



CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

CREDIT CONDITIONS SURVEY

2022 Q1

No1

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

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INTRODUCTION

The aim of the survey is to provide monitoring and analysis of bank lending, 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. The bank lending survey includes an assessment of supply and demand factors with respect to business, consumer and mortgage lending, 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 bank lending survey is addressed to banks' senior loan officers or the members of the Management Board responsible for the relevant area.

The survey will be conducted on a quarterly basis starting from the first quarter of 2022. The current report includes the results of the survey for the first 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 bank lending survey show that banks eased their credit policy in the first quarter of the current year. The easing of credit policy took place mainly in the case of consumer and mortgage loans. At the same time, there is a growing demand for all types of loans, especially for mortgage and consumer 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 second quarter of 2022. Banks reported that the easing would apply mainly to mortgage and business loans approval process. At the same time, banks expect an increase in demand for all types of loans in the second quarter.

Business loans

Credit policy. Banks reported a considerable easing of credit standards applied to business loans approval process over the Quarter 1. The easing occurred mainly on loans granted to micro business enterprises. There was a certain tightening on loans in foreign currency. Larger banks have also tightened standards on long-term loans and loans to large enterprises.

Loan demand. The demand for business loans has increased over the last quarter. The demand has increased mainly on micro business enterprises in banks with a higher market share.

Expectations for Q2 2022. It is expected that the current trend will continue, credit standards will be eased in relation to MSMEs, and loan demand will increase, mainly from MSMEs.

Mortgage loans

Credit policy. Banks eased credit standards in the last quarter. The easing of credit standards for internal mortgage lending by large banks was more significant than that for MCGF loans.

Loan demand. The demand for mortgage loans increased over the last quarter. The demand increased mainly for the loans granted at the expense of the MCGF.

Expectations for Q2 2022. It is expected that the current trend will continue, the standards applied to both types of mortgage loans, especially to mortgage loans issued at the expense of the MCGF will further soften, and the demand for these loans will increase even more.

Consumer loans

Credit policy. Standards for consumer loans, especially salary-based loans approval standards, have been eased over the past quarter. The easing was mainly carried out by large banks. At the same time, banks reported that they expect the demand for consumer loans to increase in the next quarter. Major 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 Q1 2022

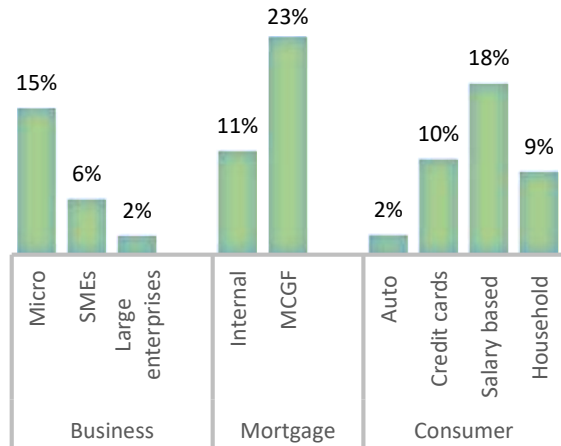


Chart 2. Expectations on credit standards for Q2 2022

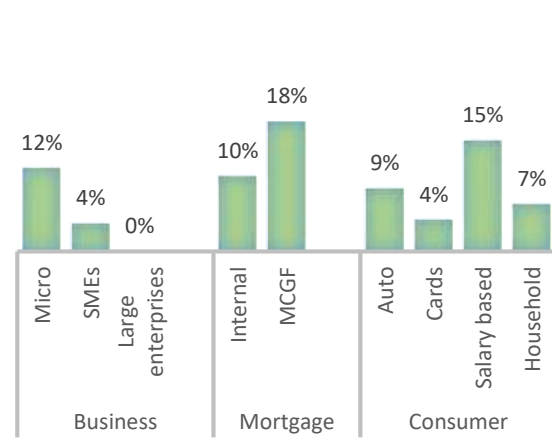


Chart 3. Changes in loan demand for Q1 2022

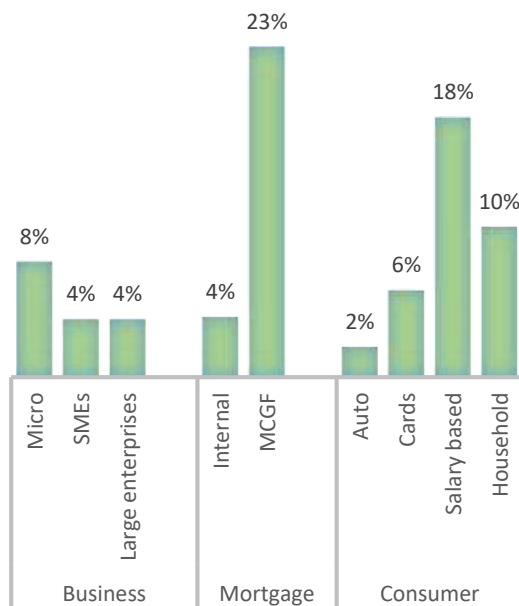
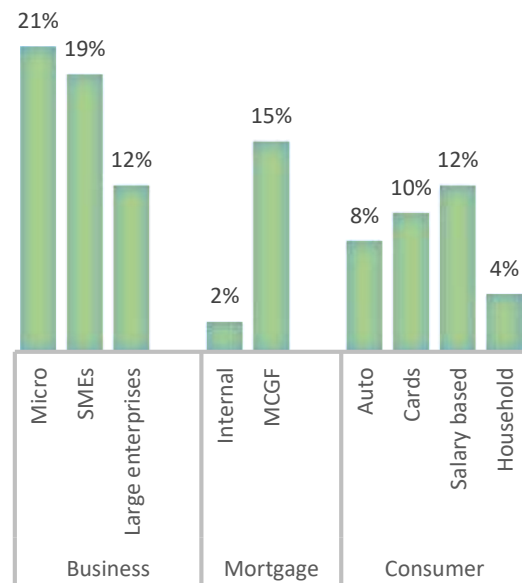


