MAGYAR NEMZETI BANK

Trends in lending

November 2016

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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 correct interpretation of these developments. To this end, it elaborates on 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, based on 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 80–90 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 provided in the Annex at the end of the analysis. Within the publication, the findings of the Lending Survey are presented in a condensed form, but the responses to the questions and the set of charts based on the findings are published in full on the Lending Survey page of the MNB's website.

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY

The development of credit institutions' lending is characterised general improvement. Lending conditions eased, both for corporate credits and retail consumer loans. Total corporate loans outstanding increased, and within that SME lending also grew, expanding by 7.3 per cent year-on-year, when self-employers are taken into account. New household lending rose substantially, and thus the sector was a net borrower in the quarter for the first time since 2009. Overall, a turnaround in lending has occurred in the corporate, SME and household segments.

In September 2016, the annual growth rate of the total corporate lending of credit institutions was 1.8 per cent. After adjustment for the portfolio separation implemented within the framework of the resolution of MKB Bank, the growth rate amounted to 3.4 per cent. It was mainly transactions that contributed to the annual expansion of lending in the third quarter, as disbursements exceeded repayments by HUF 98 billion. This expansion primarily reflected the increase in HUF-denominated loans. On a transaction basis, SME loans increased by 6 per cent in an annual comparison, with the Funding for Growth Scheme contributing substantially to this development. The outstanding loans of the self-employed showed dynamic expansion during the quarter, partly due to the Funding for Growth Scheme and loans related to state land sales. The annual growth rate of the outstanding loans of the SME sector including the self-employed came to 7.3 per cent in the third quarter of 2016.

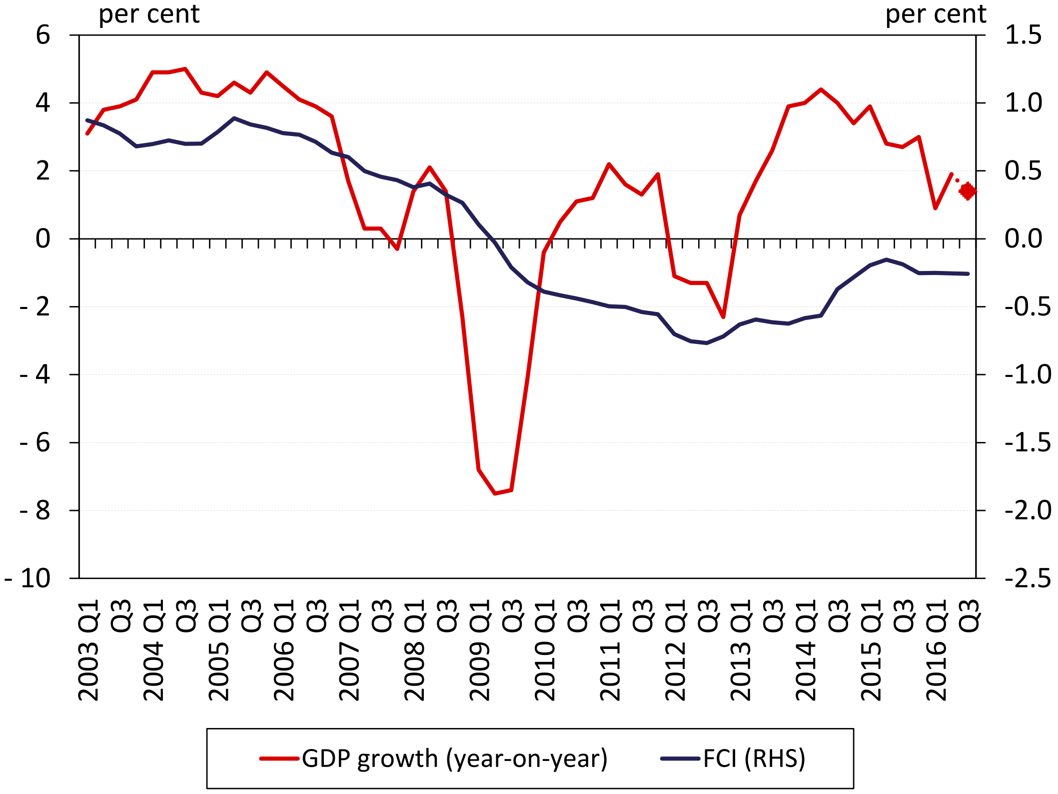
According to the banks' responses to the Lending Survey, credit conditions for corporations continued to ease during the quarter, which was justified by the favourable economic prospects and ample liquidity, in addition to increasing competition. Similarly to the previous quarters, easing was primarily seen in the relaxation of price conditions. During the quarter, the banks registered a rise in demand for long-term loans in particular, which they expect to continue for the next six months as well. The average spread of small-amount HUF loans typically taken out by SMEs decreased somewhat during the quarter.

The credit institution sector's household loan portfolio increased by HUF 37 billion as a result of loan transactions. Since the end of 2009, this was the first time that we observed an increase in the loan portfolio on a quarterly basis. However, the expansion of household loans outstanding is mainly affected by growth in loans granted to self-employers. Looking at the past one year as a whole, the loan portfolio decreased by 2.5 per cent at an annual level. The volume of new loan contracts increased by 43 per cent in an annual comparison and as part of this, housing loan output increased by 48 per cent over the past one year.

Based on the bank's responses in the Lending Survey, housing loan conditions did not change considerably while consumer loan conditions eased during the quarter. The majority of banks emphasised market competition as a factor contributing to this easing and have also eased the spreads applied on the loans. Looking forward, the banks have indicated similar trends for the next 6 months as well. Banks taking part in the survey observed a continuing expansion of loan demand, but looking forward, only a smaller proportion of banks expect a further recovery. The Home Purchase Subsidy Scheme for families continues to support loan demand. Nevertheless, on the whole the programme's impact on the construction of new homes is still muted since only one third of the concluded subsidy contracts were used for that purpose. The average APR on new housing loans remained unchanged as a result of the composition effect, while the average interest rate spread increased during the period under review, owing to the increased financing of riskier customers.

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

Financial Conditions Index (FCI) and annual real GDP growth



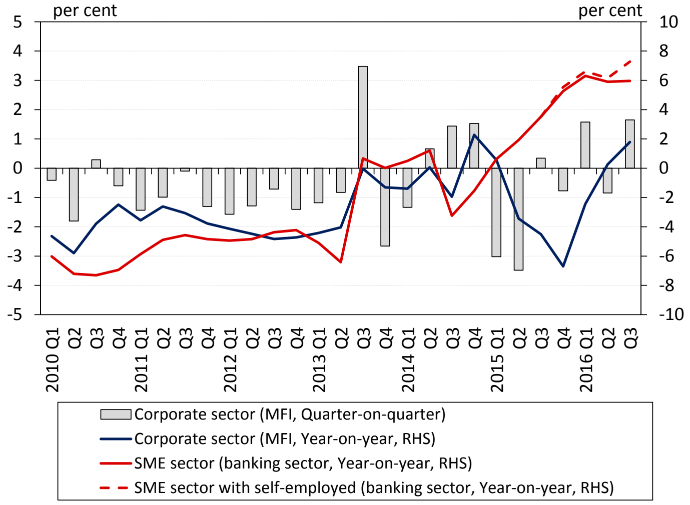
Note: The FCI shows the contribution of the banking sector through lending to the annual GDP growth rate. The 2016 Q3 data for the real GDP annual growth rate are the preliminary estimate of the HCSO.

Source: MNB, HCSO.

