SENIOR LOAN OFFICER SURVEY ON BANK LENDING PRACTICES

Summary of the aggregate results of the survey on 2006 H1
September 2006

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Financial Stability

The lending practices of banks were surveyed on the *eighth occasion in the summer of 2006*; this analysis presents a summary of the results. The retrospective questions in the questionnaire *refer to 2006 H1*, and thus the base period for these questions is 2005 H2, whereas the forward-looking questions contain projections for *2006 H2* compared to the trends of the previous half year. The questionnaire concentrates on two areas: the household and corporate lending segments. The total amount of loans outstanding in the individual market segments and the shares of responding banks are shown in Appendices 1 and 2, while the detailed presentation of the replies to the questions is contained in Appendices 3 and 4.

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).

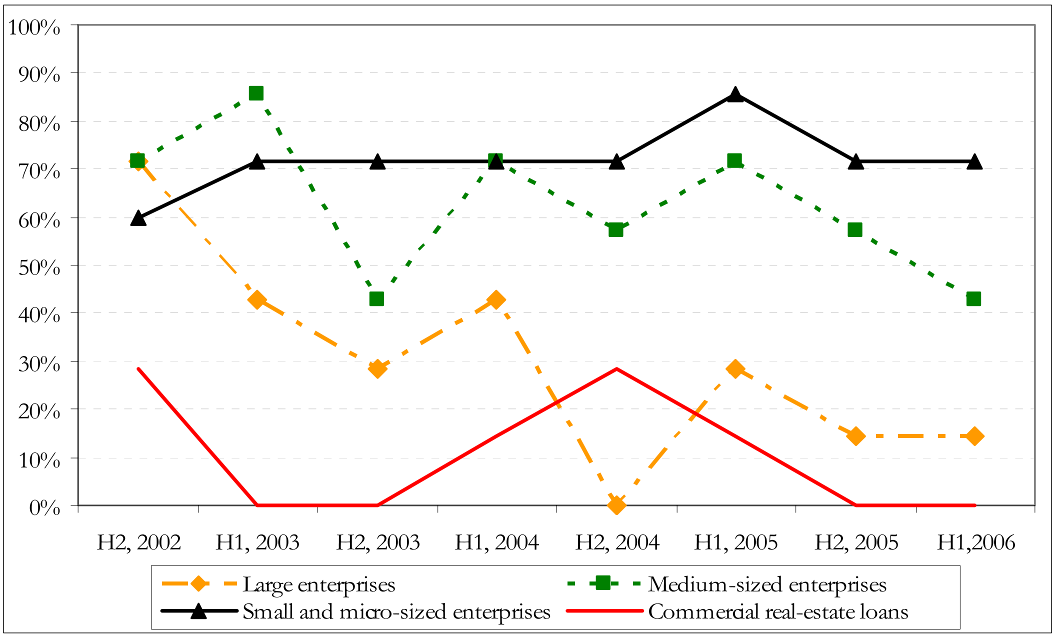
Aggregate results of the questionnaire

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 Charts 14 and 15).

In the first half of 2006 the banks continued to raise their openness to the small and medium-sized enterprise (SME) sector, as their propensity to lend to these segments continued to increase at the highest rate. The respondents emphasised that lending market to large enterprises is saturated, while the financing of housing projects on the commercial real estate loan market has taken a downturn.

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 continued to strengthen in the previous half year. The creditworthiness standards and lending conditions are in place; beyond the tightening of risk premium, the respondents are only fine-tuning these. With regard to increased risk premium, the respondents referred to the growing role of sector specific problems and uncertainty underlying the economic environment, while the decision to ease certain conditions was explained with intensifying competition and growing tolerance for risks. Three of the seven banks indicated the tightening of loan covenants for the next half year, one bank wishes to increase risk premium and another plans more stringent collateralisation requirements.

Primarily as a result of the increase in the demand of customers for debt and inventory financing, 29% of the banks indicated a growth in loan demand. By the second half of 2006, in reaction to the announced budgetary measures, the banks forecast lower demand for investment loans and higher demand for liquidity loans. Accordingly, they expect total demand to remain unchanged in comparison to the first half year (Charts 16–21).

Large enterprises[1]

The mature market of the large enterprise segment is characterised by customised services; therefore the significance of creditworthiness standards is low. This is well reflected by the fact that the banks reported unchanged standards for the fourth time. The area of lending conditions

[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.

continues to witness only moderate fine-tuning: the banks typically change different conditions (in line with earlier forecasts); a uniform trend is only reflected by the tightened requirement of risk premium.

By the second half of 2006, none of the respondents indicated an easing of any conditions, owing to creditworthiness standards and lending conditions judged to be already too moderate. The banks forecast tightening predominantly in relation to loan covenants (3 banks), while two participants wish to further increase the premium on more risky loans, and two banks also intend to tighten collateralisation requirements.

Medium, small and micro-sized enterprises

The increase in willingness to lend continued in relation to the sector of medium, small and micro-sized enterprises, growing significantly in some cases. Contrary to earlier trends and forecasts, however, this was generally not accompanied in the half year by the easing of creditworthiness standards. In net terms, the banks eased the standards only in relation to small and micro-sized enterprises (net 14%, although one bank has shifted in the direction of tightening).

With regard to the lending conditions applied to *medium-sized enterprises*, similarly to the large enterprise segment, the banks are increasingly moving in the direction of fine-tuning; that is, only a few banks indicated easing with respect to the maximum amount, fee and spread of the credit line. Nonetheless, this segment, too, indicates the tightening of premium charged on risky loans.

Further tightening of the risk premium and collateralisation requirements was indicated by net 29% of the banks for the next half year, while an easing was generally projected only in relation to the maximum amount of the credit line.

With regard to *small and micro-sized enterprises*, we may establish that the standard products have generally been introduced in parallel with the introduction of the scoring systems. Thus the banks are fine-tuning these on the basis of experience. This implies the easing and in some cases the tightening of certain conditions by individual banks in relation to the basic conditions.

One bank eased the maximum amount of the credit line, another reduced the spread, another strengthened the loan covenants and another increased the fees charged for providing the credit line. The more stringent application of the risk premium, however, reflects a trend in this segment as well, with three of the seven banks indicating such intention. Banks continuously eased collateralisation requirements in the recent period. Although they projected the same trend for the first half of 2006 in connection with the last survey, the introduction of standard products in this half year was linked to the tightening of such requirements by two banks, and only one bank reported easing. In comparison to the other two segments, in addition to standardisation, the respondents underlined growing uncertainty and a downturn in the economic environment as a more determining factor in the tightening processes, since smaller companies are more exposed to negative developments affecting the external environment.

With regard to the next half year, the banks wish to ease the lending standards (net 29%) and conditions applied to small and micro-sized enterprises, primarily in consequence of overly stringent scoring systems and standard products. The respondents set out an easing of collateralisation requirements (43%), credit line fees and the spread (29%), as well as the maximum amount of the credit line (14%). The banks wish to increase stringency only in relation to loan covenants (29% of banks).

Demand side

In the first half of 2006, demand in all corporate segments was perceived by each bank to be at least as strong as it was in the previous half year. Of the seven surveyed banks, two reported stronger demand in each corporate segment, respectively, yet expectations were not met in the segment of medium, small and micro-sized enterprises. The banks evaluated clients' increased need for debt and inventory financing as the most important reason behind growing loan demand.

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

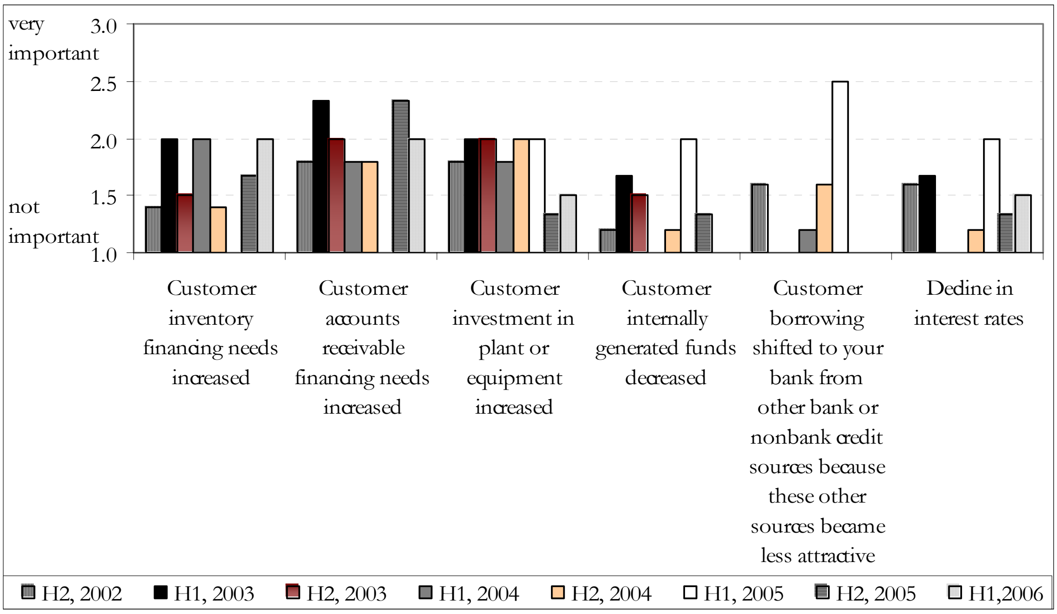
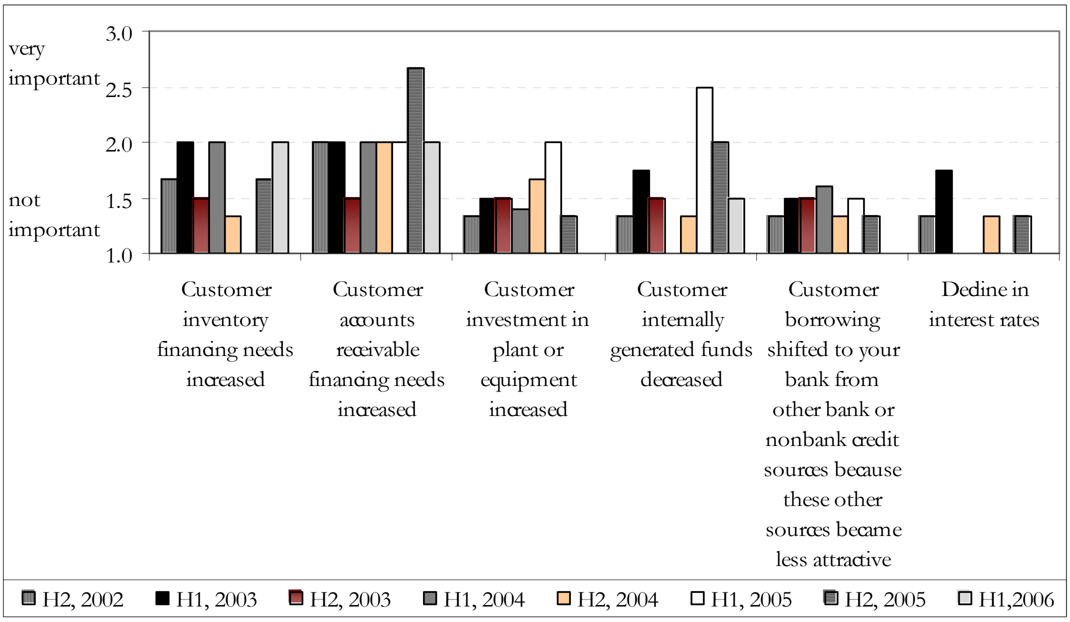


