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

- *Credit standards were tightened across all categories of lending, while terms and conditions – mostly for loans to enterprises.*
- *Demand decreased not only for long-term loans to enterprises, but, as the financing needs for inventories and working capital declined, also for short-term loans to enterprises.*
- *For the third consecutive quarter, banks reported a decrease in demand for loans to households for house purchase, and, for the first time, also for consumer credit and other lending to households.*
- *In the following quarter, most of the surveyed Latvian banks expect a tightening of credit standards and a fall in demand for loans to enterprises.*

Latvijas Banka conducted a euro area bank lending survey in cooperation with the European Central Bank (ECB) in December 2022, covering lending developments during the fourth quarter of 2022 and bank expectations for the first quarter of 2023. 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.

Lending to enterprises and households gradually decreased during the reporting period. Short-term loans in the corporate sector substantially contracted at the end of the year. The projected fall in the economic activity, rise in credit payments, cautiousness of borrowers and lower banks' risk appetite also weighed on the dynamics of long-term loans to enterprises and loans to households for house purchase. Next comes a more detailed presentation of the factors behind changes in credit standards, terms and conditions, as well as demand and how these changes affected lending in Latvia during the fourth quarter of 2022.

Credit standards

Since the beginning of the Russian-Ukrainian war, Latvian banks tighten their credit standards for loans to enterprises and households every quarter (see Chart 1). A similar trend towards a tightening of credit standards is also observed in the euro area as a whole.

Chart 1[1]

Changes in credit standards by category of lending

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

Latvian banks tightened their credit standards for loans to enterprises slightly earlier than for loans to

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

households – already in the first quarter of 2022. The tightening of credit standards reached its highest intensity in the above category of lending during the second quarter of 2022 when standards were tightened in two out of the four surveyed Latvian banks. Meanwhile, in the fourth quarter of 2022, as expected before, credit standards for loans to enterprises were tightened by one bank; furthermore, the results did not differ for loans to enterprises in general and by subcategories.

Chart 2

Contribution of various factors to credit standards for loans to enterprises
(net percentage of banks reporting the factors behind the application of tighter credit standards; %)

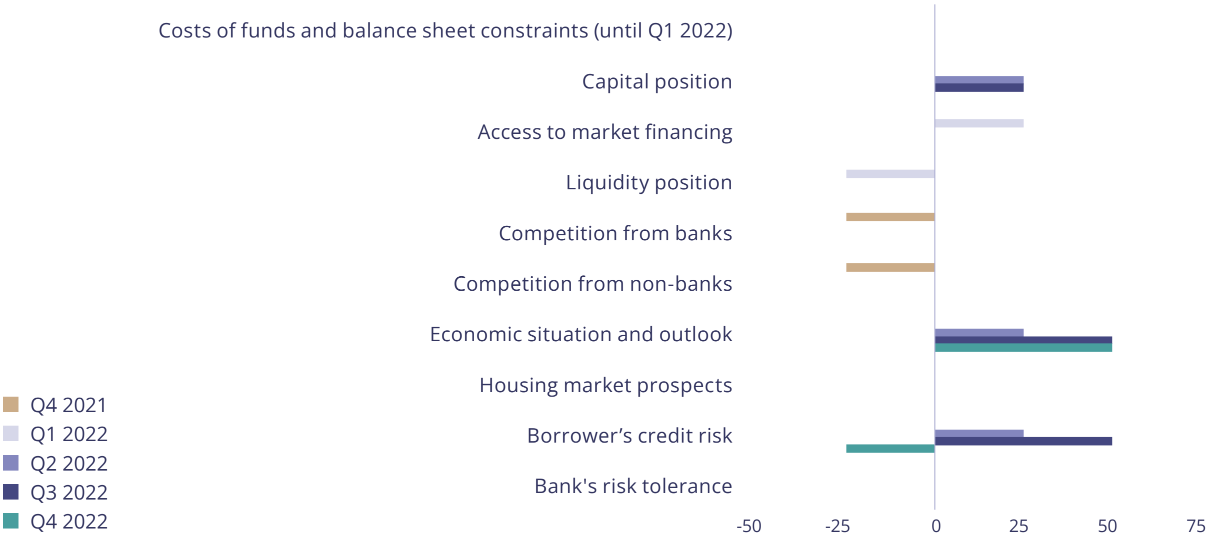
The analysis of factors indicates that in the fourth quarter of 2022, banks expressed concern about the economic, industry and firm-specific situation and outlook less frequently (see Chart 2). Over the reporting period, the above factors contributed to the application of tighter standards in one of the surveyed Latvian banks (for comparison: in two banks during the second quarter of the same year). This can be explained by the fall in prices observed in the raw material market during the second half of 2022 as well as by the anchoring of expectations about the success achieved by the ECB's monetary policy tightening in containing the inflation spiral. It should be noted that one Latvian bank pointed out that the application of tighter credit standards to loans to enterprises during the fourth quarter of 2022 was additionally facilitated by the build-up of the risk related to the collateral demanded and a decrease in the bank's risk tolerance.

