BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

BANK LENDING SURVEY RESULTS 2019

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BOX 1: BANK LENDING SURVEY RESULTS[1]

The quarterly BLS carried out by the ESCB provides qualitative information on banks' lending conditions, developments in the past three months, and expectations of banks in relation to loan supply and demand for enterprises and households.[2] In the 2019 edition, the surveys also asked a number of *ad hoc questions* relating to the banks' access to retail and wholesale funding, the impact of new regulatory or supervisory requirements, the effect of the ECB's expanded asset purchase programme (APP), the ECB's negative deposit facility rate and the effect of NPLs on the banks' lending policies. Across the euro area, 144 banks participated in the 2019 survey rounds, of which four were Maltese banks, which together accounted for about 91% of total resident bank credit.[3]

The Box covers bank lending developments that occurred during 2019. The surveys were run prior to the intensification of COVID-19's spread, and hence replies reflect perceptions prior to the onset of the pandemic. Meanwhile, the latest round of the BLS that was carried out during April 2020 sheds some light on the lending developments during the coronavirus outbreak.

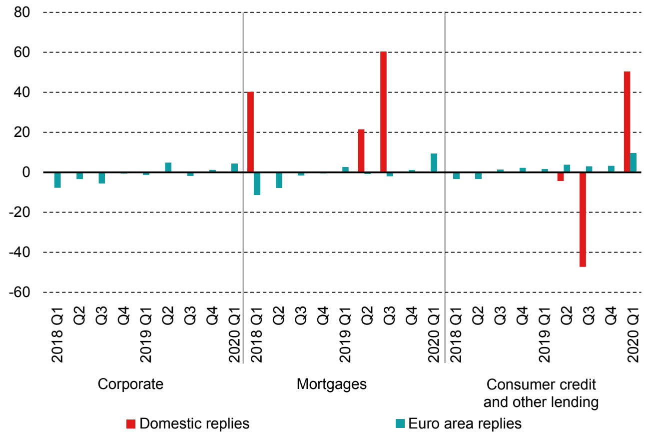
Credit supply conditions

As in previous years, domestic participant banks reported that they maintained their credit standards on loans to enterprises unchanged at tight levels during 2019 (see Chart 1). Similarly such credit standards were kept stable in the first quarter of 2020, with the majority of the domestic BLS banks expecting them to remain unchanged over the second quarter of 2020. In the euro area, although competition from banks continued to have an easing impact on lending standards, overall corporate credit standards tightened marginally during 2019 as a result of higher risk perceptions related to the general economic outlook and industry or firm-specific situations and to a lower extent due to the impact of euro area banks' capital position.

In 2019, domestic BLS banks kept their overall corporate credit terms and conditions stable (see Chart 2). Nonetheless, the margins on average loans to enterprises narrowed further, particularly due to pressures from competition. All the domestic participating banks kept their corporate credit terms and conditions unchanged during the first quarter of 2020.

On the other hand, euro area banks reported some tightening of the overall corporate terms and conditions

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



Sources: ECB; Central Bank of Malta calculations.

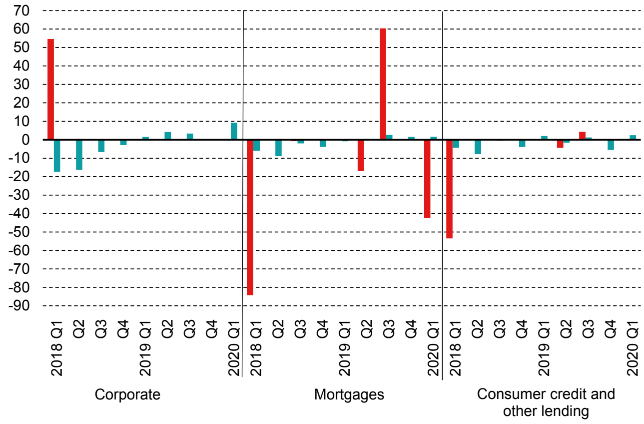
1 This Box was prepared by Ariana Bartolo, an Economics Officer within the Financial Stability Surveillance and Research Department of the Central Bank of Malta. Any errors and views expressed in this box are the author's sole responsibility.

2 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.

3 The BLS data for all euro area countries are published on the ECB's SDW.

due to increased banks' funding costs, balance sheet constraints and heightened risk perceptions, which also resulted in wider margins for riskier loans. However, some factors such as competitive pressures continued to have an easing impact attenuating somewhat the tightening effect and resulting in some narrowing of margins on average loans to enterprises throughout the year.

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



Sources: ECB; Central Bank of Malta calculations.

