

The resurgence of COVID-19 cases in early 2021 has temporarily set some businesses back, with firms in certain sectors revising earlier expectations of an improvement in operating conditions in 2021. While the outlook for these sectors is expected to remain highly challenging, the recent easing of containment measures, vaccine roll-out, and continued repayment assistance support from banks are expected to temper any material

increase in risky loans. Improvements in the global and domestic economy should further support debt-servicing capacity, amid more targeted policy support going forward. Banks remain well-buffered against an expected increase in credit losses from the business sector, supported by pre-emptive provisions built up in 2020 (refer to the Chapter on 'Financial Institution Soundness and Resilience' for further details).

## Insights from Surveys on Credit Conditions

This information box examines the credit conditions for businesses in 2020 and the outlook for 2021 amid rising credit risks and higher loan losses experienced by banks. It draws detailed insights from supply<sup>12</sup> and demand-side<sup>13</sup> surveys conducted by the Bank in the fourth quarter of 2020.

### Banks' capacity to lend remains sound, but risk appetite turned cautious

In aggregate, preliminary lending targets for 2021 across banks suggest that the banking system will be more than able to support credit demand consistent with the projected GDP growth. This is underpinned by the ability of banks to lend, given strong capital, funding and liquidity buffers. However, heightened credit risks and rising impairments and other related costs are increasing risk aversion and could affect specific lending decisions by banks. Given the highly uncertain economic outlook and its dependency on the progress of vaccinations and evolution of the virus, banks are taking a more cautious approach in meeting demand for new credit. Heightened repayment risks and an uncertain macroeconomic outlook remain key factors that could weigh on credit conditions in 2021.

Banks surveyed indicated that credit conditions could tighten a little more for corporate borrowers, while conditions are expected to ease for SMEs in the first half of 2021 compared to conditions in 2020 (Chart 1.9). This mainly reflects the larger loan sizes and typically unsecured nature of larger corporate loans. Conversely, SME loans are generally smaller in size, secured by collateral and continue to receive material support from various government measures.

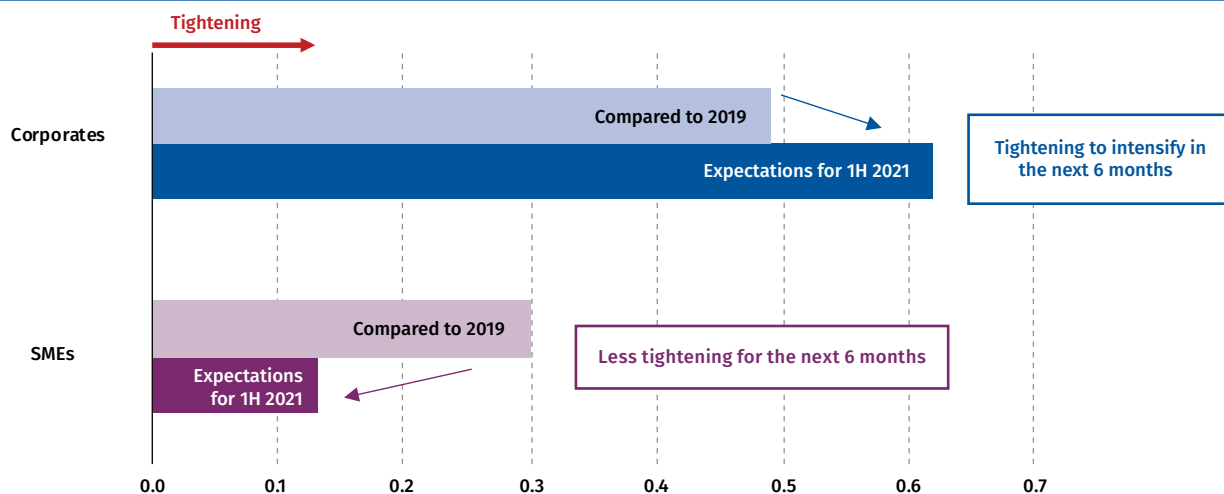
The more cautious bank risk appetite was also consistent with businesses' perception of financing conditions. Following the partial resumption of economic activity in May 2020 after movement restrictions were eased, businesses indicated an improvement in their demand for bank financing, but had lower perceived availability of bank financing. This resulted in a larger financing gap<sup>14</sup> observed over the past six months. Smaller businesses were the most affected by this financing gap. Approximately 32% of SMEs indicated that the financing gap deteriorated. Larger businesses fared better, with 82% reporting either an unchanged or a decreased financing gap (Chart 1.10). Despite the greater tightening indicated by banks for non-SMEs, the more favourable credit conditions perceived by non-SMEs could be due to their more established relationship with banks, allowing for more bespoke negotiations for loans. Larger businesses can also rely on more diverse sources of financing such as capital markets and internal funds. Taken together, non-SMEs may therefore have lower perceived constraints when it comes to the availability of financing.

