MAGYAR NEMZETI BANK

Trends in lending

August 2015

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Analysis prepared by Máté Bálint, Zita Fellner, Zsolt Oláh
(Directorate Financial System Analysis)

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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, the publication elaborates on the developments in credit aggregates, the demand for loans perceived by banks, and credit conditions. Within credit conditions, a distinction is made between price and non-price conditions. 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 the balance sheet statistics of the banking sector. Both the volume of new loans and net changes in the banking sector's 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 on the indicators describing developments in lending 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.

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY

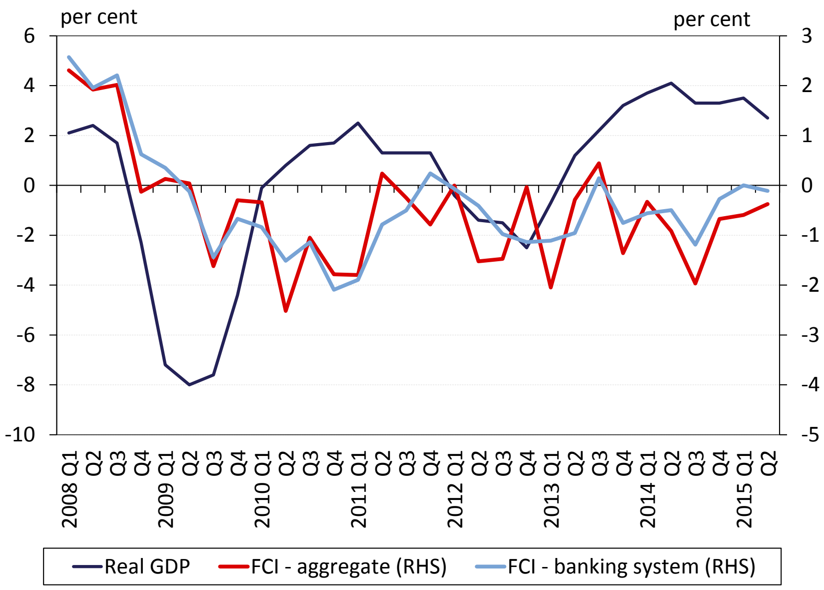
Outstanding lending to non-financial corporations by credit institutions contracted significantly in the second quarter, but overall developments in corporate lending during the period under review were characterised by two distinct trends depending on corporate size categories. Although lending to the SME sector expanded on the whole, there was a substantial decline in outstanding loans to large corporations, and the transaction-based annual growth rate of outstanding borrowing by non-financial corporations dropped to -3.4 per cent. The decline in outstanding borrowing was attributable to a few large-volume corporate transactions. These included transactions to replace bank finance with direct financing provided by the parent company. At the same time, lending to SMEs expanded by around 1.8 per cent in annual terms in the period under review, with the FGS continuing to play a substantial role in this regard. The aggregated volume of contracts concluded within the FGS in 2015 Q2 was 15.6 per cent higher on a year-on-year basis.

Credit conditions generally eased during the quarter, accompanied by a drop in financing costs. Banks participating in the lending survey also reported growth in demand, which may strengthen further in the next half year, supported by the drawdown of EU funds. Actual figures for the annual growth rate still fall substantially short of the 6-7 per cent – or in the case of SME lending, 10 per cent – necessary for sustainable growth, in which continuing tight supply constraints play a substantial role.

Lending to households continued to recover: the volume of gross new loans extended to households by credit institutions increased by 9 per cent year-on-year. Based on the lending survey, banks generally eased their credit conditions during the quarter, while they reported an increase in demand for both housing and consumer loans. The recovery in the volume of new household loans may also be attributable to the drop in the annual percentage rate of charge.

According to the Financial Conditions Index, which summarises lending developments in the corporate and household segments and monetary conditions based on preliminary data, the banking sector's cyclical impact on growth was almost neutral.

Financial Conditions Index (FCI) and annual real GDP growth

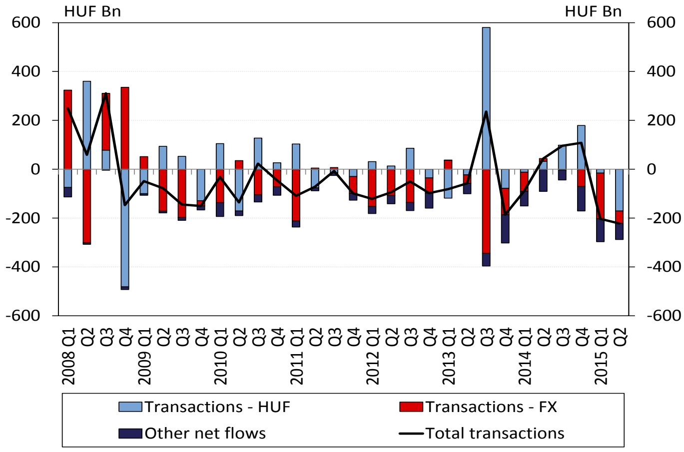


Note: Based on preliminary data. The annual growth rate of the FCI shows the contribution of the financial intermediary system (banking sector) to the annual growth rate of real GDP. While the banking sector sub-index only contains the variables related to lending, the 'overall' index also contains the monetary conditions, i.e. the interbank rate and the exchange rate. A revision was made to the time series because of the transition of the model to a transaction basis.
Source: MNB.

2. DEVELOPMENTS IN LENDING TO THE CORPORATE SEGMENT

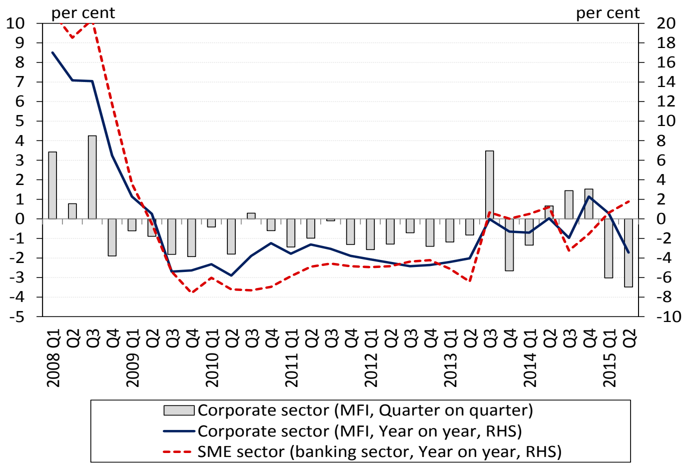
In the second quarter of 2015, the outstanding loans of credit institutions to non-financial enterprises decreased on a transaction basis. The decrease of HUF 222 billion – registered as the combined effect of disbursements and repayments – was primarily the result of individual transactions with large corporations, while outstanding loans to the SME sector increased by 1.8 per cent annually. The gross volume of new lending aggregated according to contract conclusions expanded significantly, and thus prolonged disbursements may result in an increase in the outstanding portfolio in the following periods. Based on banks' answers to the lending survey, the terms of corporate loans eased further during the quarter, which may be followed by further easing in the second half of 2015. Furthermore, the banks participating in the survey noticed an increase in credit demand in the second quarter, primarily for long-term loans. Owing to the continued reduction in the policy rate, the financing costs of newly contracted corporate loans fell, despite the increase in the average spread in the reporting period, in the case of forint loans.

