Credit Conditions Survey September 2020

Background

This note presents the September 2020 *Credit Conditions Survey* results and summarises banks' comments. Information from the *Survey* is one input into the Reserve Bank's overall assessment of credit market conditions, financial system risks and monetary policy transmission.

Interpreting results

The *Credit Conditions Survey* asks banks a range of qualitative questions about changes in conditions in bank lending markets. 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 tightened their 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 September *Survey* was completed in the last two weeks of September 2020 by 12 New Zealand-registered banks – including all of the five largest banks. The period covers credit conditions observed between 1 April 2020 and 30 September 2020 and asks how banks expect them to evolve over the next 6 months.

Please note the Reserve Bank conducted an out-of-cycle *Survey* at the end of June 2020 to understand how domestic credit conditions had changed after the first nationwide lockdown.

Summary of bank comments

Banks reported that domestic credit developments over the past six months have been predominantly demand driven. Banks report demand for residential mortgage lending has been high – particularly from first home buyers and investors. Several banks report they have loosened internal loan-to-value (LVR) limits, but have tightened their serviceability standards. Banks report low business confidence has muted business' investment intentions, and decreased demand for lending for capital expenditure. Banks note they have modestly tightened business lending standards, but that this has been limited to granular changes to risk appetite settings for industries particularly exposed to the impacts of COVID-19. Banks continue to report a low appetite for commercial property and dairy lending – this represents trends that precede COVID-19. Banks report that the cost of funds and the easing of regulatory restrictions – in particular, the removal of LVR restrictions – has contributed to easier credit availability. However, banks indicate their own risk tolerance and perception of risks is constraining credit availability (Figure G1).

Household lending

Banks reported that outside of the alert level 3 and 4 lockdowns demand for residential mortgage lending has been high – particularly from first home buyers and investors. Banks attributed the strong demand to low interest rates improving applicants' debt servicing ability and New Zealanders returning from overseas (Figure A1). Several banks cited the removal of the LVR restrictions – combined with dissatisfaction with returns on other investments – as fuelling residential investor demand. One bank noted overseas travel restrictions has caused some households to repurpose savings towards home ownership and property renovations. Another bank noted it hadn't observed the typical slowdown in transaction volumes leading up to the general election. Several banks noted the housing market has, thus far, been supported by the wage subsidy and mortgage deferral schemes. These banks anticipate that as the 'warm glow' from Government assistance packages begin to fade – and the level of unemployment rises – the number of distressed sales will increase. One bank commented that higher unemployment and declining incomes will continue to drag on demand for credit card lending (Figure B1).

Banks reported residential mortgage lending standards remain broadly unchanged (Figure A3). Several banks reported an increase in their appetite for high LVR lending. One bank noted that its internal LVR limit for residential investment and 'interest only' lending had increased from 70 percent to 80 percent since the removal of the LVR restrictions. However, one bank reported it had introduced regional LVR limits, with applicants in particular regions

requiring a current property valuation before an application will be approved. Several banks noted that serviceability standards have been tightened for high LVR loans (Figure A3). These banks noted this generally took the form of more intensive due diligence to verify applicants' income and job security. Two banks noted they have increased surplus income requirements and removed of ancillary income (Airbnb, bonus and commission income) from income assessments. One bank noted it had introduced lending limits for specific employment types – with a cautious approach being taken towards applicants who are self-employed applicants or employed in particular industries exposed to the COVID-19 shock. Several banks noted they have lowered their test servicing rate to reflect the low interest rate environment.

SME lending (annual turnover <$50m)

Banks noted that during the first lockdown there was strong demand from SMEs for liquidity facilities to meet outgoings. Since then, banks report demand for working capital has slowed as businesses have been able to access the wage subsidy scheme and the IRD's Small Business Cashflow Scheme to bridge revenue shortcomings. Banks expect demand for working capital to increase once the effects of the wage subsidy scheme dissipate. (Figure C1). One bank noted that businesses have been focussed on cost extraction to support cash flow, but the cessation of the wage subsidy scheme, together with supply chain issues, will place more pressure on businesses working capital positions. Banks report low business confidence has muted investment intentions and expect demand capital expenditure to remain low. Several banks noted businesses are wary to increase debt given the high level of uncertainty. One bank noted that many businesses have already begun to resize to match their new 'normal' operating levels. Several banks noted applications for relief – such as suspended principal repayments and covenant relief – has been high over the past six months. Banks noted that they generally accommodated these requests for applicants who had strong pre-COVID balance sheets and good debt servicing histories.

Banks reported there has been a modest tightening of credit availability to the SME sector (Figure C2). Although banks noted this mostly involved granular changes to risk appetite settings for particular industries considered to be more exposed to the impacts of COVID-19. These banks noted their focus was on supporting existing customers and had offered existing business customers support through tenor extension, principal deferrals and covenant relief. Banks reported the focus of new lending remains on quality of origination and application of appropriate covenants. One bank noted that it has adapted its credit assessment process so that it was more prospective – with forecasted revenue given greater weight than historical financial performance. Several banks reported that the interest mark-

up above cost of funding had increased to ensure that loan margins reflected risk and cost of capital (Figure C3).

