

Irish Household Finances Survey 2007

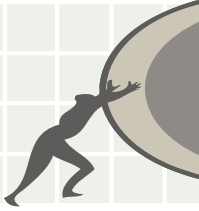


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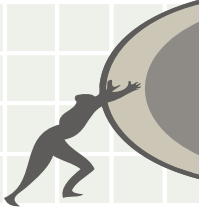
David Duffy

**Preliminary findings of a survey-based
assessment of the burden of personal
debt in Ireland.**



MAIN FINDINGS

- ▶ While higher interest rates have inflicted some pain on Irish consumers, there is no evidence of a sharp deterioration in their debt burden in the past year.
- ▶ Strong growth in after tax incomes and the increase in mortgage interest relief likely limited the damage from larger monthly loan repayments.
- ▶ Irish borrowers continue to be far more cautious in relation to debt than their UK counterparts in spite of notably lower interest rates and faster income growth on this side of the Irish Sea.
- ▶ Very recent mortgage borrowers (post 2003) don't appear to be under greater strain than more 'mature' borrowers. This may reflect a greater expectation of tough financial circumstances in the early years of a mortgage on their part as well as a smaller than expected easing in the burden faced by 'older' mortgage holders.
- ▶ Not surprisingly, borrowers with both mortgage and non-mortgage debt face a notably heavier burden than others.
- ▶ 98 per cent of Irish households are managing their current borrowing without substantial concerns.
- ▶ The rise in consumer debt in recent years needs to be seen in context of a substantial rise in the wealth of the average Irish household.
- ▶ At end 2007 Irish households are expected to owe roughly €200 billion but they also hold over €330 bio of financial assets and have houses worth an estimated €630 bio.



Introduction

Higher interest rates, concerns about the housing market and increased uncertainty about the broader Irish economy have prompted an increased focus on the financial well-being of Irish households of late. While it is commonplace for headlines to proclaim a troublesome and/or unanticipated build-up of debt related problems for Irish consumers, there remains relatively little economic research into the nature or extent of such difficulties.

In an effort to shed some light on this topic IIB Homeloans and the ESRI have conducted annual surveys on household debt in 2005, 2006 and 2007. The approach adopted owes much to broadly similar surveys of UK household finances carried out on behalf of the Bank of England. The 2007 survey of Irish Household Finances was conducted in the first half of July, roughly 15 months after its 2006 counterpart. The survey was conducted using telephone interviews with a representative sample of 750 Irish adults.

It must be recognised that surveys of this nature are unlikely to capture the full extent of difficulties that may be suffered by individual borrowers. However, by using a representative sample we can hope to assess the extent to which such problems might be prevalent across the Irish economy. In other words, we may arrive at a means to assess whether media concerns regarding debt problems relate to specific individual circumstances (what might be described in statistical terms as 'tail events') or alternatively, such reports might reflect widespread problems that carry significant macroeconomic threats.

Once again we must begin this analysis by emphasising that it should not be regarded as particularly earth shattering news that many consumers view their debts in a negative light. If asked about virtually any other significant aspect of household outgoings, one would expect the majority of consumers to indicate that paying for those goods and services places at least some

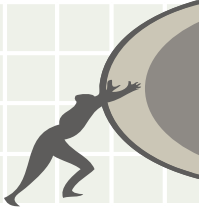
burden on their household finances. So, it is entirely predictable that repaying debt will not be seen in a particularly favourable light. This caveat must be highlighted because this survey didn't ask consumers to make any association between the benefits to households arising from goods and services purchased with the assistance of debt. The real significance of this sort of survey lies in a capacity to make comparisons with the experience of other countries and/or previous years. Such comparisons may make it possible to identify emerging changes in the burden of debt that could have implications for a significant group of consumers or even for the Irish economy as a whole.

Section I: Does non-mortgage debt hint at increasing pain or progress?

The 2007 study follows the approach of previous years and separates the treatment of mortgage and non-mortgage debt. This is because the relevant interest rates and borrowing periods are likely to be very different. In addition, mortgage debt is closely related to the purchase of what is, for most consumers, their major asset. So, it is likely to be seen in a different light to non-mortgage debt. Finally, it could also be argued that in certain circumstances, non-mortgage debt may reflect a need to finance an unanticipated shortfall in spending power. So, in some instances it might signal emerging difficulties in household finances.

