



CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

CREDIT CONDITIONS SURVEY

2022

Q3



ACRONYMS

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

NBCI – Non-Bank Credit Institution

IT – Information Technologies

SME – Small and Medium Enterprises

LTV – Loan to value ratio

MSME – 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 varies 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 third 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

According to the results of the survey, the trend of softening of banks' credit policy continued in the third quarter of 2022. Credit policy easing occurred mostly in relation to loans granted to MSMEs. Banks forecast further easing of credit policy in the fourth quarter of the year. Banks reported that easing would mainly apply to business loan approval process. Over the past quarter, demand for business loans in foreign currencies decreased, demand for home appliance loans remained unchanged, and demand for other loans increased. The main factors contributing to the increase in loan demand were companies' working capital needs for business loans, consumer confidence and the digitalization of consumer and mortgage loans. At the same time, banks reported they expect demand for all types of loans to increase in Q4, except for business loans in foreign currency.

Business loans

Credit policy: Banks reported significant easing of credit standards applied to business loan approval process in the last quarter. The easing occurred mostly on loans granted to MSMEs. For large businesses, credit standards remained unchanged. There was a certain tightening on loans in foreign currency.

Loan demand: Banks saw a substantial increase in demand for business loans in the last quarter. The demand increased significantly for loans to small and medium businesses.

Expectations for Q4 2022: According to the survey results, credit standards for business loans are expected to be relaxed further and the demand for business loans, especially for loans to MSMEs, is expected to increase.

Mortgage loans

Credit policy: Banks relaxed credit standards significantly in the last quarter.

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

Expectations for Q4 2022: It is expected that mortgage lending standards will ease, and demand for mortgage loans will rise.

Consumer loans

Credit policy: Consumer loan approval standards, especially standards for the credit card and salary-based loans have softened over the past quarter.

Loan demand: During the last quarter, salary-based loans have been the driving force behind increased demand for consumer loans. This trend was more pronounced in large banks. The demand for home appliance loans remained unchanged.

Expectations for Q4 2022: Banks reported expectations of softening consumer credit standards and increased demand for consumer loans, especially for credit card loans.

Chart 1. Changes in credit standards for Q3 2022 *

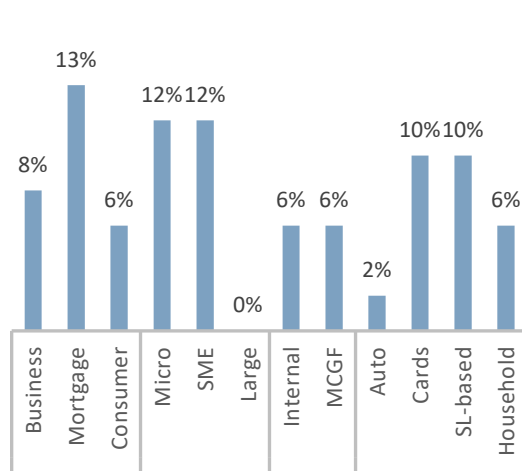


Chart 2. Expectations on credit standards for Q4 2022

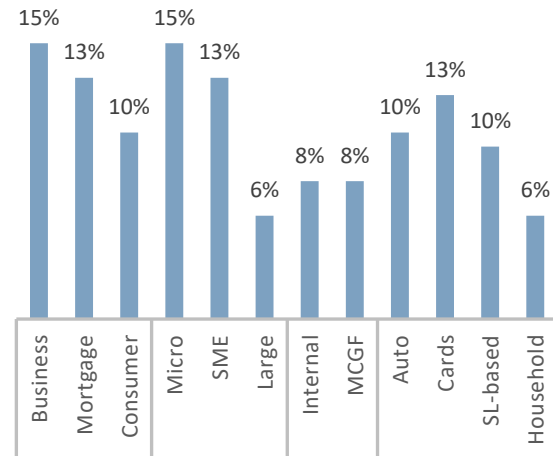


Chart 3. Changes in loan demand for Q3 2022**

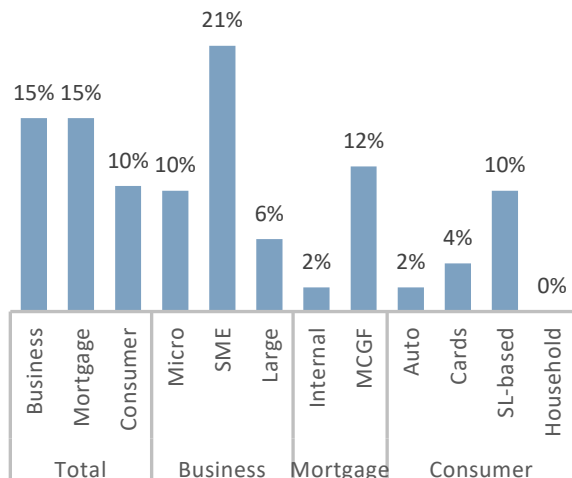
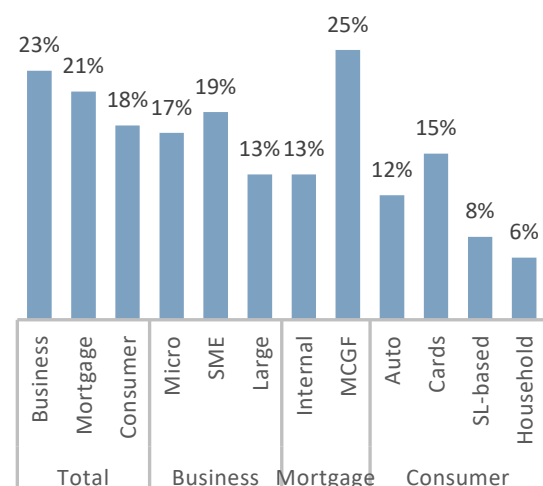


Chart 4. Expectations on loan demand for Q4 2022



*A Diffusion Index varies between [-100,+100]. A positive 100% index means that 100% of respondents reported a significant relaxation of credit standards, while negative 100% means that 100% of respondents reported a significant tightening.

**A Diffusion Index varies between [-100,+100]. A positive 100% index means that 100% of respondents reported a significant increase in loan demand, while negative 100% means that 100% of respondents reported a significant decrease.

Analysis of loans across sectors

Business loans

Business credit policy. In Q3 2022, banks relaxed credit standards for business loans, mainly in relation to the loan term. The trend is projected to strengthen further in Q4. Though the survey results indicate stricter lending policy with respect to foreign currency business loans in the third quarter, it is expected to soften in the fourth quarter.

Banks' positive expectations with regard to certain economic sectors, credit risk appetite, and quality of loan portfolio had a softening effect on credit standards, while inflation, the exchange rate, the discount rate and expectations for the economy as a whole had a tightening effect. At the same time, in contrast to the previous quarter, in Q3 2022, credit standards were tightened due to the risks associated with the quality of borrowers' collaterals and the risks of the financial condition of the banks' main creditors. Compared to last quarter, competition with other banks and the bank's liquidity position had less impact on business credit standards. Banks reported that, unlike in the previous quarter, risks associated with the collateral realization and general economic expectations led to a tightening of credit standards during Q3.

Credit conditions for business loans, including SME loans, were mostly softened in Q3 this year. The easing was mainly with respect to the interest rate on loans, margin on low-risk loans, commission and collateral conditions. In contrast to the previous quarter, the restrictive criteria did not change.

Compared with the second quarter of this year, credit conditions for loans to large and micro enterprises have become relatively more stringent.

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

(Diffusion Index: positive = softening, negative = tightening)

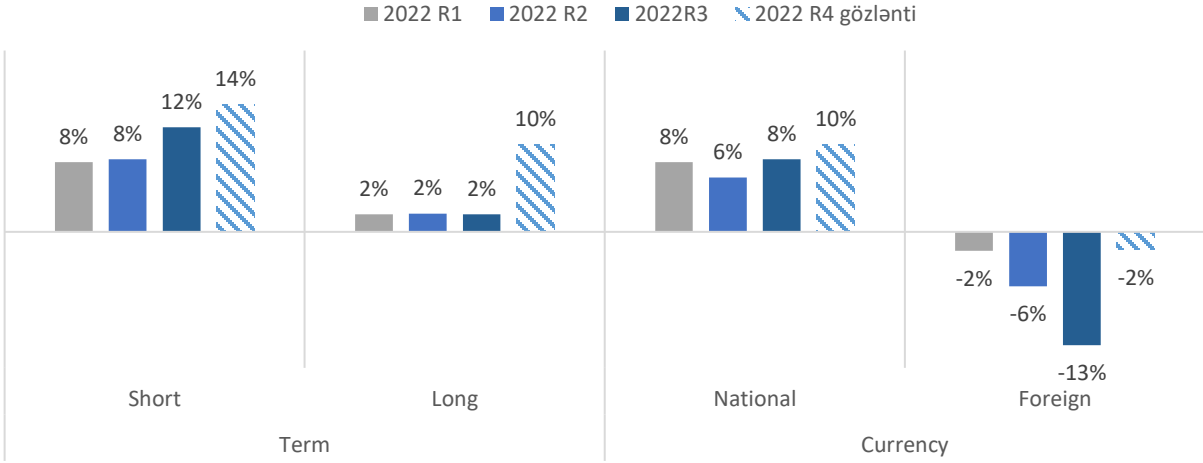


Chart 6. Factors affecting credit standards for business loans

(The Diffusion Index: positive = softening, negative = tightening)

