



# Report on Financial Stability

*April 2010*

# Main risks and risk moderating measures

**I. High net external debt, high loan-to-deposit ratio in the banking system, significant household FX-loan stock still represent high vulnerability**

- *Risk moderating measures: government regulation on prudential lending based on MNB's initiative*

**II. Banks' procyclical behavior, i.e. supply constraints in corporate lending may set back economic recovery**

- *Risk moderating measures: developing state guarantee programs and interest rate subsidies in corporate lending*

# *I. High net external debt*

# As a result of the adjustment of the real economy in the recession Hungary's net external financing capacity improves

*(External position and net financing capacity of individual sectors (as a percentage of GDP))*

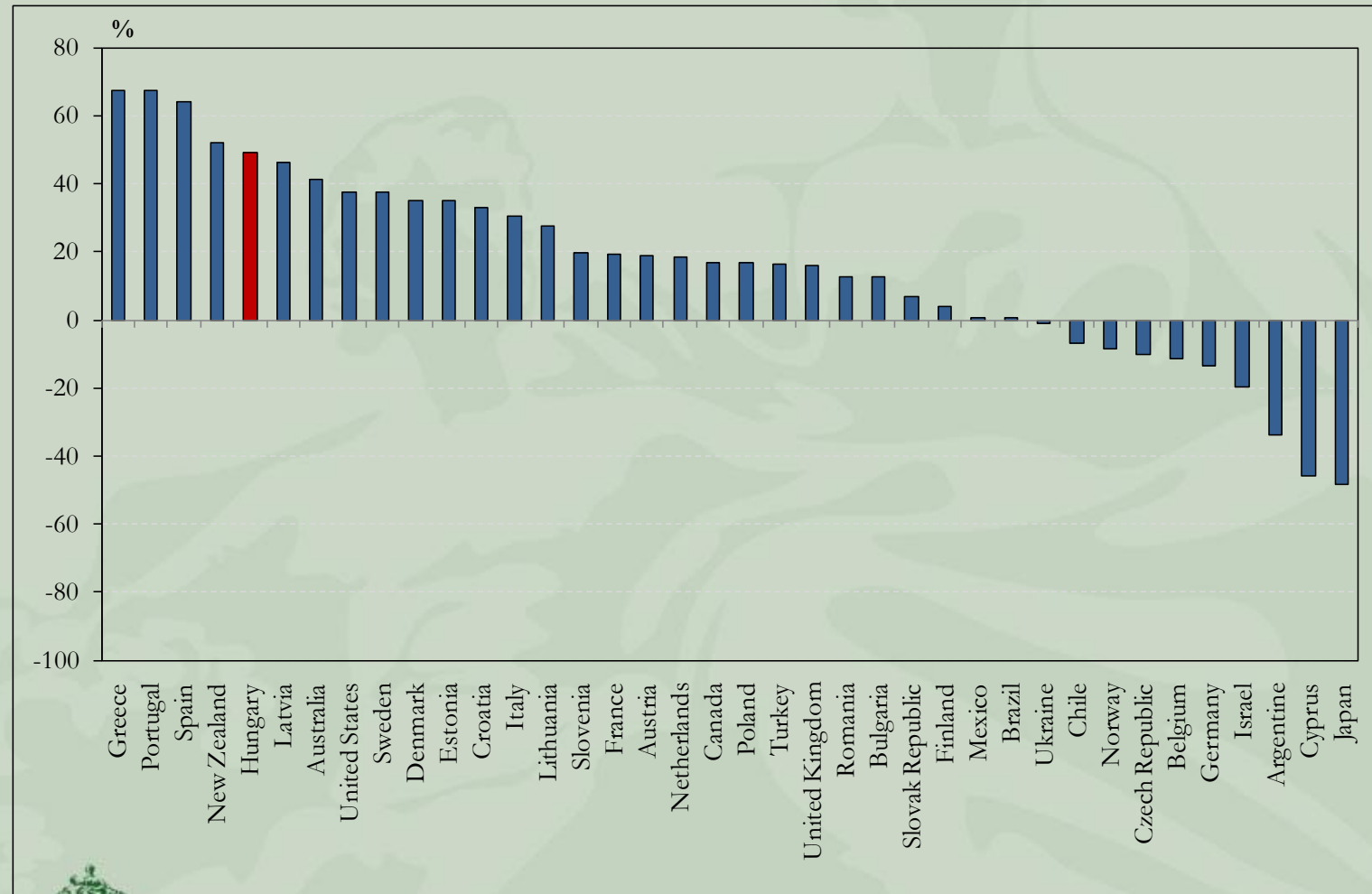
|  | 2003             | 2004        | 2005        | 2006        | 2007        | 2008        | 2009            | 2010       | 2011       |
|--|------------------|-------------|-------------|-------------|-------------|-------------|-----------------|------------|------------|
|  | <i>Estimated</i> |             |             |             |             |             | <i>Forecast</i> |            |            |
| A. Current account                                 | -8.0             | -8.3        | -7.2        | -7.5        | -6.8        | -7.2        | 0.4             | -0.4       | -0.4       |
| B. Capital account                                 | 0.0              | 0.1         | 0.7         | 0.7         | 0.7         | 1.0         | 1.4             | 2.0        | 2.4        |
| <b>C Net financing position, "top-down" (=A+B)</b> | <b>-8.0</b>      | <b>-8.2</b> | <b>-6.5</b> | <b>-6.8</b> | <b>-6.1</b> | <b>-6.2</b> | <b>1.8</b>      | <b>1.6</b> | <b>2.0</b> |
| I. Public budget*                                  | -8.3             | -8.3        | -9.4        | -9.5        | -5.8        | -3.8        | -4.7            | -5.2       | -4.5       |
| II. Households                                     | 0.1              | 2.3         | 4.3         | 3.3         | 1.5         | 1.2         | 3.3             | 4.5        | 4.1        |
| III. Corporations and "error" (=C-I.-II.)          | 0.2              | -2.2        | -1.4        | -0.5        | -1.8        | -3.7        | 3.2             | 2.4        | 2.4        |

Note: In addition to the fiscal budget, the consolidated general government includes local governments, institutions discharging quasi-fiscal duties (Hungarian State Railways [MÁV] and the Budapest Public Transport Company [BKV]), the MNB and authorities implementing capital projects initiated and controlled by the government and formally implemented under PPP schemes. Stability reserves and reserves payable for interest have not been taken into account in the forecast for the financing requirement of the general government.

Source: MNB.

# Net external debt declined, although its level remains high in international comparison

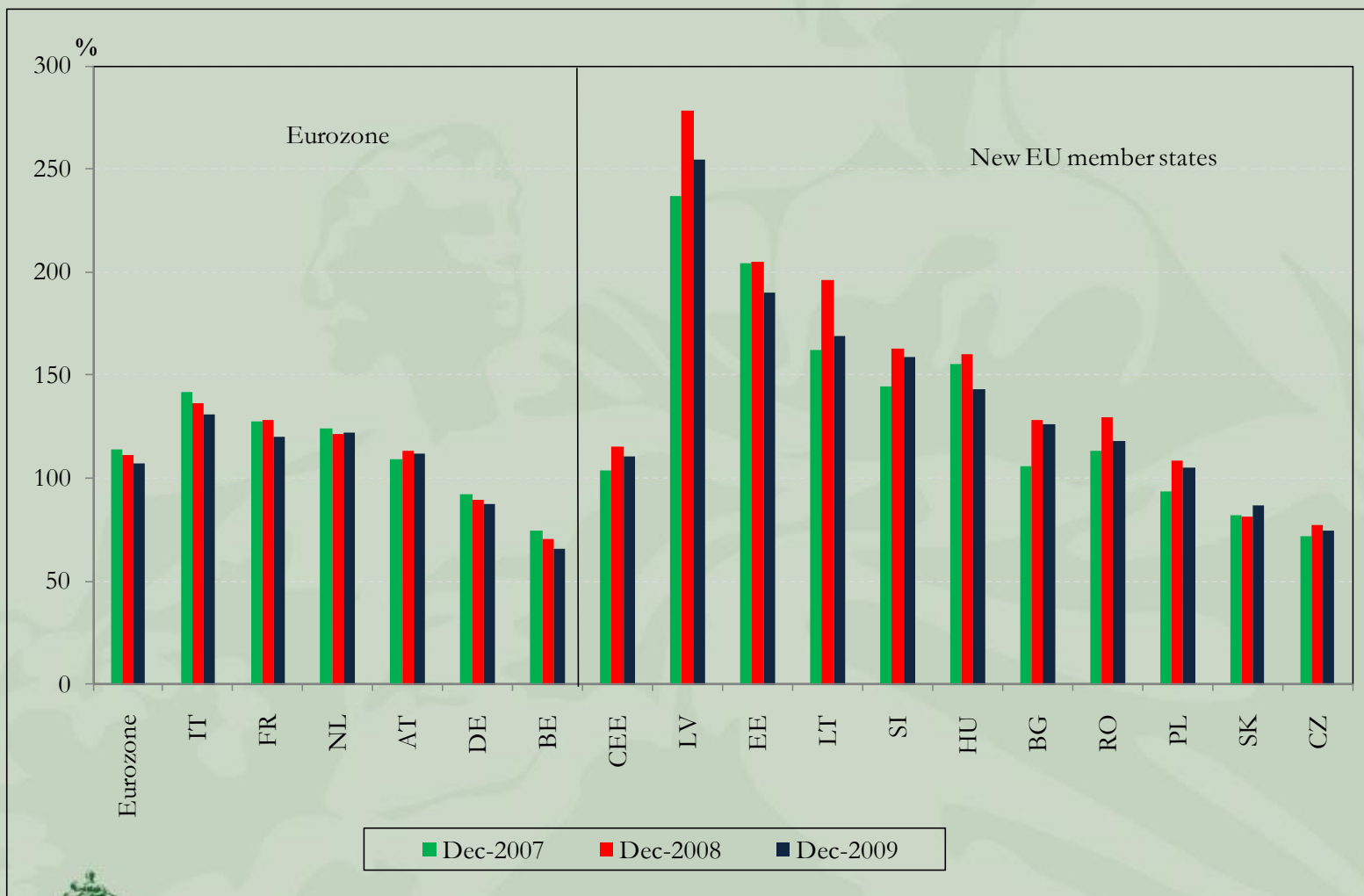
*(Net external debt as a proportion of GDP, 2008)*



Source: IFS, Eurostat.