Chart 1: Net quarterly change in the corporate loan portfolio, by currency



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

Chart 2: Annual and quarterly growth rate of lending to corporates and the SME sector



*Note: In the case of the corporate sector, the time series is based on transactions, while the SME data are based on estimated transactions from Q4 2013. * First quarter of 2015, revised.*
Source: MNB.

Domestic corporate lending

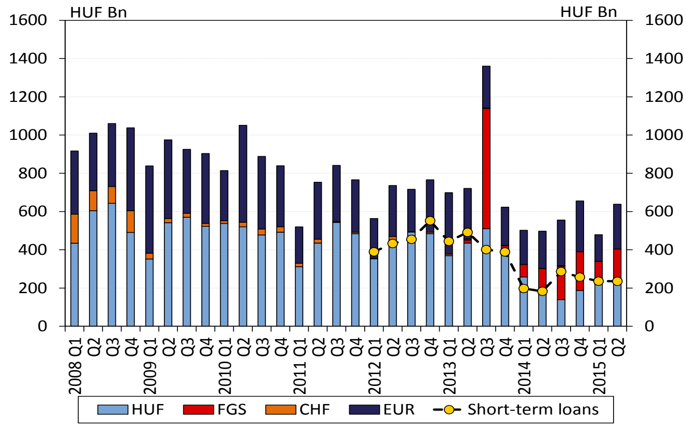
Owing to repayments by large corporations, outstanding corporate loans decreased significantly. Outstanding borrowing by non-financial corporations from the credit institution sector decreased by HUF 222 billion as a result of transactions in the second quarter (Chart 1). The decrease primarily affected the forint loan portfolio, in a value of almost HUF 171 billion. In the case of foreign currency loans, the decrease in the portfolio due to transactions amounted to HUF 51 billion. Write-offs and reclassifications reduced outstanding loans by another HUF 61 billion. This decline was driven by high volume, individual large corporate transactions. Amongst other things, the debt consolidation of BKK reduced outstanding loans to non-financial corporations by HUF 52 billion. Unused credit lines available for non-financial corporations increased by HUF 292 billion during the quarter, and its level significantly exceeds the average level for the preceding 12 months and the level for June 2014. Growth in credit lines of this magnitude may indirectly result in the expansion in outstanding borrowing in the coming periods through actual disbursements.

Outstanding loans to small and medium-sized enterprises increased last year. The transaction-based annual growth rate of outstanding borrowing by non-financial corporations from the credit institution sector dropped to -3.4 per cent in the second quarter of 2015. At the same time, the growth rate of outstanding loans to small and medium-sized enterprises[1] from the banking sector continued to increase, at an annualised rate of almost 1.8 per cent[2] (Chart 2). The quarterly growth rate of corporate lending by the banking system amounted to -3.7 per cent,

[1] The growth rate of SME lending may be distorted by the fact that as an indirect result of the large loan amounts, some companies may be reallocated to the large enterprise segment.

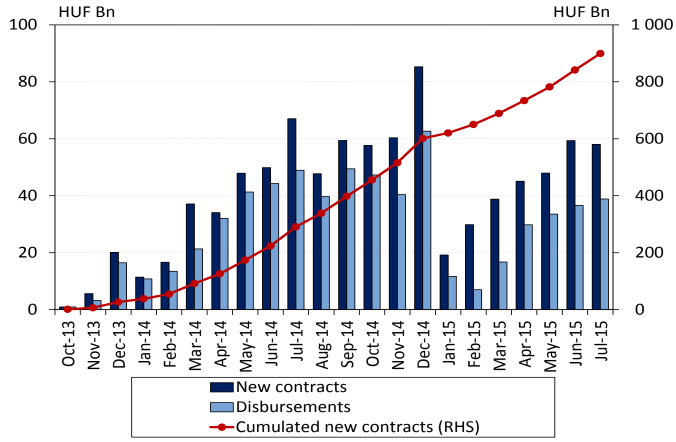
[2] We provide an estimate of SME segment's transactions by breaking down other changes (write-offs and reclassifications) to total loans.

Chart 3: New corporate loans in the overall credit institution sector



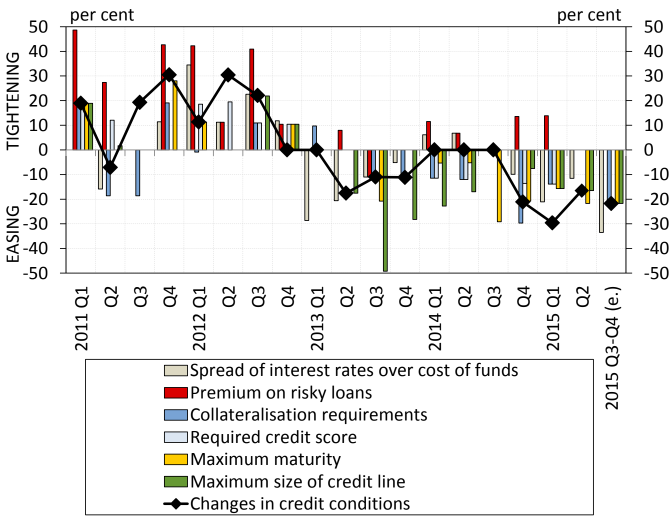
Source: MNB.

Chart 4: Contracts concluded in Phase 2 of the FGS and loan disbursements by month



Source: MNB.

Chart 5: Changes in credit conditions in the corporate segment



Note: Net ratio is the difference between tightening and easing banks weighted by market share.

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

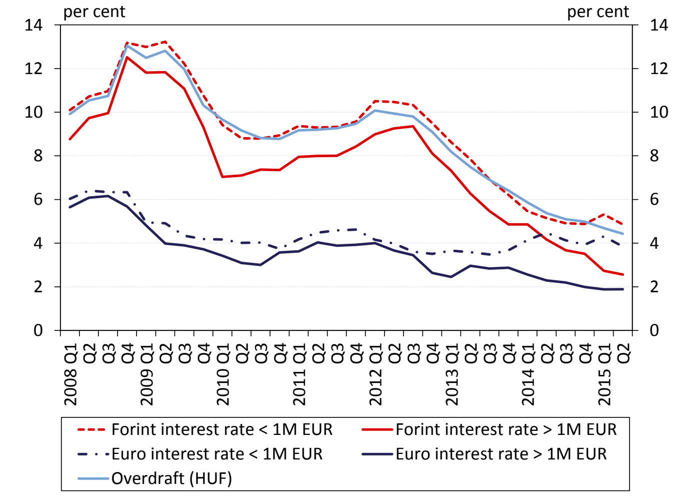
with the expansion of outstanding loans by small and medium-sized enterprises contributing an increase of 0.8 percentage points and the fall in large enterprises' outstanding borrowing at the end of the quarter contributing a decline of 4.5 percentage points. The decline in domestic lending does not by definition mean a decrease in the funding necessary for the activities of companies operating in Hungary. It is mainly large corporations that have easier access to foreign funding which may decide, based on aspects of corporate governance, to choose to obtain financing from the parent company, thereby reducing outstanding borrowing from credit institutions. Furthermore, the waiting period for the receipt of grants from the European Union may also constrain demand for borrowing, which may have resulted in the postponement of capital investment projects.