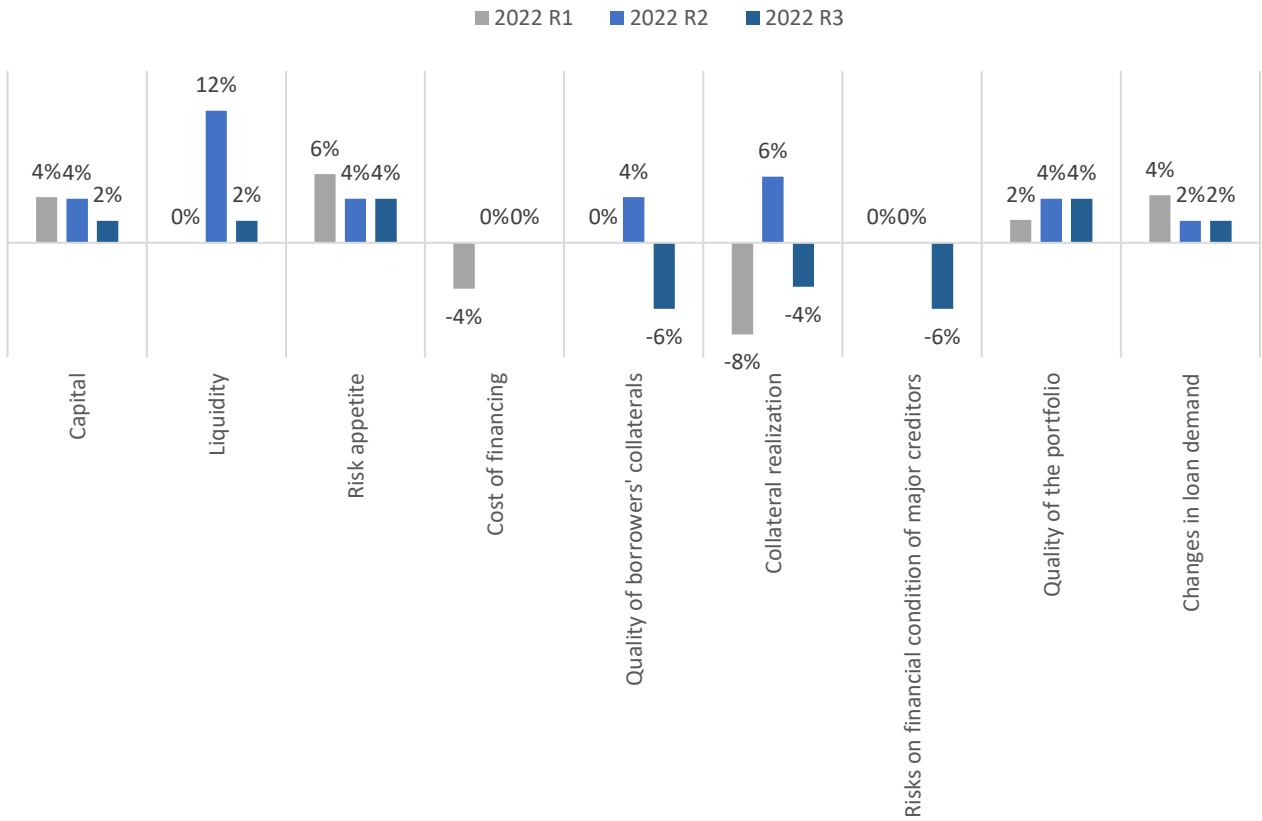


Chart 7. Factors affecting credit standards for business loans

(Diffusion Index: positive = softening, negative = tightening)

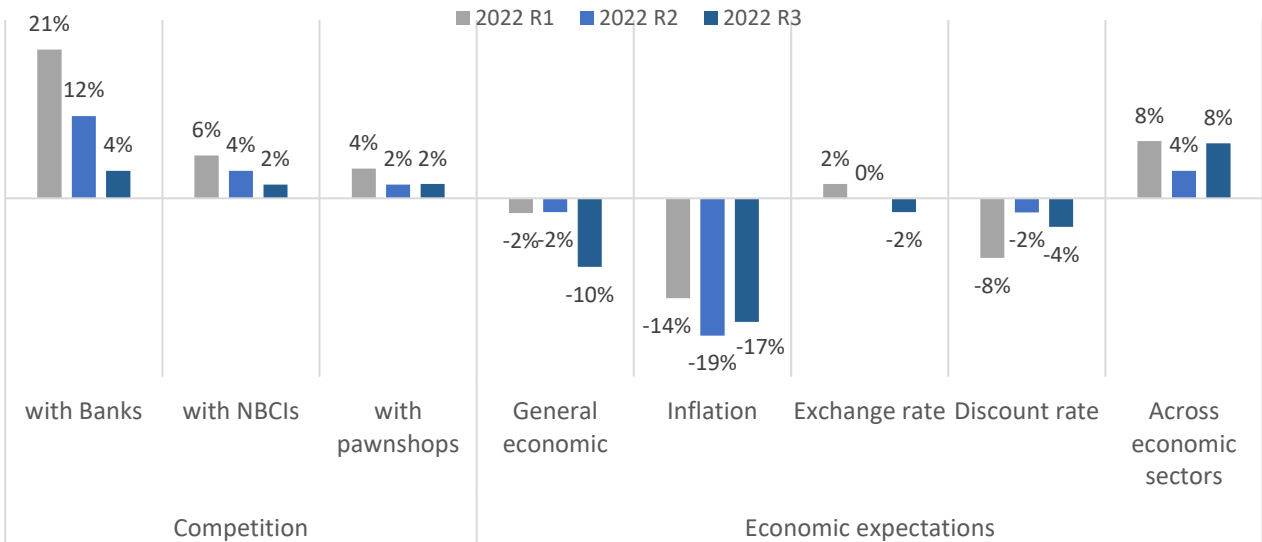


Chart 8. Factors affecting credit standards for loans to SMEs

(Diffusion Index: positive = softening, negative = tightening)

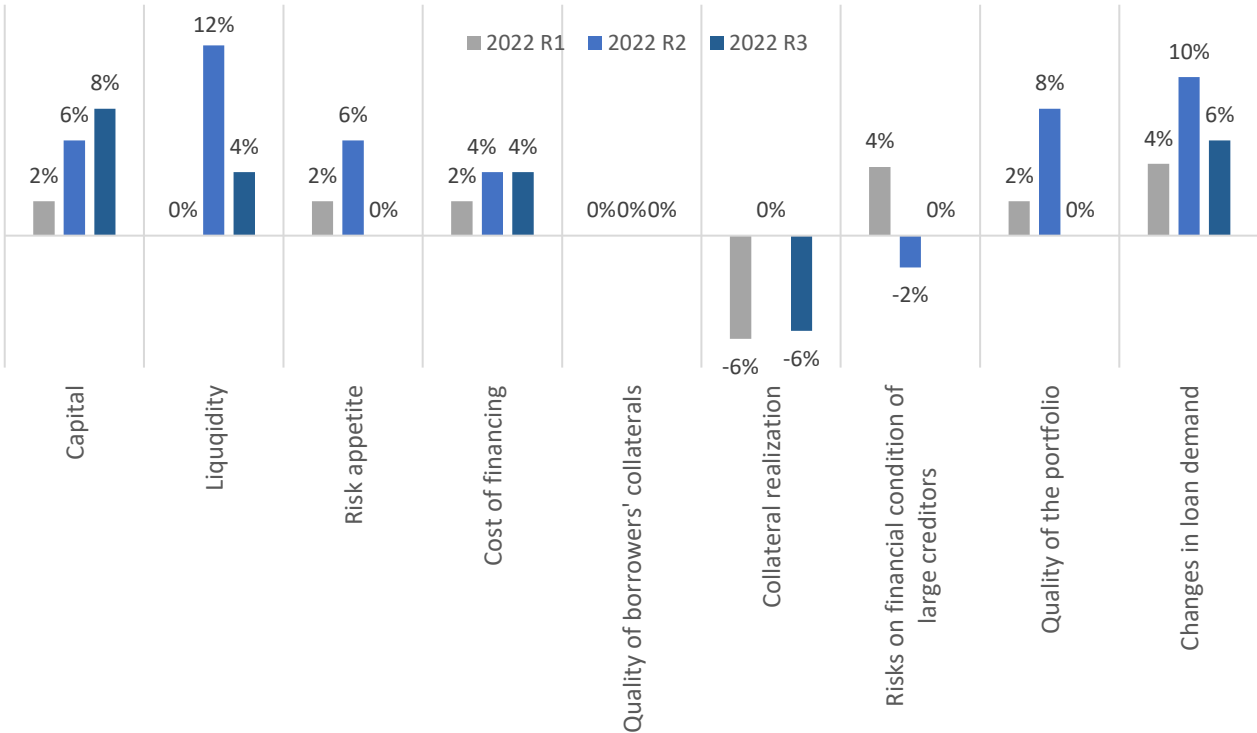


Chart 9. Factors affecting credit standards for loans to SMEs

(Diffusion Index: positive = softening, negative = tightening)

