

Euro area bank lending survey of June 2022: main results for Latvia

- Latvian banks tightened credit standards for loans to enterprises for the second consecutive quarter and also to households for the first time over the last year.
- Weakening of the situation and prospects observed in the economy, sectors and certain enterprises determined the application of tighter terms and conditions, including higher margins, on loans to enterprises.
- Demand for short-term loans to enterprises grew on account of the increased need for working capital and inventories.

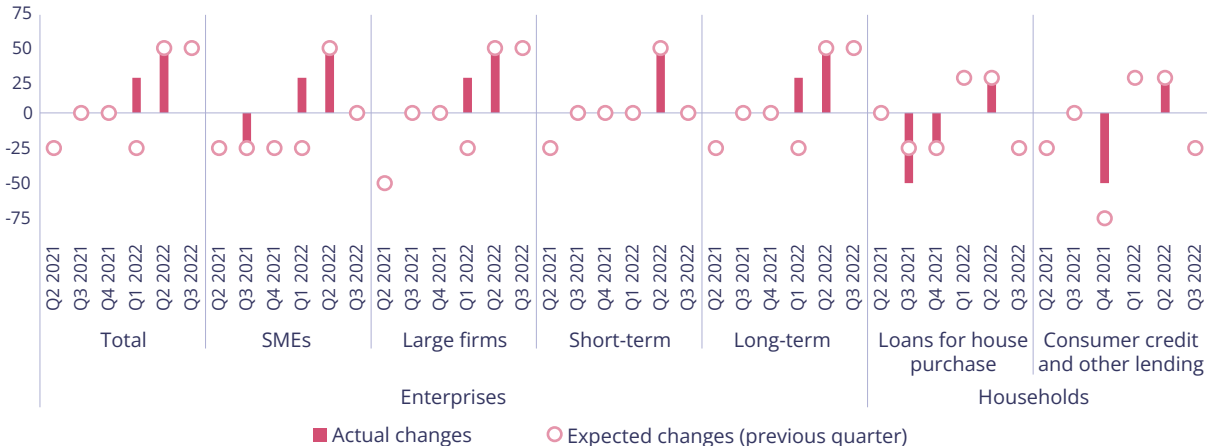
Latvijas Banka conducted a euro area bank lending survey in cooperation with the European Central Bank in June 2022, covering the lending developments during the second quarter of 2022 and bank expectations for the third quarter of 2022. Four Latvian banks whose total market share in lending to non-financial corporations and households is high enough to represent the lending development in Latvia participated in the survey. Their replies have been incorporated in the euro area bank lending survey results.

During the reporting period, demand for short-term loans mounted, particularly in the energy sector. Lending developments in long-term loans to enterprises remained rather sluggish. Lending to households continued on an upward path in the second quarter. However, rising risks in both sectors could suppress the demand and contribute to banks' caution over the following quarters. More detailed presentation of the factors behind credit standards, terms and conditions, as well as changes in demand and how these factors affected lending in Latvia is available below.

Credit standards

During the reporting period, the number of the surveyed Latvian banks, which indicated that they had tightened credit standards for loans to enterprises as a whole in all segments in the second quarter and intend to tighten them for long-term loans to large firms in the following quarter, increased (to two). One Latvian bank, for the first time over the past year, tightened credit standards for loans to households – both for loans for house purchase and for consumer credit and other lending (see Chart 1).

Chart 1¹
Changes in credit standards by lending sector
 (number of banks reporting a tightening of credit standards)



Latvian banks tightened credit standards for loans to enterprises in the second quarter of 2022. This was mainly due to the weakening economic situation and outlook, as well as due to the weakening outlook of sectors and certain enterprises and the increasing credit risk of a borrower (each factor was mentioned twice). A weaker capital position and the related higher costs were a less important factor (mentioned once) behind tightening of credit standards for loans to enterprises (see Chart 2).

