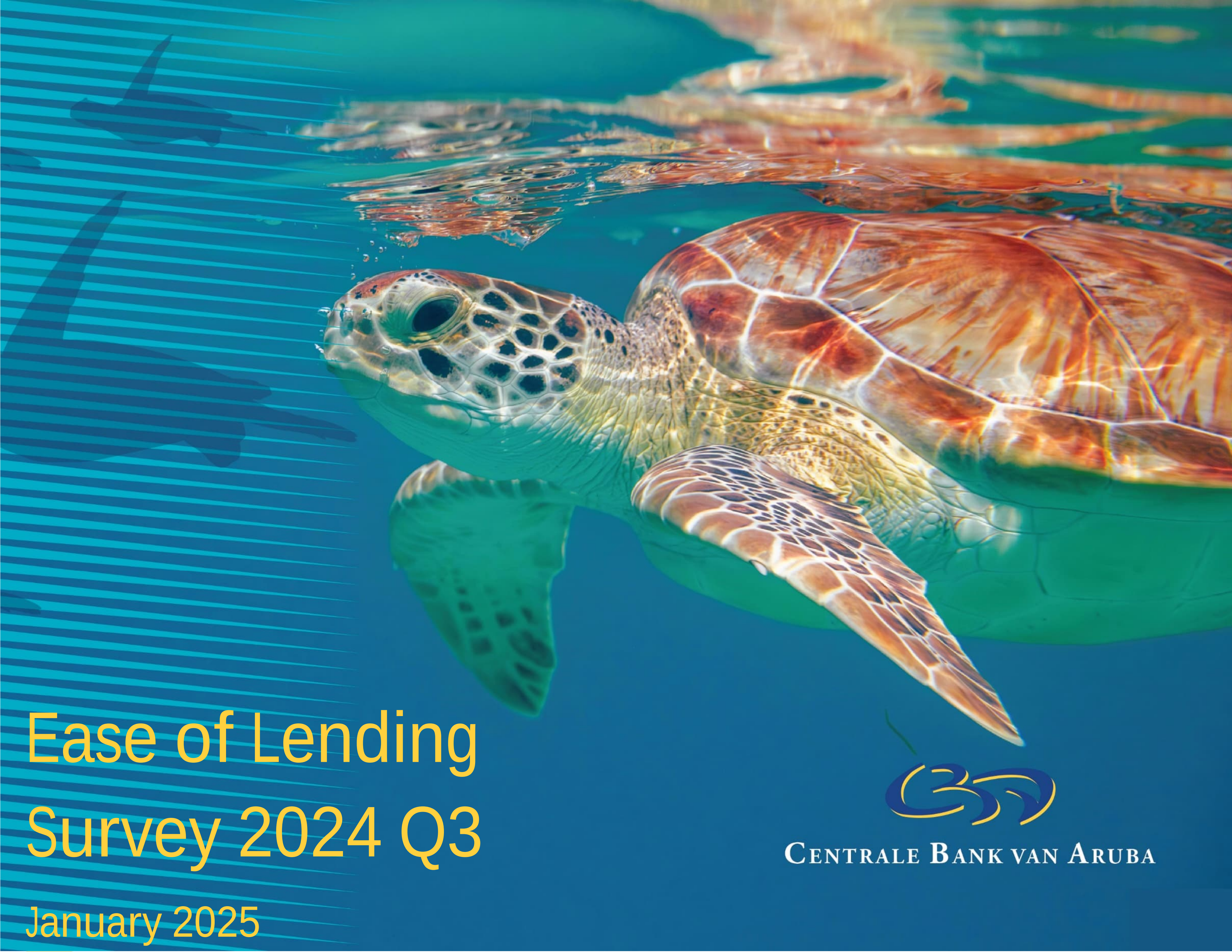


Ease of Lending Survey 2024 Q3

January 2025

CENTRALE BANK VAN ARUBA

Cover design:
Our turtles.
They choose Aruba’s beaches as a safe haven;
They choose Aruba’s beaches are their breeding ground;
They connect and communicate through vocalizations and body language.
Their slow and steady pace represents resilience and endurance.

Abstract

The downward trend in credit conditions reversed in the third quarter of 2024

The Central Bank of Aruba (CBA) recently concluded its Ease of Lending Survey (ELS) for the third quarter of 2024. The ELS captures commercial banks' sentiments about loan supply and demand. From the 16 questions, the CBA generates and aggregates indices (between 90 and 110) for business and individual loans. An index between 90 and 100 suggests pessimistic sentiments, and an index between 100 and 110 implies optimistic sentiments.

The results show that the overall (unweighted) credit conditions index stood at 102.2 in the third quarter of 2024. This figure highlights that after three quarters of declining optimism, commercial banks now perceive improved credit conditions. This shift came about through better current credit conditions (index: 102.6) and future credit conditions (index 101.7).

