TRENDS IN LENDING

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(August 2018)

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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 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 on 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 based on 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 methodology of the indicators describing the developments in lending and 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

The dynamic increase in corporate lending continued in 2018 Q2, and thus on a year-on-year basis, as a result of transactions, total corporate loans outstanding rose by HUF 750 billion, corresponding to an annual expansion of 12.1 per cent. According to the preliminary data, loans to the SME sector rose by nearly 16 per cent year-on-year, within which the micro segment expanded the most, with an increase of 22 per cent. In Q2, the transaction-based increase in loans outstanding amounted to HUF 240 billion, of which some HUF 140 billion was related to the SME sector. There has been no major rise in the ratio of fixed-rate loans, especially in case of long-term loans, since the decline seen following the phasing out of the Funding for Growth Scheme: while in 2015, 80 per cent of HUF-denominated SME loans with over 1-year maturity were disbursed with interest rate fixation, this ratio was only 20 per cent over the last one year. Convergence to the ratios observed in the more developed European countries would be desirable.

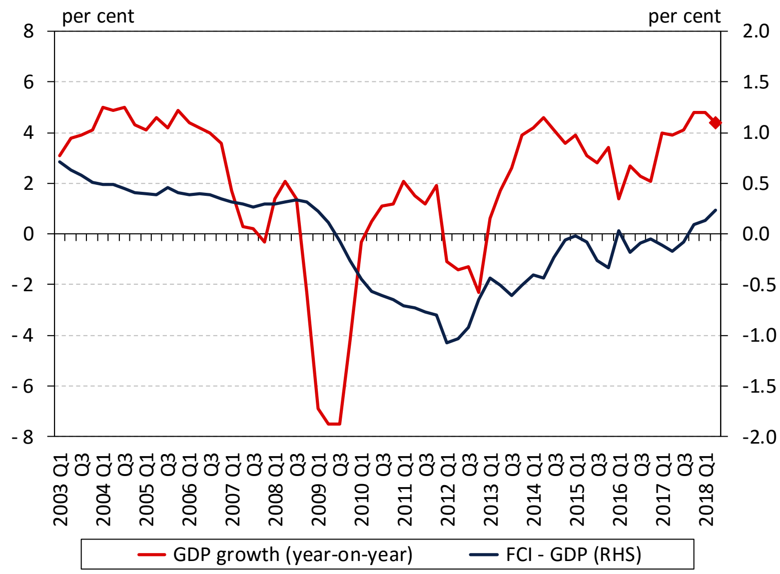
Based on banks' responses to the Lending Survey, credit conditions eased in each corporate segment in Q2, which – according to banks' perception – was mainly reflected in a decline in interest rate spreads and was primarily due to increased competition and favourable developments in economic prospects. Corporate credit demand tended to strengthen in the segment of longer-term loans. Looking ahead to the next half year, banks expect these trends to continue.

During the quarter under review, as a result of disbursements and repayments, household loans outstanding increased by HUF 159 billion, corresponding to an annual rise of 4.1 per cent. Although this is the strongest growth observed since the crisis, it is not exceptional in a regional comparison, also taking into account the low level of financial deepening measured on the basis of the credit-to-GDP ratio. The growth is facilitated by the continuously increasing volume of new loans: in the past one year, the total value of household borrowing was 31 per cent larger than that of the contracts a year earlier. By product type, housing and personal loans prevail, with annual increases of 39 per cent and 48 per cent, respectively.

Interest rate spreads on housing loans with interest rate fixation decreased in the period under review, and thus the average spread in the case of loans with 1-5 years of initial fixation reached the level of variable rate loans, and in the case of loans with over 5 years fixation it approached to 0.2 percentage point of that level. Among housing loan disbursements, in parallel with the spread of Certified Consumer-Friendly Housing Loan products, the ratio of loans with up to one-year initial rate fixation declined to 18 per cent. According to banks' responses, credit conditions were eased to a small extent in the quarter under review, and thus the expansion in demand continues to lead the market both in the housing and consumer loan segments.

The MNB summarises the supply conditions of lending developments using the Financial Conditions Index. According to this indicator, the cyclical impact of the banking sector's lending activity on economic growth can be deemed neutral. Accordingly, in terms of the annual expansion in the real economy, neither a significant cycle-strengthening nor growth-restraining impact is experienced.

The Financial Conditions Index (FCI) and annual real GDP growth



Note: The FCI quantifies the banking sector's contribution through lending to the annual GDP growth rate. The 2018 Q2 data for the annual real GDP growth rate is the seasonally and calendar adjusted first estimate of the HCSO.

Source: MNB, HCSO

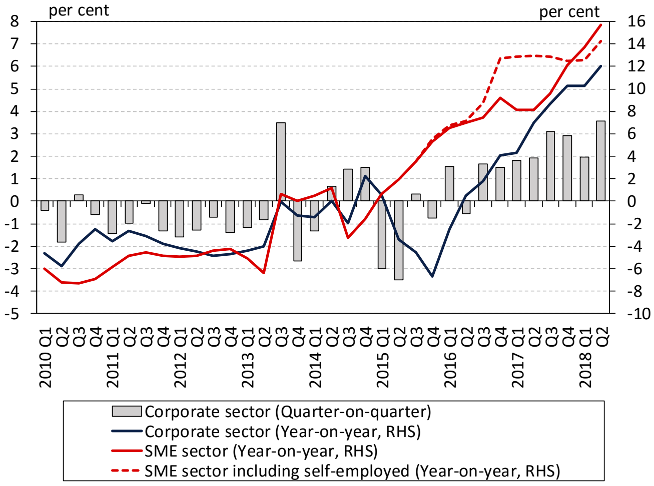
2. DEVELOPMENTS IN LENDING IN THE CORPORATE SEGMENT

In 2018 Q2, the transaction-based growth in corporate lending continued, amounting to nearly HUF 240 billion. Accordingly, corporate loans outstanding have increased by a total HUF 750 billion in the past 12 months, yielding a growth rate of 12.1 per cent. Based on the preliminary data, lending to the SME sector in a narrow sense and taking into account the self-employed as well expanded, year-on-year, by nearly 16 per cent and by 14 per cent, respectively. Within the SME segment, the strongest expansion was observed in the case of micro corporations, with an increase of 22 per cent annually. The value of new contracts also rose significantly, by 19 per cent in the past year. There has been no major rise in the ratio of fixed-rate loans, especially in case of long-term loans, since the decline following the phasing out of the Funding for Growth Scheme: while in 2015, 80 per cent of HUF-denominated SME loans with over 1-year maturity were disbursed with interest rate fixation, this ratio was only 20 per cent in the last one year. Convergence to the ratios observed in the more developed European countries would be desirable.

Based on banks' responses to the Lending Survey, credit conditions eased in all company size categories in Q2. According to banks' perception, the easing in conditions was reflected in a decline in interest rate spreads, and was primarily attributable to increased competition and favourable developments in economic prospects. Corporate credit demand tended to strengthen in the segment of longer-term loans. Looking ahead to the next half year, banks expect these trends to continue.

During the past year, corporate loans outstanding increased in all of the countries in the region, but the highest growth was observed in Hungary. Interest rate spreads declined in all the countries in the region in Q2.

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



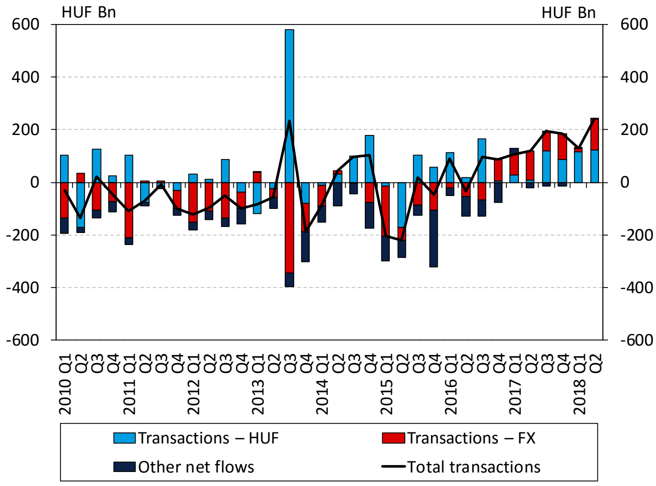
Note: Transaction based, prior to 2015 Q4 data for SMEs are estimated based on banking system data. Source: MNB

Domestic corporate lending

The dynamic increase in corporate lending continued. Over the past one year, the outstanding loans of non-financial corporations rose by more than HUF 750 billion on a transaction basis, corresponding to an annual growth rate of 12.1 per cent (Chart 1). The outstanding loans of the sector of micro, small and medium-sized enterprises in a narrow sense increased at an annual rate of 15.7 per cent, while the annual growth rate of SME sector[1] loans including the self-employed was 14.2 per cent. By corporate size, the largest expansion was observed in the case of micro corporations, with an increase of 22 per cent annually, while small and medium-size enterprises' loans outstanding grew by 12 and 13 per cent,

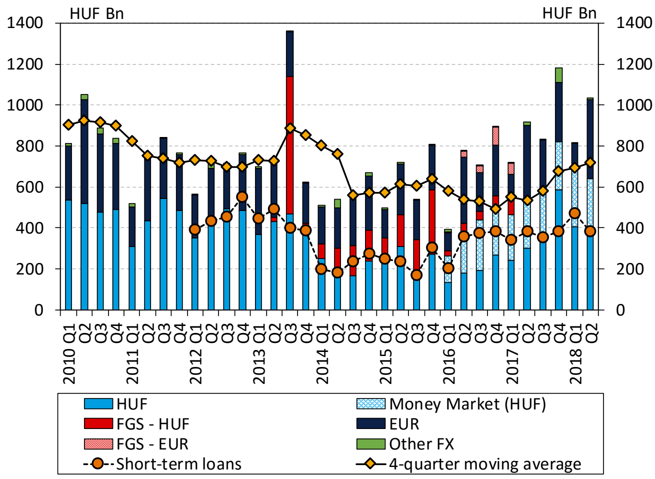
[1] Although the self-employed belong to the household sector in a statistical sense, they also qualify as SMEs based on their activities and legal definition.

