LENDING SURVEY
Senior loan officer opinion survey on bank lending practices

Aggregated results of the first three surveys

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To gain a better understanding of banks' corporate and household lending behaviour, Magyar Nemzeti Bank (MNB) launched a biannual survey entitled 'Senior loan officer opinion survey on bank lending practices' (or 'Lending survey' in short) in early 2003, which was followed by two subsequent surveys in summer 2003 and in early 2004. Since the MNB staff found that at least three data points were needed for adequate analysis, the results were not published in the initial period. Moreover, based on the lessons learnt from earlier surveys, a number of minor modifications were made to the questionnaires.

This study presents the findings of the first three surveys. The results of the corporate questionnaire are tabled in Annex 2, while those of the household sector in Annex 4. Appendices 1 and 3 contain data on the surveyed banks' total outstanding loans and market shares in the corporate and household sectors respectively. In presenting the survey results for both (i.e. the corporate and household) sectors, the structure of the relevant questionnaires will serve as a guideline. When analysing the factors behind changes and developments, the study will express the responses made by senior bank executives rather than the MNB's expert opinion. The primary aim will be to discover how respondents perceive and assess market processes, or how banks develop their strategies, particularly their lending policies, based on the assessment given by owners and senior executives. General market trends will be identified by aggregating individual, micro-level responses. In terms of the factors characterising credit supply and demand, 2002 H1 were taken as the base period in the survey, with the noted changes and developments cumulating thereafter. Backward-looking questions are related to the immediately preceding six months (actual). The noted developments and changes are plotted relative to the period preceding that. Forward-looking questions, on the other hand, relate to the six months following the immediately preceding period, i.e. the base period (expectations, plans). To denote change, the so-called net percentage indicator (expressed as a percentage of the respondents) were used, which is calculated as the number of banks reporting change less the number of those reporting change in the opposite direction, divided by the total number of respondents (respondents are unweighted).[1]

[1] Net percentage = the number of respondents reporting tightening/increase/strengthening as a percentage of total respondents – the number of respondents reporting easing/decrease/weakening as a percentage of total respondents.

1. Lending to non-financial enterprises

1.1. Loans to non-financial enterprises other than commercial real estate loans
(Questions 1-9 of Annex 2, seven responding banks)

The corporate lending market is characterised by the existence of a number of different processes, with the tendencies observed in different loan classes based on company size showing substantial differences. Banks' willingness to extend loans has seen persistent, unabated net increase[2] in all corporate size classes with no reports of a drop in the last eighteen months.

Large enterprises

Banks tightened corporate credit standards[3] in net terms period after period in the eighteen months between 2002 H2 and 2003 H2. Actual net percentage figures for 2003 are equal with six months earlier planned data (see Chart 1). Most loan terms[4] became tighter in the eighteen months between 2002 H2 and 2003 H2, and the actual or planned tightening was translated by banks the most heavily into higher premia on riskier loans. Incidentally, the latter was also observed with the two other size classes. By contrast, the term 'maximum size of loans or credit lines' was somewhat of an exception to the general trend – banks eased it (i.e. increased the amount of the loan/credit line[5]) by 14.3% between 2002 H2 and 2003 H1, and they expected the trend to continue into 2003 H2. However, actual data for 2003 H2 suggest that this term in effect tightened (see Chart 2). Interpreting this nominal term may be somewhat controversial – if a bank intends to leave its lending policy unchanged in real terms or in terms of risk, it must raise the maximum size of loans/credit lines because of inflation or economic growth. As a combined result of the changes in loan terms and standards, the number of banks reporting tightening dropped from five and four to two in 2003 H2, which indicates the likelihood of a lower degree of tightening at aggregate level. Expectations for 2004 H1 show a higher net tightening of standards (up from 14.3% to 42.9%) relative to the previous six months. The key factors behind the tightening of loan terms in the past three six-month periods were worsening industry-specific problems, less favourable economic outlook and low banking profitability (the latter is illustrated by the fact that pricing conditions have become or are set to become tighter). Banks' propensity to take risk is also on the decrease.

[2] With willingness to make loans, the number of those reporting "increased considerably/somewhat – decreased considerably/somewhat" as a percentage of the number of respondents.

[3] Based on a bank's lending policy, credit standards consist of internal banking rules which will determine (based on the classification by sector, area, size, financial indicators etc.) what types of loans (collateralised, non-collateralised, investment, overdraft etc.) it will provide, and to which clients. The questionnaire measures changes in such standards including cases when a bank has modified the implementation or application of an existing lending policy (e.g. greater consistency in implementation).

