Trends in lending

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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, 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 2013 Q4 on, 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 the developments in lending and the methodology of the Financial Conditions Index is given 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

A general improvement was observed in the development of credit institutions' lending to the private sector. During the quarter credit conditions eased, which was accompanied by increasing demand. In parallel with the recovery of the real economy, the volume of new loans increased.

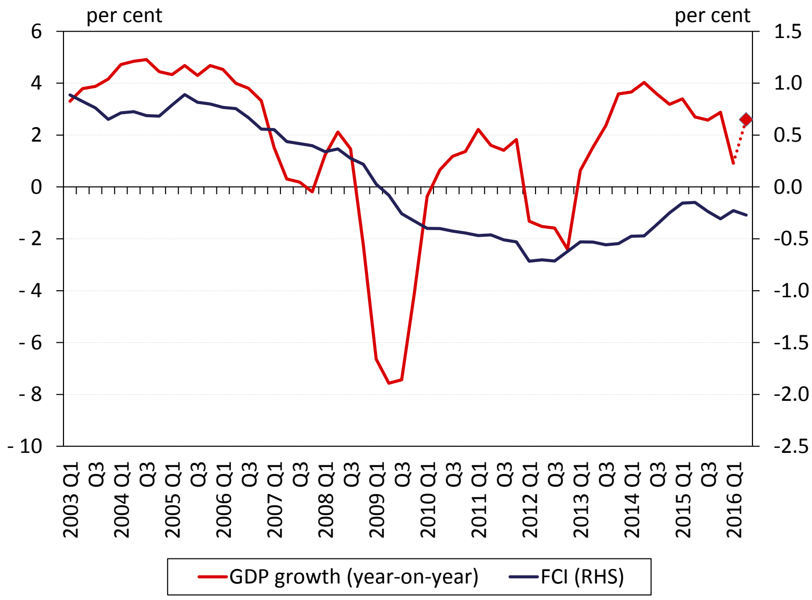
In 2016 Q2, SME loans from credit institutions increased on a transactional basis by 5 per cent in an annual comparison, with the second and third stages of the Funding for Growth Scheme contributing substantially to this. With this, SME lending is situated at the bottom of the 5 to 10 per cent growth band considered sustainable by the MNB. Loans extended in the third stage of the programme contributed by approximately HUF 54 billion to transactions during the quarter. Overall, the annual growth rate of corporate lending as a whole took a positive turn from its earlier low level caused by individual factors, and consequently the portfolio expanded by 0.3 per cent on an annual basis by the end of June, which would be equal to 1.9 per cent annual growth after eliminating the effect of portfolio separation at the end of the year. At the same time, repayments exceeded disbursements by HUF 51 billion in the period under review.

According to banks' responses to the Lending Survey, similarly to international trends, credit conditions for companies continued to ease during the quarter, which was partly caused by stronger competition, partly due to the favourable economic prospects and the Market-based Lending Scheme. Similarly to the previous quarter, easing was primarily seen in the relaxation of the price conditions. Conditions of availability of commercial real estate loans were also eased, which was explained by the mitigation of the problems affecting the industry and the improvement in banks' risk tolerance. The banks registered a rise in demand for long-term loans in particular during the quarter, which they expect to continue for the next six months as well, owing to the financing needs of new investments by their customers. The average financing cost of forint small-amount loans decreased somewhat, primarily taken out by SMEs.

The volume of new household loan contracts increased by 38 per cent in an annual comparison; within this, the disbursement of housing loans and personal loans rose to the greatest extent, as the volume increased by 46 per cent and 47 per cent on average annually, respectively. The loan portfolio contracted by 4.2 per cent last year, and households were still net debt repayers during the quarter. At the same time, disbursements already exceeded repayments in June. Based on banks' responses to the Lending Survey, credit supply conditions eased both in the housing and consumer segment in Q2. The annual percentage rate of interest on new housing loans remained unchanged, while interest rate spreads increased slightly during the quarter, which can be explained by lending to riskier customers. According to the survey, the respondent banks registered further expansion in demand for loans, especially for housing loans, as unanimously indicated by the participating institutions. The latter was also supported by the Home Purchase Subsidy scheme, under which loan contracts were signed in an amount of HUF 21.5 billion. Three-quarters of these were requested for the purchase of used homes by customers. In the light of current experiences, it would be worth to review the program details to see how the rules could be modified in order to increase the weight of new homes.

Based on the Financial Conditions Index, which summarises lending developments in the corporate and household segments, the banking sector had a moderately negative impact on the annual growth of the real economy through its lending activity.

Financial Conditions Index (FCI) and annual real GDP growth

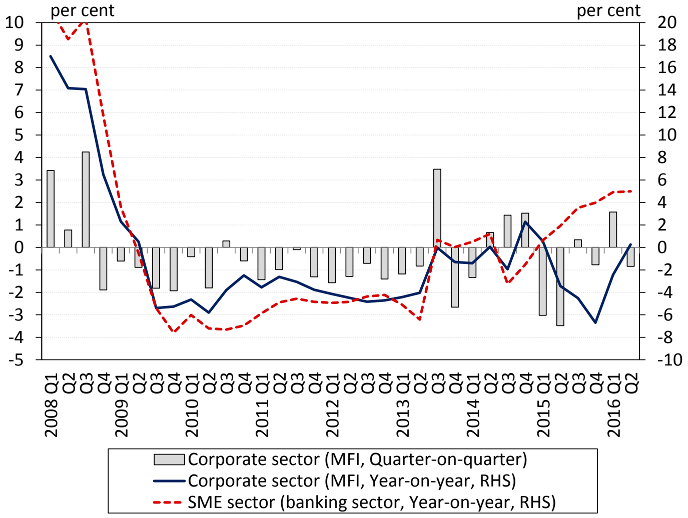


Note: The FCI shows the contribution of the banking sector through lending to the annual GDP growth rate. The 2016 Q2 data for the annual real GDP growth rate are the preliminary estimate of the HCSO. Source: MNB, HCSO.

2. DEVELOPMENTS IN LENDING IN THE CORPORATE SEGMENT

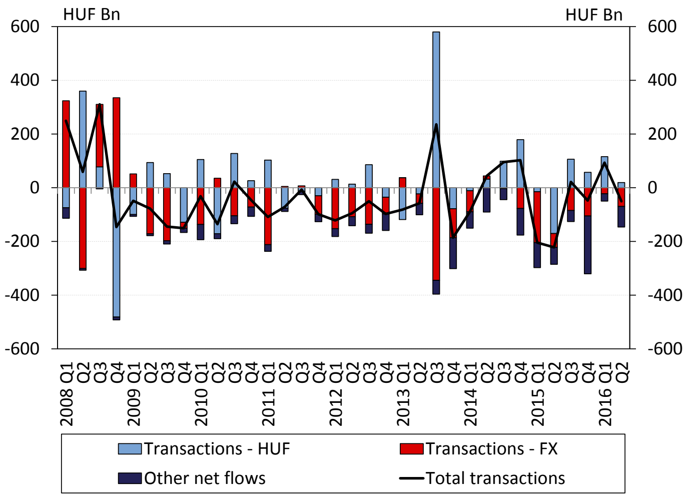
In 2016 Q2, the annual growth rate of corporate loans turned positive and rose to 0.3 per cent. At the same time, repayments exceeded disbursements by HUF 51 billion during the quarter. The expansion of the SME sector's loan portfolio reached 5 per cent at the end of June in year-on-year terms, with this segment characterised by accelerating dynamics since the end of 2015. According to the banks' responses to the Lending Survey, similarly to international trends, loan conditions continued to ease during the quarter, which was caused by stronger competition, the favourable economic prospects and the central bank's Market-based Lending Scheme. Banks participating in the survey anticipated further easing of conditions during the next six months. In Q2, banks perceived a rise in demand for long-term loans, which may be followed by a further increase in the second half of 2016, related to investment funding. The average financing cost of corporate HUF loans decreased, for small-amount loans primarily taken out by SMEs.

