Senior loan officer survey on bank lending practices

Summary of the aggregate results of the survey for 2011 Q3
November 2011

MAGYAR NEMZETI BANK

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The lending survey facilitates the analysis of how major banks perceive and evaluate market developments and how they develop their respective strategies, in particular their lending policies. Aggregating individual answers, weighted by banks' market shares, helps researchers draw conclusions regarding likely changes in the directions and trends in the credit market. The conclusions of this analysis always present the answers provided by senior bank officers; however in certain cases additional background information might be presented so that the user could easily oversee the tendencies. The survey was conducted between 1 and 18 October 2011.

The results of the survey are presented below in the form of a descriptive analysis and by means of charts illustrating the answers. Annex 1 contains the charts pertaining to the individual segments. The methodological background is described in details in Annex 2. Numerical data on the market shares can be found in Annex 3, and answers to the questions are presented in detail in Annexes 4, 5 and 6 (Annexes 3, 4, 5 and 6 are attached as a separate Excel file). The retrospective questions in the questionnaire relate to changes in 2011 Q3, while the forward-looking questions ask respondents for their views about changes they expect over the next six-month period, i.e. in 2011 Q4 and 2012 Q1. Questions focus on changes perceived relative to the previous quarter: the base period is 2011 Q2 for retrospective questions and 2011 Q3 for forward-looking questions.

In the case of the household segment, a total of 14 banks were involved in the interviews. 10 banks responded to questions related to housing loans, while 14 banks and 6 financial enterprises questions on consumer loans. Based on data from the end of 2011 Q3, the surveyed institutions accounted for 94% of the banking sector both in the housing loans and consumer loans segment. The corporate questionnaire was completed by 7 banks, with a total market share of 80% and 96% of the corporate loan and commercial real estate loan markets, respectively. A total of 7 banks were interviewed on the subject of loans extended to municipalities. Based on data from the end of 2011 Q3, the institutions surveyed covered 97% of total municipal exposure by banks.

Contents

The interest rate on HUF-denominated corporate loans has stagnated around 8.5 percentage points for a long time; there is strong asymmetry, however, as the rate mainly reflects conditions for customers with excellent scoring. Due to the tight credit conditions, the range of the creditworthy borrowers has narrowed significantly, and thus borrowers financing at higher interest rates have no access to credit. Small and medium-sized enterprises which still have access to credit are able to borrow at rates higher than the average, at above 10 per cent.

The decreasing number of creditworthy borrowers can be attributed to declining risk appetite and the recent deterioration in lending ability (weaker capital and liquidity position). Since publication of the previous lending survey, the global economic outlook has deteriorated, the sovereign debt crisis has escalated, and risks in the euro-area banking sector have risen. These developments have resulted in a deteriorating lending capacity of the euro-area banking sector, leading to tighter credit conditions and stagnation in corporate lending, which had expanded dynamically in previous quarters. The economic outlook in Hungary has deteriorated, and contagion risks via parent banks have risen significantly. As a result, the non-price conditions of micro- and small firms and commercial real estate lending were reported to have tightened.

As regards the household segment, there was no material change in lending in the third quarter, while banks reported a broad-based tightening, mainly through increasing mortgage lending rates, over the next six months.

Table 1
Summary table on developments in supply and perceived demand by banks

Segments		Supply		Perceived demand	
		2011 Q3	2011 Q4–2012 Q1 (e.)	2011 Q3	2011 Q4–2012 Q1 (e.)
Household	Housing	→	↓	↓	→
	Consumer	→	↓	→	↓
Corporate		↓	→	→	→

Note: The up-arrow denotes an increase and the down-arrow a decrease.

DECREASING CREDIT AVAILABILITY AND SLIGHTLY TIGHTER CREDIT CONDITIONS POINT TO TIGHTENING CREDIT SUPPLY IN THE CORPORATE SEGMENT

In net terms,[1] 19 per cent of the respondent banks reported that they had tightened their credit conditions in the corporate segment. This tightening affected micro- and small-sized firms, while there was no change in the terms of large and middle-sized firms (Chart 19). The collateral requirements, loan covenants, interest rates and the level of creditworthiness of micro- and small-sized firms were reported to have tightened over the past three months. Looking forward, an overall net 6 per cent of the banks expected easing, which is the combined outcome of net tightening in the case of large and middle-sized firms and easing in the case of micro- and small-sized businesses. It is important to stress, however, that such forward-looking plans for easing were not realised in previous quarters, as pointed out in previous surveys. Thus, their materialisation remains uncertain. Banks cited lending ability (weaker capital and liquidity position) and decreasing risk appetite as factors contributing to tightening (Chart 30).

Overall, the banking system was characterised by two trends in the period up to Q3: banks which would have increase credit availability would have done so without easing their credit conditions, while some banks curtailed lending and adjusted their terms accordingly. Hungary's economy was hit by significant external shocks in Q3 as a result of the deteriorating global economic outlook, escalation of the sovereign debt crisis and rising risks in the banking sector of the euro area. As a result, for the first time in a long time banks indicated lower willingness to lend (Chart 18), but – compared to the deterioration in the economic outlook – only relatively few banks tightened their corporate lending conditions.

[1] Weighted by the market share of the difference in tightening and easing banks. The ratio does not reflect the extent of tightening/easing.

However, it is important to note that Hungary cannot remain unaffected by the existing tensions in the euro-area banking system.

The earlier trend in perceived demand for loans continued in 2011 Q3: in net terms (20 per cent in Q3), banks reported that they had perceived an increase in demand for short-term corporate loans. By contrast, a net 11 per cent had perceived weaker demand for long-term (mainly investment) loans relative to Q2. There was, however, a significant change in the forward-looking answers, similar to housing loans, as banks' optimism had disappeared. This was the first time since early 2010 that in their forward-looking answers for the next six months the respondents did not expect any rebound in demand for long-term loans; on the contrary: a net 23 per cent of the respondents anticipated a further decline (Chart 32).

As regards commercial property loans, a net 40 per cent of the banks − a considerably higher proportion than in the previous survey − reported that they had tightened credit conditions (Chart 19). Banks expected widespread tightening in all of the segments of commercial real estate lending (residential, offices, industrial (logistics) and retail) to continue over the next six months (Chart 35). Their responses reveal that the external shocks that materialised in Q3 mainly affected commercial real estate lending. Most banks cited their capital position as the main reason for tightening and thus, in addition to the prevailing low willingness to lend, deteriorating lending ability has also become an obstacle to financing large-volume commercial real estate projects.

Due to the escalating Eurozone sovereign debt crisis and its spill-over into the banking system, a net 16 to 20 per cent of banks, i.e. a higher number than in the previous quarters, reported that they had tightened their credit conditions and expected further tightening over the next three months. Tightening also contributed to a halt in corporate lending, which had started to gather momentum earlier this year. All of this suggests that the sovereign debt crisis has started to affect the real economy adversely through the banking system as well, which poses a downside risk to the euro-area economy. By contrast, the pick-up in lending continued in the Central and Eastern European region, aside from the Baltic countries and Hungary, where the loans outstanding essentially stagnated in the third quarter.

Special topic: Interest rate spread on corporate loans

As regards corporate loans, the interest rate spread on the benchmark interbank rate has been stagnating around 2.5 percentage points for a long time both in the case of HUF-denominated and EUR-denominated loans, which means an 8.5 per cent and 4 per cent interest rate, respectively. Taking into account high cost of provisioning, above 2.5 percentage points, on the whole, the resulting interest rate spread can be considered low. This is especially true in the case of EUR-denominated lending, as external domestic FX funding has become much more expensive. These facts imply that the interest spread primarily reflects the interest rate conditions granted to more creditworthy corporate clients, which have access to credit under more favourable conditions.

Based on corporate size, as expected, large enterprises are able to borrow at the most favourable conditions, at around 2 percentage points spreads. As regards, small- and medium-sized enterprises, on average they can borrow at a 1.5 percentage points higher, approaching a 4 percentage points interest rate spread (Table 2). The interest rate spread of HUF-denominated loans is at around 2.5 percentage points, while that of the FX-denominated loans is 0.5-1 percentage point higher, given the higher external funding costs.

Table 2
Average interest rate spread on corporate loans

Percentage points		HUF		FX		HUF	FX	Large enterprises	Small and medium-sized enterprises (SME)
		Large enterprises	SME	Large enterprises	SME				
Average spread	H1	1.7	3.6	2.6	4.1	2.6	3.1	2.1	3.9
	Q3	1.5	3.4	2.7	4.3	2.5	3.1	2.1	3.9

Note: The spread above the 3-month benchmark interbank rate.
Source: MNB.

At the same time, it must be taken into account that the scope of the creditworthy borrowers has narrowed significantly, and thus the table reflects only the interest rate conditions of this narrower portfolio of borrowers. Riskier clients can borrow at a markedly higher rate above the 4 percentage point spread. However, demand for loans may be subdued at such a high rate.

TIGHTER INTEREST RATE CONDITIONS ON HOUSEHOLD LOANS

Based on banks' responses, there was no major change in the credit conditions of households in Q3. However, a net 65 per cent of the banks expected to tighten credit conditions for housing loans, and 16 per cent for consumer loans (Chart 4). The tightening was planned in the lending rates, but a few banks also expected the tightening even of the loan-to-value ratio, maturity and the payment-to-income ratio (Charts 5-6). Rising interest rates may be attributed to surging funding costs, but with this step banks may also wish to reduce the losses incurred by the final repayment of foreign currency mortgage loans. The final repayment scheme incurs not just one-off losses to banks through principal write-offs, but over the longer term, banks may also lose highly profitable interest income stemming from highly creditworthy customers, i.e. those with the lowest probability of default. This also affects long-term profitability negatively. Tightening banks may offset these negative effects through higher HUF interest rates. Hence, higher interest rates deter customers from refinancing their foreign currency loans, resulting in smaller one-off losses incurred by the principal repayment.[2] The planned tightening of credit conditions on consumer loans would affect each segment based on banks' responses. A net 41 per cent of the respondents (banks and leasing companies) expected to tighten credit conditions for vehicle loans, 21 per cent for home equity loans and 8 per cent for unsecured consumer loans over the period of 2011 Q4 and 2012 Q1 (Chart 12).

As regards loan demand, a net 52 per cent of the banks reported that they had perceived declining demand for housing loans, while demand for consumer loans was reported to have remained broadly unchanged in Q3 (Chart 8). As a result of the escalating sovereign debt crisis in Q3 and the bleaker economic outlook, banks' forward-looking optimism, which had been prevailing since the end of 2009, disappeared, as they did not expect any rebound in demand over the next six months.

Changes in domestic lending practices differed from those in the region and the euro area in the third quarter. The escalating sovereign debt crisis in Q3 marred the lending ability of euro-area banks, halting the expansion in lending seen in recent quarters. In the euro area, a net 18 per cent of banks reported that they had tightened further their credit conditions[3] for housing loans and 10 per cent for consumer loans (as opposed to unchanged conditions in the domestic banking sector). This ratio is significantly higher than the one in the previous quarters. Banks expected tightening to continue until the end of this year. However, these tensions did not yet spill over into the Central and Eastern European banking sectors in Q3. While a gradual deleveraging of households' foreign currency debt continued in Hungary against a background of lacklustre demand for loans, lending to households continued to expand, with the exception of the Baltic States, across the region.

