Senior loan officer survey on bank lending practices

Summary of aggregate results of the survey on 2004 H1
September 2004

Analysis prepared by: Katalin Bodnár
Financial Stability Department

The survey on bank lending practices was conducted *in the summer of 2004 for the fourth time*. This analysis summarises the results of the latest survey. The retrospective questions of the questionnaire refer to 2004 H1, therefore, the base period for these questions is 2003 H2, whereas the forward-looking questions contain projections for 2004 H2 compared to the trends of the first half. The questionnaire concentrates on two areas: the *household* and *corporate lending* segments. The questionnaire relating to household lending was filled in by *10 banks* (within this, 7 banks answered the questions relating to housing loans and 9 banks answered those relating to consumer and other loans), while *7 banks* answered the questions relating to corporate lending. 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 instead of our own professional opinion. We try to explore how 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 wish 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 unweighted).

Foreign currency lending

The current questionnaire did not contain any special supplementary questions, but because of the topicality of this issue, we touched upon the experiences in foreign currency lending in the course of each interview. It is characteristic of both the corporate and household sectors that *a higher proportion of newly issued loans is denominated in foreign currency, primarily in Swiss francs,* than in forints.

In the *corporate sector* several senior bank officers stated that, while earlier it was almost exclusively exporting firms that took out foreign currency loans, now *non-exporters* also use that option. *Small enterprises*, which have not sought to borrow in foreign currency up to the present, wish to use this option in a higher proportion than before. Banks active in corporate lending did not voice any concerns about foreign currency loans, in spite of the fact that corporate foreign currency indebtedness involves high risks, which the banks cannot fully handle. Several of them stated that it is not only large companies that use instruments for hedging exchange rate risks, but also small ones; however, on the basis of this survey we did not manage to find out about the types of these instruments. It is also probable that some of the companies use foreign currency borrowing for *speculative purposes*.

The emergence of foreign currency lending is characteristic of both market segments of *household lending*. Opposite to the corporate market, in this case several senior bank officers emphasised that *households are unable to take account of both exchange rate and interest rate risks linked with foreign currency loans*. In the absence of hedging instruments and as a result of bank lending practices, both risks are completely borne by households. The senior bank officers mentioned that, due to the interest rate differential, it is better for clients to be indebted in foreign currency in the short run, but long-term risks are high. In the housing loan market, slackening demand due to the stricter regulatory environment and higher interest rates was counterbalanced by the emergence of foreign currency loans bearing favourable interest conditions. Of consumer loans, *car purchase finance* is almost exclusively provided in foreign currencies; however, foreign currency based products are being developed in several other areas as well. It is a characteristic trend that banks provide foreign currency loans under *tighter conditions* than forint loans, and that some general regulations relating to forint-denominated loans also became stricter due to foreign currency loans.

Evaluation of the aggregate results of the questionnaire

1. Corporate lending market

The opening towards *small and medium-sized enterprises* continued in the corporate lending market. The survey provides clear evidence that, while banks continue to strongly rely on large enterprises, small and medium-sized enterprises have increasing significance. In addition to the shifts in supply in accordance with the above trend, responding bank officials also reported more robust demand.

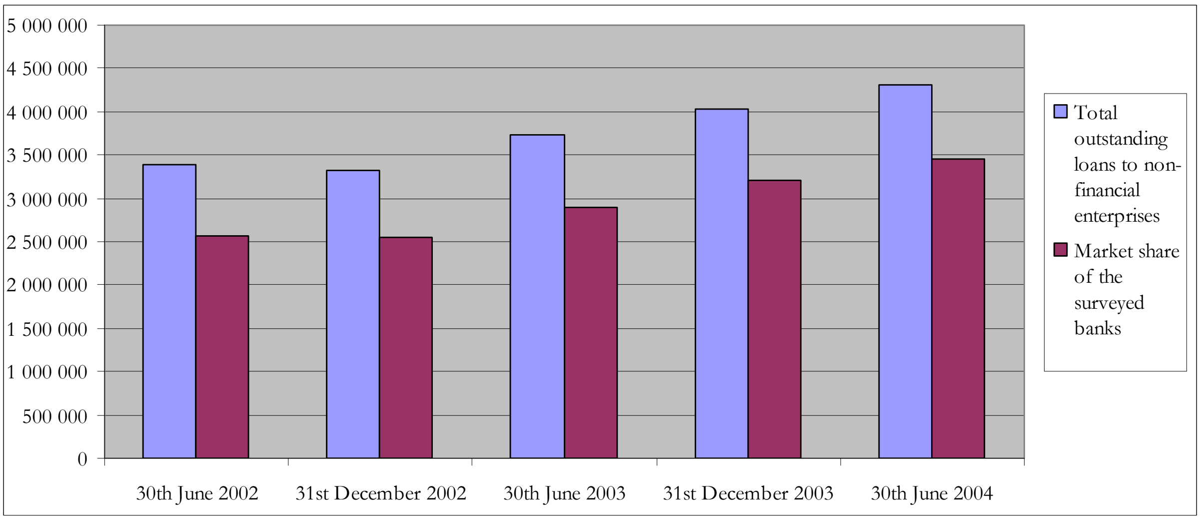
On the basis of the questionnaire, the *commercial real estate lending* market appears to have become *saturated*, as had been expected by banks. On the supply side, this is indicated by the fact that banks did not tighten the conditions and, on the demand side, banks' answers did not signal a change in demand on aggregate.

During previous surveys we experienced a continuous worsening in the risk assessment of the sectors. Our current results, however, show that the assessment of economic sectors *moved towards the safer side* in 2004 H1. In addition to a trend of stabilisation in the domestic and global (and within this, the European) macroeconomic environment, this change in trend may have been caused by the amelioration of concerns related to joining the European Union.

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

We slightly changed the structure of the corporate questionnaire: senior loan officers were asked to provide the direction and extent of changes for each corporate category and for the total non-financial corporate sector. Classifications into corporate categories 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.

Chart 1 Shares of responding banks within the total corporate lending portfolio (excluding commercial real estate loans)



Supply side

Corporate sector

In the corporate sector, banks reported a significant increase in their willingness to lend in the first half of the year. This trend was also characteristic earlier, but now it became much stronger, since 71.4% of responding banks increased their willingness to provide new loans. Propensity to lend mostly continued to grow towards medium-sized, small and micro-sized enterprises, but banks did not report a decline in willingness to lend in any of the corporate segments.

Creditworthiness standards required for accepting credit applications became somewhat stricter, although less than projected in the previous semi-annual period. Some banks tightened the overall conditions of providing loans, but not to a considerable extent. In the non-financial corporate sector, the increase in risk premium was most characteristic, and the spread between lending rates and cost of funds increased somewhat as well. On the whole, we experienced increased tightness in the case of fewer banks and factors than in the previous semi-annual periods.

Banks primarily referred to the less favourable or uncertain economic outlook and the industry-specific problems as the reasons for tightening, but less aggressive competition and tolerance of lower risks were also significant factors in the segment of small and medium-sized enterprises.

Banks did not project a change in creditworthiness standards for 2004 H2. As during the earlier semi-annual periods the standards became increasingly tighter, their unchanged nature is a sign of a turnaround. Banks responding wish to change lending conditions in such a way that the increase in premium on high-risk loans, the obligations undertaken by the debtor and the collateral requirements are balanced by raising the maximum amount of loan, as well as by reducing the fees for loan provision and the spread.

