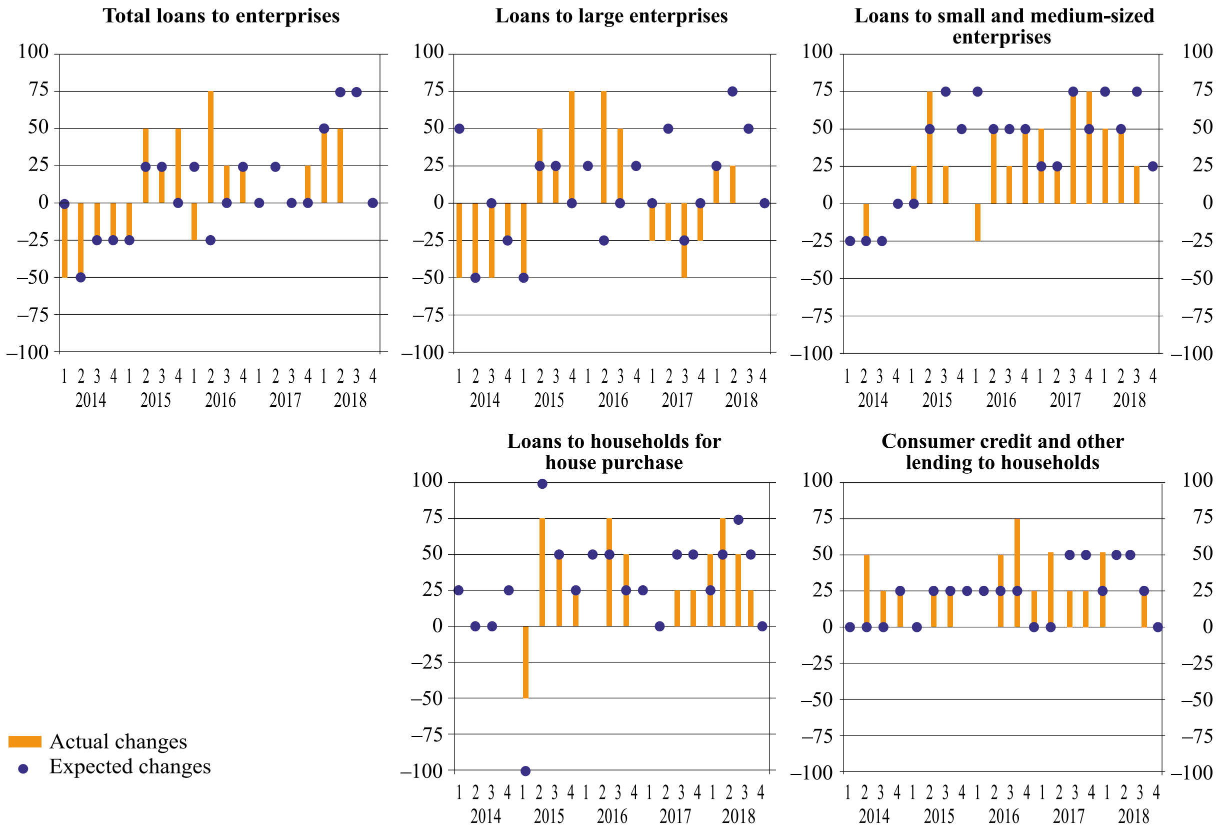
Euro area bank lending survey of October 2018: main results for Latvia

Latvijas Banka conducted a euro area bank lending survey in cooperation with the European Central Bank in October 2018, covering the lending developments during the third quarter of 2018 and bank expectations for the fourth 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 third quarter of 2018, the demand for some types of loans to enterprises continued on an upward path in two banks (see Chart 1). The demand for loans to small and medium-sized enterprises, which needed more funds for inventories and working capital, picked up in one bank. The demand for long-term loans increased in another bank as enterprises needed additional funding for mergers, acquisitions and corporate restructuring. The demand for loans to enterprises was also affected by their desire to invest in fixed assets (see Chart 2).