<sup>12</sup> The Credit Conditions Survey to Banks (4Q 2020) surveyed 17 banks, comprising domestic banking groups, locally-incorporated foreign banks and development financial institutions.

<sup>13</sup> The BNM Survey on Firms' Access to Financing 2020 surveyed around 2,000 businesses comprising micro, small, medium and large businesses.

<sup>14</sup> The change in financing gap is defined as the difference between the change in firms' demand for, and the change in perceived availability of bank financing. An increase in financing gap would be represented by an increase in the demand for bank financing and/or a decrease in the perceived availability of bank financing.

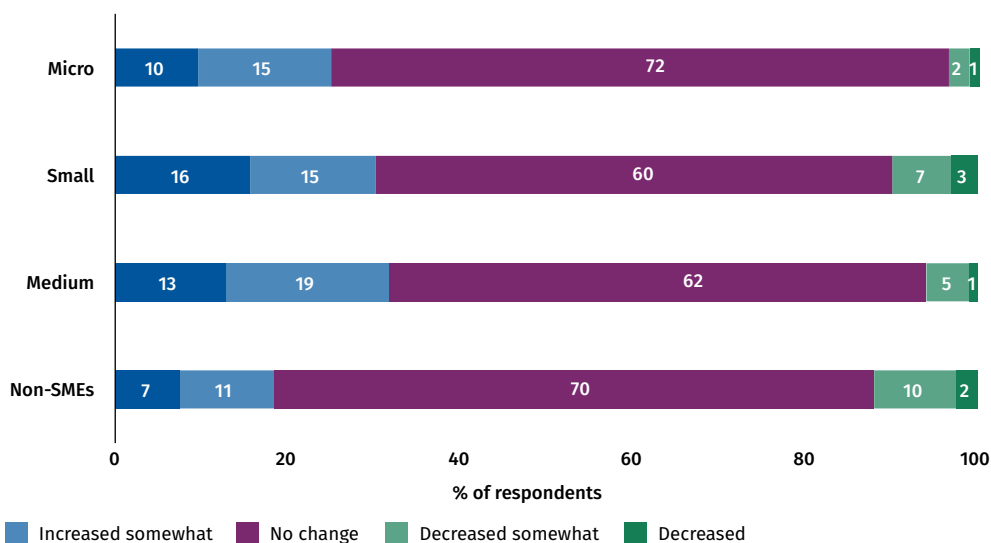
Chart 1.9: Banks' Expectations for Changes in Credit Supply Conditions by Size of Firms



Note: Weighted responses of banks surveyed. Scores are derived on a net basis, i.e. two banks with the same degree of easing and tightening will offset each other based on their share of loans. Scale: Ease significantly (-2); Ease somewhat (-1); Neutral (0); Tighten somewhat (+1); Tighten significantly (+2)

Source: Credit Conditions Survey to Banks (4Q 2020)

Chart 1.10: Firms' Demand for Bank Financing vs Perceived Availability for Bank Financing, 2H 2020

