



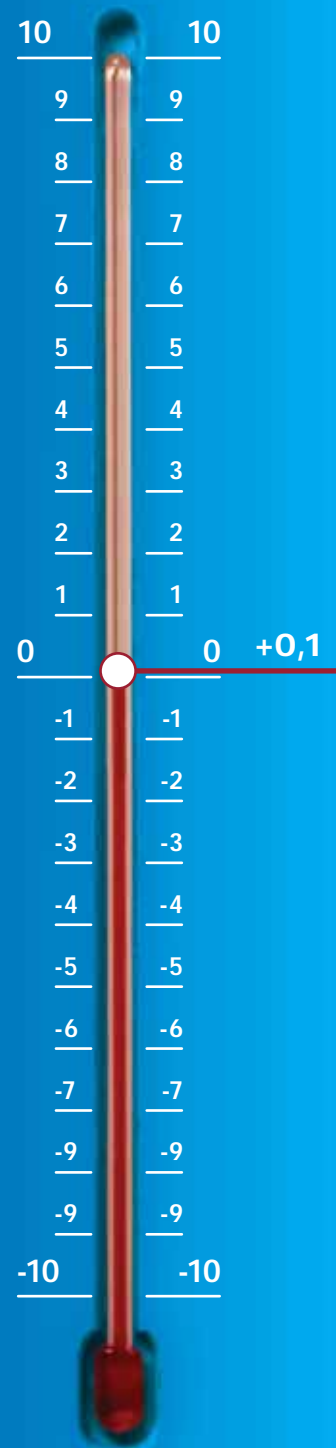
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KPMG Corporate Lending Sentiment Index

November 2011

kpmg.hu





KPMG Corporate Lending Sentiment Index – close to the freezing point

KPMG's Restructuring practice conducted a survey of senior lending officers in the fall of 2011 following its first survey published in June about their opinion on the current status of the corporate lending market and their expectations regarding its future development.

As a consequence of the economic crisis, the corporate loan portfolio of the Hungarian banking sector shrunk by 5-10% annually in 2009 and 2010, while the amount of impaired loans continued to rise. Against this background, banking executives expressed cautious optimism in the previous survey made by KPMG in June; they forecasted a growing demand for corporate loans and willingness for lending activity, while lending standards were not expected to change considerably, in the near future. Accordingly, the starting value of the Corporate Lending Sentiment Index was 1.45 points on a -10 to +10 scale.

The deteriorating European economic environment, decreasing export demand and the continuing stagnation of private consumption have had a negative impact on the growth and profitability prospects of companies in the previous months. Furthermore, Hungarian regulatory changes and growing uncertainty in the financial markets adversely affected corporate lending activity.

The effect of these negative developments can be perceived in the value of the sentiment index in October, which decreased to +0.1 (following the +1.45 value in June) on a -10 to +10 scale. The near zero value of the index clearly reflects that expectations on the market shifted negatively during the previous four months and corporate lending is not expected to improve in the short term.

Some further highlights from the Hungarian corporate lending survey are:

- The willingness of banks to place new corporate loans has not changed considerably since June.
- The majority of financial institutions are said to be open to finance operations and investments; however, they would provide loans related to real estate developments only with significant limitations, while certain banks totally refuse that type of finance.
- Although a significant number of bank executives expect lending standards will remain unchanged on the whole, many banks intend to tighten their monitoring activity on clients in the next three months.
- Most of the participating banks haven't experienced any change in the demand of corporate loan products, while some of them reported slightly weakening activity in recent months.
- Senior lending officers forecast a decreasing volume of corporate loan stock in the Hungarian banking sector for the following months – as opposed to the expected stagnation in June. Half of the banks project a growing portfolio at their own institution, while the other half believe theirs will shrink in the near future.
- A large number of the participants forecast slightly deteriorating quality of their corporate loan portfolio, while others expect no change by the end of the year. An above average growth of impaired loans is expected in the real estate, and the building and construction sectors.
- The majority of banking executives see the future a little more pessimistically than the current macroeconomic forecasts of the Hungarian government. One-third of the respondents consider a GDP growth between 1% and 3% reasonable, approximately half of them project stagnation, while the remainder forecast a decrease of more than -1% in 2012.
- According to senior banking officers, a predictable economic policy, business environment and consistent government communication would have a positive impact on corporate lending activity. Further stimulating measures could be the reduction of burdens on commercial banks, increased state subsidies on the demand side provided to corporate investments, tax incentives in the building and construction industry and enhanced flexibility of state owned guarantee institutions.

