Credit Conditions Survey June 2020

Background

The Reserve Bank conducted an out-of-cycle *Credit Conditions Survey* at the end of June to understand how domestic credit conditions have changed post-lockdown. The March *Survey* was collected in early March and therefore reflects the views of respondents prior to the announcement of the COVID-19 alert level system and nationwide lockdown. We do not intend on turning this into a quarterly survey on an ongoing basis.

This note presents the June *Survey* results and summarises banks' comments.

Interpreting results

The *Credit Conditions Survey* asks banks a range of qualitative questions about changes in conditions in the bank lending market. Banks provide separate responses for household, small and medium-sized enterprise (SME), corporate, commercial property and agricultural lending. The questions focus on *observed* changes in loan demand and credit availability over the previous six months and *expected* changes over the next six months. It also asks banks how their own lending standards have changed over the past six months. The Reserve Bank produces aggregate indicators from the survey. These indicators are loosely referred to as 'net percentage changes'. Aggregate indicators are constructed by assigning each response a score between -100 and 100. A positive score indicates a bank observed (or expects) an increase in credit demand or availability, or a tightening of their own lending standards, and vice versa. Aggregate indicators are then constructed by weighting bank responses by their market share for the relevant sector.

More information about the *Credit Conditions Survey* can be found in this *Bulletin* article.

Survey period

The June *Survey* was completed in the last two weeks of June 2020 by 12 New Zealand-registered banks, including all of the five largest banks. The period covers credit conditions observed over the first six months of 2020 and asks how banks expect them to evolve over the second half of the year.

Summary of bank comments

Bank submissions suggested that domestic credit developments post-lockdown have been predominantly demand-driven. Banks observed a decline in demand for credit over the first half of 2020. Banks did experience an increase in demand for loans for working capital from SMEs and corporates to meet fixed expenses and sheep and beef farmers experiencing drought conditions. However, demand for credit for capital expenditure has fallen. Banks noted low interest rates may support credit demand, however, uncertainty about the strength of future final demand is causing businesses to review their investment intentions. Banks reported that they have tightened several lending standards, particularly around serviceability requirements and interest rate margins across more risky sectors. For some sectors (such as commercial property and dairy) this represents a continuation of trends that precede COVID-19. However, banks reported closely scrutinising new lending to sectors directly exposed to the COVID-19 shock, such as tourism, retail, accommodation and construction. Banks noted further tightening of lending standards is likely.

Household lending

Banks reported a decline in demand for mortgage lending over the first half of 2020 (Figure A1). The volume of enquiries fell which banks attributed to the nationwide lockdown. Several banks noted enquiries from both owner-occupiers and investors rebounded in May. In the second half of 2020 banks anticipate a fall in demand for mortgage lending. Banks noted that lower interest rates may support demand. However, banks predict the economic impacts of COVID-19 will largely offset this. One bank noted they expect more distressed house sales as government financial assistance packages begin to roll off and the level of unemployment increases. Banks also expect increased unemployment will dampen demand for consumer lending (Figure B1). One bank noted that they expect consumer demand for credit cards and personal loans to continue to fall as demand for 'buy-now, pay-later' payment options increases.

Banks reported mortgage lending standards remain broadly unchanged (Figure A3). Whilst banks reported no material changes to their serviceability standards, they noted COVID-19 has resulted in greater income uncertainty given the likelihood of higher unemployment and fewer hours worked. Banks therefore expect to perform more thorough due diligence to assess income and job security, with higher haircuts applied to variable or 'at risk' income (for example, bonus, commission, boarder/flatmate rent, Airbnb income) included in servicing assessments. Banks expect this will impact credit available to applicants (Figure A2). Most banks did not report a change in appetite for high-LVR lending despite the

temporary removal of restrictions. One bank did note that high-LVR applicants would likely require very strong servicing positions and that property type and location would need to be less susceptible to price declines.

SME lending (annual turnover <$50m)

Banks reported an increase in SME applications for relief in response to the COVID-induced lockdown (Figure C1). Banks reported support largely came in the form of suspension of repayments or moves to ‘interest only’ terms, modifications (or waivers) of loan covenants and temporary liquidity lines for working capital to meet fixed costs. Banks expect this to continue over the second half of 2020. Demand for credit for capital expenditure fell in the first half of the year and banks expect demand to remain muted for the remainder of the year reflecting deteriorating business confidence. Some banks noted that they do not expect credit demand to increase due to considerable uncertainty around the strength of future final demand and the expectation that economic conditions will deteriorate further. Banks expect many businesses will resize to match the new level of demand, but some SMEs will fail. This will dampen demand for credit.

Banks reported there has been a modest tightening of credit availability in the SME sector. Several banks reported that the interest mark-up above cost of funding had tightened to ensure that loan margins reflected risk and cost of capital (Figure C3). Banks reported the focus remains on quality of origination and application of appropriate covenants. Banks noted that lending standards will likely adapt as economic conditions change, and many banks expect to apply tighter lending standards to customers operating in the tourism, retail, accommodation and construction sectors.

