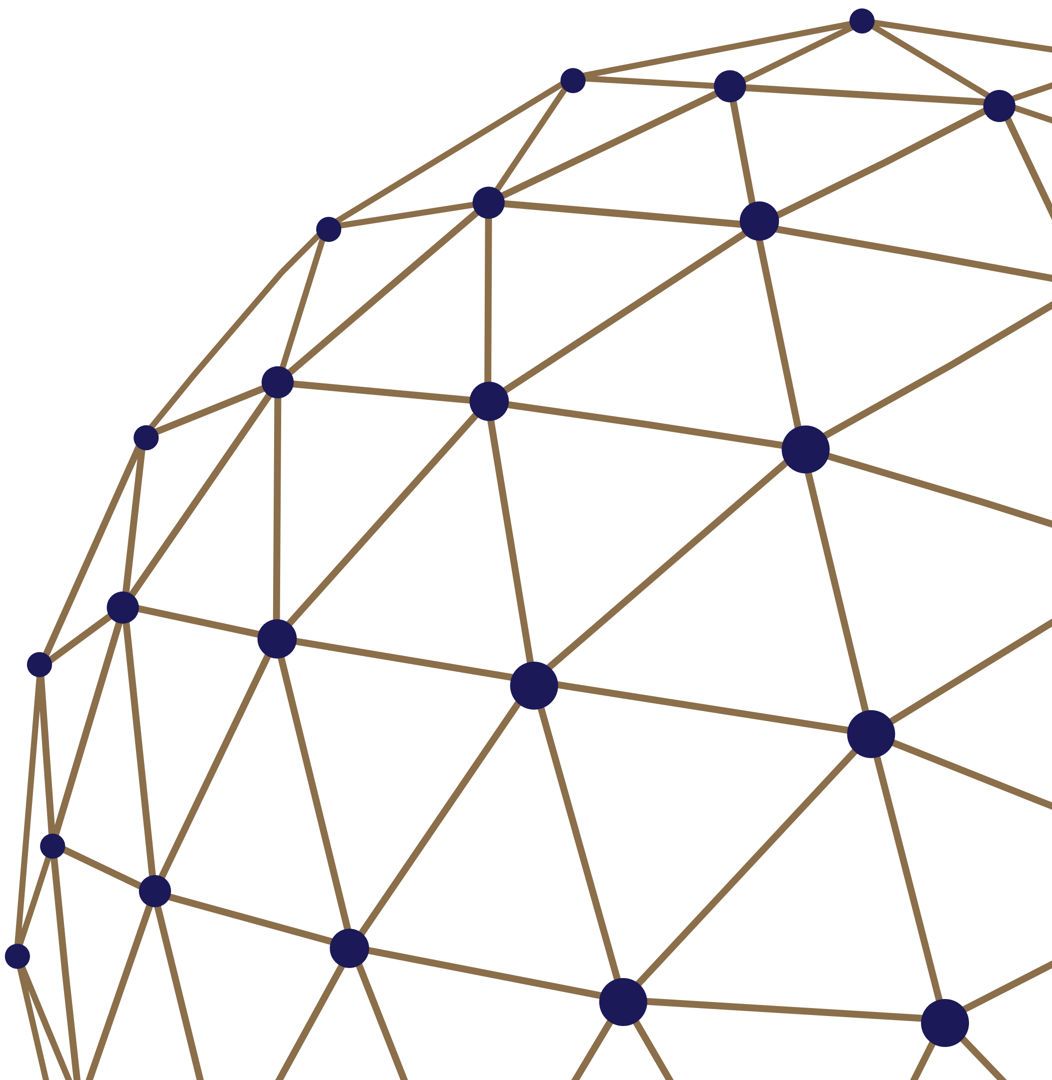
Trends in lending

August 2013



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

- *The credit aggregates present quantitative developments in economic agents' loans outstanding on the basis of banking sector (banks and branches of foreign banks) balance sheet statistics. Both the volume of new loans and net changes in banking sector loans outstanding (net of exchange rate effects) are presented.*

- *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 presented in the Annex at the end of the analysis. Within the publication, the findings of the Lending Survey are presented in 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.

Contents

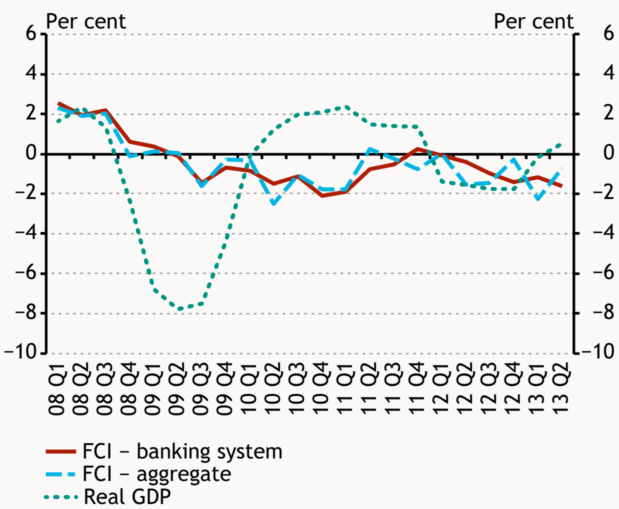
1 Executive summary

Credit supply constraints of the banking system are still tight, only alleviated by central bank and government measures for the time being. Policy rate cuts have reduced lending rates generally by 3 percentage points. Futhermore the Funding for Growth Scheme reduced financing costs for participating SMEs by nearly 4 percentage points. In the housing loans segment by using the state interest subsidy scheme lending rates could be reduced by around 2 percentage points.

In 2013 Q2, the amount of loans outstanding in the corporate segment continued to shrink, falling by some 6.4 per cent on a year-on-year basis. As opposed to the previous period, the decline primarily affected long-term loans. Compared to the previous quarter, credit conditions eased to some extent, but credit supply constraints remain tight. Banks' cautiousness continues to prevent wider easing. The downward trend observed in interest rates on forint loans continued, reflecting the cuts in the central bank base rate. Overall, it is still true that, due to tight non-price conditions, only a limited range of companies can benefit from the favourable interest rate conditions. The Bank's Funding for Growth Scheme is aimed at easing credit supply constraints, the effect of which may be expected in the third quarter.

Total loans outstanding continued to decline in the household segment as well with a 5.4 per cent drop on a year-on-year basis. At the same time, the volume of new lending moved from its earlier historical low, which was mainly due to the long-awaited upswing in state-subsidised lending. Easing in household credit conditions continued. The annual percentage rate of charge (APR) on actual transactions declined, and the APR on housing loans fell below 10 per cent, which only happened before in 2010 H2. At the same time, the interest rate spread remains high in international comparison as well. In spite of the easing, the conditions are still considered tight.

Financial Conditions Index (FCI) and annual real GDP growth



Note: The annual increase in the FCI shows the contribution of the financial intermediary system (banking sector) to the annual growth rate of real GDP. If the sign of the FCI is identical to that of the output gap, the banking sector behaves procyclically. While the banking sector sub-index only comprises the variables related to lending, the 'total' index contains the monetary conditions, i.e. the interbank rate and the exchange rate as well.
Source: MNB.

