Q2 2020 overview of the banking sector

The economic turbulence caused by the Covid-19 health crisis also affected the banks operating in Estonia in the second quarter. Applications for payment holidays were received more frequently at the start of the quarter and credit risks increased. To lessen the impact of the crisis on the banks, Finantsinspektsioon issued two advisory guidelines on 21 April to give a framework for payment moratoriums. The most difficult period for the banks had passed by the end of June and fewer applications for payment holidays were received.

Key indicators	Q1 2020	Change	Q2 2020
Yearly growth in the loan stock	0.9%	?	- 0.7%
Yearly growth in the stock of deposits	12%	?	15%
Loan-to-deposit ratio	97%	?	95%
Share of long-term overdue loans in the portfolio	0.8%	?	0.80%
Liquidity coverage ratio	144%	?	172%
Net profit	109 mln €	?	106 mln €
Cost-to-income ratio	52%	?	51%
Return on equity	9.2%	?	9.1%
Return on assets	1.14%	?	1.08%
Core Equity Tier 1 ratio	26.3%	?	26.7%

The banks also managed to keep their credit quality indicators under control. Overdue loans to the banks were at 3.4% of the portfolio of household and corporate loans at the end of March and non-performing loans were at 1.9%, but at the end of June these figures were 2.8% and 2.1%. The value of loans for which payment holidays had been granted was 11.3% of the total portfolio of household and corporate loans at the end of the second quarter. Payment holidays had been granted to 18% of the corporate loan portfolio, but to only 5.2% of the household portfolio.

Aggregate indicators for payment holiday applications

The loan stock of the banking sector in the second quarter was 0.7%, or 27.5 billion euros, smaller than in the same quarter of last year. In the previous quarter the loan stock was still 0.9% larger than a year earlier. These indicators include the Latvian and Lithuanian branches of Luminor, without which the growth in the loan stock would have been 3.2% in the second quarter and 5.7% in the first.

The loan stock of the Estonian banking sector was 0.8% smaller than in the first quarter of 2020. The loan portfolio shrank in size because the volume of corporate loans declined. The volume of loans to non-financial companies was 2.3% smaller in the second quarter than it was a year earlier. Loans to private sector companies were down 2.7% in total amount while loans to state companies were up by 3.4%. The volume of loans to financial companies was 11% smaller in the second quarter. How the Covid-19 crisis impacted lending is also shown by comparison with previous quarters, as the stock of loans to both financial and non-financial companies was down 2.1% over the quarter, at 3.3 billion euros for financial companies and 9.7 billion for non-financial companies. The impact of the reduction in the corporate loan portfolio on the loan portfolio of the total sector was offset by an increase of 0.4% in the stock of loans to households from the previous quarter and of 3% from the second quarter of last year. The stock of loans to households was 13.6 billion euros by the end of the second quarter.

Deposits stood at 30.5 billion euros at the end of the second quarter. Although the yearly growth in deposits was already fast before the second quarter, reaching 12% in the preceding three quarters, deposits in the second quarter were as much as 15.3% larger than in the second quarter of last year. There was 6.5% more in deposits than there was in the first quarter. As the loan volume of the sector shrank in the second quarter and growth in deposits was extraordinarily fast, the loan-to-deposit ratio fell from 97% in the previous quarter to 90%, which can to some extent be considered quite anomalous.

The impact of the Covid-19 crisis on the quality of the loan portfolio was limited in the second quarter

The Covid-19 crisis did not cause any sharp deterioration in the quality of the loan portfolio in the second quarter. The measures that had been taken, especially the moratorium, prevented the worst from happening. Applying payment holidays to loans during the most difficult times helped borrowers in the second quarter to cope better with their liabilities and so reduced any accumulation of payment problems.

Non-performing loans increased as a share of all loans from 1.6% at the end of March to 2.1% by the end of June. The provisions of the banks equally increased by 19 million euros over the three months, taking the total volume of provisions in the sector to 292 million. This is 1.3 times the volume of loans overdue more than 90 days at the end of the second quarter, having been 1.2 times more in the previous quarter. There could not be any great increase in loans long-term overdue by more than 90 days because of the Covid-19 crisis, as the crisis erupted in March and by the end of the second quarter it had only just lasted over 90 days. In consequence the share of the loan portfolio that was overdue more than 90 days was at the same level at the end of June as in the previous quarter at 0.8%.

The liquidity of the banks was good before the Covid-19 crisis erupted and it improved even further during the second quarter. Liquid assets may have increased at the end of the first quarter and in the second quarter because the banks wanted to be able to react to the crisis. At 9.3 billion euros, the liquid assets of the banks were 24% larger in the second quarter than in the first. The average liquidity indicator of the banking sector for the assets used to calculate the liquidity coverage ratio (LCR) increased at almost all the banks. The ratio of LCR liquid assets in total assets rose from 20.4% in the first quarter to 23.3%, and the LCR rose from 144% to 172%. All the banks continued to meet the liquidity coverage requirement of an LCR of 100%. Alongside the funds dedicated for meeting the liquidity coverage ratio, the banks also have other liquid assets, notably deposits in credit institutions, and including these, liquid assets increased by seven percentage points by the end of the second quarter to 30.7%. The share of non-resident deposits fell from 10.9% to 10.3%.

The banking sector earned net profit of 106 million euros on an individual basis in the first quarter, which was 3.3 million euros less than in the first quarter and 13 million euros less than in the same quarter of the previous year. The sector earned less in dividend income in the second quarter, while interest income was lower than in the first quarter and than in the second quarter of last year. Because net profit was a little lower, the average return on equity of the banks was down 0.1 percentage point in the second quarter at 9.1%. For comparison, the average return on equity of the banks in the European Union was only 1.3% in the first quarter, and 5.7% in the fourth quarter of last year. The annual cost-to-income ratio of the banking sector continued to fall from its peak of 53.7% in the fourth quarter of last year, declining to 52.3% in the first quarter and 51.2% by the end of June.

Main development trends and risks

- The negative impact of the Covid-19 crisis on the figures for the Estonian banking sector was limited in the second quarter. The situation in banking had stabilised by the end of the second quarter, but the risks from the continued spread of the Covid-19 virus and its negative impact on the economic environment remain large.
- The decline in the loan stock in the second quarter came from businesses. The volume of loans to private individuals continues to grow. The smaller banks again stand out for the rapid growth in loans, meaning that questions may arise about credit quality.
- The loan quality of the banks remains good. The share of non-performing loans remains small at 2.1% of the loan stock and the share of all loans that were long-term overdue by more than 90 days remained the same as in the first quarter at 0.8%. The Covid-19 crisis has not yet had time to move this indicator substantially.
- The share of long-term overdue loans may rise in the second half of the year because of the general deterioration in the economic environment and because payment holidays or moratoriums and state support measures will end. Long-term overdue loans were still covered by write-downs at the end of the second quarter
- The banks have liquidity and their capital indicators are good. The average Liquidity Coverage Ratio (LCR) of the banking sector was 1.7 times the requirement at the end of the second quarter. Strong capitalisation helps them to cope successfully with a possible increase in credit losses caused by the crisis, and so reduces the risks to capital.
- The profitability of the banks remains good. The return on equity of the sector was 9.1% in the second quarter or only 0.1 percentage point lower than in the previous quarter, again beating the average for the European Union. Potential increases in credit losses as the crisis and the moratorium end could hurt profitability in the quarters ahead.

[Quarterly reviews of the banking sector]

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