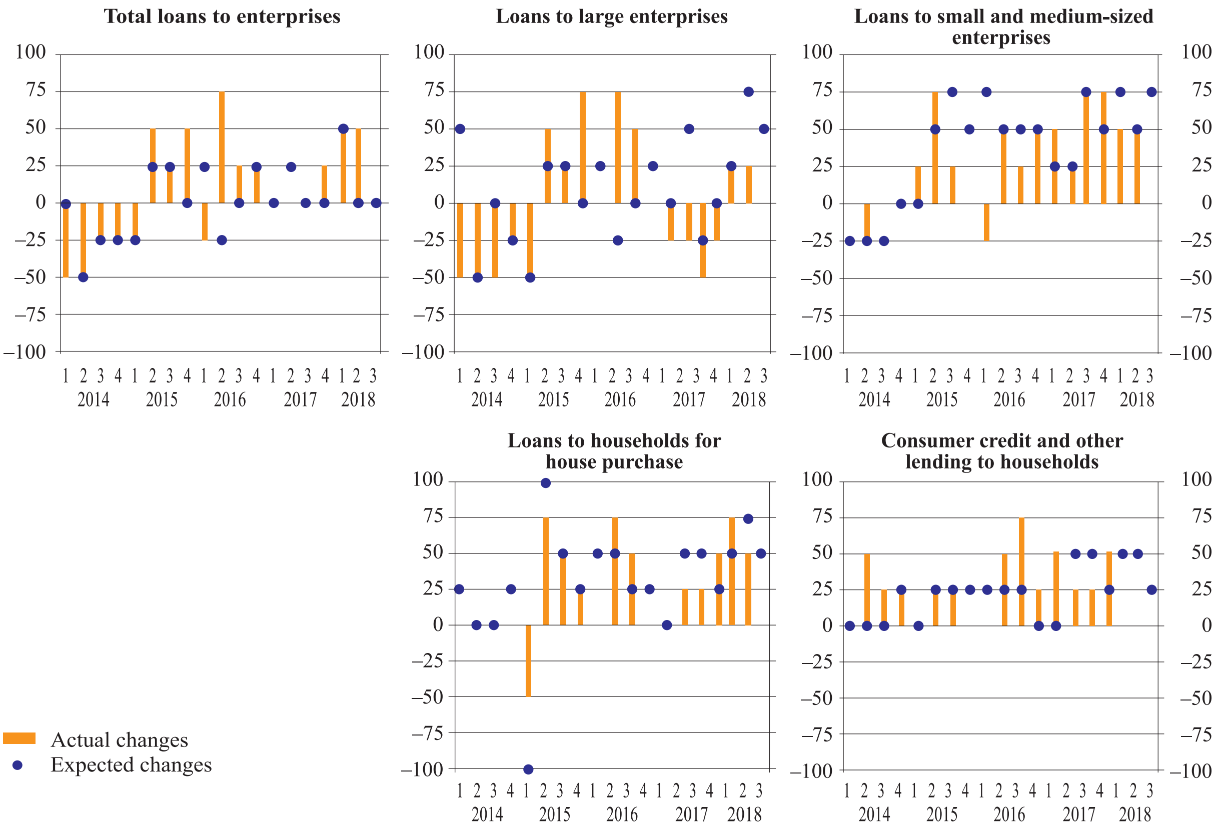
Euro area bank lending survey of July 2018: main results for Latvia

Latvijas Banka conducted a euro area bank lending survey in cooperation with the European Central Bank in July 2018, covering the lending developments during the second quarter of 2018 and bank expectations for the third quarter of 2018. 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.