Corporate lending (annual turnover >$50m)

Banks reported high demand for standby liquidity facilities over the first half of 2020, along with a reduced demand for credit for capital expenditure and mergers and acquisitions (Figure D1). Generally, banks expect these trends to continue over the next six months, although some banks expect transactions that were put on hold due to COVID-19 may begin to progress again. Banks also reported a significant increase in requests for covenant relief. Banks noted they approved these requests if the corporate customer had a strong pre-COVID balance sheet. One bank noted that in some cases they required equity injections by shareholders to support the covenant amendment.

Banks reported their focus remains on supporting existing corporate customers, with new clients being carefully scrutinised. Several banks report there has been no broad change in corporate lending standards. Instead, banks are taking a sector specific approach, with

greater focus on high risk sectors exposed to discretionary spending, e.g. retail, tourism and accommodation. One bank reported that they will continue to support corporate clients with covenant relief but will require more frequent reporting. Banks reported a tightening in the pricing of credit over the previous six months to reflect the increased risk and several banks commented that they expected pricing to increase over the next six months due to deterioration of companies' performance (Figure D3).

Commercial property lending

Banks reported a decrease in demand for commercial property lending during the first half of the year and forecast a significant slowdown over the latter half, particularly for development lending (Figure E1). Banks reported that uncertainty surrounding the depth and duration of the downturn has affected market confidence and slowed pre-sales in residential development projects, although demand is reportedly strong in the Auckland market. With regards to investment lending several banks reported that uncertainty around tenant covenants is slowing the market with a flight to quality evident in most sales transactions occurring. Interest in retail, accommodation, and hospitality properties has softened.

Banks reported that the current economic environment means that they are generally more cautious and have reduced their appetite for both new development and investment lending (Figure E2). This represents a continuation of the trend towards tighter commercial property lending standards over the previous three years (Figure E4). Interest in new exposures to certain sectors (accommodation, tourism, retail) and regions (Queenstown) is very low. One bank noted that higher LVR standards are being applied to retail, secondary office and hotel properties. Banks noted that the greatest uncertainty concerned the impact of COVID-19 on commercial property values. One bank reported that commercial property valuations are difficult to obtain as valuers are preferring to wait until market evidence exists post COVID-19. Several banks noted that more current valuations will be required and that valuation cycles would be increased. There has been a focus on increasing interest margins over last six months and banks expect this to continue for the next six months (Figure E3). Several banks noted that they were downgrading their commercial property portfolios which has the effect of increasing capital utilisation and reducing their capacity for new lending.

Agricultural lending

During the first half of 2020 banks observed an increase in demand for working capital from sheep and beef farmers experiencing drought conditions and delays to the processing of livestock caused by supply chain disruptions (Figure F1). Banks observed very low demand for dairy farm purchases. Banks also reported horticulture credit demand remains strong,

particularly from the kiwifruit industry. Banks also reported agricultural customers are reviewing capital investment in light of COVID-19 and are generally adopting a cautious approach to new borrowing. In the next six months banks expect continued economic uncertainty to limit demand for agricultural loans. One bank noted an increased focus among dairy farmers on debt repayments, combined with uncertainty around impacts of new environmental standards, was limiting demand for new dairy lending. Banks expect an increase in demand for working capital from sheep and beef farming over the next six months due to the lagged effect of the drought and COVID-19.

Banks reported appetite for new dairy lending was limited due to uncertainties around the impacts of new environmental standards and banks' continued focus on ensuring farmers take advantage of good commodity prices and low interest rates to deleverage. The trend towards tighter dairy lending standards precedes COVID-19 (Figure F4).

