MAGYAR NEMZETI BANK

TRENDS IN LENDING

2018
MARCH

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Trends in lending

(March 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 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 based on the balance sheet statistics of the banking sector. Both the volume of new loans and net changes in banking sector 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 2017 Q4, thus on a year-on-year basis total corporate loans outstanding rose by 10.4 per cent as result of transactions. In the unprecedented growth since the crisis, large one-off borrowings played a role as well. Lending to the SME sector, including the self-employed, rose by almost 12 per cent. In the fourth quarter, the balance of transactions was similarly high as in the previous quarter, amounting to a total of HUF 184 billion. As a result, increase in total corporate loans outstanding in 2017 was more than twofold as in the previous year. The volume of new loan contracts concluded in 2017 exceeded that recorded a year ago by 30 per cent, and an increase in the average loan amounts has been observed as well.

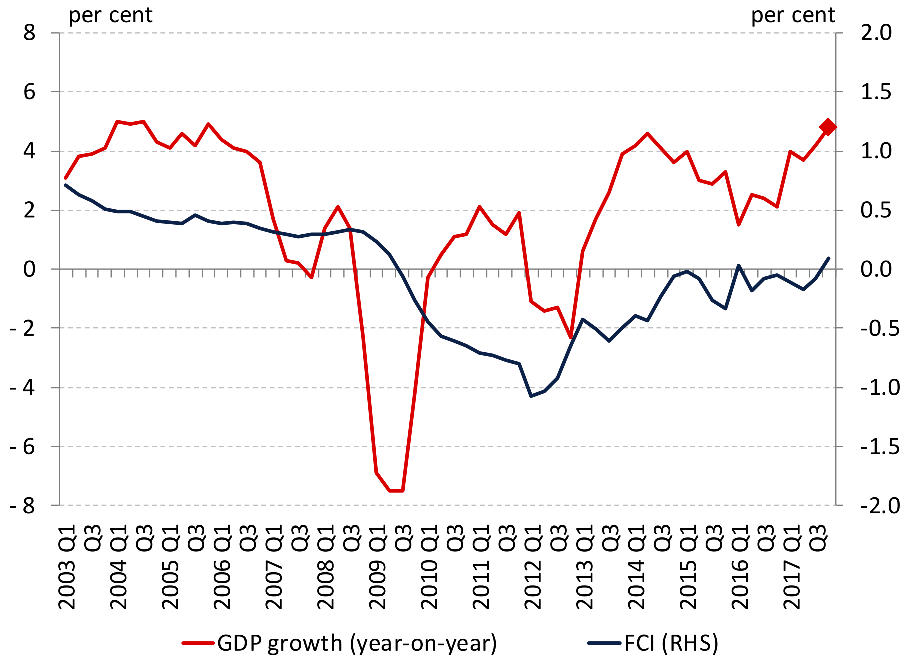
Based on banks' responses to the Lending Survey, credit conditions eased in both corporate segments in the fourth quarter. Competition in the banking sector further intensified, which was primarily reflected in the falling interest rate spreads. Based on the credit institutions' responses to the Lending Survey there was a pick-up in credit demand in both the large corporate and the SME segments. Looking ahead to the next half-year, banks anticipate these processes will persist, particularly in the case of long-term loans. In 2017, under a general decrease in interest rate spreads, outstanding lending to enterprises rose across the region, though to a lesser extent than recorded in Hungary.

Loans outstanding to households increased 2.7 per cent year on year by the end of 2017. In the period under review, the annual average increase in the volume of new loans was 41 per cent. Within that, new housing loans and personal loans grew by 39 per cent and 47 per cent, respectively.

Based on the Lending Survey responses, banks continued to ease the conditions of consumer loans, and looking ahead they also anticipated further easing both for housing and consumer loans. As perceived by banks, housing credit demand kept growing, which is still helped by the Home Purchase Subsidy Scheme for Families: in the fourth quarter, 16 per cent of the volume of newly issued housing loans was related to the HPS. The average APR of new forint housing loans decreased in all initial interest rate fixation categories, while regarding the spreads, a decrease was observed only in the case of the loans with an interest rate fixation of 1-5 years. Looking ahead, the Certified Consumer-Friendly Mortgage products may contribute to both the expansion of fixed-rate loans and to the decrease in spreads through the rising competition. In the fourth quarter, 13 per cent of the new housing loans and 23 per cent of the longer fixation period loans were already such certified loans. A more intense run-up has been observed with the Certified Consumer-Friendly Mortgage products in the last quarter: these products reached a 40 per cent share in December 2017.

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

Financial Conditions Index (FCI) and annual real GDP growth



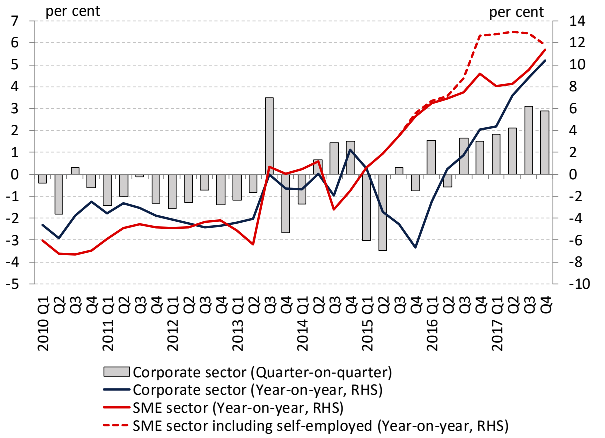
Note: The FCI quantifies the banking system’s contribution to the annual GDP growth rate through lending. The 2017 Q4 data for the real GDP annual growth rate is the seasonally and calendar adjusted first estimate of the HCSO.

Source: MNB, HCSO

2. DEVELOPMENTS IN LENDING IN THE CORPORATE SEGMENT

In 2017 Q4 the combined balance of the disbursements and repayments of corporate loans was HUF 184 billion. In the past one year, a more than twofold increase was registered in total corporate loans outstanding compared to the previous year, rising in total by HUF 615 billion on a transaction basis, which corresponds to annual growth of 10.4 per cent. The growth rate in the narrow SME sector and in the SME sector including the self-employed was 11.4 per cent and 11.8 per cent, respectively. The volume of new contracts rose substantially in the fourth quarter, thus the aggregate volume of new contracts concluded in 2017 exceeded that registered a year ago by 30 per cent. Based on the banks' responses to the Lending Survey, the credit demand of enterprises strengthened once again in the fourth quarter. Competition among banks also continued to increase, which was mostly reflected in the decrease of interest rate spreads. Banks anticipate the trend will continue in the next half-year as well. In 2017, total corporate loans outstanding, on a transaction basis rose across the region, with the highest growth registered in Hungary. In the fourth quarter, interest rate spreads decreased in all countries of the region.

