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CENTRAL BANK OF MALTA

BANK LENDING SURVEY RESULTS 2021

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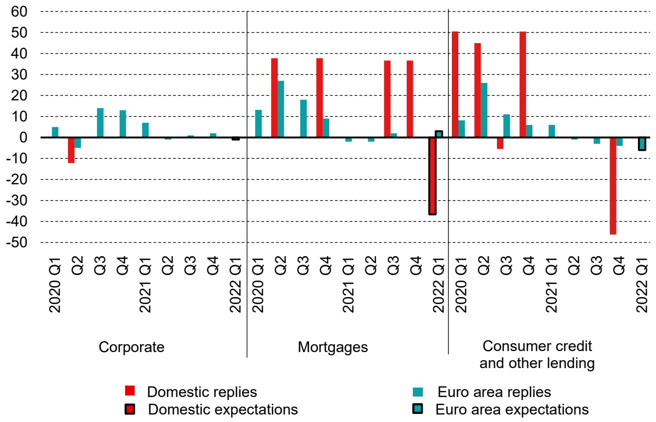
BOX 1: BANK LENDING SURVEY RESULTS

During 2021, the Bank carried out four quarterly rounds of the BLS to gather information on lending demand and supply conditions for both enterprises and households.[1] Expectations for the first quarter of 2022 were drawn from the replies in the January 2022 survey round. The BLS also contains several ad hoc questions which provide information to support the ECB's Governing Council monetary policy decisions. During 2021, around 150 euro area banks participated in the survey, of which four were Maltese banks. The latter represented about 90% of the overall domestic bank credit, indicating the high respresentativeness of the Maltese sample.[2] This Box provides insights on the main results of local participating banks which are also compared with the aggregated outcome of euro area banks.

Credit supply conditions

Credit standards on loans to enterprises of domestic banks remained stable throughout 2021, following some easing in the second quarter of 2020 (see Chart 1). In contrast, after some tightening in the second half of 2020, euro area banks tightened further their corporate credit standards in the first quarter of 2021 and remained broadly stable for the rest of the year. Such net tightening was mainly due to higher risk perceptions, related to both industry and firm-specific conditions, and to lower risk tolerance by euro area banks. Looking ahead to the first quarter of 2022, domestic and euro area banks expected credit standards for loans to firms to remain broadly unchanged.

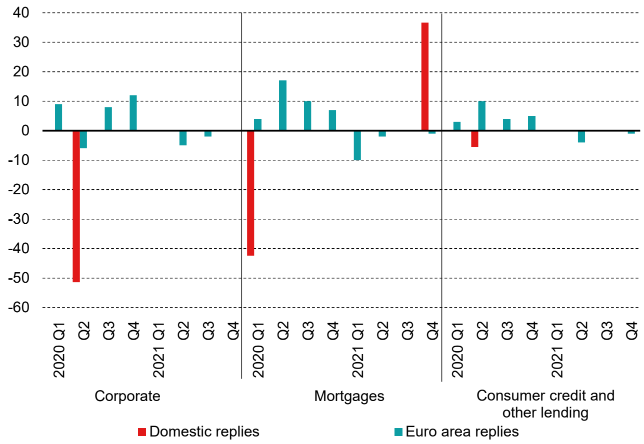
Chart 1
CREDIT STANDARDS
(+ indicates net tightening/- indicates net easing)



Sources: ECB; Central Bank of Malta calculations.

On aggregate, domestic BLS banks reported stable corporate credit terms and conditions during 2021, following the net easing in the second quarter of 2020 (see Chart 2). Euro area banks reported marginal net easing in the second and third quarters of 2021, owing to competitive pressures and favourable funding costs and balance sheet conditions. This led to narrower margins on average loans, longer maturities and larger loan sizes.

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



Sources: ECB; Central Bank of Malta calculations.

