The Results of July 2012 Survey of Credit Institution Lending to Non-financial Corporations and Households

In July 2012, the Bank of Latvia conducted its regular credit institution survey on lending and compiled the information on lending development trends in the first half of 2012 and credit institutions' expectations for the second half of the year. The survey covered nine credit institutions whose loans to resident non-financial corporations and households represented 92% of the aggregate credit institutions' loan portfolio at the end of the first half of 2012.

The uncertainty of European development trends and its effects on the economy of Latvia as well as considerable inconsistency between the positive economic growth in Latvia and the recession in a number of European countries found their reflection also in the lending policies of Latvian credit institutions. The results of the July credit institution survey suggest that the distinctions in lending policies of credit institutions that surfaced in 2011 gained momentum in the first half of 2012, reaching a high since the first survey in 2007.

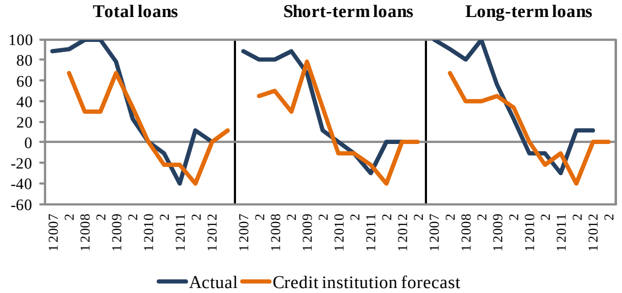
Credit standards, terms and conditions

According to the survey results, credit institution lending standards for non-financial corporations remained broadly unchanged in the first half of 2012 (see Chart 1.a). Nevertheless, opposite trends in credit institutions' lending policies have become apparent more explicitly: while some credit institutions report the setting of slightly tightening credit standards, the others point to their easing trends. Consequently, overall changes in lending standards and the underlying factors should be treated with caution in 2012 due to highly distinctive approaches to lending by different credit institutions.

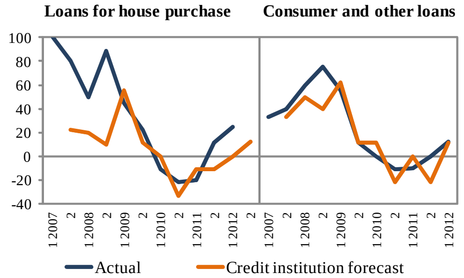
Chart 1. **Changes in credit standards for a) non-financial corporations and b) households**

(net percentage of credit institutions reporting tightening of credit standards)

a)



b)



It is noteworthy that the observed difference is strongly affected by credit institutions' distinctive stances to overall and sector growth perspectives of the Latvian economy. There are credit institutions with an optimistic view on the economic growth in the foreseeable future, and they are easing their credit standards accordingly. On the other hand, however, there are credit institutions that rather critically assess the dynamics of economic activity or (a comparatively large part of them) the contribution of individual sectors to the overall economic growth in the near term; hence they do not ease their lending standards or even set tighter ones (see Chart 2.a). As in the previous surveys, tight competition among credit institutions figures as the main factor promoting more favourable lending terms for non-financial corporations. It should be noted that the financial position of credit institutions in the first half of 2012 was not generally conducive to tighter lending standards for non-financial corporations, which is contrary to the previous survey results, while the access to market financing contributed to their easing.

Distinctive approaches of credit institutions were reflected also in the changes of lending terms and conditions, e.g. some survey participants increased margins on ordinary loans while others lowered them. Overall, the terms and conditions eased somewhat, except for risky loans for which interest rate margins were increased by several credit institutions.

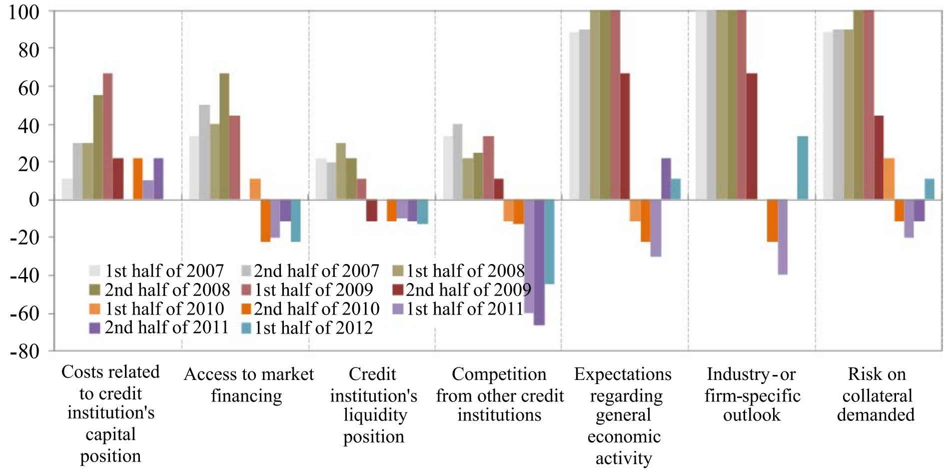
Among credit institutions, cardinal distinctions were not observed in terms and conditions for lending to households: they generally were slightly tighter than in the previous half of the year (see Chart 1.b). Although the majority of credit institutions stuck to previously set lending terms and conditions, some, however, pointed to slightly or even substantially tighter lending standards for households for house purchase as well as for consumer and other loans, thus impacting the overall result. Similar to 2011, it is difficult to distinguish specific factors that substantially affected the setting of terms and conditions for household borrowings. For some credit institutions, tighter credit standards resulted, in part, from higher costs of funds and balance sheet constraints as well as weaker competition in this segment (see Chart 2.b). Other survey participants pointed to slightly tighter standards for loans for house purchase, e.g. interest margins on ordinary and risky loans were raised.

