

# LENDING TO NON-FINANCIAL CORPORATIONS AND RELATED CREDIT CONDITIONS

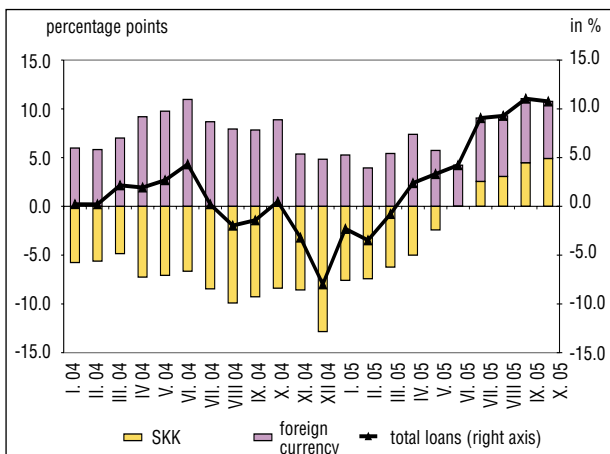
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A much discussed phenomenon of today's credit market is the relatively dynamic growth in household lending. But in terms of shaping the supply side of the economy, it is corporate loans – loans to non-financial corporations (NFCs) – that play the significant role. Alongside foreign investment inflows, lending to NFCs is creating conditions for the financing of technological development, sustainable growth, and real convergence. The favourable environment for the entry of NFCs into the credit market is laying the basis for growth of the economy's productive capacity. The purpose of this article is to outline the trends within lending to NFCs, as well as the credit conditions and risk premium of this sector in comparison with that in the V4 region and the euro area. The period under review ends with October 2005.

## Lending to non-financial corporations grew in 2005

Lending to NFCs recorded gradual growth in 2005 after falling in volume the previous year largely due to specific factors – for example, the sale of banks' non-performing loans, debt restructuring in enterprises and the transfer of loans to the public sector. Loans in foreign currency grew relatively sharply (in October 2005 they were up by SKK 13.9 billion year-on-year) under the effect of persisting expectations for appreciation of the Slovak koruna and comparatively favourable interest rates (the rate on out-

**Chart 1 Year-on-year dynamics in lending to non-financial corporations and contributions of loans in SKK and foreign currency (FC) to total year-on-year dynamics**



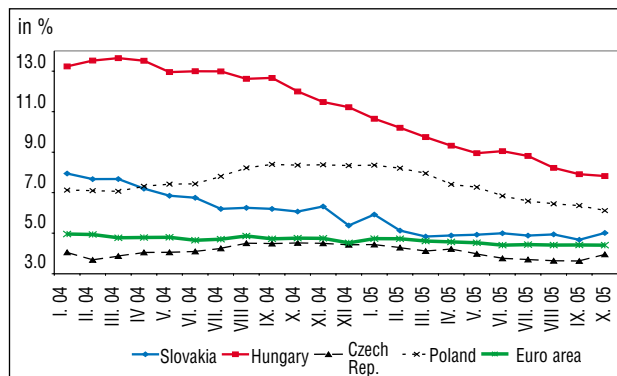
Source: NBS.

standing loans in EUR is approximately 1.3 percentage points lower than in SKK). Koruna loans, too, recovered their growth (year-on-year up by SKK 11.7 billion in October 2005).