Mortgage credit standards as reported by domestic participating banks tightened during the second and third quarters of 2019, owing to the introduction of the Central Bank of Malta (CBM) Directive No. 16 on regulation of Borrower-Based Measures (BBM) (see Chart 1).[4] These thereafter remained unchanged in the last quarter of 2019 and in the first quarter of 2020, with expectations that domestic banks will maintain these unchanged also in the second quarter of 2020. Similarly, overall credit terms and conditions for mortgages tightened in 2019, driven by developments reported during the third quarter of 2019 as half of the domestic respondents tightened their LTV ratio, loan size limits and the term-to-maturity to bring them in line with the recently-introduced BBM (see Chart 2). This tightening was partly offset by easing in the margins for both average and riskier loans. Yet, domestic lending rates for mortgages remained higher than those of the euro area, at around 3% and 2%, respectively.[5] Some easing effect was also reported in the second quarter as one bank eased its mortgage credit terms and conditions due to higher competitive pressures and higher risk tolerance. During the first quarter of 2020, the majority of domestic respondents kept their terms and conditions for mortgages stable, with only one bank reporting some easing on the back of narrower loan margins on average loans owing to higher competitive pressures.

Euro area banks reported some offsetting developments in mortgage credit standards resulting in an overall stable position (see Chart 1). Although pressures from competition continued to be the main factor contributing to the easing of mortgage credit standards – particularly in the second and third quarters of 2019 – this was offset by some tightening arising from funding costs and banks' risk tolerance particularly in the first and last quarters of 2019. Mortgage credit terms and conditions meanwhile tightened slightly in 2019, partly reverting the easing reported in the previous year (see Chart 2). This was mainly due to pressures from funding costs, balance sheet constraints and banks' risk tolerance, together with a tightening of margins for riskier loans. Euro area banks' margins on average loans meanwhile eased slightly, partly offsetting the tightening effect on riskier loans.

After two years of stable credit standards for consumer credit and other lending to households, domestic banks eased such standards during the second and – to a much higher extent – in the third quarter of 2019 (see Chart 1). The latter, however, reflected increased limits on unsecured lending by one domestic participant bank. Such standards remained stable in the last quarter of 2019. During

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[4] https://www.centralbankmalta.org/centralbankofmaltadirectives
[5] Source: The figure for Malta's mortgage interest rate is from BR06 data. The euro area figure is from the ECB's SDW. Figures are reported as at March 2020.

the first three months of 2020, one domestic BLS bank reported some tightening as it reduced the limits on unsecured lending in response to the economic impact of the COVID-19 pandemic. Meanwhile, another domestic BLS bank was expecting to ease its credit standards for consumer credit in 2020 Q2 to support its customers mostly affected by the COVID-19 pandemic. Meanwhile, the tightening reported by euro area banks persisted in 2019, mainly owing to a lower risk tolerance by banks in line with higher risk perceptions related to the general economic environment.

Domestic banks' credit terms and conditions on consumer credit and other household lending were on average kept unchanged during 2019, with one domestic surveyed bank reporting offsetting results in the second and third quarters of the year (see Chart 2). The higher credit limits reported during the second quarter of 2019 – on the back of increased competitive pressures and higher risk tolerance – were later tightened owing to the introduction of Central Bank of Malta Directive No. 16 in the third quarter of 2019, which impacted the size of loans and term-to-maturity.[6] Meanwhile, during the first quarter of 2020, all domestic participating banks kept their consumer credit terms and conditions unchanged.

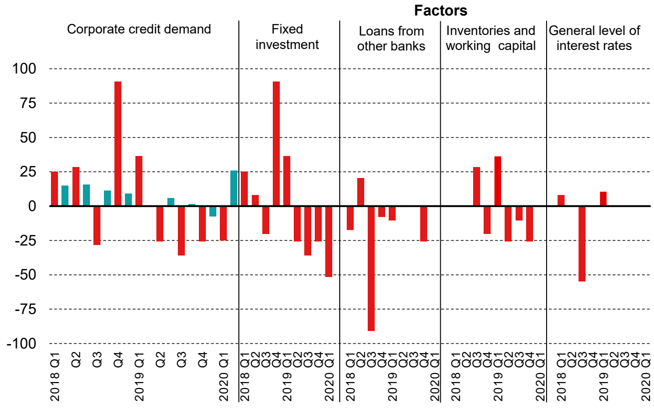
On the other hand, euro area banks eased their overall terms and conditions on new consumer credit and other household lending, mainly on the back of competitive pressures which resulted in narrower spreads on average loan margins.

Credit demand conditions

Domestically, a drop in corporate credit demand was observed during 2019, reflecting lower fixed investment and working capital requirements coupled with competitive pressures from other banks (see Chart 3). Meanwhile, in the first quarter of 2020, two domestic BLS banks reported offsetting replies as a result of the COVID-19 outbreak. One domestic BLS bank indicated an increase in corporate credit demand as enterprises experienced higher working capital requirements, while another reported a fall in such demand due to lower fixed investment on the back of heightened uncertainties and market disruptions. Nonetheless, all domestic participant banks expect their demand for corporate loans to increase during the second quarter of 2020 to finance higher working capital requirements.

