



**CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN**

CREDIT CONDITIONS SURVEY

2022

Q2



ACRONYMS

MCGF - The Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan

NBCI – Non-Bank Credit Institution

IT – Information Technologies

SMEs – Small and Medium Enterprises

LTV – Loan to value ratio

MSMEs – Micro, Small and Medium Enterprises

NPL- Non-performing loans

SL – Salary

RE – Real estate

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Introduction

The aim of the survey is to provide monitoring and analysis of credit activity of banks, to identify and assess threats to financial stability early on, to determine the appropriate prudential policy, and inform the participants of the financial sector about relevant trends. This survey includes an assessment of supply and demand factors with respect to business, consumer and mortgage loans, as well as identification and assessment of banks' risks:

- *Dynamics of changes in credit standards (policy);*
- *Factors affecting the dynamics of credit standards;*
- *Changes in credit terms and conditions;*
- *Dynamics of loan demand changes;*
- *Factors affecting the dynamics of loan demand;*
- *Changes in risk dynamics.*

The survey contains qualitative questions and does not require quantitative assessment. The balance statistics method is used to convert survey results into quantitative data. The index ranges from negative 100% to positive 100%. A positive 100% indicates that 100% of respondents observe a significant softening or an increase in the trend, while a negative 100% indicates that 100% of respondents observe a significant tightening or decline. When the index is 0%, this means that the trend has not changed from the previous quarter. When calculating the index, respondents' answers are equally weighted regardless of the bank's size. The credit conditions survey is addressed to banks' senior loan officers or the members of the Management Board responsible for the relevant area.

The survey is conducted on a quarterly basis starting from the first quarter of 2022. The current report includes the results of the survey for the second quarter. The expectations presented in the report do not reflect the expectations of the Central Bank of the Republic of Azerbaijan, but only opinions of respondents (banks) of the current and future lending trends.

Overview of results

Results of the survey show that banks eased their credit policy in the second quarter of the current year. The easing of credit policy took place mainly in the case of business loans. At the same time, there is a growing demand for all types of loans, except for internal mortgage loans. Competition in the banking sector is the main factor contributing to the easing of credit standards. Increased demand for business loans is driven by financing needs of enterprises for working capital, while the main factors contributing to the growth in demand for mortgage and consumer loans are changes in interest rates of consumer and mortgage loans and digitization. Banks expect credit policy to continue softening in the third quarter of 2022. Banks reported that the easing would apply mainly to business loans approval process. At the same time, banks expect an increase in demand for all types of loans in the third quarter except the business loans in foreign currency.

Business loans

Credit policy: Banks reported a considerable easing of credit standards applied to business loans approval process in the last quarter. The easing occurred mainly on loans granted to micro businesses. There was a certain tightening on loans in foreign currency.

Loan demand: The demand for business loans increased over the last quarter. The demand increased mainly on loans to micro and medium business entities.

Expectations for Q3 2022: It is expected that the current trend will continue, credit standards, mainly the credit standards on loans in national currency and in relation to MSMEs will be eased, and loan demand will increase, mainly from MSMEs.

Mortgage loans

Credit policy: Banks mainly eased credit standards in the last quarter. In general, while easing was mainly due to MCGF-backed loans, large banks eased credit standards for internal mortgage loans more significantly.

Loan demand: The demand for mortgage increased over the last quarter. The main driver of the demand was the increase in demand for loans granted at the expense of the MCGF.

Expectations for Q3 2022: It is expected that the standards applied to mortgage loans will soften, and the demand for these loans will increase.

Consumer loans

Credit policy: Consumer loans standards, especially salary-based loan approval standards, have been eased over the past quarter.

Loan demand: Over the past quarter, the main increase in demand for consumer loans was for salary-based loans and credit cards. This indicator was higher for large banks.

Expectations for Q3 2022: Banks reported that they predict an increase in demand for consumer loans in the Q3 2022. Large banks predict an increase in demand mainly for credit cards, while other banks predict an increase in demand for salary-based loans.

