

Box 2

THE RESULTS OF THE OCTOBER 2007 BANK LENDING SURVEY FOR THE EURO AREA

This box describes the main results of the October 2007 bank lending survey for the euro area conducted by the Eurosystem.¹ Respondent banks reported that credit standards for loans to enterprises tightened in the third quarter of 2007, especially for large enterprises.² This followed a long period where standards remained basically unchanged or were eased slightly. The shift towards net tightening was in all likelihood a reflection of developments in global credit markets in recent weeks. This was confirmed by the replies to the ad hoc questions included in the October 2007 survey relating to recent credit market developments (see the last section of this box). As in previous quarters, banks reported that net demand for loans to enterprises was positive. However, it was considerably weaker in the third quarter of 2007 than in the recent

1 A comprehensive assessment of the results of the October 2007 bank lending survey for the euro area was published on 5 October 2007 on the ECB's website.

2 The reported net percentage was 31%. The net percentage refers to the difference between the proportion of banks reporting that credit standards have been tightened and the proportion of banks reporting that they have been eased. A positive net percentage would indicate that banks have tended to tighten credit standards ("net tightening"), whereas a negative net percentage would indicate that banks have tended to ease credit standards ("net easing").

past.³ The main factor contributing to loan demand in the third quarter was fixed investment, whereas net demand for loans to finance M&A activity and corporate restructuring declined significantly. For the fourth quarter of 2007, banks expect further tightening of credit standards applied to loans to enterprises, while net demand for loans to enterprises is expected to remain positive.

As regards loans to households for house purchase, banks reported a tightening of credit standards in the third quarter of 2007, following a slight net easing in the previous quarter. However, this tightening was much more limited than in the case of loans to enterprises. Net demand for loans to households for house purchase remained significantly negative in the third quarter of 2007 as a result of a deterioration in housing market prospects and worsening consumer confidence. For the fourth quarter of 2007, banks expect a further tightening of credit standards applied to loans for house purchase and a further deterioration in net demand for loans to households for house purchase.

With regard to credit standards for consumer credit and other lending to households, banks reported a slight net easing of credit standards in the third quarter of 2007, compared with basically unchanged standards in the previous quarter. Net demand for consumer credit and other lending remained slightly positive. Looking ahead, in the fourth quarter of 2007 banks expect to tighten credit standards on loans for consumer credit and other lending to households, whereas net demand is expected to remain unchanged.

Loans or credit lines to enterprises

Credit standards: Reflecting the credit market developments affecting euro area banks over recent weeks, credit standards for loans or credit lines to enterprises tightened in net terms in the third quarter of 2007 (31%, compared with -3% in the previous quarter). This follows a long period where credit standards remained basically unchanged or were eased slightly (see Chart A, panel a). It may be noted that virtually all banks which tightened credit standards on loans to enterprises reported that they “tightened somewhat” rather than “tightened considerably”. For the first time since the introduction of the survey, competition from other banks contributed to a net tightening of credit standards (see Chart A, panel e). This may also be related to the fact that banks’ capital and liquidity position and their access to market funding deteriorated to some extent (see Chart A, panel b). A deterioration of banks’ perception of risks regarding general economic activity and the industry or firm-specific outlook likewise contributed to a net tightening (see Chart A, panels c and d).

