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

Latvijas Banka conducted a euro area bank lending survey in cooperation with the European Central Bank in April 2020, covering the lending developments during the first quarter of 2020 and expectations for the second quarter of 2020. Four Latvian banks whose total market share in lending to non-financial corporations and households is large enough to represent lending development in Latvia as a whole participated in the survey. Their replies have been incorporated in the euro area bank lending survey results.

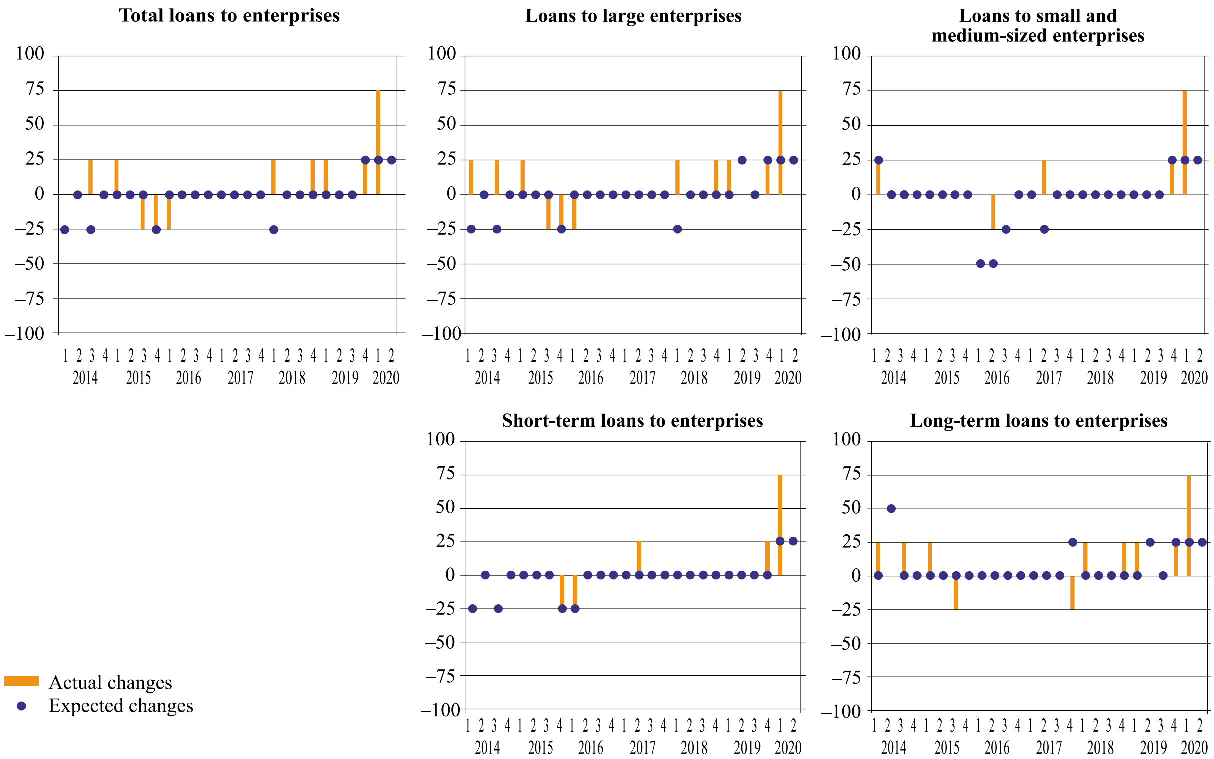
Loans to enterprises

In the first quarter of 2020, Latvian banks tightened credit standards for loans to enterprises (see Chart 1) in view of both continuing with further anti-money laundering measures and facing a new shock, i.e. the negative effect of the COVID-19 pandemic on the economy and its outlook as well as the uncertainty it creates. According to the results of the euro area bank lending survey, three of the four surveyed Latvian banks tightened credit standards for overall loans to enterprises in the first quarter of 2020 (two banks tightened them moderately and one bank – considerably). Moreover, short-term loans were more affected by these changes: two banks tightened credit standards for short-term loans considerably and one bank – moderately, while credit standards for long-term loans were tightened substantially by one bank and moderately by two banks.