The volume of new contracts has expanded significantly. The gross volume of new corporate lending by credit institutions amounted to HUF 638 billion in the second quarter (Chart 3), representing growth of approximately 17 per cent compared to the average volume of new loans of the previous four quarters and growth of 28 per cent in year-on-year terms. Within new lending, forint-denominated loans accounted for almost 403 billion, while euro-denominated for HUF 235 billion. The majority of new loan contracts – about 63 per cent – were concluded for a term exceeding one year.[3] The ratio of loans contracted under the Funding for Growth Scheme amounted to 31 per cent within the total amount of lending.

The ratio of FGS loans within outstanding SME loans continued to expand. In the second quarter of 2015, contracts were signed under the Funding for Growth Scheme in a value of HUF 152 billion, and thus the utilisation of the Scheme increased to HUF 841 (Chart 4). Nearly 19,000 micro, small and medium-sized enterprises participated in the second stage of the programme, resulting in a total of 23,000 companies in the two stages together. The volume of loans disbursed until the end of June amounted to HUF 608 billion. The Funding for Growth Scheme contributed significantly to the growth of outstanding borrowing by the SME sector, and approximately one-third of the total outstanding loan stock was extended under the programme. In the second quarter, 42 per cent of the loans extended to the SME sector were granted under the FGS, which further

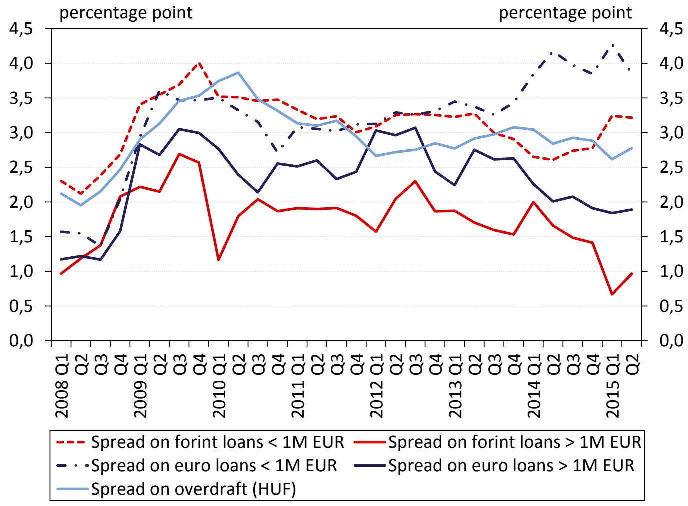
[3] The lengthening of the average maturity of the borrowing reduces the need to renew the loans, which serves to restrict gross lending, even if the loan stock remains unchanged.

Chart 6: Interest rates on new corporate loans



Note: Loans with floating interest rates or with up to 1-year initial rate fixation.
Source: MNB.

Chart 7: Interest rate spreads on new corporate loans



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

increased its ratio in the entire SME loan portfolio.

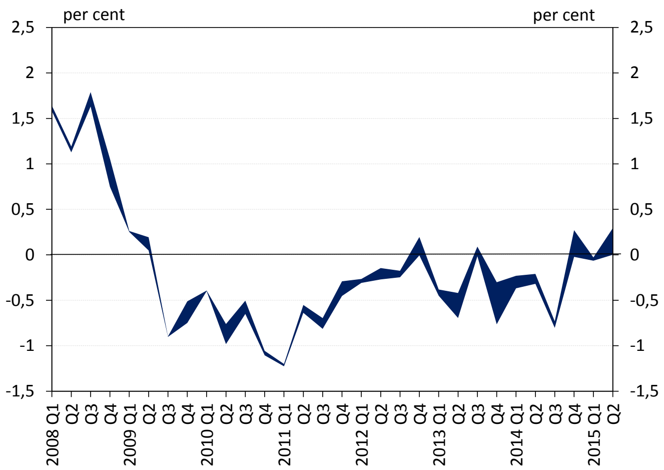
In the second quarter, credit conditions continued to ease. Based on the answers in the lending survey, in net terms,[4] about 17 per cent of the banks eased conditions. Among the factors contributing to the change, respondent banks mentioned market share objectives and the intensification of competition in the highest ratio. At the same time, improvement in economic prospects, favourable liquidity and the capital position of the banks also contributed to easing. In terms of standards, the spread between loan interest rates and funding costs, the length of maximum maturity and the maximum amount of credit line have become more favourable for companies (Chart 5). Looking ahead, approximately 22 per cent of the banks reported that they would ease credit conditions in the second half. In addition to easing lending conditions in the second quarter, the responding banks also anticipated the easing the tight collateralisation requirements.

Owing to the continued decrease in the policy rate, interest rates on corporate forint loans dropped. The interest rate on[56] newly disbursed corporate forint loans decreased by 0.2 percentage points during the quarter, and by the end of June it reached 3.1 per cent (Chart 6). The interest rate on overdrafts decreased by 0.3 percentage points to 4.4 per cent. The interest rate on loans up to EUR 1 million decreased by 0.5 percentage points, both for forint and euro loans. In the case of forint loans, the drop in the interest rate is the result of the decline in the reference rate arising from the decrease in the policy rate, which also went down by 50 basis points during the quarter. In the scope of high-amount loans, interest rates on forint loans dropped by 0.2 percentage points, while interest rates on euro loans remained unchanged.

The spread on small-amount forint loans did not change tangibly, while the spread on high-amount loans rose slightly. While the reference interest rate decreased, the average 3-month spread above BUBOR on new corporate loans denominated in forint did not change in the case of loans of up to EUR 1 million compared to the value of the previous quarter, and thus stood at 3.2 percentage points at the end of the second quarter (Chart 7). The average spread on high-amount forint loans increased by 0.3

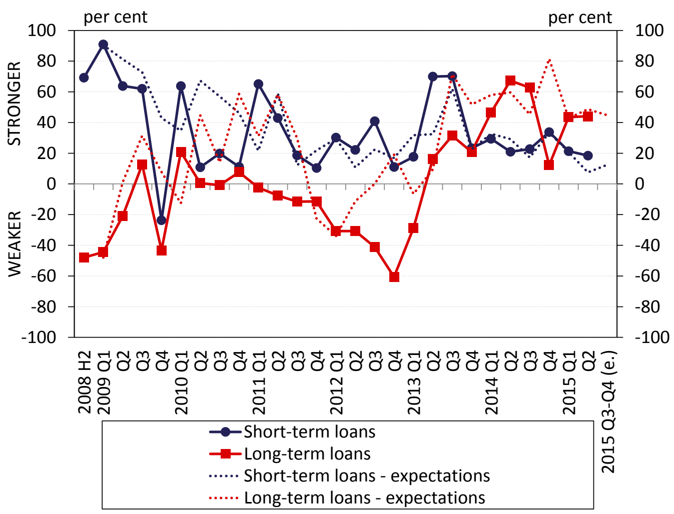
[4] Difference between banks that tightened and eased their conditions, weighted by market share.
[5] In the case of new lending, we examined floating-rate loans or loans with interest rate fixation for no more than one year. The majority of loans granted in the Funding for Growth Scheme are long-term loans, and therefore the interest rates reviewed in this publication are only shaped by smaller, short-term FGS loans.
[6] In addition to market-based loans, the preferential interest rate – i.e. maximum 2.5 per cent – on loans disbursed to creditworthy SMEs within the framework of the second phase of the Funding for Growth Scheme provided a form of low-cost financing.

