



Foreign currency lending: the “flow” and the “stock” problem

Júlia Király - Ádám Banai

2nd NBRM Research Conference "Policy Nexus and the
Global Environment: a New Consensus Emerging from
the Crisis?"

26 April 2013

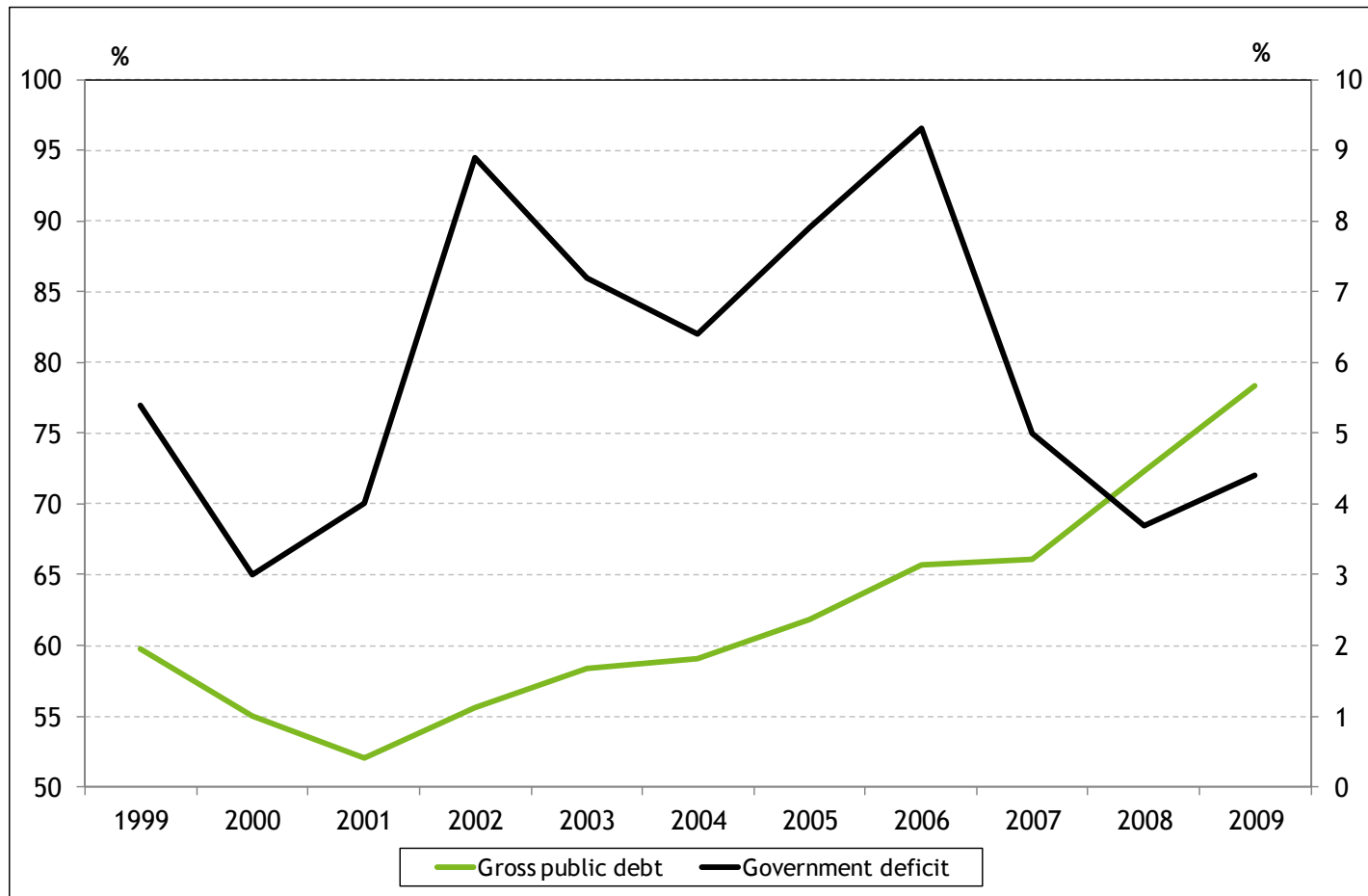
Agenda

- Accumulating imbalances (the ‘flow’ problem) 2001-2008
 - *Macroeconomic environment in the years of FX lending*
 - *Households motives: rationality and irrationality*
 - *Banks motives: profit-seeking and risk-based competition*
 - *Micro-rationality vs. macro-risks*
 - Problem of the accumulated stock (the ‘stock’ period) 2008 - present
 - *Attempts at a solution*
 - *The way forward*
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Accumulating imbalances (the 'flow' problem) 2001-2008