[4] Based on the agreement between the bank and the client, what are the terms and conditions under which the bank will provide the loan in question. Loan terms may be classified into two groups – (i) price-terms (cost(s) of credits/credit lines, spreads of loan rates over the cost of funds, premia on riskier loans) and (ii) non-price terms (maximum size of loans/credit lines, loan covenants, collateral requirements).

[5] In 2002 H2 some banks even eased their pricing behaviour.

As a rule, the deterioration of the macroeconomic environment is coupled with higher lending risk and a drop in banks' risk appetite, which in turn manifest in tighter standards. The questionnaires suggest that the reported tightening is not simply the result of a general shrinkage of credit supply, for lending willingness to provide new loans still implies growth in lending and the persistence of a fierce competition. The latter is corroborated by the fact that no bank rated less aggressive competition as a major factor that may have contributed to the tightening of credit terms and standards in 2003, and even for 2002 H2 it was cited only by a single bank as a relatively significant factor. Overall, large enterprises are still to be regarded as banks' major target segment. Rather, the tightening is reflected in changes in quality, banks try to make a more pronounced distinction between various client groups, and they place a heavier emphasis on risk-based pricing and on achieving desired levels of profitability. Instead of the aggressive acquisitions seen earlier, banks are less keen to recruit new or keep existing clients. The extraordinary liquidity excess of January-March 2003 was assessed by the majority of respondents as a provisional development, hence, they did not step up their lending activity.

Respondents reported a sharp (i.e. higher-than-expected) decline in the rise in credit demand between 2002 and 2003 H2, while as regards the past six months bank executives suggested that the upward trend even stopped (see Chart 3). The responses imply that demand was pulled by a rise in corporate funding requirement. Therefore, those perceiving weaker demand attributed that tendency to a fall in the funding requirement, more specifically, in fixed investment. For 2004 H1 banks expect a small increase in net terms in demand for credit by large enterprises.

Chart 1 – Changes in credit standards for approving applications for loans/credit lines to large non-financial enterprises (positive net percentage = tightening)

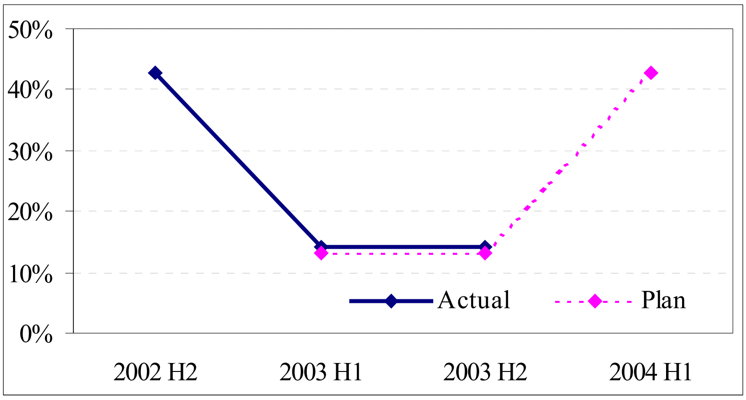


Chart 2 – Changes in terms for premia on riskier loans and in the maximum size of loan/credit line (positive net percentage = tightening)

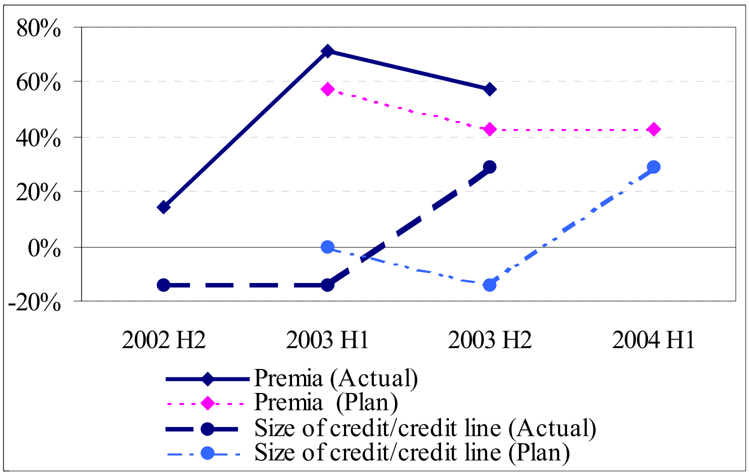
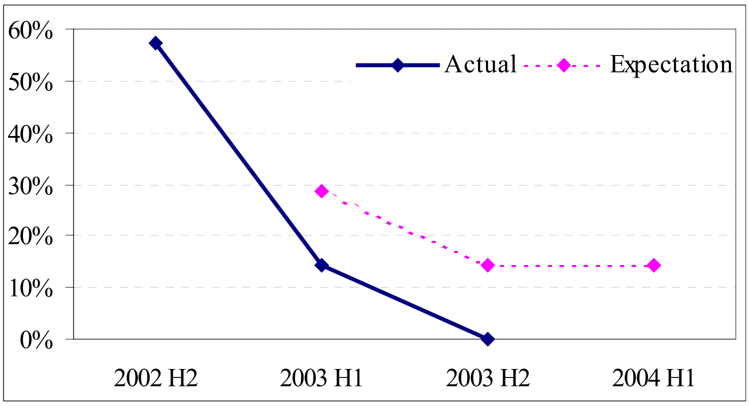


