

Euro area bank lending survey of October 2020: main results for Latvia

In October 2020, Latvijas Banka, in cooperation with the European Central Bank (ECB), conducted the euro area bank lending survey on the lending developments during the third quarter of 2020 and bank expectations for the fourth quarter of 2020. Four Latvian banks whose total market share in lending to non-financial corporations and households is large enough to represent overall lending development in Latvia participated in the survey. Their replies have been incorporated in the euro area bank lending survey results.

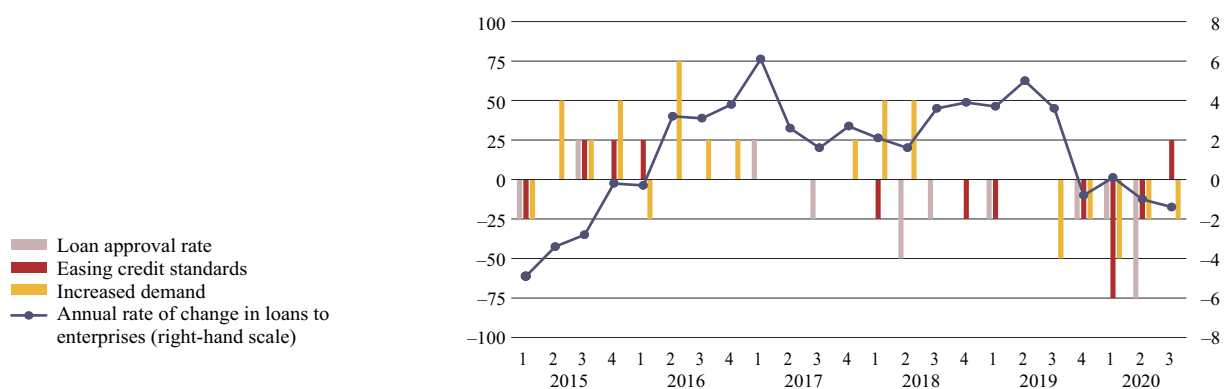
Loans to enterprises

Lending to Latvian enterprises contracted in the third quarter of 2020 (see Chart 1) as demand for loans to large enterprises continued to decline and the pace of easing credit standards after tightening them in the first half of the year was slow. However, demand for loans to small and medium-sized enterprises remained broadly unchanged on account of the support measures extended by the government through AS Attīstības finanšu institūcija Altum and the need for inventories and working capital in the context of economic recovery.