Chart 3: Reasons for increasing loan demand of small and micro-sized firms (1 = not significant; 2 = somewhat significant; 3 = very significant)



The banks forecast basically unchanged demand for the next half year, owing to changes affecting the economic environment. Net 14% of these expect a fall in demand in the category of large enterprises and anticipate the strengthening of demand from small and micro-sized enterprises, respectively. They are of the view that investments characterising the large enterprise segment and the related loan demand will decrease at a higher rate, while a loss of income and the downturn of investment spiralling through supplier dependence to the smaller companies can weaken such companies' already volatile liquidity position and generate additional demand for liquidity loans. The actual development of demand will be determined by the outcome of the two effects, which remains uncertain for the time being (Chart 21).

1.2. Commercial real estate loans

(Questions 10-15 of Appendix 3)

Supply side

On aggregate, the willingness of banks to grant new commercial real estate loans remained unchanged in the first half of 2006; there was only one bank which indicated greater lending willingness and one which reported lower lending willingness.

With regard to creditworthiness standards, in the previous survey three banks indicated their intention to ease standards by the first half of 2006. In contrast, net 14% of respondents decided on tightening, underlining the worsening sector specific problems (e.g. high number of unsold homes) and too lenient requirements defined for housing construction projects, e.g. too low pre-sale expectations and low downpayment (Chart 16). Forecasts are also for standards to tighten in the next half year (two banks wish to tighten and one to ease), referring to the worsening of the income position of households, further aggravating the already unfavourable housing market. The banks do not indicate special risks or new trends in relation to other areas of project financing (office-blocks, warehouses, shopping centres).

Demand side

The banks' expectations for the first half of 2006 were quite positive – net 43% forecast a rise in demand. Eventually only one bank reported a growing market, while two recorded a fall in the number of new loan applications. The banks are pessimistic regarding the prospects for the next half year: of the seven respondents, four indicated a fall in demand and only one bank expected increasing demand for project loans.

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

(Question 16 of Appendix 3)

Among industrial sectors, in the first half of 2006 most respondents (four of seven and six, respectively) indicated an increase in risks related to the construction and food industries within the manufacturing sector. Banks also attached moderately greater risk to companies operating in agriculture, financial activity and the machine industry. Companies in the hotel and catering industry and the waste processing sector improved their position.

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

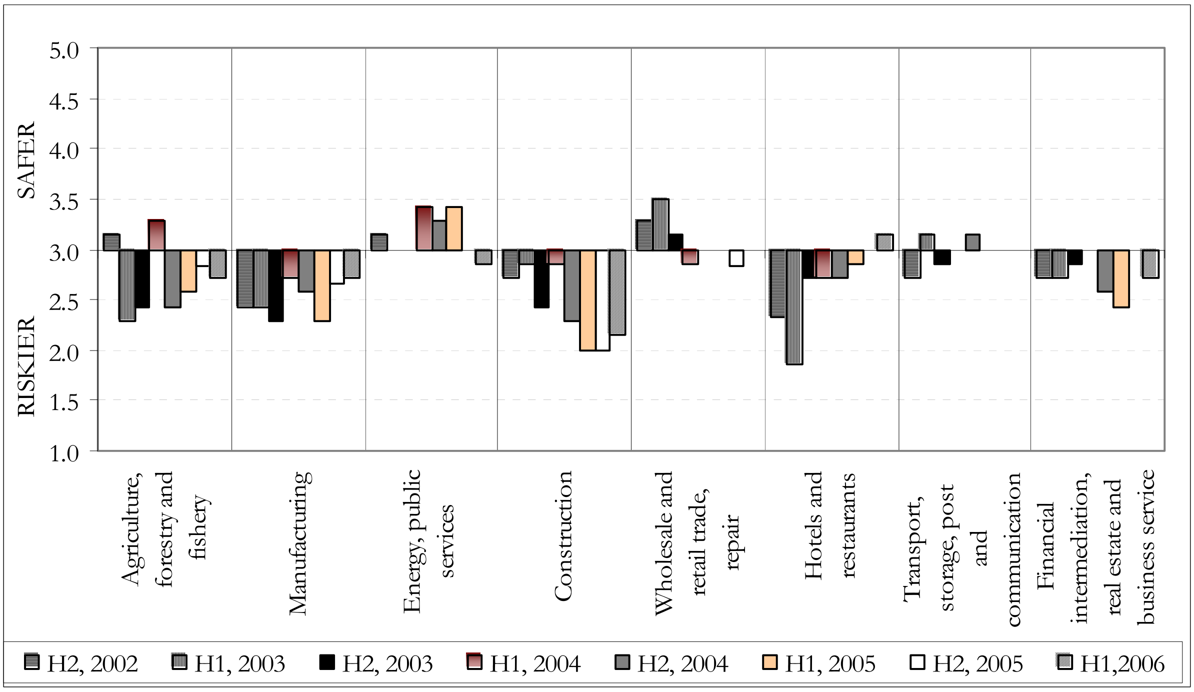
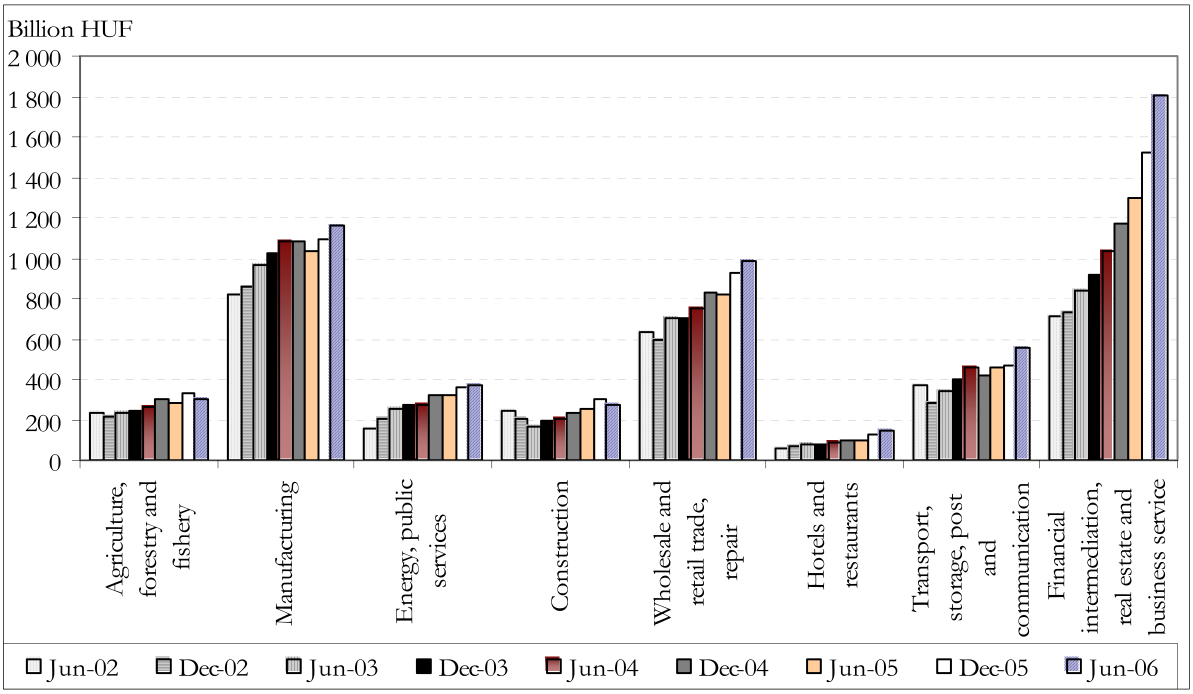


Chart 5: Sectoral structure of loans to non-financial firms



2. Household lending market

The household questionnaire was completed by 12 banks, with 8 answering the questions related to housing loans and 11 banks answering those on consumer loans (see Chart 22 and 23).