Demand for loans

In the second quarter of 2018, the demand for loans to enterprises increased marginally in two of the four surveyed Latvian banks. Most often (in two cases) banks reported a minor rise in the demand for long-term loans and for loans to small and medium-sized enterprises. Less frequently (in one case) it was noted that the demand for short-term loans and sizeable loans had increased slightly (see Chart 1). Fixed investment (in three banks), the need to build up inventories and working capital (in two banks), the need to merge, acquire or restructure enterprises (in one bank) as well as the need to refinance or restructure debt or agree on new conditions (in one bank) contributed somewhat to a higher demand for loans and credit lines. Loans granted by other banks (in two banks) as well as the general level of interest rates limited a rise in the demand for loans.

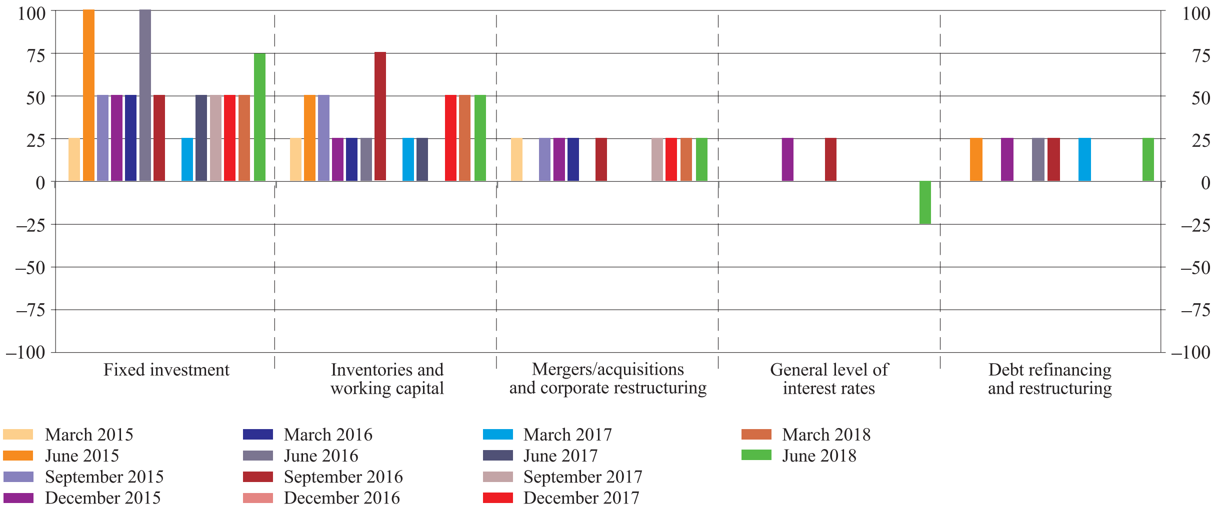
Chart 1
CHANGES IN LOAN DEMAND
(net percentage of banks reporting increased demand for loans; %)



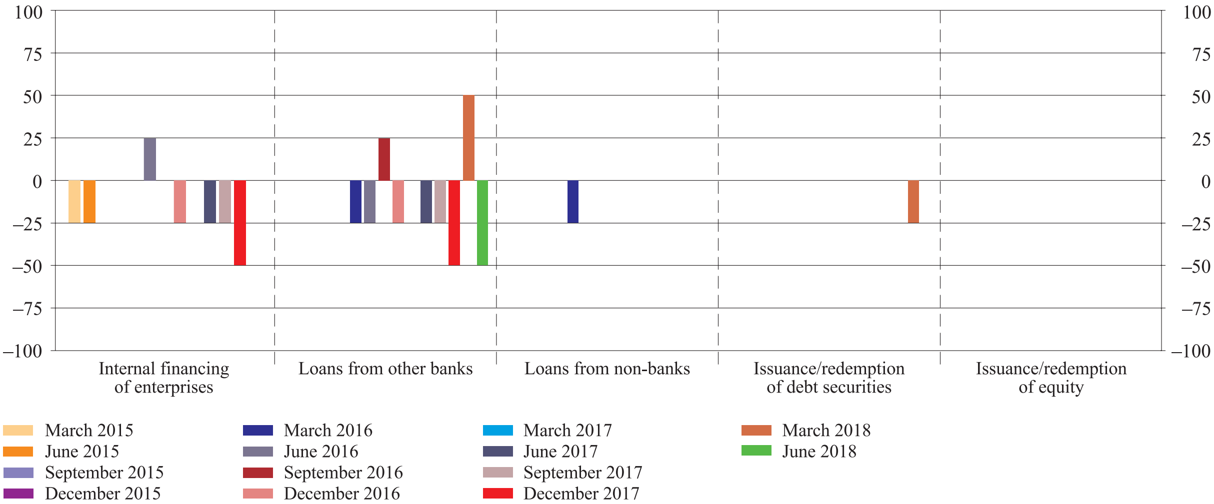
Most of the surveyed Latvian banks (75%) expect the demand for loans to enterprises to increase slightly in the third quarter. In the majority of cases (75%), it is expected that the demand for loans to small and medium-sized enterprises as well as the demand for short-term loans to enterprises will grow somewhat. Two banks expect that the demand by large enterprises and that for long-term loans will pick up.

