Trends in lending

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

- *The credit aggregates present quantitative developments in economic agents' loans outstanding on the basis of the balance sheet statistics of the banking sector. Both the volume of new loans and net changes in the banking sector's loans outstanding (net of exchange rate effects) are presented. From Q4 2013 the analysis presents the trends in lending in the overall credit institution sector (banking system and foreign branches, cooperative credit institutions).*
- *Changes in non-price credit conditions are presented in a qualitative manner based on the Lending Survey, in which the banks that are active in the given segment and jointly cover 85–95 per cent of the credit market indicate the direction of change compared to the reference period. The Lending Survey includes price conditions in a qualitative manner as well, in the form of the spread on the cost of funds, the premium on risky loans and the fees charged.*
- *The interest rate statistics contain the price conditions, i.e. aggregate interest rates on credit institutions' new loans realised, weighted by the contract amounts. The lending rate can be decomposed into the reference rate and the spread on the reference rate.*
- *Banks active in the given segment provide qualitative responses in the Lending Survey in respect of their expectations and the changes in demand for loans they perceive. Similarly to credit conditions, banks indicate the direction of the change.*
- *Detailed information on the indicators describing the lending processes 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.*

CONTENTS

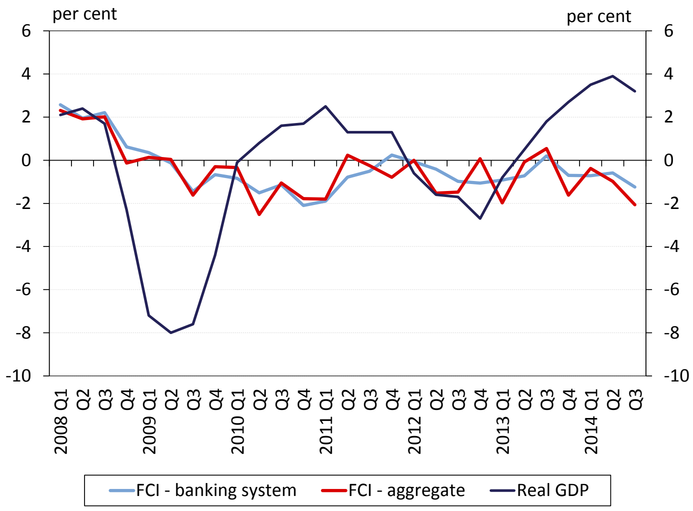
1. EXECUTIVE SUMMARY

In Q3 2014, there was a substantial increase in the corporate sector's loans outstanding from credit institutions, based on transactional data. Disbursements exceeded repayments by HUF 97 billion, with the expansion of loans outstanding almost fully attributable to growth in forint loans. By the end of Q3, the total volume of loans disbursed in the second phase of the Funding for Growth Scheme (FGS) increased to almost HUF 400 billion. The Monetary Council decided to increase the scheme's limit to HUF 1,000 billion, and also extended the deadline for concluding loan contracts by one year, until the end of 2015. The transaction-based annual growth rate of corporate loans fell to -2 per cent, which is attributable to the strong base effect of the high volume of loan disbursements realised one year ago, during the first phase of FGS. During the period under review, the financing costs of new market-based corporate loans decreased further; consequently, in addition to the interest rate spread, even the nominal interest rate of new corporate loans can be deemed favourable by regional standards. However, it still holds true that only the enterprises deemed creditworthy by the banks can benefit from the favourable price conditions. Based on the responses given by banks in the lending survey, the conditions of corporate loans have not changed substantially and no considerable easing may be anticipated in the next half year either. However, according to the respondent banks demand for long-term loans may continue to increase, which may also reflect the impact of the FGS limit increase.

In the third quarter of 2014 the household loan portfolio of credit institutions decreased further, as repayments exceeded disbursements by HUF 26 billion. The contraction of the loan portfolio reflects the continued shrinking of foreign currency loans, while the aggregate forint lending was characterised by recovery. The disbursements of forint loans exceeded repayments by HUF 61 billion, while the volume of new household loans during the quarter amounted to HUF 160 billion, which is 32 per cent higher on an annual basis. Based on the responses given by banks in the lending survey, the terms and conditions of consumer loans eased in Q3, while there was no substantial change in those of housing loans; moreover, in their responses looking two quarters ahead a narrow range of banks indicated tightening in housing loan conditions. Based on the survey the banks reported recovery primarily in demand for housing loans, and in the next half-year they expect additional growth in demand for both product types. In Q3, the interest rate spread of new housing loans decreased, but it is still considered high by regional standards.

According to the Financial Conditions Index, which summarises lending developments in the corporate and household segments, and the monetary conditions, calculated on the basis of the preliminary data, the contractionary effect of banking sector increased during the quarter, which is primarily attributable to the aforementioned base effect.

Financial Conditions Index (FCI) and annual real GDP growth

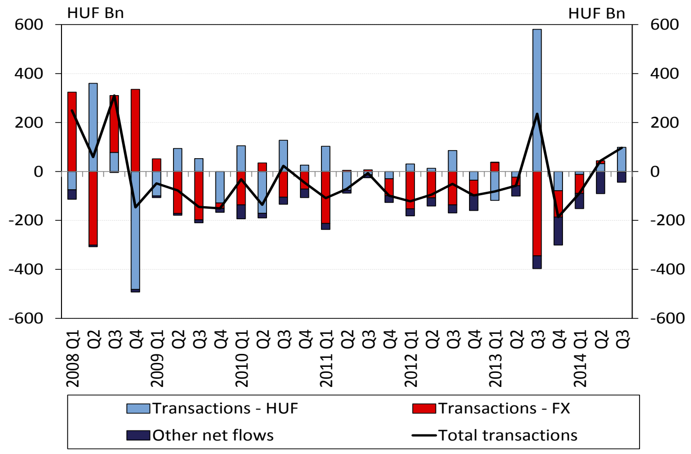


Note: Based on preliminary data. The annual growth rate of FCI shows the contribution of the financial intermediary system (banking sector) to the annual growth rate of real GDP. While the banking sector sub-index only contains the variables related to lending, the 'overall' index also contains the monetary conditions, i.e. the interbank rate and the exchange rate.
Source: MNB.

