



Trends in lending

June 2014





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The objective of the publication Trends in Lending is to present a detailed picture of the latest trends in lending and to facilitate the appropriate interpretation of these developments. To this end, it elaborates on the developments in credit aggregates, the demand for loans perceived by banks and credit conditions. Within credit conditions, price and non-price conditions are distinguished: non-price conditions influence changes in the clientele considered creditworthy by banks and the conditions of access to credit. Price conditions, in turn, show the price of borrowing for creditworthy companies. In addition, with the help of the Financial Conditions Index (FCI), the analysis summarises the impact of the financial intermediary system on the economy. In particular, the key statistics examined in the analysis are the following:

- *The credit aggregates present quantitative developments in economic agents' loans outstanding on the basis of banking sector balance sheet statistics. Both the volume of new loans and net changes in banking sector loans outstanding (net of exchange rate effects) are presented. From Q4 2013 the analysis presents the trends in lending in the overall credit institution sector (banking system and foreign branches, cooperative credit institutions).*
- *Changes in non-price credit conditions are presented in a qualitative manner based on the Lending Survey, in which the banks that are active in the given segment and jointly cover 85–95 per cent of the credit market indicate the direction of change compared to the reference period. The Lending Survey includes price conditions in a qualitative manner as well, in the form of the spread on the cost of funds, the premium on risky loans and the fees charged.*
- *The interest rate statistics contain the price conditions, i.e. aggregate interest rates on credit institutions' new loans realised, weighted by the contract amounts. The lending rate can be decomposed into the reference rate and the spread on the reference rate.*
- *Banks active in the given segment provide qualitative responses in the Lending Survey in respect of their expectations and the changes in demand for loans they perceive. Similarly to credit conditions, banks indicate the direction of the change.*

Detailed information about the indicators describing the lending processes and the methodology of the Financial Conditions Index is provided in the annex at the end of the analysis. Within the publication, the findings of the Lending Survey are presented in a condensed form, but the responses to the questions and the set of charts based on the findings are published in full on the Lending Survey page of the MNB's website.

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1 Executive summary

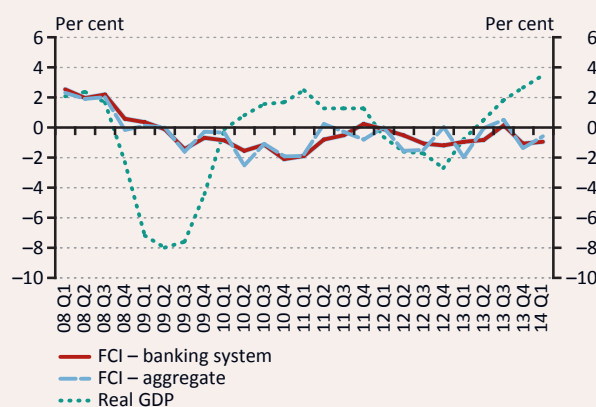
In 2014 Q1, based on the transactional data, lending to non-financial corporations declined, in other words repayments exceeded disbursements. Similarly to previous quarters, this decline occurred primarily in foreign currency loans. In year-on-year terms, developments in lending show an overall improvement, driven by the more than HUF 800 billion disbursed during the past three quarters in the context of the Funding for Growth Scheme. The annual rate of decline of the total corporate credit portfolio stood at 1.3 per cent compared to the 3-4 per cent average of the past years, while lending to SMEs expanded by 0.5 per cent based on estimated transactions. While funding costs fell in case of forint loans, the decline was smaller than the central bank interest rate cuts, yielding an overall rise in the spread. According to the lending survey, credit conditions did not change significantly in the past quarter. Respondent banks indicated a rise in demand for both long-term and short-term loans compared to the previous quarter.

Household loans outstanding within the total credit institution sector shrank by HUF 100 billion based on transactions, mainly driven by the decline in foreign currency loans. The annual rate of decline in loan volume slowed slightly to 5 per cent. New lending within the total credit institution sector to households amounted to HUF 96 billion in Q1, which was nearly 27 per cent higher in year-on-year terms. The results of the lending survey revealed that banks continued to ease conditions on consumer credit, while leaving conditions on housing loans unchanged. The average spread on new housing loans fell by a little over 0.3 percentage point, but remains relatively high by international standards. Responses to the lending survey reveal a pick-up in demand for consumer credit and housing loans, with the majority of banks expecting a further upswing in demand looking ahead.

In March and April 2014, a questionnaire-based survey was commissioned by the MNB covering a representative corporate sample in an effort to assess the financing decisions of non-financial corporations and the determinants thereof. Evaluation of the sample reveals that, considering macroeconomic weight of firms, their business activity is mainly held back by factors related to the economic environment. Access to sources of finance is a relevant factor, but this area exhibits a different asymmetry: while larger firms with ample internal funding are less impeded by financing constraints, the ratio stating that such constraints are a severe difficulty is still high. Over 70 per cent of the SMEs included in the survey were familiar with the MNB's Funding for Growth Scheme, and eight to nine per cent of eligible firms were taking part in the scheme. Furthermore, more than half of the firms participating in the Funding for Growth Scheme stated that they would have not borrowed in the absence of the scheme, while 10 per cent stated that they would have borrowed, but only a smaller sum.

According to the Financial Conditions Index, which summarises lending developments in the corporate and household segments, and monetary conditions based on the preliminary data, conditions improved slightly, but the banking sector still exerted a contractionary effect on the real economy.

Financial Conditions Index (FCI) and annual real GDP growth

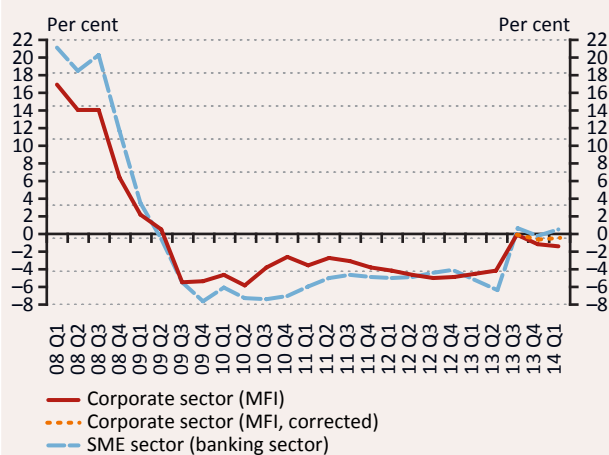


Note: The annual increase in the FCI shows the contribution of the financial intermediary system (banking sector) to the annual growth rate of real GDP. While the banking sector sub-index only contains the variables related to lending, the 'overall' index contains the monetary conditions, i.e. the interbank rate and the exchange rate as well. Source: MNB.

2 Developments in lending in the corporate segment

In 2014 Q1, loan repayments by non-financial corporations exceeded new disbursements by HUF 91 billion, of which HUF 30 billion was linked to the repayment of intercompany loans (granted to a bank's affiliated company). The decline occurred primarily in foreign currency loans. In quarter-on-quarter terms, the annual rate of decline in loans outstanding did not change substantially, amounting to 1.3 per cent in March. The Funding for Growth Scheme contributed to the rise in forint lending in Q1 with HUF 66 billion in new loan contracts, which together with the first phase contributed greatly to the 0.5 per cent year-on-year expansion in loans outstanding to SMEs based on estimated transactions within the banking system. Banks reported unchanged credit conditions in their replies to the lending survey, but as a positive development – similarly to regional trends – cyclical factors had a smaller impact on the tightening of credit conditions, and the economic outlook actually already contributed to easing. Funding costs for forint loans declined, partially following the policy rate cuts, but the spread increased. It should be emphasised that interest rates still only reflect credit conditions for creditworthy companies, which is only a small group owing to the tightening that was applied since the outbreak of the crisis. In terms of demand, respondent banks indicated a rise for both long-term and short-term loans in quarter-on-quarter terms.

