Euro area bank lending survey of December 2018: main results for Latvia

Latvijas Banka conducted a euro area bank lending survey in cooperation with the European Central Bank in December 2018, covering the lending developments during the fourth quarter of 2018 and expectations for the first quarter of 2019. 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.

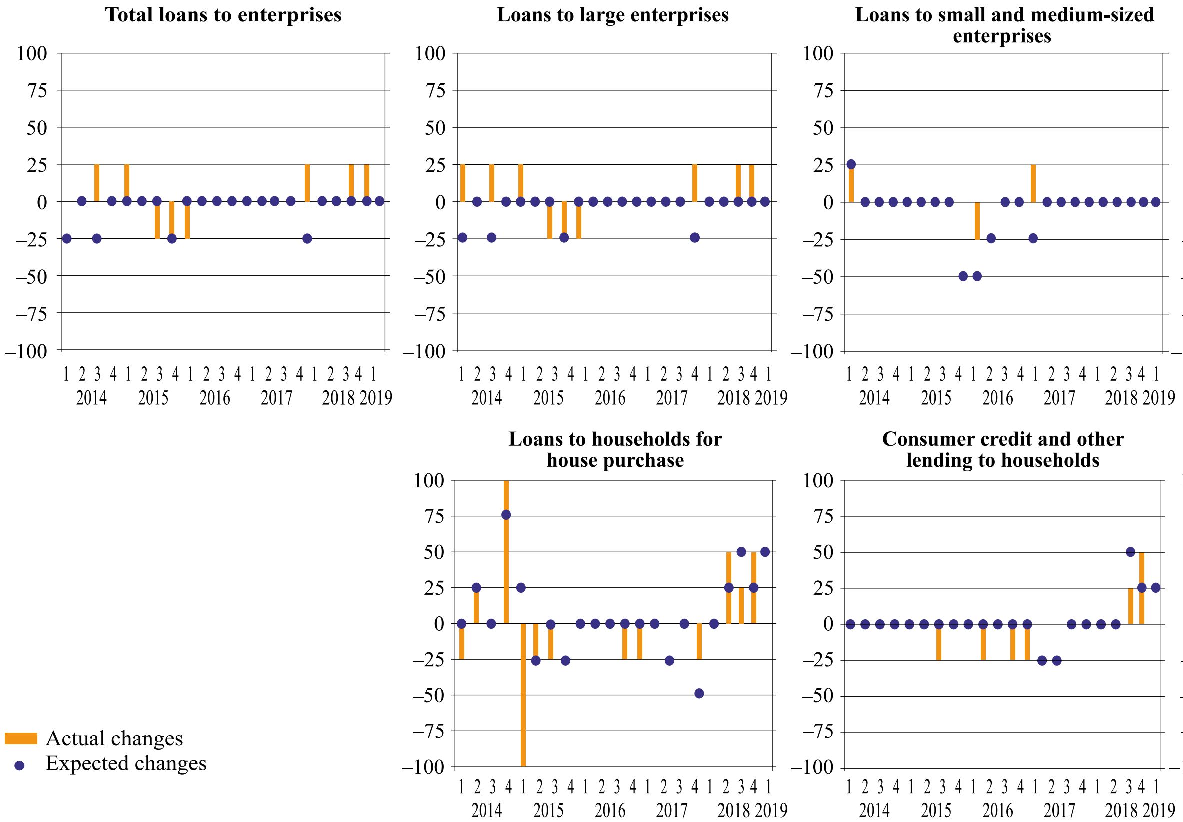
Credit standards

One of the four surveyed Latvian banks applied slightly tighter credit standards for long-term loans to enterprises in the fourth quarter of 2018. This affected the credit standards set by the bank for enterprises as a whole (see Chart 1). The tightening of credit standards was driven by the reduction in competition from other banks, the situation in individual sectors or enterprises, the deterioration in prospects and creditworthiness. Irrespective of somewhat tighter credit standards, the share of completely rejected applications for loans remained unchanged in the surveyed banks. The above banks had no intention to change credit standards for loans to enterprises in the first quarter of 2019.

