Q2 2021 overview of the banking sector

The first half of 2021, including the second quarter, was favourable for the Estonian banking sector, which was in line with general developments in the economy. Faster growth than expected of 5.4% in the economy in the first quarter was followed in the second quarter by even faster growth of 12.9% in Estonian GDP.

Key indicators	Q1 2021
Yearly growth in the loan stock	2.8%
Yearly growth in the stock of deposits	21.6%
Loan-to-deposit ratio	82%
Share of long-term overdue loans in the portfolio	0.60%
Liquidity coverage ratio	183%
Net profit	117 mln eurot
Ratio of expenses to income	48.2%
Return on equity	9.6%
Return on assets	1.08%
Core Equity Tier 1 ratio	27.1%

The amount in loans subject to payment holidays continued to decline steadily until the end of June. The amount in household loans subject to payment holidays has declined throughout 2021 and by the end of June, such loans accounted for 0.8% of the loan portfolio. Corporate loans with holidays were 2.8% of the portfolio. The ability of households to repay their loans largely recovered, and they no longer needed payment holidays to any significant degree at the end of the second quarter. However, the restrictions introduced because of Covid-19 put pressure again on businesses in certain sectors, meaning that corporate loans had greater need of payment holidays than household loans did.

Overdue loans accounted for 1.9% of the portfolio of household and corporate loans together in the banking sector at the end of June, which was 0.03 percentage point more than in June and March. At the same time the share of non-performing loans continued to decline, falling to 1.6% by the end of June.

As growth picked up in the economy in the second quarter, so did the issuance of new loans. The low reference base of last year needs to be considered when looking at the economy overall and at the size of the loan stock, as the loan stock of the banking sector declined by 0.7% in the second quarter of 2020. Even so the growth in loan volumes has accelerated increasingly in the past four quarters, and it was up to 5.8% by the end of the second quarter of this year. This is not far behind the growth of 7% seen in the quarters immediately before the Covid-19 pandemic. The loan portfolio of the banking sector stood at 29.1 billion euros at the end of June. The growth over the year in volumes was again led by households, but the growth in the loan stocks of companies and of local governments also contributed significantly. Alongside the growth in the volume of loans to households, the growth in the loans to non-financial companies is also picking up, and it reached 2.3% in the second quarter having fallen by 0.3% in the first quarter. The growth was faster in the loan stock of private sector companies at 2.8% over the year and 1.2% over the quarter. The volume of lending to private sector companies increased primarily in the real estate, agriculture and construction sectors.

The share of the loan stock that was overdue by more than 90 days declined from the end of March to the end of June by 0.05 percentage point to 0.55%, having been 0.8% a year earlier. The fall was quite general and affected almost all sectors of the economy. The reversal of the write-downs that had started in the second half of 2020 also continued in the second quarter. Write-downs were 1.45 times as much in value as loans overdue more than 90 days at the end of the second quarter, having been 1.38 times as much three months earlier.

Although deposits were 13% larger at the end of June than they were at the end of the second quarter of last year, they were 0.9% down on the previous quarter at 34.5 billion euros. The deposits of households, companies and financial institutions have grown over the year, but central government deposits have declined. Deposits declined from the first quarter primarily because of the general government, in the form of the social security fund, the central government and local governments, and also because of companies.

The fall in the volume of deposits and the increase in the loan stock of the banking sector meant that the loan-to-deposit ratio stopped falling, and it rose from 82% at the end of March to 84%. The volume of liquid assets in the banking sector was also smaller than in the first quarter, as it was down by 7.8% or 11.6 billion euros, though the volume was still a quarter more than a year previously.

The banking sector earned net profit of 113 million euros on an individual basis in the second quarter, which was 8.3 million euros more than a year earlier. Despite revenues, including dividend revenues, falling while operating expenditures remained fairly unchanged, the net profit of the banking sector was given a substantial boost by smaller credit losses of 6 million euros in the second quarter of 2021, down from 38 million euros in the second quarter of 2020. The return on equity of the sector reached 9.3% in the second quarter having been 9.1% in 2020, and the return on assets was 1.04%, having been 1.08%. The expenses-to-income ratio rose by 0.5 percentage point to 49%.

Main development trends and risks

- The good credit quality of the banking sector improved further in the second quarter of 2021.
- The share of non-performing loans and long-term overdue loans declined in the second quarter. The decline was broadly based and took in most sectors, reflecting the general positive developments in the economy. Even so the risks from the Covid-19 pandemic have not gone anywhere, which also means that most of the sectors affected remain under

pressure.

- The growth in the loan stock of the banking sector accelerated further and the stock increased by 5.8% over the year. Alongside the stock of loans to private individuals, the stock of corporate loans is seeing growth accelerate.

- After liquidity had increased strongly for a year, the volume of liquid assets declined unexpectedly in the second quarter. The liquidity risk of the Estonian banking sector still remains low.

- The profitability of the Estonian banks in the return on equity in the second quarter of 2021 remained high at 9.3%, while the average in the EU in the first quarter was 7.6%.

- The rapid growth in lending volumes and the increase in risk assets caused some weakening of the capital indicators in the second quarter. Capitalisation remains strong though, and this will help the Estonian banking sector to cope successfully with any possible credit losses.

Quarterly reviews of the banking sector

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