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



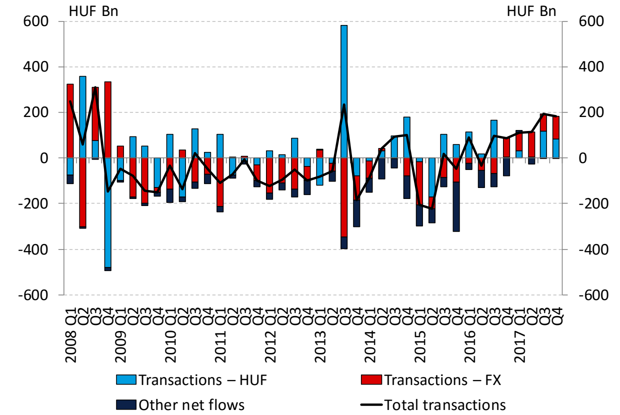
Note: Transaction based, prior to 2015 Q4 data for SMEs are estimated based on banking system data. Source: MNB

Domestic corporate lending

Annual growth rate in corporate lending reached 10 per cent in 2017. In 2017, outstanding loans of non-financial corporations rose by HUF 615 billion on a transaction basis, corresponding to a growth rate of 10.4 per cent (Chart 1). The outstanding loans of the micro, small and medium-sized enterprises in a narrow sense increased at an annual rate of 11.4 per cent, while the annual growth rate of SME sector[1] loans including the self-employed was 11.8 per cent. After a temporary rise in the loan transactions of the self-employed related to land purchases, lending to this sector returned near to the underlying trend. Lending to SMEs was supported by the central bank's Market-based Lending Scheme (MLS) in 2017 as well, under which credit institutions committed to a lending increment of HUF 230 billion for last year. The credit institutions surpassed the commitment substantially, the fulfilment ratio was 250 per cent at sector level (see Box 1). All of the commitments of the participating banks' will remain in place in 2018, thus the MLS will act as an incentive for lending to SMEs this year as well.

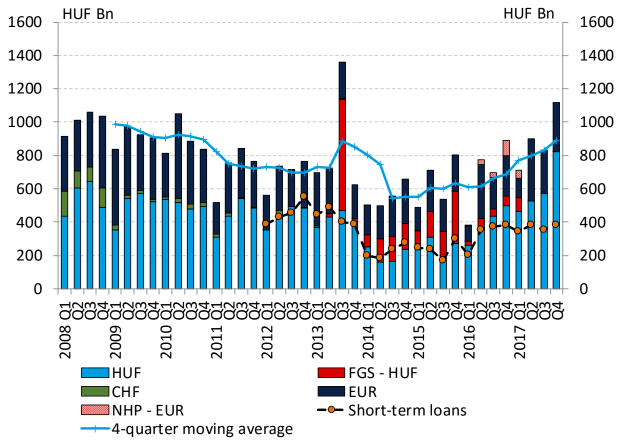
[1] Although the self-employed belong to the household sector in a statistical sense, they also qualify as SMEs based on their activities and legal definition.

Chart 2: Net quarterly changes in corporate loans outstanding, by currency



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

Chart 3: New corporate loans in the credit institution sector



Source: MNB

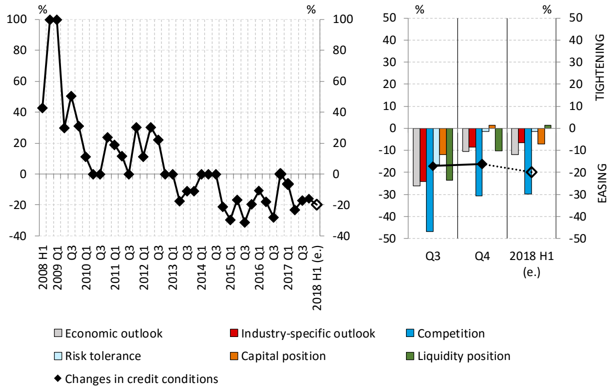
EU-funded loans also contributed to the financing of SMEs. In 2017, the loan-type financial assets, available from EU funding – not included in the transaction-based growth presented above – contributed to corporate lending as well. The outstanding loans disbursed by the banks, acting as intermediaries in the remittance of funds, was close to HUF 60 billion at the end of 2017. To date funds of nearly HUF 440 billion have been announced for SMEs as funding available through tenders and the applications received have already exceeded the allocation available within the given tender in several cases. Thus the disbursement of zero interest EU-funded loans – primarily supporting the implementation of investments – and the low-interest loans combined with non-refundable subsidies, may rise even more dynamically in 2018. These funds at disposal, supported by solutions based on venture capital may mitigate domestic SMEs' demand for financing unsatisfied on a market basis.

In the fourth quarter the balance of corporate credit transactions was similarly high as in the previous quarter. In the fourth quarter of 2017 the transaction-based growth in credit institutions' corporate loans outstanding was around HUF 184 billion (Chart 2) – falling short of the value recorded in the previous quarter only by HUF 10 billion – influenced by the SME sector borrowings and some one-off borrowings of certain large corporations. 55 per cent of the growth is attributable to foreign currency loan transactions. In relation to the third phase of the Funding for Growth Scheme, net drawdowns in the fourth quarter amounted to merely HUF 10 billion.

There was a significant increase in the volume of new corporate loan contracts in the fourth quarter. Credit institutions concluded new contracts in Q4 amounting to HUF 1,116 billion in total (including money market transactions) with non-financial corporations (Chart 3)[2]. The aggregate volume of new contracts concluded in 2017 recorded growth of 30 per cent year on year, and an increase in

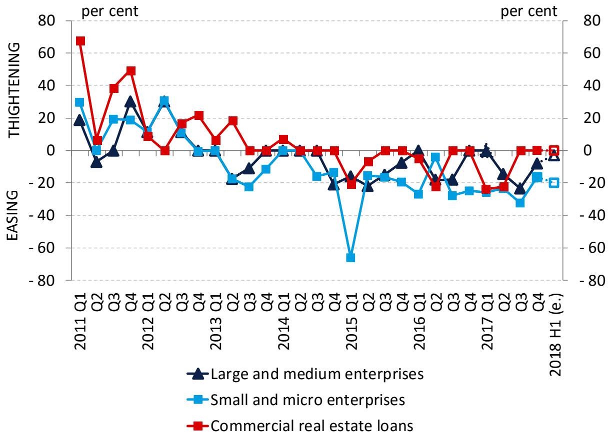
[2] Loans with a maturity of less than one month and the renewal of earlier credit line agreements appear among the new corporate loan contracts, however, they increase neither the value of transactions, nor the amount of loans outstanding at the end of the month.