Large enterprises

Within the financial corporate sector, large enterprises continue to be dominant (partly due to granting loans to firms closely connected with large corporations). However, they carry fewer new opportunities than small and medium-sized enterprises. The overall *willingness of banks to lend grew in the past semi-annual period*, but not to the extent as in the other two categories. Most banks did not change their creditworthiness standards (*Chart 3*), while the conditions of lending became tighter, primarily with the increase in the risk premium and the spread (*Charts 5-6*.). The majority of responding banks held the opinion that standards and lending conditions remained on the whole unchanged.

For the next six months banks projected *unchanged or slightly tighter the creditworthiness standards* in the segment of large enterprises. No significant changes in lending conditions are planned. An exception is the premium on high-risk loans, which is expected to increase in this segment as well. Opposite to previous trends, banks do not intend to increase their spreads and wish to tighten other conditions less than planned earlier.

Small- and medium-sized enterprises (SMEs)

As mentioned earlier, in line with previous trends banks show increased willingness to lend to SMEs. This can be seen, above all, *in the development of new products and the standardisation of credit structures, loan appraisal and risk management, as well as in relaxing certain standards and conditions.* According to the survey results, the segment of small and micro enterprises looks most attractive for banks, therefore, *stronger competition is expected* in this segment.

Medium-sized enterprises

In addition to lending conditions, creditworthiness standards for enterprises classified by banks as medium-sized also became *tighter (Chart 3).* Similarly to large enterprises, banks increased both the risk premium and the spread in this sector as well (*Chart 5-6*). The reasons included bad economic outlook, industry-specific problems and less aggressive competition.

Banks do not foresee to tighten the standards for medium-sized enterprises in H2. This indicates a turnaround in the earlier trend. Conditions for loan provision will not change in most of the responding banks, although earlier they anticipated tighter conditions.

Small and micro enterprises

Several banks reported *significantly higher propensity to lend* to small and micro enterprises in the past semi-annual period. At the same time, we experienced *easing creditworthiness standards* and tighter lending conditions at the aggregate level. However, this aggregate number conceals differences among banks, *as in several banks the conditions eased overall.* Among the potential causes of becoming less tight, loan officers attached the same level of importance to more favourable economic conditions, fewer problems, less aggressive competition and tolerance for higher risks (*Chart 7*).

Banks projected easing standards and lending conditions during the next semi-annual period. As regards lending conditions, one bank projected a fall in credit provision fees and one a fall in the spread, another one projected higher premium and one tighter collateral requirements, while several banks projected an increase in the maximum amount of credit in 2004 H1.

Demand side *(Chart 8)*

Corporate sector

In accordance with their earlier forecast, bank officials responding to the questionnaire perceived that non-financial corporations' demand for loans was stronger in 2004 H1 than in 2003 H2. The increase in receivables and inventory financing requirements, as well as higher investment into fixed assets were mentioned as the most important reasons for this. Several entities mentioned the low level of interest rates abroad explaining the higher demand for foreign currency loans.

Banks expect a further increase in the non-financial corporate sector's demand for loans in the period ahead, but opinions are split with regard to the segment to which this growth is attributed. Five banks projected an increase in demand within the segments of both large and the medium-sized enterprises, while three banks projected an increase in demand in the segment of small and medium-sized enterprises.

Large enterprises

In the segment of large enterprises, banks experienced higher demand for loans in the past semi-annual period. They reported the increase in receivables and inventory financing requirements, as well as higher investment into fixed assets as underlying reasons for this. For the following six-month period 71.4% of responding banks expect a further, significant increase in demand by large enterprises for loans. This is in contrast with previous semi-annual periods, when no such growth was projected.

Medium-sized enterprises

In the past six-month period several banks perceived higher or even significantly higher demand by medium-sized enterprises for loans. The reasons for this growth in demand are the same as in the case of large enterprises, in addition to the low level of interest rates abroad, which led to an increase in demand for foreign currency loans. A more significant proportion of responding banks than earlier expect growth in demand for loans in this segment as well.

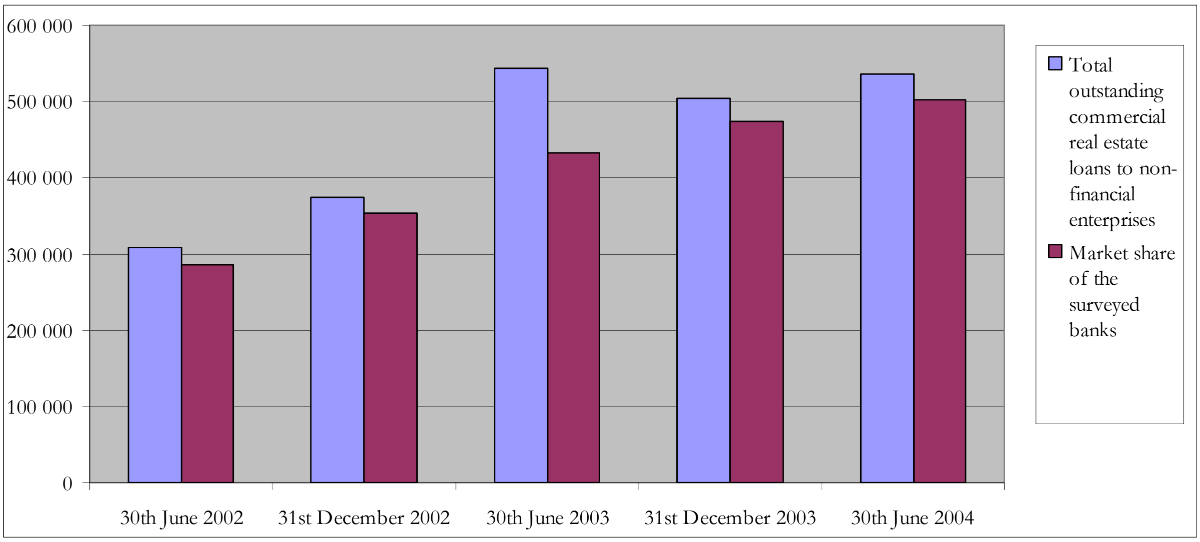
Small and micro enterprises

In 2004 H1, the demand of small and micro enterprises for loans was perceived by almost each bank as stronger than before. While in 2003 H2 only two banks perceived higher demand, now 5 banks received more credit applications from this segment. Stronger demand for credit is attributed to the same factors by banks as in the case of other corporate segments, but in this case even more banks mentioned that they were selected by clients instead of other banking or non-banking credit sources, that is, they perceived a shift in demand due to increased competition. In addition, one of the responding banks also mentioned government subsidy programmes, and one of them the low interest rates abroad, as great incentives boosting demand. Fewer banks expect further growth in this segment than in the segment of large and medium-sized enterprises.

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

In line with the experiences with previous questionnaires, commercial real estate lending continues to be the only market segment where an answer indicating a decline in propensity to lend was given by the banks. Growth in the total lending portfolio and in the lending portfolios of responding banks is the lowest in this segment, compared with other segments under survey. We also have to note that this market is dominated by a few banks whose answers unanimously show unchanged supply and demand. Changes were mostly signalled by small market participants.

