SENIOR LOAN OFFICER SURVEY ON BANK LENDING PRACTICES

Summary of the aggregate results of the survey on 2005 H2
March 2006

Analysis prepared by Mónika Papp

Financial Stability

The latest, *seventh* survey on bank lending practices was conducted in *early 2006*, and this analysis presents a summary of the results. The retrospective questions in the questionnaire refer to 2005 H2, and thus the base period for these questions is 2005 H1, whereas the forward-looking questions contain projections for *2006 H1* compared to the trends of the previous half year. The questionnaire concentrates on two areas: the household and corporate lending segments. The total amount of loans outstanding in the individual market segments and the shares of responding banks are shown in *Appendices 1 and 2*. Appendix 5 discusses the characteristics of consumer lending by financial enterprises.

In presenting the results, we follow the structure of the relevant questionnaire in both of the 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 responding senior bank officers 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 present 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).

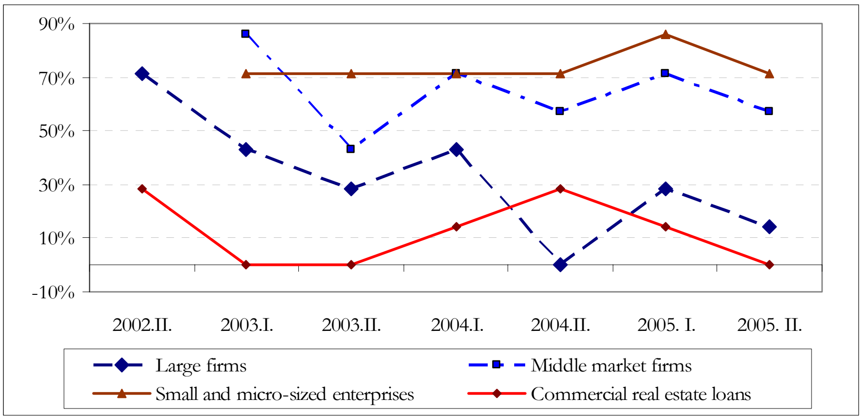
Aggregate results of the questionnaire

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, with a total market share of 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 94% (see Chart 14 and Chart 15).

According to the general opinion of the surveyed loan officers, there was a pick-up in corporate lending activity in the second half of 2005. The banks continued to raise their openness to small and medium-sized enterprises (SMEs) sector, as their propensity to lend to these segments increased steadily, and as a response to the more aggressive competition the banks eased standards and lending conditions. As far as lending to large enterprises and commercial real estate loans is concerned, there was only fine-tuning, and the banks plan to ease their standards of real estate lending in the first half of 2006. Most of the banks expressed optimism about demand in the following half year.

Chart 1: Willingness of the banks to lend in the different sectors of the corporate loans market (Ratio of those reporting tightening minus those reporting easing)



1.1. Corporate lending, excluding commercial real estate loans

(Questions 1-9 of Appendix 3)

Supply side

Non-financial enterprises as a whole

Banks' willingness to lend still increased, but fewer banks reported an increase compared to 2005 H1: three of the seven surveyed banks gave a positive answer, whereas in the previous period six banks responded positively. Opening up to the SME sector is still a main factor behind the figures. This increasing willingness does not appear in the easing of creditworthiness standards: the banks unanimously judged standards to be unchanged, while in the previous survey 71% of the banks planned easing for the second half of the year. The banks changed their lending conditions in different manners: one bank tightened loan covenants, and two banks increased the risk premium. Most of the banks (three of them) reported easing in lending fees, and in addition a net 14% of the banks also changed the following lending conditions positively from the perspective of borrowers: collateralization requirements; spreads; and maximum size of credit lines.

For 2006 H1, in the category of non-financial enterprises as a whole, one bank reported a tightening of creditworthiness standards, while the others do not intend to change them. As for lending conditions, most of the banks plan to change collateralization requirements and risk premiums: three banks plan easing in terms of collateralization requirements and three plan tightening in terms of risk premiums (see Chart 16-20).

Large enterprises[1]

In 2005 H2 only one bank's willingness to lend increased, although none of the reporting banks changed standards. However, lending conditions were changed in various ways: two banks increased risk premiums, one of them tightened loan covenants particularly due to industry-related reasons, while two banks eased lending fees in response to competition. Creditworthiness standards have been unchanged for three semi-annual periods, and lending conditions have been fine-tuned: banks have changed different conditions, and there is still no uniform trend.

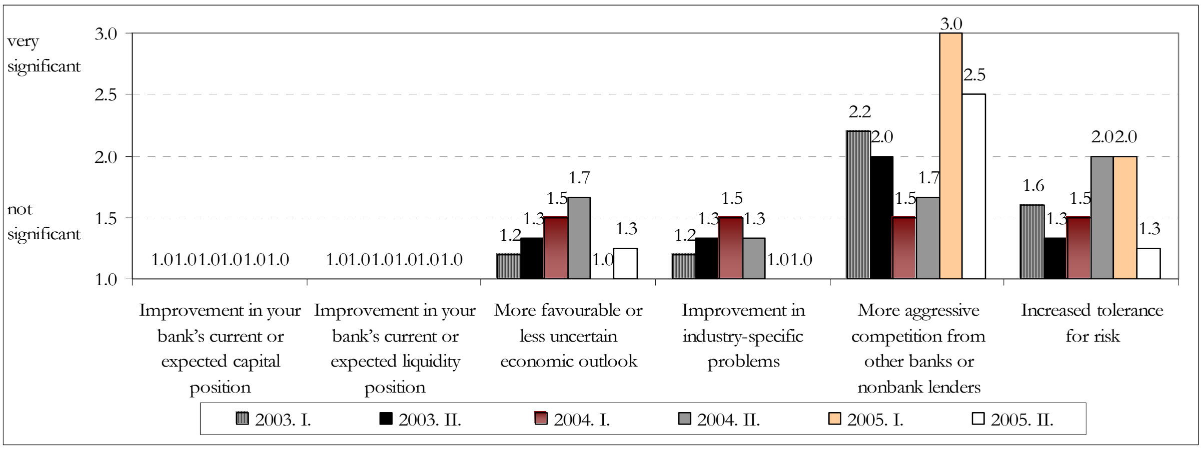
[1] Classifications into corporate categories still vary among banks, and bank officials provide the extent and direction of the changes for the categories used by themselves. Therefore, corporate size as shown by the questionnaire is by no means unambiguous, which must be taken into account when evaluating the results.

For 2006 H1, the banks tended to project tightening, and in particular they intend to raise risk premium in the segment of large enterprises.

Small and medium sized enterprises

The willingness to lend continued to increase both in the segment of medium, and small and micro-sized enterprises – in some cases significantly. In accordance with the projections of the previous survey, this increasing willingness was also accompanied by easing of creditworthiness standards in the case of medium-sized enterprises (29% of the banks eased). As in all of the previous surveys, the banks reported easing in the segment of small and micro-sized enterprises: in 2005 H2 three banks eased their standards. In the case of medium-sized companies, the banks continued to decrease lending fees, and also to tighten loan covenants and risk premiums. As far as lending to small and micro-sized enterprises is concerned, for 2005 H1 two banks reported the easing of collaterisation requirements, with this number increasing to three banks for the second half of 2005; in this segment two banks also decreased lending fees. Net tightening was observed in terms of loan covenants. The banks mainly mentioned aggressive competition as a reason behind easing.

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



As far as medium-sized enterprises are concerned, a net 14% of the banks reported the tightening of creditworthiness standards for the first half of 2006, while in the case of small and micro-sized enterprises 57% of surveyed participants indicated a continuation of easing. Regarding lending conditions, the banks wish to make nearly the same changes in the two size categories: they continue to ease collaterisation requirements and to raise the maximum size of loans, while they plan to tighten risk premiums and to increase the cost of credit lines. In the case of small and micro-sized enterprises, two banks plan to ease loan covenants.

Demand side

In the second half of 2005, demand in all corporate segments was perceived by each bank to be at least as strong as it was in the first half of the year. Of the seven surveyed banks, four reported stronger demand in the sector of large and small and micro-sized enterprises, and three experienced greater demand in the sector of medium-sized companies. The banks evaluated clients' increased need for debt and inventory financing as the most important reason behind the growing loan demand, which they attributed mainly to the characteristics of the state budget settlement system and intercompany debts. In the case of small and micro-sized companies, the decrease of own sources also played an important role in the increase of demand, as it did in the previous semi-annual period.