Chart 1

CHANGES IN LOAN APPROVAL RATE, CREDIT STANDARDS AND DEMAND AND ANNUAL GROWTH RATE OF LOANS FOR ENTERPRISES

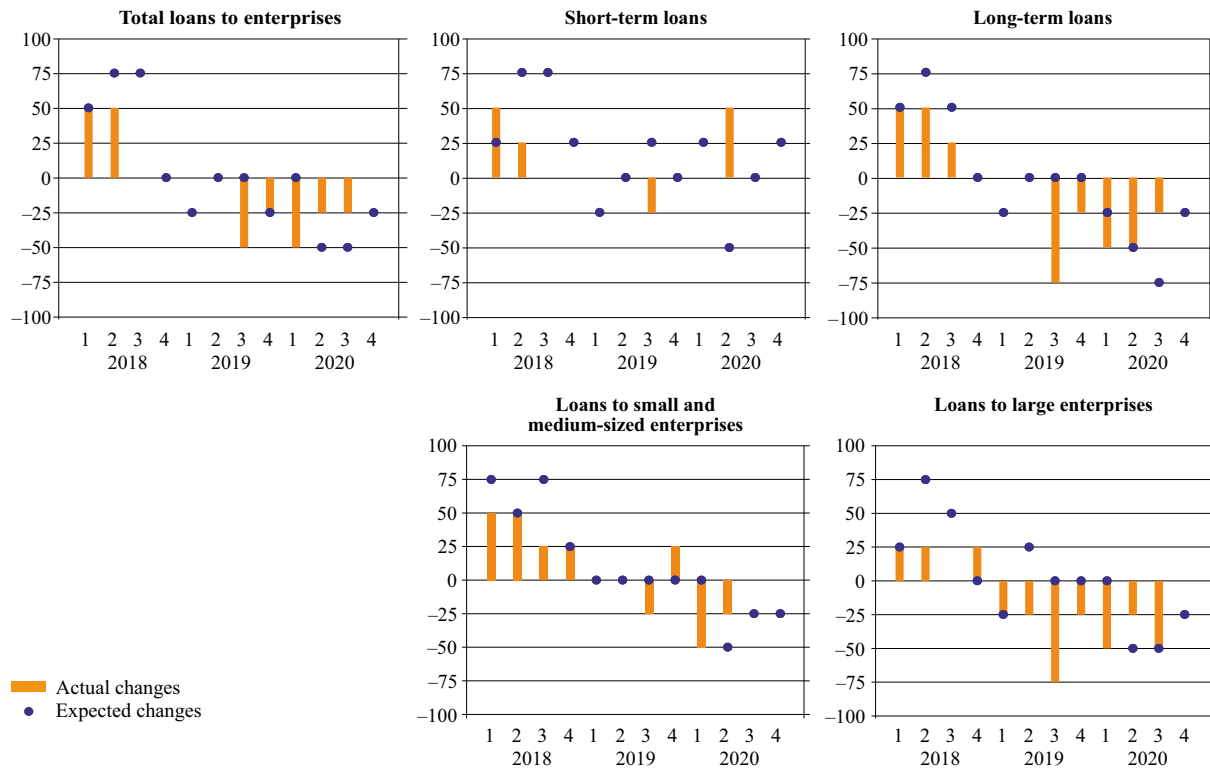
(net percentage of banks reporting increased loan approval rate, easing credit standards and higher demand; annual growth rate of loans; %)



Sources: bank lending survey and the ECB's Statistical Data Warehouse.

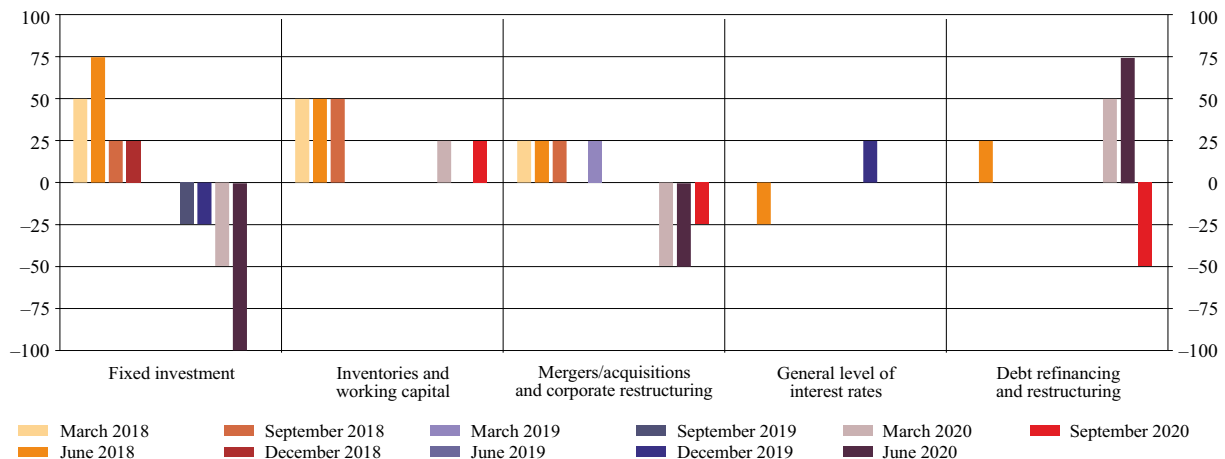
According to most banks, demand for loans to enterprises overall continued on a downward trend in the third quarter, with demand for loans to large enterprises decreasing (see Chart 2). According to the respondent banks, demand for long-term loans contracted more than that for short-term loans. Two surveyed Latvian banks reported a decline in demand for loans to large enterprises: a decrease in demand for long-term loans was recorded by both banks, whereas a fall in demand for short-term loans – only by one bank. Meanwhile, demand for loans to small and medium-sized enterprises, including demand for short-term loans and overall loans, remained unchanged in the third quarter. The number of banks reporting a higher demand for short-term loans and loans to small and medium-sized enterprises equalled that of banks suggesting a lower demand. Demand for long-term loans to small and medium-sized enterprises decreased in the third quarter (with one more bank reporting a decrease as compared to those that did not).