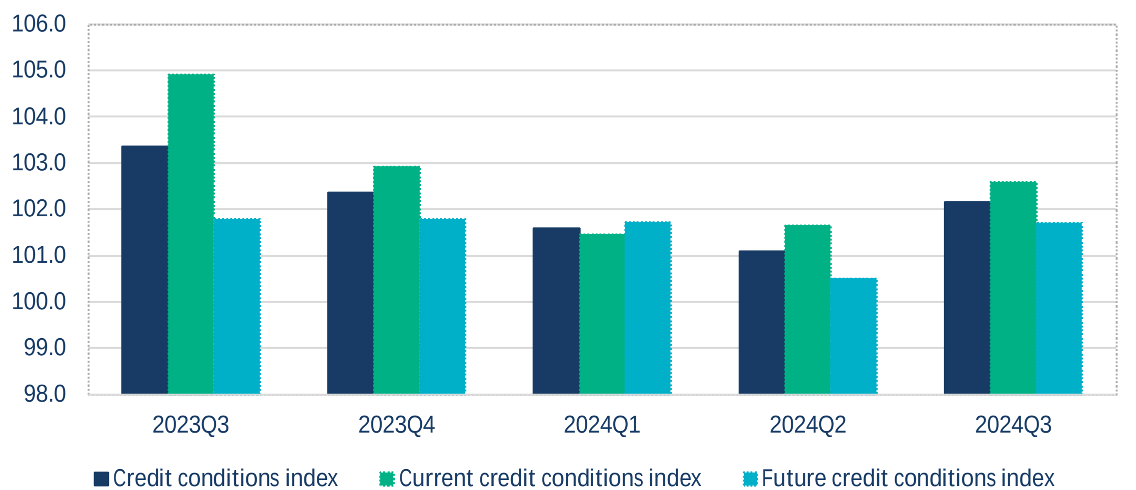
Contents

I. Developments in credit conditions

Credit conditions index

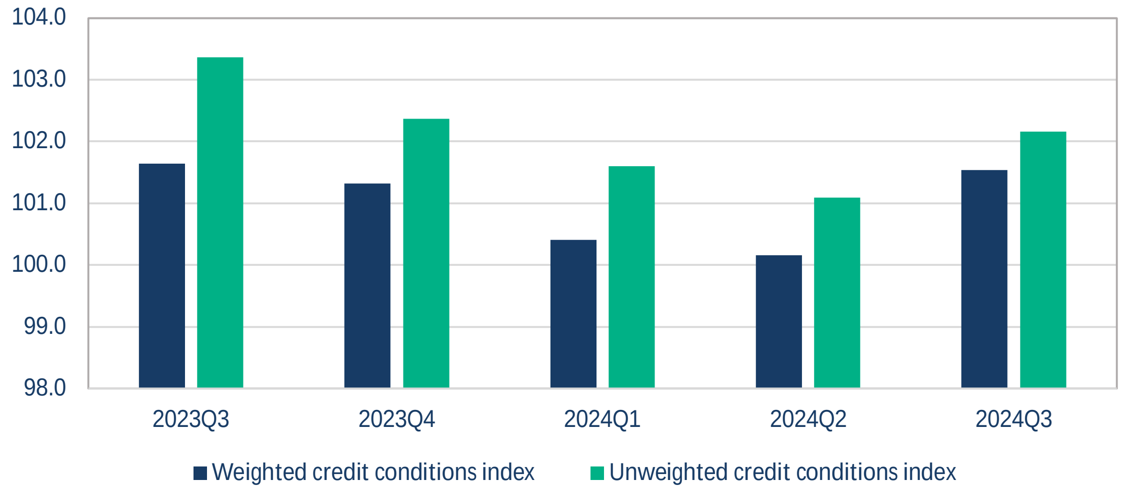
The overall (unweighted) credit conditions index rose to 102.2 in the third quarter of 2024, up from 101.1 in the second quarter of 2024. This increase indicates that commercial banks perceived credit conditions more favorably than in the previous charter (Chart 1). The improved perception mirrored increasing current (index: 102.6) and future credit conditions (index 101.7). In particular, commercial banks were more optimistic about credit conditions for businesses, while on credit conditions for individuals they were less optimistic. The improved credit conditions index signals a pivot after three quarters of deteriorating credit conditions.

Chart 1: Development in credit conditions index



This trend reversal is also noticeable in the weighted credit conditions (index: 101.6), which adjusts the responses of commercial banks according to their loan portfolio size. Conversely, in the unweighted credit conditions, smaller banks appear more prominently. Thus, the sentiment of strengthened credit conditions was irrespective of bank size distribution.

Chart 2: Weighted versus unweighted credit conditions index



Current credit conditions index

Commercial banks noted improved current credit conditions, as the (unweighted) index rose from 101.7 in the second quarter of 2024 to 102.6 in the third quarter of 2024. The more favorable outcome was primarily associated with brighter current conditions for business loans (index: 103.4 vs. 100.8). In particular, commercial banks reported a growing proportion of approved business loans (index: 103.8 vs. 101.3) and increased willingness to extend business loans (index: 103.8 vs. 100). Indeed, business loans (resident stock only) rose from Afl. 1,896.9 million end-June 2024 to Afl. 1,938.8 million end-September 2024. However, commercial banks were less optimistic about loans to individuals, in which the current conditions index fell from 102.5 to 101.6 in the mentioned period. This finding is at odds with the expanded loans to individuals (resident stock only, excluding mortgages) from Afl. 440.4 million end-June 2024 to Afl. 456.2 million end-September.

