SENIOR LOAN OFFICER SURVEY ON BANK LENDING PRACTICES

Summary of aggregate results of the survey on 2004 H2

March 2005

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Financial Stability Department

The latest, *fifth* survey on bank lending practices was conducted *at the beginning of 2005*. This analysis summarises the results. The retrospective questions of the questionnaire refer to 2004 H2, and thus the base period for these questions is 2004 H1, whereas the forward-looking questions contain projections for 2005 H1 compared to the trends of the previous half year. The questionnaire concentrates on two areas: the *household* and *corporate lending* segments. The total amount of loans outstanding in the individual market segments and the shares of responding banks are shown in *Appendices 1 and 3*.

When presenting the results, we follow the structure of the relevant questionnaire in both main lending segments. *Our examination of the reasons for the changes and processes reflects the explanations of senior bank officers rather than our own professional opinion. We try to explore how the senior bank officers questioned see and evaluate market processes and how banks formulate their strategies, and their lending policies in particular, on the basis of the senior officers' and owners' assessment of the situation.* In addition, we aim to find out the direction of the market by aggregating the individual micro-level answers.

To indicate the changes, we use the so-called *net change indicator*, expressed as a percentage of banks responding. We calculated this indicator by deducting from the number of persons projecting a change (tightening/growing/strengthening) the number of persons projecting the opposite (easing/decreasing/weakening) and dividing the result by the total number of persons responding (the answers are not weighted).

Evaluation of the aggregate results of the questionnaire

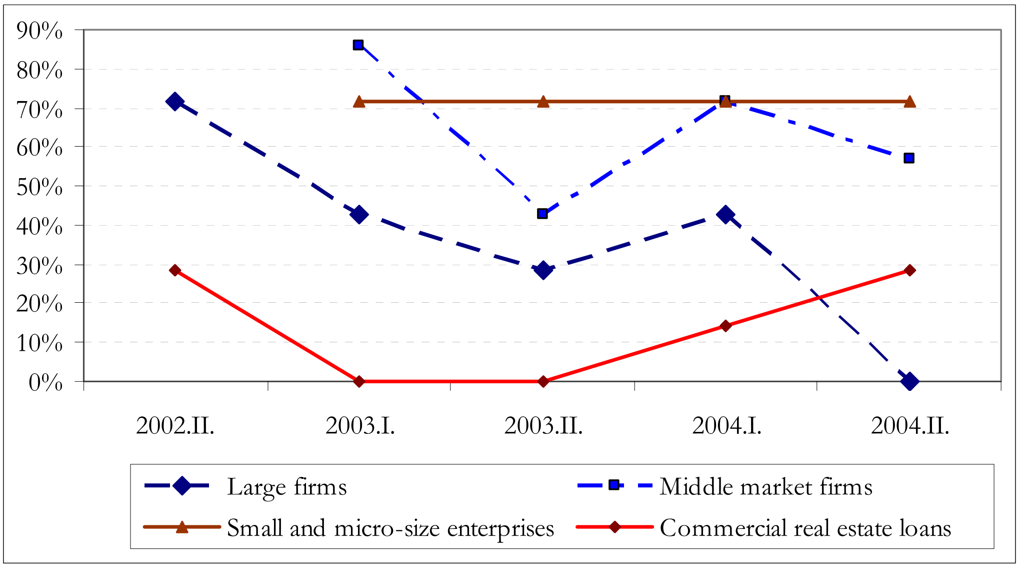
1. Corporate lending market

The standard structure of the questionnaire has not changed as compared to the previous half year. As far as the recent tendencies of corporate lending are concerned, we added two supplementary questions to the current survey on the solvency of non-financial companies and on the tendencies and risks of lending in foreign currency. The aggregate market share of the surveyed seven banks is 85% in the market of corporate loans (excluding commercial real estate loans) and 95% in the commercial real estate market.

In the corporate loan market, this is solely the segment of small and medium sized enterprises (*SMEs*) where banks anticipate the possibility of growth and where the competition for clients is increasingly strong. The market of loans to large firms and commercial real estate loans appears to be stagnating, reflected both in demand and supply.

The above tendencies are well indicated by the changes in the banks' willingness to lend (Chart 1): the majority of the banks reported an increase of their willingness to lend for small and micro-sized and middle-market firms in all of the surveys carried out so far. In 2004 H2, none of the surveyed institutions increased their willingness to lend for large enterprises, while in the case of commercial real estate loans, the willingness to lend increased slightly. For H1 2005 banks plan to ease standards and lending conditions for small and medium sized companies and they expect an increase of demand for loans in the segments of large companies and commercial real estate loans.

Chart 1: Willingness of the banks to lend in the different sectors of the corporate loans market



Reasons for and tendencies of lending in foreign currency

In the latest issue of the *Report on Financial Stability*, Magyar Nemzeti Bank highlighted the fact that the growth of the foreign currency denominated loans of non-financial companies was higher than that of loans denominated in forint, and its structure has also changed. While the ratio of euro-denominated loans is stagnating, the volume of Swiss franc loans is growing against loans denominated in US dollars. For this reason, in the current survey we have touched upon the reasons of the growth of foreign currency loans and the degree of foreign currency indebtedness of the companies without natural hedge.

The volume of foreign currency loans to companies has increased at each surveyed bank and it is a general tendency that the ratio of the loans denominated in Swiss franc or euro is significant in the new lending. As far as the reason for this growth is concerned, each senior loan officer mentioned the interest rate differential and the lower repayment rate as being primary, adding that companies have confidence in the stability of the exchange rate. It is mainly SMEs whose demand for foreign currency – almost exclusively Swiss franc – loans increased, but these are also those companies which usually have no foreign currency income.

Each surveyed senior loan officer mentioned that having income in foreign currency is taken into account as a positive factor in the decision about the credit accommodation. If there is no foreign currency denominated income, supplementary collateral is required. In addition, some of the banks introduce hedge instruments which can be purchased by the enterprises.

Liquidity and solvency of non-financial firms and changes in arrears

In accordance with the conclusion of the earlier *Report on Financial Stability*, the other problem concerning loans to non-financial companies concerns the worsening of the loan portfolio. That is why the loan officers were asked during the interviews whether they perceived liquidity problems or delays in the payback of the credit in the corporate sector.

From the seven surveyed banks, six had such experience, almost unanimously in the construction industry and among SMEs. As an explanation of the payment delays developing in connection with commercial loans in the construction industry, bank officers said that large companies – because of real liquidity problems or abuse of their power – fall into delay against their subcontractors, who consequently delay their loan repayments or apply for prolongation. Besides the construction industry, liquidity problems arose in the agriculture sector and in the whole SME sector as a result of the reservation of area-based support and, respectively, the reservation of VAT.

In summary, the above problems materialized in two forms: first, increase of the loan demand from enterprises, and second, a worse loan portfolio. Banks expect the continuation of the current tendencies and partial market clearing in the construction industry.

1.1. Corporate lending, excluding commercial real estate loans
(questions 1-9 of Appendix 2)

Supply side

Non-financial enterprises as a whole

As far as non-financial companies are concerned, 57.1% of the banks reported that their propensity to lend has increased. This ratio is lower than it was previously, but it is still considered to be high. The index can be totally explained by the opening towards SMEs; none of the banks increased their willingness to lend towards large enterprises. Creditworthiness standards eased in the case of 28.6% of the banks (2 institutions), while others left them unchanged as a whole.

Conditions of providing loans were eased as a whole, except for the premium on risky loans, which was tightened. Nevertheless, this latter also reflects the change in relation to the earlier tendency: while previously 71.4% of the surveyed banks reported tightening, now this ratio is not more than 14.3%. The increasingly fierce competition of banks and non-bank lenders, and the increasing tolerance for risk were the main reasons for easing. More favourable economic conditions also were mentioned, but with less weight.

In 2005 H1 only one bank plans to ease lending conditions. Significant changes will not be implemented at the remaining institutions. The maximum size of credit lines is planned to be eased in case of 42.9% of the responding banks. Decrease of the spread was forecasted by one bank, while the interest rate premium is to be increased by two institutions.

Large enterprises[1]

The willingness of the banks to lend to large enterprises and the creditworthiness standards towards them has not changed as compared to the previous half year. Significant revision of lending conditions was not carried out either. Only the spread between credit rate and funding costs has changed in a net sense, as one bank reported its decrease.

[1] Classifications into corporate categories still vary among banks, and bank officials provide the extent and direction of the changes for the categories used by themselves. Therefore, corporate size as shown by the questionnaire is not unambiguous at all, which must be taken into account when evaluating the results.

