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RECENT DEVELOPMENTS IN FINANCING AND BANK
LENDING TO THE NON-FINANCIAL PRIVATE SECTOR.
FIRST HALF OF 2022

Laura Álvarez, Pana Alves and Javier Delgado

ABSTRACT

In 2022 to date there has been a tightening of financing conditions for firms and households, with a strong rise in the cost of corporate debt issuance and a contraction in the supply of loans. However, the pass-through of market interest rates to bank lending interest rates appears to be somewhat slower than in other historical bouts of interest rate hikes. Against this backdrop, the flow of new funding raised by households and firms and their outstanding debt have increased moderately or remained stable. Lending by deposit institutions (DIs) for non-financial business activities declined in 2022 Q1, more than offsetting the increase in the balance of loans for house purchase, while in April and May their joint performance was moderately expansionary. Since early 2022 and despite the worsening of the macro-financial environment, the credit quality of the DIs' portfolio has continued to improve in general, except in the case of financing allocated to the sectors most affected by the pandemic, as well as in Official Credit Institute (ICO)-backed loans as a whole. The materialisation of adverse macro-financial scenarios might lead to less buoyancy in the volume of bank lending and the deterioration of its quality in the coming quarters.

Keywords: financing, credit, households, non-financial corporations, deposit institutions, credit portfolios, non-performance, Stage 2 loans, monetary policy transmission.

JEL classification: E44, E51, G21, G23, G28.

RECENT DEVELOPMENTS IN FINANCING AND BANK LENDING TO THE NON-FINANCIAL PRIVATE SECTOR. FIRST HALF OF 2022

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Introduction

This article examines developments during the early months of 2022 in funds raised by households and non-financial corporations (NFCs) from an aggregate standpoint and in resident deposit institutions' (DIs) credit exposure to these sectors.¹ The article also reviews the quality of credit in DIs' balance sheets and pays special attention to non-performing loans (NPLs) and Stage 2 loans by economic sector. Lastly, a box is included which analyses the pass-through of the recent increase in market benchmark interest rates to the average cost of new loans to households and firms. It concludes that the pass-through is growing at a slower pace than in recent bouts of interest rate hikes and that the contained costs of certain liabilities, such as private-sector deposits, might be contributing to this difference in the pass-through dynamics.

Funds raised by the non-financial private sector

One of the issues that will most influence corporate and household financing in the coming months will be the decisions on monetary policy to be adopted by the European Central Bank (ECB) to mitigate the inflationary pressures currently observed in euro area countries. Thus, in December 2021, the ECB started a process of monetary policy normalisation with the announcement of the conclusion, in March 2022, of the net asset purchases under the pandemic emergency purchase programme (PEPP). Since then, the ECB Governing Council has taken other steps in that direction by ending net purchases under the asset purchase programme (APP) on 1 July and raising the key interest rates by 50 basis points (bp) at its July meeting. It also noted that in upcoming meetings it will be appropriate to further normalise interest rates and that the future policy rate path will be data-dependent. This has

¹ Developments in these approaches will not necessarily coincide, since households and NFCs do not receive funding only from these financial intermediaries. Households, in particular, may also obtain credit from specialised lending institutions (SLIs), especially consumer credit, while NFCs may tap capital markets by issuing corporate debt. For a detailed explanation of the differences between the two approaches and other statistical aspects, see Alves et al. (2019), Box 1, "Statistical information for the analysis of outstanding balances of financing and credit", Analytical Articles, *Economic Bulletin* 3/2019, Banco de España.

translated into a rise in the market benchmark (especially long-term) interest rates. Thus, in 2022 H1, 12-month EURIBOR increased by 135 bp, to 0.85%, positive for the first time in six years, and the 10-year OIS rate, which acts as the euro area long-term risk free interest rate, rose by around 180 bp.

In this setting, between December 2021 and June 2022 the average cost of long-term bond issuance by Spanish firms increased by slightly more than 200 bp, to stand at 3.9% (see Chart 1.1).

Changes in the average costs of new loans to households and firms were much more subdued up to May (latest data available), with a slightly rising trend in most segments. This would reflect, in part, a somewhat slower pass-through of market interest rates to bank lending interest rates than in other historical bouts of interest rate hikes (see Box 1). This pass-through is expected to continue over the coming months.

According to the Bank Lending Survey (BLS),² credit standards for loans to the non-financial private sector seem to have tightened across the board during 2022 H1. In the case of households, this tightening was concentrated in 2022 Q2 (see Chart 1.2). The contraction in the supply of credit is attributable to banks' heightened risk perceptions and lower risk tolerance. It has also been reflected in an increase in the proportion of rejected loan applications across all credit segments during this period. In June, banks anticipated a widespread contraction in credit supply for Q3, which would be more acute in the case of financing to SMEs.

The results of the latest round of the ECB Survey on the Access to Finance of Enterprises (SAFE)³ in the euro area show that, between October 2021 and March 2022, Spanish SMEs' perception of the availability of bank financing had not changed. However, their expectations about the availability of bank loans over the following months were significantly lower at the time of responding to the survey (see Chart 1.3). This would be in line with the contraction in the supply of credit indicated by the banks participating in the BLS for Q2 and which they anticipate for Q3.

According to the BLS, the demand for loans hardly seems to have changed during 2022 H1 in most segments, although that for house purchase has continued to grow moderately (see Chart 1.4). Financial institutions anticipated in June that bank loan applications would decline in 2022 Q3 across all segments, albeit more acutely in the case of household loan applications, particularly for house purchase.

According to the SAFE, loan demand by SMEs moderated between October 2021 and March 2022, with the percentage of SMEs that had applied for loans standing at its lowest (22%) since the SAFE began to be compiled in 2009 (see Chart 1.3), which

2 See [Menéndez Pujadas and Mulino \(2022a\)](#) and [\(2022b\)](#).

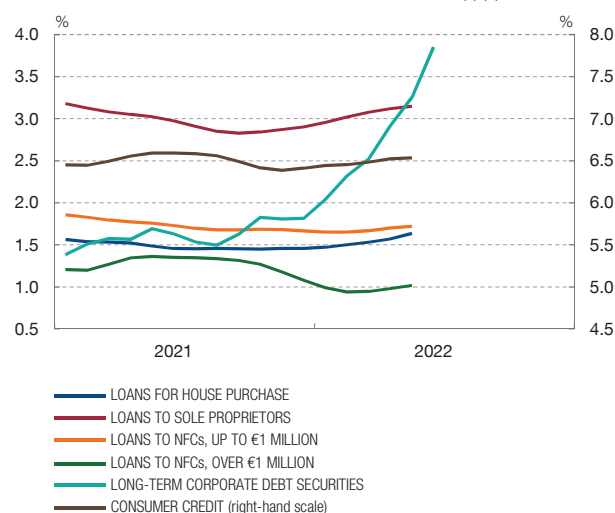
3 See [Menéndez and Mulino \(2022c\)](#).