Chart 2 Share of responding banks in commercial project loans within the total project loan portfolio



Supply side

The banks polled in the questionnaire changed their willingness to provide commercial real estate loans in the first half in various ways. The *index signalling a 14.3 % strengthening* reflects the higher willingness of two banks, the lower willingness of one bank and the unchanged willingness of five banks. *Creditworthiness standards remained unchanged at an aggregate level*, one bank tightening and one easing them. This indicates a shift in previous trends, as during the previous three surveys tighter lending conditions and credit rating standards were projected.

Banks except one anticipated unchanged standards for the second half of 2004.

Demand side *(Chart 8)*

In 2004 H1, demand for commercial real estate loans was perceived by the banks *as unchanged overall*. The aggregate index, however, reflects very different opinions: two banks thought that demand was weaker, two thought it was stronger and three thought it was unchanged. Of the responding banks, 28.6% expect a net increase in demand for the next half.

Summary charts on the results of the corporate questionnaire

Chart 3 Creditworthiness standards by corporate category and in the field of commercial real estate loans (positive = tightening)

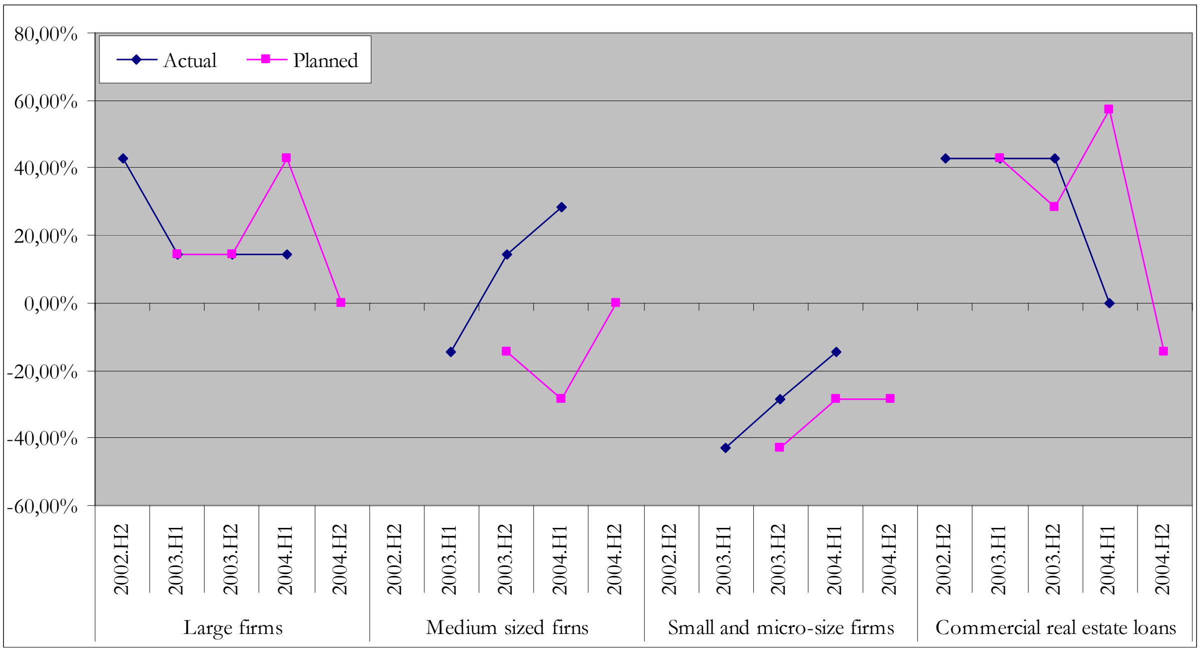


Chart 4 Maximum size of loans/credit lines by corporate category (positive = tightening)

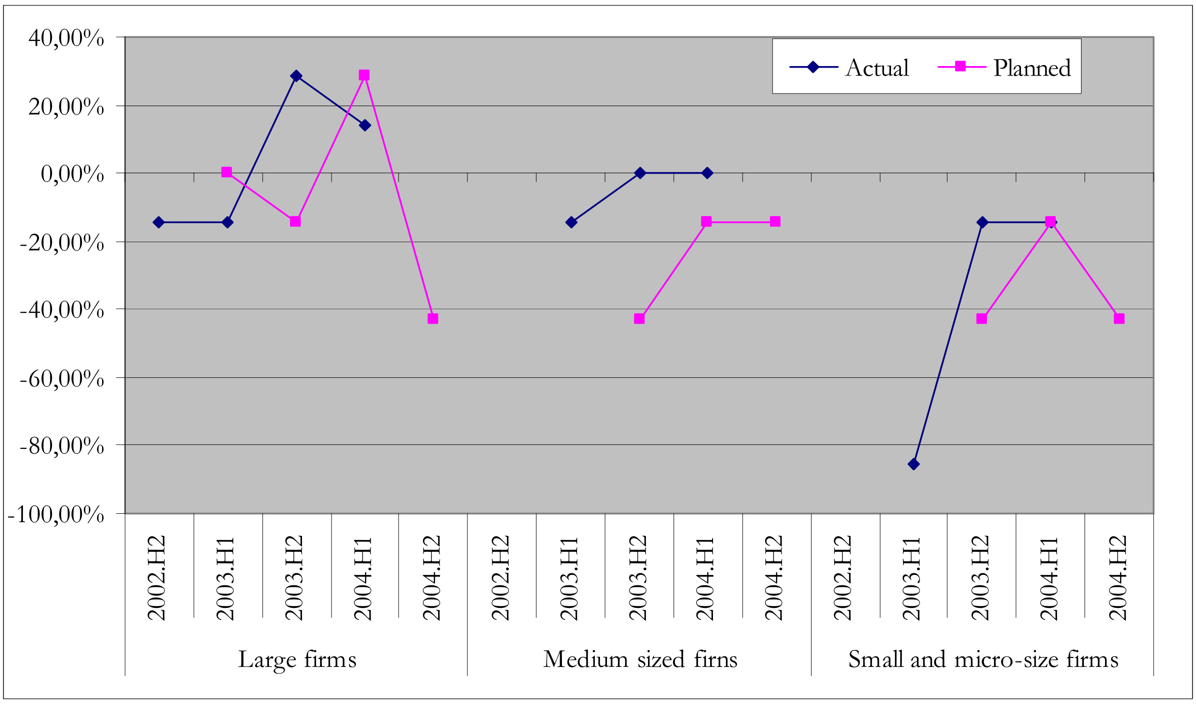


Chart 5 Spread between lending rates and costs of funds in a breakdown by corporate category (positive = increase)