Banking activity in the household segment is intense and continuously on the rise. With a view to gaining market share, respondents are easing the standards and lending conditions and introducing new products on a regular basis. Banks witnessed higher demand in the past half year than in the previous period, generally attributed to growing demand for foreign currency mortgage loans. As currently the precise effects of the announced fiscal measures are difficult to foresee, expectations of the loan officers about the next half year are becoming uncertain.

Chart 6: Willingness of the banks to lend in the different sectors of the household lending market (ratio of those reporting tightening minus those reporting easing)

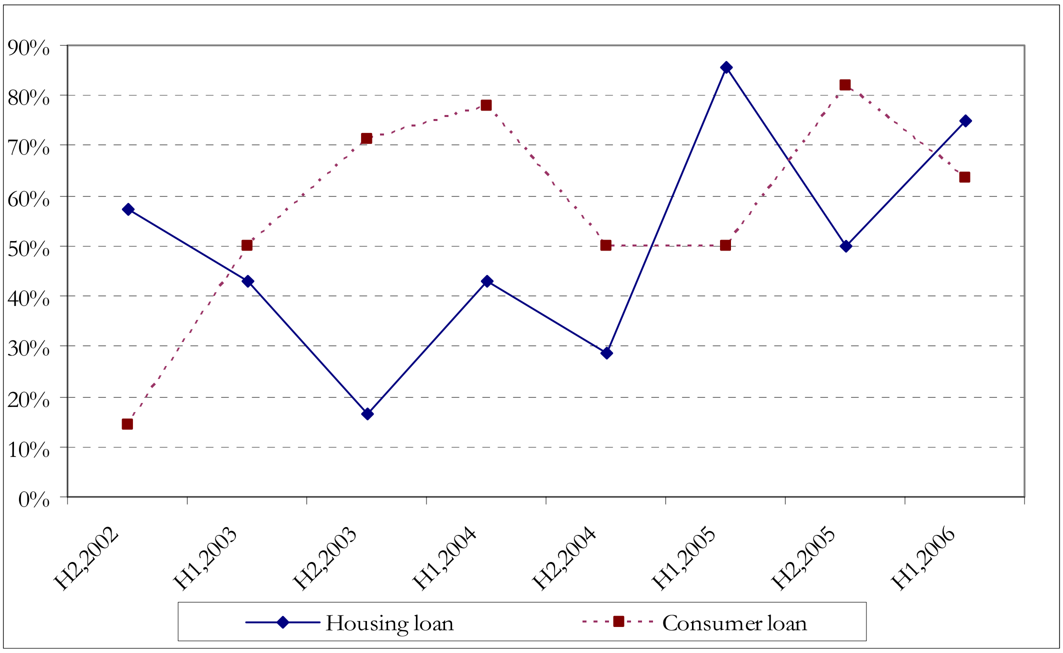
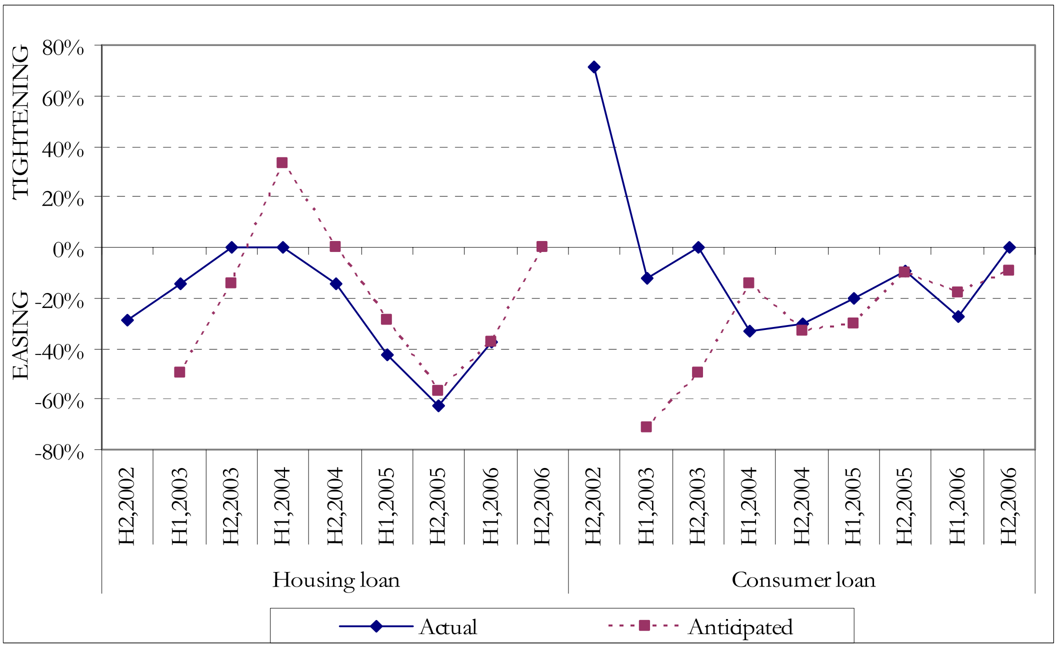


Chart 7: The change of creditworthiness standards of housing loans and consumer loans (positive=tightening)



2.1. Housing loans

(Questions 1-9 Appendix 4)

Supply side

Competition continued to intensify in the housing loan market in the first half of 2006. Of the eight respondents, six reported an increased willingness to provide housing loans, while the remaining two did not reduce their supply. Among housing loans, more banks indicated a rise in willingness to provide foreign currency loans.

In the previous survey, half the banks indicated a further easing of standards/conditions, and only one bank projected moderate tightening. Basically in line with forecasts, the creditworthiness standards were eased: two banks reported such easing in relation to forint loans and three in relation to foreign currency loans.

The banks generally further eased lending conditions, with a higher number of banks indicating an easing of foreign currency loan conditions.

- With the exception of one bank, all respondents eased the spread of foreign currency loans (the interest rate increases of foreign central banks were typically not or only in part passed on to customers, or the banks possibly offered a more favourable temporarily discounted interest rate for new customers for the first, introductory interest period).
- Half of the respondents decreased the upfront charges (the remission of origination fees and real estate appraisal fees was typical).
- Four banks also reduced the minimum required amount of downpayment.
- Three banks further increased the loan-to-value ratio (introduction of new products), while one bank tightened it.
- One respondent indicated an easing of the maximum payment-to-income ratio in relation to a new product, the no income verification housing loan.

On aggregate, six respondents judged their lending policy to have eased in relation to forint loans and seven in relation to foreign currency loans, again underlining increasingly intense competition as the main cause, particularly as regards foreign currency loans. When defining determining factors, only one bank referred to positive trends on the mortgage bond market, one to the improving assessment of the creditworthiness, one to the income position of customers and one participant to the upward trend on the housing market.

The banks were uncertain as to the development of lending policy in the next half year. In reaction to the impact of the announced fiscal measures, two banks wish to shift in the direction of tightening, while two respondents indicated the continuation of the easing trend.

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

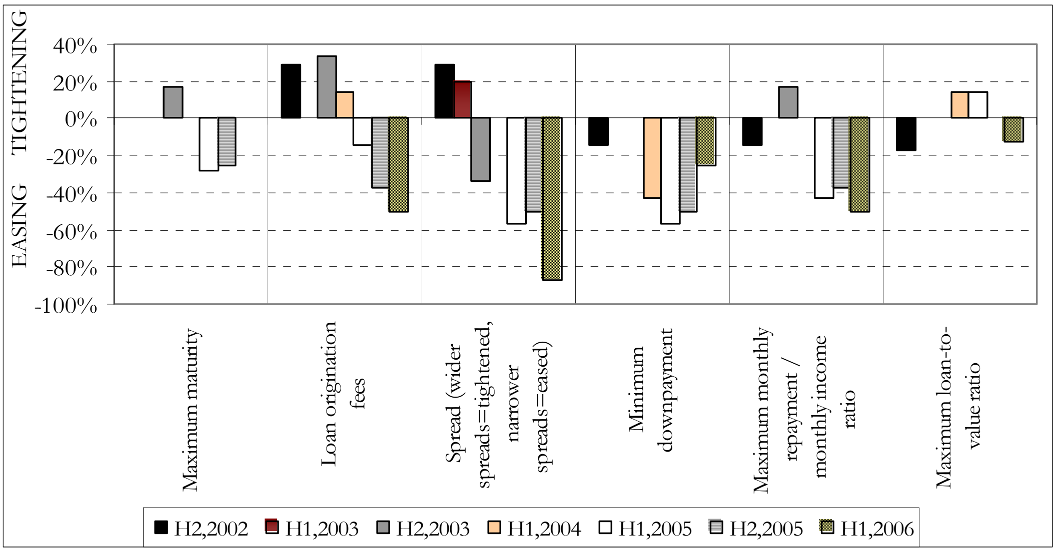
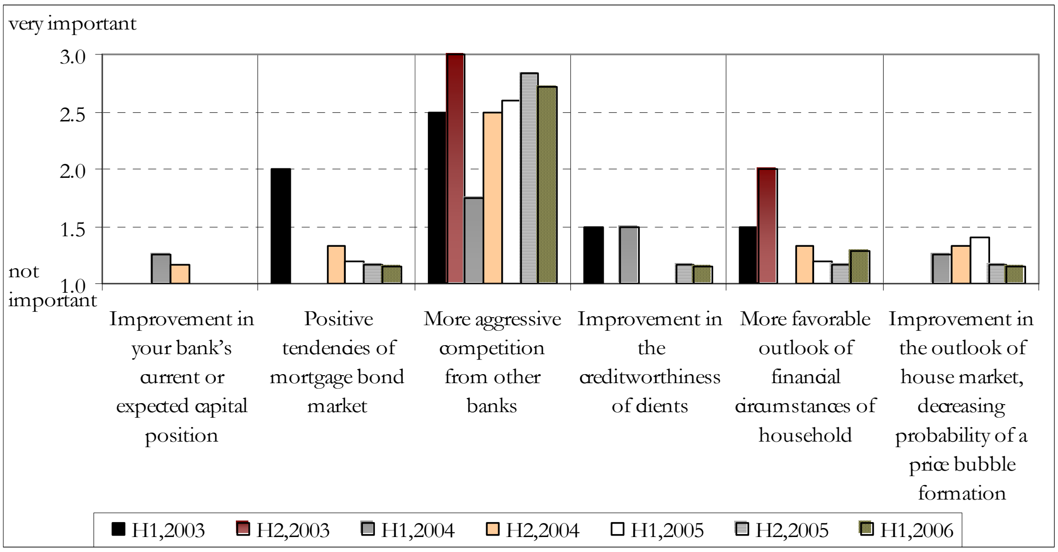