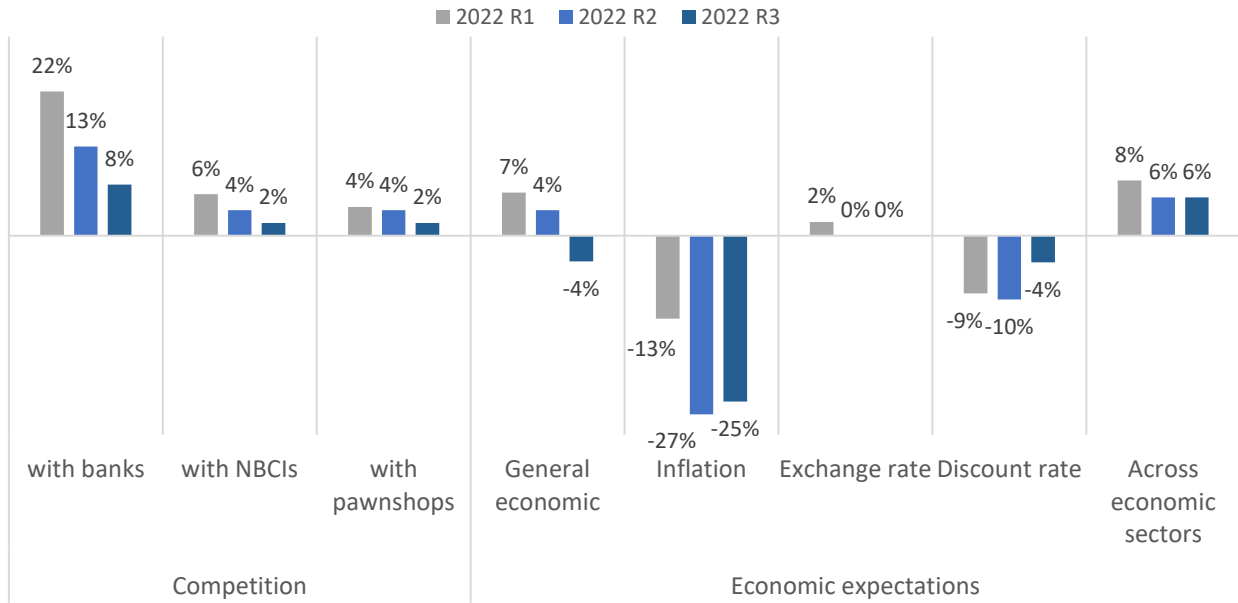


Chart 10. Changes in credit conditions for business loans

(Diffusion Index: positive = softening, negative = tightening)

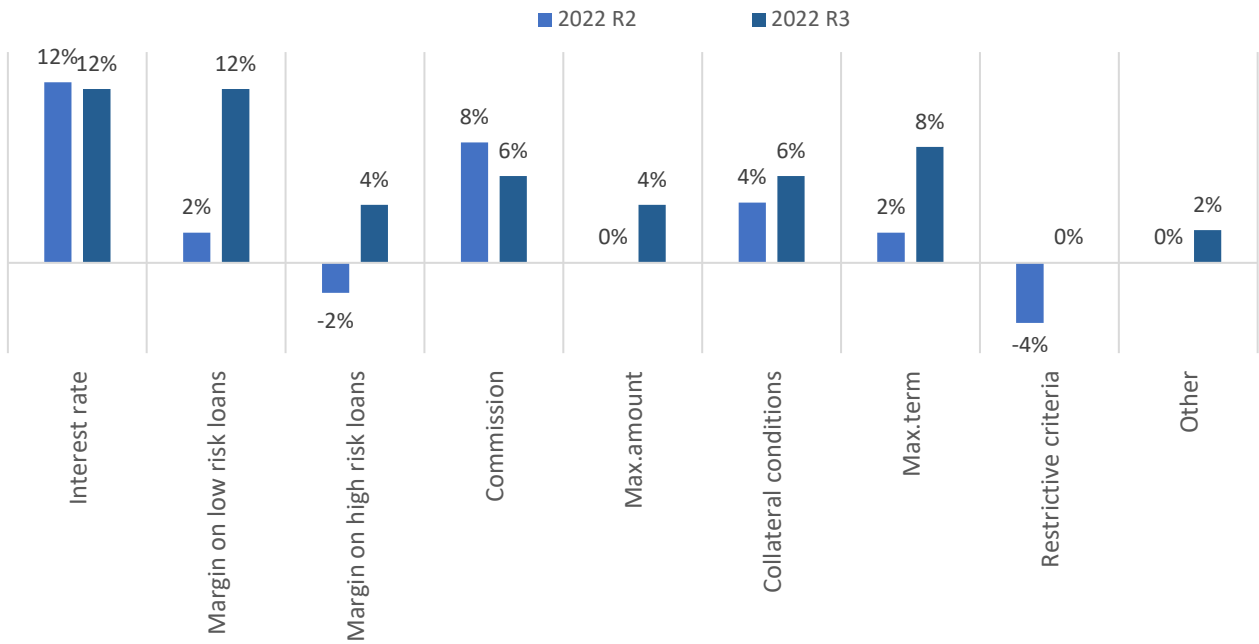


Chart 11. Changes in credit conditions for loans to SMEs

(Diffusion Index: positive = softening, negative = tightening)

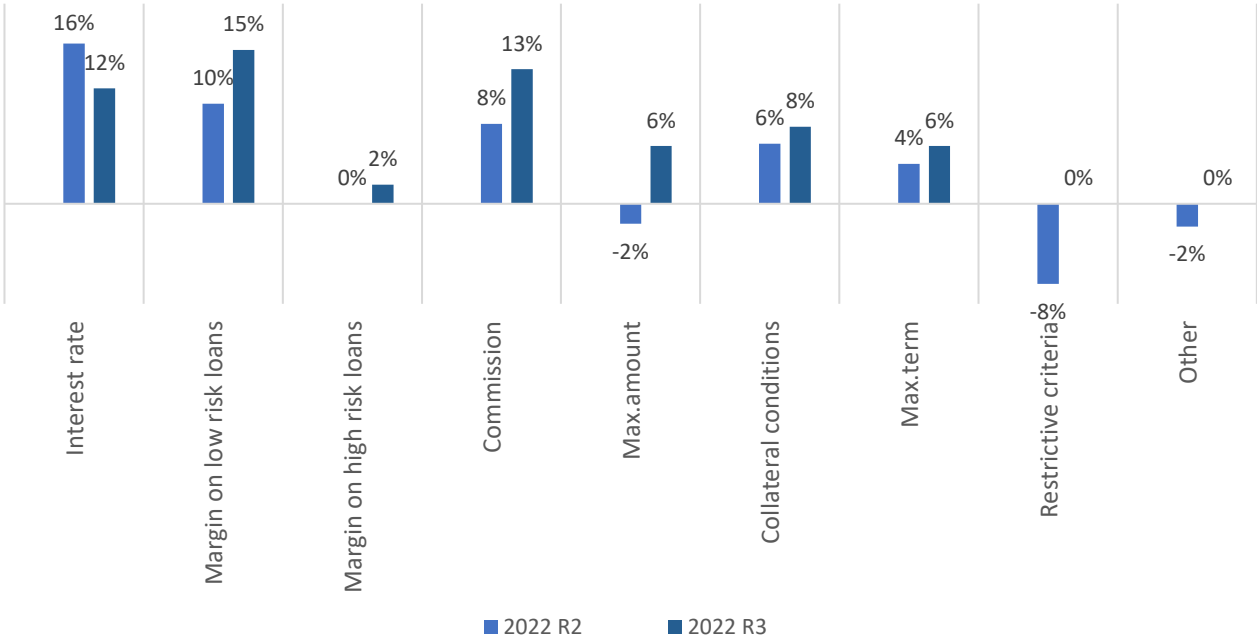


Chart 12. Changes in terms and conditions on loans to large enterprises

(Diffusion Index: positive = softening, negative = tightening)