Chart 3 – Demand for loans/credit lines by large non-financial enterprises (positive net percentage = increase)



Small and medium-sized enterprises (SMEs)

Based on annual net turnover, the classes of small and medium-sized enterprises (SMEs) were subdivided into two smaller segments – small and micro vs. medium-sized enterprises. As the first survey had used a different classification, i.e. micro vs. small and medium-sized firms[6], only post-2003 H1 data series may be subject to interpretation. The information available to senior bank executives is only accurate on the size categories which are used by the bank in question, a fact from which they found it difficult or were unable to disregard whilst filling in the questionnaire. Therefore, since these responses do not lend themselves to interpretation in the specific size classes set up by Bank staff, the broader, i.e. smaller and larger SME classes, were used instead. It should also be noted that while filling in the

[6] In the first survey Bank staff used the definition included in the relevant piece of legislation, which in addition to turnover, also considers balance sheet total and the number of employees in setting up the categories. In the first survey a supplementary question was taken of the criteria used by banks to categorise enterprises based on size, yet, MNB staff found that in the majority of the cases annual turnover was the sole criteria banks used and also the one on which their responses were based. According to the legal text, the only difference between small and micro enterprises is that of the number of employees (no distinction is made in terms of turnover), and since the classification set up by banks excludes such factors, we have decided to merge the two categories.

questionnaire, responding executives found it difficult in all size classes (including large enterprises) to differentiate between the possible factors behind the changes in demand. Such factors included the various kinds of funding needs (inventories, outstanding claims, fixed investment) and the changes in other funds (own funds, other banks etc.), and the reason for banks' failure to specify their responses was that they do not collect such aggregate data. In the light of the above, the findings should be taken with certain cautions.

Stock data suggest that robust growth in lending to SMEs took off in 2001. The increasing openness toward that sector may be explained by lower risk (SMEs which survived in the 1990's are now on a firmer footing), the prospect of higher profitability, and, last but not least, various government subsidies[7]. In the SME sector banks used to apply extremely tight credit standards and loan terms; as a result, only a minor proportion of entrepreneurs would have access to loans[8]. Banks attention continued to shift towards the market even in 2003, with a far sharper pick-up in willingness to lend to SMEs than to large enterprises.

Larger SMEs

With larger SMEs market opening began earlier, as 2003 already saw generally tighter credit standards and terms. As a result, the number of banks reporting tightening as opposed to those reporting easing was higher by two in both reporting periods. Among the increasingly tighter terms, foremost attention was given to premia on riskier loans, which were tightened (i.e. increased) the most considerably, with over half of the respondents indicating tightening in both reporting periods. The majority of banks expressed their intention to tighten it further in 2004 H1. Apart from less favourable prospects for the economy and worsening industry-specific problems, deterioration in banks' liquidity position also added significantly to the tightening. In this segment, selected by a number of banks as a key target group, banks were probably less focussed on recruiting more clients by easing up credit standards and terms, at the expense of factors such as profitability and risk, which gradually came to the forefront of their attention. In 2004 H1 banks plan a net easing in credit standards; conversely, they wish to tighten loan terms with the exception of the maximum size of loans/credit lines.

Senior bank executives reported a persistent rise in demand for credit by larger SMEs in the course of 2003, which they attributed mostly to the swell of funding requirements. For 2004 H1 they expect a further increase in demand in net terms.