Chart 1

CHANGES IN CREDIT STANDARDS FOR LOANS TO ENTERPRISES

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

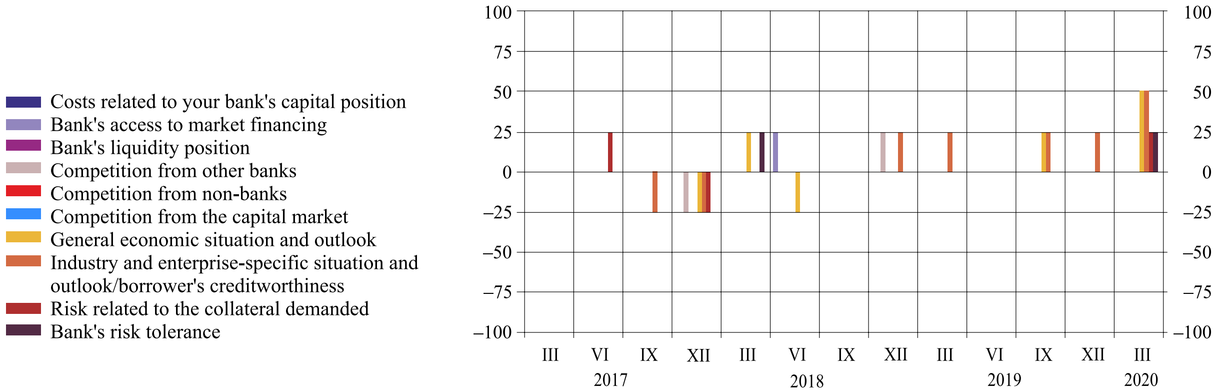


Factors related to the negative effect of the COVID-19 pandemic dominated in banks' explanations concerning the tightening of credit standards for loans to enterprises (see Chart 2). Two of the four surveyed banks indicated that the tightening of credit standards for loans to enterprises resulted from the overall economic situation and weakening outlook, deterioration of the situation or outlook in certain sectors or enterprises and worsening of a borrower's creditworthiness. Both banks also named several other reasons for tightening credit standards for loans to enterprises. One bank mentioned an increase in the risk related to the collateral demanded and a lower level of the bank's risk tolerance, but the other one – the unpredictable impact of the COVID-19 pandemic on the economic situation and outlook in the short and medium term. Another of the four surveyed Latvian banks explained that the need to tighten credit standards was based on additional anti-money laundering and combating the financing of terrorism measures to be applied.

Chart 2

FACTORS CONTRIBUTING TO THE NET TIGHTENING OF CREDIT STANDARDS FOR LOANS TO ENTERPRISES

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



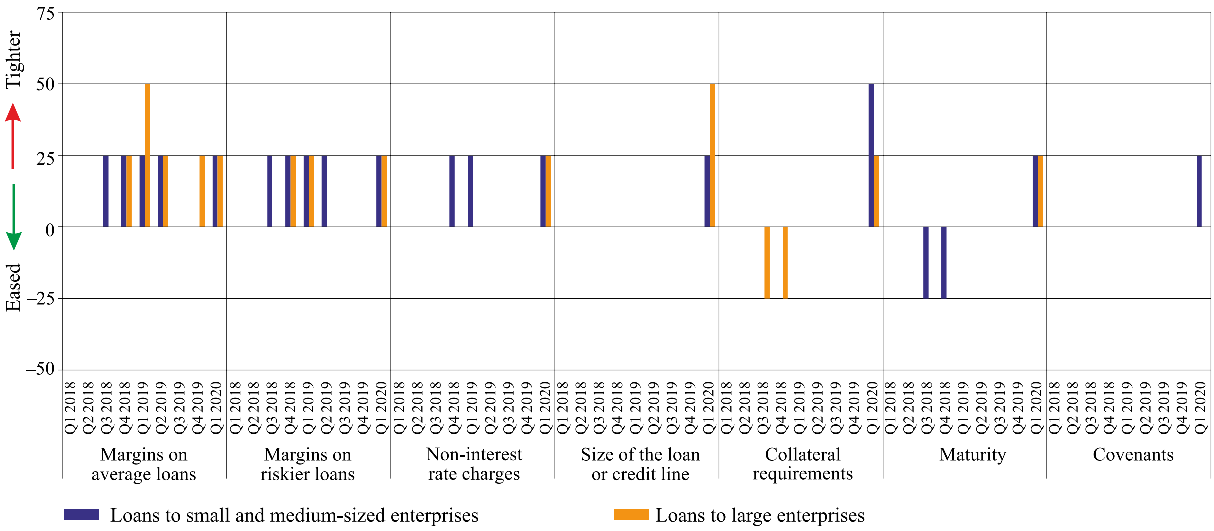
The second quarter might see some easing of credit standards. Only one of the four surveyed Latvian banks also intends to tighten its credit standards for loans to enterprises in the second quarter (tighten considerably for long-term loans as well as loans to both small and medium-sized enterprises, while tighten moderately for short-term loans and loans to large enterprises.

