MAGYAR NEMZETI BANK

SENIOR LOAN OFFICER SURVEY ON BANK LENDING PRACTICES

MARCH 2008

Summary of the aggregate results of the survey on 2007 H2

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on Bank Lending Practices

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Financial Stability

In 2003, the Magyar Nemzeti Bank launched its Senior Loan Officer survey in the interests of more deeply understanding developments and processes related to the lending market. This survey is conducted every six months. The latest one was conducted in January and examined the corporate and household lending segments and, for the first time, the municipal lending segment as well.

In relation to the household lending market, the results of the survey indicated that banks' willingness to lend increased both in respect of housing loans and consumer loans in 2007 H2. Credit brokers play an increasingly important role in sales activity and in the process of refinancing (in terms of new placements brokers may account for up to 50%). Respondents relaxed their credit conditions, and their plans for 2008 H1 also point in this direction, primarily due to the strong competition in the banking sector. This competition is also motivating banks to launch new, riskier products. According to the participating banks, the household segment's willingness to borrow has remained at steadily high levels while real wages are declining, as households are maintaining their previous level of consumption in this manner. Banks reported a slight deterioration in portfolio quality in 2007 H2, and forecasted this trend to continue for personal loans, credit card products and mortgage loans.

It is worth underlining that the easing tendencies in household lending conditions in Hungary stand in contrast to the foreign lending surveys, as banks reported a clear trend towards tighter household lending conditions in the euro area, USA, Great Britain, Poland and Lithuania.

In the corporate segment, the willingness to lend is not increasing, and – in contrast to the previous trends – there was even a decline in the growth rate for small and micro-sized enterprises. Respondents perceived an increase of credit demand in the corporate segment, although this was not motivated by increasing investment, but rather by increasing inventory financing needs and a decrease in firms' internally generated funds. Banks tightened their credit conditions (in spreads over funding costs in the corporate segment), because of the unfavourable economic prospects, industry-specific problems (especially in the construction industry) and deterioration in banks' liquidity position. In respect of commercial real estate loans, banks reported significant tightening of credit standards for housing projects, whereas the position for office building projects was better than previously expected. Respondents experienced a slight increase in default rates in 2007 H2 and expect this trend to continue. The tightening trends in the corporate segment experienced in this survey for Hungary were similar to the results of foreign lending surveys, which showed credit condition tightening in the corporate segment.

In the case of municipalities, banks reported strong demand for financing. This increase in demand was related primarily to bond issuance as such issuance need not be conducted within the framework of public procurement procedures, and there are fears that this favourable treatment will be abandoned. Banks tightened their conditions in the municipal segment.

US sub-prime crisis indirectly affected the majority of respondents: funding costs increased by not more than 80 basis points. Banks will partly or fully transfer this increase in funding costs to customers, but the extent depends on the competitive situation.

Aggregate results of the questionnaire

The results of the survey are presented in the form of a descriptive analysis, amended by an assessment of the data based on the answers to the survey. Annex 1 contains the figures of the total amount of outstanding loans in each segment and answers, while Annex 2 presents the methodological background. Numerical data on the segments is contained in Annex 3. Answers to questions are presented in Annexes 4, 5, 6 (in a separate Excel file attachment). In presenting the results of the survey conducted in January 2008, we follow the structure of the relevant questionnaire in all the three lending segments (household, corporate and municipal). The retrospective questions in the questionnaire refer to 2007 H2: thus the base period is 2007 H1, whereas the forward-looking questions contain projections for 2008 H1, compared to the trends of the previous half year.[1]

1. Household lending market

In the domestic environment, which is currently dominated by the macroeconomic stabilisation measures, banks' activity in the household segment continues to show an increasing trend both in the housing loan and consumer credit markets, although the increase in willingness to lend is more restrained than seen in the survey for the previous half year. While standards typically remained unchanged (albeit there was easing reported in the case of one bank), the participants attempted to support their willingness to lend, which was still increasing (although more moderately than earlier) by means of further easing in lending conditions. In respect of housing loans, one-half of the respondents perceived a rise in demand. In the consumer credit market almost all banks (other than those specialising in motor vehicle and hire purchase loans) experienced a strengthening in demand.

[1] During the six-month periods under review, the number and scope of surveyed banks changed (e.g. as a result of mergers). Regarding the subject of housing loans, since the launch of the survey (except for December 2003) we conducted the interviews with 7 banks, then in December 2005 the number of banks surveyed increased to 8 and later, from December 2007, to 9. In the beginning we interviewed 7 banks about consumer credit, increasing to 9 from 2004 H1, to 10 from end-2004, to 11 from end-2006, and to 12 from June 2007. The number of banks questioned in our latest survey is 13.

Chart 1 Willingness of banks to grant housing loans and consumer loans (difference between the ratios of those reporting higher and lower willingness to lend)

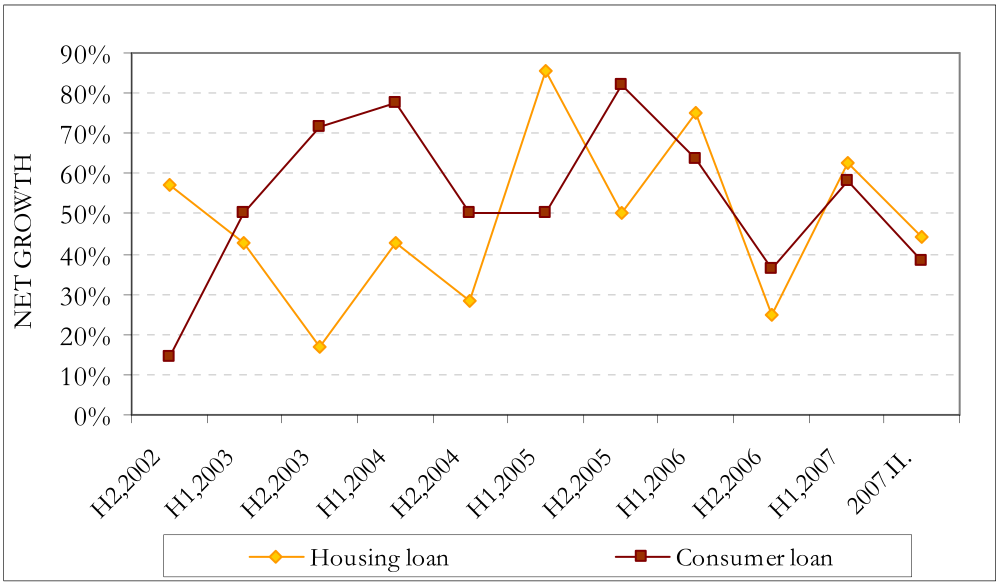
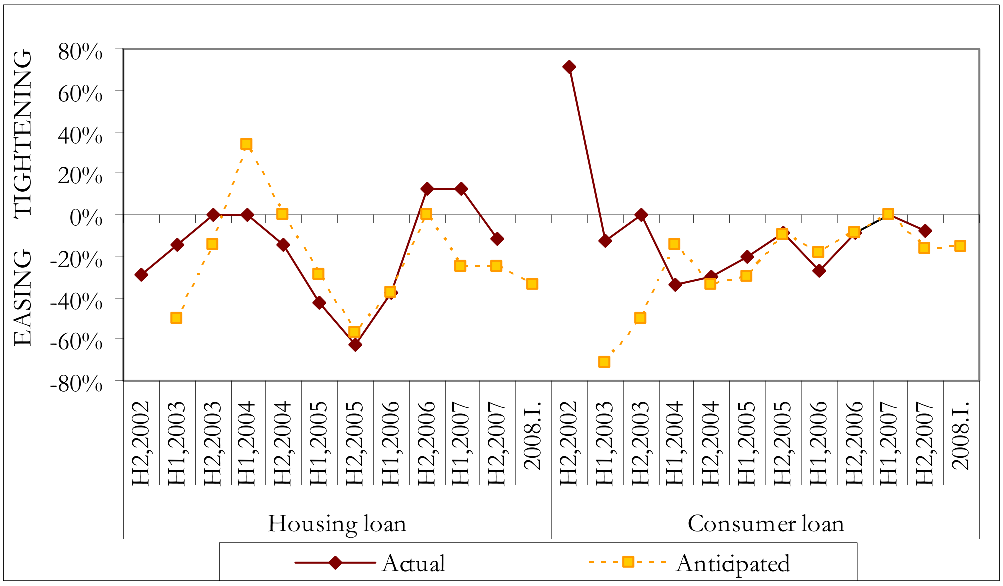


Chart 2 Change in the creditworthiness standards of housing loans and consumer loans (ratio of banks indicating tightening minus those reporting easing in lending standards)



Housing loans

(Questions 1–9 and 14 of Annex 4)

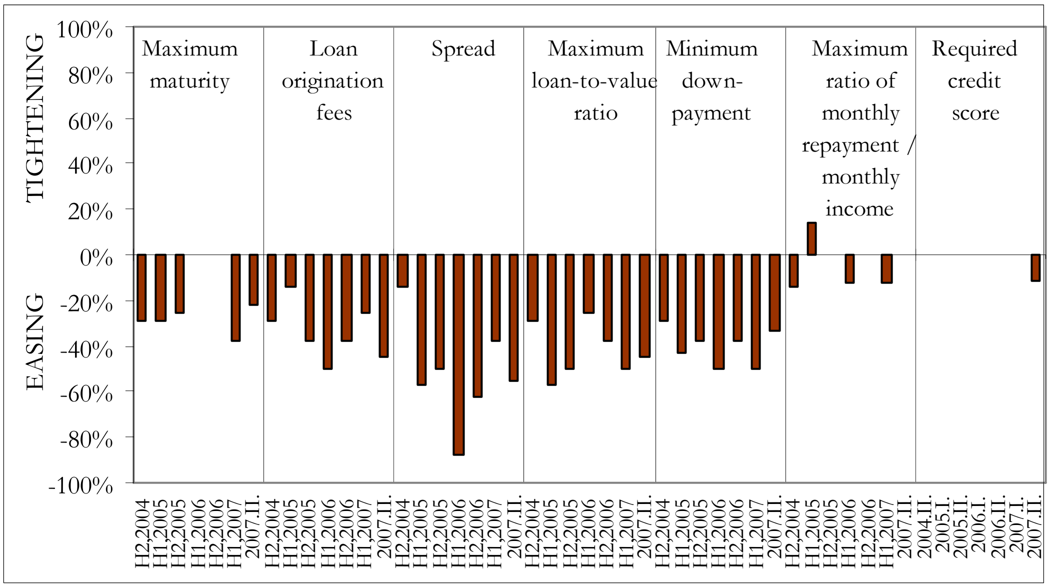
Supply side

Following a significant increase in willingness to lend in 2007 H1 as reflected by the answers, a more subdued increase in willingness to lend was observed (Chart 1): four of the respondents reported a more aggressive lending policy, while five maintained the high levels of willingness to lend reached in earlier periods. Activity in lending for housing continued to be basically related to foreign currency loans, while lending in forints was mentioned by the participants as a non-existent market.

The increase in willingness to lend was mainly reflected in a further easing of lending conditions, while the lending standards (with the exception of one easing bank) were left nearly unchanged by the banks, similarly to the trends seen in the previous half year. As opposed to the trends typical until 2006 H2, when banks steadily eased ***their lending standards*** in the hope of acquiring new market share, the trend observed in 2007 H1 continued in 2007 H2 as well, as only one of the responding banks reported easing. The other institutions kept their respective standards unchanged (Chart 2), presumably due to the uncertainty surrounding households' income situation, the risk level and external effects on the banking sector (mainly the consequences of the sub-prime mortgage market crisis).

However, in accordance with the longer-term trend, there was significant easing in the ***conditions of housing loans***.[2]

Chart 3 Lending conditions in the market of housing loans (ratio of those reporting tightening minus those reporting easing)



- Two banks indicated that they increased the maximum loan maturity of their housing loan products, typically to 35 years.
- Four banks continued to reduce or remit loan origination fees in the framework of promotion campaigns. Most of the banks surveyed already have so-called 'handling charge free' schemes ('only interest type product').
- In the case of foreign exchange based (typically CHF) housing loans, participants' behaviour is less variable. Most of the participants (five banks) eased the contract schemes in terms of the spread, while four institutions left them nearly unchanged, despite the increasing funding costs.
- The amount of minimum downpayment required and the maximum extent of the loan to value ratio (so-called LTV) were further eased by three and four banks, respectively (non-simultaneous changing of the two parameters was observed at one bank).

2 Almost all banks treat the HUF and FX schemes the same way in determining standards and conditions, as and demand for HUF housing loans is very low, the conclusions basically apply to both product types equally, except fees charged for granting the loans and the spread. In the case of HUF loans these two parameters were only eased by one bank each in the same way, as for FX loans as well.

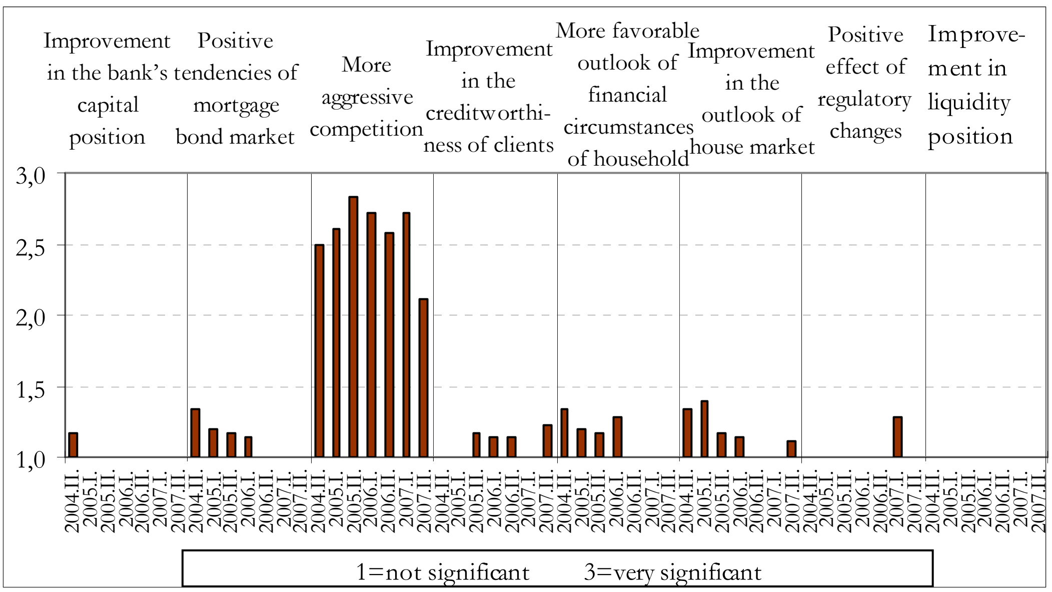
- Compared to the previous survey, one additional credit institution indicated its initiation of asset based financing. Most of the respondents have products which are not based on direct examination of income. However, some respondents still refrain from clearly asset based housing financing.
- The survey also included a question on the minimum required level of creditworthiness. Stemming from the various levels of maturity of their portfolios, institutions demonstrated different behaviours in this respect: one bank tightened, two banks eased, and the remaining six institutions left the required level of creditworthiness nearly unchanged.

In the banks' opinion, the easing of lending conditions continued to be fostered mainly by the strong competition. A more favourable-than-expected situation in the housing market and the expected improvement in customers' creditworthiness were indicated as reasons for easing by one bank each. The fight for agents and the competition generated by agents play an ever increasing role in the aggressive competition.[3]

In 2007 H2, an important new product development was that two institutions introduced a product which allows households to access Japanese yen based housing loans, with somewhat stricter conditions (stricter LTV ratio and repayment burden/income ratio) than experienced with products introduced earlier.[4]

However, in the respondents' opinion, housing leasing is still present as a complementary product only, and does not represent a serious market eroding force in the case of households. Four of the nine participating institutions own their respective financial corporations which provide housing leasing services. Based on the responses, household real estate leasing accounts for a minimal share (below 1% on average), compared to the magnitude of housing loans. In terms of the standards related to real estate leasing, the institutions apply basically the same principles, and it is the product-specific features which account for the differences in standards and lending conditions.