In their assessment of the possible credit standard development in the first quarter of 2023, three of the four surveyed Latvian banks indicated their intent to tighten credit standards for loans to enterprises. The tightening of credit standards for loans to enterprises during the following quarter might be related to expectations about a decline in the economic activity during the first half of 2023.

The tightening of credit standards for loans to households began and the highest intensity was reached a quarter later than for loans to enterprises (in the second and third quarters of 2022 respectively). During the reporting period (the fourth quarter of 2022), the forecasts for the previous quarter about a tightening of credit standards for loans to households in three banks did not come true: credit standards for both loans for house purchase and consumer credit and other lending were tightened in one surveyed Latvian bank. One bank intends to tighten credit standards for loans to households in the following quarter.

Chart 3

Contribution of various factors to credit standards for loans to households for house purchase
(net percentage of banks reporting the factors behind the application of tighter credit standards; %)



The difference between changes in credit standards for loans to households observed in the fourth quarter of 2022 and projected in the third quarter of the same year can be explained by a lower household credit risk assessment performed by Latvian banks and a stable financial situation (see Chart 3). The weakening economic situation and outlook was behind the application of tighter credit standards to loans to households for house purchase during two periods – the third and fourth quarters of 2022. Meanwhile, the increase in the borrower's credit risk was mentioned as a factor behind the application of tighter standards three times only in the third quarter; however, already in the fourth quarter, this increase contributed to easing credit standards for loans to households for house purchase in one Latvian bank. During the reporting period, none of the surveyed Latvian banks pointed to the negative impact of the cost of funds and balance sheet constraints on credit standards for loans to households for house purchase.

One surveyed Latvian bank attributed the application of tighter credit standards to consumer credit and other lending to households during the fourth quarter to the weakening economic situation and outlook.