Banks, having pointed out tightening of their credit standards for loans to enterprises, also made their terms and conditions for such type of loans less attractive, mostly due to higher assessment of the existing risks (see Chart 3). In the first quarter of 2020, two of the surveyed Latvian banks reported tightening of their credit terms and conditions for overall loans to enterprises on account of changes in their risk perception (in two banks) as well as an unfavourable effect of the bank's risk tolerance (in one bank) and cost of funds and balance sheet constraints (in one bank). In the first quarter, collateral requirements were reinforced more often (on two occasions), while all other terms and conditions were tightened on one occasion: margins on average and riskier loans, non-interest rate charges, the size of the loan or credit line, and loan covenants and maturity.

Chart 3

CHANGES IN CREDIT TERMS AND CONDITIONS FOR LOANS TO ENTERPRISES BY SIZE OF THE LOAN

(net percentage of banks reporting tightening credit terms and conditions; %)

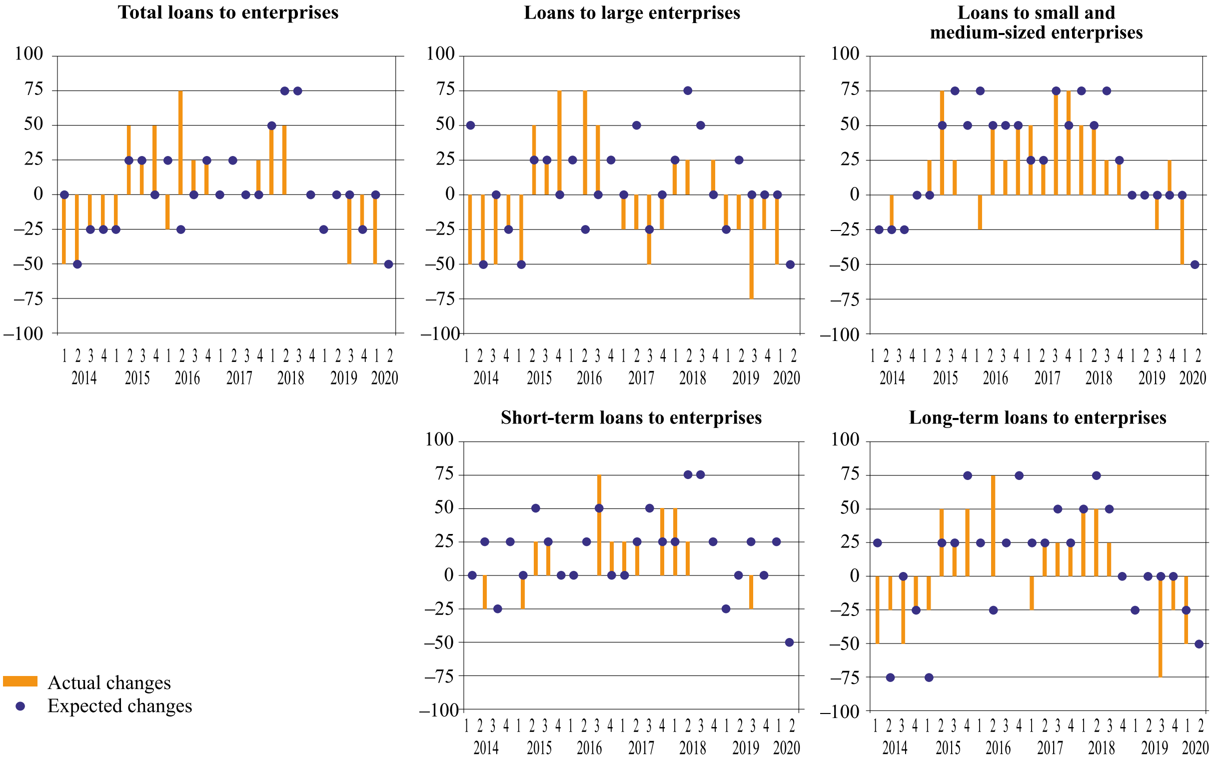


According to most banks, demand for overall loans to enterprises decreased in the first quarter of 2020 as basically long-term trends were assessed rather than the initial reaction of enterprises to the crisis caused by the COVID-19 pandemic (see Chart 4). One of the four surveyed banks said that demand for loans to enterprises had decreased considerably, two of them pointed out it had decreased moderately, while one bank considered the demand to have increased substantially. Notably, according to banks, demand for short-term loans has remained unchanged: one bank observed that it had declined somewhat, while another one reported a considerable increase. As regards demand for long-term loans, it has shrunk, and its assessment is the same as that of overall loans to enterprises.

Chart 4

CHANGES IN LOAN DEMAND

(net percentage of banks reporting increased demand for loans; %)