Future credit conditions index

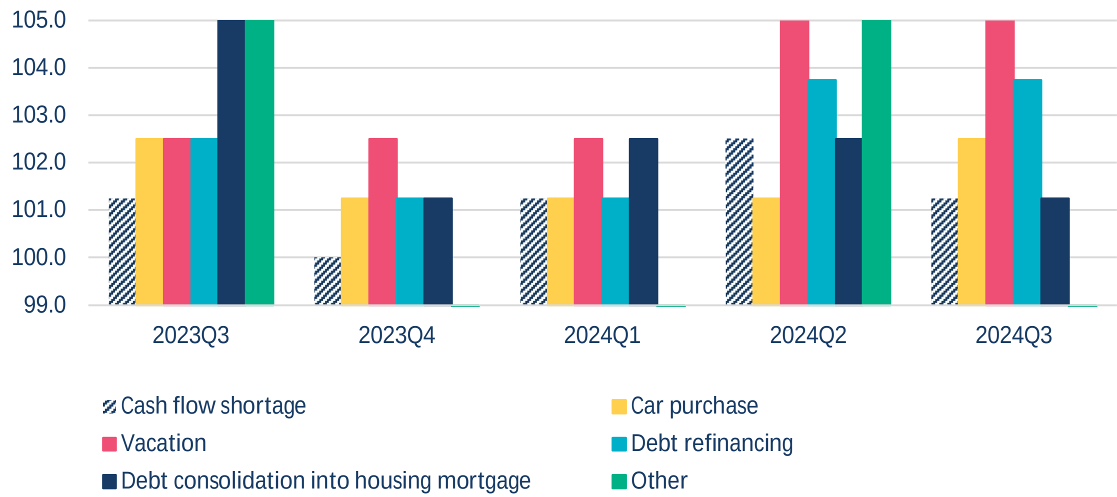
During the third quarter of 2024, the future conditions index registered 101.7, compared to 100.5 in the second quarter of 2024. Accordingly, commercial banks anticipated a more advantageous outlook for credit conditions. This turnout resulted from commercial banks foreseeing improved business loan conditions (index: 103.4 vs. 99.2). Specifically, the perception is that the proportion of approved business loans will rise (index: 103.8 vs. 98.8) and willingness to extend business loans will strengthen (103.8 vs. 98.8). On the other hand, commercial banks expect credit conditions for individual loans to worsen (index: 100 vs. 101.8).

II. Drivers of credit conditions

Drivers of current credit conditions

Various supply and demand factors influenced the current credit conditions in the third quarter of 2024. From the demand side of individuals, there was interest in vacation loans and debt refinancing (Chart 3). These two categories were also relevant in shaping demand in the previous quarter.

Chart 3: Contributors to changes in individual loan demand, index (current quarter)



Vacation loans in particular have recently seen significant demand in the last two quarters. For example, all commercial banks reported “a little more interest” in vacation loans from individuals in the third quarter of 2024. The method to quantify survey responses such “a little more interest” is the theme of Box 1:

Box 1: Quantifying qualitative ELS responses

Quantifying the qualitative responses of the ELS is crucial to understanding the trend in commercial bank sentiment and behavior, which may be relevant for the monetary policy of the CBA. Other major central banks also quantify the qualitative responses of bank lending surveys. This process involves aggregating and normalizing survey responses. However, the aggregation of survey responses varies across central banks. For example, the Bank of England[1] differentiates between "increased considerably" and "increased slightly" when calculating the percentage of positive responses, in contrast to the Fed[2] and the Bank of Canada[3]. Meanwhile, the ECB[4] considers both differentiated and undifferentiated positive responses. Regardless of the aggregation approach, all four central banks report net percentages (that is, the difference between positive and negative response rates) which are normalized to vary between -100 and 100. The rest of this box will elaborate on the aggregating and normalizing method of the ELS.

Aggregation

Similar to the four reviewed central banks, the ELS maintains a five-point scale for questions. For example, in the third question of the ELS, commercial banks are asked about the drivers of individual loan demand over the last three months. Commercial banks can then answer that these drivers went "up a lot", "up a little", "same", "down a little", and "down a lot". The corresponding points for these scales are 1, 0.5, 0, -0.5 and -1, respectively. Accordingly, similar to the Bank of England and the ECB, extreme responses are assigned a double weight. Consequently, the unnormalized score for each driver in the third question equals:

(1) $Unnormalized\ score\ = (1{,}0.5{,}0, -0.5, -1) * (k_1, k_2, k_3, k_4, k_5)^T = k_1 + 0.5k_2 - 0.5k_4 - k_5$

where T denotes the transpose operation and k_i indicates the number of responses recorded for "up a lot", "up a little", "same", "up a little" and "down a lot".

Normalization

Given that there are four commercial banks in Aruba, and the five-point scale ranges between -1 and 1, the unnormalized score in equation (1) varies between -4 and 4. The reviewed central banks typically normalize their scales between -100 and 100. However, in keeping with

[1] https://www.bankofengland.co.uk/credit-conditions-survey/2023/2023-q4
[2] https://www.federalreserve.gov/data/sloos/sloos-202410-table-1.htm and https://www.federalreserve.gov/data/sloos/sloos-202410-chart-data.htm
[3] https://www.bankofcanada.ca/wp-content/uploads/2011/07/senior_loan_officer_survey_backgrounder.pdf
[4] https://www.ecb.europa.eu/stats/pdf/bls_user_guide_202309.en.pdf