Chart 1
Annual growth rate of lending to corporates and the SME sector



Note: In case of the overall corporate sector the time series is based on transactions, while the SME data is based on estimated transactions from Q4 2013. The corrected line is adjusted for one-off factors (loan repayment at a bank's affiliated company).

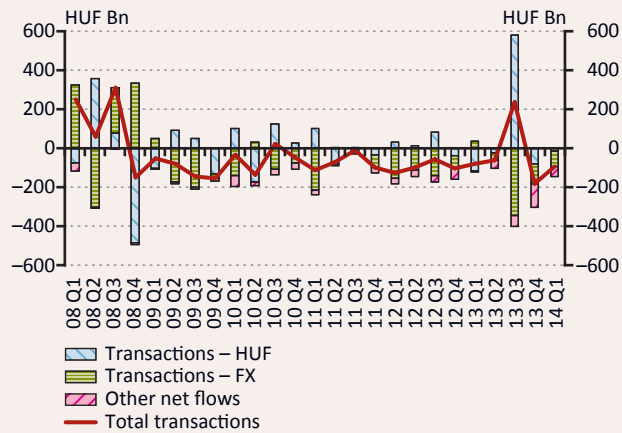
2.1 DOMESTIC CORPORATE LENDING

The loans outstanding of the SME segment increased, while those of large enterprises decreased, based on transactions.

Loans outstanding for the entire corporate sector within the overall credit institution sector shrank by 1.3 per cent in 2014 Q1, while the SME segment saw a 0.5 per cent rise in year-on-year terms based on transactional data within the banking sector (Chart 1).¹ In 2014 Q1, total repayments by non-financial corporations to the credit institution sector exceeded disbursements by HUF 91 billion. Other changes, i.e. write-offs and reclassifications reduced credit institutions' outstanding loans by another HUF 52 billion (Chart 2). A significant one-off impact also played a role in this negative transactional value, as an affiliated company repaid a loan amounting to HUF 30 billion to its owner bank. Excluding this one-off impact, the result of transactions would be around HUF -60 billion. Foreign currency loan transactions reduced the corporate loan portfolio by HUF 78 billion during the quarter, while forint loan transactions reduced it by HUF 13 billion.

¹ We provide an estimate of SME segment transactions by breaking down other changes (write-offs and reclassifications) to total loans.

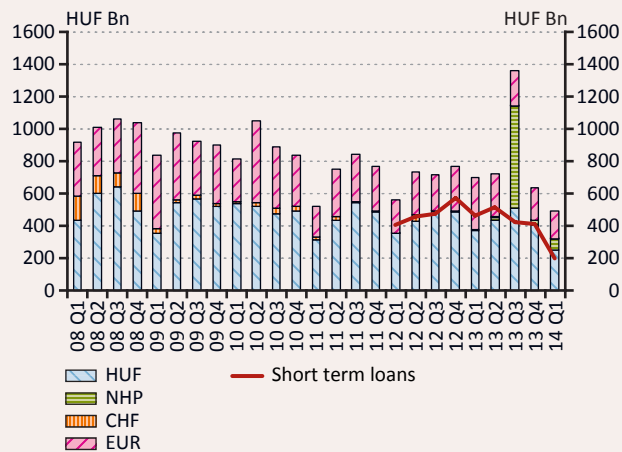
Chart 2
Net quarterly change in outstanding domestic loans to corporations; breakdown by currency



Note: Seasonally unadjusted change in outstanding amounts, with rolling exchange rate adjustment.
Source: MNB.

The volume of new contracts was restrained, mainly owing to the fall in short-term loans. Gross lending by the overall credit institution sector amounted to HUF 495 billion in 2014 Q1 (Chart 3), which is subdued compared to earlier quarters. Sixty-four per cent of new loans were denominated in forint. The relatively small volume of new loans stems from several factors. Firstly, the volume of new disbursements in the first quarter is usually affected by negative seasonality. Furthermore, many firms brought their borrowing forward in time due to the time limits imposed by the first phase of the FGS, also decreasing the new loans granted in the months that followed. Another important factor is that increasing average maturities due to FGS loans reduces the need for refinancing of loans outstanding, entailing a sustained decline in the volume of new short-term loans.² For the corporate sector as a whole, contracts for short-term loans fell by HUF 270 billion year-on-year, registered mainly in the SME segment.

Chart 3
New corporate lending volumes



Source: MNB.

² The decline in new lending stemming from this reason is not equal to a decline in the extent of funding, it only affects the scheduling of finance.

Table 1
Main characteristics of the first and second phase of FGS

	FGS I. stage	FGS II. stage (End of May 2014)
Contracting period	June 2013– August 2013 (3 months)	October 2013– December 2014 (15 months)
Period for disbursements (investment loans)	June 2013– September 2013 (June 2014)	October 2013– December 2014 (June 2015)
Contracted amount	701 billion HUF	175 billion HUF
new loans	290 billion HUF	172.5 billion HUF
new investment loans	177 billion HUF	132.4 billion HUF
Number of contracts	9844	5902
new loans	5964	5832
new investment loans	3679	5099
Proportion of new loans	41.4 per cent	98.5 per cent
New investments loans to new loans	61 per cent	77 per cent
Sectoral distribution	Trade. repair (23.9%) Agriculture (14.6%) Manufacture (17.6%)	Trade. repair (22.9%) Agriculture (33.7%) Manufacture (17.4%)

Note: Loans granted for prefinancing EU funds are included in investment loans.

Source: MNB.

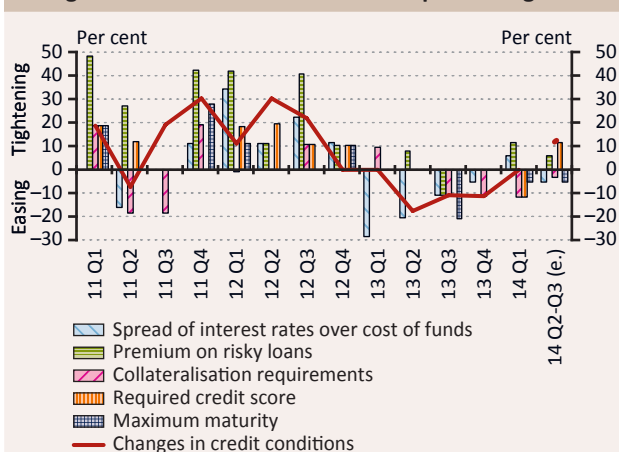
Utilisation of the second phase of the FGS is gradually rising.