Based on the Financial Conditions Index, which gauges the developments of lending in corporate and household segments and also monetary conditions, the overall tightness of credit conditions continues to hinder the growth in outstanding loans and the closing of the output gap.

2 Developments in lending in the corporate segment

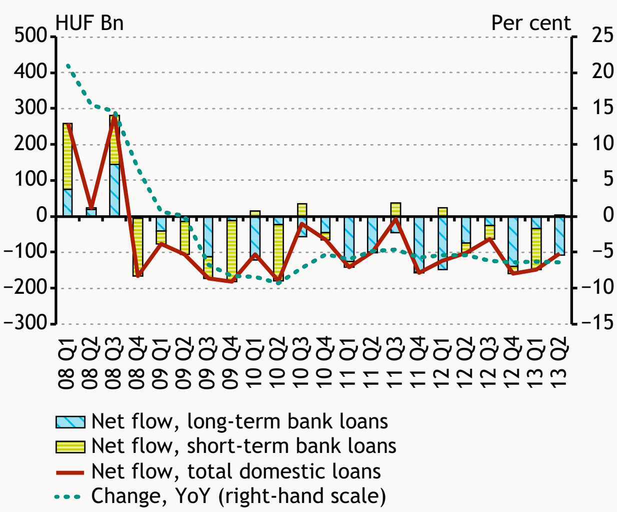
Total loans outstanding continued to fall in the corporate segment. In Q2, the decline amounted to HUF 105 billion, corresponding to an annual rate of 6.4 per cent. In contrast to Q1, the contraction in total loans outstanding was attributable to long-term loans. Foreign currency loans declined again, to a similar extent as forint loans. Based on responses to the Lending Survey, banks' credit conditions eased in net terms compared to the previous quarter, but the majority of respondents still reported unchanged conditions. Any major improvement in the trends in lending would require permanent and large-scale easing of conditions, which is prevented by banks' cautious behaviour. Interest rates on forint loans have been following the decline in the policy rate, while euro interest rates increased during the quarter under review. Interest rate spreads are still not considered high compared to the regional average. Overall, due to tight non-price conditions, only a limited range of companies can benefit from the favourable interest rate conditions. Based on the Financial Conditions Index, the banking sector continues to be contractionary in corporate lending, thus restraining economic recovery.

In the SME segment, the contractionary behaviour of the banking sector is eased by the Funding for Growth Scheme (FGS) by reducing financing costs by nearly 4 percentage points. In line with the expectations, the majority of disbursement is expected in August–September, thus the effect of the FGS will be seen in the third quarter. In the early August numbers the acceleration of disbursement is already observable. The data received to date are favourable from the aspect that the ratio of new investment loans is significant within the demand for these loans.

Corporate lending continued to decline in 2013 Q2, mainly affecting long-term loans outstanding.[1] In 2013 Q2, the banking sector's non-financial corporate loans outstanding declined by 6.4 per cent on a year-on-year basis, i.e. by a total HUF 105 billion in the quarter under review (Chart 1). The entire decline occurred in long-term loans outstanding, whilst short-term loans expanded, although to a small extent. In contrast with the observations in the previous quarter, foreign currency loans outstanding declined again to the same extent as forint loans.

Developments in the volume of gross lending are more favourable than in the same periods of 2011 or 2012. The change in loans outstanding is the balance of new loans and principal repayments as well as of receivables sold and written off. Developments in new corporate loans were more favourable, although the amount of maturing loans continues to be significant (the volume of receivables sold and written off remains low). As a result, the change in net loans outstanding became negative again. The new volume (gross lending) amounted to a total of HUF 691 billion in 2013 Q2, exceeding the value of the previous quarter. Total

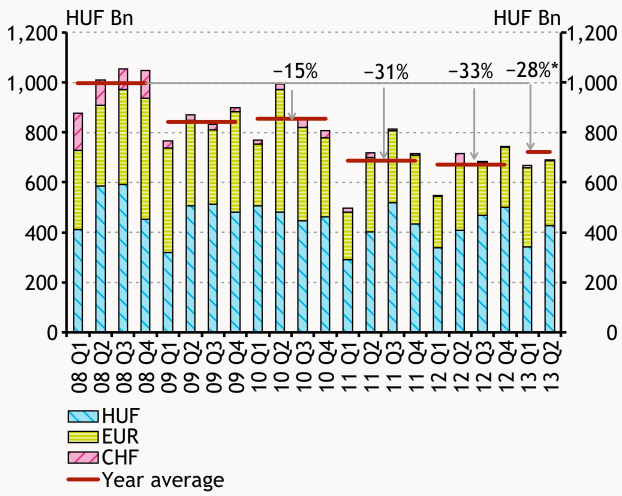
Chart 1
Net quarterly change in outstanding bank loans to corporations; breakdown by maturity



Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment. Merging financial enterprises into banks is excluded from the data.
Source: MNB.

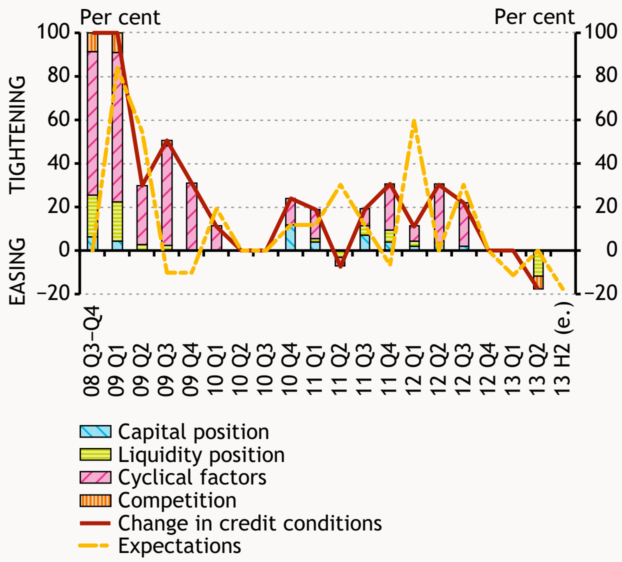
[1] Compared to the previous two years, non-bank financing (net cross-border lending in particular) increased by HUF 197 billion in Q1. However, only a limited number of companies can use these funds; accordingly, for a significant portion of economic agents they do not result in an easing of credit conditions.

Chart 2
Gross corporate lending



** Based on a pro-rata calculation of data within one year.*
Source: MNB.

Chart 3
Contribution of individual factors to changes in banks' credit conditions in the corporate segment



Note: The difference between tightening and easing banks, weighted by the market share. Contribution of given factors to the tightening/easing that took place, normalised to the net percentage balance of respondents reporting tightening/easing.
Source: MNB, based on banks' responses.

lending in 2013 H1 exceeded the volumes of the same periods of both 2011 and 2012, mainly as a result of more favourable developments in Q1 (Chart 2). Although the developments in foreign currency lending were more favourable early in the year compared to previous years, in Q2 the volume of forint loans exceeded the values of the same periods of previous years.