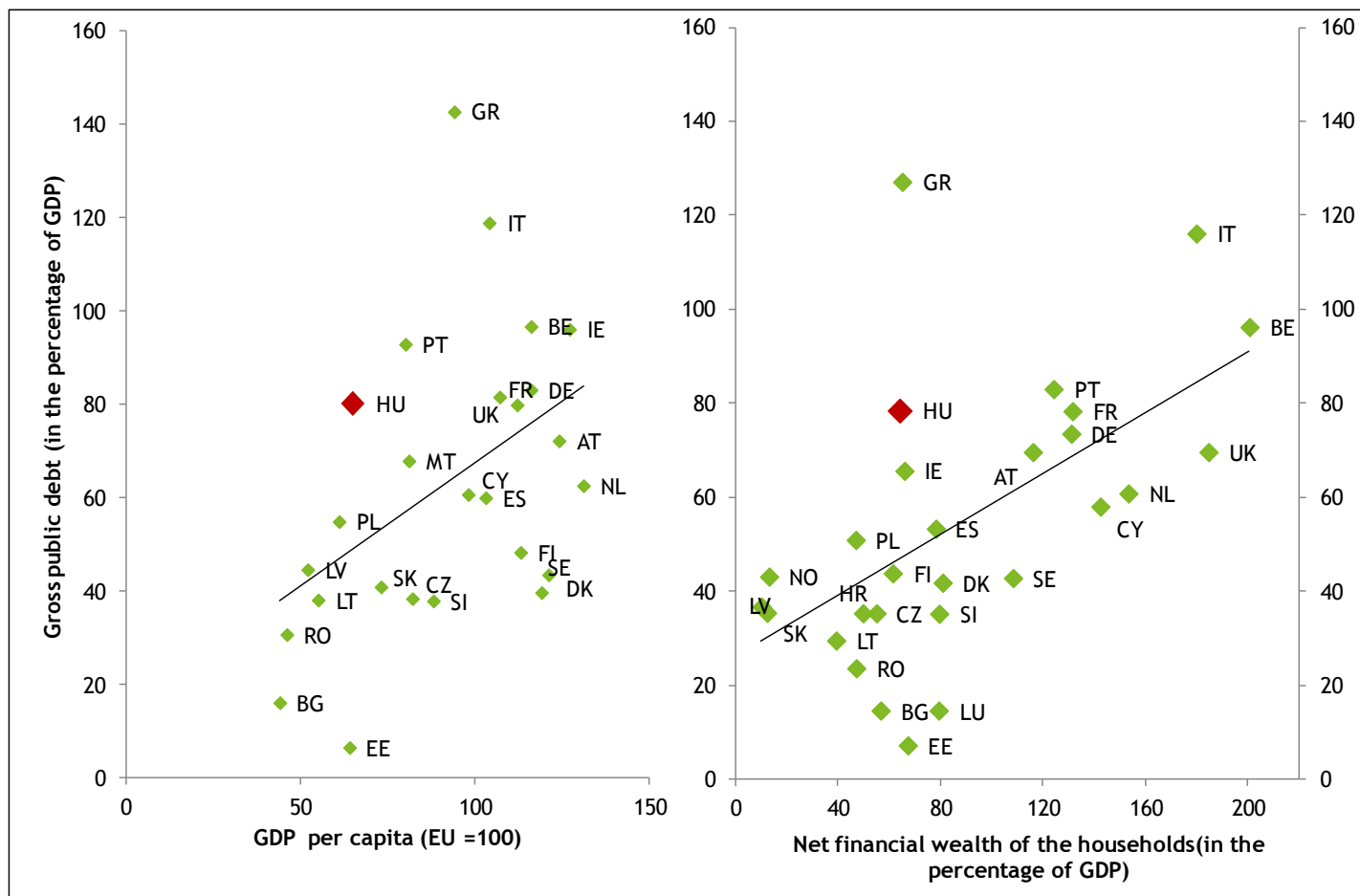
Macro (1): „Fiscal alcoholism” - high budget deficits before the crisis

Budget deficit/GDP and gross public debt/GDP (1999-2009)



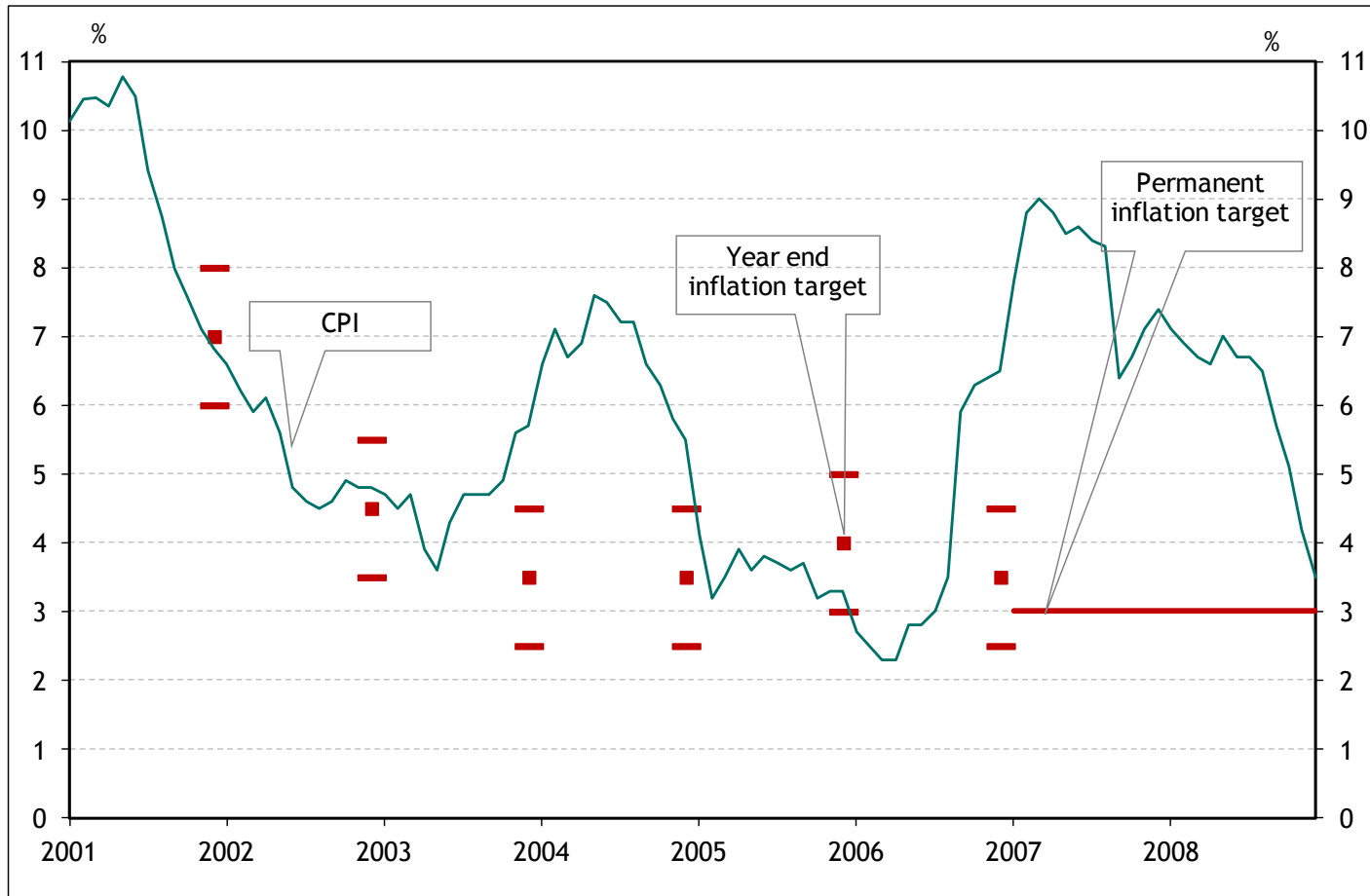
Macro (2): High public indebtedness in regional comparison