Chart 1: Growth rate of loans outstanding of the whole corporate sector and the SME sector



Note: Transaction based, prior to 2015 Q4 data for SMEs are estimated based on banking system data, 2016 Q1 figure reviewed. Source: MNB.

Chart 2: Net quarterly changes in the corporate loan portfolio, by currency



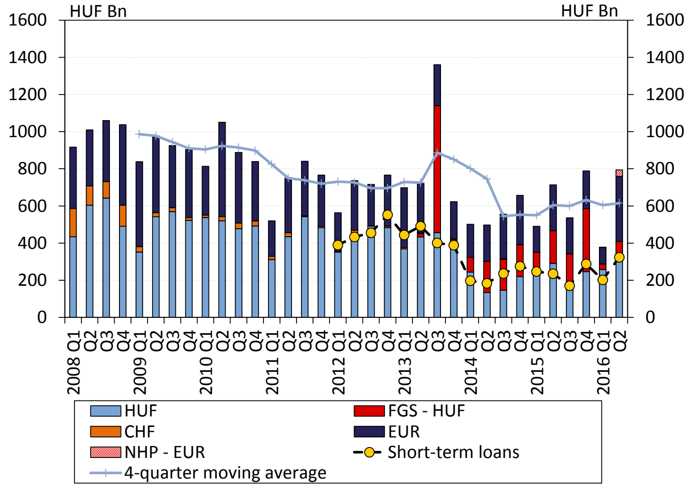
Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment, excluding individual institutional effects. Source: MNB.

Domestic corporate lending

The annual growth rate of corporate lending improved significantly. The annual growth rate of credit institutions' lending to the corporate segment turned positive and reached approximately 0.3 per cent at the end of the second quarter (Chart 1). This improvement was primarily due to base effect, since by the end of June several individual, large volume items had disappeared from the base. At the same time, the portfolio separation implemented within the framework of the resolution of MKB Bank is still part of the annual rate. Within corporate lending, loans to the SME sector expanded by 5.0 per cent in year-on-year terms. In 2016, both new contracts in the Funding for Growth Scheme (third stage) and disbursements of the second stage carried over to 2016 contributed to the rising growth rate of the loan portfolio.

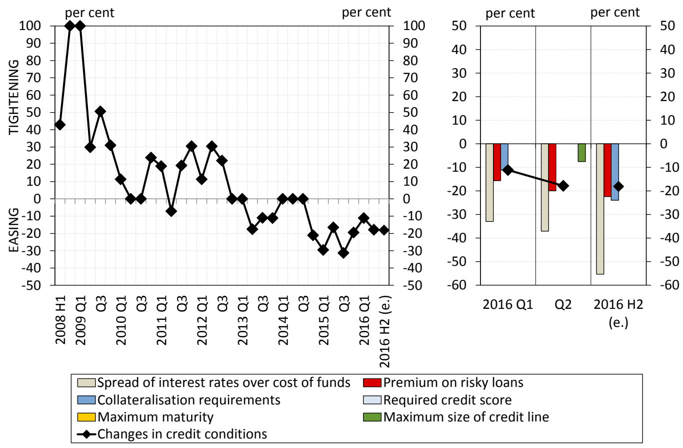
In the second quarter, the corporate loan portfolio slightly decreased. In 2016 Q2, credit institutions' outstanding loans to enterprises decreased by about HUF 51 billion as a result of transactions (Chart 2).Forint loans increased by HUF 19 billion, while foreign currency loans declined by a total of HUF 70 billion in the period under review. The loans extended in the third stage of the Funding for Growth Scheme contributed approximately by HUF 54 billion to the increase in transactions during the quarter. In addition to loan transactions, write-offs and reclassifications (other change in stocks) reduced the outstanding borrowing of non-financial corporations by a total of approximately HUF 77 billion. During the quarter, the volume of undrawn credit lines increased by HUF 279 billion, which may provide additional reserves for portfolio increases in the following quarters. In recent years, the portfolio of overdrafts has reached a historically high level and also increased by HUF 13 billion during the quarter, constituting 18 per cent of the entire corporate loan portfolio.

Chart 3: New corporate loans in the credit institution sector



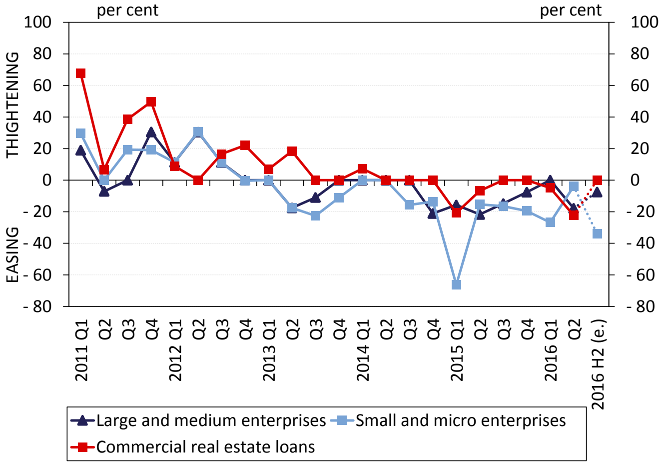
Source: MNB.

Chart 4: 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.

Chart5: Changes in credit conditions in the corporate sub-segments



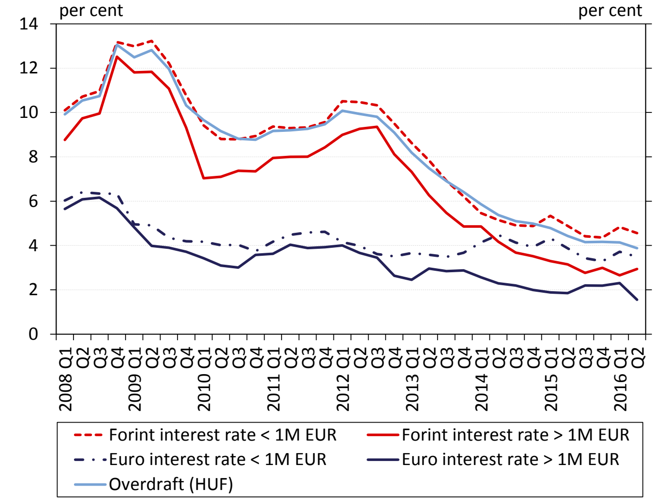
Note: Net ratio is the difference between tightening and easing banks weighted by market share. Source: MNB, based on the answers of respondent banks.

The volume of new contracts rose significantly in the period under review. The corporate sector concluded new loan contracts with the credit institution sector in an amount of HUF 794 billion in the second quarter (Chart 3). A significant increase compared to the same period of previous years was primarily registered in euro loans, the volume of which amounted to almost HUF 385 billion in the period under review. This increase is primarily the result of several individual large corporate items, some of which served to renew earlier loans. The volume of new forint loans also expanded significantly, as their value amounted to a total of HUF 409 billion. It should also be noted that in parallel with the increase in forint loan volumes, extensions of short-term loans also increased. These loans amounted to HUF 324 billion, a significant part of which had a term of less than one month. Loans with a maturity of less than one month and the renewal of earlier credit line agreements increased neither the loan portfolio observed at the end of the month, nor the value of transactions. Loan agreements signed within the framework of the third phase of the Funding for Growth Scheme contributed to the volume of forint loans by HUF 78 billion and to euro loans by HUF 34 billion.

In line with the banks' expectations, corporate lending conditions continued to ease. Based on responses to the Lending Survey, 18 per cent of the banks eased their corporate lending conditions in net terms[1] (Chart 4). Banks indicated an easing of standards in the case of large and medium corporate products and for commercial real estate loans (Chart 5). Similarly to the previous quarter, banks eased price conditions for corporate loans, such as the spread and the premium on riskier loans. They once again mentioned intense competition and the improving economic prospects as the cause of this easing, and the fulfilment of commitments made concerning the interest rate swap conditional to lending activity (LIRS) – part of the Market-based Lending Scheme – was also mentioned. Among the factors contributing to the relaxation of conditions for commercial real estate loans, the mitigation in industry specific problems and – in parallel with portfolio cleanings – the improvement in banks' risk tolerance were mentioned. Looking ahead, a net 18 per cent of respondents expect general easing in lending conditions in the second half of 2016, which may once again be primarily implemented through the reduction of price conditions.