In the bank where an increase in demand for loans to enterprises was observed in the first quarter of 2020, it was strongly supported by debt refinancing/restructuring and renegotiation on new terms and conditions in cases where the size of the loan expands as well as borrowing by enterprises to strengthen the liquidity situation for better management of the crisis effects caused by the COVID-19 pandemic. Debt refinancing/restructuring and renegotiation on new terms and conditions as well as the need to boost inventories and working capital also facilitated demand in another bank, although the overall demand for loans to enterprises in it had decreased. When explaining the reasons for a decline in demand for loans to enterprises in the first quarter, two banks made reference to lower need for long-term loans and two banks pointed out that financing needs for mergers/acquisitions and corporate restructuring had decreased (see Chart 5).

The first quarter saw a further rise in the rejection rate for loan applications in this lending segment; this rate increased somewhat only in one surveyed Latvian bank. An increase in the rejection rate for loan applications combined with a declining demand may suggest both tightening of credit standards and a higher risk level of the loans applied for.

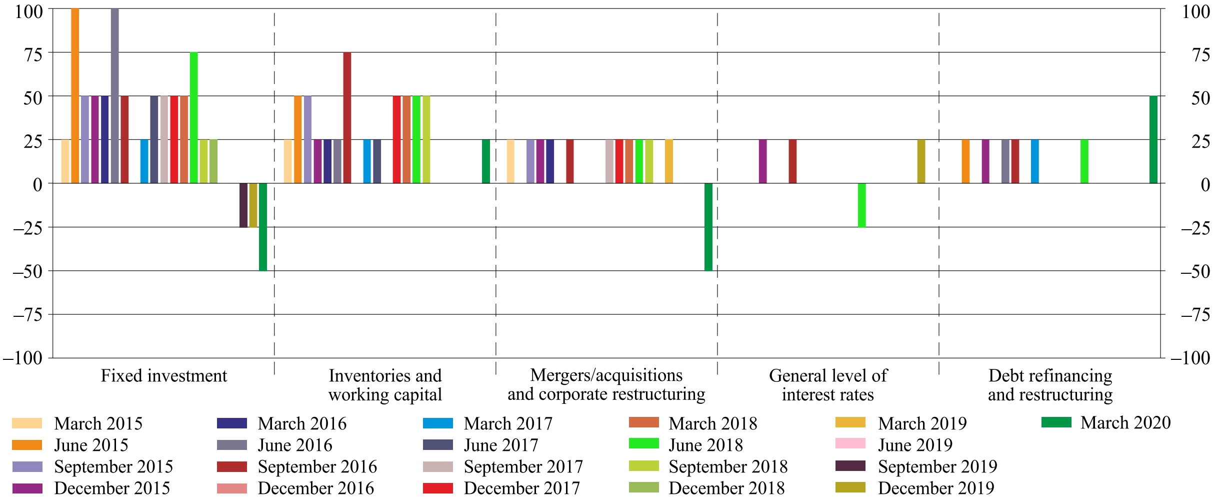
Most surveyed Latvian banks also forecast a fall in the overall demand for loans to enterprises in the second quarter of 2020. Two of the surveyed banks envisage that the demand will decrease substantially, one bank – that it will edge down moderately, while one bank foresees that the demand will increase considerably. The projected drop in demand for short-term loans to enterprises is slightly smaller: in three banks it is equal to the change in demand for overall loans to enterprises, but in one bank the expected fall in demand for short-term loans to enterprises is more moderate than that in demand for overall loans to enterprises.