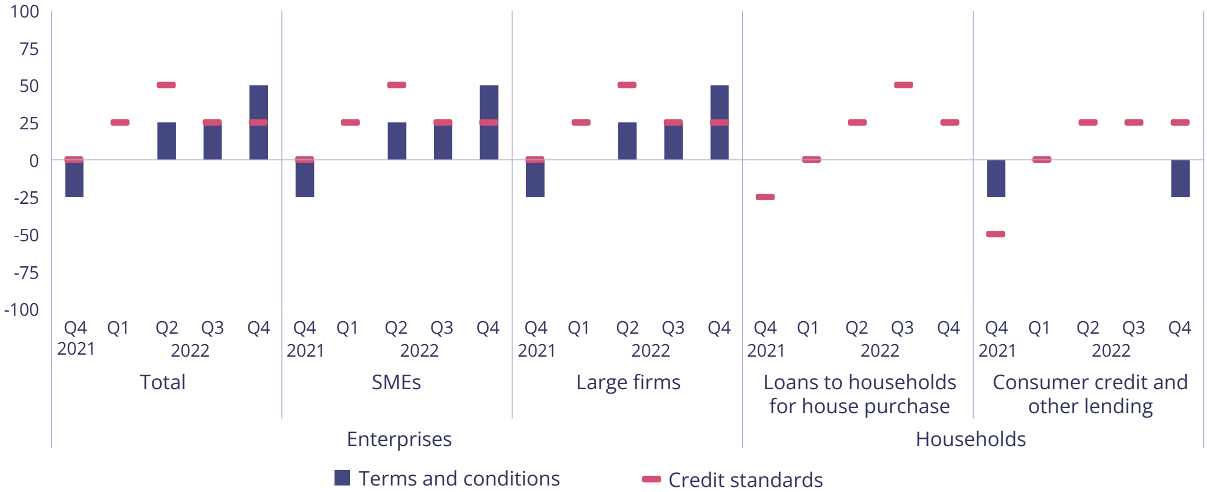
Credit terms and conditions

In the reporting period, the surveyed Latvian banks tightened their overall terms and conditions for loans to enterprises more frequently than they tightened their credit standards. Thus, it became both more difficult and less beneficial for enterprises to receive a loan. The overall terms and conditions for loans to households for house purchase were not changed; however, they were eased by one bank for consumer credit and other lending to households. With credit standards tightening, a lower share of households were able to qualify for loans; however, if they succeeded, terms and conditions remained unchanged (for loans for house purchase) or even improved (for consumer credit and other lending) (see Chart 4).

Chart 4

Changes in overall terms and conditions compared to changes in credit standards by category of lending

(net percentage of banks reporting a tightening of overall terms and conditions as well as credit standards; %)

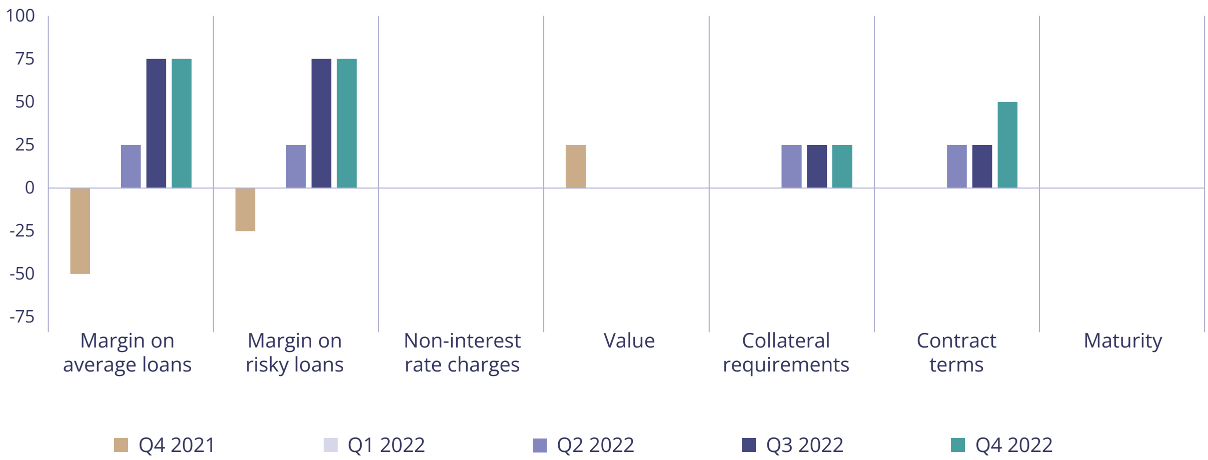


When describing terms and conditions for loans to enterprises, most (three) surveyed Latvian banks reported an increase in margins in the fourth quarter of 2022 (see Chart 5). Meanwhile, the rise in the agreed interest rate on loans to enterprises does not exceed the increase in money market indices caused by the ECB's monetary policy tightening, thus the margin has actually contracted somewhat. The differences between the statistical data and the survey results could indicate a higher share of loans to enterprises with the interest rate not pegged to a money market index or a higher percentage of loans to lower risk enterprises as credit standards tighten. In addition, two surveyed Latvian banks pointed out that they tightened other contract terms in the reporting period, while one Latvian bank indicated a tightening of terms and conditions related to collateral requirements.