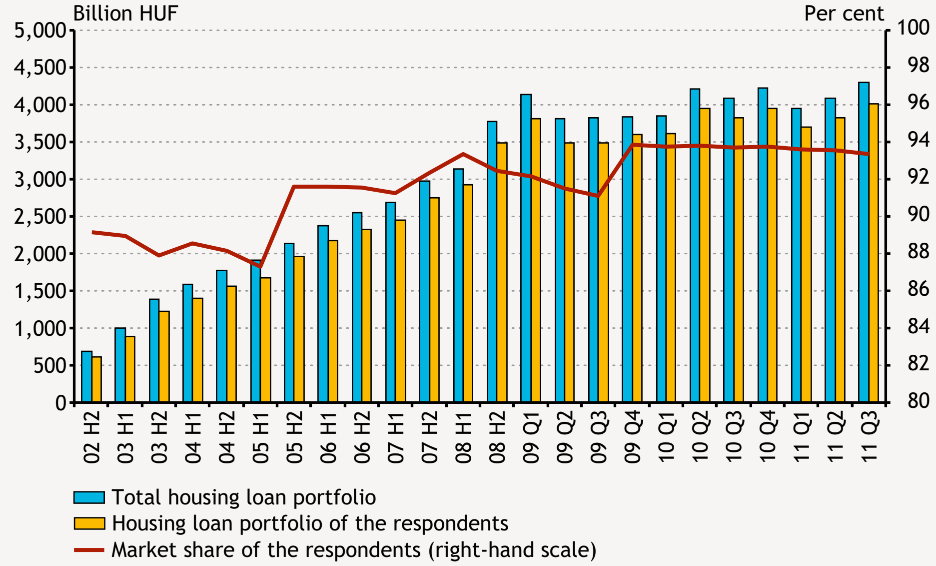
[2] For further details regarding final repayment, see Magyar Nemzeti Bank (2011): *Report on Financial Stability.* November. http://english.mnb.hu/Kiadvanyok/mnben_stabil/mnben-stab-jel-201111.

[3] Based on the ECB lending survey: http://www.ecb.int/stats/pdf/blssurvey_201110.pdf?389721afeee528d5ac87b8165fa25605.

Annex 1: Charts on developments in loan portfolios and answers to the questionnaire

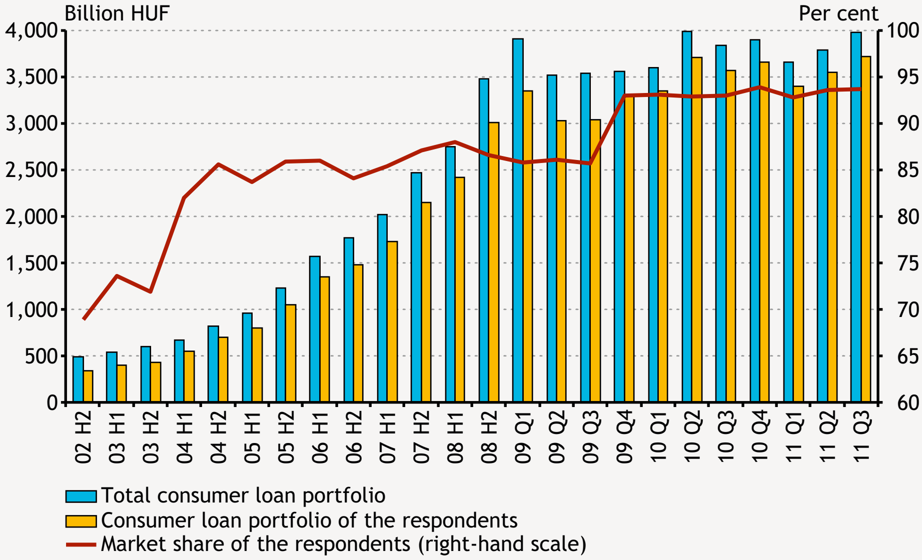
LENDING TO HOUSEHOLDS

Chart 1
Outstanding amount of housing loans and the market share of banks completing the questionnaire



Note: The number and scope of banks varied during the half-year periods under review (e.g. as a result of mergers and the inclusion of new banks). From 2009, stock data also include those for credit institutions and branches.

Chart 2
Outstanding amount of consumer loans and the market share of banks completing the questionnaire



Note: The number and scope of banks varied during the half-year periods under review. The chart only plots market shares of the banks surveyed; it does not plot market shares of financial enterprises. From 2009, stock data also include those for credit institutions and branches.

Chart 3
Willingness of banks to extend housing loans and consumer loans

(net percentage balance of respondents reporting increased/decreased credit availability weighted by market share)

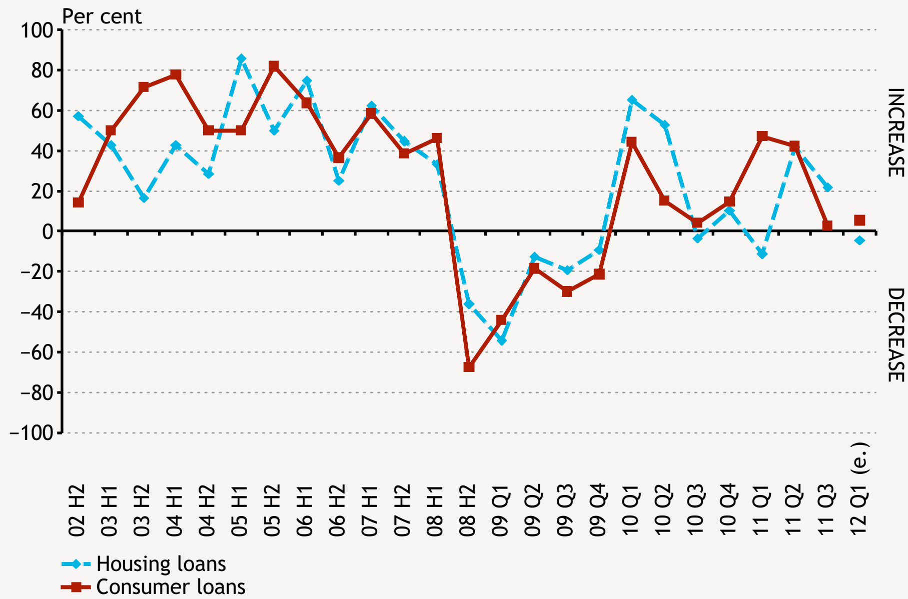
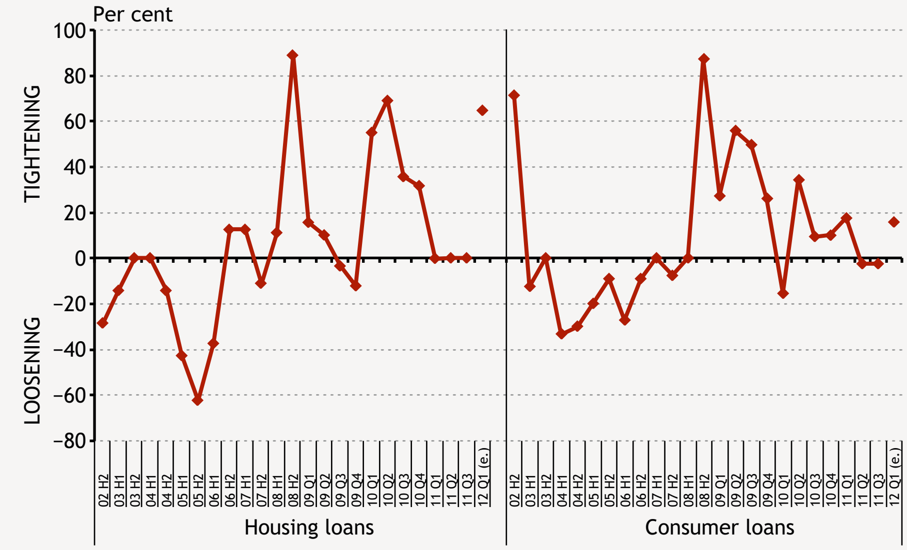
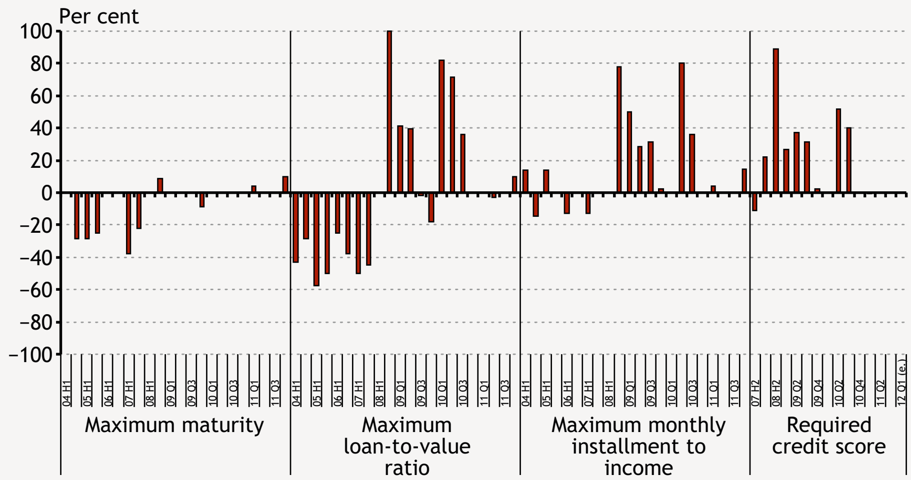


Chart 4
Credit conditions in the housing loan and consumer loan markets
(net percentage balance of respondents tightening/easing credit standards weighted by market share)



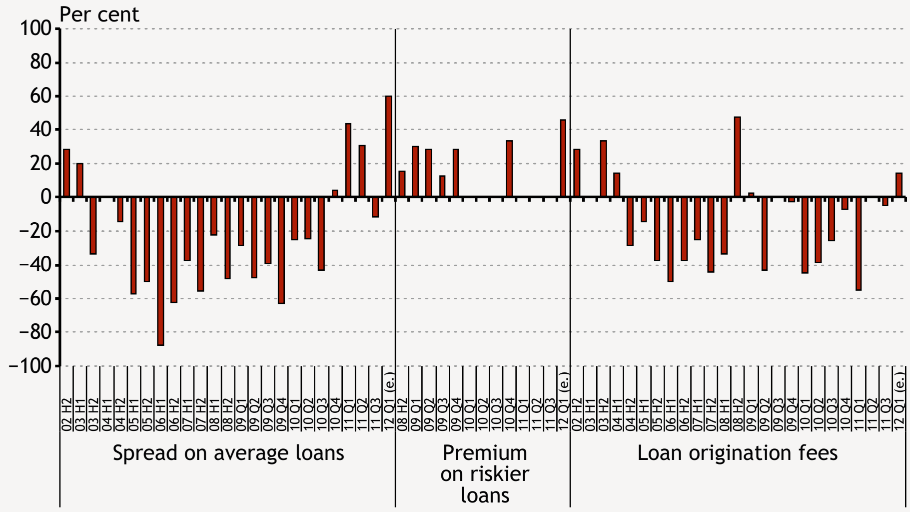
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 5
Credit conditions in the housing loan market – non-price conditions
(net percentage balance of respondents tightening/easing credit conditions weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 6
Credit conditions in the housing loan market – price conditions
(net percentage balance of respondents tightening/easing credit conditions weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 7
Factors contributing to changes in credit conditions in the case of housing loans
(net percentage balance of banks indicating a contribution of individual factors to tightening or easing weighted by market share

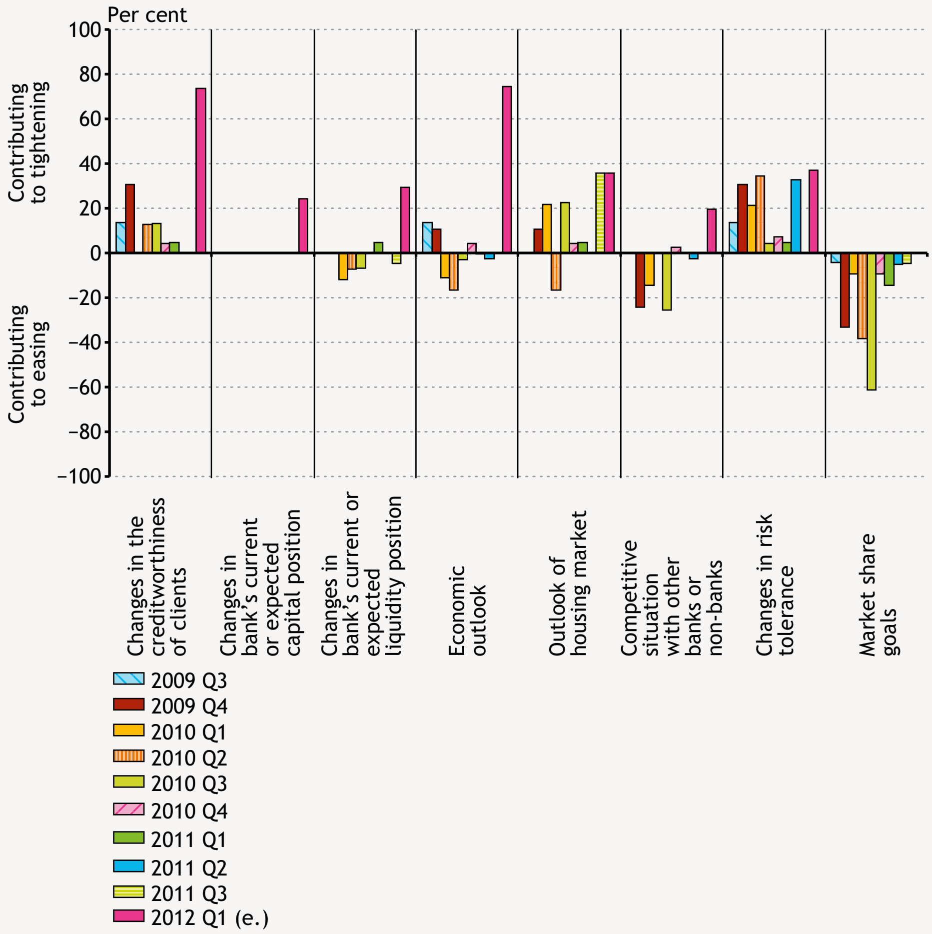


Chart 8
Perceived demand for loans in the household segment
(net percentage balance of respondents reporting increase/decrease in demand weighted by market share)