Chart 4. Expectations on loan demand for Q2 2022



ANALYSIS OF LOANS ACROSS SECTORS

Business loans

Chart 5. Changes in term and currency standards for business loans in Q1 2022

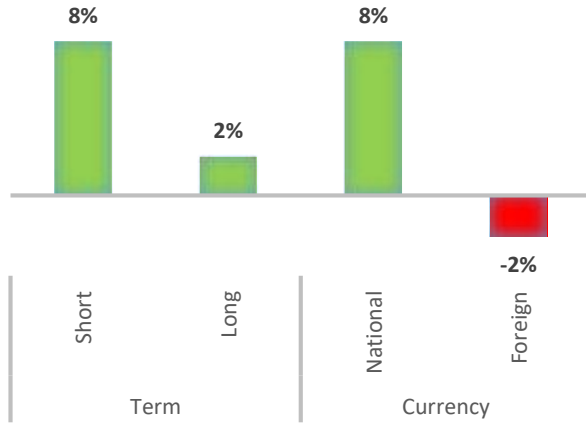
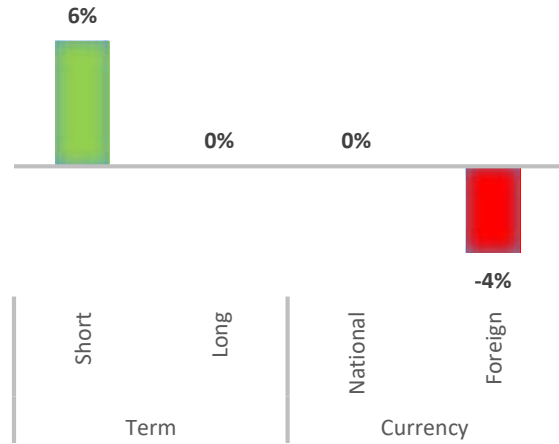
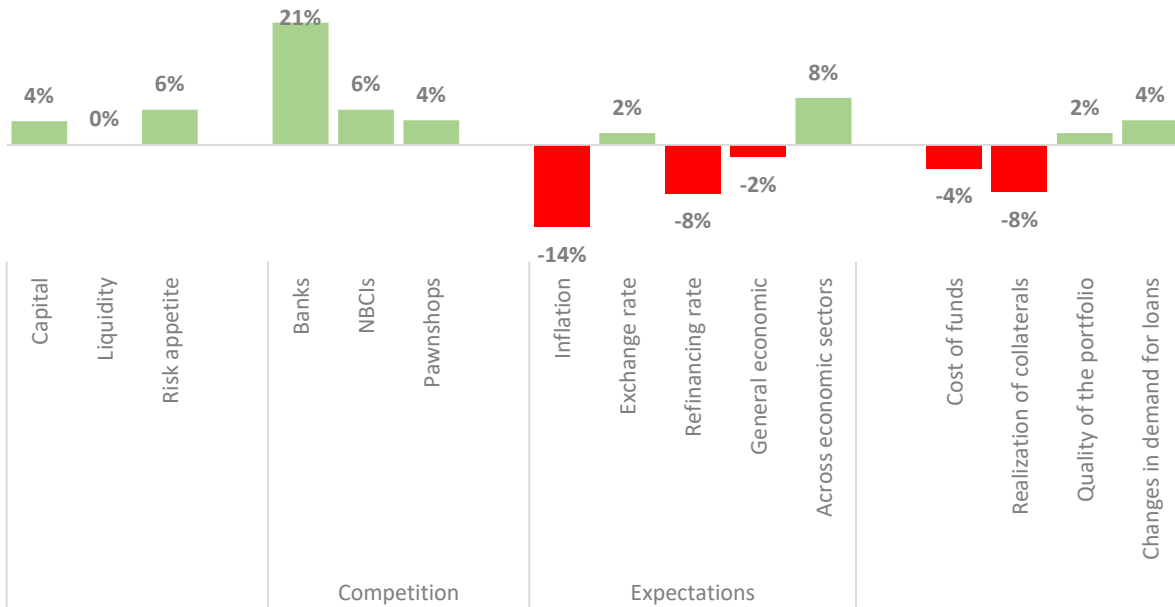


Chart 6. Expectations on term and currency standards for business loans in Q2 2022



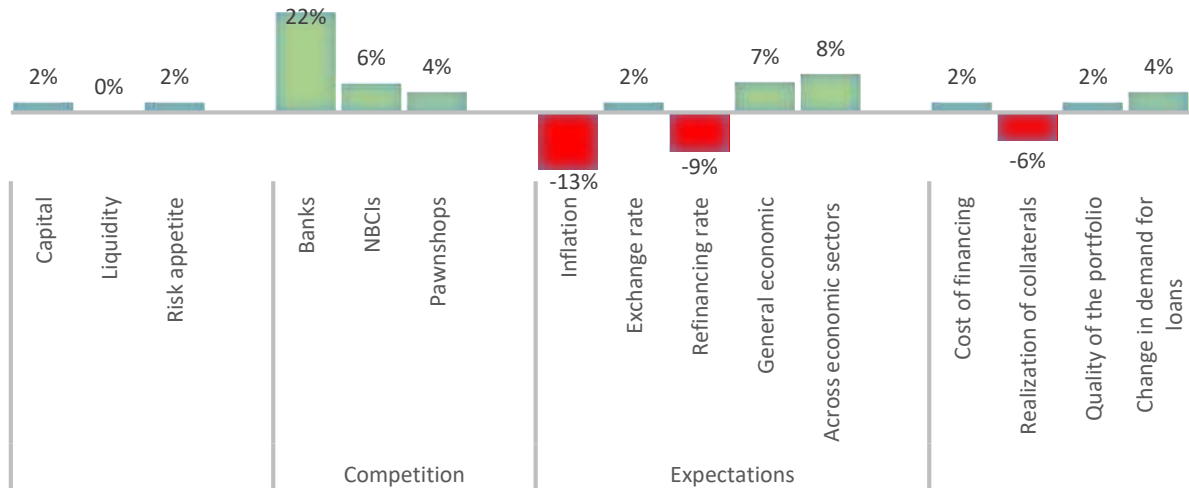
In Q1 2022, banks eased credit standards for business loans, mainly related to the duration of loans. Banks predict tightening of business loans in foreign currency in the first quarter, and this trend is expected to continue in the second quarter.