Chart 5

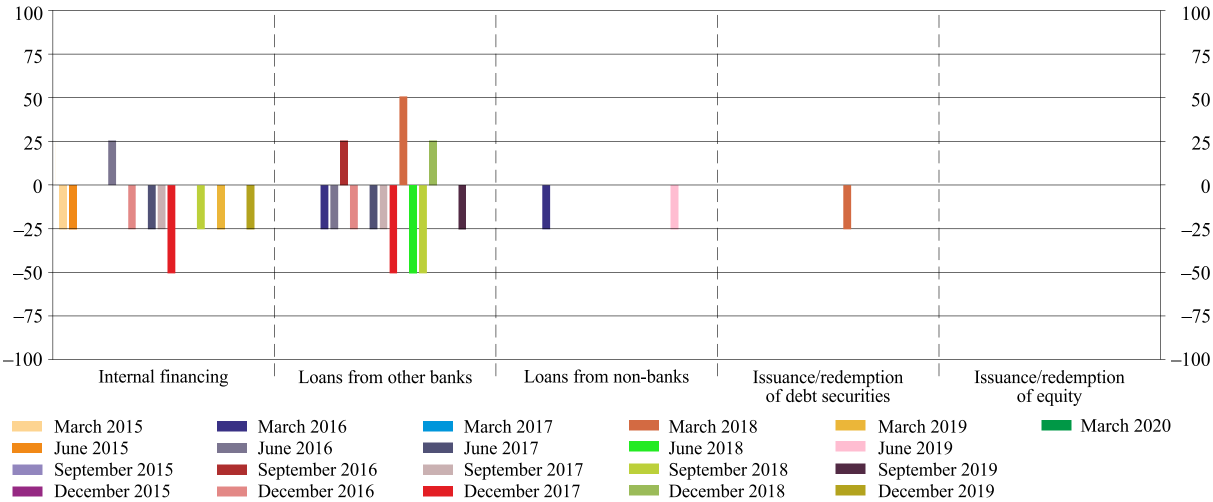
FACTORS CONTRIBUTING TO DEMAND FOR LOANS TO ENTERPRISES

(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



Loans to households for house purchase

Banks have become stricter with respect to issuing new loans for house purchase. Two surveyed banks pointed out that they had considerably tightened credit standards for loans to households for house purchase, and they both explained that the weakening of the general economic situation and development prospects as well as worsening of the borrowers' creditworthiness contributed to making such a decision (see Chart 6). One bank also tightened credit standards due to weaker housing market development prospects and the bank's lower risk tolerance. In the first quarter, the rejection rate for loan applications in the category of loans to households for house purchase also increased considerably in one bank. Three of the four surveyed Latvian banks intend to tighten their credit standards for loans to households for house purchase in the second quarter, two of which plan to tighten them considerably.

With banks raising their risk assessment and becoming more cautious, they also tightened several credit terms and conditions for loans to households for house purchase: the loan-to-value ratio and other loan size limits (see Chart 7). Two of the four banks pointed to the application of a lower loan-to-value ratio and one bank – to somewhat stricter other loan size limits. Both banks introduced tighter credit terms and conditions due to the weakening of risk perceptions; one of them also lowered its risk tolerance. In one bank, however, more favourable cost of funds and lower balance sheet constraints facilitated a decrease in margins on loans to households for house purchase.