Chart 1

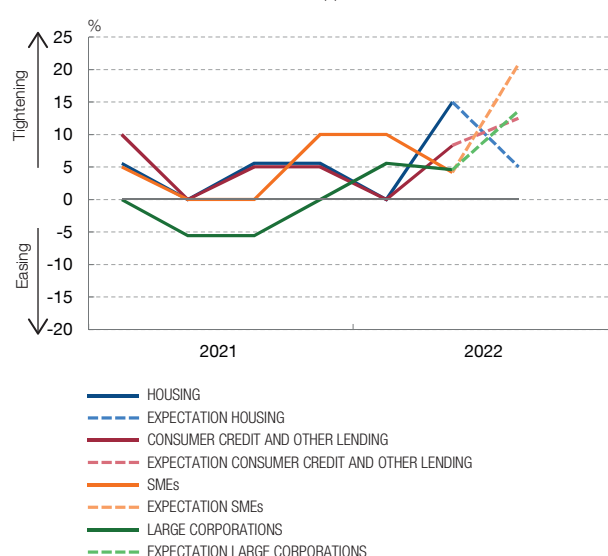
FINANCING CONDITIONS HAVE TIGHTENED SLIGHTLY IN RECENT MONTHS, WHILE DEMAND FOR LOANS, EXCEPT LOANS FOR HOUSE PURCHASE, IS WEAK

The average costs of new loans to households and firms have risen slightly in recent months, in line with the start of monetary policy normalisation. Credit standards for loans to households and non-financial corporations have tightened moderately in 2022 H1 and both the BLS and the SAFE point to a contraction of the supply of credit to SMEs in the coming months. Demand for credit, particularly from SMEs, is weak. In contrast, loan applications for house purchase appear to have continued to grow.

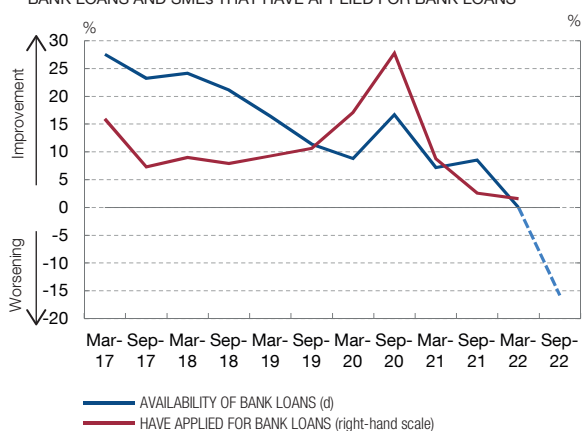
1 COST OF FINANCING: NON-FINANCIAL PRIVATE SECTOR (a) (b)



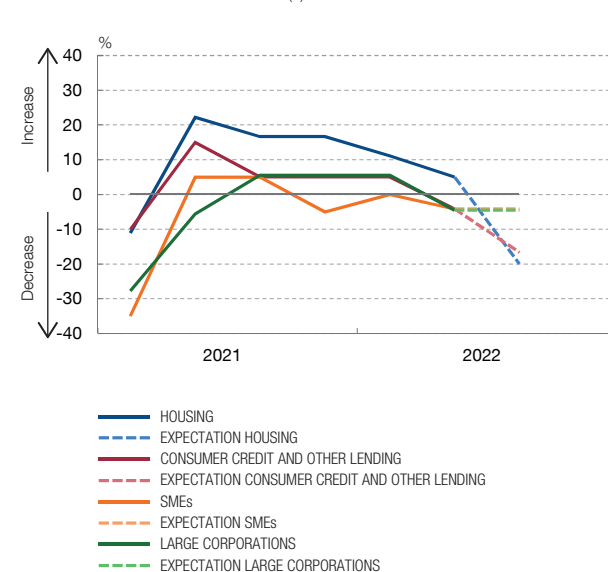
2 BLS: CHANGE IN CREDIT STANDARDS (c)



3 SAFE: SMEs' PERCEPTION ABOUT THE AVAILABILITY OF BANK LOANS AND SMEs THAT HAVE APPLIED FOR BANK LOANS



4 BLS: CHANGE IN LOAN DEMAND (e)



SOURCES: ECB, Banco de España and Refinitiv Datastream.

- a Credit transactions include those with DIs and with SLIs.
- b Bank lending interest rates are narrowly defined effective rates (NDEs), i.e. they exclude related charges, such as repayment insurance premia and fees. They are also trend-cycle interest rates, i.e. they are adjusted for seasonal and irregular components (small changes in the series with no recognisable pattern in terms of periodicity or trend).
- c Indicator = percentage of banks that have tightened their credit standards considerably \times 1 + percentage of banks that have tightened their credit standards somewhat \times 1/2 – percentage of banks that have eased their credit standards somewhat \times 1/2 – percentage of banks that have eased their credit standards considerably \times 1.
- d Percentage of SMEs indicating an improvement less those indicating a worsening.
- e Indicator = percentage of banks reporting a considerable increase \times 1 + percentage of banks reporting some increase \times 1/2 – percentage of banks reporting some decrease \times 1/2 – percentage of banks reporting a considerable decrease \times 1.



would be in line with the decline in applications indicated by the BLS for the same period.

Against this backdrop of buoyancy in the demand for mortgage loans, and despite the incipient contraction of supply in this segment in Q2, a notable increase was observed in new lending to households for house purchase, continuing with the trend of the previous months (see Chart 2.1). In contrast, the volume of new loans for consumption remained steady and in May (the latest data available) stood 18% below the pre-pandemic levels.