Chart 7. Factors affecting the credit standards for business loans in Q1 2022



In Q1 2022, competition with other banks acted as the main factor that softened the standards for business loans. At the same time, competition with NBCIs and pawnshops had a softening effect on credit standards. The tightening effect on business lending standards is driven mainly by inflation, refinancing rate and economic expectations. Note that, banks reported positive expectations on some sectors of economy (agriculture, commerce and transport). At the same time, difficulties in realizing collaterals for loans and the high cost of financial resources caused the tightening of credit standards.

Chart 8. Factors affecting the credit standards for loans to SMEs in Q1 2022



The impact of the said factors on loans to SMEs is milder. Thus, although the factors of inflation, refinancing rate changes and collateral realization have a tightening effect, it was reported that their impact on loans granted to SMEs was softer. At the same time, although economic expectations and cost of funds were reported to have a tightening effect on business loans, these factors had a softening effect on loans to SMEs.

Chart 9. Changes in credit conditions for business loans in Q1 2022

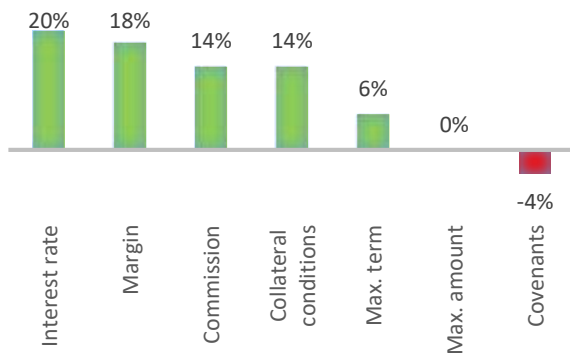
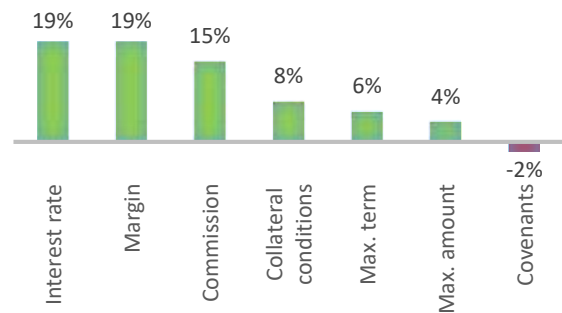


Chart 10. Changes in credit conditions of loans to SMEs in Q1 2022



In the first quarter of the current year, the business portfolio, including the terms and conditions of granting loans to SMEs, were mainly softened. The relaxations were mainly related to the interest rate of the loans, applied margin, commission and collateral conditions. Although the loan covenants were tightened, this tightening was somewhat limited for loans to SMEs.

Chart 11. Changes in terms and conditions on loans to large enterprises in Q1 2022

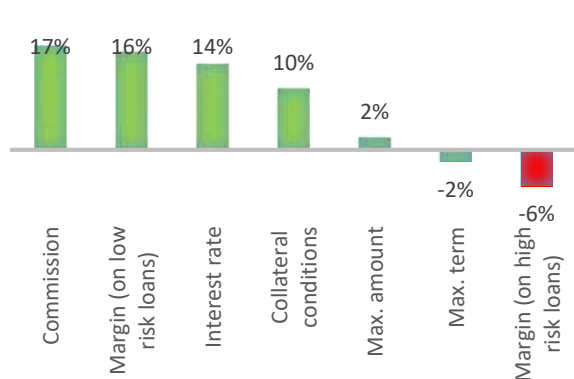
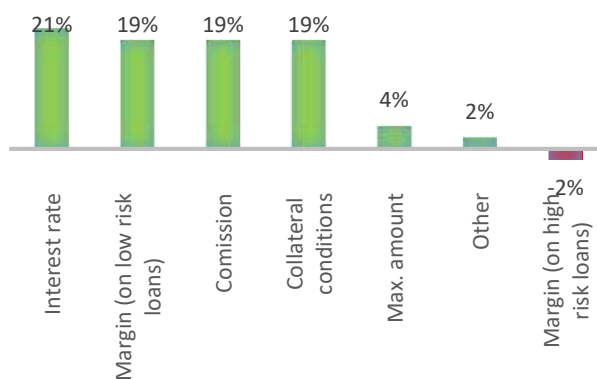


Chart 12. Changes in terms and conditions on loans to micro enterprises in Q1 2022



Changes in the terms and conditions of loans to large and micro business entities were also in the same direction. There was tightening of the maximum duration of loans to large enterprises.

