BOX 2: BANK LENDING SURVEY RESULTS[1]

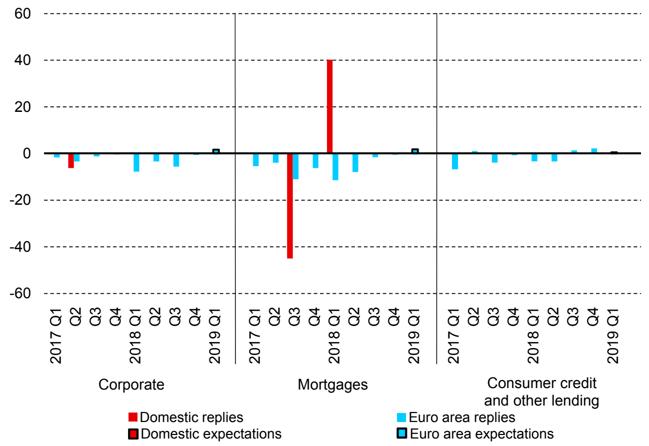
The ECB's Bank Lending Survey (BLS) is conducted every quarter to qualitatively gauge banks' lending conditions in the euro area. During 2018 almost 150 banks across the euro area participated in this survey.[2] Four core domestic banks took part, which together accounted for about 92% of overall bank credit to Maltese residents. The Survey distinguishes between three loan categories: credit to enterprises; mortgages; and consumer credit (with the latter also including other types of lending to households). It delves into factors affecting both supply and demand conditions and also asks survey respondents about their views for the next quarter.[3] Moreover, a number of *ad hoc* questions are included covering retail and wholesale funding, the impact of the ECB's expanded asset purchase programme (APP) and the ECB's negative overnight deposit facility rate, the effect of any new regulatory or supervisory requirements and the impact of non-performing loans on the banks' lending behaviour.

Credit supply conditions

During 2018, the Maltese surveyed banks maintained their credit standards on loans to enterprises at tight levels and expected to keep such credit standards unchanged at this level even in the first quarter of 2019 (see Chart 1). In contrast, credit standards for loans to enterprises in the euro area eased marginally in 2018 mainly owing to higher competition, as banks continued to support loan growth. However, they were expected to tighten credit standards in the first quarter of 2019.

At the same time, on balance, domestic participants have opted to tighten their terms and conditions applicable to corporate loans. This was largely driven by one bank which applied higher non-interest rate charges on the unutilised credit balance in the first quarter of 2018 to cover for the opportunity cost of tied-up capital. No further changes were reported in subsequent quarters (see Chart 2). In contrast, higher competitive pressures led euro area banks to ease further their corporate terms and conditions in 2018, resulting in narrower margins on average loans. This notwithstanding, the extent of easing decreased throughout the year to the lowest level recorded since this question started to be posed to respondents in 2015.

Chart 1
CREDIT STANDARDS
(+ indicates net tightening/- indicates net easing)



Sources: ECB; Central Bank of Malta calculations.

Maltese banks reported partly offsetting developments for mortgage supply conditions. During the first quarter of 2018, some tightening in mortgage credit standards was reported by

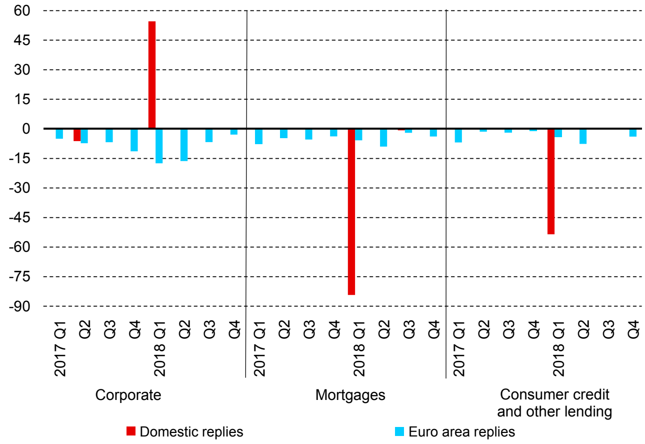
[1] Prepared by Ariana Bartolo, an Economics Officer within the Financial Stability Surveillance and Assessment Office of the Central Bank of Malta. Any errors and views expressed in this box are the author's sole responsibility.

[2] The BLS data for all euro area countries are published on the ECB's Statistical Data Warehouse (SDW).

[3] Supply conditions include credit standards and terms and conditions. Credit standards refer to the bank's internal guidelines or loan approval criteria, established prior to the actual loan negotiation. These specify the required borrower characteristics such as income levels, age and employment status which banks consider in their credit scoring methods. Credit terms and conditions refer to the conditions of a loan that a bank is willing to grant, namely the interest rate, loan size, fees, collateral requirements, maturity terms and other conditions.

one domestic bank following the introduction of stricter borrowers' affordability criteria (see Chart 1).[4] However, mortgage credit terms and conditions were eased both in the first quarter of 2018 and in the third quarter of 2018, though to a much lesser extent. This was mainly due to competitive pressures which resulted in narrower loan margins (see Chart 2). Domestic lending rates charged by Maltese banks for mortgages remained higher than those charged in the euro area, standing at about 3% and 2.1%, respectively.