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

a) Financing needs, contributing factors or objectives underlying the demand for loans

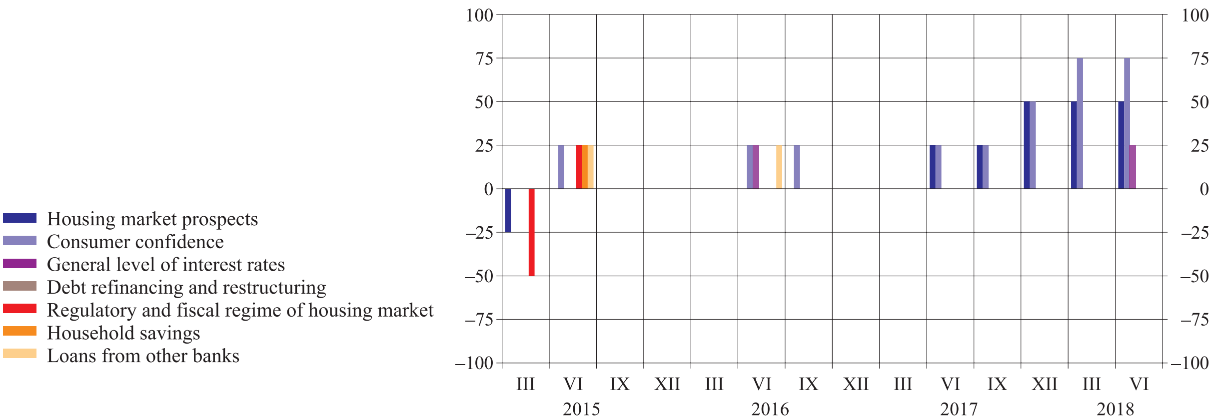


b) Use of alternative sources of finance



The second quarter of 2018 saw household demand for loans for house purchase move up marginally in two of the surveyed Latvian banks. The factors most frequently mentioned as slightly contributing to an increase in the demand for loans for house purchase (see Chart 3) were as follows: strengthening of consumer confidence (in three of the four banks), the improvement in housing market prospects (in two banks) and the general level of interest rates (in one bank).

Chart 3
FACTORS CHARACTERISING HOUSEHOLD DEMAND FOR LOANS FOR HOUSE PURCHASE
(net percentage of banks reporting positive factor contributions; %)