Chart 4 Reasons for easing of creditworthiness standards and lending conditions for housing loans



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[3] One of the participants indicated that they were able further relax the LTV ratios because they had revised their real estate evaluation system, and can now work on the basis of more reliable assessments.

[4] We shall return to this question when in the discussion of current issues.

With regard to housing loans we asked again, whether the banking liquidity position and its expected change had any effect on the easing trends. Amidst the international turbulence, participants indicated an increase in funding costs in connection with liquidity, which points much more in the direction of future tightening rather than justifying easing.

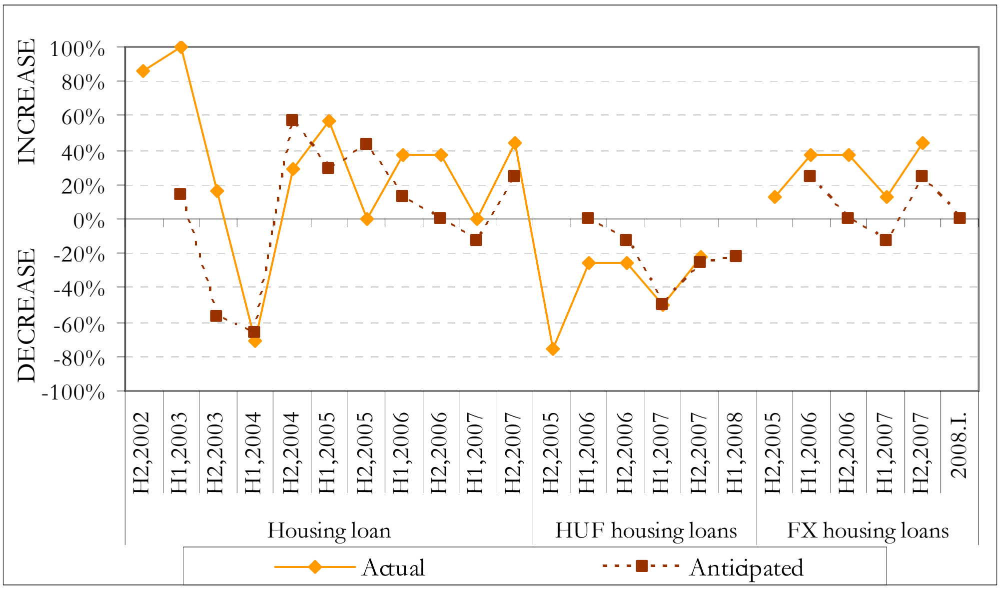
Based on the plans for 2007 H2, three banks envisaged a further easing of creditworthiness standards/lending conditions in 2008 H1, which is basically driven by the intention of keeping existing customers and acquiring new ones.

Demand side

During the interviews conducted in July 2007, market participants' expectations were guardedly optimistic. An increase in demand in net terms was expected by one-quarter of the participants. As a backtest, most of the participants (five banks) perceived an increase in demand compared to the previous half year (apart from seasonal effects). Three institutions perceived unchanged demand, while one institution experienced weakening. Most institutions indicated supply-driven demand as the reason for the increase in demand, as the widening choice of products and the more intense competition have a demand-boosting effect, strengthening consumption smoothing effects.

It was still only the foreign exchange loans where banks experienced an increase in the number of loan applications. As far as forint loans are concerned, similarly to the previous half year, the banks interviewed did not indicate any special interest in these product schemes. One-third of respondents considered demand for forint housing loans even weaker than in the previous half year, while one institution experienced some strengthening, in line with the fact that no appreciation of the forint was seen in the past half year.

Chart 5 Demand for housing loans
(ratio of banks indicating an increase vs. banks indicating a decrease)



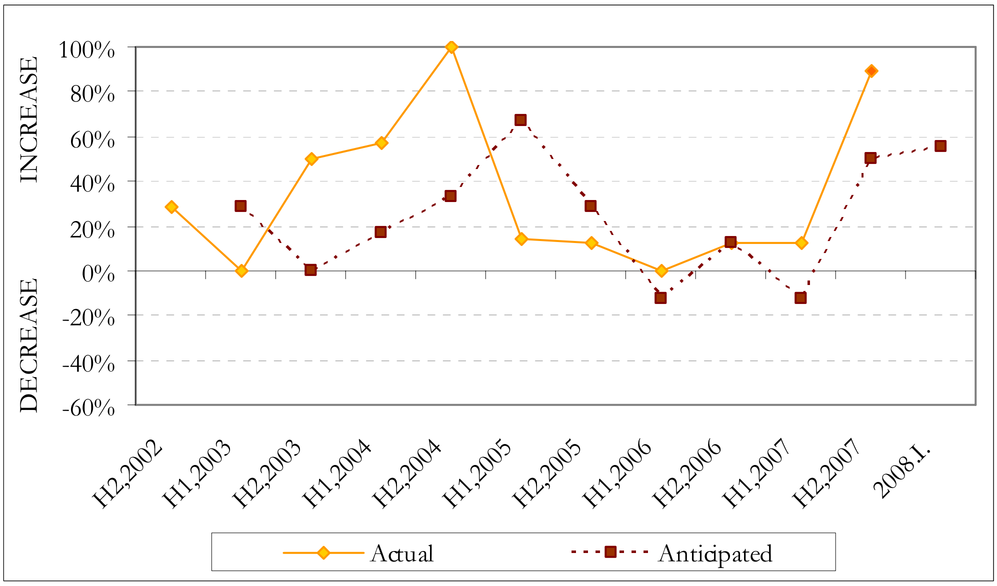
With regard to demand in the next half year, two participants gave optimistic projections, and two participants forecasted a decline in demand, which equals static expected demand on average. Respondents still believe that growth is possible only in respect of foreign exchange loans, while seven institutions forecasted unchanged demand for forint loans, and two institutions expected falling demand for forint loans. For the time being, institutions expect broadly unchanged demand in the household real estate market.

Nominal housing prices

Overall, the banks participating in the survey – based on the sample available for them – perceived a modest increase in nominal housing prices. There were significant differences in the perceived price movements in terms of new and used homes. While seven banks saw a slight nominal price increase in the market of new homes, five banks reported low price increases in the market of used homes.

Most institutions forecasted a slight price increase for the next half year. An upswing in prices is still rather expected in the market of new homes, where six banks projected a slight additional nominal increase. According to six banks, prices will not change in the market of used housing, two banks expect a smaller increase, and one expects a slight decline in the prices of used homes.

Chart 6 Nominal housing prices according to senior loan officers (ratio of those reporting higher minus those reporting lower prices)



As in the previous surveys, some of the respondents once again mentioned that there are considerable differences in developments in housing prices according to location and size of the real estate. For example, the area in which the given bank finances real estate developments for housing plays an important role in the assessment of the prices of new homes.

Consumer and other loans

(Questions 15–21 of Annex 4)

The questions regarding the policy of lending for consumption were analysed according to the following product groups: general purpose mortgage loans (9 participating banks), personal loans (9 participating banks), motor vehicle loans (2 participating banks and 5 financial enterprises with banking backgrounds), hire purchase loans (4 participating banks), credit cards (10 participating banks), and as a new item and separate segment we also included the overdraft credit product (with 6 banks responding). For certain product groups longer time series are not available for us: thus we present the last one-year trends of the market segment. However, in future studies we shall also strive to provide analyses based on time series.

Supply side

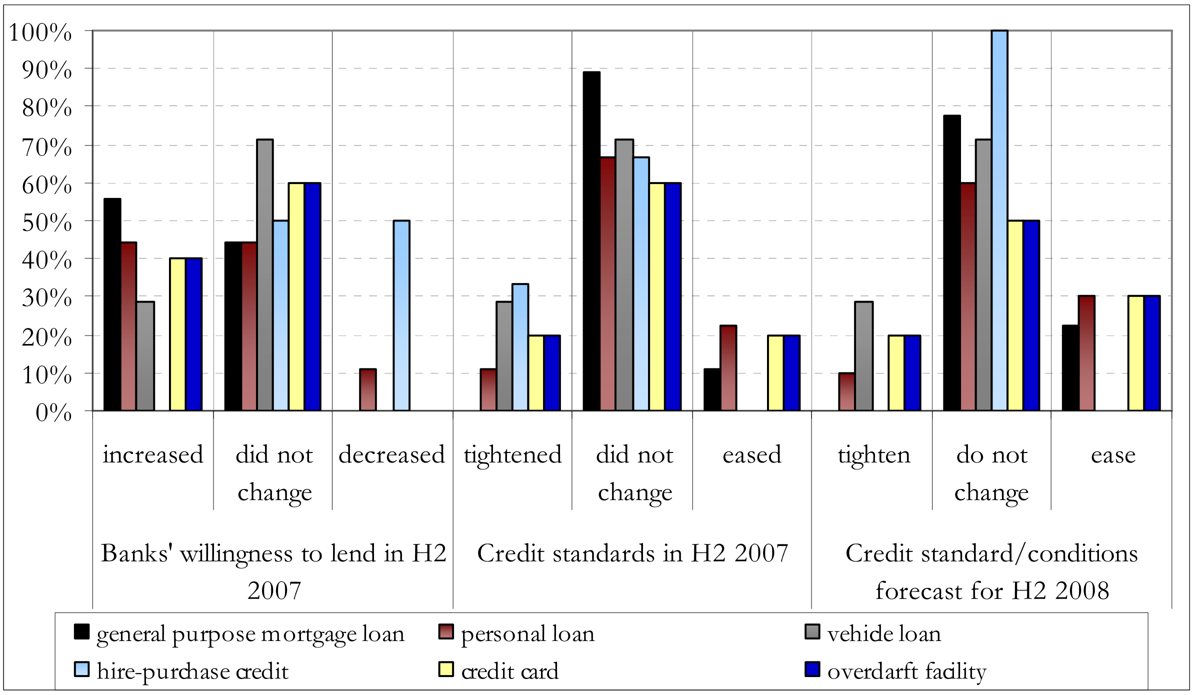
Similar to the market of housing loans and in accordance with the trends observed in 2007 H1, banks' willingness to lend continued to increase in respect of consumer lending as well (Chart 1). This increase in willingness was especially spectacular in respect of personal mortgage loans, where one institution indicated a significant rise, and four reported a somewhat increasing willingness to lend. This trend complies with the fact that several institutions indicated an increasing role of 'refinancing' loans, when both the institutions and the customers try to replace less favourable housing loans agreed upon earlier with general purpose mortgage loans. This trend is basically not about a restructuring within one's own portfolio, but rather about acquiring one another's loans.[5]

The increase in the willingness to lend was usually coupled with a slight easing of ***lending standards***[6] (Chart 2). In this segment as well, participants changed the terms and conditions of lending mainly as a result of competition. With regard to motor vehicle loans, two out of seven respondents reported a slight increase in willingness. Institutions indicated a basically similar, modest increase in the willingness to lend in the segment of loans without collateral, with the exception of hire purchase loans, where one out of four respondents reported the complete termination of this branch of business, i.e. a significant fall in willingness, while another participant reported a slight decline. With regard to the supply side, marketing campaigns continued to play a significant role, together with cross sales connected to the bank's other products in case of credit cards as well as co-branding with service providers operating in other sectors.

[5] Loan replacement trends are discussed in more detail in the section on current issues.

[6] Banks typically change the standards of general purpose mortgage loans together with those of lending for housing. Thus, in accordance with the market strategy, at the bank where easing took place, it also took place in general purpose mortgage loans.

Chart 7 Willingness to lend and creditworthiness standards for different consumer loan products (ratio of banks giving the relevant answer)



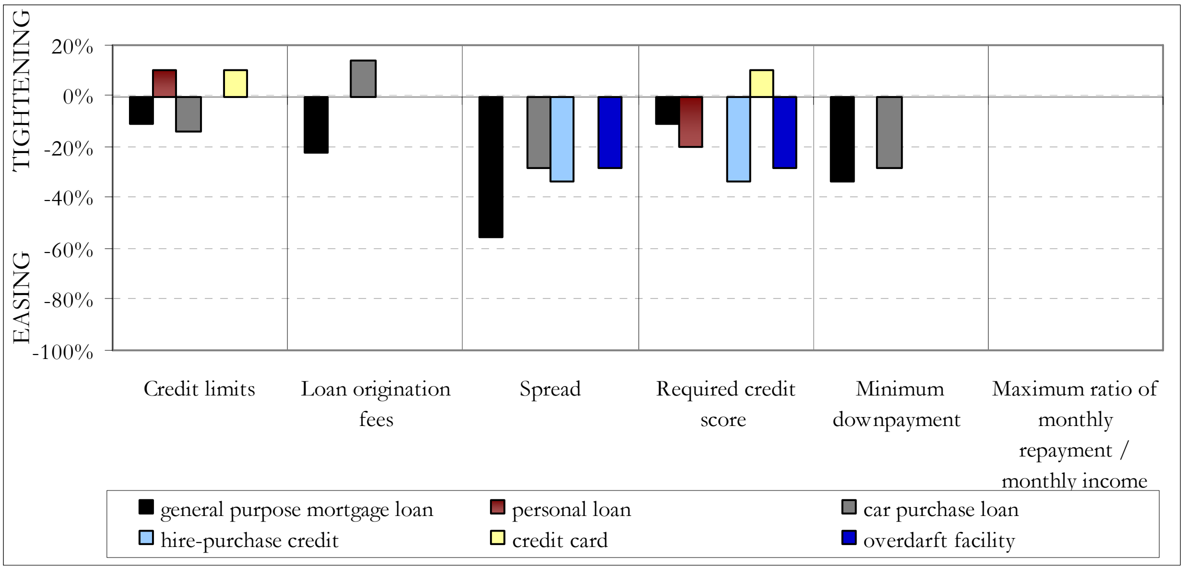
In terms of ***lending conditions***, in line with the longer-term trend, a slight overall easing was typical. Only two banks applied tightening in terms of the spread between the lending rate and the funding costs, although in the case of one product at each bank there was tightening due to the riskiness of the bank's portfolio (Chart 25).

Easing was reported in the following terms and conditions:

- Two banks somewhat reduced the amount of the credit limit, while other participants left it unchanged. There was one institution which indicated a raising of credit limits, but due to the earlier high level this cannot be considered as an effective change.
- One respondent eased the loan origination fees, while the others did not change them.
- Some banks still do not or only partly price the increase in funding costs in the interest rates of foreign exchange based products. Overall, spread easing is much more observable, although in individual product groups of some participants interest hikes have taken place, which offset the spread narrowing of previous periods to a certain extent.
- Two of the responding banks somewhat eased the level of required minimum creditworthiness. Three institutions eased the magnitude of the downpayment and the loan to value ratio. The change affected general purpose mortgage loans and vehicle loans.
- In addition, the introduction of tightening in terms of the level of minimum creditworthiness in personal loans and credit cards was indicated by one and two banks, respectively, as a reaction to an increase in the riskiness of the portfolio.
- With regard to general purpose mortgage loans we also inquired about developments in maximum maturity: nearly one-fourth of the institutions reported a slight easing of maturity.

It is important to emphasise that some of the participants eased the conditions for new placements only for customers with a credit history, i.e. different conditions apply to old and new customers. This is in line with the fact that banks are using so-called 'behavioural scoring' techniques to an increasing degree.

Chart 8 Lending conditions for various consumer loan products (ratio of those reporting tightening minus those reporting easing)



Similarly to previous half years, respondents continued to indicate almost exclusively the increasingly keen competition as the background for relaxing their lending policy. They especially emphasised the role of agents, who contributed to the significant increase in loan replacements between banks to a great extent. Aggressive competition in vehicle lending was indicated by the respondents to a lesser extent. Banks tend to consider financial enterprises to be less and less of competitors compared to the earlier survey results because, as they explain, for the time being they typically work in different segments with different target groups (Chart 27).