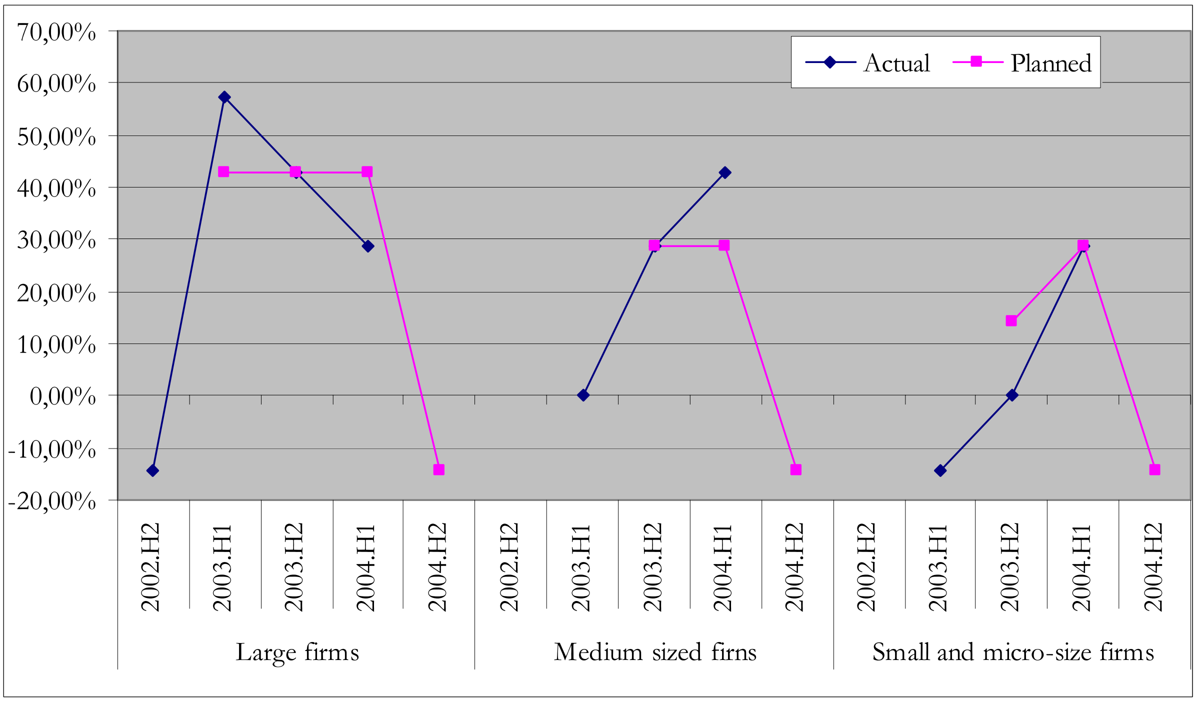


Chart 6 Premium on higher-risk loans in a breakdown by corporate sector (positive = increase)

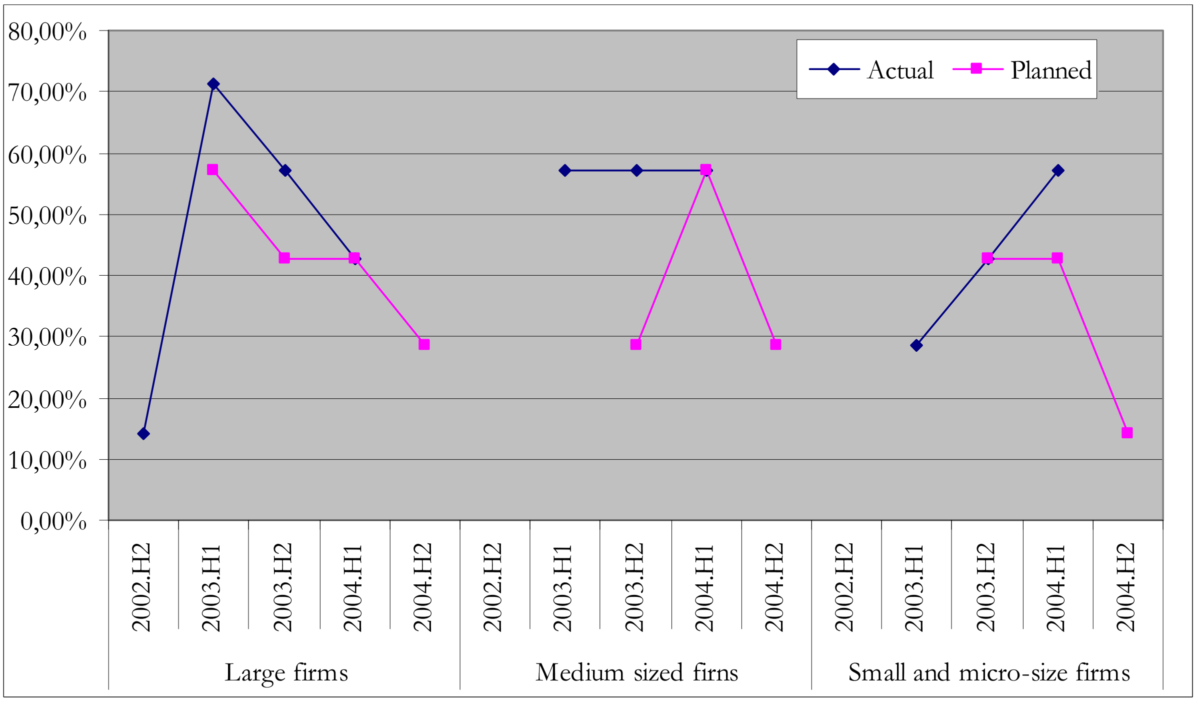


Chart 7 Reasons for easing creditworthiness standards and lending conditions in the case of small and medium-sized enterprises (1 = not significant; 2 = somewhat significant; 3 = very significant)