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



Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment, excluding individual institutional effects. Adjusted for the impact of the change in some banks' accounting standards at the beginning of 2017. Source: MNB

Chart 3: New corporate loans in the credit institution sector



Source: MNB

respectively. As a result of favourable demand and supply conditions, the high growth rate may continue in Q2 as well, in which the complementary financing requirements related to EU funds as well as the stimulating effect of the central bank's Market-based Lending Scheme (MLS) may also play a role.

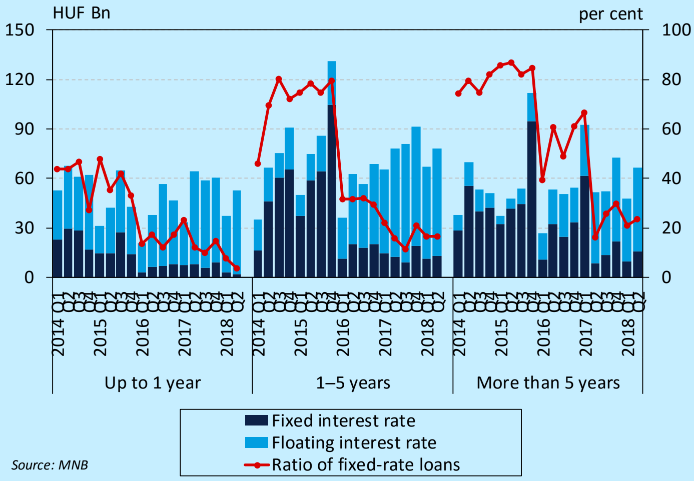
The volume of transactions increased significantly in Q2. As a result of disbursements and repayments, credit institutions' loans outstanding expanded by nearly HUF 240 billion (Chart 2), of which some HUF 140 billion is related to the SME segment (within that, 66 HUF billion was related to the micro segment, 26 billion to the small segment and 44 billion to the medium segment). This quarterly growth is unprecedented since the crisis, except for the first phase of the Funding for Growth Scheme (FGS) in 2013. The expansion was even across HUF and FX loans, although a major part of the FX transactions was related to a one-off, extremely high-volume borrowing by a large company. Although within the framework of the third phase of the FGS undertakings may draw their loans until the end of June 2019, disbursements during the quarter under review were already almost entirely offset by the repayments of the loans taken in this phase.

The volume of new corporate loan agreements was above HUF 1,000 billion again. In 2018 Q2, credit institutions concluded new contracts with non-financial corporations amounting to a total HUF 1,034 billion, including money market transactions (Chart 3). The total volume of new loan agreements concluded in the past 12 months reached nearly HUF 3,900 billion, representing an increase of approximately 20 per cent compared to one year earlier. This was mainly attributable to the nearly 30 per cent expansion in forint loans.

BOX 1: LOANS WITH INTEREST RATE FIXATION IN THE CORPORATE SEGMENT

With the dynamic expansion of SME lending, it is also worthwhile to analyse the structure of this lending. One such dimension is the developments of new disbursements by interest rate fixation. Regarding new loans in recent quarters, it was confirmed that the ratio of loans with initial interest rate fixation remains low. One of the fundamental conditions of sustainable economic growth is that undertakings should find funding for their investments the interest burden of which is stable and predictable. The FGS made it possible for SMEs, but with the phasing out of the scheme, these possibilities narrowed in the credit market, and the ratio of fixed-rate corporate loans dropped considerably, mainly in the case of longer maturities. The higher interest rate level of fixed-rate loans drives clients towards variable-rate schemes, which seem to be more advantageous in the short run, but pose a risk in the longer run. It is typical that of the SME loans with maturities of over one year only every fifth contract was concluded with a fixed rate in the past one year.

New SME forint loans by interest rate fixation and maturity

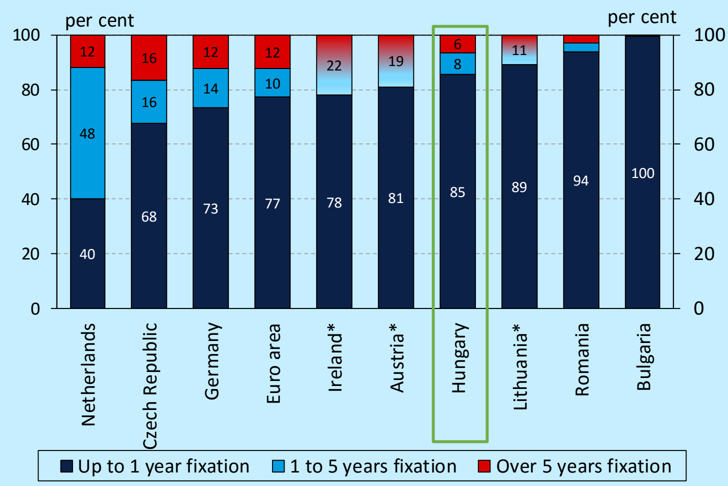


Source: MNB

The predictability stemming from fixed interest rates can boost borrowing willingness and lower risks in the case of enterprises that have no reserves to pay higher interest in a potentially changing interest rate environment. This typically affects small businesses, which have not only lower income generation capacity and accumulated reserves, but in the absence of interest-bearing assets – unlike some larger companies – the interest income on such assets does not offset the rise in interest rates. Accordingly, it is also important for financial stability to build up a healthy structure of loans in which the ratio of fixed-rate loans is higher than it currently is.

The ratio of fixed-rate loans is low in international comparison as well. In the MNB's opinion, a change in the quality of the structure of the loans outstanding is desirable. As a result, the ratio of longer-term and fixed-rate loans would approximate to the ratio observed in developed countries, which is higher than in Hungary. While in the past one year in Hungary some 85 per cent of low-amount loans amounting to less than EUR 1 million were variable-rate loans or ones with rate fixation of maximum 1 year, in the euro area this ratio was nearly 10 percentage points lower. Among the countries of the region, this ratio was around two thirds in the Czech Republic.

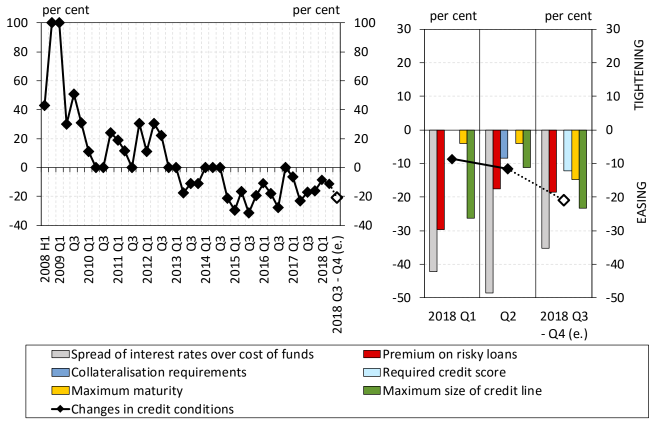
Corporate loans up to EUR 1 million by interest rate fixation period



*Note: Contracts concluded between April 2017 and March 2018 *More detailed breakdown for loans with interest rate fixation over 1 year was not available.*

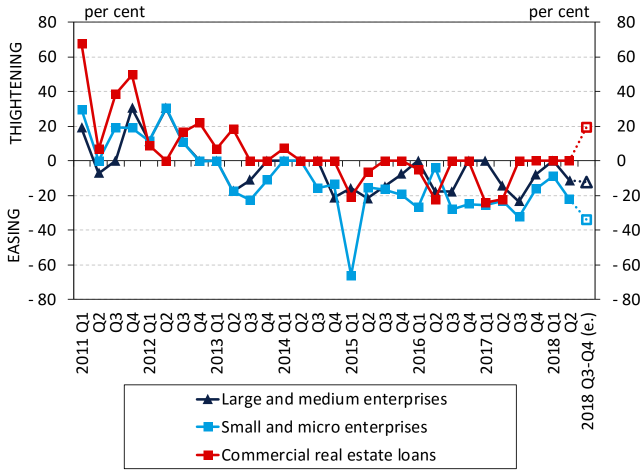
Source: National central banks, ECB.