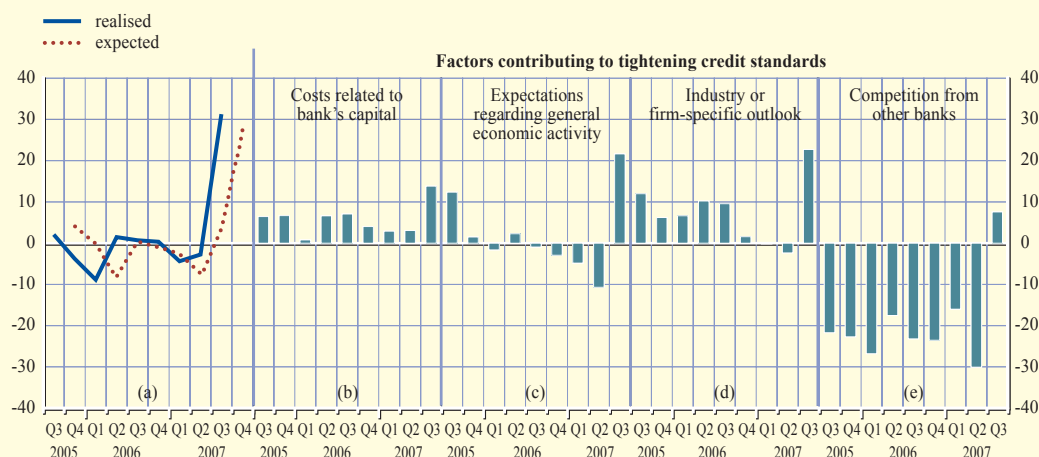
As regards the conditions and terms of credit, banks tightened credit standards by widening their margins on both average loans (11%, up from -19% in the previous quarter) and riskier loans (37%, up from 2% in the previous quarter). Other terms and conditions were also used in order to tighten credit standards in the third quarter of 2007. These included shortening the maturity of loans or credit lines, reducing the size of loans or credit lines, and demanding more loan covenants and collateral.

The net tightening of credit standards applied on loans to small and medium-sized enterprises (15%, up from -7% in the previous quarter) and, to a larger extent, to large enterprises (33%, up

³ The term “net demand” refers to the difference between the proportion of banks reporting an increase in loan demand and the proportion of banks reporting a decline.

Chart A Changes in credit standards applied to the approval of loans or credit lines to enterprises

(net percentages)



Notes: The net percentage refers 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”. “Realised” values refer to the period in which the survey was conducted. “Expected” values are the net percentages calculated from the responses given by the banks in the previous survey. For instance, “expected” values for 2007 Q4 were reported in the October 2007 survey. 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 a tightening and to an easing.

from -1% in the previous quarter). The particularly strong tightening of credit standards on loans to large enterprises could be related to a slowdown in M&A-related financing and a worsening of conditions with regard to securitisation and structured credit markets following the turmoil of recent weeks (see also the section on the ad hoc questions below). As regards loan maturities, the net tightening was somewhat more pronounced for long-term loans (30%, up from -4% in the previous survey) than for short-term loans (16%, up from -2% in the previous survey).

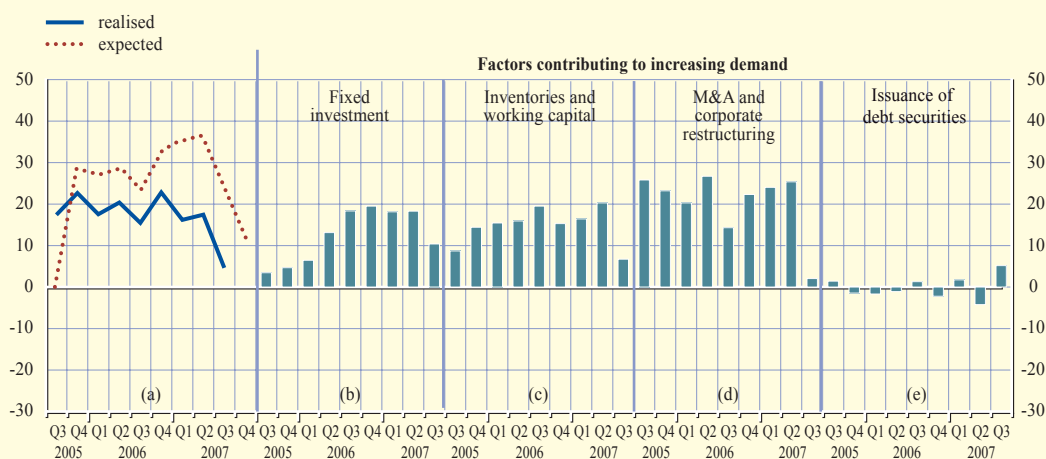
Looking ahead to the fourth quarter of 2007, banks expect a further net tightening of credit standards applied to loans to enterprises (see Chart A, panel a).

