015	5.16	5.65	6.01
Q2 2015	5.09	5.35	5.11
Q3 2015	4.95	4.76	4.66
Q4 2015	4.92	4.75	5.11

Source: Central Bank of Ireland

NFC rates that include renegotiations. This implies that much of the NFC renegotiations actually undertaken may represent changes to loan terms and conditions that are in line with normal business activity. As with households, ‘bad loans’ and renegotiations below the prevailing market interest rate are excluded.

Over the 13 months to end-December 2015, renegotiated loans represented an average of 20 per cent of all NFC loans in Ireland (Chart 6). Over the same period, renegotiations represented 33 per cent of total NFC loans in Germany, while the corresponding ratios in both Italy and Portugal were 18 and 15 per cent, respectively. This shows that the Irish level of renegotiations are not significantly out of line with data on other countries, although these data are not available for all euro area countries as of yet.

2. Domestically Orientated Enhancements

In addition to the euro area wide improvements to the MIR framework, the Central Bank of Ireland introduced a number of domestically orientated improvements. These improvements involved the introduction of new interest rate series, not related to the MIR framework, for both mortgage lending and SME loans.

2.1 Households

Mortgage Lending Rates

Since December 2014, the Central Bank of Ireland has collected mortgage interest rate statistics on a quarterly basis for a range of fixed and variable maturities. Mortgage volumes and corresponding interest rates are collected in terms of ‘New Business’ and ‘Outstanding Amounts’ for both Principal Dwelling Houses (PDHs) and Buy-to-Lets (BTLs). In contrast to the MIR framework which quotes euro area harmonised rates and volumes based on agreed contracts, the new mortgage lending series references drawn down mortgage rates and volumes for Irish residents only. This important definitional distinction provides a pure mortgage series more suited to domestic analysis. While allowing for a more targeted domestically orientated analysis pertaining to the specificities of the Irish market, this series is not available for other euro area countries. Accordingly, comparisons on a harmonised basis are not possible.

The new data show that new business mortgage rates have generally trended downwards over the course of 2015 (Table 1). Standard Variable Rates (SVR)[9] for PDHs were 44 basis points lower during the fourth quarter of 2015 compared to the final quarter of 2014,

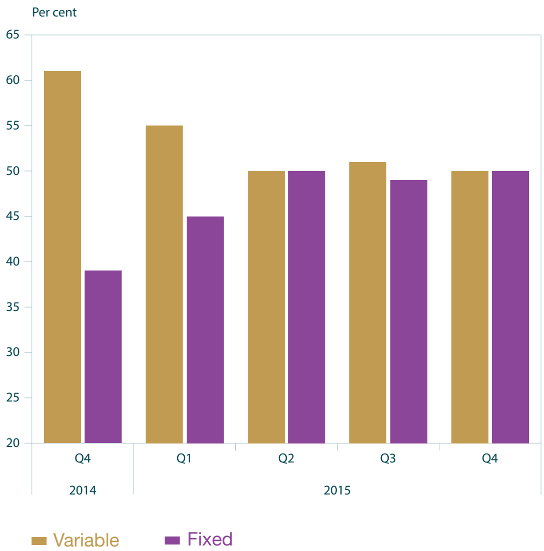
9 SVRs include Loan to Value (LTV) mortgage products.

Table 2: Outstanding Amounts - Mortgage Rates (as of December 2015)

	SVR	Tracker	1-3 year fixed	>3 year fixed
Principal Dwelling Houses				
Q4 2014	4.18	1.03	4.51	3.99
Q1 2015	4.26	1.05	4.18	4.03
Q2 2015	4.10	1.05	4.08	3.95
Q3 2015	4.07	1.07	3.93	3.86
Q4 2015	3.96	1.07	3.83	3.79
Buy-to-Let				
Q4 2014	4.53	1.09	5.33	4.62
Q1 2015	4.52	1.09	5.08	4.60
Q2 2015	4.39	1.09	4.97	4.49
Q3 2015	4.55	1.09	4.79	4.08
Q4 2015	4.61	1.1	4.68	4.29

Source: Central Bank of Ireland

Chart 7: Share of Fixed versus Variable Interest Rates for New Business Mortgages[10]



Source: Central Bank of Ireland.

having steadily declined from 4.2 per cent in the final quarter of 2014. Since the first quarter of 2015, PDH interest rates fixed for between 1-3 years have been priced below SVRs. In general, new business fixed rates have fallen below SVRs for PDH mortgage customers throughout 2015. Currently, there is no active market for tracker rate mortgages in Ireland.