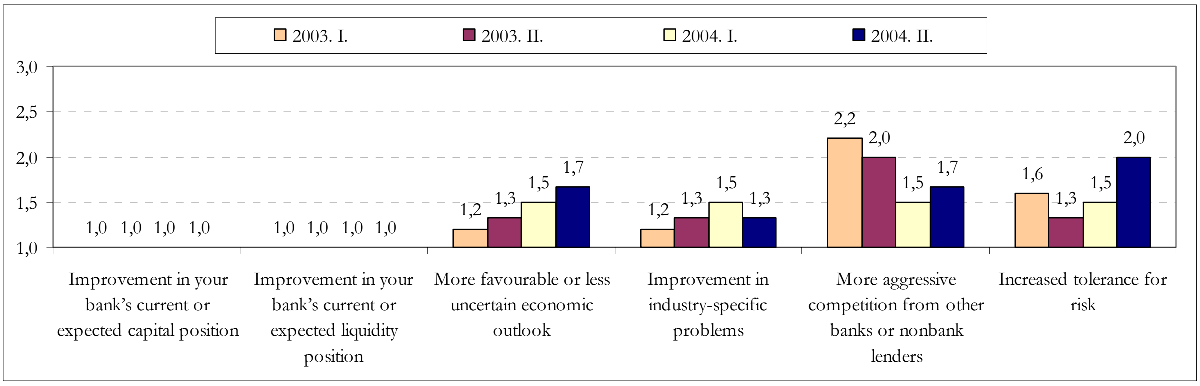
For the following half year, banks plan to leave creditworthiness standards unchanged, and tighten the lending conditions as a whole. When banks tighten one or other condition, they do it across all categories of size, not only in the case of large companies. Nevertheless, as far as SMEs are concerned, easing of other conditions offsets this tightening, in contrast with large enterprises.

Small and medium sized enterprises

The majority of the banks reported that their willingness to lend to both middle-market firms and small and micro-sized enterprises had increased. Creditworthiness standards and all of the credit conditions were eased, except for the premium on risky loans, which was increased by fewer banks than before. The main reason for easing was the competition, but a more favourable economic outlook has also contributed to this tendency. Finally, increasing tolerance for risk was also listed as a significant reason to ease.

For the forthcoming half-year, banks have scheduled a further easing of creditworthiness standards and credit conditions in both categories, mainly for small and micro-sized companies.

Chart 2: Reasons for easing creditworthiness standards and lending conditions in the case of small and micro-sized enterprises (1 = not significant; 2 = somewhat significant; 3 = very significant)



Demand side

Non-financial enterprises as a whole

In 2004 H2 57.1% of the surveyed banks reported that the demand for loans increased in the non-financial corporate sector, and this was lead first of all by SMEs. It has to be highlighted that banks had difficulties in explaining the increase in the number of loan applications with supply-side or demand-side reasons. This can be illustrated by the fact that aggregate demand was usually reported to be unchanged, while higher demand at a single bank was explained by a supply-side shift. In addition, as a main reason of higher demand for loans, banks mentioned the increasing financing needs of claims and investment in plant or equipment.

As far as the forthcoming half year is concerned, banks expect moderately stronger loan demand from non-financial companies.

Large enterprises

Two of the surveyed banks perceived higher loan demand from large enterprises in 2004 H2 than previously, while one bank reported that the demand had decreased. Those perceiving higher demand explained this by increased investment and inventory financing needs.

For 2005 H1, 71.4% of the banks participating in the survey expect that the demand for loans will rise.

Small and medium enterprises

In 2004 H2, 42.9% of the banks perceived increased loan demand from middle market firms, 71.4% from small and micro-sized companies. Investment in plant or equipment and increasing financing needs of claims – the latter explained by commercial loans in the construction industry, reservation of VAT and delays in payment of sums obtained on tenders – were mentioned as main reasons for higher demand. Some of the loan officers reported that agents turned to his or her bank from other institutions. As far as middle market firms are concerned, an increase of inventory financing needs played an important role, too.

As far as the following period is concerned, the majority of the banks (85.7%) expect further rising loan demand from middle market firms, somewhat less (57.1 % of the responding banks) from the side of small and micro-sized enterprises.

Chart 3: Reasons for increasing loan demand of middle-market firms (1 = not significant; 2= somewhat significant; 3 = very significant)

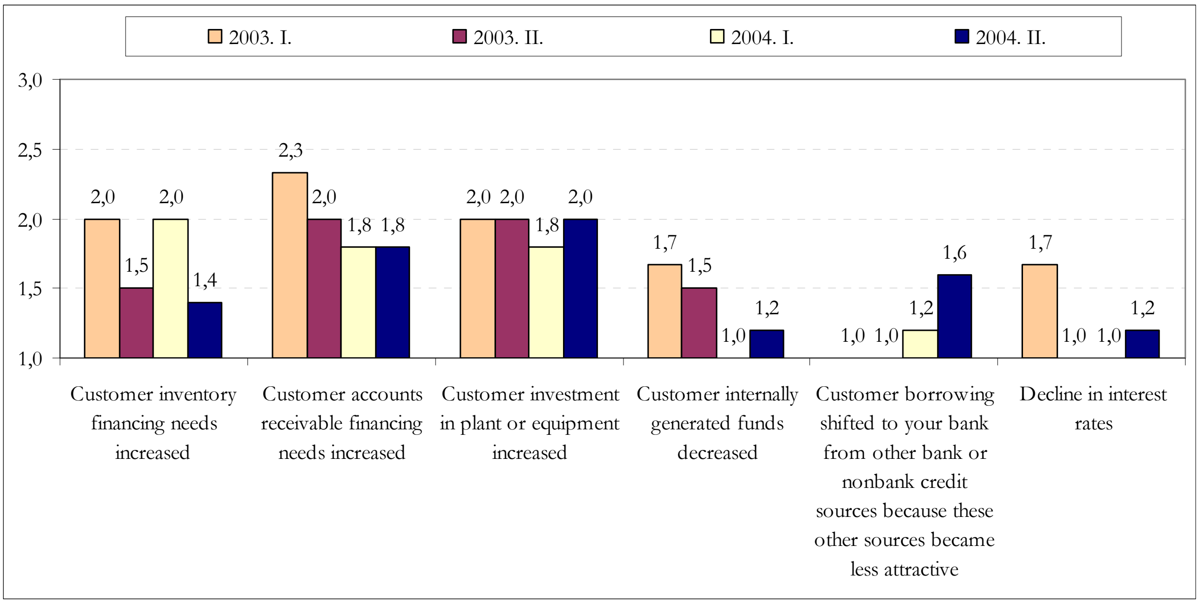
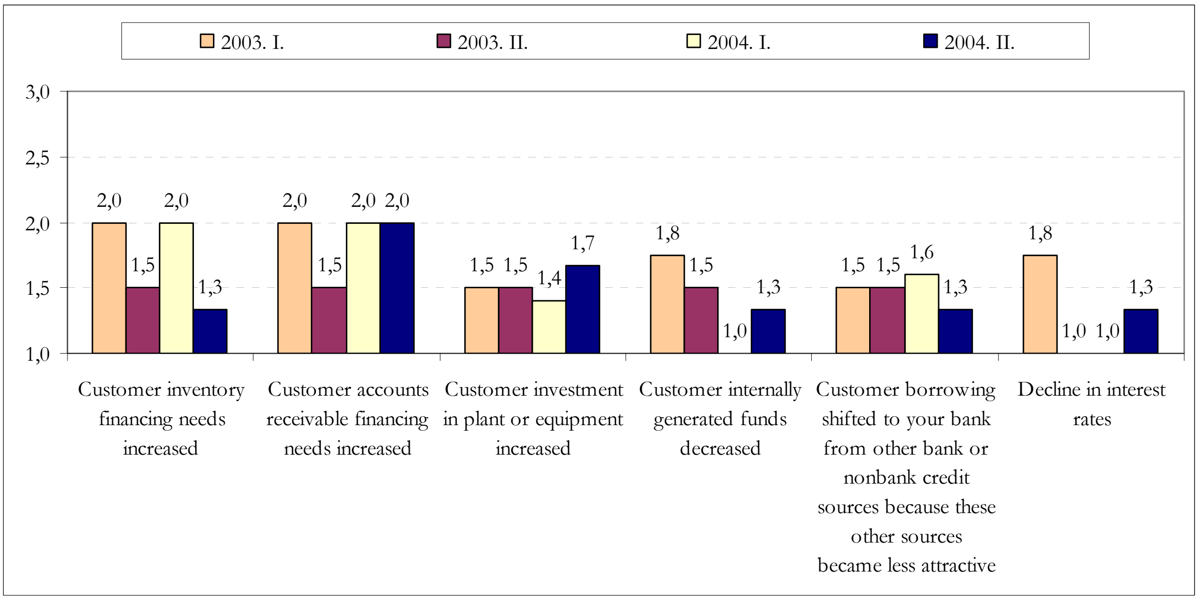


Chart 4: Reasons for increasing loan demand of small and micro-sized firms (1 = not significant; 2 = somewhat significant; 3 = very significant)



1.2. Commercial real estate loans
(questions 10-15 of Appendix 2)

Supply side

The willingness of the banks to grant commercial real estate loans remained rather unchanged in 2004 H2, with only two banks giving an account of a higher willingness to lend. One bank eased creditworthiness standards, explaining this decision by stronger competition. In the forthcoming half year, there is also only one institution planning to ease standards.