Chart 1. Changes in credit standards for Q2 2022

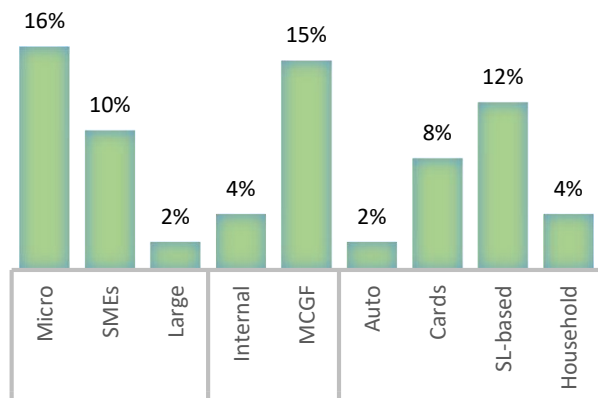


Chart 2. Expectations on credit standards for Q3 2022

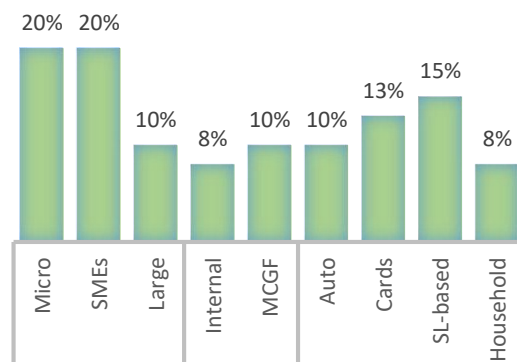


Chart 3. Changes in loan demand for Q2 2022

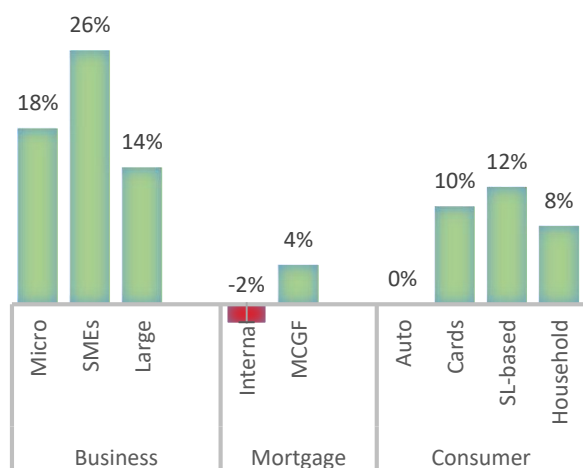
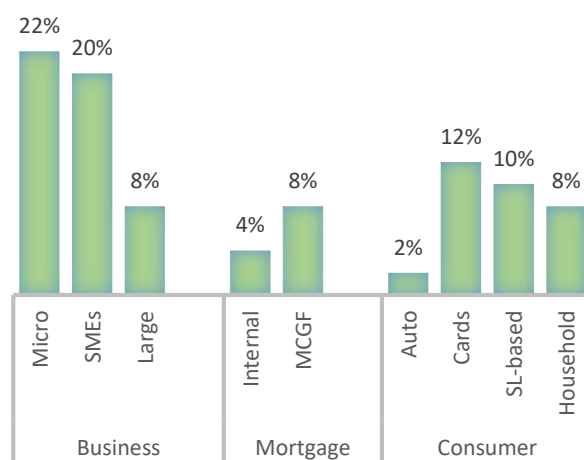


Chart 4. Expectations on loan demand for Q3 2022



Analysis of loans across sectors

Business loans

Chart 5. Changes in term and currency standards for business loans in Q2 2022

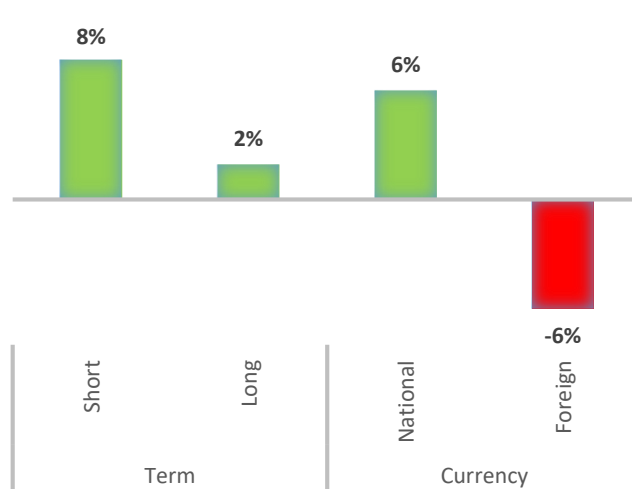
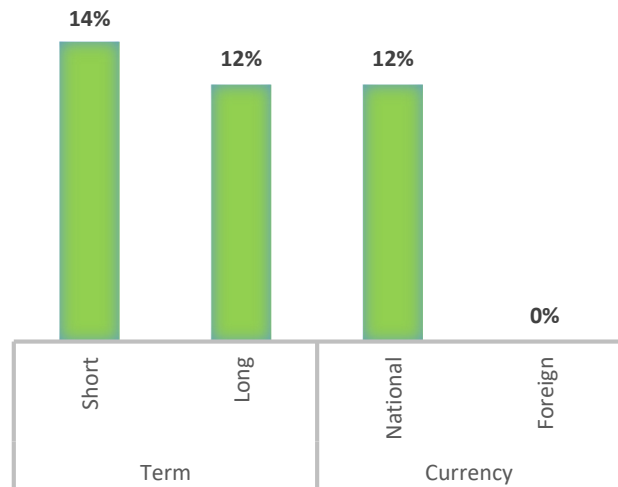
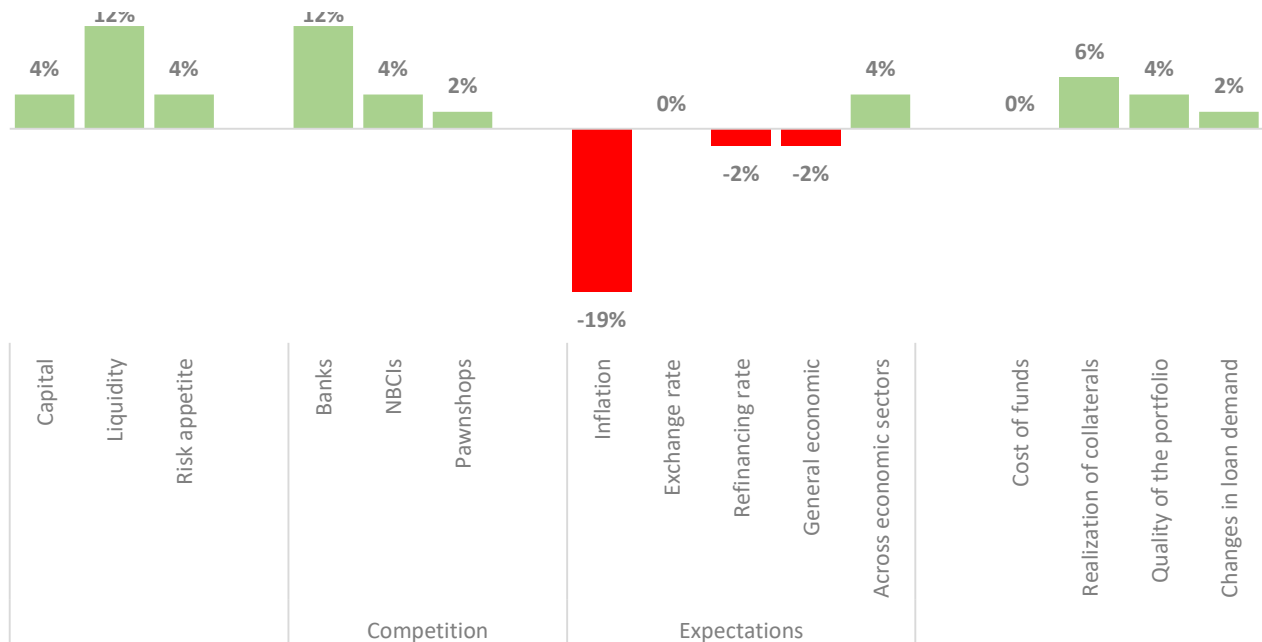


Chart 6. Expectations on term and currency standards for business loans in Q3 2022



In Q2 2022, banks eased credit standards for business loans, mainly related to the term of loans and this trend is expected to continue in the third quarter. Banks reported a tightening of business loans in foreign currency in the second quarter, but they forecast it to remain neutral in the third quarter.

