Áron Drabancz – Anna Marosi – Alexandr Palicz

Lending in crisis – 2008 versus 2020

Summary
The study analyses the reasons for and extent of the differences in lending trends in Hungary in the wake of the 2008 financial crisis and the Covid-19 crisis. In 2008, the lack of monetary and fiscal room for manoeuvre, coupled with the lack of a macroprudential framework and the unhealthy lending structure exacerbated the banking sector’s procyclical behaviour and caused a credit crunch, deepening the economic downturn. When the Covid-19 crisis occurred, however, Hungary had a significantly sounder macroeconomic and lending structure, and a complex, developed macroprudential framework. All of this helped to underpin credit dynamics during the economic downturn. The large volume of guarantee and loan programmes and the payment moratorium played a pivotal role in this positive outcome, which was also supported by macroprudential measures maintaining the lending capacity of banks.¹

Journal of Economic Literature (JEL) codes: G20, H12
Keywords: coronavirus crisis, lending, crisis management

INTRODUCTION
In early 2020, the rapid global spread of a novel coronavirus caused an unprecedented shock. Due to the immediate impact of the ensuing pandemic, the disruption of global supply chains and social distancing measures, the global economy – including Hungary – faced a simultaneous contraction on both the supply and the demand side (OECD, 2020), with the extent of the downturn exceeding the decline experienced in the 2008 crisis (HCSO, 2021)

ÁRON DRABANCZ, analyst at Magyar Nemzeti Bank (drabancza@mnb.hu), ANNA MAROSI, economic analyst at Magyar Nemzeti Bank (marosia@mnb.hu), PALICZ ALEXANDR, economic analyst at Magyar Nemzeti Bank (palicza@mnb.hu).
The financial system is inherently pro-cyclical, i.e. banks’ lending activity and profitability correlate with and even “amplify” the short-term business cycles in the economy. This may contribute to making economic developments more volatile and to increasing the amplitude of the business cycle (Horváth et al., 2002). The very nature of the banking system can therefore deepen economic downturns. A macroeconomic shock such as the one caused by the coronavirus impacts the credit market via several channels: the decline in demand observed in sectors affected by supply chain disruptions and lockdowns (tourism, hospitality, entertainment, manufacturing, transport) leads to adverse labour market and income effects, which in turn lead to an increase in the riskiness of the household portfolio. However, the reduction in aggregate income is also associated with a reduction in corporate profitability, which may increase the past-due or non-performing loan portfolio. In an uncertain environment, economic actors restrain their demand for credit, while banks reduce their supply of credit to mitigate the risks in their loan portfolios. The contraction in lending and the rise in the cost of risk can have a negative impact on bank profitability and hence capital adequacy, and also hamper recovery from recession (Darvas, 2013), thus exacerbating the economic downturn (Borio et al., 2001; Adrian – Shin, 2008).

Therefore, in order to prevent the banking system from deepening the downturn resulting from economic shocks, it is crucial to maintain lending capacity. This can be ensured by the authorities via fiscal and monetary policy incentives as well as macroprudential instruments. In this paper, we show how the (Hungarian) crisis management in relation to the coronavirus crisis differs significantly from the 2008 crisis. In the 2008 crisis, the lack of fiscal and monetary policy room for manoeuvre and the absence of macroprudential instruments led to a credit crunch, whereas credit expansion has been sustained in the current crisis.

The structure of the paper is as follows: in Chapter 2, we show how the macroeconomic and credit market situation in Hungary was different at the time of the outbreak of the coronavirus pandemic compared to the situation before the 2008 crisis. In Chapter 3, we discuss in more detail the developments in the corporate credit market, while in Chapter 4 we discuss the developments in the household lending segment. In Chapter 5, we present the measures in response to the coronavirus crisis that were taken within the macroprudential framework developed in the aftermath of the 2008 crisis, while in Chapter 6 we discuss the domestic experience of the payment moratorium.

**Evolution of Risks Built up in the Banking System**

The crisis which started in the US subprime mortgage market in the summer of 2007 and spread rapidly to developed and emerging markets made it clear that the banking system is key to the health of the economy and that imbalances in this system have serious consequences. However, when comparing the situation following the outbreak of the coronavirus with the 2008 crisis, a number of differences can be seen: while the 2007-2008 financial crisis spread from the balance sheets of financial institutions to the real economy, the current crisis started from the real economy. In contrast to the period before 2008, Hungary was hit by the shocks of the pandemic in a stable macroeconomic condition (lower and declining public debt-to-GDP ratio, stable financing structure, low unemployment rate) (Table 1).
Table 1: Evolution of selected economic indicators in Hungary before the crisis