# Banking system's loan-to-deposit ratio declined, although its level remains high in regional comparison

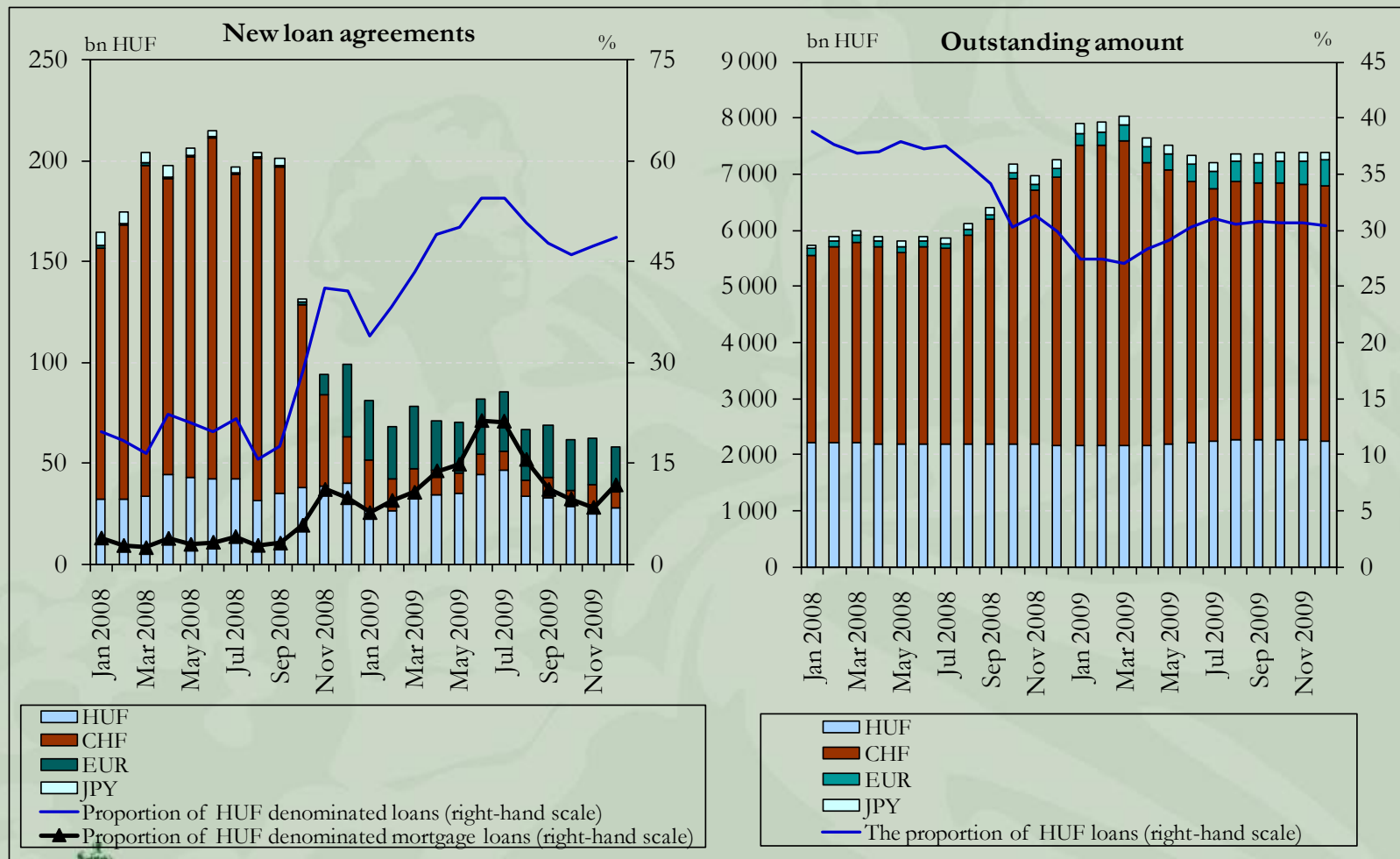
*(Loan-to-deposit ratios in international comparison)*



Source: ECB, MNB.

# HUF lending has gained ground in new lending but FX loans still dominate in stocks...

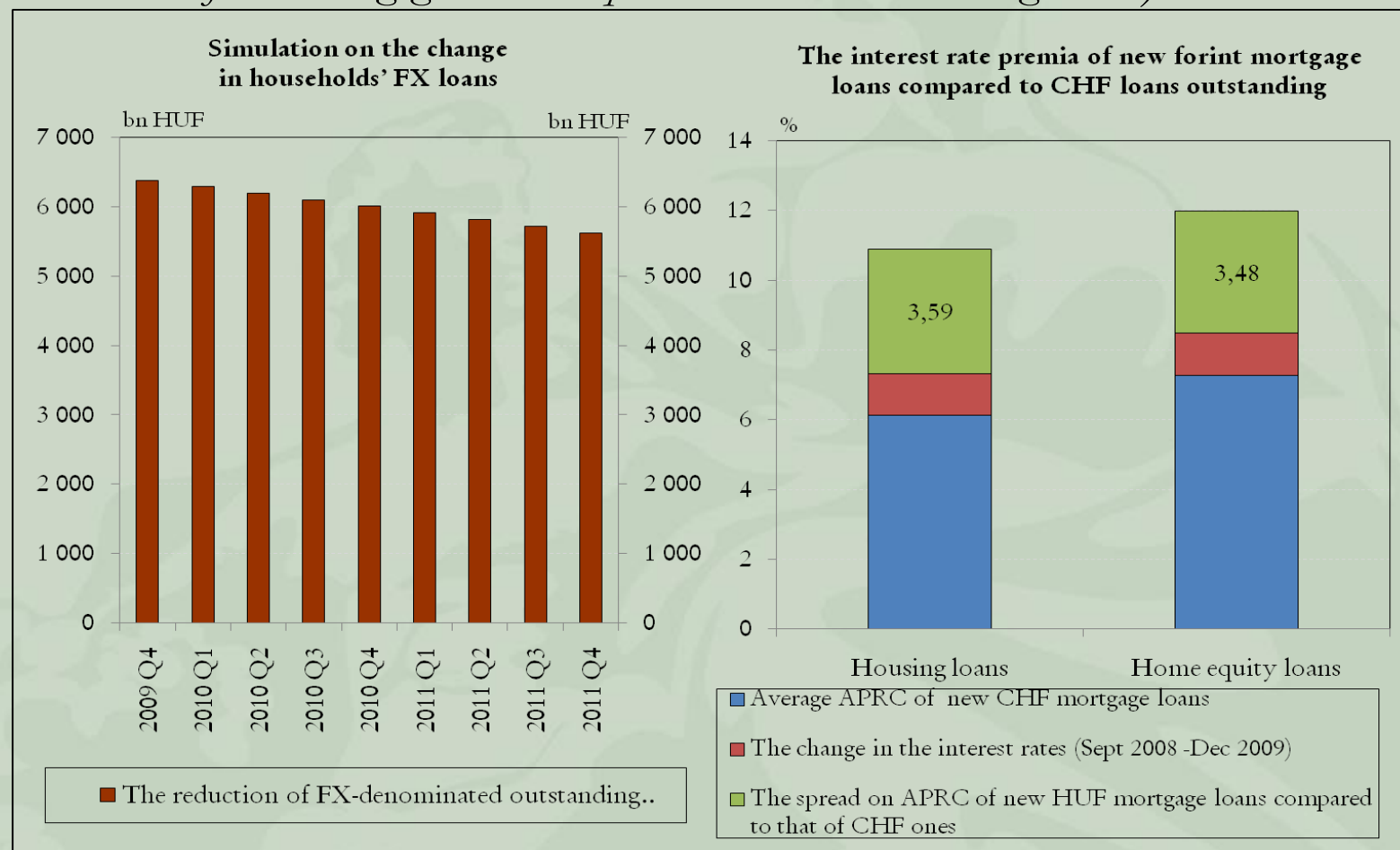
*(New contracts and stocks with denominations)*





# ...and will decrease only gradually

*(Simulation on the change in households' foreign currency loans and the interest rate premium of new forint mortgage loans compared to CHF outstanding loans)*

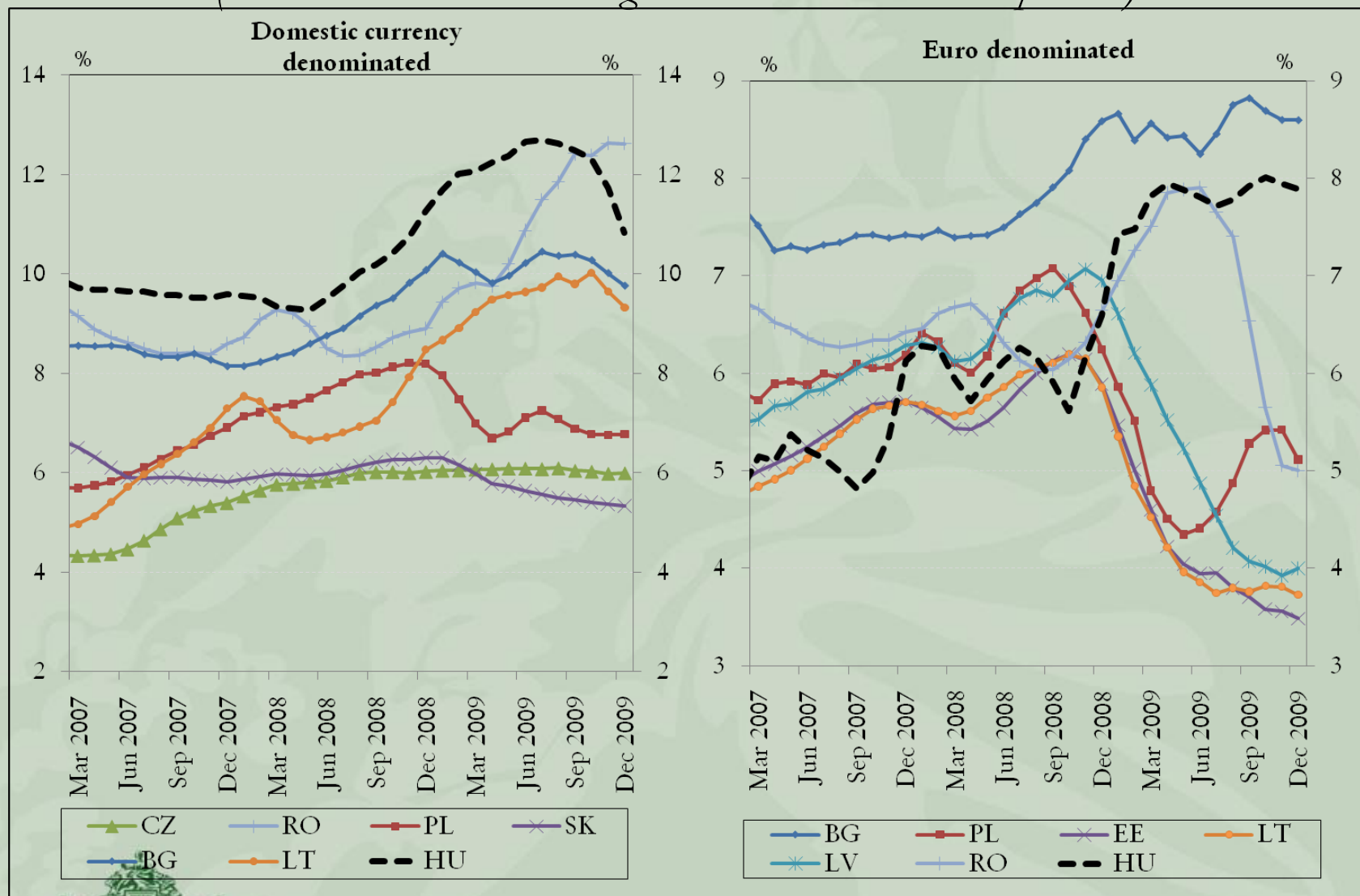


Note No new loans are assumed in the simulation.