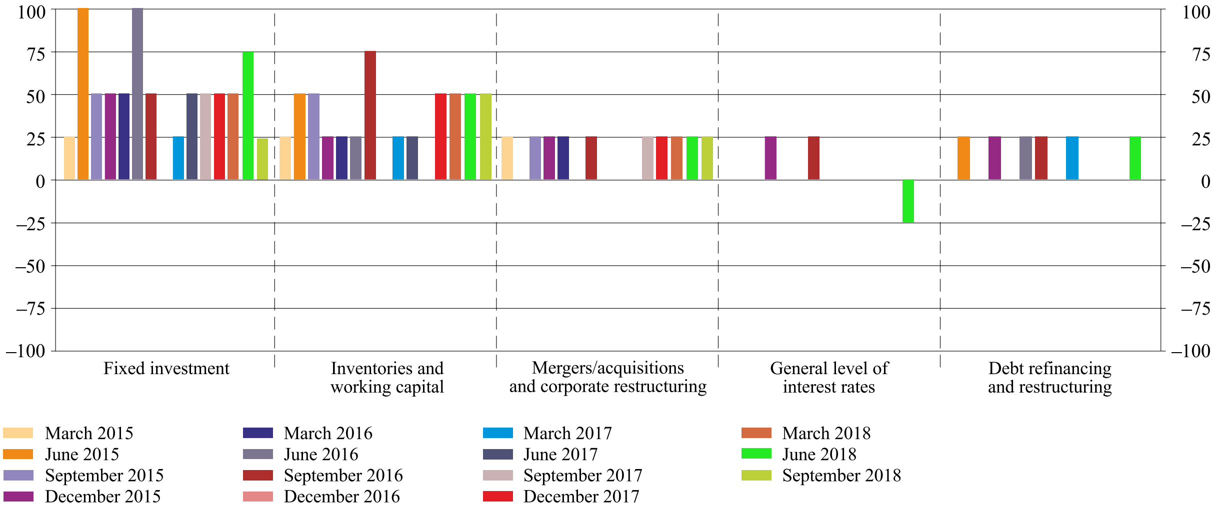
Chart 1
CHANGES IN LOAN DEMAND
(net percentage of banks reporting increased demand for loans; %)



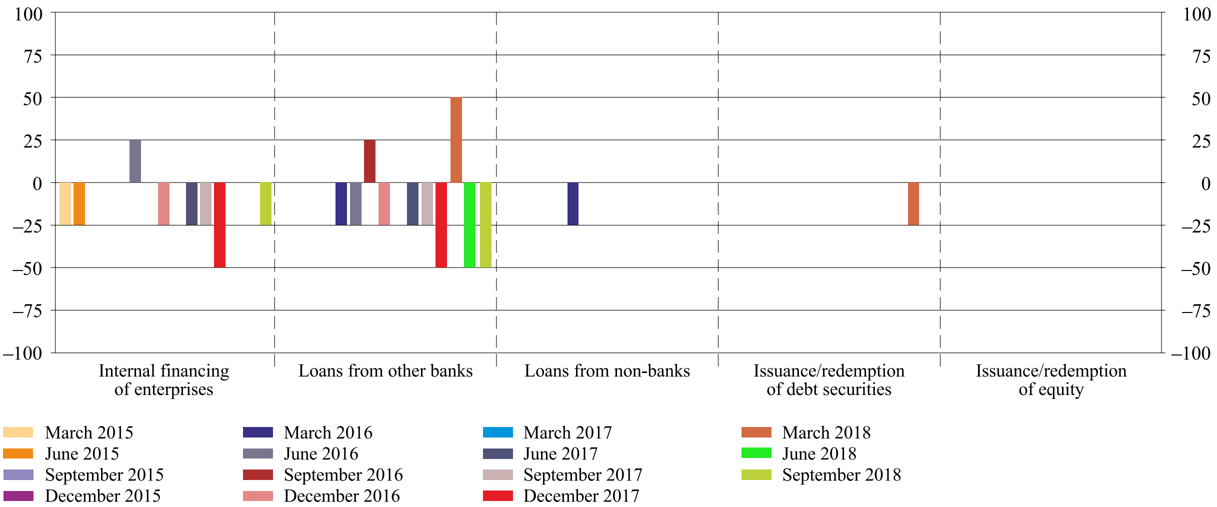
At the same time, two of the surveyed Latvian banks pointed out that loans by other banks somewhat reduced the demand for loans to enterprises in the third quarter of 2018, implying that the level of competition was high in the corporate lending sector. One of the four surveyed Latvian banks reported that it was the utilisation of internal funds of enterprises that also had a negative impact on the demand for loans to enterprises in the third quarter.