Chart 2

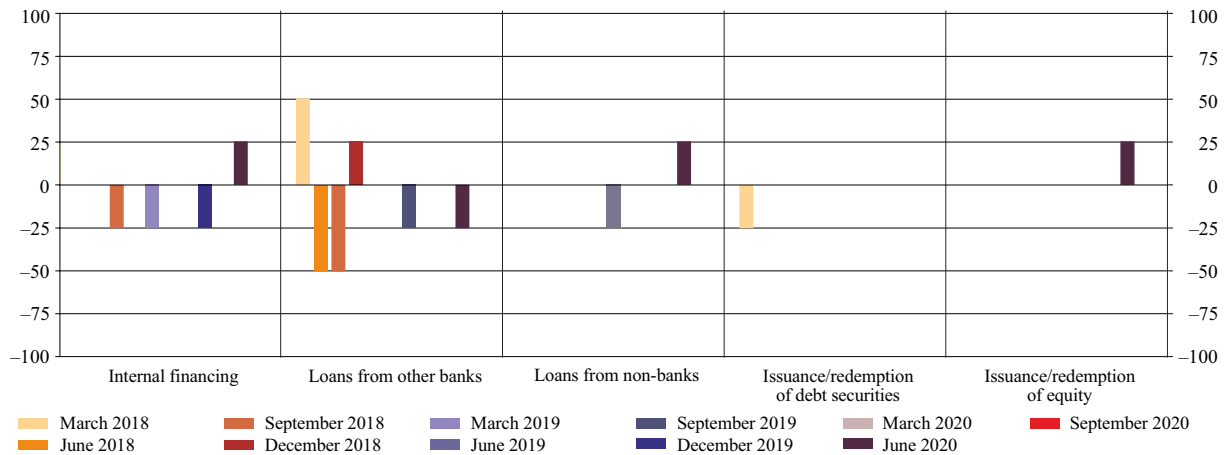
CHANGES IN DEMAND FOR LOANS TO ENTERPRISES*(net percentage of banks reporting increased demand for loans; %)*

Enterprises which were forced to defer principal repayments due to the crisis caused by the COVID-19 pandemic had already done so in the first half of the year, and debt refinancing/restructuring and renegotiation contributed to a decline in demand (in two banks) in the third quarter. Meanwhile, a weaker demand for loans to large enterprises (in one surveyed bank) was explained by a reduced need for fixed investment, inventories and working capital, as well as by mergers, acquisitions and corporate restructuring. The impact of these factors on demand for loans to small and medium-sized enterprises differed: the need for fixed investment had no major effect on demand, the need for inventories and working capital supported it (net in one bank), while a lower need for mergers, acquisitions and corporate restructuring reduced the demand (in one bank). The financial instruments offered by AS Attīstības finanšu institūcija Altum supported demand for loans to small and medium-sized enterprises in one surveyed Latvian bank. One of the surveyed banks expects that demand for long-term loans to enterprises will somewhat decrease in the fourth quarter (see Chart 3).

Chart 3

FACTORS CONTRIBUTING TO DEMAND FOR LOANS TO ENTERPRISES*(net percentage of banks reporting positive factor contributions; %)***a) Financing needs, contributing factors or objectives underlying the demand for loans**