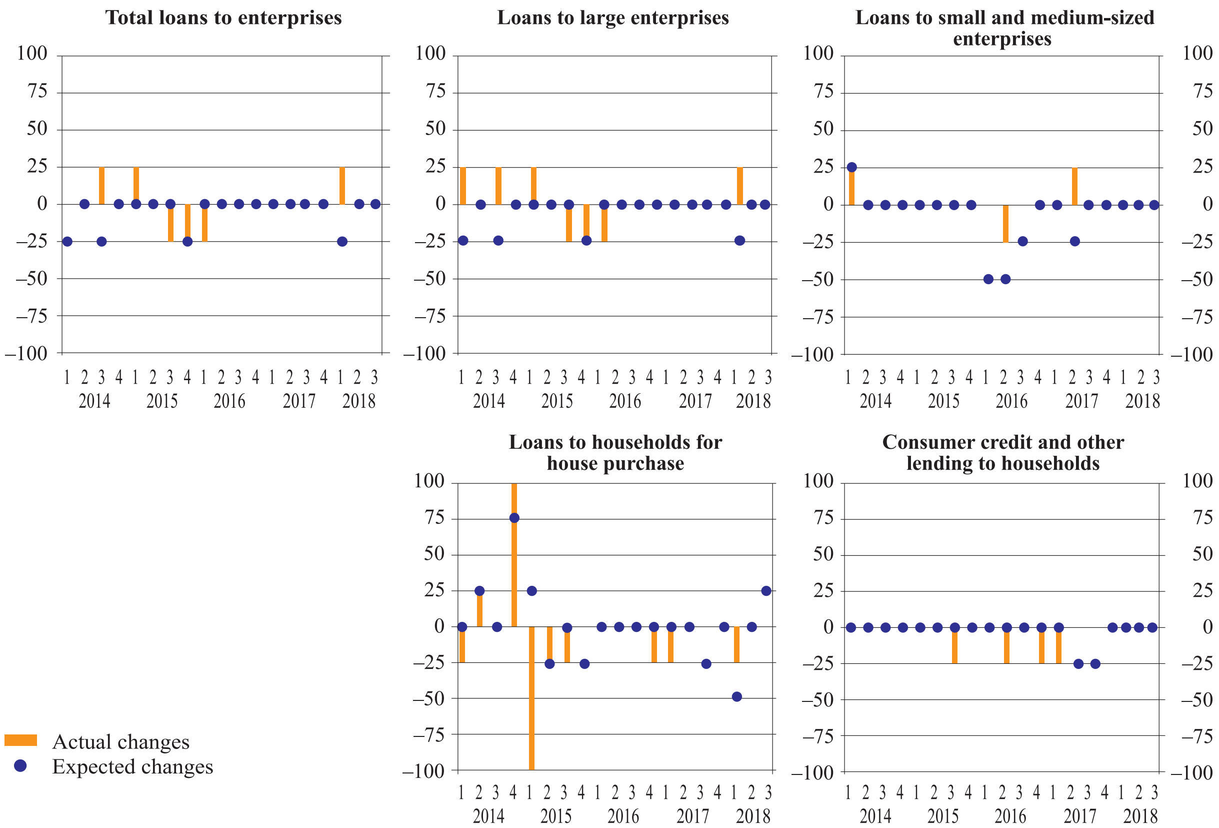


Overall, the demand for consumer credit and other lending to households remained unchanged in all surveyed banks. However, consumer confidence and households' spending on durable goods (cars and furniture) increased slightly the demand for such credits in one surveyed Latvian bank. Also, in respect of demand growth in the third quarter, Latvian banks are less optimistic. Two Latvian banks (three banks in the first quarter) expect a rise in the demand for loans to households for house purchase and one bank (two banks in the first quarter) – for consumer credit and other lending to households.