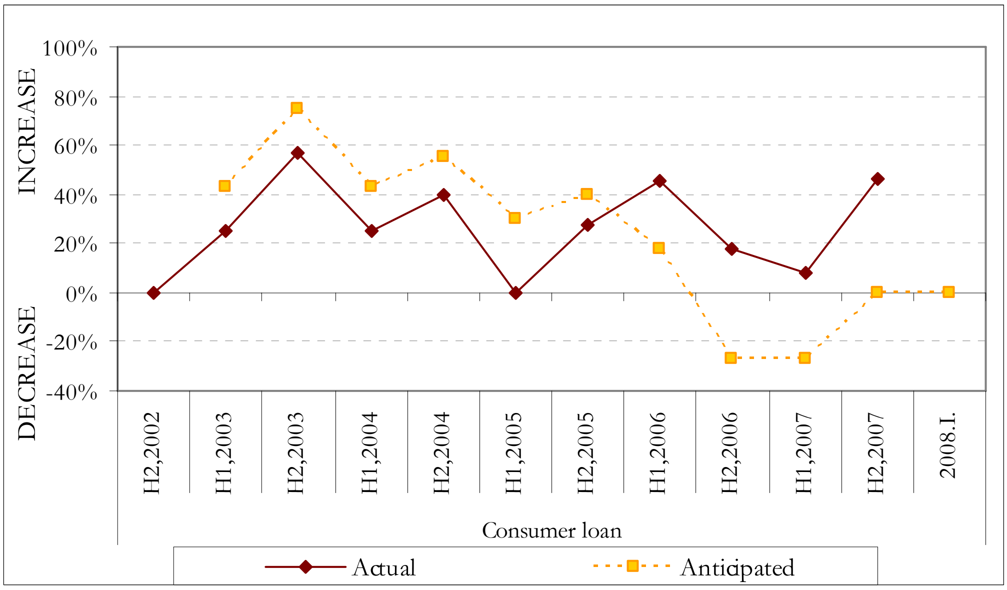
Where tightening took place, the underlying reasons were as follows: deterioration in the bank's liquidity situation, the current deterioration in the availability and conditions of sources or deterioration therein expected for the near future, perception of a moderation in competition which had previously been aggressive, deterioration in customers' creditworthiness and worsening prospects for households' income situation.

Based on the respondents' aggregated answer, a further slight easing can be expected for 2008 H1. As a result of finer risk assessment methods, several institutions reported expected easing in the segments of personal loans, credit cards and overdraft facilities. Some of the banks forecasted further easing in the segment of general purpose mortgage loans (Chart 7).

Demand side

In the previous survey, respondents' expectations regarding demand in 2007 H2 were quite diverse: three participants predicted an increase in demand, while another three predicted a decline in demand for loans. Overall, demand perceived in 2007 H2 exceeded the expectations, and, apart from participants specialising in vehicle and hire purchase lending, almost all institutions experienced an increase in demand compared to 2007 H1.

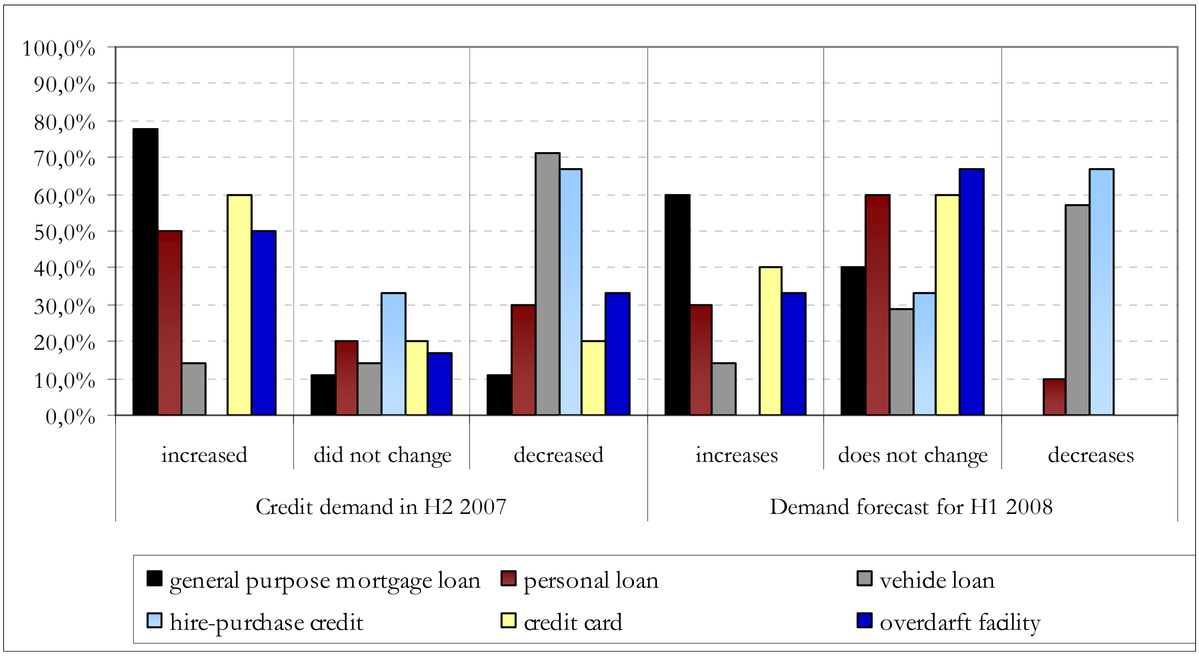
Chart 9 Demand for consumer loans
(ratio of banks indicating an increase vs. banks indicating a decrease)



However, the extent of this slight overall increase in demand was different in the various product groups:

- In vehicle lending, similarly to the previous half year's experience, almost all participants perceived a decline in the number of new loan applications (only one participant reported an increase in demand, while another noted unchanged demand).
- The decline was also considerable in hire purchase loans. Some of the decline in demand in certain customer segments may have been caused by the substitution effect of other products (credit card, general purpose mortgage loans).
- Credit cards have become more popular, as a result of new product developments and co-branded cards.
- Some upswing in demand was perceived in the segment of personal loans, which may partly be attributable to consumption smoothing reasons. There could be similar substituting effects as in the case of hire purchase loans, thus some participants reported declines in demand.
- Similarly to the previous half year, respondents perceived a significant strengthening in demand for general purpose mortgage loans, while foreign exchange schemes were popular.

Chart 10 Demand for various consumer loan products
(ratio of banks specifying the given answer)



For 2008 H1, apart from the vehicle loan and hire purchase loan markets, respondents remain optimistic. Most expect a further increase in demand for general purpose mortgage loans and credit cards.

Developments in the riskiness of the household portfolio

(Questions 10–13 and 22–25 of Annex 4)
For the first time in our survey, we attempted to ask more detailed questions regarding the changes in riskiness. We inquired about the Basel risk parameters, the default rate and the loss given default in the survey. We emphasise that we asked about risk perception and trends based on available data, rather than about validated risk parameters, as most institutions were not able to launch the method based on more advanced internal ratings (IRB). The questions focus on the changes, and thus a complete picture would be provided if risk levels were also available.

Based on the answers, a slight deterioration in the default rate was seen in 2007 H2, and institutions forecasted a continuation of this trend (Chart 11). The deterioration mostly took place in the segments of mortgage loans (mainly as a result of the maturation of the portfolio) as well as personal loans and credit cards.

The institutions did not report any drastic deterioration in loss given default. With the strengthening of monitoring activity and an increase in the efficiency of collection, the majority of respondents experienced stable development in the past one-half year, and expect the same for 2008 H1 (Chart 12).

Chart 11 Default rate of loans to households

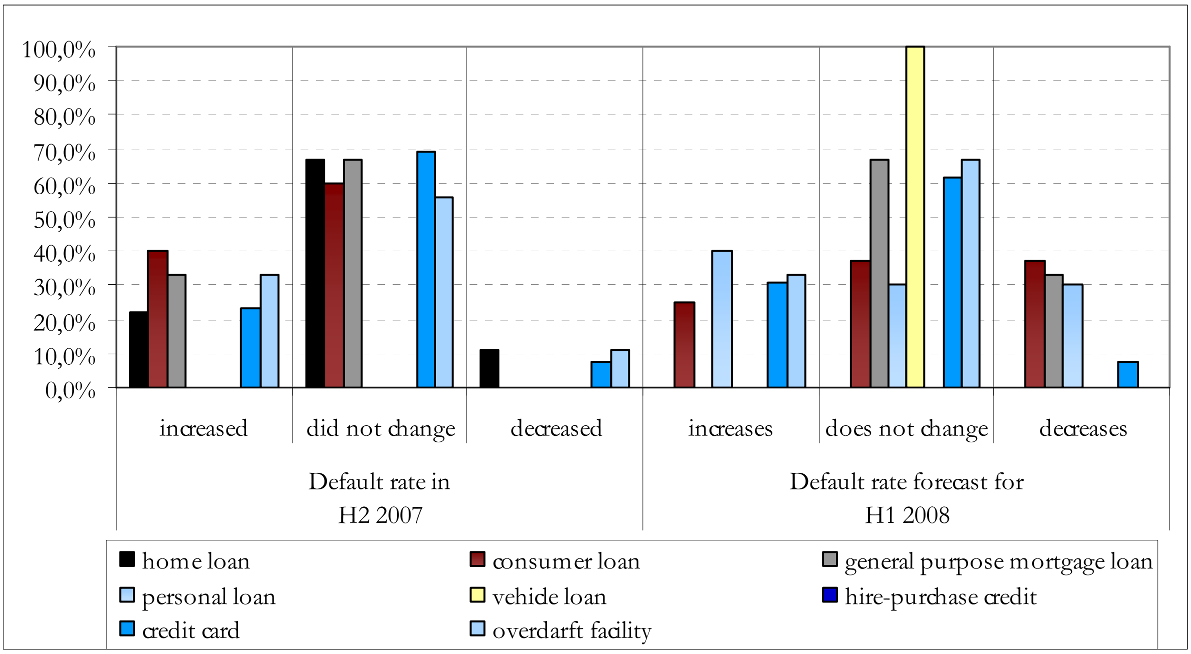
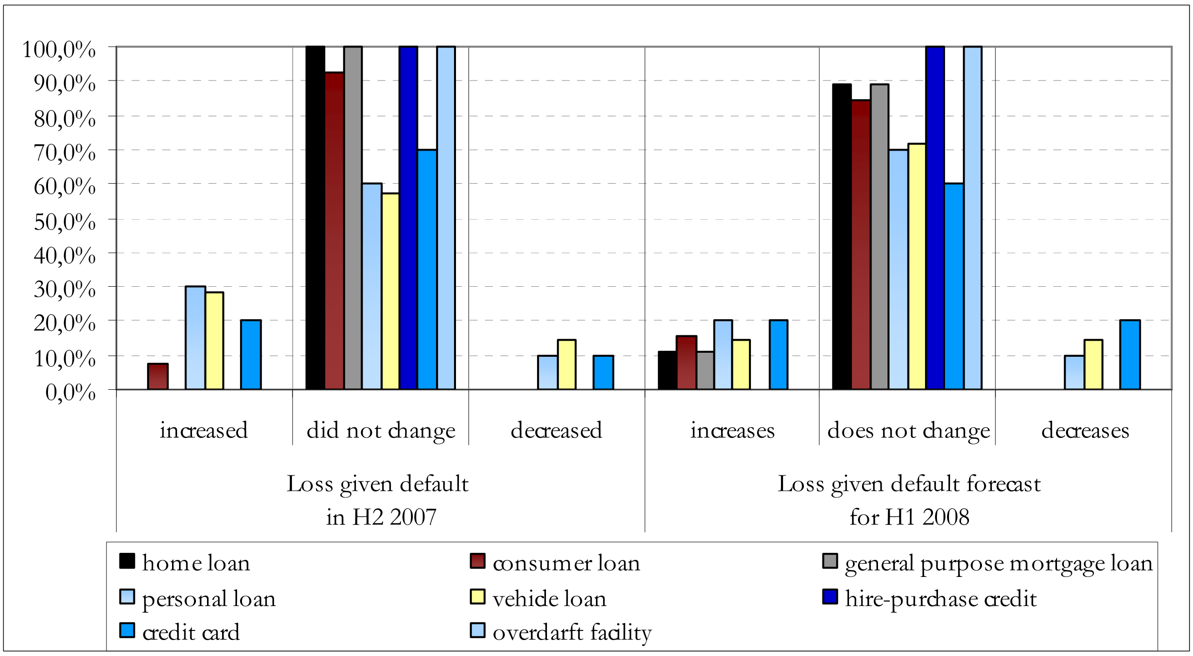


Chart 12 Loss given default of loans to households



2. Corporate lending market

In the corporate loan market, it is still only the financing of small and micro-sized enterprises where willingness to lend seems to be increasing (albeit moderately), although in the last half year the growth dynamics of the willingness to lend declined in this segment as well. Most respondents only fine-tuned the elements of the corporate credit rating system (partly in conformity with the Basel II IRB preparation), although two banks moved in the direction of tightening creditworthiness standards. Based on the plans for the next half year, this process seems to be continuing. Banks also tightened their lending conditions, and – in contrast to the trends of previous periods – they have extended this to the small and micro-sized enterprises segment as well. In 2007 H2, it was the current and expected deterioration in banks' liquidity situation (availability and conditions of sources), the less favourable economic prospects and sector-specific problems, which are becoming increasingly serious, that played an important part in the tightening of standards and lending conditions. In 2007 H2, demand for loans remained practically unchanged in the large and medium-sized enterprises segment, while in the small and micro-sized enterprises segment the responding banks reported a tangible strengthening in this half year as well. Demand for loans in the period under review was basically aimed at liquidity financing, while demand for investment loans dropped off.

The answers of banks active in financing commercial properties were diverse, and it is difficult to ascertain any clear trend. Some decline in willingness to lend was experienced in respect of commercial real estate, while an overall moderate tightening took place in lending standards. Demand for loans for housing projects declined, while demand for office buildings increased, and there were no changes in the other categories.

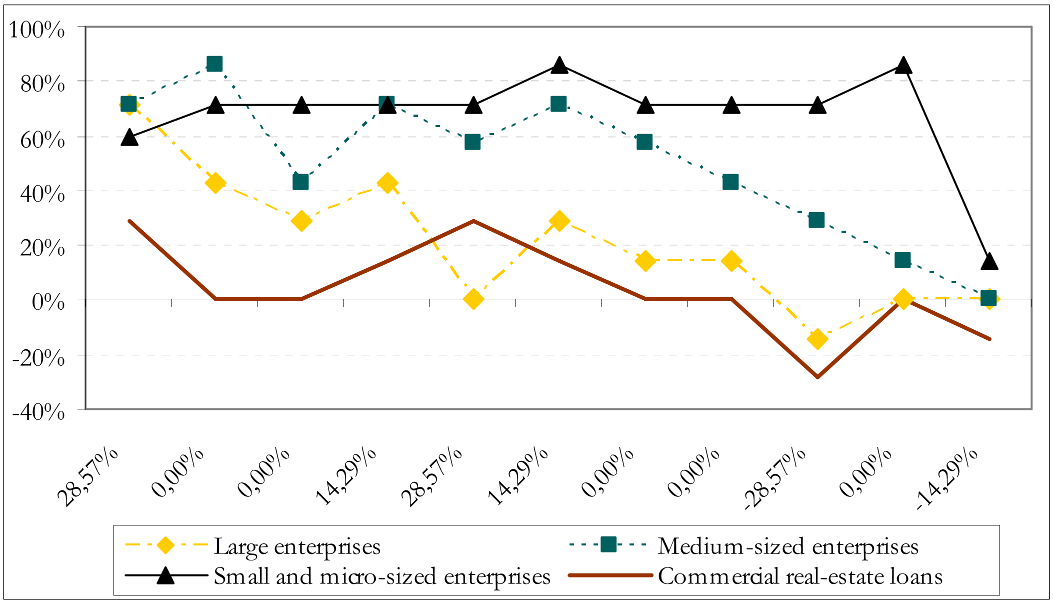
Corporate lending excluding commercial real estate loans

(Questions 1–9 of Annex 5)

Supply side

Overall, in 2007 H2, most of the responding banks restrained the ***increase in their willingness to lend***.