Chart 4: Changes in credit conditions in the corporate segment



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

Chart 5: Changes in credit conditions in the corporate subsegments

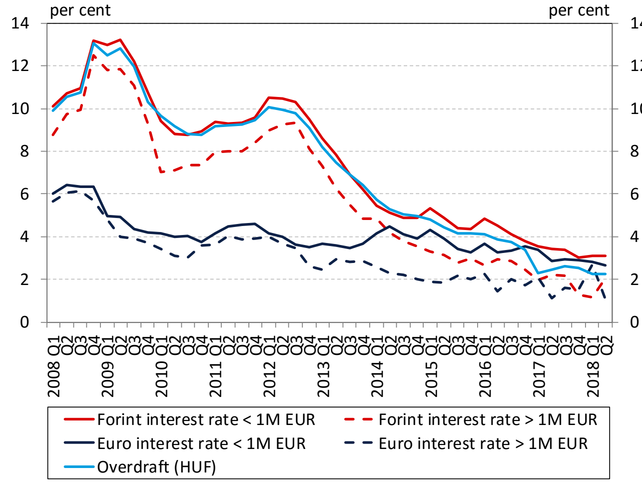


Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Source: MNB, based on banks' responses

Corporate credit conditions continued to ease. In 2018 Q2, in net terms, 12 per cent of the banks participating in the Lending Survey reported an easing of credit conditions (Chart 4). Regarding the partial credit conditions, respondents mainly indicated a decline in interest rate spreads. The majority of respondents mentioned the competition among banks, the achievement of market share targets and favourable economic prospects among the factors contributing to the change. Looking ahead to the next half year, one fifth of the respondents expect further easing, which is expected to be attributable to increasing competition, and may mostly be reflected in a decline in spreads.

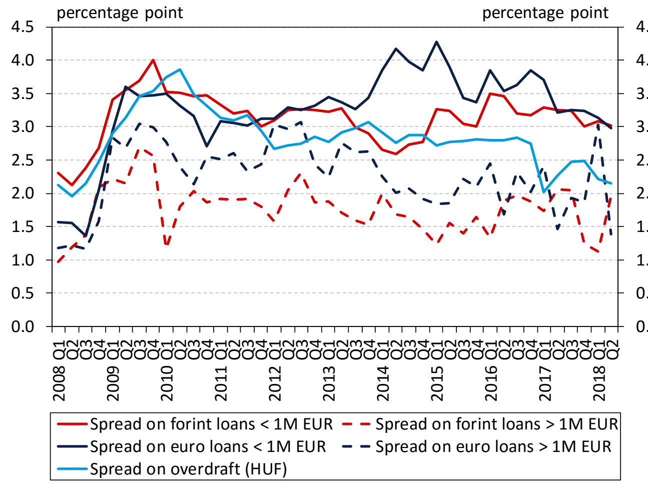
The easing of credit conditions affected all corporate segments. In Q2, in the micro and small enterprises segment and in the medium-sized and large companies segment, in net terms, 22 per cent and 11 per cent of banks, respectively, indicated an easing of credit conditions. In the case of loans extended to finance commercial real estate, despite the rising demand, according to the responses, conditions have remained unchanged for four quarters in a row (Chart 5). Looking ahead to the next half year, in the case of micro and small enterprises and in the medium-sized and large companies segment a net 34 per cent and 12 per cent of banks, respectively, expect further easing. At the same time, 20 per cent of them already expect tightening conditions in the case of commercial real estate loans.

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

Chart 7: Interest rate spreads on new corporate loans



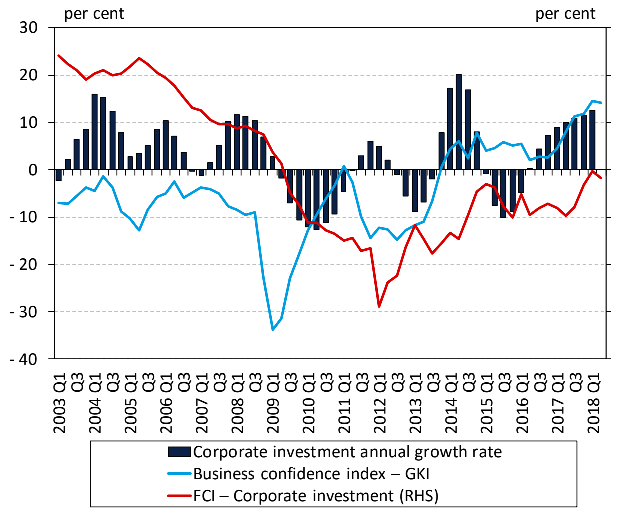
Note: Spread on the 3-month BUBOR and EURIBOR. Loans with variable interest rates or with up to 1-year initial rate fixation. From 2015, based on data net of money market loans exceeding EUR 1 million. Source: MNB

During the past quarter the interest rate on small-amount HUF loans remained unchanged, while the interest rate on FX loans declined slightly. The average interest rate levels of small-amount HUF loans (below EUR 1 million) and overdrafts remained practically unchanged, while the interest rate on high-amount HUF loans[2] – excluding money market transactions[3] – increased by 0.9 percentage point. The average interest rate on small- and high-amount euro loans declined by 0.2 and 1.6 percentage points, respectively (Chart 6). High-amount, one-off items also played a significant role in the latter decline. The changes in interest rates are mainly attributable to changes in spreads in the case of both HUF and FX loans. In the case of small-amount loans the spreads were stable in the past quarter, while spreads on high-amount HUF loans increased, and spreads on FX loans declined (Chart 7).

[2] In the case of new contracts, we examine 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 we review are only affected by a small part of the FGS loans.

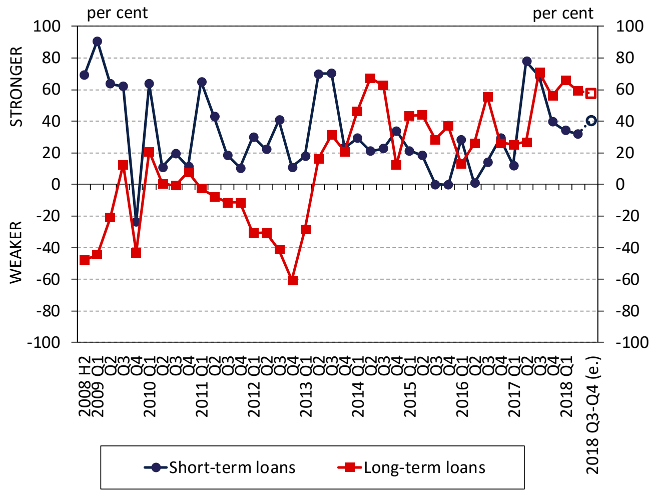
[3] Money market transactions are loans with a value of over EUR 1 million extended to non-financial corporations; their term is short (typically less than 1 month) and they serve to fund some kind of financial operation. It has been possible to exclude money market transactions since 2015, although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

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



Note: The sub-index of the FCI quantifies the banking sector's contribution, through lending, to annual growth in corporate fixed investment. Quarterly, smoothed values of the monthly GKI business confidence index have been indicated. Source: MNB, GKI

Chart 9: Changes in credit demand by maturity

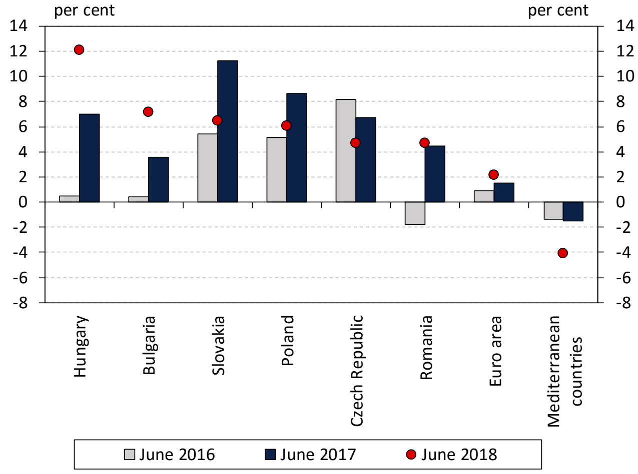


Note: Net percentage balance of respondent banks indicating stronger/weaker demand, weighted by market share. Source: MNB, based on banks' responses

The corporate sub-index of the Financial Conditions Index was at the cyclically neutral level in 2018 H1 again. The banking sector's lending activity does not have any major cyclical impact on the changes in the level of corporate investment (Chart 8). According to the GKI index, business confidence improved in 2018 Q1 and remained stagnant at this elevated level in Q2. The MNB's business activity survey suggests that the improvement mainly took place in the services sector, but rises in business confidence were observed in the segments of industry and construction as well compared to end-2017. According to the questionnaire survey, in the entire corporate sector, improvements in production and employment possibilities were perceived by respondents, while the assessment of the economic and business environment remained practically unchanged.

