

Information release

14 December 2010

Lending to Irish Small and Medium Sized Enterprises: Q1-Q3 2010

This release presents the first results of a new Central Bank series on lending to Irish small and medium sized enterprises (SMEs). Following on from the Mazars reviews, the Central Bank undertook to collect data on the level of activity in the SME lending market, with the first round of data available with reference to Q1 2010. The SME lending data introduced here will become a regular feature in a new quarterly statistical release *Trends in Business Credit* which will be available from late-Spring 2011.

The main trends evident in the data collected so far are:

- The outstanding amount of SME lending averaged €69.3 billion over the first three quarters of 2010, of which approximately €11.7 billion related to financial intermediation, €24.2 billion was with respect to the property related sectors and €33.3 billion related to the non-property non-financial, or ‘core’, sectors.
- SME loans account for approximately 28 per cent of the total amount of business credit advanced by Irish resident credit institutions, with this share rising to 62 per cent for core SME sectors.
- Over the six months ending Q3 2010, there was an underlying decline of 5.1 per cent in total SME lending, with the decline in lending to the core SME sectors being 4.5 per cent over the same period. This indicates that repayments on SME loans have been greater than draw-downs over the period.
- The underlying decline in SME lending in the six months ending Q3 2010 has been proportionately greater than the underlying decline in total business related lending over the period.

- The underlying decline in core SME lending is taking place in a context where gross new lending, i.e. the amount of new loans drawn-down by SME customers, has averaged approximately €700 million each quarter so far in 2010.

Below, the background to the new series and the definitions and methods used in compiling the data are outlined. The trends evident in the data itself are then discussed, and comparisons made with the detail previously published by Mazars. To conclude, the future plans for the SME lending series and other business credit are explained.

Background

Small and medium sized enterprises (SMEs) are a significant feature in the Irish economy, accounting for an estimated 53 per cent of total employment (Q3 2010)¹. Indigenous firms are also more likely to be found in the SME category, implying they are an important source of retained earnings domestically. Maintaining a sustainable flow of credit to SMEs has been an important feature in the various Government support mechanisms established for the domestic banking sector. The Central Bank has, therefore, commenced this series to provide an accurate and meaningful measurement of the flow of lending to Irish SMEs by resident credit institutions.

For the purpose of this series, 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.

Credit institutions report to the Central Bank, on a quarterly basis, the outstanding amount of loans issued to Irish SMEs from their offices in the State. This detail is reported by the sector of economic activity the SME customer is engaged in, alongside other details which allow the Bank to compile accurate measures of the flow of lending to SMEs. Extracting the necessary detail required in some instances significant updates to credit institutions internal management information systems, which in some cases are still ongoing, and further improvements in data quality are expected in the future. The methodology and compilation are consistent with the wider framework

¹ Central Bank estimate using data from the Quarterly National Household Survey, Q3 2010 and the Earnings and Labour Costs Survey, Q3 2010 (CSO).

used in the *Money and Banking Statistics* publish by the Central Bank². This allows for meaningful comparisons to be made between lending to SMEs and other credit advanced, such as that to large businesses and private households.

The Central Bank began collecting this data from the main retail institutions with reference to Q1 2010³. This included the five institutions that participated in the Mazars SME Lending reviews and other institutions that had the largest probability of having SME customers. From end-December 2010, the reporting requirement for SME lending will be applicable to all credit institutions resident in the State. It is not expected that this will have a significant impact on the trends discussed in this introductory note, as coverage of the SME lending market is dominated by the institutions currently reporting this data.

SME Lending by Sector of Economic Activity

The outstanding amount of loans to SME counterparties at end-Q3 2010 was just under €67.3 billion, down from €69.9 billion at end-Q2 2010 and €70.9 billion at end-Q1 2010. This figure, however, includes lending to certain financial vehicle corporations (FVCs) in the financial intermediation sector, mostly mortgage backed securitisation vehicles, whose balance sheet size brings them into the SME definition. Excluding the financial intermediation sector, SME loans outstanding amounted to approximately €55.6 billion at end-Q3, €23 billion of which was with respect to SMEs engaged in the property related sectors of construction and real estate. The outstanding amount of loans to the non-financial and non-property related SMEs, or ‘core’ SME sectors, was €32.5 billion⁴, down from €33.5 billion at end-Q2 and €34 billion at end-Q1 (Table 1).