Smaller SMEs

With smaller SMEs, due to the higher risk easing started from a tighter base and with considerable delay, and continued into H2 2003 though to a smaller degree than in the previous six months. As a combined effect of the changes in credit standards and conditions, the number of those reporting easing was down from five to three, while those reporting tightening was up from one to two. Despite the generally easing environment, the results for other market classes, i.e. respondents' intention to raise (i.e. tighten) premia on riskier loans, are visible in this case too. Banks believed that

[7] Such as the so-called Széchenyi-card, or Európa credit, etc.
[8] At the turn of the millennium, only a few percentage points of small and micro enterprises had access to bank loans.

the easing in 2003 was caused mostly by an increasingly fierce competition, while they gave the same explanation about the tightening as they did for larger SMEs. Banks plan to further ease their credit standards in net terms in 2004 H1; as regards loan terms, however, they wish to take tightening measures with the exception of the maximum size of loans/credit lines.

Similarly to larger SMEs, demand for credit by small SMEs was seen by senior executives as a factor following a continuously upward trend. This may be attributed to an increase in funding needs in 2003 H1, and to an equal degree to the combined effect of a rise in funding needs and a drop in access to other funds in 2003 H2. Responding banking executives expect a further rise in demand in 2004 H1.

1.2. Commercial real estate loans

(Questions 10-15, Annex 2, seven responding banks)

Following the net increase in 2002 H2, in both halves of 2003 lending willingness remained essentially unchanged in net terms. It was only in this corporate market segment that some banks registered a decline in lending willingness. Banks reported tightening standards for commercial real estate loans to an equal degree in all the three reporting periods even in excess of lending to large enterprises. And the net tightening in 2003 H2 was higher than they had expected (see Chart 4). The main factors responsible for the tightening were worsening industry-specific problems and concerns about developments in real property prices. In addition, lower risk appetite by individual banks also augmented the trend towards tightening. In 2004 H1 five banks plan further tightening measures, while only one intends to move to the opposite direction. All in all, as compared with the base period (2002 H1), banks appear to take greater care in selecting what projects they wish to fund.

Banks expected the domestic project loan market to start saturating from mid-2003 i.e. demand to decline in net terms (see Chart 5). However, this had not materialised by 2003 H2. Demand continued on its upward trend, albeit at a slower pace, due mainly to a quicker-than-expected rise in housing projects. Unchanged from earlier periods, respondents continue to expect demand to decline in 2004 H1.

Chart 4 – Changes in credit standards for approving applications for commercial real estate loans (positive net percentage = tightening)

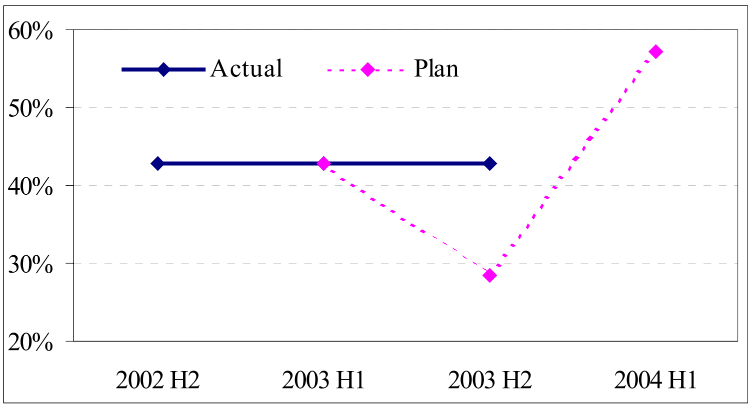
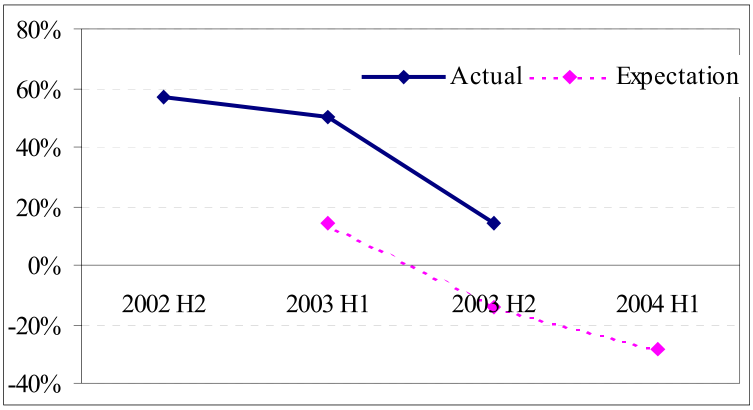


Chart 5 – Demand for commercial real estate loans (positive net percentage = increase)