Background

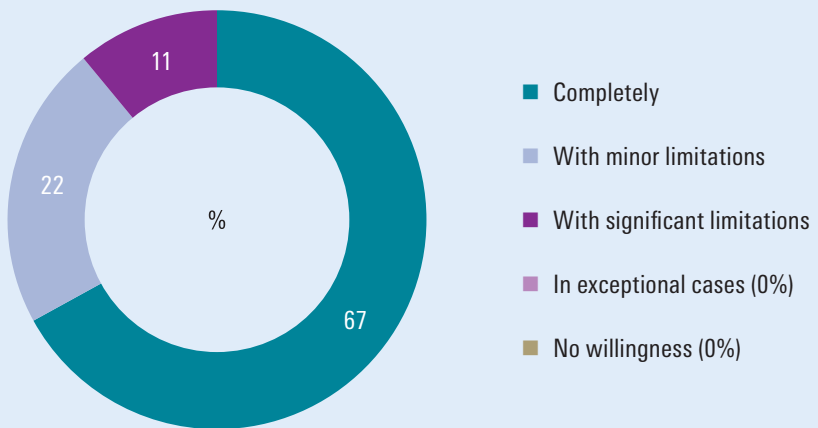
Willingness to finance

The participating banks' willingness to lend has not decreased in the previous four months. Some two-thirds of the interviewed executives are said to be open to providing corporate loans. With different levels of limitations, the remaining banks are ready to finance enterprises as well.

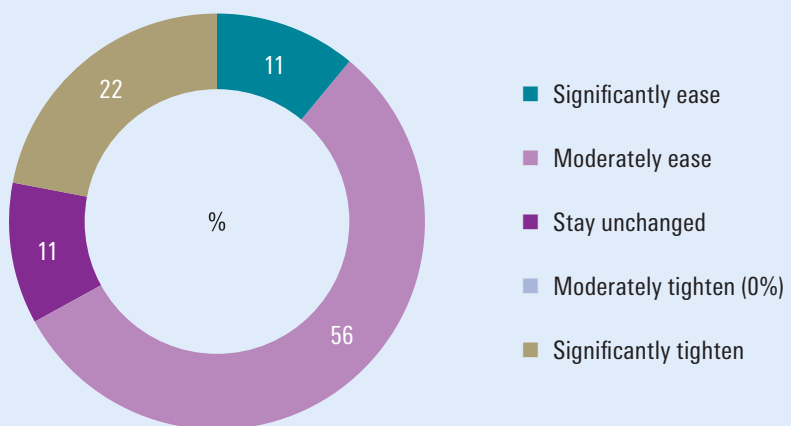
The highest level of willingness is perceived in working capital loans, with exception of two banks: all of the banks are completely open to offering such financing while more than half of the respondents would provide investment loans with minor limitations.

Responses regarding M&A finance varied more: although half of the banks are completely open to it or have minor limitations, the other half would finance M&A activity only in exceptional cases, or show no signs of willingness at all. Real estate related loans are the most refused type of finance among the surveyed banks; with one exception, all of the participants would provide loans to real estate developments, but only with significant limitations, or they would refuse that type of finance.

Banks' willingness to finance companies in principal
(% of the participating banks)



Expectations for the changes in lending standards
(% of the participating banks)



Lending standards

Similarly to the survey prepared in June, the majority of the participating banks don't expect overall changes regarding lending standards in the forthcoming quarter; however two credit institutions are more pessimistic with their expectations on significantly tightening standards.

Examining the different lending conditions, diverse expectations can be found regarding the evolution of the interest rate spread. One-third of the respondents don't expect any change, while another third forecast moderate growth in the following three months. One participant thinks that the spread is going to increase considerably, while the remainder project a moderate decrease.