By the end of May 2014, contracts had been concluded for HUF 175 billion of the HUF 500 billion available in the second phase of the FGS (Table 1). The majority of firms participating in the second phase did not take part in the first one. The longer timeframe and the restriction of refinancing loans to 10 per cent explain the lower volume compared to the first phase. The more focused nature of the second phase is apparent in the fact that while HUF 177 billion of the HUF 701 billion contracted in the first phase consisted of new investment loans (3,679 contracts), these account for HUF 132 billion of the HUF 175 billion (5,099 contracts) in the current phase.

The rejection rate of FGS loans is roughly equal to the rate for other loans.

The responses to the supplementary questionnaire included in the lending survey reveal that the median rejection rate for FGS loans is 24 per cent for micro enterprises and 19 per cent for small and medium-size enterprises. The rejection rate is roughly on par with the rate observed for non-FGS loans. From the 8 large banks participating in the survey 3 indicated that the majority of rejections were based on factors other than the FGS conditions dictated by the MNB (insufficient down-payment, collateral, cash-flow). Bank responses reveal that in the case of a quarter of credit applications filed and rejected in the context of the FGS it was a problem that the 2.5 per cent margin does not cover credit risk.

Chart 4
Changes in credit conditions in the corporate segment



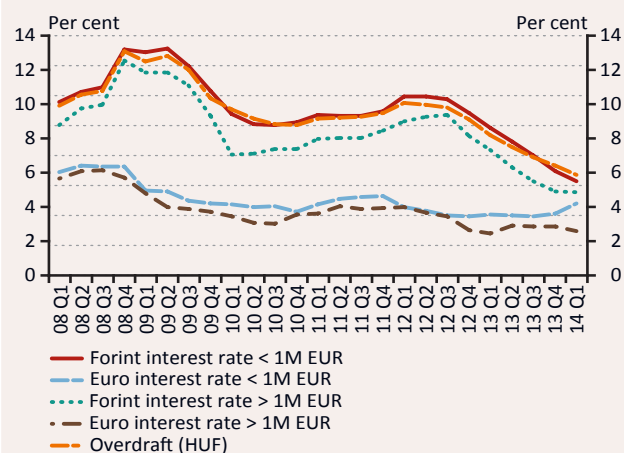
Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share.

Source: MNB, based on the answers of responding banks.

Credit conditions remained mostly unchanged.

Banks left credit conditions on corporate loans broadly unchanged in the first quarter, but responses are heterogeneous in terms of specific changes. In net terms, 11.5 per cent of respondent banks eased their non-price terms (collateral requirements and minimum creditworthiness), while a small percentage of banks tightened their price terms (premiums on riskier loans and spreads between cost of funds and interest rates on loans) in Q1 (Chart 4). Banks' prudent behaviour is clearly reflected in the broader tightening of premiums on higher-risk loans in recent years. Looking ahead, a net 11.5 per cent of banks indicated their intention to tighten conditions on loans to enterprises in the upcoming six months.

Chart 5
Interest rates on new corporate loans

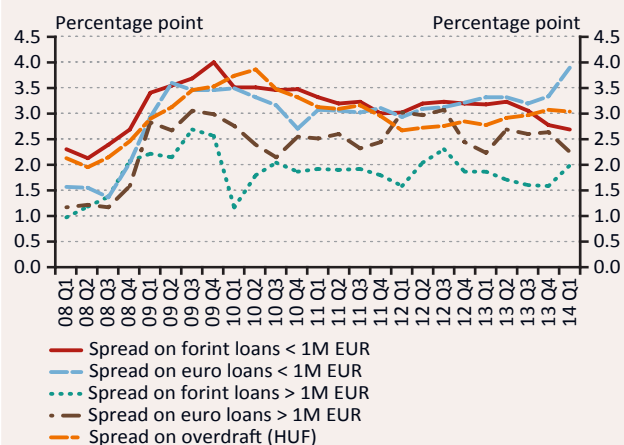


Note: loans with floating interest rates or with up to 1 year initial rate fixation.

Source: MNB.

Interest rates on new corporate forint loans continue to fall in most sub-markets. Parallel to the decline in the policy rate, forint loan interest rates fell broadly in Q1, standing at 5.1 per cent compared to 5.3 per cent the previous quarter (Chart 5). The decline was more prominent among loans below EUR 1 million, dropping from 6.1 to 5.5 per cent in Q1. The decline was only marginal in the case of larger forint loans. The preferential interest rate of at most 2.5 per cent on loans disbursed in the context of the second phase of the Funding for Growth Scheme represents a form of favourable financing for creditworthy SMEs. The interest rate on small euro-denominated loans increased, while the rate on larger loans fell. The average interest rates on overdraft loans fell by 0.6 percentage points on average during the quarter.

Chart 6
Interest rate spreads on new corporate loans



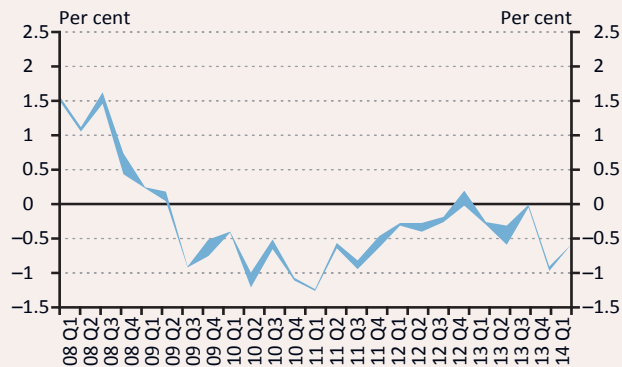
Note: spread on the 3-month BUBOR and EURIBOR. Loans with floating interest rates or with up to 1 year initial rate fixation.

Source: MNB.

Different developments can be seen in spreads, depending on loan size and currency denomination. The spread on forint loans increased overall during the quarter, driven by the 0.4 percentage point rise among large loans (Chart 6). Meanwhile, the spread on smaller loans declined, with the dampening effect of short-term working capital loans granted during the second phase of the FGS possibly contributing to this.³ Spreads on overdraft loans stagnated close to the previous quarter's level, following a rising trend in the previous two years. Spreads on small euro loans rose at a higher rate, by 0.6 percentage points, while spreads on large euro loans fell by 0.4 per cent. It should be added that the low volume of new contracts could generate a stronger composition effect in interest rates and spreads.

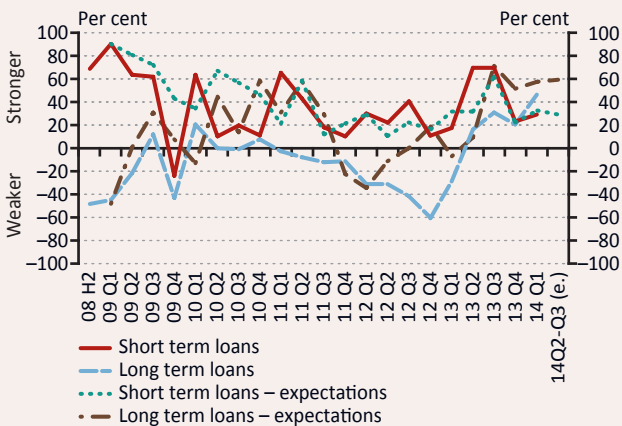
³ Within new lending, loans with floating interest rates or with up to 1 year initial rate fixation were taken into account. The majority of loans granted within the Funding for Growth Scheme are long-term loans, therefore the interest rates reviewed by us are only influenced by short-term FGS loans, amounting to a smaller volume.