According to the Lending Survey, an overall easing took place in corporate credit conditions. Based on banks' expectations in the previous Survey, conditions were expected to remain unchanged, but according to the responses to the questionnaire, in 2013 Q2 a net 18 per cent of banks reported that they had eased their corporate credit conditions (Chart 3). The last time conditions eased was in 2011 Q2. It should be added, however, that the vast majority of banks reported unchanged conditions, and thus the aggregate value cannot yet be considered as a turnaround in lending.

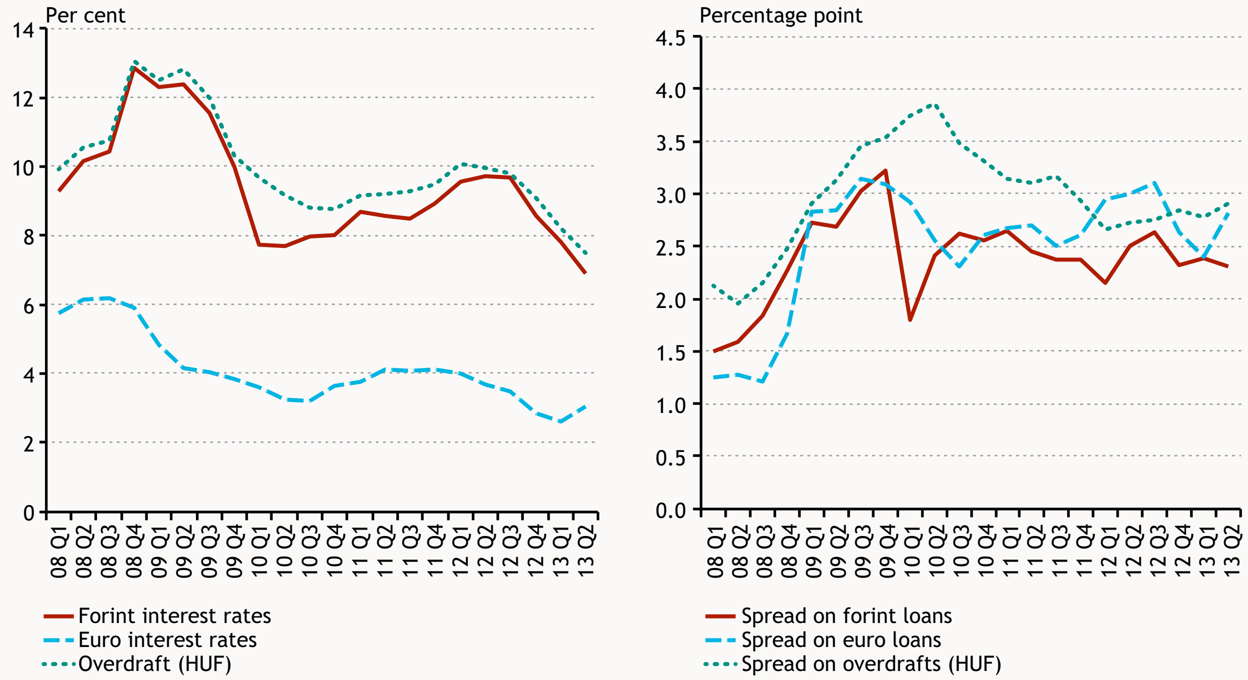
More widespread easing is prevented by banks' cautiousness. Economic outlook and industry-specific problems continued to entail a tightening of conditions, although the liquidity situation already points to an easing of conditions in the case of more than half of the banking sector in net terms. Market share objectives also had a similar impact in the case of 27 per cent of banks in net terms. Looking ahead, a net 18 per cent of the banking sector indicated an easing of conditions for the coming half year.

Forint lending rates continued to fall. Based on actual transactions, the average quarterly interest rate on forint loans declined from 7.8 per cent in Q1 to 6.9 per cent (Chart 4). This decline was practically identical to the change in the reference rate (three-month BUBOR) in the same period. The average interest rate spread was 2.3 percentage points. Overall, to date corporate lending rates followed the easing cycle launched in the summer of 2012.

Both the interest rate and the spread increased in the case of euro-denominated loans. Lending rates on euro-denominated loans increased in Q2, from an average of 2.6 per cent to 3 per cent. The euro reference rate (three-month EURIBOR) remained practically unchanged in the period under review, and thus the relevant spread increased from 2.4 percentage points in the previous period to 2.8 percentage points in Q2.

The banking sector continues to be contractionary in the corporate segment. Both the Lending Survey and the interest rate statistics of transactions carried out are needed for the assessment of corporate credit market. The Lending Survey shows developments in credit supply

Chart 4
Interest rates and interest rate spreads of new corporate loans

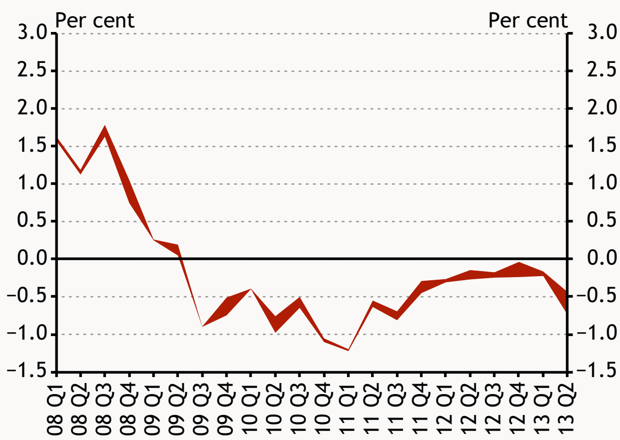


Note: Spread on the 3-month BUBOR and EURIBOR.
Source: MNB.

constraints, which determine whether a company is creditworthy, whereas the interest rate statistics contain the lending rates for companies seen as creditworthy. Due to the tight non-price credit conditions, at present only a narrower range of enterprises can benefit from the lower interest rates. Compared to the previous quarter, in 2013 Q2 the corporate sub index of the Financial Conditions Index worsened somewhat, amounting to −0.6 per cent, i.e. real GDP deteriorated this much due to the corporate credit supply constraints in the period between 2012 and 2013 Q2 (Chart 5).

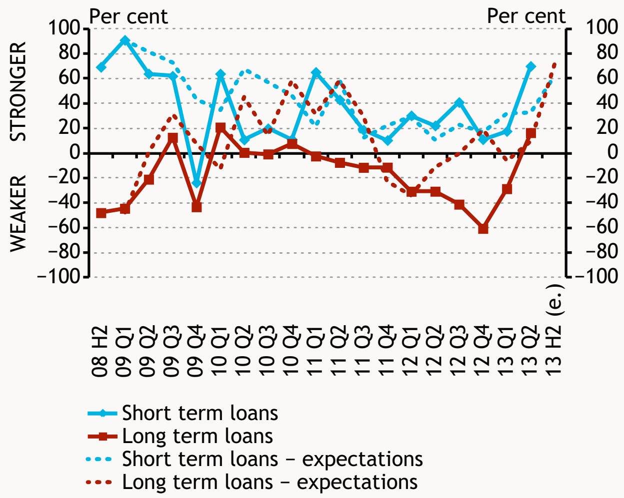
There was also a pick-up in demand for long-term loans. According to the Lending Survey, the trend observed for several quarters in credit demand perceived by banks broke: in 2013 Q2, demand increased not only for short-term loans, but also for long-term loans. This latter development is also worthy of note, because in the past two years banks had reported increasingly strong declines in demand for long-term loans. Based on the expectations of the majority of banks, demand will increase in both credit segments in the coming half year (Chart 6). Expectations regarding an increase in demand may also be attributable to the MNB's SME lending stimulus, although banks expect increasing demand from large enterprises as well.