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

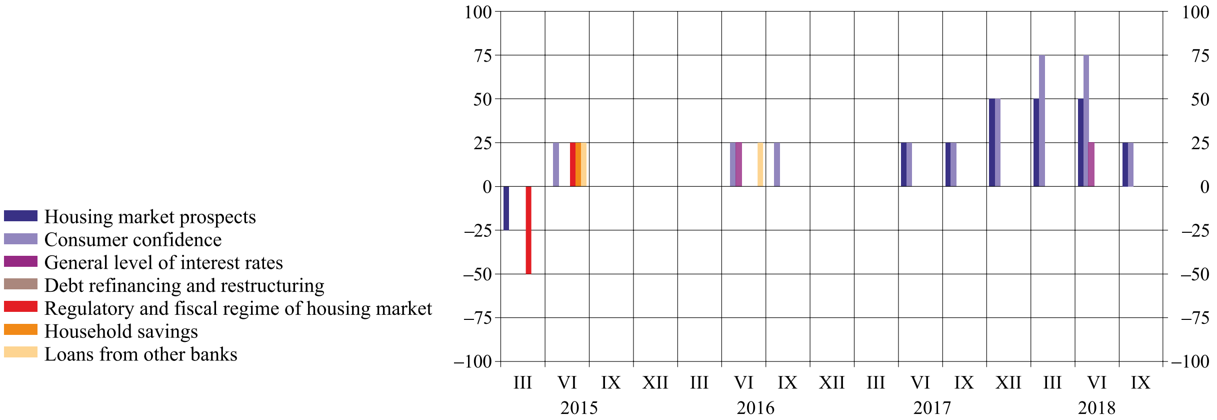


Compared to previous quarters, Latvian banks were more cautious when forecasting the demand for loans to enterprises in the fourth quarter of 2018. It was only one of the four surveyed Latvian banks that envisaged a slight increase in the demand for loans to small and medium-sized enterprises as well as the demand for short-term loans to enterprises.

The third 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, favourable situation in the housing market and tightening competition (see Chart 3). Due to improved consumer confidence and increased households' spending on durable goods (cars, furniture) the demand for consumer credit and other lending to households also augmented in one of the surveyed Latvian banks.

Latvian banks are more cautious when forecasting not only the demand for loans to enterprises but also the demand for loans for house purchase, consumer credit and other lending to households. All surveyed banks envisaged that the demand for both loans for house purchase and consumer credit and other lending to households would remain at the existing level in the fourth quarter of 2018.

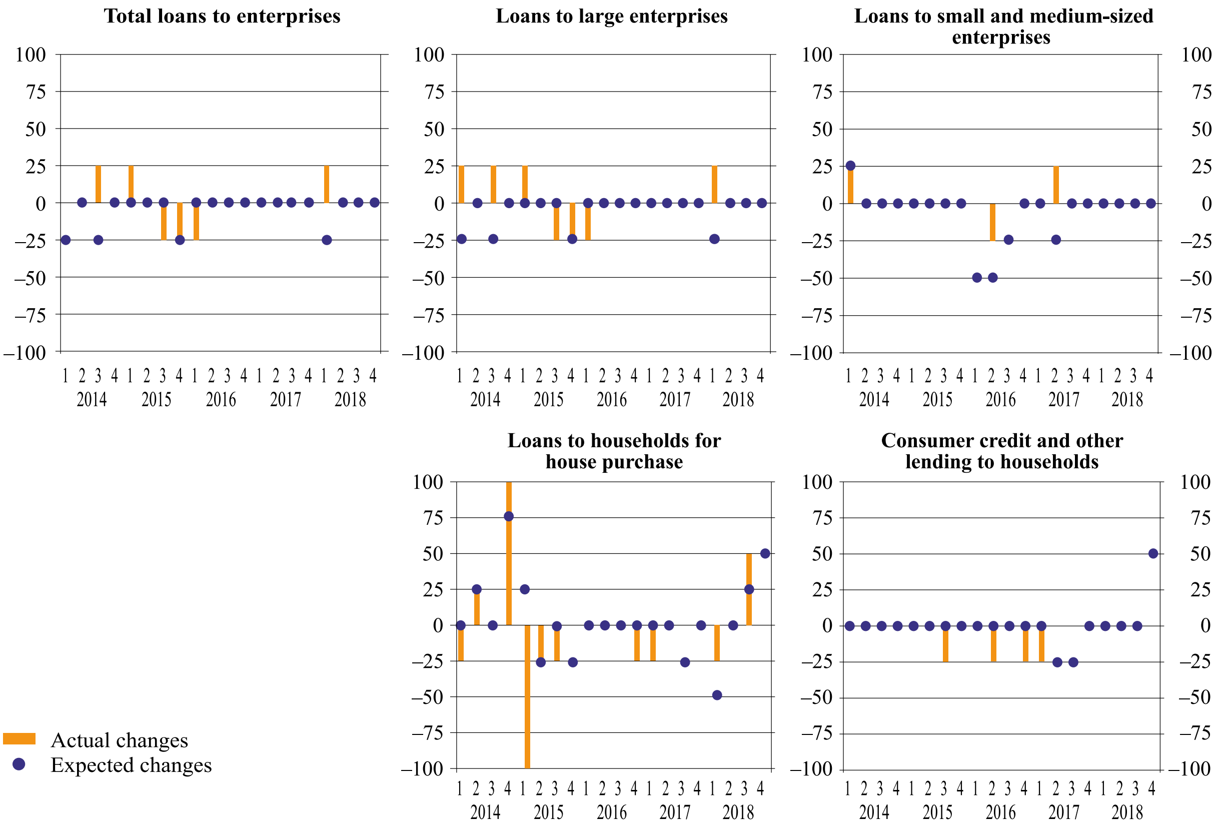
Chart 3
FACTORS CHARACTERISING HOUSEHOLD DEMAND FOR LOANS FOR HOUSE PURCHASE
(net percentage of banks reporting positive factor contributions; %)