Corporate lending (annual turnover >$50m)

Banks reported that corporate demand for standby debt facilities increased over the past six months. This was attributed to heightened uncertainty around the future availability of liquidity – particularly the inability to issue via debt capital markets (Figure D1). Banks noted that demand for working capital peaked during the first lockdown. Banks reported very few additional requests during the more recent Auckland lockdown. Banks noted that debt capital markets appeared to be re-opening to a broader group of issuers, and that this has taken pressure off bank standby facilities. One bank reported a recent pick-up in demand for working capital as corporates try to position themselves with sufficient liquidity to weather future shocks.

Banks reported their focus remains on supporting existing corporate customers, with new-to-bank clients being carefully scrutinised. Banks reported that there has been no broad change to corporate lending standards. Instead, banks are taking sectoral and institution-specific approaches, with greater focus on high risk sectors exposed to discretionary spending, e.g. retail, tourism and accommodation. One bank noted it is actively encouraging corporates in high risk sectors to maintain good credit metrics by raising equity, restricting dividends or encouraging corporates to identify and divest from unprofitable business lines. Banks reported a tightening in the pricing of credit over the previous six months to reflect increased risk. Several banks commented that they expect pricing to increase over the next six months due to deterioration of companies' performance (Figure D3).

Commercial property lending

Banks reported low demand for commercial property lending over the past six months, and expect demand to continue to fall over the next six months (Figure E1). Despite this several banks commented that they have experienced strong demand from overseas and retail investors searching for yield. Banks noted the outlook for retail and secondary office sectors looks particularly dire, whilst investor demand for industrial property with established tenants continued to grow. One bank noted that the supply of new investment opportunities remain limited and there is concern regarding future tenant demand. Several banks noted that pre-sales for residential developments had recovered well, particularly in Auckland. One bank noted it had not seen a material increase in settlement defaults. One bank noted that capacity in the construction industry has increased as current projects are completed, whilst proposed new developments have been paused or deferred indefinitely.

Banks report they have reduced appetite for both development and investment lending, citing the uncertain impact of the downturn on the commercial property sector (Figure E2). Several banks noted they have no-to-little appetite for new-to-bank customers, and for retail and secondary office properties due to actual and forecasted increase in vacancy rates. Banks report that commercial property lending standards have tightened substantially since the beginning of the year. This is particularly true for properties considered to be at higher risk, e.g. tourism and hospitality related properties in particular regions (Figure E3). Banks have been reporting that they have been tightening commercial property lending standards for the past three years (Figure E4). One bank noted that it had exceeded its internal commercial property RWA limit, which was the main factor influencing the provision of credit to the sector. One bank noted that despite the outlook for commercial property the Chinese-owned banks have increased their appetite for investment and development property assets. One bank noted that it continues to be selective when considering applications for residential development lending due to low profit margins.

Agricultural lending

Banks noted commodity prices were performing well given the impact of COVID-19. Despite this banks reported that increased customer focus on debt repayment – combined with uncertainty concerning the longer-term impacts of new environmental regulation – is constraining demand for dairy lending (Figure F1). One bank reported its dairy customers were reviewing long-term capital investment in light of COVID-19 and the forecasted global recession and were generally adopting a cautious approach. One bank noted that capital expenditure was being funded by cash, or not at all. One bank noted the shortage of specialist labour was also undermining farmers' confidence. Banks reported credit demand for horticultural lending remained strong – particularly from the kiwifruit industry – but expect this to normalise in the future. One bank noted it expects elevated demand for working capital from sheep and beef farmers to continue over the next six months due to the lagged effect of the drought.

Banks reported they have limited appetite for new dairy lending due to concerns around environmental sustainability and the effect of new environmental regulations. Several banks noted they were applying tighter lending standards to dairy to help customers deleverage, and to improve the overall credit risk profile of their dairy portfolios during a time when land values are softening. One bank noted that where LVR ratios are nearing peak limits, clients are being encouraged to take advantage of good commodity prices and low interest rates and to enter contractual principal repayment arrangements. The trend towards tighter dairy lending standards precedes COVID-19 (Figure F4).

