MAGYAR NEMZETI BANK

Trends in lending

August 2017

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The objective of the publication 'Trends in Lending' is to present a detailed picture of the latest trends in lending and to facilitate the correct interpretation of these developments. To this end, it elaborates on the developments in credit aggregates, the demand for loans perceived by banks and credit conditions. Within credit conditions, a distinction is made between price and non-price conditions. Non-price conditions influence changes in the clientele considered creditworthy by banks and the conditions of access to credit. Price conditions, in turn, show the price of borrowing for creditworthy customers.

In addition, with the help of the Financial Conditions Index (FCI), the analysis summarises the impact of the financial intermediary system on the economy. In particular, the key statistics examined in the analysis are the following:

- *The credit aggregates present quantitative developments in economic agents' loans outstanding on the basis of the balance sheet statistics of the banking sector. Both the volume of new loans and net changes in the banking sector's loans outstanding (net of exchange rate effects) are presented. From 2013 Q4 on, the analysis presents the trends in lending in the overall credit institutions sector (banking system and foreign branches, cooperative credit institutions).*
- *Changes in non-price credit conditions are presented in a qualitative manner based on the Lending Survey, in which the banks that are active in the given segment and jointly cover 80-90 per cent of the credit market indicate the direction of change compared to the reference period. The Lending Survey includes price conditions in a qualitative manner as well, in the form of the spread on the cost of funds, the premium on risky loans and the fees charged.*
- *The interest rate statistics contain the price conditions, i.e. aggregate interest rates on credit institutions' new loans realised, weighted by the contract amounts. The lending rate can be decomposed into the reference rate and the spread on the reference rate.*
- *Banks active in the given segment provide qualitative responses in the Lending Survey in respect of their expectations and the changes in credit demand they perceive. Similarly to credit conditions, banks indicate the direction of the change.*

Detailed information on the indicators describing the developments in lending and the methodology of the Financial Conditions Index is given in the Annex at the end of the analysis. Within the publication, the findings of the Lending Survey are presented in a condensed form, but the responses to the questions and the set of charts based on the findings are published in full on the Lending Survey page of the MNB's website.

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1. EXECUTIVE SUMMARY

In 2017 Q2, corporate lending continued to grow; thus, a growth of 7 per cent could be observed in an annual comparison. Overall, the expansion of credit to the entire corporate segment was also within the band of 5-10 per cent, deemed desirable by the MNB. Within the corporate segment, lending to the narrow SME sector grew by 8.3 per cent, while lending to the broad SME sector, including the self-employed, increased by 13 per cent. Lending to SMEs was able to expand on market basis following the closing of the Funding for Growth Scheme (FGS) in 2017 Q1. Market-based lending is still supported by the MNB's Market-based Lending Scheme, under which banks raised their lending commitments relating to this year to almost HUF 230 billion. This represents about 6 per cent of loans outstanding of the SME sector, which projects continued positive developments in corporate lending.

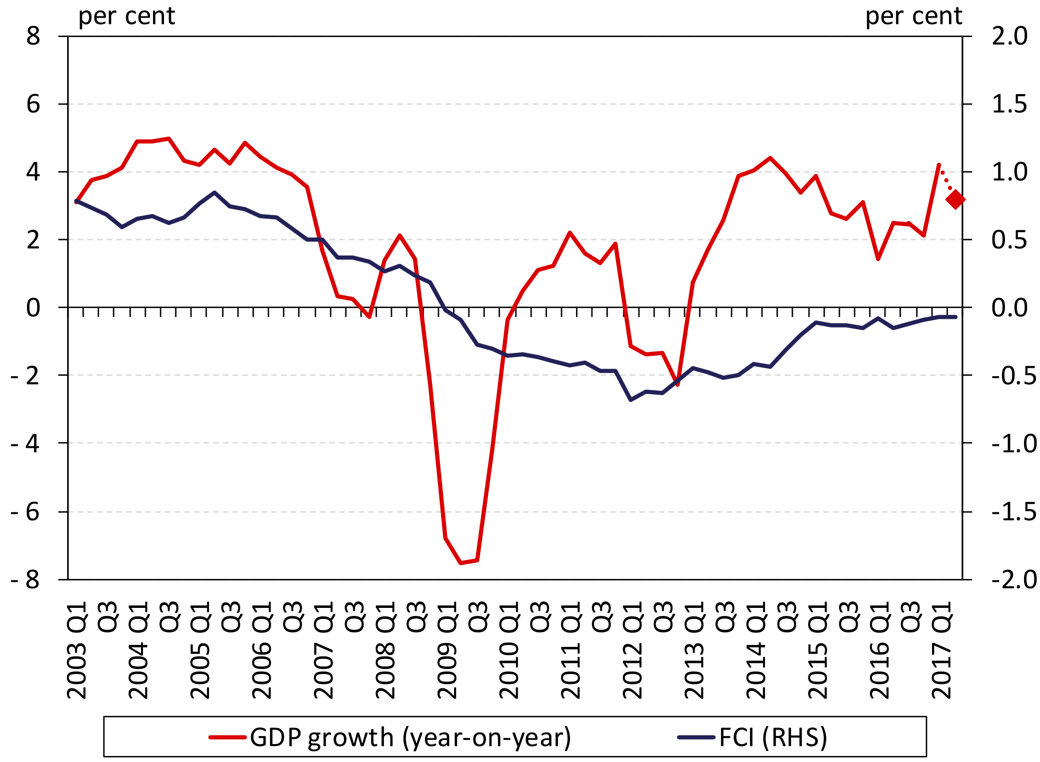
Based on the responses to the Lending Survey, corporate credit conditions were eased in Q2 in all enterprise size categories. This is primarily due to the improvement in general economic prospects and the intensification of bank competition. Banks projected further easing for 2017 H2, which may be reflected primarily in a decrease in interest rate spreads. Banks perceived rising credit demand from enterprises, primarily for short-term loans, which they expect to persist in 2017 H2 as well. During the personal interviews, lending managers reported intensifying price competition. All participants confirmed that the risk profile of the portfolio placed in the past years is excellent.

Lending to the household sector rose by 2.8 per cent year-on-year by June 2017, which is unprecedented since the beginning of the global financial crisis. The annual value of household loan transactions amounted to HUF 162 billion, with Q2 contributing to this by HUF 73 billion. The annual average increase in the volume of new loans was 46 per cent. Within this, new housing loans and personal loans were up 35 per cent and 51 per cent respectively, year-on-year. By loan purpose, 17 per cent of new housing loans were used for new house purchase or construction.

According to the banks' responses to the Lending Survey, conditions for both housing and consumer loans remained practically unchanged in the period under review; however, in the case of housing loans a moderate easing is expected for the next half year. The latter may be attributable to the fact that, in parallel with the spreading of Certified Customer Friendly Mortgage products, market participants anticipate a more intensive competition. Banks continued to report a pick-up in credit demand in case of both products, and looking ahead they expect this trend to continue. The rise in demand is still supported by the Home Purchase Subsidy Scheme for Families (HPS). In Q2, 16 per cent of the volume of new housing loans were linked to the HPS. Both the average APR and the interest rate spread on new housing loans declined modestly in the period under review, though they still considerably exceed the regional average. Contrary to previous trends, the ratio of variable rate housing loans increased slightly within new housing loans; thus, their share was 41 per cent.

Based on the Financial Conditions Index which summarises lending developments in the corporate and household segments, the banking system exerted an approximately neutral cyclical impact on the annual growth of the real economy through its lending activity i.e. it has neither a strengthening nor a contractionary effect on economic growth.