Chart 4: Changes in credit conditions in the corporate segment



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

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



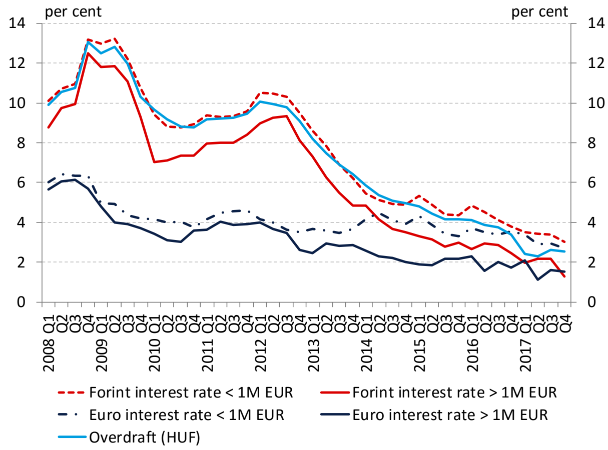
Note: Net ratio is the difference between tightening and easing banks, weighted by market share. Source: MNB, based on banks' responses

average loan amounts was observed as well. In terms of currency denomination, the ratio of forint loans reached 74 per cent after further growth relative to the previous quarter, while in terms of maturity, the ratio of long-term loans rose to 66 per cent from 58 per cent registered in the previous quarter. The latter development can partly be attributed to large one-off borrowings of some state-owned companies and the ongoing pick up in commercial real estate lending.

Mainly due to the competition among banks, corporate loan conditions have eased. In 2017 Q4, in net terms, 16 per cent of the banks participating in the Lending Survey eased corporate loan standards (Chart 4). Almost one third of them noted that bank competition was a key driver of the change, with achieving market share objectives, favourable economic prospects and the liquidity situation also mentioned most often as additional influencing factors. According to the findings of the survey, the easing was mostly reflected in the lower credit spreads (according to 40 per cent), which was also confirmed by the data. In addition, 26 and 19 per cent of the respondents mentioned the increase in the maximum size of credit lines and the lengthening of the maximum maturity, respectively. Looking ahead, 20 per cent of the respondents anticipate further easing in the next half year, which they believe will be driven primarily by bank competition and will be accompanied by a further decrease in spreads.

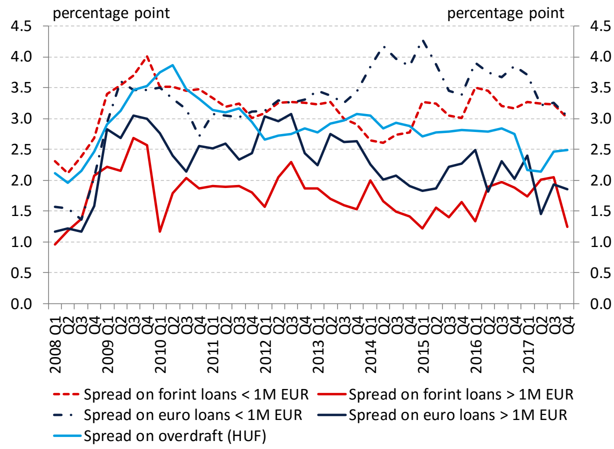
Credit conditions eased in both corporate segments. In terms of enterprise size and looking at the fourth quarter, in the micro and small enterprises segment a net 16 per cent of banks, while in the medium-sized and large companies segment 8 per cent of banks, indicated an easing of credit conditions. At the same time, in line with the expectations, none of the respondent institutions changed the conditions of commercial real estate loans (Chart 5). Looking ahead, easing is expected primarily in the micro and small enterprise segment. In this segment, in net terms, 20 per cent of the banks, while in the medium and large enterprise segment merely 3 per cent of them anticipate

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

further easing in the first half of 2018. In the case of commercial real estate, loan conditions are still not expected to ease.

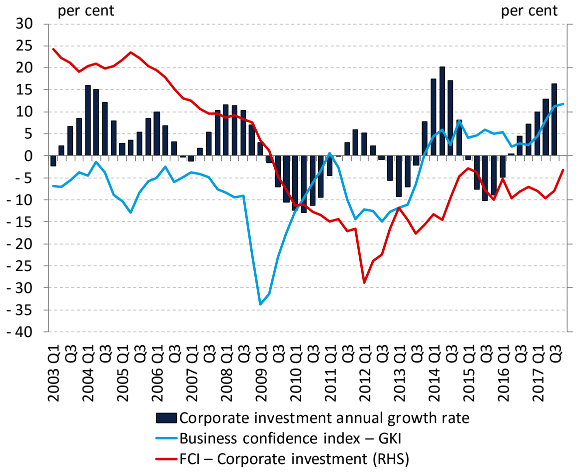
The interest rate on both forint and foreign currency loans decreased during the quarter. The interest rate on market-based new corporate forint loan contracts[3] – excluding money market transactions[4] – decreased by 0.3 percentage points in the case of small loans and by 0.9 percentage points in the case of loans. The changes confirm the intensification of bank competition, although the custom-priced loans of priority clients also made a major contribution to the changes. The average interest rate level on forint overdrafts decreased by 0.1 percentage point (Chart 6). The average interest rate on small and large euro loans dropped by 0.2 and 0.1 percentage points, respectively. The decrease in the interest rates was fully attributable to the fall in spreads for euro loans, while in the case of forint loans it was also predominantly caused by the lower spreads. In the case of small and large forint loans a 0.2 and 0.8 percentage-point drop in the spreads could be observed, respectively, while there was no change in the case of overdrafts in the period under review (Chart 7).

The banking sector's lending activity does not have any major cyclical impact on the changes in the level of corporate investments. The corporate sub-index of the Financial Conditions Index improved in the past quarter, and it is close the neutral level (Chart 8). The GKI business confidence index continued to rise moderately, thus the whole year was characterised by a continuous improvement in economic expectations. According to the MNB's business activity survey, an improvement in prospects was mainly observed in the case of the production and economic environment, but the perception of the business environment and employment conditions has also become more

[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 we review are only affected by a small part of the FGS loans.

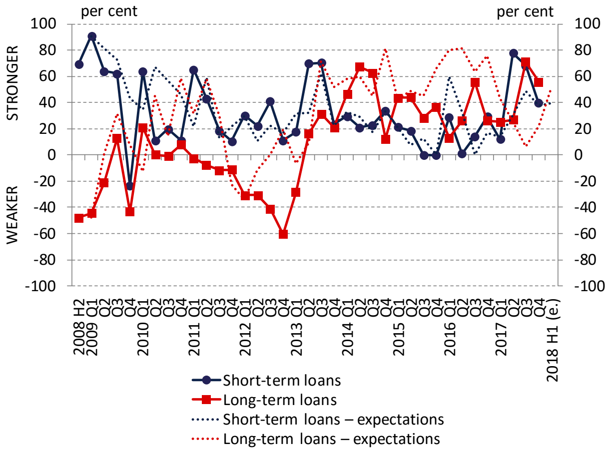
[4] Money market transactions are loans with a value of over EUR 1 million extended to non-financial corporations; their term is short (typically less than 1 month) and they serve to fund some kind of financial operation. It is possible to exclude money market transactions since 2015, although in the 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 to annual growth in corporate fixed investment through lending. Retrospective changes in the time series are explained by the methodology described in Point 3 of the Annex and the revision of the data used. Quarterly, smoothed values of the monthly GKI business confidence index have been indicated. Source: MNB, GKI

Chart 9: Changes in credit demand by maturity

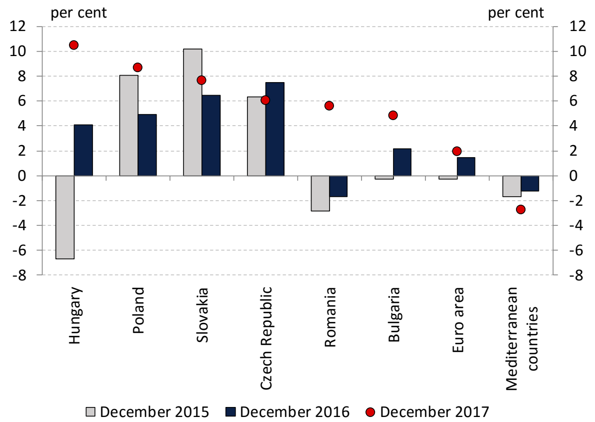


Note: Net ratio is the difference between banks reporting stronger and weaker demand, weighted by market share. Source: MNB, based on banks' responses

positive. In a breakdown by sector, the largest improvement in the perception of business activity was observed at industrial enterprises, but the services and commercial economic activity index also rose during the quarter.