Appendix – *Credit Conditions Survey* September 2020 Results

Households – mortgage lending

Figure A1: Demand for credit

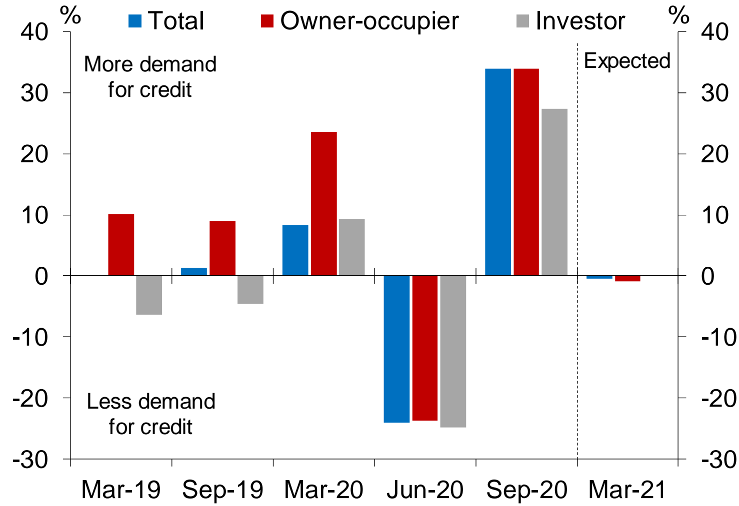


Figure A2: Credit availability

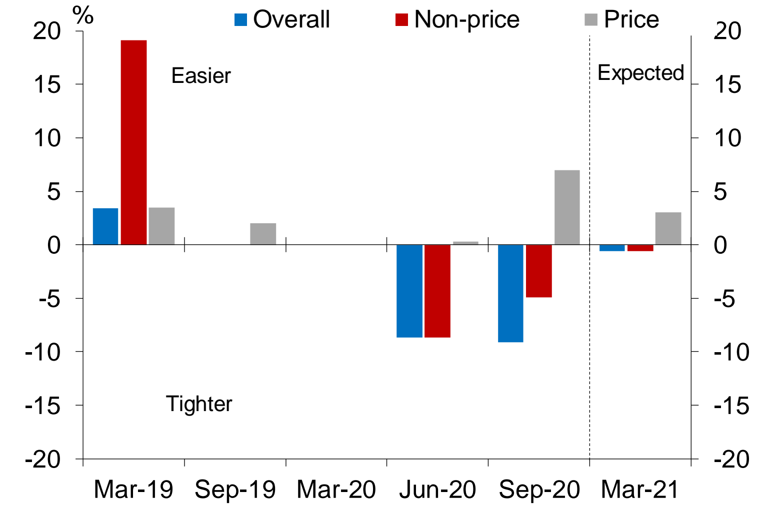


Figure A3: Lending policies and credit terms

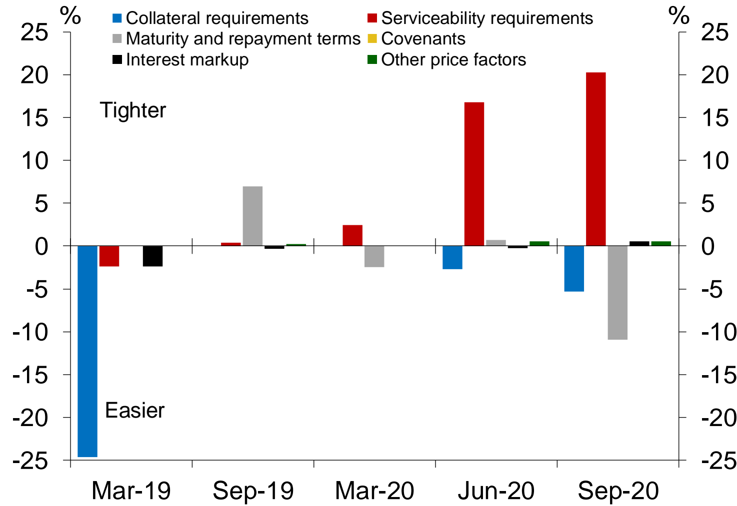
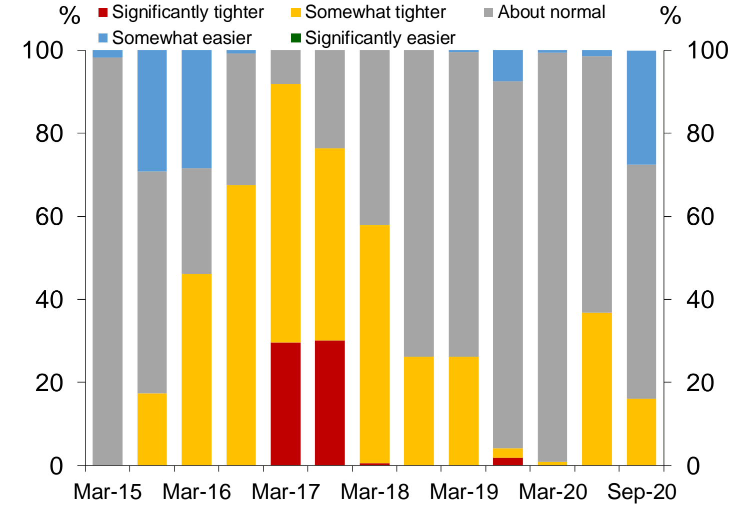