More than half of the bank executives forecast no change regarding their monitoring activities, while others expect tightening steps in the future. Collateral requirements related to corporate loans are presumed not to vary at three quarters of the responding banks, whilst some restrictions are realistic according to the remaining interviewees.

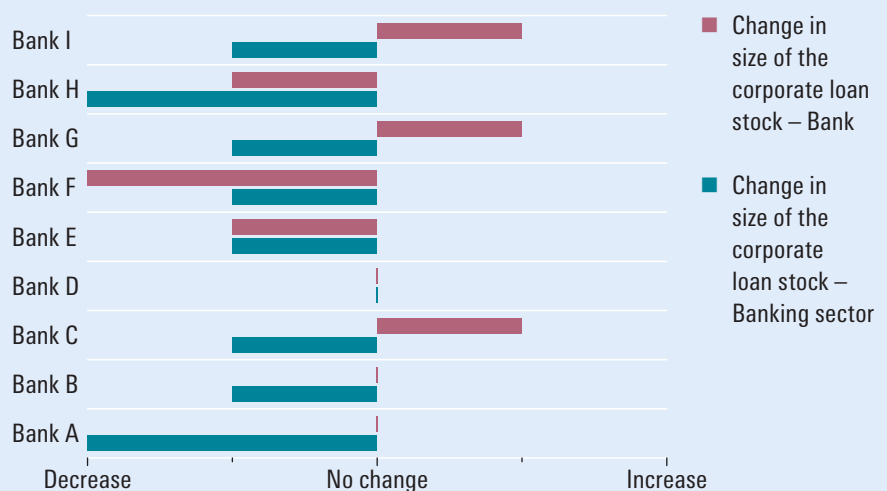
Demand

According to the KPMG survey conducted in June 2011, half of the banking executives indicated that they experienced some increase in the demand on corporate loan products in the second quarter of the year, while the rest of the respondents reported no significant changes. In relation to the previous four-month period, the vast majority of the lending officers did not realise any change in demand: 25% experienced some decrease whereas only one reported a minor increase.

Growth prospects

Expectations regarding the volume of the corporate loan stock are considerably more pessimistic as compared with the results of our previous survey, in relation to the individual banks and for the banking sector as a whole. The participating banks (with the exception of one institution) project further decline of new corporate loan placements in the banking sector; however, the interviewed executives tend to be more optimistic regarding their own institution than the Hungarian banking industry. Three banks expect their loan stock to increase, while another three of them project stagnation. Two others forecast a decrease in volume, but there was also a respondent who expected a significant drop in the next 12 months.

Expectations for the development of the volume of corporate loan stock





Portfolio quality

Commercial banks have negative expectations on the structure of the corporate loan stock for the remaining part of the year. Two-thirds of the respondents agree that portfolio quality would deteriorate slightly (the share of impaired loans would increase) by the end of the year. The remainder of bank executives does not project noteworthy changes, and no one believes that a substantial improvement in portfolio quality would be realistic in the final quarter.

Beyond the projections of the corporate loan stock quality on a macroeconomic level, its breakdown to industries was also examined in our survey. An above average increase of overdue and nonperforming loans is expected primarily in the real estate and construction industries. Companies in the financial sector show a mixed picture: most of the respondents project higher deterioration of portfolio quality, while a minority forecasts average or a below average increase of impaired loans.

On the other hand, telecommunications and postal services and the agriculture and food industries are considered to be most resistant, in which the deterioration of portfolio quality is expected to remain below the average level.