## Development of koruna loans boosted by fall in interest rates

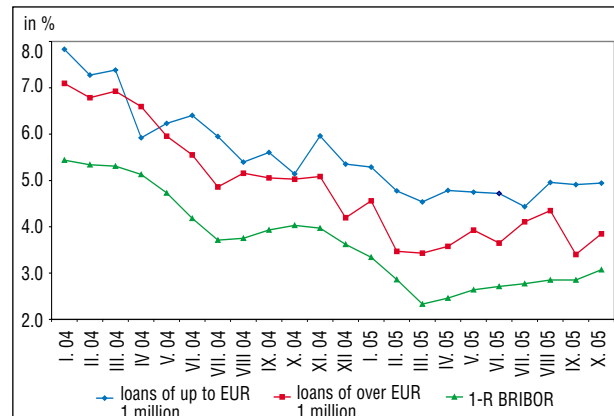
The growth in koruna loans was supported by a gradual decline in nominal interest rates that followed the reduction of key interest rates by the NBS and developments in the interbank money market. Nominal interest rates on loans to NFCs fell almost to the level in the euro area, and in comparison with Hungary and Poland, they were significantly lower (by 2.8 and 1.1 percentage points respectively).

**Chart 2 Development of interest rates on new loans to non-financial corporations**



Source: NBS, Czech National Bank, National Bank of Hungary, National Bank of Poland, European Central Bank.

**Chart 3 Development of interest rates by lending volume**



Source: NBS.

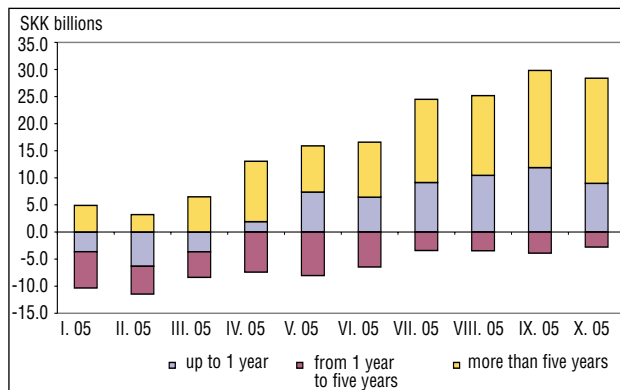


The development of lending rates by loan volume shows that rates fell both for large enterprises and for small and medium-sized ones. That said, the interest charged on loans of up to EUR 1 million, which are more likely to be taken out by SMEs, is higher than that on higher loans (mostly granted to large enterprises). The banking sector is therefore taking account of the lower risk with large enterprises.

### Long-term loans recorded highest growth

A positive feature of lending to NFCs in 2005 was the steady growth in long-term loans with a maturity of more than five years, which made the greatest contribution to the overall increase in lending. The growth of loans with terms of five years or longer did more than compensate for the decline in loans maturing between one and five years. Growth in short-term lending of up to one year reflected the increase in the use of current account overdraft facilities. In terms of time structure, the growth in lending to NFCs indicates that a significant volume of money lent is earmarked for the financing of investment and development activities in this sector<sup>1</sup>.

**Chart 4 Year-on-year growth in lending to non-financial corporations, expressed in absolute terms and according to maturity**



Source: NBS.

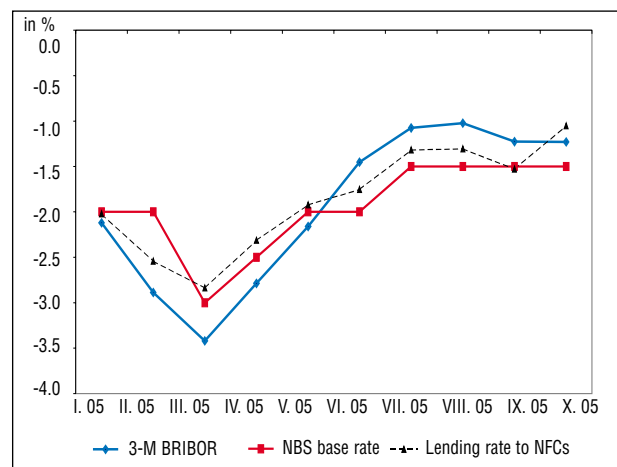
### Credit conditions and risk premium for non-financial corporations

The conditions under which a NFC may draw a bank loan is directly related to risk undertaken by the bank in providing the loan. The credit risk, or risk premium, applied by the bank may be approximated with the interest-rate spread between the lending rate and the twelve-month interest rate on the interbank market (BRIBOR). This interest-rate spread in Slovakia has long been stable and fluctuating

<sup>1</sup> The special-purpose structure for lending to NFCs in SKK and foreign currency is only available during 2005. According to this methodology, the volume of investment loans grew by SKK 27.3 billion between January and October 2005.

