

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

Latvijas Banka conducted a euro area bank lending survey in cooperation with the European Central Bank in July 2020, covering the lending developments during the second quarter of 2020 and bank expectations for the third 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.

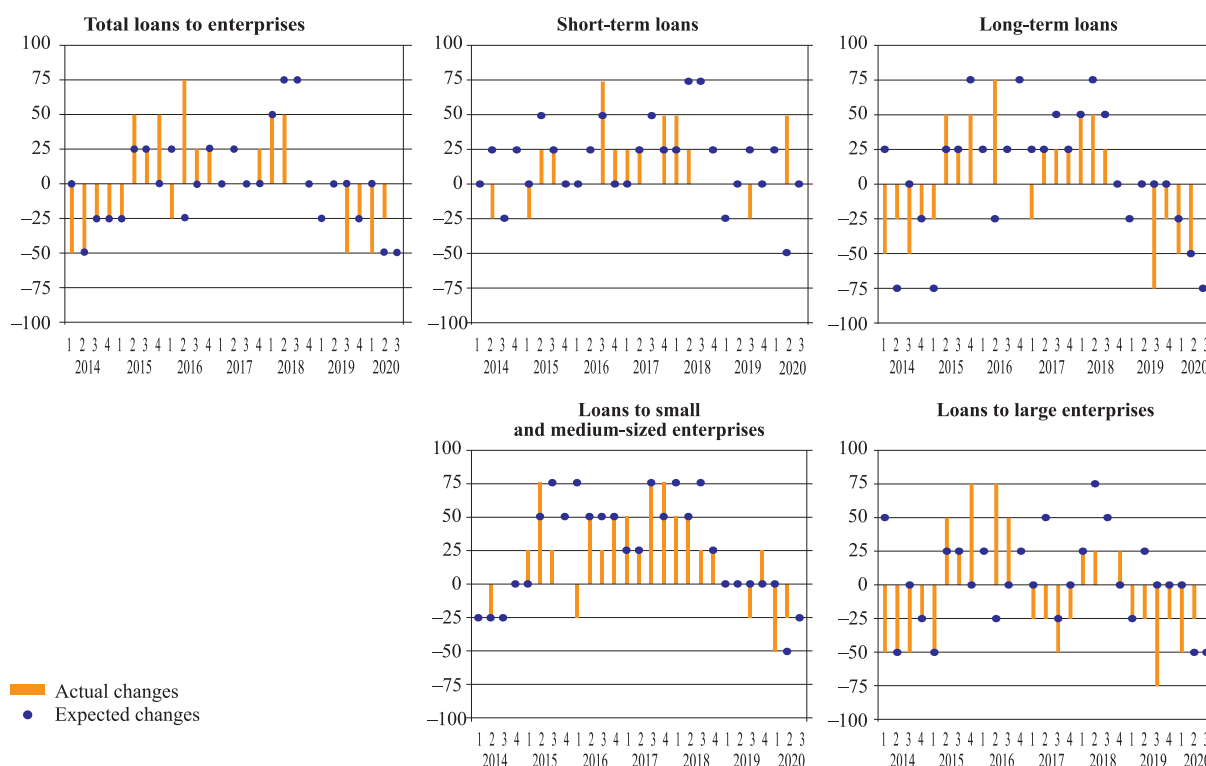
### Loans to enterprises

In the second quarter of 2020, lower demand for long-term loans to enterprises was offset by a higher demand for short-term loans as well as the need for debt refinancing or restructuring and renegotiation of the existing loans; therefore, the fall in lending to enterprises was not steeper than usual. The second quarter developments in loans to enterprises were primarily determined by changes in demand, the quality of loan applications and changes in lending policies implemented during the current quarter and particularly during the previous quarter.