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2008</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economic performance</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP growth (per cent)</td>
<td>0.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Unemployment rate (15-74 year, per cent)</td>
<td>7.8</td>
<td>3.3</td>
</tr>
<tr>
<td><strong>Government debt and budget</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government debt (in per cent of GDP)</td>
<td>71.8</td>
<td>66.3</td>
</tr>
<tr>
<td>Foreign currency denominated debt of general government debt (per cent)</td>
<td>37.4</td>
<td>17.4</td>
</tr>
<tr>
<td>Foreign share of government debt (per cent)</td>
<td>51.4</td>
<td>33.9</td>
</tr>
<tr>
<td>Budget deficit (in per cent of GDP)</td>
<td>-3.7</td>
<td>-2.0</td>
</tr>
<tr>
<td><strong>External balance</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account balance (in per cent of GDP)</td>
<td>-7.1</td>
<td>-0.8</td>
</tr>
<tr>
<td>Net external debt (in per cent of GDP)</td>
<td>52.6</td>
<td>7.9</td>
</tr>
<tr>
<td>Gross external debt (in per cent of GDP)</td>
<td>97.1</td>
<td>53.3</td>
</tr>
</tbody>
</table>

Source: MNB (2020a)

One remarkable difference is that, in parallel, the resilience of the domestic banking system has also improved significantly over the past decade (Table 2). Banks had sufficient liquidity, profitability and healthy balance sheets to help dampen the impact of the pandemic.

Table 2: Certain indicators of the Hungarian banking system in 2008 and 2019

<table>
<thead>
<tr>
<th>Key banking system indicators (per cent)</th>
<th>2008</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquid assets / total assets</td>
<td>10</td>
<td>30.9</td>
</tr>
<tr>
<td>Credit / deposit ratio</td>
<td>152</td>
<td>75</td>
</tr>
<tr>
<td>Foreign liabilities / total liabilities</td>
<td>34</td>
<td>12.7</td>
</tr>
<tr>
<td>Rate of loans overdue for more than 90 days</td>
<td>4.6</td>
<td>2</td>
</tr>
<tr>
<td>Capital adequacy ratio of the banking sector</td>
<td>11.2</td>
<td>20.6</td>
</tr>
<tr>
<td>Net NPL / own funds</td>
<td>16</td>
<td>2</td>
</tr>
<tr>
<td>Return on equity</td>
<td>11.3</td>
<td>11.6</td>
</tr>
<tr>
<td>Operating expenses as a ratio of total assets</td>
<td>2.4</td>
<td>2</td>
</tr>
<tr>
<td>Ratio of foreign currency loans - household loans</td>
<td>67</td>
<td>0.5</td>
</tr>
<tr>
<td>Proportion of variable rate mortgages - households</td>
<td>77.5</td>
<td>48.7</td>
</tr>
<tr>
<td>Corporate credit dynamics (year/year)</td>
<td>6.5</td>
<td>13.9</td>
</tr>
<tr>
<td>Household credit dynamics (year/year)</td>
<td>19.1</td>
<td>16.7</td>
</tr>
</tbody>
</table>

Note: The proportion of variable-rate mortgages in 2008 is based on expert estimates.

Source: MNB (2020a)
The structure of private sector’s loans outstanding was also substantially healthier at the time of the outbreak of Covid-19, compared to the period preceding the 2007-2008 economic crisis, which also contributed to limiting the impact of the coronavirus on the credit market.

Compared to the economic crisis of 2007-2008, the composition of corporate lending was much more favourable before the coronavirus. On the one hand, the credit market was not characterised by excessive foreign currency (project) lending, as a result of which after 2008, in parallel with the increase in non-performing loans, loans outstanding declined until 2015 (Matolcsy, 2020). On the other hand, partly as a legacy of the previous crisis, corporate indebtedness was low, with the GDP-proportionate volume of corporate debt amounting to only 17.2 per cent at the end of 2019, the fourth lowest level in the European Union.

The central bank’s actions introduced to address the 2008 crisis also played a significant role in the favourable corporate lending structure in place prior to the Covid-19 crisis: as a new, targeted element of the monetary policy toolkit, the central bank launched the Funding for Growth Scheme (FGS) in June 2013 to alleviate the persistent market disturbance in SME lending. The long-term availability of fixed, favourable interest rates provided predictability for SMEs, thus significantly stimulating demand for loans from businesses; it also increased competition for credit institutions to acquire and retain clients, thus increasing propensity to lend and contributing to the loosening of lending conditions. The scheme not only provided participating companies with a predictable and lower interest burden, but also contributed to lowering interest rates on market-based loans through increased competition, in parallel with the interest rate reduction cycle.