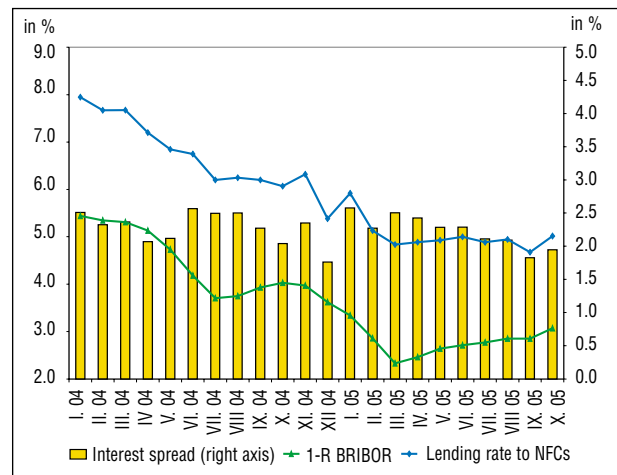
around 2%. The intensity with which NBS base rate changes are pass through into money market rates and customer rates for NFCs is similar. In other words, customer rates are reacting flexibly to changes in the money market. The low volatility of the interest-rate spread signals a stable degree of risk in the NFC sector. Recent months have seen a slight decline in the interest-rate spread, which indicates a reduction in the risk premium, probably in relation to the strong economic growth and the increased profitability of NFCs.

**Chart 5 Year-on-year changes in the NBS base rate, three-month BRIBOR, and lending rate to non-financial corporations**



Source: NBS.

**Chart 6 Interest rates on domestic currency loans to NFCs in Slovakia, the 12M BRIBOR, and the spread between them**



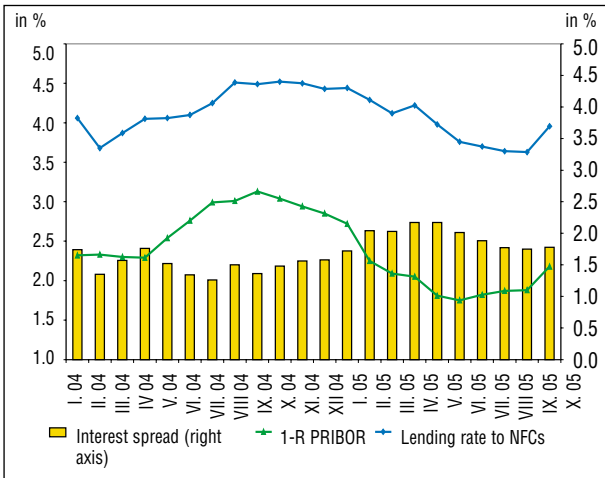
Source: NBS.

### Risk premium in Slovakia is comparable with other countries

As in Slovakia, the interest-rate spread/risk premium in Hungary and the Czech Republic is fluctuating around 2%.

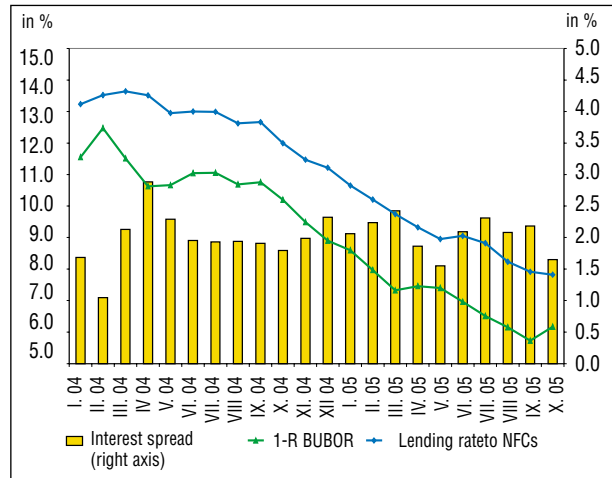


Chart 7 Interest rates on domestic currency loans to NFCs in the Czech Republic, the 12M PRIBOR, and the spread between them