As regards financing for productive activities, fund-raising through debt securities issuance declined substantially in the first four months of 2022, but surged again in May, while the volume of new bank loans in excess of €1 million was highly buoyant (see Chart 2.2). This suggests that large firms with access to capital markets are shifting from financing with debt securities to financing with bank lending. This is on account of the cost of bonds having increased significantly while that of bank lending to larger firms has continued to decline. Also, the heightened uncertainty prompted by the war in Ukraine and the increase in production costs could be leading firms to build up liquidity buffers, making use of credit facilities for this purpose. The flow of new bank loans amounting to less than €1 million has increased more moderately in recent months and remains below pre-pandemic levels. All of this would be consistent with the less favourable performance of supply and demand in the lending to SMEs segment, as mentioned earlier. The performance of new lending to sole proprietors was relatively stable and also stands below the 2019 levels.

In terms of outstanding balances, funding raised by households continued to increase in recent months, albeit moderately, and since 2021 H2 stands above the 2019 levels. This has been the result of growth in the balance of consumer credit and loans for house purchase, which has offset the decline in funding raised by sole proprietors (see Chart 2.3). The balance of non-financial corporations' debt has remained relatively steady during the first five months of the year. The reason is that financing from corporate debt issuance, which stood well above pre-pandemic levels, has declined recently, while the balance of lending by resident financial institutions has remained relatively stable and external financing has grown moderately in recent months (see Chart 2.4). Across all segments the outstanding balance of loans to firms stands at levels higher than those recorded before the health crisis.

Lending by the resident banking sector

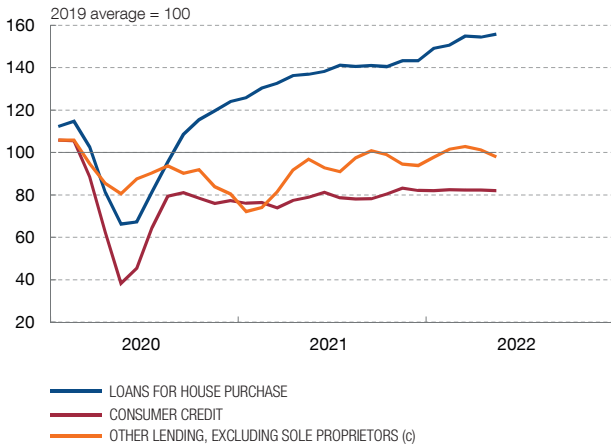
The outstanding amount of lending by DIs to the resident private sector in Spain fell by 0.8% in 2022 Q1, to stand at €1,164 billion in March 2022. The decline vis-à-vis March 2021 was of 0.5%, somewhat higher than the year-on-year rate of decline in

Chart 2

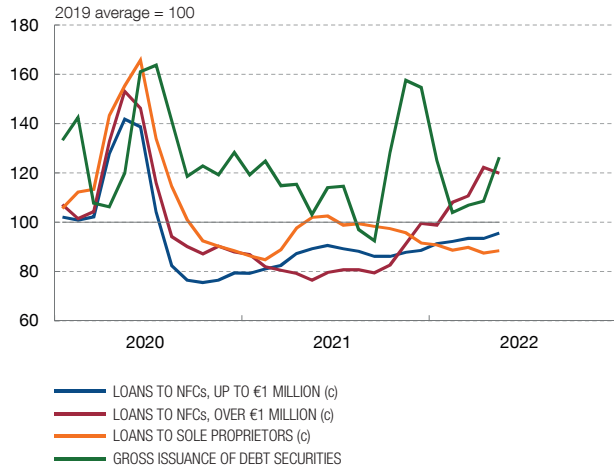
NEW LENDING AND THE OUTSTANDING BALANCE OF LOANS HAVE GROWN OR REMAINED STABLE IN RECENT MONTHS

Since end-2021, the flow of new lending for house purchase has regained buoyancy, while the volume of new consumer credit transactions has remained stable. The issuance of corporate debt securities has declined, but increased in May, while new bank loans in excess of €1 million picked up, signalling a substitution effect of one source of financing with another for large firms. In terms of outstanding balances, total funding raised by households grew timidly, driven by consumer credit and loans for house purchase. Non-financial corporations' debt hardly changed in the first five months of 2022, since the slight decline recorded in the balance of debt securities is being offset by the small increase in external financing, while the balance of bank financing remains stable.

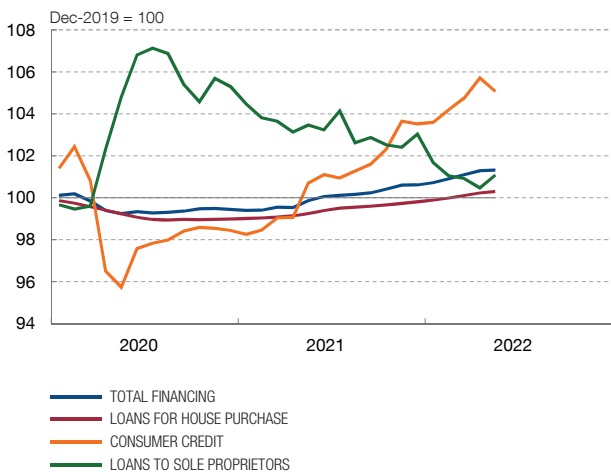
1 NEW LENDING TO INDIVIDUALS (a)
3-month cumulative seasonally adjusted flows (b)



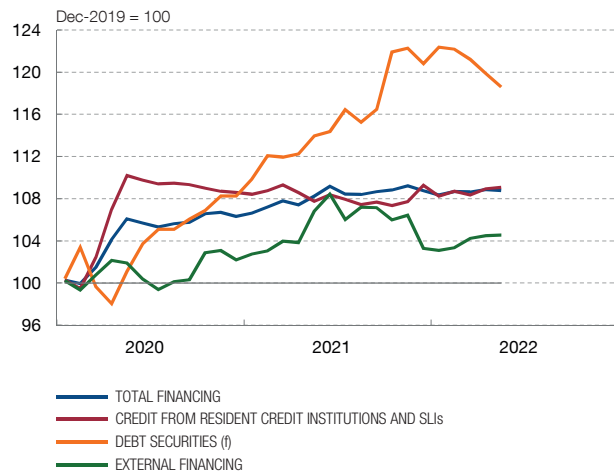
2 NEW LENDING FOR PRODUCTIVE ACTIVITIES (a)
3-month cumulative seasonally adjusted flows (b)



3 BANK LENDING TO HOUSEHOLDS (a)
Seasonally adjusted balance of credit (d)



4 FINANCING TO NFCs (a)
Seasonally adjusted balance of credit (d)



SOURCE: Banco de España.