Appendix – *Credit Conditions Survey* June 2020 Results

Households – mortgage lending

Figure A1: Demand for credit

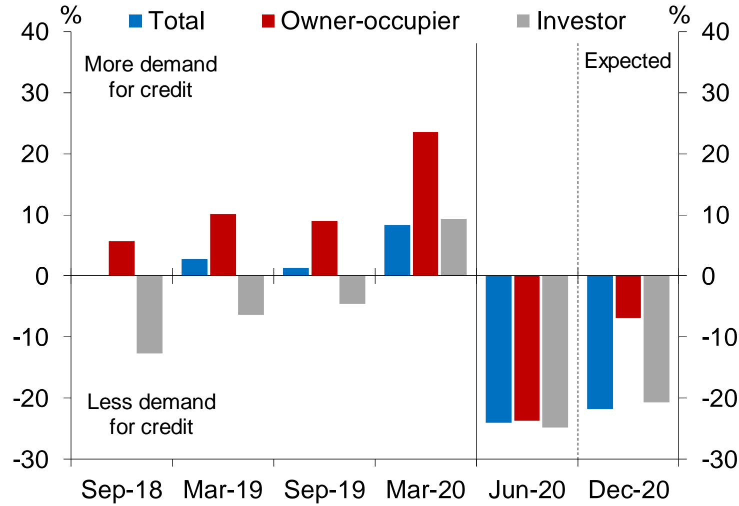


Figure A2: Credit availability

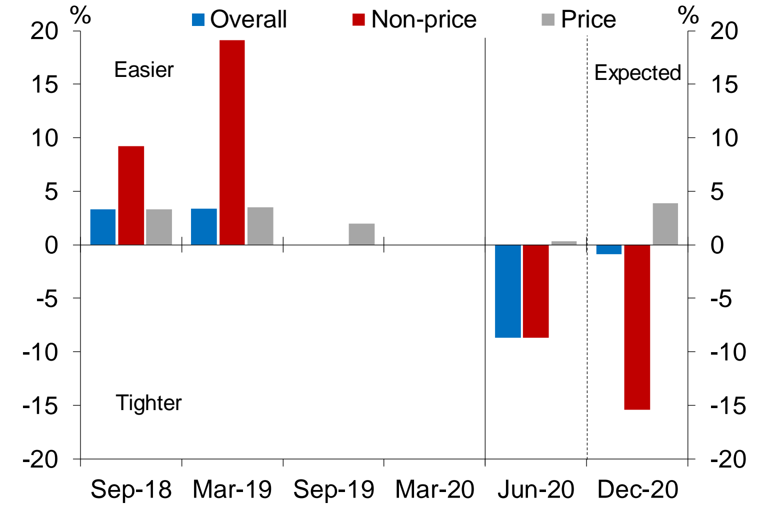


Figure A3: Lending policies and credit terms

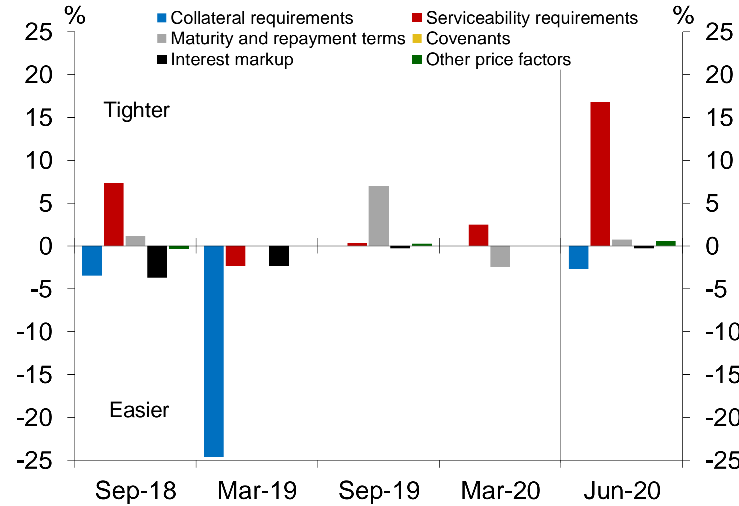
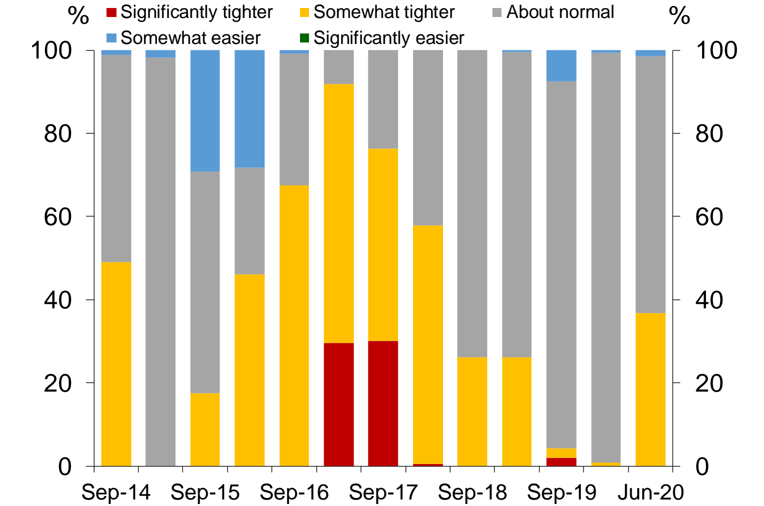


