Senior loan officer survey on bank lending practices

Summary of aggregate results of the survey on 2005 H1

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of the

Financial Stability Department

The latest, *sixth* survey on bank lending practices was conducted in *July 2005*. This analysis summarises the results. The retrospective questions of the questionnaire refer to 2005 H1, and thus the base period for these questions is 2004 H2, whereas the forward-looking questions contain projections for 2005 H2 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).

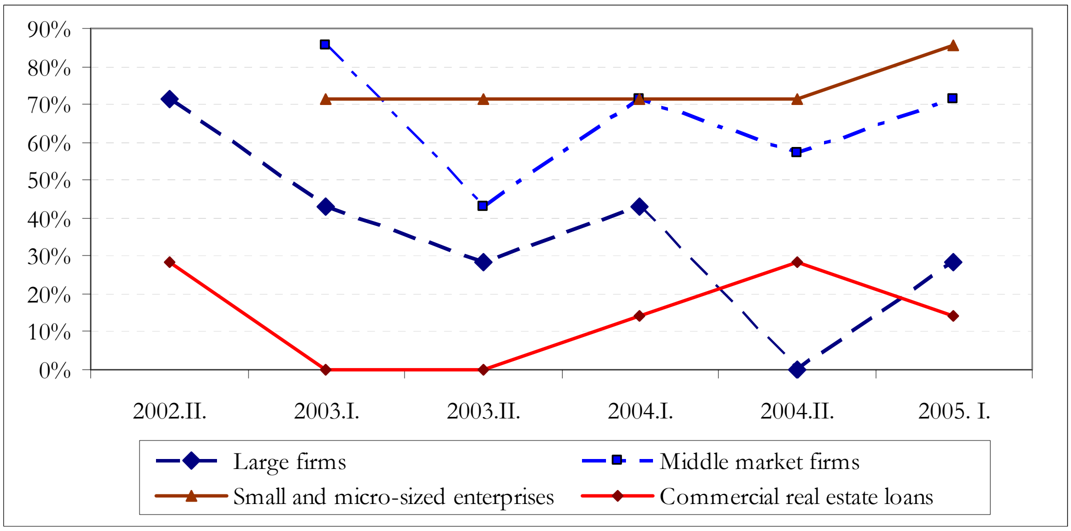
Evaluation of the aggregate results of the questionnaire

1. Corporate lending market

The standard structure of the questionnaire on corporate lending has not changed as compared to the previous half year. The questionnaire was completed by seven banks the market share of which is 85% on the market of corporate loans excluding commercial real estate loans. The market share of the surveyed banks on the commercial real estate loans market is 96% (see Chart 11 and Chart 12).

According to the general opinion of the surveyed loan officers, there were no radical changes on the corporate loans market in the first half of 2005. Banks still compete actively in the small and medium sized enterprises (SMEs) sector: banks' propensity to lend has increased continuously, but the demand for loans stagnates. As far as lending to large enterprises and commercial real estate loans are concerned, both supply and demand stagnated and as a response, banks plan to tighten their lending policy in the second half of the year.

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



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, 86% of the banks reported that their willingness to lend increased, which reached the highest rate during the last period. Only one bank reported change of the creditworthiness standards and each lending condition. As a whole, there are some sign of easing, except for the risk premium which was increased by 3 of the 7 surveyed banks in the first half of 2005.

For the second half of 2005 the majority of the banks (71%) reported easing of creditworthiness standards, which also counts as the highest ratio until now. Except for the risk premium banks plan to ease lending conditions as well – most of them wish to increase the maximum size of loans/credit lines.

Large enterprises[1]

In the first half of 2005 willingness to lend to large enterprises increased in the case of 29% of the surveyed banks. Creditworthiness standards have been unchanged for a year now, and lending conditions have been fine-tuned: banks change different conditions, there is no single tendency.

In the forthcoming half year two banks plan to change different lending conditions. As a whole, two institutions will ease standards and one of them will tighten its lending policy.

Small and medium sized enterprises

The majority of the banks reported a greater willingness to lend to both medium and small and micro sized enterprises in the first half of 2005 – in some cases significantly. Despite this, only one bank eased the creditworthiness standards in the case of small and micro sized enterprises, while there was no significant change in the lending conditions. As far as lending conditions to medium sized companies are concerned, lending fees were eased by one bank and loan covenants were tightened by another, while risk premium was increased by two institutions. Risk premium to small and micro sized enterprises was tightened by two banks and two of them eased collaterisation requirements. As a whole, one bank eased lending conditions to micro enterprises, while two did the same in relation to small and micro sized enterprises. Aggressive competition played a significant role in this.

For the forthcoming half year, banks plan to ease creditworthiness standards and lending conditions to SMEs, with the exception of the risk premium. Most banks plan to ease collaterisation requirements, first of all to small and micro sized companies.

Demand side

In the last half year, a net 14% of the surveyed banks reported higher demand from non-financial companies. One bank experienced lower demand from large enterprises, higher demand was reported by net one bank in the sector of medium sized companies and by net two banks in the sector of small and micro sized enterprises. Advantage in the competition of banks was the main reason behind the increased loan demand of the medium sized enterprises, but higher inventory financing needs and lower interest rates played an important role as well. In the case of small and micro sized companies, the main reasons are the same, but the highest rate was attributed to the decrease of own sources.

In the case of the question related to loan demand it is striking that in the last two half years the deviation of the expected and the realised demand was significant. This can be explained by the fact that, because of the expectations of the owners and profitability plans, loan officers are excessively optimistic when they foresee demand. For the following half year the majority of the banks expect somewhat higher loan demand from SMEs, first of all from medium sized enterprises.

[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 by no means unambiguous, which must be taken into account when evaluating the results.