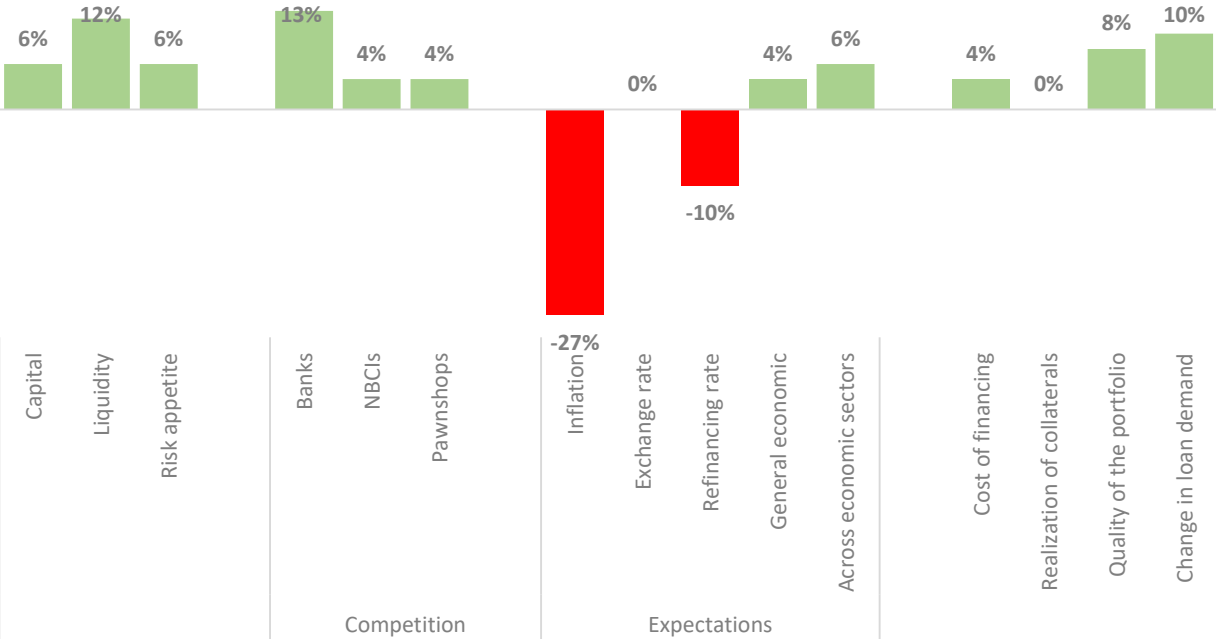
Chart 7. Factors affecting the credit standards for business loans in Q2 2022



In Q2 2022, competition with other banks and a bank’s existing and expected liquidity position acted as the main factors that softened the standards for business loans. At the same time, competition with NBCIs and pawnshops had a certain softening effect on credit standards. The tightening effect on business lending standards was driven mainly by inflation, refinancing rate and economic expectations.

Banks reported positive expectations agriculture, commerce and transport. Compared to the first quarter, collaterals realisation caused the softening of credit standards.

Chart 8. Factors affecting the credit standards for loans to SMEs in Q2 2022



As with general business loans during the Q2, competition and banks’ current and expected liquidity were main softening factors for SME loans as well. While economic expectations have tightened business loans, the same factor has had a softening effect on loans granted to SMEs. Banks reported that the impact of the collateral realization decreased compared to the previous quarter and did not have a tightening effect on credit standards in the second quarter.

Chart 9. Changes in credit conditions for business loans in Q2 2022

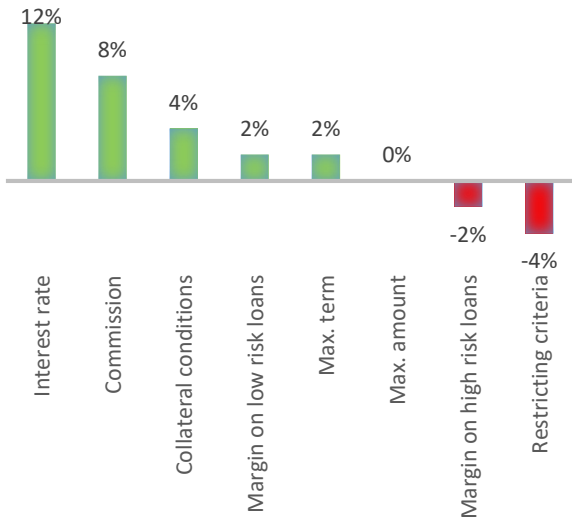


Chart 10. Changes in credit conditions for loans to SMEs in Q2 2022

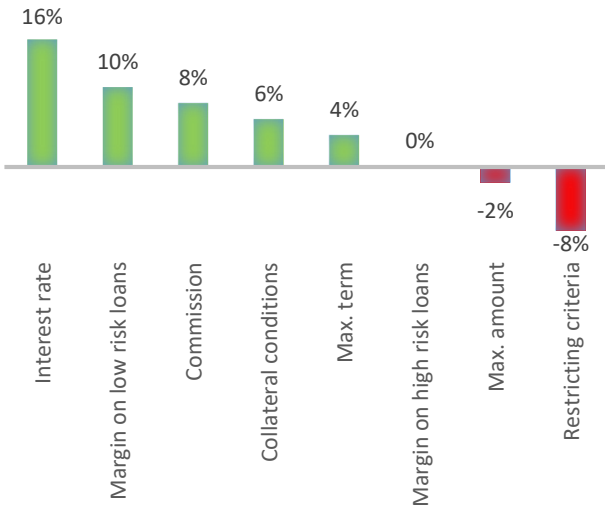


Chart 11. Changes in terms and conditions on loans to large enterprises in Q2 2022