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

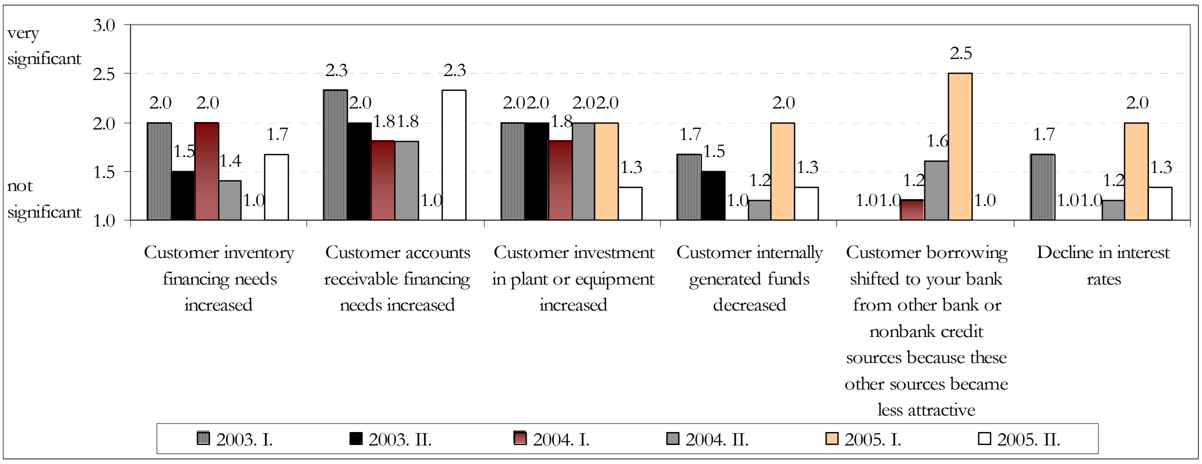
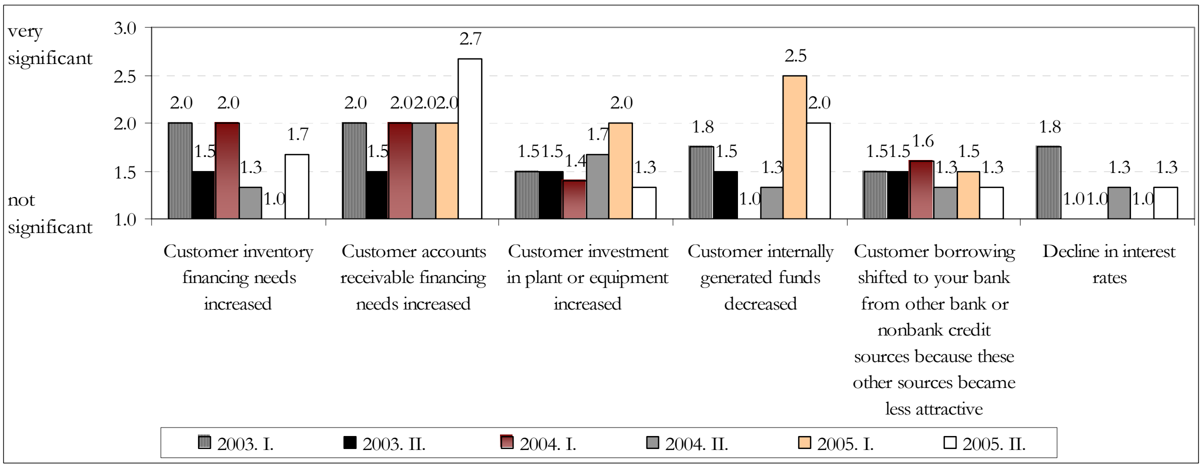


Chart 4: Reasons for increasing loan demand of small and micro-sized firms (1 = not significant; 2 = somewhat significant; 3 = very significant)



In respect of the question on loan demand, as opposed to the last two half years, the deviation of expected and realised demand was not significant: nearly as many banks forecasted higher demand for the second half of 2005 as actually experienced it in the given period. With regard to the following half year more than half of the banks are still optimistic, and project higher demand. Higher demand was expected by 6 banks in the segment of medium-sized enterprises, by 4 banks in the segment of small and micro-sized enterprises, and by 2 banks in the large corporate segment, but the others also do not forecast decreasing demand (see Chart 21).

1.2. Commercial real estate loans

(Questions 10-15 of Appendix 2)

Supply side

On aggregate, the willingness of banks to grant new commercial real estate loans – taking into regard that it was already at high level – remained unchanged in the second half of 2005, while there was only one bank which reported greater lending willingness and one which reported lower lending willingness. Concerning creditworthiness standards – as opposed to the previous half year's tightening tendency and in line with the earlier trend – two banks decided to ease, which they explained with more aggressive competition and the diminishing probability of a real estate price bubble. For first six months of 2006, three banks already reported easing of standards, while none of the respondents plan tightening (see Chart 16).

Demand side

In the previous survey, on aggregate the banks did not expect demand for commercial real estate loans to change, which they also confirmed based on new loan applications. However, it is important to highlight that the individual participants experienced different demand developments: two banks reported higher demand, while two reported lower demand. For the forthcoming half year the banks have positive expectations: a net 43% of the surveyed banks forecasted an increase in demand (only one bank forecasted lower demand, while 4 expect increasing interest in such loans).

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

(Question 16 of Appendix 3)

In the second half of 2005, in terms of the different economic sectors, the assessment of manufacturing, construction and agriculture sector worsened again, and furthermore, enterprises with trade, repair and transport activities were considered slightly riskier. By contrast, the assessment of financial services, real estate and business service activities, which had continuously deteriorated in the previous periods, did not continue to worsen. On aggregate, based on the banks' view, none of the industrial sectors became safer, although some of the banks reported positive tendencies in some industrial sectors.

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

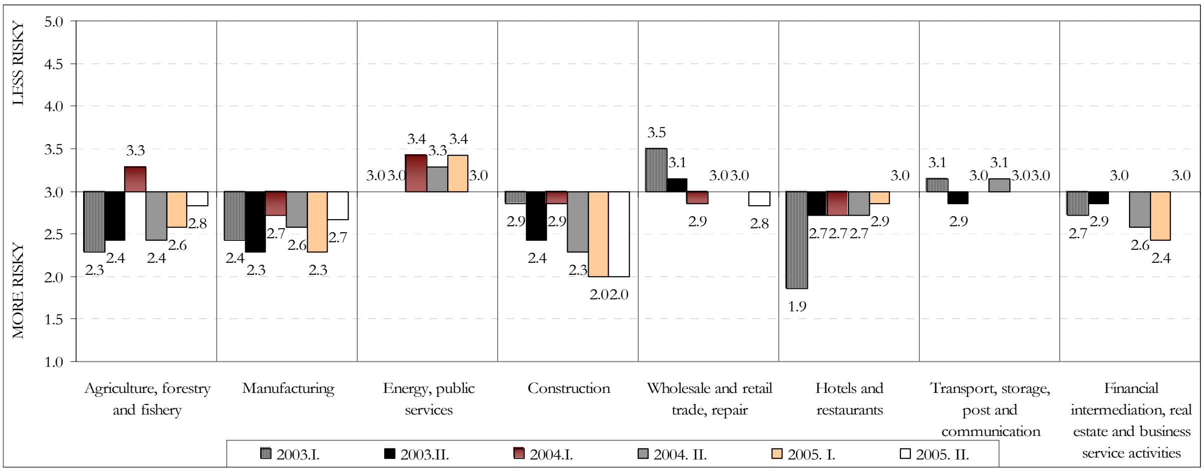
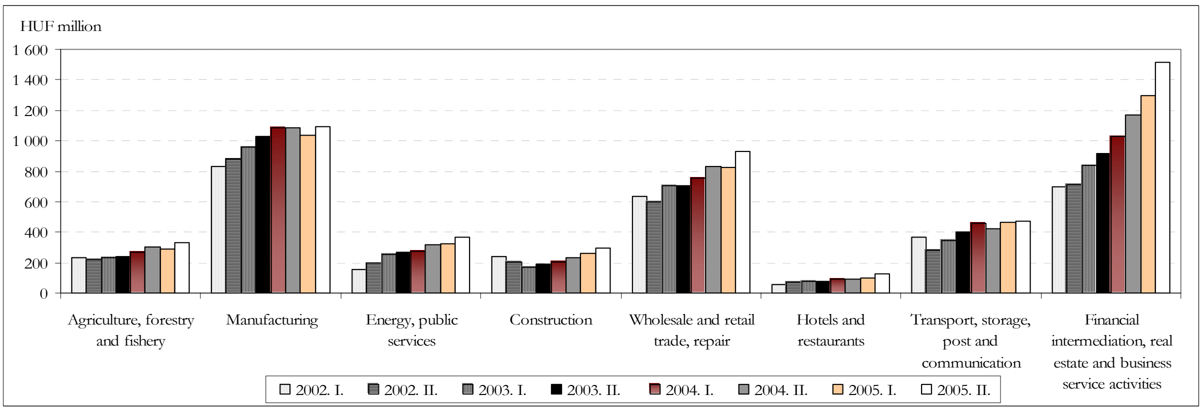