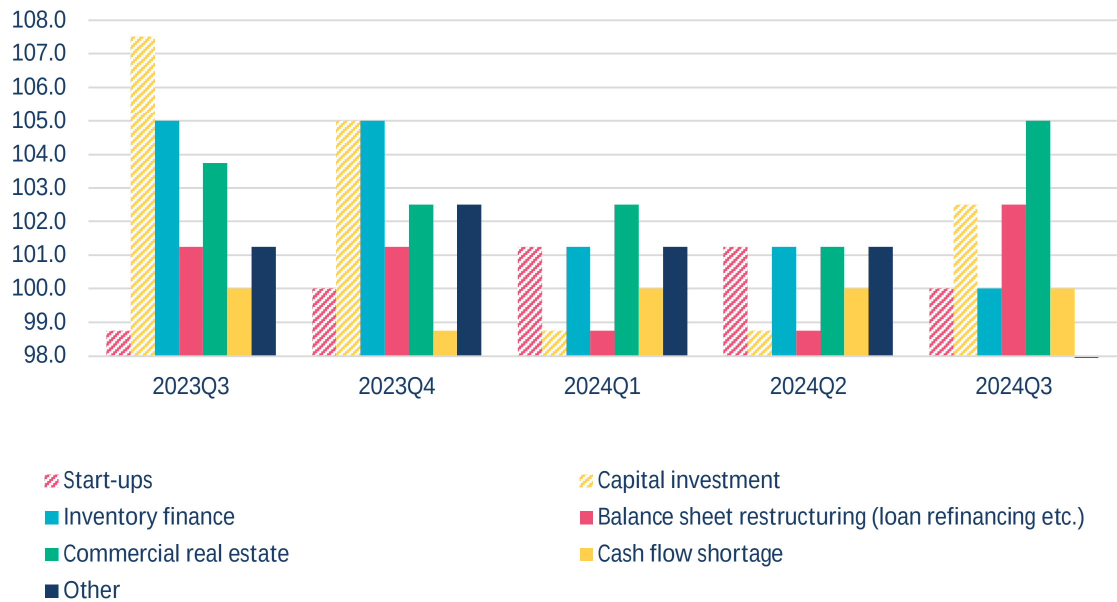
the normalization scale of the CBA's credit conditions index and consumer confidence index, the index is normalized between 90 and 110, :

(2) $$Normalized\ score = \left(\frac{Unnormalized\ score}{4}\right) * 10 + 100$$

To summarize, quantifying the qualitative responses of the ELS involves assigning a double weight to "up a lot" and "down a lot" responses, akin to the Bank of England and the ECB. Yet, it normalizes the responses between 90 and 110, distinct from the four reviewed central banks. As a final note, this Box only described the approach to derive Chart 3 for ease of exposition, but it generalizes to subsequent charts.

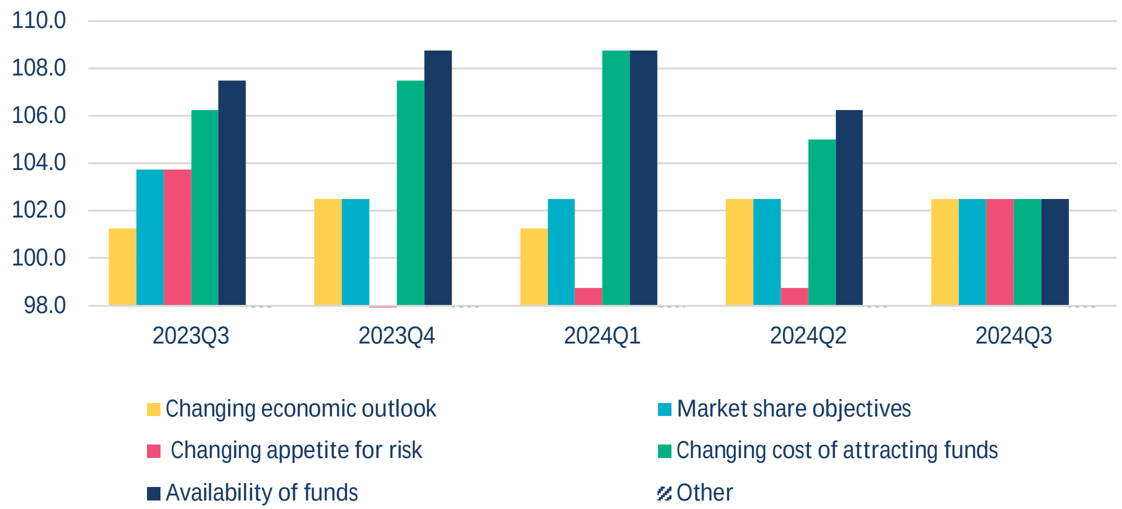
On the business side, commercial banks reported significant demand for commercial real estate (Chart 4). Specifically, three commercial banks reported that commercial real estate "went up a little" or better. This demand represents a peak compared to the previous quarters. To a lesser degree, capital investments and balance sheet restructuring also impacted business loan demand after their absence in two consecutive quarters.