Figure A4: Credit availability compared to last three years



Households – consumer lending

Figure B1: Demand for credit

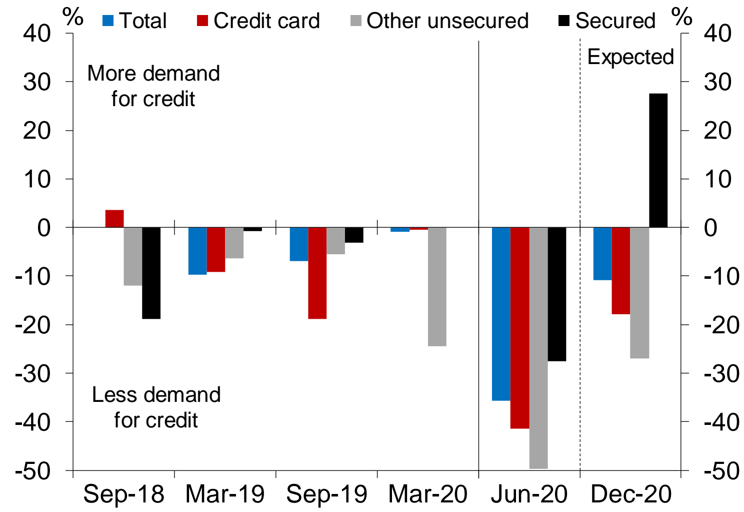
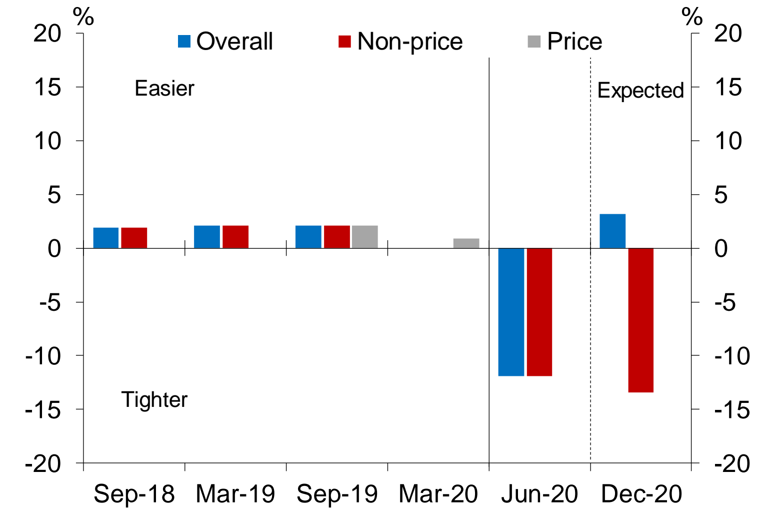


Figure B2: Credit availability



SME lending (annual turnover <$50m)