Loan demand: By comparison with the strong demand for corporate loans observed over the past couple of years, net demand for loans to enterprises slowed significantly in the third quarter of 2007, although it remained slightly positive (5%, compared with 18% in the previous round; see Chart B, panel a). The main reason that net demand remained positive was fixed investment, while financing for inventories and working capital, as well as for mergers and acquisitions and corporate restructuring, contributed to the slowdown in demand (see Chart B, panels c and d). Another notable factor contributing to positive loan demand (although to a relatively modest extent) was the issuance of debt securities, which may suggest that some firms have turned to banks, possibly owing to difficulties in tapping the corporate debt market for funding during the past few weeks. In terms of borrower size, net loan demand on the part of small and medium-sized enterprises continued to be stronger than that of large enterprises (6% and -1% respectively). Finally, net demand was positive across the maturity spectrum, with demand for long-term loans being somewhat stronger than that for short-term loans.

For the fourth quarter of 2007, demand for loans to enterprises is expected to remain positive, although less so than in the previous quarter (see Chart B, panel a). Specifically, banks expect

Chart B Changes in demand for loans or credit lines to enterprises

(net percentages of banks reporting a positive contribution to demand)



Notes: The net percentages for the questions on demand for loans are defined as the difference between the sum of the percentages for “increased considerably” and “increased somewhat” and the sum of the percentages for “decreased somewhat” and “decreased considerably” “Realised” values refer to the period in which the survey was conducted. “Expected” values are the net percentages calculated from the responses given by the banks in the previous survey. For instance, “expected” values for 2007 Q3 were reported in the October 2007 survey.

corporate net demand to remain positive across all firm sizes and loan maturities in the fourth quarter of 2007.

Loans to households for house purchase

Credit standards: In the third quarter of 2007, banks reported a net tightening of credit standards for housing loans to households, following a slight net easing in the previous quarter (12%, up from -1% in the previous survey round; see Chart C, panel a). The main factors behind the net tightening were some deterioration in banks’ balance sheet positions (see Chart C, panel d) and a worsening of both housing market prospects and expectations regarding general economic activity (see Chart C, panels b and c). Competition from other banks continued to contribute to a net easing, although less so than in previous quarters (see Chart C, panel e).

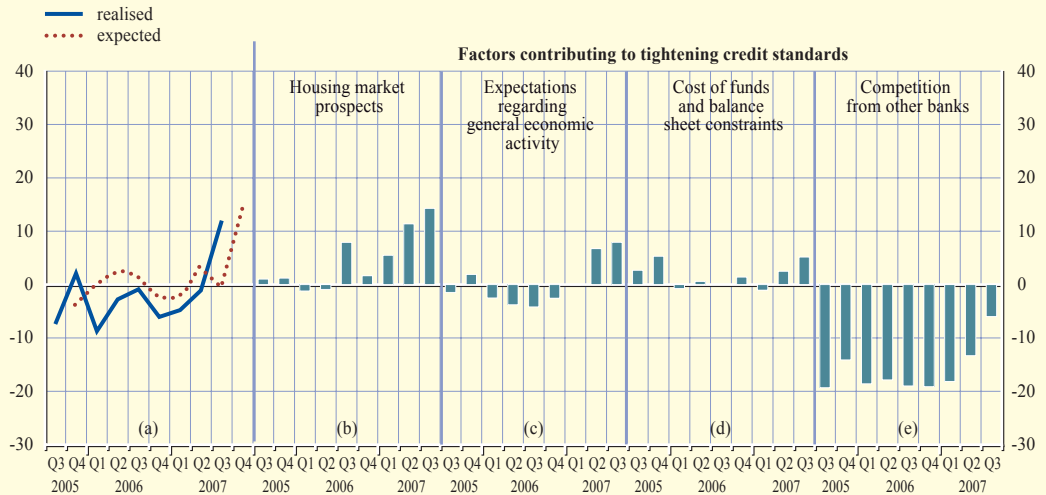
The net tightening of credit standards for loans for house purchase was implemented mainly by widening the margins on riskier loans and via higher collateral requirements and loan-to-value ratios. At the same time, margins on average loans continued to contribute to a net easing, but somewhat less than in previous quarters (-8%, up from -22% in the previous quarter).

For the fourth quarter of 2007, respondent banks expect a further net tightening of credit standards for loans to households for house purchase (see Chart C, panel a).