Chart 5
Sub-index of the FCI for corporate lending



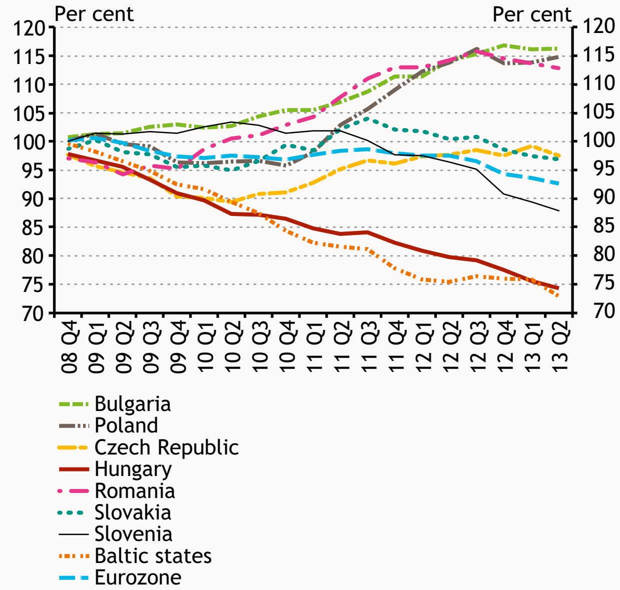
Note: The index quantifies the impact of financial conditions on annual GDP growth through corporate lending. The band illustrates the methodological uncertainty.
Source: MNB.

Chart 6
Changes in loan demand according to maturity



Source: MNB, based on banks' responses.

Chart 7
Changes in corporate loans outstanding in international comparison
(October 2008 = 100, exchange rate adjusted)



Sources: MNB, ECB, national central banks.

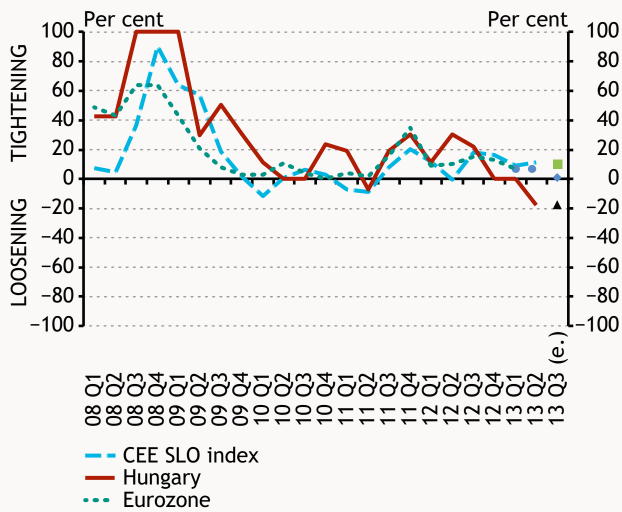
2.1 INTERNATIONAL OUTLOOK IN CORPORATE LENDING

Total loans outstanding declined in the region as well. An international comparison reflects a broadly uniform picture of developments in corporate loans outstanding. Compared to the previous quarter, corporate loans outstanding declined in most CEE countries and in the euro area as well (Chart 7). Within the region, only Poland saw a significant increase. This time, the fall in corporate loans in the euro area affected not only the periphery countries, but the majority of core countries as well. It should be added, however, that except for Hungary, the Baltic states and Slovenia, the amount of corporate loans outstanding is close to or exceeds the pre-crisis levels in the countries under review.

Corporate credit conditions tightened in the countries of the region. Lending surveys only allow for limited international comparison of credit conditions, as they only indicate the change in the direction of tightening/easing and not its extent. Accordingly, while the picture for this quarter is brighter in Hungary compared to the tightening in credit conditions in the region and the euro area, in view of the earlier significant tightening, credit supply constraints may still be greater in Hungary than in the region. Banks' responses suggest that the tightening in conditions may still be attributable to the risks in the economic outlook. Looking ahead, conditions are expected to continue to tighten in the Central and Eastern European countries and to remain unchanged in the euro area.

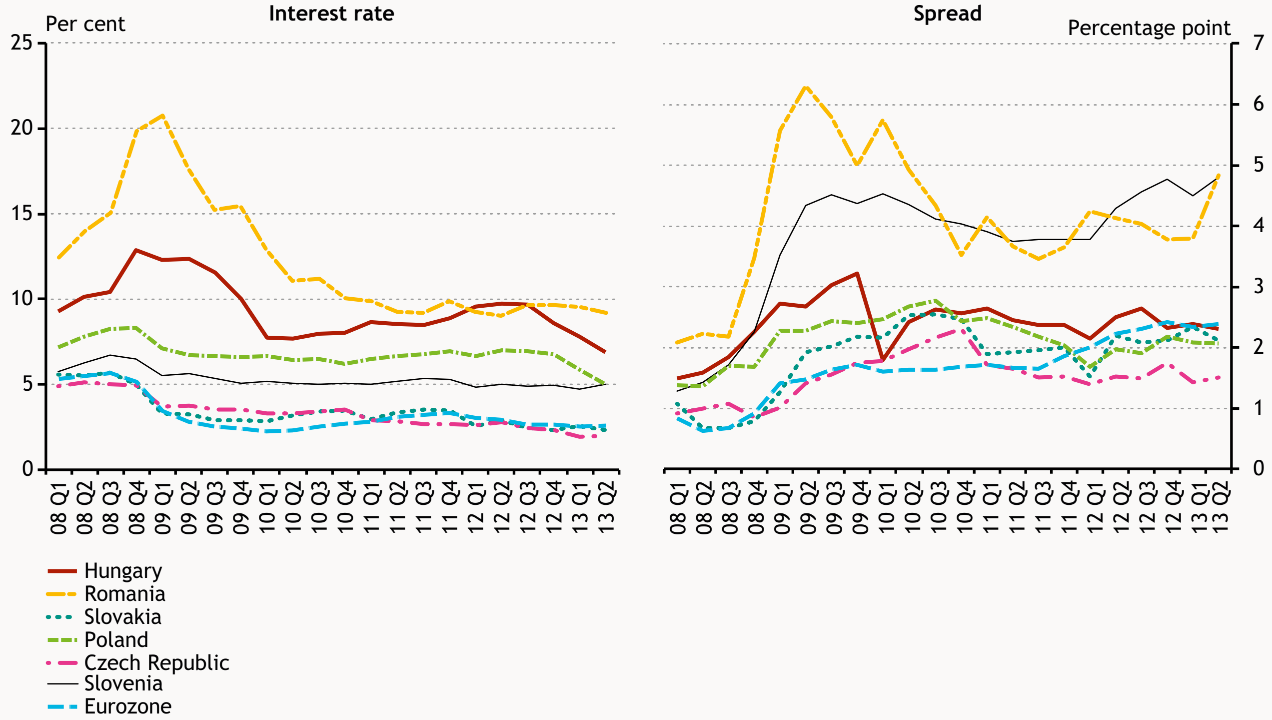
The interest rate level declined in most countries in the region. In respect of new corporate loans denominated in domestic currency, interest rates fell considerably in Hungary, Poland, Romania and Slovakia, while they

Chart 8
Domestic corporate credit conditions in international comparison



Note: CEE index: data for the Czech Republic, Poland, Slovakia, Slovenia and Romania weighted on the basis of outstanding loans to residents. The data indicate directions and not degrees.
Sources: ECB, selected central banks and MNB.