Chart 1

CHANGES IN CREDIT STANDARDS

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



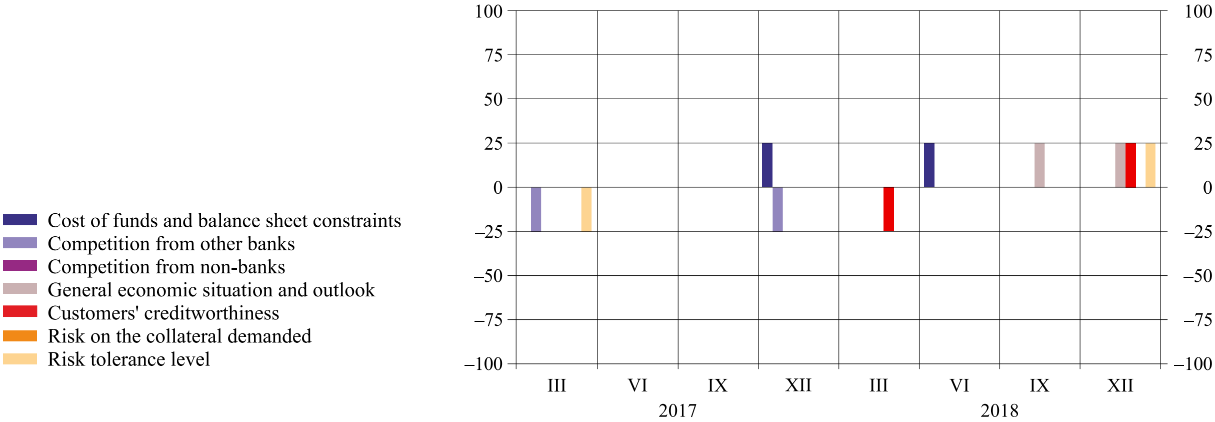
Credit standards were tightened by both the sector of lending to households and that of lending to enterprises in the fourth quarter of 2019. One surveyed Latvian bank applied considerably tighter credit standards for loans to households for house purchase during the reporting period. The reasons behind this decision were higher cost of funds and balance sheet constraints faced by the bank, its more cautious assessment of economic and housing market prospects, the deterioration in borrowers' creditworthiness and the raising of the risk tolerance level. However, the share of rejected loans in the total requested loan amount remained unchanged in all surveyed Latvian banks in the fourth quarter of 2018.

In the fourth quarter of 2018, one of the four surveyed banks somewhat tightened credit standards also for consumer credit and other lending to households since the assessment of the general economic situation and outlook carried out by the bank deteriorated, as did consumers' creditworthiness, and the bank's risk tolerance level was increased (see Chart 2). The share of completely rejected applications for consumer credit and other lending to households continued to expand slightly, as pointed out by one surveyed bank.

Chart 2

FACTORS EXPLAINING THE APPLICATION OF TIGHTER CREDIT STANDARDS FOR CONSUMER CREDIT AND OTHER LENDING TO HOUSEHOLDS

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



In the next quarter, one of the surveyed Latvian banks intends to tighten slightly credit standards for loans to households for house purchase as well as for consumer credit and other lending to households.