1 Bank lending survey data have been used in all charts.

Chart 2

Contribution of various factors to credit standards for loans to enterprises

(number of banks reporting the factors contributing to tightening of credit standards; net; %)



Tightening of credit standards for loans to households for house purchase and also for consumer credit and other lending to households in the second quarter is related to a weaker economic situation and outlook, as well as a higher credit risk of a borrower (each factor was mentioned once for both segments). Moreover, with regard to loans for house purchase one surveyed Latvian bank indicated that it had tightened credit standards as the capital position weakened and the related costs mounted.

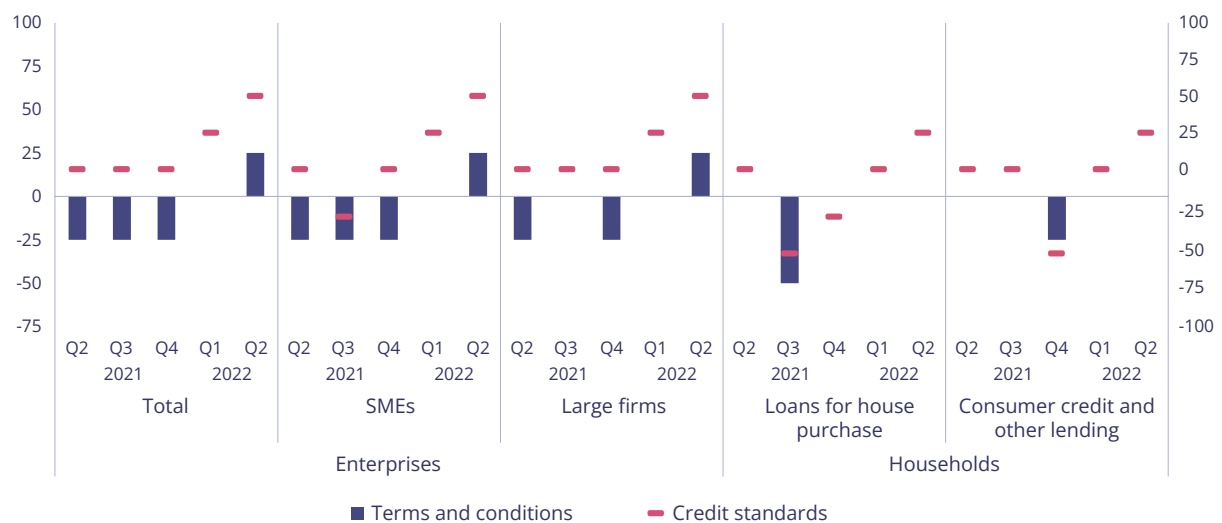
Credit terms and conditions

It was only in the corporate sector and in one bank that general terms and conditions changed in the second quarter. They were tightened both for loans to small and medium-sized enterprises (SMEs) and large firms (see Chart 3).

Chart 3

Changes in general terms and conditions compared to changes in credit standards by lending sector

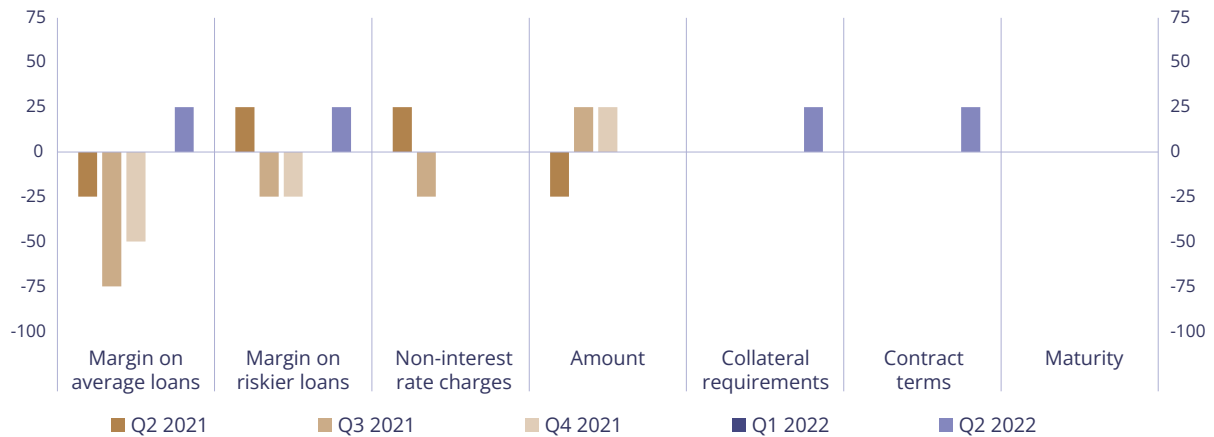
(number of banks reporting a tightening of general terms and conditions, as well as credit standards; net; %)