Chart 13 Willingness of banks to lend in each sector
(ratio of banks indicating a higher vs. a lower willingness to lend)



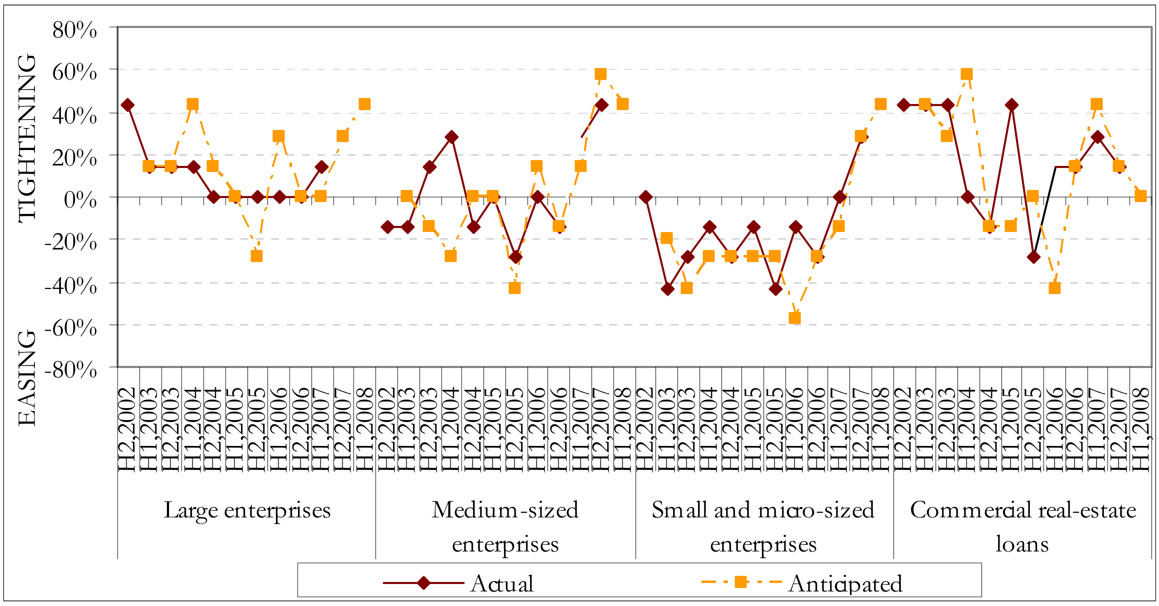
Examining the developments of the past years, the above chart demonstrates that banks did not increase their willingness to lend for large and medium-sized enterprise. In the past, a stable increase in the willingness to lend was reported for small and micro-sized enterprises, while in this survey we saw that the ratio of those reporting an increase in the willingness to lend declined in the small and micro-sized enterprises segment as well. (In this segment two banks somewhat reduced their willingness to lend,[7] while three banks somewhat increased their willingness to lend.)

The responding banks tightened their lending standards and even some lending conditions, in price factors as well. Banks try to compete by developing systems which allow fast service and standardisation, rather than competing in terms of price factors.

The trend experienced in 2007 H1, when two banks tightened their corporate ***lending standards***, clearly continued (again two banks indicated comprehensive tightening). In the small and micro-sized segment, two institutions indicated tightening of lending standards. No banks indicated easing of standards in any of the examined segments.

[7] In the earlier surveys none of the banks indicated any decline in willingness to lend.

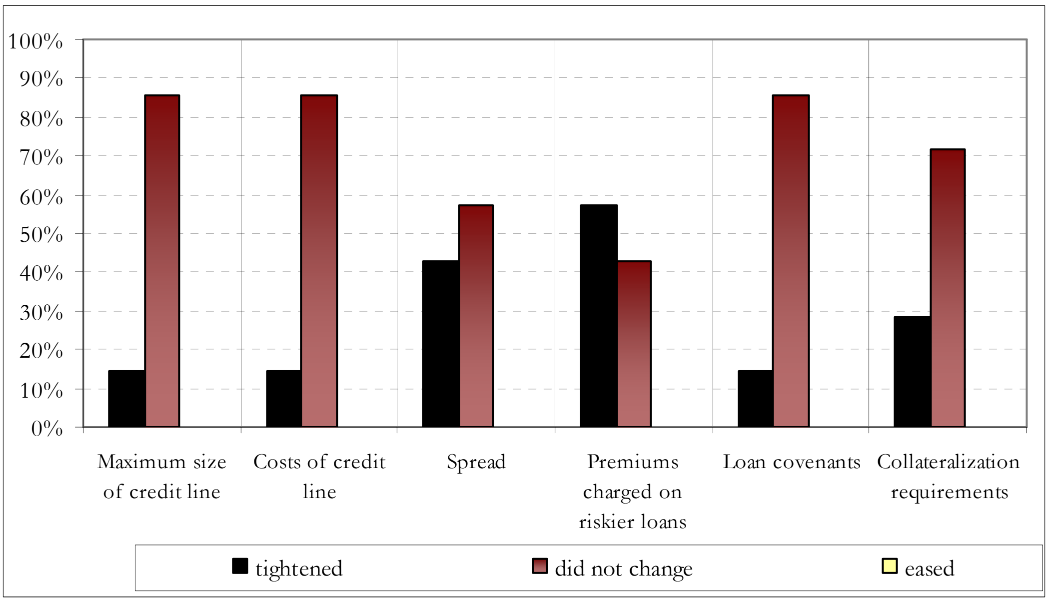
Chart 14 Creditworthiness standards by corporate category and in the field of commercial real estate loans
(ratio of those reporting tightening minus those reporting easing)



In 2008 H1, the trend seems to be strengthening, because compared to the previous half year even more participants plan to tighten lending standards.

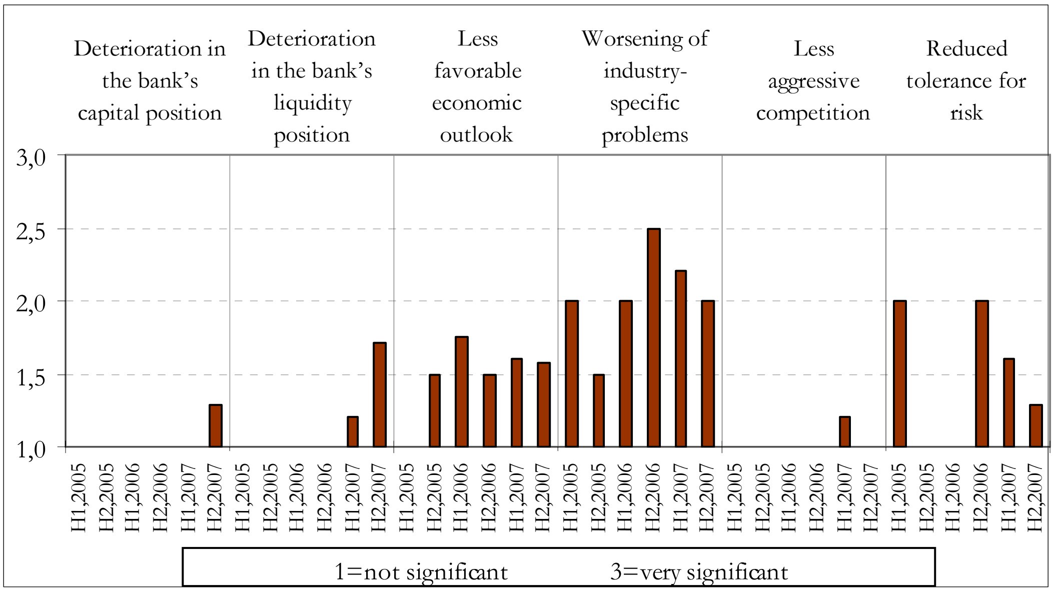
What can be seen in terms of ***lending conditions*** (Charts 29–34) is that some banks moved towards slight tightening in 2007 H2. In addition to the tightening of covenant requirements and collateral requirements, several banks carried out tightening in the price factors (fees, spread, premium) as well. Tightening is mainly typical in the spread between the funding cost and the lending rate as well as in the premium for risky loans (Chart 15). While tightening affected only the lending to large and medium-sized enterprises in the past, in 2007 H2 tightening took place in the small and micro-sized enterprises segment as well.

Chart 15 Lending conditions in the corporate business in 2007 H2
(ratio of banks specifying the given answer)



Market players which carried out tightening[8] continued to underline the increase in the riskiness of individual economic sectors and size categories (e.g. small and medium-sized enterprises) as the most important reasons. Moreover, the still unfavourable domestic economic environment and deterioration in the liquidity position stemming from the sub-prime mortgage market crisis also prompted banks to introduce stricter conditions. At two banks the developments perceived in portfolio quality led to a stronger appearance of risk management aspects, which resulted in a decline in these banks' willingness to lend. At one bank the reason for tightening was reconsideration of the conditions, due to the realisation of losses stemming from earlier monitoring weaknesses, and another bank mentioned again that it introduced tightening measures as a result of applying the Basel II standards.

Chart 16 Reasons for tightening the lending conditions in the corporate business as a whole

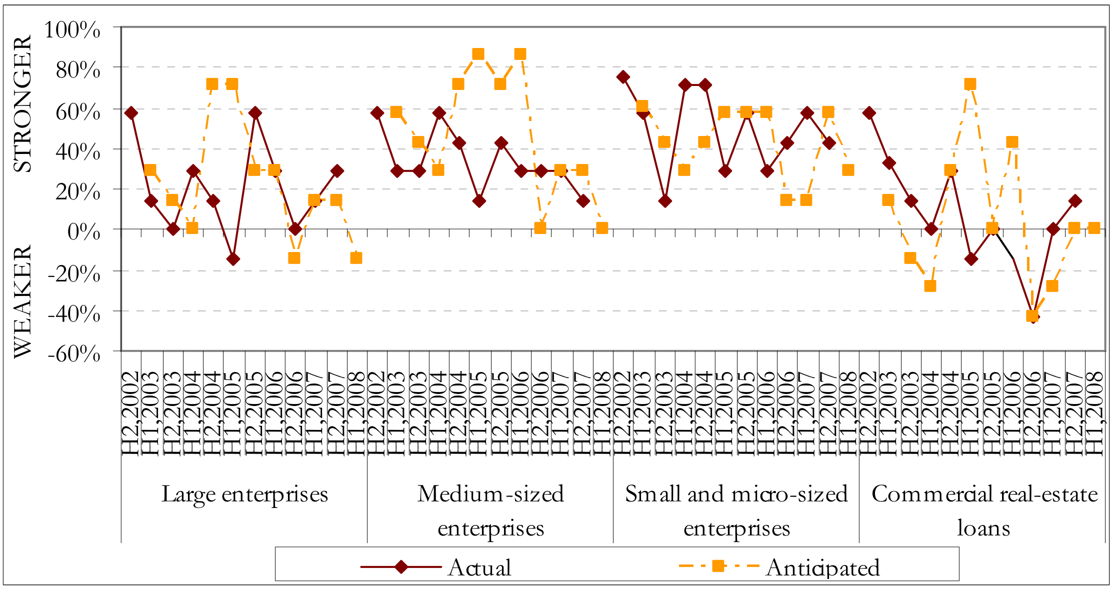


Banks plan to move in the direction of tightening in 2008 H1 as well. Only one participant forecasted easing as a result of a strengthening its monitoring system and in the hope that the current problems will diminish. Most banks plan tightening with regard to the spread between the lending rate and funding costs, and several banks also indicated strengthening of the risk premium, fees and collateral requirements (Charts 29–34). It is also noteworthy that two banks are working on strengthening their monitoring and collection activities.

[8] Six of the responding institutions indicated tightening in one of the parameters.

Demand side

Chart 17 Loan demand by corporate size
(ratio of banks indicating an increase vs. banks indicating a decrease)



Demand in 2007 H2 was broadly in line with expectations (considering the aggregated answers): most banks experienced unchanged or somewhat increasing demand, while two institutions reported a decline in the category of medium-sized enterprises, and one also in the large enterprise category. On average, the observed growth rate of demand was somewhat lower than expected in each segment.

With regard to changes in the structure of demand for loans, the institutions experiencing stronger demand for loans explained the trends with increases in customers' inventory financing needs and declines in own funds. The two banks which experienced a decline in demand explained this with a decline in customers' investment in tangible assets.

Overall, for the next half year the majority of respondent banks expect nearly unchanged demand (without seasonal effects). Some institutions indicated a moderate decline in demand for loans by medium-sized and large enterprises, while two banks expect an increase in loans to small and micro-sized enterprises.

Commercial real estate loans

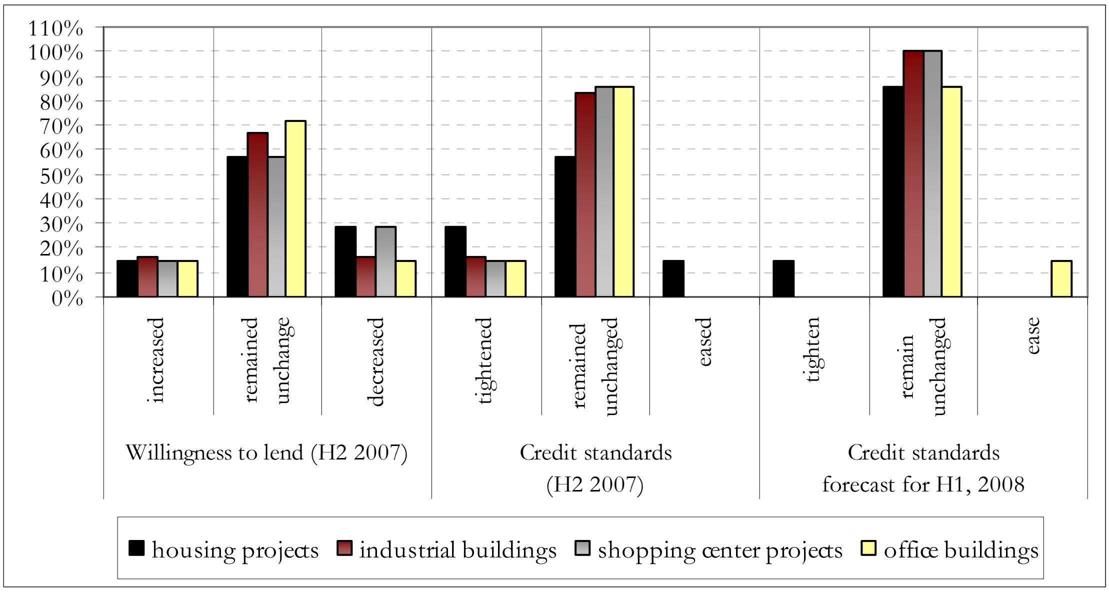
(Questions 14–19 of Annex 5)

From 2006 H2 on, the questions on commercial real estate loans contain a breakdown according to the following real estate categories: housing projects, office, logistics centre and shopping centre projects. As longer time series are not available on these real estate categories, we present last year's trends in these market segment. In future studies we shall also analyse the data on a time series basis.

Supply side

In terms of commercial real estate loans, in 2007 H1 no clear trend could be identified in the developments in banks' ***willingness to lend***. Answers were quite diverse. Overall, a slightly declining willingness was observed with regard to lending for housing projects and shopping centre projects.

Chart 18 Willingness to lend and creditworthiness standards in commercial real estate loans (ratio of the banks giving the relevant answer)



Similarly to the previous half year, participants mainly see an increased risk in housing project financing, which was coupled with a tightening in lending standards at two banks. Even those banks which carried out further expansion in this market segment recently did so carefully, turning to higher quality projects.

