TRENDS IN LENDING

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(September 2019)

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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 particular, the key statistics examined in the analysis are the following:

- *The credit aggregates present quantitative developments in economic agents' outstanding loans based on the balance sheet statistics of the banking sector. Both the volume of new loans and net changes in the banking sector's outstanding loans (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 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

2019 Q2 was characterised by an exceptional, HUF 435 billion expansion in transactions, as a result of which outstanding corporate loans grew at an annual rate of 16 per cent. This growth was unprecedented since the global financial crisis. Outstanding loans increased by 13 per cent in the SME sector, with a contribution from disbursements of the Funding for Growth Scheme Fix as well, which was launched in January 2019. During the quarter, several exceptionally large transactions also played a key role in growth, which was broad-based in a breakdown by sectors and banks as well. The volume of new loans was similar to that of the previous quarter, but the share of longer-term contracts increased in the period under review. While as in the countries of the region, the average interest rate on low-amount loans rose slightly in Q2, interest rates on high-amount loans declined to some extent, primarily as a result of changes in spreads.

While credit conditions tightened somewhat in the euro area as a whole, there were no major overall changes in conditions in Hungary according to the findings of the latest Lending survey. At the same time, some respondents reported an easing in price conditions, while a few banks tightened conditions on commercial real estate loans. The ratio of credit institutions that considered market competition as a factor pointing to an easing of conditions was higher. According to most banks, demand for longer-term loans grew more strongly than for shorter-term loans. On the whole, responding credit institutions expect similar trends both on the demand and supply sides in the next half year as well.

The annual value of household loan transactions was close to HUF 500 billion, with a contribution of HUF 170 billion in 2019 Q2, and thus annual growth in these outstanding loans amounted to 8 per cent. Housing loan and personal loan disbursements rose further in the period under review (by 20 per cent and 36 per cent, respectively). In real terms, granting of housing loans is four-fifths of the 2008 level that directly preceded the crisis, but in the current credit cycle the debt cap rules reduce the risk of excessive indebtedness and also spur the reduction in households' exposure to interest rate risk.

Banks do not see any room for easing in credit supply conditions, while they expect a pick-up in demand in the case of housing loans and consumer loans. The support programmes launched in July 2019 within the framework of the Family Protection Action Plan also contribute to this. As noted by the banks, buoyant demand was seen in July for prenatal baby support, and for the time being clients whose credit rating is already good are taking advantage of this programme.

The spread of loans with longer interest rate fixation, even up to the end of the term, reduces the financial stability risks of the household loan portfolio. 27 per cent of the volume of housing loans granted in Q2 was fixed until maturity, one-fifth had a 5-year interest rate fixation and half of that were fixed for 10 years. Since its introduction in October 2018, the debt cap rule on the payment-to-income (PTI) ratio differentiated by interest rate fixation periods has encouraged households to take loans with longer interest rate fixation, contributing to an increase in the volume-based share of loans with interest rate fixation of at least 10 years, which rose from 20 per cent to 50 per cent in one year.

Overall, the MNB does not consider the current dynamics of credit expansion to be overheated in the segments in terms of structure or volume, taking into account developments in the real economy and the low level of credit penetration.

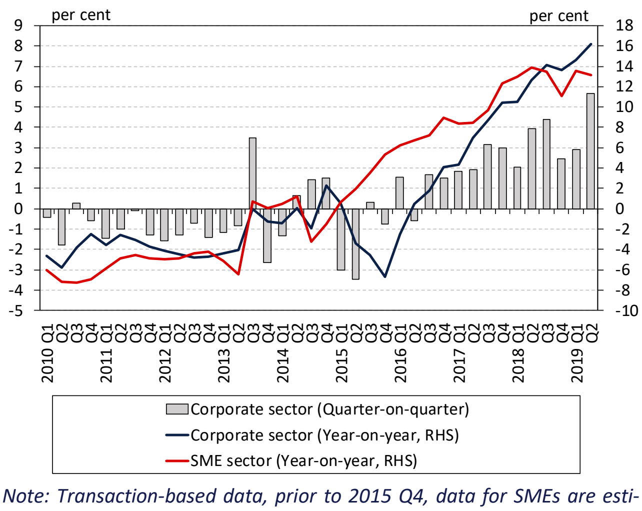
2. LENDING DEVELOPMENTS IN THE CORPORATE SEGMENT

As a result of transactions, outstanding loans increased sharply, rising by HUF 435 billion in Q2. Forint-denominated loans accounted for nearly 60 per cent of the growth, which was broad-based across banks and sectors, but several exceptionally large transactions also contributed to the expansion. Accordingly, in 2019 Q2 the annual growth rate of outstanding corporate loans amounted to 16 per cent, which is the highest value since the crisis and is exceptional in international comparison as well. Based on the preliminary data, expansion of 13 per cent was observed in the SME segment. The share of long-term loans increased considerably among new loans. Lending to SMEs is also supported by the Funding for Growth Scheme Fix, which was launched in January 2019; participating credit institutions concluded contracts with enterprises in an amount of some HUF 135 billion in the first six months of the scheme. While interest rates on low-amount loans rose slightly in the past quarter, interest rates on high-amount contracts declined; both changes are mainly attributable to the spreads.

According to the responses of the banks participating in the Lending Survey, there were no overall changes in lending conditions in the corporate segment in Q2. At the same time, some precautionary motives are already being seen in banks' behaviour in the case of commercial real estate loans. In net terms, 16 per cent tightened conditions in that segment, while around one quarter of them held out the prospect of tightening. The majority of banks reported that demand for longer-term loans had strengthened in the previous two quarters. Overall, credit institutions expect similar trends for the next half year as well. On the interviews conducted with credit institutions banks reported that price competition is still very intensive (which is also true for the contracts concluded under FGS Fix). Competition between banks is already the case for the medium-size and small enterprises categories as well, while there is less and less room for reducing margins.

Some euro area credit institutions tightened their lending conditions in the past quarter, primarily due to the uncertain economic prospects and increased risk aversion. The ECB decided to launch the third series of targeted longer-term refinancing operations (TLTRO III), as lending dynamics in the euro area are becoming increasingly fragile in the face of a worsening macroeconomic environment, declines in outstanding loans were observed in some Member States, and refinancing pressure is expected to build up at some euro area banks in the autumn.

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

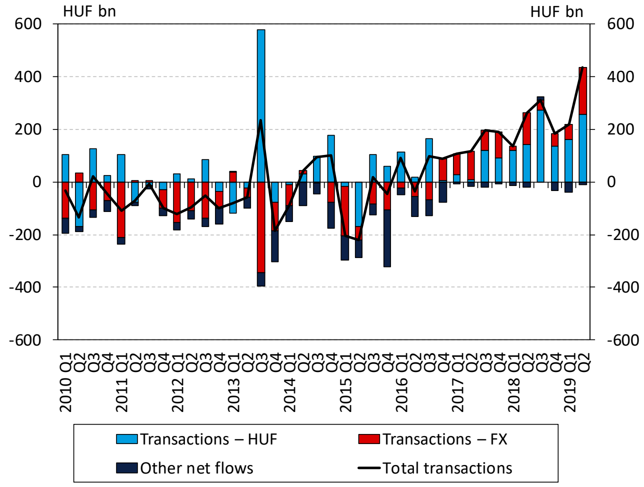


Note: Transaction-based data, prior to 2015 Q4, data for SMEs are estimated based on banking system data. Source: MNB

Domestic corporate lending

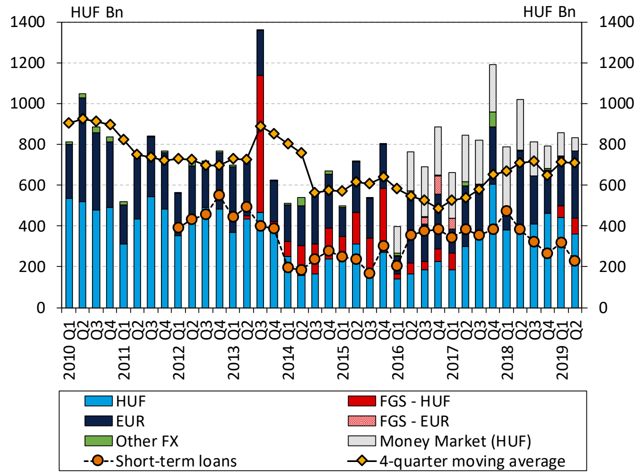
Corporate lending expanded by 16 per cent in one year. Over the past four quarters, the outstanding loans of non-financial corporations rose by HUF 1,151 billion based on the transactions, corresponding to annual growth of 16 per cent (Chart 1). This dynamic expansion is mostly attributable to forint loans, which increased by 21 per cent year-on-year, while outstanding FX loans rose by 10 per cent. In addition to the broad-based expansion both in terms of sectors and banks, several exceptionally high-amount transactions also contributed to the rise in lending, which was unprecedented since the crisis. Both large corporations and SMEs dynamically increased their outstanding loans, and according to preliminary data, the SME sector's outstanding loans grew by around 13

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 institutions sector



Source: MNB

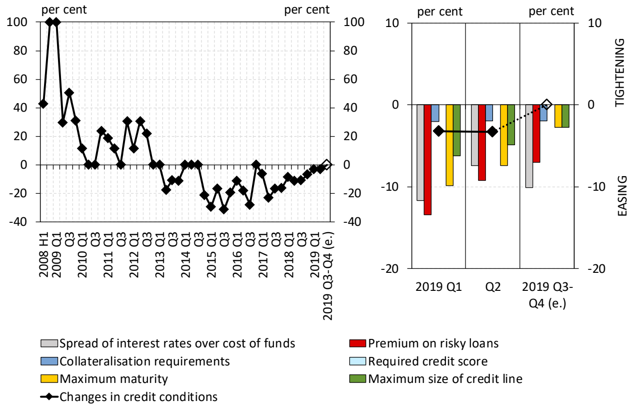
per cent. In 2018, SME lending was also still supported by the central bank's Market-Based Lending Scheme (MLS), while from 2019 the Funding for Growth Scheme *Fix (FGS fix)* is playing a role, which aims at increasing the ratio of long-term, fixed-rate loans.