2. DEVELOPMENTS IN LENDING IN THE CORPORATE SEGMENT

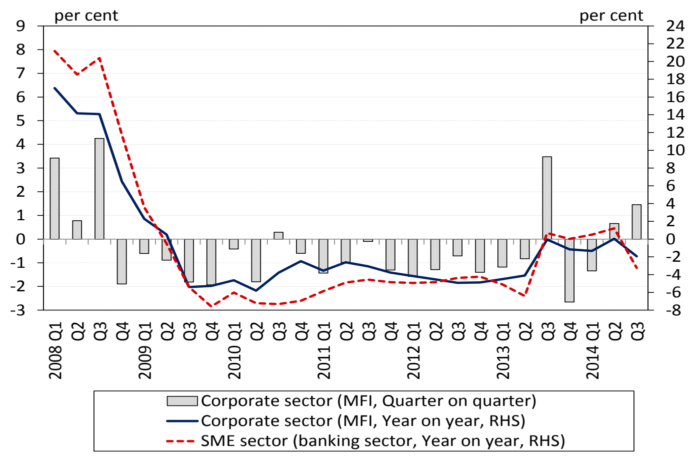
Based on transactional data, there was a substantial increase in the outstanding loans of non-financial enterprises from the credit institution sector in Q3 2014. Disbursements exceeded repayments by HUF 97 billion, which is almost fully attributable to growth in forint loans. During the quarter, utilisation of the second phase of the Funding for Growth Scheme (FGS) increased to nearly HUF 400 billion, and the Monetary Council raised the limit of the scheme to HUF 1,000 billion and also extended the deadline for the conclusion of the loan contracts by one year, until the end of 2015. While developments were favourable on quarterly basis, the transaction-based annual growth rate of corporate loans fell to -2 per cent, with this downturn attributable to the strong base effect of the large volume of loan outflow realised one year before in the first phase of FGS. Based on the responses by banks in the lending survey, corporate loans conditions have not changed substantially and nor is any considerable easing anticipated in the next half year. Furthermore, the majority of the respondent banks reported a growth in the demand for long-term loans in Q3. All in all, the financing costs of the enterprises decreased further, and accordingly in a regional comparison they are no longer deemed exceptionally high; however, significant diversity could be observed in the spreads of the various product types.

Chart 1: *Net quarterly change of the corporate loan portfolio, by currency*



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

Chart 2: *Annual and quarterly growth rate of lending to corporates and the SME sector*



Note: In the case of the corporate sector, the time series is based on transactions, while the SME data is based on estimated transactions from Q4 2013.
Source: MNB.

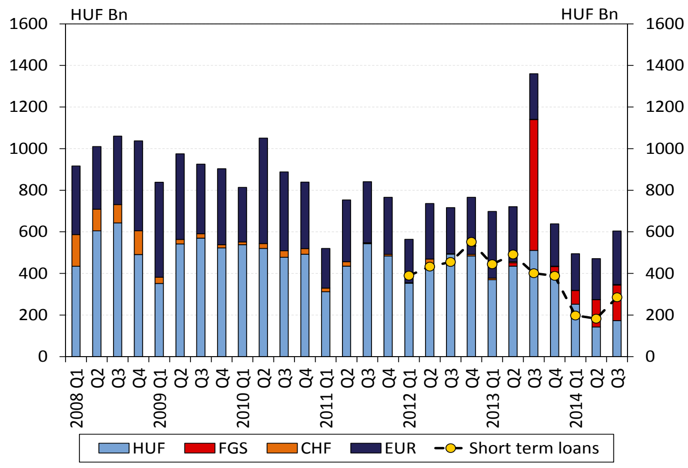
Domestic corporate lending

Based on transactions, there was substantial growth in the forint-denominated corporate loan portfolio. In 2014 Q3, the outstanding loans of non-financial enterprises from the credit institution sector as a whole increased by almost HUF 97 billion, based on transactional data (Chart 1). In the case of forint loans, disbursements exceeded repayments by HUF 99 billion, while foreign currency loan transactions amounted to about HUF -2 billion. Other changes, i.e. write-offs and reclassifications, reduced credit institutions' outstanding corporate loans by HUF 42 billion in total in the period. The ratio of long-term loans in the total portfolio rose slightly during the quarter, and thus on aggregate long-term forint loans continued to gain ground, as has been observed since the launch of the first phase of FGS.

The annual growth rate decreased due to base effect. The base effect arising from the high volume of credit outflow during the first phase of FGS in the same period of last year significantly reduced the growth rate of Q3 2014, particularly in the SME segment, which is in the focus of the scheme. At the end of the quarter, the annual growth rate of outstanding loans of non-financial enterprises from the credit institution sector as a whole was close to -2 per cent. The growth rate of outstanding loans of small- and medium enterprises in the banking sector also fell, with its value at -3.2 per cent at the end of Q3 (Chart 2).[1] However, the quarterly dynamics reflect some improvement: apart from 2013 Q3, the almost 1.5 per cent transaction-based growth achieved in Q3 was last seen before the outbreak of the crisis.

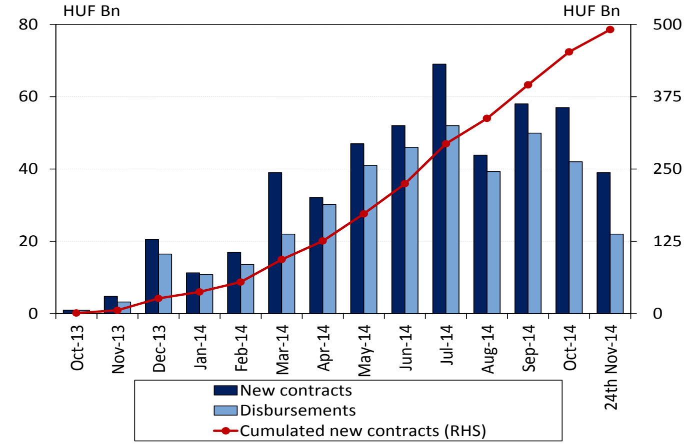
[1] We provide an estimate of SME segment transactions by breaking down other changes (write-offs and reclassifications) to total loans.

Chart 3: New corporate lending volumes



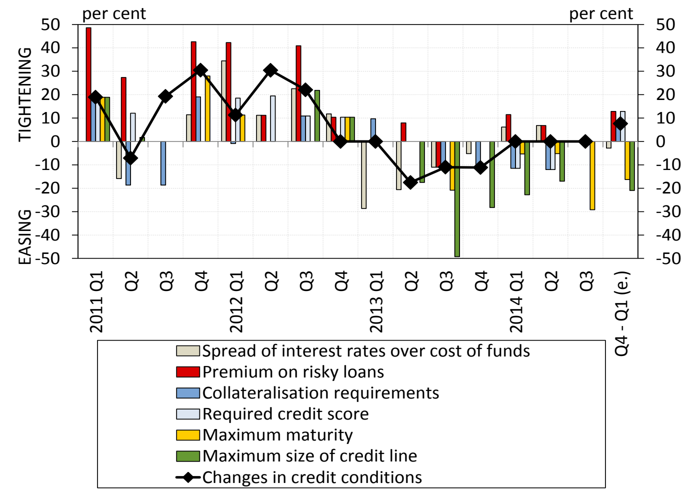
Source: MNB.

Chart 4: Contracted and disbursed loan volumes in the second stage of the FGS by month



Source: MNB.

Chart 5: Changes in credit conditions in the corporate segment



Note: Difference of the ratio of banks forecasting tightening and easing, weighted by market share.

Source: MNB, based on the answers of respondent banks.

There was a substantial increase in the volume of new loans compared to the previous quarter. The gross volume of new corporate loans of the entire credit institution sector amounted to HUF 604 billion in Q3 (Chart 3). The growth is primarily attributable to the increase of euro loans, and the forint loans granted within the framework of the Funding for Growth Scheme. Within new lending, forint- and euro-denominated loans accounted for HUF 344 billion and EUR 257 billion, respectively. The ratio of FGS loans within new forint loans rose to 49.7 per cent, while the financing of foreign currency loans was dominated by the Eximbank schemes. The amount disbursed within the Funding for Growth Scheme facility increased by approximately HUF 171 billion during the quarter. The share of short-term loans increased within new lending, but it is still significantly lower than in the period preceding the Funding for Growth Scheme. The lower share of short-term loans can be partially explained by the decreasing refinancing needs, as a result of the longer average maturity.