² For details see the regular Money and Banking Statistics and the accompanying information releases and explanatory notes at http://www.centralbank.ie/sta_late_data.asp.

³ The institutions currently reporting this data are ACC Bank, Allied Irish Bank, Anglo Irish Bank, Bank of Scotland (Ireland), Danske Branch AS trading as National Irish Bank, EBS Building Society, Permanent TSB, Irish Nationwide Building Society, KBC Bank Ireland, Bank of Ireland and Ulster Bank.

⁴ This includes €2.8 billion in utilised overdraft/revolving facilities, i.e. 8.7 per cent of total. This compares with €2.6 billion at end-Q2 (7.8 per cent of total) and €2.9 billion at end-Q1 2010 (8.6 per cent of total).

Table 1: Outstanding Amount of Lending to SMEs, by Sector of Economic Activity, €m									
	Q1 2010			Q2 2010			Q3 2010		
		% Share Total	% Share Core Total		% Share Total	% Share Core Total		% Share Total	% Share Core Total
Agriculture and Forestry	4,449	6.3	13.1	4,414	6.3	13.2	4,378	6.5	13.5
Fishing	325	0.5	1.0	301	0.4	0.9	324	0.5	1.0
Mining and Quarrying	365	0.5	1.1	366	0.5	1.1	357	0.5	1.1
Manufacturing	2,495	3.5	7.3	2,409	3.4	7.2	2,382	3.5	7.3
Electricity, Gas and Water Supply	240	0.3	0.7	323	0.5	1.0	310	0.5	1.0
Construction	5,091	7.2	-	5,024	7.2	-	4,756	7.1	-
Wholesale/Retail Trade and Repairs	8,149	11.5	24.0	8,015	11.5	24.0	7,762	11.5	23.9
Hotels and Restaurants	9,127	12.9	26.8	9,151	13.1	27.3	8,703	12.9	26.8
Transport, Storage and Communications	1,702	2.4	5.0	1,656	2.4	4.9	1,567	2.3	4.8
Financial Intermediation	11,857	16.7	-	11,786	16.9	-	11,644	17.3	-
Real Estate Activities	19,909	28.1	-	19,582	28.0	-	18,382	27.3	-
Non-Real Estate Business Services	2,957	4.2	8.7	2,758	3.9	8.2	2,749	4.1	8.5
Education	270	0.4	0.8	243	0.3	0.7	256	0.4	0.8
Health	1,706	2.4	5.0	1,721	2.5	5.1	1,592	2.4	4.9
Other Community, Social and Personal Services	2,168	3.1	6.4	2,077	3.0	6.2	2,078	3.1	6.4
Unallocated	56	0.1	0.2	29	0.0	0.1	28	0.0	0.1
Total	70,867	100		69,854	100		67,270	100	
Total Core SMEs (ex property and financial sectors)	34,010	48.0	100	33,462	47.9	100	32,488	48.3	100

The hotel and restaurant sector had the largest share of core SME lending from Q1 2010 to end-Q3, averaging 27 per cent, followed by businesses in the wholesale/retail trade sector (23.9 per cent). Agriculture and forestry businesses have the third largest share of core SME lending, with loans outstanding of €4.4 billion (13.5 per cent of core SME lending) at end-Q3 2010. The remaining sectors of significance, e.g. manufacturing, transport/storage communications and non-real estate business services, have much smaller shares of core SME lending ranging from 4.8 to 8.5 per cent.