Chart 1

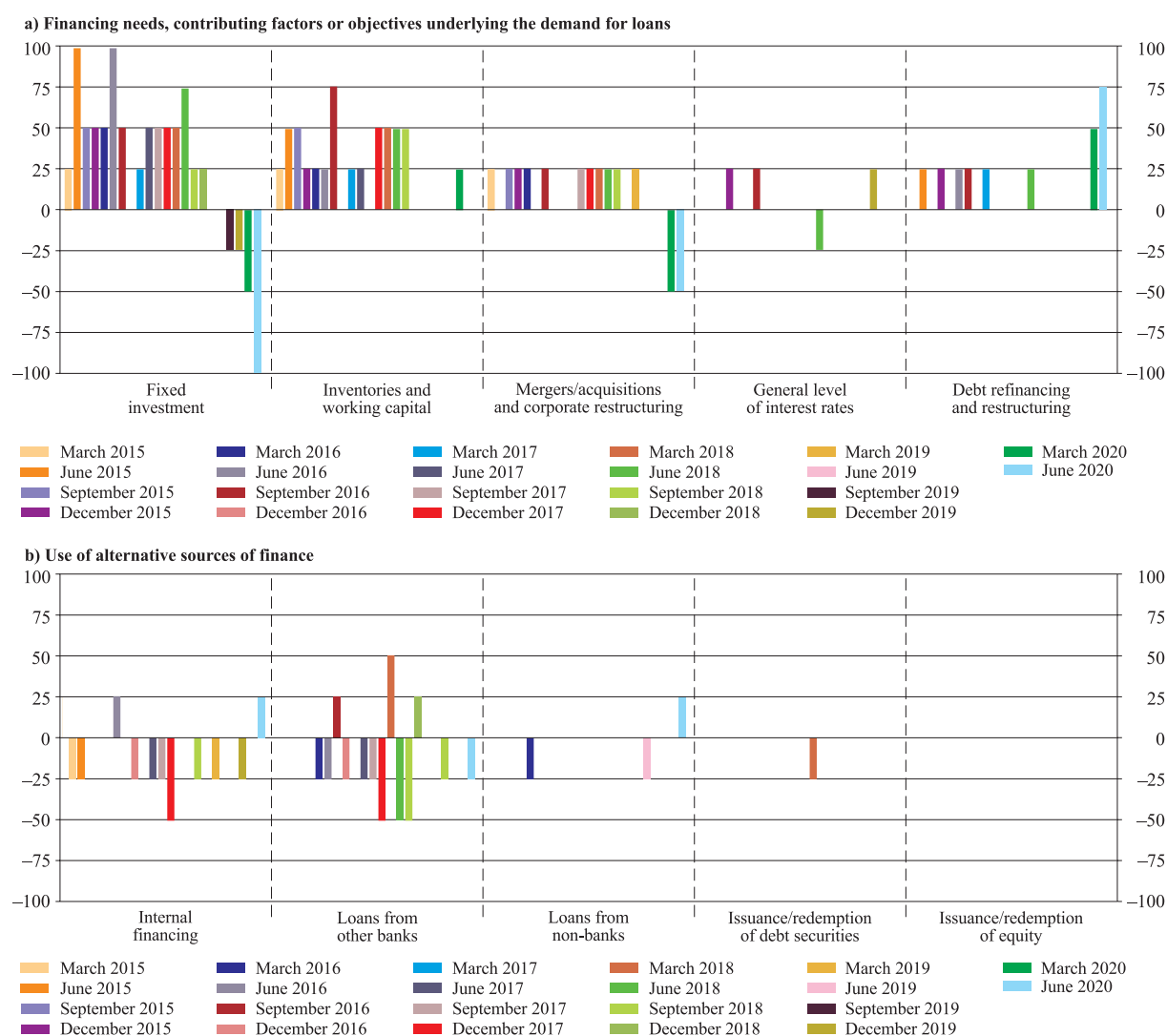
#### CHANGES IN LOAN DEMAND

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



Banks report an overall decline in the demand for loans to enterprises in the second quarter of 2020 and expect that it will continue to shrink also in the next quarter. Three of the four surveyed Latvian banks reported that the overall demand for loans to enterprises somewhat decreased in the second quarter or is expected to decrease in the third quarter. One respondent bank reported a significant but temporary increase in loans to enterprises, yet it also expects a considerable decline in the next quarter.

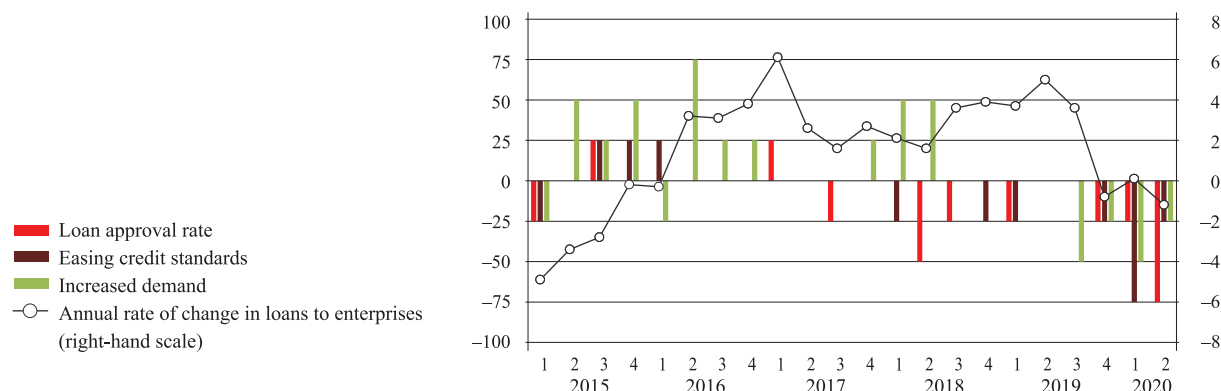
Latvian banks noted a difference in the rises in the demand for short-term and long-term loans for enterprises in the second quarter of 2020. According to the respondent banks, the demand for long-term loans overall somewhat decreased, whereas the demand for short-term loans to enterprises increased. Two of the four surveyed Latvian banks reported a net rise in short-term loans to enterprises, and the same number reported a net decline in the demand for long-term loans to enterprises in the second quarter. The observed differences are expected to decrease in the next quarter: banks anticipate that the demand for short-term loans will remain unchanged, whereas the demand for long-term loans, according to three banks, is expected to decline.