2. DEVELOPMENTS IN LENDING IN THE CORPORATE SEGMENT

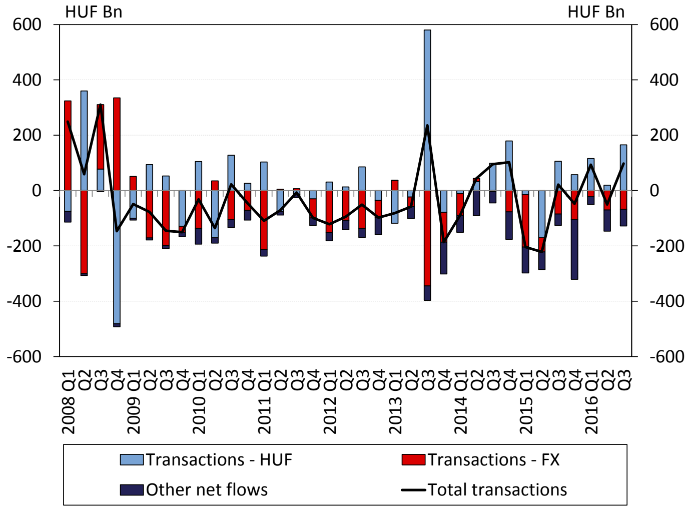
In 2016 Q3, the annual growth rate of corporate lending was 1.8 per cent. Transactions during the period contributed strongly to this, as disbursements to non-financial corporations exceeded repayments by a total of HUF 98 billion. The increase mainly characterised the short-term loan portfolio. The loan portfolio of the SME sector grew by 6 per cent annually in the third quarter. According to the banks' responses to the Lending Survey, corporate credit conditions continued to ease during the quarter, partly due to stronger competition and partly to the favourable economic prospects and ample liquidity, according to the banks. The banks participating in the survey anticipated further easing of conditions during the next six months, which will most likely be supported by favourable funding possibilities and their liquidity position. Banks reported rising demand for long-term loans in Q3, which may be reflected in the loan portfolios in the upcoming quarters. Credit institutions expect a further increase in demand during the next six months. The average financing cost of new corporate HUF loans decreased further for small-amount loans.

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. 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.

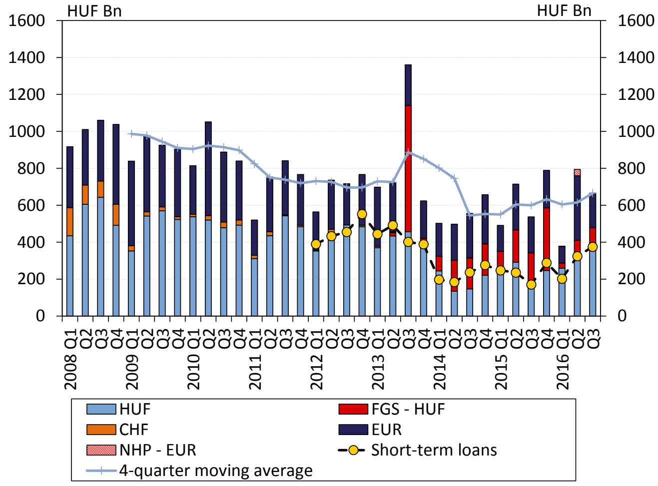
Domestic corporate lending

A continued rise in the SME loan portfolio was seen in the third quarter. The annual growth rate of credit institutions' lending to the corporate segment reached approximately 1.8 per cent during the third quarter (Chart 1). However, the portfolio separation implemented within the framework of the resolution of MKB Bank will continue to affect the annual rate until the end of 2016. Excluding this impact, the growth rate was 3.4 per cent. Within overall corporate lending, loans to the SME sector expanded by 6 per cent year-on-year. The Funding for Growth Scheme contributed significantly to the annual growth of the loan portfolio. The outstanding loans of self-employed persons showed a dynamic expansion during the quarter, which is attributable to the Funding for Growth Scheme and loans for state land sales. Consequently, the annual growth rate of the SME sector's outstanding loans including self-employed persons came to 7.3 per cent in the third quarter of 2016.

The total corporate loan portfolio increased significantly in the third quarter. During the third quarter of 2016, the transaction-based expansion of the corporate loan portfolio of credit institutions amounted to some HUF 98 billion (Chart 2). In contrast to the HUF 165 billion increase in HUF-denominated loans, foreign currency loans decreased by HUF 68 billion in the period under review. Loans extended in the third stage of the Funding for Growth Scheme contributed approximately HUF 100 billion to the increase in transactions during the quarter, of which transactions under the HUF pillar amounted to HUF 81 billion. 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 HUF 60 billion. During the quarter, a substantial amount of short-term loans were disbursed[1] (partly against

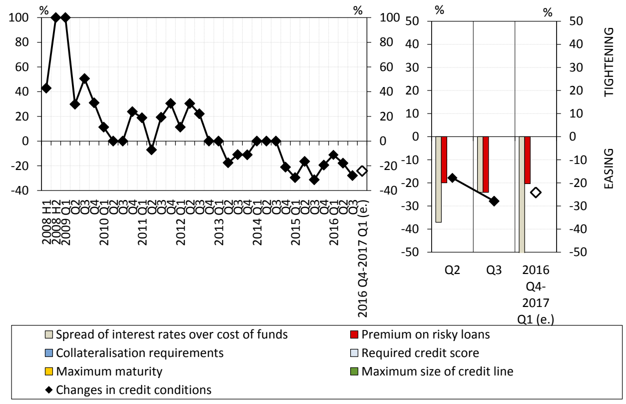
[1] Loan with a maturity of less than one year.

Chart 3: New corporate loans in the credit institution sector



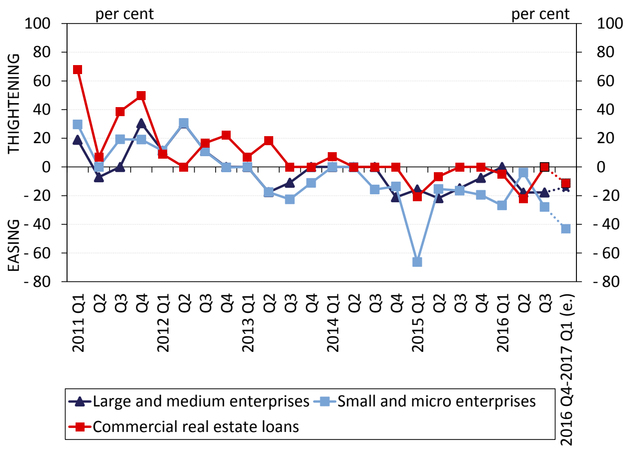
Source: MNB.

Chart 4: Changes in credit conditions in the corporate segment



Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Source: MNB, based on the answers of respondent banks.

Chart 5: Changes in credit conditions in corporate sub-segments



Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Source: MNB, based on the answers of respondent banks.

the previously contracted, but undrawn credit lines), and thus the proportion of long-term loans within total outstanding borrowing dropped by approximately one and a half percentage points to 71 per cent. Outstanding overdrafts, which had reached a historically high level in recent years, increased by HUF 13 billion during the quarter.

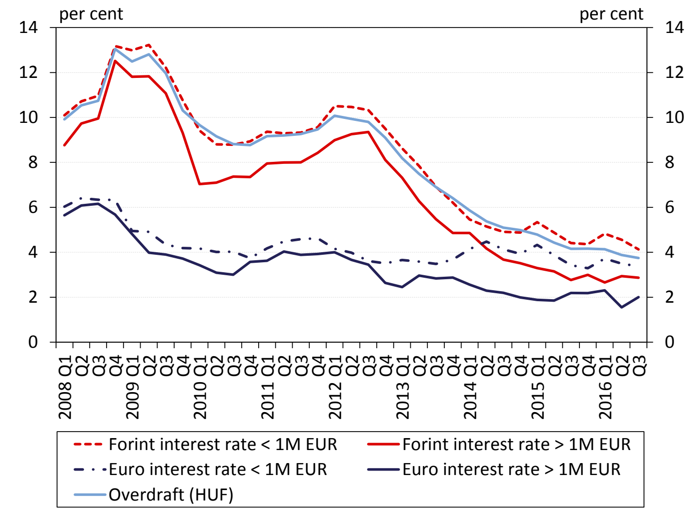
As an average for the year, an expansion in the volume of new contracts was seen during the quarter. New loan contracts of the credit institution sector with non-financial corporations amounted to HUF 700 billion in Q3 (Chart 3). The gross volume of new loan contracts concluded during the quarter increased compared to the same period of last year and also based on the annual average. The volume of new HUF-denominated loans increased the most, reaching HUF 478 billion. Within HUF-denominated loans, the proportion of short-term loans was significant, amounting to HUF 331 billion.[2] Loan agreements signed within the framework of the third phase of the Funding for Growth Scheme contributed to the volume of HUF loans by HUF 81 billion and to EUR loans by HUF 33 billion.

Credit conditions continued easing as a result of increasing competition between banks. Based on responses to the Lending Survey, 28 per cent of the banks eased their corporate lending conditions in net terms[3] (Chart 4). The loosening of standards was observed in both enterprise size categories (Chart 5). Similarly to the previous quarter, banks eased price conditions for corporate loans, such as the spread, the premium on riskier loans and the fees charged. Among the factors contributing to easing, the banks once again emphasised competition and the improving economic outlook, but ample liquidity was also mentioned as a factor. Based on the observation of the banks, the quality of the corporate loan portfolio generally improved both in terms of the default rate and the loss given default, which may have contributed to the perception of the economic outlook. Looking forward, a net 24 per cent of the respondents expect general easing in lending conditions for the next six months, which may be implemented through further reduction of price conditions. They also expect an easing of the standards required for accepting credit applications for commercial real estate loans. In net terms, one quarter of the respondents noted that the expected future change in the bank's liquidity position and in the availability of funds and

[2] 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.