Public debt as a percentage of per capita GDP and the financial savings of households



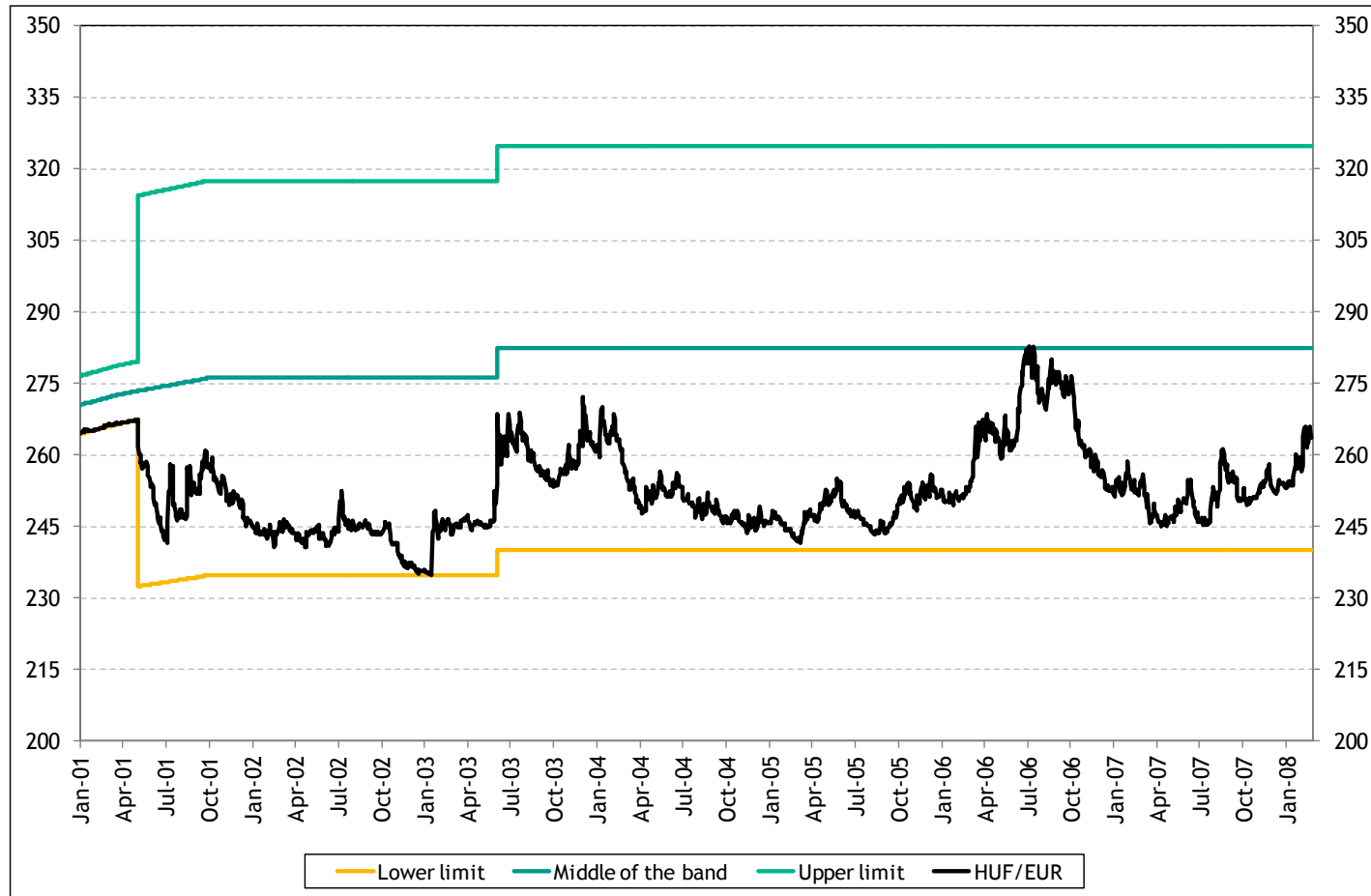
Macro (3): Permanent demand-side inflationary pressure due to government spending

Inflation - actual and target



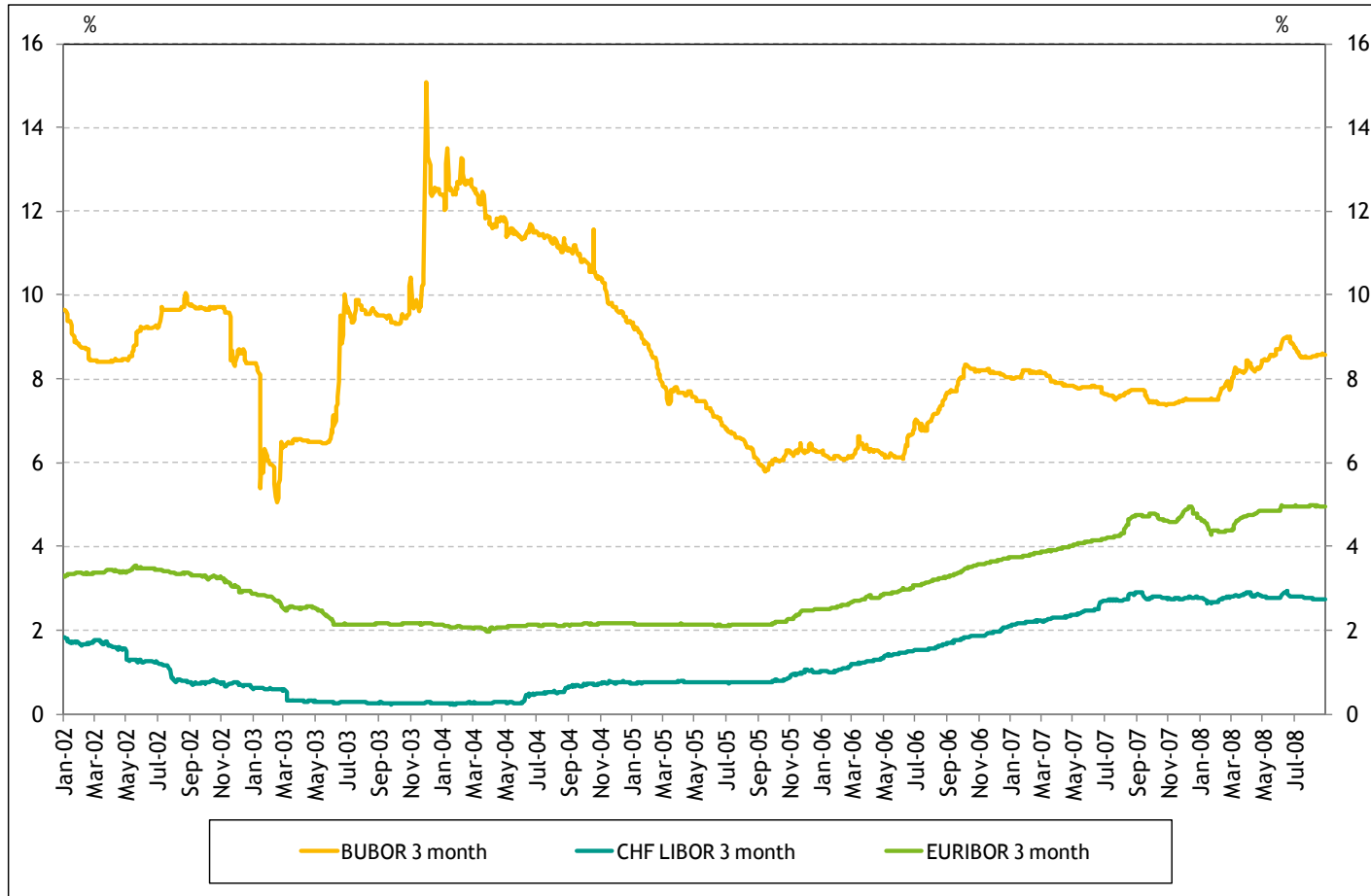
Macro (4): „dirty floating” and its consequences