Chart 9: Reasons for relaxation of creditworthiness standards and lending conditions in the case of housing loans
(1 = not significant; 2 = somewhat significant; 3 = very significant)



Demand side

In the first half of 2006, the rise in loan applications was most prominent on the market of foreign currency loans. Net 38% of questioned banks indicated increasing demand for housing loans, contrary to the forecasts of the previous survey in which, with the exception of one bank, the respondents predicted unchanged demand. (Five banks witnessed higher demand in comparison to the previous half year, while two registered lower demand for foreign currency loans. Not a single bank reported higher demand for forint loans; two banks indicated a falling number of submitted loan applications.) (Chart 13)

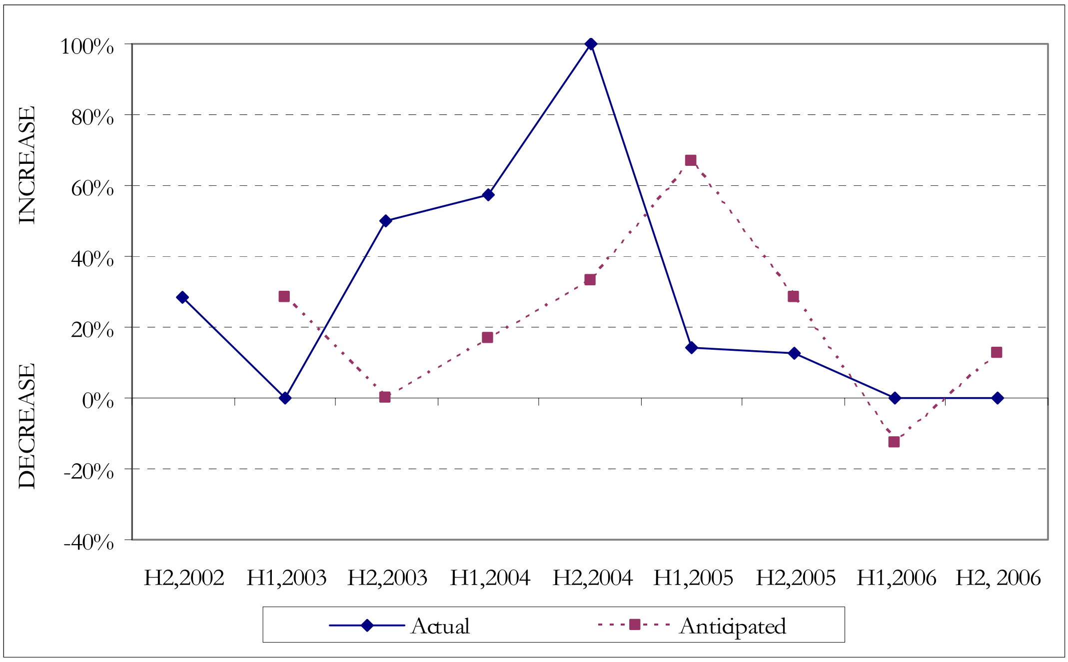
On aggregate, the banks forecast unchanged demand for the next half year, although there is a wide spread of opinion. Two banks predicted increasing demand, with two banks anticipating a slowdown, depending on whether households will bring forward their demand in reaction to the announced budgetary measures (most of the loss of income will be felt from January 2007), increase their accumulation of real assets, or consumption will fall as a consequence of reduced income.

Nominal house prices

The banks did not report any growth on the real estate market in this half year. All the banks agree that nominal house prices have not changed on aggregate, basically corresponding to the forecasts.

The prospects are not favourable for the next half year; only 12.5% of the responding banks expect house prices to rise.

Chart 10: Nominal flat prices according to Loan Officers (ratio of those reporting higher minus those reporting lower prices)



2.2. Consumer and other loans

(Questions 10-16 of Appendix 4)

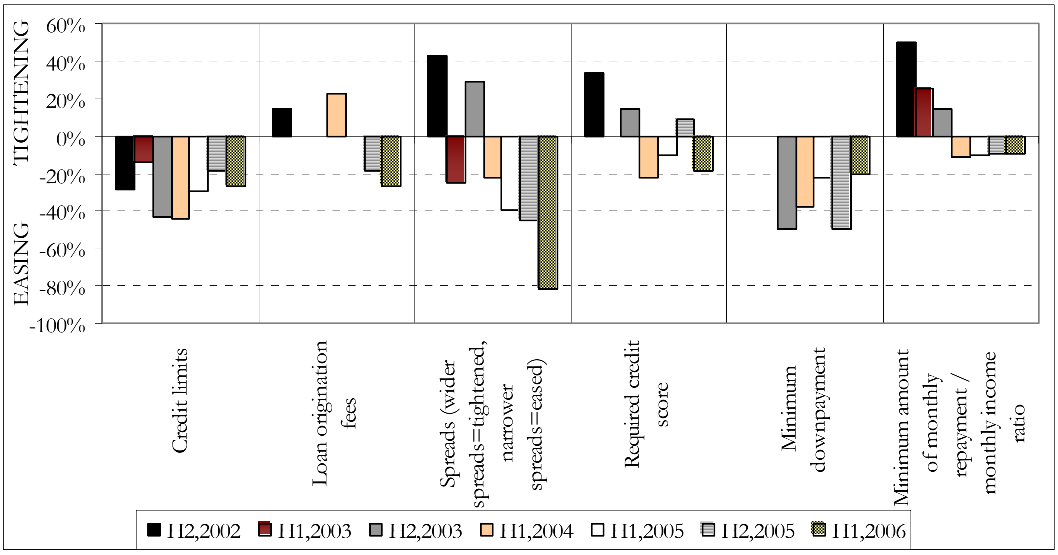
Supply side

Similarly to the housing loan market, there is also intense competition on the market of consumer loans. Of the eleven questioned banks, seven indicated a further increase in the willingness to lend. As a result of more favourable conditions, the market was boosted by (typically foreign currency) mortgage loans (home equity loan) and their popularity is expected to continue in the next period. In parallel with recognising the demand of customers, this product type has typically gained emphasis in the lending policy of banks, in contrast with traditionally offered uncollateralised products. The market characteristics of these two product types vary significantly and the banks tend to be more active on the newly developed market, offering vast potential as they anticipate greater growth in this segment. Thus we will separately indicate cases in which the banks apply different strategies in relation to mortgage loans and uncollateralised loans.

Five banks modified their creditworthiness standards – four shifted in the direction of easing, while one decided on tightening. Easing was primarily linked to mortgage loans; the market left standards basically unchanged in relation to uncollateralised products (with varying individual bank strategies). On aggregate, all banks eased their lending conditions.

- Similarly to the housing loan market, the banks decreased the spread of foreign currency loans in the highest number (nine out of eleven banks).
- A net 27% of respondents increased the maximum amount of the credit line and reduced loan origination fees (in this case, too, in the framework of extended discount offers).
- Three banks decreased the amount of downpayment, of relevance predominantly in relation to mortgage loans, and only one bank tightened such condition.
- In the past half year, 18% of respondents reduced the minimum accepted value of scoring applied for loan assessment.

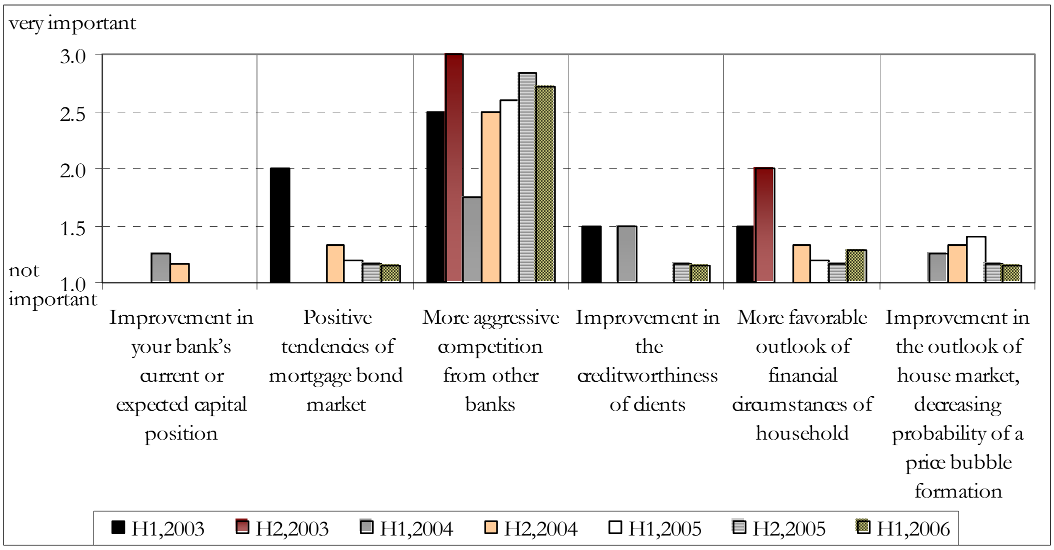
Chart 11: Lending conditions in the consumer credit market
(ratio of those reporting tightening minus those reporting easing)



Respondents continue to explain the easing of lending policy primarily with intensifying competition between banks and also with non-bank financial intermediaries, and only two banks, respectively, attributed importance in decision making to more favourable prospects for the income position of households and the improved creditworthiness level of customers.