In the second quarter, one surveyed Latvian bank widened the margin, tightened collateral requirements and contract terms for loans to enterprises (see Chart 4). At the same time, margins on riskier loans for house purchase were widened in the household sector (in one bank). One bank narrowed margins on consumer credit and other lending to households.

Chart 4**Changes in terms and conditions for loans to enterprises**

(number of banks reporting a tightening of terms and conditions; net; %)



In the second quarter, the economic situation and outlook, as well as the weakening of the situation and outlook in sectors and certain enterprises and a higher risk related to the collateral contributed to tightening of terms and conditions for loans to enterprises (see Chart 5). One surveyed Latvian bank reported the expected tightening impact of the above factors on terms and conditions for loans to enterprises in the second quarter. By contrast, the incentive effect stemming from the easing of the heavy pressure from the strong competition on terms and conditions for loans to enterprises observed in 2021 has decreased in 2022.

Chart 5**Contribution of various factors to terms and conditions for loans to enterprises**

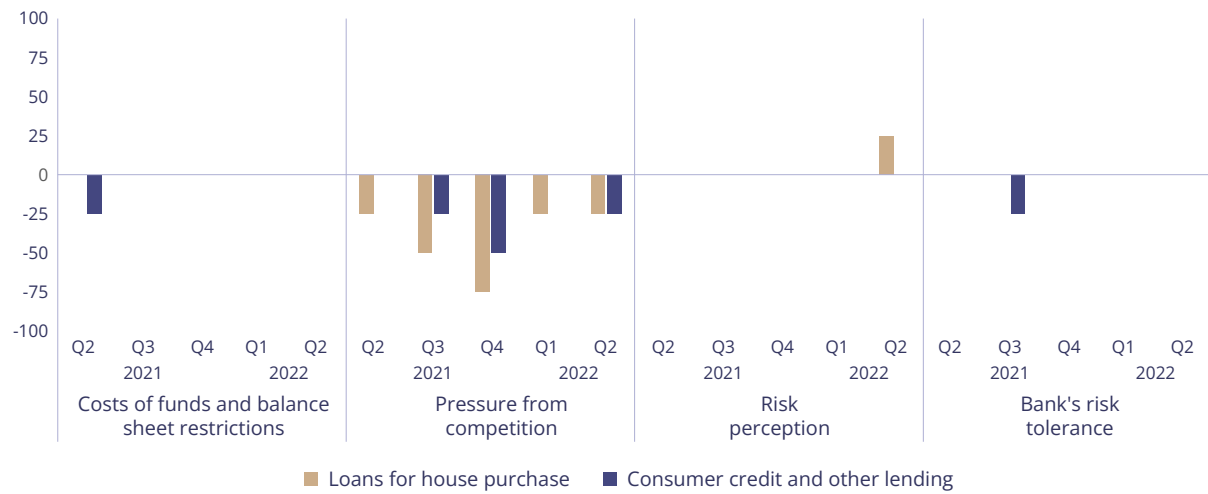
(number of banks reporting the factors contributing to tightening of terms and conditions; net; %)



A higher perceived risk was a significant factor contributing to widening of margins on both average and riskier loans to households for house purchase in one bank in the second quarter (see Chart 6). Unlike the sector of lending to enterprises, competition from other banks, which determined the narrowing of margins on average loans to households, remained unchanged in the sector of lending to households. This was not a decisive factor for loans to households for house purchase. By contrast, competition from other banks made one surveyed Latvian bank narrow margins on average consumer credit and other lending to households in the second quarter.