An exceptionally high level of borrowing was observed in Q2. As a result of disbursements and repayments, credit institutions' outstanding loans expanded by HUF 435 billion in 2019 Q2 (Chart 2), of which forint loans and FX loans amounted to HUF 256 billion and HUF 179 billion, respectively. Long-term loans (with initial maturity exceeding one year) accounted for most of the growth both in the case of forint and FX loans, in line with the remarkable intensity of corporate investment activity. In some sectors, one-off, high-amount transactions also played a role in the significant expansion. The outstanding loans of the financial and insurance sector[1] increased by HUF 158 billion as a result of transactions in the past quarter. The outstanding loans of the electricity, gas, steam and air-conditioning supply sector were up by HUF 47 billion, while those of construction rose by HUF 58 billion during the quarter. Overall in Q2 2019, total outstanding loans in the commercial real estate sector reached 60 per cent – without exchange rate adjustment – of the HUF 1,670 billion registered at the end of 2010. The intensive investment activities of property funds also contribute to the less dynamic loan expansion in the commercial real estate sector, while outstanding loans on purchased properties are paid back in most cases.

In 2019 Q2, the volume of loan contracts concluded by companies corresponded to that of the previous quarter. Net of money market transactions, credit institutions concluded new contracts totalling HUF 769 billion with non-financial corporations in Q2. The value of new issues remained practically unchanged compared to the previous quarters and was slightly lower compared to the volume in the same prior-year quarter (Chart 3). Looking at the initial maturities of loan contracts, the ratio of long-term loans within new loans has increased considerably in the recent quarters. The FGS *fix* launched in 2019 also contributed to

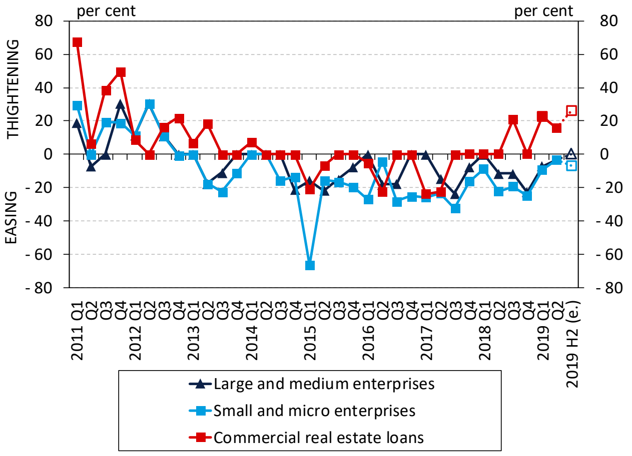
[1] The sector is a subset of the non-financial corporations sector, and it typically comprises holding companies.

Chart 4: Changes in credit conditions in the corporate segment



Note: Net percentage 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 sub-segments



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

this, and it may also be attributable to the buoyant investment activity, the development of commercial and residential properties as well as the expansion in loans to finance acquisitions. In 2019 H1, credit institutions concluded contracts with enterprises in the amount of around HUF 135 billion under FGS *fix*.[2]

Credit conditions in the corporate segment remained practically unchanged in 2019 Q2 as well. In net terms, a mere 3 per cent of the participating credit institutions reported an easing of conditions in the latest Lending Survey, while the vast majority of the banks left conditions broadly unchanged (Chart 4). Nevertheless, some of the respondents mentioned an easing of price conditions: a net one fifth of the institutions reported a decline in the fees charged for granting loans, and in net terms nearly one tenth of them reported lower premia on riskier loans. Banks also confirmed the case of intensive price competition on the yearly lending interviews (Box 1). Thus, while most of the credit institutions did not change conditions, a net 40 per cent of the respondents still considered market competition as a factor pointing to an easing of conditions. Responding credit institutions do not expect a change in conditions in the next half year.

Conditions on commercial real estate loans became tighter. While no major changes were observed in the lending conditions for large and medium-sized or small and micro enterprises in Q2, conditions on commercial real estate loans tightened according to a net 16 per cent of the responding credit institutions. Logistics centres are an exception to the above, for which the standards remained unchanged (Chart 5). One quarter of the banks in net terms reports the tightening of conditions in the commercial real estate segment in the next half year, since according to the majority of credit institutions (65 per cent in net terms) there is a risk of a build-up of a real estate market price bubble.

[2] The volume is net of the loans issued by financial enterprises and loans acquired by sole proprietors.

BOX 1: 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 2019, interviews were conducted with senior loan officers at 12 banks and financial enterprises. Eight and nine financial institutions shared their experiences concerning the developments in corporate and household lending segments.

Corporate lending

All of the banks participating in the interviews reported that they managed to fulfil or exceed their respective plans for H1, and they also formulated similarly positive expectations for H2. Banks are optimistic looking ahead to next year as well, although they expect the robust lending dynamics experienced in the previous years to decline.

As before, competition among banks is still intensive, client acquisition is an increasing challenge, and banks are typically made to compete already in the smaller corporate size categories as well. With the low ratio of declined loan applications, banks do not see unsatisfied financing needs in the market; they typically give offers to all well-established loan requests. In their opinion, also as a result of conscious demand, price competition continues to be intensive, and the room available for margin reductions is dwindling. According to several credit institutions' experiences, some of the loans are granted with such low interest rate that it exceeds the risk costs and other related costs only together with incomes from cross sales. In addition to that, they are able to meet their plans concerning the nominal interest income by increasing the volume of lending. In the case of preferred clients, they also strive to give more competitive offers by easing the collateral requirements, providing more flexible customer service as well as developing internal processes. With an extremely low ratio of defaults, the quality of the newly granted loan portfolio continues to be excellent, and the payment record is expressly good according to banks.

Banks are satisfied with the cooperation with guarantee organisations. In their new contracts they typically apply a guarantee if, in the case of creditworthy companies, sufficient collateral is not available for implementing the transaction. Institutional guarantees may only slightly facilitate banks' opening towards the riskier segment as credit institutions are conservative, and they consider portfolio quality as a primary aspect.

Banks welcomed the launch of the FGS *fix* and the related opportunity of preferential depositing. As a result of the strong price competition, participating banks can attain the maximum 2.5 per cent interest rate ceiling only in the case of smaller corporations, while lending to larger clients takes place at a much lower interest rate. Although most of the companies presumably compare the costs of fixed and variable rates, due to clients' price sensitivity only few fixed transactions other than FGS transactions – or other refinanced products – are implemented.

There is considerable interest in the Bond Funding for Growth Scheme, primarily among larger corporations. Until now, banks had not experienced any wait-and-see attitude or postponed borrowing because of the scheme. They expect it to be a considerable additional element of capital increase, and it will be a substitute for borrowing only to a lesser degree. According to the majority of banks, the advantage of the scheme is that market participants may learn about the process of bond-based fund raising.

Responding credit institutions treat the topic of the generational change as a priority; they strive to call their clients' attention to the resulting risks and the possibilities of preparing. The age of the owner/head is typically included in banks' rating systems. On occasion they finance acquisitions (typically when the buyer or the company intended to be acquired is their client), and in certain cases they facilitate the transfer of the corporation with advisory services.