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

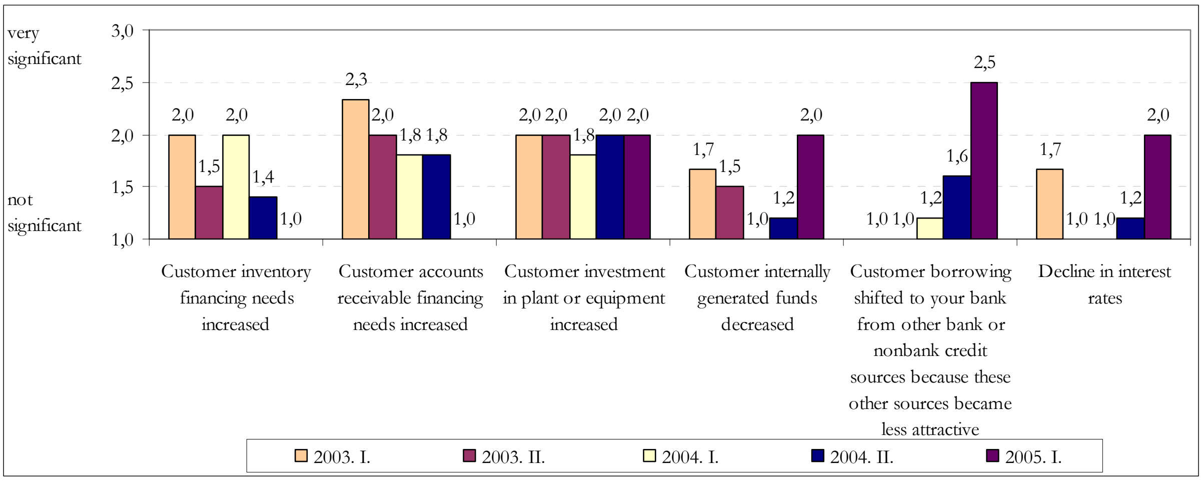
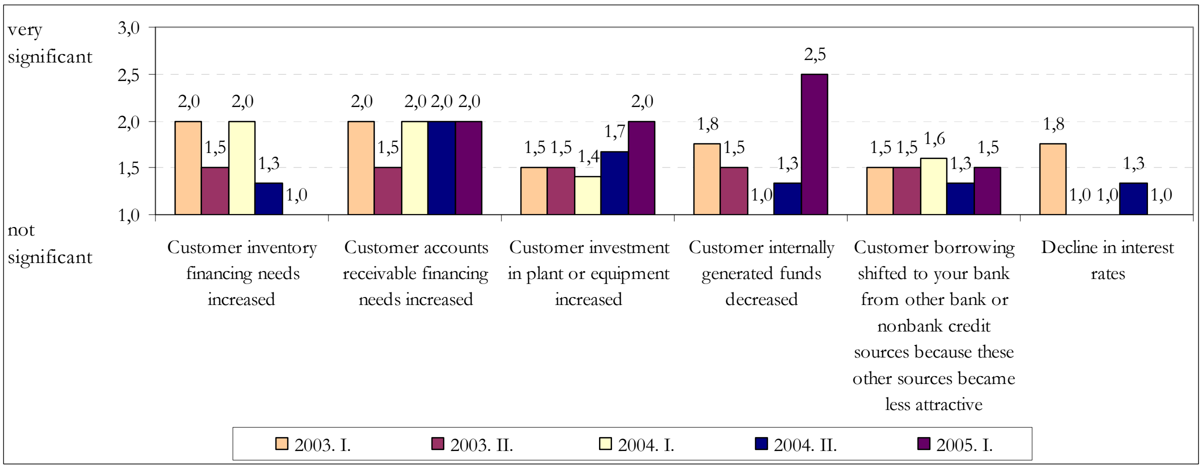


Chart 3: Reasons for increasing loan demand of small and micro-sized firms (1 = not significant; 2 = somewhat significant; 3 = very significant)



1.2. Commercial real estate loans

(questions 10-15 of Appendix 2)

Supply side

The willingness of banks to grant new commercial real estate loans more or less remained unchanged in the first half of 2005 – there were only two banks which reported higher and one which reported lower lending willingness. In 2005, the tendencies seem to be opposite to the previous ones: three banks tightened creditworthiness standards, while earlier standards were unchanged or slightly eased. All banks explained tightening with different reasons, the highest mark was given to more serious industry-related problems. For the forthcoming half year, banks do not plan to change creditworthiness standards.

Demand side

A net 14% of the surveyed banks reported that demand for commercial real estate loans was lower than before. One of the banks reported significantly lower, one slightly lower and one slightly higher demand. For the forthcoming period banks do not expect demand for commercial real estate loans to change.

1.3. Change in credit risk assessment of the various industrial sectors

(question 16 of Appendix 2)

In the first half of 2005, banks reported that risk assessment of manufacturing and construction, industry, financial services, real estate and business service activities deteriorated significantly, and that of agriculture worsened slightly. In the construction industry this can be explained by the earlier problems (increasing financial gridlines), while in the financial services sector by the worsening financial strength of the leasing and factoring companies. The increase of exposure towards the latest industries can be observed in the banking system (see Chart 5). As far as manufacturing is concerned, food industry can be considered the riskiest sub-sector.

Energy and public services became safer, while the risk assessment of the remaining sectors has not changed.

Chart 4: 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)

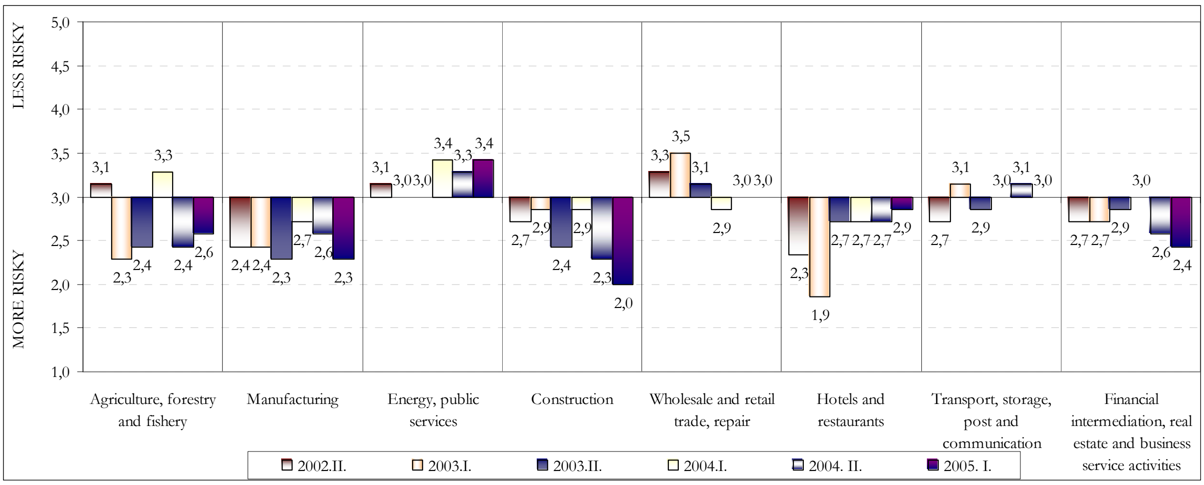
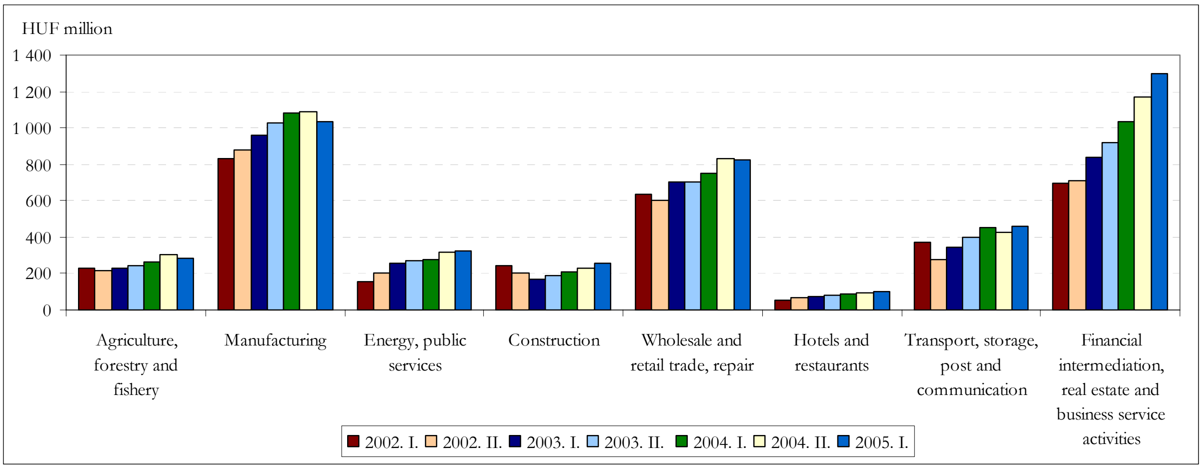