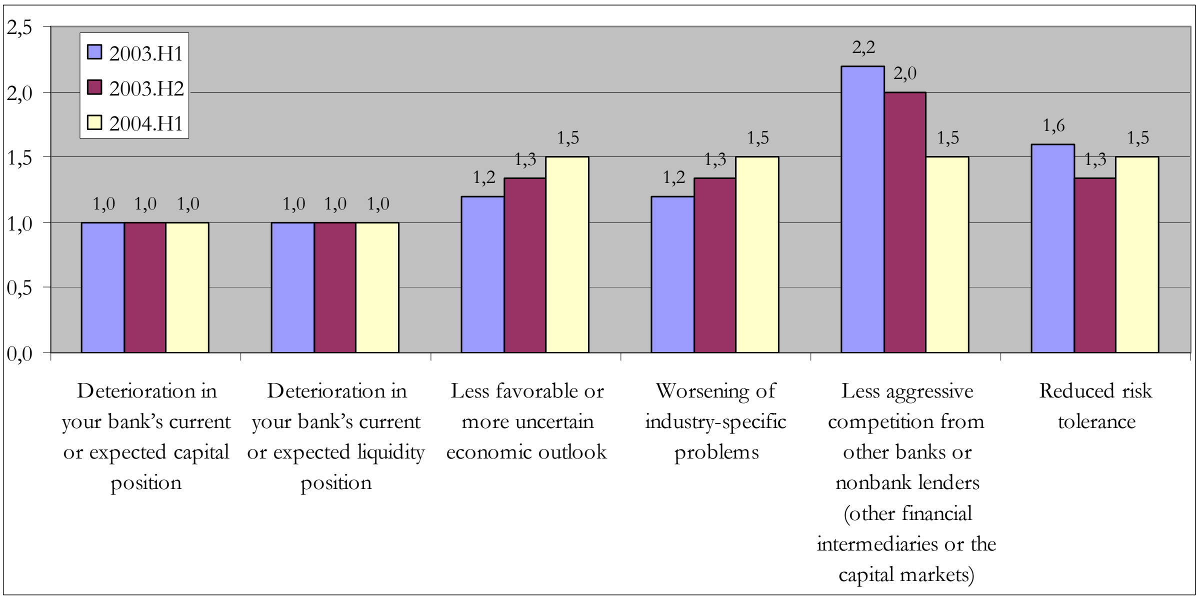
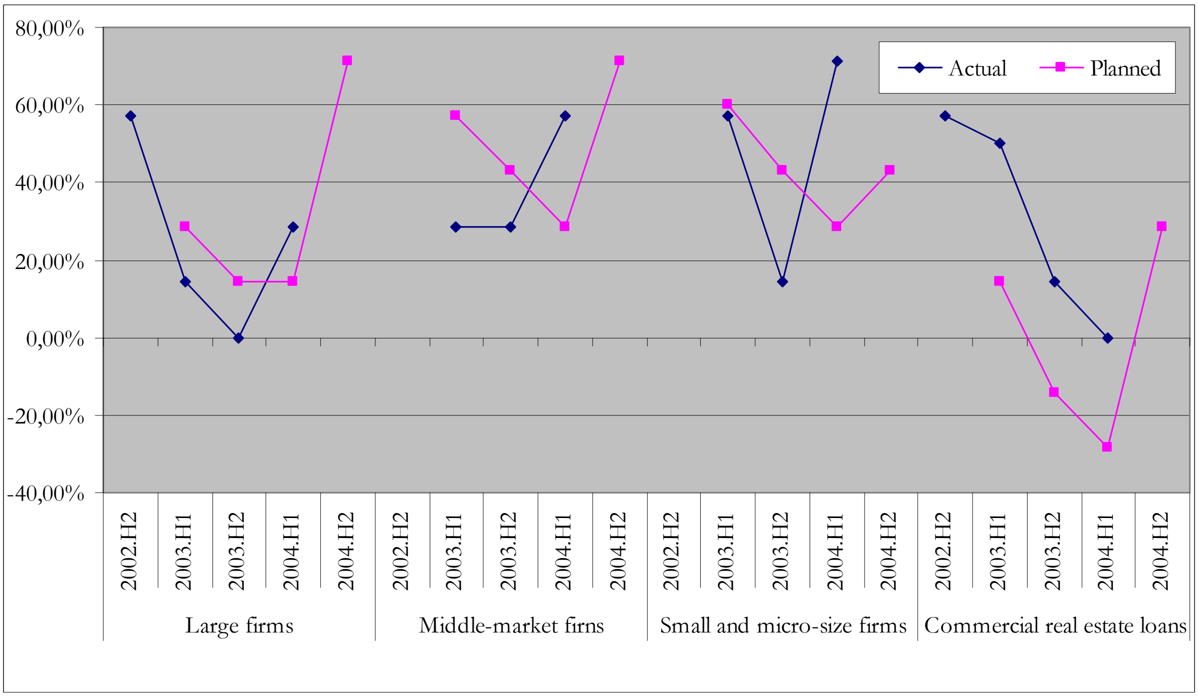


Chart 8 Demand for loans in a breakdown by corporate sector and in the market of commercial real estate lending (positive = stronger demand)



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

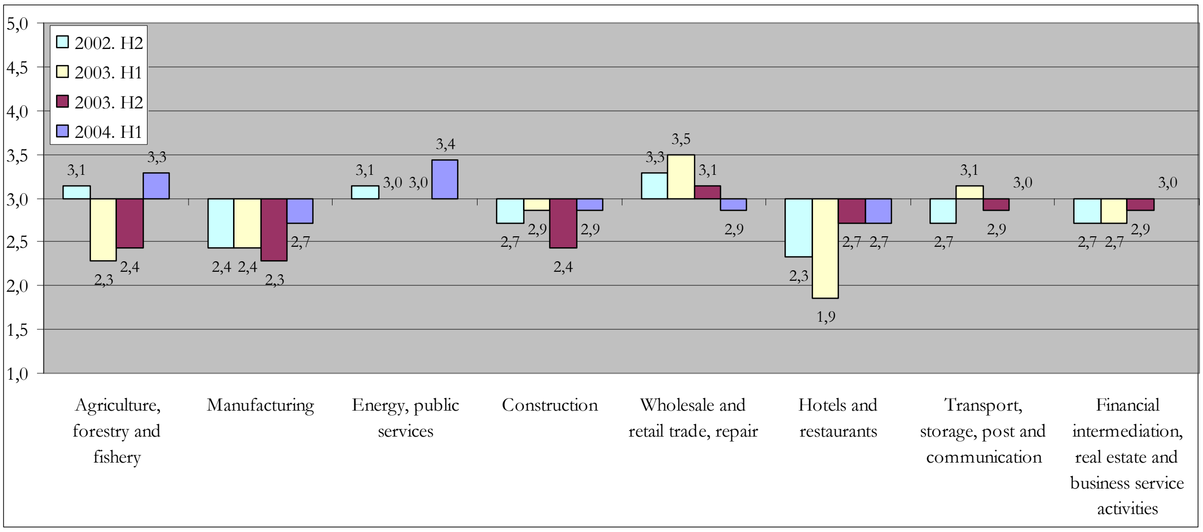
Comparing the answers of banks participating in the survey with earlier results we found that fewer banks consider corporations as riskier in all areas, except for one.[1] Naturally, this result conceals different answers (*Chart 9*).

During previous surveys banks voiced their concern about the *agricultural sector*, which was expected to become more risky due to joining the EU. On the basis of the aggregate index, we can still see that the assessment of the sector has slightly moved towards the safer end. The reason for this may be the fact that, due to community support programmes, agricultural activities became more calculable and easier to finance, therefore, some banks are more willing to provide loans. The differing ways of assessing EU accession are reflected in the classification of the other sectors as well.

Risk assessment of companies operating in *electricity, gas, heating and water supply* improved. Two banks, however, considered *manufacturing* as carrying more risks (in particular, the assessment of the food industry worsened), but the sector's average rating has slightly moved towards the safer end of the scale compared to the results of earlier surveys. The same is characteristic of *construction and of enterprises operating in transport, storage, and communications, in financial activities and in real estate, renting and business activities.*

Only the aggregate index of *trade and repair* moved towards the riskier end of the scale, due to more fierce competition in this field.

Chart 9 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)



[1] In the questionnaire we ask senior bank officers to give account of their current risk assessment of industries compared to the previous semi-annual period. In our experience they rather assess the sectors in relation to each other. They tend to consider a sector more risky even if the circumstances have not changed compared to the previous semi-annual period, but it is less safe than the areas considered more neutral.