Financial Conditions Index (FCI) and annual real GDP growth



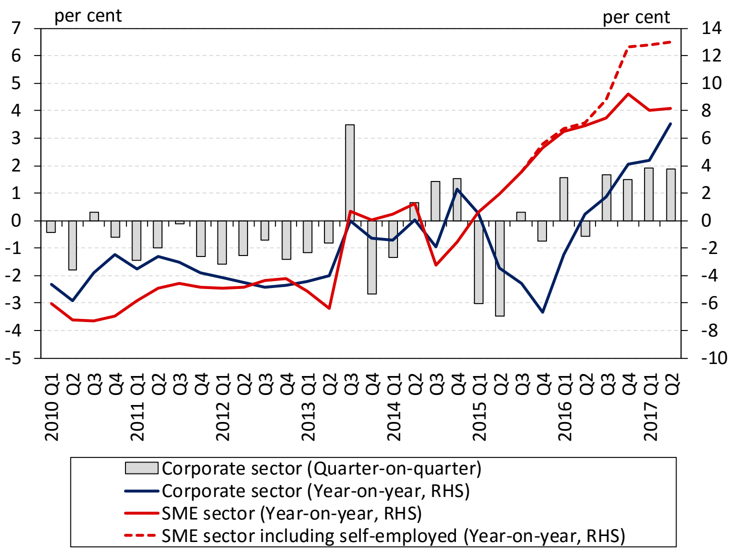
Note: The FCI quantifies the banking system's contribution through lending to the annual GDP growth rate. The 2017 Q2 data for the real GDP annual growth rate is a preliminary, seasonally and calendar adjusted estimate of the HCSO.

Source: MNB, HCSO.

2. DEVELOPMENTS IN LENDING IN THE CORPORATE SEGMENT

In 2017 Q2, the transaction-based growth in corporate lending continued and it amounted to HUF 115 billion. In the last 12 months, loans outstanding increased by more than HUF 410 billion as a result of transactions, representing a growth of 7 per cent. Lending to the narrow SME sector, belonging to the corporate sector, grew by 8.3 per cent, while lending to the broad SME sector, including the self-employed, rose by 13 per cent in annual terms. Based on the Q2 data, the dynamics of lending to SMEs was able to persist even on market basis, after the closing of the FGS in the first quarter. The central bank's Market-based Lending Scheme continues to support market-based lending. At the tenders announced in July within the framework of the second phase of the scheme, banks raised their lending commitments for this year to almost HUF 230 billion, which accounts for roughly 6 per cent of the outstanding lending to SMEs. Based on the responses to the Lending Survey, the corporate credit conditions were eased in all enterprise size categories. The easing is primarily attributable to the improvement in the general economic prospects and the intensification of bank competition. Further easing is expected to take place in the second half of the year, which may appear primarily in the decrease in the spread between the cost of funds and the interest rate on loans. Banks perceived strengthening credit demand from the enterprises, primarily for the short-term loans, which they expect to persist in the second half of the year as well.

Chart 1: Growth rate of loans outstanding of the whole corporate sector and the SME sector



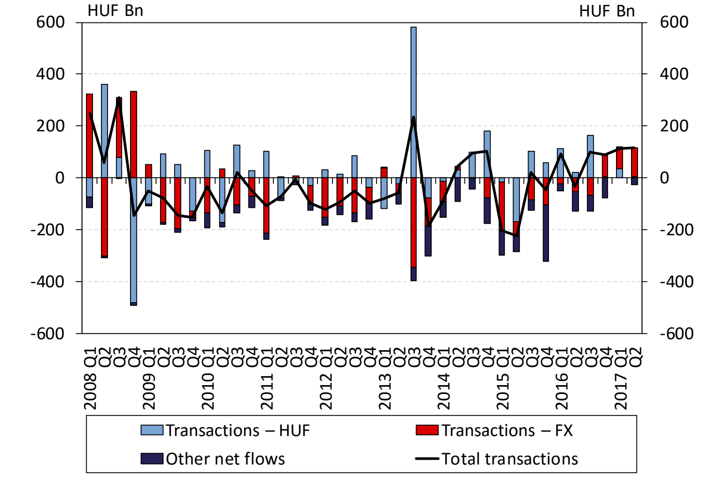
Note: Transaction based, prior to 2015 Q4 data for SMEs are estimated based on banking system data. Source: MNB.

Domestic corporate lending

Dynamic increase in corporate lending continued. In the past one year the outstanding borrowing of non-financial corporations rose by more than HUF 410 billion on a transaction basis, representing a growth of 7 per cent (Chart 1). The improvement in the annual growth is in part also attributable to the fact that transactions in the second quarter were well above those recorded one year before. The outstanding borrowing of the micro, small and medium-sized enterprises, taken in the narrow sense, rose by 8.3 per cent in annual terms, similarly to the rate observed at the end of the previous quarter. The annual growth rate of the outstanding loans to the SME sector[1], expanded with the self-employed taking a loan for economic activity – allocated for the purpose of statistics to the households category – was 13 per cent. Lending to SMEs was able to expand on market basis, after the closing of the Funding for Growth Scheme (FGS) in 2017 Q1. After the FGS, the central bank's Market-based Lending Scheme (MLS) continues to support lending. Within the framework of MLS, banks originally committed to a credit growth of HUF 170 billion for 2017, which was raised in the second phase of the scheme in early July by more than 30 per cent, to almost HUF 230 billion. This is about 6 per cent of the outstanding lending to the SME sector, which projects continued positive developments in corporate lending.

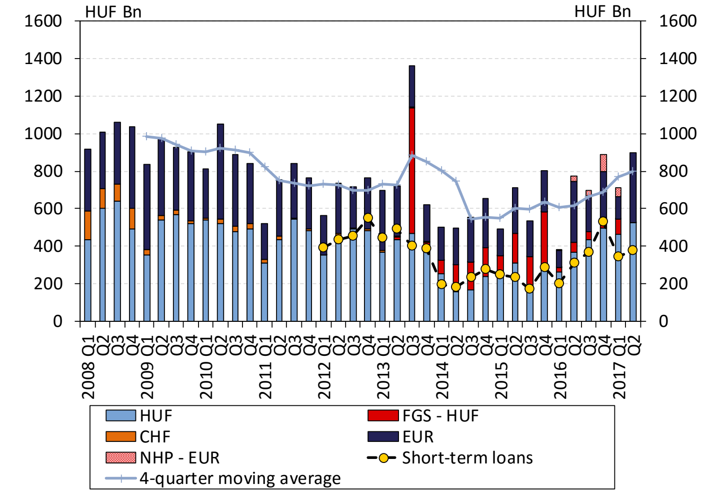
[1] Although the self-employed belong to the household sector in a statistical sense, they also qualify as SMEs based on their activities and legal definition.

Chart 2: Net quarterly changes in corporate loan portfolio, by currency



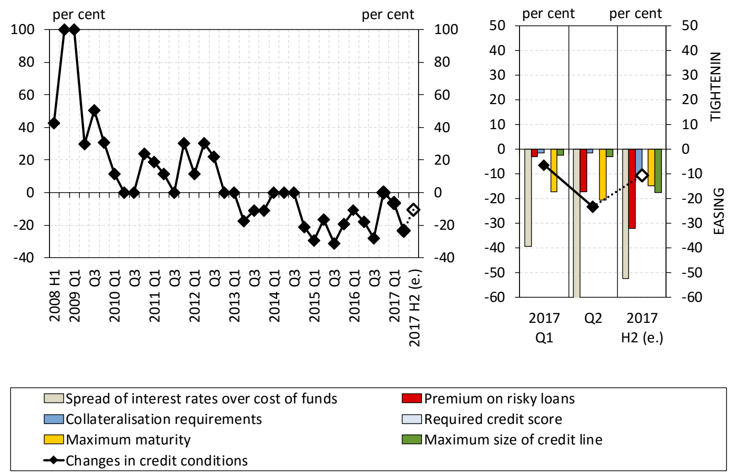
Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment, excluding individual institutional effects. Source: MNB.

Chart 3: New corporate loans in the credit institutions sector



Source: MNB.

Chart 4: Changes in credit conditions in the corporate segment



Note: Net percentage balance of respondents reporting tightening/easing credit conditions weighted by market share. Source: MNB, based on banks' responses.