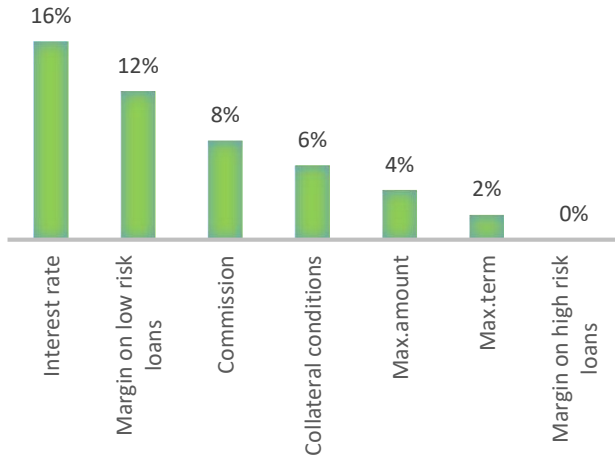
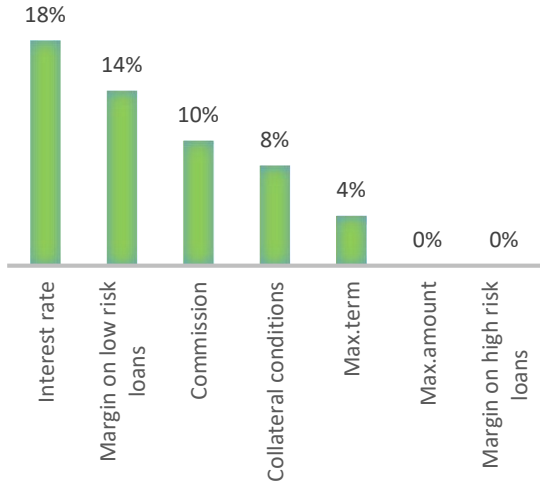


Chart 12. Changes in terms and conditions on loans to micro enterprises in Q2 2022



In the second quarter of the current year, the business portfolio, including the terms and conditions of granting loans to SMEs, were mainly softened. Softening were mainly related to the interest rate of the loans, margin on low risk loans, commission and collateral conditions. In terms of business loans, the restrictive criteria and margin on high-risk loans have been tightened, while for SME loans, there was a tightening in the restrictive criteria and maximum amount.

Compared to the first quarter of this year, there was an easing in credit conditions for loans to large and micro business entities. The easing was mainly on the interest rate and the margin on low-risk loans. Credit conditions for the margin on high-risk loans remained unchanged. In addition, there was no change in the maximum amount of loans granted to micro businesses.

Chart 13. Changes in demand for business loans in Q2 2022

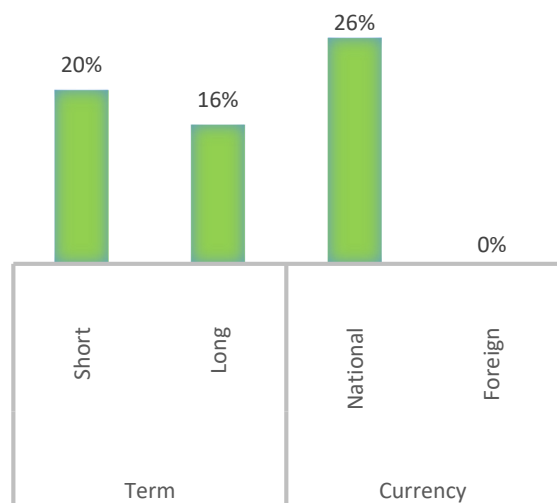
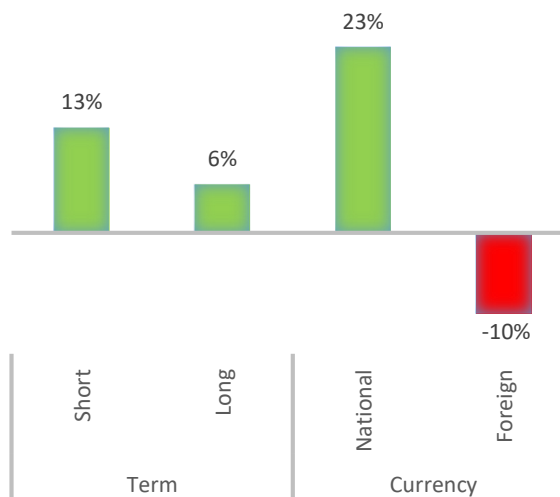


Chart 14. Expectations on demand for business loans in Q3 2022



In the second quarter, banks reported an increase in demand for long-term and short-term loans in local currency, and a stable demand for loans in foreign currency (there was a decrease in demand for loans in foreign currency in the first quarter). Banks expect an increase in demand for both long-term and short-term loans in local currency in Q3 2022, while the demand for loans in foreign currency will decrease.

