BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

BANK LENDING SURVEY RESULTS 2020

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BOX 2: BANK LENDING SURVEY RESULTS[1]

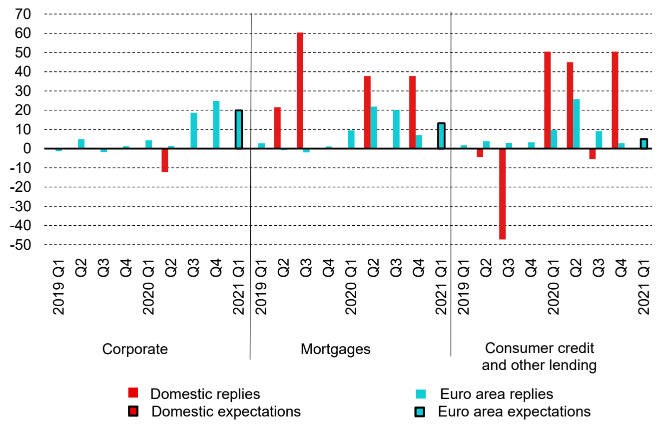
The Bank, as a member of the European System of Central Banks, carried out the Bank Lending Survey (BLS) each quarter to assess developments on credit supply and demand conditions for enterprises and households for 2020, and expectations for 2021Q1.[2] The Survey also incorporates several ad hoc questions to analyse the impact of various measures, including but not limited to, those relating to the pandemic. Across the euro area, 143 banks participated in the 2020 survey rounds, of which four were Maltese. The latter accounted for about 93% of total resident bank credit in Malta.[3] This Box gives an account of the results of the local surveys conducted by the Bank and compares such outcomes with the collective replies of other euro area countries.

Credit supply conditions

For the first time in three years, some easing in corporate credit standards on loans to NFCs was reported in the second quarter of 2020 (see Chart 1). Such easing reflected the measures introduced to support the economy, particularly the implementation of the MDB CGS, which enabled banks to ease their credit standards coupled with the introduction of moratoria. This scheme provides guarantees to banks when lending to corporates for working capital requirements and when faced with acute liquidity shortages owing to the pandemic.[4] In contrast, euro area banks tightened corporate credit standards particularly during the second half of 2020 owing to weakened economic activity, specifically in some sectors, and lower risk tolerance by these banks.

Domestic BLS banks also reported an easing in their corporate credit terms and conditions in the second quarter of 2020, on the back of narrower margins on average loans, longer maturities, lower non-interest rate charges and eased collateral requirements, which in part reflected the implementation of the MDB CGS and the introduction of moratoria measures (see Chart 2). Meanwhile, euro area banks reported some tightening in the overall corporate terms and conditions due to heightened risk perceptions, lower risk tolerance and, to a much lower extent, reflecting the increased banks' funding

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



Sources: ECB; Central Bank of Malta calculations.

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[1] This Box was prepared by Shaun Zaffarese, a Financial Analyst within the Financial Stability Surveillance and Research Department of the Central Bank of Malta.

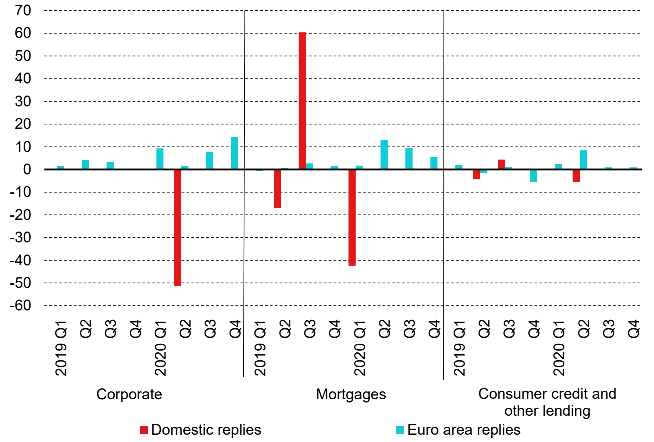
[2] Supply conditions include credit standards and terms and conditions. Credit standards refer to the bank's internal guidelines or loan approval criteria, established prior to the actual loan negotiation. These specify the required borrower characteristics such as income levels, age and employment 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.