Chart 6

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

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

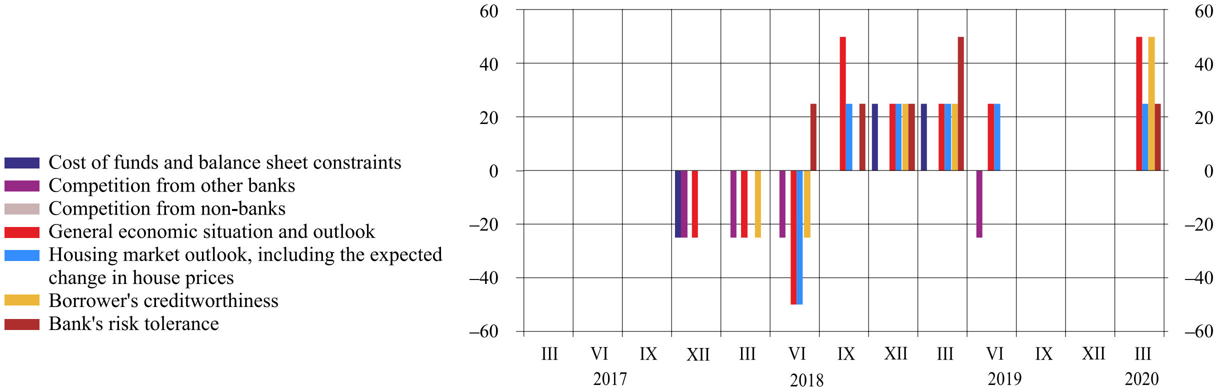
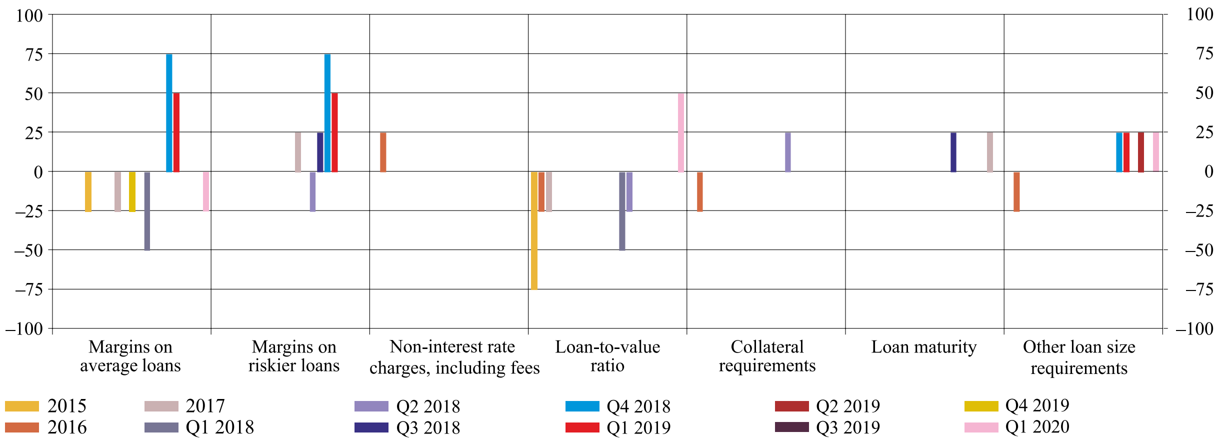


Chart 7

CHANGES IN CREDIT TERMS AND CONDITIONS FOR LOANS TO HOUSEHOLDS FOR HOUSE PURCHASE

(net percentage of banks reporting tightening credit terms and conditions; %)



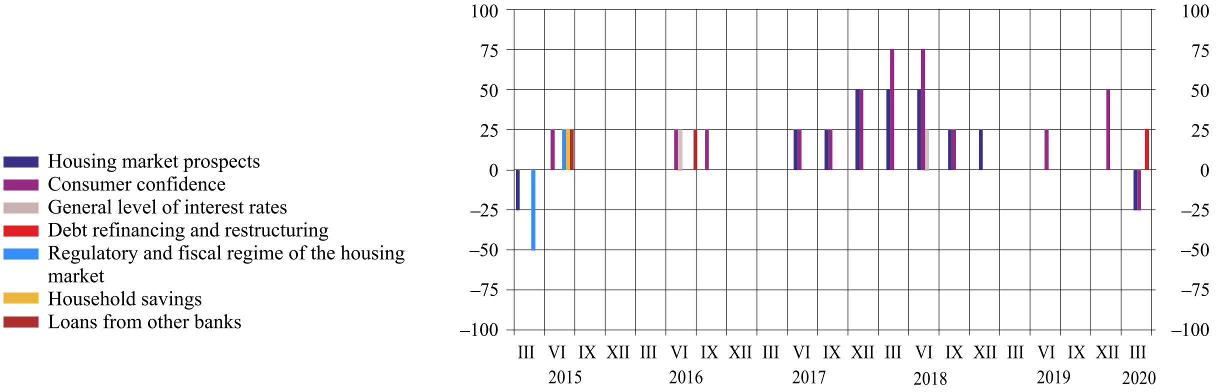
According to the banks, demand for loans to households remained broadly unchanged in the first quarter of 2020. It should be noted, however, that the opinions of the surveyed Latvian banks on demand for household loans for house purchase were at opposite ends: one of them pointed to a considerable decrease in demand; one of them said the demand decreased somewhat; one of them mentioned it increased slightly; and one of them stated the demand increased considerably. The banks reporting an increase in demand attributed it to debt refinancing/ restructuring and renegotiation (one bank). According to one of the four surveyed banks, an improvement in household sentiment, observed at the beginning of the quarter, facilitated demand. However, household sentiment plummeted already at the outset of the crisis caused by the COVID-19 pandemic, thus affecting the overall quarterly lending results. Two of the four surveyed Latvian banks observed that demand for household loans for house purchase fell on account of deteriorating household sentiment at the end of the quarter (in one bank it decreased moderately, while one bank recorded a substantial decline). In addition, one surveyed bank pointed out that the decline in the above demand was also caused by the housing market outlook, including the expected change in house prices (see Chart 8).