In the euro area, although overall corporate credit demand for the first three quarters of the year remained positive on the back of the general level of interest rates, mergers and acquisitions and fixed investment, a downward trend was observed in the last quarter of 2019 for both large, and small and medium size enterprises. This was due to lower financing needs, especially due to the

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

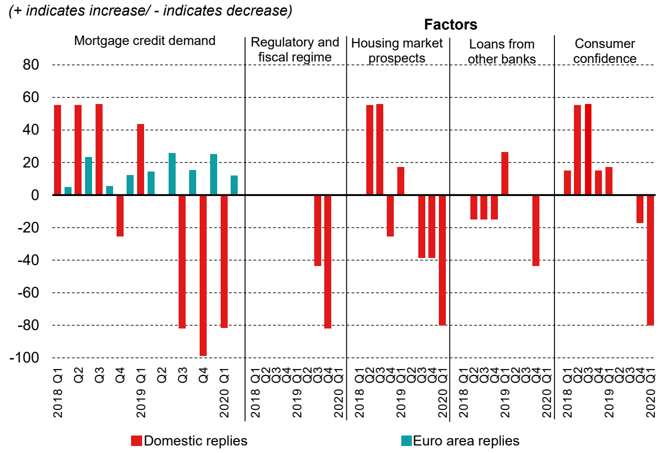


Sources: ECB; Central Bank of Malta calculations.
Note: The impact of factors relate solely to the domestic corporate credit demand.

6 Central Bank of Malta Directive No. 16 may have to some extent impacted the provision of consumer credit and other household lending since in some instances additional loans, such as for example to purchase furnishings, were granted in combination with mortgage loans, having the same conditions. These are now granted as a personal loan.

availability of firms' internal funds and debt securities issuance.

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



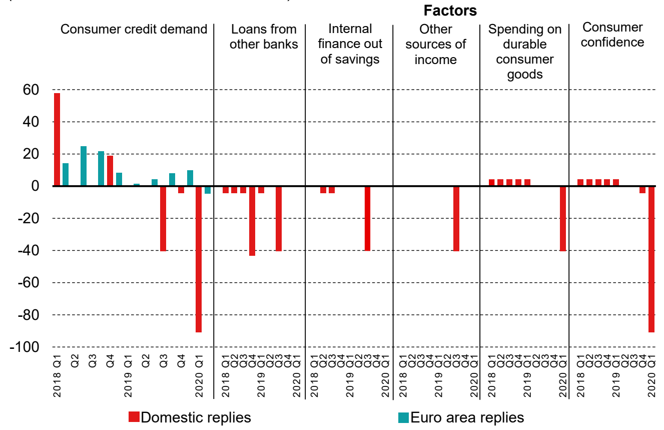
Sources: ECB; Central Bank of Malta calculations.
Note: The impact of factors relate solely to the domestic mortgage credit demand.

After reporting higher demand for mortgages during the first quarter of 2019, domestic BLS banks reported a significant drop in demand in the second half of 2019 (see Chart 4). This reflected the stricter regulatory and fiscal regime including the newly-introduced regulatory BBMs. Housing market prospects, competitive pressures and – to a lower extent – consumer confidence also contributed to lower demand for housing loans in the second half of 2019. Furthermore, during the first three months of 2020, the majority of domestic BLS banks reported a fall in demand for loans for house purchases owing to uncertain housing market prospects and lower consumer confidence owing to the pandemic. Expectations for the second quarter of 2020 show that all the domestic BLS banks are anticipating a further decline in the demand for mortgages, as a result of ongoing repercussions from the COVID-19 spread.

On a pan-European front, similar to previous years, euro area banks' net demand for housing loans strengthened further mainly on the back of the low level of interest rates, favourable housing market prospects and consumer confidence. Other financing needs including debt refinancing/restructuring and the regulatory and fiscal housing market regime also had a positive impact.

Domestic BLS banks have reported largely unchanged overall demand for consumer credit and other lending to households during 2019, with the exception of two banks which reported lower demand in the third and fourth quarters (see Chart 5). This was mainly owing to competitive pressures and the use of alternative finances particularly via internal savings. During the first quarter of 2020, half of the respondents reported a fall in the demand for consumer credit due to a drop in consumer confidence and lower spending on durable consumer goods in response to the COVID-19 pandemic. Although this fall

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.

was expected to continue over the second quarter of 2020, one domestic BLS bank reported an expected recovery in its demand for consumer credit and other lending, linked with its intention to ease related credit standards.