**Chart 2****FACTORS CONTRIBUTING TO DEMAND FOR LOANS TO ENTERPRISES***(net percentage of banks reporting positive factor contributions; %)*

The banks reporting a decline in the overall demand or just the demand for long-term loans mentioned the following reasons: loans from other banks (one bank) and lower financing needs (three banks), including for fixed investment (three banks), for mergers and acquisitions or restructuring (two banks) and for inventories and working capital (one bank). The banks reporting a higher overall demand or demand for short-term loans to enterprises highlighted the following main contributing factors: debt refinancing, restructuring or renegotiation (three banks), an increased financing need for inventories and working capital (two banks) and weaker prospects of using alternative sources of finance like the enterprises' internal finance, loans from non-banks and issuance/redemption of equity (one bank).

**Chart 3****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; %)

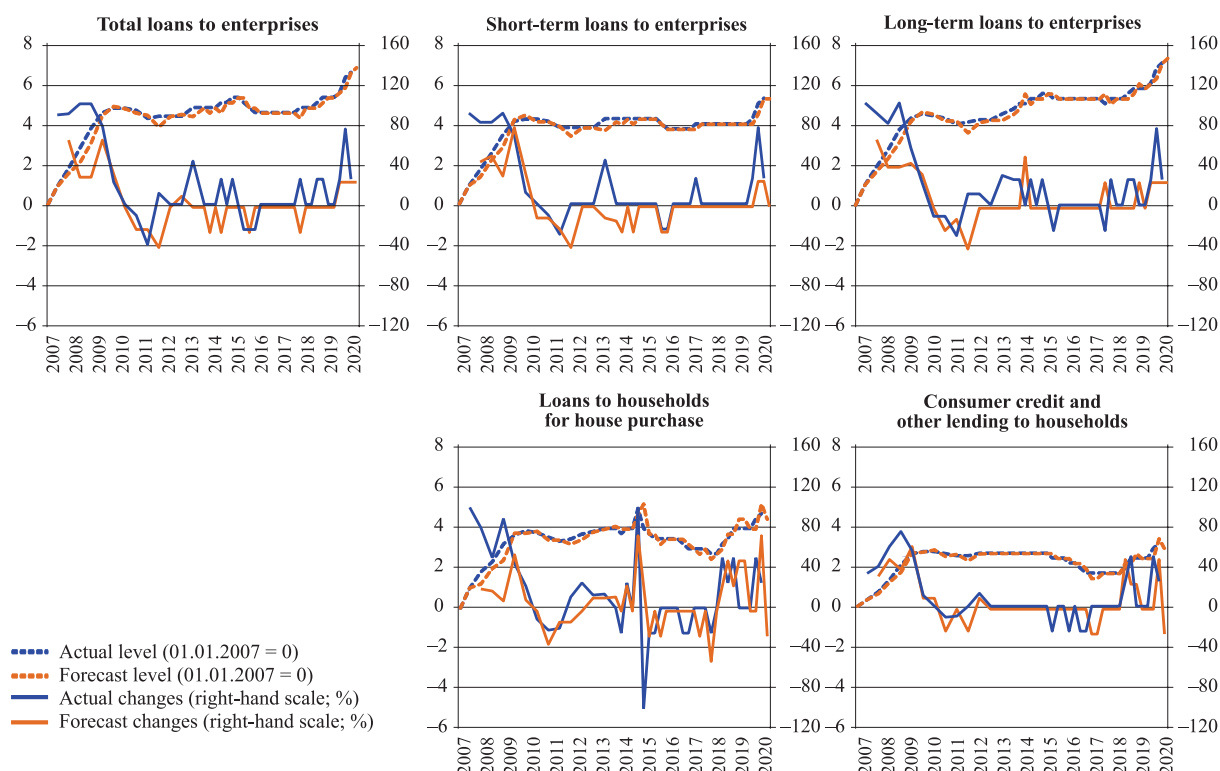


Sources: bank lending survey and the ECB's Statistical Data Warehouse.