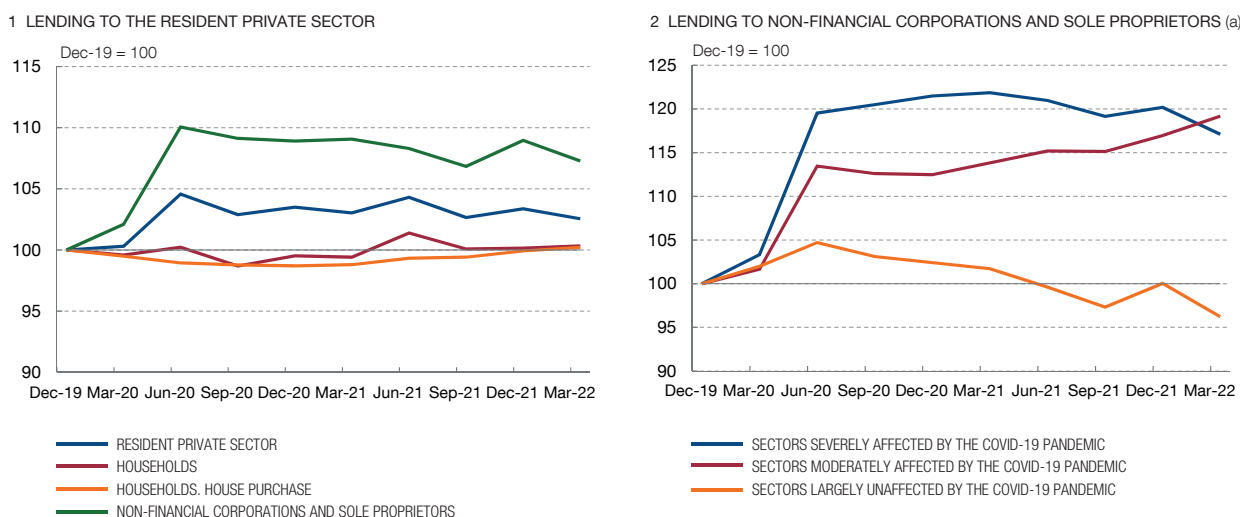
- a Bank financing series include financing granted by DIs and SLIs.
- b Flows relative to the 2019 monthly average.
- c Includes renegotiations of previous loans.
- d Cumulative net flows based on the outstanding balance at December 2019.
- e Excludes securitised lending.
- f Includes issues by resident subsidiaries of NFCs.



Chart 3

BANK LENDING TO THE PRIVATE SECTOR IN SPAIN FELL BY 0.8% IN 2022 Q1 (QUARTER-ON-QUARTER), OWING TO THE CONTRACTION OF LENDING TO THE BUSINESS SECTOR, WITH MORE MARKED GROWTH IN LOANS FOR HOUSE PURCHASE

The outstanding balance of bank loans to the resident private sector in Spain fell in 2022 Q1 and in the 12 preceding months, owing to the behaviour of non-financial corporations and sole proprietors. Within this institutional sector, the fall was more pronounced in the sectors severely affected by the pandemic and in the largely unaffected sectors, and grew in those that were moderately affected. In the household sector, significant year-on-year growth in lending for house purchase was observed, with a return to pre-pandemic levels.



SOURCE: Banco de España.

a Lending to the most severely affected sectors is proxied by that for sectors with a fall in turnover of more than 15% in 2020 and identified in the FI-130 regulatory return. Specifically, the most severely affected sectors include hospitality (accommodation and food service activities), the manufacture of refined petroleum products, social services and entertainment, transport and storage, and the manufacture of transport machinery. Lending to moderately affected sectors is proxied by the following sectors in the FI-130 regulatory return: basic metals, the manufacture of machinery, other manufacturing, professional services, mining and quarrying, wholesale and retail trade, and repair of vehicles. The largely unaffected sectors comprise the group of other productive activities.



the previous quarter (-0.1%). The rates of change observed up to 2022 Q1 thus continued to signal some degree of normalisation in the private sector's bank debt, which had grown in 2020 to meet the liquidity needs arising from the health crisis. That said, the stock of lending in March 2022 was 2.6% higher than before the COVID-19 pandemic (see Chart 3.1). The subsequent increase in lending by DIs led to moderate year-on-year growth of the outstanding amount of loans to the resident private sector at the end of May 2022 (a rise of 0.6%, according to the monthly statements).

The flow of new lending to the resident private sector was 12.6% higher in the first three months of 2022 than in the same quarter of the previous year. Preliminary monthly data for April and May show an even higher increase with respect to the same period a year earlier, thus confirming growth in the first quarter. In these early months of the year, drawdowns on credit facilities accounted for around 30% of total new lending, a figure similar to that observed in the same period in 2021.

By institutional sector, the outstanding balance of loans to households grew by 0.2% in the first three months of 2022, owing to the performance of loans for house purchase, the stock of which returned to pre-pandemic levels. In March 2022, the balance of loans for house purchase rose by 0.3% in the quarter, with a year-on-year increase of 1.4% (up 0.2 pp on that observed in the previous quarter), compared with the year-on-year decline posted in March 2021. Conversely, consumer credit contracted by 2.5% year-on-year in March, posting a decline that was 2.1 pp higher than in the previous quarter. Preliminary monthly data as at May 2022 indicate a continuation of the growth trend in overall lending by DIs to households, with year-on-year growth of 1%.

Turning to non-financial business activities, lending dropped by 1.5% in 2022 Q1, representing a year-on-year decline of 1.6%, compared with growth of 0.1% observed three months earlier. Monthly data to May 2022 suggest slight year-on-year growth (0.3%) in this portfolio, to some extent reversing the previous trend. However, the stock of lending to non-financial corporations and sole proprietors continued to decline moderately with respect to the levels reached following deployment in 2020 of the bulk of the ICO guarantee scheme⁴ to tackle COVID-19.

As shown in Chart 3.2, the growth in lending to firms at the start of pandemic was largely concentrated in the business sectors most severely affected by the crisis.⁵ However, their outstanding balance has moderated in recent quarters, with year-on-year declines of 3.9% in March 2022. The sectors moderately affected by COVID-19 have overtaken them in terms of accumulating bank financing, growing by 4.7% in March 2022 with respect to the previous year (up 0.7 pp on December 2021). Lastly, the sectors largely unaffected by the pandemic again posted significant declines in the first quarter of the year (-5.4% year-on-year, a decline 3.1 pp higher than in December). The latter is the only group of sectors whose current stock of loans stands below pre-pandemic levels.

