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CCAMTAC- Regional Research/Analytical Economic Policy Seminar

"Disentangling the effect of supply and demand factors on bank lending. Evidence from Bank Lending Survey in Azerbaijan"

Tuesday, November 29, 2022

Introduction:

Norbert Funke, Director, CCAMTAC

Moderator:

Aliya Kistaubayeva, Economic Analyst, CCAMTAC

Presenter:

Ilkin Huseynov, Head of the Microeconomic Research Division, Research Department, Central Bank of Azerbaijan

Discussant:

Ruy Lama, Senior Economist, Institute for Capacity Development, IMF

Credit to the economy is a crucial aspect of economic policy. While monetary authorities consider credit channel when affecting inflation via policy rates, credit extension also helps to analyze the state and outlook for the economy. As a result, credit dynamics and conditions affecting credit market developments have been studied by policymakers from various perspectives. Recently the Central Bank of Azerbaijan conducted research to identify the effect of supply and demand factors on bank lending and stepped forward to share their findings with the CCAMTAC community.

Representing the CBAR research team, Mr. Ilkin Huseynov started his presentation by giving a description of the structure and responses obtained from Azerbaijan's bank lending survey (BLS), which assesses both the supply side of bank loans (requirements to borrowers, credit standards and conditions), and the demand side (the demand for bank loans by households and enterprises). Descriptive analysis showed that there is a co-movement between the survey responses and the dynamics of newly issued loans. The relationship was particularly more evident in the case of consumer loans.

After explaining the methodology, Mr. Huseynov summarized the results of the study and outlined the main findings. Results indicated that both supply and demand conditions play an important role in the dynamics of consumer loans, but the relationship appears to be asymmetric, as it is significant only when the BLS indicators signal a softening in credit conditions ("supply easing") and a decrease in demand. For consumer loans, the association between the above indicators and credit growth differs across banks: the relationship was statistically significant for non-systematically important (NSI) banks in different model specifications. No significant association is found between BLS indicators and business lending dynamics as the individual bank interest rate is found to be the only determining factor of lending to businesses.

The impact of individual factors of supply conditions was not uniform and differed across systematically important (SI) banks and others. Among supply-side factors, supply tightening originating from banks' perception of risk appeared to have a positive impact on banks' consumer lending growth in the case of SI banks while the same factor has a negative association in the sub-sample of smaller banks (NSI). The loosening of credit conditions related to access to financial sources has been observed to have a positive effect on the growth rate of business loans in SI banks. Overall, tightening (easing) due to the costs related to maintaining banks' capital adequacy showed a positive (negative) association with bank lending growth of SI banks. The findings suggested that a uniform regulation (i.e., "costs related to maintaining bank's capital adequacy" in our example) may end up having disproportional effects on different types and sizes of banks and indicated the importance of a banking regulatory system where a more symmetric distribution of the regulatory burden is achieved.

In his comments, IMF senior economist Mr. Ruy Lama pointed out that the study revealed that the supply indicators tend to affect lending during the bust, while the demand variables impact credit growth during a boom. He also gave several possible explanations that could account for the asymmetric impact of demand and supply factors. On the policy implications, Mr. Lama suggested checking the credit gap and, if t credit departs from the trend, then macroeconomic policies should stabilize credit during an economic contraction, while macroprudential policies can be tighter during the boom. He concluded by sharing some ideas for possible extensions of the study and future avenues of research.

During the general discussion, the questions to the presenter covered: (i) the coverage of BLS, (ii) state ownership of banks, (iii) availability of lending and deposits in foreign currency, and (iv) leveraging research findings in CBAR policymaking.

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