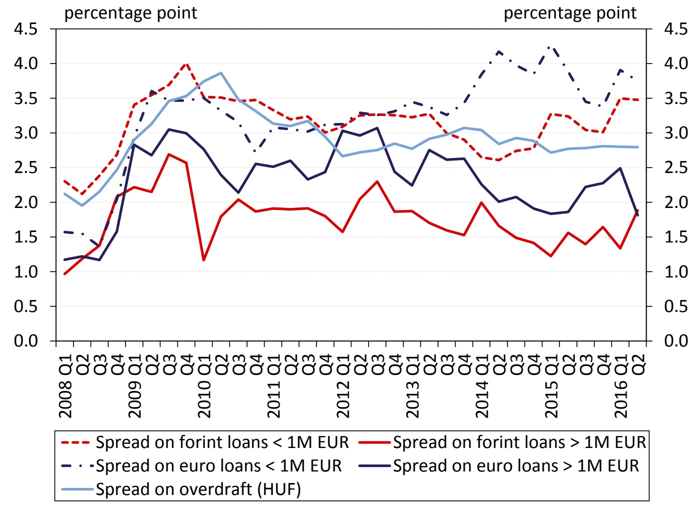
[1] The difference between banks that tightened and eased their conditions, weighted by market share.

Chart 6: Interest rates on new corporate loans



Note: Loans with floating interest or with up to 1-year initial rate fixation. Adjusted for money market loans > 1M EUR since 2015. Source: MNB.

Chart 7: Interest rate spreads on new corporate loans



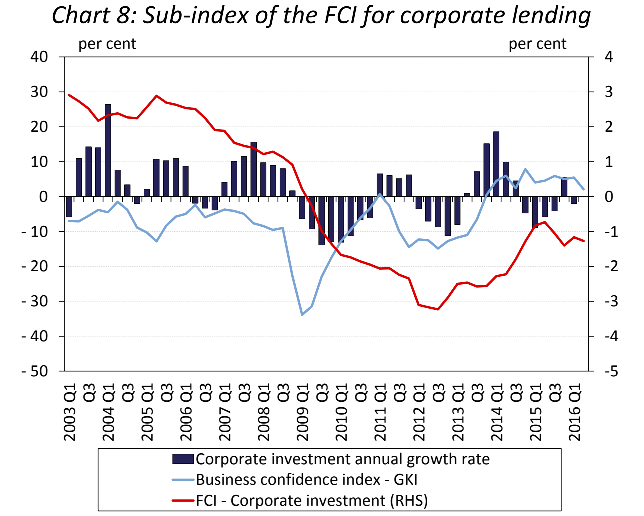
Note: Spread on the 3-month BUBOR and EURIBOR. Loans with floating interest or with up to 1-year initial rate fixation. Adjusted for money market loans > 1M EUR since 2015. Source: MNB.

Financing costs of small-amount forint and euro loans decreased. The interest rate on new market-based corporate loans[2] increased by 0.3 percentage point on average in the case of high-amount forint loans (Chart 6). This value has been filtered to remove the so-called money market transactions, to which only a few large players have access. Due to the extremely high volume and typically low interest rate level of such transactions, they can significantly distort the average interest rates, and accordingly this justifies filtering them out.[3] In the case of forint loans under 1 million euros, the average interest level decreased by 0.3 percentage point, which can be explained by the decrease in the reference interest rate, while the average spread (Chart 7) remained unchanged. The average interest rate level on high-amount euro loans decreased by 0.8 percentage point, which is attributable to the disbursement of a few exceptionally high-volume corporate loans with low spreads. The further decline in the three-month EURIBOR into the negative range and the decrease in the average spread also contributed to the decline in the interest rate level on small-amount euro loans. Spread on overdrafts did not change during the quarter.

[2] In the case of new contracts, we examined the floating-rate loans or loans with interest rate fixation for less than one year. The majority of loans granted in the Funding for Growth Scheme are long-term loans, and therefore the interest rates reviewed by this publication are only shaped by smaller, short-term FGS loans.

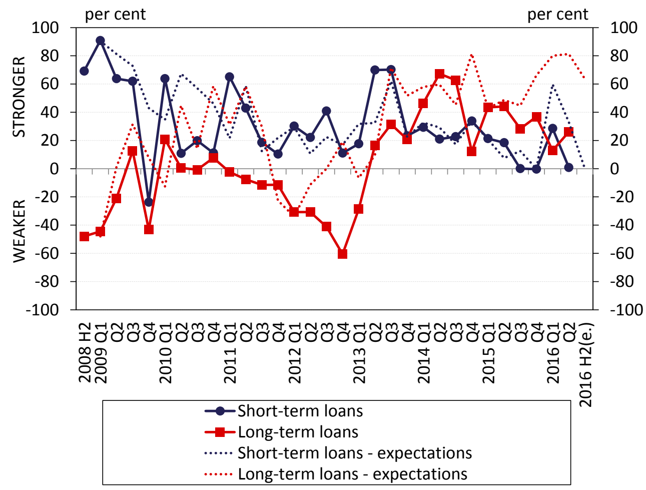
[3] Money market transactions are loans extended to non-financial corporations with a value of over EUR 1 million; their term is short (typically less than 1 month) and they serve to fund some kind of financial operation. Therefore, they do not generate investments in the real economy. From 2015, it has been possible to generate data from which money market transactions are filtered out, and at the same time, in the previous period they did not distort significantly the observed average interest rates, owing to their low weight.

Chart 8: Sub-index of the FCI for corporate lending



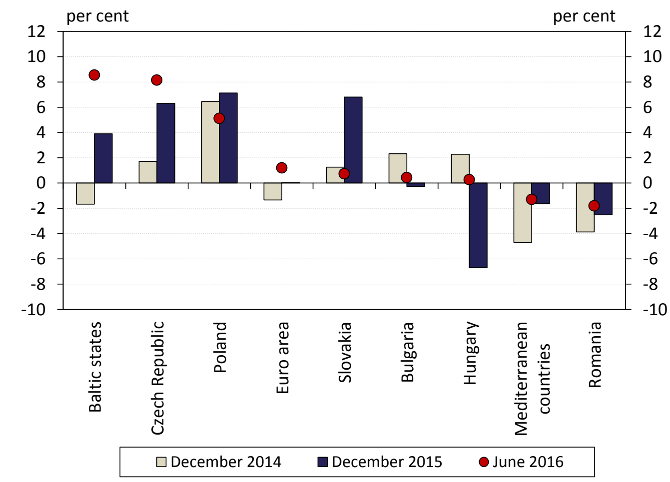
Note: The sub-index of the FCI quantifies the banking system's contribution, through corporate lending, to the annual growth in corporate fixed investments. Source: MNB and GKI.

Chart 9: Change in loan demand by maturity



Note: Net ratio is the difference between banks reporting stronger and weaker demand, weighted by market share. Source: MNB, based on the answers of respondent banks.