As to the demand dynamics in this lending segment in the second quarter of 2020, the banks share a similar view. Three of the four surveyed banks believe that demand for household loans for house purchase will drop considerably in the second quarter of 2020. Only one bank projected a considerable increase in the demand.

Chart 8

FACTORS CONTRIBUTING TO HOUSEHOLD DEMAND FOR LOANS FOR HOUSE PURCHASE

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



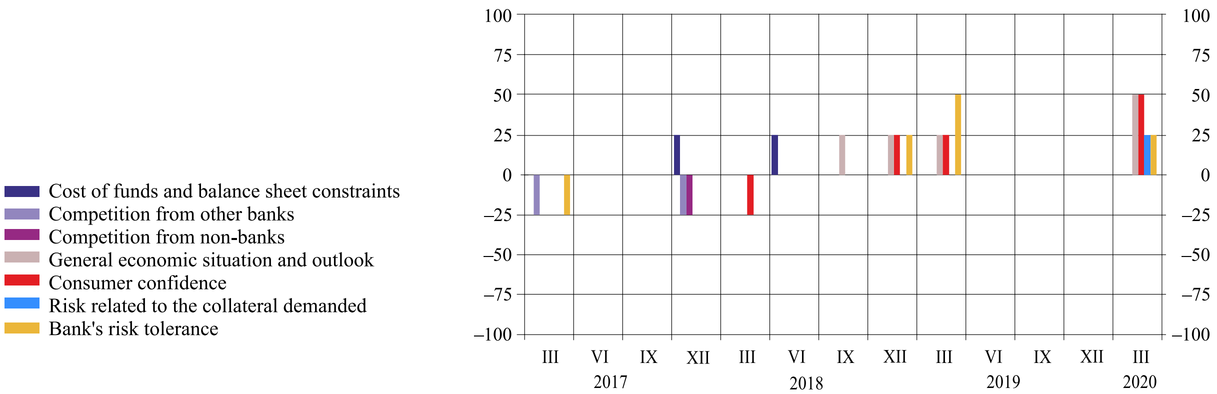
Consumer credit and other lending to households

Two of the surveyed Latvian banks had considerably tightened their credit standards for consumer credit and other lending to households. In both banks, the weakening of the general economic situation and outlook as well as worsening of the creditworthiness of consumers contributed to adopting the decision on tightening credit standards. Apart from the above factors, in one of the banks such dynamics were also facilitated by a higher risk related to the collateral demanded and a lower risk tolerance. One of the surveyed Latvian banks did not observe an increase in the rejection rate for loan applications in this lending segment in the first quarter of 2020. Two of the four surveyed Latvian banks intend to tighten their credit standards for consumer credit and other lending to households in the second quarter (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; %)