In general, credit institutions do not anticipate changes in credit standards in the second half of 2012, and the number of credit institutions pointing to possibly tighter overall credit standards or easing ones for specific types of loans is small (see Chart 1).

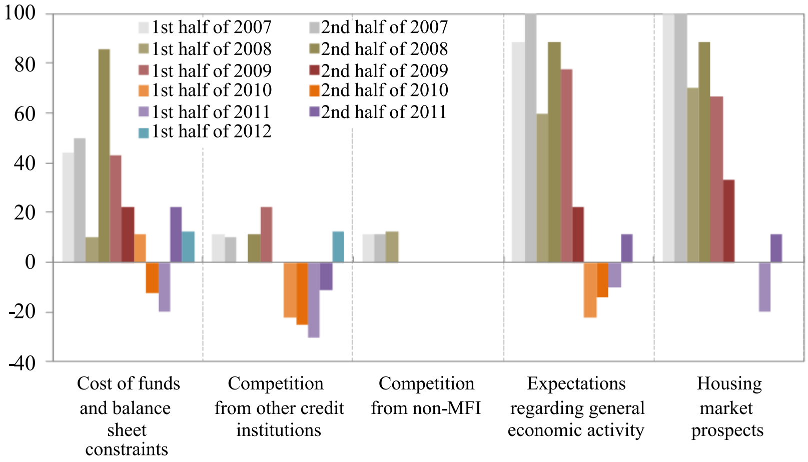
Chart 2. **Factors contributing to tightening credit standards for a) loans or credit lines to non-financial corporations and b) loans to households for house purchase**

(net percentage of credit institutions reporting positive factor contributions)

a)



b)



Loan demand

Credit institutions indicate that, as there was a need to invest in fixed assets and provide funding for inventories and current assets, **the overall loan demand from non-financial corporations continued to strengthen** in the first half of 2012 (see Chart 3.a). Those credit institutions which reported contracting demand referred to loans from other credit institutions as the core explanation of such contraction and a simultaneous confirmation of strong competition among credit institutions.

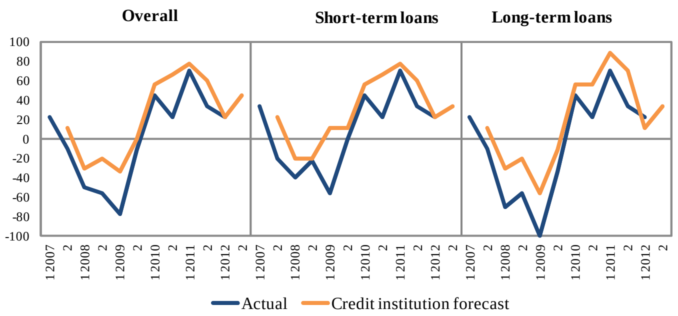
Household demand for loans also strengthened. The rise was particularly pronounced in the segment of **loans for house purchase** supported by growing household confidence in the improvement of their financial position and housing market outlook (see Chart 3.b).

In general, the respondents anticipate a further growth in non-financial corporation demand for loans, while, although the outlook for the demand from households is not stable, overall it points to slight weakening for loans for house purchase (see Chart 3).

Chart 3. **Changes in a) non-financial corporation demand and b) household demand for loans or credit lines**

(net percentage of credit institutions reporting increased demand)

a)