Chart 6**Contribution of various factors to margins on average loans to households by loan segment**

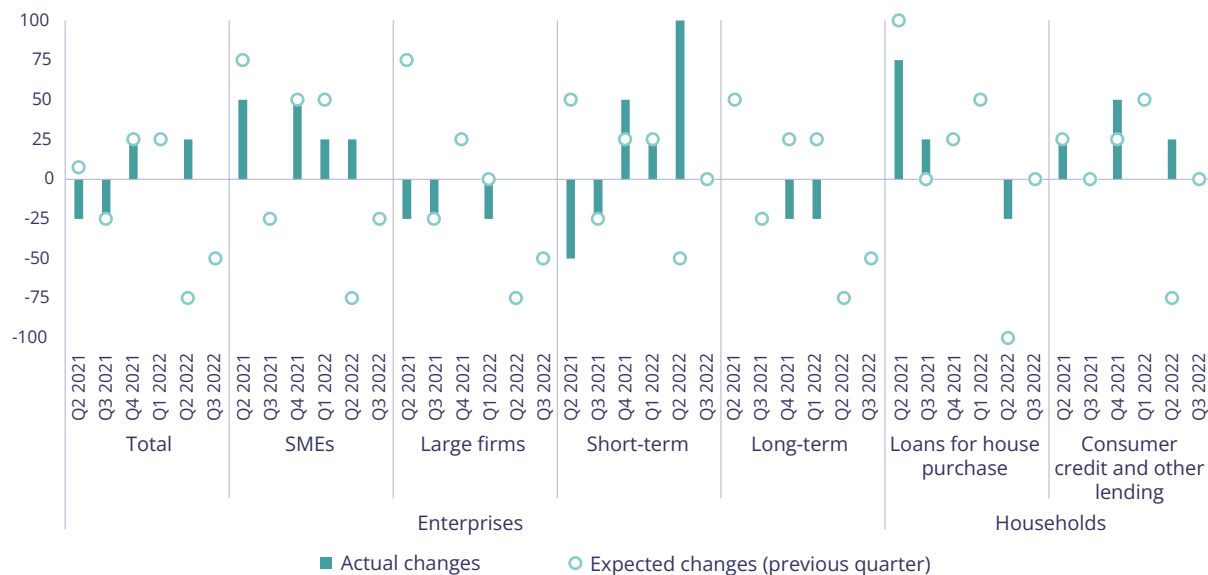
(number of banks reporting the factors contributing to a widening of margins; net; %)

**Demand for loans**

Demand for short-term loans to enterprises increased in all surveyed Latvian banks during the reporting period (see Chart 7). Changes in other loan segments were less frequent. For example, one surveyed bank pointed out that demand for loans to SMEs grew in the second quarter. During the reporting period, demand for loans to households for house purchase shrank in one bank for the first time over the past year. Meanwhile, demand for consumer credit and other lending to households increased in one bank in the second quarter.

Chart 7**Changes in loan demand by lending sector**

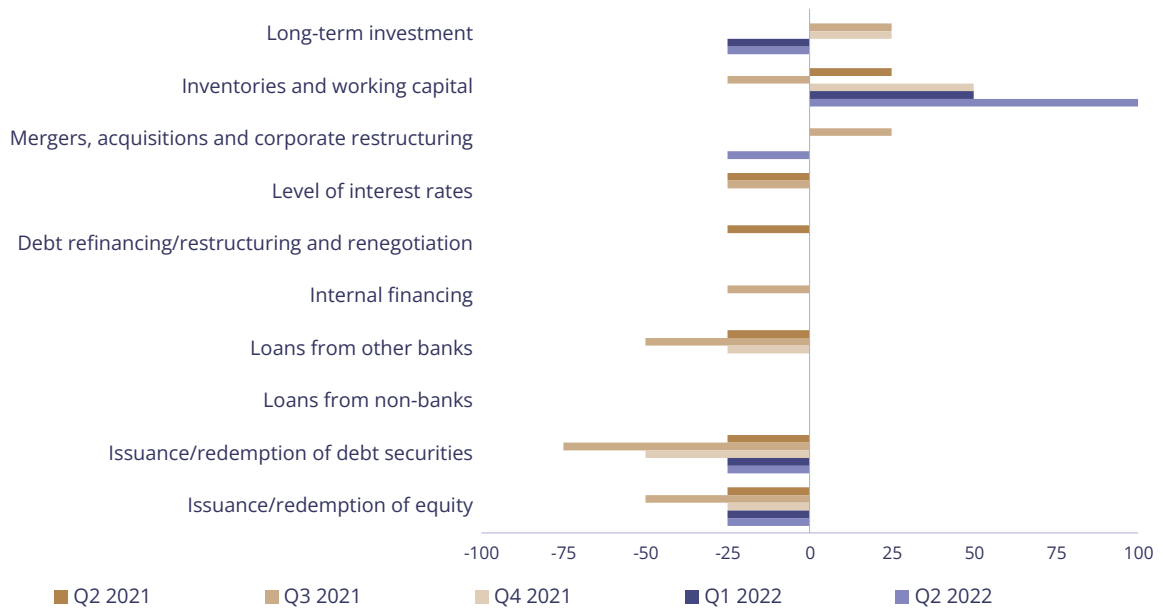
(number of banks reporting higher demand; net; %)