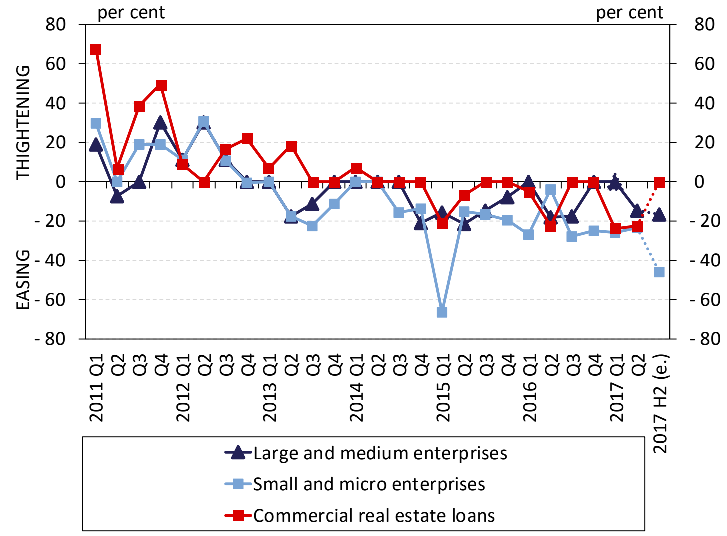
In the past quarter outstanding corporate loans increased similarly to previous quarters. In 2017 Q2, transaction-based growth in credit institutions' corporate loan portfolio – similarly to the previous quarter – amounted to around HUF 115 billion (Chart 2), of which HUF 71 billion can be linked with the SME sector. The largest part of the growth is attributable to the foreign currency loan transactions: in the case of foreign currency loans – partly as result of the large volume of borrowing related to the large corporate sector – disbursements exceeded repayments by HUF 110 billion, while in the case of forint loans by HUF 5 billion. During the quarter the forint transactions increased by HUF 43 billion and the FX transactions increased by HUF 28 billion in the corporate segment in case of SME sector. The FGS contract conclusion period closed at the end of the first quarter, but the remaining tranches can be drawn down until mid-2018. In the second quarter HUF 41 billion was drawn down in relation to the loans granted in the third phase of the scheme, which were distributed roughly fifty-fifty between the forint and the foreign currency pillars.

The volume of new market-based loans increased. In the second quarter credit institutions concluded new contracts in the value of more than HUF 900 billion with the non-financial corporations (also including the money market transactions) (Chart 3). The total volume of new loan contracts concluded in the past twelve months exceeded that of last year by almost 30 per cent, with essentially identical growth rate in the case of forint and foreign currency loans. In terms of maturity, the division of new loans between the short and long maturities was balanced, at almost 50-50 per cent[2].

Corporate credit conditions were further eased, and easing is expected for the second half of the year. In 2017 Q2 one-quarter, in net terms, of the banks participating in the Lending Survey eased the conditions of corporate loans (Chart 4). Within that, two-thirds of them reported that the easing appeared in the decrease in the interest rate spreads, while more than 40 per cent of them indicated that the fees charged for lending had decreased and almost 20 per cent of them mentioned the prolongation of the permitted maximum loan maturity. The easing is primarily attributable to the improvement in the

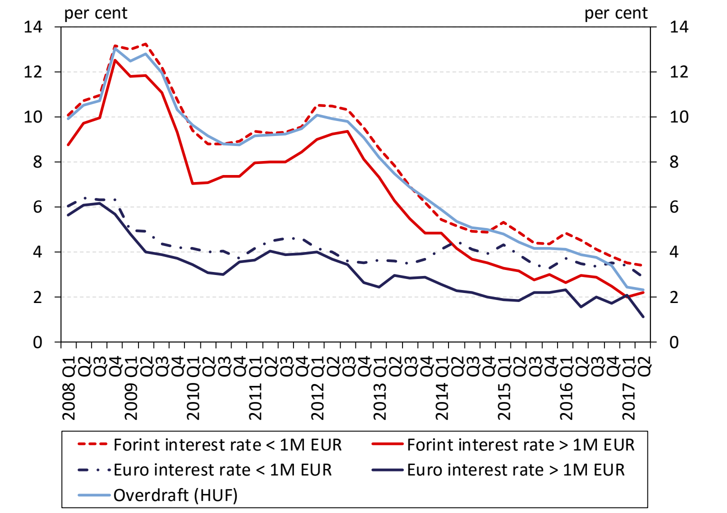
[2] Loans with a maturity of less than one month and the renewal of earlier credit line agreements increase neither the loans outstanding at the end of the month, nor the value of transactions.

Chart 5: Changes in credit conditions in the corporate sub-segments



Note: Net ratio is the difference between tightening and easing banks, weighted by market share. Source: MNB, based on the answer of respondent banks.

Chart 6: Interest rates on new corporate loans



Note: Loans with variable interest rates or with up to 1-year initial rate fixation. From 2015, based on data net of money market loans exceeding EUR 1 million. Source: MNB.

general economic prospects and the intensification of bank competition. Looking ahead, net 11 per cent of the respondents anticipate further easing in the next half-year, which may also be realised primarily through the decrease in spreads. In respect of the second quarter, an almost identical ratio of the respondents, i.e. about net 20 per cent of them, reported the easing of the lending conditions in respect of all enterprise size categories and commercial real estate loans as well (Chart 5). In the next half-year, in the case of the micro and small enterprise segment, net 46 per cent of them, while in the case of large and medium-sized enterprises 16 per cent of them anticipate further easing, while in the case of commercial properties they expect no change in the lending conditions.

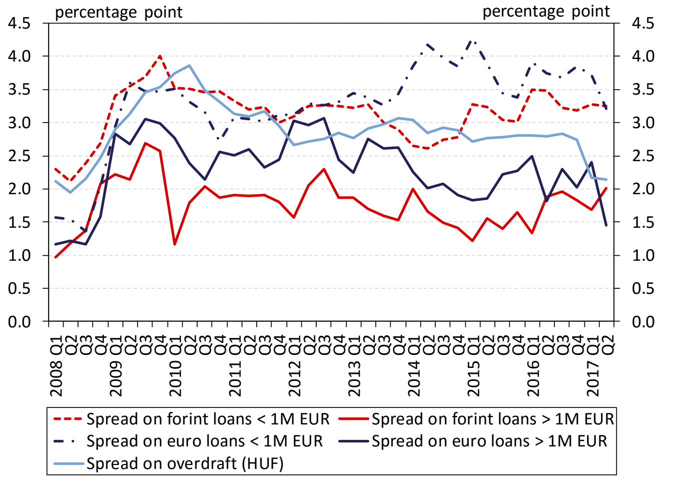
The interest rate on new euro loans has significantly decreased. The interest rate on new market-based corporate loans[3] in the case of large-amount forint loans – excluding money-market transactions[4] – increased by an average of 0.2 percentage point, while it decreased by 0.1 percentage point in the case of forint loans below EUR 1 million and forint overdraft facilities (Chart 6). The average interest rate on large-amount euro loans decreased by almost 1 percentage point, which is in part attributable to the low interest rate on the preferential interest loans extended to certain key clients of banks, but the average level of interest rates dropped by 0.5 per cent also in the case of small-amount euro loans compared to the previous quarter. In the case of large-amount forint loans, the average interest rate spread rose by 0.3 percentage point, under a decrease in the benchmark rate, while it remained constant at the small-amount forint loans. In the case of the euro loans, the significant decrease in interest rates took place under a steady benchmark rate, i.e. it can be explained fully by the decrease in the interest rate spread (Chart 7).

No material change occurred in the effect of the banking sector's lending activity to corporate investments. In 2017 Q2, the corporate sub-index of the Financial Conditions Index continued to be negative (Chart 8), i.e. the level of corporate investment was slightly reduced by the restrained

[3] In the case of new contracts, we examined variable-rate loans or loans with interest rate fixation up to one year. The majority of loans granted under the FGS are long-term loans, and therefore the interest rates reviewed by us are only affected by smaller, short-term FGS loans.