Chart 8: Sub-index of the 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. The time series was revised.
Source: MNB.

Chart 9: Change in loan demand by maturity



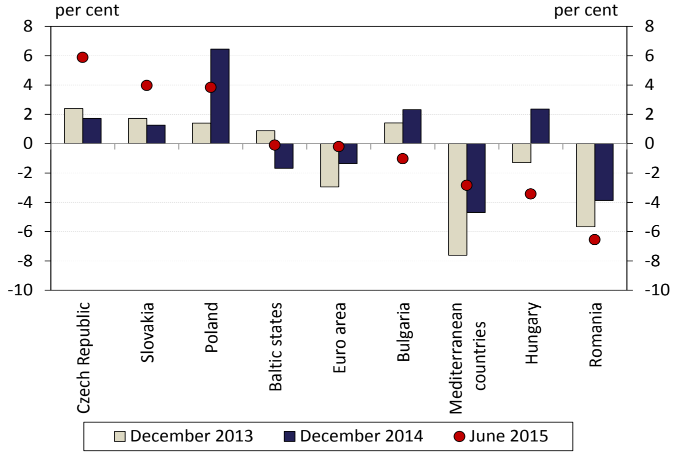
Source: MNB, based on the answers of respondent banks.

percentage points, and thus the difference – which had increased between newly extended small-amount and high-amount forint loan spreads during the previous quarter – decreased. The spread on overdrafts increased by almost 0.2 percentage points. In the case of euro loans, in contrast to forint loans, the decrease in interest rates was not caused by a drop in the reference interest, but rather by the moderation of the average spreads. The spread on small-amount euro loans decreased by 0.4 percentage points, while that of high-amount loans remained unchanged, and thus the difference between the spreads on the two loan categories decreased in the case of euro loans as well.

The banking system exerted no contractionary effect on the cyclical level of output through corporate lending. In the second quarter of 2015, the corporate sub-index of the Financial Conditions Index – estimated based on preliminary data – was slightly above 0 per cent, also taking into account the uncertainty band (Chart 8). The decline in the 3-month interbank rate (BUBOR) contributed to the improvement of the index.

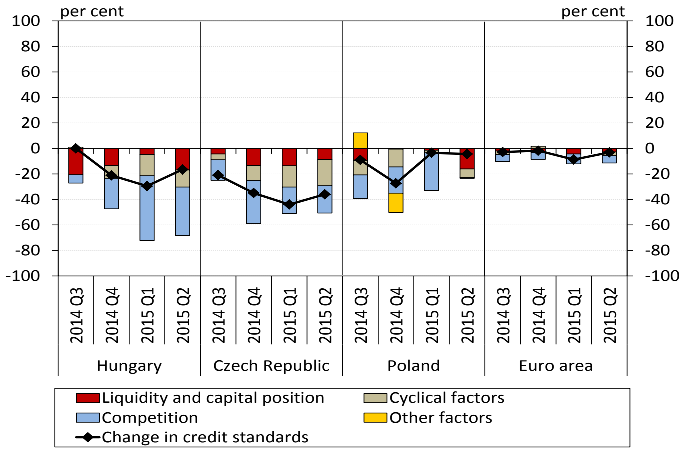
Perceived loan demand continued to expand, especially in respect of long-term loans. Based on the answers in the lending survey, 44 per cent of banks – in net terms – reported increased demand for long-term loans, and 18 per cent indicated a pick-up in demand for short-term loans (Chart 9). Rising demand continues to apply to forint loans, while the participants of the lending survey indicated a decrease in demand for foreign currency loans. The same ratio of respondents reported a strengthening of perceived demand from small and medium-sized enterprises and an increase in demand from large enterprises. Looking forward, in net terms 45 per cent of the banks anticipate a further expansion in demand, which will continue to apply mainly to forint loans, according to their expectations. The increase in demand from small and micro-sized enterprises may be more intensive in the next half of the year, according to the expectations of the respondents, since within this group the ratio of those anticipating an increase in demand by small and micro-sized enterprises was higher than those expecting rising demand by large and medium-sized enterprises.

Chart 10: Annual transaction-based growth rate of corporate loans in international comparison



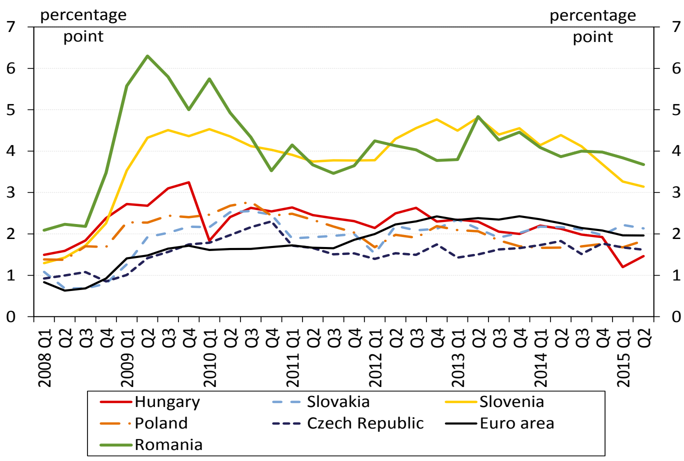
Note: Mediterranean countries: Greece, Italy, Portugal and Spain. Baltic states: Estonia, Lithuania and Latvia.
Source: ECB, MNB.

Chart 11: Changes and factors contributing to changes in corporate credit conditions in an international comparison



Note: Category values are derived from the arithmetic average of the factors thematically classified therein. Positive values indicate the tightening of standards, while negative ones indicate the easing of such.
Source: MNB, ECB, national central banks.

Chart 12: International comparison of interest rate spreads on corporate loans extended in domestic currency



Source: MNB, ECB, national central banks.

International outlook in corporate lending

In the Visegrád countries, outstanding corporate loans continued to expand, while stagnating in the euro area. From the second quarter of 2014 until the end of the second quarter of 2015, outstanding loans to companies calculated on a transaction basis fell by 0.2% in annual terms in the monetary union. However, the split in the euro area continues to be significant: while the corporate loan portfolio increased by 3 per cent on average in the core countries, it dropped by an average of 5 per cent in the peripheral countries, with a significant degree of heterogeneity. Considering the Visegrád countries, in the Czech Republic and Slovakia the annual growth rate of the corporate loan portfolio increased compared to the previous quarter, whereas in Poland it fell slightly, but remained positive (Chart 10).

Credit terms continue to show signs of easing in Europe. According to the lending survey conducted in the second quarter, on the whole euro-area corporate credit terms eased somewhat, primarily as a result of the easing in Italy (Chart 11). This means that since the beginning of 2014 – in parallel with the improvement in the economic sentiment indicator – there has been a constant, slight easing in corporate credit terms in the monetary union. In the group of Visegrád countries, a higher extent of easing was observed in Hungary, Slovakia and the Czech Republic, whereas in Poland credit standards remained broadly unchanged. Based on the responses in the lending surveys, cyclical factors, the liquidity and capital position, as well as competition all acted toward the easing of conditions.