1.3 Changes in the credit risk evaluation in various economic branches

(Question 16, Annex 2)

(1= considerably riskier, 2= somewhat riskier, 3= remain basically unchanged, 4= somewhat safer, 5= considerably safer)

	2003 H2		2003 H1		2002 H2	
	Number of respondents	**Average rating**	Number of respondents	**Average rating**	Number of respondents	**Average rating**
Agriculture, forestry and fishery	7	**2.4**	7	**2.3**	7	**3.1**
Manufacturing	7	**2.3**	7	**2.4**	7	**2.4**
Energy, public services	7	**3.0**	7	**3.0**	7	**3.1**
Construction	7	**2.4**	7	**2.9**	7	**2.7**
Wholesale and retail trade, repair	7	**3.1**	6	**3.5**	7	**3.3**
Hotels and restaurants	7	**2.7**	7	**1.9**	6	**2.3**
Transport, storage, post and communication	7	**2.9**	7	**3.1**	7	**2.7**
Financial intermediation, real estate and business service activities	7	**2.9**	7	**2.7**	7	**2.7**

Throughout the period between 2002 H2 and 2003 H2 the risk perception of most industry groups deteriorated, which reflects an increasingly unfriendly macroeconomic environment. The largest degree of deterioration was seen in manufacturing and tourism caused primarily by exogenous factors. Responding banks believed that the underlying reasons behind the weaker performance of manufacturing were the stagnation in key export markets and the strong forint in the first two reporting periods. By contrast, tourism was hit by global recession, as well as the strong forint, which also affected manufacturing. Furthermore, banks assessed risks to agriculture and construction as increasing in 2003. Several respondents expressed their concerns over the competitiveness of domestic agricultural businesses after Hungary's accession to the EU. Throughout the reporting period, trade was the only sector which was assessed to be on a permanently upward track.

2. Household loans market

2.1. Loans for house purchase

(Questions 1-10, Annex 4[9])

Throughout the period between July 2002 and December 2003 the boom in the housing loan market was largely caused by the government's housing subsidy scheme. The subsidy scheme, or rather its expected modifications and the modifications themselves[10], which are not mentioned here, had a major effect on both demand and supply side developments (price, credit standards, certain loan terms). Competition among banks is relatively restricted due to the loan terms set by the government. Given the government's intervention, it is not worth comparing expected and actual data; therefore, they have not been charted here.

Surveys for 2002 H2 and 2003 H1 showed that bank's willingness to make new loans was up by a high net percentage value, which, however, faltered in 2003 H2 with only one bank reporting a rise. Unlike in previous reporting periods, banks did not ease their credit standards any further in net terms in 2003 H2. Loan terms[11] were eased in net terms in 2002 H2 only to be left essentially unchanged in 2003 H1 and tightened in 2003 H2 except for the spread. Clearly, the key factor behind the tightening was the modification of the subsidy scheme. As a result of the latest regulatory changes (i.e. December 2003), banks plan a further net tightening for 2004 H1. In addition, the loan-to-value ratio of new originations of both types of loans (subsidised and market rates) remains low with distribution slanted towards a lower loan-to-value ratios.

In respect of the number of loan applications, 2002 H2 and 2003 H1 saw soaring[12] demand, which remained strong in 2003 H2, though modest compared with the previous six months. The demand side was also influenced by the regulatory environment, mainly by fears of restrictions in the regulations themselves. Banks expect a fall in demand compared with the precious reporting period due largely to the above-mentioned restrictions on subsidising conditions.

Based on banks' responses, house prices saw a nominal increase in net terms in 2002 H2 and, following a period of stagnation in 2003 H1, in 2003 H2. Nevertheless, respondents pointed out that there are some major inequalities in this area between the various segments (Budapest vs. non-Budapest, up-market vs. mid-market, small vs. large homes, houses vs. flats etc.). The number of banks expecting a modest price increase (3) in the period ahead was higher than that of those expecting lower prices (2) (see Chart 6). From the surveys conducted so far it is clear that, in the absence of relevant data bases, executives in charge of this business area are unable to detect

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[9] Six banks responded to the survey of 2003 H2, while the previous two questionnaires were filled in by seven entities.