Chart 5: Sectoral structure of loans to non-financial firms



2. Household lending market

As far as household loans are concerned, we surveyed 11 banks: 7 of them answered the questions related to housing loans and 10 those on consumer loans. It can be mentioned that in contrast with earlier tendencies, housing loans came to the front again: willingness to lend increased and creditworthiness standards and lending conditions were eased more on this market than in the case of consumer loans (see Chart 7 and Chart 6). Demand for housing loans increased more than on the other sub-market.

Chart 6: 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)

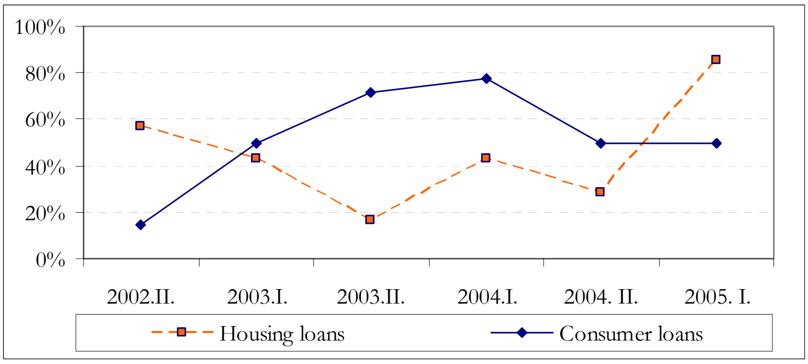
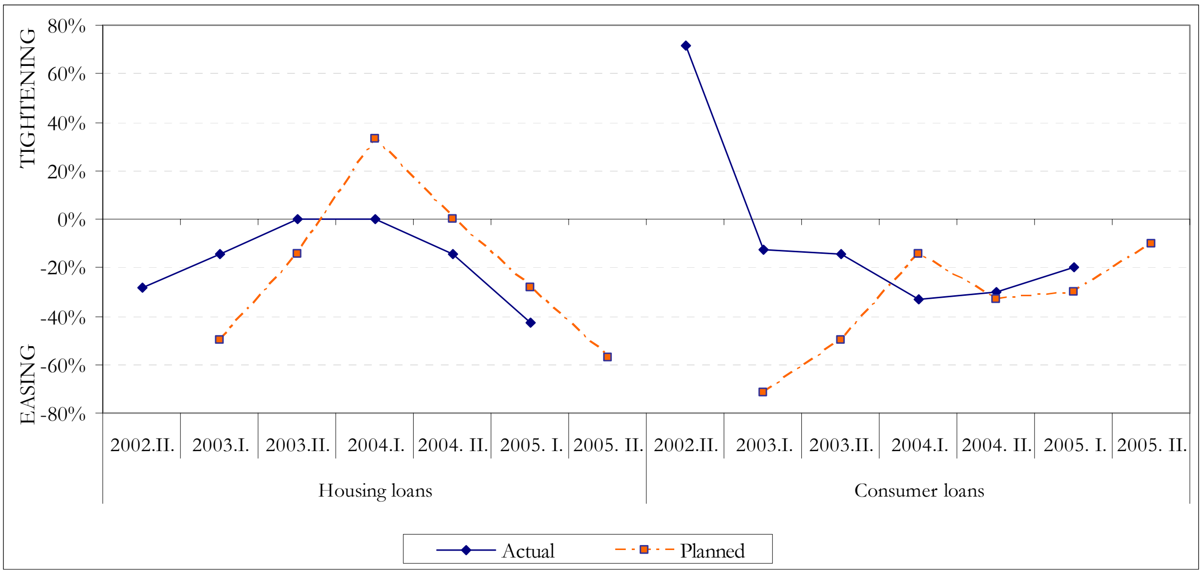


Chart 7: Creditworthiness standards in the housing and consumer credit market (ratio of those tightening minus those easing the standards)



2.1. Housing loans

(Question 1-10 of Appendix 4)

Supply side

On the market of housing loans, willingness to lend increased in the first half of 2005 in the case of almost all banks, and creditworthiness standards were eased by more banks than earlier, namely by 43% of the respondents. Lending conditions were in general eased by banks: spread decreased and the maximum loan-to value ratio increased in the case of 57% of the respondents; minimum downpayment decreased in the case of 43% (see Chart 8). As a whole, five banks judged that their lending policy eased, the main reason for this was the more aggressive competition.

For the following half year the majority of the banks plan to ease creditworthiness standards again, which means that the tendencies of the last two half years will remain.

Chart 8: Lending conditions in the market of housing loans (ratio of those reporting tightening minus those reporting easing)