The heightened geopolitical tensions triggered by the Russian invasion of Ukraine have brought an increase in the price of commodities, particularly energy and some

4 See Royal Decree-Law 8/2020, which establishes a guarantee scheme for a maximum amount of €100 billion. Additionally, Royal Decree-Law 25/2020 establishes a second guarantee facility to support business investment, for a maximum amount of €40 billion. According to the announcement of the Council of Ministers on 29 March, a new ICO guarantee facility amounting to €10 billion was set up to mitigate the increase in energy costs, as part of the economic policy response to the outbreak of the war in Ukraine, and the extension of repayment periods and payment holidays for existing ICO loans was approved for sectors particularly affected by the outbreak of this conflict.

5 Drawing on the FI-130 regulatory return, three groups of sectors are proxied, according to the intensity of the fall-off in turnover in 2020: (i) sectors severely affected by the pandemic (those whose sales fell by more than 15%); (ii) moderately affected sectors (sales down by between 8% and 15%); and (iii) largely unaffected sectors (the rest). Based on this classification and the information available in the FI-130, the severely affected sectors include accommodation and food service activities, the manufacture of refined petroleum products, social services and entertainment, transportation and storage, and the manufacture of transport equipment; the moderately affected sectors include basic metals, the manufacture of machinery, other manufacturing, professional services, mining and quarrying, wholesale and retail trade, and repair of vehicles. Lastly, the largely unaffected sectors comprise the group of other productive activities.

foods, which may particularly affect the sectors that are heavily reliant on them, such as transport and hospitality, also especially affected by the onset of the pandemic. However, in the current crisis, lending to these sectors has not grown on a par with lending during the COVID-19 crisis. Until March 2022, year-on-year growth of bank lending for transport and hospitality was 1.8% and -9.3%, respectively, compared with 15.2% and 25.6% in March 2021.

Quality of bank lending

The volume of NPLs to the resident private sector fell by 7.1% year-on-year in March 2022, 1.7 pp more than in December 2021. The quarter-on-quarter decline was also significant (2.2%). These figures once again show that the behaviour of NPLs during the COVID-19 crisis differed from that of earlier crises,⁶ and highlight the importance of the support measures deployed to preserve households' and firms' ability to repay. Monthly data available to May 2022 indicate no increase in NPLs; instead, a year-on-year fall of 8.4% has been observed.

As Chart 4.1 shows, at end-Q1, NPLs remained well below pre-pandemic levels (December 2019) both for households (-14.8%) and for non-financial corporations and sole proprietors (-7.9%). In 2022 Q1, NPLs to households fell by 3.6%, shrinking by 9.8% year-on-year, 3.7 pp more than in the previous quarter. Business sectors posted a fall of 1.1% in the first quarter, and a year-on-year decline of 5.1% (same as in December 2021).

Stage 2 loans⁷ contracted significantly in 2022 Q1 (-7.3%), the year-on-year rate of change returning to negative territory (-2.2%) following the significant increases recorded as a result of the COVID-19 pandemic (see Chart 4.2). This contraction is particularly pronounced in households, with the year-on-year decline reaching 10% in March 2022. This segment has therefore not suffered any sustained adverse effects as a result of the end of the moratoria adopted in response to the outbreak of the COVID-19 pandemic, unlike non-financial corporations and sole proprietors, where the year-on-year rate of change remains positive (3.6%), albeit far more moderate than that observed in the previous quarter (25.7%).

Additional impairment was observed in the quality of ICO-backed loans in 2022 Q1, both in relation to the NPL ratio (up 3.6 pp since December 2021 to 4.1%) and in terms of the weight of Stage 2 loans (from 8.5% to 22.7% at the same dates). Both suggest that this loan segment is riskier than overall business lending, and one in which further impairment may be observed in the coming months. In addition, the

⁶ See *Banco de España* (2017).

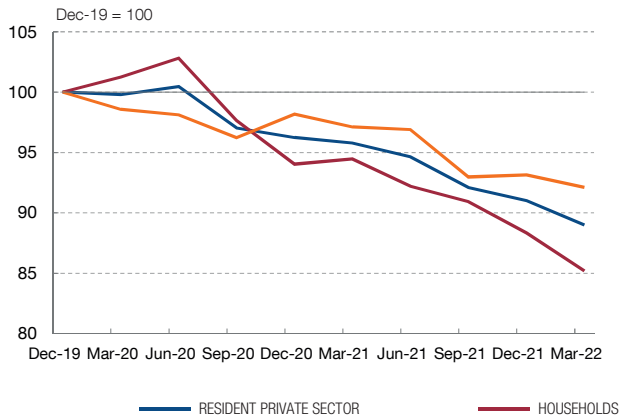
⁷ Pursuant to Circular 4/2017, a loan is classified as a Stage 2 exposure when credit risk has increased significantly since initial recognition, even though no event of default has occurred.

Chart 4

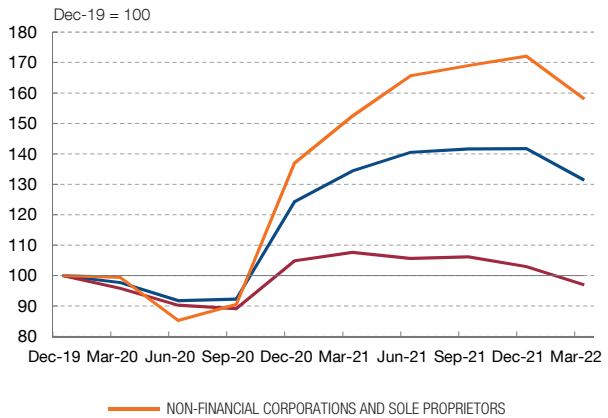
NPLs TO HOUSEHOLDS AND FIRMS CONTINUED TO DECLINE IN EARLY 2022, AS DID STAGE 2 LOANS, REVERSING THE PREVIOUS TREND

NPLs to the resident private sector continued to decline in recent quarters, especially for households. Stage 2 loans fell notably in 2022 Q1 with respect to the previous quarter, following the significant increases observed since December 2020, particularly in the business sectors most severely affected by the pandemic. The weight of NPLs and Stage 2 loans in total lending stabilised in 2022 Q1 for the business sector and decreased slightly for households.