Chart 7
Sub-index of FCI for corporate lending



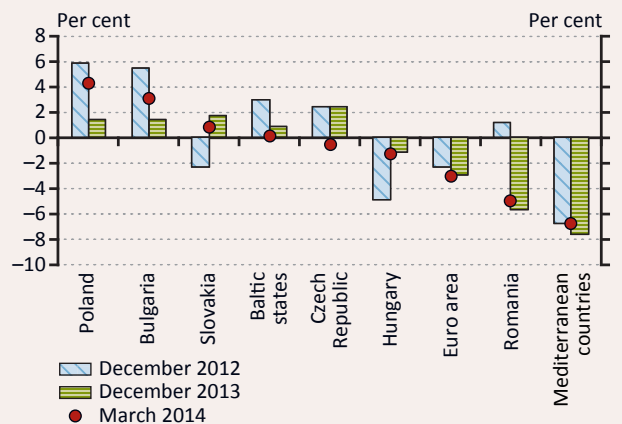
Note: The index quantifies the impact of financial conditions on annual GDP growth through corporate lending. The band illustrates the methodological uncertainty. Based on preliminary data. Source: MNB.

Chart 8
Change in loan demand by maturity



Source: MNB, based on the answers of responding banks.

Chart 9
Annual transaction-based growth rate of corporate loans in international comparison



Note: Mediterranean countries: Greece, Italy, Portugal, Spain. Baltic states: Estonia, Lithuania, Latvia. Source: ECB, MNB.

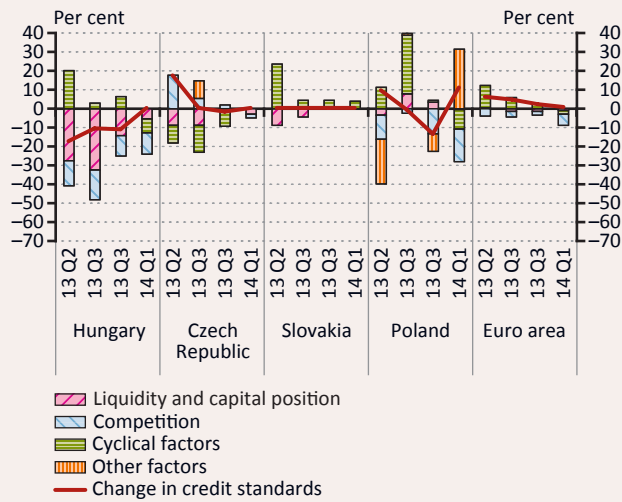
The contractionary effect of the banking system has decreased in the corporate segment. In 2014 Q1, the corporate sub-index of the Financial Conditions Index was at a level of around -0.6 per cent; i.e. real GDP declined by this extent due to the tight corporate credit supply in the period between 2013 and 2014 Q1 (Chart 7). While the sub-index of the FCI for corporate lending rose slightly compared to the previous quarter, its sustained negative value suggests that a durable upturn in the credit market through a marked easing of corporate credit conditions would be needed for corporate credit supply to effectively drive economic growth.

Banks mostly perceived a rise in demand for long-term loans. Based on the lending survey, in net terms, 47 per cent of banks reported increased demand for long-term loans and 30 per cent indicated a pick-up in demand for short-term loans (Chart 8). Looking ahead, banks continue to expect a pick-up in corporate credit demand. Among the drivers of rising loan demand, many banks cited stronger need for inventory financing in the previous quarter, along with the overall interest rate level and changes in tangible asset investments. According to expectations, the latter may have the strongest impact driving the rise in loan demand in the upcoming quarter, with a net 60 per cent of banks expecting this development.

2.2 INTERNATIONAL OUTLOOK IN CORPORATE LENDING

Growth in outstanding corporate loans has fallen in most countries in the region since late-2012. While the volume of outstanding corporate loans has been continuously shrinking in the euro area over the past two years, it has increased in several CEE countries (Chart 9). However, growth rates have slowed down in most countries, and growth based on transactions has fallen compared to late-2012 in nearly all countries. Slovakia and Hungary are exceptions, with dynamics in the latter driven mainly by the Funding for Growth Scheme. The euro area continues to be characterised by strong heterogeneity in terms of lending: Mediterranean countries experienced a much more negative rate of decline in loans outstanding compared to the rest of the euro area. Most recent data reveal that in 2014 Q1 disbursements far exceeded repayments in Poland and Bulgaria, while the loan volume stagnated or shrank in other CEE countries.

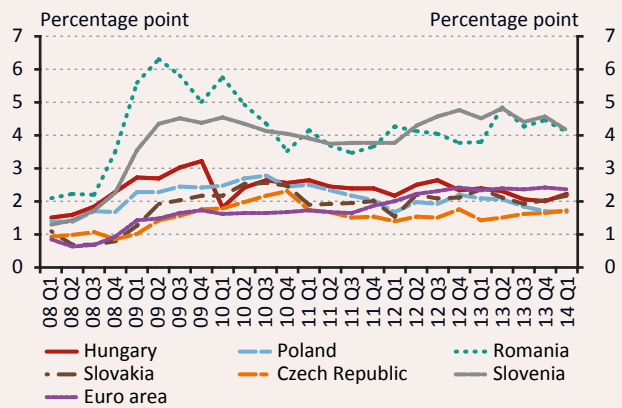
Chart 10
Changes and factors contributing to changes in credit conditions in lending to non-financial corporations in international comparison



Note: The individual categories are made up from the average of thematically common factors. Positive values show a tightening of credit conditions, negative values depict easing in conditions.
Source: MNB, ECB, national central banks.

Improving economic outlook could ease banks' cautiousness in the region. The lending surveys for the first quarter indicate that, in terms of the Visegrad countries, only Polish banks tightened corporate credit conditions. Polish banks cited the instability of the international situation and the recent regulatory recommendations on credit exposure as the reasons behind this tightening. Continuing the trend of previous quarters, the ratio of banks tightening credit conditions fell further in the euro area. It is favourable that countries in the region reported that cyclical factors had a smaller impact on banks' credit supply (Chart 10). In Hungary, similarly to previous quarters, industry-specific issues were the cyclical factors which induced tightening, while economic prospects pointed towards easing of conditions. All other factors – capital and liquidity position, competition and the change in risk tolerance – pointed towards easing.

Chart 11
International comparison of interest rate spreads on corporate loans extended in domestic currency



Source: MNB, ECB, national central banks.

Creditworthy firms in Hungary can access credit under good terms in international comparison. Although the average interest rate spread on forint loans rose by 0.2 percentage points in the first quarter in Hungary, its overall level remains on par with the regional average (Chart 11). Countries with the highest spreads within Central and Eastern Europe – Slovenia and Romania – saw a material decrease, while spreads remained largely unchanged in other countries. Hungary is characterised by a higher interest rate than most of its peers within the region, despite the decreasing trend, with only Romania featuring higher cost of finance for firms.