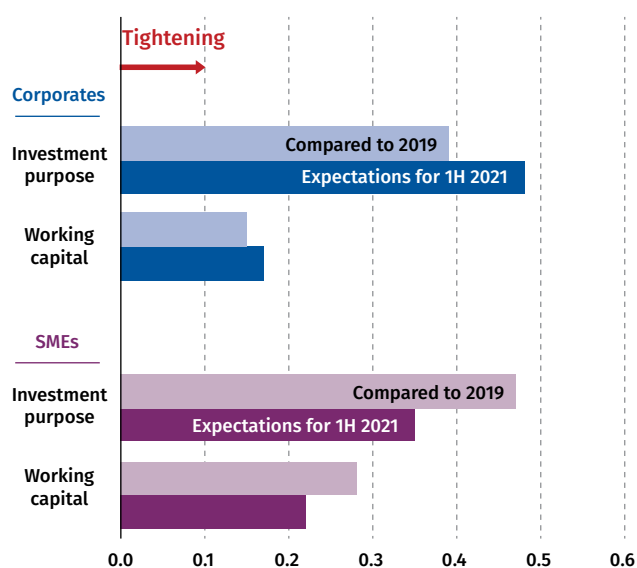


Note: Chart represents the difference between individual respondents' responses to their demand for bank financing and the perceived availability of bank financing in the last 6 months of 2020 on a scale of 'Decreased', 'Unchanged' and 'Increased'. An increase in financing gap would be represented by an increase in the demand for bank financing and/or a decrease in the perceived availability of bank financing

Source: BNM Survey on Firms' Access to Financing 2020

Consistent with higher concerns over repayment risks, supply of credit is likely to be more forthcoming for working capital financing which have shorter tenures compared to financing for investments and capital expenditure (Chart 1.11). This is generally aligned with the financing needs of businesses surveyed, which also indicated greater demand for working capital compared to capital expenditure financing over the first six months of 2021 (Chart 1.12). Looking further ahead, a pick-up in demand for investment financing is expected. Banks have the capacity to meet this demand growth, which would be more rooted in the improving strength and pace of economic recovery.

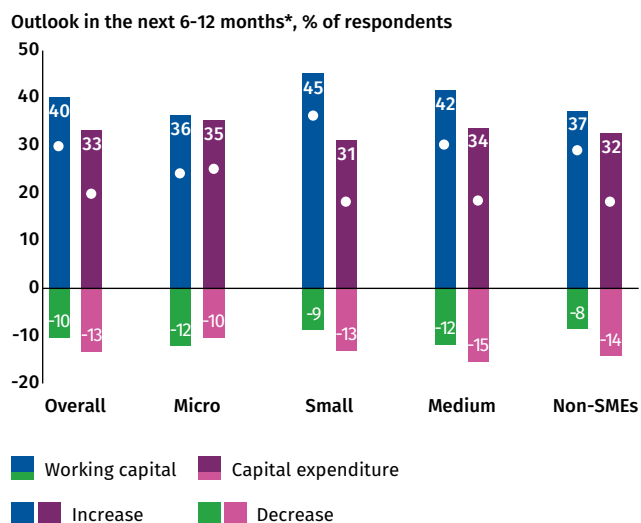
**Chart 1.11: Banks' Expectations for Changes in Credit Supply Conditions by Financing Purpose**



Note: Weighted responses of banks surveyed. Scores are derived on a net basis, i.e. two banks with the same degree of easing and tightening will offset each other based on their share of loans. Scale: Ease significantly (-2); Ease somewhat (-1); Neutral (0); Tighten somewhat (+1); Tighten significantly (+2)

Source: Credit Conditions Survey to Banks (4Q 2020)

**Chart 1.12: Firms' Expectations for Changes in Demand for Financing by Financing Purpose**



\* Respondents were asked on their expected demand for working capital and capital expenditure financing in the next 6-12 months on a scale of 'Decrease', 'Unchanged' and 'Increase'. Respondents who responded 'Unchanged' or 'Not applicable' were not included in this chart. The net figure (in dots) is the difference between the percentage of respondents who responded with 'Increase' and 'Decrease' for each financing allocation category