Chart 15. Impact of the below factors on demand for business loans Q2 2022

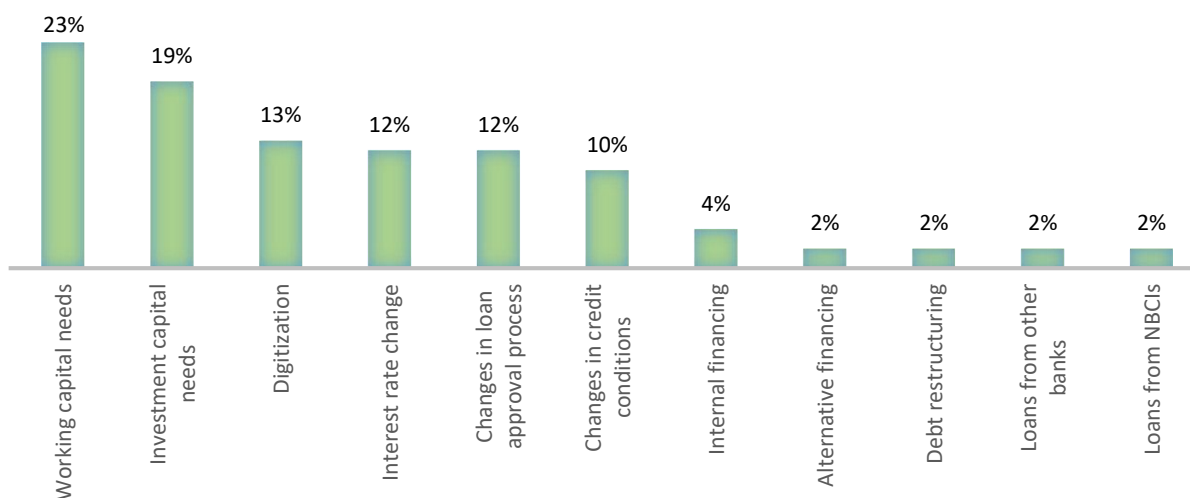
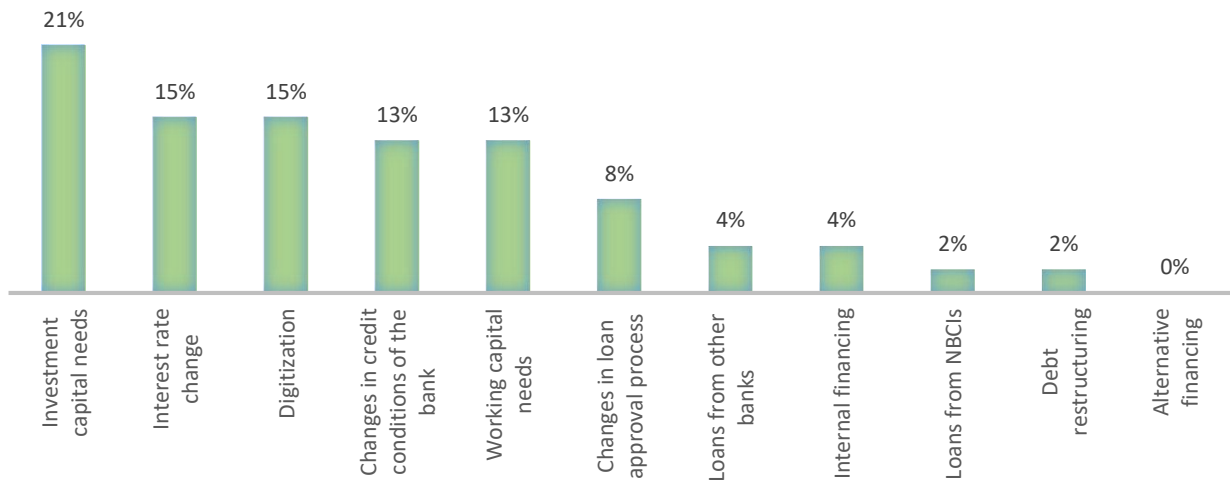


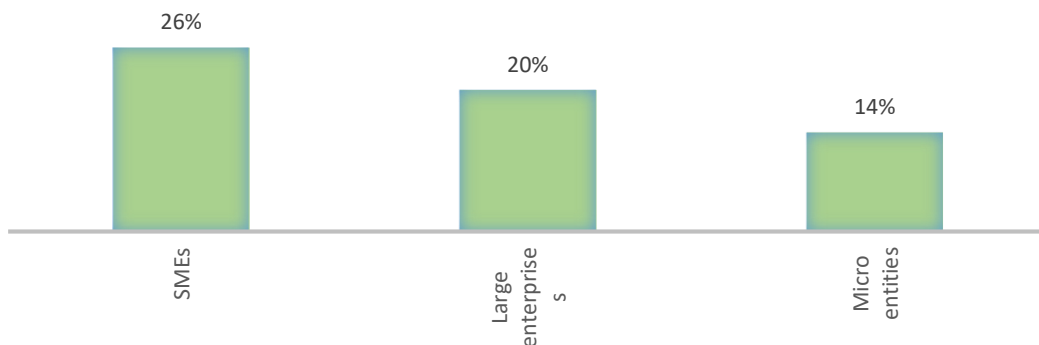
Chart 16. Impact of the below factors on demand for loans to SMEs in Q2 2022



The increase in demand for business loans in the second quarter of 2022 was mainly driven by working capital needs of businesses, investment capital needs and digitization. In addition to these factors, the main factor that had a positive effect on loan demand for SMEs was the change in interest rates. At the same time, compared to the last quarter, debt restructuring for SMEs had a slight positive effect on increase in demand.

In order to assess the creditworthiness of the business sector, changes in the indebtedness level of businesses in the second quarter of the current year were also surveyed. According to the results of the survey, the level of indebtedness of businesses has increased (especially in the category of SMEs). In comparison with the previous quarter, the level of indebtedness by large business subjects increased more in the second quarter.

Chart 17. Changes in indebtedness level of business entities in Q2 2022



Mortgage and consumer loans

Chart 18. Factors affecting credit standards for mortgage loans in Q2 2022

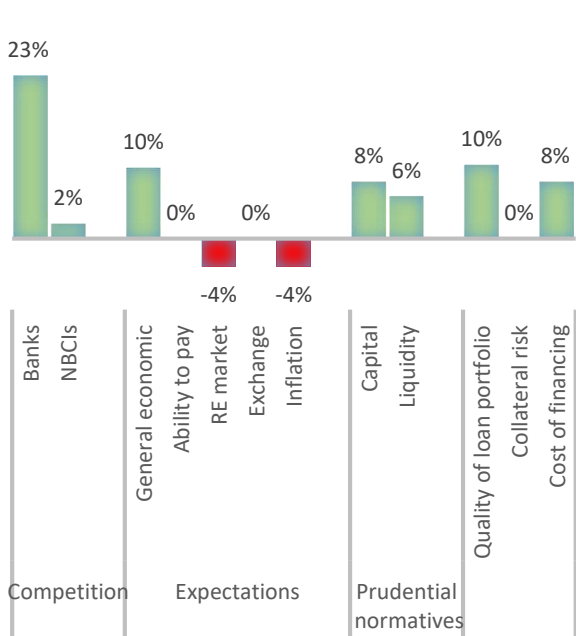
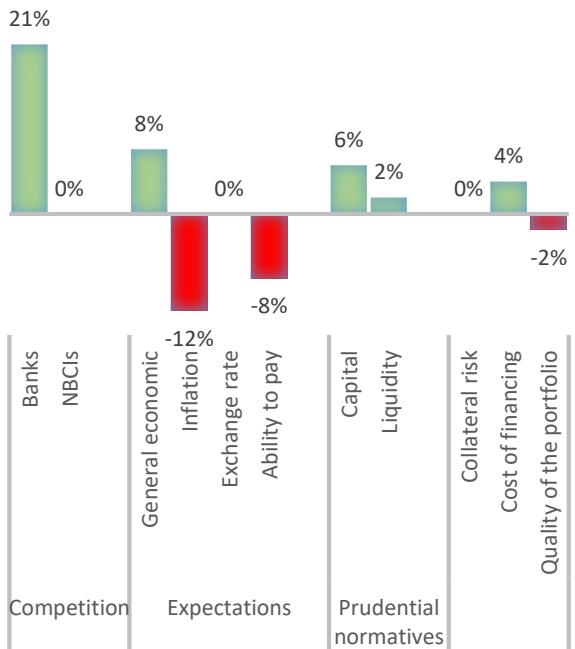