Chart 6: Sectoral structure of loans to non-financial firms



2. Household lending market

The household questionnaire was completed by twelve banks, with eight answering the questions related to housing loans and eleven banks answering those on consumer loans[2] (see Chart 21 and 22). In the second half of 2005 – in contrast with the previous half year and in line with earlier tendencies – the market turned to the consumer credit segment again: ten of the eleven banks increased their willingness to grant consumer loans, and only four of the eight banks indicated stronger activity in the housing loan segment. The change in creditworthiness standards is not parallel with the development of willingness to grant loans, as more of the banks decided to ease the standards of housing loans than that of consumer loans. Lending standards were eased in both segments while the demand experienced by banks was higher only in the consumer loan segment.

Chart 7: Willingness of the banks to lend in the different sectors of household lending market (Ratio of those reporting tightening minus those reporting easing)

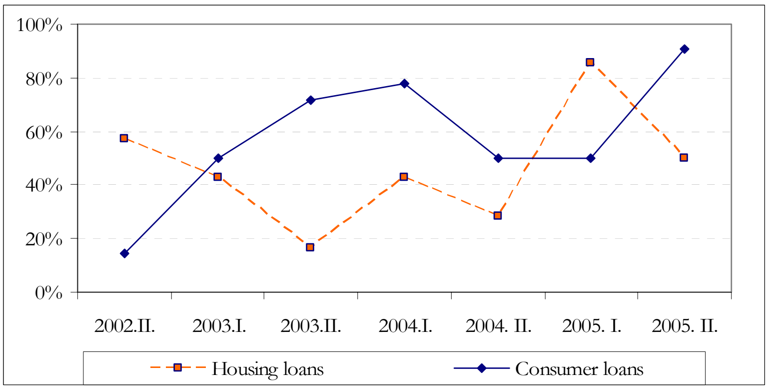
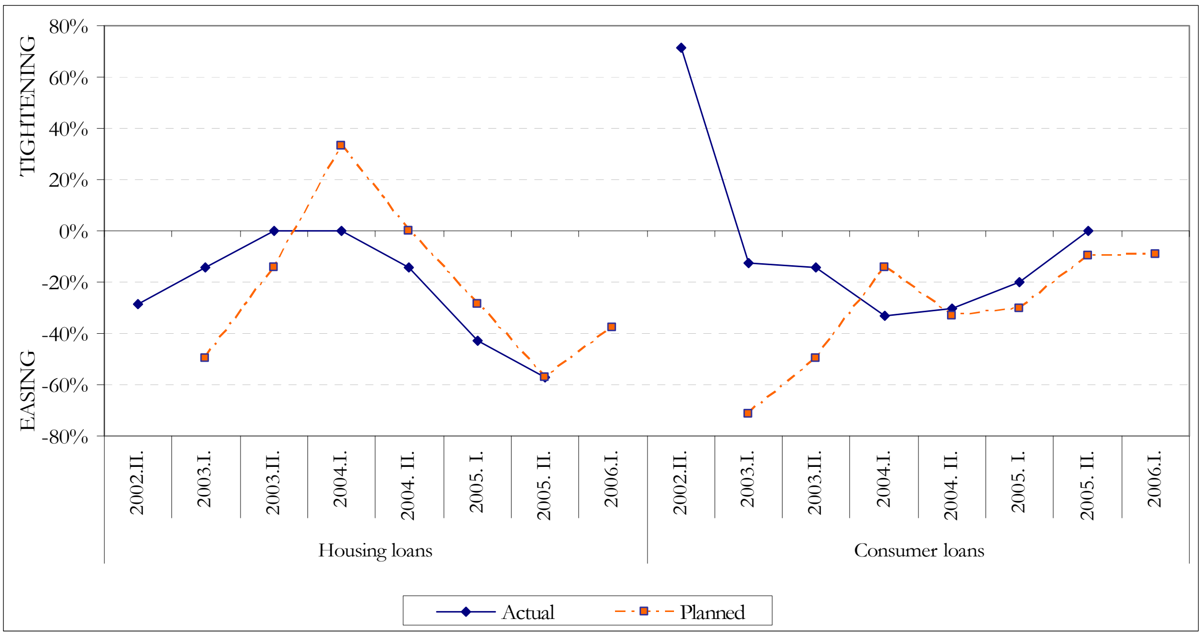


Chart 8: The change of creditworthiness standards of housing loans and consumer loans (positive=tightening)



[2] This time we invited one more bank to take part in the survey. In order to avoid the distortion of the answers because of the changing number of participants, we did not take into account the new participant's answers in those questions that compared the anticipation of the previous survey with the results of this survey.

2.1 Housing loans

(Questions 1-10 Appendix 4)

Supply side

In the second half of 2005, four banks increased and four did not change the willingness to grant housing loans. This indicates that the number of banks still able to increase the activity on this segment has decreased compared to the first half of 2005. The creditworthiness standards in line with the anticipation of the previous survey were eased by four banks, while none of the participants tightened them. Lending conditions were in general eased by banks: half of the respondents decreased the spread and increased the maximum loan to value ratio, but the minimum downpayment was also decreased by three banks. As a whole, six banks judged that their lending policy eased, the main reason behind was the more aggressive competition. Only one or two bank declared that the positive tendency on the mortgage bond market, the improvement of creditworthiness of clients and the outlook of housing market respectively also influenced their decision.

For the first half of 2006, 50% of the respondents anticipated the easing of credit standards and lending conditions and only one bank the tightening of them, so we expect the continuation of the trend which has already lasted for 3 semi-annual periods.

Chart 9: Lending conditions in the market of housing loans
(ratio of those reporting tightening minus those reporting easing)

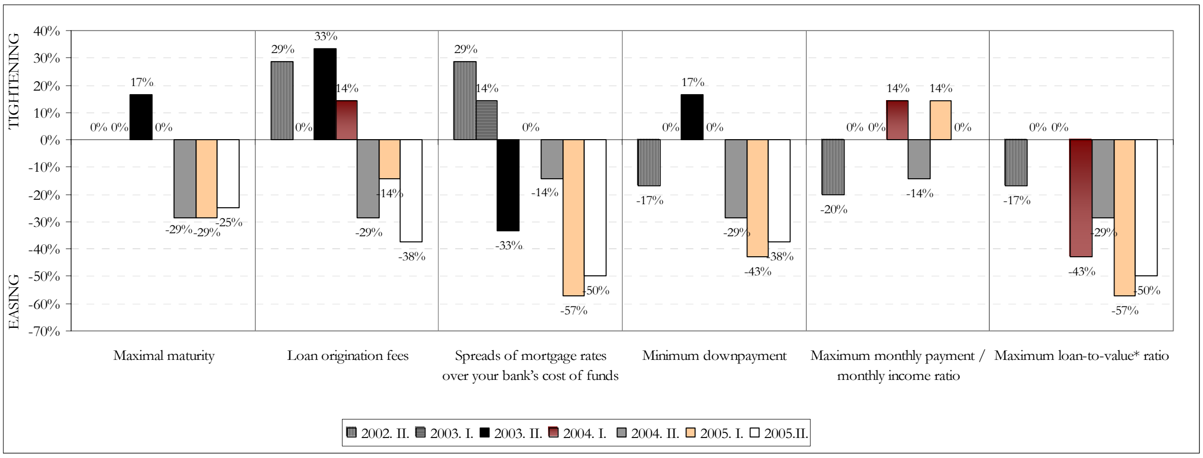
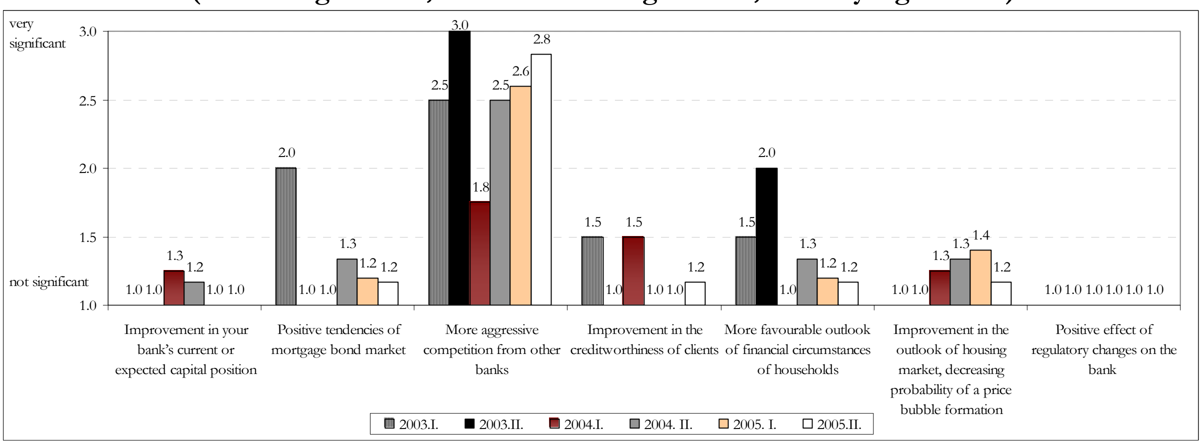