Fully in line with expectations expressed in the previous half year, three banks plan to further ease the standards in the next half year, while two plan tightening. When providing the answers, for the time being few banks considered the expected impacts of the planned fiscal measures. Thus the results are essentially based on experience linked to the normal course of business.

Chart 12: Reasons for easing creditworthiness standards and lending conditions in the consumer credit market
(1 = not significant; 2 = somewhat significant; 3 = very significant)

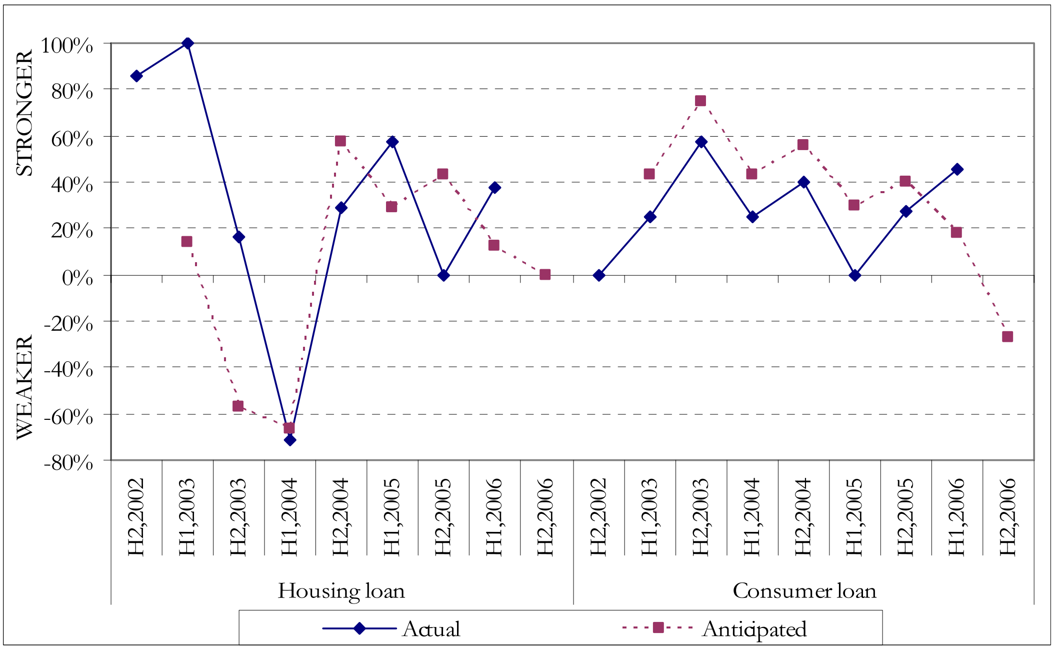


Demand side

In the previous survey, 27% of the banks expected growing demand for the first half of 2006. In fact, an even higher ratio, 45% of them reported an increase in demand for loans. The responses assigned importance to the role of foreign currency mortgage loans, as well as the higher average loan amount, in parallel with the growth of quality consumption.

The banks' responses vary significantly regarding the assessment of expected demand in the second half year. They also judge differently the degree of the impact of the announced fiscal measures on household income and its spread through time. Accordingly, three banks forecast a rise in demand, while six respondents expect a fall in the number of loan applications.

Chart 13: Demand for loans in the housing loan and consumer credit markets (ratio of those reporting an increase minus those reporting a decrease)



3. Ad hoc questions

In the course of the current interviews, we supplemented the standard questionnaire with two issues of current relevance. The first such issue examined the impact of the announced government package on the financial sector; the second – similarly to the previous survey – assessed the expectations of loan officers relating to foreign currency lending.

Impact of the announced fiscal measures [2]

The impact on the financial sector is revealed through two factors. Firstly, the laws (e.g. modification of corporate tax) directly affecting the participants of the sector generate a loss of income for the respondents; secondly, changes affecting households and companies may bear an impact on the creditworthiness of customers, demand for loans, supply of banks and the quality of the existing portfolio. The interviews primarily attempted to survey expectations related to the indirect effects.

- Creditworthiness

All the questioned banks expect a worsening creditworthiness of customers. The increased tax burdens and the rise in costs (e.g. energy) adversely affect the financial position of both the corporate and the household sector.

With regard to the *corporate sector*, respondents generally underlined the impact on small and micro-sized enterprises, since the liquidity position of these firms is already volatile. As a result of the banks' intensive opening toward small and medium-sized enterprises, the impact will in all likelihood point in the direction of growing risks.

In relation to the *household segment*, some banks already indicated a worsening of creditworthiness, independently of the planned fiscal measures, due to increased indebtedness (on the basis of the analysis of the monthly payment/monthly net income ratio). The measures will reduce household disposable income and will likely lead to the restructuring of the consumer basket. The banks expect the effects to be felt from 2007 (most of the amendments are affective as of 1 January and the rise in energy prices will also be felt in the winter).

- Loan demand

The banks underlined two factors regarding the development of *demand for corporate loans*.

One such factor is related to the separation of demand for investment and liquidity loans. Partly as a consequence of the worsening assessment of the economy and their own position, companies are expected to defer investment, causing a possible fall in demand for such loans. The respondents expressed the view, however, that a worsening income and liquidity position may induce an increase in demand for liquidity loans. The latter expectation may boost lending primarily to the SME sector, since this segment comprises companies whose liquidity position is already more volatile, and they are more sensitive to economic cycles (production for the domestic market, fall in supplier activity due to decreasing investment).

The banks noted additional sector specific differences, which depend on whether the given company produces for exports or for the domestic market.

[2] When analysing the responses given to the questions, we should emphasise that, at the time of conducting the survey (July 2006), in their answers the respondents indicated an uncertainty factor: the elements of the package had not been accurately elaborated and approved, and the banks did not have sufficient time to analyse in depth the potential effects of the stringency plan.

The banks are of the view that the development of *demand for household loans* depends on the short and long-term expectations of households. The assessment of the future behaviour of households is linked to higher uncertainty on both time horizons than is the case with companies.

Two banks expect a rise in demand for consumer loans in the short term, while two expect an increase in the long term. These respondents primarily underlined the consumption smoothing and favourable creditworthiness until 2007 in their answers. The other loan officers expressed the view that the consumption financed from loans has yet to reach the west European level; thus loan demand will not increase rather households are likely to modify their consumption basket and limit consumption, shifted in the direction of quality products recently. The answers vary even more with a product breakdown; some banks indicated the largest fall in relation to uncollateralised loans, while others expect rather a decrease in demand for home equity loans on grounds of deferred home renewals, also predicting in parallel a growth in lending through credit cards.

The majority of respondents also expect a fall in demand for housing loans. Only a couple of banks indicated that investment in real assets could induce a rise in demand for housing loans, or that demand will not slacken, for households are not likely to defer home purchases.

- Loan supply, creditworthiness standards, loan conditions

In relation to *corporate loans*, 50% of surveyed loan officers replied that the bank will be more cautious in devising the loan supply in light of experience of the past half year and the expected impact of the fiscal measures. They generally do not wish to modify the standards, rather the loan conditions, particularly regarding the pricing of loans offered to firms and industrial sectors becoming increasingly risky. The other half of respondents explained unchanged or increased supply with shareholder expectations. But they, too, do not plan an easing of standards, rather the expansion of the portfolio through the modification of conditions and the introduction of new products.

No bank wishes to reduce the loan supply in the *household segment*, in reaction to the measures. In fact, the vast majority indicated a further strengthening of supply motivated by shareholder expectations and intense competition. As a means of implementing the above, almost all respondents underlined the expansion of the product range and the growing role of sales and marketing in place of the modification of standards and conditions.

- Portfolio quality

In the *corporate segment*, the quality of the portfolio has already worsened in the recent period and this trend is likely to continue in reaction to the measures. Half the respondents believe that the worsening quality will generally affect the portfolio; two banks noted the sensitivity of small and micro-enterprises, while one respondent predicts a rise in the rate of qualified loans among existing loan portfolios as a result of expected, more stringent lending.

All respondents agree that the *household* loan portfolio will worsen in reaction to the measures. The banks' opinion varies as to the severity of the negative trend; some only expect temporary problems, while others predict greater risks in relation to certain products. Problems may arise particularly in connection with the repayment of small amount uncollateralised loans and the already risky car loans. There is typically greater willingness among customers to repay mortgage loans, owing to the value and importance of collateral.

With regard to both segments, the respondents emphasised that they will prepare an action plan for managing the worsening of the portfolio (products combined with different kinds of insurance, extension of maturity, rescheduling of repayment, etc.).

Foreign currency lending

Earlier trends continued in relation to foreign currency loans, that is, foreign currency loans dominated newly granted loans, and the rate of Swiss franc loans is rising.

The development of *demand* for foreign currency loans was not affected by interest rate increases nor by the weakening of the forint rate witnessed in the past half year. The interest rate increases by foreign central banks are automatically priced in corporate loans; in relation to household loans, however, respondents brought varying decisions as to the transfer of increasing cost of funds. Demand for foreign currency loans continues to be strong, as the amount of repayment is a determining factor in customers' decisions – expected to favour foreign currency loans in the long term as a result of the interest margin between the forint, euro and Swiss franc – and there is a smaller probability of increased amounts of repayment resulting from exchange rate fluctuations, given a weaker rate upon borrowing.