Non-mortgage debt is relatively small in comparison for mortgage debt in Ireland. Central Bank data indicate that roughly 85% of Bank lending to the household sector relates to mortgage debt. Central Statistics Office figures, that also include consumers' financial transactions with non-bank institutions such as credit unions and hire purchase companies, suggest the mortgage portion of debt, while still dominant, is at around 70 per cent of total household debt.

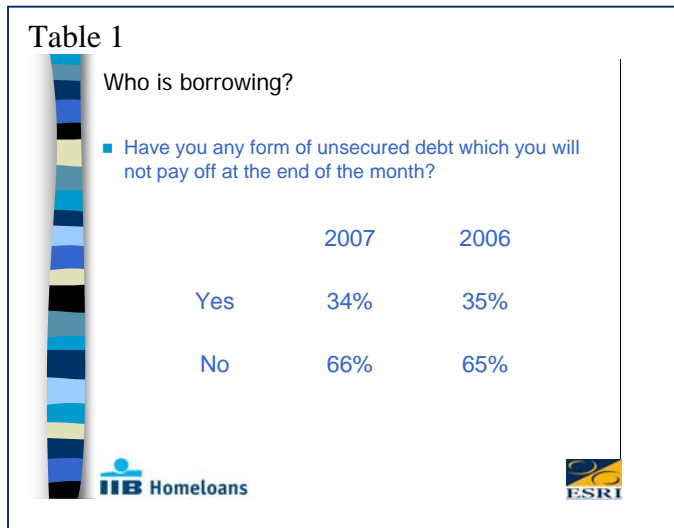
If debt problems were deteriorating markedly, one might expect a significant increase in



numbers regularly running into debt. Instead, the data in Table 1 below suggest a marginal easing in the number of consumers accessing non-mortgage debt between 2007 and 2006. At least in part, this likely reflects a rational response to rising borrowing costs in the interim. At the margin, it might also reflect the recent maturity of SSIA's which could have facilitated some paydown of previous debts. What we can say is that the 2007 data do not suggest that an increasing number of Irish consumers are regularly running into debt. These results contrast with those emerging from a similar UK survey which hints at a greater incidence of debt in that country in the past twelve months. One explanation for different outcomes in the two surveys might be notably faster employment and income growth in the Irish economy than in its UK counterpart.

able to dig a little deeper below the 'macro' surface to allow a fuller picture to emerge of broad trends in consumer borrowing across the Irish economy. These trends are discussed below.

It might have been expected that Irish borrowers would have become a good deal more concerned about their outstanding debt in the period between the 2006 and 2007 surveys. This is because of the increase in debt and, perhaps more importantly, because of the increased burden of financing this debt that follows from almost relentless upward pressure on interest rates between the Spring of 2006 and the Summer of 2007. During this period, the key ECB interest rate rose from 2.5% to 4.00%. However, the rise in Irish retail interest rates has been more modest with the cost of non-mortgage credit for periods up to 5 years rising between 55-65 basis points.



Irish consumers reported that the average annualised increase in their non-mortgage debt was just under 13% between 2006 and 2007. When account is taken of a slight reduction in numbers in debt, this result corresponds is entirely consistent with the 11% annual increase in non-housing finance to the personal sector reported in Central Bank sectoral lending data for June 2007. With economy-wide after-tax incomes expected to grow by almost 10% across the Irish economy in 2007, this scale of increase in non-mortgage debt does not seem outlandish. That said, these aggregate data could conceal substantial differences in the experiences of individual borrowers. Fortunately, the survey is

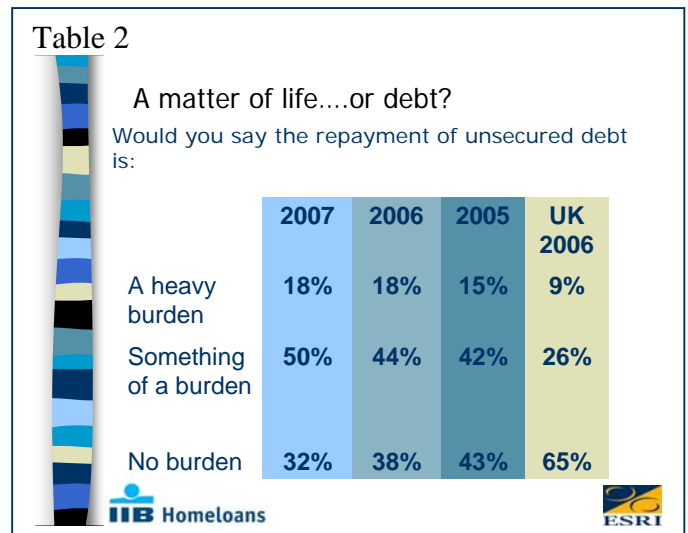
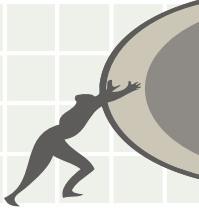