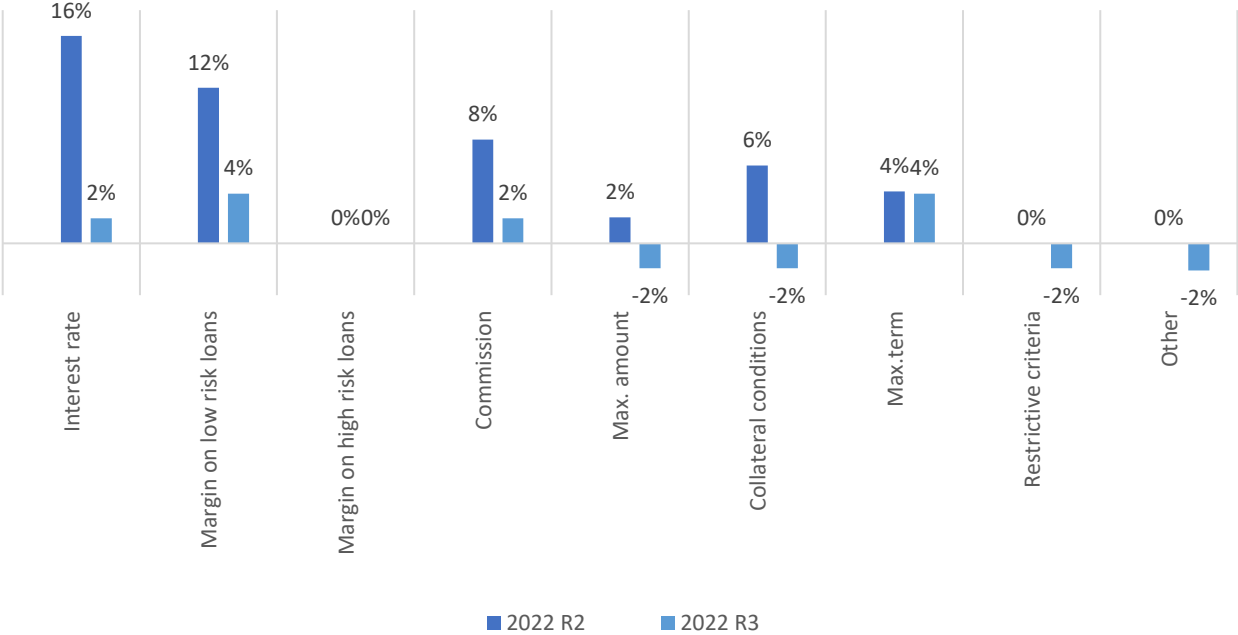
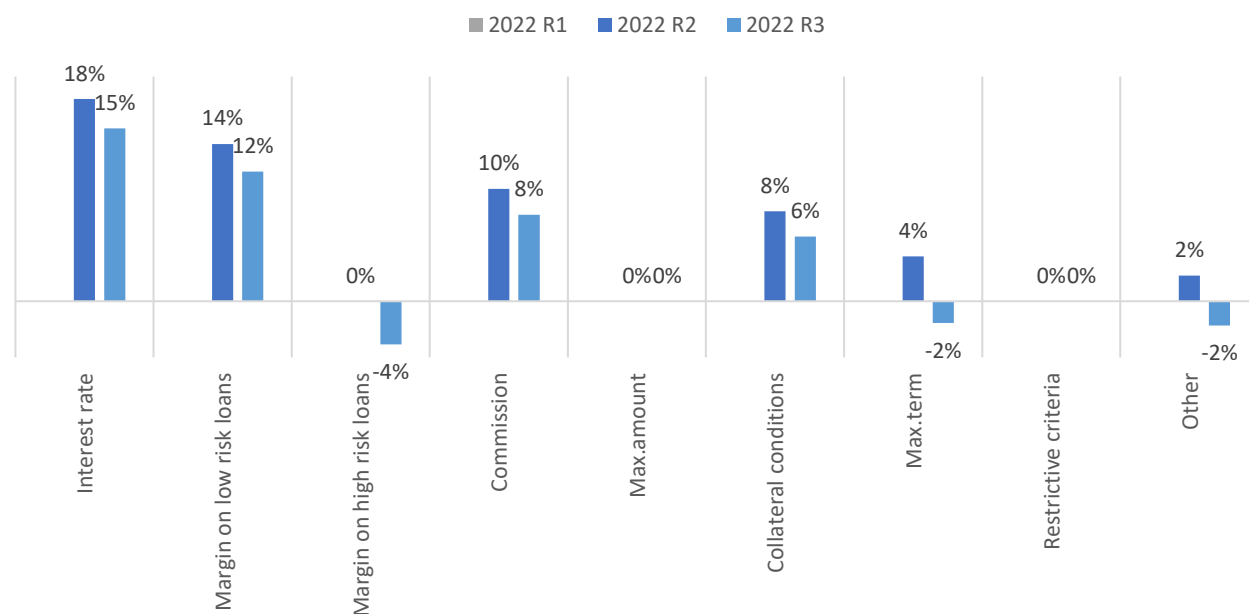


Chart 13. Changes in terms and conditions on loans to micro enterprises

(Diffusion Index: positive = softening, negative = tightening)



Business loan demand. Banks reported an increase in demand for short-term loans in local currency and a decline in demand for loans in foreign currency in the third quarter. Banks expect an increase in demand for long-term loans in Q4 2022, while the current downward trend in demand for loans in foreign currency is expected to continue.

In Q3 2022, the main factors influencing an increase in demand for business loans were the working capital needs of business entities, investment capital needs, digitalisation and the interest rate. At the same time, unlike last quarter, obtaining loans from other banks and NBCIs for businesses, obtaining loans from NBCIs for SMEs had a decreasing effect on demand.

In order to assess the creditworthiness of the business sector, the survey also covered changes in the indebtedness level of businesses in the third quarter of the current year. According to the results of the survey, the level of indebtedness of MSMEs increased, while the level of indebtedness of large enterprises decreased.

Chart 14. Changes in demand for business loans

(Diffusion Index: positive = increase, negative = decrease)

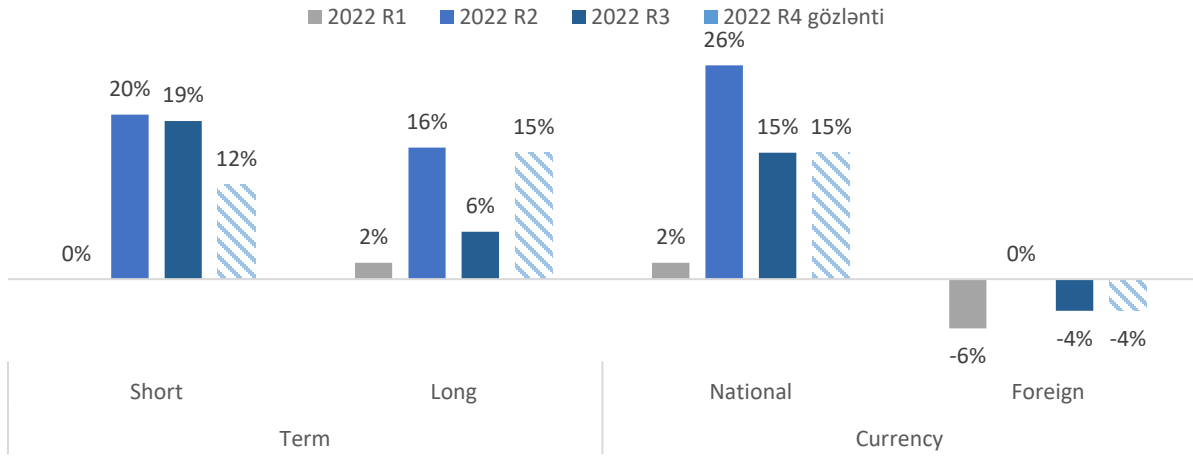


Chart 15. Factors affecting the demand for business loans

(Diffusion Index: positive = increase, negative = decrease)

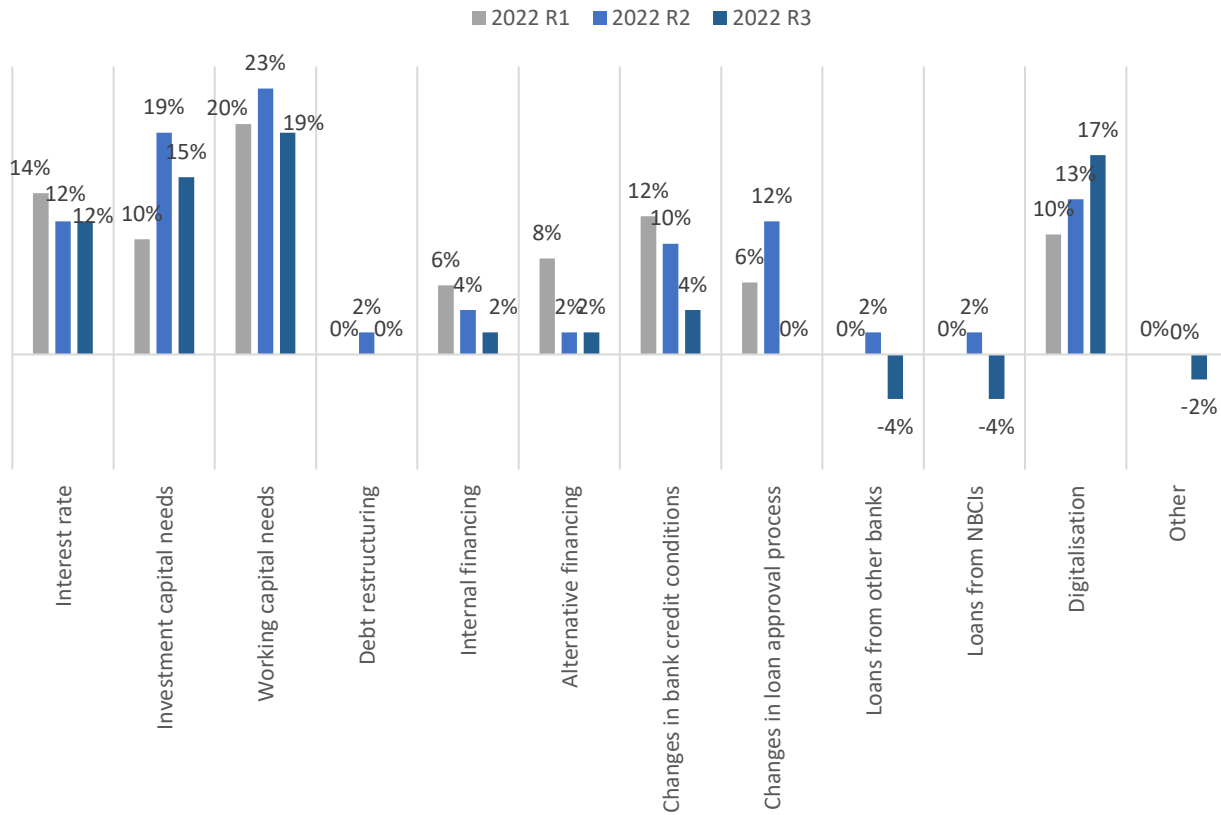


Chart 16. Factors affecting the demand for loans to SMEs

(Diffusion Index: positive = increase, negative = decrease)