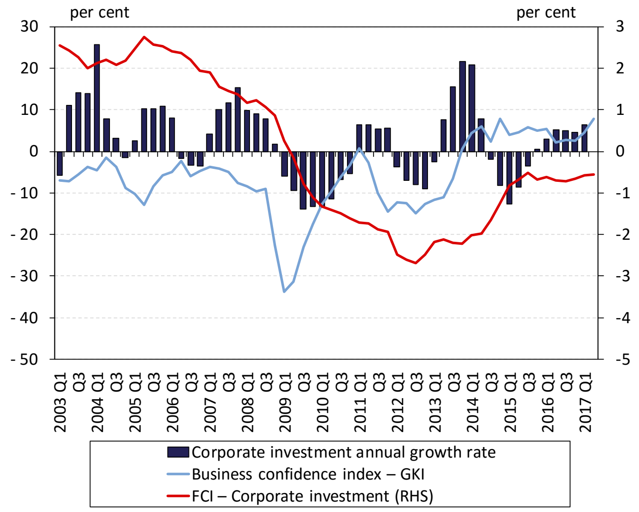
[4] Money market transactions are loans with a value of over EUR 1 million extended to non-financial corporations; their term is short (typically less than 1 month) and they serve to fund some kind of financial operation. It has been possible to exclude money market transactions since 2015, although in the previous period, due to their low weight, they did not significantly distort the observed average interest rates.

Chart 7: Interest rate spreads on new corporate loans



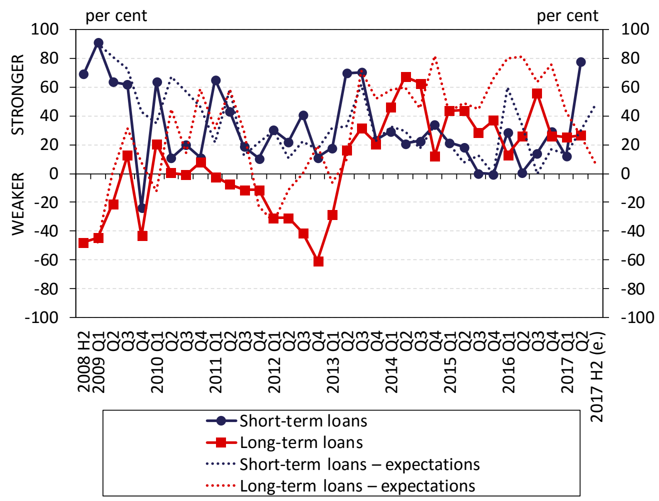
Note: Spread on the 3-month BUBOR and EURIBOR. Loans with variable interest rates or with up to 1-year initial rate fixation. From 2015, based on data net of money market loans exceeding EUR 1 million. Source: MNB.

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



Note: The sub-index of the FCI quantifies the banking system's contribution, through corporate lending, to annual growth in corporate fixed investments. Source: MNB, GKI.

Chart 9: Change in credit demand by maturity

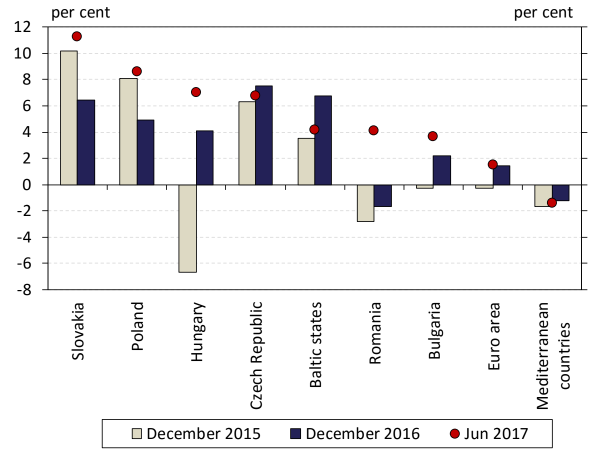


Note: Net ratio is the difference between banks reporting stronger and weaker demand, weighted by market share. Source: MNB, based on the answers of respondent banks.

lending of the banking sector. The business confidence index, which captures expectations, rose, similarly to the previous quarter.

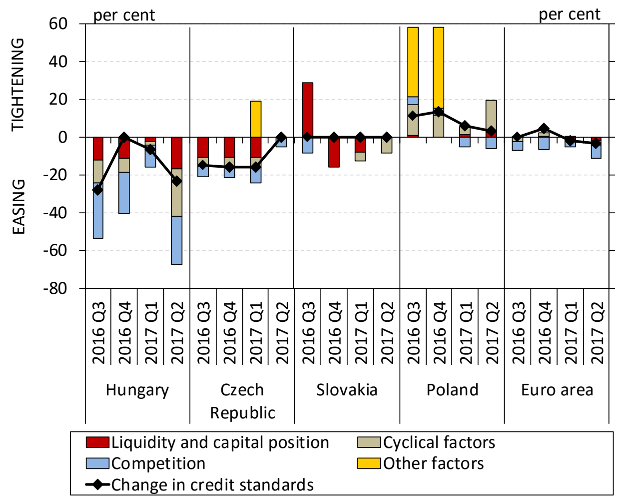
Corporations' credit demand rose, particularly for the short-term loans. Based on the responses given in the Lending Survey, net 60 per cent of the banks experienced a pick-up in credit demand among companies, albeit to a different degree within the individual categories. In terms of maturity, banks perceived a soar in demand for short-term loans: here net 78 per cent of the respondents reported a pick-up, while in the case of long-term loans only about 27 per cent of them perceived the same (Chart 9). Rising demand for forint loans was reported by net 45 per cent of them, while according to their perception, demand for foreign currency loans has not changed materially. Contrary to the surveys of the last four quarters, this was the first time that the respondents reported that pick-up in the large and medium-sized enterprise segment exceeded that in the small and micro enterprise segment. Respondents expect rising demand in the next half-year, primarily for the short-term loans: in this segment almost 50 per cent of them, in net terms, report increasing demands, while in the case of long-term loans only net 7 per cent of them anticipate the same. The pick-up in demand is still expected to be more wide-ranging in the case of the large and medium-sized enterprises.

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



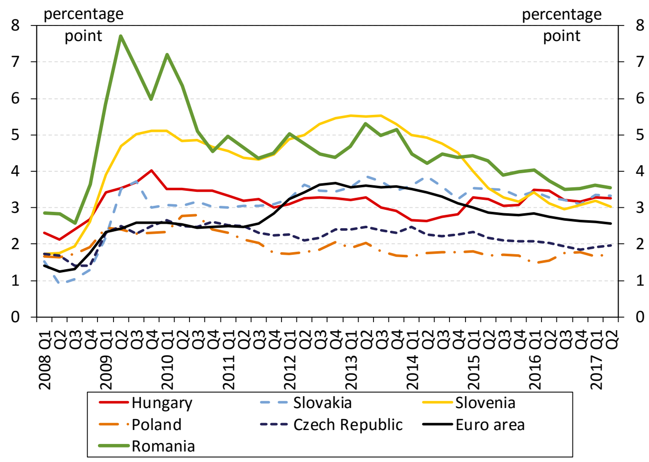
Note: Mediterranean countries: Greece, Italy, Portugal and Spain. Baltic states: Estonia, Lithuania and Latvia. Source: ECB, MNB.

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



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

Chart 12: International comparison of interest rate spreads on small-amount corporate loans extended in domestic currency



Note: Variable-rate loans below EUR 1 million, with maturities of up to one year; therefore, FGS loans with the maximum 2.5 percentage point spread are not included. Source: MNB, ECB, national central banks.

International outlook in corporate lending

The Visegrád countries are in the vanguard of the credit growth. Within the euro area, corporate loans increased by an average 1.5 per cent over the past year (Chart 10). The growth is still attributable to the core countries (primarily to France and Germany), while the portfolio continued to decrease in the Mediterranean countries, mainly due to the decline in Italy. In the Baltic States the growth rate fell back to 4 per cent, while the Visegrád countries are characterised by a dynamic growth: Corporate lending increased in Slovakia by 11 per cent, in Poland by 9 per cent, while in Hungary and in the Czech Republic by 7 per cent.

Corporate credit conditions continued to ease in the euro area. Based on the banks' responses to lending surveys, corporate credit conditions eased in the euro area, similarly to the previous quarter, with a net 3.4 per cent of banks performing easing (Chart 11). About net 20 per cent of the respondents specified bank competition as the reason for the easing, while 6 per cent mentioned the improving general economic outlooks and 4 per cent the favourable liquidity situation. Corporate credit conditions in the Visegrád countries show a heterogeneous picture: while there was a material easing in Hungary, conditions in the Czech Republic and Slovakia remained unchanged, while in Poland they were slightly tightened.