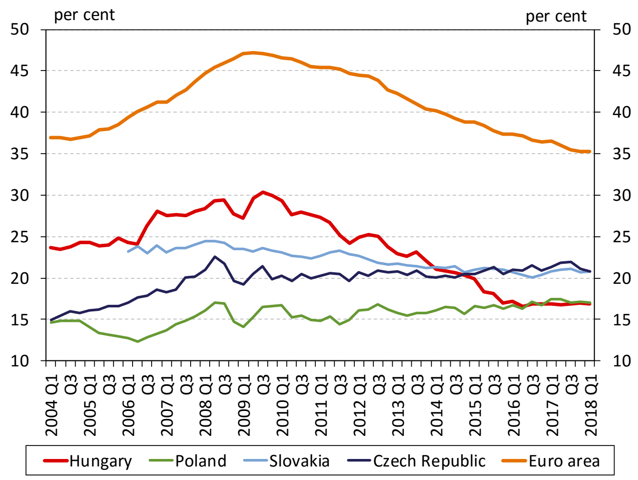
Demand for long-term loans is still increasing. In the Lending Survey, nearly two-thirds of respondent banks in net terms reported strengthening in the demand for long-term loans, and one-third in the case of short-term loans (Chart 9). More respondents perceived expansion in demand among small and micro enterprises than in the case of large and medium-sized companies. As before, nearly half of the respondents perceived a pick-up in demand for HUF loans, while in the case of FX loans, compared to the past two quarters, slightly higher proportion, i.e. roughly 20 per cent, reported an upswing in demand. In their opinion, the pick-up in demand was primarily attributable to investments in tangible assets and to the low interest rate environment. Looking to the next half year, nearly 40 per cent of banks expect further upturn in demand, but according to their expectations the key role will be played by the rising financing need and not by the decline in the interest rate level. More respondents expect an expansion in demand for long-term loans than in demand for short-term loans. In the case of the commercial real estate market, falling short of the previous quarters, only about one fifth of the respondents expect a

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



Note: Mediterranean countries are Greece, Italy, Portugal and Spain. Source: ECB, MNB

Chart 11: Corporate credit-to-GDP in an international comparison



Source: ECB, MNB

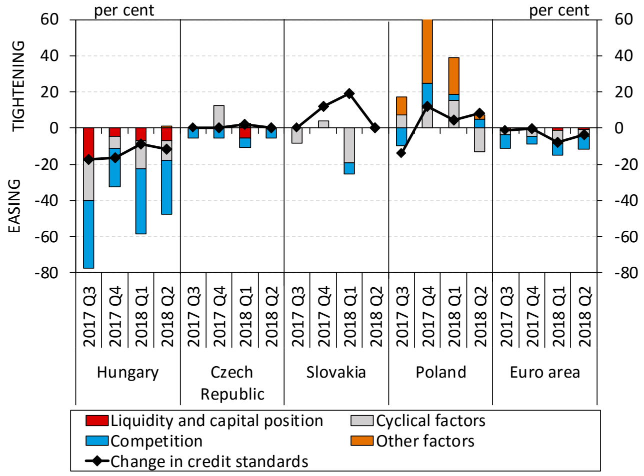
pick-up in demand, and in connection with the announcement of raising the VAT on new housing, one-third of the respondents expect weaker demand in relation to housing projects.

International developments in corporate lending

The growth rate of corporate loans in Hungary is still the highest in the CEE-region. Loans outstanding expanded in all the countries of the region during the past one year, but in the past half year the rate of growth increased only in Hungary and Bulgaria, while growth decelerated somewhat in the other three Visegrád countries and Romania. Until the end of Q2, corporate lending expanded by more than 12 per cent in Hungary, by 7 per cent in Bulgaria, by around 6 per cent in Slovakia and Poland, and by some 5 per cent in the Czech Republic and Romania, in year-on-year terms (Chart 10). Similarly to the previous quarters, the increase somewhat exceeded 2 per cent in the euro area, while the decline in loans outstanding continued to accelerate again in the Mediterranean countries, primarily as a result of the strong bank portfolio cleaning in Italy.

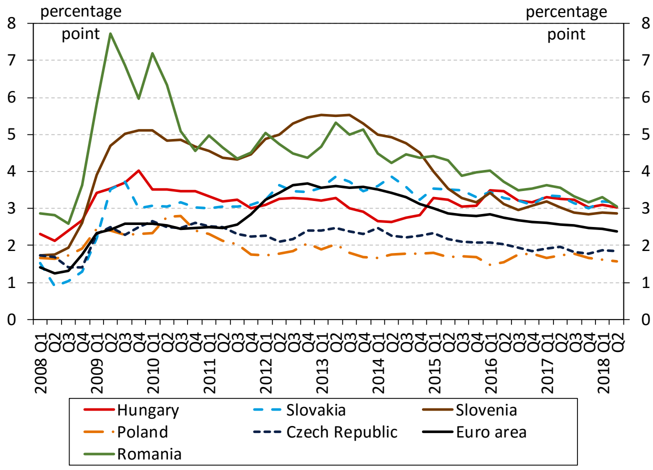
There is ample room for an increase in loans outstanding both in international and historical comparison. In 2018 Q1, credit institutions' corporate loans outstanding in Hungary reached 17 per cent of GDP, which is considered low in international comparison. Of the Visegrád countries, an above 20 per cent indebtedness as a proportion of GDP is observed in Slovakia and the Czech Republic, while this ratio is a great deal higher in the euro area, exceeding 35 per cent (Chart 11). As a result of the corporate and banking sector balance sheet adjustment following the crisis, the degree of credit penetration essentially declined steadily, and compared to its peak of more than 30 per cent in 2009, the credit-to-GDP ratio has fallen by nearly 14 percentage points.

Chart 12: Changes and factors contributing to changes in corporate credit conditions in an international comparison



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

Chart 13: 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

Within the region, the conditions of corporate loans eased to the greatest degree in Hungary in the past one year. In the Visegrád countries, according to the latest lending surveys, corporate credit conditions eased in Hungary, remained unchanged in the Czech Republic and Slovakia, and tightened slightly in Poland in Q2. According to banks' responses, this latter development is primarily explained by the quality of the loan portfolio as well as the change in competition between banks. In the euro area, 3 per cent of banks in net terms eased their lending conditions, primarily as a result of the strengthening competition between banks and the change in risk assessment (Chart 12).

The average interest rate spread on corporate loans declined only slightly in the countries of the region. In Q2, the average interest rate spread on corporate loans below EUR 1 million declined to the largest degree in Romania, where the change amounted to 26 basis points (Chart 13). Only a small decline of below 10 basis points took place in the other countries of the region and in the euro area. In Romania, as a result of a rise in the reference rate together with an increase in risks concerning the economy, the average interest rate on loans increased by 34 basis points even in parallel with the narrowing spread, while interest rates remained practically unchanged in the other countries of the region and in the euro area.

BOX 2: INTERVIEWS WITH SENIOR CORPORATE LOAN OFFICERS

Once a year the quarterly questionnaire-based bank lending survey is complemented by a series of interviews conducted by the Magyar Nemzeti Bank. In July 2018, 16 interviews – each lasting 1–1.5 hours – were conducted with senior loan officers of 12 banks and financial enterprises. Covering some 90 per cent of the market, 9 and 11 institutions shared their experiences concerning developments in corporate lending and the household segment, respectively.

Corporate lending

All of the banks participating in the interviews reported that they were able to exceed their respective plans for the first half of the year, and based on the volumes of ongoing transactions and the usual seasonality they are optimistic concerning the second half of the year as well. Looking ahead for a couple of years, they believe that prospects are favourable; if there is no significant deterioration in the macroeconomic environment, the high rate of credit expansion justified by the fundamentals may continue.

Competition between banks is considered very strong. They do not see too much potential for further price competition, although there might be still room for easing the collateral requirements. According to large banks' reports, mainly certain smaller participants strive to offset the moderate interest incomes attainable in the low interest rate environment through the increase in lending volume resulting from the looser collateral requirements. In their opinion, in the future, banks will rather be able to compete for clients by accelerating transactions and internal procedures; lack of development in this area already entails a visible risk of losing business. All participants consider the ratio of rejected loan applications to be low. Nevertheless, the quality of the newly granted loan portfolio is deemed to be very good, and the ratio of defaults is extremely low, although they expect risk costs to slightly increase and 'return to normal' from the current low level in a couple of years. In several actors' opinion, lending rates are often much lower than justified by the real risk cost, to the extent that based only on the expected gain on interest some of the transactions would not even be profitable without revenues from cross selling.

However, while the rejection ratio is low, banks typically continue to prefer corporations with favourable risk profiles, that are profitable, operate in sectors that produce for export as well and are less sensitive to business cycles. Credit history is extremely important; start-ups are typically not financed. These corporations' demand for funds is often not met. Apart from this, however, respondents think that it is possible to find a bank for realistic corporate loan demands. As for the funding of riskier enterprises, institutional guarantees help in many cases. Banks consider their cooperation with guarantee organisations to be good, and the latter have improved their procedures significantly in recent years. At the same time, several banks admitted that there is room to increase the efficiency of the guarantee system, as in several cases guarantees are applied in the case of loans where the risks would not necessarily justify it. As noted by various participants, under the present circumstances, above a certain risk level, they are not willing to lend even if a guarantee is used, i.e. an institutional guarantee may facilitate banks' opening towards the riskier segment only to a small extent, and it tends to play a significant role in the funding of companies that have little collateral but are creditworthy.