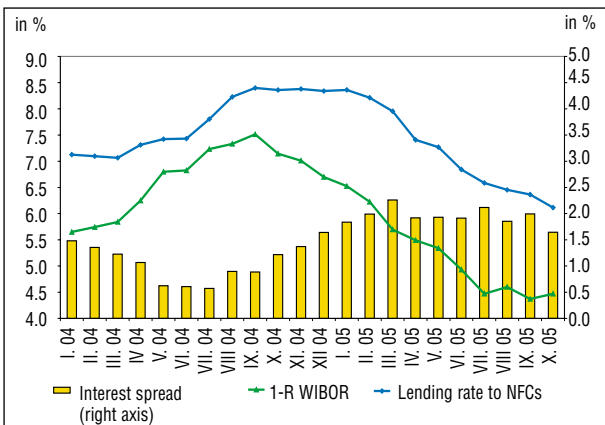
Source: Czech National Bank.

Chart 8 Interest rates on domestic currency loans to NFCs in Hungary, the 12M BUBOR, and the spread between them



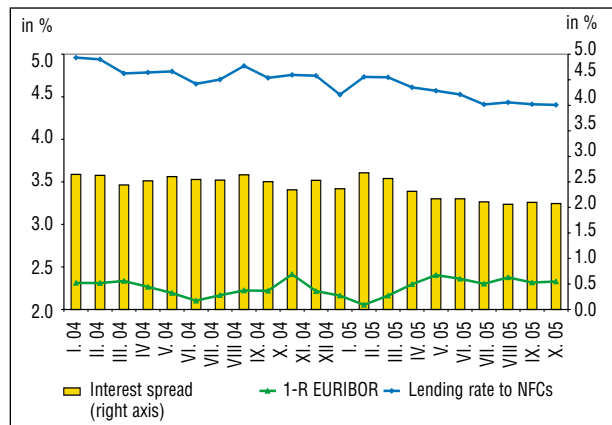
Source: National Bank of Hungary.

Chart 9 Interest rates on domestic currency loans to NFCs in Poland, the 12M WIBOR, and the spread between them



Source: National Bank of Poland, www.money.pl.

Chart 10 Interest rates on EUR loans to NFCs in euro area, the 12M EURIBOR, and the spread between them



Source: ECB, www.euribor.org.

Another similarity between these countries and Slovakia is the promptness with which changes in interbank interest rates are reflected in customer lending rates to NFCs.

The pattern among V4 countries was slightly broken in Poland when gradual growth in interbank interest rates during 2004 was not fully passed through to the lending rates to NFCs, and the interest-rate spread remained very low. In 2005, however, interest rates declined and the spread grew repeatedly, up to around 2%.

In the euro area, interbank interest rates and customer lending rates to NFCs have reached a relatively stable level. When the euro area interbank rate EURIBOR rose slightly at the beginning of the year, it was probably caused by anticipation of an increase in ECB key rates. As yet, however, these developments have not been reflected in the lending rates to NFCs, and so there has been a slight decline in the interest-rate spread over recent months. The interest-rate spread in the euro area is similar to that in Slovakia, the Czech Republic, Hungary and

Poland, at round 2%.

### Conclusion

The development of lending to NFCs in Slovakia in 2005 has created the conditions for convergence of the Slovak economy and the growth of its production potential. The steep fall in interest rates, now around the level in the euro area, has provided a favourable credit environment for the corporate sector. Among the V4 countries, Slovakia has the second lowest lending rates for NFCs. The interest-rate spread indicates a stable degree of risk in this sector while the risk premium is comparable to that in the euro area and in the other V4 countries.