# Households face higher interest rates

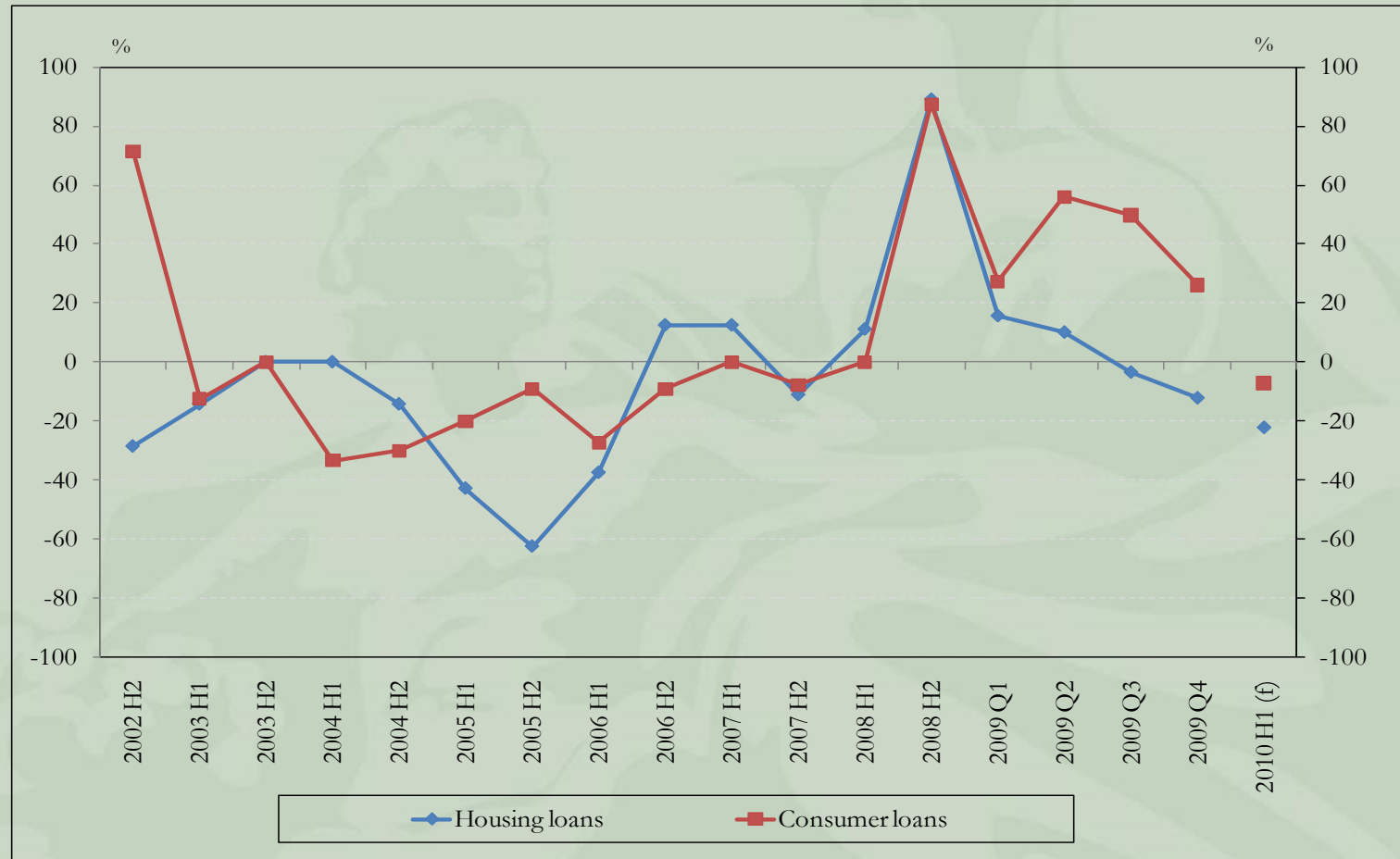
*(Interest rates on new housing loans in international comparison)*



Forrás: National central banks.