Table 2 shows Irish consumers assessment of their debt burden. Perhaps surprisingly, there has been no increase in the share reporting that the repayment of debt was putting a heavy burden on their household finances in the past year. We might expect that this group would increase as a proportion of population of borrowers because of higher repayments even if there had not been a marked worsening of the debt climate. On this basis, the 2007 results suggests that rising interest rates have not prompted a major deterioration in the borrowing



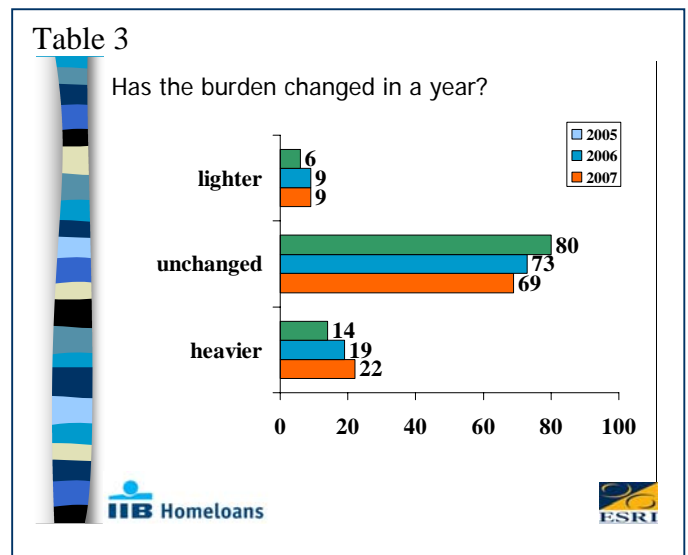
burden in the past year and a half. As well as the smaller increase in retail borrowing rates than in ECB rates we think there are several reasons why more consumers did not report a sharp deterioration. We reckon that strong growth in after-tax incomes together with a substantial rise in mortgage interest relief and the maturity of SSIs combined to substantially offset the impact of higher interest rates. These positive counterweights prevented more borrowers from seeing a significant increase in their borrowing burden.

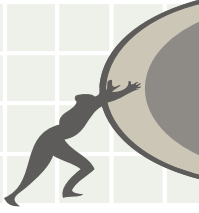
An understandable but less threatening development is the increase seen in the share of those indicating some burden on their household finances because of borrowing. This group rose to 50% of borrowers from 44% in 2006 and there was a corresponding reduction in the proportion of those entirely untroubled by their debt financing obligations to 32% from 38% last year. Although this group would have benefited from the positive influences described above, the reality of increased monthly loan repayments could well have caused some increase in numbers feeling a modest pinch from higher interest rates. In summary, these results provide no indication of a sharp deterioration in the debt climate among Irish households in the past year. Instead, they suggest the bulk of Irish consumers have felt some squeeze on their finances from higher interest rates and an increased level of debt. However, a number of influences seem to have limited any deterioration.

As has been the case in previous years, a comparison of Irish and UK survey data show a wide gap in attitudes to debt. Although the incidence of debt in the UK is greater and borrowing costs notably higher, UK borrowers are notably more relaxed about the burden debt imposes on their household finances. The proportion of borrowers indicating any impact from borrowing is twice as high in Ireland as in the UK. In Ireland 2 out of 3 borrowers indicate some impact whereas 2 out of 3 British borrowers suggesting their unsecured loans are not posing them any problems. The 2007 results are broadly similar to previous surveys. In view

of stronger increases in after-tax incomes and employment in Ireland, it might be argued that such differences in attitude to debt reflect cultural rather than economic factors. Certainly, the experience of widespread and increasing levels of debt is a relatively new one for Ireland. Both its recent nature and the rapid pace of increase of late may make debt an uncomfortable issue for many Irish borrowers. As a result, it is not entirely surprising that Irish borrowers seem to take a relatively cautious attitude to debt. If this interpretation is correct, the absence of widespread feckless borrowing habits should imply fewer risks both in terms of a sharp deterioration in debt-related problems and of a broader economic downturn.