The above reflects the continuation of the saturation of this market. This is strengthened by the fact that (although in the questionnaire we asked only about commercial real estate loans granted for residential agents) some of the banks reported that they are expanding abroad, meaning that they find a possibility of growth mainly in the markets of the neighbouring countries.

Demand side

A net 28.6% of the banks perceived higher demand for commercial real estate loans, but this reflects a high diversity of the answers, just as previously. One surveyed loan officer reported significantly higher, two somewhat higher, and two somewhat lower demand. As far as the next half year is concerned, the banks almost unanimously expect higher demand.

1.3. Change in credit risk assessment of the various industrial sectors
(question 16 of Appendix 2)

Comparing the answers of banks participating in the survey with earlier results, we found that while in 2004 H1 risk assessment of all sectors became safer, now the number of those banks increased again which considered corporations more risky.

The worsening of the risk assessment was most visible in agriculture and the construction industry. As far as agriculture is concerned, banks mentioned delays in payment of funds, problems of the food processing industry and the current clearing of the market as the main reasons behind increasing risks. An increase of commercial loans was perceived by all responding banks, but they also saw signs of market clearing, which can improve risk assessment in the future.

Manufacturing industry as a whole was not judged to be much more risky than before, but some sub-segments, primarily the food processing industry, were considered to be significantly more problematic as compared to the previous surveys. There were, however, several sub-sectors in manufacturing industry which became safer, but this was not enough to improve the aggregate assessment.

Chart 5: Risk assessment of industries (average ratings: 1 = became significantly more risky; 2 = became somewhat riskier; 3 = remained almost the same; 4 = became somewhat safer; 5 = became significantly safer)

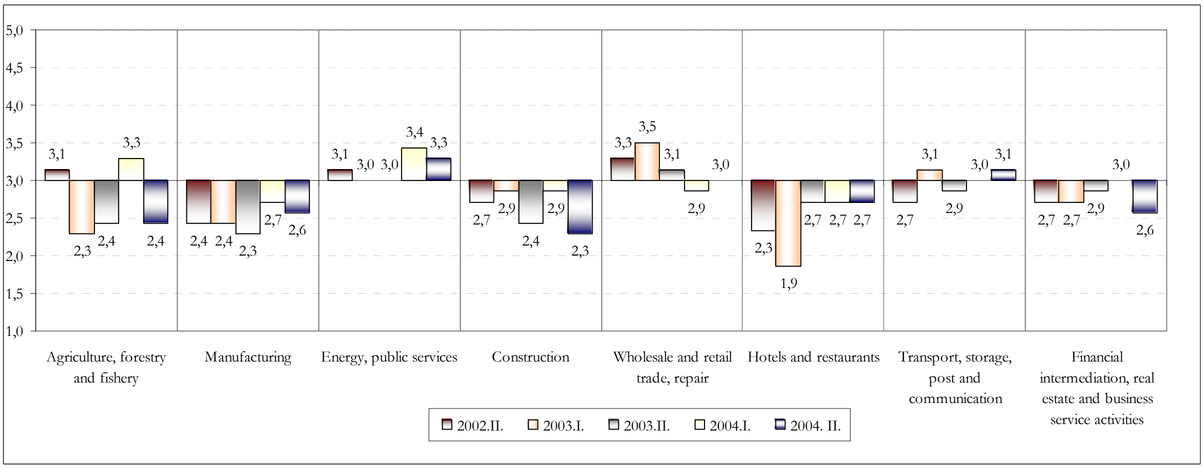
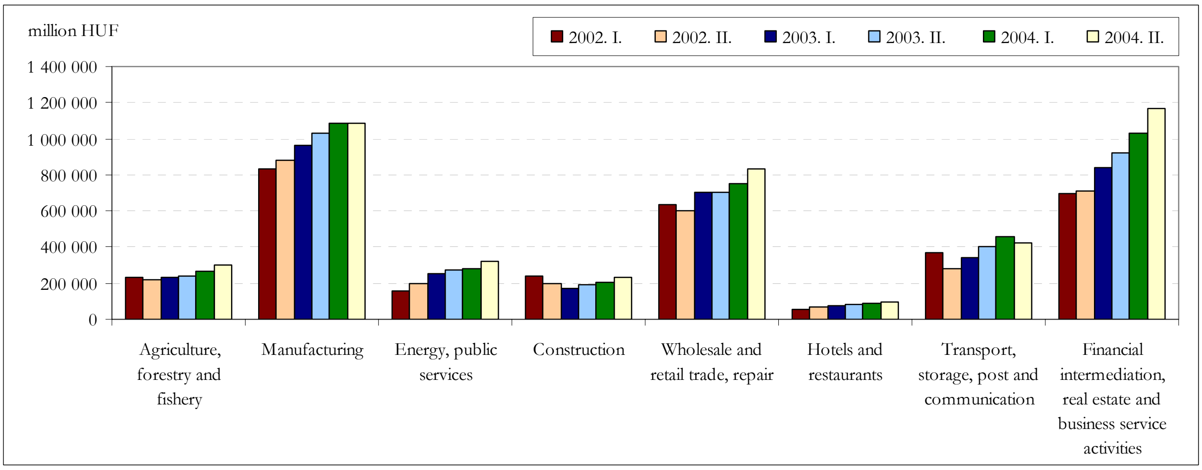


Chart 6: Sectoral structure of loans to non-financial firms



2. Household lending market

The questionnaire on the household lending market was expanded. In addition to housing and consumer loans we also examined the lending behaviour of financial enterprises owned by banks – in fact the car leasing enterprises – in a new part, the questions and the structure of which are the same as that of the housing and consumer loans part. We asked loan officers of banks to answer these questions, five of those invited to fill in the questionnaire on household loans were able to do this.

The results were aggregated for the market of housing and consumer loans as previously, and the answers about car purchase leasing were examined together with those of the banks' financing car purchase loans.

The market share of the seven banks filling in the questionnaire on housing loans is 88.15%, that of the 10 banks answering the questions on consumer loans is 85.65%.

The last half year was characterised by an easing of the creditworthiness standards and lending conditions in both the housing and consumer loans market (Chart 7), and the continuation of this trend is expected for the forthcoming period. The willingness of banks to lend increased in both markets, albeit in the case of fewer institutions than before. As far as loan demand is concerned, one third of the responding banks expect it will be higher in 2005 H1.

We found that it was mainly the volume of loans denominated in foreign currency that increased on both markets, and loan officers also reported that 90-100% of the new foreign currency loans is denominated in Swiss franc. The ratio of foreign currency to forint loans in new loans differs largely among banks, but at several institutions the ratio is around 80-100%.

Chart 7: Creditworthiness standards in the housing and consumer credit market (ratio of those tightening minus those easing the standards)