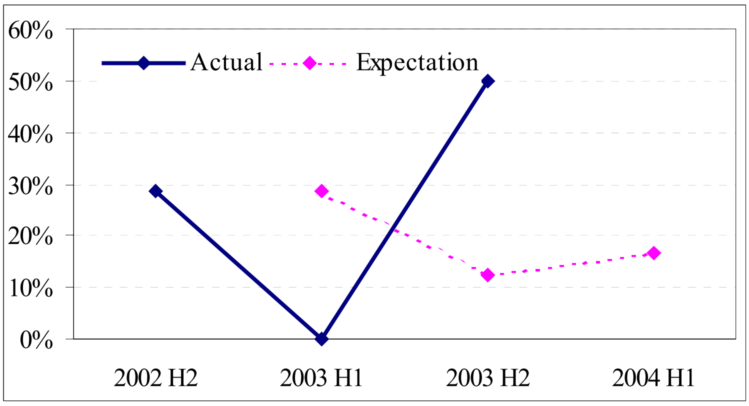
[10] "Fortunately" for the survey, the changes to the subsidy system were always made at the end of the reporting period (June and December 2003), thus, their effects were easy to detect.

[11] Non-price related – maximum maturity, minimum downpayment, maximum monthly repayment / monthly income ratio, maximum loan-to-value ratio; price-related: spreads between interest rates and the bank's cost of funds (including subsidies which affect interest revenue/expense) and loan origination fee(s).

[12] Nearly all banks reported an increase, and, in effect, most of them marked the "increased considerably" category.

finer price movements precisely, or find it difficult to aggregate price movements in different house segments.

Chart 6 – Nominal home property prices
(positive net percentage = increase)



2.2. Consumer lending
(including unrestricted use loans with collateralised mortgage)

(Questions 11-15, Annex 4[13])

In this market segment, the number of banks reporting growth in lending willingness increased (it was up to five out of seven in 2003 H2) period after period. This may be linked to developments in the housing market, where in 2003 H2, we can still see virtual stagnation in lending willingness and demand growth in net terms for two reasons. First of all, housing loans used to have a crowding-out effect of some sort on consumer credit; and, secondly, a pick-up in demand for consumer credit usually follows demand growth for housing loans only with some delay (for instance, owners also wish to furnish their newly-purchased home). While the majority of banks tightened their standards and terms for consumer credit[14] in 2002 H2, by 2003 those taking easing measures were in clear majority, though of less than expected (see Chart 7). Similarly, while the majority of loan terms were tightened in net terms in 2002 H2, most of them were eased in 2003 H1, only to remain nearly unchanged in 2003 H2. Of all the terms, only maximum amount of loans/credit lines showed a continuous increase (easing). Developments in the size of corporate sector loans/credit lines are analogous to those seen in consumer credit – assuming an unchanged level of risk, the substantial wage increase points to a rise in the maximum size of loans/credit lines. The easing in the lending environment was attributed by banks mostly to the pressure arising from increasing competition in both banking and non-banking sectors. As regards the period ahead, they expect further that tendency to continue.

Senior bank executives believe that this market segment has considerable growth potential, which is corroborated by the fact that in the past eighteen months an increasing number of banks reported net growth in demand, albeit somewhat lower

[13] Seven banks were surveyed in 2003 H2 and 2002 H2, and eight in 2003 H1.

[14] Non-price related – size of loans/credit lines, minimum downpayment, maximum ratio of monthly repayment / monthly income, minimum credit score requirement; price-based – spread(s) between interest rates charged on outstanding balances and the bank's cost of funds, loan origination fee(s).

than expected. Most of them expect further growth in demand in the period ahead (see Chart 8).

Chart 7 – Credit standards for approving applications for consumer credit (positive net percentage = tightening)

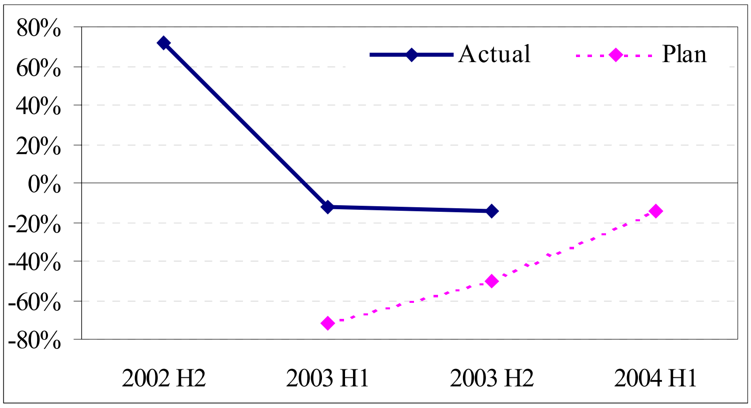


Chart 8 – Demand for consumer credit (positive net percentage = increase)