Mortgage interest rates on outstanding amounts have declined for both variable and fixed rate PDH loans since Q4 2014 (Table 2). Variable PDH rates have fallen 22 basis points from the fourth quarter of 2014 to Q4 2015. Over the same period, rates fixed for 1-3 years have declined by 68 basis points. Conversely, while fixed buy-to-let interest rates have also fallen, variable BTL interest rates rose by 8 basis points over the year to December 2015. In general, the last 12 months has seen fixed rates become increasingly competitive, in terms of their pricing relative to the equivalent SVRs. Tracker rates for both PDH and BTL mortgages have remained broadly stable since the last quarter of 2014, reflecting stability in official interest rates. BTL mortgage interest rates are typically higher than the corresponding rates for PDH loans, owing to the different risk profiles for both product types.

During the last quarter of 2014, 61 per cent of all new business mortgages were variable interest rate products. However, the proportion of new business variable rate mortgages has declined significantly over the last number of quarters to end-December 2015 (Chart 7). The ratio of fixed versus variable rate mortgages has shifted to approximately 50-50 from Q2 2015 onwards. This shift in the market share of fixed rate mortgage products reflects the increasingly competitive fixed interest rates offered by domestic banks during the course of 2015.

10 References the volume of new business mortgages drawn down over the respective quarter.

Table 3: Sectoral SME Lending Rates

		Interest Rates on Outstanding Amounts - per cent per annum				
		Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
1.	Primary Industries	4.32	4.41	4.35	4.40	4.30
2.	Manufacturing	4.02	4.17	3.91	3.96	3.73
3.	Electricity, Gas, Steam and Air Conditioning Supply	4.08	4.05	4.01	3.81	3.78
4.	Water Supply, Sewerage, Waste Management and Remediation Activities	4.19	4.35	2.98	2.88	2.87
5.	Construction	3.92	4.04	3.97	4.04	3.78
6.	Wholesale/Retail Trade & Repairs	3.46	3.52	3.40	3.41	3.44
7.	Transportation and Storage	3.98	4.01	3.91	3.96	3.76
8.	Hotels and Restaurants	2.96	2.92	2.97	2.95	3.01
9.	Information and Communication	3.93	3.91	3.89	3.86	3.90
10.	Financial Intermediation (Excl. Monetary Financial Institutions)	1.30	0.97	1.09	1.08	1.13
11.	Real Estate Activities	2.57	2.46	2.55	2.52	2.59
12.	Business and Administrative Services	3.86	4.00	3.80	3.85	3.81
13.	Other Community, Social and Personal Services	3.52	3.54	3.52	3.55	3.42
14.	Education	3.88	3.93	4.05	4.12	4.16
15.	Human Health and Social Work	3.19	3.26	3.20	3.09	3.20
		Interest Rates on New Lending - per cent per annum				
		Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
1.	Primary Industries	5.52	5.45	5.16	5.09	4.94
2.	Manufacturing	4.72	4.4	4.26	4.14	4.06
3.	Electricity, Gas, Steam and Air Conditioning Supply	4.78	3.17	3.04	0.74	2.79
4.	Water Supply, Sewerage, Waste Management and Remediation Activities	–	–	–	–	–
5.	Construction	6.21	6.63	6.39	5.03	5.89
6.	Wholesale/Retail Trade & Repairs	5.28	5.01	5.31	4.88	4.64
7.	Transportation and Storage	6.4	6.21	6.26	6.02	4.38
8.	Hotels and Restaurants	4.02	4.55	4.33	4.46	4.18
9.	Information and Communication	5.62	3.85	4.87	3.54	4.19
10.	Financial Intermediation (Excl. Monetary Financial Institutions)	5.95	6.18	4.93	4.42	3.09
11.	Real Estate Activities	4.38	4.24	3.49	3.47	4.17
12.	Business and Administrative Services	5.54	5.18	5.46	4.89	5.29
13.	Other Community, Social and Personal Services	6.93	5.75	4.12	5.23	4.42
14.	Education	5.09	4.82	5.12	5.28	5.16
15.	Human Health and Social Work	5.53	5.23	4.10	3.99	4.39