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



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

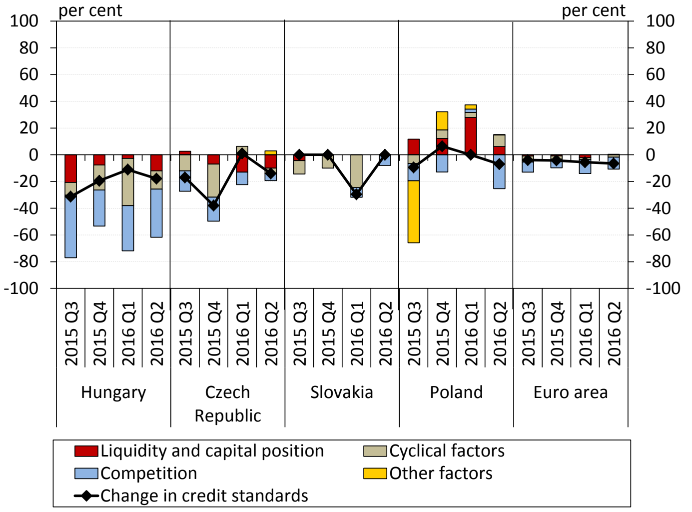
The banking sector's lending activity still has a moderate contractionary effect. In 2016 Q2, the corporate sub-index of the Financial Conditions Index remained below zero (Chart 8), meaning that the conservative lending activity of the banking system slightly reduced the annual volume of corporate investment. The value of the business confidence index published by GKI, which captures the changes in expectations, fell slightly, but stayed in positive territory during the quarter.

Demand for long-term corporate loans continued to rise. A net 26 per cent of banks reported a general increase in demand for long-term corporate loans (Chart 9) within the framework of the Lending Survey. This rising demand affected both forint and foreign currency loans. In net terms, 6 per cent of the banks reported a rise in demand from large and medium enterprises, and a net of 22 per cent noted the same from small and micro enterprises. Banks primarily identified clients' increased funding requirements for working capital needs as the driving factor behind this increase. Looking ahead, 64 per cent of the banks expect further rise in demand for long-term loans, while overall, the responding banks anticipate no change in demand for short-term loans. According to their expectations, rising loan demand may be induced by an increase in investment in tangible assets. A net 79 percentage of the respondent banks indicated an expansion in demand for loans funding housing projects and office buildings, and the majority of them anticipate further development in this regard.

International outlook in corporate lending

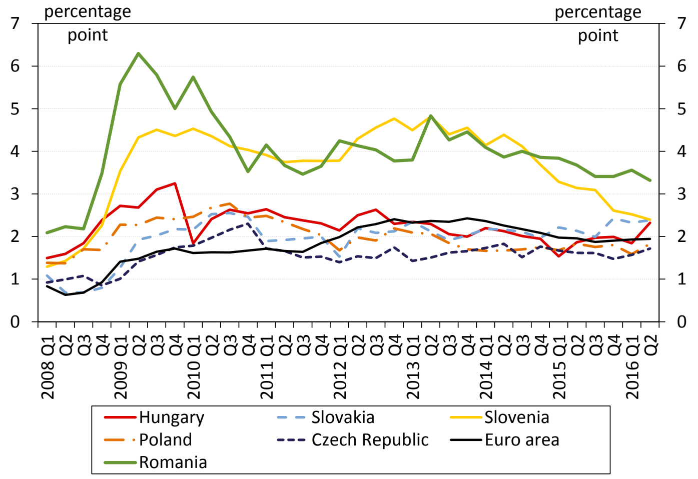
The region continues to be characterised by positive corporate credit dynamics. In the euro area, corporate loans outstanding increased by 1.2 per cent on average over the last four quarters, which is still driven by the increase in the core countries, while the periphery is characterised by declines in corporate lending. While the corporate loan portfolio increased by 2.6 per cent on average in the former group, in the Mediterranean states it decreased by 1.3 per cent. Outstanding loans to non-financial corporations increased in the Visegrád countries in an annual comparison, while it decreased (Chart 10) in Slovenia, Romania and Croatia. Compared to the previous quarter, lending dynamics slowed down the most in Slovakia and Romania, but a decrease was also registered in the Czech Republic and Poland.

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 spreads on corporate loans extended in domestic currency



Note: Variable-rate loans with maturities of up to one year; therefore, FGS loans with the max. 2.5 percentage point spread are not included. In the case of Hungary adjusted for money market loans > 1M EUR since 2015. Source: MNB, ECB, national central banks.

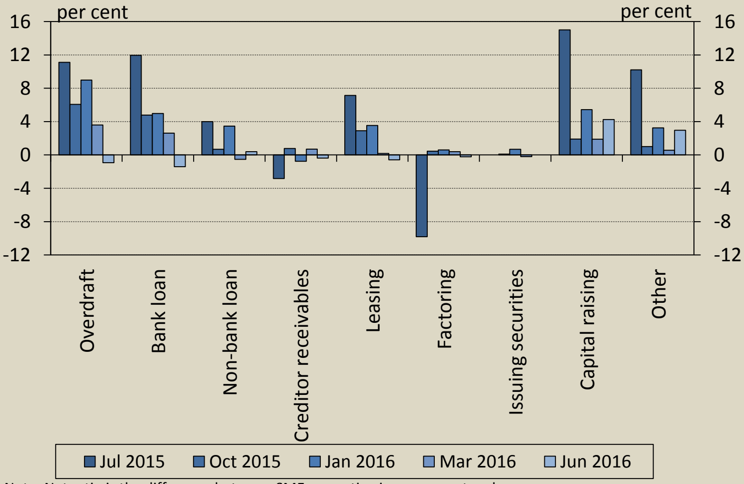
Corporate credit conditions continued to ease in the region. Based on banks' responses to the lending surveys, which approximately half of the banks completed before the British referendum, it was not possible to identify any shock impacting corporate credit conditions related to Brexit. In the euro area, corporate lending conditions eased overall, which – with the exception of the tightening in Greece – was the result of average easing or no change in each country. Accordingly, a net of 7 per cent of banks eased corporate lending conditions in the euro area (Chart 11). With the exception of Slovakia, the Visegrád countries were also characterised by easing lending conditions. Across Europe, stronger competition remained the most often mentioned factor pointing towards easing. Among the factors contributing to the increase in demand, the respondent banks identified mergers and funding for working capital most often, while the contribution of investments continued to decline.

Average interest rate spreads increased in the Visegrád countries. The average interest rate spread on corporate loans did not change significantly in the euro area in the second quarter, while the average level of interest decreased owing to a reduction in the reference interest rate by 0.1 per cent (Chart 12). In the region, the average interest rate spread on corporate loans increased in Hungary, Poland, the Czech Republic and Slovakia, while it declined in Romania and Slovenia. Although the reduction of the reference interest rate counterbalanced the increase in the spread in Slovakia, in the other countries the direction of the change in interests was identical with of the movement in spreads.

Box: The financing situation of micro, small and medium-sized enterprises

As part of its regular research on economic activity, the MNB uses questionnaire-based surveys to explore the growth opportunities, funding conditions and investment activity of enterprises, in order to identify the barriers that the SME sector needs to overcome. Based on the results of this survey, the following section presents how enterprises perceived the easing implemented in lending conditions over the last year, with a focus on small and medium-sized enterprises.

Access to finance for SMEs in the previous 6 months



Note: Net ratio is the difference between SMEs reporting improvement and deterioration in availability.

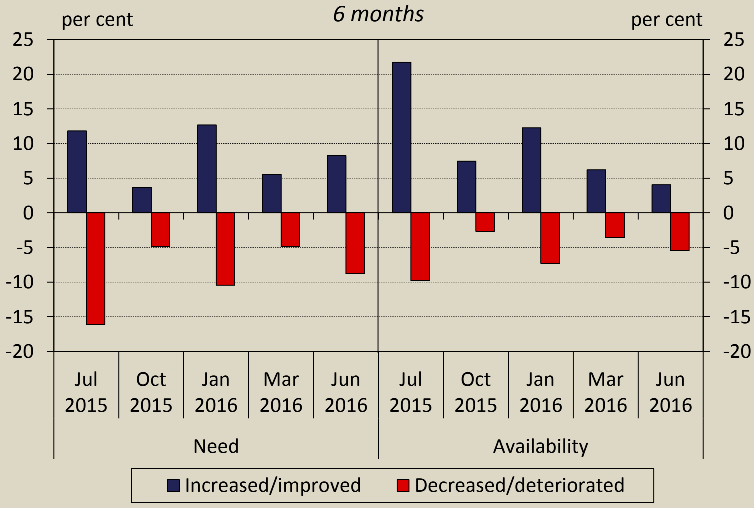
Source: MNB survey

The expectations of the SME sector concerning investments did not change over the last year. Enterprise size played a significant role regarding the expectations of companies: with an increase in company size, the intention of implementing the investments scheduled for the next half the year strengthens: while 10 per cent of micro enterprises are convinced that they are able to implement their planned developments, 20 per cent of small enterprises and 30 per cent of medium enterprises are certain of this. Overall, one-third of SMEs consider it likely that they will be able to implement some type of development or investment during the next one year. Over the last year, enterprises have reported an upsurge in demand for developments to expand activity and an improvement in funding conditions. Since the beginning of the year, however, the mounting shortage of skilled labour has been identified as a barrier to business growth.