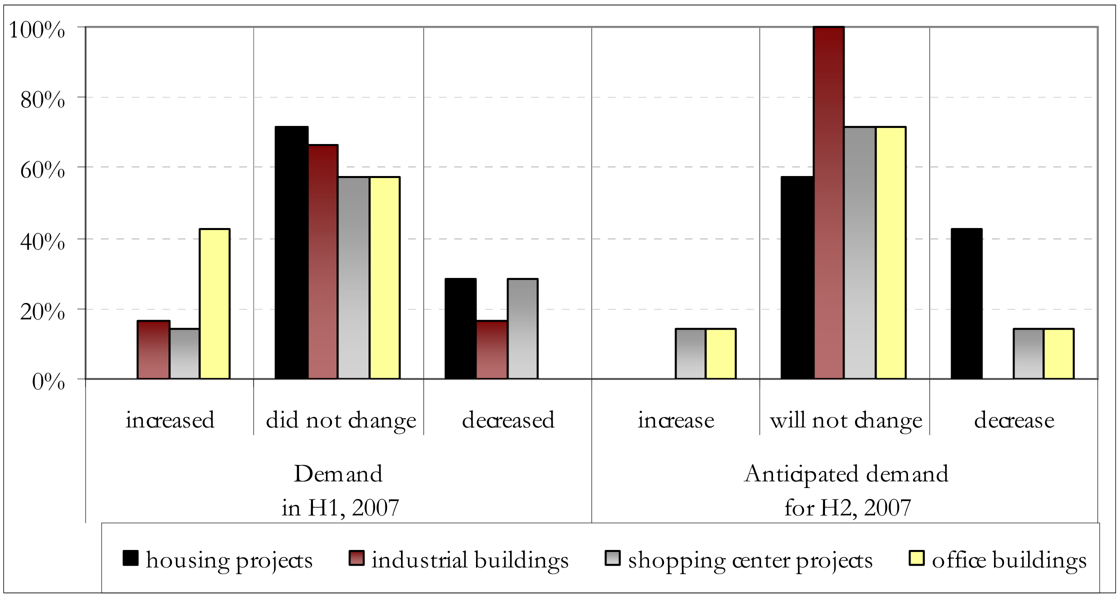
The participating banks mainly indicated increasing industry-specific problems and the risk of the evolution of a real estate price bubble as the underlying reasons for tightening standards. For 2008 H1 the respondents do not plan any material changes in their lending standards, with the exception of one bank which is planning a slight tightening.

Demand side

Overall, banks mostly indicated stagnating demand in the market of commercial real estate loans (Chart 35). However, answers were very widely spread according to individual participant and real estate categories. Strengthening in net terms as well can be perceived only in demand for financing office building projects. Considering average trends for housing projects and shopping centre projects, the responding senior loan officers experienced a decline in demand for loans.

Overall, for the next half year participants expect some decline in credit demand for housing projects, whereas unchanged demand is expected in respect of other commercial real estate loans.

Chart 19 Demand for loans in the various market segments of commercial real estate lending (ratio of banks specifying the given answer)



Change in the credit risk assessment of the various industrial sectors

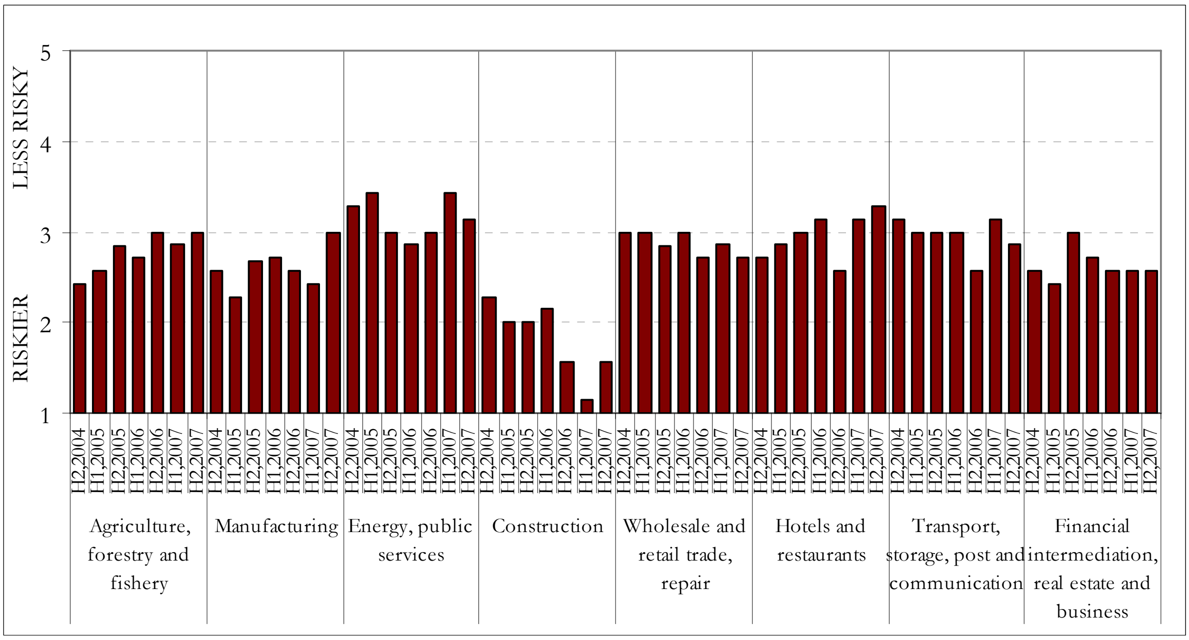
(Question 24 of Annex 5)

In the opinion of the banks interviewed, in 2007 H2 the risk assessment of the following sectors changed considerably:[9]

- As a continuation of the multi-annual trend, in 2007 H2 survey participants clearly indicated a significant increase in the riskiness of the construction industry. The increase in riskiness is related to a decline in orders and the increase in the resulting gridlock in the past half year.[10]
- Three participants indicated an increase in the riskiness of financial activity.
- Overall, the survey participants reported increases the risk assessment in the food industry, trade and repairs, and some of manufacturing segments (textile industry, printing industry and similar sub-sectors of light industry).
- Recently, based on the answers, an improvement in risk assessment in the hotel and catering category was perceived: five banks' judgements remained unchanged, while two banks indicated that lending to this sector had become somewhat safer due to an upswing in domestic tourism.
- Opinions on the electricity generation and machine industries varied. For the electricity generation industry three respondents indicated that it had become safer, while two institutions reported it becoming riskier. As for the machine industry, one participant indicated an increased risk, while two participants indicated that it had become somewhat safer. Two participants emphasised the riskiness of transportation activity.

Chart 20 Risk assessment of sectors

(1 = became significantly riskier, 2 = became somewhat riskier, 3 = remained almost unchanged, 4 = became somewhat safer, 5 = became significantly safer)



[9] We have highlighted those sectors where at least two banks indicated changes.

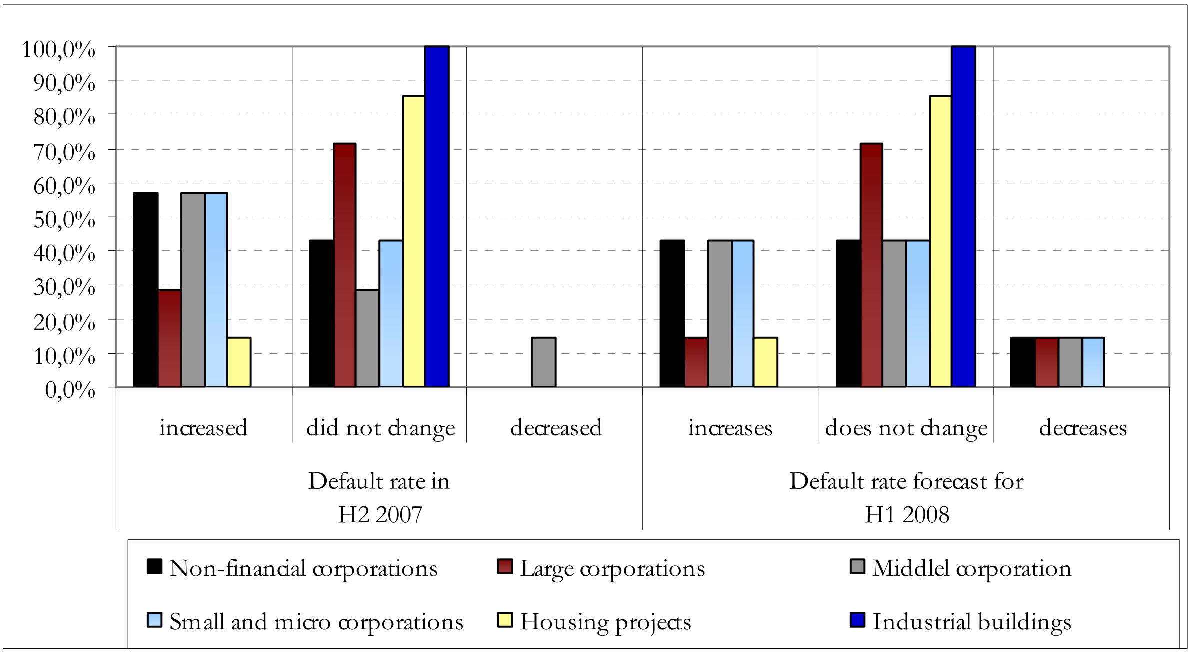
[10] It is worth mentioning that the riskier perception of construction industry is more related to the level of risk, and not to the changes in last half-year.

2.4. Developments in the riskiness of the corporate loan portfolio

(Questions 10–13 and 20–23 of Annex 5)
For the first time in the survey, we endeavoured to ask more detailed questions regarding changes in riskiness. Similar to what was mentioned in the household segment, we asked about the Basel risk parameters, i.e. the default rate and the loss given default. We emphasise that we inquired about risk perception and trends based on available data, rather than about validated risk parameters, as most institutions could not launch the method based on more advanced internal ratings (IRB). The questions focus on the changes, and thus a complete picture would be provided if the risk levels were also available.

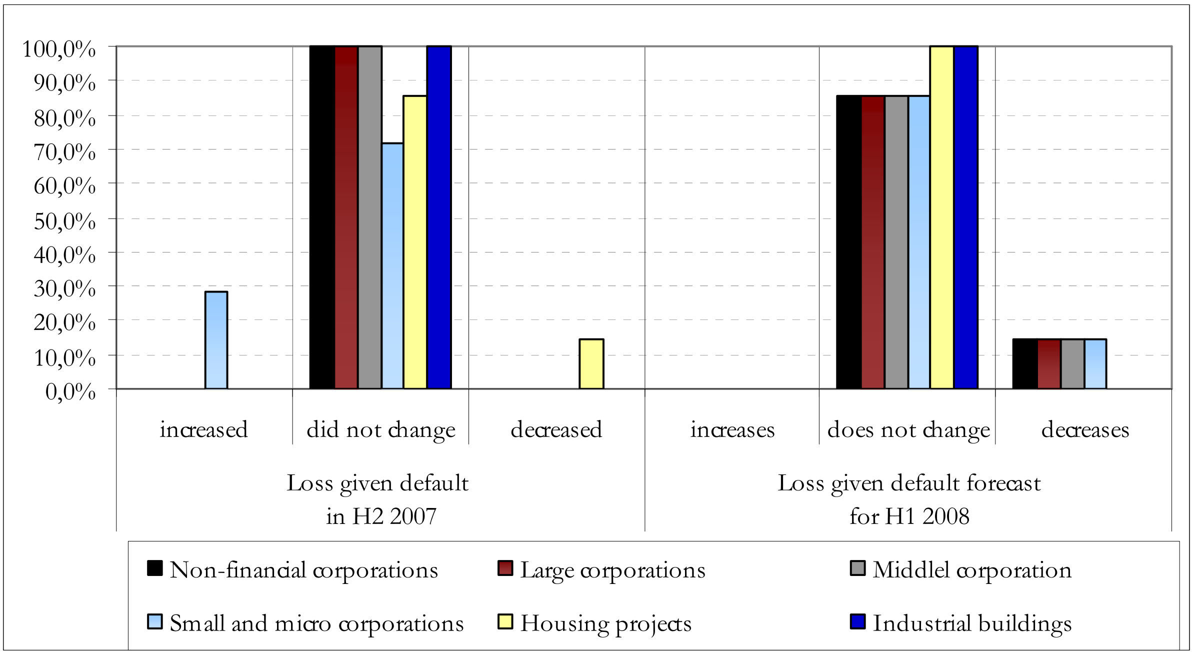
Based on the answers, a slight deterioration in the default rate was seen in 2007 H2, and the institutions forecasted a continuation of this trend (Chart 21). The deterioration was mainly observed in case of medium-sized as well as small and micro-sized enterprises.

Chart 21 Default rate of corporate loans



Two banks indicated deterioration in the loss given default in the case of small and micro-sized enterprises, primarily with regard to loans without collateral. The institution which indicated a decline in both the default rate and the loss given default explained this trend with a strengthening in monitoring ('soft collection'). The responding banks do not expect any change in loss given default.

Chart 22 Loss given default of corporate loans



3. Market of loans to municipalities

(Annex 6)

In 2007, strong growth started in municipal bond holdings, and thus the amount outstanding vis-à-vis municipalities increased to HUF 533 billion, corresponding to approximately 50% growth in one year. Due in part to this fast growth, we devoted a separate section in the survey to trends in lending to municipalities. As only the data from the present survey are available so far, we basically carry out an analysis of these results.

The questionnaire consists of two parts: one relating to municipal loans and the other relating to municipal bonds.

Municipal loans

(Question 1-11 of Annex 6)

Looking at the supply side, regarding municipal loans, respondents indicated an unchanged average ***willingness to lend*** compared to 2007 H1. One institution indicated that its willingness increased somewhat, while one bank's willingness declined considerably as bonds came to the fore. The institutions (two of the responding six) carried out some tightening of **standards** in the past half year, although some parameters of the **lending conditions** were slightly eased in the same period. The amount of the credit limit, the fees charged for providing the credit line, the premium on riskier loans and the collateral requirements were eased by two institutions and tightened by one. At the same time, in respect of the spread between the lending rate and the funding costs, two banks eased, while three banks tightened conditions. The institutions which reported tightening mainly indicated deterioration in the liquidity position as an underlying reason, while in the opinion of the respondents the main reason for easing was the more aggressive competition of other banks.

For the next half year, two-thirds of the surveyed banks indicated that they intended to somewhat tighten their creditworthiness standards and lending conditions. This tightening will appear in the spread between the lending rate and the funding costs, in the premium on riskier loans, in the loan covenants and the collateral requirements.

In the last half year, banks experienced some strengthening in demand for loans to municipalities. The banks which perceived higher demand highlighted the decline in municipal customers' own funds and the effects of economic policy on municipalities. Demand for loans was reduced by a shift towards municipal bonds, with the underlying reason being the fear of the termination the current regulation, which is favourable from a public procurement aspect. Overall, respondents continue to expect slightly increasing demand for the next half year. Three banks expect an increase, while one expects modestly declining demand for loans. The institutions did not perceive any significant changes in municipalities' **loan portfolio quality** in 2007 H2.

Municipal bonds

(Question 12-17 of Annex 6)
Five of the institutions interviewed participate in the municipal bond issue business. The respondents indicated that 100% of the bonds are subscribed by the organising institution, thus the issue organised also becomes part of the bank's portfolio. With regard to bond issuance, in the past period each institution experienced an increase in demand, but for the next half year only two banks expect a further increase. Three banks expect unchanged demand, while one expects demand to decline. Underlying the clear increase in bond issuing activity is the fact that closed bond issues are exempt from the public procurement procedure and the fear of a change in the related rules. Another reason was the municipalities' concerns that borrowing limits might be tightened. As for the standards, in bond-based financing the banks intend to follow the same standards as in lending. There may be differences due to the character of financing, for example, the intended use of the loan is less tied in the case of a bond.