Chart 10: Reasons for relaxation of creditworthiness standards and lending conditions in the case of housing loans
(1 = not significant; 2 = somewhat significant; 3 = very significant)



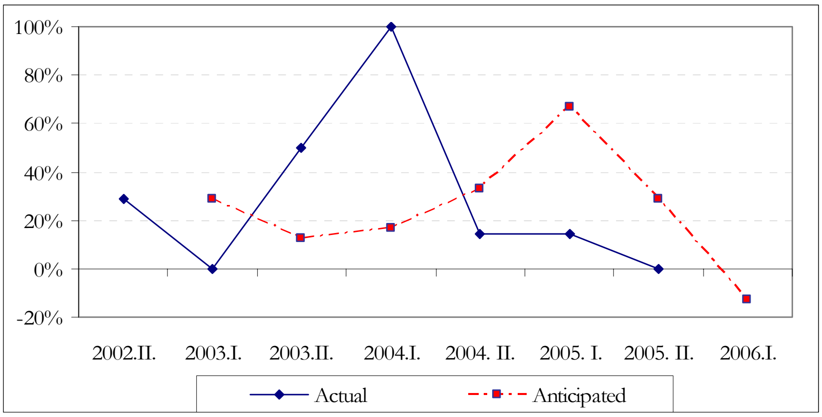
Demand side

Demand for housing loans did not change in the second half of 2005 on aggregate, but the answers of individual banks varied considerably: three banks declared higher demand and three banks lower demand, and only two banks did not perceive any change in general (see Chart 23). For the first half of 2006, in contrast to the last 3 surveys, respondents anticipated unchanged demand (seven banks) or lower demand (one bank).

Nominal house prices

In the second half of 2005 banks did not perceive a change in nominal house prices in contrast to their anticipations in the previous survey, in which 29% of the participants indicated an increase in nominal house prices for the same period. With regard to the coming six months the respondents are pessimistic: 12.5% of them expect a decrease in prices (seven banks anticipated unchanged nominal house prices and one bank expected lower nominal house prices).

Chart 11: 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

Ten of the eleven respondents declared greater willingness to grant consumer loans in the second half of 2005, and only one bank stated that its willingness remained unchanged at a high level. In general, the creditworthiness standards remained unchanged, but all of the loan conditions except for the minimum creditworthiness of the clients were eased: half of the respondents decreased the minimum downpayment and 45% of the participants reduced the spread. The main driving factor of the easing process was intensifying competition with banks and non-bank financial intermediaries, but the more favourable outlook of the financial circumstances of households and the improvement in client creditworthiness also influenced three banks and one bank, respectively.

However, two banks plan to tighten standards for the next half year, and three banks indicated further easing of standards.

Chart 12: Lending conditions in the consumer credit market (ratio of those reporting tightening minus those reporting easing)

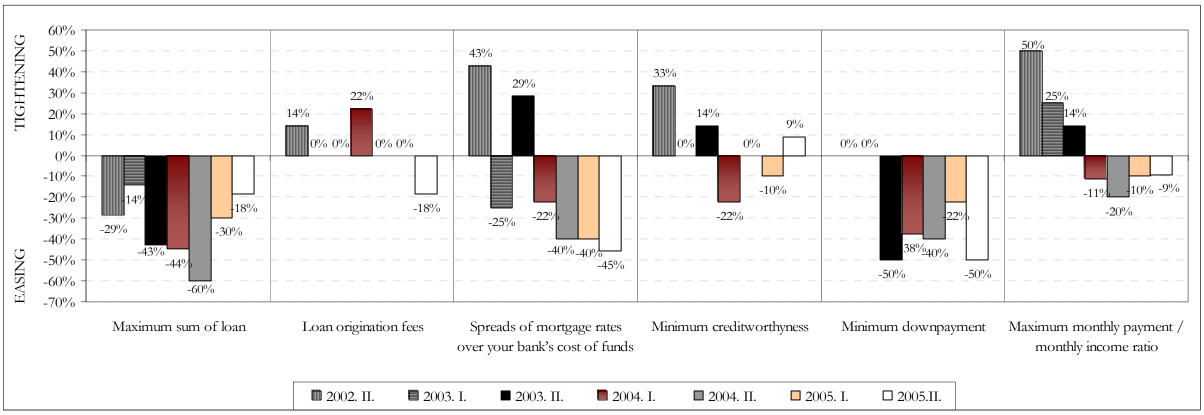
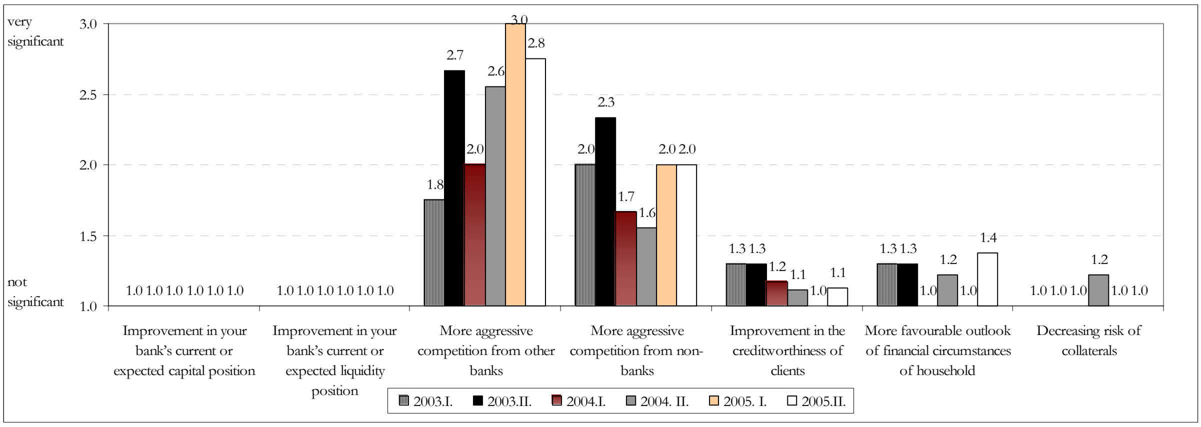


Chart 13: Reasons for relaxing creditworthiness standards and lending conditions in the consumer credit market (1 = not significant; 2 = somewhat significant; 3 = very significant)



Demand side

In the last survey, participants generally held an optimistic view of demand for the second half of 2005: 40% of the respondents anticipated higher demand than they had realized in the first half of 2005. Looking back, the picture is not so definite – probably in connection with stronger competition – banks perceived demand in the second half of 2005 differently: four of them reported stronger demand, three weaker demand, and three unchanged demand. As a whole, the net ratio of those reporting a stronger demand is 20%.

A net 27% of respondents gave optimistic answers again and forecasted an increase in demand (see Chart 23).

2.3 Consumer credits granted by financial enterprises

(Appendix 5)

In this survey, we also asked five banks about the lending activities of their related financial enterprises. As this was not previously a standard component of the questionnaire (it was included only in the first survey in 2005), we are not able to present the changes over time, and we can only present a general picture of the current situation.