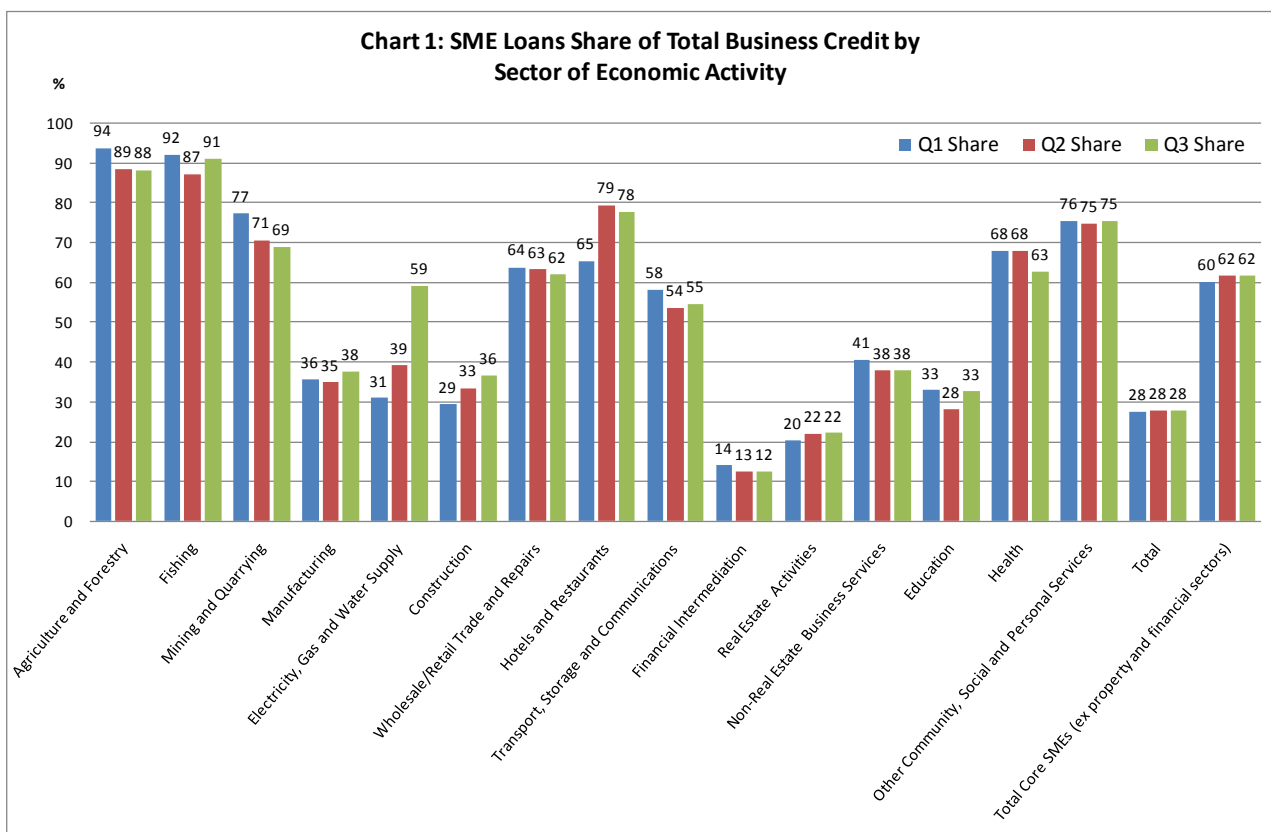
Table 2: Gross New Lending to SMEs, by Sector of Economic Activity, €m

	Q1 2010			Q2 2010			Q3 2010		
		% Share Total	% Share Core Total		% Share Total	% Share Core Total		% Share Total	% Share Core Total
Agriculture and Forestry	183	17.1	25.4	180	18.5	27.1	148	14.8	19.6
Fishing	8	0.7	1.1	7	0.7	1.0	17	1.7	2.3
Mining and Quarrying	6	0.5	0.8	3	0.3	0.5	5	0.5	0.7
Manufacturing	69	6.4	9.6	58	5.9	8.7	92	9.2	12.2
Electricity, Gas and Water Supply	8	0.7	1.1	19	2.0	2.9	2	0.2	0.3
Construction	85	7.9	-	47	4.8	-	44	4.4	-
Wholesale/Retail Trade and Repairs	118	11.0	16.4	135	13.9	20.3	146	14.6	19.3
Hotels and Restaurants	78	7.2	10.8	71	7.3	10.7	68	6.8	9.0
Transport, Storage and Communications	35	3.2	4.8	25	2.6	3.8	29	2.9	3.8
Financial Intermediation	21	2.0	-	22	2.3	-	9	0.9	-
Real Estate Activities	246	23.0	-	237	24.5	-	191	19.2	-
Non-Real Estate Business Services	117	10.9	16.3	85	8.7	12.7	122	12.2	16.2
Education	2	0.2	0.3	5	0.5	0.8	4	0.4	0.5
Health	30	2.8	4.1	31	3.2	4.7	26	2.6	3.5
Other Community, Social and Personal Services	65	6.1	9.0	45	4.6	6.8	94	9.5	12.5
Unallocated	1	0.1	0.2	0	0.0	0.0	0	0.0	0.0
Total	1,071	100		970	100		998	100	
Total Core SMEs (ex property and financial sectors)	719	67.1	100	664	68.4	100	753	75.5	100