There was no significant change in the average interest rate spread of corporate loans across the region. In the euro area, in the second quarter the average interest rate on corporate loans below EUR 1 million approached 2.2 per cent, after a minor decline, under a steady benchmark rate (Chart 12). Interest rate spreads have not changed significantly in the Visegrád countries. The largest change could be observed in Hungary, where the degree of the fall in the average level of interest rates reached 0.1 percentage point, while in the rest of the countries only more moderate changes than this took place. The changes in all cases are almost fully attributable to the change in the benchmark rates, without substantial change in the spreads.

Box: Experiences of the personal interviews with the senior corporate loan officers

The MNB conducted personal interviews with the experts of 11 Hungarian credit institutions in order to obtain more profound, qualitative information on the trends that take place in the individual segments of lending. The banks' experiences are summarised below.

The Funding for Growth Scheme (FGS) launched major borrowing activity in the past years, drawing the financing institutions' attention to the small and medium-sized enterprises. The phase-out of FGS causes no major difficulties for the enterprises, mainly due to the favourable interest environment and real economy processes. Although many brought-forward investments were also implemented within the framework of FGS, no decline can be experienced in credit demand. Several actors mentioned that the labour shortage forces some of the SMEs to implement modernising investments. A further role can be played by the deferred credit demand related to the EU support schemes. As regards the EU grants, banks typically stated that on the whole they tend to exert a credit demand increasing impact through the own resources and grant pre-financing schemes, even though investment loans may be crowded out by the combined products. They mentioned the impossibility to plan the time of the availability of the grants as a problem, which may induce the postponement of the investment and the related financing.

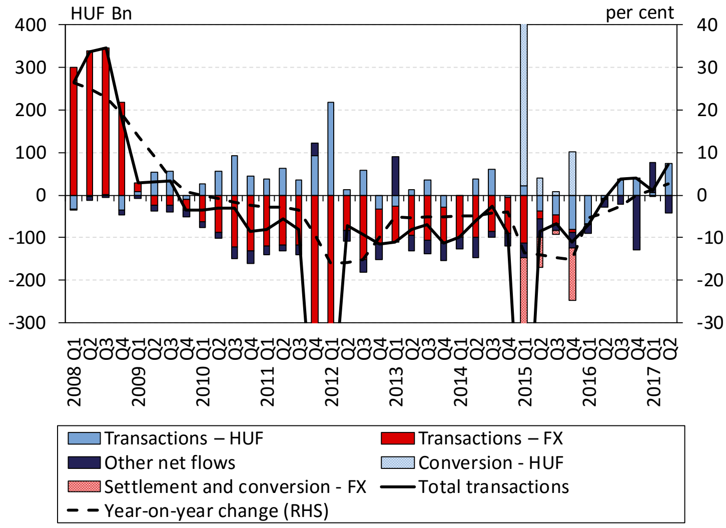
After the phase out of the FGS, demands for fixed-interest products remained high; the majority of the respondent credit institutions do offer such products; however, fixing over 5 years is less attractive to the clients due to its relatively high cost. Furthermore, as a result of the programme, the spread of 2.5 per cent became a guiding anchor to the clients, increasingly forcing banks to apply a downward deviation from that. Thus price competition for corporate clients deemed creditworthy becomes increasingly fierce; some of the actors believe that the pricing of certain transactions by the competitors is questionable in terms of long-term profitability.

Part of the banking experts mentioned that beside price competition, signs of risk competition can be seen, manifesting itself in easing collateral and/or own resource requirements. Nevertheless, all actors stated that the quality of the portfolios placed in recent years is still excellent, where the favourable cyclical developments presumably have a determinant role. Some actors believe that for the time being the portfolio is so clean that there would be room to open up slightly to the riskier enterprises as well. In the case of smaller companies, institutional guarantees have an increasing role; the credit institutions noted that the guarantee institutions try to satisfy market demands faster and more flexibly. They mostly mentioned the volume and quality of the information available on the clients as the primary obstacle the financing of smaller and riskier clients.

There are major differences between the individual credit institutions in the activity experienced in the areas of project financing (particularly commercial properties). Some of the actors fully preclude project financing, while others see a growth opportunity in it. The financing institutions usually prefer residential property projects the most, followed by the office and hotel projects. At present several high-quality projects are launching in the market; however, some of the banks believe that major risks may build up in this area of financing, if actors commence excessive easing as a result of the strong competition and the less experienced counterparties move towards the financing of projects with low own resources – as it was the case in the pre-crisis period.

In 2017 Q2 the household loans transactions amounted to HUF 73 billion, with a 2.8 per cent annual rate of growth on transaction basis. Disregarding the loans taken by sole proprietors, the decline in the outstanding borrowing was merely 0.6 per cent in annual terms. The value of new contracts amounted to HUF 350 billion in the quarter, and on average it rose annually by 46 per cent. Within the total volume, new housing loans increased by 35 per cent and new personal loans by 51 per cent over the past year. According to banks' responses to the Lending Survey, conditions for both housing and consumer loans remained practically unchanged in the quarter under review. Compared to the previous period, a larger ratio of the banks indicated the easing of the housing loan conditions for the second half of the year, which may be related to the introduction of the Certified Customer Friendly Mortgage products. In addition, banks perceived a pick-up in credit demand in both product ranges and they expect this trend to continue in the next half year as well. The rise in demand is still supported by the Home Purchase Subsidy Scheme for Families (HPS), and in Q2, 16 per cent of the volume of new housing loans were linked to the HPS. Both the average APR and the interest rate spread on new housing loans declined in the period under review. However, the level of spreads can still be considered high in a regional comparison.

Chart 13: Net quarterly change in household loans by denomination



Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment. The annual change in the outstanding amount reflects the effect of settlement. Source: MNB

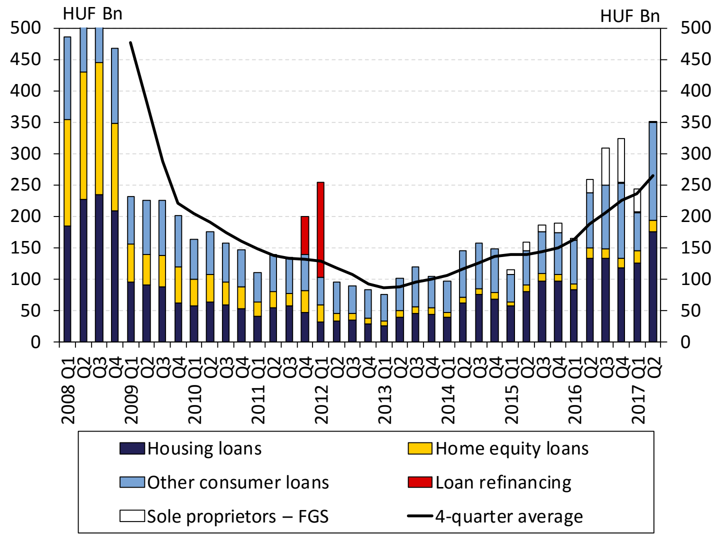
Domestic household lending

The annual growth rate of lending to households is at a level unprecedented since the crisis. In 2017 Q2, the credit institutions' outstanding lending to households rose by HUF 73 billion as a result of loan transactions, being the consolidated result of the growth in forint loans in the amount of HUF 74 billion and the decline in FX loans in the amount of HUF 1 billion (Chart 13). In the period under review, write-offs and reclassifications resulted in a decline of HUF 42 billion. As a result of transactions, housing loans increased by HUF 26 billion and consumer loans by HUF 18 billion, while the volume of other loans were up HUF 30 billion, which is predominantly attributable to loans to the self-employed sector.[5] On the whole, the value of the household loan portfolio's annual transactions amounted to HUF 162 billion, representing a 2.8 per cent increase year-on-year, which is unprecedented since the outbreak of the crisis. The loans of the self-employed sector had a major effect on this, but the annual decline rate improved to 0.6 per cent even disregarding them. The value of household transactions was reduced by HUF 20 billion by a unique sale of a loan portfolio during the quarter.