Figure A4: Credit availability compared to last three years



Households – consumer lending

Figure B1: Demand for credit

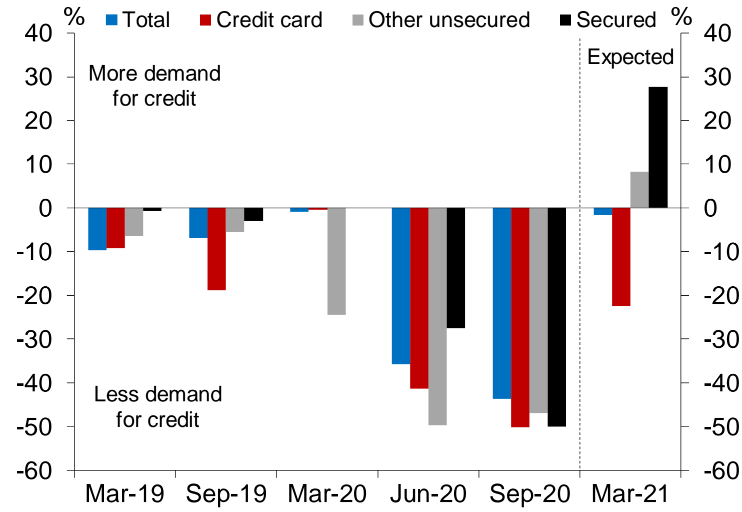
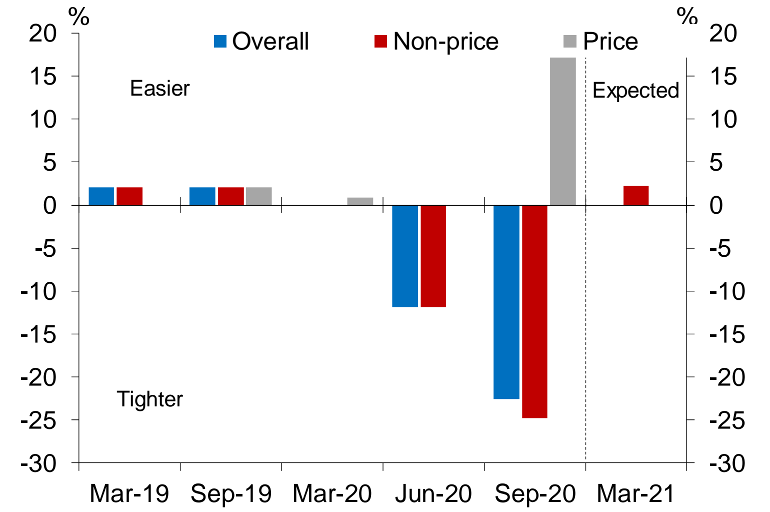


Figure B2: Credit availability



SME lending (annual turnover <$50m)