Box 1

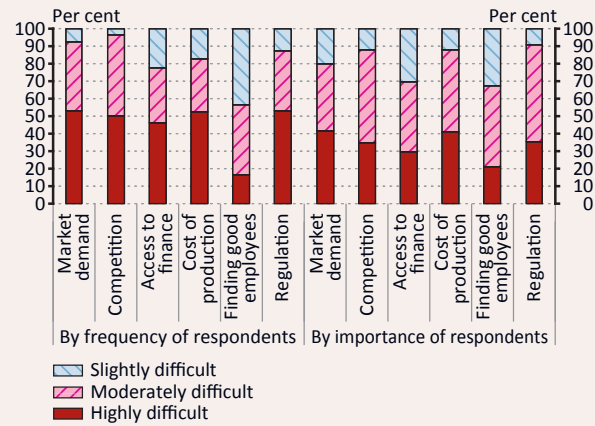
Findings of the Corporate Questionnaire

In March and April 2014, a questionnaire-based survey was commissioned by the MNB covering a representative corporate sample in an effort to assess developments in financing, business and investment activity and the determinants thereof. The sample, consisting of 750 individuals, is representative in terms of company size (micro, small, medium-sized and large enterprises), geographical location (Eastern, Western or Central Hungary) and sector. The questionnaire covers both financing and investment decisions for the period elapsed since July 2013, along with plans for the upcoming six months to one year. In selecting the sample, we also made sure that the included firms were representative not only in terms of frequency, but also in terms of their macroeconomic significance (value added, employment) by applying a supplementary weighting. Comparability with the ECB's "Access to finance" survey conducted semi-annually was a key consideration when compiling the questionnaire, but the Hungarian version contains many additional country-specific questions. The questionnaire focuses not only on bank loans, but also attempts to assess the motives for and challenges to seeking external funding and the form of utilisation of funds across the board for sources of funding. The survey sheds light on the credit demand generated by firms and deeper insights into the strong heterogeneity of the availability of sources of financing.

Eighteen per cent of respondents had never used external financing or the option is not currently relevant to their needs. At the same time, bank loans, various lines of credit (overdraft facilities, credit card) and subsidised loans are predominant within the debt profile of firms accessing external finance, while financial leasing, factoring, trade credit and inter-company loan are less prominent. Nearly 40 per cent of respondents reported an increase in their borrowing requirements between July 2013 and March 2014, arising mainly from investment plans (18 per cent) and working capital financing needs (12 per cent). The macroeconomic ratio of indebted firms having reported a dip in their borrowing requirement was only 3 per cent.

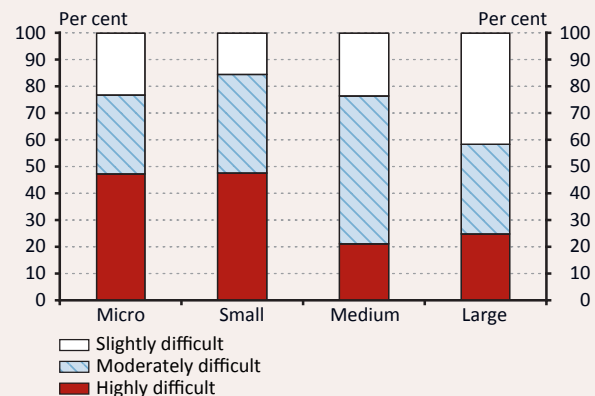
Firms' assessment of the determinants of their business activities is a key component of the survey, and proved once again to be a significant factor shaping their borrowing requirement. Responses reveal that the significance of these factors can be evaluated both individually and relatively to each other. The assessment of the sample, taking into account macroeconomic weight, identified the following factors holding back firms' activity: market competition, the regulatory environment, production and labour costs and market demand. There is no significant difference between indebted and non-indebted firms in terms of these factors. An interesting finding is that although difficulties stemming from macroeconomic and regulatory factors are quite substantial compared to financing constraints, the latter features stronger polarisation also influenced by company size. Among financially constrained and indebted corporations nearly half of micro and small enterprises considered financing constraints to be a severe difficulty, while 21 and 25 per cent of medium and large corporations regarded this factor as a slight difficulty. While only 13 per cent of small enterprises, 42 per cent of large corporations regard accessible financing conditions as a slight difficulty, which reflects the differences in financing conditions according to corporate size. In other words, larger firms with ample internal funding are less impeded by financing constraints, but many of them still consider this factor to be a severe difficulty.

Significance of factors constraining firms' business activity (indebted SMEs)



Source: MNB, Corporate survey.

Access to finance by corporate size among indebted corporations



Source: MNB, Corporate survey.

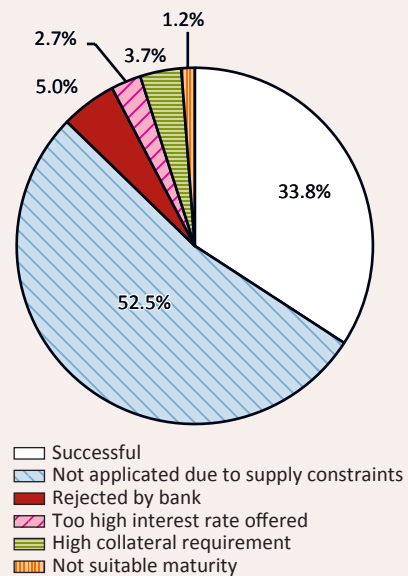
Companies planning to access external funding since July 2013 tended to report an overall lack of change in bank credit conditions (transaction rates, spread, collateral requirements, etc.). An analysis of credit products by currency and maturity reveals that longer-maturity loans are more difficult to access and more expensive than shorter-maturity loans, and foreign currency loans in particular are more difficult to access than forint loans. Twenty-three per cent of respondents applied for loans in the period under review, while the remainder reported relying on sufficient internal funds (56 per cent of firms not applying for credit) or the absence of any investment plans (43 per cent of firms not applying for credit). Strict price and non-price conditions were also frequently mentioned, by 47 per cent of individual respondents and 34 per cent considering macroeconomic weight. Twelve per cent of respondents (5 per cent considering macroeconomic weight) cited fear of rejection as the factor holding them back from applying for credit. Overall, these reflect substantial supply-side constraints, mainly among smaller firms.

During the period under review, 88 per cent of credit applicants cited inventory funding or liquidity needs as the reason behind their application, while 69 per cent cited property or machinery investments or renovation. Nearly two-thirds of applicants were granted most of the credit amount applied for (at least 75 per cent), while 8 per cent were only granted a smaller portion. Eleven per cent of credit applications were unsuccessful due to rejection by the bank, 8 per cent due to rejection by the applicant (due to the offered interest rate or maturity) and another 8 per cent due to collateral requirements.

Over 70 per cent of the SMEs included in the survey were familiar with the MNB's Funding for Growth Scheme. Eight to nine per cent of eligible firms were taking part in the scheme, using the funds primarily for the acquisition of assets, funding inventory, property purchases or renovation of assets. Eighty-five per cent of loan applications were successful and only 12 per cent were rejected; these proportions are very similar to the ones exhibited across corporate lending on the whole. Nevertheless half of the firms participating in the Funding for Growth Scheme stated that they would have not borrowed in the absence of the scheme, while 10 per cent stated that they would only have borrowed a smaller amount.

Participating firms reported moderate views regarding future prospects. The majority does not plan to increase headcount or revenue, or only slightly, and mainly plan to cover their funding needs from internal sources. A mere 30 per cent of the firms included in the sample plan to apply for bank credit. Firms with no investment plans cited the absence of any investment needs, the poor economic outlook or deteriorating profitability as the reason for their decision, while larger firms cited the sufficiency of internal funds.