Chart 9
International comparison of interest rate conditions of corporate loans extended in domestic currency



Sources: ECB, selected central banks and MNB.

increased in Slovenia compared to the previous quarter. In Hungary, the interest rate is still considered high in a regional comparison, in spite of its steady decline for nearly a year. In terms of spreads, however, Hungary is not considered an outlier. The spread remained unchanged in the majority of the countries in the region, with the exception of Romania, where the fall in the reference rate exceeded the decline in the interest rate level. As a result, the spread increased by roughly 1 percentage point compared to the previous quarter (Chart 9).

Box 1
Experiences to date in relation to utilisation of the Funding for Growth Scheme (FGS)

Based on feedback from credit institutions and the representatives of business circles, compared to the original concept, in addition to raising the credit limit, the MNB made two other major amendments to the Scheme: first, the time limit for drawing the loans was extended by one month, and second, due to the much higher credit demand in Pillar I, the MNB allowed credit institutions to use their respective quotas not yet utilised in Pillar II for lending within the framework of Pillar I.

A total amount of HUF 124 billion was disbursed under Pillar I of the FGS until mid-august. In line with the expectations, the disbursement is stern-heavy, meaning that the majority of disbursement is expected in August–September. In the early August numbers the acceleration of disbursement is already observable, thus the allocated amounts may be disbursed at the end of September.

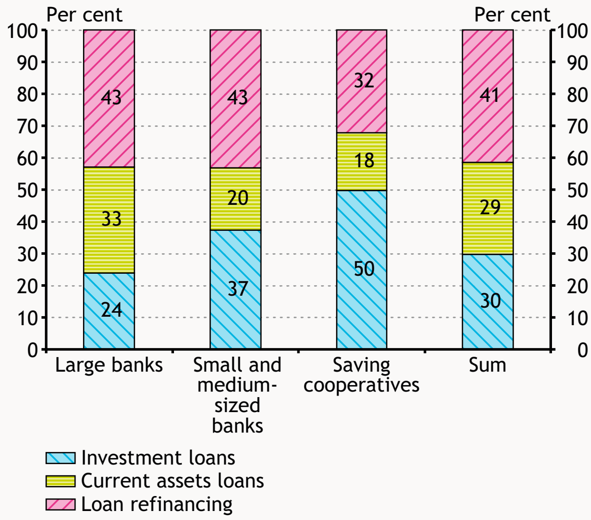
The share of new loans is around 60 per cent within total banking sector so far, and approximately half of it is new investment loans. Thus, the share of refinancing loans accounts for around 40 per cent. The relatively high share of new loans is attributable to the increase in customers' credit demand as a result of the favourable interest rates. The ratio of loan purposes varies according to the sizes of credit institutions. In Pillar I, large banks provide a smaller portion of investment loans, and nearly half of the loans are for refinancing. The proportion of loans for refinancing is similar in the case of small and medium-sized banks, but the ratio of investment loans is higher among new loans. By contrast, more than half of the loans of cooperative banks are investment loans and hardly more than one quarter of them are for refinancing.

Average maturity is 7.9 years in case of new investment loans, while 5.1 years in case new working capital loans. In the case of refinancing loans the maturities of the new ones are longer than that of the replaced loans: 7.3 years in case of refinancing investment loans, while 5.9 years in case of refinancing working capital loans.

In pillar II, aimed at refinancing foreign currency loans into forint denominated loans, around HUF 60 billion was disbursed so far, of which 80 per cent is denominated in euro, while the rest 20 per cent is denominated in Swiss franc. The average maturity here is 7.7 years in the case of investment loans, while 5.7 years in the case of working capital loans. Compared to the replaced loans, the average maturity shortened at the investment loans, while remained basically unchanged at working capital loans.

Contracted amounts in FGS – breakdown by product type

(first pillar)



Source: MNB.

3 Developments in lending in the household segment

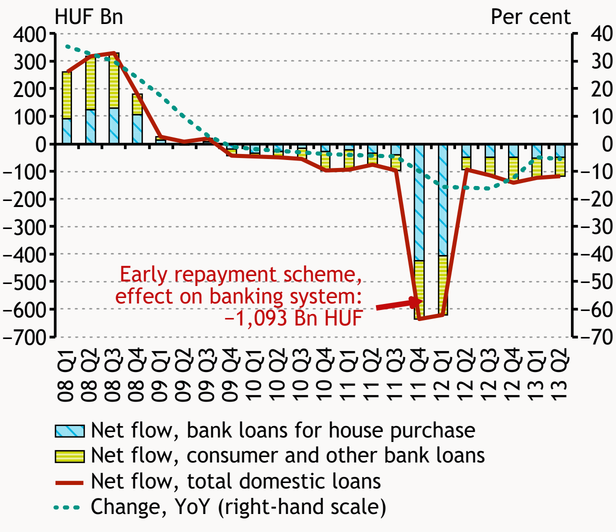
Loans outstanding continued to decline in the household segment, mainly as a result of the fall in foreign currency loans outstanding. During Q2, total loans outstanding declined by HUF 118 billion, i.e. by 5.4 per cent on a year-on-year basis. The rate of decline was reduced by the fact that the volume of new loans departed from its historical low seen early in the year. Loans disbursed within the framework or the interest rate subsidy scheme, which could reduce lending rates by around 2 percentage points, played a significant role in the increase in the volume of housing loans disbursed.

Household credit conditions continued to ease. The APR on actual transactions declined, and the APR on housing loans fell below 10 per cent, which only happened before in 2010 H2. The decline in APR is attributable to the fall in the reference rate, while the interest rate spread did not decline, and thus in a regional comparison it is still considered to be extremely high. By contrast, in the case of home equity loans the spread also declined considerably. In spite of the easing, based on the Financial Conditions Index, the banking sector continues to be contractionary in household lending.

Due to the decline in foreign currency loans outstanding, both housing loans and consumer credit continued to decline in the household segment. Household loans outstanding in the domestic banking sector fell by a total HUF 118 billion compared to the previous quarter (Chart 10), corresponding to a 5.4 per cent decline in the outstanding loans on a year-on-year basis. This decline took place both in housing loans and loans for other purposes. In terms of currency composition, most of the decline took place in foreign currency loans, due to principal repayments on the large stock accumulated prior to the crisis. At the same time, forint loans outstanding also declined, even if only slightly.