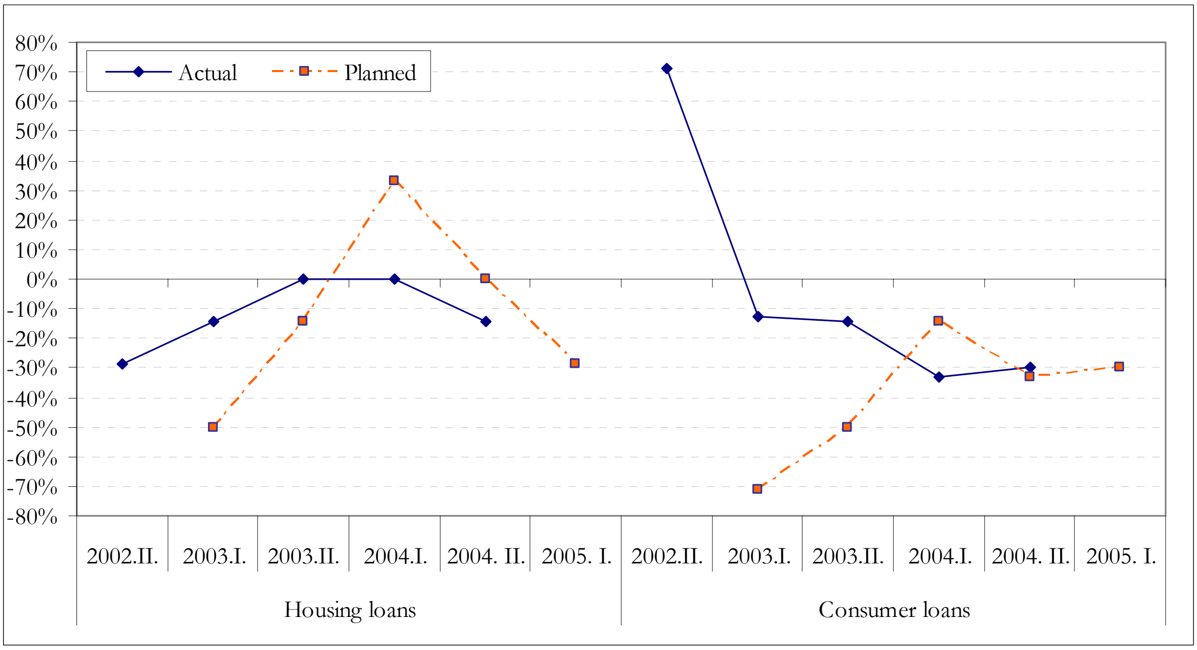
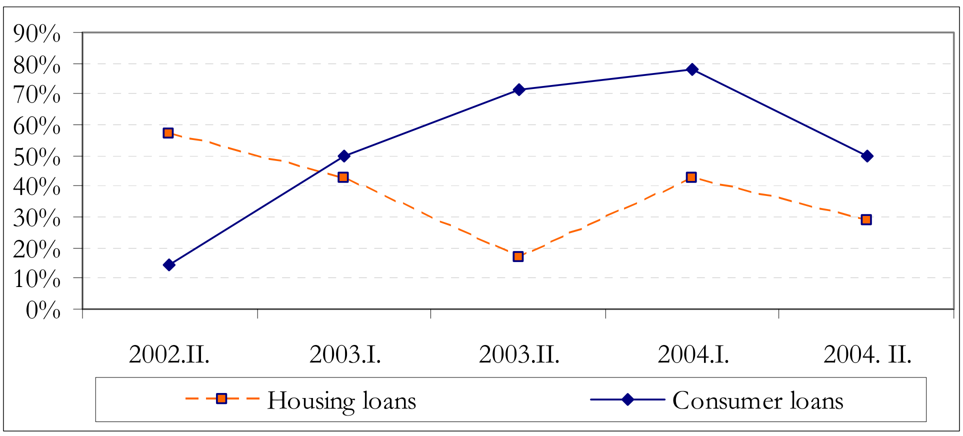


Chart 8: Willingness of the banks to lend in the housing and consumer credit market (ratio of those banks reporting higher demand minus those reporting lower demand)



2.1. Housing loans
(Question 1-10 of Appendix 4)

Supply side

Compared to the previous surveys, fewer banks (28.6%) reported a greater-than-before willingness to lend. Creditworthiness standards eased in the case of one institution and remained unchanged at the remaining banks. Each lending condition was eased by at least one bank, and other conditions, not listed in the questionnaire were also eased. The main reason for this tendency was competition, which became more aggressive. It is to be highlighted that – as opposed to the previous surveys – none of the banks reported an improvement in the creditworthiness of the agents. Banks rather perceived or expect its worsening.

Despite this, for 2005 H1 banks again plan to ease – moderately or significantly – creditworthiness standards (28.6% of the responding banks in net terms).

Demand side

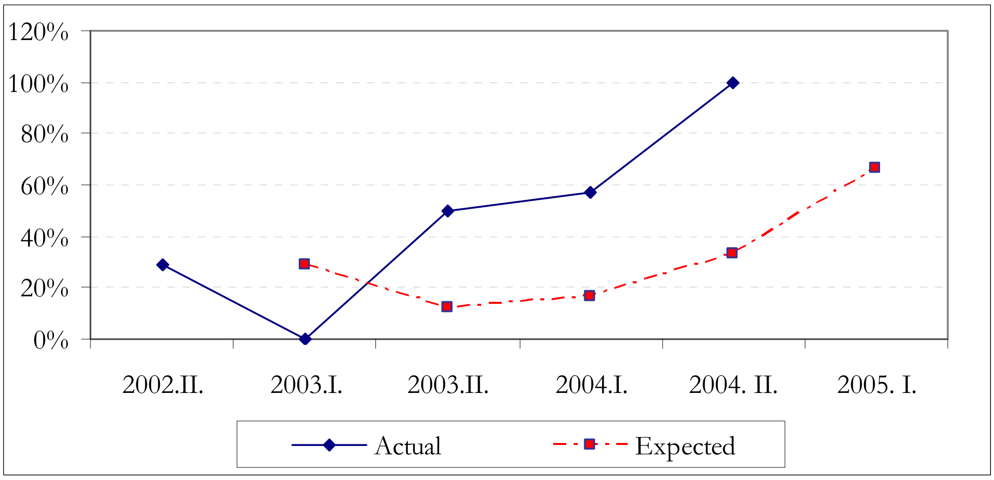
While in 2004 H1 almost all the surveyed loan officers gave reported a drop in demand, in 2004 H2 the expected significant growth was realised. Significant increase in demand was perceived by 28.6% of the surveyed banks (2 institutions), moderate increase by 14.3% (1 bank), and decrease by one bank.

Expectations for 2005 H1 vary: the majority of the banks expect a moderate increase, but there are also expectations for unchanged or lower demand. As a net ratio, 28.6% of the banks foresee stronger demand, partially in connection with the now started government programme called "*Fészekrakó*", the expansion of which is anticipated.

Nominal house prices

Nominal flat prices were perceived higher in the previous half year than in 2004 H1. Almost all of the interviewed loan officers made a distinction between new and existing flats: the increase of the price of the latter was judged to be lower or zero. For 2005 H1, 83.3% (in net terms 66.7%) of the respondents expect a further increase of flat prices. Thus the number of banks anticipating higher prices increased.

Chart 9: Nominal flat prices according to Loan Officers (ratio of those reporting higher minus those reporting lower prices)



2.2. Consumer credit
(questions 11-15 of Appendix 4)

The number of banks invited to fill in this part of the questionnaire increased in relation to both 2004 H2 and 2005 H1 by one bank each. The growth of the number of banks with significant market share reflects stronger competition.

Supply side

As far as consumer loans are concerned, the propensity of banks to grant loans increased – in some cases significantly. In the second half of 2004, or rather during the whole year, one third of the banks eased creditworthiness standards, and lending conditions were also eased. Sixty per cent of the respondents increased the maximum sum of loans, a net 40% of them lowered spread between loan interest rates and funding costs and minimum initial downpayment (if there is any). In addition, the other conditions not listed in the questionnaire were eased (for example the maximum maturity was increased). A significant part of the market was affected by easing in 2004, caused almost exclusively by stronger competition. Loan officers perceived that higher competition came first of all from the side of banks, or that easing was mainly lead by this factor. Competition from non-bank lenders was also mentioned as a reason, but less remarkably than previously.

In the forthcoming half year banks plan to further ease standards (a net 30% of respondents) and they anticipate stronger competition.

Demand side

Demand for consumer loans – probably in connection with stronger competition – was perceived differently by the banks: six of them reported stronger, two weaker, and two unchanged demand. As far as the forthcoming half year is concerned, the answers differ too: a net 30% of the banks anticipate stronger demand, but decline or stagnation was forecasted by some institutions apart from seasonal effects.

2.3. Car purchase loans

The aggregate market share of car leasing companies of those banks which filled in the questionnaire on financial companies and banks involved in car purchase loans is about 50%. Half of the loan officers interviewed reported that their willingness to lend had increased, but one bank's propensity to lend dropped in the second half of 2004. A net 16.67% of respondents eased creditworthiness standards. Lending conditions as a whole were eased: primarily institutions increased the maximum sum of loans, decreased the spread and the minimum initial down payment if there is any. Other conditions not listed in the questionnaire were also eased.

There were two institutions where creditworthiness standards and lending conditions were tightened as a whole, the main reasons being the higher risk of the collateral or other causes not listed in the survey. The majority of institutions eased their standards and conditions, explaining this by competition.

In 2005 H1 institutions plan to hold unchanged or ease somewhat their creditworthiness standards (a net 33.3% of respondents plan to ease) as compared to 2004 H2.

Demand for car purchase loans was perceived to be higher by half of the respondents, and lower by the remaining part. For the first half of 2005 the majority of the institutions anticipate a – moderate or significant – fall in loan demand; two of them, however, expect an increase.