The forint in the exchange rate band



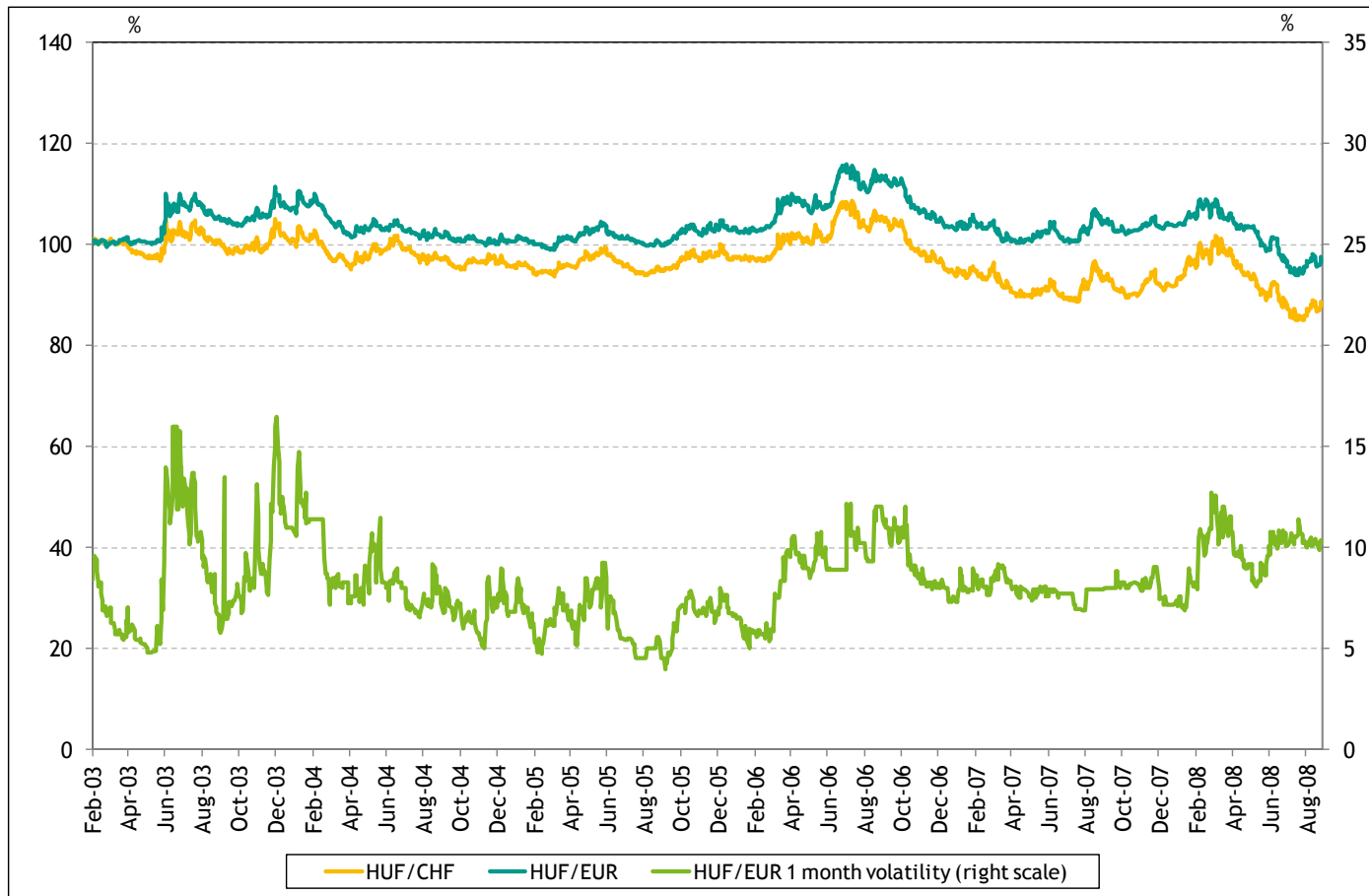
Household (1): perceived differentials in rates