4. Current issues and trends

As in the earlier surveys, we used open questions to ask the participating banking specialists about current developments, such as the effects of the domestic macroeconomic environment, the ramifications of the sub-prime crisis, trends in domestic sales of loans (agent channel, debt refinancing, lending in yen) and the effects of the introduction of Basel II. The following is a summary of the answers received from the heads of various business branches of thirteen banks, highlighting the major trends.

Effects of the macroeconomic environment:

The institutions participating in the survey perceived a decline in household consumption to a lesser extent in lending. Institutions have counted on a strong willingness to borrow in the past, and they continue to do so with an eye to the future. The effect of the decline was more reflected in the decreasing savings of households. As a result of the flagging growth in corporate investment, a dampened effect appeared in the decline in the willingness to borrow for investment. Declining growth in public investment influenced both the municipal and the corporate sides, the effect of which were mainly felt in construction. A deterioration in the portfolio may take place, but institutions' expectations for 2008 are somewhat more optimistic, provided that the indirect real economy effect of the market turbulence caused by the sub-prime crisis on Hungarian corporations is not significant.

The banks were asked if they expected a fall in demand for loans in the event of an increase in disposable real income. Respondents clearly rejected this hypothesis.

The effects of the sub-prime crisis:

Respondents unanimously indicated that an increase in the risks of obtaining funds and in the costs of obtaining funds can be felt, although it affects the responding banks to varying degrees, depending on the funding received from the parent bank. Some of the banks did not perceive any changes in funding costs, although one bank reported about an increase by 80 basis points. Some banks have already started to renegotiate the current loan charges with their customers, although there is an institution where this effect has not yet appeared in the cost of parent bank financing. With regard to the fears related to the deterioration in the growth prospects of the European Union and the USA as well as the collapse of the loan market, the participants were rather optimistic, and trusted that the negative trend in Europe would turn around.

The trends of domestic loan sales (agent channel, debt replacing, lending in yen):

According to the respondents, in the household segment most of the new loans are sold through the agent channel. In the case of housing loans, home intermediaries and insurance brokers play an increased role. This trend is clearer in the case of the general purpose mortgage loans. The proportion of broker-intermediated loan in terms of new placements may be 50-60% at some institutions.

Within new loans, the proportion of refinancing loans for replacing debts at other banks is increasing. Primarily general purpose mortgage loans are used for replacing earlier housing loans, and within general purpose mortgage loans the aim of debt refinancing may even account for a 50% share at certain institutions. However, exact data cannot be shown, as not all institutions can determine the actual purpose of use of the general purpose loans. A significant part of debt refinancing is also carried out through the agent channel. This trend plays an important part in acquiring one another's loans, thus self-regulatory initiatives may also come up in this subject. Some of the respondents reported that a growing share of the increase in consumer loan demand is related to the refinancing of HUF-based housing loans with FX-based home equity.

In 2007 H2, an important new product development was that two institutions introduced Japanese yen based housing loan products, with somewhat stricter conditions (stricter LTV ratio and repayment burden/income ratio) than seen with previously introduced foreign exchange products. Most participants indicated that they are unwilling to introduce Japanese yen products due to their riskiness. Two of the nine institutions are sure that due to parent bank standards and a conservative approach they will not introduce these types of products, while seven institutions may enter this market, depending on the market situation as well as the number and size of those newly entering the market of lending in yen.

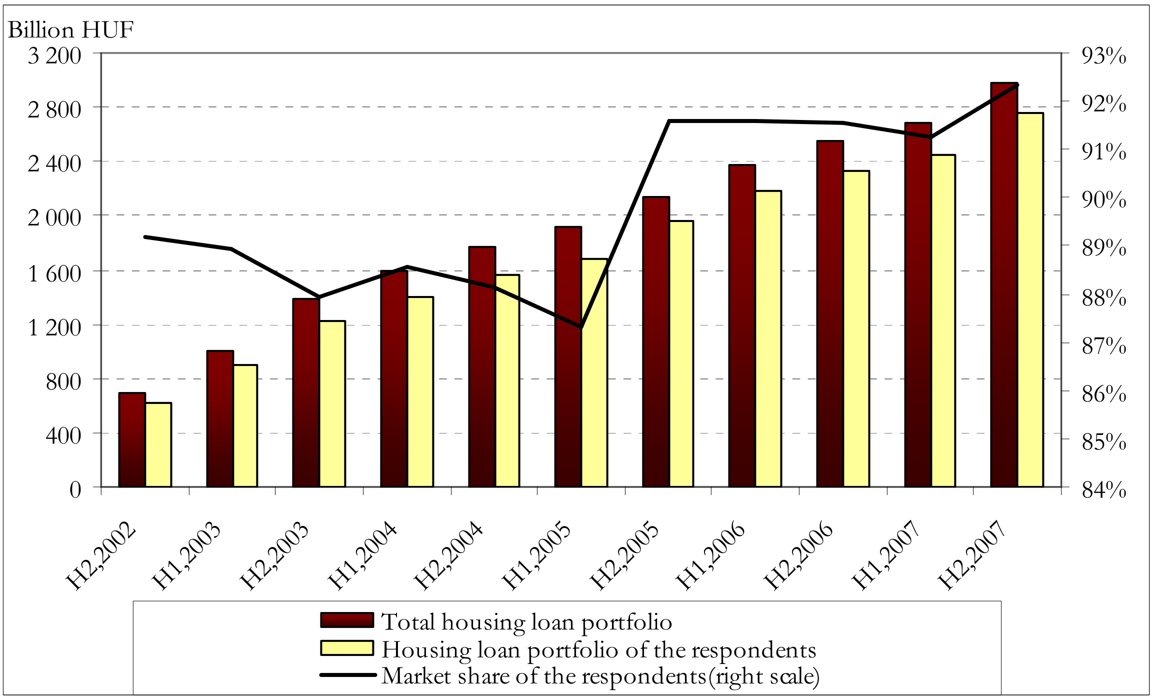
The effects of introducing the Basel II:

For the domestic banking sector, the most important influencing factor regarding implementation of Basel II regulations compulsory from 1 January 2008 is that the majority of institutions are starting or have started with a standard method in terms of credit risk. However, over the medium term, a significant share of the institutions are preparing for the method based on internal rating (IRB). The credit risk standard method itself would not result in any material change, but the preparatory steps for IRB are already resulting in current changes in banking processes. Respondents indicated that the introduction of Basel II does not fundamentally change their willingness to lend, and that the transparency of risks, the involvement of risks when making decisions and the standardisation of processes constitute an important step forward. In the opinion of the majority of respondents, all this results in a more transparent risk profile, although one may not disregard the high costs and needs for resources in the course of implementation.

ANNEX 1: CHARTS ON THE LOAN PORTFOLIO AND ANSWERS TO THE QUESTIONNAIRE

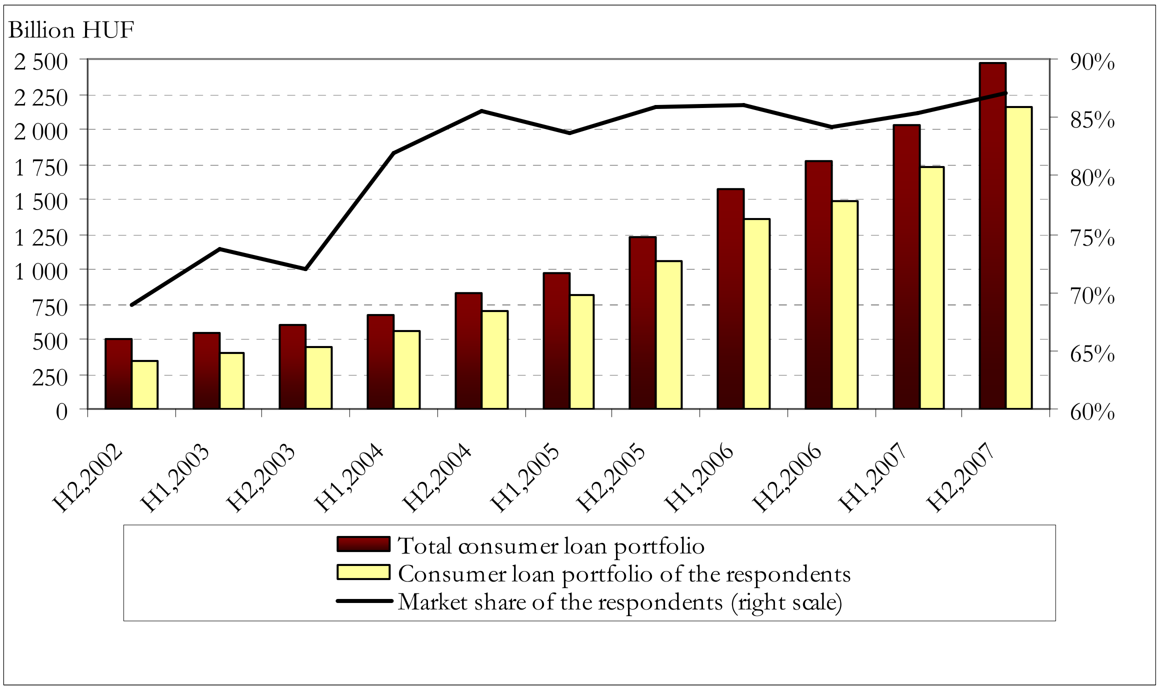
Household segment

Chart 23 Housing loans and market share of banks completing the questionnaire



Note: During the half years under review, the number and scope of banks surveyed changed (e.g. as a result of mergers and the involvement of a new bank). On the last occasion there were nine participating banks.

Chart 24 Consumer loans and the market share of banks completing the questionnaire



Note: During the half years under review the number of banks interviewed changed. On the last occasion, the number of institutions providing an expert assessment was thirteen. The chart only shows the share of banks interviewed; the share of financial enterprises is not shown.

Chart 25 Lending conditions in the market of consumer loans (ratio of those reporting tightening minus those reporting easing)

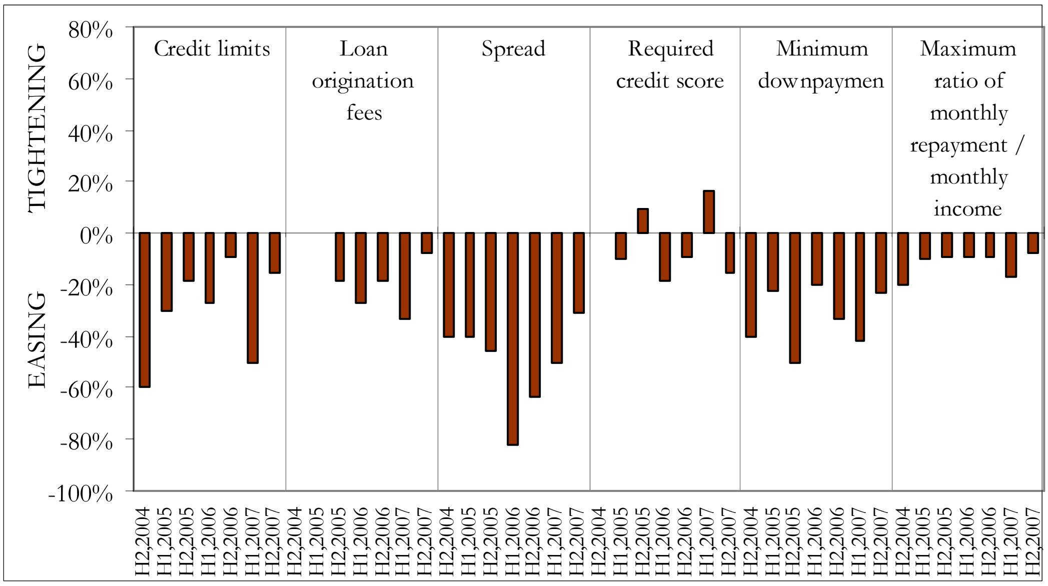
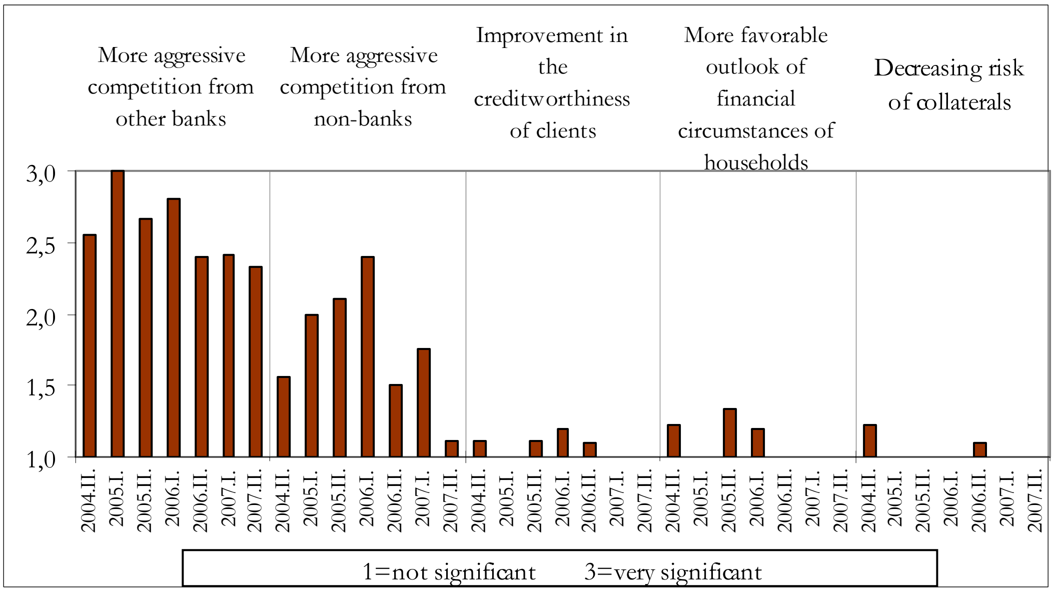


Chart 26 Reasons for easing of creditworthiness standards and lending conditions in the case of consumer loans



Corporate segment

Chart 27 Shares of responding banks within the total corporate lending portfolio

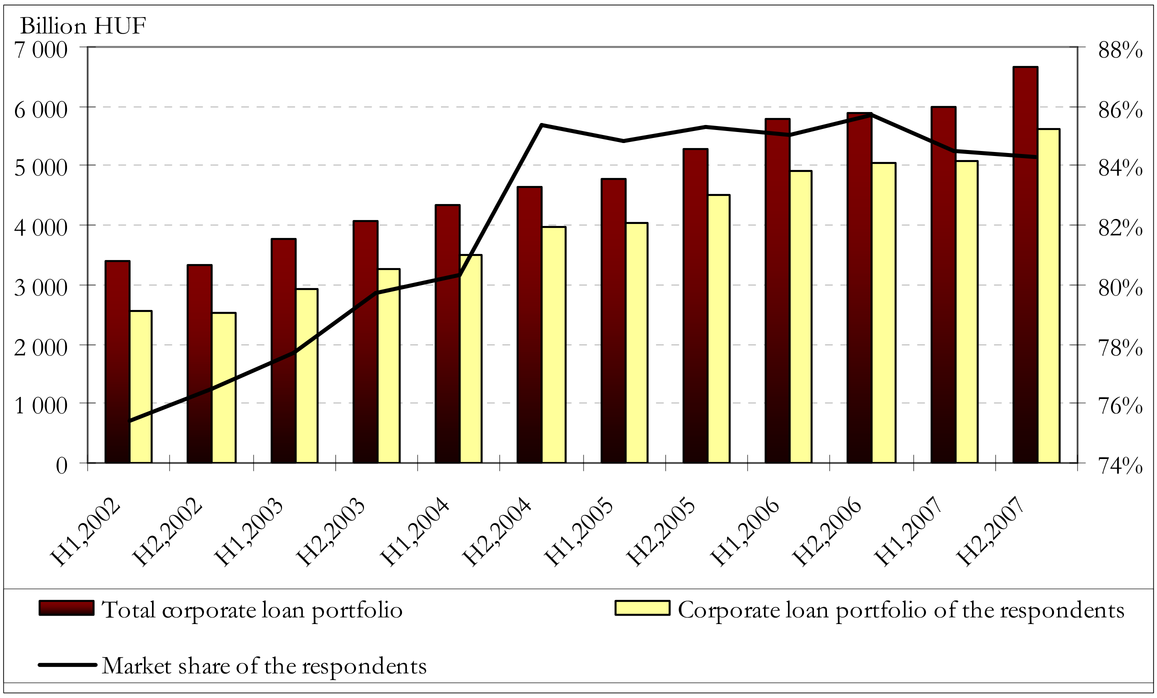


Chart 28 Shares of responding banks within the total commercial real estate loan portfolio