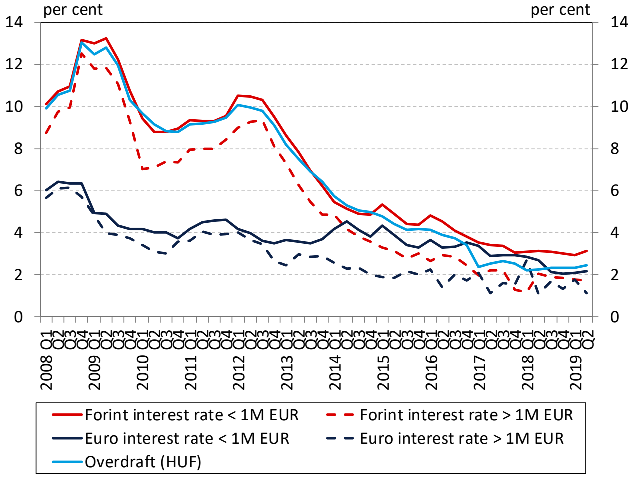
Several banks treat the subject of 'green energy' as a priority area and are consciously pursuing business in that direction. Some of them are active in the financing of solar panel systems, although for the time being they do not see any significant market need for other 'green products'. Green financing is mostly typical connected to financing energy efficient housing renovations, construction projects and certain types of leasing transactions.

Commercial real estate lending

Banks currently perceive intensive competition in the financing of commercial real estates as well. Participants report similar preferences by property types: the majority prefers the best-quality offices and industrial logistics properties, while the actors are divided concerning the funding of residential buildings and hotels. Increased prudence is observed in the market, and more emphasis is put on the levels of debt indicators and pre-emptive right for rent/sales as well as the analysis of risk scenarios. The risks of FX project loans identified by the MNB as well may be present in the case of each segment to different degrees; the related risks are typically lower in the office and logistics real estate segments.

In banks' opinion, the office market has reached its mature phase, and delays in construction are considered to be one of the main risk factors, which may be caused by the shortage of labour and increases in raw material prices. Banks attempt to handle this by financing projects of sponsors that have strong financial backgrounds. In the case of new projects, they mentioned the examination of market demand, the supply of competitors as well as the tenant composition of the given real estate and the cautiously chosen financing ratio as important factors.

Chart 6: Interest rates on new corporate loans



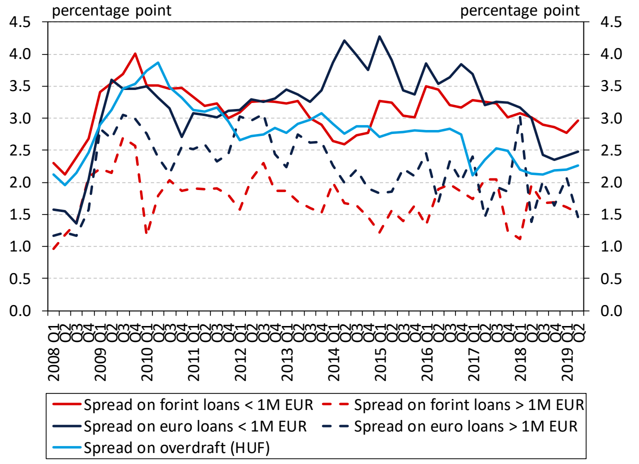
Note: Loans with variable interest rates or with up to 1-year initial rate fixation. From 2015, based on data net of money market loans exceeding EUR 1 million. Source: MNB

The financing costs of small-amount loans increased slightly. Net of money market transactions,[3] the average interest rate level on forint loans below EUR 1 million[4] rose by 0.2 percentage points in Q2 and thus amounted to 3.1 per cent in 2019 Q2 (Chart 6). Although to a lesser degree, the interest rate level on overdraft facilities also rose by roughly 0.1 percentage point, reaching 2.4 per cent. The interest rate on small-amount euro loans increased 5 basis points to 2.2 per cent in the past quarter. The rise in interest rates in the case of all three product types is explained by an increase in spreads (Chart 7).

[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.

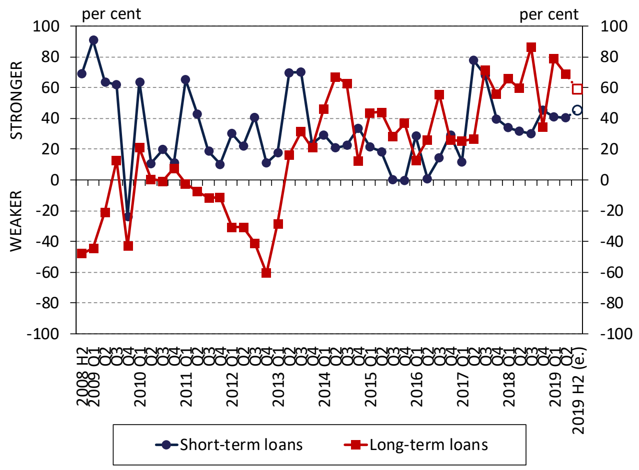
[4] In the case of new contracts, we examined variable-rate loans or loans with interest rate fixation up to one year.

Chart 7: Interest rate spreads on new corporate loans



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

Chart 8: Changes in credit demand by maturity

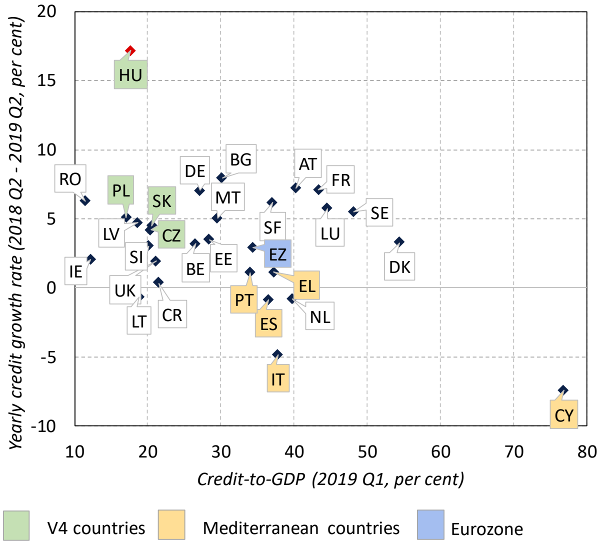


Note: Net percentage of respondent banks indicating stronger/weaker demands, weighted by market share. Source: MNB, based on banks' responses

In contrast to low-amount loans, the interest rate on high-amount loan contracts declined. The average interest rate on high-amount forint loans decreased by 4 basis points to 1.7 per cent. The average interest rate on high-amount euro loans declined to a greater degree, falling by 0.6 percentage points to 1.1 per cent. One-off, high-volume items also played a role in the changes in interest rate levels in the case of both currencies. Similarly to low-amount loans, the changes in interest rates are mainly attributable to changes in spreads in case of both forint and euro loans.

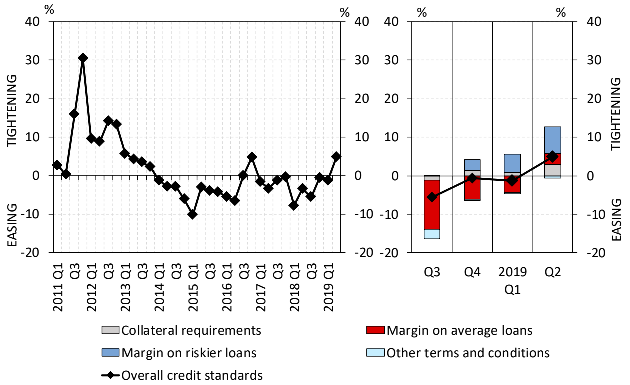
Demand for long-term loans increased. According to the findings of the latest Lending Survey, in net terms, 70 per cent of the participating banks experienced increasing demand for long-term loans in Q2, while 40 per cent of them reported mounting interest in short-term loans (Chart 8). Banks mostly experienced increasing activity in forint lending, with nearly net 70 per cent of them reporting this. The FGS *fix* launched in early 2019 may have played a role in the above trend. In net terms, nearly 70 per cent of banks also stated that clients' investments in tangible assets had contributed to the rise in the demand for loans. Fewer credit institutions in net terms expect an expansion in demand for long-term loans in the next half year.