Chart 13. Changes in demand for business loans in Q1 2022

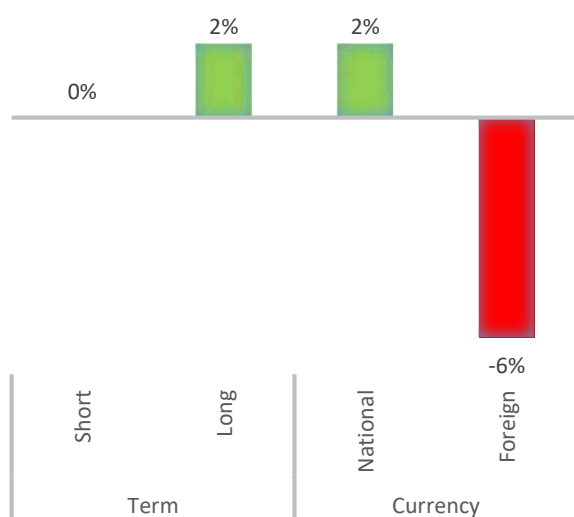
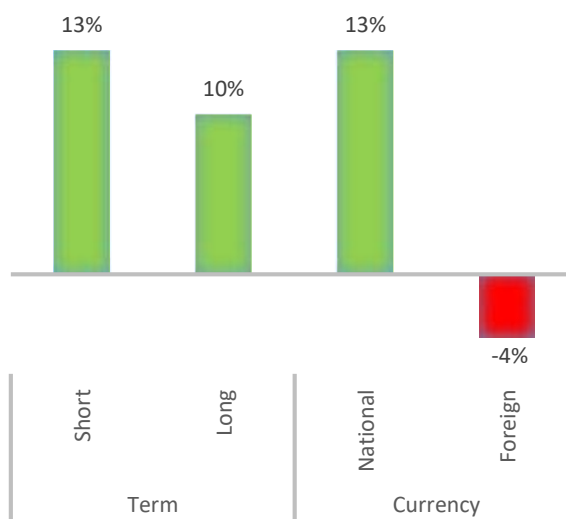


Chart 14. Expectations on demand for business loans in Q2 2022



In the first quarter, banks reported an increase in demand for long-term loans in local currency, a stable demand for short-term loans, and a decrease in demand for loans in foreign currency. Banks expect an increase in demand for both long-term and short-term loans in local currency in Q2 2022, while the demand for loans in foreign currency will decrease.

Chart 15. Impact of the below factors on demand for business loans to SMEs in Q1 2022

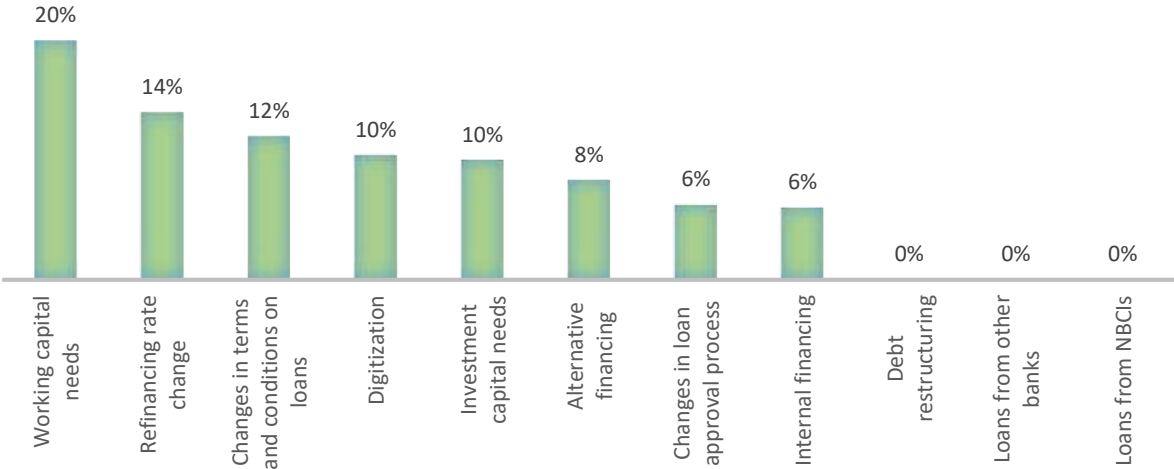
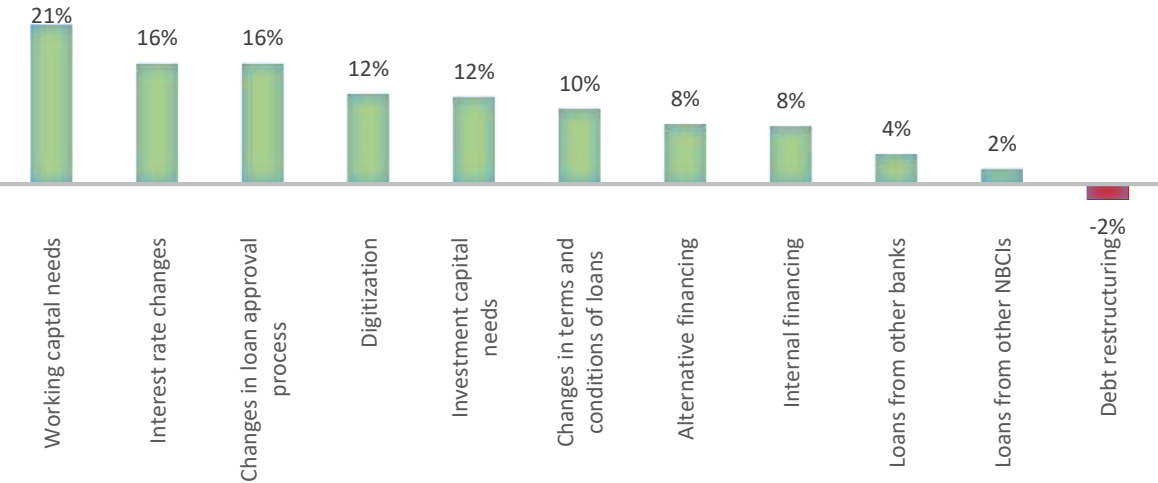