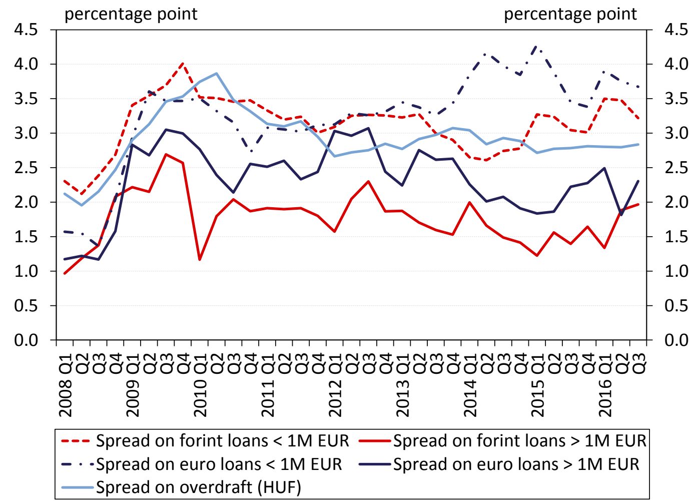
[3] The difference between banks that tightened and eased their conditions, weighted by market share.

Chart 6: Interest rates on new corporate loans



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

market share targets may contribute to the easing of standards and conditions over the next six months.

The financial costs of small-amount loans decreased further. After filtering out money-market type transactions,[4] the interest rate on new market-based corporate loans[5] decreased by 0.1 percentage point on average in the case of high-amount HUF loans (Chart 6), resulting from the decrease in the reference rate and the increase in spreads. In the case of HUF loans under a value of 1 million euros, the average interest level decreased by 0.4 percentage point, which can be explained partly by the decrease in the reference interest rate (BUBOR) and partly by the decrease in the average interest spread (Chart 7). Within this product segment, the interest spread decreased by an average of 0.3 percentage point. The spread on HUF overdrafts did not change significantly during the quarter. The average interest level of large volume EUR loans increased by 0.5 percentage point compared to the low value of the previous quarter which was impacted by outstanding items. The interest level of small amount EUR loans decreased by an average of 0.1 percentage point as the result of the reduction of the average interest spread. Overall, we can say that the reduction of the spread on small-amount loans is in line with the responses of the banks in the Lending Survey, in which the majority of the banks indicated that they reduced the spread of the loans extended for small and micro businesses which typically take out small amount loans.

The banking sector's lending activity continues to have a moderate contractionary effect. In 2016 Q3, the corporate sub-index of the financial conditions index was in the negative range (Chart 8), meaning that the annual level of corporate investments was slightly reduced by the restrained lending of the banking system. The value of the business confidence index published by the GKI exceeded expectations as it improved slightly during the last quarter compared to the previous quarter, but overall the value of the index is lower than it was in 2015.

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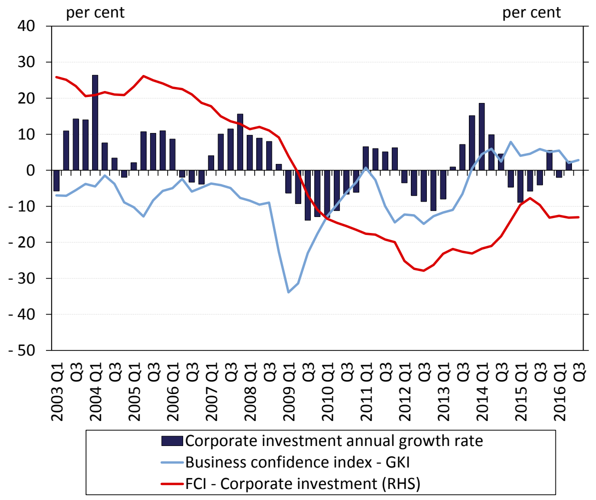
[4] Money market transactions are loans extended to non-financial corporations with a value of over EUR 1 million; their term is short (typically less than 1 month) and they serve to fund some kind of financial operation. Therefore, they do not generate investments in the real economy. From 2015, it 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 significantly distort the observed average interest rates, owing to their low weight.

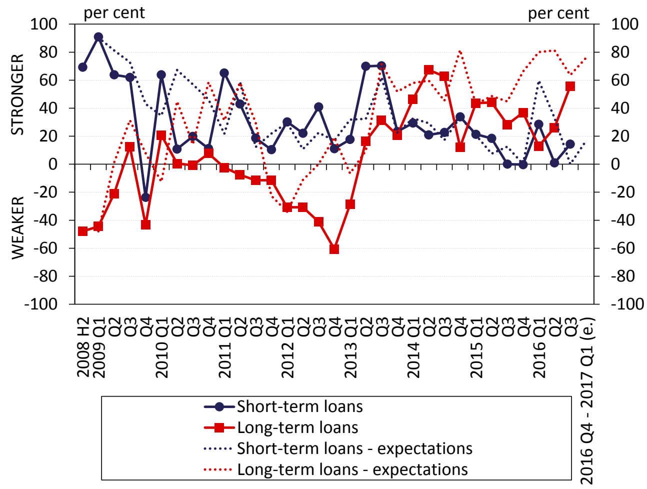
[5] In the case of new contracts, we examined floating-rate loans or loans with interest rate fixation for less than one year. The majority of loans granted under the Funding for Growth Scheme are long-term loans, and therefore the interest rates reviewed by this publication are only shaped by smaller,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

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



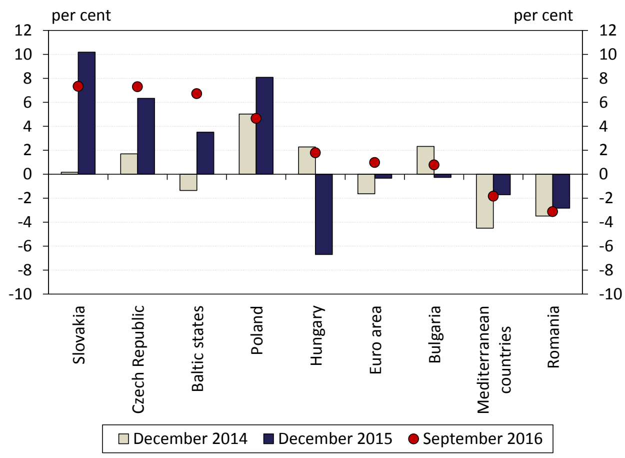
Note: The sub-index of the FCI quantifies the banking system's contribution, through corporate lending, to the annual growth in corporate fixed investments. Source: MNB and GKI.

Chart 9: Change in loan demand by maturity



Note: Net percentage balance of respondents banks indicating stronger/weaker demands, 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



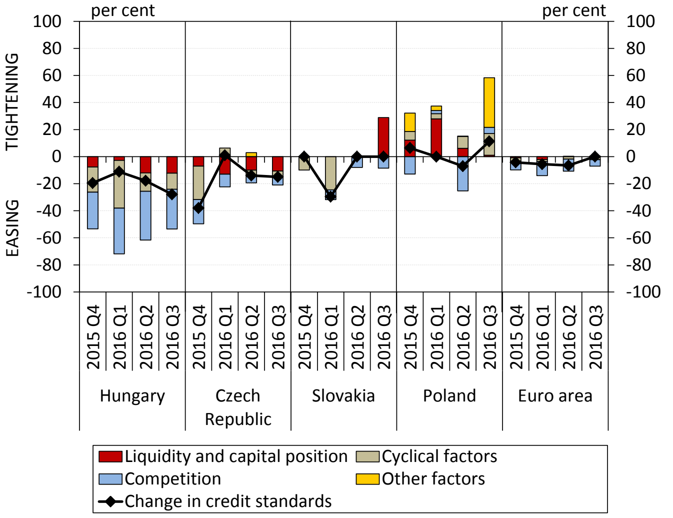
Note: Mediterranean countries: Greece, Italy, Portugal and Spain. Baltic states: Estonia, Lithuania and Latvia. Source: ECB, MNB.