# Tight conditions impede household lending, but credit structure may become healthier

*(Credit conditions on households)*

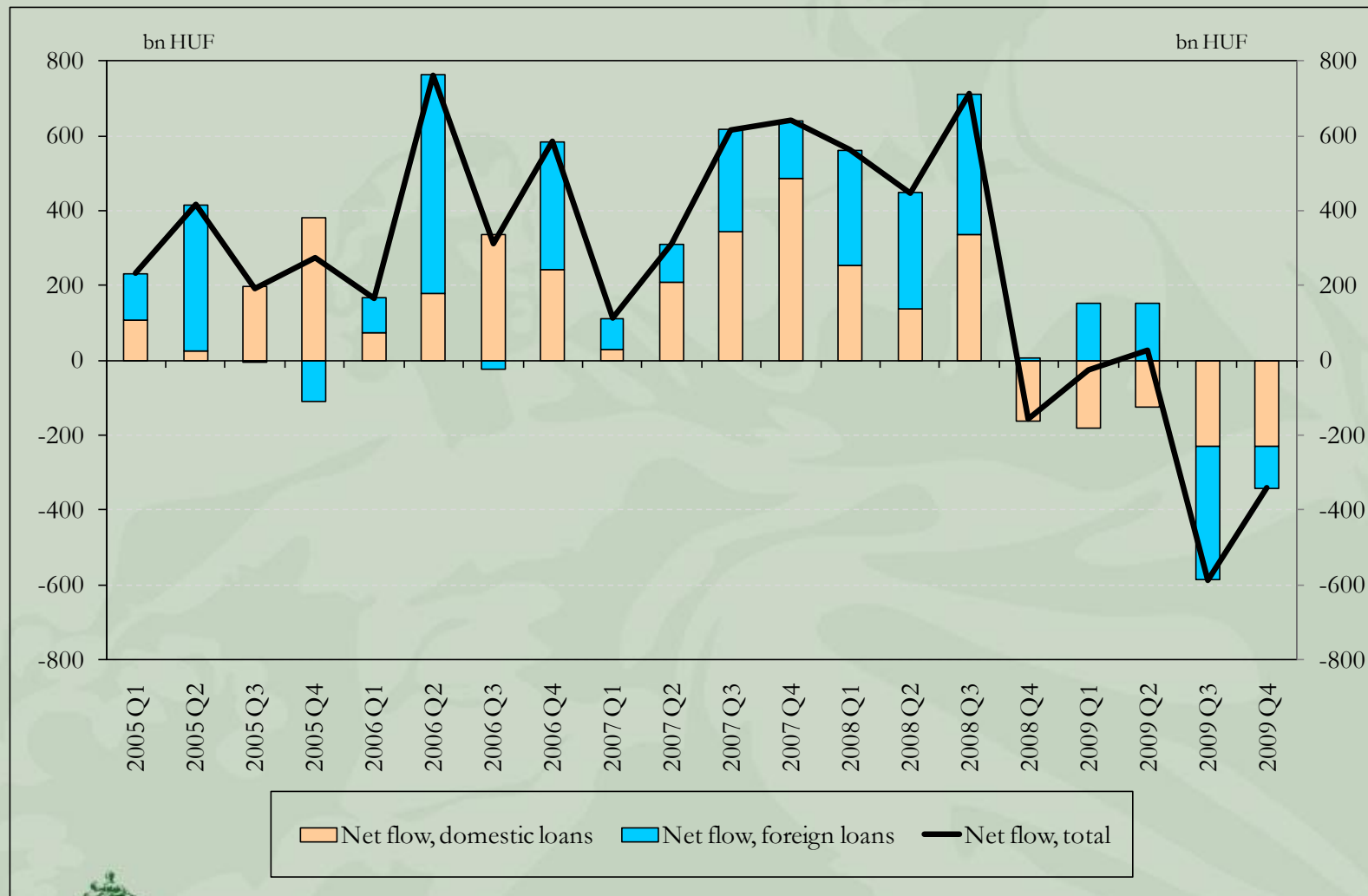


Note: Net percentage of respondents reporting tightening/easing

## *II. Procyclical behavior of the banking system*

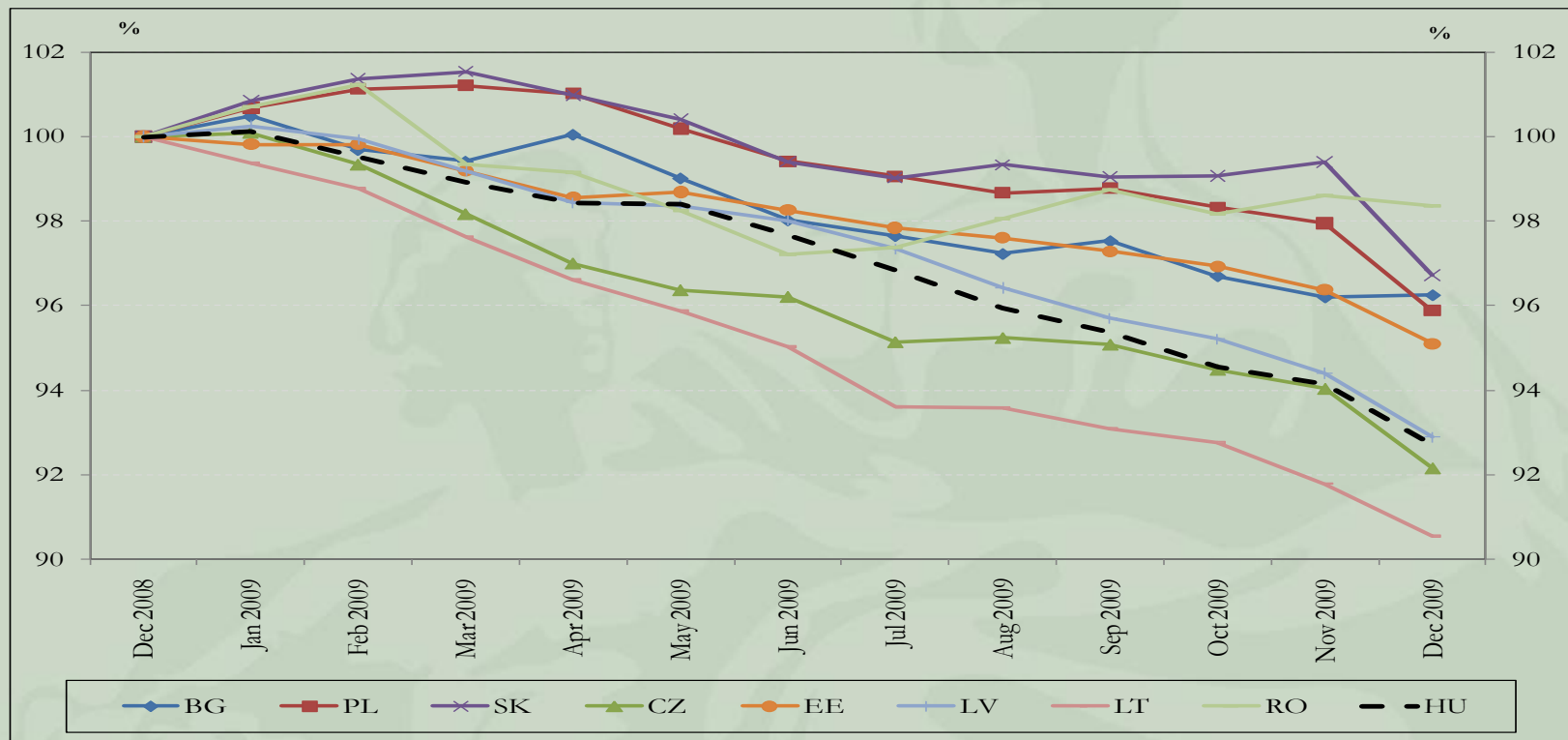
# The fall in corporate lending is significant

*(The net credit flow to non-financial corporations)*



# The decline is significant in international comparison

*(Domestic corporate loan stocks in the CEE region, Dec. 2008 =100)*



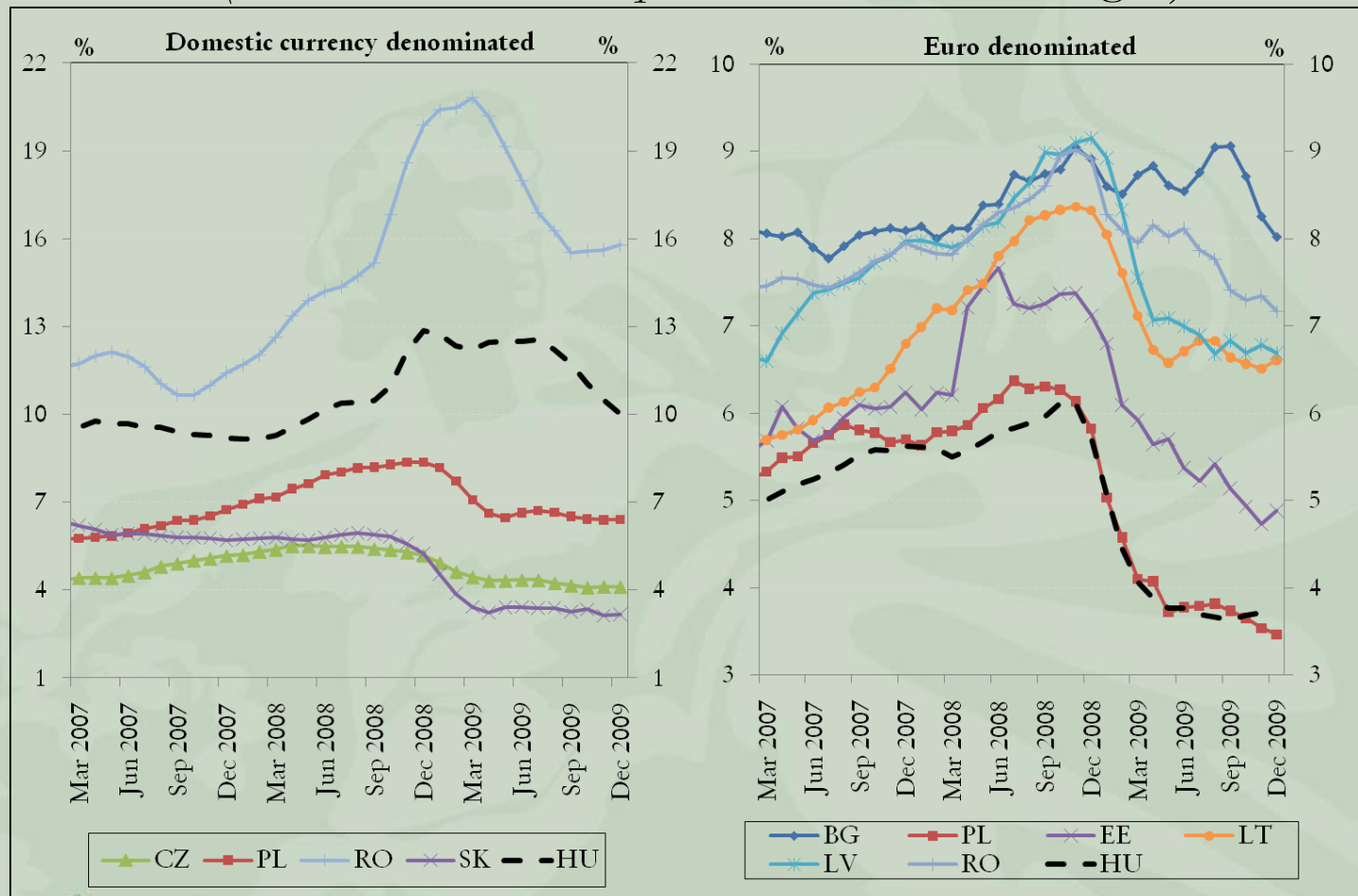
*(Contraction in corporate lending in December 2009 for different reference dates)*

|                         | BG   | PL   | SK   | CZ   | EE   | LV   | LT   | RO   | HU          |
|-------------------------|------|------|------|------|------|------|------|------|-------------|
| Dec. 2008 =100 per cent | 96,4 | 96   | 95,5 | 91,2 | 94,1 | 92,7 | 90,3 | 95,4 | <u>90,7</u> |
| Oct. 2008 =100 per cent | 96,3 | 95,9 | 96,7 | 92,2 | 95,1 | 92,9 | 90,6 | 98,4 | <u>92,7</u> |

Source: National banks.

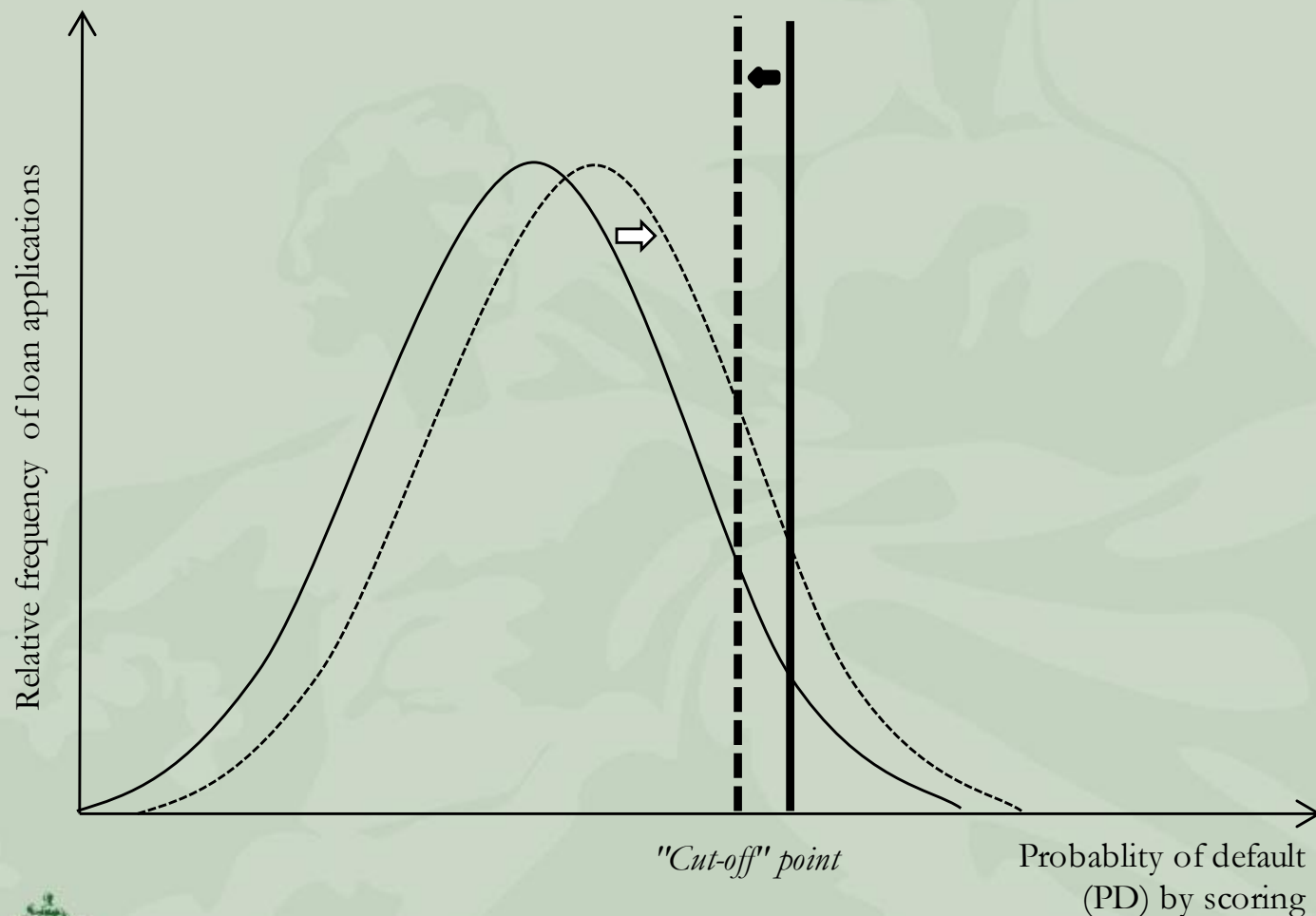
# HUF interest rate of corporate loans is one of the highest, while euro interest rate is one of the lowest in the region