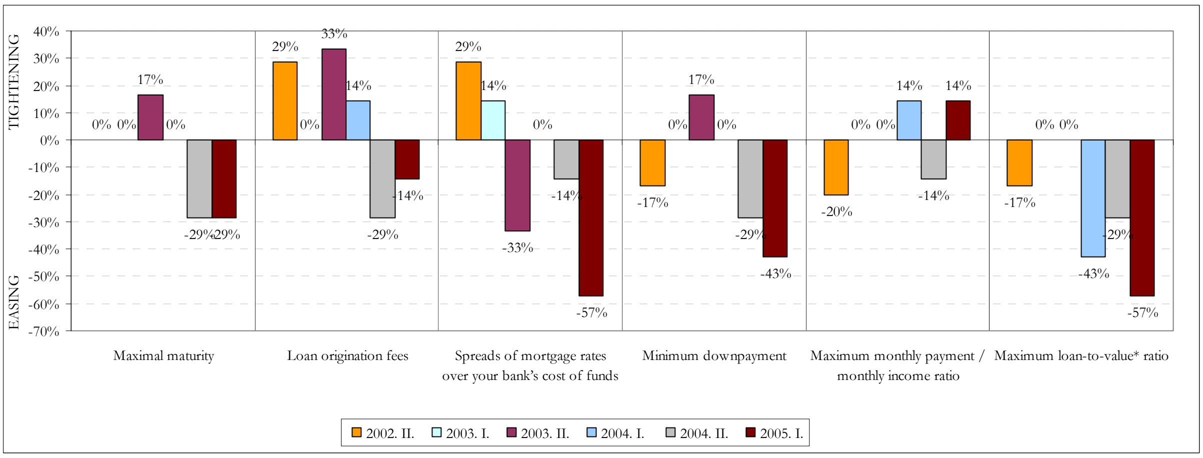
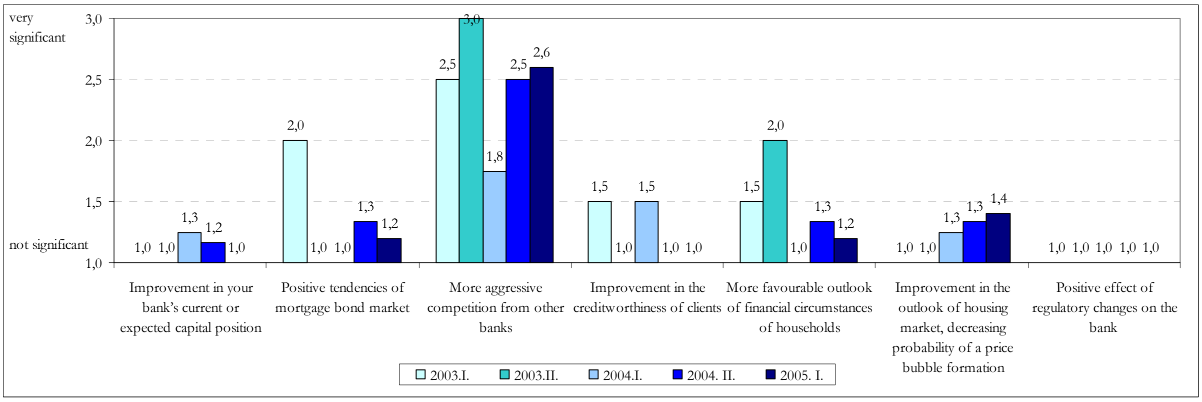


Chart 9: Reasons for relaxing creditworthiness standards and lending conditions in the case of housing loans (1 = not significant; 2 = somewhat significant; 3 = very significant)



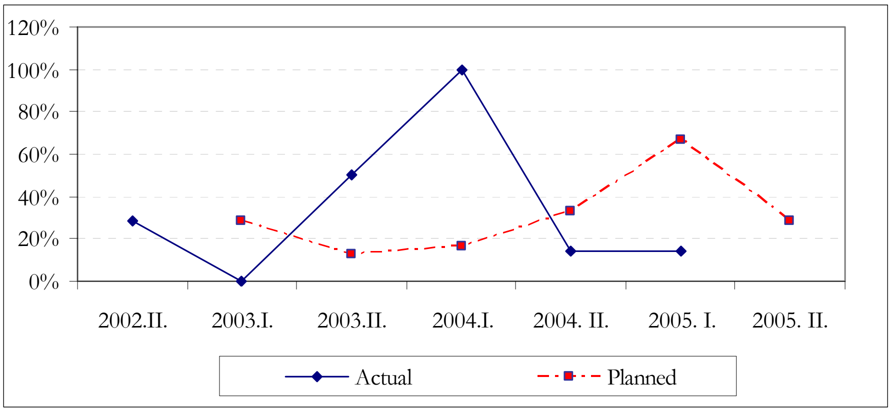
Demand side

In the first half of 2005, 57% of the surveyed banks perceived higher loan demand than earlier. For the forthcoming period, 43% of the loan officers expect a further increase, others expect unchanged demand.

Nominal house prices

As a whole, all banks but one perceived an increase of nominal housing prices, but many loan officers highlighted that there are significant differences between categories. For the second half of 2005, 29% of the banks expect a further increase of house prices.

Chart 10: 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)

Supply side

Half of the surveyed banks reported that their willingness to grant consumer loans increased (in some cases significantly), that of others remained unchanged on a high level. Creditworthiness standards were eased by three banks and tightened by one; lending conditions as a whole were eased as well. Four banks decreased the spread, three increased the maximum sum of loans and two decreased minimum downpayment. Overall, four banks considered their lending policy as lighter, believing that competition of banks and non-bank financial intermediaries was the main reason behind it.

For the next half year all banks but one plan a further easing of the standards.

Demand side

Demand for consumer loans – probably in connection with stronger competition – was perceived differently by the banks: 4 of them reported stronger, 4 weaker, and 2 unchanged demand. As a whole, the net ratio of those reporting a change of demand is zero. As far as the forthcoming half year is concerned, a net 40% of the banks anticipate stronger demand.

3. Actual questions, tendencies

During the latest interviews we asked banks in both segments whether they take income expectations into consideration, whether they have introduced refinancing products or plan to do so and, finally, we put a question about foreign currency loans.

As far as lending decisions are concerned, banks take actual income of both enterprises and households into consideration, but they do not calculate expected income; their decisions are based on static calculations. On the household loan market banks draw conclusions from the current income and actual labour market situation regarding the expected income of the clients. As far as loans to enterprises are concerned, several banks carry out sensibility examinations and reconsider business plans when deciding on commercial real estate loans.

We decided to ask loan officers about refinancing products because in connection with the more aggressive competition we expected that this could be a new instrument for obtaining new clients. On the basis of the answers of loan officers, these products are present on the market but they are not considered as a means of getting a significant market share. If there is demand to refinance current outstanding loans, this can be resolved in the framework of normal lending procedures, but these products are not applied as a means of increasing market share. Some banks on the corporate loan market plan to develop such products.

As far as foreign currency lending is concerned, previous tendencies seem to remain: new lending is dominated by foreign currency lending – mainly in Swiss franc. Some banks on the corporate loan market experienced that large enterprises turn to forint loans in line with the decrease of forint interest rates, but SMEs still prefer foreign currency loans. Turning to forint loans was not noticeable on the household lending market either. Clients continue to minimise monthly payments, not taking exchange rate risk into consideration.