[4] The CGS has been approved by the European Commission on 2 April 2020 under the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, as part of the wider package of Government's COVID-19 Response Support Programme. European Commission Press Release: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_578

costs and balance sheet constraints. This mainly led to tightened collateral requirements and wider margins.

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



Sources: ECB; Central Bank of Malta calculations.

Tightened credit standards were reported for mortgages by domestic participant banks (see Chart 1). This was mainly the case in the second quarter of 2020 as the pandemic outbreak led to a deterioration in the general economic situation, with the tightening in the fourth quarter reflecting concerns on housing market prospects, borrowers' creditworthiness and thus lower risk tolerance by the banks. No further changes were anticipated at that time for the first quarter of 2021. Similarly, euro area banks also reported tightened mortgage credit standards, driven by the same factors as reported by the domestic BLS banks. However, in January 2021, euro area banks expected a further tightening for the first quarter of 2021.

Domestically, overall credit terms and conditions for mortgages eased prior to the pandemic, on the back of narrower average loan margins in the first quarter of 2020 due to competitive pressures (see Chart 2). In subsequent quarters, mortgage terms and conditions remained unchanged on balance, as loan margins were eased due to higher competitive pressures, but later in the year loan-to-value (LTV) ratios were tightened due to heightened risk perceptions and lower risk tolerance owing to the pandemic. In the euro area, overall mortgage terms and conditions continued to tighten during 2020, particularly as the pandemic resulted in higher risk perceptions and lower risk tolerance. Euro area banks reported lower LTV ratios, reflected in wider margins on riskier loans, more stringent collateral requirements, shorter maturities and reduced loan size limits.

Credit standards for consumer credit and other lending to households tightened both domestically and in the euro area (see Chart 1). In Malta, banks reported significant tightening except in the third quarter of 2020, where on balance, credit standards were eased to support those households that suffered loss of income amid the pandemic. The factors contributing to the tightening reflect prospects of deteriorated creditworthiness of the borrowers on the back of weakened economic activity, resulting in lower risk tolerance by banks. Meanwhile, euro area banks tightened credit standards further in 2020 owing to anaemic economic activity and borrowers' credit-worthiness concerns, which triggered lower risk tolerance by banks. At the time of the survey, such tightening was anticipated to persist through the first quarter of 2021.

Domestically, banks were keener on changing credit standards rather than terms and conditions on consumer credit and other lending to households. This is also equally true for euro area banks. In Malta, terms and conditions for consumer credit were somewhat eased in the second quarter of 2020 with one bank reporting narrower margins on average loans, less strict collateral requirements, larger credit limits and longer maturities to aid customers mostly hit by the pandemic (see Chart 2). On the other hand, euro area banks tightened throughout the year, with lower credit limits, wider margins particularly on riskier loans, tighter collateral requirements and shorter maturities reported on the back of heightened risk perceptions and lower risk tolerance.