Figure C1: Demand for credit

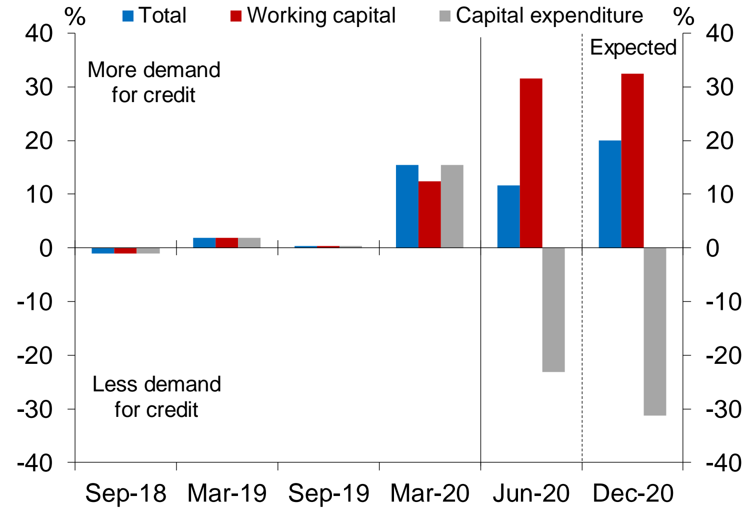


Figure C2: Credit availability

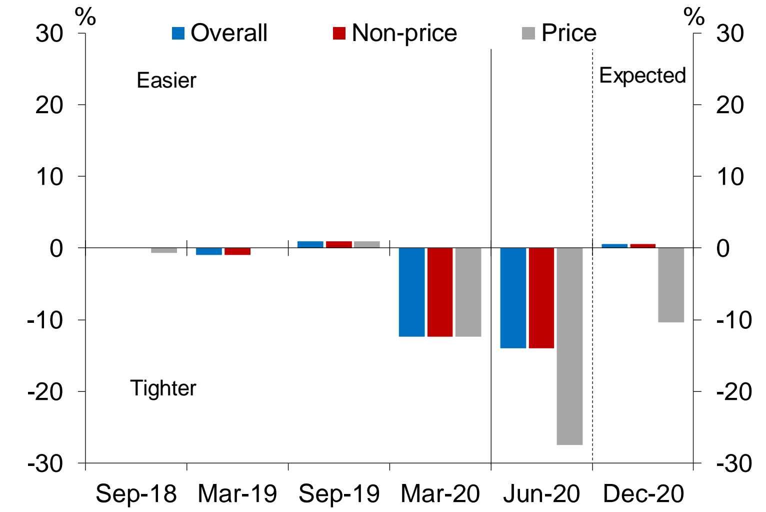


Figure C3: Lending policies and credit terms

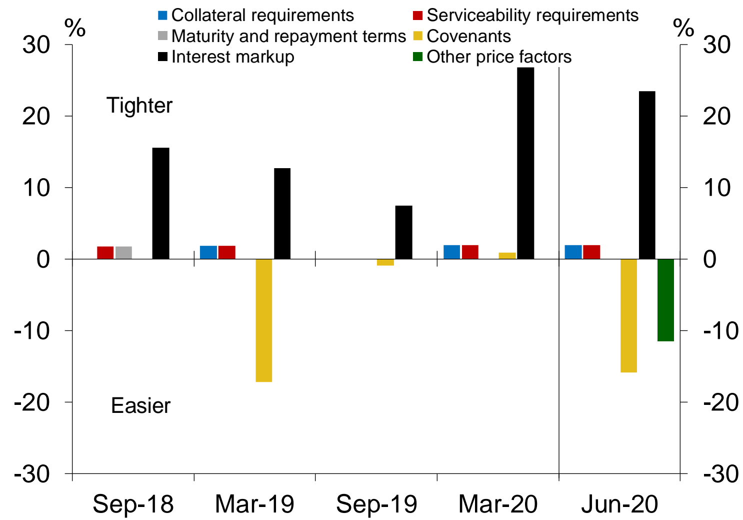
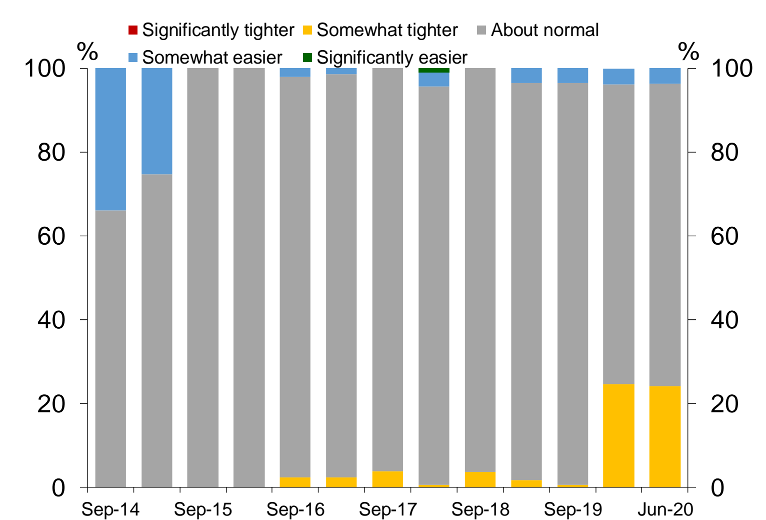


Figure C4: Credit availability compared to last three years



Corporate lending (annual turnover >$50m)

