

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

- *Latvian banks continued to tighten their credit standards for loans to both enterprises and households.*
- *Margins on average and riskier loans increased across almost all categories of lending.*
- *Growth in demand for loans to enterprises was mainly driven by an increased need for working capital and inventories.*
- *Demand for loans to households for house purchase decreased, while that for consumer credit and other lending to households increased.*

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

In the third quarter, corporate lending activity was relatively high on account of a constant demand for short-term loans. Lending to households started to contract gradually as credit standards tightened, also leading to lower demand for 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 they affected lending in Latvia.

Credit standards

In the third quarter of 2022, Latvian banks tightened their credit standards for different types of loans for the third consecutive quarter (see Chart 1). In the first quarters of the year – immediately after the beginning of the Russian-Ukrainian war – credit standards for loans to enterprises tightened more often, while in the third quarter, banks more frequently reported a tightening of credit standards for loans to households for house purchase.

Chart 1¹

Changes in credit standards by category of lending

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



One surveyed Latvian bank, in net terms, tightened credit standards for loans to enterprises in the third quarter and intended to continue doing so in the fourth quarter. As in the previous two quarters, the bank's negative assessment of the economic outlook, industry or firm-specific situation and outlook continued to have a tightening impact on credit standards. In addition, a higher risk related to the collateral demanded, as well as the bank's lower risk tolerance and weaker liquidity position (each factor was mentioned once) had a tightening impact on credit standards for loans to enterprises in the third quarter.

Chart 2

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

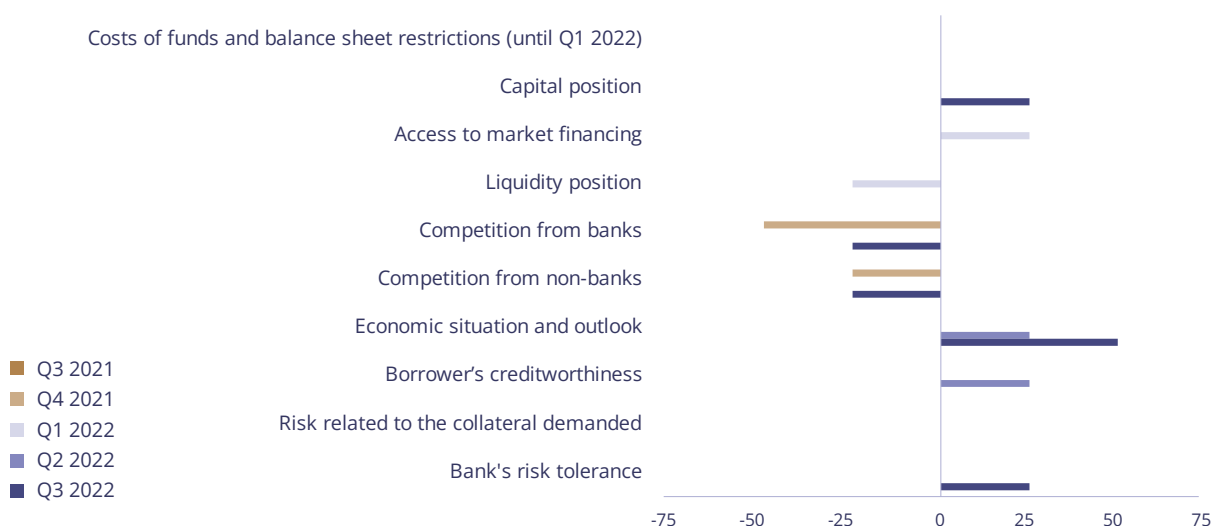


Two surveyed Latvian banks tightened credit standards for loans to households for house purchase in the third quarter of 2022 and three banks intended to do so in the fourth quarter. Two surveyed banks mentioned concerns about the weakening economic situation and outlook as well as the deterioration of the borrowers' creditworthiness (see Chart 2) stemming from the increase in money market interest rates, inflation outpacing household nominal income and the surge in utility payments in the winter season as the main drivers of tightening credit standards for housing loans. When reviewing the applications for loans to households for house purchase, banks have to raise the minimum level of household spending in the assessment of their creditworthiness. One bank admitted that the tightening of credit standards for loans to households for house purchase was driven by a weakening of its capital position and higher associated costs in the third quarter.