Chart 9: Annual growth rate of corporate loans and the credit-to-GDP ratio



Sources: ECB, MNB

Chart 10: Changes in the conditions on corporate loans and the factors resulting in the changes in the euro area



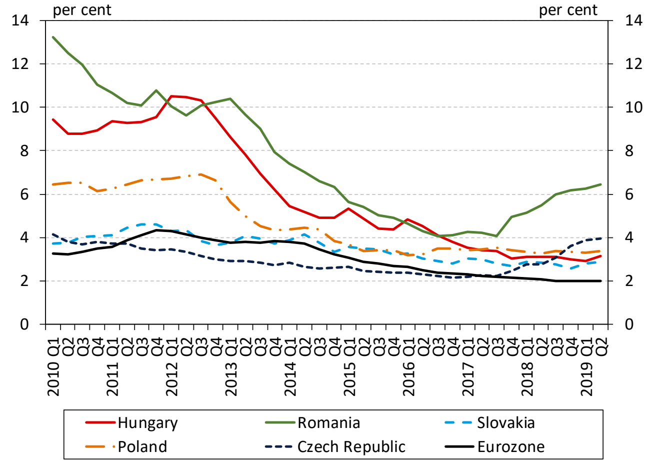
Note: 'Other terms and conditions' contain non-interest fees, the size of the loan, the covenants and the maturity. Positive values indicate the tightening of conditions, while negative ones indicate the easing thereof. 'Credit conditions' show the general developments in the conditions of access to loans, while the individual partial conditions depict the changes in the conditions on loans already taken. Source: ECB

International outlook in corporate lending

The growth rate of corporate lending in Hungary is outstanding within the European Union. Calculated as a result of transactions, the annual expansion in outstanding corporate loans exceeded the average of the euro area in each country of the region in 2019 Q2 (Chart 9). While an expansion of more than 2 per cent in outstanding loans is observed in the euro area as a whole, the stock of corporate loans is still decreasing in the Mediterranean countries, mainly in Cyprus and Italy in 2019 Q2. The TLTRO III instrument announced by the ECB in March may be the most beneficial in those Member States, which are facing a decline in loan stock (Box 2.). While the credit-to-GDP ratio in Hungary rose by nearly 0.9 percentage point by the end of 2019 Q1 compared to the same period of the previous year as a result of a remarkable rise in outstanding loans in parallel with strong GDP growth, the corresponding ratio declined in Slovakia and the Czech Republic, as the nominal growth in gross domestic product exceeded that of outstanding loans.

Lending conditions tightened in the eurozone. While lending conditions remained almost unchanged in the Czech Republic and Hungary in Q2, they were eased in Slovakia and were tightened in Poland, mainly due to higher market financing costs. On the whole, the euro area also moved towards some moderate tightening, as a result of which, in the opinion of the ECB, the easing cycle that had started in 2014 was interrupted. Mainly due to the uncertainty related to economic prospects and as a result of elevated risk aversion, tightening took place in some larger euro area Member States – to a greater degree in Italy and France and to a lesser extent in Germany (Chart 10).

Chart 11: International comparison of interest rates 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. Sources: MNB, ECB, national central banks

Average interest rates rose in the region. In 2019 Q2, the average interest rate on loans with an amount of less than EUR 1 million, extended in domestic currency with a maximum 1-year interest rate period increased by 0.2 percentage point in Hungary and Romania, by 0.1 percentage point in Slovakia and the Czech Republic and by 5 basis points in Poland (Chart 11). Except for the Czech Republic, the rise in the interest rate entailed an increase in interest rate spreads in all of the countries in the region. Nevertheless, short-term interbank rates, which serve as reference rates in calculating the spread, increased in all the countries of the region, and in the Czech Republic the extent of this rise even offset the slight decline in spreads. In Romania, in addition to the increase in the spread, as a result of inflation, which was high in regional terms and an increase in the risks affecting the economy, the 3-month ROBOR increased by a factor of five, rising from 0.6 per cent to 3.1 per cent in the past two years, and this also contributed to the average interest rate on corporate loans, which was high in a regional comparison. The gradual rise in the Czech reference rate is explained by mounting inflationary pressure and interest rate hike expectations. Meanwhile, the average level of interest rates and interest rate spreads on contracts remained unchanged in the euro area.

BOX 2: Expected use of the TLTRO III instrument of the European Central Bank

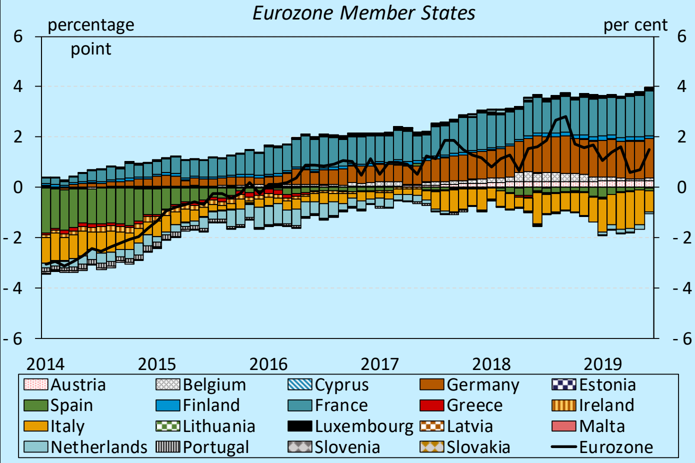
The European Central Bank (ECB) announced the third stage of the targeted longer-term refinancing operations (TLTRO) in March 2019 and the details were disclosed following the June meeting of the Governing Council. As in the previous stages, the interest rate on TLTRO III funds is calculated based on the difference between the given bank's loan dynamics and its lending reference value. A bank may receive the maximum interest rate reduction if it exceeds its benchmark net lending by 2.5 per cent as at 31 March 2021. In this case, the interest rate is 10 basis points above the average interest rate on the deposit facility prevailing during the term of the loan (currently -0.4 per cent). In the case of a lower performance the size of the decrease in the interest rate will be graduated linearly. The ECB will hold quarterly auctions (seven in total) between September 2019 and March 2021; the maturity of the loans is two years. Counterparties are entitled to borrow up to a total of 30 per cent of the stock of eligible loans as at 28 February 2019, reduced by any amount that they previously borrowed under TLTRO II that is still outstanding.

Euro area banks borrowed some EUR 720 billion in the first two stages of the TLTRO, which thus became an important element of the ECB's complex set of unconventional instruments. Upon closing the programme, the ECB considered its application successful, as in the most vulnerable countries the decline in participating banks' outstanding loans slowed down considerably, while in the less vulnerable Member States the expansion in outstanding loans accelerated significantly in the case of credit institutions applying for TLTRO financing.

According to the justification, TLTRO III was introduced in order to preserve favourable lending conditions. The TLTRO II loans maturing within a year cannot be used as collateral in banks' liquidity management any longer,[5] and thus in order to maintain the level of the liquidity indicators, some banks may be exposed to refinancing pressure as they would have to acquire the missing TLTRO financing on the market at a higher cost. All of this, in turn, could result in a decline in lending activity, strengthening the factors that weaken the demand side of lending (e.g. the weakening industrial production data and business confidence indices in the euro area).

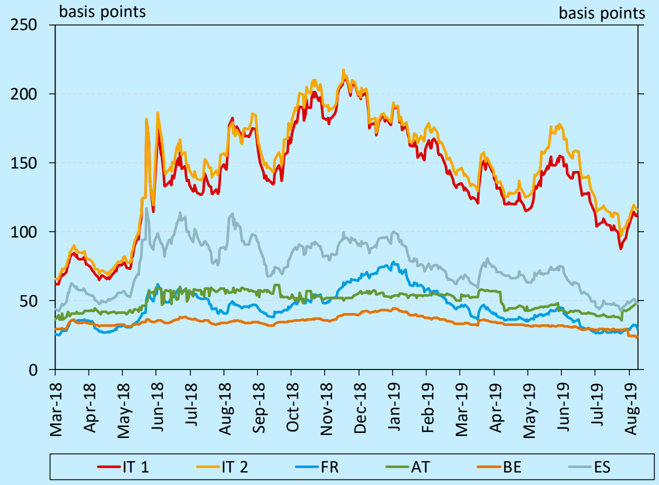
The launch of TLTRO III points to monetary easing. This is corroborated by the ECB's communication in recent months, as due to the increase in global uncertainties and the negative risks related to the economic prospects of the euro area as well as the lower inflation path and expectations, the ECB seems to be open even to reducing further the policy rate and the rate of the deposit facility. Based on the announced details, the TLTRO III is more intended to be a safety net type of instrument, as its conditions of use are less flexible. Compared to previous schemes, its pricing is less generous as the ECB does not intend to direct market participants towards the TLTRO that otherwise may have access to market funds at a favourable price. Nevertheless, this pricing continues to be very advantageous for banks in the more vulnerable Member States. It narrows the scope of potential borrowers that credit institutions cannot extend the maturity, if they early repay the loan and draw it down again. Moreover, the amount that credit institutions can borrow in each of the seven planned operations will be limited to 10 per cent of their stock of eligible loans, which portends that banks may prefer to draw several smaller amounts.

Credit growth rate in the NFC sector and contributions of the Eurozone Member States



Note: Based on transactions *Source: ECB*

CDS spread on selected banks' five-year senior debt



Source: S&P.

It is mostly Italian and Spanish banks[6] that may be involved in TLTRO III, as in the first two stages of the instrument they received most of the TLTRO funds, and thus they have the highest refinancing requirement. The conditions may be especially attractive for Italian financial institutions, as their fund raising is significantly more expensive compared to financial institutions operating in the core countries. Moreover, CDS spreads on the two largest Italian banks have been rising again since the end of July. All of this makes obtaining funds, and ultimately lending, much more expensive, increasing the vulnerability of the Italian economy. Italian corporate outstanding loans have been declining at an accelerating pace again since the summer of 2017, and thus TLTRO III may help to reduce the rate of decline.