Chart 19. Factors affecting credit standards for consumer loans in Q2 2022



The competitive environment in the sector played a key role in easing the standards for mortgage loans. At the same time, positive economic expectations, quality of the portfolio, the fact that banks’ capital and liquidity level is in the comfort zone also had a softening impact on standards for mortgage loans in the second quarter of the current year. Expectations on exchange rate stability, population’s ability to pay and collateral risk have not affected credit standards, while inflation expectations had a tightening effect. Compared to the first quarter of the current year, expectations on real estate market also had a tightening effect in the second quarter. A similar trend is observed in consumer loans, but unlike mortgage loans, expectations on the population's ability to pay have a tightening effect on consumer credit standards. At the same time, it is observed that the quality of the consumer loan portfolio has a tightening effect on loans. As in mortgage lending, factors that have a softening effect on consumer loan standards are high competition, positive economic expectations, as well as high capital and liquidity indicators of banks.

In the second quarter of 2022, banks eased all credit conditions for mortgage and consumer loans. The easing was mainly observed in interest rates. Banks made more softening on terms and conditions for mortgage loans, except for restrictive covenants and the term of loans. Credit easing by large banks was more significant.

Chart 20. Changes in terms and conditions of mortgage loans in Q2 2022

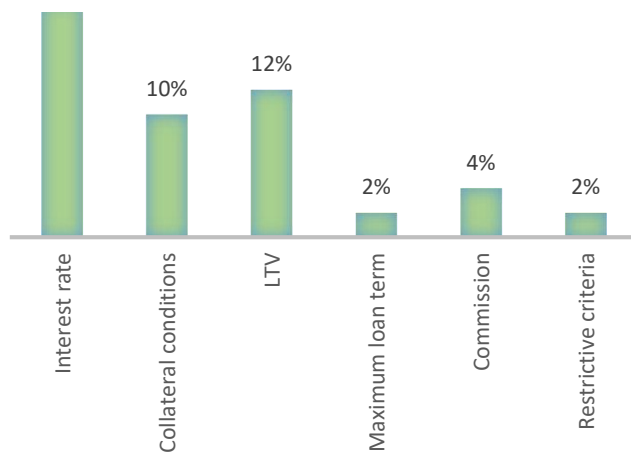
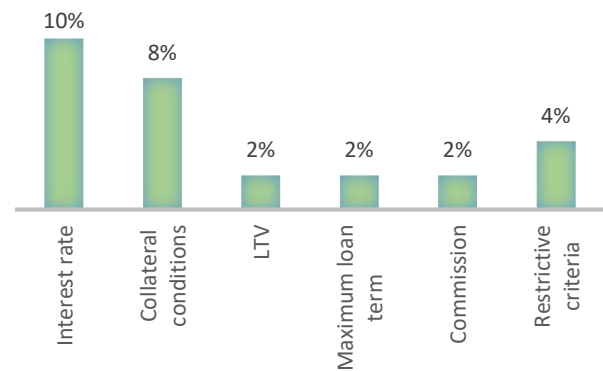


Chart 21. Changes in terms and conditions of consumer loans in Q2 2022



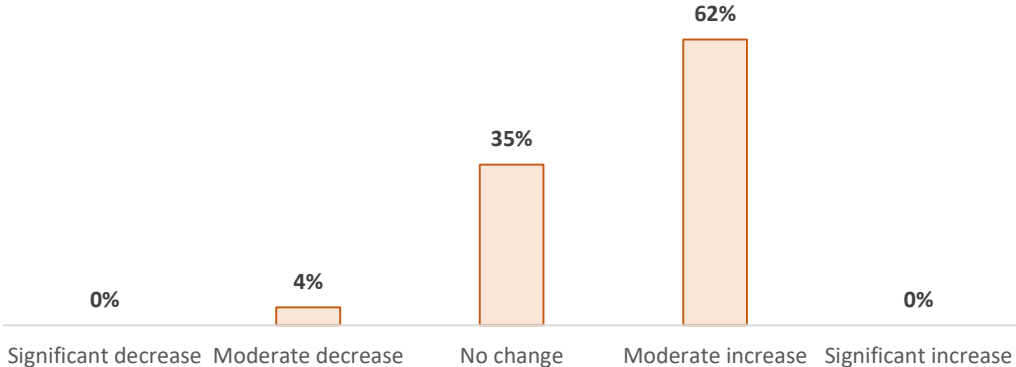
As mentioned above, demand for both mortgage and consumer loans increased in the second quarter of the current year. It was reported that digitization was the main reason of increase in demand. Compared to the first quarter of the current year, mainly small banks reported competition with other banks as the main factor affecting the decrease in demand for mortgage and consumer loans.

Chart 22. Factors affecting the change in demand for mortgage and consumer loans in Q2 2022



Finally, to assess the creditworthiness of the population, changes in the level of indebtedness of the population in the second quarter of the current year were also surveyed. 35% of the sector's banks reported that indebtedness remained unchanged, 62% stated that debt level increased moderately, and 4% reported a moderate decrease.