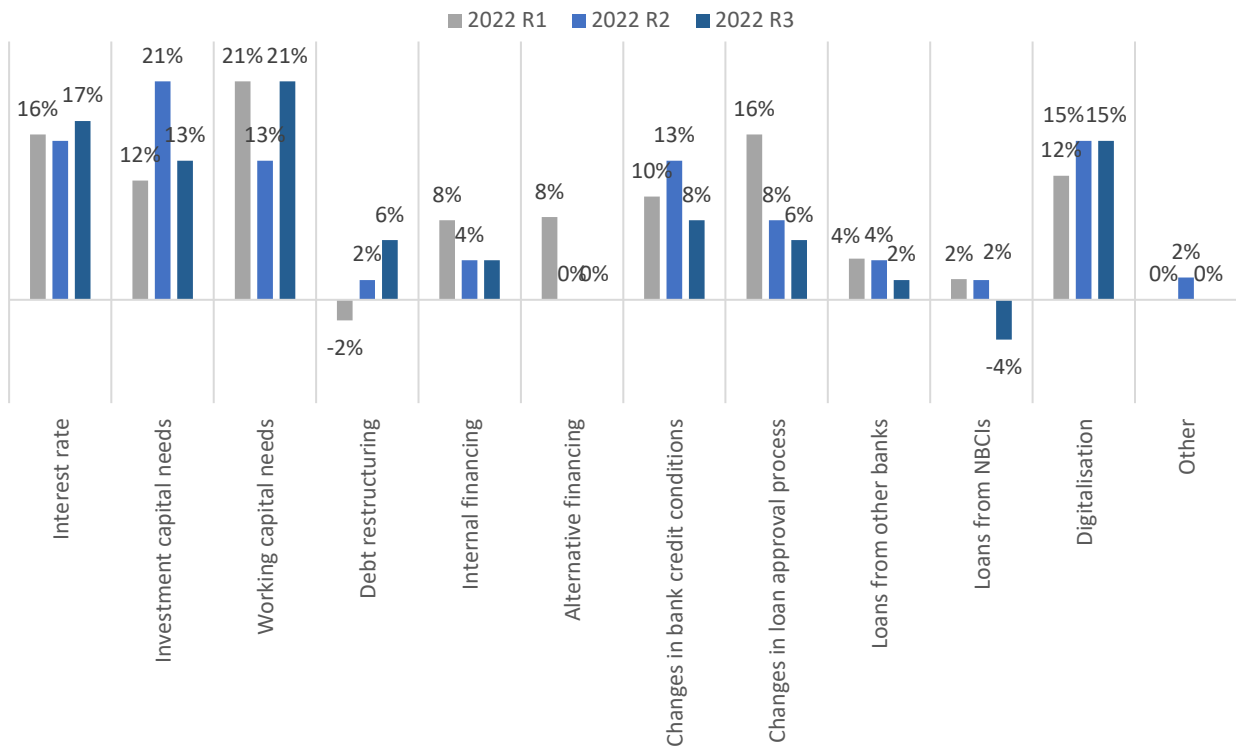
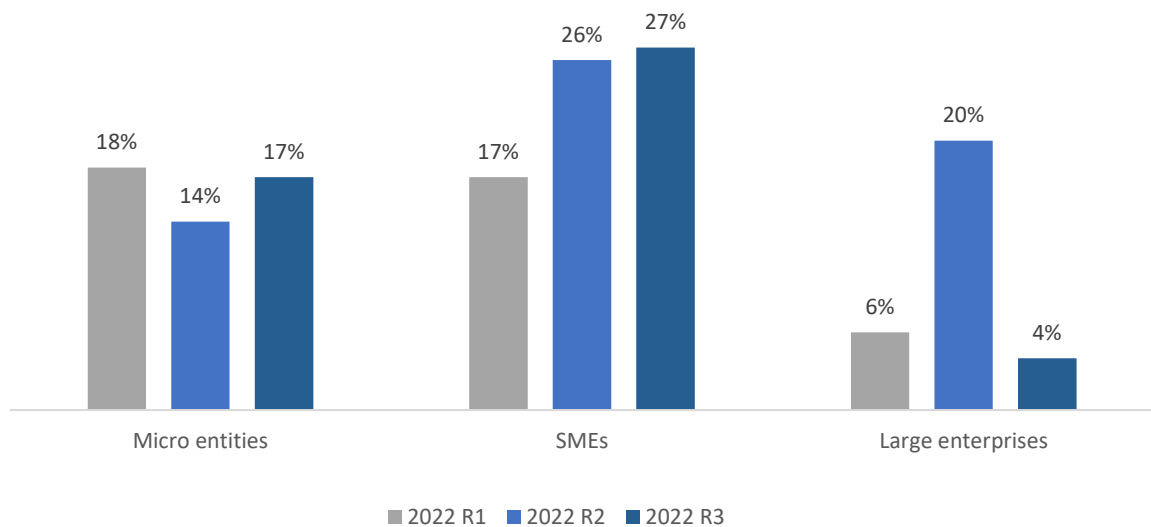


Chart 17. Changes in indebtedness level of business entities

(Diffusion Index: positive = increase, negative = decrease)



Mortgage and consumer loans

Mortgage and consumer credit policy. The competitive environment in the sector played a key role in easing mortgage lending standards. The fact that banks' liquidity levels are in the comfort zone also had a softening impact on standards for mortgage loans in the third quarter of the current year. Expectations of inflation, exchange rate stability, solvency of the population and collateral risk have tightened mortgage credit standards. In contrast to Q1 and Q2 of this year, the impact of banks' capital position on mortgage credit standards remained unchanged.

Economic expectations and the existing and expected capital position of banks act as main factors that have a softening effect on consumer lending standards. The tightening effect of the population's ability to pay and inflation expectations on the consumer portfolio was lower than in previous quarters.

Banks softened mortgage and consumer loans mainly in terms of interest rates.. Except for the commissions, terms and conditions for the mortgage loans have been relaxed more than for other types of loans. In Q3 2022 as opposed to the previous two quarters the maximum duration of consumer loans acts as a factor tightening credit conditions.

Chart 18. Factors affecting credit standards for mortgage loans

(Diffusion Index: positive = softening, negative = tightening)

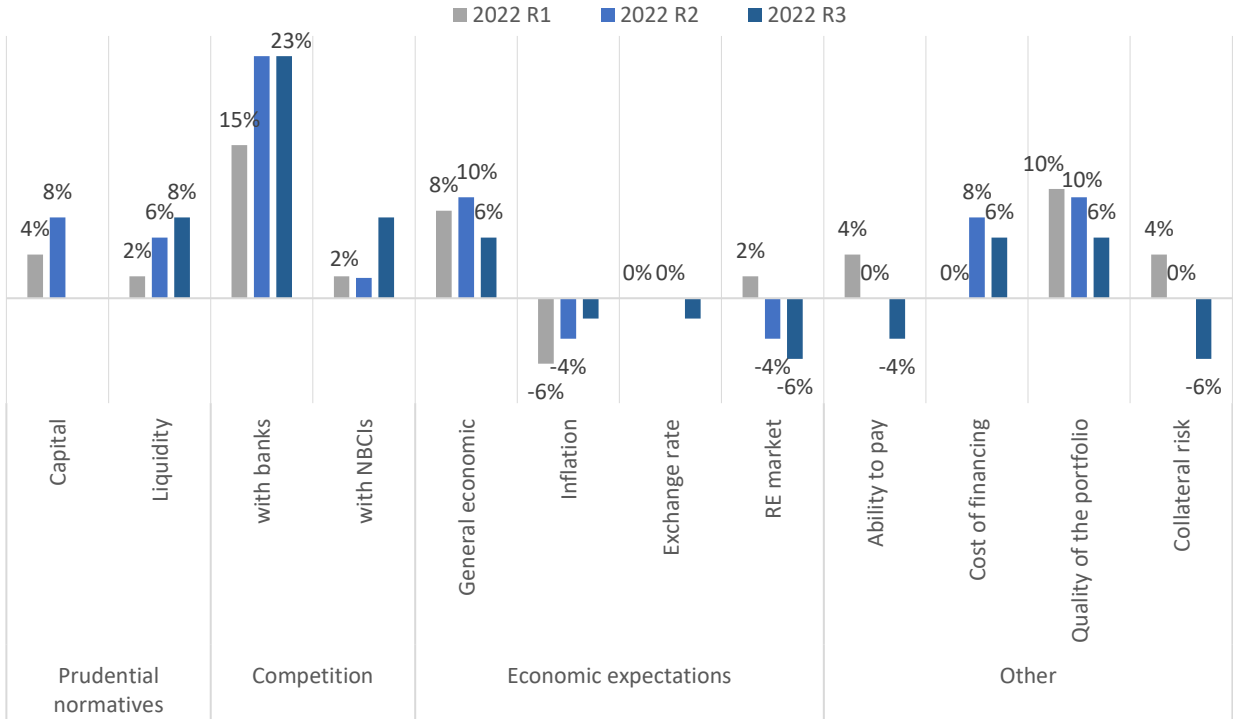


Chart 19. Factors affecting credit standards for consumer loans

(Diffusion Index: positive = softening, negative = tightening)