CHARTS ON THE VOLUME OF LOANS AND ANSWERS TO THE QUESTIONNAIRE

Chart 10: Shares of responding banks within the total corporate lending portfolio (excluding commercial real estate loans)

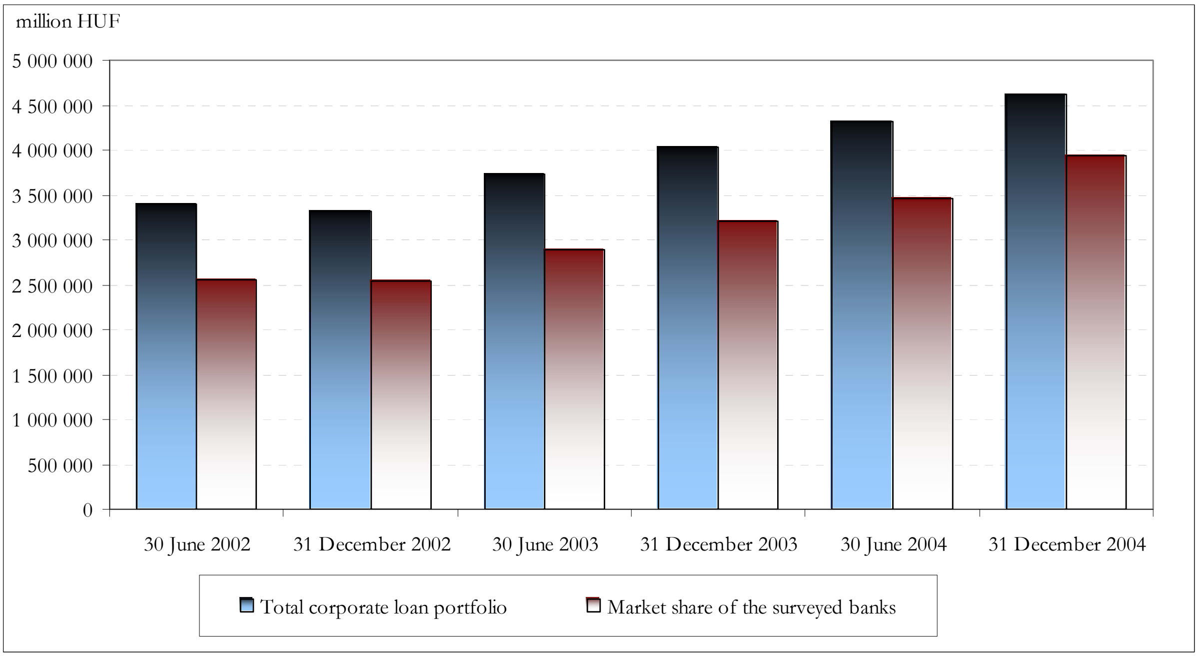


Chart 11: Share of responding banks in commercial project loans within the total project loan portfolio

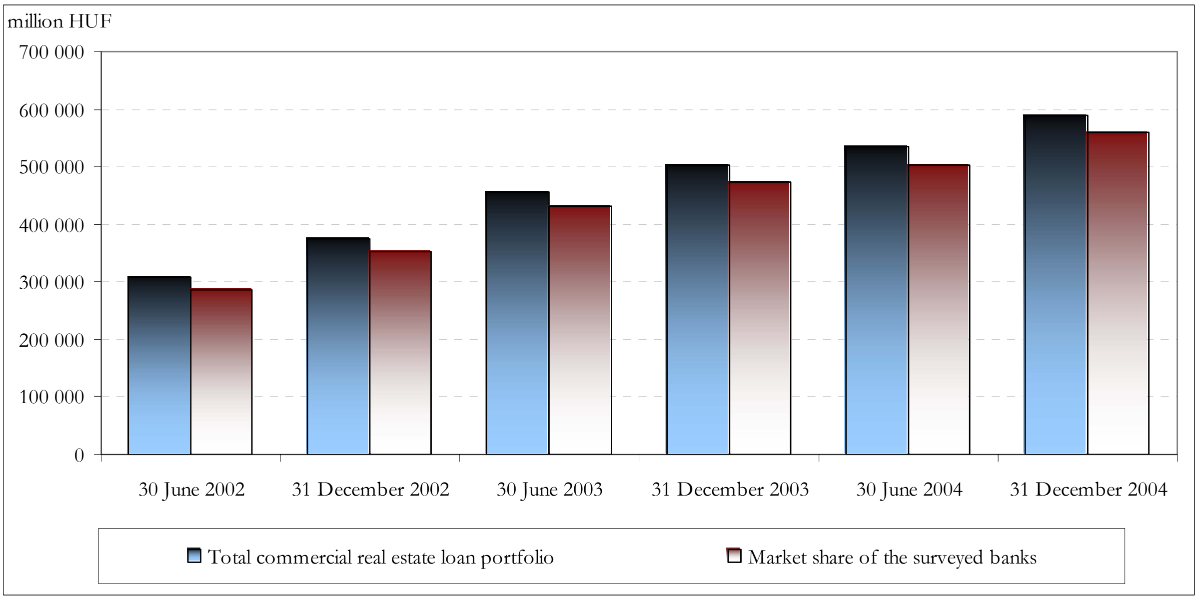


Chart 12: Creditworthiness standards by corporate category and in the field of commercial real estate loans (ratio of those reporting tightening minus those reporting easing)

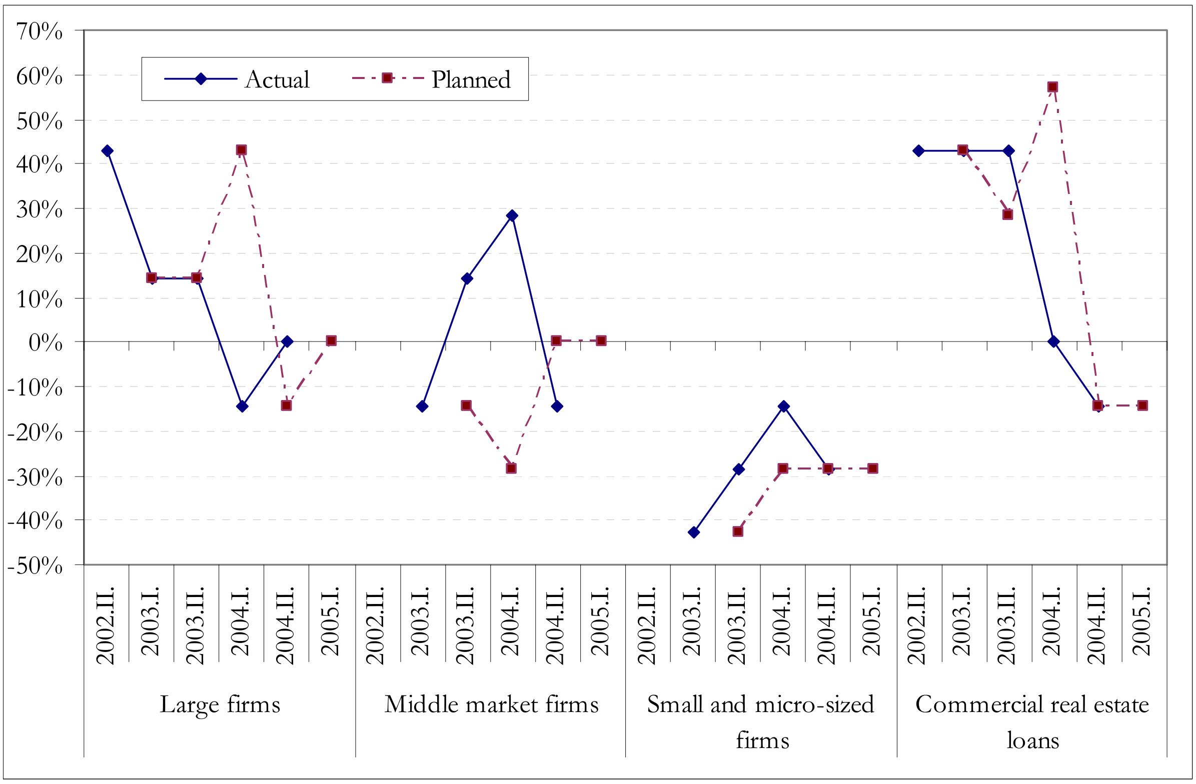


Chart 13: Maximum size of loans/credit lines by corporate category (ratio of those reporting tightening minus those reporting easing)