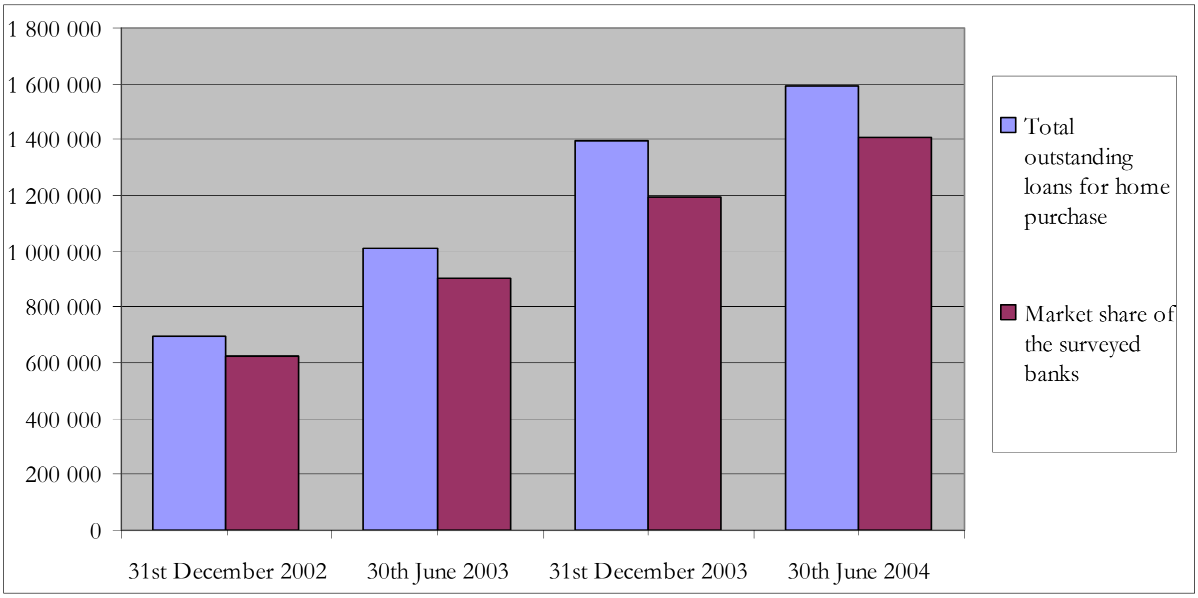
2. Household lending market

There was no material change in the structure and content of the questionnaire relating to the household lending market. Question 5, which examines the loans-to-collateral ratio in the case of subsidised and market-priced housing loans, will be eliminated from the analyses and the questionnaire, because it has become part of banks' statutory data supply.

In addition to foreign currency lending, mentioned above, the current trends reflect the wider use of unrestricted mortgage loans and credit card products, although opinions were split in the case of the latter.

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

Chart 10 Market share of banks answering the questions relating to housing loans



Supply side

In 2004 H1, *42.9% of the banks filling in the questionnaire reported an increase in propensity to provide housing loans*. Similarly to the previous period, the banks *did not change* creditworthiness standards (*Chart 17*) and on aggregate this is characteristic of the conditions of housing loans as well (*Chart 11*). An exception is the maximum loan-to-value ratio, which was lowered by three entities out of the seven asked. The spread between lending rates and costs of funds changed in the case of several banks: they fell in the case of three banks and increased in the case of the same number of banks, but these effects cancel each other out in the aggregate index.

Standards and conditions were relaxed in the case of four out of the seven banks. Among the reasons for easing, the most important ones were competition and improvement in the creditworthiness of clients; however, the improvement in banks' capital strength and the danger of a real estate price bubble developing in the housing market also played a role. For some of the responding banks the change in government regulations on subsidised housing loans also played a role in the easing, but two banks tightened their conditions as a consequence of the same factor.

Banks on aggregate do not plan to change their creditworthiness standards and lending conditions for housing loans during the second half of the year.

Chart 11 Lending conditions in the market of housing loans, past figures (positive = easing)

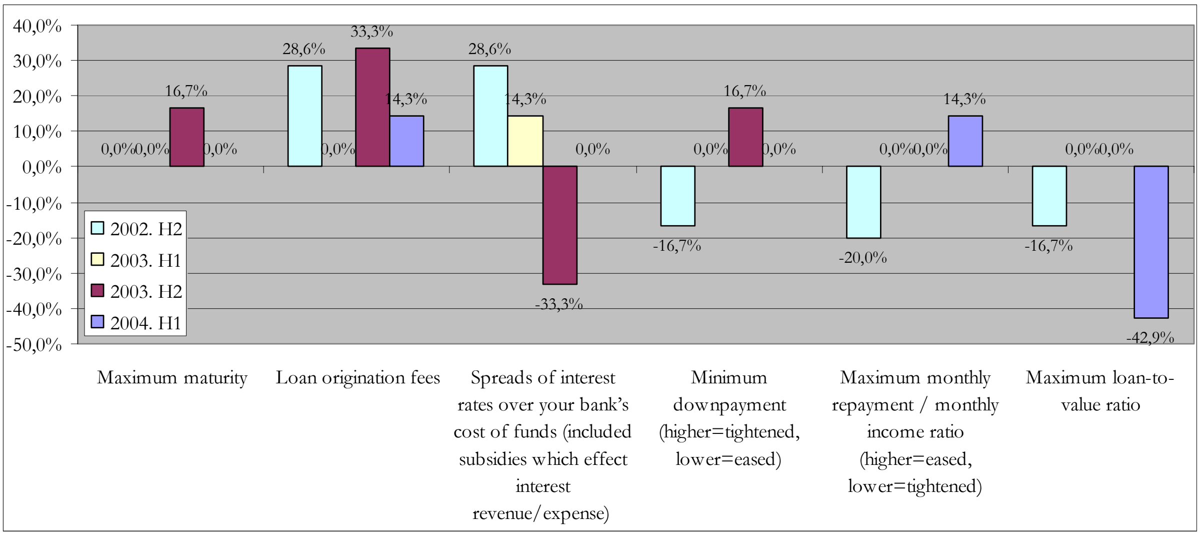
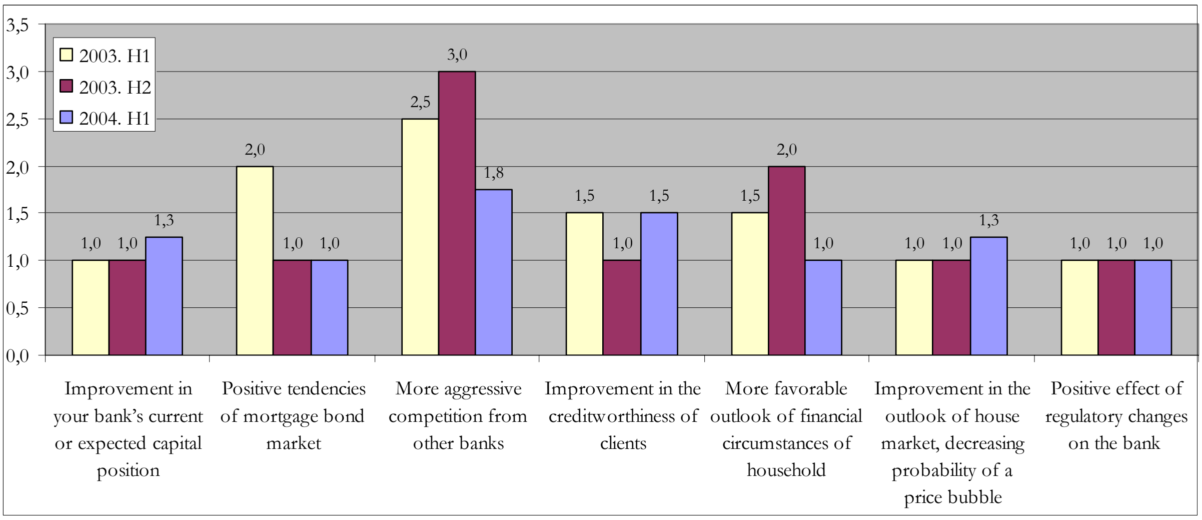


Chart 12 Reasons for relaxing creditworthiness standards and lending conditions in the case of housing loans (1 = not significant; 2 = somewhat significant; 3 = very significant)