Chart 5

Changes in terms and conditions for loans to enterprises

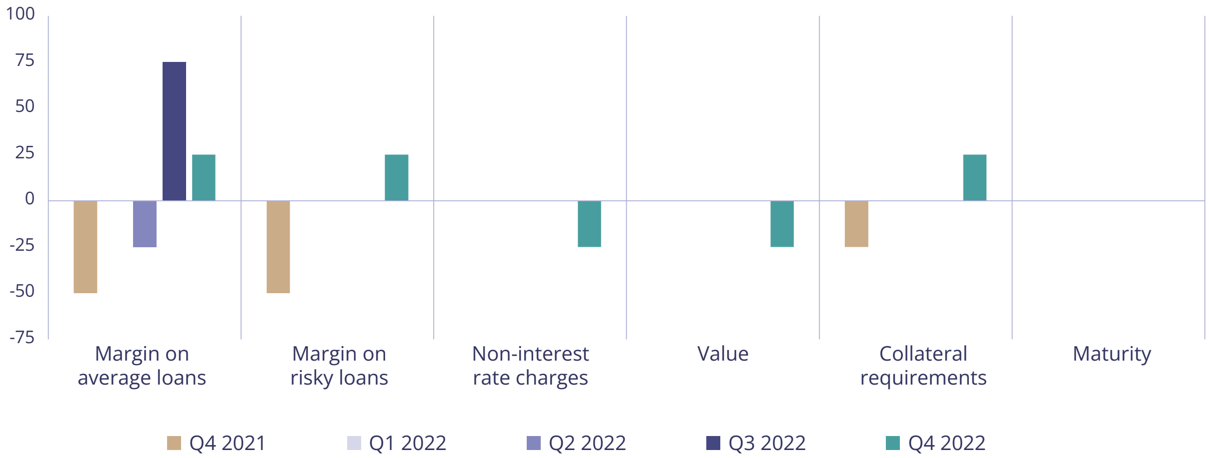
(net percentage of banks reporting a tightening of terms and conditions; %)



The application of tighter overall terms and conditions to loans to enterprises in the fourth quarter of 2022 was driven by the same factors behind the application of tighter credit standards: a weaker economic, industry and firm-specific situation and outlook, a higher borrower's credit risk, a higher risk related to the collateral demanded and a lower risk tolerance of banks. There were no significant differences between changes in terms and conditions for loans to small and medium-sized enterprises and loans to large firms.

Chart 6

Changes in terms and conditions for consumer credit and other lending to households
(net percentage of banks reporting a tightening of terms and conditions; %)



In the reporting period, there were changes in some terms and conditions for consumer credit and other lending in the household sector. All in all, the overall terms and conditions for consumer credit and other lending to households were eased during the fourth quarter as commissions (non-interest rate charges) decreased and the value of loans to be granted increased (see Chart 6). However, contrary to the overall direction of changes in the above credit subsector, one surveyed bank raised its margin as well as tightened terms and conditions related to the collateral demanded.

Chart 7

Terms and conditions for consumer credit and other lending to households and factors behind them
(net percentage of banks reporting a tightening of terms and conditions and factors behind them; %)