CHARTS ON THE VOLUME OF LOANS AND ANSWERS TO THE QUESTIONNAIRE

Chart 11: Shares of responding banks within the total corporate lending portfolio (excluding commercial real estate loans)

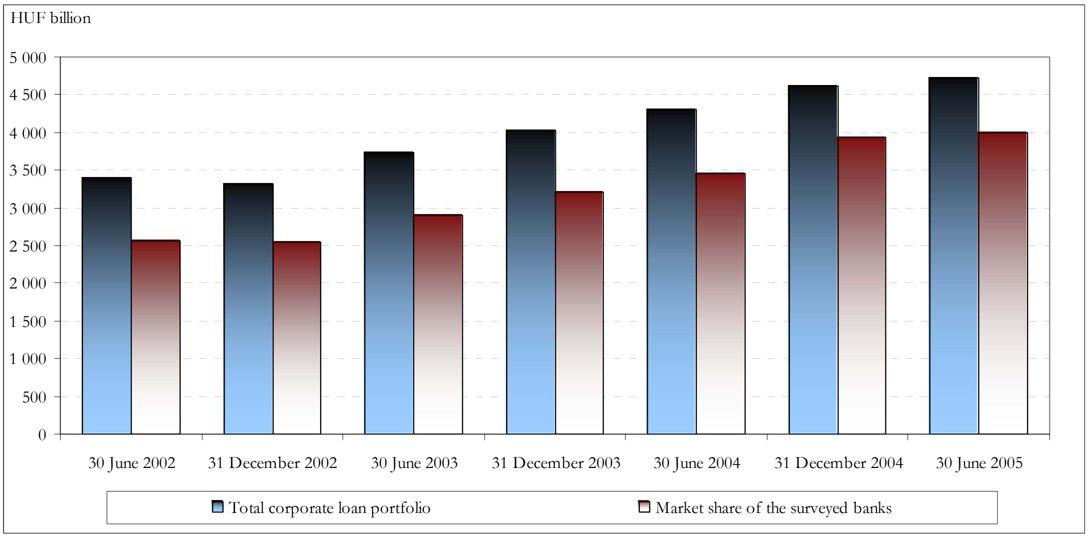


Chart 12: Share of responding banks in commercial project loans within the total project loan portfolio

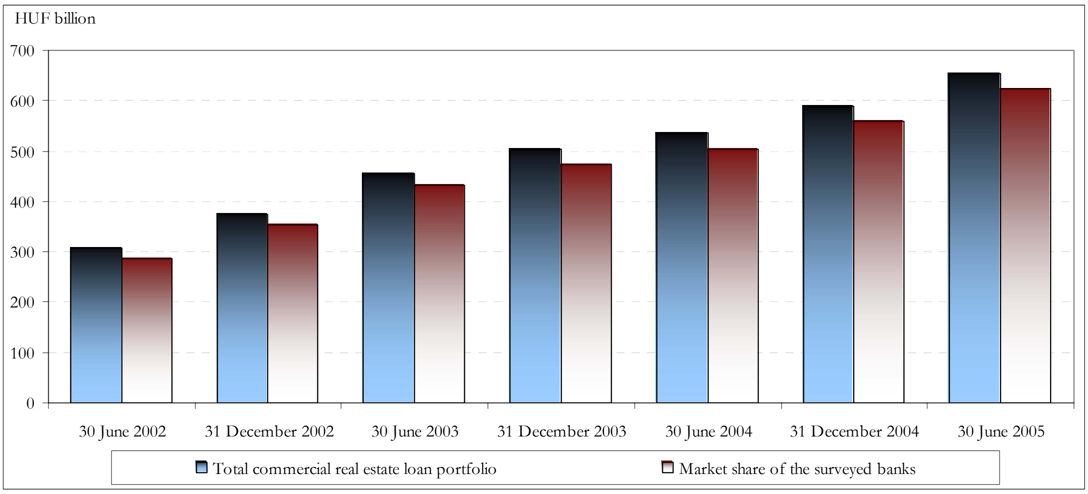


Chart 13: Creditworthiness standards by corporate category and in the field of commercial real estate loans (ratio of those reporting tightening minus those reporting easing)

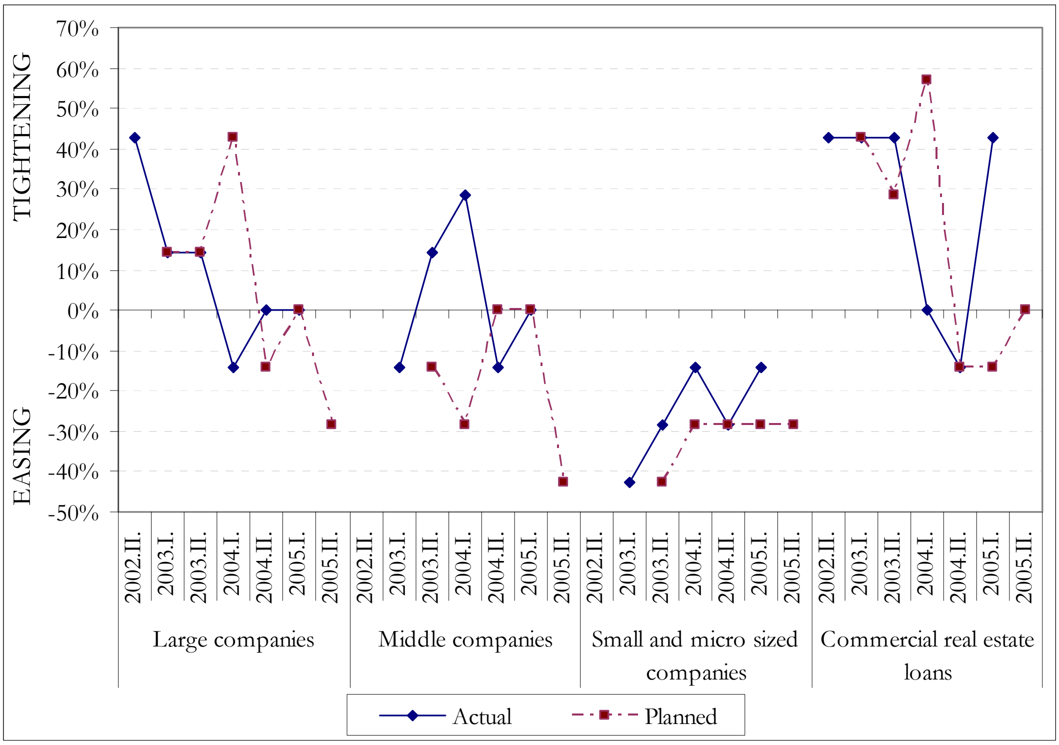


Chart 14: Maximum size of loans/credit lines by corporate category (ratio of those reporting tightening minus those reporting easing)