Credit terms and conditions

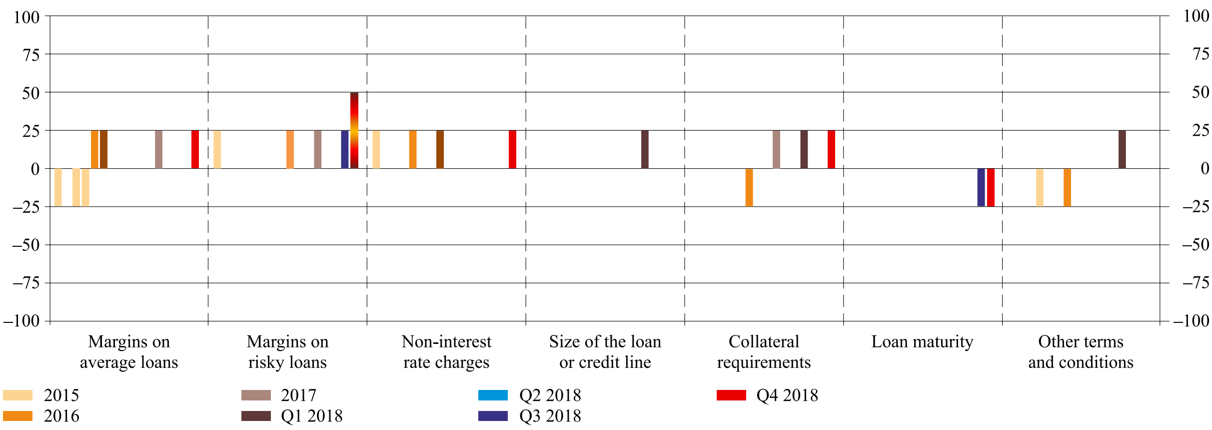
For the first time since 2014, when Latvia became a participant of the euro area bank lending survey, three of the four surveyed Latvian banks tightened at least one of the terms and conditions for loans to enterprises. The terms and conditions for loans to large enterprises were tightened by three banks, while those for loans to small and medium-sized enterprises – by two banks.

The margins on riskier loans to enterprises were widened most frequently, i.e. by two of the four surveyed Latvian banks (see Chart 3). The margins on average loans were widened less frequently, i.e. by one bank. The widening of margins on loans to enterprises can be explained by the cost of funds and balance sheet constraints as well as by a decrease in competitive pressure from other banks. The cost of funds and balance sheet constraints affected both the ordinary and riskier loans to enterprises, while the reduction in competitive pressure from other banks – only the riskier loans to enterprises.

Chart 3

CHANGES IN TERMS AND CONDITIONS FOR LOANS TO ENTERPRISES

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

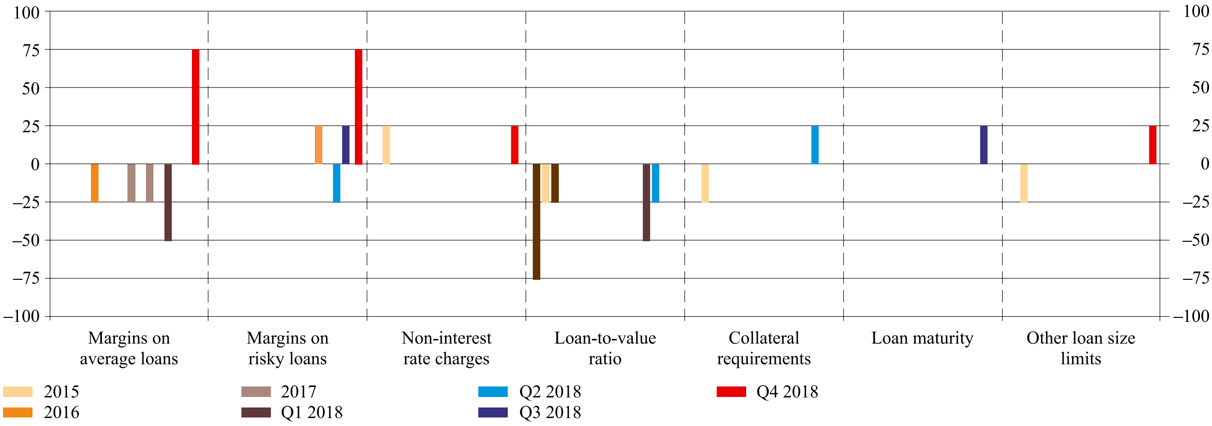


During the reporting period, three of the surveyed Latvian banks also somewhat tightened other credit terms and conditions for loans to enterprises, each of them changing only one of the above terms and conditions. Thus, the non-interest rate charges and the collateral requirements were somewhat raised as well as more rigorous assessment of customer safety related to the measures of prevention of money laundering was introduced in one of the surveyed banks. At the same time, one of the four surveyed Latvian banks lengthened slightly maturities of loans to enterprises.