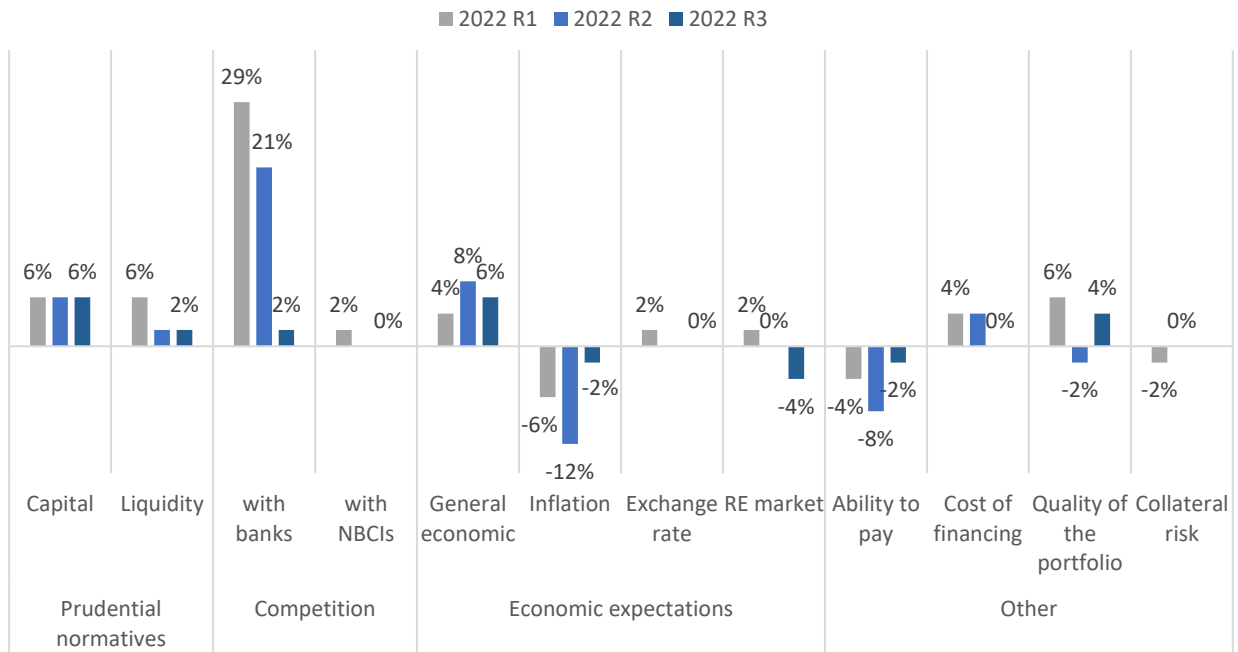


Chart 20. Changes in terms and conditions of mortgage loans

(Diffusion Index: positive = softening, negative = tightening)

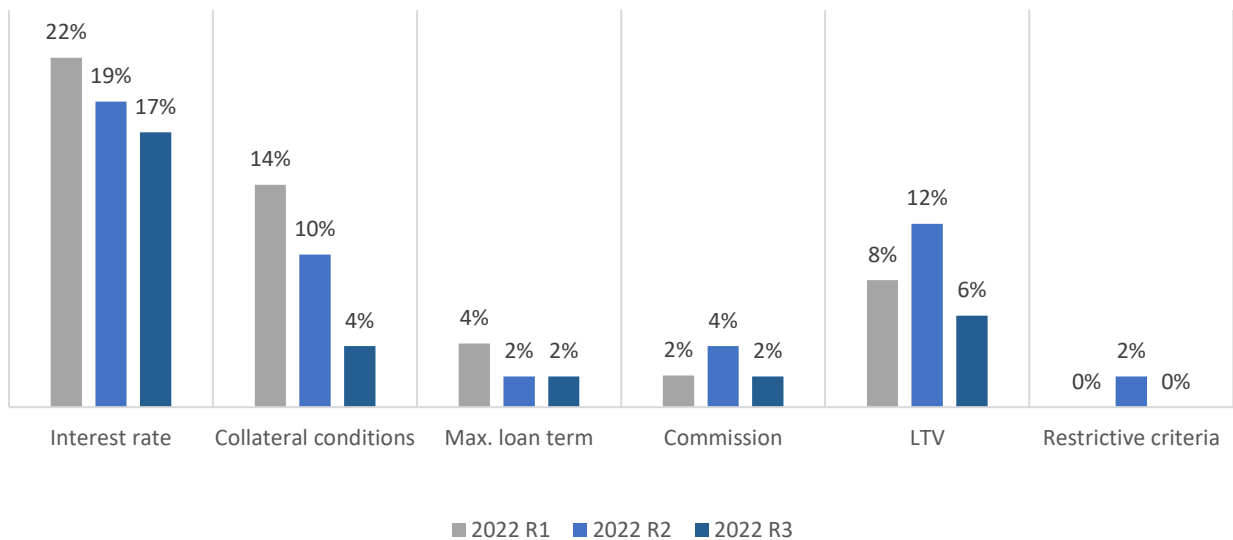
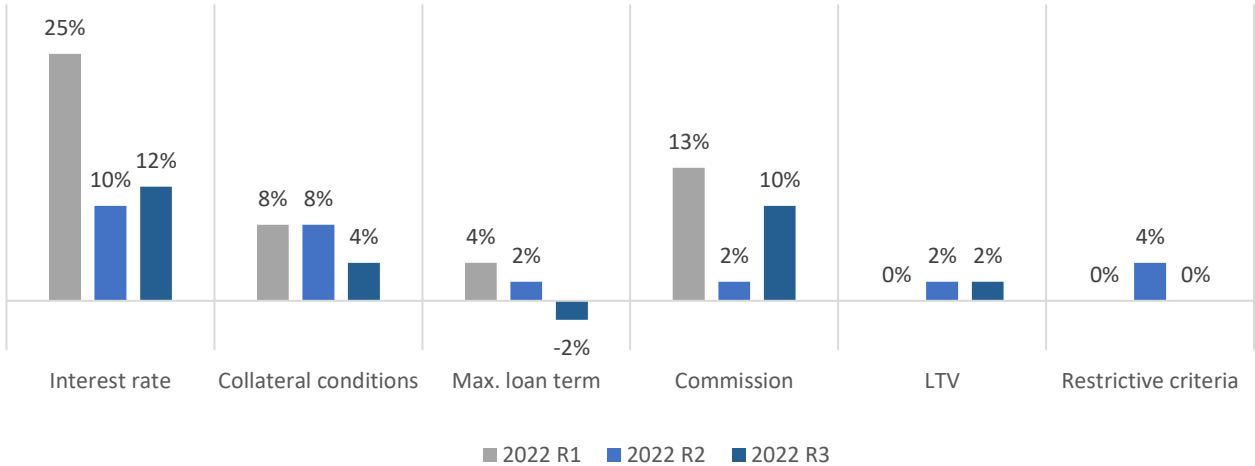


Chart 21. Changes in terms and conditions of consumer loans

(Diffusion Index: positive = softening, negative = tightening)

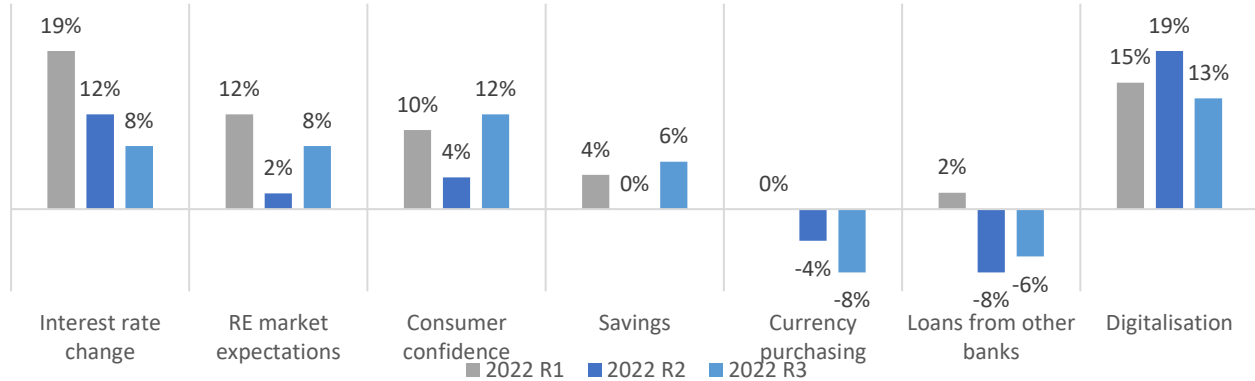


Mortgage and consumer loan demand. In the third quarter of 2022, there was a stronger growth in demand for mortgage loans than in the previous quarter. The growth in demand for consumer loans was relatively slow. Consumer confidence and digitalisation were cited as the main reasons for the increase in demand. Compared with the previous quarter, smaller banks reported competition with other banks as the main factor affecting the decrease in demand for mortgage and consumer loans.