Loan demand: Net demand for loans to households for house purchase remained significantly negative in the third quarter of 2007 (at -15%, up from -22% in the previous quarter; see Chart D, panel a). This essentially reflected a less favourable assessment of housing market prospects and a worsening of consumer confidence, which dampened net demand more than in the previous quarter. It should also be noted that the bank lending survey does not directly

Chart C Changes in credit standards applied to the approval of loans to households for house purchase

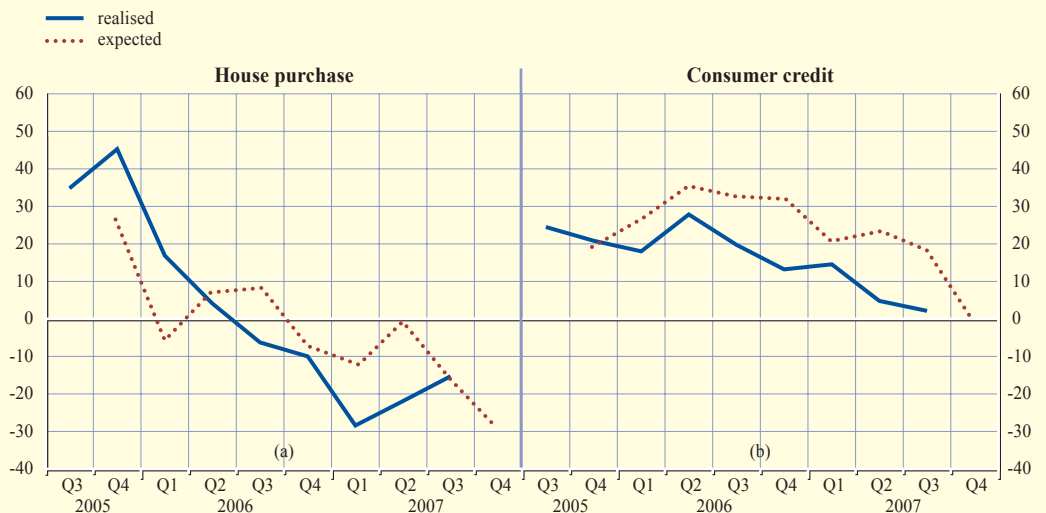
(net percentages of banks contributing to tightening credit standards)



Notes: The net percentage refers 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”. “Realised” values refer to the period in which the survey was conducted. “Expected” values are the net percentages calculated from the responses given by the banks in the previous survey. For instance, “expected” values for 2007 Q4 were reported in the October 2007 survey. 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 a tightening and to an easing.

Chart D Changes in demand for loans to households for house purchase and consumer credit

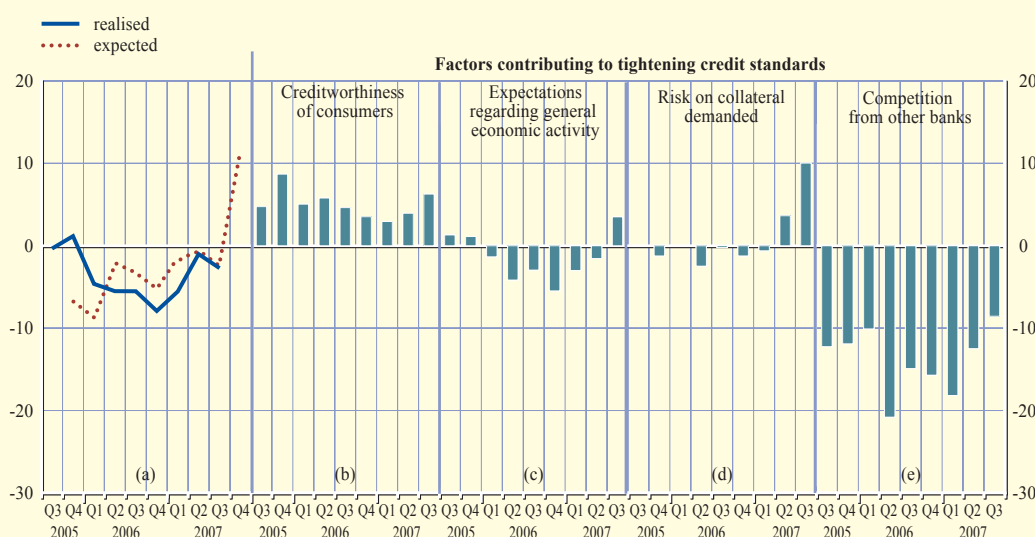
(net percentages of banks reporting a positive contribution to demand)