During the second half of 2021, domestic participant banks tightened credit standards for mortgages, mainly due to lower risk tolerance and tightening of lending standards (see Chart 1). A partial reversal was expected in the first quarter of 2022 through some easing in credit standards. Following the tightening in 2020, euro area banks eased their credit standards in the first half of 2021 on the grounds of improved economic activity and competitive pressures from other banks. However, euro area banks tightened mortgage credit standards in the third quarter of 2021, and were expected to tighten further in the first three months of 2022.

Turning to mortgage terms and conditions, in the last quarter of 2021, domestic participant banks reported some net tightening through a lower loan-to-value (LTV) ratio owing to higher risk perceptions and lower risk tolerance (see Chart 2). On the other hand, overall mortgage terms and conditions in the euro area eased particularly during the first quarter of 2021, due to competitive pressures, which led to narrower margins on average loans.

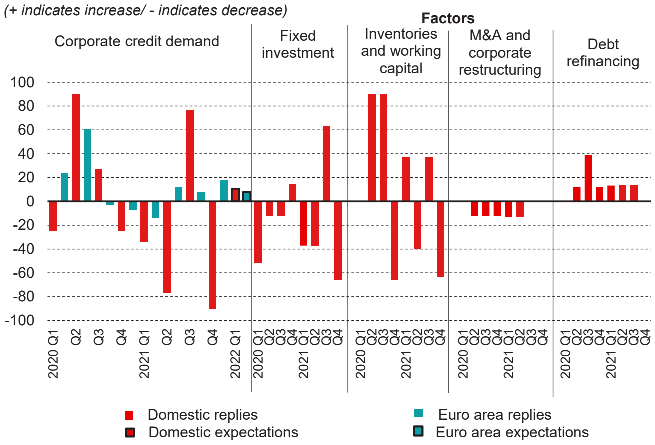
Following the net tightening in 2020, domestic banks kept credit standards for consumer credit and other household lending stable during the first three quarters of 2021, but were eased in the last quarter of the year largely due to the improved economic conditions (see Chart 1). Looking ahead, domestic BLS banks did not anticipate any changes for the first quarter of 2022. Meanwhile, the tightening reported by euro area banks in 2020 continued into the first quarter of 2021. However, credit standards were eased as from the second quarter driven by competitive pressures from other banks, lower costs of funds, and increased risk tolerance of banks. Such easing impact was anticipated to persist through the first quarter of 2022.

Domestic banks kept their credit terms and conditions on consumer credit and other household lending stable during 2021 (see Chart 2). Meanwhile, euro area banks eased such credit terms and conditions in the second and last quarter of 2021, owing to competitive pressures leading to narrower margins on average loans, longer maturities, larger credit limits and less strict collateral requirements reported.

Credit demand conditions

During 2021, on balance, domestic demand for corporate loans fell due to lower long-term loans by large corporates. This reflected a drop in loans for fixed investment, inventories and working capital requirements, and lower loans for mergers and acquisitions and corporate restructuring (see Chart 3). Such drop in domestic demand was reported in three out of the four survey rounds conducted in 2021, with an increase in demand reported in the third quarter, mainly reflecting higher financing for fixed investment, while corporate debt refinancing contributed positively to demand. Looking ahead to the first quarter of 2022, offsetting developments were expected by domestic banks, whereby

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



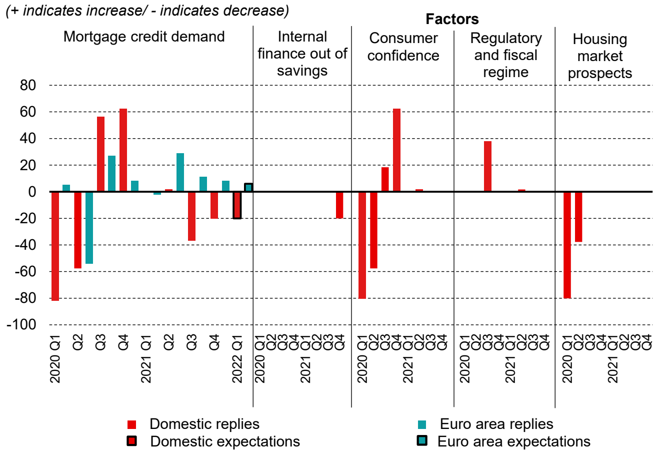
Sources: ECB; Central Bank of Malta calculations.
Note: The impact of factors relate solely to the domestic corporate credit demand.

lower credit demand for corporates owing to the uncertainty caused by the pandemic was offset by a pick-up by large corporates via long-term loans.