[5] When calculating the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR), the TLTRO II operations can be taken into account at 100 per cent. However, their weight falls to 50 per cent in the case of a maturity that is shorter than 1 year but longer than 6 months, and to 0 per cent for maturities shorter than 6 months.

[6] As Moody's estimates, financing from TLTRO operations amounts to 6 per cent of all assets of the Spanish and Italian banking sectors.

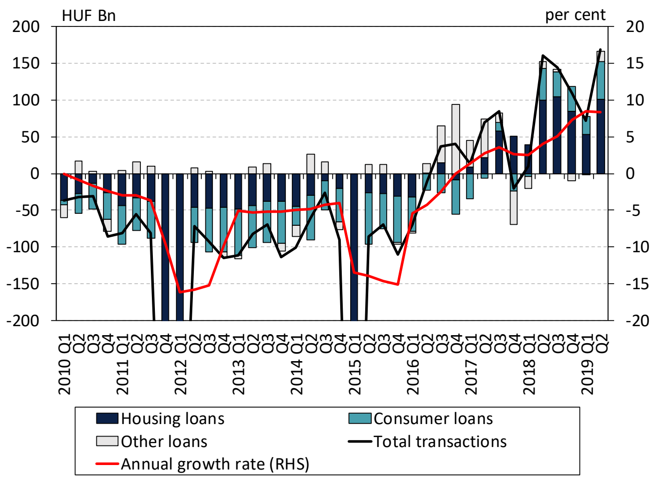
3. LENDING DEVELOPMENTS IN THE HOUSEHOLD SEGMENT

In 2019 Q2, outstanding household loans increased by HUF 170 billion, and thus the annual growth rate of the stock of loans amounted to 8.4 per cent. In the past one year, the value of new housing loan contracts was 20 per cent higher, while that of personal loans was 36 per cent higher than in the previous one-year period. In real terms, the granting of housing loans is at roughly four fifths of the 2008 level, but in the current credit cycle the debt cap rules reduce the risk of excessive indebtedness, and also encourage the reduction of the exposure to the interest rate risk. In spite of the wait-and-see attitude related to the prenatal baby support launched in July within the framework of the Family Protection Action Plan the volume of new loans did not decline, while the number of contracts for used homes decreased. Personal loans are still alternatives to the housing loans for lower-amount housing purposes as a result of the decline in lending rates and an increase in contract amounts.

Based on the findings of the Lending Survey, banks do not see any further room for easing credit conditions. The amendment to the debt cap rules effective from 1 July 2019 will not result in major changes in credit standards in H2 according to the overwhelming majority of the responding institutions. Banks expect a rise in demand, with a contribution from the government's support programmes. As noted by banks, buoyant demand for the prenatal baby support was seen in July, and for the time being clients whose credit rating is already good are making use of this option.

27 per cent of the volume of housing loans disbursed in Q2 has fixed interest rates for the entire maturity – these loans are completely free of interest rate risk. The rest of new housing loans has an interest rate period of 5 or 10 years. Products with longer interest rate fixation are gaining ground: the share of loans with an interest rate fixation for 10 years doubled during the one year preceding June.

Chart 12: Quarterly transactions of the household loan portfolio by loan purpose

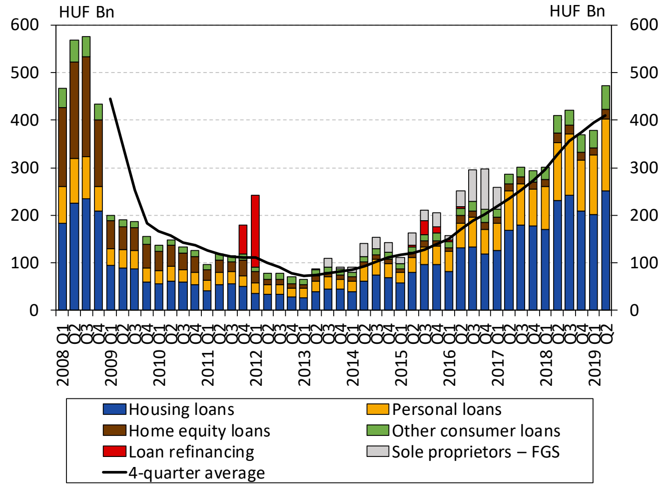


Note: The transactions contain the effect of the settlement. Source: MNB

Domestic household lending

Household loans outstanding expanded by 8.4 per cent in the past one year. In 2019 Q2, credit institutions' household loans outstanding increased by nearly HUF 170 billion as a result of transactions (Chart 12). Two thirds, i.e. HUF 101 billion, of the expansion in the stock was attributable to housing loans, while consumer loans grew by HUF 51 billion. Rearrangement is seen in consumer loans, as the net repayment of home equity loans is accompanied by an increasing expansion in personal loans. There was a modest increase of HUF 14 billion in other loans outstanding as a result of transactions in Q2. As a result of disbursements and repayments, the stock expanded by HUF 496 billion year on year, corresponding to an annual growth rate of 8.4 per cent.

Chart 13: New household loans in the credit institutions sector



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

Table 1: Number of contracts and average loan volume of new housing and consumer loans

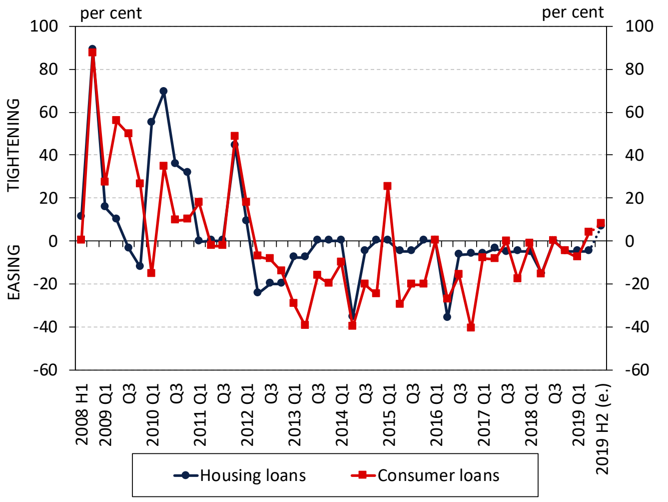
		H1 2018	H1 2019	% change
Number of contracts (thousand)	Housing loans: purchases of used homes	35.1	33.2	-5.5
	Housing loans: renovation and other	9.3	7.9	-15.2
	Housing loans: construction and purchase of new homes	6.3	8.0	27.2
	Personal loans	140.0	155.5	11.1
Average loan amount (HUF million)	Housing loans: purchases of used homes	8.3	9.6	14.9
	Housing loans: renovation and other	3.8	4.0	5.3
	Housing loans: construction and purchase of new homes	10.3	12.1	17.3
	Personal loans	1.5	1.8	15.3

Source: MNB

The buoyant housing market also supports the granting of new loans. In Q2, the credit institutions sector concluded new loan contracts with households in a value of HUF 472 billion (corresponding to 26-per cent growth year-on-year, Chart 13). The granting of housing loans (HUF 252 billion) and personal loans (HUF 152 billion) continues to prevail: while the issue of the former product rose by 20 per cent, annual average expansion of 36 per cent was observed in the case of new personal loans. As a result of housing market developments (strong demand, tight supply), even in spite of the postponements related to the prenatal baby support introduced in July, the volume of lending did not drop in Q2. In the past 12 months, banks granted housing loans in a total value of HUF 904 billion. Although this exceeds the pre-crisis level in nominal terms, in real terms it only amounts to roughly four fifths of the pre-crisis level. Moreover, as a result of the prevailing debt cap rules, borrowing by households will take place with a decline in the risk of excessive indebtedness, with decreasing exposure to the interest rate risk.

The average amount of loan rose in the case of all loan purposes. In 2019 H1, the number of housing loan contracts was 3 per cent below the level observed one year earlier. However, this modest decline masks the differences in terms of specific loan purposes: the number of loan contracts for the purpose of purchasing or building new homes increased by 27 per cent, while the number of contracts for used homes and renovation fell by 6 per cent and 15 per cent, respectively (Table 1). The drop in the number of contracts for the purpose of buying used homes can also be explained by the postponements related to the prenatal baby support, which was also mentioned by banks in the series of interviews surveying the developments in lending (Box 3). The fall in the number of contracts for renovation and other housing purposes is related to the favourable conditions on personal loans. The average loan amount rose in the case of housing loans as well, increasing to HUF 9.6 million on average in the case of used homes and to HUF 12.1 million on average in the case of building or purchasing new homes by June 2019. These developments reflect the price increase observed in the housing market.