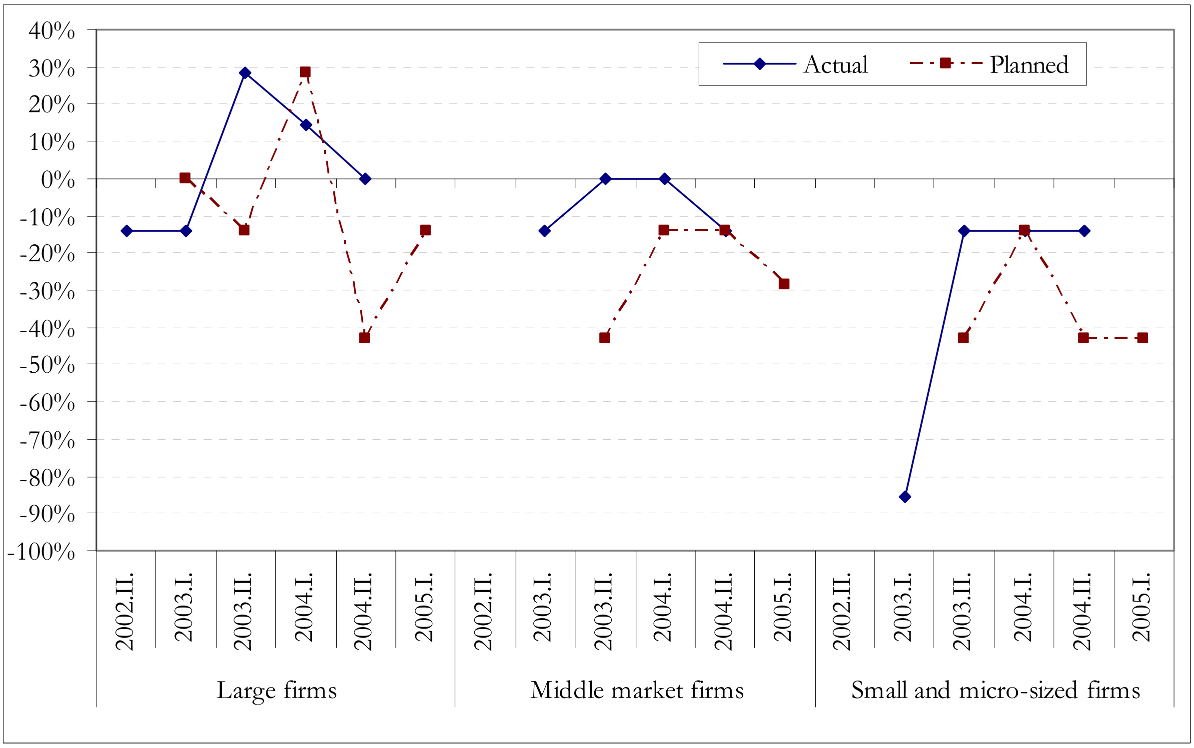


Chart 14: Spread between lending rates and costs of funds in a breakdown by corporate category (ratio of those reporting tightening minus those reporting easing)

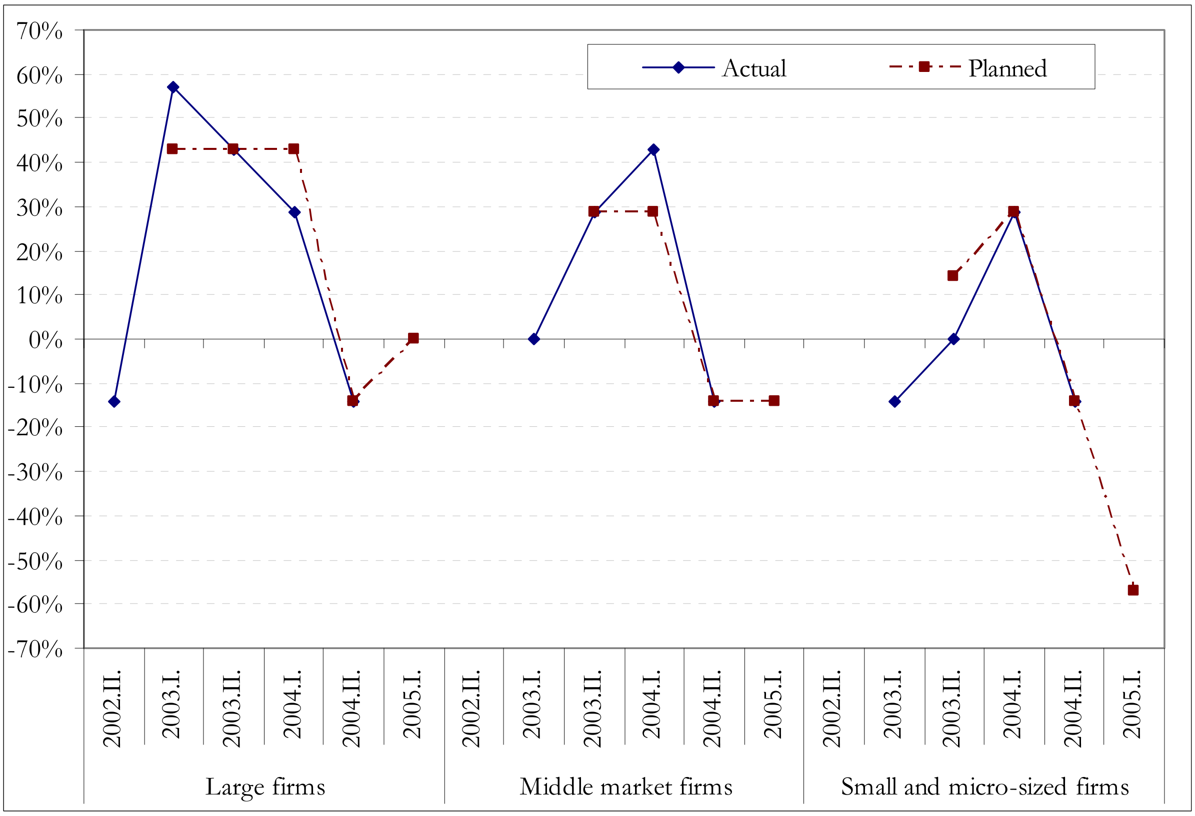


Chart 15: Premium on higher-risk loans in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

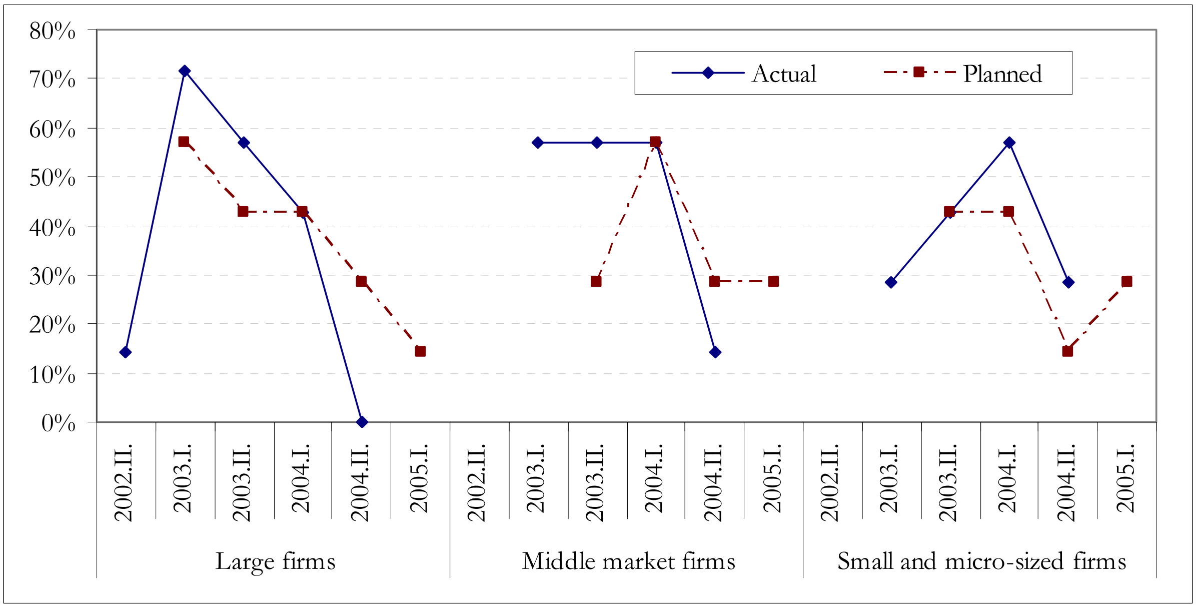


Chart 16: Demand for loans in a breakdown by corporate sector and in the market of commercial real estate lending (ratio of those reporting an increase minus those reporting a decrease)