Chart 3

Contribution of various factors to credit standards for consumer credit and other lending to households

(the factors behind the application of tighter credit standards; net percentages of banks reporting a tightening of credit standards; %)



Developments in consumer credit varied across the surveyed Latvian banks during the reporting period: two banks reported a tightening of credit standards for consumer credit and other lending to households and one bank indicated an easing of them in the third quarter. Thus, credit standards for consumer credit and other lending to households were overall tightened less frequently than those for loans to households for house purchase in the third quarter. However, Latvian banks intend to tighten credit standards for consumer credit and other lending to households as often as those for loans to households for house purchase in the following quarter (in three cases).

The most persistent and notable factor behind the tightening of credit standards for consumer credit and other lending to households (see Chart 3), similarly to loans to households for house purchase and loans to enterprises, was the weakening economic situation and outlook in the third quarter (in two cases). When describing trends in consumer credit and other lending, a higher bank's risk tolerance, a lower capital position and higher associated costs were mentioned once as factors contributing to tightening credit standards. At the same time, one of the surveyed Latvian banks reported competition from banks and non-banks as a factor having an opposite impact (contributing to easing credit standards) on credit standards for consumer credit and other lending to households.

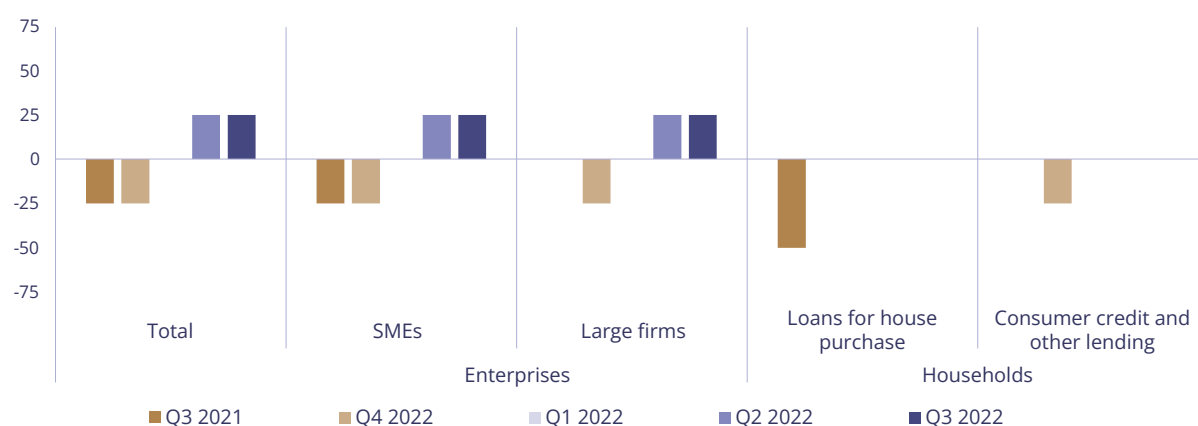
Credit terms and conditions

The surveyed Latvian banks tightened their overall terms and conditions on loans of different categories during the reporting period, although less frequently than they tightened their credit standards. For instance, only one of the four surveyed Latvian banks tightened its terms and conditions on loans to enterprises in the third quarter (see Chart 4).