In contrast, at euro area level, an overall increase in the demand for corporate loans was reported from the second quarter of 2021, which offset the drop reported in the first quarter. The increase in demand occurred on the back of higher debt refinancing needs as well as for inventories and working capital requirements. In the first quarter of 2022, euro area banks expected a continued net increase in demand for corporate loans, with a somewhat larger increase from small and medium-sized enterprises (SMEs).

Following the strong domestic mortgage demand during the second half of 2020 aided by the pandemic-related fiscal incentives, developments were more contained in the first half of 2021, with demand declining in the second half of 2021. Maltese respondents noted that borrowers were using more of their own funds to purchase property, coupled with uncertainty on property market developments going forward (see Chart 4). Lower demand was expected to persist in the first quarter of 2022 owing to competitive pressures from other banks, coupled with the tapering of Government tax incentives.

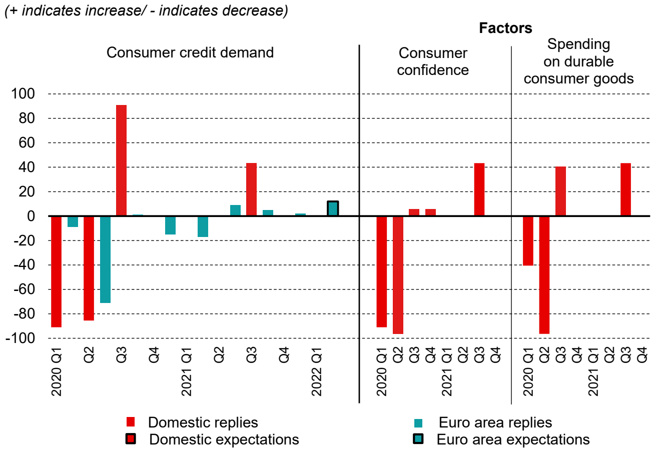
Chart 4
MORTGAGE CREDIT DEMAND
(+ indicates increase/ - indicates decrease)



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

Except for a marginal drop in the first quarter of 2021, euro area banks reported higher net demand for mortgages, driven by improved consumer confidence, the low level of interest rates, better housing market prospects and to a lower extent debt refinancing by households. Furthermore, euro area banks expected mortgage demand to rise further in the first quarter of 2022.

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.

Domestic demand for consumer credit and other lending to households was generally contained in 2021. However, some pick-up in demand was reported in the third quarter largely due to higher spending on durable consumer goods on the back of improved consumer confidence (see Chart 5). Furthermore, consumer credit demand was expected to remain stable for the first quarter of 2022. Meanwhile, euro area banks continued to report lower demand even for the first quarter of 2021, owing to lower consumer confidence and decreased spending on durable goods on the back of the uncertainty brought about by the pandemic. As containment measures were relaxed and consumer confidence improved, an increase in demand was reported as from the second quarter of 2021, reflecting higher spending on durables. In the first quarter of 2022, euro area banks' demand for consumer credit and other lending to households was expected to increase further.

Ad hoc questions

The BLS questionnaire included an ad hoc question on banks' access for wholesale and retail funding. In line with developments in 2020, access to retail funding in 2021 increased for domestic BLS banks mainly from higher short-term deposits, reflecting the precautionary behaviour of savers owing to the pandemic-induced uncertainty. Meanwhile the use of the short-term interbank unsecured money market decreased somewhat, while funding through the very short-term unsecured money market remained quite stable.[3] Euro area banks noted an improvement in their access to retail funding, mainly through short-term deposits. In addition, access to money markets and wholesale funding via both the short-term and medium-to-long-term debt securities improved. Furthermore, compared to a year ago, access to securitization improved somewhat.