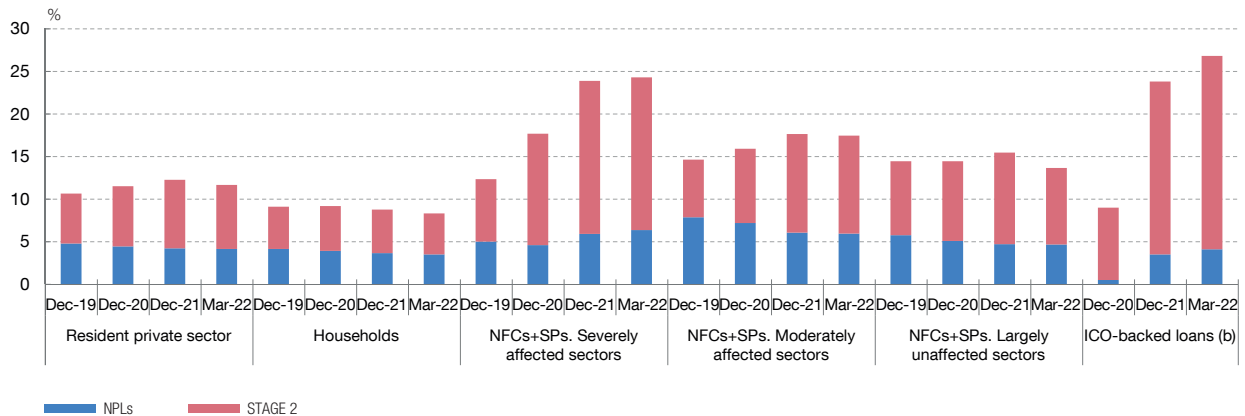
1 NPLs, RESIDENT PRIVATE SECTOR



2 STAGE 2 LOANS, RESIDENT PRIVATE SECTOR



3 WEIGHT OF NPLs AND STAGE 2 LOANS IN TOTAL LENDING (a)



SOURCES: ICO and Banco de España.

- a Lending to the most severely affected sectors is proxied by that for sectors with a fall in turnover of more than 15% in 2020 and identified in the FI-130 regulatory return. Specifically, the most severely affected sectors include hospitality (accommodation and food service activities), the manufacture of refined petroleum products, social services and entertainment, transport and storage, and the manufacture of transport machinery. Lending to moderately affected sectors is proxied by the following sectors in the FI-130 regulatory return: basic metals, the manufacture of machinery, other manufacturing, professional services, mining and quarrying, wholesale and retail trade, and repair of vehicles. The largely unaffected sectors comprise the group of other productive activities.
- b Transaction-level analysis measuring the proportion of ICO-backed loans to firms and sole proprietors that fall into the NPL or Stage 2 categories.



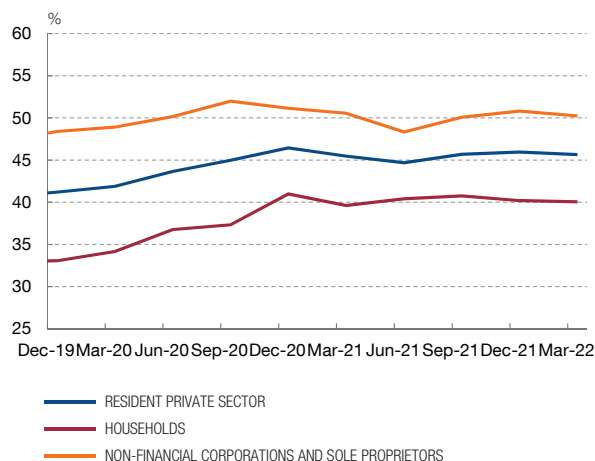
payment holidays from which a large portion of these loans have benefited will end in 2022 Q2 (by June 2022 the payment holiday on close to €39 billion of ICO loans, representing 90% of all loans with a payment holiday, will come to an end), increasing the financial pressure associated therewith.

Chart 5

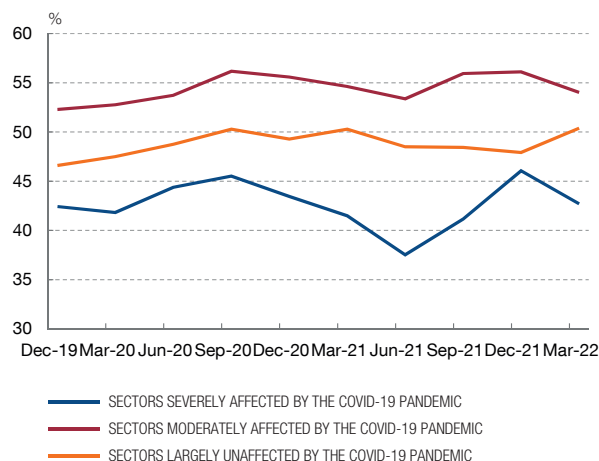
THE NPL COVERAGE RATIO FELL SLIGHTLY IN 2022 Q1, OWING MAINLY TO THE PERFORMANCE OF THE SECTORS MOST SEVERELY AFFECTED BY THE PANDEMIC

The NPL coverage ratio for the resident private sector contracted slightly in 2022 Q1, although it has remained highly stable in recent quarters, standing above pre-pandemic levels. On the most recent data, the ratios dropped in the sectors most severely and moderately affected by the pandemic, whereas it rose in the largely unaffected sectors.

1 NPL COVERAGE RATIO. RESIDENT PRIVATE SECTOR
Business in Spain. DI



2 NPL COVERAGE RATIO. BUSINESS SECTORS (a)
Business in Spain. DI



SOURCE: Banco de España.

a Lending to the most severely affected sectors is proxied by that for sectors with a fall in turnover of more than 15% in 2020 and identified in the FI-130 regulatory return. Specifically, the most severely affected sectors include hospitality (accommodation and food service activities), the manufacture of refined petroleum products, social services and entertainment, transport and storage, and the manufacture of transport machinery. Lending to moderately affected sectors is proxied by the following sectors in the FI-130 regulatory return: basic metals, the manufacture of machinery, other manufacturing, professional services, mining and quarrying, wholesale and retail trade, and repair of vehicles. The largely unaffected sectors comprise the group of other productive activities.