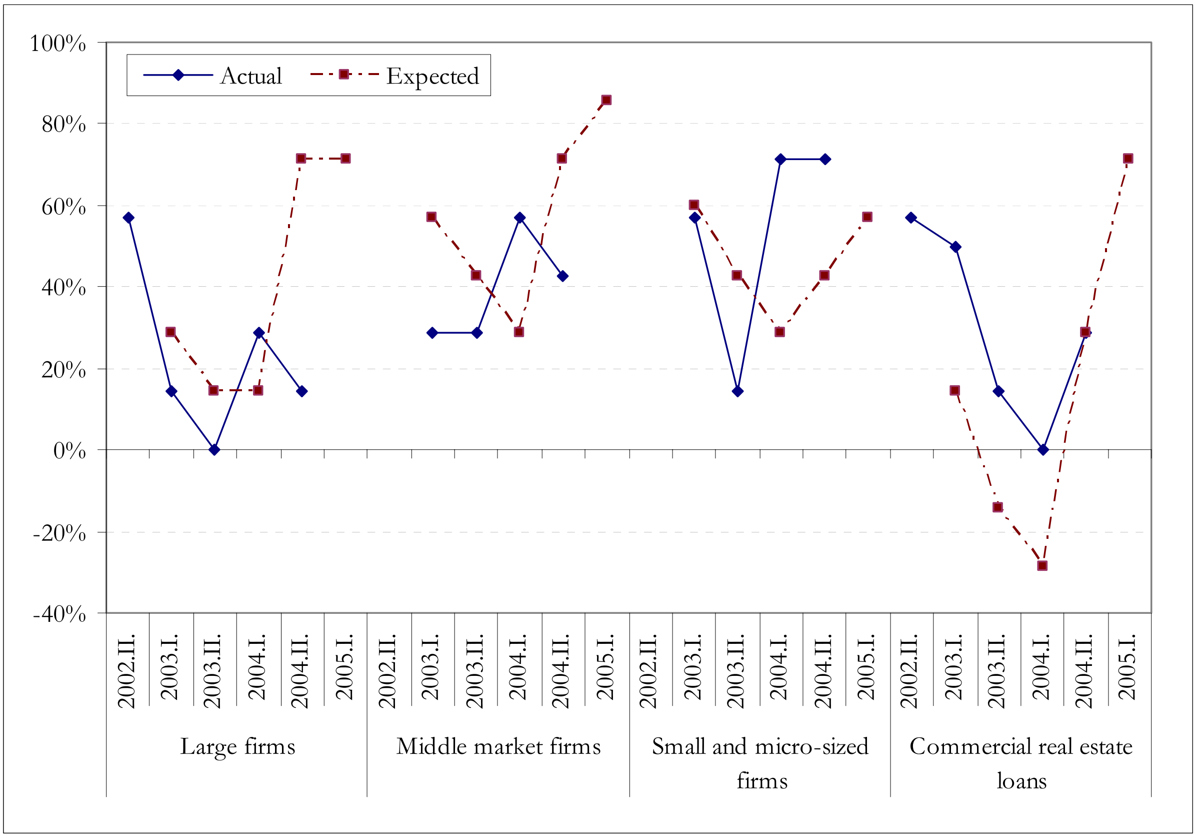


Chart 17: Market share of banks answering the questions relating to housing loans

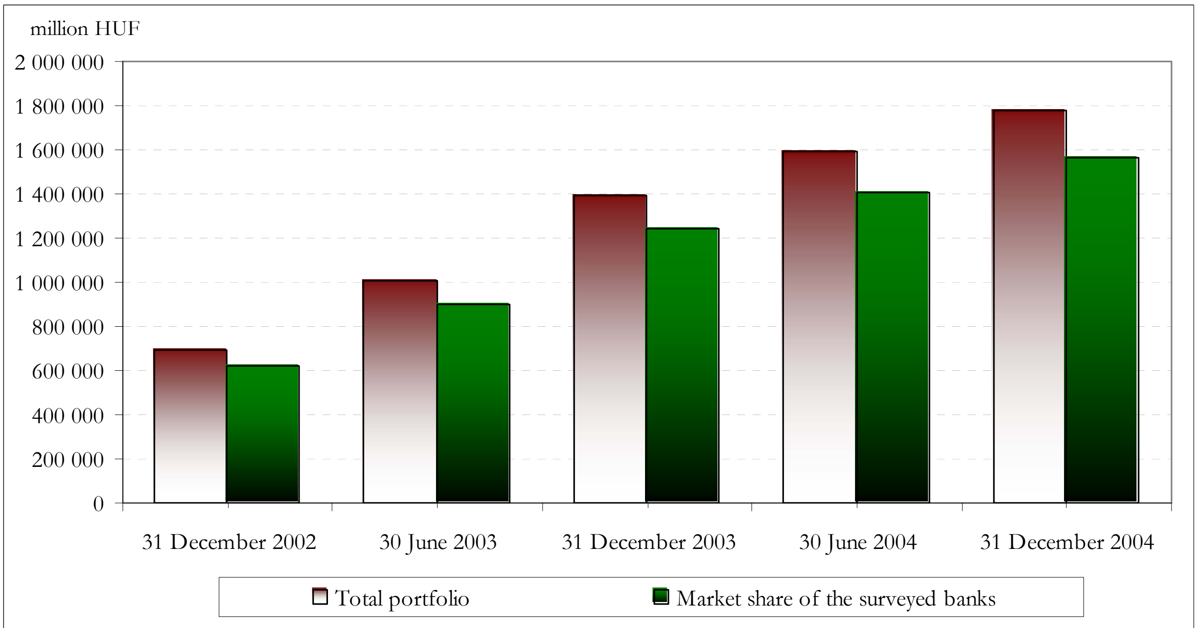


Chart 18: Market share of banks responding to questions relating to consumer credit (8 banks until December 2003, 9 banks in June 2004, 10 banks in December 2004)

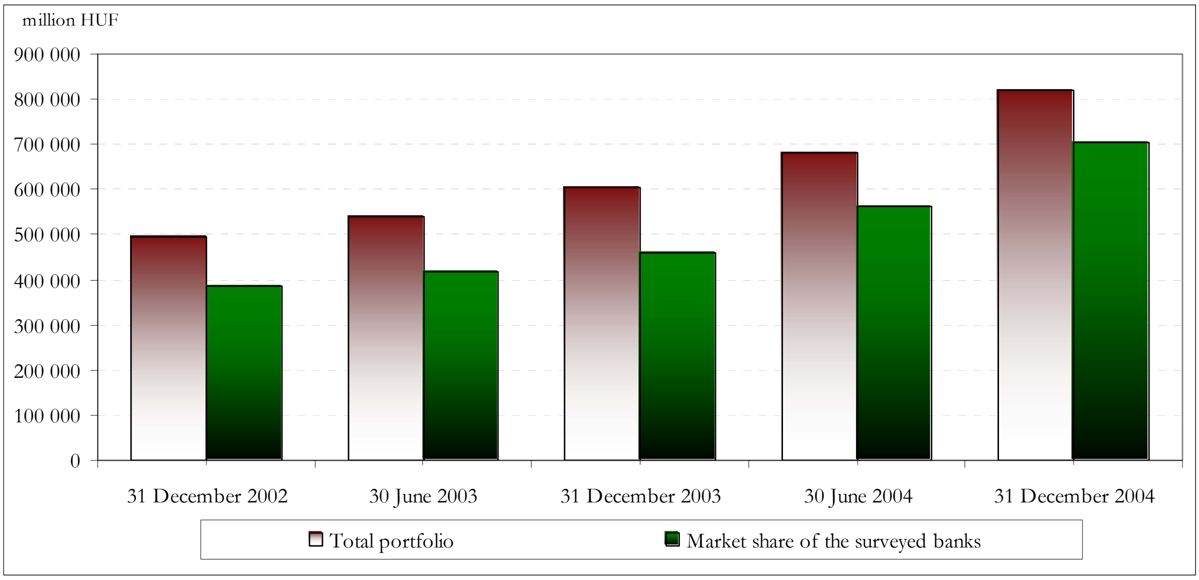


Chart 19: Lending conditions in the market of housing loans (ratio of those reporting tightening minus those reporting easing)