Finally, to assess the creditworthiness of the population, changes in the level of indebtedness of the population during the second quarter of the current year were also surveyed. 50% of the sector’s banks reported that indebtedness remained unchanged, 38% reported a moderate increase in indebtedness levels, and 12% reported a moderate

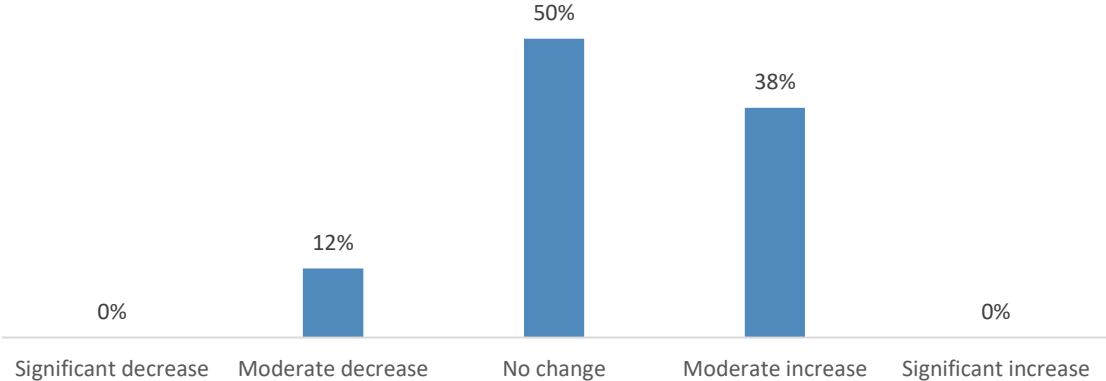
Chart 22. Factors affecting the change in demand for mortgage and consumer loans

(Diffusion Index: positive = increase, negative = decrease)



decrease.

Chart 23. Changes in the indebtedness level of population in Q3 2022



Risk profile

According to the survey results there has been a decrease in credit, exchange rate and operational risks in the banking sector. There have not been major changes in other risks. Interest rate risk is expected to remain unchanged in the next quarter, while other risks are predicted to decrease.

According to the results of the survey, credit risk increased in the industry and agriculture, and decreased in the trade, transport and other non-production sectors.

As per the survey results, a decrease in credit risk of business entities during the last quarter was mainly driven by MSMEs. However, negligibly, credit risk of large enterprises has also decreased as opposed to the increase in the credit risk observed during the last two quarters.

In contrast to the trend observed in the second quarter of this year, during the third quarter, the loan portfolio default rate in sectors of the economy other than industrial sector has decreased. The banks also reported a decrease in loan portfolio default rate of MSMEs and large businesses. It was reported that the main decline in the loan portfolio default rate occurred in transport and services sectors. In general, default rate of the banking sector's loan portfolio has decreased.

The survey also covered the measures taken by banks to reduce credit risks.

Thus, in Q3 2022, the most widely used mechanism for reducing the NPL portfolio was the initiation of legal proceedings as in previous periods. Banks also reported the use of restructuring, asset sale and other methods.

54% of banks reported no change in the applicability level of NPL resolution methods in the third quarter, 27% reported a moderate increase, while 19% reported a moderate decrease.

Chart 24. Changes in the banks' risks***

(Diffusion Index: positive = increase, negative = decrease)

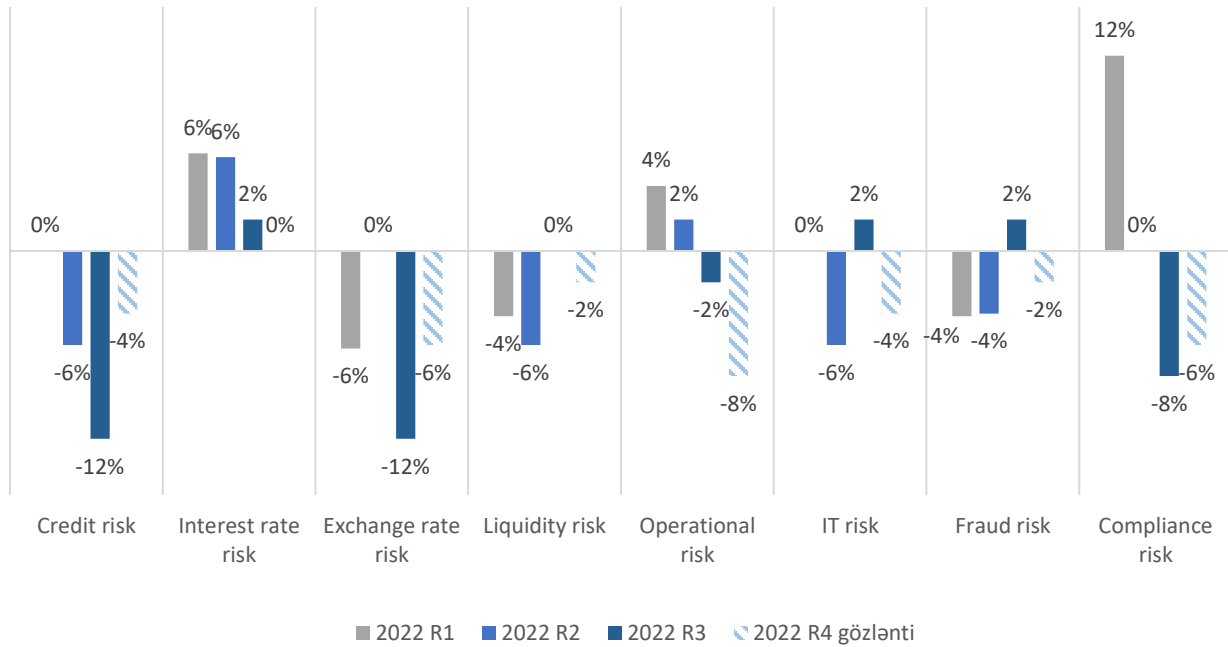
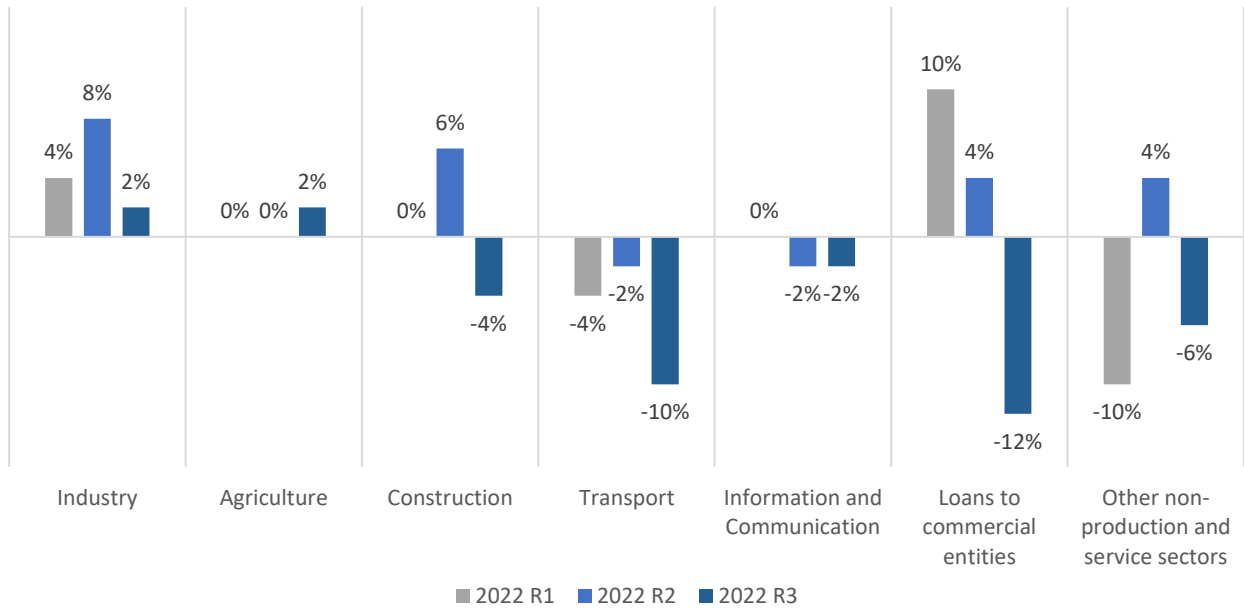


Chart 25. Credit risk changes across sectors

(Diffusion Index: positive = increase, negative = decrease)



*** A Diffusion Index varies between [-100,+100]. A positive 100% implication indicates that 100% of respondents reported a significant increase in loan demand, while a negative 100% implication indicates a significant decrease.