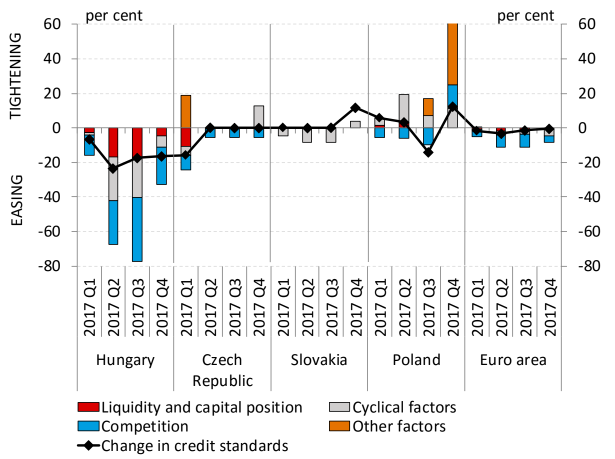
The increase in demand for long-term loans exceeded expectations. In the Lending Survey, in net terms 56 per cent and 40 per cent of the respondents reported a pick-up in demand for long-term and short-term loans, respectively, during the quarter (Chart 9). In the case of short-term loans this is in line with the expectations of the previous quarter; however, in the case of long-term loans it exceeds the expectations as only 22 per cent of the banks, in net terms, anticipated an expansion. In terms of enterprise size, the ratio of those perceiving demand growth was around 40 per cent in the case of both large and medium-sized enterprises as well as small and micro enterprises. In a breakdown by currency, again about 40 per cent of the respondents reported growth in demand for forint loans, while no material change was observed in the case of foreign currency loans. Banks essentially expect the trend to continue in the next half year, i.e. 40 per cent of them anticipate further growth in demand, at a similar rate in both size categories. Only 12 per cent of the respondents deem growth in demand for foreign currency loans likely, while 52 per cent of them expect demand for long-term loans to rise. Under the continuing improvement in the prospects of the commercial property market, the majority of the respondents anticipate demand growth in the segment, particularly in the area of housing projects.

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



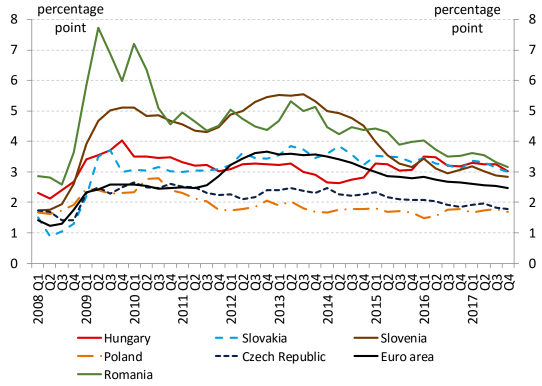
Note: Category values are derived from the arithmetic average of the factors thematically classified therein. Positive values indicate a tightening of conditions, while negative values indicate an easing thereof.
Source: MNB, ECB, national central banks

International developments in corporate lending

The growth rate of corporate loans was the highest in Hungary within the region. Dynamic growth was observed in all of the Visegrád countries in 2017: corporate lending rose by more than 10 per cent in Hungary, as mentioned above, by 9 per cent in Poland, by almost 8 per cent in Slovakia and by 6 per cent in the Czech Republic (Chart 10). Growth in the euro area was close to 2 per cent, while the rate of decrease in the Mediterranean countries' portfolio has accelerated, primarily as a result of the decline in Italy.

In the region, the conditions of corporate loans eased to the largest degree in Hungary for the third quarter in a row. Based on the banks' responses to the lending surveys, in the Visegrád countries corporate credit conditions in the fourth quarter eased in Hungary, remained unchanged in the Czech Republic, and tightened somewhat in Slovakia and Poland. Based on the responses, the tightening in Poland is primarily attributable to the industry-specific problem characterising construction, as well as to the rise in the risk of certain clients. Conditions in the euro area eased only to a small degree on the whole; 0.5 per cent of banks, in net terms, headed in this direction (Chart 11). The intensification of bank competition has remained the primary factor for easing.

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



Note: Variable-rate loans below EUR 1 M, 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

The average interest rate spread on corporate loans decreased in the region. In the fourth quarter, the average interest rate spread on corporate loans below EUR 1 million decreased in all countries of the region (Chart 12). The largest change, 22 basis points, was observed in Hungary. Spreads fell by 15 basis points in Slovakia and Romania, by roughly 10 basis points in Poland, and to slightly smaller degrees in the Czech Republic, Slovenia and in the euro area. Parallel to this, the direction of changes in interest rates on corporate loans varied; the largest drop was observed in Hungary (-32 basis points), while interest rates in Romania increased by 88 basis points due to the material rise in the reference rate.

Box 1: Fulfilment of lending commitments in Market-based Lending Scheme

The MNB launched the Market-based Lending Scheme (MLS) in 2016, aimed at facilitating the smooth return to market-based lending after the termination of the Funding for Growth Scheme (FGS) and ensuring sustainable economic growth through SME lending. Within the scope of the MLS and by means of concluding interest rate swaps with commercial banks (LIRS), the MNB developed an incentive system aimed at long-term market-based lending. The credit institutions participating in the scheme undertook to increase their SME lending activity during the given calendar year by one quarter of the face value of the LIRS transaction concluded with the MNB, which can be sustained for up to three years.

In 2016, LIRS transactions to the tune of HUF 780 billion were concluded, which represented commitments of increased SME lending amounting to HUF 195 billion in total. In that year, the participating banks increased their lending to SMEs by more than HUF 300 billion, despite their commitment of HUF 195 billion. Although most banks participating in the MLS exceeded their pledged SME credit growth in 2016, the commitments could not be raised until mid-2017, therefore the commitments for 2017 dropped from HUF 195 billion to HUF 170 billion on account of the (partial) termination of certain LIRS transactions at the beginning of the year.