Chart 4

Changes in overall terms and conditions by type of loans

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

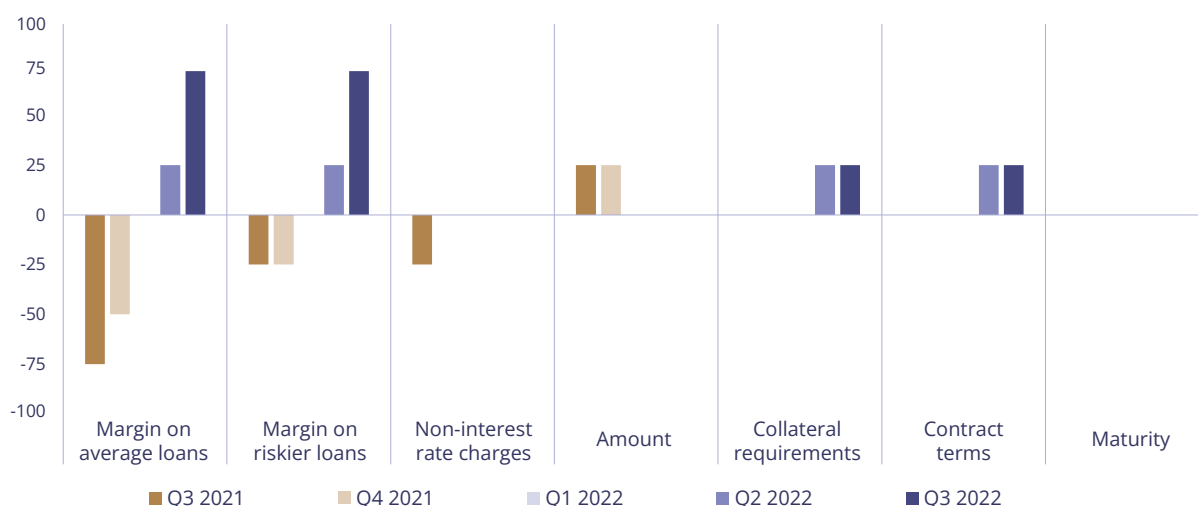


Margins were widened most frequently during the reporting period. For instance, three of the four surveyed Latvian banks widened margins on average and riskier loans to enterprises. At the same time, one bank reported more stringent collateral requirements and contract terms for loans to enterprises (see Chart 5).

Chart 5

Changes in terms and conditions on loans to enterprises

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



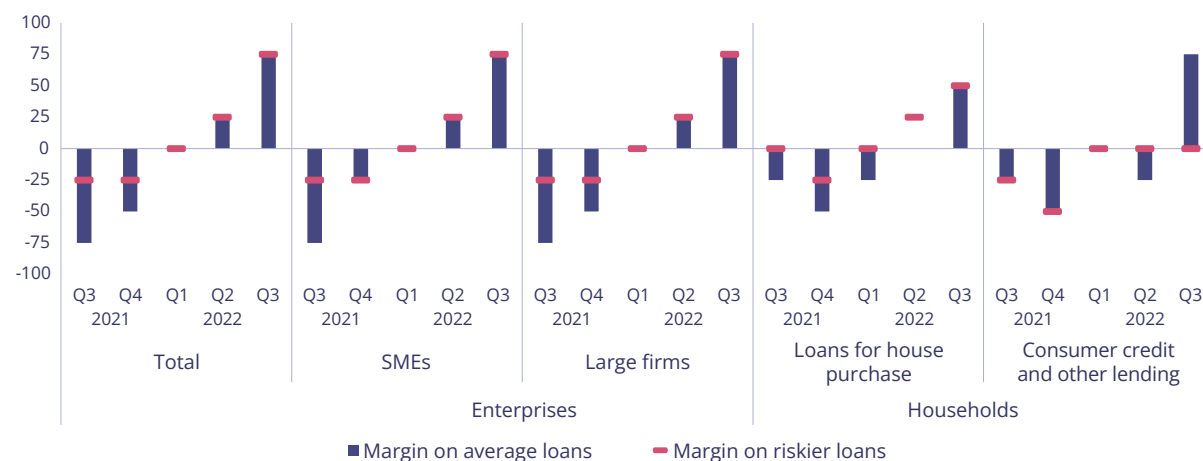
The surveyed Latvian banks widened margins across all categories of lending in the third quarter (see Chart 6). Banks widened margins on loans to enterprises to small and medium-sized enterprises as often as to large firms (in three cases). Two Latvian banks reported a widening of margins on loans

to households for house purchase in the third quarter – margins on both average and riskier loans widened for the first time after several subsequent declines over the previous year. Three of the four surveyed Latvian banks widened margins on average consumer credit and other lending to households in the third quarter.

Chart 6

Changes in margins by category of lending

(net percentages of banks reporting an increase in margins; %)



The surveyed Latvian banks explained that the widening of margins on loans to enterprises was primarily due to the worsening of the economic situation and outlook in the third quarter (three banks). Less frequently (in one case) the widening of margins was attributed to the deterioration of the bank's liquidity position, industry or firm-specific situation and outlook, the build-up of the risk related to collateral demanded and the bank's declining risk tolerance level (see Chart 7).