Chart 16. Impact of the below factors on demand for loans to SMEs in Q1 2022

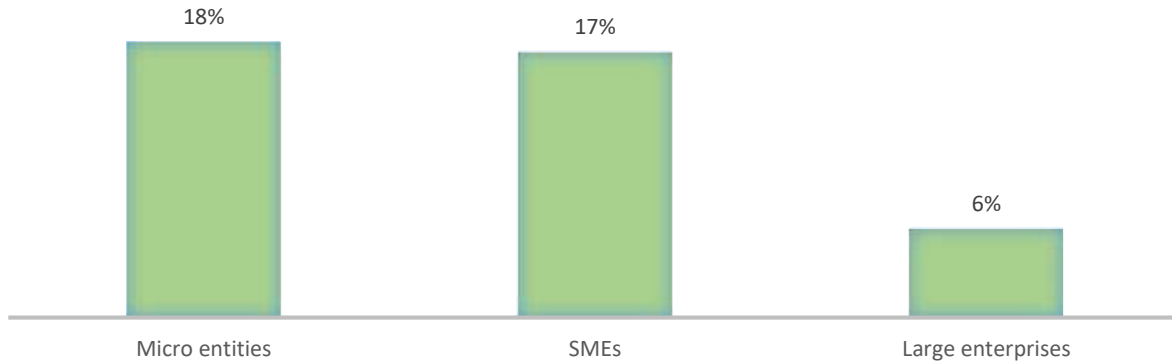


The increase in demand for business loans in the first quarter of 2022 was mainly driven by working capital needs of businesses, changes in interest rates and digitization. Although debt restructuring did not affect the total demand for business loans, it had a decreasing effect on demand for loans by SMEs. However, some large banks reported

that the restructuring had a positive impact on demand from both businesses as a whole and SMEs.

In order to assess the financial situation of the business sector, changes in the indebtedness level of businesses in the first 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 MSMEs).

Chart 17. Changes in indebtedness level of business entities in Q1 2022



Mortgage and consumer loans

Chart 18. Factors affecting credit standards for mortgage loans in Q1 2022

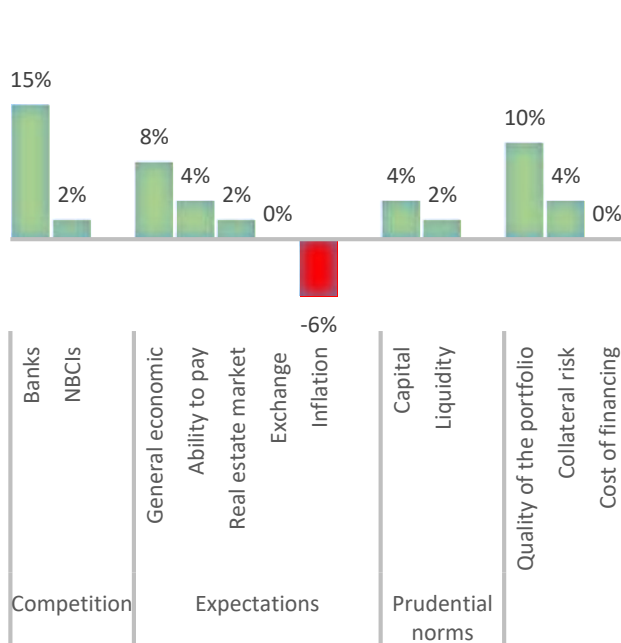
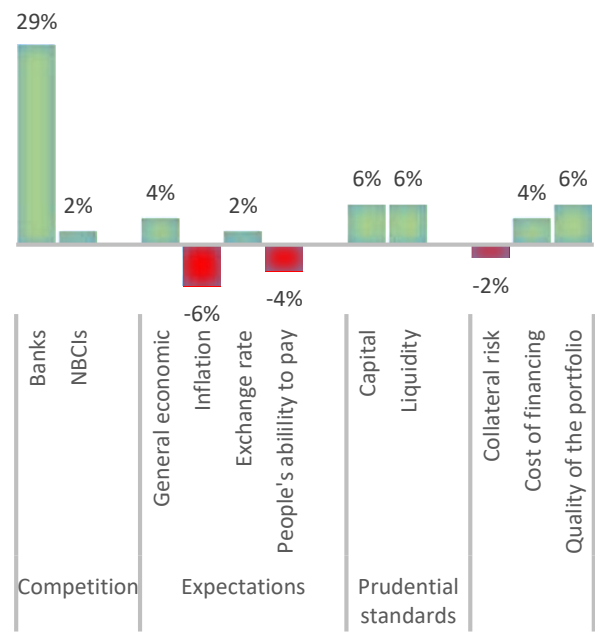


Chart 19. Factors affecting credit standards for consumer loans in Q1 2022



The competitive environment in the sector played a key role in easing the standards for mortgage loans. At the same time, positive economic expectations, 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 first quarter of the current year. Exchange rate expectations have not affected credit standards, while inflation expectations had a tightening effect. 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 collateral risk is higher for consumer loans and has a tightening effect. In addition, competition for consumer loans in the banking sector is higher, and as such, it had an easing effect on consumer loans' standards.