Chart 26. Credit risk changes across business entities

(Diffusion Index: positive = increase, negative = decrease)

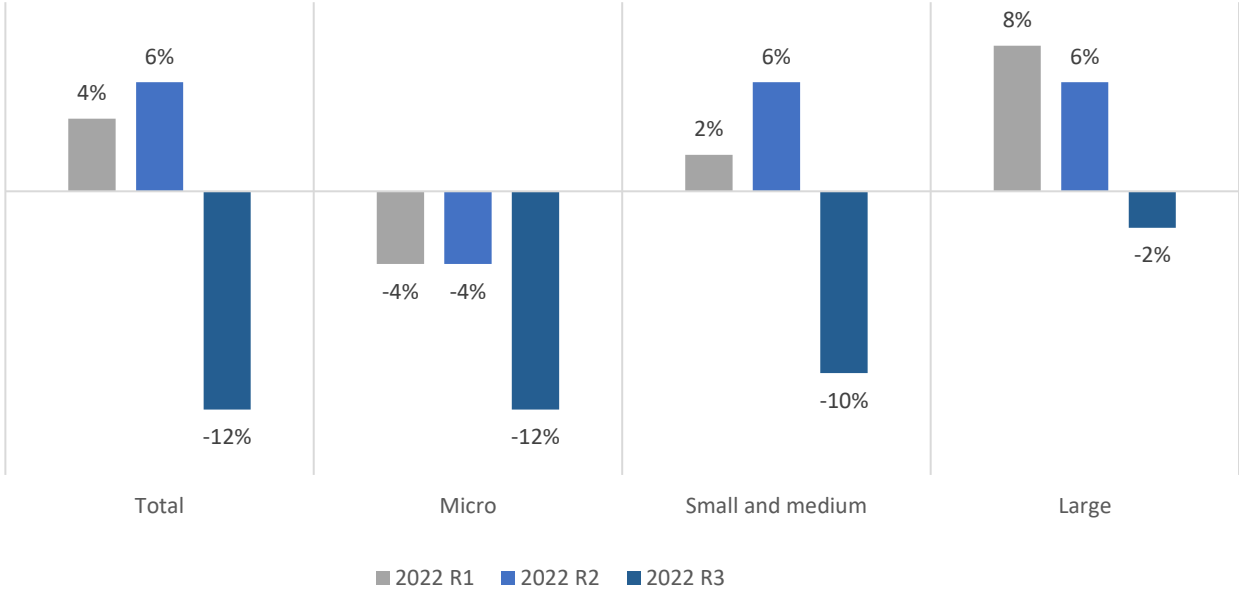


Chart 27. Changes in credit portfolio default rates across economic business entities in Q3 2022

(Diffusion Index: positive = increase, negative = decrease)

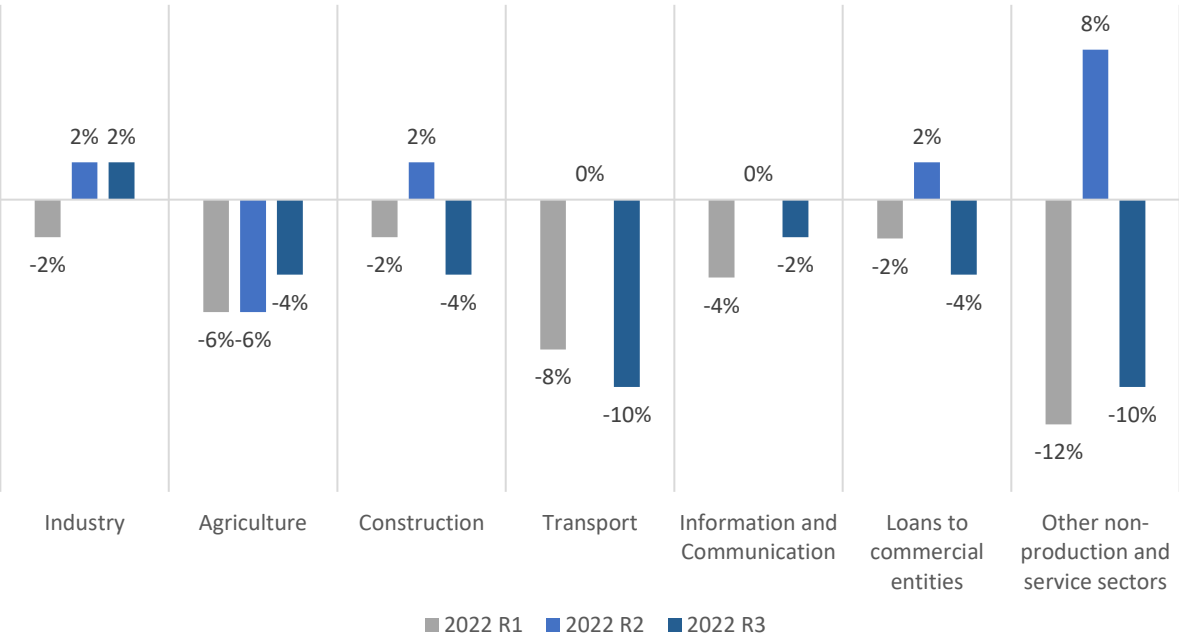


Chart 28. Changes in credit portfolio default rate across business entities

(Diffusion Index: positive = increase, negative = decrease)

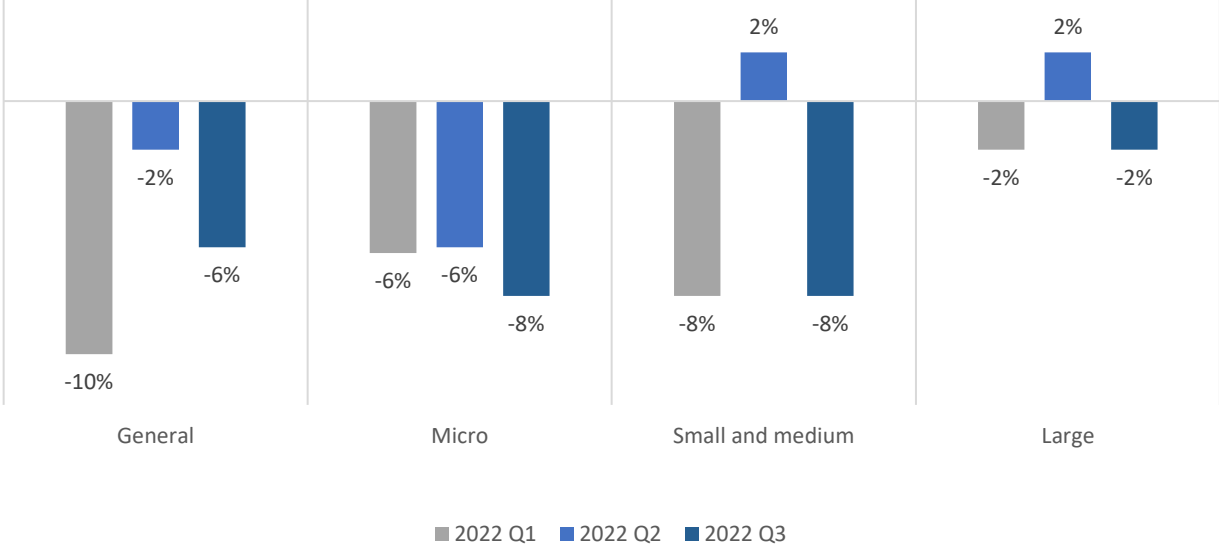


Chart 29. Mechanisms applied to decrease NPL portfolio in Q3 2022

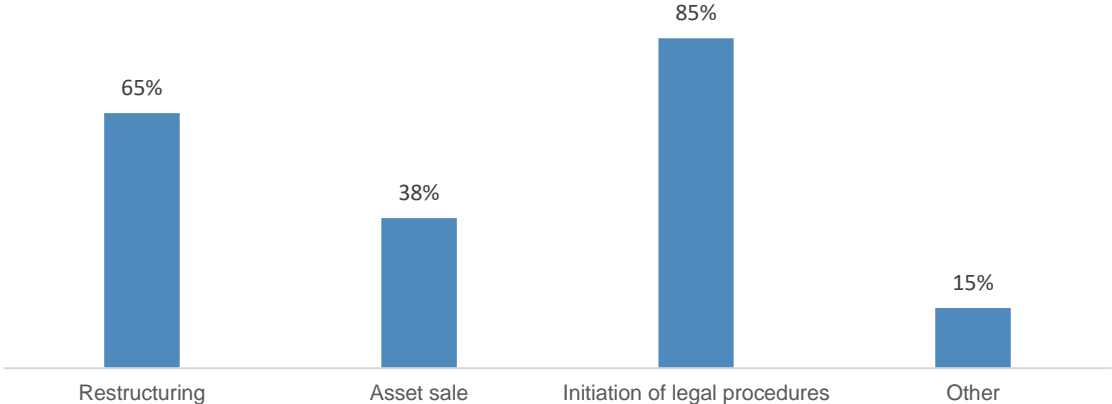


Chart 30. Changes in the applicability of NPL resolution mechanism in Q3 2022