Much the same picture emerges from an analysis of responses to another question which asks how debt circumstances have changed in the past twelve months. These answers set out in Table 3 below provide some additional information to that gleaned from the question set out in Table 1. They show that some 22 per cent of consumers felt their debt burden had increased in the past year. This represents a relatively modest acceleration from the 19 per cent reporting a similar change in the 2006 survey. In the light of larger debt and higher interest rates it might have been expected that there would have been a more pronounced increase. A comparison of responses across the three year period 2005-2007 could suggest that consumers had already begun the process of adapting to higher debt and perhaps even the





prospect of rising rates as early as a year ago. It may also be the case that larger taxation changes also acted as a more significant counterweight in 2007. These responses again tend to suggest that the vast bulk of borrowers are adapting to higher interest rates without excessive difficulty. As was the case a year ago, some 9 per cent of borrowers reported a slight easing in their debt burden. Presumably, these would include a significant number of SSIA holders who may have used those funds to reduce debt.

there was a broadly offsetting reduction in debts in the €7,500 – 10,000 range. We also looked at the proportion of borrowers in each of these ranges who indicated that these debts imposed a heavy burden. Borrowings in the €5-10K ranges are seen posing more problems than in the past but borrowings above €10K appear less problematic than they were in the previous survey. This bears out the findings of OECD research that suggests larger debts tend to be concentrated among high earners who are in a better position to handle them.

Table 4

Most borrowing is reasonably modest

Debt Amount EUR	% of borrowings in this range			Share indicating a heavy burden		
	2007	2006	2005	2007	2006	2005
Under 1,000	29	25	32	6	13	5
1,000 – 2,999	15	30	24	21	21	14
3,000 – 4,999	25	14	12	12	11	7
5,000 – 7,499	14	11	15	25	20	16
7,500 – 9,999	8	13	9	19	12	17
10,000 +	10	7	9	19	31	19
	100	100	100	18	18	15

IIB Homeloans ESRI

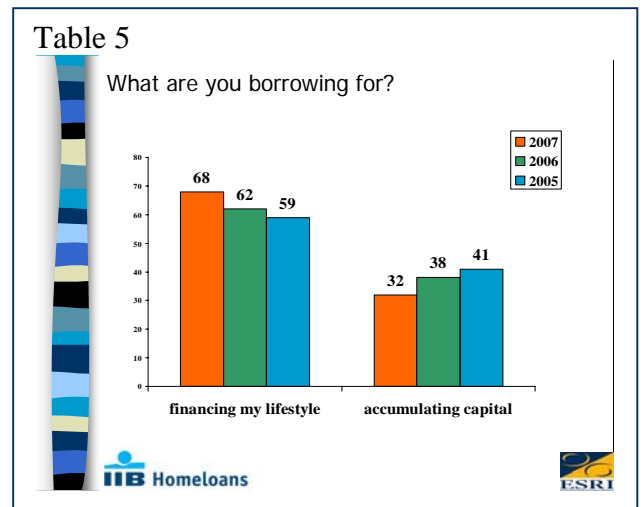
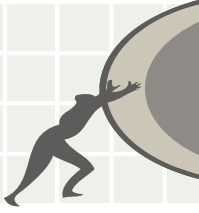


Table 4 provides one possible reason why debt concerns are not widespread. In the main, it remains the case that most borrowing is still reasonably modest. The most common debt amount reported in 2007 was under 1,000 Euro. In 2006 borrowings in the €1,000-3,000 range were more prevalent. This slight reduction may owe something to the strength of income growth in the past years. It might also be the case that these results could have been influenced by budget tax and social welfare provisions that would have had most impact on relatively low incomes. On the other hand, there was also a slight rise in the amount of debt between €3,000 and 5,000. So, the proportion of borrowings under €5,000 held broadly steady. This suggests few dramatic changes in borrowing habits have occurred in the past 12 months. At the other end of the scale there has been some increase in the proportion of borrowers with non-mortgage debt of more than €10,000. This appears to reflect a stepping-up of debt levels as