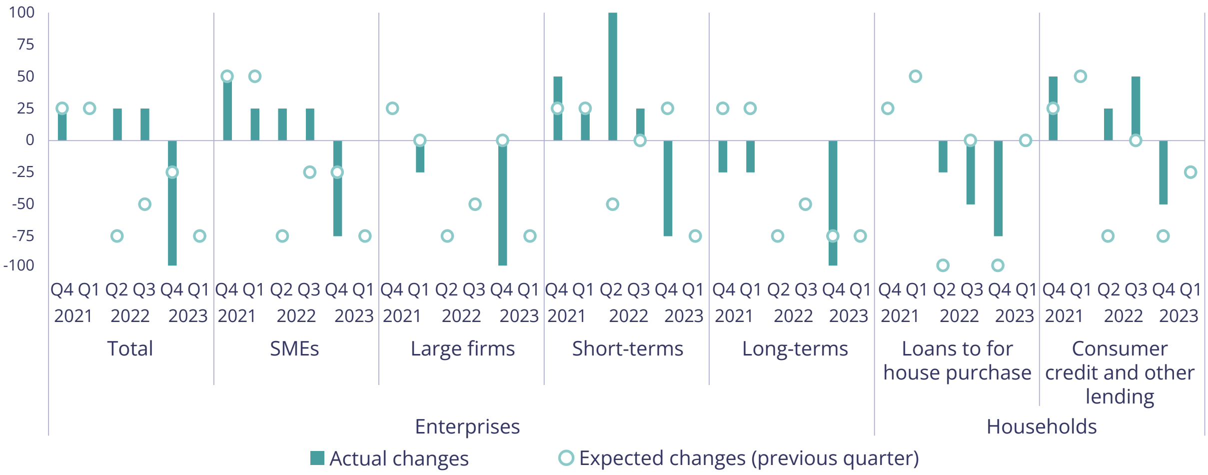
During the reporting period, the easing of the overall terms and conditions for consumer credit and other lending to households was facilitated in half of the surveyed Latvian banks (two banks) by a higher risk tolerance of banks. Less frequently (in one case) it was noted that the easing of terms and conditions in this category of lending was driven by increasing mutual competitiveness (see Chart 7).

Demand for loans

In the fourth quarter of 2022, demand fell in all categories of lending, most frequently – in the corporate sector (see Chart 8). The drop in demand for long-term loans and loans to large firms during the reporting period was for the first time within a year indicated by all surveyed Latvian banks, while the decline in demand for short-term loans and loans to small and medium-sized enterprises – by most banks (three out of four). The decrease in demand for loans to households for house purchase was pointed out by the surveyed Latvian banks almost as frequently (in three cases), while the fall in demand for consumer credit and other lending to households – less frequently (twice). Demand for loans to households for house purchase has declined for three consecutive quarters, while demand for consumer credit and other lending, like for loans to enterprises, declined for the first time during the last year.

Chart 8

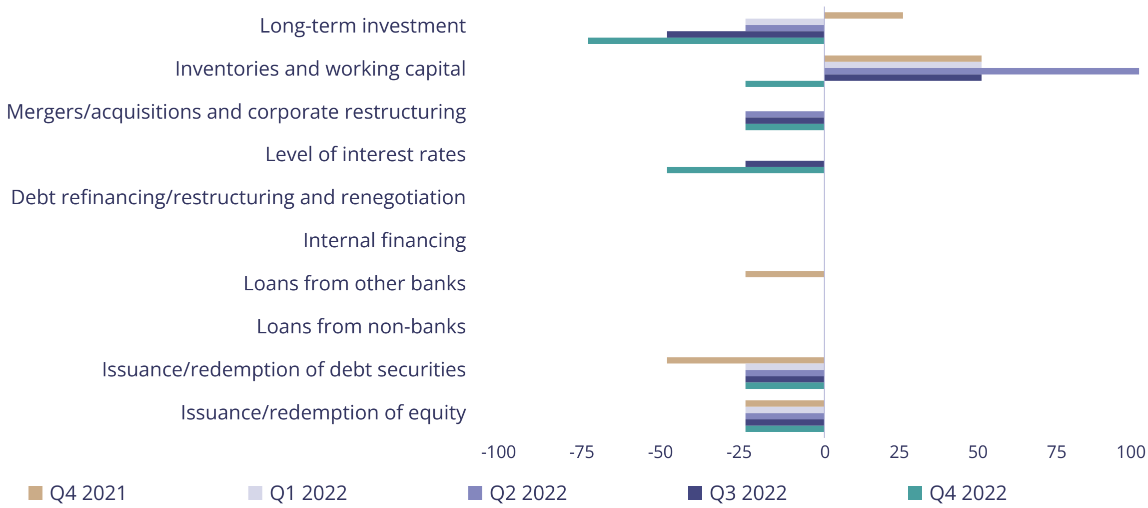
Changes in loan demand by category of lending
(net percentage of banks reporting increased demand; %)



The surveyed Latvian banks were unanimous in their opinion that demand for loans to enterprises fell in the fourth quarter of 2022 as, with the raw material prices declining, the financing needs for inventories and working capital constantly growing during the first half of the year also decreased (see Chart 9). Furthermore, as the ECB increasingly tightened its monetary policy, the negative effect of the rise in money market interest rates on demand for loans to enterprises strengthened. Banks also indicated a smaller need for long-term investment even more frequently than before (three times in the fourth quarter). In the reporting period, like several quarters before, one surveyed Latvian bank suggested that reduced mergers, acquisitions or corporate restructuring activity contributed to the decrease in demand for loans to enterprises. The expansion of the debt and equity market was also regularly mentioned as a factor dampening demand.