Chart 2
CREDIT TERMS AND CONDITIONS
(+ indicates net tightening/- indicates net easing)



Sources: ECB; Central Bank of Malta calculations.

Euro area banks continued to ease both their mortgage credit standards and terms and conditions. These mainly reflected increased competitive pressures, lower risk perceptions coupled with improved borrowers' creditworthiness and positive housing market prospects. Such factors contributed in narrowing interest rate margins on average and riskier loans to a lower extent. Mortgage credit standards were, however, expected to tighten in the first quarter of 2019.

During 2018, domestic participant banks opted to keep credit standards on consumer credit and other household lending stable at tight levels and expected to keep this stance during the first quarter of 2019 (see Chart 1). Meanwhile, although in the first half of 2018, euro area participants reported some easing due to stiffer competition from both banks and non-banks and improved creditworthiness of consumers, these credit standards were tightened marginally in the second half of 2018 as a result of increased funding costs and balance sheet constraints. The tightening was expected to persist also in the first quarter of 2019 (see Chart 1).

Following three years of stable credit terms and conditions on consumer credit and other household lending, domestic banks reported some easing during the first quarter of 2018. This reflected increased competition which led to narrower interest margins as banks aimed to reverse the decline in consumer credit experienced over a number of years (see Chart 2). Similarly, euro area participants continued to ease their terms and conditions for this loan category, owing to increased competition and lower risk perceptions, which also led to narrower margins particularly on average loans.

Credit demand conditions

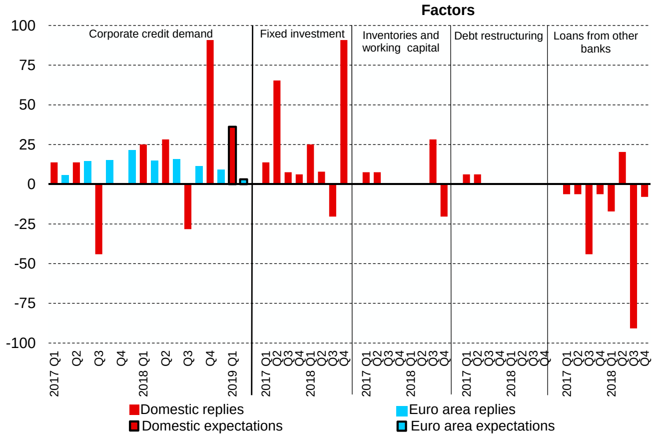
Domestic demand for corporate credit generally increased in 2018, except in the third quarter. Robust economic developments in 2018, particularly the increase in gross fixed capital formation continued to drive corporate loan demand, most notably in the last quarter of 2018 (see Chart 3). In the third quarter of 2018, domestic banks reported stiffer competition from other banks, increased debt securities issuance, together with lower demand for fixed investment, mergers and acquisitions, all of which contributed to lower corporate credit demand. This decline was slightly offset by higher financing needs for inventories and working capital, which was partly reversed in the last quarter of 2018. Overall domestic corporate credit demand was expected to increase in the first quarter of 2019.

[4] These were thereafter kept unchanged, and expected to remain stable during the first quarter of 2019.

In the euro area, demand for corporate loans remained positive although this decelerated throughout 2018, with only a marginal increase anticipated for the first quarter of 2019. The higher demand mainly reflected the all-time low level of interest rates, together with increased financing needs owing to mergers and acquisitions and debt restructuring, coupled with increased fixed investment and funding for inventories and working capital.

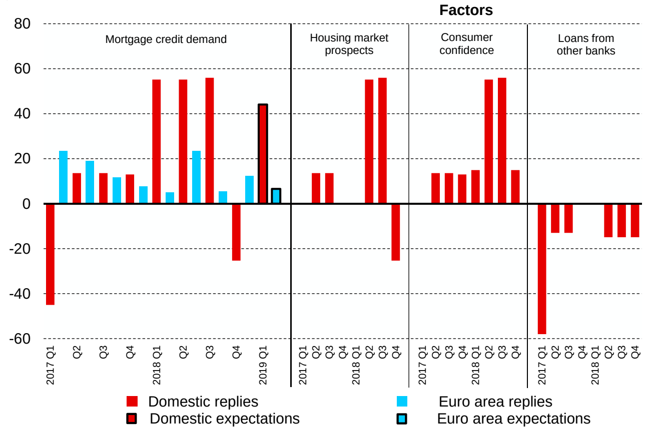
Mortgage credit demand by domestic respondents increased significantly during the first three quarters of 2018, owing to higher consumer confidence and better housing market prospects. However, in the last quarter of the year, one bank reported lower demand which was attributable to a slowdown in housing market prospects and competitive pressures from other banks (see Chart 4). Nonetheless, Maltese banks anticipated that mortgage credit demand would start to grow again during the first quarter of 2019.