*(Interest rates on new corporate loans in the CEE region)*



# Creditworthiness decreases and so does the risk-taking willingness of banks

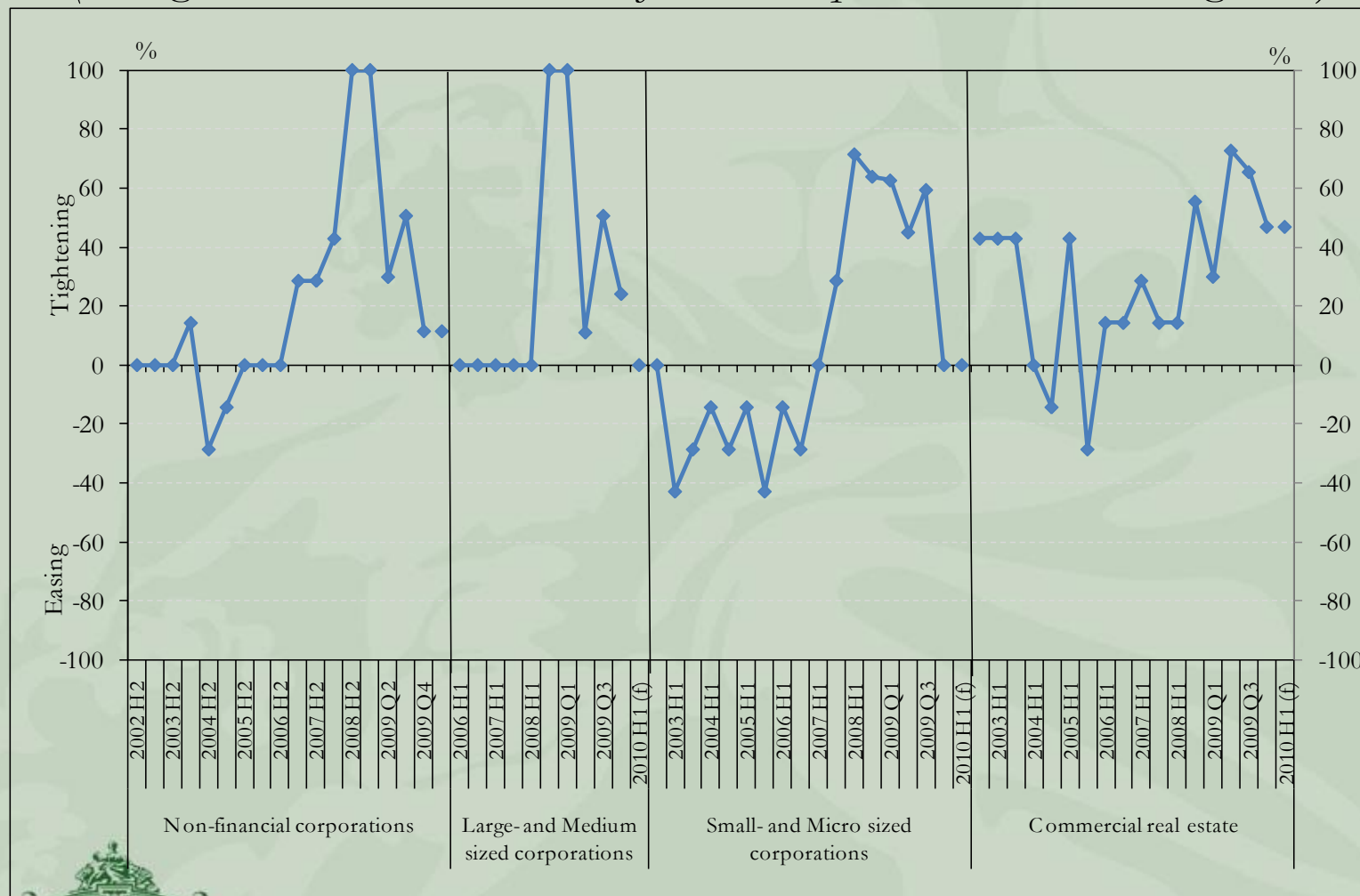
*(Distribution of new loan applications according to risk)*





# Tighter conditions mean lending to companies with high creditworthiness

*(Changes in credit conditions to non-financial corporations in the banking sector)*



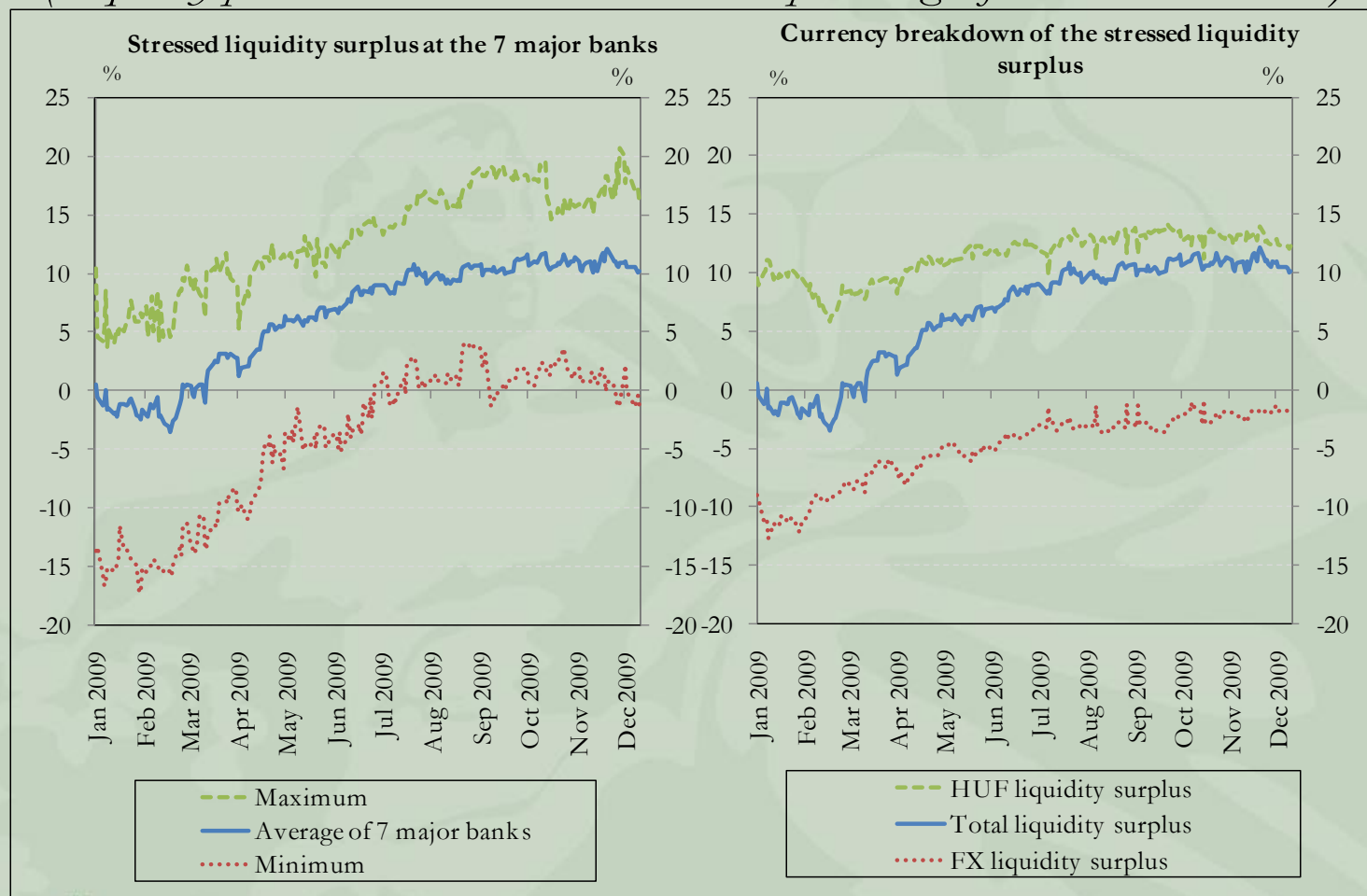
Note: Net percentage of respondents reporting tightening/easing

Source: MNB.

*III. Banks' shock-absorbing capacity is adequate*

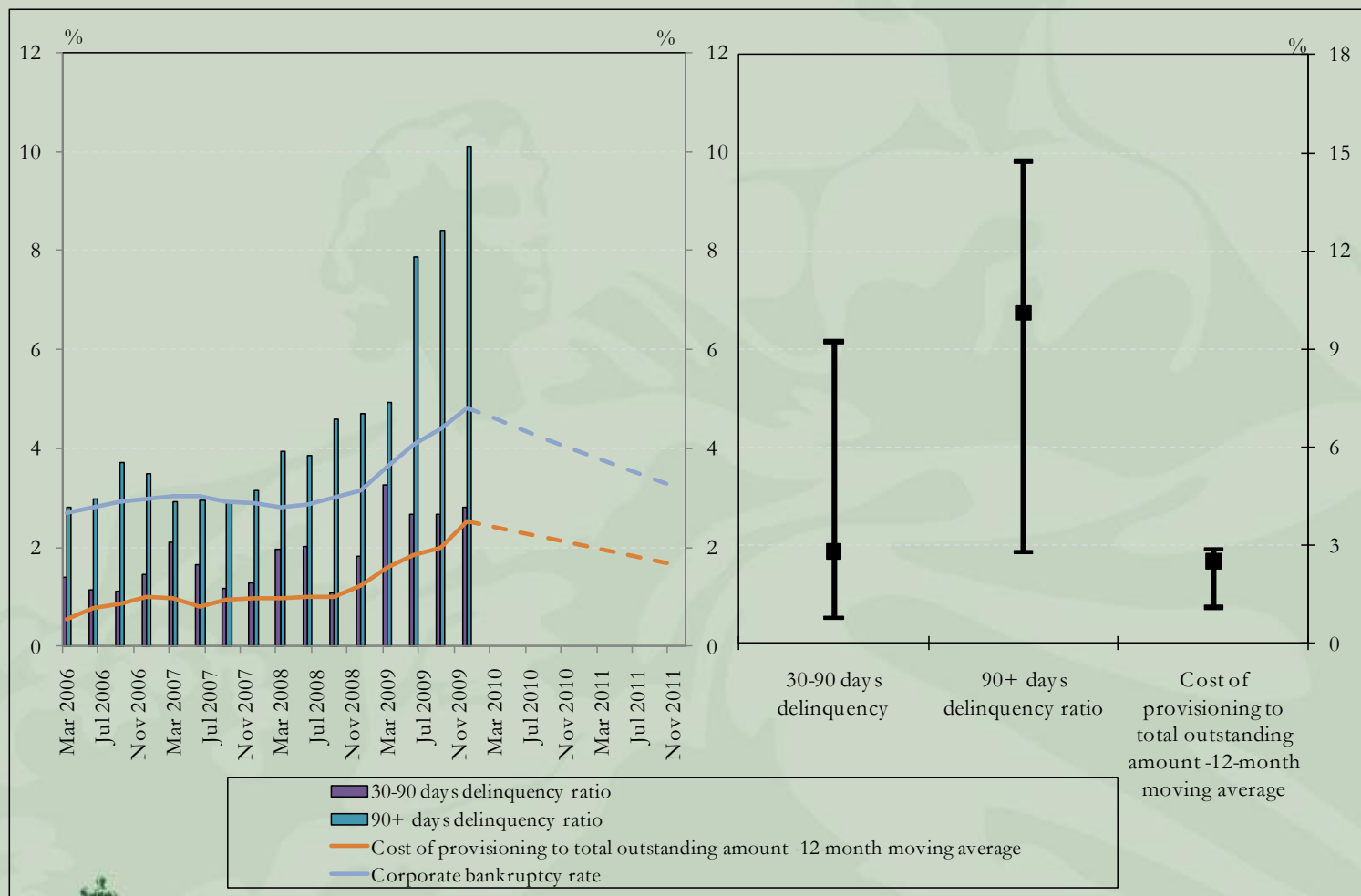
# Liquidity position is adequate in stress situation, however foreign currency liquidity need may occur