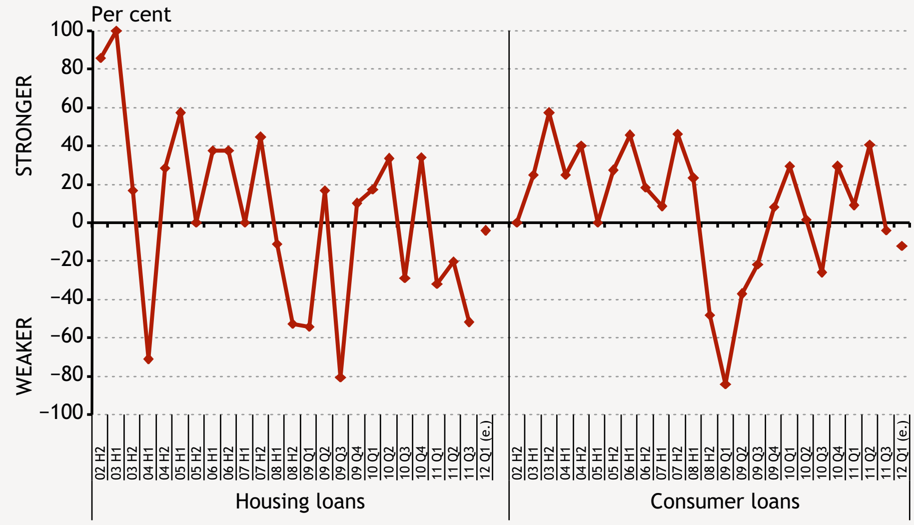
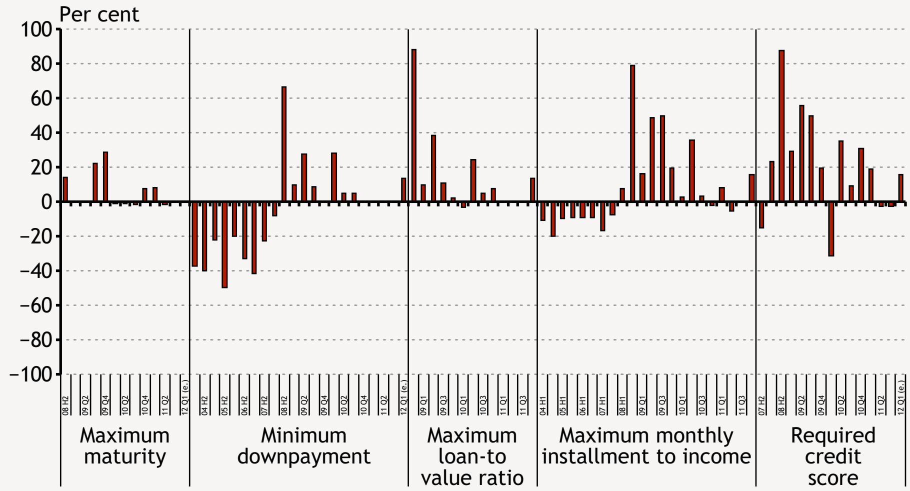
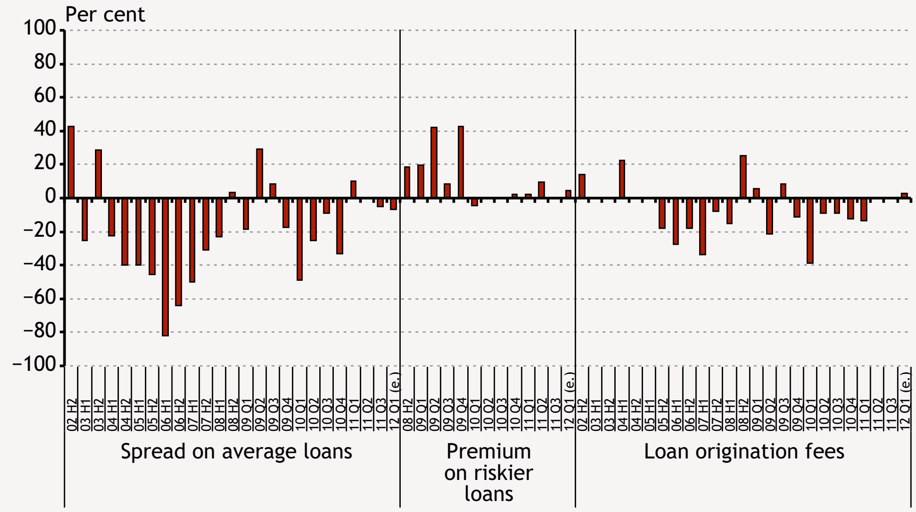


Chart 9
Credit conditions in the consumer loan market – non-price conditions
(net percentage balance of respondents tightening/easing credit conditions weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 10
Credit conditions in the consumer loan market – price conditions
(net percentage balance of respondents tightening/easing credit conditions weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 11
Factors contributing to changes in credit conditions in the case of consumer loans
(net percentage balance of banks indicating a contribution of individual factors to tightening or easing weighted by market share)

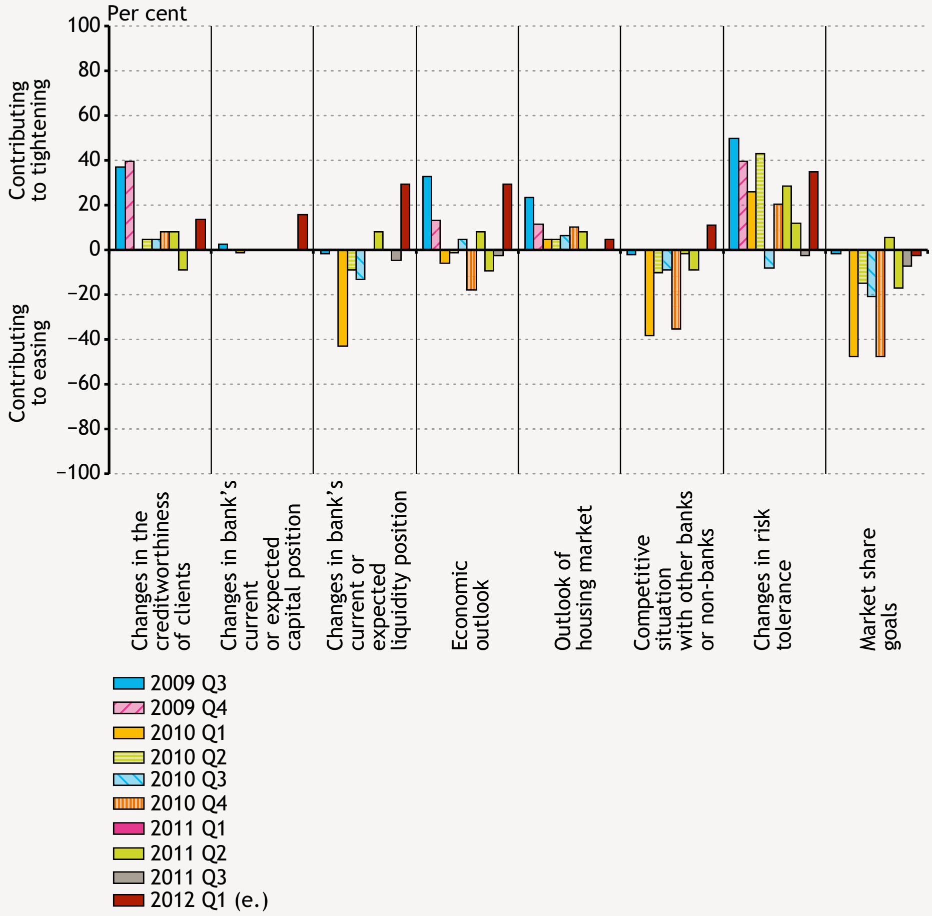
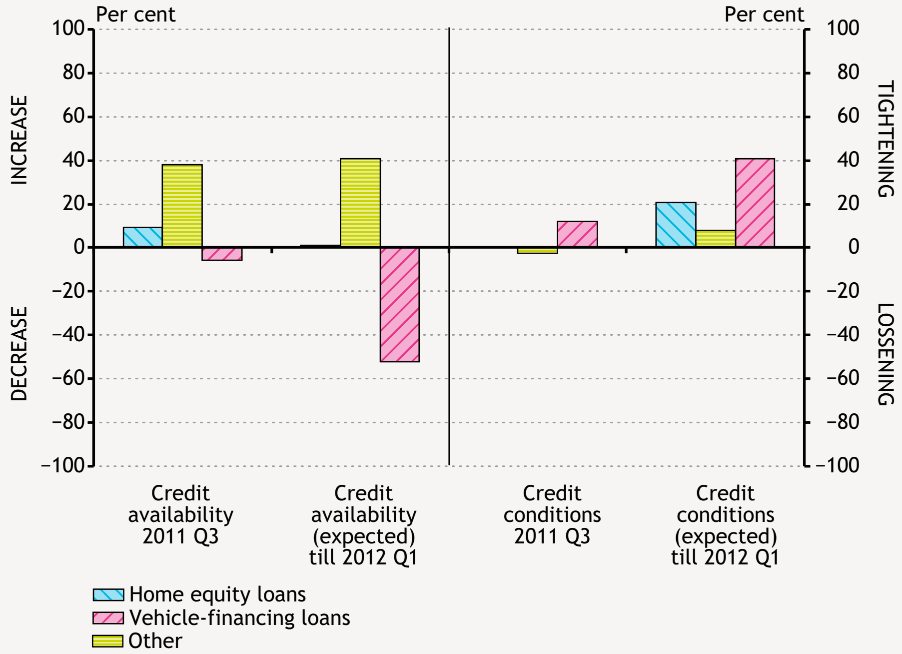
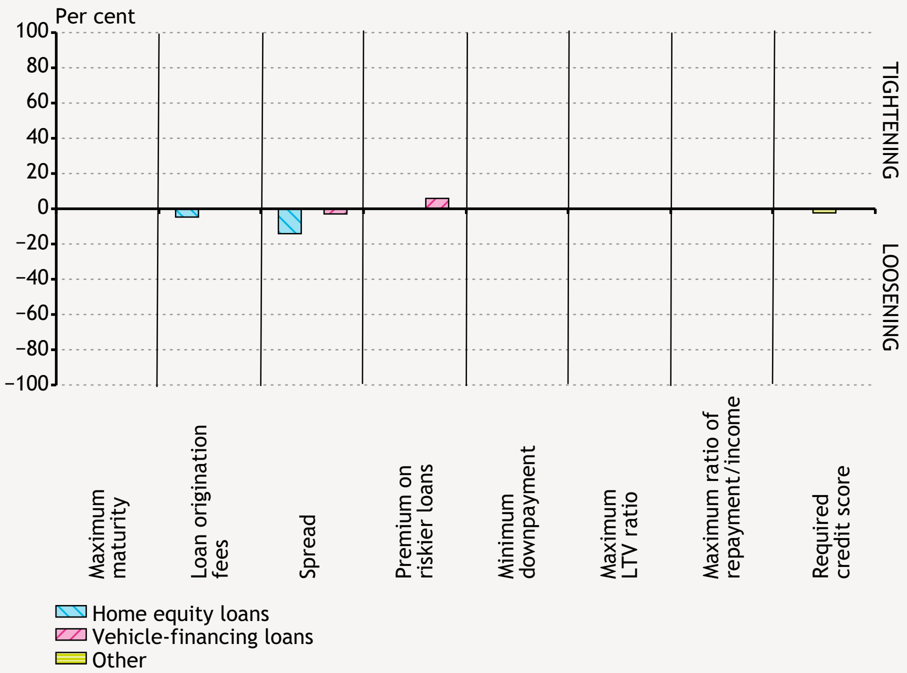