Figure C1: Demand for credit

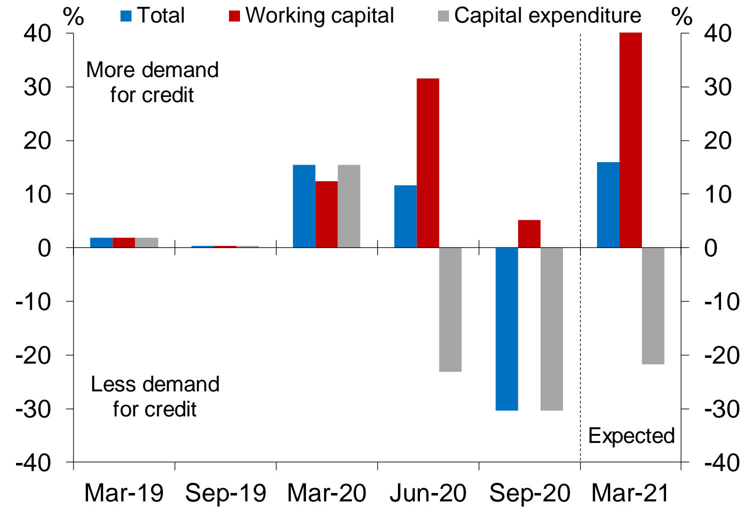


Figure C2: Credit availability

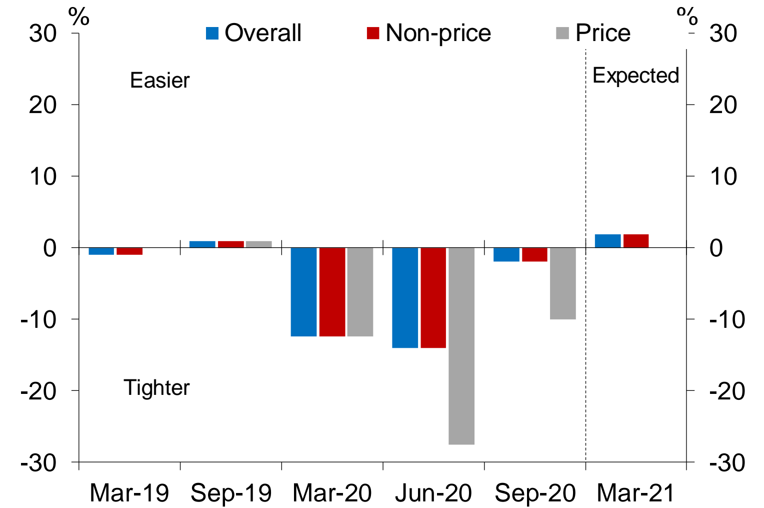


Figure C3: Lending policies and credit terms

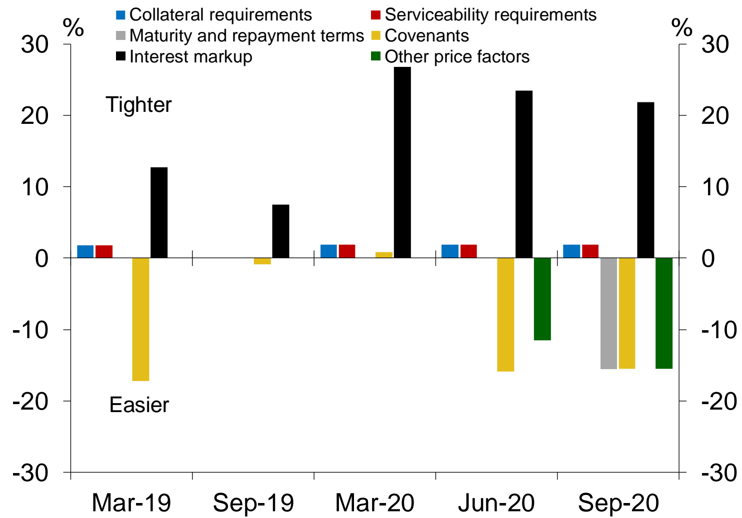
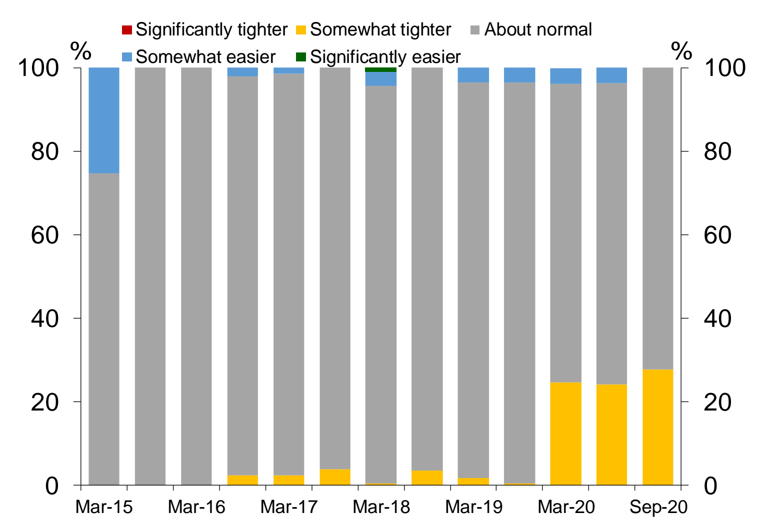


Figure C4: Credit availability compared to last three years



Corporate lending (annual turnover >$50m)