At the same time, the surveyed Latvian banks reported an increase in rejection rate for loans to enterprises much more often in the second quarter of 2020, which can be explained by both lower quality of loan applications and tightening credit standards. A higher rejection rate for loans to enterprises was reported by three of the four respondent Latvian banks (more often than tightening of credit standards).

**Chart 4****QUARTERLY AND CUMULATIVE CHANGES IN CREDIT STANDARDS**

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



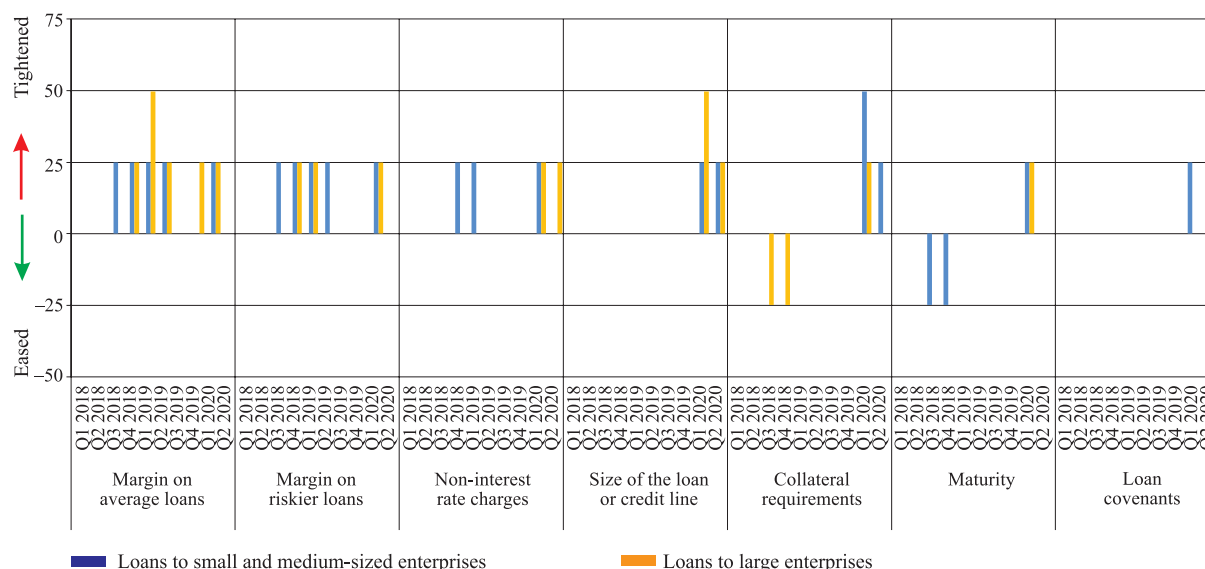
One respondent Latvian bank reported tightening credit standards for loans to enterprises in the second quarter, explaining it by higher costs related to the bank's capital position, weakening general economic situation and outlook, industry or firm-specific situation and outlook as well as borrower's creditworthiness. It has to be remembered that most (3/4) of the surveyed banks tightened the credit standards for loans to enterprises already in the previous quarter. Considering the limiting impact of the general economic situation and outlook, one bank is expecting tightening of credit standards for loans to enterprises in the next quarter.

According to the surveyed Latvian banks, the development of the demand for loans to small and medium-sized enterprises was similar to that for loans to large enterprises in the second quarter of 2020. Nevertheless, one bank expects that in the next quarter the overall demand will be weakened by lower demand for loans to large enterprises. At the same time, another bank expects that only credit standards for long-term loans to small and medium-sized enterprises will be tightened in the third quarter.