The banks typically further strengthen their *supply* of foreign currency loans, primarily through the introduction of new products capable of managing exchange rate risks to some degree.

The volatile exchange rate of the past half year, particularly in June, could significantly increase the repayments of foreign currency loans granted earlier. The banks reported that they have not yet witnessed the worsening of the foreign currency loan *portfolio* up to the end of the half year, but the possible effect of the rise in the exchange rate in June on the portfolio is expected to affect portfolio quality only with minor delay.

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)

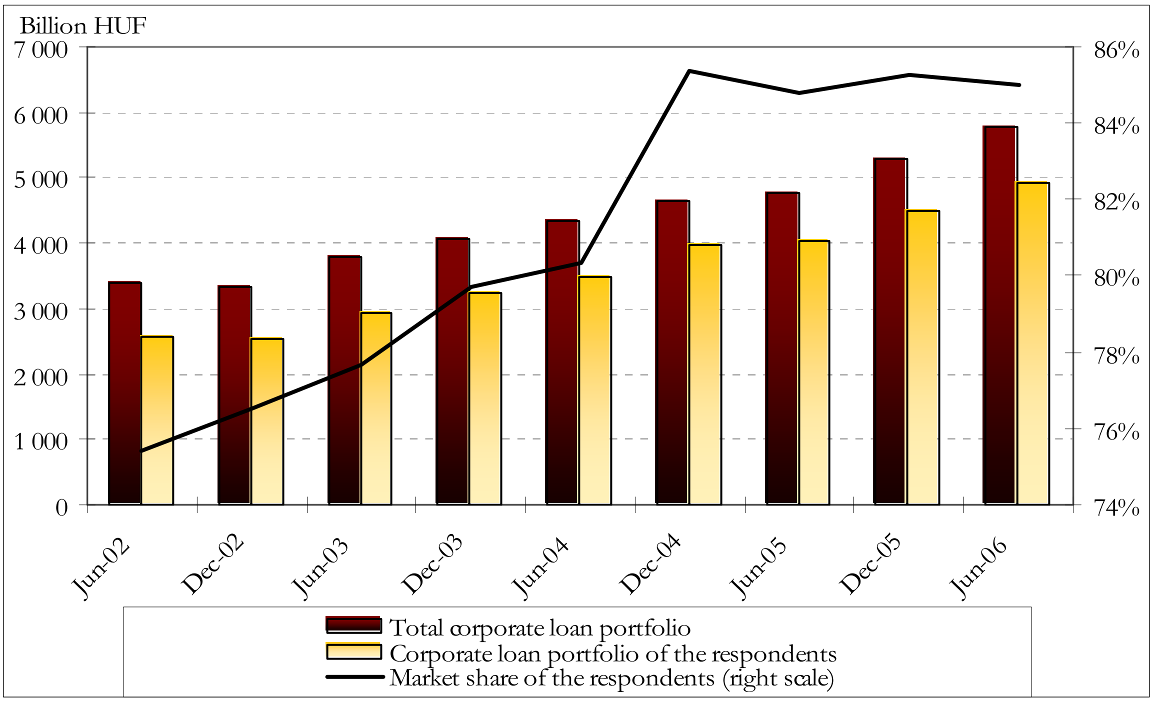


Chart 15: Share of responding banks in commercial project loans within the total project loan portfolio

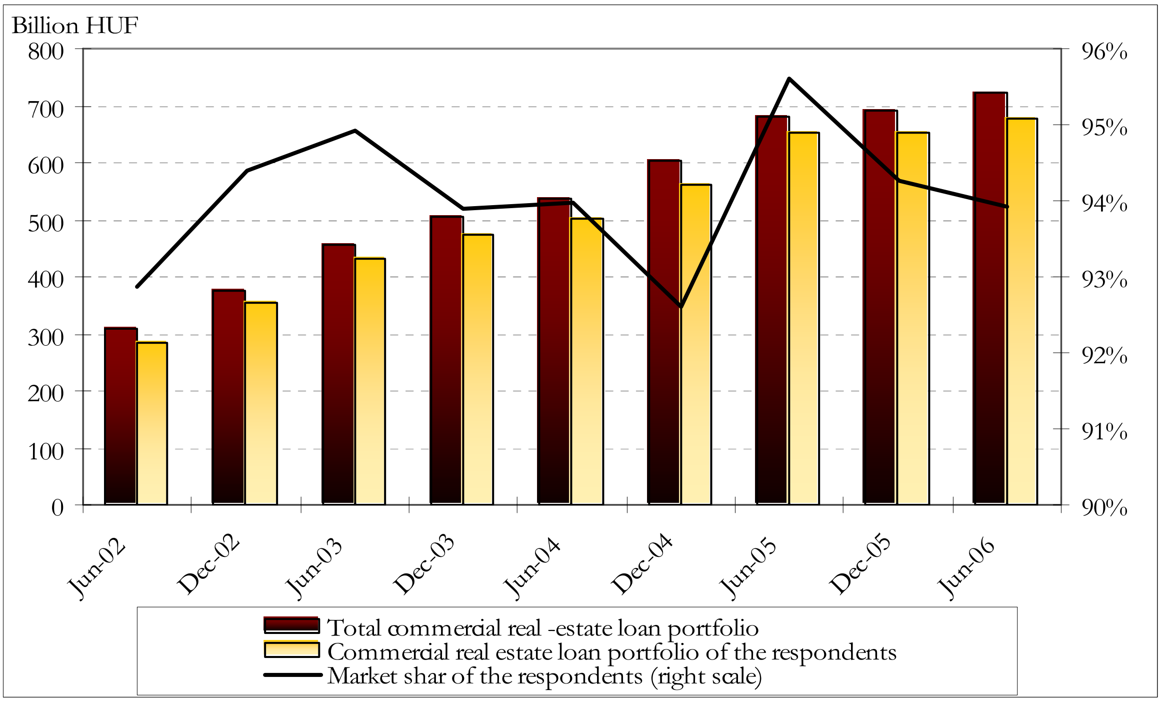


Chart 16: Creditworthiness standards by corporate category and in the field of commercial real estate loans
(ratio of those reporting tightening minus those reporting easing)

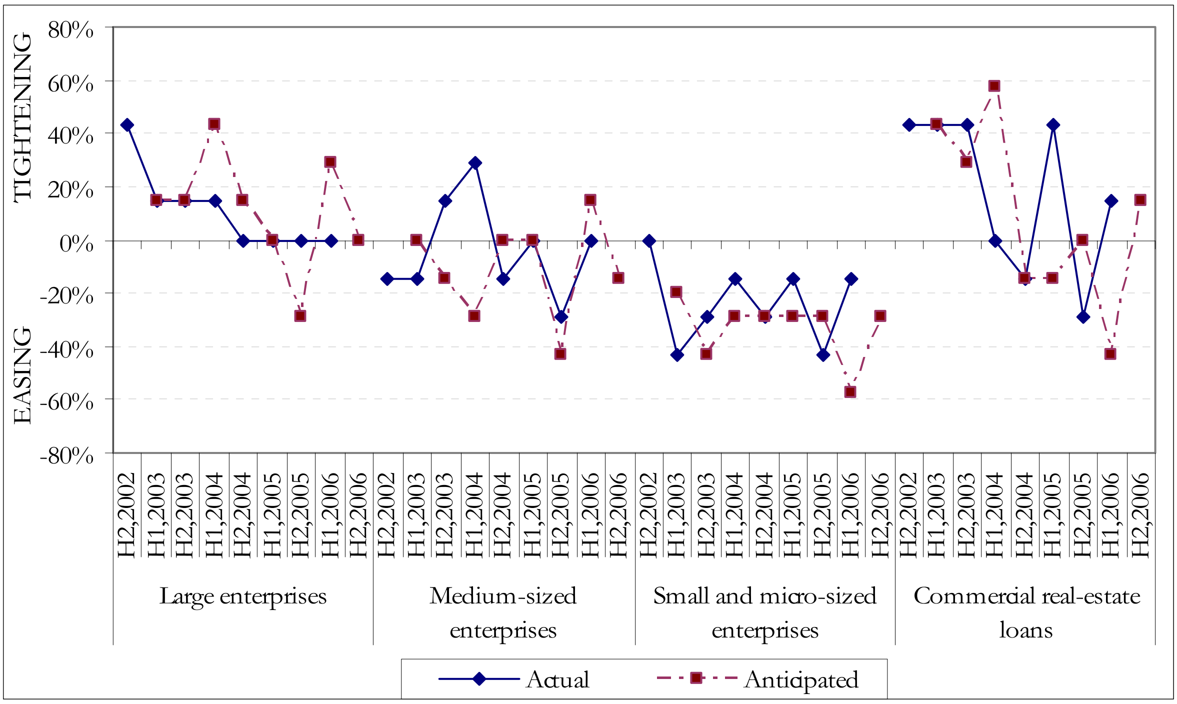


Chart 17: Maximum size of loans/credit lines by corporate category
(ratio of those reporting tightening minus those reporting easing)