Notes: The net percentages for the questions on demand for loans are defined as the difference between the sum of the percentages for “increased considerably” and “increased somewhat” and the sum of the percentages for “decreased somewhat” and “decreased considerably”. “Realised” values refer to the period in which the survey was conducted. “Expected” values are the net percentages calculated from the responses given by the banks in the previous survey. For instance, “expected” values for 2007 Q3 were reported in the October 2007 survey.

Chart E Changes in credit standards applied to the approval of consumer credit and other lending to households

(net percentages of banks contributing to tightening credit standards)



Notes: The net percentage refers 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”. “Realised” values refer to the period in which the survey was conducted. “Expected” values are the net percentages calculated from the responses given by the banks in the previous survey. For instance, “expected” values for 2007 Q4 were reported in the October 2007 survey. 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 a tightening and to an easing.

capture other factors affecting loan demand for house purchase, in particular the level of interest rates, which may be an additional driving force behind the decline in demand observed in recent quarters. Looking ahead to the fourth quarter of 2007, banks expect net demand to remain significantly negative (see Chart D, panel a).

Loans for consumer credit and other lending to households

Credit standards: In the third quarter of 2007, banks reported a slight net easing of the credit standards applied to the approval of loans to households for consumer credit and other lending, as compared with basically unchanged standards in the previous quarter (-3%, up from -1% in the previous round; see Chart E, panel a). Competition from other banks remained the main driver behind the net easing (see Chart E, panel e), whereas consumer creditworthiness and risk on collateral demanded, as well as less favourable expectations regarding the general economic outlook, were the main factors contributing to a tightening (see Chart E, panels b to d). The net easing was mainly implemented via the lengthening of loan maturities, whereas margins on average and riskier loans contributed to a tightening. For the fourth quarter of 2007, responding banks expect credit standards for consumer credit and other lending to households to tighten (11%, compared with -2% in the previous round; see Chart E, panel a).

Loan demand: Banks reported that net demand for consumer credit and other lending to households remained positive but basically unchanged in the third quarter of 2007 (2%, compared with 5% in the previous round; see Chart D, panel b). For the fourth quarter of 2007, banks expect net demand for loans to households for consumer credit and other lending to remain basically unchanged.

Ad hoc questions on the recent credit market developments

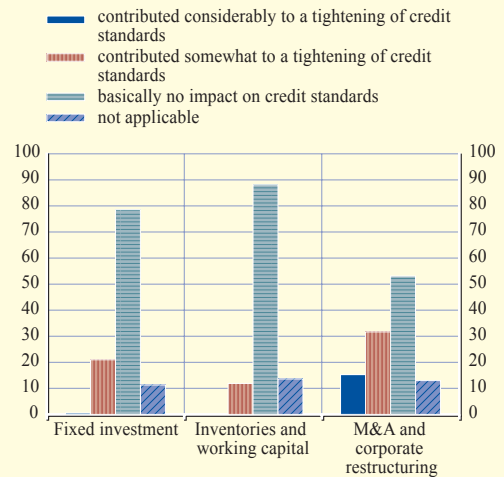
For the second time, the survey included a set of ad hoc questions. The questions added this time aim to gauge the extent to which the tensions in US sub-prime mortgage-related bonds and their spillover into structured credit markets in August 2007 – which have led to a more cautious valuation of credit risk worldwide – have affected banks' credit standards for loans and credit lines to enterprises and loans to households in the euro area. The questions focus first on the impact on credit standards and then on access to wholesale funding.

Consistent with the regular questions in the survey, the ad hoc questions suggest that the impact of credit events has differed depending on the loan segment. Loans and credit lines to enterprises were more affected than loans to households. In particular, credit standards for loans and credit lines to large enterprises were tightened somewhat, as reported by around one-third of the responding banks. Credit standards for loans and credit lines to small and medium-sized enterprises were also tightened somewhat, and by more than those for loans to households for house purchase or for consumption and other purposes.