Supply side

In the second half of 2005, two of the five respondents increased their willingness to grant loans and these two financial enterprises also eased creditworthiness standards. However, as a whole, the standards remained unchanged, as two other participants tightened standards. With regard to loan conditions, four respondents indicated a decrease in the spread and in the minimum downpayment, and two participants noted easing of loan origination fees and the ratio of maximum monthly payment to monthly income. All of the respondents emphasized keen competition as the main driving force behind the easing trend.

For the first half of 2006, 60% of the participants plan to ease creditworthiness standards and loan conditions.

Demand side

Compared to the first half of 2005, 40% of the respondents perceived higher demand for the consumer loans in the second half of the year. For the first six months of 2006, only one financial enterprise anticipates an increase in loan demand, and the other participants do not expect any changes.

3. Ad hoc questions

In the non-standard part of the survey, we examined the factors that can influence loan demand, the effects of exchange rate and interest rate movements on FX loans, and portfolio quality in the corporate and household sector as well. In the corporate segment, we also asked questions on inter-company debts and cross-border lending.

Factors influencing loan demand differ in the corporate and household segment, and they are also not the same regarding the corporate categories. The factor that influences the demand for household credit products the most is the price, but marketing and advertising are also important in the decision procedure (see Chart 25). In the corporate segment banks compete mostly through price and collateral requirements. The importance of the factors changes with the size of the company: for smaller ones the minimum downpayment and the collateral requirements can influence the decision (because of the lack of collateral and own funds), while for larger enterprises the flexibility of the bank and its products are the critical points in addition to the price (see Chart 26).

In foreign-currency (FX) lending, we can see the continuation of the earlier tendencies: in newly-granted FX loans, Swiss franc loans dominate in particular. The movement of exchange rate and interest rates experienced in the second half of 2005 did not influence demand for FX loans. Only some banks reported that medium-size and large enterprises began to hedge their position at least partly, and only one bank indicated consideration of tightening standards relating to FX loans as a consequence of higher risk. Banks did not perceive lower demand for FX loans in the household sector, as exchange rate movement was not significant and participants did not transmit the increase in euro and Swiss franc base rates to client lending rates because of strong competition.

Respondents judged the quality of the portfolio as good in both segments. In the corporate segment, a negative tendency might commence as banks open to small and micro enterprises, as this is accompanied by easing of collateral requirements. In the household segment, the outlook for portfolio quality is not so well-defined. Part of the banks anticipate a deterioration in quality because of portfolio aging, the high ratio of household debt, the additional risks related to FX lending, the weakening of credit standards and the growing frequency of fraud. On the other hand, as a result of the more discerning, professional credit approval and forcible collection procedures as well the positive outlook for household income, some banks expect that portfolio quality will be maintained or improve.

As for inter-company debts banks pointed out the construction industry and its contractors again as most affected sectors. Real credit loss relating to inter-company debts was not perceived; indeed, for some banks this even resulted in an increase in the factoring portfolio and in income as well.

In respect of cross-border lending, banks emphasized the significance of project finance, due to the fact that it is generally the local subsidiary of the banking group that is responsible for other kind of activities. The answers regarding the activity of the parent company in Hungary were very similar. Risk-taking of the parent company might occur, but it is not typical, while Hungarian subsidiaries have advantages in domestic lending.

CHARTS ON THE LOAN PORTFOLIO AND ANSWERS TO THE QUESTIONNAIRE

Corporate segment

Chart 14: Shares of responding banks within the total corporate lending portfolio (excluding commercial real estate loans)

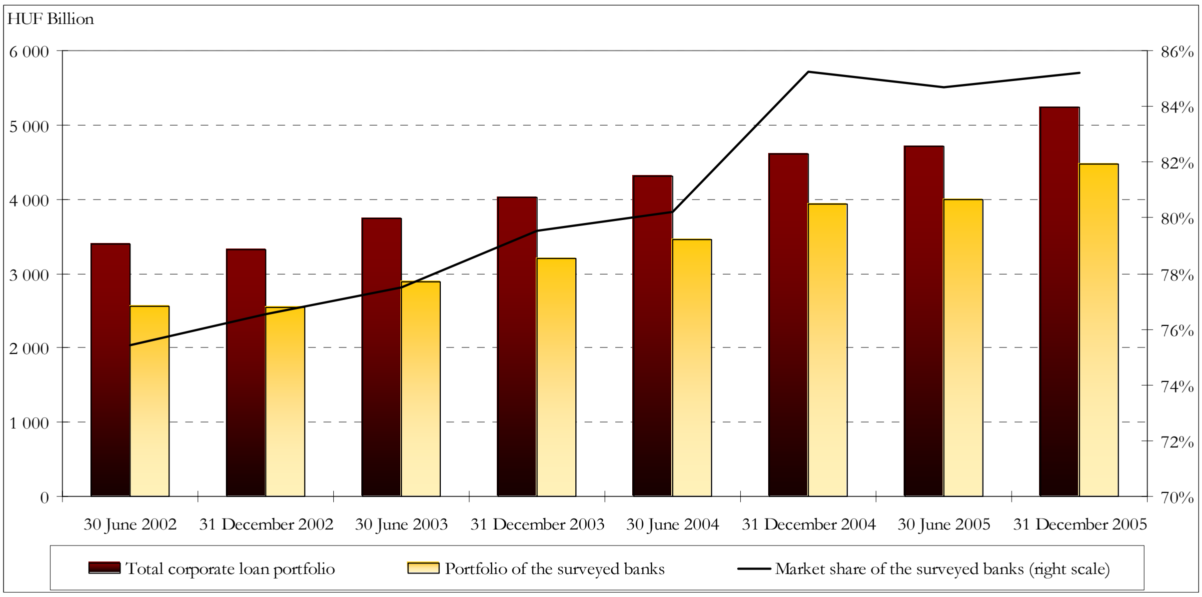


Chart 15: Share of responding banks in commercial project loans within the total project loan portfolio

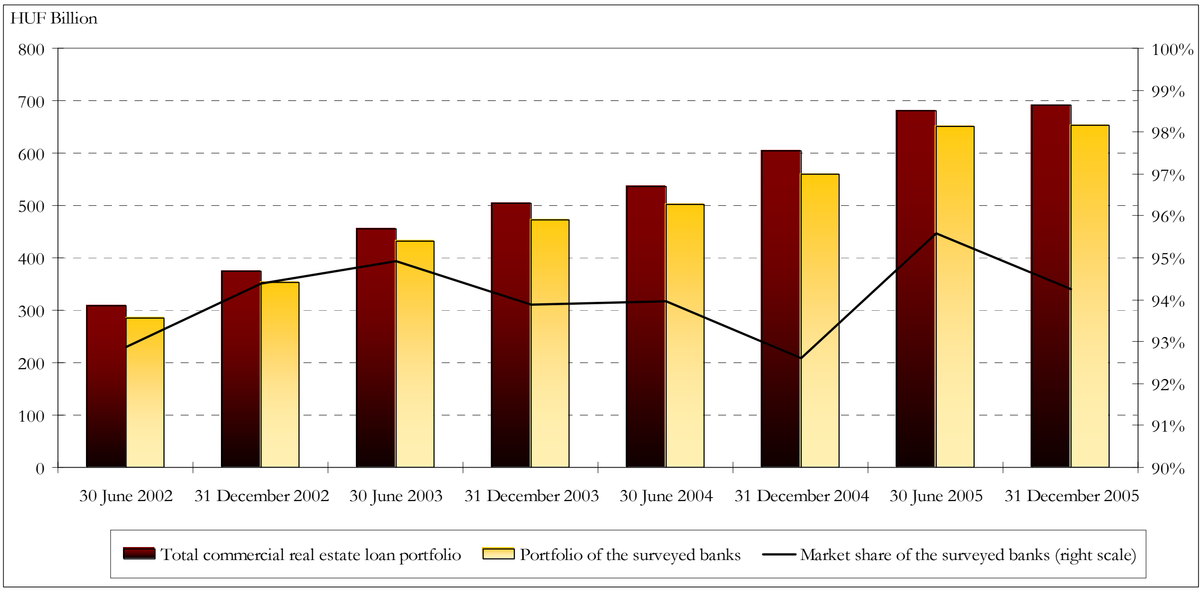


Chart 16: Creditworthiness standards by corporate category and in the field of commercial real estate loans
(ratio of those reporting tightening minus those reporting easing)