Gross new lending⁵ to SME counterparties totalled €998 million during Q3 2010, compared with €970 million in Q2 and €1.1 billion in Q1 2010 (Table 2). New lending to the core SME sectors totalled €753 million during Q3, the highest it has been in the three quarters of SME lending data collected to date. In absolute terms, the real estate sector received the largest amount of new SME lending during the first three quarters of 2010 at €675 million (22.2 per cent of total gross new SME lending). New core SME lending over the period was concentrated in the agriculture and forestry sector (23.9 per cent of core new lending), the wholesale/retail trade sector (18.7 per cent of core new lending), non-real estate business services (15.2 per cent of core new lending) and manufacturing (10.2 per cent of core new lending). Overall, gross new lending was lower for 9 of the 15 sectors in Q3 than in Q1 2010. These quarter-on-quarter comparisons are likely to be influenced by seasonal factors.

⁵ New lending is defined in such a way as to exclude renegotiations of existing loans, which are considered as new lending in the regular money and banking data collected as part of ECB requirements. The figures given for new lending may, however, include some renegotiations at present, as not all the credit institutions currently reporting have the facility to generate this data from their existing systems. Data on gross new lending are, therefore, upper bound estimates. This measure should improve significantly in Q1 2011.

Gross new lending during Q3 accounted for 2.3 per cent of the outstanding amount of core SME lending at the end of Q2. This ratio was highest for the fisheries sector (5.7 per cent), non-real estate business services (4.4 per cent) and services to households (4.5 per cent). The share of gross new SME lending during Q3 2010 was higher for core SMEs compared with their share of the outstanding amount of total SME loans at end-Q2, as it was when comparing Q2 activity with the end-Q1 position. This suggests that efforts may be underway by some institutions to actively grow the core SME loan book. Supporting this interpretation is the finding that the share of core SME loans in the total business credit advanced to the non-property and non-financial business sectors rose in Q2 2010 to 62 per cent, from 60 per cent in the previous quarter (Chart 1) and remained at this level in Q3. Core SME loans, however, still make up a much smaller proportion of total business credit advanced of about 13 per cent.