The MNB continues to closely monitor developments in fixed-rate loans, which are of key importance in terms of financial stability. In this respect, banks said that the Funding for Growth Scheme still has an impact on clients' mindset: SMEs became accustomed to the interest rate maximised at 2.5 per cent within the scheme, and in most cases they are not ready to pay a higher price. In the case of a fixed-rate loan with a maturity of more than 5 years, the interest rate justified on a market basis would at present be much higher than that, i.e. around 5 per cent, and thus – as the interest rate is deemed high – transactions like this often do not take place, although there is significant demand for long-term, fixed-rate funds. Although since the phasing out of the scheme some banks in certain cases – partly as a result of the central bank's means to stimulate lending other than the FGS – grant fixed-rate and low-rate loans even without favourable refinancing, it may become increasingly difficult, taking into account the expected future increases in banks' costs of funds. Although the majority of enterprises presumably compare the costs of fixed and variable rates, no clear consensus was seen among the respondents as to how prudent and conscious SMEs are when choosing from these alternatives. In the present low interest rate environment many clients do not take into account that interest rates might increase significantly later, or they tend to underestimate the relevant impact, and thus they prefer to opt for variable-rate loans. Other clients, although they expect that interest rates will rise in the future, opt for variable-rate loans because for the time being it may be difficult for them to earn enough to pay for the higher fixed rate.

In banks' opinion, EU funds do not have a crowding out effect vis-à-vis loans. On the contrary, grants increase enterprises' willingness to invest, and the related complementary and advance financing provides favourable opportunities for banks. At the same time, on the basis of credit institutions' experience, corporations often adjust their credit demand to the currently available grants both in terms of timing and type of investment. The available amount of grant often stimulates overspending, and SMEs tailor their investment larger than planned. A possible future fall in the volume of grants entails the risk of a decline in investment demand.

Commercial real estate lending

At present, 3–4 banks are significantly active in the market in the financing of commercial real estates. These institutions' preference in terms of types of real estates is rather heterogeneous: office, logistics and retail properties are usually preferred, while housing developments and hotels are typically funded more cautiously.

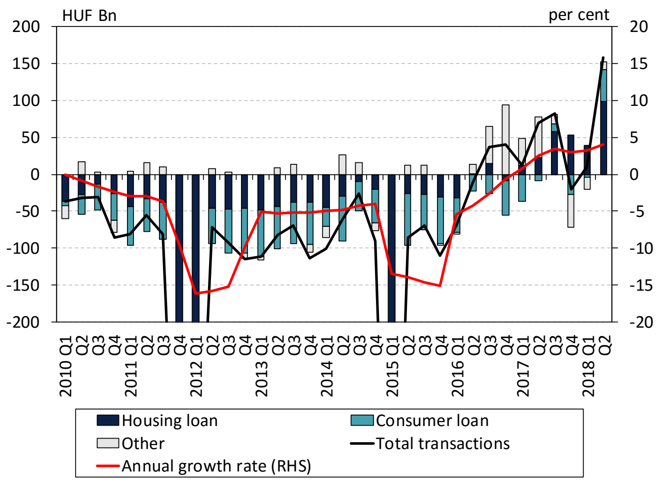
In this loan segment, willingness to take risks started to strengthen from a low level. At present, competition is typically seen in price conditions and has not spread over to the easing of risk parameters. In the case of developments, backers closely monitor the changes in the status of their risk-taking, as shortage of capacity, which is currently typical of the construction industry, poses an increased construction risk for them.

The financing of commercial real estate projects mostly takes places in euro in the case of all types of properties. Banks consider lending in euro as natural hedging, as rents are also typically determined in euro in the lease agreements of commercial properties. This practice may have evolved in the recent decades on the basis of the expectations of foreign (institutional) investors, of whom there are many in the market.

3. DEVELOPMENTS IN LENDING IN THE HOUSEHOLD SEGMENT

In 2018 Q2, as a result of transactions, household loans outstanding increased by HUF 159 billion, mainly due to the contribution of the housing loan segment. Accordingly, the transaction-based annual growth rate rose to 4.1 per cent, representing the strongest expansion in the new credit cycle to date. The increase in loans outstanding is supported by the still rising volume of new loan contracts: annual average growth in new disbursement was 31 per cent, and within that the expansion in the value of housing and personal loans amounted to 39 per cent and 48 per cent, respectively. Lending dynamics are supported by the slight easing of borrowing standards and the expansion in demand. The contribution of the Home Purchase Subsidy Scheme for Families to borrowing for housing is positive. The scheme is still popular: 16 per cent of housing loans borrowed were related to this subsidy in terms of volume. The ratio of loans with longer interest rate fixation also increased compared to variable-rate loans or loans repricing within a year: this share already amounted to 82 per cent in Q2. Certified Consumer-Friendly Housing Loan products became increasingly popular during H1, reaching a share of 53 per cent within the fixed-rate housing loans issued. Within new housing loans, the most popular product is the 5-year interest rate fixation, and with the spread of Certified Consumer-Friendly Housing Loan products the interest rate spread on loans with longer interest rate fixation declined in the period under review. Thus interest rate spreads on loans with 1-5 years initial fixation reached the level of variable rate loans, and in the case of loans with over 5 years fixation it approached to 0.2 percentage point of that level.

Chart 14: Net quarterly changes in the household loan portfolio by loan purpose



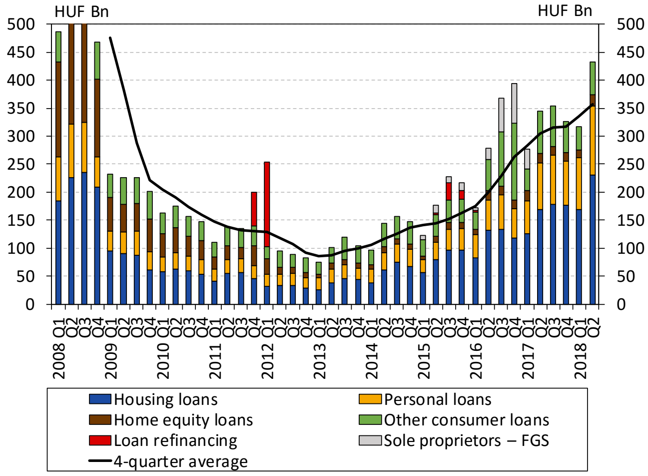
Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment. The annual change in the outstanding amount reflects the effect of settlement. Source: MNB

Domestic household lending

Household lending growth accelerated to 4.1 per cent in H1. In 2018 Q2, as a result of disbursements and repayments, credit institutions' household loans outstanding expanded by HUF 159 billion, nearly two thirds of which was attributable to the increase in housing loans outstanding (Chart 14). Housing loans and consumer loans rose by HUF 99 billion and HUF 44 billion, respectively, in the quarter under review. As a result of the annual HUF 231 billion expansion in transactions, the annual growth rate of household loans outstanding rose to 4.1 per cent by the end of the quarter.

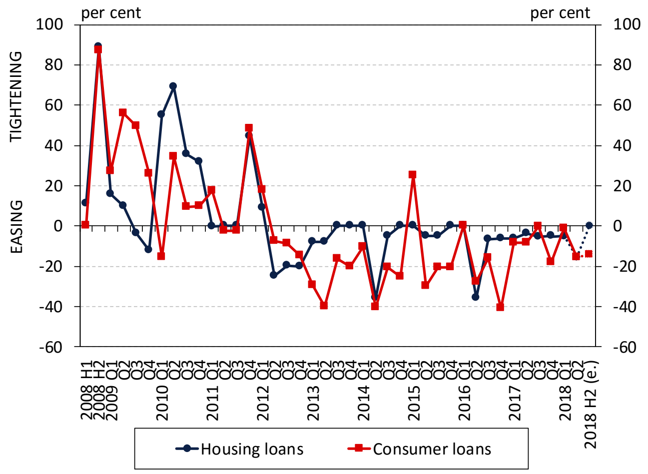
New lending was determined by housing market developments during the quarter. The value of household loan contracts concluded in 2018 Q2 amounted to HUF 433 billion, and thus on an annual average the volume of new loans was up by 31 per cent (Chart 15). More than half of the contracts were for housing purpose, and the amount of personal loans was also

Chart 15: New household loans in the credit institution sector



Note: Loan refinancing indicates only refinancing related to the early repayment scheme and the FX-conversion. Other consumer loans include vehicle, hire purchase and other loans. Source: MNB