The success of loan applications

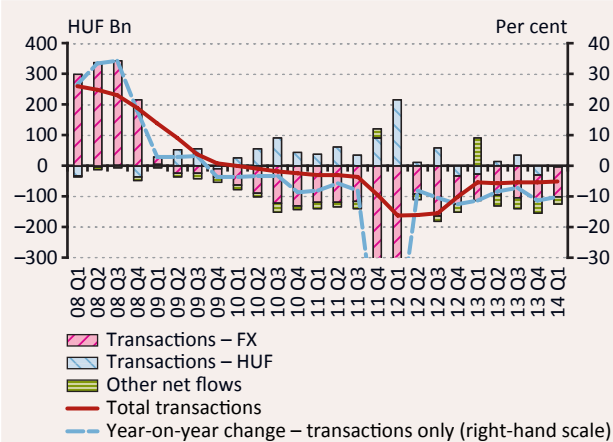


Source: MNB, Corporate survey.

3 Developments in lending in the household segment

Within the credit institution sector as a whole, outstanding household loans declined further, continuing the trend of previous quarters, with the balance of disbursements and repayments amounting to a HUF 100 billion reduction in loans outstanding. Accordingly, the annual rate of decline was similar to the previous quarter, changing from 5.2 to 5 per cent. The fall in lending resulted almost entirely from the decline in outstanding foreign currency loans. New lending to households within the overall credit institution sector amounted to HUF 96 billion in Q1, which was 27 per cent higher in year-on-year terms, but was somewhat lower compared to the previous period. The findings of the lending survey revealed that banks further eased conditions on consumer credit while leaving those on housing loans unchanged. The annual percentage rate (APR) charged on new housing loans continued to fall, in line with the central bank's policy rate cuts. Responses to the lending survey reveal a pick-up in demand for consumer credit and housing loans, with the majority of banks expecting a further upswing in demand looking ahead.

Chart 12
Net quarterly change in outstanding household loans in the credit institution sector as a whole

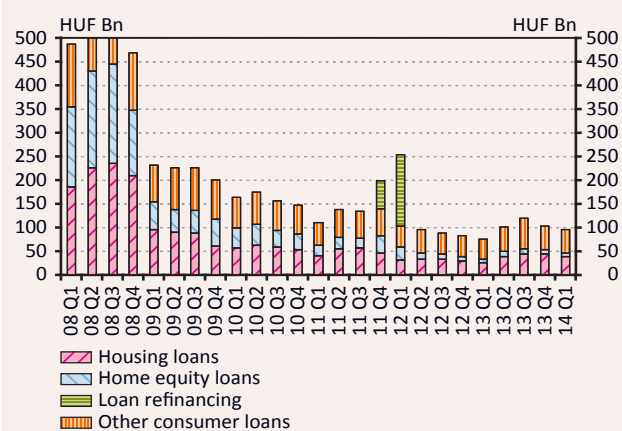


Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment.
 Source: MNB.

3.1 DOMESTIC HOUSEHOLD LENDING

Foreign currency loans outstanding continued to shrink. Household loans within the total credit institution sector shrank by HUF 100 billion as the balance of disbursements and repayments (Chart 12). Write-offs and reclassifications reduced household loans outstanding by another HUF 26 billion. A large portion of this reduction – HUF 75 billion – was related to consumer credit, while housing loans decreased by HUF 50 billion. The annual rate of decline of lending stemming from transactions slowed from 5.2 to 5 per cent. The contraction in loans outstanding almost entirely resulted from the decline in foreign currency loans. Foreign currency loan transactions amounted to more than HUF -98 billion, while forint loan transactions did not change significantly based on the impact of transactions.

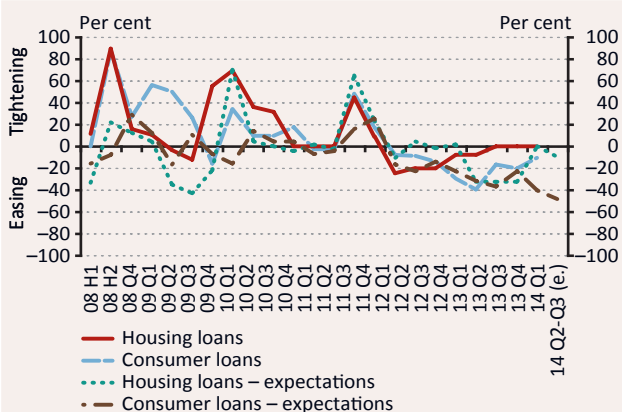
Chart 13
New household loans in the overall credit institution sector



Source: MNB.

The volume of new household loans rose significantly compared to last year. The gross household lending of the credit institution sector amounted to HUF 95 billion in Q1, which is close to the value of the preceding period (Chart 13). However, there is a clear pick-up in lending compared to last year: the volume of new household loan contracts rose by 27 per cent compared to 2013 Q1. The upswing was most prominent in the number of new housing loans. State-subsidised housing loans accounted for a similar proportion as in previous quarters: nearly 30 per cent. The low interest rate environment is still dampening the rise in the ratio of state-subsidised loans (“Home Creation Programme”). The advantage in terms of cost provided by the 6 per cent minimum transactional interest rate of the subsidised scheme was substantially reduced in the wake of interest rate cuts.

Chart 14
Changes in credit conditions



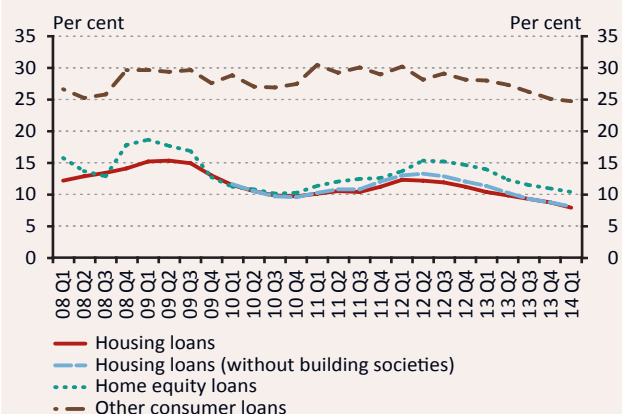
Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share.

Source: MNB, based on the answers of responding banks.

Further easing of consumer credit conditions continues.

The responses for the lending survey reveal that in net terms, 10 per cent of the banks eased their conditions on consumer credit, while leaving the conditions on housing loans unchanged (Chart 14). As regards consumer credit, in line with the trends of recent quarters, easing primarily affected unsecured loans. Easing mainly materialised in non-price terms (minimum creditworthiness and payment-to-income). Looking forward, further easing of household credit conditions can be expected: in net terms nearly half of banks would ease consumer credit conditions further, particularly the required level of creditworthiness.

Chart 15
Annual percentage rate of charge of new household loans



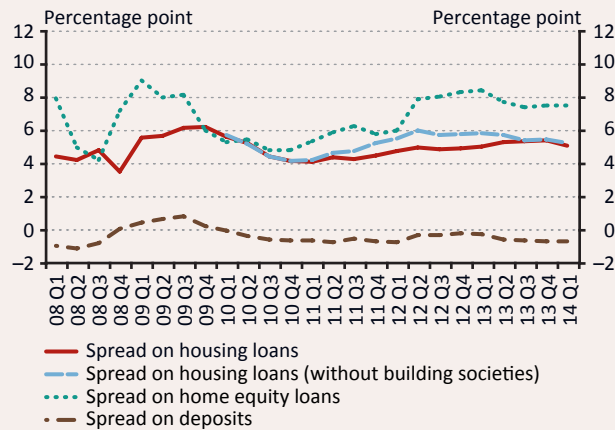
Source: MNB.