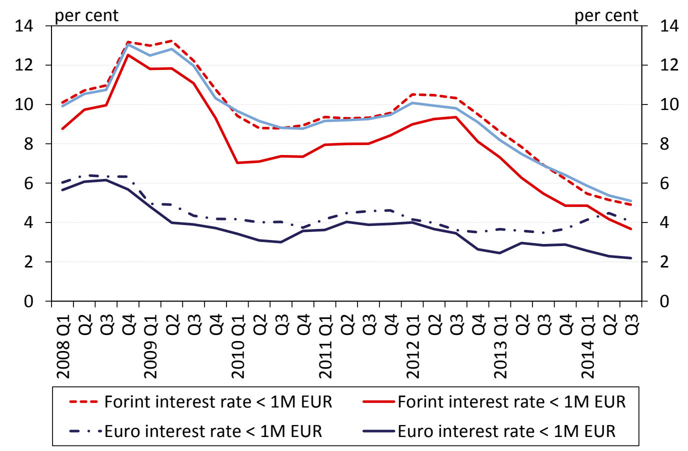
The limit of the Funding for Growth Scheme was increased. During the quarter, utilisation of HUF 500 billion credit limit related to the second phase of the Scheme increased from 45 per cent to almost 80 per cent by end-September, followed by similar growth until mid-November, almost reaching HUF 500 billion (Chart 4). Also considering the continuous increase in the utilisation of the scheme, the Monetary Council decided at the beginning of September to raise the limit to HUF 1,000 billion, and at the end of October it extended the deadline for concluding loan contracts until end-2015.

Credit conditions did not change in 2014 Q3. Based on the responses in the lending survey, on the whole there was no substantial change in credit conditions; in net terms,[2] 29 per cent of respondent banks eased conditions only in respect of the maximum maturity (Chart 5)Looking ahead, only a low percentage of banks reported that they would tighten credit conditions in the next 6 months. In accordance with this, they anticipated increasing the premium on high-risk loans, the collateralisation requirements and the minimum creditworthiness level. However, in terms of the maximum maturities and the maximum size of the loans, they tended to expect easing.

The interest rate on new corporate loans continued to decrease in Q3. In quarter-on-quarter terms, the interest

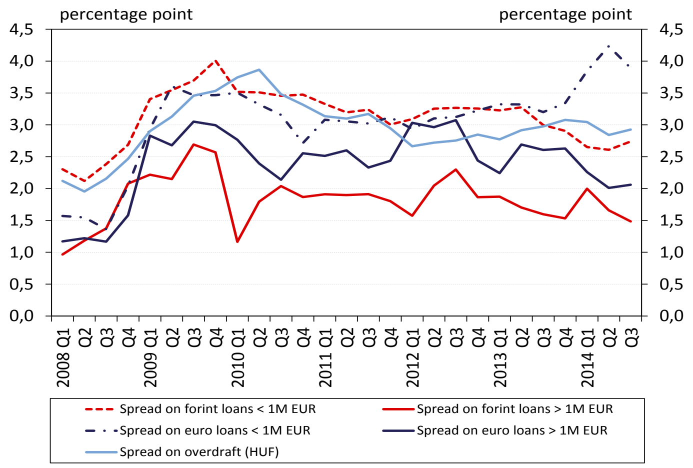
[2] The difference between banks performing tightening and easing, weighted by market share.

Chart 6: Interest rates on new corporate loans



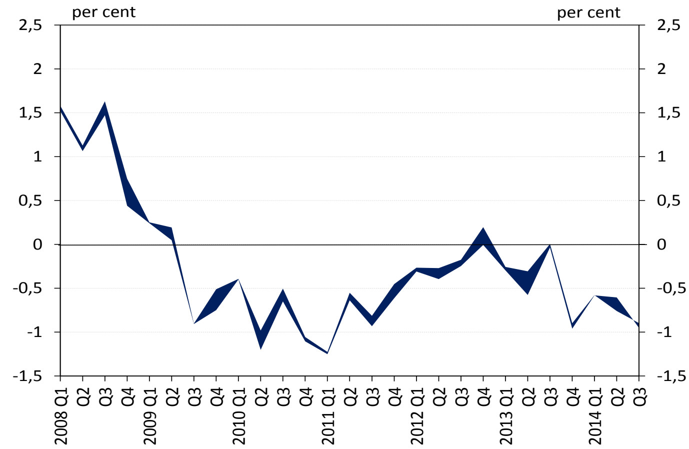
Note: Loans with floating-rate interest or with up to 1-year initial rate fixation.
Source: MNB.

Chart 7: Interest rate spreads on new corporate loans



Note: Spread on the 3-month BUBOR and EURIBOR. Loans with floating-rate interest or with up to 1-year initial rate fixation.
Source: MNB.

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



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

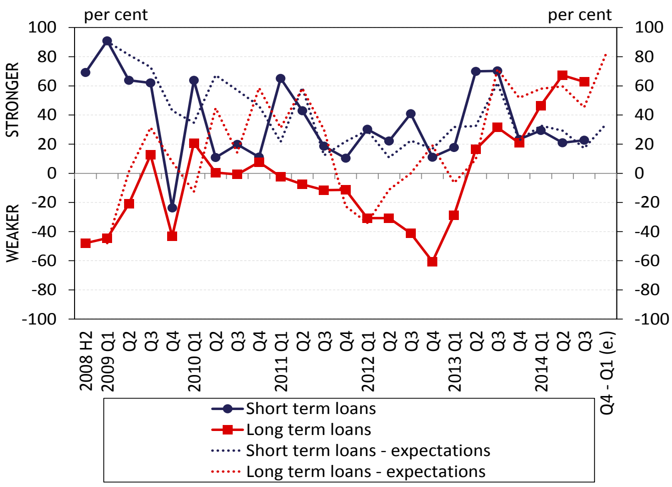
rate on market-based[3] new forint loans decreased further. In the case of new corporate loans, there was a decrease of 0.5 percentage points, from 4.7 per cent to 4.2 per cent. The decrease impacted both large and small loans; however in the case of loans exceeding EUR 1 million the rate of decrease was higher: while interest rates on the latter fell by 0.5 percentage points to 3.7 per cent, the average interest rate on small loans decreased by 0.2 percentage points to 4.9 per cent (Chart 6). The interest rate decrease for overdrafts was about 0.3 percentage points. In addition to market-based loans, the preferential interest rate – i.e. maximum 2.5 per cent – of loans disbursed to creditworthy SMEs within the framework of the second phase of the Funding for Growth Scheme provided a form of low-cost financing. In respect of euro loans of lower volume, the average interest rate fell by 0.5 per cent after the increase seen in the previous quarters. The interest rate of high-value lending has not changed significantly.