b) Use of alternative sources of finance

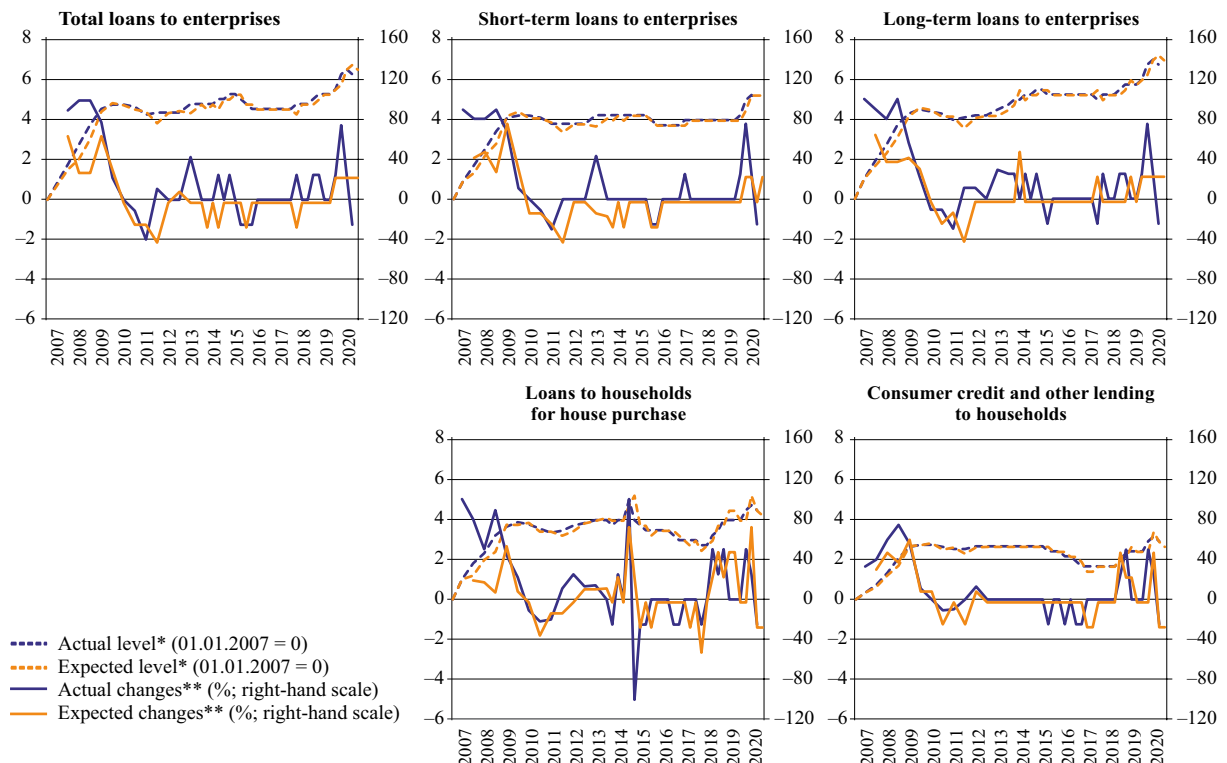


With the spread of COVID-19 abating temporarily and the measures to contain it becoming looser, in the third quarter half of the surveyed Latvian banks eased their credit standards for loans to enterprises either in a small lending segment or for a short period of time (see Chart 4). One bank, explaining it by improvements in the general economic situation and outlook, somewhat eased credit standards for loans to small and medium-sized enterprises, while credit standards for overall loans to enterprises remained unchanged. Another bank, having eased credit standards in the third quarter, expects tightening of credit standards for loans to enterprises (overall and in all subsectors) again in the fourth quarter, explaining it by a better economic situation and improvements in the situation and outlook for certain sectors and enterprises, a lower credit risk of borrowers and a collateral-related risk, as well as a higher bank's risk tolerance level.

Chart 4

QUARTERLY AND CUMULATIVE CHANGES IN CREDIT STANDARDS

(net percentage of banks reporting tightening credit standards; %).



* Cumulative changes in net percentage of banks reporting tightening credit standards.

** Net percentage of banks reporting tightening credit standards.

The terms and conditions for loans to enterprises were not significantly changed by the surveyed Latvian banks in the third quarter. One bank slightly raised its non-interest rate charges for loans to enterprises, but this did not affect the general terms and conditions for the respective loans. The share of rejected applications for loans to enterprises also remained unchanged.