Demand for corporate loans continued to expand, primarily for long-term loans. Within the framework of the Lending Survey, in net terms 56 per cent of banks reported an increase in demand for long-term loans (Chart 9). This rising demand affected both forint and foreign currency loans, but more banks observed rising demand for forint loans. In a breakdown by size category, it can be seen that increased demand was more widespread among small and micro businesses, but the demand of large and medium-sized companies also increased during the period under review. According to a net 37 per cent of the banks, decreased interest levels may also have contributed to the recovery in loan demand. A net 39 per cent of the banks noted a general recovery in demand for commercial real estate loans, while more than 81 per cent of them indicated strengthening demand for loans to construct office buildings. 39 per cent of the banks mentioned an increase in demand for loans financing the implementation of apartment projects, while a net 54 per cent mentioned expanding demand in the loan market of logistics centres. Respondent banks expect a recovery in every commercial real estate loan market (office buildings, apartment projects, logistics centres, shopping malls) and in every enterprise size category over the next two quarters. Increasing loan demand is supported by the favourable interest environment, the investment demand of corporations and their need to finance their stock of receivables, while the market of commercial real estate may be boosted by a turnaround in real estate investment appetite.

International outlook in corporate lending

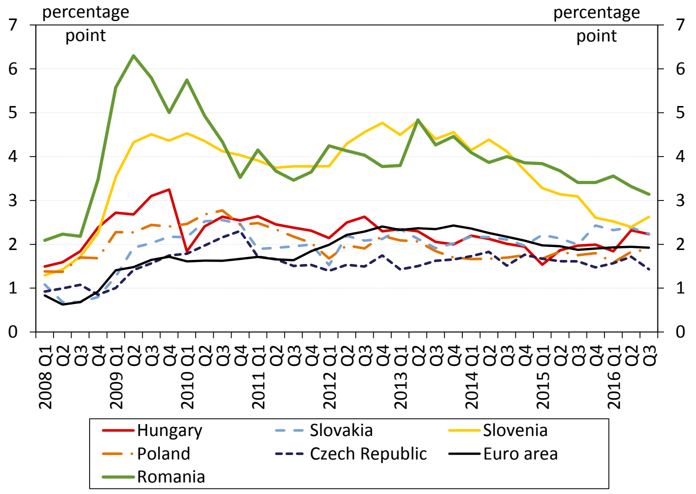
The expansion of corporate lending can be observed both in the euro area and in the region. Within the euro area, the corporate loan portfolio increased by an average of 1 per cent over the last one year (Chart 10). The corporate loan portfolio of the Mediterranean countries was characterised by a slowing decline over the past years, but in 2016 Q3 this process seems to be reversing, as the rate of contraction accelerated to 1.8 per cent, which is mainly attributable to developments in Italian corporate lending. As opposed to this, in the so-called central countries, mainly as the result of the net borrowings of French and German corporations, the loan portfolio increased by an average of 2.7 per cent. Within the Visegrad Group and the Baltic states, the loan portfolio of non-financial corporations increased year-on-year, in Croatia it stagnated, while in Slovenia and Romania it decreased.

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 conditions, while negative ones indicate the easing thereof. Source: MNB, ECB, national central banks.

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



Note: Variable-rate loans with maturities of up to one year; therefore, FGS loans with the fixed 2.5 percentage point spread are not included. Source: MNB, ECB, national central banks.

Regional trends in corporate credit conditions are rather heterogeneous. Based on the responses of the banks in the Lending Survey, credit conditions remained overall unchanged within the euro area (Chart 11). The easing of corporate credit conditions was mainly encouraged by competition, along with a lower risk perception, although to a lesser extent. The change in European banks' financing costs and risk tolerance had a more or less neutral effect on credit standards. Within the Visegrad Group, credit conditions remained unchanged in Slovakia, eased in the Czech Republic and tightened in Poland.[6] Financing demand continued to increase in the euro area, primarily driven by corporate mergers, while the contribution of corporate investments remains low.

With the exception of Poland, the average interest spread on corporate loans decreased in the region. The average interest spread on corporate loans less than EUR 1 million decreased by 0.1 per cent in the euro area during the third quarter (Chart 12). In the region, the average interest rate spread on corporate loans decreased at the highest rate in Hungary, where it fell by around 0.3 percentage points, followed by Romania (0.2 percentage points), while in Slovakia, Slovenia and the Czech Republic it fell by 0.1 percentage point. In contrast to the above trend, the interest spread increased by 0.2 percentage point in Poland. Parallel to this, interbank interest rates serving as the reference interest rates either decreased or remained unchanged within the Visegrad Group, meaning that interest rate levels within the various countries were in line with the spreads.

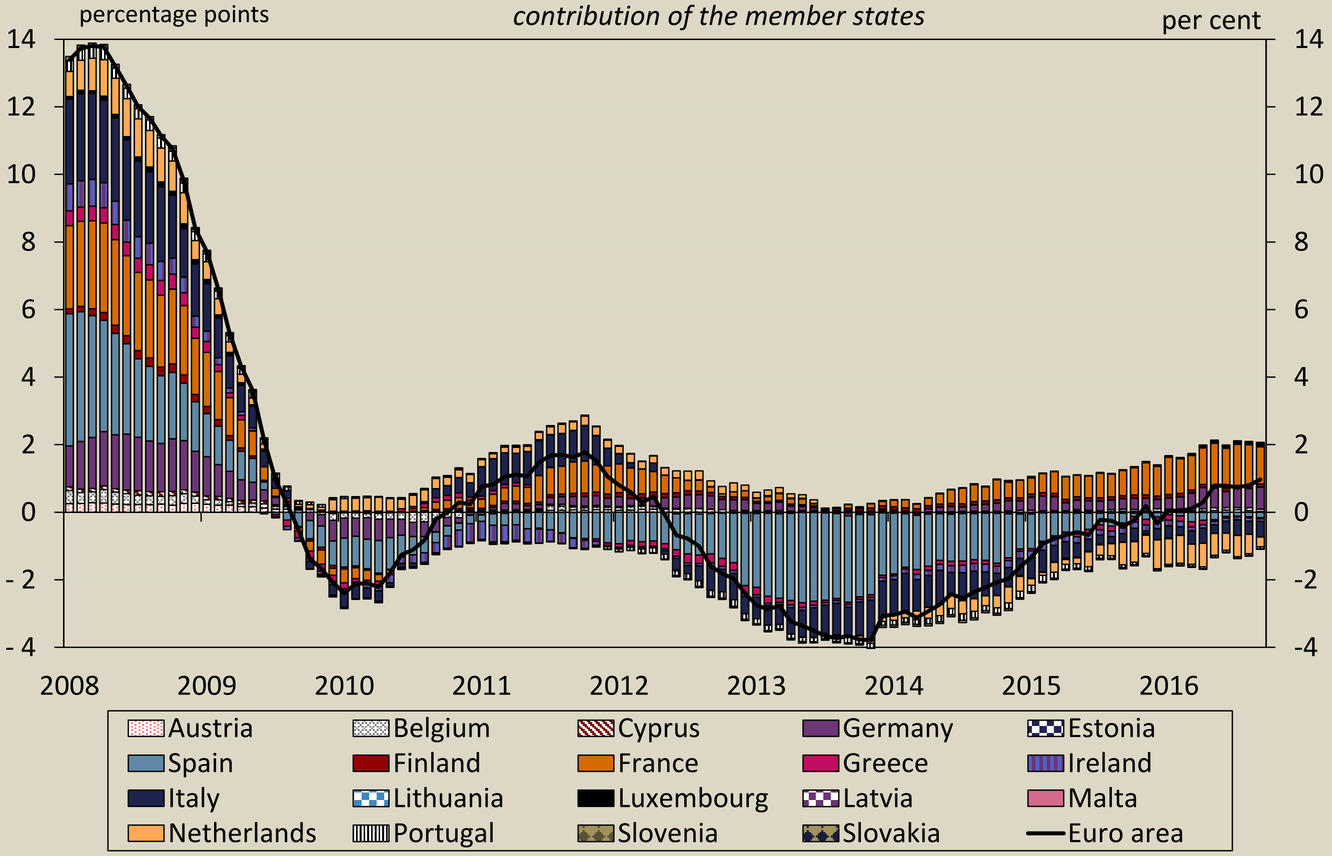
[6] In Poland, the tightening of credit conditions of long-term loans granted for small and medium-sized companies was observable for the net one third of the banks.