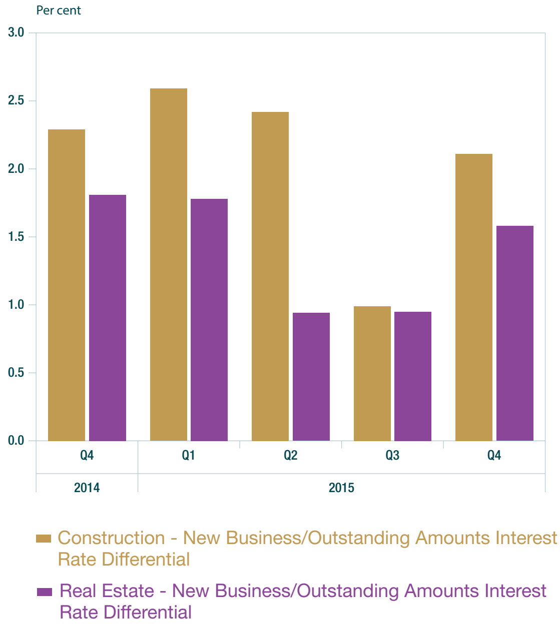
Source: Money and Banking Statistics, Central Bank of Ireland

2.2 Non-Financial Corporations

In order to provide more granular SME interest rates, sectoral SME rates have been collected since December 2014. Interest rates for fifteen broad economic sectors, such as manufacturing, construction and real estate are now compiled for both 'new business' and 'outstanding amounts'. These sectoral series are based on actual drawn down SME loans[11], and do not follow the MIR methodology, which is based on agreed contracts.

11 A Medium Sized Enterprise is any entity engaged in an economic activity, which employs fewer than 250 persons and whose annual turnover is greater than €10 million and less than or equal to €50 million or whose annual balance sheet is greater than €10 million and less than or equal to €43 million. Small enterprises are those engaged in an economic activity, which employs fewer than 50 persons and whose annual turnover or annual balance sheet is less than or equal to €10 million.

Chart 8: Real Estate & Construction: Degree to which 'New Business' SME Rates exceed 'Outstanding Amount' SME Rates



Source: Money and Banking Statistics, Central Bank of Ireland.

Sectoral SME lending rates

Interest rates applicable to small- and medium-sized entities differ from those granted to large NFCs. In addition, the sector of economic activity within which an SME operates can impact loan pricing, as the perceived level of risk can vary significantly across economic sectors (Table 3).

In terms of new business, the average interest rate applied across the 15 SME sectors covered was 4.39 per cent over the fourth quarter of 2015. However, individual SME sectors exhibited a wide range of prevailing interest rates. SME loans to the 'electricity, gas, steam and air conditioning supply' sector were just 2.79 per cent over Q4 2015, while rates to the construction sector were markedly higher at 5.89 per cent, over the same period. The sectoral distinction of SME lending rates is an important enhancement allowing for a more granular understanding of SME lending dynamics.

Chart 8 outlines the interest rate differential between 'new business' and 'outstanding amounts' for two of the largest SME sectors, i.e. the construction and real estate sectors. These sectors illustrate the variance between new business SME interest rates and those applicable to outstanding amounts. Over the five quarter period to December 2015, the SME interest rate differential between new lending and outstanding amounts for the construction sector averaged 2.08 per cent. Similarly, the corresponding differential for the real estate sector was over 1.4 per cent. In addition to a much more risk adverse approach to lending, the elevated pricing of new business SME loans may reflect the upward movement in interest rate spreads for domestic credit institutions following the financial crisis. Section 3 discusses loan-to-deposit spreads vis-à-vis households and NFCs