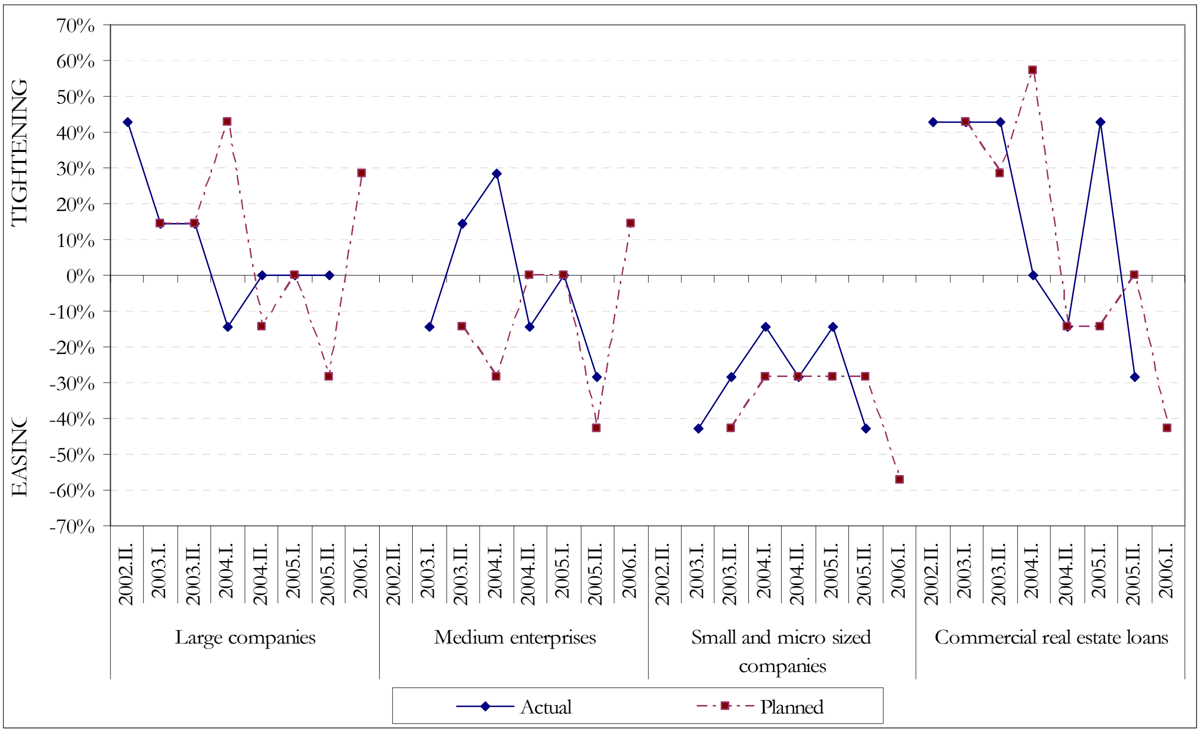


Chart 17: Maximum size of loans/credit lines by corporate category
(ratio of those reporting tightening minus those reporting easing)

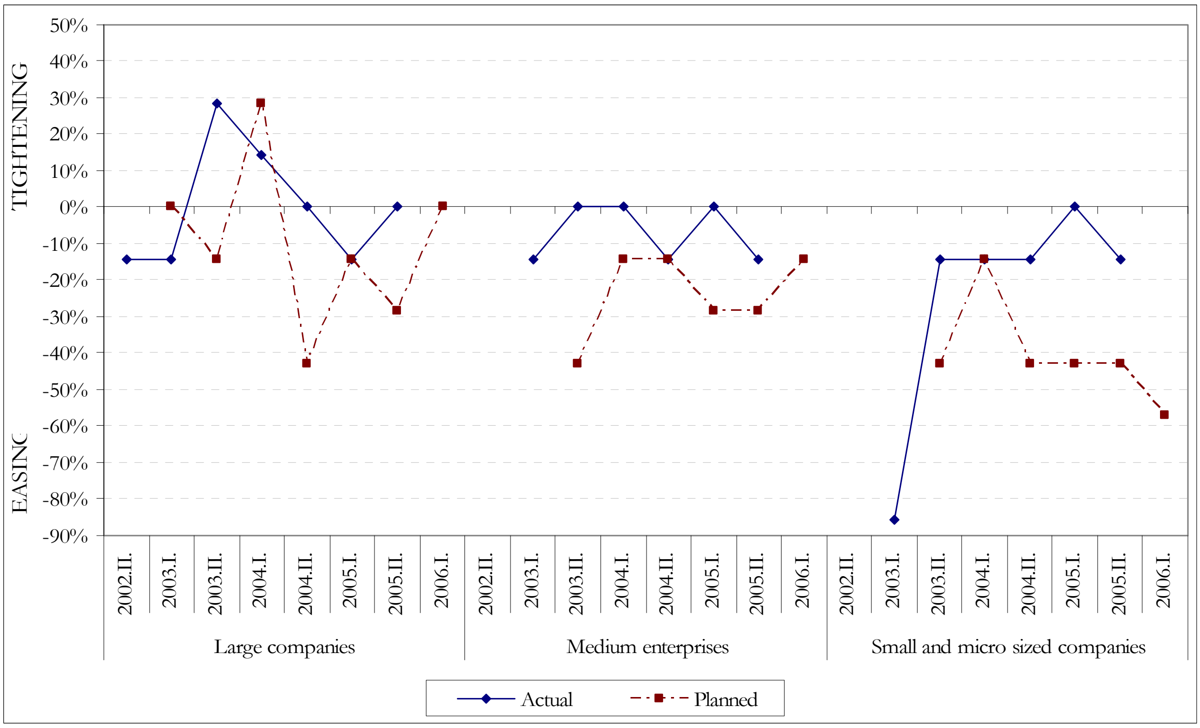


Chart 18: Spread between lending rates and costs of funds in a breakdown by corporate category (ratio of those reporting tightening minus those reporting easing)

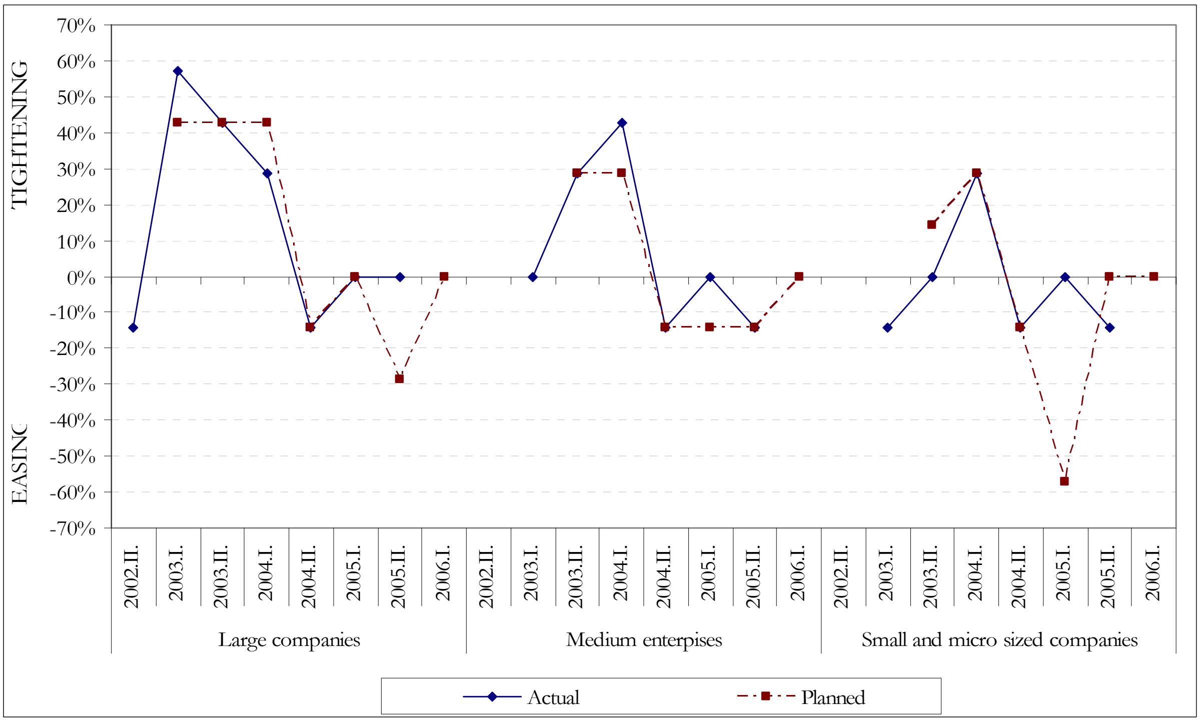


Chart 19: Premium on higher-risk loans in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