The spread on housing loans also decreased along with their annual percentage rate of charge (APR).

The APR on housing loans fell to 7.9 per cent in Q1 from 8.8 per cent in Q4 (Chart 15).⁴ This decline stems from the higher ratio of floating interest rate loans within new loans, featuring lower APRs. Their ratio rose from 39 per cent in the previous quarter to 44 per cent in 2014 Q1. The APR on new loans fell more than the decline in the reference interest rate, bringing the spread on housing loans down from 5.5 to 5.1 percentage points (Chart 16). The price conditions of schemes offered by building societies were similar to products offered by banks in the previous two quarters, but exhibited more accessible price conditions in 2014 Q1. Average APR based solely on bank schemes was 8.1 per cent, while the spread was 5.3 percentage points.

⁴ The interest subsidy provided by the state does not appear in the interest rates reported by the bank, as banks report the interest rates inclusive of the subsidy.

Chart 16
Interest rate spreads on new household loans



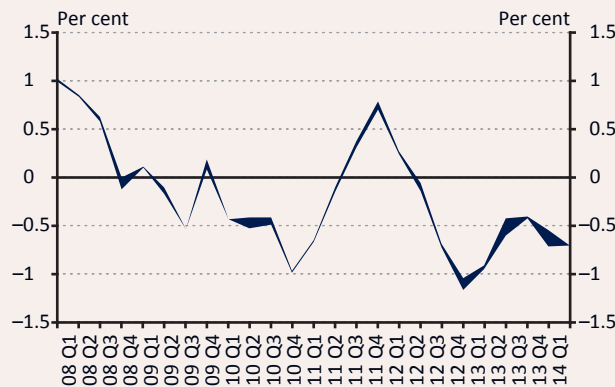
Note: Interest rate spread on 3-month BUBOR. Spreads based on APR.
Source: MNB.

The APR on home equity loans also declined. The downward trend in the APR on home equity loans also continued, as the average APR fell to 10.4 per cent in 2014 Q1 from 11 per cent in 2013 Q4. The lowering of the APR almost matched the decline in the reference rate; thus the spread on home equity loans did not change substantially and remained around 7.6 percentage points. The average APR on other consumer credit fell by nearly 0.4 percentage points in Q1, declining to 24.8 per cent (Chart 15).

The impact of the banking system through the household segment remains contractionary. The household sub-index of the FCI remained essentially unchanged: according to the index, the banking sector's moderate credit supply reduced the annual GDP growth rate by 0.7 per cent between 2013 and 2014 Q1 (Chart 17). Only consumer credit conditions eased significantly over the past year, with most banks leaving housing loan conditions unchanged. Thus in light of the earlier broad tightening that took place, high interest rate spreads and tight non-price conditions also reflect subdued credit supply. The loan-to-value (LTV) ratio of completed transactions in 2014 Q1 stood at 56 per cent, substantially lower than the regulatory threshold (80 per cent for forint housing loans) and the average of earlier years.

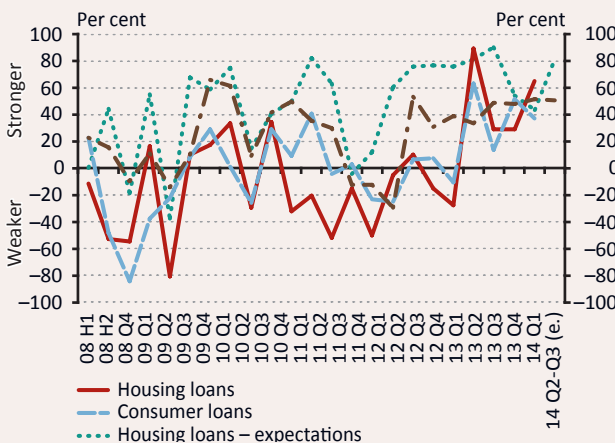
Banks perceive an upswing in demand for household loans. In net terms, 65 per cent of banks reported increased demand for housing loans in 2014 Q1 based on the lending survey, and slightly over a third indicated a pick-up in demand for consumer credit (Chart 18). Responses reveal that looking ahead, banks are expecting a further pick-up in demand for both consumer and housing loans in the wake of lax monetary conditions and improving real economic prospects. It should be noted that the pick-up in demand started from the relatively low basis of previous quarters, thus its level may still be low.

Chart 17
Sub-index of FCI for household lending



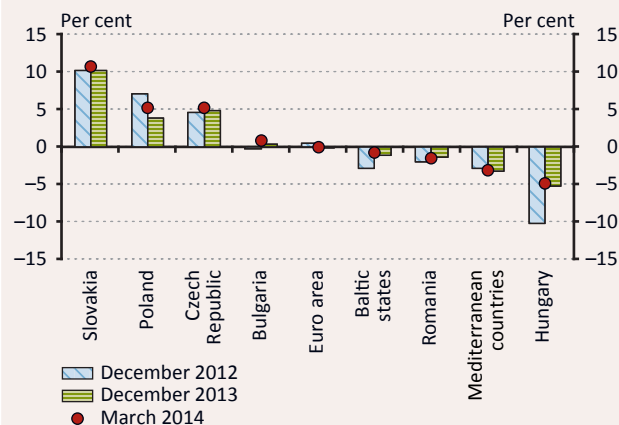
Note: The index quantifies the impact of financial conditions on annual GDP growth through household lending. The band illustrates the methodological uncertainty. Based on preliminary data.
Source: MNB.

Chart 18
Credit demand in the household segment



Source: MNB, based on the answers of responding banks.

Chart 19
Annual transaction-based growth rate of household loans in international comparison



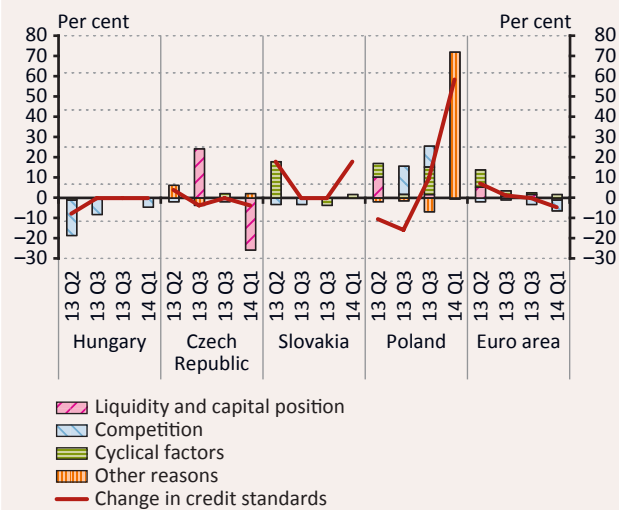
Note: Mediterranean countries: Greece, Italy, Portugal, Spain. Baltic states: Estonia, Lithuania, Latvia.
Source: ECB, MNB.