With commodity prices mounting and enterprises making stock provisions for precautionary purposes, the need for working capital and inventories (see Chart 8) determined growth in demand for short-term loans to enterprises in the second quarter. During the reporting period, demand for long-term loans to enterprises stagnated as it was adversely affected by a reduced need for long-term investment, more dynamic activity in the debt securities market and an increasing interest in equity issuance (each factor was mentioned once).

Chart 8

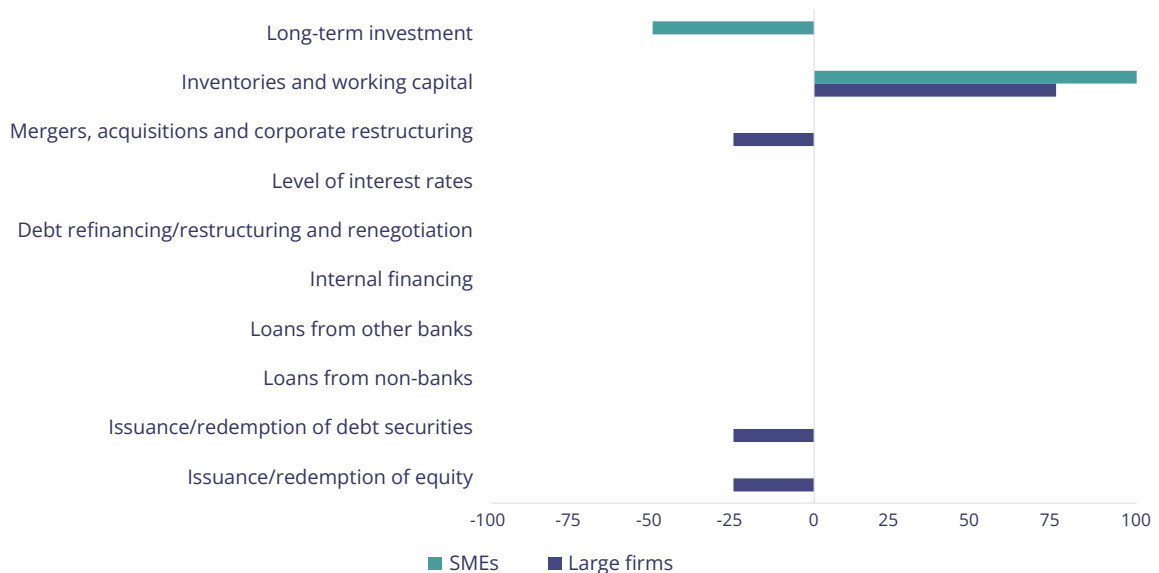
Contribution of various factors to demand for loans to enterprises
(number of banks reporting higher demand; net; %)



Contribution of various factors to demand varied across enterprises during the reporting period (see Chart 9). The Russian-Ukrainian war and surging commodity prices mostly affected SMEs whose increased need for inventories and working capital boosted demand for loans in all surveyed Latvian banks, but a reduced need for long-term investment had a dampening effect on demand in two banks. As regards large firms, debt securities and equity market development and an increased need for mergers/acquisitions and corporate restructuring had a negative impact on demand in one bank during the reporting period.