Chart 23. Changes in the indebtedness level of population in Q2 2022



Risk profile

According to the results of the survey, the operational and interest rate risks have increased in the sector, while fraud, liquidity and exchange rate risks have decreased. In the next quarter, mainly the interest rate risk, and compared to the second quarter, credit and liquidity risks are expected to increase, while operational risk is predicted to decrease.

Chart 24. Changes in the bank's risks in Q2 2022

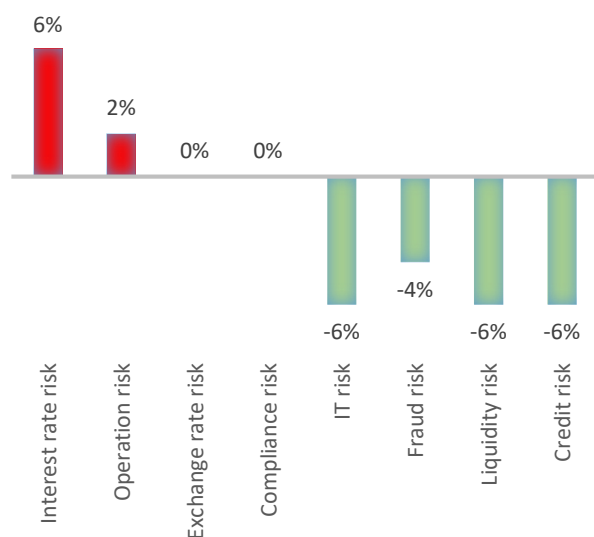
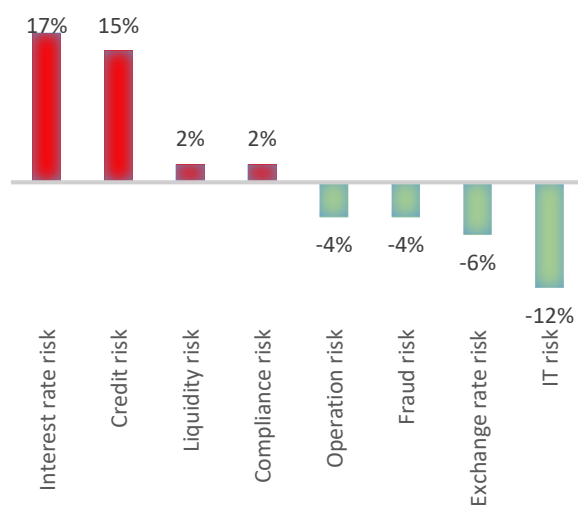
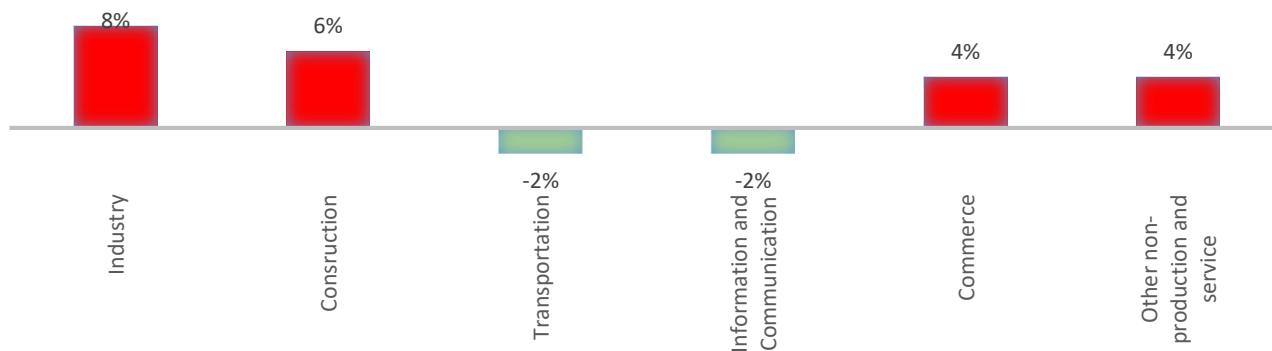


Chart 25. Changes in the bank's risks in Q3 2022



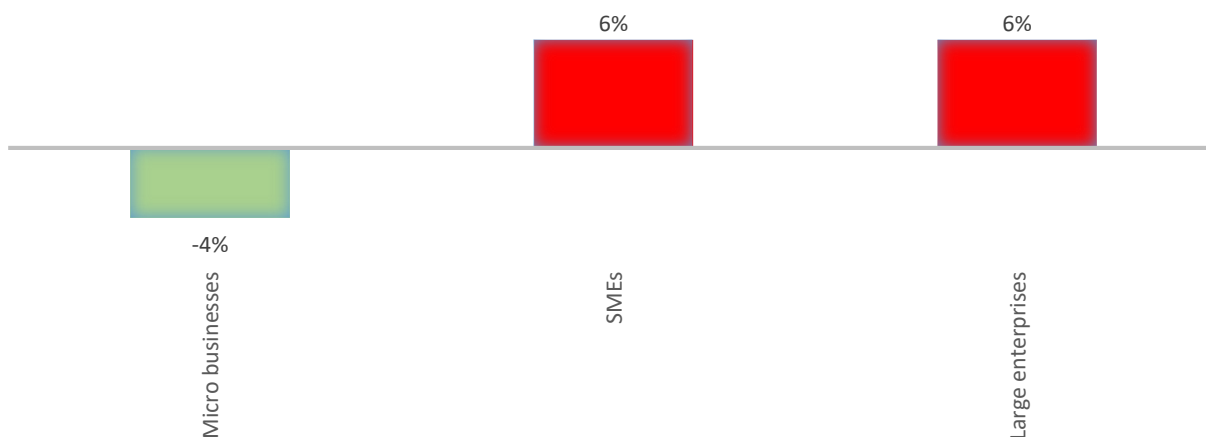
According to the results of the survey, credit risk increased in the industry, construction, commerce and other non-production and service sectors, and decreased in the transport and communication sectors.

Chart 26. Credit risk changes across economic sectors in Q2 2022



According to the results of the survey, the credit risk of businesses increased mainly in large enterprises and SMEs and decreased in micro enterprises over the last quarter.