Chart 16: Changes in credit conditions in the household segment

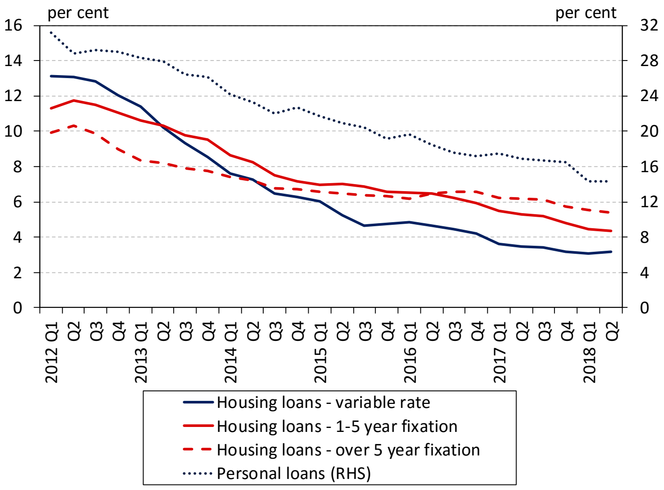


Note: Net percentage balance of respondents tightening/easing credit conditions weighted by market share. Source: MNB, based on banks' responses

significant. As a result, growth of 39 per cent and 48 per cent, respectively, was observed in the markets of the two most popular loan products. Within other consumer loans, in parallel with 48 per cent growth in vehicle loans, the extension of hire purchase and other loans typically declined. Within housing loans, the purchase of used homes continues to be the most typical loan purpose, amounting to a ratio of 75 per cent during the quarter, while 16 per cent of the contracts were concluded for the construction or purchase of new homes. In the past one year, households concluded housing loan contracts with a total value of HUF 756 billion, which is 88 per cent of the amount issued in 2008. Nevertheless, the debt cap rules effective in the current credit cycle and to be tightened in the future prevent households' excessive indebtedness and interest rate risk.

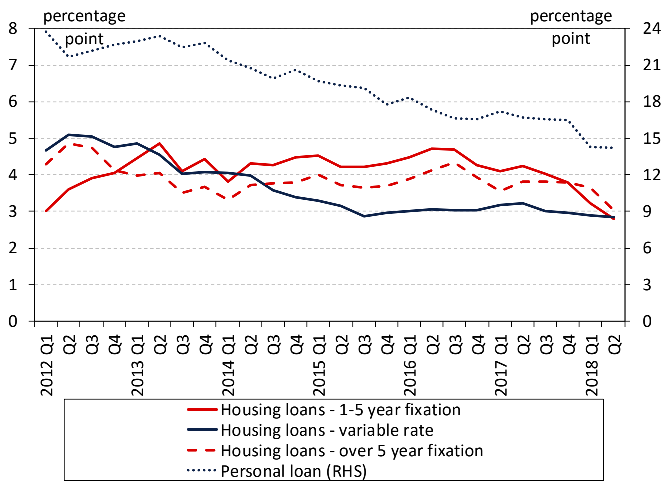
A few banks eased their credit conditions in the housing and consumer loan segments. In net terms, 15 per cent of the banks participating in the Lending Survey reported an easing of housing loan conditions (Chart 16), which mainly concerned the spreads: 60 per cent of banks in net terms reduced the spread between the lending rate and the costs of funds. Nearly two thirds of the responding banks mentioned the favourable housing market developments, and more than 40 per cent mentioned market share targets as factors supporting easing. Banks expect a dynamic housing market and strong market competition for the next half year as well. Accordingly, 30 per cent of them in net terms anticipate that there is room for a further reduction of spreads, although the intention to raise was also indicated. In line with the amendment to the debt cap rules to be introduced on 1 October 2018, 40 per cent of the banks held out the prospect of tightening the PTI ratio, and thus, on the whole, no further easing is expected in overall housing loan conditions. Also, 15 per cent of banks in net terms eased the conditions of consumer loans in Q2, mostly concerning personal loans; this was justified by

Chart 17: Annual percentage rate of charge on new household loans



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

Chart 18: Interest rate spreads on new household loans



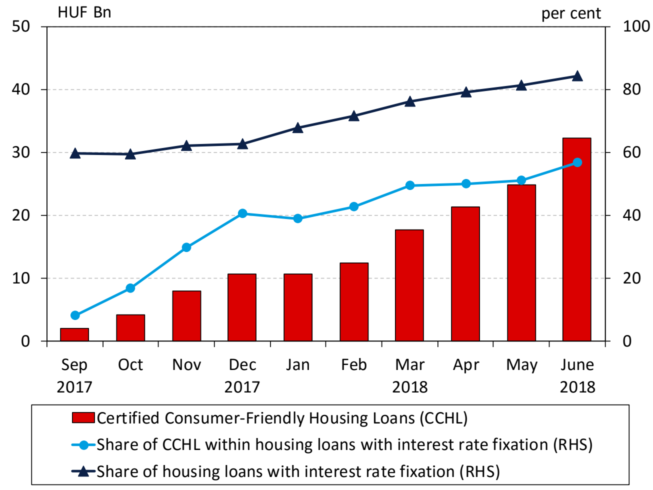
Note: APR-based smoothed spread over the 3-month BUBOR in the case of variable-rate housing loans or ones with up to 1-year rate fixation, while in the case of housing loans fixed for a period longer than 1 year, the smoothed spread over the relevant IRS. For personal loans, APR-based smoothed spread over the 3-month BUBOR. Source: MNB

an increase in market competition. Regarding partial conditions, banks primarily increased the maximum terms of loans, while heterogeneity was observed in terms of spreads. For the next half year 14 per cent of banks in net terms indicated easing in credit conditions, still primarily motivated by market share targets. More than half of the banks in net terms plan to reduce spreads, but the intention to tighten was also indicated.

The proportion of fixed-rate products within new housing loans increased to 82 per cent. In 2018 Q2, in the case of variable-rate housing loans the average annual percentage rate of charge (APRC) on new forint housing loans increased by 12 basis points compared to the previous quarter, while it declined further in the case of fixed-rate housing loans (Chart 17). Declines of 8 basis points and 16 basis points took place in the case of new housing loans with interest rate fixation between 1–5 years and over 5 years, respectively. In parallel with that, demand for loans with initial rate fixation over one year continued to grow. Within new loans, the share of loans with interest rate fixation between 1–5 years rose by 3 percentage points to 46 per cent, while the ratio of loans with initial rate fixation of over 5 years was up by 7 percentage points to 36 per cent in Q2. Clearly, loans with initial rate fixation of 5 years can be considered the most popular ones; their share grew by 5 percentage points to 40 per cent within new housing loans in Q2.

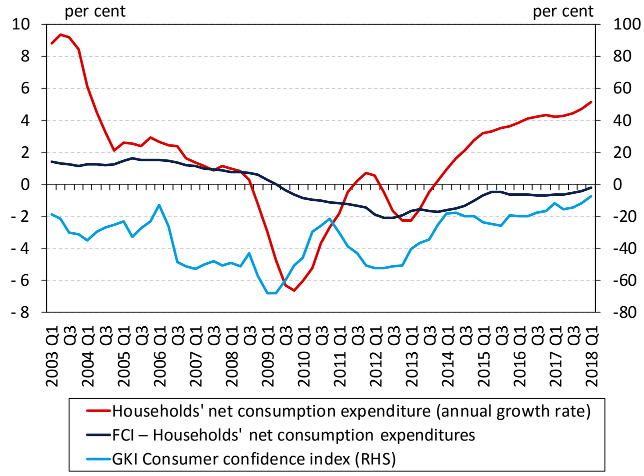
The spread on housing loans with a 1-5 year initial interest rate fixation declined to the level of variable-rate loans. In the period under review, the spread on fixed-rate housing loans declined considerably as a result of a decline in APRCs, which took place in spite of an increase in the costs of funds, i.e. a rise in reference rates (Chart 18). Compared to the previous quarter, declines of 44 basis points and 62 basis points were observed in the case of loans with interest rate fixation between 1–5 years and

Chart 19: Issue of Certified Consumer-Friendly Housing Loan products and loans with interest rate fixation



Source: MNB

Chart 20: Sub-index of the FCI for household consumption expenditures



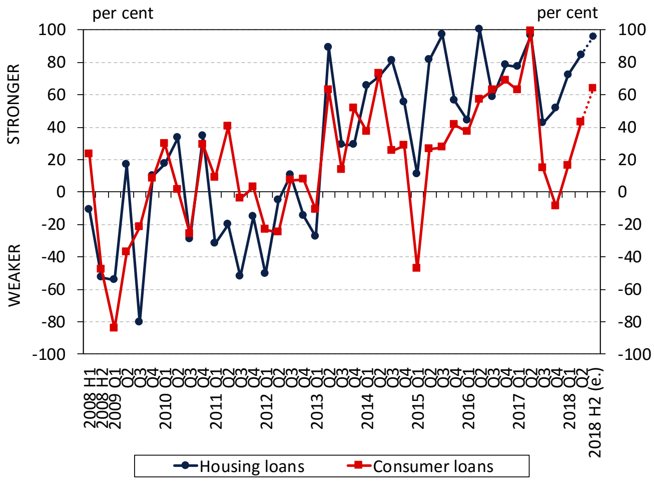
Note: The FCI quantifies the contribution of the banking sector's lending activity to the annual growth rate of household consumption expenditures. The chart indicates the quarterly, smoothed values of the monthly GKI business confidence index. Source: MNB, GKI

over 5 years in a quarterly average, respectively. The increasing popularity of Certified Consumer-Friendly Housing Loan products also contributed to the decline in spreads: since the launch of the certified loans in September 2017, the average spreads on loans fixed for 1–5 years and for over 5 years were down by 1.2 percentage points and 0.8 percentage points, respectively. Thus, at the end of the quarter, the former category reached the level of variable rate loans, and the latter approached to 0.2 percentage point of that level. In the case of personal loans the significant, 2.2 percentage point fall in interest rate spreads observed in Q1 of this year was not followed by a further significant decline; the indicator was 8 basis points lower on a quarterly basis.