Financing costs continued to drop slightly in the region. In the euro area, interest rates on corporate loans continued to decrease in the second quarter (by 0.1 percentage points), resulting in the average level of interest rates dropping below 2 per cent. In the countries of the region, interest rates decreased by 0.1-0.3 percentage points. With the exception of Hungary and Poland, interest rate spreads decreased slightly in the region. In the case of Hungary, the interest rate spreads increased slightly in the second quarter following a large drop in the preceding quarter; however, average interest rate spreads on corporate loans are still the lowest in Hungary in a regional comparison (Chart 12).

Box 1: The role of foreign funds in the funding structure of large corporations and SMEs

In the recent past, it has happened several times that during a particular month the balance of new lending and repayments resulted in a drastic contraction of the corporate lending market, by HUF 100-200 billion. Stagnation or a downturn in lending is usually associated with a slowdown in economic growth, but a drop of such magnitude in the stock of lending is much more technical in nature and does not reflect a contraction of real economic activity. Among the changes of technical nature, the realignment of the funding structure of large corporations with an international background plays a key role, and as a strategic decision of the parent company this decision is usually made abroad (in many cases independently of domestic developments), and the balance sheets of Hungarian credit institutions only reflect its impact.

Concentration of outstanding loans of non-financial corporations from credit institutions (December 2014)

Outstanding amount of principal	Total principal (HUF Bn)	Number of contracts	Average principal (HUF Bn)
Up to 0,1 HUF Bn	1395	131 195	0,01
0,1 - 1 HUF Bn	2100	7 675	0,27
1 - 10 HUF Bn	2593	1 011	2,57
Over 10 HUF Bn	1326	79	16,78
Total	**7414**	**139 960**	**0,05**

Source: Central Credit Information System

There is a relatively high level of concentration in the Hungarian corporate credit market: over one-half of the entire outstanding loan belongs to less than 1 per cent of the lending transactions. In December 2014, according to the data of the Central Credit Information System, in the category of lending transactions above the value of HUF 10 billion Hungarian banks were responsible for 79 deals, which were concentrated in the balance sheets of approximately 60 companies. It can be said about many of the latter that with some of their transactions (which may take place simultaneously), they can exert significant influence on the size of the Hungarian loan market. Comparing the principals of these 79 contracts at the end of 2014 and in June 2015, one can see that in 16 cases the whole amount of the debt was reimbursed, reclassified or written-off in the balance sheets of financial intermediaries. Only in 3 of the 16 aforementioned cases did the maturity fall in this period according to the loan contracts.

There are several factors that may influence the realignment of the funding structure of large corporations with foreign owners. The parent company may decide to centralise the liquidity management of the company group (i.e. the treasury function) and allocate the funds to the rest of the members of the group through its own balance sheet. In addition to the aspects of management, this could provide cost benefits as well, if the parent company is able to obtain funding at better conditions in the capital market of its own country than the subsidiary. Although changes of this kind can cause significant swings in the domestic loan stock, they do not reflect frictions in the lending market. Even so, it can be said that such one-off transactions do not fit the trend observed after the onset of the crisis that was identified as a gradual expansion in net debt of companies to foreign entities, in parallel with the tightening of the corporate foreign currency credit market.[7]

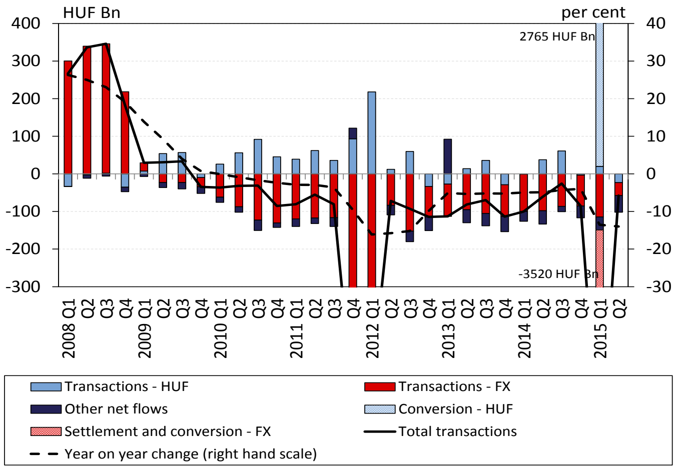
The role of foreign funding can also be registered in the activity of smaller enterprises in the lending market, but in a somewhat different form than in the case of large corporations. For SMEs, grants available from the EU represent an alternative funding option, although these grants are often supplemented by funds obtained from the domestic loan market and, at the same time, they also determine the aim and date of financing. In the personal interviews conducted in the framework of the lending survey, respondents also confirmed that, while in total we cannot talk about the perfect fungibility of EU funds and funding from credit institutions, from the side of credit demand the intention of waiting can be clearly seen, which is apparently causing a temporary downturn in lending.

[7] See the Financial Stability Report of May 2014 for more details on this topic.

3. DEVELOPMENTS IN LENDING TO HOUSEHOLDS

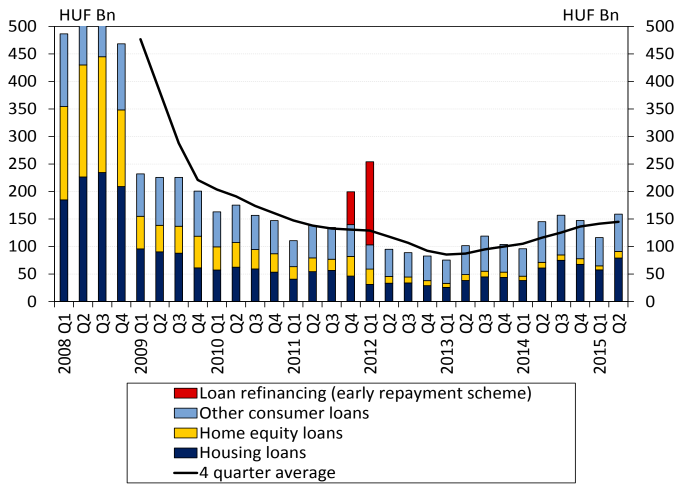
In 2015 Q2, the household loan transactions of the credit institutions sector resulted in a decrease of some HUF 58 billion in the outstanding stock. Outstanding forint loans decreased by HUF 24 billion, while total foreign currency loans fell by HUF 34 billion, and thus the annual rate of the portfolio contraction increased to 14 per cent from 13.5 per cent in the previous quarter. The volume of gross new loans extended to households by the entire sector of credit institutions totalled HUF 159 billion, representing an increase of 9 per cent in year-on-year terms. Based on banks' responses to the lending survey, conditions on housing loans remained broadly unchanged in Q2, while those on consumer loans eased. Easing was primarily recorded in the reduction of the spreads of interest rates over cost of funds. However, the banks indicated that in the next half year no major easing of credit terms and conditions is expected, either for housing or consumer loans. Furthermore, according to the survey, banks reported a marked increase in demand for housing loans and a slight increase in demand for consumer loans, while they anticipate a similar trend for the coming period as well. The APR on new household loans continued to fall in Q2, accompanied by a decline in the interest rate spread on newly extended mortgage loans.