Credit standards

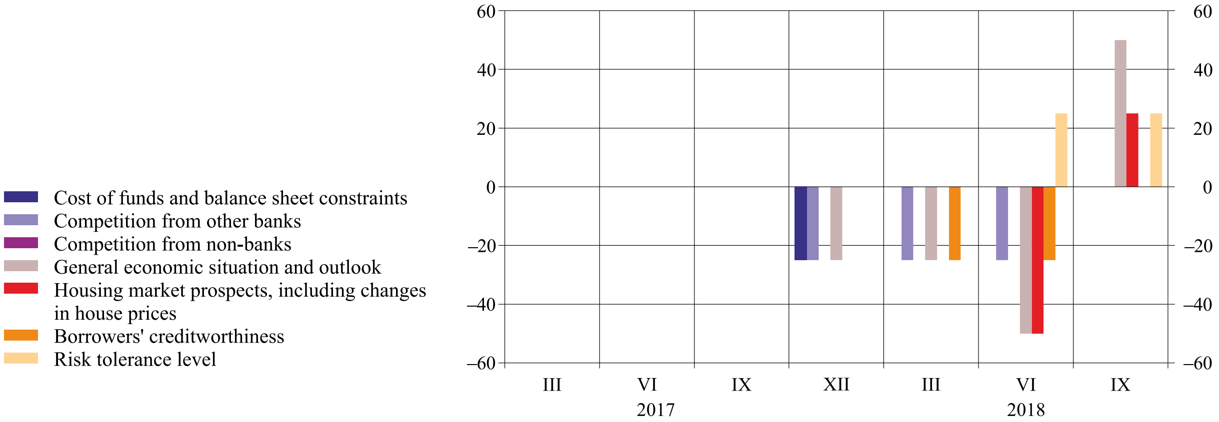
Latvian banks kept their credit standards for loans to enterprises unchanged in the third quarter of 2018, and they do not intend to change them in the next quarter either. However, the share of completely rejected applications for loans edged up slightly in one surveyed bank. With credit standards remaining unchanged, this could suggest deterioration in the quality of loan applications (see Chart 4).

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



With regard to the sector of lending to households, Latvian banks changed their decisions taken in previous quarters concerning credit standards for loans for house purchase. In the third quarter of 2018, after easing credit standards in previous quarters, two of the surveyed Latvian banks tightened them marginally again for loans for house purchase. The introduced changes in two of the surveyed banks can be explained by initially far too optimistic view of the general economic situation and prospects, and in one bank – by initially far too optimistic view of the market outlook and the possible raising of the risk tolerance limit (see Chart 5). In the third quarter of 2018, the share of rejected loans in the total requested loan amount remained unchanged in all surveyed Latvian banks.

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



Latvian credit institutions did not change credit standards for consumer credit and other lending to households in the third quarter of 2018. The share of completely rejected applications for consumer credit and other lending to households climbed marginally in one surveyed bank.