The volume of new loans increased compared to its historical low. In the period following the completion of the early repayment programme, the volume of new household loans declined in each successive quarter and reached its historical low in early 2013. In 2013 Q2, new loans extended by the domestic banking sector amounted to a total HUF 85 billion, up 35 per cent on the volume from Q1 (Chart 11). Within total loans, forint-denominated housing loans amounted to HUF 37 billion, with the volume of housing loans with interest rate subsidy accounting for 30 per cent of this, i.e. a total HUF 11 billion. In view of the lower initial instalments compared to loans with market interest rates, the interest rate subsidy scheme may result in a material increase in demand. Compared to the previous period, the amount of newly disbursed subsidised loans doubled in Q2.

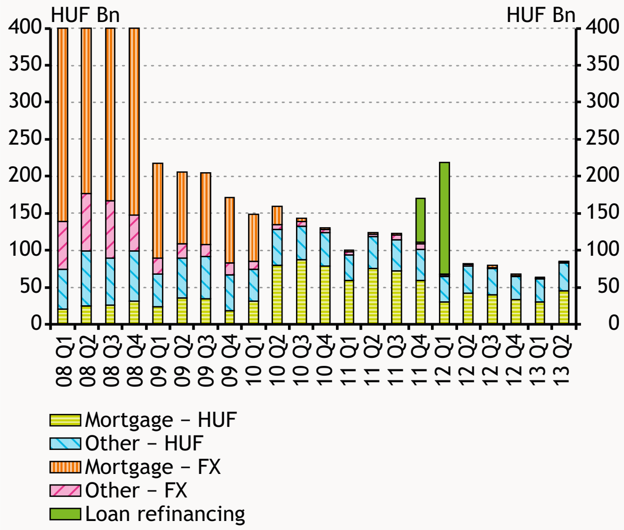
Chart 10
Net quarterly change in household loans outstanding



Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment. Merging financial enterprises into banks is excluded from the data.
Source: MNB.

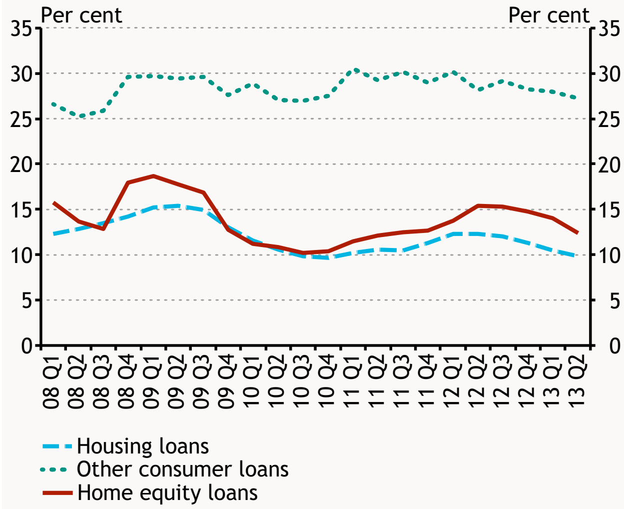
The Lending Survey showed that credit conditions continued to ease in the household segment. A net 8 per cent of banks reported that they had eased conditions on housing loans, and nearly 40 per cent reported that they had eased conditions on consumer credit (Chart 12). The latter was mainly typical of uncovered consumer loans, but affected home equity loans as well. The easing appeared in

Chart 11
New loans in the household segment



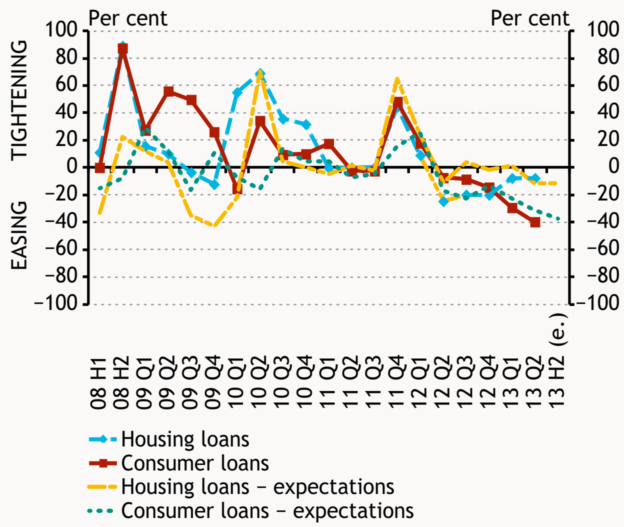
Source: MNB.

Chart 13
Lending rate of new household loans (APR)



Note: Quarterly average of interest rates (APR) on granted loans.
Source: MNB.

Chart 12
Changes in credit conditions



Note: The net proportion is the difference between tightening and easing banks, weighted by the market share.
Source: MNB, based on banks' responses.

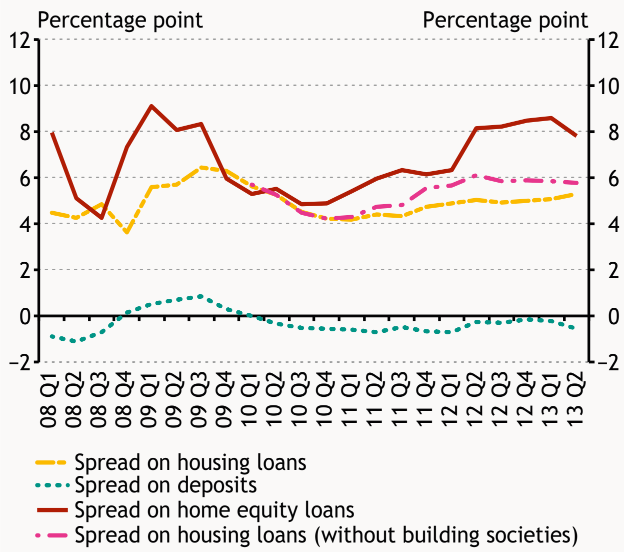
both price and non-price conditions in both segments: the spread between the cost of funds and the lending rate declined in the case of both types of loans, while in the case of housing loans and consumer credit the LTV and the minimum required credit score, respectively, also eased. Banks' responses suggest that conditions will continue to ease over the next half year as well.

The APR on housing mortgage loans fell below 10 per cent. The APR on housing loans declined from 10.5 per cent in Q1 to 9.9 per cent (Chart 13).[2] In recent years, APR below 10 per cent was typical only in 2010 H2. At the same time, two significant differences must be highlighted in comparison to this period: first, within new loans the market share of building societies with favourable interest rates and special schemes is much higher; the APR would be 10.4 per cent without them. Second, the spread on the reference rate is about one and a half percentage points higher than in 2010 (Chart 14). In the case of traditional bank schemes, the APR followed the fall in the policy rate, but due to the increase in spreads in the case of home savings and loan associations the total effect of the base rate cuts does not appear in the aggregate figures.