Chart 3
CORPORATE CREDIT DEMAND
(+ indicates increase/ - indicates decrease)



Sources: ECB; Central Bank of Malta calculations.
Note: The impact of factors relate solely to the domestic corporate credit demand.

Chart 4
MORTGAGE CREDIT DEMAND
(+ indicates increase/ - indicates decrease)



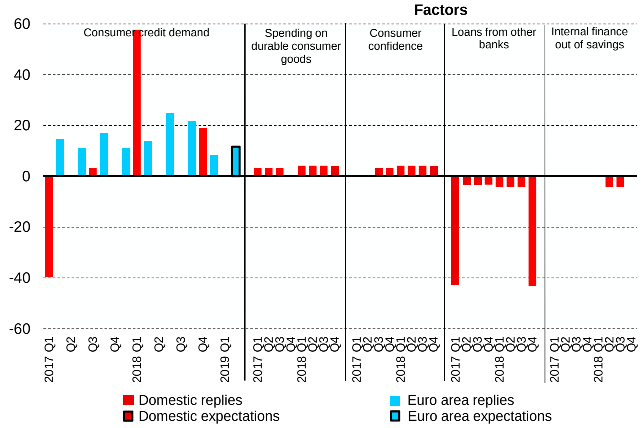
Sources: ECB; Central Bank of Malta calculations.
Note: The impact of factors relate solely to the domestic mortgage credit demand.

In the euro area, demand for mortgages remained positive owing to the low level of interest rates, better housing market prospects and higher consumer confidence. Euro area banks expected further growth in mortgage credit demand in the first quarter of 2019.

Domestic banks reported an increase in demand for consumer credit both during the first quarter and to a lesser extent in the last quarter of 2018. This reflected stronger consumer confidence and higher spending on durable consumer goods as disposable income grew. These positive factors were, however, somewhat offset by competitive pressures from other banks (see Chart 5). Demand for consumer credit however remained unchanged in the second and third quarters of 2018, as banks reported increased competition from alternative financing avenues. At the time of the survey, no changes in demand were anticipated by Maltese banks in the first quarter of 2019.

Euro area BLS banks continued to report positive growth in demand for consumer credit and other lending, particularly in the second and third quarters of 2018. The low level of interest rates, higher spending on durable consumer goods and stronger consumer confidence were the main factors driving such growth. Furthermore, euro area banks expected the increase in demand to persist in the first quarter of 2019.

Chart 5
CONSUMER CREDIT AND OTHER LENDING DEMAND
(+ indicates increase/ - indicates decrease)



Sources: ECB; Central Bank of Malta calculations.
Note: The impact of factors relate solely to the domestic consumer credit demand.

Ad hoc questions

The majority of Maltese participant banks reported broadly unchanged access to both wholesale and retail funding, with the latter representing the bulk of the funding tapped by domestic banks, in line with their traditional business models and the ample liquidity currently available. Euro area banks indicated that in net terms, access to wholesale funding deteriorated for debt securities issuance, for their access in the unsecured interbank markets and also securitisation. Euro area banks' access to retail funding also deteriorated somewhat in 2018.

The introduction of regulatory requirements or new supervisory actions did not impact domestic respondents' credit standards and credit margins. In contrast, euro area banks reported higher total and liquid assets on balance, coupled with a further strengthening of their capital position, mainly through retained earnings and to a lesser extent through capital issuance. In response to regulatory and supervisory actions euro area banks also reported a net tightening in their funding conditions and also in their credit standards and loan margins for corporates and households.

Domestic banks' lending policies were unaffected by the level of non-performing loans, which continued to decrease throughout the year. However, euro area banks indicated that the level of their non-performing loans had a tightening effect on their credit standards and terms and conditions across all loan categories.

Domestic banks meanwhile reported that the ECB's negative deposit facility rate had a negative impact on their profitability as it lowered net interest income, particularly in view of the abundant liquidity buffers placed overnight with the Central Bank of Malta. Moreover, some domestic BLS banks reported a drop in their lending rates, particularly for enterprises, followed by an increase in the lending volume for all loan categories. Similarly, euro area BLS banks continued to report a negative impact on banks' net interest income, owing to narrower margins for both loans to enterprises and households. Yet, the negative overnight deposit facility rate boosted lending volumes particularly for corporates and households.

One Maltese bank reported that the ECB's expanded APP had a positive impact on its liquidity position and market financing conditions, whilst another domestic bank said that it contributed to an easing impact on its lending standards, terms and conditions and lending volumes for loans to enterprises. However, the remaining domestic respondents did not report any impact on their assets, liquidity buffers, market financing conditions, profitability and capital position on account of the ECB's expanded APP. Over 2018, euro area banks reported that the APP had aided their liquidity positions and market financing conditions, but had adversely affected profitability due to narrower net interest margins, though lending volumes did increase following an easing in lending conditions. The APP also contributed to a decrease in banks' holdings of sovereign bonds.