Box: Dynamics of corporate loan portfolios within the European Union

Prior to the 2008 financial crisis, corporate loans issued by credit institutions had dynamically expanded within the European Union. Analysing this data by country, we can say that corporate indebtedness was extremely widespread and extended practically to all the member states. Today, it is clear that credit institutions lent excessively to some submarkets, while they underestimated the risks, especially in case of commercial real estate loans, which resulted in a lasting confidence and balance sheet adjustment crisis once the risky loans fell in default, undermining the banking system's stability. Following the recession, a slow erosion of corporate loan portfolios could be observed in numerous European countries. The extent of this erosion exceeded the natural adjustment of the excessive lending cycle, especially in those countries where the banks' risk appetite decreased the most due to the evolution of the non-performing loan portfolios.

In 2016, corporate lending started to grow (on a transaction basis) within the currency area, but at the same time, based on a breakdown by country, we can still observe substantial heterogeneity. In a break down by country, the 1 per cent growth rate in lending, which characterises the euro area overall, it is clear that this expansion is practically attributable to increased lending in two countries. Lending in France raised the annual growth rate of corporate loans within the euro area by 1.1 percentage point, while lending developments in Germany increased it by 0.7 percentage points. On the other hand, lending in Italy and in the Netherlands lowered this annual growth rate by 0.5 percentage point and 0.3 percentage point, respectively. Recovery from the economic recession still seems fragile in Europe, which is also apparent in the lending dynamics of the individual countries.

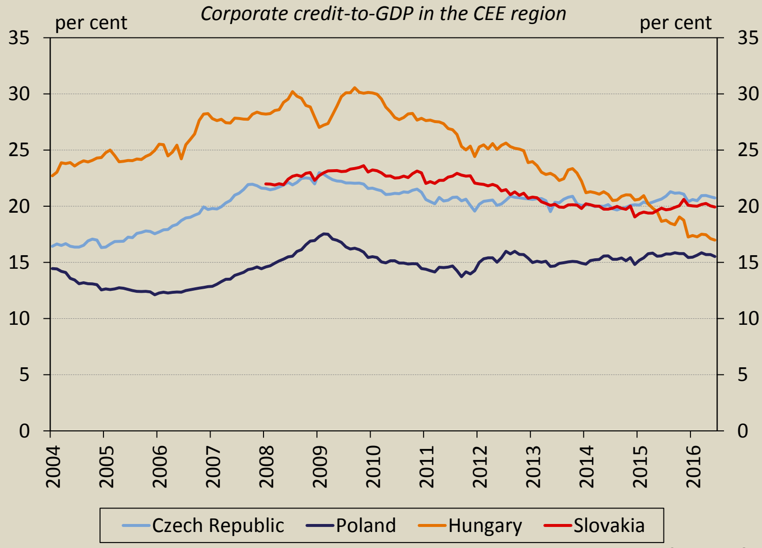
Annual growth rate of the corporate loans in the euro area and the contribution of the member states



Note: Transaction-based. *Source: ECB*

Within the Visegrad Group, similar developments could be observed as in the monetary union. The lending cycle prior to the crisis was followed by protracted deleveraging, but in terms of the rate of this erosion, substantial differences can be observed in terms of the specific countries. While in Hungary the corporate credit-to-GDP ratio had dropped by almost half compared to its historic peak by 2016 Q3, showing a decline of 14 percentage points, the same value in the other regional countries varies between 2 and 4 percentage points. This means that in Hungary a substantial gap may have been created, compared to the equilibrium level of lending.

In these countries, the length of the decline is also different. In Poland, Slovakia and the Czech Republic, the reduction of the loan portfolio already stopped two years earlier. As a result, in the Czech Republic and Slovakia, the GDP-proportionate indebtedness of non-financial corporations already exceeds the traditionally higher level in Hungary. At the same time, a turnaround in lending also took place in Hungary in 2013, resulting in a stagnation of the corporate loan portfolio compared to the previous contraction. Due to GDP growth, this still means a reduction in credit-to-GDP terms, but in 2016 stagnation was replaced by an increase in the corporate loan portfolio.



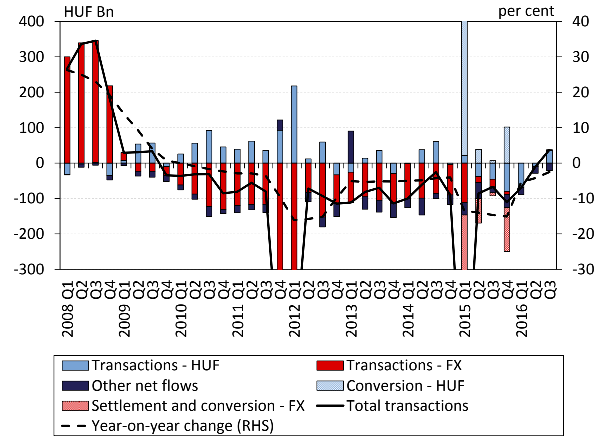
Source: ECB

With the recovery in lending, a closing cyclical position may characterise the corporate credit-to-GDP of non-financial corporations in certain countries in the European Union. The easing of credit terms may also play a key role in this development: for micro, small and medium-sized companies which have a more pronounced need for the financing of domestic banks, the increasing competition between banks and the low interest environment already led to a widespread easing in price conditions in 2016, and this trend may continue in respect of non-price conditions as well.

3. DEVELOPMENTS IN LENDING IN THE HOUSEHOLD SEGMENT

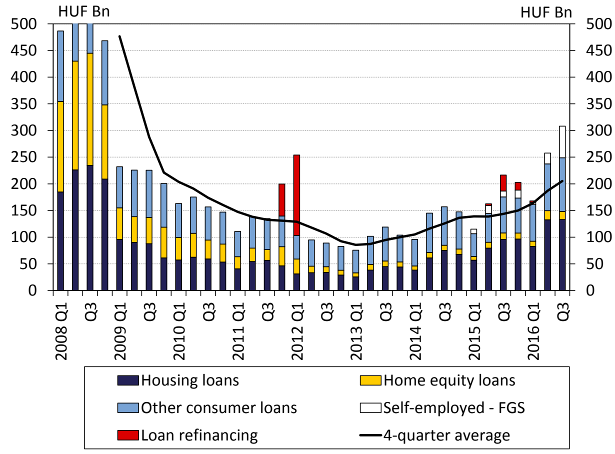
In 2016 Q3, household loans extended by credit institutions amounted to a total of HUF 37 billion, and accordingly the annual rate of decline of the household loan portfolio dropped to 2.5 per cent in September. After adjusting for FGS-loans, the volume of new loan contracts amounted to HUF 249 billion in total in the period under review, representing an annual average increase of 43 per cent compared to the same period of the previous year. Within the total volume, new housing loans increased by 48 per cent over the past one year. Based on the bank's responses in the Lending Survey, housing loan conditions remained unchanged while consumer loan conditions eased during the third quarter. Based on the feedback of the banks, similar developments can be expected for the next six months. The continuing expansion of loan demand observed by the banks taking part in the survey was seen, but looking forward, a smaller proportion of banks expect further recovery. The Home Purchase Subsidy Scheme for families (HPS) continues to boost loan demand: during the quarter, 15 per cent of new housing loans were related to the HPS. Overall, the impact of the programme on the construction of new homes is still muted since only one third of the concluded subsidy contracts were used for the construction or the purchase of new homes. The average APR on new housing loans remained unchanged as a result of composition effect, while the average interest rate spread increased during the period under review, owing to the increased 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 indicates only the refinancing related to the early repayment and conversion into forints. Source: MNB.

Domestic household lending

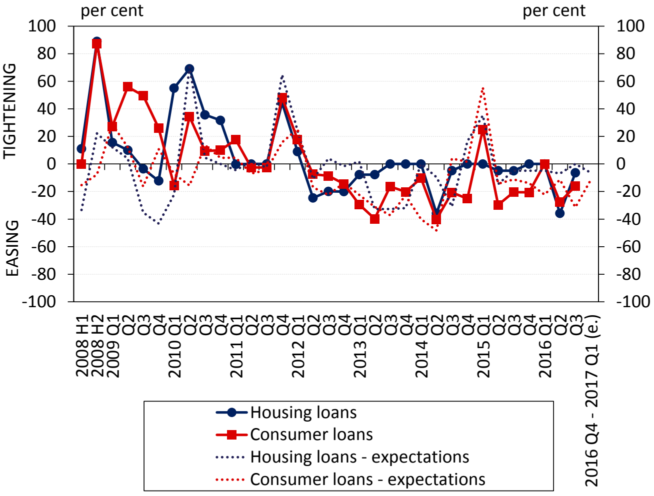
In the household sector, we observed an expansion in loans outstanding in the third quarter. In 2016 Q3, loans of credit institutions granted for households increased by HUF 37 billion as a result of transactions (Chart 13). In the period under review, write-offs and reclassifications resulted in a decline of HUF 21 billion. Looking at the currency breakdown, outstanding HUF loans increased by HUF 35 billion, while foreign currency loans grew by HUF 2 billion. The net increase in outstanding housing loans and other loans amounted to HUF 10 billion and HUF 6 billion, respectively.[7] Loans granted to self-employed persons amounted to HUF 51 billion, and this had a strong impact on the category of other loan transactions.[8] The transaction-based annual rate of decline in the portfolio stood at 2.5 per cent, but – after adjustment for the settlement and the FX-conversion of vehicle loans and personal loans at the end of 2015 – the annual decline in loans outstanding would amount to 2.2 per cent.