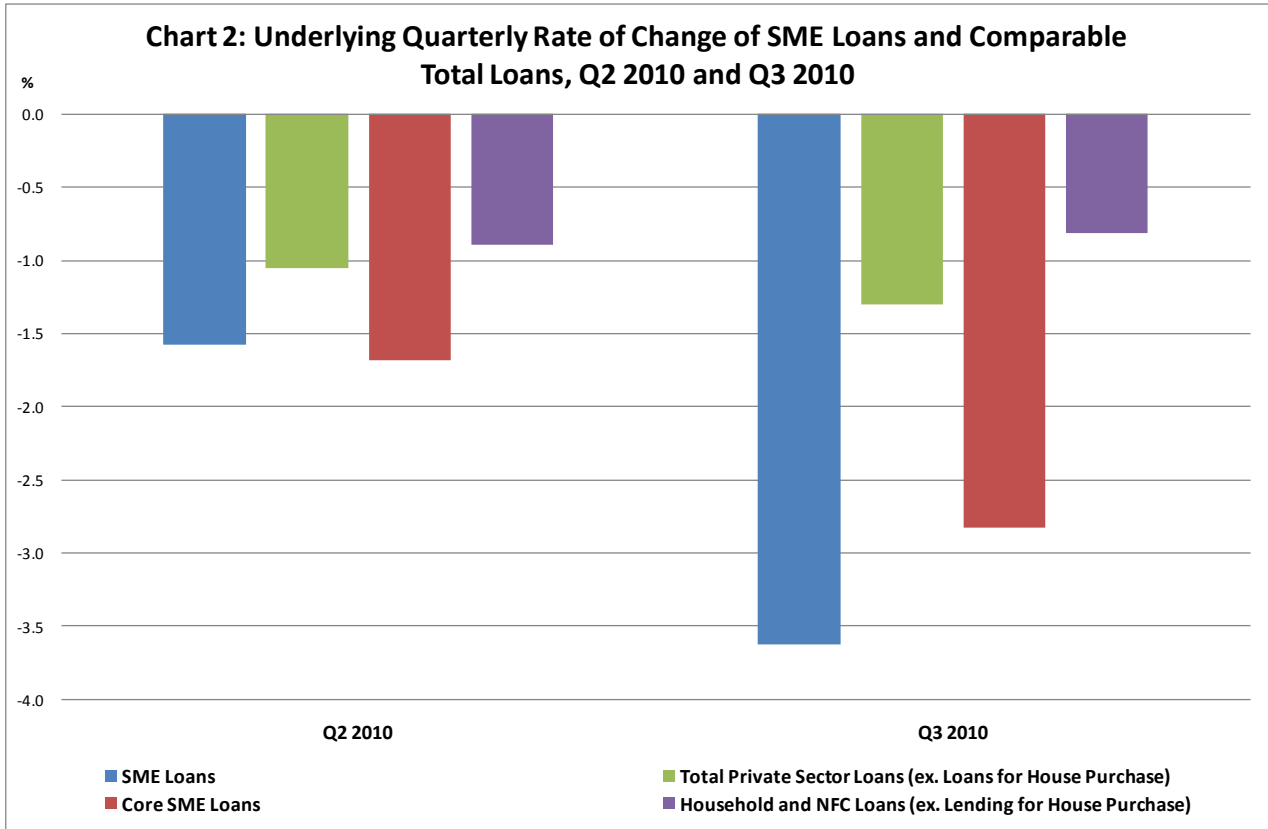
Despite the evidence that some institutions are attempting to increase their SME loan book, the underlying rate of change in SME lending was negative in the six months ending Q3 2010. The net flow of total SME lending during Q3 was minus €2.5 billion (3.8 per cent), following on from a decline of €1.1 billion during Q2 2010 (1.6 per cent). During Q3, this decline mostly related to an underlying fall in lending to the property related sectors of €1.5 billion. Core SME lending fell by

€944 million over Q3 2010, or 2.9 per cent. This compares with a quarterly decline of 1.7 per cent over Q2. These figures imply that repayments on SME loans continue to be higher than gross new lending up to end-Q3 2010 (Table 3). Most sectors witnessed underlying declines in SME lending over Q3 2010.

	Q2 2010		Q3 2010	
	€m	% Underlying growth Q-o-Q	€m	% Underlying growth Q-o-Q
Agriculture and Forestry	-27	-0.6	-40	-0.9
Fishing	-16	-4.9	24	7.3
Mining and Quarrying	-2	-0.5	-8	-2.3
Manufacturing	-91	-3.7	-49	-2.0
Electricity, Gas and Water Supply	83	34.5	-14	-4.5
Construction	-41	-0.8	-201	-4.2
Wholesale/Retail Trade and Repairs	-122	-1.5	-236	-3.0
Hotels and Restaurants	-13	-0.1	-436	-5.0
Transport, Storage and Communications	-119	-7.0	-87	-5.6
Financial Intermediation	-112	-0.9	-126	-1.1
Real Estate Activities	-389	-2.0	-1,263	-6.9
Non-Real Estate Business Services	-162	-5.5	-7	-0.3
Education	-5	-1.8	16	6.4
Health	12	0.7	-122	-7.6
Other Community, Social and Personal Services	-84	-3.9	17	0.8
Unallocated	-27	-47.7	-1	-5.2
Total	-1,115	-1.6	-2,534	-3.8
Total Core SMEs (ex property and financial sectors)	-573	-1.7	-944	-2.9

The underlying decline of 2.9 per cent in core SME loans during Q3 was proportionately greater than the underlying fall in non-mortgage household and NFC loans⁶ combined over the period (0.8 per cent) for the institutions that reported SME data (Chart 2). This pattern is even more pronounced than in Q2 2010, and implies that the SME loan book is contracting at a faster pace than the total lending advanced to other parts of the private-sector, including larger non-financial corporates.