The weight of NPLs and Stage 2 loans declined slightly in 2022 Q1, accounting for 4.1% and 22.7%, respectively, of total lending to the resident private sector, although that of Stage 2 loans remains above the ratios observed before the pandemic (see Chart 4.3). In the first three months of the year, the weight of NPLs only increased (0.5 pp) in the sectors most severely affected by the COVID-19 crisis, such as the hospitality and tourism sectors, sensitive to the rise in energy and food prices, in which the weight of NPLs increased by 0.3 pp and 0.9 pp, respectively, up to March 2022.

Forborne loans (more than half of which were classified as non-performing), which tend to be associated with repayment problems on the part of borrowers, grew by 8.8% in March 2022 year-on-year (down 5.5 pp since December 2021). The volume of forborne exposures in lending to households fell by 6.6% year-on-year, but rose by 22.7% in lending to firms.

Foreclosed assets (which return to the bank following foreclosure proceedings) amounted to €23 billion in December 2021 (latest available figure). This represents a

decline of €7.7 billion (25.1%) with respect to the situation in 2019 immediately preceding the pandemic, and a volume well below that accumulated following the global financial crisis (€77.9 billion in December 2013).

Despite the positive aggregate behaviour of NPLs and Stage 2 loans in 2022 Q1, which continued until May, the worsening macro-financial environment resulting from inflationary pressures and geopolitical tensions, and the petering out of the support measures, could entail forward-looking risks of credit quality impairment.

Lastly, the NPL coverage ratio⁸ for the resident private sector stood at 45.6% in March 2022 (see Chart 5.1), 4.4 pp above the ratio posted in December 2019, before the onset of the pandemic. In the first quarter of the year, this ratio dropped slightly (0.3 pp) owing to a reduction in the coverage ratio for lending to households (-0.2 pp) and to non-financial corporations and sole proprietors (-0.6 pp).

The NPL coverage ratio presents differences across the sectors of activity based on the extent to which they have been affected by the pandemic (see Chart 5.2). It is important to note that the pre-pandemic starting position already varied across the three groups, with the highest coverage ratio in the moderately affected sectors. In 2022 Q1, the coverage ratios fell in the most severely affected (-3.4 pp) and moderately affected sectors (-2.1 pp), and rose in the largely unaffected sectors (2.5 pp), thus prompting a degree of convergence.

26.7.2022.

⁸ This ratio corresponds to loan loss provisions as a percentage of NPLs.

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PASS-THROUGH OF MARKET INTEREST RATES TO THE COST OF BANK LOANS

A notable increase in the interest rates negotiated on money and capital markets, higher in the case of longer-term operations, has been observed since early 2022. These interest rates generally serve as a benchmark to set the interest on loans to firms and households, such that changes in the former usually feed through to the latter more or less fully, albeit with some lag as a result of various factors. First, this lag may appear as a result of the duration of the bank loan arrangement process. For instance, lending transactions included by financial institutions in the interest rate statistics for a given month may refer to transactions initiated in previous months. This may be particularly important in the case of mortgage loans, where the borrower could have received a binding loan contract offer up to two or three months before the date on which the loan is reported in the statistics.¹ Second, there are motives inherent to the banking business which explain this rigidity in the interest rates applied to loans, including most notably banks' reluctance to raise their rates frequently for commercial reasons.

The purpose of this box is to analyse the extent to which the speed at which market interest rates are passed through to the costs of new bank loans in recent months is in line with what has been observed in other historical periods of interest rate hikes. The analysis is conducted for loans for house purchase and loans to NFCs, the segments concentrating the highest volume of transactions, distinguishing in the latter case between loans up to €1 million and loans over €1 million. Also, new lending operations based on different interest rate revision horizons are analysed for some segments.²

Charts 1 to 4 show, for different credit market segments, the cumulative change in the cost of bank loans and their benchmark market interest rates between December 2021 and May 2022 (latest data available). Also shown for comparison purposes are the changes in these interest rates over the first five months of another historical bout of interest rate hikes (which started in September 2005 for the short- and medium-term benchmarks and in September 2010 for longer-term benchmarks³).

As shown in Chart 1, between December 2021 and May 2022 average interest rates with a short-term initial rate fixation period (hereafter, short-term interest rates) for loans for house purchase (mainly floating-rate loans) rose by a mere 22% of the change during that period in 12-month EURIBOR, which is the main benchmark for these loans. This proportion is clearly lower than that observed (58%) in the first five months following the start of the interest rate hike episode of 2005. In the case of interest rates with a long-term initial rate fixation period (hereafter, long-term interest rates) for this segment, mainly fixed-rate loans, the pass-through in the same period has been even lower (13%), in relation to the changes in the benchmark rate (20-year interest rate swap, IRS), although in the past cycle selected, which occurred in 2010, a similar pass-through was observed (see Chart 2).

In the segment of loans to NFCs of up to €1 million, interest rates with a medium-term initial rate fixation period have increased from December 2021 to May 2022 by 25% relative to the change observed in the benchmark rate (3-year IRS) in the same period, whereas in 2005, the pass-through during the first five months from the start of the rate hike cycle was 58% (see Chart 3). The bank rates on loans of more than €1 million to the NFC segment have risen by 12% relative to the increase in the benchmark rate. Again, this contrasts with developments in 2005, when the pass-through of changes in benchmark rates was more pronounced (41%) five months after the start of the rate hike cycle (see Chart 4).

In short, the above evidence suggests that in the most recent months for which data are available, the pass-through of market interest rates to bank lending rates is proving more sluggish than in previous episodes of interest rate hikes. This may be due, at least in part, to the fact that the interest rates on bank deposits, the main source of funding of financial institutions, have been subject to less pressure up until now. Indeed, as shown in Chart 5, in contrast to 2005, the remuneration of customer deposits has not increased in response to the rise in money market

1 In this respect, mention should be made of the European Standardised Information Sheet (ESIS) included in Law 5/2019 of 15 March 2019, regulating real estate credit agreements. The ESIS is considered as the bank's binding offer during the period agreed until the agreement is entered into, which must be within at least ten days.

2 Lending to firms where interest rates are revised in under one year is not considered, since in this case the interest rate that is generally used as a benchmark (3-month EURIBOR) has shown a low rate of change in the period examined. Neither is lending to firms where interest rates are revised after five years or more, since the volume of these loans is very low.

3 To choose the cycle of interest rate hikes in the historical period, a significant cumulative rise in the benchmark interest rate (of at least 69 bp) must have been recorded and the upward cycle must have lasted at least six months.