Chart 4: Contributors to changes in businessis loan demand, index (current quarter)



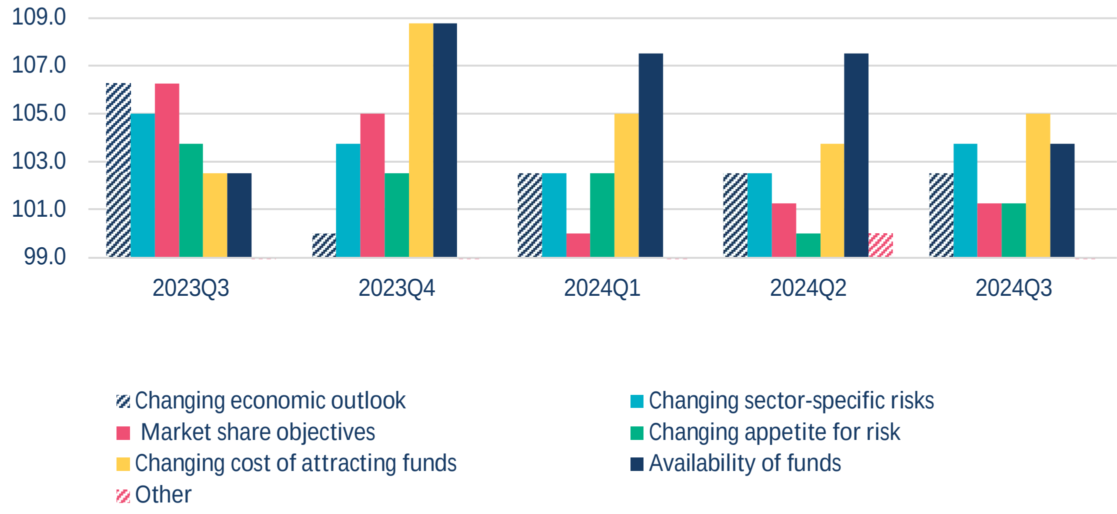
From the supply side, the changing cost of attracting funds and fund availability impacted credit to individuals (Chart 5). However, their impact on individual loans has clearly been fading since the second quarter of 2024. Although the survey does not specify the impact of fund availability on credit extension, excess liquidity of commercial banks is a key proxy. Namely, the excess liquidity of commercial banks rose by Afl. 43.3 million at the end of September 2024 compared to the end of June 2024. This increased availability of funds usually suggests *mutatis mutandis* a positive disposition to credit extension.

Chart 5: Contributors to changes in individual loan supply, index (current quarter)



Funding costs and fund availability were the most prominent drivers of business loan supply (Chart 6). However, since the second quarter of 2024, their influence has diminished. Although the survey does not confirm whether these factors supported or hindered business loan supply, rising excess liquidity typically lowers the cost of attracting funds, which should encourage lending. Yet, during the period under review, this pattern was absent. Specifically, excess liquidity increased while the weighted average interest rate on new deposits remained at 3.1 percent.

Chart 6: Contributors to changes in business loan supply, index (current quarter)



Drivers of future credit conditions

Several supply and demand factors may shape the credit conditions in the fourth quarter of 2024. For individual loans, commercial banks foresee strong demand due to cash flow shortage and vacationing (Chart 7). Notably, these two factors are at their highest since the beginning of the ELS. As for business demand, two commercial banks anticipate demand growth from commercial real estate and capital investments (Chart 8). Over an extended period, both factors display the same resurgence since the second quarter of 2024. As more survey results become available, it can be determined if these changes are due to seasonal expectations.

Chart 7: Contributors to changes in individual loan demand, index (next quarter)

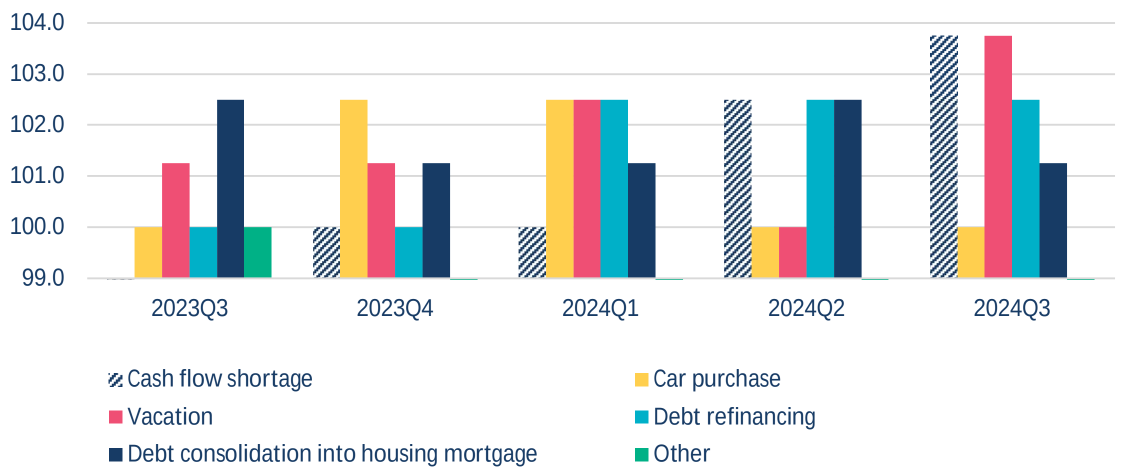
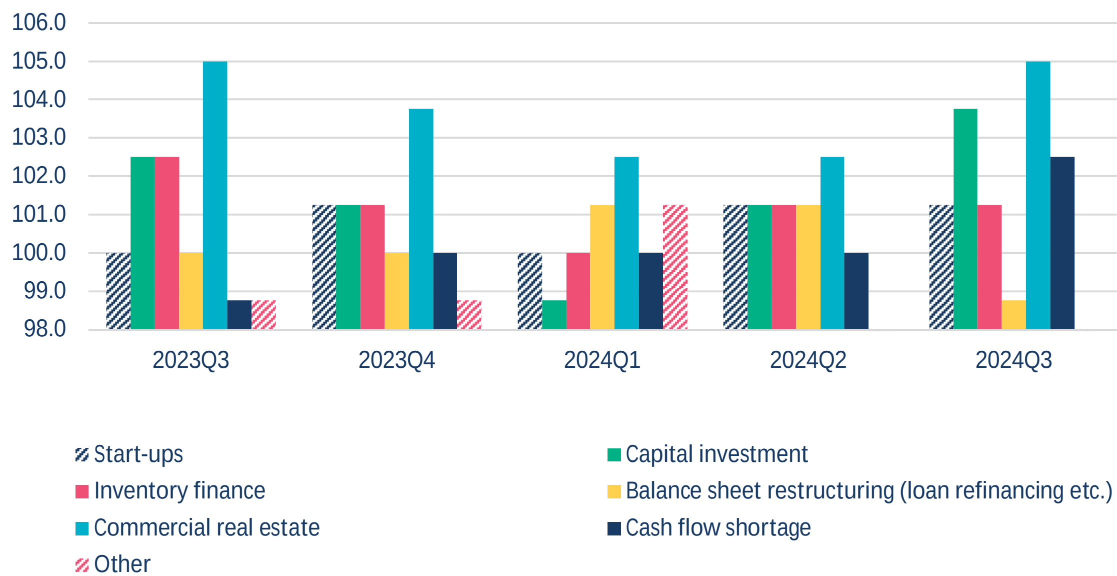