Chart 13: Net quarterly change in the household loan portfolio, by currency



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

Chart 14: New household loans in the entire credit institution sector



Source: MNB.

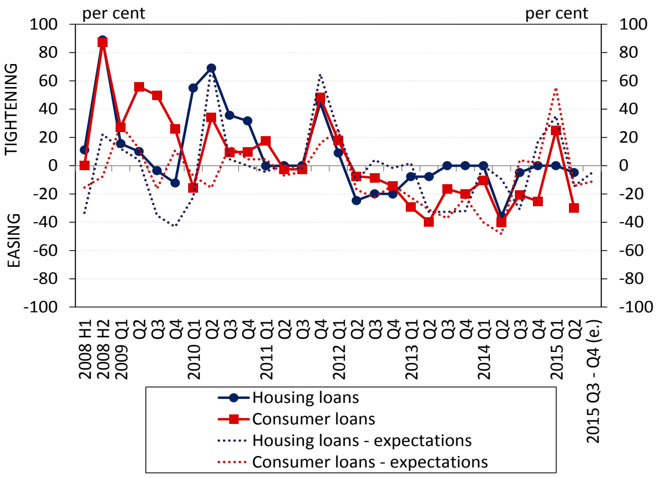
Domestic household lending

The rate of decline in the household loan portfolio remains unchanged. In 2015 Q2, outstanding loans to households by credit institutions decreased by HUF 58 billion as a result of transactions (Chart 13). Write-offs and reclassifications generated a decrease of HUF 44 billion. In the case of forint loans, repayments exceeded disbursements by HUF 24 billion, and in the case of foreign currency loans, by HUF 34 billion. The portfolio of both housing and other loans decreased: in the case of the former the net flow amounted to HUF -30 billion, and in the latter HUF -72 billion.[8] The transaction-based annual decline in the portfolio increased to 14 per cent from 13.5 per cent recorded in the previous quarter. The one-off impacts of the settlement and conversion of foreign currency loans affect the level of this indicator substantially: eliminating this, the annual growth rate would amount to -3.9 per cent.

New housing and home equity loans increased in year-on-year terms. The gross volume of new lending to households by the entire credit institution sector amounted to HUF 159 billion in Q2 (Chart 14). The value of new contracts in the household sector is higher by some 9 per cent on a year-on-year basis. In the case of housing loans, growth amounted to 30 per cent on an annual basis, while the extension of home equity loans increased by 16 per cent compared to 2014 Q2. In the case of other consumer loans, the quarterly volume of new contract conclusion was 8 per cent below the corresponding value in 2014 Q2. For the quarter as a whole, loan refinancing amounted to some HUF 2.5 billion. After the termination deadline by August, there are 90 more days available for actual loan refinancing; therefore its impact could still be felt in gross lending in the following two quarters.

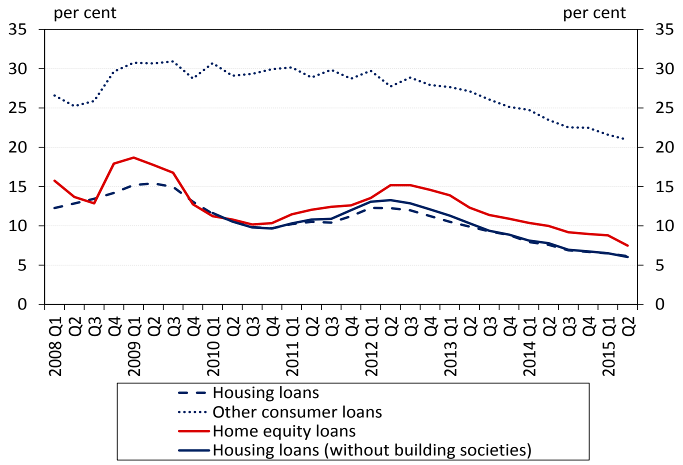
[8] The net portfolio change is the balance of the transactions and other flows (write-offs, reclassifications).

Chart 15: Changes in credit conditions in the household segment



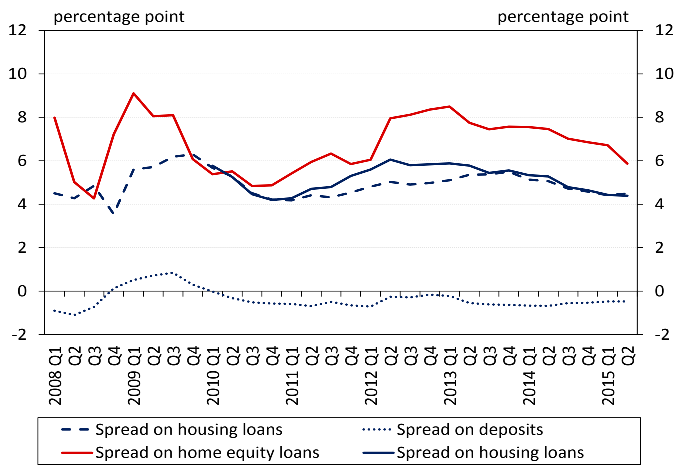
Note: Net ratio is the difference between tightening and easing banks weighted by market share.
Source: MNB, based on the answers of respondent banks.

Chart 16: Annual percentage rate of charge on new household loans



Note: Quarterly average of lending rates on newly disbursed loans.
Source: MNB.

Chart 17: Interest rate spreads on new household loans



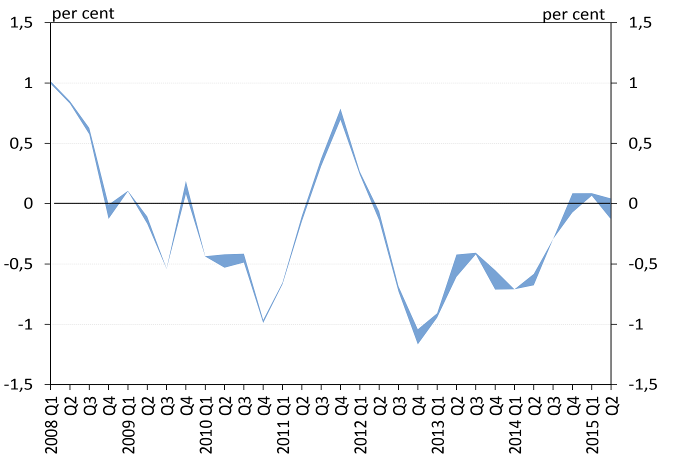
Note: Quarterly average of the interest rate spreads on 3-month BUBOR. Spreads based on the APR.
Source: MNB.

Conditions on housing loans did not change significantly, while those on consumer loans eased. In net terms, 30 per cent of the respondent banks reported that in total they had eased conditions on consumer loans in Q2. The ratio of banks that eased conditions exceeded the ratio indicated for this period in Q1 in the case of consumer loans (Chart 15), while in the case of housing loans, despite the indicated easing, conditions remained practically unchanged. In the field of consumer loans, a net 38 per cent of the respondents reduced the spread of interest rates over cost of funds, but conditions related to maximum maturity, fees charged for loan disbursement and required credit score were also relaxed. In the case of housing loans, considering the specific conditions, a significant ratio of banks (almost two thirds in net terms) also chose to reduce their interest rate spreads. Looking forward, 11 per cent of the respondents predicted further easing on consumer loans, and 5 per cent on housing loans.