Figure D1: Demand for credit

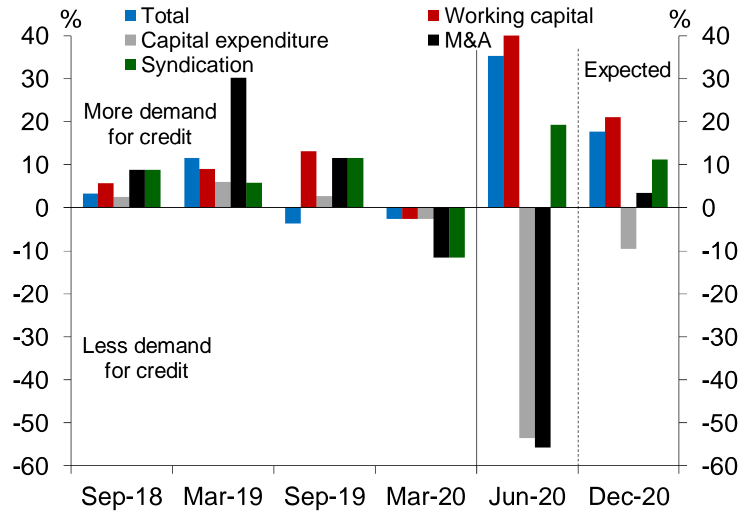


Figure D2: Credit availability

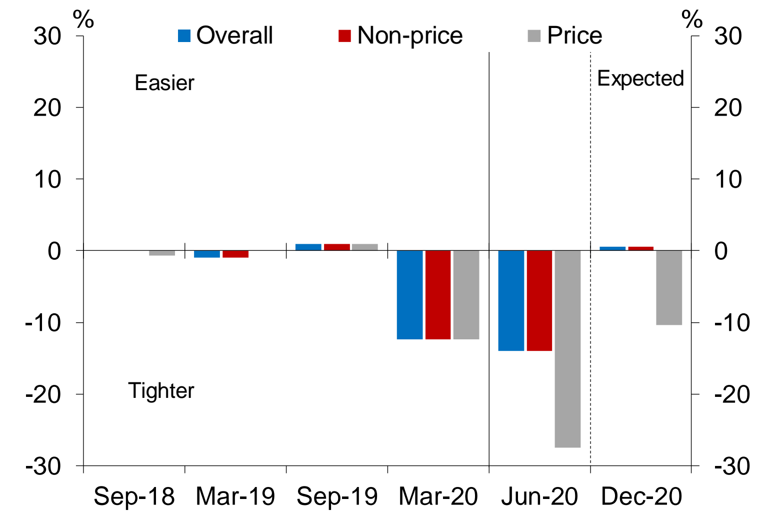


Figure D3: Lending policies and credit terms

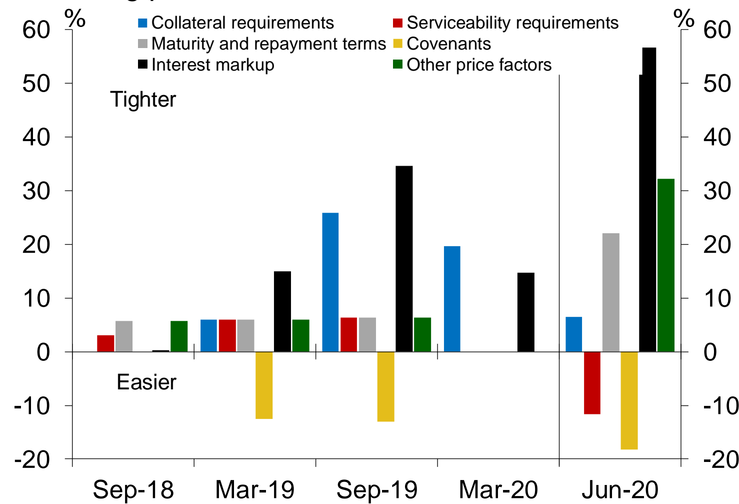
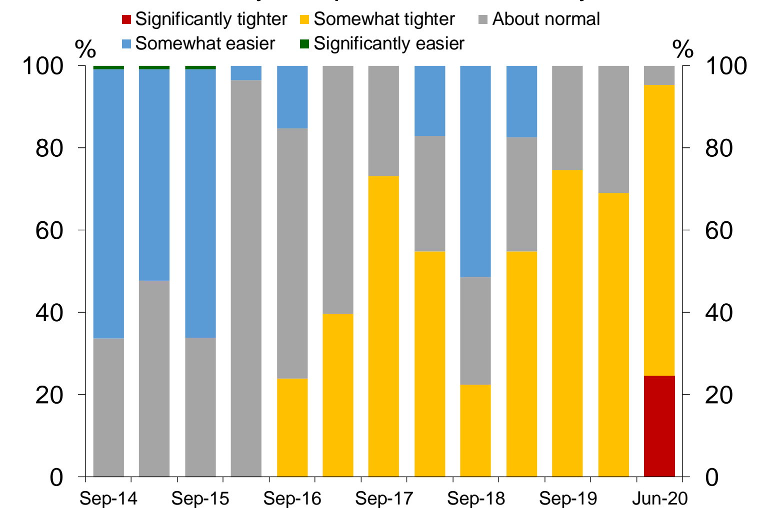