In contrast, demand for consumer credit and other household lending in the euro area increased throughout the year, though still below the level reported in 2018. The low level of interest rates, consumer confidence and increased spending on durable goods all had a positive impact on consumer credit demand in the euro area.

Ad hoc questions

During 2019, Maltese participant banks reported increased access to retail funding largely from higher inflows of short-term deposits and to a lesser extent from long-term deposits. Meanwhile, access to wholesale funding remained generally stable for the majority of domestic banks. While the COVID-19 pandemic did not impact domestic banks' retail funding during the first quarter of 2020, two domestic participant banks reported a deterioration in their very short-term money market, with one of these banks anticipating a further deterioration in its interbank unsecured money market in the second quarter of 2020.

On their part, euro area banks indicated that their access to wholesale funding improved during 2019, predominantly on the back of higher issuance of medium- to long-term bonds. Access to securitisation, retail funding and unsecured interbank money market all improved for euro area banks during 2019.

With regards to the impact of the new regulation on domestic banks' lending behaviour, in the first half of the year one domestic BLS bank reported an increase in its risk-weighted assets on account of both average and riskier loans as a result of the Capital Requirements Regulation (CRR).

Meanwhile, euro area banks reported that new regulatory or supervisory requirements led to a strengthening of their capital position, and an increase in total assets and liquid assets. Euro area banks' risk-weighted assets also rose – driven entirely by increased lending. Moreover, while funding conditions eased slightly, the euro area banks' credit standards and credit margins tightened across all loan categories in 2019.

Survey results covering the period from the last quarter of 2018 up to the third quarter of 2019 show that the ECB's expanded APP did not impact the domestic participant banks' assets, liquidity buffers, market financing conditions, profitability and capital position. Their lending policies and volumes were also not affected by the impact of the APP. Meanwhile, during the last quarter of 2019 and first quarter of 2020, one domestic participant bank reported that the APP and the Pandemic Emergency Purchase Programme (PEPP) contributed to lower total assets, whereby the volume of euro area sovereign bond holdings fell. This bank anticipated a further decline in its total assets but an improvement in its liquidity position during the second and third quarters of 2020, while the majority of the domestic BLS banks anticipated no changes in relation to their assets, liquidity position, profitability and capital position.[7] Meanwhile, euro area banks reported that the APP contributed to an improvement in their market financing conditions and liquidity positions, but led to a deterioration in their profitability as net interest margins narrowed. Furthermore, the APP continued to have a net easing impact on credit standards particularly on household loans and terms and conditions of all loan categories. Euro area banks indicated a positive impact on their lending volumes for both enterprises and housing loans.

The ECB's negative deposit facility rate (DFR) contributed somewhat to a decline in the profitability of most domestic respondents, as reflected by lower NII. However, this decline was attenuated fol-

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[7] During the April 2020 round, the survey question on the impact of the ECB's APP was amended to include the direct and indirect effects of both the APP and the PEPP, following the COVID-19 pandemic.

lowing the ECB's introduction of a two-tier system in October 2019, with the majority of the domestic participating banks indicating that such system was beneficial for their profitability. Meanwhile, one of the domestic BLS banks noted a decline in its profitability due to lower NII and market financing conditions. One of the domestic BLS banks reported a drop in its lending rates for all loan categories resulting in narrower interest rate margins but higher lending volumes owing to the negative DFR. Furthermore, during the April 2020 round, covering developments during the last quarter of 2019 and first quarter of 2020, some domestic BLS banks also reported a decline in their retail deposit rates.[8]

Similarly, euro area banks' NII fell, together with a decrease in their lending rates and loan margins for both enterprises and household loans. This was partly offset through a positive impact on their non-interest rate charges and lending volumes for all the types of loans. In the April 2020 BLS round, euro area banks reported a negative impact of the DFR on deposit rates, with some respondents trying to compensate for the negative rates via higher non-interest rate charges on deposits. Euro area banks indicated that the two-tier system had a positive impact on their profitability and – to a much lower extent – on their liquidity position and market financing conditions. In addition, euro area banks reported that lending rates across loan categories declined, while deposit rates for both enterprises and households rose following the introduction of the two-tier system.

With regards to the impact of non-performing loans, the majority of the domestic BLS banks did not report any changes related to their lending policies, although one of the reporting domestic banks reported some easing of credit standards for mortgages during the first half of 2019 on the back of strong economic growth. Throughout 2019, euro area banks meanwhile reported a tightening of their credit standards for all loan categories, and terms and conditions – particularly for corporates and consumer credit and other lending to households when considering the impact on their NPL ratio.

[8] In the April 2020 round, banks were asked for the first time to indicate the DFR impact on deposits held by corporates and households. Also, BLS banks were asked to assess the impact of the ECB's two-tier system on their profitability, lending and deposits, compared with the situation without a two-tier system.