Chart 9

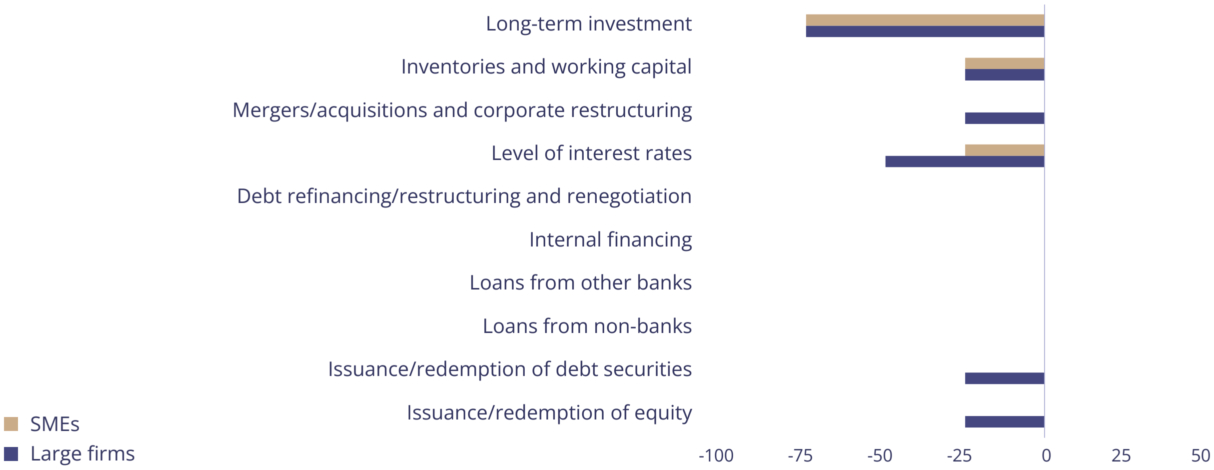
Contribution of various factors to demand for loans to enterprises
(net percentage of banks reporting the factors contributing to higher demand; %)



In the fourth quarter of 2022, the surveyed Latvian banks observed a falling demand for loans to large firms more frequently than for loans to small and medium-sized enterprises as the expansion of the debt and equity market only weighs on demand for loans to large firms (see Chart 10). During the reporting period, the rise in money market interest rates also affected demand for loans to large firms more frequently than demand for loans to small and medium-sized enterprises (in two banks and one bank respectively).