The volume of new contracts continues to expand dynamically. The volume of credit institutions' new household loan contracts amounted to HUF 249 billion in Q3, after adjustment for FGS loans granted to self-employers (Chart 14). The volume of new household loan contracts increased by 43 per cent on annual average compared to the same period of last year. The annual growth rate was 48 per cent in the case of housing loans, while home equity loans increased by 31 per cent and other consumer loans by 57 per cent.

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

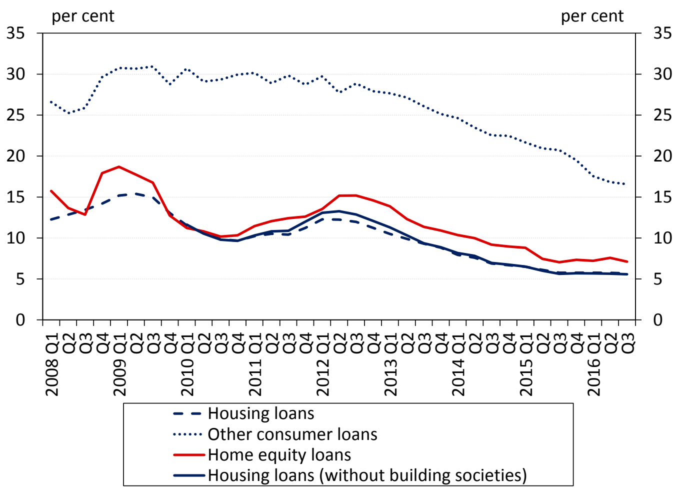
[8] Households as a statistical category contains natural persons and self-employed persons together.

Chart 15: Changes in credit conditions in the household segment



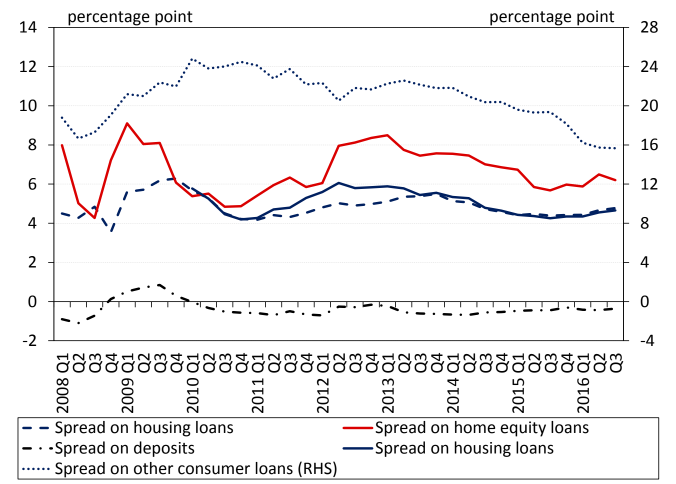
Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Source: MNB, based on the answers of respondent banks.

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



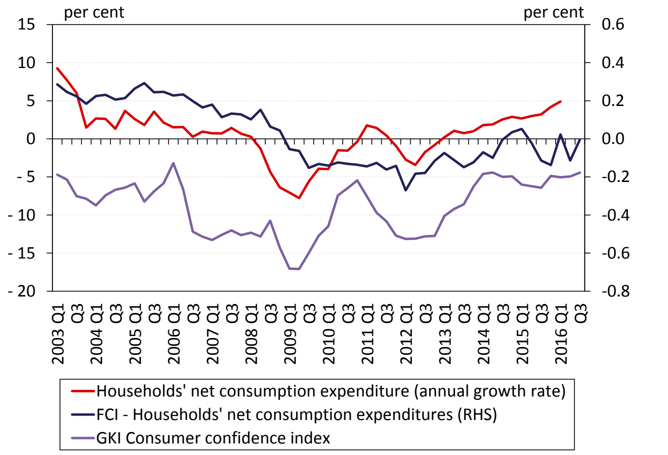
Note: Quarterly average of interest rate spreads on the 3-month BUBOR. Spreads based on the APR. Source: MNB.

During the quarter, credit terms of housing loans did not change, while the credit standards of consumer loans eased. Based on answers to the Lending Survey, in net terms, 6 per cent of the banks eased housing loan conditions in 2016 Q3, despite the fact that according to one third of the banks, their market share targets would justify this move (Chart 15). In terms of standards, in net terms 28 per cent of the banks reduced spreads, 14 per cent reduced the charges for loan disbursement and 15 per cent loosened the maximum loan-to-value ratio. A further and proportionally less significant easing was observed in the premium on risky loans and in the required level of the payment-to-income ratio. Looking forward to the next six months, a more significant easing was indicated only for the spreads of the set of credit standards, which may be justified by increasing competition. Concerning consumer loans, in net terms, 16 per cent of the banks eased their lending conditions; most reduced the spreads (74 per cent), citing the improving economic outlook, their market share targets and competition as the reasons.

The APR on housing loans remained unchanged, while average spreads increased in the period under review. In 2016 Q3, the average APR level for new housing HUF loans did not change and stood at 5.7 per cent at the end of September (Chart 16). However, the unchanged credit costs are caused by the composition effect: the smoothed total credit cost of both variable and fixed interest housing loan products dropped (by 0.2 and 0.1 percentage point, respectively), but the proportion of fixed interest rate loans (with a higher average credit cost) has increased somewhat within newly disbursed loans. In respect of spreads, an increase was observed in the period under review: spreads over the 3-month BUBOR rose by 0.1 percentage point, to 4.8 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.

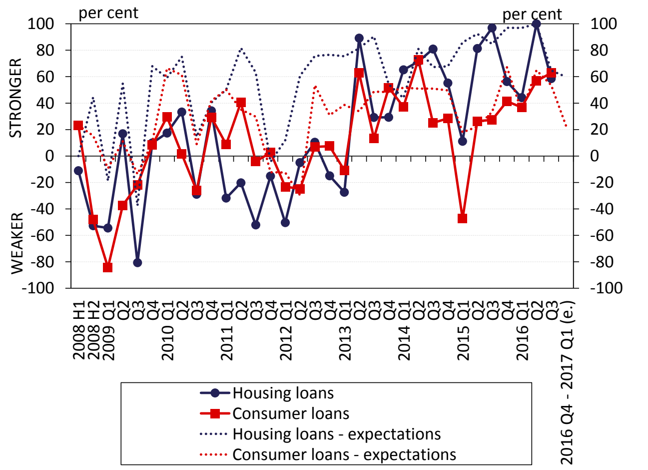
The credit cost of consumer loans declined in the third quarter. Interest rates on home equity loans fell by 0.5 percentage point, while rates on other consumer loans dropped by 0.3 percentage point in Q3. Consequently, by the end of September, the average interest rate level of home equity loans was 7.1 per cent and that of other loans was 16.6 per cent (Chart 16). In the case of home equity loans, the interest rate spread was reduced by 0.3 percentage point, to 6.2 percentage points (Chart 17). Term deposits continue to ensure somewhat cheaper funding for banks as compared to interbank loans.

