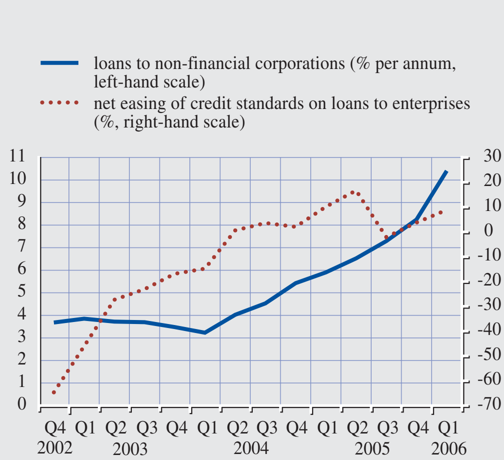
Box 10

ASSESSING THE FINANCIAL STABILITY IMPLICATIONS OF RECENT FINDINGS FROM THE ECB BANK LENDING SURVEY

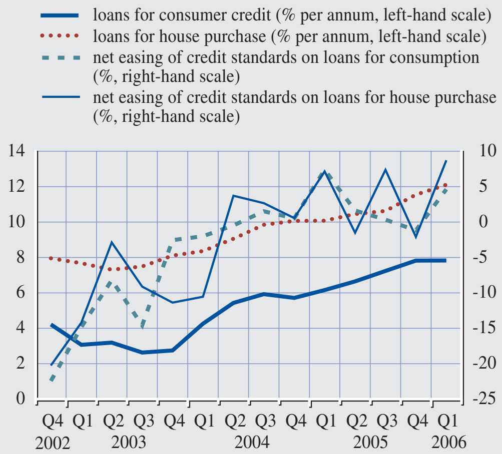
The ECB's Bank Lending Survey (BLS) provides timely qualitative information about the credit standards being applied by euro area banks on loans to enterprises and households. In addition, the BLS provides early evidence on the contributing factors behind changes in credit standards as well as the conditions and terms applied to banks' lending activity. This may help in detecting turning points in the credit cycle, and thus contributes to a comprehensive financial stability assessment. With this perspective in mind, this Box examines the results of the BLS since the finalisation of the December 2005 FSR.

Chart B10.1 Changes in bank credit standards applied to loans and credit lines to enterprises, and the annual growth rate of loans to non-financial corporations



Source: ECB.
Note: See footnote 1 for the definition of net easing.

Chart B10.2 Changes in bank credit standards applied to loans to households and the annual growth rate of loans to households



Source: ECB.
Note: See footnote 1 for the definition of net easing.

In recent years, credit standards applied to loans to enterprises and households have been substantially eased, supporting the strong rebound in loan growth to the private non-financial sector over the past two years (see Charts B10.1 and B10.2).[1] In recent quarters, however, there have been some indications that banks have started to bring the easing cycle to a halt, which might suggest growing concerns about credit quality in an environment of booming credit growth and strong loan demand.

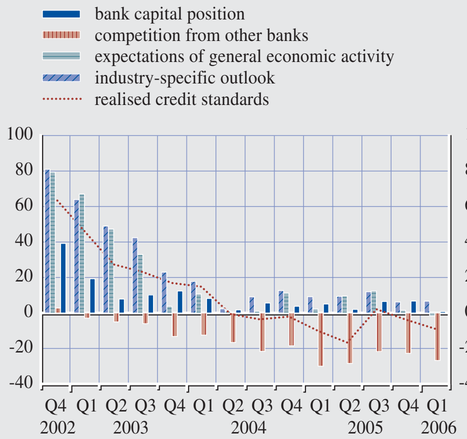
Concerning credit standards vis-à-vis the non-financial corporate sector, the April 2006 BLS revealed that banks applied a slight net easing in the first quarter of 2006 compared to the previous quarter. The net easing[2] was somewhat more subdued in the most recent quarters compared to the first half of 2005, and might partly reflect rising loan demand, as firms are increasingly seeking financing to fund investment and M&A (see Chart B10.3). In terms of the factors contributing to this net easing, banks reported that the main drivers were competition from other banks and, more recently, also improved economic prospects (see Chart B10.4). At the same time, the industry-specific outlook and banks' capital position pulled credit standards toward a net tightening, which might suggest increasing concerns about corporate credit quality in the period ahead (see also Box 4). Perhaps reflecting these credit risk concerns, banks reported that while credit standards had primarily been eased by relaxing margins on average loans, margins on riskier loans have become more restrictive. Thus, in recent quarters banks appear to have become more discriminating in their credit risk assessment.