The FGS, which closed on 31 March 2017, was a key driver of SME lending: after its launch in June 2013, nearly 40,000 micro, small and medium-sized enterprises benefited from favourable financing of more than HUF 2.8 billion. The programme made a significant contribution to the turnaround in lending: following the launch of the FGS, the previous 5-7 per cent annual decline in SME lending stopped, and from 2015 onwards lending gradually started to grow (MNB, 2017). Subsequently, the MNB launched the FGS fix scheme in early 2019 to increase the share of more predictable fixed-rate products in investment financing. Under the scheme, which was available until 29 May 2020, participating credit institutions concluded loan or lease agreements with more than 17,000 companies for more than HUF 500 billion.2

Prior to the 2008 crisis, the structure of household lending was also unhealthy. Foreign currency loans, with much more favourable pricing terms than those of forint loans, pushed the population (which had significant credit demand) towards indebtedness in euro, Japanese yen and, most importantly, Swiss franc, exposing the segment to significant exchange rate risk. In 2008, more than two-thirds of household loans outstanding were denominated in foreign currency (Table 2).

Moreover, fierce risk-based competition among banks led to foreign currency loans being made available to borrowers whose income position did not guarantee long-term solvency. The situation was exacerbated by the fact that the contracts were created in a legal environment that allowed banks to unilaterally modify the contractual terms during the term of the contract, thus exposing debtors to interest rate risk, in addition to exchange rate risk (Dancsik et al., 2017).

All of this significantly increased the risks of the retail portfolio. Risk-based competition prior to the 2008 crisis, followed by the adverse labour market effects of the unfolding crisis and
a significant increase in the debt servicing burden due to the depreciation of the exchange rate and unilateral interest rate hikes by banks (MNB, 2012a:46-47) led to significant defaults in the segment: by the end of 2014, mortgage loans over 90 days past due accounted for one-quarter of the total mortgage loan portfolio, affecting around 140,000 borrowers (Dancsik et al., 2015).

By contrast, the retail portfolio before the pandemic exhibited a much healthier structure than twelve years before. On the one hand, after 2015, almost all household loans were denominated in forint, protecting borrowers from exchange rate risk. The conversion of foreign currency and foreign currency-based mortgage loans into HUF in autumn 2014, followed by the conversion of foreign currency and foreign currency-based unsecured loans, also played a significant role in this (for more details, see Dancsik et al., 2017). On the other hand, transparent pricing is also supported by Act LXXXVIII of 2014 amending Act CLXII of 2009 on Consumer Credit and certain related acts (the “Fair Banking Act”), which made the interest rate development of credit contracts transparent and thus trackable, consequently also contributing to the predictability of repayments.

The outstanding loan stock is also more resilient to interest rate shocks: in the newly disbursed mortgage loan market, the issuance of products with variable interest rates has virtually disappeared, and at the time of the Covid-19 outbreak 60 per cent of the mortgage loan stock had an interest rate fixed for more than one year (MNB, 2021a), resulting in more predictable repayment patterns. The borrower-based measures, introduced on 1 January 2015 and amended on 1 October 2018 to encourage borrowers to opt for loans with longer interest rate fixation periods, and the Certified Consumer-friendly Housing Loan scheme introduced in summer 2017 played a significant role in this.

Moreover, in contrast to the 2008 crisis, households entered the crisis with stronger balance sheets. While for the European Union as a whole, the household sector’s debt burden as a share of household income has barely decreased since the 2008 economic crisis (from 98 per cent to 90 per cent), the debt-to-income ratio of the Hungarian population was much lower at the beginning of the pandemic (33.4 per cent) than 12 years earlier (64.3 per cent) (MNB, 2021a).

This is also due to the reduction of debt accumulated in the previous credit cycle and favourable income trends, but the aforementioned borrower-based measures effective from 1 January 2015 also effectively discouraged overindebtedness: 80 per cent of the current household loans outstanding (70 per cent of mortgages) are already linked to contracts concluded under these rules (MNB, 2021a). Lower indebtedness leads to less adjustment pressure, thus further limiting the impact of the shock caused by Covid-19.

Finally, the favourable quality of the retail portfolio is reflected in the fact that by December 2020 the default rate in this segment had fallen to 3 per cent. Naturally, as with any economic shock, the pandemic can also affect debtors’ ability to pay. At the same time, in order to maintain repayment capacity, Hungary introduced a moratorium on 18 March 2020 for all payment obligations of households and businesses.