Changes in spreads were quite diverse last quarter. The average spread on new, forint-denominated corporate loans fell by 0.1 percentage points. Although the spread on the BUBOR of smaller forint loans increased from 2.6 percentage points to 2.7 percentage points, the decrease of 0.2 percentage points in the spread on loans exceeding EUR 1 million pushed the average spread on new corporate loans as a whole towards a decrease. (Chart 7). Thus, the average spread of larger forint loans amounted to almost 1.5 percentage points. After a temporary drop, the spread on overdrafts once again increased in quarter-on-quarter terms, rising by about 0.1 percentage points. In the case of euro loans, the interest rate spreads on smaller and larger loans approximated each other somewhat. The spread on loans below EUR 1 million fell by 0.3 percentage points, while that of loans exceeding EUR 1 million did not change significantly.

The banking sector's contractionary impact via corporate lending increased. In 2014 Q3, the corporate sub-index of the Financial Conditions Index estimated on the basis of preliminary data was at around -1 per cent, i.e. real GDP declined by this extent due to the tight corporate credit supply in the period between 2013 Q3 and 2014 Q3 (Chart 8). The decline in this indicator is primarily attributable to the deterioration of the annual trends as a result of base effect. While trends in corporate lending show signs of

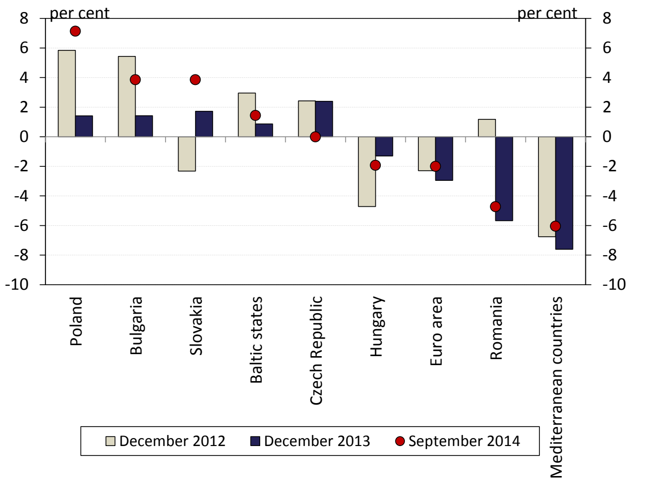
[3] In the case of new lending, we examined floating-rate loans or loans with interest rate fixation for no more than one year. The majority of loans granted within the Funding for Growth Scheme are long-term loans, therefore the interest rates reviewed by this publication are only shaped by smaller, short-term FGS loans.

Chart 9: Change in loan demand by maturity



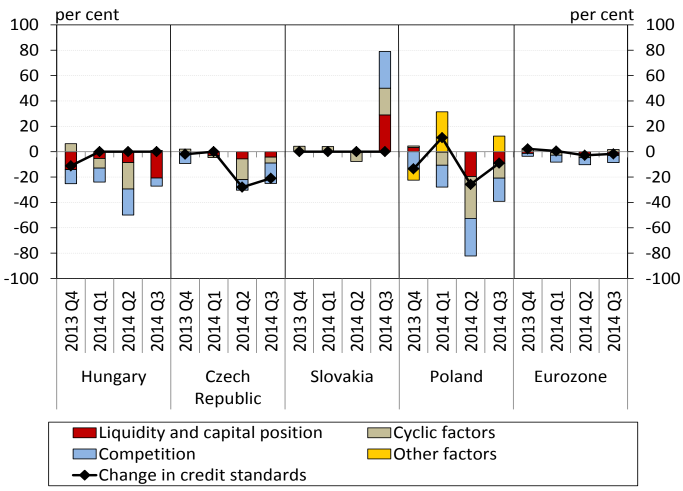
Source: MNB, based on the answers of respondent banks.

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



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

Chart 11: Changes and factors contributing to changes in corporate credit conditions in international comparison



Note: Category values are derived from the arithmetic average of the factors thematically classified therein. Positive values indicate the tightening of standards, while negative ones indicate the easing of such.
Source: MNB, ECB, national central banks.

recovery, the volume of corporate financing is well lower than its pre-crisis level. A sustained upturn in the credit market through a marked easing of corporate credit conditions would be necessary for corporate credit supply to effectively drive economic growth.

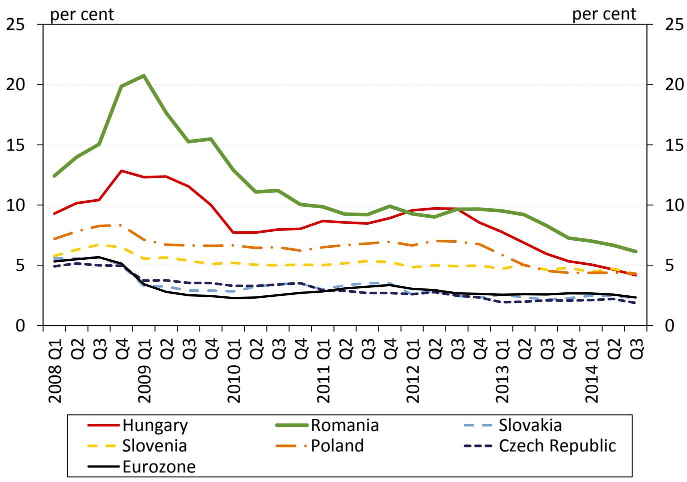
The recovery in credit demand continued, especially for long-term loans. Based on the lending survey, a large number of respondent banks – i.e. in net terms 63 per cent of them – reported increased demand for long-term loans, and 23 per cent of them indicated a pick-up in demand for short-term loans (Chart 9). The decrease in the average interest level, the increase in the purchase of tangible assets and increased inventory and debt financing demand were indicated by 71, 39 and 34 per cent, in net terms of the banks, respectively, as a factor boosting demand. According to the expectations, the expansion in credit demands may continue in the next two quarters as well, the largest part of which may be attributable to the increasing investment in tangible assets.

International review of corporate lending

The corporate lending growth rate in the European Union is still heterogeneous. In the third quarter, outstanding loans increased further in the region, while they decreased in the euro area on aggregate level. There is still considerable heterogeneity in the change in outstanding loans within the monetary union. The outstanding corporate loan portfolio increased based on transactions in seven euro-area member states, and shrank in eleven member states, including the Mediterranean countries. The portfolio shrank the most intensively in Spain, Ireland and Slovenia, but in all three cases this technical impact was primarily attributable to the activity of their national asset management agencies. On regional average, in annual terms, a recovery in lending was observed; in the case of Poland and Slovakia the annual growth rate continued to increase in Q3 compared to the previous quarter. As opposed to this, the loan portfolio is still shrinking at a fast pace in Romania (Chart 10).

The easing of lending standards continued in the euro area. The results of the lending surveys for Q3 revealed that lending standards for the corporate sector were eased or remained unchanged in the region. All in all, the easing which commenced in the previous quarter continued in the euro area, but this was reported only by a small percentage of respondent banks. Based on the lending survey of ECB, this is attributable to the fact that banks also perceived the slowdown in the European economic recovery and adjusted their perception of economic prospects accordingly. The

Chart 12 : International comparison of interest rate conditions on corporate loans extended in domestic currency



Source: MNB, ECB, national central banks.