3.2 INTERNATIONAL OUTLOOK IN HOUSEHOLD LENDING

The contraction of household lending in Hungary is high in a European comparison. In respect of the Visegrad Group, only Hungary saw the household loans outstanding of credit institutions shrink based on transactions over the past two years (Chart 19). The annual rate of decline in loans outstanding was 5.2 per cent in Hungary at the end of 2013 compared to the 4.8 and 3.8 per cent rise in the Czech Republic and Poland, respectively, while lending to households rose by over 10 per cent in Slovakia in 2013. The annual rate of decline in loans outstanding at the end of Q1 2014 indicated a decline in household leverage in Hungary, the Mediterranean countries, Romania and the Baltic states.

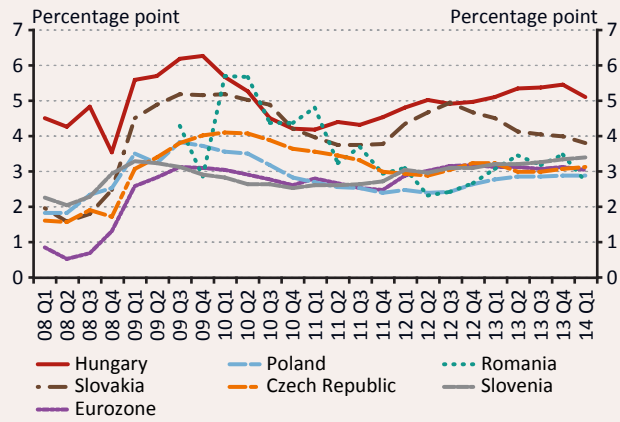
Housing credit conditions tightened in several countries in the region. Housing credit conditions tightened in Slovakia and Poland, while a small portion of banks in the Czech Republic and the euro area eased their conditions on housing loans. In net terms, nearly 60 per cent of Polish banks tightened their conditions (Chart 20), spurred by the supervisory recommendation issued by the Polish authority regarding mortgage loans. It should be noted that the responses to the lending survey provide insight on the changes in credit conditions compared to the preceding period, and not a picture of their overall level.

Chart 20
Changes and factors contributing to changes in credit conditions in lending for house purchase in international comparison



Note: The individual categories are made up from the average of thematically common factors. Positive values show a tightening of credit conditions, negative values depict easing in conditions.
Source: MNB, ECB, national central banks

Chart 21
International comparison of spreads on housing loans extended in domestic currency



Note: APR-based spreads above the 3-month interbank interest rate.
 Source: MNB, ECB, national central banks.

The interest rate spread on housing loans declined or remained unchanged in the majority of countries within the region. Similarly to Hungary, Slovakia and Romania along with the euro area on average saw a dip in APR-based spreads on new housing loans in the first quarter (Chart 21). By contrast, Slovenia and Poland have seen a slight rise in their interest rate spreads. The interest rate of Hungarian households remains 3.5-4.5 per cent higher on average compared to the region and the euro area. The interest rate spread on new housing loans in Hungary remains salient in a regional comparison, largely contributing to the situation.

Annex: Methodological notes

The analysis is based on statistical data and the findings of the Lending Survey.

1. Credit aggregate and lending rate data

A statutory task of the Magyar Nemzeti Bank is to publish statistical data regarding the functioning of the system of credit institutions and the financial position of the country. The statistics compiled, press releases presenting the main data as well as the methodological descriptions of preparing the statistics are available on the MNB's website at:

<http://english.mnb.hu/Statiztika>

2. Lending Survey

The Lending Survey facilitates the analysis of how major banks perceive and evaluate market developments and how they develop their respective strategies, in particular their lending policies. In the case of the household segment, a total 14 banks were involved in the interviews. 10 banks responded to questions related to housing loans, while 14 banks and 6 financial enterprises answered questions on consumer loans. Based on data from the end of 2014 Q1, the surveyed institutions accounted for 91 per cent of the banking sector in the case of housing loans outstanding, while 93 per cent in the case of consumer loans outstanding. The corporate questionnaire was completed by 8 banks, with a total market share of 82 per cent and 94 per cent of the corporate loan and commercial real estate loan markets, respectively. A total 7 banks were interviewed on the subject of loans extended to municipalities. Based on data from the end of 2014 Q1, the surveyed institutions covered 95 per cent of total municipal exposure by banks.

The survey consists of a standard questionnaire in each segment, and since the survey conducted in January 2010 we have also asked ad hoc questions of current concerns related to the credit markets. The retrospective questions refer to 2014 Q1 (compared to 2013 Q4), whereas the forward-looking questions concern the next half-year period, i.e. the

one covering 2014 Q2 and 2014 Q3 (relative to 2014 Q1). The current questionnaire was completed by the senior loan officers between 1 and 16 April 2014.

To indicate changes, the survey used the so-called net change indicator, expressed as a percentage of respondents. This indicator is calculated as follows: market share-weighted ratio of respondents projecting a change (tightening/increasing/strengthening) minus market share-weighted ratio of respondents projecting a change in the opposite direction (easing/decreasing/weakening).

The detailed findings of the Lending Survey and the set of charts are available at:

http://english.mnb.hu/Kiadvanyok/hitelezesi_felmeres

3. The Financial Conditions Index (FCI)

In addition to short-term interest rates and the nominal exchange rate, which represent the behaviour of money markets, the FCI condenses the information contained in other price, quantitative and qualitative variables characterising the financial intermediary system into one indicator. The FCI gauges the impact of the financial sector on real economy. The annual change in FCI mentioned in the survey shows the contributions of the financial system and the banking sector to the annual real GDP growth rate.

The weights of the variables that determine the FCI are derived from a VAR (vector autoregressive) model based on the Bayesian structural VAR model developed by Tamási and Világi (2011).⁵ In the VAR model, the use of the so-called sign restriction method allows the identification of monetary policy shocks as well as the supply shocks of financial markets and the banking sector. The identified shocks allow calculation of how unexpected changes in individual financial variables affect the growth in GDP. The advantage of the method is that it is possible to exclude the endogenous reaction of financial variables on the developments in economic activity, i.e. a real cause and effect relationship can be identified.

⁵ Tamási, B. and B. Világi, 2011, Identification of Credit Supply Shocks in a Bayesian SVAR Model of the Hungarian Economy, MNB Working Papers 2011/7.

The FCI is based on the following variables:

- 3-month interbank rate (BUBOR);
- nominal effective exchange rate;
- corporate loans outstanding;
- household (consumer and home equity) loans outstanding;
- interest margin on corporate loans;
- interest margin on household (consumer and home equity) loans.

In addition to the total FCI, sub-indices may also be calculated. Accordingly, for example, the 'banking sector' FCI net of money market effects is prepared with the weighting of credit aggregates and interest margins. At the same time, the

VAR model serving as the basis for the FCI does not provide information on the size of the effect of the interbank rate through household and corporate loans. Only rough estimates can be given for this, based on the shares of household and corporate forint lending to the private sector lending. This uncertainty is expressed by the fact that the effect of household and corporate loans on GDP is illustrated in banded charts. One of the limits of the band only measures the effect of credit quantity and interest margin calculated on the basis of the VAR model. For the calculation of the other limit of the band, the effect of money market interest rates is also taken into account, but this calculation is already based on the aforementioned estimate, and not on the VAR model.

TRENDS IN LENDING

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