Chart 14: Changes in credit conditions in the household segment



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

The role of personal loans continued to grow. The number of personal loan contracts concluded in H1 exceeded the level of the same period of 2018 by 11 per cent (Table 1). As a result of favourable pricing conditions, rapid credit appraisal, the spread of online loan applications and an increase in the loan amount that can be applied for, unsecured consumer loans are exerting a crowding-out effect in the market of low-amount housing loans and home equity loans. In 2019 Q2, the share of personal loans within all new loans amounted to 30 per cent, corresponding to a 6-percentage point rise over the past three years. The average amount of loans in this product was HUF 1.8 million in H1, reflecting an increase of 15 per cent in year-on-year terms.

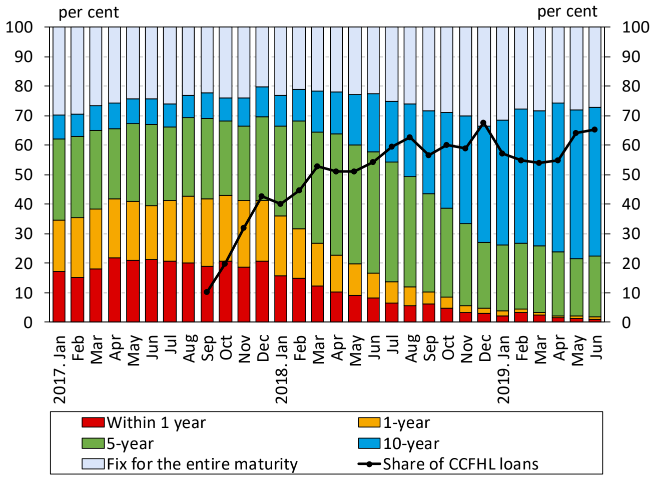
Banks do not see any room for further easing. In 2019 Q2, in net terms, 5 per cent of the banks participating in the Lending Survey eased the conditions on housing loans further (Chart 14), which, in terms of the partial conditions, primarily affected the spreads. Responding institutions indicated their favourable liquidity situation and housing market developments as factors supporting easing. Looking ahead to the next half year, however, 7 per cent of respondents in net terms envisaged tightening, which may primarily be reflected in the payment-to-income ratio, in line with the PTI amendment introduced by the MNB on 1 July 2019 (Table 2). Banks did not make any major changes in conditions on consumer loans in Q2. By contrast, half of the banks eased credit conditions on motor vehicle financing. In H2, in net terms, 8 per cent of them plan to tighten the standards of consumer loans due to a decline in risk tolerance.

Table 2: PTI rules for HUF-denominated mortgage loans with maturities over 5 years

	Interest rate fixation period		
	Floating or fixed for less than 5 years	At least 5 years, but less than 10 years	At least 10 years or fixed for the whole term
Limits set for loans from **1 October 2018**			
Income below **HUF 400 000**	**25%**	**35%**	**50%**
Income at least **HUF 400 000**	**30%**	**40%**	**60%**
Limits set for loans from **1 July 2019**			
Income below **HUF 500 000**	**25%**	**35%**	**50%**
Income at least **HUF 500 000**	**30%**	**40%**	**60%**

Note: PTI limits for loans denominated in other currencies have also been modified. Source: MNB

Chart 15: Distribution of the new housing loan volume by interest rate fixation, and the share of Certified Consumer-friendly Housing Loan products



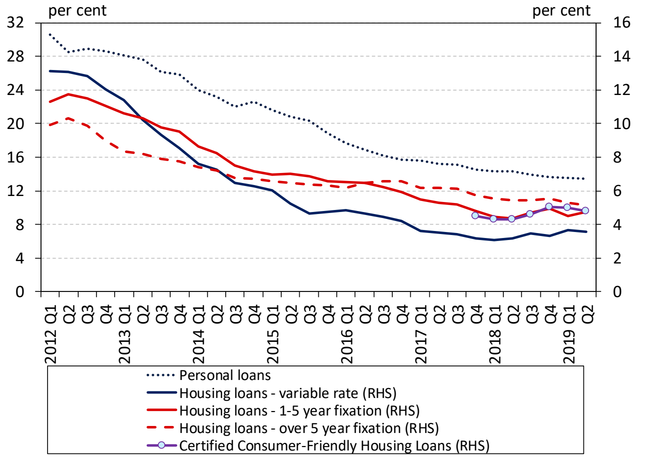
Note: Share of CCHL products compared to new issues with at least 3 years of interest rate fixation (at least 5 years since Q4 2018) excluding disbursements by building societies. Source: MNB

Housing loans with fixed interest rate for the entire maturity reduce the interest rate risk. Loans with a fixed interest rate for the entire term also contributed to the decline in households' aggregate interest rate risk. The volume of these housing loans accounted for 27 per cent of total issue in Q2, in line with the ratios seen in previous years. On the basis of contract number, the share of housing loans with fixed interest rates until maturity was between 40 and 50 per cent in H1, amounting to 46 per cent in June, i.e. almost half of the new contracts are completely free of interest rate risk. At the same time, the share of loans with interest rates variable within a year, whose repricing is the fastest, is increasingly marginal within the loans whose interest rate is not fixed until maturity; in June it amounted to a mere 3 per cent of new loans.

Prudent indebtedness of households is supported by the amendments to both the debt cap rules and the CCHL framework. As of 1 October 2018, the debt cap rule for the payment-to-income (PTI) ratio[7] was tightened in the case of mortgage loans with an interest rate period shorter than 10 years, and as of 1 July 2019 the debt cap rule allows the undertaking of a higher ratio of instalments above a monthly net income of HUF 500,000 instead of HUF 400,000 (Table 2). In addition, starting from 1 October 2018 loans with a 3-year interest rate period were taken out from the scope of Certified Consumer-friendly Housing Loan (CCHL) products. However, simultaneously with that, credit institutions were allowed to start the distribution of CCHL products with interest rates fixed for 15 years.

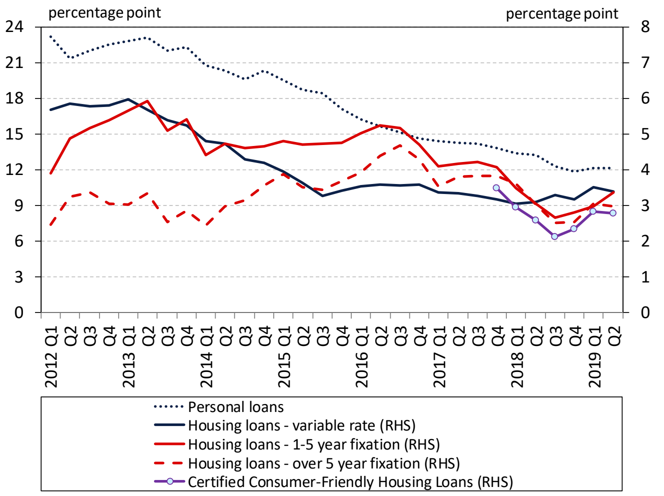
[7] Upon entry into force of the instrument on 1 January 2015, in the case of new forint loans taken after 1 January 2015, the payment-to-income ratio was not allowed to exceed 50 per cent, and in the case of customers with high income (net income of HUF 400,000 or higher) it could not exceed 60 per cent. Stricter PTI limits were established in the case of new loans taken in euro or other foreign currencies: 25 per cent and 10 per cent, respectively, or 30 per cent and 15 per cent in the case of clients with high income.

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

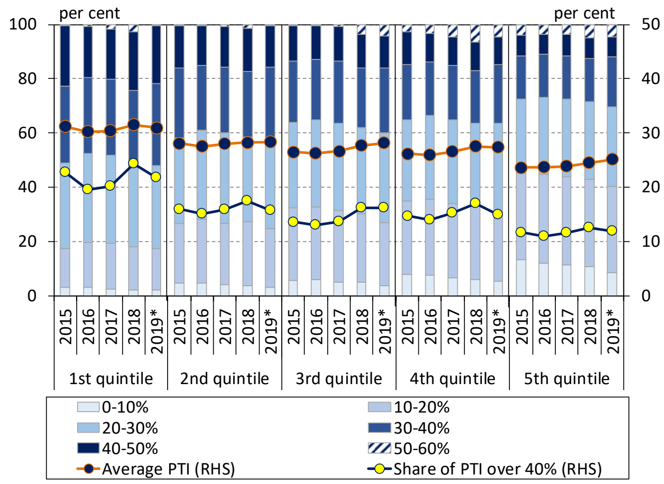


Note: In the case of variable-rate housing loans or ones with up to 1-year rate fixation the 3-month BUBOR, while in the case of housing loans fixed for a period longer than one year, the APR-based smoothed spread over the corresponding IRS. For personal loans, APR-based smoothed spread over the 3-month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

Interest rate periods also became longer. Within housing loans which interest rates are not fixed for the entire maturity, variable rate loans or loans with an interest rate fixation below 1 year practically disappeared from new loans, and almost exclusively loans with interest rate fixation of exactly 5 or 10 years are the typical products (Chart 15). However, while the ratio of loans with interest rate fixation for 5 years already declined to 20 per cent in June from the 41 per cent observed one year earlier, the ratio of loans with interest rate fixation for 10 years increased from 20 per cent to 50 per cent in the last one year. In Q2, 62 per cent of the housing loan contracts with initial rate fixation of at least 5 years were Certified Consumer-friendly Housing Loans.