Credit standards

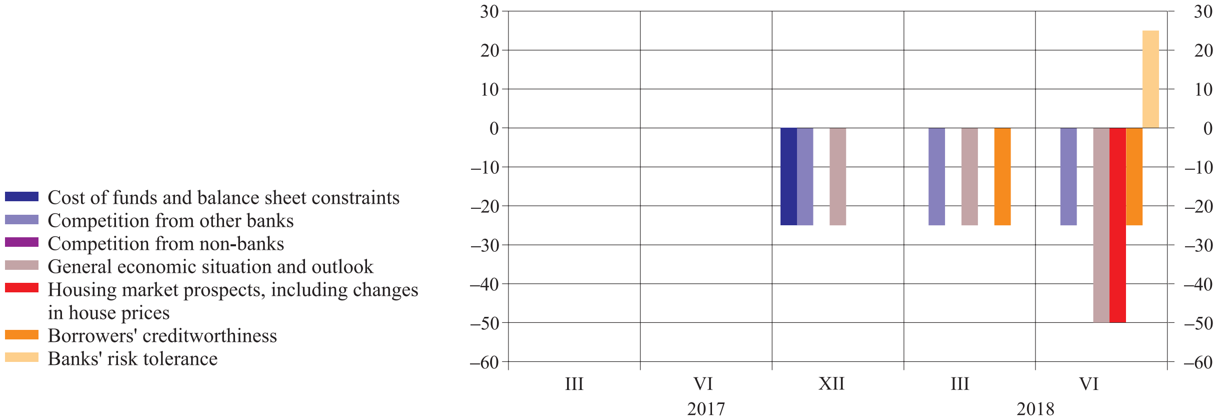
One bank admitted that the tightening of credit standards for loans to enterprises was somewhat supported by its access to market resources, whereas the easing of credit standards – by the general economic situation and outlook. However, credit standards for loans to enterprises were not changed in the second quarter of 2018, and the surveyed banks have no intention of doing so also in the next quarter (see Chart 4). The share of completely rejected applications for loans to enterprises edged up slightly in two Latvian banks in the second quarter.

Chart 4
CHANGES IN CREDIT STANDARDS
(net percentage of banks reporting tightening credit standards; %)



Although one of the four banks slightly eased credit standards for loans to households for house purchase in the second quarter, another one tightened them due to higher risk tolerance of the bank. Banks' higher assessment of the general economic situation and outlook as well as housing market prospects somewhat contributed to easing credit standards for loans to households for house purchase most often (in two of the surveyed Latvian banks). It was banks' higher assessment of credit worthiness of their borrowers as well as increasing competition that less frequently (in one bank) slightly supported easing of the respective credit standards (see Chart 5). Thus, credit standards for loans to households remained broadly unchanged in the second quarter of 2018. The share of rejected applications for loans to households for house purchase remained unchanged in all surveyed Latvian banks in the second quarter of 2018. One of the four surveyed banks intends to somewhat tighten credit standards for loans to households for house purchase in the third quarter.

Chart 5
FACTORS EXPLAINING THE APPLICATION OF TIGHTER STANDARDS FOR LOANS TO HOUSEHOLDS FOR HOUSE PURCHASE
(net percentage of banks reporting positive factor contributions; %)