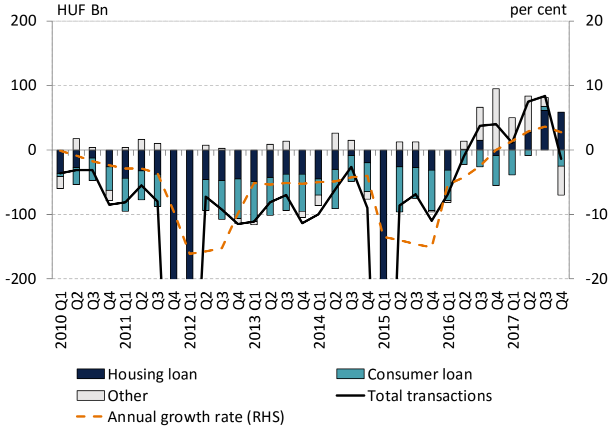
The Monetary Council decided to launch the second phase of the MLS in May 2017 to allow banks to raise their lending commitments. At the LIRS tender in July, the MNB concluded transactions totalling another HUF 228 billion with the credit institutions, raising banks' SME lending commitment for 2017 from HUF 170 billion to HUF 227 billion. Thus banks' lending commitment increased by 34 per cent on average across the banking system, while 3 out of the 9 participating banks at least doubled their commitment.

All 16 banks with LIRS transactions at the end of 2017 met their commitments, increased in several cases. As a result, banks achieved a 250 per cent fulfilment at the sector level, even surpassing the figure from the previous year. No credit institution wished to voluntarily lower their commitment for 2018, therefore the commitments of around 6 per cent of total SME loans outstanding may contribute to the stabilisation of the lending dynamics between 5–10 per cent, which is regarded by the MNB as the range necessary for sustainable economic growth.

3. DEVELOPMENTS IN LENDING IN THE HOUSEHOLD SEGMENT

Although household loan transactions reduced outstanding borrowing by HUF 14 billion at the end of 2017, there was growth of 2.7 per cent last year. The total volume of new contracts was HUF 326 billion in 2017 Q4, and an annual average expansion of 41 per cent was observed. Within the total volume, new housing loans increased by 39 per cent and new personal loans by 47 per cent over the past one year. During the quarter, 19 per cent of new housing loans, i.e. some HUF 33 billion, was disbursed for the construction or purchase of new homes. Based on the responses to the Lending Survey, banks eased their consumer loan conditions, achieved under the easing of spreads and the payment-to-income ratio required by the banks. For the next half year, a significant proportion of banks expect an easing in housing loan conditions, in line with the increase in competition and the expected expansion of the Certified Consumer-Friendly Mortgage products. Based on banks' perceptions, there was a further acceleration of housing credit demand, and they expect this to continue in the next half year as well. This demand growth is still supported by the Home Purchase Subsidy Scheme for Families, with 16 per cent of the volume of newly issued housing loans related to this programme in Q4. The disbursement of Certified Consumer-Friendly Mortgage products in the fourth quarter amounted to HUF 23 billion, accounting for 13 per cent of the new issue and 23 per cent of the longer fixation period housing loans. A more intense run-up was observed in the Certified Consumer-Friendly Mortgage products in the last quarter: these products reached a 40 per cent share in December 2017. The average annual percentage rate of charge (APR) on new forint housing loans decreased in all initial interest rate fixation categories, while regarding the spread, a moderate decrease can only be observed for loans with an interest rate fixed for 1-5 years.

Chart 13: Net quarterly changes in the outstanding household loan portfolio by loan type

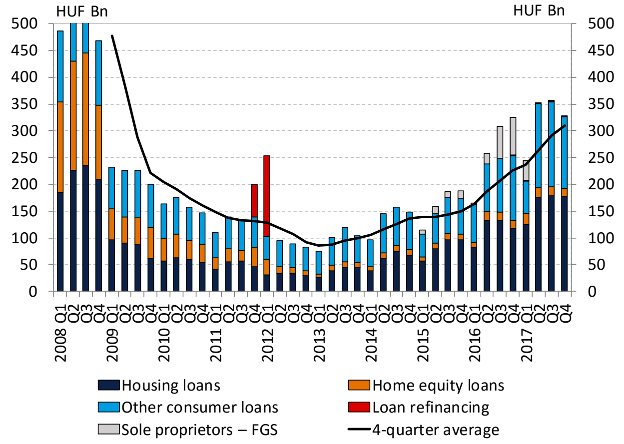


Note: Seasonally unadjusted net change in outstanding amounts, with rolling exchange rate adjustment. The annual change in the outstanding amount reflects the effect of settlement. Source: MNB

Domestic household lending

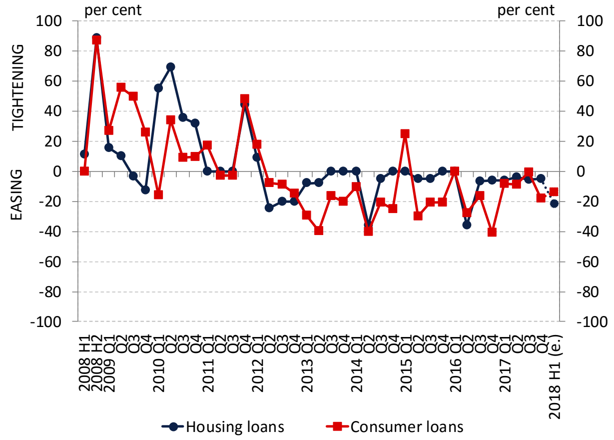
Household loans outstanding increased by 2.7 per cent as a result of transactions. In the fourth quarter of 2017, loans of credit institutions granted to households decreased by HUF 14 billion as a result of transactions (Chart 13). Due to loan transactions, housing loans rose by HUF 59 billion, while consumer loans decreased by HUF 25 billion in the quarter under review. Overall, the value of annual household loan transactions amounted to HUF 156 billion, resulting in an expansion of 2.7 per cent year-on-year. Even the growth rate calculated without the land financing transactions of the self-employed reached almost 2 per cent in the fourth quarter.

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



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

Chart 15: Changes in credit conditions in the household segment

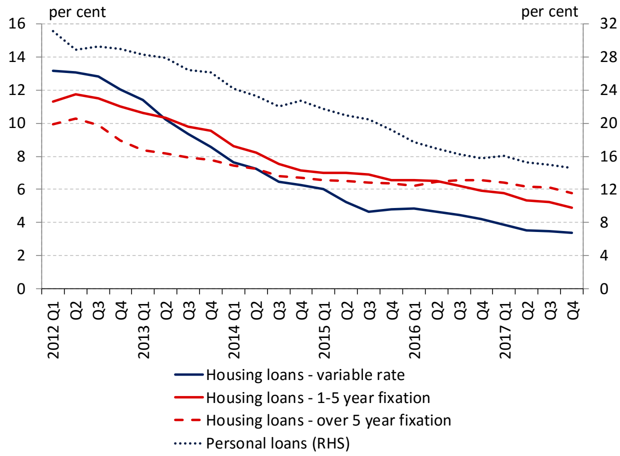


Note: Net ratio is the difference between tightening and easing banks, weighted by market share. Source: MNB, based on banks' responses

The new housing loans in 2017 amounted to 76 per cent of the issuance in 2008. The volume of new household loan contracts concluded in the fourth quarter of 2017 amounted to HUF 326 billion (Chart 14), thus the volume of new loans was up 41 per cent as an annual average. The annual growth rate in the case of housing loans and home equity loans amounted to 39 per cent and 21 per cent, respectively. The disbursement of other consumer loans rose by 45 per cent, and within that personal loans and vehicle loans registered year-on-year growth of 47 and 59 per cent, respectively. 71 per cent of the new housing loan contracts concluded during the quarter under review were for used homes, and19 per cent for the construction or purchase of new homes. The total annual value of housing loan contracts was HUF 650 billion in 2017, which is around three quarters of disbursements seen in 2008. However, in the current lending cycle the debt cap rules prevent households from excessive indebtedness.