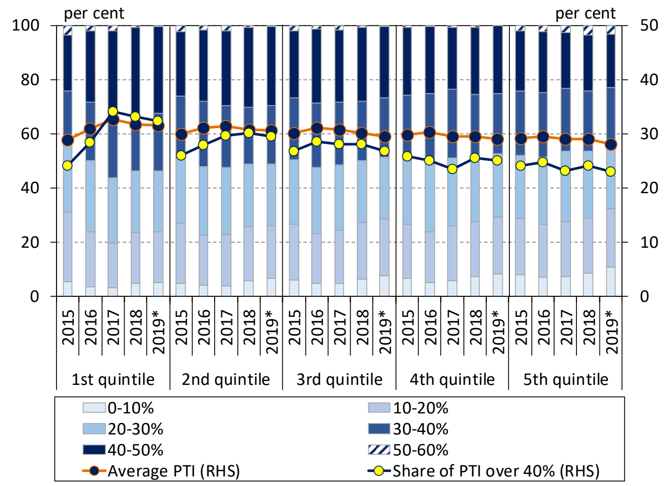
Spreads on CCHL products and housing loans fixed for a longer period are the lowest. In parallel with a decline in the longer-term costs of funds (relevant IRSs), compared to the previous quarter a slight decrease in interest rates was observed in the case of products with an interest rate period of longer than 5 years and CCHL products (-0.2 percentage point) (Chart 16). At the same time, a very small interest rate rise was seen on a quarterly basis in the case of housing loans fixed for maximum 5 years (+0.2 percentage point). In the past quarters, interest rates – which did not completely follow the decline in the costs of funds – resulted in a slight increase in spreads or stagnation in the case of newly granted housing loans. In Q2 this year, the spread on CCHL products and on housing loans with an interest rate period over 5 years was around 3 percentage points, falling short of the spread on products fixed from maximum 5 years (Chart 17). In the past quarters, the spread on personal loans was stagnant around 12 percentage points, which is the most favourable level in recent years.

Chart 18: PTI distribution of newly disbursed housing loans by income quintiles



*Note: Distribution by contract number. Without taking into account the effect of the 85 per cent rate for the instalment of mortgage loans with an interest rate fixed for at least 5 years. Income quintiles were determined according to borrowers' income distribution. * 2019 data pertains to the first half of the year. Source: MNB*

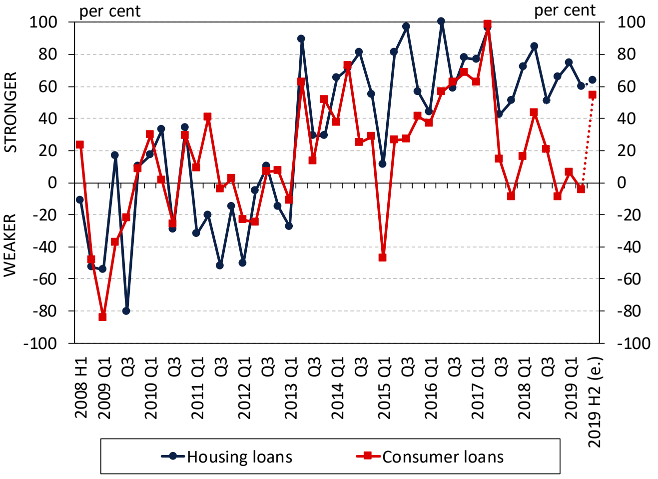
Chart 19: PTI distribution of newly disbursed personal loans by income quintiles



*Note: Distribution by contract number. Income quintiles were determined according to borrowers' income distribution. * 2019 data pertains to the first half of the year. Source: MNB*

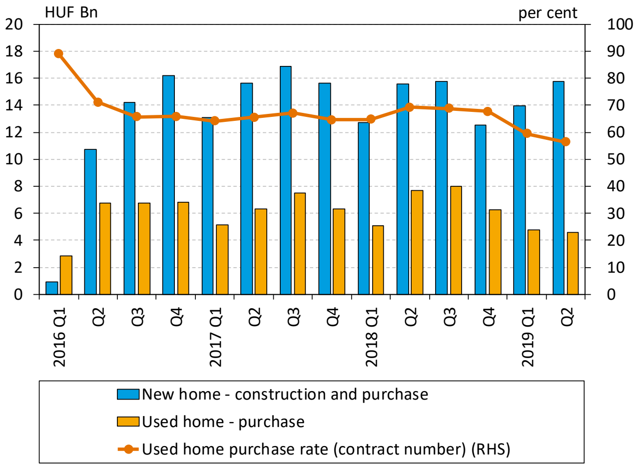
No significant increase in the stretching of households' income position is seen in the case of lower-income borrowers. The average payment-to-income (PTI) ratio of the disbursed housing loans has been around 28 per cent since 2017. Although there are differences across the individual income categories, in the case of the borrowers that belong to the lowest income quintile, which is typically considered more vulnerable, no major increase is seen in the stretching of the income position even at an indebtedness that is some 2 percentage points above the average: in the case of the lowest-income borrowers, the ratio of housing loans disbursed above a 40 per cent PTI ratio was stable at around 20–25 per cent; moreover, between 2018 H1 and 2019 H1 it declined by 3 percentage points (Chart 18). The average PTI ratio is stagnant at around 30 per cent in this income quintile. In the case of personal loans, the rise in the average PTI ratio and in the share of loans disbursed with a higher PTI ratio exceeding 40 per cent stopped in 2017, and both indicators have declined since 2018 (Chart 19). In the case of personal loan borrowers belonging to the lowest income quintile, the average PTI ratio was around 30 per cent in 2019 H1, and the PTI ratio exceeded 40 per cent only in the case of less than one third of these borrowers. The decline in the dynamics of household indebtedness is basically attributable to favourable employment and real wage developments.

Chart 20: Credit demand in the household lending segment



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

Chart 21: HPS contracts according to purpose

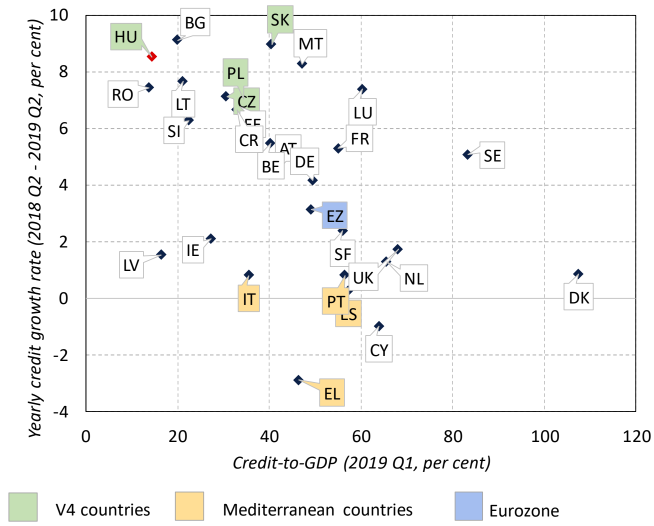


Source: Ministry of Finance

Banks continued to experience a pick-up in demand for housing loans. In net terms, 60 per cent of the respondent banks participating in the Lending Survey reported an increase in demand for housing loans in 2019 Q2. In the case of consumer loans, however, responding institutions have experienced a downturn in the expansion in demand for three quarters already (Chart 20). Looking ahead to the next half year, however, banks expect growth in both product groups. This growth is also facilitated by the support programmes of the government (Home Purchase Subsidy Scheme for Families (HPS), village HPS, prenatal baby support). Within the framework of the prenatal baby support, a maximum of HUF 10 million can be applied for, for free use, without the involvement of any collateral. Accordingly, this scheme may rearrange the household loan market, as for the eligible clients it may substitute housing loans or higher-amount personal loans. In the case of the former product it may even have a credit expanding effect, as considering the support as own funds makes bank loans available even for families that previously were not creditworthy due to the LTV regulation.