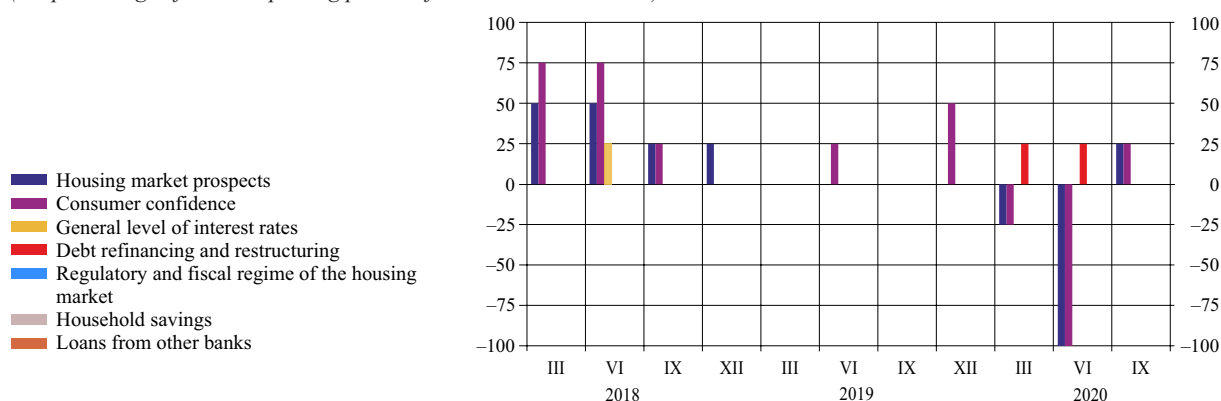
Loans to households for house purchase

The developments in loans to households for house purchase were primarily determined by renewed demand, and banks had a chance to recover the losses seen in the previous quarters. As projected in the second quarter, demand for loans to households for house purchase rebounded in the third quarter. Half of the surveyed Latvian banks (two banks) noted that, with consumer confidence increasing in one bank, and housing market prospects improving in the other one, demand for loans to households for house purchase picked up slightly in the third quarter (see Chart 5).

Chart 5

FACTORS CONTRIBUTING TO HOUSEHOLD DEMAND FOR LOANS FOR HOUSE PURCHASE

(net percentage of banks reporting positive factor contributions; %)

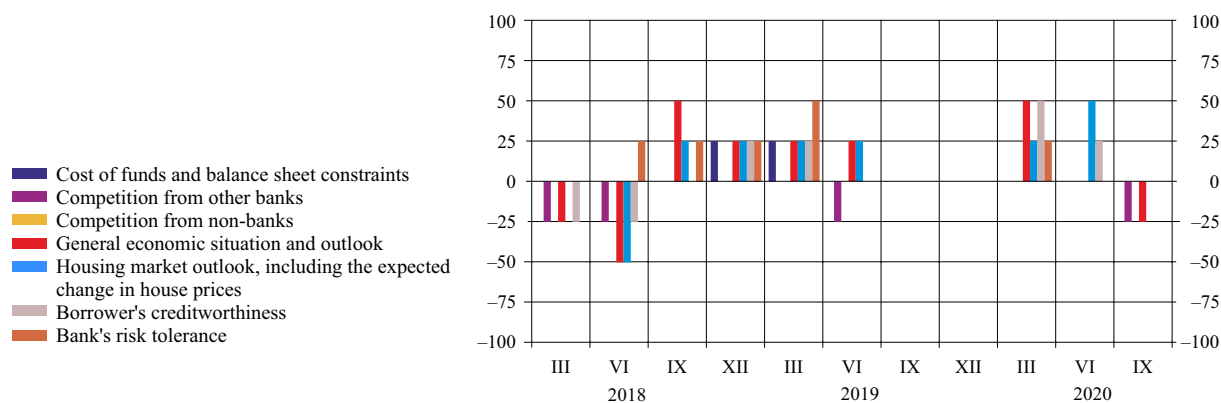


Banks also became somewhat more flexible in funding households. One of the four surveyed Latvian banks reported that it slightly eased its credit standards for loans to households for house purchase in the third quarter due to the competition from other banks and the improvement in the general economic situation and outlook (see Chart 6).