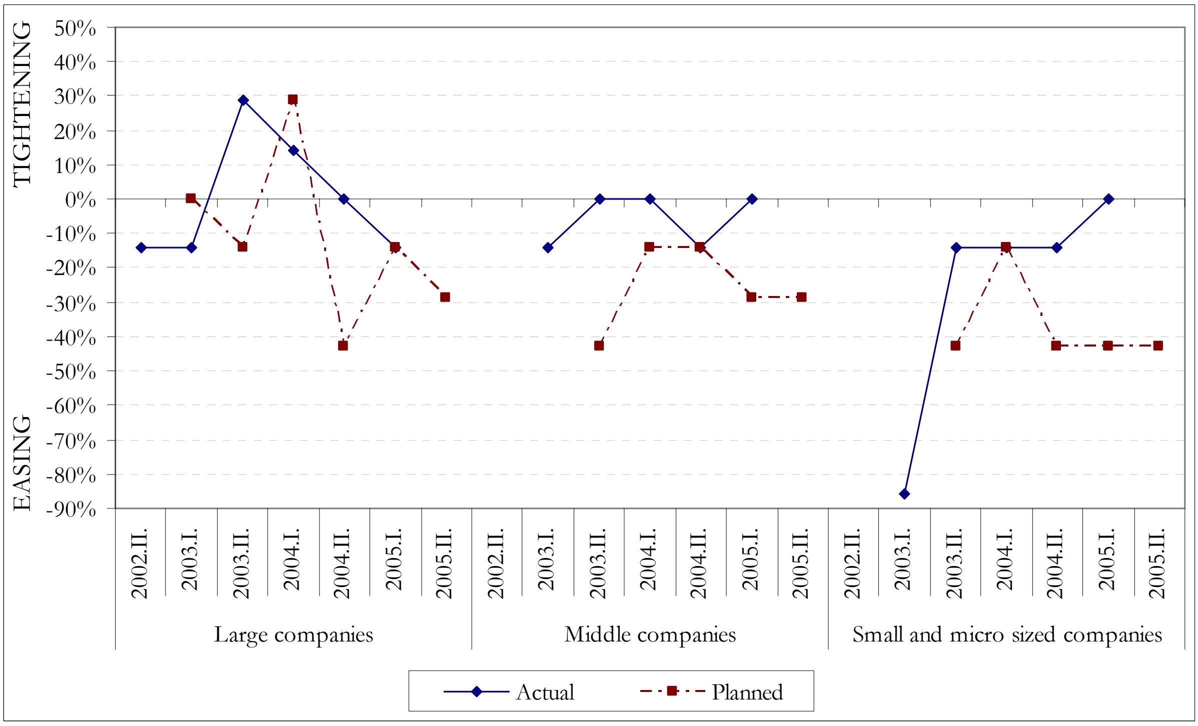


Chart 15: Spread between lending rates and costs of funds in a breakdown by corporate category (ratio of those reporting tightening minus those reporting easing)

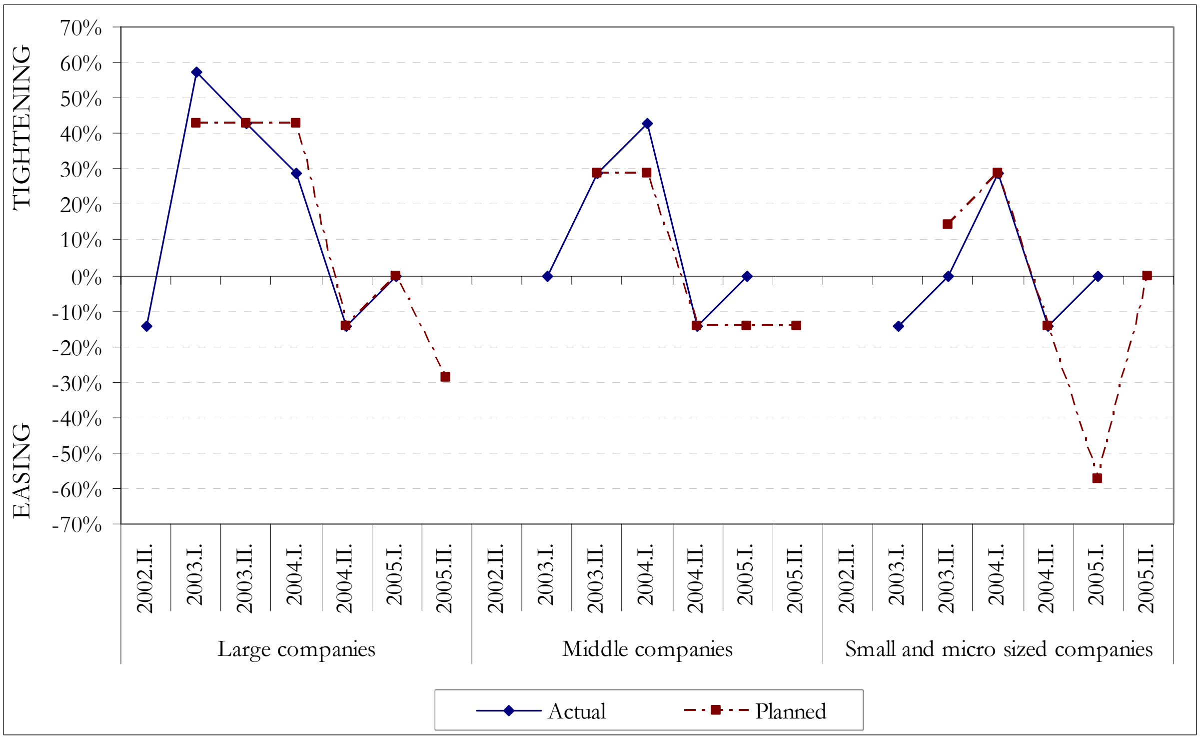


Chart 16: Premium on higher-risk loans in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

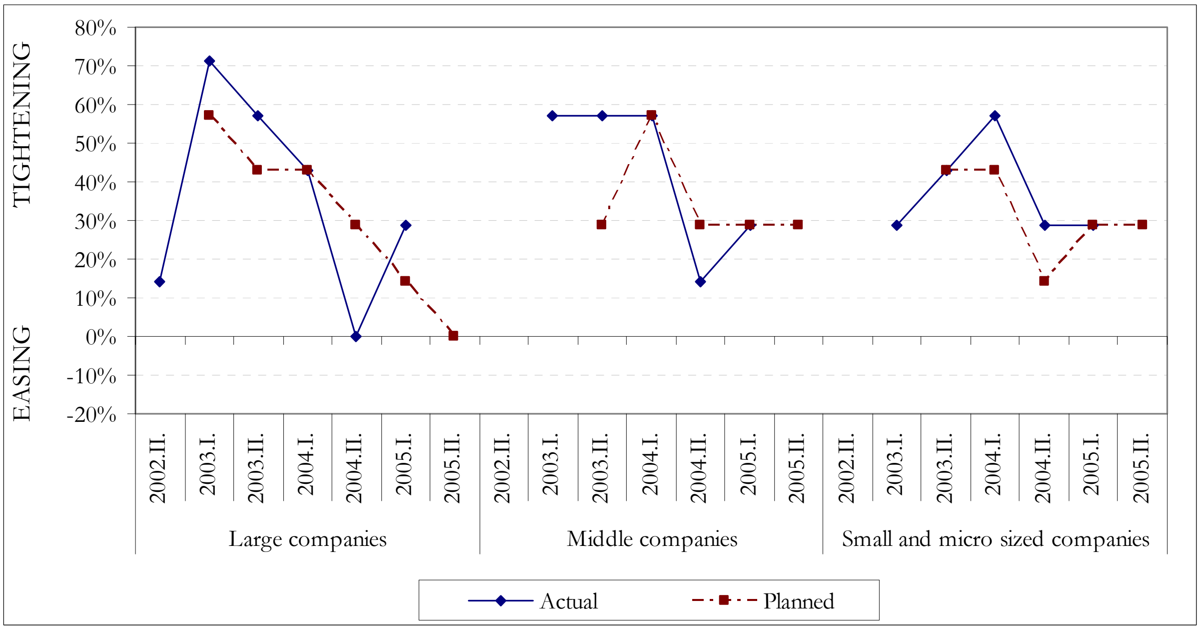


Chart 17: Reasons for easing creditworthiness standards and lending conditions in the case of small and micro-sized enterprises (1 = not significant; 2 = somewhat significant; 3 = very significant)

