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BANK LENDING SURVEY RESULTS

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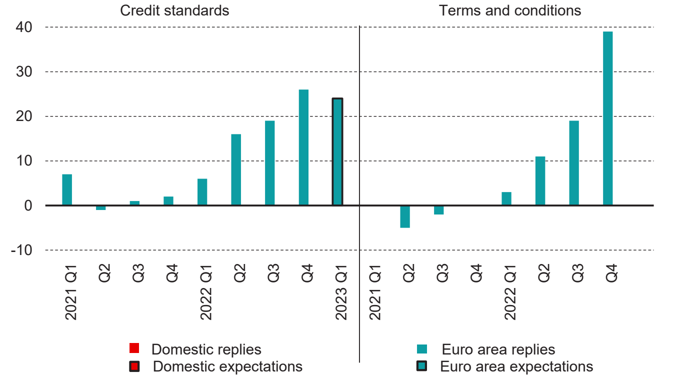
BOX 2: BANK LENDING SURVEY RESULTS[1]

The aim of this boxed article is to provide a summary of the replies to the BLS by the participating banks during the 2022 survey rounds. The BLS was distributed to a sample of around 150 banks across the euro area, including four banks in Malta which captured about 92% of the overall domestic bank credit.[2] The BLS is conducted on a quarterly basis to monitor developments in the lending policies and credit demand of enterprises and households, as well as their expectations.[3] The survey also contained a number of ad hoc questions related to funding conditions and the effect of monetary policy decisions, and new regulatory and supervisory actions on lending standards.

Loans to enterprises

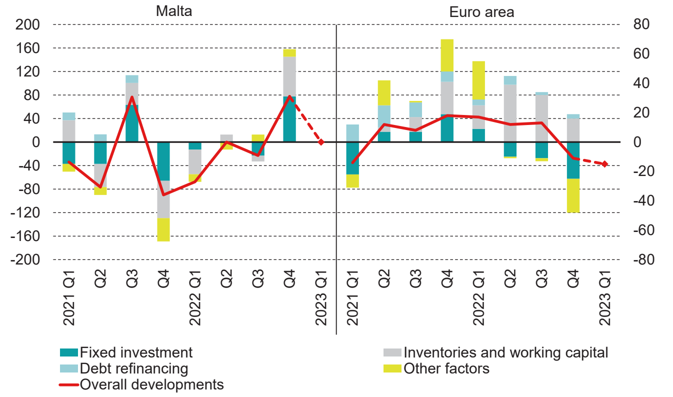
Over the past couple of years, on balance, domestic credit standards and terms and conditions for new loans to enterprises remained stable, but a few banks reported tighter loan-to-value (LTV) towards the CRE sector in the second half of 2022 (see Chart 1). Notwithstanding, net demand for domestic corporate loans improved somewhat in 2022. During the first three quarters of the year, demand declined owing to lower financing needs for inventories and working capital requirements, as well as for fixed investment in the CRE sector, services, and manufacturing, particularly in the energy-intensive firms. However, demand picked up momentum in the last quarter of the year, driven by the wholesale and retail trade sector (see Chart 2). In contrast, euro area banks reported stronger net tightening of corporate credit standards and terms and conditions across all main economic sectors. This was the result of higher risk perceptions and lower risk tolerance due to the weaker

Chart 1
CORPORATE CREDIT STANDARDS, AND TERMS AND CONDITIONS
(+ indicates net tightening/- indicates net easing)



Sources: ECB; Central Bank of Malta calculations.
Note: Given domestic replies indicate no change in lending standards, no domestic developments are visible in the chart.

Chart 2
CORPORATE CREDIT DEMAND
(+ indicates increase/ - indicates decrease)



Sources: ECB; Central Bank of Malta calculations.
Note: Domestic and euro area developments are plotted on the left and right axis, respectively. Stacked columns show the factors impacting corporate credit demand. Markers plotted on 2023Q1 refer to expectations.