Interest rates in Hungary, in the euro area and in Switzerland



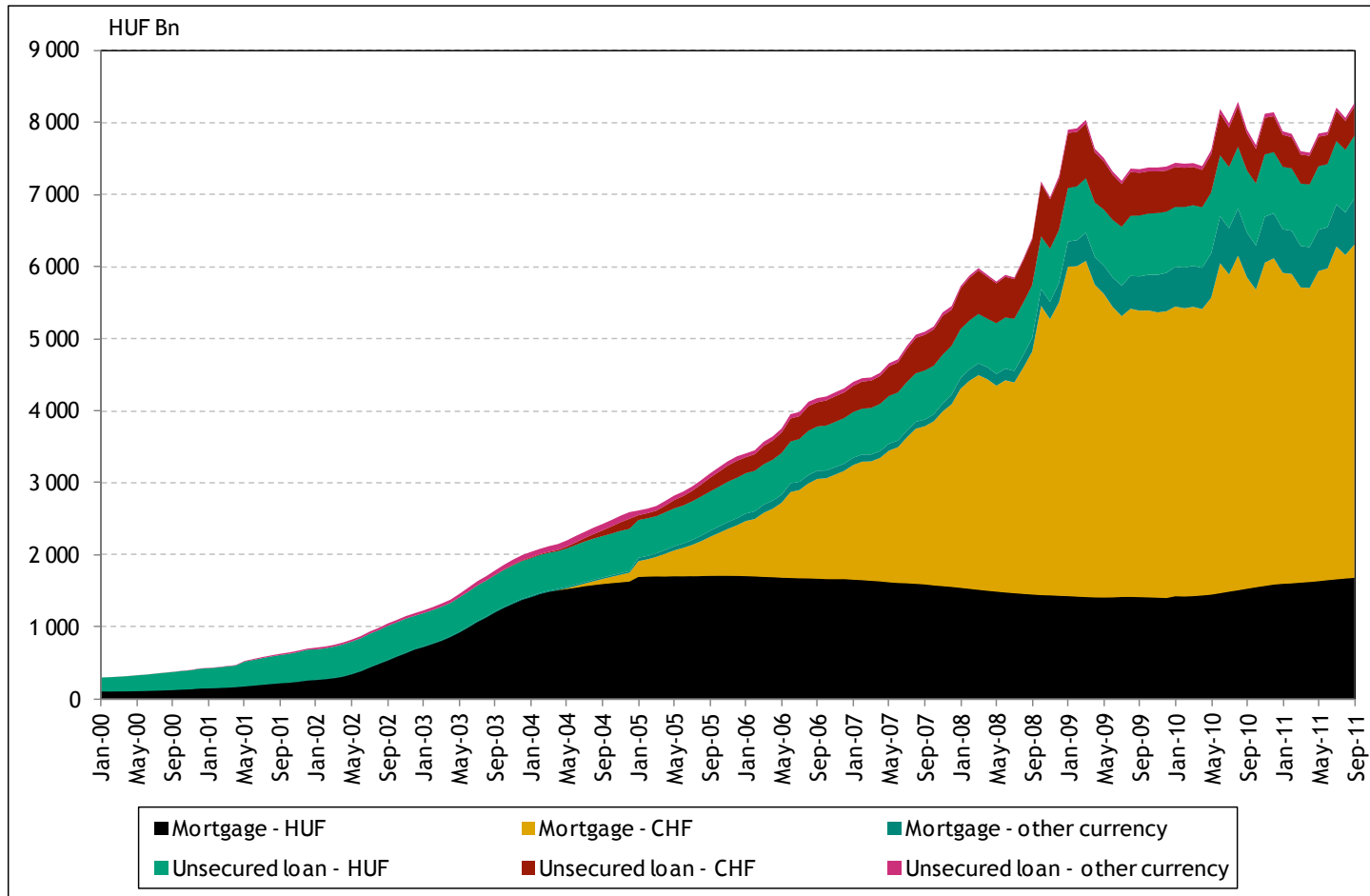
Household (2): Relatively stable HUF exchange rate vis-à-vis the euro and the CHF

HUF exchange rate vis-à-vis the CHF and the EUR and the volatility of the latter



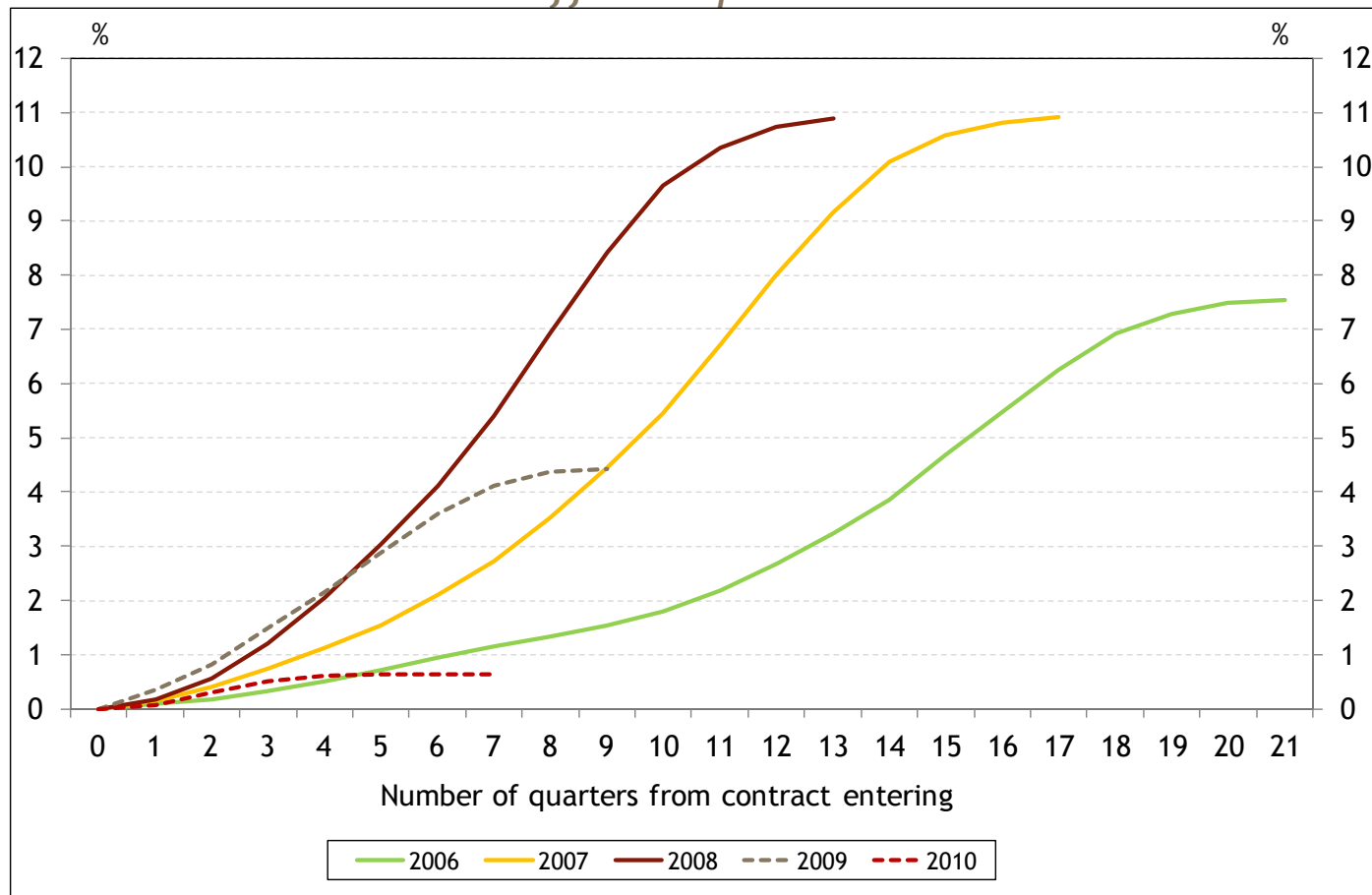
Banks (1): accumulating unhedged fx loans