The value of new contracts rose by 46 per cent in an annual average. The volume of credit institutions' new household loan contracts amounted to HUF 350 billion in 2017 Q2 (Chart 14). The volume of new loans was up from the previous year by an annual average of 46 per cent. The annual growth rate in the case of housing loans and home equity loans amounted to 35 per cent, while other consumer loans increased by 63

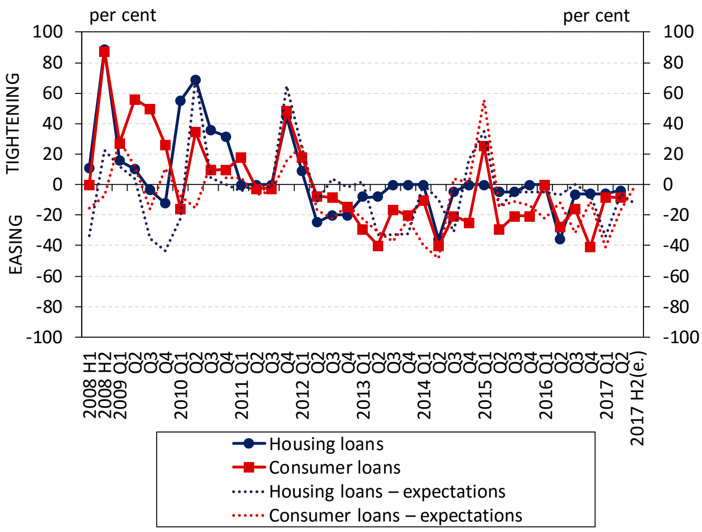
[5] The statistical category of households includes both retail customers and the self-employed sector (sole proprietors and small-scale producers).

Chart 14: New household loans in the entire credit institutions sector



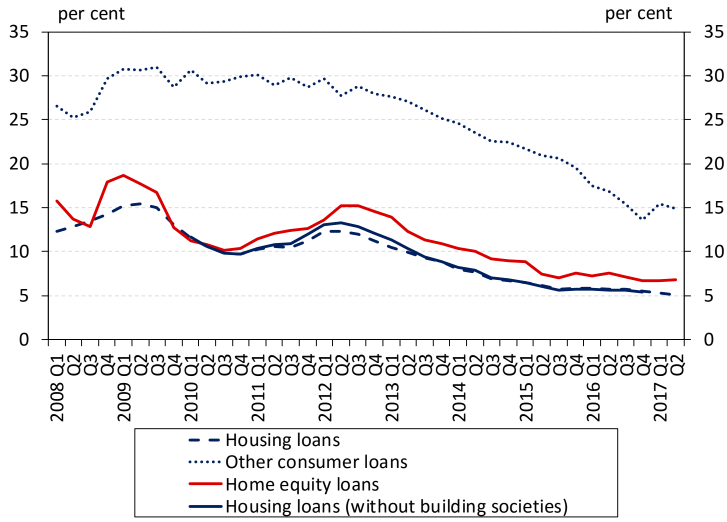
Note: Loan refinancing indicates only the refinancing related to the early repayment scheme and the FX-conversion. Source: MNB

Chart 15: Changes in credit conditions in the household segment



Note: Net percentage balance of respondents reporting tightening/easing credit conditions weighted by market share. Source: MNB, based on banks' responses

Chart 16: APR of new household loans



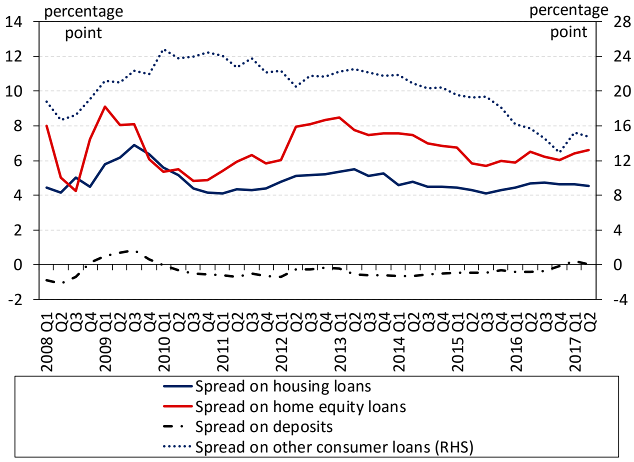
Note: Quarterly average of lending rates on newly disbursed loans. Source: MNB

per cent. Within that, new personal loans were up by 51 per cent in annual terms. The share of loans for new home construction or purchasing accounted for 17 per cent of new housing loans in 2017 Q2, while this rate was merely 10 per cent a year ago.

Credit conditions have not been eased materially by the banks. In net terms, 4 per cent of the respondent banks of the Lending Survey reported that they eased their housing loan conditions (Chart 15). On the other hand, considering the partial conditions, a significant proportion of banks indicated easing: in net terms, 59 per cent of the respondent banks reduced the spreads, 37 per cent of them allowed longer maturities, while 18 per cent reported a tightening of the payment-to-income ratio. Two-thirds of the respondent banks explain the easing of housing loan conditions with their market share objectives, half of them with developments in the housing market and 42 per cent of them with the ample liquidity. On the whole, the conditions of consumer loans were eased by net 8 per cent of the banks in the period under review, which manifested itself among the partial conditions mainly in the lower spreads, but in a few cases the tightening of the PTI conditions could be also observed. In the second half of the year, 13 per cent of the banks plan to ease the conditions of their housing loans – which may be linked to the Certified Customer Friendly Mortgage products, to be introduced in autumn – while in the case of consumer loans none of the banks anticipate further change.

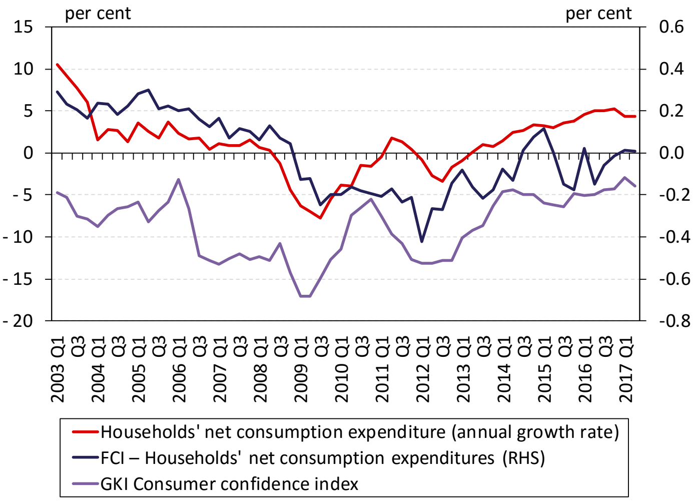
The spread on both the fixed rate and the variable rate housing loans decreased during the quarter. The average APR on new HUF housing loans declined by 0.2 percentage point to 5.1 per cent in 2017 Q2 (Chart 16). The average smoothed APR on variable rate loans decreased by 14 basis points, while that of the fixed rate housing loans was down 33 basis points. During the quarter, the composition effect pointed to a 7 basis points decline in the average APR: compared to the previous quarter, the ratio of fixed-rate loans (typically involving higher lending cost) within new loans decreased by 4 percentage points to 59 per cent (contrary to the trend observed in the previous quarter). The average of spreads declined by 0.1 percentage point in the period under review, thus amounting to 4.5 percentage points at end-June (Chart 17).