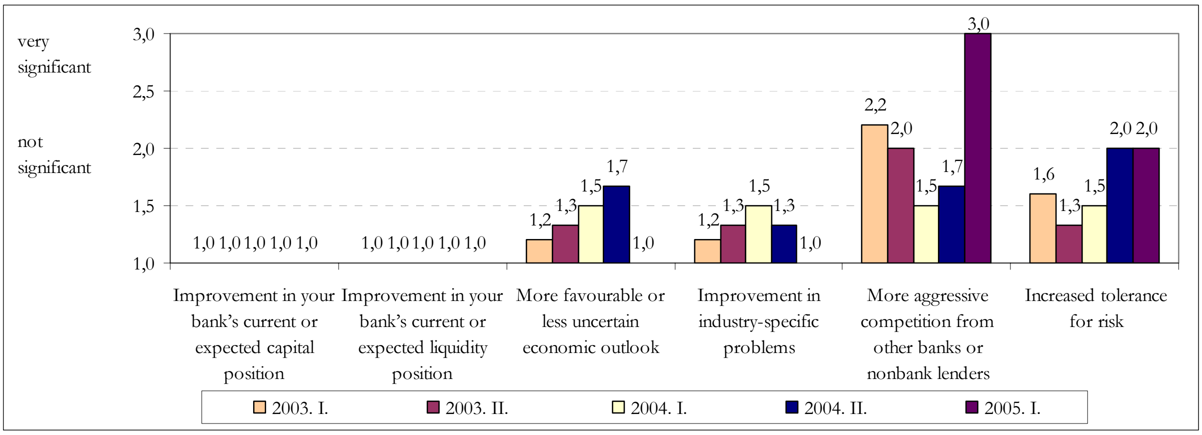


Chart 18: Demand for loans in a breakdown by corporate sector and in the market of commercial real estate lending (ratio of those reporting an increase minus those reporting a decrease)

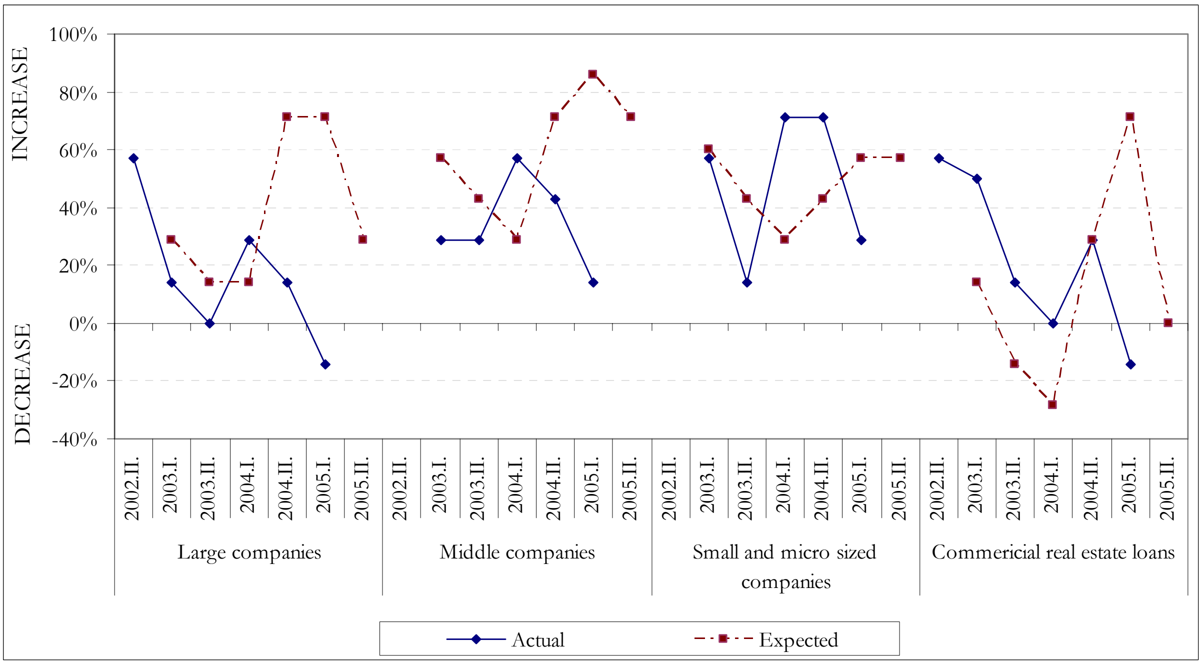


Chart 19: Market share of banks answering the questions relating to housing loans