The APR on home equity loans also continued to decline. The average APR on home equity loans fell from 14 per cent in the previous quarter to 12.4 per cent in Q2. The reference rate declined to a lesser extent during the period under review, with the spread falling from 8.6 percentage points to 7.8 percentage points. The average APR on unsecured

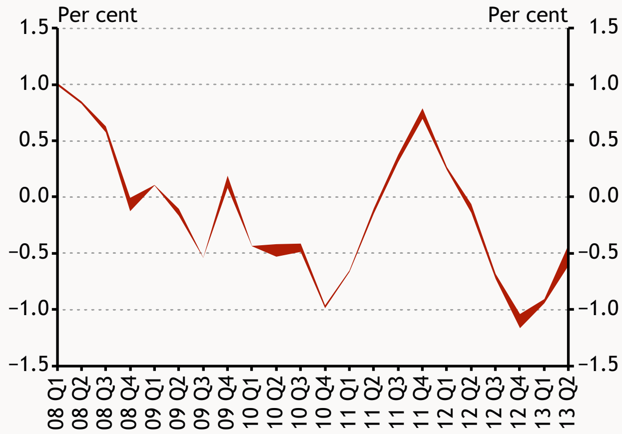
[2] The interest rate subsidy provided by the state does not appear in the interest rate levels reported by, as the reported interest rates are corrected by the subsidy. According to banks' announcements, the APR on subsidised-rate loans is between 7 and 8 per cent, which is some 1.5–2.5 percentage points lower than the APR on products with market interest rates.

Chart 14
Interest rate spread on new household loans
(based on APR)



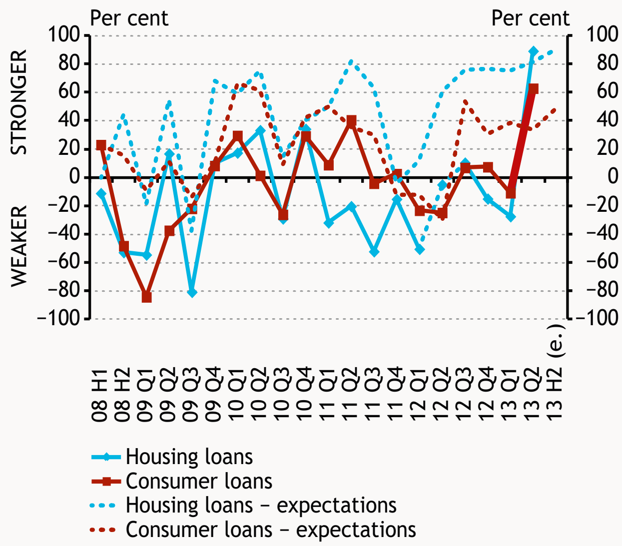
Note: Interest rate spread over the 3-month BUBOR.
Source: MNB.

Chart 15
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.
Source: MNB.

Chart 16
Credit demand in the household segment



Source: MNB, based on banks' responses.

consumer loans also declined in 2013 Q2, amounting to 27.3 per cent in that quarter (Chart 13).

Overall, the banking sector is contractionary in the household segment. In spite of the easing, the interest rate spread on new mortgage loans is above 5 per cent, whereas the loan-to-value ratio (LTV) is 53 per cent on average, while it was above 60 per cent prior to the early repayment programme, and the regulation allows as much as 80 per cent. With a slight improvement compared to the previous quarter, the household sub-index of the FCI amounted to -0.6 per cent, i.e. the subdued credit supply of the banking sector lowered annual GDP growth by this amount between 2012 and 2013 Q2 (Chart 15).

A pick-up in demand can be observed in the household segment as well. The significant majority of banks had expected an increase in demand for household loans for several quarters, but in the past these expectations always proved to be wrong. For 2013 Q2, however, the vast majority of banks reported an increase in demand for housing loans, and many of them also reported rising demand for consumer loans. Looking ahead, banks expect a further increase in demand in both segments: a net 81 per cent expect an upturn in demand in the case of housing loans and a net 34 per cent in the case of consumer loans (Chart 16).

2.1 INTERNATIONAL OUTLOOK IN HOUSEHOLD LENDING

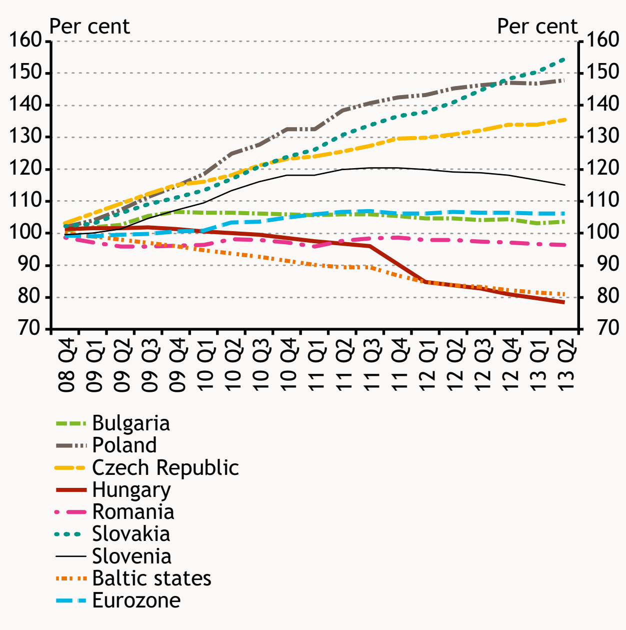
Household loans outstanding show a mixed picture in the region. The quarterly change in lending to households was heterogeneous in the countries of the Central and Eastern European region. While household loans outstanding increased in the Czech Republic and Poland, it contracted in Slovenia and Romania, just like in Hungary. The amount of household loans outstanding remained practically unchanged in the euro area (Chart 17). Looking at a longer period reveals that the considerable amount of household loans accumulated prior to the crisis is shrinking steadily in Hungary and the Baltic states, while financial deepening continued in the countries where there had been no significant surge in lending prior to the crisis (Poland, Czech Republic and Slovakia).

Overall, household credit conditions remained unchanged in the Central and Eastern European region. Based on the CEE index calculated for the countries of the region, there was no overall change in household credit conditions (Chart 18), although some heterogeneity is observed across countries. In Poland, a small percentage of banks reported easing, whereas in Slovakia 20 per cent of banks in net terms reported tightening of their conditions. Although to a small extent, the tightening of conditions continued in the euro area. Looking ahead, conditions are expected to remain unchanged in the region. However, in the case of the favourable data for Hungary it has to be taken into account that banks tightened their credit conditions considerably in the period of the early repayment.

The APR is declining, but mixed developments are seen in spreads. The APR on housing loans declined in the euro area and in the region in Q1. Nevertheless, due to major falls in reference rates, the decline in the APR did not always entail a decline in the spread (Chart 19). Spreads over the 3-month interbank yield declined in Slovakia and the Czech Republic, remained unchanged in Slovenia and the euro area, and increased in Romania. Interest rate spreads in Hungary continue to be remarkably higher (i.e. some 2 percentage points) than in the region or the euro area.