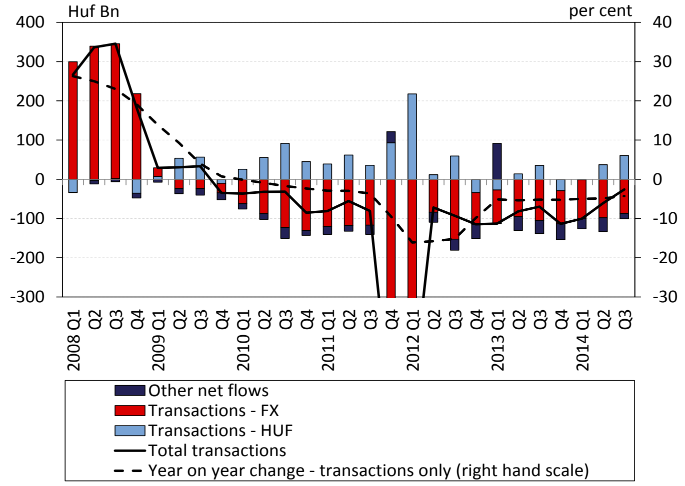
banks of the monetary union expect the easing of conditions and the increase of the demands (the latter primarily due to growth of the borrowing requirement arising from debt restructuring, as well as from mergers and acquisitions). Among the Visegrad countries, Poland and the Czech Republic saw easing, while conditions were reported to have remained unchanged in Slovakia, similarly to Hungary. The factors influencing the changes in credit conditions would justify tightening in Slovakia, while in the rest of the countries the cyclical factors, the liquidity and capital position, as well as the competition pointed towards the easing of conditions (Chart 11).

The financing costs of Hungarian corporations continued to approximate the regional average. Corporate loan interest rates decreased in all countries in the region, as well as in the euro area on average. In quarter-on-quarter terms, interest rates fell to the largest extent in Hungary and Romania, by 0.5 percentage points in both countries. This was supplemented by the fact that spreads also declined in all countries, with the exception of Poland. The difference between the interbank rate and corporate lending rate decreased the most dynamically in Slovenia and the Czech Republic, dropping by 0.3 percentage points in both cases (Chart 12).

3. DEVELOPMENTS IN LENDING IN THE HOUSEHOLD SEGMENT

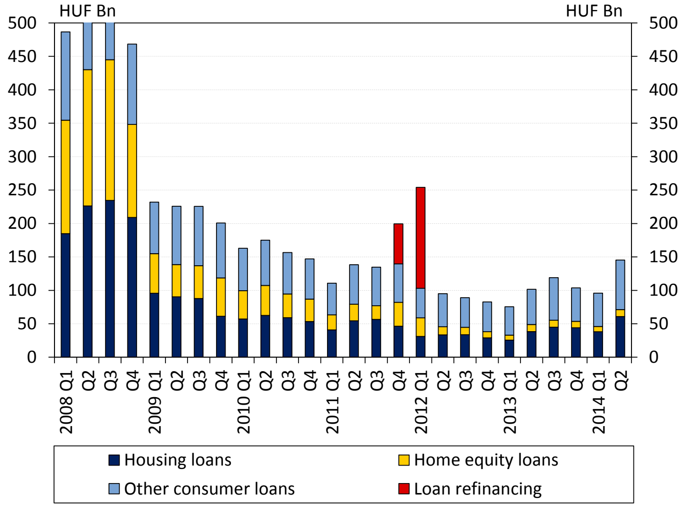
In 2014 Q3, the credit institution sector's household loan portfolio declined by about HUF 26 billion, resulting from disbursements and repayments. The shrinking loan portfolio reflects the continued decline in foreign currency loans, while disbursements exceeded repayments by nearly HUF 61 billion in the case of forint loans. The volume of new contracts expanded considerably, by almost 32 per cent on a yearly basis, and amounted to nearly HUF 160 billion during the quarter. Based on the responses by banks in the lending survey, the terms and conditions of consumer loans eased in Q3, and moreover, looking six months ahead some of the banks indicated a tightening of the housing loan conditions. Based on the survey the banks reported recovery primarily in the demands for housing loans, and in the next half-year they expect additional growth in the demands for both the consumer and the housing loans. The annual percentage rate of new household loans continued to decrease as a whole, accompanied by a decline of the interest rate spread of new mortgage loans. However, the latter may still be deemed high by regional standards.

Chart 13 : Net quarterly change in outstanding household loans in the credit institution sector as a whole



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

Chart 14: New household loans in the overall credit institution sector



Source: MNB.

Domestic household lending

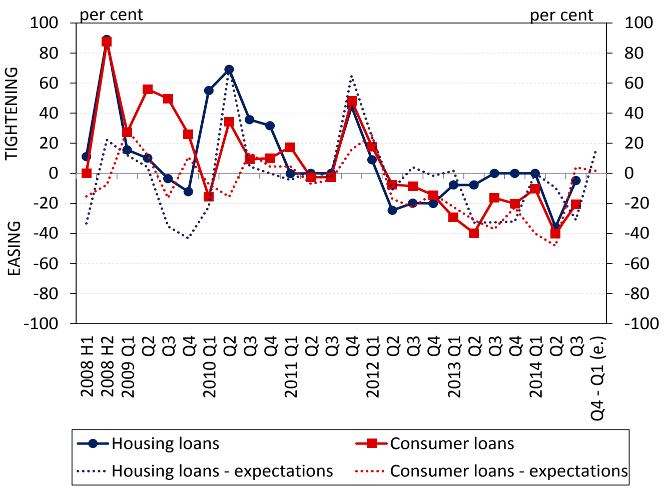
The shift towards forint lending continued. Based on transactions, credit institutions' household loan portfolio declined by almost HUF 26 billion in 2014 Q3 (Chart 13), while write-offs and reclassifications generated a further decrease of HUF 14 billion in the household loan portfolio. In the case of forint loans, disbursements exceeded repayments by HUF 61 billion, while foreign currency loans outstanding shrank by HUF 87 billion based on transactions. The transaction-based annual rate of decline fell compared to previous period and amounted to 4.3 per cent in Q3. The decline in the loan portfolio affected both housing and other loans, with the former shrinking by HUF 13 billion and the latter by HUF 27 billion.[4] The rise in the ratio of forint loans within the household loan portfolio continued as foreign currency loans were scaled back and the forint loan portfolio expanded.

The volume of new loans continued to pick up. The gross volume of new household loans of the entire credit institution sector amounted to HUF 157 billion in Q3 (Chart 14). Credit institutions concluded new contracts with the household sector for a value that is higher by almost 32 per cent year-on-year. This amount of new lending was last seen in 2010, not counting the loan redemptions during the early repayment period. The increase in lending is strongest in the case of housing loans, but other, unsecured consumer loans also rose substantially. Within new housing loans, the ratio of state-subsidised schemes fell to 23 per cent. The decline is attributable to the fact that – due to the reduction of the policy rate – market-based contracts often provide as favourable a level of interest rates as the state interest-subsidised scheme.