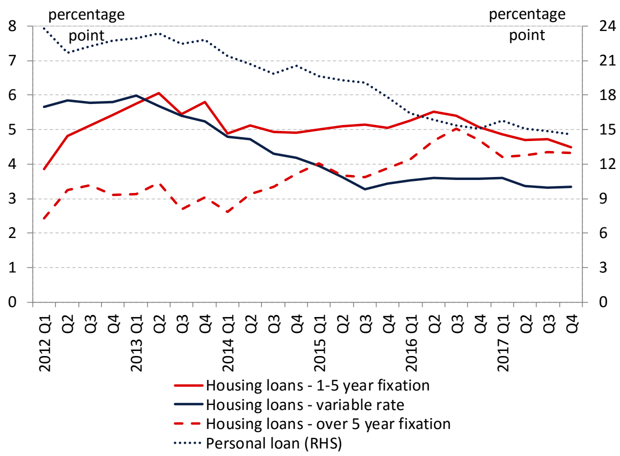
Banks eased the conditions of consumer loans. In net terms, only 5 per cent of the respondent banks participating in the Lending Survey reported that they eased their housing loan conditions (Chart 15). On the other hand, looking at the specific conditions, there were major changes in the spreads: in net terms, 59 per cent of the respondent banks reduced the spread of the interest rates over the funding costs in the case of less risky loans. In addition, banks saw that there was scope for increasing the loan-to-value ratio. 61 per cent of the respondent banks mentioned housing market developments and 44 per cent of them their favourable liquidity situation as factors supporting the easing. In net terms, 18 per cent of the banks eased the conditions of consumer loans, realised by reducing the spreads and easing the payment-to-income ratio required by the banks. In the next half year, in view of the favourable housing market developments, 21 per cent of banks plan to ease housing loan conditions, most of them through a further reduction of spreads and by raising the maximum loan-to-value ratio. In the case of consumer loans, 14 per

Chart 16: Annual percentage rate of charge on new household loans



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

Chart 17: Interest rate spreads on new household loans

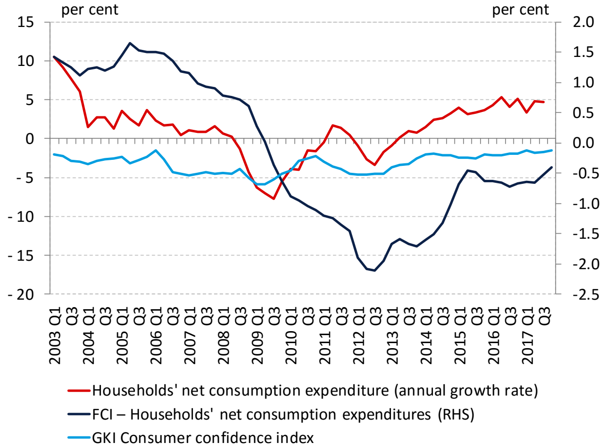


Note: In the case of variable-rate housing loans or ones with up to 1-year rate fixation, APR-based smoothed spread over the 3-month BUBOR, while in the case of housing loans fixed for a period longer than one year, the APR-based smoothed spread over the corresponding IRS. For personal loans, APR-based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

cent of the respondent banks in net terms indicated their intention to ease in the next half year, assuming a change in the competitive conditions.

The proportion of fixed-rate loans within new housing loans increased. The average annual percentage rate of charge (APR) on new forint housing loans decreased in the case of all interest rate fixation periods in 2017 Q4 (Chart 16). A drop of almost 10 basis points and 40 basis points was observed in the case of variable rate housing loans and fixed rate housing loans, respectively, compared to the previous quarter. Within new housing loans, the ratio of loans with interest rate fixed for over one year rose: the proportion of housing loans with initial rate fixation for a maximum of one year decreased by 4 percentage points to 44 per cent compared to Q3, while demand for loans with an interest rate fixed for 1-5 and 5-10 years increased in the period under review by 3 and 2 percentage points, respectively. 13 per cent of the housing loans issued during the quarter, totalling roughly HUF 23 billion, were Certified Consumer-Friendly Mortgage products, and this was 23 per cent of the longer fixation period loans. A more intense dynamic was observed for the Certified Consumer-Friendly Mortgage products in the last quarter: these products reached a 40 per cent share in December 2017. The interest rate spread on housing loans changed only in the case of loans with an initial rate fixation of 1-5 years, registering a drop of 20 basis points quarter-on-quarter. In the case of personal loans, the interest rate spreads fall short of those registered in 2017 Q3 by 30 basis points (Chart 17). Within consumer loans, the interest rate spread on home equity loans decreased by 0.3 percentage points, while that on other consumer loans rose by 0.2 percentage points, thus they stood at 5.7 and 14.1 percentage points, respectively, at the end of December.

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. Retrospective changes in the time series are explained by the methodology described in Point 3 of the Annex and the revision of the data used. For technical reasons, the chart indicates one-hundredth of the quarterly, smoothed values of the monthly GKI business confidence index. Source: MNB, GKI

The impact of the financial intermediary system on household consumption strengthened somewhat. By the end of 2017 Q3, households' consumption expenditures increased by 4.7 per cent year-on-year. Besides this, a slight improvement took place both in Q3 and Q4 in the consumer confidence index that projects a continuation of the favourable trend. According to the MNB's survey, consumer confidence in financial, employment and economic conditions improved in 2017 Q4, while large expenditures planned in the short term also rose. The consumption expenditure sub-index of the Financial Conditions Index rose slightly, but the cyclical effect of banks' credit supply on the consumption expenditure of households was still neutral on the whole (Chart 18). At portfolio level consumer loans fall behind mortgage loans, but in terms of their number they represent a significantly higher volume, hence in social terms these loans have an impact on a larger number of households than housing loans. For this reason, unsecured consumer loans deserve special attention in the financial sector's lending activity (see more in Box 2).