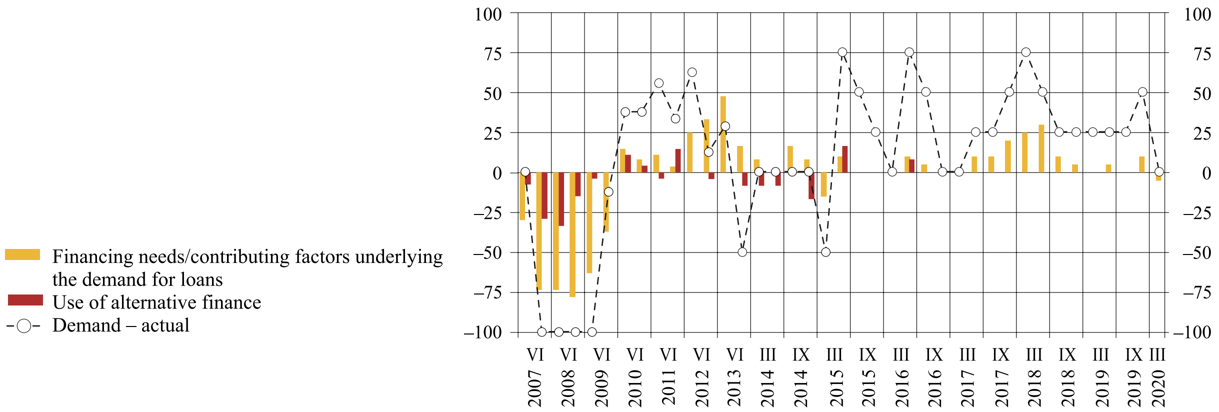
Due to the weakening of risk perceptions in two surveyed Latvian banks and lowering of risk tolerance in one bank, consumer credit and other lending to households decreased somewhat in the first quarter of 2020.

Demand for consumer credit and other lending to households decreased considerably less frequently than that for loans to households for house purchase (see Chart 10). Only one of the surveyed Latvian banks noted that demand for consumer credit and other lending to households decreased substantially in the first quarter of 2020 on account of weaker consumer confidence and (to a lesser extent) high interest rates. As to the second quarter, two of the surveyed banks project that the demand for the above types of loans will decline considerably, one bank believes it will fall moderately, while one bank forecasts a considerable increase.

Chart 10

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

(arithmetic mean of each group of factors; each factor is measured as a net percentage of credit institutions reporting positive factor contributions; %)



Ad hoc questions

The euro area bank lending survey of April 2020 included several ad hoc questions regarding the banks' access to the financial market, the ECB's asset purchase programme, the negative deposit facility rate and targeted longer-term refinancing operations (TLTRO III).

In response to the ad hoc questions regarding the access to the financial market, one of the surveyed Latvian banks pointed out that its access to wholesale debt securities contracted considerably, while access to the inter-bank unsecured money market worsened somewhat in the first quarter of 2020. The bank expects its access to its usual sources of retail funding to deteriorate somewhat in the next three months.

For one Latvian bank, the ECB's asset purchase programme helped to improve market-based financing conditions in the fourth quarter of 2019 and the first quarter of 2020, thus contributing to the application of lower interest rates on household loans for house purchase. The bank expects that the opportunities provided by the ECB asset purchase programme up to now will facilitate the lowering of interest rates and an increase in household loans for house purchase in the next six months as well.

Speaking about the impact of the negative deposit facility rate concurrently with that of the two-tier reserve remuneration system, two of the four surveyed Latvian banks admitted that over the previous six months they faced a drop in their profitability and the same is expected in the coming six months on account of lower interest income. Nevertheless, both banks observed that the ECB two-tier reserve remuneration system eased the downward effect of the negative deposit facility rate on profitability and interest income. One Latvian bank pointed out that on account of the negative deposit facility rate and the two-tier reserve remuneration system, enterprise and household deposits and interest rates on them decreased in it over the previous six months and will fall in the next six months, with non-interest rate charges declining simultaneously.

Looking at TLTRO III, three of the four banks mentioned that they had not yet decided on participation in the operations in the future. All three banks would be encouraged to participate by the favourable TLTRO III conditions and willingness to improve their profitability. Only one bank pointed out its willingness to increase liquidity on the grounds of precaution in order to reduce or prevent the potential future financing difficulties as the second reason for participation in the TLTRO III. Should the banks eventually decide on the participation in TLTRO III, they would use the obtained funding for diverse purposes in the coming six months. One of the surveyed banks believes that during the coming six months the above funding could be used for replacing the funds obtained on the interbank market. Another bank would like to use it for purchasing domestic bonds, other financial assets and maintaining liquidity. According to one surveyed Latvian bank, the potential participation in TLTRO III might improve its profitability in the coming six months.