Chart 6

FACTORS CONTRIBUTING TO TIGHTENING CREDIT STANDARDS FOR LOANS TO HOUSEHOLDS FOR HOUSE PURCHASE

(net percentage of banks reporting positive factor contributions; %)

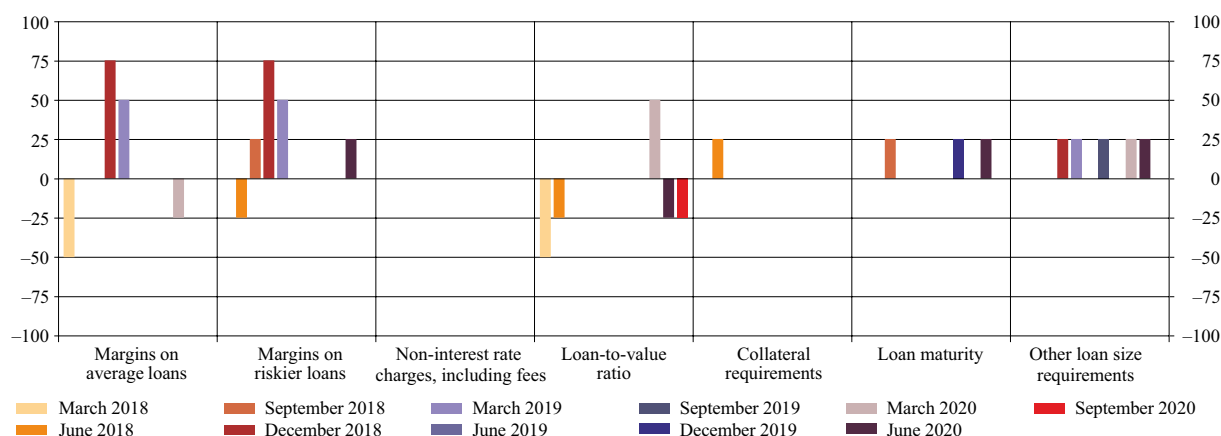


The above bank also slightly eased credit terms and conditions for loans to households for house purchase by increasing the loan-to-value ratio and pointing to higher competitive pressure and a lower bank's risk tolerance level as a rationale behind its decision (see Chart 7). The share of rejected applications for loans to households for house purchase remained unchanged in all surveyed Latvian banks in the third quarter.

Looking at the future prospects for lending to households, Latvian banks remained optimistic. One of the surveyed Latvian banks expects that demand for loans to households for house purchase will increase somewhat in the fourth quarter, and one bank intends to slightly ease credit standards in the respective segment over this period.

Chart 7

CHANGES IN CREDIT TERMS AND CONDITIONS FOR LOANS TO HOUSEHOLDS FOR HOUSE PURCHASE (net percentage of banks reporting tightening credit terms and conditions; %)



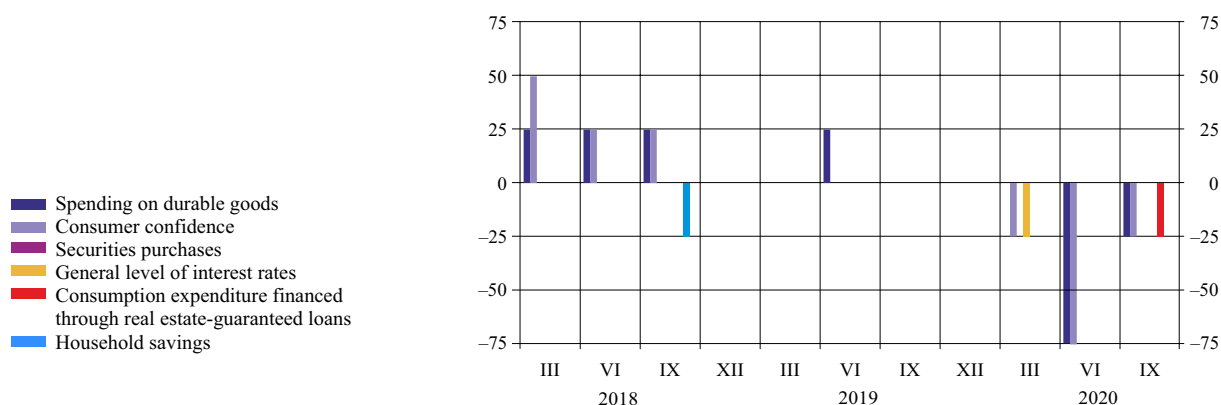
Consumer credit and other lending to households