*(Liquidity position in the stress scenario as a percentage of balance sheet totals)*



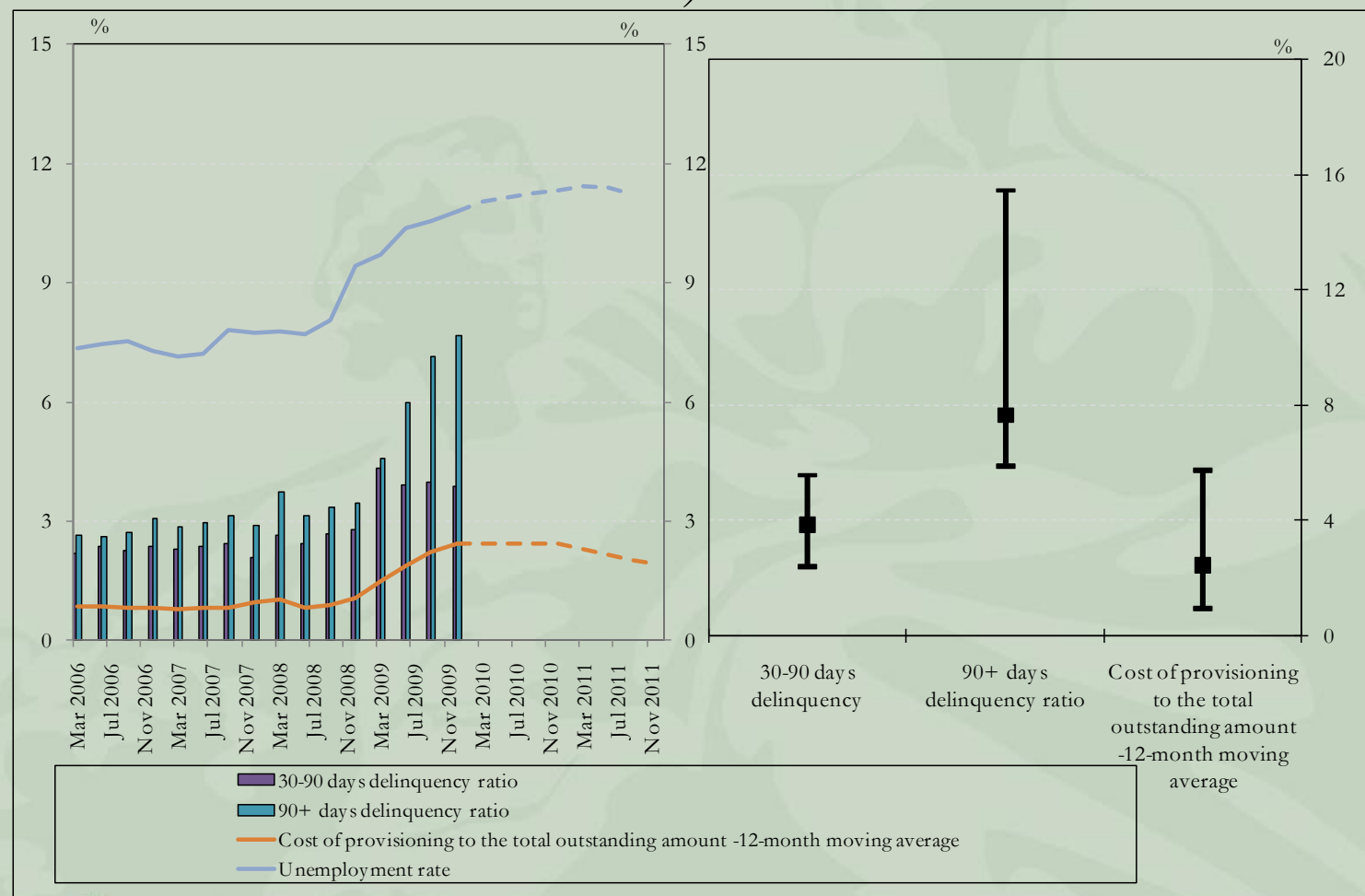
# Credit portfolio quality deteriorated in the corporate sector...

*(Major quality indicators of the banks' corporate portfolio and their distribution)*



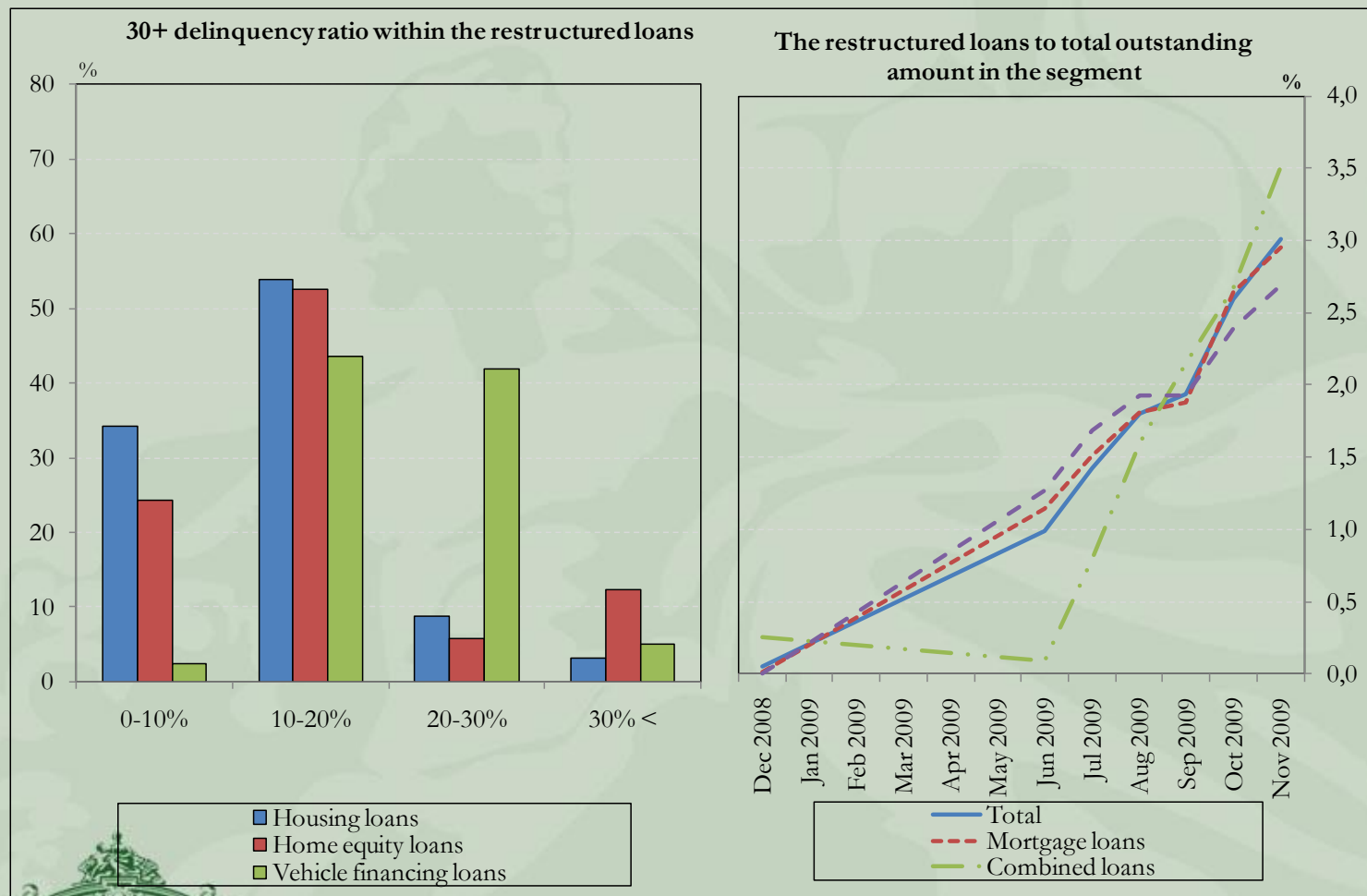
## ... and in the household sector as well

*(Major quality indicators of the credit institutions' household portfolio and their distribution*