Chart 17: Interest rate spreads on new household loans



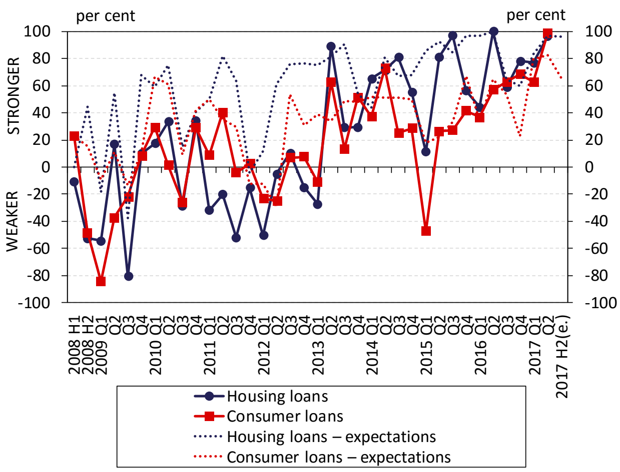
Note: In the case of variable-rate or for up to one year fixed-rate housing loans 3-month BUBOR, while in the case of housing loans fixed for a period longer than one year, the 3-year APR-based smoothed spread over the IRS. For the rest of the products, APR-based smoothed spread over the 3-month BUBOR. Source: MNB

Chart 18: Sub-index of the FCI for household consumption expenditures



Note: The FCI quantifies the contribution of the banking sector's lending activity to the annual growth rate of household consumption expenditures. For technical reasons, the chart indicates one one-hundredth of the GKI index. Source: MNB and GKI

Chart 19: Credit demand in the household lending segment



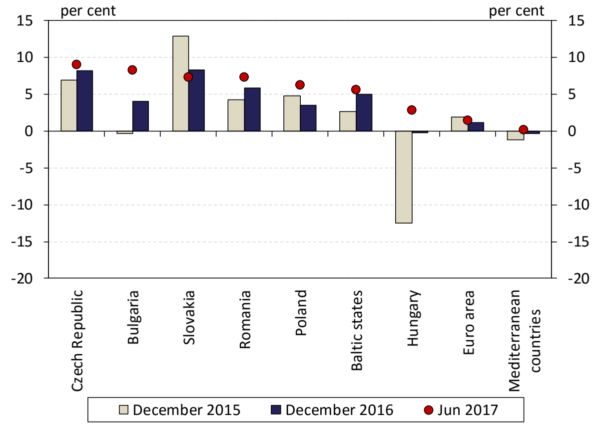
Note: Net percentage balance of respondents banks indicating stronger/weaker demands, weighted by market share. Source: MNB, based on banks' responses

The spread on unsecured consumer loans continued to decrease. Interest rates on home equity loans rose by 0.1 percentage point, while rates on other consumer loans dropped by 0.5 percentage points in Q2. Consequently, at end-June 2017, the average interest rate level of home equity loans was 6.8 per cent and that of other loans was 15 per cent (Chart 16). Interest rate spreads also developed differently depending on the collateral coverage: in the case of home equity loans they increased by 0.2 percentage point to 6.6 percentage points, while following a 0.4-percentage point fall, spreads in the case of unsecured consumer loans reached 14.8 percentage points by the end of the quarter (Chart 17).

On the whole, the financial intermediary system has a neutral effect on the consumption of households. The households' consumption expenditure rose by 3.8 per cent on an annual basis by the end of 2017 Q1. The improvement in economic activity was accompanied by a slight decline in the consumer confidence index in Q2. Based on the MNB's business activity survey, the weakening of consumer confidence may be attributable to the fact that the majority of the households anticipate no improvement in their financial conditions, accompanied by increasing inflation expectations and the narrowing of the savings opportunities. According to the consumption expenditure sub-index of the Financial Conditions Index, the overall impact of loan supply of the financial intermediary system on the consumption expenditure of households was still neutral (Chart 18).

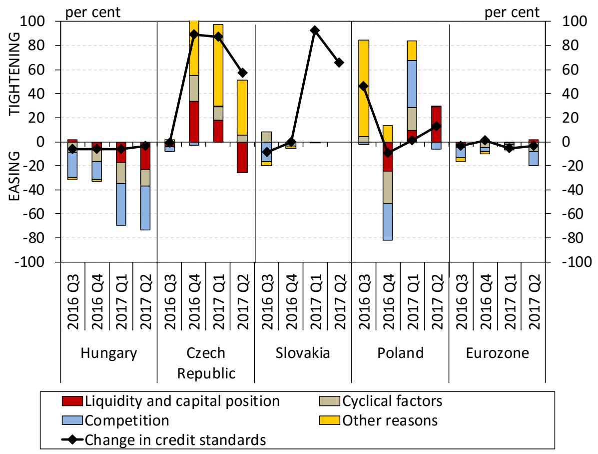
Credit demand widely increased in both segments. 2017 Q2, almost all of the banks participating in the Lending Survey perceived an increase in demand in the housing loan segment and similarly to this, almost all participants anticipate further increase for the second half of the year as well. The Home Purchase Subsidy Scheme for Families (HPS) increases demand for housing loans this year as well: between start of April and end of June, HPS-related loan contracts were concluded in the value of HUF 28 billion, accounting for 16 per cent of the new housing loans extended during the quarter. A wide range of the bank perceived a rise in the demand in the consumer loan segment as well; however, for the next half-year two-thirds of the banks, in net terms, anticipate further increase in demand.

Chart 20: Annual transaction-based change in household loans in an international comparison



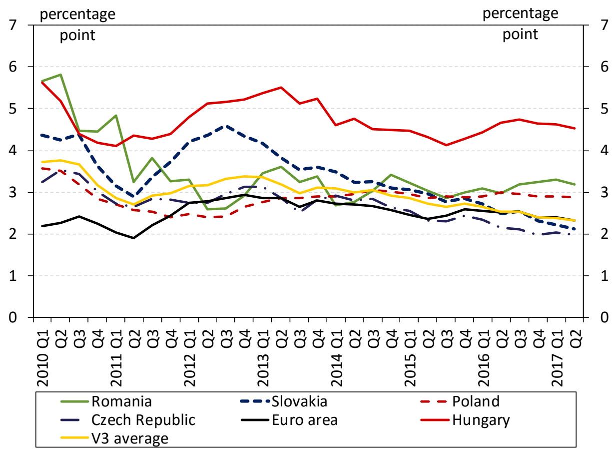
Note: Mediterranean countries: Greece, Italy, Portugal and Spain; Baltic states: Estonia, Lithuania and Latvia. Source: ECB, MNB.

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



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

Chart 22: International comparison of spreads on housing loans extended in domestic currency



Note: In the case of variable-rate or for up to one year fixed-rate housing loans 3-month interbank rate, while in the case of housing loans fixed for a period longer than one year, the 3-year APR-based smoothed spread over the IRS. Source: MNB, ECB, EMF, Datastream, national central banks

International outlook in household lending

Household lending is characterised by continued expansion in the region and in the euro area. The average annual growth rate recorded for the euro area stood at 1.4 per cent in 2017 Q2 (Chart 20). In year-on-year terms the households' debts rose in most of the Member States, with the Mediterranean Countries already also recording an increase in the average outstanding borrowing. Similarly to the European trends, the households' outstanding debt is also on the rise in the CEE region: the Czech Republic posted an annual growth of 9 per cent, Slovakia 7 per cent and Poland 6 per cent.

Housing loan standards further tightened in the Visegrád countries during the quarter. According to the lending survey of the European Central Bank, the euro area banks continued to ease the conditions of their housing loans. Respondent banks still explained the easing by the increasing competition. By contrast, in the Visegrád countries lending conditions were tightened similarly to the previous quarter: while in Poland 13 per cent, in net terms, of the banks applied tightening, in Slovakia and the Czech Republic this ratio was 60 per cent (Chart 21). In Poland 30 per cent of the banks explained the tightening by their liquidity and capital position, while in Slovakia and the Czech Republic tightening was triggered by the stricter debt cap rules.

Spreads on new housing loans decreased both in the euro area and in the countries of the region. In 2017 Q2, the average APR on new housing loans in the euro area was unchanged at 2.2 per cent. Of the countries in the region, average APR on housing loans denominated in the local currency rose by 0.1 percentage point in the Czech Republic and Slovenia, remained unchanged in Poland, and declined by 0.1 percentage point in Slovakia and Romania. As regards the spreads, with the exception of Poland, a decline of 0.1 percentage point characterised the average price of both the CEE region and the euro area. The level of spreads in Hungary may still be deemed high by international standards: on average it exceeds the average of both the euro area and the other countries in the region by 2.2 percentage points (Chart 22).