Chart 8: Contributors to changes in business loan demand, index (next quarter)



Concerning the supply side, three commercial banks envisage the changing appetite for risk and cost of attracting funds to influence the willingness to extend credit to individuals in the short term. Consequently, their contribution indices were the highest among the seven components in the third quarter of 2024 (Chart 9). Akin to individual loans, the changing cost of attracting funds will likely co-determine business loan supply (Chart 10). Furthermore, fund availability and sector-specific changes will likely influence commercial banks' decisions on business loans.

Chart 9: Contributors to changes in individual loan supply, index (next quarter)

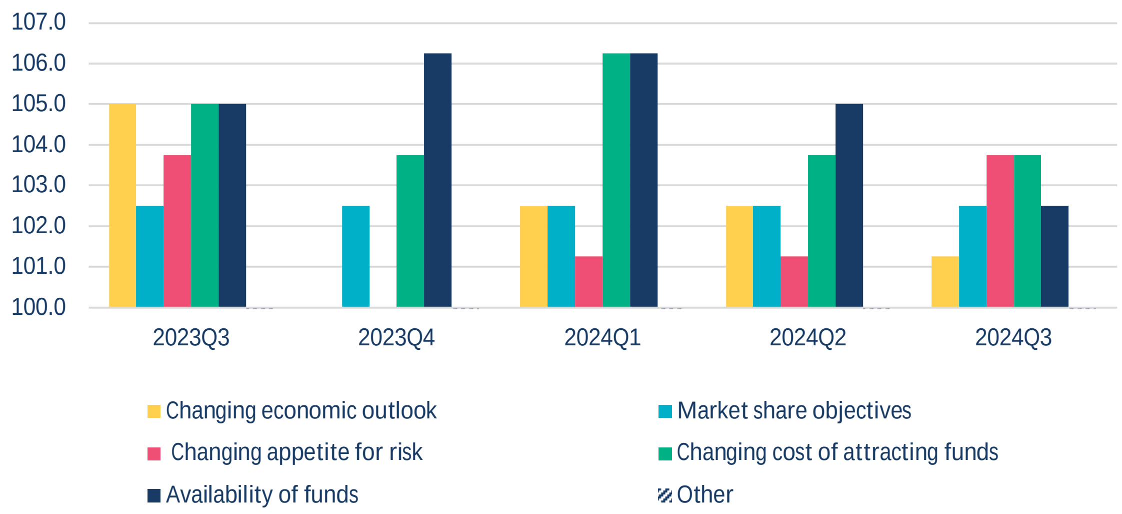
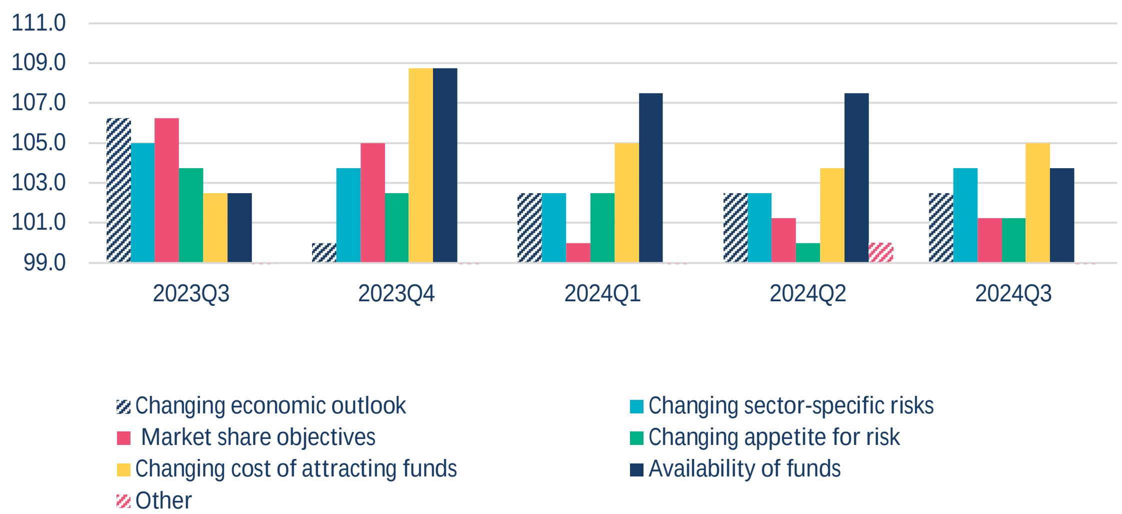