In terms of the economic impact of the pandemic, the most vulnerable sectors were the arts and entertainment, tourism and hospitality, mining, manufacturing and transport and warehousing, and given their weight in the total loan portfolio, it is the loans to employees in the latter two sectors that pose the greatest risk in the longer term: overall, the share of the retail loan
portfolio with increased credit risk is estimated to be 10 per cent (MNB, 2021a). Although there is no specific forecast for the percentage of non-performing loans in the retail lending market after the end of the moratorium, the MNB (2020a) estimated a default rate of only 10 per cent at the end of the scenario, even in a very severe stress scenario lasting for two years.

**Corporate Lending**

The aforementioned favourable macro-financial structure provided not only fiscal stimulus during the pandemic, but also allowed the government and the Magyar Nemzeti Bank (MNB), the central bank of Hungary, to take credit market and macroprudential measures designed to prevent pro-cyclicality in the banking system, i.e. the mutually reinforcing adverse effects of the financial and business cycles.

In the corporate credit market, in addition to the moratorium, the large-volume loan and guarantee programmes that were announced helped the most to sustain lending activity: the state and central bank loan programmes announced in spring 2020 amounted to roughly HUF 2,000 billion, while guarantee programmes were announced in the amount of HUF 1,000 billion, which accounted for around 70 and 35 per cent of corporate lending in 2019, respectively (MNB, 2020a). The programmes were extended and renewed several times as the pandemic dragged on, so that for most of the programmes at least twice the original budget was available to companies to offset the negative real economic impact. This contributed to the fact that corporate credit grew by 9.4 per cent in 2020 as a whole, representing the fourth fastest pace in the European Union and a much more favourable trend compared to the previous crisis (Chart 1). The announced subsidised programmes were largely SME-focused, and accordingly the annual growth rate in this segment fell much less as a result of the pandemic, reaching almost 14 per cent at the end of 2020.

**Chart 1: Percentage change in corporate loans following the outbreak of the 2008 crisis and the appearance of the coronavirus in Hungary**

![Percentage change in corporate loans following the outbreak of the 2008 crisis and the appearance of the coronavirus in Hungary](chart.png)

Source: MNB
The pro-cyclical nature of the banking system is often reflected in the tightening of non-price lending conditions, i.e. banks are more selective in who they lend to (cherry picking). The tightening of lending conditions in 2020 was much less widespread than during the previous crisis: the tightening of lending standards after the emergence of the coronavirus was limited to a much narrower range and lasted for a shorter period (3 quarters) than after the 2008 crisis, as the tightening of lending standards in Hungary prevailed for roughly 4 years thereafter (Chart 2). In addition, loan demand remained strong during the pandemic, with banks experiencing rising demand for long-term loans, which are of key importance for investment, for all but one quarter, while from the second half of 2008 until the second quarter of 2013, banks reported typically weakening demand in the long-term loan market (MNB, 2021a:28).

Chart 2: Changes in lending conditions in the corporate segment

![Chart showing changes in lending conditions from 2008 to 2021.]

Note: Net ratio is the difference between tightening and easing banks, weighted by market share.
Source: MNB, based on banks’ responses

As a result of the subsidised programmes, the aggregate issuance of new corporate loan contracts in 2020 as a whole rose substantially, exceeding the volume from 2019 by 18 per cent (MNB, 2021b). The most prominent of the state and central bank lending programmes, FGS Go!, accounted for 42 per cent of total corporate disbursements and 68 per cent of SME lending in the period from March 2020 to end-2020 (Chart 3).
State and central bank lending programmes also had a positive impact on employment. The MNB estimates that as a result of the programmes companies with more than five employees employed 4 per cent more workers, i.e. an average of 0.8 more employees at the end of 2020 compared to March 2020, than their counterparts not taking advantage of the programmes (Drabancz et al., 2021).

**Household Lending**

Due to the favourable structural conditions and moderate adjustment pressures discussed above, the dynamics of household lending growth were sustained during the period of the pandemic. Household loans outstanding grew by 14.5 per cent in 2020 as a result of disbursements and repayments, which was the fastest rate in the EU and also represents a much stronger expansion in lending compared to the 2008 crisis (Chart 4).
Chart 4: Percentage change in retail loans following the outbreak of the 2008 crisis and the appearance of the coronavirus in Hungary

Source: MNB

Positive transaction trends persisted even though banks’ increasing risk aversion led to tightening of lending conditions following the emergence of Covid-19 (Chart 5): according to the MNB’s lending survey, in the second quarter of 2020, in net terms, more than one-third of banks surveyed tightened conditions on housing loans and almost four-fifths tightened conditions on consumer loans, following the outbreak. In parallel with the lockdowns and increasingly gloomy consumer sentiment, banks also reported a fall in loan demand during this period, which was reflected in a decline in new disbursements, especially in the case of personal loans⁵ (Chart 6).