Chart 27. Credit risk changes across businesses in Q2 2022



On contrary to the trend observed in the first quarter of the current year, banks reported an increase in the default rate across many economic sectors, as well as on SMEs and large business entities in the second quarter. The default rate in the agricultural sector decreased, there was no change in the transport, information and communication sectors, and there was an increase in the default rate of the credit portfolio in the service, industry, commerce and construction sectors. It was reported that the main increase in the default rate occurred in the service sector. As for business entities, there was a decrease in the default rate of loans to micro businesses. In general, the default rate of the credit portfolio of the sector decreased.

Chart 28. Changes in credit portfolio default rates across economic sectors in Q2 2022

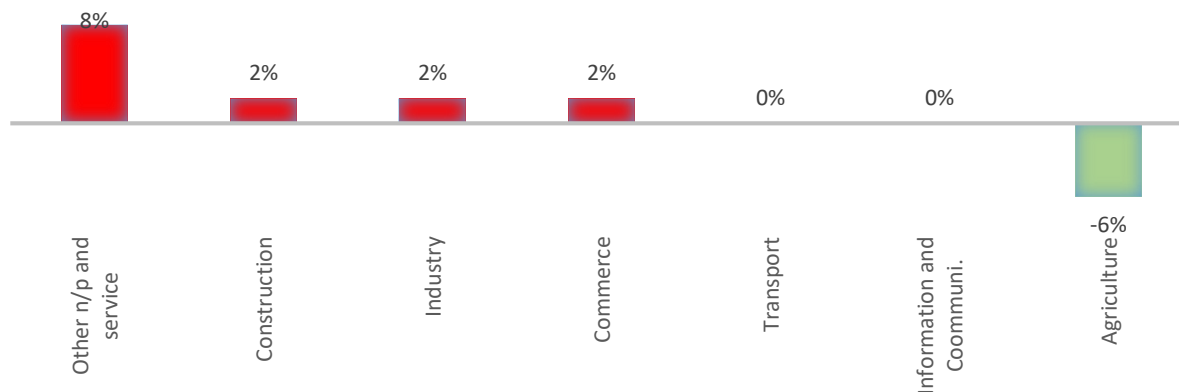
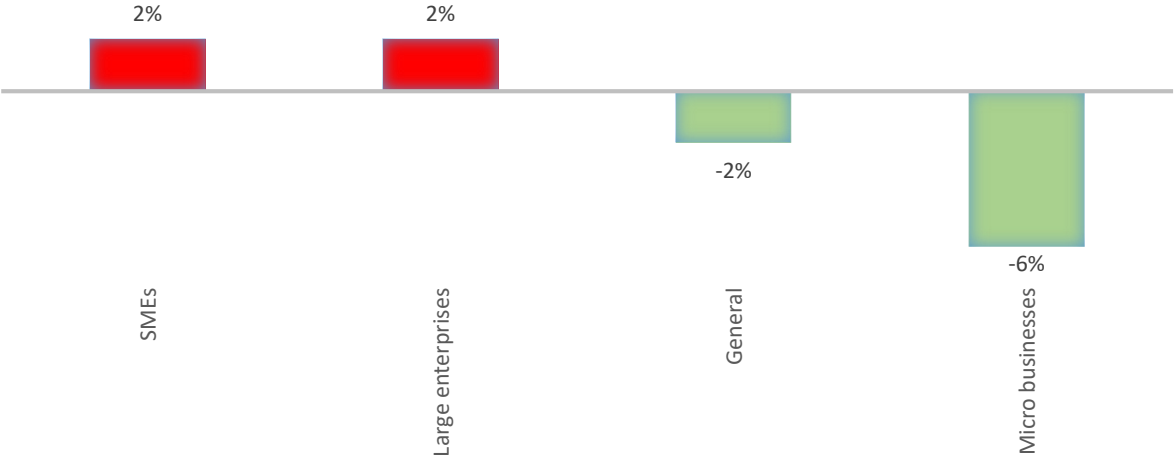
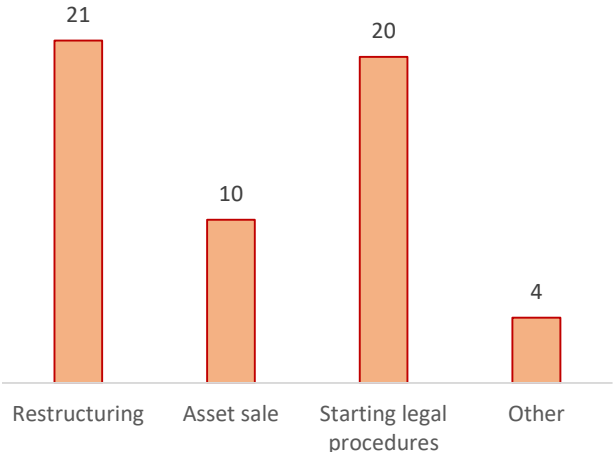


Chart 29. Changes in credit portfolio default rate across business entities in Q2 2022



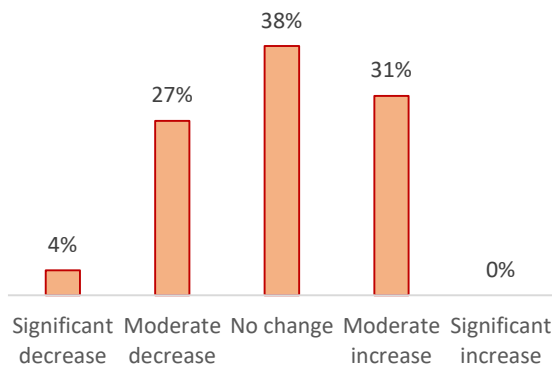
Measures taken by banks to reduce credit risks were also surveyed.

Chart 30. Mechanisms applied to decrease NPL portfolio in Q2 2022



Among the NPL resolution mechanisms, debt restructuring alongside with legal procedures were mainly utilized. Banks also reported utilization of asset sale and other methods.

Chart 31. Changes in the applicability of NPL resolution mechanism in Q2 2022



38% of banks reported no change in the applicability level of NPL resolution methods in the second quarter, 31% reported a moderate increase, 27% reported a moderate decrease and 4% reported a significant decrease.