Chart 10: Contributors to changes in business loan supply, index (next quarter)

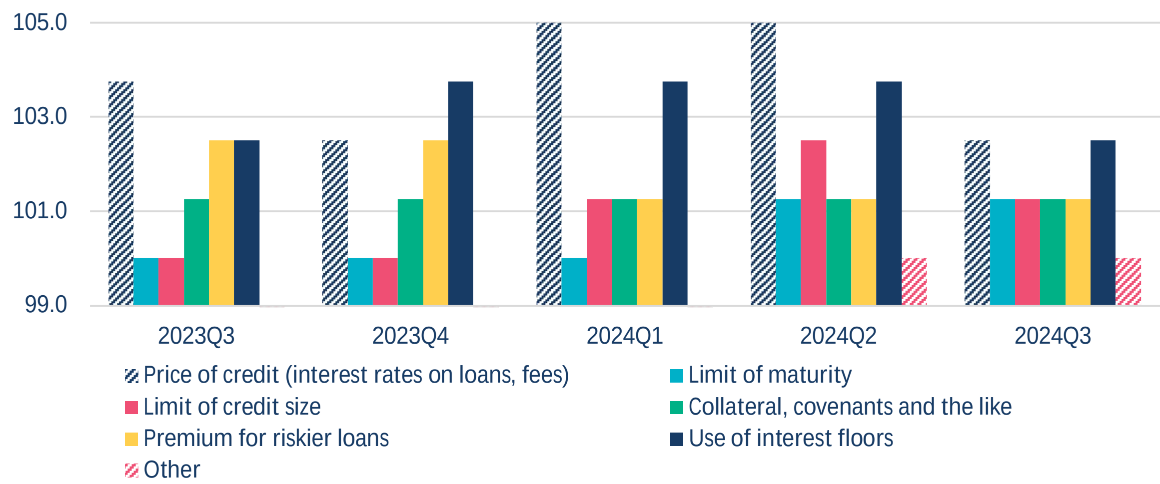


III. Effects of credit supply conditions

Effects of current credit supply conditions

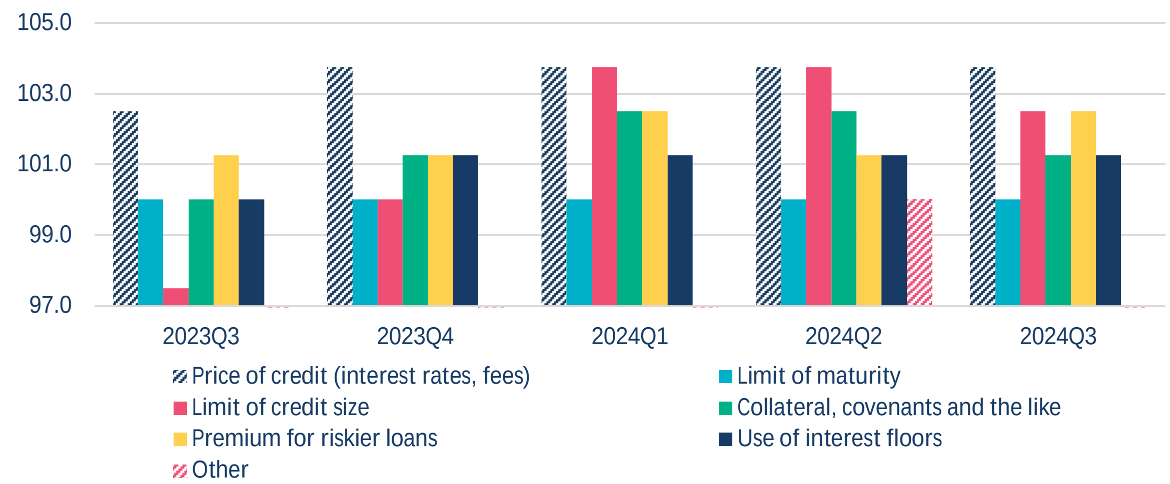
In the third quarter of 2024 commercial banks' willingness to extend individual credit (index: 101.6) was mainly associated with changes in interest rate floors and credit pricing, similar to previous quarters (Chart 11). Despite the survey being silent on whether credit price increased or decreased, supplementary data provide insights. Explicitly, the weighted average interest rate on new individual loans declined from 6.5 percent in the second quarter of 2024 to 6.3 percent in the third quarter of 2024. This drop is consistent with a growing excess liquidity.