**Chart 5**

**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; %)



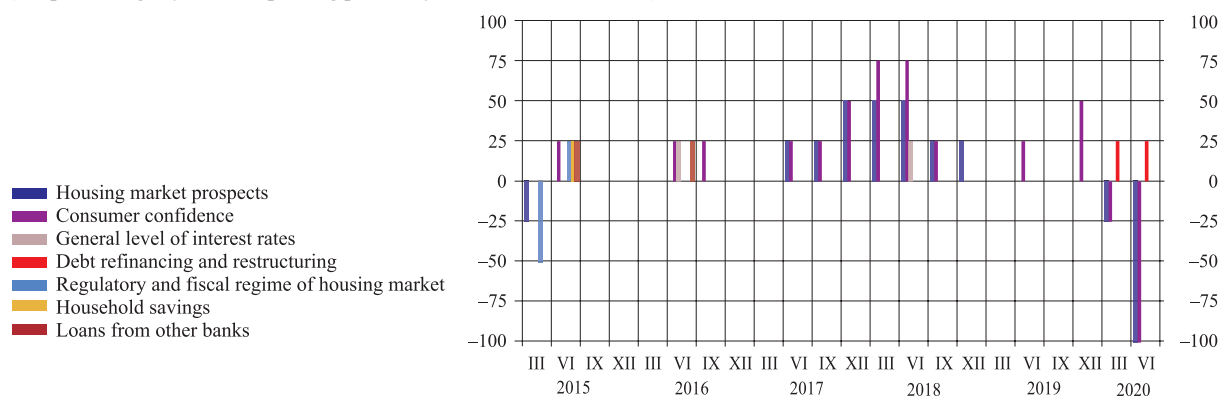
Due to higher costs of funds, balance sheet restrictions, higher risk perception and lower risk tolerance limits, the terms and conditions regarding loan size and collateral requirements for both loans to small and medium-sized enterprises and loans to large enterprises were tightened in one of the surveyed Latvian credit institutions.

### Loans to households for house purchase

The developments in loans to households for house purchase were primarily determined by lower demand, yet an even steeper fall in lending was prevented by the repayment holidays previously granted for existing loans, debt refinancing, restructuring or renegotiation. Banks continued to tighten their credit standards as well as credit terms and conditions for loans to households for house purchase in the second quarter of 2020.

All respondent Latvian banks agreed that the demand for loans to households for house purchase decreased in the second quarter of 2020. The views with regard to the intensity of this fall, however, differed: three banks stated that the demand for loans to households for house purchase decreased significantly, whereas one bank reported only a minor decline. Banks expect this fall in demand to be just temporary and anticipate a recovery already in the next quarter. Three of the surveyed Latvian banks expect a slight increase in demand for loans to households for house purchase in the next quarter, whereas one bank anticipates a minor decline.

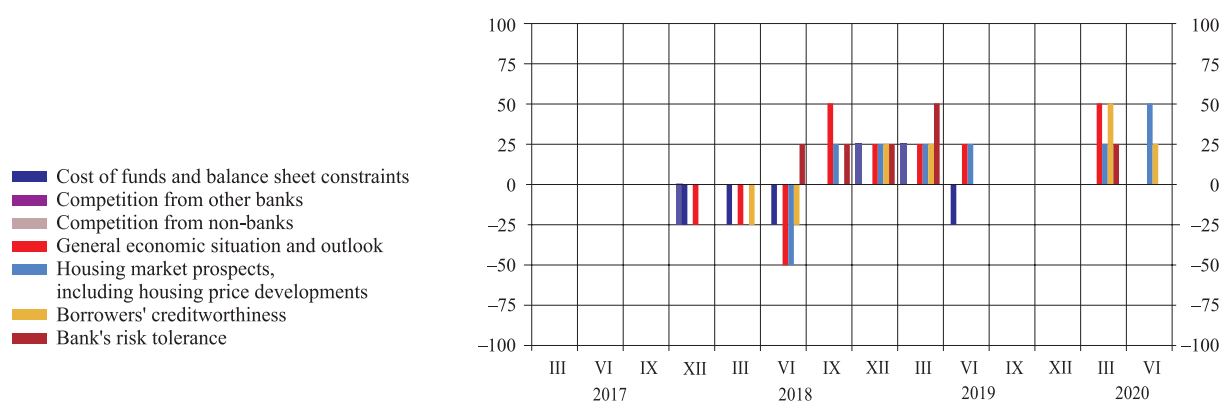
Chart 6

**FACTORS CONTRIBUTING TO HOUSEHOLD DEMAND FOR LOANS FOR HOUSE PURCHASE***(net percentage of banks reporting positive factor contributions; %)*

All of the surveyed Latvian banks mentioned weakening consumer confidence and housing market prospects as the main drivers of the fall in demand for loans to households for house purchase. The contribution from the weakening consumer confidence was considered significant, whereas that from the deterioration of the housing market prospects was viewed as moderate. Three of the surveyed Latvian banks considered that the negative effect of weaker consumer confidence on demand for loans to households for house purchase was significant, whereas one bank thought it to be minor. The negative effect of weaker housing market prospects was viewed as minor by three respondent Latvian banks and as significant by one bank. In one bank, the effect of the above-mentioned factors on demand for loans to households for house purchase in the second quarter was mitigated by debt refinancing, restructuring and renegotiation.