Disbursement of Certified Consumer-Friendly Loan products increased. 41 per cent of the housing loan contracts concluded during the quarter under review (with a value of HUF 78 billion) were Certified Consumer-Friendly Housing Loans, accounting for 53 per cent of housing loans with over 1-year interest rate fixation (Chart 19). The importance of CCHL products and fixed-type loans has increased: in June, 84 per cent of new loans were fixed-rate, and within that, with steady growth, the share of CCHL-products reached 57 per cent.

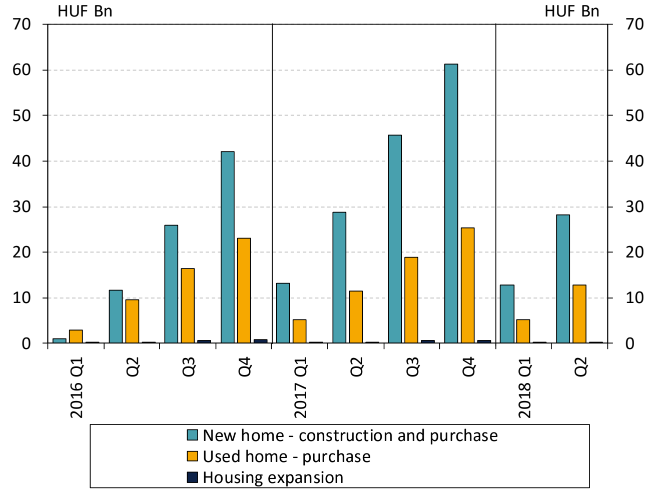
The impact of the financial intermediary system on households' consumption is cyclically neutral. By the end of 2018 Q1, households' consumption expenditures expanded by 5.1 per cent year-on-year. In parallel with that, the consumer confidence index improved further in H1, pointing to a continued favourable trend. According to the MNB's survey, consumer confidence related to the economic environment and concerning the possibilities of employment and saving also increased, which may be accompanied by a rise in short-term, higher-amount spending. According to the consumption expenditure sub-index of the Financial Conditions Index,

Chart 21: Credit demand in the household lending segment



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

Chart 22: Cumulative volume of contracts in the Home Purchase Subsidy Scheme for Families by purpose



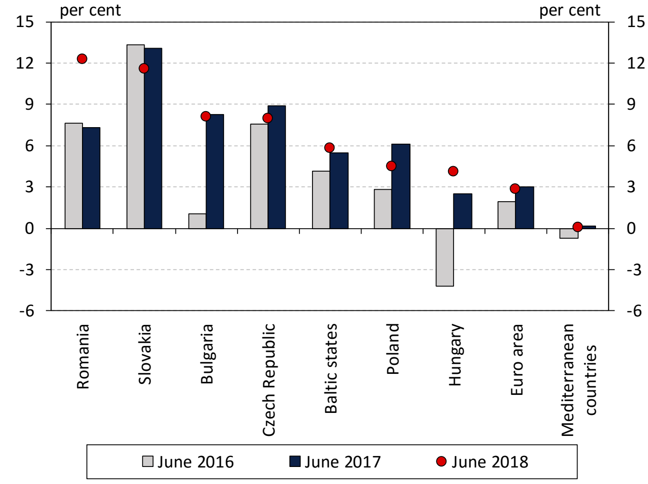
Source: Ministry of Finance

the cyclical impact of banks' credit supply on the consumption expenditure of households is still close to neutral on the whole (Chart 20).

Banks anticipate buoyant demand, especially for housing loans. In 2018 Q2, a wider share of banks participating in the Lending Survey, i.e. 43 per cent in net terms, perceived an increase in demand in the consumer loan segment, and almost two thirds of them expect a further pick-up in demand in the next six months, primarily for personal and vehicle loans (Chart 21). The majority of responding banks, i.e. 85 per cent in net terms, perceived higher demand for housing loans, and almost all of them anticipate further expansion in the next half year as well.

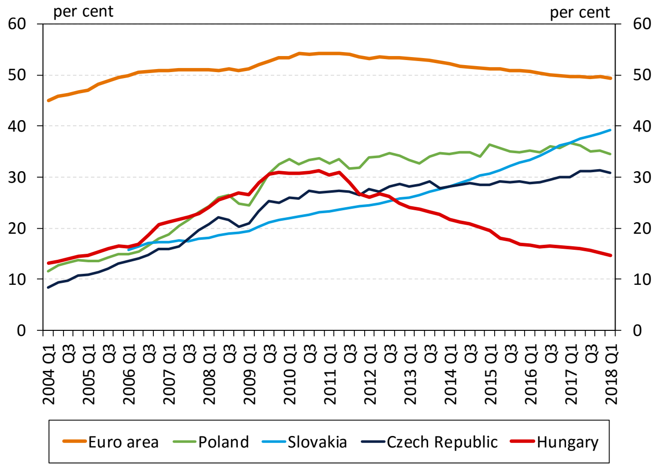
The demand for housing loans continues to be supported by the Home Purchase Subsidy Scheme for Families. In 2018 Q2, borrowing amounting to HUF 37 billion was combined with the use of the Home Purchase Subsidy Scheme for Families, accounting for 16 per cent of new housing loans granted in the quarter. During the quarter under review, the volume of housing loan contracts concluded within the framework of the scheme exceeded the issue of the same period of last year by 23 per cent. The subsidy of HUF 10+10 million helped households to purchase homes with a total value of HUF 9 billion in the period under review. Since the beginning of 2016, 62,000 subsidy contracts with a total value of HUF 195 billion have been concluded within the scheme. Households spent two thirds of this amount on constructing or purchasing new homes, and one third on buying used homes (Chart 22).

Chart 23: Annual transaction-based growth rate of household loans in an international comparison



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

Chart 24: Household credit-to-GDP in an international comparison



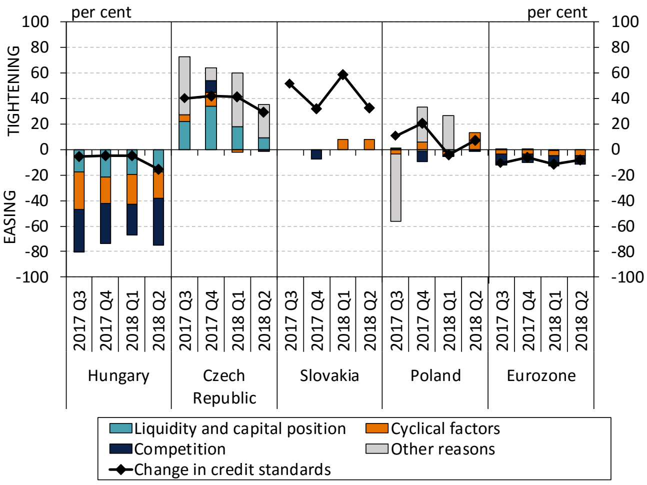
Source: ECB, MNB

International outlook in household lending

Lending to households expanded significantly in the CEE-region. At the end of the quarter, the annual average growth rate amounted to 3 per cent in the euro area, but household loans outstanding expanded even to a greater degree in the Central and Eastern European region (Chart 23). In the case of the Visegrád countries, Slovakia recorded growth of nearly 12 per cent, while annual growth of 8 per cent and 5 per cent was observed in the Czech Republic and Poland, respectively. Romania with 12 per cent and Bulgaria with 8 per cent expansion in household loans were outliers in the region. In spite of the strong growth, risks inherent in household indebtedness are limited in the region as the countries' credit-to-GDP ratio is below the 50 per cent average of the European Union (Chart 24). Ratios below 10 per cent were observed for Hungary and Romania, and between 30–40 per cent in the case of the Visegrád countries in early 2018. Accordingly, there is still room for financial deepening in the countries of the region.