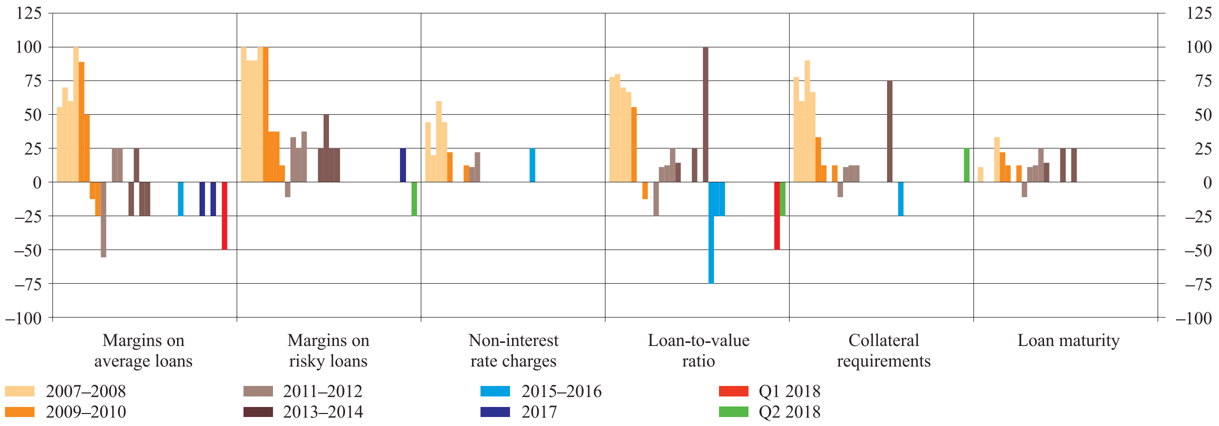


Although costs of funds and balance sheet restraints somewhat contributed to tightening standards for consumer credit and other lending to households in one bank, all surveyed Latvian banks kept their credit standards unchanged in this lending segment in the second quarter of 2018 and intend to do so also in the third quarter. The share of completely rejected applications for consumer credit and other lending to households climbed marginally in one bank.

Credit terms and conditions

In the second quarter, most of banks changed various terms and conditions for loans to households for house purchase. Moreover, they took different directions (see Chart 6): the general terms and conditions, the margins on risky loans as well as the loan-to-value ratio were eased slightly, while the collateral requirements were somewhat tightened (each of the conditions changed simultaneously in one bank).

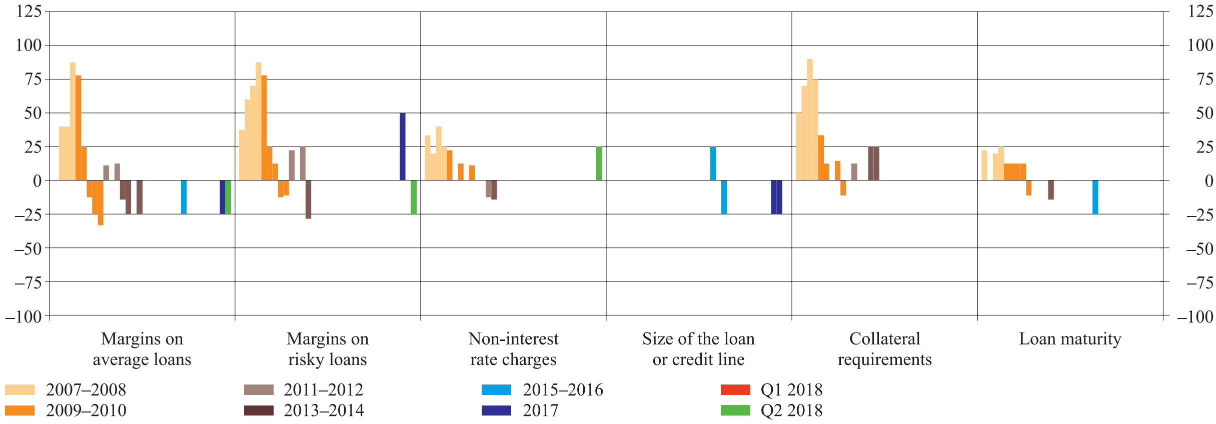
Chart 6
CHANGES IN CREDIT TERMS AND CONDITIONS FOR LOANS TO HOUSEHOLDS FOR HOUSE PURCHASE
(net percentage of banks reporting tightening credit terms and conditions; %)



Pressure from banks' mutual competition contributed slightly to easing the credit terms and conditions for average loans to households for house purchase, while risk perceptions and the banks' risk tolerance – to tightening credit terms and conditions. The application of tighter terms and conditions for risky loans to households for house purchase was supported considerably by risk perceptions and banks' risk tolerance and marginally – by costs of funds and balance sheet restraints.

The margin on consumer credit and other lending to households was reduced somewhat due to competition pressure in one bank. At the same time, another bank slightly increased non-interest rate charges for risky consumer credit and other lending to households on account of higher risk rating (see Chart 7).

Chart 7
CHANGES IN CREDIT TERMS AND CONDITIONS FOR CONSUMER LOANS AND OTHER LENDING TO HOUSEHOLDS
(net percentage of banks reporting tightening of terms and conditions; %)



In the second quarter of 2018, credit terms and conditions for new loans and credit lines to enterprises remained basically unchanged.