Chart 20. Changes in terms and conditions of mortgage loans in Q1 2022

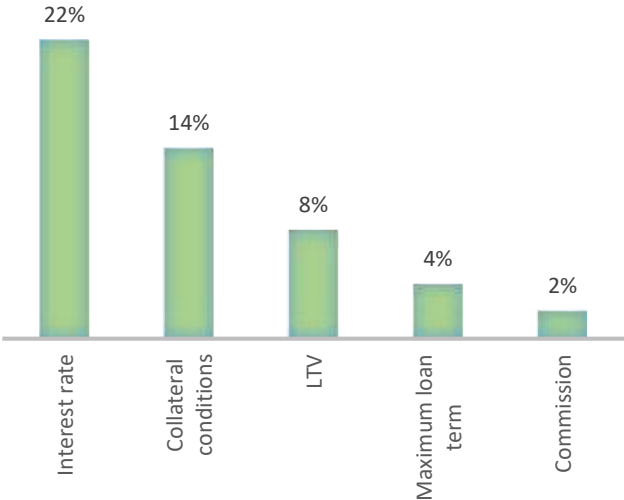
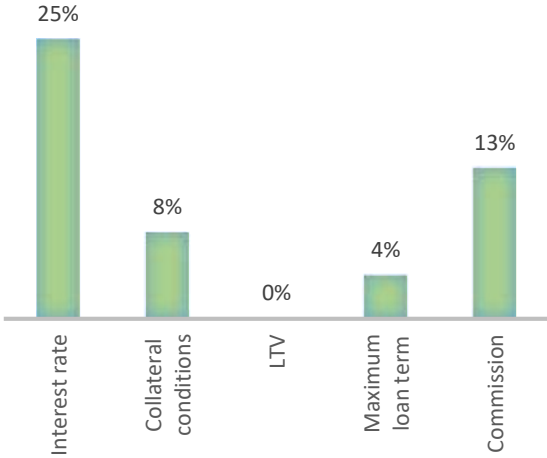
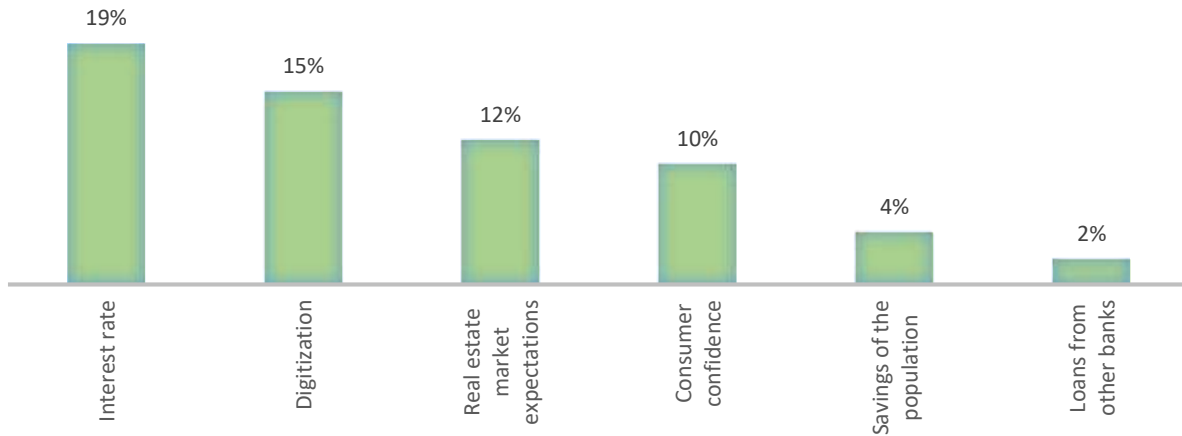


Chart 21. Changes in terms and conditions of consumer loans in Q1 2022



In the first quarter of 2022, all conditions for mortgage loans and all conditions on consumer loans (except for the loan-to-value ratio (LTV)), softened. The softening was mainly observed in terms of interest rates. Banks have eased commissions on consumer loans more than on mortgage loans. The softening of credit conditions by large banks has been more significant.

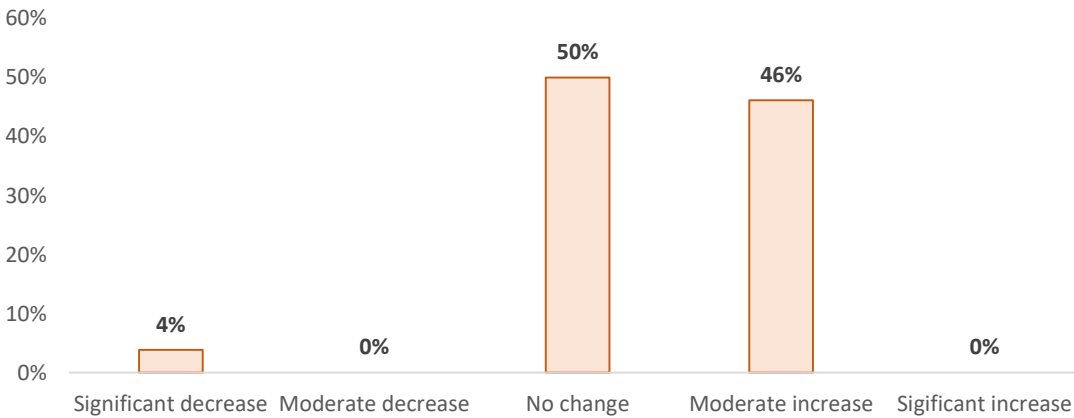
Chart 22. Factors affecting the change in demand for mortgage and consumer loans in Q1 2022



As mentioned above, the demand for both mortgage and consumer loans increased in the first quarter of the current year. Interest rate changes were the main reason of increase in demand.