Box 2: Focus on consumer credit

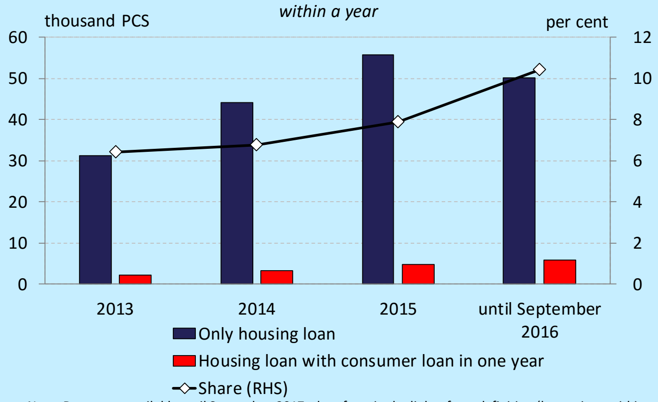
In recent years, developments in the housing market have drawn attention to the mortgage market, however, a similarly spectacular rise in demand for consumer credit has also been observed. Although they lag behind mortgages as regards volume, consumer loans represent a much bigger magnitude in terms of number. According to data from the Central Credit Information System, at the end of 2017 Q3, in addition to the 959,000 mortgage contracts held by Hungarian households, there were more than 5 million other loan contracts (including credit cards and overdrafts), therefore consumer credit is crucial not only from a stability but also a social perspective with regard to the development of households' financial vulnerability.

Based on micro statistics,[5] the situation of potentially vulnerable households with unsecured consumer credit was analysed regarding loan contracts concluded after 2013, and the share of personal loans within consumer credit, without credit cards and overdrafts, was found to be 43 per cent, while hire purchase represented 32 per cent. Our research focused on these loan products. The analysis paid special attention to households characterised by repeated or combined[6] borrowing. The examination of lending institutions shows that 55 per cent of consumer loan contracts since 2013 were concluded between customers and credit institutions, while 45 per cent were concluded between customers and financial enterprises. It can also be seen that financial enterprises typically enter into lower-value contracts with their customers: 89 per cent of their contracts are below HUF 400,000, whereas 84 per cent of the loans extended by credit institutions exceed this amount. Therefore financial enterprises mainly cater to customers in a less favourable financial position. In a regional comparison, the average loan amount, which accurately reflects the level of economic development, is the lowest in the eastern and southern regions of the country, while the largest amounts are requested by customers in the western part of the country and around the capital.

With respect to the income position of the borrowers, debtors with consumer loans typically have lower income than those with housing loans. In the case of consumer loans, the gross monthly income of the debtors does not exceed HUF 300,000 in 77 per cent of the cases, while the number of consumer loans taken out by those with a gross monthly income of over HUF 500,000 make up slightly over 5 per cent of the total. In the case of personal loans, income and the loan amount are positively correlated. While the loan amount is between HUF 100,000 and HUF 200,000 in the lowest income categories, loans of over HUF 1 million, typically extended by banks, dominate in the case of incomes over HUF 400,000.

In 31 per cent of the consumer loans disbursed since 2013, borrowers already had another consumer loan at the time of borrowing, while in 14 per cent of the cases the customer's loan contract was terminated within 30 days before taking out the new consumer loan. Financial enterprises cater to those amassing consumer loans, since in their case 46 per cent of the contracts are repeated borrowings. The comparison of repeated borrowings to "one-off" borrowings shows that the value of the former is typically lower, and they are mostly used by lower-income households for shorter maturities. This may indicate that financially tighter households have to rely on taking out consumer loans more often.

Number and proportion of borrowers taking out only housing loans and those supplementing the housing loan with a consumer loan within a year



Note: Data were available until September 2017, therefore, in the light of our definition (borrowings within a year of taking out the housing loan), the proportion could be produced until September 2016.

Source: CCIS

Our analysis also examined the features of combined borrowing, where a housing loan was followed by a consumer loan within a year. Among the housing loans taken out between 2013 and September 2016, debtors took out consumer loans within a year of borrowing in 8 per cent of the cases. However, this proportion is increasing, which may be attributable to the rising house prices. Due to the increasing property prices, house purchases can easily stretch households' financial positions, therefore households use consumer loans to finance the extra costs usually associated with buying a home (furnishing, renovation).

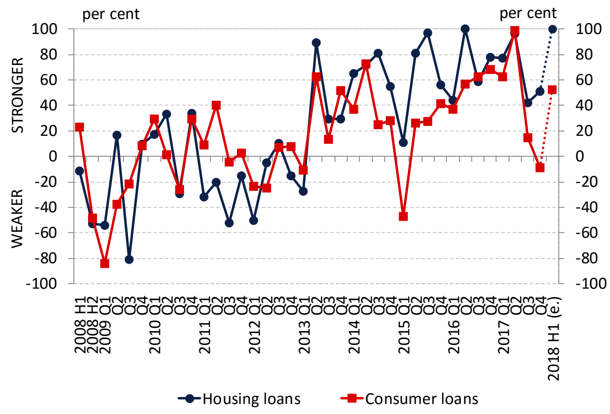
Even at longer maturities, the housing loans that were later coupled with consumer loans were characterised by a higher payment-to-income ratio and loan-to-value ratio than those that were not followed by a consumer loan. This suggests that these households' liquidity was more constrained when they took out the housing loan.

The number of dependent children in a household increases families' monthly subsistence costs, therefore it is important to consider the number of children in households taking out consumer loans. While in the case of the consumer loans taken out by households without dependents the share of repeated borrowing was 29 per cent, the same figure was 37 per cent for families with three or more children. Even among large families with many children, repeated borrowing is more typical of those with lower income. All in all, it can be stated that families raising several children are more at risk and more vulnerable from a financial perspective, and the social consequences of a potential default are also more severe in their case.

[5] Based on data from the Central Credit Information System, the L11 reporting and the anonymous micro-level income statistics reported by the National Tax and Customs Administration (NAV) annually.

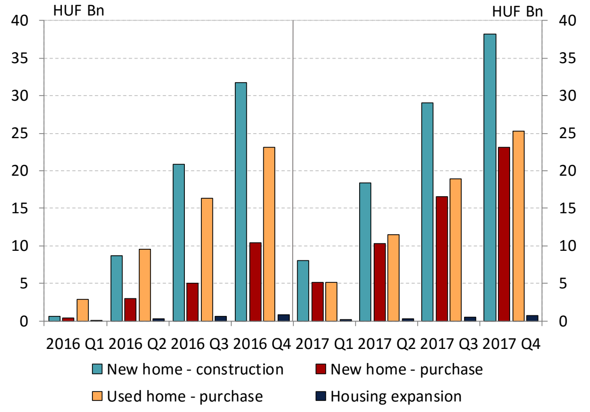
[6] Those taking out the consumer loan not long after taking out a housing loan, or those concluding a new loan contract after the termination of a consumer loan (or even before that).