Contrary to the forecasts for the second quarter, demand for consumer credit and other lending to households shrank in the third quarter. One of the surveyed Latvian banks reported that demand in the above lending segment declined somewhat in the third quarter as the need for durable goods (cars, furniture, etc.) decreased and household savings were increasingly used (see Chart 8). By contrast, another bank indicated that demand for consumer credit and other lending to households fell on account of weaker consumer confidence in the third quarter. The surveyed Latvian banks expected demand for consumer credit and other lending to households to remain at the existing level in the fourth quarter.

Chart 8

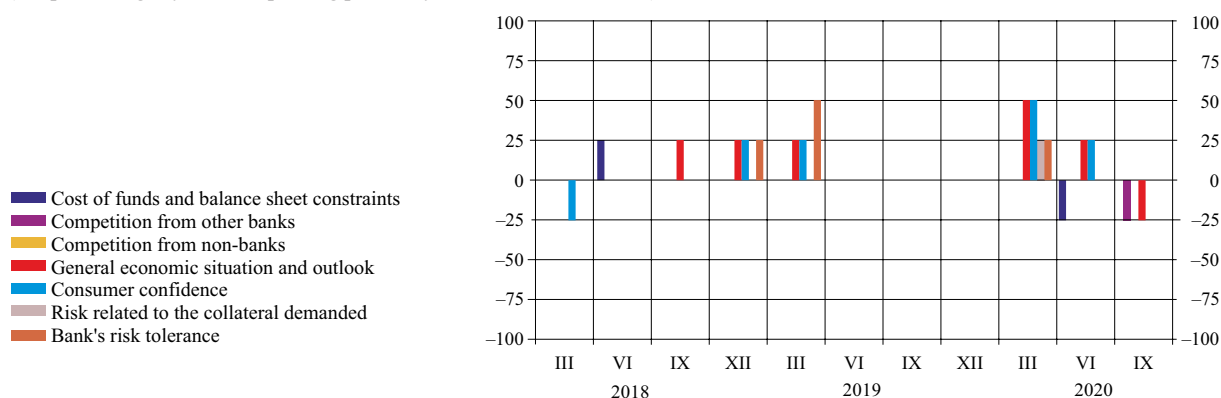
FACTORS CONTRIBUTING TO HOUSEHOLD DEMAND FOR CONSUMER CREDIT AND OTHER LENDING TO HOUSEHOLDS

(net percentage of banks reporting positive factor contributions; %)

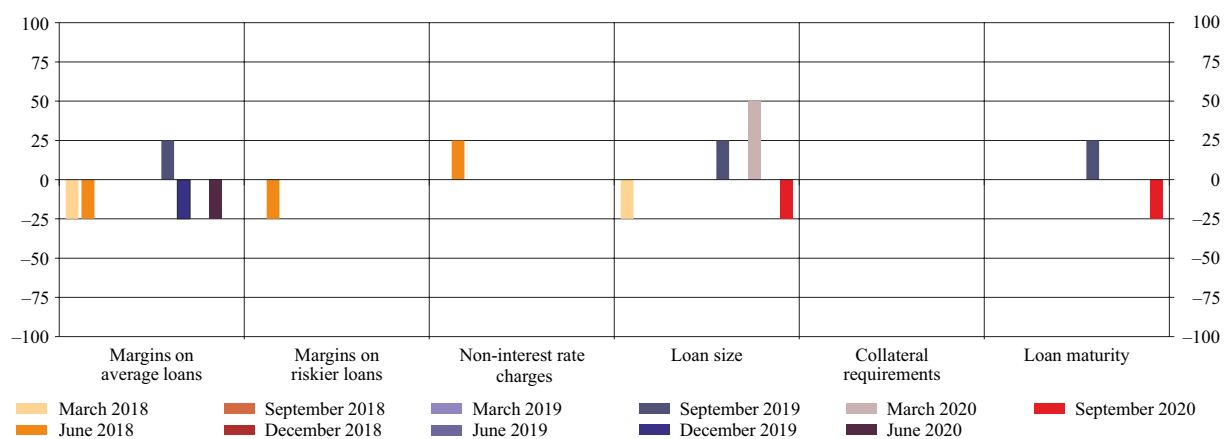


The demand for consumer credit and other lending to households decreased, but households choosing to apply to banks approached the assessment of their creditworthiness more responsibly. The bank recording lower demand in the above lending segment, recorded a minor decrease in the share of rejected applications for loans.