Chart 5: Changes in credit conditions in the household segment

Note: Net ratio is the difference between tightening and easing banks, weighted by market share.
Source: MNB, based on banks’ responses
Chart 6: New household loans in the credit institutions sector

Note: Loan refinancing indicates only refinancing related to the early repayment scheme and the FX-conversion. Other consumer loans include vehicle loans, hire purchase and other loans, without prenatal baby support loans.

Source: MNB

Despite the falling demand and tightening supply, the strong retail loan expansion was partly due to the moratorium’s restraining effect on repayments: the participation rate of eligible retail loans was 54 per cent at the end of 2020 (MNB, 2021b). This means that for slightly more than half of the then-outstanding loan portfolio, principal repayments were suspended, which raised the growth rate calculated as the result of disbursements and repayments: if we include the repayments not made due to the payment moratorium, we estimate that lending growth would have been 8.4 per cent in 2020 (MNB, 2021b).

At the same time, household lending was promoted by state-subsidised loans. In the retail segment, 35 per cent of the loan volume disbursed in 2020 was state-subsidised (Chart 7). This was mostly due to the prenatal baby support loans that quickly gained popularity thanks to favourable terms and conditions, which started to be disbursed from July 2019. These loans account for the largest volume within subsidised loans, and their weight is indicated by the fact that a year and a half after their launch, in December 2020, they already accounted for 13 per cent of total household loans outstanding. The market-stimulating effect of the prenatal baby support loans is shown by the fact that, according to a survey conducted by the MNB in June 2020, 63 per cent of prenatal baby support loan borrowers said that the introduction of the product had created new goals or helped them to achieve their existing credit goals, which could only have been achieved using their own savings or not at all in the absence of the prenatal baby support loan (Fellner et al., 2020). This stimulating, but at the same time in terms of financial stability not threatening, effect of prenatal baby support loans may have also prevailed in the pandemic period as these loans were taken up by the relatively better educated, better-off segment of society, whose labour market situation also proved to be resilient.
Chart 7: Disbursement of market-based and subsidised loans in the household segment

Source: MNB (2021b)

MACROPRUDENTIAL MEASURES

In the context of the 2008 global financial crisis, it became clear that so-called microprudential policies alone – which ensure the individual stability, prudent and legitimate operation of banks – cannot prevent financial disturbances that cause significant losses to the real economy, and that macroprudential interventions focusing on the financial system as a whole and addressing risks at a systemic level are also needed. However, before the 2008 crisis, there was neither a legal nor an institutional framework for this in most countries, meaning that there was no well-defined mandate and dedicated instruments for macroprudential policy (MNB, 2018).

After the crisis, a macroprudential policy framework was developed at the international level. The regulatory process that began in the wake of the crisis resulted in the so-called Basel III set of standards, published by the Basel Committee on Banking Supervision at the end of 2010 and transposed in the EU by the Single Rulebook adopted in 2013. In Hungary, the macroprudential framework was created by the sectoral laws implementing these requirements and the MNB Act providing for the macroprudential regulatory mandate. Since then, the MNB has, on the one hand, put in place the instruments to be introduced at the EU level, and, on the other hand, actively used measures that can be taken at the national level to address country-specific financial stability challenges and risks (MNB, 2019). The focus of the MNB’s macroprudential policy has been to actively manage the risks that have previously emerged and to prevent the build-up of future risks.

Macroprudential measures also made a major contribution to addressing the consequences of the 2008 crisis and reducing the likelihood of similar systemic risks in the future. This is one of the reasons why the Hungarian financial system built up robust resilience prior to the coronavirus crisis in 2020 and thus faced the pandemic-induced stress situation with more capital, higher liquidity buffers, a more secure funding structure and better asset quality. Owing
to this, and to the central bank and government measures taken in response to Covid-19, the banking system was able to support the economic recovery by maintaining lending activity.

A comprehensive regulatory framework was already in place at the start of the Covid-19 crisis, which supported direct action to mitigate the effects of the pandemic. Prudential regulatory measures can primarily support the financial system in two areas: on the one hand, they strengthen the lending capacity of financial institutions, as these are in the best position to mitigate the real economic downturn, and on the other hand, they increase the stability of the financial system, which could be threatened mainly through rising credit losses.