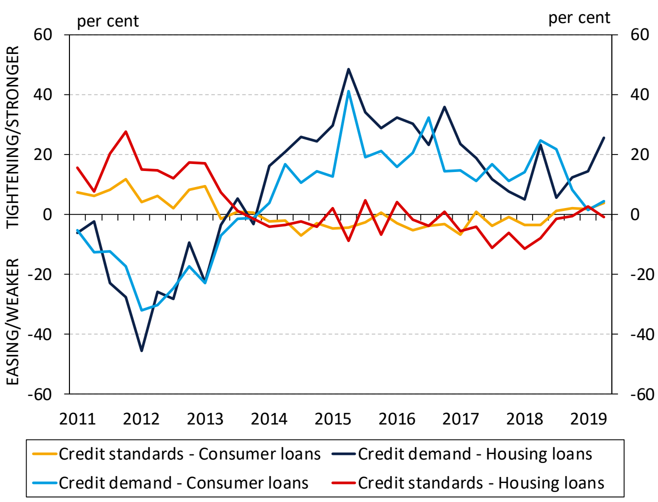
The role of new homes is increasing in HPS applications. In 2019 Q2, 14 per cent, i.e. some HUF 35 billion, of the housing loans issued were related to the Home Purchase Subsidy Scheme for Families. During the quarter, households concluded support contracts within the framework of the HPS in a value of HUF 21 billion, and 77 per cent of this volume was applied for in connection with the purchase or construction of new homes (Chart 21). In 2019 H1, the volume of contracts concluded within the framework of the HPS related to the purchase or construction of new homes exceeded the level of the same period of the previous year by 5 per cent, while in the case of used homes a decline of 27 per cent was observed, which may also be explained by the postponements related to the prenatal baby support. Although the number of support contracts related to new homes also shows a growing trend, every second contract is still concluded for the purchase of used homes.

Chart 22: Annual growth rate of household loans and their ratio to GDP



Source: ECB

Chart 23: Household credit conditions and changes in demand in the euro area



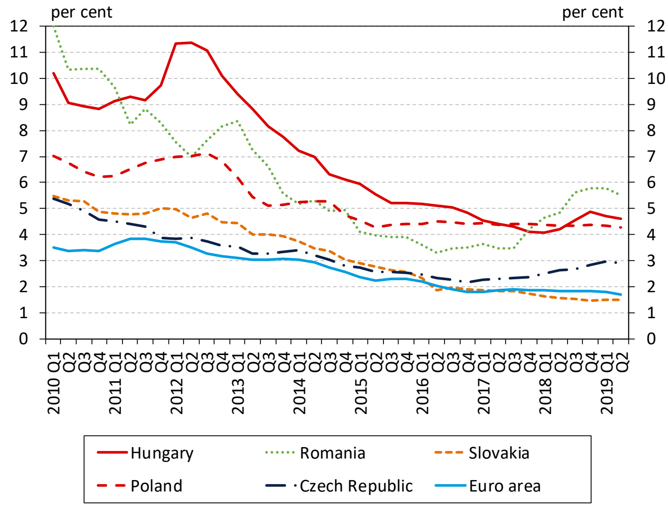
Source: ECB

International outlook in household lending

There is a steady increase in household loans outstanding in the euro area. The improvement in the financial position of the household sector observed in Hungary is typical for most euro area countries. According to the Financial Stability Review of the European Central Bank, as a result of an increase in wages and an improvement in labour market conditions, and in spite of a slowdown in economic growth, consumer confidence is rising and households' expectations are positive regarding the future developments in finances and employment. In line with that, household loans outstanding are also increasing, and the indebtedness of euro area households grew by 3 per cent in the past one year (Chart 22). Firstly, there is significant heterogeneity across member countries: contraction is still observed in Greece and Cyprus, while annual growth exceeds 8 per cent in Slovakia and Malta. Secondly, these dynamics of lending do not increase the credit-to-GDP ratio, which is still nearly 50 per cent. Although credit conditions are not easing, and euro area banks even tightened in net terms in the consumer segment as a result of an increase in the perceived risks (Chart 23), demand is robust, supported by historically low interest rates (Chart 24) and the cyclical position of the housing market.

Household loans outstanding are expanding at an annual rate of 7–9 per cent in the Central and Eastern European region. The rise in household lending in the countries of the region is exceptional even in a European comparison. However, this in itself does not indicate a stability risk as the size of credit institutions' loans outstanding is relatively small compared to the size of the economy: the credit-to-GDP ratio is 14 per cent in Hungary and Romania, and is between 30 and 40 per cent in Slovakia, the Czech Republic and Poland. Until now, the expansion in lending in the Visegrád countries has been coupled with tightening credit conditions, which were primarily attributable to the tightening of the debt cap rules. In 2019 Q2, however, the changes that took place in the case of housing loans were smaller than before: there was some slight tightening in Slovakia, no change in Poland, while slight easing took place in the Czech Republic as a result of an increase in market competition. Price conditions on housing loans (interest rates)

Chart 24: Interest rate on housing loans granted in domestic currency



Sources: MNB, ECB, EMF, Datastream, national central banks

continue to be historically favourable in the region; moreover, they even declined compared to the previous quarter (Chart 24).

BOX 3: INTERVIEWS WITH SENIOR HOUSEHOLD LOAN OFFICERS

The market participants that were asked in the July series of interviews surveying the domestic trends in lending were able to meet their sales plans for 2019 H1; the market performed in line with the expectations or exceeded them. However, the expansion in incomes often stems from an increase in the average contract size, not from the rise in the number of clients or contracts.

Regarding the debt cap rules, despite the buoyant competition, the past period was characterised by stable payment-to-income (PTI) and loan-to-value (LTV) ratios. Banks extend housing loans at an average LTV ratio of 50–60 per cent, but in Budapest they are afraid that the real estate market is becoming overheated. As they said, the amendment to the PTI rules did not have a major impact on the volume of lending, and they still do not lend close to the limit.

The vast majority of the housing loans granted are Certified Consumer-friendly Housing Loans, typically with 5-year and 10-year interest rate periods. As senior loan officers see it, clients consciously look for housing loans fixed for a long term and use web sites where offers are compared. Selling through intermediaries, which was typical in the pre-crisis period, seems to be picking up again, and – depending on the network of branches – may amount to as much as 30–50 per cent of new loans in the case of mortgage loans. In connection with the MNB recommendation aiming at the refinancing of variable-rate mortgage loans with fixed-rate loans, it can be established that the interest of a narrow scope of debtors already requested was aroused by the offers sent to them by post by their own banks. This is partly attributable to the summer season, and in the current period of rising wages and low interest rates consumers do not see loan refinancing that entails a higher instalment as being rational. In the opinion of senior loan officers, an interest rate hike coupled with a rise in instalments is expected to result in a greater wave of prepayments or refinancing.

With regard to personal loans, the strong competition is reflected in the easing of price conditions, while credit institutions are not willing to open towards riskier clients. Clients' payment-to-income ratio is somewhat higher in the case of these loan products, as they often apply for personal loans following a housing loan, and in addition to vehicle purchasing their most frequent loan purpose is home renovation. Only some of the largest market participants offer personal loans of HUF 10 million; the majority are more conservative, setting an upper limit of HUF 7–8 million on average.

As experienced in July, the prenatal baby support, which can applied for since 1 July 2019, is extremely popular, and some postponement preceded the launching of the scheme. According to the banks, in the initial period almost all those interested apply for the maximum HUF 10 million loan with a maturity of 20 years. The banks noted that for the time being many of the applicants – more than half of them in the case of certain institutions – are from the premium household segment (high income, higher education and better financial literacy). Banks called attention to the fact that some of this client segment use the possibility of arbitrage – with an investment objective – with this scheme. Nevertheless, accepting the support as own funds makes bank loans available even for families that previously were not creditworthy due to lack of own funds and the loan-to-value regulation. Banks do not expect the prenatal baby support to have a significant crowding-out effect in the case of housing loans in new lending or in the outstanding stock. At the same time, they expect some substitution effect in the case of personal loans.

For credit approval and a reduction of the lead time, banks are working to develop their online loan application systems, although this year their IT capacities are partly occupied by the compliance with regulations and the development of loan products supported by the state (instant payment system, Home Purchase Subsidy, prenatal baby support, credit register). All respondents' objectives include the introduction of online personal lending covering the entire lending procedure, and those who have already launched it, for the time being have made it available only for their own clients. Senior loan officers urged the creation of automated income and real estate databases, which could make lending procedures more efficient.

Institutions that are active in the lower income segment of households reported that competition became stronger in the case of hire purchase loans in 2019 H1, while the share of the more profitable credit card segment declined, and the ratio of lower-priced personal loans increased. Applications for overly high amounts of loans and hitting the PTI limit were the most frequent reason for rejections. The average contract size is increasing, in line with the rise in wages. Generally the majority of clients have one loan product, but the role of cross-selling shows a growing trend.

4. ANNEX: NOTES ON 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. Nine banks responded to questions related to housing loans, while ten banks answered questions on consumer loans. Based on data from the end of 2019 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 86 per cent.

The survey consists of a standard questionnaire in each segment. The retrospective questions refer to 2019 Q2 (compared to 2019 Q1), whereas the forward-looking questions concern the next half-year period, i.e. covering 2019 H2 (relative to 2019 Q2). The current questionnaire was completed by the senior loan officers between 1 July and 16 July 2019.

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 the market share-weighted ratio of respondents projecting a change in the opposite direction (easing / decreasing / weakening).

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

TRENDS IN LENDING

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