Chart 9

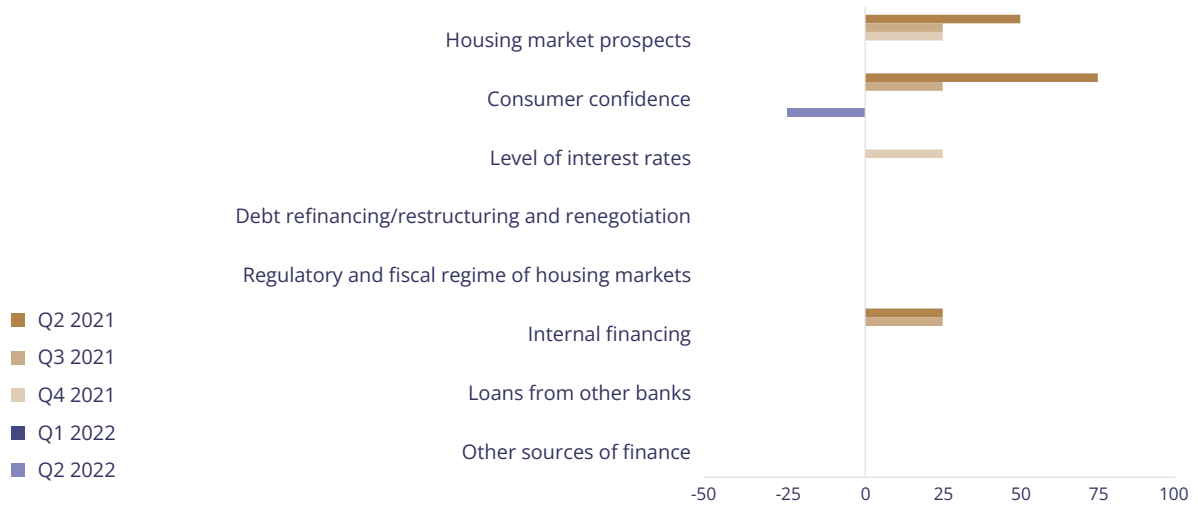
Contribution of various factors to demand for loans to enterprises by enterprise size group
(number of banks reporting higher demand; net; %)



In the second quarter, a decline in demand for loans to households for house purchase was driven by lower consumer confidence in one bank (see Chart 10). Meanwhile, an increased need for durables, as well as high household demand for energy efficiency improvements and popularity of the respective state support programmes contributed to growth in demand for consumer credit and other lending to households in one surveyed Latvian bank during the reporting period.

Chart 10**Contribution of various factors to demand for loans to households for house purchase**

(number of banks reporting the factors contributing to higher demand; net; %)



The share of rejected applications for loans in the sector of lending to enterprises fell in one surveyed Latvian bank in the second quarter.

Ad hoc questions

The euro area bank lending survey of June 2022 included several ad hoc questions. The issue which concerned Latvian banks most was changes in credit standards, terms and conditions, as well as in demand for loans to enterprises by sector.

In the first half of 2022, two surveyed Latvian banks tightened credit standards in the sectors of industry and construction, one bank – in the services sector (except financial services and real estate) and the residential real estate sector. Over the next half of the year, one bank intends to tighten credit standards for loans to construction sector enterprises. Terms and conditions for loans to enterprises were eased in the sector of commercial services (in one bank) in the first half of 2022, and one bank intended to ease them in the services sector (except financial services and real estate activities), as well as in the wholesale and retail trade sectors over the next six months.

In the first half of 2022, demand for loans to enterprises grew in the industrial sector (in two banks) and in the retail trade and wholesale sectors (in one bank), but it contracted in the services sector, except financial services and real estate activities (in one bank).

In the second half of 2022, the surveyed Latvian banks expected growth in demand in the wholesale and retail sectors (two banks), as well as in the sectors of industry, services, except financial services and real estate activities, and residential real estate (one bank).