Chart 7

Contribution of various factors to margins on loans to enterprises by risk level

(net percentages of banks reporting the factors contributing to an increase in margins; %)



The widening of margins in the household sector was explained by changes in risk perceptions: in the third quarter, two banks mentioned the upward impact of the above factor on loans to households for house purchase, while one bank – on consumer credit and other lending to households. Two banks attributed the widening of margins on consumer credit and other lending to households to higher competitive pressure that had driven the risk taking behaviour (to ease standards) by increasing margins.

Demand for loans

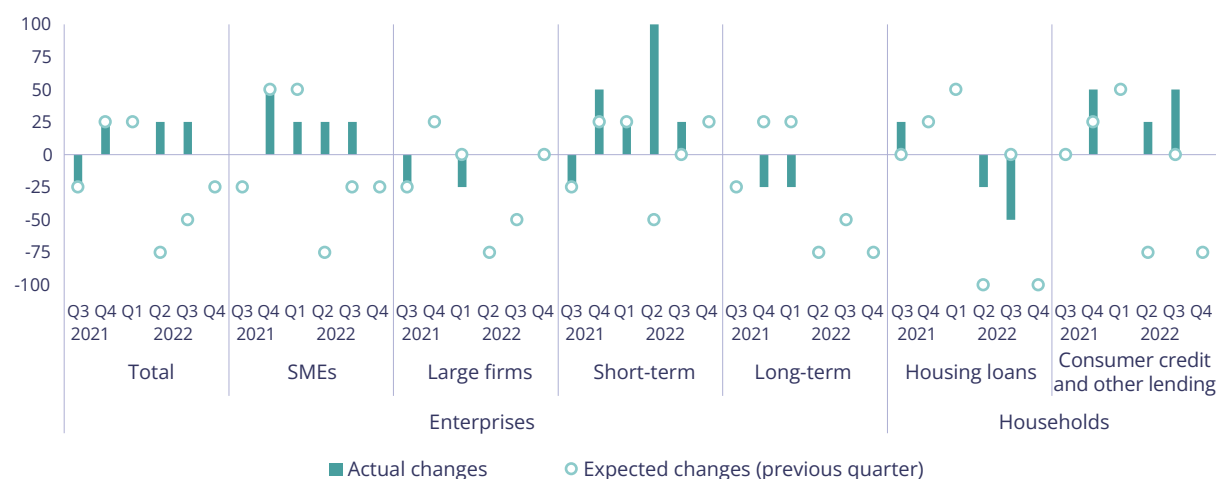
Demand developed differently across the categories of lending in the third quarter (see Chart 8). Most frequently (twice) the surveyed Latvian banks reported a decline in demand for loans to households for house purchase, while demand for consumer credit and other lending to households picked up

at the same time. All surveyed Latvian banks expected that the next quarter would see a further decrease in demand for housing loans, and three banks projected that demand for consumer credit and other lending to households would also decline for the first time in 2022. The surveyed banks did not have a uniform opinion concerning demand for loans to enterprises: one bank reported a rise in demand for short-term loans to small and medium-sized enterprises in the third quarter. One surveyed bank, in net terms, expected a fall in demand for loans to enterprises as demand for long-term loans to small and medium-sized enterprises was declining.

Chart 8

Changes in loan demand by category of lending

(net percentages of banks reporting increased demand; %)



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 third quarter (see Chart 9). Two of the four surveyed Latvian banks reported the negative impact of the above factors on demand for loans to households for house purchase during the reporting period. Meanwhile, demand for consumer credit and other lending to households rose in the third quarter as internal financing of households decreased (in one bank) and increased demand for financing for the introduction of energy efficient solutions persisted (in one bank).