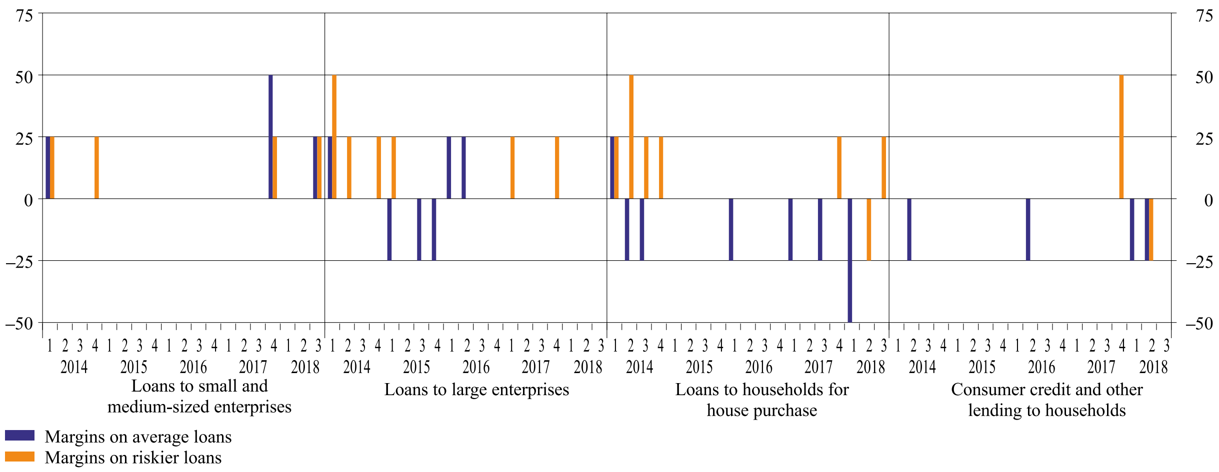
Two of the surveyed Latvian banks intend to tighten slightly credit standards for loans to households for house purchase as well as for consumer credit and other lending to households in the next quarter.

Credit terms and conditions

Loans to enterprises became somewhat more expensive; however, banks started to offer loans with longer maturities. In the third quarter of 2018, one of the four surveyed Latvian banks increased slightly margins on average and riskier loans to small and medium-sized enterprises, the rationale behind the decision being higher costs of funds and balance sheet restrictions. This affected the margins on riskier loans to enterprises as a whole. However, the margins on average loans to enterprises remained unchanged overall in Latvian banks since another bank slightly narrowed the respective margins due to competitive pressure. Being subject to competitive pressure, one bank extended somewhat the maturity of the offered loans.

Terms and conditions for loans to households for house purchase tightened somewhat. One of the surveyed four Latvian banks tightened its general terms and conditions for loans for house purchase, based on a higher level of the assessed risk and the bank's risk tolerance level. In the lending sector concerned, the above bank also shortened marginally the maturity of the available loans. It slightly widened the margins on risky loans due to higher costs of funds, balance sheet restrictions, risk perceptions and risk tolerance limits (see Chart 6).

Chart 6
CHANGES IN MARGINS ON LOANS OF DIFFERENT CATEGORIES
(net percentage of banks reporting an increase in margins; %)



Although the margins on both average loans for house purchase and average consumer credit and other lending to households remained unchanged, competitive pressure somewhat contributed to a decline in the outstanding amount of these loans in one Latvian bank surveyed.

Ad hoc questions

In the framework of the euro area bank lending survey of October 2018 on lending development trends, banks were asked several ad hoc questions concerning the effects of the European Central Bank's expanded asset purchase programme and the negative deposit facility rate.

Over the last six months, one of the surveyed Latvian banks has seen the expanded asset purchase programme contribute marginally to a decline in assets, including holdings of euro area government bonds, and this situation will remain unchanged in the above bank during the next six months. At the same time, none of the surveyed Latvian banks has indicated that the expanded asset purchase programme has had a substantial impact on credit standards, credit terms and conditions or loans granted in any of the lending sectors.

It was the negative deposit facility rate that somewhat contributed to shrinking net interest income in two of the four surveyed Latvian banks in the second and third quarters of 2018. Both banks envisaged that the monetary policy instrument would continue to support the decline in net interest income also in the fourth quarter of 2018 and in the first quarter of 2019. One bank reported that the negative deposit facility rate slightly supported not only the shrinkage of net interest income but also that of the variable part of the interest rate on loans to enterprises, loans to households for house purchase and consumer credit and other lending to households.