In the past three months banks have tightened credit standards for loans to enterprises, in particular with respect to loans related to M&As and corporate restructuring (see Chart F). Moreover, banks expect credit market tensions to have a somewhat greater effect on credit standards over the next three months than has been seen over the past three months.

Banks generally reported that the recent tensions in the credit markets have hampered access to wholesale funding over the past three months.⁴ In particular, securitisation activities have been hampered for the selling of loans for house purchase and corporate loans. Banks also experienced difficulties in accessing wholesale funds through the interbank money market. It should be noted that banks had difficulties in raising funds through both medium to long-term bonds and short-term debt securities over the past three months. Wholesale funding market access is not expected to become easier over the next three months, although the picture varies somewhat by funding source (see Chart G). Access to interbank and debt securities markets is expected to continue to be hampered over the next three months, with only a slight improvement (i.e. a reduction in the percentage of banks responding “considerably hampered”, and a corresponding increase in the percentage of banks responding “somewhat hampered”). By

Chart F Effect of the recent credit market events on banks' credit standards for the approval of loans and credit lines to enterprises over the past three months (percentages of banks)

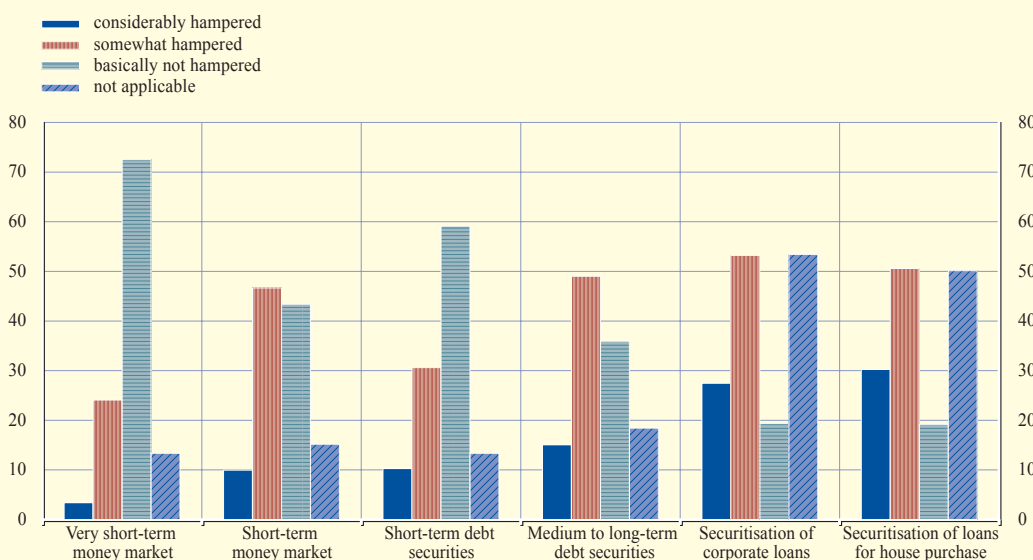


Note: The column “not applicable” is calculated as the number of banks replying “not applicable” as a percentage of the total number of banks participating in the survey. All the other columns are calculated as the number of banks choosing a particular reply as a percentage of the number of banks not replying “not applicable”. Euro area figures are weighted averages of country results.

⁴ It should be noted that not all the funding methods are relevant for the banks in the various euro area countries.

Chart G Expected access to wholesale funding over the next three months

(percentages of banks)



Note: The column “not applicable” is calculated as the number of banks replying “not applicable” as a percentage of the total number of banks participating in the survey. All the other columns are calculated as the number of banks choosing a particular reply as a percentage of the number of banks not replying “not applicable”. Euro area figures are weighted averages of country results.

contrast, securitisation of corporate loans is expected to become somewhat more difficult over the next three months by comparison with the last three months.

Difficulties in accessing wholesale funding over the next three months are also expected to exert some impact on the amounts that those banks are willing to lend and/or the margin at which funds are lent over the next three months. Banks’ willingness to lend over the next three months may, to some extent, be further affected by the effect of the credit events on costs related to the banks’ capital positions.