Conditions for consumer loans eased, while those of the housing loans remained unchanged. All in all, in net terms, 21 per cent of the respondent banks eased conditions for

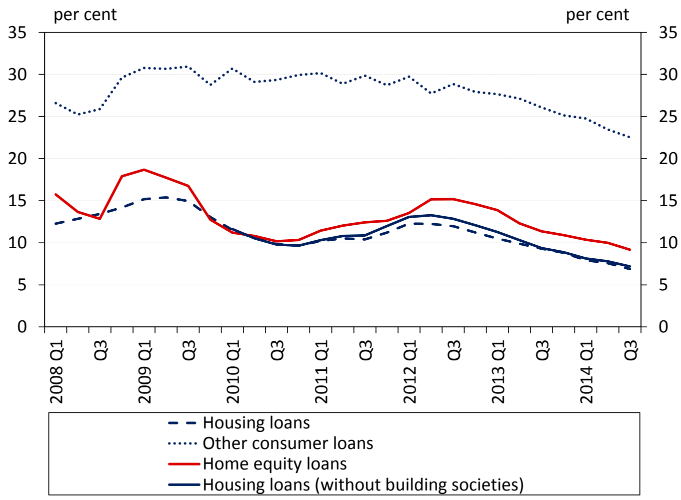
[4] The net portfolio change is the balance of the transactions and other flows (write-offs, reclassifications).

Chart 15: Changes in credit conditions



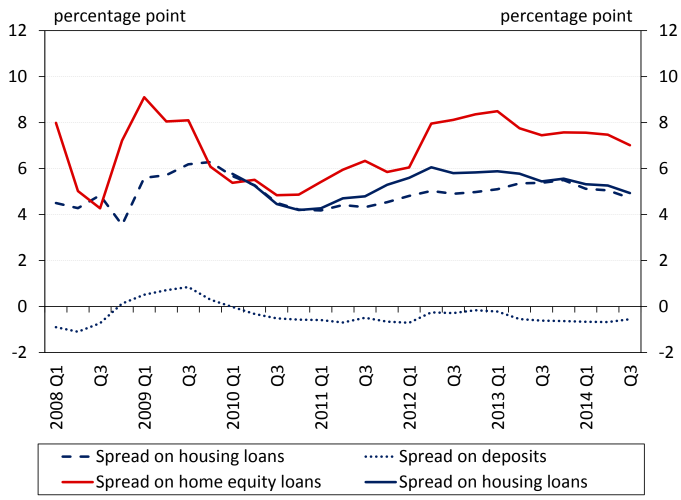
Note: The net proportion is the difference between tightening and easing banks, weighted by the market share.Source: MNB, based on the answers of responding banks.

Chart 16: Annual percentage rate of charge of 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 the interest rate spreads on 3-month BUBOR. Spreads based on the APR.
Source: MNB.

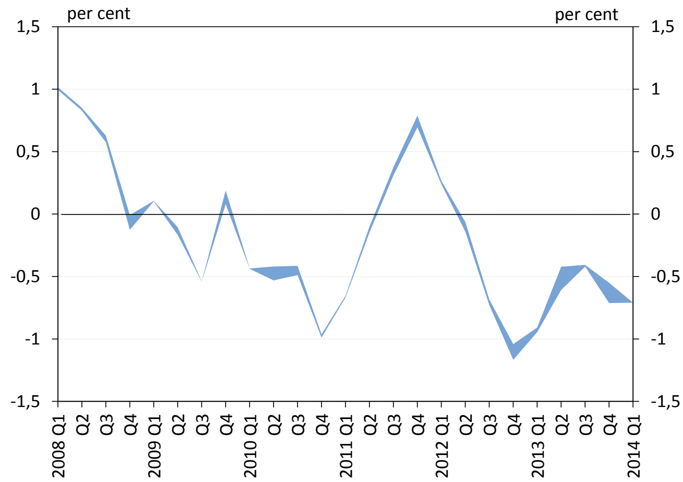
consumer loans. This was reflected in the decrease of the minimum creditworthiness level, the disbursement fees and the spread between the lending rate and funding costs. The latter also decreased for housing loans, but the overall conditions in this segment remained unchanged (Chart 15). Regarding the upcoming half-year, in net terms about 16 per cent of the banks plan to tighten conditions on housing loans, while leaving conditions on consumer loans practically unchanged.

Housing loan spreads continued to decline. The annual percentage rate (APR) further decreased even after the end of the policy rate cutting cycle. The average annual percentage rate on new contracts concluded in the third quarter was 6.9 per cent (Chart 16). The decrease resulted partially from the composition effect stemming from the increase in the ratio of floating rate schemes which has already lasted for three quarters. The average annual percentage rate on floating rate loans was 6.5 per cent compared to 7.3 per cent for fixed rate loans. The interest rate spread on the reference rate (3-month BUBOR) fell by almost 0.4 percentage points (to 4.3 percentage points) for floating rate loans and by 0.3 percentage points (to 5.1 percentage points) for fixed interest rate products, in quarter-on-quarter terms. Consequently, the decline in the interest rate spreads on new loans, which has been seen since the last quarter of 2013, continued (Chart 17).

The annual percentage rate of consumer credit also decreased. The annual percentage rate of consumer credits shrank in the case of both mortgages loans and other consumer credit. The APR on home equity loans fell by 0.8 percentage points to 9.2 per cent (Chart 16), while the borrowing cost of unsecured consumer loans decreased to a larger extent, namely by 1.2 per cent for personal loans and 0.9 per cent for car purchase finance. The decrease in the APR exceeded the decline in the reference interest-rate across most loan segments, resulting in a slight narrowing of spreads (Chart 17).

The banking sector was less contractionary through the household loan segment. The household sub-index of the financial conditions index substantially improved compared to the previous quarter: according to the index, via the credit supply the banking sector slowed annual GDP growth by 0.3 per cent between 2013 Q3 and 2014 Q3 (Chart 18). The rise in new lending in the previous quarters and the easing of loan conditions suggest a recovery in the credit market, but loan conditions are still tighter than before the crisis. The latter is also reflected in the persistently low average value of the loan-to-value ratio of 57 per cent, which is substantially lower than the regulatory threshold (80 per cent in the case of forint-

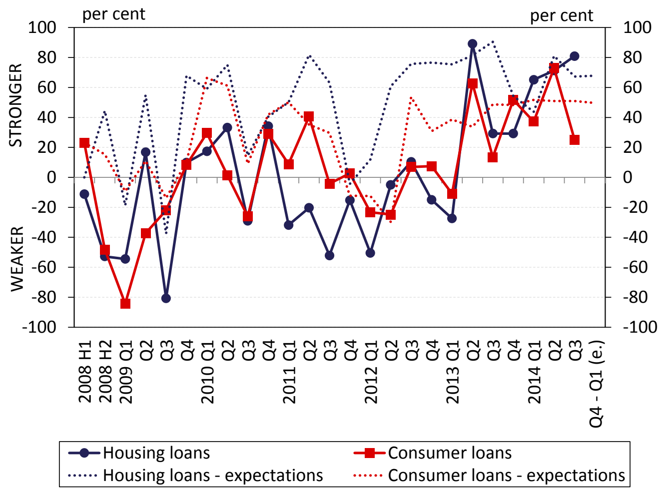
Chart 18: Sub-index of the FCI for household lending



Note: The index quantifies the impact of financial conditions on annual GDP growth through household lending. The band illustrates the methodological uncertainty. Based on preliminary data.

Source: MNB.