Figure D1: Demand for credit

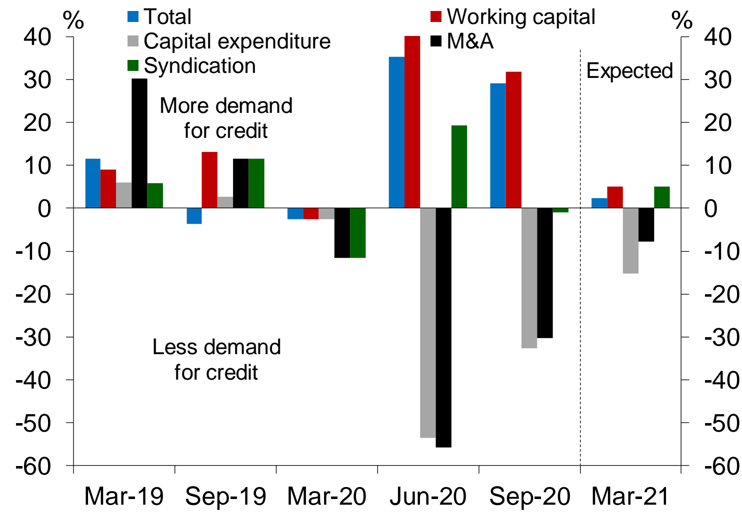


Figure D2: Credit availability

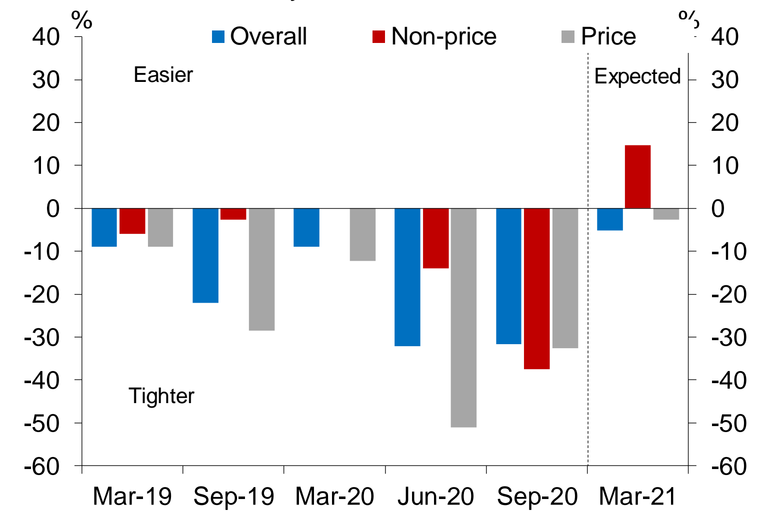


Figure D3: Lending policies and credit terms

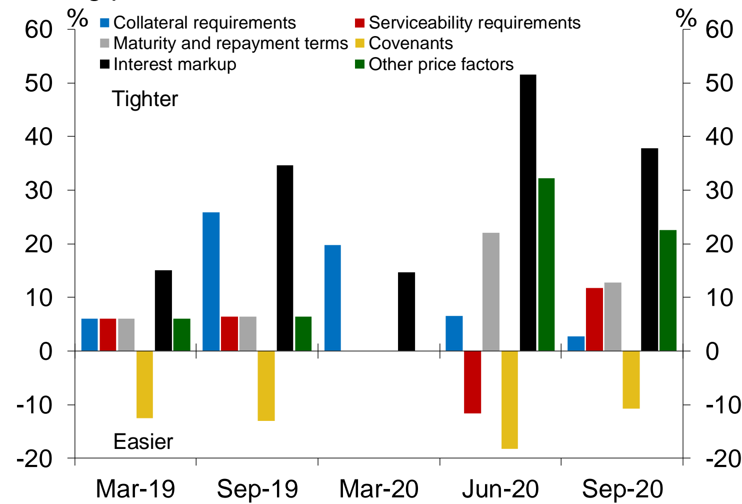
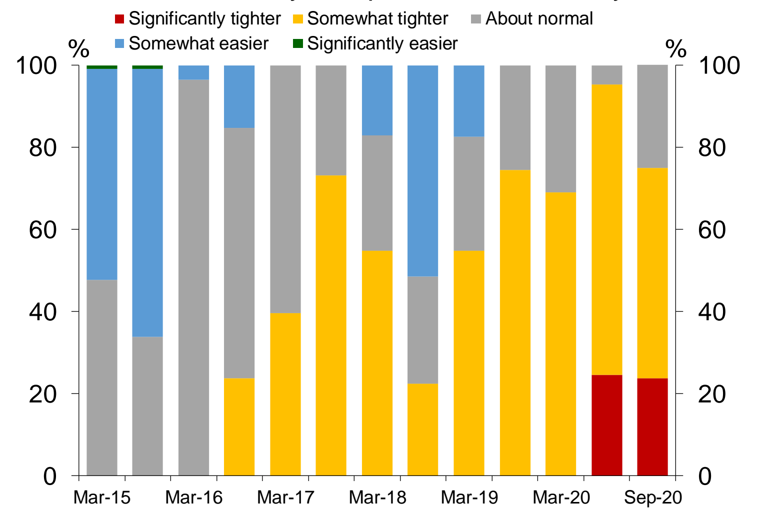