In the April 2021 survey round, domestic participant banks reported that the ECB's asset purchase programme (APP) and the pandemic emergency purchase programme (PEPP) aided their liquidity position and cost of funding in view of the improved market financing conditions.[4] Meanwhile, on profitability, domestic respondents reported that lower NII offset higher capital gains. Lower NII was also reported during the October 2021 survey round, which covered the second and third quarters of the year, and was expected to persist up to the first quarter of 2022. Similarly, euro area banks also reported that the APP and PEPP contributed to a better liquidity position and market financing conditions. Their profitability deteriorated given lower NII, which was partly offset by higher capital gains. Moreover, because of the APP and PEPP, euro area banks reported eased terms and conditions and higher lending volumes for corporate and household loans.

The BLS survey rounds included a bi-annual ad hoc question on the impact of NPL ratios on banks' lending policies. On aggregate, respondents noted that the current level of the NPL ratio caused some tightening effect on credit standards for corporate loans during the first half of 2021. Furthermore, they expect some tightening in terms and conditions for corporate loans in the first half of 2022 owing to greater costs relating to the capital position. This amid increased regulatory requirements, coupled with risk perception and lower risk tolerance. On balance, euro area banks reported that NPL ratios resulted in tighter credit standards and terms and conditions for corporate loans and, to a lower extent, consumer credit. This was due to higher risk perceptions related to the general economic outlook and borrowers' creditworthiness, lower risk tolerance and pressure related to supervisory or regulatory requirements.

The ECB's negative deposit facility rate (DFR) continued to affect negatively the profitability of both domestic and euro area banks owing to lower NII, although this was to some extent mitigated through the two-tier system.[5] On balance, the DFR enabled banks to report a drop in lending and deposit rates, coupled with narrower loan margins for both corporates and households. Meanwhile, domestic banks reported that the ECB's negative DFR led to a rise in non-interest charges on corporate deposits during the last quarter of 2020 and in the first quarter of 2021. Meanwhile, euro area banks reported some positive impact of the DFR on their loans and deposits volumes.

The questionnaire also contained feedback on the impact of the TLTRO III operations on banks and their lending policies. Some domestic BLS banks participated in the March 2021 TLTRO operations given the attractive financing conditions. This led to improved liquidity, market financing conditions and profitability, as well as contributed to some easing of credit standards. The latter contributed to higher lending volumes of corporate loans and consumer lending, with such developments expected to persist into the first quarter of 2022. A large share of euro area banks participated in the March 2021 TLTRO III operations, while a more limited number of banks participated in the June and September 2021 TLTROs. The profitability motive remained the most important reason for banks to participate, with funds being mostly used to grant loans to the non-financial private sector, and to a lower extent, to hold liquidity for future use. Euro area banks indicated an overall positive impact of TLTROs on their financial situation, market financing conditions and profitability, with an easing impact on their terms and conditions across all loan categories. In addition, some positive impact on lending volumes particularly to enterprises was also evident.

In 2021 domestic banks did not report any changes in their credit standards and loan margins owing to new regulatory and supervisory actions. However, domestic banks reported an increase in their total and liquid assets, as well as their capital position through higher retained earnings. These developments are expected to persist in 2022, given new MREL eligible deposits to be issued to meet the MREL regulatory requirements and the issuance of new shares to the public. Euro area banks continued strengthening their capital position against the backdrop of regulatory or supervisory actions in 2021, driven mainly by higher retained earnings. Following new regulations or supervisory measures implemented in the context of the pandemic, euro area banks' total assets via liquid assets and risk-weighted assets increased, coupled with an easing impact on funding conditions. Moreover, euro area banks' credit standards and credit margins for both loan categories tightened in 2021.