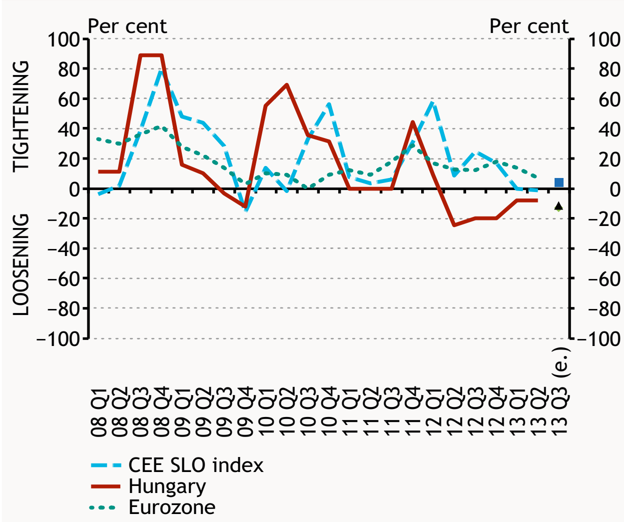
Chart 17
Changes in household loans outstanding in international comparison

(October 2008 = 100, exchange rate adjusted)



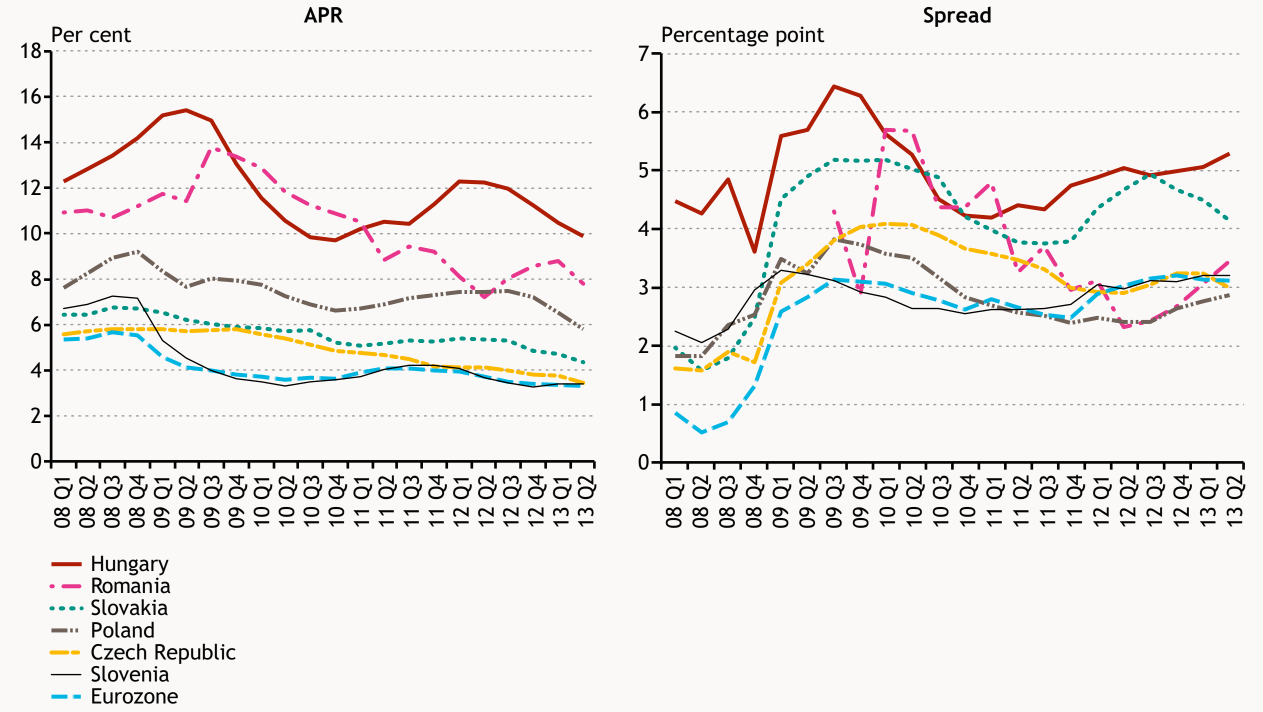
Sources: ECB, selected central banks and MNB.

Chart 18
Household credit conditions in international comparison



Note: The data indicate directions and not degrees.
Sources: ECB, selected central banks and MNB.

Chart 19
International comparison of interest rate conditions of housing loans extended in domestic currency



Sources: ECB, selected central banks and MNB.

Annex: Methodological notes

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

1. Credit aggregates and lending rate data

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

2. Lending Survey

The Lending Survey facilitates the analysis of how major banks perceive and evaluate market developments and how they develop their respective strategies, in particular their lending policies. In the case of the household segment, a total 14 banks were involved in the interviews. 10 banks responded to questions related to housing loans, while 14 banks and 6 financial enterprises questions on consumer loans. Based on data from the end of 2013 Q2, the surveyed institutions accounted for 92 per cent of the banking sector in the case of housing loans outstanding, while 94 per cent in the case of consumer loans outstanding. The corporate questionnaire was completed by 8 banks, with a total market share of 84 per cent and 94 per cent of the corporate loan and commercial real estate loan markets, respectively. A total 7 banks were interviewed on the subject of loans extended to municipalities. Based on data from the end of 2013 Q2, the institutions surveyed covered 97 per cent of total municipal exposure by banks.

The survey consists of a standard questionnaire in each segment, and since the survey conducted in January 2010 we have also asked ad hoc questions of current concerns related to the credit markets. The retrospective questions refer to 2013 Q2 (compared to 2013 Q1), whereas the forward-looking questions concern the next half-year period, i.e. the one covering 2013 H2 (relative to 2013 Q2). The current questionnaire was completed by the senior loan officers between 1 and 16 July 2013.

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

The detailed findings of the Lending Survey and the set of charts are available at:
http://english.mnb.hu/Kiadvanyok/hitelezesi_felmeres

3. The Financial Conditions Index (FCI)

In addition to short-term interest rates and the nominal exchange rate, which represent the behaviour of money markets, the FCI condenses the information contained in other price, quantitative and qualitative variables characterising the financial intermediary system into one indicator. The FCI gauges the impact of the financial sector on the real economy. The annual change in the FCI mentioned 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).[3] In the VAR model, the use of the so-called sign restriction method allows the identification of monetary policy shocks as well as the supply shocks of financial markets and the banking sector. The identified shocks allow for the calculation of how unexpected changes in individual financial variables affect GDP growth. The advantage of the method is that it is possible to exclude the endogenous reaction of financial variables on the developments in

[3] Tamási, B. and B. Világi (2011), "Identification of Credit Supply Shocks in a Bayesian SVAR Model of the Hungarian Economy", *MNB Working Papers*, 2011/7.

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 overall FCI, sub-indices may also be calculated. Accordingly, for example, the 'banking sector' FCI net of money market effects is prepared with the weighting of credit aggregates and interest margins. At the same time, the VAR model serving as the basis for the FCI does not provide information on the size of the effect of the interbank rate through household and corporate loans. Only rough estimates can be given for this, based on the shares of household and corporate forint lending in the private sector lending. This uncertainty is expressed by the fact that the effect of household and corporate loans on GDP is illustrated in banded charts. One of the limits of the band only measures the effect of credit quantity and interest margin calculated on the basis of the VAR model. For the calculation of the other limit of the band, the effect of money market interest rates is also taken into account, but this calculation is already based on the aforementioned estimate, and not on the VAR model.

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