# Increasing ratio of restructured loans, but 'redefault' is not negligible

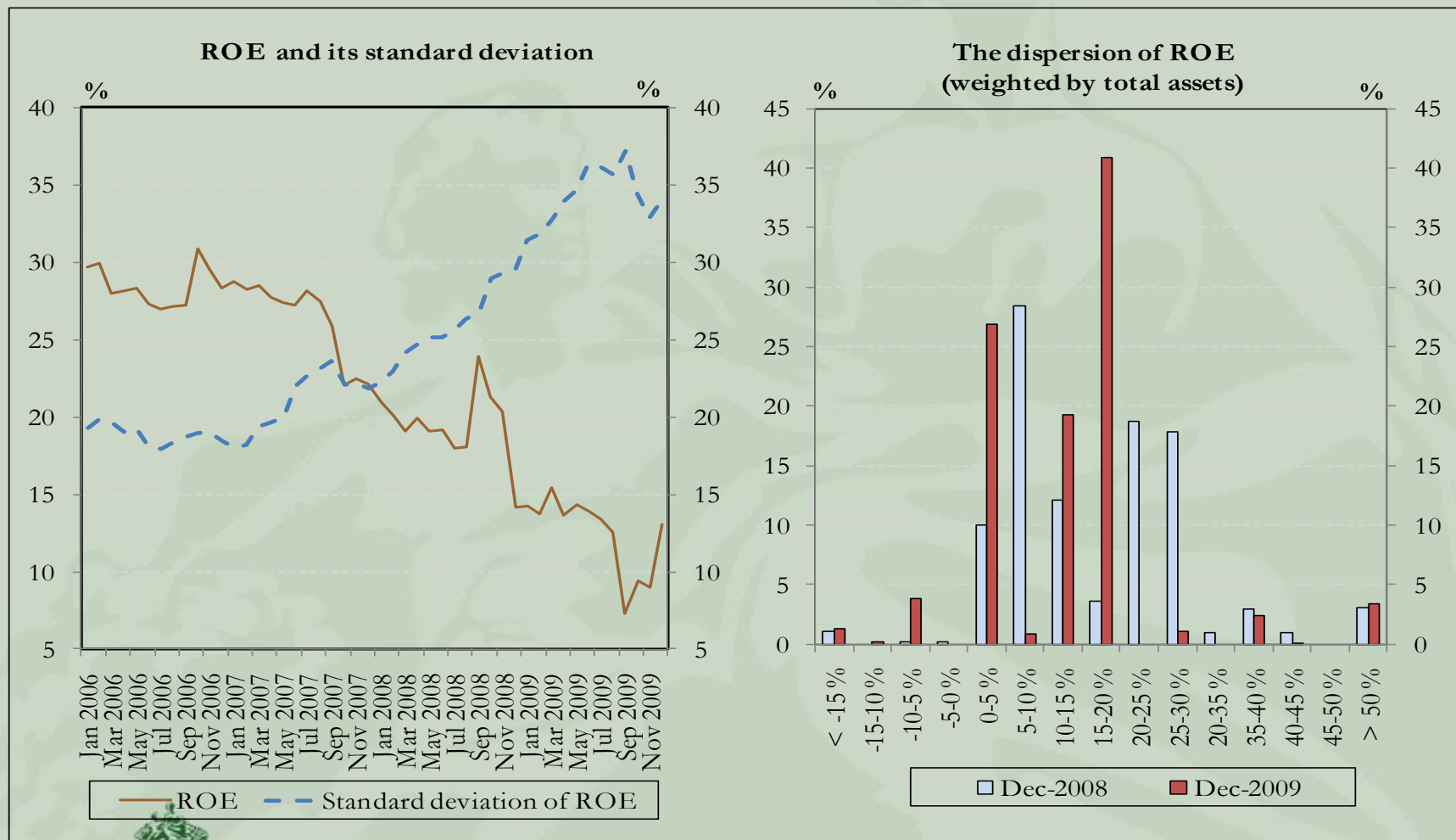
*(Distribution of redefaulters among banks after restructuring and ratio of restructuring to the total credit portfolio in relation to households)*



Source: MNB.

# Despite the credit losses the banking sector reached high profitability

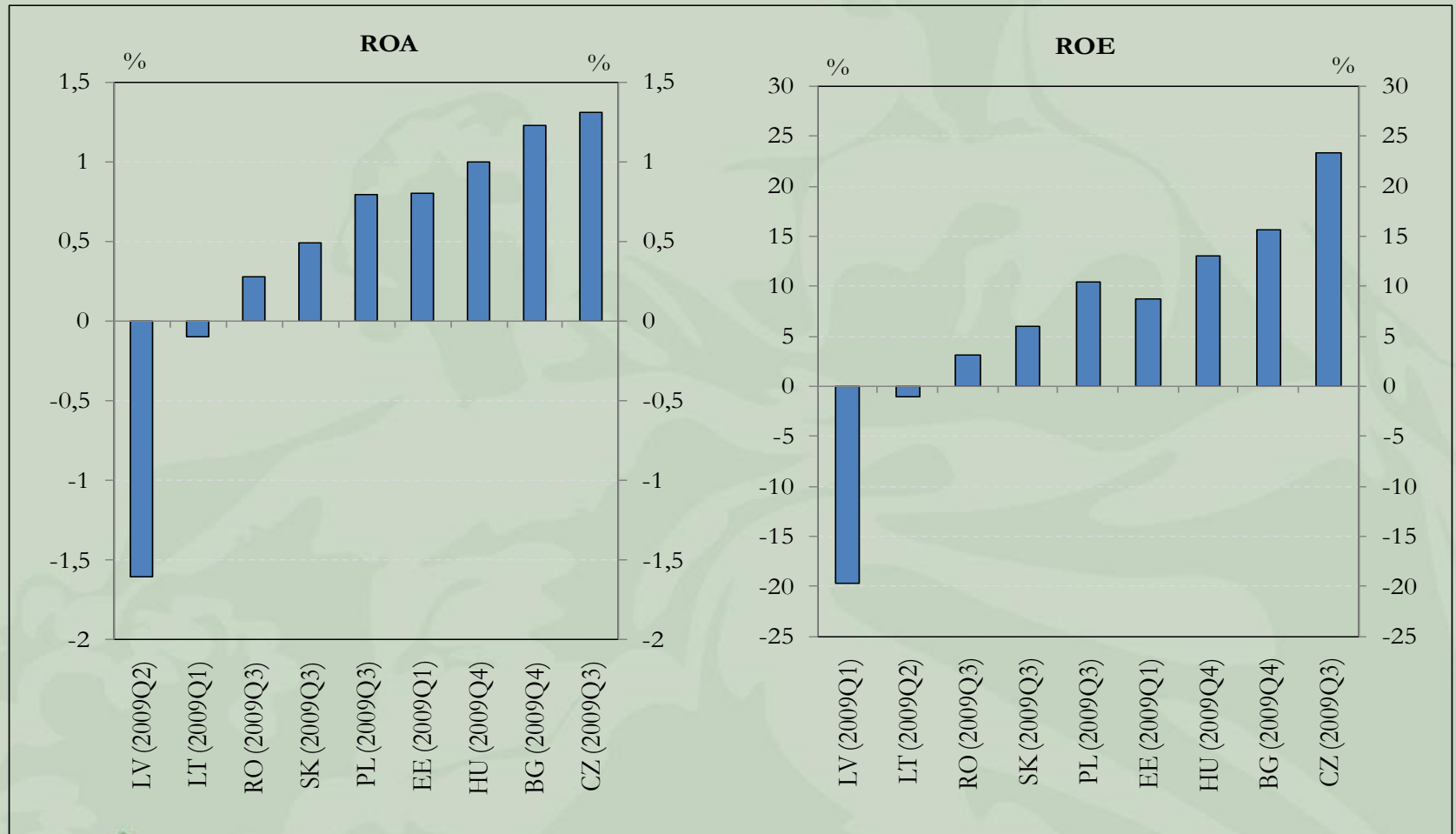
*(ROE indicator of the banking sector, its standard deviation among banks and dispersion by total assets)*





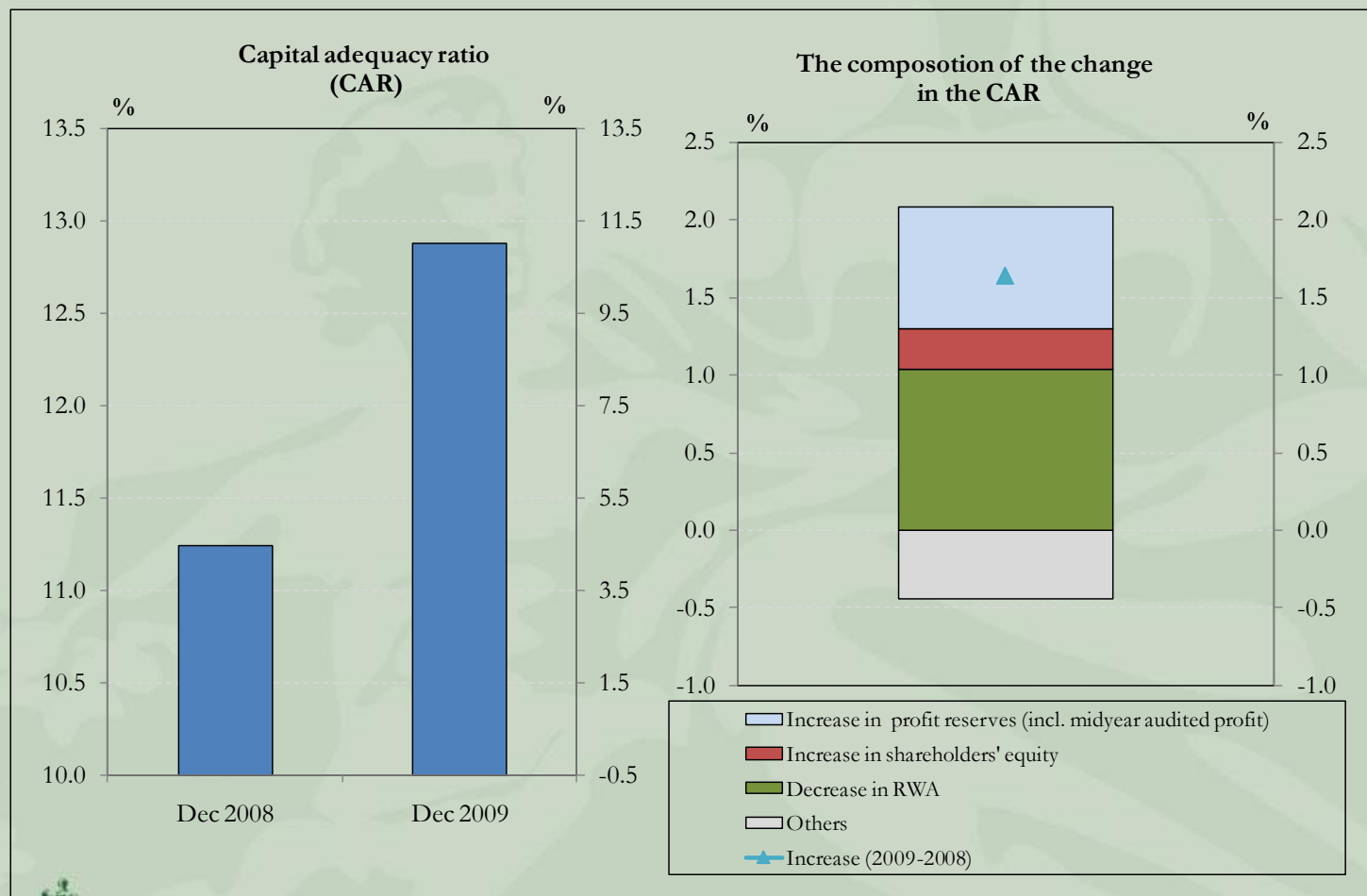
# Profitability of Hungarian banking sector remains high in international comparison