Chart 11: Contributors to terms of credit changes for individuals, index (current quarter)



Price changes in businesses loans were intertwined with the willingness to supply credit (index: 103.6) (Chart 12), similar to individual loans. Namely, three of the four commercial banks reported that the credit price was slightly more influential on business credit term changes. Despite the survey foregoing questions about the direction of credit price movements, supplementary data indicate that the weighted average interest rate on new business loans fell from 6.6 percent in the second quarter of 2024 to 6.0 percent in the third quarter of 2024.

Chart 12: Contributors to terms of credit change for businesses, index (current quarter)



Effects of future credit supply conditions

Commercial banks' eagerness to supply credit in the short term (index: 100.6) is reflected by different levers. For individual credit, these levers primarily include credit price and premiums for riskier loans (Chart 13). For credit to businesses, most commercial banks reported that the levers were equally important in influencing terms of credit for businesses, which conduced to indices close to 100 (Chart 14).

Chart 13: Contributors to terms of credit change for individuals, index (next quarter)

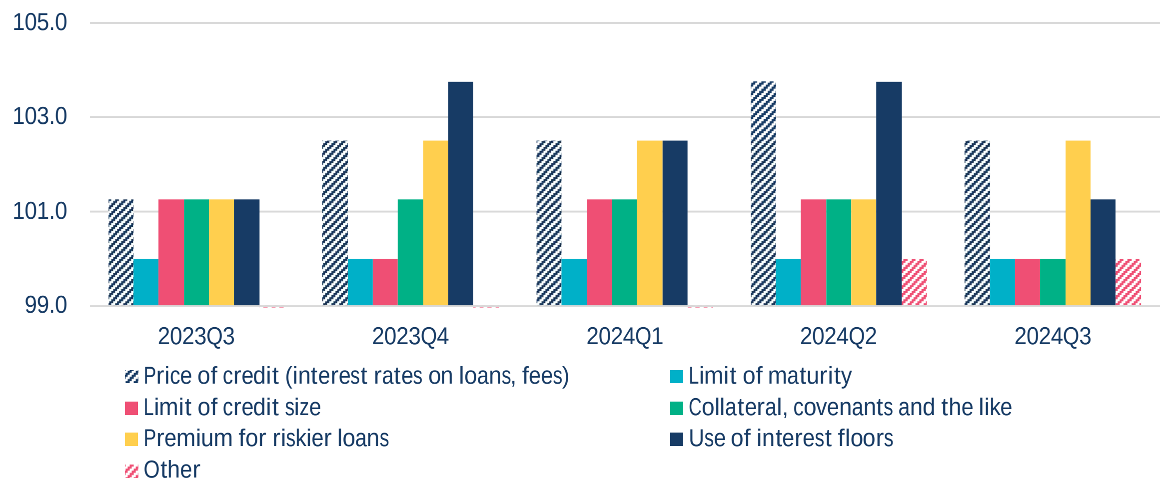
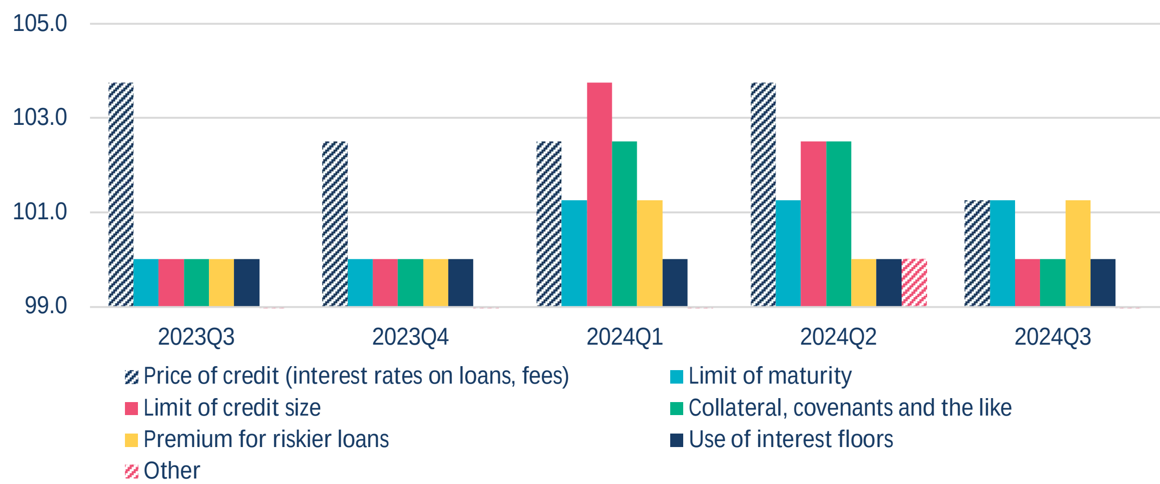


Chart 14: Contributors to terms of credit change for businesses, index (next quarter)



IV. Concluding remarks

The results show that the overall (unweighted) credit conditions index stood at 102.2 in the third quarter of 2024. This figure highlights that after three quarters of declining optimism, commercial banks now perceive improved credit conditions. This shift came about through better current credit conditions (index: 102.6) and future credit conditions (index 101.7). Various supply and demand factors in turn, influenced the current credit conditions. On the demand side, individuals showed interest in vacation loans and debt refinancing, while businesses generated significant demand for commercial real estate. From the supply side, the changing cost of attracting funds and fund availability impacted credit to individuals. Similarly, funding costs and fund availability were the most prominent drivers of business loan supply. Overall, the current, positive credit supply conditions were accompanied by a decrease in credit prices.

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