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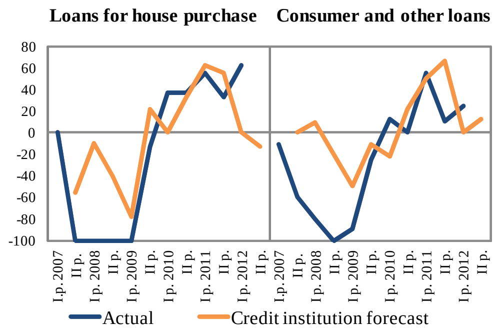
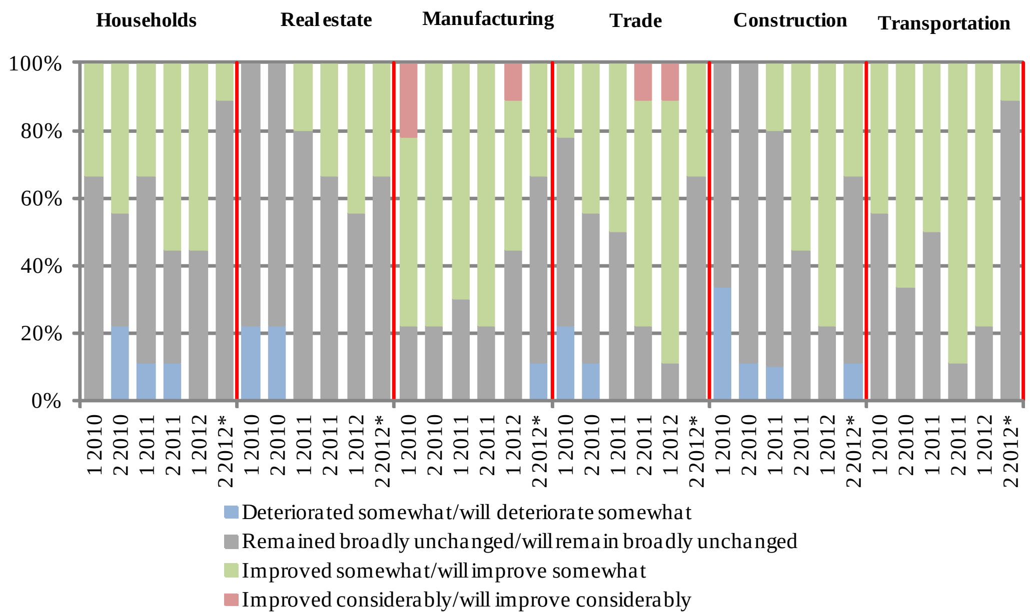


Financial position of borrowers

According to the assessment of credit institutions, the financial position of households and non-financial corporations of leading sectors of the Latvian economy continued to improve in the first half of 2012. The situation in construction, trade and transportation received a particularly high assessment (see Chart 4). Even though the outlook for the second quarter of 2012 is slightly more cautious, **credit institutions expect the financial position of households and non-financial corporations of leading sectors of the Latvian economy to remain broadly unchanged or to improve somewhat.**

Chart 4. **Assessment of changes in financial position of households and non-financial corporations in individual sectors**

(percentage of responses)



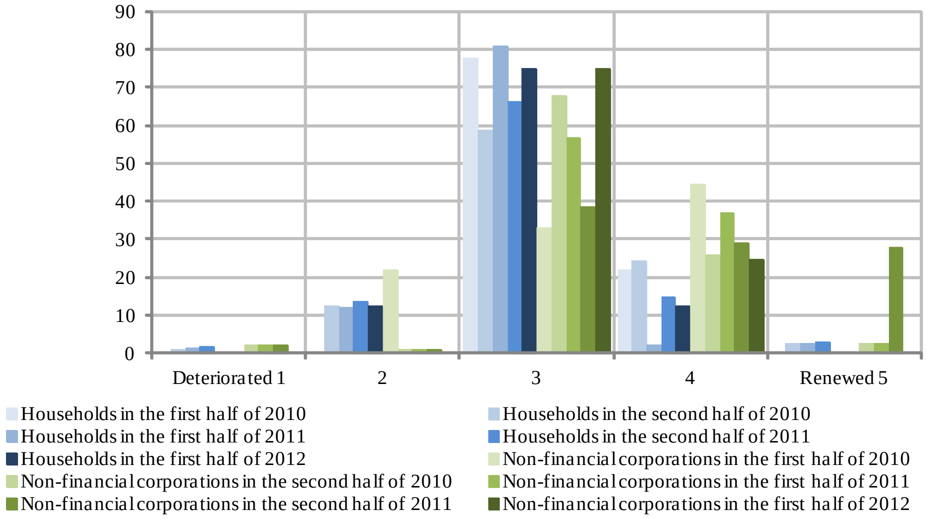
* Forecast.

Loan restructuring

The answers of respondents suggest that creditworthiness of households and non-financial corporations after applied temporary postponement of debt liabilities was assessed primarily as unchanged (see Chart 5). However, contrary to the outcomes of the previous survey, none of the credit institutions reported completely renewed creditworthiness of non-financial corporations or households after the expiration of loan restructuring term.

Chart 5. **Changes in customer creditworthiness after expiration of debt liabilities postponement term due to loan restructuring**

(vis-á-vis period prior to restructuring; percentage of responses)



The lending survey results suggest that so far high resilience of the Latvian economy to growing external uncertainty enabled credit institutions to assess the near-term economic growth and borrowers' creditworthiness more positively and individual sector outlook more critically. Likewise, the uncertain course of European developments underpins credit institutions' distinctive assessment of Latvia's future economic development, which is the underlying factor for growing differences in lending policies of credit institutions. Despite worrying signals at the beginning of 2012, the European financial market and banking sector strain does not adversely affect the access to market financing and the financial position of credit institutions in Latvia. **Overall, with the Latvian economy on a progressive growth track, relatively more dynamic lending to non-financial corporations of several sectors will apparently persist. Nevertheless, new loans to households are most likely to remain at a low level and the household credit portfolio to contract further.**