The penetration of financing resources used by SMEs clearly demonstrates the resources which are the most relevant for them to access. The highest ratios are found for overdrafts and credit lines provided by banks, as two thirds of SMEs use these sources of financing. Here again, we can observe a significant level of heterogeneity by company size: while 55 per cent of the respondent SMEs have a bank loan, almost 90 per cent of large corporations use this kind of financing service. Furthermore, the penetration of the borrowing of non-bank loans and the application of accounts payable and leasing stand at around 50 per cent. Raising capital, the issuance of securities and the sale of receivables cannot be said to be typical forms of financing.

SMEs' access to the major sources of financing typically improved in 2015, while in the first half of 2016 the enterprises participating in the survey[4] considered access to be generally unchanged. Regarding bank loans, in the past year SMEs reported an improvement in access conditions, while in the period under review the same ratio reported an increase in their needs as the ratio as reported a decrease in the same. Based on the data, on the whole in recent years the financing position of the SME sector has improved, which is also supported by the Financial Conditions Index from a macroeconomic perspective. In the second half of the year, the Market Based Lending Scheme may contribute to a further relaxation of financing constraints.

SMEs' needs and access for bank loan in the previous 6 months



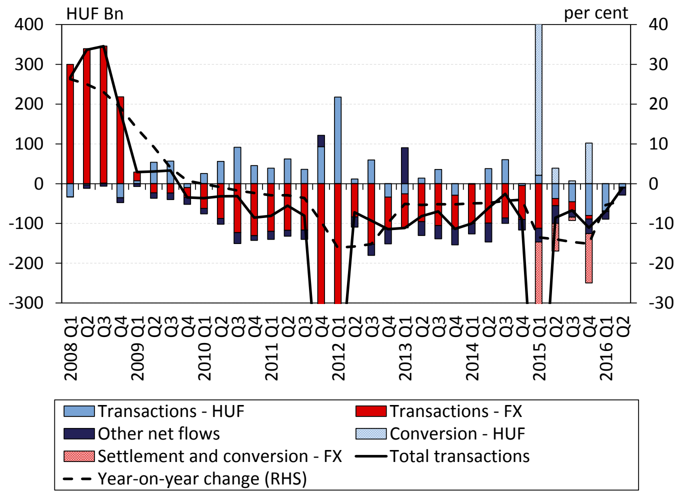
Source: MNB survey

[4] The net ratio is the difference between enterprises that register an improvement in access and those that register a deterioration.

3. DEVELOPMENTS IN LENDING TO HOUSEHOLDS

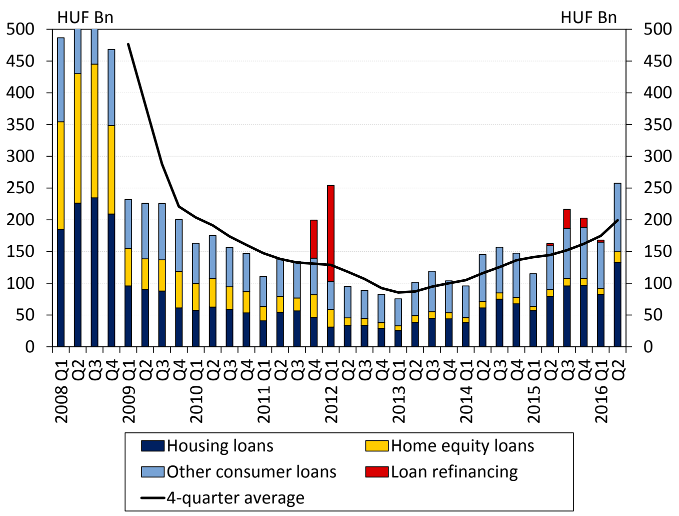
In 2016 Q2, the portfolio of household loans of the credit institution sector decreased by a total of HUF 11 billion as a result of the disbursements and repayments; consequently, the overall loan portfolio decreased by 4.2 per cent by the end of June in year-on-year terms. At the same time, disbursements already exceeded repayments in June. The volume of new loan contracts amounted to HUF 258 billion in total in the period under review, representing an annual average increase of 38 per cent compared to the same period of the previous year. The largest rise was recorded in the case of housing loans and personal loans, where disbursements have increased by 46 and 47 per cent respectively in the last year. Based on banks' responses to the Lending Survey, the conditions of housing loans and consumer credit were also eased in Q2, and in the case of the latter an easing of lending conditions was also predicted for the next half year. In parallel with that, a continued rise in credit demand was observed according to the banks participating in the survey, especially in housing loans, where all institutions indicated growth. The average APR on new housing loans remained unchanged, while the average interest rate spread increased during the period under review, owing to the financing of riskier customers.

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



Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment. The annual change in the outstanding amount reflects the effect of the settlement. Source: MNB.

Chart 14: New household loans in the credit institution sector



Note: Loan refinancing denotes only refinancing related to the early repayment scheme and the FX-conversion. Source: MNB.

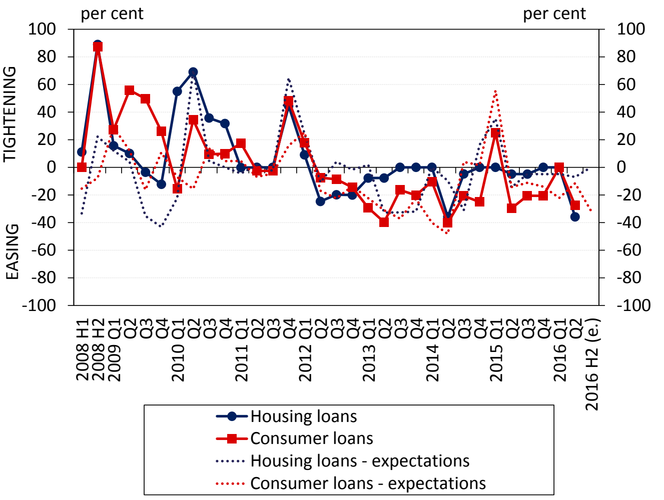
Domestic household lending

Borrowings exceeded repayments by the end of the second quarter in the household sector. In 2016 Q2, credit institutions' household loan outstanding decreased by HUF 11 billion as a result of transactions; however, at the end of the period the value of monthly credit disbursements actually exceeded that of repayments (Chart 13). In the period under review, write-offs and reclassifications resulted in a further decline of HUF 18 billion. In the case of HUF loans and FX loans, repayments exceeded disbursements by HUF 9 billion and HUF 2 billion, respectively. The decrease in outstanding housing loans and other loans amounted to HUF 3 billion and HUF 26 billion, respectively.[5] The transaction-based annual rate of decline in the portfolio stood at 4.2 per cent, while the value of the decline in loans outstanding would amount to 3.9 per cent with the adjustment of the settlement and the FX-conversion of vehicle loans and personal loans at the end of 2015.

The volume of new contracts continues to expand dynamically. The volume of credit institutions' new household loan contracts amounted to HUF 258 billion in Q2 (Chart 14). The value of new loan disbursements exceeded the same period of the previous year by 62 per cent, and the four-quarter rolling volume increased by 38 per cent year-on-year. The annual growth rate was 46 per cent in the case of housing loans, while home equity loans increased by 31 per cent, other consumer loans by 30 per cent; within that the disbursement of personal loans increased by 47 per cent.