Another ad hoc question focuses on banks' changes in lending conditions and loan demand across the main economic sectors.[6] Although, most of the domestic banks reported stable credit standards and terms and conditions on new loans, some tightening was reported in the first half of 2021 for real estate loans, while the terms and conditions of wholesale and retail trade loans were eased somewhat. No changes were reported in the second half of 2021, although some easing in the terms and conditions across all the main economic sectors was expected during the first half of 2022. Loan demand declined across a number of sectors in 2021, with the most prominent being within the real estate, services, wholesale and retail trade, and construction sectors. Meanwhile, offsetting developments were reported for manufacturing loan demand. Looking ahead to the first half of 2022, lower demand was expected for new loans in manufacturing, wholesale and retail trade, construction, and commercial real estate sectors. Euro area banks indicated a moderate net tightening of credit standards and terms and conditions for new loans to enterprises across the main economic sectors, particularly in the first half of 2021. On balance, demand for loans in all economic sectors increased further during 2021, particularly in real estate activities.

The survey also carried a question on the impact of COVID-19 government guaranteed loans. Domestic respondents noted that credit standards for such guaranteed loans remained unchanged in 2021 but terms and conditions for loans to SMEs and large corporates were eased somewhat. Offsetting effects in terms of demand for guaranteed loans were reported, although on aggregate demand dropped owing mainly to firms' lower liquidity needs, the use of less precautionary buffers, lower financing of fixed investment and lower loan substitution. As for loans without government guarantees, corporate lending standards were eased somewhat in the second half of 2021. Euro area banks eased their lending conditions for corporate loans with COVID-19-related government guarantees, with lower demand for such loans noted in 2021. These owing mainly to precautionary liquidity needs, lower fixed investment, and loan substitution. Meanwhile, when considering loans without government guarantees, euro area banks reported a slight net tightening impact for credit standards, while the terms and conditions eased and demand for such loans increased.

Conclusion

While on aggregate lending standards for domestic corporates remained unchanged in 2021, survey replies to ad hoc questions indicated particularly that some easing pressures continued throughout the year. Specifically, the DFR and TLTRO had some easing effects, with some easing also reported across the wholesale and retail trade loans, while some tightening was reported for real estate loans. Notwithstanding the generally stable lending standards, survey replies indicated that demand for corporate loans declined on average due to lower demand for guaranteed loans as firms required less financing for liquidity needs and for fixed investments. Lower demand was driven by the real estate and construction sectors, services sectors, as well as the wholesale and retail trade. Indeed, growth in resident NFC credit slowed down to 0.3% in 2021, from 9.0% a year earlier.

Domestic participating banks reported a tightening in both the credit standards and terms and conditions for mortgages, in part owing to lower risk tolerance by banks and higher risk perceptions. This was corroborated with a drop in demand for such loans. While resident mortgages grew strongly, from 6.6% in 2020 to 10.8% in 2021, new loans data shows a slowdown mirroring the drop in demand reported in the BLS. Although domestic banks' credit standards for consumer credit were eased and there were indications of a pick-up in demand during the third quarter of 2021, overall lending fell.

Participant banks continued to report an increase in retail funding, with overall resident deposits increasing by 9.3% during the year. The liquidity position of the banks was further supported by the ECB's APP and PEPP, which led to higher liquidity and lower cost of funding. However, banks' profitability was negatively impacted through lower NII. This was also the case due to the ECB's negative DFR, as banks continued to place their excess liquidity with the Central Bank of Malta.

Notes

[1] 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.

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

[3] 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.

[4] During the April 2021 survey round, banks considered the direct and indirect impact of APP and PEPP over the past six months, thus covering the last quarter of 2020 and the first quarter of 2021.

[5] The ECB's 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%.

[6] The main economic sectors refer to manufacturing, construction (excluding real estate), services (excluding financial services and real estate), wholesale and retail trade, and real estate (broken down in commercial and residential real estate).