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



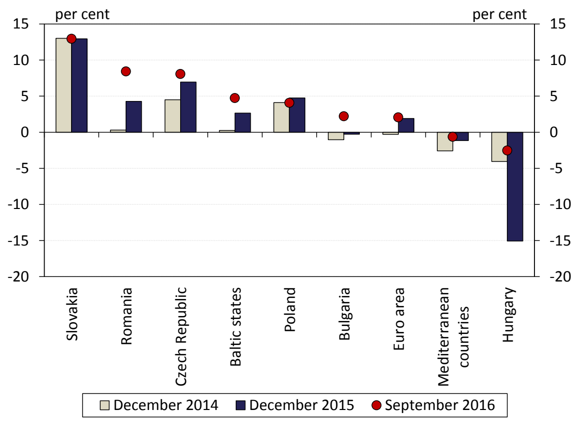
Note: The index quantifies the contribution of the banking sector's lending activity to the annual growth rate of household consumption expenditures. For technical reasons, the chart indicates one one-hundredth of the GKI index. Source: MNB.

Chart 19: Credit demand in the household lending segment



Note: Net percentage balance of respondents banks indicating stronger/weaker demands, weighted by market share. Source: MNB, based on the answers of respondent banks.

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



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

Overall, the financial intermediary system continues to have a neutral effect on the consumption of households. The consumption expenditure of households might have continued to expand in 2016 Q3, while consumer confidence showed a slight improvement compared to the end of June. 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).

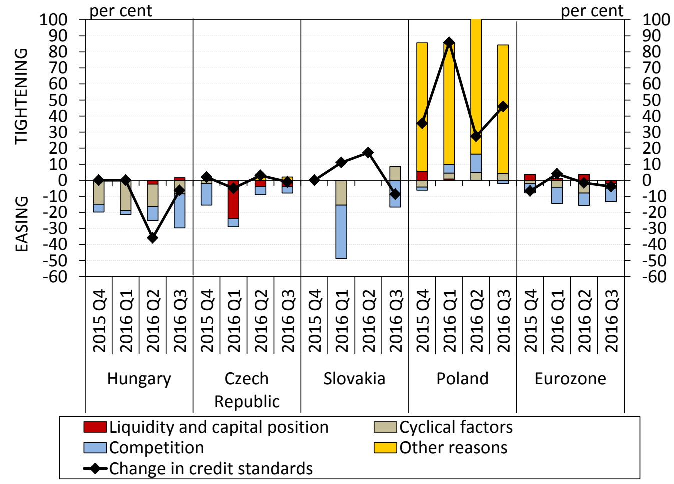
The expectations of the banks are more reserved regarding the further expansion of loan demand. In Q3, roughly 60 per cent of the banks taking part in the Lending Survey reported an expansion of demand both for housing loans and for consumer loans. (Chart 19.) Looking forward, the same proportion of banks expects a further expansion of housing loan demand, while in the case of consumer loans, only one quarter of the banks expects further growth. In 2016, the Home Purchase Subsidy Scheme for families – which was redesigned in February this year – also has a substantial impact on demand for housing loans. In Q3, HUF 20 billion worth of loans were extended in connection with the HPS, representing 15 per cent of the volume of new housing loans. Overall, the impact of the programme on the construction of new homes is still muted. From July to September, only one third of the concluded subsidy contracts was used for the construction or purchase of new flats, while two thirds was intended for the purchase of used flats.

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 improved slightly in 2016 Q3, amounting to 2.1 per cent at the end of September (Chart 20). Significant, although declining heterogeneity remains within the currency area: while households' debts increased in the majority of member states in year-on-year terms, the loan stock continued to decline in 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 4 per cent in Poland.

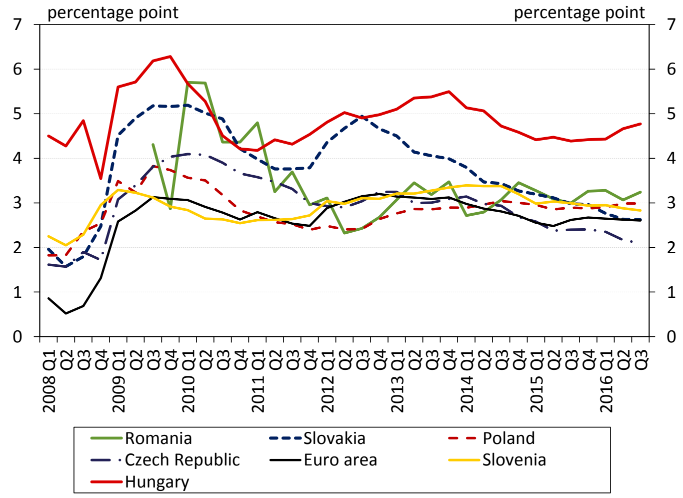
Housing loan conditions continued to ease in the euro area. Based on the survey of the European Central Bank, the banks eased the conditions of housing loans in the euro area in net terms, especially in relation to interest rate spreads. Based on the banks' responses, the loosening of standards was mainly justified by rising competition in the period under review. A wide range of banks reported an expansion in loan demand, which they mainly explained by the low interest rate environment. Lending conditions evolved heterogeneously in

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 conditions, while negative ones indicate the easing thereof. Source: MNB, ECB, national central banks.

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.

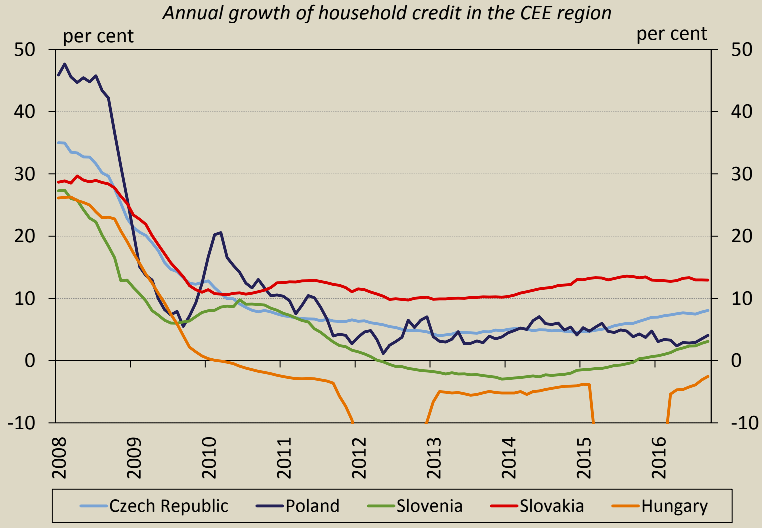
the regional countries: In Slovakia, following the tightening during the first six months of the year, housing loan conditions eased in the third quarter, in the Czech Republic these conditions remained unchanged, and in Poland many banks tightened these conditions (Chart 21). In Slovakia, competition between banks was the only factor for easing; a net half of the banks cut credit spreads, while the loan-to-value requirements tightened and fees and charges increased. In the Czech Republic, in addition to competition, low financing costs also supported the easing of conditions, but despite this factor the standards remained unchanged overall, and banks reported a reduction in spreads. In Poland, a wide scope of banks tightened housing loan conditions and identified, among other factors, the implementation of the constraints on the sale of agricultural properties in April 2016. In terms of standards, the most significant tightening affected the loan-to-value requirements. In Slovakia, demand for housing loans declined somewhat, but for the next quarter, the net one third of the banks expect growing demand. In the Czech Republic, loan demand increased during the quarter, but in Poland the significant drop-off in this demand will continue according to the banks. In the whole of the euro area, additional expansion during the upcoming quarter may follow the increased demand reported by a net 23 per cent of the banks based on the responses.

The average spread on newly disbursed housing loans typically remained unchanged in the region and in the euro area. In the euro area, there was an average decline, in Slovenia and the Czech Republic, the costs of housing loans declined by 0.1 percentage point during the quarter, while the average interest rate of housing loans disbursed in local currency remained unchanged in Slovakia and Poland and increased by 2 percentage points in Romania. Interest rate spreads typically did not change during the period under review: in the euro area they remained at 2.6 percentage points on average, which is 2.2 percentage points lower than the spreads in Hungary (Chart 22). For the majority of the regional countries no shift was observable, only in the Czech Republic did spreads decline by 0.1 percentage point, and in Romania they increased by 0.2 percentage point. This means that spreads in Hungary can still be considered high, as they exceed the average spread in the Visegrad Group by 2.2 percentage points.

Box: Lending to the household sector in the Central and Eastern European region

In contrast to the developments in Hungary, households' indebtedness has increased continuously as a result of loan transactions in Slovakia, Poland and the Czech Republic since the onset of the crisis in 2008. Among the countries of the region, households' indebtedness decreased only in Slovenia (between 2012 and 2015) but in 2016, outstanding loans seem to be expanding.