Chart 12
Willingness to lend and credit conditions for different consumer loan products
(net percentage balance of respondents weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 13
Credit conditions for different consumer loan products in 2011 Q3
(net percentage balance of respondents tightening/easing credit conditions weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 14
Demand for different consumer loan products
(net percentage balance of banks reporting increase or decrease weighted by market share)

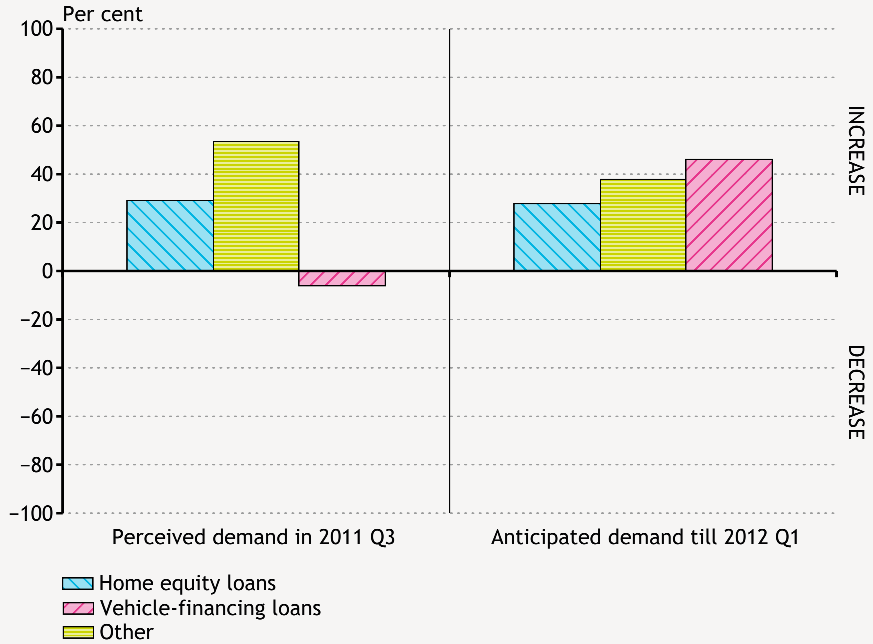
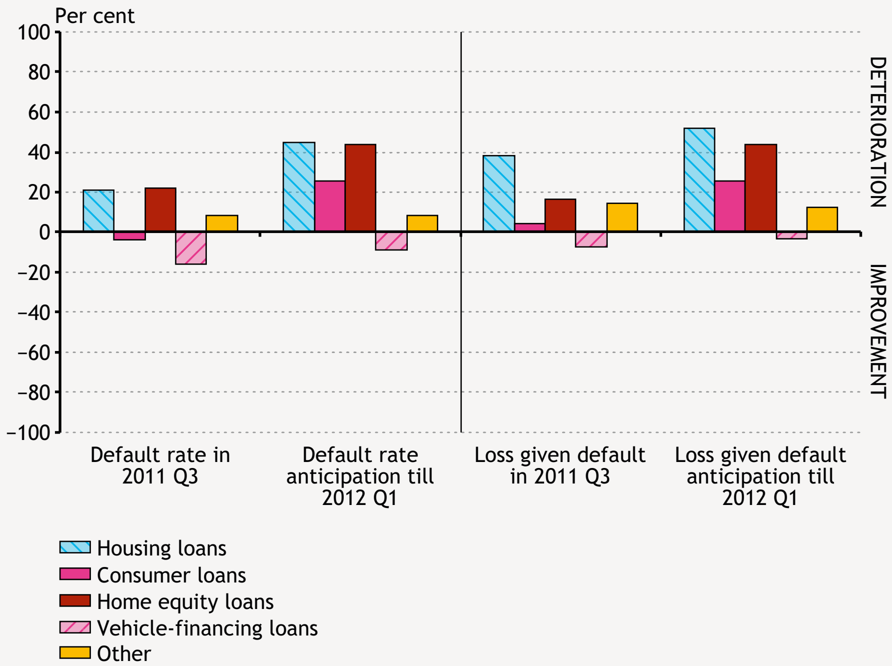
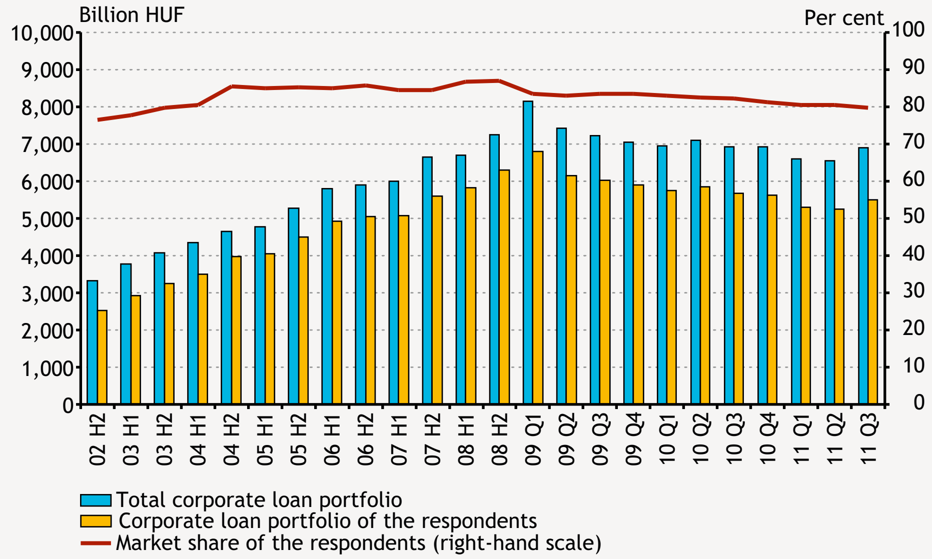


Chart 15
Default rate of loans to households and loss given default
(net percentage balance of banks reporting increase or decrease weighted by market share)



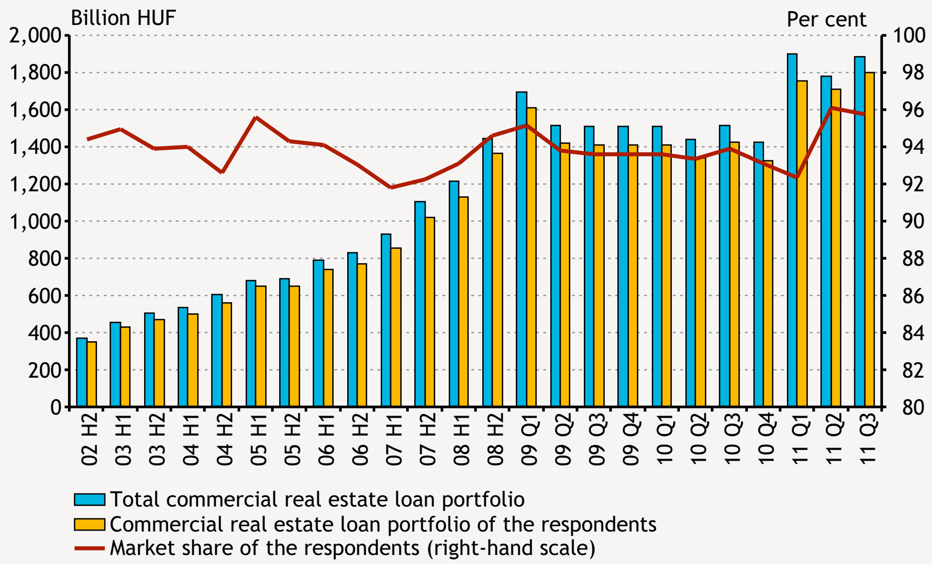
LENDING TO THE CORPORATE SECTOR

Chart 16
Outstanding amount of corporate loans and the market share of banks completing the questionnaire



Note: From 2009, stock data also include those for credit institutions and branches.

Chart 17
Outstanding amount of commercial real estate loans and the market share of banks completing the questionnaire



Note: From 2009, stock data also include those for credit institutions and branches. From 2011 the data includes loans for commercial real estate purchase, not just for development.

Chart 18
Willingness of banks to extend corporate loans
(net percentage balance of respondents reporting increased/decreased credit availability weighted by market share)

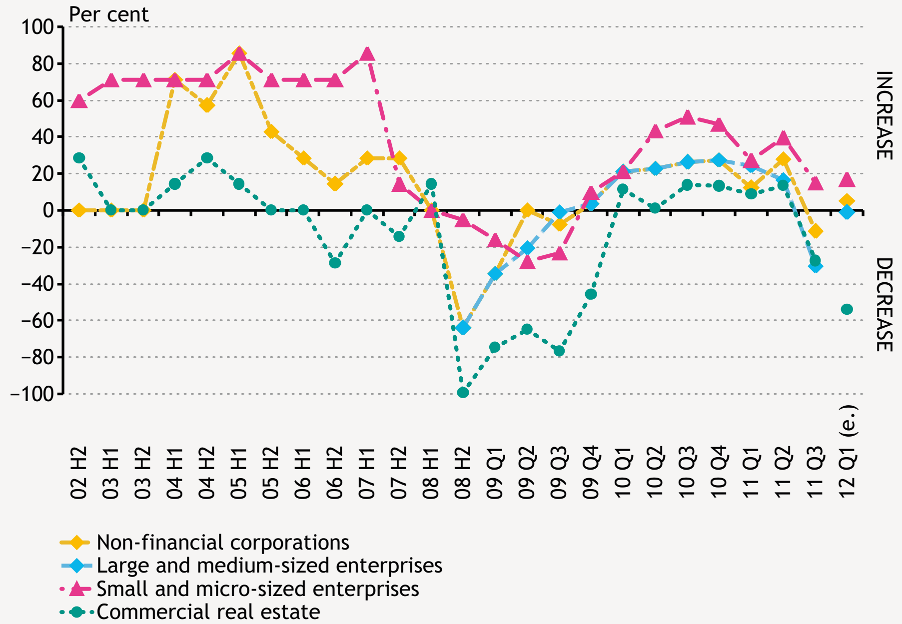
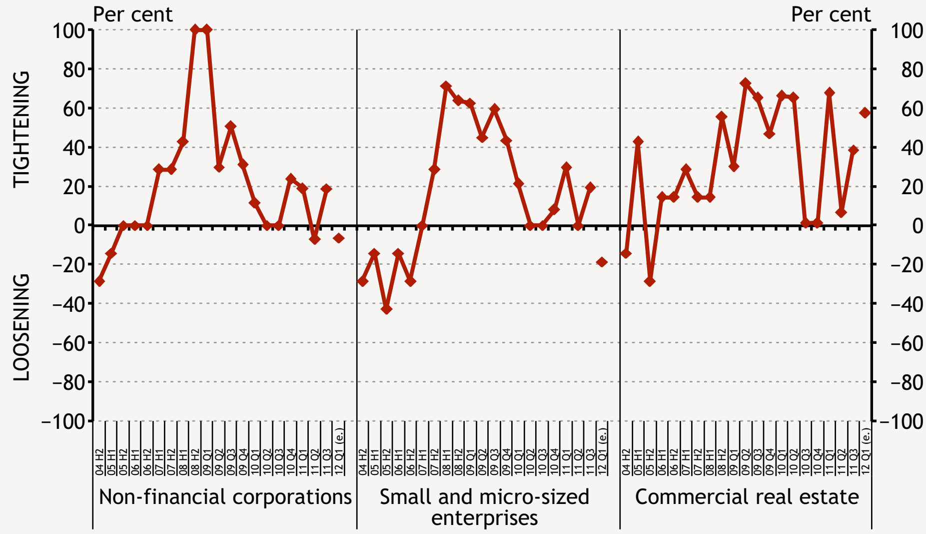
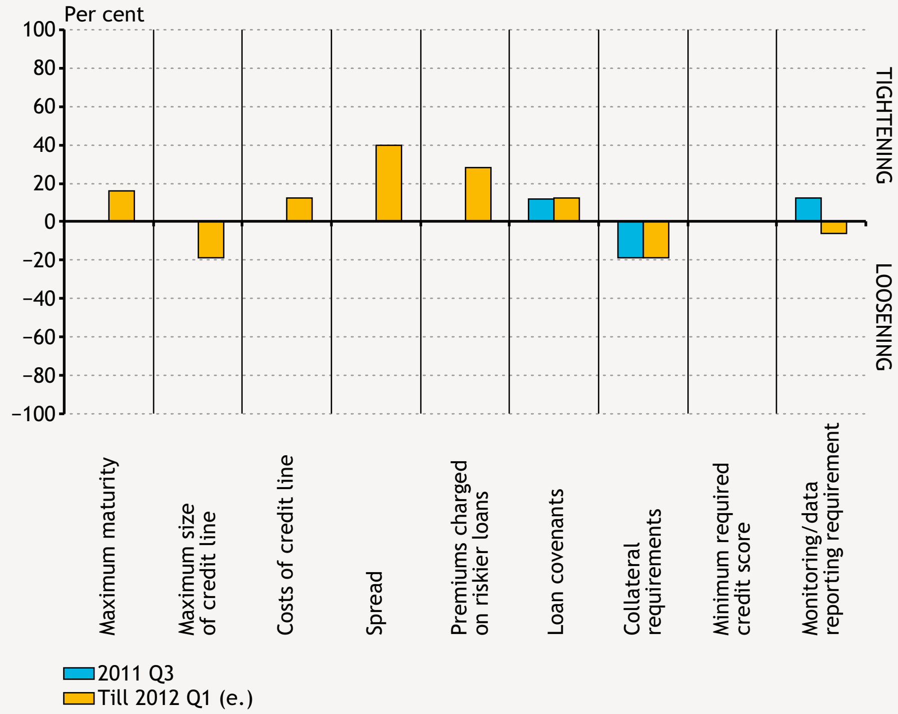