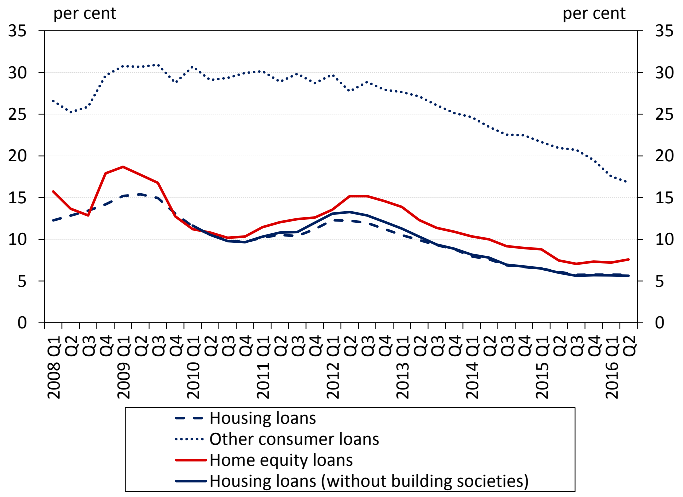
[5] The net portfolio change is the balance of the transactions and other flows (write-offs, reclassifications).

Chart 15: Changes in credit conditions in the household segment



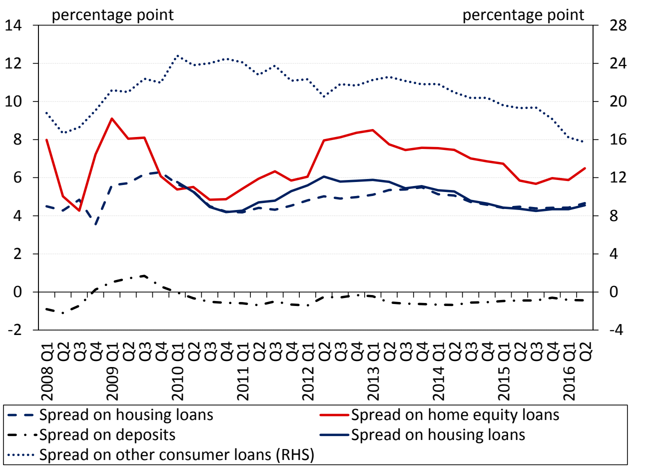
Note: Net ratio is the difference between tightening and easing banks, weighted by market share. Source: MNB, based on the answers of respondent banks.

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



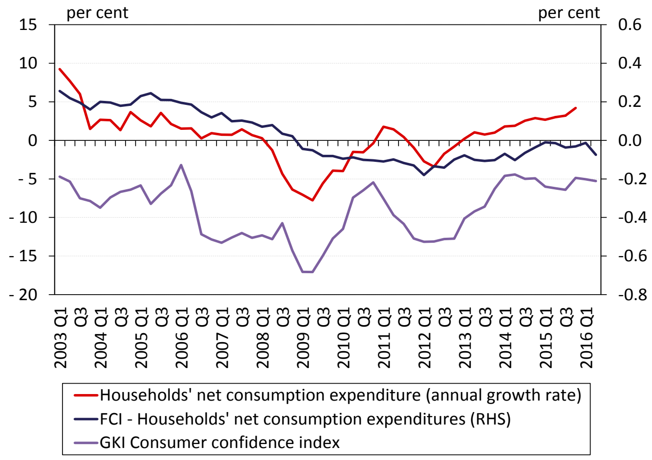
Note: Quarterly average of interest rate spreads on the 3-month BUBOR. Spreads based on the APR. Source: MNB.

Lending conditions were eased in the housing and consumer credit segments as well. Based on the answers to the Lending Survey, in net terms, 36 per cent of the banks eased the conditions of housing loans in 2016 Q2, after a period of no change of almost two years (Chart 15). In terms of standards, the easing mainly affected price conditions: in net terms, over half of the banks reduced spreads, and 12 per cent reduced the fees for loan disbursements. A further and proportionally less significant easing was observed in the premium on risky loans, in the maximum loan-to-value ratio, in the payment-to-income ratio and in the minimum required level of creditworthiness. The latter may indicate that the banks also opened up to riskier customer segments during the quarter. The respondent banks primarily explained the easing of conditions by housing market prospects, along with developments in market share objectives. However, looking forward they did not indicate any further easing of credit standards in the second half of the year. Concerning consumer loans, in net terms, 28 per cent of the banks eased their lending conditions, and they predicted further easing of a similar extent until the end of 2016. According to the banks, the easing observed in Q2 appeared exclusively in the spreads and the maximum payment-to-income ratio, which were justified by the improvement in the economic outlook, market competition and share objectives.

The APR on housing loans remained unchanged, while average spreads increased during the period under review. In 2016 Q2, the average APR level for new housing HUF loans did not change, standing at 5.7 per cent at the end of June (Chart 16). The costs showed heterogeneity in terms of interest payment: the smoothed APR of variable-rate housing loan products was reduced by 0.2 percentage point and stood at 4.7 per cent at the end of June, while the average annual percentage rate of charge on fixed-rate loans increased by 0.1 per cent, amounting to 6.4 per cent at the end of H1. In respect of spreads, an increase was observed in the period: the spreads above the 3-month BUBOR rose by 0.2 percentage point, to 4.7 percentage points (Chart 17). This seems to contradict the significant reduction of spreads indicated in the Lending Survey, but it underpins the easing of the minimum creditworthiness level and the increase in risk appetite, which may result in a composition effect: those customers who would have been considered creditworthy according to the earlier standards may face lower spreads, while new, riskier customers had higher interest rate spread. In addition, banks that disburse loans at higher financing costs on average showed stronger activity in lending for housing purposes during the quarter.

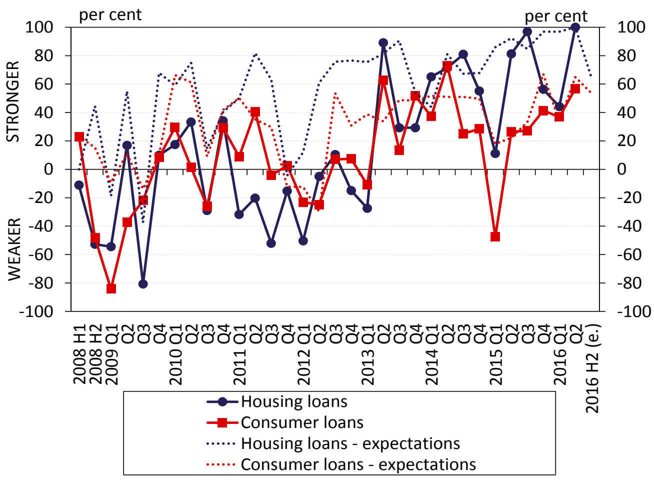
Financing costs of unsecured consumer loans continued to decrease in the second quarter. Interest rates on mortgage-backed consumer loans increased by 0.4 percentage point in Q2,

Chart 18: Sub-index of the FCI for household consumption expenditures



Note: The index quantifies the contribution of the banking sector's lending activity to the annual growth rate of household consumption expenditures. For technical reasons, the chart indicates the GKI index divided by 100. Source: MNB, GKI.