Credit standards for consumer credit and other lending to households were slightly eased in the same way as those for loans to households for house purchase. One of the four surveyed Latvian banks pointed out that it slightly eased its credit standards for consumer credit and other lending to households in the third quarter and also intended to continue doing so in the fourth quarter due to the growing competition from other banks and the improvement in the general economic situation and outlook (see Chart 9).

Chart 9**FACTORS CONTRIBUTING TO TIGHTENING CREDIT STANDARDS FOR CONSUMER CREDIT AND OTHER LENDING TO HOUSEHOLDS***(net percentage of banks reporting positive factor contributions; %)*

Due to higher competitive pressure and improved risk perception, (one bank) somewhat increased the permissible level of consumer credit and other lending to households and extended their term, thereby also positively affecting the general terms and conditions for the respective loans (see Chart 10).

Chart 10**CHANGES IN CREDIT TERMS AND CONDITIONS FOR CONSUMER CREDIT AND OTHER LENDING TO HOUSEHOLDS***(net percentage of banks reporting tightening credit terms and conditions; %)***Ad hoc questions**

The euro area bank lending survey of October 2020 included several ad hoc questions regarding the impact of the ECB's unconventional monetary instruments (targeted longer-term refinancing operations (TLTRO III), the negative deposit facility rate and the asset purchase programmes).

Three of the surveyed Latvian banks participated in the auction of the ECB's TLTRO III in June 2020; however, they have not yet decided on their participation in the next auctions. The willingness to increase profit by using the opportunity to borrow on particularly favourable terms was the main reason for participating in the auction of TLTRO III. This reason could also encourage banks to decide on their participation in the next TLTRO III auctions. The participation in TLTRO III is expected to support the profitability of Latvian banks.

The surveyed Latvian banks most often plan to use the borrowed funds for lending to the non-financial sector. However, only one bank expects that the participation in TLTRO III will support easing of credit terms and conditions and an increase in loans to enterprises in the fourth quarter and the first quarter of 2021. Latvian banks relatively less frequently use TLTRO III funds for purchasing domestic bonds or other financial assets. Two of the surveyed Latvian banks used TLTRO III funds for purchasing domestic bonds or other financial assets.

The negative deposit facility rate contributed significantly to reducing net interest income and, consequently, also profitability in two of the surveyed Latvian banks in the second and third quarters of

2020. However, the ECB's two-tier system for remunerating excess reserve holdings helped to slightly ease the effect of the negative deposit facility rate. To further improve its financial position, one of the above Latvian banks applied higher non-interest rate charges on corporate deposits. Both banks expect that the negative deposit facility rate will also continue to contribute to reducing net interest income and profitability of these banks in the fourth quarter of 2020 and the first quarter of 2021; however, the intensity of its impact could decline in one bank. The impact of the ECB's two-tier system for remunerating excess reserve holdings on net interest income and profitability as well as the impact of the negative deposit facility rate on non-interest rate charges on corporate deposits will remain similar to those observed in the previous six months.

The ECB asset purchase programmes affected the performance indicators of one surveyed Latvian bank this year and will continue to do so next year. For the above bank, the ECB asset purchase programmes have a long-term positive impact on the liquidity position and the equity ratio (in the second and third quarters, in the fourth quarter and in the first quarter of 2021). At the same time, over a shorter period of time (in the second and third quarters of 2020) the total assets of this bank decreased and the market financing conditions improved under these programmes. In the fourth quarter of 2020 and the first quarter of 2021, the ECB asset purchase programmes will somewhat contribute to an increase in holdings of euro area government bonds.