Changes in terms and conditions for loans to households for house purchase were more substantial than those in terms and conditions for loans to enterprises (see Chart 4). Three of the four surveyed Latvian banks widened the margins on all loans for house purchase irrespective of their risk level. These were minor changes, except the significant widening of margins on riskier loans in one of the above three banks. Moreover, loan size limits were tightened slightly by one surveyed bank.

Chart 4

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



The widening margins on loans to households for house purchase in the three banks during the reporting period can be explained by a higher cost of funds and balance sheet constraints, but this widening of margins in one of the above banks was also primarily driven by the deterioration in risk rating and to a lesser extent – by the establishment of a tighter risk tolerance level in the bank. Weaker competitive pressure also affected other restrictions.

Credit terms and conditions for consumer credit and other lending to households remained unchanged in the fourth quarter of 2018. However, one surveyed Latvian bank pointed out that cost of funds and balance sheet constraints, risk perceptions and the bank's risk tolerance level somewhat contributed to the introduction of tighter credit terms and conditions.

Demand for loans

The demand for some types of loans to enterprises continued on an upward path in two surveyed Latvian banks whose margins on loans to enterprises remained unchanged in the fourth quarter of 2018. This had no major effect on the demand for loans to enterprises as a whole (see Chart 5).

The demand for loans to small and medium-sized enterprises edged up in one bank and that for loans to large enterprises – in another one. The demand for loans to large enterprises moved up slightly since they needed more funding for fixed investment. One bank observed that a minor rise in the demand for loans to enterprises was caused by the fact that these enterprises made less use of loans from other banks.

When forecasting the demand for loans to enterprises in the first quarter of 2019, Latvian banks were more cautious than in previous quarters. One of the four surveyed Latvian banks anticipates a slight decline in the demand for both short-term and long-term loans to large enterprises.

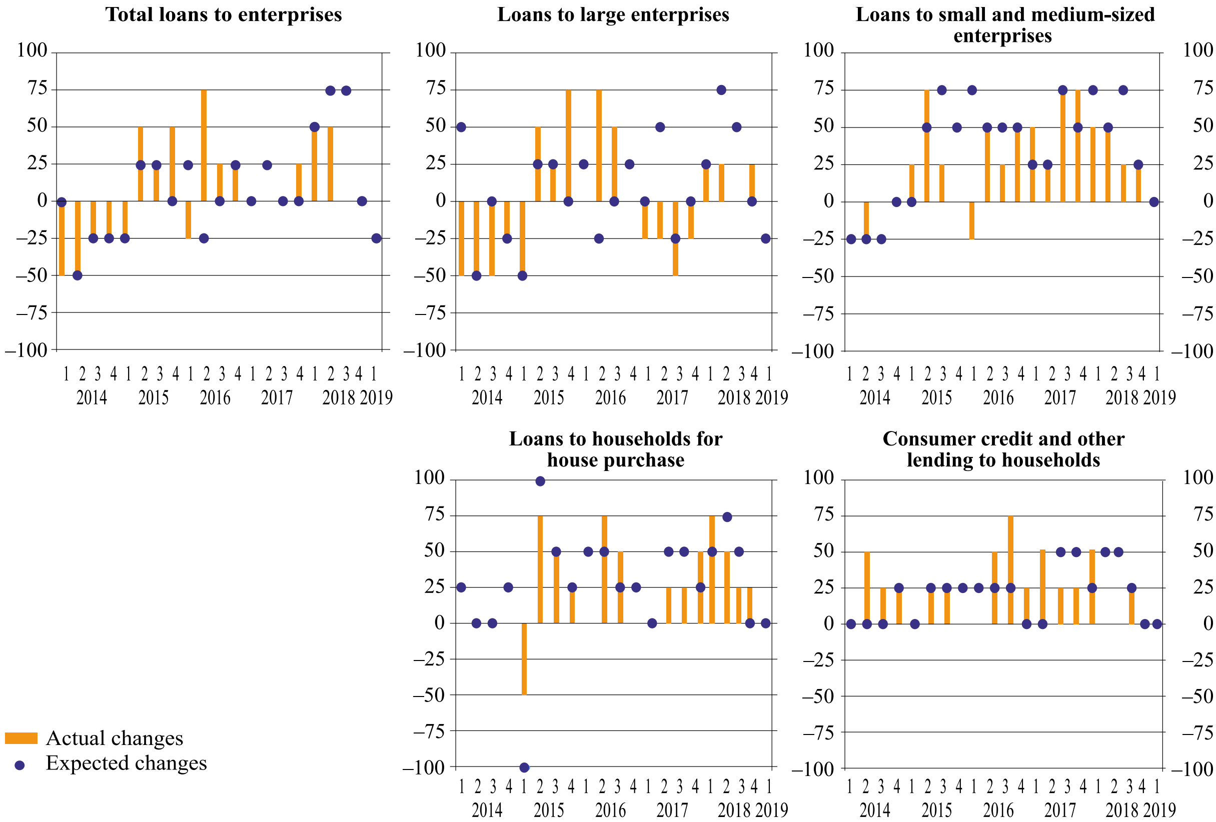
The fourth quarter of 2018 saw household demand for loans for house purchase move up marginally in one of the surveyed Latvian banks. This was supported by improved consumer confidence and a favourable situation in the housing market. At the same time, one bank had observed a slight decrease in consumer confidence, which is likely to affect the demand for loans for house purchase in the future. The demand for consumer credit and other lending to households remained unchanged in all surveyed Latvian banks during the reporting period.