Expected deterioration of portfolio quality of the industries

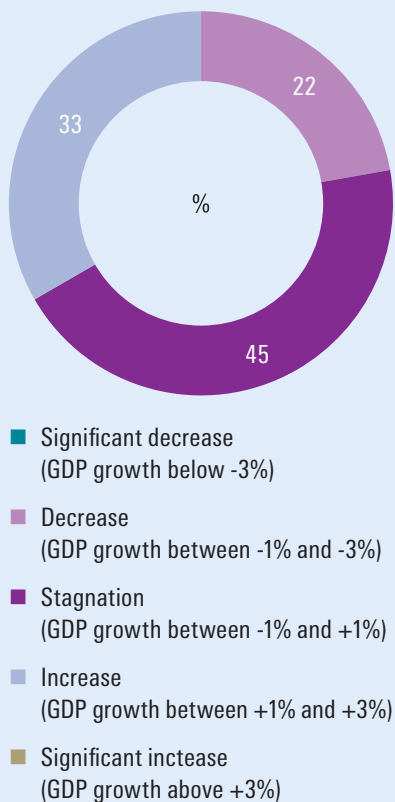
(1 – No deterioration expected 5 – Significant deterioration expected)

| | |
|-------------------------------|-----|
| Telecommunication | 1,6 |
| Agriculture and food | 1,8 |
| Manufacturing | 2,1 |
| Fishery, hunting and forestry | 2,1 |
| Energy | 2,1 |
| Transportation | 2,2 |
| Commerce | 2,4 |
| Hospitality | 2,7 |
| Business services | 2,8 |
| Entertainment | 3,0 |
| Financial services | 3,2 |
| Construction | 3,8 |
| Real estate | 3,8 |

Macroeconomic prospects

In view of the slowdown of Hungarian economic growth from the second quarter of 2011, we raised the question on macroeconomic prospects in the survey. Not one of the participating banks expects the formerly forecasted GDP growth of around 3% in 2012. However, a higher than 3% decrease is not considered as a realistic scenario either. Three of the banks project a growing GDP between 1% and 3% that is in accordance with the current government forecasts. Nearly half of executives are more pessimistic, projecting stagnation, while two of them expect recession in 2012.

Expectations on the Hungarian economic growth in 2012 (% of the participating banks)



Potential incentives for corporate lending

According to bank executives, the lack of predictable economic policy, business environment and consistent government communication has a negative effect on corporate lending activity. The “hostile atmosphere” around banks was also mentioned, which needed to be altered. The executive of one institution would welcome the reduction of burdens on commercial banks from the government (banking tax, the cost of subsidizing foreign currency debtors transferred to the banks), while another emphasizes the importance of stimulating the demand side with economic stabilisation and supported corporate investments. Bank executives made recommendations on introducing state subsidies provided to the real estate sector, considering tax allowances as the most appropriate instrument. Many of the respondents mentioned that a more flexible operation of state owned guarantee institutions would also be desirable.

Notes:

- The survey was prepared by KPMG Tanácsadó Kft’s Restructuring team in September and the beginning of October 2011. The sentiment index takes 10 factors equally into consideration from the following highlighted areas: the openness of banks to the financing of companies for different purposes; the expectations of the participating bank managers on the development of their own and the overall sector’s corporate loan portfolio; expectations on the development of certain lending standards; and observations on the changes of demand for corporate loans.
- The questionnaire-based survey includes replies from the representatives of seven leading Hungarian commercial banks and from the Hungarian Development Bank. The total outstanding corporate loan portfolio of the participating banks represented more than 70 percent of the Hungarian market in 2010.
- KPMG Tanácsadó Kft’s Restructuring team provides a full range of services in connection with corporate lending, from advising them on financing decisions through independent business reviews to financial and operational restructuring.
- Among other (domestic, municipality) segments, the Hungarian National Bank prepares a detailed quarterly survey that includes corporate lending issues as well, under the title “Felmérés a hitelezési vezetők körében a bankok hitelezési gyakorlatának vizsgálatára”. The primary goal of the National Bank’s survey – prepared by interviewing lending executives of 15 banks and six leasing companies – is to expand the range of volume and price data with primarily qualitative information on credit supply and demand contributing to a more accurate assessment of risks of financial stability, that analysis based on this information be more widely used in the business sphere. The corporate lending survey prepared periodically by KPMG differs significantly in detail and methodology from that of the Hungarian National Bank, and its goal is to provide an easily understandable guidance for companies on the willingness to finance in the banking sector, and to give an overview to banking executives about the expectations of the banking sector.

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