Figure D4: Credit availability compared to last three years



Commercial property lending

Figure E1: Demand for credit

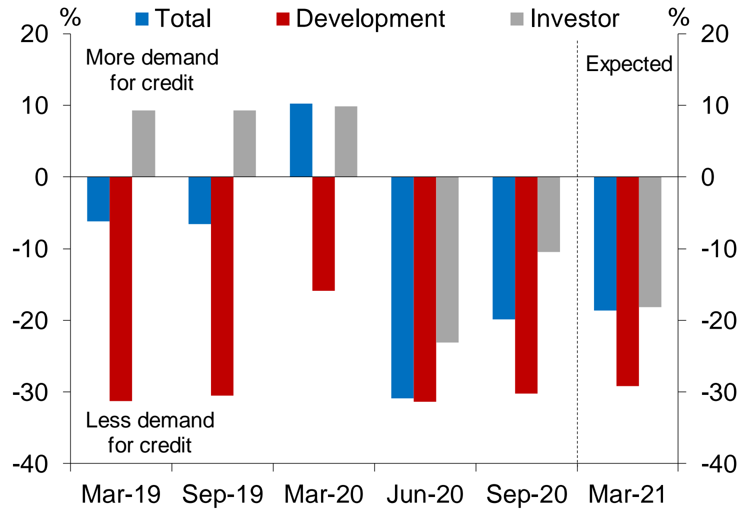


Figure E2: Credit availability

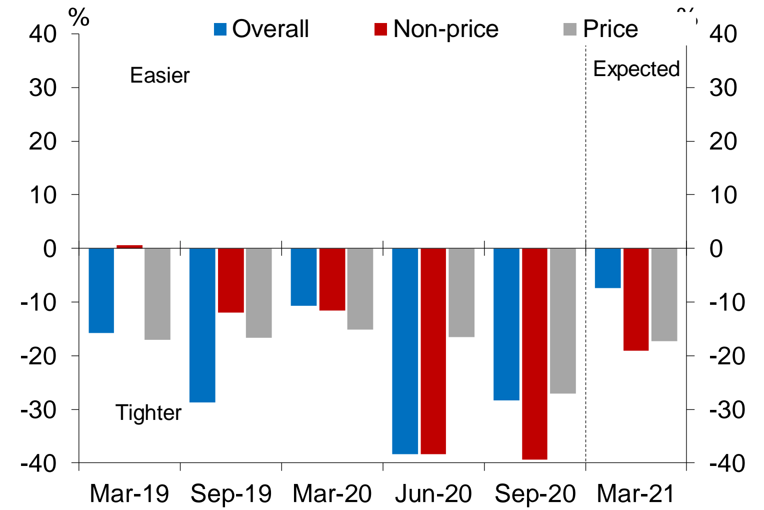


Figure E3: Lending policies and credit terms

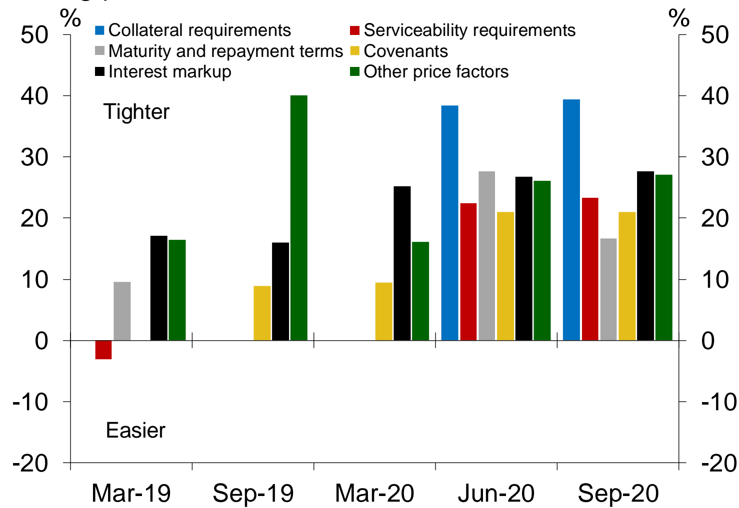
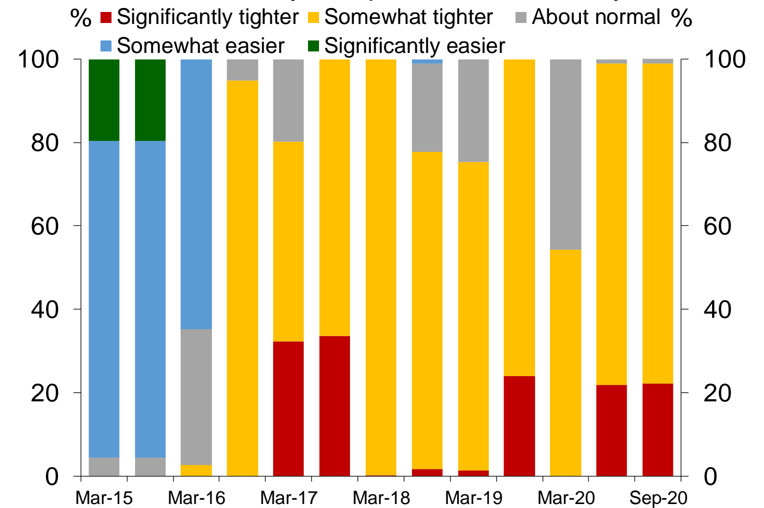