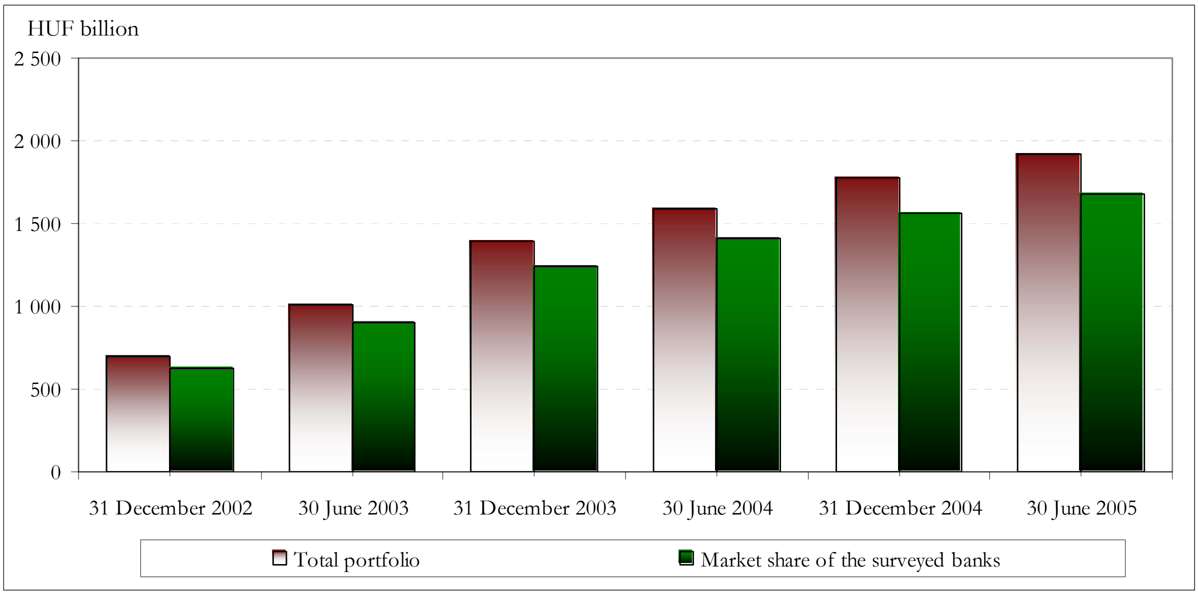


Chart 20: Market share of banks responding to questions relating to consumer credit (8 banks up to December 2003, 9 banks in June 2004, 10 banks in December 2004)

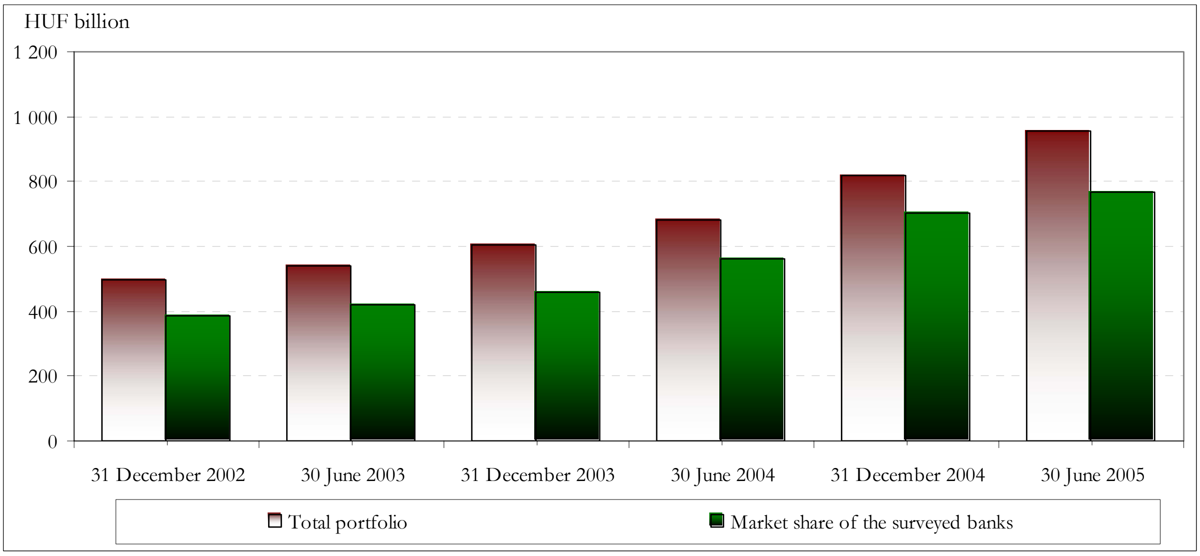


Chart 21: Lending conditions in the consumer credit market (ratio of those reporting tightening minus those reporting easing)

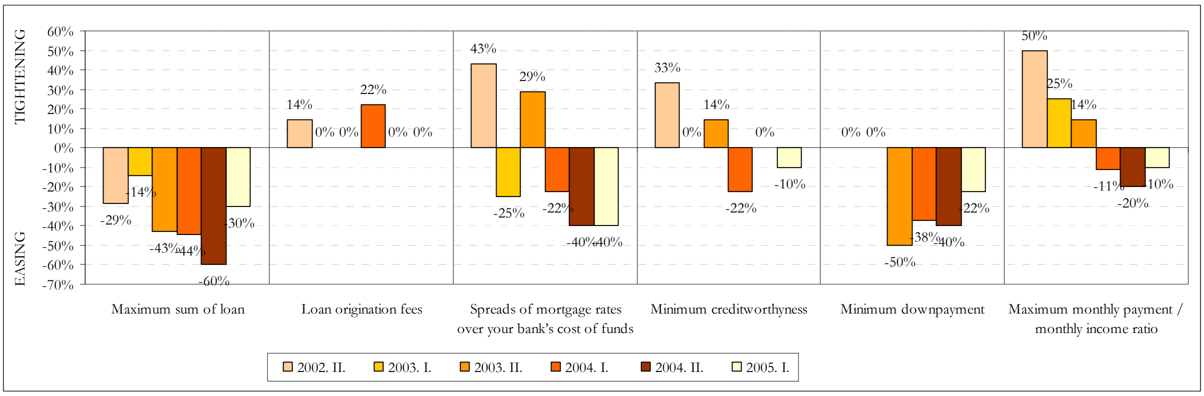


Chart 22: Reasons for relaxing creditworthiness standards and lending conditions in the consumer credit market (1 = not significant; 2 = somewhat significant; 3 = very significant)

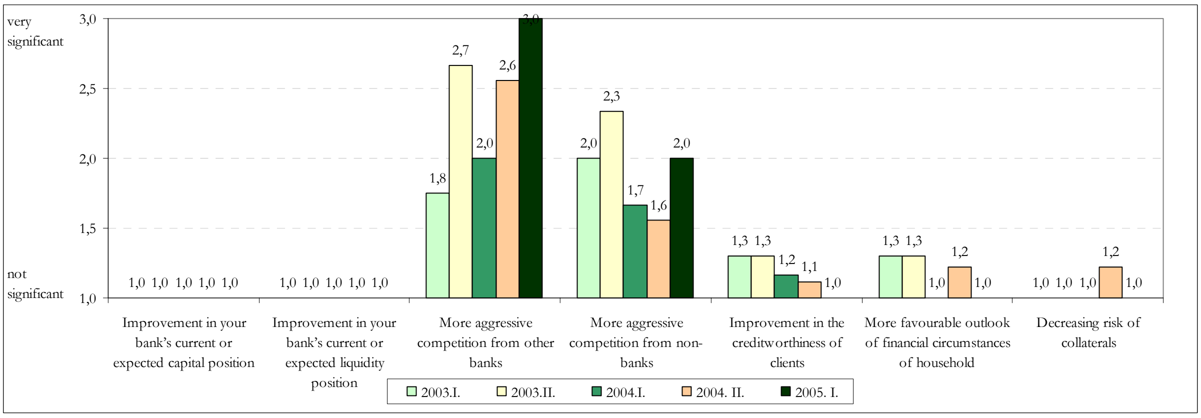


Chart 23: Demand for loans in the housing loan and consumer credit markets (ratio of those reporting an increase minus those reporting a decrease)