As has been the case in previous surveys, we also asked borrowers whether they were using non-mortgage debt to finance their lifestyles or to accumulate capital. As Table 5 indicates, the 2007 results show an increase in lifestyle related borrowings, which also suggests a continuing trend in this direction. In part, the 2007 survey results could reflect the fact that consumers are no longer borrowing to finance their SSIA's. However, it seems to also reflect a greater acceptance of debt as a way of life in Ireland today. In view of the scale of income growth across the Irish economy in the past year, it would be surprising if 68% of borrowers were obliged to borrow because of an unanticipated shortfall in spending power. Moreover, the evidence emerging right across the survey tends not to point towards an increased number of borrowers who have been forced to resort to debt to make good an unplanned gap between their incomes and outgoings. Instead, in many instances this result may reflect a view, that with

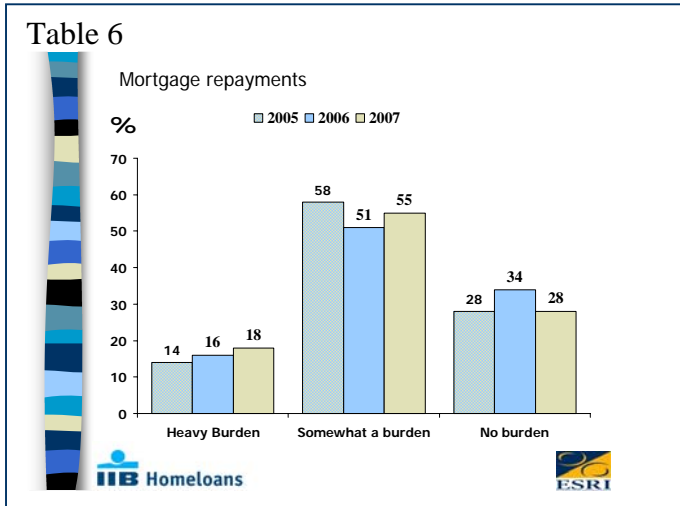


credit readily available and still affordable, that it makes sense to take on debt in exchange for greater access to goods and services now rather than in the future.

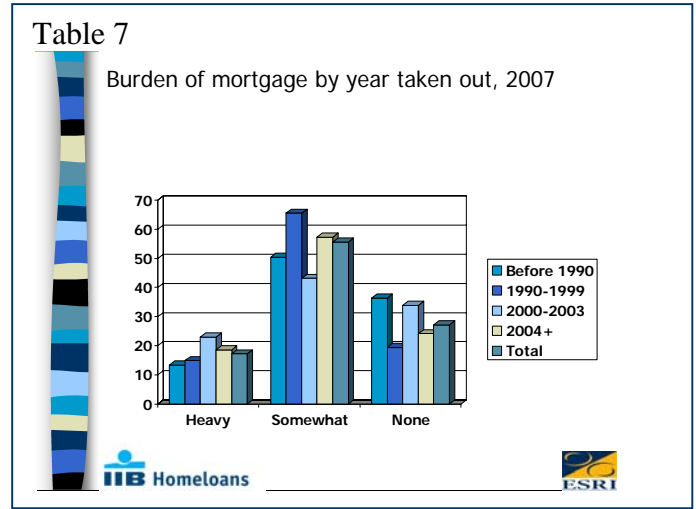
Section II: Mortgage Debt

In the 15 months between the Household Finances Survey of April 2006 and July 2007 activity in and prospects for the Irish housing market changed quite significantly. Between the two surveys ECB rates rose from 2.5 per cent to 4 per cent, with a knock-on impact on mortgage rates. The value of mortgage debt outstanding rose by 25 per cent over the period to reach €133.4 bn. Between April 2006 and February 2007 the permanent tsb/ESRI house price index shows that house prices continued to rise. Since February moderate monthly declines have been recorded.

between 40 and 49 years, 25 per cent are aged between 50 and 65 years and 4 per cent are aged over 65.

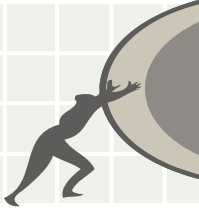


Of those that took part in the IIB Homeloans/ESRI survey, 37 per cent indicated that they had an outstanding mortgage. Many of these are relatively recent mortgages. Some 35 per cent of those with a mortgage have purchased their dwelling since 2004, 24 per cent purchased between 2000 and 2003, a further 24 per cent between 1990 and 1990, and 17 per cent purchased before 1990. The average mortgage term has risen slightly to just over 24 years (across all borrowers), compared with 23 years at the time of the last survey. Of those that have a mortgage, the majority (39 per cent) are aged 39 years or younger, 32 per cent are aged