**Capital requirements**

Banks may feel pressure to maintain their capital adequacy ratios and limit their lending at the very time when the real economy needs financial support the most. The aim of macroprudential capital buffers is to ensure that – by using the accumulated capital buffers – banks can continue to provide financial services that are important to the real economy in a crisis without breaching minimum capital requirements. The purpose of the buffers is to increase the resilience of the banking system to shocks, so that lending is not reduced and assets are not sold abruptly in circumstances where capital levels are expected to deteriorate due to a fall in profitability and an increase in lending losses. The revised capital requirement framework (including macroprudential capital buffers) following the 2008 crisis and the increased profitability following the recovery have allowed the banking system to generate significant surplus capital. Due to this, capital buffers were available to fulfill their purpose of supporting the maintenance of lending activity at the onset of the pandemic. However, there may be a number of effects, mainly related to market expectations and the design of the regulatory framework, which may discourage banks from maintaining their lending even at the cost of falling below the capital buffer requirements (Behn et al., 2020). In response, the prudential authorities have announced numerous measures to facilitate the use of capital by banks for covering losses and to reduce their incentives to restrict lending. These measures will help the banking system to maintain its lending activity even while absorbing losses (ECB, 2020).

**Liquidity and funding instruments**

The ECB and the prudential authorities in several EU countries have stressed that banks can use the liquidity buffers they have built up even if the liquidity coverage ratio (LCR) falls below the required level. The purpose of introducing the LCR was to ensure that banks have sufficient liquidity buffers available to use in the event of a stress situation. This prevents the need to curb lending in the event of temporary turbulence in financial markets and fundraising difficulties due to liquidity problems, and reduces the risk of contagion, which could lead to systemic liquidity problems.

In Hungary, the MNB has introduced national macroprudential rules concerning foreign currency funding, including the foreign exchange funding adequacy ratio and the foreign exchange coverage ratio, which were temporarily tightened in spring 2020 to address the risks of the pand-
emic to bank funding in a preventive manner. The measures were justified by the uncertainties of the Covid-19 crisis affecting domestic and cross-border financial markets and capital flows, and the potential regulatory responses of Member States. However, as the uncertainty eased, in September 2020, the MNB reinstated the rules to their pre-pandemic state (MNB, 2020b).

Borrower-based measures

Borrower-based measures, which are being applied in a growing number of countries, are essentially designed to prevent the build-up of excessive retail lending risks and to ensure that adequate income and collateral reserves are available. Their countercyclical calibration may have limited effectiveness in mitigating the effects of the pandemic. In the event of the exogenous shock caused by the pandemic, regulations may be relaxed to stimulate the economy and alleviate temporary liquidity problems for the public; however, market participants tend to become risk averse in the uncertainty caused by the stress situation and generally do not take advantage even of the room for manoeuvre provided by previous regulations. However, the relaxation or suspension of the borrower-based measures could also lead to a build-up of risks and over-indebtedness, where a portfolio of less shock-resistant clients with reduced income could be built up in some sub-markets or institutions due to the prioritisation of profitability. The risks from a possible relaxation of the borrower-based measures therefore outweigh the potential benefits.

Chart 8: Macroprudential measures taken to mitigate the effects of the coronavirus epidemic in EEA countries

Note: The measures depicted on the map are loosening measures; apart from these there have also been tightening liquidity and funding measures in Hungary and Bulgaria. In the case of Hungary, these have already been withdrawn, while in Bulgaria they are still in force. The withdrawal steps taken since the introduction of mitigation measures are indicated with circles on the map. The dark brown circle indicates the withdrawal measures that have already entered into force, and the light brown circle indicates the withdrawal measures that have been announced but have not yet entered into force.

Source: MNB, ESRB
In the European Economic Area (EEA) countries, macroprudential measures to prevent disruption to lending activity and banking services have been widely used in response to the Covid-19 outbreak (Chart 8). The tools used in the context of the pandemic mostly involved reducing capital and liquidity requirements or temporarily tolerating breaches of regulatory requirements in order to maintain bank lending capacity. As regards easing capital requirements, the most typical measures included the toleration of using the capital conservation buffer (euro area countries, Hungary, etc.), the release of the countercyclical capital buffer (Latvia, Norway, Bulgaria, Ireland, the Czech Republic, etc.), the reduction in the Pillar II capital recommendation (euro area countries, Hungary, etc.) and of the systemic risk buffer (Netherlands, Hungary, Poland). As regards liquidity requirements, toleration of a temporary violation of the regulatory requirement related to the 100-per cent liquidity coverage ratio may be mentioned as a general European measure, which in some countries (Hungary, Bulgaria) was complemented by the amendment of liquidity requirements prescribed within national competence. For some countries (Czech Republic, Finland, Malta, Norway, Portugal, Slovenia), the effective borrower-based measures have also been relaxed (MNB, 2020b). Although in some countries measures have been taken to reinstate previous requirements, a general withdrawal of easing is not expected until 2022 or thereafter in most cases, given the crucial role of the banking system in recovery and re-launching the economy.