Annual growth of household credit in the CEE region



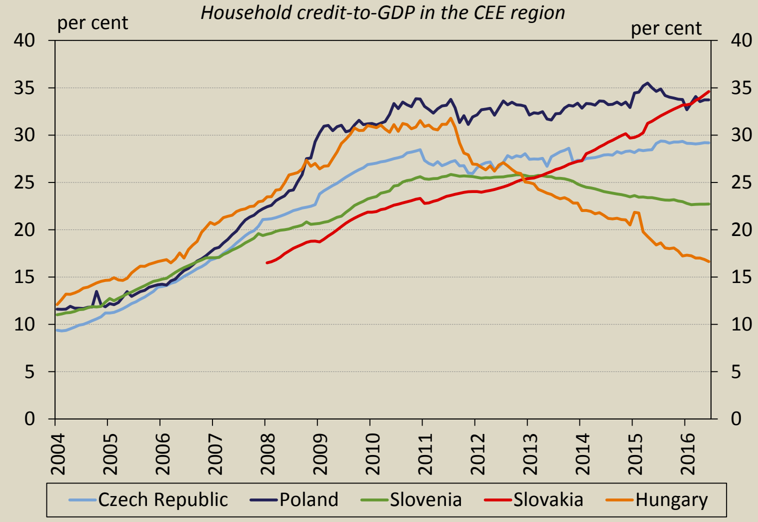
Note: Transaction-based growth rate. *Source: ECB*

Several factors play a joint role in the recovery of household lending. The low interest rate environment and improving consumer confidence improve the willingness of households to take out loans, but this impact may be stronger in the countries in the region due to interest rates lower than in Hungary, resulting from the spreads. The lower level of spreads is also attributable to a better quality retail loan portfolio of the banks: within the region, the share of non-performing loans is the highest in Hungary.

However, in Slovakia and in the Czech Republic the expansion is also supported by the fact that no foreign currency loan portfolios were built up prior to the crisis and that the proportion of non-performing loans can be considered low. As opposed to this, in Poland the share of foreign currency loans in the household loan portfolio was 27 per cent in September 2016. A decision on the – non-mandatory – conversion of Polish foreign currency loans was taken in August 2016. In Slovenia, the share of foreign currency loans increased to 19 per cent during the crisis (mainly CHF-denominated loans) but from 2009 this rate has been constantly declining and by September of 2016, it amounted to only 7 per cent.

The expansion of the household loan portfolio seen in the countries of the region is in line with the developments seen in most EU member states. In Slovakia, the 13 per cent increase in household lending represents the most dynamic recovery in a European comparison. Housing lending is at its historic peak, which, in turn, has a strong impact on the housing market: the price hike of used homes reached the peak seen after 2008. According to the Czech central bank, the reason underlying the sudden jump in new household loans in the Czech Republic is that the financial cycle is in a rising phase in the economy. In comparison with the EU, the level of indebtedness is low while real estate prices are rising, which is coupled with historically low loan interest rates at around the levels seen in 2008. In Poland, the expansion in lending was not followed by higher housing market prices: in addition to the rising demand induced by the low interest rate environment, demographic processes, increasing wages and the government's housing support programme, the supply side is also expanding thanks to the regulatory environment.

Household credit-to-GDP in the CEE region



Source: ECB

In the Central and Eastern European region, household indebtedness is the highest in Slovakia at 35 per cent as a percentage of GDP. The Slovakian central bank identifies this as a risk: while in the euro area the size of the household loan portfolio represents 51 per cent of GDP, and the Slovakian level can be considered low in aggregate terms, the increase in indebtedness is concentrated in a certain age group, and based on income, it is mainly observable in the case of households with a median income level.

In a European comparison, it is a typical regulatory trend that macroprudential public authorities try to prevent future excessive indebtedness of households through debt cap rules. In Slovakia, Slovenia and the Czech Republic, the central bank fulfils this function, while in Poland the financial supervision is responsible. In Hungary, a mandatory rule has been in force since 1 January 2015, whereas central bank or supervision recommendations have typically entered into force over the past years in the other countries in the region. Regulatory authorities can prevent a debt overhang through requirements regarding collateral coverage, income proportionate repayments and other loan characteristics. Recommendations for new loans regarding the maximum loan-to-value (LTV) are in force in all four countries. However, the share of loans with a high LTV is still increasing in Slovakia, even after these rules came into effect. An income indicator, such as the payment-to-income (PTI) in Hungary, is in force only in Slovenia. Recommendations regarding the maximum maturity also appeared in Poland and in Slovakia, and in Poland the regulator suggested adjusting the loan currency to the currency of the client's income as the result of the issues with FX loans.

In terms of households, Hungary is at the bottom of the lending cycle, so it cannot be compared to the other countries of the region which are now taking measures to prevent excessive indebtedness. Nonetheless, although Hungarian regulations are in line with the European trends and prescribe limitations for similar indicators, they apply stricter debt cap rules than the regional economies, where the issue of avoiding excessive risk-taking and unhealthy indebtedness is a current one.

Macroprudential regulation against the excessive indebtedness of household

	Czech Republic	Poland	Slovenia	Slovakia
Loan-to-value	According to the central bank recommendation which entered into force on 1 October 2016, the LTV of newly disbursed housing loans may not exceed 95 per cent (from 1 April 2017 the limit will be reduced to 90 per cent). From 1 October 2016, new housing loans with an LTV between 85 and 95 per cent should not exceed 10 per cent (from 1 April 2017, new housing loans with an LTV between 80 and 90 per cent might not exceed 15 per cent).	Limit on LTV is 85 per cent from 2016; 85 per cent or 90 per cent if the part above 85 per cent is insured or collateralised with funds on bank account, government or NBP securities.	From 30 August 2016, recommendation on the maximum LTV of new housing loans is 80 per cent.	From 2014, according to the central bank recommendation, the LTV of newly disbursed housing loans should not exceed 100 per cent. From April 2016, new housing loans with an LTV between 90 and 100 per cent should not exceed 15 per cent (from 1 January 2017, the limit will be reduced to 10 per cent).
Payment to income	Banks should apply internal rules during credit scoring on loan-to-income (LTI) and debt service to income (DSTI).	From 2014 for creditworthiness assessment bank should set their internal DSTI limits, but financial supervision authority can challenge these limits. Banks should pay particular attention to loans for which DSTI ratios exceed 40 per cent (for borrowers with incomes below the average salary in the region) and 50 per cent (for other borrowers).	From 30 August 2016 the recommended maximum level of the DSTI ratio is 50 per cent for borrowers with monthly income less than or equal to EUR 1,700; and for borrowers with monthly income exceeding EUR 1,700: 50 per cent for that portion of income up to EUR 1,700 inclusive, and 67 per cent for that portion of income exceeding EUR 1,700.	Bank's internal systems should include an indicator containing household income, standard household living costs, and total debt servicing requirements.
Other	Recommendation on determining the financing of buy-to-let purchases of residential property, with an appearance of higher risk level, application of an LTV of 60 per cent at most. Other recommendations related to prudent credit standards.	Banks should recommend to their clients loans of maturity not longer than 25 years. If clients ask for loans of longer maturity, banks are recommended by the supervision authority to grant loans of maturity of maximum 35 years. The currency of the loan and the customer's income should be the same. In the case of customers receiving income in several currencies, the bank should ensure that the currency of the loan and the currency in which the borrower obtains the highest income in his total income considered, and in the case of other currencies, the bank should assume a possible depreciation by 20 per cent.		From March 2015, maximum maturity for new housing loans should be 30 years (with no more than 10 per cent of new loans exceeding this limit), for other new loans the limit is 8 years.

Source: ESRB, national central banks.

4. APPENDIX: NOTES ON THE METHODOLOGY

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, the press releases presenting the main data and the methodological descriptions of preparing the statistics are available on the MNB's website at: Website: http://www.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 of 11 banks were involved in the interviews. Nine banks responded to questions related to housing loans, while 11 banks and 7 financial enterprises answered questions on consumer loans. Based on data pertaining to 2016 Q3, with respect to housing loans, the surveyed institutions accounted for 84 per cent of the banking sector, while their percentage share in consumer loans was 86 per cent. 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 Q3 (compared to 2016 Q2), whereas the forward-looking questions concern the next half-year period, i.e. the one covering 2016 Q4 and 2017 Q1 (relative to 2016 Q3). This questionnaire was completed by senior loan officers between 1 and 17 October 2016.

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://www.mnb.hu/penzugyi-stabilitas/publikaciok-tanulmanyok/hitelezesi-felmeres

3. *The Financial Conditions Index (FCI)*[9]

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 nine 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

[9] 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).[10] 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.

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

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