Chart 9

Contribution of various factors to demand for loans to households for house purchase

(net percentages of banks reporting the factors contributing to higher demand; %)



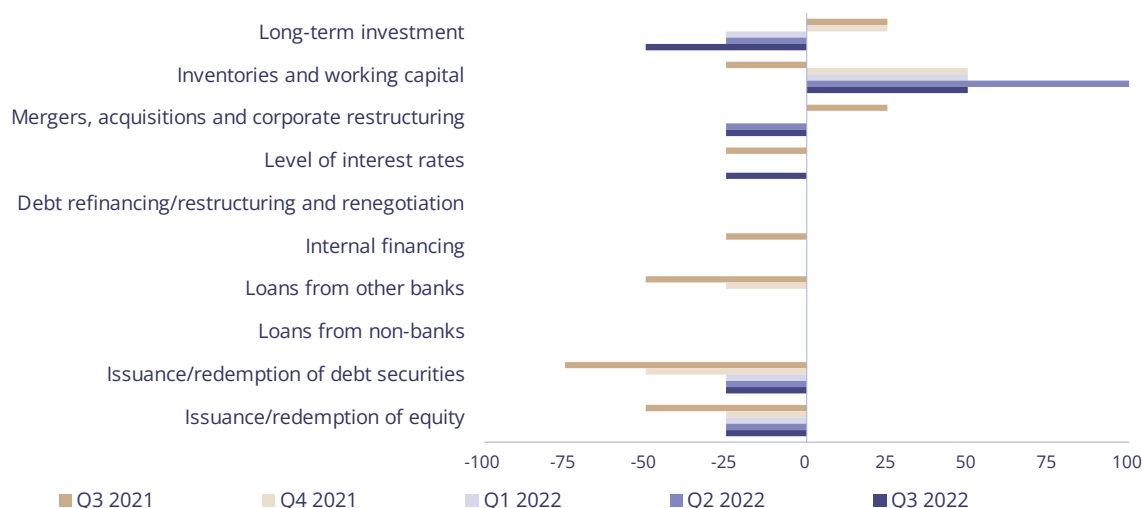
Changes in demand for loans to enterprises were not significant in the third quarter as they were driven by several counteracting factors (see Chart 10). During the reporting period, demand for short-term loans to enterprises was driven by an increased need for inventories and working capital (in two banks), which can be explained by the necessity to adapt to working in the face of the Russian-Ukrainian war, including by expectations of the price rise of raw materials and supply challenges. At the same time, a reduced need for long-term investment had an increasingly negative impact on demand for loans to enterprises in the third quarter – two surveyed banks reported the impact of the above factor. Demand for long-term investment is falling against the backdrop of high uncertainty and

concerns about the economic downturn in the coming quarters. One surveyed Latvian bank indicated that reduced mergers, acquisitions and corporate restructuring activity and rising interest rates contributed to the decrease in demand for loans to enterprises in the third quarter. Likewise, one bank has pointed out for several consecutive quarters that the expansion of the debt and equity markets creates competition for loans to enterprises, resulting in reduced demand for them.

Chart 10

Contribution of various factors to demand for loans to enterprises

(net percentages of banks reporting increased demand; %)



One of the surveyed Latvian banks acknowledged that in the third quarter, the share of rejected applications for loans increased across all categories of lending, particularly for consumer credit and other lending to households.

Ad hoc questions

The euro area bank lending survey of September 2022 also included several ad hoc questions, inter alia, regarding the impact of various ECB non-standard monetary policy instruments on banks' financial situation and lending.

Two surveyed banks reported the impact of the negative deposit facility rate in the second and third quarters: in one case, it reduced the bank's profitability, contributing negatively to net interest income, and reduced the firms' deposit rate, while in the other case – had an impact on loans to households for house purchase. In two Latvian banks, the two-tier excess reserve system increased their profitability by improving net interest income in the second and third quarters.

Three of the four surveyed Latvian banks pointed out that the ECB's targeted longer-term refinancing operations affected them over the past six months before the survey and will affect them over the next six months: two banks reported a positive impact, while one bank – a negative one. Latvian banks indicated that owing to the ECB's targeted longer-term refinancing operations their profitability was/ will be on the rise, their capacity to meet regulatory and supervisory requirements strengthened/ will strengthen, their credit standards for loans to enterprises were/will be eased and their credit standards for loans to households for house purchase were/will be relaxed

during the above period (each factor was mentioned once). Meanwhile, one Latvian bank pointed out that the amount of loans to enterprises decreased over the past six months before the survey and will decrease over the next six months under the impact of the ECB's targeted longer-term refinancing operations.