Hungary took the necessary measures in a timely manner, in line with international actions, which supported the maintenance of lending capacity (Chart 9). As regards capital requirements for banks, the MNB temporarily waived compliance with the capital conservation buffer and the Pillar 2 capital guidance, reduced the capital buffer requirement for systemically important institutions and also decided to postpone the review of the systemic risk buffer. To prevent over-reliance on short-term external funding, the MNB also modified the requirements for the foreign exchange funding adequacy ratio and the foreign exchange coverage ratio, but reinstated them in autumn 2020 in view of the evolution of risks. In the case of the mortgage credit funding adequacy ratio, the MNB decided to ease the bank cross-ownership requirement and postpone the planned tightening in response to market conditions. The temporarily reduced or freely available capital requirements more than doubled the amount of free capital available for domestic lending, as a result of which thousands of billions of forints of additional lending could be financed. For the capital buffer for other systemically important institutions (O-SII), it was already announced at the time of release that the capital buffer would have to be gradually rebuilt from 2022 onwards to ensure prudent operations.
Lessons learned from the Domestic Application of the Payment Moratorium

One of the most recent and most impactful measures affecting lending in the wake of the pandemic was the introduction of payment moratoria. Their basic aim is to help debtors who are experiencing temporary liquidity difficulties but are solvent in the longer term, thus avoiding a dramatic increase in non-performing loans and maintaining lending and economic activity. The payment moratorium compensates for the shock-like drop in the income and sales of households and businesses caused by Covid-19 by temporarily postponing the repayment of loans. The moratorium also limits or delays the occurrence of potential defaults, thus mitigating the immediate impact of the coronavirus crisis and allowing time for market players to adjust as necessary.

In the EU, almost all countries (24 in total), with the exception of Northern European countries, introduced some form of payment moratorium.\(^8\) However, the measures introduced show a high degree of heterogeneity in terms of the legal form of the moratorium, the conditions for its application, how to apply for it, its duration and its extension. In addition to Hungary, 14 other EU countries acted within the legal framework, while 9 countries adopted a uniform national practice on payment moratoria in the form of a banking association.
recommendation. A payment moratorium as wide-ranging as the one in Hungary, covering corporate and retail loans unconditionally, was only introduced in a few EU Member States. In most countries, a moratorium is only available under certain conditions, i.e. direct exposure to the negative effects of the coronavirus epidemic (e.g. unemployment, declining sales). As regards entry into the moratorium, the situation in Hungary was unique in that it was fully automatic for the debtor, requiring no special application. In other EU countries, an opt-in type of measure was used, i.e. the debtor could request a moratorium by submitting a request, as opposed to the Hungarian situation where a declaration of opt-out was required. In the EU, a moratorium of 3-6 months was typically introduced, while countries in the Central and Eastern European region opted for a longer period of 6-9 months. The moratoria were typically extended until the end of 2020 or until June 2021 for a narrower scope of participants (Drabancz et al., 2021).

Chart 10: International practice of payment moratoria in the EU (data as of 31 July 2021)

![Map of Europe showing countries with extended, expired, not applied, and not an EEA state moratoriums.]

Source: ESRB, MNB collection

In response to the pandemic, on 18 March 2020 the Government of Hungary announced a payment moratorium on all payment obligations arising from loans of households, non-financial corporations, financial undertakings and investment funds, in line with the MNB’s proposal. Based on the payment moratorium, repayments on all loans disbursed until 18 March 2020 were automatically suspended until 31 December 2020 without a separate request, but debtors had the right to continue repaying their loans. The interest repayments not paid due to the moratorium are not capitalised but also not waived, and must be paid by the client in equal annual instalments at maturity, so that the repayments cannot increase after the moratorium has expired, but instead the remaining term of the transactions increases. Due to the duration of the pandemic and its resurgence from September 2020, the Govern-
ment decided to extend the payment moratorium first for 6 months and then for a further 3 months, in the same form, until 30 September 2021.

As of May 2020, around 1.6 million retail borrowers and 50,000 businesses were in the moratorium, accounting for 50-60 per cent of eligible retail and business loans. After introduction of the programme, the stock of loans under moratorium gradually declined as the pandemic situation improved and economic uncertainty eased. By June 2021, the number of retail clients under the moratorium had fallen to 1.15 million and HUF 2,800 billion in loans, representing a reduction from 58 per cent to 48 per cent of the eligible stock of loans placed by 18 March 2020, while it accounted for only one-third of total retail loans. The decline in corporate participation was sharper: the number of companies participating in the moratorium fell from 50,000 to 25,000-30,000 by June 2021. By June 2021, the related stock of loans had fallen to HUF 1,900 billion, from the initial 53 per cent to 33 per cent of the eligible stock and 20 per cent of total corporate loans.