A higher rejection rate for loan applications from households was also reported by those Latvian banks which tightened their credit standards for loans to households for house purchase in the second quarter of 2020 and vice versa: one bank reporting easing of the credit standards also had a lower loan rejection rate. Survey results reveal an overall net increase in the rejection rate for household loans (a significant increase in one bank, a slight one in another bank, no change in one bank and a slight decrease in one bank). Given the current circumstances, in addition to tightening of the lending policies, rejection of household loan applications could be also explained by lower quality of loan applications.

Chart 7

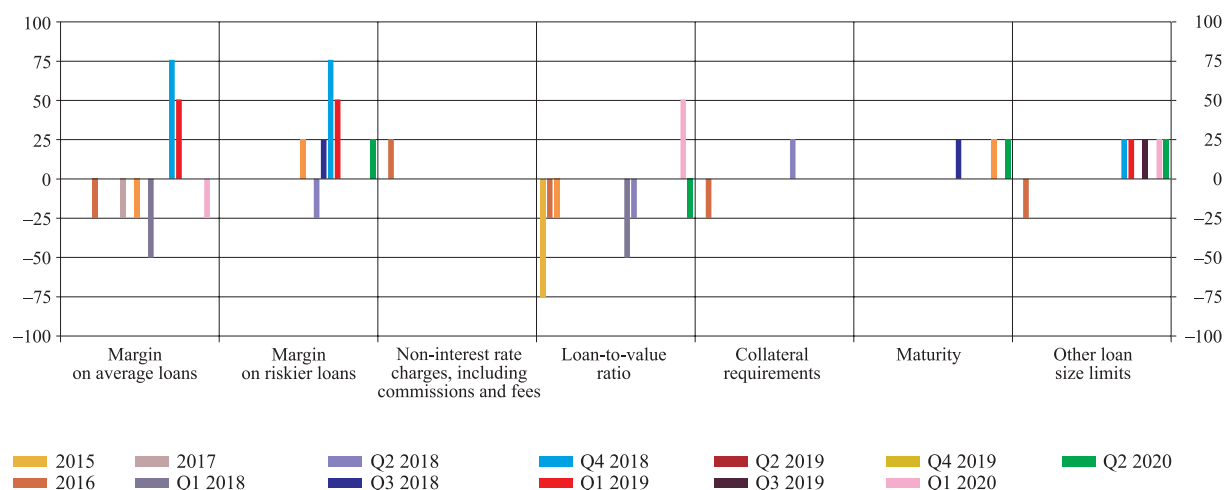
**FACTORS CONTRIBUTING TO TIGHTENING CREDIT STANDARDS FOR LOANS TO HOUSEHOLDS FOR HOUSE PURCHASE***(net percentage of banks reporting positive factor contributions; %)*

One Latvian bank reported tightening of credit standards for loans to households for house purchase in the second quarter of 2020. Tightening of credit standards for loans to households for house purchase in the second quarter of 2020 was explained by deterioration of the housing market prospects (in two banks), borrowers' creditworthiness (in one bank) and environment (in one bank). At the same time, the views regarding the effect of the general economic situation and outlook on credit standards for loans to households for house purchase differed: one bank reported it as a contributor to tightening and

another one as a contributor to easing of credit standards. No further tightening of credit standards in this segment is expected in the next quarter, and, in fact, some easing could be anticipated. Three of the respondent Latvian banks intend to preserve their current credit standards for loans to households for house purchase in the next quarter, whereas one bank even expects some easing.

**Chart 8**

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



Credit terms and conditions for loans to households for house purchase have remained broadly unchanged in the surveyed Latvian banks in the second quarter (one bank has slightly tightened the terms and conditions, while another one has eased them). Terms and conditions regarding the margins on riskier loans, loan size and maturity were slightly tightened, whereas the terms and conditions concerning loan-to-value ratios were slightly eased. Latvian banks had quite contradictory views as to the factors contributing to changes in terms and conditions applied in this lending segment. With cost of funds and balance sheet restrictions as well as risk perception in various banks moving into opposite directions, only a decrease in risk tolerance reported by one bank had a meaningful effect.