With regard to the household sector, in the first quarter of 2006 banks reported a slight net easing of credit standards on both loans for house purchase and for consumption. This seemed on the one hand to reflect strong competition from other banks, as well as to some extent from non-

1 "Net easing" is defined as the difference between banks reporting that credit standards were eased compared to the previous quarter and those banks reporting that credit standards were tightened, i.e. a positive figure indicates a "net easing".
2 The net percentages refer to the difference between the sum of the percentages for "tightened considerably" and "tightened somewhat" and the sum of the percentages for "eased somewhat" and "eased considerably". The net percentages for the questions related to the factors are defined as the difference between the percentage of banks reporting that the given factor contributed to tightening and the percentage reporting that it contributed to easing.

Chart B10.3 Changes in bank credit standards applied to loans and credit lines to enterprises and contributing factors

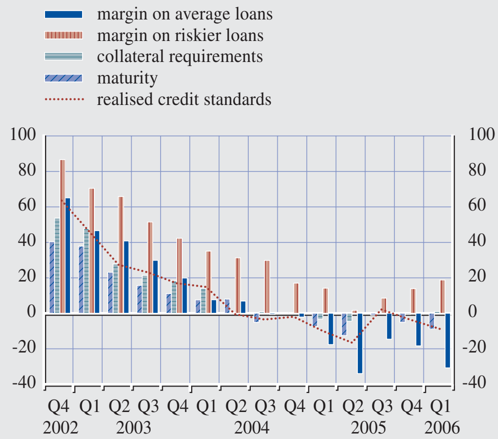
(net %)



Source: ECB.
Note: See footnote 2 for the definition of net percentages.

Chart B10.4 Changes in bank credit standards applied to loans and credit lines to enterprises, including terms and conditions

(net %)

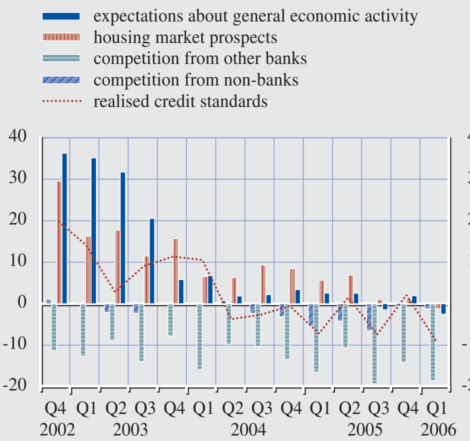


Source: ECB.
Note: See footnote 2 for the definition of net percentages.

banks too (see Chart B10.5). On the other hand, it reflected some concerns about the creditworthiness of borrowers (especially concerning consumer loans, which are typically less collateralised). While some apprehensiveness remains about housing market prospects and the general economic outlook, these seem to have abated somewhat in recent quarters. As in the corporate sector, the broadly unchanged credit standards applied on loans to households in recent quarters occurred against a background of strong and still rising loan demand. This was perceived by the banks to be driven by households' positive expectations regarding housing market developments, coupled with rising consumer confidence. Banks also recently seem to have started to differentiate their pricing of risk more, as credit standards applied to loans to

Chart B10.5 Changes in bank credit standards applied to loans to households for house purchase and contributing factors

(net %)



Source: ECB.
Note: See footnote 2 for the definition of net percentages.

Chart B10.6 Changes in bank credit standards applied to consumer credit loans to households and contributing factors

(net %)

Source: ECB.
Note: See footnote 2 for the definition of net percentages.

households for both house purchase and for consumption were eased via lower margins on average loans, while margins on riskier loans were increased (see Chart B10.6).

All in all, credit standards applied on loans to enterprises and households seem to have been relaxed over recent years and supported the private sector's access to bank finance. This was also reflected in very strong loan growth especially over the past two years. Nevertheless, in recent quarters some indications appeared that banks were becoming more concerned about their risk-taking, as they gradually slowed down the net easing of credit standards. They also became more discriminating in their treatment of borrowers of different credit quality.