1 This Box was prepared by Christian Mamo, a Principal Economist, and Shaun Zaffarese, a Financial Analyst, within the Financial Stability Surveillance Office of the Central Bank of Malta.

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

3 Lending policies 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.

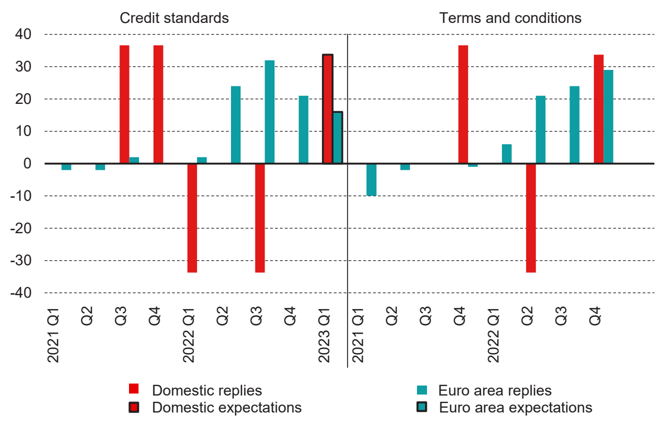
macroeconomic and financial conditions triggered by the war in Ukraine, coupled with industry and firm-specific factors. Consequently, margins on both average and riskier loans widened, while collateral requirements rose. Notwithstanding, euro area banks reported a marginal pick-up in demand for corporate loans in the first nine months of 2022, reflecting higher financing needs for inventories and working capital across all main economic sectors. As lending policies tightened further, demand fell, turning negative in the last quarter of the year, and was expected to decline further in the first quarter of 2023, as credit standards tighten further.

Loans to households for house purchase

Following the net tightening in 2021, sustained competitive pressures led domestic banks to ease their credit standards for mortgages in 2022, following the lifting of the remaining pandemic-related measures (see Chart 3). On balance, the terms and conditions on mortgages remained stable, as margins at first were narrowed due to increased competitive pressures but were later tightened as interest rates started to rise. According to survey respondents, net domestic demand for mortgages recovered in the first quarter of 2022 reflecting improved consumer confidence and remained stable for the rest of year. Surveyed banks expected mortgage demand to remain stable even in the first quarter of 2023 (see Chart 4).

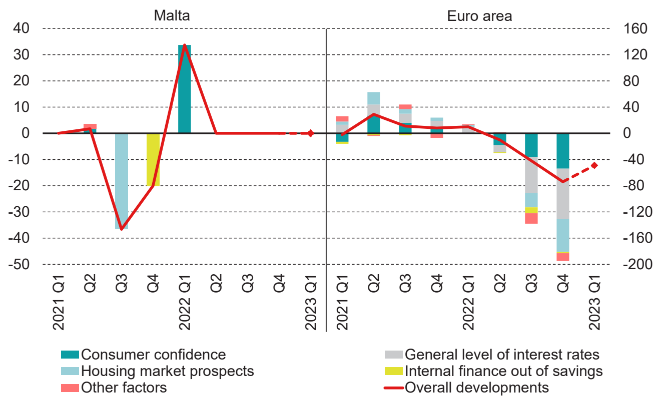
In the euro area, banks tightened mortgages' credit standards and terms and conditions, largely reflecting an adverse economic environment and deteriorating housing market prospects, higher risk perceptions, and rising funding costs. As a result, mortgage demand declined strongly, particularly in the second half of the year, with the drop in the last quarter being the largest ever reported in the BLS. This net tightening was expected to persist in the first quarter of 2023, amid further increases in key policy rates and a worsening in consumer confidence, with expectations that mortgage demand was going to fall further.

Chart 3
MORTGAGE CREDIT STANDARDS, AND TERMS AND CONDITIONS
(+ indicates net tightening/- indicates net easing)



Sources: ECB; Central Bank of Malta calculations.