Figure E4: Credit availability compared to last three years



Agricultural lending

Figure F1: Demand for credit

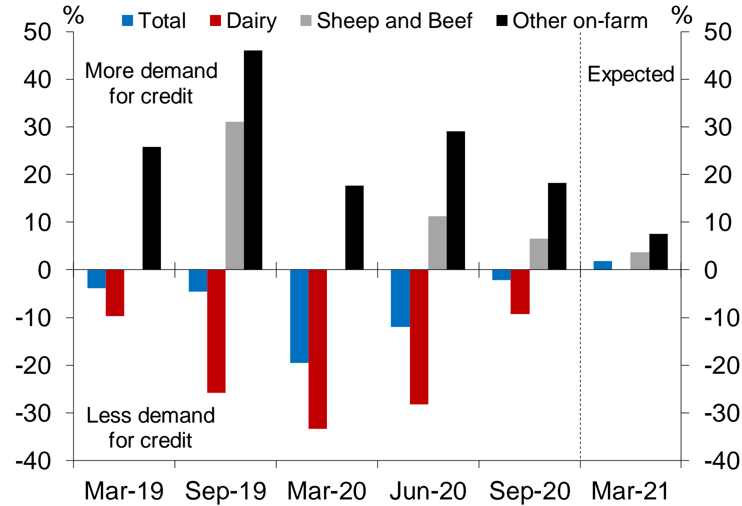


Figure F2: Credit availability

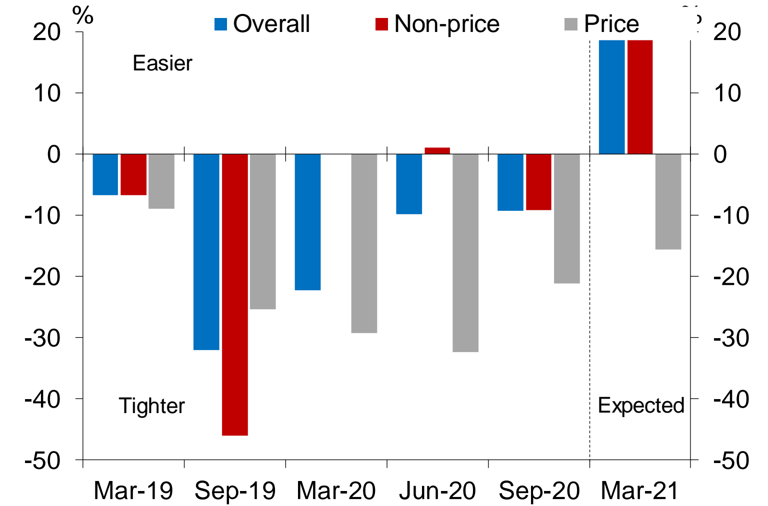


Figure F3: Lending policies and credit terms

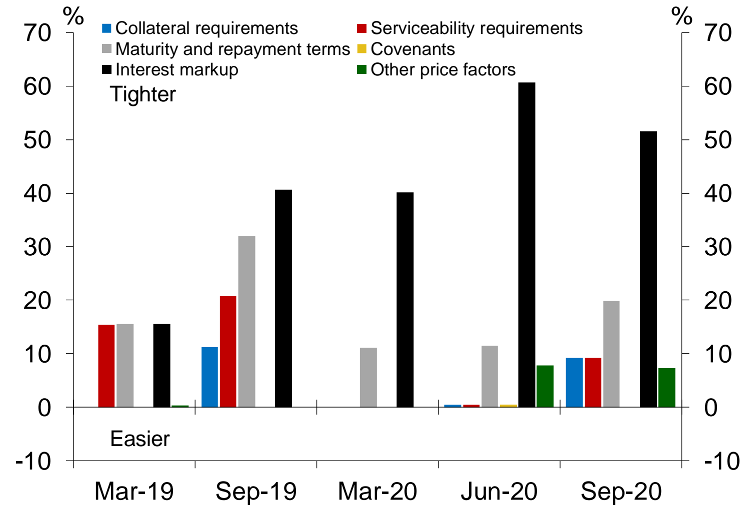
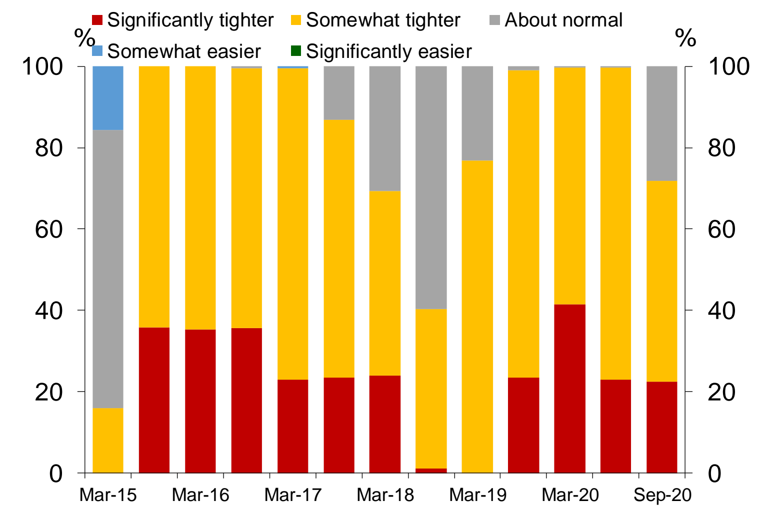


Figure F4: Credit availability compared to last three years



General

Figure G1: Drivers of credit availability