Chart 19
Credit conditions by corporate category and for commercial real estate loans
(net percentage balance of respondents reporting tightening/easing weighted by market share)



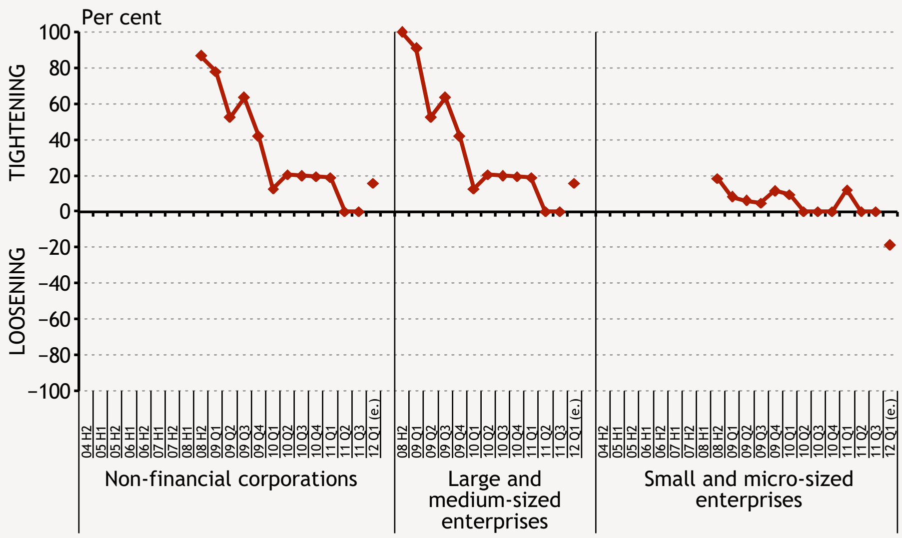
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 20
Credit conditions in the corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



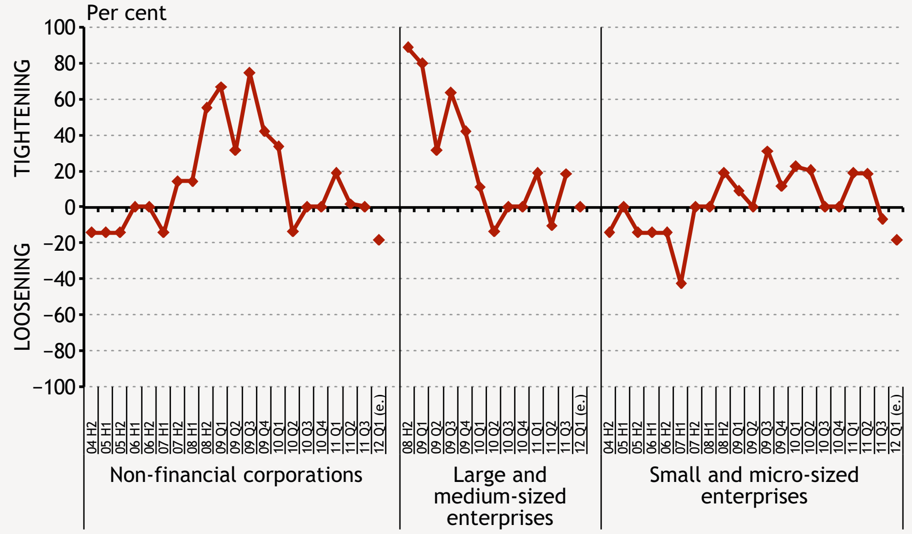
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 21
Maximum maturities by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



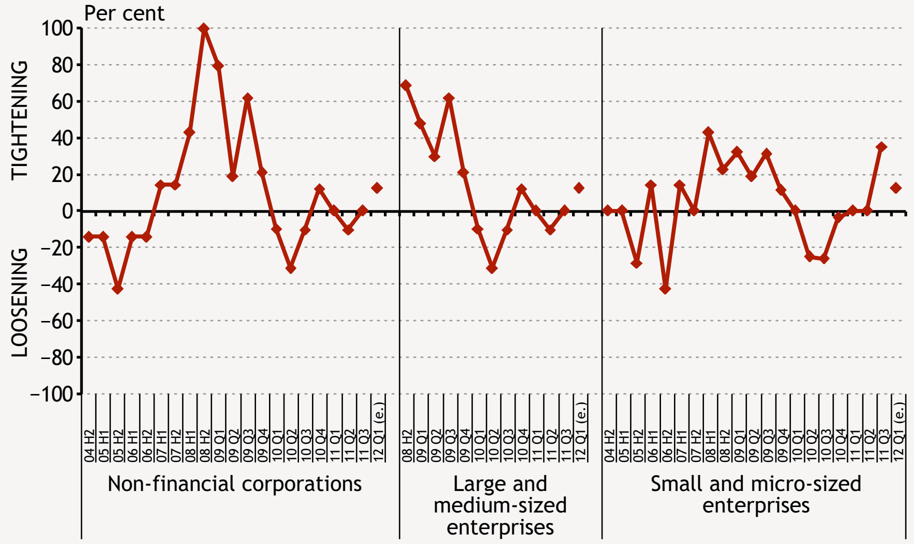
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 22
Maximum size of loans/credit lines by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



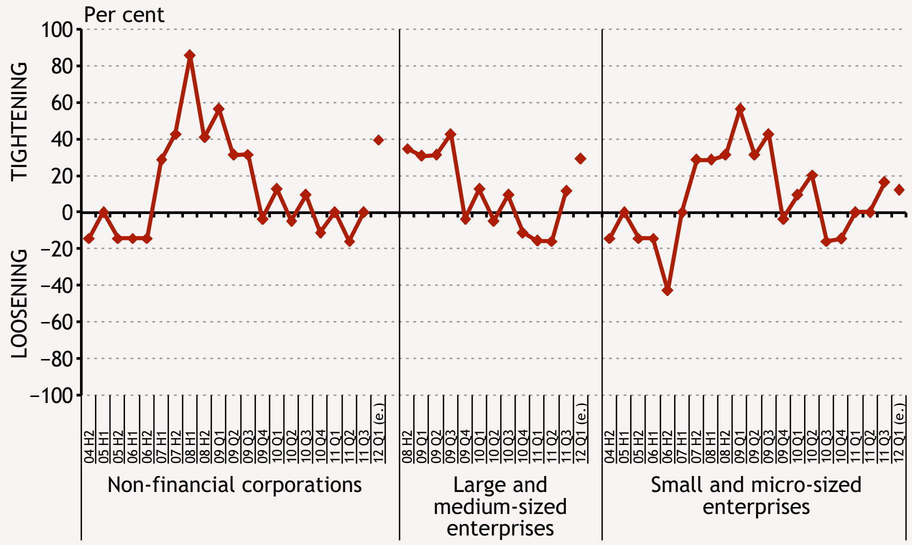
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 23
Fee(s) charged for extending loans/credit lines by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



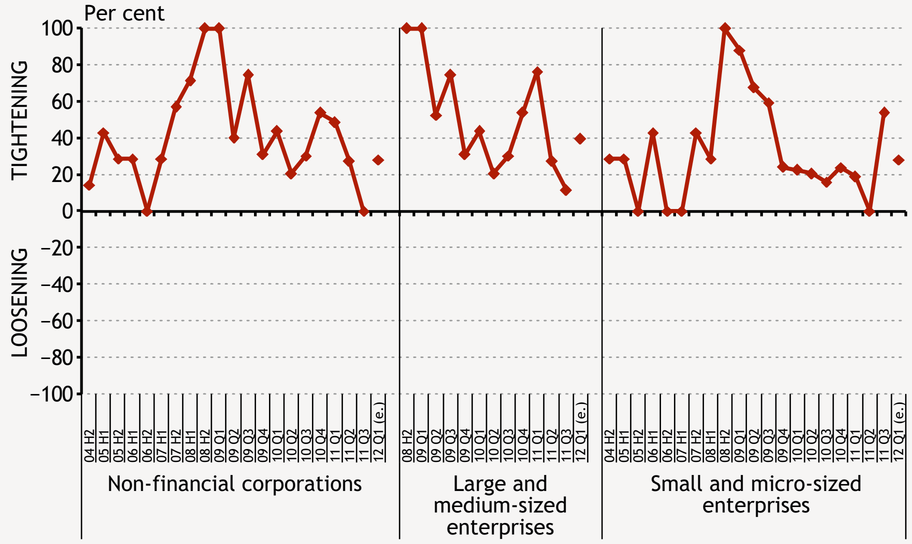
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 24
Spread between lending rates and cost of funds by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



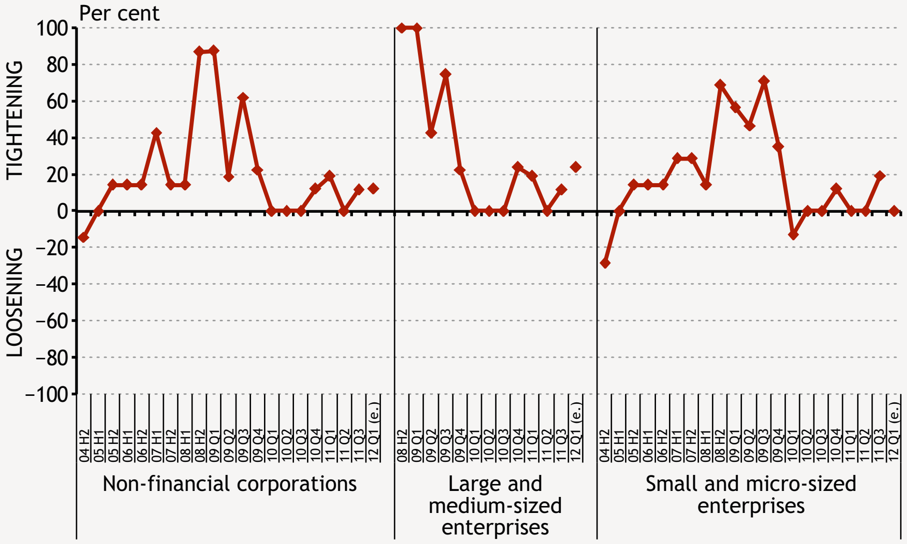
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 25
Premium on riskier loans by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