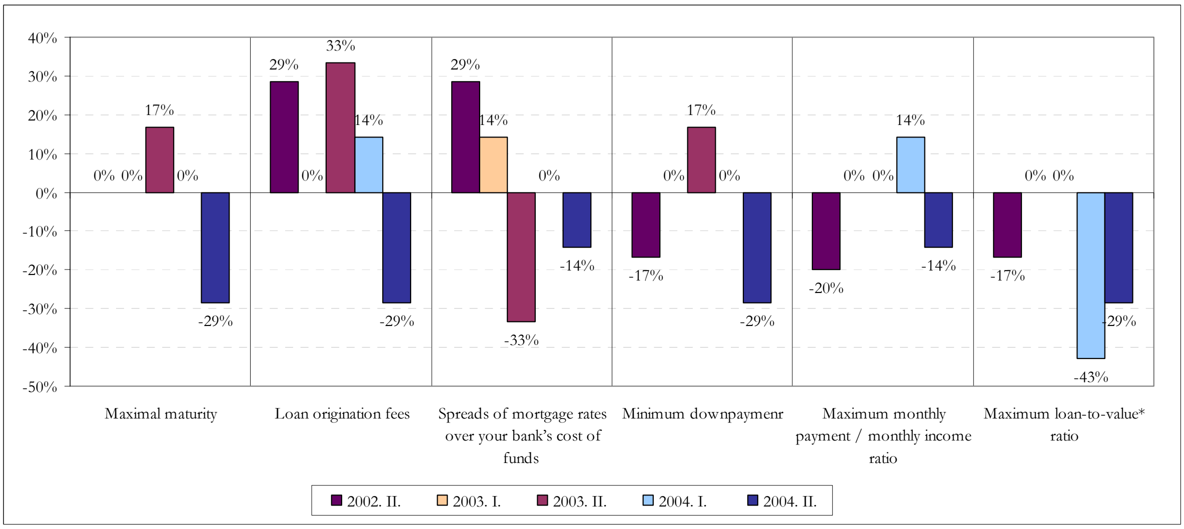


Chart 20: Reasons for relaxing creditworthiness standards and lending conditions in the case of housing loans (1 = not significant; 2 = somewhat significant; 3 = very significant)

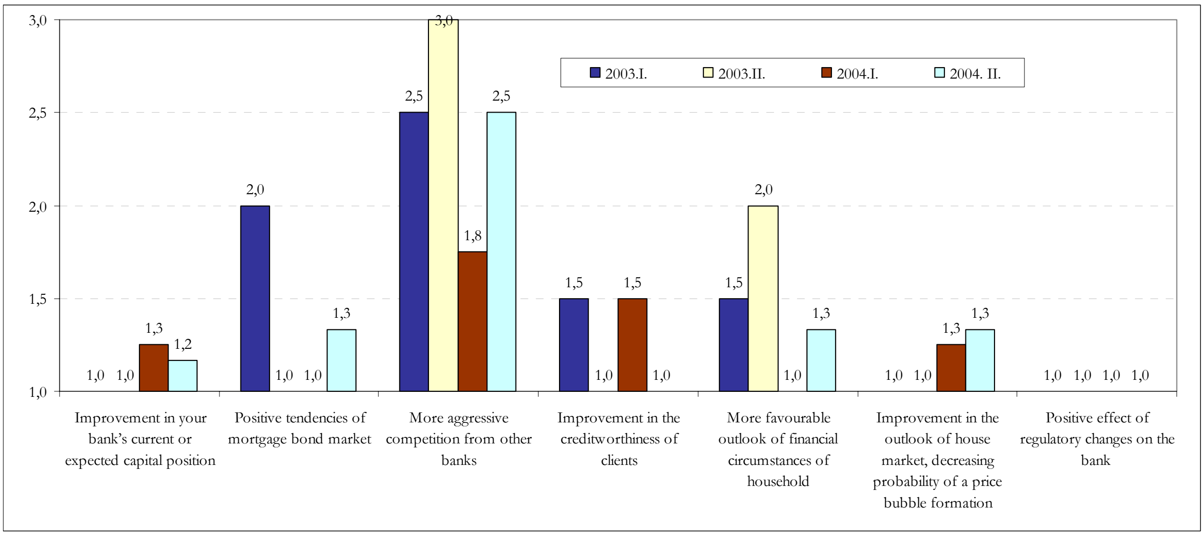


Chart 21: Lending conditions in the consumer credit market (ratio of those reporting tightening minus those reporting easing)

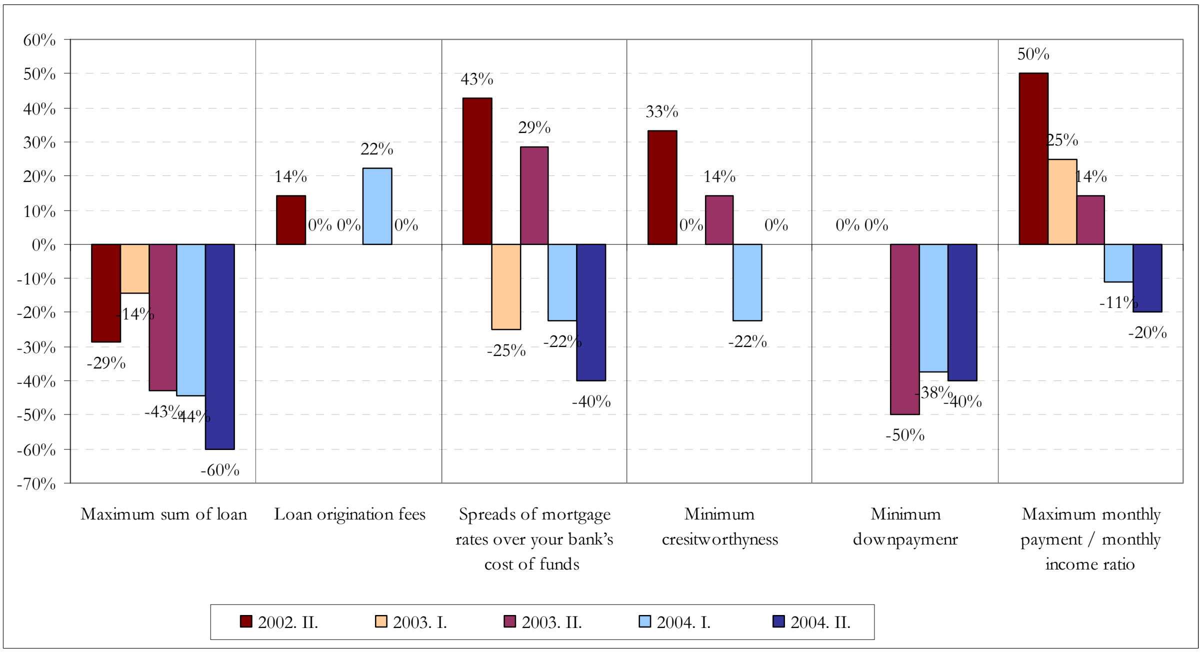


Chart 22: Reasons for relaxing creditworthiness standards and lending conditions in the consumer credit market (1 = not significant; 2 = somewhat significant; 3 = very significant)

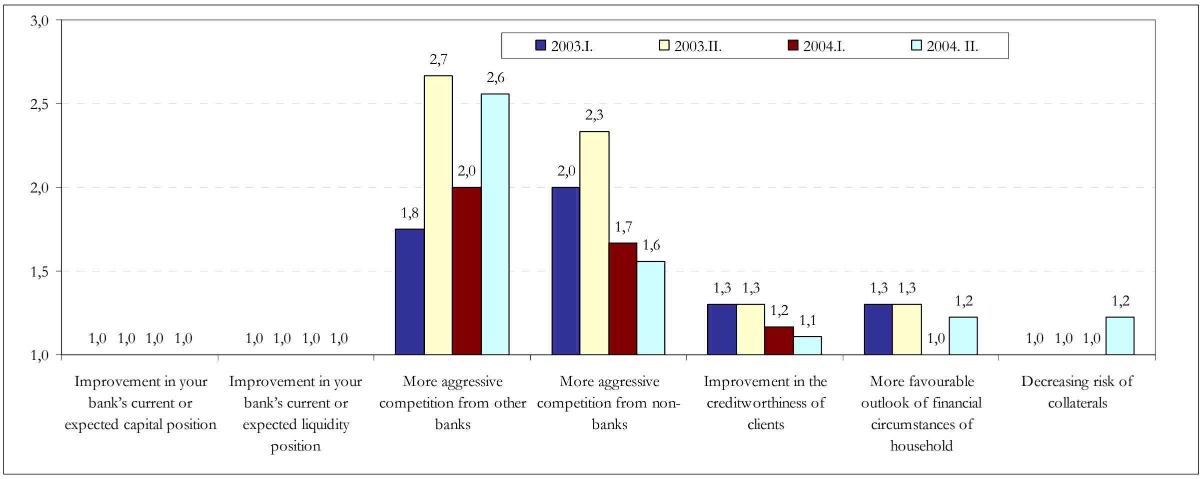


Chart 23: Demand for loans in the housing loan and consumer credit markets (ratio of those reporting an increase minus those reporting a decrease)