Figure D4: Credit availability compared to last three years



Commercial property lending

Figure E1: Demand for credit

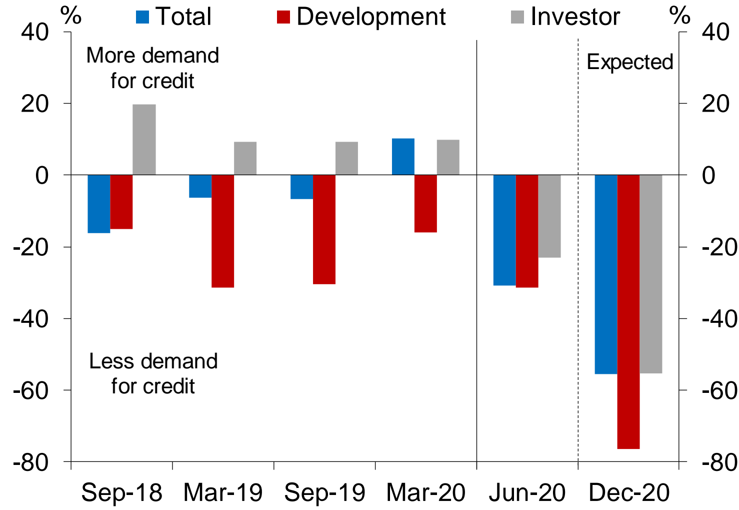


Figure E2: Credit availability

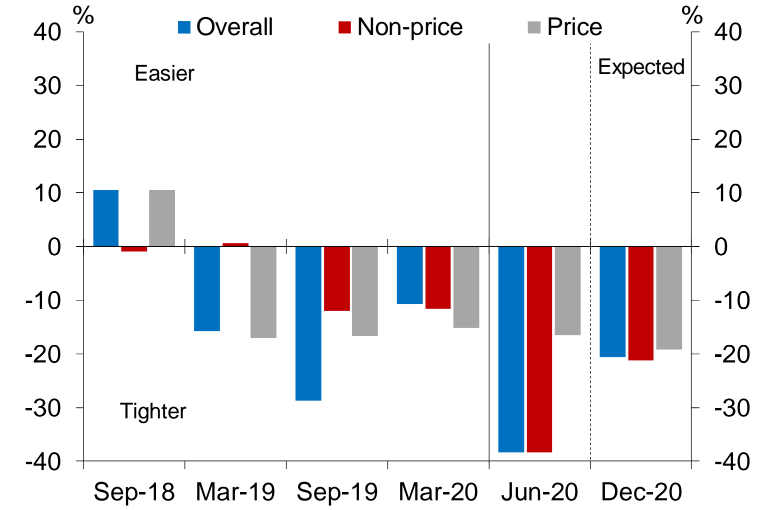


Figure E3: Lending policies and credit terms

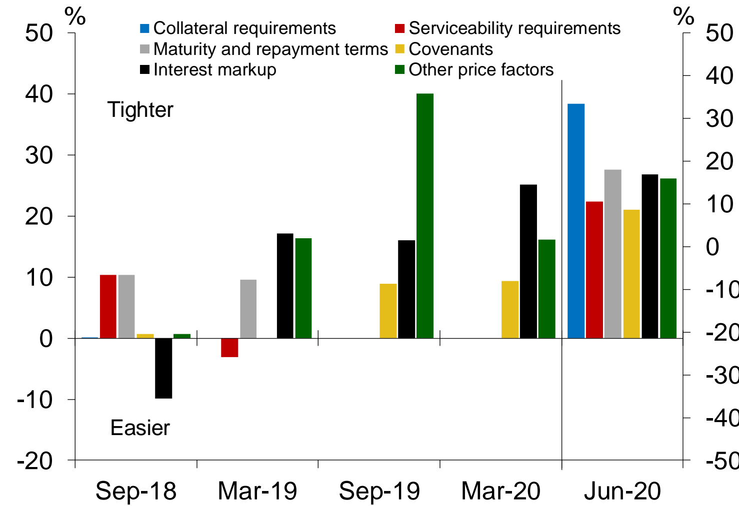
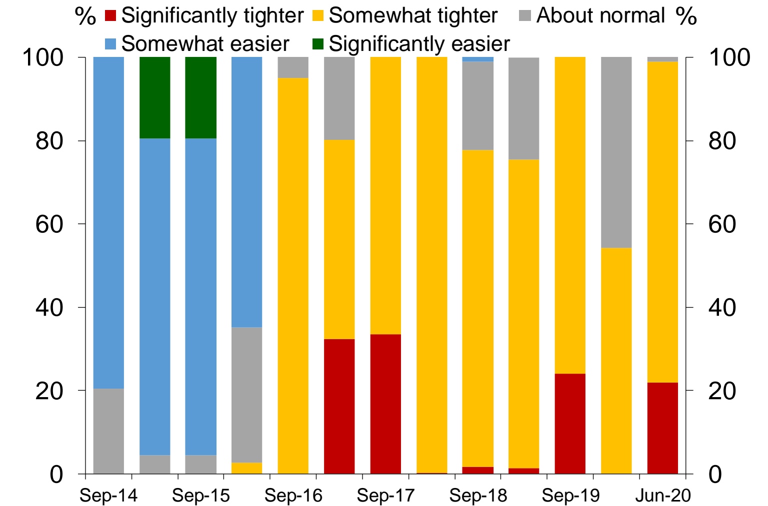