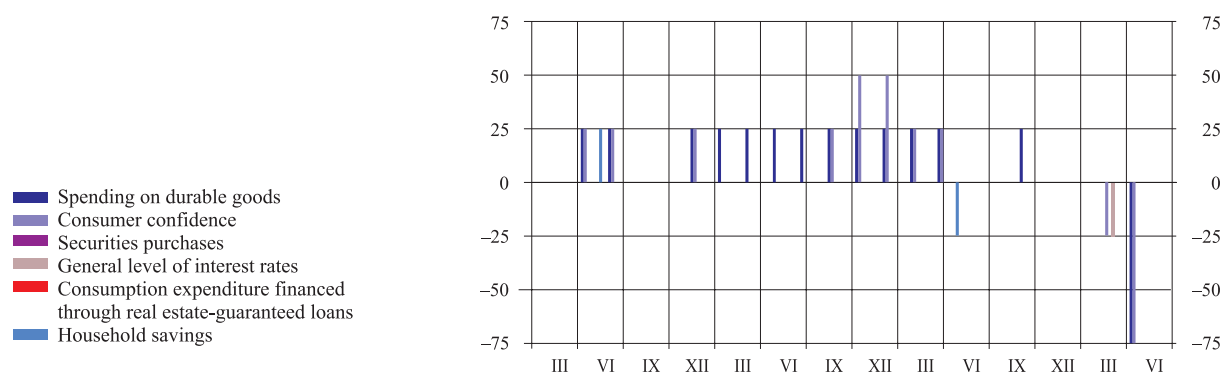
**Consumer credit and other lending to households**

The decline in demand for consumer credit and other lending to households in the second quarter was slightly smaller than that in demand for loans to households for house purchase: a considerable fall was reported by two banks, a small one by one bank and a small increase was reported by one bank).

**Chart 9**

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

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



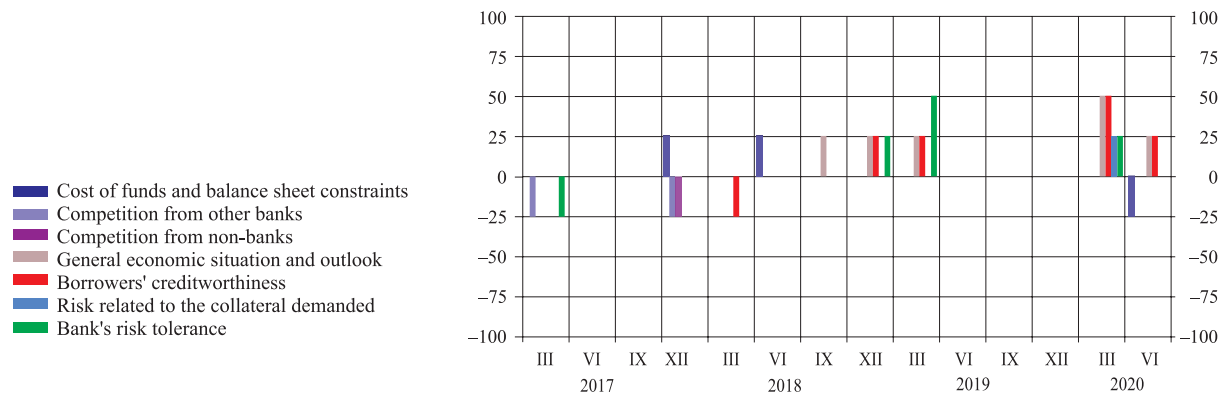
All Latvian banks, even those reporting an increase in demand for consumer credit and other lending to households, observed that a significant contributor to a fall in demand in this particular segment was declining consumer confidence (three banks reported that the effect was significant, whereas one thought that it was small). Lower demand for durable consumer goods (e.g. cars) was a downward factor which

was mentioned only slightly less often (by three banks). One bank, where demand for consumer credit and other lending to households increased, mentioned the need for restructuring consumer credit as the underlying reason. Nevertheless, Latvian banks are quite optimistic with regard to the next quarter's developments in demand: two banks expect a slight increase in demand, whereas one bank thinks that it might somewhat decrease.