Interest rates on housing loans continued to decrease and interest rate spreads rose slightly. The reduction in the APR on housing loans, a process that began in 2012, continued (by 0.35 percentage points). The typical APR on new contracts signed in this quarter thus amounted to 6.1 per cent (Chart 16). The decline in the average interest rate on newly extended loans occurred as the combined effect of a significant decrease in interest rates on loans with a floating interest rate and a slight increase in interest rates on loans with a fixed interest rate. However, the average interest rate spread increased by 0.1 percentage point to 4.5 percentage point in Q2 (Chart 17).

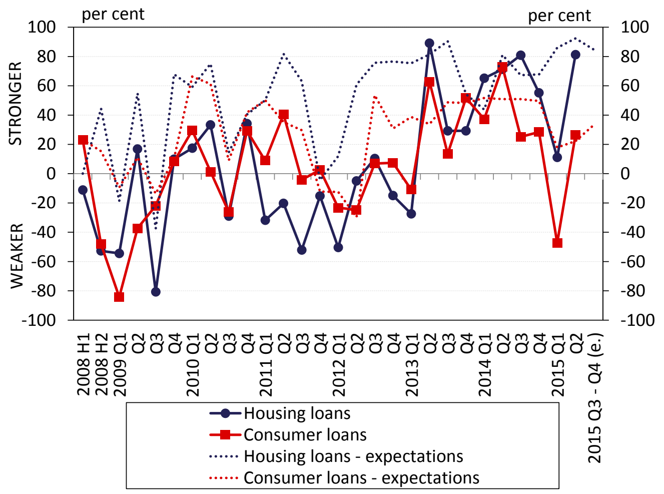
The APR and interest rate spread on consumer loans continued to decline. The interest rate on consumer loans secured by a mortgage dropped by 1.3 percentage points, and their average level was 7.5 per cent in Q2 (Chart 16). The APR on other consumer loans dropped by some 0.6 percentage points, and their average level was 21 per cent in June. The fall in the level of interest rates exceeded the rate of decline in the reference rate (3-month BUBOR); therefore, interest rate spreads also dropped in the consumer loan segment, and in the case of home equity loans they dropped by 0.8 percentage points to 5.9 percentage points.

Chart 18: Sub-index of the FCI for household lending



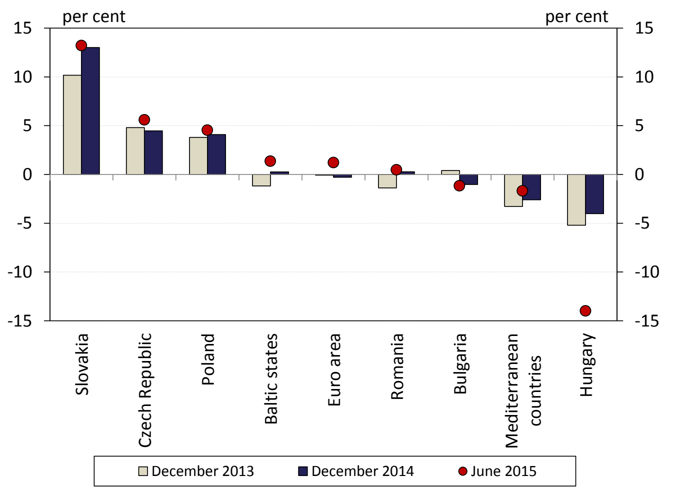
Note: The index quantifies the impact of financial conditions on annual GDP growth through household lending. The band illustrates the methodological uncertainty. Based on preliminary data.
Source: MNB.

Chart 19: Credit demand in the household segment



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

Chart 20: Annual transaction-based growth rate of household loans in international comparison



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

The banking sector had no significant impact on the annual growth in GDP through its credit supply to households. The household sub-index of the Financial Conditions Index did not change significantly in quarter-on-quarter terms, and accordingly developments in household lending had a neutral impact on GDP growth (Chart 18). The fall in the average level of interest rates and growth in new loans contributed to the improvement in the index.

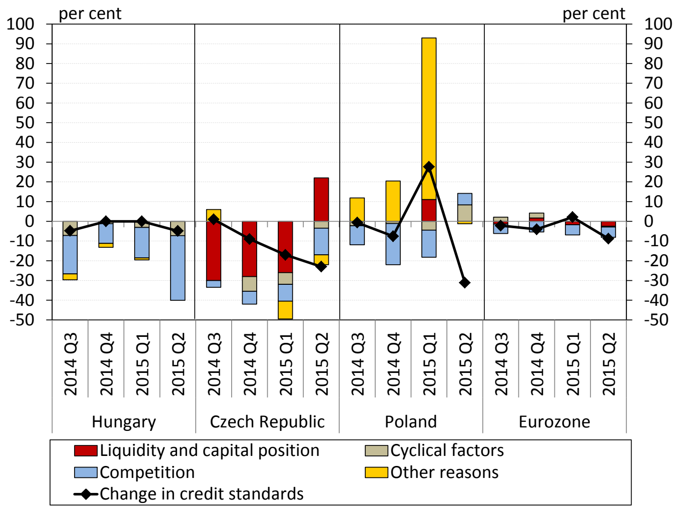
The banks noted a recovery in credit demand in both segments. In net terms, 81 per cent of banks reported higher demand for housing loans in Q2, while 26 per cent indicated an expansion in demand for consumer credit (Chart 19). These ratios are roughly identical with the forecasts which were provided in Q1. Looking forward, in net terms 85 per cent of the banks expect a pick-up in demand for housing loans, and 33 per cent in demand for consumer loans in 2015 H2.

International outlook in household lending

The debts of households in regional countries continue to grow dynamically in a European context. In Slovakia, Poland, the Czech Republic and Romania, household borrowing continued to expand on an annual basis as a result of transactions (Chart 20). The average annual growth rate calculated for member states of the euro area turned positive in the quarter, after showing a close-to-zero per cent growth rate in Q1. The North-South division that has been observed in Europe continues to apply, although during 2015 Q2 the growth rate of France and Italy turned positive (2.6 and 0.9 per cent, respectively).

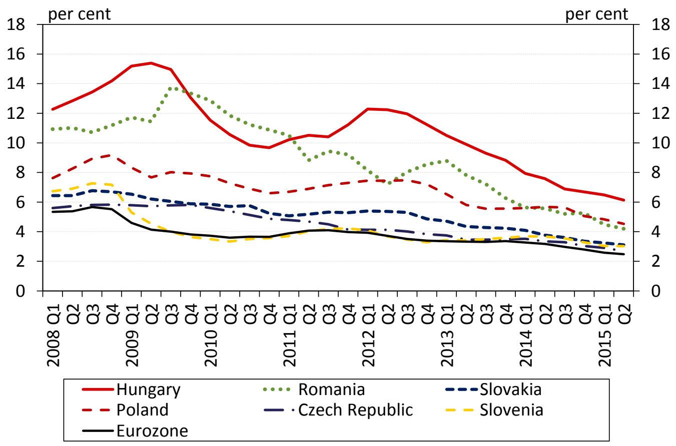
Terms and conditions on housing loans eased in Europe. Banks in the CEE region eased their conditions on housing loans, with the exception of Slovakia (Chart 21). With a significant degree of heterogeneity, credit terms also eased in the euro area on average after some slight tightening in 2015 Q1. In parallel with this, banks reported a more intensive pick-up in demand for housing loans according to the Bank Lending Survey of the European Central Bank: in net terms half of the respondent banks indicated growth, while in Q1 30 per cent registered a pick-up in demand. In accordance with the domestic developments as well, the easing of the conditions is justified by the intensification of the competitive market situation all over Europe.