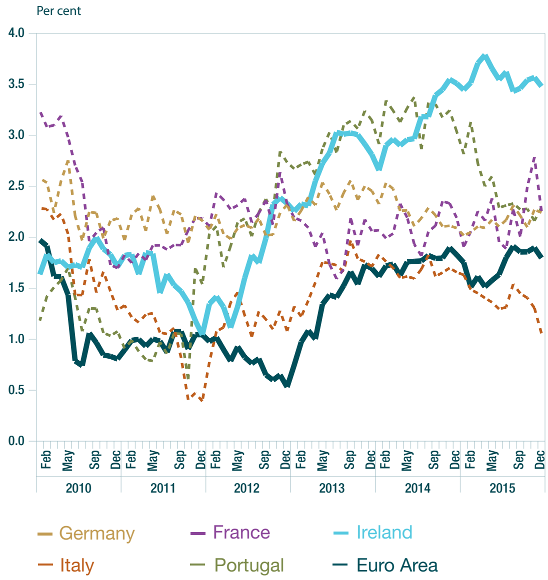
3. Loan-to-Deposit Spread Developments – Ireland and the Euro Area

3.1 Households

The loan-to-deposit spread is the difference between new business term deposits and the weighted average rate on new business loans to households for either house purchase or consumer purposes, with a floating or up to 1 year initial fixation rate. Interest rate spreads presented in this section are based on MIR data which allows cross-country comparisons on a harmonised basis.

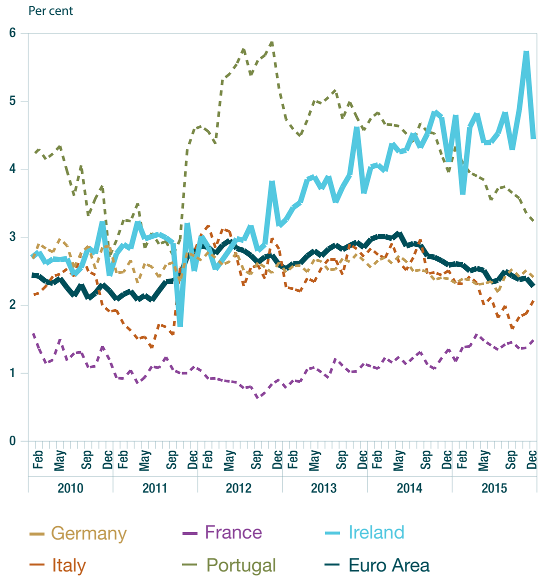
Irish new business loan-to-deposit spreads for households have increased sharply over recent years (Chart 9). Spreads have increased from circa 100 basis points at end-April 2012 to almost 379 basis points at end-April 2015. More recently, interest rate spreads have eased slightly to stand at 348 basis points at end-December 2015. Nevertheless, the loan-to-deposit spread in Ireland remains high compared to the euro area average. The elevated Irish spreads have predominately reflected a combination of downward pressure on term deposit rates combined with relatively stable pricing on loans, despite a funding environment that has seen successive reductions in benchmark ECB interest rates, such as the MRO.

Chart 9: Household Loan-to-Deposit Spread - Ireland and the Euro Area



Source: MIR Statistics, European Central Bank & the Central Bank of Ireland.

Chart 10: NFC Loan-to-Deposit Spread - Ireland and the Euro Area



Source: MIR Statistics, European Central Bank & the Central Bank of Ireland.

At end-December 2011, the loan-to-deposit spread for both Ireland and the euro area was just over one per cent, at 104 basis points. However, since that point in time, the average loan-to-deposit spread for both Ireland and the euro area have diverged significantly. From December 2011 to end-December 2015, euro area margins increased and have averaged just over 140 basis points. Over the same period, however, Irish spreads have increased sharply averaging almost 280 basis points. Chart 9 illustrates the development of interest rate spreads for a selection of euro area countries. It is evident that the loan-to-deposit spread for household loans in the Irish market is elevated when compared to other euro area countries. However, the various factors driving loan-to-deposit spread movements may vary from country to country, and these must be borne in mind when using the MIR framework for cross-country comparisons. Box B provides further insights on euro area MIR comparisons.

3.2 Non-Financial Corporations

An equivalent loan-to-deposit spread to that calculated for households is also compiled for NFCs. The loan-to-deposit spread is the difference between new business NFC term deposits and the weighted average rate on new business loans to NFCs up to €1 million, with a floating or up to 1 year initial fixation rate. In a similar fashion to the spreads observed for household loans for house purchase, Irish NFC loan-to-deposit margins are elevated relative to other euro area countries (Chart 10).

From February 2012 onwards, Irish NFC loan-to-deposit spreads began to diverge from the average euro area margin. Over the period April 2012 to end-December 2015, euro area margins averaged some 271 basis points. However, during the same period, Irish spreads grew significantly, averaging just over 396 basis points. At end-December 2015, the loan-to-deposit spread for Ireland stood at 444 basis points.