**Chart 10**

**FACTORS CONTRIBUTING TO TIGHTENING CREDIT STANDARDS FOR CONSUMER CREDIT AND OTHER LENDING TO HOUSEHOLDS**

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

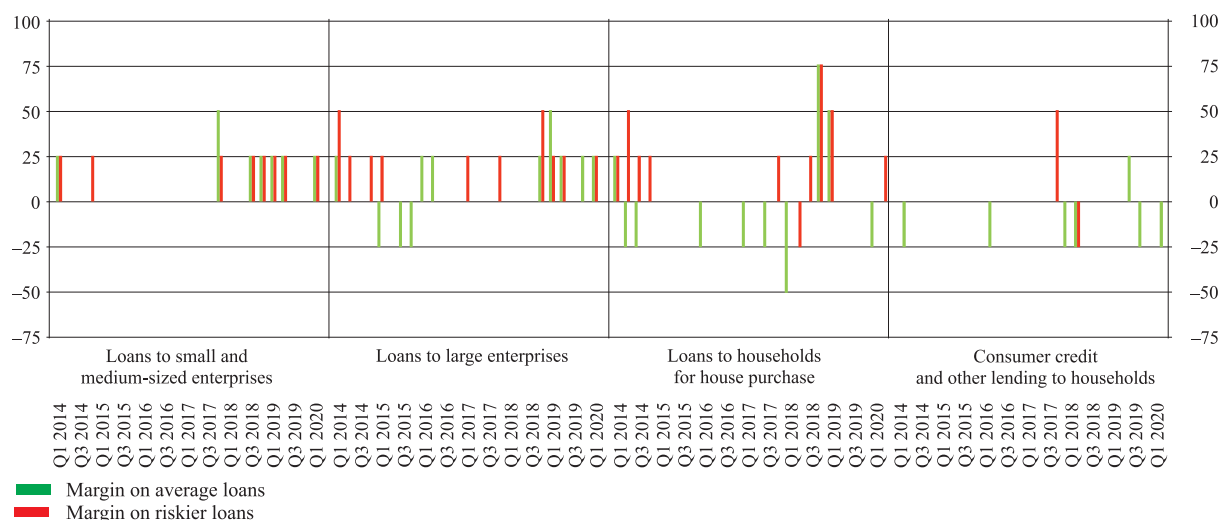


Credit standards for consumer credit and other lending to households were also tightened in the second quarter, same as credit standards for loans to households for house purchase, thereby contributing to an increase in the rejection rate for loan applications (in one bank). The main factors contributing to tightening credit standards were deterioration in the general economic situation and outlook (in one bank) and worsened borrowers' creditworthiness (in one bank). Nevertheless, it has to be admitted that the surveyed banks viewed the effect of general economic situation and outlook differently: it was a factor contributing to tightening of credit standards in two banks, whereas one bank reported it as an easing factor. In addition to that, lower cost of funds and balance sheet constraints were mentioned as a factor preventing further tightening of credit standards (in one bank). At the same time, one of the respondent Latvian banks intends to slightly ease credit standards for consumer credit and other lending to households in the next quarter.

**Chart 11**

**CHANGES IN MARGINS ON LOANS OF DIFFERENT CATEGORIES**

(net percentage of banks reporting increased margins; %)



One of the surveyed banks eased the general terms and conditions for consumer credit and other lending to households in the second quarter due to lower cost of funds and balance sheet restrictions in the first half of the year as well as increased risk perception. As a result, margins on average consumer credit and other lending to households were slightly narrowed (in one bank). At the same time, the developments



in terms and conditions regarding loan size were contradictory: one bank increased the loan size limits, whereas another bank decreased the limits due to lower risk tolerance.

### **Ad hoc questions**

Euro area bank lending survey of July 2020 included several ad hoc questions regarding the impact of banks' non-performing loan ratios on lending policies as well as the change in credit standards, terms and conditions and demand for loans to enterprises across the economic sectors.

This year, the ratio of non-performing loans will be another factor influencing the lending policies in half of the surveyed Latvian banks, particularly in enterprise segment. It contributed to tightening credit standards in one bank in the first half of the year and could contribute to a minor tightening of credit standards in the second half of the year as well as some tightening of credit terms and conditions for loans to enterprises in another bank. Moreover, in one of the banks, the ratio of non-performing loans had a negative effect on the lending policy in the household segment as well in the first half of the year (with regard to both loans for house purchase and consumer credit and other lending to households). The main reasons why the ratio of non-performing loans affected or is expected to affect the lending policies of both banks were associated with high balance sheet clean-up costs as well as pressure related to supervisory and regulatory requirements.

In the first half of 2020, at least in half of the cases, Latvian banks tightened credit standards and terms and conditions for loans to enterprises in construction and real estate sector, particularly in residential real estate sector. Credit standards, terms and conditions applied to other sectors (manufacturing, services (excluding financial services and real estate), trade) were tightened at least in one of the banks. The surveyed Latvian banks had different experience with regard to changes in demand for loans to enterprises across various sectors in the first half of 2020. Overall, demand for loans to enterprises contracted or is expected to contract in the second half of 2020 almost in all sectors. In the first half of the year, lower demand was recorded in services (excluding financial services and real estate) and residential real estate sectors (by one bank). As to the second half of the year, Latvian banks overall expect a fall in demand in manufacturing (one bank), construction (excluding real estate; two banks), real estate (three banks), including a lower demand for loans to commercial real estate (two banks) and residential real estate (three banks).