PASS-THROUGH OF MARKET INTEREST RATES TO THE COST OF BANK LOANS (cont'd)

Chart 1
CUMULATIVE CHANGE IN THE COST OF LOANS FOR HOUSE PURCHASE IN THE SHORT TERM AND IN THE MARKET INTEREST RATE (b)

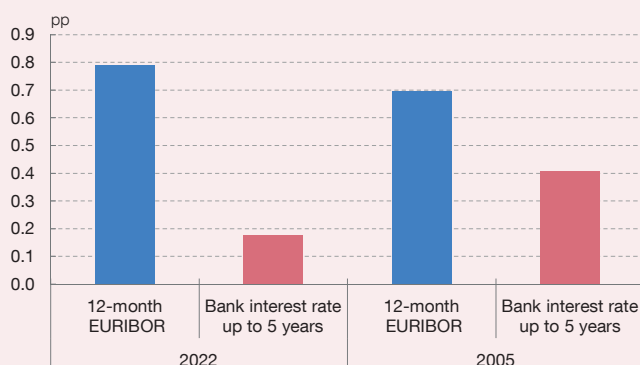


Chart 2
CUMULATIVE CHANGE IN THE COST OF LOANS FOR HOUSE PURCHASE IN THE LONG-TERM AND IN THE MARKET INTEREST RATE (c)



Chart 3
CUMULATIVE CHANGE IN THE COST OF LOANS TO NFCs UP TO €1 MILLION IN THE MEDIUM-TERM AND IN THE MARKET INTEREST RATE (b)



Chart 4
CUMULATIVE CHANGE IN THE COST OF LOANS TO NFCs OVER €1 MILLION IN THE MEDIUM-TERM AND IN THE MARKET INTEREST RATE (b)



SOURCE: Banco de España.

- a Bank lending interest rates are narrowly defined effective rates (NDEs), i.e. they exclude related charges, such as repayment insurance premia and fees. They are also trend-cycle interest rates, i.e. they are adjusted for seasonal and irregular components (small changes in the series with no recognisable pattern in terms of periodicity or trend). Also, the bank rate term does not necessarily indicate the maturity of the lending transaction, but rather the frequency with which the interest rate on the arranged loan is revised.
- b The cumulative change in interest rates is shown for two cycles between month 0 and month 5. In 2022 month 0 relates to December 2021 and in 2005 to September 2005.
- c The cumulative change in interest rates is shown for two cycles between month 0 and month 5. In 2022 month 0 relates to December 2021 and in 2010 to September 2010.

interest rates. This stability can probably be explained by financial institutions' lower funding needs, against a backdrop of high liquidity ratios and a proportion of deposits to loans exceeding 100%, well above the figures recorded in 2005 (see Chart 6). Moreover, it should be noted that, in recent months, the remuneration of deposits was high compared with money market rates, since it continued to be constrained by its zero lower bound,

limiting its scope for rebound until money market interest rates recovered their usual spread relative to bank deposit rates.⁴ However, in June 2022, 12-month EURIBOR already stood at 85 bp, representing a larger spread vis-à-vis bank deposit rates than that observed in normal times (around 40 bp).⁵ In this setting, financial institutions, competing to raise funds, will foreseeably begin to increase the remuneration of bank deposits in the coming months.

4 See, for example, Ulate, Mauricio. 2021. "Going Negative at the Zero Lower Bound: The Effects of Negative Nominal Interest Rates". *American Economic Review*, 111(1), pp. 1-40.

5 The spread was calculated for 2003 to 2008. The subsequent period, considered atypical because of the financial and sovereign debt crisis and, more recently, on account of the period of low policy interest rates, was excluded.

PASS-THROUGH OF MARKET INTEREST RATES TO THE COST OF BANK LOANS (cont'd)

Chart 5
CUMULATIVE CHANGE IN THE REMUNERATION OF HOUSEHOLDS' FIXED-TERM DEPOSITS VS THE MARKET INTEREST RATE (a) (b)

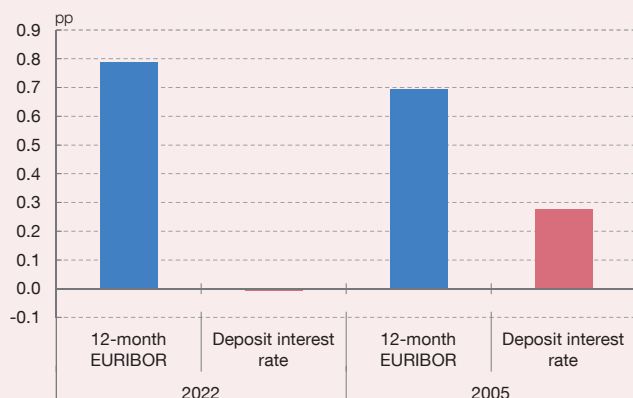
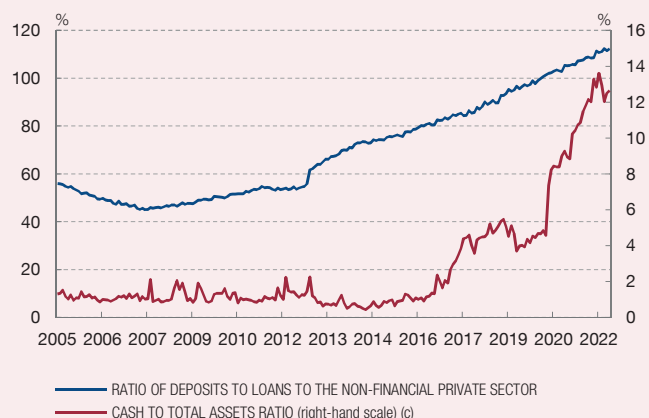


Chart 6
RATIO OF DEPOSITS TO LOANS TO THE NON-FINANCIAL PRIVATE SECTOR AND CASH TO TOTAL ASSETS RATIO



SOURCES: Banco de España and ECB.

- a Deposit interest rates are narrowly defined effective rates (NDEs) on new transactions involving fixed-term deposits.
- b The cumulative change in interest rates is shown for two cycles between month 0 and month 5. In 2022 month 0 relates to December 2021 and in 2005 to September 2005.
- c The numerator includes cash balances and the volume of loans to central banks. The latter are included as they are considered to largely comprise cash balances at central banks.