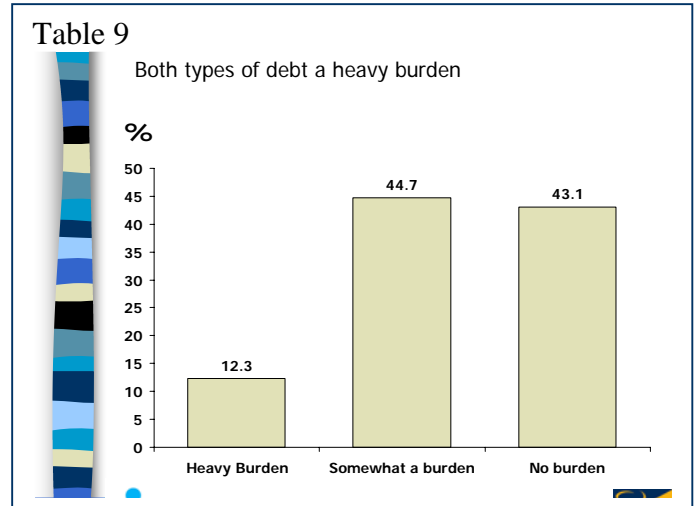
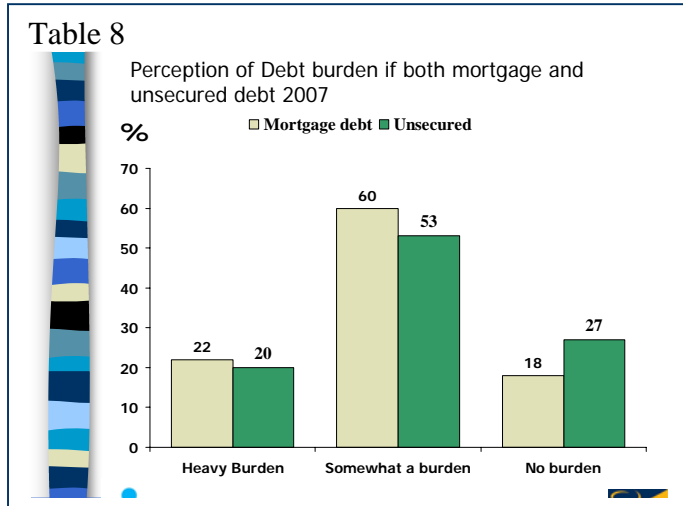
The survey also shows a shift in the distribution of mortgage repayments, with 29 per cent indicating that their monthly mortgage repayment is over €1,000. This compares to roughly 15 per cent in 2006. However, higher mortgage repayments and rising interest rates have not led to a substantial deterioration in people's perceptions of the burden of their mortgage debt. The proportion stating that the repayment of their mortgage debt is a "heavy burden" rose marginally to 18 per cent, from 16 per cent in 2006. The percentage responding that the repayment was "somewhat of a burden" rose to 55 per cent, from 51 per cent in 2006. Finally, those who find the repayment of their mortgage to be "No burden" declined to 28 per cent, from 34 per cent in 2006. These changes are not surprising given higher interest rates. As we have noted in previous Household Finance Surveys we take some comfort from these statistics as they suggest that borrowers are not complacent about their mortgage debts. Neither is there any indication of a dramatic increase in debt problems.

Those who took their mortgage out prior to 2000 are less likely to consider their mortgage repayments to be a "heavy burden". However, of the respondents to the survey it is those who took out their mortgage between 2000 and 2003



who are more likely to indicate that their mortgage repayment is a “heavy burden”, 23 per cent. While the survey did not ask why this group found their mortgage debt to be a heavy burden a possible explanation is that these would have drawn down their mortgages at a time when interest rates were falling. ECB rates were cut from 4.75 per cent in October 2000 to 2 per cent in June 2003 and thereafter remained unchanged until the end of 2005.

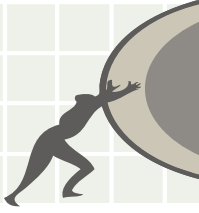
note that if the respondent has both types of debt there is a more negative perception of the burden of mortgage debt than unsecured debt. However, the pass through of ECB interest rate increases has been much greater for those with variable rate mortgages than for other forms of debt.