Chart 19: Credit demand in the household lending segment



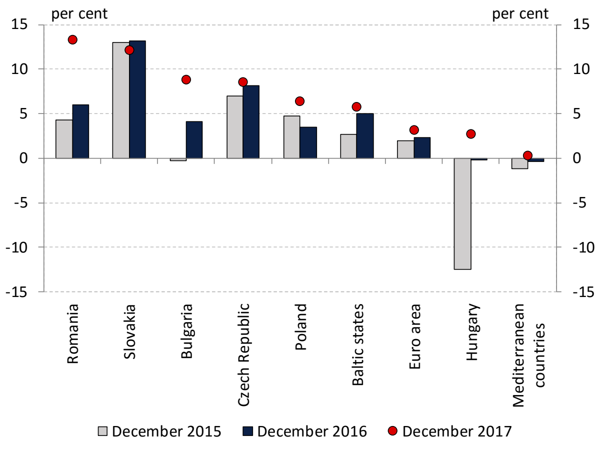
Note: Net ratio is the difference between banks reporting stronger and weaker demand, weighted by market share. Source: MNB, based on banks' responses

Chart 20: Cumulative volume of contracts in the Home Purchase Subsidy Scheme for Families by purpose



Source: Ministry for National Economy

Chart 21: Annual transaction-based change in 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

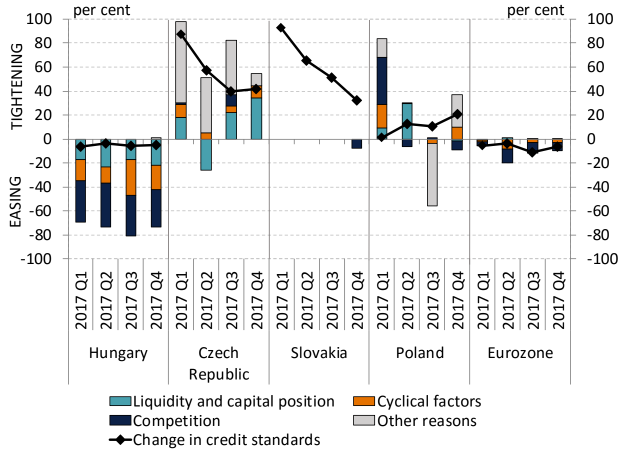
Banks anticipate strong demand for housing loans. In 2017 Q4, in the consumer loan segment, a narrower range of banks, i.e. a net 9 per cent, perceived a decrease in demand; however, 53 per cent of the banks in net terms expect a pick-up in demand for the next half year. Almost half of the banks participating in the Lending Survey perceived an increase in demand for housing loans, and all of them expect further demand growth in the first half of 2018 as well (Chart 19), hence this year as well the demand for housing loans is increased by the Home Purchase Subsidy Scheme for Families. Between October and December loan contracts related to the HPS were concluded at a value of HUF 29 billion, accounting for 16 per cent of the new housing loans extended during the quarter. Since the beginning of 2016, 49,000 subsidy contracts with a total value of HUF 153 billion have been concluded within the scheme. Households intended to spend two thirds of this amount on constructing or purchasing new homes, and one third on buying used homes (Chart 20).

International outlook in household lending

Lending to households expanded significantly in the region. The average annual growth rate in the euro area amounted to 3 per cent at the end of 2017 (Chart 21). Households' outstanding loans expanded in the Central and Eastern European region as well, to a larger extent in the Visegrád countries than in the euro area: Slovakia, the Czech Republic and Poland recorded annual growth rates of 12 per cent, 9 per cent and 6 per cent, respectively.

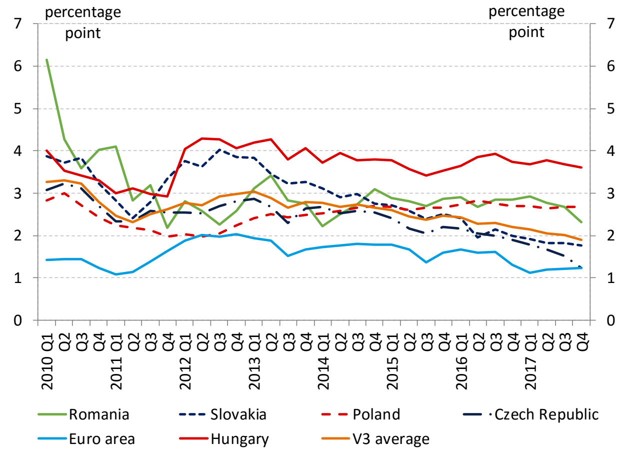
Housing credit conditions tightened in the region in 2017. The Bank Lending Survey of the European Central Bank revealed that euro area

Chart 22: 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 conditions, while negative ones indicate the easing thereof. Source: MNB, ECB, national central banks

Chart 23: 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 a 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 1-5 years over the 3-year IRS, in the case of a 5-10-year fixation over the 7-year IRS, in the case of a longer than 10-year fixation over the 10-year IRS, APR-based smoothed spread. Source: MNB, ECB, EMF, Datastream, national central banks

banks eased the conditions on housing loans in 2017 on a small scale. The respondent banks regard the intensification of competition as the primary factor giving rise to easing. Nevertheless, credit conditions tightened in the Visegrád countries in each quarter in 2017: in net terms, 21 per cent of the banks in Poland, 42 per cent in the Czech Republic and more than one-third of banks in Slovakia tightened their conditions during the fourth quarter (Chart 22), partly as a result of regulatory tightening.

Spreads on new housing loans continued to decline in an international comparison. At the end of the year, the average APR on newly granted housing loans in the euro area declined further slightly, and currently stands at 2.2 per cent. In the countries of the CEE region, the average APR on housing loans issued in domestic currency increased considerably only in Romania (by 0.8 percentage points). There was no major change in the average APR in the other countries. The spreads declined more than 30 basis points in Romania, but a large fall was also observed in the spreads on housing loans in the Czech Republic, at 28 basis points – the decrease in these countries can be partly attributed to the declining share of the floating-rate housing loans and the differences between the spreads on different interest rate fixation periods. The Visegrád countries registered an average decrease of 12 basis points, while in the euro area there was no substantial change in the spreads. Accordingly, partly due to the composition effects observable in the countries under review, the level of spreads in Hungary may still be deemed high by international standards, despite the decreasing trend seen in the previous periods: it exceeds the average of both the euro area by 2.4 percentage points and the Visegrád countries by 1.7 percentage points on average (Chart 23). The favourable trends characterizing the housing loan market, e.g. the run-up of Certified Consumer-Friendly Mortgage products can support the narrowing of the gap.

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: https://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 of 11 banks were involved in the interviews. 9 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 2017 Q4, the surveyed institutions accounted for 82 per cent of the banking sector in the case of outstanding housing loans and 90 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 89 per cent.

The survey consists of a standard questionnaire in each segment. The retrospective questions refer to 2017 Q4 (compared to 2017 Q3), whereas the forward-looking questions concern the next half-year period, i.e. covering 2018 H1 (relative to 2017 Q4). The current questionnaire was completed by the senior loan officers between 29 December 2017 and 17 January 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: https://www.mnb.hu/en/financial-stability/publications/lending-survey

3. *The Financial Conditions Index (FCI)*[7]

Numerous indicators and hence a substantial amount of information are available regarding the functioning, status, environment and performance of the system of financial intermediation. To condense the information relevant to the financial system and 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, known as 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.

[7] 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, comprising 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).[8] 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 on GDP of banks' willingness to lend. 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.

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

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