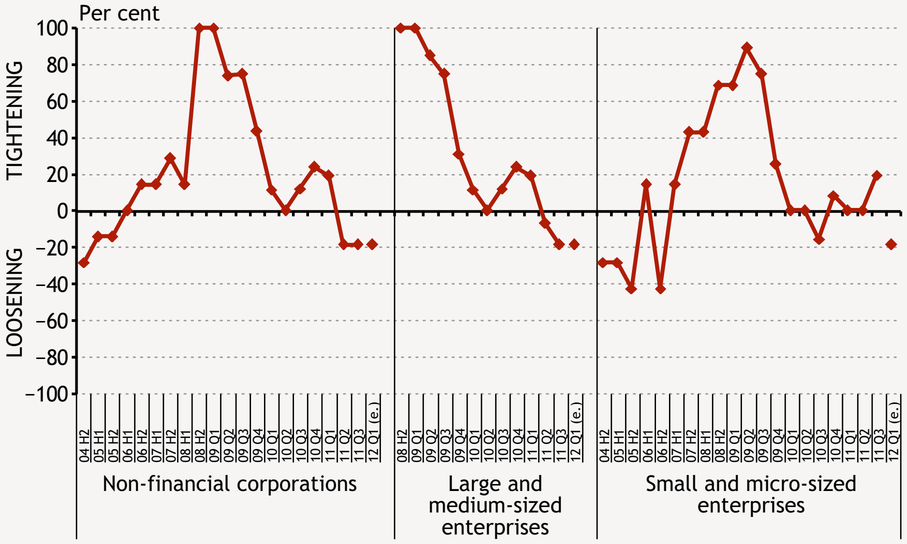
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 26
Covenant requirements by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



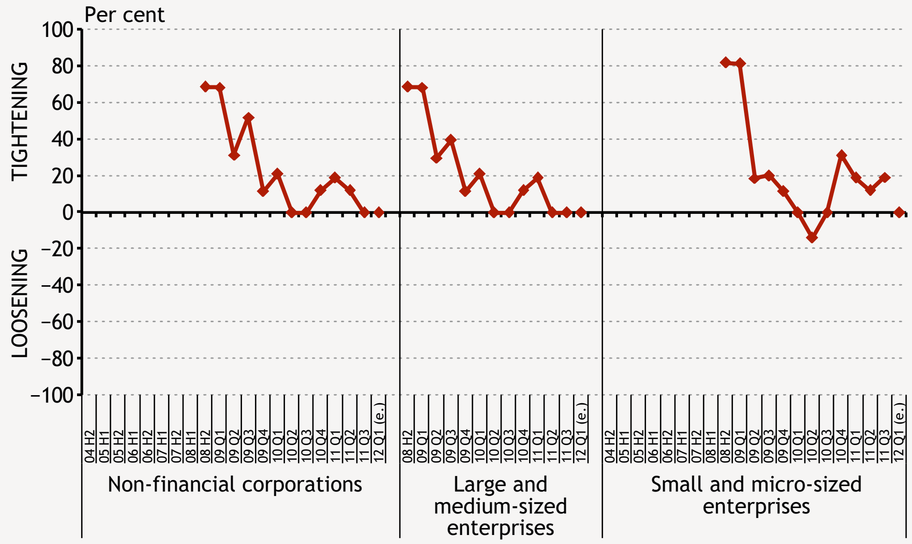
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 27
Collateral requirements by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



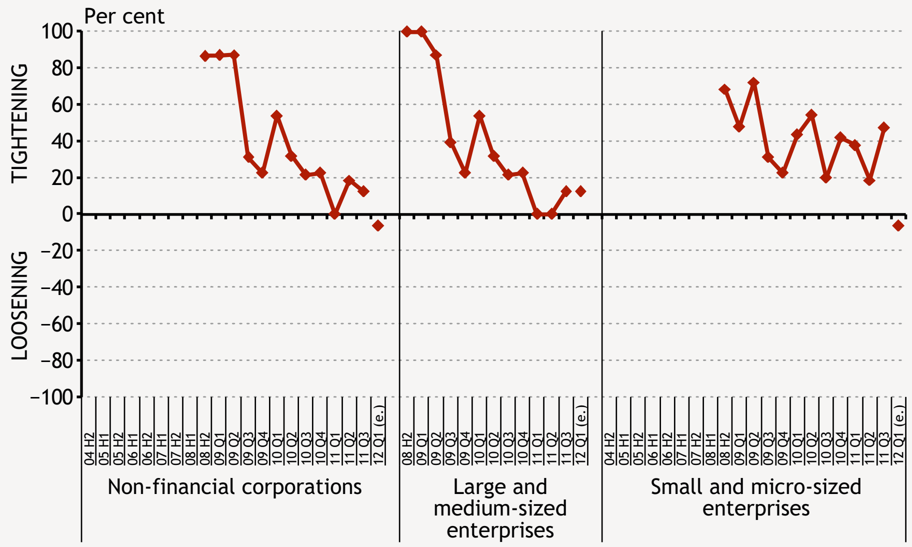
Note: The magnitude of tightening/easing is not shown in the chart.

Chart 28
Minimum required credit score by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 29
Monitoring/reporting requirements by corporate category
(net percentage balance of respondents reporting tightening/easing weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 30
Factors contributing to changes in credit conditions on corporate loans
(net percentage balance of banks indicating a contribution of individual factors to tightening or easing weighted by market share)

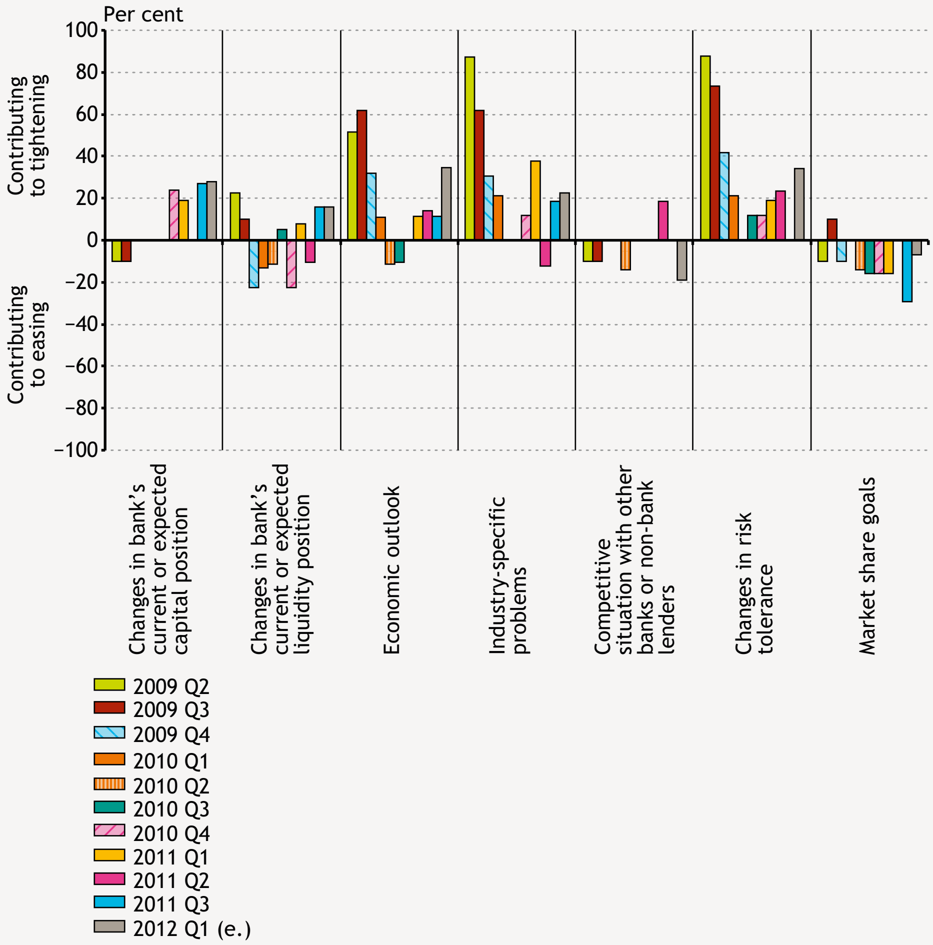


Chart 31
Perceived demand for corporate loans
(net percentage balance of respondents reporting increase/decrease in demand weighted by market share)

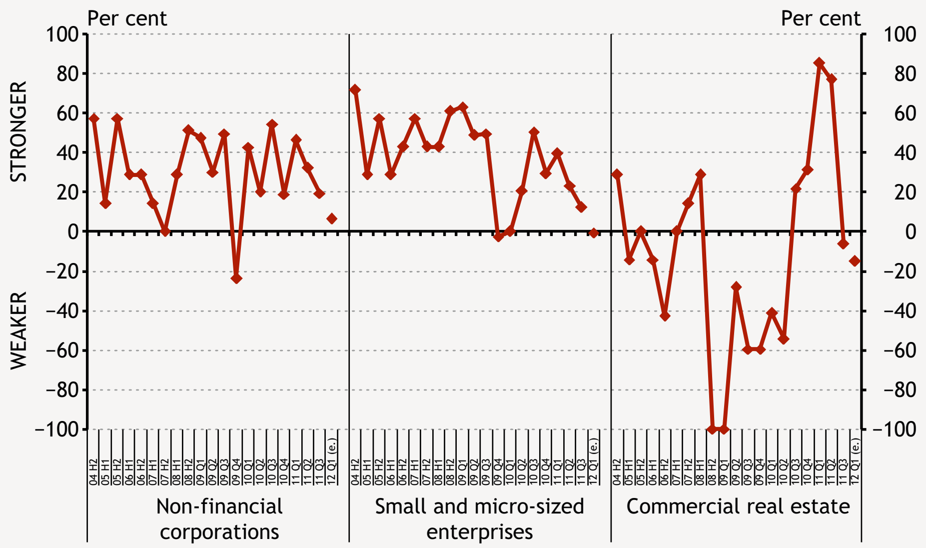


Chart 32
Perceived demand for corporate loans by maturity
(net percentage balance of respondents reporting increase/decrease in demand weighted by market share)

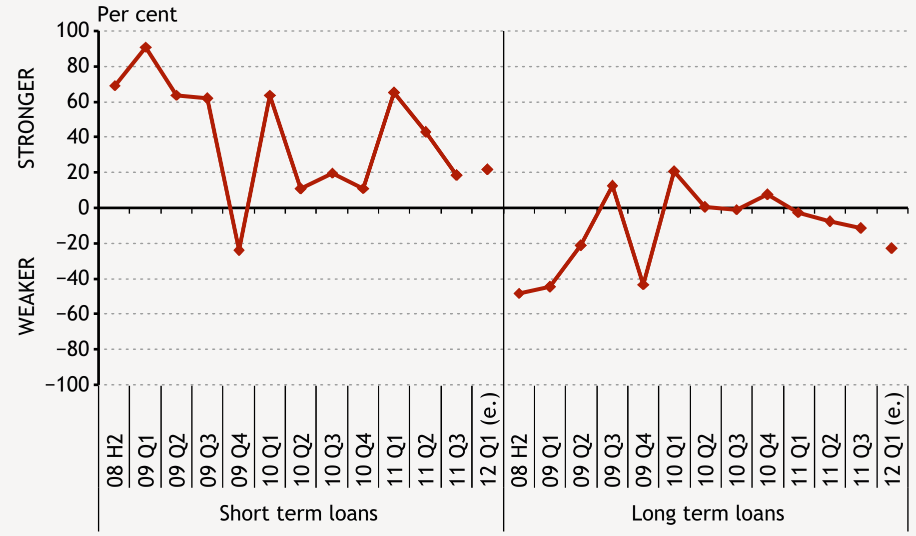


Chart 33
Factors contributing to corporations 'demand for loans based on banks' perceptions
(net percentage balance of banks indicating a contribution of individual factors to increase or decrease weighted by market share)