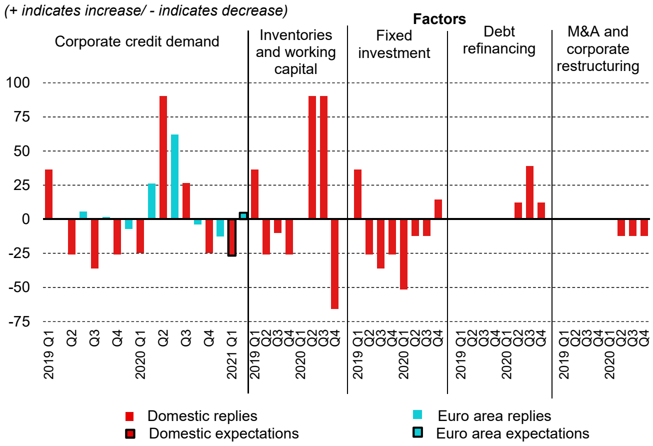
Credit demand conditions

In Malta, demand for corporate loans increased, as higher short-term loans for inventories and working capital needs were observed in the second quater of 2020, coupled with higher demand for long-term loans for corporate debt financing in the third quarter. These more than offset the drops reported in the first and last quarter of 2020 (see Chart 3).[5] The higher liquidity needs reflected the negative financial impact of the pandemic, as restrictions posed by the Government to limit the COVID-19 spread led to the temporary closure of many businesses. Such demand was being met by the MDB CGS (see Chapter 1). At the same time, domestic banks, on balance, anticipated a marginally lower demand for corporate loans in 2021Q1, due to prevailing uncertainties and also partly due to a lower base effect.

Replies at the euro area level largely mirrored domestic developments, with an overall increase in the demand for corporate loans on the back of higher short-term liquidity needs for inventories and working capital, as well as for debt refinancing, mainly in the first half of 2020.

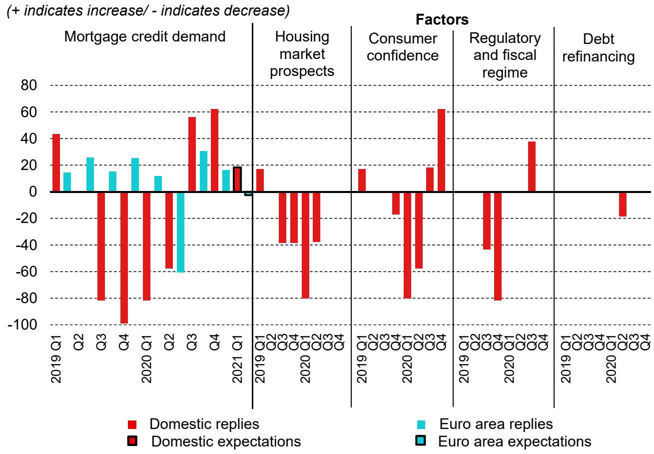
Domestic demand for mortgages declined in the first half of 2020, maintaining the trend that was already present in the second half of 2019 (see Chart 4). This mainly resulted from weaker housing market prospects and deteriorated consumer confidence. Furthermore, loss of household income by some individuals and the temporary closure of bank branches brought about by the partial lockdown inhibited the ability to process requests and contributed to lower demand. Meanwhile, during the second half of 2020, mortgage

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)

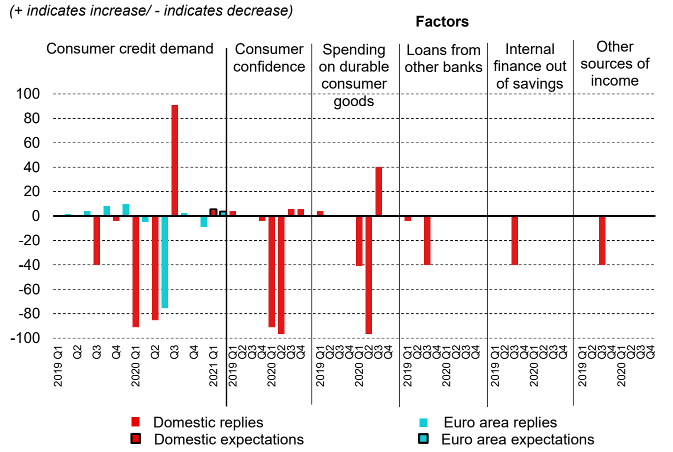


Sources: ECB; Central Bank of Malta calculations.
Note: The impact of factors relate solely to the domestic mortgage credit demand.

[5] The increase in corporate loan demand was partly offset by lower fixed investment in the first quarter of 2020 due to the initial stages of pandemic uncertainties, and also lower needs for working capital in the last quarter of the year due to a base effect caused by the abnormally high demand reported in this regard in previous quarters.

demand showed some tentative signs of recovery as housing market prospects and consumer confidence both improved in line with increased promises of sale following the end of a partial lockdown in June, as well as the Government's temporary reduction in stamp duty rates on property purchases (see Chapter 1). With regards to expectations for the first three months of 2021, most of the domestic BLS banks indicated that they do not anticipate any material developments, except for one bank which expected a further increase in the demand for mortgages. This reflected the tentative signs of an economic recovery driven by renewed hope on the roll out of the vaccination programme.