Household loan portfolio of the banking system



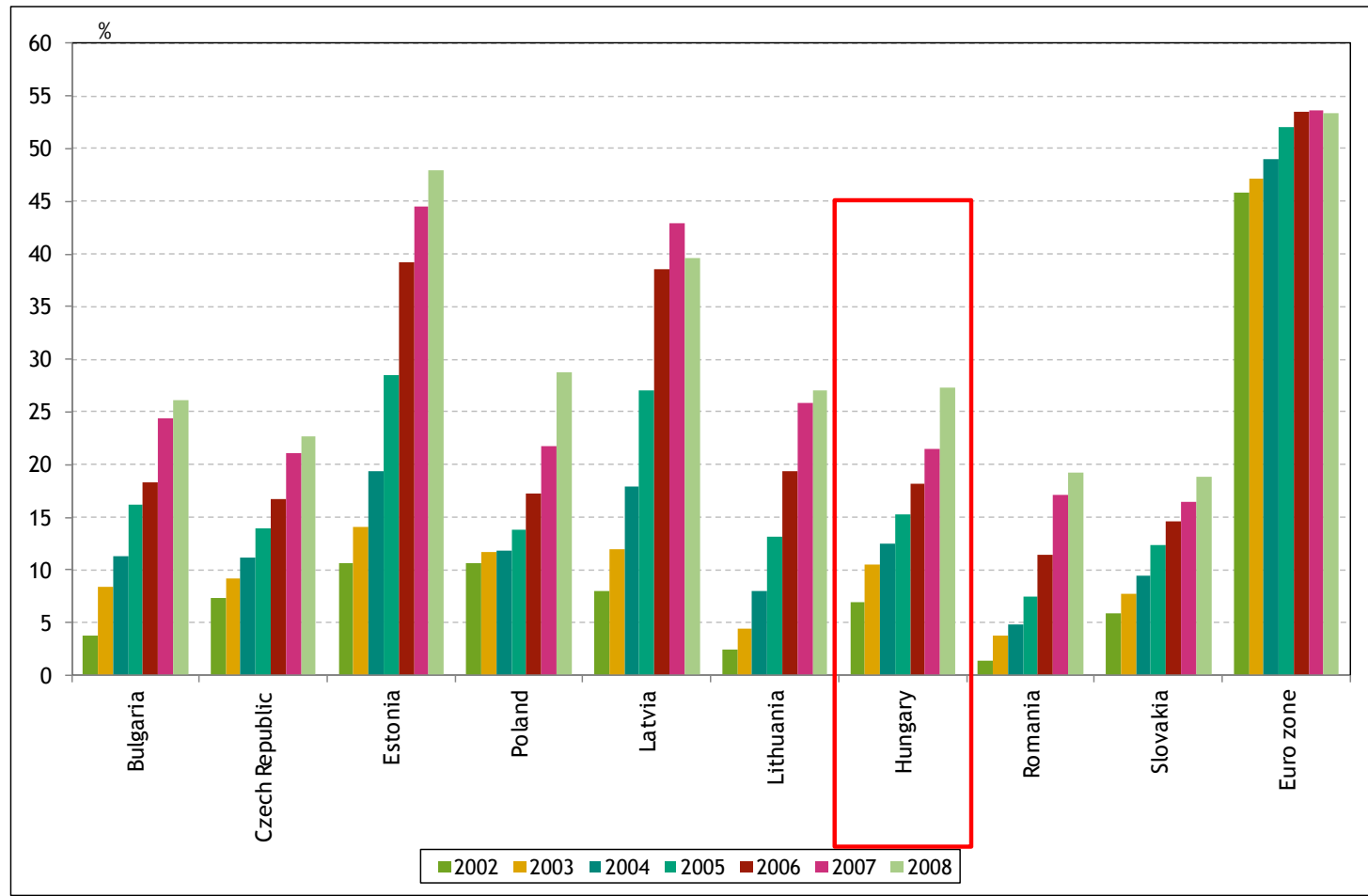
Banks (2): consequences of risk based competition

Ratio of non-performing household foreign exchange mortgage loans drawn in different periods