With regard to house price expectations the majority of respondents, some 63 per cent, expect there to be a fall in house prices over the next year, with no difference in this between those with or without a mortgage. It may also be the case that, unlike the case in the historic past, the burden of debt has not fallen quickly as a result of high inflation. So, borrowers find the payment burden does not ease markedly for some considerable time. Mortgage holders are marginally more optimistic with 20 per cent expecting house prices to increase compared to 16 per cent of those with no mortgage. However, those who find their mortgage repayment to be a “heavy burden” are more pessimistic than other mortgage holders, just over 3 out of 4 expect house prices to fall over the next 12 months. This compares to 59 per cent for those who find their mortgage repayment to be somewhat of a burden.

It is not surprising that for many borrowers the burden of debt increases if they hold both mortgage and non-mortgage debt. Borrowers with both forms are 50 per cent more likely to describe their mortgage debt as imposing a heavy burden while roughly 25 per cent more describe their non-mortgage debt in this way. However, a relatively small proportion of borrowers regard both those forms of debt as a burden. Only 12 per cent of those borrowers indicate that both mortgage and non-mortgage debt impose a heavy burden on their household finances. This equates to some 2 per cent of Irish households. So, 98 per cent of households don't feel mortgage and non-mortgage debt is posing a heavy burden. Of the 2 per cent of households facing these difficulties, roughly 1 in 3 have incomes under €40K. So, the majority have incomes above the average industrial wage. These results suggest some fears regarding the extent of debt problems in Ireland at present could be exaggerated. While many individuals may face substantial strains relating to debt, the 2007 survey results suggest these represent a very small share of borrowers. Moreover, there has been little evidence of any

Given the path of interest rates on both mortgage and unsecured debt it is interesting to



dramatic deterioration because of higher borrowing costs in the next year.

Section III: Is Debt the Means to an End?

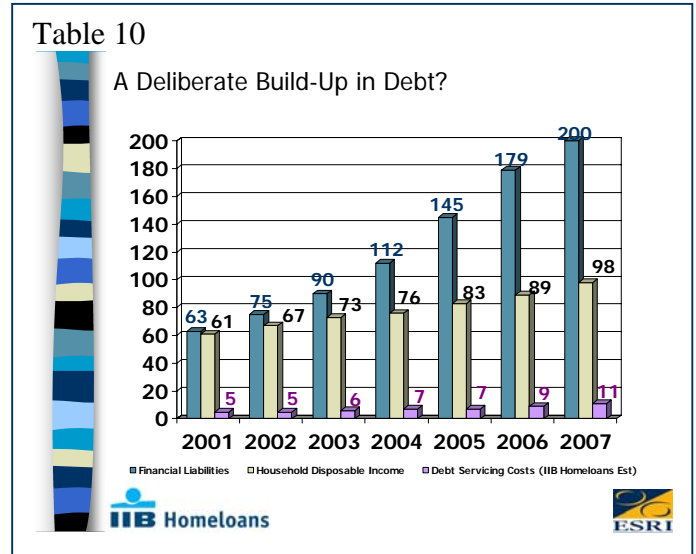
The bulk of this analysis has concerned itself with Irish borrowers' subjective assessment of their current debt burden. On the whole, we think it suggests that the vast majority of borrowers are approaching their debt in a prudent manner. For most of them, access to debt provides a planned means of increasing the range of goods and services they can consume at present. Neither the changes that have occurred between the 2006 and 2007 surveys nor a comparison with similar UK data suggest any broad based deterioration.

These findings may appear at odds with the tone of a significant amount of commentary on the debt position of Irish households. While the IIB Homeloans/ESRI survey suggests most consumers are conscious of their debt and it's implications for their household finances, it is sometimes suggested that problems are emerging for many Irish households because of reckless borrowing habits. These survey results suggest that for the vast bulk of borrowers this is not the case.

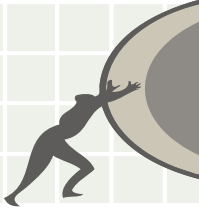
Another perspective on this issue is provided by CSO institutional accounts data which were published for the first time in April of this year. These data, provide a more comprehensive 'macro' picture by presenting a household balance sheet which shows rising household debt in the context of a substantial increase in assets. Unfortunately, these CSO data are only available up to 2005. Drawing on these official numbers, we estimate corresponding figures for 2006 and 2007 on the basis of trends in relevant indicators.

Before looking at the overall balance sheet of Irish households, we attempt to put the build-up of debt in recent years in some context. Table 10 (below) shows the financial liabilities of Irish households and our estimates of the associated servicing costs. To put some perspective on

these, we also set out the trend in household after tax income.