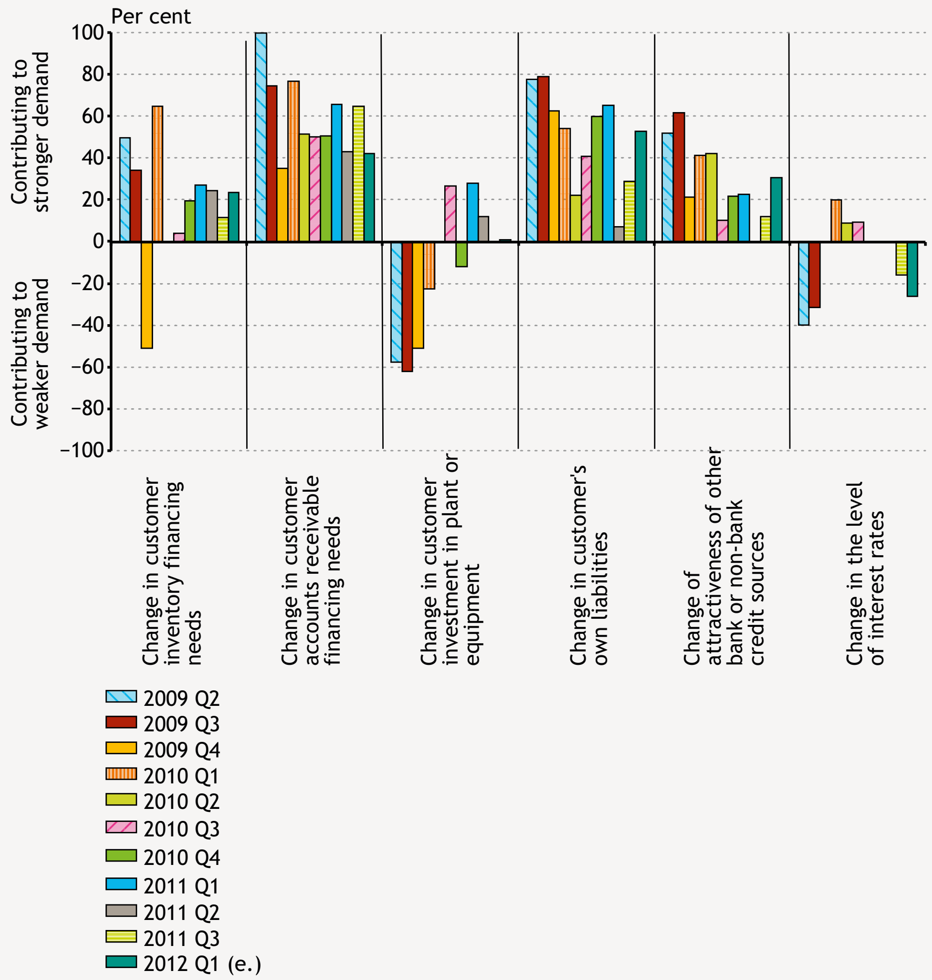


Chart 34
Changes in loan portfolio quality by sector
(net percentage balance of respondents reporting improvement/deterioration weighted by market share)

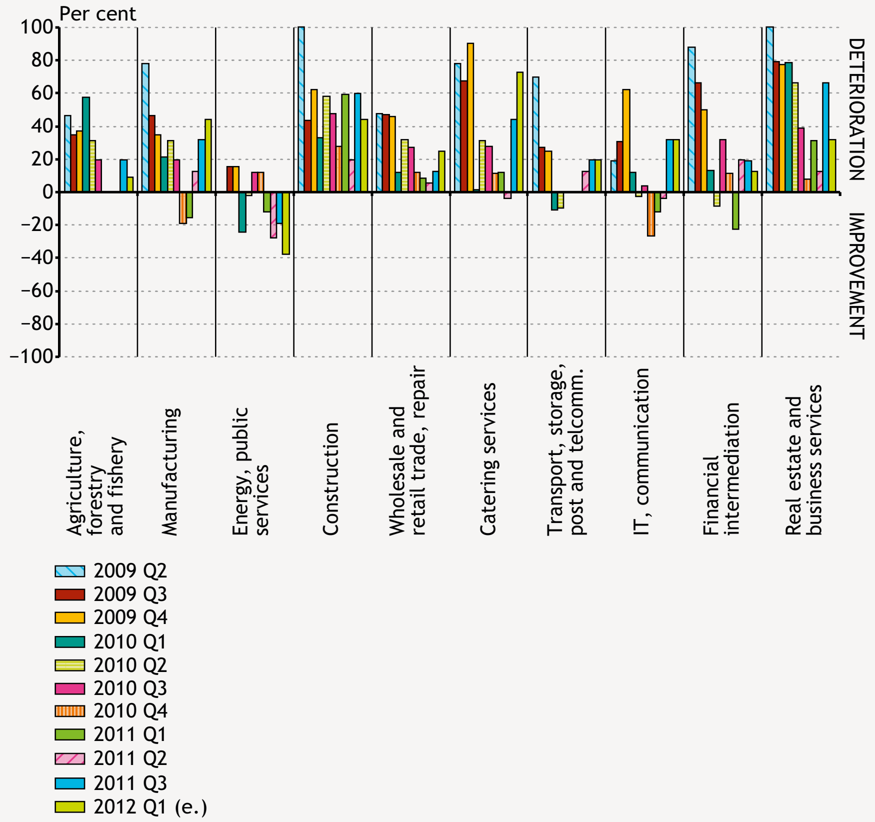
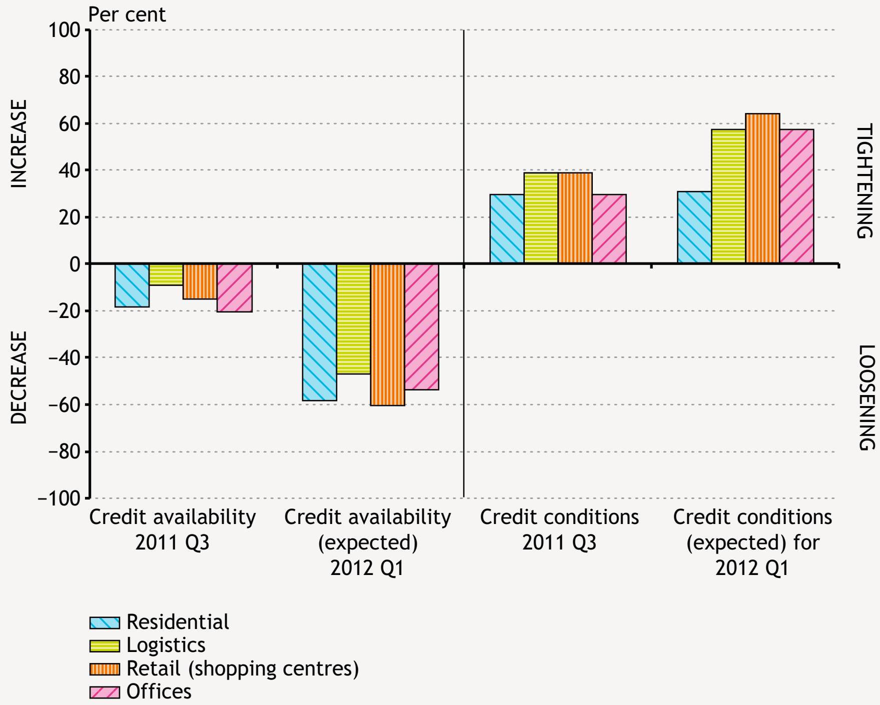


Chart 35
Credit availability (Willingness to lend) and credit conditions in the commercial real estate segment
(net percentage balance of respondents reporting an increase/decrease and tightening/easing weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 36

Demand for loans in specific segments of the commercial real estate market

(net percentage balance of respondents reporting an increase/decrease in demand weighted by market share)

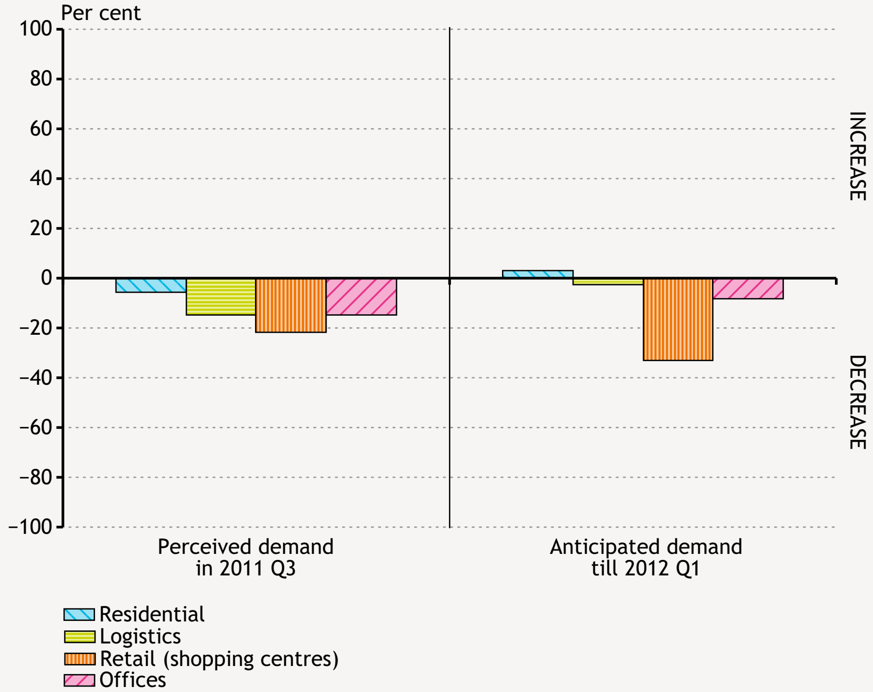


Chart 37

Developments in perceptions of risk associated with corporate loans based on answers provided on default rate and loss given default

(net percentage balance of respondents reporting increased/decreased risk weighted by market share)