Chart 19: Credit demand in the household lending segment



Source: MNB, based on the answers of responding banks.

denominated housing loans) and the average of earlier years.

The vast majority of banks perceived a further increase in demand for housing loans. Based on the lending survey, in net terms 81 per cent of banks reported higher demand for housing loans in Q3, while 25 per cent indicated a pick-up in demand for consumer credit (Chart 19). The low loan costs, the increasing real income, and the expanding employment contributed significantly to the growth in demand. The majority of respondent banks expect a further increase in both loan segments. The macroprudential regulations on maximising the instalments and the loan value, which come into force from 2015 January, may theoretically reduce demand for credit, but this effect primarily occurs among the less eligible clients, who already cannot satisfy the credit conditions required by the banks.

Box: Impact of the bill on the "fair banking system" on the pricing of household loan contracts.

On 11 November 2014 the Government submitted the bill referred to as the "fair banking system" bill, the key objective of which is to regulate the tasks related to the provision of information on lending, and the transparent and objective pricing of the household loans. The scope of the act covers both newly disbursed loans and the already existing portfolio.

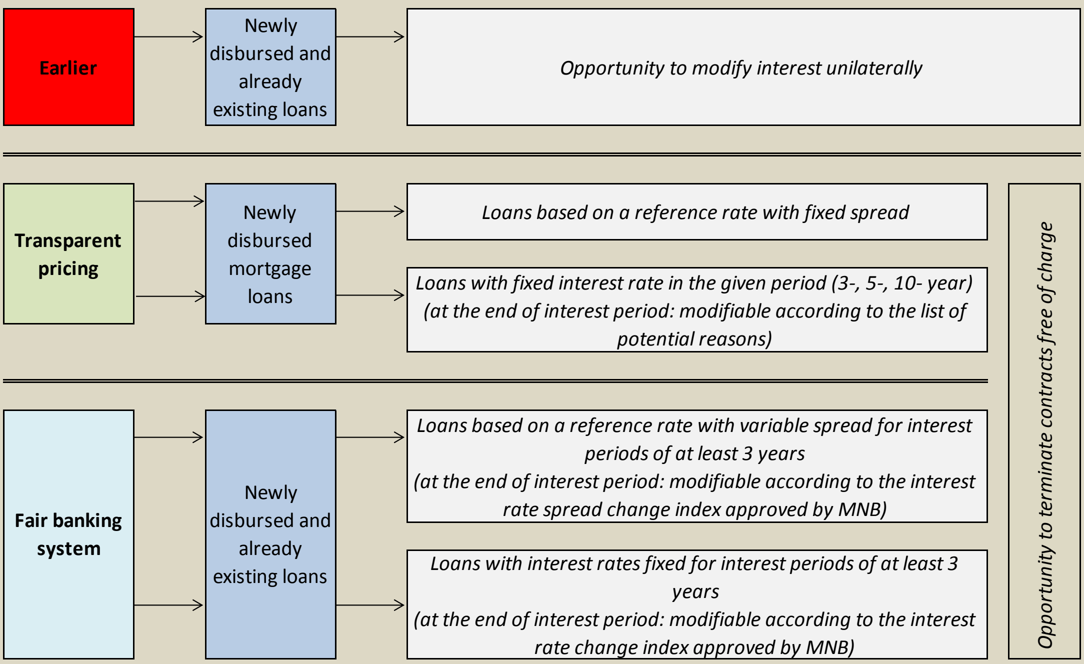
The bill is not the first initiative aimed at improving the pricing of household loans. While earlier – in the period marked by the expansion of foreign currency lending – the retail loan contracts usually permitted the lenders to modify the price terms of the contract unilaterally after disbursement, Act CXLVIII of 2011 on Transparent Pricing allowed, in the case of mortgage loans, only the granting of loans with fixed interest in the given period or loans based on a reference rate with fixed spread. In the first case, if the interest rate changes unfavourably for the client at the end of the interest period, he is entitled to terminate the contract free of charge, which represents a substantial control against increases in the interest rate by the banks.

The recently submitted bill may be regarded as an expansion of the principles included in the Act on Transparent Pricing, as it covers all retail credit products with maturity shorter or longer than 3 years, and regulates not only new contracts, but the already existing portfolio as well. According to the planned regulation, in the case of loans with maturity shorter than 3 years the lenders may apply two types of pricing: fixed interest rate or variable interest rate tied to the reference rate published on the webpage of the MNB, with a fixed spread. In the case of loans with maturity longer than 3 years lenders may grant loans with interest rates fixed for interest periods of at least 3 years, or with variable interest rate tied to a reference rate plus an interest rate spread fixed for the entire maturity, or at least for 3-year interest periods. As an additional condition, upon the expiry of the interest periods, the lenders may only modify the interest rate or the interest rate spread corresponding to the change of the objective interest rate or interest rate spread change indices approved and published by the MNB.

The MNB will assess the compliance with the interest rate change indices submitted by the banks with the act within 30 days. The indices must satisfy the following conditions:

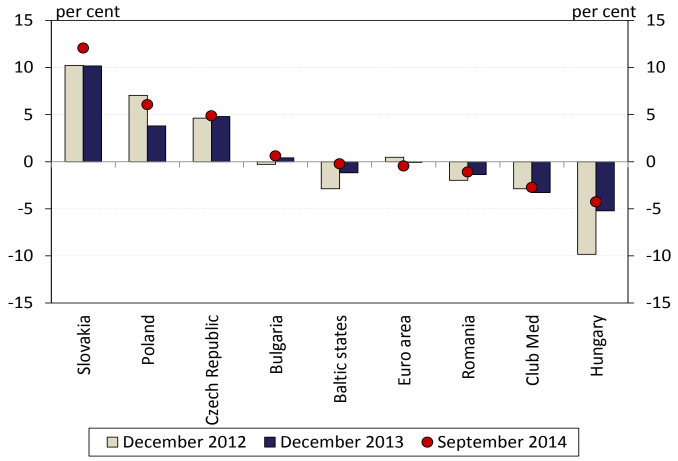
- they must express the change of the circumstances, other than the business risks, related to the refinancing costs of lending and to granting of the loan in an objective manner,
- they must include circumstances that are beyond the control of the lenders, independent of them and cannot be prevented by them.

Furthermore, the submitted bill also stipulates a cap on the number of interest rate changes during the entire maturity, which may result in disbursing longer-term loans with longer interest periods.



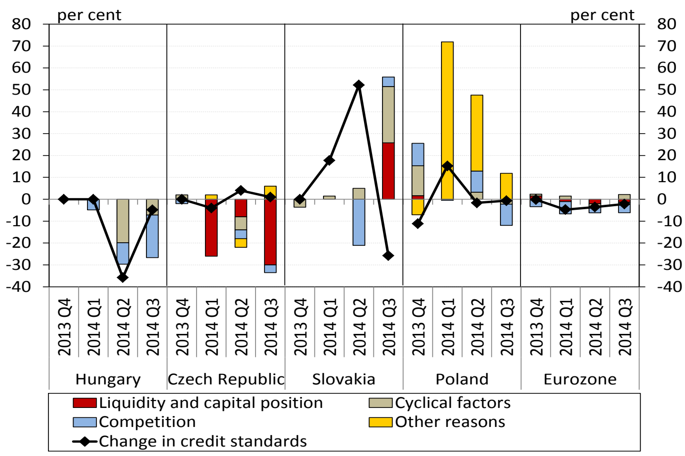
The possibility of terminating the loan free of charge at the end of the interest periods is also included in the bill on the "fair banking system". The extension of the regulation already applicable to mortgage loans disbursed after April 2012 to the entire portfolio may significantly boost the role of loan refinancing and thereby the intensity of the banks' competition in the future.