Chart 10

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

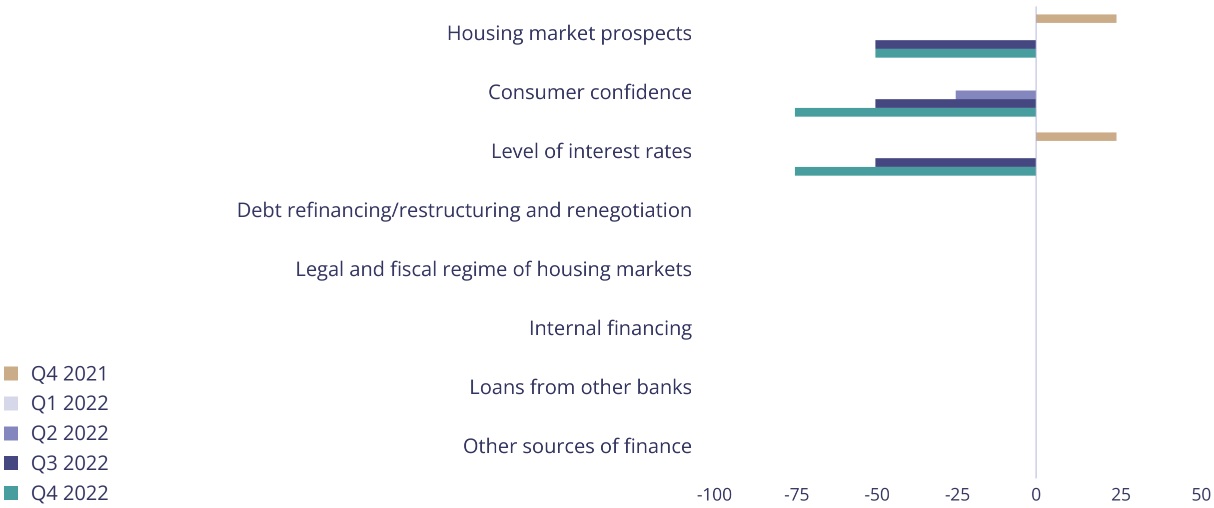


In the reporting period, the effect of a decline in demand on lending in Latvia was also amplified by tighter credit standards. One of the surveyed Latvian banks acknowledged that in the fourth quarter of 2022, the share of rejected applications for loans increased across loans to enterprises. Almost all surveyed banks agreed that demand for loans to enterprises would continue falling in the first quarter of 2023 as well. This fall can be attributed to the economic recession forecasts for the first half of 2023.

Declining housing market prospects and consumer confidence as well as rising interest rates all contributed to the fall in demand for loans to households for house purchase in the fourth quarter, as in the previous quarter (see Chart 11). The surveyed Latvian banks named declining consumer confidence and rising interest rates as the factors dampening demand more frequently in the reporting period (in three cases; in two cases in the third quarter). Meanwhile, the negative effect of declining housing market prospects on demand for loans to households for house purchase was acknowledged by the surveyed banks in the fourth quarter as frequently (in two cases) as in the previous quarter.

Chart 11

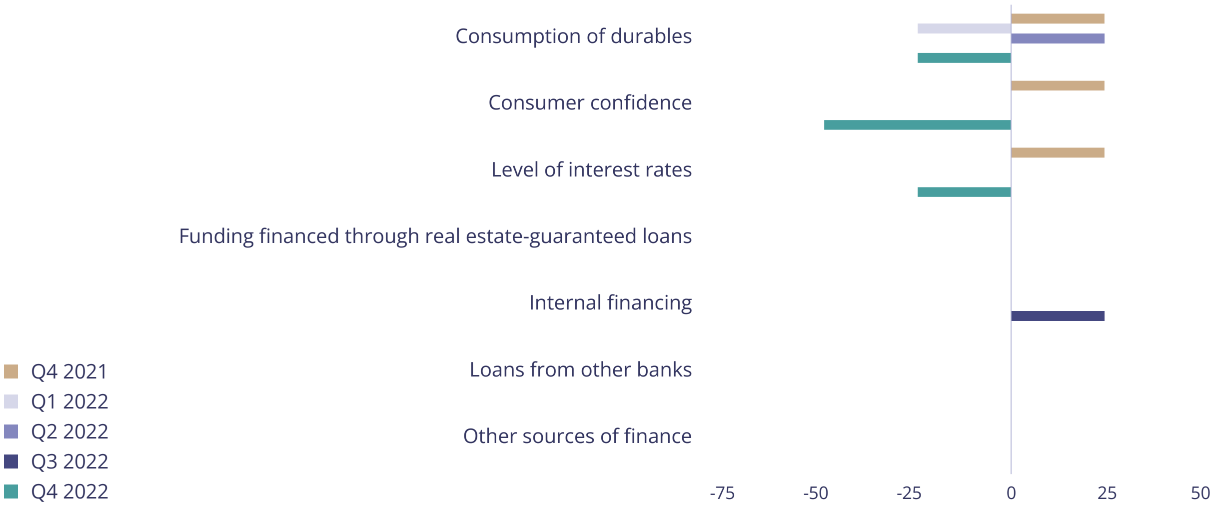
Contribution of various factors to demand for loans to households for house purchase
(net percentage of banks reporting the factors contributing to higher demand; %)