Chart 19: Credit demand in the household lending segment



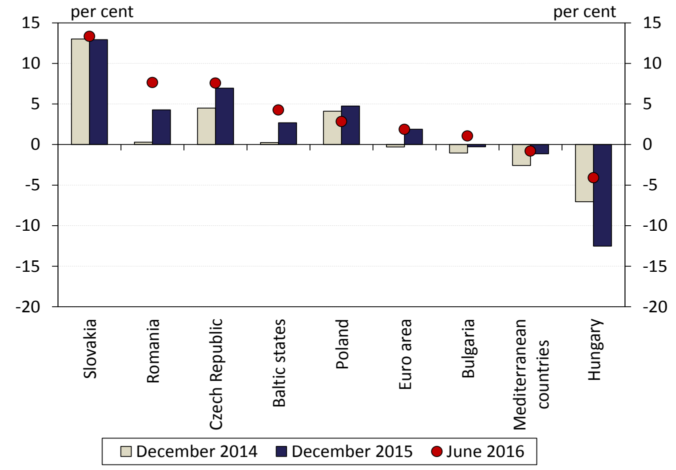
Note: Net ratio is the difference between banks reporting stronger and weaker demand, weighted by market share. Source: MNB, based on the answers of respondent banks.

while rates on other consumer loans fell by 0.7 percentage point. Consequently, by the end of June the average interest rate level of mortgage-backed consumer loans was 7.6 per cent and that of other loans was 16.8 per cent (Chart 16). In the case of home equity loans, the interest rate spread increased by 0.6 percentage point, to 6.5 percentage points (Chart 17). Deposits continue to ensure somewhat cheaper financing for banks as compared to interbank loans.

On the whole, the financial intermediary system continues to have a neutral effect on household consumption. Household consumption increased in year-on-year terms in 2016 Q2, but consumer confidence remained unchanged and still stands at its end-2015 level. According to the MNB's survey, the perception of the economic activity of the household sector has mainly improved in terms of expectations of price changes, while households take a conservative approach regarding high-amount expenditures: 6–8 per cent of households plan to purchase/build a flat or a house. According to the consumption expenditure sub-index of the Financial Conditions Index, the impact of the financial intermediary system on the consumption of households is neutral (Chart 18).

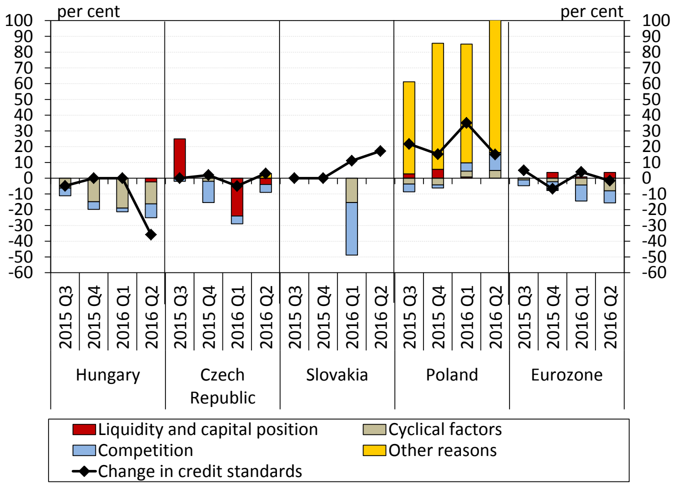
All banks reported an increase in demand for housing loans. In accordance with the preliminary expectations, all banks participating in the Lending Survey experienced an increase in the demand for housing loans during Q2, and 57 per cent indicated an increase in demand for consumer loans (Chart 19). Looking forward, about two thirds of the respondent banks anticipate a further pick-up in demand for housing loans in the second half of the year. In the case of consumer loans, in the net terms, half of the banks anticipate expansion. According to the MNB's survey, about 9 per cent of households plan to take out a loan in the course of the next one year. On average, one third of them plan to borrow a housing loan and two thirds plan to take out a consumer loan. Available since February 2016, the Home Purchase Subsidy scheme for families (HPS) also supports demands for housing loans: in Q2 about 12 per cent of newly disbursed housing loans were associated with applications for HPS.

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.

Chart 21: Changes and factors contributing to changes in housing loan 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.

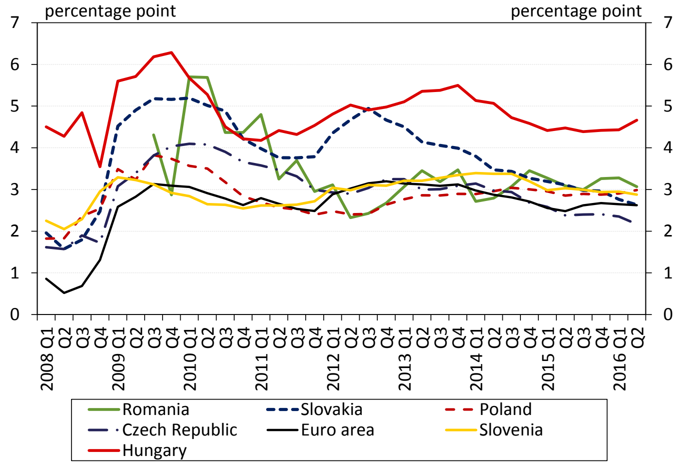
International outlook in household lending

Household lending increased in both the CEE region and the euro area. The average annual growth rate recorded for the euro area slightly deteriorated in 2016 Q2, and at the end of June it still stood only at 1.9 per cent (Chart 20). Significant heterogeneity remains within the currency area: while households' debts increased in the majority of the member states in year-on-year terms, loans outstanding continued to decline in Latvia, Ireland and in most Mediterranean countries. As a result of transactions, outstanding household loans expanded dynamically in the region: the annual increase in lending to households was 13 per cent in Slovakia, 8 per cent in Romania and the Czech Republic, and 3 per cent in Poland. In European terms, the indebtedness of households is the highest in Slovakia; in addition, this is where it has been expanding the most dynamically, which can be explained by the optimism about the debt servicing capacity driven by the low interest environment. However, outstanding borrowing is concentrated in certain age and income segments, and therefore poses a significant stability risk according to the assessment of the central bank of Slovakia.[6]

Terms and conditions on housing loans were tightened in the region and slightly eased in the euro area. The standards of housing loans were tightened slightly in the Czech Republic and significantly in Slovakia and Poland (Chart 21). In Slovakia, this can be explained by the implementation of the recommendations of the central bank on prudent lending. In Poland a wide scope of banks identified, among other factors, the implementation of the constraints on the sale of agricultural properties in April 2016. In the Czech Republic, the tightening was also implemented for regulatory reasons: according to the recommendation of the central bank, from 2015 disbursement of loans with LTV exceeding 100 percent should be avoided, and the ratio of loans with LTV between 90-100 per cent must not exceed 10 per cent. In contrast with the CEE region, in the countries of the euro area lending standards were eased slightly on the whole: the competitive situation and risk assessment supported easing, and these together had a more significant impact than the tightening effect of the liquidity and capital position, and the Mortgage Loan Directive of the European Union. According to the survey of the European Central Bank, demand continued to rise steadily during the quarter: as a result of the low interest rate environment, the increasing consumer confidence and favourable housing market developments, one third of banks in net terms experienced a modest or significant increase. This is

[6] Národná Banka Slovenska (2016): Financial Stability Report, May 2016.http://www.nbs.sk/_img/Documents/ZAKLNBS/PUBLIK/SFS/FSR_052016.pdf

Chart 22: 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.

also what the banks expect when looking forward.

The average spread on newly disbursed housing loans typically decreased in the region. With the exception of Poland, the costs of housing loans declined in the countries of the CEE region: average interest rates on housing loans denominated in domestic currency declined by 0.3 percentage point in Romania, 0.2 percentage point in the Czech Republic and Slovakia and 0.1 percentage point in Slovenia during the quarter. The interest rate spreads changed in the same direction as the level of interest rates (Chart 22). The average level of interest rates was down 0.1 percentage point in the euro area, but the spreads remained unchanged. Overall, the level of domestic interest rate spreads continues to be high, exceeding the averages of the euro area and the region by 2 and 1.9 percentage points, respectively.