Finally, in order to assess the financial situation of the population, the changes in the level of indebtedness of the population in the first quarter of the current year were also surveyed. 50% of the banks in the sector reported that indebtedness remained unchanged, 46% stated that the level of indebtedness increased moderately, and 4% reported a significant decrease.

Chart 23. Changes in the indebtedness level of population in Q1 2022



Risk Profile

According to the results of the survey, the compliance, operational and interest rate risks (the risk arising from the mismatch in the value of assets and liabilities due to fluctuations in interest rates) have increased in the sector, while fraud, liquidity and exchange rate risks have decreased. In the next quarter, the same risks are expected to increase at a lower rate, while credit, IT and fraud risks are predicted to decrease.

Chart 24. Changes in the bank's risks in Q1 2022

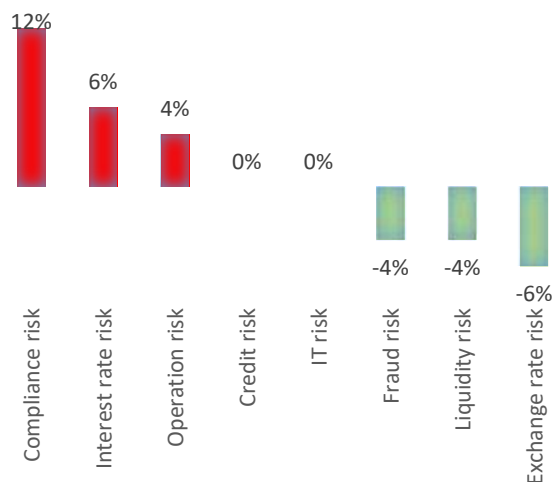
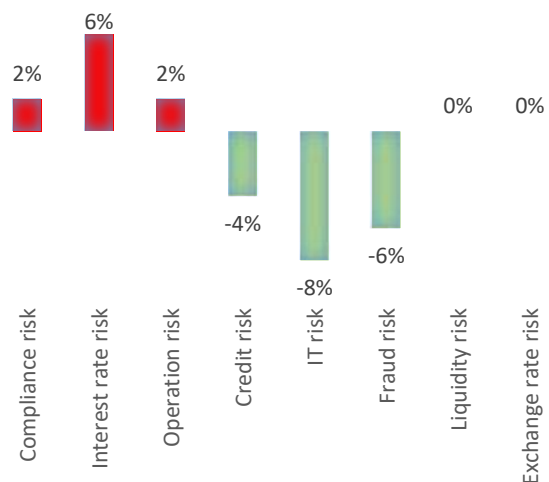
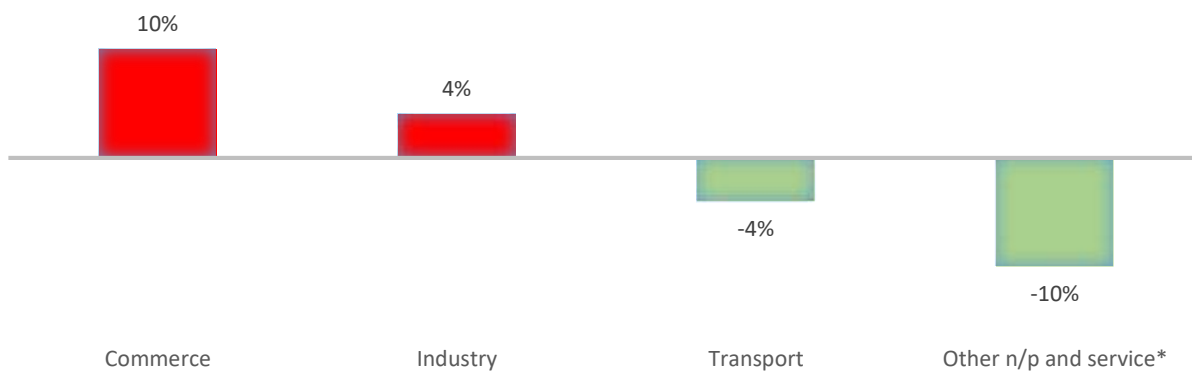


Chart 25. Changes in the bank's risks in Q2 2022



According to the results of the survey, credit risk increased in the commerce and industry sectors, and decreased in the transport and service sectors. The reduction of risk in these areas is explained by the revival of areas that suffered major stagnation during the pandemic.

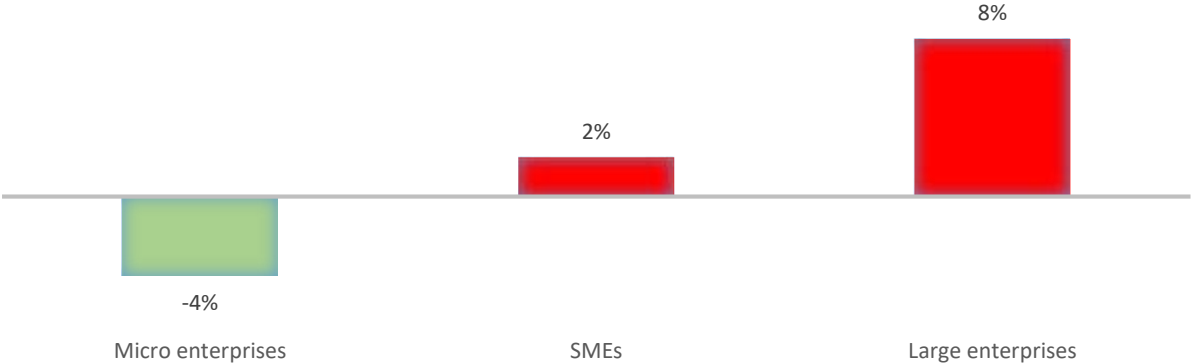
Chart 26. Credit risk changes across economic sectors in Q1 2022



* Other non-production and service

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

Chart 27. Credit risk changes across businesses in Q1 2022



Banks reported a decrease in the default rate across all economic sectors and business entities. The decrease in the default rate occurred mainly in the service sector and in SMEs.