Ad hoc questions

In the framework of the euro area bank lending survey of July 2018 on lending development trends, Latvian banks were asked several ad hoc questions concerning the impact of new regulatory or supervisory measures, the significance of the factors determining the level of banks' lending margins as well as the effect of the share of banks' non-performing loans (hereinafter, NPL) on the lending policy.

Over the last six months, one surveyed Latvian bank saw its total assets, including liquid assets, decline slightly and its risk-weighted assets, including average risky loans, increase somewhat due to the new regulatory or supervisory measures. The situation will remain unchanged in the above bank during the next six months. The new regulatory or supervisory measures triggered a slight tightening of credit standards for loans to households for house purchase and a simultaneous minor decrease in margins in this bank over the past six months, and it intends to keep the situation unchanged in the next six months.

In response to the question concerning the importance of the factors determining margins on various loans between 2014 and 2017 and over the past six months, Latvian banks pointed out that the significance of the factors determining margins on loans to enterprises and on loans to households for house purchase were equal.

With regard to both types of loans, the most important factors determining margins in the last six months were the banks' profitability aim (very significant in one bank and slightly significant in another one) and risk perceptions (somewhat important in three banks). In the same context, banks' operation costs were slightly significant in two banks and in one bank – also competition and costs related to banks' capital position. Over the past six months, banks' liquidity position and access to funding had no major effect on margins applied to any of the types of loans under consideration.

Consequently, the factors, which played an important role in determining margins on loans to enterprises and households for house purchase over the preceding six months, were most affected by changes also from early 2014 to late 2017. During the given period, the importance of banks' profitability aim increased most steeply in Latvian banks (very significantly in two banks and slightly in two banks). It was followed by four factors: banks' operation costs, costs related to banks' capital position, risk perceptions and competition whose significance edged up equally rapidly (very substantially in one bank and slightly in two banks). An increase in the importance of banks' liquidity position and their access to funding was mentioned the least by Latvian banks regarding the period considered.

The significance of the factors determining margins on consumer credit and other lending to households was somewhat different. Over the last six months, the factors of competition and risk perceptions were relatively more important with regard to consumer credit and other lending to households than in relation to loans to enterprises and households for house purchase. Meanwhile, according to banks, the significance of competition and costs related to banks' capital position regarding consumer credit and other lending to households changed to a lesser extent during the period from early 2014 to late 2017.

Latvian banks acknowledged that the share of NPL had a major effect on their credit standards as well as on credit terms and conditions from early 2014 to late 2017. During the above period, the share of NPL had the strongest impact on banks' lending policies with regard to loans to enterprises and the smallest one – on consumer credit and other lending to households. Three of the four surveyed Latvian banks pointed out that the share of NPL contributed to tightening credit standards, terms and conditions for loans to enterprises (substantially in one bank and slightly in two banks). When assessing the impact of NPL share on loans to households for house purchase during the specific period of time, one bank (net) pointed out that the contribution of the NPL share to tightening credit standards was substantial, and two banks (net) noted that it facilitated tightening of credit terms and conditions (substantially in one bank and slightly in one bank). Only one bank (net) reported that the NPL share substantially contributed to tightening credit standards, terms and conditions for consumer credit and other lending to households between early 2014 and late 2017.

During the above period, the impact of NPL share on Latvian banks' lending policy was driven mainly by their risk tolerance (substantially in one bank and slightly in two banks) as well as risk perceptions (substantially in one bank and slightly in one bank). Less frequently (in one of the four banks), the impact of NPL share during the given period was driven by costs related to banks' capital position, their balance sheet clean-up costs and pressure related to supervisory or regulatory requirements.

Over the last six months, the NPL share in one of the surveyed Latvian banks somewhat contributed to tightening credit standards, terms and conditions for loans to households for house purchase. Over the next six months, the NPL share will somewhat support tightening of credit terms and conditions for loans to households for house purchase, consumer credit and other lending to households in one of the four surveyed Latvian banks.