Q4 2020 overview of the banking sector

Despite the Covid-19 crisis and the negative expectations, the whole year, including the fourth quarter, was a successful one for the banking sector in Estonia. The probability of the results for the banking sector deteriorating has increased at the start of this year though. The amount of loans with payment holidays has essentially stopped falling throughout the sector, and the share of such loans in the loan portfolio remained at 2.5% in February 2021 for the third month in a row; this is the figure for payment holidays granted since the outbreak of the Covid-19 crisis, and so does not indicate the usual level for the sector. The share of corporate loans with a payment holiday in the corporate loan portfolio was 3.3% in the fourth quarter and at the end of February, while the figure for loans to households was 1.8%.

Main indicators	Q3 2020	Change	Q4 2020
Yearly growth in the loan stock	-0,2%	?	2,3%
Yearly growth in the stock of deposits	14,7%	?	20,3%
Loan-to-deposit ratio	88%	?	83%
Share of long-term overdue loans in the portfolio	0,69%	?	0,59%
Liquidity coverage ratio	175%	?	179%
Net profit	90 million €	?	115 million €
Ratio of expenses to income	50%	?	48%
Return on equity	8,4%	?	8,8%
Return on assets	0,99%	?	1,00%
Core Equity Tier 1 ratio	26,4%	?	25,7%

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In the early phase of the Covid-19 crisis on 25 March the extraordinary weekly reporting by the banks put overdue loans at 3.4% of the portfolio of household and corporate loans, but at the end of February 2021 this was down to 2.5%, close to where it had been at the end of last year. Restructured loans were 3.1% of the portfolio on 25 March, and 2.9% at the end of February. The share of non-performing loans in the sector hit its lowest point of 1.6% at the end of the fourth quarter, and by the end of February the share of such loans has risen to 1.7%; it was 1.9% in March 2020. Consumer loans stand out particularly within this, as the share of such loans that were non-performing was 2.3% at the end of the fourth quarter, having been 1.7% a year earlier.

After the loan stock contracted in the second quarter of last year, the banks became bolder again in the second half of the year. In consequence the loan portfolio of the banking sector was 2.3% larger than a year earlier in the fourth quarter at 28.26 billion euros after posting growth over the year of 0.2% in the third quarter, meaning its growth for the year was 2.3%. The growth in loan volumes was driven above all by private individuals, though the loan stock of non-financial companies increased by 0.7% over the year. The loan volume of non-financial companies grew through businesses in the real estate sector. The loan stock of the accommodation and food service sector was down over the year by a third however, while the loan stock of retail was down 12% and that of manufacturing by 8%.

The share of the loan stock that was overdue by more than 90 days fell to 0.6% by the end of the fourth quarter from 0.7% three months earlier and 0.8% a year earlier. The volumes of loans written down by the banks increased in the second quarter because of the Covid-19 crisis, but write-downs receded again in the second half of 2020. The write-downs were 1.4 times as much in value as the loans overdue more than 90 days at the end of the year, as they had been in the third quarter, having been 1.2 times as much at the end of 2019.

Deposits continue to grow rapidly in the final quarter of the year as they had in the preceding quarters, growing by 20% over the year and 7.6% over the quarter to reach 34.1 billion euros. The liquid assets of the Estonian banking sector grew by 13% in the fourth quarter to 11.8 billion euros. All the banks continued to meet the liquidity coverage requirement of an LCR of 100%.

The banking sector earned net profit of 115 million euros on an individual basis in the third quarter, which was 40 million euros more than in the same quarter of the previous year. Notably more was earned than a year ago in dividend income and income from financial investment, while net profit was also boosted by low interest expenses and service fee expenses. The return on equity of the sector was 8.8% in 2020, passing the figure of 7.7% from the previous year. The expenses-to-income ratio fell by the end of the year to 48%, having been 54% in 2019.

Main development trends and risks

- Various support measures helped the banking sector keep its credit quality under control last year and in some places even to improve it. Even so it should be remembered that the good results of the fourth quarter and of the whole year were achieved partly because of the support given, primarily wage subsidies from the state and the payment holidays offered by the banks. This means that the full or partial removal of the support measures could cause some of the risks that have so far been successfully kept under control to be realised in 2021.

- After the shock caused by the Covid-19 crisis in the second quarter, the banks became bolder again in the second half of the year and were more active in issuing loans. The loan stock in the sector was larger in the final quarter of 2020 than in the previous quarter and than in the same quarter of the previous year. The growth was driven primarily by private individuals, though companies, especially in real estate, also contributed.

- The loan quality of the banks remains good. The share of non-performing loans was actually lower at the end of 2020 than it was a year earlier, and the share of loans overdue more than 90 days fell to 0.6% by the end of the fourth quarter, helped partly by sales of non-performing loans. These positive development trends were aided by payment holidays, meaning it is reasonable to assume that without the support measures the share of overdue loans would have been higher. Long-term overdue loans were still covered to 144% by write-downs at the end of the year.

- The Liquidity Coverage Ratio (LCR) of the banking sector was 1.8 times the requirement at the end of the year. As well as holding LCR assets, the banks held additional liquidity in non-LCR instruments. The banks have focused a lot of attention on liquidity since the end of the first quarter of 2020, which has helped keep liquidity risk low in the Estonian banking sector.

- The banks in Estonia are substantially more profitable than those in the European Union on average, as the return on equity of the sector was 8.8% in 2020, which was even higher than in the previous year. The average figure for the European Union was 2.5% at the end of the third quarter of 2020. The restrictions imposed on economic activity because of the second wave of the Covid-19 virus, and the ending of the support measures, including moratoriums, pose a clear negative risk to credit quality. These risks being realised would hurt the profitability of the sector.

- The CET1 ratio at the consolidated level fell from 26.6% in the third quarter to 25.7% by the end of the year, but it again shows that the banks have strong capital adequacy. 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.

- Cyber risks have become the most important IT risks. Phishing attacks of various types against clients have increased, as have distributed denial of service (DDOS) attacks against the banks. The banks have so far coped well with the DDOS attacks and there have been no large-scale, long-lasting interruptions to services. This area requires constant attention and development though.

Quarterly reviews of the banking sector