Chart 28. Changes in credit portfolio default rates across economic sectors in Q1 2022

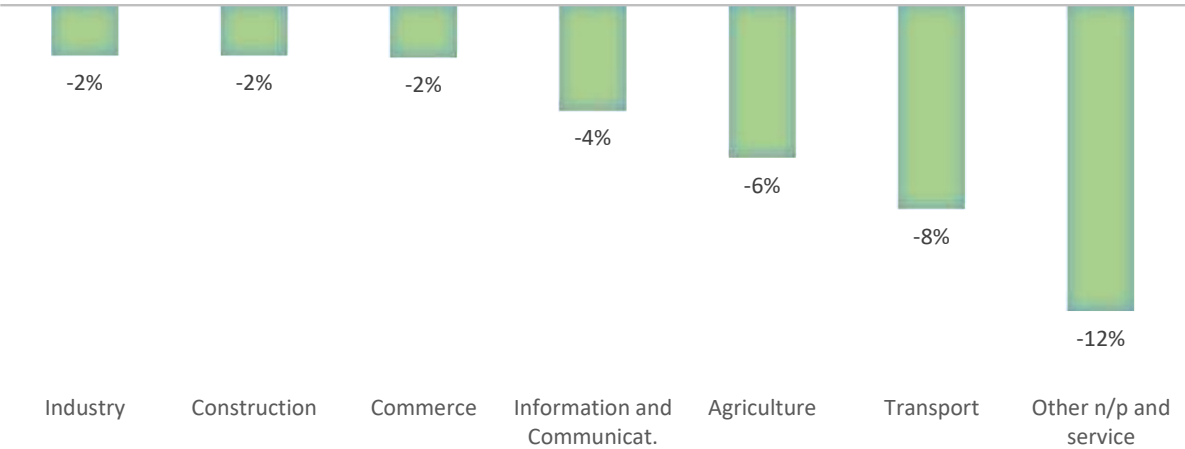
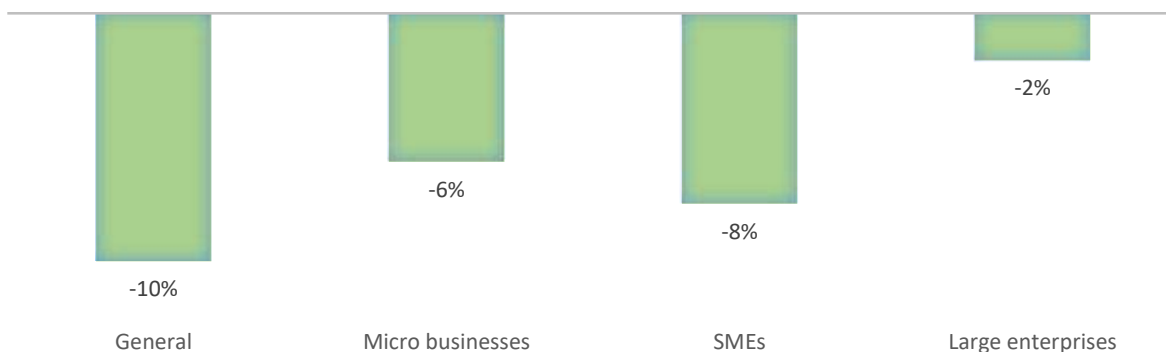
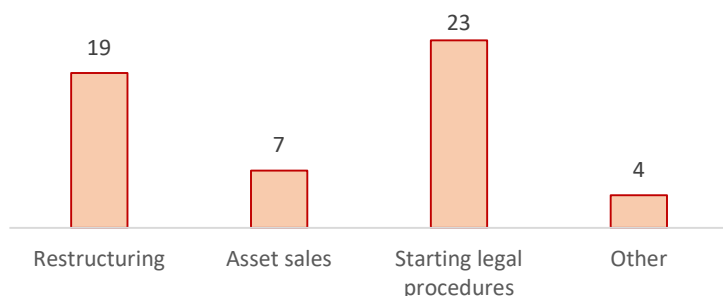


Chart 29. Changes in credit portfolio default rates across business entities in Q1 2022



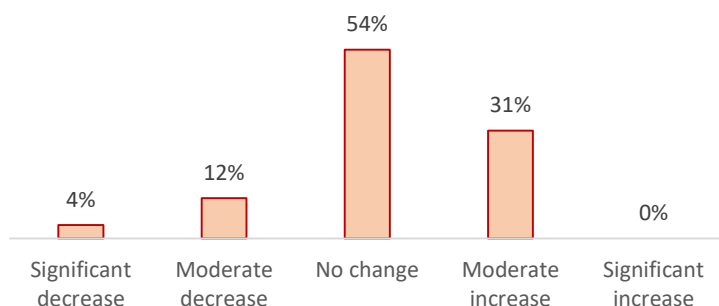
Measures taken by banks to reduce credit risks were also surveyed.

Chart 30. Mechanism(s) applied to decrease NPL portfolio in Q1 2022, number of banks



Thus, among the resolution mechanisms applied in order to reduce the non-performing loan portfolio over the first quarter, the initiation of legal procedures was the most used. Banks reported that they used debt restructuring, sale of NPLs and other tools.

Chart 31. Changes in the applicability of NPL resolution mechanism in Q1 2022



54% of banks reported no change in the applicability level of NPL resolution methods in the first quarter, 31% reported a moderate increase, 12% reported a moderate decrease, and 4% reported a significant decrease.