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.

Euro area banks' net demand for mortgages turned negative particularly in the second quarter of 2020, driven by lower consumer confidence triggered, in turn, by the intensification of the pandemic and the subsequent lockdowns. However, demand turned positive again in the second half of 2020, supported by the low level of interest rates and, to a lesser extent, the impact of housing market prospects. At the time of the survey, euro area banks expected mortgage demand to experience a further marginal decline in the first quarter of 2021.

Demand for consumer credit and other lending to households in Malta also suffered a significant drop in the first six months of the year, driven by the effects of the containment measures introduced at that time (see Chart 5). In the third quarter, spending on consumer goods resumed as containment measures were gradually lifted, but remained stable in the last quarter of 2020. In the January 2021 survey round, a slight pickup in demand was once again expected for the rest of the quarter. Banks in the euro area also reported lower demand for consumer credit and other household lending, particularly in the second quarter of 2020, largely reflecting the stringency of the containment measures and their impact on consumption. In the second half of the year, demand remained relatively stable but was expected to increase slightly in the first quarter of 2021.

Other information from ad hoc questions

Throughout 2020, domestic BLS banks reported higher access to retail funding, largely from higher short-term deposits. The uncertainty created by the pandemic as well as the impact of stringent containment measures contributed to higher precautionary and forced savings, which in turn led to higher bank deposits. Such trend was expected to persist also over the first quarter of 2021. Lower debt securities issued and funding through the unsecured money market was reported, with one bank also expecting the latter to persist into the first quarter of 2021. Euro area banks indicated that their access to retail funding improved during 2020, as well as for the very short-term interbank unsecured money market, but deteriorated for the short-term inter-bank unsecured money market.[6] Access to funding via wholesale debt securities and securitisation of loans also weakened.

[6] The very short-term money market refers to funding with a duration of up to one week, while the short-term money market consists of funding for more than one week.

Domestically, the majority of the BLS participant banks reported that the ECB's asset purchase programme (APP) and the PEPP had no impact on their business in the first quarter of 2020. Meanwhile, in the second and third quarter of the year, the APP resulted in a slight decrease in sovereign bond holdings, and with it NII. Concurrently, the liquidity position improved further, although this contributed to higher financing costs given that the proceeds were deposited with the Bank at a negative rate. Looking ahead, at the time of the survey, none of the domestic BLS banks expected any changes for the last quarter of 2020 and first quarter of 2021. Euro area banks reported that the APP contributed to higher assets, improved liquidity and capital levels, and better market financing conditions, but profitability for euro area banks weakened through lower NII. Furthermore, euro area banks reported eased terms and conditions, and higher lending volumes for all loan categories also as a result of the APP and PEPP.

With regards to the ad hoc question treating the impact of the negative deposit facility rate (DFR), some domestic participant banks reported that this contributed to lower reported profitability in the last quarter of 2019 and for the first three quarters of 2020, with some banks also reporting that it contributed to lower lending and/or deposit rates. The negative DFR resulted in narrower margins, lower non-interest rate charges, which, however, were compensated for by higher loan and deposit volumes. Meanwhile, on balance, non-interest rate charges on household deposits remained unchanged during the six months ending March 2020. Going forward, during the six months ending 2021Q1, Maltese banks expected that the DFR would result in higher loan and deposit volumes and dampened profitability. On the other hand, the ECB's two-tier system had a positive impact on domestic BLS banks' profitability owing to higher NII.[7] Such development was expected to continue until March 2021. Euro area banks reported that in the four quarters to September 2020, the DFR mainly contributed to lower profitability through lower NII, reduced lending and deposit rates, as well as narrower margins for all loan categories. The two-tier system had a positive impact on profitability, mainly through increased NII and, to a much lower extent, led to improved liquidity and market financing conditions.