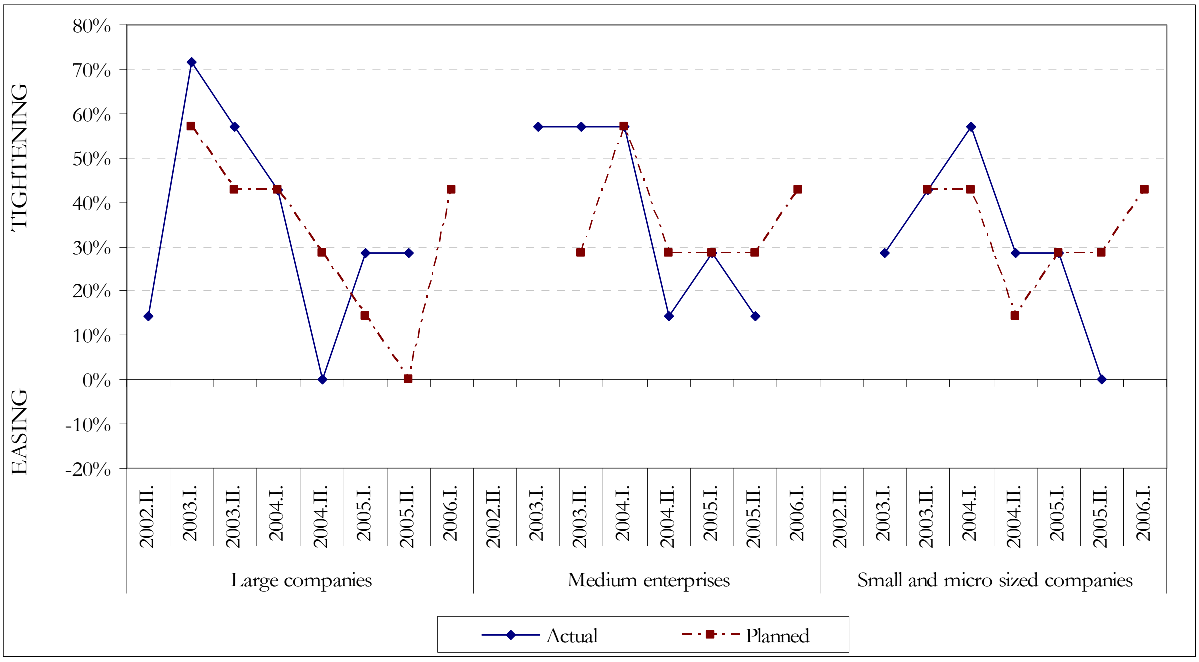


Chart 20: Collateral requirements in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

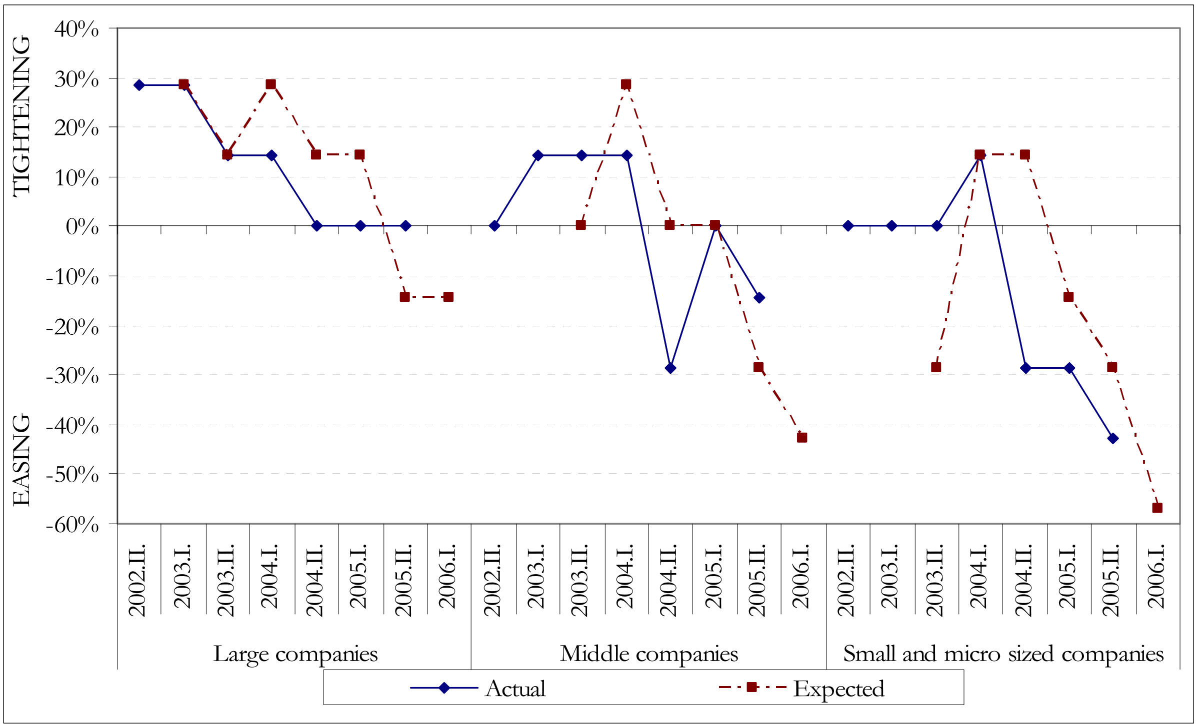
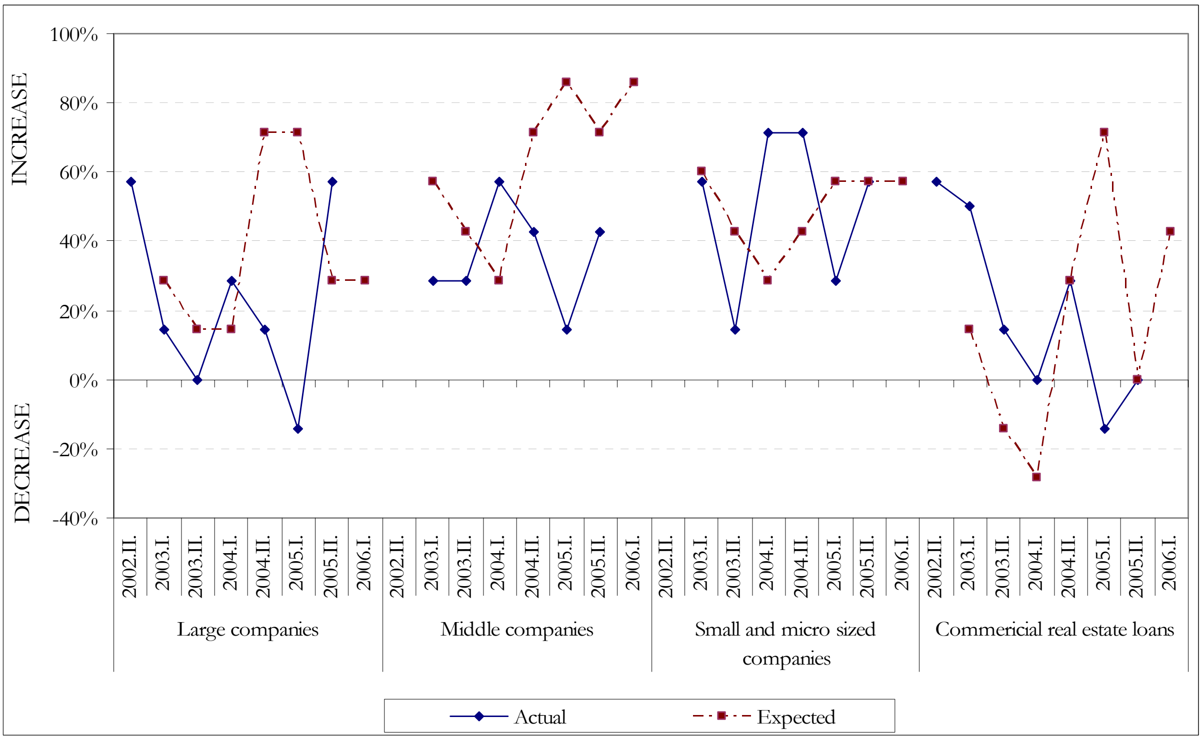
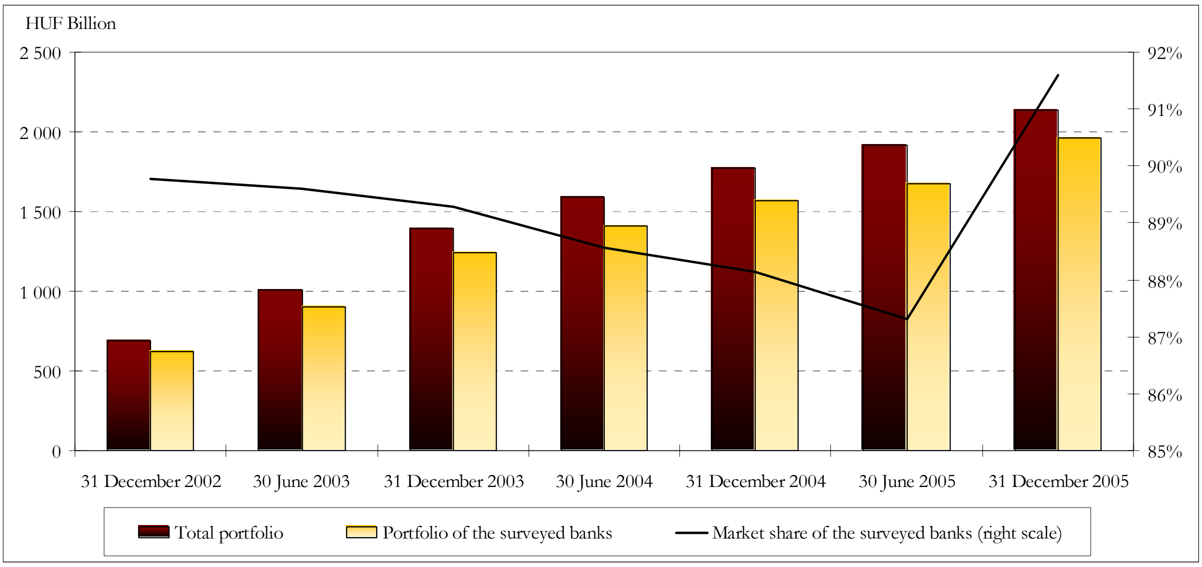