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



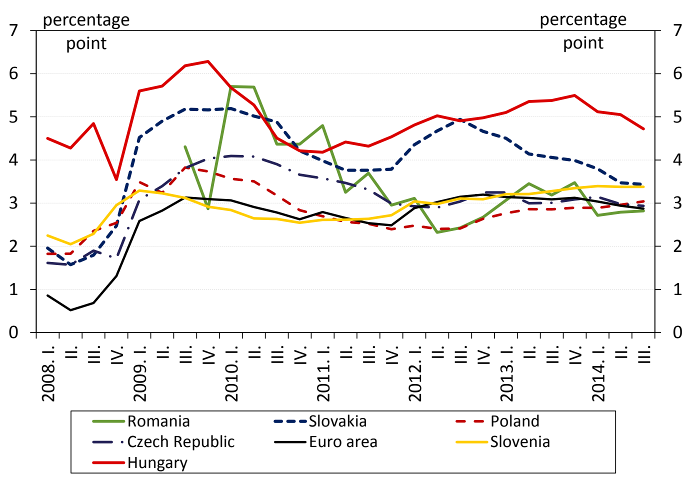
Note: Mediterranean countries: Greece, Italy, Portugal and Spain. Baltic states: Estonia, Lithuania and Latvia.
Source: ECB, MNB.

Chart 21: Changes and factors contributing to changes in housing loan credit conditions in an international comparison



Note: Category values are derived from the arithmetic average of the factors thematically classified therein. Positive values indicate the tightening of standards, while negative ones indicate the easing of such.
Source: MNB, ECB, national central banks.

Chart 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.

International review of household lending

Outstanding household loans continue to grow at a fast pace in the Visegrad countries. Based on transactions, the loan portfolio increased in the vast majority of CEE countries. In terms of annual dynamics, apart from Hungary, only Romania saw its portfolio decline among the countries of the region, while the Visegrad countries were characterised by positive annual growth rates (Chart 20). All in all, the outstanding loans of households remained almost unchanged in the member states of the euro area in Q3. The aggregated annual growth rate of around zero per cent resulted from various factors: the marked decrease rate of about 5 per cent in the Mediterranean countries is offset by the positive change of the other member states, such as Luxembourg, Malta, Belgium and Slovakia.

The conditions of housing loans somewhat eased in Europe. Within the countries of the region a significant range of banks reported that they had eased housing loan credit conditions in Slovakia, while conditions were reported to have remained essentially unchanged in Poland and the Czech Republic (Chart 21). In the euro area, household loan conditions eased, following the trends of the previous quarter, both in the housing loan and the consumer loan segments, although looking ahead only a few of the respondents anticipate easing in 2014 Q4. In respect of housing loans, a particularly high percentage of banks noted rising demand during the quarter. The survey conducted by the European Central Bank emphasises that in addition to the easing of conditions, the heterogeneity of the loan supply conditions of the various countries also decreased, and that the constraints may still be deemed strict despite the easing.

The difference between the Hungarian and regional interest rate spreads decreased. In the majority of the countries in the region – with the exception of Hungary – the interest rate spread on housing loans did not change significantly in 2014 Q3. In the case of Romania and Poland, the spread on the reference rate of housing loans slightly increased, while the rest of the countries were characterised by a decrease. Among the countries in the area, the Hungarian spread decreased to the largest extent, i.e. by 0.3 percentage points, and although it further approximated the regional average as a result, it still exceeded the average by 1.6 percentage points (Chart 22). The spreads on concluded deals also narrowed in the euro area; however the households of the various countries still face highly diverse price conditions on credit (nominal interest rate).

ANNEX: METHODOLOGICAL NOTES

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

1. Credit aggregate and lending rate data

One of the statutory tasks of the Magyar Nemzeti Bank is to publish statistical data regarding the functioning of the system of credit institutions and the financial position of the country. The statistics compiled, press releases presenting the main data as well as the methodological descriptions of preparing the statistics are available on the MNB's website at:

http://english.mnb.hu/Statisztika

2. Lending Survey

The Lending Survey facilitates the analysis of how major banks perceive and evaluate market developments and how they develop their respective strategies, in particular their lending policies. In the case of the household segment, a total 11 banks were involved in the interviews. 9 banks responded to questions related to housing loans, while 11 banks and 7 financial enterprises answered questions on consumer loans. Based on data from the end of 2014 Q3, the surveyed institutions accounted for 90 per cent of the banking sector in the case of housing loans outstanding and 90 per cent in the case of consumer loans outstanding. The corporate questionnaire was completed by 8 banks, with a total market share of 86 per cent and 94 per cent of the corporate loan and commercial real estate loan markets, respectively. A total 7 banks were interviewed on the subject of loans extended to municipalities. Based on data from the end of 2014 Q2, the institutions surveyed covered 91 per cent of total municipal exposure by banks.

The survey consists of a standard questionnaire in each segment, and since the survey conducted in January 2010 the MNB has also asked ad hoc questions on current concerns related to the credit markets. The retrospective questions refer to 2014 Q3 (compared to 2014 Q2), whereas the forward-looking questions concern the next half-year period, i.e. the one covering 2014 Q4 and 2015 Q1 (relative to 2014 Q3). The current questionnaire was completed by the senior loan officers between 1 and 16 October 2014.

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

The detailed findings of the Lending Survey and the set of charts are available at:

http://english.mnb.hu/Kiadvanyok/hitelezesi_felmeres

3. The Financial Conditions Index (FCI)

In addition to short-term interest rates and the nominal exchange rate, which represent the behaviour of the financial markets, the FCI condenses the information contained in other price, quantitative and qualitative variables characterising the financial intermediary system into one indicator. The FCI gauges the impact of the financial sector on the real economy. The annual change in FCI mentioned in the survey shows the contributions of the financial system and the banking sector to the annual real GDP growth rate.

The weights of the variables that determine the FCI are derived from a VAR (vector autoregressive) model based on the Bayesian structural VAR model developed by Tamási and Világi (2011).[5] In the VAR model, the use of the so-called sign restriction method allows the identification of monetary policy shocks as well as the supply shocks of financial markets and the banking sector. The identified shocks allow calculation of how unexpected changes in individual financial variables affect the growth in GDP. The advantage of the method is that it is possible to exclude the endogenous reaction of financial variables on the developments in economic activity, i.e. a real cause and effect relationship can be identified.

The FCI is based on the following variables:

- 3-month interbank rate (BUBOR),
- nominal effective exchange rate,
- corporate loans outstanding,
- household (consumer and home equity) loans outstanding,
- interest margin on corporate loans,
- interest margin on household (consumer and home equity) loans.

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

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

TRENDS IN LENDING

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