Throughout the year ending September 2020, none of the domestic BLS banks participated in the March and September TLTRO III operations, however, the participation in future operations is being considered by some banks quoting attractive financing conditions which would improve profitability through the purchase of domestic sovereign bonds and other financial assets, as well as improved credit intermediation. Meanwhile, about one-third of euro area banks participated in both the March and September TLTROs, mainly due to attractive conditions and to secure financing given the uncertainty of financial markets. The share of banks which planned to participate in future TLTROs declined from about half of the banks in 2020Q1 to less than one-fifth of the banks in 2020Q3, with those which planned to participate quoting profitability and precautionary motives and, to a lower extent, the need to meet regulatory and supervisory requirements. Such funding would be used towards granting loans to the non-financial private sector, holding liquidity with the Eurosystem, and the substituting of maturing debt securities, interbank lending and TLTRO II funding. In 2020, euro area banks reported that TLTRO III operations positively impacted the banks' financial situation and led to higher lending volumes to enterprises.

The BLS also looked into the impact of NPL ratios on lending policies. Domestic BLS banks reported no changes in their lending policy owing to changes in NPLs, although some tightening of credit standards, and terms and conditions for corporate loans is being anticipated during the first half of 2021 through higher costs related to its capital position, increased pressure from supervision, and also a lower risk tolerance. Euro area banks tightened their credit standards, and terms and conditions for loans to enterprises and consumer credit, on the back of higher risk perceptions related to the general economic outlook and borrowers' creditworthiness, and lower risk tolerance by the banks.

[7] The two-tier system for reserve remuneration exempts part of credit institutions' liquidity holdings in excess of minimum reserve requirements from negative remuneration at the annual rate of 0%.

On balance, domestic banks reported that new regulatory and supervisory requirements led to higher retained earnings and capital requirements coupled with increased assets and risk-weighted assets. Such impact is expected to persist in 2021, with some respondents also mentioning that risk-weighted assets are expected to decline. Meanwhile, euro area banks reported a strengthening in their capital position, with total assets, risk-weighted assets and liquid assets also increasing. Euro area banks indicated that regulatory or supervisory actions had a strong easing impact on their funding conditions, and some tightening on their credit standards across all loan categories in 2020.

A new question introduced in the July 2020 BLS round assessed developments in lending standards and demand at a sectoral level.[8] On balance, domestic BLS banks reported eased terms and conditions in almost all of the main economic sectors, except for commercial real estate loans. Heterogeneity among banks was present in the developments reported on credit demand. During the first half of 2020, offsetting developments in demand were reported in the construction and real estate loans, while others reported higher demand for loans related to manufacturing, but lower demand for loans in the services sector. In the second half of the year, demand for real estate loans declined, while higher demand for loans in manufacturing, services and construction sectors was reported by some banks. For the first half of 2021, at the time of writing, two banks expected lower demand across the main economic sectors.

Euro area banks tightened credit standards, and terms and conditions across all the main economic sectors during 2020. Demand increased for lending towards wholesale and retail trade, services, manufacturing and construction, particularly in the first half of 2020. Otherwise, demand for real estate loans declined for euro area banks, both for commercial and residential real estate.

The survey introduced a question to assess qualitatively the impact of COVID-19 support measures. Domestic respondents reported positive impacts emanating from eased lending standards for enterprises, as well as from the higher corporate credit demand that was stronger in the second half of 2020. The demand arose mainly to cover liquidity needs but also requests for precautionary reasons. Meanwhile, expectations for the first half of 2021 indicate that corporate terms and conditions, and demand were expected to remain generally the same at the time of the survey, with some marginal tightening in credit standards possible on an aggregate basis. Euro area banks reported tightened lending standards and higher demand for corporate loans due to such guarantees, particularly in the first half of the year which were mainly used to cover acute liquidity needs, to act as a precautionary liquidity buffer and as a substitution of existing loans.

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[8] The main economic sectors refer to manufacturing, construction and real estate, services (excluding financial services), and wholesale and retail trade.