Thus, the payment moratorium made it possible to implement an important stimulus measure at the level of the national economy. We estimate that at the level of the national economy, the payment moratorium could have left some HUF 1,700 billion of temporary excess liquidity at households and corporates benefiting from the programme by the end of 2020, which amounts to 3.5-3.7 per cent of GDP in 2019. Of this, the household segment accounted for around HUF 580-620 billion, or 1.2-1.3 per cent of GDP in 2019. In the corporate segment, the liquidity impact of the moratorium is estimated at HUF 1,100 billion by the end of the year, or 2.3-2.4 per cent of GDP in 2019. A nine-month extension of the moratorium until September 2021 could leave some HUF 450-500 billion of extra liquidity available for households and HUF 600-700 billion for corporates (Drabancz et al., 2021).

At the same time, a prolonged moratorium beyond the pandemic increases the interest accrued during the moratorium to be repaid later, significantly lengthens the maturity of loans and obscures the real repayment capacity of clients. A prolonged suspension of repayments may even worsen the payment discipline of clients in the future. Another problem for household debtors from a consumer protection perspective is that in many cases debtors are not aware of the actual impact of the moratorium on their credit contract and are unable to properly assess the risks of using it (MNB, 2021a). Consequently, once the moratorium expires, the stock of problem bank loans could rise, which could erode banks’ capital positions and impair their willingness to lend through losses incurred, thus increasing overall financial stability risks. For this reason, a possible extension of the moratorium can only be justified for genuinely vulnerable clients in order to avoid the build-up of potential systemic risks. Based on the MNB’s June 2021 estimate, participation in the moratorium and based on the debtor’s activity and financial situation, 10 per cent of the retail loan portfolio and 12 per cent of the corporate loan portfolio are considered to be high-risk (MNB, 2021a). This group should and must be supported in starting to repay their loans gradually, while lower-risk clients should start to repay their loans according to the normal repayment schedule, in order to keep financial stability risks at a low level and to ensure that the banking system can continue to adequately supply the economy with lending.
Summary

The pandemic at the beginning of 2020 resulted in an unprecedented shock to the global economy, with the scale of the economic downturn exceeding the contraction seen in the 2008 crisis. In contrast to the 2008 crisis, during which the lack of macro-financial room for manoeuvre and the absence of a macroprudential framework exacerbated the pro-cyclical nature of the banking system, leading to a credit crunch and thus prolonging the crisis, private sector loans were able to expand during the Covid-19 crisis, i.e. the banking system contributed to economic stabilisation. A profitable banking system with a more robust capital position and the more favourable macroeconomic conditions all played a significant role in this, in addition to the measures taken to combat the negative legacy of the 2008 crisis, such as foreign currency lending, (unilaterally) variable lending rates and excessive debt-to-income ratios.

The favourable macro-financial structure provided not only room for manoeuvre for fiscal stimulus during the pandemic, but also allowed the government and the MNB to take credit market and macroprudential measures designed to dampen pro-cyclicality in the banking system, i.e. the mutually reinforcing adverse effects of the financial and business cycles. A particularly important step was the introduction of a moratorium on repayments, which helped to preserve debtors’ solvency during the crisis. In the corporate lending market, in addition to the moratorium, the large-volume loan and guarantee programmes which were announced helped the most to sustain lending activity. The issuance of state-subsidised loans also played a significant role in retail lending, in particular the prenatal baby support loans, which have a significant market stimulus effect. Relaxing prudential requirements for banks, such as waiving some capital requirements or tolerating their breach, has further helped to sustain lending activity by expanding banks’ lending capacity.

Notes

1 The views expressed in this paper are those of the authors and do not necessarily reflect the official view of the Magyar Nemzeti Bank.
3 The conversion at a fixed exchange rate also protected consumers from the adverse movements in market exchange rates in early 2015, when the Swiss central bank removed the Swiss franc’s peg against the euro, which stabilised the Swiss franc’s exchange rate against the forint at a 10-15 per cent stronger level.
4 Following the 2008 crisis, the potential growth rate of the Hungarian economy declined significantly due to underinvestment and financing constraints (MNB, 2012b:3).
5 The decline in personal loans was also due to the APR cap introduced in March 2020 and set to expire at the end of 2020, as the product development process led to a temporary pause in the product’s distribution at a number of banks.
6 The regulation on prudential requirements for credit institutions and investment firms (Capital Requirements Regulation – CRR), and the Directive on the prudential regulation and supervision of these institutions (Capital Requirements Directive IV – CRDIV), together with the delegated acts adopted by the European Commission, implementing measures, recommendations and opinions issued by the various EU bodies concerned, the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA).
7 FAQs on ECB supervisory measures in reaction to the coronavirus (eurropa.eu).
Civic Review · VOL. 17. Special Issue, 2021

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