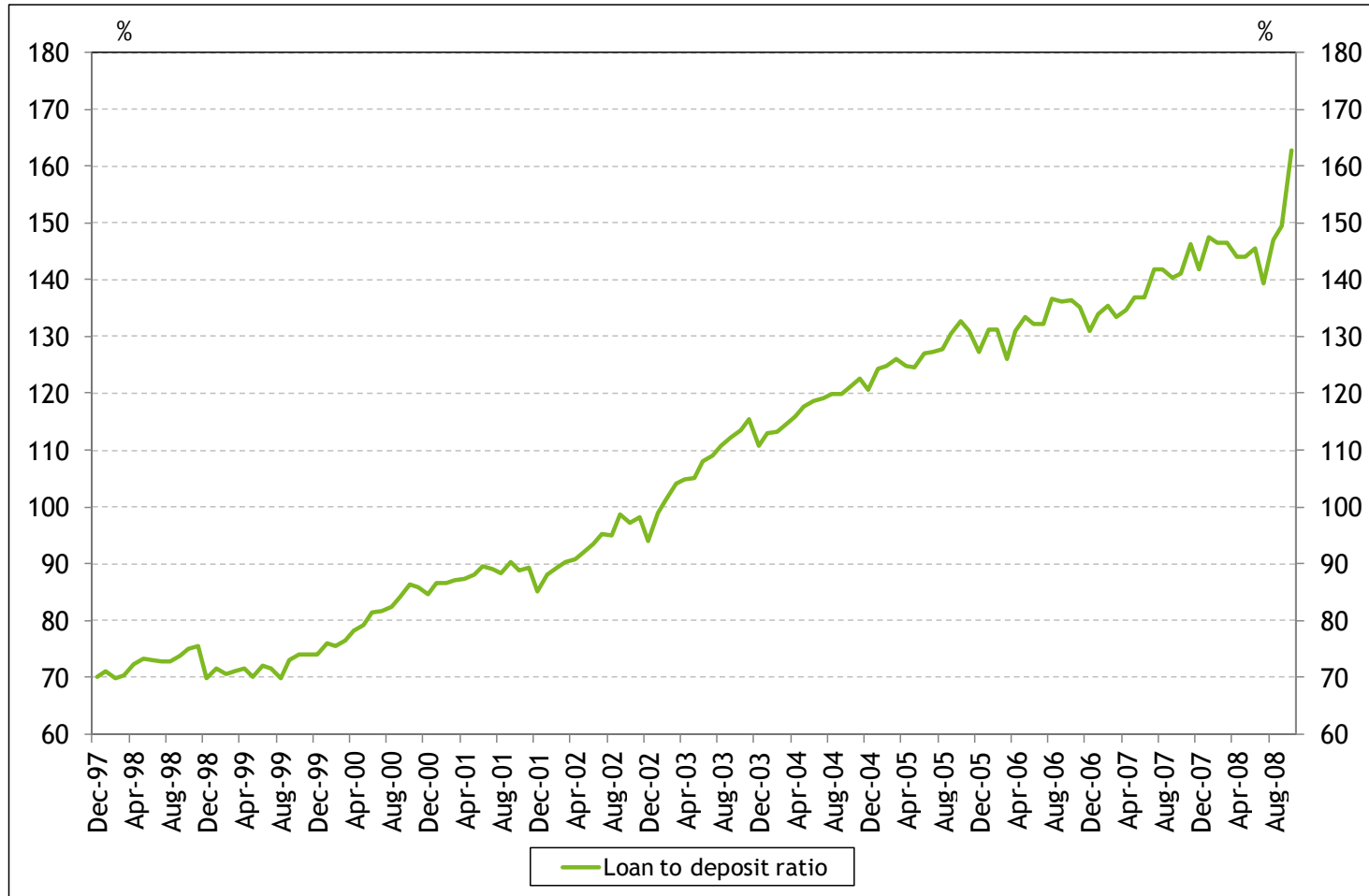
Banks (3): Not too high loan to GDP ratio in regional comparison

Household loans as a percentage of GDP in international comparison



Banks (4): lack of prudence

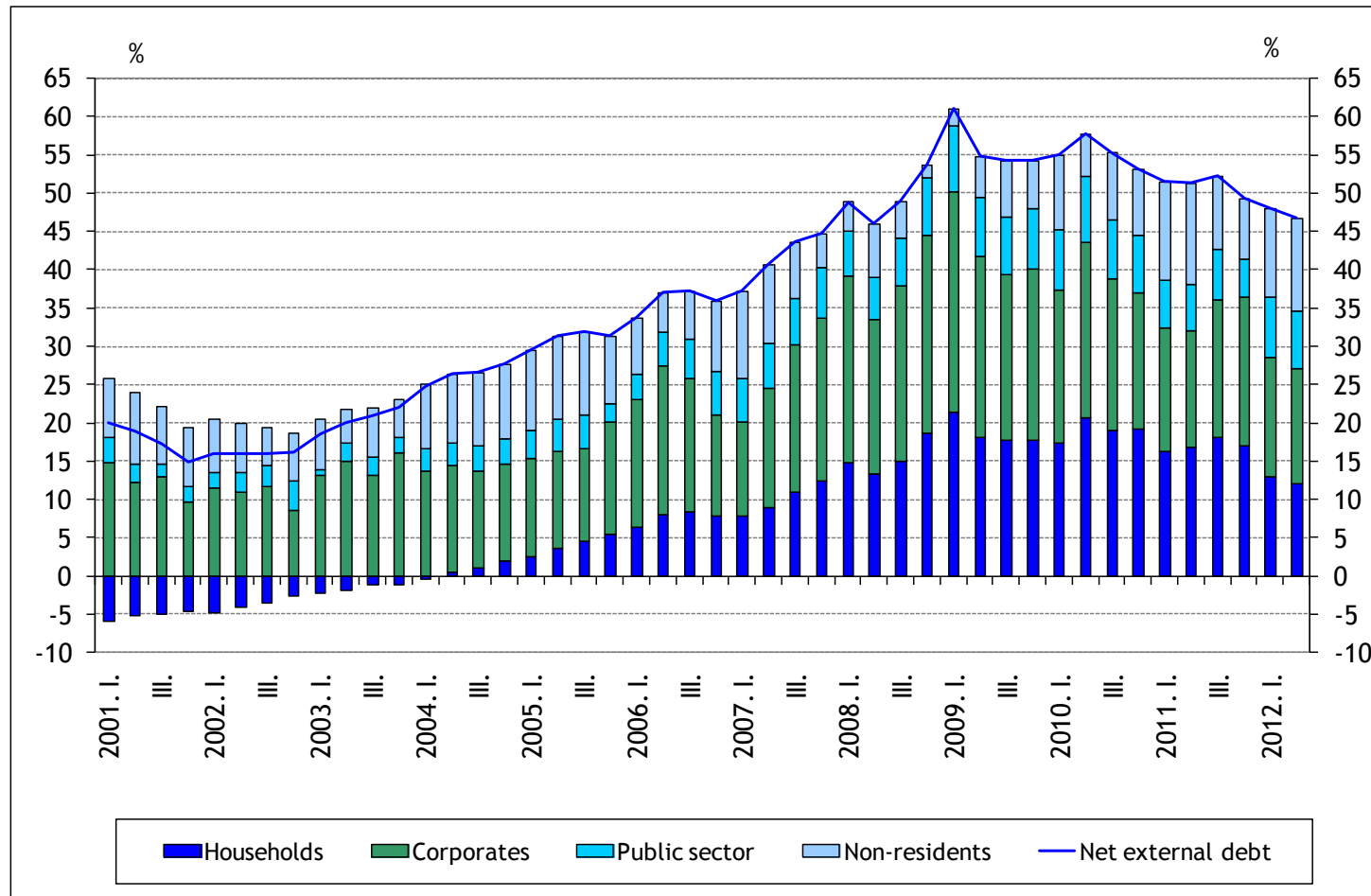
Loan-to-deposit ratio of the domestic banking system