⁶ From an institutional economic sector perspective, an SME can be in the household sector if the business is not incorporated, such as the case in sole traders or partnerships. In *Money and Banking Statistics*, these non-incorporated SME loans would be included, among other things, in the loans to households for 'other' purposes,



Comparison with Mazars Review, Q4 2009

The Mazars reports covered five of the institutions currently reporting SME data to the Central Bank. The sector definitions and the instrument definitions applied by Mazars differed slightly to that employed by the Central Bank and so direct comparisons between the last set of Mazars data (Q4 2009) and the SME lending data presented here are not straight forward. However, by excluding financial intermediation and property related sectors, some comparisons are feasible (Table 4). Mazars reported an outstanding amount of lending on this basis at end-Q4 2009 of €30.7 billion, compared with a total of €34 billion from the new Central Bank series at end-Q1 2010. The wider coverage of institutions for the Central Bank series is likely to be the most significant factor in the difference between the two series.

Table 4: Comparison of Outstanding Amount of SME lending, Mazars and Central Bank, €m

	Mazars Q4 2009	Central Bank Q1 2010
Agriculture and Forestry	4,150	4,449
Fishing	325	325
Mining and Quarrying	303	365
Manufacturing	2,630	2,495
Electricity, Gas and Water Supply	279	240
Construction	1,249	5,091
<i>excluding speculative and construction activities carried out on contract</i>		1,204
Wholesale/Retail Trade and Repairs	6,954	8,149
Hotels and Restaurants	7,327	9,127
Transport, Storage and Communications	1,512	1,702
Financial Intermediation*	348	11,857
Real Estate, Renting and Business	3,816	19,909
<i>excluding real estate activities</i>		2,957
Education		270
Health*	1,472	1,706
Other Community, Social and Personal Services*	1,915	2,168
Total	32,280	70,867
Total (excluding Financial Intermediation and Property Related)	30,683	34,010

*Definition used by Mazars differs significantly from that used by the Central Bank.

Source: Mazars Review of Lending to SMEs, Q4 2009. Central Bank of Ireland

In terms of new lending during the quarter, Mazars reported total credit draw-downs of €1,069 million by SMEs during Q4 2009. This compares with new lending to SMEs of €719 million during Q1 2010 as reported to the Central Bank. Seasonal factors as well as certain definitional factors, particularly in relation to re-negotiations, may explain some of the difference in new business activity between Q4 2009 and Q1 2010.

Conclusion

Accurate and comprehensive data on lending to SMEs in Ireland is necessary given their importance to the domestic economy. The Central Bank is proactively addressing this issue by providing the series introduced in this release and, importantly, placing it in the wider domestic money and banking statistical framework so that meaningful trends can be analysed. The data on SME lending will become a key part of a new quarterly statistical release, *Trends in Business Credit*, which will be published for the first time by end-Spring 2011. *Trends in Business Credit*

will replace the current quarterly release *Developments in Private-Sector Credit by Sector of Economic Activity*. The new data release will present data on credit advanced to all enterprises by sector of activity based on NACE Rev. 2⁷. This release will also be more comparable with the monthly *Money and Banking Statistics*.

The brief overview of the SME lending data for Q1 to Q3 2010 presented here has shown that, similar to total credit, SME lending has been contracting in recent months. This is despite evidence that some credit institutions may be actively trying to grow their SME loan book for particular business sectors. The decline in SME lending has, however, been more pronounced to date in 2010 than the total decline in non-housing related household and NFC loans.

⁷ NACE Rev 2 is the official statistical classification of economic activities in the European Community, which is maintained by Eurostat. Details are available at http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-RA-07-015/EN/KS-RA-07-015-EN.PDF