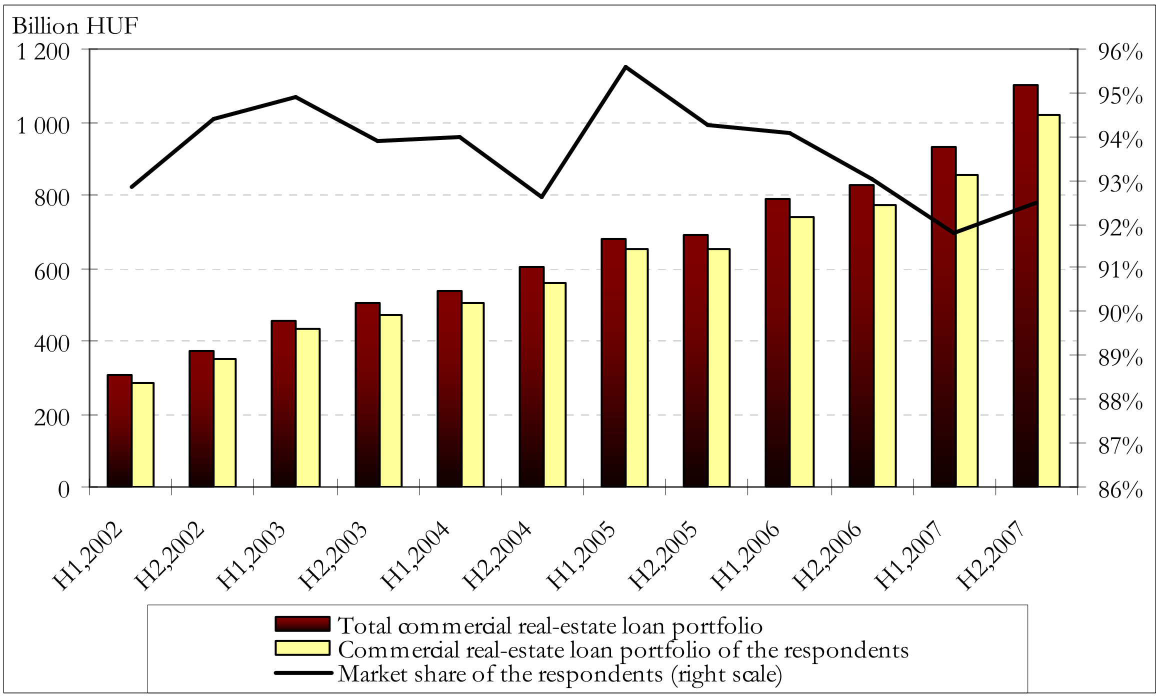


Chart 29 Maximum size of loans/credit lines by corporate category (ratio of those reporting tightening minus those reporting easing)

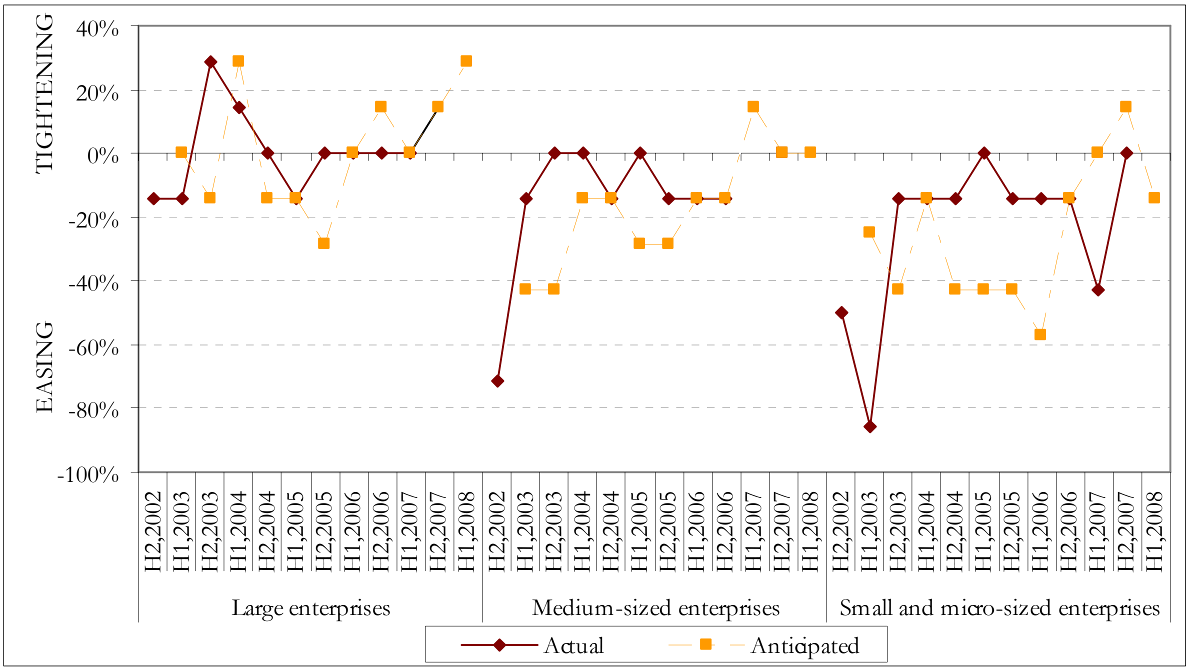


Chart 30 Fee(s) charged for extending loans/credit lines by corporate category (ratio of those reporting tightening minus those reporting easing)

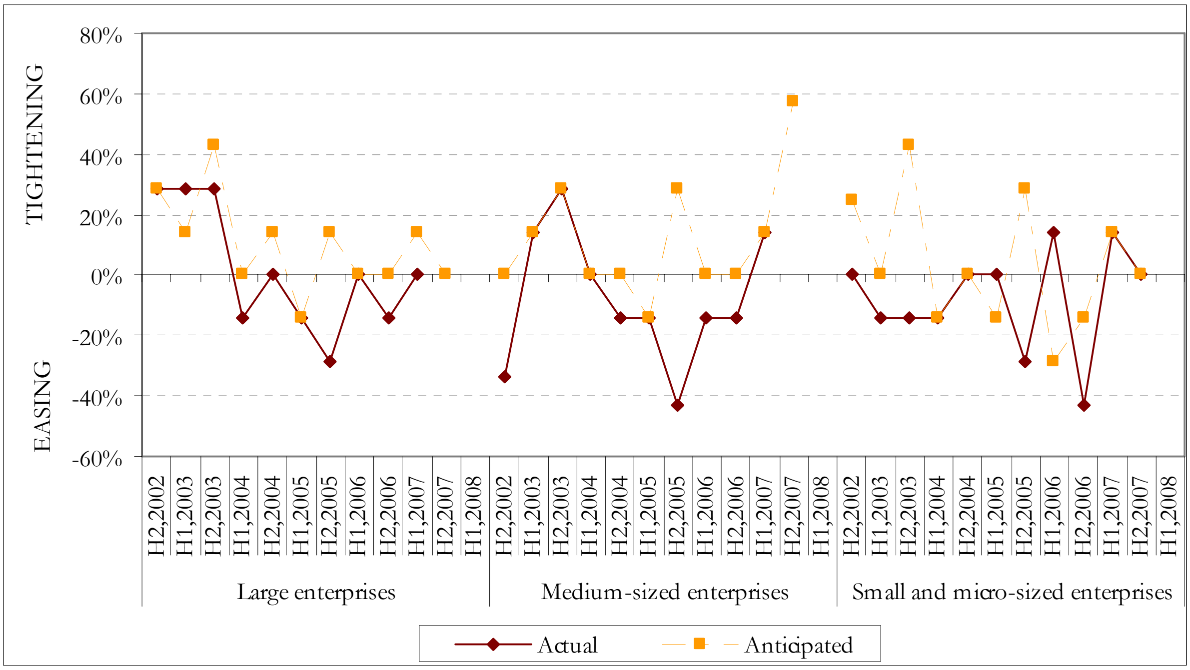


Chart 31 Spread between lending rates and costs of funds in a breakdown by corporate category (ratio of those reporting tightening minus those reporting easing)

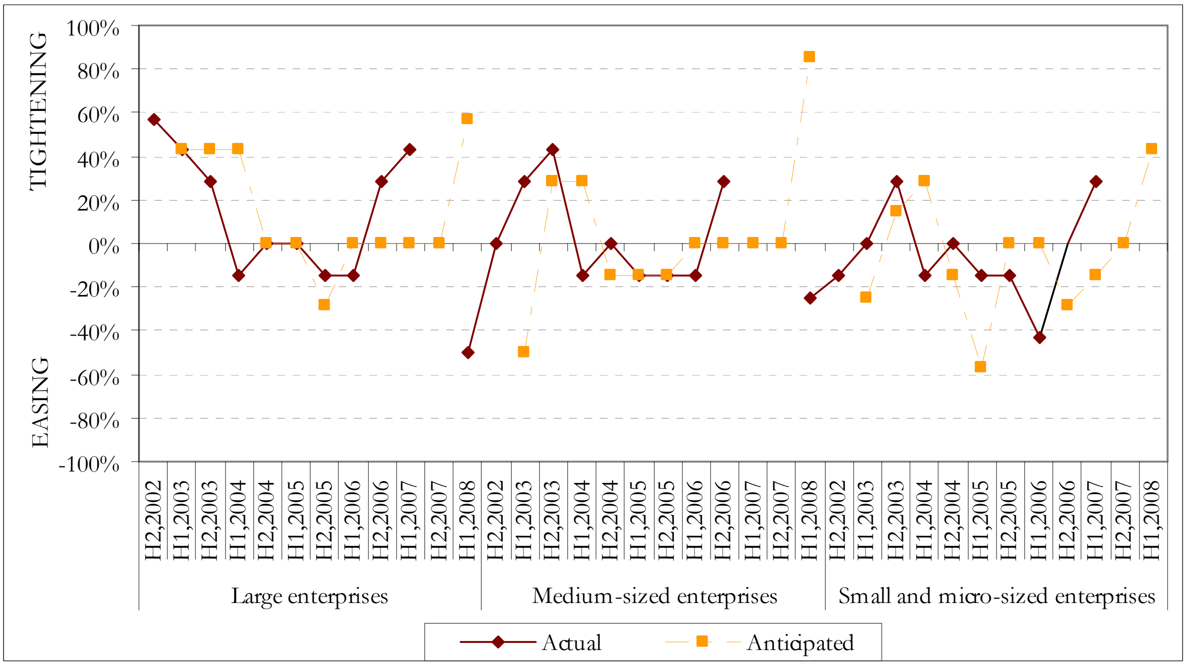


Chart 32 Premium on higher-risk loans in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

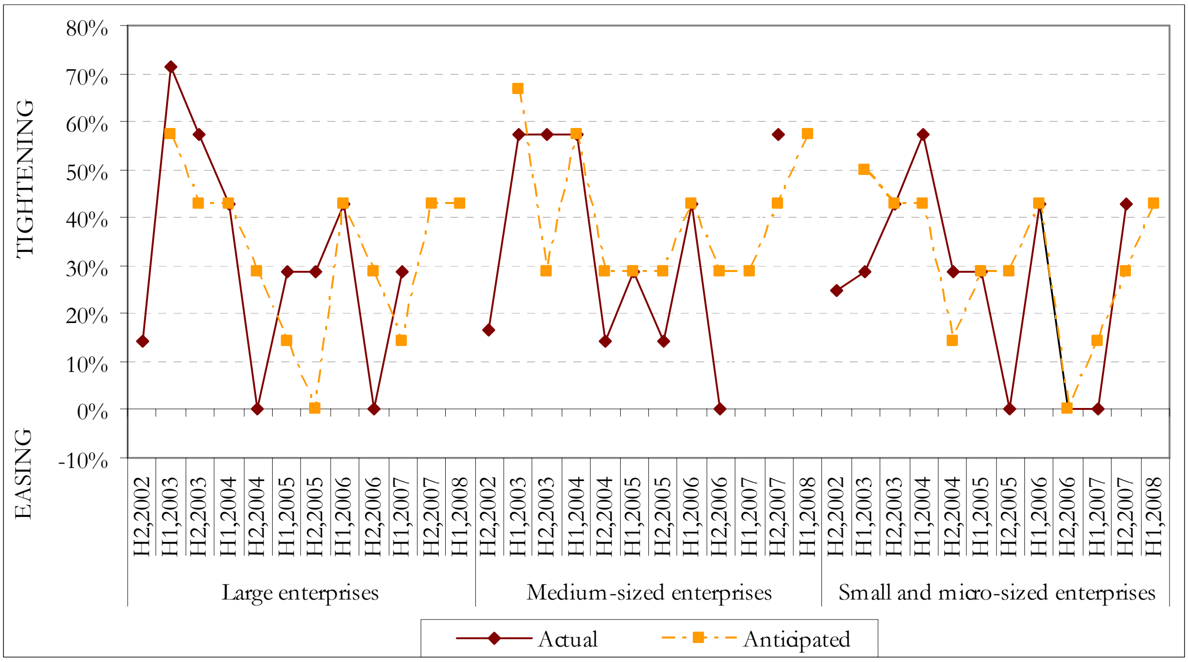


Chart 33 Collateral requirements in a breakdown by corporate sector (ratio of those reporting tightening minus those reporting easing)

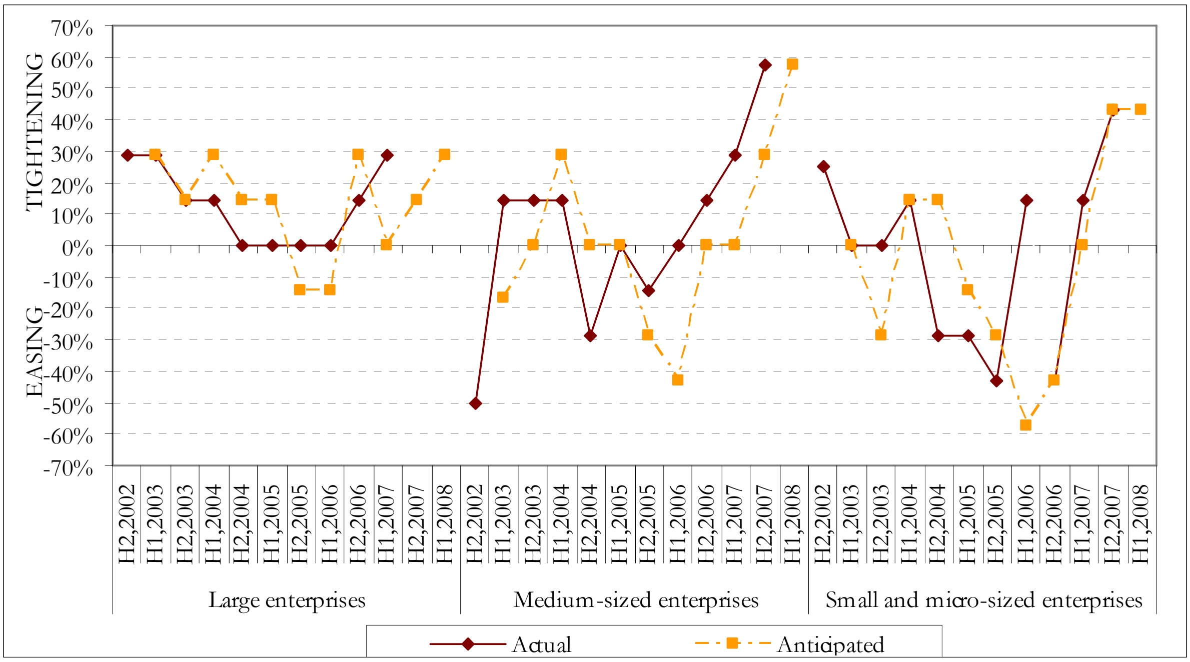


Chart 34 Covenant requirements by corporate category (ratio of those reporting tightening minus those reporting easing)