Box: New rules on prudent lending in the region and the euro area

Based on the implications of the global economic crisis, in 2014 a Community legislation directive was created concerning consumer loan contracts related to residential properties (EU Mortgage Credit Directive). The directive contains several requirements aimed at consumer protection, including those on the contents and transparency of information provided directly and by way of advertising, the prohibition of tie-in products, the obligatory reflection period, standardised methods of the calculation of APR, the assessment of creditworthiness and the activity of credit intermediation. As defined at the European level, the approach of prudent lending has changed: during the assessment of creditworthiness the main concern is "to verify the prospect of the consumer to meet his obligations under the credit agreement", and with certain exceptions it "shall not rely predominantly on the value of the residential immovable property exceeding the amount of the credit or the assumption."

The deadline for the implementation of the directive into national legislation was 21 March 2016, but so far, in addition to Hungary, only Austria, Denmark, Estonia, France, Germany, Ireland, Italy, Slovakia and the United Kingdom have managed to implement the directive. Through the loan coverage and payment-to-income ratio indicators, these provisions result in the tightening of loan assessment standards in those countries where the conditions had previously been more relaxed.

The tightening policy of credit standards has reached the region as well. In October 2014, the central bank of Slovakia issued a recommendation, in addition to the EU Directive, concerning the regulation aimed at the management of household lending processes. The recommendation was issued because the lending growth rate significantly exceeds the European average, especially in housing loans, while the outstanding loan stock is also outstandingly high in international comparison. Given these circumstances, the indebtedness of households may become one of the stability risks in the Slovakian economy, which is intended to be prevented by the shift to prudent lending.

In Slovakia, the EU Directive is implemented by the Housing Loan Act (2016/90), and the Slovakian central bank will rephrase the contents of the recommendation, recalibrated by the data collected since then, in a bank directive. In the law, the early repayment penalty is also capped at 1 per cent of the amount. This could stimulate competition and increase the number of refinanced loans in the housing loan market, but may also lead to the build-up of risks, if banks renew loans with short rate-fixation periods. Although the recommendations of the central bank started including a guideline on the debt coverage indicator as well on new loan disbursement (the indicator must not reach 100 per cent and the ratio of loans with an LTV indicator above 90 per cent is being capped gradually), the share of loans with an LTV indicator of around 90 per cent still increased. The directive now in preparation will cover the following areas:

- the customer is allowed to take a housing loan if he/she will still have an income left after the deduction of the subsistence level and the existing repayment (also considering the interest rate risk);
- a cap is imposed on the ratio of loans with an LTV indicator reaching 90 per cent;
- the prudent internal system of the creditor for the assessment of the collateral.

The central bank of the Czech Republic issued a recommendation in June 2015 starting from the recommendation of the European Systemic Risk Board (ESRB) for macro-prudential purposes, in an express effort to avoid excessive indebtedness and capital gearing. According to the article of the recommendation on the loan coverage ratio, in the scope of newly disbursed loans the ratio of loans with a loan coverage ratio of 90 to 100 per cent must not exceed 10 per cent (by institution, by quarter), and the disbursement of loans with an LTV ratio of above 100 per cent is not recommended. Concerning the identification of debt servicing capacity, Czech central banks recommends the implementation of loan-to-income (LTI) or disbursement service to income (DSTI) limits in the credit scoring systems.

The central bank of the Czech Republic assessed compliance with the recommendation in its stability report in the second half of 2015. The results show that not every institution has met the recommendation: the ratio of loans with an LTV indicators exceeding 100 per cent amounted to 4 per cent; and although those between 90 and 100 per cent met the 10 per cent limit at the sectoral level, at individual bank level they did not. The ratio of loans with a loan-to-income ratio (LTI > 5) continued to rise after the publication of the recommendation; in addition, every tenth newly disbursed loan has an excessive debt coverage ratio (DSTI > 40%). The central bank recommends that financial institutions should reduce the maximum LTV. Naturally, the continuous implementation of the rules by the banks means tightening lending conditions in the Czech Republic as well.

The debt cap rules were implemented in Hungary in January 2015, the purpose of which was to prevent the excessive indebtedness of households in the future. Having been implemented in March this year, the directive did not result in a tightening of lending conditions in Hungary. The currently applicable limits apply to both loan coverage and payment-to-income ratio, and this latter includes the need to automatically consider the probability of repayment in the future when the credit application is assessed.

4. 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/statistics

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 of 11 banks were involved in the interviews. 9 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 2016 Q2, the surveyed institutions accounted for 84 per cent of the banking sector in the case of outstanding housing loans and 86 per cent in the case of outstanding consumer loans. The corporate questionnaire was completed by 8 banks in total, which represent 79 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 90 per cent.

The survey consists of a standard questionnaire in each segment. The retrospective questions refer to 2016 Q2 (compared to 2016 Q1), whereas the forward-looking questions concern the next half-year period, i.e. the one covering 2016 Q3 and Q4 (relative to 2016 Q2). The current questionnaire was completed by the senior loan officers between 1 and 18 July 2016.

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 the 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)*[7]

Numerous indicators and hence a substantial set of information are available regarding the functioning, status, environment and performance of the system of financial intermediation. In order to condense the information relevant to the financial system and to describe the underlying processes, many central banks (including the Magyar Nemzeti Bank) apply factor models, which allow them to present key information extracted from hundreds of time series in a few variables, i.e. factors. Based on the results of the factor model, the FCI discussed in the publication shows the contribution of the banking sector to the annual real GDP growth rate.

The database used for the factor analysis is composed of individual bank data; namely, certain individual data of the largest 9 banks and some aggregate indicators of the rest of the banking sector. From the panel database consisting of 10 banks, the following indicators were included for the purposes of the factor analysis:

- Liquidity:
  - liquid assets as a percentage of the balance sheet total
  - stable funding as a percentage of the balance sheet total
  - FX swaps outstanding as a percentage of the balance sheet total

[7] Hosszú, Zs. (2016): *The impact of credit supply shocks and a new FCI based on a FAVAR approach,* MNB Working Papers 2016/1, Magyar Nemzeti Bank.

- Capital:
    - own leverage
    - parent bank leverage
    - capital buffer as a percentage of the balance sheet total
- Risk:
    - changes in the proportion of non-performing portfolios
    - cost of provisioning as a percentage of the total portfolio
    - risk-weighted assets as a percentage of the balance sheet total
    - interest and commission revenue as a percentage of the balance sheet total

The question to decide during factor analysis is the exact number of estimated variables that can capture the essential information contained by the data. The MNB decided this question based on the factors' impact on macroeconomic variables: inserted in a VAR (vector autoregressive) model, the first two financial factors proved to be significant. At the same time, these two factors explain around 50 per cent of the variance of bank data.

The factors and the VAR model were estimated in accordance with the methodology presented in Koop and Korobilis (2014).[8] Based on the relationship between the factors and the original variables, the two factors were respectively interpreted as an indicator gauging banks' lending capacity, and as an indicator capturing banks' willingness to lend; at the same time, only the factors' change over time has significance; their level does not; in other words, a single data point does not carry information in itself. With that in mind, the final FCI was quantified based on the effect of these two factors on macroeconomic variables. According to the FAVAR estimate, as opposed to the factor measuring lending capacity, after the crisis the factor expressing willingness to lend significantly influenced changes in outstanding borrowing. Thus, the FCI was identified as the impact of banks' willingness to lend on GDP. The indicator is interpreted very similarly to the previous FCI: it shows the contribution of the banking sector to the annual real GDP growth rate through the sector's lending activity. In other words, if the FCI takes a value of 1, one percentage point of the annual growth rate of GDP can be attributed to the lending activity of the banking sector.

In addition to the total impact of the FCI on GDP, sub-indices can also be calculated on the basis of the VAR model. The FCI's corporate lending sub-index indicates the contribution of the banking sector's lending activity to the annual growth rate of corporate fixed capital investment. The FCI's household consumption expenditure sub-index quantifies the contribution of the banking sector's lending activity to the annual growth rate of household consumption.

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[8] Koop, G. and Korobilis, D. (2014): A new index of financial conditions, *European Economic Review*, vol. 71, pp. 101–116.

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