Box: Experiences of the personal interviews with the senior household loan officers

The perception of the credit institutions determinant in lending to households related to the processes of the first half-year coincided in many respects, while looking ahead and evaluating the operating environment, the picture is somewhat more heterogeneous.

In the new lending cycle the majority of the large banks already reported increasing portfolios and new housing lending often exceeded the plans. About 40-45 per cent of the new sales take place via intermediaries – typically real estate agents – where the market, partially due to the regulatory measures, has been significantly cleaned and the riskiness of the referred loans is at most at the same level as those sold by the branches. Large banks anticipate the preservation of the traditional sales channels; however, the service roles, geographical optimisation and modernisation of the branches is still on the agenda. On the other hand, the actors pay special attention to the acceleration and simplification of the lending processes, which may be also stimulated by the implementation of the Certified Consumer Friendly Mortgage. During the summer, several banks submitted to the MNB their fixed-interest loan products, typically with 3-5 and 10-year interest rate fixation, and all banks reported further product development. In relation to the interest fixing, the responses showed a halt in the share of fixed-interest products, which increased dynamically up to 50-60 per cent in the last 2 years, because a part of the clients prefer lower instalment to the management of the interest rate risk.

The market participants expect that the Certified Consumer Friendly Mortgage may rearrange market positions, but only a few of them opt for price-cutting strategy, they rather aim at providing the 3–5 best offers. Instead of the risk and price competition, banks rather plan to compete in the service quality and the speed of service. The currently effective debt cap rules cannot be deemed a lending obstacle, as the banks' internal regulations are typically stricter than those. Driven by the macroeconomic principles – wages, housing market – lenders experience an increase both in the average loan amount and the maturity. While in 2016 the typical loan amount was HUF 5-6 million, in the first half-year this increased to HUF 7-8 million, and the expectations of certain banks forecast already HUF 10 million by the year-end. The majority of the banks expect a market expansion for minimum the next 1-1.5 years, driven by the recovering demands. In the case of home constructions, the constructions risks, arising from shortage of capacity, were mentioned as key risk in addition to the prices.

Loan refinancing is still very low, but the number of those performing a final repayment is on the rise, often by resorting to the use of building society deposits, or employer's contribution/loan provided as fringe benefit, for the repayment.

The recovery of the market for the banks active in consumer lending was beyond their expectations. The respondent banks have no plan to open towards riskier clients beyond the easing of the price terms, experienced in the past quarters. The broadening of the client base is supported by improving income position. The market of home equity loans is negligible compared to the previous cycle, while unsecured loans hit single-digit interest rates. The latter already represent a competitive alternative to the mortgage loans due to the simplicity and the speed of the lending process. Banks listed property renovation, energy modernisation, car purchase as the most frequent loan purposes and loan refinancing in a smaller part. In the case of new loan applications online administration is becoming increasing popular, to which the legislative change facilitating easier client identification also contributed.

In respect of the operating environment, the actors still see substantial room for the acceleration and simplification of the processes, in respect of which they also formulated their requirements toward the current regulations. The majority of the proposals mentioned the acceleration and automation of the Land Registry administration, direct enquiry from the tax authority on the verifiable income data, as well as the broadening of and easier access to the CCIS information, adopting the regional best practices (Czech and Slovakian) in the domestic practice.

Banks regard digitalisation as a necessary task of utmost importance, which frees capacities in the long run, improve their efficiency and the customer experience, which gains growing importance in the increasingly fierce competition. The optimisation of internal processes is a priority for almost all actors. At present those actors are at the forefront of the developments whose resources were tied up in the past to a lesser extent by the management of non-performing portfolios.

4. ANNEX: NOTES ON THE METHODOLOGY

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

1. *Credit aggregate and lending rate data*

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

2. *Lending Survey*

The Lending Survey facilitates the analysis of how major banks perceive and evaluate market developments and how they develop their respective strategies, in particular their lending policies. In the case of the household segment, a total of 11 banks were involved in the interviews. 9 banks responded to questions relating to housing loans, while 10 banks and 11 financial enterprises answered questions on consumer loans. Based on data from the end of 2017 Q2, the surveyed institutions accounted for 85 per cent of the banking sector in the case of outstanding housing loans and 86 per cent in the case of outstanding consumer loans. The corporate questionnaire was completed by 15 banks in total, which represent 94 per cent of the corporate loan market, while the market share of the 14 banks responding to the questionnaire related to commercial real estate loans is 94 per cent.

The survey consists of a standard questionnaire in each segment. The retrospective questions refer to 2017 Q2 (compared to 2017 Q1), whereas the forward-looking questions concern the next half-year period, i.e. the one covering 2017 Q3 and Q4 (relative to 2017 Q2). The current questionnaire was completed by the senior loan officers between 3 and 18 July 2017.

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

The detailed findings of the Lending Survey and the set of charts are available at: http://www.mnb.hu/penzugyi-stabilitas/publikaciok-tanulmanyok/hitelezesi-felmeres

3. *The Financial Conditions Index (FCI)*[6]

Numerous indicators and hence a substantial set of information are available regarding the functioning, status, environment and performance of the system of financial intermediation. In order to condense the information relevant to the financial system and to describe the underlying processes, many central banks (including the Magyar Nemzeti Bank) apply factor models, which allow them to present key information extracted from hundreds of time series in a few variables, i.e. factors. Based on the results of the factor model, the FCI discussed in the publication shows the contribution of the banking sector to the annual real GDP growth rate.

The database used for the factor analysis is composed of individual bank data; namely, certain aggregate indicators of the 9 largest banks and of the rest of the banking sector. From the panel database consisting of 10 banks, the following indicators were included for the purposes of the factor analysis:

- Liquidity:
    - liquid assets as a percentage of the balance sheet total
    - stable funding as a percentage of the balance sheet total
    - FX swaps outstanding as a percentage of the balance sheet total

[6] Hosszú, Zs. (2016): The impact of credit supply shocks and a new FCI based on a FAVAR approach, MNB Working Papers 2016/1, Magyar Nemzeti Bank.

- Capital:
  - own leverage
  - parent bank leverage
  - capital buffer as a percentage of the balance sheet total
- Risk:
  - changes in the proportion of non-performing portfolios
  - cost of provisioning as a percentage of the total portfolio
  - risk-weighted assets as a percentage of the balance sheet total
  - interest and commission revenue as a percentage of the balance sheet total

The exact number of estimated variables that can capture the essential information contained by the data is a decision point in the course of factor analysis. The MNB made the decision based on the factors' impact on macroeconomic variables: inserted in a VAR (vector autoregressive) model, the first two financial factors proved to be significant. At the same time, these two factors explain around 50 per cent of the variance of bank data.

The factors and the VAR model were estimated in accordance with the methodology presented in Koop and Korobilis (2014).[7] Based on the relationship between the factors and the original variables, the two factors were respectively interpreted as an indicator gauging banks' lending capacity, and as an indicator capturing banks' willingness to lend; at the same time, only the factors' change over time has significance; their level does not; in other words, a single data point does not carry information in itself. With that in mind, the final FCI was quantified based on the effect of these two factors on macroeconomic variables. According to the FAVAR estimate, as opposed to the factor measuring lending capacity, after the crisis the factor expressing willingness to lend significantly influenced changes in outstanding borrowing. Thus, the FCI was identified as the impact of banks' willingness to lend on GDP. The indicator is interpreted very similarly to the previous FCI: it shows the contribution of the banking sector to the annual real GDP growth rate through the sector's lending activity. In other words, if the FCI takes a value of 1, one percentage point of the annual growth rate of GDP can be attributed to the lending activity of the banking sector.

In addition to the total impact of the FCI on GDP, sub-indices can also be calculated on the basis of the VAR model. The FCI's corporate lending sub-index indicates the contribution of the banking sector's lending activity to the annual growth rate of corporate fixed capital investment. The FCI's household consumption expenditure sub-index quantifies the contribution of the banking sector's lending activity to the annual growth rate of household consumption.

[7] Koop, G. and Korobilis, D. (2014): A new index of financial conditions, European Economic Review, vol. 71, pp. 101–116.

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