Source: BNM Survey on Firms' Access to Financing 2020

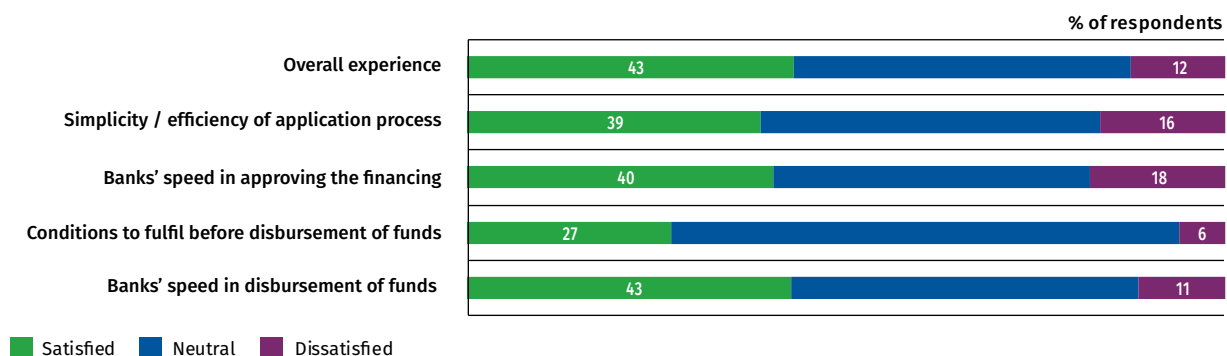
The cumulative reductions of 125 bps of the OPR in 2020 have also reduced banks' internal hurdle rates<sup>15</sup> and helped stabilise financing rates. However, stiff competition for customers over the years have led to aggressive pricing and narrowing profitability. While banks generally maintain effective lending rates that are above hurdle rates, a significant increase in loan losses may erode profit buffers and affect the pricing for and supply of credit, especially to higher-risk segments.

In the nearer term, non-price tightening measures were expected to be more pervasive among the surveyed banks. These include tighter credit scoring criteria, more stringent collateral requirements, imposition of loan covenants and maximum loan size limits. More extensive background checks and more proactive actions, such as the use of alternative information sources, as well as more frequent engagements were also conducted with business borrowers to better assess their financial and operating conditions. These measures do not appear to have materially increased difficulties for borrowers, with 88% of businesses reporting either positive or neutral feedback on bank processes (Chart 1.13). Positive experiences were generally linked to process improvements that alleviated hardship and practical difficulties faced by borrowers during the MCO, which had helped expedite credit approvals and disbursements despite the challenging operating conditions.<sup>16</sup> These process improvements include the increasing use of online processes and template financing to facilitate guarantor approvals, the conduct of virtual site visits and flexibilities on certain conditions precedent for loan disbursements.

<sup>15</sup> Hurdle rate refers to the risk-adjusted breakeven point in pricing where banks' income from giving out a loan is sufficient to cover expected credit losses, associated funding costs and overhead costs.

<sup>16</sup> Corroborated by the Credit Conditions Survey to Banks (4Q 2020).

Chart 1.13: Firms' Opinion on Banking Processes



Source: BNM Survey on Firms' Access to Financing 2020

### Measures introduced to address risks to financial stability

Adjustments observed to the risk appetite of banks are expected and prudent given the current environment. However, excessive risk aversion may also pose risks to financial stability. Policy responses during this crisis have therefore been aimed at supporting credit flows to the economy, in particular for viable borrowers and segments that are more likely to be disproportionately impacted by more cautious bank lending behaviour. The series of policy measures introduced has and will continue to lend support to intermediation activities in the current environment of heightened credit risks. First, financing conditions have remained conducive on the back of continued accommodative monetary policy. Second, Targeted Repayment Assistance programmes with flexible repayment options continue to be made available to borrowers who need them. Third, the extension of regulatory flexibilities serves to expand the financial and operational capacity of banks to support existing and new borrowers. Fourth, the various financing facilities under BNM's Fund for SMEs, and the credit guarantee schemes for both SMEs and corporates have supported the continued flow of credit to viable businesses amid higher credit risk aversion.

Having entered this crisis with strong capital and liquidity positions, the banking industry continues to be well-placed to facilitate credit flows to the economy. Micro lending decisions by banks can, however, produce asymmetric outcomes on businesses affected by the pandemic. As the economic recovery becomes more entrenched, the effects are expected to dissipate and easing in credit conditions will become broader-based.