Problem of the accumulated stock (the 'stock' period) 2008 - present

Significant net external debt and domestic players run exchange rate risk

GDP-proportionate open exchange rate position of individual sectors



Attempts at a solution

Both the government and banks launched programs to mitigate borrowers' burden:

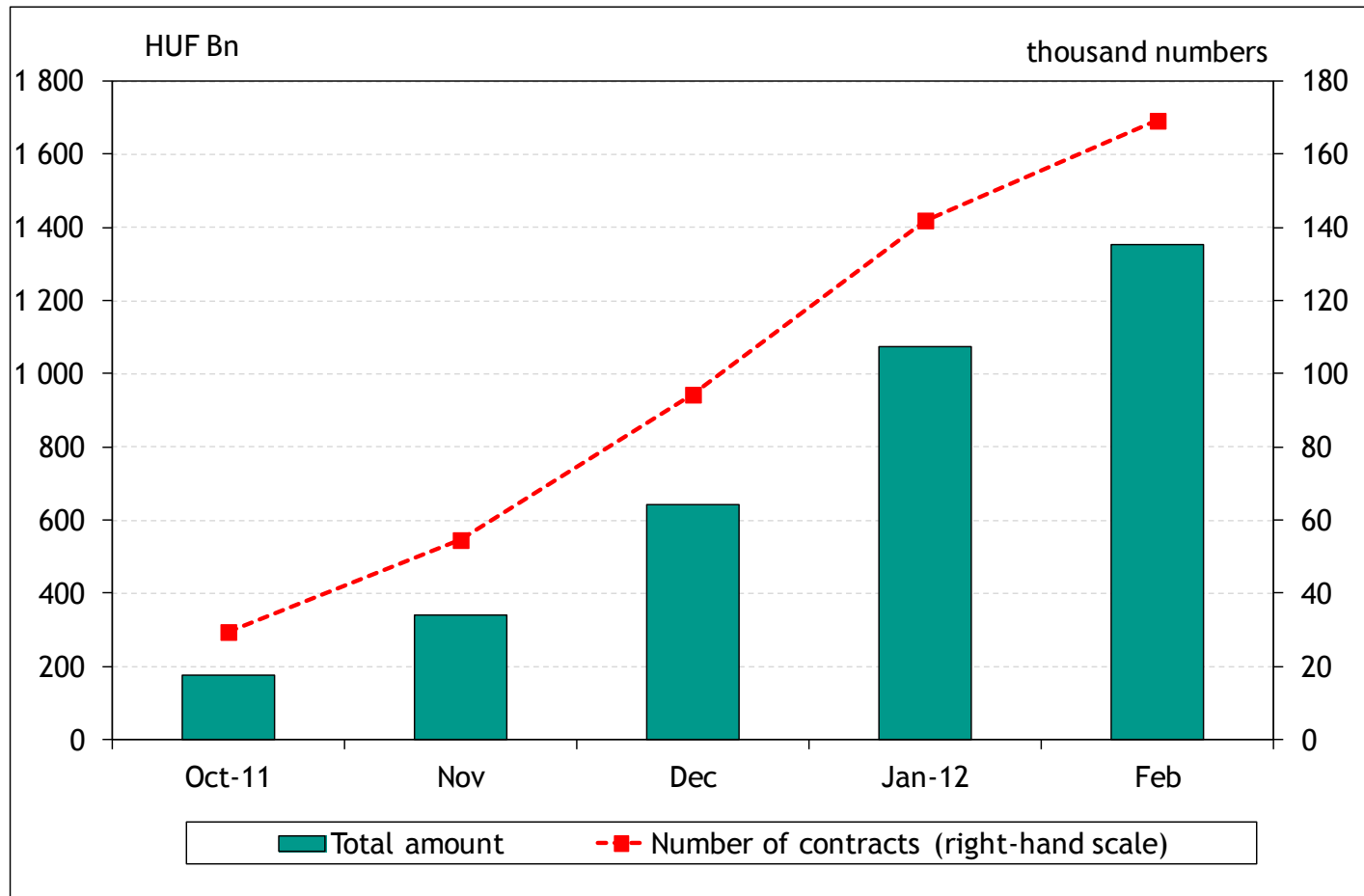
- **Restructuring by banks** - ease the terms of payment usually for a period of 1 to 3 years
- **Exchange rate cap** - participating debtors may pay their installments at fixed exchange rates

	<i>Jun-12</i>	<i>Jul-12</i>	<i>Aug-12</i>	<i>Sep-12</i>	<i>Oct-12</i>	<i>Nov-12</i>	<i>Dec-12</i>
Number of contracts	20 168	35 444	47 950	63 258	76 852	88 260	99 584
Loan stock (billion HUF)	180,9	309,5	468,3	596,5	712,8	812,7	916,2
Proportion to total FX loan portfolio	4,69%	8,34%	12,58%	16,37%	19,66%	28,04%	30,85%

- **Early repayment scheme** - Debtors could repay their total debt at a preferable exchange rate on a temporary basis

FX mortgage stock decreased by 23 per cent but the banking system suffered huge losses

Fully repayed FX-mortgage loans



What is the way forward?

- Reallocation of the burden always has negative impacts:
 - Excessive burden on the *banking system* is immediately reflected in the decline of lending
 - *General government* unable to assume the burden without limitations
- With stable and predictable economic policy exchange rate fluctuation will be tolerable
- To outgrow the problem stable economic growth and income is needed
- The management of the situation must be based on the consensus of banks, the government and borrowers