Chart 21: Changes and factors contributing to changes in housing loan credit conditions in an international comparison



Note: Category values are derived from the arithmetic average of the factors thematically classified therein. Positive values indicate the tightening of standards, while negative ones indicate the easing thereof.
Source: MNB, ECB, national central banks.

Chart 22: International comparison of housing loan costs provided in domestic currency



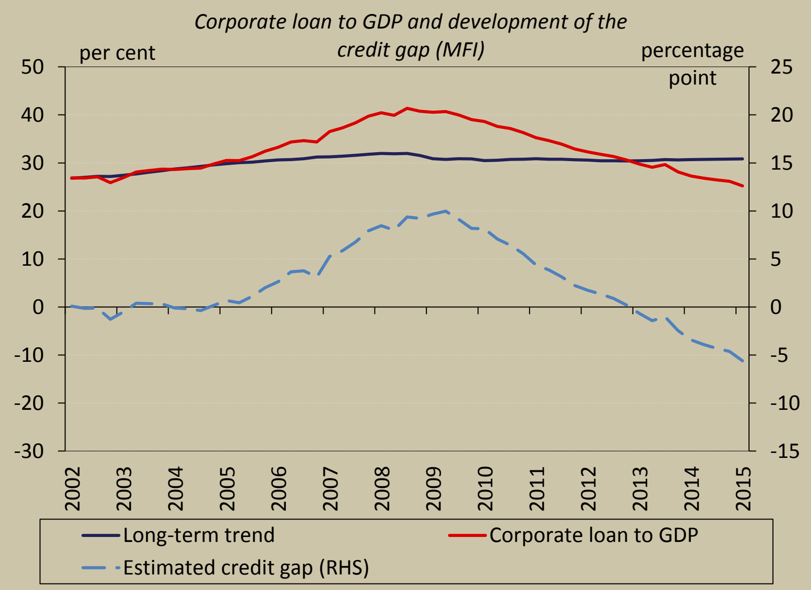
Note: Quarterly average of APR on newly disbursed loans.
Source: MNB, ECB, national central banks.

In the international reference countries, the APR and interest rate spread on housing loans also typically declined. In countries of the Central and Eastern European region, the APR on housing loans showed a decline in 2015 Q2, with the exception of Slovenia. In Hungary, the drop in interest rates exceeded the decline characterising the region and on average the member states of the euro area, although the interest rate level is still considered high compared to the latter (Chart 22). Interest rate spreads mostly decreased slightly, simultaneously with the decline in interest rate levels; only the Hungarian interest rate spread increased, despite a drop in the APR. In Slovenia, interest rates increased in parallel with the change in the reference rate, and thus the interest rate spread did not change significantly during the quarter.

Box 2: Closing of the credit gap and equilibrium growth

In its discussion paper entitled "Hungarian Banking System in Transition"[9] the MNB specified the annual growth rate of the nominal outstanding borrowing required to support long-term sustainable economic development at around 6-7 per cent, both in the household and the corporate sector. Although signs suggesting a positive turnaround have appeared in corporate lending – such as easing of the price and non-price conditions, and trend-like growth of credit demand – the growth rate of outstanding borrowing still lags considerably behind this value, which would facilitate convergence.

Contraction of the credit-to-GDP ratio was a general phenomenon in the CEE countries as well, although the rate thereof was higher in those countries where the credit institution sector was characterised by a high NPL ratio and poor profitability (e.g. Latvia, Lithuania, Hungary, Romania, Slovenia). In Hungary, the private credit-to-GDP ratio has declined considerably since 2009, and thus a substantial "gap" has built up compared to the sound level of equilibrium. In the long run, this may give rise to severe growth sacrifices particularly in the corporate sector, as lending constraints and a credit crunch may result in a substantial reduction of economic activity, or even in a reduction of capacities. On the other hand, lending constraints have a larger proportional impact on the smaller, more vulnerable SME segment as they are hit harder by banks' risk aversion.



The return to the equilibrium level of lending would be facilitated by credit growth higher than at present. Although since 2013 the contraction of corporate lending seems to be decelerating and about to turn around, and the dynamics of the SME lending became positive (1.8 per cent at present) additional growth would be required to achieve a long-term sound level of equilibrium. It would take at least 5 years to reach the level of the lending trend even with a 6-7 per cent annual growth rate of the total outstanding corporate borrowing. Moreover, in the SME segment – hit harder by the credit crunch – an above average growth rate, as high as 10 per cent, may also be justified. Taking this latter as a basis, convergence to the level of equilibrium would take minimum 3 years.

[9] MNB (2013a): Hungarian banking system undergoing a transformation. Discussion paper for the formulation of a consensus vision of the Hungarian banking system.

ANNEX: METHODOLOGICAL NOTES

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

1. *Credit aggregate and lending rate data*

One of the statutory tasks 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://www.mnb.hu/en/publications/reports/trends-in-lending

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 respect of the household segment, a total of 11 banks were involved in the interviews. Nine banks responded to questions related to housing loans, while 11 banks and 7 financial enterprises answered questions on consumer loans. Based on data from the end of 2015 Q2, the surveyed institutions accounted for 86 per cent of the banking sector in the case of outstanding housing loans and 87 per cent in the case of outstanding consumer loans. The corporate questionnaire was filled in by 8 banks on aggregate, which represent 81 per cent of the corporate loan market, while the market share of the 7 banks responding to the questionnaire related to commercial real estate loans is 92 per cent.

The survey consists of a standard questionnaire in each segment, and since the survey conducted in January 2010 the MNB has also asked ad-hoc questions on current issues related to the credit markets. The retrospective questions refer to 2015 Q2 (compared to 2015 Q1), whereas the forward-looking questions concern the next half-year period, i.e. the one covering 2015 H2 (relative to 2015 Q2). The current questionnaire was completed by senior loan officers between 1 and 16 July 2015.

To indicate changes, the survey uses 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://www.mnb.hu/en/financial-stability/publications/lending-survey

3. *The Financial Conditions Index (FCI)*

In addition to short-term interest rates and the nominal exchange rate, which represent the behaviour of the financial 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 the real economy. The annual change in the FCI discussed in the survey shows the contribution 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).[10] In the VAR model, the use of the so-called sign restriction method allows the identification of monetary policy shocks as well as supply shocks affecting the financial markets and the banking sector. The identified shocks allow calculation of how unexpected changes in individual financial variables

[10] Tamási, B.–B. Világi (2011): Identification of Credit Supply Shocks in a Bayesian SVAR model of the Hungarian Economy. *MNB Working Papers,* 2011/7.

affect 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.

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 can also be calculated. Accordingly, for example, the 'banking sector' FCI net of financial 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. 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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