The surveyed banks envisage that the demand for both loans for house purchase and consumer credit and other lending to households will remain broadly at the existing level in the first quarter of 2019. As regards loans to households for house purchase, banks do not share the view on the direction of the potential changes in demand, i.e. one bank considers that it will increase slightly in the first quarter of 2019, and one – that it will decrease somewhat.

Chart 5

CHANGES IN LOAN DEMAND

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



Ad hoc questions

In the framework of the euro area bank lending survey of December 2018 on lending development trends, banks were asked several ad hoc questions concerning the impact of the new regulatory or supervisory requirements and non-performing loans (hereinafter, NPLs) on lending.

One surveyed Latvian bank pointed out that it had tightened slightly credit standards for loans to households for house purchase in the second half of 2018 due to regulatory or supervisory requirements. Meanwhile, two banks indicated that the above requirements would tighten somewhat credit standards not only for loans to households for house purchase but also for consumer credit and other lending to households in the first half of 2019.

The new regulatory or supervisory requirements had an impact on terms and conditions for loans to households in one of the four surveyed Latvian banks in the second half of 2018, and this impact will continue in 2019. The new regulatory or supervisory requirements triggered a minor widening of margins on loans to households for house purchase in this bank in the second half of 2018, and it intends to widen the above margins slightly further in the first half of 2019. At the same time, the new regulatory or supervisory requirements could contribute to a slight narrowing of margins on consumer credit and other lending to households in the above bank in the first half of 2019.

In the second half of 2019, NPLs contributed to the introduction of slightly tighter credit standards as well as terms and conditions for loans to enterprises in one surveyed Latvian bank, in which the NPL-related impact on the lending policy was driven by risk perceptions and the risk tolerance level. In another credit institution, the impact of NPLs on the introduction of a tighter lending policy was supported by the bank's cost of funds and balance sheet constraints.

The surveyed Latvian banks project that the impact of NPLs will intensify in the first half of 2019. During this period, NPLs will contribute to the introduction of slightly tighter credit standards as well as terms and conditions not only for loans to enterprises but also for consumer credit and other lending to households. A number of factors affecting the pass-through of NPLs to banks' lending policies are becoming more significant.

Two banks whose lending policies are affected by NPLs mentioned that in the first half of 2019 the impact of NPLs would be slightly supported by costs related to the banks' capital position, the pressure associated with supervisory or regulatory requirements, the banks' risk perceptions and the risk tolerance level. Only one bank reported that its balance sheet clean-up costs and access to market financing would also continue to determine the impact of NPLs.