Declining consumer confidence, rising interest rates and reduced need for durables in the reporting period also weighed on demand for consumer credit and other lending to households (see Chart 12). When describing demand in the above lending segment, the surveyed Latvian banks mentioned declining consumer confidence most frequently (in two cases). The effect of the rise in market interest rates on demand was less significant for consumer credit and other lending to households (mentioned once) than for loans for house purchase (mentioned three times). The impact of money market interest rates on the interest rates on consumer credit is normally substantially lower than that of money market interest rates on the interest rates on loans for house purchase, taking into account that interest rates on consumer credit are mostly fixed, while those on loans for house purchase are pegged to money market indices.

Chart 12

Contribution of various factors to demand for consumer credit and other lending to households
(net percentage of banks reporting the factors contributing to higher demand; %)



Banks believe that demand for loans to households for house purchase will remain unchanged in the first quarter of 2023. One bank pointed out that demand for consumer credit and other lending to households will continue declining in the next quarter.

Ad hoc questions

The euro area bank lending survey of December 2022 included several ad hoc questions to banks, inter alia, regarding the impact of new regulatory and supervisory activities and the changes in credit standards, terms and conditions and demand in the major sectors of the economy.

The new regulatory and supervisory activities affected two out of the four surveyed Latvian banks in 2022 and will also affect them in 2023. As a result, one bank saw changes in 2022 and will see changes in 2023 in several financial performance indicators: risky loans will somewhat contract, capital issuance will fall substantially and bank financing conditions will tighten. Another bank expects that owing to the regulatory and supervisory activities its retained earnings and own funds will slightly increase in 2023. The new regulatory and supervisory requirements could contribute to the widening of margins on consumer credit and other lending to households in one of the banks in 2023.

When describing the lending development in the major sectors of the economy, two surveyed Latvian banks indicated a tightening of credit standards for loans to enterprises in the second half of 2022, while three surveyed Latvian banks pointed out that they would tighten them in the first half of 2023. Both banks tightening their credit standards for loans to enterprises in the second half of 2022 introduced changes in energy-intensive manufacturing and construction (except real estate). Three banks will also tighten their credit standards in energy-intensive manufacturing in the first half of 2023. In other sectors of the economy, one surveyed bank tightened its credit standards in the second half of 2022, while two banks intended to tighten them in the first half of 2023. One of the banks demonstrates particularly significant changes in credit standards – in the industrial sector, including energy-intensive manufacturing, and in the construction and residential real estate sectors.

During the same period, two surveyed Latvian banks also tightened their terms and conditions for loans to enterprises. In the second half of 2022, both banks tightened their terms and conditions for loans to enterprises in the industrial sector, including energy-intensive manufacturing, in the wholesale and retail trade sector as well as in the real estate sector. Meanwhile, in the first half of 2023, they intend to tighten their terms and conditions in the industrial sector, including energy-intensive manufacturing, and in the real estate sector. In other sectors, terms and conditions for loans to enterprises were tightened or were intended to be tightened by one surveyed bank in the reporting period.

Most banks (three) pointed out that in the second half of 2022, demand for loans to enterprises contracted in the construction and real estate (commercial real estate) sectors. Less frequently (in one case) during the respective period, banks indicated falling demand in the industrial sector, including energy-intensive manufacturing. Two surveyed Latvian banks pointed to falling demand during the second half of 2022 in other sectors (in the services sector (except financial services and real estate activities), the wholesale and retail trade sector and the residential real estate sector). When describing the expected demand for loans to enterprises in the first half of 2023, all surveyed Latvian banks agreed that demand would decline in the industrial sector, including energy-intensive manufacturing, as well as in the real estate sector. Most banks (three out of four) indicated the expected falling demand in the construction (except real estate) sector as well as in the wholesale and retail trade sector. A fall in demand for loans in the services sector is foreseen by Latvian banks the least (in two cases) in the first half of 2023.