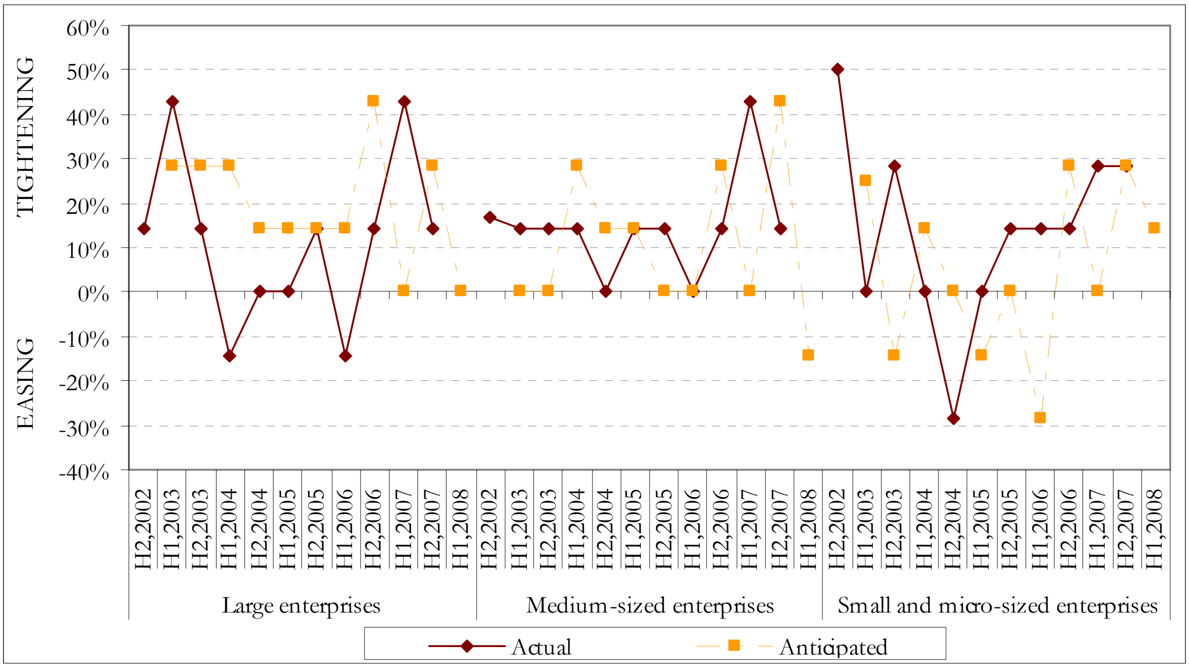
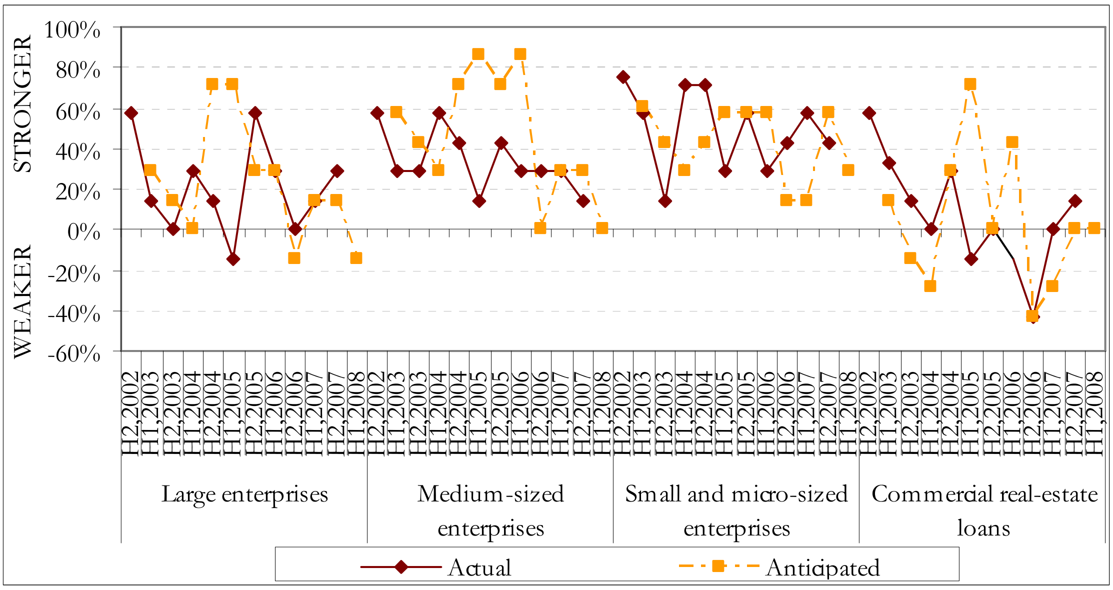


Chart 35 Demand for loans in a breakdown by corporate sector and in the market of commercial real estate lending
(ratio of banks indicating an increase vs. banks indicating a decrease)



Municipality segment

Chart 36 Total municipal loan portfolio and the share of banks completing the municipality questionnaire

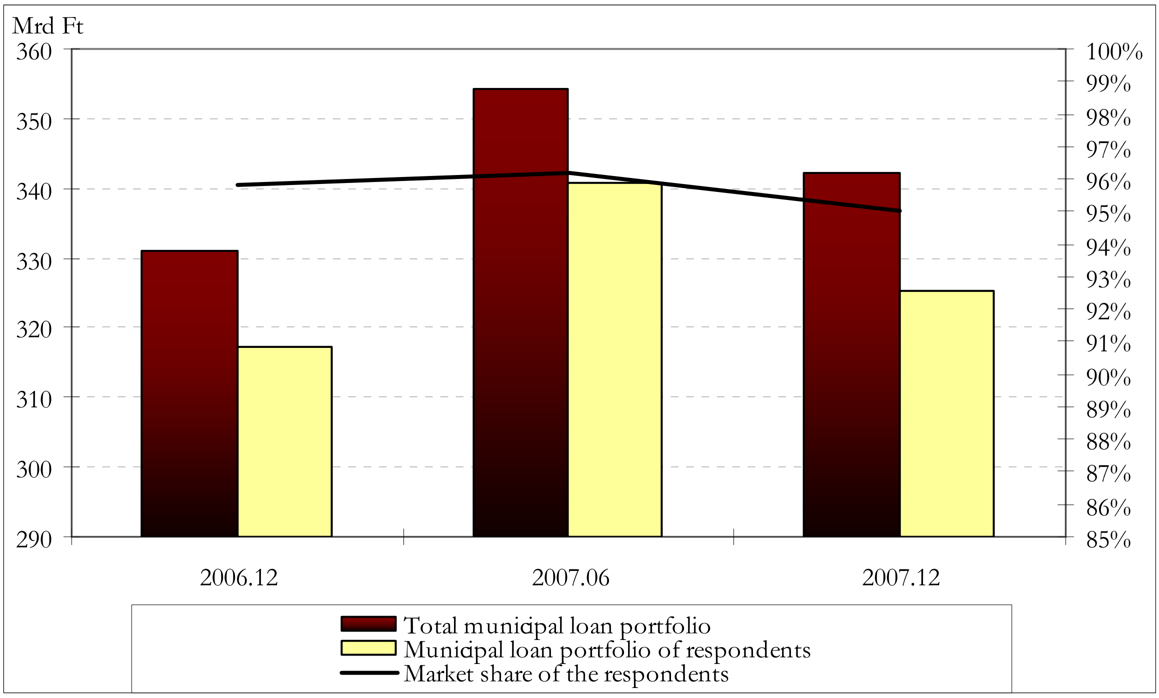
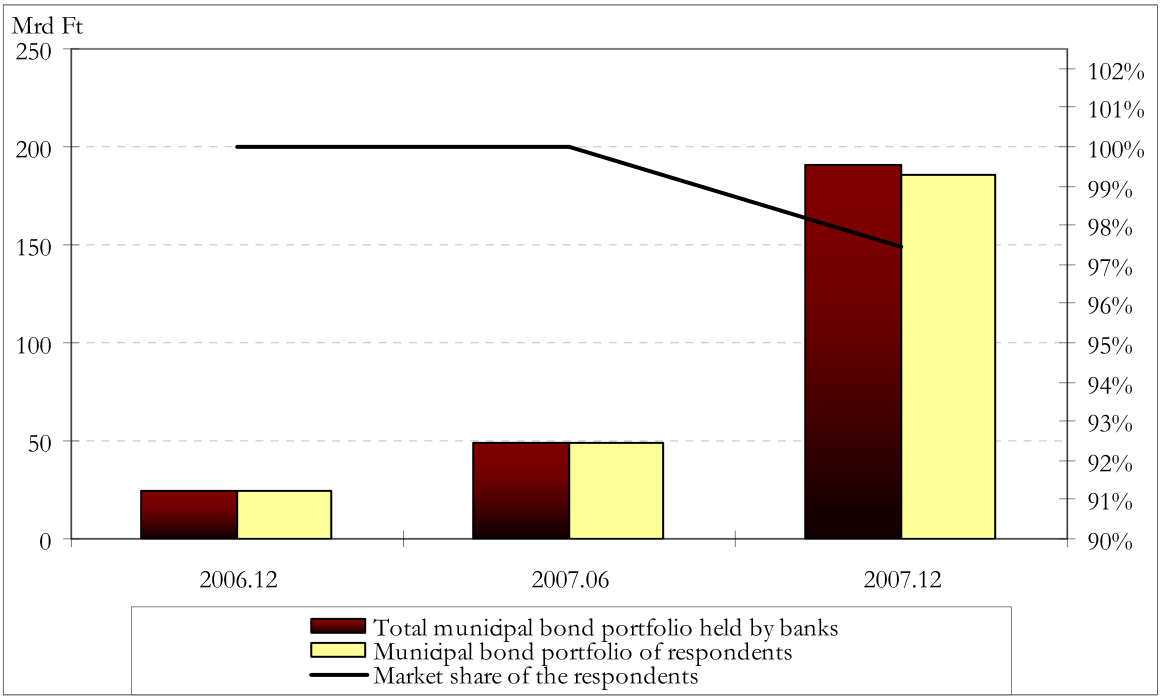


Chart 37 Municipal bonds held by the banking sector and the share of banks completing the questionnaire



ANNEX 2: METHODOLOGICAL NOTES

The survey allows for an analysis of how major banks perceive and evaluate market developments, and, based on the management's and owners' assessment of the situation, how they formulate their respective strategies and their lending policies in particular. Aggregating individual, micro-level answers helps us to draw conclusions regarding the directions and trends in the changes in the market. The conclusions of this analysis always present the senior bank officers' replies rather than our own professional opinion. Taking account of our earlier experiences, international surveying practices and current trends some changes have been made to the survey. On the one hand, in order to analyse the credit risk profile in a more detailed manner, we asked the experts in individual lending segments about the changes in the levels of the default rate and the loss given default ('LGD'), in line with the practice of the Bank of England. On the other hand, in view of the increase in activity, we extended the survey to cover the area of municipal financing.

In accordance with the previous practice, the questionnaires were sent to the senior loan officers of the credit institutions involved in the survey. The questions were answered and the questionnaire, which also contained fixed questions, was filled in during an interview, providing an opportunity for more thorough explanations. Leasing companies belonging to the banks surveyed gave written answers to the questions relating to motor vehicle financing.

The household questionnaire was completed by 13 banks altogether, with 9 answering the questions related to housing loans, while 13 banks and 5 financial enterprises owned by banks answered those on consumer loans[11] (Charts 23 and 24). In terms of housing loans, based on end-2007 data the surveyed institutions cover 92.3% of the banking sector,[12] while their percentage share in consumer credit was 87.1%. The questionnaire was completed by seven banks, with a total market share of 84% and 92% in the markets of corporate loans and commercial real estate loans, respectively (Charts 27 and 28). Altogether we interviewed six banks in the segment of loans to municipalities. Based on end-2007 data, the institutions surveyed cover 95.9% of the banking sector's municipal exposures (Charts 36 and 37).

As for methodology, in each segment the survey consists of a so-called standard questionnaire and a questionnaire which contains current issues. In standard part of the questionnaire we surveyed the experienced and expected changes in lending willingness, credit standards/ conditions, credit demand, portfolio quality and in case of corporate segment risk assessment of different sectors. Two different types of scaling are applied for multiple choice questions:

Five-step scaling: this scale is applied for assessment of changes in lending willingness, demand, credit standards/ credit conditions, risk parameters, risk assessment of different sectors:

- 1: This evaluation reflects considerable increase in demand, in lending willingness, a considerable tightening in credit standards/credit conditions, a considerable increase in housing prices, risk parameters, in the case of risk assessment of the sectors assessment 1 stands for a considerable increase in risk perception related to the given sector.
- 3: This evaluation means no change in the assessed parameters.

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[11] During the half years under review, the number and scope of banks surveyed changed (e.g. as a result of mergers). Regarding the subject of housing loans, from the launching of the survey (except for December 2003) we conducted the interviews with 7 banks, then in December 2005 the number of banks surveyed increased to 8 and later, from December 2007, to 9. In the beginning we interviewed 7 banks about consumer credit, increasing to 9 from 2004 H1, to 10 from end-2004, to 11 from end-2006, and to 12 from June 2007. The number of banks questioned in our latest survey is 13.

[12] In our analysis the banking sector does not include the Eximbank, KELER and the Hungarian Development Bank (MFB).

- 5: This evaluation means considerable decrease in credit demand, in lending willingness, a considerable easing of credit standards/credit conditions, a considerable decrease in nominal housing prices, in risk parameters, and less riskier perception of different sectors of corporate segment.

  Ratings of 2 and 4 provide an intermediate assessment (e.g. a slight increase or decrease in credit demand).

Three-step scaling: This scale is applied for assessment of reasons for changes in credit standards/ conditions and demand:

- 1: This evaluation means that the evaluated factor did not contribute significantly to the changes.
- 2: This evaluation means that the evaluated factor contributed to a certain extent to the changes.
- 3: This evaluation means that the evaluated factor contributed considerably to the changes.

The keywords of the questionnaire could be defined in the following way:

Willingness to lend reflects the intention of respondents to expand in the given segment of lending.

Credit standards covers the internal policies that determine the relationship between the characteristics of customers, customer groups (sector, geographical location, size, financial ratios, etc.) and grantable credit products (only secured loans, overdraft credit facility).

Among credit conditions we can differentiate between price-related factors and non-price related factors. Non-price related conditions (e.g. collateralization requirements, loan covenants, etc.) are concrete contract conditions. In case of price-related conditions we survey spread over funding costs and risk premia, for example.

The attached Annexes 4, 5, 6 contain the whole questionnaire and the aggregated answers (in the case of numeric answers).

In this survey, through the questions about current concern we tried to compile a qualitative assessment of the impacts on lending activity stemming from the domestic macroeconomic trends, the sub-prime mortgage market problems (the so-called sub-prime crisis) and Basel II implementation.

In presenting the results, we follow the structure of the relevant questionnaire in all three lending segments (households, corporate and municipal segments). The retrospective questions in the questionnaire refer to 2007 H2, and thus the base period for these question is 2007 H1, whereas the forward-looking questions contain projections for 2008 H1, compared to the trends of the previous half year.

To indicate the changes, we use the so-called net change indicator, expressed as a percentage of banks responding. We calculated this indicator by deducting from the number of persons projecting a change (tightening / growing / strengthening) the number of persons projecting the opposite (easing / decreasing / weakening), and dividing the result by the total number of persons responding (the answers are not weighted).