*(Profitability position of the domestic banking sector in regional comparison)*



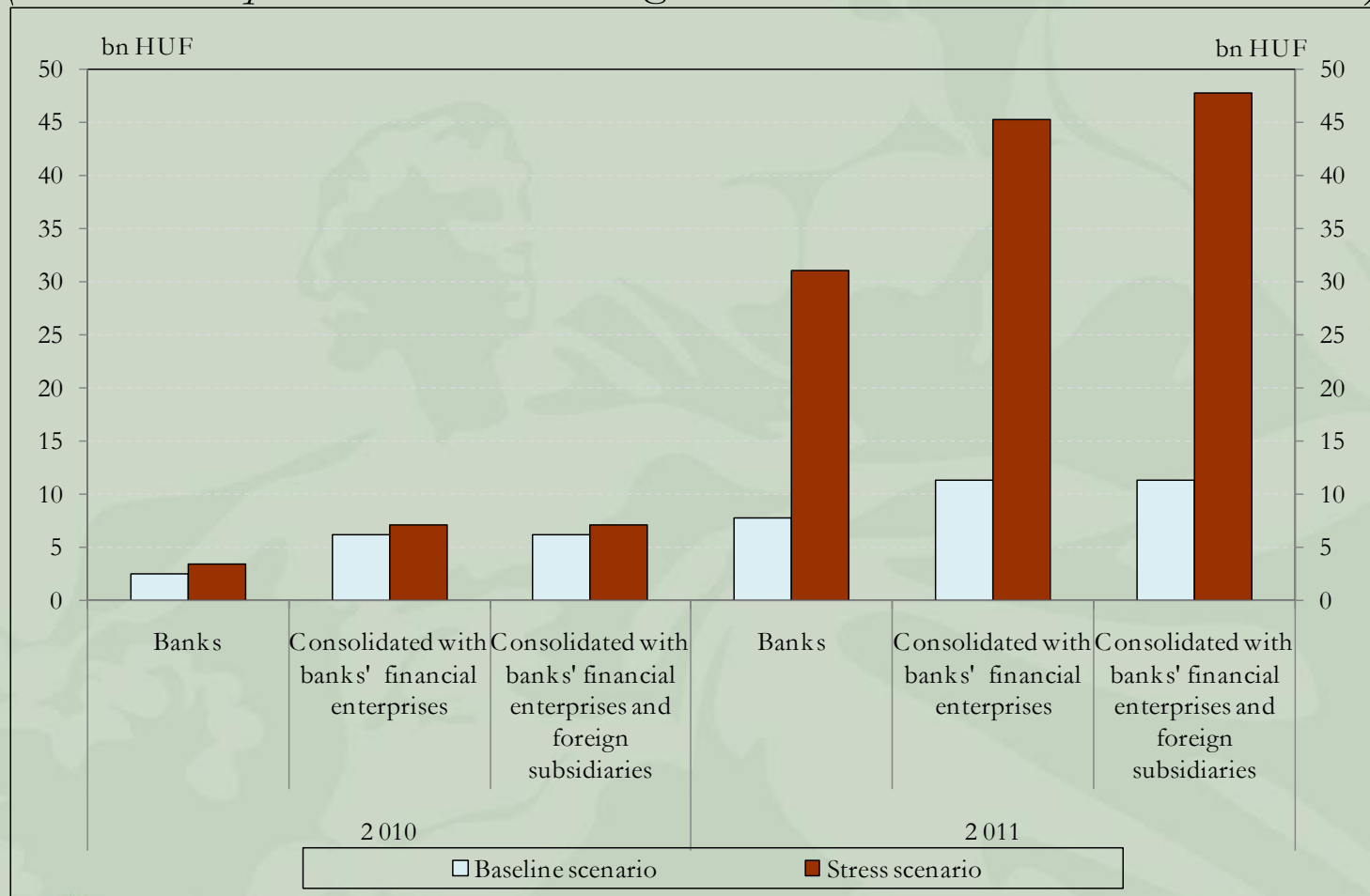
# CAR improved as a result of high profits, decrease of RWA and capital injections from parent banks

*(Capital adequacy ratio of the banking sector in 2008-09 and decomposition of its change)*



# The additional capital need of the banking sector is negligible in the baseline scenario and manageable in the stress scenario

*(Additional capital need in the banking sector in the baseline - and stress scenario)*



Note: The additional capital injection is the sum of individual bank additional capital needs. The data for 2011 contains the capital injection need for 2010.

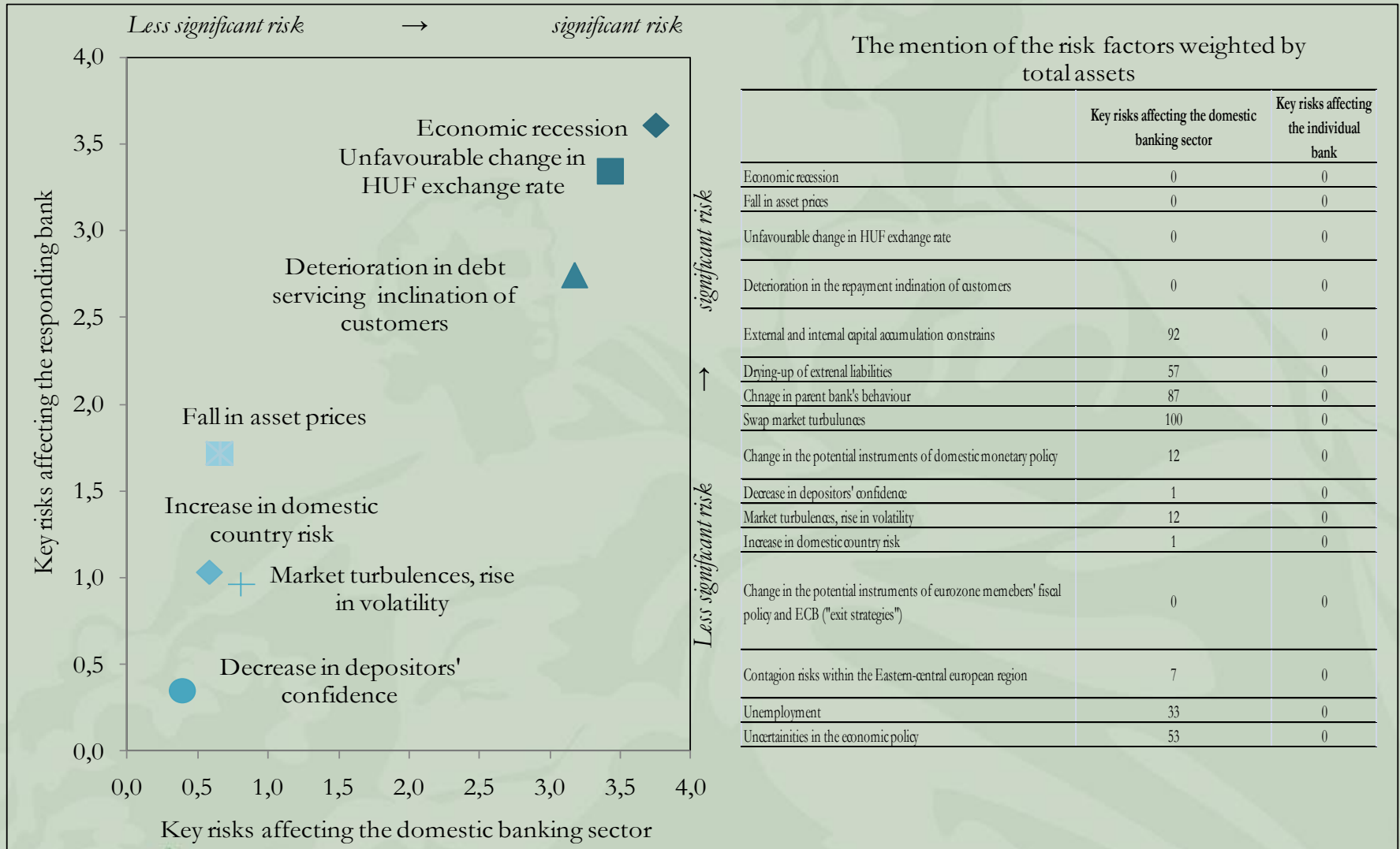
Source: MNB.

## *IV. Market expectations*

# Expectations of domestic banks

|   | End of 2009 value     | Target interval for end of 2010* |
|---|-----------------------|----------------------------------|
| <b><i>I. Balance sheet developments</i></b>                             |                       |                                  |
| <b>1. Increase of balance sheet total (y-o-y growth in per cent)</b>    | 2,2%                  | 0,9%                             |
| <b>2. Growth targets for credits (y-o-y growth in per cent):</b>        |                       |                                  |
| a. Households   | 0,1%                  | 0,9%                             |
| b. Non financial corporations   | -7,1%                 | 6,4%                             |
| c. Financial corporations   | -20,1%                | -8,3%                            |
| <b>3. Growth targets for deposit taking (y-o-y growth in per cent):</b> |                       |                                  |
| a. Households   | 6,0%                  | 3,5%                             |
| b. Non financial corporations   | -1,7%                 | 6,3%                             |
| c. Financial corporations   | -18,1%                | 4,8%                             |
| <b>4. Loan-to-deposit ratio (change in percentage point)</b>            | -17 percentage points | -1,8 percentage points           |
| <b><i>II. Portfolio quality</i></b>                                     |                       |                                  |
| <b>1. Ratio of non-performing loans to total loans (per cent)***</b>    |                       |                                  |
| a. Households   | 7,2%                  | 8,7%                             |
| b. Non financial corporations   | 10,1%                 | 10,5%                            |
| d. Loans total****  | 6,2%                  | 7,4%                             |
| <b>2. Newly allocated provisioning (in HUF billion)</b>                 |                       |                                  |
| a. Households   | 2,5%                  | 2,6%                             |
| b. Non financial corporations   | 2,5%                  | 2,1%                             |
| d. Loans total****  | 1,6%                  | 1,6%                             |
| <b><i>III. Profit</i></b>   |                       |                                  |
| Profit before tax (HUF billion)   | 306 bn HUF            | 334 bn HUF                       |
| ROA (%) (before tax)  | 0,97%                 | 1,1%                             |
| ROE (%) (before tax)  | 13,0%                 | 12,5%                            |
| <b><i>IV. Capital position</i></b>                                      |                       |                                  |
| Growth in Risk Weighted Assets total (y-o-y change, in per cents)       | -6,8%                 | 1,5%                             |
| Capital adequacy ratio (per cent)                                       | 12,9%                 | 13,5%                            |

# Results of Market Intelligence survey on risks characterising the year 2010



# Q&A