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

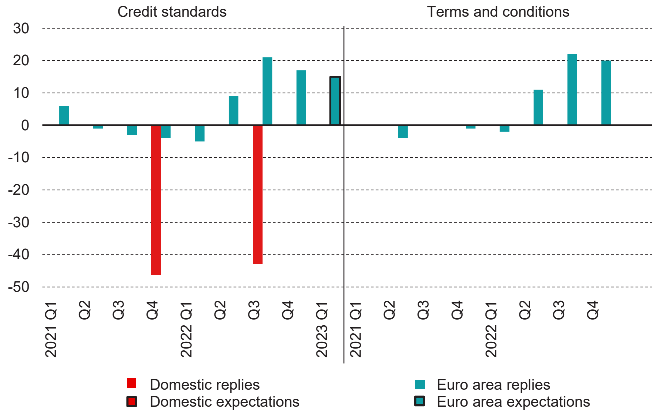


Sources: ECB; Central Bank of Malta calculations.
Note: Domestic and euro area developments are plotted on the left and right axis, respectively. Stacked columns show the factors impacting corporate credit demand. Markers plotted on 2023Q1 refer to expectations.

Consumer credit and other lending to households

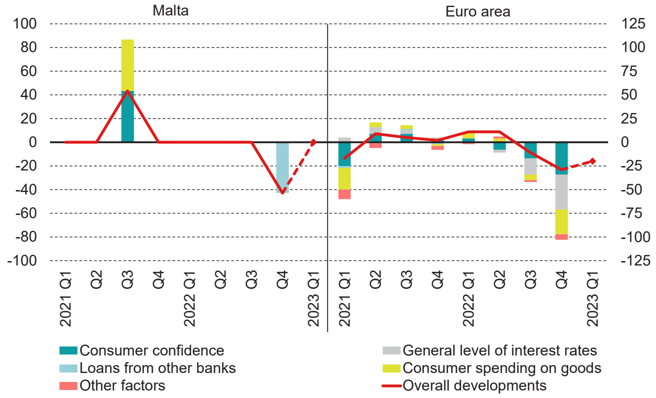
For the second consecutive year, domestic respondents eased credit standards for consumer lending as the remaining covid-related restrictions were lifted (see Chart 5). On the other hand, terms and conditions remained unchanged throughout the past couple of years. Yet, demand for consumer credit remained largely stable until the third quarter of 2022 but dropped in the last quarter reflecting higher competitive pressures from other banks (see Chart 6).

Chart 5
CONSUMER CREDIT STANDARDS, AND TERMS AND CONDITIONS
(+ indicates net tightening/- indicates net easing)



Sources: ECB; Central Bank of Malta calculations.

Chart 6
CONSUMER CREDIT DEMAND
(+ indicates increase/ - indicates decrease)



Sources: ECB; Central Bank of Malta calculations.
Note: Domestic and euro area developments are plotted on the left and right axis, respectively. Stacked columns show the factors impacting corporate credit demand. Markers plotted on 2023Q1 refer to expectations.

In contrast, euro area banks reported an overall net tightening in both credit standards and terms and conditions, reflecting the perceived deterioration in the general economic activity, worsened borrower creditworthiness, and increased cost of funds and risk perceptions. Up until the first half of 2022, demand for consumer credit rose marginally, mainly to satisfy the higher spending on durable consumer goods. However, as lending policies tightened, and interest rates started to rise, consumer confidence deteriorated, which affected consumer spending. This was expected to persist in the first quarter of 2023 as euro area banks anticipated continued net tightening of consumer credit standards.

Ad hoc questions

While during 2022 domestic BLS banks did not report any material changes in their wholesale funding, some minor developments were reported in terms of retail funding. One bank continued to strategically focus on short-term deposits, resulting in lower fixed-term deposits. Other respondents noted the more challenging environment in accessing retail funding particularly in the latter half of the year, on the back of the uncertain economic environment driven by the high level of inflation and the corresponding higher fixed-income yields. Consequently, following the ECB's interest rate hikes, some banks raised interest rates on term deposits in a bid to attract more retail funding. Going forward, such developments are expected to persist amidst the uncertain external macroeconomic environment and increasing interest rates. Euro area banks also reported a similar deterioration in their access to money markets and retail funding.