Chart 21: Demand for loans in a breakdown by corporate sector and in the market of commercial real estate lending (ratio of those reporting an increase minus those reporting a decrease)



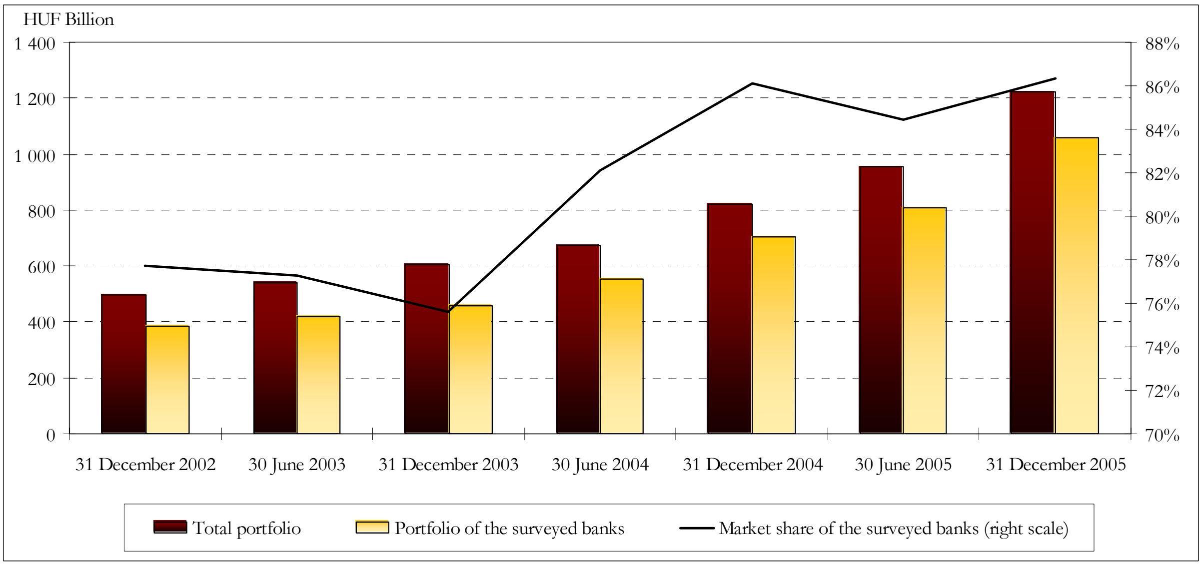
Household segment

Chart 22: Market share of banks answering the questions relating to housing loans



Comment: Over the years, participating banks and their number in the particular surveys changed (e.g. because of fusion). Up to now, seven banks had answered our questions; in the current survey the number of participating banks was eight.

Chart 23: 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)



Comment: Over the years, participating banks and their number in the particular surveys changed (e.g. because of fusion). In the beginning, seven banks answered our questions, in the second half of 2004 we invited nine banks, in 2005 the number of respondents changed to ten, and in the current survey the number of participating banks increased to eleven.

Chart 24: Demand for loans in the housing loan and consumer credit markets (ratio of those reporting an increase minus those reporting a decrease)

Ad hoc questions

Chart 25: Factors influencing demand in the corporate segment (0 = not significant; 1 = somewhat significant; 2 = very significant)

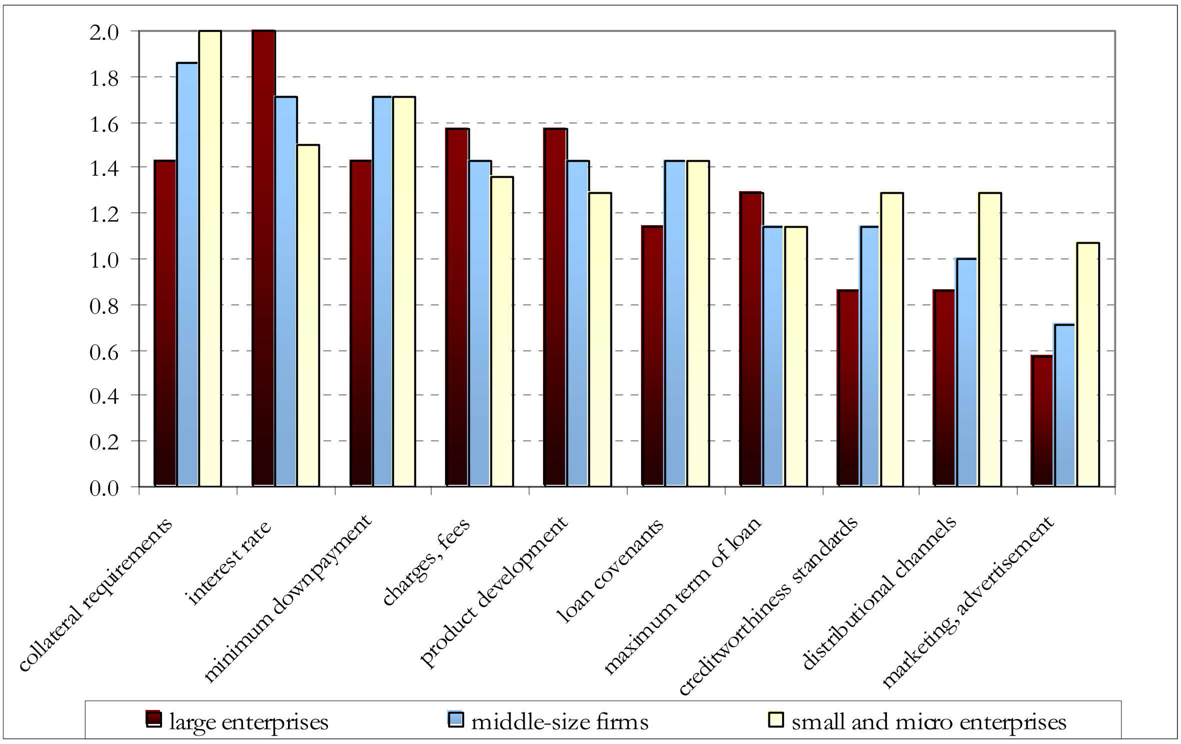


Chart 26: Factors influencing demand in the household segment (0 = not significant; 1 = somewhat significant; 2 = very significant)