Conclusions

This article outlined the key enhancements to the existing MIR framework following the introduction of a revised ECB Regulation in 2015. During the same period, the Central Bank of Ireland also introduced a number of domestically orientated initiatives to provide new statistical series for mortgage interest rates and sectoral SME lending rates.

The 'gross new lending' series shows that the proportion of renegotiated contracts in total household loans for house purchase is significantly higher in Ireland than in the euro area. The elevated volume of household renegotiations in Ireland has resulted in lower weighted average MIR rates compared to those applicable to gross new lending.

The majority of Irish household renegotiations during 2015 are accounted for by fixed rate mortgage products, suggesting that a large proportion of renegotiated loans are due to customer switching and other regular market behaviours. In contrast, while the volume of NFC renegotiated loans is material, it does not appear to be significantly higher than other euro area countries. Furthermore, the impact of renegotiations on NFC lending rates is negligible, suggesting that actual renegotiated NFC loans are a result of normal market activity.

The new mortgage lending rates provide clear evidence of a shift from variable to fixed rate products for new household loans for housing purposes. Based on new drawdowns, there has been a general movement towards fixed rate products throughout 2015. During the fourth quarter of 2014, over 60 per cent of new business mortgages drawn down were variable interest rate products. However, since mid-2015 this ratio has shifted to circa 50 per cent.

SME lending rates have been identified for a range of economic sectors. This sectoral breakdown shows a high level of pricing disparity across economic sectors. SME interest rates varied from circa 2.8 per cent in some sectors to almost 6 per cent in others. Additionally, the SME rates illustrate a pronounced pricing difference between new business loans and those applicable to outstanding amounts. For large SME sectors such as construction and real estate, this differential amounted to approximately 2.1 and 1.4 per cent, respectively, during 2015.

Interest rate margins, defined as the difference between term deposits and applicable MIR loan rates for both households and NFCs, are an important profitability indicator for credit institutions. Spreads for domestic banks, in terms of households and NFCs, are elevated when compared to the euro area. Despite particularly low ECB benchmark rates, domestic banks lending rates have remained stable, while deposit rates have generally declined.

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Annex I

The MIR Framework

Monetary Financial Institution Interest Rate (MIR) statistics relate to euro-denominated loans and deposits vis-à-vis both households and non-financial corporations (NFCs). These rates have been collected since January 2003 in a harmonised framework across the eurozone, replacing the retail interest rate statistics previously collected by national central banks (NCBs) in a non-harmonised manner. MIR statistics are compiled on a monthly basis from data submitted to the Central Bank by resident monetary financial institutions (MFIs). The aim of MIR statistics is to produce a set of euro area interest rates on deposit and lending business that provides a comprehensive, detailed and harmonised statistical picture of the level of interest rates applied by MFIs, and their changes over time.

MIR statistics are primarily collected for the implementation of monetary policy by the European Central Bank (ECB). The provision of accurate and timely interest rate data represents an essential component of monetary policy analysis and the corresponding decision making process at a euro area level. The legal mandate for NCBs to collect MFI interest rate statistics are laid down in Regulation ECB/2001/18[12], which defines the statistical standards according to which MFIs must report their interest rate statistics. The ECB's MIR regulation is supported by the 'Manual on MFI interest rate statistics', which further clarifies the statistical requirements[13]. The collection of a harmonised set of euro area MIR statistics can be utilised for a number of purposes. Primarily, the MIR statistics are used for:

- Facilitating a more complete assessment of the impact of monetary policy on the overall macroeconomy.
- Analysing the monetary policy transmission mechanism, and particularly, the extent and speed of the interest rate pass-through between official/market rates and lending & deposit interest rates.
- Assessing the effect of interest rate movements on the cost of capital and how this influences investment and saving decisions of various economic agents.
- Monitoring structural developments in the banking and financial system arising from changes in MFI interest rates and in volumes of both lending and borrowing.

12 Regulation ECB/2001/18 was amended by Regulation ECB/2009/7, which provides for a number of improvements in respect of the reporting scheme for new loans to households and non-financial corporations. www.ecb.europa.eu/ecb/legal/date/2002/html/index.en.html?skey=ECB/2001/18.

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