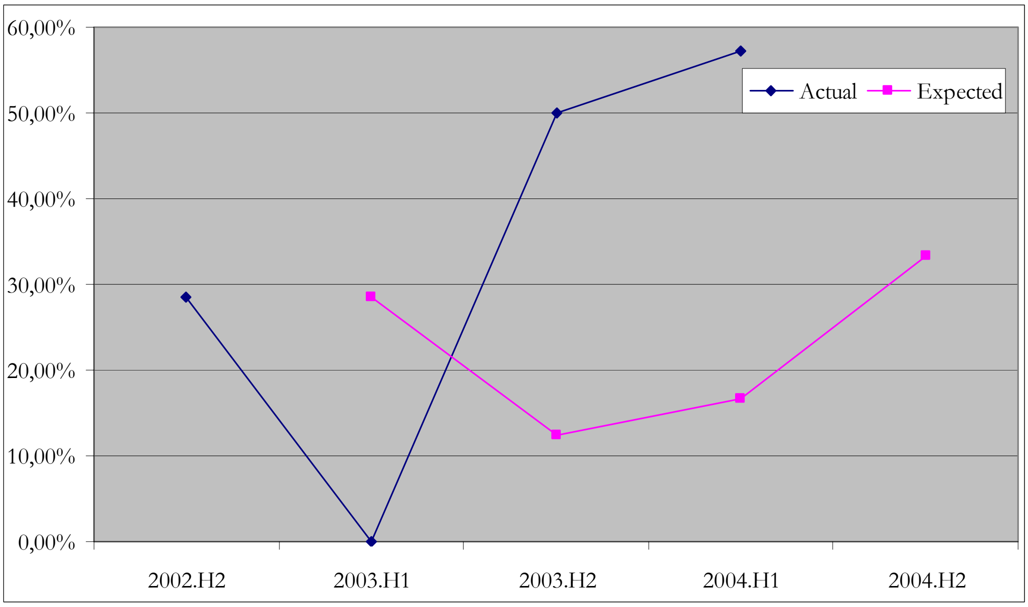
Demand side *(Chart 18)*

Responding loan officers experienced a considerable downturn in demand for housing loans in 2004 H1. The first quarter turned out to yield particularly weak results, while in the second quarter there was an upswing in demand and at the same time foreign currency loans became dominant. Responding banks signalled this downturn in advance in the previous questionnaire. Their explanation for this was that households had brought forward house purchases due to the favourable conditions in past years. Indebtedness due this factor also influenced the consumer lending market in 2004 H1, in addition to the market of housing loans. The majority of banks expect demand to recover in H2.

Nominal house prices

Banks perceived that *nominal house prices* were higher in 2004 H1 than in 2003 H2. Here, real estate prices in Budapest and its surroundings as well as in large provincial towns rose significantly, while the prices in other regions stagnated, particularly in the eastern part of the country. Banks expect *further increase in house prices* in 20014 H2. More banks shared this expectation than in the previous semi-annual periods.

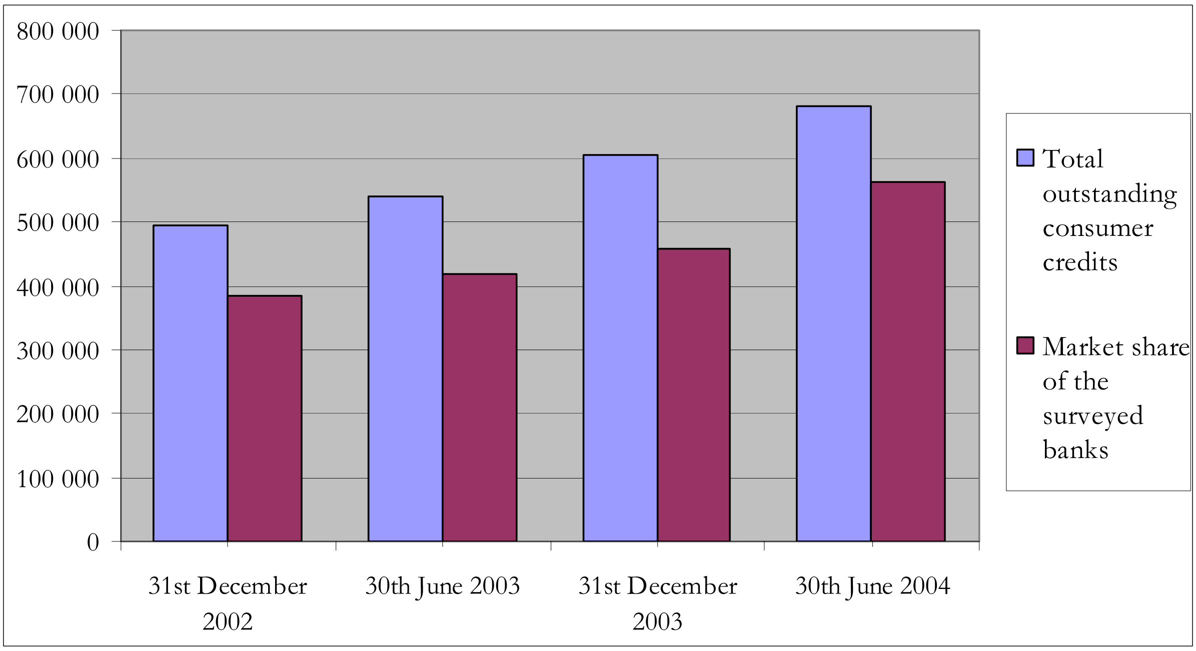
Chart 13 Nominal flat prices according to Loan Officers



2.2. Consumer credit

(questions 11-15 of Appendix 4)

Chart 14 Market share of banks responding to questions relating consumer credit



Supply side

Continuing past trends, a significant increase in the loan portfolio and product supply, coupled with more aggressive competition, was experienced on the supply side of consumer loans in the period surveyed. The increase in the number of responding banks from 7 to 9 can also be explained by the higher number of market participants and shifts undergoing in the market.

Seven out of the responding nine banks expressed increased propensity to provide consumer credit in 2004 H1. At the same time, there was an overall easing in creditworthiness standards (*Chart 17*) and lending conditions (*Chart 15*). As far as lending conditions are concerned, the biggest change affected credit limits, which were increased by four banks. Three banks lowered the minimum initial downpayment for consumer credit and several of them mentioned that they did not request initial downpayment as a condition for providing the loan and, therefore, there was probably no more room for relaxing this condition. Among the reasons for easing the standards and conditions, increased competition in the interbank market was given the highest score (2), although this was lower than in the previous semi-annual period (2.7). Increasingly aggressive competition by non-bank financial intermediaries is also significant, but it moved towards the end of the scale indicating less importance. In addition to the improved creditworthiness of clients, banks mentioned clients' increased propensity to take on debt, the good credit portfolio and the characteristically high average APRC, due to which banks are forced to compete by altering lending conditions, as the reasons for easing. The two banks that tightened their conditions referred to their intention to improve the portfolio as well as to technical reasons.

For the next half of the year, the banks expect a further easing in standards and conditions, which foreshadows continued strong competition.