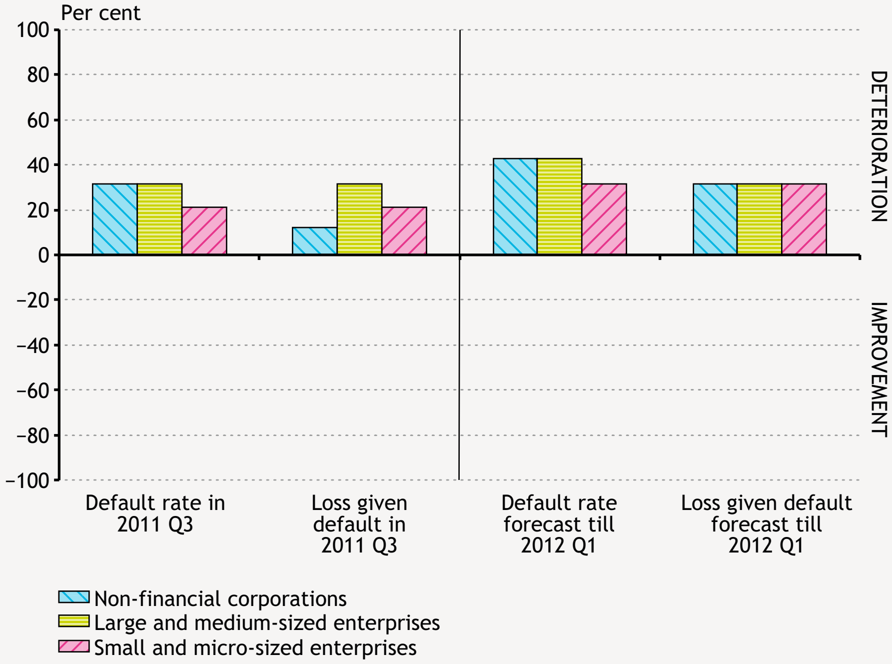
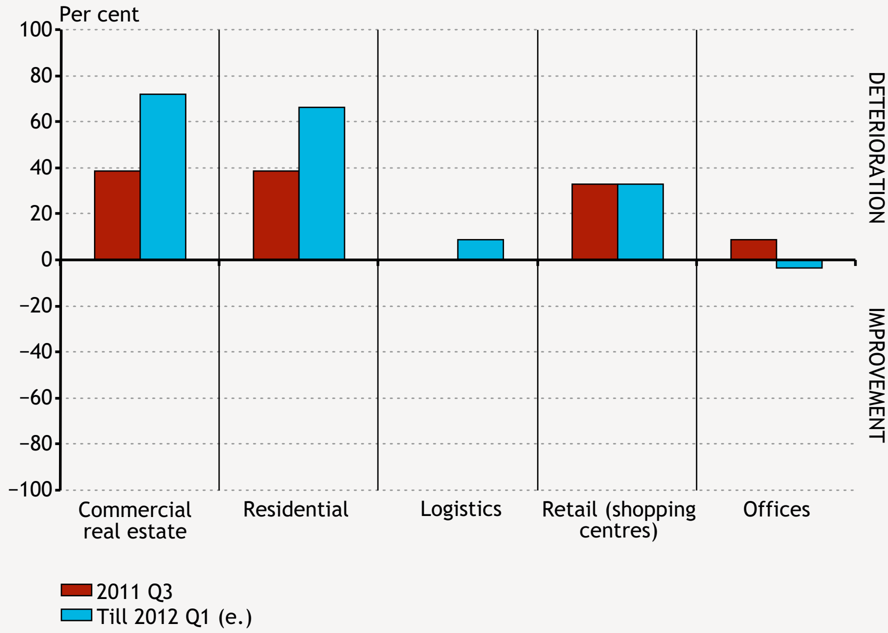
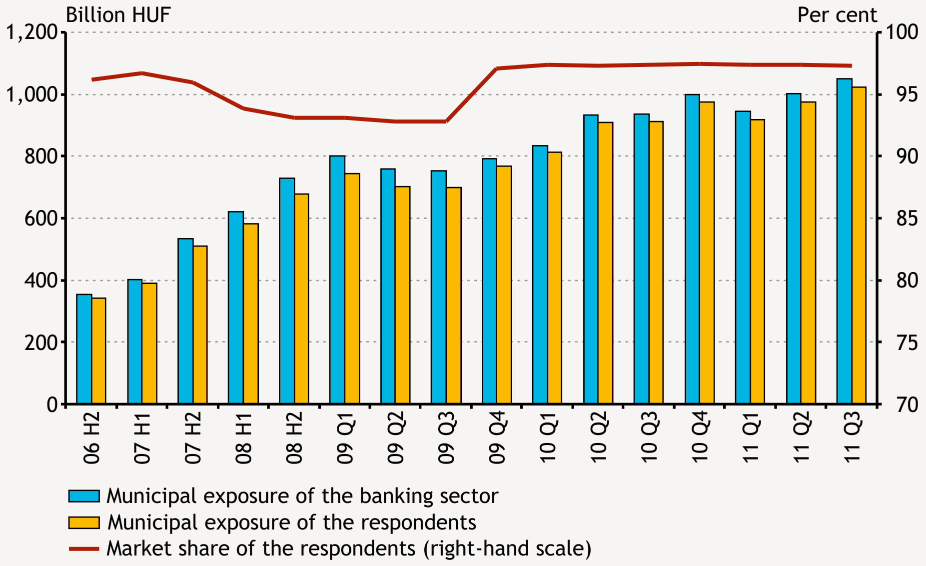


Chart 38
Changes in the quality of the commercial real estate loan portfolio
(net percentage balance of respondents reporting improvement/deterioration weighted by market share)



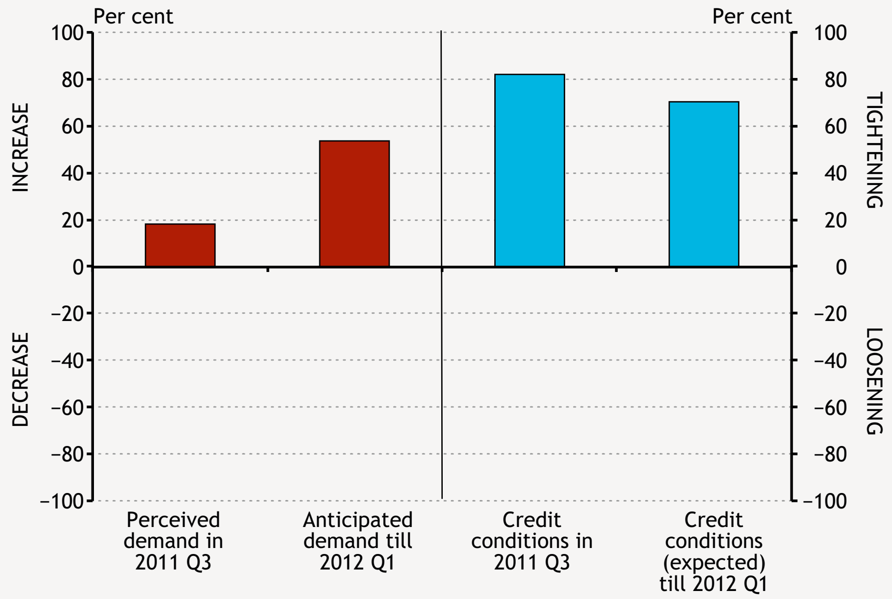
LENDING TO MUNICIPALITIES

Chart 39
Total exposure to municipalities and the share of banks completing the questionnaire



Note: From 2009, stock data also include those for credit institutions and branches.

Chart 40
Perceived demand for loans and credit conditions in lending to municipalities
(net percentage balance of respondents reporting an increase/decrease and tightening/easing weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Chart 41
Credit availability (Willingness to lend) and portfolio quality in lending to municipalities
(net percentage balance of respondents reporting an increase/decrease and deterioration/improvement weighted by market share)

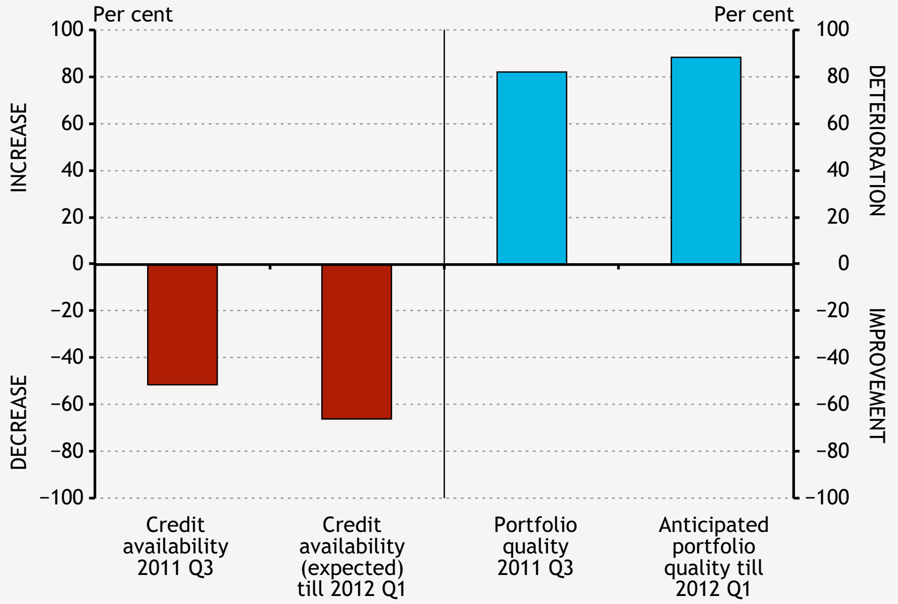
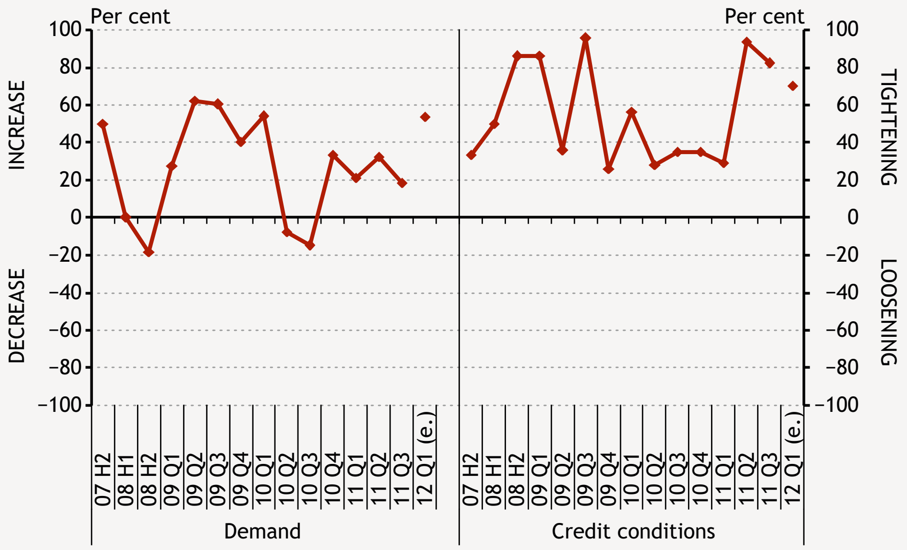


Chart 42
Credit availability (Willingness to lend) and credit conditions in lending to municipalities since 2007 H2
(net percentage balance of respondents reporting an increase/decrease and tightening/easing weighted by market share)



Note: The magnitude of tightening/easing is not shown in the chart.

Annex 2: Methodological notes

In terms of methodology – starting from January 2010 – the survey consists of the standard questionnaire in each segment, and we might also ask ad hoc questions of current concerns related to the lending segment. The retrospective questions in the questionnaire refer to the previous quarter year (previous quarter in the past), (e.g. to 2011 Q3 in October 2011), whereas forward-looking questions contain projections for the upcoming half year (e.g. for 2011 Q4–2012 Q1 in October 2011), relative to the trends of the previous quarter year (previous half year in the past).

To indicate changes, the survey used the so-called net change indicator, expressed as a percentage of respondents. This indicator is calculated as follows: market share-weighted ratio of respondents projecting a change (tightening/increasing/strengthening) minus market share-weighted ratio of respondents projecting a change in the opposite direction (easing/decreasing/weakening).

The standard part of the questionnaire asked respondents for changes in willingness to lend (volume of loans), credit standards and credit/disbursement conditions, as well as changes in demand (observed in the last quarter and, as expected for the next half year, seasonally adjusted changes in new credit applications) and in portfolio quality as perceived by the respondent, and changes in the risk assessment of different sectors in the case of the corporate questionnaire. The survey applied a five-step scaling to assess changes in the willingness to lend, demand, standards/conditions, risk parameters, however on the charts we only show the direction, excluding magnitude:

- A rating of 1 reflects a considerable increase in demand and in willingness to lend, a considerable tightening in credit standards/credit conditions, a considerable increase in housing prices and risk parameters and, in the case of the risk assessment of sectors, a score of 1 indicates a considerable increase in risk perception relative to the half year preceding the survey, or relative to the current half year or for the upcoming half year in the case of a forecast.

- A rating of 3 indicates an unchanged assessment, both for the current half year and for the forecast pertaining to the upcoming half year.

- A rating of 5 reflects a considerable decrease in demand and in willingness to lend, a considerable loosening of credit standards/credit conditions, a considerable decline in housing prices and risk parameters and, in the case of the risk assessment of sectors, a rating of 5 indicates a significantly safer climate relative to the half year preceding the survey, or relative to the current half year or for the upcoming half year in the case of a forecast.

Ratings of 2 and 4 allow for an intermediate assessment between two extremes (e.g. demand increasing to some extent).

Keywords used for the purposes of the questionnaire are defined as follows:

Credit availability (willingness to lend) reflects the respondent's intention to expand and increase its portfolio in the specific segment.

In terms of **credit conditions**[4], there is a distinction between price-related and non-price related factors. Non-price related credit conditions (such as collateralisation requirements, loan covenants, maximum size of loans/credit lines, etc.) represent specific contractual terms; the bank will not disburse the loan unless these conditions are met. Regarding the non-price related factors, the survey queried respondents on items such as the spread between the interest rate level and the cost of funds, and risk premium.

[3] As credit standards and credit conditions are interrelated concepts, we surveyed overall changes in credit conditions and standards, followed by a separate query on individual credit conditions.

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