Figure E4: Credit availability compared to last three years



Agricultural lending

Figure F1: Demand for credit

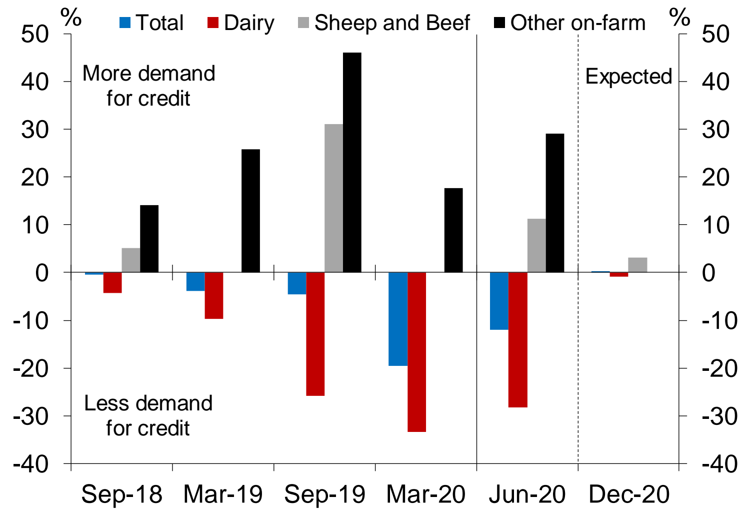


Figure F2: Credit availability

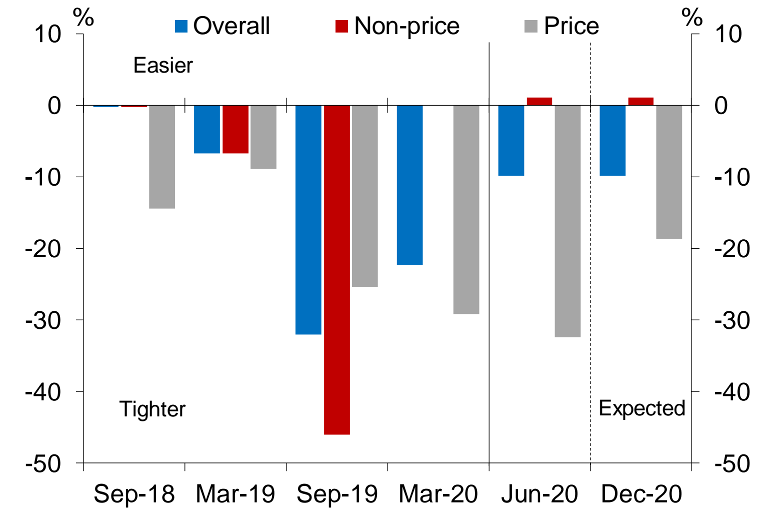


Figure F3: Lending policies and credit terms

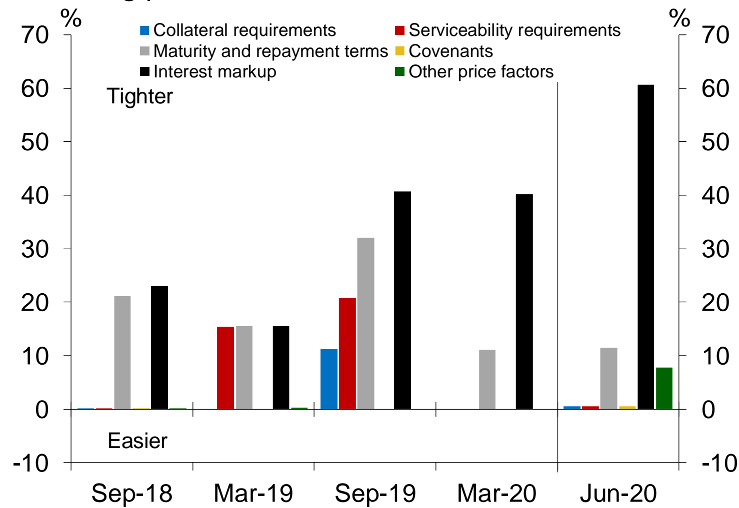
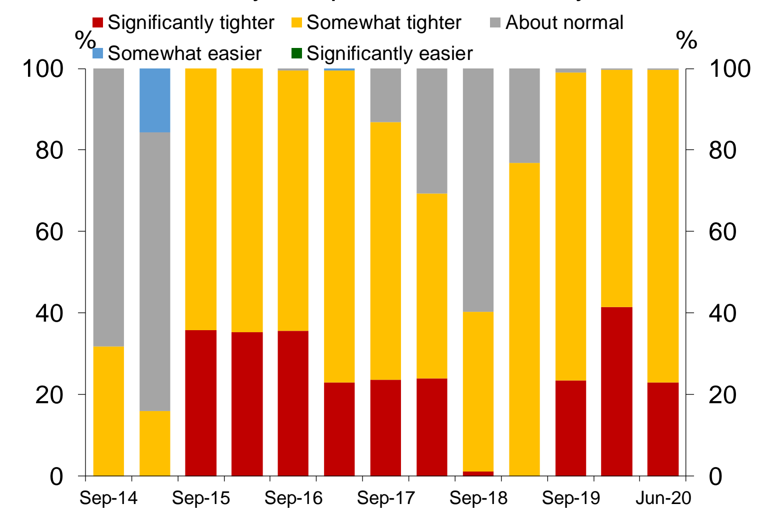


Figure F4: Credit availability compared to last three years



General

Figure G1: Drivers of credit availability