During the first half of 2022, the ECB's APP continued to affect some domestic banks both on their overall assets, mainly through the lower holdings of sovereign bonds, and the consequent effect on their profitability levels through lower NII. However, once the APP was discontinued as from July 2022, domestic BLS banks found the opportunity to add to their holdings of sovereign bonds, and thus increase their NII from securities. Meanwhile, euro area banks reported that during the first half of the year the APP contributed to increased liquidity, access to market financing, and higher lending for house purchases and corporates. However, as the scaling down of monetary policy accommodation took place, their financial position deteriorated, having a major negative impact on their market financing conditions, liquidity position and slightly on their profitability. They also expected that the end of the APP would bring with it a limited tightening impact on their terms and conditions across all loan categories, which was expected to be translated into lower lending volumes for mortgages during the first half of 2023.

Until July 2022, the negative deposit facility rate adversely impacted the profitability of both the domestic and euro area participant banks owing to lower NII received, which was partly offset by the two-tier system for remunerating excess liquidity holdings.[4]

Domestic participant banks did not participate in TLTRO III operations during 2022, with outstanding amounts repaid early by end 2022, reflecting their abundant liquidity. Meanwhile, euro area banks made much lower use compared to previous operations. Given the discontinuation and early repayment options for TLTROs, euro area banks expected the overall financial and lending conditions to be less favourable, following the gradual monetary policy tightening.

While domestic respondents reported no material impact of the NPL ratio on banks' lending policy, euro area banks reported some small net tightening on credit standards for loans to corporates during the first half of the year, reflecting increased risk perceptions and capital-related funding costs.

Surveyed banks were also asked on the impact of new regulatory and supervisory actions on their total assets and capital position. As some domestic banks actively expanded their balance sheet, they increased their capital base to continue meeting their minimum capital requirements and maintain adequate management buffers, in order to be in a position to address non-performing exposures (NPEs) in line with the recent Banking Rule (BR) 09 update and the general increase in risk weighted assets in view of the upcoming CRR II regulation implementation. These developments are expected to continue in 2023. In addition, some other banks tightened credit margins following the implementation of higher regulatory capital buffers. In the euro area, banks reported an increase in their capital to reflect the new regulatory or supervisory requirements, with banks also tightening their credit standards across all loan categories.

Conclusion

The BLS replies for 2022 and the banks' expectations for early 2023, were very much dominated by the uncertain macroeconomic environment coupled with tighter financial conditions. Nevertheless, domestically, although overall lending standards for corporates were stable throughout 2022, the ad hoc questions highlighted some offsetting factors. Specifically, the availability of funds from previous TLTRO operations allowed banks to apply more flexible credit standards and terms and conditions across all the main economic sectors but tightened somewhat the terms and conditions for CRE loans in the second half of 2022. Notwithstanding the generally stable lending standards, demand for corporate loans

[4] 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%.

declined in the first three quarters of 2022 mainly for CRE, the services sectors and manufacturing, particularly the energy-intensive firms, but recovered significantly during the last quarter of the year, especially in the wholesale and retail trade sector.

With regards to household lending, while on balance terms and conditions remained stable both for mortgages and consumer credit, credit standards for these two loan categories were eased as the pandemic-related tightening was lifted. This was corroborated with a higher demand for mortgages in the first quarter of 2022, while increased competition resulted in the demand for consumer credit to abate for some banks.

On the funding side, domestic banks did not report any significant changes in their usual sources of wholesale funding, albeit retail funding became more challenging and costlier owing to the tighter financial conditions which led some banks to increase, albeit marginally, interest rates on time deposits. Meanwhile, although domestic banks did not participate in the most recent TLTRO III, some still benefited from previous liquidity-providing operations that enabled them to improve their profitability.