Chart 15 Lending conditions in the consumer credit market, past figures (positive = easing)

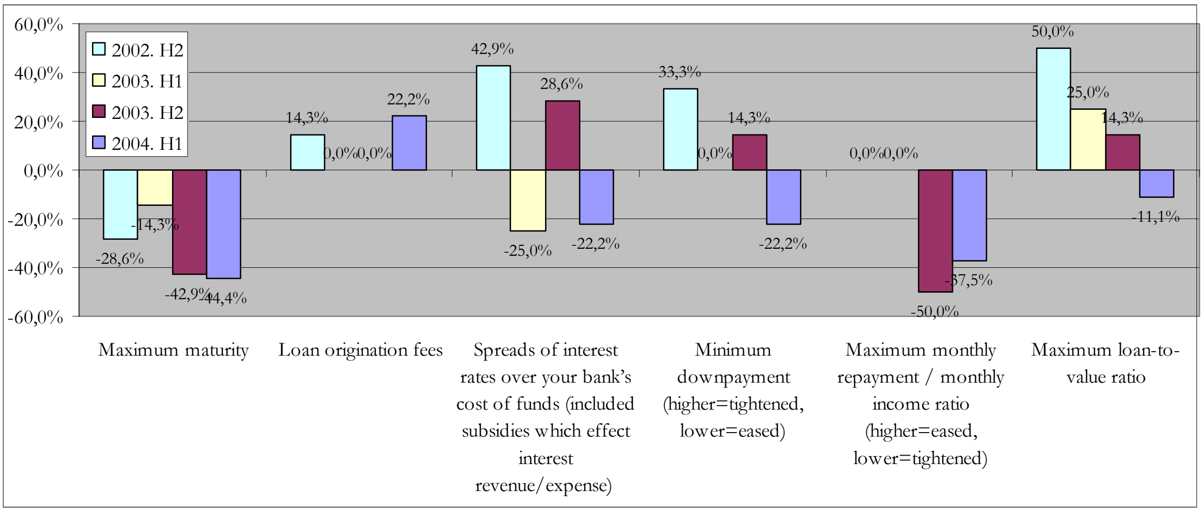
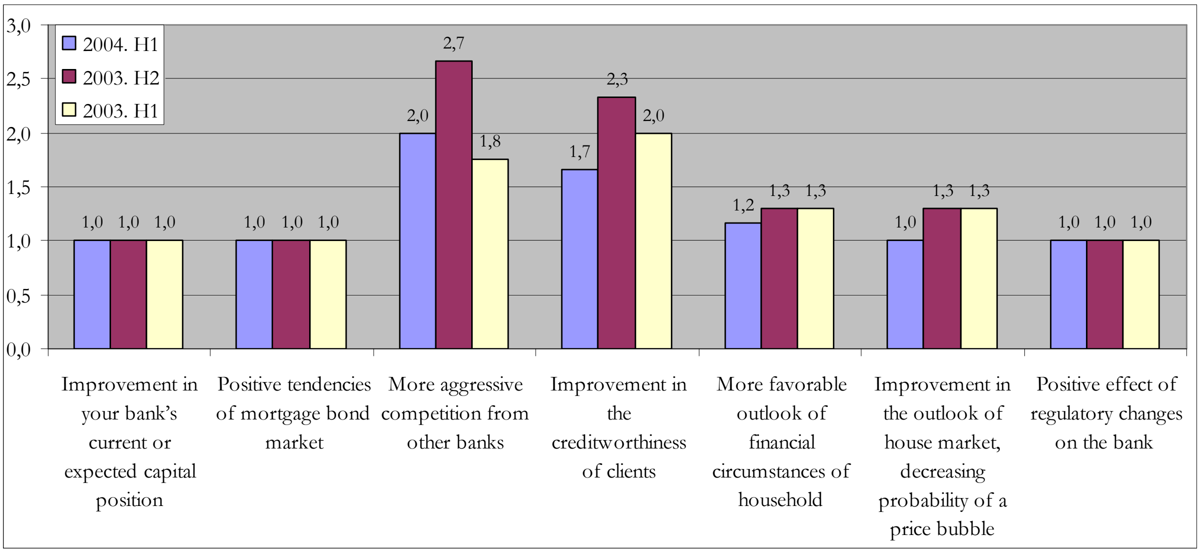


Chart 16 Reasons for relaxing creditworthiness standards and lending conditions in the consumer credit market (1 = not significant; 2 = somewhat significant; 3 = very significant)



Demand side *(Chart 18)*

In the consumer credit market, an increase in demand was perceived by 25% of respondents expressed in net terms. That was lower than in the previous period. Some senior bank officers thought that there was less lending potential due to the higher level of indebtedness in consequence of earlier home purchases and to the higher level of satisfaction of consumer demand. Nevertheless, two-thirds of the banks expect an increase in the period ahead, in addition to the seasonal increase in demand towards year-end.

Summary charts on the results of the household questionnaire

Chart 17 Creditworthiness standards in the consumer credit market (positive = tighter)

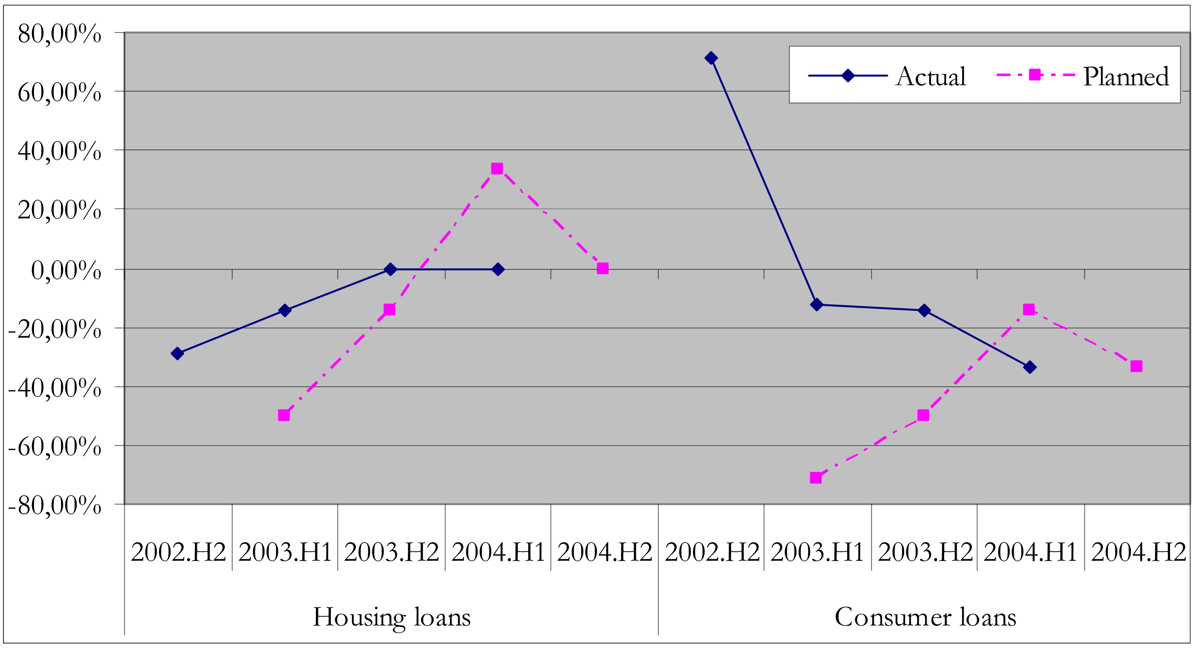


Chart 18 Demand for loans in the housing loan and consumer credit markets (positive = higher demand)