Q3 2020 overview of the banking sector

The various indicators for the performance of the banking sector continued to improve in the third quarter. The moratorium on loans that had been introduced to reduce the negative impact of the Covid-19 crisis came to an end. The impact of the crisis on the banks in Estonia in the third quarter was most visible for the loan portfolio in the data on payment holidays.

Key indicators	Q2 2020	Change	Q3 2020
Yearly growth in the loan stock	- 0.7%	?	0.2%
Yearly growth in the stock of deposits	15.3%	?	14.7%
Loan-to-deposit ratio	90%	?	88%
Share of long-term overdue loans in the portfolio	0.8%	?	0.69%
Liquidity coverage ratio	172%	?	175%
Net profit	106 mln €	?	90 mln €
Cost-to-income ratio	51%	?	50%
Return on equity	9.1%	?	8.4%
Return on assets	1.08%	?	0.99%
Core Equity Tier 1 ratio	26.7%	?	26.4%

The share of loans in the household and business portfolio of the banks that had payment holidays peaked in June, when 11.3% of loans had one. The share of such loans has fallen since then, and this was particularly noticeable in the final month of the third quarter. The share of corporate loans with a payment holiday stood at 15.6% of the corporate loan portfolio at the end of September, while the share of household loans was 4.7%.

Overdue loans to the banks were at 3.4% of the portfolio of household and corporate loans on 25 March in the early phase of the Covid-19 crisis and non-performing loans were at 1.9%, but at the end of September these figures were 2.9% and 1.9%. Restructured loans were 3.1% of the portfolio on 25 March, and 3.3% at the end of September. The statistics on payment holidays cover data from all the Estonian banks and their foreign branches.

Having been quite reticent about providing loans in the second quarter, the banks started to lend a little more bravely in the third quarter. The loan portfolio of the banking sector was 1.1% larger in size than in the previous quarter at 27.85 billion euros, and it was 0.2% larger than a year earlier. In the second quarter for comparison, the total volume of lending was down 0.8% over the quarter and 0.7% over the year. The growth from the second quarter to the third quarter came in both the portfolios of loans to private individuals and loans to businesses, but the growth over the year came primarily from loans to private individuals.

The rapid growth in deposits continued in the third quarter. The stock of deposits in the banking sector was up 4% over the quarter and 14.7% over the year at 13.8 billion euros, having posted quarterly growth of 6.5% and yearly growth of 15.3% in the second quarter. This shows the reaction of the banks to the economic turbulence. Household deposits and corporate deposits both grew, and so did central government deposits. The smaller banks continued to take in deposits from dedicated platforms. Since the Covid-19 crisis started, more than half of the growth in deposits in the banking sector has come from government deposits. The rapid growth in deposits pushed the loan-to-deposit ratio even further to its most extreme level ever of 88%, from 90% in the second quarter.

The share of non-performing loans decreased at the consolidated level from 2.1% at the end of June to 1.9% by the end of September. The share of the loan stock that was overdue by more than 90 days fell to 0.7% by the end of the third quarter from 0.8% three months earlier. The volumes of loans written down by the banks increased in the second quarter because of the Covid-19 crisis, but as credit quality indicators improved a little in the third quarter, the write-downs were reduced from 292 million euros to 278 million euros. The write-downs were 1.4 times as much in value as the loans overdue more than 90 days in the third quarter, having been 1.3 times as much in the second quarter.

The continuing increase in the liquid reserves of the banks could partly be a consequence of the difficult times, though it could equally be because smaller banks are building up liquidity to cover planned growth in lending. The Liquidity Coverage Ratio (LCR) for the banking sector showed the volume of liquid assets at the banks jumped in the third quarter by 13% over the quarter to 10.5 billion euros. The ratio of liquid assets to total assets in the sector rose from 23.3% in the second quarter to 25.3%, and the LCR rose from 172% to 175%. All the banks continued to meet the liquidity coverage requirement of an LCR of 100%. Alongside the funds dedicated for meeting the liquidity coverage requirement, the banks also have other liquid assets, notably deposits in credit institutions, and including these, liquid assets increased by the end of the third quarter to 32.2% from 30.7% three months earlier.

The banking sector earned net profit of 90 million euros on an individual basis in the third quarter, which was 3.7 million euros more than in the same quarter of the previous year. Interest expenses were smaller than a year earlier and a little more was earned in interest income and income from financial investment, but less was received in service fee income. A fall in dividend income left the average return on equity of the banks 0.7 percentage point smaller than in the previous quarter at 8.4%. The comparative return on equity in the banking sector of the European Union was only 0.5% in the second quarter. The current income-to-expenses ratio for the year fell from 51.2% in the second quarter to 49.7%.

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, but improvement in them was already visible in the third quarter.
- The virus faded away in the summer and expectations about the healthcare and economic situation became more optimistic, which increased the risk appetite of the banks in the third quarter. The loan stock in the sector was larger than in the previous quarter and than in the third quarter of the previous year. The stock of loans to private individuals continued to grow and, unlike in the second quarter, the stock of loans to businesses also grew in the third quarter. Particularly fast growth in loans at the smaller banks may cause risks with credit quality.
- The loan quality of the banks remains good. The share of non-performing loans even fell from 2.1% of the loan stock in the second quarter to 1.9%, and the share of loans that were long-term overdue by more than 90 days fell from 0.8% to 0.7%.
- Looking forward, the share of non-performing and long-term overdue loans could increase not only because restrictions are introduced in response to the new wave of the virus and payment holidays are ended, but also because state support measures come to an end. Long-term overdue loans were still covered by write-downs at the end of the third quarter.
- The banks are holding good liquid reserves. The Liquidity Coverage Ratio (LCR) of the banking sector was 1.75 times the requirement at the end of the third quarter. As well as meeting the requirement, 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, and in the third quarter the liquidity risks to the Estonian banking sector were small.
- The banks in Estonia are substantially more profitable than those in the European Union on average. The return on equity of the sector was 8.4% in the third quarter, which was a little less than in the previous quarter primarily because dividend income was smaller. The possible return of the crisis and the ending of the loan moratorium could increase credit losses, and this could hurt profitability in the coming quarters.

The CET1 ratio at the consolidated level fell from 26.7% in the second quarter to 26.4% by the end of September, 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.

[Quarterly reviews of the banking sector]

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