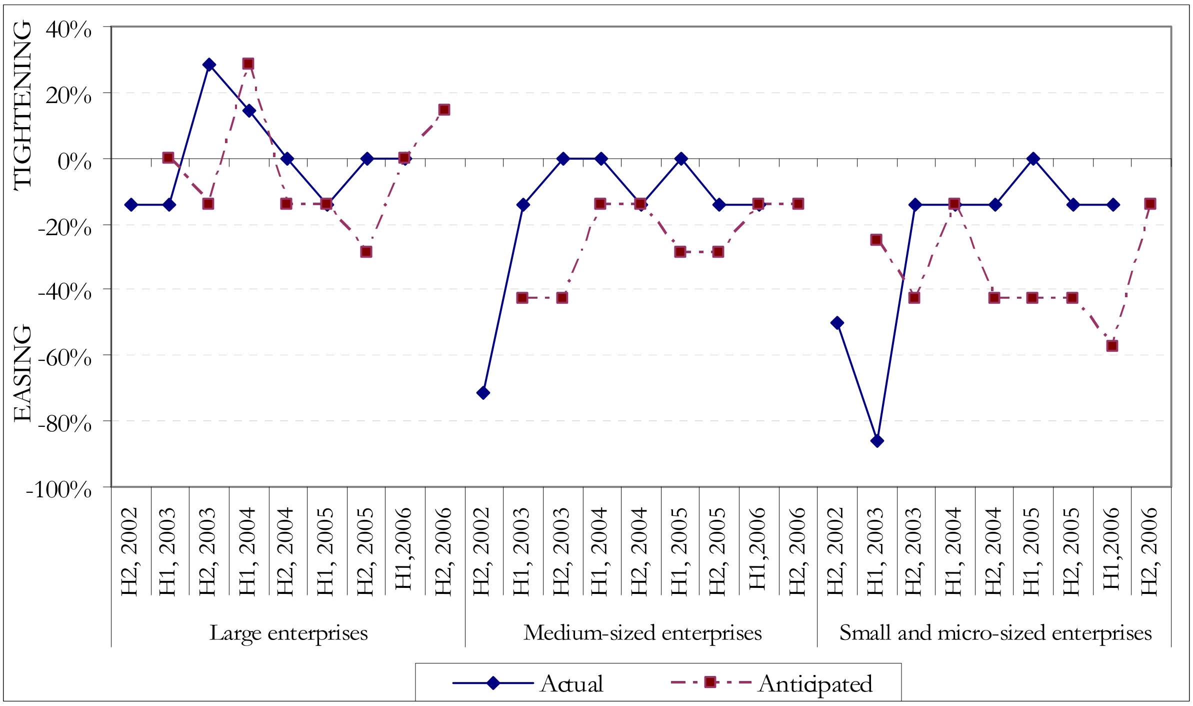


Chart 18: Spread between lending rates and costs of funds in a breakdown by corporate category (ratio of those reporting tightening minus those reporting easing)

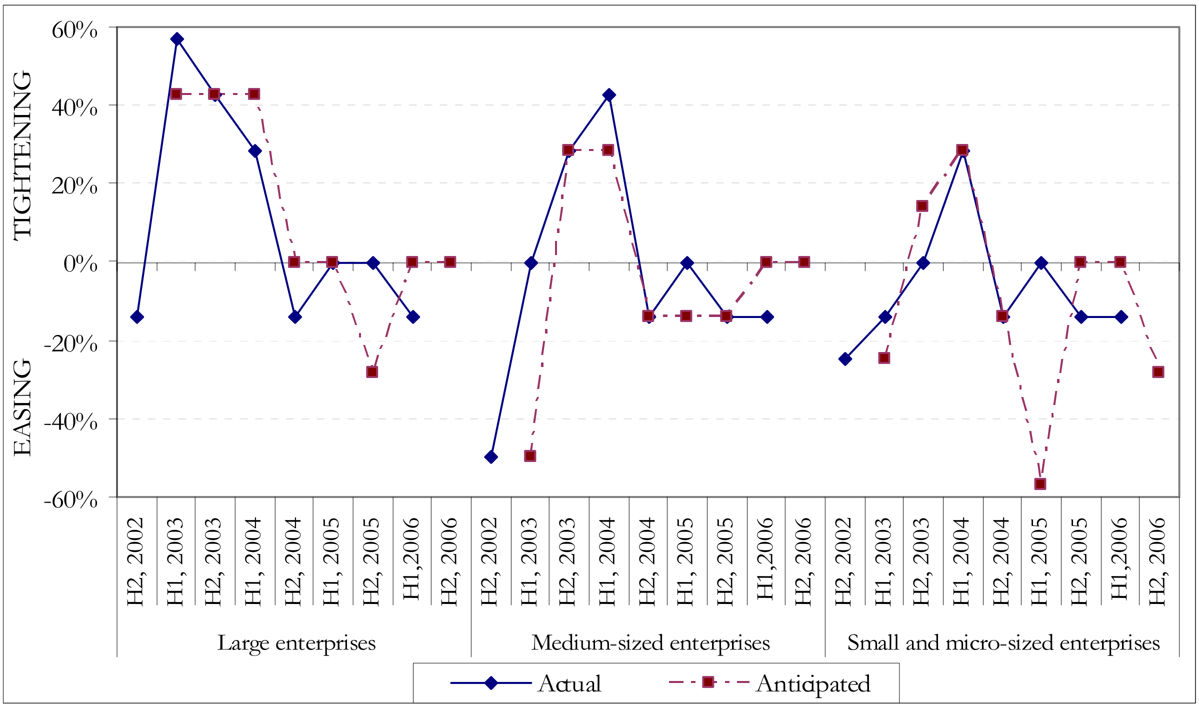


Chart 19: Premium on higher-risk loans in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

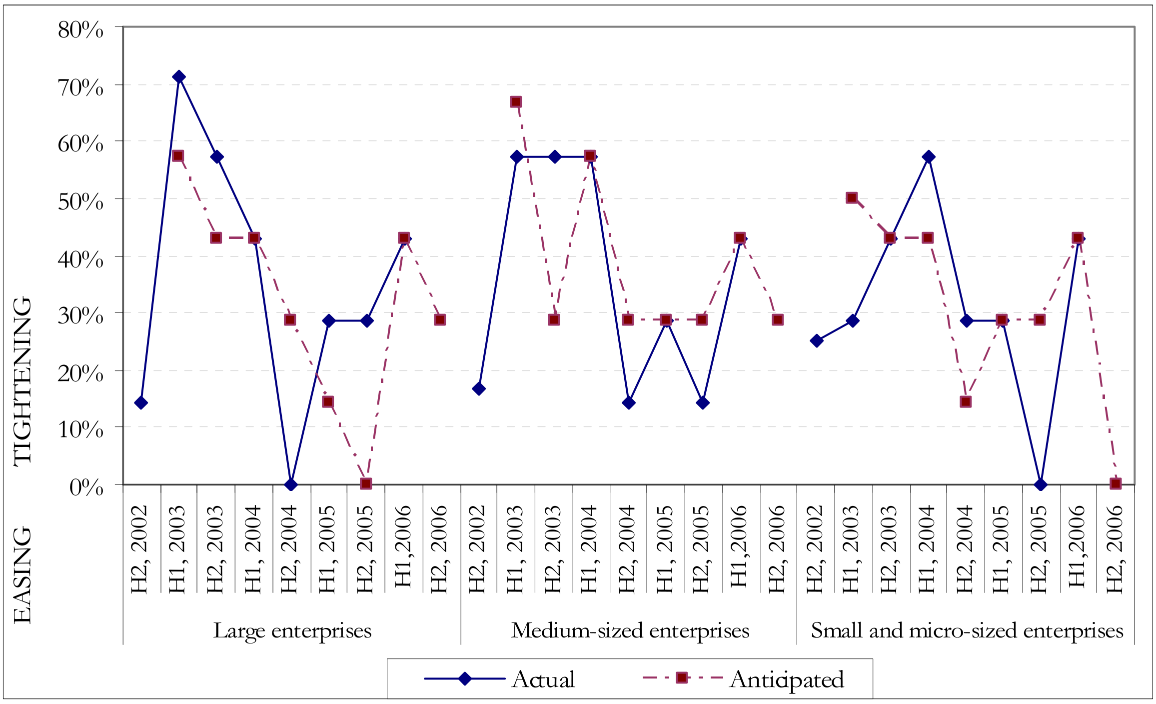


Chart 20: Collateral requirements in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