As Table 10 indicates, the financial liabilities of the Irish household sector are on a sharply rising trend. By the end of this year, these liabilities will have increased by more than 200 per cent since 2001. However, this has to be seen in the context of very strong growth in the economy as a whole. After tax incomes have also grown rapidly – by some 60 per cent over the same period. As consumer prices have increased by just under 24 per cent on our estimates, the average Irish household has experienced a substantial increase in their discretionary spending power. Consumers may have come to regard this as an increase in what might be termed their 'permanent' incomes, in other words they judged their long-term prospects to have improved dramatically. If this is the case it would be logical that they would adjust their spending behaviour in order to translate higher permanent income into lasting wealth. It is understandable that consumers opted to build up debt levels particularly as the cost of doing so (ie interest rates) was so low by historic standards. Indeed, it could be argued that Irish consumers were significant under-borrowed previously in view of improving incomes and the particularly young population profile. Reflecting declining interest rates between 2001 and 2003, debt servicing costs remained very subdued. So, it is not surprising that Irish households opted to increase their debt levels. Because of the more

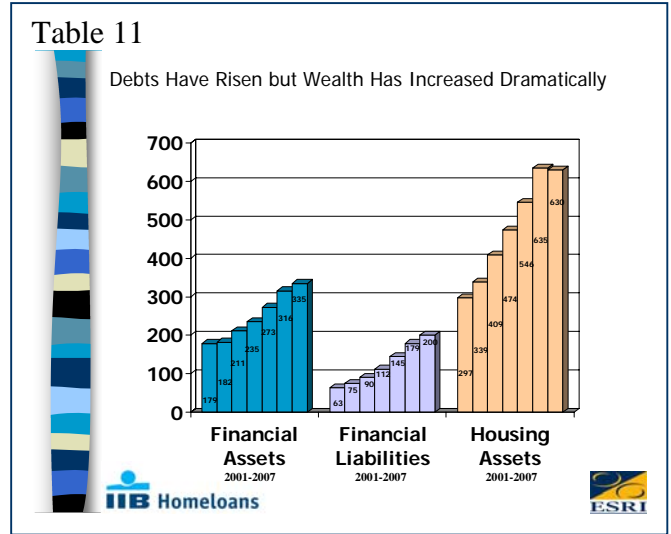


recent trend towards higher interest rates, debt servicing costs have risen of late but the proportion of aggregate household income absorbed by debt servicing costs has risen only modestly, from 8 per cent of economy-wide after-tax incomes in 2001 to 11 per cent of these incomes in 2007. Of course, it must be recognised that this increased burden is not evenly shared across the population. On the other hand, it should be remembered that these figures do not take any account of the offsetting boost from higher interest rates that has accrued to households with savings. While these caveats must be acknowledged, the broad picture emerging from these data suggests that at least at an aggregate level the problems caused by higher interest rates do not appear particularly threatening to the Irish economy.

The data set out in Table 10 above offer a plausible rationale for at least some of the build-up in debt levels seen in recent years. The emerging trends of higher servicing costs and a likely easing in income growth may also hint at slower growth in debt in the years ahead. However, the data in Table 10 still focus on only one element of the picture.

The major contribution of the CSO sectoral accounts data is that they allow us to look at both sides of the balance sheet of Irish households. Drawing the two sides of the balance sheets together shows that Irish households have accumulated significant debt in the process of building substantial assets. Table 11 below summarises the trend in household financial liabilities (debt) relative to the build-up of financial assets and housing. It is frequently overlooked that in spite of the relatively young age structure of the population and rapid growth in debt in recent years, Irish households have maintained a substantial net positive financial balance in recent years. In addition, the value of the housing stock has increased sharply. While weaker equity markets and a softening in house prices suggest a marginal fall in household wealth this year, the picture remains extremely strong. Indeed, it is likely that both debt and assets will remain on a rising trend even if the

pace at which both increase is likely to be more modest in the years ahead.



Judged from this perspective, the accumulation of household debt in recent years looks an altogether more rational and less threatening development. It appears that Irish households have moved from one equilibrium, encompassing modest incomes and wealth, to another characterised by higher debt in the context of notably higher incomes and a related increase of wealth. If this interpretation is correct, this debt build-up needn't threaten any painful adjustment to consumer spending or to the broader Irish economy. Instead, as Table 12 below shows, rapid income growth has encouraged the accumulation of wealth partly funded by higher debt. On the evidence of the 2007 survey of household finances, this has not been an entirely painless process for Irish borrowers but neither has it been anywhere near as threatening as is often suggested.