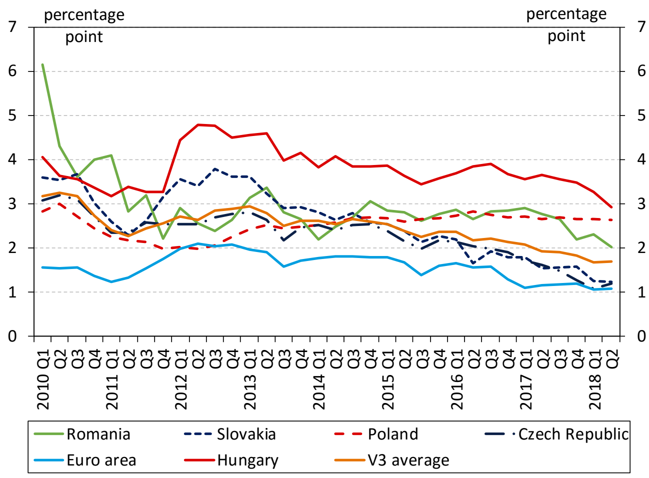
Housing credit conditions tightened in the region. The lending survey of the European Central Bank revealed that a small share of euro area banks eased conditions on housing loans in 2018 Q2. In net terms, nearly 8 per cent of the responding banks reported easing. Banks consider the increase in competition as the main factor explaining easing, which, according to the survey, was primarily reflected in the narrowing of spreads. At the same time, credit conditions tightened in the Visegrád countries, aside from Hungary: in net terms, 7 per cent of the banks in Poland, 29 per cent in the Czech Republic and almost one third of the banks in Slovakia reported tightening of their conditions during Q2 (Chart 25). In the Czech Republic, banks tightened partly because of the liquidity and capital situation, but central bank macroprudential measures affecting banks' internal rules as well as changes in the assessment of the creditworthiness of clients

Chart 25: 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 tightening conditions, while negative ones indicate easing. Source: MNB, ECB, national central banks

Chart 26: International comparison of spreads on housing loans extended in domestic currency



Note: In the case of variable-rate housing loans or ones with up to 1-year rate fixation, APR-based smoothed spread over the 3-month interbank rate, in the case of housing loans fixed for a period between 1–10 years over the respective IRS, in the case of a longer than 10-year fixation over the 15-year IRS, APR-based smoothed spread. Source: MNB, ECB, EMF, Datastream, national central banks

and in lending policy also played a rule in the tightening. The tightening was primarily attributable to cyclical factors in Slovakia and Poland.

Developments in spreads on new housing loans show a mixed picture in international comparison. In 2018 Q2, the average APRC on loans issued in domestic currency remained practically unchanged as an average of both the euro area and the Visegrád three. The average APRC increased slightly in Romania, the Czech Republic and Hungary, and declined to some extent in the other countries of the Central and East European region. At the same time, the largest average fall in the interest rate spread (34 basis points on a quarterly basis) took place in Hungary in the region (Chart 26). Hungary is followed by Romania, where – in parallel with a rise in the cost of funds – a decline of 29 basis points took place on a quarterly basis. The average spread remained practically unchanged in the euro area and the V3 countries on average. In the Czech Republic, however, while longer-term reference rates declined, growth of 12 basis points was observed. The level of spreads in Hungary is still considered high in international comparison, but the difference is becoming smaller: the spread on housing loans in Hungary exceeds the averages of the euro area and the Visegrád countries by an average 1.8 percentage points and 1.2 percentage points, respectively.

BOX 3: INTERVIEWS WITH SENIOR HOUSEHOLD LOAN OFFICERS

As noted by the banks, market developments in the household loan segment are in line with preliminary plans this year; growth is reaching and, in some cases, even exceeding the target figures. At the same time, according to the expectations of several institutions, growth in the market will decelerate in H2 and in 2019, which is partly explained by a base effect as well.

The average amount of loans is growing in the case of housing loans, while households continue to borrow mainly to purchase used homes. Due to delays in construction, clients' demand for new homes is low. The interviewed institutions are promoting products with longer interest rate fixation periods in the housing loan segment. In addition, they call attention to the interest rate risk in information materials as well. Banks perceived the rapid increase in the weight of loans with interest rate fixation and within that of the Certified Consumer-Friendly Housing Loan products in their own course of business as well in H1. Products with 5-year interest rate fixation are the most popular ones, but at the same time it was also reported that demand is steadily shifting towards longer interest rate fixation. According to their experiences, clients collect information on the Certified Consumer-Friendly Housing Loans before inquiring at bank branches. This results in the impression that consumers' price sensitivity is growing. Nevertheless, it continues to be an obstacle to convert the existing portfolio for loans with longer interest rate periods that clients perceive a too great difference between the prices of fixed- and variable-rate loan products. The ratio of loan refinancing cannot be considered significant either, and considering that it is a more complicated procedure in the case of mortgage loans, it tends to be limited to unsecured consumer loans, in view of the favourable interest rate conditions. The volume of prepayments is also low, and still no rising trend is seen. Moreover, market participants expect a decline, as one of their primary sources – in addition to savings in home savings and loan associations – is the cafeteria allowance, which might not be allowed to be used for this purpose in the future.

The debt cap rules, which have been in force since 2015, still do not represent an effective limit, although certain institutions – taking account of the increasing housing prices – are willing to grant loans close to the limits in terms of the loan-to-value ratio. In market participants' opinion, the tightening of the payment-to-income ratio planned for October will not significantly hinder lending. It will only divert demand towards loans with longer interest rate fixation, and accordingly they do not even expect high volumes of borrowing brought forward prior to the entry into force of the new regulation.

Lending institutions consider the utilisation of the Home Purchase Subsidy Scheme for Families to be good; according to their experience, it is a popular type of subsidy. Due to the rapid increase in housing prices in Budapest, it mainly has a strong impact outside the capital city. At the same time, concluding the contract requires substantial administrative work, and in certain cases the procedure is long; therefore, for lower amounts fewer people use it.

The increase in new personal loans is largely the result of the fact that – with the easing of pricing conditions – these may represent a competitive alternative to housing loans. Several institutions raised the amount of loan that can be applied for: at present, the maximum amount of personal loan is HUF 10 million in the market. In addition, credit scoring takes much shorter time when taking out an unsecured consumer loan (in the case of own clients it is typically between 1–2 hours and 12 days, whereas in the case of housing loans it takes 2–3 weeks, or even longer because of the appraisal). In fact, raising the amounts of loans is allowed by the improvement in households' income position, the whitening of the economy as well as the favourable business conditions and labour market situation. In line with the above, according to banks that conduct relevant surveys among their own clients, in the case of general purpose personal loans housing purposes (e.g. renovation), vehicle purchasing and loan refinancing are significant, whereas traditional personal loan purposes (e.g. family events, health expenditures, education and consumer durables) are losing ground. This shift in loan purposes entailed a rise in average amounts in loan contracts.

In the banks' opinion, there is strong competition in the market, especially in the case of personal loans, where major commercial banks have also appeared in addition to the earlier key market participants. At the same time, their common opinion is that there is no more room for significant easing in non-price conditions. The appearance of riskier clients was not reported, and no portfolio deterioration was perceived: several institutions indicated that, considering the low non-performance ratio of the new portfolio, this ratio can still increase later without any stability problems. However, several banks mentioned cases when a client becomes non-performing in a way that he leaves for abroad after taking out a personal loan.

In terms of the sales channels, for several banks an important role is played by agents, who account for one half to two thirds of the contracts in the case of banks that use this channel. Several institutions noted that the amounts in the loan contracts sold by agents are higher than in the ones sold in bank branches, while in terms of quality they correspond to the loans sold through classical sales channels. Significant developments are in progress in online sales platforms, but at present the obstacle there is that usually the whole process of borrowing cannot be conducted online. The main technical obstacle is the introduction of video identification and electronic signature. Nevertheless, based on the experiences of banks implementing partly-online borrowing, demand for online banking is not associated with the age of the customer, although at a point in the process clients require personal help in a bank branch for borrowing.

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 compiled statistics , the press releases presenting the main data and the methodological descriptions of preparing the statistics are available on the MNB's website at: http://www.mnb.hu/en/statistics

2. *Lending Survey*

The Lending Survey facilitates the analysis of how major banks perceive and evaluate market developments and how they develop their respective strategies, in particular their lending policies. In the case of the household segment, a total 11 banks were involved in the interviews. Nine banks responded to questions related to housing loans, while 10 banks and 11 financial enterprises answered questions on consumer loans. Based on data from the end of 2018 Q2, the surveyed institutions accounted for 81 per cent of the banking sector in the case of outstanding housing loans and 89 per cent in the case of outstanding consumer loans. The corporate questionnaire was completed by 15 banks in total, which represent 91 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 87 per cent.

The survey consists of a standard questionnaire in each segment. The retrospective questions refer to 2018 Q2 (compared to 2018 Q1), whereas the forward-looking questions concern the next half-year period, i.e. covering 2018 H2 (relative to 2018 Q2). The current questionnaire was completed by senior loan officers between 29 June and 17 July 2018.

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

The detailed findings of the Lending Survey and the set of charts are available at: http://www.mnb.hu/en/financial-stability/publications/lending-survey

3. *The Financial Conditions Index (FCI)*[4]

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.

[4] 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.

The database used for the factor analysis is composed of individual bank data, consisting of certain aggregate indicators of the 9 largest banks and the rest of the banking sector. From the panel database 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
- 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 question to decide during factor analysis is the exact number of estimated variables that can capture the essential information contained by the data. The MNB decided this question 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).[5] 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.

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

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