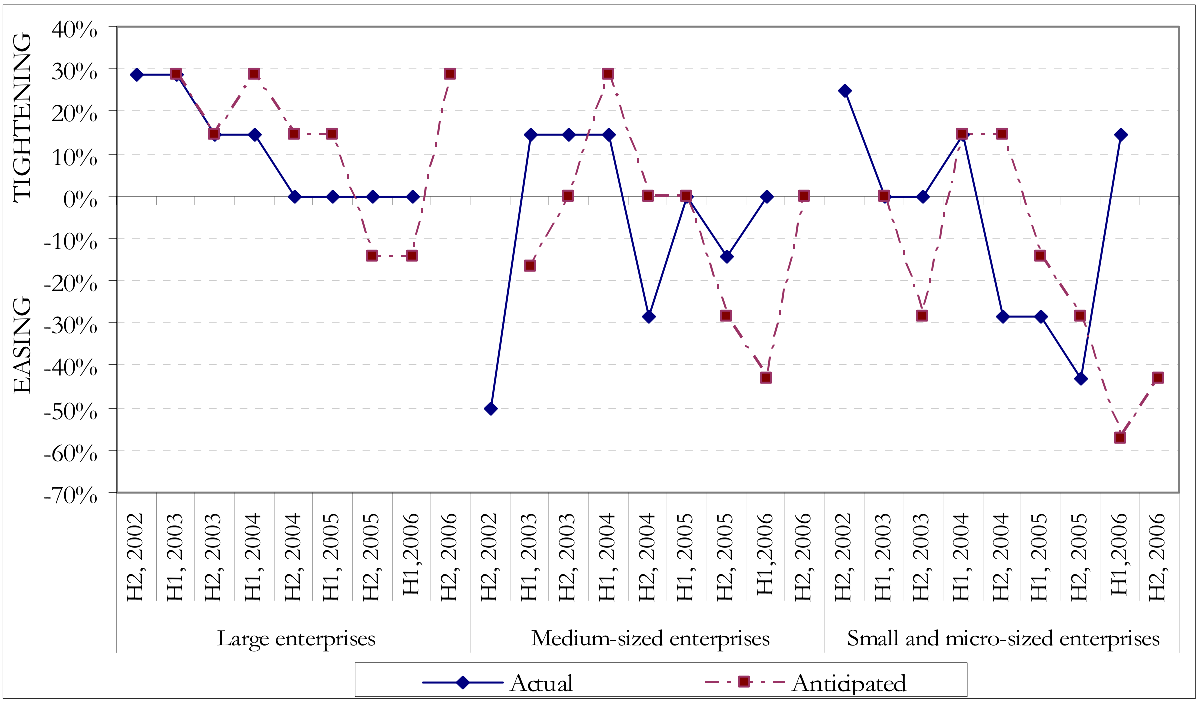
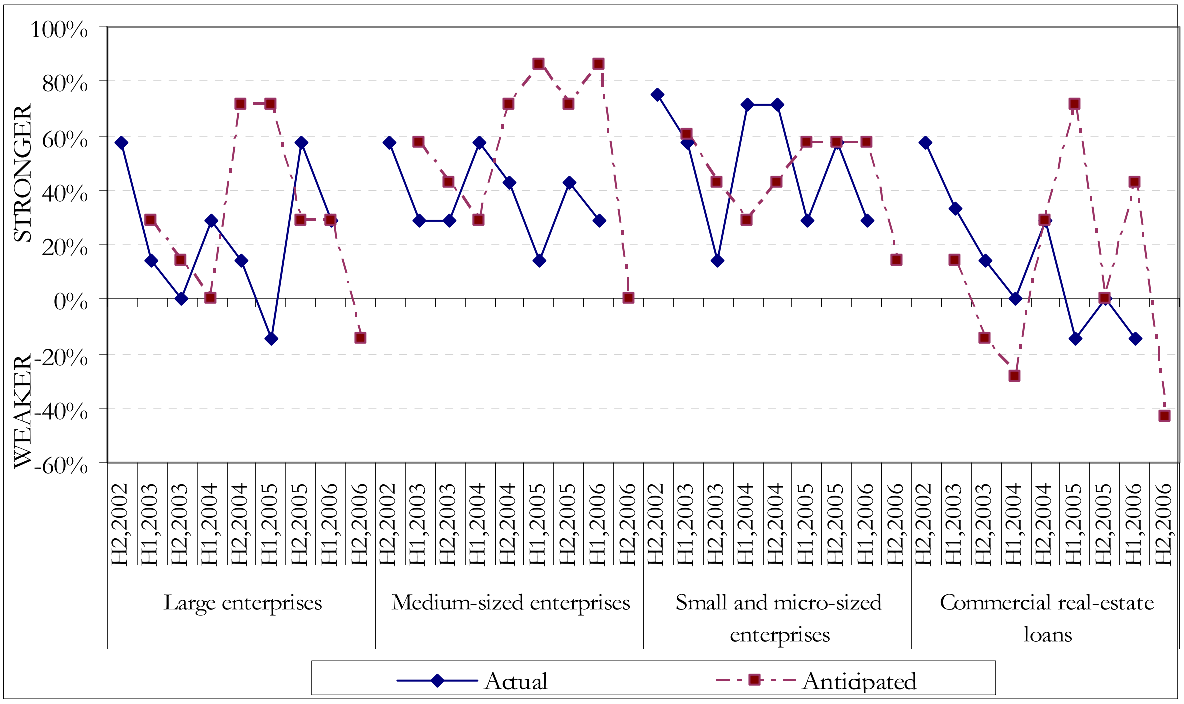
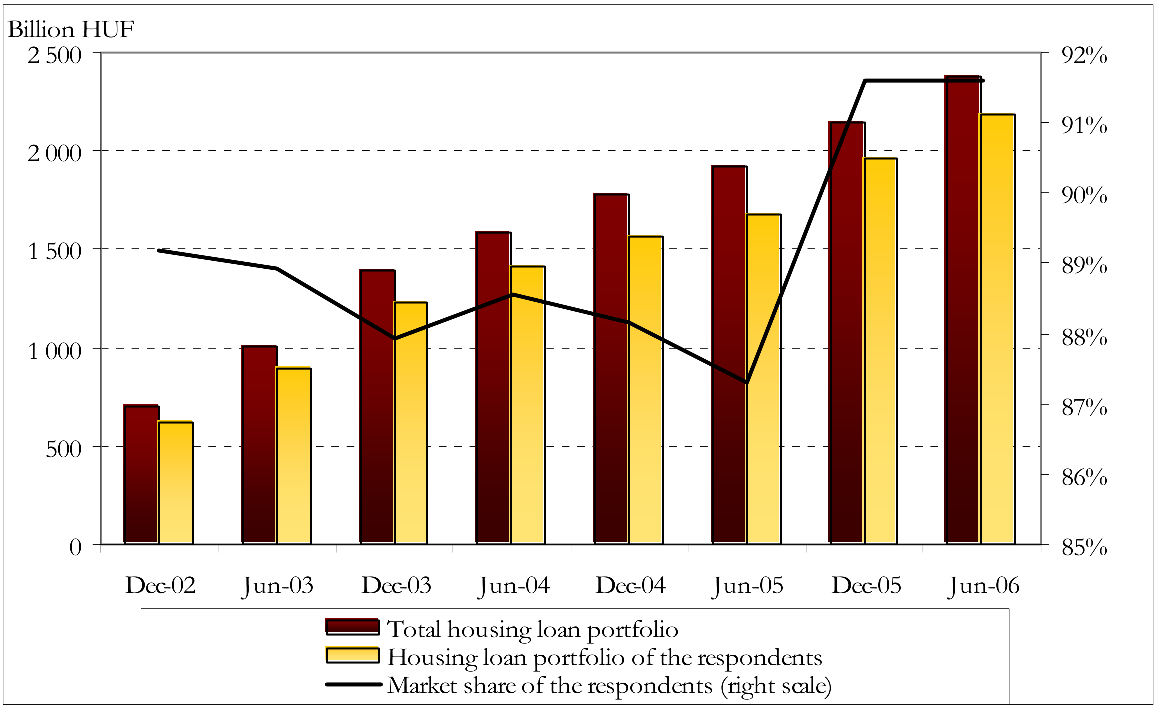


Chart 21: Demand for loans in a breakdown by corporate sector and in the market of commercial real estate lending (ratio of those reporting an increase minus those reporting a decrease)



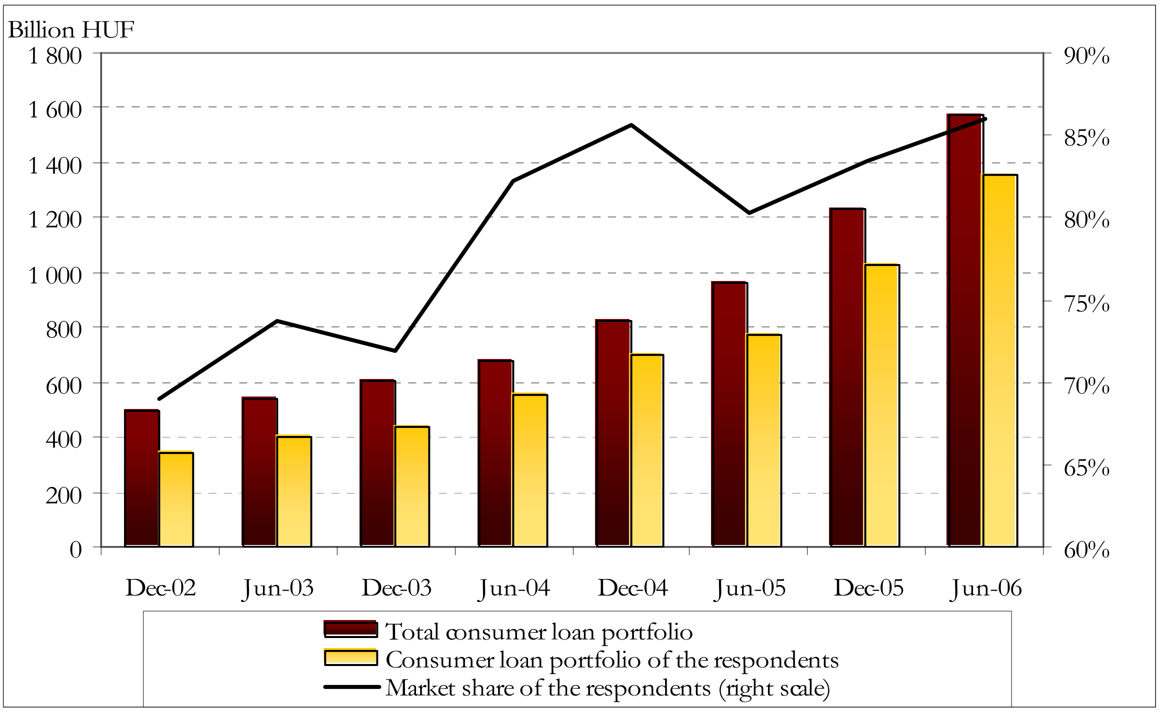
Household segment

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 have changed (e.g. because of fusion). Previously (with the exception of December 2003) seven banks answered our questions; since December 2005 the number of participating banks has been eight.

Chart 23: Market share of banks responding to questions relating to consumer credit



Comment: Over the years, participating banks and their number in the particular surveys have changed. In the beginning seven banks answered our questions; we invited nine banks to assess the first half of 2004; then the number of respondents changed to ten from the end of 2004, and in the previous survey the number of participating banks increased to eleven.